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WORKING PAPER NO. 85-98

**CALIFORNIA OFFICE SPACE:
THE 1984 RECORD AND 1985 OUTLOOK**

By

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CALIFORNIA OFFICE SPACE:
THE 1984 RECORD AND 1985 OUTLOOK

by

Cynthia Kroll

University of California, Berkeley

Working Paper No. 85-98

August 1985

Shyam Taggars, research assistant at the Center for Real Estate and Urban Economics in Spring 1985, gathered, compiled and verified much of the data used in this study. He also provided helpful comments on earlier drafts of this paper. Directors and staff at many brokerage firms in California were generous with time and information. Firms sharing data with us include Coldwell Banker, Grubb & Ellis, Cushman & Wakefield, and MacMillan, Moore & Buchanan. The First American Title Insurance Company, the chambers of commerce of San Diego, Oakland, and San Jose, and economic development corporations in Alameda and San Mateo counties also assisted us in our efforts to gather information.

CALIFORNIA OFFICE SPACE: THE 1984 RECORD AND 1985 OUTLOOK

ABSTRACT

This paper describes the growth in demand and supply of office space in California since 1980. Square footage of office space in the state has increased by almost 80 percent since 1980, while the demand for office space has grown by only 55 percent. As a result of this intense period of construction, total square footage in the state's major metropolitan markets has risen from 150 million to almost 270 million. The amount of space available in the state's nine most active metropolitan counties has risen from under 6 million square feet in 1980 to over 40 million square feet by December 1984. With absorption averaging 20 million square feet yearly, the state had a 2 year supply of space and a 15.5 percent vacancy rate entering 1985.

There is some variation in rates of building, absorption, and vacancies among counties, but overbuilding appears to be strong statewide. The highest vacancy rates can be observed in Central Valley counties (such as Sacramento) and in rapidly expanding suburban areas (such as San Diego and Contra Costa counties). However, even San Francisco has added almost 10 million square feet in the past 4 years, with vacancies rising from 1 percent in 1981 to about 10 percent in early 1985.

Construction activity in 1985 is unlikely to reduce vacancies significantly or to shrink the existing 2 year supply of space. Approximately 25 million square feet of space are likely to be added in the state's major metropolitan markets during the year. However, the strength of office construction in 1985 masks a general softness in the office market. Much of the space presently coming on line was already under construction in 1984. If vacancy rates do not drop, the pace of construction is likely to slow by 1986.

CALIFORNIA OFFICE SPACE: THE 1984 RECORD AND 1985 OUTLOOK

Introduction

Despite a severe recession in the early 1980s, construction of office space has been strong throughout the United States. In many parts of the country demand for new space has lagged far behind supply, with vacancy rates reaching record levels of over 30 percent in suburban Denver and Houston in summer of 1983. California cities and suburbs have shared in this rapid pace of construction and in the excess of supply over demand. The past half decade has seen major new office complexes added to downtown San Francisco and Los Angeles, as well as to many rapidly expanding suburban counties. This building activity has led to more than a four-fold increase in vacancy rates since 1980.

How serious is the vacancy problem? Casual observation of past trends indicate that office building commonly follows a cycle of heavy overbuilding followed by slowdowns, rapid absorption, and tight rental markets. Is the current stock of office space simply at one extreme of this cycle, and if so, how rapidly will excess vacancies be absorbed?

This paper examines recent office building activity in California and compares construction and absorption levels for the period from 1980 through 1984. Major questions examined include: a) Are current vacancies simply the result of delays in absorbing newly constructed space or of a more sustained excess of construction over demand for space? b) How many years supply of office space are currently available in California's major

metropolitan markets? c) To what extent do employment growth patterns in the past four years explain the difference between demand and supply of office space in the state? d) Are there significant variations in the market among the different metropolitan areas in the state? and e) What is the outlook for building and office space absorption in 1985?

A Comment on the Data

Inventories of office space vary extensively from place to place in terms of comprehensiveness of coverage, type of space measured, and timing of data collection. Thus any aggregate figures for the state as a whole must be approximate. Data for this paper came from commercial brokerage firms, real estate consultant firms, and chambers of commerce. In a number of cases, estimates of total stock or vacancies varied considerably among sources for the same county. Because of these measurement inconsistencies, the data is perhaps most useful when comparing indices among counties (such as vacancies or the ratio of supply to absorption) rather than absolute levels of construction or absorption, or when studying the changes in one market over time.

The data reported here covers office construction in nine counties. These include Los Angeles, Orange and San Diego in Southern California; San Francisco, Alameda, San Mateo, Contra Costa, and Santa Clara, in the San Francisco Bay Area; and Sacramento, in Central California. Unless otherwise indicated, figures reported here for metropolitan California refer to these nine major metropolitan markets.

California Overview

Inventories of commercial office space in California show approximately 270 million square feet in California's major metropolitan areas -- Southern California, the San Francisco Bay Area, and Sacramento (see Figure 1). Including other metropolitan space not regularly inventoried and space in smaller California cities, the state had over 300 million square feet of commercial office space (leased space in buildings 25,000 square feet or greater) as of December 1984. Of the 270 million square feet located in the 9 counties focussed on in this study, 40 percent was added between 1980 and 1984.

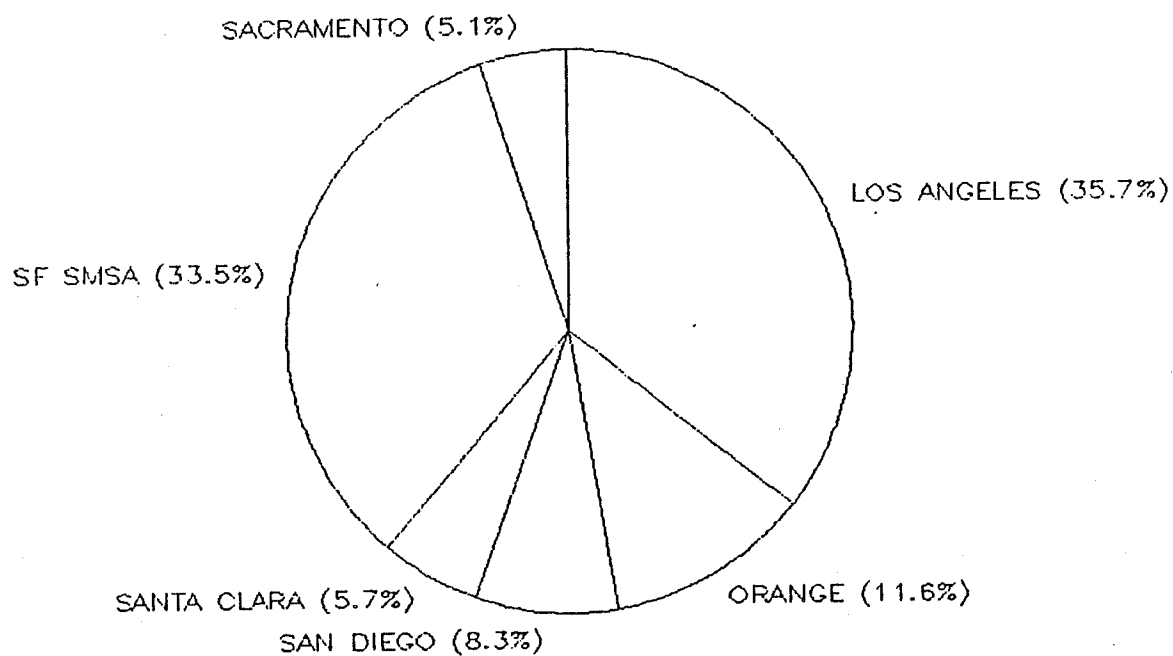
Since 1980, office stock in California's major metropolitan areas has increased by almost 120 million square feet, or an average of 27 million square feet per year. These increases primarily result from new construction but also include space added through renovation of existing buildings or through conversion of owner occupied buildings to multi-tenant uses.

The growth in office stock over the past four years was almost half again as great as absorption (an additional 79 million square feet occupied, or 20 million square feet per year).¹ Total vacant square feet of office space in metropolitan California has risen from under 6 million (3.7 percent of office stock) to over 40 million (15.5 percent of stock).

The surplus office space phenomenon in California first became apparent in 1982, when 30 million square feet of space were added to the stock. Because of an economic recession, that

FIGURE 1

DISTRIBUTION OF OFFICE SQUARE FOOTAGE MAJOR CALIFORNIA REGIONS



Source: Center for Real Estate and
Urban Economics (CREUE)

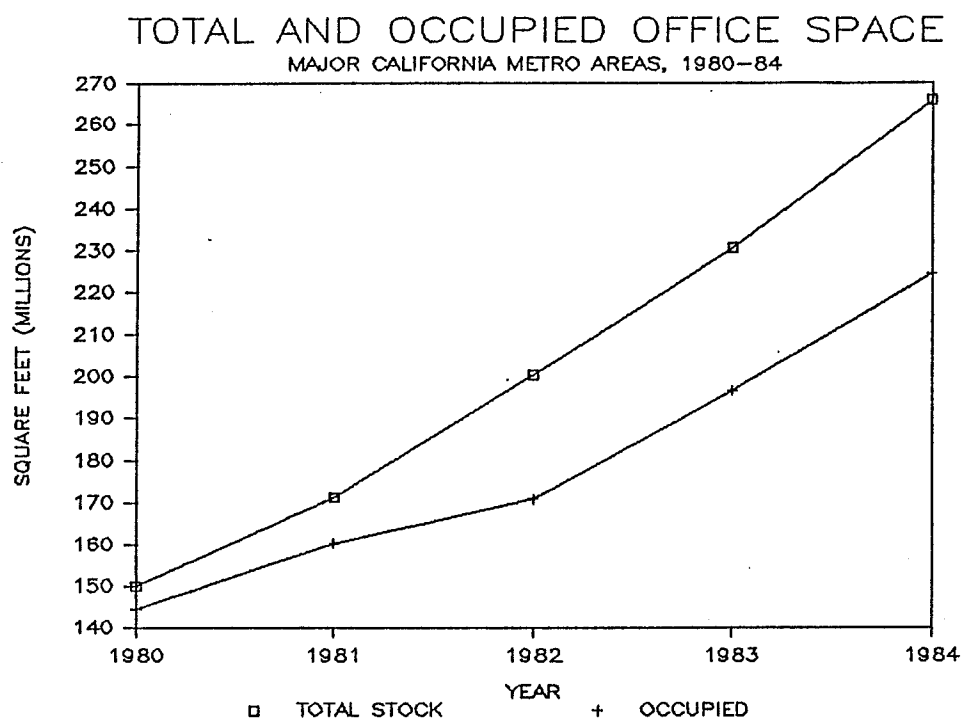
year had a very large gap between absorption and new construction, with only 36 percent of all additional space being absorbed (see Figures 2 and 3).

Building activity in 1983 was similar to the 1982 level, but absorption jumped from 10.6 million square feet to 25.7 million square feet. In 1984 construction continued to be strong. Including some major renovations and owner-occupied conversions in Los Angeles, approximately 30-35 million square feet were added in 1984, with 23 to 28 million square feet absorbed.²

Despite the narrowing gap between construction and absorption in 1983 and 1984, vacancies have continued to rise. This has occurred because the amount of office space added yearly has exceeded the amount absorbed by a percentage amount greater than the vacancy rate in the previous year. Thus vacancies jumped from 6.4 percent in 1981 to 14.8 percent in 1982 and 1983 and to 15.5 percent in 1984. Additions to office stock in 1984 exceeded absorption by 26 percent (see Table 1).

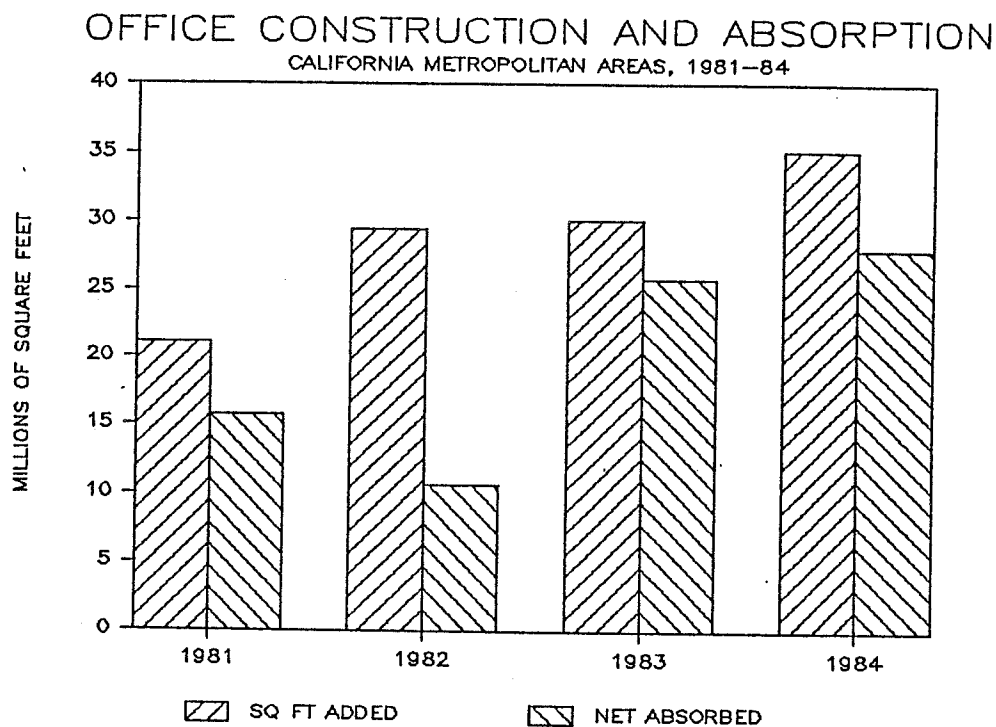
Rental rates have begun to respond to this overbuilt condition. Rates vary widely both within and among metropolitan areas. Some space in suburban concrete tilt-up buildings and in a few older downtown buildings continues to rent for below \$1.00 per square foot, while rents in the most expensive, luxury space may exceed \$4.00 per square foot monthly. Asking rents have dropped as much as 5 percent in many locations throughout the state since 1982. Even in areas where asking rents have remained unchanged, building owners are increasingly making concessions such as additional months of free rent (sometimes up to 2 years),

FIGURE 2



Source: CREUE

FIGURE 3



Source: CREUE

TABLE 1: OFFICE SPACE AND ABSORPTION IN METROPOLITAN CALIFORNIA
(MILLIONS OF SQUARE FEET)

YEAR	TOTAL STOCK	PERCENT VACANT	OCCUPIED	1-YEAR INCREASE	NET ABSORBED	TOTAL VACANT
1980	150.0	3.71%	144.5			5.6
1981	171.2	6.41%	160.2	21.1	15.7	11.0
1982	200.5	14.81%	170.8	29.4	10.6	29.7
1983	230.7	14.77%	196.6	30.1	25.7	34.1
1984	265.8	15.53%	224.5	35.1	27.9	41.3
% CHANGE 1980-84	77.16%		55.42%			
AVERAGE CHANGE YEARLY				28.9	20.0	

Source: Compiled from data provided by Coldwell Banker, Grubb & Ellis, Greater San Diego Chamber of Commerce, Oakland Chamber of Commerce, and previous Center for Real Estate publications. Data by county is reported in Appendix A - C.

internal improvements to the building, or free parking, in order to fill up vacant space.

California Office Jobs and the Demand for Space

Earlier studies of office space absorption have found that there has been a fairly stable relationship between the amount of office space absorbed and growth of office type employment.³ Office-type jobs have grown more rapidly than state-wide employment overall in California in the 1980s, but the pace of employment growth still lags far behind the rate of growth of office space.

Over 40 percent of all new jobs added in California between 1980 and 1984 were in "office-type" sectors, including finance insurance and real estate, business services, legal services, membership organizations, social services, and miscellaneous services. Overall, jobs in these sectors grew by 16.5 percent during this period, while total statewide employment grew by just over 7 percent (see Table 2).

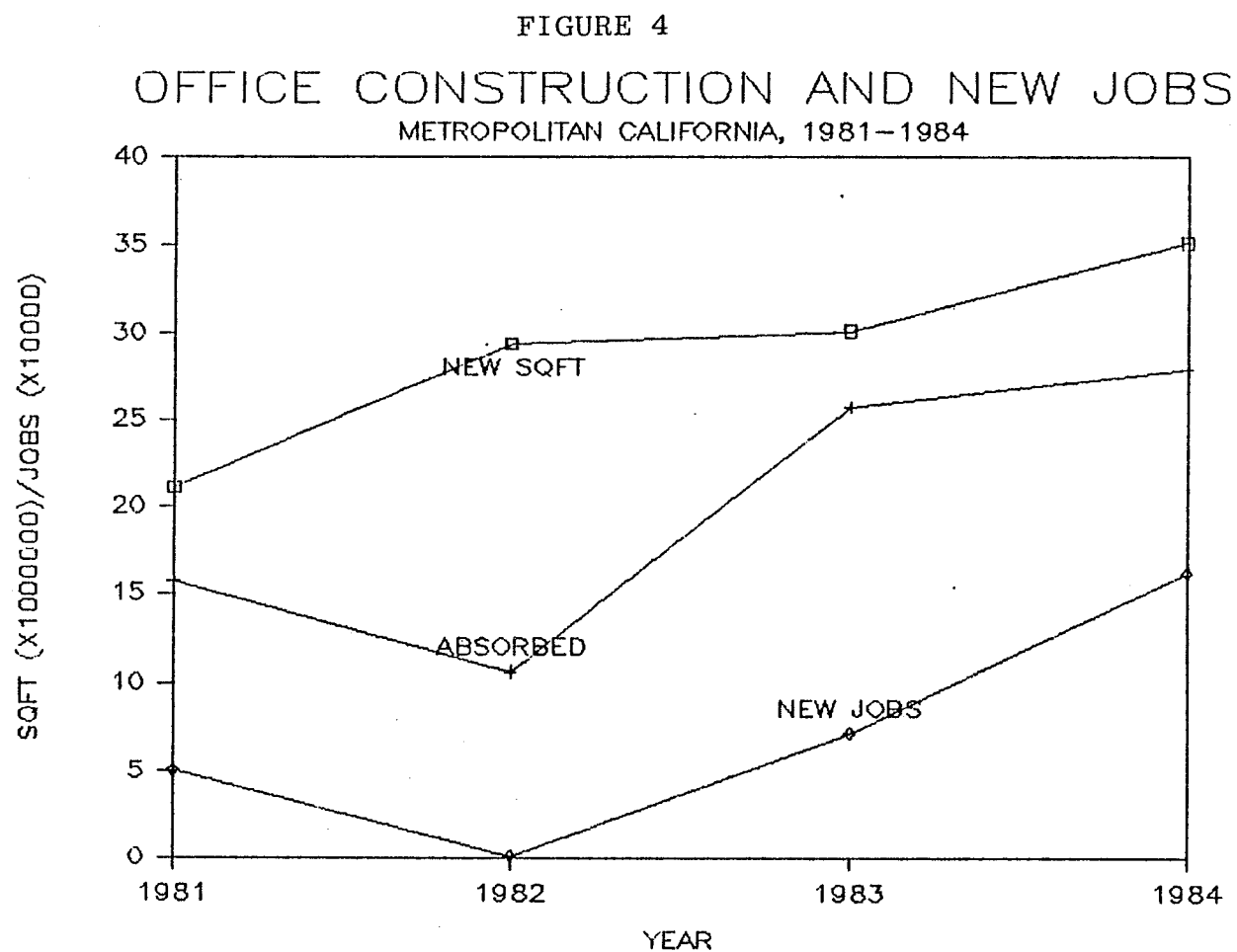
The very slow pace of growth of office type jobs in 1982 and the employment decline in many other job sectors contributed to the slowing rate of office space absorption in that year (see Figure 4). Job growth in office sectors was strong in 1983 and 1984, one factor in the gains in absorption observed more recently.

Job growth rates vary considerably within office-type sectors and among locations in California. Employment in business services is growing far faster than employment in other

TABLE 2: CALIFORNIA OFFICE EMPLOYMENT GROWTH (THOUSANDS OF JOBS)

	1980	1981	1982	1983	1984	JOB INCREASE TOTAL	1980-84 PERCENT
FINANCE, INSURANCE & REAL ESTATE	623.1	642.9	642.4	661.7	695.0	71.9	11.54%
BUSINESS SERVICES	467.3	485.7	484.7	529.5	619.4	152.1	32.55%
OTHER OFFICE SERVICES	638.2	650.6	653.2	660.8	699.7	61.5	9.64%
TOTAL OFFICE JOBS	1728.6	1779.2	1780.3	1852.0	2014.1	285.5	16.52%
STATE EMPLOYMENT (nonagricultural)	9848.8	9985.2	9810.3	9965.9	10553.2	704.4	7.15%

Source: California Employment Development Department, Employment
Data and Research Division, March 1984 Benchmark Data



Source: CREUE

office-type sectors. Jobs in business services grew by one third between 1980 and 1984, and the share of all office-type jobs in business services has risen from 22 percent in 1972 to 27 percent in 1980 and 31 percent in 1984. Employment in finance, insurance and real estate is growing more moderately, increasing by 11.5 percent since 1980, while employment in other office-type sectors has grown by 9.6 percent over this period.

Office jobs have grown more rapidly in Southern California than in the San Francisco Bay Area, with the San Francisco/Oakland SMSA showing an 11 percent increase in four years, the San Jose SMSA showing a 13 percent increase, and the three southern California SMSAs (Los Angeles/Long Beach, San Diego, and Anaheim/Santa Ana) growing by 16 percent. Finance, insurance, and real estate jobs have grown most rapidly in suburban Contra Costa and Marin counties and in San Diego County. Santa Clara County has had the fastest growth in business service jobs, double the rate of growth of any other major metropolitan county. Suburban Contra Costa and Orange counties have the fastest growing jobs in other office-using sectors (see Table 3).

The Southern California Office Market⁴

Office space construction in southern California has been dominated by activity in Los Angeles County (see Figure 5). Total office stock in Los Angeles increased by 46 million square feet between 1980 and December 1984. An additional 13.2 million square feet were added to Orange County, and San Diego gained 10.4 million square feet of office space.

TABLE 3: MAJOR OFFICE EMPLOYMENT SECTORS, CALIFORNIA METROPOLITAN AREAS
(THOUSANDS OF JOBS)

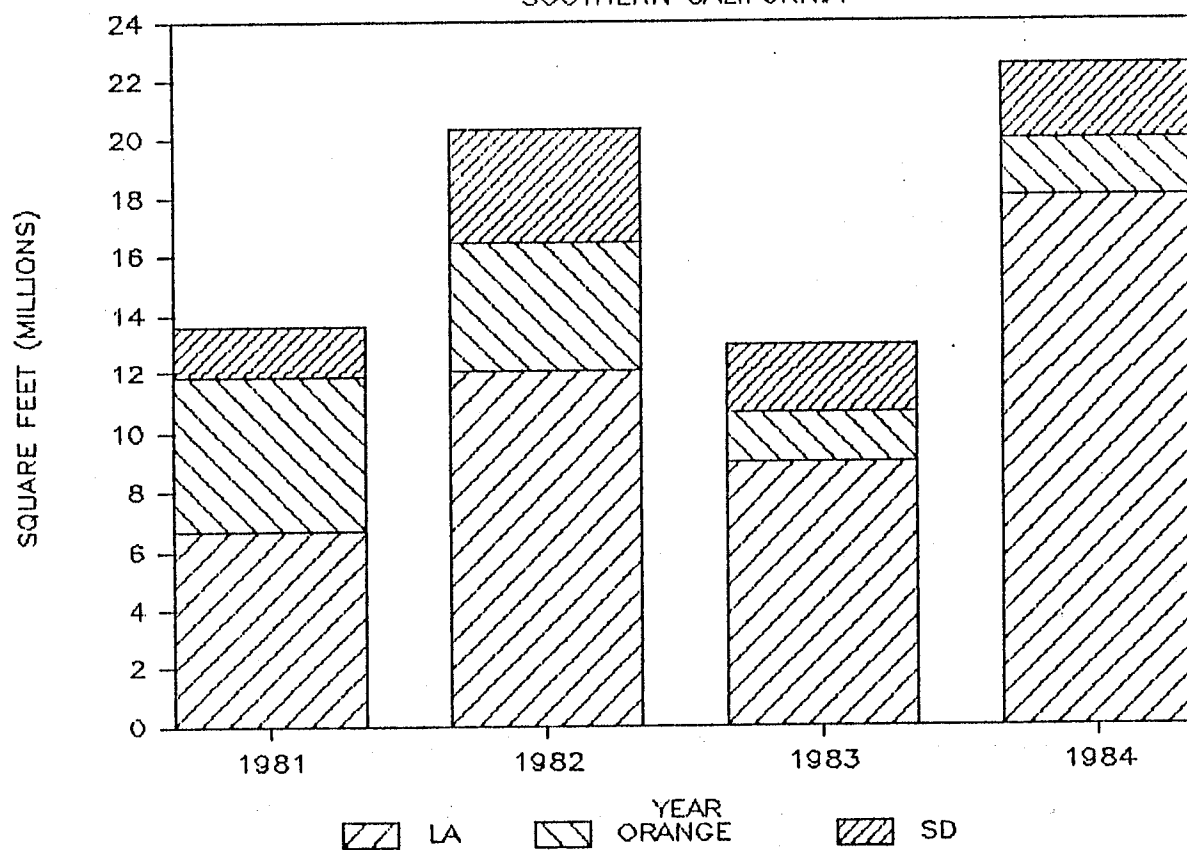
		1972	1980	1981	1982	1983	1984	% CHANGE 1980-84
ALAMEDA	FIRE*	19.8	25.1	25.0	23.8	26.3	27.2	8.37%
	BUSINESS	13.1	21.0	21.1	21.7	24.7	28.6	36.19%
	OTHER OF.	18.2	23.6	24.5	24.7	25.8	26.6	12.71%
SAN FRANCISCO	FIRE	63.9	87.3	90.3	88.2	84.5	83.3	-4.58%
	BUSINESS	20.4	41.0	46.4	39.1	44.3	47.7	16.34%
	OTHER OF.	35.5	63.0	64.6	66.5	63.8	65.3	3.65%
CONTRA COSTA	FIRE	5.6	12.2	12.7	13.5	15.5	16.9	38.52%
	BUSINESS	4.5	9.2	8.4	8.0	9.5	11.0	19.57%
	OTHER OF.	7.3	12.0	12.9	13.5	14.7	15.4	28.33%
SAN MATEO	FIRE	9.5	16.8	16.6	16.6	18.4	19.0	13.10%
	BUSINESS	5.4	12.5	12.4	12.7	15.6	17.3	38.40%
	OTHER OF.	11.4	15.2	14.4	13.8	14.4	14.9	-1.97%
MARIN	FIRE	3.0	7.8	8.5	9.7	10.2	10.0	28.21%
	BUSINESS	1.9	3.5	3.7	4.2	5.1	5.5	57.14%
	OTHER OF.	N/A	N/A	N/A	N/A	N/A	N/A	N/A
S.F. S.M.S.A. TOTAL		219.5	350.2	361.5	356.0	372.8	388.7	10.99%
SANTA CLARA	FIRE	15.9	27.6	28.7	28.4	29.6	30.9	11.96%
	BUSINESS	21.5	48.4	51.7	52.9	60.5	84.7	75.00%
	OTHER OF.	28.6	44.5	44.7	44.6	46.9	50.3	13.03%
SACRAMENTO	FIRE	12.6	23.2	23.9	23.9	24.8	26.4	13.79%
	BUSINESS	4.7	11.1	12.2	12.4	13.6	13.8	24.32%
	OTHER OF.	11.9	21.2	22.8	22.4	23.2	24.5	15.57%
ORANGE	FIRE	25.0	57.2	61.2	60.9	64.2	70.1	22.55%
	BUSINESS	17.1	45.0	47.3	49.6	55.8	68.5	52.22%
	OTHER OF.	17.9	38.7	43.1	43.8	46.8	49.1	26.87%
LOS ANGELES	FIRE	183.4	234.6	239.3	234.1	235.9	250.5	6.78%
	BUSINESS	N/A	191.1	193.8	190.9	208.1	239.6	25.38%
	OTHER OF.	N/A	230.5	230.5	230.7	233.1	240.1	4.16%
SAN DIEGO	FIRE	22.7	38.7	40.7	42.6	45.8	48.6	25.58%
	BUSINESS	12.1	28.6	31.4	32.8	34.3	39.5	38.11%
	OTHER OF.	24.0	40.2	40.6	40.4	41.2	45.7	13.68%
SO. CALIFORNIA TOTAL		302.2	904.6	927.9	925.8	965.2	1,051.7	16.26%
CALIFORNIA	FIRE	409.3	623.1	642.9	642.4	661.7	695.0	11.54%
	BUSINESS	232.5	467.3	485.7	484.7	529.5	619.4	32.55%
	OTHER OF.	415.3	638.2	650.6	653.2	660.8	699.7	9.64%

* Categories include FIRE -- finance, insurance and real estate (SIC 60 - 67); business services (SIC 73), and other office related services (SIC 80 - 89).

N/A Data not available.

Source: California Employment Development Department and CREUE.

FIGURE 5
OFFICE SPACE ADDED YEARLY
SOUTHERN CALIFORNIA



Source: CREUE

A. Job Growth and Absorption in Los Angeles County⁵

Office stock in Los Angeles County grew by 93 percent between 1980 and 1984. Renovations and conversion of owner-occupied buildings to multi-tenant status accounted for about 20 percent of the added space.

Over the same time period, office-type jobs increased by 11 percent. Because demand has grown much more slowly than supply, the Los Angeles area has absorbed on average only two-thirds of added office space in the 1980s. About 10 to 12 million square feet have been added yearly since 1980, while only 6 to 8 million square feet have been absorbed.

Rents in Los Angeles are beginning to respond to the pressure of an office vacancy rate above 16 percent. Top asking rents were in the range of \$3.40/square foot, monthly, in 1982, but have now dropped to \$3.00/square foot.

Building in 1985 shows no sign of slowing in response to high vacancies and lower rents. An additional 12 million square feet of space is under construction in the county this year, bringing total inventory to over 100 million square feet by December 1985. This may lead to further office vacancy increases in Los Angeles County in 1985.

B. Orange County

Orange County office square footage has grown more slowly than the Los Angeles inventory (a 75 percent increase since 1980), but job growth and office space absorption has been more rapid. While Los Angeles added 500 new square feet for every new office job between 1980 and 1984 (excluding renovations and conversions), Orange County added only 280 square feet for each

new job. Almost three fourths of all new space added in Orange County since 1980 came on line in 1981 or 1982, while close to three-fourths of the job growth occurred after 1982. As a result, vacancy rates peaked at 22.9 percent in 1982. Since then, slower building and growing absorption has lowered vacancies for the county, dropping to 12.1 percent in December 1984.

Although Orange County is primarily a suburban market, it includes buildings that can command prices rivaling those in downtown San Francisco and Los Angeles. Top asking rents reached as high as \$4.00 per square foot in 1984. Rents and vacancies are likely to remain stable in Orange County in 1985. The county will have its strongest building year in three years, with up to 3.2 million square feet added, while absorption has averaged 2.7 million square feet in the past four years, and 3.3 million square feet were absorbed in 1984.

C. San Diego

Office construction activity in San Diego County shows in miniature many of the factors that characterize office building statewide. First, the downtown area continues to be an important location for builders, with over 2 million square feet added since 1980. Second, new suburban areas are expanding rapidly -- much of the new office space construction is occurring in the north county and north city. Third, despite a much slower growth in the demand for space, office construction activity continues to be strong.

Office space in San Diego County almost doubled between 1980 and 1984, while occupancy levels grew by just over 50 percent and

office-type jobs grew by 25 percent. On average, absorption levels have reached only 58 percent of total additions in the 1980s, and vacancies have grown from less than 5 percent in 1980 to 23 percent in December 1984.

As in other parts of the state, the gap between absorption and additions was particularly large in 1982, with almost 4 million square feet added to San Diego's office stock, and less than 1 million additional square feet occupied. However, even in 1984, absorption was only two-thirds of additions, and over 5 million square feet remained vacant. At an average absorption level of 1.5 million square feet yearly, this is more than a three year supply of space.

Rents in San Diego range from \$1.30 to \$2.90 per square foot, monthly. Vacancies may increase in 1985, while rents are likely to remain stable or drop. This is the case because additions in 1985 will almost certainly exceed absorption. As of mid-1984, 4 million square feet of space were under construction.

The Office Market in the San Francisco Bay Area⁶

Overall, the San Francisco Bay Area is characterized by slower growth in office space than in Southern California, but by much greater variation among counties. Office construction continues both in downtown and suburban areas, but downtown areas are receiving a much smaller share of total office space than in earlier decades. While Oakland and San Francisco had 70 percent of all office space in 1980, only one-third of new office space added to the region in the past 4 years was located in these two

central cities (see Figure 6). More than half of all new square footage added is in suburban areas.

This is an extension of suburbanization trends that began in the 1970s. One consequence of this is that, while vacancy rates are high in the newest growth areas in the region, some of the suburbs that began growing in the 1970s are now expanding more slowly and have significantly lower vacancies than elsewhere in the region.

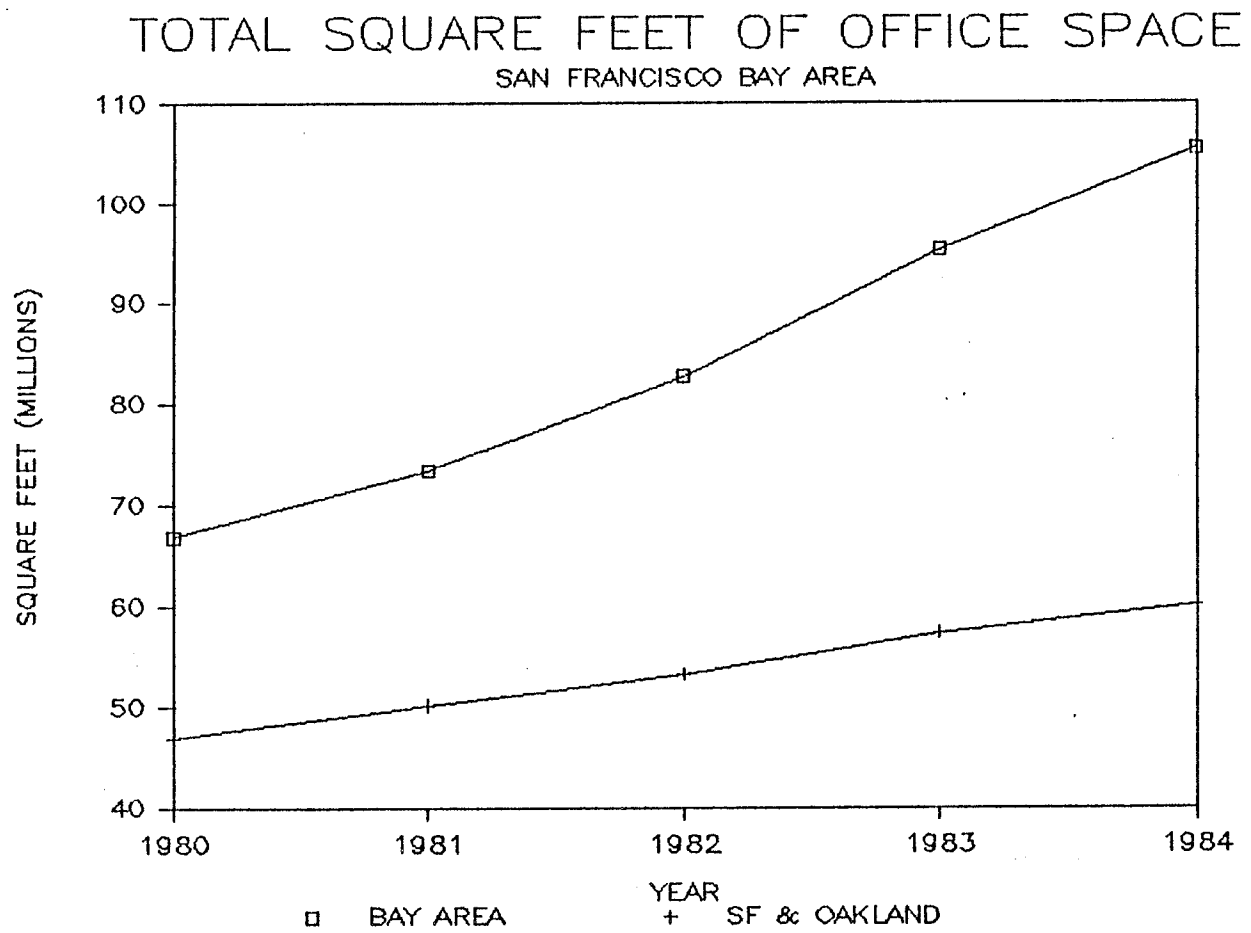
A. San Francisco

The vast majority of office square footage in San Francisco is in the downtown area, and historic data is not readily available for the rest of the city. In the late 1970s and early 1980s, San Francisco had one of the lowest vacancy rates observed in any major U.S. city, with less than 1 percent of all square footage vacant in 1981. However, construction of almost 8 million square feet of office space between 1982 and 1984 brought vacancies to 9 percent by December 1984 and over 10 percent in the spring of 1985.

The rate of office growth in San Francisco appears moderate compared to growth in other parts of the state, but high rents, high costs of business operations, and difficulties assembling space have led to slow job growth in the city. Office stock increased by 25 percent from 1980 through 1984, space occupied increased by 16.6 percent, and office jobs overall grew by only 2.6 percent.

Absorption of office space has fluctuated rapidly from year to year, reaching almost 3 million square feet in 1981 and 1983, but with virtually no new absorption in 1982, and less than 1

FIGURE 6



Source: CREUE

million square feet absorbed in 1984. With 4.5 million square feet vacant as of December 1984, the city has between a two- and three-year supply of space available, even without new construction.

Top rents in San Francisco reached a peak of about \$40/square foot yearly in 1982, but dropped to \$35-\$38/square foot in 1982 and 1983. The future of office space availability and rents in San Francisco depends not only on developer decisions but also on the outcome of the proposed Downtown Plan, which could restrict new construction to 500,000 square feet per year.⁷ Without such a restriction, downtown vacancies may continue to rise in 1985. The institution of a growth limit in San Francisco would affect job growth and the demand for office space in suburban areas as well as downtown.

B. San Mateo County

San Mateo County was one of the earliest suburban office markets in the San Francisco Bay Area. More than half of its stock was added in the 1970s, a period when office supply was quickly absorbed. Since 1980, an additional 4.4 million square feet have been built, an increase in total stock of 63 percent, while occupied space has increased 58 percent and office jobs have grown by 15 percent. Absorption was relatively strong despite a high ratio of square feet added per new office job (over 650 square feet per job), indicating either that the county had unmet demand in the early 1980s or that nontraditional office users are filling much of San Mateo's new office space. This latter situation would not be surprising, as San Mateo County has

been an important expansion site for Silicon Valley firms.

Despite having a somewhat tighter market than other parts of the Bay Area or southern California, office rents in San Mateo County do not reach the levels of downtown San Francisco or Los Angeles. However, San Mateo County is one of the few locations where rents have continued to rise since 1982, ranging between \$1.00 and \$2.75 per square foot in 1984.

Higher land prices, limited travel routes, and fewer available land parcels are all likely to continue to lead San Mateo's office stock to grow at a slow to moderate pace. With approximately 1.2 million square feet of space under construction in 1985 and average absorption of 1 million square feet, vacancies may increase slightly in San Mateo County in 1985, but should remain well below the levels in other parts of metropolitan California.

C. The East Bay--Contra Costa and Alameda Counties

The 680 Corridor, defined by a highway running through a suburban portion of Contra Costa and Alameda Counties, has been one of the fastest growing office markets in California. Expanding local services and the movement of firms from other parts of the Bay Area have contributed to a 30 percent increase in office employment in Contra Costa County between 1980 and 1984. Most of these jobs have gone to the 680 corridor, where total office stock has grown by 127 percent and office occupancy has more than doubled.

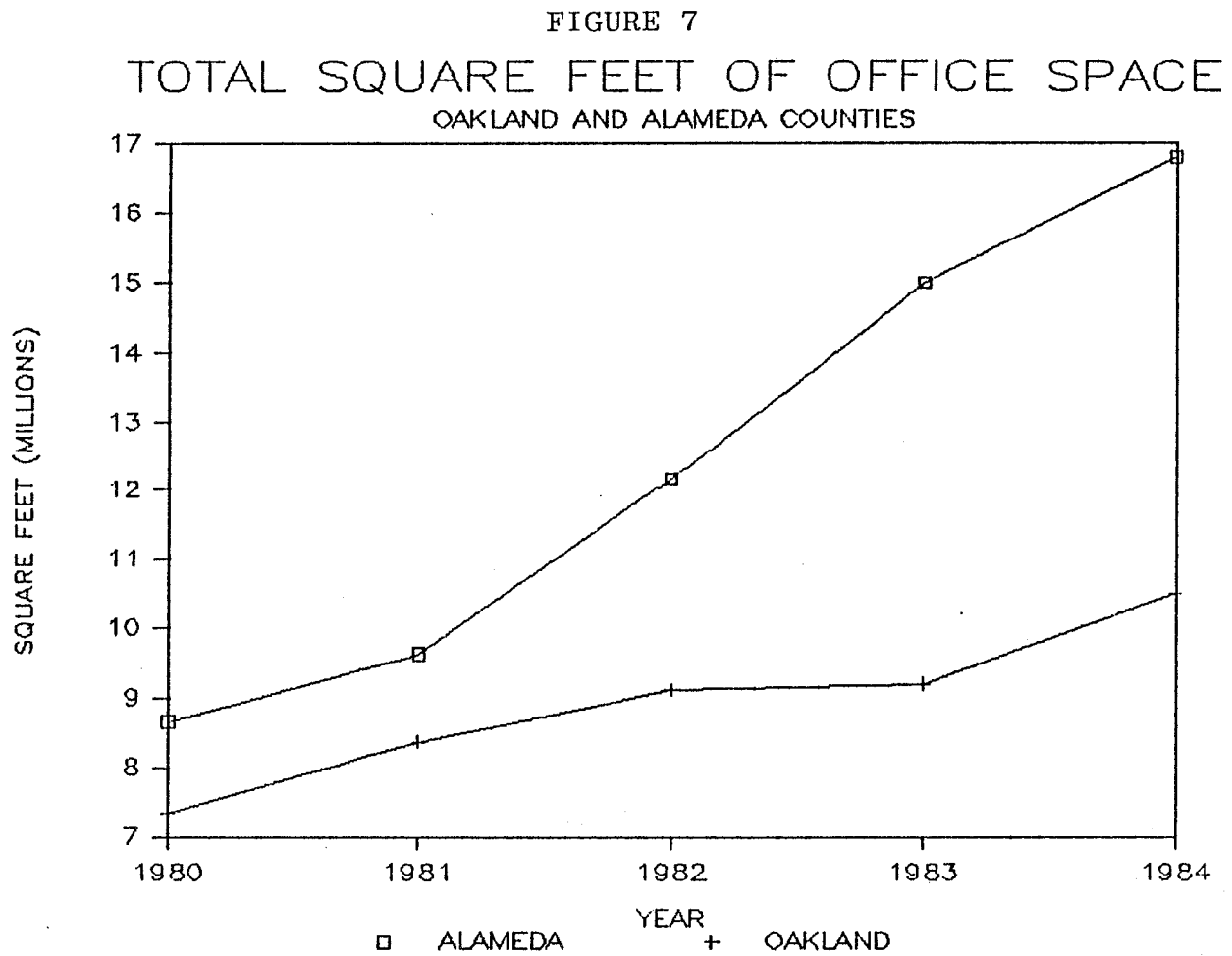
An additional 8 million square feet of space have been added to the more urban parts of Alameda County. This portion of the East Bay has had an increase in office stock of 94 percent,

compared to an 18 percent increase in office jobs and a 72 percent growth in occupancy. The city of Oakland accounted for over 80 percent of Alameda County office space in 1980, but smaller cities and suburban areas have captured 60 percent of more recent growth (see Figure 7).

Despite moderate job growth in Alameda County and very strong job growth in Contra Costa County, vacancies have risen substantially since 1984. Vacancy rates along the 680 corridor rose from 8.4 percent in 1980 to 20 percent in 1983 and 18.5 percent in December 1984. Other parts of Alameda County had vacancies averaging 17.9 percent in December 1984. These high rates of vacancy may be due in part to the tremendous amount of new growth occurring in recent years, and to delays inherent in leasing new space. However, on average, office space absorption has been only three-quarters the level of additions along the 680 corridor and only 70 percent of additions in other parts of Alameda County. Even in 1984, when the 680 corridor had its highest level of absorption (1.5 million square feet), this was still 12 percent below the increase in stock.

Rents in Alameda and Contra Costa counties tend to be far lower than rents in San Francisco. Rents in downtown Oakland or Walnut Creek may reach \$2.50/square foot, monthly, while rents in the suburban fringe may still be at or below \$1.00/square foot. Asking rents have stabilized or dropped slightly since 1982, with much of the price negotiation centering on months of free rent, the cost of parking, and internal improvements to the space.

Despite high vacancies and stabilizing or declining rents,



Source: CREUE

1985 is likely to continue to be a strong year for building in the East Bay, especially along the 680 corridor. However, the image of this area, as a place with inexpensive land, accommodating planning agencies, and an available resident labor force, is beginning to change, affecting longer term prospects for growth. Rising land and housing prices and community led growth control movements could moderate the pace of building in Alameda and Contra Costa's suburban areas.

D. Santa Clara County

While the demand for office space in Alameda and Contra Costa counties has been fueled largely by population growth and by the relocation of major office employers, in Santa Clara County many of the growing office using businesses are closely tied with the growth of high technology manufacturing. Employment in business services in the county grew by 75 percent between 1980 and 1984, while other office jobs grew more moderately, in the range of 12 to 13 percent.

Estimates of office activity in Santa Clara County vary widely from broker to broker. At one extreme, Grubb & Ellis estimates that over 30 percent of all space is vacant, While MacMillan, Moore & Buchanan estimates only an 11 percent vacancy rate in December 1984. The following discussion draws largely on Grubb & Ellis inventory figures, with some adjustments using Coldwell Banker vacancy estimates.

Santa Clara County has had the fastest rate of increase in office stock of all coastal metropolitan California markets in recent years. Between 1980 and 1984, office stock in Santa Clara County increased one and one third times, to 15.2 million square

feet of space.⁸ Presently, only 10 - 12 million square feet of space are occupied, leaving at least 20 percent of the county's space vacant. The amount of space added in Santa Clara County has been steadily rising, with 1 million square feet of space added in 1981, 1.5 million in 1982, 2.8 million in 1983, and 3.5 million in 1984. Absorption has fluctuated widely from year to year, with no more than half of a million square feet absorbed in 1982, but possibly as much as 2.5 million square feet newly occupied in 1984.

Rents in Santa Clara County in general are in the suburban range of between \$1.50 and \$2.50/square foot, with top asking rents in a few buildings reaching \$3.00/square foot, monthly. Even with very high vacancy rates in the past two years, rents have continued to increase, according to Grubb & Ellis and MacMillan, Moore & Buchanan. However, with an additional 4 million square feet of space planned in 1985, vacancies will again be in the range of 20 percent or higher. Even if absorption remains at its 1984 level, and some planned construction is postponed, the county has at least a 2 - 3 year supply of office space available and will certainly feel downward pressure on rents.

Sacramento County: A Central Valley Example⁹

Sacramento County has attracted speculative office builders because of its position as the state capital, with demand for space from government and related services, and because of its diverse labor force and moderately priced housing, which may

attract other relocating office employers. The largest office development center in the Central Valley, Sacramento office space grew by over 180 percent in the 1980s. The county currently has 13.6 million square feet of space, with 10.4 million square feet occupied.

Absorption over the past four years has averaged 1.5 million square feet yearly, 68 percent of average additions, and less than half of the 3.2 million square feet currently vacant in the county. Absorption in 1983 and 1984 was much stronger than in earlier years, but building also increased dramatically, and vacancies rose to a record 23.3 percent in December 1984.

Rental rates have been stable in Sacramento County, in the range of \$1.45 to \$1.65/square foot. Current estimates of new building indicate that approximately 2 million square feet of space will be added in Sacramento in 1985. With an average absorption level of 1.5 million square feet, vacancies will remain high and there may be downward pressure on rents.

Conclusions

The office building boom in California appears to have gone beyond its normal cyclical swings, with excess building over absorption likely to lead to continuing high vacancy rates for at least another year. Nevertheless, the stabilization or drops in rental rates hint that building cannot continue at this rate without developers feeling major costs.

Employment growth explains part of the recent experience with changes in demand for office space and office occupancy, but employment patterns must be considered carefully in the context

of other trends influencing office occupancy as well. First, the growth of employment (an element in demand) is not independent of the growth in supply. New office complexes in suburban Contra Costa or Orange counties allow employers who might otherwise locate in downtown space to move out of Los Angeles, San Francisco, or Oakland.

Second, office vacancies were relatively low in many markets in 1980, just as building took off. Thus, absorption in some locations may have been boosted by unmet demand already present in the county, rather than by new employment growth.

Third, the square feet demanded per employee is not a fixed figure. For example, companies moving to lower cost space are likely to lease more space per employee. In addition, the growing use of office equipment, replacing many clerical functions previously handled by employees, reduces the rate of growth of employment but is likely to increase square feet required per employee.

Because this paper has included neither a detailed analysis of the factors involved in the demand for office space nor projections of office employment, any comments on future absorption must be speculative. However, the review provided above suggests some general conclusions on future directions of office building and absorption in the state.

Judging from building plans in California's major metropolitan areas and from past experience with the growth in demand for space, office space added in 1985 is likely to exceed net increases in demand by about 20 percent. Business growth in

California is not expected to be stronger than in 1983 or 1984, with the result that vacancies may rise above their current level of over 15 percent.

Developers operating in California's major metropolitan markets will need to consider a number of factors affecting supply and demand in these counties in the next few years. In Los Angeles County, new downtown towers are providing major competition to other major office nodes, but the strength of demand for space in downtown has not yet been proven. San Francisco faces serious competition for tenants from expanding projects in the East Bay. Some brokers predict negative absorption and far higher vacancy rates in San Francisco if large office employers continue to leave the city.

Suburbs that experienced rapid job growth in the 1970s, such as Orange and San Mateo counties, already face tighter land markets, and are gaining office space at a slower pace. The most explosive suburban areas in the 1980s, such as suburban San Diego in the south, and the 680 corridor in the north, may soon face similar barriers to growth. Tighter land markets or citizen reactions to the transformation of residential suburbs into employment centers are likely to dictate a slower pace of expansion in the future.

California's Central Valley cities will continue to offer available land and a lower cost operating environment for firms, but nevertheless are likely to be relatively weak markets for speculative office buildings in the near future. Absolute job growth will be moderate in these areas, slowed by lagging conditions in agriculture and by state and local attempts to

limit expansion of government jobs.

While 1985 office space construction still appears strong, this masks a softness in the office market statewide. Builders will be completing projects already under construction, but new projects planned for 1986 and 1987 may be delayed until vacancies drop and the two year supply of space presently vacant is reduced.

Footnotes

1. Absorption and new additions to stock are reported as net figures. Total added space for a single year is the difference between total stock in the current year and total stock in the previous year. Absorption for a single year is the difference between occupied space in the present and previous year, and thus includes newly occupied space minus square feet emptied by tenants.
2. Of the 18 million square feet increase in Los Angeles County's inventory of office stock, as measured by Coldwell Banker, at least 8 million square feet was added to the market through renovations and the conversion of owner occupied to multi-tenant space. Because of this, the 18 million square feet addition to stock and the 14 million square feet net absorption for Los Angeles, as noted in Appendix A, are probably inflated, with some of the converted space occupied by previous tenants.
3. See Cynthia Kroll, Employment Growth and Office Space Along the 680 Corridor: Booming Supply and Potential Demand, Working Paper 84-75, Center for Real Estate and Urban Economics, University of California at Berkeley, February 1984.
4. Appendix A contains tables and illustrations further describing office growth in southern California counties.
5. Data on Los Angeles presented some problems in showing an aggregate overview over time. Coldwell Banker was the major source of data, with Grubb & Ellis figures used for comparison where questions arose. Published Coldwell Banker figures for 1983 showed 77 million square feet of office space in Los Angeles County. Figures obtained by phone for 1984 showed 95 million square feet, an 18 million square foot increase. Construction estimates for this period are for between 6 and 10 million square feet of new space. Conversations with the Coldwell Banker research office indicate that the additional square footage probably consists of renovated space and owner-occupied conversions.
6. Appendix B contains tables and illustrations further describing office growth in the San Francisco Bay Area.
7. An analysis of the potential effects of the Downtown Plan is provided in Kenneth T. Rosen and Ruth Shragowitz, "The Proposed Growth Limit on Commercial Construction for San Francisco," Working Paper 85-94, Center for Real Estate and Urban Economics, University of California at Berkeley, May 1985.
8. Data in this section is from Grubb & Ellis, South Bay Forecast, for the years 1983, 1984 and 1985. MacMillan,

Moore & Buchanan, Inc., has substantially different estimates, as published in its Santa Clara County Office Space Survey, 1984. MacMillan, Moore & Buchanan estimate only 12.9 million square feet of space, with 1.4 million square feet (11 percent of stock) vacant. This very different picture appears to result from MacMillan, Moore & Buchanan's less comprehensive inventory of buildings in the city of San Jose and in Cupertino. It may also reflect at what stage in construction the different firms add buildings to existing inventory.

9. Appendix C contains tables and illustrations further describing office growth in Sacramento County.

APPENDIX A
OFFICE BUILDING ACTIVITY IN SOUTHERN CALIFORNIA

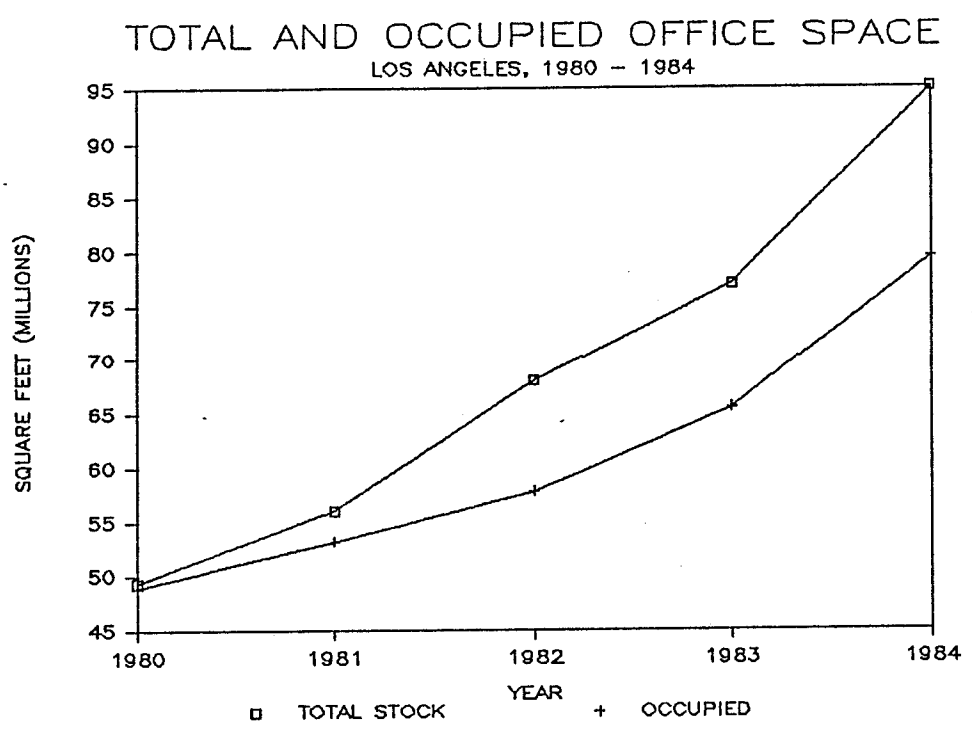
TABLE A-1: OFFICE BUILDING ACTIVITY IN LOS ANGELES COUNTY

	1980	1981	1982	1983	1984
TOTAL INVENTORY OF OFFICE SPACE (MILLIONS OF SQ.FT.)	49.3	56.0	68.0	77.0	95.0
ADDED DURING THE YEAR* (MILLIONS OF SQ.FT.)	5.0	6.7	12.0	9.0	18.0
VACANT SPACE (MILLIONS OF SQ.FT.)	0.5	2.8	10.2	11.6	15.6
VACANCY RATE	1.00%	5.00%	15.00%	15.00%	16.40%
ABSORPTION* (MILLIONS OF SQ.FT.)		4.4	6.0	7.7	14.0
RENT RANGE (\$/SQ.FT.)	N/A	\$11.40 \$36.00	\$12.00 \$41.00	N/A	\$14.00 \$36.00

* Addition and absorption figures for 1984 are inflated by the inclusion of up to 10 million square feet of renovated space and buildings converted from single owner to multi-tenant status.
N/A Not available.

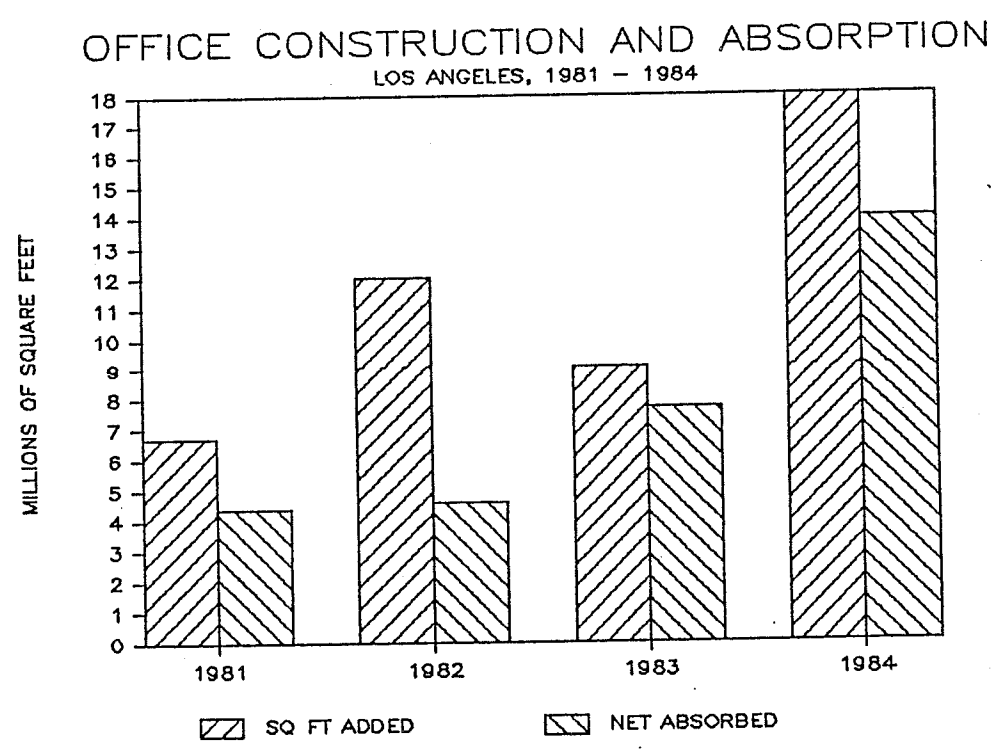
Source: Coldwell Banker Real Estate Consulting Services and Grubb & Ellis.

FIGURE A-1



Source: CREUE

FIGURE A-2



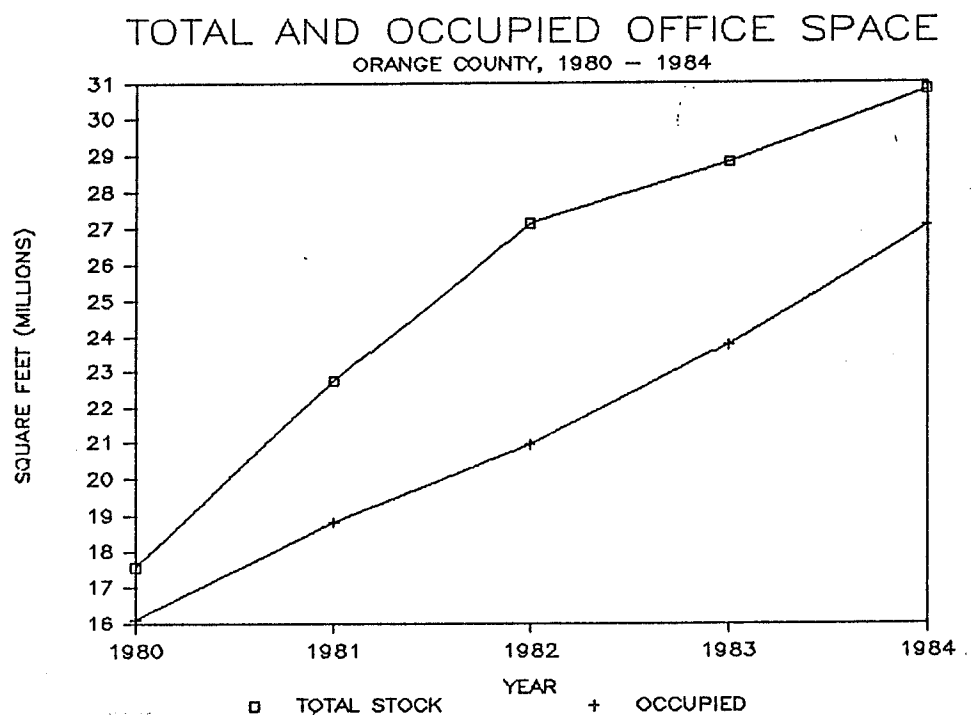
Source: CREUE

TABLE A-2: OFFICE BUILDING ACTIVITY IN ORANGE COUNTY

	1980	1981	1982	1983	1984
TOTAL INVENTORY OF OFFICE SPACE (MILLIONS OF SQ.FT.)	17.6	22.7	27.2	28.8	30.8
ADDED DURING THE YEAR (MILLIONS OF SQ.FT.)	-----	5.2	4.4	1.6	2.0
VACANT SPACE (MILLIONS OF SQ.FT.)	1.5	3.9	6.2	5.0	3.7
VACANCY RATE	8.30%	17.20%	22.90%	17.50%	12.10%
ABSORPTION (MILLIONS OF SQ.FT.)	2.4	2.4	2.2	3.2	3.5
RENT RANGE (\$/SQ.FT.)	N/A	N/A	N/A	N/A	\$1.20 \$4.00

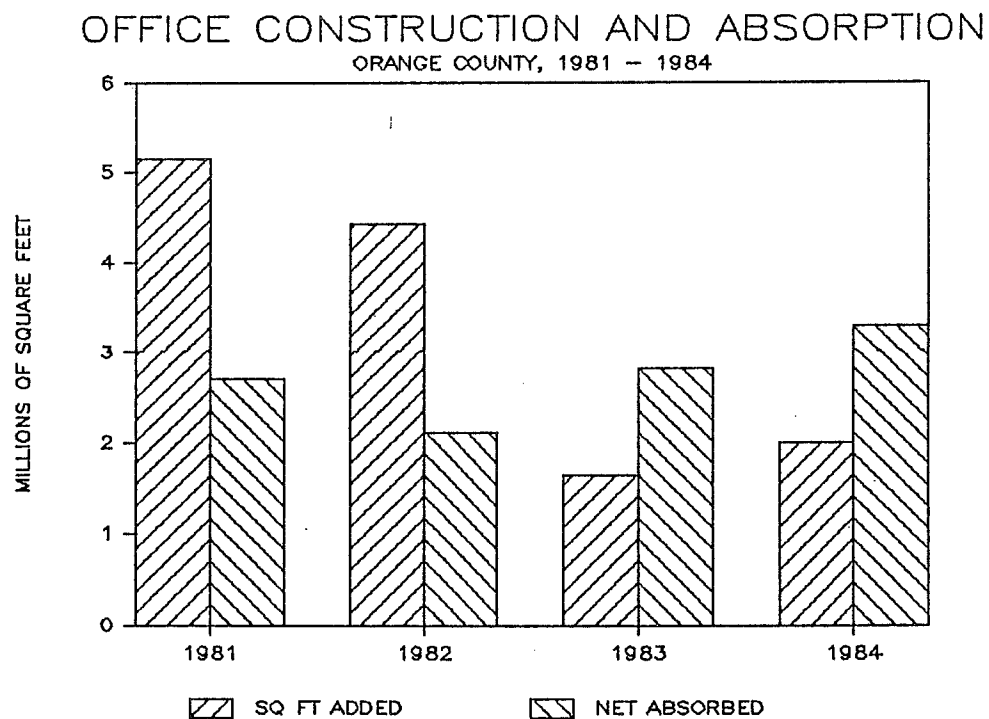
Source: Newport Economics Group

FIGURE A-3



Source: CREUE

FIGURE A-4



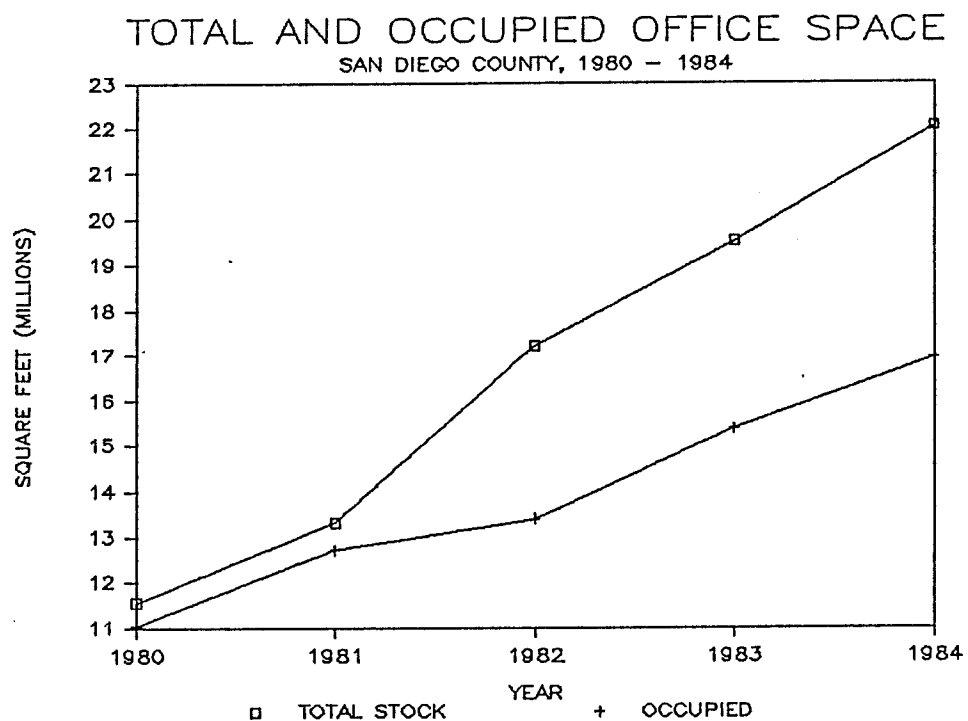
Source: CREUE

TABLE A-3: OFFICE BUILDING ACTIVITY IN SAN DIEGO COUNTY

	1980	1981	1982	1983	1984
TOTAL INVENTORY OF OFFICE SPACE (MILLIONS OF SQ.FT.)	11.6	13.3	17.2	19.5	22.0
ADDED DURING THE YEAR (MILLIONS OF SQ.FT.)	1.4	1.8	3.9	2.3	2.5
VACANT SPACE (MILLIONS OF SQ.FT.)	0.5	0.6	3.8	4.2	5.0
VACANCY RATE	4.50%	4.50%	22.20%	21.30%	23.15%
ABSORPTION (MILLIONS OF SQ.FT.)	1.0	1.7	0.7	2.0	1.6
RENT RANGE (\$/SQ.FT.)	N/A	N/A	N/A	\$18.00 \$35.00	\$15.96 \$35.04
N/A Not available.					

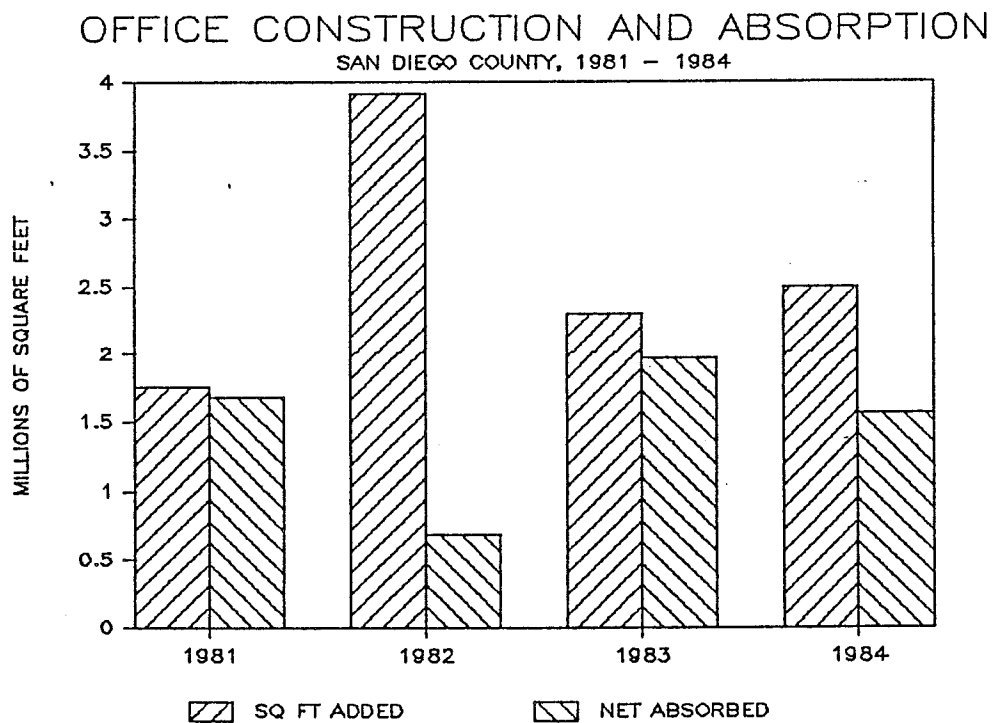
Source: San Diego Chamber of Commerce (1980-1983), Grubb & Ellis (1984), Coldwell Banker (vacancies)

FIGURE A-5



Source: CREUE

FIGURE A-6



Source: CREUE

APPENDIX B
OFFICE BUILDING ACTIVITY IN THE SAN FRANCISCO BAY AREA

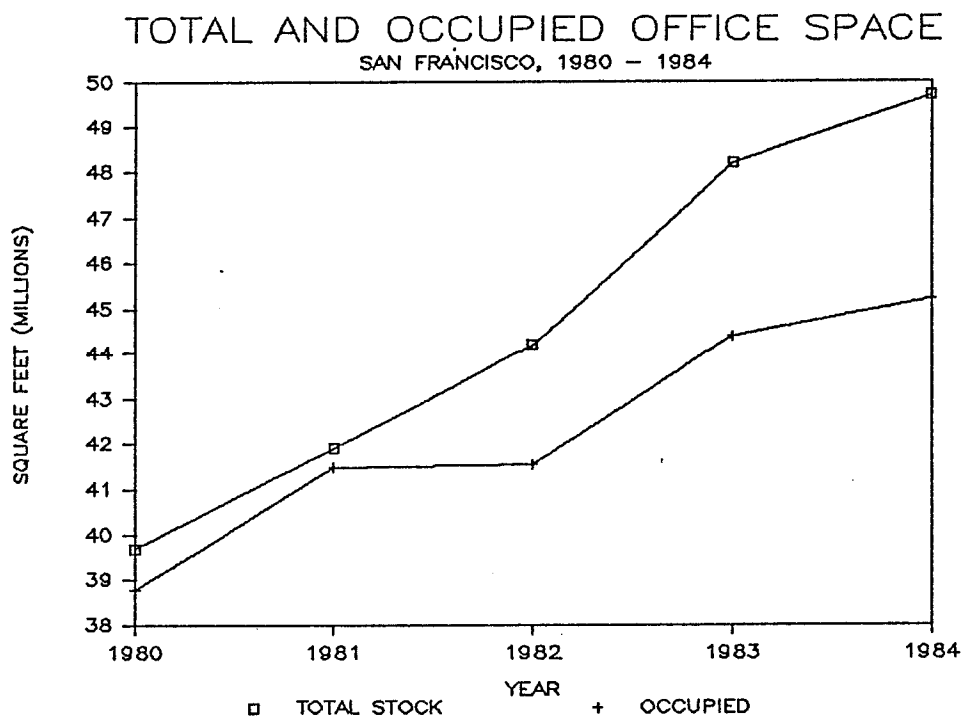
TABLE B-1: OFFICE BUILDING ACTIVITY IN SAN FRANCISCO*

	1980	1981	1982	1983	1984
TOTAL INVENTORY OF OFFICE SPACE (MILLIONS OF SQ.FT.)	39.7	41.9	44.2	48.2	49.7
ADDED DURING THE YEAR (MILLIONS OF SQ.FT.)	1.9	2.2	2.3	4.0	1.5
VACANT SPACE (MILLIONS OF SQ.FT.)	0.9	0.4	2.7	3.8	4.5
VACANCY RATE	2.30%	1.00%	6.00%	7.90%	9.00%
ABSORPTION (MILLIONS OF SQ.FT.)	1.7	2.7	0.1	2.8	0.8
RENT RANGE (\$/SQ.FT.)	\$25.00	\$36.00	\$40.00	\$35.00	\$27.00 \$38.00

* Downtown San Francisco only.

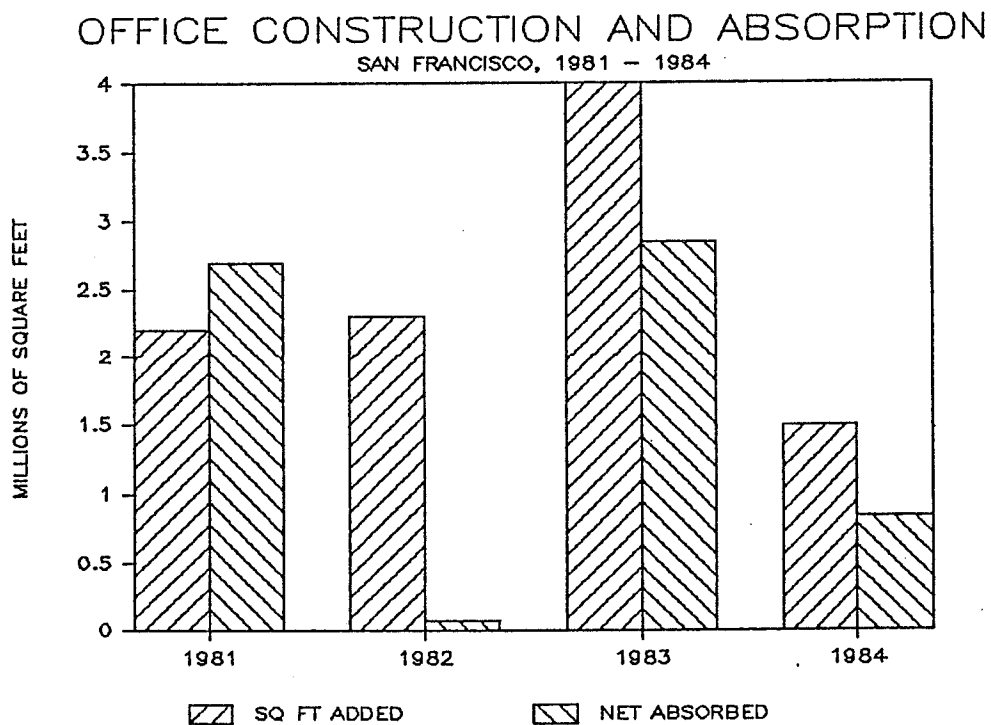
Source: Research and calculations by the Center for Real Estate
and Urban Economics

FIGURE B-1



Source: CREUE

FIGURE B-2



Source: CREUE

TABLE B-2: OFFICE BUILDING ACTIVITY IN SAN MATEO COUNTY

	1980	1981	1982	1983	1984
TOTAL INVENTORY OF OFFICE SPACE (MILLIONS OF SQ.FT.)	7.0	7.8	8.5	10.0	11.4
ADDED DURING THE YEAR (MILLIONS OF SQ.FT.)	----	0.8	0.7	1.5	1.4
VACANT SPACE (MILLIONS OF SQ.FT.)	0.3	0.3	0.7	1.1	0.8
VACANCY RATE	4.00%	4.00%	8.00%	11.00%	7.00%
ABSORPTION* (MILLIONS OF SQ.FT.)	0.6	0.8	0.3	1.1	1.7
RENT RANGE (\$/SQ.FT.)	\$0.70 \$1.60	\$0.75 \$2.00	\$0.90 \$2.50	\$1.10 \$2.60	\$1.00 \$2.75

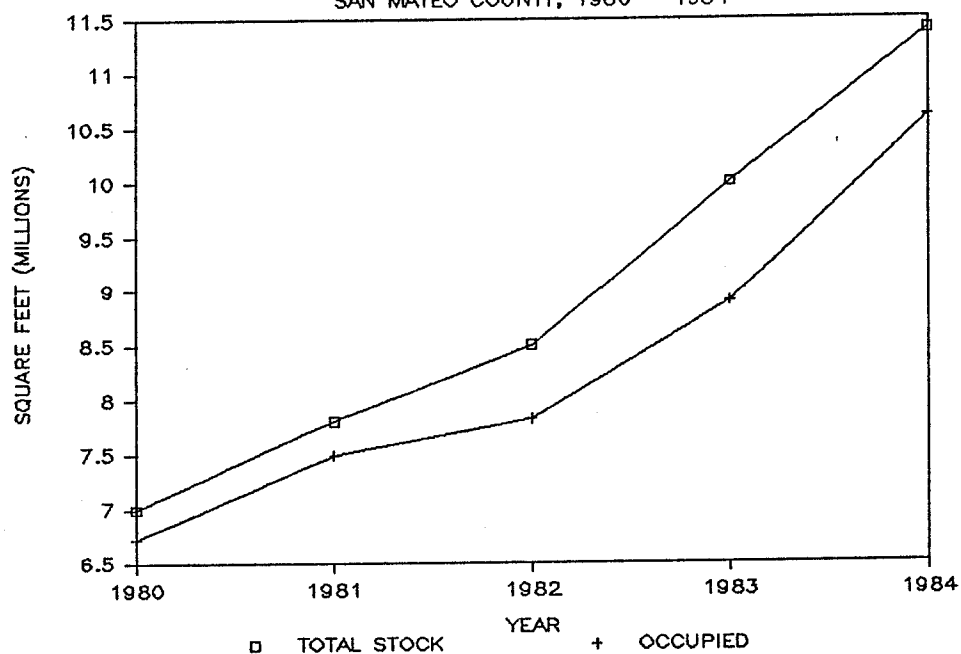
* Net absorption (i.e. the difference between space occupied in the present year and space occupied in the previous year)

Source: Henry Bostwick, San Mateo Development Association

FIGURE B-3

TOTAL AND OCCUPIED OFFICE SPACE

SAN MATEO COUNTY, 1980 - 1984

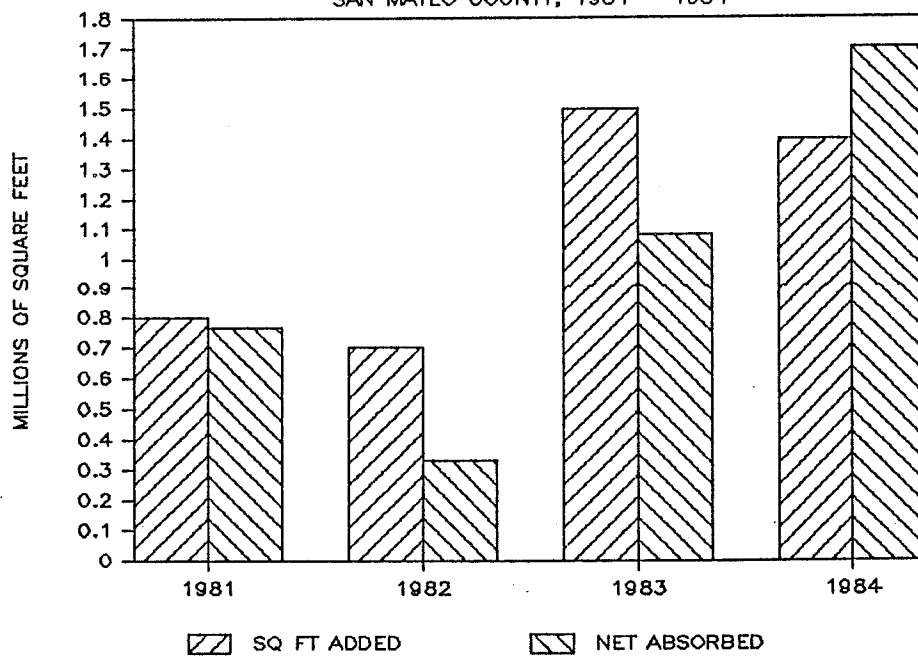


Source: CREUE

FIGURE B-4

OFFICE CONSTRUCTION AND ABSORPTION

SAN MATEO COUNTY, 1981 - 1984

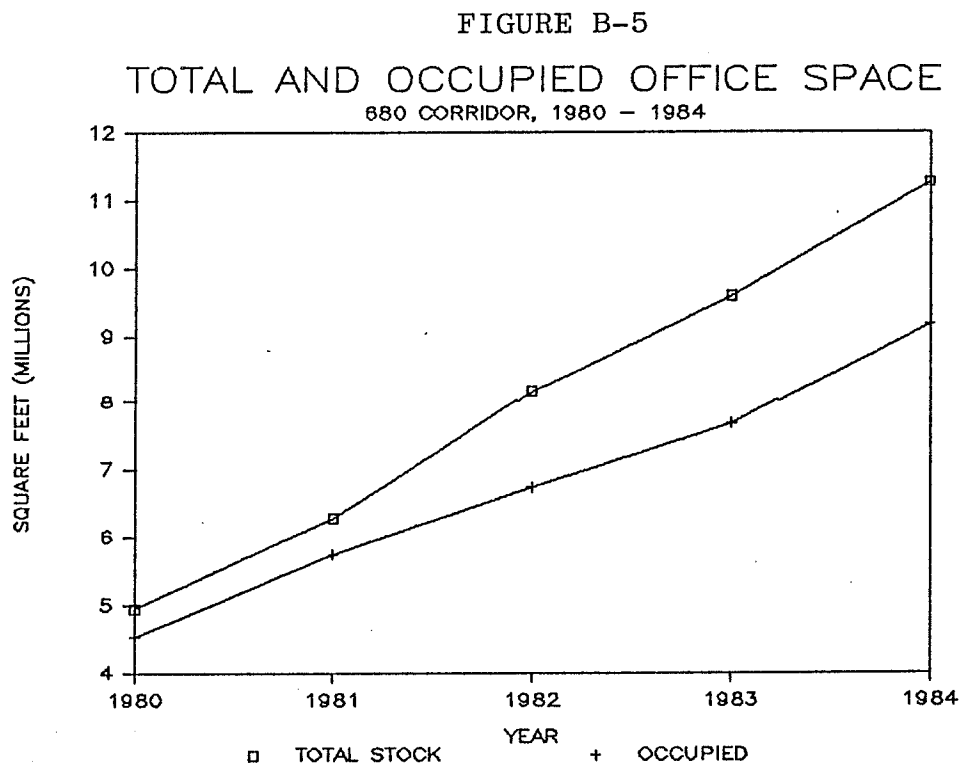


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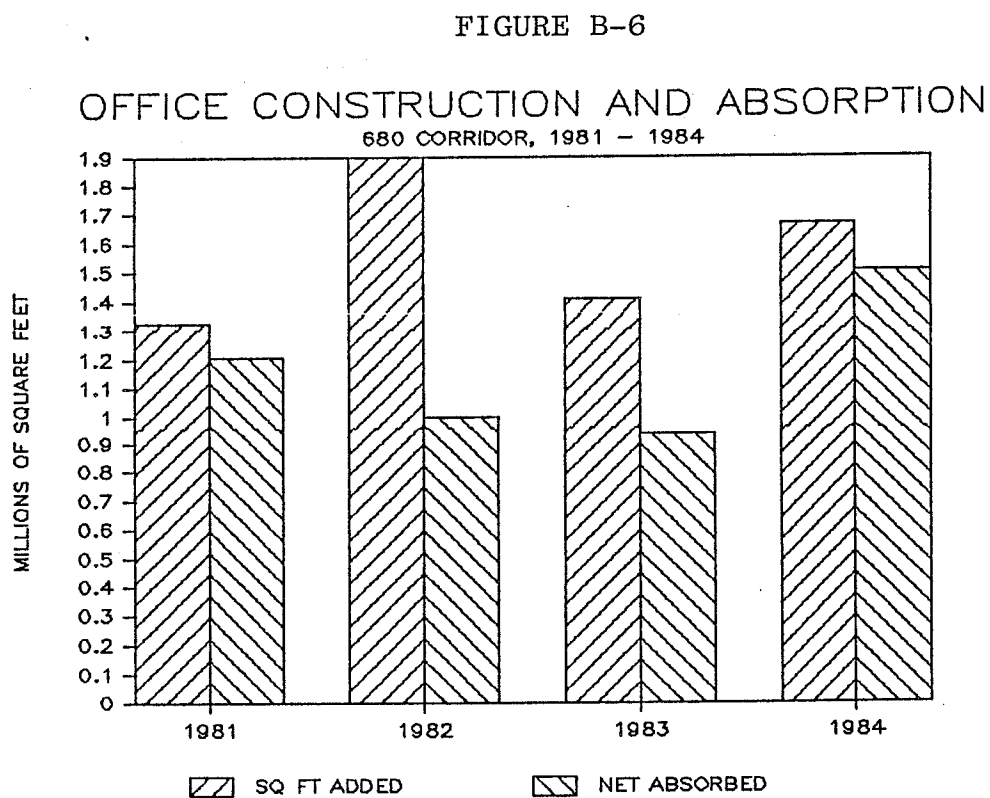
TABLE B-3: OFFICE BUILDING ACTIVITY ALONG THE ALAMEDA - CONTRA COSTA 680 CORRIDOR

	1980	1981	1982	1983	1984
TOTAL INVENTORY OF OFFICE SPACE (MILLIONS OF SQ.FT.)	5.0	6.3	8.2	9.6	11.3
ADDED DURING THE YEAR (MILLIONS OF SQ.FT.)	1.1	1.3	1.9	1.4	1.7
VACANT SPACE (MILLIONS OF SQ.FT.)	0.4	0.5	1.4	1.9	2.1
VACANCY RATE	8.40%	8.60%	17.60%	20.00%	18.50%
ABSORPTION (MILLIONS OF SQ.FT.)	0.8	1.2	1.0	0.9	1.5
RENT RANGE (\$/SQ.FT.)	\$1.01 Wt.Avg.	\$1.28 Wt.Avg.	\$1.43 Wt.Avg.	\$1.22 \$1.81	\$1.11 \$1.76

Source: Coldwell Banker, and Cynthia Kroll, Employment Growth and Office Space Along the 680 Corridor: Booming Supply and Potential Demand, Working Paper 84-75, Center for Real Estate and Urban Economics, University of California at Berkeley, February 1984



Source: CREUE



Source: CREUE

TABLE B-4: OFFICE BUILDING ACTIVITY IN ALAMEDA COUNTY*

	1980	1981	1982	1983	1984
TOTAL INVENTORY OF OFFICE SPACE (MILLIONS OF SQ.FT.)	8.7	9.6	11.4	15.0	16.8
ADDED DURING THE YEAR (MILLIONS OF SQ.FT.)	N/A	1.0	1.8	3.6	3.0
VACANT SPACE (MILLIONS OF SQ.FT.)	0.6	1.0	1.9	1.7	3.0
VACANCY RATE	7.20%	10.10%	16.80%	11.20%	17.90%
ABSORPTION** (MILLIONS OF SQ.FT.)	0.5	0.6	0.8	3.8	0.5
RENT RANGE (\$/SQ.FT.)	N/A	N/A	N/A	\$1.35	\$1.25 \$1.50

* Excludes 680 portion of Alameda County

** Net absorption (i.e. the difference between space occupied in the present year and space occupied in the previous year.

N/A Not available.

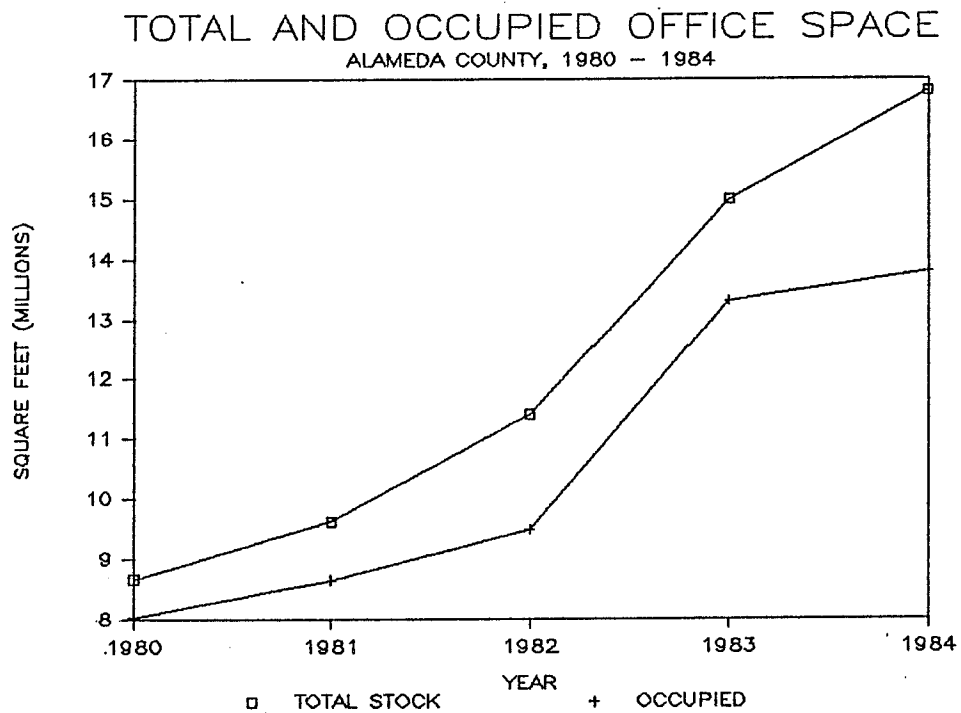
Source: Coldwell Banker and Grubb & Ellis

TABLE B-5: OFFICE BUILDING ACTIVITY IN OAKLAND

	1980	1981	1982	1983	1984
TOTAL INVENTORY OF OFFICE SPACE (MILLIONS OF SQ.FT.)	7.3	8.4	9.1	9.2	10.5
ADDED DURING THE YEAR (MILLIONS OF SQ.FT.)	-----	1.0	0.7	0.1	1.3
VACANT SPACE (MILLIONS OF SQ.FT.)	0.6	1.2	1.4	1.1	1.8
VACANCY RATE	7.63%	14.12%	15.30%	11.79%	17.20%
ABSORPTION (MILLIONS OF SQ.FT.)	0.3	0.4	0.5	0.4	0.6
RENT RANGE (\$/SQ.FT.)	\$0.58 \$2.00	\$0.70 \$2.50	\$0.75 \$2.60	\$1.00 \$2.25	\$1.00 \$2.50

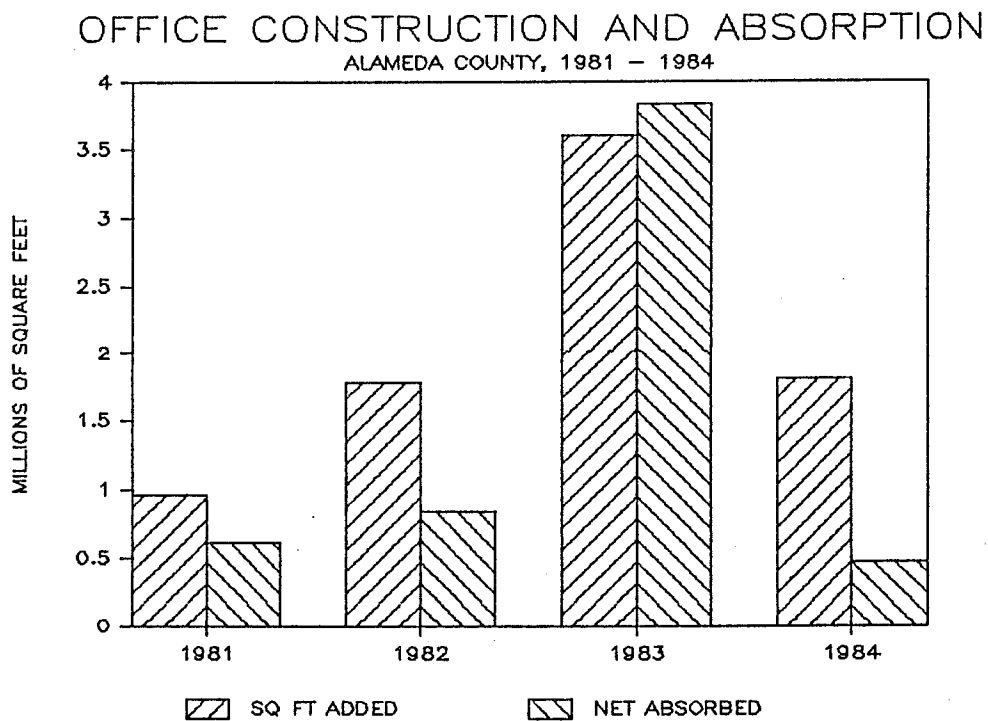
Source: Oakland Chamber of Commerce and Coldwell Banker

FIGURE B-7



Source: CREUE

FIGURE B-8



Source: CREUE

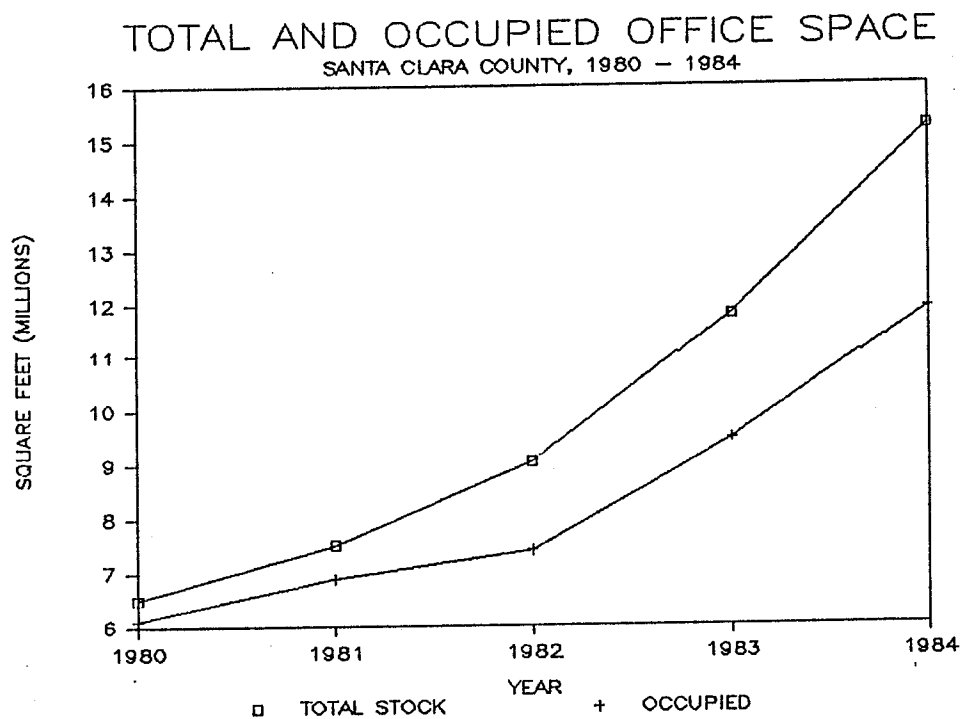
TABLE B-6: OFFICE BUILDING ACTIVITY IN SANTA CLARA COUNTY

	1980	1981	1982	1983	1984
TOTAL INVENTORY OF OFFICE SPACE (MILLIONS OF SQ.FT.)	6.5	7.5	9.0	11.8	15.2
ADDED DURING THE YEAR (MILLIONS OF SQ.FT.)	N/A	1.0	1.5	2.8	3.5
VACANT SPACE* (MILLIONS OF SQ.FT.)	0.4	0.6	1.6	2.4	3.4
VACANCY RATE*	1.00%	8.30%	18.00%	20.00%	22.00%
ABSORPTION (MILLIONS OF SQ.FT.)	N/A	0.8	0.5	2.0	2.5
RENT RANGE (\$/SQ.FT.)	N/A	N/A	\$1.40 \$1.95	\$1.50 \$2.20	\$1.45 \$2.25

* Vacancy estimates are a composite estimate developed by CREUE staff. Estimates ranged widely from different sources; rates in 1984, for example, ranged from 11% to 35%.
N/A Not available.

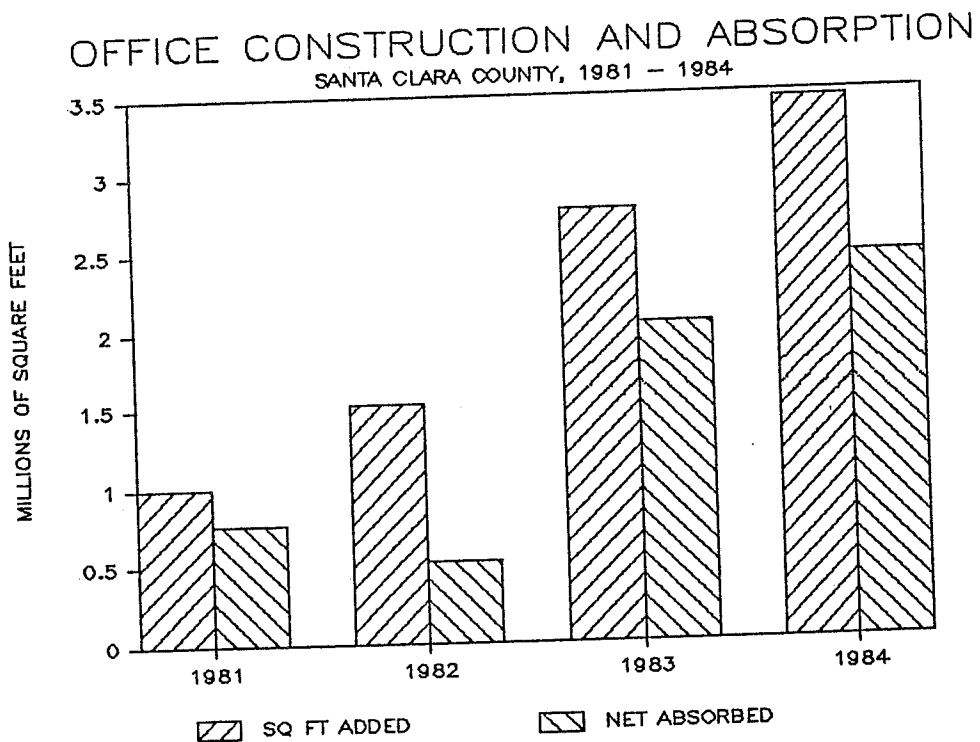
Source: Grubb & Ellis, South Bay Forecast, Cushman and Wakefield, Coldwell Banker, and MacMillan, Moore & Buchanan.

FIGURE B-9



Source: CREUE

FIGURE B-10



Source: CREUE

APPENDIX C
OFFICE BUILDING ACTIVITY SACRAMENTO COUNTY

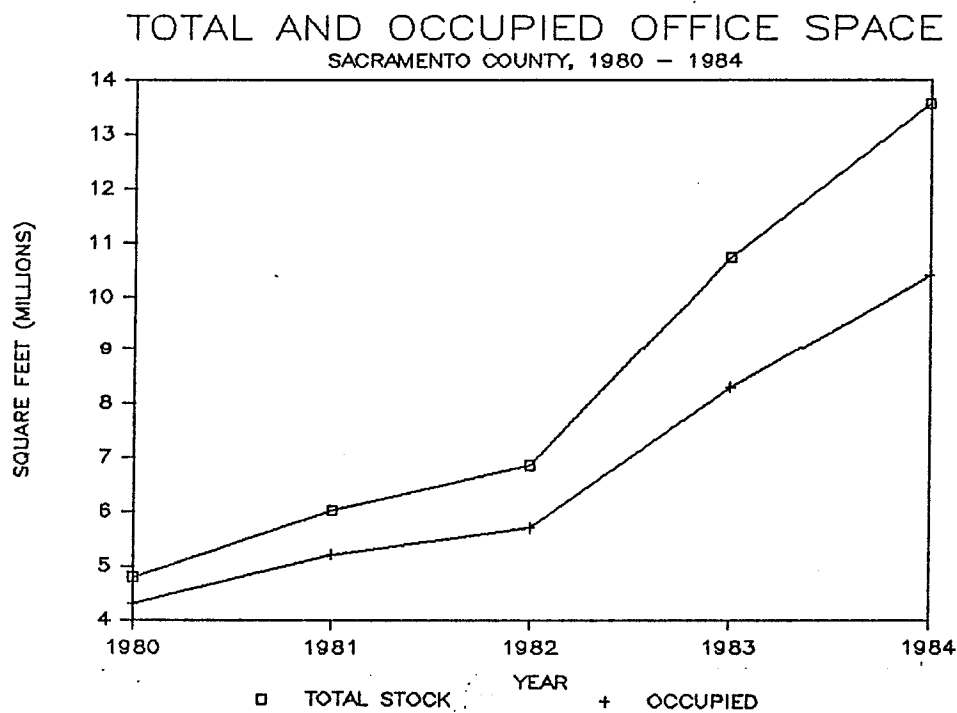
TABLE C-1: OFFICE BUILDING ACTIVITY IN SACRAMENTO COUNTY

	1980	1981	1982	1983	1984
TOTAL INVENTORY OF OFFICE SPACE (MILLIONS OF SQ.FT.)	4.8	6.0	6.9	10.7	13.6
ADDED DURING THE YEAR (MILLIONS OF SQ.FT.)	N/A	1.2	0.8	3.9	2.8
VACANT SPACE (MILLIONS OF SQ.FT.)	0.5	0.8	1.2	2.5	3.2
VACANCY RATE	10.00%	13.20%	16.80%	22.90%	23.30%
ABSORPTION* (MILLIONS OF SQ.FT.)	0.5	0.9	0.5	2.6	2.1
RENT RANGE (\$/SQ.FT.)	N/A	\$1.45 \$1.65	\$1.45 \$1.65	\$1.45 \$1.65	\$1.45 \$1.65

* Net absorption (i.e. the difference between space occupied in the present year and space occupied in the previous year.
N/A Not available.

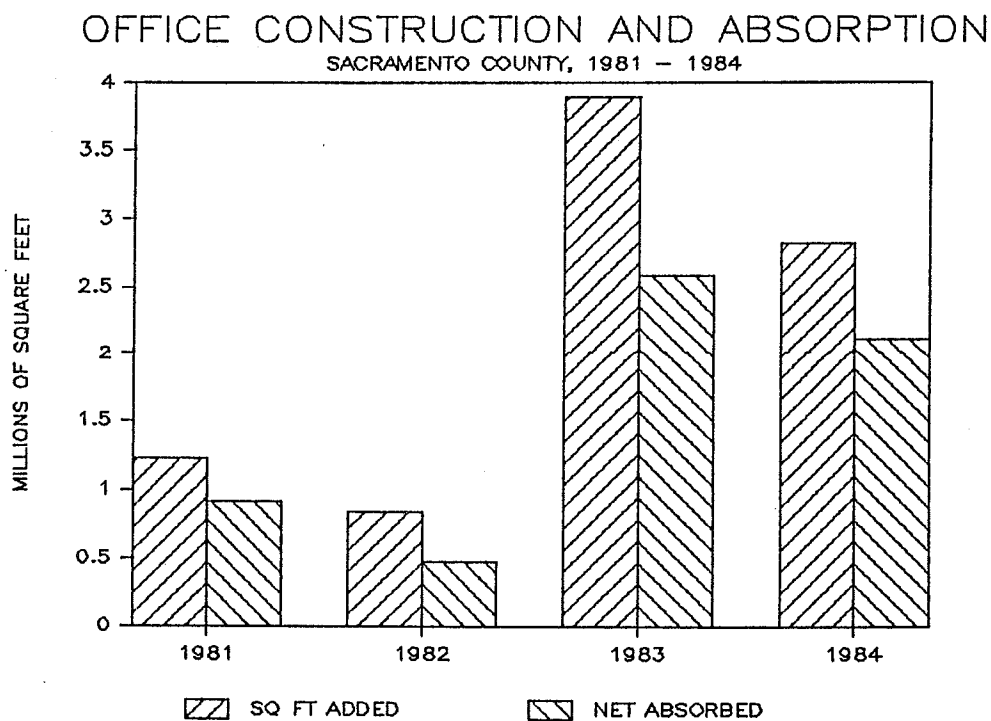
Source: Coldwell Banker

FIGURE C-1



Source: CREUE

FIGURE C-2



Source: CREUE