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A New Approach for a New Facility

For companies that are dreaming about a new facility, but are hesitant to put the time and money into a build-to-suit or cannot find the ideal building to lease, build-to-suit-to-lease might be just what they have been looking for.

By Mark C. Fitzgerald, CCIM

WHEN companies realize that they need a new facility to meet the needs of their growing business, three options typically come to mind: (1) build and own; (2) acquire an existing building and renovate; or (3) lease an existing building. However, there is also a fourth option: build-to-suit-to-lease.

Each strategy presents its own advantages and disadvantages, and a prudent business owner should evaluate each option to determine which alternative best suits his or her unique needs. The more strategic issues to be considered include availability of land for development, inventory of existing buildings for sale or lease, availability and cost of capital (debt and equity), immediacy of need, duration of need, and tax implications.

Building a new facility involves a significant investment of time and financial resources. After a suitable location is identified, the intended user must then go through the arduous task of obtaining land development approvals, selecting an architect, designing the building, selecting a contractor, and arranging for financing. The end result yields a customized facility that maximizes productivity and communicates the desired image of the company to employees and customers alike. However, this option typically involves the longest ges-



Philips CSI's office facility, Greenfield Corporate Center, Lancaster, Pa.

tation period from identification of need to utilization of space. In some situations, the approval process could take years and cost hundreds of thousands of dollars before construction could begin. Also, this approach typically requires the user to invest between 15 and 30 percent of the total project cost in equity. In addition, the building becomes a significant depreciable asset on the company's balance sheet.

The acquisition of an existing facility can streamline the up-front portion of the build-to-suit-to-own process. It can eliminate some of the issues of land development and design, and reduces the long lead time associated with new construction. However, there are other issues that may become potentially problematic.

For instance, antiquated mechanical, electrical, life-safety, and structural elements may cost more to upgrade to current code than they would cost to construct new. And, it's not uncommon for existing facilities to be impacted by environmental problems, which can be expensive to remediate and create long-term liability to the new owner. Finally, the cost and time required to renovate the interior space is often as expensive and time-consuming as new construction when major renovations are involved. The end result: expenses can far exceed the user's budget.

Leasing an existing facility is usually the quickest and least-costly alternative for many business owners. Typically, lease terms range from one to three years if little or no tenant improvements are being made by the landlord. Terms often increase to five to 10 years when significant renovations are requested. Notwithstanding the longer term, flexibility to accommodate future growth or downsizing can often be structured into most lease arrangements. While faster and less capital-intensive, this may not be the right solution for a business with a highly customized work process. Tradeoffs in facility design and the inability to define the long-term operating costs associated with older buildings cause some to reject this option.

Build-to-Suit-to-Lease

Build-to-suit-to-lease is a model that allows the user/tenant to design and customize a new facility to meet his or her unique needs in an accelerated timeline without the large capital expenditure that comes with building and owning. This is the opposite of a sale-leaseback arrangement, in which a business agrees to sell its facility to an investor and then lease the facility back.

In a build-to-suit-to-lease agreement, a business works with a developer to design and build a customized facility and then leases it from the developer. Under this structure, the business never owns the facility. As a result, capital dollars can be directed to other non-facility-related areas to grow the business while strengthening the balance sheet since most lease arrangements are treated as operating leases and not capital leases. The end result is a new, customized facility with a very low expenditure of capital by the user. Many well-capitalized developers offer this as an alternative to the typical build-to-own and lease options.

For business owners, a build-to-suit-to-lease arrangement permits the firm to move into a new, customized facility much faster than if they built independently. It also permits the firm to keep its focus on growth without the



Philips CSI's office and production facilities are connected by a sunlit corridor. This reduces long-term risk for the developer as the facilities can be separately leased to possible future tenants.

myriad distractions, time commitment, and capital drain that a build-to-own decision entails. A build-to-suit-to-lease scenario also yields a customized facility designed to enhance the company's image, productivity, and logistics. These critical factors are often compromised, to varying degrees, when leasing an existing facility.

How Does it Work?

A key facet of the build-to-suit-to-lease solution rests within the developer's ability to secure land; obtain land-development approvals; and develop a firm design and construction budget early in the process, minimizing cost and time to the user/tenant.

Selecting a full-service, financially strong developer — one that can provide a single point of contact for site selection, architectural design, municipal approvals, financing, construction, and post-move-in property maintenance and property management — is the starting point for businesses that want to pursue a build-to-suit-to-lease project.

While not required, a user/tenant can maximize efficiency by selecting a company that has developed a master-planned corporate center where the infrastructure — including roads, water, sewer, electric, gas, fiber optics, and storm-water-management systems — is already in place. Additional-

ly, zoning, traffic-impact studies, topography studies, wetland evaluations, environmental audits, and lot subdivisions are generally already in place, which can greatly streamline the land-development approval process. Finally, on- and off-site development costs, which typically account for 10 to 20 percent of the total project budget, are known in advance, which will minimize the uncertainty associated with this aspect of the project.

Selecting a developer/landlord with experience working with your type of business — whether it is office, industrial, manufacturing, or research and development — is critical. Ideally, the design-build developer can produce a schematic design within 90 to 160 days of a letter of intent. The cost to develop the schematic plans is generally borne by the tenant/user. However, if an acceptable lease transaction is negotiated, the developer/landlord waives the fee and includes the design cost in the total project cost.

The benefits of using the build-to-suit-to-lease approach are numerous:

- ◆ The user/tenant hires a single firm that is responsible for land-development approval, design, construction, and financing.
- ◆ Instead of managing multiple relationships and issues, the user/tenant interfaces with one firm responsible for coordinating all aspects of the

development process.

◆ Front-end costs are minimized as lease rates can be developed at 30 to 35 percent of design, saving the user/tenant considerable time and money to get to a go/no-go decision.

◆ The user gets the developer's input during the design and value-engineer-

industry-leading, high-tech image. As the company grew, it was apparent to senior management that Philips needed to move to a different facility.

After many months of weighing alternatives and pursuing a build-to-suit-to-own alternative, Philips turned with interest to a build-to-suit-to-lease

ing a new facility, Philips increased operational efficiency, greatly enhanced their facility's image, and reduced their total space occupied by 15 percent as a result of a more efficient design.

Jerry Gabbard, former president & CEO of Philips, described his experience. "The build-to-suit-to-lease process provided Philips with a single-source solution to the challenge of building our new facility. The developer's expertise in zoning issues, development, design, construction, and leasing allowed the project to proceed smoothly and meet an aggressive schedule."

By understanding the build-to-suit-to-lease alternative, business managers avoid limiting themselves to the traditional build or lease options. By partnering with a qualified developer to create a mutually beneficial lease structure, firms seeking a new facility can direct their capital and human resources toward growing their business instead of managing long-term construction or settling for a less-than-perfect existing facility. **AREA**

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A build-to-suit-to-lease arrangement permits a firm to move into a new, customized facility faster than if they built independently.



Philips CSI's production facility is designed to complement its office facility.

ing stage of the process, greatly reducing the potential for costly user change orders.

A Case Study

Philips CSI, a leading international electronics firm with North American operations based in Lancaster, Pa., was leasing space at an antiquated facility that was not optimal logistically and did not properly present the firm's

alternative in Greenfield Corporate Center in Lancaster. The process was a collaborative effort between user and developer from the start. Within months of signing a letter of intent, Philips and the developer were able to adequately address zoning issues, development cost, design, and pricing of an inter-connected 65,000-square-foot office and 147,000-square-foot research and development building. By design-