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The art of lease restructuring

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It's often said that a company's work force is its lifeblood, and if that's true then keeping its real estate costs and facility rents down can be seen as the vital transfusion often needed to keep the bloodstream flowing. In today's difficult economic times, it is important for commercial tenants and business owners to look for ways to trim expenses and cut costs to survive while the economy continues to remain in a state flux. It's safe to say that every company, whether directly related to the real estate industry or not, has been and is in the process of trying to figure out ways to run as lean and mean as possible. These moves include personnel changes and lay-offs, consolidations, revamping of expenses and compensation structures. However, many times there is a simple solution that can avoid upsetting workflow balance while providing some key relief to the bottom line: the skillful art of what is now commonly known as "lease restructuring."

With commercial vacancy rates nearing record highs and rents plummeting to lows not seen since well before the start of this century, there is no doubt that now is not the greatest time to be a landlord. However, as one side of the fence struggles the other can flourish, and if there is a silver lining during these difficult economic times, it is that now is a great time to be a tenant.

San Diego, like most markets around the country, has seen a significant drop in rental rates triggered by high vacancies caused by consolidations, space give-backs and a general lack of growth in the marketplace. This has created a situation where landlords are forced to provide tenants with rent reductions and considerable concessions in the form of free rent, improvement dollars and other allowances to entice tenants into their buildings. Additionally, landlords will go to great lengths to keep existing tenants in good standing from leaving, and will often be open to restructuring leases well in advance of their expiration dates.

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Many of today's tenants who signed longer-term leases years ago are left with the uneasy feeling of knowing that they are paying much higher rates than their neighbor who just moved in last week. While it's true that timing is everything, it doesn't necessarily mean you can't do something about it today. With that said, calling your landlord and complaining about your situation will hardly garner you any sympathy, as they have their own issues and, after all, you are contractually bound to pay the rents you agreed to. However, more and more tenants today are seeking the services of sophisticated tenant representation firms who are skilled in lease restructuring, resulting in immediate savings for tenants, rather than having to wait for the timing of their lease expiration to catch up with them.

Restructuring a lease, like any negotiation, really comes down to leverage. When a tenant has time left on the lease, the natural assumption is that leverage is with the landlord. He knows you can't pick up and move until the lease expires, and there is also a considerable disruption to your business and costs associated with moving. While this may be true, the savvy tenant can reverse this notion by conveying a sense of urgency, combined with the uncertainty of the future and high costs to release the space if and when the tenant does move.

For starters, it is important to make it clear that keeping things as they are and re-addressing them as the lease expiration gets a little closer is not acceptable. Simply asking to restructure early is not enough reason for it to be granted. Your landlord must realize that not working with you now will negate any possibility of retaining you as a tenant in the future. If your landlord senses there is a possibility of deferring this event, then he will. Not only does he get to keep collecting a higher rent for a longer period of time, but he also holds out hope that current market rates may increase as times goes on.

In addition, you need to create a "win/win" so that your landlord will be inclined to work with you. This typically requires some additional carrot, which usually comes in the form of an additional lease term. It generally means adding to your current remaining lease term. Simply offering up more term is not usually going to be enough. No landlord wants to disrupt their current cash flow or reduce it, but the fear of having it vanish altogether and the thought of spending three or four times more than that to reproduce it is where the real leverage comes from.

One important thing to remember is that re-leasing costs in today's climate can be astronomical. This is primarily due to the "downtime" to find another tenant for the space. With the vast glut of commercial space on the market, tenants looking to relocate have far greater choices than ever before. The time it takes to lease a vacant space has also increased significantly. In the past it might take three to four months to find a replacement tenant, but that number today can be as high as two or three years, depending on the submarket and the space. Add improvement costs that come with up-fit for a new tenant along with marketing costs to re-lease the space, and even the most discounted renewal rate potentially will be much more profitable than re-leasing the space.

The trick to all of this, however, is to eloquently discuss lease re-negotiations without flinching or insulting your landlord, while pointing out the benefits of restructuring the lease sooner rather than later. Although it might not be their first choice, it is usually far better than the alternative of having to re-lease the space in the future and the uncertainty that goes with it. If handled properly, this process can result in significant rent savings and/or additional concessions that immediately improve your company's bottom line -- which in today's climate could be the difference between success and failure.

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