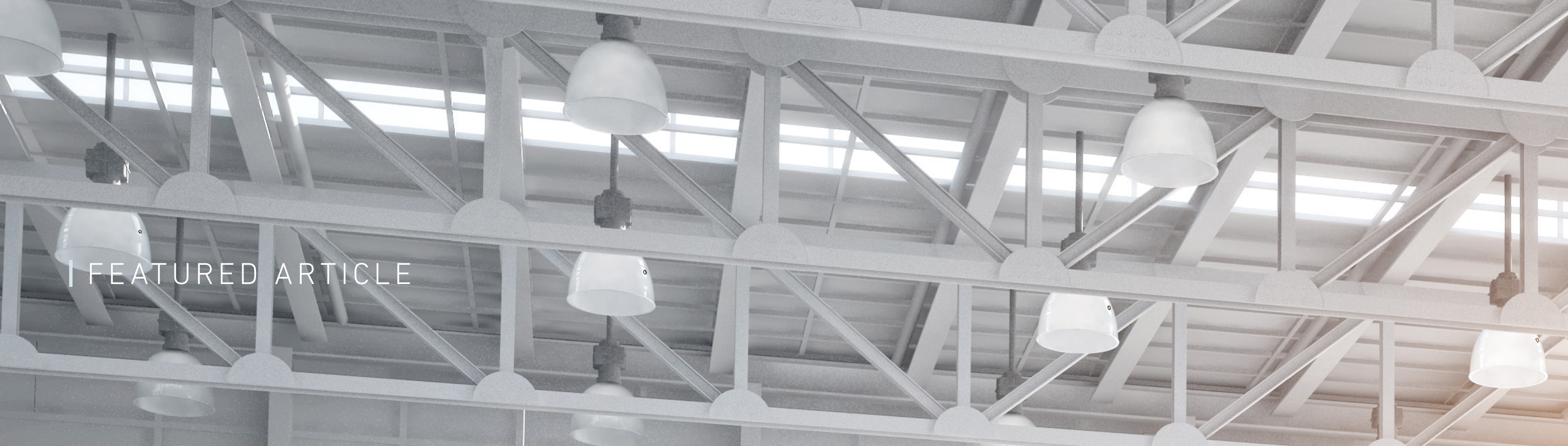


FEATURED ARTICLE

Trends in Commercial Property Leasing

By Steve Lewis

While general commercial real estate trends and their impact on leasing can be identified on a national basis – i.e., strong or weak demand for space, high or low vacancies, rising or falling rental rates – astute SIORs must pay closer attention to the specific trends in their markets, and the needs of the users and owners of the space they represent.

For example, Gary P. Grochowski, SIOR, senior vice president at Colliers International, Detroit, who represents office landlords, notes that "what's really taking off here, as we come out of the recession, is the affinity to being in downtown, walkable communities – to the point where it's affecting the market."

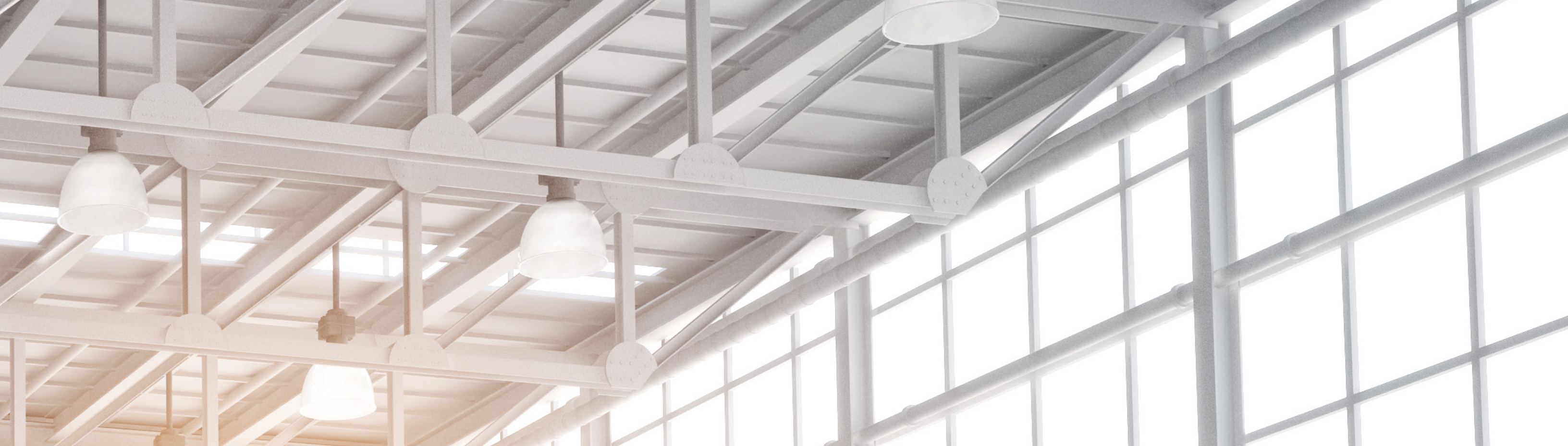
"Traditionally, metro Detroit has been a suburban office market," says Grochowski, "with big parking fields and parks located near homes. Now, we're seeing people considering downtown areas at a substantial level – sometimes with almost twice what suburban rates are," he notes.

"In Metropolitan Atlanta in the office arena we are seeing two emerging trends in commercial property leasing," observes Thomas F. Davenport III, SIOR, president of Lavista Associates, Inc., in Atlanta. "Repurposing older obsolete industrial facilities for loft office use has become prevalent in four office submarkets over the past five years with more planned. Also, the introduction of speculative office finishes referred to as 'spec suites' over the same time period has generated leasing velocity across our entire region."

"Tenants are seeking more and more efficiency and are putting more people in the same or smaller amounts of space," adds Jeffrey A. Dreher, SIOR, MBA, senior real estate advisor with Commercial Kentucky/Cushman & Wakefield Alliance in Louisville, Ky. "This in turn creates the need for more parking and higher use of bathrooms and other common areas. We are also seeing a rise in the costs for tenant improvements and upgraded common areas within tenant spaces as employers try to compensate for smaller employee spaces and a competitive job market by offering nicer spaces with more amenities like high-end 'lounge' spaces."

Dreher adds that while "these are not necessarily new trends, they are definitely becoming more prevalent."

Grochowski sees a similar trend in Detroit. "Another trend is less square foot per employee," he asserts. "If you move out of traditional office space and you can get down from 200 to 150 sq. ft. per person, there are savings, and you're really not doubling your rent [by going downtown] because you're going to smaller spaces."



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From the employee standpoint, he continues, "if I'm a 20-something my question is, 'Do I want to work in a stodgy space where I get my own office or with a new, fun, tech company and downtown but work at a cubicle, or maybe even bench seating with 12 other colleagues?' They'll take the downtown area." He says he'd also be very interested in seeing a study done on compensation. "I bet you have to pay less [for employees] to be in downtown than in a suburban location," he poses.

When it comes to industrial space, George Pino, SIOR, RPA, president of State Street Realty in Doral, Fla., says that in the Miami market tenants are looking for advisors on the front lines. "We just continue to make sure we do our research every day and are well educated about the advantages available," he says. On the landlord side, "we constantly talk to users and occupiers of warehouse space to understand what efficiencies they can use."

Ceiling height, he continues, is the biggest driver. "Tenants want 30-plus ceilings where they can rack higher, rather than having to use more floor space," he explains. "You don't see anything under 30 feet any more, where the norm up to four years ago was 24 feet."

So what are SIORs doing to meet the needs they have identified? "When representing property owners we are recommending loft conversions in certain submarkets if the costs for delivery will generate the returns expected," says Davenport, "and often we recommend having a 'spec suite' offered in our inventory for marketing purposes. Even if they do not fit a prospect's requirement, they provide a marketable illustration of possibilities for the customer."

"The increased tenant improvement costs have forced us to look at creative ways to make up the difference," says Dreher. "For example: additional term, tenant contributions toward improvements, or higher rents are common strategies to overcome the additional costs."

"For my business I look to gather more listings in those downtown areas," says Grochowski. "From a landlord rep. perspective, representing a lot of landlords in those older style buildings is not as desirable; I encourage them to create amenities in the buildings to compete. For example, people like to get out and walk outside, so let's create a walking path. We have big, behemoth parking, so let's create one around that."

In addition, he says, "you'd better have some kind of food service, or even a food truck or a pop-up in the lobby or vending." What are really popular, he adds, are unmanned kiosks. "With security cameras and self-checkout it's a great amenity," Grochowski asserts.

He also recommends conference rooms, building WiFi, and common area seating area. "Someone can come out of their office suite if they want to work on a laptop and they can go work in a chair; the nice ones even have work tables," Grochowski observes. "That's one way traditional suburban buildings can at least get a leg up on the competition, by having those amenities people look for in those downtown areas."

Strong Market Environments

Whatever market challenges these SIORs are facing, they all have the benefit of working in a positive overall environment. "The Miami area continues to enjoy take-up with job growth, a diverse economy, strong fundamentals, foreign investment, and very active construction," says Pino.

"In terms of commercial real estate, the vacancy specifically in the Miami airport submarket is probably 4.2 percent, which is now the lowest we've seen in the last 10 years. We also see rental rates at the highest level in 10 years."

Demand is still strong, he continues, for both Class A and Class B space. "Both have low vacancy and strong, strong demand," Pino asserts, adding that "we have very strong demand for modern, efficient buildings – that's the name of the game."

"The Metropolitan Atlanta market is very active at this point, posting healthy absorption and true rental rate growth in most office submarkets. Secondary markets are also benefiting from the demand drivers, albeit at a slower pace," says Davenport.

"Class A product has driven most of the office space absorption in our region and garnered the highest percentage of rental growth, but the loft office developments have created a different class of alternatives for both corporate and creative tenants," he continues. "Atlanta's office market has seen a 15 percent increase in effective rental growth, a meager .0059 supply increase, and a vacancy decrease of 4.0 percent over the past three years."

Dreher also paints a rosy scenario. "Overall market activity has been very strong and consistent, which is good to see with 2008 and 2009 in the not-too-distant past," he says. "New Class A product has been particularly hot in the Louisville suburban market, which is likely a result of an improving economy and the desire for new development following the lack of development during the Great Recession."

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As a result of the new suburban development and improving economy rental, he continues, "rates for new product have risen over 10 percent compared to new product built just a few years ago. The increase in the cost for new product has helped overall suburban rates increase by similar amounts."

"There is still a large premium for Class A space, and in metro Detroit there are a limited number of true Class A; most are B or B-plus," says Grochowski. "They are pretty nice, but not mahogany and granite entryways, or polished elevator cabs."

There are very low vacancy rates in the downtown areas, he continues, with new construction in all of the downtown areas. "In some cases downtown rates are as much as double some of the traditional suburban, so call it $15-$16 vs. $25-$32," Grochowski observes. "And these buildings are really just a couple of miles apart."

Looking at Future Trends

In addition to addressing current leasing trends, Grochowski is also preparing for future trends. "I think we will see a lot more temporary or month by month offices," he predicts, "And there are centers that have been around, but are kind of rebranding the concept to the different expectations of employees – work in bench seats, or cubicles."

As co-working evolves, he continues, other alternatives could include concrete floors, exposed ceilings, hard-walled offices, and "more professional" carpet and ceiling tiles. "Their appeal will be more to the attorneys and professional sales people," he says. "Those sorts of professionals need a place to work remotely or in different locations within the same city – they do not want to drive across town to go to the office. Most people now go to Starbucks rather than spending too much time getting back to the office."

For his part, "if I consult with a landlord I might go so far as to create a co-working space with minimal or little cost to attract that professional to my building. Ultimately he may decide he needs an office there, so that drives tenant traffic.

If I consult with a tenant, and they say a lot of people live on the east side and most clients live on the west they want to locate in the middle. In the future, it may evolve to: let's locate on the east side, but if I need to go to clients on the west side I'll be able to use these co-working sites since I have contracts where I can have four seats any time I want."

"I forecast video imaging of office space requirements to take off in the near future," adds Davenport, "which will facilitate quicker building analysis by tenants and the time from tour to transaction."

The new WELL Building Standard also has the potential to impact leasing trends, although SIORs are not in agreement on the depth of that impact. "Nobody's pointing to you and saying you have to have a WELL building," says Grochowski. "It's not a top-five thing."

Davenport notes that "short-term, the unknown expense considerations of this standard will impact leasing activity in projects that adhere to the WELL Building Standard requirements, but in the future the economics will be quantified and the resulting improved building conditions will be embraced."

"It isn't yet clear yet what impact the WELL Building Standard will have on leasing," adds Dreher, "but one thing we know for certain is that it will definitely increase the cost of initial construction and occupancy."

Dreher, however, is clear that some things should never change. "Regardless of what new trends emerge in the future, SIORs should rely on the experience, resources, and best in class skill set that all SIORs possess to advise their clients to the current trends within their respective markets," he concludes. ▽

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