

RENTER PREPARE: WHAT WENT DOWN MAY BE GOING UP

By: Jack Garson, Esq.
As seen in Forbes

Office tenants take notice. Even though real estate experts are predicting only modest declines in Washington-area vacancy rates, rent hikes are probably on the way, at least in parts of the market.

Over the next two years, rents downtown will stabilize and in some instances increase, predicts Sigrid Zialeita, research director for Cushman & Wakefield in McLean.

The suburbs, particularly tech-heavy Northern Virginia hard hit by the slump and excess space, may only see a dollar or two increase over the next two years.

Still, a dollar here, a few more there. It all adds up.

So what should a tenant do?

Is now the time to make an office move? Should there be an effort to negotiate new lease terms?

"For cases like those, we recommend you lock in a deal now," says John Germano, CB Richard Ellis senior managing director for the Washington region. "Today tenants still have a window of opportunity. They will have more flexibility relative to rental rates and for expansion options or any other types of concessions."

SOME OPTIONS TO CONSIDER

A good rule-of-thumb with a lease is to get an option that allows you to renew it for the same number of years, says Bethesda attorney Jack Garson or the law firm Garson Law LLC.

"For example, a five-year option term would go with a lease that has an original five-year term," he says. "The real question is whether the landlord will let you renew at the same rent as the original deal. Most won't, particularly in a tighter rental market where rates are going up."

It may be more realistic to ask the landlord for an option to renew at a rental rate equal to the fair market value of the

premises with a cap on how high that rent could be.

"A typical compromise could be to agree that the rent increase cannot be more than 115 percent of the rent during the last year of the term, but cannot be less than 103 percent," Garson says.

Although a 15 percent increase sounds astronomical today, it could be a good deal if rental rates suddenly take off.



"Given that rental rates have been depressed, particularly in Northern Virginia, depressed rents could very well double during the next 10 years," Garson warns.

"Remember, if rates drop, you don't have to exercise your option. You can always renegotiate the lease."

KEEPING YOUR SPACE, AND THEN SOME

Another way to lock in rates is an option to lease additional space at a rent equal to that of your existing space.

Tenants also could negotiate to cap the amount of rent that can be charged for the expansion space.

"More likely, the landlord will offer you the right of first refusal to lease the expansion space," Garson says. In other words, you would have the opportunity to match any deal that the landlord offers someone else.

If rental rates are going up and the option to expand is unavailable, tenants could seek to lease more space than they currently need with the right to sublease that space. Tenants who lease a larger space have more bargaining power when it comes to negotiating a deal, in effect getting volume discounts.

"Landlords who get the big deals will do everything to make sure such tenants do not move," Germano says. "It's these tenants who are looking now to make a relocation and to craft the best deal they can."

GOING FROM A B TO AN A

While the rental market is beginning to show movement, Germano explains much of it is a flight to more quality space.

"Tenants in B-class buildings are moving to A-class space since the difference in rents is only slight," he says. "Consequently, you will see a vacancy in the A product definitely going down, and those rental rates going up."

If a business is considering a move just to save costs, Garson says to think carefully before making a decision.

"Better rental rates may not necessarily be better for business," he says.

A company in Bethesda, for example, might have good access to customers in both Northern Virginia and Maryland. But if it moves farther out, the business might isolate some clients who regard the new location as too far away. Also, the company could have trouble attracting talented workers who don't cherish the long commute.

"Relocating does not always make good business sense," Garson says. "It's better to maximize your lease terms for the ideal location for business."

ABOUT JACK GARSON



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Jack Garson's practice focuses on Real Estate, Construction and Business law. He serves as a legal advisor for numerous local, regional and national companies. In his role as legal counsel, Jack also serves as a strategic advisor and lead negotiator. Further, Jack provides guidance on the structure of complex transactions, the resolution of business disputes, the growth and sale of companies, and the management of issues such as liability and risk reduction, employment practices, and enhancing profitability.

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