

GLOBAL REAL ESTATE MONITOR

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Office Leasing Strategies: Filling Space in a Down Market

The ongoing recession and an uncertain business environment continue to negatively impact the U.S. office market, pushing vacancy rates up and rental rates down. But even in this tough market, new office leases have been signed.

“All the things that are important in a good market are five times more important in a down market,” says John Brownlee, senior vice president of KDC, a Dallas-based owner and developer. “The simple things like relationship-building, a high level of customer service, listening well and good follow-up really make a difference.”

Across the United States, office vacancy rates have returned to levels not seen since 2005, increasing 95 basis points to register at 14.74 percent at the end of the first quarter, according to Colliers International.

Meanwhile, lease rates dropped substantially during the first quarter 2009, with asking rents for CBD space dipping by 5.5 percent to \$43.36 per square foot. Suburban asking rents also fell during the quarter, declining by 1.4 percent to \$27.69 per square foot. On an annual basis, CBD rents are down 13 percent and suburban rents are down 3.8 percent, according to Colliers International.

Weak demand is at the root of the declining market. First quarter absorption was again negative with occupied space contracting by 27.8 million square feet, the fifth consecutive quarterly contraction and significantly worse than a year ago when absorption was –a negative 1.3 million square feet. Companies are now shedding space at the quickest pace since the third quarter 2001 when occupied space shrank by 28 million square feet, according to Colliers International.

However, many owners are keeping up the fight. GE Capital Real Estate, for example, has completed tenant renewals and new leases totaling about 6.6 million square feet of office space in North America during the first half of 2009. Roughly 5.2 million square feet of that total were lease renewals, while the remaining leases were new.

“In these tough market conditions, we’re realizing success by sticking to the basics,” says GE Capital Real Estate President and CEO Ron Pressman. “We’re taking time to understand what tenants need, including use of surveys, focus groups and one-on-one discussions.”

The Global Real Estate Monitor talked with office owners across the United States to determine the most successful office leasing strategies for a down market. Read on for details.

Position your assets properly

Dallas-based KDC has inked more than 340,000 square feet of new office deals at the Campus at Legacy, a 1.2-million-square-foot, three-building project in Plano, Texas. KDC purchased the buildings from EDS in 2005, and after months of market research, it redeveloped the buildings into Class A office space.

“We looked at doing a more radical redevelopment that would take us to a price point similar to most of the other buildings in the market,” Brownlee notes. “Instead, we positioned the project as a great value for the Legacy submarket, and that strategy is paying off for us now.”

In the past 12 months, KDC has signed leases with Pepsi Co. for just under 100,000 square feet, as well as a 40,000-square-foot lease with Dr Pepper/Snapple Group Inc. and another 40,000-square-foot lease with St. Jude Medical Center, according to Brownlee.

“You have to find your position in the market by learning the market and asking potential tenants their opinions on your property,” Brownlee says. “You have to be realistic about your position in the market.”

Offer concessions and other perks

The leasing environment today strongly favors tenants, and that means owners must be willing to offer concessions and other perks such as increased tenant allowances, building signage and free parking, according to Simon Adams, a partner with Reed Smith.

“Owners with tenants and cash flow in place with little or no mortgage debt are willing to do almost anything to capture tenants,” says Kurt Rosene, senior vice president of The Alter Group, a Chicago-based company that develops and owns office properties. “The folks who have a lot of leverage find that lenders are much less willing to work with them in offering huge concessions.”

The most common concession that owners are offering today is free rent. It’s not uncommon for owners to offer as much as 12 months of free rent to a new tenant, Rosene says, adding that he’s recently seen owners offer two years of free rent as an enticement.

Along with free rent, many owners have increased their tenant improvement allowances by 10 percent to 15 percent, Adams says. And most owners are more willing to provide monument or eyebrow signage as part of the overall lease when they previously would have required additional payment.

[Parking rates and after-hours utilities charges are other areas where owners are being more flexible, says Craig Ersek, principal and executive vice president of Essex Asset](#)

Management, an Irvine, Calif.-based firm that manages more than 16 million square feet of commercial property throughout California and Arizona. “All those soft costs tend to be put on the negotiating table in a down market,” he notes.

Some owners are taking concessions to the next level by agreeing to cap expenses, says David Weisman, a partner in Greenspoon Marder’s real estate group. “Although it’s difficult for owners to cap expenses because they don’t what they’ll be from year to year, they’re agreeing not to pass on those expenses,” he notes.

And finally, larger credit tenants are even wrangling standard non-disturbance (SND) clauses from owners, says Jonathan Larsen, an executive managing director with Transwestern Commercial Services. Without an SND, a lender can come in and change the lease rate if the owner is forced to relinquish the property because of default. The SND protects tenants, but it is not commonly offered in hot markets.

Engage the brokerage community

In a down market, concessions and other types of perks aren’t just for tenants – they’re for brokers too. In an effort to drive traffic to their buildings, many owners have become very creative with their broker incentives, Ersek says.

Many owners have increased broker commissions from the standard three percent to four percent and are offering bonuses of \$1 to \$2 per square foot. They’re even giving away gift certificates for expensive dinners, golf trips, exotic vacations and designer clothing to encourage property tours.

Moreover, owners are changing the payment schedule for broker commissions. “Because of concerns about the financial health of building owners today, the brokerage community is very concerned about getting paid,” Rosene says. “That’s why a lot of owners are offering to pay 100 percent of commissions up front.”

Serve as a community liaison

Many owners have found that they can differentiate their properties simply by serving as a liaison between tenants and the community. “We’ve found that we can reduce the competition by developing a strong relationship with municipalities,” says Grady Johnson, senior real estate director for Opus North Corp.

The company recently signed a 144,500-square-foot lease with DeVry Inc. at Highland Landmark V, a 251,000-square-foot Class A office building in Downers Grove, Ill. DeVry Inc. will occupy approximately 60 percent of the eight-story building, which was completed in September 2008. It is the fifth and final building in the 42-acre Highland Landmark office park, developed by Opus.

Strong relationships with local neighborhood groups and city officials can benefit tenants in a variety of ways, Johnson says. From job training programs to tax abatements, an owner can work with local economic development personnel to create tenant incentives that go beyond free rent or building signage.

“Owners are realizing that this tough market is here to stay for some time,” Rosene says.
“They know they must do more to capture tenants and keep their buildings full.”