

The Changing Look of Office Space

How Will it Impact Lease Negotiations?

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They are the new trends hitting the office market nationwide—

collaborative, open-space offices; co-working spaces; innovative common area amenities—and both landlords and tenants, and the attorneys advising them, should be prepared to address the unique leasing issues attributable to the new look of the office space.

This article explores the new trends in the office market, reviews the particular considerations for landlords and tenants, and provides practical guidance for addressing these issues in the typical office lease.

The Office Reimagined

The 1980s saw a boom in office buildings in New Jersey, and the blueprints for offices then centered around isolated, one-dimensional workplaces. That was all before information technology and the globalization of business hit the big time, and a new type of

worker was introduced to the mix: the Millennial.¹ These workers are more socially interconnected, work collaboratively and value innovation and mobility. All of these changes have brought about shrinking office footprints and tenant requirements for open, collaborative spaces, with the flexibility to accommodate their growing (or shrinking) needs.

Tenants are also seeking innovative common areas. They want those spaces to be close to public transit and walkable suburban main streets, or alternatively to have similar experiences and

options within the common areas of their buildings. Savvy landlords are answering the call by offering fitness centers, food truck options, amphitheaters, coffee lounges with baristas, nap rooms and wellness centers (just to name a few) as part of office building amenities.

The co-working space concept is also on the rise, and itself poses a different set of issues for office landlords and tenants. The number of co-working spaces worldwide is growing at an amazing pace. While only 600 such spaces existed in 2010, recent studies indicate more than

enclosed conference rooms, open-space work plans may require demolition of partitions; installation of sliding walls, moveable screens and features; and upgraded technology. In short, these work letters call for more flexibility for the tenant's evolving needs. At first, one might think this simplification of the workspace means simplified work plans and diminished tenant allowances. That may not be entirely accurate. Demolishing walls, reconfiguring building systems (including HVAC) and installing high-tech features to accommodate an open-space plan could bring with it a hefty price tag. Thus, landlords should be wary of the costs upfront and set basic rents (which include the amortization of tenant improvements expenses) and any tenant allowances appropriately. Some tenants will opt to undertake the work themselves, in which case the landlord should reserve its right in the lease to have ample review and approval rights of the tenant's plans and the right to maintain a supervising role in the undertaking of the fit-out.

Co-Working

A 2018 report by brokerage firm Jones Lang LaSalle (JLL) found that co-working was the second largest area of leasing activity in the nation, beating out the finance and insurance, health-care and law firm sectors.⁴ In 2018 alone, it made up nearly two-thirds of the country's office market occupancy gains, and is a sector that has grown an average of 23 percent each year since 2010.⁵ The inherent risks to landlords in these shared-space arrangements is the potential for increased liability from multiple, unrelated users and occupants, and potential strains on building services and common areas. To minimize the risks, landlords should take a fresh look at certain provisions in their leases.

First, landlords can help manage the potential risks by reviewing their standard insurance requirements and

indemnification provisions. Multiple users come with the potential for increased injury and property damage. Increasing the limits of the tenant's commercial general liability insurance, in consultation with the landlord's own insurance brokers or risk managers, and making sure the policies include the landlord as an additional insured, will help mitigate the landlord's exposure in the event of an issue. Another risk-shifting measure is requiring that indemnification provisions in leases not only indemnify the landlord for acts or omissions of the named tenant, but also for acts and omissions of any user or occupant of the premises.

A guaranty from a corporate parent of the tenant or a personal guaranty from an individual having ownership or control of the tenant should also help mitigate the risk multiple space users may have on landlords. The guarantor should secure payment of rent and other monetary funds to the landlord, and should guaranty performance and compliance obligations of the tenant under the lease. Thus, even though the landlord has no privity of contract with the individual occupants, the guaranty offers additional protections directly from what should be a financially sound source. In that regard, the landlord should require periodic submission of financial statements concerning the tenant and any guarantors.

Strains on building services and utilities, and impacts on a building's insurance and common areas, may also be impacted by the co-working use, and landlords will want to pass all these additional costs on to the tenant. For example, if the HVAC system becomes overtaxed because of an increase in occupants, landlords may provide supplemental units, and provide in the lease that the cost of such additional HVAC is borne by the tenant. The landlord may also insist on a provision whereby increases in its costs to insure

the building and property resulting from such tenant's particular use be reimbursed by the tenant as part of operating costs. Yet another means to address the potential problems of multiple, unrelated users is for the landlord to set limitations on parking rights and occupancy maximums for the premises.

End of Term

The open-space office concept poses issues for the end of the lease term that should be addressed by the parties upfront. Landlords must consider how functional the space will continue to be after the tenant using the open space has vacated. If initial improvements required the demolition of walls and partitions, the landlord will have to consider whether the next tenant will want a more traditional office space. Specialized installations, like floor inlays with company logos, should be removed by the tenant upon the expiration of the lease term, or earlier termination of the lease, at the tenant's expense. In short, parties to the lease will have to negotiate upfront what stays and what must be removed or replaced at the end of the lease term.

Tenant Considerations

On the other side of the same coin is the tenant seeking customizable, flexible space that is fluid enough to accommodate its quickly changing workplace needs. The same basic considerations that affect landlords will also affect tenants of the open-space concept premises.

Amenities

Whereas in the past, tenants may have only required a common lobby, cafeteria and onsite parking facilities, they are now looking to provide their employees with restaurant, fitness and leisure options. Tenant-favorable lease provisions in this regard provide that if a specified amenity or service is not completed and operational, or not offered,

within a given time frame after the lease is signed or the premises are delivered to the tenant, then the tenant has the option to obtain a rent credit for each day of delay, or may even go so far as providing the tenant a right to terminate the lease. While landlords will want to limit tenant rent abatement and termination rights, tenants with the right bargaining power will have ample opportunity to insist on these provisions. As for the costs associated with these upgraded amenities, the tenant should negotiate to specifically exclude from operating expenses the costs of upgrades or alterations undertaken during the lease term, unless such capital improvements are required by governmental authority after the commencement date or otherwise provide a savings in operating expenses. From the tenant's perspective, such expenditures are long-term landlord investments that will either be recouped via base rentals or are otherwise the cost of doing business. However, where the landlord insists on recouping its costs, and the parties agree to amortize the costs, the tenant will want the rate of amortization to be over the useful life of the improvement, as opposed to only the remaining term of its lease. That, of course, puts the landlord at risk of not being reimbursed for the full amount of its investment because most leases will expire before the end of the full amortization term and new leases will likely exclude capital expenditures incurred prior to their commencement dates, so tenants should expect landlord resistance to these proposals.

Alterations

While the open-space floor plan is decidedly simplistic and cost effective for the tenant, there are hurdles that must be overcome by the tenant. First of all, not all landlords will be at the ready to tear up walls and refurbish building systems to accommodate open-space floor plans. Tenants and landlords must

work cooperatively to reimagine an existing space as cost-effectively as possible, and it is prudent to do so upfront, before a lease is signed. The lease should address tenant improvement plans and set out a clear process for review and approval of them. Another consideration for the tenant is the prospect that the open-space concept may not eventually work for its workforce. Some research has shown that the open-space concept actually reduces productivity because of the increased noise levels, and decreases face-to-face interaction.⁶ Thus, provisions for future alterations should clearly provide tenant rights to remodel the premises with limited landlord interference; in other words, if the landlord needs to consent, then the consent should be reasonable.

Co-Working

The main concern for the tenant running a co-working business is liability. Tenants need to understand how to mitigate their own exposure so they will be prepared to honor the insurance and indemnity requirements of their own lease. This means insuring their occupancy and shared services agreements with co-working users clearly set forth maintenance, repair, insurance and indemnity obligations, as well as obligate users to comply with the lease terms.

End of Term

As already stated above, end-of-term issues will need to be negotiated upfront to address the somewhat unique tenant improvement provisions in open-space workspaces. The tenant will want the landlord to agree that initial improvements do not need to be removed, or at the very least will want to know upfront what the landlord's expectations for premises restoration will be. For possible future alterations, the tenant will also want to know upfront whether the landlord will request removal of any improvements or installations via a

notice from the landlord given at the time the landlord is notified of the tenant's intentions.

Conclusion

It is a bold, evolving time in the office sector, and the benefits for both landlords and tenants abound, but so does the potential for issues and risks. The most prudent parties will take a closer look at standard lease provisions, with an eye out for how the new trends in this sector should be addressed and how inherent risks should be mitigated. ☞

Endnotes

1. According to The Pew Research Center, Millennials are individuals born between the years 1981 and 1996. Michael Dimock, *Defining Generations: Where Millennials End and Generation Z Begins*, <http://www.pewresearch.org/fact-tank/2019/01/17/where-millennials-end-and-generation-z-begins/> (Jan. 17, 2019).
2. Ben Johnson, *We Work...and Shop and Eat*, *Shopping Centers Today*, March 2018.
3. Colliers International White Paper, *Amenities: A Hot Commodity*, <https://www.colliers.com/-/media/files/united%20states/white-papers/office-amenities-2015.pdf> (Summer 2015).
4. *U.S. Office Market Statistics, Trends & Outlook*, <https://www.us.jll.com/en/trends-and-insights/research/office-market-statistics-trends> (2019).
5. *Flexible Space Evolves*, <https://www.us.jll.com/en/trends-and-insights/research/flex-space> (2019).
6. Nicole Spector, *Is an open office plan hindering your productivity? Here's how to make it work for you.*, <https://www.nbcnews.com/better/business/open-office-plan-hindering-your-productivity-here-s-how-make-ncna893586> (July 23, 2018).