

Swisher's annual report shows flat office market; 14.6% vacancy

BY PAULA GARDNER

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The local office market starts 2007 with data that shows significant vacancy increases, according to an annual survey by Swisher Commercial, but the stories behind that jump tell of little change over the previous year.

New construction coming online and one large office shifting back from to direct-lease are driving much of the vacancy increase in Washtenaw County.

That leaves the rest of the office market flat, following a year that saw what brokers describe as "eerie silence" during summer months followed by hype over the downtown Ann Arbor Google deals in the fall.

The overall vacancy rate for the area was 14.69 percent at year-end, up 2.07 percent from late 2005, according to Swisher. The report is the most detailed available in the Ann Arbor market, since the brokerage surveys third-party space for lease in buildings of 3,000 square feet or more.

What the numbers don't show is how the pace of 2006 was dramatically different from previous years.

As a result, many brokers are saying that the flat year can be viewed as a victory over the market forces that threatened much of southeast Michigan.

"Brokers get accustomed to a certain rhythm and a certain cadence of inquiries and phone calls and showings," said Bart Wise, vice president at Swisher. "It ebbs and flows. But for a good part of 2006, you had brokers feeling it was eerily quiet. It was slow and people were not even motivated to go out and look at space."

That changed some in the fall, and by the end of the year some deals were headed towards closings.

But the pace remains slow and the process is more time-consuming than in years past, Wise said. Deals are still falling apart.

And tenants are approaching deals with more caution, he added.

"There are a lot of tenants renting with shorter leases," Wise said. Flexibility in lease duration and options to expand are all increasingly in play

during negotiations, brokers said.

Prices remain competitive, though much of the less-expensive space on the market has been absorbed and landlords have resisted price concessions that affect base rental rates. Many report giving increased terms of free rent or more tenant improvement dollars to sweeten a deal, since the amount of space available has prompted many tenants to broaden searches to multiple sites.

DOWNTOWN

The Google deals - first, a temporary office on Main Street and later a four-year deal for 80,000 square feet in McKinley Towne Centre - inspired the region, some brokers said.

"I think people were ready for some good news," said Ron Dankert of Swisher. "There had been such a never-ending flow of negative stuff, especially out of Detroit."

The benefits for downtown drawing that size of a tenant are significant, brokers said. The vacancy rate downtown is 15.67 percent, according to Swisher, representing 263,000 square feet of vacancy in a 1.68 million square-foot market.

The vacancy rate numbers shows the daytime capacity downtown that goes unfilled. By applying an industry-average of 100 square feet needed for each employee, downtown could accommodate 2,630 more workers.

In comparison, the downtown vacancy rate at year-end 2002 had climbed to 7.6 percent in a market with 1.4 million square feet - leaving about 111,000 square feet available, or capacity for 1,110 workers.

The district gained some space, including 60,000 square feet in Liberty Square - formerly Tally Hall - that had been listed as leased, but had not been occupied for several years. New space coming into the mix includes McKinley Towne Centre and The Collegian.

But at the same time, many retailers and restaurateurs reported lower revenue in 2006 and some closed, prompting more churn among retail storefronts than the district had seen in the past decade.

The vacancy rates for office and flex space by districts:

Downtown	15.67 percent	▲ 3.18
North	17.29 percent	▲ 10.33
East	12.46 percent	▼ 0.05
Clark/Golfside	2.16 percent	▼ 6.35
South	15.56 percent	▼ 0.56
West	7.01 percent	▼ 0.29
TOTAL:	14.69 percent	▲ 2.07

Source: Swisher Commercial

"You need office density for downtown to survive," said Jim Chaconas of McKinley Commercial Brokerage. "You have half the density than you used to."

Google is inspiring to the region, but not a strong enough magnet to bring a number of new tenants downtown, said Chris Grant of First Martin Corp.

Larger floorplates also can be an issue for some landlords downtown, since new tenants in the Central Business District - beyond Google - tend to be smaller.

"If you're downtown and you have large floorplates, you still have a challenge there if you can't break it up," said Newcombe Clark of Bluestone Realty Advisors.

And the area is likely to have to contend with still more tenants moving from downtown as parking issues heat up. Mike Giraud of Colliers International cited several who are exploring different areas.

"The issue in every case has been the scarcity of parking and the additional cost," Giraud said. "...It's definitely an issue, and it has to be overcome."

FORECAST

Economics will drive changes in the office market and so far brokers are seeing some expansion among existing companies, a few contractions and little interest from outside companies exploring entry to this market.

That, they said, could hinder absorption in 2007.

"Job growth is the key to new tenants," Grant said.

Clark said he's seen some new

tenants move into Burlington Office Center and some longer-term tenants in the area re-emerged with new offices, such as Charles Schwab and Liberty Mutual.

"I think that's a positive sign," Clark said. "Whether that's enough ... remains to be seen."

Clark represented the owners of a spec building that was completed at 760 W. Eisenhower in 2006. New tenants - such as Charles Schwab - moved in, and 9,000 square feet remain available.

New construction is attributed as the cause of the vacancy rate jumps, according to Swisher. That includes the 200,000-square-foot Earhart Corporate Center at Plymouth Road and US-23 and the 25,000 square foot building on Depot Street by First Martin.

New space headed onto the market in 2007 includes 120,000 square feet in South State Executive Park; the Dakota office building on West Stadium; a 34,000-square-foot building in Valley Ranch Business Park; and spec construction on South State Street by Kirco.

Few brokers would advise clients that the time is right to build on spec. Medical uses may find tenants, Chaconas said. That's one driver in the Clark Road vacancy improvements, where the district has only a 2 percent vacancy rate, or about 10,000 square feet in the area close to Saint Joseph Mercy Hospital.

But the timing has to be precise for spec construction to pay off, and the hallmarks of today's office market - with delayed decision-making - makes that a risky bet, many said.

"As long as the landlords are comfortable carrying the (spec buildings), the rest of the market hasn't been impacted," Wise said.

As far as the rest of the market, Wise said he projects that this year will show improvement over 2006.

"I'm seeing some encouraging signs right now," he said. "But I don't expect a ... big turnaround!"

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