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City landlords starting to get friendly, tenant friendly

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Commercial leasing activity is a real-time reflection of where our economy is at any given moment.

In robust times, commercial tenants are aggressive in leasing space, often to the point of banking space for future expansion. In poor economic times, commercial tenants often seek to shed space, commensurate with the contraction in their industries and their top and bottom lines.

The New York City commercial real estate leasing market is somewhere near the middle of the arc: property owners, who have had the upper hand in recent go-go times, are on the verge of granting concessions that we have not seen in years, and prospective tenants, who have held weaker cards in recent times, are demanding more.

On any given day, in Herrick's transactional real estate department, where I co-chair the leasing practice, we might represent a property owner seeking tenants or prospective tenants seeking space. So I am confident that from my vantage point, I am seeing a fairly clear picture of the city's leasing activity.

With the exception of certain high-end retail leasing, which has to date enjoyed immunity from an otherwise softening market, most leasing has slowed to where I anticipate that in the near future, the negotiating environment will be much more tenant-friendly.

General retail leasing activity is down, signaling a softening in consumer-driven commercial activity. The volume of office leasing — a crucial window into the city's business economy — has also slowed.

Another sure sign that the pendulum has swung from owner-friendly territory to neutral territory is the diminishing size of the leases that are closing. For now, the days of 200,000 s/f plus leases are over, as corporate and professional services tenants watch every penny and lease only enough to meet their immediate needs.

That, of course, is only for now, because as surely as the pendulum has swung toward the center and may continue into tenant-friendly territory, it surely will swing back the other way. Only those with crystal balls would dare prognosticate on timing, but we know these matters are cyclical.

For now, however, landlords who have long disdained carving their vacancies into small pieces are increasingly happy to cobble together smaller leases that, in the aggregate, at least fill some vacant space. There are two reasons for that shift, and both are economy-driven:

- Traditional big users — financial services firms, for instance, and law firms — are simply not in the market for large blocks of space, meaning that smaller users are the only ones actively seeking commercial space.
- Owners are facing unique underwriting challenges. Major financial institutions, which historically have been viewed as the gold standard among office tenants, are reporting major losses and layoffs, making them -- for now -- perceived as less rock-solid and credit-worthy as than they were before.

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We are seeing far more balance in lease negotiations, and I suspect that we are on the verge of seeing tenants holding the stronger hand. The shifts have been far more subtle than dramatic, but discernable to the naked eye.

I anticipate a relatively rapid return to a negotiation climate where landlords grant more generous packages -- work letters and free rent, for instance -- than they have in some time. Previously intransigent positions have softened, and might well soften more.

The one area, interestingly, where owners are holding firm is in the right of prospective tenants to sub-let their space.

This is a business decision that owners must make, but the equation looks like this: A property where a prospective tenant has the right to sublease is — all other things being equal — a more attractive property. But a landlord with, say, 200,000 s/f of vacant space does not want to compete with a tenant looking to sub-let 50,000 of its square feet.

So far, probably sensing that some of today's tenants will be tomorrow's sub-lessors, many owners are holding firm on limiting tenants' rights to sub-let space. This, like almost everything in transaction real estate, is market-driven and subject to change. Owners with significant vacancies and carrying costs may eventually soften their positions on sub-leasing to become even more attractive to tenants.

The bottom line in commercial leasing in New York is that fewer deals are closing, owners and prospective tenants are feeling each other out to test market conditions unseen here in recent times, and the shrewd ones are keeping an eye on that ever-swinging pendulum.

It was solidly in the owners' camp for quite some time, and although it would be premature to say it has swung into the tenants' camp, it certainly seems to be heading that way. ■