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## **Re: Exclusive Tenant Representation - The Business Case**

When space challenged companies face relocating, growing, shrinking – whatever the case - they need make a number of complex decisions and quite a few minor ones too.

Whether a relocation of 5,000 square feet or 150,000 square feet, evaluating alternative space options remains a complicated, painstaking, and time-consuming process.

What are the issues we must consider as we do a Needs Analysis? If we take time to answer these questions carefully first, then going forward will be so much easier . . . .

Is your business growing, changing or diversifying?

What is your current situation? Why do you need the space?

Are you happy with your current location? Management? Space, etc.?

Do you have room to expand? Renew? How much notice is needed?

What do you like most about your current location?

What is your timeframe in making a decision? Why?

Who do you need to be close to? Removed from?

How important is exposure to your business? Why?

How important is image/profile? What image would you like to project?

How many parking stalls do you require?

What are your needs in terms of telecommunications?

Is a security system required?

What is the ideal location for your company? Why?

When does your lease expire?

Do you have the right to sublease? Under what conditions?

What 'end of lease' costs are you required to pay?

What renewal &/or extension provisions do you have? Exercise dates?

What length of lease term will you consider? Why?

What more do you want or need to know before a decision is made?

What are you currently paying? What is your budget?

What amenities are important?

Any special requirements?

Do you require handicapped accessibility?

Where do you see your business headed in the next 2-5 years?

What is the future of your industry?

What is your biggest threat or opportunity?

Is your Lease planning cycle fit your business planning model

Allowing sufficient time is a basic but essential element in the process; users occupying less than 20,000 square feet should ideally allow at least nine months from the space survey until the move-in date; users who need more than 20,000 square feet should plan for a lead time of approximately nine to 18 months or longer. Reality proves that we can, and regularly do, accomplish all of these things in a compressed time frame though we must remember there will be 'effectiveness trade-offs' as a result.

Part of this time is needed to sort out the questions and alternatives that present themselves. For example, should a company investigate just a few building alternatives, or should it investigate everything so as not to miss a "good" deal? If the current building is satisfactory, what is the best strategy for negotiating with the current landlord and achieving the best renewal rates possible? After alternatives are narrowed down to a few, how should they be evaluated so a comparison can be made? Factors to evaluate include parking, operating-expense calculations, options (for renewal and expansion), gross-up (the calculations landlords use to charge tenants for common areas, including restrooms, corridors, and lobbies), and tenant-improvement allowances. In recent years this evaluation process has become more complicated due to the large amounts of office space available in most markets; the differences between the quoted rental rate and the lower rates that can be negotiated due to market supply.

[Often, clients have an existing lease that prevents them from being nimble. Do you want the next when to restrict you as well? Today's business environment demands everyone be flexible and open to opportunities – so it is important as we go forward to develop a plan and negotiate a lease affording maximum flexibility.]

Even before facing any of these issues, companies must decide one essential question before all the others--whether or not to use the services of an office-leasing consultant, or tenant representative. Should company representatives go out on their own and negotiate directly with building owners and owners' agents?

If you elect to hire a specialist, how do you choose? What distinguishes one from the other? Or do you negotiate directly on the most visible projects and hire a agent for the remaining alternatives?--a strategy that usually confuses and complicates the entire process. Worse yet, some firms hire multiple agents while simultaneously delegating the space search to several internal managers--a situation bound to result in conflict and confusion.

Choosing; Stay v. Move

Sometimes, a company decides that its present building is adequate and chooses not to move. But even this decision warrants careful thought and planning by the tenant. With rental rates increases in recent years, what originally seemed to be an attractive rental rate offered in a lease signed five years ago will likely not be at all realistic today.

If the present building works and the economics are competitive, usually both the tenant and the landlord gain by retaining the existing tenancy. The tenant representative's job is to ensure both sides are well represented in the deal.

Part of being well represented is being well informed. When landlords know that relocation alternatives are abundant and tempting, they are likely to give more concessions. Generally speaking, landlords are competitive only when they have to be.

In some cases I suggest tenants request a proposal from their current landlord. I can then meet with the landlord and receive a second proposal. Often this results in tenants saving substantially vis-à-vis rental packages they otherwise would have agreed to.

In part, savings came about because I remind the landlord about the costs that would be incurred if the tenant were to vacate and the space had to be re-leased. These costs include tenant improvements for the new occupant, rental losses during the construction of the improvements, and marketing costs. Landlords almost always prefer to pay a commission to retain a tenant rather than to re-let vacant space, and they are not alienated in this process when they see how the benefits are in their favour.

A tenant's Request for Proposal (RFP) can also be very valuable in the negotiating process. It sets forth the tenant's "wish list" for rent, terms, conditions, improvements, expansion, and other crucial items. However, the proposal should be properly prepared and presented to get appropriate landlord response. Asking for the moon may terminate negotiations with some developers; sensitivity in this regard is critical to the ultimate success of negotiations.

What About the Agent's Fee? And who pays?

It is estimated more than 75% of large corporations use agent services, while most of the remainder have in-house real estate departments. Eliminating the agent's commission/fee by dealing directly with the building owner is not the source of concern it once was.

Leasing commissions are paid, in most cases, by the head lease or sublease landlord. In some cases they are paid by the tenant, however we can usually negotiate an offsetting cash inducement from the landlord to cover the cost.

Think of it as a comparison of tenant agents with travel agents. A traveler can plan their entire itinerary, go to/call/click various airlines directly, learn the quirks and nuances of the different airlines and their varying policies, coordinate the entire travel package, and still pay the same price as the traveler who uses the services of an experienced travel agent. In both industries, rarely do you get a discount for doing it yourself.

We often hear of tenants who make direct deals at above-market rents due to their lack of market experience. Also, in many cases the building is represented by an exclusive agent, who shares the fee with the tenant's agent; the fee is not discounted just because the tenant walks in the door without representation. And, as in the legal system, who wants to be represented by the opposing party's lawyer?

The Reports Are Useful

Tenant agents can provide users a number of useful reports: discounted cash-flow analyses of the various alternatives and evaluations of free rent, tenant improvements costs that go beyond standard building allowances, parking charges, base rent increases, operating expense calculations, and options to renew and/or expand. Discounted cash-flow analysis may require analyzing the timing of free rent, the cost differential of tenant improvement allowances, and the cost of money. A comparison of NER [net effective rate] between competing opportunities is a great equalizer – to see how landlords evaluate the business

terms is always helpful to assist tenants understand which elements of negotiation have greater or lesser impact.

In the case of new buildings, some developers use the operating expense base to recapture lease concessions. This has become an increasingly important factor to examine. Landlords who offer future expense estimates that are sometimes unrealistically low give cause for litigation when tenants receive their first-year "increase" bill. For example, if a base operating budget of \$ 5 per square foot per annum is offered, and the first year's expenses are actually \$ 7 per square foot, the \$ 2-per-square-foot additional rent could negate what a user might have thought was a great deal. However, agents can minimize this problem by evaluating comparative buildings' actual operating costs to ensure that the costs of the building selected are in line with reality.

Looking at buildings only from a base-year standpoint still may not provide a valid comparison. Some buildings may have issues of renovation, upgrading, change of ownership or management which may result in increased operating costs. Taxes, utilities and insurance will not vary greatly building to building, however other costs and how they are managed can fluctuate significantly. Tenant reps need to keep these factors in mind as well.

Another expense to consider is after-hours HVAC costs. Tenants with small space needs who require HVAC after normal business hours should closely evaluate relocating to an office building offering small HVAC package units or supplementary systems rather than moving to a large office building that needs to operate the building's entire system to accommodate a partial-floor user. The cost of after-hour usage can vary substantially, ranging from \$10 per hour in small buildings to \$400 per hour or more in large office complexes – if it is available at all.

Tenant reps should also evaluate the gross-up [load factor]. Tenants should know how much the building's shared spaces are costing them; the difference between an 8% and a 13% gross-up factor can be significant. For example, for a tenant with a five-year lease for 50,000 square feet paying an annual rent of \$18 per square foot, the difference between an 8% and a 13% gross-up factor equals \$225,000. ( $50,000 \times 18 = 900,000$ ;  $900,000 \times 5 = 4,500,000$ ;  $8\% \text{ of } 4,500,000 = 360,000$ ;  $13\% \text{ of } 4,500,000 = 585,000$ ;  $585,000 - 360,000 = 225,000$ ).

### Concurrent Leases

Tenant reps provide clients another valuable service when they evaluate the re-letting or subletting potential of their client's existing space before the tenant signs a new lease elsewhere. The need for this service arises when companies grow or change within their lease term necessitating a move.

Just as sub-lease opportunities are worth looking at from a tenant perspective, one must also examine exit strategies in a current lease as well as a prospective one.

A tenant rep agent needs to be careful and clear in planning to arrange a sublease, so that tenants do not have to write-off the remainder of the lease term in their lease calculations.

As we look at opportunities it is important to be clear about expectations of profit v. cost of subleasing existing space. In most markets, subleases of less than three years have been extremely difficult to unload. In these case cooperation with landlords can often produce

great results of lease surrender and new long term leases for parties who would otherwise be sublease tenants.

### Lease Evaluations

Although office-leasing agents are not lawyers and should not attempt to carry out legal consultation, they can evaluate the lease document's function in normal and customary market situations. The need for this evaluation may arise when institutional landlords use the same lease throughout the country without taking into account regional differences. Most of these institutional leases are biased in favour of the landlords, but the most unfavourable clauses will often be deleted if agents challenge them during negotiations. A tenant rep agent may also be helpful in negotiating with a landlord who unthinkingly uses a lease form drawn up many years ago. Even though the new landlord may be a nice person, tenants must live with lease contracts for years; if the building is sold, the document is the tenant's main recourse to ensure fair play.

### Hazardous Materials

In recent years, the presence of asbestos and other hazardous materials has become factors in office building selection. This is at issue particularly in buildings built before 1976. Asbestos, PCB ballasts and lead based paints in older buildings are things to watch for. Knowing the facts before the lease is signed is crucial for tenants who otherwise may be forced to deal with disruption or temporary relocation for removal of these materials. In addition, how is the issue of who pays for removal or monitoring addressed in the lease?

### Who's Got the Time?

Most office decision-makers do not have the luxury of devoting substantial portions of their time to a successful office relocation. This is another way that tenant agents can help. They can do the majority of information gathering, while decision-makers do just that--make decisions.

### How Important is Experience?

Tenants usually relocate within a specific market once every five or ten years. Obviously, they cannot compete with the in-depth market knowledge of the office-leasing specialist who is involved with the marketplace on a daily basis. Experienced agents know not only what is available but also what specific landlords are willing to do in terms of rent, terms, concessions, and a host of other factors. Agents who know details of prior transactions have invaluable resources for negotiations that are not available by simply asking landlords what they are willing to do.

For example, if a leasing agent knows that a landlord offered a more attractive incentive package to a prior tenant than what is on the table, this is invaluable. Or if the agent suspects that a landlord is having financial difficulties or is always behind on time commitments for tenant build-outs, this information can help clients make much better transactions than if they were unaware.

Developers and landlords know that tenants with experienced tenant representation are aware of competing buildings and can switch negotiations if transactions do not proceed smoothly. This alone can save tenants substantial amounts of time and money.

## No Easy Road

Office-space leasing is many times more complex than in the past. Office-building alternatives are everywhere, and leases that used to be a few pages long now commonly number 20 or more pages. The bottom-line effects of an improperly negotiated lease can have long-term devastating effects on the tenant. Experienced tenant representatives understand the needs and requirements of tenants and landlords, and they are able to serve both parties fully.

## Once You've Decided To Hire A Tenant Representation Agent, What's Next?

Once the decision is made, how do you evaluate the services of competing agents to be sure you have a fit that is right for you, right for your company and a choice who will serve your company's interest first, last and only. While you might expect any agent to be sure to consider properties listed by their own firm, you want to be sure you do not miss an opportunity and that all viable options which meet your requirements are offered on a level playing field basis. The agent who should win your business is the one who best demonstrates his or her ability to best represent your interests ahead of their own and ahead of the interests of landlords.

For a full evaluation of your office requirements and a thorough Needs Analysis call me at your convenience. I would be pleased to assist and to discuss our services.

Yours truly,

**MaxComm Realty Advisors Inc.**

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