

THE LEGAL TENANT

A Studley Real Estate Publication for the Legal Industry

ISSUE 3

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FALL 2005

CHAIRMAN'S LETTER

Welcome to the third issue of *The Legal Tenant*, Studley's newsletter designed exclusively to provide law firms with the tools necessary to make prudent and informed real estate decisions.

Construction is an important and growing component of the real estate process. With construction costs and timing affecting every real estate decision, it is imperative for a firm to understand all of the pieces of a construction project. In this issue, we will explore the specific costs of building out law firm space, examine strategies to mitigate construction costs through early planning and budgeting, and discuss the impact of the dramatic increases in material prices and contractors' fees over the last few years.

A law firm's biggest assets are its attorneys and staff. Their intellectual capital forms the basis of the firm's business. To support this capital, a firm requires an office environment that reflects its values and promotes the recruitment and

retention of high-caliber attorneys and staff.

Although some of the price tags associated with construction projects might be surprising, the long-term benefits and efficiencies gained through capital investments in existing or new office space can and should, if conceived and executed properly, outweigh the up-front costs. By creating an environment of which attorneys and staff are proud (and happy), a firm's office space can be an important component of the firm's future success.

I hope you find this information helpful, and as always welcome your feedback at www.thelegaltenant.com.

Sincerely yours,



Mitchell S. Steir
Chairman and C.E.O

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EDITOR'S FEATURE

For the uninitiated, what it takes to create quality, high-end, law firm office space can be downright shocking. All-in costs to create functioning, furnished law offices from a raw concrete "shell" run from \$120 to \$180 per square foot. Assuming a relatively tight occupancy ratio of 700 square feet per attorney, this translates into \$84,000 to \$126,000 per attorney. While landlords generally contribute to the cost of building out space as part of a lease transaction, the out-of-pocket expenses for law firms can still run \$65 to \$135 per square foot or \$45,500 to \$94,500 per attorney, based on the local market.

What makes construction such a costly endeavor? How can a law firm better manage the process to control its schedule and budget? In this edition of *The Legal Tenant*, we will explore the costs of building out law firm space and some of the issues driving those expenses.

Note: There are many scenarios a law firm may consider beyond building out brand-new space, such as various levels of renovation to existing spaces (either in move or renewal situations) or splitting off various operational units. For the sake of simplicity, this issue deals primarily with the concerns associated with new construction.

► Why is law firm space so expensive?

Law firms justifiably require office space that meets the needs of its attorneys and staff, while effectively projecting the firm's culture and image. For successful recruitment and retention in such a highly competitive field, providing a comfortable environment with modern systems and technology is a priority. Design details like state-of-the-art conference

facilities, reliable networks and technology, upgraded finishes, walls that extend beyond the ceiling to the slab to minimize noise, and the use of glass to allow sunlight into interior hallways and workstations all contribute to the comfort and functionality of the office space. And, all cost money.

Most of today's firms shoulder a large portion of the expense to build out office space even after the landlord's tenant improvement allowance. Though the costs may seem exorbitant, they are, for the most part, justified by the result – an affordable, effective, efficient workspace.

► What makes up the costs?

According to Studley's Project Management Group, the cost to construct new, *corporate* office space with basic furniture and sensible finishes averages about \$100 per square foot (assuming an office-intensive environment with new furniture). Building out *law firm* space with upgraded finishes and built-in workstations and filing systems results in a 20 to 80 percent premium.

What makes up the extra cost over basic office space to create a law firm-like environment? Typically, the additional expenses are items that are not essential to operations, but help raise the appearance and comfort of the law firm's offices for its personnel and clients. Some of these include:

- Individual temperature controls in each attorney's office. While basic space might include controls for every three to four offices, providing attorney's with individual office thermostats will cost an additional \$1.50 per square foot.

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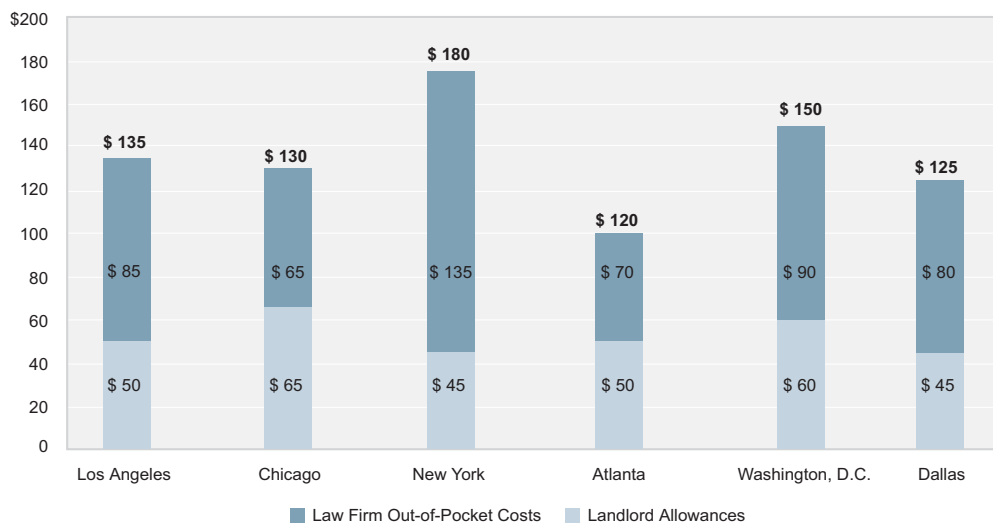
DID YOU KNOW?

As construction costs continue to rise steadily, tenant improvement allowances – the money that landlords provide tenants to build out space – have remained relatively constant. As a result, the "out-of-pocket" contributions that a law firm makes toward the cost of a build-out have increased dramatically. Although the situation varies by market, landlord and building, the shortfall has increased between 60 to 80 percent since 2000.

This chart shows the variance between the average cost of building out and furnish-

ing new office space in major U.S. metropolitan cities compared to the average tenant improvement allowance for a typical 10-year lease transaction in a Class-A downtown building. The current all-in costs for building out and furnishing law offices from raw space normally range from \$120 to \$180 per square foot. In most markets, less than half of these costs are covered by tenant improvement allowances. How to finance this disparity and what steps can be taken to mitigate these costs are important questions facing law firms today.

Average Build-Out Costs (All-In) vs. Average Landlord Allowances in Select U.S. Markets



This chart represents the average cost to build-out and furnish new law firm space for a 50,000-square-foot, 10-year lease in a Class-A downtown building.



GETTING IT DONE

Client: Thompson Hine LLP
Building: One Atlantic Center
 1201 West Peachtree Street
 Atlanta, GA

Client Situation

Thompson Hine LLP, a leading Midwest corporate law firm and one of the top 200 firms in the country, wanted to establish a presence in the highly competitive legal market of Atlanta. Thompson Hine turned to Studley, with whom the firm has a national relationship, to secure a location that conveyed the firm's image and was conveniently located for its attorneys, staff and clients.

Consideration & Analysis

Understanding Thompson Hine's requirements, Studley recommended that the firm concentrate its search on the midtown market of Atlanta. This area houses most of the major law firms in Atlanta and, by locating there, Thompson Hine's profile within the community would be established immediately. The area's exceptional amenities and Class-A

buildings have proven to be an asset in the recruiting and retention of high-quality lawyers and staff.

Despite its many positive attributes, the midtown market had abundant vacancy and offered many buildings with space that could accommodate Thompson Hine's requirement. Studley focused its efforts on identifying properties that offered the ability to grow into contiguous expansion space, and, important for a new office, spaces in which out-of-pocket expenses could be reduced significantly.

Transaction Solution

Studley uncovered a floor of a major block of space that had previously been occupied by a law firm in One Atlantic Center, generally considered to be one of

the finest buildings in the Southeast. Studley negotiated a below-market rental rate and a concession package that included a phased-in rent structure designed to match the firm's projected growth in revenues with its rental expenses during the initial two years of the term. Studley also negotiated flexible lease rights to other floors in the elevator bank to accommodate both organic and merger-related growth.

The space itself offered an exceptional opportunity for the firm. The existing space had an extensive build-out including numerous temperature-control zones, a high-density filing system, upgraded technology and the highest quality finishes. By utilizing the existing layout and technology, Thompson Hine's out-of-pocket expenses were limited to cosmetic changes to align the space with the firm's standards and culture.

In the end, the firm was able to create the space it wanted without incurring out-of-pocket construction expenses. Taking advantage of the existing space represents a projected savings of over \$1 million, or 67 percent, from the costs of

recreating similar quality space. Thompson Hine will assume occupancy of the 22nd floor of One Atlantic Center, located at 1201 West Peachtree Street, in early 2006.



One Atlantic Center



ASK STUDLEY

Can I use second-generation space to reduce my construction costs?

Second-generation space is any space left behind by another tenant. Sometimes when the stars align and the existing layout corresponds with a new tenant's needs, all or portions of a former tenant's space can be reused to the benefit of the new tenant's budget.

The benefits of second-generation space are obvious. Using existing walls, internal stairways, and, sometimes, even furniture eliminates the costs of recreating and purchasing these items. Assuming the existing furniture is suitable, moving into second-generation space can reduce construction/furniture costs by as much as 75 percent.

The caution is that, while many law firm layouts are similar, it is unusual for them to be exactly the same between any two firms. And, the larger the firm, the harder it is to find a good match. Often the reason a second-generation space is available is because the law firm that left it behind had built the space in an earlier, more generous time with larger offices, an abundance of administrative workstations, multiple reception areas, and a substantial library, thus making the space somewhat inefficient.

Bear in mind that, if there is a match between one firm and a second-generation space, it probably will not be a match for many other prospective tenants. This means that, while a landlord might try to extract value for the improvements, they will usually let them go for a big discount, since the alternative is often demolition and a larger tenant improvement package for another new tenant.



MARKET ACTIVITY - Major transactions throughout the country

MARKET	TENANT	ADDRESS	SF	TRANSACTION TYPE
Atlanta	Morris, Manning & Martin, LLP	3343 Peachtree Road	193,998	Renewal
Atlanta	Balch & Bingham LLP	30 Ivan Allen Boulevard	60,000	New
Chicago	Kirkland & Ellis LLP	300 N LaSalle Street	600,000	New
Chicago	Seyfarth Shaw LLP	131 N Dearborn Street	294,200	New
Chicago	Brinks Hofer Gilson & Lione	NBC Tower - 455 N Cityfront Plaza Drive	100,000	Renewal/Expansion
Chicago	Greenberg Traurig, LLP	77 W Wacker Drive	80,000	Renewal/Expansion
Chicago	Johnson & Bell, Ltd.	33 W Monroe Street	74,095	New
Cincinnati	Keating Muething & Klekamp PLL	1 E 4th Street	101,611	Renewal
Cleveland	Taft Stettinius & Hollister, LLP	127 Public Square	45,000	Restructure
Columbus	Porter Wright Morris & Arthur, LLP	41 S High Street	130,500	Restructure
Dallas	McKool Smith, PC	100-400 Crescent Court	71,503	Renewal
Dallas	Cooper & Scully, PC	900 Jackson Street	63,223	Renewal
Denver	Harris, Karstaedt, Jamison & Powers, PC	188 Inverness Drive W	30,860	New
Houston	Connelly, Baker, Maston, Wotring & Jackson LLP	700 Louisiana Street	29,474	New
Kansas City	Lathrop & Gage LC	2345 Grand Boulevard	183,000	Renewal/Expansion
Los Angeles	Greenberg Traurig, LLP	1601 Cloverfield Boulevard	100,000	Expansion
Los Angeles	Sonnenschein Nath & Rosenthal	601 S Figueroa Street	82,000	Renewal
Los Angeles	Van Etten Suzumoto & Becket LLP	1800 Century Park East	50,276	Relocation/Expansion
Los Angeles	Wilson, Elser, Moskowitz, Edelman & Dicker LLP	555 S Flower Street	41,694	New
Miami	Akerman Senterfitt	1 SE 3rd Avenue	116,000	Renewal
Miami	Steel Hector & Davis LLP (part of Squire Sanders & Dempsey LLP)	200 S Biscayne Tower	90,000	Renewal
New York	Fried, Frank, Harris, Shriver & Jacobson LLP	1 New York Plaza	378,960	Renewal
New York	Mayer, Brown, Rowe & Maw LLP	1675 Broadway	242,000	Renewal/Expansion
New York	DLA Piper Rudnick Gray Cary US LLP	1251 Avenue of the Americas	206,000	Renewal/Expansion
New York	Linklaters	1345 Avenue of the Americas	158,000	Expansion
New York	McDermott, Will & Emery	340 Madison Avenue	156,435	New
New York	Fulbright & Jaworski LLP	666 Fifth Avenue	138,000	Renewal
New York	Milberg Weiss Bershad & Schulman LLP	1 Penn Plaza	116,619	Renewal
New York	Arnold & Porter LLP	399 Park Avenue	105,000	Renewal
Newark, NJ	McCarter & English, LLP	Riverfront Center	230,000	New
Newark, NJ	McElroy, Deutsch, Mulvaney & Carpenter, LLP	3 Gateway Center	40,828	New
Orange County	Gibson Dunn & Crutcher LLP	3161 Michelson	83,738	Relocation
Orange County	Snell & Wilmer LLP	600 Anton Boulevard	55,000	New
Philadelphia	Blank Rome LLP	One Logan Square	220,000	Renewal
Philadelphia	Pelino & Lentz, PC	One Liberty Place	32,770	Renewal
San Francisco	Heller Erhman LLP	333 Bush Street	250,000	Renewal/Expansion
San Francisco	Sonnenschein Nath & Rosenthal	525 Market Street	60,000	Relocation
San Francisco	Kirkland & Ellis LLP	555 California Street	50,000	Expansion
Silicon Valley	Simpson Thatcher & Bartlett LLP	2550 Hanover Street	50,000	Expansion
Silicon Valley	Dechert LLP	1117 California Avenue	43,630	Sublease
Silicon Valley	Finnegan, Henderson, Farabow, Garrett & Dunner, LLP	3300 Hillview Avenue	43,000	New
Washington, D.C.	DLA Piper Rudnick Gray Cary US LLP	505 9th Street NW	248,324	Relocation
Washington, D.C.	LeBouef, Lamb, Greene & MacRae LLP	1101 New York Avenue	113,000	Relocation
Washington, D.C.	Reed Smith LLP	1301 K Street NW	80,000	Renewal

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► The Budget

• Internal glass panels that bring in light from the exterior offices to the hallways cost an average of \$350 for each two-foot by eight-foot panel.

• For firms occupying more than one floor of a building, internal stairs help the flow of traffic and communication. This feature can range from \$80,000 per floor for a basic staircase to \$250,000 per floor for a more artistic effort.

• A twenty-person conference-room table can cost as little as \$7,500 for a laminate-covered table and up to \$25,000 for a more decorative, sophisticated marble table with accommodations for network connectivity and audio visuals.

• Artwork, necessary to finish even the most basic space, is an expense that varies infinitely, based on the tastes and preferences of the firm.

In Figure 1, we have developed a sample law firm build-out budget that shows the different cost components of a new build-out and how a firm can realistically spend \$150 per square foot for its space (with the opportunity to spend even more).

Once a law firm understands the cost implications of building out new space, it is important to take steps to manage the process intelligently and strategically in order to most effectively spend money.

The first step is to create a budget. As everyone knows, budgets are essentially educated "guesses" driven by qualified assumptions. Prudent budgeting incorporates contingencies and cost-escalation factors that can vary drastically depending on the project's complexity, schedule and the estimated date that the contractor will lock in prices. The typical build-out budget allocation for a new construction project in any major market is illustrated in Figure 2.

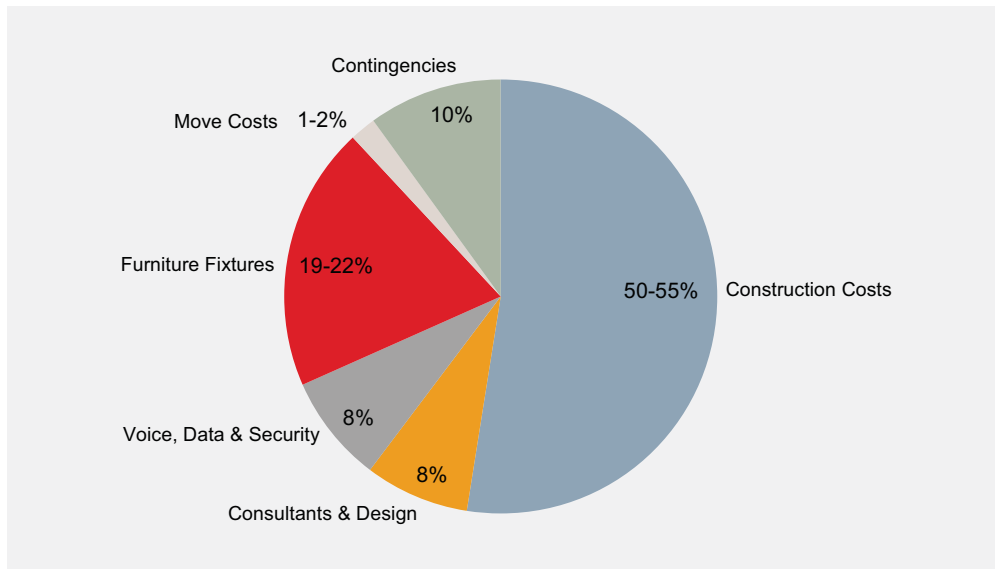
In a typical build-out, 10 percent of a construction budget is spent on soft costs – design fees, engineering fees, permits, project management and move-related items. Nationally, for the past five years, these costs have only increased 15 to 20 percent (see Figure 3). Fierce competition among service providers continues to keep price increases at a minimum.

Figure 1: Sample Budget for Law Firm Space at \$150/sf *

Project Square Footage: 50,000	\$/SF	Percentage of Total Budget
CONSULTING & DESIGN FEES	\$10.05	6.7%
Architectural Design Contract	6.50	4.3%
Electrical Engineering	1.00	0.7%
Mechanical Engineering	0.75	0.5%
Structural Testing/Engineering	0.25	0.2%
Permit Application Fees	0.25	0.2%
Telecommunication Consultant	0.75	0.5%
Plan Revisions-Architect	0.20	0.1%
Plan Revisions-Engineering	0.10	0.1%
Lighting Consultant	0.25	0.2%
OTHER CONSULTING FEES	\$2.85	1.9%
Project Management	2.25	1.5%
Move Consultant	0.35	0.2%
AV Consultant	0.25	0.2%
CONSTRUCTION	\$77.37	51.4%
Tenant Improvement Alterations		
Demolition and Clean Up	1.50	1.0%
Connecting Stair	2.57	1.7%
Millwork	18.00	12.0%
Doors	5.00	3.3%
Glass and Glazing	3.50	2.3%
Drywall	9.00	6.0%
Tile and Stone	1.50	1.0%
Acoustic Ceiling	3.25	2.2%
Carpet/Flooring	4.25	2.8%
Paint and Wallcovering	3.00	2.0%
Fire Sprinkler	1.75	1.2%
Plumbing	1.00	0.7%
HVAC	3.50	2.3%
Electrical	8.00	5.3%
Rekeying	0.25	0.2%
Signage	1.00	0.7%
Contractor OH, Insurance and Fee	8.05	5.4%
Design Contingency (3%)	2.25	1.5%
VOICE/DATA INFRASTRUCTURE	\$10.75	7.1%
Telephone System	3.00	2.0%
Voice and Data Cabling	3.25	2.2%
Network Migration	1.00	0.7%
UPS	1.50	1.0%
Miscellaneous Telecom Equipment and Racks	2.00	1.3%
FURNITURE, FITTINGS AND EQUIPMENT	\$33.71	22.4%
Furniture Casegoods and Workstations	30.00	19.9%
Central Library Shelving	0.51	0.3%
Workroom Files	0.30	0.2%
Miscellaneous Casegoods and Furniture	0.70	0.5%
High Density Files-Central Files	2.20	1.5%
RELOCATION & MOVE COSTS	\$2.00	1.3%
Movers-People and Contents	1.00	0.7%
De-install and Re-install Computers and Equipment	0.50	0.3%
Antique and Art Relocation Insurance	0.50	0.3%
TOTAL W/O CONTINGENCY	\$136.73	90.9%
Contingency Amount	13.67	9.1%
TOTAL WITH CONTINGENCY	\$150.40	100.0%

* Sample budget is for illustration purposes only. Actual costs will vary by market and a firm's specific needs. Please consult your own advisor for information on your market.

Figure 2: Typical Build-Out Budget Allocation



Another 30 percent of the overall construction budget for a standard law firm project is spent on furniture, fixtures and telecommunications equipment. Law firms have some ability to control these costs more closely as the desired finishes and equipment can be selected to fit within the budget.

The largest percentage of the overall budget is devoted to "hard costs" – the actual construction expenses that include materials and the general contractor's overhead and fee. At approximately 60 percent of the total budget and increasing 20 to 25 percent over the last two years, these costs are driving the overall rise in out-of-pocket expenses for law firms in relocation or renovation projects.

Budgeting early and verifying pricing regularly throughout the process can help control costs and keep a project within its budget. Prices can increase dramatically between the time of the contractor's initial estimate and the start of a project, sometimes beyond the anticipated escalation factors. By tracking the price of materials often, a law firm is in a better position to

adjust the budget to reflect the additional costs or to modify the design specifications to mitigate the cost increase.

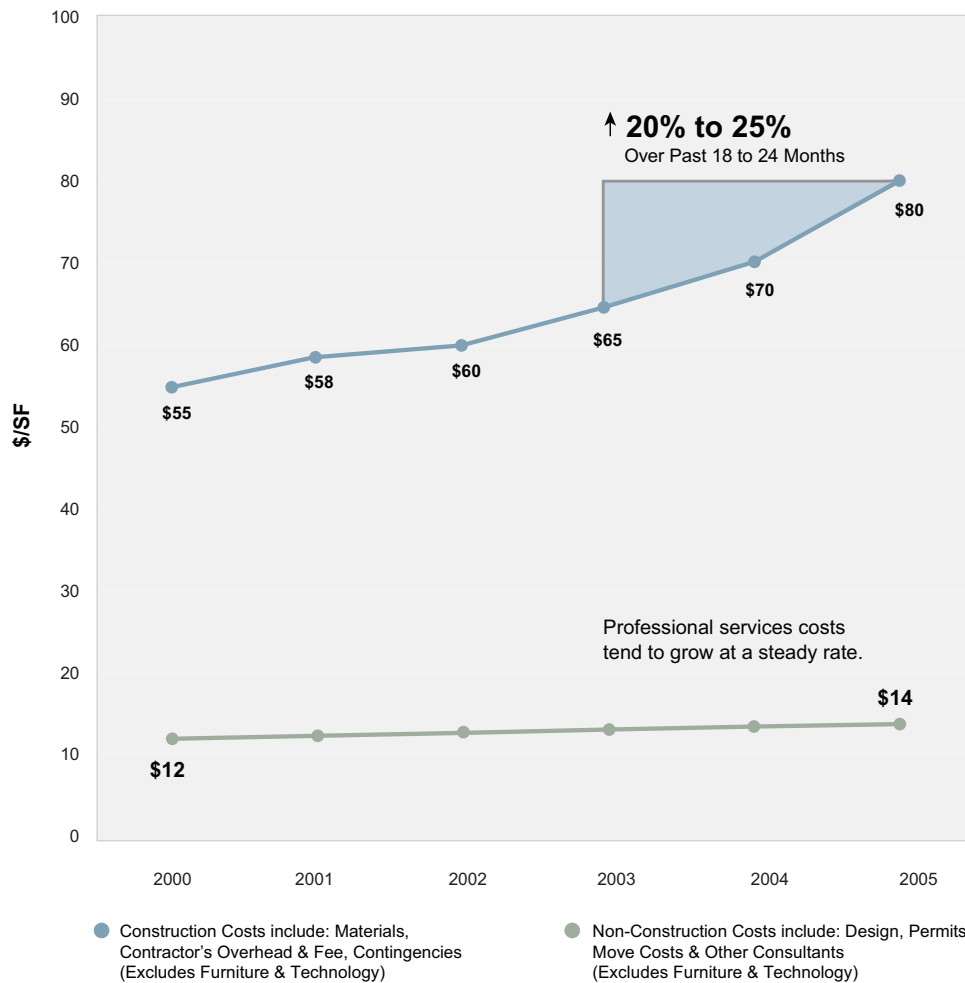
► Why are construction costs rising?

More than ever, the economics of supply and demand are affecting the construction industry and significantly impacting tenants' wallets. Over the past 12 to 18 months, Studley's Project Management Group has witnessed an 18 to 20 percent increase in project costs for new buildings and a 12 to 15 percent increase for the all-in cost of tenant improvement projects.

These increases have come from several factors – a domestic shortage of materials such as steel, drywall and concrete that are being used for construction projects in China and Iraq; the higher cost of manufacturing and transporting materials due to rising fuel prices; and a shortage of contractors and subcontractors fueled by the robust commercial and residential real estate sectors. Recent natural disasters are also affecting costs within the construction industry although full ramifications are still evolving.

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Figure 3: Average Construction Costs vs Average Non-Construction Costs



● Construction Costs include: Materials, Contractor's Overhead & Fee, Contingencies (Excludes Furniture & Technology)
 ● Non-Construction Costs include: Design, Permits, Move Costs & Other Consultants (Excludes Furniture & Technology)



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► Timeline for Build-Out

The time needed for planning, designing and constructing law firm space is another key element in the creation of new offices.

As shown below, the process of planning and building out a 50,000-square-foot space in a major metropolitan area should safely begin 40 to 42 weeks prior to the desired move date. Larger spaces can take even longer.

Starting late or running into delays is, to a point, not critical, but can be costly. Ways to catch up include:

- Working overtime which requires, of

course, paying overtime rates;

- Starting the design and construction before the lease is signed, which poses the risk of losing the money already invested if the deal falls through; and

- Splitting permits for separate floors and staggering occupancy.

One of the greatest variables in any project is the time required to obtain a building permit. In some municipalities, the vagaries of the permit process can add six to eight weeks to the traditional construction timeline. The amount of time spent to formally bid out a project to contractors and subcontractors must also be incorporated into the overall timeline. This entire process can add approximately four to six weeks; however with

today's surplus of construction work for contractors, it has become increasingly more difficult to engage them in this process.

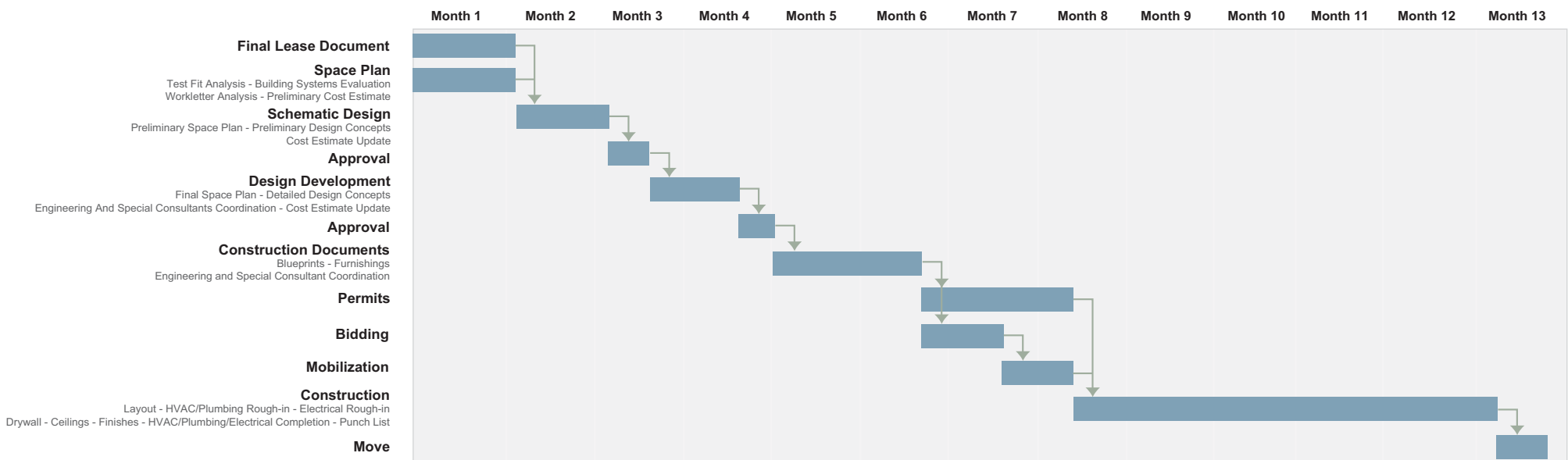
With the amount of time and energy needed to complete a formal bid, contractors sometimes choose to forego participating in the entire process in order to focus on existing opportunities. Therefore, to complete a renovation or build-out in today's construction environment, it is important for a firm or its real estate advisor to have strong relationships with local general contractors.

There are several ways to mitigate time constraints in a construction project, but, at the end of the day, the most effective method to meet production schedules is to give ample time for unforeseen issues

and to start the process early.

While the up-front costs of building out law firm space are high, the long-term impact can be even higher. How a space functions and feels to attorneys, staff and clients affects workflow, image, and, in the end, profitability. And with long-term leases, these effects will be felt for years, possibly decades. Design and construction decisions should be taken seriously since one of the realities of a construction project is its relative permanence and the expense of making changes. By collecting input from a broad base of "stakeholders" within the firm and pulling together the best team of advisors, you can ensure your decisions are efficient, cost-effective and well-informed.

Figure 4: Sample Timeline to Build Out 50,000 SF Law Firm



NEXT ISSUE

One of the initial challenges of the real estate decision process is understanding how to choose the right team of advisors for your firm.

As with any professional services firm (including law firms), many factors involved in the team selection process are intangibles including reputation, personality and pre-existing relationships. Others are easier to ascertain - experience, work product and references. Given the importance of real estate as the second largest expense after personnel, it is important to make intelligent and informed decisions when choosing advisors.

process? The number of consultants needed will surprise you.

A partial list includes:

- Architect
• Electrical Engineer
• Furniture Vendor
• General Contractor
• Legal Counsel
• Lighting Consultant
• Mechanical Engineer
• Move Consultant
• Plumbing Engineer
• Project Manager
• Property Manager
• Security Consultant
• Structural Engineer
• Telecommunications/Data Consultant

The next issue of The Legal Tenant will help you navigate the large pool of advisors and explain the role and responsibility of each member of your real estate team.

In the next issue of The Legal Tenant, we will begin at square one - assembling your real estate team. After you've hired a real estate advisor, who else is necessary to ensure a smooth and effective real estate

2005 AMLAW TOP 100 REPRESENTED BY STUDLEY. Table listing 100 law firms and their ranking, with a legend indicating current/past Studley clients.

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Studley is the leading commercial real estate services firm specializing in tenant representation. Founded in 1954, Studley pioneered the "conflict-free" business model of representing only tenants in their commercial real estate transactions.

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- Thomas M. Fulcher, Jr.
Kelly Givens
Andrew Lechter
Project Management Group

