



Fall/Winter 2002

## ***THE MILLER REPORT***

Failing and consolidating businesses continued to hemorrhage office space since the early part of 2002 and rents fell at their fastest rate since 1991. One of the most unusual aspects of the current office market downturn has been the sheer amount of sublet space pouring onto the market. According to Reis, Inc., a real estate research firm, what's most worrisome about the current figures is that sublease space represents 29% of the 498 million square feet of vacant space on the market nationally. Typically, sublease space is less than 10% of the total vacancy rate. The big numbers mean that tenants loaded up on far more space than they needed and must now compete with landlords for new tenants.

Despite this pressure on landlords, we are not predicting a repeat of the carnage the real estate industry witnessed in the early 1990s, when creditors seized hundreds of office buildings. Back then, the vacancy rate topped out at 19%, a level few expect the current market to reach. Also, properties are not as highly leveraged as they were then and interest rates are lower, giving landlords more lasting power. The concern is that sublease space which is usually marketed at a discount, will further drag down an already soft market. By and large, this is good news because if you are a tenant, you can probably, with the

help of the right broker, benefit from this downturn. However, this translates into more bad news for landlords. As the buildup of vacant space continues there is an increase in rent cuts to fill properties. Landlords typically are quicker to increase concessions than cut rents because buyers and lenders are more likely to use rents to calculate a building's value. The drop in effective rents (the income stream net of deal related expenses) is chipping away at the bottom line of property owners.

Does this imply that investors are buying properties at a bargain? The facts show that the converse is true. Thus far in 2002, thirteen trophy buildings have changed hands in Midtown Manhattan. The total volume of sales amounts to \$2.2 billion. This equates to \$423 per square foot, up significantly from last year's figure of \$273 per square foot.

### **A TENANT'S MARKET**

As tenant representatives we continue to advise clients to renegotiate leases early if there is a high probability of locking in more favorable economic terms and perhaps new concessions from their landlord. We are currently engaged in several lease renewal and restructure conversations that began two to four years prior to the clients' lease expirations. Restating an earlier point, many property owners, whether they are foreign or domestic pension funds, family-managed or

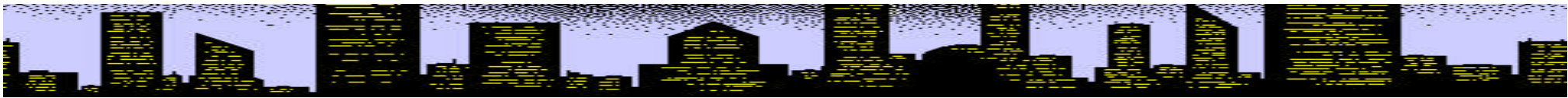
REITs, are very concerned about future cash flow. As a result of this nervousness, some tenants may "qualify" for a lower rental rate, cash allowances for upgrading the installation, a rent abatement and more lenient expansion and/or escape provisions.

Across the board, rents are down and landlord concessions are up. Twelve to eighteen months ago, tenants negotiating 10-year deals were looking at a concession package of 1-3 months of free rent and maybe \$25.00 per square foot in landlord work. Today, the free rent period is closer to 4-6 months and work allowances are in the \$40.00 per square foot range. Of course, some sub-landlords offer even more aggressive deal terms than conventional landlords.

Additionally, to further entice office tenants to consider moving to lower Manhattan, the city and federal government have offered economic incentives in the way of tax credits of \$4,800 per employee, grants of \$3500 per employee and Real Estate Tax Abatements of \$2.50 per square foot. The total concession package can amount to approximately \$11 per square foot.

### **THE RIGHT BROKER**

In New York City's commercial real estate market, the \$64,000 question that pops up each and every time a client has a space requirement is...



### “...Should I work with one broker or open it up to several?”

When assisting clients in the search for new space or the renegotiation of an existing lease, one of the techniques we employ is to create an environment where the landlords compete for our client's tenancy. When a tenant and broker work closely together, landlords and their agents understand that the tenant is being educated to the market and all space options are analyzed on an apples to apples basis. This works best in a high vacancy, concession-rich climate. This strategy almost always reduces costs, shortens negotiations, and results in more tenant-friendly lease agreements.

In addition, the broker who has a trusting, honest relationship with the client is much more likely to focus on the assignment in a professional manner. The exclusive broker has a greater incentive to give the assignment their time and attention. While the non-exclusive broker is busy seeing what “sticks against the wall,” the exclusive broker is listening to the client's requirements, presenting appropriate availabilities and acting as the client's advocate.

We at Miller & Partners pride ourselves on our high incidence of repeat business which is a direct reflection of the level of service we provide to our clients and our reputation as problem solvers. As most of you already

know, we strive to establish strong relationships with our clients and assist them beyond the signing of the lease agreement, over the course of many years and through various market cycles.

### **TECHNOLOGY AND COST CONTROL**

Corporate real estate executives are continuing to spend money on upgrading their firms' technology despite the downturn in the economy. In a study undertaken by the International Development Research Council (IDRC), the impetus to continue technology spending was to ultimately cut costs. According to Lawrence L. Edge, Executive Director of IDRC, “Some of the savings are not readily measurable within the corporate real estate department itself, but the impact of how corporate real estate is moneyed affects the entire organization.” Wells Fargo & Co. is one example of a company committed to their technology development. Last year the company invested in developing on-line systems, and this year, they are training their employees to use them. The bank employees will be able to access the system allowing them to deal with such issues as downsizing of office space, purchasing office furniture and payment of bills.

### **MORE ON SAVING MONEY**

? Lucent lost more of its luminescence as some cubicles in its Murray Hill, NJ headquarters were lit by just one fluorescent bulb rather than the usual four.

? During the summer the British Broadcasting Corp. considered a controversial ban on free biscuits at internal meetings, a move that would save over \$400,000 per year.

? Left idle during layoffs and a hiring freeze, the 30-strong corporate recruiting team at Corning transformed into the opposite of itself, an outplacement unit.

? The Swedish Navy announced that because of spending cutbacks, it would scale back its operations from around the clock to 9-to-5, Monday through Friday.

\*excerpted from *Fortune*, December 24, 2001.

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