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Contradictory Signals From Commercial Property

By ANTOINETTE MARTIN

TWO powerful trends seem to be clashing in commercial real estate in New Jersey, market experts say. Corporate consolidations and layoffs have produced painfully high vacancy rates in many cities. Meanwhile, the market for sales of commercial properties as investment is remarkably healthy.

"The way we're selling property now, we are going to have the busiest year we have ever had," said Andrew Merin, executive vice president of Cushman & Wakefield of New Jersey.

In their midyear report issued in July, Cushman & Wakefield analysts reported that in the first half of 2002, the dollar volume of sales of investment properties was roughly comparable to that in the year-earlier period. There were more sales, C.& W. said, but the average size of the buildings sold was much smaller than in 2001.

Vacancy rates are up sharply this year compared with last for all types of commercial property, except retail, according to the report. Of the four types of commercial property, "office, industrial, retail and multifamily residential," the hardest hit has been office space. "Class A vacancy rates have skyrocketed from 10.5 percent at year-end 2000, to 14 percent at year-end 2001, to 15.4 percent at the end of this year's first quarter," the report said.

In a few places, Newark and Parsippany, for example, there were slight improvements in the vacancy rate, according to the report. But along Interstate 287, in Middlesex County, the vacancy rate more than quadrupled to 27.1 percent from 6.6 percent; in Somerset County, also on Interstate 287, Franklin Township had the highest vacancy rate in the state, 41 percent, up from 15.3 percent just a year ago. Vacancy rates along the Route 78 corridor nearly tripled, to 24.8 percent from 8.7 percent. In the Meadowlands and the Woodbridge-Edison area, rates more than doubled, to 17.4 percent and 15.6 percent, respectively.

With office space, demand is based on job growth, "and that is flat," Mr. Merin noted. He added a sober prediction. "Once the job growth picks up, it will be another 12 months or so before the demand begins to grow," he said. "A significant recovery may take from one to three years."

And yet, Mr. Merin is among market professionals who cite a surge in sales of commercial properties. Mr. Merin said C.& W. recently brokered the sales of six large properties: the Essex Green Shopping Center in West Orange and five office buildings in Florham Park. It is now working on deals for four properties each valued at more than $100 million, he added.

Mr. Merin referred to the robust investment market coming in the face of the anemic economic climate as a paradox.

GVA Williams's president, David Simson, meanwhile, said his company had experienced a surge in business, with a half-dozen sales in process, and described the situation as a disconnect between vacancy rates and the pace of sales.

And Jon Mikula, senior director of the financial intermediary company Holliday Fenoglio Fowler, said that despite the poor economy and burdensome vacancy rates, lenders were not reporting increased delinquency on loans. "It's a strange phenomenon all around," he said, joining the chorus of incredulity.

One obvious factor in stimulating investment sales is that interest rates are at historic lows, market experts agree. Lynn DeMarco, director of the Capital Advisors Group, Insignia/ESG, said, "The current low interest rates are allowing investors to be aggressive and still achieve appropriate returns."

But rates have been startlingly low since the beginning of the year. So what else is spurring investment at the moment?

"From the lending point of view," Mr. Mikula said, "it is partly that it is time to get money out the door. At the beginning of the year, with the stock market uncertainty, many lenders decided to allocate more money for real estate. But with the economy not doing so well, there haven't been enough transactions to utilize nearly all of it.

"So now it's summer, the lenders have these grandiose allocations and plans, and they have got to get this capital on the market. Money becomes cheaper, and the terms less conservative."

It is possible for investors, "even individual investors," to borrow up to 85 percent of the value of a property at an interest rate of 6.5 percent or even lower, he and other market experts said.

ONE mortgage banker, CIBC World Markets' managing director Michael Higgins, confirmed that banks will generally finance mortgages for up to 75 to 80 percent of sales price, and insurance companies will secure mortgages up to 85 percent on "good quality real estate."

"The reason is," Mr. Higgins said, "most investors today realize that you've got some good solid leases on commercial properties, and we are not overbuilt as in the 80's."

GVA Williams recently marketed a 185,000-square-foot office complex on Route 78 in Lebanon, Mr. Simson said, in which approximately 15 percent of the space is vacant but all the current tenants have five or more years left on their leases. "The property was an enormous attraction," Mr. Simson said. "We had over 15 qualified buyers and now have a signed contract with a New Jersey company."

Mr. Simson said GVA Williams also recently sold two office buildings in Parsippany, where the vacancy rate has been 20 percent or higher for more than a year. One of the buildings, on Walsh Drive, was 98 percent leased, with 70 percent of the space leased for 8.5 years, he said; the other, on Campus Drive, was fully leased and sold with competitive bidding.

Mr. Simson said his company expected a rising number of bidders in the marketplace, up about 25 to 30 percent from last year.

Class A office buildings that are substantially leased for the next five years are the most sought-after properties, according to Mr. Merin and Mr. Simson. But some investors are pursuing alternative strategies.

Robert C. Kossar of the J. G. Petrucci Company said his company was trying an end run around furious competition by trying to buy office buildings that may be in second-rate locations or not fully leased.

Mr. Kossar, who heads both acquisitions and leasing for J. G. Petrucci, conceded that with the leasing market so stagnant, "it does seem a bit strange to be out there looking to acquire vacant office buildings."

"What you have to do is find an opportunity and think ahead," he said. "If you buy an asset now, you have to plan for 24 months of vacancy. We think it's likely the market will be soft that long, but it is coming back, and you have to position yourself for that."

J. G. Petrucci recently acquired Post Office Plaza in Somerville, Mr. Kossar said. The 85,000-square-foot building has two empty units of 3,500 and 4,500 square feet on the first and second floors that were previously bank offices. Mr. Kossar said his company was banking on the excellent leasing history of the building.

"It has a great location," Mr. Kossar said, "at the crossroads of Routes 22, 202, 206 and I-287. Newark Airport is within 20 miles. It is across from a train station, and employees can have lunch at 10 different restaurants within a few blocks."

He said his company tried to "dig and dig and dig to find value," and then, "Essentially, we place a bet on what we find."

"It's actually a good time to buy," he said.

Or sell, Mr. Merin said. "The current wave of capital will be short-lived," he predicted in a speech delivered at the midyear economic roundup held by the New Jersey chapter of the National Association of Industrial and Office Properties. "When it dries up, it is likely that the market fundamentals will still be questionable."

Mr. Merin advised state property owners that the finance market was "as good as it's going to get right now." If owners have stable tenants in a building, they should take advantage of the situation, he said, and "consider exiting now."