CPN

Economic Update - Sublease, Shadow Space Vex Office Owners

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Office landlords have a lot on their minds these days. As companies contract, demand for space drops, and landlords are being pressured to lower rents--which no one wants to do--or increase incentives for tenants to stay, which is only a little more palatable. Sublease space, which bothered office property owners in the early 2000s, has also returned.

So has shadow space. "Shadow space is definitely a reality that landlords will be forced to address in many major commercial real estate markets," Kenneth Boyle, managing partner at Greenwich, Conn.-based Hanover Real Estate Partners, told *CPN.* "Current vacancy rates across the country are, in many cases, significantly understated since they don't take into account vast amounts of unneeded space currently leased to tenants who have downsized their employee counts."

That space is just sitting there, waiting to cause trouble. "As tenants with excess space have their leases expire, landlords will be faced with a significant increase in available office space that, in many markets, is unlikely to get absorbed," Boyle said.

What to do about it? Boyle recommends that landlords be proactive. "Many tenants are reluctant to announce layoffs in advance, but it's important to approach tenants at the first signs of downsizing, or if a landlord notices an overabundance of vacant desks in a tenant’s space or even empty parking spaces," he said. "If addressed proactively, it may be worthwhile for a landlord to take back excess space in exchange for an extension of the lease term for the remaining space, or some other lease concessions.”

Once upon a time, Starbucks was the retail brand that could do no wrong. But the recession has spared few retailers significant market contractions. On Wednesday, the Seattle-based coffee giant reported net income of $25 million, or 3 cents a share for its 2Q09 (ended March 29), down from $108.7 million or 15 cents a share during the same quarter last year. Comp-store sales fell 8 percent companywide, and the company has decided to cut the number of new stores in 2009 even more than previously announced. In other words, demand for specialized coffee drinks has gone from *venti* to short.

Gross domestic product numbers in the United States are also a little short, experiencing a larger-than-expected first-quarter drop, according to the U.S. Department of Commerce. Even though there was a modest uptick in consumer spending in 1Q09 (2.2 percent), U.S. GDP fell at an annualized 6.1 percent in the first quarter--nearly the same as the 6.3 percent annualized decline in 4Q08.

There was good news for City Center, the $8.6 billion resort project under way in Las Vegas: its lenders, led by Bank of America, have agreed to see it through to completion. Presumably the lenders believe that someday people will start coming back to Vegas in something like pre-recessionary numbers, and they want City Center to be there to take their money. Co-owners Dubai World and MGM Mirage have also agreed to kiss and make up, or at least Dubai World is dropping its lawsuit against MGM Grand.

Wall Street took everything in stride on Wednesday, even the sour GDP report. The Dow Jones Industrial Average gained 168.78 points, or 2.11 percent, while the S&P 500 was up 2.16 percent and the Nasdaq saw a 2.28 percent rise.