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7 Tips For A Smooth Headquarters Move

By **Natalie Rodriguez**

Law360, New York (October 04, 2012, 11:57 PM ET) -- With the office real estate market starting to wake up, more and more corporations are preparing to move their headquarters — a process rife with pitfalls from deal negotiation to construction. But there are several key planning and contract moves companies can make to ensure a smooth transition, experts say.

Nationally, occupied office space rose by 9.2 million square feet in the second quarter of 2012, with the recovery concentrated in tech-dominated West Coast markets, according to a recent report by global real estate services firm Jones Lang Lasalle Inc. And several real estate attorneys and consultants have noted a spike in activity from corporations searching for new homesteads.

Tommy Burt, CEO and co-founder of Austin, Texas-based commercial construction services firm Burt-Watts Inc., told Law360 he'd seen consistent and growing activity in his market over the past 10 months. And Chicago alone, spurred by a proactive mayor, has announced agreements from about a dozen companies, including Motorola Mobility LLC and the transportation arm of General Electric Co., to plant headquarters within city limits.

But as the office real estate markets firm up, they're also starting to swing from favoring tenants toward favoring landlords, Neil R. Markson, managing partner of Bernkopf Goodman LLP, pointed out. The kinds of amazing rent deals tapped by businesses lucky enough to have been looking for office space in 2009 are starting to dry up.

So that means counsel advising companies on real estate deals have to come to the table with ever-sharper negotiating tools, experts said.

"Often, the lawyer in these transactions is the quarterback," said Patrick A. Ramsey, a Los Angeles partner in Paul Hastings LLP's real estate department.

Take Care in Site Selection

The economic downturn has thrown out many of the old rules that dominated headquarters philosophy, like the once-narrow focus on downtown areas in major urban markets, where rents are highest.

"We're finding that our clients have a strong desire to relocate to more fiscally sound locations," John Boyd of New Jersey-based real estate consulting firm The Boyd Co. Inc. said.

A presence in markets like New York and Los Angeles still offers major value for certain companies. But experts tell companies to at least consider splitting up its personnel and businesses in a move. Administrative or other back-office departments might relocate to lower-rent areas, while top management and their support stick to the office spaces with more cachet. With most corporations still picking back up after the economic downturn, many are open to the idea.

"Our clients, by and large, have already downsized their operations, already outsourced call

centers and customer service functions ... already re-engineered their distribution centers. So what's left on the table?" Boyd said.

For a company with the freedom to choose an entirely new market for its headquarters, now is also the time to test the waters for potential tax breaks and other government incentives. According to Boyd, several governors are proactively campaigning for companies to set up shop in their states: Rick Perry in Texas, Rick Scott in Florida and Dennis Daugaard in South Dakota.

Build a Manageable Steering Committee

A key part of the process is to put together a steering committee with several key personnel to sift through the mountains of information and make decisions on the move and the build-out of the new space, experts say.

"The involvement of that committee and the process is key," Burt said, noting that successful committees tend to include point people from facilities and operations, finance departments, and management, as well as in-house legal counsel.

While it's sometimes impossible for the largest, most complex companies, Burt suggests keeping the committee down to eight to 10 people.

"When we run into problems is when the steering committee is not able to meet," Burt said.

A larger company will often want to secure its own project or construction manager, even if the landlord is going to be doing the bulk of improvements to the space.

"That puts the burden on someone who has experience in the area," Markson said.

Explicit provisions in lease agreements are key, if sometimes forgotten. A lease should include provisions for reasonable access to the site and coordination of efforts so that construction delays don't pile up because of miscommunication, according to Robert M. Carney, a Boston-based real estate partner for Sherin & Lodgen LLP.

Back Up the Timeline with Penalties

A realistic timeline is also crucial.

"The headquarters company really needs to get out ahead of this and identify what [its] critical deadlines are. ... I've been involved in some projects where it's way too tight and there's not enough slippage one way or another," Carney said.

As with any project, delays happen. With a major headquarters move, setbacks can pop up during negotiation of the lease, navigation of the regulatory approval process and construction work. While securing the right to end a deal if certain goals are not met might appeal to counsel looking to protect their clients, experts warn to use this tool carefully.

"Everyone hates a termination right. It makes a great hammer, but it's not [often] a viable option," Carney said.

It could ultimately kill a deal where the company is expecting the landlord to build out the new space for it when the project gets to the financing stage.

"It's something banks just hate to see," Carney said.

Writing a 1-for-1 or 2-for-1 rent credit provision into the lease is a better option. Under this stipulation, the landlord has to kick in free rent if it falls short of certain targets, he said.

"If the landlord blows a milestone by 10 days, the tenant would get 10 free days of rent or 20 free days," Carney said.

But he advises giving the landlord a chance to make up the time — for instance, by having construction workers put in overtime. This keeps the situation win-win: The tenant doesn't have to rack up fees by extending its time at its old space, and the landlord doesn't have to give up any free rent.

Lay Out Your Financial Cards, But Make Landlords Show Their Hands

In light of the economic downturn, parties to a major headquarters move — or to any office deal — are more likely to fidget about running out of money before the project is done.

"There's a very heavy cost to move or improve a premise to [a company's] specifications," Ramsey said.

More deals now require letters of credit and other documents showing financial support for the parties on both sides of the table, according to experts. Often the burden is on the landlord, but the cost of borrowing money can be much higher for the landlord than for a highly rated company seeking traditional financing, Ramsey noted.

Companies can add self-help or takeover rights to any agreement, which would allow the tenant to step in and finish a project if a landlord fails to deliver. But that's a "nebulous" remedy, as most companies that could do this would choose to spearhead the project in the first place, according to Carney.

So more deals are starting to ask the landlord's financial backer to take on the role of backstop.

"They want to see that a lender will step in and complete the project in the landlord fails," Carney said.

Another important issue to negotiate is the liability on the lease, which determines what happens if the tenant doesn't move in, the landlord misses deadlines or the deal falls through. Counsel has to pin down whether liability will be limited to a firm's assets or if there will be additional recourses.

"If everything goes to pot, what are you going to put up yourself?" Markson asked.

Secure Expansion and Contraction Rights

With any move, a corporation has to think about its long-term growth patterns, and its counsel need to make sure the lease agreement is flexible enough to allow for minimal growing pains, experts say.

Expansion rights should be spelled out so the company can easily secure more space within the building in the future. But the economic slump also has companies — particularly those in the hard-hit personal services industries — looking for the option to shed square footage if necessary down the road, experts said.

"I also find that a lot of tenants and corporations are interested in the worst-case scenario," Markson said. "What kind of giveback rights do we have with respects to our space ... or assignments and sublets?"

Ideally, Markson likes to secure a provision allowing the tenant to sublet out the space without having to get the landlord's approval on the subletter. Rarer, but more valuable, are clauses allowing for a giveback of space with adequate notice to the landlord.

Bag Base-Year Taxes

Two little words can save companies money in tax liability: base year. A base-year provision marks the starting point for the tenant's tax liability on a property. Under it, the landlord agrees to pay taxes based on the rate during the base year, which is locked into the contract. The tenant then covers any increases beyond that.

"The ideal situation is to at least have a base so you're only paying for the actual increase in taxes," Markson said.

When a company moves in toward the end of a year, counsel can push for the base to be set at the rate for the following year. This not only shelters a tenant from having the landlord calculate its tax bill based on a date before it arrived on the premises, but also saves it money, according to experts.

Grab Contract Goodies with Long-Term Value

Little details that could have major value for companies over the long haul sometimes get left on the negotiating table, including signage rights on the new space.

"The head office arena is what I would term the next frontier of corporate rebranding and re-engineering," Boyd noted — especially for trophy sites with Class A space and Leadership in Energy and Environmental Design certifications.

Provisions to ban competitors from leasing out space in a company's new home are also gaining ground, particularly with technology-oriented companies, Ramsey said. But it's also a good option for financial clients or others dealing with sensitive information.

Even in the excitement of moving to a new space, it's important to plan for when the company eventually leaves it — even if that might be 20 years out.

"Quite often the language isn't that favorable for the tenant," Markson noted, adding that contracts can require demolition of any improvements the tenant has made to the site. That means when a company is heaping up costs in building out yet another new space, it could be hit unexpectedly with a significant bill on the space it's preparing to exit.

Markson recommends negotiating a provision that requires the company just to move out furniture.

--Editing by Kat Laskowski and Elizabeth Bowen.

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