

Entrepreneurs

How To Renegotiate Your Lease

Christopher Steiner, 02.02.09

You have more bargaining power than you think.

Variable costs like payroll, office supplies and advertising usually draw first blood in a recession. But some ostensibly fixed burdens are ripe for whittling, too, if you know how to negotiate. A big one: leased real estate.

In this market, even agreements inked for the next five or 10 years are open for negotiation. Indeed, landlords have all but come to expect the conversation.

“With the kinds of hits that most businesses have taken in sales, they can’t afford to pay out at the occupancy rates they have been,” says Ivan Friedman, chief executive of RCS Real Estate Advisors in Manhattan.

What kind of deal can you cut? That depends on a few things—your landlord’s overall occupancy rate and your flexibility with moving are two big ones—but basically it comes down to how bad things really are. Matthew Bordwin, managing director of the Real Estate Services Team at KPMG Corporate Finance, says that lease reductions can be anywhere from 5% to 50%, and breaks of 30% are not uncommon.

“What it comes down to for the landlord is this: Would they rather take a 30% reduction in rent or simply take zero?” he says. “They usually opt for the 30% break.”

Consider a high-end clothing boutique, with 15% operating margins (profit before interest and taxes). Say rent typically eats 12% of sales (or \$1 for every \$8 of sales). With retail sales off in the neighborhood of 40% in the last year, that rent-to-sales ratio looks more like 20%, slicing already slender margins by more than half. Either find a way to cut costs, or go out of business.

You may have to whip out your books to plead your case, advises Bordwin. “Landlords know that they probably need to

consent to some form of a rent reduction if they want to keep tenants in this environment,” he says. “There aren’t many idle threats being made today. So many businesses find themselves in trouble.”

Another negotiating lever: “Tenants can walk down the street and throw a dart and find empty space elsewhere,” says Bordwin. “And it’s likely that the other landlord will find a way to get them in.”

Due diligence helps, too, so know the market. A landlord with a glut of empty space likely will be more willing to cut a generous deal. “The landlord with a Circuit City and a Linens ‘n Things can’t afford another tenant leaving,” says Bordwin. “He’s already behind the eight ball.”

Even relatively healthy renters can press their landlords for breaks. In this economy, stability is a coveted asset. “The stronger tenants, historically, have not gotten rent reductions when they’ve asked,” says Bordwin. “But now, [even they] are having an easier time getting their rents lowered by simply asking. Nobody wants to lose a paying renter right now because it could take months or years to refill that space.”

A good strategy for healthy businesses looking for rent reductions is to pursue a lease extension, says RCS’s Friedman. Landlords are apt to surrender a 20% decrease in rent for a commitment of two to five years. Tenants should ask for that decrease to begin immediately, says Friedman.

“If you have a lease that’s expiring in, say, six months, that’s as good as a bankruptcy these days,” says Friedman. “You can then say, ‘Look, if we don’t get a substantial decrease, we’re leaving.’”

Bottom line: In this economy, treat no cost as fixed. Says Friedman: “Occupancy costs have become a controllable expense.” ■