

## Commercial real estate experts proceed into 2008 with caution

By THOR KAMBAN BIBERMAN

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The office, industrial and even the retail commercial space markets have been somewhat slower than normal in San Diego County, and it could be a while before they rebound.

Developer Dennis Cruzan of the Cruzan/Monroe development firm, said there has been a bit of disconnect between what sellers are willing to accept and buyers are willing to pay.

"There has been a bit of cooling in the past couple of months, but we'll know more in the first quarter or the beginning of the second quarter," Cruzan said.

He said there is no getting around the fact that the subprime mortgage collapse is affecting the commercial as well as the residential markets.

"The psychology of lending has changed. There is more equity required and there is more conservative underwriting," Cruzan continued.

When asked if the more than 3 million square feet of office space currently under construction will present a problem for the county office market next year, Cruzan said most of the space will be absorbed.

"If the economy is fine, things should be OK," Cruzan said, adding that the Carlsbad and Interstate 15 submarkets present the most concern on the office side. "Most projects are getting leased up."

Carlsbad had more than 1.4 million square feet of vacant office space as of the end of the third quarter, according to a Voigt Commercial report. A Burnham Real Estate Services survey said another 1.6 million square feet of office space is in the pipeline in Carlsbad.

The I-15 market has more than 2 million square feet of available space. Millions of square feet more are planned where former industrial parks in Rancho Bernardo are expected to be converted into new office parks.

As far as office investment, most seem to agree that the surge of sales earlier in the decade have pretty much run their course, and the market isn't nearly as hot.

"There has definitely been a softening," said Brian Walsh of the Walsh Chacon

tenant representation commercial brokerage and investment firm.

Walsh, who said he has seen a sizable chunk of sublease space coming on the office market, hasn't seen a lot of new tenants these days. He predicted it will be six to 12 months before the office market sees strong tenant movement.

"It's real similar to the '90s," said Walsh. Prospective sellers are content to sit on their properties, while tenants seem happy to remain wherever they are, he added.

Even though it is clearly a tenant's market, the landlord still has some leverage.

"It's really expensive to move," he said. Office space lease rates have actually jumped substantially downtown in recent months following The Irvine Co.'s renovation of the half dozen office buildings it owns in the core area. It subsequently raised the rates in buildings ranging from One America Plaza to Symphony Towers.

Chris Stai, Equastone vice president of acquisitions, said his firm has definitely seen a slowing, and conceded he isn't sure how long it may last.

While Stai remains optimistic for the long term, he predicted Equastone will be very particular about what it purchases during the next 12 months.

Unlike what happened on the residential side, loan defaults in commercial properties remain at low levels, Stai said.

Moving over to the industrial side, Cruzan said it is becoming increasingly difficult for projects to pencil — especially in mid-county markets such as Sorrento Valley.

"It's a function of the dwindling supply of land. Industrial makes more sense in the far southern and far northern parts of the county," Cruzan said.

Rob Hixson, a CB Richard Ellis (NYSE: CBG) senior vice president and chairman of the Otay Mesa Planning Group, agreed.

"There's a lack of land because we don't yet have all the freeways," he said.

Hixson said he is excited about the newly opened South Bay Expressway (state Route 125) between the border and Spring Valley, but that the rest of the

planned infrastructure needs to be brought on line if the mesa is to realize its potential.

He also noted that a state goods movement bill is providing \$400 million toward transportation on the mesa. The plan will include bringing SR-905 from Airway Road to Britannia Boulevard. Work is expected to get under way early next year.

The next phase will bring SR-905 from Britannia Boulevard to Airway Road. That work is expected to be completed in 2012.

After SR-905 is completed, the new SR-11 is scheduled to bring a freeway from SR-125 near the 905 junction to a new planned border crossing on East Otay Mesa.

In the meantime, Hixson noted that the South Bay Expressway will provide easy access to and from East County areas that weren't nearly as accessible before.

He is also pleased to report that the long-awaited Otay Mesa Community Plan will finally be completed by next spring. While many of the properties within the city of San Diego have been built out, Hixson said projects are starting to move in the unincorporated portions of the mesa.

"Two or three projects have maps," Hixson said.

The finished lot prices on the mesa are generally ranging from \$13 to \$15 per square foot with some lots priced in the \$16 range, he said.

In another sector, while the bloom is off the rose in the retail market, developer Craig Clark of C.W. Clark Inc. said retail should remain quite strong for the foreseeable future.

"I feel if housing doesn't unravel, it should be fine," he said.

Clark, who developed the Marketplace at Liberty Station, said while there is no denying that underwriting standards have become more stringent during the past year — this is a good thing for the development industry.

Bill Thaxton, a Flocke & Avoyer Commercial Real Estate senior vice president, said even if the retail vacancy has bumped up from about 3 percent to near 5 percent within the past year, that this is still extremely strong.

"The higher vacancies provide opportunities to the mom and pops, and there is still a tremendous amount of competition to get the best locations," Thaxton said.

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