'I Thought It Was A Mistake': Office Lease Expirations Are Lining Up, With Tenants In Driver's Seat

By Dees Stribling

It's an office tenant's world. Everyone else is just living in it.

On the heels of four years of hard times for office owners, a new wave of lease expirations is on its way. Tenants have leverage like never before as they negotiate the leases that will influence landlords' balance sheets for years to come.

"What we're seeing now, in the last 24 months, I've never seen before," said Atlas Capital Advisors Managing Principal Serge Vishmid, a tenant rep specialist. "There were times when tenants had the upper hand, but it's not like this."

About 217M SF of office leases are set to expire this year or in 2025, according to Cred iQ, with another 202M SF expiring in 2026 and 2027, based on its analysis of office properties financed by CMBS, which means the total will be greater.

This reality, coupled with historic office availability, means some truly remarkable negotiations for tenants that are scoring lower rents and more favorable lease terms.

Vishmid worked on a deal in December in which a 21K SF Southern California tenant was about to go forward with a lease renewal because its existing landlord had made what the tenant thought was a good offer.

"Then, at the very last minute, we got a phone call from The Irvine Co." Vishmid said. "They told me, 'We're going to be sending you something, and it's not a mistake.' I got it and I thought it was a mistake."

Irvine was offering rent 20% less than the relatively aggressive offer the existing landlord had made. The tenant took Irvine's offer.

"This market has created such an imbalance between tenants and landlords unlike anything we have ever experienced in D.C.," said Rich Lane, Transwestern executive vice president of tenant advisory in the company's Washington, D.C., office. "Tenants are taking advantage and receiving unprecedented rental abatement and tenant improvement allowances."

Landlords that aren't ready to play ball may find themselves holding the bag.

"Depending on the size of the tenant, landlords should embrace this opportunity to restructure leases two to four years before expiration, before the tenants become free agents in the market," Lane said. "My experience is that once a tenant sees opportunities in the market, the likelihood of their landlord retaining them greatly diminishes, and there are almost no market conditions that make replacing a tenant a better option than retaining them."

Over the last 18 months, Lane has represented five tenants occupying between 10K SF and 45K SF with two to four years remaining on their leases that prioritized renegotiating. But four out of the five landlords weren't responsive, asserting that it was too early to begin negotiations.

"Those four tenants all ended up signing leases at other buildings and will be relocating," Lane said. "In all four cases, the owners came back in late in an effort to salvage the deals but were too late. The one owner that engaged early was able to keep a 45K SF law firm and extend them for an additional 12 years."

Lenders, which have growing portfolios of office space as a result of delinquent loans, are even getting involved, but even they don't always have the final say.

The landlord's lender weighed in on negotiations in a late 2022 deal involving a 74K SF national headquarters in Orange County, California, Vishmid said. The space was up for renewal and the lender got involved, prohibiting the owner from dipping below a certain threshold.

"I suggested that my client go quiet and tell the landlord that they're exploring other options," he said. "The landlord came back with a huge rent reduction, 15% less than their absolute bottom, and concessions we didn't even ask for, such as additional parking, which is a big thing here in Southern California."

Not every deal will go like that, Vishmid said. Geography and the quality of the building play a big part. In the case of a tenant in South Florida that wanted to be in better space — a move from a Class-B property to Class-A — the landlord actually had the upper hand, since more than one tenant was interested in that particular space.

Higher-quality properties have been in higher demand for years, as those tenants that still use their offices want their spaces to be worthwhile.

Direct availability for trophy properties stood at 17.7% nationwide in the first quarter, while total direct office availability was 20%, according to Avison Young data.

South Florida is also one of the few metro areas left in the country where office vacancies are relatively low. The Miami-Dade vacancy rate stood at 15.4% in Q1, according to Cushman & Wakefield, compared to 23.4% in Manhattan.

Nationwide, office tenants seeking space are becoming more common as leases expire. A new report from JLL shows a 28.3% annual increase in the company's tenants-in-the-market index, which places the level of tenant demand in the market in the first quarter of 2020 at 100. The index moved to 72% of pre-pandemic levels in the first quarter.

Concessions, while common, don't appear to have escalated in the last two years, Lane said, indicating they may have peaked.

In a typical 12-year lease at a building with rents of $70 to $75 per SF, the average concession package is worth $280 to $310 per SF.

“This is equivalent to about four to five years of rent, so on a 12-year lease, there really isn't much, if any, more an owner can give to make a deal,” Lane said. “In fact, there are several cases where owners have decided not to compete in this market given these transaction costs.”