by Stephen Cross, CCIM

The 7 C's of Commercial Real Estate

Tips on How to Lease for Less

To test your working knowledge of real estate, take this two-question quiz: 1. Name the three most important considerations when choosing real estate. 2. What price should you pay? If you answered 'Location, Location, Location' and 'Market Rate', our paths have crossed just in time.

This discussion focuses on the 7 C's of commercial real estate; the essential factors business people and corporate decision-makers should consider when selecting and leasing space. Whether you require office, retail, industrial, medical or restaurant space, these insights will increase your awareness of some little known nuances of the commercial leasing process, and help you make better-informed, money-saving decisions.

Choices. You have choices … lots of choices! There are thousands of commercial vacancies represented by hundreds of agents/brokers from dozens of companies. Unfortunately, there's no comprehensive commercial multiple listing service available to the general public. Of those spaces that are advertised, few mention price. That's because the asking prices for similar buildings can vary widely and change frequently. This intentional scarcity of information makes the search for suitable space a time-consuming and frustrating process.

Therefore, in order to get access to the ever-changing inventory of vacant spaces, and guidance throughout the process, you first need to choose an advisor. Query potential candidates as you would when selecting an attorney or accountant, making certain they have significant and verifiable experience in solving your problems. Make it known that you want to be made aware of every suitable space, and under no circumstances will you accept any form of a dual agency; where one agent, or multiple agents from the same company, represent(s) both parties. Because you seek objective, unbiased advice, eliminate any agents/brokers who also list properties, as these agents have inherent conflicts-of-interest and typically steer you to their listings. The search should also include spaces available for sublease, which can generally be leased at discounted rates and for short terms. TIP: Your choice of advisors determines which properties you are shown and how much you will pay.

Concessions. A concession is any deviation from the landlord's asking price, terms, or conditions. Typical concessions include: a lower rental rate, free rent, fixturization time, early occupancy at no charge, tenant improvements, free covered parking, warranty of the air conditioning, free after hours electrical use, building signage, and favorable option rates. The list of concessions is limited only by your advisors experience and creativity, but must be negotiated prior to signing the lease. TIP: Landlords grant concessions because it is in their best interests to do so, which leads us to another C-word: Competition…as in, the greater the competition for your tenancy, the more concessions you can (and should) expect to achieve.

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Condition. There are two ways to look at the condition of buildings: the outside - how the properties are maintained; and the inside – how the spaces are configured. Poorly maintained buildings should carry a significant rental rate discount. Disregard any promises of a building makeover…pay only for what exists today. Changes to office layouts take time and cost money, so focus on spaces that are efficiently configured and provide maximum utility. TIP: New carpet and fresh paint can make an otherwise tired space look, feel and smell terrific.

Contributions. Your goal is to have the landlord pay for all required interior improvements, but not pass these costs on to you. Permanent improvements to a space are capital expenditures, and generally increase the value of commercial properties. TIP: If the desired improvements have reasonable second generation value (meaning they would likely be useful to the next tenant), and the lease term is sufficiently long (3 or more years), the property owner should be expected to recoup its costs over a period that exceeds your lease term.

Comparables. There are no public records containing data (i.e. 'comparables') detailing the price, terms, and/or concessions of commercial lease transactions; making an apples-to-apples comparison impossible. Further, many of the variables unique to leasing are subjective, difficult to quantify, and not readily apparent to the untrained eye.

In addition to asking price, location and condition, factors that can affect the amount you are willing to pay for space in otherwise comparable buildings include the quality and type of existing tenants, your ability to negotiate an exclusive right to operate your type of business, and the availability of building signage. Vacancies should also be considered, because landlords with high vacancies will generally agree to more concessions than those with low vacancies. Evaluate vacancies based on these criteria: the amount of space currently available, how long it has been available, and how much additional space the landlord anticipates becoming available. TIP: Be prepared to ask penetrating questions designed to uncover this closely-guarded information.

Cost. 'Cost' is the amount you actually pay for space, after taking into account all concessions, and is different than 'rate'. There are three types of rate: 'market', 'contract' and 'effective'.

'Market' rate has become synonymous with the landlord's asking price. The term is nothing more than 'realtorspeak' for the amount others have *purportedly* paid. It should not be used as a benchmark for the rate you would be willing to pay because it cannot be independently verified.

'Contract' rate is the amount stated on the lease agreement, and is generally less than market rate. It is a negotiated amount and does not reflect the value of concessions. Because the contract rate is used to establish the value of the property, landlords want it to be as high as possible for as long as possible.

'Effective' rate is the contract rate *less* the value of all concessions. In my experience, when the concessions and considerations mentioned above are properly negotiated, their value can effectively reduce the landlord's asking price by 8% to 36%. TIP: Tenants should focus on obtaining the lowest *overall* cost of occupancy.

Commissions. Real estate transactions typically generate commissions that are shared between the agents representing each party. Even though the property owner writes the commission check, it's the tenant that ultimately pays the tab. TIP: Make certain you receive value from your 'side' of the commission by selecting an experienced, independent, and unbiased representative; someone who works exclusively in your best interests. After all, you're paying for it.

Closing Comments. Whether you overpay, or are able to negotiate favorable terms and conditions depends on your preparation and understanding of the entire process. For the fully-informed, well-represented business person, *it's always a tenant's market.*

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