FREEHOLD
BROKERAGE

COMMERCIAL LEASING

complete guide for the leasing process

FREEHOLD GROUP

Before you lease: understanding the commercial leasing process.

It's too late to make changes after you've signed a commercial lease for an office building or retail space and the ink has dried. It's vitally important that you understand lease terms, how they'll impact you, and that you've negotiated the best deal possible for yourself before you sign a business lease. This guide features:

- Get to Know Your Broker
- Get to Know Our Company
- Lessee Questionnaire
- Common Lease Types
- Understand Before You Sign
- Frequently Used Lease Agreement Terms
- Leasing Step By Step
- Property Search
- Time to Sign
- Ready for Business
- Lease Mistakes
- Lessee Resources

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Corey Cabrera

GET TO KNOW YOUR REAL ESTATE BROKER

Corey, the Founder & Principal Broker of Freehold Group, boasts a diverse entrepreneurial background spanning real estate, design, marketing, and business consulting. Influenced by a family deeply rooted in creativity and entrepreneurship, Corey imbibed values of integrity, energy, dedication, and innovative service delivery from an early age.

With a career straddling both creative and analytical realms, Corey adeptly navigates clients through what may be the most significant transactions of their lives. He strikes a harmonious balance between robust negotiation skills and a congenial demeanor, ensuring optimal outcomes for his clients in every transaction.

As a licensed real estate broker in Oregon, Corey holds a B.S. in Architecture from Portland State University and a Master in Real Estate Development (MRED) from Portland State University's School of Business. His academic pursuits complement his practical expertise, enhancing his ability to serve his clients effectively.

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GET TO KNOW YOUR REAL ESTATE BROKERAGE

At Freehold Brokerage, we specialize in investment real estate across the Pacific Northwest. As a boutique firm, we are uniquely positioned to assist clients in enhancing returns and optimizing value. Our tailored solutions are designed to cater to the specific needs of investors and property owners seeking to buy, sell, or exchange residential, multifamily properties, and land assets.

We collaborate closely with our clients to ensure they are always primed for success. With a comprehensive understanding of real estate and a mindset akin to retailers, investors, restaurateurs, franchisors, and entrepreneurs, we offer invaluable strategies and independent, high-quality research to facilitate prudent property acquisitions. With a keen focus on risk management, we deliver top-notch advice and execution excellence across all property transactions, empowering our clients to maximize their return on investment.

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Lessee QUESTIONNAIRE

DESIRED LOCATION
Look and feel of preferred area.

PRICING & FINANCING
What is your price range? If you need financing, are you pre-qualified yet?

TIMEFRAME
Are you currently leasing? When does your current lease end?

INTERIOR
What does your ideal space look like? Bathrooms? Total square feet? Other requirements?

EXTERIOR
Employee and customer parking needs? Loading area? Other exterior requirements?

Single Net Leases (N)

Single net leases, which are often referred to as a net lease or an "N" lease, are not as common in the rental world. In a lease like this, the landlord transfers a minimal amount of risk to the tenant, who pays the property taxes. This means any other expense—such as insurance, maintenance and repairs, and utilities—are the landlord's responsibility. The landlord is also responsible for any maintenance and/or repairs that must be done during the course of the lease within the property.

Tenants under a single net lease end up paying slightly lower rent than with a standard lease because of the added cost of property taxes. But a higher rental payment doesn't alleviate the landlord's responsibility for keeping these expenses up to date.

For example, a tenant may miss or make late payments to the municipality, which means the landlord is on the hook for them. These may result in fines and/or additional fees. That's why most landlords include the property taxes in the rent payments. They prefer that the payment passes through them so they know the taxes are paid on time and in the correct amount.

Double Net Leases (NN)

Double net leases, which are also called net-net leases or "NN" leases, are especially popular in commercial real estate. In a lease like this, the tenant pays property taxes and insurance premiums in addition to the rent. The base rent— payable for the space itself—is generally lower because of the additional expenses the tenant must bear. All maintenance costs, on the other hand, remain the responsibility of the landlord, who pays for them directly.

In larger commercial developments with more than one space available to rent, such as shopping malls and expansive office complexes, tenants may have different square footage than their neighbors. So landlords typically assign taxes and insurance costs to tenants proportionally based on the amount of space leased.

Just like the single net lease, landlords should have the additional payments passed on to them, so they can pay them to the municipality and insurance company. Even though the tenant's lease includes these payments, the landlord's name is on the tax and insurance bill, meaning they are ultimately responsible. By having the tenant pay these expenses directly to them, the landlord can avoid the problems associated with late or missed payments by tenants, which could result in extra fees.

Triple Net Lease (NNN)

The triple net lease absolves the landlord of the most risk of any net lease. This means even the costs of structural maintenance and repairs must be paid by the tenant—in addition to rent, property taxes, and insurance premiums. Because these additional expenses are passed on to the tenant, the landlord generally charges a lower base rent.

When maintenance costs are higher than expected, tenants under triple net leases frequently attempt to get out of their leases or obtain rent concessions. To preempt this from happening, many landlords prefer to use a bondable net lease. This is one kind of triple net lease that cannot be terminated before its expiration date. Furthermore, the rent amount cannot be altered for any reason, including unexpected and significant increases in ancillary costs.

Landlords may prefer to use a bondable net lease as tenants may try to get out of an expensive triple net lease. Triple net leases may increase the tenant's operational expenses, and they may be on the hook for deductibles on insurance policies. They may also be responsible for any damages to the property that are not covered by the insurance company. Most triple net leases are long-term leases lasting for more than 10 years, and they generally include concessions for rent increases.

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Elements of a Lease / Points of Negotiation

Most of these factors are negotiated well before a lease is ever drafted. During the letter of intent (LOI) process, landlords and tenants will discuss and negotiate each point of the lease through their brokers, and only when both parties agree on the terms is a formal lease document drafted. The generally terms agreed to in the LOI include, at a minimum:

- Term, rate, and escalations
- Concessions (TI and free rent)
- Parking
- Sublease, expansion, and renewal options

Escalations

The longer the lease, the more a landlord is exposed to inflation and rising rental rates in the market. If a tenant has signed a lease for $20/sf, but 5 years later the market average is $30/sf, what can the landlord do to keep rates close to market level without having to renegotiate leases every year? Many landlords require base rent escalations in their leases to help account for this issue. Escalations are used as a way for the landlord to incrementally increase the base rent annually to keep up with inflating market rates. Tenants can also benefit from escalations because it allows them to pay a lower base rent in the beginning years of the lease. Without escalations, the landlord would likely charge a high rate for the entire lease. There are a few different types of escalations, and they each have their own unique provisions:

- **Amount:** In this type of escalation, a predetermined increase in base rent is agreed upon by both parties in the negotiation process. Each year, the base rent will increase by this set amount, and will continue to do so until the term of the lease is over.
- **Percent:** Similar to a specific amount of escalation, a percent escalation is a predetermined percentage increase in base rent. Each year, the current base rent will be increased by the percentage agreed upon by both parties.
- **Indexed:** Indexed escalations introduce a little more variability into a tenant's rental rate because they do not increase by a predetermined amount. Instead, the escalation follows an index (usually the Consumer Price Index) and increases based on the amount of the index. Indexed escalations can also lead to lower rent if the index being used sees a decrease from one year to the next.

Common Area Maintenance (CAM)

Fees paid by tenants to landlords to help cover costs associated with overhead and operating expenses for common areas. Common areas are spaces used for or benefited by all tenants and include, but are not limited to, hallways, elevators, parking lots, lobbies, public bathrooms and building security.

- CAM expenses are usually defined in the lease to clear up any ambiguity as to what they entail. It is important to have a clear understanding of these expenses before signing a new lease.

Exclusivity

An exclusivity clause is a clause in a commercial lease that grants a tenant the exclusive right to engage in a certain type of activity at that location.

- Ask for exclusivity for your building or complex. If you're a dentist, that means no other dental offices can open in your building. If you build a restaurant, make sure there can be no direct competitors to the cuisine you offer, etc.

Right of First Refusal

Right of first refusal (ROFR), also known as first right of refusal, is a contractual right to enter into a business transaction with a person or company before anyone else can.

- Make sure you have first right of refusal should the building or unit ever become available for sale. In other words, should your landlord decide to put the building or unit up for sale that they come to you first to offer.

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COMMERCIAL LEASING

Frequently Used Lease Agreement Terms

ADDITIONAL RENT

Additional rent refers to the charges to a tenant not included in the base rent, such as common area maintenance (CAM) fees, after-hours service, parking fees, etc.

ARBITRATION

Arbitration refers to a non-judicial dispute resolution process that involves a hearing and determination of a disputed issue by one or more neutral third parties whose decision is binding.

ASSIGNMENT

An assignment refers to the transfer of an interest (e.g., a leasehold interest) in real property.

BASE RENT

The base rent is the minimum rent due under a standard commercial lease agreement. Additional rent may be required, in addition to the base rent, depending on the lease structure.

BUILD-OUT

The build-out refers to any work required to make the premises ready for the business to operate out of the space on the first day of their lease agreement.

COMMON AREA MAINTENANCE (CAM)

The common are maintenance (CAM) expense is an amount charged to tenants on top of the base rent as additional rent. It is mainly used to cover the cost of maintenance fees for work performed to maintain the common areas of the property. CAM fees are assessed to tenants on a prorated basis depending on occupiable square feet.

COMMON AREA MAINTENANCE (CAM) CAP

The maximum amount the tenant can be charged for its share of common area maintenance expenses.

DUE DILIGENCE

The process of examining and investigating a property by or for the potential tenant, lender or purchaser of a property. Failure to exercise due diligence may sometimes result in unanticipated costs or liabilities.

EASEMENT

An easement is a publicly-recorded legal agreement that gives one party the authority to use another person's property for a specific purpose. The current owner maintains ownership of that property, but grants use to the other party for a period of time (sometimes indefinitely). For example, a property owner may provide another owner with an easement to use a strip of land as a driveway if there was no space on his own property for that driveway.

EXCLUSIVITY

Prohibiting an owner from leasing to another tenant with similar business uses. Exclusivity provisions are common in retail leasing situations.

FIT-OUT

Fit-out typically refers to activities making a commercial tenant interior space suitable for occupation. Often, a tenant's own contractor does fit-out construction, as opposed to the landlord's construction company.

MINIMUM RENT ("BASE RENT")

In the context of commercial lease agreements, the minimum rent refers to the base, fixed rent applicable for a certain period. Minimum rent can be subject to adjustment periodically, based on negotiated terms.

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COMMERCIAL LEASING

Frequently Used Lease Agreement Terms

OCCUPANCY COST

The total cost of leasing space, including minimum rent, percentage rent, taxes, insurance, maintenance, parking fees, advertising fees, merchant association fees, and any other charges assessed on a periodic basis.

OPTION

A right given in exchange for consideration (i.e., something of value) by a landlord to a tenant to buy or lease the property under specific terms and conditions for a specific period, without obligating the tenant to exercise the right. There are two common forms of options in commercial lease agreement: (a) option to extend (b) option to purchase.

POSSESSION

In commercial lease agreements, possession describes the giving or taking of occupancy of a premises. Possession of a property can occur before, at the same time, or after the commencement date of the lease or commencement of rent.

RENT ABATEMENT

A release of a tenant's obligations to pay rent for a period under certain specified situations, such as a casualty event or an act of God.

RENT CONCESSION

A period of free rent given to the tenant by the landlord.

RIGHT OF FIRST REFUSAL

As a commercial lease agreement term, this refers to the negotiated right of a tenant to match any bona fide offer received by a landlord to lease or sell the demised premises.

RULES AND REGULATIONS

Often an exhibit to a lease describing important operational aspects of the building or complex, such as hours of operation, noise control, parking regulations, delivery procedures, trash removal, etc.

SUBLEASE

A lease where the original tenant sublets all or a portion of the leasehold interest to another tenant (referred to as the "subtenant") while still retaining a leasehold interest in the property.

TENANT IMPROVEMENT (TI) ALLOWANCE

An amount, negotiated in the lease, that a landlord is willing to give a tenant to make improvements to the premises. Landlords typically recover the tenant improvement (TI) allowance from the tenant through the rent over the lease term.

TENANT IMPROVEMENTS

Modifications to the leased property to accommodate the specific needs of the tenant, such as interior walls, flooring, light fixtures, doors, window treatments, etc. Tenant improvements can be inside or outside of the premises and can be paid for by the tenant, landlord, or both. The costs of these are typically negotiated during the initial leasing process.

USE CLAUSE

A use clause limits how the tenant can use the rented space. The limitations can be as broad as what business can be conducted there or as narrow as what specific services or products can be offered.

USE PERMIT

A permit obtained from the local planning department (at the city or county level) that allows an owner or tenant to use a property for a purpose not permitted under the standard zoning ordinance. A tenant may insist that they secure a use permit prior to finalizing any long-term lease agreement.

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Leasing space for a business can be a complicated process. There are several variables to consider including location and cost. Here are general guidelines for how the leasing process works and what you should expect as a business owner. However, keep in mind that the leasing process is often unique for every situation. These steps may vary depending on a variety of factors.

The Steps

1. DETERMINE YOUR NEEDS

First, it's important to get very specific in your needs and wants. This will help you narrow your search to just spaces that will work for your business. There are three major components to decide upon: location, rent budget, and type of space.

LOCATION

Location affects your visibility as well as the quality and value of your space. Ask the simple questions - Where are our customers? Our market region? Our employees? What other businesses offer a synergistic relationship? Where is the competition located?

COST

Your monthly rent will be determined by many variables: lease rate per square foot, free rent, utilities, additional tenant improvements that are amortized into the rent, and annual rental increases as provided for in your lease. See the sections on Lease Types and Calculating Rent to learn more.

TYPE OF SPACE

The type of space you need is going to be determined by the type of product or service you provide. There are several different types of commercial properties that fall under the umbrellas of industrial, retail, and office spaces. Getting to know the various types before you begin your search can be helpful.

PROPERTY SEARCH

2. LOOK FOR THE RIGHT SPACE

One way to look for space is to drive around your market and call the listing agents of the properties that match your criteria. The challenge with this option is you won't know anything about the property or its asking rate until you call.

Another option is to secure the services of a tenant representative. They can show you what's available in the market in the locations and price ranges you want. Then you will be able to tour your top picks and perform the analysis on which property best fits your business needs.

3. CREATE A LETTER OF INTENT

A letter of intent is then sent to a property owner stating your desire to enter into a lease agreement at their property. These agreements are not leases, so they are non-committal in nature, but they do establish your intent to negotiate a term with the landlord.

Did you know? There are an estimated 5.9 million commercial buildings in the United States.

TIME TO SIGN

4. BEGIN LEASE NEGOTIATIONS

There are typically many sections of a lease that establish the terms of your agreement with the owner. Lease negotiations involve several factors including:

- Lease rate
- Length of term
- Concessions
- Rate bumps
- Renewal options

The negotiations occur regarding these points and can take anywhere from a few days to several weeks or even months to complete, depending on the complexity of the lease.

An owner will also want to establish your financial credibility as a tenant. In other words, you'll need to establish your trustworthiness to pay the rent due the owner as part of your agreement. Financials and other documents are used to establish this credibility.

READY FOR BUSINESS

5. IDENTIFY TARGET OCCUPANCY DATE

The date set for occupancy can be subject to change depending on the amount of tenant improvements (TIs) that are required. These improvements come in many forms starting with simple paint and carpet to constructing demising walls.

The more complex the TI, the more likely the target date will change. The critical stage in this process is when the TIs are completed and a Certificate of Occupancy has been issued for the space.

6. MOVE IN

Once everything is ready, the fun part begins.

Lease Mistakes

AVOID THESE MISTAKES WHEN LEASING COMMERCIAL PROPERTY

TERM CALCULATIONS

How often have you seen the term in a lease that says it's 5 years, but the dates included in the lease say something different? It seems easy enough to calculate a five-year lease, right? Yet, we have seen it time and time again that when the actual dates are included in the lease, there are actually 6 years listed rather than 5. It's a simple clerical error, yet it confuses everyone after the fact. Potentially, this clerical error could result in a tenant vacating the space, and you are not prepared to refill it. It takes months (or sometimes years) to refill, so this lack of time to prepare for many commercial spaces has the potential for lost income.

OPERATING EXPENSES

For most commercial real estate leases, tenants pay for common area maintenance (CAM), taxes, and insurance as part of their lease. Make sure you have clearly outlined what is included in CAM and how it is calculated to save yourself grief later. Taxes are generally the most significant portion of the CAM expense. Be clear on how you will apply adjustments to account for any increases in real estate taxes. If you haven't been clear and the tenant pushes back, you may end up absorbing any tax increases yourself. While there will always be some amount of ambiguity around operating expenses, where possible, be clear. It will save you time and hassles following the annual reconciliation process. When you can reference specifics in your lease, it reduces the opportunity for challenges by the tenant.

RENTABLE SQUARE FEET

Often in new builds, the exact rentable square feet are not known until the project is completed. However, when the project is complete, the lease should include the exact rentable square feet. This is particularly important at reconciliation time. The lease may reference the usable square feet, which is the space your tenant occupies from wall to wall. However, the operating expenses are calculated off the rentable square feet. Rentable square footage includes the usable square footage, plus the area that is common to all tenants. Reconciliation is calculated from the rentable square footage. Too often this information is incomplete or outdated.

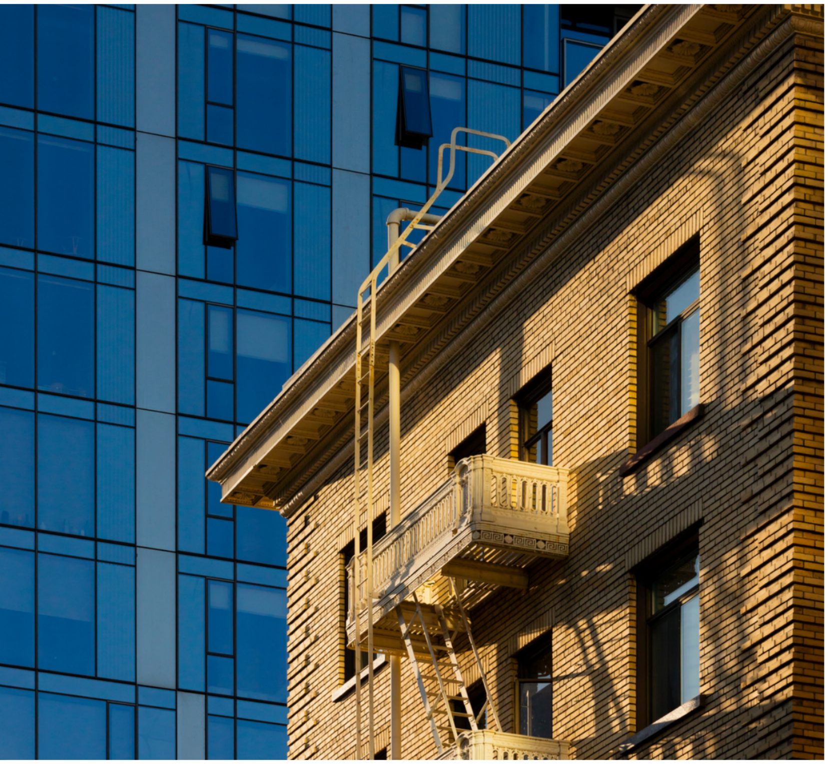
RENT DUE DATE

There are lots of different dates in a lease. Here are just a few: The date the tenant signed the lease, commencement date, date when a tenant takes possession of the property, rent due date (and when rent is considered late) Or at least it should be clear exactly when the payment is due. And for the original people involved in the negotiations, the intent likely was clear that rent is always due on the 1st. However, for staff and team members responsible for delivery years later, the intent is not nearly as clear because it is not explicitly spelled out.

USE OF SPACE OUTLINED IN THE LEASE

How the tenant uses space should be called out in the lease. Is it going to be office space or retail? What will be sold at that location? As the landlord, you need to keep the peace with other tenants in that space. If you have a tenant that is doing something that impacts another business, you can have a real mess on your hands. For instance, if one tenant has a spa, they are undoubtedly expecting a quiet environment, as are the customers. But, if another tenant signs a lease for a space that adjoins the spa, and there is no clear use of space, and the tenant provides entertainment for children's parties, there will be immediate conflict. While this is an extreme example, it illustrates the need to know exactly how space will be used. And if the lease allows, how it could be sub-leased as well.

THANK YOU



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