

San Diego County office market in for a rough ride

By **THOR KAMBAN BIBERMAN**, The Daily Transcript
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San Diego County's overall office market posted a 16.8 percent direct vacancy rate as of the end of the first quarter, but some submarkets were considerably worse than that.

Grubb & Ellis|BRE Commercial reports National City, with only about 466,000 square feet overall, had about 55 percent of its space empty as of March 31.

When asked if this number sounded too high, Phillip Linton, a Grubb & Ellis|BRE broker, said it sounded about right.

"One large building at 401 Mile of Cars Way has more than 200,000 square feet of space and only about 15,000 square feet is occupied," said Linton, adding that new construction makes up the bulk of the remaining space.

East Chula Vista, which includes office spaces in EastLake, had 40.2 percent of its 948,000 square feet vacant.

That submarket has been burdened by a wave of home foreclosures that hit the Otay Ranch community particularly hard.

"They're hurting out there," Linton added.

Governor Park in the University City submarket was 33.2 percent vacant or nearly a third of its 898,000 square feet empty.

Governor Park has both had to deal with a bad economy and competition in the nearby University Towne Centre (UTC) submarket. With a 4-million-square-foot market and significant amount of construction that was still going on up until this year, Rancho Bernardo landlords are also scrambling to fill their spaces. The vacancy in that market was 28 percent by G&E|BRE's accounts.

The submarkets of Carlsbad, Oceanside Vista and San Marcos didn't look much better.

Carlsbad and Vista each had a 26.9 percent rate, Oceanside had a 26.6 percent level and San Marcos' office space was 20.5 percent empty.

"The lack of growth and stability in the national economy continued to adversely affect the San Diego office market in the first quarter of 2009. Tenant activity remained weak and countywide quarterly net absorption was negative," the report stated.

"As San Diego County, along with the nation, continues to lose jobs -- a trend that started in May of 2008 -- San Diego's office vacancy continues to rise."

The countywide first quarter direct office vacancy rate of 16.8 percent was 100 basis points higher than the fourth quarter of 2008 -- and has

been steadily increasing since the fourth quarter of 2005 when the level was 8 percent.

San Diego's office market countywide recorded 316,158 square feet of negative absorption. Central County accounted for the majority of negative absorption returning 349,483 square feet of office space to the market.

The North County, despite its high vacancies, only returned 16,595 square feet.

G&E|BRE said the main reasons accounting for the rising vacancy rates have not changed.

These include downsizing by companies affected by the economic downturn; an increase in supply of office space due to new construction coming online in 2008; and the overall decrease in tenant activity.

The best performing submarkets included La Jolla with a 5.9 percent vacancy, Rose Canyon with a 6.1 percent rate, Old Town with a 6.2 percent vacancy and Uptown San Diego with a 7.8 percent vacancy.

"While some submarkets are holding up better than the others, market fundamentals are softening countywide yet at a moderate pace at least so far," the report continued.

"Tenants signing leases are taking advantage of the soft market and moving to higher quality office space at a reduced cost and with favorable terms. LEED-certified buildings such as La Jolla Commons in UTC and Terraces at Copley Point in Kearny Mesa are gaining popularity among well-positioned tenants, a trend that is expected to continue."

That's the good news. The bad news, the report said, is the number of properties that either need to be sold or recapitalized is increasing. This is at a time when buyers, awaiting better deals, are refusing to jump in.

Meanwhile, the report said the leasing market will continue to deteriorate sharply until and unless the federal government's efforts to reinvigorate the economy and restore liquidity succeeds.

The report said the countywide average asking rental rate for all classes of office space was \$2.65 per square foot per month full service in the first quarter compared to \$2.77 a year earlier.

Effective rents are expected to decrease further as landlords offer more concessions to keep their tenants.

The report stated the office market lags the economy by six months, meaning countywide vacancy rate could ascend rapidly and absorption could fall deeper into the red as 2009 progresses.

"Tenant downsizings are expected to generate further negative absorption, which will raise vacancy rates above current levels before a gradual market recovery begins," the report added.

The market may not look good now, and some submarkets may be in a bad way, but Grubb & Ellis|BRE concluded that San Diego's diversified economy will win out in the end.



"Once capital re-enters the market, hopefully over the next 12 months, investors and businesses will be able to shift from surviving to thriving."