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Nature Abhors a Vacuum— And So Do Landlords:

What It Takes To Get a Deal Done and Avoid Vacancies in Today's Market

Steve Lewis is the President of Wordman Inc., a marketing and public relations firm in Atlanta, Georgia. He served as Editor of the National Real Estate Investor *for eight years. He was also the Real Estate Editor of* Business Atlanta *and the Editorial Director of the real estate group of publications at Communications Channels Inc., which includes* Southeast Real Estate News, Southwest Real Estate News, *and* Shopping Center World. *His firm represents developers and contractors in the Atlanta area, and he continues to write freelance articles about the real estate industry.*

By Steve Lewis

Editor's note: *This article is the second in a two-part series on making deals in a tough market. In the first article, Steve discussed how important it is for tenants and landlords to have realistic expectations, and the responsibility of SIORs to present their clients with a candid description of their options. In this installment, he'll be taking a closer look at the concessions that are being required and how some actual deals were put together.*

Andrew S. Jaffe, SIOR, Vice President of Commercial Properties, Inc., in Tempe, Arizona, probably speaks for most of his colleagues in describing what it takes to get a deal done these days. "Landlords are cutting substantial deals on a short-term basis," he says. "They're looking to survive the market and to keep their product full. They can just about keep their heads above water if they can pay their debt service."

More specifically, Jaffe continues, major concessions are being made—and not only in terms of rent. "I knew of one tenant who got a year's free rent on renewal, a $100,000 Tenant Improvement (TI) allowance, and base rent reduced by $3.00 a square foot—and we're only talking about 10,000 square feet of space—and he got a five-year deal!" he reports.

Industrial tenants are getting "huge" concessions—rent reductions of 10 to 20 percent and additional TIs, Jaffe says, "and if the tenant has a lot of stability, the landlord will sign longer deals."

Restructuring Leases

Stan Kurzweil, SIOR, Senior Vice President of Colliers Houston & Co. in Somerset, New Jersey, says he's seen a lot of restructured tenant leases. For example, he explains, "The landlord may want the office tenant to extend a lease on which they have two or three years remaining. Say the tenant has 40,000 square feet. He may respond by saying he'd really like to reduce the amount of space, have the landlord do some work for him, and give him a reduction in rent."

A tough landlord, he says, might tell the office tenant where to go—if he has another tenant waiting to take that space. "But smart landlords are trying to renew the tenants they have," Kurzweil says. "What tenants are trying to do is take a shorter-term commitment because they don't know what will happen with the economy; at the same time, the landlord is trying to have them renew early so he can get financing. It's a push-and-pull situation."

Giving Sweeter and Sweeter Deals to Tenants

What kinds of numbers are required to make deals work? "If a tenant occupies 50 percent of a 100,000-square-foot office building, for example, the landlord may give the tenant two to six months free rent to be applied to the reduction of current rent and during the new lease term," Kurzweil says. In another scenario, a 40,000-square-foot tenant may want to reduce his space to 30,000 square feet. In that case, the landlord may say he wants the tenant to renew for another three years. In exchange, the tenant may ask the landlord to reduce the rent $5 a square foot and do additional work for him.

Things are not much different in Rosemont, Illinois, where **David L. Liebman, SIOR, JD,** is a Senior Associate with Colliers Bennett & Kahnweiler, Inc. "We're seeing pretty remarkable leasing proposals by landlords," he says. "One that I represented in two lease proposals in the last 10 days tried to undercut the market with an asking rate of almost 30 percent off the typical asking lease rate." In the end, he says, total concessions ended up being "about 40 percent off."

"We do some creative things," Liebman continues, "Say you're leasing 125,000 square feet of space. We might quote it as if it were 100,000 square feet, so you're effectively 30 percent below the face rate—and at least a month net per year."

"The market is really depressed, adds **Tim R. Ruffin, SIOR, CCIM,** Managing Partner and Senior Vice President with Colliers International in Reno, Nevada. "Rents are probably down 20 percent from their high, and values are probably down 30 percent." Tenants, he says, "get everything but the kitchen sink—lower base rent, free rent, and higher TIs. Virtually all deals are turnkey. If the landlord can afford to do it, we say make the deal—assuming it stems the bleeding. If it's really, really aggressive, we'll make it a short-term deal so we can renegotiate later since we will have a tenant in place."

James J. Stanulis, SIOR, a Principal at Colliers Dow & Condon in Hartford, Connecticut, has been involved in some recent negotiations that demonstrate what it takes to get deals done in this market. "I represented a professional association on a CBD lease," he recalls. "They were considering two Class-A towers and one Class-B mid-rise. Turnkey proposals ranged from six to 10 months of free rent on five- to seven-year deals. The effective rates were $3.00 per square foot below market."

In a second deal, he represented a 10,000-square-foot national organization in a renewal and possible suburban relocation. The tenant was offered six to 10 months of free rent on five- to seven-year terms and $25-$30 per square foot in TIs. "The effective rates are $2.00 to $4.00 below market," Stanulis says.

In a third deal, he represented a 5,000-square-foot tenant in an "on time" renewal in a Class-B CBD building. "They were paying a $15 rate with current pass-throughs," he reports. "We got a new base year and a rate reduction of $4.00 for a three-year renewal—and carpet shampoo."

Leading the Market Down

"I have a client who provides a budgeting program you use with a PDA," adds **Gregory M. Gunn, SIOR,** Senior Vice President at Coldwell Banker Commercial NRT in Salt Lake City, Utah. "They had a business downturn and had just added 3,000 square feet onto their space six months ago. They subsequently asked me to sublease the space."

Gunn, who is now in his fourth recession, told his client that they had to "lead the market down." If the market gets worse, he explains "You don't want to get caught trying to sublease your space at a higher rental rate than others. In that case, the market will pass you by and leave you holding empty space while others are subleasing their space. You're better off to start out offering the most concessions and sublease your space first, allowing the rest of the market to follow you down. If you wait or are tentative about reducing your rate, you'll end up having to match the lower rate anyway and in the end, the result is a greater financial loss because you carried the space vacant much longer. "We discounted the rate by 30 percent, but we were able to sublease the space in 60 days," Gunn reports. Conversely, I had another tenant who refused to take my advice and the space was still vacant four months later."

Working with Good—but Worried—Tenants

Jeffrey J. Milaniak, President of Heller Industrial Parks, Inc., in Edison, New Jersey, and an SIOR Developer Associate, recognizes how tough times are for tenants and will work with them whenever possible. Of course, his company is "very under-leveraged," with only 33 percent of its rent roll going to cover debt service. That gives him a little more flexibility than most landlords, but he is genuinely concerned about his tenants. "When they are honest and work with us, we bend over backwards," he says. "It's better to have them in the building."

Milaniak says he has 15 or so of these situations in various stages of restructuring, "and we have found that middle ground for each one." Most tenants, he says, are looking for a relief period of six to nine months. "The opportunistic ones want a flat restructure for as long as they can get it; the serious ones say they want a six- to nine-month window to get them toward the end of the year. We tell them that that's fine; let's sit down again in six to nine months and see where things are going."

Milaniak says he has also been able to restructure captures over the end of terms and to extend terms as well. "Requests have been all across the board—from free rent to reduced rent," he says. "We can't go to zero, so we do rent reductions in varying amounts—say, 10 or 20 percent."

A vacancy, Milaniak explains, is not only lack of income—it's an *expense*. "If a space becomes empty, re-renting it would be harder because the number of customers out looking for space is down dramatically," he says.