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SIOR holds panel discussion on tenant improvements

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Boston, MA The New England SIOR Chapter held a Panel Discussion on October 29th with three construction/landlord panelists to discuss how to avoid the horrors of deals gone bad due to costs not meeting estimate expectations. Greg Klemmer, chapter president, was the moderator with three panelists. From the landlord perspective was Kevin McCall of Paradigm Properties. The contractor was represented by Kevin Quinn and Chuck Reilly of Dacon Corp. specializing on design/build and the project manager role was Bob Liptrot of Boston Industrial Consulting as an industrial planner. The Zoom event description challenged the commercial broker with, Does a broker tell his client to spend money up front detailing needs before negotiating a “deal” or do you get close to a deal then spend money figuring out true costs? This is a timeworn problem for brokers consulting with their clients. We’ve all heard about the horror stories of deals gone bad because costs came in higher than estimated.

The three panelists were to provide three different perspectives on the proper way to navigate complicated improvements: Whether a renovation or ground up construction. They shared their views on this important topic as many of the SIORS see a wave of cGMP, clean tech, high tech conversions and construction. The event objective was educate the attendees on how to not waste time, not lose a deal and/or your reputation.

Klemmer acted as moderator and stated that no one knows how to budget accurately for tenant improvements (TI). Deals are being lost because of undervaluing TI and that the TI is then being limited by the landlord. Dacon then started the program.

Dacon: What are the biggest variable costs for renovations that derail deals? The largest TI issues are manufacturing, labs that are MEP systems, HVAC, plumbing, mechanical, electrical fire protection and plumbing (MEP). The cost estimates could be inadequate. For office investments, not so much a problem because it’s already there. Clients often don’t do due diligence and often buy before HVAC and due diligence because there’s a rush to buy. The consultant could have compressed expenses if they had seen these issues in a building in advance.

Paradigm: McCall stated that with a vacant office building, what can a broker identify that is not a cookie cutter deal and what value can a broker bring? There are no text book answers and experience is real important for any situation. Every deal is different and drives the problem. For office tenant improvements, start with the office broker. Plan for TI inventory that you can match to your space. Shell space is good open space but what is not good is that the tenant has to spend more time to figure out layout and they aren’t prepared.

If it's a build-to-suit, you still start with the end-user's program. But if it's bigger, then it's more complicated to get to a base building and timing and then you need much more detailed process.

Boston Industrial Consulting: Liptrot started by asking what level of planning is appropriate before you look for space? He indicated that some tenants are prepared but most aren't prepared on layout and details. You need some level of planning to reach a budget. He did a square footage tabulation and created a block plan to see if it fits the building at a high level then define if the budget is real or not. Tenants often do not have an appropriate budget. He suggested that you want to keep it at a block level and you need a good understanding of spatial needs right down to the department level. This process was executed at the due diligence level. Consulting was executed at the beginning of the due diligence.

Klemmer then asked if a buyer of a building wants budget pricing within 90% what do you do? How do you get to 90% accuracy? What cost do you need to get that information?

Dacon said that it took past work experience and they did a floor plan test fit. Dacon studied and made revisions with the budget prior to a closing. There are two aspects to create a budget. 1) Is creating a tenant program on requirements and equipment matrix; 2) Surprises are due to existing building conditions. Surprises are other building issues after you figured out the space plan.

McCall said that it is real important to have a team that can ask the right questions because the tenant doesn't know what they should know.

Klemmer asked the following scenario, you have a tenant with its own team, how does a landlord deal with tenant's team when the landlord has its own team?

McCall answered first and said it depends. He prefers that office tenants use his team. Some domestic office tenants aren't sophisticated while the global tenant is. The landlord knows its own building, can be more efficient and save time with his own architect. He likes to select an architect that can be efficient and do something special especially in a competitive process with other buildings such as adding a nicer lobby or appearance and be hyper responsive to tenant needs. If the project is a build-to-suit then he wants Dacon involved so Dacon can ask those questions to get to a good level of pricing.

Liptrot asked what should a broker look for in a building? He works with supply chain, warehouse and distribution. He looks at the quality of slab for forklifts, sprinkler systems for ESFR versus older systems that influences in rack sprinkler or heights of racking. There are other issues to consider like LED lighting, tiled flooring, etc. Base bay spacing is important. A new building has 50x50 column spacing while an older building has 30x40' bays. It's difficult to create an efficient layout. The quantity of docks are important. The old rule was 10,000 s/f for one dock and now we question if we have adequate docks and overhead doors.

For manufacturing we could live with conventional sprinklers since there were no high racking

systems. But now we need ventilation, heavy slabs for equipment, power and air circulation. Is the core boring on slab different from the floor plans versus actual? A slab might be 4" in reality but the plans show 6." HVAC, mechanical, electrical and power are all significant.

Klemmer asked, Is there a vapor barrier under the floor? Should he place that question on the list?

McCall said that it can be a problem with vapor barrier. Any plans aren't always what was built.

Quinn from Dacon said that you have to spend money for due diligence. He had a slab that was 4" and it was designated on paper as 6". The contractor short-sheeted the slab and now it's a structural problem.

Klemmer asked the panel, How often are plans inaccurate?

Quinn said not often but it does happen and then it becomes an OMG moment and affects the entire chain. The age of the building can affect TI and not just inaccurate plans. The life expectancy is short and needs to be replaced.

Klemmer asked about build-to-suits and gave a scenario. A 100,000 s/f shell and you know the costs so what's the biggest variable cost?

Quinn answered that the shell is the same but the site costs are a huge variable. You need geo-technical due diligence. You could find ledge, bad soils, a site that is not flat, etc. The site condition is one of the biggest variable costs. Till, ledge and high water table can kill a deal and can double or triple the budget. Your site could be a tree dump. You need a soil evaluation. When do you spend this due diligence money? Kevin said that you spend it right up front and it's worth it.

Klemmer then asked the panelists, Do you do pricing on your own or do you bring in a specialist?

Bob stated that the most difficult part is getting out of your lane and know what you don't know or do. You need to advise a specialist, to support your budget estimate and bring credibility to a budget.

Kevin Quinn said that the number #1 value that we all have is "time" and we don't want to waste time with clients that don't want to spend money for specialists and due diligence. He will walk away from a client or project when he knows that the client does not want to spend money on furthering the due diligence. He said that he is in a different lane than Bob but that they try to complement each other in the field.

Klemmer asked the panel, Is there an estimated dollar that panelists would budget for due diligence?

Kevin Quinn said to expect \$20-30,000 for due diligence for a build-to-suit or TI test fit. Bob said that he doesn't want to put a dollar amount on due diligence because the size of the project will affect

the price since TI budget are different. But a client has to know that they will have to spend money upfront to save money at the end. The due diligence is not a waste of money. He's advocating up front work and it's not a throw-away of money. He said that brokers should test the client's reality to execute money to contract for due diligence.

The Final Phase of the Program

Klemmer asked the panelists to give their final thoughts on build-to-suit preparation. Kevin McCall stated:

1. You need experience to ask the right questions
2. The program is the key element and many programs are only two to three pages in length but it is not adequate. Tenants who give two or three pages don't know what they are doing. You need a program summary that is 50-70 pages long so you can have it priced right so the landlord can quote a realistic rent. Or it's a problem if its only two or three pages and you find out later with details that the cost is 2 or 3 times more. Make sure you have a detailed program and priced well by the landlord.

SIOR members then asked questions and Chip Detwiller advised the attendees that when you go into a building, admit you are a broker, that you don't know the answers and don't try to fool anyone. Kevin McCall said that the process is complicated and a good broker value-add is to bring the right people to the table. John Connolly stated that it's important to take into account whether the labor is union or non-union. It is a significant cost difference and a broker should know. Also the towns react differently to the same TI. Three towns might have different zoning, politics and risk assessment. Permitting is different and code regulations are different for 351 towns in MA. Bob finished the program by stating that codes and regulations have changed. Because you have something in a building now doesn't mean that you will get this item in the future. Things change with regulations or someone installs something that isn't regulation compliant and it will need to be changed.