

Reality of vacant office space sinks in

BY MARK ALEXANDER, CCIM • SPECIAL TO THE NEWS-PRESS • JULY 26, 2009

Johnny Paycheck sang the hit song "Take This Job and Shove It" back in my college days of 1977. The 2009 remix should be entitled, "Take This Job and Treasure It." The U.S. has been losing jobs for a while. According to a new report by REIS, the U.S. averaged losing 670,000 jobs per month from November 2008 through March 2009. This stomach-churning pace has slowed a tad from April through June 2009 to an average of just 436,000 jobs lost per month. This is our version of good news in 2009. It is kind of like running out of milk, but you are thankful the refrigerator is still working.

The slowing pace of job losses is a sign of hope for the economy but it is not a sign of stabilization and recovery for the office market. We need job growth to achieve that.

Office building owners today are singing a different rendition of Paycheck's song entitled, "Take This Office Building and Buy It Before I Lose It to the Bank." When office space is occupied and then it goes vacant, we measure the amount of square feet and call it "negative absorption."

The U.S. office market had negative absorption of 25 million square feet recorded in the first quarter of 2009 followed by another 20 million square feet in the second quarter of 2009. This is the sixth consecutive quarter of negative office absorption since January 2008. Office properties are suffering during this prolonged recession.

There has never been a better "Tenant's Market" to rent office space than right now. There has never been a better "Buyer's Market" for office space than right now. REIS expects the pace of negative office absorption to continue slowing through the end of 2009 at an average rate of negative 11 million square feet per quarter for the last half of this year. This should help us reach a stabilization in the office market but don't expect a recovery until 2010 assuming the pace of negative absorption (and job losses) continue to dissipate at the same pace.

When tenants suddenly downsize or vacate before their lease expires, they look to sublease their space often at a discount of 10 percent to 30 percent off their contract rent today. But some tenants wise to the instability of other fellow tenants are refusing to enter into sub-lease agreements with other tenants. They fear departing tenants could default on their main lease which would then cause their sublease to be voided prematurely. So we are seeing many new tenants chose to only sign leases direct with owners which then forces the owners to settle separately with the defaulting/downsizing/ vacating main tenant.

As office vacancy increases, asking rental rates are decreasing and tenant concessions to sign new leases (i.e. build-out allowance and free rent) are increasing. Office values are on their way down. How could they not be? REIS predicts 67 million square feet of negative office space absorption for all of 2009 and this does not include new buildings that have never been occupied before or the 50 million square feet of new office product that is being delivered in 2009. If your office building does not have enough tenants to allow you to pay your mortgage, foreclosure may be nearing. This common situation today is causing many office owners to snap out of their dark cloud of denial as they finally accept the reality of today's market and pricing is getting much more aggressive. Commercial office brokers are starting to go back to work and not a moment too soon.

Even office owners who have sufficient occupancy to cover their overhead have deep concerns as their mortgages come up for renewal over the next few years. Due to much stricter lending requirements today coupled with diminishing market rental rates and growing vacancy rates, many office owners cannot qualify for their refinancing without making large additional cash down payments ... which is widely expected to cause many billions of office foreclosures over the next few years.

All this pain hitting the office market in addition to the pain banks have already endured from the residential market is causing appraisers (who mostly work for banks) to appraise office properties lower and lower. This in turn makes it even harder for the office owners to refinance ... as our muddy office market snowball continues to roll down the bumpy hill toward the bottom.

Imagine being an appraiser trying to put a value on an office building today. There are not many recent closings to use yet you are required to come up with a value. And some of the recent closings were foreclosures where the bank took the building back for the size of their mortgage. Is this recorded price at the mortgage amount really fair market value? It only proves no one was willing to pay more than the mortgage amount so presumably the fair market value from an arm's length buyer would be somewhere less. How do you reconcile that funky tomato and come up with a value that pleases everyone? This is what happens in a destabilized market. It all comes back to jobs in the end. Once we stop losing jobs, foreclosures will eventually stop and the office market will stabilize which leads to recovery when jobs start growing again.

Lee County is supposed to reach small positive job growth in 2011. It is not going to be an easy road from now until then, but we have the mettle to get through this.

I am reminded of a quote scribbled on the inside of a shipboard locker that I was made to paint as a freshman at the Massachusetts Maritime Academy in 1977.

The author had been a senior cadet writing about his reflections on just having endured a tough two-month summer sea training cruise with difficult people in southern waters with no air conditioning. As I painted that dingy smelly cabin, I listened to my radio blare the latest hit "Take This Job and Shove It," and I stumbled upon this seaman's

quote: "Let no man put us asunder for we have done that which was deemed impossible by men of lesser stature. We have done it and we will do it again."

— **Mark Alexander, CCIM Senior Medical Office Advisor Sperry Van Ness 5121 W. Hyde Park Court, Suite 204 Fort Myers, FL 33912 239-826-4174 marka@svn.com**