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Increasing tenant profitability through real estate

THE BENEFITS OF A THIRD PARTY ADVISOR:
How local market expertise will save you money
see page 5

FINANCIAL METRICS OF RENEWALS:
What is the value across a portfolio and the potential impact on EBITDA?
see page 6

LEASE RENEWALS

TIPS AND TRICKS TO ENHANCE PROFITABILITY

Why some of the worlds most progressive companies are changing the way they approach renewals.

While some companies view lease renewals as a process that is often associated with words like *paperwork* and *necessity*, there has been a shift in philosophy amongst some of the more progressive companies in North America.

In the ongoing quest to increase profitability and establish competitive advantage, today's savvy executives view lease renewals as a great opportunity to evaluate and review the evolving needs of the business. For companies where location has a tangible effect on the Profit & Loss Statement, it is one of the most critical (if not *THE* most critical) business decisions that can be made. For most retail and service companies, the lease underpins the value of the business. Rarely do companies operate without the need for adjustments for periods that exceed a typical lease term. Without certainty of lease term or functionality of location, the value of an operation that relies on real estate to access customers is greatly diminished, if not eliminated entirely.

Not only is a renewal a great opportunity to reset and review one of the most fundamental elements of their business's long term agreement- it also gives the tenant an opportunity to re-evaluate market positioning, the terms, and their future growth. Whether its an adjustment of lease terms (size, rent, configuration, additionals, fees etc.), or the potential to relocate, more companies are taking full advantage of the possible rewards in today's dynamic environment.

Most leases have a provision where the tenant can renew or extend the lease for a further period of time, usually anywhere from 5 to 10 years. Typically a *renewal* offers the tenant a new lease, while an *extension* keeps the lease "unbroken" and in place. Depending on how the original lease was crafted, renewals and extensions can be either *fixed* (pre-defined lease terms are merely exercised) or *non-fixed/silent* (you have an option to extend the term of the lease if you can agree upon the parameters). Lease extensions and fixed options decrease (but do not entirely remove) the tenants ability to address issues.

Following is a list of tips that have been developed and tested by some of the most knowledgeable real estate experts in the field.

*exceptions apply on leases where the tenant has agreed to execute an updated lease.

BEGINNER TIP

KEEP CLOSE TRACK OF YOUR LEASE EXPIRY AND RENEWAL NOTIFICATION DATES

Keep a lease abstract program which provides automatic notifications far in advance. Keep a backup system for renewals by engaging a third party under an NDA. Most renewals require between 6 - 12 months of notice to be provided to your landlord. Missing renewal notifications or failing to understand certain nuances when exercising a renewal in tight vacancy markets can be devastating - especially when you occupy high profile locations. This brings us to our next point...

BEGINNER TIP

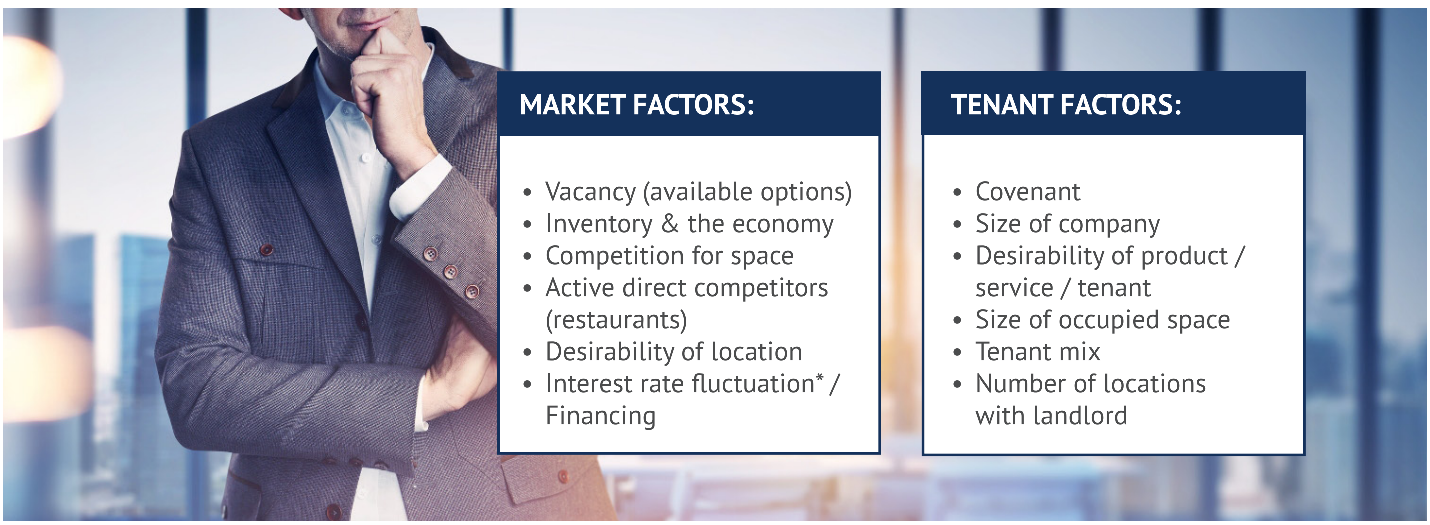
UNDERSTAND THE IMPACT LOCATION HAS ON YOUR BUSINESS

As mentioned- retailers, restaurants, service companies and many light manufacturing companies are greatly impacted by location. Without well positioned locations and certainty of lease term the value (and future) of the business is jeopardized. Conversely, options to renew, along with well crafted assignment and sublet provisions, can provide certainty and flexibility. This in turn increases the broader business value with the reduction of risk.

BEGINNER TIP

EVALUATE AND REVIEW YOUR LEVERAGE

Your ability as a tenant to impact the outcome of a renewal is almost solely derived from leverage. Understanding both the market factors and those that are applicable to you as a tenant is very important in the process. Understanding, analyzing and then capitalizing on the broad array of factors will go a long way to obtaining a better deal. Even modest savings can have a substantial effect when multiplied over numerous locations.



MARKET FACTORS:

- Vacancy (available options)
- Inventory & the economy
- Competition for space
- Active direct competitors (restaurants)
- Desirability of location
- Interest rate fluctuation* / Financing

TENANT FACTORS:

- Covenant
- Size of company
- Desirability of product / service / tenant
- Size of occupied space
- Tenant mix
- Number of locations with landlord

ADVANCED TIP

USE TIMING TO YOUR ADVANTAGE

Don't assume that a landlord cannot be approached at any time or specifically when it suits your purposes. Volatility in market conditions, vacancy rates, interest rates, economic shifts, demographic shifts and the dynamic nature of retail and service companies requires constant attention - and therefore adjustments may be prudent during a lease term. Sometimes landlords approach tenants mid lease in order to procure additional term in order to secure financing...and the proverbial door swings both ways.

ADVANCED TIP

USE RENEWAL WINDOWS TO EVALUATE YOUR LOCATION IN RELATION TO YOUR NEEDS

Relatively few companies take the opportunity to regularly review and update their needs and wants in relation to the opportunities at hand. A renewal is a narrow window of time where there is increased flexibility on a variety of operational and locational fronts. There are many elements to the review and process. We will list a few below:

- Evaluate your market position. Are there superior alternative locations available?
- Review what is happening in the market. Are the dynamics of the trade area changing?
- Are the quality and quantity of traffic flows shifting?
- Evaluate your competitive situation. Where are your competitors positioned?
- Evaluate your size in relation to operations. This is a great time to shed wasted space and become more efficient, or ask for additional space if you are cramped!
- Is the property suffering from deferred maintenance? Are large chargebacks looming?
- Review your historical costs as well as operating costs. How much have they increased during the last term in relation to your sales? In today's environment many businesses are seeing operating costs exceed the pace of revenues yet doing nothing about it.

Rarely (if ever) do markets stay completely stagnant for periods of 5-10 years... So why do 95% of tenants automatically renew without analysis?

EXPERT TIP

OUTSOURCE, OUTSOURCE, OUTSOURCE!

More and more firms are outsourcing renewals. It may seem counter-intuitive to let a third party handle something that is so internal and important to a firm's long term success, but there are several reasons why it is critical.

When a tenant calls a landlord directly, they instantly tip their hand they are "ready to renew". At best, it's like playing for a tie.

For more information see our Whitepaper on *Outsourcing*.

When I get a call or letter directly from a tenant to renew one of their locations in my property, I typically rub my hands together in anticipation. I immediately know they want to stay- and that gives me negotiating leverage. Knowing they want to stay, there's a good chance we are going to get the rental increase that we've budgeted, and typically don't have to address anything in the lease.

When I get a call or letter directly from a broker or consultant to renew a location, I rub my temples and reach for the stress ball. Not only is my tenant likely to be evaluating and aware of other opportunities, they have far more information at their disposal. What's even worse is that their agent is often motivated financially to move them to another location which reduces my negotiatng leverage. Knowing that I'm going to have to deal with comparables , market information, potential lease modifications, a review of operating costs, relocation options and a pesky agent, I'm less likely to get automatic increases. Securing new tenancies interrupts my cash flow and can be expensive while financing during renewals is a factor as well.

~VP Real Estate: One of North America's largest landlords (we guaranteed their anonymity)

The Financial Metrics of a Renewal

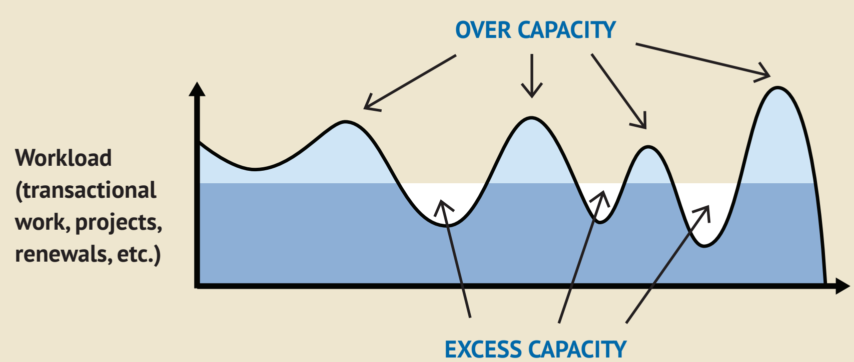
Senior executives are often challenged by the intangible nature of how much value is either created, saved, or lost with respect to hiring outside consultants. The same goes for real estate and renewals.

The balance between control, flexibility, departmental overhead, communication, confidentiality, and process are all considerations that can make for a difficult decision. As the market becomes more efficient with specialists, and with all the factors being considered, both the rationale and math for outsourcing increasingly favors the outsourced model.

THE RATIONALE:
Unlike operations- marketing divisions, finance divisions, and work volume in a typical real estate department can fluctuate greatly depending on the period. Periods of high renewal volume and growth are interspersed and cyclical- creating scenarios where staff are either underutilized or overworked (and potentially unable to commit the necessary resources). In an attempt to minimize departmental overhead, many of today's real estate departments are already understaffed. When significant projects or lease renewals arise, there is little or no time to commit the resources required and (although not immediately or readily apparent), the financial ramifications can be significant.

Income fund managers and private equity firms are some of the early adopters to outsourcing as the extra couple points on EBIDTA make the decision worthwhile...

The ability to internally replicate the experience, expertise and market knowledge of outsourcing renewals is difficult if not impossible to achieve.



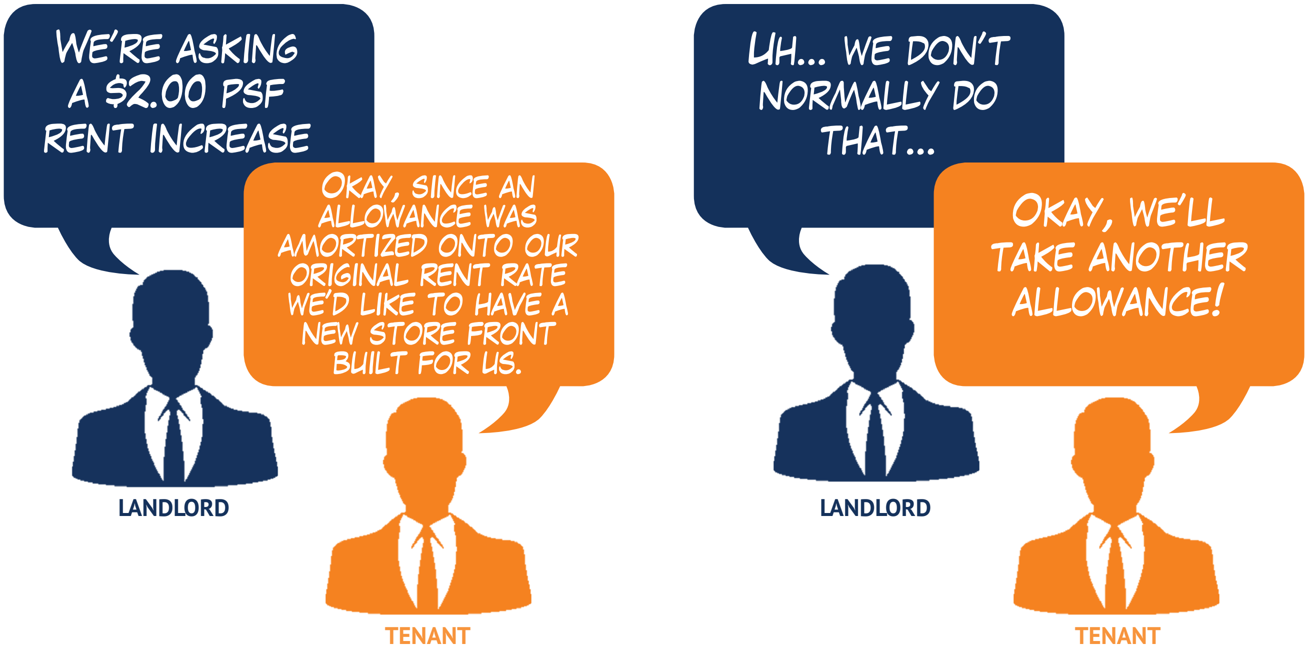
The (perceived) inability to accurately quantify the difference between a renewal that is negotiated by an internal employee versus an outsourced expert can be challenging. As a result, companies are often tempted to allocate renewal negotiations to junior or mid level employees with limited expertise or resources. However, this almost always creates a huge latent expense which is inevitably uncovered when businesses are properly valued. While low risk in theory, the ability to replicate the knowledge, expertise and market knowledge of a firm that specializes in renewals is difficult (if not impossible) to do. As we will demonstrate, the resources required to internally amalgamate market data, track comparables & relocation options, understand lease document nuances etc., isn't worthwhile and far exceeds the cost of retaining an expert.

EXPERT TIP

DON'T ASSUME NON-RENT ELEMENTS CAN'T BE NEGOTIATED DURING YOUR LEASE RENEWAL

Everything is Negotiable. Period.

Landlords often have budgets and pre-determined rental expectations that they wish to achieve. Sometimes in order to get the rental increases, they will give up on other terms. For example, in return for a rental increase, what are you getting? How about an allowance? How about some free rent? How about additional options to renew? Signage rights? Promotional items? Options on other space? Experts consider things like this and understand their leverage.



A Little About Us:

We are a specialized Commercial Real Estate firm that provides advisory services for tenants. We focus on companies where location, position and/or rent has a tangible effect on financial performance. Our mission is to help our clients increase profitability through real estate.

We have regional offices in Vancouver, Toronto and Calgary, with partner offices in Edmonton, Winnipeg, Montreal and the Maritimes. Our account executives combine industry leading programs, process and analysis with experience to ensure our clients obtain and maintain great locations at favorable terms.

Please visit our website at **www.orangegroup.ca** or call **Grant Kosowan at 403 209 4291** for more information or to book a presentation.

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