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Vacancies have commercial landlords sweetening incentives

Tenants can negotiate better concessions in down market.

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When medical device maker Vidacare Corp. started planning its expansion last year, the company found itself in a strong bargaining position in a real estate market filled with vacant leasing space.

Vidacare had its pick of several prime locations, said President and CEO Phil Faris, and was able to hold out for extra incentives.

"At the time the terms were basically the same for most of the parties," Faris said. "There were a couple that offered slightly better concessions."

He wouldn't offer specifics, but Faris said the company was won over by a 17,000-square-foot lease in an office complex on Lockhill Selma Road that included free rent and an allowance to build out the facilities.

Real estate professionals say that as long as large amounts of office space in San Antonio remain vacant, landlords will be forced to offer concessions similar to those offered to Vidacare.

"It's a cost of doing business in a down cycle," said J.J. Williams, vice president of commercial real estate firm Grubb & Ellis Co.'s office division.

Vidacare moved into the 233,000-square-foot complex at 4350 Lockhill Selma in November. Construction on the complex finished last fall, bringing it online on the heels of a glut of office space hitting the market. In 2008, 1.2 million square feet of office space came online in the northwest submarket alone,

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just as commercial real estate markets that peaked in 2006 and 2007 started to slump, Wil-

liams said.

The result is that vacancy rates have climbed to 18 percent, swinging the market strongly in favor of tenants. A balanced market has vacancy rates of about 12 percent to 14 percent, Williams said. With vacancy rates as high as they are now, rents are slipping. Asking rents fell 24 cents in the last half of 2009 to \$21.43 per square foot per year, according to numbers from Grubb & Ellis. As landlords compete to retain tenants and woo new ones, they're forced to differentiate themselves, Williams said. "If landlords want to be competitive, they have to offer incentives," he said.

That means making concessions, generally in the form of free rent — two to four months of free rent is standard for a five- to 10-year lease — and tenant improvement allowances, often for new paint and carpeting.

"Landlords are paying sometimes \$40, \$45 per square foot for the right credit tenant to move into their building, especially the large users," he said. "But that said, there are incentives available to every tenant."

The type and scope of concessions depend on the tenant and the landlord, Williams said.

Other incentives include landlords paying

about \$1 per square foot to defray moving costs.

"If a landlord has deep pockets or is financially stable, the concessions will be on a high level," he said.

Landlords who don't have the cash on hand to offer tenant improvement or moving allowances will try different tactics, Williams said, like negotiating for a tenant to pay for improvements and compensating with free rent.

Houston-based The Richland Cos., which specializes in acquisition and management of commercial real estate and owns eight properties in San Antonio, has over the last six months tried to offer unique incentives specific to each tenant, said CEO and President Edna Meyer-Nelson.

"If you can put that cherry on top of that cupcake, and someone else didn't put that cherry on there, then you're going to get that business," Meyer-Nelson said.

Richland offers cherries that are standard, such as seasonal leases that allow tenants to pay most of their rent during peak earning periods, and not-so-standard, such as supplying a conference table for a tenant that wanted help furnishing a new space.

Tenants won't be in the driver's seat forever, Williams said. Leasing

activity has picked up in recent months, and vacancy rates will improve in the second half of 2010, making the market less favorable for tenants.

Meyer-Nelson agreed, saying the market goes in cycles that sometimes favor tenants and

sometimes favor landlords.

"We just have to follow that cycle," Meyer-Nelson said. "Because it will come back around and it will be the landlords and owners who will say, 'This is what we're going to do' to the tenants."