

Changing With the Economy

A Real Estate Story

Last week I went to lunch for the final time at a local Chinese restaurant that I had frequented for years. The restaurant was an institution in the area and had been there for years. It was the latest casualty of the slumping economy. The owners decided not to renew their lease and closed their business because of declining sales and the landlord was unwilling to reduce their rent that had risen steadily over the years. It was a common story that we have heard too often - slumping economy and rising rents.

It is understandable that the landlord does not want to reduce rents, especially in a slumping economy. Tenants throughout the complex are leaving. This has resulted in a decline in revenues. Expenses keep rising. It seems like the cycle never ends. Yearly rent increases may be acceptable in a growing economy as tenants compete for premium space. However, when the economy is stagnant or declining, it becomes harder to replace a tenant.

Someone a lot smarter than me and who was in property management, once told me that it was in the property owner's best interest to keep the building fully occupied. If there was a vacancy, it should be rented as soon as possible. Depending on market conditions, the rent could go up, down or remain the same. In a declining market, the premise should be rented at the same or slightly lower rent. Special consideration was given to existing tenants with good track records. Although the landlord may desire a higher rent for the premise, that desire may not necessarily be connected to the reality of the market place. Unless there is a new tenant already lined up for the space, the loss of income for each month that the space remains vacate will continue to grow until a tenant who is willing to pay the higher rent is found and signed to the dotted line.

In a stagnant economy, the landlord has to look at what it will cost to keep the premises vacate. Where is the money going to come from to cover the income expected from this unit? What is the market rate for a comparable unit? What other properties are competition for the same type of tenant to rent to and around the same price range? A more important question to ask is how long will it take to recover the loss rent after a new tenant has moved in? It is human nature to not want to reduce the rents even in a declining market. Refusal to do so means that the property becomes vacant.

In the restaurant's case, the premise remains vacant. There are other storefront vacancies in the complex. The loss of revenues to the owner of the complex continues to grow. Wouldn't it have made better business sense to retain an existing tenant who has been paying its rent on time by reducing the rent. There would be one less vacancy, income would continue to flow in, and the landlord's losses would be reduced.

Of course it is up to the landlord or business owner to recognize the reality of the economy and to move quickly to stem its losses. One possibility is to cut prices. Failure to take timely action will increase the losses and the landlords will join eventually their former tenants in closing their doors.