THE LATEST CRE TRENDS IN 2017

By Steve Lewis, Sponsored by SIOR Foundation

You don't have to look hard to find some expert somewhere opining about current trends in commercial real estate. Reports and predictions abound in the first quarter of every year, and recognizing global tends are certainly helpful as one looks ahead to the coming year. Where is construction headed? How strong (or weak) is demand? How much money is available for financing? What are investors looking for?

There is a fairly strong consensus on where national trends are heading: Rates will still be low; employment will continue strong; with relatively slow construction, absorption will remain strong – perhaps through 2018.

The list goes on; but national trends can only take you so far. As National Real Estate Investor pointed out in its 2017 forecast, "The impacts vary considerably by region and sector."

What sets a real estate broker apart from the competition is not his or her knowledge of global trends, helpful though that may be, but their insights into the uniqueness of their market – the "mini-trends" that may apply only in their demographic area, and awareness of which can be the key to success.

Comments from SIORs about the leading trends in 2017 show just how unique those trends can be.

For example, in the Boston area new legislation legalizing some uses of marijuana has increased the demand for large warehouses with low ceilings (who'd a 'thunk' it?). In Knoxville, owner-occupied space, especially among physicians, is a hot trend. And in Louisville there is greater demand for non-traditional office space, thanks to Millenials.

So while these and other markets reflect national trends to varying degrees, it is the failure to identify and respond to local market variations that could leave an SIOR behind the eight ball.

Please Come to Boston

It's true that Boston, with its vaunted 128 corridor, sees technology driving overall tenant demand, with e-commerce a close second. "We've seen a tremendous increase in both warehousing and call centers," notes Arlon I. Brown, SIOR, senior advisor SVN, Parsons Commercial Group, Boston.

As an SIOR, the key for meeting this new need is "identifying the buildings that make sense for these operations," he says. He also pays close attention to needs beyond the obvious. Take, for example, the Big-Box users. UPS came to make a purchase to park vehicles because they were supporting Amazon. "It has a trickle-down effect; they need all these ancillary functions," he explains.

But "the whole marijuana thing," as Brown calls it, has the market moving – although a bit uncertain given the change in administration. At present, medical marijuana is legal in Boston. Recreational marijuana has been approved, and is supposed to go in effect next summer. This has, at least for the present, made formerly undesirable buildings quite desirable.

"A number of real estate companies with large warehouses have had trouble leasing those with low ceilings," says Brown. "Now they are in demand."

He notes that the Colorado warehouse vacancy rate has plummeted since marijuana was legalized, but says with the new administration making noises about coming down hard on states that have legalized a federally illegal drug, "We really don't know what will happen."

Meanwhile, Parsons has a couple of deals under agreement, and notes that some larger users of this type have signed leases and recruited people. He is "by all means" looking to list such properties. With limited availability of land and the cost to build exorbitant,

> "In today's world of ever increasing margin compression across almost all industries, we will likely see today's trends continue for some time to come."

"things we wouldn't even look at are like gold now."

"Reverse Urban Sprawl"

N. Justin Cazana, SIOR, CCIM, principal/broker with Avison Young in Knoxville, sees that more companies "doing reverse urban sprawl are starting to head downtown from suburban Class-A office buildings. "It's not a large number, but enough that you can stand up and take notice," he says. Thanks to Millenials, he continues, older Class-C products have become refurbished.

Cazana has also observed a trend toward corporate downsizing in the last few months, including three significant Fortune 500 companies downsizing anywhere from 40 to 90 percent. Despite a good economy and a strong job market, he says, companies are still looking to limit their expenses.

Then there are the docs. "We've seen a trend toward owner-occupied offices and for more and more physicians to own their own buildings," says Cazana. "We've seen a number of doctors who had their own practice, were bought out by a system, the contract expired, and they've gone out on their own." Financing, he notes, is easy for physicians.

These changes, says Cazana, "affect me in a good way." On the medical side, he notes, doctors and physician groups look for significant purchases; he has done deals between $1 million and $6 million, and others have done even larger deals.

The key here, he says, is having a constant presence, whether with practice managers, top physicians, or systems he has done work for in the past. "They tend to take a little longer and they can be very particular; it takes a lot of work, and if you are not patient you will fail very, very quickly," Cazana warns, noting it can typically take six to nine months or more to find a building and specialty build outs take longer as well.

Increasing popularity of the CBD can be a blessing and a curse, Cazana notes, as listings in the suburbs can be affected. "I certainly do not go out and poach from my own listings, but I know some will transition to other buildings. I keep the landlords happy if I can," he says. You need to be a constant presence there as well, he says. "When we put a new cool young tenant in our trophy building downtown we shouted from the rooftops – yes, this building does not look like what it used to look like. There's a bar and beer taps in the space, open ceilings, and video games in the corner."

In the suburbs, he continues, you have to focus on the clientele you know want to be there, like financial services firms, because customers want front-door parking, or tech firms that have high occupancy and need a lot of parking.

Downsizing, he admits, "is tough." One advantage, he says, is that Avison Young is the largest real estate firm in the market and one of its teams, for example, is handling the disposition of a 50,000 square foot building, so there is also opportunity.

Non-Traditional Space – and Less Of It

In the Louisville market, Jeffrey A. Dreher, SIOR, MBA, senior real estate advisor with Commercial Kentucky, Inc., cites an increased demand for non-traditional office spaces, users putting more people in less space and greater tenant improvement costs as the key local trends.

"The increased demand for non-traditional office space means you can't just do a search of existing traditional office spaces and expect your client to pick one and negotiate a lease," he says. "For some clients you may also have to include other types of buildings that might be redeveloped or repurposed as office space." For example, he says, some old warehouse buildings that offer good office locations are being converted into office space with soaring ceiling heights, open and flexible layouts.

From the tenant's perspective, putting more people in the same or less square footage creates the need to find a space that is highly efficient for their intended layout, says Dreher. "In turn, space planning becomes a more important piece of the equation," he adds. From the landlord's perspective, it means it may take more tenants to fill vacancies than it might have in the past. This also puts added pressure on things like a building's parking ratio, increased general wear and tear, and higher operating costs to name a few.

As occupiers of office space look for more creative and sometimes non-traditional types of office space and squeeze more people in less space the cost to develop such space has gone up — sometimes dramatically, says Dreher. "Employers are also spending more money on the common spaces within an office to compensate for employees having less feet per square foot in their offices and cubicles," he observes.

The best way to overcome all these challenges, says Dreher, is to be creative. "Finding the right space and negotiating the right deal for our clients requires the ability to be creative not only in the search for the space but also in the way the space is used and the way the deal is structured," he shares.

Greater Emphasis on Data Analysis

John Barker, Jr., SIOR, president and Chief Development Officer of Red Rock Developments, offers a completely different perspective. "In office and industrial (SIORs) have become more like our partners; demography is shaping more decisions than ever," he says.

In other words, he continues, today the deal is more than just "Here's the space," especially if there is a large requirement. "Not all SIORs do it, but quite a few do; large brokerage shops are really bringing demographics into the fold," says Barker. So, for example, if there is an office user attempting to tie into younger talent, they need to know where they live. "Five years ago that was non-existent," he asserts. Today, he says, it's all about labor analytics and analysis. It's so important he adds, that, "medium and small guys need be made aware of that."

Barker does not approve of all the trends he sees. For example, he says he sees more of a menu of services provided today than ever before. "I don't think the level of service delivery in that setting is as practical or as good as a perfectionist trying to do one thing very well," he declares.

He is also discouraged by the emphasis that younger professionals put on e-mail. "They don't call me; they send me e-mail," he criticizes. "I want to see you. That trend of technologically communicating I really think will create a point in our business where it deflates our capacity to do business at all. You can't do business sitting on your ass doing e-mail," says Barker.

Looking to the Future

Will the current trends continue? Well that, it seems, depends on the trend. "In today's world of ever increasing margin compression across almost all industries, we will likely see today's trends continue for some time to come," Dreher predicts.

When it comes to technology, Brown is convinced it will stay thanks to Millenials. "My kids will buy everything on their computer; even myself I will Google something and buy it on the Internet," he shares.

Cazana sees a mixed bag. When it comes to physician-owned buildings, for example, he asserts that it is a cycle, and may last five to eight years, after which it will trend back to systems.

He sees continued growth in the Knoxville CBD for the next seven to 10 years, but adds that there will be certain firms realizing they do not need to be in the CBD any more.

"There will be a trade," he predicts. "As we see partners retire, junior partners may say 'Costs are too high, let's find a building closer to where we live.'"

As for corporate downsizing, Cazana says, "Hopefully that's just a short-term trend." He adds that it's something that had not been seen over last decade — even in the recession. His advice? "Weather the storm, and take advantage by having the right processes in place." ∇

CONTRIBUTING SIORS

John Barker, Jr., SIOR

Arlon I. Brown, SIOR

N. Justin Cazana, SIOR, CCIM

Jeffrey A. Dreher, SIOR, MBA

SPONSORED BY SIOR | FOUNDATION