

Surplus Commercial Space a Windfall for Bargain-Hunting Tenants

REAL ESTATE: Landlords lure Small Businesses With Markdowns and Makeovers

By MARION WEBB

As continuing high vacancy rates among San Diego County commercial properties force landlords to sharply cut rents and offer concessions as a means of keeping existing tenants and attracting new ones, the weak market can mean big bargains for savvy small firms looking to lease or purchase space.

Stacey Hansen, senior property manager for Essex Realty Management Inc., an Irvine-based commercial property management firm, manages several commercial properties in North County, including the



Stacey Hansen

Los Vallecitos Business Park in San Marcos, which houses Hansen's office.

At the Vallecitos Business Park, many of Essex's mostly small-business tenants took a financial hit, forcing them to leave the building, Hansen said.

"We have had tenants who have been here for 20 years move home or move out to purchase their own building," Hansen said.

Last year, an engineering tenant with three employees left the building after leasing space at the property for 15 years, he said.

"Their business had dropped so much that it didn't make much sense for them to pay rent when they had home offices," Hansen added.

The engineering tenant wasn't alone.

Retail Center Half Empty

Since Hansen started managing Essex's retail center — a 13-suite building located off El Camino Real in Oceanside — back in 2007, the management firm has lost 50 percent of its tenants.

"A couple went out of business, a hair salon (owner) decided to rent a chair at another salon, a deli had to shut down because when the economy went down they couldn't sustain revenues," Hansen said.

"Their timing was just horrible," she added, in referring to the opening of the deli.

In an effort to retain tenants and draw new ones, Essex lowered its office space lease rates at the retail center in 2007 from between \$1.50 and \$2 per square foot per month to \$1 to \$1.70 per square foot per month, according to Hansen.

However, that has not translated into a rush of new tenants, Hansen said.

At the Vallecitos Business Park, Essex is offering one month of free rent for every year signed on a lease agreement, Hansen said.

To make the property more attractive, Essex renovated each suite, asking for \$1.65 per square foot per month of office space, but then dropped rates even further to \$1.25 to \$1.10 per square foot per month. Industrial space at the business park now runs 77 cents to 79 cents per square foot

per month, which also signifies a steep markdown from three years ago.

Total occupancy at the park is now at about 80 percent: "Four of seven buildings are fully occupied," Hansen said.

Office Vacancies Remain High

Statistics on the San Diego County office market published by the San Diego Business Journal in its March 29 issue suggest an overall upward trend in vacancies, and with it, lower lease rates.

According to the news report, of the 111.4 million square feet of office space countywide, 17.1 million square feet, or 15.4 percent, remained vacant. This is the highest vacancy in 16 years in San Diego.

The report suggested that another 3.8 million square feet of office space is likely vacant, but not on the market, because it is still under lease by companies that have no current use of the space.

For businesses looking for space or existing tenants looking to restructure their leases, the weak office market leaves the window of opportunity for landlord concessions wide open.

Doug Regin, assistant director for MAAC Project Head Start, located at the Vallecitos Business Park in San Marcos, said his organization greatly benefited from hiring **Irving Hughes Inc.**, a San Diego-based commercial real estate company that exclusively represents tenants.

Under a new five-year lease agreement, MAAC Project Head Start pays a lower rate than originally proposed by Essex and negotiated \$160,000 in additional funds for

tenant improvements: new carpet, fresh paint and restroom renovations, he said.

MAAC Project Head Start and Early Head Start, a federally funded program serving 1,200 low-income children and their families in North County, recently received \$1 million in government funding to serve 100 more children in the area. Therefore, the expansion was needed and location was also critical, he said.

"We needed more space (to serve the children) and (needed to) continue to stay where we were," Regin said, adding that the project has been operating at the business park for the past 14 years.

Small Businesses Seek Office Space

Jeff Saywitz, managing director of San Diego operations at The Saywitz Co., a national commercial real estate brokerage and consulting firm based in Newport Beach, said that in the last 18 months he has seen a 20 percent to 25 percent jump of small-business clients looking for office space.

"A lot of tenants who weren't aware of the use of our services or thought it would cost too much and dealt with the landlords directly started to realize that there is big money to be saved," Saywitz said.

He stressed that The Saywitz Co. exclusively represents tenants looking to buy or lease space and charges the landlord a



Jeff Saywitz

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Irvine Co.:

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and subcontractors all working on their projects at any given time," said Byer. "It's great for us. The tenant improvement is not very strong. We don't have to lay people off and we're able to keep our operations together."

With Irvine Co. as a contracting customer, he adds, "They pay their bills, they want quality work and they're right in our backyard."

And, he adds, "It's a good time to do this. They're getting good (construction) deals right now."

Cash Flow to Pay for Improvements

He figures The Irvine Co. can do off-market renovations because it gets revenue from "other legs of the table," such as its apartment holdings, when less diversified companies aren't willing or able to do the same.

Byer credits the real estate acumen of Irvine Co. chairman Donald Bren for the company's success.

"The company is owned by a private individual," said Byer. "He doesn't have a bunch of Harvard M.B.A.'s telling him what to do. He just wants everything he owns to be top-notch."

One office tenant of the Irvine Co.-owned Plaza at La Jolla Village in UTC is commercial real estate brokerage CB Richard Ellis. Rob Merkin, senior vice president at the office, says The Irvine Co. goes out of its way to keep tenants happy.

"They do a first-rate job of managing their buildings," he said. To tenants, he



Photo courtesy of Veralliance Properties

Class A office space can be leased at this 10300 Campus Point Drive building, which is currently 55 percent occupied.

adds, "They're always respectful and responsible. If anything goes wrong, they're on it immediately."

In UTC, he sees Irvine Co.-owned building improvements as a major competitive strategy to keep the upper hand there in office leasing. "I think they always want to be considered to have the finest assets in that submarket."

Merkin admits, however, that the company's maintenance efforts seem to border on the excessive.

"They're painting a railing before I even see a chip in it," he said.

Aggressive About Tenant Deals

The company is also aggressive in cutting deals to land new tenants, adds Merkin.

"They continue to react to the marketplace. Lease rates have been in a downward trend for some time, and they continue

to try and stay in front. They're tough to compete against."

Irvine Co.'s Cheney says the office space occupancy of the company's San Diego buildings "is less than I'd like, but better than I expected."

Companywide last year the company leased 6.7 million square feet of office space, with San Diego property contributing 1.1 million square feet of that. In San Diego for this fiscal year, which ends June 30, says Cheney, "I expect to surpass that."

His reasons for seeing better times ahead?

"We're seeing increased activity," he said. "We're seeing tenants who are expanding when they renew (leases), and there are more new tenants in the marketplace. Those are very positive signs."

Mark Larson is a freelance writer for the San Diego Business Journal.

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commission, not the tenant.

"Our goal is to get tenants the best deal possible," Saywitz said. "It's a great time to be a tenant in today's marketplace with rents being as low as they were 10 years ago."

He has also seen office space rates drop significantly in San Diego County: An office space in a newer high-rise, Class A building that typically costs \$3 or more a square foot per month is now available in the \$2 range.

Beneficial Subleasing Arrangements

Also, in this marketplace, a bigger firm's loss can be a small firm's treasure.

Saywitz said that subleasing space from existing tenants, who need to get out of the space themselves, often enables small firms to lease space at lower rates than what landlords would offer them. And that isn't including deal sweeteners, such as tenant improvements.

"There are more sublease opportunities than ever before," Saywitz said. "We do deals with clients where the landlord throws in furniture, computer systems, security systems for free. This really adds significant value for small-business owners who would have to purchase these things, which can cost hundreds of thousands of dollars."

Some experts predict that the need for office space will continue to decline, as more people work from home and the use of office spaces become more flexible.

Marion Webb is a freelance writer for the San Diego Business Journal.