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Single-Tenant Buildings: A Thing of the Past?

By Michelle Napoli

GREENWICH, CT—Will the economic slowdown and tight corporate budget environment lead to fewer companies using entire buildings acting as their sole tenant? While there isn't any indication such a trend will have a widespread impact on the traditional net lease property market, it may result in an increase in repositioning opportunities with what were once single-tenant buildings but are heading for partial or full vacancy.

Those are the kinds of opportunities Greenwich, CT-based Hanover Real Estate Partners is interested in, though managing partner Reed Miller concedes that it is hard to estimate just how much actually investing the company might do along these lines in 2010. "It could be hundreds of millions of equity, or we could keep our powder dry," says Miller. The company has a base of private high net worth and family office and trust investors as equity partners.

Still, he and fellow managing partner Kenneth Boyle think the current environment--in particular a trend for companies to downsize and reduce the space they occupy, as well as the less favorable economics for companies to develop their own buildings--could result in these kinds of opportunities. In particular, says Boyle, he sees a "resurgence of tenants who in the past might have looked at building their own corporate headquarters who are now either looking to buy buildings that they can reposition into their corporate headquarters or are looking to share space in existing buildings and accept more of a multi-tenanted environment."

Large space users that are the only occupant of their buildings are now looking at their budgets and at ways to reduce space and spending, and as a result some are newly willing to share a building with others, Boyle continues. But at the same time, those companies are not necessarily in the real estate ownership or redevelopment business. And that creates opportunities to restructure leases "and convert what was a single-tenant building into a multi-tenant building," he adds. "That creates opportunity for people to come in and take the risk of repositioning and lease-up and put in the money that's necessary to reposition the asset."

Hanover Real Estate Partners certainly has some experience in the area. Recent Hanover deals include a 60,000-square-foot office building and bank branch it acquired in San Antonio, TX. It has an older, larger lobby than a more contemporary bank branch would today, meaning it would have been difficult to re-lease to a bank today. But it did attract a culinary institute as a new tenant, converting the old bank branch space into a kitchen and restaurant space, and has successfully leased some of the upstairs office space, too. Another recent example is a 100,000-square-foot office building in Stockton, CA, that had previously been net leased to Wells Fargo; Stockton now has the building about 70% leased, despite the difficult market, including a large lease signed with a health club chain that is locating a health club facility as well as its corporate headquarters there.

In a slightly older but significantly larger deal, Hanover several years ago purchased the 1.1-million-square-foot Marathon Oil Tower in Houston. It was at the time a single-tenant building occupied by its namesake tenant, though Marathon Oil was subleasing some of its space. Hanover took it over, reduced Marathon's space, kept on most of its subtenants and went to work improving the building and leasing the remaining space.

Boyle and Miller say key to selecting properties for these kinds of value-add pursuits include assets that are well positioned in their markets and buildings that lend themselves to being easily converted from a single-tenant to a multi-tenant layout. "You need some vision, and think about what some of the alternative uses might be for a property and how it would convert over" to multi-tenant use, advises Boyle. "It can be a win-win all around," adds Miller.

According to the November US Capital Trends report from Real Capital Analytics, about 10% of single-asset sales this year have involved corporate/owner-occupied properties, a percentage it says is in line with prior years' activity. But what has been different in 2009 has been a shift in the kinds of corporate dispositions: according to RCA's data, standard long-term sale-leasebacks have accounted for 23% of corporate dispositions this year, down from 42% in 2007, while sales of vacant or surplus properties have increased, from 36% of corporate dispositions in 2007 to 55% this year. Partial and short-term sale-leasebacks, meanwhile, have held steady in the same time period, accounting for slightly more than 20% of corporate dispositions.