

R/U High? Adjust Base Rent!

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We're not talking about illegal substances here. "R/U ratio" is a term that has been used in the BOMA *Standard Method for Measuring Floor Area in Office Buildings* since 1981. However, many property managers are still unfamiliar with the term, preferring instead to talk about the add-on factor, common area factor, loss factor, load factor, gross-up factor or partial floor factor. Whatever you call it, it is a number that is multiplied by a tenant's usable area to determine their rentable area, and a high R/U can give you a low feeling.

The 1996 edition of the BOMA Standard was revolutionary because it was the first version of the widely cited standard that permitted the use of a building R/U ratio, that is, the allocation of building common spaces, such as the entry lobby, to other floors of a multistory office building. More than that, it expanded the definition of building common area to include areas that serve all the tenants of a building without being used exclusively by any one tenant – mechanical rooms, fire command centers, building storage, you name it. This expansion significantly increased building R/U ratios, resulting in rentable areas increasing by 5 to 15 percent in most properties.

Articles have been written about the resulting "windfall" landlords received by this sudden increase in rentable areas. However, those who are waving their arms about this should look at average rent rates, which nationally have fallen 15 percent to 20 percent since the fourth quarter 2000. Competition for tenants has been intense and, despite the higher rentable areas, the increased R/U's in the 1996 BOMA Standard have brought no pot of gold to property owners. Indeed, those who have not had the opportunity to re-measure and boost their R/U ratios have suffered the most from the slide in rent rates.

This has exacerbated another problem that is not a new phenomenon – the sky-high R/U ratio. Some older properties and many converted from single to multi-tenant occupancy have average R/U ratios of 1.25 and higher. Today's more sophisticated tenants and their representatives scoff at these high R/U ratios. The concept of a market R/U ratio has evolved, with acceptable R/U ratios varying from around 1.10 in suburban Class C properties to about 1.18 in downtown Class A buildings. Faced with the threat of losing prospective tenants, property managers in buildings with high R/U Ratios have been submitting to tenant pressure to lower them.

There are two ways to deal with a high R/U ratio. The first is to figure out what R/U ratio will fly in the property's particular market and lower the "asking" R/U ratio to that level. This approach permanently eliminates the rentable area of the property associated the difference between its real R/U ratio and the asking R/U ratio.

The second is to maintain the property's real R/U ratio in proposals but cave to the tenants who object to it. Not all tenants may object, meaning less rentable area will be sacrificed. Also, there are two ways to cave. First, agree to the tenant's preferred R/U ratio, thereby shrinking your rent roll. Second adjust the base rent rate in the amount necessary to compensate for the higher R/U ratio. The first method leads to "the incredible shrinking building syndrome" where the rentable area of a building vanishes over time, dragging down its appraised value. The second approach preserves the rentable area and appraised value of the property.

Since one of the three principal goals of property management is to preserve the asset value of the property, it is difficult to justify any response to a tenant negotiation that would result in loss of rentable area. The best response to a high R/U ratio is to adjust the base rent rate and not compromise the rentable area of the property.

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