

Real Estate Strategies

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In Asia, Use A Tenant Rep Broker

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IF YOUR COMPANY IS ABOUT TO SIGN A REAL ESTATE LEASE FOR OFFICE SPACE IN ASIA, CAVEAT EMPTOR!

Most real estate brokers in Asia are landlord brokers. This presents a conflict of interest for a broker who represents both landlord and tenant in a business lease transaction, and can create unpleasant surprises for companies.

A typical landlord-broker relationship in Asia extends beyond a one-time tenant relationship, so expect a broker to place the landlord's interests ahead of yours. But commercial tenants do have a choice – use a tenant representation broker to represent your interests exclusively. The first rule of working in Asia is: know who represents you in all facets of your business.

The Back-Loaded Lease Trap

At home or abroad, there's no such thing as a free lunch or "free" brokerage services. In Asia, landlords do not typically offer "free" tenant improvement allowances, design services or project management services. Services such as design and project management, when included in the rental rate, come at a significantly higher cost with substantially limited downstream flexibility. This hidden profit center for landlords ensures that unsuspecting tenants have little opportunity to exit the space at lease termination.

A company new to Asia must learn to watch their back-or, the back of the lease. Often, a landlord broker merely tells a company that they want to hear about the front end of the lease, i.e. reasonable rents, early move in, handle all the logistics and all for one price. Then, wham! At year Three when the lease is up for renewal, they can't renegotiate or exit without significant financial and legal penalties.

Leases are brief because they rely on the laws to provide the interpretation. Frequently, tenants and their lawyers are not versed in the local real estate laws and overlook this due to



the subtlety of the language. Experienced local attorneys that specialize in real estate are rare in Asia. Attorneys often do not understand the true implications of real estate laws. Here's a quick guide to best leasing practices:

- **Lease rate and term:** More tenants check the local market to understand local rental rates in Class A or Class B office space. They like the idea that leases in Asia can be as short as 24 months just for the asking. They don't realize that in most Asian markets, the law dictates that leases run 24 months unless the tenant wants a longer term. A short term lease may empower the landlord to unilaterally increase rents every 24 months.
- **Longer leases and TI amortization:** Tenant improvements have to be amortized over the life of the lease. When the CFO sees that he only has a 24-month period of time to fully amortize this upfront cost, he will ask the CRE to see about a longer lease term – which actually frees the landlord from following the local lease agreement laws. A 60-month lease gives the landlord carte blanche to modify its language without the government objecting.

- **Restoration:** Tenants pay for the complete restoration of their space at termination, including demolishing it and returning it to shell condition. Landlords charge the tenant full cost to remove all improvements, using the landlord's contractor. To avoid this situation, most tenants quickly offer to donate their improvements to the landlord. This is always declined, because restoration costs are a landlord profit center.
- **Demolition:** Restoration work is really just demolition. By design, lease language fails to say clearly that the tenant can't contract for this work directly with their contractor, but must pay the landlord's charges. Often, the landlord owns a separate construction company that charges a high present cost for each demolition component. If the tenant were allowed to bid out the actual demo work, they would realize the real cost is way below the landlord's charges. The ambiguous lease gives the tenant no option and no remedy. The laws protect the landlord.
- **Tenant Rep:** By forcing the landlord to establish the cost of restoration before signing a lease, the tenant broker reduces the risk and cost of restoration. By adding it to the cost of the facility on day one, the restoration is amortized over the full lease period as an operational cost vs. a fully refundable deposit. The landlord must describe exactly what must be removed. This locks in a rate that allows the tenant to understand the full cost of occupancy and termination costs. Tenant brokers require the landlord to allow certain high end tenant improvements to remain to reduce demo costs. The more language the broker can place around this event, the easier it is to control costs.
- **The Tenant's Dilemma:** Typically, trouble starts when a tenant runs out of space or wants to relocate at the end of the lease to another building, with a lower occupancy cost. When the tenant advises their US headquarters about moving to lower cost, better space, a normal business decision becomes a pitfall. When the HQ CRE recognizes that the relocation cost must include the restoration cost and the lower rent in the prospective building, the move looks expensive. If they move, the landlord will charge the restoration costs against the original deposit, which often means little or no refund. The tenant is trapped. They must either renegotiate the existing lease at unfavorable terms or accept elevated relocation costs.
- **Sarbanes Oxley:** Before SOX, the CFO had the deposit for the length of the lease. With SOX, he has to report this as bad news and depending on the amount, the company's financial performance could be hurt.

By using ITRA's affiliate, AsiaPac International, a tenant gets a 100% tenant rep firm. We are prepared to approach a landlord and achieve what is best for the tenant by eliminating back-end lease surprises that reduce profits.

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