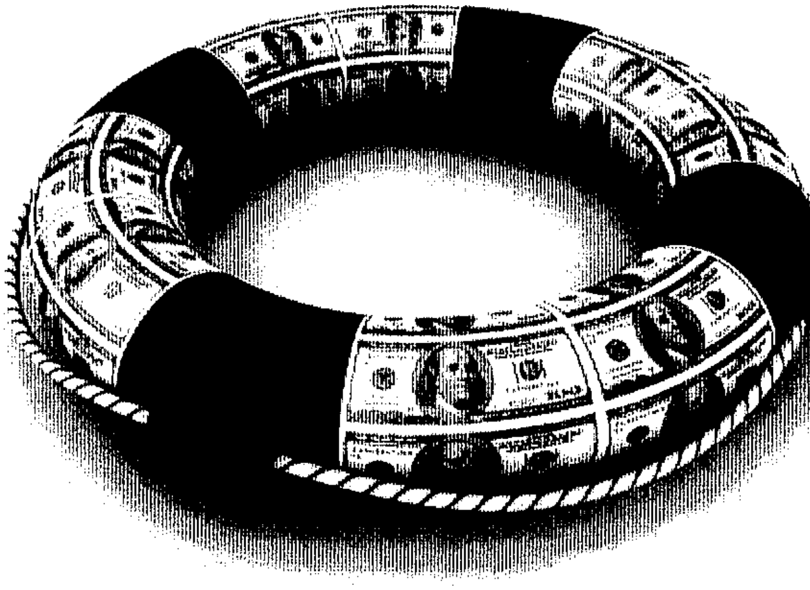
Fighting for Control of Occupany Costs:

Rent Concessions May Benefit Both Tenant and Landlord



While not a new discipline within well-structured lease administration departments, the function of lease renewal negotiation has taken on a life of its own in today's economic climate for both tenant and landlord positions. One leading lease administration director said that he has extended the renewal negotiation calendar from its customary 18-month period to include stores with renewal dates four years out.

Most leading retailers have lease renewal action plans operating in full gear to secure significant occupancy cost savings. One lease renewal negotiator exclaimed, "there is a lot of money out there, and everyone wants their fair share." Still another lease administrator for a high profile apparel chain has over 150 active negotiations underway. She confides, "I could not imagine anyone who is paying occupancy costs not taking the renewal process very seriously." In her circumstance, she is fighting to secure more favorable occupancy agreements using a percent-of-sales benchmark that more accurately reflects her company's market-to-sales balance.

Jerry King of Rent Research Consultants, Inc. specializes in lease renewal negotiations, and has taught a course on this subject at NRTA's Annual Conference for the past several years. He is seeing retailers with strong desirable site positions achieve 5 to 15 percent reductions in monthly rents, asserting that "your case improves if you are a strong tenant and the landlord really needs your commitment to stay."

When entering into negotiations, King advises his clients to approach the question with an attitude of cooperation. Yes, you need a short-term cost reduction. But, what can you do to help the landlord? Many of whom are also cash stressed, he adds.

Tenants sending letters requesting a reduction in rent definitely are getting a landlord's attention. However, with vacancy rates more than double from two years ago, solutions usually don't represent an immediate cash windfall to tenants. Landlord responses have varied, ranging from agreeing to keep a rent flat or foregoing a scheduled rent bump while in turn asking a tenant to either extend the lease or renegotiate the co-tenancy clause or some other clause.

One industry observer explained how a landlord agreed to immediate rent abatements during the current term and tagged on increased amounts at the end of the lease. King suggests that about 80 percent of renewals now involve language in which the landlord agrees to not impose the planned rent increase in exchange for a tenant's agreement to stretch out occupancy commitments.

Some industry observers expressed concern that an overly aggressive attitude on the part of retailers pushing for immediate lower rates might reap short term concessions, but may also breed bad relations down the road. Others concede that while this is a possibility, there is also a critical short-term window of time available for them to get market prices and costs in line.

Rick Burke of Lease Administration Solutions, LLC believes that most landlords recognize their tenants are experiencing revenue drops and cost increases. Using a benchmark ratio of sales per square foot, retailers need help to avoid having occupancy expenses reaching dangerous levels. At these higher cost levels, the rent becomes too much of a burden and a retailer faces the risk of having to "go dark." In those cases landlords lose too, and want to cooperate to avoid those negative situations.

Admittedly these danger levels vary depending on the industry segment a retailer falls within. Traditionally jewelry retail is at the higher end, apparel retailers fall within a middle ground and electronic and dollar store retailers are in the lower spectrum.

It is in a tenant's best interest to work closely with its landlords. This means providing sales reports to validate sales performance, and verifying trending patterms to make your case. Some developers are asking for copies of state revenue tax forms to verify data, evoking a response from several lease administration experts that the request is "ridiculous." However, the message to retailers is clear: it is incumbent upon you to substantiate the request for assistance.

The amount of rent reduction achieved varies depending on who you talk to. Some retailers admit that a reduction of 15 or more percent is unrealistic, while some report 10 to 15% is reasonable. Others say they are more likely to attain an agreement from cash-stressed landlords to hold rent at current levels rather than exercise planned increases, thus affording tenants an opportunity to achieve gains over a longer period of time. Several landlords have been offering TI (tenant improvements) dollars to help tenants move forward with improvements that make the site more viable. Unfortunately, more recent credit crunches seem to be curtailing this option. Still another retailer's negotiation strategy calls for changing his rent portfolio to a fixed cost and eliminating his percentage rent agreements.

"The landlords are faced with a double-edged sword," according to Burke. Landlords are not only faced with the tenant's closing because of a down economy, but as tenants close, this kicks in the co-tenancy clauses in the remaining tenant leases, so the landlords lose needed rental income from those who remain. This will also make it difficult for the landlord to find new tenants as well.

He observed, "the situation gives the tenant more leverage to negotiate, particularly when they know that developers face ever-growing vacancy rates."

Encouraging tenants to move in

There is also a great deal of negotiating being employed by landlords seeking to draw new tenants to their properties. Landlords will give up 3 to 12 months free rent for those tenants moving in, depending on the term length the tenant is willing to sign. They also will structure the lease so that the initial term is low in cost, and any rent increases are to be negotiated at later periods.

Landlords are also willing to talk to retail chains who traditionally are known to lease at low square footage levels that, frankly, were considered undesirable only a few years ago. At a recent industry conference several leading mall developers were observed wooing these same retailers, leading one industry veteran to quip, "Oh the times, they are a-changing."

Bullish landlords are also agreeing to pay all leasing commissions and part of build-out costs and amortize all or part of it interest-free to tenants over the term of the lease. Still another appealing lure is for a landlord to place caps on Common Area Maintenance (CAM) costs.

Using all tools available

Several lease audit firms tell how they are able to convert audit credits into valuable negotiation chips with landlords. Al Stabile, President of Gravitas Real Estate Resources, Inc. reports several circumstances in which his clients successfully translated audit results into valuable renewal tools. "An audit credit can be an incredible hurdle for a cash-tight landlord," he explained. Rather than turn to costly litigation, clients apply the credits toward a lease renewal with more profitable long-term benefits.

Another retailer who wanted to terminate a poorly performing location faced a buyout cost of $400,000. An audit performed by an outside consultant found $130,000 of overcharges by the landlord. Both parties agreed to reduce the buyout amount.

When all is said and done, landlords and tenants find themselves in the middle of a very challenging period of time. It will not last. There is a limited time period in which both parties, tenants and landlords, can significantly impact the occupancy cost equation for many years to come.