

Landlords should consider choosing 'spec' program

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If you're a landlord fighting to emerge from this most recent downturn, you've probably gotten accustomed to seeing your bottom line systematically eroded by high vacancy rates. While class A buildings are finally experiencing some sustained relief, B and C properties are still finding it difficult to stabilize.

In a tenant's market, aggressive landlords are perpetually seeking ways in which to creatively differentiate themselves from the competition. Most landlords have been offering incentives of one kind or another for years, including everything from free rent to new furniture, broker perks and more. Some landlords have found great success with this particular tactic. But incentives don't always win the deal, regardless of how attractive they may be.

At some point in a high vacancy cycle, landlords need to determine how prudent it is to keep dangling money in front of each individual tenant. For many, it makes more fiscal sense to invest those incentive dollars back into their buildings. One way to best utilize limited capital in a recovering market is to offer a spec suite program.

"Spec" or speculative suites are office spaces landlords proactively build out prior to securing a committed tenant in an attempt to anticipate the needs of the market. These pre-built office spaces generally appeal to small- and medium-size tenants and are designed to survive two to three leasing cycles with minimal modification. The move-in-ready suites can range in size from 800 to 3,000 square feet, depending on the size and physical characteristics of the building.

A spec suite program converts large blocks of vacancy into multiple, contiguous suites that are designed to appeal to the broadest possible market segment. These high-quality, move-in-ready suites present multiple options at one location, including a variety of finish packages, open or closed layouts, and expansion flexibility.

The idea of spec suite programs is not new. Landlords have been using them with varying degrees of success for decades, as cycles change and vacancy rates fluctuate. The big concern for landlords is whether or not they can completely commit themselves to employing the program. It takes significant financial resources, and creative vision to determine how best to market the suites for rapid lease at the highest possible rates.

Virtually any landlord can shoehorn a spec suite or two into any given building, with little regard for quality, design, or long-term flexibility.

However, the more restrictive any given suite is, the fewer prospective tenants will take notice. Landlords who are not willing to make a significant investment in their vacancies -- in both volume and design time

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-- might be better off leaving the spaces in raw condition. Spec programs require patient execution and often, more money up front in exchange for significant cost savings later.

Landlords committed to pursuing a spec program will achieve the most value by learning precisely when to employ the strategy. Traditionally, an ailing market stimulates landlords to build more spec spaces, as B buildings lose tenants in a flight to higher-quality A properties. This movement is accompanied by a compression in rental rate spreads among all property classes, which in turn results in tenants from all classes looking to upgrade to better space at bargain prices.

Buildings with larger blocks of vacancy -- typically 10,000 square feet or more -- are usually good candidates for spec programs if the floor plates lay out well for smaller tenants. From a construction standpoint, the landlord benefits from economies of scale if multiple spaces are built out simultaneously. Similarly, over time, small tenants that lease spec suites are highly likely to "incubate" and expand within the building, or perhaps even take space in another property of the same owner's portfolio. Landlords benefit from the opportunity to retain and grow existing tenants, while reducing future leasing costs.

Spec programs, like other cyclical real estate trends, seem to produce a bandwagon effect. Successful models inspire other landlords to give it a try, especially when more traditional methods aren't working. There are spec programs all over the metro area, but none are more plentiful than in Denver's sprawling Southeast submarket.

Within that submarket, Greenwood Village and Centennial alone account for 7.7 million square feet of total inventory, according to the CoStar Group, an industry tracking service. Of that amount, a staggering 2.8 million square feet of buildings have spec space available for lease. To put it another way, one of every three buildings in those areas offer some type of move-in-ready space.

Marketing is perhaps the most critical element in attracting a prospect's attention when there are so many available options to choose from.

The leasing strategy for a spec program must be communicated and executed to appeal to the specific needs of prospects. The marketing team must be able to anticipate those needs, and offer what traditional leasing does not, like same-day turnaround on proposals, abbreviated lease agreements, and one-stop, space shopping alternatives. This type of "high touch" service allows landlords to attract a greater number of users and convert them to long term tenants.

Ultimately, successful spec landlords can achieve higher lease rates because tenants are willing to pay more for convenience and bundled services, even in a challenging market. But only if the product is of high quality and only if the design, execution and marketing are responsive to the requirements of the market.