

ARTICLE | CAPITAL MARKETS

San Diego’s Office Market Adapts to a Post-Pandemic World

By: Matt Carlson, Hunter Rowe, and Camille Doan

4.6M SF

Reduction of Office Stock

10%

of Central Market Inventory

500K SF

Office Converting to Industrial

4.1M SF

Office Converting to Life Sciences

In the face of negative sentiment surrounding the national office market, it is important to recognize the distinct strengths and opportunities that make San Diego a viable and attractive investment. Despite being pulled into the broader narrative, San Diego’s office market has been bolstered by positive tailwinds and flourishing life sciences, technology, and industrial/flex sectors, which have consistently performed well over the past three years. With low vacancy rates across all product types, San Diego continues demonstrating its overall health and attractiveness to investors.

The remarkable growth of the life sciences sector since 2020 has been a major driving force behind San Diego’s office market. While life sciences demand has slowed in 2023 from previous historical highs, the sector’s strength has reduced available office inventory. To put things into perspective, in the suburban market alone, life sciences owners have converted 4.6 million square feet of traditional office space since 2020, accounting for approximately 10% of the total central office market. This reduction in inventory has not only solidified the market but also helped maintain rental rates and avoid the risk of a deflationary environment.

Given the robust innovation and continued growth, the demand for life sciences space is expected to remain robust over the next decade. This will inevitably put further pressure on the availability of office inventory. As such, the stability of the life sciences market will continue to

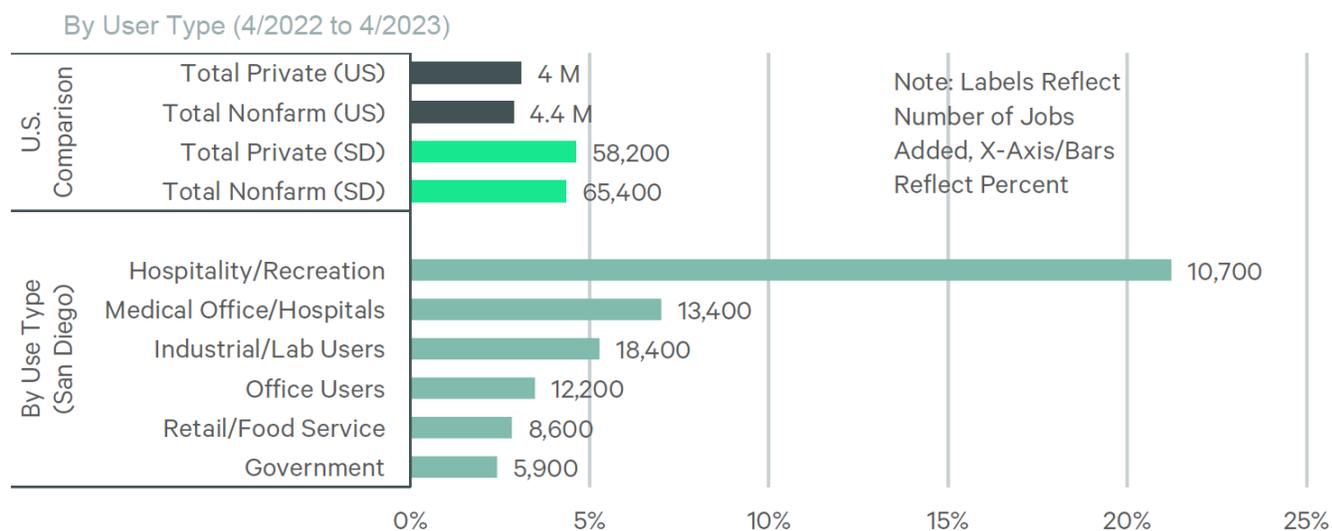
support strong office rents and will serve as a control mechanism on supply.

While some skeptics express concern about potential disruptions to the pipeline of conversions and developments, it is essential to recognize the rapidly evolving nature of science and technology. New innovations emerge continually, opening up fresh avenues of opportunity for companies and additional growth in San Diego.

In addition to these positive market dynamics, San Diego boasts healthy population trends that contribute to its resilience. Unlike the declining population in California during the past two years, San Diego County has experienced an increase. Recent population estimates from the U.S. Census Bureau reveal that California's population declined by roughly half a million people between April 2020 and July 2022. In contrast, San Diego County witnessed a population increase during the same period. According to the San Diego Association of Governments (SANDAG), the forecast indicates that San Diego County's population will reach an impressive 3.6 million by 2040.

This influx of people into San Diego is driven by the city's relaxed lifestyle and diverse economic drivers compared to other major West Coast metros. This has attracted numerous companies to establish their base in San Diego, further contributing to its economic vitality. Notably, several large corporations, including MAANG-level tech giants, life sciences and pharmaceutical companies, and national defense contractors, have made San Diego their home. This influx of companies brings job opportunities and increased investment, further bolstering the local economy. According to CBRE research, since April 2020, San Diego has experienced a remarkable job growth rate of 24.1%.

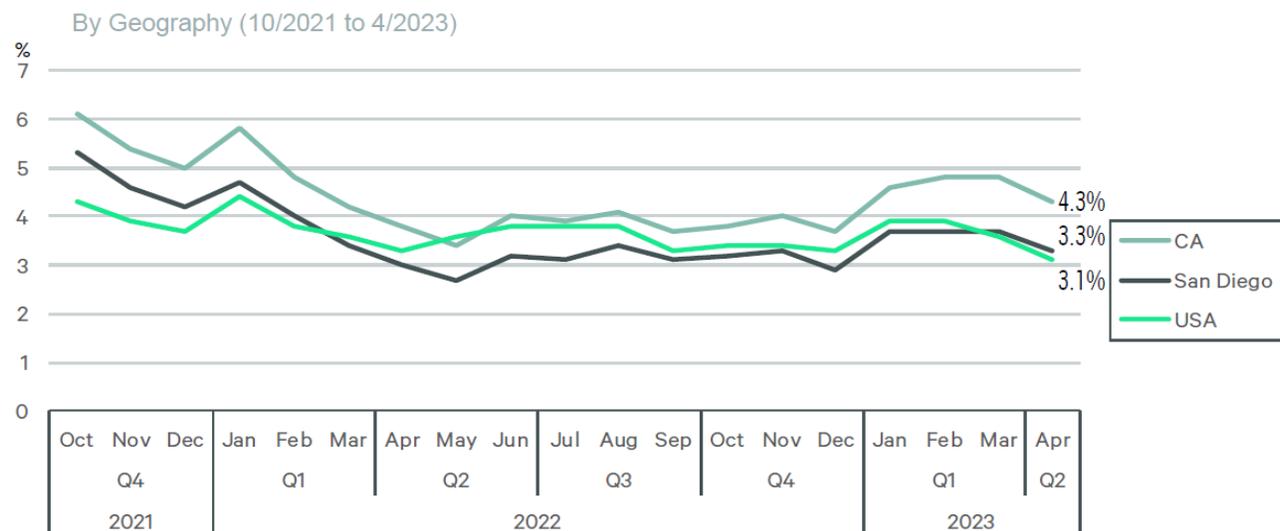
Figure 1: Year-Over-Year Employment Growth, San Diego County vs. U.S., by Use Type in San Diego County



Source: U.S. Bureau of Labor Statistics, California EDD, CBRE Research

Furthermore, San Diego County's unemployment rate has consistently remained below the national average for several years. The rate remained flat in the first three months of 2023 before declining by a notable amount in the start of Q2. In April, the countywide unemployment rate reached a low of 3.3%. These statistics demonstrate the economic stability and resilience of the San Diego region.

Figure 2: Unemployment Rate (%)



Source: US Bureau of Labor Statistics, California EDD, CBRE Research

It's worth noting that the strength of San Diego's office market extends beyond the life sciences and technology sectors. The industrial/flex products market also showcases consistent growth and resilience. The demand for warehouse and distribution space continues to rise, driven by the growth of e-commerce and the region's strategic location as a gateway to international trade, positioning us as a prime logistics hub.

As we navigate the ever-changing landscape of the office market, it is crucial to approach investment decisions with a nuanced understanding of local dynamics. While national trends may paint a less favorable picture, San Diego's specific market conditions tell a different story. The region's diverse economic sectors, population growth, and job opportunities provide a strong foundation for sustained office market performance.

Contacts:

Matt Carlson

Executive Vice President
+1 858 546 2636
matthew.carlson@cbre.com

Hunter Rowe

First Vice President
+1 858 646 4764
hunter.rowe@cbre.com

Camille Doan

Senior Associate
+1 858 646 4769
camille.doan@cbre.com

John Frager

Executive Managing Director
+1 858 546 4694
john.frager@cbre.com

Zach DiSalvo

Field Research Manager
+1 858 646 4780
zach.disalvo@cbre.com

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