

\$ave BIG on your office lease renewal

By Evan Reynolds | President, Medical Space Advisors

Most medical practitioners are searching for ways to cut their overhead cost, but many ignore the opportunity to reduce one of their largest operational costs. This opportunity comes in the form of an office lease renewal, which usually occurs only every five or 10 years. Most physicians wait until just a few months or weeks remain on their lease to start discussing renewal terms, but negotiations are most successful when carried out at least nine months before the lease expires.

This procrastination results in the landlord possessing all the advantage because he knows the tenant has no intention of moving his practice. The landlord usually will offer the busy physician a “preferred renewal rate,” and that generally ends the negotiations. The physician never had a chance in this one-sided scenario, and, unfortunately, this is common for medical tenants. Most physicians do the opposite of what they should do when they are renewing their lease, and so forego significant savings. A physician who leases 2,000 square feet easily can forfeit \$20,000 to \$40,000 over the term of a typical medical lease by failing to effectively negotiate the lease renewal.

Building owners view a medical tenant largely as a captive. Owners know that medical tenants tend to stay where they are for a long time — on average, 18 years. Owners also know that most healthcare professionals are busy and pay little attention to the lease expiration date, often realizing the expiration is imminent only when the owners notify them. At that point, the physician has lost any ability to convince the landlord that he might relocate, thereby eliminating his negotiating leverage. Most tenants don't like confrontation, so they accept the landlord's initial renewal proposal with little or no negotiation.

Lease renewal strategies

The key objective for a building owner is to maximize rental income, and the goal of the physician is to minimize rental cost. So, how does a physician

effectively negotiate his lease renewal? The short answer is that the physician should approach the negotiation as if he absolutely is moving his practice and that he seriously is considering viable relocation alternatives. All communications with the landlord must reinforce the premise that the physician diligently is evaluating alternatives in the market. These alternatives may include relocating to a new lease space or purchasing an office condominium. The physician must have no direct conversations with the building owner that may contradict or undermine the negotiation strategy. The landlord needs to know as early as possible that the physician is considering other options and that the landlord has something to lose. It can be costly for a landlord to re-lease a space, so he much prefers to renew an existing tenant. If the physician leaves the property, the landlord will have a vacancy for a period of time and will have to spend money on refurbishment and leasing commissions.

The physician's main objective is to maximize his negotiating leverage, which can be a challenge for most medical tenants. They are at a significant disadvantage in the world of commercial real estate. Medical tenants often have to sink a great deal of money into their space for build-out and usually are hesitant to move because of potential patient confusion and the hassle of moving. The build-out cost for interior construction alone can be \$80 to \$100 per square foot. The cost for moving and installation of technology easily can add \$5 to \$10 per square foot.

A commercial real estate broker who specializes in working with medical tenants can manage the process, with little time from the physician. The broker represents the physician's interests exclusively and is paid by the building owner. Landlords much prefer to negotiate directly with the tenants and might discourage them from having such representation. A broker's commission is a small fraction of the overall savings that can be generated by effective representation (the landlord's broker typically gets a greater fee if the tenant does

not have representation). Hiring a broker also reinforces to the building owner that the physician is evaluating options.

Negotiable items

In addition to the cost savings that can be realized during a lease renewal, other aspects of the lease can be improved. A personal guarantee that was required in the original lease may be eliminated, the security deposit refunded, or other lease terms that need improvement can be changed. It is important to update the year of the Base Year Operating Expense Stop if the lease is a full-service or gross lease. This type of lease is common in larger medical office buildings and multitenant office buildings. Updating the Base Year should eliminate operating expense escalations that are being paid above the current Base Year when the new renewal period commences.

This also is a great opportunity to negotiate with the landlord about refurbishing the space. This might be a few dollars per square foot to paint the walls and clean the carpet, or many more dollars for larger improvements. The improvement allowance that can be negotiated varies by building owner and renewal circumstances. It is possible to negotiate the right to apply some or all of the unused allowance funds toward rental cost. The right to utilize the improvement funds now instead of waiting until the renewal period commences also can be negotiated. The landlord likely will insist on a deadline for the improvements to be used for construction or applied toward rent.

Effectively negotiating the renewal of the current lease can save significant dollars, and the opportunity only comes around a few times during a career. Physicians can put more money in their pockets by taking full advantage of this opportunity. **DMJ**

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