Commercial value

Contractors try to uncover true value in commercial maintenance work as clients force price reductions.

PHOTO: TREASURE ISLAND LAS VEGAS, D&K LANDSCAPE, KRISTI ATKINSON

As Brian Golembiewski describes the state of the commercial market, one can only picture a vast, vacant Western movie street with just the hint of wind and the slightest bits of tumbleweed rolling across the dusty, quiet space.

"There is such a huge amount of availability of commercial property right now, but nobody is buying," says the president of Tempe, AZ-based Paramount Landscape. "There are a ton of empty buildings out there that are just waiting for things to turn around."

But contractors didn't feel these effects right away. The recession hit the commercial market one to two years after it hit the residential market. Bob Grover's commercial customers started cutting back in mid-2009. "Some customers came to us and said their tenants needed rate relief and to find a way to reduce expenses," says the president of Hillsboro, OR-based Pacific Landscape Management. "We also saw our work put out to bid more and had more customers just flat out ask if we can cut our rates."

Even for contractors like Golembiewski, who had developer clients decide to finish projects they had already started despite the economy's effects, the work has been drying up.

These contractors are not alone. Spending on non-residential construction is likely to fall more than 20% this year before recovering slightly in 2011, according to an American Institute of Architects survey.

Looking at specific facility types, construction spending on hotels will drop more than 43% this year, construction of office buildings will decline almost 30% and retail and industrial categories will be down more than 20%, the AIA says. It forecasts smaller declines for institutional categories like amusement space, educational and religious facilities and health care buildings.

The AIA cites an oversupply of facilities, weak demand for space, continuing declines in commercial property values and real estate lenders' reluctance to provide credit as the reasons for decreases.

A Society of Industrial and Office Realtors study concurs, showing vacancy rates are beginning to level but rents remain depressed and subleasing space is high. The data also shows commercial real estate development remains stagnant in all regions with low investment activity — 88% of survey respondents say it's virtually nonexistent in their markets.

This is one reason — in addition to price slashing — Christy Webber is cutting back on her commercial

TAKE-AWAYS

2010 Commercial Client Setbacks

1. Price/bid wars.
2. Oversupply of facilities/high vacancy.
3. Weak demand for space.
4. Decline in commercial property values.

2011 Commercial Client Goals

1. Continue to build customer relationships.
2. Pursue commercial property types less affected by the recession.
3. Focus on smart negotiation of prices and services; ensure profit by improving internal efficiencies or reducing service offerings on the job to meet client needs and requested price adjustments.

construction offerings. "That's an area where people are practically giving away work," says the president of Chicago's Christy Webber Landscapes. "I don't want to deal with that."

Recovery of nonresidential construction activity typically lags a wider economic revival, especially an improvement in employment, which drives demand for office and retail space. Development acquisitions are beginning to grow in many areas in what AIA describes as a buyer's market. The organization forecasts single digit gains in most commercial categories in 2011 with an overall 3.1% increase in nonresidential construction spending.

Some segments of the commercial market are faring better than others. Contractors report college campuses eager to attract and retain students as a growth area. "They recognize the importance of image, even in tough times," says Andy Felix, president of Foxboro, MA-based Tree Tech.

These customers are starting to realize "they have vacant buildings that are going to stay vacant if I don't make them look nice," adds Todd Dilley, general manager of Minneapolis, MN's The Lawn Ranger.

And sometimes a negative is a positive in disguise. Developers cut services on their commercial properties back to the point where the banks took over in Tempe, AZ. "But the banks have the money, so they've actually been hiring us back," Golembiewski says. "If you stick around until the bank takes over, it can be a good account. We are back to the full level of service on some of those properties. Obviously, this isn't good for building owners who have lost their properties to the bank, but it's actually worked out for us."

While many contractors are fighting low bids on commercial projects, Joanne Kostecky reports finding a few project managers seeking more imaginative landscape solutions. "They didn't want the typical 'just put it out to bid and have the lowest bidder do the installation of a poor design,'" says the president of Joanne Kostecky Garden Design, Allentown, PA. "They wanted something more creative."

Shying away from commercial maintenance, Webber sees opportunity in municipal work — where 65% to 85% of her business is now based. "Even some of our good municipal contracts are cutting back," she admits. "But a good thing about a lot of municipalities is they won't just take the low bid. They are fed up with contractors who don't know how to do their paperwork and don't send a good crew out — they know it costs them more in the long run. They have dealt with that before and don't want to put up with it. So they go for the middle bid, which is where we try to sit."

While the national office vacancy rate rose to 17.4% — a level unseen since 1993 — the underlying numbers that make up national figures are shifting toward a more positive outlook. With favorable supply conditions entering the downturn, office properties are poised to rebound much faster once aggregate demand ramps up, according to a report by Reis, Inc.

As the country emerges from the downturn, economists say there will undoubtedly be some surprises in commercial real estate. Though patterns of fluctuating rents and vacancies may seem counterintuitive, Reis says it's quite common to see such results at the inflection point of an economic recovery. LM

26%

U.S. commercial real estate sales in the first half of 2010 totaled only a quarter of the average of the previous six years as owners kept properties off of the market.

SOURCE: REAL CAPITAL ANALYTICS

FOUR SQUARE

New York, Boston, Washington & San Francisco

Demand for commercial properties is the strongest in these four markets.

SOURCE: REAL CAPITAL ANALYTICS

OFFICE SPACE

1.4 million sq. ft.

The national occupied commercial office space decline.

SOURCE: NATIONAL REAL ESTATE INVESTOR

FACE VALUE

41

% commercial property values are down from their 2007 peak levels.

SOURCE: MOODY'S/REAL COMMERCIAL PROPERTY PRICE INDEX