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Watch the Sublease Pendulum Swing

By Len Kanarek

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Since 2007, the drop in New York City office rents has been precipitous. Currently, leases can be negotiated for net effective rents that are 50% or less than the same space commanded two years ago. Is this the time for tenants who are either looking to expand, upgrade to a better building, or prospective new entrants to the New York market, to make a decision?

It is no secret that the driver of the current inventory of office space is the contraction or demise of large financial firms occupying big blocks of space. This impact has been magnified by the corresponding impact on the professional firms servicing the financial community. Many observers feel that Wall Street may never return to its sheer size and prominence in the New York market. Is this the time for prospective tenants to act, or are they better served by waiting as there is no consensus the market has bottomed? The answer is not clear, and is subject to change quickly depending upon the specific sub-market.

Some owners are responding to market pricing, trying to keep occupancy as high as possible. They are offering rents, free rent, TI allowances and other terms to compete for the limited number of prospective tenants. In addition to owners competing for strategic reasons, those with heavy leverage are forced to generate as much current NOI as possible. Alternatively, some owners, particularly those with properties held for an extended period with moderate leverage are being circumspect. They are reluctant to sign long term leases under current conditions, preferring not to compete on price, or limiting competitive pricing to shorter deals.

Currently, one of the key drivers of pricing in the office market is the availability of sublease space. The inventory of sublease space is significant by both historical and absolute standards. It is not just the amount of sublease space impacting market rents. Much of the sublease space is being offered by large financial institutions. Rather than looking to minimize their loss on a sublease as the primary objective, many sublessors are focusing on a quick deal and are very price competitive, with a ripple effect through the market for both direct and sublease space. This is especially true for financial institutions with impaired balance sheets that do not want to carry vacant or underutilized space.

The complexity continues. Recently, two large blocks of sublease space being offered by large financial institutions were withdrawn from the market, and owners of competitive space have taken note. Brokers tell me that asking and effective rents are changing frequently, in response to ever changing conditions within submarkets. The sublease market is certainly not a static market.

What's the best strategy for a prospective tenant seeking an attractive deal? We all know the old adage that you can't time the stock market. The same holds true for the real estate markets. If a couple of large blocks of sublease space are rented or otherwise taken off the market, the pricing of competitive space in the submarket will likely react. It may not change rents but could impact concessions, and it all comes down to dollars.

Those seeking space are well served by engaging a knowledgeable and experienced advisor or broker, and looking for space that best suits their needs at attractive pricing. Getting the right space is just as important as getting the right price, if not more so. What value is there in a great deal on space that does not fully meet tenant needs?

Once space needs are precisely identified, shop for an attractive deal. Also, don't ignore the issue of the quality of ownership, those with a reputation for flexibility, service and dealing fairly with tenants. It makes a difference. Once you sign a lease, stop focusing on market rents and concentrate on moving into the new space and using the space effectively to run your business.

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