

How to Minimize Your Security Deposit

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We're asked all the time: what is a "normal security deposit"? Unfortunately, the truth is... it depends. Let's start with the basics: the security deposit is a reflection of and hedge against the landlord's perceived financial risk. Landlords generally ask themselves two questions in evaluating security deposits:

1. How much money am I spending to get this tenant into my building (the big-ticket items here are construction dollars and free rent)
2. How much faith do I have in the financial soundness of the entity signing the lease?

If you're General Electric, you'll likely pay no security, whereas a start up no one's ever heard of is likely to pay a lot. Practically speaking, the range of security deposits runs the gamut from 0 to 24 months.

Here are a few things that may help you keep your security deposit on the lower end of this scale.

Find Built Space

Building "plain vanilla" office space in Manhattan in today's environment can easily cost \$100/sq. ft. Landlords shelling out this kind of money want their pound of flesh in the form of security. One of the easiest ways to reduce your security deposit is to find space that is already built out, as opposed to raw space where the landlord will "build to suit" or give you a cash contribution

toward the build-out. With built space, the money that went into building becomes a sunk cost and will be viewed differently and far more favorably when it comes to determining the security deposit.

Take Less Free Rent

Most office space tenants negotiate a period of time at the start of the lease where they occupy the space without paying rent. This can range from a month or two all the way to a year or more. From a landlord's perspective, free rent is a necessary evil dictated by the market. It is also looked at as cash out of their pocket that they want to securitize or in other words, it's one of the things that raises your security deposit.

From a Tenant's perspective there are two strategies worth considering:

1. Half rent instead of free rent: let's say instead of 6 months of free rent you agree to 12 months of half rent. This helps the Landlord because they have immediate cash flow, which should equate to less risk and a lower security deposit.
2. Take less free rent: every deal has a lot of moving parts. Evaluating less free rent involves simple math – what is it worth to you and to the Landlord to have less free rent in exchange for less security or perhaps a lower base rent?

Negotiate a “Burn-Down”

If you're a solid citizen and pay your rent on time, eventually, you should have established enough credibility that your Landlord feels comfortable holding less security. We call this “burning-down” the security deposit. Here's how it works: you have to negotiate this up front and it must be part of the lease. Typically, the idea is that after a period of a couple of years of consistent and timely rent payments, the landlord will give back a month (or more) of security.

For example, let's say you're signing a 15-year lease with an initial security deposit of 9 months.

You might agree that every three years the Landlord will give a back one month of security, provided you're not in default and are making timely payments. The key concepts here are a) there are no hard and fast rules – negotiate what makes sense for your business; and b) make it part of the lease document.

The beauty of commercial real estate is that everything after your name and landlord's name is a negotiation. The more you understand the rules of the game, the better you're going to be able to navigate these issues.