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A near-record glut of office space in the metro area offers small companies ample relocation opportunities for bargain lease rates.

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BODY:
Stan Hargrove's research company has grown steadily since he opened shop in Minnetonka 18 years ago after a big downtown accounting firm decided it no longer needed his services.

When his lease came up for renewal this year, Hargrove asked his real estate broker to look for a space in Butler Square, a historic building next to Target Center in downtown Minneapolis. Not only was he able to get offices in a building he has always loved, he's paying less per square foot than he paid in the suburbs, where he was growing bored with "ducks, grass and trees."

With office vacancies at near-record levels in the downtowns of Minneapolis and St. Paul and in some suburban markets because of downsizing and consolidations by large companies, brokers are finding great spaces at bargain prices for small businesses, such as Hargrove & Associates.

Vacancy rates of 20 percent and more, up from 6 percent or less a few years ago, have caused brokers to chase small, emerging companies in the hope that they'll grow into spaces being emptied by big-but-shrinking companies, according to United Properties, the large Bloomington-based real estate firm, and representatives of other brokerages.

"We see more and more of our real estate tenants who are entrepreneurs seeking the best new way to do business," United CEO Boyd Stofer wrote in a commentary on the current outlook for commercial real estate. "And we have learned the hard way that stability and credit-worthiness are not assured based only on the size of the company leasing space from us or our clients."

And with cutbacks at big corporations, there's no shortage of people who, as Hargrove did years ago, are choosing to start their own businesses rather than seek work with other companies that might put them back on the street.

Bill Kelly and Steve Alpeter learned the equipment-leasing business at Chicago-based Comdisco Inc., one of the largest business-equipment leasing and technology services companies in the world until it collapsed into bankruptcy last year. Now the two friends and neighbors have leased Class A office space in Edina's Grandview Square, where they can be their own bosses in a brand-new, gleaming structure a mile from where each of them lives. They know such space might not have been affordable to their start-up firm, First Premier Capital, if the office market hadn't been so soft.

Before the office glut hit two years ago, brokers were looking for bigger deals than a seven-employee venture such as theirs.

"They were elephant-hunting," Alpeter said. "We're just squirrels. I think we've benefited from it."

United Properties Vice President Jim Jetland agrees. "We're seeing a lot of smaller users, entrepreneurs laid off by corporate America." Jetland found the Grandview space for First Premier at 10 percent below the asking price. He could have secured an even-better deal in Eden Prairie's Golden Triangle, where high-technology failures and other factors have created a vacancy rate of about 40 percent, compared with 20 percent or more in the western suburbs and in the downtowns.

Brian Helmken, a vice president with CB Richard Ellis, represents landlords in the depressed southwest-metro market. He has been reminding his colleagues for months that hunting squirrels has worked during previous downturns in the office market and can work now.

"I had two guys who went in a sublease I was marketing, former local executives with Sprint," Helmken said. "They started their own company at 3,000 square feet in great space at great rates. We had all these great companies _ Honeywell, Cray, Sperry Univac _ cut people back in '85, '86, and they all went out and started their own businesses."

Kevin O'Neill, vice president for office leasing at Welsh Companies, said building owners are making concessions on lease terms to start-up ventures in an effort to fill empty offices. Rather than asking for the three- or five-year leases that larger companies typically sign, "I'm seeing a willingness of landlords to do shorter-term deals _ one- or two-year leases _ with these smaller entities," O'Neill said. "The owner can fill up the space for a year or two in a tough market, and a new entity can go in and get some attractive space."

Said Brent Erickson, a senior associate with United: "We're seeing people starting businesses, individuals breaking away from established companies." Erickson got Hargrove's 11-person company into Butler Square. With prices so low, he said, these entrepreneurs can even afford to lease extra space to accommodate future expansion.

One United client, a marketing-communications firm called the GEM Group, was able to move from a multi-tenant building in Edina to its own building in Minnetonka and save 20 percent per square foot. Thanks to the dot-com failures in the suburbs, GEM President David Kuettel had his pick of suburban office spaces for a company that has grown from 17 employees in 2001 to 43 this year.

"It's good for employees," Kuettel said of his new headquarters. "It's good for morale. Clients feel good when they come here. I'm pleasantly surprised."

Dealing directly

Erickson said it's not more lucrative to work with entrepreneurs than with the big tenants, but it's often more enjoyable.

"When you deal with the smaller companies, you're dealing with the person who is the owner and CEO, and they typically don't say, 'Talk to my real estate expert,' " Erickson said. "They need the advice and they need the counsel, and I really enjoy dealing with the people who are the passionate decision-makers of their businesses."

He said he might as well enjoy it, because the big companies aren't likely to be looking for space anytime soon, for a variety of reasons.

Erickson, who specializes in downtown Minneapolis space, said a wave of anticipated consolidations by big tenants combined with some unanticipated recession-related downsizing, have turned his attention to smaller users. Companies such as Wells Fargo, American Express, Target and AT&T freed up downtown office space when they consolidated into their own buildings. And the recession that followed the 2001 terrorist attacks caused other large companies to put space on the market.

"Now you have to focus on a broader range of business sizes because you can't count on the large users to be your security blanket from a credit standpoint and a growth standpoint," Erickson said. "Right now I'm staring at a pile of 15 to 20 different transactions, and I don't think any of them is over 15,000 square feet. Last year by this time, I'd probably done three transactions that were 50,000 square feet in size."

Down to three

Kelly and Alpeter say their experience at Comdisco illustrates the changing office market.

"In Minneapolis, at one time, we had about 200 employees and we had close to 80,000 square feet of office space," Kelly said of his former employer of 16 years. "And it came down to three of us in the Northland Plaza in 1,200 square feet" until the office closed in September.

Rather than try to hook on with another leasing company as sales executives, Kelly and Alpeter teamed up with a Sioux Falls bank that was interested in an equipment-leasing affiliate.

"Despite the economy we're in, we can say we're ahead of our projections," Kelly said of his new company, which opened for business in November. "We're at a run rate to do somewhere between 125 percent and 150 percent of our first-year goal. We can't wait until pocketbooks open up again because we think there's a lot of pent-up demand."

He and Alpeter hope to be doing $75 million in leasing revenue within a couple of years and have 15 or 16 employees. To accommodate that growth, they've taken an option on some adjacent space in Grandview Square that includes doors facing onto the ornate first-floor lobby.

Jetland said he has confidence that First Premier Capital will succeed in growing from a small tenant into a large tenant. But during his years with United, he has seen companies grow from start-ups into large firms and shrink back to smaller tenants. He recalled finding about 1,200 square feet of space for Born Information Systems when that company was starting and seeing the company take more than 100,000 square feet in Minnetonka's Carlson Center before shrinking because of the high-tech collapse.

Hargrove not only was looking for more space but wanted the stimulation of a downtown location.

"Butler Square is where I always wanted to be, but it was always too expensive," he said. Until now. On the seventh floor of Butler Square, with windows providing a view of downtown on one side and the nine-story atrium of the restored office building on the other, Hargrove is happy with his real estate bargain.

"This is the first time we've moved when it's a buyer's market," he said.

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Twin Cities office vacancy rates

Total vacancy rates for commercial property in the Twin Cities which have risen steadily the past five years, took a big jump in 2002. Downtown Minneapolis took the biggest hit, as its vacancy rate rose to 23.1 percent from 13.7 percent in 2001.

- Annual netro-area vacancy rates

'95 10%

'97 7.5%

'02 20.5%

(See microfilm for complete chart.)

Northeast 15.2%

South/Airport 17.8%

Southwest 18.3%

West 19.6%

Metro area 20.5%

Northwest 21.7%

St. Paul CBD# 22.3%

Mpls. CBD# 23.1%

#CBD - central business district

Source: United Properties

GRAPHIC: CHART; PHOTO

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