

Office lease negotiations Are part dance and part dogfight.

How to take advantage of the worst (best) commercial real estate market in the last 10 years.

By William Gary, ITRA MacLaurin Williams

There is a clear upside to today's down economy. Commercial Tenants should be able to secure lower rents and better leases than they have in the last 10 years.

Whether renewing a lease, renegotiating an existing lease or moving into new space with a new Landlord, the environment is right to gain lower rents, better terms, more concessions, and reduce your overhead significantly.

To achieve these savings, most of which fall directly to the bottom line as net profits, you must handle negotiations wisely. You must perform proper due diligence and negotiate firmly in order to gain the upper hand with Commercial Landlords.

If a new Tenant to a building gets a better deal than an existing Tenant obtains on a renewal, then the renewing Tenant left a lot of money on the table. As surprising as it sounds, renewing Tenants routinely get shabbier treatment from their Landlords than brand new Tenants to the same building.

Why is this so?

A typical Commercial Landlord reaches out to a Tenant perhaps one to two years before the lease expiration date and seeks to renew the lease at a moderate increase, citing "inflation, higher taxes and other costs as standard policies". The Landlord positions itself as compassionate and giving, asking "merely" for a moderate increase, giving the impression he or she has the upper-hand and that Tenants must agree to their offered terms.

Don't be fooled by a wolf in sheep's clothing.

Saying that space should be renewed at \$20.00 per square foot because the lease you signed five years ago topped out at \$19.00 is as absurd as saying that AOL is worth \$100.00 per share now, because when you bought it ten years ago you paid \$95.00 a share.



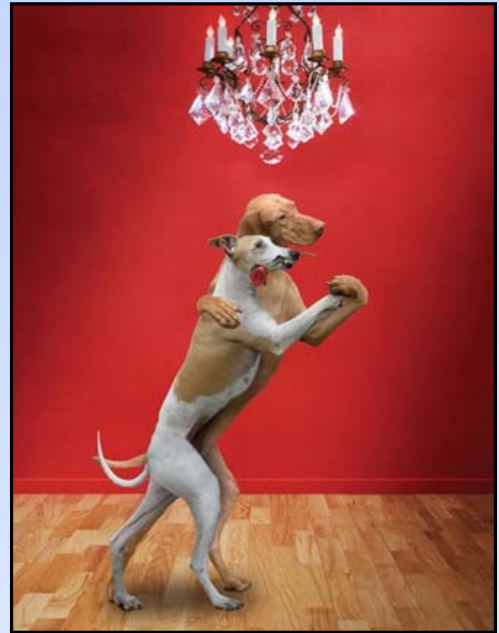
Landlords rent to the market, whether you are renewing a lease in your current building or moving from Building A to Building B. And now more than ever, Tenants hold the power in these negotiations. The key is to understand how and why Tenants have leverage now and then to use this leverage effectively to secure a fair deal based on today's market conditions.

Here are the basic (but critical) facts you need to know:

FACT #1:

Landlords need to keep their buildings occupied. Day-to-day cash flow pays the bills and net operating income (rent minus operating expenses/CAMS) determines what a building is worth, whether an owner is selling or refinancing.

In today's economy, keeping Tenants is more difficult than ever before. Companies going out of business or downsizing means there's less demand for office space. This has forced commercial vacancy rates higher. For example, in Denver office vacancy rates have reached 14.5% downtown and 14.4% in the suburbs.



FACT #2:

Small Tenants do matter to Landlords. In major market, like Metro Denver/Boulder, the average office space user rents 2,000 to 3,000 square feet. A common misconception is that Landlords don't really care unless you are a large Tenant. This is not true. These under-3,000 square foot Tenants are the lifeblood of Landlords. Even in New York City Mark Holiday, the CFO of SL Green, the largest owner of commercial real estate in NYC, has said publicly that as a Landlord, his number one priority is retaining existing Tenants of all sizes.

FACT #3:

Losing an existing Tenant is expensive. Landlords lose what amounts to approximately 18 months of rental income if a Tenant (regardless of size) vacates its space. This is based on downtime, marketing costs, free rent to a new Tenant, the cost of building out space and credit risks.

Really understanding how much money is on the table for Landlords is crucial to Tenants. This knowledge gives Tenants power and leverage. Landlords need to keep buildings occupied at any reasonable cost, so Tenants can and should demand – and get – better terms.

FACT #4:

Getting a new Tenant is expensive. New Tenants typically receive several months of free rent, plus free build-outs, by Landlords eager for them to fill empty space. Smart Tenants translate these costs into a specific dollar amount, which is then used as the guideline for what a lease should cost, whether in your current building or a competing property.

Once Tenants clearly understand these basic facts, they can truly take advantage of commercial rents that have dropped 8% and more in the last 24 months.

That said, most Tenants hate to move and Landlords know this. So, convincing a Landlord that you really will move, if you don't get the right renewal offer, is critical.

How do you do it?

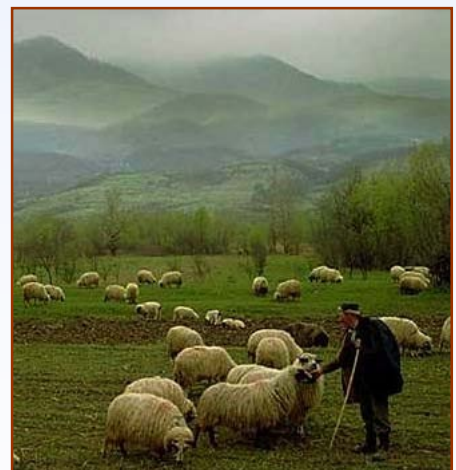
If your lease is due to expire within one to two years, don't accept your current Landlord's lease renewal offer, no matter how sweet it first appears. If your Landlord keeps your rent stable or reduces it only slightly and also offers to repaint and recarpet your offices, interpret it as a telling signal that there is a much better deal to had. In most cases, a Landlord's first offer is nowhere near its true bottom line.

You or your Tenant Representative must go through the process of looking at and carefully evaluating other space options and real offers in order to understand the market and secure the best possible lease offer. If your Landlord thinks you won't move, he or she has no incentive to give you a better deal. You must create real doubt to entice the Landlord to offer you its best terms to keep you in the building. And along the way, you might even find better space elsewhere for less.

The lease negotiation process is part dance and part dogfight. The right advocate between you and the Landlord makes it easier and more effective to leverage your power in a negotiation that will save you money now and for the long haul. We're in the worst (best) commercial real estate market for Tenants in the last 10 years.... every dollar you can cut out of your lease cost is a valuable dollar, not of gross profit, but of net profit.

Take advantage of it, while you can.

Today William Gary still works in Downtown Denver. He's a very experienced and smart shepherd who tends and protects his flock as a tough Tenant Representative at ITRA MacLaurin Williams. With respect to Commercial Landlords, he walks softly and carries a big stick.



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