

Downtown San Diego Sits on the Precipice of Change High Vacancy Area is About to Get an Influx of New Office Inventory

By Joshua Ohl

Downtown San Diego's office market is set to receive the biggest wave of new inventory in over 20 years.

About 2.8 million square feet of newly-developed space scheduled to go live over the next two years, which would increase the total inventory by 19.3%.

Though builders are betting big on the area, roughly 25% of downtown San Diego's office space is vacant, so it is unclear whether their gamble will pay off.

Siding has gone up at the Campus at Horton, Los Angeles-based Stockdale Capital Partners' \$550 million effort to convert the Westfield Horton Plaza mall into a life science and technology hub. The 750,000-square-foot office and life science project — which includes an additional 300,000 square feet of retail and experiential space — is scheduled to deliver by the end of the year. So far, no space has been pre-leased.

Over at the Embarcadero, San Diego's waterfront, the developer IQHQ is building a 1.7 million-square-foot "Research and Development District," which will consist of a similar mix of office, life science and retail space. The project plans call for five buildings, ranging in size from 119,000 square feet to 850,000 square feet. The first phases of the project are scheduled to begin delivering next year, and no tenants have yet been announced.

This comes on the heels of the largest biotech lease signed in downtown at the recent lab conversion property, Genesis, a 203,000-square-foot building at 1155 Island Ave. According to a recent report about San Diego's office market by Cushman & Wakefield, Native Microbials has leased a full floor covering 27,000 square feet at the building. That will double the space that the biotech firm occupied in space that it had subleased in Torrey Pines.

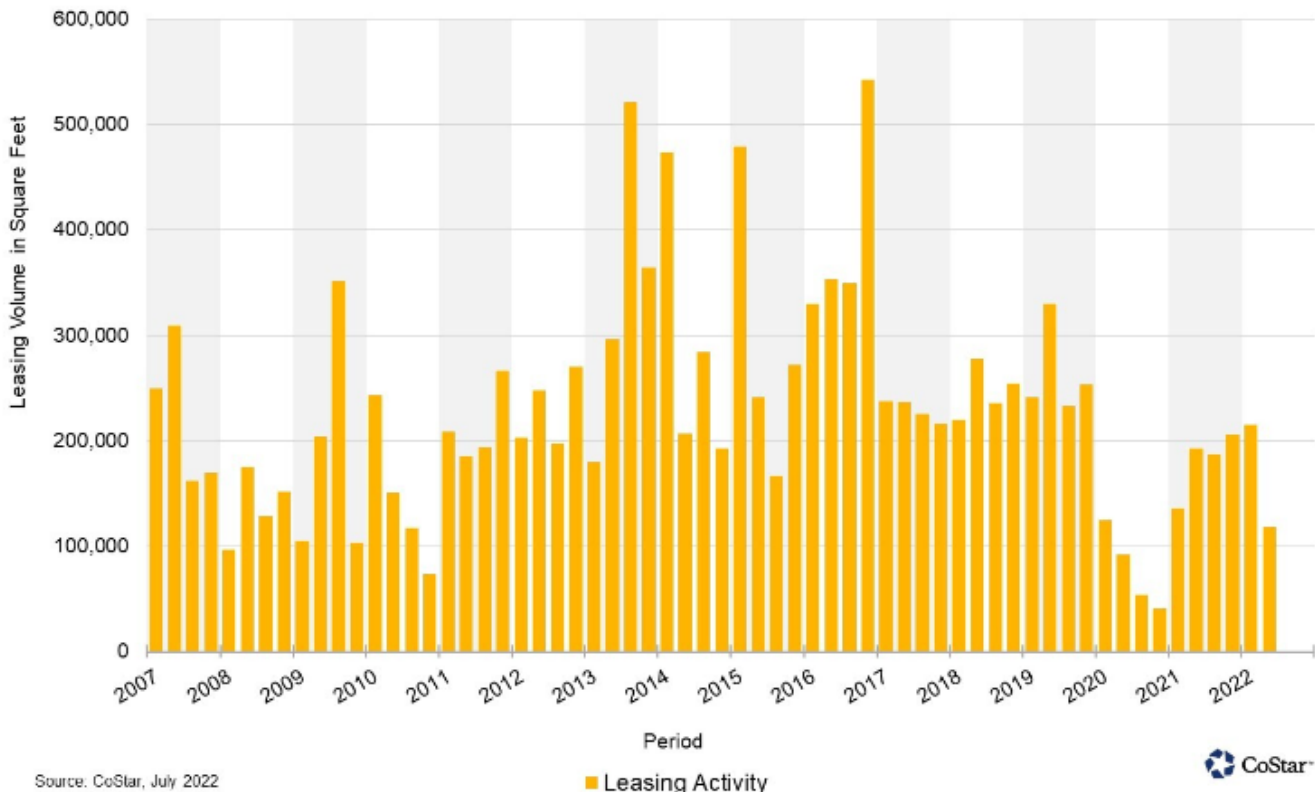
The lease is a coup for downtown, but also highlights the monumental challenges ahead.

In San Diego's north county neighborhoods, such as Torrey Pines, Sorrento Mesa, University Town Center, Del Mar Heights and Carmel Valley, a biotech firm signing a lease of that size would hardly merit a whisper when firms including Bristol Myers Squibb, Neurocrine Biosciences and Singular Genomics have signed leases for more than 200,000 square feet in the past several months.

Downtown also has roughly 6.5 million square feet of space available for lease, or more than 38% of total inventory. That has led to the region's highest vacancy rate of almost 25%. Available sublet space has also added pressure here, with more than 350,000 square feet available for sublease, more than double the average from 2016 through 2019.

Over that same trailing four-year period ahead of the pandemic, new quarterly leasing activity averaged more than 275,000 square feet, while the past four quarters averaged 100,000 square feet less. In fact, the second quarter of this year saw the lowest amount of new leasing volume since 2020 with only about 120,000 square feet leased, while new leases signed during the past four quarters were also an average of 30% smaller in size.

Downtown Office Leasing Volume Is Still Depressed



As these factors have coalesced, the median months on market for available space has been trending at a decade high of more than 20 months. That figure has doubled over the past two years.

It should also be noted that downtown faces long-term challenges tied to a swelling population of the homeless that has led the city council and the mayor to discuss enforcing encroachment laws. The most recent census by the San Diego Regional Task Force on Homelessness, which was conducted in February 2022, counted 8,427 homeless people in the San Diego region at large, a 10% increase over the organization’s last census, which was conducted in January 2020.

Of those, 4,321 were living indoors – either in homeless shelters or temporary housing – and 4,106 were living outside. Many of the unsheltered were in the downtown area. A separate count done

by the Downtown San Diego Partnership showed that 1,444 people were living on the streets of the city's central business district over February of 2022.

The lack of and high cost of parking also lead many firms to choose other locations.

Yet, downtown also has a well-educated resident base filled with young professionals who are attracted to the cultural amenities, nightlife and walkability. According to an analysis completed by the Downtown San Diego Partnership and released in a report, "More than 41 percent of downtown's 24,000 working residents are employed in occupations within management, business, science or the arts, which is around five percentage points greater than the rest of San Diego County." And the "fastest growing occupation for downtown working residents within [those sectors] are life scientists."

If IQHQ and Stockdale can secure significant high-tech or biotech tenants to anchor their new downtown developments it will likely lead to a rise in demand for the area and provide an additional lift in demand for downtown's luxury apartment units.