



Turning landlord crises into tenant opportunities

By JASON HUGHES

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It's the season to be jolly for most people this time of the year, but for some landlords and developers, it's become the Mad Hatter's Tea Party in terms of what's taking place in office-space rents in a couple of North City submarkets.

Let me frame the dilemma as best I can. Several newly nervous landlords in the swank Golden Triangle or UTC office market have been dropping their minimum rents for Class A office building space to as low as \$2.25 per square foot, per month. That's "full service," meaning the drastically reduced rental rates include everything from janitorial, property taxes to utilities. I emphasize this is for Class A space -- the cream of the crop in office space inventory -- not the heavily worn, "ugly duckling" buildings built decades ago.

For purposes of context, it hasn't been all that long ago that Class A space in the UTC easily fetched \$3.25 per foot -- and more. Suffice it to say, such space has become a real bargain for tenants wanting to locate in this prime location.

Meanwhile, rents are on the rise just a short hop up the 805 to Sorrento Mesa -- aka West Mira Mesa. Rates in the twin-building Sorrento Towers complex on the north side of Mira Mesa Boulevard are holding at a monthly rate of \$3.20 per foot -- nearly \$1 more than comparable space in the more desirable UTC neighborhood. Even more shocking is the fact that office space in the aging San Diego Tech Center -- that's the one with the red metal phallic art sculpture in front -- is holding firm at \$3.25 per foot, per month.

The obvious question follows: What tenant in his or her right mind would want to be in West Mira Mesa -- oops, Sorrento Mesa -- rather than the UTC area, especially when the UTC space is 30 percent less expensive?

Most tenants, given the means to do so, would (and should) pay at least 30 percent more for the UTC venue. But, the craziness occurring in the North City office market doesn't stop with upside-down submarket rents for existing office-building space. The idiocy continues in construction of any number of new office developments. For example, in the UTC area, Hines has broken ground on the 15-story La Jolla Commons Office Tower in which the asking price for monthly rentals will be the equivalent of \$4.30 per foot with a measly \$50 per foot for tenant improvements -- two thirds of the minimum of \$75 per foot most tenants would need to build out their spaces.

So, the typical 10,000-square-foot tenant looking to occupy office space in the UTC area has two choices: take space in one of the several existing Class A buildings for \$25,000 per month or lease space in the new snazzy new project for \$43,000 a month -- plus the additional \$250,000 the tenant would need to subsidize the miserable tenant-improvement allowance. During a five-year term, the Hines option amounts to a \$1.33 million premium for tenants to be in that new building. Last time I checked, that was a lot of money.

There's no way to overlook the downtown San Diego office market and its prevailing "greater fool" theory when trying to make sense out of nonsense. Perhaps the most stark example of a fool looking for a greater one to pawn off his overpriced investment involves a 500,000-square-foot office building, with a 48 percent occupancy, now in escrow for two-and-a-half times more than the hefty sales price the property was sold for just five years ago -- when the building was 95-plus percent occupied. The investor who overpaid for the building is praying mightily that nothing disastrous befalls his prospective buyer prior to closing escrow.

These market miscues illustrate a crisis in logic and common sense present in some of our region's office submarkets. In China, where I visited last month, I am told crisis signifies both danger and opportunity. If that's true, the common-sense crisis being experienced by a large number of building investors and landlords presents myriad opportunities for tenants who are looking for bargain office space throughout our metropolitan area.

We'll talk even more about turning landlord crises into tenant opportunities in future columns.

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