

It is a tenant's market: More space of all types (industrial, retail, office) than there are active tenants

October 01, 2009 - Northern New England

We were very busy in August and early September completing three subleases, a large office lease and a very large industrial lease. But somehow we suspect that it may be analogous to the Cash for Clunkers program. How's that? The incentives for trading in auto clunkers with stipulations that the new vehicle purchased had to be measurably more gas efficient than the clunker, was a great success (\$2b more successful than they thought). But what did it achieve? Yes, 3-4 million vehicles were purchased in the past three months. So the auto dealers had a great couple of months but now expect a definite slow down now that the cash incentives are gone. Many of these sales were simply accelerated but a year from now the numbers will settle out and not a substantial number of new cars will have been sold that would not have been sold eventually anyway. It is the same for us. A busy August may translate into a quiet fall.

Thus, our spurt of brokerage activity feels similar. A half dozen deals came together over six weeks, but that does not mean there will be six more deals over the next six weeks. One factor is simply the amount of time that it takes to consummate a lease transaction. It can be 1-2 years from the time the Tenant confirms the need for space, defines the requirement, has us issue a request for proposal, reviews responses, tours some of those, short lists from them and issues a request (demand?) for final and best offers! Once a Letter of Intent is signed, then lease drafts are issued. And for the broker, this is often when the real fun begins. On a recent 40,000 s/f industrial lease, we went through 11 revisions to the lease! A smaller office requirement (15,000 s/f) went through 6!

There is no question that it is a Tenant's market. There simply is more space of all types (industrial, flex tech, retail, office and commercial) than there are active tenants. Empty space costs \$4, \$6, \$8 or even \$10/s/f for taxes, minimal utilities, maintenance, insurance, etc., not to mention debt service. Landlords are realizing that rental concessions are going to have to be offered and that they will need to sharpen their pencils. Now there are tenants and there are tenants. In a soft economy, the credit worthiness of the tenant (the ability and willingness of the tenant to pay the stipulated rent for the entire term) is critical. In a hot market a landlord can take chances on some tenants. But in dicey times, rates drop, terms of leases get shorter, and Tenant's demand (and get) multiple concessions, which means the deals are very lean and there is no margin for error. As we enter the fourth quarter of 2009, there is a large gap between bid and ask. Landlords are kicking and screaming about reducing rates but Tenants are increasing their demands for concessions. It takes a seasoned Broker to bridge the gap, to educate both parties about what constitutes a fair deal in these lean times. For those who have not been through one or more of these corrective cycles, it is very difficult to grasp that market rates can change so quickly and so drastically.

One real concern is that as we hear about a jobless recovery stretching out to 2016. This lean period for commercial real estate could go on for quite some time. Owners who are OK right now

may not be next year, or the year after. As most real estate loans are 10 year balloon type loans, approximately 10% of the properties roll over reach year. The ability to refinance is deeply affected by occupancy, delinquencies and projections for renewals. All three of these can significantly negatively impact the value of a given property.

Through the refinance process, a number of new/current appraisals are coming out. No more 5% or 6% capitalization rates. No more rosy projections of continually rising rental income. The new loan will likely have recourse, if not 100%, a significant amount, which impacts an owner's appetite. These are some of the new realities (some would call them traditional or usual and customary lending practices). The sudden change in the markets was, and is, hard to adjust to, but the prospect that these are the new realities for quite some time also impact the players on both sides. To summarize, we see 2010 as more of 2009 (i.e., fewer, smaller deals). We think 2011 could see an uptick, albeit a cautious one, primarily because firms that have aggressively cut hours, will add back those hours before they add new employees. Given all of the tension in the markets, new hiring will be a last resort, very slow to come. So most firms will be looking for less space, not more, and they will be watching every penny in their occupancy budgets. Tie a knot and hang on. This too

William Norton, CRE, FRICS, is president of Norton Asset Management, Manchester, NH.

will pass and eventually things will get better.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540