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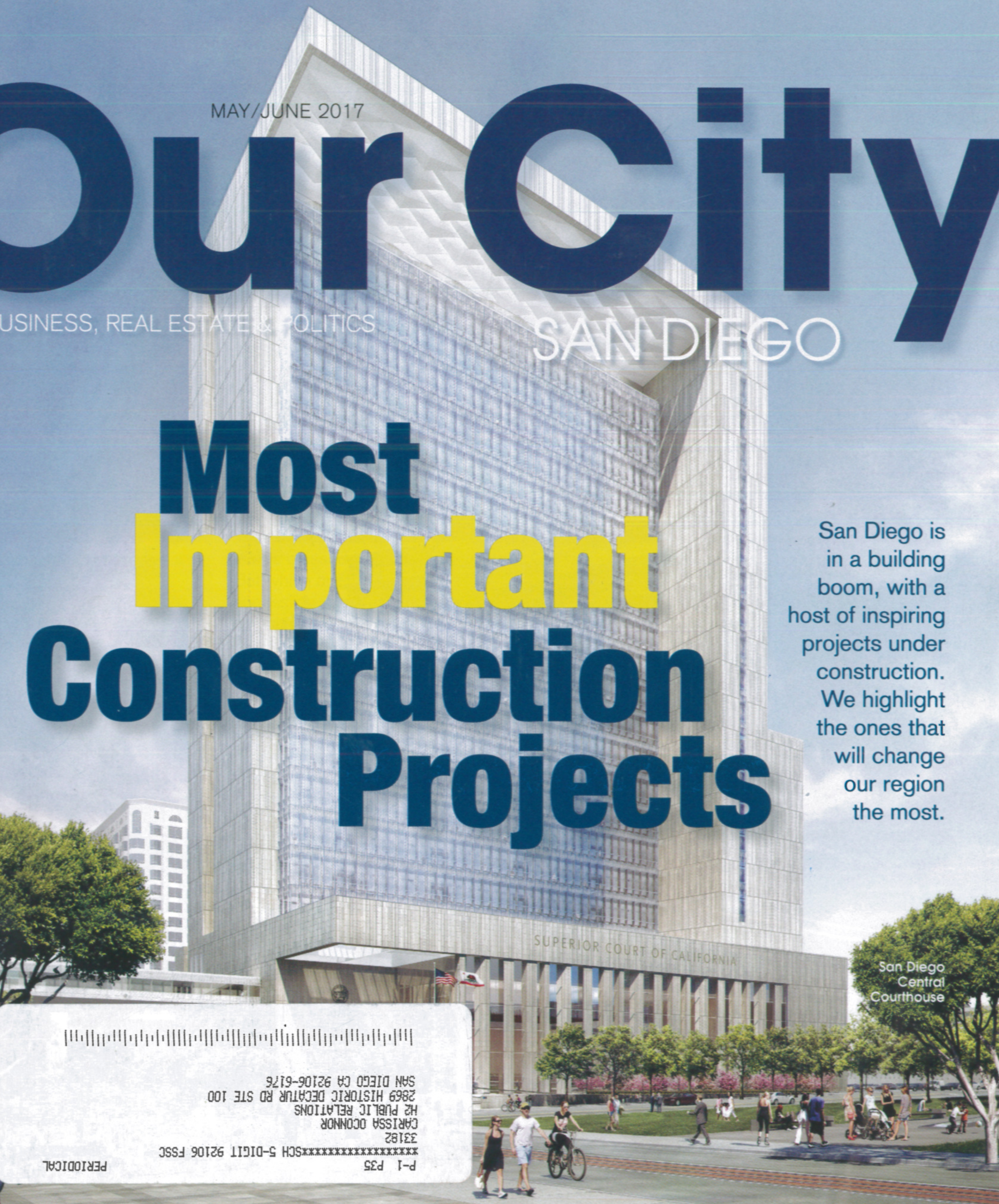
Our City SAN DIEGO

BUSINESS, REAL ESTATE & POLITICS

Most Important Construction Projects

San Diego is in a building boom, with a host of inspiring projects under construction. We highlight the ones that will change our region the most.



San Diego Central Courthouse

PHOTO BY F8GRAPHER/SHUTTERSTOCK

Downtown's next phase: Office resurgence?

Downtown seems to have everything it needs to attract office space, but financing has been tough.

By Mike Stetz

Downtown San Diego may be the next big destination for office space development. It has the available space, a growing, well-educated residential population, and amenities that today's progressive workforce craves — including coffee shops, rooftop bars and restaurants.

"If you look at the city and you look at planning, and you look at infrastructure and trips and traffic, the only place the city wants to see that kind of density is in downtown," said Matt Carlson, senior vice president of CBRE, at a recent Our City forum on the future of office space in the county.

But while downtown has been the focal point for high-end condominium and apartment developments, very little office space has been added in the past decade.

One big reason is financing, said Jason Wood, project principal at Cisterra Development. In 2007, Cisterra built Diamond View Tower, which overlooks Petco Park and commands the highest office-space rents in the county. But Wood is quick to point out that Cisterra secured financing for the project in a different time — before the financial crash.

Today's financiers are leery of an office development without a large tenant.

Cisterra developed the new Sempra headquarters downtown, but financing was not an issue because Sempra is a Fortune 500 company with $10 billion in revenue.

More indicative of the challenges facing downtown developers is Cisterra's project at Seventh Avenue and Market Street. It will deliver 156,000 square feet of Class A office space. But to get funding, Wood first had to secure a Ritz-Carlton hotel, a Whole Foods Market and 115 apartments.

The final project is an unusual mix of uses that forced his design team to be very creative.

Still, Wood said there's no way a spec office project at that location would have gotten funding. He could have done the "biggest sale pitch in the world" for a spec office building downtown and not gotten a penny out of the finance world, he said.

And yet, downtown is attracting younger people who enjoy being close to where they work, Wood said. He noted that while young people used to migrate to San Diego's beach communities, downtown is now the preferred hot spot.

Other experts are concerned that downtown office development is not adapting.

"The biggest concern I have in the market is the complete disconnect between all the residential development that we've seen in downtown San Diego and the almost complete absence of office space," said Gary London, senior principal of London Moeder Advisors.

London noted a recent UC San Diego study, commissioned by the Downtown San Diego Partnership, which showed that less than 4 percent of the people who work downtown live downtown.

"That's more than just a disconnect," he said. "It's a travesty."

Now, many downtown residents travel to job centers in Torrey Pines Mesa, Sorrento Valley and other high tech centers.

The report, called "Downtown San Diego: The Innovation Economy's Next Frontier," said millennials will help fuel a new economic growth downtown. They enjoy

Our City gathered a panel of experts to talk about the future of office real estate in San Diego. Downtown is a hot destination, they agreed. Participating were (l-r) Jason Wood, principal of Cisterra Development, Gary London, president of London Moeder Advisors and Matt Carlson, senior vice president of CBRE

the urban lifestyle.

Carlson said the same UC San Diego study showed downtown was second only to Carmel Valley from an education-level and revenue-per-household standpoint.

"The fact that downtown is just behind that group and ahead of all of the other ZIP codes in the county means that there is an unbelievable workforce there," Carlson said.

He noted a growing concern by businesses over the lack of office space. Downtown is attracting a new breed of businesses, such as digital media companies, public relations firms and software companies, he said, and they want cool space.

"If you're coming in and you're an innovative company or a technology-oriented company focused on what your employees are doing, and you want to be in a different environment, you're frustrated," Carlson said. "That's because there's not something unique for you."

While an office tower built on spec is unlikely to happen in downtown any time soon, developers are moving forward with mixed-use projects that include some office space — such as Makers Quarter.

Additionally, existing structures could be renovated for commercial use. London thinks Horton Plaza is an ideal candidate.

"To me, it's a perfect location for some large commercial office space," he said, noting that the retail footprint could be reduced to make this happen. Many malls are facing challenges because of the increase in online shopping, and Nordstrom has already left Horton Plaza.

"What we're hoping for is that the future for downtown is one that certainly doesn't replicate the dismal activities and dismal past that we've seen over the past 20 years," London said.

Carlson hopes a life sciences company will migrate downtown. Currently, most are clustered in the Torrey Pines Mesa area, but the limited available land there is making expansion difficult, forcing developers to undertake expensive renovations. As costs continue to escalate in that region, downtown will look more attractive, Carlson said.

"There is vertical lab in San Francisco," he said. "There's vertical lab in Cambridge, Mass. There's vertical lab in New York."

Wood said biotech companies initially balked at moving into the UTC area, fearing they would be too far from the action. Now that area is inundated with life sciences companies.

"Businesses are flexible with respect to geography," London said. "There are opportunities throughout the San Diego region. I'm waiting for that big biotech or high tech company to announce that they truly are interested [in downtown]. That will happen."

One draw might be downtown's lifestyle and vibe. Today's companies are looking for more than office space. They are looking for what surrounds it, Carlson said.

"Tenants today want an experience," he said. "They want fitness close by. They want a Whole Foods to go grab lunch. They want a lifestyle. They want to blur the lines of what they're doing. They want to have meetings in coffee shops and cocktails on rooftop bars. They want all of those things."

Carlson said downtown is the region's best option for office space growth, not only because of all the amenities but also because of the lack of available land elsewhere.

And in the end, it may be the lack of supply across the county that finally drives the downtown office market. Vacancy rates countywide have dropped to 14.4 percent, with health care, financial firms and life sciences accounting for 50 percent of the total demand.

Downtown has also seen a drop in vacancy rates, and that could make it easier for developers to get the financing they need for office space.