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Real Estate Services

# Office Market Report

Compared to last quarter:

Vacancy

DOWN

Absorption

UP

Lease Rates

DOWN

Transactions

DOWN

Construction

DOWN

## Office Market Highlights

- ◆ **Market Challenges** - The Office market is facing challenges as the national recession continues. The primary concerns are as follows: increasing vacancy, tenant delinquencies, scarce financing, economic uncertainty and volatility, and the gap between "ask" and "bid" pricing between buyers and sellers. However, that gap appears to be diminishing, which is evident from some recent large sales that occurred in the past two quarters. Another challenge the office market is facing is a lack of tenant demand. The slow economic environment is forcing tenant contractions/consolidations and failures, which in turn has put upward pressure on vacancy and availability rates. This has led many tenants to request rent relief from landlords, and owners renegotiating loan terms with lenders.
- ◆ **Construction** - During the first three quarters of 2009, San Diego County has added a total of 1.3 million square feet. Over the past three and a half years, over 10 million square feet of new construction has been completed in San Diego County. The record year for new development was 2001, when 3.7 million square feet of new space was added. Total space under construction checked in at 636,587 square feet at the end of the third quarter, which is 73.47% less than the amount that was under construction this same time last year. The slowdown in construction has and will ease the upward pressure on vacancy going forward.
- ◆ **Vacancy** - Direct/sublease space (unoccupied) finished the quarter at 16.15%, constituting an increase over last year's third quarter rate of 14.34%, but lower than last quarter when it was 16.6%. The lowest vacancy rate in the county can be found in the Central Suburban market coming in at 11.75%.
- ◆ **Availability** - Direct/sublease space being marketed was 20.27% this quarter, up from the 18.91% we saw this same quarter last year. This is an increase of 7.19% of new space being marketed when compared to the same quarter last year.
- ◆ **Lease Rates** - The average asking Full Service Gross (FSG) lease rate per month per foot in San Diego County is currently \$2.39, which is a 12.8% decrease over last year's rate of \$2.74 and eight cents lower than last quarter's rate. The record high rate of \$2.76 was established in the first and second quarter of 2008. Class A rates for the county are averaging \$2.67 FSG and

the highest rates are in the North City market, where rates are averaging \$2.70 FSG.

- ◆ **Absorption** - Net absorption for the county posted a positive 346,030 square feet for the third quarter of 2009, giving the office market a total of 653,537 square feet of positive absorption for the year.
- ◆ **Transaction Activity** - Leasing activity checked in this quarter at 1.3 million square feet. The average amount of leasing per quarter over the past nine quarters was 1.675 million square feet. Sales activity showed a decrease over last quarter, posting 1,317,958 square feet of activity compared to the second quarter's 2.1 million square feet. Details of the largest transactions can be found on the back page of this report.
- ◆ **Unemployment** - The unemployment rate in San Diego County was 10.4% in August 2009, unchanged from a revised 10.4% in July 2009, and above the year ago estimate of 6.4%. This compares with an unadjusted unemployment rate of 12.1% for California and 9.6% for the nation during the same period.
- ◆ **Employment** - According to the State of California Employment Development Department, San Diego County lost 55,600 payroll jobs over the last twelve months - 12,500 in professional and business services and 12,300 in retail trade, transportation & utilities services. However, government added 1,400 new jobs. Between July 2009 and August 2009 San Diego County only lost 1,400 jobs.
- ◆ **Overall** - We are starting to see a decrease in the amount of available space being added per quarter as well as an increase in investment sales activity during the past two quarters. Considering positive absorption together with decreased deliveries to the market and decreasing vacancies, the market seems to be finding its trough. We foresee an increase in investment activity in the coming quarters. Lease rates are expected to remain soft for the near future, and concessions should continue to increase in the forms of free rent, reduced parking fees, relocation funds and tenant improvement allowances to incentivize tenants to act now. We should see an increase in leasing activity as 2009 comes to an end from pent up demand, once financial markets correct themselves and as consumer confidence continues to increase.

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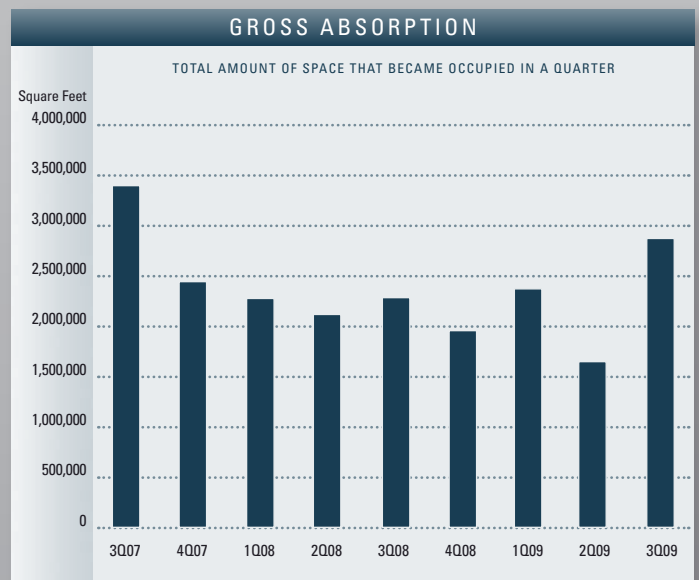
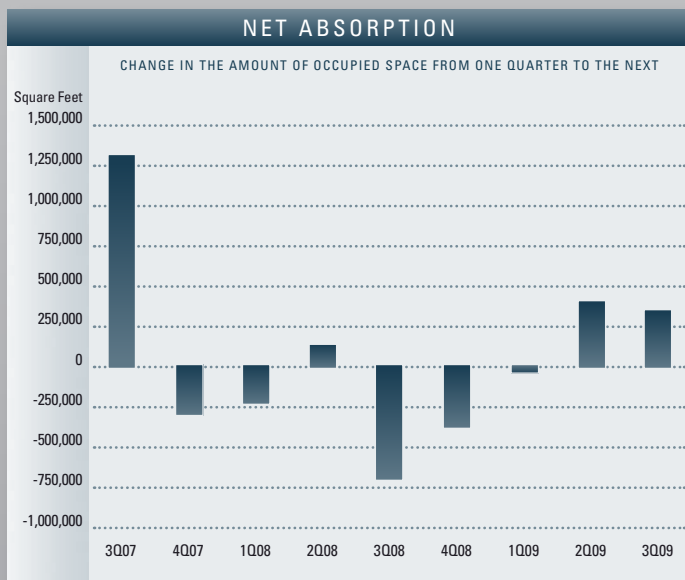
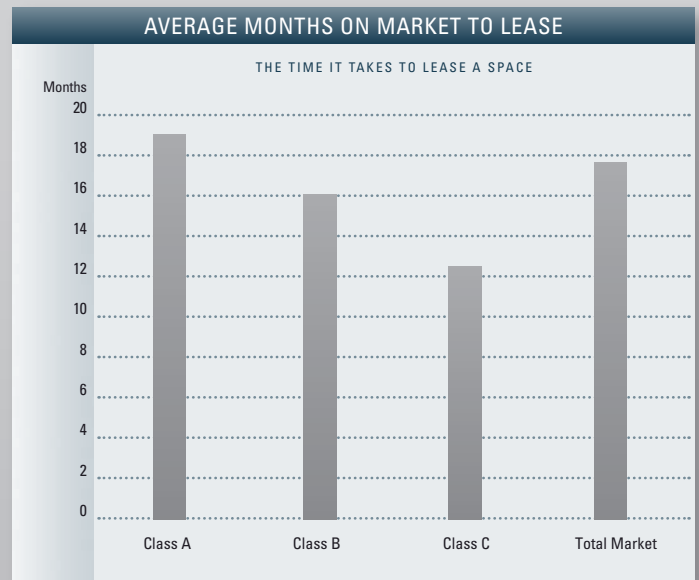
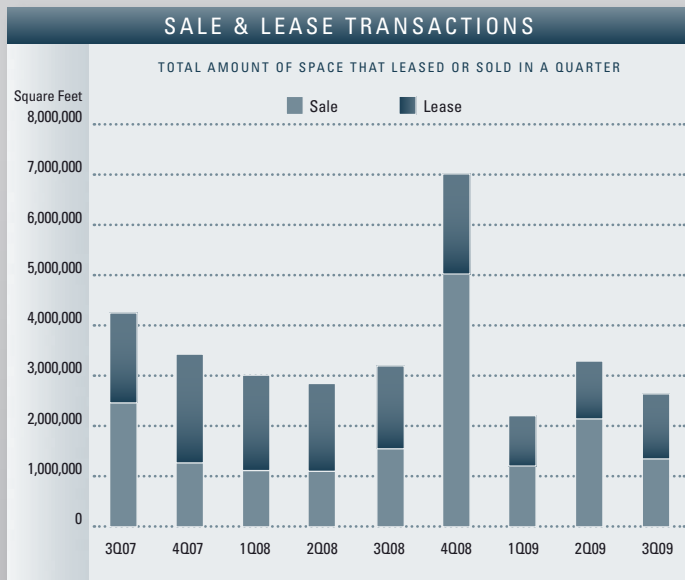
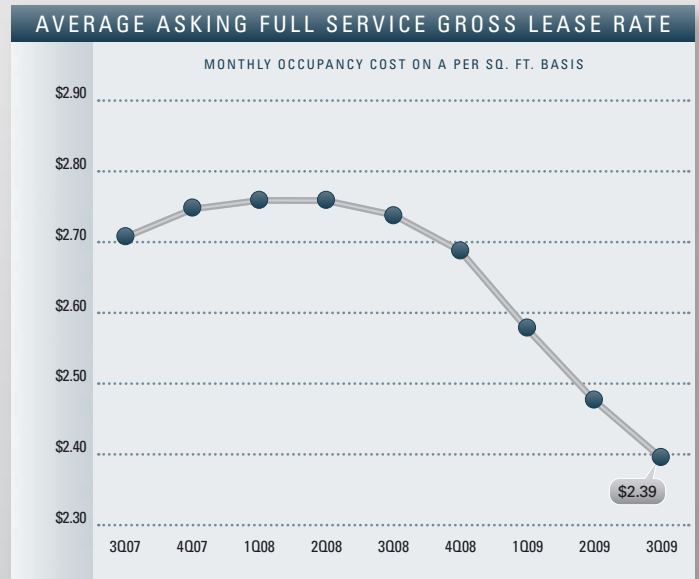
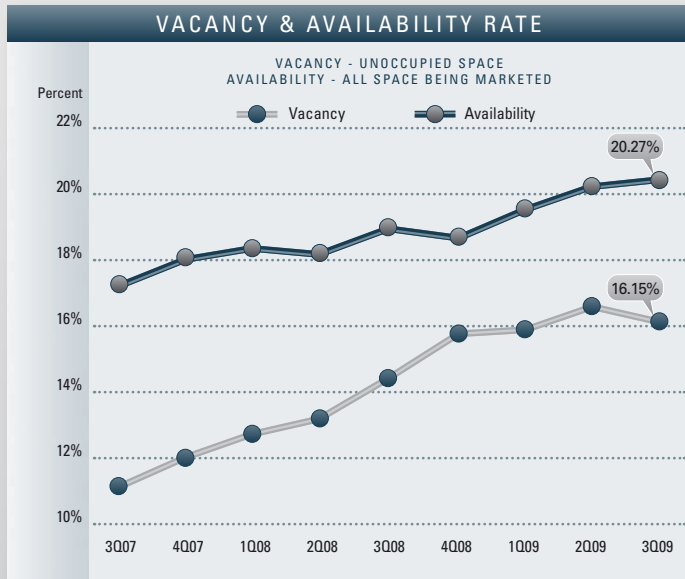
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## OFFICE MARKET OVERVIEW

	3Q2009	2Q2009	3Q2008	% CHANGE VS. 3Q08
Under Construction	636,587	956,711	2,399,488	-73.47%
Vacancy	16.15%	16.60%	14.34%	12.62%
Availability	20.27%	20.17%	18.91%	7.19%
Average Asking Lease Rate	\$2.39	\$2.47	\$2.74	-12.77%
Sale & Lease Transactions	2,629,224	3,283,066	3,182,896	-17.40%
Net Absorption	346,030	397,633	-669,217	N/A

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	INVENTORY				VACANCY & LEASE RATES				ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 3Q2009	Total Availability 3Q2009	Average Asking Lease Rate	Net Absorption 3Q2009	Net Absorption 2009	Gross Absorption 3Q2009	Gross Absorption 2009
<b>Central</b>												
Downtown	135	12,651,675	40,000	0	1,789,185	14.14%	2,248,463	\$2.49	(46,712)	12,038	203,745	682,801
Central Total	135	12,651,675	40,000	0	1,789,185	14.14%	2,248,463	\$2.49	(46,712)	12,038	203,745	682,801
<b>Central Suburban</b>												
City Heights/University	56	1,400,760	0	0	90,383	6.45%	146,095	\$1.95	6,532	17,744	16,919	47,640
Kearny Mesa	237	10,245,187	320,300	854,000	1,304,579	12.73%	1,640,366	\$1.88	246,338	642,877	344,539	912,788
Mission Gorge	59	1,559,636	0	0	122,158	7.83%	151,703	\$1.41	14,517	16,436	31,527	53,897
Mission Valley	124	6,923,178	0	55,000	1,162,257	16.79%	1,450,428	\$2.18	5,418	(11,076)	240,882	618,184
Old Town	38	1,265,963	0	0	95,807	7.57%	186,669	\$1.99	(5,181)	(16,747)	18,706	43,886
Point Loma	60	1,783,063	0	0	88,400	4.96%	160,434	\$0.00	76,000	65,002	97,016	207,715
Rose Canyon/Morena	53	1,134,164	11,160	11,397	89,241	7.87%	109,842	\$2.00	(4,741)	(12,850)	18,823	42,849
Uptown/Hillcrest	75	1,885,797	0	0	124,354	6.59%	160,794	\$1.77	1,179	18,205	18,761	62,893
Central Suburban Total	702	26,197,748	331,460	920,397	3,077,179	11.75%	4,006,331	\$2.02	340,062	719,591	787,173	1,989,852
<b>Highway 78 Corridor</b>												
Oceanside	45	915,164	0	431,832	227,949	24.91%	223,532	\$0.00	(1,229)	(12,714)	5,741	30,490
San Marcos/Vista	97	2,582,584	0	242,957	524,661	20.32%	561,130	\$1.58	1,716	(1,014)	36,214	134,450
Highway 78 Corridor Total	142	3,497,748	0	674,789	752,610	21.52%	784,662	\$1.58	487	(13,728)	41,955	164,940
<b>I-15 Corridor</b>												
Escondido	74	1,524,331	0	43,107	241,235	15.83%	303,287	\$1.37	(3,271)	(30,899)	17,387	39,046
Poway	31	1,385,049	0	364,570	65,758	4.75%	88,789	\$2.25	(24,148)	(2,303)	6,572	40,394
Rancho Bernardo	109	7,310,845	0	997,184	1,649,656	22.56%	1,801,507	\$1.92	(101,112)	275,380	543,381	814,609
Scripps Ranch	45	1,818,467	150,000	480,000	448,616	24.67%	610,174	\$2.31	19,596	(1,998)	23,427	188,122
I-15 Corridor Total	259	12,038,692	150,000	1,884,861	2,405,265	19.98%	2,803,757	\$2.05	(108,935)	240,180	590,767	1,082,171
<b>North City</b>												
Del Mar Heights	67	4,427,384	0	91,256	1,017,109	22.97%	1,260,461	\$3.90	(125,425)	(138,197)	63,562	257,666
Governor Park	19	859,834	0	0	347,242	40.38%	452,159	\$2.65	(16,189)	16,344	32,386	91,699
La Jolla	56	1,673,261	0	0	113,334	6.77%	162,613	\$2.91	(2,234)	(47,430)	30,069	58,771
Miramar	34	1,578,590	0	0	233,648	14.80%	258,102	\$1.79	(15,560)	30,143	30,756	112,681
Sorrento Mesa	128	9,221,382	0	1,448,649	1,731,307	13.67%	2,347,701	\$2.31	(125,473)	(82,799)	216,827	616,146
Torrey Pines/Sorrento Valley	58	3,763,758	0	0	236,705	12.72%	464,718	\$3.71	92,275	63,579	98,119	112,191
UTC Center	91	7,539,642	0	594,097	1,340,488	17.78%	1,795,207	\$2.77	291,400	(31,006)	411,684	689,425
North City Total	453	29,063,851	0	2,134,002	5,019,833	17.27%	6,740,961	\$2.70	98,794	(189,366)	883,403	1,938,579
<b>North County</b>												
Carlsbad	152	6,067,619	82,127	957,228	1,365,511	22.50%	1,681,255	\$2.30	72,235	54,364	188,679	599,037
North Beach Cities	109	2,406,040	33,000	20,000	317,318	13.19%	389,368	\$2.60	(21,271)	(52,395)	54,747	139,451
North County Total	261	8,473,659	115,127	977,228	1,682,829	19.86%	2,070,623	\$2.54	50,964	1,969	243,426	738,488
<b>South/Southeast Corridor</b>												
East County	126	2,541,750	0	666,000	262,044	10.31%	295,981	\$1.49	(4,361)	(9,740)	23,789	88,035
South San Diego	121	3,616,327	0	322,953	848,407	23.46%	927,977	\$1.76	15,731	(107,407)	75,641	162,247
South/Southeast Total	247	6,158,077	0	988,953	1,110,451	18.03%	1,223,958	\$1.62	11,370	(117,147)	99,430	250,282
Class A	256	30,782,438	532,127	4,491,530	6,339,192	20.59%	7,651,049	\$2.67	486,968	1,381,615	1,538,233	3,197,775
Class B	1,158	49,281,949	104,460	3,088,700	8,029,589	16.29%	10,229,583	\$2.08	(135,010)	(601,587)	1,056,296	2,999,632
Class C	785	18,017,063	0	0	1,468,571	8.15%	1,998,123	\$1.61	(5,928)	(126,491)	255,370	649,706
San Diego County Total	2,199	98,081,450	636,587	7,580,230	15,837,352	16.15%	19,878,755	\$2.39	346,030	653,537	2,849,899	6,847,113

This survey consists of office buildings greater than 10,000 square feet. Lease rates are on a full service gross basis.

RECENT TRANSACTIONS

Sales Activity

Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
3030 Science Park Road - 3 Properties	San Diego	A & B	164,091	\$115,654,000	Senior Housing Properties Trust	HRPT Properties Trust
12625 High Bluff Drive	Del Mar Hts	B	66,820	\$18,000,000	Chinatrust Bank	Fidelity National Title Company
10010 Campus Point Drive	UTC	B	62,435	\$8,304,000	Scripps Health	Campus Point Realty Corporation
5050 Avenida Encinas	Carlsbad	A	49,031	\$6,750,000	Providence Capital Group Inc.	Prudential Real Estate Investors
16810-16816 Bernardo Center Drive	Rancho Bernardo	C	6,000	\$3,600,000	US Bank	FDIC

Lease Activity

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
525 B Street	Downtown	A	102,020	August-09	Procopio, Cory, H & S, LLP	Hines
610 W Ash Street - Renewal	Downtown	A	44,760	August-09	Dept. of Homeland Security	Glenborough, LLC
9242 Lightwave Ave.	Kearny Mesa	A	38,620	July-09	Epsilon Systems	San Diego Spectrum Office LP
610 W Ash Street - Renewal	Downtown	A	38,371	August-09	ESET LLC	Glenborough, LLC
525 B Street - Renewal	Downtown	A	31,202	July-09	Reed Elsevier	Hines

Product Type

CLASS A

Most prestigious buildings competing for premier office users with rents above average for the area. Buildings have high quality standard finishes, state of the art systems, exceptional accessibility and a definite market presence.

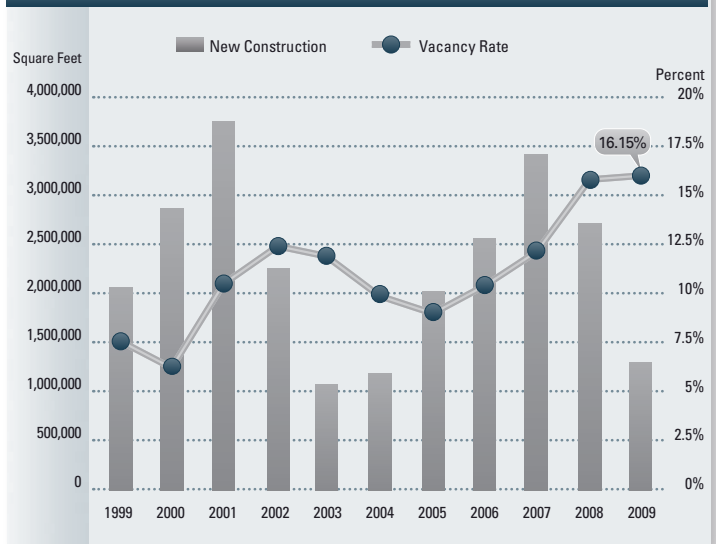
CLASS B

Buildings competing for a wide range of users with rents in the average range for the area. Building finishes are fair to good for the area and systems are adequate, but the building cannot compete with Class A at the same price.

CLASS C

Buildings competing for tenants requiring functional space at rents below the area average.

ANNUAL OFFICE NEW CONSTRUCTION VS. VACANCY RATE



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