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Negotiating a Commercial Lease

APRIL 4, 2023

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Your Presenter

- **Richard Rose** has been a commercial landlord and the owner of several furniture stores in the Washington D.C. area. As a certified SCORE mentor for 14 years, he has helped numerous clients negotiate leases and open brick and mortar stores.

About SCORE

As a resource partner of the SBA, we help small businesses by:

Providing free business advice and mentoring

Offering low or no-cost business training

Sharing free business templates and resources

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- Before making any decision or taking any action you should consult a professional.

Objectives

Develop an understanding of the important **Terms & Issues** in a commercial lease.

Develop an understanding of the **Process** used in negotiating a commercial lease.

Develop an understanding of strategies that **Mitigate Risk** in a commercial lease.

What Type Commercial Space Are You Looking For?

- Retail
- Office
- Warehouse

Understanding Commercial Rents

Base Rent

Real Estate Taxes*

Common Area Maintenance* "CAM"

Landlord's Insurance*

Percentage Rent

Marketing Fees

* Pass Throughs

Calculating Rent

- Rents are calculated per square foot - per year.
- Example: $50 per square foot for 2,400 square feet =
- $50 x 2,400 Sq Ft = $120,000 per year or $10,000 per mo.

Understanding the Terms

Rents

Full Service

Typically an Office Including Taxes, Insurance, CAM and Utilities

All In

Typically Retail or a Warehouse Including Taxes, Insurance & CAM

Industrial Gross

Typically a Warehouse including Taxes, Insurance and CAM

Triple Net

Base Rent Only

Understanding Triple Net

Triple Net is the Net of Pass Throughs

- The Net of Landlord's Real Estate Taxes
- The Net of Landlord's Insurance
- The Net of Common Area Maintenance

What Happens in a Triple Net Lease?

Tenant Pays Base Rent

Plus Taxes

Plus CAM

Plus Insurance

Example: Rachel's Bakery

Rachel is looking at a 1,200 sq ft space in a 32,000 sq ft center.
She's been quoted $40 per sq ft Triple Net – NNN.
Real Estate Taxes are estimated at $4.00 per sq ft.
CAM and Insurance are estimated at $7.50 per sq ft.

What is Rachel's Total Rent?

Doing the Numbers

Triple Net Base Rent:

- $40.00 per square foot X 1,200 sf = $48,000 per year or $4,000 per month

Real Estate Taxes:

- $4.00 estimated per square foot X 1,200 sf = $4,800 per year or $400 per month

Insurance and CAM Charges:

- $7.50 estimated per square foot X 1,200 sf = $9,000 per year or $750 per month

Total Rent = $61,800 per year or $5,150 per mo.

Rachel's Potential Risk

Five (5) Year Lease -		$309,000
Ten (10) Year Lease -		$618,000
Startup Costs -		$238,598
Potential Risk	5 years	$547,598
	10 years	$856,598

The Take-a-Way!

Executing a Commercial Lease is a Big Deal.
There will be serious consequences if you fail.

Why are the Pass Throughs Estimated?

- Real Estate Taxes:
  - $4.00 estimated per square foot X 1,200 sq ft =
  - $4,800 per year or $400 per month
- Insurance and CAM Charges:
  - $7.50 estimated per square foot X 1,200 sq ft =
  - $9,000 per year or $750 per month

How Is the Exact Amount Calculated?

Tenants Pay Their Pro-Rata Share of Pass Throughs

Calculating Pro-Rata Share

Divide Tenant's Premises in Square Feet
by the Total Square Feet in the Building.

Rachel's Pro-Rata Share

Rachel's space is 1,200 square feet

in a 32,000 square foot shopping center.

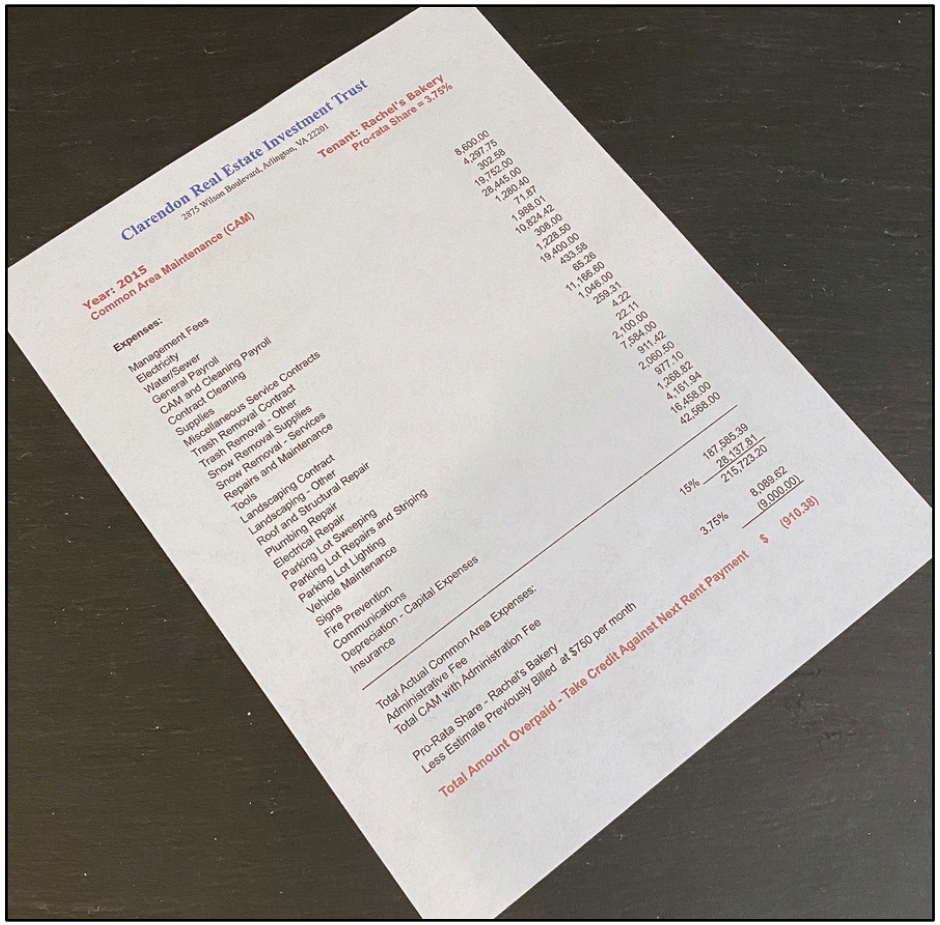
1,200 / 32,000 = .0375

Rachel's Pro-Rata Share = 3.75%

CAM Documentation

Landlord's Annual Reconciliation

(See Handouts)



Clarendon Real Estate Investment Trust
2375 Wilson Boulevard, Arlington, VA 22201

Tenant: Rachel's Bakery
Pro-rata Share = 3.75%

Year: 2015
Common Area Maintenance (CAM)

Expenses:		
Management Fees		8,800.00
Electricity		4,297.75
Water/Sewer		362.58
General Payroll		19,752.00
CAM and Cleaning Payroll		28,445.00
Contract Cleaning		1,280.40
Supplies		71.87
Miscellaneous Service Contracts		1,988.01
Trash Removal Contract		19,844.42
Trash Removal - Other		308.00
Snow Removal Supplies		1,228.50
Snow Removal - Services		19,409.00
Repairs and Maintenance		433.58
Tools		65.26
Landscaping Contract		11,166.60
Landscaping - Other		1,046.00
Roof and Structural Repair		259.31
Plumbing Repair		4.22
Electrical Repair		22.11
Parking Lot Sweeping		2,100.00
Parking Lot Repairs and Striping		7,584.90
Parking Lot Lighting		911.42
Vehicle Maintenance		2,960.53
Signs		977.10
Fire Prevention		1,268.82
Communications		4,161.94
Depreciation - Capital Expenses		16,458.00
Insurance		42,568.00
Total Actual Common Area Expenses:		187,585.39
Administrative Fee	15%	28,137.81
Total CAM with Administration Fee		215,723.20
Pro-Rata Share - Rachel's Bakery	3.75%	8,089.62
Less Estimate Previously Billed at $750 per month		(9,000.00)
Total Amount Overpaid - Take Credit Against Next Rent Payment		$ (910.38)

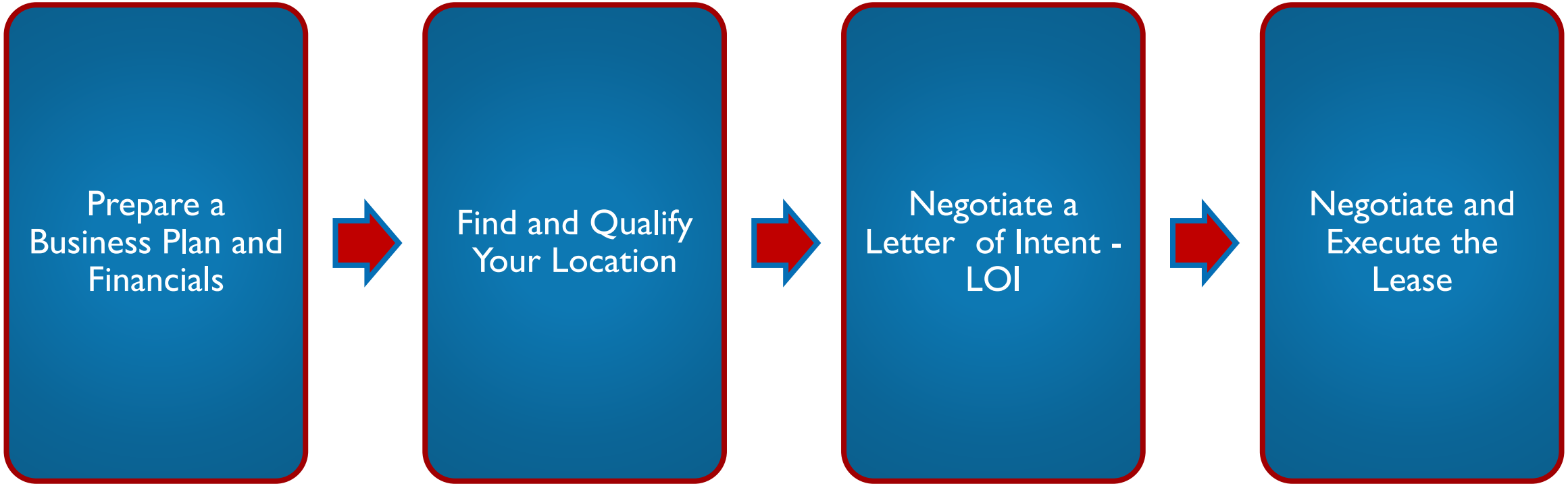
The Leasing Process

Follow the Right Process!

- You will save money
- You will avoid mistakes
- You will have less stress
- You will get a better deal

Be Patient.

The Right Leasing Process



Step 1 – Your Business Plan Must Include the Essentials

Engage a SCORE Mentor for help.

- Identify your Customer.
- Explain your Value Proposition, and your Differentiation.
- What Assumptions have you made?
- Provide a detailed Marketing Plan.
- Identify your Source of Funds.
- Include a Schedule of Startup Costs, and a Projected P&L Statement.
- Prepare a Personal Financial Statement.

Step 2 – Retain a Leasing Agent to Help Find a Location

Your Leasing Agent will:

- Review your criteria.
- Assist in finding a location.
- Provide market comps.
- Arrange for you to visit spaces.
- Prepare your Letter of Intent
- Negotiate the terms of the LOI.
- Be paid by the Landlord's Agent.

Step 3 – Retain an Architect or General Contractor

- Prepare a preliminary fit plan.
- Check out existing HVAC and other systems.
- Obtain an estimate for build-out costs.
- Determine the time-line for:
  1. Obtaining Building Permits
  2. Contruction and Fixturing
  3. Obtaining an Occupancy Permit.

You are only ready to make an offer when you understand
what needs to be done, how much it will cost, and how long it will take.

Understanding the Timeline

Finding the Right Space	1.0 Month
Obtaining Contractor's Estimate	0.5 Month
Negotiating the Deal – Signing the LOI.	1.0 Month
Negotiating & Executing the Lease	1.0 Month
Total for Pre-Lease & Lease Execution	3.5 Months
Obtaining Architectural Plans	1.0 Month
Obtaining Building Permits	2.0 Months
Construction Time	3.0 Months
Total for Permits & Construction Time	6.0 Months

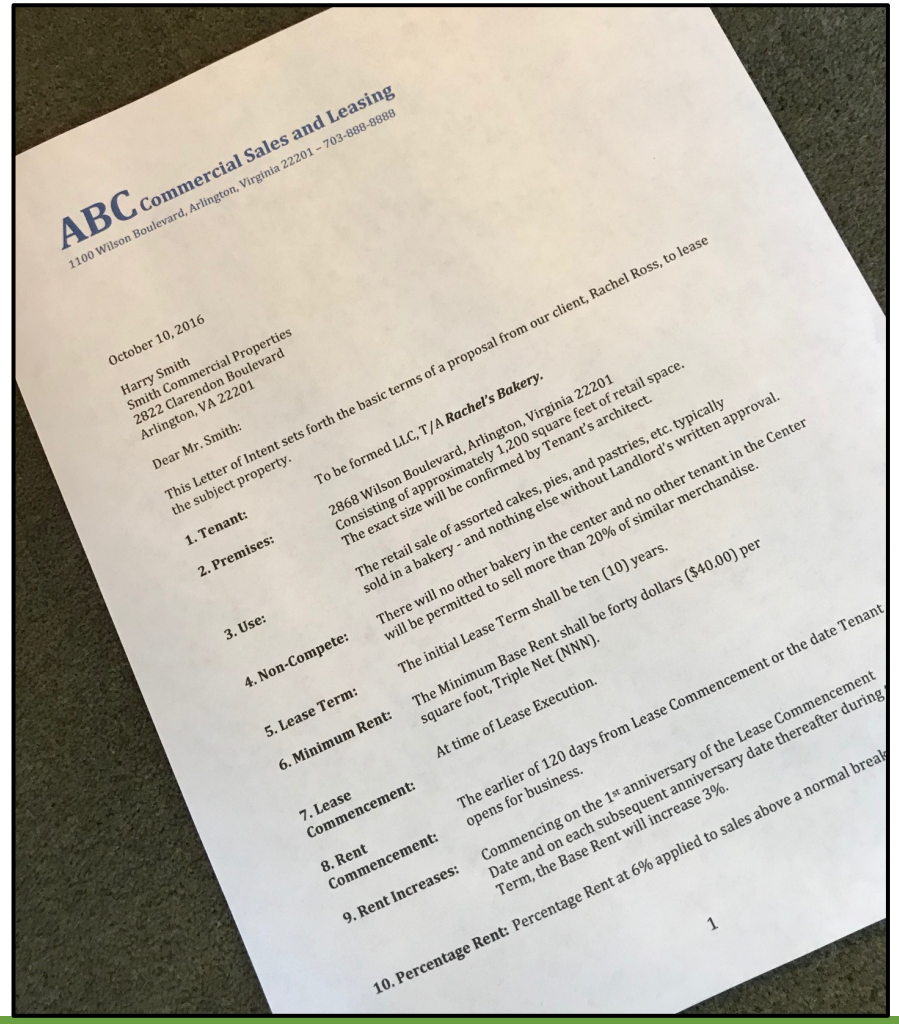
Step 4 – Negotiate the Terms of the LOI

- Offers are typically in the form of a non-binding Letter of Intent (LOI) prepared by your Leasing Agent.
- The LOI should include those issues most important to you.
- Identify Landlord issues that may have negative consequences on you or your business.

Understanding the Letter of Intent

Let's Look at Rachel's Letter of Intent

(See Handouts)



ABC Commercial Sales and Leasing
1100 Wilson Boulevard, Arlington, Virginia 22201 – 703-888-8888

October 10, 2016

Harry Smith
Smith Commercial Properties
2822 Clarendon Boulevard
Arlington, VA 22201

Dear Mr. Smith:

This Letter of Intent sets forth the basic terms of a proposal from our client, Rachel Ross, to lease the subject property.

1. Tenant: To be formed LLC, T/A ***Rachel's Bakery.***

2. Premises: 2868 Wilson Boulevard, Arlington, Virginia 22201
Consisting of approximately 1,200 square feet of retail space.
The exact size will be confirmed by Tenant's architect.

3. Use: The retail sale of assorted cakes, pies, and pastries, etc. typically sold in a bakery - and nothing else without Landlord's written approval.

4. Non-Compete: There will no other bakery in the center and no other tenant in the Center will be permitted to sell more than 20% of similar merchandise.

5. Lease Term: The initial Lease Term shall be ten (10) years.

6. Minimum Rent: The Minimum Base Rent shall be forty dollars ($40.00) per square foot, Triple Net (NNN).

7. Lease Commencement: At time of Lease Execution.

8. Rent Commencement: The earlier of 120 days from Lease Commencement or the date Tenant opens for business.

9. Rent Increases: Commencing on the 1st anniversary of the Lease Commencement Date and on each subsequent anniversary date thereafter during Term, the Base Rent will increase 3%.

10. Percentage Rent: Percentage Rent at 6% applied to sales above a normal break

1

Rachel's Letter of Intent

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Rachel's Letter of Intent

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7. Lease Commencement: At Lease Execution.

8. Rent Commencement: The earlier of 120 days from Lease Commencement or the date Tenant opens for business.

9. Rent Increases: The Base Rent will increase 3% annually.

Rent Increases

2.5% vs 3.5% – What's the Impact?

Year	2.5% Increase	Monthly	3.5% Increase	Monthly
1	48,000	4,000	48,000	4,000
2	49,200	4,100	49,680	4,140
3	50,430	4,203	51,419	4,285
4	51,691	4,308	53,218	4,435
5	52,983	4,415	55,081	4,590
6	54,308	4,526	57,009	4,751
7	55,665	4,639	59,004	4,917
8	57,057	4,755	61,069	5,089
9	58,483	4,874	63,207	5,267
10	59,945	4,995	65,419	5,452

Rachel's Letter of Intent

10. Percentage Rent at 6% applied to monthly sales above a normal break point.

Normal Break Point:

Monthly Rent divided by 6% = $4,000/.06 = $66,667 in Sales

Rachel pays 6% of sales in excess of $66,667 monthly.

Rachel's Monthly Percentage Rent

Rachel's 2018 Sales		6% Over $66,667 Normal Break
January	25,000	
February	25,000	
March	25,000	
April	25,000	
May	25,000	
June	166,667	6,000
July	25,000	
August	25,000	
September	25,000	
October	25,000	
November	25,000	
December	166,667	6,000
Total Sales	583,334	
6 Percentage Rent		12,000

Understanding Percentage Rent

What if we calculate the Normal Break Point Quarterly?

- Quarterly Rent divided by 6% -
- $12,000 /.06 = $200,000 in Sales (The Quarterly Break Point)
- Rachel pays 6% of sales in excess of $200,000 per quarter.

Rachel's Quarterly Percentage Rent

Rachel's 2018 Sales		6% Over $200,000 Normal Break
January	25,000	
February	25,000	
March	25,000	
April	25,000	
May	25,000	
June	166,667	$1,000
July	25,000	
August	25,000	
September	25,000	
October	25,000	
November	25,000	
December	166,667	$1,000
Total Sales	583,334	
6 Percentage Rent		$2,000

Rachel's Letter of Intent

11. Taxes & CAM:	Tenant shall pay its pro-rata share of Real Estate Taxes and Common Area Maintenance. (CAM)
12. Option to Extend:	One five (5) year option to extend at market rates.
13. Utilities:	Tenant shall have separate meters and be responsible for the direct payment of gas, electric and water charges.
14. Condition of Premises:	As-is Condition

Rachel's Letter of Intent

15. Tenant's Work:

Tenant shall be responsible for all improvements including, but not limited to, HVAC, electrical, plumbing and trade fixtures. Tenant's Plans will be subject to Landlord review and written approval.

Rachel's Letter of Intent

16. Tenant Improvement Allowance:

Landlord will provide $30 per sq ft TI Allowance. Tenant is responsible for all costs in excess of the TI Allowance. The TI Allowance will be paid within 30 days after Tenant is open for business and after Landlord has received Release of Lien documents from the General Contractors and all sub-contractors.

Rachel's Letter of Intent

17. Signage:	Tenant shall install, at its expense, the signage allowed by code and in accordance with Landlord's criteria.
18. Deposits:	First Months Rent and one month's Security Deposit due at Lease execution.
19. Personal Guaranty:	Rachel and Thomas Ross will sign a limited Personal Guaranty.
20. Lease Form:	Lease to be prepared by Landlord's attorney.
21. Brokerage:	Smith Commercial Properties for the Landlord ABC Commercial Sales and Leasing for the Tenant

Rachel's Letter of Intent

The Letter of Intent is a Non-Binding Agreement when it includes a Disclaimer.

This letter of intent is merely an expression of interest and shall be non-binding upon the parties hereto. Each party shall have the unilateral right to terminate negotiations at any time, for any reason or for no reason, without liability to the other party. If and when a lease has been negotiated and executed, the terms thereof shall supersede the terms of this letter of intent. This proposal shall expire on (INSERT DATE)

The Lease Agreement

- The Lease is prepared by the Landlord's Attorney . . . in favor of the Landlord!
- The Terms of the LOI will be incorporated into the Lease.
- Your attorney will review the Lease and recommend changes in your favor.

You should prepare for Success and the Consequences of Failure!

Additional Lease Issues

The Assignment & Sublet Clause

- The Transfer of an Interest in your business is an Assignment – usually 20% or more.
- An Assignment or Sub-Let will almost always require Landlord's Permission.
- This clause is particularly important if you plan to bring others into your business – or sell your business.
- The Assignment Clause is even more important if your business is in financial distress.

Additional Lease Issues

- The Default Clause
- Late Charges
- Hours of Operation
- Insurance Requirements
- Hold Over Penalties
- Rules and Regulations

richard.rose@scorevolunteer.org

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