

Learn the game before playing poker with Commercial Landlords.

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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 the 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 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 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 what is called 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. The important thing is to understand exactly who is paying for what and to make sure that this is clearly described in the lease document.

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 enticing you with low rates valid only in the first year.

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 and subleases offered by current Tenants, who are looking to unload all or part of their current leased space. Subleases can offer attractive opportunities, such as free or inexpensive furniture, phone systems and greatly reduced rental rates. It's that a Sublease creates a the existing or "primary" indirect relationship with "primary" or "master"



Big problems can arise if into default during the Additionally, many subleases are offered "as-is," i.e. without a TI Allowance to offset your construction costs. Depending on the financial strength of the primary

important to understand direct relationship with Tenant, as well as an the Landlord holding the lease.

the primary Tenant goes term of your sublease.

Tenant, it may be better to require that the primary Tenant seek a "buy-out" of its current lease from the Landlord. This will free up the space so that you can strike a "direct" lease with the Landlord. With skillful poker playing and creativity, it may even be possible to cause the primary Tenant's lease buy-out to subsidize your new lease via a lower rental rate or free rent or higher TI Allowance.

9) NEGOTIATE, NEGOTIATE, NEGOTIATE your Lease document.

Compared to a building purchase, which involves a one-time event with a Seller, a lease creates a long-term relationship between the Landlord and Tenant. In this relationship, both parties assume on-going responsibilities and liabilities as defined by the lease document. Landlords typically design leases to be heavily skewed in their favor over a wide range of issues, such as Operating Expenses, TI build-out provisions, liability and insurance matters and Tenant default provisions. However, a lease can be thoroughly negotiated, much more than you'd suspect. If you want a more equitable lease, having the right commercial broker and an experienced real estate attorney on your side can make a huge difference in the language.

10) Hire an expert professional Commercial Tenant Representative to locate the best space & negotiate your lease.

A Landlord typically pays a leasing commission to his or her "Listing Broker", whether or not a Commercial Broker represents you as a Tenant. Be aware that most traditional Commercial Brokers make their primary living by representing Landlords. You'll see many such traditional Commercial Brokers' signs placed in front of properties that they are leasing for their Landlord clients. Traditional Brokers may suffer from hidden conflicts of interest when trying to represent any Tenant, especially if you're looking at properties owned by Landlords that reward the traditional Commercial Broker with building listings when you are in the market or even in the future.

On the other hand, a true commercial simply does not accept listings from hammer the Landlord hard to gain be a true advocate for you. You should guidance and unbiased advice from a commercial broker that is dedicated to being solely your Tenant Representative. The experienced, professional Commercial Tenant Representative knows how to play poker with Landlords and win the best leases for his or her commercial Tenants.



Tenant Representative Landlords and will maximum benefits and expect better, stronger

William A. Gary is a Principal of MacLaurin Williams, which acts as a commercial Tenant and Buyer advocate for a wide variety of corporate, non-profit and government clients by providing estate brokerage and consulting services. The firm has its main office in Denver, Colorado, and delivers Tenant and Buyer Representation services throughout North America, Latin America, the Pacific Rim and Europe as a global office of the International Tenant Representative Alliance ("ITRA"). For more information, please visit www.MacLW.com or contact Will Gary at 303-294-0277 or wgary@MacLW.com.



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