

The San Diego  
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## Commercial landlords feel squeeze

*Competition heats up to get — and keep — good tenants*

BY [ROGER SHOWLEY](#)



EDUARDO CONTRERAS / UNION-TRIBUNE

Paul Twardowski (left), a Hines vice president, and Tom Turner, managing partner at Procopio, Cory, Hargreaves & Savitch, at a Hines-owned building in San Diego. Procopio, a law firm, will occupy the space.

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## SAN DIEGO COUNTY COMMERCIAL REAL ESTATE VACANCY

Third-quarter rates for office and industrial; June rate for retail

	Inventory (millions of square feet)	Vacancy rate	
<b>Office<sup>1</sup></b>			
South Bay	2.3	33.1%	
North County coastal	10.3	22.3%	
Interstate 15 corridor	7.0	20.5%	
San Diego city north	20.2	20.1%	
Downtown San Diego	11.0	15.2%	
East County	1.8	14.6%	
Suburban San Diego	19.2	13.8%	
<b>Total</b>	<b>71.8</b>	<b>18.3%</b>	
<b>Industrial<sup>2</sup></b>			
Interstate 15 corridor	20.5	15.2%	
South Bay	30.9	13.6%	
San Diego city north	43.2	13.3%	
North County coastal	51.2	12.8%	
Downtown San Diego	7.5	7.4%	
Suburban San Diego	21.3	6.1%	
East County	14.2	5.0%	
<b>Total</b>	<b>188.8</b>	<b>11.7%</b>	
<b>Retail<sup>3</sup></b>			
North County coastal	3.0	9.5%	
State Route 78 corridor	8.9	8.9%	
San Diego city central	6.9	8.7%	
South County	6.3	7.6%	
Interstate 15 corridor	8.9	7.1%	
East County	7.0	6.5%	
Mid-county beach areas	2.7	3.7%	
State Route 56 corridor	0.7	3.7%	
<b>Total</b>	<b>44.4</b>	<b>7.6%</b>	

1: Includes office buildings and office parks containing more than 10,000 square feet and subleased space.

2: Includes industrial properties of more than 1,000 square feet and subleased space.

3: Excludes regional centers and noncompetitive, unanchored

SOURCE: Cushman & Wakefield

MATT PERRY / Union-Tribune

If you're a lawyer downtown, a warehouse operator in Poway or a restaurateur in North Park, the bad economy makes it a good time to be a tenant.

Vacancies are rising, rental rates are falling, and landlords are desperate to keep their commercial tenants — or steal them from somebody else.

Nationally, real estate economists expect conditions to remain this way for at least another year. New construction isn't likely until 2013.

"After more than a year spent in suspended animation, lagging already shattered housing markets, the commercial real estate industry hits bottom in 2010," the Urban Land Institute said in a report last week. For San Diego County, the institute said commercial prospects are "fair" but are likely to rebound faster than other areas.

For tenants, the turn from boom to bust has given them more bargaining power than they've had in at least 15 years. They can threaten to move unless they get such things as rent reductions, remodeled interiors or extra parking spaces. If the offers aren't good enough, tenants can find landlords willing to give them free rent, better sign rates and other amenities.

"We're just at that point in the cycle where all things can be demanded and mostly be gotten," said local real estate analyst Gary London.

The San Diego  
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Procopio, Cory, Hargreaves & Savitch, a 240-person law firm, is taking full advantage of the tenant's market. The firm has been in the Union Bank Building at 530 B St. for 40 years, but it has sprawled onto nine of the building's 8,600-square-foot floors.

With the lease coming due, the firm decided to shop for more efficient space. It was committed to staying downtown, so the firm considered Symphony Towers and Columbia Center before signing a 10-year lease at the building across the street at 525 B St., owned by Hines and sporting the Reed Elsevier name at the top. The floors are nearly 20,000 square feet each.

"Hines was particularly aggressive with their proposals for us," said Procopio managing partner Tom Turner. "In addition to the pricing, there were some noneconomic items that really made 525 stick out for us."

Hines will put the law firm's name at the top of the building, build an open-air garden on the top floor and install internal glass stairwells between floors.

As for Union Bank, which owns Procopio's old digs, it would have preferred no change.

"The advantage we had was we probably could have offered them a little cheaper rent," said Craig Poletti, senior vice president for real estate. But he said the bank needs more space and Procopio's departure will make that possible.

Vacancies abound even in popular coastal and inland areas. Cushman & Wakefield's San Diego office found in its third-quarter review that:

- Office vacancies stand at 18.3 percent, or 13.1 million square feet. It's as if all downtown office buildings and three-fourths of the University Towne Centre-Golden Triangle office market were emptied out.

- Industrial vacancies are at 11.7 percent, or 22 million square feet, the equivalent of all of the industrial space in Kearny Mesa and Rancho Bernardo.

- Retail has the lowest vacancy, 7.6 percent, but even at 3.4 million square feet, that's as much space occupied by Horton Plaza, Fashion Valley and University Towne Centre.

Analysts are most fearful of retail's prospects because shoppers are gravitating to discounters and online merchants. Some marginal strip malls are likely to remain vacant for so long that their owners might as well bulldoze them and build something else such as apartments, London said.

"That's a huge story," he said. "I think people don't get this. They understand it intuitively, but not how big a deal in life it's going to be."

Some tenants are deciding to move, even if it isn't convenient geographically. In the case of Mor Furniture for Less, its landlord wanted to sell the Poway property where the company has operated a distribution warehouse for eight years.

Company owner Rick Haux Jr. said he is moving to a 200,000-square-foot warehouse in Otay Mesa, where the rent will be about 40 percent less.

"It was simply an economic decision," he said.

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Other tenants are in expansion mode and grabbing deals wherever they can get them.

Antonino Mastellone, who has opened more than a half-dozen Italian restaurants in the county in the past 15 years, has another in the works in North Park. He said some landlords are cutting rents in half to fill empty spaces in the hope of attracting tenants that will stay long enough to pay higher rates in two or three years.

"It was extremely easy to get a lease," Mastellone said. "There is a lot on the market right now, a lot of places for lease."

Steve Avoyer, president of Flocke & Avoyer brokerage, said some retail chains are playing hardball with their landlords, sending out blanket demands for rent reductions.

"Most landlords I know are really drilling down and looking at their tenants' business plans and sales, trying to be respectful of tenants having difficulty and maybe putting a Band-Aid on that," Avoyer said.

Rick Reeder, a tenant representative at Grubb & Ellis brokerage, said landlords are working hard to keep tenants.

"Everybody's afraid of the market and nobody wants a rollover in tenants," he said.

Added Kraig Kristofferson at CB Richard Ellis: "The one risk in this economy is, who knows what tenants are going to be around on longer-term leases and what their credit will be? Even people we thought were creditworthy tenants are having difficulties and downsizing."

For building owners, cutting rates means cutting income and lower building values.

"The entire thing that drives investment in commercial real estate is rent growth," said Tucker Hohenstein, senior director with Cushman & Wakefield. "When returns are going up, property values are increasing. When they're down, values are decreasing."