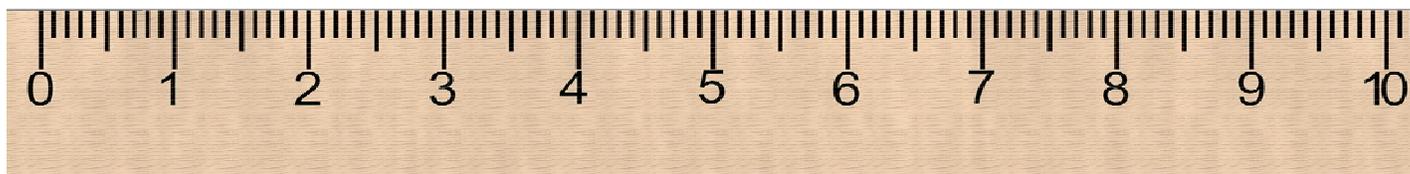


*How to Navigate
NYC's Perilous Office
Leasing Market:
A Guide for Non-Profit
Organizations*

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A MESSAGE FROM COMMUNITY RESOURCE EXCHANGE

TO NEW YORK CITY'S NON-PROFIT LEADERS:

We at Community Resource Exchange understand the impact of New York City's rapidly changing real estate market on non-profit organizations in all five boroughs. In an environment where every square foot is hotly contested, you need to be able to make a good real estate decision quickly. To assist you in your search for a space that allows you to carry out your mission effectively, we have worked in collaboration with our broker, Charles Isaacs, to prepare this practical guide. We have an electronic version which can be downloaded from our website at www.crenyc.org. We hope that you will use this information to continue to make New York City home to your organization.

Thank you,



Fran Barrett
Executive Director

ACKNOWLEDGMENTS

Thank you to: Ruth Hofheimer, an art student at Skidmore College, and Robbie Welch, Senior Assistant for Programs at CRE for their artistic contributions. Also, thanks to Randall Quan, Managing Director at CRE, for his dedication to this project.

OVERVIEW

Why are you reading this page? Probably . . .

- Your lease is expiring, and can't be renewed;
- The lease could be renewed, but the rent is too high;
- You've outgrown your space;
- The space has become inefficient;
- You're spinning off from a parent group; or
- You're starting a new organization.

Whatever the reason, you're going to need office space.

Leasing office space in New York City is not for the faint of heart, or the weak of will. It can be particularly trying for non-profits. Unless one of the city's relatively few non-profit buildings can make room for you, you'll be competing for available space with law and accounting firms, stockbrokers, ad agencies and every other type of business that uses office space. Once you find suitable space, a lengthy negotiation will ensue, leading to a lease document that can be 100 pages or more in length. On the other side of the negotiation table will most likely be sophisticated real estate professionals, trained and experienced in protecting landlords' interests, and in picking tenants' pockets.

CRE offers this manual as a tool designed to level the playing field, to help you protect your organization's long-term interests. It will guide you through each step of the leasing process, from the all-important advance planning, to finding suitable space, to negotiating the financial, legal and construction-related issues of the lease.

It can be read cover-to-cover as a how-to textbook, but most users will prefer to read the sections one at a time, as they become relevant. It can also be used as a page-at-a-time reference for the various topics covered. These topics are presented in a logical order, but they can be read in any order. Every effort has been made to explain each one as concisely as possible, and to supply you with the maximum amount of information in the minimum amount of time.

While the material covered is relevant to any relocation, our target readership is comprised of small and mid-sized non-profits, led by executives who rarely (and probably reluctantly) have to deal with the world of commercial real estate. No prior real estate knowledge or experience has been assumed. Technical jargon has been avoided. Issues that only become relevant in mega-deals have been omitted. The focus is on leasing rather than purchasing, because very few non-profits have the resources or the opportunity to purchase office space in New York.

As with most of your own and your organization's major decisions, you should seek input and guidance from trusted advisors.

About the Author

Dr. Charles S. Isaacs is President of CSI Consultants Inc. (www.npspace.com), which provides real estate brokerage and consulting services exclusively to non-profits. He has been Community Resource Exchange's real estate advisor for more than 20 years, and has guided us through all three of our relocations. Before limiting his clientele to non-profits a decade ago, he provided consulting services to some of New York's most prominent real estate firms, contributing to transactions involving several million square feet of office space. He has published numerous articles on the technical and strategic aspects of office leasing.

About the Publisher

For over 28 years, Community Resource Exchange (CRE) has worked towards a more just, equitable and livable city for all New Yorkers. CRE provides management consulting, strategic advice, and technical services every year to over 350 community-based organizations that fight poverty and HIV/AIDS. CRE provides its clients with the information, skills and leadership training to make New York City stronger - one community group at a time.

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Section I

GETTING STARTED

- 1.1 PLANNING THE PROJECT**
- 1.2 HOW MUCH SPACE?**
- 1.3 LOSS FACTORS & ADD-ONS**
- 1.4 LOOKING YOUR BEST**

PLANNING THE PROJECT

Hopefully, you have a year or two before you need to pack. That's how long it can take to plan the move, research the market, negotiate a deal, finalize a lease, and build the new space. Each step of the process needs to be carefully planned at the very beginning, with a timetable and a clearly defined outline of staff and supporting cast responsibilities. Otherwise, you'll find yourself running out of time as your current lease expiration nears, and at the landlord's mercy in negotiations for new space

Most relocation projects include five discrete phases, some of which may overlap in implementation:

1. Groundwork

At the very outset of the project, your team must be assembled. This includes your key staff people, your broker, your attorney and, in some cases, your architect. Your broker will help with strategic planning, and will be the linchpin in guiding you through the entire process. Your attorney will become familiar with your concerns, and be ready to review a draft lease when one is prepared. You might need an architect to help determine your space requirements or to prepare floor plans and construction drawings. Most tenants now also need the help of a technology/telecommunications consultant.

2. Alternate Site Study

With approximate space requirements, location preferences, and a target price range established, your broker will scour the marketplace to prepare a list of properties likely to meet your needs. After a joint consultation, you will inspect those units worth seeing in person. The list of candidates will be narrowed.

3. Financial Analysis

Your broker will subject each prospective deal to rigorous financial analysis. Base rent is only one of a dozen components of occupancy cost, each of which is structured differently in different properties. This analysis will provide you with both the Average and Effective Annual Cost for each unit under consideration. Based on these analyses, you will further narrow the list of candidates, to just a few.

4. Lease Negotiation

Your broker will conduct aggressive, simultaneous negotiations with the ownership of each property. Through a series of offers and counter-offers, subjected to continuing financial analyses, the most favorable terms possible for each one will emerge. Ultimately, you and your Board will make a decision, and a draft lease will be prepared. Your attorney will review the draft, and negotiate the remaining legal issues. Eventually, a lease will be signed.

5. Getting Ready to Move

If the space is being renovated, an architect or space planner will prepare detailed working drawings for the contractor. While it's being built, you'll need to order your telecommunications systems, stationery and furniture, and make arrangements for the physical move.

* * * *

This is only a brief schematic of the relocation process. From the beginning, all members of the team need to know what is expected of them, and when. Good advance planning, implemented by a professional team, is an absolute prerequisite to a smooth move.

HOW MUCH SPACE?

There are three basic steps to estimating the size of the space you'll be looking for:

1. Find the total square footage needed for private offices, cubicles, storage, etc.
2. Add 20-30% for internal circulation (e.g. corridors) to arrive at the Usable Area
3. Add 25-45% for the Add-On to arrive at Rentable Area

Steps 1 and 2 will give you the amount of actual space that you need to put your people and your things. Step 3 gives you the amount of space you'll actually be looking for, and renting. The difference between usable and rentable area, which can be substantial, comes as a revelation to executives leasing space for the first time. It cannot be denied that there are mysterious aspects to what might be called "invisible square feet", a topic explored in Section 1.3.

A chart like this one is a good way to start the process. (The square footages shown are only approximate; use your own.) Try not to leave anything out.

Space	SF Each	# Needed	Total SF
Small Office	80		
Large Office	150		
Reception	40		
Conference Room	300		
Storage Room	100		
Pantry	80		
Copy/Fax Room	60		
Break Room	150		
Interior Rest Room	60		
Training Area	600		
Cubicles	40		
Electrical Room	80		
File Cabinets	10		
<i>Sub-Total (Square Feet)</i>			
+ Estimated Circulation (25%)			
Total Usable SF			
+ Estimated Add-On (33%)			
TOTAL RENTABLE SF			

This exercise will result in a ball-park estimate of the amount of space you'll be looking for. Since all of the figures can change, based on the configuration and add-on factors of different spaces and buildings, you'll want your broker to search out spaces ranging in size from about 15% below to 15% above the Total Rentable Area you've estimated.

It's also a reality check, since it's very likely to result in a higher square footage requirement than you had previously estimated. Match it against your projected budget, and the prevailing market rentals, to see how this space requirement might limit the location and quality of buildings that can realistically be considered, and whether you might have to cut back on your "wish-list" or increase your rental budget.

LOSS FACTORS & ADD-ONS

The Rentable Area of virtually every office unit includes a relatively large block of square footage that cannot be used by the tenant or, sometimes, even found, but for which the tenant is nevertheless charged rent. The percentage of the Rentable Area that's not usable, or under the tenant's control, is known as the Loss Factor. The Add-On, conversely, is the percentage of Usable Area that's added on to it in calculating the Rentable Area.

For example, a unit of 2,500 Rentable SF with a 20% loss factor will have 2,000 Usable SF.

$$2,500 \times (1-20\%) = 2,500 \times .8 = 2,000$$

If the Usable Area is 3,000 SF, and the Add-On is 25%, the Rentable Area is 3,750 SF.

$$3,000 \times (1+25\%) = 3,000 \times 1.25 = 3,750$$

As George Orwell might have put it, "All square feet are equal, but some are more equal than others."

To make life even more interesting, loss factors vary from building to building, and sometimes from floor to floor. It might be 15% in a small prewar property, and 40% in a contemporary tower. Divided floors always have higher loss factors than single-tenant floors. The loss factor is almost never disclosed publicly, and can only be determined by measuring the space and comparing the usable and rentable square footages.

There are no universally accepted standards for establishing loss factors in office buildings. The Real Estate Board of NY, once upon a time, had guidelines, but they were ignored and eventually rescinded. Its not-too-helpful official position now is that, "Rentable Area is established by the Owner." A national organization, the Building Owners & Managers Association (BOMA) has its own guidelines, but compliance with them is totally voluntary, and more widespread in other parts of the country. In practice, particularly in New York, landlords set their loss factors according to "whatever the market will bear".

As a result, rentable areas bear little relation to usable areas. Floors routinely "grow" overnight following the purchase of a property, a change in the landlord's agent, or the relocation of a major tenant. A floor listed as 6,500 square feet a few years ago might now be listed as 8,000 square feet, having miraculously grown by almost 25%. In Manhattan, such discoveries are almost routine.

Rent is quoted in terms of dollars per Rentable, not Usable, Area. So, if any two buildings offer space at the same \$30 per rentable square foot, the rent per usable square foot will probably be different. If Building A's loss factor is 20%, for example, the rent is \$37.50 per USF. If Building B's loss factor is 30%, the rent is \$42.86 per USF. A building with a higher quoted rent, but a lower loss factor, can actually be less expensive than one with a lower quoted rent, but a higher loss factor.

What's a Tenant to Do?

Don't be put in the position of comparing apples to oranges. Before deciding among competing transactions, you must know the Cost per *Usable* Square Foot of each one. These calculations should be reflected in the financial analyses prepared by your broker. (See Appendix B.)

Your broker should be able to define and approximate the usable area of each unit, based on floor plans, and on industry and landlord practices. (Sorry, there's no standard definition of "usable area" either.) You will then know the cost of both the visible and the invisible square feet of each unit under consideration.

If you can't get what you pay for, at least know how much you're paying for what you *do* get.

SCHEDULING YOUR PROJECT

There is no standard schedule for an office relocation. Variables include the size and complexity of the space, the amount of construction needed, the difficulties anticipated in satisfying the requirement, and many others. Nevertheless, every relocation should be scheduled in advance. Your broker should be able to estimate the amount of time to allocate for each step of the process. You'll then want to track developments and monitor progress.

In most cases, there's a known Target Date, which might be the expiration of a current lease or some other reason why the new space must be ready for you within a certain amount of time. If you start from that Target Date, and work backward to the program's inception, you can plot the timeframes within which each step must be completed. Each step should also be assigned to the appropriate member of the team, so that everyone understands their responsibilities. There are many ways to chart the various steps; the important thing is that, one way or another, you do it. Otherwise, the project can get out of control, leaving you homeless when the big day arrives.

In plotting your schedule, these components should be among those considered . . .

- Obtain Preliminary Board Approval to start the program
- Decide which staff member will be responsible for the program's day-to-day activities
- Choose a broker to represent you
- Choose an attorney
- Choose a space planner or architect
- Choose a telecommunications consultant
- Determine preliminary space requirement
- Determine transportation requirements and location preferences
- List special requirements (e.g. ADA compliance, 24-hour access, etc.)
- Determine a realistic budget
- Prepare presentation of your finances
- Review broker's preliminary space survey
- Inspect and compare candidate spaces
- Submit Opening Proposal(s)
- Negotiate transaction(s)
- Review financial analyses
- Choose among fully negotiated transactions
- Obtain Board approval for the chosen transaction
- Shop for new furniture, fixtures and equipment
- Authorize the drafting of a lease
- Have the draft lease reviewed by broker and attorney
- Review and finalize space plans
- Execute the lease (following final negotiation among the attorneys)
- Review and approve working drawings and choice of finishes
- Monitor construction of the space
- Choose a mover
- Arrange for utilities, phone service, broadband internet, etc.
- Arrange notification of clients, funders, etc.
- Order new stationery
- Pack
- Inspect completed space and prepare punchlist
- . . . and move right in, on time and on budget!

Your relocation might not require all these steps, or it might require more than these. In any case, advance planning is essential. Some tenants retain Relocation Consultants to help with the non-lease aspects of program planning and implementation.

LOOKING YOUR BEST

Actually, your physical appearance probably won't matter at all, since it's unusual in New York for prospective tenants to personally meet the landlord. You might meet the building agent or a low-level employee when you inspect the space, or you might just meet the building superintendent. What the landlord most cares about is not how *you* look, but how your organization's *finances* and *operation* look.

Office buildings' financial structures are based on the expectation of timely rent payments. No landlord wants to take the risk of a non-paying tenant. That risk includes not only the loss of rent, but also a costly eviction procedure that can stretch out over many months or years. In addition, you may be asking the landlord to make a substantial investment in you, by building out the space and/or by providing a period of free rent. The cost of these concessions can be equivalent to 2-3 years' rent income, so the landlord needs to feel confident that the tenant will be able to pay the rent through the entire lease term.

The strength of your finances can effect not only whether or not the landlord will accept your tenancy, but also the terms of the deal that can be negotiated. Landlords are far more willing to stretch for strong tenants than for weaker ones, offering lower rentals and more valuable lease concessions. They are more likely to demand large security deposits, and sometimes personal guarantees, from tenants without a solid financial base.

For non-profits, the standard financial presentation is the IRS Form 990 and/or the latest audited financial statement. If you think these don't do you justice, you might be able to assemble supplementary materials. If, for example, you've been in existence for only a short time, but you have a multi-year funding commitment from a foundation, a letter from that foundation can be very helpful.

Different landlords have different financial standards and requirements. Some just won't rent to organizations that depend on year-to-year funding. You should assemble your presentation very early in the space search, and review them with your broker. He or she should be able to advise you on how to help yourself in this area, and, if necessary, focus on properties owned by less demanding landlords. Your broker might suggest appending the financial statement to each initial leasing proposal, in order to elicit early responses. If your finances aren't strong enough to satisfy a particular landlord, you don't want to find out at the last minute, after a lengthy lease negotiation and after you've rejected other leasing opportunities.

You want your program operation to "look its best" also. For many landlords, the character and quantity of non-profit tenants' client traffic is a major issue. Some simply don't want certain constituencies in their buildings. Others are just afraid that high occupancy tenants will overburden the elevators and rest rooms. If your operation is anything other than strictly administrative, you should prepare a letter describing it in the best possible light. Your broker should advise you on this, so that you position yourself to have the widest variety of leasing options. While there are buildings that do welcome heavy traffic, these may not be the ones you would prefer to occupy.

Section II

DEALING WITH BROKERS

2.1 DO YOU NEED A BROKER?

2.2 AVOIDING BROKER CONFLICTS

2.3 CHOOSING YOUR BROKER

2.4 THE BROKERAGE AGREEMENT

DO YOU NEED A BROKER?

Leasing office space is never a promising do-it-yourself project, especially in New York. It involves complex negotiations with experienced, sophisticated landlords, attorneys and brokers, whose primary activity is extracting money from tenants. They're very good at it.

That's the main reason why you, like every other tenant, need professional representation by an experienced real estate broker, who will not only handle the negotiations, but also guide you through the entire process. The good news is that, in most cases, you won't have to write a check for these services. Your broker's commission will be paid by the landlord, after a lease is signed.

How does this work? You've probably noticed that every office building has a leasing agent. These agents are brokers hired by the landlords to fill vacant space. When a lease is signed, the building agent is paid a commission for representing the landlord.

If the tenant is represented by their own broker, though, the commission is paid to the tenant's broker. (The landlord's agent receives an override.) This odd practice actually works to your benefit, since it allows you, the tenant, to determine whether the broker who is paid the commission represents *the landlord* or represents *you*. You incur no out-of-pocket cost for the services you receive from your tenant broker.

This is why big corporations, even those that have their own real estate departments, maintain relationships with local real estate brokers. They benefit from real estate expertise and negotiating savvy provided by a professional, who is accountable solely to them but paid, if at all, by someone else.

In addition, sophisticated tenants guarantee accountability by giving one broker the exclusive right to represent them. Briefly, there are three basic reasons to do this:

1. The exclusive broker has no financial interest in which of the competing deals gets signed, and can be totally objective in advising the tenant. Conversely, a non-exclusive broker cannot be relied upon for advice, since he or she may have a vested interest in one of these deals.

2. It signals the landlords that the tenant is professionally represented, and that they will have to compete with others for the tenant's business. Landlords' attitudes usually change as soon as they are contacted by the tenant's broker.

3. It protects the tenant from legal entanglements that inevitably arise when multiple brokers are involved, and from the annoyance of constant solicitations.

Non-exclusive brokers, both legally and practically, are sub-agents of the landlords. The negotiating leverage, expertise and objectivity that you need in your relocation program can only be provided by an exclusive broker, who is *accountable solely to you*.

It should be noted that some tenants prefer a consulting relationship, to which most brokers are also amenable. In this arrangement, the tenant pays the consultant a fee for services, whether or not a deal is closed, and there is no brokerage commission. This is unusual in the corporate world, and even more so among non-profits.

AVOIDING BROKER CONFLICTS

Even in a big city, the real estate community is a pretty small world. If you're not careful, you could find that the brokerage firm you hired to represent *you* is also the leasing agent *for the landlord*.

In such a negotiation, whose interests will be best protected?

Here's a hint: *Not Yours!*

Landlord agencies bring brokers ongoing business, and big bucks. If a brokerage firm is representing a landlord on a unit of space, it is usually the agent for the entire building, earning a commission every time space in that building is rented. It might even represent that landlord in leasing and managing an entire portfolio of properties. Do you think that company would jeopardize such a relationship for your little account, which might not become active again for many years?

Conflict of interest is endemic to the real estate industry. In their sales pitch, brokers try to minimize the appearance of conflict by claiming that tenant and landlord representation are entirely separate divisions of their companies, and that neither division dictates the activities of the other. This is sales talk. It is not true.

Landlords hire a brokerage firm, not a division or an individual broker. That firm is *legally obligated* to represent the interests of the landlord without compromise of any kind. Every broker in the firm, whether or not they do work on a particular building, is bound by that obligation. Even if your broker would like to fight for your interests, he or she cannot legally compromise the interests of the landlord.

There are a few ways to mollify the effects of potential conflicts, but they are complicated and usually don't work. The simplest way is the best way: *Retain a broker who only represents tenants!* If you can find one who combines experience and expertise with a philosophical commitment to your mission, that's even better.

CHOOSING YOUR BROKER

You realize you need professional assistance in your quest for new office space, so you interview real estate brokers. They may have been recommended by colleagues, or you might have come across their advertising or web sites. The brokers make all kinds of promises about how aggressively they will represent your interests. They deluge you with promotional material demonstrating the size and strength of their companies. They provide client lists and references. How to decide?

Here's one way. If you choose the candidate who best answers these questions, you'll probably have made a good choice.

1. Are you free of any potential conflicts of interest? (See Section 1.3)
2. Do you have a track record of successfully completing similar assignments?
3. Do you understand the particular requirements of this search?
4. Have you demonstrated a capacity for aggressive tenant advocacy?
5. Will you handle this assignment personally, or will day-to-day activities be delegated to a less experienced assistant?
6. Do you know which landlords or buildings are most likely to welcome (or refuse) our tenancy?
7. Can you help us get other services we might need (e.g. legal, architectural, engineering, moving, etc.)?
8. Do you have an independent, demonstrated commitment to non-profits, or to our mission in particular?

Note that none of these questions were about being able to find buildings with available space that might be suitable for you. That's because office space availabilities are "open-listed", which means that all brokers have access to identical information. Sometimes, it takes some digging, but the information is all out there. Most brokers have a few scraps of information that others don't, but this is rarely a reason to choose one over another.

Intangibles are important too. Ask yourself whether there's positive personal chemistry between you, enough to work together through a difficult project over many months. Consider whether the broker seems capable of conceiving creative solutions to problems that haven't yet arisen.

Finally, you'll want to check references. No candidate will provide you with negative references, so you'll need to have more than cursory conversations with the people you call. Have a list of questions handy, perhaps including some of those listed above.

Once you've made your choice, the "terms of engagement" need to be agreed upon. You and the broker will have obligations to one another that need to be spelled out. Ordinarily, this is formalized in a written agreement drafted by the broker. (Section 2.4)

THE BROKERAGE AGREEMENT

As in any business relationship, life with your broker will be much smoother if both parties know what to expect of one another. Here are some standard contract clauses, followed by brief rationales for each.

Tenant hereby appoints Broker as its sole real estate broker, and grants Broker the exclusive right to find, negotiate for, and secure space for its operations currently housed at _____. Tenant agrees to lease or purchase such space solely through Broker.

This is the exclusive arrangement described in Section 2.1.

This agreement shall be effective upon the execution of this agreement, and shall continue until _____

Typically, the agreement extends until the end of your current lease. If it's a long-term agreement, you might want to negotiate a cancellation clause. This can create legal complications down the road, though, so it's really important to choose the right broker in the first place.

Broker will acquire the details on all contemplated or presently available locations, and will select and present to Tenant those which, in Broker's professional opinion, are most suitable for Tenant's purposes. Broker will prepare financial analyses of all transactions under consideration by Tenant, and will negotiate the terms of purchase or lease on behalf of Tenant.

These are the broker's basic responsibilities. If additional services are contemplated, they should be put in writing as well.

All negotiations will be conducted solely by Broker, subject to Tenant's final approval, which may be withheld for any reason. It is expressly understood that Broker may not bind or contract Tenant in any manner, and that all transactions are subject to the approval of Tenant's Board of Directors.

This division of responsibility is critical. If you get into backdoor negotiations with the landlord, your broker's negotiating leverage is undermined. But landlord and broker must be clear that only you and your Board can make any binding decisions.

Broker is authorized to solicit the cooperation of other real estate brokers, and to work with them on a cooperating basis in connection with this exclusive right. Tenant agrees to refer all inquiries, proposals and offers to Broker, including those from owners, lessors and other brokers.

This is an extension of the preceding paragraph. Any conversations you have with other brokers can trigger legal claims that can cause you all kinds of trouble. If anyone calls you about space, just give them your broker's number.

Unless otherwise agreed, Broker will look only to the landlord for its compensation. Notwithstanding the foregoing, in the event (a) the landlord does not agree to pay the commission due or (b) Tenant secures space to Broker's exclusion, then Tenant will pay Broker's commission.

The broker is almost always paid by the landlord, but there can always be an exception, such as (a) which should be discussed in advance and possibly eliminated; and (b) which would be your own fault.

Subsequent to the expiration or termination of this agreement, Tenant will continue to recognize Broker as its sole real estate broker with respect to any properties previously submitted by Broker, and which appear on a list furnished by Broker within ____ days of such termination or expiration.

If the agreement ends before a deal is made, the broker is entitled to be protected on properties previously presented, but only on those.

Broker will not act as agent for any landlord during the term of this agreement.

Get this if you can, to protect against conflict of interest (Section 2.2).

Section III

FINDING SPACE

3.1 SETTING PARAMETERS

3.2 FROM SEARCH TO NEGOTIATION

3.3 THE OPENING PROPOSAL

SETTING PARAMETERS

At any given time, there are tens of millions of square feet available in New York City. Obviously, you don't want to look at all of them. Realistically, in view of the many program-related demands on your time, you want to look at as few as possible. The more specific you can be, at the outset of the space search, the more efficient that search will be.

You've already determined the approximate square footage that you need (*Section 1.2*), and you have a target relocation date and a preliminary budget. If you give some thought to the following additional issues (and others you can add to the list), your broker can narrow down the listings to focus attention only on units that can fit your needs. (Even better, rate each one with a priority level between 1 and 5.)

Location

- Are there particular sections or neighborhoods most convenient to your staff and clients/constituents?
- Are you required to be in a specific borough, community board, council district or catchment area?
- How close must you be to which subway or bus lines?
- Does on-street or off-street parking need to be available?
- Do you need to be within walking distance of a specific site (e.g. City Hall, Family Court, or a university)?

Amenities

- Must the building be compliant with the Americans with Disabilities Act?
- Do you need access at night and/or on weekends?
- Will you need private bathrooms within your space?
- What level of security will make your staff and clients comfortable?
- What level of soundproofing is needed for the private offices?
- Are there infrastructure necessities, such as broadband access or unusual floor loads?

Office Configuration

If the space is going to be built out for you (or by you), its specific configuration can wait until a later stage of the process. Many non-profits, though, particularly small ones, find themselves looking for space that is already built, so they can move right in. Some need to move quickly and don't have the time for space to be designed and constructed. Others want lease terms too short to justify substantial financial investment in their occupancy. If this is the case, it would be helpful to subject the items on your *Section 1.2* wish-list to your 5-point priority grading system.

Lease Term

The length of the lease is a mutual landlord-tenant commitment. Some units are available only for long-term lease, and some only for short terms. Which do you prefer? If your organization is young, and its future is unpredictable, a short term of 3-5 years, or even less, will allow time to reevaluate before making a long-term commitment. At the other extreme, if your organization is established and stable, but has a challenging requirement (such as heavy client traffic), you might prefer a 15-20 year lease, so you don't have to go through this exercise again for a long, long time. Some non-profits can be flexible about this, but others cannot. (This topic is explored further in *Section 6.1*)

Budget

Here's where the field really gets narrowed down. Even in a "tenant's market", non-profits' budget limitations eliminate a large percentage of the available space from consideration. There is no point wasting time looking at space that you can't possibly afford.

Even in the NYC mega-market, there may be only a few available units of space that score high on your rating system. Some non-profits need to allow years to find their needle in the haystack. Sometimes, creativity has to be applied to lessen the need for certain space requirements. In other cases, the broker finds exactly what the tenant needs, and is able to quickly negotiate a rent within the projected budget. The probability of this outcome for your search will be multiplied if he or she starts out with a comprehensive understanding of your priorities.

FROM SEARCH TO NEGOTIATION

Once the parameters of the space search have been determined, your broker can scour the market to identify suitable relocation candidates. Since NYC availabilities are openly listed, brokers have ready access to basic information about space being offered for lease, so the field can be quickly narrowed. Using additional resources, such as landlord contacts, floor plan reviews, research through city agencies and viewings, your broker can narrow it further. Unless your budget parameter is set too low or you have an otherwise unusually difficult requirement, your broker will be able to present you with information on the most promising candidates, including the basic terms of the deals that will be the likely outcome of negotiations, relatively quickly.

Market Conditions

All this is done in the framework of a market ruled, with an invisible iron hand, by the law of supply and demand. Because these factors fluctuate, and because demand is a cyclical component of economic conditions, timing is a critical factor in both the number and quality of the realistic choices you will have, and in the type of deal you'll be able to negotiate. Your broker's job is to negotiate the best deal possible, within the context of the prevailing market conditions.

Unfortunately, you don't have much control over the timing of your space search, so the role of plain old luck can't be minimized. In a landlord's market, some tenants opt for a short-term lease, hoping that the market will soften by the time it expires. In a tenant's market, you should consider pursuing a long lease term, with options to renew and expand, in order to lock in the presently low rentals.

Site Inspections

Once you've reviewed the broker's list of candidate properties, the final cut will ideally include between three and five alternatives. Sometimes, there is only one affordable availability, which makes negotiation much more difficult. In any case, you need to physically inspect each of these candidates at least once, and involve your key staff and board members as appropriate to your organization.

You'll probably be hosted by the landlord, the building agent, or the super. You should feel free to ask any questions about the physical characteristics of the building and the space. It is not, however, advisable to discuss the financial aspects of the prospective deal; leave this to your broker, who knows when and how to raise these issues.

If the space is already built, the goal of the inspection is to visualize how your operation will fit into it. Are the size and number of the various rooms adequate? Do the carpeting or ceiling tiles need replacement? Does it have an old, tired paint job? Is there enough natural light? Are there enough electrical outlets, telephone jacks, internet connections? It would be a good idea to prepare, ahead of time, a checklist of the space characteristics that are most important to you.

If the space needs to be rebuilt for you, the inspection will require a little more imagination. If the previous buildout hasn't yet been demolished, visualizing its potential will be even more difficult. (Fortunately, you won't have to make a commitment until after a new floor plan is prepared.) You can still, however, form an impression of such things as the building's general condition, the natural light in the space, column placement, and other aspects that won't change after the space is rebuilt. Most large buildings have a "standard installation", with defined specifications of materials; if so, you can ask to be shown how it turned out in another tenant's offices.

Make the Landlords Compete

Following the space inspections, you'll narrow the list of candidates even further. But don't narrow it too much. Your leverage is enhanced when your broker is simultaneously negotiating with a few landlords, and can play them off against one another. If there is only one property in negotiation, your broker will have to bluff his or her way through it, so the landlord thinks that you might take your business elsewhere. When a landlord thinks you have no alternatives, there is very little incentive to compromise on anything.

THE OPENING PROPOSAL

The Opening Proposal is often the most critical moment in a lease negotiation. If it is properly prepared, it puts the landlord on notice that you are professionally represented and will not be taken advantage of. It also opens discussion of many potentially deal-breaking issues that are too often left until after a lease has been drafted, which is the worst time for disagreements or misunderstandings to emerge. By that time, your range of relocation alternatives has been limited, you may have invested funds in space design, and the amount of time remaining to make a commitment may be running short. The passage of time invariably tends to shift the balance of negotiating power toward the landlord's side of the table.

A well-crafted lease proposal is a statement of intent to execute a lease based on a detailed recitation of the terms and conditions, both legal and business in nature, which the proposed lease is to reflect. Any issues between the parties that the proposal uncovers can then be negotiated before the drafting of a lease. If there are differences that can't be reconciled, you can shift your attention to another property while there is still time to do so. The comprehensiveness of the broker's negotiation will minimize the amount of time required of your attorney once a lease is drafted.

Comprehensiveness is crucial. The proposal should be drafted by your broker with a high attention to detail, taking nothing for granted. It must be presumed by that any issues omitted or inadequately addressed will ultimately be resolved in the landlord's favor.

In addition to such basic issues as rent and lease commencement/expiration, some of the questions that should be considered in preparing an aggressive proposal are the following:

- What restrictions will be put on the use of the premises?
- What are the base years and formulas for tax and operating expense escalation?
- Which of the landlord's expenses will be included in calculating operating expense escalation, and which will be excluded?
- How will you be charged for electricity usage? If sub-metered, what is the landlord's profit margin?
- What rights will you have to sublease the space? If there is a profit, which party will get the benefit?
- What rights will you have to renew the lease? How will the renewal rent be determined?
- Will the rent include cleaning services?
- What rights will you have to make alterations to the space during your occupancy?
- What will your obligations be at the expiration of the lease?
- What rights will you have to accommodate future expansion or contraction?
- If you lose a major funder, can you cancel the lease?
- Which party will pay for space planning and construction?
- Who will be responsible for maintaining the air conditioning equipment?
- Will you have access to the space during nights and weekends?
- During what hours will the space be heated and air-conditioned?
- What penalties will accrue if the space is not ready on time because of landlord or tenant delays?

This is only a small sample of the potentially deal-breaking or otherwise costly issues that the Opening Proposal might address. The proposal should represent your preferred solution to all the financial, construction and legal issues discussed in Sections IV, V and VI. Not all these issues can actually be negotiated in all cases, since some landlords don't trust their building agents to handle certain matters, and insist on waiting until their attorneys are involved. Nevertheless, your broker should pursue early negotiation of as many as possible. Even if negotiation of some issues must be left to a later date, the very submission of a thoughtful, comprehensive proposal elevates your negotiating leverage by signaling the professionalism of your representation.

The delivery of this document will trigger a round of intense negotiations. To the extent that the issues can be resolved at this juncture, the final negotiation following the drafting of the lease will be relatively swift and painless for both parties. If, on the other hand, the ensuing negotiation uncovers issues that cannot be resolved, it will end sooner than it would have if the proposal had not been written, and you can shift your attention to another property.

Section IV

FINANCIAL ISSUES

- 4.1 BASE RENT, STEPS & ESCALATIONS**
- 4.2 ELECTRICITY**
- 4.3 LEASE CONCESSIONS**
- 4.4 CLEANING SERVICES**
- 4.5 LOFT BUILDING ISSUES**
- 4.6 SECURITY DEPOSITS & PERSONAL GUARANTEES**

BASE RENT, STEPS & ESCALATIONS

Office rentals are quoted in terms of dollars per rentable square foot. Since, in New York, there's no standard definition of exactly what a rentable square foot is (*Section 1.3*), these quotes are always misleading. Further, the quoted rental represents only a portion of the tenant's financial commitment. In addition to this "Base Rent", there may be "Steps", which increase it every few years during the lease term. While both these variables are fairly straightforward and can usually be agreed upon (or not) early in the negotiation, the third major variable, Escalation, can be considerably more complex. By the late years of a long-term lease, the combination of rent steps and escalations may equal or even exceed the base rent.

All office leases contain mechanisms to increase (escalate) the rent during the term of the lease. These provisions were first developed to protect the landlord's bottom line against unexpected increases in operating costs. In recent times, though, especially when vacancy rates are low, landlords negotiate escalation provisions that would be better characterized as profit centers, saddling the tenant with substantial, and often unjustified, costs.

Every transaction you consider will trigger a different escalation pattern. The rent in Buildings A and B, each \$35 per square foot at the outset, might rise to \$45 after 10 years in Building A, but mushroom to \$70 in Building B. This is a critical area for both financial analysis and aggressive negotiation, where you will depend on your broker to project and contain your future occupancy costs.

Landlords have exercised a remarkable level of creativity in devising escalation formulas. A complete explanation and analysis of all extant species of escalation could easily fill an entire book. Each one varies in calculation, rationale, sets of advantages and disadvantages, and hidden opportunities for landlord profit. In essence, though, they fall into a few broad categories, which are often combined in a single lease.

The Tax Pass-Through

When a property's real estate taxes increase, the tenant is charged its proportionate share of the increase. For example, if the annual property tax goes up by \$100,000 and you occupy 5% of the building, your additional annual rent is \$5,000. Your broker should verify that the percentage stated in the lease is accurate, since it is not all uncommon for landlord to recoup well over 100% by inflating tenants' percentage occupancies. Almost all leases contain a form of this provision.

Note on Taxes: Even though non-profits are exempt from property taxes if they own their space, there is no exemption if they lease (unless the landlord is another non-profit). Taxes are a component of the rent, whether it is a gross lease or a net lease.

The Operating Expense Pass-Through

When a property's operating expenses increase, the tenant is charged its proportionate share of the increase. This formula, calculated as described above, is the most justifiable method of sharing increases in such costs as utilities, maintenance, cleaning and security. It can be, however, the subject of intense negotiation. Appended to your proposal should be a list of all landlord costs that are to be excluded from the pass-through, such as ground lease payments, financing costs, depreciation, advertising, capital expenditures, and insurable losses. The lease should also contain a protocol through which you can audit the alleged cost increases.

While the pass-through formula was once the standard operating escalation formula, and is often still used in large leases, most landlords have found that they can avoid the hassle of audits, and generate more revenue, by using a Variable Index or Fixed Index formula.

The Variable Index Formula

When some external index changes, the rent increase is based on that change. The indices most commonly used are the hourly labor cost (known as "Porter Wage"), which has many variations and may or may not include the cost of fringe benefits, and the Consumer Price Index. These formulas, unlike the pass-through, allow for simple verification of escalation charges, but nearly always generate higher profits for the landlord. Both the choice of the index, and the method of translating index changes into rent increases, must be negotiated.

The Fixed Index Formula

The rent is increased by a fixed, stated percentage each year. This formula assists in planning, since the rent for each year is set in advance. These percentage increases must be aggressively negotiated because they multiply geometrically. Market conditions play a critical role in this negotiation.

Each of these formulas presume a Base Year or Base Amount, which specifies when and at what level escalations begin to accrue, and must also be negotiated. For example, should the base period be the time of negotiation, lease signing, lease commencement, occupancy or rent commencement?

Depending on the escalation provisions of competing transactions, it is possible that the building with the lowest base rent will generate the highest actual occupancy costs. In order to understand the future costs of the proposed leases, detailed financial projections for the full lease terms must be compared. A prototype financial analysis of a single transaction is presented in Appendix B.

ELECTRICITY

The Base Rent in NYC office buildings almost never includes the provision of electricity to the tenant. If you are lucky, your space will be directly metered to Con Ed, and you will only pay the actual cost of your usage. More typically, tenants have to purchase their electricity from their landlords, who long ago discovered that this was an extremely lucrative business. Further, it is unregulated by the state Public Service Commission, which regulates all utilities but carved out a convenient exception for the Con Ed service area. Since NYC landlords can charge whatever the market will bear for electricity, negotiation will be the only way to limit your contribution to the landlord's profit margin.

There are two primary methods that landlords use to resell electricity: Submetering and Rent Inclusion.

Submetering

Many buildings are wired with a single master connection to Con Ed. From there, the landlord can distribute electricity to the various tenants and record their usage with submeters. At the end of the month, the building management reads the submeters and bills the tenants. . . after tacking on a profit, of course, and there lies the rub.

Landlords claim that submetering entails such costs as meter reading, bookkeeping, billing and collection, all of which are routinely handled by the management company. Some markup may be justified, but how much is reasonable? Back in the 1980's, the Federation of Apparel Manufacturers surveyed its Garment District members, and found that landlords were marking up their electricity costs by 30%, 50% and even 100% in some cases. The City offered tax incentives to landlords who would limit their markup to 12%, but there wasn't much interest when so much money was being made.

If you're considering a building wired for submetering, the only way to contain the landlord's margin of profit is to negotiate it, and to begin that negotiation with your Opening Proposal.

Rent Inclusion

Many landlords prefer to forego the hassles involved in submetering, and instead simply add a few dollars per rentable square foot to the base rent. When the practice of Rent Inclusion started, it was common for the landlords to hire electrical consultants, who would count the tenants' light bulbs and office machines, then estimate the cost of running them. The landlords would add on an undisclosed profit margin, and bill each tenant separately. Some large tenants hired their own consultants, discovered this hidden profit center, and challenged their bills. Eventually, when major tenants began routinely demanding audit rights, landlords dropped the pretense of the electrical survey. The cost of Rent Inclusion today is a flat rate determined by actual electrical costs, office market conditions and the all-important negotiation.

Since rent inclusion charges for electricity at dollars per rentable square foot, it multiplies the effect of exorbitant loss factors. For example . . .

Your non-profit needs 5,000 usable square feet, and is choosing two buildings. In Building A, the loss factor is 20% and the electricity is \$2.75 per RSF. In Building B, the loss factor is 33% and the electricity is \$3.35 per RSF.

In Building A, you'll have to lease 6,250 RSF, and you'll pay \$1,432 monthly for electricity. In Building B, you'll need 7,500 RSF, and your monthly electricity bill will be \$2,094. The difference in electricity cost for the same amount of usage, in the same amount of usable space, is more than 46%.

Following the negotiation of electricity costs in competing buildings, future submetering costs can be estimated and rent inclusion costs can be specified. This is an important factor in creating long-term financial projections; it can significantly mitigate or magnify differences in base rentals.

LEASE CONCESSIONS

Lease Concessions sweeten the deal for a tenant without reducing the property's future cash flow. Landlords often prefer to grant concessions rather than lower the rent, because their property's value in a refinancing or a sale depends on its cash flow. Sometimes, the value of concessions is primarily intangible, such as rights to the building name. More typically, they are key financial elements of the deal, taking the form of a free-rent period and/or a free buildout, or a contribution toward the tenant's construction costs. They represent capital costs to the landlord that generate rental income throughout the term of the lease, and are often financed through a lending institution when the lease is signed. Along with debt service, property taxes and operating expenses, their amortization (or payback) is an essential component of the rent. The negotiation of these provisions is part and parcel of the rent negotiation, even if they are discussed separately.

Market conditions play a crucial role in setting the boundaries of this negotiation. In a weak market, where space can sit empty for years, a free-rent period doesn't really cost the landlord anything if there are no other prospective tenants waiting in the wings. Under circumstances like these, 10-year leases have been negotiated with the equivalent of 3-4 years base rent in concession value. In a strong landlord's market, conversely, the availability of concessions can virtually disappear. Regardless of market conditions, though, any landlord's relative willingness to make this investment will also be a function of the strength of the tenant's financial statement.

The length of the lease term is another important factor, since a longer lease gives the landlord a longer income stream through which to amortize the cost of concessions. The annual payback component of the rent is then smaller, which makes possible larger concessions and/or a lower base rent than might otherwise be achievable. If a substantial construction investment is required, it may not be feasible to amortize the cost in a lease term of less than ten years.

The type and amount of concessions available at otherwise equivalent buildings may also vary, depending on the landlords' particular practices, investment objectives or mode of financing. Some, for example, will not build the space for you under any circumstances, but will grant more than enough free rent to cover most of the cost, or will write you a reimbursement check. Others will provide the necessary construction, but insist that rent payments begin on the day of completion. Some will provide architectural and engineering services; others will only build from plans provided by the tenant. Sometimes, an impasse over the number of rent-free months can be resolved by moving some of them into future years. Then there are those landlords who underprice the market on the base rent and will not grant tenants any concessions at all.

There are absolutely no standards in lease concessions. At any given point in time, the base rents that can be negotiated for buildings of the same quality in the same submarket will be pretty close together. The type and value of lease concessions, though, can vary significantly. While market conditions, tenant finances, lease term and landlord practices sketch out the broad outlines of what is achievable, the package of concessions you actually receive will primarily depend on your broker's negotiating savvy. In most cases, construction (if necessary) and free rent are among the first issues to be discussed, and they are often the last to be resolved.

In this negotiation, your broker needs to first understand your needs and preferences. For example, you might or might not be willing to take on the task of designing and/or building the space. Maybe you won't be able to afford the moving costs unless the first couple of months are rent-free, even if the landlord is building the space. Your broker will need a complete understanding of both your physical requirements and your financial situation in order to negotiate a transaction that will work for you over both the short and the long term.

CLEANING SERVICES

One way or another, your office space will have to be cleaned. You need to know who will provide these services, and how they will be provided, before you sign a lease. Unless your own staff will do the cleaning, there are three basic ways of getting the job done:

- (a) The landlord provides the service as part of the rent;
- (b) The building has a “preferred vendor”, with whom you negotiate on your own; or
- (c) You contract with an outside cleaning service of your choice.

In any of these arrangements, there must be a contract that includes specifications, i.e. a written statement of the scope and frequency of services to be provided by the vendor. If the landlord is providing the service, these specifications should be appended to the lease. If the basic specifications, in the lease or in your own contract, are inadequate to your needs, upgrades will trigger additional costs, which should always be negotiated in advance.

The specifications should state that the vendor is insured and bonded; that cleaning services will be performed during hours that won't interfere with your activities (such as “no earlier than 5 pm on weekdays”); and that all cleaning products will be used in accordance with manufacturers' instructions.

The following can be used as guidelines for the scope and frequency of basic cleaning services.

NIGHTLY

- Dust and wipe clean all furniture, fixtures, window sills, files, picture frames, desk lamps, chair railings, moldings, and all other horizontal surfaces within normal reach.
- Empty and clean all trash receptacles, and remove trash.
- Wash all water fountains and coolers.
- Remove gum and other foreign matter, and spot clean hard flooring as necessary.

WEEKLY

- Vacuum carpeting and flooring in offices, conference rooms, and traffic areas.
- Dust all louvers within reach.
- Sweep all hardwood floors.
- Remove finger marks from all surfaces near light switches, doors, etc.
- Wipe and disinfect telephone handsets.
- Wipe-clean all exposed glass furniture tops.

PERIODIC

- Bi-monthly, high-dust all wall hangings not reached in nightly cleaning.
- Wash windows every six months, both interior and exterior.
- Wipe-clean all bright metal work as necessary.
- Bi-monthly dust louvers, ducts, high moldings and other areas not reached in nightly or weekly cleaning.

If you have your own lavatories, there will be additional cleaning specifications, such as . . .

NIGHTLY

- Sweep, wash, rinse, and disinfect all floors.
- Wash and polish all mirrors, shelves, bright metalwork and enameled surfaces.
- Wash and disinfect all basins, bowls, urinals, fixtures, and both sides of toilet seats.
- Clean partitions, tile, dispensers and receptacles.
- Empty and clean all sanitary disposal and waste receptacles.
- Clean flushometers, piping, hinges and other metalwork.
- Supply soap, paper towels and sanitary products, and fill dispensers.
- Remove graffiti and spot-clean walls.
- Thoroughly wash all tile, partitions and enamel surfaces (weekly or bi-monthly).

LOFT BUILDING ISSUES

As manufacturing has declined in New York City, particularly in Manhattan, hundreds of former industrial properties have been converted to other uses. Depending on market demand, location and building configuration, they have been given new life as residential properties, office buildings, self-storage facilities, rehearsal studios, and just about anything else that requires four walls and a roof. No longer factories and warehouses, they are now generally referred to as “loft buildings”.

The quality of these conversions is extremely uneven. Some have all the amenities of conventional office buildings, plus high ceilings and large windows, and have joined the ranks of the city’s Class B or B+ stock. Others show glaring effects of penny-pinching, and cannot comfortably accommodate office tenants. Most are somewhere in the wide spectrum between these two extremes.

Loft buildings are generally priced lower than conventional office buildings, and thus become attractive to tenants when prevailing rents are high, or when budgets are tight. Non-profits are particularly sensitive to these factors, and often find themselves considering such non-conventional alternatives. Special care must be taken in investigating these properties, inspecting the space and negotiating the transaction. Items that might be taken for granted in other office buildings must be questioned in these.

Among the questions that need to be asked and answered are . . .

- Does the building have a Certificate of Occupancy for office use?
- Are any major building code violations outstanding?
- What is the distance from various subway lines?
- Is the elevator capacity adequate?
- How is the space fireproofed?
- How is it air conditioned? How is it heated? Are there enough radiators, and do they work?
- Are there enough electrical outlets and phone jacks?
- Is there broadband internet access?
- Are the lobby and other common areas clean and well-lit?
- Are the lavatories adequate? Are they kept clean?
- How often are the windows cleaned?

In addition, the rental structures of these properties are different from those of conventional office buildings. Ordinarily office rents are “gross rents”, which include building services except for tenant electricity and, sometimes, cleaning. In contrast, retail rents are usually “net rents”, that don’t include any services, and usually don’t include the tenant’s share of property taxes. Loft buildings’ rental structures are somewhere in between. There is no standard here. There are dozens of variations; nothing can be taken for granted. The base rent quoted for space in a loft building only has meaning once it is determined what is included and excluded, and the actual non-rent fees and charges are projected.

Some of the costs that may not be included in the rent are . . .

- Real estate taxes
- Heating fuel
- Air conditioning
- Common area electricity
- Water & sewer charges
- Sprinkler service
- Trash removal
- Common area cleaning
- Building security

In addition to negotiating the base rent and the costs of the various additional items, the method of verifying landlord calculations of pass-through costs, and any add-on profit margins, must also be negotiated.

SECURITY DEPOSITS & PERSONAL GUARANTEES

This can be among the most contentious areas of the lease negotiation. Landlords want to be assured that the tenant won't disappear or just stop paying rent. Few non-profits without significant assets have funds available to satisfy this concern by depositing huge security deposits in their landlord's bank accounts. Creativity is often required to bring the parties together on this issue.

Your broker's Opening Proposal should stipulate a minimal, but reasonable, security deposit, usually measured in months of base rent. Actual negotiation, though, will usually not begin until (a) the concession package has begun to take shape, since this constitutes the landlord's primary upfront investment, and (b) the landlord has reviewed your financial statements, in order to judge the level of risk involved. An institutional tenant with a substantial endowment can usually insist on a waiver of security, since there is little or no risk of default. For all other non-profits, some form of security will be required, and the greatest demands are made of those with the least resources. Different landlords have different standards in this area, so negotiating the security clause in competing properties may take different forms.

Besides the amount of the security deposit, the disposition of income earned on these funds must also be negotiated. Who will receive the benefit of the interest, landlord or tenant? If it's the tenant, is the interest paid annually or at the end of the lease term? Is the landlord entitled to a service charge for bookkeeping?

It is not unusual for an otherwise attractive deal to be blocked by a landlord's insistence on a security deposit equal to 4, 6 or 12 months base rent. Ironically, such demands are usually made of those tenants who least can afford it. In these cases especially, creative paths must be explored. Which ones are appropriate in any given situation depend on the tenant's particular situation and the landlord's receptiveness to alternatives.

Installments & Burn-offs

Sometimes, landlords will accept an installment payment, with part of the security deposited at the lease signing and the balance at a specified later time. Another approach is to arrange for a percentage of the deposit to be returned to the tenant after a certain number of on-time rent payments have been made.

Letters of Credit

Maybe your bank has more confidence in your financial stability than does the landlord. If so, the bank can issue a Letter of Credit, which guarantees payment of the deposit amount if you default on the rent. The bank will charge an annual fee during the time that this document remains outstanding, but you will avoid any upfront demand for funds.

Advance Rent Payment

If you have advance program funding, or accrued funds from previous years, you might be able to trade upfront rent payments against the security deposit. If a landlord is demanding four months security, for example, he or she might respond positively to an offer of one month security plus advance payment of the first six months' rent.

Personal Guarantee

Some landlords ask that a creditworthy individual, usually the Executive Director or a Board member, provides a personal guarantee. That person then becomes personally liable for all the tenant's obligations under the lease if the tenant cannot fulfill them. Except in the rarest of cases, this request should never be granted.

Good-Guy Guarantee

The "Good-Guy Guarantee" is one of the more creative ways to assuage some of the landlord's anxiety while limiting the guarantor's liability. In essence, the responsible person guarantees that, if the tenant has to break the lease, then (a) adequate notice will be given; (b) the tenant will vacate the space and return the keys; and (c) the rent will be paid until then. Both parties accept a level of risk, but neither's risk is open-ended. A typical lease clause can be found in Appendix C. (Note: Your Board must retain the right to substitute the guarantor at any time.)

Section V

CONSTRUCTION

5.1 WHO PLANS THE SPACE?

5.2 WHO BUILDS THE SPACE?

5.3 NEGOTIATING THE WORKLETTER

5.4 RELATED LEASE ISSUES

WHO PLANS THE SPACE?

The unit of space you zero in on might be in move-in condition, or in need of only cosmetic improvements, such as new paint or carpeting. If so, the landlord's low capital cost should be reflected in a base rent reduction. In addition, your relocation schedule can be accelerated since there will be no lengthy buildout negotiation, and cosmetic renovations can be accomplished very quickly. Most tenants, though, are not this fortunate. Typically, particularly in units larger than 3,000 square feet, the space needs to be gutted and rebuilt to meet the new tenant's needs. In these cases, work cannot begin until detailed construction drawings have been prepared by an architect. If the landlord is building the space, the lease can't be executed until preliminary plans, at the minimum, have been agreed upon and appended to the document.

These plans are prepared by architects, whose services can be expensive. Architectural fees cannot be avoided if you are contracting the work yourself. Most non-profits, though, prefer to lease space in buildings where the landlord will take responsibility for construction. Many of these landlords have found that both parties benefit when architectural services are provided as well.

Usually, the space planning in these cases are done either by the landlord's preferred architect or by an employee of the landlord. Either way, the fees are much lower than the retail price that the tenant would have to pay. From the tenant's point of view, this cost might be \$2-3 per square foot financed over the lease term, as opposed to an upfront cash outlay of \$5-10 per square foot. It's a "win-win", since the cost is lower to both parties and the landlord gains a marketing advantage.

The building architect's familiarity with the property's configuration and infrastructure saves planning time. The architect can also contain construction costs for both landlord and tenant by tailoring the plan to fit, if at all possible, the building's standard workletter specifications, so that any additional "above-standard" costs are avoided or minimized.

In theory, this arrangement works for everyone. The landlord saves money on marketing and on construction, so the net cost of the architectural fee is little or nothing. The tenant has the space designed by an expert on the particular property, quickly and efficiently, at no out-of-pocket cost, and does not have to risk any penalties for late submission of working drawings.

In practice, though, life can be a little more complicated. The building architect might not understand your requirements, might be more responsive to the landlord's needs than to yours, or just might not be as competent or creative as you would like. Tenants often find they need to hire their own space planner or relocation consultant for services that range from architect communications to the creation of preliminary plans and specifications. This can speed up, and reduce the stress level, in what can be an extremely lengthy and frustrating experience, at a fraction of the cost that would have been incurred without the assistance of the building architect.

WHO BUILDS THE SPACE?

Most non-profits are only able to consider space requiring substantial modification, or a completely new buildout, if the landlord is willing to do the work. Some, though, are fortunate enough to have cash reserves or credit resources, or are able to mount a successful capital campaign, to fund the construction project. Funders may be more amenable to contributing toward capital costs than toward ongoing expenses like rent. A contribution from the landlord can also be obtained in the lease negotiation.

If you decide to take the project on, you'll hire an Architect to plan the space, a Contractor to build it, a Project Manager to make sure it's done properly, and possibly an Expediter to move the permits and approvals through the city bureaucracy. Before making this decision, though, all the pro's and con's should be carefully weighed. The charts below list some of the factors that need to be taken into account.

IF THE TENANT BUILDS THE SPACE

PRO	CON
Lower Base Rent or More Free Rent	Retail Prices for Labor and Materials
Tenant Control of Process	Bidding and Contracting Processes
Simplified Lease Negotiation	Cost of Architect, Project Manager, etc.
Opportunity for Greater Creativity	Risk of Cost Overruns
Choice of Contractor	Risk of Delays in Completion
Wider Choice of Materials	Staff Supervisory Responsibilities
Possible Capital Campaign	Possible Fundraising Shortfall

IF THE LANDLORD BUILDS THE SPACE

PRO	CON
Limited Out-of-Pocket Cost	Complex Workletter Negotiation
Wholesale Pricing of Materials	Possible Limitations on Creativity
Limited Supervisory Responsibilities	No Choice of Contractor
Landlord Assumes Most Risks of Delays	Limited Choice of Materials
Space Planning Cost May be Included	Higher Base Rent or Less Free Rent

Even when the landlord takes responsibility for building the space, the tenant is not absolved of all capital costs. Program budgeting may need to take into consideration out-of-pocket payments for such items as . . .

- Above-Standard Construction
- Supplementary Project Management
- Voice/Data Cabling and Wiring
- Furniture, Fixtures & Equipment
- Security System
- Announcements & New Stationery
- Relocation Consultants
- Legal Fees
- Moving Costs

If you will be responsible for building the space, neither the landlord nor the landlord's contractors should be entitled to any supervision, profit or overhead charges.

NEGOTIATING THE WORKLETTER

Pleasant stories with tragic “twist” endings can be enjoyable in the movies, but they should be avoided in real estate. Here’s one that occurs all too often:

A tenant finds suitable space, and negotiates acceptable lease terms, which include a “New Building Installation” provided by the landlord. After committing to the transaction, the tenant finds out that the “Building Standard” materials, finishes and electrical infrastructure are inadequate. Before moving in, the tenant has to lower its standards, write a big check or agree to higher rent.

Unanticipated construction costs can bust any budget. They can be avoided, or at least minimized, through comprehensive planning and aggressive negotiation.

Terms like “Build-to-Suit” or “New Building Installation” should not be taken at face value. The landlord’s actual commitment is specified in an amendment to the lease called a Workletter. This document specifies in detail the quantity and quality of everything the landlord agrees to put into the space, including walls, doors, hardware, ceilings, floor coverings, outlets, lighting, plumbing and paint. If you need anything that is not listed in the Workletter, you can’t expect the landlord to pay for it. If the workletter isn’t properly negotiated, you *can* expect to incur substantial unexpected costs.

The landlord may offer a Building Standard Workletter, which is common to all tenants in the property. Since this document is unlikely to accommodate your real-life requirements, it must be carefully scrutinized, and compared with your plans, needs and desires. Then the negotiation begins. Anything you need that’s not included in the negotiated Workletter is an “above-standard construction cost”. Typically, the tenant must pay such costs before moving in, although sometimes the landlord can be persuaded to accept reimbursement, with interest over the lease term, through additional rent. The amount of the above-standard cost can also be subject to negotiation, but quite often tenants must “go back to the drawing boards” and revise their plans to reduce the construction cost. The complexity of this negotiation sometimes dwarfs those of the lease’s other business terms combined.

There are two provisions which, if successfully negotiated, can help keep the cap on your bottle of headache remedies.

Substitution Clause

The workletter will not only omit items that you want. It will also include items that you don’t need, for which you should receive a credit. Language must be included that guarantees your right to get these credits.

Unit Prices

If there are to be any credits, or additional charges, they should be calculated according to a unit price list included in the document. If you want to add or remove a door or a partition from the specifications, for example, the dollar amount involved will then be known in advance.

All restrictions and delay remedies must be negotiated as well, and any charges by the landlord for the review of tenant plans should be specifically precluded.

There is usually a fair amount of flexibility in negotiating the workletter, since landlords are usually only concerned about total construction cost. If you need less than the standard ratio of private offices, for example, you should be able to trade that off against higher quality carpeting. But the negotiation must be done as early as possible, based on comprehensive space planning. If you’ve engaged an architect or relocation consultant, she or he can offer invaluable assistance to you and your broker in this process.

RELATED LEASE ISSUES

There are a number of critical construction-related issues, besides the Workletter, that can cause problems unless properly negotiated. Most of these can be included in the Opening Proposal, so that they can be resolved in a timely fashion.

Lease Commencement Date

This is a simple matter when the premises are already in move-in condition. Lease Commencement might automatically take place when the lease is signed by both parties, or it might be on a specified date. If there is free rent at the beginning of the lease, that's when the clock starts ticking toward the Rent Commencement date.

This is usually also the case when construction is going to be a tenant responsibility. If the landlord needs to do any work outside the leased premises, though, the lease should not commence until it is completed. This "Base Building Work" might consist of such items as HVAC repairs, lobby or elevator renovation, corridor painting or restroom upgrades. There must also be a Certificate of Occupancy in place, any hazardous materials must be removed, and any renovations promised to bring about compliance with the Americans with Disabilities Act must be completed, prior to Lease Commencement.

If the landlord is building the space, Lease Commencement is likely to be triggered by "substantial completion of construction". This is a vague term that needs to be defined more clearly if future disputes are to be avoided. A reasonable definition of substantial completion might be "completion of all base building work, and all construction specified in the Plans and the Workletter except minor punchlist items, which items shall be completed by the Landlord within x days."

Delays

There are any number of reasons why your space won't be ready when anticipated. That's why landlords often promise substantial completion by a specified date, but never want to guarantee it in the lease. There may also be reasons, both operational and financial, though, why you need to be able to move in by a certain date. This conflict often gives rise to serious disagreements in lease negotiations.

Whenever possible, an outside date for completion should be specified in the lease, even if it is well beyond the anticipated completion date. Depending on your situation, you might need to insist on financial penalties if the space is not ready by this date. There would be exceptions for delays caused by an event beyond the landlord's control, such as a trade union strike, or by your own failure to submit plans on time. If the delay is the result of a business dispute between the landlord and the contractor, for example, or if materials are not ordered in a timely fashion, you should be compensated for the resulting disruption to your program and any holdover costs in your current space. All contingencies should be anticipated *in the lease*.

Notices and Trigger Dates

The lease should contemplate the entire space planning and construction process. Any completed task by one party which triggers a responsibility of the other party needs to be stated, along with a requirement of adequate written notice.

"Substantial Completion" is the most critical of these events, since it triggers Lease Commencement. The lease must state how much (written) advance notice you will have of this, how many days you will have to inspect the premises and submit your punchlist (or your disagreement), and to whom the notice and response are to be addressed.

Alterations During the Lease Term

Unless you negotiate a right to do minor alterations during the course of the lease, the landlord may charge unreasonable fees to allow such work to be done. You should also have the right to use a contractor of your choice (not the landlord's brother-in-law). The lease should specifically release you from any obligation to restore the space to its original condition at the time of expiration.

Section VI

LEGAL ISSUES

6.1 THE LEASE TERM

6.2 OPTIONS

6.3 SUBLEASE & ASSIGNMENT

6.4 ACCESS & COMFORT CONTROL

6.5 MISCELLANEOUS LEASE PROVISIONS

THE LEASE TERM

How long should your lease term be?

Some tenants have little realistic choice in this matter. For example . . .

- Many landlords will not commit to more than a 3-5 year lease term for tenants leasing less than about 2,500 square feet, or for start-ups.
- If an expensive buildout is required, the cost of amortizing the investment in less than 10 years will usually be prohibitive.
- Non-profits that find great difficulty finding a suitable location because of their operation (e.g. landlord objections to daily visits by youth or by poor people) will want to secure their hard-found new home for as long as possible.

Most non-profits, though, do have some flexibility. Often, there are solid arguments on both sides of the short-term/long-term debate, and a balance must be struck. This issue should be discussed among staff and Board members as early as possible in the space search.

Some of the factors that should be taken into consideration are the following:

Internal Growth

If you are projecting a fairly stable level of staffing for the foreseeable future, you're a candidate for a long-term lease. If you expect to grow substantially in a few years, you'll probably want the flexibility to relocate to larger quarters at that time, so you'll prefer a short-term lease (or an expansion option).

If your organization doesn't have a business plan that looks a few years into the future, right now would be an excellent time to develop one.

Market Conditions

Real estate markets are cyclical, with "tenants' markets" followed by "landlords' markets" and vice versa. While it is usually a mistake to make a leasing decision by attempting to time these shifts in market conditions, it is equally an error to ignore them. Your broker should be able to give you valuable advice here. If market conditions are moving against tenants, you might want to lock in a long-term deal. If they are shifting in tenants' favor, you might want to create an opportunity to negotiate a less expensive deal a few years from now.

Leasehold Improvements & Concessions

The landlord's cash outlay for renovations, free rent, brokerage commissions and all other capital costs are investments that you will pay back, with interest, over the term of the lease. (Usually, this "amortization" is a component of the base rent, and is not separately itemized.) A short-term lease requires a faster payback than a long-term lease. For example, an investment of \$50 per square foot at an 8% interest rate is amortized by \$7.28 PSF annually over a 10-year term, but requires \$12.16 PSF annually in a 5-year term. In order to break even, the landlord would have to charge almost \$5 PSF more in the shorter-term lease. Because of this dynamic, tenants can also negotiate more free rent in long-term leases than in shorter ones.

While the amortization of capital costs is a pretty straightforward mathematical calculation, your projections of organizational growth and of real estate market conditions might or might not turn out to be accurate. For this reason, a good lease negotiation includes a comprehensive discussion of exit strategies and options, which are covered here in the following two sections.

OPTIONS

Options give a tenant the right to take certain actions, without obligating them to do so. They can be useful tools in long-term planning, and in coping with unforeseen circumstances. Since they shift power to the tenants, landlords hate to grant them. This reluctance, though, can often be overcome through skillful negotiation.

Cancellation Option

As discussed above, tenants derive many benefits from a long-term lease. The longer your lease term is, though, the less certain you can be about the continued suitability or affordability of the space. While you will be signing your lease in good faith, it is often advisable to obtain some form of option to cancel. Like everything else in your lease, there are no standards here, only negotiation.

Cancellation options can be unrestricted, or they can be triggered by a certain contingency. If your organization is funded primarily by a state agency, for example, you would want the ability to cancel the lease if that funding drops by a large percentage in any given year. This would allow you to move to smaller quarters without being burdened by the original lease obligation, and the threat of bankruptcy.

The landlord will insist on a significant notice period, sometimes as much as 9 months, in order to allow for re-leasing of the space. Depending on the landlord, the structure of the deal, and the ever-important market conditions, there may also be a financial penalty triggered by exercise of a cancellation option. A common formula reimburses the landlord for unamortized lease concessions and other capital costs, but there are no standards except that the size of the penalty should always decline with the passage of time.

Renewal Options

In almost all cases, tenants should attempt to obtain a renewal option, or a series of renewal options, since they confer powerful leverage as the lease expiration nears. Assuming the space remains suitable, the option can be exercised if the rent is below the market rate at that time. If the market is lower than the renewal rate, the option can be declined in favor of a new negotiation. The key points to negotiate are the length of the option(s), the method of calculating the renewal rent, the length of the notice period, and any new concessions that would be triggered by exercise of the option.

Expansion & Contraction Options

These options can provide a level of comfort in a long-term lease even if the future space requirement is uncertain. Contraction options are usually feasible when the tenant is leasing more than one discrete unit, such as space on two or more floors. Expansion options can involve adjacent space that becomes available, space on the same floor, or space anywhere in the building. The tenant might obtain the right to lease the expansion space at a specified rent or at fair market value. If this isn't possible, there are weaker options, including a right of first refusal and a right of first offer.

Specific target and notice dates, combined with specific dollar figures or verifiable formulae such as "Fair Market Value" percentages, with realistic definitions and strong arbitration provisions, should be linked to all expansion, contraction and renewal options. If you will have a cancellation option with a penalty, both the timing and the calculation of that penalty should be clearly specified. Without these provisions, any option you obtain will turn out to be no more than a minefield waiting to explode.

Holdover

The Holdover Clause is more of a protection against unforeseen circumstances than an option. If you have leased new space in anticipation of your lease's expiration, but you can't move out because the new space isn't ready in time, you become a "holdover tenant". This can create all kinds of problems for the landlord if the space has been leased by another tenant, so they usually try to exact draconian penalties. If the size of the penalty is raised in the Opening Proposal, though, landlords are often amenable to moderating it substantially in the interest of closing the deal.

SUBLEASE & ASSIGNMENT

Another exit strategy is the right to sublease the space, or assign the lease, to another party. In an assignment, the new tenant “steps into the shoes” of the original tenant, who is then freed of any further obligations under the lease. In a sublease, the subtenant pays the rent to the original tenant, who remains responsible to the landlord. Sublease and assignment rights are critical to nearly every tenant. Since landlords often see them as another form of an option which, in addition, can damage the financial standing or prestige of the property, they try to restrict these rights as much as they can. The sublease/assignment clause can be thousands of words in length, and often consumes a large percentage of negotiating time and effort.

Your Opening Proposal should take the first steps to minimize any impediments to sublease or assignment. Some of your objectives should be . . .

- Any sublease/assignment to an affiliated entity should be as-of-right, with a requirement of notice but no requirement for landlord consent.
- In other cases, the landlord should be specifically prohibited from unreasonably withholding or delaying consent to a sublease or assignment. Alternatively, the lease can set forth specific conditions under which the landlord would be required to grant consent.
- Tenant creditworthiness may be a requirement for assignment, but not for subletting.
- If the landlord is to retain recapture rights (i.e. a right to cancel your lease and take the space back), such rights should be exercised immediately after notification of your intent to sublet, not after you’ve gone to the trouble of finding a new tenant.
- There should be even fewer restrictions on your ability to sublease a portion of the premises (from desk space up to about 40% of the space) to another non-profit, particularly a related entity.

The proposal should specify the percentage divisions of future profits that would arise if you can sublease the space for more than you’re paying. Landlords don’t like to see tenants making money in their buildings, but a profit split can usually be agreed upon. Such a provision should allow you to recoup all your subleasing expenses (e.g. marketing, concessions, brokerage and legal fees) off the top, before the profits are calculated and divided.

Other landlord concerns that will intrude into the negotiation include . . .

- Use of the space inconsistent with your Use Clause (a good reason why that clause should be worded as broadly as possible).
- Increased burden on building infrastructure because of higher traffic.
- Competition with vacant space being marketed by the landlord.

A favorable Sublease Clause can be more than an exit strategy. If you’re anticipating future growth, it can be a tool for controlled expansion. For example, suppose you need 10,000 SF right now, but expect to need 5,000 SF more in five years, and have no way of knowing whether the additional space will be available at that time. You might negotiate a long-term lease now for 15,000 SF and immediately sublease 5,000 to another tenant for five years. When the sublease term is up, you could expand into that space if you need it, or continue subleasing if you don’t.

Since you remain responsible for the rent during the sublease term, controlled expansion entails a degree of risk that the subtenant defaults (or doesn’t even materialize for a while). These risks can be eliminated through a “put” or a “takeback”, in which the landlord retains responsibility for the expansion unit until, in this case, year 6 of your lease.

ACCESS & COMFORT CONTROL

With all the dozens of items that need to be evaluated and negotiated during the relocation process, sometimes the most basic things can be taken for granted or overlooked. Among these are how and when people can get in and out of the building, and how comfortable they'll be when inside. Some of these issues can be negotiated, while others cannot. None of them, though, should be disregarded.

Access

Many office buildings offer their tenants 24-hour, 7-day access, with varying levels of security, while others are locked up except during regular business hours. If you need access to your offices during nights and weekends, one of your broker's first inquiries should be whether this will be feasible. If after-hours access requires special arrangements or costs, these must be taken into account.

Security

The wide range of security arrangements offered by office buildings may also, depending on your needs, eliminate some from consideration. Some buildings offer no real security service beyond a camera in the lobby, if anything. Others seem harder to get into than the White House. You have to decide what level of security will make your staff, visitors and clients comfortable. Will they feel unsafe if anyone at all can walk into the building? Will they feel harassed if they have to pass through metal detectors and armed guards?

Service Hours

You also need to know the building's service hours for heating, air conditioning and both passenger and freight elevators. If you will need overtime service in any of these areas, the hourly charge must be negotiated in the lease. Such vague terms as "reasonable charges" should be avoided.

Package A/C Units

Many older properties, which were built before central air conditioning, provide air conditioning with "package units" that are placed inside, or nearby, the leased premises. These can give the tenant control over the service hours and the thermostat setting, but may entail responsibility for maintaining the unit. The system must be inspected and brought up to date, any existing warranties must be passed through, and the responsibility for maintenance must be negotiated in the lease.

HVAC Specifications

A simple statement that the landlord will provide heating and air conditioning is not sufficient. It is advisable to include minimum specifications in the lease, so that there's a reference in case of dissatisfaction. The following specification statement is adequate to most tenants' needs:

The air conditioning system will provide interior conditions of 72 degrees Fahrenheit dry bulb and not greater than 50 percent relative humidity when outside conditions are 85 degrees Fahrenheit dry bulb and 72 degrees Fahrenheit wet bulb, except to the extent such services shall be limited by any governmental authority. The heating system shall be capable of maintaining 72 degrees Fahrenheit based on outdoor conditions of zero degrees Fahrenheit, except to the extent such service shall be limited by governmental authority.

MISCELLANEOUS LEASE ISSUES

The Use Clause

Every lease limits or specifies the type of activity that is permitted to the tenant. This is the purpose of the Use Clause, which can be a negotiating minefield. It's a critical area of discussion, since it sets the parameters not only for your tenancy, but for any subtenant that might succeed you in the space. If, for example, it states that the space will be used by a legal assistance service and that's what you do, it will be fine for you, but you won't be able to sublease to anyone with a different mission. The Use Clause should be drafted as broadly as possible; the preferred language is "general office (or administrative) use". If you're planning to use the space for more than administration, the Use Clause should also explicitly allow training or program operation, or whatever term fits your activities, but worded as vaguely as it can be negotiated. Your broker should address this issue from the outset, in the Opening Proposal.

Default & Notice Clauses

If you default in your obligations under the lease, there are serious penalties. You could lose your rights to any remaining free rent, to sublease the space, or to remain in it. If you're evicted, you could still be liable for the rent, as well as for legal fees and other charges. Leases prepared by landlord attorneys make this much too easy to occur, so the default provisions should be carefully scrutinized and negotiated to the point of reasonableness. If you're late in paying the rent, for example, the landlord should be required to notify you and give you a feasible amount of time to get up to date.

There are a variety of other notice provisions in every lease; all of them should be reviewed. The attorney's draft will provide the landlord with plenty of notice of anything the tenant wants to do, and the tenant with very little. It is usually not difficult to modify these provisions in the lease negotiation.

In Case of Fire

The landlord's responsibilities to restore and repair fire damage will be specified in the lease, along with limitations on those responsibilities as well as rights to terminate the lease under certain circumstances. In the post-9/11 world, it is also advisable for tenants to negotiate protections and termination rights if the premises become unusable due to an explosion or other disaster that occurs outside the building. Landlords never offer this, but many do agree to it.

Hazardous Materials

Your broker's Opening Proposal should stipulate that the landlord will provide you with adequate documentation that the premises are not contaminated by asbestos or any other hazardous materials. Many landlords will readily offer in response Form ACP-5 or ACP-7, which are NYC Department of Environmental Protection inspection reports that are prepared by licensed professionals. If a landlord has no such documentation, and will make no binding representations as to non-contamination, you may want to eliminate that property from consideration.

Self-Help Remedies

Office leases provide landlords with lots of remedies if their tenants don't fulfill their responsibilities, such as paying the rent on time. Landlords have responsibilities to provide services as well, but remedies available to the tenant have to be negotiated. In serious cases of the landlord's failure to perform, especially if your ability to carry on your business is impaired, the rent should be abated. If the landlord fails to make an important repair in a reasonable amount of time, and you have the ability to get it done, you should be able to deduct the repair's cost from your rent. Most landlords resist granting these rights. Their importance to any individual negotiation depends on the landlord's reputation, the state of the building's upkeep, and other factors by which you measure the risk of occupancy. (See *Appendix D* for a sample self-help clause.)

Insurance

Tenants are required to carry liability and "all-risk" insurance policies, with coverage limits that depend on the landlord and the size of the tenancy. You probably won't know how much coverage the landlord wants you to have until you receive the draft lease; this too can be subject to negotiation. Most landlords require proof of coverage before handing over the keys.

Section VII

ADDITIONAL TOPICS

7.1 BUYING & SHARING OFFICE SPACE

7.2 NEGOTIATING A LEASE RENEWAL

7.3 RESTRUCTURING A LEASE

BUYING & SHARING OFFICE SPACE

Since people who run non-profits are, by necessity, creative, it's not surprising that they often think of unconventional ways to solve their office space needs. These generally fall into three categories, two of which are Space Ownership and Space Sharing. The third is obtaining free space from a board member's law firm, a church, the City or some other willing donor. This almost never works out, but it's certainly cost-effective if it's really feasible. (If you've read this far, this is probably not an option for you.)

Buying Office Space

Most non-profits don't have the resources to purchase office space in New York. For those who enjoy the luxury of seriously evaluating this option, it can be an exciting adventure that opens a new chapter in their organization's evolution. There are many dimensions of advantages in ownership. There are also serious drawbacks in comparison to leasing, which must also be considered.

Among the advantages . . .

- It sends a message of presence and stability to staff, clients and funders.
- It provides long-term space security, free of fluctuations in the office market.
- Property taxes, which are a component of rent payments, are eliminated.
- The value of the investment can increase over time, through equity buildup and appreciation.
- As the owner, you will control how the property is managed.
- A pending purchase presents an opportunity to run a Capital Campaign.

On the other hand . . .

- There is a limited supply of availabilities, and competition from professional investors.
- Renovation costs can be substantial.
- Staff responsibilities for property management can distract from program operation.
- Flexibility for future expansion can be limited.
- The investment is illiquid and undiversified, unlike stocks and bonds.
- If surplus space must be leased to others, market risk is inevitable.

These factors must all be taken into account in making this momentous decision. In addition, your broker or consultant should prepare detailed financial projections of both lease and purchase scenarios.

Sharing Space

Non-profits, being collegial entities, are better candidates than most businesses to take advantage of the benefits that can become available through sharing office space, such as . . .

- The cost of conference rooms, break rooms, kitchens and other common areas can be split.
- If both will be on the lease, their combined financial strength can add to negotiating leverage.
- Savings can be realized in the purchase of telephone systems and computer networks.
- Some staff costs, such as reception, can be divided.
- Both organizations can benefit from synergy, particularly if they share a related mission.

Like any relationship, though, this can turn into a disaster if certain questions aren't thought through in advance, among them. . .

- If both partners are on the lease, who will make space management decisions?
- How will the conference space be allocated or reserved?
- What will happen if one of the partners becomes unable to afford its share of the rent?
- What will happen if one of the partners outgrows its share of the space?
- Will the arrangement survive future changes in the partners' Executive Directors?

If a space-sharing arrangement can be agreed upon, the detail should be put in writing to prevent any future misunderstandings.

NEGOTIATING A LEASE RENEWAL

Because of the many benefits that lease renewals offer tenants, most of the office leases signed each year are renewals or extensions of existing leases. The most obvious of these is avoidance of the substantial cost and operational disruption entailed by moving. Another is the opportunity to “play the market”: If local market conditions are softening, for example, a short-term renewal permits a tenant to remain in place, without making a long-term commitment, until market rentals have dropped. Lease renewal also precludes the nuisances of changing stationery and communicating a new address to funders and clients.

Most non-profits, however, do not approach the renewal negotiation from a strategic perspective. Negotiations are often ill-informed or poorly timed. Sometimes, the organization simply accepts the landlord’s first offer, and does not negotiate the renewal at all. These are costly errors, which *guarantee* an above-market rental during the renewal term. Sophisticated tenants, in contrast, approach a lease renewal with the same level of strategic planning that would guide them through relocation. If your renewal triggers a significant rent increase, the future viability of your organization may depend on an effective real estate strategy. Facing a difficult situation, the last thing you want to do is make it worse.

An effective lease renewal strategy is based on four key components:

1. Bring In a Professional to Negotiate with Your Landlord.

Your landlord has nothing to do but think about real estate. Because, as a non-profit executive, you have a lot more (important) things to think about, you are no match for him or her in lease negotiations. And he or she knows it. When you bring an experienced broker or consultant into the discussions, though, it immediately puts the landlord on notice that market realities will not be ignored, and that your interests will be zealously protected in all aspects of the upcoming negotiation.

2. Give Yourself Enough Time to Maintain Flexibility and Leverage.

Real estate people know that it takes 12-18 months, on average, for any tenant to relocate. If you delay starting your program until there are only a few months left on your lease, the landlord knows that renewal may be your only realistic choice, and that he or she has you over a barrel. You then become a “captive tenant”. In negotiating a renewal (or anything else, for that matter), you can be successful only if you have the luxury of walking away from the table.

3. Use Market Conditions to Create a Baseline Value.

How much is your space really worth? The value of any unit of office space is a function of supply-and-demand conditions in your sub-market, i.e. comparable space in similarly located properties. Part of your broker/consultant’s role is to research these market conditions, and to establish a baseline value for your space.

This negotiation baseline should be determined by the value of the space *to your landlord*, not to you. The first question is, “What rent could the landlord reasonably expect to realize, *after* deductions for expenses, if an outside tenant rented the space?” For example, if a market-rate transaction includes a landlord contribution of \$60 per square foot toward tenant improvements, but your renewal would not require this expense, the rent for a ten-year renewal should be about \$9 per square foot lower than the market rent. Marketing costs and rent abatements are other expense deductions that should be considered. Remind the landlord, as well, that your renewal entirely eliminates market risk, and that occupancy and rent payments will not be interrupted.

4. Make the Landlord Compete for Your Tenancy.

You must create a competitive environment to be effective in your negotiation. In order to do this, your consultant/broker needs to identify, price, and sometimes even negotiate, viable relocation alternatives, even if your preference is to stay put. Your landlord cannot be expected to negotiate seriously unless he or she knows that you can, and might, take your business elsewhere. Even if you have absolutely no intention of relocating, you need to identify one or several “stalking horse properties” against which the landlord will have to compete.

RESTRUCTURING A LEASE

For tenants whose space is likely to remain suitable beyond the expiration of the lease, their best opportunity to secure those needs is often through restructuring the existing lease, two to three years prior to the expiration date. That remaining term on the lease offers powerful leverage in the renewal negotiation, leverage that will dwindle as time passes. Most tenants, however, even sophisticated corporations, let this opportunity slip by.

The concept is a simple one, although its execution can be extremely complex. If rents are rising, for example, the restructured lease can trade a small rent increase during the short remainder of the existing lease for a below-market rate during the longer extension term. If the market is softening, it may be possible to negotiate an immediate reduction in the existing rent, in return for an extended commitment that eliminates the landlord's risk of future vacancy. In either case, the tenant uses the remaining lease term, and the landlord's avoidance of significant capital costs, as leverage in restructuring and extending the lease.

A successful restructuring negotiation requires a comprehensive understanding of the many variables that could bear on it. A proposal that makes sense for both you and your landlord has to be based on several categories of information, such as . . .

- *Market Conditions:* How does the current market rental, and the projected future market rental, for space similar to yours, compare with your existing rent? For this type of space, what are the near-term trends concerning escalations, concessions, and other lease issues?
- *Space Planning:* Given your projections of staffing and program operation, will the space continue to meet your needs seven or more years into the future? If you will need more space, can it be made available in the building? Would renovations be required to spruce it up or to make it more efficient for you?
- *Building Study:* What is the building's current vacancy rate? Are any major tenants planning to leave in the near future? What's happening in the space adjacent to yours? Are any tenants interested in expanding into your space? What capital costs would the landlord incur to attract a new tenant, including marketing, brokerage, construction and free rent?
- *What If You Don't?:* If you let the lease expire, what relocation options are you likely to have? How much expense and disruption would a new lease entail? Would relocation have a positive or negative impact on fundraising and program operation?

Based on the answers to these questions, and others that may arise, a new deal structure can be crafted that benefits both you and your landlord. This can be accomplished in any market environment, and can accommodate expansion or contraction, space renovations and base building improvements. Skillfully executed, this strategy can provide you with a below-market rent, *and* provide the landlord with the equivalent of a market-rate deal, while eliminating market risk for both parties. You benefit from this negotiation even if it's not successful, since it gives you strategic insight into the market conditions and the possible renewal negotiation that awaits you in the next year or two.

APPENDICES

- (A) GLOSSARY OF OFFICE LEASING TERMS**
- (B) SAMPLE FINANCIAL ANALYSIS**
- (C) SAMPLE “GOOD-GUY” GUARANTEE**
- (D) SAMPLE SELF-HELP CLAUSE**

GLOSSARY OF OFFICE LEASING TERMS

Above-Standard Cleaning

Cleaning specifications over and above those considered “standard” for the building, such as the care of special carpeting, kitchens or rare woods.

Above-Standard HVAC

Comfort levels to be maintained in the space over and above those considered “standard” for the property, including after-hours heating and air conditioning.

Above-Standard Installation

Construction necessary to prepare a space for tenant occupancy in addition to that specified in the building standard installation.

Amortization of Installation

A method for landlord financing of all or part of the tenant installation, whereby the tenant reimburses the landlord with interest over the term of the lease.

Arbitration

A less costly method than litigation of resolving landlord-tenant disputes during the term of the lease.

Asbestos

A potentially toxic construction material used in the past, which must be removed by professionals.

As-Is

Agreement by the tenant to accept the premises without any alterations by the landlord.

Assessed Value

A value placed on the property by the municipality for the purpose of taxation, which may or may not bear a close relation to market value.

Assignment Rights

The lease clause which specifies the circumstances, if any, under which the tenant may transfer its rights and obligations under the lease to another party.

Base Rent

The basic per-annum rental specified in the lease.

Base Year or Amount

The year or amount fixed in the lease as the basis upon which future escalation will be calculated. (The Base Year is not necessarily the first year of the lease.)

Building Core

The vertical backbone of the building, including elevators, air shafts, lavatories, stairways, mechanical shafts, etc.

Building Module

Standard dimensions for the division of the leased unit into individual offices, dictated by the spacing of window mullions.

Building Standard Installation

The workletter specifications routinely offered to all prospective tenants in a building.

Center-Core

A building configuration in which the building core extends through the center of each floor, usually optimizing the number of perimeter, windowed offices.

Cleaning Specifications

A detailed list of the tasks to be accomplished by a cleaning contractor, and the frequency of each.

Common Areas

Portions of the building designated for the benefit of all or a group of tenants, such as lobbies, corridors, lavatories and mechanical areas.

Compartmentalization

The division of floors into smaller units to meet fire code requirements.

Contiguous Space

Units of space immediately adjacent to the subject space.

CPI Escalation

An escalation formula through which the base rent, or a portion of the base rent, is increased annually by the percentage increase in the Consumer Price Index over that of the base year.

Cross-Over Floor

A floor served by two elevator banks, permitting passengers to transfer from one bank to another without returning to the lobby.

Demising Walls

Walls meeting code specifications to divide tenant areas from each other and from common areas.

Direct Metering

Purchase of electricity directly from the utility company, with direct billing for usage and no landlord markup.

Direct Pass-Through

An escalation formula through which the tenant is charged its pro rata share of increases in the building's real estate taxes and/or operating expenses over the base amount or those of the base year.

Effective Annual Rent

The "bottom line" of a financial projection, generated by reamortizing the Net Present Value of the cash flow stream projected over the term of the lease.

Elevator Bank

A series of elevators dedicated to serving specific floors.

Escalation

Charges in addition to base rent and rent steps, which may be calculated according to a variety of formulae.

Escalation Cap

An agreed-upon amount beyond which escalation will not be charged.

Expansion Option

The agreed-upon terms upon which a tenant has a right, but not an obligation, to expand into specific additional space.

Fair Market Value

The rental which could reasonably be achieved under prevailing market conditions at a specified time. (Often used to set future rentals in connection with expansion or renewal options.)

Free Rent

A period of time during which the tenant has possession of the space, but is not required to pay rent.

Gross Base Rent

A base rental that includes the tenant's share of property taxes and operating expenses in the base year.

Hold-Over Clause

The lease clause that specifies the penalties that will be incurred by a tenant who remains in the premises after the Lease Expiration.

HVAC Specifications

The defined minimum comfort levels that the landlord is required to provide in the space during stipulated days and hours, including specific bulb temperature range representations.

HVAC Zones

Portions of a tenant area (or of a building) characterized by dedicated thermostatic control.

Indexed Escalation

An escalation formula that increases the rent each year by a specified percentage.

Lease Audit

A consultant's investigation of whether landlord billing is in accordance with the lease.

Lease Commencement

The date when the term of the lease begins, often but not always the same as the Possession Date.

Lease Expiration

The date when the tenant's rights and obligations under the lease are scheduled to end (although certain specified obligations may survive).

Lease Take-Over

The assumption by a landlord of a tenant's prior lease obligations at another property.

Lease Term

The period between the Lease Commencement date and the Lease Expiration date.

Loss Factor

The percentage of Rentable Area that is not Usable Area. (Loss factors vary widely among buildings in any market, and are often established arbitrarily by landlords.)

Mullions

Divisions of large windows or glass curtain walls, which permit the division of surrounded space into Building Modules.

Net Base Rent

A period of time during which the tenant has possession of the space, but is only required to reimburse the landlord for its pro rata share of property taxes and operating expenses.

Net Free Rent

A base rental that does not include the tenant's share of property taxes, operating expenses or utility costs.

Net Present Value

The current value of a future cash flow stream, discounted at a given rate.

Non-Disturbance

The tenant's right to continued occupancy under the existing lease terms, regardless of the landlord's fulfillment of obligations to others (e.g. mortgage and ground lease payments).

Operating Expenses

The cost to the landlord of heating, lighting, air conditioning, maintenance, insurance and general operation of the property.

Partitioning

Divisions between tenant areas, individual offices and office suites.

Porter Wage Formula

An escalation formula which increases the rent based on changes in a specified labor rate over those prevalent in the Base Year, sometimes including the cost of fringe benefits.

Possession Date

The date when the tenant takes control of the space, either for interior construction or for actual occupancy.

Post-Lease Alterations

Alterations to the premises made by a tenant during the lease term, which may require the consent of the landlord.

Profit-Splitting

An arrangement through which profits generated by a sublease or assignment are shared between tenant and landlord, according to a specified formula.

Real Estate Taxes

Taxes levied on the owner of a property, calculated by multiplying a set rate by the property's assessed valuation.

Recapture

The right of the landlord to void a tenant's lease for all, or a portion, of the premises in order to prevent a sublease or assignment.

Renewal Option

A lease clause specifying the terms and conditions under which the tenant may extend the lease term, without obligating the tenant to do so.

Rent Abatement

A period of time during which the tenant is not charged rent for the space.

Rent Commencement

The date upon which the tenant is obligated to begin paying rent.

Rent Inclusion

A separate charge for electricity by the landlord, based on an estimate of tenant usage (which might have little or no relation to the tenant's actual usage).

Rent Steps

Agreed-upon increases in the Base Rent that take effect at specified dates during the term of the lease.

Rentable Area

The square footage used to calculate Base Rent. It includes the Usable Area, a percentage of common and mechanical areas, and sometimes square footage that simply does not exist.

Restoration Clause

A lease clause requiring the tenant to restore the premises to its original, pre-lease condition upon the expiration of the lease.

Restrictive Covenant

A lease clause prohibiting the landlord from renting space in the building to certain types of users, usually competitors of the tenant.

Right of First Offer

A tenant's right to be offered additional space in the building by the landlord before that space is put on the open market, or offered to any other party.

Right of First Refusal

The right of a tenant to match the terms offered by another party in a transaction, and thereby replace that party as principal. (Usually used in connection with anticipated expansion or renewal).

Security Deposit

An amount deposited with a landlord to ensure the tenant's fulfillment of its obligations.

Side-Core

A building configuration in which the Building Core extends up the side of a building.

Sublease Rights

The lease clause defining the tenant's rights, if any, to sublease all or part of its space to one or more other parties, and the consequences of so doing.

Submetering

An arrangement through which the landlord purchases electricity from the utility company and resells it (usually at a profit) to each tenant, whose usage is separately metered.

Substitution Clause

A provision in the Workletter permitting the tenant to substitute materials of equal cost without additional charges.

Takedowns

Fixed, specific terms under which the tenant is obligated to expand its occupancy in the property, including areas, possession dates and rental rates.

Target Assessment

A revised assessed valuation, which goes into effect over a period of time.

Tax Rate

The dollar amount due in real estate taxes for each \$1,000 in assessed valuation (frequently called the "mill rate").

Tenant Improvement Allowance

A dollar amount provided by the landlord to reimburse the tenant for costs incurred in constructing the Tenant Installation.

Tenant Installation

Interior construction necessary to customize the space for occupancy by the tenant.

Transition Year

A year in which a property's assessed valuation is incrementally increased as it approaches a new or target assessment.

Turnkey Installation

An installation completely finished to the tenant's specifications, with no need for additional construction. (Used as shorthand in negotiations, but must be defined specifically in the Workletter.)

Underfloor Ducts

A duct system permanently installed in the floors for telephone, computer and electrical wiring.

Unit Price Clause

A section of the Workletter stipulating the unit prices of materials. (Used in the application of a Substitution Clause or in the calculation of credits for materials not used.)

Usable Area

The square footage exclusively occupied and controlled by the tenant. (Sometimes characterized as "carpetable" area, though there is no standard method of calculation.)

Use Clause

The specified use of the space by the tenant (and any subtenants) as defined in the lease.

Utility Escalation

A lease provision requiring additional charges based on increases in the cost of electricity, gas, steam and/or fuel, over the costs of these in the Base Year.

Working Drawings

Architectural drawing required before a building permit can be obtained and construction can commence. (Typically including partition plans, HVAC plans and specifications, plumbing, electrical, reflected ceiling, finish detail, etc.)

Workletter

The landlord's itemized schedule of specific labor and materials to be provided in constructing the Tenant Installation.

Appendix B

SAMPLE FINANCIAL ANALYSIS

10,000 Usable Square Feet
13,661 Rentable Square Feet

26.8% Loss Factor

Lease Term:	10 years	3 Months Free Rent
Base Rent:	\$35.50 per RSF plus cleaning	
Cleaning:	<u>2.00</u> per RSF	
Gross Rent:	\$37.50 per RSF	<u>Capital Costs</u>
Rent Steps:	\$2.00 per RSF in Year 6	\$43.50 per RSF (incl. A&E)
Electricity:	\$3.00 per RSF	8% Financing
		\$6.33 per RSF per annum
Real Estate Tax:	\$4.21 per RSF (Year 1 Base)	
Operating Base:	<u>\$19.30</u> per RSF (Porter Wage -- Year 1 Base)	
Escalation Base:	\$23.51 per RSF (Combined)	
Escalation Rate:	3% per annum	

<u>Lease Year</u>	<u>Gross Rent</u>	<u>Combined Escalation</u>	<u>Electricity Cost</u>	<u>Capital Amortization</u>	<u>TOTAL per RSF</u>	<u>TOTAL COST</u>	<u>NPV</u>
1	\$28.13	\$0.00	\$3.00	\$6.33	\$37.46	\$511,725	\$495,714
2	37.50	0.71	3.00	6.33	47.54	649,434	586,702
3	37.50	1.43	3.00	6.33	48.27	659,359	555,510
4	37.50	2.18	3.00	6.33	49.01	669,581	526,091
5	37.50	2.95	3.00	6.33	49.78	680,109	498,338
6	39.50	3.74	3.00	6.33	52.58	718,276	490,823
7	39.50	4.56	3.00	6.33	53.40	729,446	464,851
8	39.50	5.40	3.00	6.33	54.24	740,951	440,350
9	39.50	6.27	3.00	6.33	55.11	752,801	417,231
10	39.50	7.17	3.00	6.33	56.00	765,007	395,411

Net Present Value:	\$4,871,021
Effective Annual Cost:	\$674,744
	\$49.39 per RSF
	\$67.47 per USF
<i>Calculated at 7%</i>	

<u>Per RSF</u>	<u>Per USF</u>	<u>Average Annual Cost</u>	<u>TOTAL</u>
\$37.56	\$51.31	- Gross Rent -	\$513,149
3.44	4.70	- Combined Escalation -	47,016
6.33	8.65	- Capital Amortization -	86,520
<u>3.00</u>	<u>4.10</u>	- Electricity -	<u>40,984</u>
\$50.34	\$68.77	- TOTAL -	\$687,669

Appendix C

SAMPLE "GOOD-GUY" GUARANTEE

(Included in the Lease as an Exhibit)

In order to induce the aforesaid Landlord to enter into this Lease and for other valuable considerations, the receipts whereof is hereby acknowledged, _____ (the "Guarantor") hereby makes the following guaranty and agreement with and in favor of Landlord and its respective legal representations and assigns. The following personal guaranty, made for the benefit of the Tenant, is the only provision of the Lease to which the Guarantor is personally liable, unless provided elsewhere in the Lease, as all other provisions, clauses and terms of this Lease are binding upon the Tenant.

The undersigned guarantees to Landlord, its successors and assigns, that he/she shall pay to Landlord all Rent, Additional Rent and all other charges that has accrued under the terms of the Lease, (hereinafter collectively referred to as "Accrued Rent"), to the latest date that Tenant and its assigns and sublessees, if any, shall have completely performed all of the following:

- A. Vacated and surrendered the Premises to Landlord pursuant to the terms of the Lease, and
- B. Delivered the keys to the Premises to Landlord, and
- C. Provided Landlord with 180 days prior notice of the date Tenant shall vacate the Premises.

D. Paid to Landlord all Accrued Rent to and including the date which is the later of (a) the surrender of the premises, or (b) receipt by Landlord of the keys to the Premises.

E. This guarantee is absolute and unconditional and is a guarantee of payment and not of collection. The parties hereto waive all notice of non-payment, non-performance, non-observance or proof, or notice, or demand, whereby to charge the undersigned therefore, all of which the undersigned expressly waive and expressly agree that the validity of this Agreement, and the obligation of the Guarantors hereto shall in no wise be terminated, affected or impaired by reason of the assertion by Landlord against Tenant of any of the rights or remedies reserved to Landlord pursuant to the performance of the within Lease. The under-signed further covenants and agrees that this guarantee shall remain and continue in full force and effect, as to any renewal, modification or extension of the Lease and during any period when Tenant is occupying the premises as a "statutory tenant". As a further inducement to Landlord to make this Lease and in consideration thereof, Landlord and the under-signed covenant and Agree that in any action or proceeding brought by either Landlord or the undersigned against the other on any matters whatsoever arising out of, under, or by virtue of the terms of this Lease or of this guarantee that Landlord and the undersigned shall and do hereby waive trial by jury. This guaranty shall not be affected by any assignment of the Lease unless Owner has given its approval.

F. This guarantee shall be construed in accordance with the Laws of the State of New York.

G. In the event of assignment of Lease by Tenant with Landlord's consent, this guarantee shall cease upon delivery of an original copy of assignment to Landlord and provided the assignee executes a guarantee the same in form and nature to the instant guarantee.

In witness whereof the undersigned has set his hand this ____ day of _____, 20____.

By: _____

Name: _____

SS#: _____

Address: _____

SAMPLE SELF-HELP CLAUSE

Anything to the contrary contained in this Lease notwithstanding, if (i) Landlord fails to supply a particular service to Tenant which Landlord is required to supply; (ii) as a result thereof, Tenant cannot reasonably and practicably conduct its business in at least seventy percent (70%) of the demised premises, in substantially the same manner as such business was theretofore regularly conducted; (iii) such inability shall continue for more than ten (10) consecutive business days; and (iv) Landlord's subject failure to supply the particular service to Tenant is not beyond the reasonable control of Landlord and/or is not the result of force majeure, then the fixed annual rent and additional rent payable under Articles _____ of this Lease shall be abated on a per diem basis in the proportion in which the affected space bears to the demised premises, commencing on the first day after the above-stated ten (10) consecutive business day period has ended, and such abatement shall end immediately upon Landlord's supplying the subject service.

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