# Threat of foreclosure determines rental rates

In the past year, there were nine recorded closings of office building sales in Bonita Springs. They ranged from a high of $149 per square foot on U.S. 41 to a low of $47 PSF on Bonita Beach Road. The average sales price was $110 PSF, with a median sales price of $104 PSF.

This indicates more of the transactions were at the lower end of the range. More than half of these nine sales were sold by foreclosing banks.

Just three years ago, we witnessed office sales in Bonita Springs ranging from $150 to $250 PSF where the majority of these buildings were 100 percent leased and valued using the income approach to valuation.

According to CoStar, today's Bonita Springs office market has a 13 percent vacancy factor.

## Setting rental rates

Commercial property owners in the past would naturally set their rent as high as they could get away with.

Today, the main factor in setting rental rates seems to be determined by how close they are to losing their building to foreclosure, with asking rents often based more on staving off foreclosure than securing market based rents.

But this practice sets new market lows regardless of the motivation for agreeing to such terms. Due to various levels of distress among office owners, there appears to be a wide range of asking rents in the marketplace today.

For example, Florida Cancer Specialists recently rented 7,600 square feet of general office space at

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In years past, this Class A building where Sony once resided regularly rented for rates between $18 and $25 per square foot plus a common area maintenance charge of $9-plus PSF. The cancer specialist practice got a great deal and signed their new lease in April 2011 for a five-year term lease starting at $15.25 PSF with no CAM and the base rent escalated 2 percent per year.

The property owner pays for the practice's electricity and daily janitorial. This equates to an approximate net rental rate of $6.25 PSF ($15.25 minus $9) for Class A space in Fort Myers.

According to CoStar, the city of Fort Myers office market has 14 percent vacancy and south Fort Myers/San Carlos Park has 16 percent vacancy.

Market rate movement from $18 to $25 PSF net rent to $6.25 PSF is obviously a significant downward adjustment that will have dramatic implications on other comparable rental values and property values.

## Defensive renting

Commercial real estate owners want to keep their investments. If their loans are coming due and their occupancy is low, they do not have much choice other than to lower rents until it motivates a tenant to move from another location into their building.

You can imagine the ill will this creates among competing office building owners with space to rent who do not have loans coming due in the near-term. According to Mortgage Bankers Association, $155 billion worth of commercial mortgage loans in the U.S. is due to mature in 2011 and another $125 billion is due to mature in 2012.

## Market stabilization

When will the marketplace stabilize for commercial owners? I cannot speculate on the date.

But the following six market conditions need to occur before we see a full recovery:

- Unemployment needs to be in the 5 percent to 7 percent range.
- People need to be making good wages again.
- Consumer and business confidence must return, and be represented in spending figures.
- Vacancy levels need to reach 8 percent or less in commercial property type submarkets.
- Commercial financing needs to be more widely available at competitive rates through the re-emergence of CMBS financing.
- Bank sales of commercial properties must slow to a level where they have no further negative effect on property values.

We will get there and better days are ahead. It is just a matter of time and perseverance.

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