

# Beyond the square foot rate

How to focus on the entire picture when buying or leasing commercial real estate **Interviewed by Sue Ostrowski**

**W**hen buying or leasing commercial real estate, cost is an important consideration. But while dozens of factors can play in to the overall cost, too many business owners focus solely on the cost per square foot, says Joseph V. Barna, principal and co-founding partner of CRESCO Real Estate.

"In today's real estate market, there is often too much focus on the square foot rate rather than looking at the total picture of what the actual cost of occupancy is," says Barna. "Historically, the focus was on, 'This building is \$10 per square foot and this one is \$12 per square foot.' But in today's sophisticated environment, there are multiple components that previously were seldom discussed and the user really needs to look at the entire picture."

*Smart Business* spoke with Barna about the factors to consider beyond the cost per square foot when leasing or buying commercial real estate.

## What factors need to be considered when buying or leasing commercial real estate?

Building efficiencies are one consideration. If one warehouse is \$2.50 per square foot and another is \$3.15 per square foot, people will often rule out the more expensive one based solely upon the base rate. But if you look at things such as utilities, that \$2.50 building may be inefficient. It has old windows, a wooden roof, an antiquated heating system, and you'll spend \$1.10 a foot to heat the building, as opposed to the \$0.35 to heat the more modern, energy-efficient building. So if you make a decision based on paying \$2.50 per square foot instead of \$3.15 per square foot, you may be saving \$0.65 per square foot and feel like a hero, but when you look at all the other factors, you may be way overpaying as it relates to the actual cost of occupancy.

You need to look at the total picture. For example, your insurance rates could be lower in a building with a modern ESFR sprinkler system. In the less expensive building, you may be saving on the square foot rate, but you'll make that up by paying higher insurance premiums, contributing to a higher cost of occupancy.

Another example is location. You need to consider your employee count, the profile of employee you're looking for, where those people are located and what the going wages are. If you are staffing a call center, you may find a great deal in a building on the far west side, but if your employee base is on the far



**Joseph V. Barna**  
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east side, you're going to have a hard time getting the employees you want at the wage you want to pay.

Location can also be a factor if you are in a distribution business. You may be paying a lower rate per square foot and think you have a good deal, but highway access for your carriers is terrible and they're sitting in traffic on two-lane roads, burning fuel and time and driving up the cost of distribution. If you were in a better location with interstate accessibility, you could lower your costs with easier access to the end user.

All of these factors contribute to the cost of occupancy and to your bottom line.

## How do taxes and incentives factor into the equation?

Taxation is different between communities, and in some communities, the rates are double what they are in neighboring ones. Look at what you are paying tax on, because that could affect where you locate.

There are also incentives available, and these incentives can vary widely among cities, counties and states. It's easy to make the mistake of committing on a building location before evaluating what incentives might be available, and once you sign a lease or purchase agreement, it's too late to ask.

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## Can business owners negotiate the process alone, or do they need outside help?

It's not uncommon for people to do it on their own, but they forget that owners of the real estate have an experienced real estate representative looking out for their best interests. If you don't have someone representing you, as well, you are at a significant disadvantage.

Real estate brokers are familiar with the market and have access to real time market knowledge. They are aware of market trends, value fluctuation, type of space in abundance and incentives. Unless business owners are in the market on a daily basis, they won't be aware of where and how they can maximize value.

## Once a building has been identified, how can a broker help with lease negotiations?

The negotiation of the lease document is going to have a direct impact on occupancy costs. For example, in an office environment, there is gross rentable square footage, floor rentable square footage and usable space, but most tenants are not aware of the distinction and how they impact cost.

Also, rate increases included in lease documents are usually tied to Consumer Price Index escalators. But there is very little relevance when comparing CPI increases to reasonable market values in real estate. A broker can negotiate tying increases to a more relevant index, or put caps on increases, but if you don't negotiate leases on a regular basis, you will miss that, increasing your costs over the terms of the lease.

In addition, if someone has weak credit, the owner may require a personal guarantee. Most people assume that the guarantee is for the life of the lease and for the full amount, but that can actually be negotiated as a guarantee for a percentage of the total, a set number of years or up to a certain amount.

Finally, while you can't change uncontrolled pass-throughs for operating costs, such as electricity or real estate taxes, you can negotiate controlled costs, such as management fees. If you don't use a broker, and don't know the norms and trends, you're missing an opportunity and are probably leaving money on the table. <<