Conditions Stabilize, but Large Leases Remain Rare

By Allison Landa

Bob Champion doesn't use the word recovery. Instead, the president of Los Angeles-based Champion Real Estate Co. sees today's conditions as drifting back down toward earth.

"The industry is not 'recovering,'" he told *CPE*. "Instead, it is coming to grips with the reality that growth will be very slow, only occurring in specific niches, while at the same time the industry will continue to deleverage."

Regardless of terminology, however, most experts agree that the economy is beginning to gain a little more solid ground under its feet. This begs the question: Does stabilization translate into larger leases?

According to Champion, the companies that are most confident in terms of taking space are those who not only have demonstrated the ability to profit in the present environment, but also recognize that today's values may not be available tomorrow. "(Users who) recognize that they will be growing are locking up space on terms not seen in eight years," he said.

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Paul Leonard
Jones Lang LaSalle

Taking Advantage of Historic Lows

Brian Parno expresses somewhat more optimism than Champion. As chief operating officer of Stirling Capital Investments, he finds himself closely watching activity in several segments—and feeling optimistic.

"We…are actually encouraged by the levels of transaction calls most people are witnessing relative to last year," he told *CPE*. "We tend to think that an increase in deal flow signals the end of the downward trend for industrial deals. This is not to suggest that things will automatically begin to improve from a landlord's perspective, but we think there will be a tendency toward a firming of deal parameters toward the end of 2010."

Like Champion, Parno believes that companies with solid foundations are moving to lock in real estate at historically low rates in order to gain a foothold once the economy fully recovers. That said, he believes deals, as a whole, are not focused on growth, but rather on recovery and maintenance.

"Generally speaking, the industry as a whole is still not functioning well," he said. "We have yet to see any recovery in terms of growth. There is deal activity, but it seems to be focused on replacement and/or downsizing activity and not deals that indicate an increase in demand."

Moreover, Parno noted, when combined with a drastically lower value for properties, debt proceeds from a low loan-to-value ratio leave developers with a huge gap of required equity capital—creating a premium demand for equity and thus rendering most deals unfeasible at today's lease rates.

Chris Wilson, president of Wilson Commercial Real Estate, added that historically low rents are actually causing worry amongst some retailers who feel pressured to act now. "There appears to be some concern among retailers that the best of days to lease space are here and fleeting," he said. "And, as the economy continues to improve, an opportunity may be lost."

Some Confident, Some Not

As a retail specialist, Wilson uses this sector as the prism through which he looks at the industry. He continues to see space leased to retailers who serve price-conscious consumers.

That said, he believes overall retail expansion is weak and generally limited to promotionally price-driven retailers—for now. "Retailers have been reducing inventories and general overhead to regain profitability, and we see this trend continuing for at least another six to nine months," he said.

Jones Lang LaSalle research manager Paul Leonard said the industry remains in a tenant-favorable environment, with only a few examples of large leases and significant expansions over the last months, as opposed to a somewhat less cheery picture for total leasing volume as a whole. With leasing at historical lows, he said, the first quarter of 2010 lacked a large amount of mid-sized leases between 15,000 square feet and 40,000 square feet.

"Conditions certainly appear as though they're headed toward a much more neutral environment by this time next year," he said. "With that in mind, some tenants have determined that now is the time to lock in favorable rates before the market turns."

Shadow Space

As Leonard noted, before considering expansion, companies must first look to fill unused space not currently on the market, also known as shadow space. Until the job recovery gets on solid footing, this is unlikely to happen. However, he also believes that some tenants, encouraged by signs of recovery, may hold onto excess space in anticipation of future growth.

While acknowledging that shadow space is an issue with which the industry will grapple for years to come, Parno takes a slightly sanguine approach to the topic.

"We would stop short of calling it a 'plague'," he said. "(It's) more like an illness that will run its course." CPE