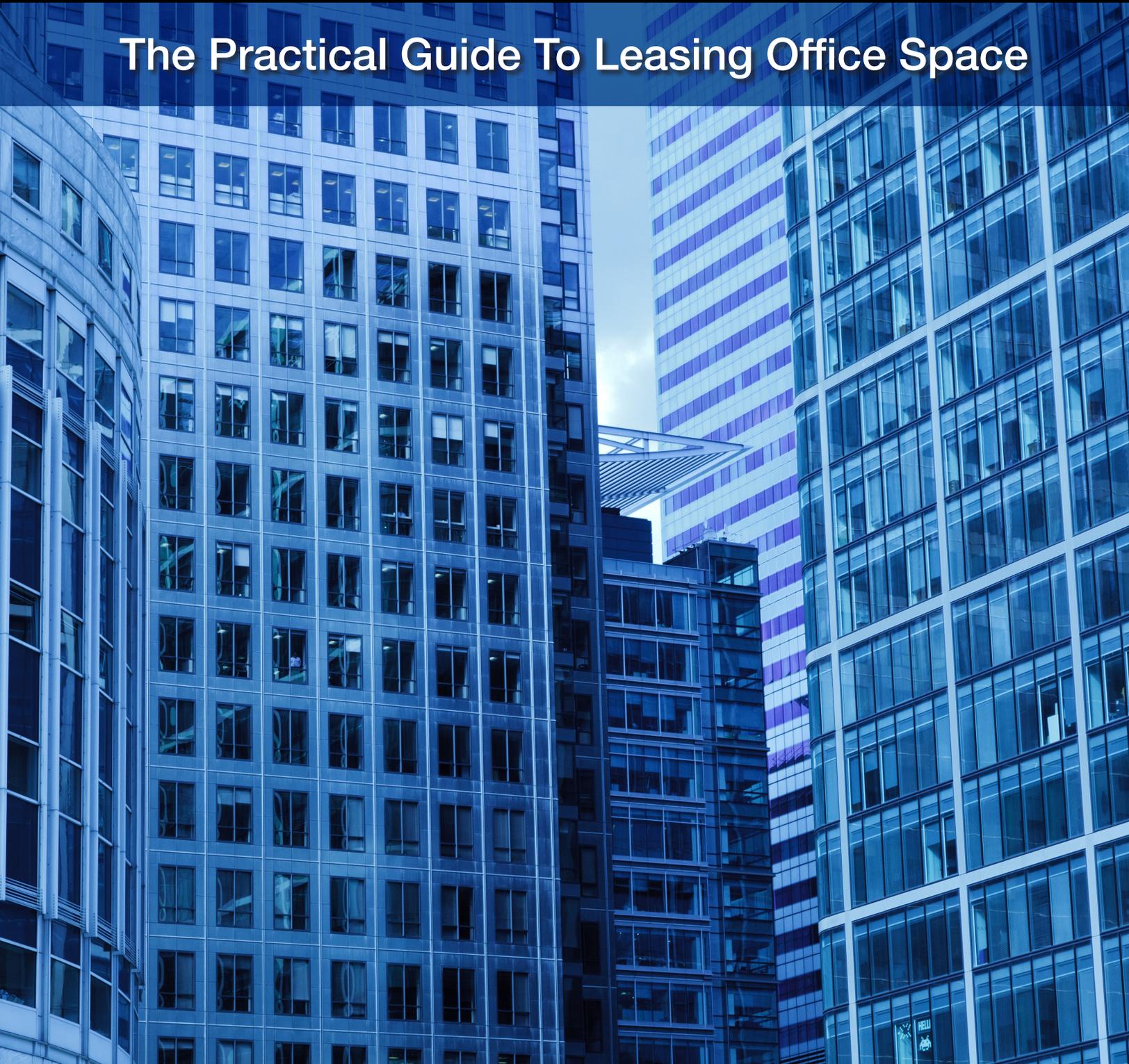




The Practical Guide To Leasing Office Space



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The Practical Guide to Leasing Office Space

Thank you for your interest in *The Practical Guide to Leasing Office Space*. The guide was created for the sole purpose of making your next office leasing process more effective and less costly.

What This Guide Is

This guide is a thorough review of most (read – not all) of the areas to consider when negotiating a lease, whether that be the renewal of an existing lease, an expansion, a relocation or the first lease for a young company. We have tried to cover most of the issues that arise in a typical lease transaction. The intent of this guide is to provide you with the right questions to ask and a number of pitfalls to look for.

What This Guide Is Not

This guide is not meant to be a replacement for trusted advisors (brokers, lawyers, project managers, etc.). This guide is written by a commercial real estate broker and investor with over twenty years of experience in the industry. We have seen countless times the benefits tenants experience when they engage quality professionals to assist them.



Chapter 1: First Steps — Questions to ask internally before making your first call

Whether your first call is directly to a building representative, a tenant representative (broker) or simply to an acquaintance who had previously been through the office leasing process, questions are going to be asked of you to help assist you. With little variation, the questions will (should) include:

Location: In what area do you want to specifically focus? This could even be asked by the building representative because she will want to know if they are at the bullseye of your search or on the outskirts.

It goes without saying that a larger search area will result in more options. However, it might be best to focus on the specific area you really prefer and then expand out later if you are not able to find an ideal location. If it is important to be on a certain commuter line or near specific amenities (or walking distance from home), focus on those specific areas first.

Size: What size your office should be might be a mystery to you, and that is understandable. In the industry, average square feet per employee benchmarks are often quoted. They have been decreasing steadily for many years as companies focus on efficiency and as more people work remotely.

Depending on whose study you use, the average number today might be right around 175 square feet per employee. However, this number can vary wildly between companies. An old-school law firm might exceed 300 square feet per employee (large offices, excessive file storage areas, an abundance of conference rooms, etc.).

On the other end of the spectrum would be one of our clients who generally has just over 100 square feet per employee in their many offices. This is a conscious design choice they have made not based on economics, but rather operations and culture. They want their employees to sit in desks (not cubicles) in an open environment to foster communication and collaboration.

There are a number of ways to estimate the size of space needed prior to the beginning of a search. The easiest – and most common – is to explain to your representative what type of layout you would like/need. This would include details such as the following:

- Number of private offices and approximate size of the offices
- Number of desks and/or cubicles in an open area — size/layout of desks/cubicles
- Will you have a receptionist and/or waiting area?
- How many meeting rooms/conference rooms do you need? What size should they be?
- Will you have a lunch room? Does this include a seating area or do your employees eat outside the office/at their desk?
- Do you need space for file cabinets?

Chapter 1: First Steps — Questions to ask internally before making your first call

Most brokers can take the answers to these questions and make an estimate on size range sufficient to begin the search. If the initial search results/floor plans come back smaller or larger than you need, the search can be refined.

One way to get a more definitive idea of the amount of space required would be to hire a space planner to “program” your requirement. The planner would ask all of the questions above (and more, with additional clarity) and would be able to provide you with a tighter likely range of sizes for your search.

For smaller requirements, this effort comes at an additional cost up front and is usually bypassed. For larger projects (10,000 square feet and up, for example) brokers will often work with a space planner to provide this service at no additional cost (essentially, the broker agrees to take it out of her fee).

Whatever avenue you choose, getting the size down correctly is important. In our experience, companies spend too much time focused on rent per square foot and not enough time on finding the best layout and efficiency.

Consider the example below of two competing spaces:

Space A is in a class A building in the perfect location with all of the amenities you are looking for. In addition, it is an efficient building from a space standpoint. The industry measures this with an R/U factor (Rentable/Usable). The denominator (Usable) is the actual square footage of the office suite itself. The Rentable area is the area adjusted for the pro rata amount of common area (hallways, restrooms, mechanical rooms, etc.).

Space B is a class B building with a good location with pretty good amenities and nearly as efficient as Space A.

Compare the Economics

	Space A	Space B
Usable area	1,900	2,100
R/U factor	1.14	1.20
Rentable area	2,166	2,520
Gross Rent psf/year	27.00	22.00
Monthly rent	4,874	4,620

Now, in this example, Space A is obviously still more expensive. However, despite the fact that the gross rent per square foot for the Space A option is 18.5% more expensive, the actual rent paid would only be 5.5% more expensive.

You will almost always save more in rent by finding/designing efficient space than by negotiating down to the last 25 cents per square foot on the rate.

Chapter 1: First Steps — Questions to ask internally before making your first call

Lease Term: It's important that anyone assisting you with a space search understand your preference as to length of lease term you are hoping to commit to.

For example, if you were to tell them you wanted a six-month lease, they might suggest you consider executive office suites. Most cities have multiple options for this type of space. While the per square foot cost is a premium to traditional office space, it is often furnished and can include a host of services, including phone, internet, faxing/scanning and meeting space/conference room areas. If you truly think you might only be in an office space for six months or so, you will find that executive office suites will be less expensive once you spread the costs of furniture purchase/installation, cabling, phone setup, etc. over such a short period of time. Most brokers can give you introductions to one or more executive office suite locations. The office suite company will typically pay them a small referral fee for making the introduction. The larger motivation for the broker, however, will be the hopes of working with you on a larger office lease in the future.

A more typical “short” term would be three years. Even this length would typically require you to find a space that had an existing layout that largely met what you are looking for. The building owner is unlikely to make significant alterations to the space for this length of term.

With lease terms of five years or longer, the owner will generally be willing to make significant contributions to “Tenant Improvements”, in some cases completely rebuilding the space at their cost (“turnkey”). If you are willing (and even prefer) to commit to a longterm lease and significant improvements are not required, you should expect to have some portion of the savings reflected in reduced rent.

Commencement Date: For companies who have not been through the process before, the most surprising part is how long it can take. Now, executive office space leases or as-is leases between two motivated parties can happen very quickly. But heavily negotiated bases with significant improvements can take four months or more.

How?

• Initial Building Search and Tours	1-2 weeks
• RFP Proposals and Counter Offers	1-3 weeks
• Lease Language Negotiations	1-4 weeks
• Construction/Furniture Installation/IT	8-12 weeks
Total	11-21 weeks

Chapter 1 | First Steps — Questions to ask internally before making your first call

The good news is that this process can happen more quickly (quick negotiation between motivated parties, quality attorneys, municipalities that issue building permits on a reasonable timeframe, limited construction issues, etc.).

The bad news is that this process can even stretch out longer than this range (difficult negotiations, unreasonable attorneys, slow municipalities and significant construction).

Many companies contact us and tell us they would like to be in an office space in two to four weeks. That's not impossible, especially if they are open to executive office suites or willing to give up their ideal layout and location for an as-is space. Most companies, however, should expect a longer timeframe.

Image: A, B and C building classifications might not mean anything to you at the beginning of this process. However, if you explain what type of image you want to convey for your company (or employees/future employees) along with desired amenities a broker will be able to figure out what class of building you are looking for.

An even better way to communicate this to your broker is to point out one or two buildings/office complexes that you like. There are many other ways to further define the search (proximity to clients, proximity to employees, eco-friendly buildings, only on floors 10+, only buildings with a conference center, only buildings with a full gym, etc.), but the items above will typically be a good start.



Chapter 2 | Select a Representative

Like all industries, the quality of advisors can vary dramatically. And motivation plays a big part in who should (and will) represent you. If you are a law firm looking for 50,000 square feet on a long term basis, you should expect to be represented by the top talent in a given market (or submarket). They will give you their full attention because they will be well motivated (big fee). As in any profession, they have built an expertise over time and rightly expect to be well compensated for it. They have also gotten to know the majority of property owners in the market and, most importantly, their motivations.

If you are looking for a relatively small office space (less than 2,000 square feet, for example), and especially if you are hoping to lease for a shorter term, you might get better results hiring a broker with only a few years of experience, but who might be more eager to work hard on a relatively small transaction. In most cases, these less experienced brokers have been spending a lot of time learning about a specific submarket and often have access to senior brokers if they have questions as a transaction moves through the process.

As with anything, there are exceptions to these suggestions. For example, you might find a veteran broker who works independently and who can justify working on smaller transactions because she doesn't have to split the fee with "the house" and/or partners. Also, you might find a senior broker who views your company as one which is likely to grow and who will put more time in a smaller transaction than she normally would with the hope of working on a much larger transaction with you in a few years.

But won't I get a better deal if I don't hire a broker to represent me?

Not likely. A local representative who understands the market will make sure you are getting the best lease terms possible.

But Doesn't This Increase the cost to the landlord?

Probably. They will have a higher leasing commission cost. However, it will be nominal compared to the lease revenue they will receive. And most sophisticated landlords will welcome the involvement of a tenant representative if they can help navigate a transaction.

Inexperienced or unwise property owners often view a tenant's representative as a threat. After all, the involvement of a tenant's representative does increase the transaction costs. In addition, the terms of the lease will now be more favorable to the tenant.

So why do almost all larger, sophisticated landlords welcome the involvement of tenant representatives? Two reasons. 1. A good tenant representative helps guide the transaction and moves things along more quickly. You are hiring a representative for their expertise, but also because they can take on time-consuming tasks that you and/or your staff shouldn't be bothered with. 2. Sophisticated landlords want to work in the future with your representative. They want to treat you fairly and — going forward — be a good landlord to you because they want future clients of your representative to become their tenants as well.

Finding the professional who is an expert in the area you are focused on and who will be properly motivated to do a good job for you is a critical step in a successful office lease project.

Chapter 3 | The Search

Once you have selected a representative and have shared your search parameters, she will get to work putting together an initial market availability report.

Unless yours is a particularly difficult requirement, this should take no more than three to five business days. A diligent broker will pull this information from multiple sources, including:

- Broker's knowledge of individual spaces that may or may not currently be on the market.
- Broker's outreach to other brokers/landlords in the market to ask for information on spaces matching the search criteria. Many markets have platforms in place for brokers to make these inquiries via email to the entire market.
- Property database: most major commercial real estate markets have one (and sometimes multiple) online databases available to brokers by subscription.

This process has been much improved in recent years. However, the quality of information still trails the residential market dramatically. In most cities, you can go into the website of a local residential brokerage company and find detailed information for nearly every house listing — including 5-20 photos of the interior and exterior of the property.

You will be surprised to find out that most commercial properties (even \$100 million downtown office towers) will:

- Not have their own website
- Be listed on the major online databases but usually:
 - have incomplete economic, amenity, etc. information
 - do not include complete floor plans of vacant space
 - include no photos of amenities
 - include no photos of vacancies

So, even though a vacancy might represent well beyond a million dollars in investment, it's marketed with far less information than an \$80,000 ranch home in a rural setting. This will change in time (it's a mystery to us why this hasn't happened yet). For now, however, this is information your broker will likely have to request from the listing agent or property owner.

The format in which this information is presented to you will vary depending on the broker. We use software that makes all information available on your PC, tablet, phone or in a PDF format, depending on your preference. In general, you should expect the summary to include a:

- List of the properties with addresses
- Map of the property locations
- General comparison of the quoted economics
- Brochure and — ideally — floor plans for each option

With this you and your team should have sufficient information to break the options down to a tour list. Work with your broker to narrow down the list and arrange for a date and time that works for everyone to tour the properties.

Chapter 4 | The Tour

You've narrowed the property list, set up a tour time and finalized the logistics (If you are driving between properties, are you taking multiple vehicles? Is the broker picking you up at your current office/hotel?). Now it is time for the property tour.

You will likely be presented with a "tour book" at the beginning of the tour. This will likely include all of the information detailed above (list, map, comparison, brochures, floor plans, etc.). You can use this book to make notes, corrections, etc.

We prefer to follow and change the information in real time. The software we mentioned above is particularly helpful in a tour. Just like a hard copy tour book, the property list, map, brochures, etc. are available in the digital format (or your smartphone or tablet). In addition, the app allows you to do several things on a tour, including:

- Take photos of each suite, amenities, grounds, etc. and have them automatically added to the property information for the entire team.
- Make notes as you tour the buildings, which are compiled for the team to access.
- Make changes to the square footages, rent, etc. if new information is presented in the tour.

The additional photos and notes can be particularly helpful if - as is often the case — there are one or more team members unable to join in on the tour, but who want to get as many details as possible.

Once the tour is complete, it is time to narrow the list to the 2-3 property finalists. From here, we will prepare a request for proposal (RFP) from each.

Chapter 5 | Request for Proposal (RFP)

By the time you have gotten to this point, your broker will have a pretty good idea of what items should be included in your Request for Proposal (RFP) for each property.

If you have the time, and particularly if the property owners are agreeable to paying for it, it is very helpful to have a floor plan and schedule of finishes included in this RFP. Many landlords instead send a proposal based on a limit on the improvement dollars spent. This might be fine if there is time to get hard pricing on construction in the future, but it is not ideal.

A (not exhaustive) list of what the RFP might include:

At a minimum

- Square footage (ask them to provide their Rentable/Usable factor as well)
- Term
- Net Rent per square foot
The way this is quoted differs between markets. Some will have one rent per square foot for all rent and others will split it between net (or base) rent and operating expenses (landscaping, janitorial costs, utilities, real estate taxes, etc.)
- Tenant Improvement allowance
They might include a request to build out at landlord cost. A specific plan if it has already been done/priced out can be helpful
- Operating Expenses detailed
We also often request either an annual cap on operating expense increases or specific caps on individual operating expense items (management fees, repair items, etc.)

Deal points that might be important to you (and reasonable to request given your size, etc.):

Renewal Option: A renewal option is a potential benefit to any tenant and at a minimum gives you the ability to renew in your space. Typically, this is done at a “market” rate, which can be defined in many ways and arbitrated. Keep in mind that there is absolutely no benefit to the building owner and can actually be a significant liability to them if it prohibits them in the future of signing a larger and/or longer-term lease.

Expansion Option: This can be written in a myriad of ways, but each basically allows some preferential right to expand into an (usually) adjacent space. Building owners will rarely allow an open-ended right to expand, but will sometimes allow a preferred right ahead of outside prospects.

Parking dedication or reservation: Most suburban office locations can provide sufficient parking for the average company. But urban areas (or suburban areas for higher density parking users) might have to negotiate designated parking (even at a cost) or at least ask for information on area ramps, etc.

Chapter 5 | Request for Proposal (RFP)

Termination Option: This is obviously one that the building owner is not eager to give. However, we are often able to negotiate this into the lease. Be prepared - there is almost always a significant cost to a termination option. Usually you will have a fee equal to unamortized improvements and transaction costs plus a few months of gross rent. However, it might be worth it if you need to get out of the lease due to growth, business sale, etc. We recently met with a client that has grown much faster than they had anticipated. They needed more space and – although one option was to grow within their landlord’s portfolio – they were certainly glad we had negotiated a termination option. The cost of the termination fee was six figures, but substantially less than eating the cost of the balance of their lease and WAY less than operating in a cramped environment in a crucial growth phase.

Environmental Initiatives/Energy Efficiencies: What efforts have been made to achieve energy efficiencies and/or benefit the environment? Is the building Energy Star rated (a program run by the EPA and a benchmark of how energy efficient the building is)? Is the building LEED certified (a popular building rating system guided by the U.S. Green Building Council)? What other green initiatives have the building ownership taken on (lighting upgrades, HVAC, modernization, recycling programs, etc.)?

Signage: How important? What are the availabilities for signage at the building exterior, property, monument, lobby and suite entrance levels? It is rare, but we do have clients that have gotten building signage even though they are a relatively small tenant in the building. And don’t eliminate the concept of paying for building signage placement if it is important to you and the building owner is open to it.

Chapter 6 | Finalist(s) - Getting to the LOI (Letter of Intent)

You sent the RFPs, the proposals have come back and you now have to narrow the field down to one to three options.

We would recommend only limiting your final option to one building if:

- It is the clear favorite.
- You have time to go to a plan B if things fall apart prior to lease execution, and
- Your chosen building is not aware that they are the top choice before negotiations have been completed.

Why do we suggest continuing negotiations with no more than three buildings?

- Rarely do you have more than three buildings you are eager to occupy.
- Lease negotiations can break down for a number of reasons, but rarely do three fail all at the same time.
- This process can become time consuming — not only for the prospective landlord, but also your team. This is especially true if floor plans and/or construction pricing is being assembled for each option.

Remember, at this point you are still a ways from having a signed lease and even further from occupying your new office. If you are trying to narrow from a list and timing is important, your representative should be able to tell you which landlords can move more quickly. This assessment will likely be based on past experience with the landlord, construction required and possibly other factors.

Chapter 6 | Finalist(s) - Getting to the LOI (Letter of Intent)

As with everything, markets and motivations will guide the negotiations. This is true not only of the rent amount, but on all business terms. Your representative will help you understand when you have gotten to the point where you are unlikely to be able to push further.

Of course, you have every right to continue to push on terms that are particularly important to you. This is especially true if you literally will remove a building from consideration if the landlord won't move on one or more terms. Your representative's responsibility to you is to help guide you to what terms can be negotiated based on many factors, including, but not limited to:

The personal or corporate motivation of the landlord

- Your strength in negotiations could be much stronger if the landlord is about to lose the building to foreclosure unless they can get your lease done, for example, than if they are at 95% occupancy and have strong leasing activity.
- The investment required by the landlord to get the lease done
 - the ideal situation for all parties is to find a space that requires little or no construction work. However, that rarely happens.

The size of the building/complex

- One client of ours really likes having prominent building signage in their offices around the country. We request it in all of our RFPs, including once when we were occupying 1,400 square feet of a 1.4 million square foot office tower. I'll let you guess what the response was.
- Your financial strength
- You almost certainly will be asked to submit your financial statements to the building owner. If you submit your statements to three owners, you will likely get three different assessments each from the owners. If you are a fastgrowing company on the verge of profitability and likely strong future growth you might be seen by some landlords as exactly that. Others might limit their assessment to your current status — an unprofitable company. If you have relatively weak financials but a great story, make sure the owner understands your story.

If you are comfortable that the terms have been negotiated as favorably as possible and have a favorite building, it is time to agree to terms and move to lease negotiations. The agreement can be verbal or in the term of a signed LOI. Either way, it is almost always not legally binding — that is what the lease is for.

Chapter 7 | Lease Negotiations

Unlike a residential home sale, where the documentation used in the transaction is nearly identical to all other transactions, almost every office building owner has their own lease document. For very simple, short-term leases this document might be two to three pages. However, we have dealt with many leases in excess of fifty pages.

Should I hire an attorney?

Yes! But what if it is a small, short-term lease? It is obviously your call, but our opinion is that a good attorney should be able to look at a simple agreement and give you an opinion/suggested changes while spending no more than one or two billable hours.

My brother-in-law is a highly-regarded environmental attorney — I'll send it over to him

Don't. Just like you should hire a broker who is an expert in the submarket you are focused on, your attorney should have real estate expertise. Admittedly, this is less important for a small short-term lease, but the more complex the transaction is, the more important it is to have an attorney who is a real estate expert on your side.

How do I find a good real estate attorney?

If you don't have an existing relationship with a good real estate attorney, your representative should be able to give you the name (and likely multiple names) of good real estate attorneys.

Keep in mind, the best real estate attorneys charge a healthy hourly rate. But the most expensive attorney you will ever hire is the one with a lower hourly rate combined with limited real estate experience.

How long will this process take?

This of course depends on a lot of factors, including the motivation and availability of all parties (tenant, broker(s), landlord, attorney(s), architects, contractors, etc.). A simple, short-term lease might take less than a week. A large, complex transaction could take months. Good representation will speed up the process.

With good representation and reasonable parties involved, a successful lease negotiation should almost always be the end result — which is a fully-executed lease document.

Chapter 8 | Construction/Project Management

The lease is signed, the floor plans have been agreed to and the construction costs have been negotiated. So the work is done until Commencement Date, right?

This might actually be the case for some situations where you are leasing an executive office suite or coworking facility, but in most cases there is still plenty of work to do. Some of the tasks that might be part of your near future are:

- Office furniture purchasing and setup
- Phone/data contracting and setup
- Updating of stationary/business cards/marketing materials
- Notification to clients and vendors of new location
- Oversight of construction progress
- Move coordination

This is an incomplete list but hits the main points. Many companies assign one or more employees to oversee these tasks. Others, preferring not to tie up internal resources, hire a project manager.

A project manager isn't needed for every project, but they can be incredibly helpful for busy companies. A good project manager can make an office move a smooth process and limit the internal resources (and frustration) required.

Your representative will likely know one or more good project managers. They might even have one on their own staff.

Chapter 9 | After the Move — Representation Shouldn't End at Lease Execution

The day the lease is signed is usually the day the invoice for the commission is sent from the broker to the building owner. Too many brokers see this as the end of their involvement/commitment.

A quality broker will be a resource for you throughout the construction phase, move process and the entire lease term.

If you have an issue with your landlord midlease, you should be able to reach out to your representative for help. The same is true if you need to expand, contract, add a couple of walls, etc.

That isn't to say your representative will be able to alter the legal commitments of your lease; but they should be able to intervene when a conflict arises or a change is needed.

Leasing office space isn't brain surgery. But most companies soon realize it is more complex than they had anticipated. **Hiring a high-quality broker to represent you can make the process easier and reduce your costs — all at no cost to you.**

The Practical Guide to Leasing Office Space is provided by The Terrace Group. Find Your Office Space Simply.

We save you time and money by finding a highly-qualified, proven expert to assist you with your commercial real estate needs. If we are helping you find space, there is no cost to you.

We negotiate the best possible deal for you and we are paid by the building owner.

Contact The Terrace Group for your next transaction at terracegroup.com.

Founder Eric Dueholm is a licensed real estate broker and is an agent for The Terrace Group. He is a twenty year veteran of the commercial real estate industry and has completed over 10 million square feet of office and industrial transactions throughout the United states and internationally.



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