

**HOLDING STEADY.** The office market continues to show a balance in availability and demand. The overall vacancy rate of 10.4% is flat year over year, as lease rates continue to press upward, and the gap between availability and vacancy narrows, with availability dipping to the lowest level in over a decade, at 12.9%.

**VACANCY.** Direct/sublease space (unoccupied) finished the quarter at 10.44%, unchanged from the vacancy level seen a year prior in the first quarter of 2017, but still well below the last peak of 16.1% seen in 2009. Kearny Mesa posted the lowest vacancy rate of any major submarket (minimum of four million square feet of inventory) at 6.17%.

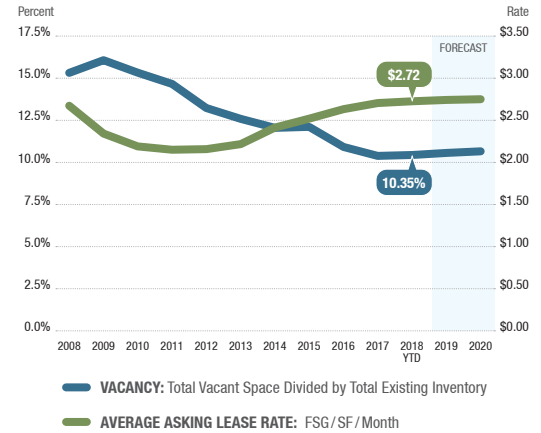
**LEASE RATES.** The average asking full-service gross (FSG) lease rate per square foot per month in San Diego County was \$2.72 at the end of the first quarter, a two cent increase over the previous quarter's rate, and an annual increase of 3.4% from 2017's first quarter rate of \$2.63. The overall average asking rate in San Diego County has increased 27% since 2011.

**TRANSACTION ACTIVITY.** Sale and lease transactions totaled 3 million square feet in the first quarter, a decrease from the 3.7 million square feet which transacted in the first quarter of 2017. AbacusNext leased the 65,000 square foot Eastgate Summit office building which has been vacant since The Irvine Company completed construction of the building in 2016. The transaction activity statistic can have some lag time in being reported, so look for figures to end up even higher in the next report.

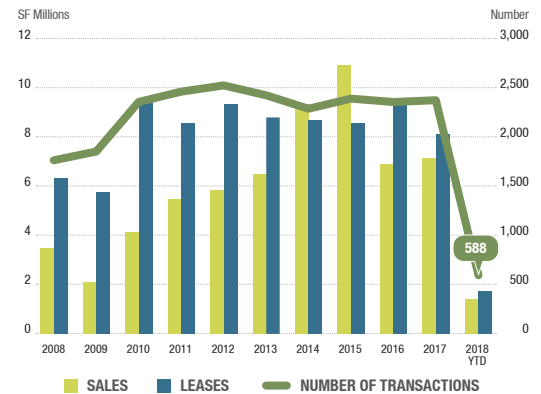
**EMPLOYMENT.** The unemployment rate in San Diego County was 3.5% in February 2018, down from a revised 3.6% in January 2018, and below the year-ago estimate of 4.4%. This compares with an unadjusted unemployment rate of 4.5% for California and 4.4% for the nation during the same period. According to the State of California Employment Development Department, San Diego County gained 27,900 payroll jobs between February 2017 and February 2018, including 8,700 from professional and business services, which reported the largest overall gain. The educational and health services sector reported a growth of 5,200 jobs, and the construction sector reported an increase of 5,200 jobs.

**OVERALL.** The San Diego office market is steady for now and still showing definite signs of growth, but tenant demand is inconsistent, coming in spurts, as we are in the latter stages of the current recovery. Construction levels of new office product remain very low, as developers continue to focus on repositioning projects. Unemployment rates have continued to trend downward since the peak in January 2010. The stable trend of the increase in jobs and minimal speculative construction will help set the San Diego office market on firm footing.

### VACANCY vs. AVERAGE ASKING LEASE RATE



### TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



### Market Statistics

|                           | Change Over Last Quarter | 1Q 2018   | 4Q 2017   | 1Q 2017   | % Change Over Last Year |
|---------------------------|--------------------------|-----------|-----------|-----------|-------------------------|
| Vacancy Rate              | ■ FLAT                   | 10.44%    | 10.35%    | 10.46%    | (0.12%)                 |
| Availability Rate         | ▼ DOWN                   | 12.91%    | 14.06%    | 13.63%    | (5.27%)                 |
| Average Asking Lease Rate | ▲ UP                     | \$2.72    | \$2.70    | \$2.63    | 3.42%                   |
| Sale & Lease Transactions | ▼ DOWN                   | 2,995,984 | 4,227,100 | 3,693,020 | (18.87%)                |
| Gross Absorption          | ▲ UP                     | 1,994,816 | 1,784,776 | 2,576,778 | (22.58%)                |
| Net Absorption            | ▼ NEGATIVE               | (152,971) | 118,622   | 402,629   | N/A                     |

**EMPLOYMENT.** The labor market in San Diego County will continue to improve, although we anticipate job growth to slow. In 2017 there was a 1.2% increase in total employment, and a 1.0–1.5% increase is projected for 2018. With an expected growth in tourism and 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.

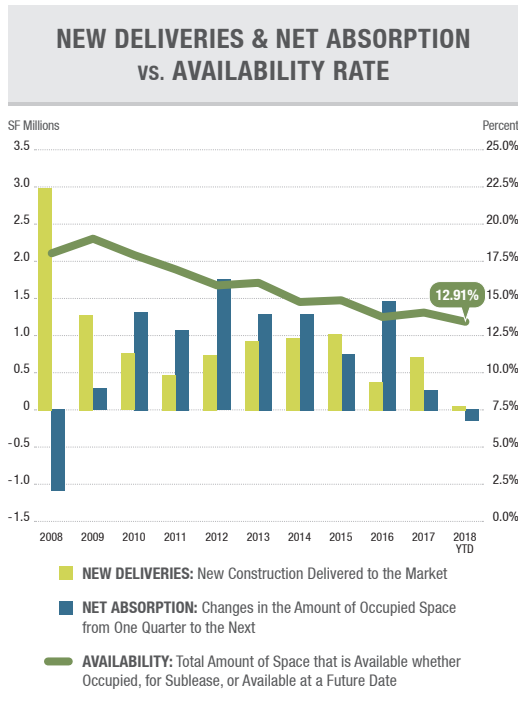
**LEASE RATES.** Expect the average asking lease rate to increase by a moderate 2.0–2.5% over the next four quarters.

**VACANCY.** While landlords were happy to see hundreds of thousands of square feet absorbed by co-working companies in the past 12–18 months, these new operators in the market will be competing for tenants, and could act as a headwind to future occupancy gains. Conversely, while the overall occupancy level has remained flat, availabilities have seen significant decreases which portends to less pressure on the vacancy rate in the coming quarters. We anticipate the countywide vacancy to remain relatively stable around the 10–11% range.

**CONSTRUCTION.** New office development remains muted, with only 49,000 square feet delivering in the first quarter, which is a pace more than 80% below the ten-year average. The low rate of construction for years has contributed to the significant reduction in vacancy. More office space is coming to market via extensive renovations and the repositioning of older projects. The most notable current example of this is AMP&RSAND, the 340,000 square foot former Union-Tribune headquarters, which is being converted into a creative office project.

**AVAILABILITY.** Direct/sublease space being marketed was 12.91% at the end of the first quarter, a 5.3% decrease from the 13.63% availability rate from one year ago in the first quarter of 2017.

**ABSORPTION.** The San Diego office market started 2018 with 152,971 square feet of negative net absorption in the first quarter, wiping out the nearly equivalent amount of positive net absorption the market posted in the previous quarter. There has been approximately 9 million square feet of positive net absorption for the overall San Diego market since the start of 2010.



Significant Transactions

Sales

| Property Address                       | Submarket                         | Class | Square Feet | Sale Price    | Buyer                          | Seller                     |
|--|-----------------------------------|-------|-------------|---------------|--------------------------------|----------------------------|
| 3570–3580 Carmel Mountain Rd.          | Del Mar Heights/<br>Carmel Valley | A     | 197,832     | \$105,000,000 | The Irvine Company             | PGIM Real Estate           |
| 6310 Greenwich Dr. & 5060 Shoreham Pl. | Governor Park                     | B     | 76,047      | \$21,500,000  | Equinvest Capital              | FPA Multifamily, LLC       |
| 3142–3156 Vista Way                    | Oceanside                         | B     | 69,432      | \$14,940,000  | Pacific Gateway Towers, LLC    | Fenway Properties          |
| 5151 Shoreham Pl.                      | Governor Park                     | B     | 38,679      | \$10,825,000  | Performance Wealth Investments | Palisades Equity Partners  |
| 5125 Convoy St.                        | Kearny Mesa                       | B     | 23,408      | \$8,800,000   | MedMen                         | Apex Investment Group, LLC |

Leases

| Property Address         | Submarket       | Class | Square Feet | Transaction Date | Tenant                   | Owner                        |
|--------------------------|-----------------|-------|-------------|------------------|--------------------------|------------------------------|
| 4850 Eastgate Mall       | UTC             | B     | 64,833      | Jan-2018         | AbacusNext               | The Irvine Company           |
| 10641 Scripps Summit Ct. | Scripps Ranch   | A     | 59,527      | Mar-2018         | TrellisWare Technologies | Newport National Corporation |
| 16950 Via Tazon          | Rancho Bernardo | B     | 57,420      | Jan-2018         | UCSD                     | The Granum Family Trust      |
| 9330 Scranton Rd.        | Sorrento Mesa   | A     | 40,667      | Jan-2018         | Paylease                 | McCarthy Cook                |
| 9620 Towne Centre Dr.    | UTC             | B     | 26,897      | Jan-2018         | Undisclosed              | The Irvine Company           |

|                                     | INVENTORY        |                          |                   |                     | VACANCY & LEASE RATES |                     |                       |                          |                           | ABSORPTION            |                     |                         |                       |
|-------------------------------------|------------------|--------------------------|-------------------|---------------------|-----------------------|---------------------|-----------------------|--------------------------|---------------------------|-----------------------|---------------------|-------------------------|-----------------------|
|                                     | Number of Bldgs. | Net Rentable Square Feet | Square Feet U / C | Square Feet Planned | Square Feet Vacant    | Vacancy Rate 1Q2018 | Square Feet Available | Availability Rate 1Q2018 | Average Asking Lease Rate | Net Absorption 1Q2018 | Net Absorption 2018 | Gross Absorption 1Q2018 | Gross Absorption 2018 |
| <b>Downtown</b>                     |                  |                          |                   |                     |                       |                     |                       |                          |                           |                       |                     |                         |                       |
| Downtown                            | 130              | 12,938,172               | 60,000            | 3,905,060           | 1,517,049             | 11.73%              | 2,443,729             | 18.89%                   | \$2.58                    | 55,901                | 55,901              | 250,969                 | 250,969               |
| Downtown Total                      | 130              | 12,938,172               | 60,000            | 3,905,060           | 1,517,049             | 11.73%              | 2,443,729             | 18.89%                   | \$2.58                    | 55,901                | 55,901              | 250,969                 | 250,969               |
| <b>Central</b>                      |                  |                          |                   |                     |                       |                     |                       |                          |                           |                       |                     |                         |                       |
| City Heights / University           | 31               | 1,110,005                | 0                 | 0                   | 61,307                | 5.52%               | 71,930                | 6.48%                    | \$2.21                    | (16,775)              | (16,775)            | 1,775                   | 1,775                 |
| Coronado                            | 6                | 124,831                  | 0                 | 0                   | 14,649                | 11.74%              | 14,649                | 11.74%                   | \$3.65                    | 562                   | 562                 | 3,650                   | 3,650                 |
| Kearny Mesa                         | 235              | 10,733,022               | 0                 | 690,000             | 662,143               | 6.17%               | 0                     | 0.00%                    | \$2.23                    | (36,478)              | (36,478)            | 197,899                 | 197,899               |
| Mission Gorge                       | 23               | 545,432                  | 0                 | 0                   | 11,853                | 2.17%               | 11,853                | 2.17%                    | \$1.31                    | 2,194                 | 2,194               | 4,852                   | 4,852                 |
| Mission Valley                      | 129              | 7,135,579                | 163,000           | 0                   | 730,546               | 10.24%              | 1,065,727             | 14.94%                   | \$2.49                    | (34,015)              | (34,015)            | 130,401                 | 130,401               |
| Old Town / Point Loma               | 66               | 2,118,111                | 0                 | 425,000             | 108,107               | 5.10%               | 241,051               | 11.38%                   | \$2.51                    | 7,410                 | 7,410               | 29,503                  | 29,503                |
| Park East                           | 8                | 155,884                  | 0                 | 0                   | 6,266                 | 4.02%               | 6,266                 | 4.02%                    | \$1.95                    | 0                     | 0                   | 0                       | 0                     |
| Rose Canyon / Morena                | 53               | 1,202,150                | 0                 | 0                   | 39,876                | 3.32%               | 91,969                | 7.65%                    | \$1.92                    | 1,037                 | 1,037               | 15,291                  | 15,291                |
| Uptown / Hillcrest                  | 104              | 2,734,853                | 0                 | 0                   | 178,032               | 6.51%               | 219,121               | 8.01%                    | \$2.60                    | (30,694)              | (30,694)            | 38,989                  | 38,989                |
| Central Total                       | 655              | 25,859,867               | 163,000           | 1,115,000           | 1,812,779             | 7.01%               | 1,722,566             | 6.66%                    | \$2.35                    | (106,759)             | (106,759)           | 422,360                 | 422,360               |
| <b>I-15 Corridor</b>                |                  |                          |                   |                     |                       |                     |                       |                          |                           |                       |                     |                         |                       |
| Escondido                           | 90               | 1,908,813                | 76,400            | 46,614              | 145,623               | 7.63%               | 262,627               | 13.76%                   | \$2.00                    | 16,339                | 16,339              | 23,237                  | 23,237                |
| Poway                               | 30               | 1,324,065                | 0                 | 160,000             | 55,869                | 4.22%               | 117,370               | 8.86%                    | \$2.14                    | 15,586                | 15,586              | 30,626                  | 30,626                |
| Rancho Bernardo                     | 107              | 6,973,657                | 0                 | 2,183,595           | 1,012,265             | 14.52%              | 964,181               | 13.83%                   | \$2.88                    | (172,419)             | (172,419)           | 253,224                 | 253,224               |
| Scripps Ranch                       | 51               | 2,707,872                | 158,994           | 137,000             | 325,226               | 12.01%              | 391,319               | 14.45%                   | \$2.36                    | 40,768                | 40,768              | 86,605                  | 86,605                |
| I-15 Corridor Total                 | 278              | 12,914,407               | 235,394           | 2,527,209           | 1,538,983             | 11.92%              | 1,735,497             | 13.44%                   | \$2.53                    | (99,726)              | (99,726)            | 393,692                 | 393,692               |
| <b>North County Coastal</b>         |                  |                          |                   |                     |                       |                     |                       |                          |                           |                       |                     |                         |                       |
| Carlsbad                            | 156              | 6,363,228                | 362,258           | 99,986              | 1,301,773             | 20.46%              | 1,425,133             | 22.40%                   | \$2.50                    | (32,604)              | (32,604)            | 141,866                 | 141,866               |
| Del Mar Heights / Carmel Valley     | 76               | 4,752,340                | 0                 | 949,790             | 717,787               | 15.10%              | 1,049,897             | 22.09%                   | \$4.15                    | 12,439                | 12,439              | 121,115                 | 121,115               |
| North Beach Cities                  | 111              | 2,544,081                | 0                 | 19,933              | 178,757               | 7.03%               | 235,431               | 9.25%                    | \$3.57                    | (27,498)              | (27,498)            | 45,002                  | 45,002                |
| North County Total                  | 343              | 13,659,649               | 362,258           | 1,069,709           | 2,198,317             | 16.09%              | 2,710,461             | 19.84%                   | \$3.25                    | (47,663)              | (47,663)            | 307,983                 | 307,983               |
| <b>North City</b>                   |                  |                          |                   |                     |                       |                     |                       |                          |                           |                       |                     |                         |                       |
| Governor Park                       | 20               | 890,555                  | 0                 | 0                   | 76,301                | 8.57%               | 147,249               | 16.53%                   | \$2.73                    | (3,761)               | (3,761)             | 3,753                   | 3,753                 |
| La Jolla                            | 47               | 1,394,595                | 0                 | 0                   | 120,786               | 8.66%               | 165,898               | 11.90%                   | \$3.06                    | (8,926)               | (8,926)             | 20,861                  | 20,861                |
| Miramar                             | 33               | 1,610,914                | 0                 | 0                   | 148,995               | 9.25%               | 191,460               | 11.89%                   | \$1.86                    | 14,768                | 14,768              | 49,079                  | 49,079                |
| Sorrento Mesa                       | 121              | 9,518,886                | 0                 | 1,971,063           | 1,213,658             | 12.75%              | 1,446,281             | 15.19%                   | \$2.76                    | 13,372                | 13,372              | 132,921                 | 132,921               |
| Sorrento Valley                     | 31               | 838,908                  | 0                 | 0                   | 62,574                | 7.46%               | 137,480               | 16.39%                   | \$2.46                    | 4,021                 | 4,021               | 12,249                  | 12,249                |
| Torrey Pines                        | 41               | 2,698,845                | 0                 | 0                   | 92,373                | 3.42%               | 101,339               | 3.75%                    | \$3.64                    | 27,383                | 27,383              | 32,638                  | 32,638                |
| UTC                                 | 92               | 8,600,401                | 150,000           | 303,124             | 1,045,466             | 12.16%              | 1,389,033             | 16.15%                   | \$3.37                    | (48,868)              | (48,868)            | 253,047                 | 253,047               |
| North City Total                    | 385              | 25,553,104               | 150,000           | 2,274,187           | 2,760,153             | 10.80%              | 3,578,740             | 14.01%                   | \$2.91                    | (2,011)               | (2,011)             | 504,548                 | 504,548               |
| <b>Southern &amp; Eastern Areas</b> |                  |                          |                   |                     |                       |                     |                       |                          |                           |                       |                     |                         |                       |
| Chula Vista                         | 91               | 2,925,484                | 0                 | 1,425,100           | 258,958               | 8.85%               | 304,461               | 10.41%                   | \$2.59                    | 6,382                 | 6,382               | 23,275                  | 23,275                |
| National City                       | 14               | 508,388                  | 0                 | 0                   | 1,300                 | 0.26%               | 1,300                 | 0.26%                    | \$2.24                    | 2,746                 | 2,746               | 2,746                   | 2,746                 |
| Otay Mesa                           | 13               | 318,004                  | 0                 | 0                   | 3,373                 | 1.06%               | 3,373                 | 1.06%                    | \$2.06                    | 7,971                 | 7,971               | 7,971                   | 7,971                 |
| Southeast San Diego                 | 9                | 381,826                  | 0                 | 0                   | 63,650                | 16.67%              | 63,650                | 16.67%                   | \$2.20                    | 0                     | 0                   | 0                       | 0                     |
| East County                         | 152              | 3,724,641                | 17,654            | 61,800              | 107,060               | 2.87%               | 150,806               | 4.05%                    | \$1.94                    | 14,935                | 14,935              | 41,004                  | 41,004                |
| Southern & Eastern Areas Total      | 279              | 7,858,343                | 17,654            | 1,486,900           | 434,341               | 5.53%               | 523,590               | 6.66%                    | \$2.41                    | 32,034                | 32,034              | 74,996                  | 74,996                |
| <b>Highway 78 Corridor</b>          |                  |                          |                   |                     |                       |                     |                       |                          |                           |                       |                     |                         |                       |
| Oceanside                           | 63               | 1,349,948                | 0                 | 335,249             | 136,157               | 10.09%              | 182,823               | 13.54%                   | \$1.98                    | 10,417                | 10,417              | 10,417                  | 10,417                |
| San Marcos                          | 37               | 1,375,278                | 0                 | 1,991,538           | 120,906               | 8.79%               | 148,793               | 10.82%                   | \$2.34                    | 4,867                 | 4,867               | 16,855                  | 16,855                |
| Vista                               | 50               | 1,209,379                | 0                 | 0                   | 209,861               | 17.35%              | 218,884               | 18.10%                   | \$1.94                    | (31)                  | (31)                | 12,996                  | 12,996                |
| Highway 78 Corridor Total           | 150              | 3,934,605                | 0                 | 2,326,787           | 466,924               | 11.87%              | 550,500               | 13.99%                   | \$2.06                    | 15,253                | 15,253              | 40,268                  | 40,268                |
| Class A                             | 277              | 35,153,445               | 937,348           | 10,857,265          | 4,279,744             | 12.17%              | 5,293,316             | 15.06%                   | \$3.24                    | (297,111)             | (297,111)           | 754,280                 | 754,280               |
| Class B                             | 1,257            | 52,773,486               | 50,958            | 3,847,587           | 5,579,206             | 10.57%              | 6,854,453             | 12.99%                   | \$2.48                    | 91,171                | 91,171              | 1,018,678               | 1,018,678             |
| Class C                             | 686              | 14,791,216               | 0                 | 0                   | 869,596               | 5.88%               | 1,117,314             | 7.55%                    | \$1.98                    | 52,969                | 52,969              | 221,858                 | 221,858               |
| <b>San Diego County Total</b>       | <b>2,220</b>     | <b>102,718,147</b>       | <b>988,306</b>    | <b>14,704,852</b>   | <b>10,728,546</b>     | <b>10.44%</b>       | <b>13,265,083</b>     | <b>12.91%</b>            | <b>\$2.72</b>             | <b>(152,971)</b>      | <b>(152,971)</b>    | <b>1,994,816</b>        | <b>1,994,816</b>      |

This survey consists of buildings greater than 10,000 square feet. Lease rates are on a full-service gross basis.



## Runway Remains, but How Much?

by **Connor Wieck**

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Following the trend of 2017, office transaction volume remained strong in the first quarter of 2018, with a greater than 10% quarter-over-quarter increase in total square feet leased and sold. With a nation facing a ten-year low unemployment factor of 4.1%, local office space is seeing the direct effects: increasing rental rates and low vacancy. Smaller tenants are continuing to grow, and your typical “garage start-ups” are finding a place in the market as they are transitioning into smaller office spaces. Many tenants continue to target economical options within the San Diego market, as evidenced by the 91,000 square feet of positive net absorption in Class B office space in the first quarter, which led all office classes in positive net absorption to start the year. The demand for office space has fluctuated around moderate to high levels, and landlords are luring tenants away from traditional office space, with amenity-rich space and specialized tenant improvements. Tenants are becoming less resistant to changing submarkets in an effort to find space that can accommodate the culture of their company.

Small-business confidence has largely increased in Q1 as optimism has developed over the newly enacted tax-reform package. With this renewed confidence, along with overall strong economic conditions, small businesses are focused on the potential to grow and scale their businesses. This is driving companies from co-working spaces such as WeWork out into the market. Landlords have also seen value from the tax-reform package through debt interest deductions, building cost recovery and pass-through taxation. This, in turn, allows landlords to invest capital in aspects of their properties that will help drive tenants to their buildings.

In March, President Donald Trump blocked Broadcom’s aggressive attempt to take over Qualcomm — which would have, in one sense or another, affected approximately 1,000,000 square feet of office space in central San Diego. The blocked takeover was well received in the local market, as Qualcomm is one of only two Fortune 500 companies based in San Diego, and it has a considerable impact on the regional economy.

Overall, the San Diego office market continues to climb. As interest rates increase, banks are becoming more particular with their lending, and buyers more selective with their acquisitions. With unemployment at 3.5% in San Diego, we expect the market to follow the same framework we have seen over the past year. We don’t anticipate any major market turn in 2018, but advise all to proceed with caution as we move forward.

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This survey consists of properties representing both single tenant and multi-tenant buildings. The lease rates are based on a full-service gross 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. ©2018 Voit Real Estate Services, Inc. License #01991785.

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## Product Type

**CLASS A:** Most prestigious buildings competing for premier office users with rents above average for the area. Buildings have high-quality standard finishes, state-of-the-art systems, exceptional accessibility and a definite market presence.

**CLASS B:** Buildings competing for a wide range of users with rents in the average range for the area. Building finishes are fair to good for the area, and systems are adequate. However, Class B buildings cannot compete with Class A buildings of the same price.

**CLASS C:** Buildings competing for tenants requiring functional space at rents below the area average.

## Submarkets

**DOWNTOWN:** Downtown

**CENTRAL:** City Heights / University, Coronado, Kearny Mesa, Mission Gorge, Mission Valley, Old Town / Point Loma, Park East, Rose Canyon / Morena, Uptown / Hillcrest

**I-15 CORRIDOR:** Escondido, Poway, Rancho Bernardo, Scripps Ranch

**NORTH COUNTY COASTAL:** Carlsbad, Del Mar Heights / Carmel Valley, North Beach Cities

**NORTH CITY:** Governor Park, La Jolla, Miramar, Sorrento Mesa, Sorrento Valley, Torrey Pines, UTC

**SOUTHERN & EASTERN AREAS:** Chula Vista, East County, National City, Otay Mesa, Southeast San Diego

**HIGHWAY 78 CORRIDOR:** Oceanside, San Marcos, Vista