3 Secrets of Varying Rental Rates

By Aaron Kuhl, *Medical Office Brokers*

Often within a commercial real estate sub-market such as the Scottsdale Airpark, tenants notice rental rates quoted across a wide range. This discrepancy can be puzzling, leading renters to wonder about the variance between similar spaces within the same geographical location. Rental rates are set with a variety of factors in mind, which might not be readily apparent to the average renter. Here's an inside look at the factors in play.

Reason 1: Ownership structure is a driver of rental rates. In commercial real estate, there are two kinds of commercial real estate owners: the institutional variety or the "mom and pop" type. While thought to be totally market driven, rental rates are often driven by the situation of the owners.

Institutional owners are concerned with budgets and financial projections, and therefore want to maintain a consistent "rent roll"—which is the list of rental values in one building. For example, a market rental rate is $20 a square foot, but a savvy landlord wants to maintain a rent roll of $21.80 psf. The landlord will charge the higher rate but give away one month of free rent per year to effectively give the tenant a $20-psf value without compromising the higher rent roll.

Mom-and-pop owners are less concerned with rate per square foot and simply want to have the space full and overhead covered. It's not unusual for them to set monthly rent in a round number such as $5,000. Mom and pops aren't as concerned if the rent is $10 psf below market rate, as long as the rent covers the monthly expenses or comes close.

Whether you are dealing with an institution or a mom and pop, it's important to understand the motivations of a landlord when negotiating in order to get the best deal.

Reason 2: Type of property is especially important when evaluating rental rates within a market, such as the Scottsdale Airpark. An amazing diversity of available spaces here is for lease, mirroring the diversity of businesses in the area.

From class A office buildings and anchored retail centers to light industrial manufacturing, the type of building is very important to rental rates. The prime rental rates are typically reserved for fresh, anchored retail centers with a host of national credit tenants. In these properties, visibility is good, parking sufficient and the flow of new potential customers is a lure and justification for higher rents.

Conversely, older buildings with minimal parking and visibility appeal to fewer potential tenants. It is conceivable to have an anchored, fully leased retail center charging $30 psf plus expenses while less than a quarter mile away a vacant light industrial building with no visibility is desperate to lease at $15 per square foot.

Reason 3: Inherent benefits of the space itself influence rates. Sometimes suites within the same building command different rates. The rationale for this is related to either benefits or obsolescence of a specific suite.

For example, is one suite offered with a prominent entry and the other buried at the end of a hallway? Is there a host of natural light in one suite while another is located in a basement? Is one built out as a formal dental office with adequate power and plumbing while the other is a shell without air conditioning?

Rental rates as well as incentives can vary for suites within the same complex. It's all about supply and demand for a landlord. A former restaurant could represent an expensive reproduction or an expensive demolition. The dental office might be a great asset—they cost more than $80 psf to build from a shell. But if it's been vacant for a long time and a general office user comes along, it's a major liability for the landlord to convert it back to office.

Whatever type of space is being sought, a wise renter will do their research to determine not only rents in the area, but the reasons behind a particular rate. Approaching any rental market with knowledge of the types of owners, properties and fellow renters can only help inform a value-rich lease agreement. ■

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