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SAN DIEGO COUNTY

Office vacancies to rise, retail may tumble

By **THOR KAMBAN BIBERMAN**, The Daily Transcript
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San Diego County's Class A office vacancy -- now at about 14 percent -- is projected to climb to 20 percent before it eventually stabilizes, while a population drop could further hurt retail.

However, industrial may be stronger than expected, commercial real estate firm **CDC Commercial** said in its 2009 Gold Report.

Office

During 2008, San Diego County office vacancies that had been about 12 percent at the beginning of the year vacancy had climbed to about 14 percent by year-end.

"Expect that trend to continue until it plateaus at about 18 percent. Class A will tip the scales at over 20 percent because of all the new inventory ..." the report states.

Even in the best of times, San Diego vacancy rates would have risen with the many large new office projects being built representing millions of square feet of added inventory.

Now in a recession, the problem has been compounded.

"The bigger issue is will developers hang on when faced with two- to three-year lease ups instead of 12 to 18 months?" CDC asked.

"The timing of this has been bad," said Don Zech, president of San Diego County-based CDC, before adding that he believes the office market will nevertheless bottom out within the next few months.

Industrial

While current economic conditions are causing softer industrial tenant demand, and credit markets are tight, CDC expects the county's industrial market to remain strong.

"The credit markets may be tighter, but tight vacancies (generally averaging 8 percent or less countywide) will remain in industrial which hasn't been overbuilt. In fact, markets like central San Diego (Kearny Mesa) and Rancho Bernardo are having inventory removed from the market by tear down and/or conversion to office," the report continued.

The report said 2009 will see more sales of industrial condominiums and also sees plenty of opportunities for more traditional purchases, as well.

"We expect the SBA spigot to get opened up wide creating an opportunity for small businesses to buy their own buildings at soft prices," CDC added. "Less fortunate owners/users of buildings who are strapped for cash will find themselves selling and leasing back their buildings as their only source of capital in these credit-tight times."

Retail

"The declining housing market, the end of cheap credit, rising unemployment, and consumer cutbacks on spending are finally catching up with the retail sector. More and more retailers (big and small) are filing for bankruptcy or reigning in expansion plans," the report stated. "More than ever, landlords need to put emphasis on tenant retention to help keep a grip on existing tenants."

The report said proactive landlords are not just offering rent reductions to troubled retailers but also must help with increased marketing, renovating stores and store fronts, "and do what they can to help keep traffic up."

The higher cost of capital, store closings and retailer credit problems will all contribute to a slow down in net absorption of retail space, as well as rising vacancies.

CDC says one of the big questions is whether failed stores like **Mervyn's**, **Circuit City** and **Linens 'N Things** are left vacant or are quickly absorbed by **Kohl's**, **Forever 21**, **Best Buy**, **REI**, **Winco**, **Cabela's** and other retailers that have been in an expansive mode.

In the meantime, while most of California and San Diego County have continued to grow, there is at least one notable exception.

U.S. Census data found that the city of Escondido actually saw its population decline by about 9,500 people within the past year. CDC said this is statistically significant from a retail perspective.

"This loss of population has an immediate effect on the demand for retail which is about 15-20 square feet per person," the report added. "To put this another way, the loss of 10,000 persons equate to 150,000 to 200,000 square feet of lost demand for retail in the Escondido market."

Most of the new retail development in San Diego County in the coming years is expected to be renovation and/or additions to existing centers.

"However, the collapse/consolidation of the auto industry is going to make some great retail sites available in the coming years," the report added.

Bob Baker Auto Group (Mission Valley), **San Diego Dodge** (National City), the former **Guy Hill Cadillac** (Pacific Beach) and **Witt Lincoln Mercury** (Mission Valley) have each become available for re-uses.

In conclusion, **PriceWaterhouseCoopers** said that the region is experiencing the worst commercial real estate market since what that firm referred to as the "1991-1992 depression."

The good news, CDC said, is there are still things to cheer about.

One positive aspect the Gold Report noted, is the military's plan to spend \$4 billion in construction projects in San Diego County within the next year.

Add to that whatever San Diego might receive from President Barack Obama's proposed \$850 billion economic stimulus package. The new president has pledged to use much of these funds to rebuild America's infrastructure from coast to coast.

"With a strong California legislative contingent in Washington, it is hoped that California and San Diego will see more than their share of construction/infrastructure projects coming to San Diego County," CDC wrote. "These projects could be the key to saving the region's construction industry and getting people back to work."