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Projecting **Leasing** Trends for 2010

Any return to 'normalcy' seen only in second half.

BY BRADLEY A. KAUFMAN

IN CLOSING my article last year at this time, I quoted Mitchell Roschelle, a partner in the real estate advisory practice group at PricewaterhouseCoopers here in New York City, for his take on things, and Mitch summarized by saying, "All in all, 2009 will be a down year, for values and rents."

With respect to landlords in New York City, both office and retail, boy was Mitch ever right!

Throughout the year, landlords saw rents drop ever lower while concession packages, at least those being offered (since there weren't a whole of takers), grew steadily. The mood in the city's real estate market was "doom and gloom" and that phrase appeared in numerous articles on the subject throughout the year 2009.

As national unemployment rates steadily increased and corresponding vacancy rates did likewise, New York City also saw significant increases in unemployment and vacancy rates, though not to the extent felt by the rest of the country.

What exactly happened in 2009 and what can we expect for 2010? Once again, this year I will review leasing activity in the city, while interjecting commentary from well known and well regarded non-legal real estate professionals. I will also include in this article their and my predictions of what we can expect for 2010.

The Year 2009

The year 2009 began and continued much in the way that we thought it would.

As unemployment and vacancy rates increased in New York City, corresponding rental rates decreased and concession packages increased, in some cases significantly so. Large blocks of space were available throughout the marketplace, both on a direct from landlord and sublease basis, and retail vacancies abounded. The experts with whom I spoke last year anticipated this and, as you will see below, believe that it will continue through 2010, at least through the first half of the year.

So what happened to New York City real estate in 2009? Lewis Miller, vice chairman of CB Richard Ellis here, suggests that you need to look a little further back to see what went on last year:

"In 2008 the Manhattan market registered almost 13 million square feet of negative absorption, with almost 10 million square feet of that in Midtown. This [was] the largest level of negative absorption in more than 20 years. Through October of [last] year, the market [had] experienced an additional 12 million square feet of negative absorption.

"As a result, the number of blocks of space on the market has increased to historical highs, even at the large end of the market. In Midtown, for example, there are now 151 blocks of contiguous space of 50,000 square feet or larger on the market, 52 of which are sublet opportunities."

Of course this kind of pressure on the marketplace must have a significant effect. As Lewis notes:

"The effects of this have been acute in Manhattan, with average asking rents over the past 12 months plummeting from $81.71 per rentable square foot to $56.89 per rentable square foot in Midtown, a 30 percent decline. The decline in rents was even more severe in higher end buildings, which have seen rents decline by up to 50 percent in some cases."

Subleasing

As noted above, subleasing took on greater importance as the year 2009 progressed and looks likely to play an important part in the leasing trends of 2010.

Josh Kuriloff, vice chairman and member of the global advisory board of Cushman & Wakefield Inc. agrees when he notes:

"The increase in sublease availability had a dramatic impact on pricing in the Manhattan market. Attractive, built space was being aggressively priced by tenants who needed to shed space quickly. By mid-2009 the asking rent on Midtown class A sublease space had fallen almost 35 percent from a year earlier and this space was priced at a historically low $23 below space offered directly from landlords.

"The competition for tenants in a weak market led to an unprecedented rapid decline in rents. Asking rents on available space plunged 27 percent in one year. In addition, landlords and sub-landlords offered larger incentive packages to attract or retain tenants. As a result, net effective rents on transactions that have taken place including tenant incentives (free rent and tenant improvement allowance) fell as much as 45 percent."

Significant subleases during the 2009 year included a 31,000-square-foot/13-year sublease at 7 World Trade Center by currency trading firm FXDD, taking a portion of the space previously leased, but never occupied, by ABN Amro, and a 69,000-square foot lease at 277 Park Ave. by the law firm of Cozen O'Connor from JPMorgan Chase.

A subset of subleasing is the continued expansion of the New York City office suites market, where landlords and tenants have pre-built space and broken it up into separate units, hoping to make the larger blocks of space more attractive to smaller users. An entity by that title, "NYC Office Suites," entered into an 11-year sublease with Harper Collins for approximately 75,000 square feet, anticipating a multitude of just such transactions.

Law Firms

The Cozen O'Connor sublease was not the only major law firm transaction in 2009, as quite a number of them, particularly those seeking big blocks of space, took advantage of significantly lower rental rates and greater concession packages in New York City.

Wachtell, Lipton, Rosen & Katz renewed for approximately 250,000 square feet at 1285 Avenue of the Americas and Orrick, Herrington & Sutcliffe subleased approximately 213,000 square feet at 51 W. 52nd St. Patton Boggs subleased 60,000 square feet from another law firm, King and Spalding, at 1185 Avenue of the Americas; Holland & Knight similarly subleased 82,000 square feet from Clifford Chance at 31 W. 52nd St.; and McKool Smith subleased 33,000 square feet from Akin Gump Strauss Hauer & Feld at 1 Park Ave.

In other significant law firm leasing transactions in 2009, Loeb & Loeb did a 20-year direct lease for approximately 155,000 square feet at the Rudin family's 345 Park Ave., adding approximately 36,000 square feet to the space Loeb already leased in that building; Stroock & Stroock & Lavan renewed for another 10 years and 220,000 square feet at its long-time home at 180 Maiden Lane; and at year end Gibson, Dunn & Crutcher re-upped for in excess of 250,000 square feet at 200 Park Ave.

Even smaller law firms got into the mix, including Tarter Krinsky & Drogin, in an expansion and renewal of its lease at 1350 Broadway for approximately 27,000 square feet. Ingram Yuzek Gainen Carroll & Bertolotti likewise renewed its space of approximately 20,000 square feet at 250 Park Ave. with landlord, AEW Capital Management.

Other firms, such as San Francisco based Morrison & Foerster, which presently leases approximately 160,000 square feet at Vornado Realty Trust's 1290 Avenue of the Americas has reportedly retained CB Richard Ellis to look for at least 200,000 square feet for a direct or sublease and expansion of its offices here in New York City.

Another interesting twist is that law firms that had merged recently and are maintaining separate offices in the city are looking to consolidate those offices, including Bingham McCutchen, which in 2009 acquired McKee Nelson and has offices at 1 Battery Park Plaza and 399 Park Ave., and Sonnenschein Nath & Rosenthal, which took over Thatcher Proffitt & Wood and its offices at 2 World Financial Center.

The Significant Transactions

Despite the "doom and gloom" mentality, the year 2009 was not without significant leasing transactions. These included, in no particular order:

• Gap's 265,000-square-foot lease at 40 Worth St., consolidating and relocating from 620 Sixth Ave. and 675 Sixth Ave.;

• Country-Wide Insurance Company's renewal downtown for over 100,000 square feet in Donald Trump's

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40 Wall St.;

• Omnicom's 100,000-square-feet renewal, extension and expansion at 200 Varick St.;

• Cablevision's renewal for 45,000 square feet at 530 Fifth Ave.;

•Studley's relocation of its New York City headquarters from 300 Park Ave. to Boston Properties' 399 Park Ave. for 10 years and 61,000 square feet;

• Broadpoint Gleacher Securities Group's expansion and renewal for 75,000 square feet at Vornado's 1290 Avenue of the Americas (representing an expansion and consolidation from various New York City locations);

• CV Starr & Co., a Hank Greenberg (formerly of AIG) renewal and expansion for 120,000 square feet also at Boston Properties' 399 Park Ave.;

• Siska Hennessy Group's 15-year lease at 1515 Broadway for approximately 65,000 square feet;

• Aetna's 40,000 square feet for 10 years at SL Green's 100 Park Ave.;

• Hedge Fund D.E. Shaw's renewal and doubling of its space at 1166 Sixth Ave. to a whopping 240,000 square feet;

•Rose Associates' renewal at George Comfort & Son's 200 Madison Ave.

There was even a reportedly "triple digit" deal (though for only 10,000 square feet) by financial firm Stowe & Youngbert at RFR Realty's Lever House.

However, even with this significant leasing activity, as we begin 2010 there are significant blocks of space throughout Manhattan, including George Comfort & Son's 700,000 square feet of vacancy as a result of Ogilvy & Mathers vacating Worldwide Plaza in 2009.

Landlords Sprucing Up

While obviously lowering rents and increasing concession practices are a landlord's best friend in enticing tenants to their spaces, in depressed situations, landlords have sought alternative methods.

Landlords of trophy and grades A–C space alike have taken to renovating various portions of their buildings, including lobbies, windows, elevators and mechanical systems, so as to entice new tenants to their buildings or existing tenants to renew their leases. Sprucing up "curb appeal" is certainly one method to make buildings and spaces more desirable.

A prime example of that is SL Green's significant and tremendously successful renovation of 100 Park Ave., including obtaining a level of Leed status and Boston Properties' remaking of the former Citicorp Building into a prime mixed use (read office tenant friendly) destination for major tenants in Manhattan.

In the Retail Sector

While the first part of the decade in the retail sector was dominated by banks popping up at every corner in the highest traffic commercial corridors, particularly Madison and Sixth avenues, this was less than the norm in 2009.

Jim Wacht, president of Sierra Realty Corp., explains the reasons:

"This is the year that market dominance by banks, Starbucks and other large national retail chains ended. As a result, vacancies increased and leasing velocity decreased significantly. Once landlords capitulated and lowered their expectations to meet the new market realities, the smaller national chains and experienced local retailers eagerly began to make up the slack.

"Landlords, who shunned these retailers a year ago were now willing to sit down and negotiate very favorable deals with them. Not only were rents 25 to 30 percent lower than they were a year ago, but landlords were now willing to entertain longer-term leases, offer more generous rent abatement packages and entertain uses they would not have considered in a strong market. Security deposit demands were reduced and retailers were often able to rent stores that have been recently lavishly built out by the prior but unsuccessful tenant and I expect the year 2010 will be remembered as the year of the local, market savvy retailer."

Landlords of **trophy** and **grades A–C** space alike have taken to **renovating** various portions of their buildings, including lobbies, windows, elevators and mechanical systems, so as to **entice new** tenants to their buildings or **existing** tenants to renew their leases.

Good examples of these types of opportunistic retailers are Camper, the Spanish shoe company, opening its second New York location at 635 Madison Ave.; Whitehouse Black Market signing on at 508 Broadway; Peter Nygard opening his first eponymous Manhattan location on Broadway between 40th and 41st street in Times Square; and Isaac Mizrahi opening his first store in New York City under his own name at 23 E. 67th St. between Madison and Fifth avenues.

This is not to say that other dry good retailers were not likewise opportunistic, and in fact 2009 saw Old Navy opening a 64,000 -square-foot store in Chelsea, and Abercrombie & Fitch's higher end big brother, Hollister, opening up its second Manhattan flagship at 666 Fifth Ave., moving into the high visibility space in that prime retail corridor.

Non-dry good retailers also got into the act, as Trader Joe's replaced Barney's at 675 Sixth Ave. in a 40,000-plus-square-foot deal and TGI Friday's and Tim Horton's expanded throughout New York City. It is also rumored that Wal-Mart may be actively seeking significant space in the city, once again signaling that that retailer likewise seeks to be opportunistic.

What for the New Year?

What then can we expect for the year 2010? Here is what David Falk, President–New York Tri-State Region and principal of Newmark Knight Frank, suggests:

"All in all, Midtown Class A buildings reflect the aftermath of the demands of the financial services enterprise, Midtown South offers little because of the lack of built space and within Midtown South, the Meatpacking District remains steady and robust. Going forward, in 2010, I do not believe that rents are going to change but I do believe that following the second quarter of 2010, going into the third quarter, concession packages may begin to go back to what we consider normalcy."

Josh Kuriloff agrees, noting:

"The challenges of 2010 will be greater in the first half of the year as companies remain reluctant to add employees unless absolutely necessary. And when job growth does resume, it is likely to be sluggish in the early stages until there is confidence that the recovery will be sustained. In addition, the changing workplace will have an impact on real estate demand. As more companies shift to higher density environments with more alternative workplace strategies, absorption is likely to rise more slowly than we have come to expect."

While David suggests "normalcy" will return to the marketplace, I believe that at best this will take place in the second half of the year and that the first half will continue to reflect much the same in terms of the leasing trends that we saw throughout 2009, to wit, a continued drop in asking rents and increase in concession packages. After that, let's all hope David is right, that we can return to "normalcy," and that becomes the watchword for the year at least by the second half.

Conclusion

So, 2010 promises to be an interesting year.

There are many landlords that are not even active participants in the market presently, whether due to lender (mezzanine and senior debt holders) constraints, or having bought properties at the wrong time (read height of the market) and thus now cannot compete with owners of buildings that purchased them before the hot office sales market.

Nonetheless there are still quite a number of landlords able to adjust their pricing so as to be competitive even in this recessionary market. There will also be many tenants whose leases expire in the next year or two (or even longer) who will want to take advantage of lower rates in restructuring leases or relocating.

That seems to me to be the game plan for 2010: Take advantage of a marketplace that is seeking to stabilize by renewing in place on favorable terms or permitting yourself to be enticed to move into a building with an aggressive landlord. I anticipate significant leasing activity, particularly during the second half of the year and I, like my colleagues, look forward to a return to normalcy.