

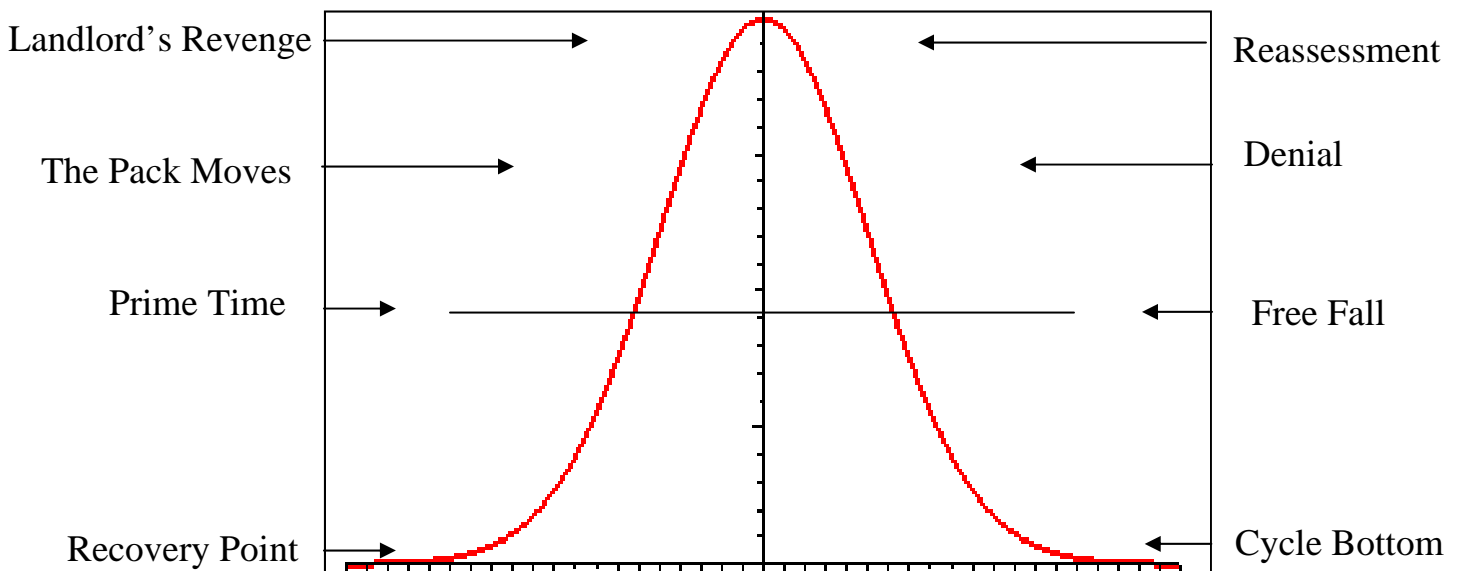
# Tenants Benefit by Understanding Business Cycles

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Most people are not in the real estate business and the comings and goings of that which is topical in real estate is just not important until it comes time to consider business changes that will need to be supported by real estate. Like the general business cycles that most of us are familiar with in our core industries, commercial real estate goes through cycles as well. Seldom does this industry create an environment that impacts the overall business cycle; by its nature commercial real estate is a trailing industry.

Having said this it is not uncommon for the development community to build new office space in a rising business cycle in the hope that there will be sufficient future demand for leased space from tenants. This is particularly tricky because it will take two to four years from inception to completion to have a building ready for occupancy. A lot can happen in a rising business cycle, but those who can anticipate the increasing demand for leased office space will be rewarded as they bring tenant ready office space to the market when space for expansion is limited. Supply/demand imbalances created by the variance in business cycles and the development community's ability to meet office space demands is important to understand for the office user. Knowledge of these cycles is important in planning major moves, determining lease expirations and choosing negotiating strategies. Careful thought in these areas, which is often outside the realm of relocation planning, can add substantial dollars to an organizations bottom line during the course of a single lease term.

Let's get back to business cycles and see if we can't simplify the basic bulge and show how an understanding of this wave will be beneficial to a relocating company.



There are six distinct segments to the business cycle from a tenant's perspective. The first is "Prime Time", that period which starts at the Recovery Point of the general business cycle and continues up until the point that the news media has confirmed the recovery is here and it is okay to move about the business community freely. Those who can identify these tipping points will get the best deals. They will be able to negotiate the lowest rents in the best locations, receive the most concessions from the landlord and get bargain prices from everyone involved with the move. Staffing companies are often one of the first industries to feel the shift in momentum.

Once a sufficient number of "Prime Time" transactions have been completed and the building owners and commercial real estate community begin to rejoice about the recovery – the shift is on!

This is when "The Pack" moves. Reassured by the local business news reports that revival is on the horizon and businesses begin to notice rising internal indicators, industries rush to grab office space to support the coming good times; title companies and mortgage brokerages are often in the forefront. Companies increasingly pay higher rents and receive fewer concessions than their peers in "Prime Time." If you find yourself negotiating a lease during this part of the cycle you'll want to be prepared before starting so you'll be able to move quickly to complete your negotiations before the next cycle is underway.

And now its time for "Landlord's Revenge." Landlords have suffered through another long down cycle and the recent period of recovery has been overdue. They have welcomed steadily improving conditions, but now its time to make up for all the down cycles losses for as long as the tenant demand holds out.

This period is characterized by rapidly increasing prices, no free rent or concessions and a limited number of options from which to choose. It is not uncommon in this part of the cycle to see tenants pay for all their own tenant improvements that just a short time before, were fully paid for by the landlord.

If one must take space in this phase of the cycle, keep leases short and improvements to a minimum, because it won't be too long before the cycles will move again and we will see the waning of this peak landlord advantage.

Nothing lasts forever and before long office space has gotten so expensive that tenants begin to "Reassess" the necessity of moving. Companies will begin to explore renegotiating existing leases or shifting office expansion to markets with lower rental costs. The intensity in the leasing market begins to wane even though most businesses are charging along because of the recent two positive phases in the business cycle, this is the twilight of the landlord's revenge.

“Denial” is the phase that can be the trickiest in which to relocate. Here the landlords are in denial about the softening leasing market. This is characterized by the longer vacancies, the first signs of business failures and the emergence of sub-lease space returning to the market place. We call this the most difficult cycle to lease space because rates are higher then they will be in the near future, concessions are still absent. By holding off making a move decision in this part of the cycle a company can substantially reduce long term facility costs.

It would seem that the “Free Fall” phase is the one in which tenants should be looking toward for their relocation planning, but we haven’t hit bottom yet and “no one is going anywhere.” In the early and mid stages of this cycle landlords will maximize concessions and reduce rental rates to the lowest point in the cycle. This is an ideal time to relocate or renegotiate a lease. The major inhibiting factor is that the tenant’s company also may be experiencing a business down turn and it may be difficult to take advantage of low leasing rates with so much uncertainty on the horizon. If your company has the capacity to plot recovery trends against the general economy or if your business is counter cyclical you should be planning to take advantage of this part of the business cycle and position the firm so real estate facility decisions can contribute to the bottom line for years to come.

Understanding business cycles will enable decision makers to position leasing and acquisition decisions to take advantage of business cycle lows. Advantages to be attained will be in the areas of:

1. lower rental rates
2. higher tenant improvement allowances for interior build out
3. stronger positions in lease negotiation
4. favorable terms for options, renewals, and contractions

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