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# The Riddle Report



## Allow Subleasing For Commercial Tenants

In some office building markets throughout the country, some existing tenants have sought to sublease some or all of their rented space as they shrink operations or eliminate locations. The problem for landlords is whether it is a better strategy to enforce lease restrictions against subleasing or to work with tenants on the theory that the sooner cheap sublease space is filled, the better for all. (In addition, another problem could be whether landlords should insist on sublease restrictions in new leases being negotiated now.)

### The Restrictions

If there is no provision against the sublease in the original lease, the tenant has the right to assign or sublease without the owner’s consent or approval. However, most leases do contain this provision. In previous decades, when rents were at high levels, tenants could obtain the landlord’s consent only if no other space was available in the building, and even then, the landlord might have insisted on sharing in any profit realized on the sublease. (In those days, subrent was often higher than the prime rent.)

Tenants are interested in cutting costs of unused space and are often willing to accept current market rents, something landlords are reluctant to do for prime space.

### Negotiation and Cooperation

Although the building owner may take the position that no consent will be given

to a sublease as long as prime space is available in the building, the tenant may make some good arguments for cooperation.

First, when there is much space available all around, a tenant looking for space can find it easily. A landlord is better off having a tenant in possession, even with a sublease, because the tenant may stay when the sublease expires.

Second, the landlord takes the risk that a prime tenant with much excess space may default under the lease either by being forced out of business or because the tenant is willing to risk a lawsuit to collect unpaid rent. By being cooperative in finding a subtenant, the landlord reduces the risk of a default by the prime tenant and has the additional security of the subtenant’s rent payments (even though the amount may be less than the prime rent).

Perhaps most important, the landlord may gain the reputation for good tenant relationships that can help in the competitive years ahead. Helping the tenant to shed excess space can pay off when the tenant considers renewal of the present lease. Landlords who are known for taking a reasonable approach to tenant problems, both during and after lease negotiations, are bound to have an edge when a tenant must make a choice between very similar rental space in different buildings. □

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This publication is not a solicitation but is an information service from this office.

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When ideas in tax and other legal areas in this publication seem to fit your situation, it is recommended that you discuss them with your professional advisor before taking action.

## Lease Clauses For Protection Of Confidential Information

Typically, a landlord has access to leased premises at all times for purposes of making repairs and inspections. But in today's information age, many tenants have valuable trade secrets, confidential information, and unique documentation in tapes, CDs, DVDs, listings, and other intellectual property that should not be accessible to the landlord.

A software company tenant, for example, should try to obtain the right in the lease to maintain locked documentation rooms where even the landlord's janitorial and maintenance people have no access and the landlord is given no copies of keys, pass cards, or cipher lock combinations to the additional locks installed by the tenant on the documentation room door.

### Lease Provisions

One legal expert suggested the possibility of lease provisions that software companies can use to protect against any access to trade secrets and confidential information. The following lease provisions might be negotiated:

#### Locked Documentation Rooms

Notwithstanding any other provisions of this lease to the contrary, Tenant shall be permitted to designate certain portions of the Premises as safe or confidential areas, to be known as Locked Documentation Rooms, to which Landlord shall have no access,

unless accompanied by Tenant's authorized representatives. Landlord, when so accompanied by Tenant's representative shall have the right to inspect any Locked Documentation Rooms during the Tenant's normal business hours after giving Tenant reasonable prior notice requesting such an inspection. Landlord shall not be responsible for providing Janitorial services with respect to any Locked Documentation Room. Landlord shall not receive copies of keys, pass cards or cipher lock combinations to Locked Documentation Rooms.

#### Cipher Locks and Security System

Tenant shall be permitted to install (and substitute any existing locks) on interior premises doors with combination or cipher locks. Tenant shall also be permitted to install electronic security systems in the premises, including, but not limited to, pass card door lock systems and camera surveillance systems, subject to compliance with all applicable building and fire codes.

#### Landlord's Nondisclosure

The tenant should also insert in the lease a confidentiality/nondisclosure provision which prohibits the landlord from disclosing confidential information and/or trade secrets of the tenant to which the landlord may have gained access when exercising its rights under the lease. □

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## Searching For Commercial Tenants

At all times, good or bad, we must aggressively search for replacement tenants. A month's rent from a vacant unit can never be recovered. Just running expensive advertising for this space can be nonproductive. A better way might be to have a professional management company that keeps all local brokers who specialize in leasing informed of the advantages and amenities of the building.

Here are some other ideas:

- Make sure the management company you choose is experienced and professional. They must know the building intimately and be able to communicate and show the benefits and amenities to potential tenants with enthusiasm. A truly professional company will manage the building as exclusively as if this building was the only property they manage.
- Don't scare away potential tenants with marketing gimmicks like free rent. This kind of offer can give

the tenant a negative impression and start him/her looking for the things that must be wrong with the building. The professional approach is to stress the positive features of a building and work with potential tenants to match the criteria the tenant feels are most important to him.

- First impressions are most important. The outside of the building and landscaping must be perfect. Don't make the mistake of many owners who cut the landscaping budget to save money. This is the worst place to save.
- A good management company will look over your property for any deferred maintenance, and advise you about problems that need to be corrected. They will advertise and publicize vacant space through the proper media and in cooperation with other brokers. We are here to help enhance your property and its value. Please give us a call. □

## Commercial Condominiums

Like apartment dwellers who are finding that it is less expensive to buy than to rent, business and professional firms are moving toward buying offices rather than leasing. While buying or constructing an entire building is an option for major corporations or for smaller firms outside metropolitan areas, owning commercial space generally means being part of a condominium structure.

Small office buildings are the most common type of commercial condominiums. The strongest demand for this type of space is from lawyers, doctors, advertising firms and other professional and service companies, as well as small private corporations. These firms often accumulate capital not needed in their business, and their occupancy of a particular location can have value to them in the form of goodwill so that they are interested in controlling the space.

From a financial point of view, the basic appeal of commercial condos space is that over the long run, owning can be considerably less expensive than leasing. While rents may be low in the current market, renewals over the years are likely to mean rent increases. By comparison, mortgage financing is now available at relatively low fixed interest rates for terms of ten years or more. In addition, well-located and well-maintained space can appreciate significantly over the period of ownership.

Tax considerations are less favorable for owners as compared to tenants. A tenant can deduct 100 percent of rent payments as a business expense. A condominium owner can deduct only the interest on a mortgage loan, as well as depreciation (using a 39-year life). While the tax benefit of leasing may be slightly better than those from owning, the likelihood of appreciation of value should more than offset the difference.

A further advantage of condo ownership is that it eliminates undesirable provisions that may be in a lease. For example, a landlord may have the right to relocate the tenant if a major tenant requires more space. Using an office at night

or on weekends may require the tenant to pay for utilities and services. In general, small tenants have little negotiating power when negotiating a commercial lease.

### Management Concerns

Like a residential property, a commercial condominium is managed by a board of directors made up of unit owners. Certain matters may require approval of a majority of owners, thus assuring each owner a say in any decisions affecting the building. Often the condominium charter gives the board a right of first refusal when a unit is offered for sale. In this way, control over the type of building occupants can be maintained. This arrangement frequently prevails when all occupants of the building are in the same or a related business or profession.

### Changing Needs In Space

A frequent concern of small business or professional owners is that space requirements may change at some time in the future. In a rental building, where turnover is likely to exceed that in a condominium, a tenant is more likely to be able to adjust its space requirements. In the case of a condominium, an owner anticipating a future need for more space can buy a larger space initially and lease it short-term until required (assuming leasing is permitted). However, it may be more difficult to obtain additional space if needed.

### Cooperative Office Buildings

Cooperative office buildings became feasible only after a 1986 tax law permitted business corporations to qualify as "tenant-stockholders" eligible to deduct taxes and interest payments.

One major difference between a cooperative and a condominium is that a co-op board of directors has the right to disapprove a proposed buyer, whereas a condo board only has a right of first refusal. Thus, cooperative ownership gives greater assurance that tenants will occupy a building in a similar business or in related lines of business, if that is the intention of the owners. □

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## Quick Profits Around New Hospital

What happens to nearby property values when a new hospital is built? Usually the surrounding area feels a ripple effect. Land values increase. Developers are quick to provide new space for offices and stores. The biggest profits are realized by the investors who get involved early (during the planning stages) before or while the hospital is built.

In one location in the Southeast, as a new hospital went up, the area around it began to pop its economic seams. Among the new activities that created an abnormal demand on land located near the hospital were:

- Physicians offices.
- Walk-in clinics.
- Medical supply companies.
- Residential apartments for hospital employees.

- Fast food outlets.
- Day Care centers.
- Long-term care facilities

A few decades ago when doctors regularly made house calls, hospitals were isolated structures and viewed as "places to rest". Now, however, doctors prefer to locate their offices near the hospital. The whole area begins to boom with ancillary services that are both directly and indirectly related to health.

There is often a need to expand the medical facilities at existing hospitals to handle a growing population and larger numbers of senior citizens. Land prices can soar when the hospital decides to buy nearby land for expansion. Watch for it, the alert investor can again have an opportunity for profits. □

## Are These Items In Your Leases

The following is a useful list of items that should be clarified between the parties in the lease of a commercial building:

1. What is the amount of usable space? Since the rent may be based on a square foot rate, the rate may be quoted on a rentable or a usable area. Rentable space means the actual office area, plus a proportionate share of facilities and corridors that service the floor on which the office is located. This concept is used in most buildings. Usable space is the actual space located within the walls of the office and excludes any part of the service facilities.
2. Who pays the broker's commission? Maybe the broker has been working for the tenant, but the fee is usually paid by the lessor. Often the lessor has hired the broker to represent him in the negotiation. The lease should reflect the obligation and who will pay it.

3. On what basis is electric current or other utilities paid? The tenant usually will pay for his own utilities. However, it can be computed in two different ways. It could be a flat rate added to the rent. Sometimes, each office is provided with its own meter and charged only for the actual consumption of the utilities.
4. What services will be provided? There are a number of services in a building. There may be elevator service, air conditioning, restroom maintenance, parking that is available to tenants or will be rented. The tenant's right to use these services and the limitations should be spelled out.
5. Is there a "most-favored tenant" clause? If a tenant moves into a new building that is only partially filled, he may demand a clause in the lease that will give him the benefits of any rental concessions that the landlord may subsequently make in order to obtain tenants. □

## Help With Investment Real Estate

When you have searched for new real estate investment opportunities, with values that have been changing, you know that finding and evaluating them is becoming more sophisticated and complex. More investors are turning to real estate consultants as a means of providing a sounding board for their ideas as well as expertise in the planning and construction stages for their projects.

Today's investor in real estate must have a grasp of market conditions and potential that is usually beyond their own available time to attain. Investors need assurance about the true condition of the market. With increased competition, the market place is becoming more complicated.

Feasibility studies are essential for commercial office, industrial, resort and hotel investors. With this kind of

information, planning is better and there is less chance for error.

Real estate investing is not just looking for the structure and the land. It is investing in the type of property that you want at the price and terms that suit you at the time you want to make the purchase.

Our office is open and ready to assist you. We have been experts in property values in this area for a long time. We can help you with enough information so that you can make your own decisions on the value of property either in listing your present property for sale or in purchase of another. If you wish to consider structuring a tax-deferred exchange into that next property, we can guide and aid you with that transaction.

Let us guide you in your investments. □



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A CCIM is a professional real estate practitioner with proven technical expertise in commercial property. A CCIM is a person truly committed to the fundamentals of effective commercial-investment brokerage. The CCIM has completed a full schedule of Post Graduate Level Courses in investments, taxation, development and marketing all types of commercial-investment properties. The designation of Certified Commercial-Investment Member is unquestionably the highest degree awarded in the commercial-investment real estate practice.