

TIGHT MARKET. The San Diego Flex R&D market fundamentals continued to remain tight at the finish of the third quarter of 2017, with low availability, strong demand, and a moderate supply in the construction pipeline. Moreover, with the steady pace of job growth in the biotech and life sciences industries that drive the Flex/R&D market in San Diego, the market should continue to grow at a slow but steady pace.

VACANCY. Direct/sublease space (unoccupied) finished the first quarter at 6.97%, a decrease of 14.81% when compared with the same time last year, and a decrease of more than 50% from 2010's recession low of 16.12%.

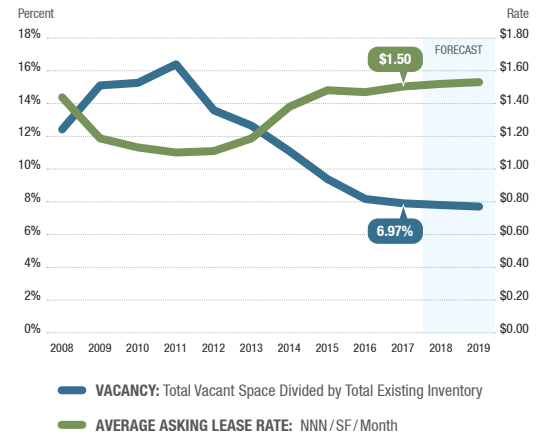
LEASE RATES. The average asking triple net lease rate per square foot per month in San Diego County was \$1.50 at the end of the third quarter, which is an increase from last quarter's rate of \$1.46. Although a dip in price occurred this quarter, the average asking lease rates have risen a full forty cents since the recession lows seen in the first and second quarters of 2011, and are still continuing an upward long-term trend.

TRANSACTION ACTIVITY. The combined amount of square feet leased or sold in the third quarter totaled 2.4 million square feet, which is roughly double the 1.2 million square feet transacted in the second quarter. This statistic can have some lag time in being reported, so look for this quarter's figures to end up somewhat higher in the next report.

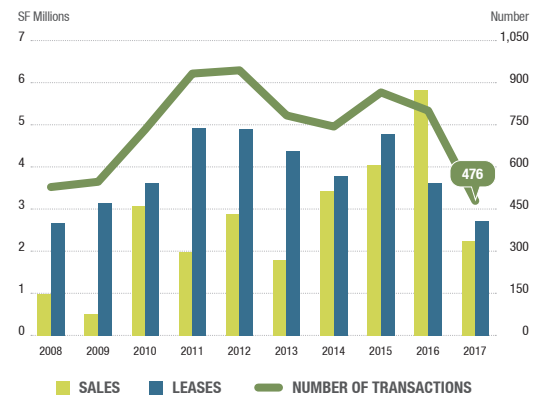
EMPLOYMENT. The unemployment rate in San Diego County was 3.6% in May 2017, down from a revised 3.8% in April 2016 and below the year-ago estimate of 4.3%. This compares with an unadjusted unemployment rate of 4.2% for California and 4.1% for the nation during the same period. According to the State of California Employment Development Department, San Diego County gained 20,300 payroll jobs between May 2016 and May 2017, including 6,000 from government services, which reported the largest overall gain. The construction sector reported a growth of 5,000 jobs, and the educational and health services reported an increase of 3,900 jobs.

OVERALL. The San Diego Flex R&D market remains strong through three quarters of 2017, but as the life science and biotech sectors continue to be a major driver in San Diego's economy, the market will continue to grow at a steady pace. Because this booming industry targets space in San Diego specifically, there will be ongoing construction and new deliveries in response to the demand, and this will contribute to the slow uptick in availability in the coming future.

VACANCY vs. AVERAGE ASKING LEASE RATE



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



Market Statistics

	Change Over Last Quarter	3Q 2017	2Q 2017	3Q 2016	% Change Over Last Year
Vacancy Rate	▼ DOWN	6.97%	7.69%	8.19%	(14.81%)
Availability Rate	▼ DOWN	10.61%	11.92%	12.96%	(18.14%)
Average Asking Lease Rate	▲ UP	\$1.50	\$1.46	\$1.47	2.04%
Sale & Lease Transactions	▲ UP	2,427,075	1,270,973	1,692,542	43.40%
Gross Absorption	▬ FLAT	1,009,857	1,063,689	861,353	17.24%
Net Absorption	▲ POSITIVE	171,077	578,207	224,992	N/A

EMPLOYMENT. The labor market in San Diego County will continue to improve, although we anticipate job growth to slow to 1.8%, or 25,000 jobs, over the year. With an expected growth in tourism and the local economy in general, look for sectors like leisure and hospitality to lead the way for employment gains, followed by health care and biotech, and government employment.

CONSTRUCTION. Construction in the Flex/R&D sector has been largely concentrated in the biotech subset of properties. For the remainder of the Flex/R&D market, there has been remarkably little new construction. We expect this to change with the “creative industrial” trend migrating into the Flex/R&D market.

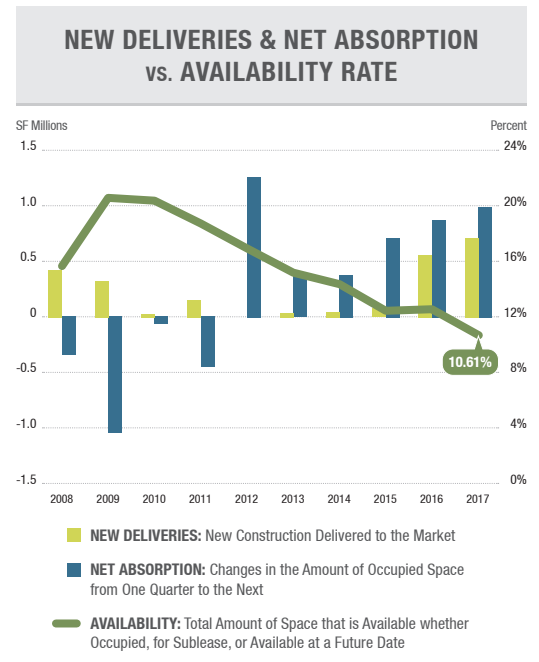
LEASE RATES. Expect average asking rates to increase by approximately 2–3% over the next four quarters.

VACANCY. With new deliveries hitting the market this year, we anticipate vacancy rates to tick up slightly in the coming quarters, to the 7–8% range during 2018.

CONSTRUCTION. Through the first three quarters of 2017, 707,341 square feet of new Flex and R&D product has been completed, which surpasses the annual total of every year since 2006. At the end of the third quarter, there were 326,523 square feet under construction in San Diego County’s flex market. Notably, Kearny Mesa has 156,000 under construction, and over 400,000 square feet of Flex/R&D properties under renovation. This relatively large amount of Kearny Mesa construction in the Flex/R&D sector is in contrast to almost no office or industrial construction in Kearny Mesa, one of the most centrally located areas of the county.

AVAILABILITY. Direct/sublease space being marketed was 10.61% at the end of the quarter, an 8.14% decrease from the previous year’s rate of 12.96%.

ABSORPTION. The San Diego Flex R&D market has reached 1 million square feet of positive net absorption through the first three quarters of 2017, for a total of 4.6 million square feet of positive net absorption since the start of 2010.



Significant Transactions

Sales						† Estimated allocation from portfolio sale	* Voit Real Estate Services Deal
Property Address	Submarket	Square Feet	Sale Price	Buyer	Seller		
2855 Gazelle Ct.	Carlsbad	176,000	\$79,400,000	Ionis Pharmaceuticals	BioMed Realty		
10390–10455 Pacific Center Ct.	Sorrento Mesa	384,558	\$66,500,000 †	City Office REIT, Inc.	Kilroy Realty Corporation		
10450 Pacific Center Ct.	Sorrento Mesa	134,000	\$44,000,000	Crown Realty & Development	Gramercy Property Trust		
6759–6779 Mesa Ridge Rd.	Sorrento Mesa	133,841	\$20,100,000	Jewell Capital, LLC	CW Capital Asset Management		
8825 & 8875 Aero Dr.	Kearny Mesa	140,470	\$18,500,000	Protea Properties *	LNR Partners, LLC *		

Leases						* Voit Real Estate Services Deal
Property Address	Submarket	Square Feet	Transaction Date	Tenant	Owner	
7475 Lusk Blvd.	Sorrento Mesa	252,000	Aug-2017	Nuvasive	HCP	
16550 Via Esprillo	Rancho Bernardo	180,946	Jul-2017	Amazon	Greenlaw Partners	
5935 Darwin Ct.	Carlsbad	52,260	Aug-2017	Reef	Pacific Development Partners	
10170 Sorrento Valley Rd.	Sorrento Valley	40,811	Jul-2017	Lighthouse Strategies	CIRE Partners	
3912 Calle Fortunada	Kearny Mesa	36,673	Aug-2017	Maxwell Technology	Calle Fortunada Invs Group, LLC *	

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 3Q2017	Square Feet Available	Availability Rate 3Q2017	Average Asking Lease Rate	Net Absorption 3Q2017	Net Absorption 2017	Gross Absorption 3Q2017	Gross Absorption 2017
Central													
Central City	15	175,224	0	0	9,442	5.39%	9,442	5.39%	–	0	466	3,118	9,731
East City	2	26,892	0	0	0	0.00%	0	0.00%	–	0	0	0	0
Southeast City	17	197,755	0	0	0	0.00%	0	0.00%	–	5,000	5,000	5,000	5,000
Kearny Mesa	204	5,518,640	156,000	0	631,986	11.45%	667,011	12.09%	\$1.39	(337,657)	(375,263)	49,081	198,061
Mission Gorge	29	287,556	0	0	15,210	5.29%	32,393	11.26%	\$1.63	(244)	5,715	5,321	17,815
Rose Canyon/Morena	38	609,335	0	0	18,546	3.04%	28,756	4.72%	\$1.07	4,080	14,988	14,343	48,946
Sports Arena/Airport	30	380,720	0	0	0	0.00%	0	0.00%	–	0	1,350	0	1,350
Miramar	218	4,702,558	0	141,760	335,271	7.13%	528,413	11.24%	\$1.33	64,537	3,745	125,374	293,426
Sorrento Mesa	159	5,925,069	0	646,000	507,217	8.56%	678,993	11.46%	\$1.83	70,339	194,490	121,763	327,109
Sorrento Valley	102	2,353,949	0	0	197,889	8.41%	337,823	14.35%	\$1.75	21,319	(21,715)	60,845	142,332
Torrey Pines/UTC	72	6,131,902	170,523	641,463	616,015	10.05%	853,659	13.92%	\$3.29	(36,945)	593,268	4,980	405,927
Central County Total	886	26,309,600	326,523	1,429,223	2,331,576	8.86%	3,136,490	11.92%	\$1.66	–209,571	422,044	389,825	1,449,697
East County													
El Cajon	77	851,324	0	0	2,590	0.30%	2,590	0.30%	\$0.85	(920)	15,799	520	32,775
La Mesa/Spring Valley	39	306,088	0	0	11,793	3.85%	10,668	3.49%	–	4,632	(368)	10,000	15,118
Santee/Lakeside	54	564,061	0	0	3,308	0.59%	6,212	1.10%	–	0	0	3,212	3,212
Outlying SD County S	20	78,080	0	0	0	0.00%	0	0.00%	\$1.10	0	0	410	2,010
East County Total	190	1,799,553	0	0	17,691	0.98%	19,470	1.08%	\$0.88	3,712	15,431	14,142	53,115
North County													
Escondido	80	752,671	0	0	12,619	1.68%	14,952	1.99%	\$1.23	3,253	41,796	4,418	50,338
Oceanside	33	985,977	0	0	32,963	3.34%	40,486	4.11%	–	1,080	(15,019)	3,313	12,533
San Marcos	59	1,053,462	0	0	49,184	4.67%	97,398	9.25%	\$1.04	23,984	29,519	31,164	70,944
Vista	62	1,393,694	0	0	78,374	5.62%	106,202	7.62%	\$1.20	(7,883)	(15,815)	16,729	70,341
Carlsbad	250	6,163,573	0	146,108	500,552	8.12%	776,022	12.59%	\$1.35	123,234	121,415	224,145	491,589
North Beach Cities	18	155,333	0	0	2,592	1.67%	2,835	1.83%	\$1.95	(1,677)	(1,712)	0	1,480
Outlying SD County North	18	139,412	0	0	0	0.00%	6,200	4.45%	–	500	1,796	500	1,796
North County Total	520	10,644,122	0	146,108	676,284	6.35%	1,044,095	9.81%	\$1.32	142,491	161,980	280,269	699,021
I–15 Corridor													
Poway	60	1,505,288	0	0	39,531	2.63%	66,580	4.42%	\$1.39	15,568	78,287	28,305	158,774
Rancho Bernardo	93	4,527,959	0	0	138,289	3.05%	378,019	8.35%	\$1.64	195,703	253,032	211,177	683,194
Scripps Ranch	27	713,377	0	233,741	10,214	1.43%	17,104	2.40%	\$1.33	0	11,794	18,732	40,740
I–15 Corridor Total	180	6,746,624	0	233,741	188,034	2.79%	461,703	6.84%	\$1.61	211,271	343,113	258,214	882,708
South County													
Chula Vista	81	1,453,288	0	0	56,109	3.86%	174,379	12.00%	\$1.28	20,318	3,861	53,358	77,466
National City	23	303,615	0	0	8,032	2.65%	12,925	4.26%	\$1.75	2,856	893	14,049	19,174
Otay Mesa	9	215,354	0	256,022	37,594	17.46%	141,443	65.68%	\$0.65	0	47,313	0	47,313
San Ysidro/Imperial Beach	4	81,972	0	0	960	1.17%	55,960	68.27%	–	0	(960)	0	0
South County Total	117	2,054,229	0	256,022	102,695	5.00%	384,707	18.73%	\$0.73	23,174	51,107	67,407	143,953
San Diego County Total	1,893	47,554,128	326,523	2,065,094	3,316,280	6.97%	5,046,465	10.61%	\$1.50	171,077	993,675	1,009,857	3,228,494

Lease rates are on a triple-net basis.



Market Adapting to Tight Conditions

by **Brandon Keith**

SENIOR VICE PRESIDENT / PARTNER, SAN DIEGO

The San Diego industrial market has been at or near all-time highs for rental rates, and all-time lows for vacancy for the past couple years. In some central county areas, rental rates for the most desirable R&D properties can be higher than even some Class B office rates. The market has been reacting to these conditions in a number of ways.

While landlords have been aggressive on face rents for some time now, well positioned properties are really pulling back on offering much in the way of tenant improvement allowance or free rent. In many parts of the county, tenants may be fortunate to get two months of rental abatement on a five-year lease and may be more likely to receive just one month of rental abatement or 30–45 days of early occupancy with no rental abatement. In the central county submarkets, landlords can now be more selective when it comes to which tenant they ultimately bring into their property. Landlords are taking a harder look at tenant credit and giving preference to tenants that have cleaner and less intense uses.

Tenants have been dealing with these tight market conditions in their own ways. Higher clear height has become more and more of a priority as companies try to maximize the efficiency by utilizing more cubic feet of volume, and getting all they can out of their space. Increasingly, parking has become a focus for industrial tenants as another way to get everything they can out of the smallest footprint possible, with rental rates being so high. In this market, many if not most tenants are renewing their lease in their existing location, due to very few alternatives, unless business conditions are requiring a relocation.

The tight conditions are not limited to the central county areas alone. Good luck to you if you need space in Escondido, El Cajon, or National City. Even Otay Mesa has a dearth of options for many size ranges, which was almost unimaginable just a few years back. The northwest corner of the county is the only area where there has been any significant level of new development. Fundamentals have been steadily increasing in Carlsbad, Oceanside, and Vista, but the current wave of new deliveries is making conditions less lopsided in the landlord's favor in those areas.

There will always be pockets where one size range of availabilities has more competition, or a spate of new construction can soften the landlords' control on the area to some extent, but overall the San Diego industrial market is not conducive to significant new industrial development. As long as the economy remains on solid ground, the overall San Diego industrial market will remain tight, with no major change on the immediate horizon.

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This survey consists of properties representing both single tenant and multi-tenant buildings. The lease rates are based on a triple-net basis. The information contained in this report is gathered from sources that are deemed reliable, but no guarantees are made as to its accuracy. This information is for Voit Real Estate Services' use only and cannot legally be reproduced without prior written consent from the management of Voit Real Estate Services. ©2017 Voit Real Estate Services, Inc. License #01991785.

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Product Type

MFG./DIST.: Flex/Research and Development (R&D) buildings can be one story, one story with a mezzanine, and two story built-out structures with a high ratio of window wall to floor area with lower ceilings. They generally have over 50% built-out office space or laboratory use, with the remaining space being utilized as light manufacturing or warehousing. In addition, the parking ratio must be at least 3 spaces or greater per 1,000 square feet.

Submarkets

CENTRAL COUNTY

Central City, East City, Southeast City, Kearny Mesa, Mission Gorge, Rose Canyon/Morena, Sports Arena/Airport, Miramar, Sorrento Mesa, Sorrento Valley, Torrey Pines/UTC

EAST COUNTY

El Cajon, La Mesa/Spring Valley, Santee/Lakeside

NORTH COUNTY

Escondido, Oceanside, San Marcos, Vista, Carlsbad, North Beach Cities, Outlying SD County North

I-15 CORRIDOR

Poway, Rancho Bernardo, Scripps Ranch

SOUTH BAY

Chula Vista, National City, Otay Mesa, San Ysidro/Imperial Beach, Outlying SD County South