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Vacated Mortgage Industry Space Not Competing with New Development

OFFICE Under-construction office buildings in Orange County offer more amenities, green certification than 'shadow' space

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Subprime lending woes have cast a pall over the Orange County office market, but the picture is not as bleak as the headlines might lead one to think.

Most of the space being vacated by subprime companies doesn't compete directly with the new Class A developments that are currently under way, according to Greg May, a senior vice president in the Newport Beach office of Grubb & Ellis.

"Your tenant is typically going to be looking for higher-end tenant improvements, and is willing to pay the freight for it," May said.

Obviously, the mortgage meltdown has made an impact. According to the latest survey by Voit Commercial Brokerage, Orange County's office vacancy rose to 8.49 percent during the first quarter of this year. That's more than half a percentage point higher than the 7.96 percent recorded in first quarter 2006.

The availability rate, which includes sublease as well as direct space, grew to 12.35 percent compared to 10.41 percent. Jerry J. Holder, Voit's vice president of market research, said the increase largely stems from the amount of space mortgage companies and related businesses have put back on the market.

On the plus side, Orange County registered another record high on average asking lease rates in the first quarter — \$2.63 per square foot per month, full service gross, which is 10 percent higher than it was last year. That's largely due to all the new construction that is coming on the market, Holdner said. He foresees continued lease rate growth in the 5 percent to 10 percent range this year.

"There is some activity, so it's not all doom and gloom," Holdner said.

Underscoring that point, Hines recently signed a second tenant at its new office tower under construction in Irvine, 2211 Michelson. Wachovia Corp., one of the country's largest diversified financial services companies, leased the building's entire second floor plus ground-floor retail space in a 25,400-square-foot transaction.

Doug Holte, Hines senior vice president, said the transaction is significant because it represents a new Orange County headquarters for a national financial institution.

"They're going to begin with 25,000 square feet and grow from there," Holte said.

Wachovia bought World Savings as well as Western Financial last year, and is a large player in the Orange County banking industry, he added. Hines has previously developed facilities for the bank in cities such as Houston and Atlanta over the past 20 years.

Robert W. Thagard of ORION Property Partners represented Hines and its joint venture development partner, Crescent Real Estate Equities. Wachovia was represented by Webber Beall and Justin Collins of Lincoln Property Co. Commercial Inc.

The Wachovia lease comes on the heels of Pathway Capital Management, which signed on for 37,000 square feet earlier this year.

"We like the combination of those two tenants: a local investment management firm and a national bank," Holte said. "They're both great clients to us and represent validation of this project as a good business location."

Hines broke ground for the project in January 2006, and the building will be the first of the new wave of high-rise office construction in Orange County to open. Counting a couple of deals that are out for signature, the 266,000-square-foot building is now about 30 percent leased.

The transaction also suggests that sustainable design has all the makings to become a significant factor among corporate office users. The project was the first office building in California to receive pre-certification under the U.S. Green Building Council's Leadership in Energy and Environmental Design-Core and Shell program, thanks to its maximization of interior daylight, reduction in electricity and water usage, and innovative wastewater handling.

Since it's also good to be green outside, 2211 Michelson will offer extensive gardens with 50 new trees and outdoor landscaped seating areas.

"Wachovia really attributed value to that, which was a nice confirmation of that attribute

of our building," Holte said.

The trend going forward, he said, will be toward sustainable design and what Holte calls "high-performance workspace" — buildings that are superior in terms of fresh air, daylighting, outdoor spaces, materials and energy. They're high-performance, he explained, because they offer the best possible workspace for high-performance employees.

The change literally happened this year, Holte said. Previously, few tenants asked about sustainably designed buildings, and many of them didn't even know what "LEED" meant.

"When we look back, we'll say 2006 was the year of the tipping point when the users of space, the actual tenants, and the providers of capital, meaning lenders and investors, all realized that LEED is meaningful, and it's smart business," Holte said.

Designed by Paul Danna of the Los Angeles office of DMJM, 2211 Michelson features an exterior of white architectural metal panels and silver vision glass. The tower will include four penthouse corner balconies, and the typical-size floorplate will contain 23,000 square feet of column-free space.

Holte said 2211 Michelson was designed for corporate and professional firms, and never was aimed at mortgage tenants. From a physical design standpoint, he said, the size and shape of its floorplates were not suitable for firms that need "seas of cubicles" to accommodate mortgage salespeople. In addition, Hines felt that the mortgage industry's hyper growth in 2003 and 2004 would not be sustainable.

Wachovia is slated to occupy its space later this year, moving in employees from other locations as well as adding new ones. It's not a consolidation, Holte said, but "assembling a headquarters team from existing employee locations and new employees that they're hiring."

"I would say eight out of 10 tenants we're speaking to are growing," Holte said. "We're actually encouraged by the story that's not told as much, which is that Orange County on a job basis is pretty robust."

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