

WHEN LEASE RATES DROP, LEASE RESTRUCTURES MAY BE A GOOD OPTION

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If you look at the historical data regarding recessions and their effect on office rents, we are headed for a lower point in the cycle. Many corporate space users may be wise to consider this as an opportunity to extend and renew their existing leases at lower rates than they are currently paying. There can be great benefits from early renewals and restructures, and even some landlords, eager to retain tenants, are initiating discussions with existing tenants.

For corporate space users who want to reduce expenses, restructuring an office lease could be the perfect solution. However, before approaching your landlord, make sure you are prepared to argue a good case. First, ask yourself some questions: Do you need flexibility? Is your current space still functional? What are the conditions in your specific submarket? If rents are still heading down, you may want to wait a little longer before trying to restructure an existing lease. A very important factor is your company's future. Can you forecast long-term space needs? In the end, each situation is different based on the tenant's, landlord's and market's conditions.

Is now the time to restructure your lease?

It only makes sense to restructure your lease if good economic results can be attained. Points to consider include: (1) is the space in question a core asset, (2) are you planning any large capital expenditures, (3) would restructuring the lease fit into your overall business objectives and long-term strategic plan. Even if all answers point to a "go", you will still need to convince your landlord to go along with your idea. Start preparing your case so you will have plenty of leverage when the time comes to make your presentation to your landlord.

Find out what's happening in your submarket.

Your landlord knows exactly what is going on in your submarket. Do you? Although your plans may be to extend your lease term where you are, you need to know what the options are in other buildings. In addition, it will help your case if your landlord learns that you are looking at other options. Have rental rates dropped in your market? By how much? Have they gone up? Are vacancies increasing? Have you noticed any new construction of buildings?

What's happening with your building?

If your building is stronger, or weaker, than other buildings in your submarket, it will have an effect on your negotiations and options. For instance, if the building is over 90% leased with most of the tenants in long-term leases (over five years), your odds of winning your case will be reduced. On the other hand, a building with lower occupancy and short-term leases will give you much more leverage in your negotiations.

What's happening with your building's owner?

Is your building owned by a smaller private group or individual, or is it owned by an institutional entity or REIT? Is there a loan on the building? Can you find out when it matures? What is the goal of the ownership: do they prefer to buy and hold for the long-term, or do they prefer to buy and sell after making a few improvements to the building and increasing the occupancy? Knowing the answers to these questions can tell you if now is the right time to approach your landlord.

What is the best method to restructure your lease?

After you know the answers to the previous questions and you want to go forward, you are prepared to start negotiating. Knowing your own company's position, as well as your landlord's position, prepares you to increase your odds of success.

Your knowledge can be powerful

In preparing your approach to your landlord, think about the information you've gathered about your submarket conditions, your building and the ownership. Does your landlord need cash flow to continue ownership? Would he be more interested in the long-term value of his building? Or does he, perhaps, need to refinance the building soon? Then decide how you might be able to match your needs to satisfy his needs.

Play up your good credit and dependability

After the credit crisis of the past year, landlords and lenders are much more sensitive about credit. If you haven't missed a payment with your landlord, you're always on time with payments, and your credit history is strong, make sure you point out that you are a good risk as a long-term tenant and add value when a lender is reviewing the building's rent roll. The value of a building is based on income stream and the quality of tenants. And your landlord is well aware of that.

Approach it from the landlord's financial perspective

Put together an analysis that outlines the income and expenses involved for the landlord if you move out and the space is empty (no cash flow) for several months or longer. Include the cost of having to prepare the space for a new tenant. Some of those costs will include new improvements to the premises, broker commissions, and possibly a few months of free rent. Then add the profits that the landlord will eventually see from the future market rents. Compare that analysis to the cost of restructuring and extending your existing lease, with new market rental rate (which will be lower if all the factors are in effect). Include a minor refurbishment of your space if needed. Your comparison and analysis should demonstrate the landlord's projected losses and profits for both scenarios.

Some of the benefits for you, the tenant, can include: a better economic picture, more money available for expenditures or improvements, newly negotiated lease terms possibly with more flexibility such as termination options, growth and space reduction options for the future. Overall, a lease restructure that is well thought out can be a good change for both sides, improving the long-term building value and locking in cash flow for the landlord while saving money and providing flexibility for you.