

Real Estate Strategies

Tenants Seize Opportunities As Market Bottoms

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IMAGINE ALL OF THE OFFICE TENANTS IN A CITY THE SIZE OF PITTSBURGH VACATING THEIR SPACE AT ONCE! THIS EQUALS THE RISE IN VACANCIES EXPERIENCED BY THE US COMMERCIAL OFFICE MARKET DURING THE RECENT ECONOMIC RECESSION.

At year's end, office vacancies were still rising in Dallas/Fort Worth (the highest in the country at 21.3%), Atlanta, Boston, Cincinnati, Columbus, Denver, Detroit, Pittsburgh and Sacramento. Except for the occasional blip, absorption of office space has been negative since the first quarter of 2001. The cumulative net absorption for the US market from first quarter 2001 through third quarter 2003 was a negative 99.6 million square feet.

However, the third quarter of 2003 actually reversed the two-year trend of growing office vacancy in the US market with a positive net absorption of 12.64 million square feet—a huge blip in the long-term trend—Costar reports.

While office rents dropped more than 6% in 2003, they are expected to rise slightly in 2004, and over 4% in 2005, according to the National Association of Realtors' projections. Some economists predict the addition of two million jobs this year meaning rent concessions by landlords may soon be off the table.

With occupancy rising in many US markets—Austin, Charlotte, Chicago, Cleveland, Kansas City, Long Island,

Los Angeles, New York City, Northern New Jersey, Phoenix, Portland, San Diego, Seattle, South Florida, St. Louis, Tampa/St. Petersburg and Washington—a modest economic turnaround seems imminent.

With recovery inevitable, and fewer office buildings shedding tenants, the opportunity for tenants to negotiate their best deal for long-term commitments is shrinking. Tenants should take advantage of negotiating opportunities while they can.

It's Still A Tenant's Market

ITRA Realty Group tenant representatives are helping many corporate tenants lower their basic overhead and/or move to better quality buildings/locations.

In Atlanta, my firm, ITRA /Corporate Real Estate Advisors, helped one company that was paying over \$23 per rentable square foot (SF) negotiate a renewal lease in the same space for a sizable rent reduction, to \$16.75 SF with six months free rent, turnkey improvements and a cancellation option. We negotiated an immediate \$4 SF rent reduction for another firm with six months remaining



on their lease from \$23 to \$19 SF, plus six months free rent, a 2% escalation, 2004 expense-stop and a \$10 SF improvement allowance.

Tom Mastrogiovanni, CPM, of ITRA / Masthead Realty Advisors, LLC in Dallas represented a client paying \$22.50 SF plus expenses with 18 months left on their lease. A five-year lease was negotiated for \$18.00 SF with expenses capped at 5%, three months free rent, and turnkey improvements.

Thomas McKenzie, SIOR, of ITRA /McKenzie Realty Company in Houston, TX reports that landlords in that city are willing to “early renew” tenants at rates 20% less than they are currently paying with free rent concessions.

Joseph Cherry, CCIM, of ITRA /Cherry & Associates in Charlotte, NC, negotiated 12 months free rent on a six-year lease with \$23 SF rehab allowance, and fixed expansion and renewal rate options. Mylinda Vick, CCIM, of ITRA /Cherry Associates, Nashville, TN, reports that Class A space rental rates fell an average of \$2.50 SF in her market, and free rent is expected. Moving allowances are also offered for larger tenants.

Ross Selinger of ITRA /Selinger Enterprises reports that rents in Long Island have been dropping by 5% to 20% below the asking price. He negotiated a lease allowing the tenant to pay rent on 80% of the space for two years and then kick up to the full space rate.

“We see a combination of landlord work plus free rent in all of our transactions,” states Al Duryea of ITRA /New York Realty Group in Manhattan. “Some costs—such as

cleaning and AC maintenance— are being shifted to the tenant...the concept of full service may be fading.”

Move Up, Pay Less

In Denver, Will Gary and Norm DeHart of ITRA / MacLaurin Stewart represented an architectural firm with 13,162 SF of space. Their current landlord offered a \$23 SF deal with \$5 SF improvement allowance. They located a superior building and negotiated upgraded space at \$20.43 SF and \$40 SF in improvements. The new landlord also paid a \$75,000 cancellation fee at the old building while allowing the TI Allowance to be spent on furniture and computer cabling.

In San Francisco, which was hard hit when techs tanked in 2000, Mark Rosen of ITRA /Rosen Realty Group reports that landlords are offering more generous tenant improvement concessions while giving tenants greater latitude in using their improvement dollars. “We’re negotiating up to six months free rent, cancellation and expansion options and even renewal options at a discount off future market rates. Landlords are even offering a month’s free rent on short leases – one-to-three years. Many owners actually encourage such short-term leases because they believe they’ll be able to get higher rents within the next three years.

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