Long Beach Business Journal
August 30-September 12, 2011

Real Estate Markets Ride A Wave Of Uncertainty

Geoff McIntosh is broker and co-owner for Main Street Realtors in Long Beach and boardmember for the Pacific West Association of Realtors. He anticipates a "nice, stable market for the next several years." (Photograph by the Business Journal's Thomas McConville)

By **Sean Belk**
Staff Writer

With local, state and federal governments wrangling over budget deficits, weak job growth and a slowdown in economic recovery, local real estate markets aren't radically shifting one way or the other, and economists say it may stay that way for a while.

In Long Beach, there are some bright spots: a strong industrial base driven by international trade; slight gains in office occupancy; more investment in multifamily properties; and high affordability of single-family homes in a desirable coastal climate. But demand is spotty among real estate segments due to a wave of uncertainty.

Unemployment appears to be the main cause for concern, as jobless rates across the country remain mostly unchanged. California's unemployment rate jumped to 12 percent as of July, remaining the second highest for states in the country. Long Beach's rate also rose sharply, reaching the highest it's been in at least a year at 14.6 percent.

"Things continue to be weak, certainly," said Gary Painter, associate professor for USC's Lusk Center for Real Estate. "The real estate market is not going to recover until we have a turn for the better in the job market, broadly. There's been some slightly positive news over the last few months, but no one's getting really excited about the prospects of a quick recovery."

Statewide single-family home sales are up over a year ago, and home prices have been relatively flat, if not declining, as a steady stream of distressed properties hit the market. As of July, data for the third quarter presents a mixed outlook for the residential sector, Painter said. "It's sort of just a lot of mixed evidence," he said. "There's more sales than the previous year, but prices are lower than they were."

Low interest rates make now the best time to buy or refinance property, he added. But, until job growth improves, many buyers aren't able to make the down payments required in the current underwriting environment. Painter said that the real estate market shouldn't fully rebound until the state's unemployment rate falls below 10 percent.

In the meantime, some investors are moving on properties, developers are gearing up for new construction and the federal government has vowed to keep mortgage interest rates low for the next few years by injecting more money into financial markets.

But, most buyers and sellers are still waiting for what the future will bring. While the federal government focuses on long-term solutions for pulling the economy out of a slump, a maelstrom of financial concerns has ensued over the last few months, including a topsy-turvy stock market, increasing national debt, a downgrade of the U.S. credit rating and the potential for continued inflation.

Although international trade activity has slowed, Nancy Sidhu, chief economist for the Los Angeles County Economic Development Corporation, said cargo traffic was abnormally high throughout much of last year. An expected increase in consumer spending during the holidays should bolster the shipping season in coming months, she said. "Progress is coming and it's being made, it's just very slow," Sidhu said.

In Los Angeles County, industries experiencing employment gains over the last year include: information (radio, TV, publishing and the motion picture industries); healthcare; leisure and hospitality; and private education. Private sector jobs have also increased by a total of 21,400 over last year, which is an encouraging sign, she added.

Job declines have mostly been in local and state government, construction and wholesale/retail trades. International trade related jobs have been relatively flat, but should pick up slightly by the end of the year, she said.

The local industrial, office and retail sectors have somewhat stabilized and should continue to see modest improvements. But, as for the residential sector, while it may be close to the bottom, recent uncertainties over job loss should halt any sharp recovery. "If we don't have a big uptick in housing I wouldn't be surprised," Sidhu said.

Jerry Nickelsburg, a senior economist for UCLA's Anderson Forecast, said companies are still reluctant to hire because of the uncertain times and as a result there's been muted growth in commercial office space. The slowdown in the U.S. and California economies also hasn't been good news for property owners looking to increase rates to recover losses over the past few years, he said.

But, a recent survey released in July shows that Los Angeles County developers are more committed to new construction by 2014, a trend that started last year. "There's still some concern about financing, but that turn from negative to positive [last year] has built on itself and so developers are increasingly optimistic about three years out," Nickelsburg said. "That means they are more likely to bring projects on line and start residential construction in the intervening period."

Residential: Home Prices Dip, Inventory Remains Tight

While single-family home sales have been somewhat propped up over the last two years due to state and federal tax credits that artificially injected more demand into the housing market, sales in California during July were still up 4.5 percent over last year, according to the California Association of Realtors.

Local markets took a bigger hit, but July statistics represent a true reflection of where the market is, considering the expiration of tax credits, said Geoff McIntosh, broker and co-owner of Main Street Realtors. Data shows July single-family home sales were down roughly 8 percent in Long Beach compared to 2010 and down 17 percent compared with 2009.

As of July, the median price for single-family homes sold in Long Beach dropped about 8 percent compared to the same month in 2010, while the asking median price was flat during the same time period, according to data from Clarus MarketMetrics.

McIntosh said the decrease in property values might help spur more home sales since properties are now more affordable and interest rates remain low. "What I anticipate is that we're going to see a nice, stable market for the next several years and, with the promise of low interest rates remaining with us, it's going to afford people tremendous opportunity to get into real estate that frankly they wouldn't be able to afford five years ago," he said.

As of July, Long Beach has an average of four months worth of unsold inventory, which is the lowest it's been in two years, according to real estate agents.

"I think that we'll continue to see this reduced inventory, which is also very good for stability in the Long Beach market," McIntosh said. "There's not an excess of inventory and what we're experiencing right now is good properties going on the market and selling frequently in multiple offers again."

Michael Simpson, real estate broker and owner of Keller Williams Coastal Properties, said Long Beach is between a seller's and buyer's market, but the steady decline in inventory shows the market is "poised" for a rebound. The sweet spot for home sales, he said, is in the first time buyer range, or anything lower than $500,000.

"[Home sales] have been kind of flat, but I think it's poised," Simpson said. "It's either at or near the bottom, there's no doubt about it, and with the amount of unsold inventory, we're entering into a different type of market."

The other positive is that, with home prices low, it's currently cheaper to buy a home than to rent in some cases. However, he added that what's holding back buyers is low consumer confidence, worries about job loss and challenges in financing.

Still, Simpson said now is the best time to buy for those who can afford it since prices won't stay low forever. High-end homes priced at $500,000 to $1 million have already started edging up in price by about 1 percent, he said. "It's like a switch and it just turns on and nobody really realizes the market is starting to shift in an upward trend," Simpson said.

Bob Stallings, broker and owner of RE/MAX Real Estate Specialists, said his office has seen a 30 percent increase in transactions over last year, although volume is up 20 percent, which means prices have declined slightly.

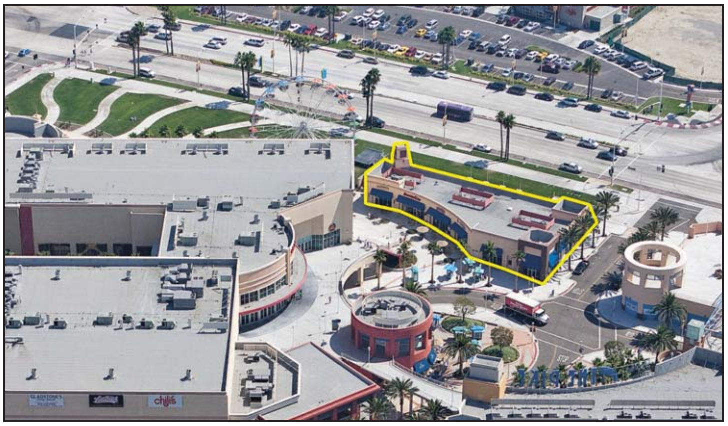
But, property values should stay relatively flat for a couple of years and should see slight declines in the upcoming fourth quarter, which is typical for the season. He added some areas such as North and West Long Beach were heavily hit with distressed properties and may see more declines in values.

What may impact the high-end home market, however, is if the Federal Housing Administration reduces single-family loan limits on mortgages from $729,750 to $625,500, known as jumbo loans, by October 1. While efforts are in play to pass an extension, Stallings said the changes would "definitely have a negative impact on the real estate market."

On the whole, however, Stallings said that Long Beach is still one of the most affordable and desirable locations in the Southern California for real estate. "I think the outlook is excellent for our area," Stallings said. "We are very affordable and we've got a great community to live in. We're 20 minutes from L.A. and I think people will continue to want to buy in Long Beach."

Apartments: Occupancy Rising, Investors Jump On Properties

In the multi-family sector, investor demand has picked up this year as occupancy levels continue to rise at a faster



The Pike at Rainbow Harbor moved forward recently with plans to create a new "gateway" by demolishing the building known as D-2 (outlined in yellow in photograph at left), next to the Ferris wheel along the north portion of the grass area, clearing the way for better visibility from Shoreline Drive and the creation of a new gathering area for the public. The construction of the gathering area should be finished in the next few months. Elimination of the building also allows for more flexibility in using the grassy area by creating the infrastructure acquired for new power supplies to enable more events. The photographs present a before and after look of the site. (Photographs by the Business Journal's Thomas McConville)

rate than the housing market. Apartment rents have stabilized, interest rates are low and the market in general has hit bottom, said Eric Christopher, a Southern California apartment specialist and broker for INCO Commercial.

"It's at a place where investors are finally understanding we're pretty much at the bottom of the market even though we got a lot of stimuli in the financial market," he said.

"The buyers right now are actually in a frenzy for apartments."

With the recent stock market gyrations, Christopher said more people are diverting investments into real estate, which is a much more stable bet over the long-term. "I've talked to people in the last 30 days who say, 'I got to get out of the stock market. I cant handle it,'" he said.

However, many apartment landlords aren't willing to sell their rental properties since cash flows are coming back, rents have firmed up and vacancies are more manageable than a year ago. "There's a lot of buyers and not enough inventory to satisfy them right now, at least at the price point," Christopher said. He said occupancy should remain relatively stable and apartment sales should be up 5 to 7 percent this year over 2010.

The USC Casden Forecast's 2011 Multifamily Market Report attributes a slight increase in occupancy in the Long Beach subsector over last year to a consequence of falling rents. During 2010, the report states average rents declined by 1.7 percent.

Christopher said rental rates should stay stagnant for at least the next year and shouldn't come back up again until there's more job creation, except in cases of landlords renovating facilities. "I think we're probably static on rents for the next 12 months unless you go in and create some serious value in a place," he said.

Steve "Bogie" Bogoyevac, apartment broker for real estate investment group Marcus & Millichap, said investors have been much more active this year than 2010, which has to do with better occupancy, improving operations and low interest rates (anywhere from 4 to 4.5 percent), which gives buyers "leverage" in today's market.

"The market is pretty vibrant," he said. "The properties on the market that are priced appropriately are getting a lot of activity, a lot of offers and are selling." Bogoyevac said he has closed five deals as of June 1 and has eight more in escrow.

The apartment vacancy rate for Long Beach is roughly 5 percent, according to Bogoyevac. But, with property values low, many investors are now buying homes, improving them and renting them out as income properties, creating somewhat of a "shadow market" affect in apartment unit occupancy rates.

However, he added that the steady decline in vacancy in apartment buildings in Long Beach and the Southern California area has had a positive impact on the apartment market in general. In fact, Bogoyevac said some property owners have pulled back on concessions, such as discounts on deposits and move-in specials that were once the norm.

Commercial: Office Market Sees Signs Of 'Strengthening'

Commercial office buildings have been significantly impacted by recent volatile economic conditions, with companies downsizing, relocating or holding back on expansions, keeping vacancy rates relatively high over the past few years.

Brokers and economists say the recent slowdown in the economic recovery and job creation may only impede projected growth in various commercial real estate sectors in coming years. But, in Long Beach, there have been some slight improvements over the last few months.

According to Cushman & Wakefield's second quarter South Bay office report, the suburban Long Beach submarket saw its overall vacancy rate fall from 22.2 percent at the end of 2010 to 20.4 percent as of June, with occupancy gains of 76,040 square feet. The area covers buildings in East Long Beach, Bixby Knolls and the Long Beach Airport.

The Downtown Long Beach submarket, which has a roughly 18 percent vacancy rate, also saw slight positive net absorption in the second quarter this year. "While weakness in the overall [South Bay] market will linger for several more quarters, some submarkets could begin to strengthen, leading the charge for a mild recovery in 2012," according to the report.

Some significant office transactions in the second quarter include: Ignify, Inc. signing on to 10,597 square feet at 200 Pine Ave., Veterans Affairs leasing 21,264 square feet at 4811 Airport Plaza Dr. and the City of Long Beach renewing a lease for 23,518 square feet at 100 Broadway.

Also, the Downtown Plaza building at 211 E. Ocean Blvd. has recently been purchased and Opus Bank has leased 6,722 square feet.

"The real estate market seems to be holding it's own," said Bob Alperin, Cushman and Wakefield's regional senior director. "As far as demand, I don't think the rates have risen, but we're getting some absorption which is a good thing. I would say there has been some improvement and there seem to be more people in the market looking. We're seeing some activity."

Watson Land Company leased a near 150,000 square foot industrial property to Herbalife International Inc. at 18431 Wilmington Ave. within the master-planned Dominguez Technology Center. The company relocated its operations from its previous 82,000-square-foot location within Watson Industrial Center in Carson. (Photograph by Watson Land.)

In the downtown area, the Port of Long Beach is currently in negotiations to purchase the One World Trade Center building downtown from Legacy Partners, Inc. as its new headquarters, which would absorb 100,000 square feet of vacant office space in the market. "There's some deals that are working in downtown right now that should take some space off the market. We'll see what happens," Alperin said.

Still, the office market is expected to see more vacancies this year, which undoubtedly should put more pressure on property owners. Boeing is expected to vacate 176,000 square feet of office space in the eight-story 4801 Airport Center Dr. by December. It previously vacated 120,000 square feet in an adjacent building after relocating 800 employees to its Huntington Beach facility. With no new large tenants looking to absorb large vacancies, Cushman states the South Bay's overall vacancy could surpass 23 percent at year's end.

At Douglas Park, north of the Long Beach Airport, Steve Economos, office broker for 360 Commercial, said Newcastle Partners is currently marketing three office buildings for sale after two have gone into escrow. The property owner hired the Orange County-based brokerage firm to take a new direction in marketing the space to clients, he said.

"The ownership simply thought the marketing campaign got stale and wanted to inject new blood and new energy into it," Economos said. "We've come in with completely new marketing materials and a new and aggressive push to revitalize the park."

Although office lease rates have remained relatively flat, many landlords are using "significant leasing incentives to attract and retain tenants," such as free rent, and offered tenant improvements rather than rolling back rates, according to the Cushman report.

Although activity has been slightly positive, Alperin said the gains in occupancy seen in Long Beach are more relative to the city's geography and small market and don't negate the fact that unemployment continues to persist. "I think overall the economy is still struggling," he said.

Steve Warshauer, an office and industrial broker for First Team Ream Estate, said office vacancies are "slightly less" than a year ago. Southern California Edison, for instance, has recently moved into the third floor of a building at the Kilroy Airport Center that has been listed for years, he said.

In the last few months, Warshauer said there's been more activity in Long Beach than anywhere else locally, citing the city's close proximity to the ports, freeways and airports. "Activity level in Long Beach is better than what I have in L.A. or Orange County," Warshauer said. "Part of it is our geographic location . . . It's right in the middle. Given that there's space available everywhere, you tend to look here first."

Retail Market: Vacancies Rise, Distressed Sales Pick Up

Retail businesses, whether large chains or small mom-and-pops, have suffered from a steep drop in income as consumers have less discretionary dollars due to high gasoline prices, rising costs of commodities and other factors. Despite increased sales in some retail categories, empty storefronts and vacancies continue to rise in Long Beach.

Doug Shea, commercial broker and principal for INCO Commercial, said many retail properties have now become distressed since either landlords or tenants haven't able to turn then around in the painful economic recovery. "This is probably one of the lowest cycles I've ever seen," he said. "There's just not the discretionary income, and everybody is just really holding on to it."

The upside is that potential buyers are now entering the market to take up properties at a much lower cost. The empty retail space has opened up the possibility for potential investors or owner/users to enter the market after being constrained by virtually no new construction, Shea said.

"We're seeing a little bit more buying of retail due to the distressed properties on the market," he said. "The retail properties themselves have been hurting so now people are starting to sell those properties and people are starting to buy them."

But, large chunks of vacant space are hard to fill back up again and continued vacancies make it tough for properties owners to ask for higher rates. Another constrain is that conditional uses grandfathered in by previous owners have expired in some cases and allowances, such as for parking, might not be permitted for the intended use anymore.

Borders Bookstore left roughly 100,000 square feet on the market after shuttering two locations in Long Beach last year and is subleasing the space out until its contract expires. One Dollar Book Store is currently leasing the Borders location at The Pike at Rainbow Harbor as a temporary fix until a permanent tenant can occupy the space.

Brian Russell, a commercial real estate broker for Coldwell Banker Commercial BLAIR WESTMAC, said the continued economic downturn has made it hard for small mom and pop stores to survive. In the last few months, tenants have gone out of business due to either a downturn in sales or being asked to leave by new landlords who acquired properties through foreclosure purchases.

"Tenants are affected not only because their sales are down in a recessionary period, but owners are losing property to foreclosure and buyers come in and tell tenants to leave, so there's all sorts of competing pressures and aspects going on in this recessionary period," Russell said.

While there are more vacancies, there's also been a distinct uptick in people looking for space, he said. Values and lease rates have stayed "constant" from last quarter, and landlords continue to be willing to negotiate terms in a tenant's market. Given the deals for retail tenants, Russell added that now is a good time for businesses to lease space or buy property at a low rate, which has been the case for some startups and businesses looking to upgrade.

Industrial: Demand Rises Slowly With 'Flight To Quality'

The South Bay industrial real estate market has maintained high occupancy due to heavy demand for distribution facilities, manufacturing and warehouses connected to international trade through the ports of Long Beach and Los Angeles, aerospace and aviation, e-commerce operations or other industries.

According to a second quarter report by Lee & Associates, the vacancy rate for the South Bay industrial sector increased slightly from 5.1 percent in the first quarter to 5.2 percent in the second quarter. But, overall, the vacancy is relatively healthy compared to the rest of the U.S. and overseas markets due to supply chain business flowing through the ports.

Although cargo traffic has dropped off slightly in recent months, there have been improvements. The vacancy rate in the Inland Empire for instance, has dropped from 11 percent to roughly 7 percent over the last few years.

In most cases, there's been what's called a "flight to quality," where gradual demand has mostly been for high quality, or Class A, product, spurring recent development projects, such as at Douglas Park near the Long Beach Airport. There are currently two owner/users that have developed facilities there.

Watson Land Company, one of the largest industrial developers in the country, is currently constructing a 250,000 square foot Class A building in Carson after tearing down an obsolete office building. The space has already been leased at a strong rental rate, said Bruce Choate, the company's president and CEO. "We feel pretty good about where things are in light of the economy," he said.

Choate said industrial related companies are doing relatively well and more businesses are looking for higher quality "functional" buildings at a lower asking price. "The well designed, well located buildings are being absorbed much more quickly than the C Buildings or the buildings with a less desirable location," he said.

Watson Land's industrial centers are almost fully occupied. It recently leased a near 150,000 square foot industrial property to Herbalife International, Inc., which expanded from one of Watson's other properties, signing on for 10 years. Other transactions include Calko, a third party logistics company, relocating its corporate headquarters to Carson, taking up 135,000 square feet of industrial space, and OHL leasing nearly 150,000 square feet.

With continued improvements in the industrial market, Choate said there are fewer and fewer requests for concessions, while rents have stabilized and are actually starting to increase in some cases. "They're not where they were at the height of the market of course, but they're starting to firm up," he said.

Jim Flynn, president of The Carson Companies, said activity is "reasonably active," mainly due to the rebound in international trade seen last year and into the first part of this year. The developer is currently fully occupied other than a 129,000-square-foot building being renovated on Victoria Avenue in Compton that should come on the market in about six months. "While the economic downturn hit the industrial market, it didn't hit it as hard as the other categories of real estate," he said.

The typical vacancy appears to be in older buildings, anything built 30 years ago or further, which are now functionally obsolete, Flynn said. Most of them were built for manufacturing that, for the most part, have been "chased away" by California's unfriendly business climate and attracted to state's with a lower cost of doing business, he said.

As a result, what's left has to be renovated for buyers and renters in the current market, which are mostly distribution companies that require large truck courts and space for goods, such as food, clothing and electronics. New Class A buildings appear to be what such companies as General Mills, Yoplait Yogurt, Fed Ex and Epson are occupying these days, he said.

Brandon Carrillo, industrial broker for Lee & Associates, said activity in the overall industrial market has improved, but continues to be somewhat inconsistent. With issues related to the national debt in the U.S. and Europe and a global slowdown, some companies continue to hold back on capital to purchase or develop new property.

However, the pent up demand might soon spur more industrial development as investors find real estate a sure bet over the stock market and a hedge against inflation, he added. "We're still getting deals done and getting activity, it's just not to the volume we would like it," Carrillo said. "But I think once the dust settles . . . I think investors are going to start making protective moves."

(Note: Turn the page for more real estate news. The next Real Estate Quarterly is scheduled for November 8.) ■