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Even the small tenants deserve market leverage

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by Eric Gold

Good business has an awful lot to do with human nature. Although most business people would claim to consistently provide each client or customer with the same level of good service, we all know that's just not the case.

That young, affluent couple, for example, that dines in the same fine restaurant three times a week usually is going to get better tables, better service and more perks than the family who visits the same establishment three times a year. That's just human nature -- and good business. The same could be said for landlords and their office buildings.

Landlords might claim to offer a 1,000-square-foot tenant the same level of service and the same tenant improvement opportunities as a 15,000-square-foot tenant, but that's almost never the case. Landlords by nature are going to be more attentive -- and more generous -- to larger tenants. They're going to offer larger tenants more incentives and allow for more negotiating leverage than small tenants enjoy because it's just good business for them to do so.

It's not such good business for small tenants, of course. In fact, small-office tenants face an uphill battle for lease space regardless of economic conditions and market fundamentals. The smaller the tenant, the less important they are to their landlords, and in many cases, to the brokers who represent them.

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It doesn't matter what particular business they're in, or even if they have excellent credit and impeccable references. Tenants who lease spaces of 5,000 square feet or smaller are simply less likely to get what they deserve, even if they're represented by a broker. Usually, this is the fault of the tenant.

Small tenants in general tend to underestimate their own importance by either failing to retain a broker, putting too much trust in the landlord or the listing broker, or allowing an attorney or other advisor to negotiate their lease. Any one of those options usually leads to a bad deal for the tenant.

Hiring the right type of broker should be the absolute baseline requirement for a small tenant. It doesn't cost the tenant another dime because the brokerage fees are already factored into the landlord's pro forma.

Tenants who ignore this and insist on foregoing representation will miss at least 25 percent of potential lease opportunities because they evaluate only what they can see. That is, their search for space begins and ends only with buildings that advertise vacancies to the public. In fact, a great number of available spaces never are advertised, including potentially suitable sublease spaces.

And for the small tenant going it alone, the search for space is only the beginning of a journey filled with fiscally dangerous challenges.

The commercial office lease is a complicated document that specifies a lot more than just rental rates. There are other, equally important items to consider, such as operating expenses, parking charges, tenant finish allowances, free rent, options to renew, subleasing rights, landlord relocation rights and square footage measurement methods, just to name a few.

Rental rates, by the way, are determined by the market's supply and demand -- not by what the landlord may claim the vacant space is worth, or what it will cost to operate the building. One common mistake small tenants make is to assume they're negotiating a good deal for themselves if the landlord agrees to offer a renewal rate equal to or slightly less than what the tenant is currently paying.

In fact, rental rates fluctuate up and down, so a perceived good deal might end up being a couple of dollars higher than current market rates. Multiply that by the tenant's total square footage over a typical term of three or five years, and you're talking about a significant amount of money that the tenant unnecessarily puts in the landlord's pocket.

Small tenants are no better off working with just the listing broker, whose job is to negotiate the best possible terms for the landlord. While listing brokers might not be unethical or unfair to tenants, they're certainly not going to advise the tenant on how to avoid potentially costly pitfalls when it comes to the nuances of the lease.

And while attorneys are an invaluable resource for small tenants when reviewing the legal language of the lease, they aren't real estate professionals and should never be entrusted with negotiating the business terms of a lease. Nor should accountants or financial planners do the negotiating.

Tenants clearly benefit from these types of professionals, who advise them on how to maximize the efficiency of their operations, but they're not qualified to offer advice on the business terms of a lease.

Even retaining a qualified broker doesn't give the small tenant license to sleep through the building search and leasing process. Tenants have a responsibility to perform a certain amount of their own due diligence. The smaller the tenant, the more important this becomes.

It pays for the small-business owner to question the tenants in the buildings where they may eventually lease. How have the other tenants been treated? How responsive was the landlord when problems arose within the space or in common areas? Are the landlord and property manager accessible at any time, or operating primarily from out of town or out of state? Does the landlord offer a simplified lease for small tenants?

These are among the basic questions a tenant can ask independently of what a broker may be doing. And the smaller the building, the more important each tenant should be to that landlord. This is something small tenants should always be aware of, but usually aren't.

Large tenants are always going to have the upper hand when it comes to negotiating clout. That's a given. But small tenants have leverage, too. They just need to know where -- and how -- to exercise it.

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