COLLIERS INTERNATIONAL

VEGAS VALLEY OFFICE TEAM

Las Vegas Office Market Insight | Q2 09

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Market Buzz

Is it safe to come out now? Apparently the answer is "Yes". Fearing the unknown, office tenants were in hibernation during Q1. Pounded by a continuous flow of bad news, decision makers avoided commitment. During the later part of Q2, market sentiment saw a distant light at the end of the tunnel and leasing activity has increased from dormant to moderate.

Renewals continue to dominate leasing activity for several reasons. Firstly, in an uncertain economy most tenants remain focused on short term commitments (less than 3 years). The cost and business disruption associated with moving offices usually isn't justified by a short term solution.

Secondly, landlords have come to appreciate the value of a bird in the hand. Market rates are irrelevant if there are no new tenants willing to commit. In recent months, landlords have lowered their short term expectations and signed renewals at rates they would have turned away just 12 months ago. Also, renewals usually minimize costs to the landlord associated with re-tenanting (tenant improvements and leasing down time) and those savings can be passed on to the tenant.

So who is moving? Though still in the minority, an increasing number of tenants are looking closely at the market with serious intent to re-locate their office. They fall into the following categories:

1. Expansion
   The few tenants experiencing growth are limited by their landlord's office portfolio. If their landlord can't offer enough contiguous space, they have no choice but to look elsewhere.

2. Contraction
   Substantial reduction in size often renders the existing space inefficient. Break rooms, lobbies and conference rooms are no longer in proportion and the result is a relocation or substantial (and disruptive) construction.

3. Cost
   Landlords are more flexible than ever, however their lenders and expense overhead will only allow them to drop their rates so far. Class A buildings can't sustain Class C prices, at least not for an extended period. If a tenant needs to lower their cost of occupancy dramatically, a new landlord and product type may be the only solution.

Subleasing continues to be popular for tenants seeking low rates, a short term commitment, or both. While the supply of direct office space continues to grow, the supply of sublease space has remained neutral at approximately 650,000 sf. In other words, sublease space is being absorbed as quickly as it comes onto the market.

Looking forward to the remainder of 2009, tenants can expect continued discounting of lease rates, greater willingness of landlords to agree to short term renewals, and increased supply from which to choose. Looking further out to late 2009 / early 2010, commercial loan defaults will result in a change in ownership for some office projects. New owners purchasing loans or real estate from lenders at discounted prices will put further downward pressure on leasing rates. If your lease expires in the next 18 months, an overwhelming number of attractive options will be available for your consideration.

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TENANT NEWS

Counter Me...Please!

Is your landlord taking a renewed interest in your tenancy? They should be. In today's market, nothing is more valuable to a landlord than a tenant with a solid future. It may seem surprising then, that the following scenario is common…

As lease expiration approaches, the landlord contacts the tenant to discuss renewal and sends a proposal. Based on market conditions, the tenant expects a substantial discount from the previous rate but instead receives a rate that is similar to their existing structure. Disenchanted, they look at alternative space, find more attractive rates, and return to the landlord to announce that they're moving elsewhere.

The landlord's response is to send a second, more competitive offer. The end result is, more often than not, a renewal based on terms that are mutually agreeable to both landlord and tenant. The question many tenants ask is, Why didn't the landlord make a competitive offer in the first place?

The answer is that it's all part of the process. The landlord wants to test the tenant's market knowledge. Market conditions change quickly and many tenants don't have the time or resources to research rates and concessions. The more market knowledge you can demonstrate, the greater your negotiating leverage with the landlord.

The landlord wants to keep you, but unless you counter their offer, they're not going to present you with the most attractive terms available. The ideal scenario is to begin by gathering market information via proposals from competing properties, then negotiate with your landlord. It can be a time consuming process but the benefits will be enjoyed for the term of your lease.

The majority of tenants outsource this process to a tenant representative broker with current market knowledge. If you're considering handling the process yourself, its worth discussing with a tenant broker first to determine if they could add value to the process.

Leasing a Ferrari for the Price of a Pinto

As office space becomes more affordable, tenants with solid financials will be tempted by upmarket space at discounted rates. The opportunity to upgrade at favorable terms should be viewed with a long term perspective.

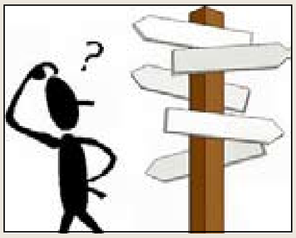
At the extreme, the market may offer an opportunity to move up to a Class A building for less than you were paying at a Class C building a year ago. Under current market conditions most landlords will offer their lowest rates on a short lease term lease (1 – 3 years). Their strategy is to maximize occupancy while new tenants are difficult to find. Landlords anticipate that when the market recovers, presumably in 1 – 3 years, they will increase rates.

This is an opportunity to enjoy discounted Class A office space if you fit into one of 2 categories:

1. You're comfortable with moving (again) back down to less expensive space when the market enters the next phase of the cycle. Depending on the effect this will have on your clients and staff, moving again may be a worthwhile price to pay.
2. Your long term goal is to occupy Class A space and your business will be able to generate the increased revenue necessary to justify higher rent when the market recovers.

If dramatic changes to your office environment are disruptive to your business and you're unsure about your ability (or need) to pay for Class A office space in the future, avoid the temptation! Instead, focus on negotiating the best terms on the type of office environment that has worked successfully for you in the past.

Should I Stay or Should I Go?



Landlords are offering attractive terms to renew; competing landlords are offering incentives to move. Is it a good time to relocate?

If you're dissatisfied with your current space, the answer is an unqualified "Yes!" On the other hand, if you're happy with your existing location, researching the alternatives will, at the very least, provide you with the knowledge necessary to negotiate your renewal.

Paralyzed by uncertainty, many tenants renew to avoid 'making a decision'. In reality, staying put is a decision, and its one that should only be made after considering all options.

Assuming you're familiar with your office space requirements, the first step is to make a list of potential alternative locations. You can do this by driving around looking for leasing signs, subscribing to a commercial leasing database, or using a tenant broker. The next step is to physically tour the spaces that most closely match your requirements. Once you're narrowed the search to the 2 – 3 most desirable locations, request a proposal from each landlord (including your existing landlord).

You're now ready to begin comparing your options. You may notice that the proposed terms differ from the "advertised rates". The reasoning is that landlords will offer their most attractive terms to the most desirable tenants. If your business enjoys financial stability, sharing that information with landlords will encourage additional "concessions".

The important thing to note at this point is that you're probably not looking at the best offer from each landlord. Securing the best offer involves negotiation of the lease terms that are most important to your business (lease rate, tenant improvement allowance, escalations, etc). Landlords have a limited basket of concessions to give and they'll want to focus on those items that are most desirable to the tenant; often referred to as "hot buttons".

After fully negotiating terms on alternative locations, you're armed with the information necessary to make a "Stay or Go" decision. Gathering the information, negotiating the terms, and analyzing the alternatives is time consuming but it's the only way to ensure you're making the right decision. Consider outsourcing the task to a tenant broker if you want to stay focused on your business.

Language of Leasing

When does \$1.00 = \$1.70?

Comparing Lease Types

The most common source of confusion when comparing office leasing rates is lease type. The leasing rate only tells part of the story; it's important to look further into what's included in the rate. The language varies by market but in Las Vegas 99% of all office leases fall into 1 of 3 categories:

1. Triple Net (NNN):
   The Base Rent is exclusive of all operating expenses. Common Area Maintenance ("CAM"), utilities and janitorial services (to the suite) are all paid separately by the tenant. NNN leases are most commonly found in Class C buildings.

2. Modified Gross (MG):
   The Base Rent includes CAM charges. Utilities and janitorial services (to the suite) are paid separately by the tenant. MG leases are most commonly found in Class B buildings.

3. Full Service Gross (FSG):
   The Base Rent includes CAM charges, utilities and janitorial services (to the suite). FSG leases are most commonly found in Class A buildings.

See below for an approximate rule of thumb for the dollar difference between each of the 3 Lease Types described above:

NNN + (\$0.35 to \$0.45) = MG
MG + (\$0.30 to \$0.35) = FSG

The range will vary depending on the building type and efficiency of the landlord's operations.

In all lease types, year over year increases in CAM, utilities and janitorial services are paid for by the tenant.