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The so-called 'deals' in landlord negotiations

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Everybody loves to brag about getting a special deal -- either buying something at the cheapest price ever or fetching a record-high price for something they sell. This, in part, is borne out by the old adage in residential real estate that suggests there are two things homeowners often lie about: what they paid for their house and what they sold it for.

Of course, there are very few occasions in which a buyer can actually verify whether he or she is getting it at the very cheapest price possible. We tend to think so when we see and respond to "Liquidation Sale" in bold red letters on a furniture store window or when we're able to con the server at McDonald's to throw in a "free" bag of French fries with our Big Mac. How many times have you heard somebody claim that they bought their new car at a price lower than what the dealer paid for it? As if the dealer can stay in business by selling something under his cost.

Fact is, there is a tremendous markup in furniture; French fries are as cheap as they are unhealthy and in the automobile sales business, there are all sorts of dealer kickbacks and the like that enable a dealer to "recover" his "losses" through rebated payments and incentives from automobile manufacturers.

The same bargain myths exist in the office space market nowadays, except that it takes on a different form: the "ask-really-high-settle-a-little-lower" approach. The straight-faced landlord tells a tenant, shopping for office space, the standard leasing rate for a particular space is $4 per square foot per month. Once the tenant regains consciousness from sticker shock, the landlord pulls out a "special" deal for $3.20 per foot, often resulting in the unwary tenant thinking he or she got a really good deal. After all, it's not every day that you can negotiate a 20 percent savings.

Or is it? What about those inflated asking prices that are floated out there with the sole intent to mask the actual price the landlord wants as a "deep discount" rate? The $3.20, in all actuality, is super retail.

Let's add in a little context. Five years ago, the landlord was no doubt trying to rent out that space for $2 per foot and was more than willing to throw in six months of free rent and a hefty tenant improvement allowance. Today, that landlord -- or the chump who bought the building from that landlord -- is asking $3.20 with no free rent and half the tenant improvement money. To make it saleable, he has to make the initial offer at $4 to protect the tenant from realizing he or she has been had by the so-called discount price. About the only solace such tenants have is the knowledge that other tenants are being taken, too.

Most tenants and others realize there are inflationary pressures on office space and other costs. What tenants don't understand is the "Brazilian-like" inflationary-level commercial property owners have been using to calculate their rental increases. Case in point: U.S. inflation during the past decade has averaged less than 3 percent per annum compounded. Yet, commercial owners have increased rents during this period by about 15 percent compounded.

How does this work and why? It works mostly through what I'll refer to here as reverse engineering. Landlords pay exorbitant prices for office buildings and properties and then back those prices into the rental rates they need in order to support what they paid for the property. They totally ignore any notion of supply and demand, positive or negative absorption, job gains and losses in calculating their rents. As such, these landlords are operating in a market vacuum where the surrounding economics such as I've just mentioned are disregarded.

This form of negotiations is somewhat akin to Las Vegas odds, in which the house wins far more than it loses and in which tenants need all the help they can get to at least level the playing field, if not overcome landlord odds.

Tenant representatives don't always come to the table with all the aces up their sleeve on behalf of their office space clients. But they do have X-ray vision that at the very least allows them to see the cards being held by the house -- my metaphor here for the landlord. They certainly know the market trends in leasing rates for the area, how long the space has been vacant, how well -- or not well - is the building being operated and whether the tenant will actually enjoy being in that building over the course of a multiyear lease.

All of us appreciate doing business with people who solve problems and fulfill important needs and we're all too happy to put a premium on being able to do so. What's particularly vexing is paying a premium for problem makers -- not solvers -- who are lousy property managers and who are just as likely as not for their own benefit to pack a case of Cuban cigars and season tickets to the Padres into an unsuspecting tenant's operating expenses.

The best defense is a good offense. Tenants need representatives who are wiser and craftier than the landlords to be sure they are getting a genuine deal in leasing office space.

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