

FORECAST

Real Estate, Construction & Green

Commercial real estate could be the next shoe to drop

Just in time for a residential rebound, commercial properties buckle under recession's weight

By **CLAUDE SOLNIK**

Take off those rose-colored glasses when it comes to commercial real estate — and put them away at least for a while.

While observers see signs of an improving residential real estate market, many said commercial real estate could face an even more challenging 2010, including foreclosures and falling sale prices.

The residential market for at least a year has been in the throes of recession amid rising foreclosures, stalled sales and credit crunches.

But the commercial market seems to have remained healthier in comparison in part due to banks' reluctance to foreclose as vacancies rise and property values slide.

"On the commercial side, people are still waiting for the other shoe to drop," said Jed P. Dallek, a tax partner and real estate niche practice leader at Grassi & Co. in Jericho. "There's very little liquidity in the market."

Others said demand dropped as firms closed — including those in the mortgage industry, such as American Home Mortgage and Lend America — and companies reduced head count. Continued downsizing could create commercial real estate problems in 2010.

"There's more supply than demand going on right now," said Mark Bosswick, a tax partner at Berdon with Long Island operations in Jericho. "There's been a con-

traction even in existing companies. People are taking on less space."

This excess supply has suppressed prices.

"Prices are cheaper than they were," said John Magnani, director of the commercial division of Manhasset-based Daniel Gale Sotheby's International Realty. "And the rates are probably the cheapest they've been in a long time."

Average asking rents for offices as of the third quarter fell to \$27.67 per square foot from \$28.17, down 3.4 percent from a year ago and below \$28 for the first time since 2006, according to studies by Newmark Knight Frank, in Melville.

"We're seeing the largest spreads between asking and taking rents that I've ever seen in 25 years," said Brian D. Lee, executive managing director of Newmark Knight Frank. "The deviation between asking and taking means the appearance is the market is much healthier than it is."

Compounding the bad news, Long Island's office vacancy rate hit double digits recently, starting 2010 on an ominous note. And it isn't likely to turn around anytime soon.

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The Long Island office vacancy rate rose to 12.1 percent at the end of the third quarter from 11.9 percent in the second quarter, although that's down from 12.5 percent a year ago.

The industrial vacancy rate rose to 4.3 percent in the third quarter, up slightly from 4.2 percent in the second quarter as asking rents fell to \$9.16 per square foot from \$9.39 the prior quarter.

Retail real estate is the most challenge-laden sector as stores are suffering from the economic fallout.

"Retail real estate is probably the most discretionary," Bosswick said. "I see retail real estate decreasing as the consumer cuts back on spending."

He also said real estate investment trusts aren't likely to rescue much real estate soon due to their own problems. Many "have a tremendous amount of debt they borrowed to expand over the last few years."



Bob Giglione

Jed P. Dallek, real estate niche practice leader at Grassi & Co., said lower prices could pique interest from buyers with ready cash.

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Buyers' market

COMMERCIAL, from 31A

This doesn't mean tough times for all commercial real estate sectors. Southampton real estate attorney John Caravella said energy-efficient buildings might do best in the upcoming year.

"I expect over the next 12 to 18 months those in the market will be looking for buildings and projects that are energy efficient, provide the maximum return on the dollar and provide the greatest tax incentives," he said.

Buyers also may have new opportunities to snap up buildings or stakes in buildings from owners facing financial pressures and foreclosure. Bosswick believes banks are postponing taking action to avoid carrying commercial properties on their balance sheets.

"I don't think the banks want to take the property back," he said. "They don't know what to do with the property any more than the property owner does."

Bosswick said some landlords will find themselves unable to re-finance or renegotiate.

"There are large properties and portfolios that are not going to be able to be refinanced next year," Magnani added. "That's the next wave a lot of people are concerned about."

Lee also believes it's only a matter of time before banks put pressure on owners. "Lenders pretend loans are still good and extend mortgages," Lee said. "I believe prices will begin to fall in commercial real estate as banks begin to foreclose on commercial properties and they're sold."

Dallek said problems could lead to opportunities, producing deals for those able to buy. "Cash is king," he said. "If you've got cash, you can buy distressed debt or properties."

He added that commercial real estate, like the general economy, is affected primarily by unemployment. "You won't see any improvement in the commercial real estate market until people get more jobs," Dallek said.