nyc Question of the Month

What should you do when the big squeeze is on?

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Not since the end of 2000 has the commercial real-estate market received so much press—and for good reason. The commercial market has surged ahead. As a result, we are entering the most challenging time in more than 20 years for companies looking to acquire commercial real estate

Effect of Residential Market on Inventory

The residential market in Manhattan had been on an upward course since the mid-1990s. The prices of residential development sites were $100 per developable s/f in the early 1990s and reached well over $400 per s/f before the recent slowdown. The demand by residential developers also affected existing commercial buildings converted to residential use in places such as Chelsea, Midtown South and the Financial District. This was further accelerated by favorable tax changes in Lower Manhattan for conversions as well as up-zoning in areas such as Chelsea. In addition, there was the loss of approximately 14 million s/f of office space at the World Trade Center. The result was a significant reduction in the inventory of commercial space.

Since 1991, many commercial buildings have been added to inventory, including 7 World Trade Center and the New York Times Building. These buildings are all geared to the high end of the market—large corporations and professional firms.

In addition, over 10 million s/f of buildings were converted to residential from commercial. The buildings converted were suboptimal office buildings, but they did provide relatively inexpensive office space for nonprofits and as a result tempered commercial rents.

The net effect was not only the trimming down of inventory by over 13 million s/f, but more dramatically a reduction in space in buildings that had offered lower rental rates.

Greater Demand

In addition to supply problems, the demand side has blossomed. Employment in New York City and Manhattan in particular peaked in 2000. New York has not yet reached the pre-9/11 employment levels, but we have added over 120,000 jobs in the last two years. At 200 s/f per person, this translates into the need for 24 million s/f.

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Results

With the slowing of the economy in 2000 and 2001, there was an increase in available space—the vacancy was over 10% in Manhattan. From 2002 through 2004, the loss of jobs and inventory kept the vacancy rate steady at around 10%. Since 2004, the loss of inventory combined with an increased demand has reduced the vacancy rate to just over 6% in Manhattan.

It takes two years to build a new commercial building. Compare this to the demand for office space, which has increased rapidly and can change overnight. Most professionals we have spoken with do not see any decrease in the near-term demand. As a result, the average cost per rentable square foot (RSF) for office space in Manhattan has gone from a low of $24/RSF in 1994 to a pre-9/11 high of $48/RSF to a post-9/11 low of $38/RSF. Today the average cost is again $48/RSF, but there is no "tech-bubble." Developers have not replaced the lost inventory and the economy is not in imminent danger. The result will be higher rents for everyone.

Solutions

For companies undertaking a space search, there are a number of strategies that should be utilized. First, widen the search area. Spaces may exist within your budget that are located farther away than the initial plan. Do you absolutely have to be in Manhattan? Looking in the boroughs or in the suburbs may provide better options.

Second, economize on the amount of space you need. Make sure the space is well thought out and efficient.

Third, start the process well in advance of when you "must" move. Pre-plan the entire acquisition/leasing process so that when the right opportunity appears you are ready to act.

Fourth, have professional representation. This will help in demonstrating to your executive committee or board the value of one option over another.

Finally, evaluate the market at one time. We see tenants look at buildings in a serial fashion. One building appears favorable, but if the deal falls through they find a second and a third in a series. Look at all buildings simultaneously. This helps decision-makers understand the value of one option over another and creates leverage for the organization by having multiple options at the same time.

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