The Incredible Shrinking Building
By Bill Tracy, NCARB, MBA

Those who keep tabs on the changing state of our real estate economy publish endless statistics on rent rates, vacancies, shadow space and the like. These phenomena are of real concern to building managers, but there is one issue that is not getting much attention, and that is shrinking buildings.

The phrase "shrinking building", refers to compromises in floor area measurement practices that brokers and property managers make in a weak economy as enticements for tenants. These enticements seem minor in light of other concessions that are extracted by tenants in a market that favors them. Their impact goes unnoticed but can be significant.

What kinds of floor measurement concessions are being made?

First, some landlords agree to utilize an older measurement method, such as the 1989 BOMA Standard Method of Measuring Floor Area in Office Buildings, rather than the current 1996 version of that standard. Because the 1989 standard does not allow the landlord to allocate building common areas over the entire building, the R/U Ratio (sometimes called the loss factor) can be as much as 5% lower, with a corresponding reduction in rentable area for the tenant and the property if this concession is made to all tenants.

Secondly, some landlords may negotiate the R/U Ratio with prospective tenants. For example, a building with a 1.15 R/U Ratio, measured under the BOMA Standard, might be leased to a tenant using a 1.12 R/U Ratio because the tenant saw that ratio in another proposal for space in a building down the street. In this example, the rentable area of a tenant would be reduced by about 3%.

Thirdly, some landlords make deductions to usable area that are not supported by the BOMA measurement method. Columns, walls, window sills, minor floor openings, rooms containing minor building equipment, entry door recesses and corridor extensions are examples of areas being shaved off from the space that would normally be included in the tenant's usable area. These reductions, when multiplied by the R/U Ratio, can easily reduce a tenant's rentable area by 3% to 5%. Astute tenant representatives are aggressive in pushing for these concessions in today's market.

Taken together, these concessions can shrink the rentable area of a building by as much as 10%. The most unfortunate aspect of this practice is that this shrinkage is often permanent because lease information systems generally record only the agreed rentable area without noting what the rentable area should have been.

The impact of this loss on the appraised value of the property can be enormous since the capitalization rate and rent rate both act to leverage the loss in rentable area. For example, a loss of 10% in a 50,000 square foot building is 5,000 square feet, multiplied by a rent rate of $20/SF is $100,000 per year, and divided by a 12% cap rate equates to a $833,000 loss in property value. This is big money.

There is an easy solution: never compromise floor area measurement! The rent rate can be adjusted to reflect measurement issues, and can be re-adjusted to market at a later time a whole lot easier than trying to increase the rentable area. Furthermore, rent rate concessions will not have the same impact on the appraised value of your property that loss of rentable area does. This is because appraisers utilize comparable properties to determine fair rents, replacement costs and the like, but the area of a property is a given.

A senior BOMA member once remarked to me that negotiating rentable area is like negotiating your height. “I’ll agree to be seven feet tall if you agree that you are five feet tall!” While lawyers will tell you that you can negotiate anything, this not only flies in the face of reason but has the potential of causing problems in the future. Likewise with negotiating rentable area; just don’t do it!

As published in BOMA Matters, January, 2003