

Tech woes hit home

Santa Cruz-area office space goes vacant as Silicon Valley real-estate slump spreads



Janine Collins/Sentinel

A banner advertises office space for rent in the Flatiron Building at Pacific Avenue and Front Street.

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The high-tech collapse that has devastated the office real-estate markets in San Francisco and Silicon Valley is stalking Santa Cruz.

Though rental rates here in Silicon Beach are at an all-time high, they appear headed for a downturn but not a Nasdaq-style wipeout.

"This time last year, there was no office space available," said Peter Eberle, executive director of the Downtown Association.

But rents are falling, and available space is on the rise as technology-related companies downsize or bail out of Santa Cruz County.

"The pattern we are seeing is that vacancy will continue to go up," said Mark Bollozos, research director for BT Commercial, a full-service real-estate bro-

kerage headquartered in San Jose.

Yet there is no clear pattern emerging within the county's four markets. Santa Cruz and Scotts Valley appear to be faring well, while vacancy rates in the Watsonville and Aptos/Capitola/Soquel markets have more than doubled in the past year.

Santa Cruz typically has lagged behind economic slowdowns — including housing prices and layoffs — in San Jose and San Francisco by as many as six months.

On average, office space during the first quarter of 2001 leased for \$2.51 per square foot — up from \$2 last year and nearly double the 1999 rate.

Analysts predict the overheated rental market will cool to \$2 by the end of the month, a correction that stunned Bay Area landlords immediately after the stock market crashed last year. "All of the gains in

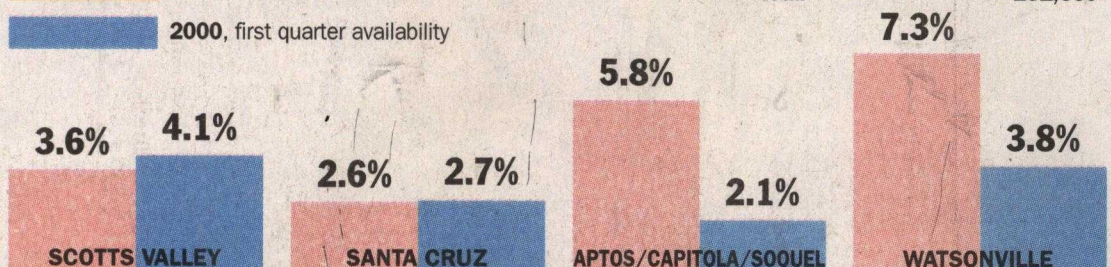
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Available office space

Below is the percentage of available office space in Santa Cruz County cities during the first quarter compared to the same time last year. To the right is the total square footage available this year.

2001, first quarter availability
2000, first quarter availability

	Available sq. ft.
Scotts Valley	71,108
Santa Cruz	56,834
Aptos/Capitola/Soquel	47,630
Watsonville	105,997
Total	281,569



Office space

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rental rates — and they were significant in 1999 and 2000 — the market has given all that back,” said Jim Koch, managing partner of CSFB Realty Corp., a New York-based real estate brokerage with offices in Palo Alto.

But Santa Cruz County, with a 4.4 percent vacancy rate, a frequent measure of the local economy, has been somewhat insulated because there is not the concentration of dot-coms — businesses Koch describes as “trying to put eyeballs on a Web site.” While there have been dot-com casualties, the diversity of the local high-tech industry has offered some protection.

“We have had dot-coms affected in this area, but not nearly like it has been in Silicon Valley,” said Steve Sheldon of BT Commercial’s Soquel office. “There have been some companies shrinking and giving up space for sublets.”

Telecommunications giant Nokia recently abandoned more than 10,000 square feet on two floors of the downtown Flatiron Building, 1538 Pacific Ave., and is offering the space for sublease. Nokia also has offices in Scotts Valley. Lutris Technologies, which provides products for Web and wireless developments, has moved out of several thousand square feet in the University Town Center at 1101 Pacific Ave. The company consolidated those employees into its offices a few blocks away in the Redtree Building, above the Borders bookstore.

“We didn’t have the growth we were planning on,” said Yancy Lind, Lutris chief executive officer. “Right now, the high-tech economy is clearly hurting, and it is not clear when things are going to get better. We are not counting on significant growth for some time.”

Lutris is among several high-profile, high-tech tenants in downtown Santa Cruz, such as LightSurf, Thuridion and Altera.

“All the businesses in the Cooper House and Redtree Building are strong and at full capacity,” Eberle said, adding that office rents have dropped to \$1.75 to \$2 per square foot from the \$2.65 average during the first quarter. “These are companies that have survived the hiccup of the economy and are still on the cutting edge.”

Another trend, according to real-estate analysts, is the length of time property remains on the market. In the high-tech heyday a year ago, landlords didn’t need to advertise. Today, analysts say, it’s clearly a tenant’s market.

“You are seeing space on the market for months, whereas before it was days, if it got on the market at all,” said Koch, whose client list includes Adobe, Novell, Informix and Aspect Communications.

When Erik Johnson advertised office space in his Coral Street building a year ago, the phone didn’t stop ringing.

“I had 40 to 50 responses, and most of them were dot-commers,” said Johnson, owner of Erik’s DeliCafé. “But a month ago I only had four or five responses — and no dot-commers.”

Landlords, who previously held the

winning hand, are offering concessions to prospective tenants, such as two or three months free rent, tenant improvement allowances and paying broker commissions.

“All these things were previously very normal in the market, but they went away in 1999 and 2000 when the market got so tight,” Koch said.

Though the vacancy rate in Santa Cruz barely has changed from 2.6 percent during the first quarter last year — most recent figures available — the amount of space has nearly doubled in Watsonville.

A proposed multistory office building in the 200 block of Watsonville’s Main Street has waxed and waned in size in the last few years. As recently as last year, the development was under the auspices of George Ow Jr. and Barry Swenson in partnership with Watsonville’s Redevelopment Agency.

Ow hoped to attract high-tech firms from the Silicon Valley and Santa Cruz. Since Ow backed out, the city has concentrated on luring Graniterock into the building, which will also house a new library.

Jan Davison, director of Housing and Economic Development for Watsonville, said recently the city is reconsidering adding residential space to the mix, in large part because of the economic downturn.

In the Aptos/Capitola/Soquel market, where rents are lowest in the county, the vacancy rate has jumped from 2.1 percent to 5.8 percent, according to BT Commercial.

Yet in Scotts Valley, the amount of available space has declined slightly, from 4.1 percent in the first quarter last year, to 3.6 percent for the same period in 2001.

High-tech companies, willing to pay inflated rents, are being blamed for driving up rents for other tenants who have had a tough time bargaining at the expiration of their leases.

“When there is no space, and you can get whatever you want for space, that is capitalism,” said Eberle.

Despite the creeping downturn, Santa Cruz does not appear headed for the 10 and 7 percent vacancy rates seen in San Francisco and Silicon Valley, respectively.

“Overall, the market in Santa Cruz County is still very healthy,” said Bollozos, the research director. “For any market, 10 percent is the standard. And we’ve been below 5 percent for the past two years.”

Koch is optimistic that the mix of high-tech tenants in Santa Cruz is well-positioned to survive the slump.

“Most tech companies in Santa Cruz are developing products that have value,” Koch said. “If they can tighten their belts in the crunch, they will be the last to feel the recession, and the first to recover.”

But Koch cautions the real-estate downturn is not over.

“There is no sign of recovery yet,” Koch said. “I think the real-estate market will recover when the Nasdaq eventually recovers. The best prediction I’m hearing is maybe a year.”

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