

San Diego Retail Real Estate Market Ranks Second Nationally

REAL ESTATE: Vacancy, Job Growth, Rents Among Factors Considered in Report

■ By LOU HIRSH

As consumers slowly make their way back to shops and restaurants, San Diego's retail real estate market is gradually recovering from recessionary lows for in-store purchases, lease deals and building acquisitions.

Even though cautious optimism has surfaced in the early months of 2010, industry researchers and other observers are still predicting rising vacancies this year. However, local leasing is likely to remain a buyer's market, as landlords compete to fill empty spots and new retail construction remains virtually non-existent compared with pre-recession levels.

A January investment research report by the commercial brokerage firm Marcus & Millichap ranked San Diego No. 2 in the nation — after Washington, D.C. — among 44 major metro areas for the relative health of its retail market. The firm's annual report rates communities on a series of 12-month, forward-looking indicators of supply and demand, taking into account factors including job growth, vacancy, construction, household formation, retail sales and rents.

San Diego also placed second to the nation's capital in another recent report by the same firm, gauging apartment investment markets. In retail, San Diego moved up from its third-place finish in 2009.

According to Encino-based Marcus & Millichap, San Diego had the nation's second-lowest retail vacancy rate among major metro areas in 2009. At 5.7 percent, it was higher than San Francisco's 4.1 percent, but lower than the U.S. average of 9.7 percent.

Local Vacancy Rate to Rise

Researchers project San Diego will retain its ranking in 2010, though the local vacancy rate is expected to reach 6 percent as the national rate hits 10.6 percent. By contrast, the local vacancy rate was 3.3 percent in 2007.

Developers are forecast to deliver 420,000 square feet of retail space to the San Diego metro area in 2010, expanding inventory by 0.5 percent. Asking rents are expected to fall 1.2 percent in 2010, to \$27.29 per square foot, while effective rents — with incentives factored in — are projected to drop 2.5 percent, to \$23.80 per square foot.

In 2009, local asking and effective rents slipped 4.7 percent and 7.1 percent, respectively, Marcus & Millichap reported.

One of the factors the firm considers in the report is job growth, and it projects small gains in San Diego-area jobs this year — some 12,500 positions, primarily in the government sector — after more than 70,000 local jobs were lost in the last two years.

Local real estate firms have not finalized their 2010 first-quarter data, but report heightened interest in vacant leased spaces compared with the same point of 2009, even though deals are taking longer to finalize than before the recession, as tenants shop around.

Jack Illes, a local partner in the Urban Strategies practice of Cassidy Turley BRE Commercial, said he's seeing an uptick, compared with a year ago, in retail tenants checking out potential new locations.

Greater Interest

Those include chain and locally based restaurants, some of them scouting sites va-

cated by other eateries in the past two years. Tenants such as specialty grocers are looking at well-priced in-fill locations that may have been passed over during the boom years.

"We recently had people flying out from Boston to see properties we've had listed locally," Illes said, noting that wasn't happening much in early 2009.

With leasing prices staying competitive, there's little stimulus for new retail construction. A year-end 2009 report by Cassidy Turley BRE noted that there were 87,902 square feet of retail space under construction across San Diego County, nearly all of that in downtown San Diego. That space under construction represents 0.2 percent of the county's retail inventory.

John Bemis, executive vice president of retail leasing and development in the

Atlanta office of Jones Lang LaSalle, said it could be 2012 before the U.S. retail industry is registering consistently positive sales growth and dropping vacancies, with connected increases in leasing and building activity. Much depends on the confidence of consumers, who continue to focus on paying down debt as they trim spending.

Investors Sitting on the Sidelines

As 2010 progresses, there should be more lender financing available nationwide for purchases of land and buildings, though prices on land are still not as attractive as those for existing building and lease acquisitions, and investors remain cautious.

"Lots of capital is still waiting on the sidelines to be invested into retail," Bemis said.

At a recent retail forum in Del Mar, pre-

sented by the local chapter of the NAIOP, aka the National Association of Industrial and Office Properties, experts said they don't expect retail space rents to rise significantly for a few more years, and they won't reach pre-recession peaks for many more.

"There's a lot of activity at discount low price points," said John Visconsi, president of Southwest regional operations for Kimco Realty Corp. However, since there's very little new development, "tenants are coming back and taking available spaces," he said, which could soon put upward pressure on rents.

Don Moser, founder of Retail Insite, noted at the forum that 100 local retail spaces above 10,000 square feet became available in 2008. However, in the current market, about 70 percent of big-box spaces are being absorbed by new tenants.