

## Mapping Out a Real Estate Recovery

PROPERTY: Commercial Comeback Is Uneven as Sector Charts New Course

By [Lou Hirsh](#)

Monday, May 27, 2013

The commercial real estate recovery is progressing steadily in San Diego County so far in 2013, but local experts are still curbing their expectations as to when things might switch into a higher gear.

Except for the multifamily market — with numerous apartment projects now under construction or in the pipeline, especially in downtown San Diego — they note there is little to suggest that a commercial building boom is in the making anytime soon.

That's even with continued and sustained job growth, traditionally the biggest driver of office space demand. According to a recent report by the San Diego Regional Economic Development Corp., the San Diego region's job growth rate of 2.49 percent from January 2012 to January 2013 was the eighth highest among the 25 largest U.S. metro markets for the period.

San Diego added approximately 30,600 jobs during that span. Observers note that the benefits of the currently rising economy are spread unevenly in the world of real estate, depending on location, product type and industry being served.

“It depends on who you are — if you're a broker, things are good, because there are more transactions happening,” said Mark Riedy, executive director of the Burnham-Moores Center for Real Estate at University of San Diego. “If you're an owner of property, there's limited supply, which means more bidders, which means prices are going up.”

### **Downturn Dynamics Linger**

Exuberance is tempered, however, by the local region's historically high barriers to new construction. There are also elements lingering from the downturn, including tough access to credit for some types of businesses, and the tendency of companies to do more with less, including devoting less space per-worker even with bolstering overall staffing.

Rising use of technology, including mobile devices and space-saving digital storage gear, is also tamping down the need for square footage.

“Three or four years into a recovery, and with interest rates this low, we're likely behind where we were at the same point of past economic recoveries,” Riedy said.

Early indicators, however, point to office leasing and space absorption in 2013 meeting or beating the trends of 2012. The brokerage firm Cassidy Turley San Diego recently reported that the pace of the San Diego County office recovery was “moving faster than expected,” with 140,000 square feet of net absorption — more space being occupied than vacated — in the first quarter.

Brett Ward, senior vice president with Cassidy Turley San Diego, said the local region is on track this year to match or beat 2012’s full-year tally for positive absorption.

“When the local market last year hit 1 million square feet in positive absorption, that was the first time since 2005,” Ward said. “It was a huge milestone, especially for the landlords.”

Ward said Cassidy Turley is currently tracking 2.4 million square feet of active tenant requirements, with the vast majority focused in central San Diego. The most active industries now scouting space are technology, financial services, energy, and professional and business support services, which combined created 7,700 local jobs in 2012.

### **‘Very Spotty Market’**

New office construction is currently sporadic, with a few pre-leased and build-to-suit projects underway but no substantial speculative construction taking place. Ward said a continuation of current trends, however, could bring a return of spec office construction within high-demand submarkets in late 2014 or early 2015.

“With virtually no new speculative construction, the forecasted job growth would drop the San Diego office vacancy rate into the single digits by mid-2014,” Ward said. The current countywide office vacancy rate is around 12 percent.

Tony Russell, executive vice president in the San Diego office of Jones Lang LaSalle, expects current trends to continue “for the next year or so.” San Diego County office conditions, he said, vary widely by submarket and product type.

“In some ways it’s a very spotty market,” Russell said. “You go to places like Sorrento Mesa or UTC, and it seems like it’s landlord-focused. But then you go to some of the markets like Kearny Mesa and Mission Valley, where there is more class B space available, and it seems like it favors tenants more.”

Brokers agree that tenants seeking smaller spaces remain in a better position to get bargains from landlords in most submarkets than those needing more room — especially above 50,000 square feet.

“There are still plenty of options out there if you’re looking for 3,000, or 4,000 or 5,000 square feet,” Russell said.

## Limited Retail Space Demand

Job creation may be bolstering household spending, but not creating big new demand for retail space. Observers note that San Diego's retail space vacancy is currently among the lowest for U.S. metro regions, at around 5 percent. Yet there are only three new shopping centers currently in development for completion within the next two years — one in Scripps Ranch, and two in South County.

“The retailers are going more for just-in-time delivery of goods from the manufacturers, as they're ordered by the customers, so they don't need the large blocks of space to stock up on large inventories so much anymore,” said Michael Lea, director of the Corky McMillin Center for Real Estate at San Diego State University.

In many cases, a customer is getting products shipped directly from a retailer's regional warehouse directly to the home, he said. That is on top of the still growing amount of products now purchased through purely Internet-based sellers such as Amazon, although the bulk of U.S. retail sales are still made in brick-and-mortar stores.

Then one commercial sector currently humming at top gear is multifamily. Alan Nevin, principal with consulting firm The London Group in San Diego, noted there are currently about 10,000 apartments in the county's development pipeline, with about a third of those in downtown San Diego.

“We've tended to have a burst of apartment building about every 10 years since the 1960s,” Nevin said. “Each burst usually lasts about three years.”

Nevin said the current burst, in terms of construction, is in its first year and probably has at least an additional two to go. One factor different this time around is that the builders are not only local players, but a host of national developers, fueled by ample sources of low-cost financing.

They're attracted by a climate of rising rents, brought on by the region's tight supply and rising demand among young people forming new households, and others shut out of the for-sale housing market by rising prices and stringent financing requirements.

“For a lot of years, San Diego was not on the radar of national apartment builders,” Nevin said. “That's no longer the case.”