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RIVERSIDE-SAN BERNARDINO, CALIF.

Commercial Sector Expects Things to Get Worse

By MAURA WEBBER SADOVI | SPECIAL TO THE WSJ

California's Inland Empire, the two-county region that stretches east of Los Angeles, has gone from a booming development smorgasbord to a basket case in a few short years.

The Riverside-San Bernardino area's unemployment level rose to 9.5% in November, tying with Detroit to lay claim to the highest unemployment rate of any large U.S. metropolitan area, according to the Labor Department. Third-quarter home-foreclosure rates were the third-highest of the nation's metros surveyed by RealtyTrac and the area's median single-family home price fell 39.4% to $227,200 in the third quarter from a year earlier, according to the National Association of Realtors.

The Inland Empire's commercial real-estate market also is by no means the picture of health. Roughly one-fifth of its office market is now vacant, store rents are plummeting and a rising number of warehouses are emptying as retailers have filed for bankruptcies and imports into the nearby ports of Los Angeles have slumped.

Still, as in many parts of the country, for now the downturn of commercial property in this region isn't as severe as that of its residential sector and job market.

Home to about 4.2 million people, the Inland Empire was favored in recent years by new residents and many industrial investors drawn to its expanse of relatively affordable land near Los Angeles.

So far, the region's commercial market isn't yet topping out the nation's various misery indexes, but it appears likely things will get worse before they get better. "We don't know when and where the bottom is," says Tim O'Rourke, executive vice president with Jones Lang LaSalle's industrial group in Los Angeles.

Mr. O'Rourke says the Inland Empire industrial market is still viewed as having long-term promise due to the area's above-average population growth and location. But as retail bankruptcies mount, an increasing amount of distribution space is going vacant, including a warehouse in Rancho Cucamonga previously occupied by Wickes Furniture Co., he says.

Warehouse vacancies in the third quarter remained among the country's lowest, even after roughly doubling over the past 12 months, according to Boston-based Property & Portfolio Research Inc., a real-estate research firm. Harder hit are metrowide office vacancies, which rose above 20%, and fourth-quarter retail rents, which had the third-highest percentage decline of 76 major metros tracked by New York-based Reis Inc., a real-estate research firm.

Delinquencies on commercial mortgages packaged and sold as bonds, which represent nearly a third of the commercial real-estate debt market, suggest the Inland Empire's retail market is getting hit particularly hard by the downturn, as evidenced by delinquencies on commercial mortgage-backed securities, or CMBS. A study of delinquencies in the region's largest cities and towns showed four retail properties with delinquent CMBS loans valued at a total of $165 million, according to Richard Parkus, head of research on such bonds for Deutsche Bank.

There were no delinquent office, warehouse, apartment or hotel loans in the region, according to the CMBS survey. But the retail problems gave the market an aggregate commercial delinquency rate of 3.8% as of December, well above the overall national delinquency rate of 1.2%, Mr. Parkus says. "Retail is going to get slammed in the Inland Empire, and it's already starting," Mr. Parkus says.

That outlook for the office and warehouse sector is also looking tougher. Financial companies are still emptying office space, including about 265,000 square feet in Rancho Cucamonga to be vacated by a unit of Citigroup Inc. in March.

New supply also will raise competition for shrinking warehouse users. While most public companies have ended any speculative building in the area, some 7.4 million square feet of warehouse facilities are expected to be completed this year, the highest volume of major markets tracked by PPR in the U.S.

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