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Real Estate Business

Commercial real estate expects another tough year

Sunday, February 10, 2008

BY JAMES QUIRK

STAFF WRITER



Caution, uncertainty, downturn, "wait-and-see," market corrections.

Those are the words used most frequently by North Jersey's office real estate experts in defining where the region's commercial real estate markets are headed this year.

For everyone in the business, 2007 was a study in extremes. Early in the year, many North Jersey brokers were confident that soaring rental rates in Manhattan would prompt companies to relocate to New Jersey in droves, drawn by the availability of much cheaper, much newer Class A space. Some companies predicted 2007 could be the year North Jersey's office markets emerged from the doldrums that have defined it since 2002.

That didn't happen. Instead, the subprime mortgage meltdown, and the subsequent credit crunch, sent shockwaves throughout the nation's real estate markets.

Since North Jersey is closely tied to New York City -- the nation's most robust office real estate market -- the effects of the subprime crisis have been more subtle here than elsewhere. However, the largest commercial real estate companies in North Jersey agree 2008 will be a difficult year, and no one expects much growth.


"In 2008 and 2009 in the New Jersey office market, it will take a step backward," said Thomas Reilly, executive vice president of Jones Lang LaSalle's New Jersey operation. "We have been flat here for an extended period of time. We're seeing that our corporate clients, given the uncertainty in the economic environment, are really saying, 'Hold the presses, we want to see how things play out from a revenue perspective.' Anyone who had any intentions to have capital expenditures in 2008 is saying, 'Hmm, maybe we should keep our powder dry.' "

The year ended with a whimper for office markets across the U.S. The nationwide vacancy rate for office buildings edged up to 12.6 percent from 12.5 percent at the end of the third quarter, according to the Manhattan-based Reis Inc., a research firm. This was the first increase in the national average since 2003.

But North Jersey and Manhattan's office markets have proved to be resilient. In the fourth quarter of 2007, vacancy rates in midtown Manhattan fell to 4.7 percent from 4.9 percent in the third quarter, according to data from CB Richard Ellis, the world's largest commercial real estate broker.

Absorption and rents remained flat in North Jersey. David Houston, president of Colliers Houston in Teaneck, pointed out that the office vacancy rate in North Jersey for 2003 was 13.2 percent. The vacancy rate for the region is currently 13.1, according to Colliers' data methods.


This indicates three things about North Jersey moving forward into 2008, Houston said. First, the market's fundamentals continue to be strong, and the office market here does not have the glut of overdevelopment that has hurt other markets, such as Atlanta,




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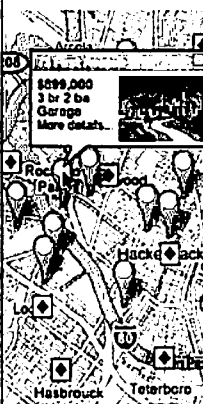
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southern Florida and Arizona. Secondly, the market will remain flat unless more jobs are created. And thirdly, while the office market has held steady, a sustained recession could tip the balance downward.

"The fact of the matter is, it's flat," Houston said of North Jersey's office market. "We have created some new jobs, but we have a labor force of 4.2 million that grows by only 1.1 percent a year. And not every job created requires office space. Until we start significantly increasing job creation up to 70,000, 80,000, 90,000 a year – something we're capable of doing and have done before, as recently as the middle of the last decade – we're not going to see much of a change in the market."

New Jersey added 29,400 jobs in 2007, according to preliminary data from the state Department of Labor. This is 13 percent less than the 33,900 jobs added in 2006, and well short of the historical average since World War II of about 40,000 jobs a year.

"If we can avoid recession – a big if – and if the economy gets through this, hopefully we can create some meaningful jobs outside of retail and government, which is where most of our new jobs have been created," Houston said.

But even if the state manages to create more office-filling jobs this year, the credit crunch has dramatically changed how many new projects are coming online, and how likely some companies are to take on an expansion strategy. The days of buyers making highly leveraged deals are over, said Michael J. Pembroke, senior vice president of the Hackensack-based commercial real estate company Russo Development.

This will have ripple effects in North Jersey well into the second quarter of this year, Houston said. He and David Simson, president of GVA Williams, said they are concerned over the likelihood that the subprime crisis will force more financial firms to lay off employees – workers who would normally be filling office space.

Inflation has returned as a problem. The consumer price index for the North Jersey-New York metropolitan area rose 3.7 percent this year, the highest increase since 2004, according to Bureau of Labor Statistics data. That's still less than the national average, which increased 4.1 percent in 2007.

"What really concerns me is the inflation rate," said Gil Medina, executive managing director for Cushman & Wakefield's New Jersey operation. "And it appears that not just the housing sector, but other sectors as well, are all experiencing rocky times. There are many concerns with the economy moving forward – there are too many signs of trouble. The question is, are we going to be able to skirt these reefs and get to the other side in one piece?"

But it's possible 2008 may offer more than just 12 months of gloom and uncertainty. Cushman & Wakefield's Metropolitan Area Capital Markets Group, for example, expects the office market to pick up positive momentum after the second quarter. All of the officials interviewed for this article took pains to emphasize one point: Even in this turbulent current market, good deals are still being made.

"Buildings that are well-run, managed properly and that have a flight-to-quality for employees are still desired by many companies, and therefore will always be successful in this market," Simson said. "We are cautiously optimistic that 2008 will be stronger than all of the prognosticators in Wall Street and on television predict."

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