

Ignorance is not bliss in the current *Tenant Market*



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H—Here we are in 2008, and what a turbulent time we are in. So it begs the question, what brought this on? About four or five years ago in Orange County, Calif., businesses were expanding at a healthy rate. I often worked with clients that would lease 10 percent to 20 percent more square feet than they actually needed with the anticipation of expanding in the coming months or years. And I specifically remember working with a call center that was anticipating hiring up to 50 percent more employees prior to them signing the office lease. The mortgage business. . . now that was an industry on fire.

On the residential front, it seemed

that every quarter interest rates would decrease thus prompting the residential home owner to refinance in order to benefit from the lower payment while at the same time their property values were continuing to increase.

Factors that helped fuel that fire appeared to be an unlimited abundance of Wall Street capital seeking a safe haven in the investment market. After the well qualified home owner and refinance market dried up, the next pool of buyers were the investors and the, “not so qualified investor.” All of them wanting the same thing, to ride the investment train upward and become a millionaire over night like their friends.

Now we have the advent or the exploitation of the no income variation, or, as some in the industry call it, the "liar loan." This was a, "no documentation believe me" loan. As a result, income was stated which far exceeded the job description. That should have been the time when the light should have gone on, but didn't. Many of these easy qualifier loans were interest only, variable rate loans, or a combination of many different types of loan products.

In Orange County, we have about 140,000,000 base inventory square feet of office space with 18,000,000 square feet available for lease. That's an average of about 13 percent in the vacancy rate over all. It's an interesting situation in that while the boom train was rolling down the tracks, vacancy was about 7 percent, which prompted investors and realtors to help house the booming economy. It seemed to be the beginning of the perfect storm.

At about the same time the new high rise office market was nearing completion, the real estate market in general and the economy in particular began to slow down. Now, we have a situation where nervous businesses are worried about their future and holding back plans for expansion, while landlords are desperately looking for new tenants or doing what



ever they can to hold on to existing tenants. Paradoxically, these high rises needed to achieve very aggressive rents due to the cost of land and construction costs during this period of time. During this time, there was a global demand on most raw materials which in turn increased pressure on development costs.

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This situation is critical. Commercial office vacancy rates have increased dramatically. We are seeing landlord's become extremely aggressive in their marketing efforts in order to lure the limited number of tenant's in the market to their buildings. The



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time of free rent, moving allowances, increased tenant improvement dollars for a build out, broker bonuses, and other types of creative concessions are back in full swing.

There are opportunities for both landlords and tenants in this particular market cycle, although, it's my belief that the tenant has the upper hand. Should a tenant need to relocate, landlords are competing very aggressively for their business. A client I recently represented was able to reduce their occupancy costs by 27 percent. The client received rental abatement, relocation compensation, and a turnkey tenant improvement allowance.

Opportunities exist for landlords that purchased properties years ago allowing them to be in a better position to provide concessions. However, landlords who purchased recently and paid market price anticipating that the lease rates would continue to rise and are finding it challenging.

The difficulties for the tenant (with such an abundance of available space) are the sheer challenge of trying to

make a decision. When there are so many landlords competing for the same tenant, the tenant has some difficult decisions to make. For example, in a recent transaction I completed, the tenant did not need 20 percent of his current office space. However, he did not want to relocate. The landlord did not want to lose a quality tenant and as a result, became very cooperative and extremely aggressive with the terms. Would this have happened four years ago? Absolutely not.

As a broker, questions that need to be asked include: How does a broker help assist and advise his or her clients in these uncertain times? What are the trends that are developing and how can we best advise our clients? These are questions many brokers don't think about. An SIOR broker finds the answers to these questions essential to help clients make the best decisions. As a client, being informed and well educated reassures you the decisions you make or are going to make are the right ones. The benefits of working with an SIOR broker are endless.

It's been documented that SIOR brokers work extremely well with each other and can facilitate a difficult deal. We are able to educate the landlord and the tenant and consummate the transaction that benefits all parties. It's no secret the landlord wants the highest lease rate and the lowest amount of concessions in completing a transaction and the tenant wants the lowest lease rate and the most concessions in a transaction. Ideally, with a fellow colleague we are able to educate each other and achieve the most aggressive terms possible while taking any emotion out of the transaction.

I just completed a transaction with a tenant who needed to have specific tenant improvements done to the building they were interested in. In order for the building to work for them it was imperative that the improvements be completed or they had to choose another building. My client was about to agree to pay for the required tenant improvements, yet with the negotiations between the landlords' broker and myself, we came to an agreement that the landlord would pay for the necessary tenant improvements. The landlord benefited by receiving a long term lease with a tenant who had an excellent track record. The tenant benefited by being able to relocate to the building of their choice. The brokers benefited because they were remunerated for their efforts. A win-win-win for all involved.

Right now we are finding that clients are frightened. Landlords are seeing their cash flow decrease and their capital outlays and concessions increase; tenants are unsure about their business and their potential to pay rent. Brokers are able to advise and take the emotion out of the transaction and help alleviate perhaps unwarranted fears they may have. When both sides are feeling the recession's impact it needs to be conveyed that recessions are cyclical and it will get better. At the moment, the market is very dynamic and is changing very quickly. We are at ground zero and can assist with making an educated and informed decision.

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