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Small Businesses Fuel Investment

BROKERAGE *Office and industrial landlords may focus on large tenants, but growth is in little firms*

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While there may be a sense of prestige in attracting a major corporation to any city, small businesses collectively outweigh the number of large office and industrial tenants in California.

While only 2 percent of employers in the state's largest cities employ 100 people or more, according to California's Employment Development Department, developers often focus much of their attention on those types of tenants as they attempt to fill new buildings. There are landlords who cater to small businesses, but it is still somewhat difficult for biotechnology, high-tech and other startups leading economic growth in California to find suitable facilities.

Not only are most California employers small businesses, the

vast majority of companies have no more than four employees. According to the state's Employment Development Department, businesses with four employees or less make up 63 percent of the companies in San Diego County, 74 percent in Los Angeles and 67 percent in San Francisco.

Companies with fewer than 100 workers make up 97.8 percent of the 85,540 employers in San Diego, 98.5 percent of the 364,553 companies in Los Angeles and 98.3 percent of the 74,893 businesses in San Francisco.

"We have to have suites available at all times for small companies," said Jeb Bakke, senior vice president at CB Richard Ellis in San Diego.

Bakke said many tenants in the region start as small businesses and grow into much larger companies. He used his client, College Loan Corp., as an example. The San Diego-based student loan provider started



The San Diego Science Center owned by Biomed Realty Trust Inc. is an incubator for biotechnology startup firms. Companies with four employees or fewer make up 63 percent of the businesses in San Diego.

out in 8,000 to 9,000 square feet in 1999, occupies 100,000 square feet currently, and signed a lease this year for 130,000 square feet.

"[Cities] want to attract business in general, but it's easier to go after the trophy company and somebody that has a lot of jobs," said Jack Kyser, senior vice president and chief economist for the Los Angeles Economic Development Corp.

According to the state's data, while companies with 100 or more people make up 2 percent or less of the businesses in each region, those companies employ 43 percent of the workers in San Diego, 44 percent in Los Angeles and 42 percent in San Francisco.

Landing a major national firm gives cities and economic development agencies the cache they

are looking for to attract other big employers.

"It's sort of like feathers in your cap," Kyser said.

California has 52 Fortune 500 companies. Only New York and Texas have more, with 57 and 56 corporations respectively on Fortune magazine's 2007 list published in April.

San Francisco has five Fortune 500 companies and 23 more are headquartered in other Bay Area and Silicon Valley cities. Los Angeles has four companies in the top 500, with another 14 corporations based in nearby suburbs. San Diego and Orange County each have three Fortune 500 companies.

"In Southern California, we have a lot of industries that lend

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themselves to small businesses," Kyser said.

Technology businesses, including manufacturing and research, professional services, scientific industries and technical firms, are growing consistently.

"The real estate is expensive, but a lot of the workforce they need is here," Kyser said. "Even though California is a high-cost place to locate, there are some offsets."

According to the Center for Continuing Study of the California Economy in Palo Alto, California technology companies receive more than 45 percent of the United States' venture capital funding and 25 percent of U.S. patents. Those firms account for more than 20 percent of all jobs and production in the state.

Many of the tenants in Los Angeles-based **Rexford Industrial LLC's** properties are smaller companies, but they have more to do with international trade at the ports on Southern California's coast than the high-tech and biotechnology businesses that are thriving in inland markets.

"We primarily seem to focus on projects where we have medium- to small-sized tenants," said Howard Schwimmer, co-founder and managing member of Rexford Industrial.

"Most of what we do for tenants is provide a turnkey unit for them," Schwimmer said. "They want to have a space that's ready for move-in. People show up and look at a space and literally want to move in that weekend. We can look at their credit and do a lease in a 24-hour period. A lot of our competition has trouble dealing with those tenants because they're not able to respond in a timely manner."

Entrepreneurial Spirit

As a property owner dealing with a lot of medium-sized entrepreneurial businesses, Rexford has to be as entrepreneurial as its tenants, said Michael Frankel, chief financial officer at Rexford.

"These are tenants that aren't planning 12 to 18 months out for their space needs," Frankel said. "These are companies that have a container arriving from China and they need a place to put it."

With several properties under its ownership, Rexford finds that as tenants outgrow a space they can move to another of the landlord's buildings even before the end of their existing leases.

"A lot of people tend to shy away from smaller tenants because they see it as management-intensive," Frankel said. "We see it as a great advantage, because we're delivering product in extremely scarce supply. It is management-intensive, but it is manageable."

Schwimmer said the number of very small businesses, led by the owner who moves out of his home office or garage, makes up a small part of the industrial marketplace.

"No one can build that product anymore, the 1,000-square-foot unit. It hasn't been constructed in 15 years in most markets," he said.

Construction and land costs make it too expensive to build small buildings for lease or multitenant properties with several small suites. In its existing properties, Rexford has tenants leasing as little as 800 square feet, but most small companies occupy 2,000 to 10,000 square feet. The company prefers to buy existing properties and renovate them, which allows it to provide smaller spaces at less expense than new construction.

John Bonanno, a broker in the Life Sciences Group at local brokerage **Grubb & Ellis/BRE Commercial**, said landlords are getting better at working with startup firms as they develop their research into marketable products.

"San Diego has been very good in the past at raising up small companies and making them mid-size companies, but we haven't been as good at making them huge companies, though there are some successes," Bonanno said.

Some building owners have constructed buildings where small tenants can share lab space, conference rooms, vivariums and other facilities. Pasadena-based **Alexandria Real Estate Equities Inc.** owns a biotech incubator in the University Towne Centre submarket near the University of California, San Diego, and several research institutes.

Until recently, Bonanno was president of **Phase 3 Properties**, which developed the San Diego Science Center. The 105,364-square-foot building was transformed from the Mission Bay Memorial Hospital into an incubator for biotech startups in 2002. San Diego-based **BioMed Realty Trust Inc.** purchased the building in 2004 for \$29.8 million.

Bill Nork, senior vice president at **Cornish & Carey Commercial** in Emeryville, said San Rafael-based **Wareham Development** is dedicating one floor in its four-story, 245,000-square-foot EmeryStation East in Emeryville to small tenants in need of as little as 2,500 square feet.

"There's probably always a need for incubator space to grow small tenants into larger tenants," Nork said.

Preferential Treatment

However, most landlords who are leasing up new development prefer to work with big companies.

"You have to do the same amount of work for a tenant whether it's 1,000 square feet or 10,000 square feet, so most landlords would prefer to work with fewer larger tenants," Nork said. "It's unusual for someone to build a building aimed just at smaller tenants. They're designed with the larger tenant in mind, with spaces usually 3,000 to 5,000 square feet and up."

In addition to the time and work involved in lease negotiations, it can also be difficult to divide large new buildings into efficient spaces. With 20,000- to 30,000-square-foot floor plates, it is difficult to provide small suites, because the buildings end up with a lot of long deep spaces.

In San Diego, Bonanno said landlords are starting to be more flexible for small companies that expect to be in a growth mode.

"More so than ever, you see people doing shorter leases and allowing expansion options," he said. "You may see a company take 10,000 square feet when they need 5,000 now, but the landlord may charge only 50 percent or 60 percent of the rent."

Landlords aren't necessarily focused just on large companies, because they realize small businesses can become larger tenants and it can happen quickly.

"Many times landlords can participate by working with tenants in the early stage," Bonanno said. "They can tear up the lease if the company has unexpected growth in order to put them in another building the landlord owns."

However, only a small percentage of startup companies become giant corporations. Some fail and some merge with other big companies. Kyser said there probably is more risk in leasing to startups, because there is always a question of how long they will stay in business. However, Union Bank of California's recent Small Business Survey found that 67 percent of small business owners expect their profits to increase in 2007. Of the companies surveyed, 63 percent said their profits were higher in 2006 than they were in the previous year. Also 30 percent of the small businesses surveyed said they plan to hire more people and 66 percent expected to keep staffing levels stable this year.

For whatever growth is happening at local firms, Bonanno said now is a good time for small companies to be looking for space.

"There were some places where large users took spaces and they were purchased or they decided to move and they left buildings vacant," he said. "It has been beneficial for companies that need a small space. I think right now is a great time for tenants in the marketplace to be looking for space and starting companies."

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