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Vacancy rates leveling off, but still a tenant's market

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Commercial real estate sectors, hurt by weak job growth, are offering incentives in many areas that are conducive to business expansion, according to the National Association of Realtors.

Lawrence Yun, NAR chief economist, said fallout from the recession continues to impact commercial real estate. "Vacancy rates are beginning to level off in some sectors, but rent discounts and moderate levels of landlord concessions are widespread," he said. "This is very much a tenant's market, which is quite favorable for businesses that are considering expansion. It's also encouraging that there is a modest improvement in the sentiment of commercial real estate practitioners."

The Society of Industrial and Office Realtors, in its SIOR Commercial Real Estate Index, an attitudinal survey of more than 600 local market experts, shows vacancy rates are beginning to level, but rents remain depressed, and subleasing space is high.

The SIOR index, measuring 10 variables, rose 2.8 percentage points to 41 in the second quarter, but remains well below a level of 100 that represents a balanced marketplace. This is the third consecutive quarterly improvement after nearly three years of decline; the last time the commercial market was in equilibrium at the 100 level was in the third quarter of 2007.

Fifty-seven percent of respondents expect improvements in the office and industrial sectors in the third quarter.

Commercial real estate development remains stagnant in all regions with low investment activity; 88% of respondents said it is virtually nonexistent in their markets, but development acquisitions are beginning to grow in many areas in what is described as a buyer's market.

Looking at the overall market, vacancy rates will shift modestly in the coming year according to NAR's latest COMMERCIAL REAL ESTATE OUTLOOK. The NAR forecast for four major commercial sectors analyzes quarterly data in the office, industrial, retail and multifamily markets. Historic data were provided by CBRE Econometric Advisors

Office Markets

Vacancy rates in the office sector, with high levels of available sublease space, are expected to increase from 16.7% in the second quarter of this year to 17% in the second quarter of 2011, and then ease later next year.

The markets with the lowest office vacancy rates in the second quarter were New York City, Honolulu and Long Island, N.Y., with vacancies around the 9% to 11% range.

Annual office rent should fall 2.7% this year and decline another 2.1% in 2011. In 57 markets tracked, net absorption of office space, which includes the leasing of new space coming on the market as well as space in existing properties, is projected to be a negative 13.6 million s/f this year and then a positive 22.6 million in 2011.

Industrial Markets

Industrial vacancy rates are likely to decline from 14.% in the second quarter of 2010 to 13.7% in the second quarter of 2011, and then continue to ease modestly as the year progresses.

The areas with the lowest industrial vacancy rates in the second quarter were Los Angeles, San Francisco and Kansas City, with vacancies ranging between 8% and 11%.

Annual industrial rent is estimated to drop 5.4% this year, and to decline another 4.7% in 2011. Net absorption of industrial space in 58 markets tracked is seen at a negative 31.7 million s/f this year and a positive 157.2 million in 2011.

Retail Markets

Retail vacancy rates should hold steady at 13.1% in both the second quarter of this year and in the second quarter of 2011, with a level pattern for most of next year.

Markets with the lowest retail vacancy rates in the second quarter include San Francisco, Honolulu and Miami, with vacancies of 7% to 8%.

Average retail rent is expected to decline 2.6% in 2010 and then flatten out, slipping 0.1% next year. Net absorption of retail space in 53 tracked markets is forecast to be a negative 2.3 million s/f this year and then a positive 6.4 million in 2011.

Multifamily Markets

The apartment rental market - multifamily housing - is benefiting from modestly higher demand. Multifamily vacancy rates are likely to decline from 6% in the second quarter of this year to 5.6% in the second quarter of 2011.

Areas with the lowest multifamily vacancy rates in the second quarter include San Jose, Calif.; Pittsburgh; and Philadelphia, with vacancies of less than 4%.

With additions from new construction, average rent should slip 0.6% in 2010, and then hold even in 2011. Multifamily net absorption is expected to be 105,200 units in 59 tracked metro areas this year, and another 138,000 in 2011.

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