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Commercial Real Estate Planning  
Tenant & Buyer Representation  
Since 1981

From the Editor  
Paul Suzman:



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## Ten Steps To Succeed In Real Estate Planning and Execution

Here are ten steps to help you develop and execute a real estate plan for your company.

1. **Make space needs a part of your business planning.** Your business plan has projections of staff requirements, revenues and profits. It should also have projections of the amount and type of space required and where it would ideally be located. Your business plan should be a living document; the real estate section should be updated as your business plans change.
2. **Understand and quantify space requirements.** Your staff projections become the basis for estimating the amount and type of space required. When including supporting space, like conference rooms and break areas, the old rule of thumb was 250 Rentable Square Feet/person. But increased rents have promoted the use of more open environments and reduced this figure to 180-180 RSF/person. While small companies can adapt to most office configurations, larger users should hire a space planner/architect to determine specific space requirements and to optimize office layout with room for growth.

3. **Establish priorities and criteria.** Before you start to look for space, you should establish the things that are most important to your business and what they require in terms of your office space. For example, do clients visit your offices and is it important to present a certain image? If these are a priority, building quality and location are important together with convenient parking.
4. **Your budget should be your bottom line.** Before taking on a lease commitment, and a probable personal guarantee, consider initially subleasing space, and if the sublessor still occupies part of the space, sharing costs for administrative services. Concentrate on short-term flexibility. Don't let space dictate your business plan.
5. **Thoroughly survey the market.** Once you have established your requirements and your budget, do an in-depth search to find what is available within your parameters. You need to know your alternatives. In a tight market there may not be many that meet your requirements. But you should know what the market is in terms of rents, term and tenant improvement allowance. Ideally, you should have at least two viable alternatives to provide a fall back.
6. **Analyze objectively.** The larger your space requirements, the greater the dollars involved in your decision. Be sure to do enough economic analysis of your alternatives to be able to make informed choices.
7. **Plan for negotiations.** Do your homework! Know your trade offs before you start to negotiate. Know what you are willing to give up in order to get what you want. Always have a fall back, so you can negotiate from relative strength.
8. **Tailor your lease.** Every company's needs are different. Take enough time to be sure that the lease document presented to you will meet your business objectives and that the intent of the deal is accurately translated into a fair lease document. Make sure you prioritize issues before going to bat with the landlord. In a tight real estate market, they may not be very flexible.
9. **Monitor space build-out.** If your space requires extensive remodeling, be sure that the responsibility for the work is clearly designated. For larger projects, name a project executive to represent you, and then organize a team approach with the landlord/developer to build out the space. You also need to be aware of lead times and coordinate the purchase of equipment, furniture, telephones, etc.
10. **Plan move-in and follow-up.** Time is of the essence. The earlier you plan your move, the more efficient the process will be. And don't forget to do a "walk-through" before moving in to be sure that the build-out has been done according to plan.

## **BOMA Develops New Measurement Standard**

Since 1980, when the Building Owners and Managers Association (BOMA) Standard for measuring floor area in office buildings was last revised, common space has increased significantly.

In recognition of these changes, BOMA has issued a new Standard that uses a building-wide measuring method to account for spaces and amenities that benefit all tenants. Included, for example, are lobbies, conference centers, health clubs, day care facilities and core and service areas. Previous Standards measured on a floor-by-floor basis.

The U.S. General Services Administration (GSA) has adopted the new Standard for both the space it owns and for federal agency rentals from private owners. GSA will apply BOMA's Usable Area definition to evaluate competing leasing offers.

The Standard was developed by a 30-member group that included owners and managers of multi-tenant buildings, managers of owner-occupied facilities, asset managers, leasing professionals, brokers, architects, interior designers, space planners and appraisers. The document, reached by consensus, has been approved by the American National Standards Institute.

## BRIEFS

**You must have a waiver of subrogation.** A what? Subrogation allows a third party to assume another's legal right to collect a debt or damages. In a tenant/landlord/insurance company relationship, for example, subrogation allows an insurer to sue a tenant for the costs of restoring the landlord's building when, say, a tenant's employee was responsible for the damage. Since tenants pay the landlord's insurance premiums as part of operating expense, it's hardly fair for the tenant to then be sued by the insurance company. Therefore, leases should contain a mutual waiver of subrogation provision, which states that a party's insurance carrier will waive any claims acquired through subrogation against the other party. To be effective, this provision must also be a part of each party's insurance policy.

**With start-up companies, a few landlords are trying alternatives to conventional rents.** Far from altruistic, these daring owners are hoping to cash in when high-tech entrepreneurs hit the jackpot. In New York, a temporary office space provider put together a \$15 million venture-capital fund to invest in tenants in its Greenwich Village facility. A Texas real estate developer offers several months' free rent in return for equity. And an increasing number are negotiating warrants or options into their leases, giving them the right to buy stock in the offering if the company goes public. Other landlords, however, are less gung-ho. Considering start-ups high risk, they ask for hefty security deposits or letters of credit from bankers. (You'll find the full story in *The Wall Street Journal*, November 3, 1999.)

**Go Web.** If you're among the more-than-a-few businesses and professional people who are less than thrilled with the payback - or lack thereof - from their organization's website, stick with it. Make sure your expectations are realistic, beef up your design, and give the site regular attention with, at least, weekly updates. In addition to making your site easy to navigate, add links to interesting related - or unrelated - spots like museums or travel destinations. Include your World Wide Web address on all your stationery and promotional materials. Encourage your customers to visit it for the latest information on your products and services. It could be a while before you can credit a single piece of new business to your website, but without one, you might very well lose customers to more enlightened competitors. Nobody knows what will happen on Web, but most agree that without a www to your name, your credibility and viability will be in question.

## LETTERS OF INTENT

Letter of understanding, memorandum of understanding and term-sheet are among the titles given to documents that are, in fact, letters of intent. The purpose is usually to minimize the perceived binding nature of a letter of intent. Nevertheless, "if it looks like a duck and quacks like a duck, it will be deemed a duck."

In the United States, many assume that letters of intent have no legal value; internationally, they are taken far more seriously.

Overall, a letter of intent is much like an engagement. We get to know each other, and if it works out, we get married. It is, however, often easier to get out of a bad marriage than a bad lease.

The same issues and precautions regarding letters of intent apply equally to leasing, acquisition, financing, build-to-suit and other real estate and business contexts.

"There is nothing more likely to start disagreement among people or countries than an agreement." ...E.B. White

"A gentlemen's agreement is an agreement which is not an agreement, made between two persons neither of whom is a gentleman, whereby each expects the other to be strictly bound without himself being bound at all."  
...The Honorable Sir Harry Bevir Vaisey.

### *Letters of Intent*

Following is suggested language for a nonbinding letter of intent: This letter is intended to summarize the discussions between XYZ Corporation and ABC Corporation and to constitute a non-legally binding letter of intent. The discussions expressed in this letter of intent are intended to be embodied into a legally binding definitive agreement to be signed by all parties and which is subject to the approval of the respective boards of directors of the parties. Our discussions were as follows: (fill in terms)

This letter of intent reflects certain major business terms which are intended to be embodied into the definitive agreement; it is understood that the definitive agreement will contain many of the other terms and conditions which will have to be negotiated and agreed to before the definitive agreement can be finalized. Until the definitive agreement is finalized, approved by the respective boards of directors (which approval shall be in the sole subjective discretion of the respective boards of directors), and properly executed and delivered by both parties, neither party shall have any legally binding obligation to the other (whether under this letter of intent or otherwise), including, but not limited to, any obligations of good faith, and any legal duty to continue negotiations to reach such a definitive agreement. In addition, either party may discontinue negotiations at any time for any reason whatsoever.

If the enclosed correctly expresses our understanding, please execute the letter where indicated below.\*

## UBUNTU – THE MANDELA VISIT

UBUNTU is a traditional Xhosa notion that Nelson Mandela has always nurtured. It is a philosophy of mutual responsibility and brotherhood. He said, "People are human beings produced by the society in which they live. You encourage people by bringing out the best in them."

As we prepare for his visit to Seattle, it is useful to reflect on the universal appeal and veneration he has generated. He is exceptional in his unflagging adherence to his principles and in the fact that he "walks his talk" - something most of us fail to do. He sticks by his friends even when they are persona non grata and when political or financial repercussions loom.

Nelson Mandela listens to and observes people. While on Robben Island he wrote, "Few things are more exciting to me here than to listen to a man's background, the factors that influenced his thoughts and actions, the unknown battles he has fought and won." He became an avid student of Afrikaans history, literature and language. Like Sun Tzu, he believed that "you must understand the mind of the opposing commander....his literature and language." Clearly, he succeeded.

Achmed Kathrada, who was imprisoned with Mandela and who recently published his haunting "Letters from Robben Island," reported on a chess game that went on for three days at which point the young medical student with whom Mandela was playing resigned from exhaustion. This is how he played his political hands - inexorably and without haste.

Nelson Mandela always took full responsibility for his actions and beliefs. He believed, was inspired by and oft quoted the poem "Invictus":

It matters not how straight the gate,  
How charged with punishments the scroll,  
I am the master of my fate:  
I am the captain of my soul.

(We in this wonderful but litigious country might do well to reflect on such words...)

Nelson Mandela simply never allowed himself to be lowered to the level of those who held him captive and insisted that everyone on Robben Island study, the young Afrikaner wardens included. And by force of will and unflagging spirit, he elevated his grim and forbidding prison to the status of a true university.

In a letter, he stated, "...internal factors may be more crucial in assessing one's development as a human being: honesty, sincerity, simplicity... generosity... readiness to serve your fellow man..." UBUNTU

How does one best introduce such an exceptional man? The question is not academic, because at this writing, I am considering what I will say on December 8th, when I have the honor of introducing Nelson Mandela before he addresses our Seattle Rotary Club.

## NO GOOD DEED GOES UNPUNISHED

So goes the favorite adage of one of my sunrise cycling friends who knows whereof he speaks. I was reminded of this somewhat jaundiced view by a recent Newsweek article noting that over two-thirds of those put in charge of a moving process were subsequently demoted or fired.

This statistic would make move management the Kamikaze assignment of the business facilities world, especially since the same person is often involved with lease decisions and negotiations.

Shakespeare's Portia noted, "So shines a good deed in a naughty world"! With this in mind, if you are to take on this Mission Impossible, the following pointers will help your managers recognize the potential pitfalls and resulting value of your endeavors.

**1. It will always take more of your time than you think it will.** Ensure that you and top management clearly understand your current job description and what it entails. Then, week to week, budget the time required for Mission Impossible.

As tenant representatives working on projects ranging from 5,000 to 200,000 square feet, we invest from 20 to as many as 400 hours taking a project from initiation through lease signing or renegotiation. Our liaison, the project manager within a client firm, may spend twice that amount of time assembling the information we need and then forging the internal consensus necessary for a good real estate decision. And all this is *before* actual move planning has even begun!

**2. Talk to others who have had similar responsibilities.** Ask your tenant representative, attorney, accountant and colleagues for referrals to people who have been through the process. A first-hand accounting will prove invaluable as you go about budgeting your time. We've always found our clients very willing to share experiences. Ask the question, "*If you knew then what you know now...?*"

**3. The process might have a negative impact on your ability to perform day-to-day responsibilities.** Consider what will mitigate this situation, develop a written contingency plan and discuss it with your managers.

**4. Understand that a potential move is frequently a catalyst for corporate change,** and that you, as project manager, might become the lightning rod for internal politicking. Depending on how such a process is handled, the experience can be either team- and morale-building or divisive.

**5. It's a good time to audit space standards and furniture systems.** Depending on the size and age of your organization, consider having an architectural space planner execute a program early on. And speaking of early on...

**6. You can never initiate the process too early!** Just as it will likely take more of your time than you ever anticipated, it will usually take longer than expected. You can always slow an evaluation process down, but it is very difficult to play catch-up if you hold off too long - especially in our tight Northwest real estate market.

**7. Tenant improvements are most often the area of costly oversight.** Depending on the size and complexity of your requirement, consider hiring a project manager to advise and administer. Interpretation of whether landlord or tenant has financial responsibility for building improvements is fraught with potentially frustrating and expensive misunderstandings.

**Now for the good news...**One-third of those cited by Newsweek were neither fired nor demoted. And it would not be surprising if these people were aware of the above pointers. So if you choose to take this mission and want further insights, call us at 624-0000 or email me at [Pauls@officelease.com](mailto:Pauls@officelease.com).

## PROTECTING BUYERS

**Smart business decisions, not laws, protect tenants and buyers of commercial real estate.** During the past several years, more than 20 state legislatures have passed a variety of legislation pertaining to single- versus dual-agency. Driven primarily by the residential market, the statutes often give more benefits to real estate brokers - thanks to their lobbying efforts - than to the tenants and buyers they were originally intended to protect.

The laws vary among states. Some allow an agency to represent both parties as long as the tenant or buyer is fully apprised. Others presume an agent represents the tenant or buyer unless otherwise specified in writing. Several states permit transactional brokerage, which allows an agency to act as a 'facilitator,' performing all the services required by landlords and tenants (or buyers and sellers) without fiduciary responsibilities to either side.

Michael Wolken, President of Wolken Real Estate Advisors, a St. Louis-based tenant representation firm, and former Chairman of the Missouri Real Estate Commission, believes transactional brokerage is a "terrible" trend. "It is even worse than dual agency because agents bear no responsibility for their actions," says Mr. Wolken, who is also a member of the International Tenant Representative Alliance (ITRA). Bogue Miller, President of ITRA, added that "in the most successful deals, both sides have their own strong advocates. That way everything is strictly above board."

### **Loyalty Is the Key**

Whatever the outcome of these laws - and their future is unclear since none have been tested in court - commercial tenants and buyers don't need the judiciary to safeguard their interests in real estate transactions. They need simply to choose a representative whose loyalty and commitment to their interests alone is unquestionable.

"The idea that one firm can represent both sides is ludicrous," says Tom Early, President of the National Association of Exclusive Buyer Agents. Although his organization's focus is the residential market, his view makes the same sense in the business sector. Advocacy, he insists, should not be diluted by any real or implied conflict of interest.

Nevertheless, that dilution is very possible when full-service agencies, whose principal allegiance is to owners and landlords, represent tenants and buyers as well. As a practical matter, even separate departments can't guarantee that no second agenda will distort their recommendations.

Consider this not-so-hypothetical example: The ABC Corporation needs new office space. Its real estate manager has retained the XYZ Real Estate Company's Tenant Representative Division to do the job. XYZ searches the market and comes up with several good opportunities. The one that looks like the best bet (and probably is) is in a building XYZ manages. Even though church and state are supposedly separated within the XYZ operation, can ABC feel confident that it's getting the full story, that the advice is truly unbiased?

In a word, no. That's not to suggest that XYZ agents (or their real-life counterparts) would deliberately mislead a client. But as a practical matter, they're between a rock and a hard place. Recommending the XYZ building questions their objectivity; recommending an alternative may not be best for ABC. In truth, a cloud of ambiguity hangs over any relationship where the best interests of a client and a colleague might be in conflict.

### **Let Good Sense Prevail**

Keep it simple. Erase all doubts. When you're looking to lease space or to buy or build a commercial property, use a tenant representative whose sole allegiance is to your best interests. You'll find that commitment in every member of ITRA.

When you engage a member of our firm or one of our ITRA colleagues, you can be confident that...

- You'll be informed of every possibility in the market, unedited by listings, management agreements or other hidden agendas.
- In negotiations, your representatives will advance your interests without compromise or concerns for their own current or potential relationships with building owners.

Let's face it. While it's not illegal for real estate brokers to represent both owners and tenants or buyers, even on the same transaction, it's not sensible for tenants and buyers to accept that representation. Why muddy the waters when better alternatives are yours for the taking?

## **ARE YOU OVERPAYING FOR ELECTRICITY**

*By Sid Rattner, Partner, Friedman Eisenstein Raemer and Schwartz, LLP*

Electricity is among the most common pass-through expenses; it can also be among the most abused.

Electricity is billed in a number of ways, depending on the age and setup of the building. Whatever the process, our goal is to assure that you, as a tenant, pay no more than your fair share. To that end, we'll call attention to the areas in which overbilling commonly occurs and to the steps you can take to prevent it.

### **Electricity Rebilled by the Landlord**

Landlords who buy electricity at a volume discount and rebill it to tenants often take an excessive markup. They charge the substantially higher rate tenants would pay - because of their relatively low usage - if they were buying electricity directly.

Thus, the lease typically states that "the landlord may bill the tenant at rates in effect as if the tenant were purchasing the electricity directly from the utility." Your solution: Before signing the lease, find out the landlord's rate and negotiate a "landlord's markup" that includes an acceptable profit margin and the landlord's administrative cost for rebilling. In addition, make sure that the higher rate applies only to the leased premises, not to the common areas.

### **Prorated Billing**

Landlords who can't quantify how much each tenant is using normally prorate the bill based on rentable square footage. In this situation, you need to know the "electricity profile" of the other tenants. Do any run large computer installations? What about two- or three-shift operations - telemarketing or data processing, for example? If other tenants' electrical usage is abnormally high, the issue should be addressed during the lease negotiation so that you aren't subsidizing your neighbors.

### **Allocation**

Are all tenants paying their fair share of the utilities? We have sometimes found that common area expenses, which include electricity, are not being allocated properly to for-profit garages, retail tenants and specialized facilities like health clubs and restaurants. When you negotiate your lease, be sure that these issues are taken into consideration.

### **After-Hours HVAC**

The most common electricity overcharge is in billing for after-hours HVAC. These charges, which vary from building to building and city to city, depend on whether the property is old or new and whether the HVAC can be turned on by zone or if whole sections of the building must be turned on to heat or cool one tenant's space.

To arrive at the rate per hour, landlords normally take into consideration utility cost, depreciation, labor cost (if applicable), overhead and profit and, in some instances, repair and maintenance. They bill tenants accordingly and are subsequently reimbursed.

What often happens, however, is that the electricity and labor components of the hourly charge are also included in the expense pass-throughs. The reimbursement, an income item, should be deducted from the pass-throughs but isn't. As a result, tenants are paying twice for the same thing.

This is another subject that should be addressed during lease negotiations. Ask the landlord to specify his after-hours HVAC rate. If you are a large after-hours HVAC user, it is in your best interests to be familiar with charges in other buildings to determine if your landlord's rate seems to be in line. In addition, make sure that the definition of operating expenses states that "any expense reimbursements" will be reflected as an offset to pass-through operating costs.

*If you have questions on this subject or other lease-audit issues, you can reach Sid Rattner directly at 312-245-1722.*

## **OCCUPANCY COSTS II**

*This is the second of two articles on occupancy costs, based on a Harvard Business Review article by Mahlon Apgar, IV. Reprints of the article are available by calling our office.*

### **The Three Ls Drive Occupancy Costs**

Contrary to what many believe, occupancy costs are not driven by rent alone. There are, in fact, three drivers: leasing, location and layout. To reduce occupancy costs effectively, managers must understand all three and must be able to manage the close interplay among them.



### **Leasing: Not the Most Important**

Of the three Ls, leasing has the smallest impact on occupancy cost reduction, typically representing no more than 20% of the total savings potential. Nevertheless, it offers opportunities that are worth pursuing, if the circumstances are right.

The most common course is offering to trade a longer lease term - which offers a landlord stability - for lower rents, concessions such as free rent or above-standard build-out allowances, smaller base rents and escalations, more favorable operating expense pass-through formulas, or a combination. Equity participation, which can provide a share of future sale proceeds and add to current cash flow, may also be a consideration.

All of these are of value only if a company is sure it is in the right building and that a five- or 10-year extension won't become an albatross. The best sequence, therefore, is to examine location and layout options before embarking on lease renegotiations.

### **Location, Location, Location - More Than A Real Estate Axiom**

Because land is a fixed resource, location determines the use and value of land for the owner and developer. For tenants, a facility's productivity, not its land use, should determine its relative value.

How does a location affect employee productivity, transaction time, and other operating objectives? How do current locations benefit corporate strategies, technologies, customer and employee access?

Answering these questions is critical to calculating operating value and, thus, to managing the location driver.

Because location has such a high impact on occupancy cost and productivity, managers should work closely with real estate experts to evaluate submarket trade-offs. From downtown to suburbs and from established to emerging submarkets, costs can differ by 50% to 100% in the same metropolitan area.

### **Layout Is a Managerial Concern**

Executives often think of layout as a technical and administrative concern, but cost control is lost in the hands of local managers, or architects, builders, and other technicians who can rarely link space planning choices with profits and productivity.

Reducing layout-driven costs begins with a basic analysis of space requirements. Most large corporations rent more space than they need. A major stockbrokerage discovered some 800,000 square feet of excess space, nearly 20% of its real estate portfolio at that time.

Companies must match the size of each workspace to its operating use and relative cost, abandoning the traditional approach of defining a space envelope - i.e., multiplying the square-foot allowance per person by the number of projected occupants. Turning the process around is analogous to zero-based financial budgeting, but space budgets deal with square feet instead of money.

A zero-based space budget requires four steps:

- categorizing the current space,
- measuring each space use,
- sizing the required uses,
- placing them in an optimum layout.

The process can yield dramatic reductions - typically 20% to 25% less space than required by traditional planning.

Clearly, the three Ls do not exist in separate vacuums; they are interdependent. To successfully minimize occupancy costs and maximize productivity, managers must incorporate all three in the decision-making process.

## THE WORKPLACE: A WORK IN PROGRESS

### **If you don't like the weather, wait a minute!**

Sound familiar? Anyone who's ever been to the beach quickly becomes accustomed to the volatility of the weather. The volatility of the workplace is another story.

With Corporate upheaval the norm, architects, space planners, furniture companies and academia are seeking ways to make the office environment adaptable to corporate change and responsive to human needs. Comfort, flexibility and productivity - in varying order - are the words heard again and again.

At Carnegie Mellon University in Pittsburgh, Professor Volker Hartskopf and his colleagues have unveiled The Intelligent Workplace, a glass-walled, roof-top testing ground for office environments and innovations. The setting is a living laboratory where real workers respond to new products and systems in various combinations. It is a giant leap from the testing performed by individual manufacturers on their own products. At CMU, lighting, sound, HVAC, computers, furniture, space configuration...the whole shebang can be tested together to see how things work together and which combinations work best for the people who use them.

There are modular floor systems; telephones, computers and lighting that can be moved virtually at will; and desktop control panels that allow workers to manage the air flow, heating and cooling in their own spaces.

The facility's designers say that it provides "infinitely greater" comfort for its occupants while using about one-third the energy of a more conventional office space.

The Intelligent Workplace, a part of Carnegie Mellon's Center for Building Performance and Diagnostics, was developed over nine years by a consortium comprising the university, government agencies, foundations and major corporations in the office and building products industries.

On the commercial front, designers, space planners and office furniture suppliers have moved beyond their original missions. At Detroit's Solutions@Work the company's office has into what, its president, John Anderson, calls a "learning laboratory," an open design where furniture - all of it mobile - can be reconfigured on demand, and no walls interrupt the flow. The transformation process started with a strategic analysis to determine how people did their jobs and what they needed to work more effectively. Following that were company-wide brain-storming sessions, which concluded that the workplace should be "stress free, innovative and educational."

One of these is a living room with all the comforts of home. It's a place where the staff can relaxes, works, studies and holds client meetings.

## YOU GET WHAT YOU PAY FOR

One of the ironies of our current "landlord's market" is that although tenants are paying more for their facilities, it is also more feasible to sublease space should the need arise. Contraction, merger, outgrowth, all are occurrences which might trigger the need to sublease. BSR always counsels it's clients to consider the subleasability of a chosen space as an exit strategy when making facility decisions. This consideration should include location, accessibility and design.

## SQUEET!

(Shorthand for Square Feet, Our Stock in Trade) In this age of increasing competitiveness, however, we suggest that executives need to consider **cost & benefit/employee** and not solely \$/s.f. when evaluating facilities.

For many companies, facilities have become important tools, while for others, they are simply a matter of keeping employees reasonably warm and dry. Are facilities simply a cost item on a ledger, or are they are strategic assets upon which investors can expect an ROI?

In a presentation to the WSA Finance and Operations Group, Scott Wyatt, CEO of NBBJ Group, and I discussed this issue. We reviewed case studies of tech companies that had started in modest surroundings and had subsequently filled their goals of providing great space for great employees. These companies realized that their **facilities were key recruiting tools** in a very competitive labor market.

**Collaborative work** (versus solo work) is increasing due to its significant role in the success of global business. Therefore, facilities should be designed for successful collaboration while also accommodating the needs of knowledge workers, who often require a place for uninterrupted concentration. Privacy is especially important for code writing and software engineering. You don't want to hear, "I get my best work done early in the morning before everyone arrives." Finding the right balance between collaborative and solo work spaces is essential to maximizing employee productivity.

Mobile officing via modem and email is another alternative for employees who need an individual work environment. They can get their work done efficiently without appearing in the office until collaborative work or in-person conferencing is required.

A few words of caution: We strongly suggest that you guard against implementing any strategies without testing them and without genuine employee involvement. If poorly executed, productivity and capital investment will be lost, and morale will suffer. The objective is to provide the most efficient setting for both individual and group endeavors. In addition, as part of any new strategy, you should have a sound performance protocol in place to measure before-and-after productivity, a step few companies have taken.

Among the significant changes affecting the work place are a dramatically heightened awareness of work/life concerns. Employees are demanding a reasonable quality of life at work. For many, their corporate teammates become their extended family, which means the workplace has to be conducive to both work and socializing (remember the importance of collaboration!).

All in, these trends lead to a much more balanced working environment (note child care issues mentioned in my column in issue 8). If you have examples of how a good working environment and amenities have led to increased productivity and more, please let me know. [pauls@officelease.com](mailto:pauls@officelease.com)

## SLUMGULLION

SLUMGULLION is a mountain pass at 11,500 feet crossing the Colorado Continental Divide at the source of the Rio Grande River. Trees are stunted, vistas spectacular, and if you are cycling this part of the Union, you become quite focussed on two things: first, how much more oxygen is readily available in Seattle and second, the importance of collaboration. Three friends and I are doing the Bicycle Tour of Colorado at this writing.

At dinner in towns like Ouray, South Fork and Gunnison, we recount the day's adventures: passes climbed and precipitous descents into valleys that qualify as subjects for Northern Pacific Moran commissions; some, in fact, likely were. We discuss the importance of pace lines and their protocol. We understand that the lead

cyclist does 30% more work than those tucked behind, who are also relying on the lead to call out any hazards that he or she can see ahead. We know also that the transition or hand-off of the lead to the next cyclist has to be smooth and well timed, something that comes with practice and with the confidence built of experience with other team members. This is the business of cycling. There are times when you are on your own and your decisions affect only you. Decisions in pace lines, however, affect many others almost instantaneously. Sound like the realities of business management?

Over Fat Tire amber ale, I got to discussing business space issues with two of my team members who happen to have been clients over the years. Both run successful growing businesses that are bursting at their respective seams. We talked about the impact on productivity and morale of splitting operations to accommodate growth. Both are facing this possibility, and both recognize it as a compromise. We agreed that whether facilities can be divided depends largely on the nature of the business. A relatively "flat" organization with a more democratic hierarchy that relies on and encourages "cross pollination" will be less able to tolerate a split, even temporarily, than a more traditional top-down management and decision-making structure.

We discussed the costs and impacts of consolidation and how best to time and implement such events. We also looked at the nature of collaborative work and how many businesses pay lip service to the concept as opposed to truly adopting it.

So as always, I learn from clients and friends, even in the rarified air of Slumgullion Pass. Perhaps, because of a mild and swiftly passing attack of conscience for not being in the office, I consider how to better understand the needs and priorities of space users...when I'm not in a pace line.

## SUBLEASE ISSUES

One of the ironies of our current "landlord's market" is that although facilities cost more, they are also easier to sublease should the need arise. Contraction, merger, outgrowth - all are situations that might trigger the need to sublease. BSR always counsels its clients to consider the market appeal of a space when making facility decisions. This "exit strategy" consideration should include location, accessibility and design. So, unless a space was overpriced to begin with, be cautious of the "bargain" that has been on the market for an unusually long time.

### **Elegant Solutions**

Our real estate environment is tough on emerging companies with indeterminate short-term expansion requirements. One early-stage-financing internet-based company + a more established software company = elegant solution.

CAPTURA's CFO was faced with having to exercise a right-of-first-refusal on more space than they needed. Another client of BSR Ltd. was at a critical growth and financing stage, and, quite correctly, its CFO decided that his company needed an "incubator" space. The last thing shareholders wanted was a long-term space commitment or expensive furniture purchases.

Solution: short- term sublease of space, furniture and data lines!

Within the contexts of a fast changing business environment and a tightening Seattle and Eastside real estate marketplace, we seek to provide clients with practicable real estate counsel. To do this, we need to stay current with general business practices and trends. This requires "cross fertilization" - learning as much as we can from clients' experiences and from other professionals: accountants, attorneys, and strategic planners. Sound business practices in one industry will often effectively apply in another.

A colleague recently sent me a copy of Malaysian industrialist Frank Tsao's "Lessons from the Chinese Tradition." His guiding principles reminded me of the French homily: "Plus ca change etc....i.e., The more things change, the more they (the basic tenets of good business) stay the same."

Some choice extracts from Mr. Tsao's comments (each referring to a Chinese character) apply aptly to good real estate planning and negotiations:

**Ren:** the essence of which is patience and commitment. "Lack of patience will disrupt the best laid plans, and where both are resolutely applied even metal and rock can be broken." *BSR note: ...so it is important to initiate contingency facility planning long before the need becomes critical.*

**Shen:** prudence, critical thinking, careful and realistic planning. "Examine thoroughly, think critically, analyze logically, execute prudently with perseverance." *BSR note: Be sure that you really understand your options and their implications before decisions are called for.*

**Cheng:** interpersonal responsibility, sincerity, personal integrity, and commitment. "Integrity demands that you don't harm others in order to benefit yourself." *BSR note: Leaving blood on the negotiating table seldom works for clients long term...Never mention a fall-back alternative in negotiations unless really willing to resort to it.*

**Qin:** diligence and perseverance. *BSR note: This is especially applicable to client development; i.e., even if you are not hired initially, if you keep coming back and show that you're in it for the long term, you'll get the business eventually (and will form some solid friendships in the process.*

**Jian:** thrift. "Thrift mandates efficient operation and careful husbanding of resources." Also, "The key to prosperity is the ability to survive the next downturn." *BSR note: We encourage clients to consider exit strategies. Is their space readily divisible and subleaseable? We have often negotiated leases that involve a small premium for the option to cancel all or part of the lease at some point during its term.*

**Zhi:** the wisdom to take honest measure of one's own abilities and limits of one's knowledge and expertise. "When walking in the company of three, one of them will certainly have something to teach me." Also, "We have to pay attention to what is unpleasant to the ear." *BSR note: Our role is to provide realistic evaluation of alternatives and, if necessary, to tell clients what they do not want to hear. In addition, other disciplines are part of a well managed negotiation: architectural space planning, project management, real estate law, environmental assessment, etc.*

**Xin:** credibility, which is priceless. "One must prepare for adversity before the world is aware of its coming but wait to partake in prosperity only after the world has tasted prosperity." *BSR note: The transaction is not done until the lease is signed and the tenant has occupancy...for the unwary, Mr. Murphy's law enjoys ringside seats!*

Final note: Although we always have to keep our eyes on the bottom line, our real rewards are contained in a

client's appreciation such as: "BSR really understands the market and provided us with reasonable expectations of what was achievable. They did an outstanding job of negotiating on our behalf without jeopardizing our future working relationship with the building owner."

I hope these Ren to Xin observations accurately embrace the philosophy behind the above-mentioned Chinese characters.

## SYNTHETIC LEASES

**They don't appear on balance sheets, yet they deliver the tax benefits of ownership. They're called synthetic leases, and their positive impact on corporate profitability can be dramatic.** "...the market for synthetic lease structures has exploded," writes Michael L. Evans, National Director, E&Y Kenneth Leventhal, in EYKL/Forum. The reasons, he says, are "recent accounting pronouncements, the movement toward off-balance sheet structures and the never-ending quest for increased earnings..." Users can be counted in just about every American industry, and interest is spreading to Europe and Asia.

### A Definition

In simplest terms, a typical transaction works like this: A corporation needs a new facility (office or industrial building, theater, hospital, etc.). A capital source or lessor buys the real estate from the developer and leases it to the corporate user, who may buy the property at a predetermined price when the lease expires. Looks simple, but it isn't. The lease must meet critical guidelines if it is to deliver its intended advantages. Among these are:

- *Stronger balance sheets:* Balance sheets show neither the leased property nor the associated liability, which results in better financial ratios. Lease payments are reported as current expense.
- *Tax benefits:* Users are considered owners for Federal income tax purposes, which entitles them to take depreciation and to deduct the interest portion of the lease payment.
- *Total control:* Users enjoy the advantages - and disadvantages - of ownership, including potential gain or loss, operational control and responsibility for expenses.
- *Multiple financing opportunities:* Commercial paper, private placements, banks and other funding sources are readily available.
- *Lower occupancy costs:* Corporations that qualify for synthetic leases typically realize substantial long-term savings or find that they can afford a higher-quality property than would be possible with traditional financing.

### History

Synthetic leases were first introduced in the late 1980s but remained relatively unknown until the past few years. Initially, each was virtually one-of-a-kind. Increased popularity, however, has led to more standardized accounting and documentation and, consequently, to lower fees. Today's typical users are large corporations with solid credit ratings, but it seems likely that smaller, financially-sound companies will follow the trend.

### Caution

In spite of glowing reports, synthetic leases are not without certain risks apart from those inherent in any real estate venture. Because this less-traditional financing is complicated and not yet widely used, many real estate and financial professionals don't know all the ins and outs. And if a deal violates any of the very strict accounting criteria, it won't fly. So you would want to consult only experienced real estate, legal and accounting professionals who are experts in synthetic leasing and who can also help you determine whether it will support your company's business strategies and objectives.

We would be happy to discuss synthetic leases or to provide a no-obligation analysis of your real estate needs.

## WHY BIG FIRMS ARE EYEING SMALLER SPACES

Walls and doors are coming down all over corporate America. Corner offices, mahogany desks, and draperies are gone or on the way out. Fewer spaces are enclosed, even for top executives. More than ever, necessity dictates space usage. For many companies, the number of square feet allotted per employee is half of what it was just five short years ago.

What's happening? The major factor is technology, which has spawned the virtual office, hoteling, and instantly adjustable floor plans. Just think for a moment about the influence that computers, modems, fax machines and teleconferencing have had, and it is easy to see why more and more workers are passing up the daily round trip to the traditional office. Instead, they commute to a computer in their homes or to other locations that suit their needs and those of their customers. A second factor is more purely based upon functionality for individuals who continue to work in the office environment.

Cost savings opportunities abound for office managers who periodically evaluate their company's space requirements and continually challenge themselves to see if there is a more efficient way to allocate resources. We're convinced that an annual evaluation is the best way to determine future needs. Office space is a moving target that demands flexibility. Today, floor plan versatility is among the top three considerations that we are asked to investigate.

### **Alcoa Changes From the Top**

One of the most aggressive and successful re-definitions of the workplace is taking place in Pittsburgh. After decades of working in warrens of 12' x 15' offices, Alcoa began reexamining work environments from the top down. The traditional offices in Alcoa's executive suite were removed and all senior executives - including CEO Paul O'Neill -relocated into open cubicles. Staff members gather in a "communications center," equipped with TVs, fax machines, tables, and chairs for on-the-spot meetings.

The improvements in communication and team building have been notable. And, remember, this approach is happening in the executive suite! It will roll out to the entire company when Alcoa's new building is completed.

### **At P&G...Practicality Drives Space Design**

At Procter & Gamble's new facility in suburban Cincinnati, product development needs, not architectural priorities, define the space. Offices are easily reconfigured to add or remove work areas to accommodate changes in team structures. File cabinets are literally on wheels and moved from one location to another as needed, and electronic whiteboards placed around the office help capture new ideas the moment they emerge.

### **Plugging into Maximum Office Productivity**

The laptop and its electronic cousins have made the design, layout, and structural capabilities of office space more logically compact. Of course, the right telephone lines and systems, data ports, and general power sources are indispensable if maximum in-office flexibility is to be achieved. Our experience has shown that too often, these basic requirements are last on the list of leasing considerations if they are ever considered. These things must be right up front. If you assume that they will be part of a leasing package, you could be in for a costly surprise.

### **What Do Employees Think About All This?**

So far, the results have been generally positive. Tearing down traditional hierarchical structures and their architectural legacies has literally picked up the pace of some corporate cultures by improving employee morale. And, lest you get the wrong idea, we're not talking about *cramming* folks into cubbyholes for the sake of the bottom line. No one wins that way. Instead, the focus is on smart, practical work areas that make the most out of office space and resources. Does everyone agree? You can bet that there will be plenty of bumps in

the road...there always are when change occurs.

We encourage our clients to first consider their needs and then think out two and three years. Once they have established where they are and a vision of where they expect to be, we outline a plan, reach a consensus, and begin the lease search process. By the way, part of that process involves understanding your company's culture because what often works from a practicality standpoint on paper simply doesn't match-up with the personalities involved.

## INSURANCE ISSUES

**Your insurance definitely protects your landlord. What it does for you may be another story, as more than a few unsuspecting tenants have discovered after the fact.**

The insurance you're required to buy under the terms of your lease is designed primarily to protect the landlord and the lender so that mortgage payments, taxes and operating expenses get paid if the property is damaged or destroyed.

You, on the other hand, will be out of luck, unless those who negotiated your lease were especially astute. Your coverage could have gaping holes, duplications and gross ambiguities. None of those things matter very much until there's a catastrophe. Then, it's too late.

Few would argue that, at best, insurance is complicated, and policy language usually makes it more so. Combine insurance policies with lease language, and you have a recipe for disaster. Not surprisingly, at a recent conference, corporate real estate executives, staff attorneys and outside counsel agreed that insurance provisions are the least understood components of a lease. In this article, we won't tell you what coverage you need. That depends on the nature of your business, its location, assets and a host of other variables. But we will talk about some of the ways insurance provisions relate to other lease provisions (use, fire and casualty, maintenance and repair, work letter, environmental, indemnification), discuss the basics and make you aware of the more common situations where tenants often believe that they're protected when, in fact, they're not.

### **Best Case = Crystal Clear**

Ideally, everything is spelled out in the lease - how risks are allocated between you and the landlord and what coverage is necessary for both direct (example: fire and other casualty) and indirect (example: business interruption due to fire or casualty losses). As the tenant, you then know the types and costs of insurance for which you're responsible.

Such clarity, however, is rare in standard landlord-oriented leases, even though the tenant ultimately pays for all insurance as part of operating expense pass-throughs.

The lease usually states, for example, that if a fire or some other disaster makes the space unusable, the tenant won't have to pay rent. That's no problem for the landlord, whose expenses will be covered by rent continuation insurance. But what about you? Your company will have to lease other space while the building is being repaired. If the market has tightened, the rate will be higher. What's more, short-term space is usually more expensive. And what about relocation costs - moving in two directions? Without insurance that covers business interruption and extra expenses, you could be digging deep into your own pockets.

### **Fire and Casualty Insurance: The Basics**

You must have fire and casualty insurance, which will pay for damages caused by your company or its employees, but you may be paying for it twice. When the landlord has such coverage, which is passed along to you as an operating expense, your lease should provide that you don't need a separate policy.



Whether the tenant or landlord is responsible for repairs or rebuilding and to what extent should be controlled solely by the fire and casualty provision of the lease. If reconstruction is the landlord's responsibility, your obligation to leave the space at the end of the lease in its original condition should exclude repairing damage resulting from a fire or other casualty.

No matter which side is responsible for rebuilding, the insurance should cover replacement cost, not actual cash value. Among the benefits: Some leases give landlords the right to either rebuild or terminate the lease. They may be inclined toward the latter if the insurance is inadequate. The lease will often exclude a tenant's fixtures, improvements and personal property from the landlord's responsibility. In that case, be sure you have your own coverage.

Other caveats: Many leases don't require the landlord to maintain insurance. (They should.) Others aren't clear about how insurance proceeds are to be used (Some mortgages allow landlords to pay off the mortgage instead of rebuilding.) or who approves the quality and scope of rebuilding.

### **Restoration and Occupancy - Time and Costs**

Unless your lease establishes a timetable for repairs, they can drag on indefinitely. And without provisions to the contrary, you can be required to occupy and pay for whatever space is usable. Working while construction goes on around you and dividing your employees among separate facilities are hardly good for either productivity or morale. So you should be sure, via the terms of your lease, how each situation will play out.

### **Insuring Tenant Improvements**

This is another muddy area. Sometimes the landlord carries the insurance; other times, the tenant. Your interests are best served when the responsibility lies with the landlord and when insurance for both fire and casualty and tenant improvements are under the same policy. For one thing, the rate will probably be lower. For another, there will be no disputes about where the building ends and the improvement begins. And finally, all the work will be done by the same contractors, eliminating another possible area of contention.

### **Liability or Third-Party Insurance: The Basics**

Liability insurance protects your company against claims that it or someone associated with it damaged property or injured people. The coverage includes, for example, medical payments for treating injuries as well as situations such as false arrests, malicious prosecution, slander and libel. Excluded are those related to automobiles, alcohol, hazardous materials and a number of other areas you may not have considered.

In addition, policies vary; they also change from time to time. To be sure where you stand, review your policy with your insurance provider to see if you have the following coverage:

- *Premises/Operations* - protection against bodily injury or property damage based on your use and occupancy of the premises.
- *Broad Form Property Damage Coverage* - expands the above coverage.
- *Independent Contractors Coverage* - covers acts or omissions by your independent contractors.
- *Broad Form Contractual Lease Indemnification Coverage* - covers losses resulting from indemnification provisions of the lease.
- *Personal Injury Liability With Employee and Contractual Exclusions Removed* - covers personal injury of employees and contractual workers by other employees and workers.

You also need to know where you stand relative to the Americans with Disabilities Act (ADA); Y2K-related events; and "sick building syndrome," asbestos and other environmental problems.

### **All Risk Isn't All Risk**

Property and casualty policies used to be called "all risk." They're now called "special form." Whatever the

name, the coverage applies to everything - except the named exclusions, which can be extensive. Some are:

- water-related damage, including floods, sewer backups, mud, etc.
- earthquakes
- costs associated with the enforcement of any law or ordinance, such as the ADA, that requires construction, demolition, condemnation or modifications to a building or site
- boiler and machinery
- wear and tear or lack of maintenance
- utility services
- nuclear hazards
- war and military actions
- computer-related or electronic data processing losses
- interruption of power away from the premises.

You may be vulnerable in some or all of these areas. The first step is to find out which; the second is to eliminate those that aren't relevant to your company; the third is to buy coverage - policy endorsements - to fill in the gaps.

For an overall security blanket, consider an umbrella policy (kicks in when the primary liability policy reaches its limit) or an excess insurance policy (similar to an umbrella policy but can be written for both liability and property losses).

### **Lease-Related Deductibles**

To keep insurance premiums down, landlords often opt for high deductibles. The result benefits tenants initially by lowering pass-through expenses. But there's a hitch. The deductible part of any claim is passed along to tenants unless another arrangement - a cap or operating expense exclusion - is agreed to in the lease. Tenants can also get stuck paying for foundations, outdoor signage and trees, which are typically excluded from insurance coverage. The time to address these and similar concerns is during lease negotiations.

### **What do you do when you lose access to your space or to critical services?**

You may have trouble convincing the landlord, but your lease should specify that if you can't conduct business normally after three days, your rent should cease from the beginning of the disruption until the problem is solved.

Sometimes the problem is chronic rather than sudden. You lose a day of occupancy here and there, or days are interrupted. To deal with this situation, your lease should state that when the same problem prevents you from using the space on five days during a six-month period, you will pay no rent for those days.

That may solve the rent problem, but what about lost revenue and continuing expenses other than rent? The answer is business interruption insurance, which will replace lost income. Your best bet - for several reasons - is to buy that coverage from the same carrier you're using for tenant improvements, fixtures and furniture. The insurer has strong incentive to get you back into operation quickly, and there is no question that your business has been interrupted.

### **Managing Risk Intelligently**

When you're managing corporate real estate, you're managing risk. The way to do it effectively is to work with a real estate adviser, attorney and insurance counselor who understand the relationships between lease provisions and insurance coverage and make sure you get the best of both.

For further information without obligation, or for copies of the original articles, we invite you to call our office.

As always we welcome your comments.

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