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The Daily Transcript

Wednesday, February 22, 2006 editor@sddt.com http://www.sddt.com Source Code: 20060222tdd

Report says San Diego real estate not immune to downturn in 2006

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Wednesday, February 22, 2006

San Diego could well be the victim of a housing bubble, and while office, retail and industrial investments remain attractive, they too are not immune from a downturn.
These are a few of the conclusions reached in a just-published paper by **CDC Commercial** entitled The Gold Report 2006. This marks the 10th year the Rancho Bernardo brokerage and research firm has published the report.

"The bottom line is that while the San Diego market remains relatively strong, investors would be well served to pick and choose their next endeavor carefully," the report said.

While many realtors and analysts have dismissed the housing bubble as a figment of an overactive imagination, the CDC report warns that if it is real San Diego's whole economy had better watch out.

"A significant threat is the potential slowdown in the housing market. If there is a bubble and it bursts, the resulting layoffs in the mortgage, construction and real estate businesses will disproportionately hit San Diego and Southern California, which are building like there is no tomorrow," the report stated before adding that this building is particularly intense in the condominium sector.

"Riverside has a slight indication of overbuilding and many are worried about condominium volume in San Diego," the report added.

CDC said it has already become evident that there are fewer buyers for condominium properties.

"One wrong turn and most of this inventory goes back to the lenders," CDC writes.

The report said with rising interest rates and home prices flattening out, and stagnant wages, people who have been borrowing against their homes to buy everything from beds to cars may hold a tighter grip on their wallets in the coming months. That means less retail sales, less of a demand for retail space, and possibly some real trouble for landlords. Online retailing could worsen this trend.

San Diego has consistently been near the top in terms of demand for retail centers for the past several years, but if CDC is right, there will be more retail vacancies and we might not be quite as attractive as we were in the past.

The good news for retail landlords is the population here continues to increase, the area continues to have record numbers of tourists and millions of shoppers cross the border each year to purchase in the United States.

The report urges developers to not only look at new sites, but at older centers that may be given new life or converted to another use. Mixed-use developments, likely with ground floor retail, are also encouraged.

Retail investors are urged in the report to buy in areas that have less than 15 square feet of shop space per person within three miles of the center. Regional malls are excluded from this formula.

Literally billions of dollars of San Diego office buildings have been purchased in the past four years alone, but here, too, CDC sees some dangers ahead. This is despite a countywide vacancy of less than 10 percent.

The report said while office buildings have been coveted here because of their high occupancies and high rents (as much as $4 per square foot in some suburban markets), a still uncertain job market, shipping jobs offshore, and at least one other factor could make office building purchases somewhat more dicey than they were in the past.

"There is an incredible trend to cram people into less space. It used to be we estimated 250 square feet per employee. That's now down to 200 square feet. Corporate planners are looking at ways of cutting those numbers by 20 to 50 percent," the report continued.

CDC said countywide industrial vacancy declined from 6.2 percent at the end of 2004 to 5.7 percent at the end of 2005. About 3 million square feet of industrial space was absorbed last year.

Even with an estimated 6 million square feet vacant and 1.4 million square feet under construction, the report projects the industrial vacancy will be 4 percent or less by the end of this year.

"Owner users and low interest rates have driven per square foot prices (on industrial) through the roof. Labor and material costs have risen dramatically too. However, lease rates have remained relatively flat," the report warns.

The report added that rising interest rates will chill the interest of owner/users of industrial property as well as speculative investors in this sector.

Investors may cut back their activity this year, but they were extremely active in San Diego and statewide in 2005. Local totals weren't immediately available, but several large San Diego office transactions (not even counting Koll Center and One America Plaza, which closed this year) helped fuel $17.3 billion in office building sales in California last year.

A total of $6.2 billion in industrial projects were part of the mix, as was $5.4 billion in retail and $10.4 billion in apartments statewide in 2005.

Send your comments, thoughts or suggestions to thor.biberman@sddt.com