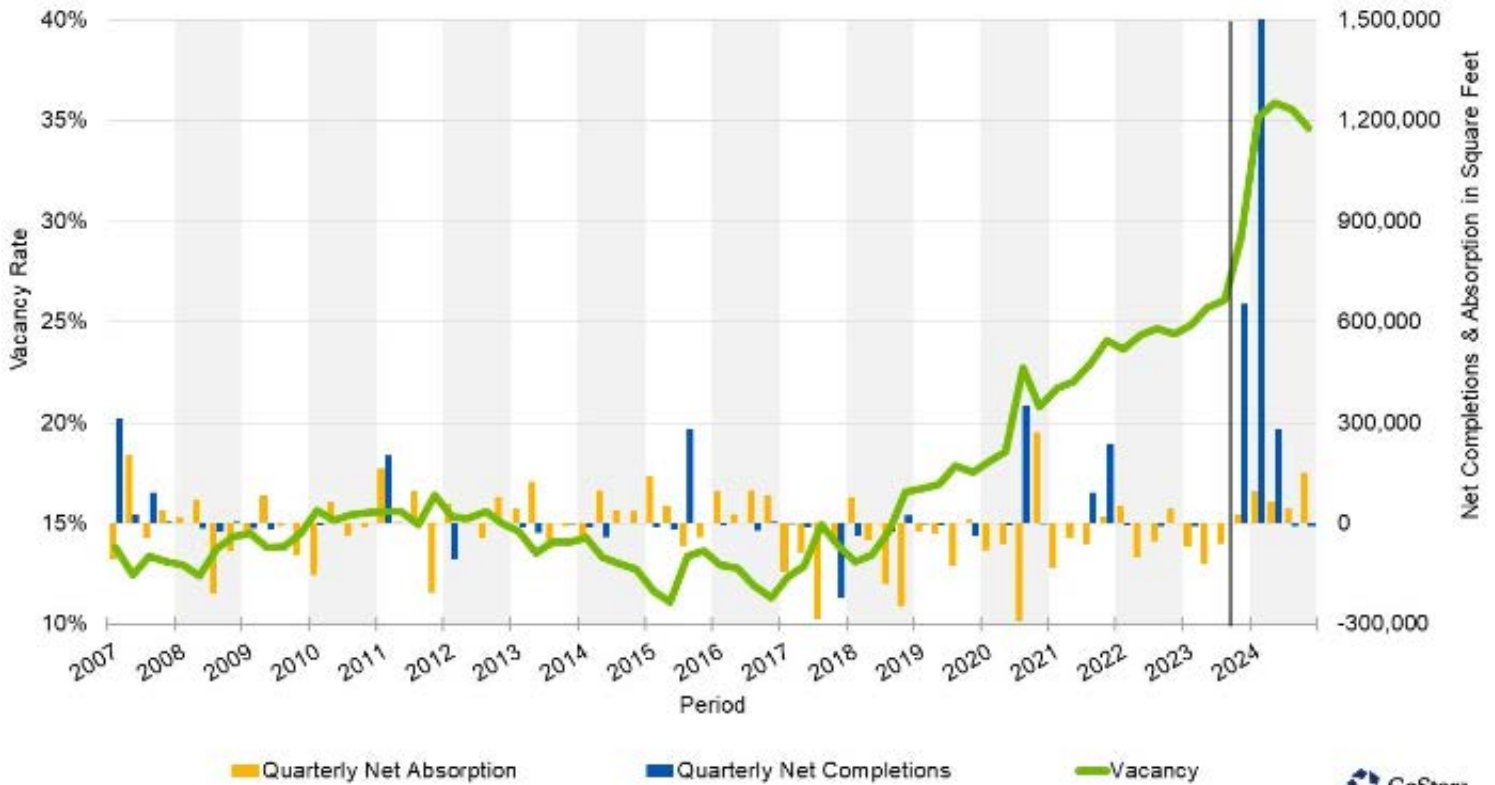


Downtown San Diego Braces for New Speculative Office Development Amid Record High Vacancy

If You Build It, Will They Come?

Downtown San Diego Braces for Supply Wave



By Joshua Ohl

Few areas of San Diego have been as disrupted by the shift in office fundamentals as Downtown. The area's vacancy rate has increased by more than 900 basis points since the end of 2019, while the availability rate has nearly doubled to 37%.

Between 2015 and 2019, quarterly leasing volume averaged nearly 300,000 square feet. Since the start of 2022, it has averaged roughly 60% of that level. The number of engagements signed quarterly since 2022 has fallen by 25% compared with 2015 to 2019, and the average lease size has declined by 20%.

More than 80% of Downtown's office inventory was built before 2000, and the vacancy rate in those buildings has increased by 10 percentage points since the beginning of 2020 to 28%. Local market participants have suggested that the vacancy in those office buildings is above 40% due to

not being marketed or being unused. Many of these properties have high parking costs and few amenities.

There have been discussions about converting some of these towers into housing, although that path is complicated by the age and layout of many of these properties. The last significant conversion was the Torbati Building on Broadway. That 1925 vintage building had roughly 14,000 square-foot floor plates and was converted into 231 market-rate apartments in 2020. The 315,000-square-foot 101 Ash building could be a template. An investor has expressed interest in converting the aging office tower into more than 400 affordable housing units. Floor plates there are roughly 25,000 square feet.

But the newest buildings have also struggled to land tenants. In Little Italy, the 234,000-square-foot 2100 Kettner opened at the end of 2021 and is still 76% vacant in the fourth quarter. It has a 1.2 per 1,000 parking ratio or about 280 spaces. That has made the property reliant on public transportation, and specifically the trolley system. For comparison, in the University Town Center, where the vacancy rate is nearly one-third of Downtown's, parking ratios are closer to 3.5 per 1,000. The 20/6 building at 450 B St. is also a recent completion here. The 91,000-square-foot building is 86% vacant. Those were the first speculative developments here in 20 years.

It is against this backdrop that Downtown is scheduled to receive a huge injection of inventory. There is 2.7 million square feet under construction that is scheduled to finish through next year. A full 90% of the pipeline is available for lease.

Two of the projects, the Research and Development District and Campus at Horton, totaling roughly 2.4 million square feet, will attempt to create a new life science cluster in the Downtown area. However, given the amount of new lab construction available in the UC San Diego area, it could prove challenging to create a new biotech cluster when another in North County is firmly established as one of the strongest in the U.S.

Local stakeholders are relatively split on the outlook for Downtown. Some have suggested that headline vacancy will settle near 40% following the current wave of construction and remain near that level. Others have suggested that activity will normalize in the coming years, with vacancy contracting toward 20% once the new developments are absorbed. Either way, most market participants Downtown are bracing for the new additions to the office landscape.