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Job Numbers Deal Blow to Office Market

By Erika Morphy

WASHINGTON, DC—The market has been bracing for terrifying unemployment figures and the Labor Department on Friday did not disappoint: In the month of December the economy shed itself of 524,000 jobs, pushing the unemployment rate to 7.2%. Since August the economy has lost 1.93-million jobs, the bulk of which have been in manufacturing, construction and retail sectors.

For the real estate industry this misery translates into a rapid decline in fundamentals. Grubb & Ellis, for instance, was projecting a two percentage point increase in office vacancies nationwide for 2009—a number that Bob Bach, SVP research, thinks is probably too low.

“I have suspected it will wind up being higher than that and these numbers certainly don’t do anything to change my mind,” he tells GlobeSt.com.

But whatever Grubb & Ellis’ final tally of projected vacancies will be—Bach is not officially changing the forecast just yet—it is clear that many markets will be experiencing negative absorption for the foreseeable future.

Some markets, of course, will be feeling the pain more than others, Robert Alter, vice president of Real Estate for FORT Properties, tells GlobeSt.com. “Unquestionably, the increasing unemployment numbers will impact the office sector. The degree to which, however, depends on the market, the property and when leases are expiring.”

For example, he says, California’s Orange County is reportedly at almost 18%; Nashville, on the other hand, touts an overall vacancy rate of around 12%, with Nashville’s strongest submarkets reporting ‘increased’ vacancies to only around 10% and primarily attributable to new completions.

“However unfortunate and painful the recent 6% or 7% rise in vacancy may be in Nashville, most experts agree that it will not likely produce the 20% vacancy rates that some analysts have projected for many large markets around the country, regardless of the current unemployment numbers,” he says. “I contend that this rationale holds true for other similar markets as well.”

At the same time, Alter continues, tenants with leases that do not expire near term are more likely to take a longer view than those who will be exposed to the market in the coming months. “As a result,” he says, “buildings with more stable rent rolls and longer-term tenants tend to be considerably more buffered.”

Landlords in New York City will be feeling the heat, Michele Browne, Managing Director of national tenant representation company Howard Ecker + Co., tells GlobeSt.com. “The jobless unemployment numbers that came out today that reached 7.2% are going to have an immediate effect on the vacancy rate here, she says. “Vacancies will rise and they will rise in very large increments—20,000-square-foot, 40,000-square-foot and 60,000-square-foot blocks will come to the market as larger companies contract.”

This will pose a real issue for landlords not only because of these rising vacancies but also because the tenants that are out in the market right now are looking for smaller spaces, she says. “In order for landlords to address the new tenant’s demands, they will need to start offering smaller spaces at more attractive rates.”

Jim Wacht, president of Sierra Realty in Manhattan, expects New York City to lose about 200,000 jobs in this downturn, which will translate into 40 million square feet of vacated real estate. “That is going to bring rents down significantly,” he tells GlobeSt.com. “I wouldn’t be surprised if we saw a 20% to 30% decline in rents on a per square foot basis.” Wacht predicts the poor market will last for the next two to four years before it levels out.

Unfortunately, poor job numbers tend to have a domino effect in the economy, says Elizabeth Kulik of the Schonbraun McCann Group, the real estate consulting division of FTI Consulting—and this effect will be particularly ugly as these numbers ripple through the real estate sector.

“The dramatic rise in the unemployment rate will have a seriously negative impact on tenants, owners and investors that have not planned for major contraction in revenue generating office space,” she tells GlobeSt.com. For instance, she explains, standard office

space requirements are about 180 square feet to 250 square feet per person. “With lay-offs occurring every day, this means that there will be a significant sublet or ‘shadow’ market that will compete with market listings,” she says.

The construction industry as well as other industries that service the office market will be deeply hit by the massive increases in vacant space, Kulik says. “Demand for new buildings will seriously decline until the vacancy is absorbed. Consequently the jobs/revenue/GNP that are created by new construction and the related office market services sectors will be lost.”

There is also a growing concern about how buildings are going to be underwritten in the near future to satisfy lending requirements

on the \$300 billion of short-term debt that desperately needs to be replaced, she adds. Finding refinancing was not going to be easy in this environment any way—with a lower cash flow—thanks to lower rents and fewer tenants—it will be that much harder.

Kathleen Wu, a partner at the law firm, Andrews Kurth in Dallas, also points out the cash flow problems that are likely to materialize for many building owners. “With fewer employees, businesses will be trying to save money and reduce their office space,” she tells GlobeSt.com.

“This cost-cutting creates a real cash-flow problem for commercial and retail property owners. We’re going to see property owners needing to refinance, and that’s going to be a problem unless this tight credit market opens up.” ■