

# Commercial Leasing: Avoiding Pitfalls and Landmines

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Presented by: Richard Rose, Certified SCORE Mentor

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# About the 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 17 years, he has helped numerous clients negotiate leases and open brick and mortar stores.

# Disclaimer

- SCORE does not provide legal advice.
- The information contained in this presentation is for general guidance on matters of interest only.
- It is not a substitute for consultation with professional accounting, tax, legal or other competent advisors.
- Before making any decision or taking any action you should consult a professional.

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

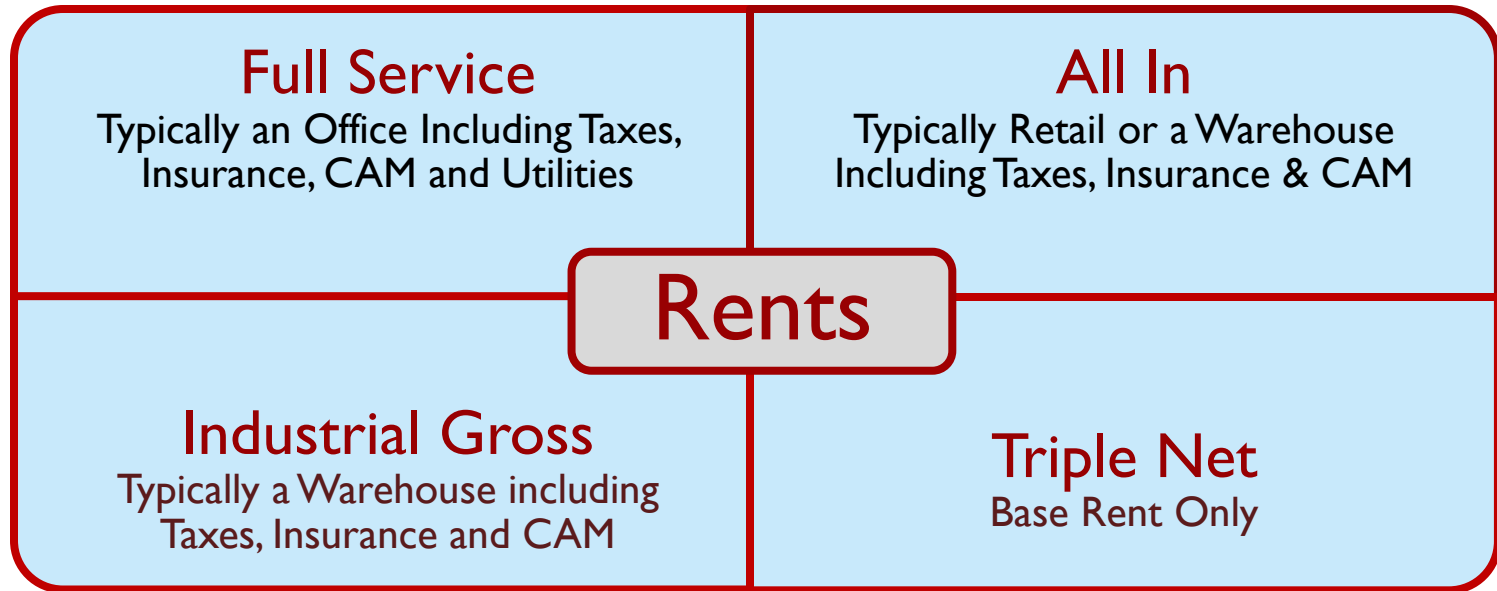
\* Pass Throughs

# Calculating Rent

- Rents are calculated per square foot - per year.
- Example: \$50 per square foot for 2,400 square feet =
- **$\$50 \times 2,400 \text{ Sq Ft} = \$120,000$  per year or  $\$10,000$  per mo.**



# Understanding the Terms



## Triple Net is the Net of Pass Throughs

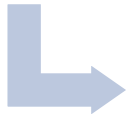
The Net of Landlord's Real Estate Taxes

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
<b>Potential Risk -</b>	<b>5 years</b>	<b>\$547,598</b>
	<b>10 years</b>	<b>\$856,598</b>



## 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%**

## Landlord's Annual Reconciliation

(See Handouts)

**Clarendon Real Estate Investment Trust**  
2075 White Mountain Avenue, VA 22091  
Tenant: Rochet's Bakery  
Promiss Note = 3,175K

**Year: 2015**  
**Common Area Maintenance (CAM)**

Management Fees	8,600.00
Electricity	4,207.75
Water/Sewer	2,927.28
General Payroll	28,352.00
CATV and Cleaning	1,200.00
Coating/Cleaning	1,883.87
Repairs	1,883.87
Mechanical/Service Contracts	10,238.42
Mechanical/Other	1,200.00
Trash Removal	19,420.00
Snow Removal	533.28
Snow Removal	11,186.28
Repairs and Maintenance	2,048.50
Taxes	4.00
Landscaping/Contract	1.23
Landscaping/Other	2,120.00
Roof and Structural	1,594.00
Plumbing Repair	2,983.42
Electrical Repair	971.42
Painting/Exterior	1,200.00
Painting/Interior	493.40
Painting/Other	1,200.00
Variable Maintenance	18,420.00
Insurance	42,988.00
Capital Expenses	
Total Actual Common Area Expenses:	187,588.39
Administrative Fee	28,352.00
Total CAM w/ Administration Fee	215,940.39
Pro-Rata Share - Rochet's Bakery	8,088.92
Less Estimate Previously Billed	(9,269.00)
<b>Total Amount Overpaid - Take Credit Against Next Rent Payment</b>	<b>\$ (910.38)</b>

# The Leasing Process

## Follow the Right Process!

You will save money

You will avoid mistakes

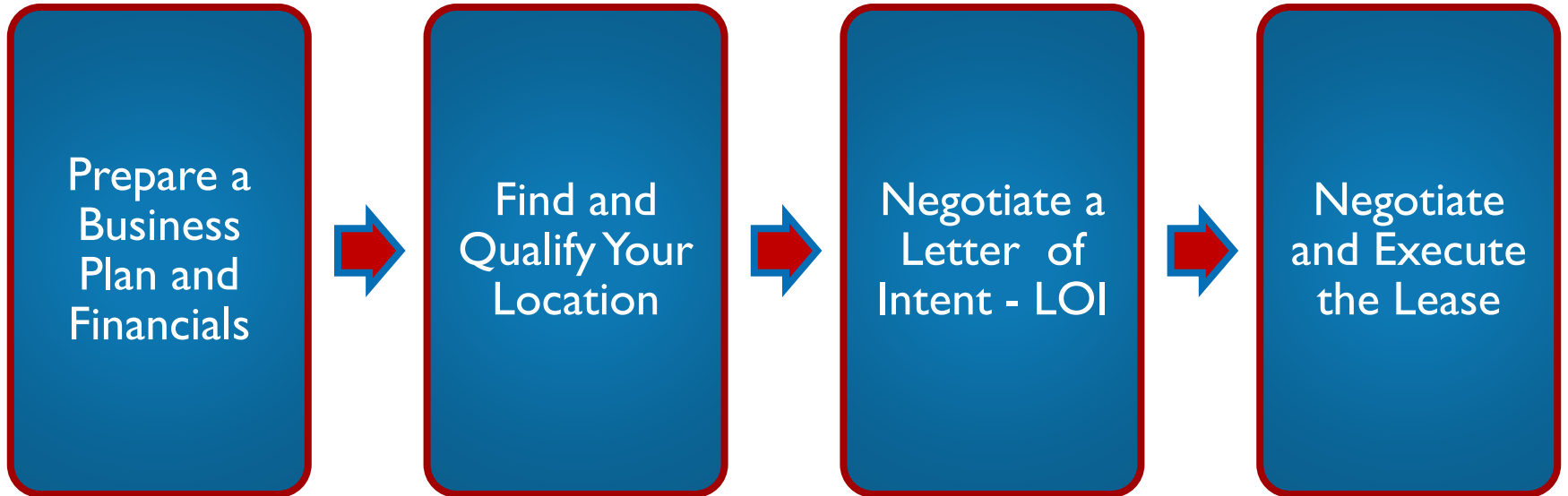
You will have less stress

You will get a better deal



**Be Patient.**

# The Right Leasing Process



# Step I – 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 Cash Flow Analysis.
- 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. Construction 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 Time-Line

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
<b>Total for Pre-Lease &amp; Lease Execution</b>	<b>3.5 Months</b>
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Obtaining Architectural Plans	1.0 Month
Obtaining Building Permits	2.0 Months
Construction Time	3.0 Months
<b>Total for Permits &amp; Construction Time</b>	<b>6.0 Months</b>

# Step 4 – Negotiate the Terms of the LOI

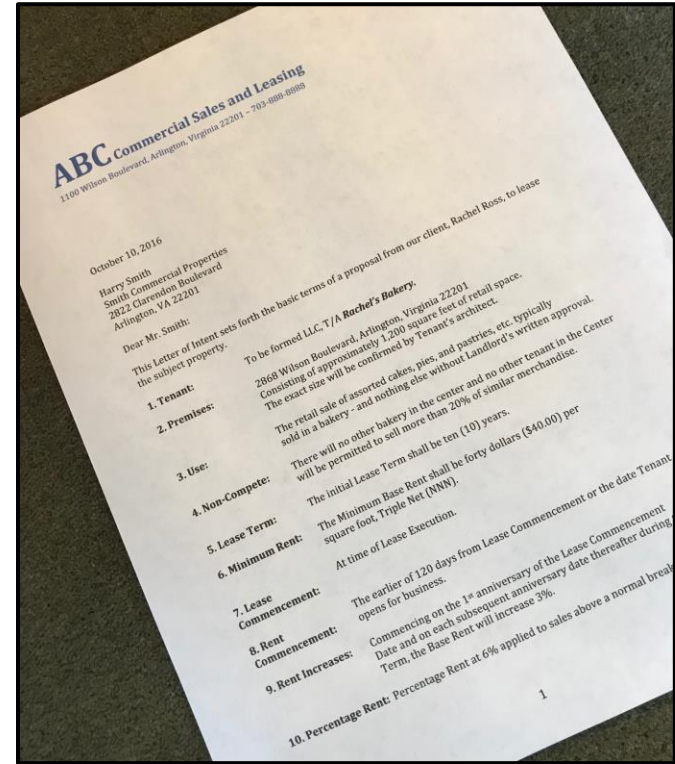


- Offers are typically in the form of a non-binding Letter of Intent (LOI) prepared by your Leasing Agent.
- The LOI should include those issues most important to you.
- Identify Landlord issues that may have negative consequences on you or your business.

# Understanding the Letter of Intent

## Let's Look at Rachel's Letter of Intent

(See Handouts)



# Rachel's Letter of Intent

1. Tenant: To be formed LLC, T/A ***Rachel's Bakery***
2. Premises: 2868 Wilson Boulevard, Arlington, Virginia. 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 be no other bakery in the Center and no other tenant in the Center will be permitted to sell more than 20% of similar merchandise.

# Rachel's Letter of Intent

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 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.

## 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	4,637	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
<b>Total Sales</b>	<b>583,334</b>	

**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	<u>25,000</u>	
April	25,000	
May	25,000	
June	<u>166,667</u>	\$1,000
July	25,000	
August	25,000	
September	<u>25,000</u>	
October	25,000	
November	25,000	
December	<u>166,667</u>	\$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

## 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!**

## 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

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[Richard.Rose@scorevolunteer.org](mailto:Richard.Rose@scorevolunteer.org)





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