

Improve profits by managing your second-largest expense

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In today's market, lease rates are escalating and landlord concessions are declining. Tenants are paying more per square foot versus a year ago and will continue to do so for the foreseeable future. Thus, it's critical to evaluate corporate real estate strategically and realize that every dollar saved has an impact on a company's bottom-line profit.

Many people view real estate dollars as a fixed cost, and try to save money elsewhere. But because occupancy costs are most companies' largest expense after payroll, commercial real estate leases are often an overlooked opportunity to improve earnings.

Negotiating a lease can be a time-consuming and frustrating endeavor, but it doesn't have to be. Just take the following tips into consideration.

Time is Money

More than half of tenants, approximately 60 percent, renew or extend their leases on expiration because they feel that their time is better spent elsewhere. But in order to obtain the best terms and conditions available in a competitive marketplace, allow yourself plenty of time to determine needs and research options. If you start negotiations too late, you won't have a choice but to renew under the landlord's opinion of fair market value.

A good rule of thumb to follow: Anchor tenants with space larger than 100,000 square feet should start looking three years before a lease is scheduled to expire. Single operations with 20,000 square feet or more should start examining options at least two years in advance, and small users a year in advance.

It's also important to determine your price range in context with current market conditions. Understand your options and related costs/benefits prior to starting your negotiations. Otherwise, you run the risk of leaving money on the table by making an uninformed decision.

Needs Analysis

A needs analysis is similar to an operations audit. Evaluate the use of current office space to make sure it's as efficient as possible and flexible enough to sustain changes. What type of and how many personnel do you have? How do employees interact with each other? Is the building layout optimal?

By embracing a non-traditional space plan, you can create efficiency without sacrificing performance. For example, a conference room can be used to host board meetings, internal training seminars, networking and community events.

A needs analysis is also a good time to evaluate reception areas. Full-floor users can especially benefit from reception renovations as they have the leverage to choose finishes, match colors/signage with a corporate identity, etc. Reception areas are all about first impressions and should mirror the image you want to project. The correct collaboration of office space and décor can help boost morale and productivity, impress clients and attract new talent.

Leasing vs. Owning

If a user has a long-term perspective and a consistent personnel size, then ownership can be financially beneficial. But, for most companies, leasing makes more sense financially due to the changing nature of business.

Because a lease has a set expiration, there is a built-in exit strategy that allows companies to change with little risk. Ultimately an owned asset can be sold, but this strategy is easier said than done. Lease payments are typically tax deductible and there is no long-term debt on the balance sheet.

Negotiate the Transaction

When preparing to renew, restructure or sign a new lease, there are more ways to save money than simply negotiating the rental rate. Use these tips to help decrease your occupancy costs and negotiate favorable rent components:

- Understand the building's operating expenses. Look at the growth rate of a building's operating expenses over the last three to five years as compared to the

market in general. Determine if inefficiencies are a management issue or a feature of the building itself. Look for property managers with well-maintained facilities.

- Be aware of how space is measured. You may be paying for more than your occupied space, so compare usable square footage to rentable square footage. Buildings with a lot of common space, like a large lobby or shared restrooms, will have more rentable square footage.
- Understand the impact of tenant-improvement costs. Tenant-improvement costs are a significant component of both landlord and tenant costs. A \$20-per-square-foot rental rate with a \$10-per-square-foot tenant-improvement allowance is substantially different than a \$20 rental rate with a \$25 tenant-improvement allowance. Knowing the financial impact to both sides in a negotiation will allow you to negotiate from a position of strength.
- Negotiate. Determine who is the ultimate decision maker and be as direct as possible with them early on. In addition to the economic factors, there are more than 40 clauses in a lease that will impact how your business operates during the lease term. Pay attention to the details, and realize there are hidden costs lurking below the surface.
- Hire an expert up front. Whether you're using a single broker or a broker and a lawyer, choose your team up front. Not only will hiring an expert save you money, but it'll save you time and headaches as well.
- Don't be overly concerned about the broker's fee. In most cases a fee is worked into the transaction, so you're paying a broker fee whether you use one or not. However, all brokers are not created equal, so understand the scope of services provided.

Big or small, every business should have a solid real estate strategy that supports its business plan to ensure that real estate does not restrict a tenant from achieving business goals. A well-planned and negotiated lease will improve profitability and increase productivity.