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The Albuquerque metro commercial real estate market showed some signs of life in the second quarter as small businesses chipped away at the nearly 2.5 million square feet of empty office space recorded early in the year.

The vacancy rate for rentable office space dipped in the Albuquerque metro area from its recent high of 18.3 percent in the first quarter to 18 percent in the second, according to the latest Office Trends Report from Grubb & Ellis New Mexico.

The decline, which translates to a net gain of 32,254 square feet of occupied space, was achieved through deals involving primarily local companies leasing a few thousand square feet at a time.

“Cumulatively, this higher volume of smaller deals is not having a dramatic effect on reducing vacancy but it could be a harbinger of recovery,” the report says.

In the second quarter, 35 office properties had vacant space fill up compared to just 20 properties a year earlier, said Ken Schaefer, Grubb & Ellis New Mexico’s research manager. Conversely, 20 properties saw space go empty in the second quarter, the same number as a year earlier, he said.

The uptick in leasing activity is likely the result of bargain hunting by companies that had leases expiring on their previous space, he said. After a

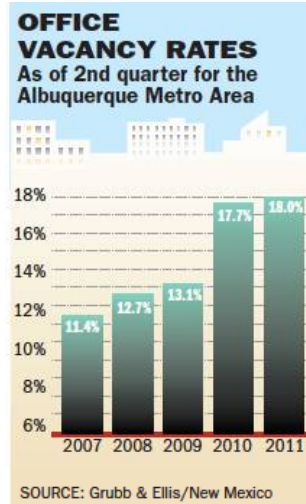


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The North I-25 corridor, seen here from atop the Mountain States Insurance building at Journal Center, has seen office vacancies almost triple since the third quarter of 2007.

CHIPPING AWAY AT VACANCIES

Metro commercial real estate market shows slight signs of life in 2nd quarter



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'Harbinger of recovery' in vacancies?

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three-year trend of rising vacancies due to the recession, the office market has skewed in favor of the renter.

The fact that small grass-roots companies are generating the activity is no surprise, said Debbie Harms, who has nearly 30 years of experience in commercial real estate and is now with NAI Maestas & Ward.

"As long as I've been doing this type of work, when we have a recession things tend to fall off a cliff," she said. "When we come back, it's the little businesses who lead the way."

The Office Trends Report does not capture all the small lease deals since it only tracks buildings with 10,000 square feet or more of space, noted Anne Apicella of Grubb & Ellis. Many small businesses gravitate to buildings that are off the grid because they have less than 10,000 square feet, she said.

"There's more activity out there than shows up in our report," she said.

Still facing headwinds

Although a possible "harbinger of recovery," the uptick in activity in the second quarter could quickly evaporate because of continued headwinds in the economy.

"It's not a trend yet," said Tim With of Grubb & Ellis.

The unemployment rate has dropped dramatically in the metro, from 8.7 percent in May 2010 to 7.3 percent in May of this year, but the drop has been largely attributed to jobless workers losing their unemployment benefits and, as a result, dropping out of the labor force.

The Albuquerque metro's labor force has shrunk to its lowest level since 2003, according to state labor statistics.

"That's why the drop in unemployment hasn't correlated into a rise in occupancy," With said.

One silver lining in the employment picture's dark cloud is a modest gain of 100 jobs during May in the professional and business



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The office submarket next to the airport has defied the local trend of increasing vacancies by tightening up over the past year.

services job category, which has traditionally been the largest private sector user of office space. The category had been losing jobs since October 2008.

Another headwind for the economy is the flagging morale of consumers, whose spending drives roughly two-thirds of the national economy.

The Index of Consumer Expectations dipped slightly in June to 64.8 percent, which is halfway between the peak of 87.6 in January 2007 and the trough of 49.2 percent in June 2008, according to monthly surveys of consumers nationwide by Thomson Reuters and the University of Michigan.

The index has held fairly flat for the past two years. In the most recent June survey, consumers were less worried about price increases than they were worried about income declines. The majority didn't expect their incomes to increase over the coming year.

"Resurgent spending is not on the horizon," said Richard Curtin, chief economist for the surveys, in a prepared statement. "Importantly, the consumer no longer has the financial wherewithal to power the economy into overdrive."

Lease rates down

Albuquerque's vacancy rate for office space used to

compare favorably with the national average, but that trend has reversed.

In the second quarter of 2010, the local rate was 17.7 percent compared to 18 percent nationwide, according to Grubb & Ellis. By the second quarter of this year, the local rate was 18 percent while the nationwide rate had dropped to 17.3 percent.

A vacancy rate of 12 percent to 14 percent is generally considered a balanced office market.

The average asking lease rate in the metro for Class B office space was \$17.07 a square foot in the second quarter, a nearly 3 percent drop from a year earlier and about where it was in 2007. Class B space accounts for two-thirds of the 13.6 million square feet of office space tracked by Grubb & Ellis.

For comparison, the average asking lease rate nationwide for Class B office space was \$22.91 a square foot in the second quarter. The national average is weighted heavily by huge, high-rent office hubs like New York City, Chicago, San Francisco and other major cities.

"Dallas has more vacant space than we have in our entire inventory," said Terri Dettweiler of CB Richard Ellis.

Asking lease rates are just that — asking. Dettweiler estimates the typical contract lease rate is about

10 percent below the asking rate. The discount is usually in the form of free rent as a concession by a landlord to lure a tenant.

"A month's free rent is 1/12 (8.3 percent) off one year's lease rate," she said.

The average asking rates tracked by Grubb & Ellis are for full-service leases where the landlord pays all costs to operate a building, including utility bills and even janitorial service, up to a pre-agreed limit.

North I-25 hit hard

The North I-25 corridor, which overtook Downtown in mid-2005 as the metro's biggest submarket for office space, has been hit hard by the recession.

Straddling Interstate 25 north of the Big I, the corridor outperformed the office market as a whole with single-digit vacancy rates through the mid 2000s. When the market as a whole hit its most recent low of a 10.6 percent vacancy rate in the third quarter of 2007, the North I-25 corridor's rate was 7.8 percent.

Since then, just over 400,000 square feet of office space has gone empty in the corridor, pushing the submarket's vacancy rate up to 19.6 percent.

The North I-25 corridor's problems include the downsizing or closing of the local operations of national companies, which tended to cluster there during good

economic times. Much of the available space is in big chunks that currently are not in demand and don't subdivide economically, brokers said.

"It's still the location of choice for probably 85 percent of the companies out there," Dettweiler said, calling the submarket's current high vacancy rate "a temporary aberration."

Downtown's vacancy rate was 21.3 percent in the second quarter, up from 18.8 percent a year earlier but within the submarket's typical range. Downtown almost always carries a higher vacancy rate than the office market as a whole, which runs counter to the national trend of lower vacancy rates in central business districts.

The airport area, which is the metro's fourth largest submarket for office space, has defied the tough times in commercial real estate by posting a decrease in office vacancy rate from 11.6 percent in the second quarter of 2010 to 10.9 percent this year.

The submarket is popular with government contractors because of its proximity to Kirtland Air Force Base and Albuquerque International Sunport. In addition, its average asking lease rate was \$13.46 a square foot, which is 21 percent lower than the metro-wide average.