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Smaller Offices, Smaller Discounts

NEW YORK CITY—A closer look at the Manhattan office market shows that rent discounts may not be as high as generally assumed for the majority of tenants. In office spaces of less than 10,000 square feet, the gap between asking and net effective rents is on the decline, says a recent report from boutique brokerage Red Real Estate. That's especially relevant in an office market where 95% of businesses employ fewer than 50 people.

"The rate of rent discounting is slowing as landlords have arrived at the point where they are either effectively moving property at the new asking price or they have reached their bottom number, even if it means a longer vacancy period," says Janelle Benjamin, co-owner and director of research at Red Real Estate. "In this case, landlords may consider waiting for a market recovery to be less risky than underpricing the property for an extended period of time."

Studying Manhattan commercial properties between September 2008 and October of this year, the firm found that the gap between asking and taking rents has dropped below 8% for smaller spaces, versus 15% for bigger ones. In the six months between September '08 and March of this year, discounts hovered between 8% and 10%, but have since fallen.

"As the market has had time to adjust to the shifts in demand, inventory and the overall economic climate, prices have begun to reflect current market values and are more stable," the report says. "More accurate pricing means there is less of a spread between the asking rents and the taking rents. This spread is also substantially smaller in the boutique or small space market than with larger offices."

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Having this perspective, according to Red Real Estate, is "especially important" for tenants that might be confused when landlords don't respond positively to lowball offers. "If the rent has already been discounted off of peak pricing and it is a boutique office, the room for negotiation may not be as generous as with a 100,000-square-foot, multiple-floor space in a large building." Even so, with larger space "lingering" on the market, "small-space tenants now have more leverage."

With average rents of around \$28 per square foot, the Penn Plaza district appears to be "the most aggressively priced neighborhood," the report says. At the other end of the spectrum, the Plaza District, Grand Central and Columbus Circle areas remain the most expensive for smaller space, with average rents of \$40 to \$43 per square foot.

"Historically, rents in the Gramercy/Union Square area were \$10 per square foot higher than Chelsea and Penn Plaza," according to the report. "Now, as buildings are more willing to divide large spaces, they are competing for the same tenants, causing prices in all areas to converge."