

Date: Oct 15, 2012; Section: Business Outlook; Page: 2

Metro's office vacancy rate continues its upward climb

By Richard Metcalf

Journal Staff Writer

If the office market is a reflection of the Albuquerque metro area's service-oriented economy, then things are looking rather wan and pale.

The vacancy rate has been stuck at 18 percent or higher for three years running with no end in sight. After a three-year slide, the average asking lease rate appears to have bottomed out at the level of mid-2007. Office construction is at a standstill.

Office real estate — and commercial real estate in general — tends to absorb the front end of recessions pretty well and then lag behind any recovery.

Most office activity is based on leases, which are binding contracts to occupy a certain amount of square footage until an expiration date, said Scott Throckmorton of Argus Investment Realty.

"Unless they declare bankruptcy or have a compliant or desperate landlord, businesses can't downsize, move or terminate until that expiration date," he said.

During the pre-recession boom years, office leases were typically for five-year terms, although many were also for three years or seven years. Now that five year leases signed in 2007 are expiring, downsized businesses are shrinking their real estate footprint by leasing smaller spaces, he said.

The upshot is that the metro's office vacancy rate climbed to 18.9 percent in the third quarter, up from 18.8 percent in the preceding quarter and 18.3 percent in the third quarter of 2011, according to the latest Office Trends Report from Grubb & Ellis New Mexico.

"The high vacancy rate illustrates the erosion in small business due to the recession," said Debbie Harms of NAI Maestas & Ward Commercial Real Estate Services.

The office market figures prominently in the local economy because 90 percent of the jobs in the metro are classified as either providing a service in the private sector or working directly for government. An estimated one out of every four of the private sector jobs are housed in offices.

"You can look up a labor report and see how well the office market is doing," said Terri Dettweiler of CBRE, a commercial real estate services company.

The biggest private-sector user of office space is the employment classification called professional and business services, which has been shedding jobs for most of the past two-and-a-half years.

"Of the 3,300 jobs lost in the metro over the 12 months ending with August, 1,500 were lost in professional and business services," said Ken Schaefer of Grubb & Ellis, citing state labor statistics.

Virtually all observers attribute the recent job losses to government contractors, which are included in professional and business services.

"We have government contractors bidding on contracts that are cancelled because there's no money to fund them," Dettweiler said. "Talk to just about any contractor, most will tell you that they have scaled back considerably."

Another scenario is government agencies pulling work in-house that formerly was put out to bid, said Tim With of Grubb & Ellis.

On top of shrinking government contractors, direct government employment has also decreased from 22.4 percent of the metro's work force in August 2010 to 21.3 percent in August 2012, or the equivalent of about 2,400 jobs. It should be noted that the federal jobs number in 2010 was inflated by temporary census hiring.

Government downsizing has played out in the office market. Local, state and federal agencies accounted for

two-thirds of the office space that went empty in the metro during the third quarter, Schaefer said.

The potential for automatic cuts in federal spending in January, known as sequestration, could cost New Mexico an estimated 20,000 jobs, many of which would be in the private sector with government contractors.

“It’s much farther reaching than government jobs,” With said. “It’s a huge fallout.”

While Albuquerque’s office market appears stuck in a slump, office real estate fundamentals are, on average, improving nationwide.

Sales of office properties are up 7 percent year-todate over 2011 and the dollar volume of loans for office properties is up 15 percent, according to the Mortgage Bankers Association’s most recent DataBook for the second quarter. The average vacancy rate has fallen from 17.5 percent in 2011 to 17.2 percent this year.

The nationwide improvement is very uneven, however, and large metros like Boston, Houston, New York City and San Francisco are leading the way toward improvement. For a third-tier or small metro, Albuquerque’s office market doesn’t look that bad.

“My real estate friends in neighboring Texas, Arizona and Colorado are telling me that they are very busy but only in certain sectors — energy, technology and health care,” Throckmorton said. “They’re in markets that are huge compared to us.”

Huge metros tended to take huge dives in officemarket fundamentals during the recession, which ended in June 2009, and its lingering hangover. Their real estate cycles are more extreme than Albuquerque’s, he said.

“Typically our recoveries have lagged and have been very subdued,” he said.

Ultimately, Albuquerque’s office market is “a tale of two cities,” Throckmorton said, expressing a view held by many others.

On the upside, he said office buildings with high occupancy tend to have one or more of the following characteristics: financially strong ownership, attentive property management, good location and up-to-date functionality.

Surprisingly, a recent Grubb & Ellis study shows the age of an office building in Albuquerque does not appear to be a decisive factor in occupancy levels under current market conditions.

On the downside, office buildings that lack the characteristics listed by Throckmorton are at a distinct disadvantage. For example, there are plenty of large office buildings and even entire office parks that have either no dedicated Internet access or antiquated access, Harms said.

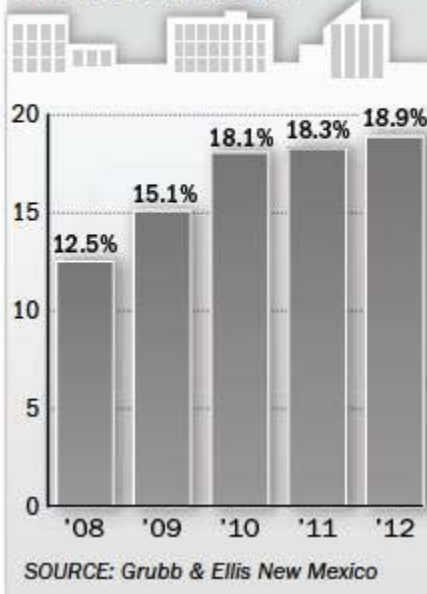


JOURNAL FILE

The North I-25 office submarket in the area around the Journal Center has a comparatively deep inventory of new buildings that likely will make it the harbinger of an economic turnaround.

OFFICE VACANCY RATE

as of 2nd quarter for the
Albuquerque metro area



JOURNAL