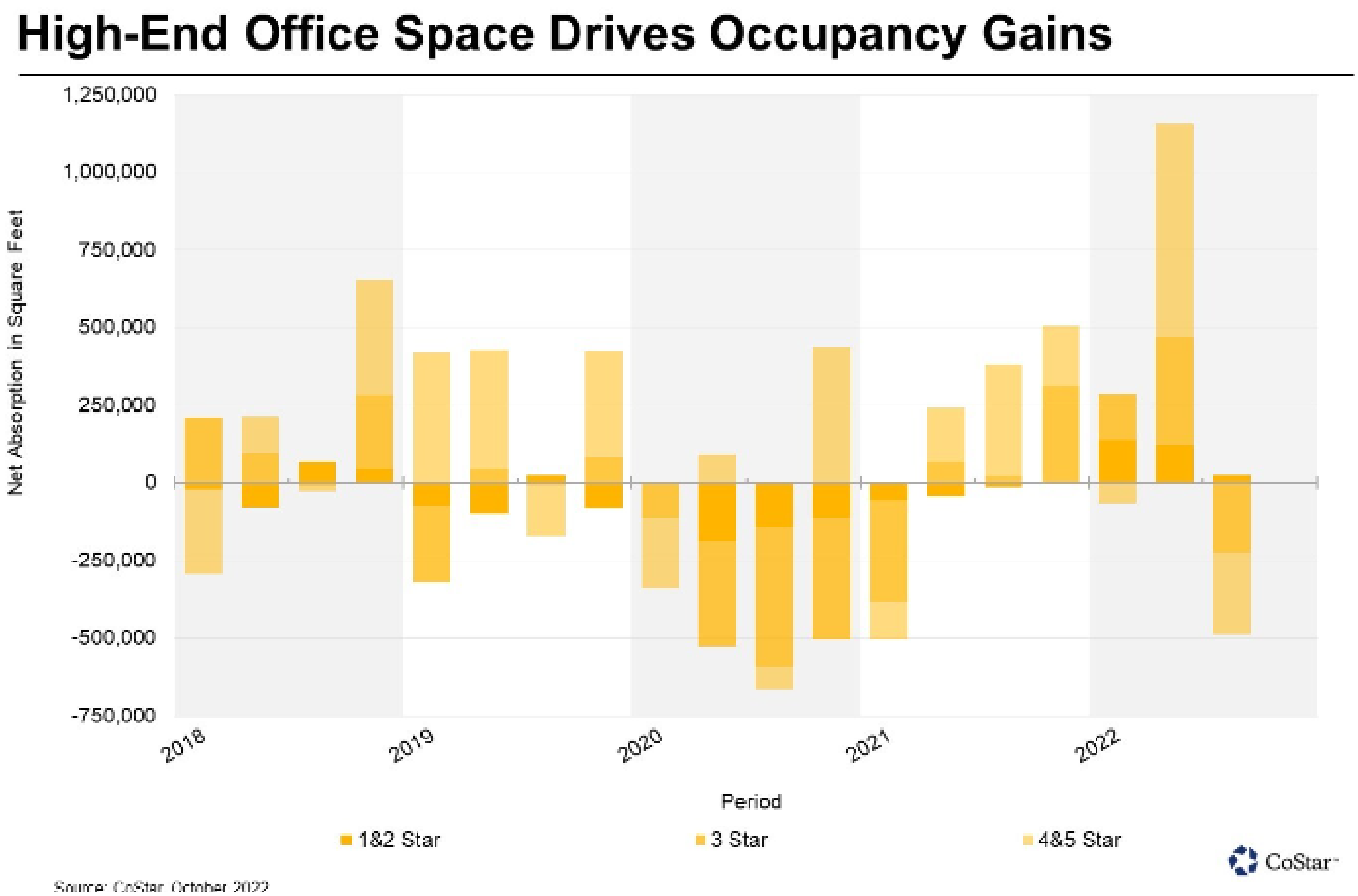
San Diego's Office Market Sees Occupancy Gains Amid the Pandemic
Class A Office Space Drives Trends



By Joshua Ohl

The San Diego office market is one of only two in California that has seen occupancy gains since the arrival of the pandemic. San Jose is the other.

Net absorption, which measures the change in occupancy over time, was positive between the second quarter of 2020 through the third quarter of 2022 in San Diego. That was driven by occupancy levels in Class A office space. Net absorption in that sector has tallied more than 1.4 million square feet in San Diego since spring 2020, more than making up for the occupancy losses that continue to haunt mid-tier and lower-end office space. Those two categories have accounted for more than 1.1 million square feet of occupancy losses during that same period, compared to occupancy gains of 200,000 square feet in those sectors from 2018 through 2019 in San Diego.

Tenants are still shedding under-used space, and the local sublet market has reached its highest level of inventory in more than 15 years, at 2.7 million square feet. That's roughly 350,000 square feet more than the zenith of available sublet space in San Diego during the global financial crisis. Office tenants are also committing to smaller footprints, and the average lease size over the past year was roughly 10% smaller than the market's average during the four years prior to the pandemic.

Similarly, there is an additional 4.5 million square feet available to start off the fourth quarter compared to the end of 2019. So, even while office vacancy has been trending downward after nearly touching 12% in 2021, it remains nearly 2% higher than year-end 2019. And although the median time on market for available space has steadily fallen over the past year, it is still roughly 20% longer than the four years prior to the pandemic.

Older office buildings in San Diego that aren’t well located are likely to struggle for the foreseeable future as hybrid and remote work is likely to remain in some fashion going forward. Generally speaking, for tenants looking for space to occupy, buildings that stand out in terms of location, amenities and vintage have a clear advantage. And while some older office properties could be repositioned to housing or modern industrial space, that won’t be a panacea for righting the ship.

Earlier this year, office leasing had been driven by biotech and high-tech firms such as Bristol Myers Squibb and Apple, and others that received huge injections of venture capital in 2021. Funding has pulled back below the $10 billion that was invested in San Diego firms in 2021, a record high, and this year is more in line with pre-pandemic levels closer to $6 billion.

That’s not to say that Apple hasn’t still been expanding, because it has. Apple tacked on more space in the University Town Center in the third quarter, a 63,400-square-foot space at Eastgate Technology Park that was among the largest deals of the quarter. That brought Apple’s footprint in UTC to at least 800,000 square feet.

Apple also acquired HP's campus in Rancho Bernardo, which sits on 67 acres, for nearly $450 million during the third quarter. Apple had already signed two leases totaling about 140,000 square feet in the office and flex campus. It is possible that Apple will ultimately consolidate its locations in Rancho Bernardo into the new campus that could include significant new development.

But the market has been reliant on those firms signing significant expansions, and should that activity pull back, as it did during the third quarter when new leasing activity tallied its lowest level since early 2021, San Diego’s office market could face further headwinds.