The New "Normal"

Rent Roll Stimulus Program – The Leasing side of pretend and extend…

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Written on the wall of a favorite watering hole on an island on the south shore of Lake Superior is the phrase: "Normal is a setting on a washing machine." The simplicity of this can make anyone smile, yet it represents the complex reality of what is relative.

As it relates to leasing, we've heard all the phrases from "extend and pretend" or "kicking the can down the road." The capital markets continue to sit in the "wait and see" mode while property owners continue to keep the lights on and the building operating not knowing when the refinance world will reopen. In the meantime, those of us living in and around a rent roll work towards cash flow preservation.

The goal: make it through the storm until the market bounces back. Back to what? What is normal? Prior to the events of 2008, normal was sub-6 cap rates, multiple offers on tertiary market properties with money flowing in from far away lands, and properties trading merely on financial models with never-ending increases in value. Is the new normal a 10 cap, 40 percent equity, 20 percent cash reserves for anything and everything from credit risk to Washington reform? Only time will tell, but until then, we champions of occupancy must preserve all that we can. The jobless recovery does not translate into corporate expansion, but rather a continuation of corporate right-sizing and early renewals riddled with tenants giving back space.

One concept for making the best of this new normal is to embrace the reality and start talks early with solid tenants. Fourteen to twenty-four months before lease expirations, offer strong and immediate rent concessions for future rent steps above their current final rents. The result is lower occupancy costs for the tenant, allowing for investment in other facets of their business to remain competitive. This could be new technology, energy- saving machinery, acquisition of another business line, etc. The landlord in return receives a longer term lease now with a future higher face rate. These concessions can, and will, help the ever-tightening cash flow of your tenants to weather the current storm, and if risk is appropriately assessed, you can enhance the value of the asset. Tenants also may be more flexible on concessions given the immediate cash flow relief, and they may not give that space back (which in many cases costs much more than the immediate rent stream set back.) This can result in future Tenant Improvement cost savings in the near term years, potentially enhancing cash flows in 2011 and 2012.

The downside risks are obvious. What if the tenant doesn't make it? What if the discussion of early renewal turns into a bidding war with the property you compete with most? These and other concerns are always there AND always will be. The key is early and regular dialog. Be a partner with your tenant. Both landlords and tenants have to do everything to make it through this long stormy night of a recession.

So, check your harnesses and lifelines. The trip to the favorite watering hole is going to be bumpy, but in the dawn of recovery, normal will still be a setting on a washing machine….and the capital will be back at the table ordering another round.

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