The New York Times

April 18, 1999

Commercial Property / The First Quarter of 1999

The Office Market Softens a Bit, but It's Still Strong

The pace of office leasing in Manhattan softened somewhat in the first quarter of 1999, after two torrid years. But asking annual rents continued to increase -- exceeding $70 a square foot in some locations, although the average remains much lower -- and real estate executives say they see nothing on the horizon to prevent the industry from having another prosperous year.

''We are at the base of a slowly rising plateau,'' said Anthony E. Malkin, the president of W & M Properties. ''Supply and demand are very nearly in balance, with demand slightly exceeding supply. We can't see dislocations anywhere.''

According to figures compiled by Insignia/ESG, a large real-estate services company, 2.9 million square feet of office space was leased in midtown in the first quarter of 1999, a substantial drop from the 5.5 million leased in the first three months of 1998. And the amount of space added to the market exceeded that taken off by 800,000 square feet, compared to the net withdrawal of 450,000 square feet in the year-ago period.

Nevertheless, the average annual asking rent in midtown has increased 20 percent over last year's first-quarter level, according to the Insignia/ESG figures, to $44.79 a square foot.

''For some reason there was a rush to close deals in the fourth quarter and so some that were set for the first quarter got done before the end of the year,'' said Joseph R. Harbert, the chief operating officer of Insignia/ESG's New York Metro Region.

Mr. Harbert said that rising rates were inducing some tenants to leave midtown for less expensive parts of the city, but he added that demand was such that rental rates still had room to climb. ''We have seen deals in the $70's,'' he said. ''Whatever dropoff there was in the first quarter did not affect the high end of the market. And prices have not peaked yet.''

He said part of the problem was the short supply of available office space. ''When you have a primary availability of 7 percent,'' he said, ''it means there is just not enough space out there.''

Because each company has different ways of categorizing and counting transactions, the numbers vary from report to report. But the trends are clear in all the reports. ''The Manhattan office market started 1999 at a slower pace after two back-to-back record-breaking years,'' reported Cushman & Wakefield, another large real estate services company. ''With traditional large space users stalling expansion, overall leasing activity was down 17 percent from the first quarter of 1998, the lowest level of first quarter activity since 1995.''

''There were no megadeals in the first quarter,'' said Alex Cohen, Cushman & Wakefield's senior manager for research. ''Reuters and Rock West got done before the end of the year,'' he said, referring to the 855,000 square foot building that the Reuters news agency is building with the Rudin family at 42d Street and Seventh Avenue and the 1 million square foot building the financial services company Morgan Stanley Dean Witter is planning to build with the Rockefeller Group on a lot on Seventh Avenue between 49th and 50th Streets, just west of Rockefeller Center.

BUT the lack of big deals in the quarter does not mean there are none to be had, Mr. Cohen said.

He said the accounting firms of E & Y Kenneth Leventhal and PricewaterhouseCoopers, the NASDAQ financial exchange and the CIBC Oppenheimer financial services company are all locking for new locations and each is shopping for about 1 million square feet of space.

''They are all looking for the best deal,'' Mr. Cohen said. ''They just haven't found it yet.''

He said premium buildings in prime locations, like 9 West 57th Street, have been signing leases calling for annual rents in the ''low to mid-$70's.'' He said demand remains strong for space along Madison and Fifth Avenues in the 50's by companies that feel they need a presence in New York and a posh address as well.

''The brokers are being contacted by people who say they just have to be in New York City,'' Mr. Cohen said. ''That part of the market is as dynamic as any time in the last 24 months.''

While some companies track vacancy rates, Williams Real Estate uses a different measure, the vacancy rate plus all space expected to come on the market within a year, and calls it availability.

By that measurement, the availability rate in Midtown South decreased 0.4 percent to 7.8 percent, as a net 277,000 square feet were taken off the market. This decline in space pushed the average annual rent up 42 cents to $30.38 a square foot.

The availability downtown moved in the opposite direction, increasing from 12.1 percent to 13.2 percent as an additional 1.1 million square feet was added to the market. But the rent trend was the same as the rest of Manhattan, with annual rent moving up 20 cents a square foot to $31.49.

''In the Williams view, availability increased from 9.7 percent to 10.2 percent in the quarter, which added a bit of liquidity to the market, but is not statistically significant,'' said Robert L. Freedman, the company's vice chairman.

Mr. Freedman said the explanation for the increase in rents and availability downtown was the completion of renovation programs in older buildings in the area and the offering of space to the market. ''A number of buildings have been redeveloped and the rents reflect the better bricks and mortar,'' he said.

According to his company's calculations, the average annual asking rent in Manhattan is $38.45 a square foot, up $1.02 in the quarter.

He said the question is where the ''sweet spot'' is in the current market; that is, the highest rent tenants will accept without motivating them to look elsewhere.

He said that $50 a square foot in annual rent was a resistance point for many companies, so the question is how much below $50 is considered acceptable. ''The sweet spot is probably around $42-$43 a foot,'' he said.

If that is as high as most tenants are prepared to go, it insures that there will be no new construction in midtown, because rents of at least $50 a square foot are needed to justify building, Mr. Freedman said.

The strong market is permitting landlords to reduce their concessions packages, which have already shriveled from those in the early and middle years of the decade. In those times owners offered hefty packages of $40 or more a square foot for the cost of interior alterations, and free rents of a year or more.

''In Midtown South, in Flatiron, in Chelsea, the rents are up 20 to 30 percent and the owners are offering nothing for work, they are as-is deals,'' said James S. Meiskin, the president of Plymouth Partners, which represents tenants.

He added that free rent was down to three or fourth months, which is the time it takes to build the interior and during which the tenant is not occupying the space.

HE said the lack of space and the stiff terms being demanded by landlords are going to lead companies to look for alternatives. ''Some people are being driven to the fringes, to places that had not even been looked at before,'' he said. ''Now people are looking at Ninth and 10th Avenues in the 40's and 50's.''

He noted that the architectural firm Gwathmey Siegel & Associates had located at 475 10th Avenue at 36th Street, a 1913 industrial building that was renovated in 1994.

Some real estate executives attribute the current prosperity to the turmoil in debt markets that started last August and gradually settled down during the rest of the year. Steeply increased prices for capital reduce the availability of funds for development, they say, preventing overbuilding.

''The most significant fact today is the overhang from the capital markets of last year,'' Mr. Malkin said. ''Risk capital for new development has disappeared. It's gone.''

But, he added, ''Financial markets are quite healthy for viable projects. The money is available.''

He said the uncertainty about buyers obtaining financing had caused many companies, including his own, to withdraw properties from the market or not offer them at all. ''When the capital market took the guns and swords out of the hands of children the transactions market was distorted,'' he said.

But with the crisis largely resolved, he said, he expects property sales to begin to resume in the second quarter.