LOS ANGELES BUSINESS JOURNAL

Prime Properties' Continued Rise Strengthens Submarket

By MARGOT CARMICHAEL LESTER - 1/23/2006
Los Angeles Business Journal Staff

Making up for lost time, downtown's Class A landlords pushed average rental rates to $2.70 per square foot in the fourth quarter as the area continued to strengthen.

Rates for downtown's prime properties have risen steadily since 2002, when they closed the year at $2.27 per square foot, according to figures from Grubb & Ellis Co. Class A rates were up 6 cents from the third quarter and 8 cents on the year, a 3 percent increase.

Still, rents haven't kept pace with the ever-increasing sums paid by investors for office properties. That could signal even steeper rent hikes on the horizon, as landlords try to recoup what they paid for their property.

"That percentage increase is actually lower than the average for other submarkets in the region for the same period, (so) the fact that purchase prices for Class A buildings have risen by nearly twice as much means that there are more increases to be expected in downtown," said Chris Runyen, senior managing director for Charles Dunn Co. Inc.

Decreasing vacancy rates, which dipped to 14.9 percent from 15.6 percent in the third quarter helped to buoy prices.

"Landlords of Class A buildings will – and should – continue to raise rental rates as their buildings continue to absorb new tenants," Runyon said.

Class B asking rates rose one cent to $1.99 per square foot at year-end, 12 cents higher than the same quarter last year and 16 cents higher than the same quarter 2003. The mark is just higher than the $1.98 recorded in the fourth quarter of 2001, when technology and telco companies were eating up second-tier space to take advantage of the Central Business District's trunk lines.

The market also is tight for tenants seeking large footprints. Of downtown's 15 trophy buildings, only four can accommodate a contiguous block of 100,000 rentable square feet and only three can accommodate a contiguous block of 200,000 rentable square feet," said Eric Duncanson, senior vice president at CB Richard Ellis Group Inc.

"These 100,000 rentable square foot spaces are in buildings that are owned by three major owners, Maguire Properties, Trizec Properties and Thomas Properties," Duncanson added. "The world of options and the world of owners have narrowed considerably."

The crunch put a damper on lease deals. "Office leasing activity is currently close to its lowest level since 1997," said independent commercial real estate broker Scot McBeath.

Downtown's whirlwind of investment activity slowed in the final quarter. A recent report from the USC Lusk Center for Real Estate predicted a slowdown in investment activity nationwide as corporate investors review acquisitions more carefully in advance of an expected interest rate increase later this year.

The largest deal: Alliance Commercial Properties bought the 411,00-square-foot Pacific Center at 523 W. Sixth St. for $66.3 million.

Other large transactions involved renewals. National Heritage Insurance Co. renewed 61,634 square feet at 1055 W. Seventh St. and law firm Lynberg & Watkins renewed its 36,887-square-foot space at 888 S. Figueroa St. Terms were not reported.

Law firms moving within the market cut other significant deals. Burke Williams & Sorensen LLP leased 24,506 square feet in a $6.5 million, 10-year lease in the Citibank Center at 444 S. Flower St. The law firm's move from 611 W. Sixth St. brings Citibank Center's occupancy to 95 percent. Squire, Sanders & Dempsey LLP leased 39,667 square feet at City National Tower, 555 S. Flower St., in a 10-year lease worth around around $13.3 million. The firm, relocating from 801 S. Figueroa St., will occupy the entire 31st floor and part of the 32nd floor.

The Los Angeles Center Studios also logged a significant new lease at year-end. The Entertainment Industry Development Corp. will move there from Hollywood's Steven J. Cannell building at 7083 Hollywood Blvd. in a 10-year, 13,000-square-foot deal.

With so few new deals, net absorption rose only slightly to 114,611 square feet in the final period from 108,798 in the third. However, year-to-date net absorption was 841,568 square feet, compared to 9,881 square feet at the close of 2004.

Expansions and notable new leases, such as the third-quarter Microsoft deal, drove the jump. Additionally, Runyen said, "Some of the buildings that were vacated (for residential conversion) over the past year have displaced tenants who have now settled into other office space in downtown, which is reflected in the absorption numbers from the same time last year"

Jonathan Larsen, executive vice president/principal with Trammell Crow Co., advises medium- to large-size tenants seeking space to evaluate the market early in 2006.

"Rental rates will hold steady, due to new space coming on line at 601 S. Figueroa St., 355 S. Grand Ave. and the large availability of office space at City National Bank Plaza," he said. "Towards the third quarter of 2006, the (overall) vacancy rate should tighten up and begin to switch over to the landlord's favor."
