

In a Down Economy - How to Get Out of a Commercial Lease and Downsize Your Office Space

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Getting out of a commercial lease can be a difficult and often daunting process but depending on your individual circumstances or real estate market you are in, you may be able to negotiate a compromise with your landlord.

During a downturn, recession or financial crisis, companies find they have more space than they need. This can be due to lay-offs or perhaps part of the business moving to another location, or because the business has not developed as much as they'd hoped. In the worst case, some companies need to close down altogether.

If you're in a position where you have too much space, then you may be able to terminate the lease early, sublet, assign or buyout of your lease obligation. There may also be an option to move out of the premises completely. Always check with your landlord before sub-letting. Remember, you will be liable to your landlord to pay rent for the remaining term of the lease and this may be more of a hassle than it is worth.

Step 1

Examine your lease for an early termination paragraph. Most commercial leases give specific terms as to the conditions you can exit the lease without penalty. If your circumstance doesn't qualify under the acceptable early termination terms of the lease, you can expect to face the financial penalties described in the contract when you break the lease. This may include legal fees, sublease / assignment fees and payment of all or a portion of remaining rent.

Step 2

Talk to your landlord informally about the lease agreement. Test the waters with your landlord in a friendly conversation to find out how receptive he is to simply terminating the lease. It never hurts to ask. The landlord may already have someone interested in your space.

Step 3

Offer a buyout to end the lease. Even if your landlord is unwilling to terminate voluntarily, he may be more cooperative if he has a financial incentive. May want to offer to cover the landlord for the time it takes him to find another tenant to rent the space. Word of caution, if the landlord finds a lower paying tenant, your business can be liable for the difference in rent until the original lease expiration.

Step 4

Take your lease agreement to a local tenant advisor, tenant representative or real estate attorney if your landlord refuses to negotiate to end to the lease. Although you can break a commercial lease without a lawyer, seeking local tenant advisor, tenant representative or legal representation ensures both you and your landlord stay within your legal boundaries during the process.

Step 5

Obtain the assistance of a tenant advisor or tenant representative to help you identify a tenant to sublease or assign the space for the remaining term of the lease or assign the lease to another entity to fulfill your lease obligation. While you are working with a professional to identify a tenant, your landlord may be able to assist identify a new tenant, as well. Depending on your situation, you may consider continuing to pay rent until a new tenant appears; even though you are no longer residing in the space.

Most landlords will want to negotiate the terms of an early termination, buyout, assignment or sublease of the space. The new sublease may be required to be approved by the landlord and must not extend beyond the rights

you have in the master lease, so you can't add space, subtract or partition a section of your space or increase or reduce the length of the lease without your landlord's permission. Again, in the instance you have identified a tenant to sublease or assign the lease, it is always best to seek the advice of a local tenant advisor or real estate attorney to negotiate the terms of the sublease or assignment of the lease.

It may be feasible to get entirely out of your lease. The shorter the period of lease term you have, the more likely this is. Your chances will also increase if the building is full. This is because the landlord should be able to find a new tenant quickly, and may even be able to increase the rent as a result.

When approaching your landlord be careful how you go about presenting your case. If you let them see that you are desperate to move or find out you are going out of business, you may end up paying a premium to get out of your lease. Again, it is always best to hire a local tenant advisor or tenant representative in this case because they can plead your case without getting you personally involved.

If you can find another tenant to take over the lease completely, you are likely to have a much stronger case. Remember, the landlord is likely to want to see the prospective tenants' audited financials, bank account statements and references.

When assigning the lease to another business, the new tenant becomes directly liable to the landlord, but you may still have some accountability. The landlord will usually require you to guarantee the payments of the next tenant, but not all tenants agree to this stipulation. Again, it is always best to seek the advice of a professional to advise you of your rights.

In any case, it is not likely that you will get out of your lease without some penalty. You may be liable for the landlord's attorney's fees, the remaining rent obligation and you may also be liable for meeting your landlord's expenses such as the improvements and commission paid to the broker on the space.

All things considered, you may find yourself better subletting the space and making other arrangements such as renting less office space nearby to accommodate the reduction in space.

If and when you do get out of your lease, there are things to bear in mind when negotiating a new lease. It's always best to hire a professional real estate tenant advisor to negotiate on your behalf to provide you as much flexibility in your next lease. For example, you could ask the broker to negotiate a break clause at various stages in the lease to allow you to terminate the agreement early.

Remember, contracts are binding by law. If your landlord refuses to accommodate, you will have little choice but to stay in your premises until the end of the lease obligation.

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John Galaxidas started Synergy in 2004. John has been involved in corporate and commercial real estate for over 20 years and has completed national acquisitions and lease transactions totaling more than 10.2 million square feet.

Prior to starting Synergy Real Estate Group, Corporate Advisory LLC and Sacramento Tenant Advisors, John was with Oxford Development, CB Richard Ellis, Cushman & Wakefield and Ernst & Young LLP, Real Estate Advisory Services and an Appointee of the Governor of California in Real Estate.

At Oxford Development, John was Executive Vice President of Corporate Services where he oversaw large national corporate accounts such as Alcoa Steel, U.S. Steel, H.J. Heinz, PNC Financial Services Group, Mellon Financial, Hilb Rogal & Hobbs, UPMC and 84 Lumber.

At CB Richard Ellis, John helped develop a new tenant / buyer representation practice for CB Richard Ellis in Salt Lake City, Utah; Albuquerque, New Mexico; and Fresno, California.

At Cushman & Wakefield, John headed the strategic planning, transaction management and merger integration team for DHL's acquisition of Airborne Express and oversaw the construction of DHL's new headquarters in Fort Lauderdale, Florida.

At Ernst & Young, LLP, John focused on corporate transaction management, strategic planning, mergers & acquisitions, project management oversight, financial and operational management for leading national and multinational accounts such as Hewlett-Packard, Agilent Technologies, Cable & Wireless - Exodus Communications, Exxon Mobil, Charles Schwab and Aerojet GenCorp.

Prior to joining Ernst & Young, John was an appointee of the Governor of California in Real Estate where he served for 8 years. Among his many undertakings, John worked on two public / private commercial development ventures between the State of California and Cisco Systems (80 acre land disposition) and Sun Microsystems (new headquarters). He headed two development projects, the construction of the CAL-EPA building (1 million square feet) and Teale Data Center, the largest State data facility of its kind in the nation.

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