

## So You Want to Sign a Commercial Lease in Toronto, Eh?

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**Toronto, like many large international cities, offers a distinctive business climate that reflects local regulations and national traditions, but the city also holds another important distinction: it has endured the volatility of the global corporate real estate market during the last four years remarkably well.**

Toronto's financial core is perhaps experiencing its strongest upswing ever, with four towers in the financial district that have been completed in the past 24 months and two more currently being constructed. That's a stark contrast to the previous 20 years when only one building was constructed. This strength is attributed to our strong banking system, which has weathered the global recession.

While the suburbs and industrial real estate lack this strength, few bargains can be found in the metropolitan area. That said, there are abundant opportunities available in nearby regions. For example, we worked with an international food company to obtain industrial space for their suburban distribution centre. The buildings that we toured were in the \$5.00 PSF net rental rate range in Toronto West as opposed to \$1.50 PSF just over our border in parts of Michigan in the United States, making certain commercial transactions in Toronto

– and generally in Canada – more difficult.

### Oligopoly of Landlords

Two-thirds of Canadian corporate real estate is controlled by seven landlords. This is actually beneficial in finding space; I would rather make seven phone calls than 20 any day. It is also beneficial for tenants that need to change their square footage mid-lease as each of the big seven landlords has millions of square feet in Toronto.

Conversely, negotiating a transaction can be painful. These landlords have many layers of management. Response times can be very slow. Creativity, entrepreneurialism, and deal-making are traits rarely demonstrated by these landlords.

For example, the leasing agent for a large landlord went on vacation for two weeks with a 25,000 square foot deal that needed only one initial



to finalize it, but the tenant never heard back from the agent and they consequently relocated. In another situation, a tenant moved from their building to one owned by a landlord with a smaller portfolio of properties after waiting seven weeks to receive a response to their offer. A lack of competition and big-company bureaucracy are not the best conditions for deal-making.

### Building Valuation is King

Landlords are reluctant to throw money at tenants, but that is their preference in almost every situation. Why? Contributing cash towards a tenant's leasehold increases the net rent. Increasing the net rents in a building increases the value of the

building, and increasing the value of the building allows landlords to leverage their buildings to buy more buildings.

Most quoted net rental rates will include \$5-\$15 PSF for tenant improvements. That kind of allowance tends to only have a cosmetic effect such as paint and carpet (the typical tenant would spend about \$45 per square foot on raw space). The dream scenario for a landlord would be to contribute the nominal tenant improvement allowance within the asking rates and then amortize the balance of improvement costs across the rent schedule, which typically adds \$5-\$15 per square foot per annum.

### **Offer to Lease vs. Letter of Intent**

Every country has slightly different procedures to get from finding the space to getting the keys. Our process is to submit an offer to lease. In Toronto, the tenant is responsible for inserting a condition to pull out of a lease in its offer. Meanwhile, the landlord will typically insert a condition to review the tenant's financials.

The offer is typically revised by the landlord, then again by the tenant. The average offer to lease typically goes back and forth four times. Once the deal is conditionally

accepted by both parties, the next step is for each to sign waiver letters, making the commitment firm and binding on both parties.

This is where it gets tricky. The transaction is now binding, but both parties have agreed to agree on the lease. In other words the deal is done, but both parties agree to make a few minor changes to the lease. Many countries have the lease as a hurdle to jump over before a deal is finalized (the deal is not done until the lease is fully executed). I am thankful we do not have that as part of our deal-making process because it takes long enough given the challenging landlord conditions mentioned earlier.

### **Transparency of Information**

Canada has an equivalent to CoStar called Altus. Although there is no alternative, Altus has created a user-friendly platform that streamlines the search process and creates reports. While this is very helpful in finding new space, there is, unfortunately, no repository of completed transactions for brokers. Therefore, finding out the current status of rental rates comes down to networking within the brokerage and landlord community. As a tight-knit community, most landlords view brokers as their

extended sales force, and they are open to sharing information.

### **Fees**

Unlike most real estate brokerages in the rest of the world, Canada is like the U.S. because real estate brokerage commissions are paid by landlords. This is true even when the broker represents the tenant. In most cases, if the tenant does not have a representative then the full fee will be absorbed by the landlord broker.

### **Conclusion**

Since Toronto's leasing market is dominated by a few, but very large, players, it makes it easy to find space, get paid on transactions, and build rapport with the leasing agents for landlords since there are relatively few of them. It is the actual negotiation of the deal that requires comprehensive market knowledge, diplomatic skill, and expert strategic action to win the best terms and secure the optimal facility when a company leases commercial space in Toronto.

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