

What's going on in the suburban office markets?

By **JASON HUGHES**

Monday, June 4, 2007

We've talked so much in recent columns about the downtown office market that now we need to take a look throughout the rest of the region, particularly the suburban areas where there has been a bustle of activity in recent months. While it's true that downtown is our civic center and the core of the region's office market, the fact of the matter is that our suburbs host some of the region's biggest and most important corporate citizens.

Our firm, for one, is seeing a significant increase in leasing activity in the northern suburbs; in particular the University Town Centre, Sorrento Mesa, Del Mar Heights and Carlsbad submarkets. The net effect of such activity varies, but the fact is the office market is busy in the 'burbs.

The heightened activity is somewhat ironic, considering recent media reports that suggest there's a lack of leasing demand for office space in general. It wouldn't be the first time the media have been out of synch, though.

A more active office market is all the more significant, given the fact that landlords have raised rents pretty much across the board, regardless of what the leasing demand levels have been. Institutional owners of office real estate think in terms of "proforma" rental rates rather than actual rents even when it has resulted in not being able to lease the space and having to endure vacancy signs in their office buildings.

Proforma rates seem to be a product of the use of private equity, otherwise known as "other people's money" (OPM) to finance office properties. Parties are often more interested or impressed by rental rate goals than rental rates achieved. But as long as the "smoke and mirrors" of proforma rents remained unchallenged, property managers can keep their jobs, managing empty suites and, of course, the OPM. They fully realize that the very minute they have to admit proforma rental rebates are not achievable, they likely will be out of work.

Those of us who deal with actual rents in the real world, where there is competition, constantly battle these jacked-up rents, otherwise and more respectfully referred to as proforma rates. In my last column, I talked about the so-called deals in landlord negotiations where landlords ask a ridiculous price for office space, hoping the hapless tenant will be thrilled to eventually settle on a lower rate that is still somewhat inflated. Call it what you want: pie-in-the-sky or proforma. It casts the same negative pall on what is, and would otherwise be, a fairly robust office market. And, it allows situations in which the landlords' brokers or other brokers who are clueless about the dynamics of the proforma rental rate market bamboozle tenants into paying higher-than-necessary rates either through trying to represent themselves or allow themselves to be represented.

I mentioned the suburbs are busy; a few examples of recent activity will illustrate my point.

Qualcomm's recent expansion has allowed Conexant Systems to relocate and downsize out of its Sorrento Mesa location and sign a letter of intent for 100,000 square feet in Torrey Hills.

The recent marriage of Entropic Communications and RF Magic has the new merged entity contemplating an expansion from 43,000 square feet to 64,000 square feet to house the new enterprise.

Meanwhile, several major tenants with expiring master leases are looking at taking subleased space to maintain some control of their occupancy costs rather than risk being held for ransom by their existing landlords who want them to renew their leases at double the rate. Windsor Capital and Academic Loan Group are two such tenants that come to mind.

At the same time, Yahoo!, Financial Profiles, EMN8, Alphatec Spine, Plaza Home Lending, Paul Hastings all have expiring leases while some companies -- Luxtera Inc. for one -- have outgrown their facilities and are exercising their termination rights. The real growth of companies such as Amylin, Divx, Five Point Capital, Peregrine Semiconductor, Nextwave, Artes, AVID and Qualcomm also have to be factored in when determining their respective impacts on the suburban office economy. Likewise, several other firms are downsizing to achieve more financial efficiency -- Premier, ACC, Continuous Computing, AP Technology, and Advanced Marketing are but a few such enterprises.

The central question is when all the leasing dust settles, will there be any net absorption in the suburbs? In other

words, will there be more square feet leased than vacated, since subleased space and renewing leases for existing space is not counted in that construct.

Thanks to Qualcomm, the Sorrento area is probably experiencing modest net absorption and perhaps the same holds true in Del Mar Heights. But elsewhere in the northern suburbs, we're not seeing any evidence of a growing office market.

No landlord has asked me for advice lately on how to rent out vacant and available space to office tenants, but if someone were to do so, I'd recommend leasing their spaces for rates that are attainable.

The bottom line is that "performing" rents that result in leased spaces will surpass "proforma" rents any day in any market.

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