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BUT SOME OPPORTUNITIES

Commercial real estate market in county continues to suffer

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While there is little doubt that San Diego County's office, industrial and retail markets have taken a hit, a **CDC Commercial** report says there are glimmers of hope if one looks hard.

Industrial

San Diego's nearly 200 million square feet of industrial property has traditionally maintained a healthy occupancy.

"However, our current economy has taken (countywide) vacancy from approximately 5 percent to just shy of 10 percent in just over a year," CDC notes.

Otay Mesa, with an estimated 3.5 million square feet of vacant space by some accounts, has been hit particularly hard.

Don Zech, CDC president, said while Otay Mesa may have had its troubles, he is upbeat about its long-term future.

He said there is a golden opportunity there because shipping costs have become so high it is becoming cheaper to manufacture in Mexico than China.

A recovery in the San Diego County's industrial market is expected to begin in late 2010 or early 2011, CDC concludes.

Office

San Diego's office market is experiencing the same declines exhibited in office markets across the nation, CDC reports.

Vacancies are increasing, leading to decreases in rent and increases in concessions. With income declining, property values have followed suit.

The report said the office vacancy nationwide stood at 13 percent at year-end but that vacancy could rise to 19 percent if companies consolidate space to reflect their smaller work force levels.

Zech says San Diego's office vacancy has already reached 18 to 19 percent if such phantom space is included.

"This phantom vacancy could swamp the marketplace if we don't see some employment recovery soon," CDC writes.

"The bleeding in the office market is not likely to stop until the end of 2010 and not show signs of recovery until the end of 2012 or early 2013."

Eric Northbrook, a **Cushman & Wakefield** executive director, sounded a bit more hopeful.

"Tenants continue to have the upper-hand in lease negotiations, but landlords are optimistic that the playing field will start to level out in 2010," he said.

Northbrook said lower rental rates will continue to be prevalent as landlords contend with high vacancies and wait for employment growth to resume.

"However, we are seeing more competition for the higher quality spaces, which will eventually lead to more stability in the market," he said.

Retail

CDC notes that rising unemployment and decreasing home values have made consumers more cautious, leading to lower sales volumes for retailers and restaurants creating more vacancy throughout the San Diego market and beyond.

High profile bankruptcies, thousands of lost jobs, sales sinking and values shrinking have created both pain and opportunity.

Home Expo, Linens N' Things, Circuit City and **Mervyns** sit empty alongside some closed **Starbucks, Hollywood Videos, Dinner Mattresses** and **La Salsa** locations.

These vacancies in turn have paved the way for **Wal-Mart, Kohl's, Best Buy**, health food markets and mom and pop yogurt and taco shops.

The closures keep coming and existing video stores may be the most imperiled.

"**Blockbuster** and **Hollywood Video** are fading fast," Zech said, adding that those video stores were generally so well located that most should refill quickly if they go dark.

Tenants who could not get into San Diego at the high rents are now being wooed by landlords with low rent and concessions.

Other chains are looking at different-sized prototypes (bigger and smaller) to take advantage of available boxes. Some retailers are actually adding stores. **7-11** for example is in the process of adding perhaps a dozen new stores in the county this year.

While these help, the vacancies may still be outpacing the leases in the retail sector.

"It could take another 1 1/2 to two years before we see a full recovery in the shopping center industry," CDC writes.

"Commercial properties have been clobbered over the last 18-24 months and probably have a little ways to still go in 2010. However, they should hit bottom in 2010 and then claw-back a third or more of their lost value over the next three years," CDC writes.

4Q2009 -- San Diego Retail Market Report

The newly formed commercial real estate brokerage Cassidy Turley BRE Commercial reported that in the second half of 2009, San Diego's retail market had 225,764 square feet of negative absorption countywide bringing year-to-date absorption to negative 1.2 million square feet.

South County accounted for the majority of negative absorption followed by Central and South Counties offsetting the positive absorption recorded in East County.

In the second half of 2009, community and strip centers returned the most space to the market compared to other center types.

Year-to-date, the highest negative absorption of 555,493 square feet was recorded by neighborhood centers followed by strip centers (199,398 square feet) and community centers (186,977 square feet).

The countywide direct retail vacancy rate of 5.9 percent in the second half of 2009 gained 270 basis points from the second half of 2008.

The countywide sublease vacancy rate of 1.3 percent increased 10 basis points from year-end of 2008.

The countywide average asking rental rate for all retail center types was $2.22 per square foot per month triple net (NNN) in the second half of 2009 compared to 2.21 in the first half of 2009 and $2.17 a year ago.

However, effective rents are expected to decrease further as landlords offer more concessions to keep their tenants.

Limited construction activity should help San Diego's retail market deal with the recession.

There are currently 87,902 square feet under construction countywide -- all of which in South County's downtown submarket -- representing 0.2 percent of the total countywide retail inventory of 60.5 million square feet.