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Boston Law Firms: Look Back To Move Forward

Legal Eagles Get A Briefing On The "Case of the Confusing Law Lease"

By David E. Fitzgerald

An unprecedented number of Boston's leading law firms are facing important real estate decisions over the next few years. CB Richard Ellis estimates 60 percent of the top 25 law firms within Boston are or will be active in the market for office space within the next 12 to 18 months.

Why is this? Law firms, until the recent slow down, have been one of the fastest growing segments of the local service economy and simply need more square footage. Additionally, consolidation among law firms has increased in recent years, most often requiring relocation in order to achieve maximum efficiency and synergy between these combined firms.

Another contributor to this massive office space demand is the cyclical nature of the real estate business. Between 2000 and 2002, a number of new buildings including, 111 Huntington Avenue, 10 St. James and Seaport Center were delivered to the market and developers successfully attracted several top law firms. These leases will now be turning over in the next few years. Coincidentally a number of other large firms have leases coming due about the same time.

A law firm's monthly rent continues to be its largest fixed expense and controlling this predetermined cost for the next five, ten or fifteen years will be one of the most important decisions facing these law firms. A competitive transaction at the right time

in the real estate cycle can make a tremendous difference in the long term profitability of a firm. Conversely, an expensive deal at the wrong time of the market can handicap a firm's profitability for years.

What can we learn from previous real estate cycles and decisions firms made at those times? Below are a few lessons learned in past cycles:

Long-term leases: In the past, firms have chosen to structure ten-year lease

ment write-offs. The enormously expensive initial improvements still have tremendous value as they are still functional and attractive. Landlords understand this dynamic; therefore firms facing a lease roll after ten years could face paying a premium price on a renewal. When structuring a new lease, firms should consider longer periods, such as fifteen-years with early termination/contraction provisions to provide the flexibility while fixing the costs.

Location and its impact on recruiting/retention: Law firms in the late 1990s, faced with sky-rocketing rents in the financial district, decided between new frontier locations for law firms: the Back Bay and the Seaport District. Both submarkets were delivering attractive new buildings that traded at a significant discount to the financial district at the time.

For the past years those firms that chose the Back Bay chose wisely. The services, amenities and transportation options were all superior. Meanwhile, the firms that chose the Seaport struggled with limited options for meals/convenient shopping and were hampered by incomplete transportation infrastructure. Location seriously impacted recruiting and retention, particularly for younger attorneys and staff, with the Back Bay perceived as a positive location and the Seaport viewed more negatively, in terms of location.

But the next ten years of term for these firms will experience an interesting twist. The Seaport District is still leasing in the price range of the \$50/RSF deal of eight years ago, while the Back Bay is no longer

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terms, before exposing themselves to a "fair market value" reevaluation of the rent for renewal periods. Building out a law firm space, with all the related expenses for furniture, fixtures, equipment and the various consultant fees can easily reach \$175-\$200/rentable square foot (RSF) or more. Even after a generous improvement allowance, this is a significant capital event for any law firm.

Historically law firms have not moved after ten years into new space to avoid having to reinvest and face potential improve-

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trading at a discount to the Financial District: in fact it is more expensive. The \$50/RSF space of eight years ago is now priced in the mid-\$70's/RSF.

Branding: A law firm's office space and building are important branding and recruiting opportunities. Exterior signage and lobby signage should be vigorously pursued – yet the question is often not even asked. Firms should include language which prohibits competitors from gaining any signage in their buildings over the life of their lease.

Delayed decision making: Firms repeatedly underestimate the time required to adequately assess the market and make decisions. In turn they are unable to respond to market opportunities and often bump into real deadlines such as renewal option notice dates. A new building takes 30-36 months to construct, so the lead time required for a lease in a new, or even a rehabbed building, is significant, particularly in light of today's financing constraints. Firms requiring the most space, 150,000 RSF and up, need to seriously buckle down on their market homework a minimum of four years in advance. Firms of 75,000-150,000 RSF should allow 30 to 48 months and firms of 30,000-75,000 RSF need 24-36 months.

Underestimate flexibility needs: Why does a firm have to be tied into renewal options of five years or longer? We have seen instances when a law firm's lease expiration narrowly misses new development opportunities, limiting their choice in the market. More flexible renewal terms, i.e., a series of two-year options rather than only five-year options, can make the difference when evaluating new projects. Other critical flexibility clauses including expansion, early termination and contraction, may not make interesting cocktail party bragging rights, but can differentiate a good deal from a great one.

Anticipate changes in the workspace: Eight years ago, when a number of firms relocated into new buildings, firms miscalculated the direction in which their business was headed, directly affecting the use of office space. Firms that derived 25 percent of their revenues from litigation saw that increase to 50-60 percent over these years – with inadequate file storage solutions and war rooms. The last generation of changes saw attorney/secretarial ratios shift quickly from 1.85/1 to more than 3/1 - after investing in expensive built-in (and inflexible) work stations. Now we are seeing a shift from secretarial to greater paralegal needs, which require differently designed interior

office space. The design of the support areas for law firms will continue to evolve – faster than space for the lawyers – and need to be more flexible in years to come with less costly reuse options. Retaining an architect that understands law firms and can anticipate the next changes in their use of space can help alleviate additional costly mistakes.

Getting into the right cycle: Why do some firms seem to always recast their leases at the top of the market while others seem to always get the timing right? Firms need to be more creative – and know what catalysts are available to them – to adjust their place in the cycle. Consider a short-term lease extension, for example, if market dynamics are not optimal. A few years of pain are better than 10 or 15 years paying top of the market rents.

Allow plenty of time, anticipate continued change, allow as much flexibility as the market will allow for term and space needs and always look for creative ways to improve your real estate situation. Working with seasoned real estate professionals who have a proven track record of advising law firms will help firms avoid repeating mistakes of the past, and allow them to take advantage of opportunities that present themselves for the future. ■

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