LeasePilot®

From LOI to Signed Lease:

The Value of Closing Leases Faster

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Introduction

90 DAYS

The average amount of time it takes to go from LOI to fully signed lease

19 DAYS

The amount of time it took to build a 57-story building

Did you know that a construction firm in China built an entire 57-story building in 19 days?

Think about that for a second. That building could have been built almost 5 times in the same 90 day time period that it takes to close a lease. It's simply unacceptable. And intuitively, the commercial real estate industry knows it's unacceptable. There is intense pressure to start getting leases closed faster. But why? And how? Unlocking the answers to those questions, and ultimately implementing systematic changes to speed up the process and reduce costs can transform an entire company and industry.

The focus of this eBook is on three fundamental questions:

1. Why should real estate companies care about closing leases faster?
2. Why is the current legal process to go from LOI to signed lease so slow?
3. What are some strategic approaches that real estate companies can implement to increase speed and reduce costs?

Throughout this E-Book, we will be referring to a hypothetical retail real estate company called RealCo. RealCo has 25 million square feet spread across 125 shopping/lifestyle centers. For more of RealCo's characteristics see the overview.

SPEED MATTERS

The first section of this E-Book will focus on some of the ways to think about and quantify the impact of speeding up the lease closing process. Intuitively, the industry knows that faster is better when it comes to getting leases signed.

But why? There are three main areas where reducing the amount of time to go from LOI to signed lease can have a significant impact on a real estate company:

(i) rent commencement,
(ii) transaction risk, and
(iii) wasted time.

As you'll see through the RealCo example, all three can have a significant impact on revenue and costs.

Rent Commencement

Increasing the speed from LOI to a signed lease can impact the commencement of rent, and the type of asset will often determine how this manifests itself.

For retail leases, every day truly matters. The majority of the time, the sooner a lease gets signed, the sooner that tenant can move in and start paying rent. For office/industrial leases, this is less common. Instead, the issue is more about the occasional need to push back a rent commencement date to accommodate a legal leasing process that is taking longer than was anticipated when the LOI was signed. When this occurs, rent commencement dates are typically delayed by at least 30 days, which results in lost revenue.

The rent implications discussed above are most commonly experienced when dealing with new leases as opposed to amendments. The reason being, that with amendments, the tenant is already in the space paying rent so the opportunity for a real estate company to accelerate rent by increasing speed is limited.

By simply reducing the time it takes to close leases by 2 weeks, each year RealCo recognizes additional revenue of:

$425K

To walk through the math quickly: we determine RealCo's per diem rent by multiplying the average premises size by the average rent psf and then dividing by 365. We then multiply that number by 14 (the 2 weeks sooner that the lease is signed). That gives us RealCo's per lease additional revenue and then we multiply that number by the total number of leases per year to get the total portfolio revenue impact.

Transaction Risk

The longer a lease or amendment remains unsigned, the more risk there is of something happening to change or kill the deal. It's the old adage—"time kills deals."

While dead deals may be relatively rare in practice, the risk is always present and the downside is significant. Each time a deal is lost, a real estate company needs to spend time and money re-marketing and re-leasing the space. In addition, it can often take 6 months to find a new tenant and that is 6 months of lost rent that comes out of a real estate company's pocket. The risk of losing a deal can be quantified by adding the cost of wasted time to the cost of vacancy.

Let's assume RealCo was deep in negotiations with a potential retail tenant looking to establish a 20,000 square foot flagship store.

The consequences are steep. Losing this one deal costs RealCo $125,000 in lost rent. On top of that, the company also has lost the time that the business people and lawyers spent putting the deal together and all other costs (such as marketing) that went into getting this deal to the point where it ultimately fell apart.

Inflated costs

There is a lot of wasted time built into the roughly 90 days that it takes to go from LOI to signed lease.

The impact of wasted time is felt by both business people and lawyers and manifests itself in two ways: inflated cost and opportunity cost.

Business people are hired and compensated to sell space, not spend time herding cats to get leases signed. The longer it takes to close leases means the more time people are spending involved in a deal and the less time they are spending finding new tenants to fill other vacancies.

Over the course of a year, business people spend up to 3 weeks on the post-LOI lease closing process. Completely removing business people from this process is unrealistic, but if they only had to spend 1/3 of this time closing deals, that would free up an additional 2 weeks to spend selling space and reducing vacancy.

For lawyers, the more time they spend on each deal, the less time they have to get to other higher value work and time sensitive matters. This creates bottlenecks that lead to a longer lease closing process.

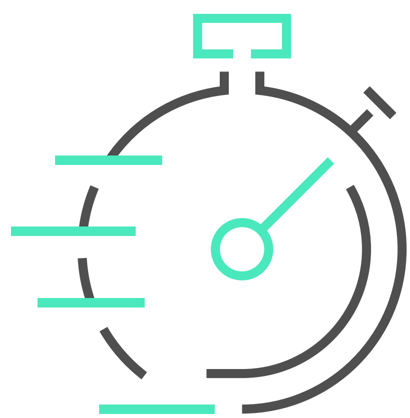
On each lease, up to 50% of a lawyer's time is spent manually entering lease terms, searching for correct language, adjusting templates to accommodate different deal terms, doing calculations and formatting.

If RealCo's business people each had 2 more weeks of time to sell space, this would amount to a total of 20 additional weeks for their entire leasing department.

If they were able to use these additional 20 weeks to increase occupancy by just .1% (from 91.2% to 91.3%—only an additional 20,000 sf of space), the result would amount to almost $400,000 of additional revenue each year.

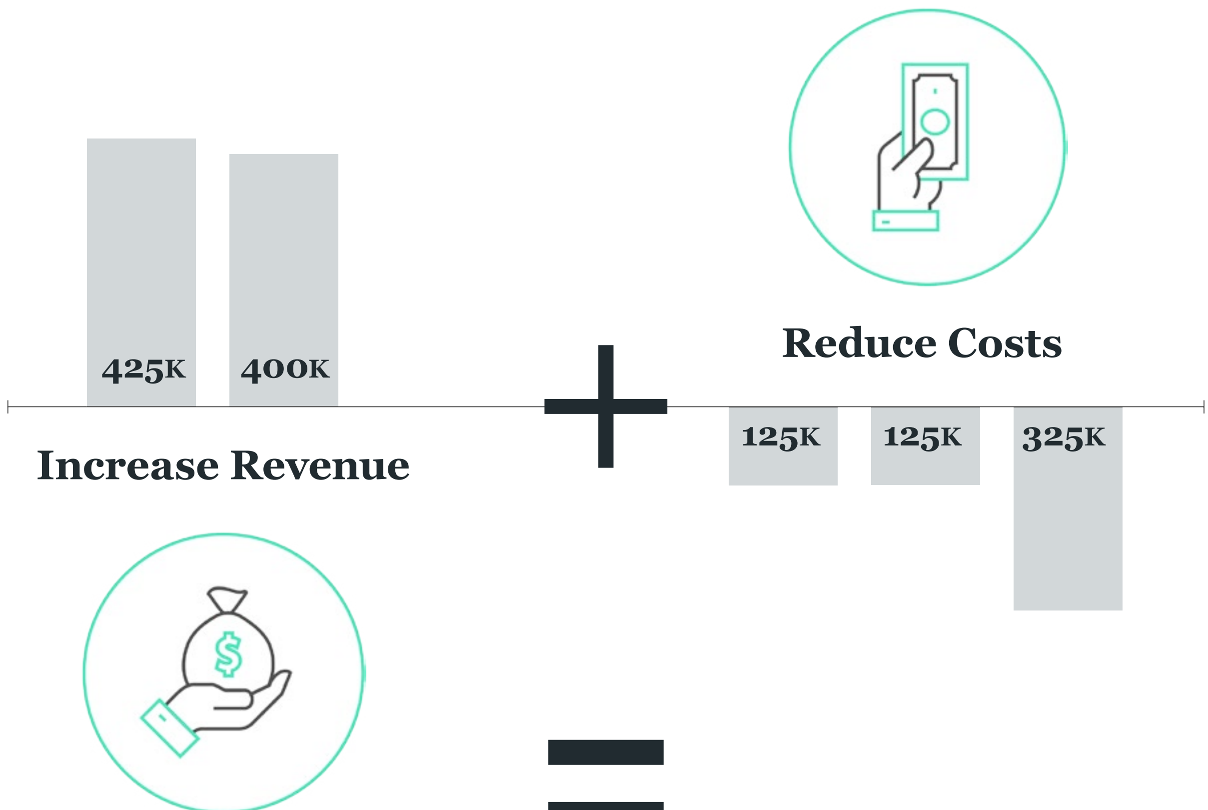
0.1% → $400K

If RealCo's leasing attorneys had 50% more time, they would be able to bring their overflow leasing work in-house leading to an additional $325,000 of savings (assuming $5K average fee per outsourced deal). In addition, they would be able to free up almost 1,300 hours of time (assuming 10 hours per lease). The value of that time saved is over $125,000.



Closing Leases Faster = Major Value

Speeding up the lease closing process has a real material impact on revenue and costs. For RealCo, simply shaving off two weeks of the lease closing process and capturing rent sooner, reducing transaction risk and reducing wasted time results in about $1.5m of combined increased revenue and reduced costs annually. And that's not even factoring in the intangible benefits of speed such as customer happiness. In this day and age where tenants are often seen as customers and not adversaries many real estate companies are trying to add value to tenants. Speeding up the lease closing process is one way to provide that value.



$1.5M Annually

A PROCESS NOT DESIGNED FOR SPEED

Despite the need for speed, why does it take so long to go from LOI to signed lease? Who or what is to blame? We constantly hear “it’s not us, it’s them” from both landlords and tenants. Both can’t be right.

In fact, there are plenty of reasons that both landlords and tenants contribute to a slow lease process. In this E-Book, we’re going to focus primarily on the three most significant factors.

Excessive Communication

There are two primary types of communication that really slows down the lease closing process. First, are the internal communications within a real estate company. Second, are the multi-party communications between all of the players on both sides of the table.

Internal Communications

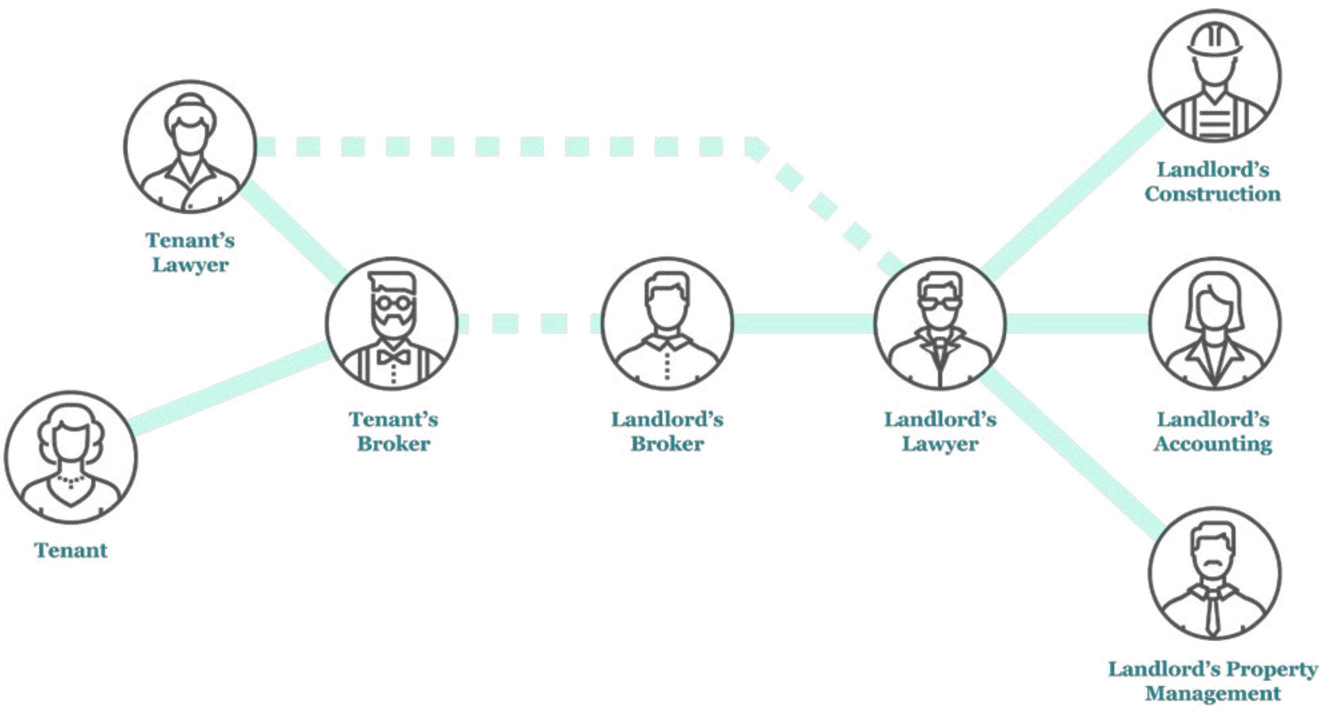
Business people negotiate the business terms of a lease and know the ins and outs of specific deals better than anyone else. However, leases are complex documents, and if not done correctly, can expose real estate companies to significant risk.

This means that even though business people know the deal best, lawyers are tasked with the ultimate preparation and negotiation of the lease document. The result is lots of communication effort for business people to share with lawyers what the deal is, and then for business people to review what the lawyers produce to confirm it tracks the intended deal structure.

Multi-Party Communications

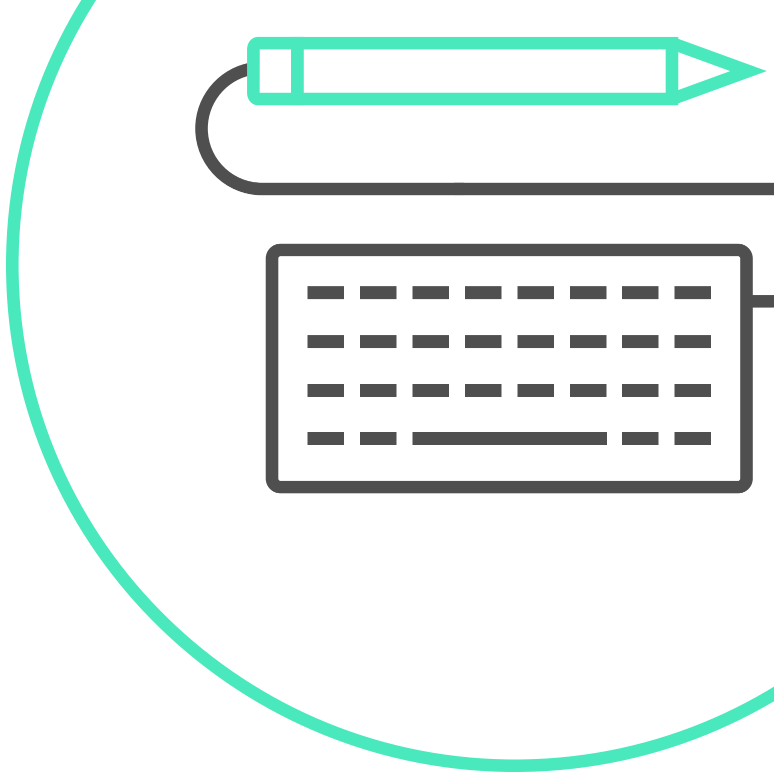
There are simply too many cooks in the kitchen. It is common for there to be upwards of 8 different people weighing in on different parts of a lease at different times—tenant, tenant's attorney, tenant's broker, landlord's leasing representative, landlord's attorney, landlord's construction team, landlord's accounting team and landlord's property management team.

One lost email, one person away on vacation, one misinterpreted comment can lead to weeks that get added to the process. At times it can feel like a game of telephone where information gets passed from one person to another to another only to be slightly changed in a material way before the message gets to the person it was intended for. Not only is it frustrating, but it adds time as the parties try to get on the same page.



Outdated Tools

For most real estate companies, the only option is to use outdated tools such as Microsoft Word.



The vast majority of other industries have evolved with time and the tools they've used have likewise become modernized. But for real estate companies, the process of going from LOI to a fully signed lease has evolved very little since MS Word overtook typewriters in 1985. In many ways, MS Word is just an advanced typewriter. The process of drafting and editing leases is still extremely manual and labor intensive—an extraordinary amount of time spent filling in blanks, changing singulars to plurals, correcting formatting, searching for correct alternative provisions and reinventing language from scratch.

All of this takes time since it is unnecessarily manual and labor intensive. With the outdated tools currently being used, the only way to meaningfully reduce time is to sacrifice quality, but this is not an acceptable outcome given the importance of lease documents.

1985	**Polaroid Camera**	**Cassette Tape**	**Microsoft Word**
2000	**Digital Camera**	**Compact Disc**	**Microsoft Word**
2017	**Smart Phone**	**Pandora**	**Microsoft Word**

Tenant Delays & the Unknown

There are without a doubt also factors that are outside of a landlord's control that contribute to the lease closing process taking an unnecessarily long time.

Tenants have their own internal inefficient processes and may even have reasons for intentionally wanting leases to take a bit longer. Uncontrollable circumstances, such as vacations, illnesses or changes in financial markets come up and can also add length to the process. But the good news is that there are factors that real estate companies can control. You don't need to take a 90 day process down to 10 days to see a meaningful impact. Even just a few days or a few weeks can have outsized benefits. For example, turning a second draft around in 3 days as opposed to 7 days could be the difference between a tenant's attorney getting to review and comment before he goes on vacation or it sitting in his inbox until he returns. That one simple change could actually result in a deal getting signed a couple weeks sooner since while the tenant's attorney is away, you could be going through your process to turn the next draft.

INCREASE SPEED & DECREASE COSTS

Now that we've touched on why speed matters and what some of the causes of the slow legal leasing process are, it's time to dive into what can be done to increase speed and decrease costs.

Right People in the Right Roles

One way to speed up the lease closing process is to re-allocate the workflow so that people aren't tasked with doing jobs they aren't best equipped to do.

Think about the composition of a football team. The players are supposed to go out and execute the plays that the coaching staff designs and calls. Now imagine that as the game winds down, the team decides to let the coaching staff play the end of the game while the players head to the locker room.

The coaching staff doesn't have skills or the in-game knowledge to effectively close out the game. They also will need to play the game at the same time as they are designing and calling plays which is a lot to handle. This is not a recipe for success.

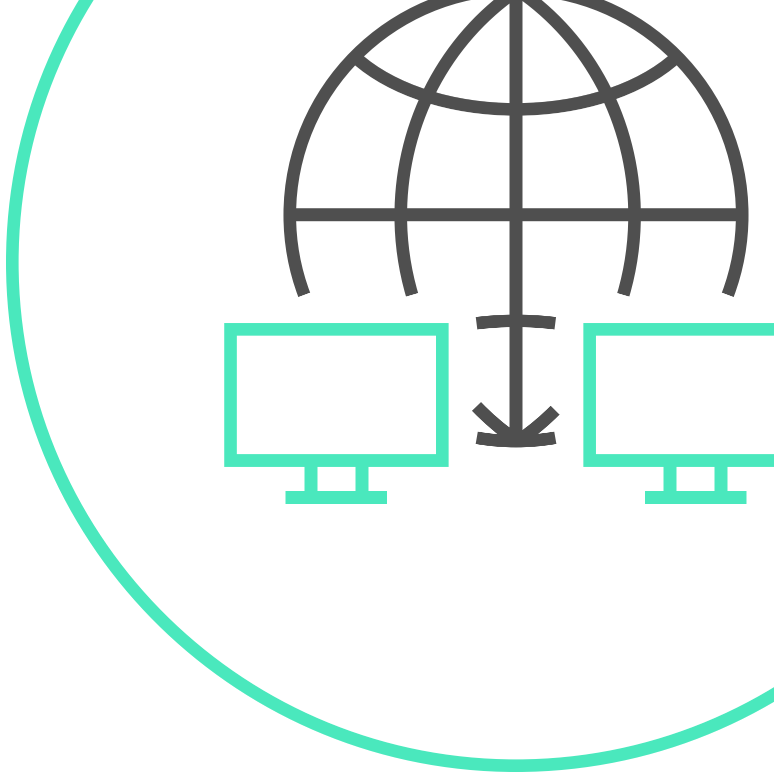
But this is effectively what happens with leasing. Once the LOI is signed, the leasing representatives are effectively taken off the field and replaced by the lawyers. It is the lawyers primary job to close out the lease, but they have no context, except for a bare bones LOI, about what has transpired between the parties so far.

What if instead, lawyers designed a system and put protections in place to give leasing representatives, or other business units, the tools to draft and edit high quality leases up to a certain point themselves without needing to involve lawyers?

This re-allocation of the workflow would accomplish numerous objectives:

1. It would actually reduce the time that leasing representatives spend closing leases since they wouldn't be involved in as much back and forth with legal about deal terms.
2. It would reduce the time that lawyers spend closing leases since they wouldn't be involved in simple deals and the back and forth with leasing representatives would be cut down.
3. It would help leases get closed faster since it would eliminate a lot of the unnecessary communication.
4. It would allow lawyers to spend more time on the bigger picture legal strategy of leasing and how to best manipulate and structure the legal leasing strategy to reduce risk.

Leverage Technology



Another significant opportunity for change and improvement is through technology. There are three main areas where technology will dramatically impact the lease closing process over time.

Lease Automation

Effectively this means using a logic-based platform to do the same work—drafting and editing leases—in minutes as opposed to take hours. For instance, by simply clicking a button to indicate that a lease has a TI Allowance, entering the amount of the TI Allowance and selecting how the TI Allowance gets paid, the lease gets updated in multiple places with the correct language updates, relevant calculations, and formatting automatically applied. Now, imagine this working for all of the 100+ lease concepts and alternatives that real estate company's currently cycle through both for first drafts and subsequent drafts. Lease automation is the only way to achieve the optimal balance of speed and quality.

Multi-Sided Platform

This means that both landlords and tenants access the lease through the same portal, albeit with different views and different permissions. This is possible with technology today given advances in document collaboration and security. A multi-sided platform would dramatically reduce communications bottlenecks. No more people saying "oh I thought I already sent that to you", or "can you re-send the draft I lost it", or "have you heard back yet from so-and-so." Lease communications would be transparent. Everyone involved in a lease would be able to go to one centralized place for all drafting, editing and communication needs.

Use of Data

Instead of treating leases as a collection of letters, that make up words, that make up paragraphs and ultimately 50+ pages of text, leases will be created from data building blocks which will allow all departments within a real estate company to access lease data faster and easier and enables real estate companies to immediately generate automatic abstracts and integrate with other software systems (including property management and financial modeling systems) to create maximum efficiency.

Call Center Model

A third way to speed up the lease closing process is to create a system called the “call center model” where deviation from “standard terms” has implications that create a disincentive for tenants to ask for them.

Principal Financial does something similar in the lending world. They have standard documents and certain standard “gives” that their business units can easily give to borrowers. But for any other requested changes, they need to escalate to their legal team which can take an additional 2-4 weeks. Oftentimes, this disincentive is enough to make the borrowers pull back their request. This forces borrowers to do a cost/benefit analysis on the modifications they are asking for.

In the leasing world, tenants aren’t required to do the same cost/benefit analysis. It’s relatively easy for a tenant’s attorney to mark up a document to oblivion, and there is no resulting cost to them. The worst thing that happens is the landlord’s attorney rejects the edits.

The only party that this materially impacts is the landlord because it is their legal team that needs to wade through all of these proposed modifications to determine what is and is not reasonable. This may not work for every lease—it is a question of leverage, but for smaller more cookie cutter deals where the real estate company has significant leverage it would be very effective.

“Coercing” tenants into accepting more standard terms and eliminating a lot of the back and forth would significantly reduce time from LOI to close. In addition, it is a more friendly way to reject changes than simply saying no, which can help with customer happiness and getting the relationship off on the right foot.

RealCo Overview

125
Shopping/Lifestyle Centers

25M
Total Square Footage

4,500
Average Lease Size (sf)

$18.85
Average Rent (psf)

91.2%
Occupancy Rate

325
Lease Deals Per Year

130
New Leases

195
Amendments

10
Internal Leasing Reps

5
Internal Leasing Lawyers

80%
In-House Leasing

20%
Outsource Leasing

90 days
From LOI to signed lease (industry average)

LeasePilot®

LeasePilot combines document automation, word processing and user-centric interfaces into a single web-based platform expressly designed to radically accelerate the entire process of drafting and editing commercial leases, from a letter of intent through lease execution.

To learn more, please visit us at leasepilot.co