

## Lease Negotiation in Asia August 2009

- 1) **The brief** – What are your objectives and essential ‘must haves’? Whilst needs may change, a written brief helps avoid selective memory when the final decisions are being made (e.g. the new office will be ‘open plan’).
- 2) **Choices, choices** – Create a simple options comparator table to track each possible lease using 10 preference criteria, such as availability, location, space (now, expansion), image/grade, service quality, local amenities, total occupancy cost, flexibility factors and parking. Never have less than 2 options ‘ready to go’. The industry conspires to reduce your options and competition tends to reduce your choices as well.
- 3) **Anchoring bias** – Asian landlords are particularly susceptible to what psychologists call ‘anchoring bias’. They have a rental figure in mind. Market research does not support this figure, but they refuse to budge. They lose the deal, but are OK with that. The economic loss is secondary to losing ‘face’ caused by having to change their ‘anchor’ figure. How important are you (really) to the landlord compared to other existing and potential new tenants?
- 4) **Lease flexibility** – Options to break, options to expand...lease flexibility comes with a cost. However, despite being fought over and costly to acquire, few are ever taken up. They may only be valuable as a bargaining chip at a rent renewal negotiation. Do you have a strategy to justify them? For complex installations, special lease conditions may be needed or incorporated in a side agreement (e.g. space for generators, out-of-hours chilled water supply).
- 5) **Life-cycle cost** – Cost of space should be expressed as a total lifecycle occupancy cost. There are templates to calculate this, which include everything from cost of financing the deposit (opportunity cost of the capital), realistic service charge costs to exit costs for reinstating the property (see 20 Thoughts on Benchmarking). Factor in additional costs of running facilities outside normal working hours. Avoid making comparisons on any other basis.
- 6) **Schedule of condition** – A factual, agreed record of how the demise was at the start of the lease is essential. Anecdotes abound of landlords using absence of this document to increase dilapidation claims, such as demanding monies for replacement upon ‘discovering’ scratches to external glazing panels and veneer finishes. The problem is, few condition schedules are done in detail to remove these risks. Such a document is not usually part of a due diligence report.
- 7) **Brokers’ fees** – The good news: the broker usually receives his fee from the landlord. The bad news: this fee is rolled up into your lease. Landlords like it this way as it gives them control and arguably influence over the broker. Few tenants are bigger than their landlords, and agents appreciate this. The fee is a percentage of the rent and service charge, so there is no direct incentive on the agent to seek out a less costly deal. Remember that the agent will most likely be dealing with the landlord regularly on a number of deals – and as a result will not want to undermine this ongoing relationship.
- 8) **Hire one broker** – Many companies new to Asia try to work with many service providers. The challenge here is the competitive nature of the market. The broker that you do not hire may leverage the information they have about you and trade it in the market. This can prejudice the marketplace against your company and could undermine the best deal that can be achieved. Be confidential with your requirement until you have one ‘best-in-class’ local broker and channel everything through them.
- 9) **‘Plug and play’** – Some space is marketed as ‘fully fitted out’, ready to start work. But the reality is that you may need to allow additional costs to refine this fit-out to your specific requirements – it is rare to find that ‘perfect fit’. The landlord may insist on using his contractor. It may still be preferable to start again. But do you have time?

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- 10) **Dilapidations** – Has the fitting out project been so designed to limit these? Plan for ease of reinstatement in the fit out design. Avoid too many tenant alterations, especially those of a structural nature. Leave plenty of time for reinstatement (as notional time to do so will form part of the landlord's claim). Also make sure to remove fair wear and tear and defects that may exist on the premises prior to your occupation.
- 11) **CAPEX write offs** – As part of calculating your total occupancy cost, plan the depreciation of capital. Consider differentiating between furniture you will use in another location and investment you will leave behind, to further ease the annual write-off.
- 12) **Rent free periods** – You will want to avoid rent for at least the duration of the fitting out project. How they are treated in the lease will depend on tax avoidance and subsequent rental valuations. Some jurisdictions encourage the landlord to grant the 'rent free period' in a side agreement, providing a 'permit to work', only. Make sure that you check with your legal counsel to ensure that side letters are in fact binding in each respective market that you are operating in.
- 13) **Strata title** – Generally to be avoided due to big limitations on flexibility, poor communal serving and the significant funds sunk into the capital purchase. Landlords within the same complex will have different investment objectives/attitudes which may result in large variations in rental levels from landlord to landlord. Advantages? Principally a hedge against rising rentals.
- 14) **Naming and signage rights** – Whilst attractive for those with a brand issue, generally best avoided. Some landlords organize small feature signage areas which can be equally as attractive to passing trade.
- 15) **Bad neighbours** – Is the landlord enforcing covenants on the other tenants? Add this into the assessment criteria. It is possible to negotiate a lease that keeps the competition away from your floor level or lift stack. In Asia, this is a significant concern because employees have been known to get poached by the competition.
- 16) **Elevators** – Capacity and waiting times at peak load are key to acceptability. Make sure this is part of the pre-lease due diligence. If in doubt, get a competent lift engineer to check it out. Good offices are ruined by this issue and poor ones vice versa.
- 17) **Legal advisers** – If you are using an in-house lawyer, make sure they have a (very) local adviser handling the actual transaction who is familiar with the local practices and laws. Language is an issue and any dispute will be assessed in the language of the local judge, whatever the contract says.
- 18) **Deposits** – Varying between near zero to massive (Japan, Korea), in these uncertain times, the key question is 'how safe is my deposit?' There is a real risk of losing it all, although this is uncommon. Deposits held in interest bearing escrow accounts are very rare too. Is there an opportunity to substitute a cash deposit with a bank guarantee?
- 19) **Facilities management** – Outside CBDs of world class cities and complexes operated by sophisticated developers, the facilities servicing may be provided by a company who knows little about modern FM and customer service. Don't expect the cleaning to be very good. Can this be covered in the service contract?
- 20) **Secret love** - Lastly, don't fall in love with one option (or location). If you do, keep it secret as it may be used against you during the negotiations. For the same reason, with deadlines, stay flexible and consider keeping them confidential.

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This document is part of the "20 Thoughts on..." series, available at [www.casp-r.com](http://www.casp-r.com)

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