The New York Times

REAL ESTATE

Commercial Property/Prices; Asking Rents for Midtown Office Space Keep Rising

By JOHN HOLUSHA JUNE 14, 1998

DEMAND for office space in midtown Manhattan has driven the average annual rental rate to over $40 a square foot for the first time this decade, according to figures compiled by Newmark & Company Real Estate. The average asking rental per square foot rose from $37.99 at the end of last year to $40.25 at the end of March, for an increase in the quarter of 5.92 percent.

Other real estate companies have different ways of measuring the market, but all agree on the direction: up.

''Transactions with rents in the 50's are no longer rare,'' said Franklin C. Speyer, an executive director of Cushman & Wakefield. ''The economy is good, and there is no lack of tenants willing to pay to stay in New York.''

Indeed, officials of Julien J. Studley, a tenants' broker, report that there are at least 15 buildings in midtown where the asking annual rent is over $60 a square foot. Other parts of the city have seen rental rates rise as well, but not to the levels seen in midtown.

Mr. Speyer said that financial services companies, fueled by the booming stock market, were leading the expansion in the use of office space, but added that entertainment, advertising, insurance and other service companies were also contributing to the demand.

In all, an estimated 120,000 jobs have been added in the city since 1993, a period of no new building.

''We have just emerged from the longest period of no new building since World War II,'' said David W. Levinson, an executive managing director of Insignia/ESG. ''Building stopped in 1990, and the Durst building won't open until next year,'' he said, referring to 4 Times Square, the 49-story tower now being built on Broadway between 42d and 43d Streets by the Durst Organization.

''That is an extraordinary period of no new supply,'' he said.

Nor is there likely to be much added, at least in Manhattan, he said. Although three more buildings probably will be built in the Times Square area, the Reuters news agency will occupy most of one -- 3 Times Square, across from the Durst building -- and together they are not expected to have a big impact on the market.

''There are 200 million square feet of space in midtown,'' Mr. Levinson said. ''The most you can add is five percent. Midtown is already built.'' Midtown is generally defined as the area south of 57th Street to the mid 30's, river to river.

The result, most brokers say, is that the market has tipped decisively in favor of landlords. Not only are asking rents going up, but concessions, notably periods of free rent and allowances for building tenants' offices, are shrinking rapidly as well.

''There is no new space, so the price is going up,'' said Robert Emden, an executive managing director at Grubb & Ellis. ''Buildings that were in the mid-40's this time last year were at $50 by the end of the year. Now the market is being tested again, and the $60 barrier is being broken.''

Mr. Emden said that with a robust economy, most companies were more interested in generating more business than in containing costs, although at least one law firm, which he did not identify, is considering putting two associates in each office to conserve space.

''The current market is making it very tough on our clients,'' said Richard Podos, vice president of Equis New York, a tenants' broker. Mr. Podos said that concessions today were even lower than at the last peak, in 1988. At that time, free rent and work allowances amounted to about 20 percent of the total value of a lease, he said. That rose to as much as 35 percent at the bottom of the office market about five years ago.

TODAY, he said, concessions are only about 10 to 15 percent of the value of a lease. ''It's going to get a lot crazier before this bull market runs out,'' he said.

Mr. Levinson of Insignia/ESG said that some companies were trying to hedge against future price increases by leasing space now in anticipation of future growth. ''We have clients who are taking space they don't expect to need until five years from now,'' he said. ''They are going to the trouble of putting in subtenants to protect themselves. That only happens in this kind of an environment.''

Many real estate executives warn that a continuing increase in the cost of office space will drive companies to New Jersey and Westchester County, where some speculative building is already under way or planned. And the executives caution that landlords who push for the last penny and adopt arrogant negotiating tactics at the top of the market can expect little sympathy from tenants when the inevitable downturn arrives.

''I find it troubling to be in a market where you can have a handshake on a deal at $40 before lunch, and then the owner goes to lunch, talks to his friends or employees, and comes back and announces that the price is $45,'' said Mitchell Steir, an executive vice president of the Julien J. Studley company. ''This increase in prices will not go on forever. We are in something of a frenzied window now, but people are going to realize that space in Westchester is half the price of Manhattan and they will start to move out.''

Barry Gosin, the chief executive of Newmark & Company Real Estate, agrees that the sky is not the limit for landlords. ''Rents this year will not increase as much as they did last year,'' he said. ''We're almost to the point where new construction is justified and we will see building in New Jersey and Stamford as long as the financial markets stay strong.''

Tenants are not completely without leverage in negotiations with landlords, particularly in renewal leases for space already occupied, said James S. Meiskin, president of Plymouth Partners, a tenants' broker. This is because there is a substantial cost in bringing in a new tenant.

''The owner will have to spend $5 a foot to demolish the space and another $35 to rebuild,'' he said. ''There will be down time, and commissions to be paid. In all, it will probably cost an owner $60 to $70 a foot to bring in a new tenant.''

He said that tenants should begin renewal talks with their landlords several years before their leases expire so they can take advantage of the owner's wish to save the expense of finding and installing a new tenant.

And, of course, not all tenants are created equal. Owners want tenants with a strong financial base -- known in the trade as credit tenants -- who will be able to keep up their rent payments even if the economy goes sour.

Such tenants will be able to drive better deals than such service providers as law firms and advertising agencies, which have little in the way of assets and have suffered in past slumps.

During the last boom, midtown south, generally the area south of the mid 30's toto Canal Street, served as a safety valve for midtown, with old loft buildings converted to offices.

That area is largely filled, but there is some speculation that development may shift to the west side of Manhattan, in the 30's. Vornado Realty Trust, for example, has invested heavily in the area around Penn Station.

THAT may occur, but for most tenants that kind of an address is not acceptable, said Andrew Roos, executive vice president of Williams Real Estate. ''Most tenants are going to pay a few bucks more to stay where they are, rather than move to a fringe area,'' he said.

Referring to two of the most discussed ideas of recent years, having employees operate without permanent office space or work from home, Mr. Roos added, ''You don't hear much about hoteling and work at home any more. Corporations have found there is a synergy in keeping all their people under one roof.''

Many real estate executives agree that the current demand for office space is ultimately driven by the stock market. Not only does the boom in stock values make people feel wealthier, it puts executives in a state of mind that expanding their business is more important than squeezing expenses.

''Interest rates are low and the economy is good, so the mood is expansive,'' Mr. Emden observed.

But if the stock market were to drop sharply in value, that attitude could be reversed very quickly.

"If the market goes down 3,000 points, all this comes to a halt," Mr. Speyer said. "When the stock market dropped in October 1987, we felt it the next day, even though it took six to seven years to completely play out."