Pulse of Commercial Space Is Stabilizing

REAL ESTATE: For Industrial Market to Improve, Consumer Spending Must Increase

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Economic TRENDS 2011

Unless there's a dramatic change in the unemployment rate, which in San Diego County stayed stubbornly above 10 percent as 2010 drew to a close, commercial real estate experts will be keeping expectations in check throughout 2011.

Without heightened demand for new space, the region's office and industrial markets are likely to remain in a stabilization rather than growth mode — continuing to recover from the dour period of 2008-09, with leasing activity picking up as tenants seek out better deals among competing properties.

Tenant-friendly conditions could remain the norm in 2011, as landlords offer rent breaks and other incentives. Existing space will continue to be absorbed as new construction remains at a near standstill in both the office and industrial markets.

The retail market, already among the strongest of major U.S. cities with its low vacancy rate, could start to see upward pressure on rents in prime locations. And the multifamily segment, with similar low vacancy rates and the county's healthiest sector for investment activity in 2010, will likely benefit from continued high demand amid low supply, as well as historically cheap financing for acquisitions.

"A significant distressed market still looms on the horizon," said Jonathan Freeman, acting president and chief executive officer of brokerage firm Cassidy Turley BRE Commercial, summing up the overall market in a recently released 2011 forecast.

"But better clarity in regulatory, capital market and general business conditions has enabled a breath of activity to return to the real estate industry."

Renewed Confidence

Barring bad economic news that causes a reversal, experts expect office purchase transactions to continue a steady recovery from the Great Recession, even if activity doesn't return to pre-2008 peaks. According to the research firm Real Capital Analytics Inc., activity in the San Diego market totaled $450 million during the first three quarters of 2010, up from $300 million a year earlier.

Confidence appears to be improving. The consulting firm PricewaterhouseCoopers LLP, also known as PwC, projects that San Diego asset values will hold steady in the next 12 months, compared with a year ago when its national survey of investors projected a decline of nearly 11 percent.

Bob Prendergast, managing director in the San Diego brokerage office of Jones Lang LaSalle, said 2011 could see a continuation of a climate where large, publicly traded real estate investment trusts make up the bulk of big-ticket office buys in prime locations.

Locally based REITs that went shopping in 2010, bolstering their nationwide portfolios, included Realty Income Corp. and Excel Trust, each with large retail holdings; as well as life sciences real estate investor BioMed Realty Trust Inc.

The heightened buyer interest could bring up prices on well located properties. "You'll probably see a more consistent stream of buying activity during 2011," Prendergast said. "It kind of came in spurts during 2010."

Foreclosures Avoided

Alex Zikakis, president and CEO of Carlsbad-based real estate investment and development company Capstone Advisors Inc., said the "tidal wave" of commercial foreclosures that many predicted a year ago never materialized, as lenders worked with borrowers and avoided flooding the market with deep-discounted properties.

Zikakis said that process will likely continue through 2014, as banks and other lenders gradually sell off troubled commercial assets.

In the industrial property market, which was never as overbuilt as offices, there is less distress and fewer opportunities for bargain hunting.

Don Ankeny, president and CEO of San Diego-based Westcore Properties, which invests primarily in industrial real estate, said 2010 was a recovery year for the sector, and 2011's fate will depend on numerous factors, including interest rates, the direction of federal tax policies, and the recovery of consumer confidence.

When consumers buy, it stimulates demand for manufacturing, warehousing and distribution centers.

"In the end, 70 percent of the economy is consumer driven, and that's going to impact everything in the market," Ankeny said.

Inactive Industrial Tenants

Bryan Teel, an associate vice president with brokerage firm Grubb & Ellis Co. in San Diego, said alleviating economic uncertainty in the coming year will play a big role in the expansion and hiring plans of small and medium-sized companies, which make up the bulk of tenants in local industrial parks.

Those companies are relatively inactive now, with most of the current leasing and acquisition activity involving larger firms, in spaces 30,000 to 50,000 square feet or bigger.

Observers agree that San Diego County commercial real estate overall is faring better than most markets across the country — and by some measures, better than neighboring counties in Southern California. That’s especially true of the retail and multifamily sectors.

“We’re seeing retail occupancy that’s around 94 percent, ticking up to 95 percent,” said Reg Kobzi, a local senior vice president with brokerage firm CB Richard Ellis. “We don’t have a lot of new building going on in retail.”

Kobzi noted there are few local big-box vacancies remaining from the national purge of store chains in 2008 and 2009. County retail sales have been trending upward in recent quarters, and developers are starting to commit to speculative projects, putting small retail buildings and neighborhood centers into the entitlement process, for possible completion in two to three years.

“This time last year, there was nobody who was talking about making deals,” he said.