



Office and Retail Tenant Improvement Trends

Sally Bach • published in the August 2015 issue

The trend for the first half of 2015 has been similar to the trends in 2013 and 2014. The first quarter of the year the construction contracts for office and retail tenant improvements started slow while eventually peaking mid-year in May, June and July. Several aspects may influence this trend such as new leases and business expansion among other factors.



The remodeled A Store on the corner of 2nd and Park Avenue.

Improvements. In order to make the dollars in a lease work for both landlord and tenant, construction costs for the improvements play a major role. Large general contractors may be challenged competing for tenant improvement contracts, typically due to their larger overhead expense. The general contractor charges (referred to as general conditions) for a typical tenant improvement should range within 10–12% of the improvement costs. In comparison, larger contractors may charge upwards of 18–22%. Smaller contractors with reduced overhead are able to provide aggressive pricing which enables tenants to pursue more leasing opportunities.



Office tenant improvement for Solon Corp.

Tenant improvements can consist of various sizes and scope ranging from small single office tenants to large enterprise corporations. This trend observation focuses primarily on small office and retail tenant improvement projects that range in size of 1500–1800 square feet.

Current trend shows a steady pace of leasing activity that directly contributes to the demand for tenant improvements.

Lease rates are the key consideration in a tenant's decision to occupy and invest in related office

improvements. In order to make the dollars in a lease work for both landlord and tenant, construction costs for the improvements play a major role. Large general contractors may be challenged competing for tenant improvement contracts, typically due to their larger overhead expense. The general contractor charges (referred to as general conditions) for a typical tenant improvement should range within 10–12% of the improvement costs. In comparison, larger contractors may charge upwards of 18–22%. Smaller contractors with reduced overhead are able to provide aggressive pricing which enables tenants to pursue more leasing opportunities.

Tucson continues to see a need for small industrial space. Based on this demand a landlord will typically divide up a property allocating 20% for office space and 80% to warehouse space. Many of these tenants like the versatility of a warehouse allowing them to right size their tenant improvement needs.

Retail improvements are often split between landlord and tenant due to the special nature of the retail business and specific finishes desired (e.g.: beauty salon vs. dentist office). While, landlords are willing to pay for improvements within a reasonable budget, any excess improvement costs will often lead to a contract between the GC and tenant for the balance of the improvements.

From a construction perspective, landlords are signing more deals with added incentives, such as including allowances for construction costs or rent abatement which allows the tenant an opportunity to build out the space, etc.

Completing improvements for landlords to increase lease activity has been steady. The cost to complete upgrades to an outdated space as simple as new flooring, updated fixtures and a fresh coat of paint can cost an average of \$12 per square foot up to \$16 per square foot. A small price to pay to reduce vacancies.

We are also seeing more Tenants that occupy multiple locations or side by side bays in a retail center choose to downsize to smaller square footage to reduce monthly expenses. However, rent savings often leads to upgraded improvements to make the most out of a smaller space. Percentage of office users downsizing compared to those that have expanded appear to be equal in comparison to 2014.

The biggest challenge for smaller general contractors is being able to find skilled labor. In the past, subcontractors were often able to start a project the next day. With the high demand for quality workers, start dates often are pushed. Small subcontractor companies have lost their high end skilled labor to larger companies willing to pay more to get the big jobs done faster. General contractors that solely focus on tenant improvements can suffer to stay on schedule if they don't have the right team on hand.

All in all, commercial tenant improvement construction has been consistent the past few years. Several key contributors such as business expansion, lease rates, construction costs and skilled work force potentially impact the office and retail improvement demand.

Sally Bach is the Owner and Managing Member of G2 Contracting, LLC, a woman-owned Residential and Commercial General Contracting Company that specializes in Commercial Office and Retail Tenant Improvements. Sally became a Real Estate Broker in April 2006 at which time she was involved in multiple commercial real estate development projects. After working in the construction industry for 13 years, Ms. Bach obtained her Contractor's license in early 2008. Sally currently serves as President for CREW Tucson. She can be reached at Sally@G2Contractingllc.com.

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