

Metro office vacancy rate hits new high

The stagnant job picture continues to weigh on the rental market for office space, pushing up the vacancy rate to a new high of 17.7 percent in the second quarter, according to the latest Office Trends Report by Grubb & Ellis New Mexico.

"Any chances for even a small rebound appear to be slight at best," the report says.

More than a half million square feet of office space has gone empty in the Albuquerque metro area since the second quarter of 2009, when the office vacancy rate was 14.1 percent. The vacancy rate set a recent record of 17.1 percent in the first quarter of this year, surpassing the previous high of 17 percent reached in the first quarter of 2004.

Now, at a 17.7 percent vacancy rate, the local office market is as depressed as it was after the savings and loan bust of the late 1980s and early 1990s.

"It's definitely the highest vacancy level in the last 20 years," said Ken Schaefer, who puts together the Office Market Trends report at Grubb & Ellis.

Albuquerque's office market is doing a little better than the nation as a whole. The average office vacancy rate was 18 percent across the country in the second quarter, equal to previous highs set in the fourth quarter of 1990 and the third quarter of 1991, according to Grubb & Ellis.

While overbuilding was a major part of the problem in the early 1990s, the issue today is almost entirely the sluggish economy and bearish employment.

"Jobs are what drive office occupancy," said Terri Dettweiler of CB Richard Ellis. "We have done nothing to create jobs in the financial sector and the services sector."

Albuquerque's unemployment rate was 8.8 percent in May, down from the high of 9.2 percent in March but well above the 7 percent jobless rate in May 2009, according to the latest state labor statistics. For comparison, the unemployment rate was 8.4 percent statewide and 9.7 percent nationwide in May of this year.



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Pima Medical Institute's expansion from 25,000 square feet in Uptown to the 44,000-square-foot former Circuit City building at 4400 Cutler NE, shown here, was the biggest move in the office market during the second quarter.

Commercial Real Estate



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The professional and business services job sector, which is the biggest private sector user of office space, has lost 700 jobs or 1.2 percent of its total since May 2009. One of the drivers of the local economy, the services sector saw job growth of 3.6 percent in 2006 and 2.1 percent in 2007.

The financial activities job sector has lost 900 jobs, or nearly 5 percent of its total, since the mortgage meltdown of mid 2007. Albuquerque has not escaped the massive contraction in the overall banking industry that continues today.

Government impact

The erosion of jobs inevitably plays out in the office market, but it could be worse. The large government presence in the metro — 20 percent of the work force is in direct government jobs — provides some stability to the local economy, noted Barbara Morgan of Metro Commercial Realty.

Through its extensive use of contractors, government has an indirect impact on the office market as well. For example, the airport area had one of the lowest office vacancy rates of any submarket in the second quarter because of its proximity to Kirtland Air Force Base and Sandia National Laboratories.

"It's the area of choice for a lot of defense contractors," Dettweiler said. "It's a decent quality submarket and convenient to the base and airport."

The metro's fourth largest submarket for office space, the airport area's vacancy rate of 11.6 percent was more than offset by rates of 18.8 percent in the Downtown submarket and 18.7 percent in the Uptown submarket. The vacancy rate was 17.1 percent in the metro's biggest submarket for office space, the North I-25 corridor, which straddles Interstate 25 north of the Big I.

The biggest single vacancy to pop up in the second quarter was Pima Medical Institute's relocation from 25,000 square feet in Uptown to the 44,000-square-foot former Circuit City building at the Pavilions at San Mateo shopping center, according to Schaefer. The move created a hole in the office market, while filling one in the retail

market.

The office market is going to take another hit with the announced plan by Ohio-based Convergys Corp. to close its 60,000-square-foot call center at 6301 Jefferson NE. Grubb & Ellis has not yet included the Convergys building in its inventory of vacant space.

A renter's market

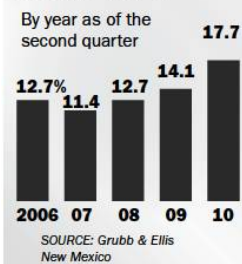
Albuquerque's office market typically has a double-digit vacancy rate, most often in the 11-13 percent range. The previous high of 17 percent in 2004 resulted primarily from the exodus of federal agencies from leased offices in Downtown to build-to-suit buildings in the North I-25 corridor.

The climb toward an 18 percent vacancy rate has changed the supply-and-demand equation. With 2.4 million square feet of empty office space in the metro, "For Lease" signs are everywhere and it's clearly a renter's market.

"One thing that has happened is some tenants think there's so much vacancy, they can come in and make unreasonable offers," Morgan said. "Most landlords try to get their asking rates, but there's so many variables. They're trying to work with tenants."

Inevitably, asking lease

OFFICE SPACE VACANCY RATES IN THE ALBUQUERQUE METRO AREA



ERIC CHAMBERLAIN/JOURNAL

rates have begun to slide.

Since peaking at about \$18 a square foot in mid-2009, the average asking lease rate for Class B office space dropped by 2.8 percent to \$17.53 a square foot in the second quarter — almost to the penny what it was two years earlier in the second quarter of 2008. Class B space makes up two-thirds of Albuquerque's office market.

"The strategies here are not any different than in any other market," said Scott Throckmorton of Argus Investment Realty. "You either drop your rate or throw some free rent into the deal. Some (landlords) do both. It's the art of the deal."

Despite incentives like reduced rates and free rent, there's not a lot of deals going down in the office market, he said. The trend is for companies to adopt a wait-and-see attitude regarding what happens in the economy, in the upcoming state elections and at the federal level with changes in tax policy and other regulations, he said.

In a weekly bulletin from Grubb & Ellis earlier this month, Pete Bolton of the company's Phoenix office recalled the three-year jobless recovery that followed the recession in 2001.

"Corporations were sitting on their wallets, and when they finally broke loose, we had a fabulous run in commercial real estate," Bolton said. "Please know that this is going to happen again."

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