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Why office space may take a long time to lease or sell

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by Eric Gold

Office properties can remain vacant or unsold for a number of reasons, especially in a slowly stabilizing market like this one. There is new construction and speculative space not yet occupied. There is sublease space and "shadow" space that's leased, but still vacant. There is economic fallout from the recession. There's inconsistent job growth. And then there's space that's just not properly priced to lease or sell.

In fact, there's an abundance of empty office space across all metro-area submarkets because it's being poorly marketed by owners, landlords, and the brokers who represent them.

This isn't something new or exclusive to metro Denver's office market. It's not even exclusive to the sale and leasing of commercial property. But it can be remedied rather quickly when so many other factors responsible for high vacancy or unsold property can't.

Granted, some tenants and buyers will overpay regardless of what the market dictates. That's always an option with the caveat that an overpriced property may appraise only for its true market value. In this case, the buyer may not be able to get a loan if the market value is significantly lower than the listed price.

Eric Gold

In general, when a property is priced more than 10 percent over what the buyer or tenant thinks it's worth, the landlord or seller may never see an offer.

This is subjective, of course, and there are no hard statistics to bear it out. But countless landlords and sellers overvalue their properties and risk lowered interest from buyers and tenants for periods of time that make the recovery of operating expenses very unlikely.

The average time an office space for lease remains vacant in metro Denver is 27 months, according to CoStar Group information services. Why would a landlord or seller increase the chances of even longer periods of vacancy by pricing their properties out of the market from the outset?

On the leasing side, an occupancy rate of 90 to 100 percent at $12.00 per square foot, for example, is much better than a rate of 50 to 60 percent at $15.00 per square foot. That's just simple math. Yet landlords will take the latter path only to later drop their lease rates, offer concessions, or both in order to get the space leased.

High prices delay sale while costs remain.

Similarly, sellers will put their buildings on the market at prices that simply don't support the vast majority of recently sold comparables. If a property is vacant or underperforming and sits idle for 600 days, will the seller ever recover the lost expenses? Operating costs can include insurance, janitorial services, property management, utilities, landscaping, and many others. Most of those expenses must be paid whether the building is occupied or not.

Like landlords, sellers in this type of situation must eventually drop their asking price, or face longer periods with unsold buildings and further lost revenue.

An additional hurdle in this case is a sort of desensitization that can set in as properties remain on the market for long periods of time. Prospects can eventually perceive a property as toxic, devoid of value, even if the price is reduced. That's an emotional reaction, of course, and may not be at all practical. But it does happen.

Tenants and buyers are faced with a vast array of choices when leasing or buying office space, especially in this type of favorable market. The process of elimination usually begins with broad strokes based primarily on price.

Any property listed above what a tenant or buyer is willing to spend simply will not reveal itself in the initial listing search. If the landlord or seller overprices the property to begin with, there's virtually no chance a prospect will ever see it on paper, let alone in person.

This is why the marketing plan is such a critical component that must be clearly spelled out in the listing agreement. Unfortunately, that doesn't always happen.

The listing broker will typically absorb some marketing costs, but not all. It depends on a host of variables, including the size of the deal, type of transaction, and of course, budget. The broker will pay for database search services, fliers, brochures and basic signage. "Extended" services are more robust—and expensive. They can include tenant/buyer broker events, print and digital advertising, and direct mailing, among others.

Problems can arise when landlords or sellers don't know exactly how their properties are going to be marketed and who will be paying for it.

This is rarely an issue with large, institutional clients, but it can be with small, private owners who may lack the experience in the leasing and selling of office properties. Regardless of size and scope of the marketing plan, it always comes down to price. Is the property appropriately priced or is it not?

Again, pricing is a subjective exercise often driven by perceived value. A broker may see something in any given property that a landlord or seller does not, and vice versa. The client has the last word, of course, which can frequently result in an overpriced property, regardless of any counsel a broker or other representative may offer.

Still, the market almost always dictates what the building or lease space is worth. And that boils down to what a ready, willing and able buyer or tenant will ultimately pay.

Eric J. Gold, president/owner of Sheldon-Gold Realty Inc. Commercial Real Estate Services in Denver,
Eric can be reached at 303-741-2500.