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Office-building dominance doesn't dictate rent hikes

By JASON HUGHES

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If San Diego's Class A office market were a Monopoly board, The Irvine Co. would be the dominant player, holding a choice number of deeds to some of the best properties locally, and leaving the rest of the players to sweat out the growing prospects of landing on those property squares.

In February, the Newport Beach-based company said it would be acquiring 17 buildings in the University Towne Centre areas, Mission Valley and Del Mar in one fell swoop. While the purchase price was not disclosed, some expert observers are saying the transaction, involving 2.1 million square feet, could be as much as $1 billion. That's "b" as in a bunch of money. At the close of escrow, The Irvine Co. becomes the largest office property landlord in the UTC office market, controlling about half the top-quality buildings in that area.

But wait, there's more. Don Bren's real estate behemoth has been feeding in the San Diego real estate market for at least two decades, amassing an inventory of midrise and campus-style office properties in the La Jolla and Sorrento Mesa areas, several large apartment properties in the community and six existing high-rise office buildings in downtown San Diego. Add to that the choice parcel at the foot of Broadway where they are planning to start construction of a 34-story Class A office tower as early as next year.

I'm duly impressed with The Irvine Co.'s longstanding reputation for substantially investing in quality high-end properties, its serious commitment to customer service and the degree to which its new downtown high-rise tower will enhance an already beautiful San Diego skyline. The company is well-known for developing its huge property holdings in Orange County to amass an impressive inventory of income properties. The net effect is market domination as evidenced by the fact that the company has owned, currently owns or otherwise controls most of south Orange County's commercial real estate market.

Controlling the market presupposes the ability to set prices or, in this case, to dictate office rents, which is not necessarily going to be the case here for a variety of market factors that, believe it or not, have a larger impact than The Irvine Co.'s appetite for income properties. Tenant demand, in fact, controls rental rates much more than what price The Irvine Co. might have paid for the building(s).

In past columns, I've talked about the factors that drive tenant demand, some of which bear repeating here to support the observations I have about The Irvine Co.'s amassing strategy.

What ownership dominance does not control is the number -- or lack thereof -- of new company formations and financing. San Diego does not have numerous major companies moving into the metropolitan area from elsewhere. This poses some constraints against being able to raise rents simply because you bought a slew of properties for top dollar and now own most of the buildings in a given area.

Also worthy of note: Much of San Diego's office user market comprises research and innovation-oriented companies that are not large-space users and typically merge with other companies, thereby consolidating their space needs.

Then, of course, there are troubling numbers of companies that leave the area because of our region's sky-high cost of living: **Buck Knives** to Idaho; **People First/Capital One** to Texas; and **IPivot/Intel** to Oregon to name but three examples of corporate exodus.

Yet another factor that weighs as a rental rate determinant is the relatively narrow strands of growth that we do see. Qualcomm is a premier example of a single company with an inordinate impact on the entire San Diego region. What happens if Qualcomm's growth were to slow down or even reverse?

So much of San Diego's regional economy, including the economic stakeholders who occupy The Irvine Co.'s office properties, depends on sustained levels of significant growth. Any slowdown, however slight, greatly affects many of our region's economic segments and the collective abilities of companies in those segments to pay rental rates that are not "regulated" by normal supply-and-demand factors. The cooling economy of the past couple of years, therefore, would preclude any hefty increase in rents.

I have to wonder about just how sweet a deal office property acquisitions in the San Diego office market are these days, given a continuing and relatively flat level of tenant demand. There are increased costs associated with buying an office building or complex. Any increase in rents or occupancy costs will go first to funding the landlord's increased property tax bill, the increasing cost of insurance, utilities and tenant improvements. Keep in mind these are fixed costs The Irvine Co. and other new office property owners need to absorb whether or not rents increase. But then again, it's The Irvine Co., an organization known for being in it for the long haul and remaining proactive in attracting new business.

All things considered, San Diego is a prime investment venue for commercial real estate if one is in it for the long term. The Irvine Co. has been around for 142 years -- much longer than the Monopoly game or the rest of us for that matter.

The only one that's been here longer is the basic law of supply and demand.

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