

# SAN DIEGO DAILY TRANSCRIPT

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## San Diego office market seems to find bottom

### County fares better than other areas

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Reports by **Jones Lang LaSalle** and **Cassidy Turley BRE Commercial** both conclude San Diego County's office market has largely bottomed out, and is faring better than much of the rest of the country.

"Leasing activity in the first quarter and some evidence of a return to equilibrium has emerged," JLL writes. "Throughout the overall market, 137,000 square feet of positive net absorption was posted in the first quarter, with the majority being recorded in Class A properties — indicating a flight to quality, with tenants capitalizing on lower rents and attractive concession packages."

If Cassidy Turley is right, the countywide absorption was a much more robust 485,382 square feet in the first

three months of the year.

There are many reasons why numbers may be so different, including when a survey is conducted, whether or not leased space is considered occupied, the amount of shadow space (leased but unoccupied) in a market and how sublease space figures into the equation.

JLL notes that while San Diego County had positive absorption, it still had more than 15 million square feet of vacant space as the first quarter drew to a close.

The good news, says JLL, is the wave of sublease space that dominated the market in the past 18 months appears to have abated.

Tenants such as **Bridgepoint Education** (NYSE: BPI), **Nuvasive** (Nasdaq: NUVA) and **Northrup Grumman** were each active in the marketplace in the first quarter. And if the past few weeks are any indication, the more than 300,000 square feet that **Nokia** (NYSE: NOK) is vacating in the Scripps Northridge project for

smaller quarters at the Summit in Rancho Bernardo, won't be vacant for long. Bridgepoint is reportedly eyeing Scripps Northridge as part of its ongoing expansion efforts.

Cassidy Turley reported the countywide direct vacancy rate of 16.9 percent recorded in the first quarter was 50 basis points lower than the fourth quarter and 110 basis points lower than the third quarter of 2009. The first-quarter vacancy rate was nearly unchanged from a year earlier, however.

Cassidy Turley said North County recorded the highest direct vacancy rate at 25.8 percent, compared to the Central (14.4 percent) and South County (16.4 percent) markets.

The countywide average asking rental rate for all classes of office space was \$2.34 per square foot per month, full-service in the first quarter compared to \$2.65 a year ago, Cassidy Turley reported. Effective rents are expected to

decrease further as landlords offer more concessions to keep their tenants.

"Few tenants are in expansion mode, yet those able to take advantage of the soft market are in the driver's seat," Cassidy Turley wrote.

While JLL notes the investment market has returned to the living, there continues to be a dearth of properties available for sale. With lenders not wanting to take properties back, there aren't many foreclosure bargains, either.

Looking ahead, JLL said activity is expected to be fairly flat for the next two to three quarters in most of San Diego County's submarkets.

"Pockets of expansion and contraction will likely emerge as high-demand areas with more attractive, modern inventory — and plenty of opportunities for bargain hunting — will be balanced by occupancy losses in less competitive submarkets with aging office product or outmoded infrastructure and/or amenities," the JLL report

stated. "Tenant demand is also forecast to be erratic with gains predicted within the government, education and biotech employment clusters, while business and professional services and construction/manufacturing will continue their contraction."

San Diego's office market resurgence will be aided by the fact there is very little construction. Cassidy Turley reported that only 292,807 square feet under construction countywide. While that may sound like a lot in an era when companies are still giving back large chunks of space, consider that One America Plaza downtown has 569,000 square feet.

So how does San Diego County's office market compare with the national market as a whole? It seems to be faring at least as well and probably better.

"The United States office market has not yet entered spring but some of its markets have begun to see rays of sunshine and pockets of moderate

temperature," JLL wrote. "This will set the stage for a period of growth and renewal with respect to demand, occupancy gains and rent levels in 2011 and beyond."

Compared to other office markets in California, there were many similarities and some differences. In San Francisco, JLL says there has been high demand for Class A space as former Class B tenants have searched for bargains and an upgrade in their surroundings. That sounds similar to what is happening here.

On the investment side, San Francisco, like San Diego, has far more demand for properties than are available. With prices generally significantly lower than they have been in many years, there is little incentive to sell.

The Los Angeles market, says JLL, has been buoyed by numerous large entertainment renewals. For the most part, however, the city's leases

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were limited to tenants needing less than 15,000 square feet — making it difficult to fill large buildings.

JLL doesn't expect to see a true recovery in the Los Angeles office market prior to 2011.

Orange County appears to have fared worse than San Diego, San Francisco and Los Angeles. JLL said while the unemployment rate declined from 10.2 percent in January to 9.7 percent in February, the Orange County office market ended the first quarter with a 20.6 percent vacancy rate.

"The quarter was also marked by continuing landlord defaults with **Maguire Properties** (NYSE: MPG) divestment of most of its Orange County properties and other landlords adding the pot of troubled assets."

JLL said Orange County's landlords "will continue to face challenges and will need to focus on retaining existing tenants, as new demand remains elusive."

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