Space: Flexible, Productive, & Cost-Effective

A Guide to Your Future Workspace

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Pivot Real Estate Services LLC
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Introduction & Questions

Whether your company is a one-person operation or employs 1,000, it is essential to evaluate and reevaluate your space needs continually. Every growing firm should consider the following questions:

1. What can you do to make the office environment as productive and stimulating as possible?
2. How can you add and relocate employees without major construction or expensive downtime?
3. How can you keep your rental expense low, considering that monthly rent may be your largest overhead expense after salaries?
4. How important is the rental rate itself compared to other space considerations such as location and image?
5. At what stage in your growth should you purchase a building?

If you neglect these issues, you will be forced to make space compromises at the very moment your new product achieves market takeoff. Insufficient planning could double your rent when you could be doubling your salary.

Your constant goal should be a productive environment at the lowest possible cost. To illustrate this point, let us trace the growth of a young business from its first office in a basement or garage to a 50,000-sq.-ft. signature, stand-alone building.

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Your First Room

While you are still employed and just getting serious about going out on your own, you might start your business in a garage, basement, or family room. Although using your home as an office has many disadvantages, its low, risk-free cost is a distinct advantage. You can even charge your business rent, and claim depreciation on a portion of your home.

Once you gain confidence in your new product or service and realize sales calls do not mix with a baby sitting on your lap, your first outside office will be cost-justified.

For your initial office, seek a low rental rate and term flexibility. For example, subleasing an inexpensive room or two on a month-to- month basis will allow you to monitor the progress of your business and begin establishing other criteria for your long-term space needs. To find such a sublet ask your banker, attorney, accountant, or business contacts about the availability of a short-term lease for a furnished suite. Your move-in costs might consist of no more than a sign on the door and a phone installation.

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Your First Suite of Offices

As your company grows, you will recognize that the three most basic requirements which should be met by your office space are location, rental rate, and image. Good fortune and further growth soon may force you to consider relocating from a one- or two-room space into your first private office suite of 1,000 to 2,000 sq. ft. At this stage, many additional space factors should be considered. Use the checklist shown in Figure 1 (left) to rank the importance of criteria for selecting your new office site.

LOCATION:
Besides the obvious need to be near customers and employees, you should consider how close you may want to be to such professionals as your accountant, attorney, and banker. Also, consider whether it might be advantageous to have easy access to a college or university, bus lines, interstate highways, restaurants, your own home, the airport, or even your competition.

Next, ask yourself, “Does my business require visual identity?” By settling for low visibility with marginal amenities in a less convenient neighborhood you could save many rental-dollars. If you do not need a location in a prestigious office park or in a convenient downtown building, do not pay for it.

Criteria	Priority	Notes
Location		
Image		
Rent		
Size		
Layout		
Occupancy Date		
Special Requirments		
Term of Lease		
Renting vs. Owning		
Flexibility		

Figure 1: Priority Checklist

IMAGE:

Do your customers come to you or must you go to them? If they visit your office, how important is the image it presents to their buying decision? Can you create an adequate impression with inexpensive poster art, carpeting only in the reception area, and a conference room shared with your employee-lunch area? If the latter option poses a problem, you might simply enlarge your own office to include a conference table.

Consider your remaining space. Can it be finished as an open warehouse area commanding a low rental rate, or must it have landlord-supplied dividing walls and drop ceilings? Movable walls and modular office systems are just as expensive initially as conventional desks and permanent walls, but are easily adapted to new layouts over their life cycle. If you own them, you can depreciate them, and they can move with you when you relocate.

How does image influence the productivity of your employees? You can create a stimulating environment, even on a tight budget, by contracting the services of an interior office designer and a space planner to recommend office layout, splashes of color, plants, art, and furniture arrangements. Space planners match the natural flow of work to the available workspace. Designers can help reduce office noise, ensure visual privacy, and improve furniture and equipment placement in individual offices.

RENT:

When you first start looking for space, you probably will think that rent is the number one criterion. Frequently, it drops to third or fourth priority once all other needs are evaluated and ranked Do not even consider ownership of space at this early stage, since it would tie up valuable cash and limit the flexibility of your future growth.

Rent is typically expressed in dollars annually, per square foot of rentable space. For example, 1,000 sq. ft. at $10 per sq. ft. equals $10,000 in rent per year or $833 per month. Rentable square feet should define the exclusive area that your business operations occupy. You do not normally pay rent for common lobbies or shared bathrooms.

As you compare one space opportunity with another, be careful to understand exactly what the landlord is including in the rent. Rental rates are often quoted “net”; in other words, they do not include some expenses the landlord expects tenants to pay directly- such as utilities, tax prorations, and increases in operating costs.

RENT (CONT):

Figure 2 (left) illustrates all the expenses involved in renting space. A gross rental rate of $20 to $22 per sq. ft. is assumed. While this may not agree exactly with the rate for 2,000 sq. ft. of moderately improved office-workshop space in your locale, the operating expense items and their relative proportion to each other will still apply. Always budget for all of these items since either the landlord has included them in the rent or you, the tenant, must pay for them separately.

As you search for space, keep in mind a rule of thumb that suggests that the least expensive space will be found in an older building, built years ago at lower construction costs, and financed at old, lower interest rates. If an office layout in such a building fits your needs, then this space—with a new coat of paint, new carpeting, and immediate occupancy— will probably provide your company with the best value. The landlord may be expected to pass on further savings if you take the space in an "as is" condition and pay for your own paint and carpet.

Conversely, a newer building or one just purchased by new investors with recently improved walls, ceilings, mechanical systems, and new, costly mortgage money- will be the most expensive space. Leasing space in such a building, however, may be justified if a customized layout with a prestigious image outranks price in importance.

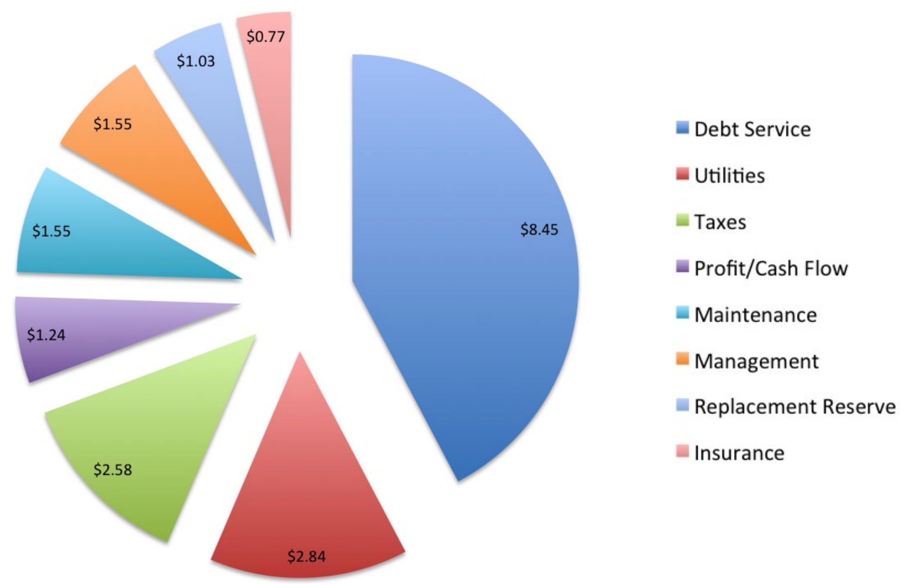

Figure 2: Gross Rent Components (Dollars per SF per Year: $20/year total)

SIZE:
A common guideline is to allow 150 sq. ft. of floor space per person if you use an open office plan and 200 sq. ft. per person for private offices. Again, interior designers and space planners can provide invaluable help in determining optimal sizes and efficiently allocating the space.

It is often recommended that a new tenant acquire sufficient space for current needs plus additional space for one to two years of reasonable growth. If sustained rapid growth is likely, then you may need even more initial space. In this case, attempt to locate next door to additional vacant space. If you ask the landlord in advance for an option to expand into this adjacent space at the current price, but in one or two years, you might save thousands of dollars. Ideally, let the landlord carry the extra space until you need it. Alternatively, rent the extra space now, at a reduced price, and sublet it until you need it. Your goal should be flexibility - to add space only as you need it, and not to burden your overhead with excess space until your business can justify its expense.

LAYOUT:
If you expect your firm to be a fast-growing operation with a complex flow of work, then you must keep your layout flexible. Use a combination of movable/semi-permanent walls, “bullpen” space, and private suites. Sketch out sizes and relative locations of space designated for office, labs, production, and storage. Ask each employee to rate the importance of visual and acoustical privacy to his/her productivity. Ask yourself, how important are separate entrances, private reception, and conference areas? Can these facilities be shared with tenants in the same building? Loss of control will be offset by reductions in monthly rental costs.

The more complex your workflow, the more a space planner can help. He or she will force you to answer difficult questions, help diagram your work flow, and prepare you for flexible expansion. A good space planner can be as vital to your profitability as a good accountant or attorney. Space planners help strike a balance between employee productivity and efficient, low- cost space utilization. This directly affects two of your largest overhead expenses: salaries and rents.

OCCUPANCY DATE:
You should investigate space availability four to six months before you actually need it, although busy, growing firms rarely can anticipate space needs this far ahead. Sudden bursts of growth, perhaps fueled by a new contract, may force you to look only at what is immediately available. Such hasty decisions can cause two problems: forced compromise and predatory landlords, both costing you money.

First, immediate occupancy typically leads you to compromise several criteria on your prioritized checklist. Choice of location and rental rate or future flexibility for growth will almost certainly suffer when you have to settle for what is immediately available.

Second, your space crisis might be seen by the landlord as an opportunity to raise the rent an extra 10 or 20 percent. He or she might sense your desperate need for space. Failure to plan ahead for a more ideal solution probably will create other “penalty” expenses, perhaps for years into the future.

SPECIAL REQUIRMENTS:
Ask your engineering or technical staff to analyze heating, ventilation, air conditioning, and electrical load requirements. Laboratory fixtures, special plumbing, or darkroom needs should be designed well in advance of occupancy. Special requirements, traditionally, are paid for in full by tenants rather than landlords.

TERM OF LEASE:
Lease terms may vary, ranging from month-to-month to as long as five or ten years. Periods of inflation and economic uncertainty prompt landlords to favor shorter-term leases. During stable eras, they prefer long-term leases.

The advantage to you of a short-term lease is flexibility— to better match business growth. The risk is that the landlord will raise your rent unexpectedly or, even worse, request your immediate departure to allow for expansion by a neighboring tenant.

If you require the flexibility of a month-to-month or very short-term lease, you can generally expect the landlord to forewarn you about a rent increase or a need to relocate. An accepted way to get long-term protection with short-term flexibility is to enter into a lease agreement for several years but include a 60- to 90-day cancellation clause which obliges you to pay a cancellation fee of one or two months' rent in return for your freedom to move out early. In a rising market, shorter-term leases often command a slight premium in rents. During an economic slump, rental rates for leases of any term tend to be roughly equivalent.

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Moving Again

Outgrowing your first suite of offices opens up a new range of choices and decisions. Each move becomes progressively more expensive than the last. You should make today's move count for several years. Your personal analyses of the criteria given in Figure 1 become even more important as you move on to larger quarters. This time, one more option becomes available: buying or constructing your own building.

Owning vs. Renting

The advantages of owning rather than renting are often misunderstood. Owning is more expensive in the short run, and it reduces your flexibility to relocate. Owning leads you to become a landlord and property manager to maximize the benefits of ownership. Yet, when your firm's space requirements exceed 5,000 or 10,000 square feet, and its pace of growth slows down or stabilizes, then the benefits of ownership may outweigh continued leasing.

Potential real estate ownership should be compared to renting on three distinct levels of analysis:

1. Estimating the monthly pretax cash flow differences.
2. Computing the after-tax benefits or the tax shelter and depreciation advantages.
3. Estimating the long-term appreciation benefits upon eventual sale of the property. Let us look at each of these, assuming a building purchase with a 20 percent down payment.

From the standpoint of monthly cash flow, the only advantage of owning is to possibly eliminate a small profit to the landlord, which, as shown in Figure 2, is just 10 percent of renting or about $1.00 per sq. ft. per year. You still will pay the same taxes, utilities, maintenance, and debt service amounts. However, once you purchase property with 20 percent down, you may elect to pay that 10 percent monthly "profit" to stockholders, private investors, or the corporation as a cash flow return on equity.

Appriciation vs. Depreciation

When assessing the costs and benefits of owning your own business property, you must first have a good understanding of the tradeoffs between property appreciation and property depreciation. Appreciation of an asset is a growth in its value, whereas depreciation is the opposite of that, or the loss of asset value. From a property standpoint, the costs and benefits depends upon who owns that property—as a renter you can deduct rent from your tax obligations but do not benefit from an appreciation of that property's value. On the other hand, the owner of a building can claim the depreciation of the building as a result of wear and tear, and may benefit from appreciation of its value in the future.

Ownership tradeoffs for a corporation— 100 percent expensing of lease payments as a renter, versus expensing only the operating expenses plus taking depreciation of their owned property—must be carefully analyzed. Simply stated, the tax shelter or depreciation advantages of ownership alone are not compelling enough in most cases to justify ownership.

From an appreciation standpoint, the benefits of ownership can be extremely attractive, but only if they are an integral part of the long- term objectives of the corporation. By remaining in one location for 5 to 20 years, a corporation not only gains the appreciation, but also could have a nearly paid-off mortgage on property worth several times its original cost. This appreciation and amortization of the mortgage might finance the next phase of growth, or fund a generous employee pension program.

Overall, the somewhat-mythical or, at least, highly unpredictable advantages of ownership often do not compare favorably with common disadvantages: loss of flexibility to relocate, loss of cash to the extent of the down payment, and loss of time required to properly manage this new asset.

Nevertheless, ownership can eventually make sense for any growing firm. The challenge is predicting the stage in your company's growth cycle at which benefits of on-site expansion outweigh relocation costs, and at which capital budgeting suggests diverting investment priority from new equipment and new people into the purchase of your own plant. The best timing for such a move varies with every firm and is influenced by economic conditions. As with any decision concerning a major capital expense, careful analysis and expert outside advice are prerequisites for making an adequate return on funds invested.

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Conclusion

From the founder's garage to the sprawling complex of the chief executive, the right workspace choices will have a lasting impact on your business. Even for seasoned veterans, the complexities of business properties can be overwhelming at times—costs abound, and potential roadblocks lurk behind every corner. Keep each of these factors at the forefront of your mind as you analyze future workspace decisions.

Doing so will help you minimize the potential for workspace crises, and let you focus on what you do best: build a successful business.

As always, Peter Allen & Associates is here to help, whether leasing your first office space or building your business real estate portfolio.

CONTACT US **today for a free consultation.**

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