

Office Market Continues Steady Slide

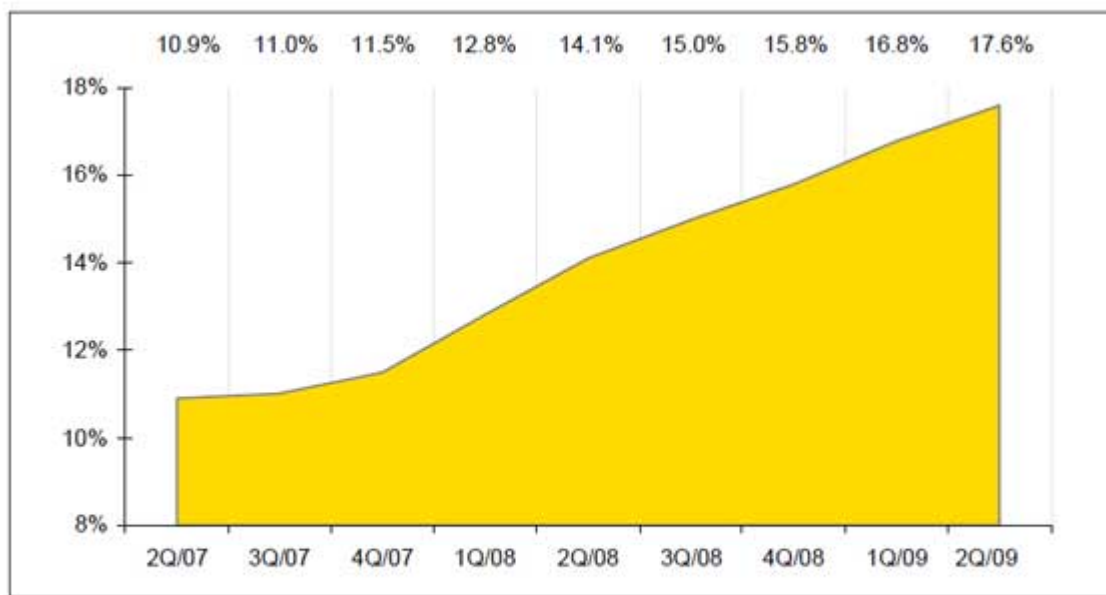
By *Bob Howard*



San Diego

SAN DIEGO-Market metrics continued their downward direction in the San Diego office sector during the second quarter, as they did throughout most US office markets, as vacancy rose nearly a percentage point, absorption remained negative and rents continued to slide. Market forecasts see little change in store until the US economy improves.

Quarterly office market reports by both Grubb & Ellis|BRE Commercial and Voit Real Estate Services attribute the weakening in the office market to the US recession and related problems. "Tenant activity remained weak in the second quarter," Grubb & Ellis|BRE said in its report.



Office Direct Vacancy Rate
All Classes of Space

July 23, 2009



The countywide direct vacancy rate reached 17.6% in the second quarter, up 80 basis points from the first quarter of 2009 and 3.5% from a year ago, according to the Grubb & Ellis|BRE figures. Voit pegs the vacancy rate at 16.37%, an increase over last year's second quarter rate of 13.18%, and says that the total of direct and sublease space now being marketed is 20.4%.

Grubb & Ellis|BRE recorded 516,224 square feet of negative absorption countywide in the second quarter, as asking rents slid to \$2.50 per square foot per month full service in the quarter compared to \$2.67 a year ago. Effective rents are expected to decrease further as landlords offer more concessions to keep their tenants. Voit put the county just barely into positive territory with absorption of 1,379 square feet for the second quarter and a total of 40,000 square feet of negative absorption for the year. Voit calculates the average asking full service gross lease rate at \$2.47, down 10 cents from the previous quarter.

In its outlook for the market, Grubb & Ellis|BRE points out that the office market, as a rule of thumb, lags the economy by six months. This means that the San Diego countywide vacancy rate "could ascend more rapidly and absorption could fall deeper into the red as 2009 progresses due to downsizing by struggling tenants," its forecast says.

As a result of these conditions, the Grubb outlook foresees that the majority of tenants will favor short-term lease extensions over long-term despite landlords offering generous periods of free rent and other concessions to tenants willing to sign long-term leases. "Expect to see more creativity and flexibility in lease terms as well as a decrease in asking and effective rents," it states. Despite these near-term concerns, the Grubb forecast notes that the long-term outlook for the San Diego market "remains optimistic due to its desirable location, demographics and diverse tenant base."

Voit sounds a similar theme in its forecast, saying that lease rates are expected to remain soft for the foreseeable future, and concessions should continue to increase in the forms of free rent, reduced parking fees, relocation funds and tenant improvement allowances. "We should see an increase in activity in the second half of 2009 from pent-up demand, once financial markets correct themselves and as consumer confidence increases," Voit's forecast states. "The final outcome hinges on how the recession progresses and how quickly credit eases up."