

Class B occupancy suffers from moves to Class A finery

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by [Jane Aldinger](#)

Class B office space in East Memphis has been fighting a losing battle over the past several years.

Singing the same tune as "The Jeffersons" theme song, tenants have been movin' on up into newer, Class A space as landlords have offered concessions and dropped rental rates.

Class B vacancy in the East Memphis office market is almost triple Class A's vacancy, according to CB Richard Ellis' fourth quarter 2004 Memphis Office MarketView. For the East submarket, Class A space posted a 5.8% vacancy rate while Class B logged 17.1%. Marketwide, Class B vacancy is 20.6% while Class A stands at 11.1%.

Clark Tower, for example, has taken some big hits, most notably with the exit of Gate Gourmet. The 57,000-square-foot tenant is relocating its headquarters from Memphis to Washington, D.C., and leaving a large hole behind at the 33-story landmark, where it has operated its offices for at least 25 years.

The building is also losing 20,000-square-foot tenant Nationwide Insurance to Highwoods Properties' Class A Shadow Creek II development in the 385 Corridor. Clark Tower now has floors 8-14 vacant, although there is no 13th floor.

"I'm going to be able to put together seven floors and 110,000 square feet for a large user on Poplar Avenue, which nobody else has," says Ron Riley, director of leasing for In-Rel Management, Inc., which owns and leases the building. "It's a unique opportunity for some sort of large corporate user that wants a presence on Poplar."

Riley is not necessarily waiting for a 110,000-square-foot user; each floor plate is about 18,000 square feet, and Frazier Baker, In-Rel leasing associate, says In-Rel plans to select at least one of those floors to demolish and take down to shell -- basically allowing a tenant to completely build-out its own space.

"I think we offer a competitive rate in comparison to other Class B and especially Class A properties," Baker says. "We can offer the amenities of a Class A building at a Class B rate."

The tower's advertised price per square foot is \$17-\$18.50.

Patrick Reilly, **CB Richard Ellis Memphis** marketing specialist, leases PennMarc Centre and the **NBC Bank** Building on Poplar and says the Class B tenants have been able to jump into Class A properties during the market downturn with little to no occupancy cost increases.

"As soft as the market has been, you have many landlords who've been willing to put incentives on the table," Reilly says.

The NBC Bank Building is currently about 85% leased, but about 27,000 square feet of the 164,873-square-foot building is leased to Coca-Cola, which has vacated the property. The 134,608-square-foot PennMarc Centre has 37,289 square feet available and is 73% leased.

Defining a building's class is subjective, although there are some widely recognized Class A properties in the Poplar East Memphis submarket that include Crescent Center, Renaissance Center and International Place. John Mercer, Highwoods' director of leasing, says those buildings have filled up during the recession, (the 338,396-square-foot Crescent Center is currently 98% leased), and some other buildings have suffered as a result of Class B tenants moving up.

The Atrium I and II properties, as well as The Centrum building, are both Class B buildings on Poplar developed by Highwoods; Atrium is about 81% leased and Centrum about 83% leased.

Highwoods' Class A buildings along Poplar tell another story. International Place Tower II is fully leased, 6060 Poplar is 95% leased and 6000 Poplar is currently 87% leased.

But Mercer says the pendulum is swinging back in favor of landlords.

"I believe it is turning back to the landlord, and I think these Class B buildings will benefit from it because there's not a lot of A left and those A spaces that are going to be left in a landlord market are going to be garnishing the higher rates that certain tenants can't afford," he says.

Joe Steffner, president of Steffner Commercial Real Estate Services, cites several reasons for the Class B vacancy on Poplar, including the fact that a disproportionate majority of sublease space was in Class B buildings.

"As that sublease space burned off and was not refilled by subtenants, it became vacant inventory," he says.

The decline of Class A rates and availability of Class A sublease space has allowed some tenants to move into Class A buildings, leaving behind holes along Poplar, but Steffner says those Class B holes will be filled along Poplar first when the market kicks back into gear.

"Because there's not that vacancy in Class A space and because those rates will continue to rise, the Class B space will start regaining occupancy again," he says. "Memphis always is the last to feel the rebound from a recession and across the country; what we're seeing in the larger cities now is a rebound."

Class A office rents posted gains in 2004, which is a good sign for Class B vacancy. Although overall quoted rates fell \$.11 per square foot from third to fourth quarter 2004, they increased \$.36 compared to year-end 2003, according to the CoStar Office Report year-end 2004. Class A quoted rates, now standing at \$19.42 per square foot, increased by \$.86 per square foot compared to fourth quarter 2003.

A big concern for the Class B buildings is in profit returns as landlords have dropped their rates to cut deals, Steffner says. Another Class B building problem is that some older buildings aren't as efficient as their newer counterparts, and functional obsolescence in floorplans and layout can come back to bite a B building, Mercer says.

Most of the 385 Corridor's properties have been built within the last 5-10 years, and are thus classified as Class A space. There is about 5.3 million square feet of Class B space in the East submarket, which makes up half of the total Class B space -- 10.6 million square feet -- according to MarketView. Downtown has 1.26 million square feet of Class B and the Airport submarket has about 1.75 million.

The 649,033-square-foot Clark Tower has a lot of space to fill, but In-Rel is a long-term holder that has invested heavily in building improvements. Since purchasing the Clark Tower in 2003, In-Rel has implemented a lobby renovation, opened The Tower Room restaurant on the building's top floor and added flat screen televisions in elevators.

In-Rel is looking at the possibility of granting building-top signage rights to a tenant who leases multiple floors. It is also exploring the idea of a 5,000-square-foot fitness center complete with men's and women's locker rooms.

As long as developers hold off on dumping more space on the market, the Class B vacancy problems should even out, brokers say. Speculative construction is still not an option for developers, Mercer says, and any new construction would require a significant amount of preleasing.

"At least today we've got realists out there building because of a true need," he says.

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