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LOS ANGELES BUSINESS JOURNAL
October 18, 2010

Enthusiasm Fades in L.A. Office Market

Special Report: REAL ESTATE QUARTERLY - L.A. COUNTY

By Richard Clough

Major events in Los Angeles County commercial and industrial submarkets in the third quarter.

To the surprise of many eternally hopeful brokers, the poor office market in Los Angeles found a way this past quarter to get even worse.

After holding steady for the first half of the year, the countywide office vacancy rate resumed an upward climb in the third quarter, jumping from 16.6 percent to 17 percent. In the process, much of the optimism that had been building in the local community that the market was nearing a bottom has gone out the window.

“I feel things have (regressed) in the last quarter in terms of the activity level, in terms of the mentality of tenants,” said Hunt Barnett, a principal with brokerage L.A. Realty Partners. “Last quarter people thought maybe that things would be better in 2011 at some point. Now, people would tell you that it’s not until 2012.”

The L.A. office market gave back nearly 650,000 square feet between July 1 and the end of September, nearly five times the amount from the previous quarter, according to data from Grubb & Ellis Co. Class A asking rents in the third quarter held steady at $3.01.

The dismal quarter was hurt by moves like that of Northrop Grumman Corp., which had previously announced a decision to relocate its headquarters to the Washington, D.C., area. The aerospace giant dumped about 140,000 square feet of new sublease space into Century City.

Meanwhile, one industry that has historically buoyed the local market, entertainment, just hasn’t been as strong of late, Barnett said. The pending sale of NBC Universal as well as general uncertainty surrounding the futures of Viacom, Fox and other major corporations have discouraged expansion in the industry.

To Barnett, though, there is a bigger issue at play: The recession mentality continues to linger.

“The recession has ended, as the economists have declared – that’s bull,” he said. “Maybe in a technical sense they’re right, but in the real world it hasn’t hit most people yet. Companies are still very short-term-minded, very concerned about the future, very cautious about hiring.”

The pain was widespread during the quarter. Among the hardest hit areas were the South Bay, which gave back 390,000 square feet; Wilshire Corridor, which now has an additional 120,000 square feet available; and Tri-Cities, where 134,000 square feet came back onto the market last quarter and 1 million square feet have come onto the market over the past year and a half. In Tri-Cities, the Glendale and Burbank submarkets fared poorly despite the sale of a 188,000-square-foot building to Lincoln Property Co.

The Westside, like the county overall, took a step back in the third quarter after showing promise earlier this year. The market gave back 86,000 square feet – due in part to Northrop Grumman’s move – after absorbing more than 400,000 square feet in the second quarter.

However, Bob Safai, founding partner of brokerage Madison Partners, said the Westside's future looks bright because there are no new buildings under construction.

"We don't have any new developments that we're dealing with," he said. "That is going to be helpful."

Bright spots

Not every area struggled in the third quarter.

Hollywood performed relatively well thanks to a handful of deals, including an $11 million lease signed by Cedars-Sinai Medical Center for a 26,000-square-foot space on San Vicente Boulevard, and the decision by Live Nation Entertainment Inc. to expand its presence in a Hollywood Boulevard building. The submarket absorbed more than 24,000 square feet as the vacancy rate fell from 14.6 percent to 13.9 percent.

The closest thing to good news in L.A. real estate, though, can be found in the countywide industrial market, where the vacancy rate remained unchanged at 3.3 percent and asking rents held steady. A lack of new product helped the sector hold steady despite a still-weak economy, said Michael Frankel, managing partner at developer and landlord Rexford Industrial.

"L.A. County is fully built out," he said. "You have an extremely scarce supply (of space,) even today."

Frankel noted that Los Angeles has an advantage in the industrial market over the nearby Inland Empire because Los Angeles primarily serves the local market while other parts of Southern California tend to house distribution centers for national and global trade, which can be more volatile.

"The infill L.A. County market tends to be tenants and businesses that disproportionately serve the regional population," he said. "That's a relatively stable tenant base."