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## Leasing Lessons

# In tight market, office tenants need to be smart

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Companies are hiring, vacancy rates are dropping, and we are heading into a market that favors landlords in most of Puget Sound's commercial neighborhoods.

This means fewer alternatives, rising lease rates and dwindling concessions, and the need to work harder to obtain favorable terms.

One constant that trumps all adversity is preparation. Here are eight questions and answers that might help you sidestep common mistakes or misapprehensions about facility negotiations.

Please note that the observations below are summaries, and are not legal interpretations. Each requires greater discussion in greater detail, and as always, an experienced real estate attorney should be retained to interpret and negotiate the actual documents.

1) It takes at least two willing parties for successful negotiations, right?

Unless you have a decent alternative, there is usually little room for negotiations. Tenants need a decent fallback for negotiations to be meaningful and not just formal acceptance of terms presented. So you need at least three willing parties for real negotiations to take place.

2) Does a signed letter of intent obligate the parties to the terms of a transaction?

Washington real estate law requires that a lease or a purchase and sale agreement must be fully executed by both parties to be binding. While a letter of intent should be taken very seriously and, hopefully, would be honored by both parties, there are many opportunities for negotiations to stall out and terms to change in the course of negotiations. Take to heart the true meaning of "good faith negotiations" because the legal definition is the lowest common denominator.

3) Does rent start only when the premises are ready for occupancy?

The answer depends on the wording in your lease. Preferably, lease payments should at a minimum commence upon "beneficial occupancy" (i.e., when you are actually in place and open for business). Sometimes, if the wording of the agreement requires rent

commencement at "the earlier of" a certain fixed period of construction or a particular date, you can end up paying rent on space that you do not yet occupy.

4) Do we pay rent only on floor space that we actually occupy?

Only in certain circumstances does the usable square footage (USF) equal the rentable square footage (RSF). Common areas such as hallways, bathrooms, and lobbies that are pro-rated and apportioned among all building tenants are added to the USF to create the RSF. The difference is known as load factor. The landlords' "gold standard" is the Building Owners and Managers Association (BOMA) measurement. But keep in mind that it is written by landlords for landlords. Load factors tend, therefore, not to decrease.

5) Is a right of first offer the same as an option (to expand)?

A right of first offer requires that a landlord offer a tenant space that becomes available prior to making it available to others. Right of first refusal gives you the first right to lease a space, but only on the same terms and conditions as another bona fide third party (with little room for negotiations). Neither of these is a true option. An option gives a user the absolute right at a certain point in time to lease a space irrespective of third-party interests, but usually at the fair market rate.

6) When a building's roof is replaced, existing tenants do not have to pay for it, right?

Wrong. Unless otherwise actually specified in the lease, the cost of capital improvements made during a lease term, such as a new roof or mechanical systems, may be amortized over the improvement's useful life and the annual cost passed through to the tenants.

7) Do landlords have to honor subleases?

Landlords usually have to approve a sublease. However, should the tenant default, and unless a subtenant actually has a direct agreement in place with the landlord (which few do), the subtenant runs the risk of eviction. Usually sublease rates are well below market, so direct agreement with a landlord would likely involve the rates coming up to market.

8) If I relocate, it will be easy to sublease my space -- especially in a market with low vacancy rates, right?

As a rule, you will lose money subleasing even in a tight market. For the most part, the word "sublease" is somewhat of a "scarlet letter." Would-be subtenants usually will expect substantial discounts. One seldom will find someone looking for exactly the amount of space for the exact remaining term. It's counterintuitive, but one is better off trying to sublease (quality) space for longer (five-plus years) terms than shorter (less than 36 months). Be very realistic about your subleasing prospects and your contractual obligations before being talked into signing a new lease.

Louis Pasteur observed that "Fortune favors a prepared mind."

And so it is with facilities and their negotiations. The better you understand your requirements and the options available, the less likely that the New Year Grinch will ruin your day, or your year.

*PAUL SUZMAN is the founder of OfficeLease, which has been representing tenants and buyers of office space for more than 25 years. Contact him at [pauls@officelease.com](mailto:pauls@officelease.com).*