

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 now at 13.77%, more than five percentage points lower than the rate of a decade ago.

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%.

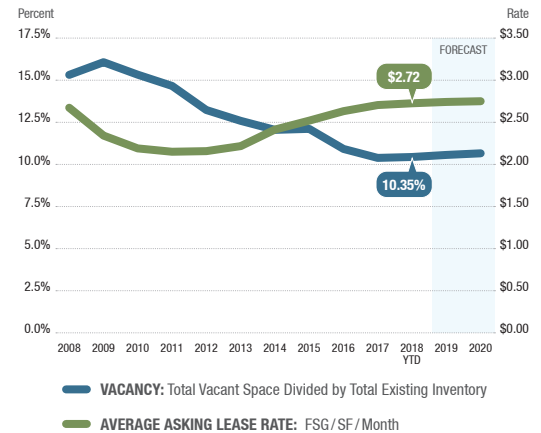
LEASE RATES. The average asking full-service gross (FSG) lease rate per square foot per month in San Diego County was \$2.72 at the end of the first quarter, a two cent increase over the previous quarter's rate, and an annual increase of 3.4% from 2017's first quarter rate of \$2.63. The overall average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

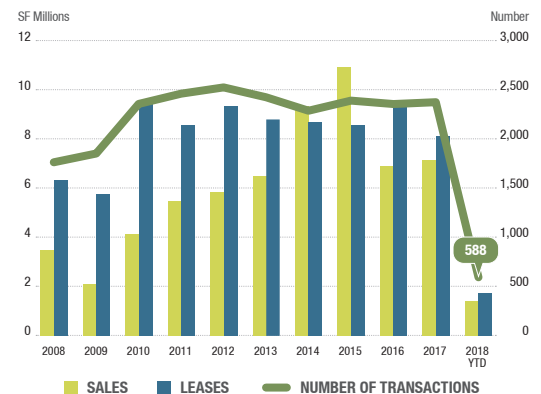
EMPLOYMENT. The unemployment rate in San Diego County was 3.5% in February 2018, down from a revised 3.6% in January 2018, and below the year-ago estimate of 4.4%. This compares with an unadjusted unemployment rate of 4.5% for California and 4.4% for the nation during the same period. According to the 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	13.77%	14.06%	13.63%	0.97%
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.

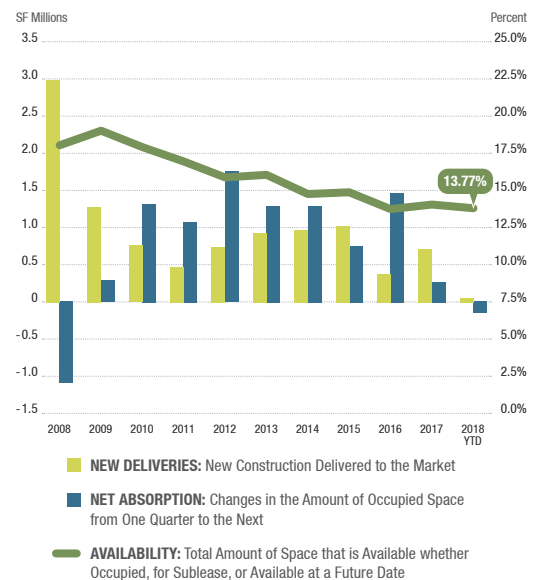
VACANCY. While landlords were happy to see hundreds of thousands of square feet absorbed by co-working companies in the past 12–18 months, these new operators in the market will be competing for tenants, and could act as a headwind to future occupancy gains. Conversely, while the overall occupancy level 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 13.77% at the end of the first quarter, a 0.97% increase 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.

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Significant Transactions

Sales

Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
3570–3580 Carmel Mountain Rd.	Del Mar Heights/ 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
Downtown													
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
Central													
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%	874,078	8.14%	\$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%	2,596,644	10.04%	\$2.35	(106,759)	(106,759)	422,360	422,360
I-15 Corridor													
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
North County Coastal													
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
North City													
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
Southern & Eastern Areas													
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
Highway 78 Corridor													
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%	5,743,316	16.34%	\$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%	7,270,619	13.78%	\$2.48	91,171	91,171	1,018,678	1,018,678
Class C	686	14,791,216	0	0	869,596	5.88%	1,125,226	7.61%	\$1.98	52,969	52,969	221,858	221,858
San Diego County Total	2,220	102,718,147	988,306	14,704,852	10,728,546	10.44%	14,139,161	13.77%	\$2.72	(152,971)	(152,971)	1,994,816	1,994,816

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?

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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