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WHAT IS "LOSS FACTOR" AND HOW TO NEGOTIATE AGAINST IT

BRAND BUZZ

The situation: You're looking to rent a new studio space. Along with all of the other must-haves on your list, you're looking for a space with a certain square footage. Your real estate broker tells you that he or she has a promising new location to show you. You walk in, excited to view the new space, only to find that it's significantly smaller than the square footage advertised—but with the same price tag as that larger space. The reason? The building you're renting from has "loss factor."

WHAT IS LOSS FACTOR?

You'll hear your broker blame the smaller than advertised space on loss factor. But what does that really mean? According to real estate attorney Zachary D. Schorr, it has to do with the difference between usable and rentable square footage. "Usable square feet is the actual space contained within the walls of the leased premises," he explains. "Typically, this is the area that you would visibly identify as the leased space that the tenant exclusively occupies. The calculation of the usable square footage does not include areas like lobbies, restrooms, stairwells, elevators, shared hallways and other common areas." However, if you're renting in a building that has many shared common areas such as these, Schorr says that the landlord will likely want you to pay on the amount of rentable square footage. "Rentable square feet is the usable square footage plus a portion of the building's common area or shared space," Schoor explains. "For rentable square footage, the commercial landlord assigns a portion of the shared space to the particular tenant's use. This is usually based on their percentage occupancy of the commercial space as a whole. Accordingly, in the commercial leasing context, the landlord calculates the monthly rent based on the rentable square footage, not the usable square footage." In short, a chunk of your rent is being put toward space that you're not teaching class out of.

WHAT CAN YOU DO ABOUT IT?

Negotiating against loss factor can be tough if you're renting in a competitive real estate market. But according to Schorr, there are a few tactics you could try in order to bring the cost down.

"First, try to negotiate the rent based on the usable square footage instead of the rentable square footage," he suggests. "Bring up the usable vs. rentable square footage by simply referring to the usable as the basis for the rent in any potential letter of intent. Alternatively, the potential tenant could bring it up in response to the landlord's draft lease."

And if that doesn't go over well? "Try to reduce exposure on the rent by asking for a cap on increases in common area maintenance expenses," Schorr explains. "For example, all of the miscellaneous charges that landlords push through to a tenant, like property taxes, building utilities, landscaping, maintenance, etc, since these are typically calculated based on the the rentable square footage." Along those same lines, Schorr says you can also ask your landlord if the rent can be based on usable square footage, and the common area expenses be the only ones that are calculated on rentable square footage.

WHEN TO NEGOTIATE

Schorr says that the earlier you negotiate rent, the better the outcome. "In general, I think it is best to bring up the key negotiation points early in the leasing process," says Schorr. "This is important because often times with large commercial buildings the tenant lacks bargaining power. As a result, the tenant should try to start the negotiations on the best foot for them so that they can determine if the premises will be a good financial fit before they go too far down the lease negotiations. There is nothing worse than being tied up in lengthy negotiations only to have the landlord and tenant realize that they are at impasse regarding a key term—like usable vs. rentable rent—at the end of the process."