

Redevelopment craze

Along the I-15 corridor, office building projects abound where industrial structures once rose

By Mike Freeman
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The transformation taking place in Rancho Bernardo's business community might best be seen at the corner of West Bernardo Drive and Via Del Campo.

From there, you can see the nearly empty site where Sony Electronics manufactured TV picture tubes for more than 30 years. The hulking, low-rise manufacturing plant was mostly torn down last year after Sony shut down the operation.

Across the street, Sony plans to build an 11-story headquarters office building in what is now a parking lot. The \$150 million building will house executives, marketing staff and product development engineers for the Japanese giant's U.S. electronics division.



CRISSY PASCUAL / Union-Tribune
Kilroy Realty is putting up a six-story, 140,915-square-foot building off I-15 and state Route 56 to complete a three-building campus.

Just east of Sony, three office buildings have gone up where ST Microelectronics used to assemble circuit boards. ST Micro's vacant plant was torn down more than a year ago. Menlo Equities of Newport Beach bought the site and constructed about 250,000 square feet of office buildings – two thirds of which have been leased to Irvine-based Broadcom, a designer of wireless chips.

The projects highlight an evolution unfolding in Rancho Bernardo and the Interstate 15 corridor. Developers are setting their sights on older industrial buildings with an eye toward tearing them down to make way for sleek new offices. Consider:

- Kilroy Realty, a Los Angeles real estate investment trust, purchased the 20-acre Unisys site in Rancho Bernardo after Unisys moved its operations to Orange County. Kilroy plans to raze the Unisys plant and construct 600,000 square feet of office space in three buildings ranging from six to 10 stories.
- Jay Paul, a Bay Area developer, has amassed 105 acres in Rancho Bernardo. It plans to tear down several old buildings over time and construct 11 new offices, ranging from five

to nine stories. The project could total 3.2 million square feet.

■Menlo Equities has purchased an industrial building constructed in the 1970s at 16798 W. Bernardo Drive with plans to eventually raze the structure to build a five-story office.

They aren't alone. Developers have planned or proposed more than 6 million square feet of office buildings in the I-15 corridor – a 75 percent increase from the current 8 million square feet that exist there today.

Although the development won't occur at once, it marks a transition away from Rancho Bernardo's roots in technology and defense manufacturing.

“I think, other than General Atomics, manufacturing is not coming back,” said Chris Pascale, a broker with CB Richard Ellis who works in the I-15 corridor. “San Diego has evolved into more of an innovation, entrepreneurial design center. So the type of buildings these guys need to operate is changing. It's not the large, expansive industrial facility for manufacturing. It's offices for engineers.”

Rancho Bernardo and some other parts of the I-15 corridor lend themselves to this transition in part because land-use rules allow mid-rise offices.

Moreover, road improvements along I-15 and state Route 56, make University City, for example, make the area easy to access from the coast, where many executives live, and from work force housing in Poway, Scripps Ranch, Temecula and developing neighborhoods of 4S Ranch and Black Mountain Ranch.

This is not the first time that old industrial buildings have been redeveloped in San Diego County. In the mid 1990s, Lennar purchased the sprawling General Dynamics aircraft manufacturing plant in Kearny Mesa and redeveloped it into both residential and commercial projects.

What makes the redevelopment taking place in Rancho Bernardo different is that it's not being driven by economic stress, such as the collapse of a major company's local operation.

Instead, it's being driven by a shortage of land.

Developers are betting that a lack of land elsewhere in the county – particularly for large corporate campuses – will drive more of the region's growing technology and software companies to Rancho Bernardo and the I-15 corridor.

“For large companies, there aren't any places for them to go anymore as Qualcomm eats up space in



Sony's 11-story office tower will be the headquarters of its U.S. electronics division.



The 108,844-square-foot Pinnacle Executive Center is mostly vacant and available for lease.



Developer Jay Paul is about to break ground on the first three of 11 buildings it plans.

Sorrento Mesa,” said Marc Posthumus, an associate vice president with Burnham Real Estate Services.

So far, there hasn't been a significant migration of tech companies to the I-15 area . For much of the past year, demand for office space in the corridor has been weak.

The area's office vacancy rate hovered near 20 percent in the second quarter – above the countywide average. The average amount of time that lease space has been on the market in the I-15 corridor area is 31 months, the highest in the county, said David Marino, a principal with tenant broker Irving Hughes.

“I-15 is a mess,” Marino said. “It's a market that's been tough for two years now. I don't know where guys like Jay Paul think they're going to find tenants.”

Posthumus counters that demand has picked up recently. A company in University City, for example, is looking along the I-15 corridor for a 600,000-square-foot campus.

“They're coming from UTC because they can't find 600,000 square feet of contiguous space that's not separated by a street,” Posthumus said. “That's a perfect example of a company that needs a large corporate campus but can't find it in the central (city) market.”

Of all the developers considering the I-15 corridor, Jay Paul's bet is probably the biggest. The company spent \$145 million acquiring the 105 acres in Rancho Bernardo.

While Jay Paul's site is in a good location, it will face competition from projects that are perhaps in better locations, brokers say.

Kilroy Realty, for example, has concentrated much of its land acquisition and office construction along Route 56 for easy access to the coast. Its Kilroy Sabre Springs project – a six-story, 140,000-square-foot building now under construction – is at the junction of the Route 56 and I-15.

Still, Jay Paul has high hopes for its property, said Matt Lituchy, chief investment officer.

“It's one of the few remaining parcels of corporate headquarters land in San Diego County, and perhaps in all of Southern California, that is still an infill location,” Lituchy said.

The company isn't wasting any time in getting started. It will break ground this month on three buildings: a 185,000-square-foot office, a 220,000-square-foot office and 40,000-square-foot amenities building with a gym, lap pool and other services.

“We just love the transportation corridor and the improvements on the I-15,” Lituchy said. “It has great access for both executive and employee housing. It's an area that's going through some transition from manufacturing to research and development and general office use.”

Looking to diversify its holdings outside of the Bay Area, the company began searching for “high-growth, technology-oriented markets” to acquire property a few years ago, Lituchy said. It looked at Phoenix, Orange County, west Los Angeles and Seattle before

focusing on San Diego.

Jay Paul may have already suffered a bit of a setback here. Sony Electronics talked with the company about being the first tenant in its project. But in the end Sony decided to build its 450,000-square-foot headquarters itself on land it already owns rather than lease space.

“While we would have liked having them, the fact that they're next door is a good thing,” Lituchy said. “We believe they're here for the long run and they're going to grow. I think they'll end up coming to us at some point down the road for some of their capacity needs.”

Brokers say the developers in the area are likely to face a couple of hurdles in leasing their projects – at least in the short term.

Although the area boasts an impressive roster of technology companies, including Sony, Hewlett-Packard, NCR/Teradata and Cymer, most already own their buildings. So the base of tenants that lease space in the area is smaller than it might first appear.

New office buildings also are likely to have higher rents than existing buildings. Some brokers question whether tenants in Rancho Bernardo, particularly defense companies, will be willing to pay those prices.

“The I-15 is a market where tenants are used to paying \$2-per-square-foot rents,” said Marino, the Irving Hughes broker. “With these new buildings, they're going to be asking \$3 or \$3.50 rents. Those are not the type of tenants that are out on the I-15 corridor. It's a very thin market of companies that are going to entertain rents starting at \$3.”

Other brokers contend that tenants looking for space along the I-15 corridor today are currently leasing in Carmel Valley or University City, where rents already are more than \$3 per square foot and rising.

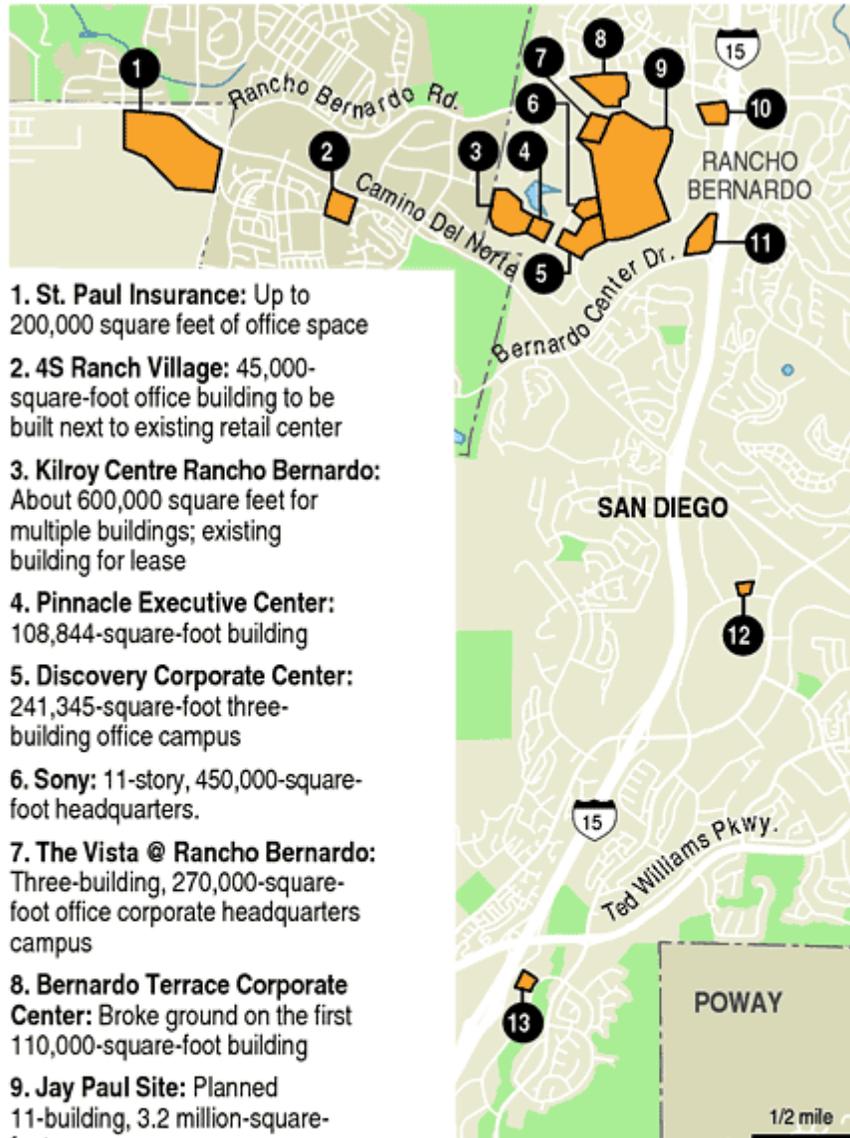
They also speculate that developers such as Jay Paul, which already lease space to major tech companies in their Bay Area projects, might be able to get proposals in front of tenants from outside the area.

“We may need a new name in town, a new big name” to fill some of the proposed developments, said Tom Van Betten, a vice president with Burnham Real Estate. “Jay Paul has developed large corporate campuses before. Maybe they have relationships. I think they have a vision for San Diego.”

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I-15 corridor projects

Properties planned, proposed or under construction.



1. St. Paul Insurance: Up to 200,000 square feet of office space

2. 4S Ranch Village: 45,000-square-foot office building to be built next to existing retail center

3. Kilroy Centre Rancho Bernardo: About 600,000 square feet for multiple buildings; existing building for lease

4. Pinnacle Executive Center: 108,844-square-foot building

5. Discovery Corporate Center: 241,345-square-foot three-building office campus

6. Sony: 11-story, 450,000-square-foot headquarters.

7. The Vista @ Rancho Bernardo: Three-building, 270,000-square-foot office corporate headquarters campus

8. Bernardo Terrace Corporate Center: Broke ground on the first 110,000-square-foot building

9. Jay Paul Site: Planned 11-building, 3.2 million-square-foot campus

10. Boardwalk: 22,818-square-foot office building

11. Zimmer Site: Possible 150,000-square-foot office building

12. Innovation Corporation Center: 150,177-square-foot-medical building

13. Kilroy Sabre Springs: Constructing 140,915-square-foot office building.



SOURCES: Burnham Real Estate; SanGIS

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