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Vacancies Suppress Southern California Recovery

By JIM CARLTON

ONTARIO, Calif. -- One drag on recovery in Southern California is illustrated by three new office buildings near the LA-Ontario International Airport. One is 60% leased. The other two sit empty.

While real estate is in a funk across the U.S., Southern California's economy is more reliant on the construction than many other places. So until these vacant buildings and hundreds of others like them fill up, the prospects for a rebound in construction and the broader economy here are bleak.

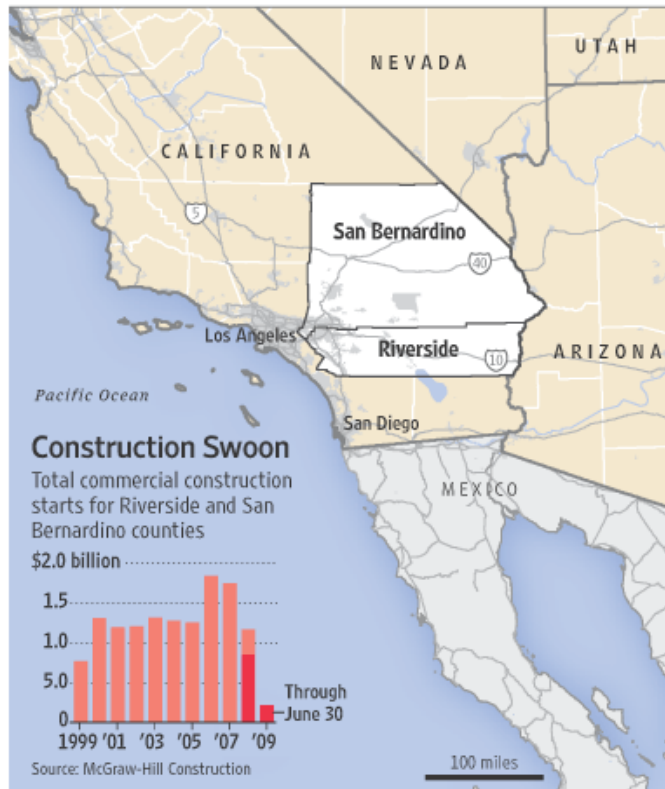
At its peak four years ago, construction was the fourth-largest employer in the Inland Empire counties of San Bernardino and Riverside, according to Jack Kyser, chief economist at Los Angeles Economic Development Corp., a nonprofit research group. The housing industry contributed more than \$24 billion in revenue to the Southern California economy in 2008, or more than double the U.S. gross revenue from Hollywood movies, according to the Building Industry Association of Southern California.

Much has changed. "New construction is now literally stopped," said Katherine Aguilar Perez, executive director of the Urban Land Institute's office in Los Angeles. The industry has shed jobs as new building starts have plummeted.

The greater Los Angeles area has lost about 90,000 construction jobs, or about 15% of the total in the past year, more than any other metropolitan area, according to the Associated General Contractors of America. The Inland Empire, east of Los Angeles, has lost about 60,000 construction jobs since 2006, or 49% of its total, according to John Husing, a consulting economist in Redlands, Calif.

Meanwhile, the number of housing permits in the five-county greater Los Angeles region has dropped 85% from 88,187 in 2005 to a projected 12,990 this year, Mr. Kyser said. The fall has been even steeper in San Bernardino and Riverside counties, where housing permits have plunged 96% from 45,299 in 2005 to a projected 2,000 this year, said Mr. Husing.

Even big builders have suspended much of their work. Lewis Group of Cos., for example, says it has put on hold two big master-planned communities: the 1,100-home Shady Trails in Fontana, where fewer than 300 units have been completed, and the 8,000-home Preserve in Chino, where about 1,300 homes have been completed. "We're going to just wait until we see a recovery," says Randall Lewis, executive vice president of the Upland, Calif. developer.



As a result, construction won't be poised to play its frequent role of leading the region of almost 25 million people out of the recession. "It's going to be difficult this time, because it won't be one sector you can point to lead the way," Mr. Kyser said.

Right now, vacancy rates show no signs of turning around. Office vacancies in San Bernardino and Riverside counties have more than tripled, to 24.6% from 8% in 2006, according to estimates by broker CB Richard Ellis. At the same time, the Inland Empire's retail vacancy rate shot up to 10.6% in the second quarter from about 5% in 2006, according to CB.

That retail vacancy rate has spelled financial trouble for many malls. In Corona, Calif., owners of the Promenade Shops at Dos Lagos defaulted on their \$125 million loan last fall and say they have since tried to work out a restructuring with the lender. Officials of the mall's owner, Poag & McEwen Lifestyle Centers LLC, say they hope to

avoid foreclosure.

The high level of office and retail vacancies suggests builders in those markets may have the toughest time in coming months. Until now, home builders have shouldered the brunt of the construction fall. Since 2007, the Building Industry Association of Southern California, which represents mostly home builders, has seen its membership fall 33% to 1,600 members from 2,400 as a result of bankruptcies and other factors, said spokeswoman Julie Senter.

The builders who have survived have done so largely by cutting staff as much as 90%. "The builders have had to scramble like mad to keep their doors open," said Mark Knorringa, chief executive of the Building Industry Association of Riverside County, an industry trade group.

One midsize builder, Jennings Pierce Jr., said he cut his work force from 85 in 2005 -- when he built 405 homes in the Inland Empire -- to 15 this year. He now expects to construct fewer than 50 homes in 2009. "We're doing our best, but it hasn't been pretty," said Mr. Pierce. His revenue has fallen from \$125 million in 2005 to a projected \$4.3 million this year.

Another builder, Hileman Co., said it had employed 200 workers for office-building projects in early 2008 but had none now. All the work is hold. The Los Angeles developer owns 530,000 square feet of office space in Southern California, including one of the three new buildings near L.A.-Ontario International Airport. The company has dropped rents about 20% in one of its properties to lure tenants to fill space left by a mortgage company that vacated in 2008, while another six-story building sits vacant.

"I have to say it's been a struggle," said Jack Hileman, the firm's founder.

It has been even more difficult for laid-off workers like George Marquecho. Mr. Marquecho, 55 years old, who lost his job as a construction laborer a year ago, said he and his wife and teenage son have had to forgo movies, restaurants and amusement parks so they can pay bills with unemployment checks a third the amount of his former income. "It's hard for guys like me just to put food on the table and meet all our obligations," he said.

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