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OFFICE OCCUPANCY INCREASES IN ORANGE COUNTY

As vacancies dry up, the benefits and ramifications for tenants and landlords can be plentiful.

By Barry Saywitz

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As the real estate markets continue to move forward, the prognosis for the remainder of 2017 is that the office sector will continue to show signs of increased rent and decreased vacancies. With growth in the technology, health care, construction and media sectors, Orange County office buildings have seen reduced vacancy in a string of consecutive quarters as the market continues to push upward.

The by-product of this decreased vacancy is an increase in rental rates and continued tightening of the market overall. What does this mean for both landlords and tenants as they look to address their real estate needs going forward?

If you are a landlord in this tightening market, you will have a greater ability to lease your space sooner with fewer concessions than you had in the past. We have already seen concessions like free rent, tenant improvement allowances and other flexibilities — which may be prevalent in a softer market — fade as the vacancy continues to drop. It may have been a rule of thumb in the past to receive a month of free rent for each year of your lease, but it simply does not exist in today's environment. Many landlords have done away with free rent, and those that do provide it are only allotting a small amount to facilitate the tenant's relocation, not merely as a concession due to the softness of the market.

Landlords for older or inefficient buildings may look to improve their spaces and bring them up to a more modern and efficient level. However, additional improvements for tenant-specific items and heavier build outs or customized improvements are less prevalent in today's market. Those additional or high-end improvements will likely be added to the rent, amortized over the lease term or simply put back to the tenant to pay for themselves. Additionally, landlords have been able to increase their annual escalations in the leases along with parking charges for those buildings that charge to park. These are additional ways for landlords to increase their bottom line and capitalize on a tighter market. Normal rent increases of 3 percent annually have increased to 4 percent or even 4.5 percent in many instances. This ultimately will cost the tenant more money over the term of the lease.

In the event that you are a tenant in this tightening market, you will need to analyze your alternatives well in advance, as there will be increased competition for available space and far fewer options for you when you do eventually go to look. The likelihood that space will remain on the market for an extended period of time is less prevalent. If there are multiple suitors for the same space, this will provide decreased leverage in your negotiating efforts. Larger landlords are also likely to continue to push rents in their buildings as they become closer to full occupancy. A landlord with a full building or very little vacancy will not feel the need to decrease rents for the next transaction.

This dynamic of decreased vacancy and an overall tightening of the market also feeds to lease renewals for tenants. Tenants who would look to renegotiate or renew their lease will be faced with higher rents as time goes on. For this reason, savvy tenants should look to renegotiate their leases in advance of the expiration to hedge against future market escalations.

There are less opportunities available in the market as vacancies decrease. This fuels increased rents, decreased concessions, and favorable conditions for landlords and a more costly environment for tenants. Savvy landlords will take advantage of market conditions, and savvy tenants will have their work cut out for them and will need to be proactive in their efforts.

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