

Commercial Real Estate

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SOS: Small Office Solutions

Office buildings typically offer space to tenants in increments from 1,000 square feet to full floors, and even an entire building, and for lease terms of three to ten years. But what options are open to small businesses, or businesses of any size that require only an office or two and wish to make short-term commitments? This article focuses on solutions for businesses with small office requirements, including executive suites and several lower cost alternatives.

Office space 101

The unit of measurement for commercial office space is the square foot (SF). Square foot measurements have two subsets: Rentable Square Feet (RSF), which is the area you pay for; and Usable Square Feet (USF), the area to which you have exclusive use. The difference is known as the “load factor,” or “load” of the building, and is comprised of the square footage devoted to common areas, including: hallways, lobbies, stairwells, elevator shafts and the like. The load factor in most office buildings ranges from 12 to 15 percent, meaning you pay for 12 to 15 percent more space than you have the exclusive right to occupy.

In many metropolitan areas, the annual rental rates for commercial office space will run in the high \$20s to the mid \$40s for Class A buildings (high image, premium locations); in the low to mid \$20s for space in Class B (well-maintained, but older) buildings; and in the mid to high teens for Class C (functional, value-priced) buildings. These rates normally include the operating expenses of the building (electrical, janitorial, property taxes, casualty insurance and common area maintenance).

Executive suites

Recognizing that a lot of businesses have short-term needs (as brief as one day, although many seek leases of three months to a year) for space as small as 60 square feet, an entire industry has been created...executive suites. Executive suite offerings range from “virtual offices” and “identity/image packages” (merely a mailing address and telephone answering service) to turn-key office setups, including staffing and amenities found in most offices. The operators of executive suite facilities typically lease large blocks of space; create a functional, multi-office environment; and then sublease small portions to others. They also provide common areas, i.e., hallways, conference rooms, kitchens, and reception areas, which add a second “load” to the cost of the space. In addition, the costs of furniture and receptionist services are passed on to the tenants. These additional pass-through

expenses, plus the operator’s profit margin, are then reflected in the price of the individual spaces.

Locating executive suites

The heading “Executive Suites” is found in many telephone directories, and in most metropolitan areas there are dozens of facilities from which to choose. As buildings and spaces tend to run together during an extended tour, be certain to take notes (and digital photos) and collect marketing materials for later reference.

Service agreements

Some executive suite facilities use a “Service Agreement” instead of a lease contract. I understand this is because they do not consider themselves to be in the real estate business, but are service providers, much like a hotel. *Warning:* This is an important distinction in that tenants signing commercial leases are entitled to a bundle of legal rights not available to “clients” or “guests” of hotels.

Direct costs

Contrary to the industry standard of quoting prices on a per square foot basis, executive suites instead quote prices on a “per suite” or “per office” basis. This has the effect of making direct cost comparisons between executive suites and commercial space difficult. To convert the monthly cost of an executive suite to dollars per square foot, multiply the monthly cost of the suite by 12, and then divide that product by the number of square feet in the suite. The difference between this amount and the price of commercial space is the premium being paid for the convenience of “checking in” to an executive suite.

Based on my recent research, the annualized cost of executive suite space in Class A buildings ranges from \$100 SF to \$200 SF. Suites in Class B and C facilities typically range from \$50 SF to \$150 SF. Prices vary according to the quality of the building and views from the offices. *Reality check:* The cost of executive suite space is typically three to eight times as expensive as typical commercial office space.

Hidden costs

Similar to a hotel, where the cost of essential extras can significantly increase the bill, many executive suites have their own menu of “extras,” such as telephone connections, Internet service, copying and printing charges (up to 15 cents for black-and-white and \$1 for color copies), secretarial services, faxes, call forwarding, kitchen and conference room

use, video conferencing and covered parking. Some even charge a “redecorating” fee. Much like a hotel, rooms with a view carry a premium over interior suites. *Gee whiz moment:* Some executive suite providers assess mandatory charges for mail and telephone forwarding for a period of three months after vacating the premises (at their “standard” rates). Because pricing and amenities vary widely, I suggest confirming what services are included in the basic rate, what services are required (at an additional cost), and the cost of optional services that are important to you.

Renewals

Lease extensions should be negotiated at least three months prior to the expiration of the term. *Caution:* Failure to renegotiate renewal terms in a timely manner may trigger an automatic renewal equal to the original term and at the then-in-effect rental rates.

Read *all* of the fine print. Because the operators of executive suites wish to streamline the decision-making process – *sign here and you can move in tomorrow* –, they typically use the shortest document possible. One agreement I reviewed condensed the equivalent of four (readable) pages of legal terms, conditions, definitions, costs and penalties to a single page of mouseprint (very fine print). I assume the reason they do this is to discourage potential “guests” from reading the agreement thoroughly enough to understand their rights and obligations. *Caution:* Executive suite agreements are binding contracts. Always have them reviewed and explained by a competent attorney before signing.

LOWER COST ALTERNATIVES

Lower-priced alternatives to full-service executive suites include: limited and no-service offices, subleasing from businesses with excess office space, and working from a residence.

Limited service offices

If furniture and the services of a receptionist are not required, consider limited service office space. These facilities are usually smaller than executive suites, although the offices are similarly sized, and many have shared conference rooms and kitchens. Note that while utilities are commonly included in the base price, tenants may be required to arrange and pay for their own telephone, Internet, and janitorial service. They are normally priced midway between traditional office space and executive suites, and are well-suited for businesses that cannot efficiently operate from a residence.

No-service offices

A handful of office buildings have morphed into “no service” business centers, which base their pricing on the number of people that can reasonably operate from the suite (i.e., two to 10 person, multiroom suites). Many feature lush courtyards but typically do not offer common conference rooms or kitchens.

Tenants typically provide their own furniture and pay a base rental rate plus the cost of telephones, Internet service, electricity and janitorial services. Once all costs of occupancy

are considered, their total cost is on par with limited service offices.

Subleasing unneeded space from businesses

If your business needs are flexible, (read: you do not mind moving) consider leasing excess space from a larger company. Many times these office spaces are furnished and offer the use of the conference room and kitchen area. Note that when the space is once again needed, you will be asked to vacate. When available, these spaces are normally priced slightly lower than comparable limited service offices.

Locating value-priced space

Limited and no-service offices, as well as subleasing opportunities, are announced via real estate and window signs that contain the words “limited service space” or “individual offices.” Additionally, many are advertised in business magazines and the classified section of newspapers (both print and Internet versions).

Working from a residence

Operating from the home, or any suitable residence, and renting a conference room from an executive suite as needed, is becoming popular among small businesses, professionals, and satellite offices of large companies. As long as the appropriate telecommunications services, a multifunction copier, and private work area are available, this alternative is by far the most economical. Note that many neighborhoods prohibit commercial uses that increase traffic, so be certain to confirm any restrictions placed on home-based businesses by reading residential zoning ordinances and the CC&Rs of master-planned communities. Many municipalities also require home-based companies to obtain a business license.

Closing comments

Even though office buildings and spaces look pretty much the same, every lease transaction is unique, and is reflective of the tenant’s understanding of the marketplace and negotiating process, as well as the urgency of the various property owners. As with conventional real estate transactions, many of the terms, conditions and costs of the small and short-term office solutions presented above are negotiable. In addition to a discounted rental rate, I suggest negotiating a period of free rent and substantial discounts on all hidden and variable costs. To learn more about the essential factors that tenants should consider when making leasing decisions, please see “*The 7 Cs of Commercial Real Estate*,” available in the Articles section at www.crossrealty.com.

Regardless of your requirements, if your core business is not commercial real estate, I suggest retaining an experienced real estate advisor to conduct the search for suitable space and protect your interests during the negotiation process. Keep in mind that leasing office space is largely a numbers game...and your goal is to get the most for the “leased.”

Stephen Cross owns CROSS Commercial Realty Advisors and counsels business owners, healthcare professionals and corporate decision-makers on ways to acquire or lease property at the lowest cost and most favorable terms. Please contact him at (480) 998-7998 or steve@crossrealty.com.