Hughes Marino
Because Where You Do Business Matters™

The Business Recovery Has Begun

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Commercial real estate demand is a leading edge indicator of changes in the job market and the economy. Companies need more office space only when they intend to hire more people. Biotech, manufacturing and industrial companies need more space only when they intend to launch additional R&D programs or ramp up manufacturing activities requiring facilities for materials, work in process and finished goods, and they need the space before they can stock the shelves. Based on The Irving Hughes Group's large volume and diversity of commercial real estate tenants represented, we are early to see the coming economic trends real-time as our active client base is expanding or contracting.

The Irving Hughes Group Reports a New Economic Indicator

The Irving Hughes Group will now track a forward-looking "Economic Change Indicator" reporting the collective square footage activity of active The Irving Hughes Group clients that are growing, shrinking or stabilized. At any given time, The Irving Hughes Group is representing approximately 150 San Diego corporate tenants in all submarkets of San Diego County, across all product types (office, lab/flex and industrial) and across all industries. This sample size represents approximately 2 million square feet of active engagements and provides great verifiable raw data with which to create an accurate forecast.

The Good News Just Came Rolling Out

At the beginning of Q1 2010, we observed that 41 percent of the active square footage demand was driven by growing companies, 46 percent from stabilized companies and only 13 percent from shrinking companies. Fully 87 percent of the square footage demand was being driven by stabilized and growing companies! Virtually all of the shrinking companies were right-sizing their space and ridding the excess left from 2007-2009 layoffs, and those companies were not anticipating further reductions in staffing. Most of the growing companies were in the medical device/health care, technology and Internet-related industries. The submarkets most likely to benefit from this growth were also the softest submarkets of Del Mar Heights, Sorrento Mesa and the I-15 Corridor. Downtown San Diego was the only submarket where there was a material negative net loss of square footage demand.

The outlook for Q2 2010 is similarly positive with 44 percent of the square footage demand in our active client base derived from growing companies, 38 percent from stabilized and 18 percent from shrinking companies. The growth is being driven by The Irving Hughes Group clients such as The Active Network, Legend Films, Daylight Solutions, Nexsan, Quantum Design, Digitaria, Awarepoint, Event Network and Skylight Healthcare Systems. Again, the downsizing is mostly from companies right-sizing their facilities to match up with their reduced headcounts from cuts made back in 2007-2009.

More Good News About the Regional Economy

In addition to this forecasted growth, we had two clients move to San Diego County this last quarter from the Los Angeles area — Osmetech is moving to 31,000 square feet in Carlsbad and Energy Innovations is moving to 23,000 square feet in Poway. In March, we had a spike in the number of clients seeking senior level executives and asking for our referrals to candidates. There is general optimism within our client base from the meetings our team is having with customers across industries throughout San Diego County. Good things are happening for the health of companies and job creation at all levels.

Does this Business Recovery Mean a Commercial Real Estate Recovery?

There won't be a commercial real estate recovery for many years to come, which is good news for corporate tenants. From the data developed, the net increase in demand only represents a 200,000 square foot total increase. While that represents space to create 800 new jobs, it won't make a dent in San Diego County's office space availability of 21 million square feet, with another 9 million of available lab/flex space and 20 million square feet of available industrial space on top of that. While commercial real estate statistics generally reflect availability in percentages, there is 50 million square feet of available space on the market, and at least half of that has to be absorbed before landlords and their listing brokers can claim it's a landlord's market again. Within this 50 million square feet, 7 million is for sublease by motivated sublessors at a discount to market. That sublease square footage has stagnated for five quarters in a row — the only consolation for landlords is that it's not getting worse. We are hitting the market's bottom in 2010 as availability rates are plateauing; aggregate sublease space has peaked and time-on-the-market is leveling out. The structural problem for commercial real estate owners is that the amount of excess space on the market is at a historic high point, and this oversupply will last for at least five years. This oversupply has caused many to speculate that commercial real estate is the "next shoe to drop" causing another ripple through the banking sector. We don't see that happening, but we will report that analysis for the next quarterly market update.

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