

**STARTING THE YEAR WITH A STEP BACKWARD.** The San Diego Flex/R&D market fundamentals started the year with a large amount of negative net absorption, over half a million square feet in total. In the relatively small Flex/R&D market, this caused the vacancy rate to spike up to 7.86%. With over half a million square feet currently under construction, there may be some softening in the Flex/R&D market this year.

**VACANCY.** Direct/sublease space (unoccupied) finished the first quarter at 7.86%, an increase of more than a percentage point from last quarter's rate, but a decrease of more than a percentage point when compared with the prior year, and a decrease of more than 50% from 2010's recession low of 16.12%.

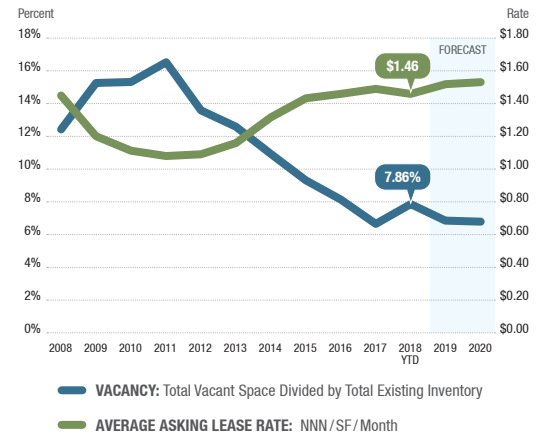
**LEASE RATES.** The average asking triple net lease rate per square foot per month in San Diego County was \$1.46 at the end of the first quarter, which is one cent higher year-over-year. The average asking lease rates have risen more than forty cents per square foot since the post-recession lows seen in 2011 and are continuing an upward long-term trend.

**TRANSACTION ACTIVITY.** The combined amount of space leased or sold in the first quarter totaled 1.3 million square feet, which is roughly equivalent to the quarterly total posted in the first quarter of 2017. 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.

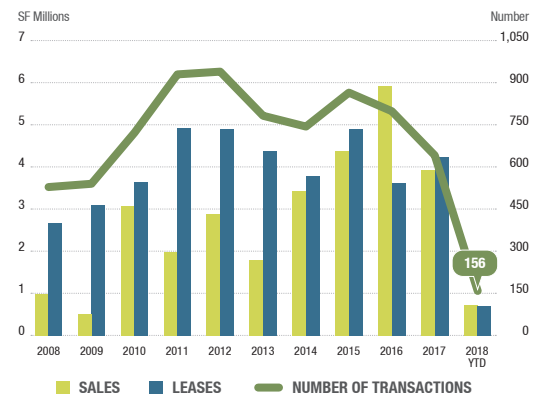
**EMPLOYMENT.** The unemployment rate in San Diego County was 3.5% in February 2018, down from a revised 3.6% in January 2018, and below the year-ago estimate of 4.4%. This compares with an unadjusted unemployment rate of 4.5% for California and 4.4% for the nation during the same period. According to 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.** Despite the vacancy rate moving upward to start the year, the San Diego Flex/R&D market continues the overall upward trend, as evidenced by the availability rate falling three percentage points year-over-year, now sitting at 9.15%. The increase in vacancy was driven by a few large move outs, and this should not have a significant effect on the small to midsize tenants in the market. In sum, this may be a year of limited occupancy gains for the market overall.

### 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	▲ UP	7.86%	6.64%	8.70%	(9.69%)
Availability Rate	▼ DOWN	9.15%	9.87%	12.56%	(27.16%)
Average Asking Lease Rate	▼ DOWN	\$1.46	\$1.49	\$1.45	0.69%
Sale & Lease Transactions	▼ DOWN	1,330,783	2,879,812	1,287,695	3.35%
Gross Absorption	▬ FLAT	809,124	835,402	1,216,895	(33.51%)
Net Absorption	▼ NEGATIVE	(588,035)	(85,774)	50,709	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.

**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.

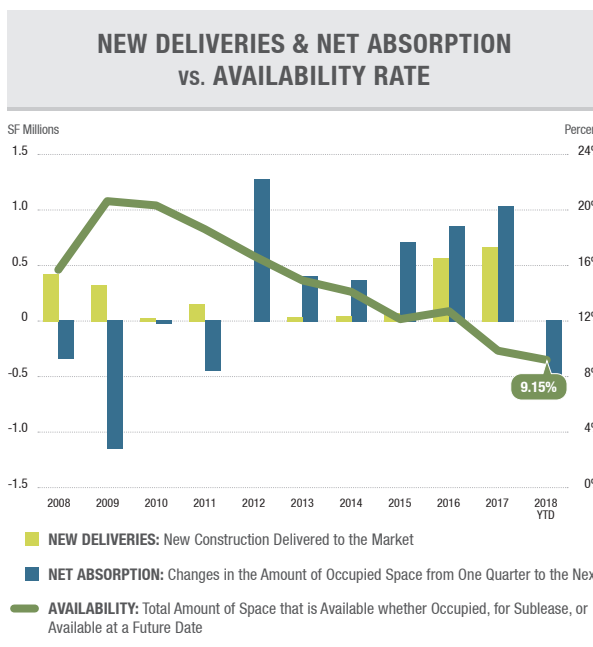
**LEASE RATES.** Expect average asking rates to increase by approximately 2–3% over the next four quarters.

**VACANCY.** With the relatively large number of deliveries last year, we expect vacancy rates to move back towards the 8% range.

**CONSTRUCTION.** In the first quarter of 2018, there were no new projects delivered. However this comes on the heels of a very strong year of construction. In 2017 there was 662,935 square feet of new Flex and R&D product completed, which surpassed the annual total of every year since 2006. At the end of the first quarter, there was 594,023 square feet under construction in San Diego County’s Flex/R&D market. Notably, all of the under-construction projects are in the central county area, which is in contrast to the industrial construction which is concentrated on the edges of the county.

**AVAILABILITY.** Direct/sublease space being marketed was 9.15% at the end of the quarter, a 27% decrease from the previous year’s rate of 12.56%.

**ABSORPTION.** The San Diego Flex/R&D market recorded 588,035 square feet of negative net absorption in the first quarter of 2018. Despite the pullback in occupancy in the first quarter of the year, the market has seen 4.1 million square feet of positive net absorption since the start of 2012.



Significant Transactions

Sales

Property Address	Submarket	Square Feet	Sale Price	Buyer	Seller
9965–9995 Summers Ridge Rd.	Sorrento Mesa	316,531	\$148,650,000	Alexandria RE Equities	Quidel
9235–9265 Activity Rd., et al	Miramar	160,943	\$28,100,000	BKM Capital Partners	Lincoln Property Company
860 Harold Pl.	Chula Vista	105,537	\$10,913,000	Lincoln Property Company	Leviton Manufacturing Co.
7720 Kenamar Ct.	Miramar	60,431	\$8,800,000	7720 Kenamar Ct Holdings, LLC	Providence Capital Group
5607 Palmer Way	Carlsbad	16,532	\$3,305,000	Aardema Family Trust	Eagle Group, LLC

Leases

Property Address	Submarket	Square Feet	Transaction Date	Tenant	Owner
1905 Ashton Ave.	Carlsbad	48,551	Jan-2018	Undisclosed	Alvarez & marsal Holdings, LLC
2258 Rutherford Rd.	Carlsbad	39,260	Feb-2018	Undisclosed	(Sublease)
4242 Campus Point Ct.	UTC	38,849	Jan-2018	Tocagen	Phase 3 RE Partners
1969 Kellogg Ave.	Carlsbad	34,413	Feb-2018	Undisclosed	Hamann Companies
5820 Nancy Ridge Dr.	Miramar	34,054	Mar-2018	Vividion Therapeutics	Alexandria RE Equities

	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>Central</b>													
Central City	16	193,266	0	0	21,802	11.28%	38,992	20.18%	\$1.93	(12,360)	(12,360)	0	0
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%	–	0	0	0	0
Kearny Mesa	205	5,536,456	156,000	0	678,690	12.26%	0	0.00%	\$1.52	(370,431)	(370,431)	19,229	19,229
Mission Gorge	29	287,556	0	0	11,043	3.84%	5,361	1.86%	\$1.46	5,437	5,437	23,320	23,320
Rose Canyon/Morena	38	609,335	0	0	26,988	4.43%	26,988	4.43%	\$1.10	(7,398)	(7,398)	16,974	16,974
Sports Arena/Airport	30	380,720	0	0	840	0.22%	840	0.22%	\$1.30	6,160	6,160	7,000	7,000
Miramar	218	4,702,696	130,000	33,859	312,467	6.64%	347,444	7.39%	\$1.52	(35,772)	(35,772)	80,393	80,393
Sorrento Mesa	162	6,128,838	0	646,000	549,029	8.96%	898,065	14.65%	\$1.87	15,329	15,329	64,601	64,601
Sorrento Valley	102	2,354,342	0	0	202,926	8.62%	311,909	13.25%	\$1.88	(61,440)	(61,440)	103,462	103,462
Torrey Pines/UTC	71	6,090,731	308,023	641,463	588,455	9.66%	767,841	12.61%	\$3.07	93,728	93,728	159,416	159,416
<b>Central County Total</b>	<b>890</b>	<b>26,508,587</b>	<b>594,023</b>	<b>1,321,322</b>	<b>2,392,240</b>	<b>9.02%</b>	<b>2,397,440</b>	<b>9.04%</b>	<b>\$1.70</b>	<b>(366,747)</b>	<b>(366,747)</b>	<b>474,395</b>	<b>474,395</b>
<b>East County</b>													
El Cajon	77	851,324	0	0	7,980	0.94%	14,430	1.70%	\$0.98	(6,310)	(6,310)	0	0
La Mesa/Spring Valley	39	306,088	0	0	9,851	3.22%	7,745	2.53%	\$1.04	11,309	11,309	14,735	14,735
Santee/Lakeside	54	564,061	0	0	0	0.00%	0	0.00%	\$1.48	3,308	3,308	6,548	6,548
Outlying SD County S	20	78,080	0	0	0	0.00%	0	0.00%	\$1.10	0	0	0	0
<b>East County Total</b>	<b>190</b>	<b>1,799,553</b>	<b>0</b>	<b>0</b>	<b>17,831</b>	<b>0.99%</b>	<b>22,175</b>	<b>1.23%</b>	<b>\$1.13</b>	<b>8,307</b>	<b>8,307</b>	<b>21,283</b>	<b>21,283</b>
<b>North County</b>													
Escondido	78	744,979	0	0	12,912	1.73%	17,462	2.34%	\$0.98	4,856	4,856	7,982	7,982
Oceanside	33	985,977	0	0	39,949	4.05%	39,422	4.00%	\$1.15	(6,986)	(6,986)	2,850	2,850
San Marcos	59	1,053,462	0	0	63,113	5.99%	111,256	10.56%	\$1.07	(4,562)	(4,562)	10,543	10,543
Vista	62	1,393,694	0	0	88,508	6.35%	91,254	6.55%	\$1.08	(39,294)	(39,294)	0	0
Carlsbad	251	6,199,734	0	146,108	583,697	9.41%	807,226	13.02%	\$1.31	(39,989)	(39,989)	176,319	176,319
North Beach Cities	18	155,333	0	0	2,055	1.32%	5,955	3.83%	\$2.00	(1,200)	(1,200)	1,920	1,920
Outlying SD County North	18	136,911	0	0	2,644	1.93%	2,644	1.93%	\$1.12	(1,322)	(1,322)	0	0
<b>North County Total</b>	<b>519</b>	<b>10,670,090</b>	<b>0</b>	<b>146,108</b>	<b>792,878</b>	<b>7.43%</b>	<b>1,075,219</b>	<b>10.08%</b>	<b>\$1.24</b>	<b>(88,497)</b>	<b>(88,497)</b>	<b>199,614</b>	<b>199,614</b>
<b>I-15 Corridor</b>													
Poway	60	1,830,757	0	0	31,919	1.74%	41,773	2.28%	\$1.14	(929)	(929)	23,990	23,990
Rancho Bernardo	94	4,596,225	0	0	380,611	8.28%	510,916	11.12%	\$1.44	(39,137)	(39,137)	28,692	28,692
Scripps Ranch	27	713,377	0	233,741	2,585	0.36%	2,585	0.36%	\$0.95	0	0	20,822	20,822
<b>I-15 Corridor Total</b>	<b>181</b>	<b>7,140,359</b>	<b>0</b>	<b>233,741</b>	<b>415,115</b>	<b>5.81%</b>	<b>555,274</b>	<b>7.78%</b>	<b>\$1.38</b>	<b>(40,066)</b>	<b>(40,066)</b>	<b>73,504</b>	<b>73,504</b>
<b>South County</b>													
Chula Vista	82	1,478,829	0	12,373	126,949	8.58%	137,806	9.32%	\$1.37	(105,375)	(105,375)	31,203	31,203
National City	22	300,015	0	0	3,425	1.14%	4,718	1.57%	\$1.15	4,343	4,343	6,125	6,125
Otay Mesa	8	171,041	0	256,022	34,443	20.14%	156,743	91.64%	\$0.67	0	0	3,000	3,000
San Ysidro/Imperial Beach	4	81,972	0	0	1,200	1.46%	56,200	68.56%	–	0	0	0	0
<b>South County Total</b>	<b>116</b>	<b>2,031,857</b>	<b>0</b>	<b>268,395</b>	<b>166,017</b>	<b>8.17%</b>	<b>355,467</b>	<b>17.49%</b>	<b>\$0.82</b>	<b>(101,032)</b>	<b>(101,032)</b>	<b>40,328</b>	<b>40,328</b>
<b>San Diego County Total</b>	<b>1,896</b>	<b>48,150,446</b>	<b>594,023</b>	<b>1,969,566</b>	<b>3,784,081</b>	<b>7.86%</b>	<b>4,405,575</b>	<b>9.15%</b>	<b>\$1.46</b>	<b>(588,035)</b>	<b>(588,035)</b>	<b>809,124</b>	<b>809,124</b>

Lease rates are on a triple-net basis.



## Steady Demand Keeps Supply Limited and Prices Up

by **Henry Zahner**

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With building sale prices and rents at record-breaking levels in most submarkets, and vacancy rates still extremely low, we are finally seeing some new availabilities pop up across San Diego County. Previously reluctant sellers have been enticed to cash in some gains, while buyers struggle to find last year's pricing. Going forward, construction of new product will be limited to the few remaining developable lots. Areas like Carlsbad and Oceanside to the north and Otay Mesa to the south have seen renewed levels of speculative product being built. While net absorption has declined in the past two years, this new product is poised to do well, and has already had a positive impact on absorption countywide. New product branding types like "creative industrial" have shown initially positive results, helping to confirm that the market is continuing to strengthen.

Total net absorption in square footage across San Diego County was 259,727 square feet for the first quarter after finishing at 401,620 square feet for 2017, which puts the start of the year ahead of last year's pace. This "bounce back" of positive absorption in the first quarter can be partly attributed to the strength of deals inked in the fourth quarter, which are now beginning to take occupancy. The market remains relatively tight as a whole. The average availability across San Diego County is 6.6%, and actual vacancy is a measly 3.5%.

Continuing the trend from last year, the "spec" buildings in the northern and southern ends of the county have taken higher end forms than in the past, incorporating high clear heights and more modern buildouts. A total of 2.2 million square feet are currently under construction, as developers are enticed to bring projects online in the current environment of record low vacancy, and record high rents. As the new construction delivers to the market, developers are counting on the continuously vigorous and pent-up tenant demand for space to persist. Carlsbad and Oceanside have led the pace of the new industrial development, with well over a million square feet being recently completed or currently under construction.

A major factor in the marketplace are the burdensome regulations and fees for new construction, which will continue increasing construction costs and completion times, and therefore affect rents. We anticipate that 2018 will continue to experience upward pressure on rents, with concessions such as free rent continuing to decrease, and tenant improvement packages being underwritten to only the worthiest credit tenants.

Looking to the future, worldwide innovations like autonomous vehicles, drones, genetic sequencing, and drug development, robotics, and efficient indoor farming techniques will continue to fuel high-tech innovation and absorption of Industrial and Flex/R&D space in San Diego County. Despite the high cost of living in San Diego, San Diego's diverse employment base, its desirable climate and lifestyle, and its proximity to international markets in Mexico and the Pacific Rim will all help support our local economy's continued growth.

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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. ©2018 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