

REAL ESTATE

IT'S A LANDLORD'S MARKET

Negotiate your industrial lease early to avoid disappointment

CANADA'S INDUSTRIAL real estate market is experiencing unprecedented demand and soaring pricing. Driven by an increase in e-commerce warehousing requirements, a shortage of designated land in urban areas and an increasing population, industrial real estate tailwinds are showing no signs of letting up.

The second quarter of 2021 saw Canada's vacancy rate dip to an all-time low of 1.9 percent. This record low vacancy rate drove average rental rates above \$10.00 per square foot nationally, largely driven by unmet warehouse demand in Toronto, Vancouver and Montreal.

If you are an industrial tenant, it is possible that you look at your industrial lease once every five or 10 years when it is time to make a decision about whether to renew your lease or relocate to another facility. In the past, this would have been an adequate strategy.

However, due to the competitive nature of the industrial real estate market today, it is wise to develop a strategy well before a lease expiry to insulate a business from complexity of the industrial climate.

Here are four strategies that will help make the process easier.

1 Model alternatives early

If you were to poll all commercial real estate agents in your market on when is the right time to begin a real estate assignment, 90 percent would answer: "NOW!"

As with all major capital investment decisions in your supply chain, the more lead-time you have the better. A good rule is to imagine that you had to relocate your operation to another city. How much time would you allow your business to execute this move without putting any undue stress on your organization?

It is not uncommon for an industrial tenant that operates a responsible business and pays the rent on time to assume that if they want to renew their lease a landlord will let them stay. Often this holds true; however the opposite can happen.



JESSE MICAK, is vice-president, Food & Healthcare Advisory at Cushman Wakefield.

The right time to begin a real estate assignment is now.

Landlords may want to sell a property vacant, pursue a different caliber of tenant, or have wildly different rental rate expectations than a tenant.

Beginning the leasing process early helps to flesh out these hurdles when there is ample lease term remaining.

2 Understand your landlord's objectives

In commercial real estate, you will encounter two different types of landlords: institutional (REIT, pension fund, banks, private equity, etc.), and private (often family owned and operated). Many owners of real estate will follow an operating and management style that is consistent with one of these groups.

Institutional landlords are highly sophisticated in their approach and will make leasing decisions by committee. They are more willing to let a building go vacant if they do not obtain the net rental rate their investors expect.

On the other hand, private landlords may outsource negotiations to a commercial real estate agent that specializes in landlord representation. They may wish to avoid any vacancy at all to avoid long-term risk.

Understanding who you may be negotiating with early on will help your planning.

3 Involve all operating departments

Many companies split their capital decisions among departments. Finance will control IT and operations will control facilities and equipment. Making these capital decisions in isolation can lead to long-term operating penalties, and potentially an over- (or under-) investment in an important area.

Going back to our first tip, by beginning the process early each department has adequate time to address the importance of their physical space. Thus, a collective facilities strategy can be created.

4 Understand your lease document

Rent is important. The date of your lease expiry is important. But what about some other expenses related to facilities?

Do you know what snow removal costs your business on an annual basis? Who is responsible for the building's roof, and how is it paid for? Your taxes are going up \$0.40 psf/annum; how is this treated in your lease? If your HVAC is broken, who is paying for it? How is it amortized?

If you can't answer all of these questions off the top of your head, don't worry; most business executives can't either, because they only open their lease document once every five to ten years.

In addition, these documents can be complicated. It is likely your commercial lease is 50+ pages, and there is only one page dedicated to rent.

When it's lease renewal time, or you are exploring relocating to another facility, it's also an opportunity to make sure the other material terms (beyond rent) are controlled and fair.

Your lease is a large document. Make sure you understand what you have and what you are signing up for. Material terms go far beyond rent, and it's important to sweat the details. ■