



## A Brief Primer on Negotiating with CBRE

**CBRE** – four letters that can strike fear in a lessor’s heart when it’s lease renewal time. However, with a little preparation and perseverance, lessors need not fear negotiations with CBRE. Moreover, the fact that CBRE is contacting a lessor is a good indication that the USPS hopes to renew the lease and remain in the lessor’s building. In this article, we hope to provide useful information to assist members dealing with lease renewals and CBRE.

### **Lease Renewal vs. Option Exercise**

When a lease contains a renewal option, it is just that. The option permits the USPS to decide to renew the lease under the terms specified in the option. If the USPS elects to exercise the option, the lessor must honor the agreement and permit the USPS to renew the lease under the previously agreed terms.

However, the USPS is not obligated to exercise a renewal option. If the USPS chooses to do so, it can attempt to negotiate a renewal of a lease on terms different than the terms of the option. In such a case, the renewal would be handled the same as the renewal of a lease that contains no options.

Because the renewal of a lease through the exercise of a renewal option will normally occur on terms that have already been negotiated as part of the option, this article focuses on renewals that are to be negotiated. That may be because an expiring lease does not contain a renewal option, or because the USPS elects to negotiate a renewal rather than exercise an already agreed upon renewal option.

### **When Does CBRE Negotiate?**

The USPS uses CBRE to negotiate renewals and to assist the USPS in determining a “fair market” rental amount for a renewal. Thus, CBE’s involvement in renewal negotiations can depend upon a couple different considerations.

First, if the renewal is of a lease with annual rents that do not exceed \$25,000, the USPS will normally negotiate the renewal itself. CBRE will not normally be involved in the renewal negotiations.

Second, even for leases involving annual rents in excess of \$25,000, CBRE may sometimes determine that the proposed rental amount is a “fair market” rental amount. In such a case, CBRE might return the proposed lease to the USPS for completion of the negotiations.

Other than the cases described above, initial lease renewal negotiations will normally be handled by CBRE. That is, lessors will normally negotiate with CBRE with regard to lease renewals for leases in which annual rent exceeds \$25,000.

### **POStPlan**

POStPlan can also impact lease renewals. Postal facilities that are on the POStPlan have seen reductions in retail services hours to two, four or six hours per day. When negotiating lease renewals for such buildings, the USPS will pay careful attention to the length and amount of its obligation. For example, the USPS may insist on the inclusion of a termination clause for a POStPlan building lease. At present, the USPS will generally only require termination clauses for buildings on the POStPlan.

### **Timing**

The USPS hopes to execute Level 1 leases (annual rent up to \$49,999) by 12 months prior to lease expiration date (LED). For level 2 leases (annual rent between \$50,000 and \$249,999) USPS seeks to have them renewed by 24 months prior to LED. For Level 3 leases (annual rent of \$250,000 or more), the goal for completing a lease renewal is to have it done by 36 months prior to LED. Normally, CBRE will contact the lessor six to twelve months prior to the planned execution date. Having such advance notice is good, because it takes time to obtain the information that's necessary to properly negotiate a lease renewal.

With the advance notice normally provided, lessors have time to prepare themselves to negotiate. However, it is advisable to respond promptly to the initial contact from the USPS and/or CBRE. A lessor should quickly return the initial call, or respond to the initial letter or e-mail, even if the response is nothing more than that the lessor has received the communication and will prepare a substantive response after conducting necessary research. It is not necessary to immediately negotiate specifics of the renewal.

### **The Letter of Intent**

When CBRE sends a letter of intent ("LOI"), the LOI serves as a proposal or "offer," and sets forth the material terms CBRE would like a renewing lessor to accept. The LOI can include proposals for such matters as rental amounts deemed to be "fair market" rent, free rent, the length of the renewal term, a tenant improvement allowance, any options, a termination clause and any commission that is payable. Those matters (other than perhaps termination clauses) are fairly typical for commercial lease negotiations.

### **Preparing for Negotiations**

When negotiating a lease renewal with CBRE and/or the USPS, there is no substitute for preparation. A lessor must have a working understanding of (among other things) (1) the terms of the lease the lessor is being asked to sign, including the impact of the maintenance rider, any tax reimbursement riders and the other lease terms, (2) the condition and age of the lessor's building and any costs of repairs or replacement the USPS will require concurrently with the renewal, (3) the costs the lessor will incur during the renewal term performing maintenance and repairs which are to be the lessor's obligation

under the proposed lease, (4) the rents being paid in the community for similar buildings at the time of the proposed lease renewal, (5) the rents then being paid by the USPS for similar buildings in the area of the lessor's building, and (6) whether it will or will not be difficult for the USPS to easily find replacement space and move if the lessor and the USPS cannot agree upon a rental amount for the renewal.

In negotiating a renewal, the USPS and CBRE will seek to establish the lowest "fair market" rent the USPS/CBRE can justify. A prepared lessor can counter USPS/CBRE contentions regarding "fair market" rent by providing alternate comparable rents determined through the lessor's own research.

One point is especially important. A lessor must have a good understanding of the amount of rent the lessor must receive in order to (i) pay any expenses for insurance and repair and maintenance which will be the lessor's responsibility under the lease, (ii) establish reserves for the payment of significant repair and maintenance expenses which could become necessary (e.g., roof replacement), and (iii) provide a reasonable profit to the lessor. Neither the lessor nor the USPS is well-served by a lease with rents that are insufficient to address each of the above considerations. Thus, the amount of rent necessary to ensure that those objectives can be met should set the floor for the rent the lessor can accept in the renewal. Since other commercial lessors in the area will also have similar concerns regarding their buildings, it should normally be the case that the amount of rent required to meet those objectives will be a rental amount that can be supported as a "fair market" rental amount.

Some actions lessors can take to prepare themselves for negotiations and determine "fair market" rents for their buildings include the following:

- Talk to contractors, other commercial lessors and experienced real estate professionals in the area to determine the amounts a commercial lessor can expect to spend for repairs, maintenance and replacement of a building and its components.
- Enlist the assistance of an experienced real estate professional to determine the rents then being paid in the area for similar commercial leased space. In doing so it is important to understand normal commercial leasing practices, such as whether lease rates established for other commercial buildings require the tenants to pay all expenses of maintenance, insurance and taxes (known as "triple net" leases). If they do, and if a lessor's lease with the USPS requires the lessor to absorb some or all of those costs, then a comparable rental rate would be one that offsets the additional costs to be borne by the postal lessor.
- Use the "FOIA" list (which can be found at the following link: [Freedom of Information Act – USPS Leased Facilities Sorted by State](#)) to determine the rents then being paid by the USPS for similar leased buildings in the area. When using the FOIA list, lessors should:
  - Choose buildings that are close to the building for which comparable rental amounts are sought, including by looking at buildings in the same town or neighboring towns and in nearby zip codes.
  - Look for buildings that are similar in size and age as the building for which comparables are being established, or make adjustments for differences in size, age and condition. Remember, you are trying to determine a rental rate per square foot that is truly

- comparable to the per square foot rental rates for “similar” buildings.
- Ask CBRE or the USPS to provide the specific comparable buildings the USPS/CBRE is using to make its rental offer. CBRE may resist providing the information, but it is perfectly legitimate for a lessor to request it and to refuse to agree upon a renewal rental without seeing it. The lessor cannot know whether the USPS/CBRE offer is reasonable without knowing whether the comparables the USPS or CBRE is relying upon are actually “comparable.” Be willing to provide the USPS or CBRE with the comparable properties discovered by the lessor, and to support the determination that those properties are actually “comparable” to the lessor’s building.
  - Determine whether the lessor’s building is on the POSTPlan, which could influence (i) the difficulty the USPS believes it would encounter moving out of the building, and (ii) whether certain tenant favorable provisions (such as a termination clause) will be requested.
  - Determine whether any factors specific to the community or property make it more or less likely that the USPS would want to stay in the building. Does the building have favorable access, street frontage or other characteristics making it particularly well-suited for USPS use? Is the building located in a County seat or other area where the USPS presence is especially desirable? Is the building especially valuable to USPS because it has features which enhance the ability of the USPS to efficiently perform its functions?
  - Finally, try to determine how easy or difficult it would be for the USPS to move to another building in the area. By commencing negotiations, the USPS communicates that it would like to stay in a building if it can negotiate a reasonable lease. Moreover, moving and retrofitting another building to the specifications required by the USPS will cost money and involve time and inconvenience the USPS would prefer to avoid. If there are numerous buildings in the area that would suit the purposes of the USPS at reasonable cost, then the USPS may be willing to move rather than pay rent the USPS considers excessive. If not, a lessor will have grounds to ask for rent at the higher end of the “fair market” range.

When a lessor is unable on its own to conduct the investigations of the factors that make the lessor’s building more or less desirable to the USPS, it is advisable for the lessor to seek professional assistance. For lessors that are uncomfortable negotiating with USPS or CBRE, AUSPL can provide contact information for real estate professionals who have years of experience negotiating postal leases. A list of consultants is available in the “Members Only” area of the AUSPL web site. Access is password protected. Call AUSPL at 800-572-9483 if you need assistance gaining access.

Finally, when negotiating with the USPS or CBRE a lessor should attempt to document in writing all communications with the USPS or CBRE. That includes making notes of telephone calls which include the time and date of the call and the identity of the USPS/CBRE representative(s) who participated.

## **Fair Market Value**

The USPS has stated that its policy is to renew leases at (and no higher than) “fair market value.” However, lessors should remember that “fair market value” is the amount that a motivated tenant and a motivated lessor wanting to do business together would be willing to pay/receive for the lease of a particular building. “Fair market value” will depend upon and be impacted by all of the factors described in this article and will generally be a range of values. The USPS and the lessor will then settle upon a value within the range. Any rental rate which is within the range and agreed upon by the parties can be considered “fair.” Thus, a lessor who performs its investigations and develops good information can establish alternative rental rates that will help set the range of values that are considered to be “fair market value.”

## **The CBRE Commission**

There is much discussion about the fact that CBRE asks lessors to pay a commission for its services negotiating USPS lease renewals. CBRE has been hired to assist the USPS in determining “fair market” rental rates and in negotiating the terms of renewals. When it does so, CBRE often asks lessors to pay a commission based upon the amount of the rents called for under the renewed lease.

In negotiating renewals, CBRE is acting for the USPS. Thus, lessors often feel CBRE should be compensated by the USPS (rather than through commissions paid by the lessors). While it is not unusual in private sector commercial leases for a tenants’ broker to receive a part of the lease commissions paid by the landlord, that normally happens only because the tenant’s broker shares in the commission the landlord agreed to pay its own broker.

Although tenants’ representatives may receive a portion of agreed upon lease commissions in non-postal commercial leases, lessors paying such commissions (including any portion shared with a tenant’s broker) will have factored in the cost of lease commissions when setting an acceptable rental rate. Also, the amounts of lease commissions are often negotiated as part of commercial lease transactions.

Keeping these practices in mind, postal lessors negotiating with CBRE should consider the following:

- A postal lessor has no contract with CBRE or other **obligation** to pay CBRE a commission in connection with a lease renewal. A postal lessor can feel free to negotiate the amount of commission - if any - to be paid to CBRE for a lease renewal.
- In lieu of a commission, a postal lessor can propose a flat “transaction fee” in an amount acceptable to the lessor.
- In any case in which a lessor is considering paying a commission or transaction fee, the amount of the commission or fee should simply be considered one of the costs the lessor incurs for the renewal. The lessor should add all such costs together and determine whether the rental rate being offered is sufficient to cover the costs and provide the expected level of return over the renewal term. If not, the lessor can choose to increase the requested rental rate to ensure that all costs of the renewal (including commissions) are adequately repaid through the payment of

rent during the renewal term. There is nothing wrong with telling a CBRE agent that any commission costs being borne by the lessor are costs that will have to be recovered through the payment of increased rent during the renewal term.

#### **SUMMARY**

Postal lessors should not be intimidated when the time comes to negotiate lease renewals with the USPS or CBRE. A Lessor has an asset the USPS wishes to lease, as shown by the desire of the USPS to renew the lease. The USPS will face a significant amount of inconvenience and expense if it is unable to negotiate a renewal and must move from an existing location. Therefore, the USPS will prefer in such a case to enter into a reasonable deal to renew its lease. Lessors who are prepared to engage in such negotiations, who know their costs (including commissions, if any) and expectations for a reasonable profit, and who know the market for similar properties in their areas should not find it unduly stressful to negotiate mutually acceptable renewals of their leases.

*If you need more help, please call us at 800-572-9483 or email [auspl@auspl.com](mailto:auspl@auspl.com). We look forward to hearing from you.*