

TENANT REPRESENTATION BY ADVISORS AND BROKERS

Tenants seeking advice and counsel to represent their interests is on the upswing due to changing market conditions.

by Peter E. Pattison, CRE

Mr. Pattison presents here Chapter 19 of the just released book "The Office Building From Concept to Investment Reality." Published as a joint venture of the Counselors of Real Estate, the Appraisal Institute and the Society of Industrial and Office Realtors Educational Fund, this book presents 43 authors addressing everything from landlord/tenant negotiations, discussed in this article, to the issues of over-built markets, financing difficulties and more. For additional information on this comprehensive book, contact the Counselors of Real Estate, 430 North Michigan Avenue, Chicago, IL 60611, 312.329.8431, Fax: 312.329.8881.

Introduction

This chapter looks at the office building from the perspective of the tenant and his advisors—a viewpoint significantly different from that of the group of real estate professionals who are called upon to maximize the value of the property.

Owners and developers buy or build office buildings and in doing so they take two sizable risks: (1) the control and management of the development process and related costs to completion; and (2) the marketing or leasing risk. Owners take these risks with the expectation of achieving the highest rental rate and best terms possible—the maximum profit.

Office buildings are produced for tenants who need business housing. Next to personnel costs, occupancy costs are the biggest expense most businesses incur. Accordingly, users want to pay the least amount possible and extract the most favorable terms.

Owners are usually highly experienced, having produced office space year in and year out. The tenant, on the other hand, is usually inexperienced since a relocation typically occurs only once in a senior executive's career. This is a compelling reason for most prospective tenants to seek the best possible counsel to help them work through the many pitfalls of leasing or purchasing space.

Tenant Advisors

Because of the complex issues facing prospective tenants, typical large transactions require a comprehensive group of tenant advisors to help the tenant through the myriad of questions, contrary facts, market assessments and programming issues with which he is suddenly confronted. These advisors can be divided into three broad groups:

1. A real estate advisor who may be an open agency broker or a tenant representative. A real estate advisor deals with the lease negotiations and the real estate market.
2. Interior architects, space planners, programmers, engineers and other consultants whose task is to deal with how the tenant functions in the premises and the resulting physical layout.
3. Real estate attorneys.

Real Estate Advisors

The primary advisor for most tenants in their consideration of leasing or purchasing office space is the real estate advisor. In smaller transactions, a real estate advisor is often the only outside help required

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by many firms who rely on building owners for architectural and engineering services and use in-house counsel. For larger transactions a more extensive team is normally required. The remainder of this chapter focuses on larger tenants who need more comprehensive services.

Over the past 45 years the vast majority of tenants have used open agency brokers ("brokers") as real estate advisors. Brokers act as middlemen to bring together a willing buyer and a willing seller. They give advice and counsel to the tenant, but in almost all real estate markets in the United States they are paid by the owner of the office building. A broker gets his authority to offer properties from the owners of properties under consideration. This authority entitles him to offer all properties to the prospective tenant whom he in fact represents. The broker's payment is contingent upon successful completion of a transaction, at which time the broker is paid a commission as the procuring cause. The definition of "procuring cause" is enormously complicated and varies from jurisdiction to jurisdiction, but in general, the broker must produce a tenant and propose terms which may be modified but usually are acceptable to both parties.

At one time, brokerage commission rates were set by local real estate boards, but the U.S. Attorney General stopped this practice in the 1970s. Commission rates now are proposed by brokers and are subject to negotiation. The Attorney General had assumed that an open market would drive rates down, but his ruling has had the opposite effect in markets where brokers determine the success or failure of buildings. Open market brokers set rates where they want and usually prevail because they have become powerful market forces. Their ranks include such legendary figures as Charles F. Noyes, Leon J. Peters, Robert Byrne, Joseph Bernstein, John Dowling and John Cushman.

The Broker's Conflict On Representation

Historically, it has always been paradoxical that tenants' interests were represented by brokers who were paid by the parties they negotiated against. This issue was seldom confronted head on in periods when market pricing and terms did not vary dramatically from building to building. With the rapid escalation and following de-escalation in rental rates and the diversity of lease terms over the past 15 years, however, more and more tenants have engaged brokers or consultants as their advisor to obtain the best representation and to avoid any conflict of interest. Even more serious is the situation where the tenant is not fully informed about how the broker gets paid or the total amount of the proposed commission. It is essential that all parties to a lease transaction identify their allegiances at the outset.

The alternative to the open agency broker is the real estate consultant or tenant representative ("real estate advisor"). Real estate advisors are paid by the prospective tenant—a practice common in other international jurisdictions. This practice was

pioneered in the United States 35 years ago by James D. Landauer, and until the mid-1980s the Landauer firm was the principal tenant advisory group in the country. Other major advisors who followed Landauer were Henry Hart Rice, Peter Pattison (the author), and in recent years, brokers turned tenant representatives such as Julien Studley and John Cushman.

Real estate advisors are compensated in various ways, but usually they are paid an agreed-upon monthly retainer for a stipulated period with a bonus payment upon completion of a successful transaction. Because the bulk of the fee is usually certain and a smaller portion is contingent, compensation tends to be significantly less than a brokerage commission, usually 25%-50% of the customary brokerage fee on large transactions. In the case of smaller transactions the fee is comparable to a commission because most real estate advisors calculate the time and effort involved and price their services accordingly. It often takes as much time to do a 20,000 square foot transaction as it does to do a 100,000 square foot transaction.

While historically brokers have performed the bulk of transactions, since 1980 the number completed by real estate advisors has increased steadily. Today most major transactions are handled by real estate advisors. In addition, investment brokerage firms have started to offer real estate advisory services on a fee basis, and major real estate brokerage firms now offer tenant representation services as an alternative to commission work. It seems likely that the future will see more and more transactions undertaken by real estate advisors, with an increasing number of brokerage firms performing an advisory role.

Qualifications And Experience For Real Estate Advisors

A good real estate advisor must be experienced in the real estate marketplace. This experience begins in many ways—as a canvasser, at a listings desk, in building management, in appraisal. Whatever the genesis, most real estate advisors go through an apprenticeship that centers on exposure to market conditions and negotiating smaller transactions. Getting to know the market is fundamental to giving good advice. Some markets can be learned in a relatively short period of time (6 months to one year), while other markets (major cities such as New York) require many years of experience. Historically, most good real estate advisors begin their careers by cold calling and knocking on doors, talking to potential users, learning about their needs and trying to match them with existing inventory. With persistence, the advisor completes a small transaction, then another. Suddenly the neophyte has a few successes behind him and he is ready for the new challenge of larger space users or more complicated transactions. The path is arduous—20 turndowns for each sympathetic listener or prospective client. However, most successful real estate advisors would not trade this experience for an easier path. Like

military basic training, this experience is hard to get through but can never be replaced.

While there is no better way to become known in the marketplace than by cold calling and knocking on doors, other forms of self promotion can prove valuable. Joining business associations, doing charitable work, attending social gatherings, joining college and school associations all provide a basis for talking about one's work, listening to the problems of others, and perhaps discovering an opportunity to provide real estate advisory services. In the past, making one's experience known was sometimes enough to get a major assignment. However, in most markets today numerous brokers and real estate advisors are competing fiercely for the same assignments and most prospective tenants find themselves overwhelmed by would-be real estate representatives offering similar services.

Getting The Assignment

Thirty-five years ago it was common to acquire assignments at the country club, and being in the right place at the right time was sometimes all that was needed to secure a major assignment. In those days, the difference between a favorable deal or a bad deal was 25¢ to \$1.00 per square foot with a long-term fixed rental rate. Today rents are seldom fixed over a long term, and usually escalate either on a stepped basis or subject to some form of index. Sometimes the difference between an average and a well-negotiated transaction will determine whether a firm can make a profit or remain in business. Numerous firms in recent years have folded because of badly conceived and negotiated office space leases. Proper real estate representation has gotten to be very serious business indeed. No longer are office leases assigned to office managers, to be signed and blessed by senior executives only upon completion. Top management now routinely is involved in major office lease decisions and is instrumental not only in deciding by whom and how they will be represented, but also in the process of negotiating terms.

To obtain an assignment, brokers and real estate advisors must contact the prospective tenants. In large brokerage firms, numerous canvassers and brokers continuously call every logical tenant. Smaller brokerage firms do some canvassing but rely more heavily on networking. Whatever means is used, the real estate advisor can only obtain an assignment when he knows which tenants are in the market. The real estate advisor must tell his story, differentiate himself from the many others seeking the business and explain why he or his firm will achieve the best possible results for the client. If he is persuasive, he has an excellent opportunity to make the short list—usually two to four firms—asked to submit a detailed proposal or make a formal presentation to a real estate committee or senior management. Formal presentations and proposals are a fairly recent phenomenon in the real estate advisory business, and are a further indication that major lease and occupancy commitments are taken seriously at the highest levels of management.

Often the selection of a real estate advisor is based not only on his qualifications, but also on the chemistry between the advisor and the client. Clients hire people with whom they feel comfortable. After the presentation has been made, no feeling is more exhilarating than being asked to return to discuss contract terms. Real estate advisory contracts tend to be short and to the point. They should specify the amount of compensation and terms of payment, termination and a clear description of the tasks required and the tasks not covered in the agreed-upon fee.

Interior Architects, Planners, Engineers And Other Consultants

When a tenant relocates to new premises, he must evaluate his space needs for the present and the future. A relocation is an opportunity for the tenant to evaluate how his business is organized, to analyze work flow, spatial and circulation requirements, adjacencies, communication relationships and proposed project standards, i.e., the size and function of offices and work stations. This work is almost always carried out by an architectural or space design firm, because a relocation to new premises requires constructing a building within a building to the exact specifications of the incoming tenant.

Most space planners work directly with the tenant, although their efforts are closely coordinated with the real estate advisor and the real estate attorney. While the architect is the main advisor in this phase of the work, he is often assisted by mechanical, electrical and structural engineers; construction managers; special consultants for such things as acoustics, lighting and telecommunications; as well as relocation advisors who coordinate the actual physical move. The space planner works closely with the real estate advisor in analyzing the cost of building the tenant's premises and allocating these costs to the owner/developer for a cash payment or customized work letter. This project cost analysis is extremely important, as the capital cost of a relocation can be very expensive.

Real Estate Attorneys

The real estate attorney is usually retained early in the process to give the prospective tenant insight into the legal problems that might emerge and to respond to the lease documents initiated by the owner's attorney. The lease documents should reflect all the terms, issues and agreements of the lease negotiation, and any legal issues that should be settled prior to the final agreement of terms, such as liability, subleasing rights and guarantees. Other clauses such as bankruptcy, condemnation, fire damage and user rights are usually left for negotiation after the first draft of the lease has been submitted.

The Tenant Representation Process

The following section sets forth the process of tenant representation, describing how the various advisors carry out their roles and how these roles are coordinated to achieve the best possible results. For purposes of illustration, the process described is comprehensive. Not all transactions have so many

steps or go into as much detail. It is the role of the real estate advisor to determine the level of service necessary in a specific situation.

Formation Of The Real Estate Advisory Team

The real estate advisory team usually consists of: (1) a senior executive or principal who oversees the assignment and typically engages in the real estate negotiations; (2) a project executive whose principle job is to ensure that all of the required tasks are undertaken, set up meetings and schedule events, and manage the day-to-day tracking of the project; (3) a financial executive who prepares estimates, budgets and long-term projections; and (4) if necessary, a junior associate who carries out market research, conducts tours and performs the small but necessary tasks associated with a major transaction. Outside the real estate advisor's firm, other team members who need to be put in place normally include a programmer/space designer, real estate counsel, engineers, a construction consultant and perhaps a telecommunications consultant.

Programmatic And Structural Issues

The real estate advisor prepares a short list of firms specializing in space programming and design for the client's consideration and review, and screens the firms on the client's behalf. He assists the client in interviewing the candidates and making the final selection.

The advisor prepares, with input from the client, a detailed statement of tasks for the planner. He also prepares a schedule and a set of contractual terms and conditions for the planner's employment. The real estate advisor typically negotiates the contract terms and conditions with the selected planner, and reviews the tasks and timing of the project with him, to make the best use of his involvement and the information he has been hired to develop.

The real estate advisor also meets with the client to gain a full understanding of its strategic and economic objectives. He advises the client on the costs and benefits of the various transaction structures that may realistically be obtained, including a straight lease, a lease with equity, a joint venture, an outright purchase, a lease with cash flow participation, a condominium interest and other alternatives. He then integrates the objectives and expectations expressed by the client into the transaction structures he believes to be achievable, and assists in deciding on the preferred type of transaction to be pursued.

Market Review And Solicitation Process

Upon being retained by the client, the real estate advisor begins to prepare a complete inventory of space available in the market that he believes would meet the client's needs. This compilation includes all existing buildings with the necessary space, sites upon which a building may be developed, and projects that are already under development. For each alternative, he prepares a profile that includes an assessment of the appropriateness of the facility, a review of the owner/developer of the project, a

summary of the terms and conditions being quoted and an assessment of what terms and conditions he believes may be obtained through negotiation.

The real estate advisor reviews each alternative with the client and planner to determine its appropriateness in terms of layout; floor size; clear spans; mechanical, electrical and structural characteristics; ratios of usable, rentable and gross areas; amount of usable and rentable space per person; and other characteristics. He then eliminates those alternatives that are clearly inadequate or deficient in key respects, and develops a short list of options that can be implemented successfully.

Armed with his detailed statement of space needs and criteria and the short list of buildings, sites and projects that may meet the client's requirements, the real estate advisor prepares a detailed memorandum setting forth the economic and strategic terms and conditions he believes will provide a successful solution for the client. This document serves as the basis for a proposed strategy and for the negotiations that are subsequently undertaken.

Financial Projections

The client is provided with detailed financial projections based on the terms stated in the memorandum. The real estate advisor meets with the client and typically makes a formal presentation of the terms and projections he has detailed. After a thorough review and client input, the real estate advisor makes any changes necessary.

For each short-listed alternative, he provides the client with a further refined set of financial projections based on (1) the "asking" terms and conditions set forth by the owner, and (2) the terms and conditions he believes can be achieved. After the client has approved this, the advisor prepares a detailed Request for Proposal (RFP) for the buildings, sites and projects on the short list, setting forth the proposal format, time frame and type of transaction he would like to pursue.

Selection And Negotiation

When proposals have been received from the short-listed parties, the real estate advisor prepares an analysis of the economic and strategic features of each proposal for review with the client. He furnishes the client with long-term (i.e., 20 year) projections of the occupancy costs they may expect to experience under each proposal, including rental expense, escalations for increases in operating expenses and real estate taxes, the cost of amortizing any tenant work not funded by the other party, and the cost of expansions which may reasonably be expected over time. These projections take into account the benefits that may accrue to the client by virtue of any equity, cash flow or other type of participation that may be proposed as a part of each transaction.

Based on this analysis, the real estate advisor then recommends that one or several of the proposals be pursued as a "preferred" option, with one or more backup alternatives. He meets with top management to present his recommendations and

typically is asked to assist in developing an internal consensus and resolve to enter negotiations to implement the selected alternative.

Now the real estate advisor begins the process of negotiation with the selected owner, keeping the client apprised of his progress to ensure that all terms and conditions remain consistent with the client's objectives. As negotiations progress, he furnishes the client with updated financial projections reflecting terms currently under negotiation, together with revised statements of the current status of the transaction terms. He coordinates the negotiations and preparation of budgets with the project team, to ensure that the terms relating to tenant work and other features are handled correctly. He works with the planner to review costs to ensure that these either are dealt with in the transaction or are understood by the client to be part of their expenditures.

As the terms under negotiation begin to converge upon those he believes are acceptable, he begins to prepare a memorandum of understanding among the parties setting forth the precise terms and conditions that will subsequently be committed to documentation. This memorandum is carefully reviewed by the client and serves as the focus of negotiations by the parties as the transaction nears resolution.

When an agreement has been reached, the real estate advisor arranges for the detailed memorandum of terms and conditions to be signed by all parties or transcribed into a letter of intent if required by counsel. As documentation proceeds, he works with the client and its counsel to resolve any issues that arise and ensure that the documents accurately reflect the bargain struck during negotiation.

Implementation

With the signing of the lease documents, responsibility for the project implementation shifts to the owner and the other advisors. The real estate advisor continues to be available to the client to ensure that the other parties live up to the terms and schedules that were negotiated. Often he is asked by his clients to attend project meetings, review budgets, change orders, and other project memoranda, and counsel them throughout the implementation process. Typically, his involvement continues through the move into the completed space and a review of the initial cycle of rental escalation billings.

Principal Issues For Negotiation

Terms and conditions vary from transaction to transaction, but the main elements in contention between the landlord and the tenant are:

1. Rent
2. Area to be leased
3. Lease term
4. Provision for increases in operating expenses and real estate taxes (escalation clauses)
5. Amount of cash or construction items that the landlord will provide to the tenant

6. Strategic rights to increase or decrease space, to cancel or extend the lease term, and to sublet
7. Other inducements which may be offered by, or extracted from, the landlord
8. Liability issues

Rent

The annual rental rate is typically quoted in dollars per square foot multiplied by the rentable area of the premises. This rate is usually expressed in dollars per annum, but in some cities it is quoted as dollars per month. Rates historically have been quoted in gross dollars, that is, the rate includes base operating expenses and an agreed-upon real estate tax base. However, in larger leases rates are often quoted in net dollars, with each tenant paying his proportionate share of operating costs and taxes.

From the end of World War II to the mid 1970s, most rental rates were fixed over a long term of 15 to 20 years. This worked well in a period of low inflation, but the high inflation rates of the late 1960s and the 1970s led most owners and landlords to fix rates for shorter periods and to increase them at programmed intervals, e.g., in years 5, 10 and 15 of a long-term lease. Today, landlords attempt to provide for an increase in rental rates in year 10 or 15 of the lease to the greater of current rents as escalated or fair market value. However, tenants often resist this, preferring to have known rates and to take advantage of favorable market conditions. Rates are the primary point of negotiation because most tenants use rates as a measure to compare their lease transaction to those of friends and competitors. Consequently, many landlords, while trying to achieve higher total dollar rents, artificially "push" rates down by adjusting the rentable area of the premises.

Rentable Area

The aggregate total rent is calculated by multiplying the dollar rate by the rentable area. Measurement techniques have therefore become extremely important as owners and landlords have "grown" buildings dramatically over the last 15 years.

Perhaps the only space measurement in an office building universally agreed upon is the gross floor area, which is obtained by measuring from the outer dimensions of the building with no deductions. Before World War II office building rentable area was defined as the area inside a tenant's demised premises, but after World War II, with the evolution of the modern office building, rentable areas were calculated by measuring the gross area, deducting vertical penetrations and then adding back a proportionate share of common facilities such as air conditioning and electrical rooms. This technique is still recommended by the Building Owners and Managers Association International (BOMA), but many cities prefer instead to use "add on" factors. This number is obtained by calculating gross floor area, deducting elevators and stairways to get the usable area of the floor and then multiplying that number by a common area factor of 1.15 to 1.25. For example, a gross floor area is 200 x 200 or 40,000 square feet. From this is deducted elevators, stairs, risers and

ducts having a total of 3,000 square feet, so the usable area is 37,000 square feet. This number is then multiplied by a factor of 1.25 to obtain a rentable area of 46,250 square feet. Measuring techniques and the definition of rentable area have become a major point of contention in many lease negotiations.

Area To Be Leased

The size, shape and location in the building of a tenant's premises all are subject to landlord/tenant negotiation. In most high-rise buildings landlords command a premium rental rate for upper floors. The tenant's principal concern is to lease space that works well for his operation and proposed tenant installation. Tenants also want the best views, adjacent to elevators and contiguous floors. On the other hand, the landlord's concern is to be certain that any space in the building not leased by the tenant is still marketable at projected rental rates.

Lease Term

Most leases vary in duration from 5 years on a short-term lease to 25 years on a long-term lease. The ideal lease for a landlord is long term with periodic increases at fixed rates or adjustments to market. American tenants have resisted these one-way adjustments, favoring leases with fixed rates and the right to cancel at year 10 or 15 for an agreed-upon penalty payment. Smaller leases usually run for shorter terms and have no cancellation rights. The length of the lease has a strong influence on the amount of capital dollars contributed by the landlord; shorter leases have a smaller contribution because of the abbreviated amortization period.

Escalation Clauses

Virtually all leases contain provisions for increases in operating expenses and real estate taxes known as escalation clauses. In addition, landlords in favorable markets often want to include a Consumer Price Index (CPI) or other index, or a portion of the index, to further adjust rates upward so that the capital portion of rent is not diluted. Capital indexing has never been fully accepted by most American tenants and CPI clauses tend to appear and disappear in leases depending on market conditions. Real estate advisors are often able to eliminate CPI clauses, but never escalation clauses. It is the real estate advisor's task to see that these clauses are fairly and properly drawn.

Operating expense escalation clauses are calculated in one of two ways: (1) actual operating expense increases, or (2) increases in accordance with an index, usually the Porters' Wage. A properly drawn actual operating expense clause requires careful definition of expenses that can be included and expenses that are excluded such as leasing costs, capital improvements and executive salaries.

Porters' Wage clauses originated in New York and were common 10 to 15 years ago, but they have become increasingly controversial and are not generally used throughout the country. When the clause was first conceived in the early 1950s, porters'

average hourly wage was basically the same as the cost to operate the building expressed in dollars per square foot. A penny for penny increase was fair and generally was accepted by tenants. With the passage of time, however, landlords used this clause as a hidden profit center by increasing the 1¢ for 1¢ to 1¢ for 1.5¢ or 1¢ for 2¢. In addition, in New York City the Porters' Wage (including fringes) is more than double the average operating cost of a building, resulting in distorted increases favoring landlords. In addition, some landlords have made extremely aggressive assumptions regarding the calculation of fringe benefits included in the Porters' Wage index. Therefore, an appropriate lease clause should specify the method used to calculate these benefits. Most well-represented tenants insist on an actual operating expense clause or an index that is equitable.

The tenant must be concerned about two important issues in real estate tax clauses: (1) to be certain that the base year is a full assessment, and (2) to avoid dramatic increases in taxes if the building is sold during the term of the lease. Many municipalities give partial assessments during a building's lease-up period. The first year of a lease term, therefore, is not necessarily an appropriate tax year on which to base increases. The resolution of this problem is complex and often very technical, but well-negotiated leases place the burden of a stable base year on the landlord and not the tenant. In addition, tenants have to protect themselves if major improvements are performed during the lease term, or sale of the building or another capital event precipitates a large increase in taxes. This has become one of the most contentious areas in lease negotiations.

Construction

Landlords typically finish the base building including the core area on tenant floors with electrical and mechanical systems ready for distribution in the tenant area. The balance of the floor is left unfinished so it can be customized for each tenant in accordance with the tenant's plans. Most leases provide for the landlord to do a certain amount of tenant work (workletter) or to make a cash contribution toward work undertaken by the tenant. In new projects, the amount of the contribution usually covers the bulk of the work. Workletters provide for partitioning, doors, floors, ceilings, lighting fixtures, HVAC and electrical distribution, telephone and electrical outlets, and miscellaneous other items such as structural reinforcing and stairwells.

The value of the workletter or the cash allowance fluctuates dramatically—from \$15 to \$100 per square foot depending on market conditions and such variables as the condition of the space, the rental rate, the length of the lease term and the strength of each party's negotiating position. Negotiation for workletters is therefore a complex undertaking and requires the real estate advisor and the space planner to be fully familiar with costs, different operating systems and the pros and cons of different building standard materials and systems. It is also invaluable to the tenant for his advisors to

have expertise in the construction process so they can set up controls for cost, quality and schedule.

If the landlord undertakes the buildout work in accordance with a workletter, he is responsible for completing the work on a timely basis. The lease term commences upon completion of the work. If the tenant accepts a cash allowance instead, it is necessary to negotiate how long he has to complete the work before rent commences. This is almost always a contentious part of the negotiations, as the landlord wants the construction period to be as short as possible while the tenant wants it to be as long as necessary to complete the work. Nothing is more unpopular to a tenant than paying rent before beneficial occupancy. Other issues surrounding tenant work are the approval of plans and alterations, the tenant's right to select his own contractor, and use of building systems such as construction lifts, rubbish removal and temporary electricity. Failure to address these issues can be very costly to the tenant.

Strategic Rights Concerning Space Needs

Long-term planning in most companies is based on 3-to-5-year projections while leases run for 10 to 20 years. Most prospective tenants, therefore, have enormous difficulty assessing their needs over a lease term. Strategic rights to add space or decrease space, to extend or cancel lease terms are often critical to allow tenants the flexibility they need to deal with future uncertainty. While rights to add or modify space commitments give flexibility to tenants, they are major hindrances to landlord leasing programs, and are highly controversial and hard fought. Nevertheless, rights to acquire additional space during the term of the lease or to modify commitments are usually obtained by tenants taking more than one floor or occupying more than 40,000 square feet of space. If the landlord is forced to provide such options, the agreement is usually subject to constraints on the amount of space, timing and flexibility. It is usually not difficult for a tenant to secure the right to extend or renew a lease at fair market value. The right to cancel is more difficult to obtain and is usually subject to significant penalty payments.

Equally important issues are the rights to sublease or assign the lease. The right to sublease is strategically important to tenants while its limitation can be enormously valuable to landlords. It is always best to confront the issue and work out an arrangement that is satisfactory to both parties. Other strategic rights include the ability to name the building, the right to appropriate signage and the right to restrict other tenancies that the tenant deems not to be in its best interest.

Other Inducements

Equity

When a prospective tenant would be the major occupant in a property, it is not uncommon for the landlord to make a portion of the equity or cash flow available to the tenant. Landlords always ask that a tenant pay for an equity position, but under certain

market conditions an equity position may be obtained at no cost. There are no fixed rules as to the amount or nature of tenant participation, but one common formula is to grant the tenant 1% of the equity for each 2% of the space it has under lease.

Rent Abatement

Another inducement for tenants is a rental abatement at the commencement of a long-term lease. This is in addition to the period of free rent meant to cover the construction of the tenant's premises. A common procedure in soft markets is for the landlord to maintain the asking rents while granting generous free rent periods at the beginning of the term. This feature is often treacherous for tenants who take the short-term benefit but find themselves saddled with non-competitive rents in the later years of the lease. This situation is referred to as "mortgaging" a firm's future. Recent changes in accounting rules have discouraged this practice.

Liability Issues

Liability issues include personal and corporate guarantees, condemnation, fire damage, inability to perform, defaults and so on. All issues in a lease have an economic impact and should be assessed on this basis. However, liability issues are generally negotiated by counsels for the landlord and the tenant.

This brief summary is not meant to be an all-inclusive list of key issues in a landlord/tenant negotiation. It does, however, highlight some of the main issues vital to the tenant's welfare that must be addressed if the tenant is to be properly represented.

Conclusion

The theme of this chapter has been to demonstrate that the interests of tenants in office buildings are usually very different from the interests of the building owners. The battle to gain strategic advantage with respect to rent and other lease terms is continual. This diversity of interests and rapidly changing market conditions have created a situation in which more tenants are seeking the best possible real estate advice and counsel. They are no longer willing to settle for representation by the building agent or a broker who may not achieve the best possible terms for them. More and more over time tenant representation will become a separate discipline. Agents will represent owners, tenant representatives will represent tenants, and both will be paid by their respective clients. In this next decade, real estate firms will have to confront this issue and adjust accordingly.