Learn the game before playing poker against 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 your company, professional firm, non-profit organization or governmental agency. For most organizations, the cost of facilities is second only to employees' wages and salaries. 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 Space Planner or 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.

#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 or customers where easy directions are important? Do you need a specific city for your mailing address?

#3 What type of building do you need?

What kind of image do you want to project to your clients, customers, 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 facility with a separate entrance, façade signage 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, cable modem service, 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 when your clock is about to run out.

#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 during the Base Year, which is most often the calendar year when the lease begins or sometimes the following year.

Other buildings, including most industrial, R&D/Flex-type buildings and some Office buildings, offer Tenants triple net ("NNN") leases. 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 defined in the lease.

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

Because it is not common to find space that *perfectly* fits your needs, 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 $6.00 to $8.00 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 $40.00 to $70.00 or more 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 $XX.00 per square foot that is included as part of your quoted lease rate. The TI Allowance is highly subject to negotiation and typically increases with the length of the lease term. If needed, "extra" TI Allowance can often be provided by a Landlord, but it will likely be amortized at an above market interest rate, usually 8% to 12%, over the lease term. Be sure to understand who (Tenant or Landlord) will manage the construction and will be responsible for unexpected delays or building code issues that may arise. Construction delays might allow your "old" Landlord to charge a "Holdover Rent Penalty" that could increase your monthly rent by a whopping 125% to 200%!

#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 Office or Industrial space, understand that you may encounter both "Direct Leases" offered directly by Landlords and "Subleases" offered by current Tenants looking to unload all or part of their current leased premises. Subleases can offer attractive opportunities, such as free or inexpensive furniture, phone systems and greatly reduced rental rates. It's important to understand that a Sublease creates a direct relationship with the existing or "primary" Tenant, as well as an indirect relationship with the Landlord holding the "primary" or "master" Tenant's lease.

Big problems can arise if the primary or master Tenant goes into default during the term of your sublease. Additionally, most subleases are offered "as-is," i.e. <u>without</u> a TI Allowance to offset your construction costs. Depending on the financial strength of the primary 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 Direct Lease via lower rental rates, free rent and/or a 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. (We call them "serial marriages.") 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, language can be thoroughly negotiated, much more than you'd suspect. If you want a more equitable lease, having the right Tenant Rep and an experienced real estate attorney on your side can make a huge difference in the final language

#10 Hire an expert, highly experienced, professional Tenant Representative to locate the best space & to negotiate your lease.

A Landlord typically pays a leasing commission to his or her "Landlord's Agent," whether or not you have a broker representing you in a transaction. But be aware that most traditional Commercial Brokers make a living by primarily representing Landlords; not Tenants.

You'll see many such traditional Commercial Brokers in the market, as they have signs placed in front of the properties that they are leasing for their Landlord clients. Traditional Commercial Brokers very frequently suffer from hidden conflicts of interest when trying to represent a Tenant, especially if you're looking at properties owned by Landlords that reward traditional Commercial Brokers with their listings…including listings in the future, long after your lease is completed.

Traditional Commercial Brokers with pockets full of property listings would like to have you think that it's no big deal for them also to represent Tenants; happens all the time they say. Unfortunately, traditional Commercial Brokers have a built-in bias in favor of Landlords, since they also seek property listings. As a result, they don't really live in the contrarian, upside-down world of a true Tenant Rep.

A true Tenant Representative simply doesn't accept listings from Landlords and will hammer Landlords hard to gain the maximum benefits for you and act as a true advocate. You should expect better, stronger guidance and unbiased advice from a dedicated Tenant Representative. A highly experienced, professional Tenant Representative knows how to play poker with Landlords and to win the best lease terms, conditions and long-term rights for you as a Tenant.

Commercial Landlords are just way too good at playing poker, because they get so much practice, to go it alone without a tough, tried and tested Tenant Rep sitting calmly at the table to help with playing your cards. There's just too much at stake for your company, professional firm, non-profit organization or governmental agency.

William Gary, MBA, MIM, is the Principal of ITRA MacLaurin Williams. The company acts solely as an advocate for a wide variety of corporate, professional, non-profit and government clients by providing Tenant and Buyer Representation services. From its main office in the Denver, Colorado, area, ITRA MacLaurin Williams delivers services throughout North America, Latin America, the Pacific Rim and Europe, as an ITRA Global Office. For more information, please visit our websites at www.MacLW.com and www.ITRAglobal.com or contact Will Gary at 303-294-0277 or email at wgary@MacLW.com.