

Subleasing Expectations in a Weak Real Estate Market

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The overall demand for office space is anemic and vacancy rates are projected to increase slightly or remain flat at best over the next 12-18 months. The total vacancy rate in Northern VA is 16.4%, unchanged from mid- 2012, and double the vacancy rate for a market in equilibrium when demand equals supply. We would expect today's 1.3% sublease space vacancy rate to be significantly higher given an overall vacancy

rate of 16.4%. However, throughout 2012 several big government contractors vacated large blocks of space when their leases expired. The large sublease spaces within these blocks of space also expired and taken off the market. Consequently, the sublease vacancy rate fell below its historical range of 1.5% to 2.0%. Tenants now seem more motivated to lease directly from building owners to lock in lower rental rates for a longer term than sublease space under a shorter term. ***“Tenants should keep their subleasing expectations modest.”***

The ability to sublease space is driven primarily by a company's (1) urgency; (2) business goals and (3) cash position. Other important factors include (4) space configuration and if move-in ready; (5) amount of time left on the sublease and (6) credit risk tolerance. A savvy broker will develop a strategy taking into consideration these factors to determine how to generate space tours and proposals that will lead to a signed sublease and achieve your goals. The strategy sets forth tactics to implement and achieve goals for the rental rate, minimizing potential concessions (e.g. free rent or renovations) and how to continually attract prospects, among others.

Prospects usually know while touring a space how well the configuration meets their space needs. Ideally, a tenant wants the subtenant to take space “as-is”. If, however, a subtenant will not take space “as-is” then tenants should be open to offering free rent in lieu of funding minor improvements.

Tenants must also be prepared to reduce the rental rate by as much as 15-30% below the market rental rate. If the market rental rate is \$30/SF and the tenant's in-place rental rate equals \$32/SF then the sublease rental rate could be as low as \$25.50 to \$23.00/SF. Tenants should be patient and willing to adjust their marketing strategy based on demand for their space and changing market conditions. As a general rule the less time left on the tenants' lease the more difficult it will be to sublease the space. Tenants are reminded and often advised to make a “deal” today to reduce losses than wait for the “perfect” deal. The unfortunate reality is at some point every sublease space has so little time left on its term it may be impossible to sublease the space. Finally, and most importantly, tenants must qualify a prospect's creditworthiness during all initial discussions, if possible, to filter out those businesses with a high risk of not paying rent.

We will customize and implement a marketing plan to sublease a space based on your corporate goals. Call us to learn more about subleasing strategies and our other tenant advisory services.