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Office vacancies stuck in doldrums

■ *Fresh challenges threaten to forestall real estate recovery*

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BY RICHARD METCALF
Journal Staff Writer

The office real estate market continued to drag along what appears to be the bottom from July through September in the Albuquerque metro area.

The vacancy rate edged up from 18 percent in the second quarter to 18.3 percent in the third quarter, according to the latest Office Trends Report from Grubb & Ellis New Mexico. The office vacancy rate was 18.1 percent in the third quarter of 2010.

Double-digit vacancy rates are the norm, even in the best of economic times. As a rule of thumb, Grubb & Ellis says a balanced office market will have a vacancy rate between 12-14 percent.

The office market isn't dormant, although the trend continues to be that most of the

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activity comes from small companies looking for less than 3,000 square feet of space, the Grubb & Ellis report says.

"Look at the type of tenants who are active — small companies with 2-10 employees — you can see why it's hard to reduce the vacancy rate," said Ken Schaefer, research manager at Grubb & Ellis.

The motivation behind the activity is primarily to move to better space at a better location, rather than to expand, commercial real estate brokers say. Another major motivation is to take advantage of low asking lease rates, which are running at 2 percent below a year ago, the report says.

"Tenants are becoming very creative at minimizing rent expense," it says. Strategies include renting an office "as is," without the cost of tenant improvements, and looking at industrial or retail buildings as alternatives for deals.

Despite the office vacancy rate hovering at around 18 percent, small companies shopping for a specific square footage in a specific submarket aren't guaranteed a broad spectrum of options, noted Anne Apicella of Grubb & Ellis.

"There's not huge choices," she said. "It's a different view of the market."

National rates dropping

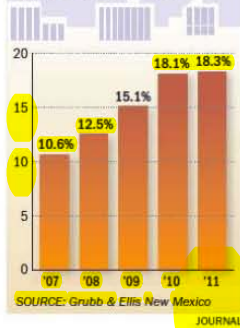
The third-quarter increase in Albuquerque's office vacancy rate bucked a national trend. The average vacancy rate dropped across the country from 17.3 percent in the second quarter to 17 percent in the third quarter, according to Grubb & Ellis.

Albuquerque's office market had held up comparatively well during the national recession of 2007-09, but it wasn't to last. The local office vacancy rate surpassed the national average in the third quarter of 2010 when it reached 18.1 percent compared to 17.9 percent nationwide.

Although the gap widened in the four quarters that followed, Albuquerque's office vacancy rate isn't relatively bad. Based on third-quarter reports

OFFICE VACANCY RATES

as of 3rd quarter for the Albuquerque metro area



available on Grubb & Ellis' corporate website, the local rate of 18.3 percent compares with:

- 27 percent in Phoenix.
- 26.8 percent in Detroit.
- 23.4 percent in Las Vegas, Nev.
- 22.9 percent in Atlanta.
- 14.3 percent in Boston.
- 9.2 percent in Manhattan.

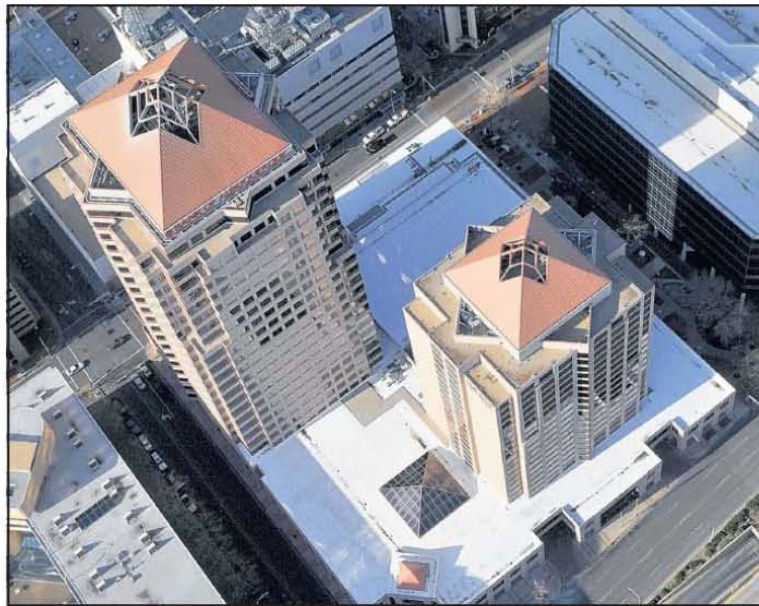
"Albuquerque's office market could be worse without the stabilizing influence of our large public sector," said Barbara Haase of Cauwels & Stuve Realty and Development. "Plus we did not experience the extreme residential meltdown of Phoenix and Las Vegas that rippled through their entire economies."

All about jobs

Close to 1.2 million square feet of office space has gone vacant in the metro since the vacancy rate was 10.6 percent in third quarter of 2007, when the local economy was functioning near its peak.

The metro's unemployment rate was 3.9 percent back then, compared to about 7 percent in the third quarter this year. But the local labor force has shrunk by 7.4 percent or close to 30,000 jobs over that four-year period, giving credence to speculation that unemployment is actually at a double-digit rate.

The office real estate market is considered a lagging indicator of where the local economy is headed. Since it takes people to fill empty offices, the market will only begin to recover after companies begin hiring again, said Terri Dettweiler



The office vacancy rate in Downtown, shown in this aerial view, stand at 21.1 percent.



The airport area, the metro's fourth-largest office submarket, posted an 11.8 percent vacancy rate in the third quarter.

buildings for the U.S. Forest Service at Journal Center and Bureau of Immigration and Customs Enforcement at Mesa del Sol.

Submarkets share the pain

The weakness in the metro's office market is widespread.

The North I-25 corridor, which straddles Interstate 25 north of the Big I, and Downtown have comparable vacancy rates of 19.7 percent and 21.1 percent respectively. Such a scenario would've seemed improbable for the metro's two largest submarkets for office space four years earlier, when the North I-25's vacancy rate was 7.8 percent and Downtown's rate was 18.7 percent.

The vacancy rate for the Uptown submarket, third largest in the metro, was 19.6 percent in the third quarter, up from 9.5 percent four years earlier.

The airport area, the metro's fourth largest office submarket, broke the metrowide pattern with an 11.8 percent vacancy rate in the third quarter, up only modestly from 9.4 percent four years earlier.

of CB Richard Ellis.

"The bottom line is jobs and job growth," she said.

Demand for office space continues to evolve with the emphasis on efficient use and reduced overhead costs, Dettweiler said. In the past, the evolution played out with portable cubicles replacing individual offices and the disappearance of storage rooms filled with file cabinets.

Now, the work-at-home movement could prove to be a headwind for a recovery of the office market, she said.

"It's Citicorp vacating 133,000 square feet of office space to send their employees home to work," she said. "Increasingly people are able to accomplish their jobs without having to be physically in their office."

Citicorp closed its call center in Albuquerque

earlier this year as a cost-saving measure, giving its 650 local employees the option of working out of their homes. Ultimately, the company said about 450 employees accepted the option. Other companies have similar work-at-home programs.

Another potential headwind is the trend of governments reducing the amount of leased space that they have in the office market, Dettweiler said. The percentage of lease deals involving government agencies was down significantly in 2010 at CB Richard Ellis, she said.

At the federal level, the trend has been to move agencies from leased space in the office market to new government buildings built by private developers. Examples include new