



ORANGE COUNTY

How to Decide Between Longer and Shorter Leases

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Whether you're a landlord or a tenant, it's critical to know your business objectives and where you want to be down the road in order to get the right deal terms, the Saywitz Co.'s Barry Saywitz tells GlobeSt.com.



Saywitz: "In this market, it's hard to have your cake and eat it too if you're a tenant. It's tough to find a short-term lease and low rent."

IRVINE, CA—Whether you're a landlord or a tenant, it's critical to know your business objectives and where you want to be down the road in order to get the right deal terms in a **lease**, the **Saywitz Co.**'s president **Barry Saywitz** tells GlobeSt.com. He also says there are pros and cons to both **longer** and shorter leases. We spoke with him about those pros and cons and how each type of lease term is affected by the delivery of new **inventory**.

GlobeSt.com: What are the advantages and disadvantages of longer leases for landlords and tenants at this point in the real estate cycle?

Saywitz: You have to look at both sides of the coin. In a hot market, the advantage of a longer-term lease for a landlord is that they can take advantage of the fact that rates are up, so they can lock in the lease at the higher end of cycle with annual escalations. Overall, that rent picture is good for them. If the tenant is there for the long term, the landlord can secure cash flow with an overall better return, and if refinance rates are still attractive, they can put improvements in place. Also, if the landlord is planning to sell down the road, a longer-term lease adds value to the property overall—should the market turn in the future, the tenant is still locked in at a higher rate, which keeps cash flow up. Regardless of rates, whatever capital I put in today, I can amortize it over time, and I won't have to spend more money if the tenant leaves in three, five or 10 years.

From the tenant side, the advantages are similar: if they do a longer-term lease, they know they have their property and space secured for a longer length of time and they don't have to move in three to five years. And if they're spending their own money on infrastructure and other improvements, they can amortize or appreciate that on their own books over the life of the lease, and they don't have to spend money on those things again if they should happen to move. Also from tenant perspective, if I was negotiating and willing to lock in at higher end of the cycle, I could negotiate a better deal—either lower rent or improvements; it provides negotiating leverage. And, if a landlord has other interested parties in a property at which I'm looking, and I'm willing to sign a longer lease, that makes me more attractive than someone else.

The downside of a longer-term lease to the landlord is not much, other than that it ties up the property for a longer period of time, so if I wanted to sell or reposition it, I'm making a long-term commitment and have to live with that, good or bad. A landlord who believes the market will continue to go up may want to do a shorter lease because they're leaving money on the table. It makes sense for you to lock in now if rates are not going to rise.

The downside to the tenant are, if I lock in on a long-term lease and rates go down, I'm stuck with a higher rent. And if the space won't work down the line, I'm stuck. But if you know what you need and are comfortable in the space, it's better to lock in and know what you've got.

GlobeSt.com: What about shorter-term leases?

Saywitz: There's more flexibility for both sides. On the tenant side, there's flexibility if you grow or don't need all the space. If the market should change, you could negotiate sooner than later if needed. If the market continues to go up, you will just pay more. Tenants who didn't lock in for a longer period of time in the last three to five years will pay the price for doing it. There's a competitive advantage to locking in rental rates: if you're a manufacturer or distribution company, and your neighbor is locked in with a low rate, they can be more competitive than you if you have to renegotiate at a higher rate. For the landlord, you may not want to lock in if you have a lot of moving pieces. But there are situations where it may not make sense to have a tenant in the building. It comes down to flexibility and risk.

GlobeSt.com: *How does the delivery of new inventory affect the way each group views lease terms?*

Saywitz: Tenants in a new **development**, whether **office** or **industrial**, will likely not be interested in a short-term lease because many have a proforma that they have to answer to, so a short-term does nothing to satisfy those criteria. A developer who is keeping the product would not entertain a short-term lease. For developers looking to lease up space because they're selling the product, they wouldn't want a short-term lease because that scares potential buyers: improvements cost more the when you have to turn over space often, so why do that and then have to do it again in three to five years? From a tenant's perspective: why would they want to do a short-term lease on new development? Why would you want to move in three years if it's new space?

Tenants need to find existing space that requires minimal improvements in exchange for not asking the landlord for a lot. From a landlord's perspective, what is your long-term play for the building? If you're keeping it, you will probably want a long-term lease. If you're keeping it or remodeling, do short-term leases. For buildings that might be renovated, it may be OK to do short-term leases. Tenants should look at those spaces. But in this market, it's hard to have your cake and eat it too if you're a tenant. It's tough to find a short-term lease and low rent.

Your strategy should be, if you're a tenant, start early, be prepared, know what you want and do not vacillate. You can't kick tires; no one will talk to you and get serious with you unless you're ready to act on a transaction. So, if you're willing to move on a transaction, that will get you action. You need to move so you're not just stuck with one option. For the landlord, figure out what your strategy is. Are you holding it for the long or short term? Will you remodel and sell or

not? And wait a little longer to get the right fit—you don't have to take the first guy who walks in the door.

GlobeSt.com: What else should our readers know about this?

Saywitz: Some tenants are used to doing three-year leases, and I say why? They say it's because they've always done it, but that's dumb. I say, "You're here. If you do a longer lease, you could negotiate lower rent."