

# Commercial Real Estate Trends

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## Commercial lending going back to the basics

By JEN LEBRON  
The Daily Transcript

When some people read "real estate crisis," they automatically think of the hundreds of thousands of homes across the country in distress. However, there is another sector of the market feeling the repercussions of the subprime mess: commercial real estate. While commercial real estate has not seen the same rapid price depreciation as the residential side, lending has tightened significantly.

"It's very difficult right now," said Bill Ballard, a member of Grubb & Ellis/BRE Commercial's capital markets group.

Ballard is not alone in his thinking.

In the National Association of Industrial and Office Properties Vital Signs 2008 Survey, 92 percent of its members think that lending is tougher in 2008 than it was last year.

However, Ballard's associate Gary Gross, who runs Grubb & Ellis/BRE's capital markets group, said getting a loan is not necessarily difficult — but the requirements are different.

"The answer is it's not that difficult if you're willing to settle for 60 percent loan to value

and rates that are higher than they were six to 12 months ago, and you've got good financial statements and a lot of liquid assets," he said. "So, there's a lot of money out there. (Lenders are) just being selective on who they're lending to."

According to Jonathan Walz, the senior director of Cushman & Wakefield's real estate finance group, while one could have gotten a commercial loan for 75 percent to 80 percent of property value a year ago, 60 percent to 70 percent loan-to-value ratio is more common.

He said financing is more difficult to obtain relative to the ease of getting it a few years ago, but better reflects past credit models.

"We've relearned our ABCs through all of this and in this case, it's the five Cs of credit," Walz said, referring to five elements a borrower should have to obtain credit: character, capacity to pay the debt back, capital, collateral and conditions of the borrower and overall economy that favor the loan.

Walz said lending standards in the commercial sector began to tighten in 2007 due to fear caused by the subprime residential mortgage meltdown.

Though commercial loans

were relatively safe by comparison, banks hurt by lost liquidity in the residential market tightened lending standards across the board.

However, he said the market will eventually respond to the demand for commercial property and turn around. Within the next few years building will slow down, creating less supply for a growing population, he said.

Marco Sessa, vice president of Sudbery Properties, said his company has not had trouble getting financing for recent projects, but did note there are fewer banks lending at this time.

"So far we've had a great relationship with a lot of the local lenders and we've been able to obtain financing for

our last couple of projects just fine," he said.

Stath Karran, executive managing director of Cushman & Wakefield in San Diego, said the market is probably not going to fully recover for several years, though capital should flow back into the market beginning next year as investors see opportunities to buy properties at what they perceive as a discount.

However, he warned if money starts flowing and investors start purchasing quickly, it is possible for a bubble to develop in the commercial sector.

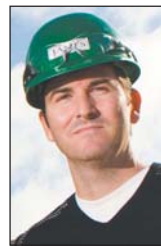
Walz said it is hard to tell what's going to happen in the

See Lending on 5

## Close-ups inside



Abrams



Lawrence

Larry Abrams of GMI Integrated Facility Solutions and James Lawrence of Ecolite Concrete are featured in this special report, on Pages 3 and 9.

## Retail landlords — riding out the downturn

By JOSEPH MARSHALL  
Sullivan Hill Lewis Rex & Engel

What is the retail landlord to do? It seems like there is a never-ending stream of bad news affecting the retail sector.

U.S. retail chain stores posted a 1 percent increase in same store sales for September, according to the International Council of Shopping Centers (ICSC). Local centers have not been as fortunate. Not surprisingly, furniture and home furnishings were down more than 9 percent, electronics and appliances were down more than 2 percent, with apparel dipping almost 2 percent in the same period.

These are the September numbers and, with the worsening economic crisis around the world, retailers can only anticipate that October and November will be worse. In late October, the Conference Board reported that the Index of Consumer Confidence dropped to 38.0, an all time low and down from 51.3 in just September.

Already we have seen some large national retailers in trouble. The department store chain **Mervyn's**, with 149 stores nationwide and 10 in San Diego county, filed for bankruptcy earlier this year and recently announced that it will have one big end-of-the-year sale and go out of business. Troubled electronics retailer **Circuit City Stores** has apparently determined not to file bankruptcy before the end of the year but may be exploring a work out with its creditors, similar to the plan adopted by **CompUSA Inc.**

last year. **The Bombay Co., Sharper Image, Linens 'N Things** and **Steve & Barry's** are other notable companies that have actually filed for bankruptcy protection in this difficult retail environment.

ICSC predicts there could be more than 5,700 store closings in fiscal 2008. What can the retail landlord do to be ready to protect itself?

Let's first separate the tenant that is going to file bankruptcy from the tenant that is merely having financial difficulties. If your shopping center has a home furnishings outlet, a carpet company or any one of another shelter-based retailer, revenues have been impacted for some time and you might well find that tenant struggling to pay the rent. Your objective, as landlord, is not to become a bank or a partner in your tenant's business, but it is not in your best interests to have that tenant go out of business, leaving you with a vacancy. Vacancies are hard to fill in this slowing economy.

The options to the commercial landlord range from rent deferrals and rent "holidays" to outright rent reductions. Which one makes the most sense depends in large part on the finances of the tenant, but also on the attitude of the landlord, the financial situation of the landlord, the relationship with the tenant, the importance of the tenant to the overall mix in the shopping center and a host of other similar factors. Some points to think about include whether a rent concession

now will be repaid, and if so when and how, and whether there are some other aspects of the lease that the landlord is interested in adjusting.

Larger problems loom if the tenant, particularly a large national tenant, files bankruptcy. Many landlords have in the past suffered some abuses in the bankruptcy setting, particularly in cases such as Kmart, where the bankruptcy court allowed long delays before landlords were able to either gain control of their property or have a new tenant in place. Those abuses have been largely corrected by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, but a bankruptcy of a significant tenant can pose a major challenge for the commercial landlord.

The real risk is that there will be a prolonged period of uncertainty, frequently with a dark major store in a prominent position in the shopping center. The landlord's goal, aside from maintaining the current rent payments, is usually to regain control of the premises. Remember that the bankruptcy code is designed to protect the debtor, so the creditors sometimes are forced into undesirable positions. This is not to imply that the landlord, particularly the shopping center landlord, doesn't have powerful weapons to wield in the bankruptcy setting. However, prompt action and competent legal advice are a must.

As soon as a bankruptcy proceeding is filed by or

against a retail tenant, regardless of the type of bankruptcy, the so-called "automatic stay" comes into existence. This is in effect an injunction that prohibits virtually any action by a landlord to affect possession of the leased property, to collect unpaid rent or any other amounts due under the lease, to draw down a security deposit or to commence any kind of proceedings that affect the lease. The landlord can't even give a three-day notice to pay rent or quit. The landlord is put on hold.

The most important concept for the commercial landlord to understand is that the bankruptcy debtor, or bankruptcy trustee if one is appointed, has the option to "assume or reject" any retail lease, subject to the approval of the bankruptcy court. Frequently a retailer will be trying to shed itself of some or all of its locations, and rejection of those leases that have no commercial value is a viable alternative.

A rejection of the lease is treated as a breach occurring the instant before the bankruptcy filing and results in the landlord having a variety of claims, including a priority claim for post-petition rent occurring after the filing but before rejection of the lease, a secured claim to the extent of any security deposit, and an unsecured claim for any unpaid rent accruing prior to the filing.

There is a cap on the amount of claim a landlord can make for rent, restricting

See Retail landlords on 6

## Property managers look toward sustainability, cutting costs

By PADMA NAGAPPAN  
Special to the Daily Transcript

Clients are looking at long-term investments, seeking more value and a reduction in operating expenses, and retaining tenants in the current market conditions, according to several property managers that the *Transcript* spoke with recently.

"In the last 18 months, property management has done really well, but we are seeing a decrease in sales and leasing," said Cybele Thompson, the director of client solutions with Cushman & Wakefield, who oversees property management and client relations for 6 million square feet of properties, roughly 40 buildings in Los Angeles.

Some of the values clients are looking for include energy conservation projects, which are big money savers, and common area improvements with the purpose of retaining tenants and attracting new ones.

Thompson said property

managers' main concern has been to minimize operating expenses for clients, by lowering energy costs and encouraging competitive bidding for contracts.

"In a down market, clients value experienced property managers even more than they did when they were flipping properties and it did not matter who managed it for them," she said.

Not being able to sell or refinance or purchase other properties has changed the clients' (or the property owners') thinking, according to Thompson.

While the lower interest rates have helped ease financing issues, new financing regulations are expected to be put in place to govern transactions that will boost activity in the market, which is currently very quiet, she said.

Wait and watch is the maxim everyone currently adheres to. "No one wants to take on more commitments

See Property managers on 10

## San Diego slips in Emerging Trends ratings, but performs better than neighboring counties

By MARY LYDON  
Urban Land Institute

The darling of the Urban Land Institute/PriceWaterhouseCoopers Emerging Trends in Real Estate survey just three years ago, San Diego fell to the middle of the pack for 2009 among big cities contending for the title of best place to develop and invest in real estate.

Now in its 30th edition, Emerging Trends in Real Estate is the most highly regarded and widely read forecast report in the real estate industry.

Of course, it isn't expected to be a robust real estate year for any city, with the survey predicting that 2009 will be the first time in decades that the markets will see negative private equity investment

returns. Most real estate professionals interviewed for the survey did expect a slow recovery to start in early 2010, though.

In the 2009 survey, San Diego received a 4.92 on the one to nine (nine being best) measurement scale in terms of best major cities for commercial and multi-family investment, with Seattle ranked No. 1 at 6.15. For both commercial real estate development and for-sale home building, San Diego scored a 3.4 and a 3.36 respectively, with San Francisco taking the top spot in both of those categories with scores of 4.79 in each.

In the 2008 Emerging Trends survey, San Diego's score on the commercial and multi-family investment scale was 5.95, with New York City receiving the top score of 7.13. San Diego scored 5.92 last year on the commercial real estate development scale, with New York City again topping the list at 7.17. San Diego received a 4.65 on the for-sale home-building scale in 2008, with New York City receiving the top score of 6.25.

The survey identified San Diego as the overall top performing market in 2006.

Real estate experts gather today at the Joe & Vi Jacobs Event Center for the ULI Emerging Trends Conference, hosted by the San Diego Urban District Council of Urban Land Institute (ULI). Dean Schwanke from ULI's headquarters in Georgetown will

present the Emerging Trends in Real Estate survey and an overview of what it means to the San Diego market. He will be joined by an array of other locally and nationally renowned real estate professionals to discuss challenges and opportunities in the real estate market for 2009.

Overall, the 2009 Emerging Trends survey called San Diego a "solid hold market," cautioning that office vacancies are in the mid-teens, the home market will hurt the historically strong retail market, and the hotel and convention market would do better with a bigger airport.

San Diego's prospects were much stronger than those of Orange County or Riverside County, both of which took

strong hits from the mortgage meltdown and now see the results trickling through the rest of their real estate industry.

Interviewees expect multi-family investment to take the top spot in 2009 in most markets due to the strong rental market created by a large Generation Y population leaving home, more Baby Boomers wanting to downsize to apartments and the mortgage market meltdown forcing current and would-be homeowners to rent instead. The report warns, however, that "high-end apartments may face softening markets" as many new, failing luxury condominium buildings hit the rental market instead.

Throughout the country,

the Emerging Trends interviewees say urban core and infill locations will be favored, as more people react to high gas prices and congestion by living and working in the same area. They also expect transit-oriented development projects to remain strong.

Cities off the global pathways fare worse than those with good seaports and international airports. Port industrial property investments are one of few bright spots identified by the survey.

Other niche development types that might perform better than average include student housing, infrastructure, medical office, senior

See Emerging Trends on 7

Close-up: Larry Abrams

## GMI offers varied services, plans to add more

By THOR KAMBAN BIBERMAN  
The Daily Transcript

Kearny Mesa-based **GMI Integrated Facility Solutions** is an eclectic firm capable of constructing tenant improvements, supplying security services, managing buildings, maintaining them and cleaning them as well.

Founded on the East Coast by Dick Sharp in 1968, what would become Guardian Maintenance moved to San Diego in 1972. Murray Abrams bought out Sharp's interest in 1976. The company had fewer than 30 employees at that time. The firm had about 50 employees when Murray Abrams' son Larry joined in 1988.

"We started (and continue to) clean offices, shopping centers and high-rise condominiums and apartment communities," Larry Abrams said. "Today we have more than 900 employees and climbing."

"These workers are located at commercial buildings in San Diego, Orange and Los Angeles counties and throughout the Inland Empire.

The company, which posted about \$26 million in revenues last year, began as a janitorial company, but kept adding new services over the years. The firm's revenues have more than doubled from about \$11.5 million annually five years ago.

Larry Abrams acquired the firm in 1989 and continues to

run GMI as president and CEO.

After acquiring the company from his father, Abrams formed GMI Building Services. He expanded the business beyond the pure janitorial aspects of cleaning restrooms, restocking paper towels and vacuuming floors to include everything from commercial carpet care and pressure window washing to flood cleanup and ensuring that polluted water from cleaning doesn't end up in a storm drain. These last efforts evolved into an environmental consulting part of the business that GMI continues today.

"We recapture the water, we use portion-controlled chemicals and recyclable microfiber cleaning cloths. There isn't a lot of waste with these measures," Abrams said.

Abrams acquired a security company in 1992 that became Guard Management Services. That part of the business offers a wide range of services from patrolling and security assessment and consulting, to video surveillance and high-technology protection.

"We have worked for many of the homeowner associations in Rancho Santa Fe — places like The Crosby, The Lakes, Rancho Pacific, and a property known as Shady Canyon in Orange County," he said.

While Abrams had dabbled in tenant improvement work since 1992, it wasn't until the

company purchased Neco & Associates in 2005 and kept former owner Chris Neco that the contracting part of the business began to take off. Neco, like GMI, was best known as a janitorial service provider, but also was a commercial maintenance general contractor.

"This acquisition was born of the customers' need for more services," Abrams said. "This service fits real well with our other services. We can be a one-stop shop."

Abrams emphasized that it isn't his intent to do large tenant improvement jobs — there are more suitable contractors for that — but smaller contracting jobs do make sense.

"There are some synergies that develop when you have multiple service lines," he said.

Abrams intends to expand GMI's offerings when the firm acquires a landscaping company and a parking lot sweeping firm in the near future. Limited engineering services seems to be another natural outgrowth.

When asked if this is the best time to expand, given the uncertain economy, Abrams said companies don't stop needing building management, security or maintenance services just because the economy is hurting. If anything, he suggested, these services are needed even more in uncertain times.

"The late 1980s were a



Photo: J. Kat Woronowicz

**CEO Larry Abrams intends to again expand GMI's offerings when the firm acquires a landscaping company and a parking lot sweeping firm.**

tough time, but then as now, we proved we were recession resistant," Abrams said. "Our service offerings are not something businesses can do without."

"This is not to say all goes on as before.

"Maybe the trash gets emptied a little less often, maybe you vacuum a little less, if the property is a shopping center, there still is an opportunity to allowances and moving often entails other expenses such as signage, furniture, new cabling and more."

Cutting back, while sometimes necessary, must be handled judiciously — the last thing anyone wants is for a space to look as if it is going

downhill.

Even in times when clients may be cutting back their services, Abrams must ensure GMI stays up with the times. "We have an online work request system that automates and tracks work requests and complaints," he said.

The firm also has been perfecting an electronic proposal system "that almost reads like a book online."

GMI has an array of clients. The firm has provided janitorial and other services for

Hines at its La Jolla Commons and 525 B St. (downtown San Diego) proj-

ects. While the La Jolla Commons building was under construction, GMI helped ensure the building and its operations were as environmentally sensitive as possible.

"Many of the things we did were applicable to the LEED (Leadership in Energy and Environmental Design) standard," Abrams added.

The firm also aided in helping **Analylin Pharmaceuticals** (Nasdaq: AMLN) gain LEED accreditation for a new building it developed in the University Towne Centre area.

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## Excess office space can be opportunity to improve usage

By JEFF HOLLANDER  
Genesler

These are tough times, and many businesses will be forced to make do with less staff and, in many cases, the resulting excess space. In the face of this challenge, office leaders can make changes to improve the way their employees work. Small and creative positive changes today could have long-lasting impacts on worker productivity and corporate profitability for years to come.

As the black cloud of a cascading economy spreads further away from Wall Street into all sectors of corporate America, savings-minded business leaders will increasingly look to cut their largest expense after payroll: real estate.

Even with the heartaches and risks to office morale, layoffs might prove easier than reducing rent obligations, according to Scott Ginsburg, executive vice president at **Jones Lang LaSalle Americas**

Inc. Ginsburg said tenants looking to return space to landlords had better be prepared to sign long lease extensions. Rare is the landlord willing to add vacancy and forego revenue in today's uncertain market.

A credit tenant with 30,000 square feet has a shot to renegotiate, Ginsburg said, because landlords are more accommodating for tenants with solid payment history who are willing to sign on for another five years — especially if the lease term is close to expiration. The more years left on an existing lease, the less likely the landlord will renegotiate.

"Why am I going to absorb vacancy and take less rent to keep you for three years?" Ginsburg said.

Jason Hughes, principal at **Irving Hughes**, said he's finding renegotiation a little easier. In fact, he helped a technology company client cut its square footage in half, reducing the office from two 10,000-square-foot floors to one. He said he's finding landlords are quick to accommodate reasonable renegotiations and are even discounting rents 15 percent to 30 percent.

Dennis Hearst, senior director at **Cushman & Wakefield** of San Diego, said there's a small segment of the market that hasn't been negatively affected by the economy. Some in this group are taking advantage of a chance to upgrade their situation and get Class A space for Class B rates. Mostly, though, he said many tenants with expiring leases are staying put — but

not all are interested in signing long-term extensions.

"What we're starting to see is a lot of renewals," Hearst said. "Construction costs have risen faster and higher than IT allowances and moving often entails other expenses such as signage, furniture, new cabling and more."

### Improving work spaces

Even if a business chooses to remain in the same space, there still is an opportunity to make meaningful improvements. According to Genesler's research, 36 percent of U.S. office space is considered by the workers using it to be ineffective. This is in large measure because the nature of work is changing.

The percentage of focus time at one desk has declined dramatically in favor of collaborative meetings and group work scenarios. Small investments can have positive impacts on the engagement of the work force, which can increase innovation and productivity. Often employees will embrace smaller private workspaces if collaborative social areas are provided nearby.

For businesses that can't reduce square footage — an even some that can — payroll reduction will be the major source of cost savings as work-flow flattens out. Layoffs free up space to create more effective spaces.

While too much space for too few people can negatively influence morale, a little more breathing room can boost spirits and productivity. Observe how people are work-



**Colliers International created an instant employee lounge in its new San Diego office by hanging a plasma screen and setting up a pool table in an unused conference room.**

ing in the office, how spaces are really used. What's empty? What's overcrowded? Where have people been doing workarounds to make space effective? It's easy, really. Look for wear patterns, improvised equipment and furnishings, over-flowing desks, unused conference rooms, etc.

Consider reconfiguring workstations to take advantage of empty spaces. If you have four-station work pods, move people around to free up the fourth station and let the other three stations share it as communal workspace.

Where possible, get rid of

See **Office space** on 12



**Advanced Equities Financial Corp.'s new San Diego offices leave window walls open and use banquettes to create daylight, collaborative/social spaces.**

## Leasing a biotech facility — the news is mixed

By TERESA Y. WARREN  
Special to The Daily Transcript

For biotech and life science companies looking to lease space in San Diego, there are good news and bad news. The good news is that the soft office leasing market means great deals for tenants who seek non-laboratory space. The bad news is that available lab space is at an eight-year low, making it more of a landlord's market.

According to Scott Ginsburg, executive vice president with **Jones Lang LaSalle** in San Diego, not since 2000 has local lab space been at such a premium. "The only difference is that today's companies are seeking space in much smaller quantities. Lab

space in the 10,000 to 20,000 square feet range have high demand, while large lab facilities north of 30,000 square feet are having trouble finding tenants.

"Approximately 18-24 months ago, we were seeing about a 16 percent vacancy rate, and this year, it has dipped just under 10 percent," Ginsburg said. Furthermore, he predicts that it probably won't change much even in these uncertain economic times. "The need for lab space these days is largely dependent upon venture funding. As long as life science companies want to be capitalized and the need for lab space continues at its current pace, lab space will be harder to come

by than office space."

Biotech seeks out different areas of the county depending upon their leasing needs. Companies in need of only office space usually want to be in Del Mar Heights, where the vacancy rate is 18 percent to 20 percent for office space, or UTC, where the vacancy rate is 15 percent to 16 percent. These markets have Class A space that will provide a positive, successful image for a life science company, which helps attract and retain a talented work force. Many local life science companies are already established in these markets, and new companies want to be located close to the leaders in their industry. Additionally, senior management often live

in communities close to these markets.

Companies in need of labs flock to Torrey Pines Mesa and Sorrento Mesa for many of the same reasons. These two markets also contain about 98 percent of all the laboratory real estate in San Diego County.

For Ginsburg, working with biotech and life science companies presents unique challenges not found with clients in other industries. "The vast majority of life science tenants are not profitable, though they are well capitalized due to venture backing — but landlords require more from these companies because of

See **Biotech facility** on 11

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