

Learn the game before playing poker against Commercial Landlords

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By William Gary, MBA, MIM



Commercial Landlords play their peculiar brand of high stakes poker every day. Leasing office or industrial space from them can be complicated, time consuming and downright tricky... and expensive, if you make even a tiny mistake.

Leasing commercial space, whether for a relocation, a renewal or an expansion, is an important business decision that creates significant long-term overhead cost. For most companies and organizations, the cost of facilities is second only to employees' salaries and wages. A building needs to work well for your organization and the lease document needs to accurately define, document and apportion the proposed costs. Here are **ten valuable tips** to take into account *before* you start playing high stakes poker with Commercial Landlords to negotiate for new space or to renew or expand a lease.

#1 Carefully analyze how much space your organization needs.

Leasing too much space can be an expensive mistake, costing tens or hundreds of thousands of dollars per year. But leasing too little space can also be a serious problem that can impede your organization's future growth. You can get a handle on your space needs by engaging an experienced Interior Architect to prepare a space inventory or "Space Program" for you. A Space Program will help to identify the amount of space needed by various departments and work groups within your organization. You may be able to identify future growth (or contraction) needs and structure your lease accordingly to fit your future size.



#2 Decide up-front on very specific geographic boundaries for your building search.

Important factors to consider include proximity to current as well as to future employees. Is street visibility or easy highway access important? For instance, do your employees travel often to customers' sites or to the airport? Might you consider avoiding inconvenient major roadway construction? Do you receive lots of visits from clients, where easy

directions are important? Do you need a specific city for your mailing address? Is it critical to maintain your current phone number?

#3 What type of building do you need?

What kind of image do you want to project to your clients, employees or potential investors? Do you prefer a traditional multi-story Office building with a common lobby entrance and shared restrooms? Or would you prefer a single-story "R&D/Flex" type of facility with a separate entrance and perhaps a drive-in door in the back? Traditional Office buildings offer space on a Rentable Square Foot ("RSF") basis while utilizing a Common Area Factor ("CAF") of approximately 10% to 15%. This CAF is added to the Usable Square Footage ("USF") of the actual area you occupy and accounts for the square footage of the shared building entrance/ lobby, hallways and restrooms. In single-story R&D/Flex and Industrial buildings, since Tenants have their own entrances and typically provide their own restrooms inside their premises, so no CAF is added to the USF.



#4 Does your company, firm or agency have special needs?

Examples of special needs include heavy parking, fiber optic telecom connections, redundant or back-up power feeds, back-up emergency generators, exterior signage, above standard electrical power or heating, ventilation and air conditioning (called "HVAC"), high ceilings, dock-high or drive-in doors and/or specialized lab or clean room equipment. It's critical to identify your "must have" requirements very early, because they may be too expensive to add later. The absence of just one of these highly variable factors may eliminate an otherwise acceptable building. If timing is important to you, then you need to know this up-front, not months into the process.

#5 What's included and NOT included in the Landlord's rental rate?

It's very important to understand that not all buildings are priced using the same format. Many traditional Office buildings offer leases on a "Full Service" or "Gross" basis, meaning that the quoted price of \$X.XX per square foot per year includes all "Building Operating Expenses," i.e. property taxes, insurance, common area maintenance, janitorial services and utilities. These buildings usually offer a "Base Year" for Operating Expenses with the Tenant paying for annual escalations (increases) that exceed the cost of Operating Expenses in the Base Year, which is most often the calendar year when the lease begins.

Other buildings, including most industrial, R&D/Flex buildings and some Office buildings, offer Tenants a triple net ("NNN") lease. In a NNN lease, the Tenant pays a Base Rent, plus all Operating Expenses for property taxes, insurance and common area maintenance. However, in a NNN lease, the Tenant *usually* contracts for and pays separately for its own janitorial and utilities. It can get confusing though, because some Landlords structure their leases in a hybrid fashion by using a combination of Gross and NNN methods. It's very important to understand exactly who is paying for what and to make sure this is clearly described in the lease.

#6 Understand the "real" costs of constructing your improvements.

Because it is rare to find space that *perfectly* fits your requirements, there is usually some interior construction required to reconfigure the space for your use. Such construction is known as Tenant Improvements ("TIs") or Tenant build-out or Tenant finish-out. These TIs can range from relatively simple new paint and carpet installation, costing \$4.00 to \$7.00 dollars per square foot, to extensive new construction, especially if you consider leasing "raw" or "shell" space that has never been built-out – which can cost \$25.00 to \$60.00 per square foot.



The key point to understand – before your lease is signed – is what the proposed build-out will cost and to be clear on how much responsibility the Tenant will have for these costs. Landlords typically offer a TI Allowance of \$X per square foot that is included as part of your quoted lease rate. The TI Allowance is very subject to negotiation and typically increases with the length of the lease. If needed, "extra" TI Allowance can often be supplied by a Landlord, but it will likely be amortized at an above market interest rate, usually 8% to 12%, over the term of your lease. Be sure to understand whom (Tenant or Landlord) will manage the construction and will be responsible for unexpected delays or building code issues that may arise.

#7 Watch out for Landlords initially enticing you with low rates valid only Year #1.

Although a very few leases are structured with fixed lease rates for the entire term, most have provisions that allow annual increases (called "escalations") that can be predetermined or can float with the changing Consumer Price Index ("CPI"). A building's Operating Expenses will also escalate annually but a smart poker player can sometimes negotiate a "cap" or ceiling on such increases. Make sure that you understand the proposed escalations for both the Base Rent and the Operating Expenses and then project and budget for these costs as you proceed through the term of the lease.

#8 Consider Subleases with both eyes wide open!

When looking for properties, understand that you may encounter both direct leases offered by Landlords by current Tenants, unload all or part of space. Subleases can offer opportunities, such as furniture, phone reduced rental rates. understand that a relationship with the Tenant, as well as an with the Landlord holding the "primary" or "master" lease.



and subleases offered who are looking to their current leased offer attractive as free or inexpensive systems and greatly It's important to Sublease creates a direct existing or "primary" indirect relationship

