CONNECTING REAL ESTATE IN THE WEST

# WESTERN REAL ESTATE BUSINESS

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## WESTERN OFFICE REPORT

### Southern California

There is no question that the office sector in Southern California is one of the hardest hit in the country. While Southern California's real estate has a tendency in the good times to escalate to even higher levels with greater returns than most other places in the country, it also has a tendency (in a downward spiral) to fall harder, faster and with more impact on the local economy.

The impact to the commercial real estate market, including declining property values, increased vacancy rates and reduced returns, have impacted investors of all types such as REITs, large developers and individual investors The name of the game right now is stabilization. Many landlords and property owners in the office market are looking to fill vacancies and create cash flow on their properties to reduce financial exposure. The values to those commercial assets will not return for some time, and savvy investors with significant capital are looking to take advantage of distressed asset sales.

Many of the larger office complexes that were developed and/or purchased at the height of the real estate market have now traded hands. This trading at current market pricing allows the new ownership to be able to lease the properties at an aggressive market rate that still provides for a return. While this does nothing to help the current rental rates in the marketplace, it does make a step at re-stabilization of the asset and will fuel leasing activity and absorption.

Certain submarkets will fair better than others. Those such as The Miracle Mile in Los Angeles, Beverly Hills, La Jolla and Newport Beach's Fashion Island, which cater to high-end users with limited amount of space and as a result less vacancy, will retain higher rental rates and higher property values. Nonetheless, they all have taken significant hits in their position from the height of the real estate market.

Other submarkets such as Corona and most other cities in the Inland Empire, as well as Carlsbad in north San Diego County, have taken a significant beating with respect to rental rates and property values. The overbuilding in these areas and lack of depth of available tenants and businesses to absorb the vacant space creates a difficult situation for property owners. Office vacancy in Carlsbad is in excess of 30 percent, and buildings offer as much as 1 year free rent knowing that there are few tenants to lease a multitude of vacant space.

In the Inland Empire, rental rates have dropped as much as 40 percent, and those businesses tied to the real estate, finance and mortgage sectors of the economy, which previously occupied a majority of the office space in those areas, are virtually non-existent and at the moment. There are no new businesses to take their place. The recovery will be a long one and will be accomplished by making deals one at a time.

The good news is that the majority of companies and tenants in the marketplace who were severely struggling and on the brink of failure has either disappeared or stabilized their operations so that they can see somewhat into the future. This allows tenants to sign longer-term leases and have a better comfort level with regards to the outcome of their business. Those tenants who are stabilized and have the capacity to sign a long-term lease have the ability to take advantage of the lowest rental rates in a long time and will be able to curb their expenses for the long haul and hedge against future increases in rental rates down the road.

Investors with holding power and capital reserves will do extremely well as the market recovers. The forward-looking real estate professional and savvy investor view the economy as an opportunity. Remember that real estate is a cycle — it goes up and down — and those that can roll with the punches will be better off at the end of the day.

*— Barry Saywitz is president of Newport Beach, California-based The Saywitz Company.*