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# The Coming Real Estate Market

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Real estate values have achieved some of their highest levels in years, for both housing and commercial properties. Yet, news reports tout dangerously high vacancies in office space markets nationwide. How can these two conflicting events coexist? They have occurred as a result of disparate events, both of which stem from the same origin.

## Event 1

Investors refuse to buy stocks. So, what have they been buying? Looking for cash flow and relatively stable and secure investments, large investors, especially those from outside of the U.S., have been buying up real estate at a fast pace. Add to this the availability of cash and extremely low interest rates. The result has been an increase in real estate prices over the last two years.

## Event 2

Corporate occupants have been cutting staff, postponing expansion plans, and giving up excess space in large quantities for the last two years. Most of this excess space continues to be offered for sublet. As little demand exists for growth space in national office markets, much of this sublet space continues to languish, causing a continued drain on the very corporations that have looked to cut their expenses by disposing of it.

Landlords, however, seem unaffected by the dearth of available space. Why? Because most of this excess space is still under lease and financially viable, its occupants still obligated to pay rent until they find companies to take it off their hands. Many real estate professionals are asking themselves what will happen to this space over time. The answers are clear yet, potentially hazardous. In most cases, corporate tenants offering sublet space remain liable for continued rental payments, even after they secure a subtenant. So, it seems that landlords, in many cases, feel secure while they continue to collect rents for the next few years. However, some companies offering sublet space may enter bankruptcy, causing landlords to lose future rental income. Furthermore, danger exists for landlords as a large portion of those leases offered for sublet will expire over the next three years. Landlords will then be faced with real vacancies, and less cash flow.

## What could happen?

Economists predict the stock market may rebound over a one to two year period beginning, in earnest, some time in the next twelve months...right around the time quantities of sublease

vacancies will become real vacancies, and begin to negatively impact landlords' cash flows. Such an increase in vacancies and a corresponding decline in cash flow could have a downward effect on office property values. Couple this with a possible shift by investors from real estate back into stocks and other investments, and real estate values could drop even further. The hoped-for silver lining to this story is that as the economy picks up steam again, fueling corporate growth, more jobs will be filled, and so will a lot of that available real estate.

### **How do we protect ourselves?**

If your company leases space in a building where significant subleases are available, it may be prudent to consider restructuring your lease to take advantage of this down cycle. Restructuring could stabilize your building financially thereby, keeping your landlord in business, and avoiding potential business interruptions for your company. This is important so that your landlord continues to provide your company with quality services. On the other hand, it may be prudent to wait-out the coming market and economic changes, and make your selection at a later date. Individual circumstances and the needs of your company will vary, and should greatly impact your decision.

### **We own our building....what should we do?**

For those companies that own their real estate, it may be an opportune time to consider the cash value of those assets. Corporate owners may realize cash value by refinancing their property holdings at today's low interest rates, which is often a non-taxable event. Another positive method of redeploying capital is to sell properties. Selling those properties that are excess and no longer useful to the company, as well as, those that the company wishes to continue occupying, can have a positive cash flow effect. The sale/leaseback transaction is an effective means to generating cash and putting it to work for the company, while enhancing shareholder value. Flexible leases can ensure the company will continue to operate efficiently while reducing business risk.

No one answer works for every company. Consulting your business advisors in confusing times is always a prudent move.

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Mr. Zedas is well-known for his ease and informative style of public speaking, and has given talks, presentations, and has lead educational programs for business, professional, government, and trade associations, including the Building Owners and Managers Association, American Management Association, the U.S. Postal Service, RealComm, Society of Industrial and Office Realtors (SIOR), and others. Andrew is National Chairman of the SIOR Tenant Representation Specialty Practice Board, and is a licensed real estate instructor in Texas and Indiana. He can be reached at 908 245 5999 or via [email](mailto:andrew@realstrat.com).

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