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How is the capital office market doing?

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In late March I participated in the "2013 Capital Region Commercial Real Estate Market Overview" by Capital Region Building Owners and Managers Association (CRBOMA). I was asked to moderate/facilitate the three person panel, as well as cover several market areas. The panel discussion got such great feedback from the CRBOMA administration as well as the attendees that I'd like to share some of the highlights from the discussion. Much of the discussion focused on the office market. First, on a national basis the office market is improving. Even amid economic recovery, federal budget uncertainties, and natural disasters, the national vacancy rate dropped in 2012.

Further positive news is that the Capital Region office market is outperforming the nation. Our vacancy rate at the end of 2012 stood at 14.2%, far better than the national average of 15.4%. Unfortunately the bad news is that our market has been trending in the opposite direction as the national vacancy rate. Our vacancy rate has been increasing since 2010. One has to wonder what is driving this trend.

A major policy decision by the state to restack its employees from leased, private properties to state-owned buildings has resulted in a $21.5 million aggregate loss in lease revenue for property owners as well as an increase in the vacancy rate both in the central business districts and suburban properties. Unfortunately, the brunt of the impact was felt in the already struggling downtown Albany office market. We'll continue to keep a watchful eye on the 600,000 s/f of NYS leased office space that is currently on a month-to-month, holdover basis. My hope is that those leases are extended so that it removes some uncertainty out of the market.

The Capital District suburban office market, which represents the largest component of our office inventory (64%), has shown modest gains in one area and losses in another. As rents have grown, the vacancy rate has also increased. The average rental rate has increased by 5.5% since year end 2010. The vacancy rate for the same period increased from 10.9% to 11.4%.

Class A office space remains very stable at a 7.6% vacancy rate. While not quite as strong as A, class B space continues to show positive gains. Not surprisingly though, class C space continues to be the recession's primary victim as it suffers from the "flight to quality" phenomenon. Class C office space had a vacancy rate of 16.5% in December 2012.

Overall, the current trends in the office market paint a very positive picture. We are seeing an end to the downsizing of past years and some firms are even beginning to add back small amounts of space. New construction projects are underway or in the planning phase. There is continued demand for medical office space, as evidenced by the many projects underway in our area. Also, mixed-use projects are showing positive signs. We are seeing many properties being re-purposed to meet the ever-changing market (Starlite Theater in Latham, ALCO facility in Schenectady). When facing lease expirations, we are seeing many tenants choosing to remain in their current locations, indicating that their landlords are making aggressive offers to keep them. Tenants are also weighing their options more closely and considering owning their office space. Favorable interest rates are certainly playing a role in this decision. As this trend continues my firm is seeing an increasing number of new projects directly resulting from the lease versus purchase decision. We are being engaged for consulting services to complete financial analyses of the lease versus own decision. Also, our property management division is securing more third party management contracts for owner-occupied buildings.

As you may have deduced, I am very optimistic that the Capital District office market is heading in the right direction. I think our office market is improving and that we will see continued improvement of our stable market.

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