

Law Firm Management

WWW.NYLJ.COM

MONDAY, OCTOBER 17, 2011

“Right-size” Real Estate

A strategic approach to managing office space.



BY LAWRENCE T. GRESSER
AND LAWRENCE J. LEE

LAW FIRMS generally have many variable expenses and one significant fixed expense: office space. It is extraordinarily difficult to predict a firm's likely growth over the term of a typical law firm lease, but the consequences of guessing wrong can be disastrous: Excess (and excessively expensive) real estate contributed to the implosion of a number of major firms, including Brobeck, Heller Ehrman and Howrey. On the other hand, having too little office space, or the wrong kind of space, can lead to lost productivity, poor morale, and significantly reduced profits.

Cautionary Tales

Recent cautionary tales amply demonstrate that it is critical to get law firm office space decisions right.

Consider Brobeck, Heller Ehrman and Howrey. Brobeck's demise had many causes, but real estate played a prominent role. The trustee of Brobeck's bankruptcy estate noted that within just three years (from 1999 to 2002), Brobeck's total real estate occupancy costs went from being on par with other law firms in the relevant markets (approximately \$30 per square foot per year) to exceeding them by two-and-a-half times (about \$39 per square foot per year).¹ From 1999 to 2002, Brobeck nearly doubled its total square footage, opened new offices, expanded its New York and San Diego offices, and even moved to a glittering new flagship office in East Palo Alto in 2002, just as revenues started to drop. In 2002, Brobeck paid \$49 million for 1,253,000 square feet of real estate, although revenues had dropped by half from its boom years.² In the end, landlords may have put the final nail in Brobeck's coffin, seeking \$50 million and involuntary Chapter 7 bankruptcy for the firm.³

Heller Ehrman was purportedly “in good financial standing” before 2008, yet real estate was mentioned prominently in articles about the firm as it fell into bankruptcy.⁴ Heller expanded its lease at its San Francisco headquarters “to take a total 250,000 square feet for 13.5 years,” making it that city's “largest law firm deal in history,” and signed a new 138,000-square-foot lease at Times Square Tower, which Heller's chairman cited as “yet another example of our firm's remarkable growth over the past five years [and] a strategic business decision that will allow us to expand our capabilities and resources....”⁵

Howrey, like Brobeck, appears to have planned only for expansion, not contraction. In the view of one columnist, “Howrey expanded too much too fast, its overhead expenses [grew] even faster than its revenue. There were offices in London, Paris, Madrid and Southern California that were never profitable....”⁶

If the Brobeck/Heller/Howrey model of managing a firm's real estate is flawed, what is the alternative? Set out below are three suggestions. First, law firms seeking new space should focus on space that has a footprint—the size and arrangement of square footage per floor—that fits the firm's business model. Second, a law firm must have the most favorable, flexible lease terms it can get from its landlord so that—ideally—the firm's lease is an asset, not a liability, in the event of a downturn. Finally, a law firm must align its space with its culture and business practices. It is by managing these three broad issues correctly that a law firm can both prosper and assure its long-term survival.

The Firm's “Footprint” Is Critical

It is difficult to overstate the importance of consciously selecting an appropriate office footprint, i.e., the shape, configuration and *quality* of floor space available to a law firm, not just the quantity. The footprint matters because there are some fundamental truths about lawyers and their offices that are unlikely to change anytime soon:

Most attorneys need their own offices. Although it is certainly true that some legal work is done in

teams, lawyers generally work alone and need privacy for tasks requiring focused concentration. It may be old fashioned to say so, but attorneys sometimes have to shut their doors and work, which means that, except perhaps for very junior lawyers (who can benefit from sharing ideas with an officemate), they need their own offices.

All attorneys want offices with windows. Despite their need for solitude, most lawyers prefer to stare at the skyline instead of Formica. Some firms have reportedly begun to use internal offices for junior attorneys, but the manner in which they are doing so—using glass to bring light into the interior space—seems to prove the rule that, where possible, external offices with windows are better for morale and productivity than internal offices.⁷

The proportion of exterior offices to square footage declines as the footprint increases on a given floor. Take two floors, one that measures 100' by 200' and one that measures 200' by 200'. The smaller floor has a surface area of 20,000 square feet and a perimeter of 600'; the larger floor has an area of 40,000 square feet and a perimeter of 800'. The firm leasing the larger floor will pay 100 percent more than the firm leasing the smaller floor—because, of course, office rent is based on square footage—but (assuming offices of equal size) will only get 33 percent more external offices.⁸

All else being equal, leasing several smaller floors will generally yield more external offices—which can be filled with revenue-producing lawyers—than leasing one large floor. Of course, all else is rarely equal: Smaller floors do not work well for every firm. Perhaps the only general rule is that firms with fewer non-legal employees (administrators, paralegals and the like) may be better off leasing smaller floors, which will have a higher ratio of (external) attorney offices to (internal) staff offices, while a larger footprint may be optimal for firms requiring a higher ratio of non-lawyers to lawyers and more interior space. Note that thanks to technological advances and resulting changes in attorney work habits, more and more firms may fall in the first category.

LAWRENCE T. GRESSER is the managing partner of Cohen & Gresser. LAWRENCE J. LEE is an associate at the firm.

Getting the Lease Right

It may not be possible to predict the future growth (or contraction) of a law firm over the 10- or 20-year term of an average lease, and it is clearly a bad idea for a firm to bet more than necessary on its powers of prediction. Securing a good office lease is therefore the single most important aspect of real estate management for a law firm.

The following list of lease points is far from exhaustive, and it is essential for a law firm to retain smart, experienced tenant-side real estate brokers and real estate attorneys and to work closely with them throughout the office selection and leasing process. But once a firm has its team in place, the following points may help:

Below market rent. This sounds obvious, even silly—Who wants to pay more rent? But the most important reason for a firm to try as hard as possible (and then try some more) to find office space that is below the average market rent is *not* that this will keep more money in the firm's pockets. It is because below-market rent can effectively transform a lease from a liability to an asset, and it is the best protection if a firm runs into difficulties and needs to shed office space. If the firm's rent is below-market and its lease is flexible with respect to assignment and subleasing, the firm may be able to sublet a portion of its space to another firm and actually turn a profit. Even if the lease does not permit subletting, below-market rent protects a firm in a downturn because the landlord will be much more likely to accept the surrender of all or part of the space, knowing that he can lease the space to another tenant at a higher rent.

Of course, below-market rent is by far the most difficult lease term to negotiate with a prospective landlord. Some things that may help are:

- starting the process of finding space early, so that the firm has substantial time to negotiate before the end of its current lease;
- being as open minded as possible about location;
- looking for buildings with large blocks of space that will be coming on the market around the time that the firm plans to move, so that the landlord will be motivated to offer the best deal possible; and
- narrowing the search at the end to two or three buildings owned by different landlords, in the hope that the prospective landlords will compete for the firm's business.

Term of lease/renewal option. Companies outside of the legal field revisit the adequacy of their office space frequently: 60 percent of companies reconsider their office space every five years, while 30 percent reconsider it every year.⁹ The 10-year leases that many law firms employ are less than optimal. The ideal, according to one source, is to have a lease with a shorter term and multiple options to renew the lease at fixed rates.¹⁰ Such an arrangement is also, of course, the most difficult to secure, but any optionality that a firm can obtain from its landlord will go a long way toward helping the firm navigate the uncertain future. It can also help make it easier for smaller firms to recruit new partners and associates toward the end of a lease term, when many firms face important decisions about continuing to practice together.

Flexible subletting/assignment clauses. Many real estate leases have clauses that permit a tenant to sublet a portion of the leased space, usually with restrictions. Such a clause permits a law firm to lease more space than its current needs dictate while allowing subtenants to pay for the space until the firm actually needs it. It is critical to negotiate for the fewest possible restrictions.

The **Project Manager** is the point person who will oversee the **day-to-day activities** of the matter and ensure client satisfaction, as well as economic performance, over the **lifetime of the project**.

"Good guy" clause. This lease provision can be difficult to get, but it is an important tool to help law firm partners avoid personal liability if the firm is forced to downsize. A "good guy" clause generally provides that if a tenant wishes to leave before the end of the lease, the tenant will give notice to the landlord, vacate the space and leave it in good condition, and pay all rent due as of the date on which the tenant vacates, then any personal guarantors—typically, one or more partners of the firm—will have no further personal liability on the lease.

Harmonizing Design and Culture

Once a firm has secured a good, flexible lease and the appropriate footprint, it is important to design the space in a way that is consistent with the culture of the firm. Below are some factors to consider.

Individual attorney office sizes and hierarchy. Recent articles on law firm office design have focused on trends toward efficient, and sometimes egalitarian, use of existing space.¹¹ Such trends have included reducing the size of partner offices or even moving to "one size fits all" offices for all attorneys.¹² These trends have to be weighed carefully in light of the positive correlation between workspace and job performance,¹³ and the right balance will depend on individual firm culture.

Collaborative space. Some firms have opted for creative uses of collaborative or communal space (e.g., a basketball hoop and climbing wall in common areas) as a "coordinated office design that is intended to promote teamwork among the firm's attorneys and support staff."¹⁴ Again, whether this use of space makes sense will depend on the firm's culture—and the culture that it wishes to promote.

Listening to the clients. Most firms have at least one particularly opulent or impressive area intended to "wow" clients. But lawyers rarely consult their clients in designing their law offices. It is worth the effort. One firm asked a dozen clients what they thought of the firm's office space. The answer was not encouraging. Most found the firm's space "deeply uncomfortable," making them feel that they'd "been sent to the Principal's office," or were visiting "[a] wealthy old woman who was trying to make her

unwanted guests leave as quickly as possible."¹⁵

Conclusion

One study suggested that "[v]isionary legal partners anticipating growth in their firms are planning as much as 15 years ahead."¹⁶ Fifteen years may feel like an eternity for a law firm, but it behooves law firm managers to think long-term about their lease terms, office configuration, and culture so as to ensure that their firm is fully protected in the event of a downturn, ready to respond quickly if things go well, and full of attorneys, staff members and clients who feel "deeply comfortable" in the space.



1. *In re Brobeck, Phleger & Harrison, LLP*, Case No. 03-32715-DM7, Notice of Motion and Motion for Order Approving Settlement Agreements of the Debtor, at 5 (N.D. Cal. Feb. 18, 2005).

2. *Id.* at 6.

3. Brenda Sandburg, "Landlords Force Bankruptcy on Remnants of Brobeck," *The Recorder* (Sept. 18, 2003), at <http://www.law.com/jsp/ca/PubArticleCA.jsp?id=900005393888>.

4. Niraj Chokshi & Zusha Elinson, "Heller Ponders Dissolution," *The Recorder* (Sept. 18, 2008), <http://www.law.com/jsp/article.jsp?id=1202424608550> ("The firm would also face decisions about what to do with the leases it holds for its 14 offices"); see also Amanda Bronstad, "Heller Ehrman's fate echoes Brobeck's collapse," *Nat'l L.J.* (Sept. 29, 2008) ("In terms of real estate Heller has sizable offices in San Francisco, Seattle, New York, Washington and Menlo Park, Calif., in Silicon Valley").

5. See, e.g., Jennie Bell, "Heller Ehrman Inks Record Lease in San Fran," *AllBusiness.com* (March 16, 2005); "Law firm signs 138,000 s/f Times Square Lease," *Real Estate Weekly* (July 7, 2004).

6. Steven Pearlstein, "Why Howrey law firm could not hold it together," *Wash. Post* (March 19, 2011).

7. See Barbara Rose, "changingspaces: Law firms (slowly) respond to egalitarian trends in office design," *ABA Journal* (June 1, 2010), at http://www.abajournal.com/magazine/article/changing_spaces ("[S]ome associates' offices were moved to the interior into space that traditionally houses files and support professionals. Glass was used throughout to bring light and views into every space").

8. This principle holds for most spaces that are suitable for law firm offices, but a very narrow, long space—say 40' by 1000'—would have much more than twice the perimeter of the hypothetical small office described above.

9. Becky Bergman, "Efficiency, Flexibility key in office space design," *San Jose Business Journal* (June 30, 2005), at <http://www.bizjournals.com/sanjose/stories/2005/07/04/focus1.html> ("According to an American Society of Interior Designers study, more than 60 percent of business decision makers said they re-evaluate office design every five years while roughly 30 percent re-evaluate office space once a year").

10. Dun & Bradstreet Credibility Corp., "The Length of the Term in an Office Lease," <http://smallbusiness.dnb.com/operations/facilities-real-estate-office-leasing/596-1.html>.

11. See, e.g., *supra* note 7.

12. *Id.*

13. Sara O. Marberry, "Calculating the Value of Design," *ABA Journal* (June 1992).

14. See *supra* note 7.

15. "Law office design: it's part of the marketing, yes...but don't ask which part," Tinker X, at http://www.tinkerx.com/writing/legal_marketing_toc/office-design/.

16. See *supra* note 7.

Reprinted with permission from the October 17, 2011 edition of the NEW YORK LAW JOURNAL © 2011 ALM Media Properties, LLC. All rights reserved. Further duplication without permission is prohibited. For information, contact 877-257-3382 or reprints@alm.com. # 070-10-11-29

COHEN & GRESSER LLP

800 Third Avenue
New York, NY 10022
Ph 212 957 7600
Fax 212 957 4514
www.cohengresser.com