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Report on Business
Your Business

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If the recent recession taught business owners any lessons in the fine art of cash-flow management, one of the most pertinent dealt with the often crippling financial consequences of expensive office rent.

As business dried up for many firms, their monthly rental obligations loomed large. For landlords, the recent downturn was a painful reminder that the commercial real estate sector is not immune to downward market pressures.

According to a recent report by commercial real estate services firm CB Richard Ellis Group, office vacancy rates across Canada continued to rise in the first quarter of this year, posting a year-over-year jump from 7.5 per cent in 2009 to 10.1 per cent.

Another key indicator, sublet space as a percentage of vacant office space, logged a year-over-year first-quarter gain from 20.8 to 21.9 per cent this year. Although vacancy rates have continued to climb, increases have largely stabilized since the peak of the recession.

"The few transactions that did take place [over the past four quarters], took place at anywhere from a 15 to 30 per cent discount on the net rental rates," says Stan Krawitz, founder and manager of Toronto-based real estate brokerage Real Facilities Inc. "The increasing vacancy rate is dominated by new buildings coming on stream … especially in major markets like Vancouver, Toronto and Calgary."

All of this has resulted in an increasing willingness on the part of landlords to reconsider their rental fees as they compete to retain tenants.

That Canada-wide glut of office space has opened a window of opportunity to small- and medium-sized business owners who may have been feeling a cash-flow pinch. For most, expensive rental leases are their single largest cash-flow burden – and any cutback in overhead would be a welcome relief.

This perfect storm of economic contraction and increased real estate supply has ushered in a brief era of mass rent renegotiations – one that may soon be coming to an end.

Mr. Krawitz predicts that as the economy continues to bounce back and market demand is further restored, many landlords will allow their spaces to sit idle for six to 12 months if necessary to avoid losing money on long-term leases negotiated at recessionary levels.

All of this means that SME owners hoping to cash in on cheaper rents, or hoping to downsize their spaces, need to act fast.

But renegotiating a lease isn't as easy as knocking on a landlord's door and requesting a rent rollback. On the contrary, Mr. Krawitz says renegotiation is a task best left to real estate professionals trained to understand market realities and leverage them to a tenant's advantage when negotiating with landlords.

Those tenants who do attempt the feat on their own should bear certain key points in mind.

The first consideration, Mr. Krawitz says, is to understand the health of their business and how their rent stacks up in the current market, as well as the ease at which their landlord could lease the space to another tenant.

"You need to put all of those variables into a formula that says, 'What is my landlord's best alternative to a negotiated outcome if I were to leave?' " Mr. Krawitz explains.

"These landlords are so sophisticated and do this every day that if one piece of the puzzle is not presented properly, they simply leave the bargaining table and you're stuck with the lease you have. That could be the difference between staying in business and going out of business."

He urges all small business owners to step up to the bargaining table armed with cash-flow and income statements to prove that a decrease in rent is necessary to keep their business healthy. But even this involves a delicate touch.

Mr. Krawitz urges his clients to prepare a presentation that not only explains why a rent reduction is essential for them, but also how it can benefit the landlord in the long term.

"You have to be able to put together a presentation that says, if you help me now, here's how I'm going to be in business three, four, five or even 10 years from now. Here's why I've had a problem and here's why helping me helps you."

In tough times, landlords will often agree that locking in a less-lucrative tenant for the long-term is a wise move, particularly if it helps them secure financing on their properties. However, if they see renewed prosperity on the horizon, Mr. Krawitz says they might take a pass and wait until a lease expires to begin negotiating, assuming there's no ancillary benefit for them to pro-actively work to retain certain key tenants.

But as Mr. Krawitz points out, the real opportunity for small businesses hoping to improve cash flow isn't necessarily best served by simply asking to pay less in rent, but downsizing their space altogether.

As many firms have been forced to shrink their staff count during the recession, they've attempted to sub-let all or part of their oversized office spaces to cut costs.

But offering landlords an opportunity to reclaim space they might be able to rent to new tenants at higher rates – and in turn slashing the recession-weary firm's monthly overhead –creates a win-win scenario for both parties.

"I think that's where the current timing works quite nicely for the tenant," Mr. Krawitz explains. "Because the landlords are feeling a little more comfortable about the fact there are tenants to back-fill vacant space, I believe the greatest ability for tenants is in the [office space] reduction area."