

SD RETAIL DOING FINE. In the face of the changing retail landscape, the San Diego retail market has maintained solid fundamentals with availability at 4.41%, and the vacancy rate is still near a ten-year low. In spite of the rise of e-commerce, the San Diego retail real estate market remains robust with tight supply and high average asking rents.

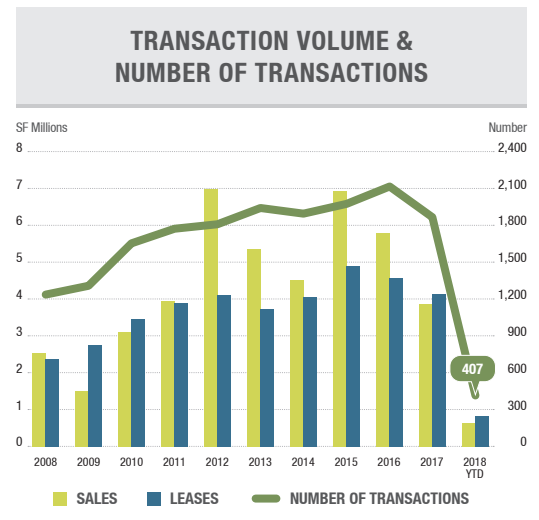
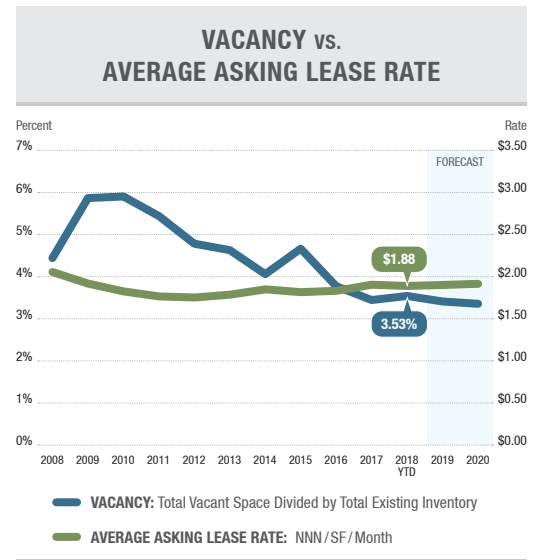
VACANCY. Direct/sublease space (unoccupied) finished the first quarter near an all-time low of 3.53%, 22 basis points lower than last year's 3.75% vacancy rate. The current vacancy rate is more than 40% below the previous peak levels seen in 2010.

LEASE RATES. The average asking triple-net lease rate per month per square foot in San Diego County was \$1.88, an increase of two cents, or 1.1%, over the \$1.86 rate of first quarter 2017. The highest average asking rate in the market was in the I-15 Corridor submarket, posting \$2.82 per square foot per month, on a triple-net basis.

TRANSACTION ACTIVITY. The combined amount of retail property sold or leased during the fourth quarter was approximately 1.9 million square feet, which was an increase over the 1.5 million square feet transacted in the prior quarter. The transaction activity 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. The San Diego retail market continues to remain on solid footing, as market fundamentals exhibited positive growth throughout 2017, and remain in good position to start 2018. Vacancy ended the quarter at 3.53%, near a post-recession record low. There have been winners and losers in the retail landscape evolution. There is a dearth of shadow vacancy in the Westfield UTC mall in Downtown, as that mall prepares for probable redevelopment. Since the great recession, there has been a steady stream of prominent retailers that have floundered or ultimately gone under, from one-time icon Sears, to the more recent demise or Toys "R" Us, but the market continues to adapt and move forward.



Market Statistics

	Change Over Last Quarter	1Q 2018	4Q 2017	1Q 2017	% Change Over Last Year
Vacancy Rate	▲ UP	3.53%	3.43%	3.75%	(5.86%)
Availability Rate	▼ DOWN	4.41%	4.85%	5.02%	(12.10%)
Average Asking Lease Rate	▼ DOWN	\$1.88	\$1.90	\$1.86	1.08%
Sale & Lease Transactions	▲ UP	1,858,722	1,501,361	2,262,239	(17.84%)
Gross Absorption	▼ DOWN	924,569	1,649,722	1,083,863	(14.70%)
Net Absorption	▼ NEGATIVE	(122,922)	534,654	19,152	N/A

CONSTRUCTION. The completion of Westfield’s UTC Mall’s renovation and expansion closes the books on the driving force behind the majority of the recent construction volume. Going into 2018, the level of retail projects under construction has now dipped below 300,000 square feet for only the second time since the start of 2011. Indicative of the trend in future construction coming increasingly from mixed-use development, Westfield UTC has broken ground on a 23-story apartment tower. Likewise, the 37-story Ballpark Village mixed-use apartment project adjacent to Petco Park will include 60,000 square feet of retail space.

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 average asking rates to increase by a moderate 2–3% over the next four quarters.

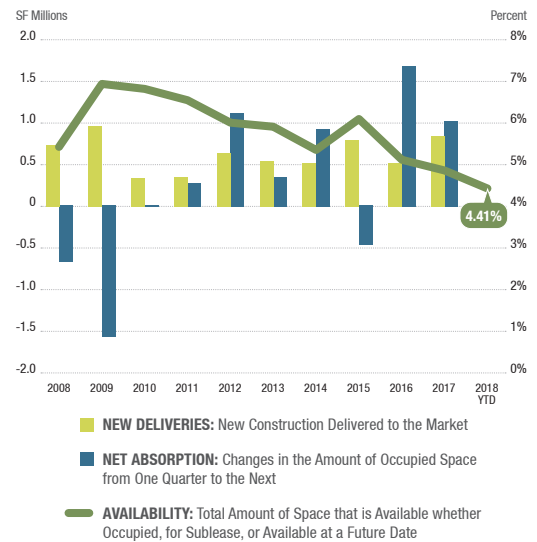
VACANCY. We anticipate the vacancy rate to remain stable and low, with much of the occupancy gains already captured. With the current dearth of retail properties under construction, we do not anticipate new supply to apply upward pressure on the overall market vacancy rate.

CONSTRUCTION. Following the 837,453 square feet of new retail projects completed in 2017, (the highest annual total since 2009), there is now just over a quarter million square feet of retail product under construction. Currently, the construction pipeline is being driven by infill projects, with few development sites being pursued outside of the built-out areas in the county.

AVAILABILITY. Direct/sublease space being marketed was 4.41% at the end of the first quarter. This was the first year to see availability rates fall below 4.5% since 2008. The Central South area of the county posted the lowest availability rate in the county, at 2.12%

ABSORPTION. The San Diego retail market posted 122,922 square feet of negative net absorption in the first quarter alone, led by the Central North part of the county which accounted for 62,667 square feet of negative net absorption in the first quarter.

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Significant Transactions

Sales

Property Address	Submarket	Square Feet	Sale Price	Buyer	Seller
4101–4171 Oceanside Blvd.	Oceanside	99,740	\$32,500,000	Oceanside 5, LLC	Del Oro College, LLC
687 S. Coast Hwy. 101	Encinitas	48,561	\$24,000,000	RAF Pacifica Group	Loja Real Estate, LLC
643–665 5th Ave.	Downtown (Gaslamp)	19,884	\$19,850,000	Asana Partners	Blatteis & Schnur
7660 El Camino Real	Carlsbad	50,689	\$184,000,000	Dionysus Investments, LLC	Spirit SPE HG 5015-1, LLC
1403–1427 Broadway	Chula Vista	62,855	\$10,200,000	South Bay Automotive, LLC	The Heritage Group

Leases

Property Address	Submarket	Square Feet	Transaction Date	Tenant	Owner
3514 College Blvd.	Oceanside	59,000	Jan-2018	Hobby Lobby	95 College Plaza, Ltd.
3029 University Ave.	North Park	40,000	Jan-2018	Target	CKL Investments
8788 Navajo Rd.	La Mesa	19,134	Mar-2018	Aldi	JH Real Estate Partners
360 5th Ave.	Downtown (Gaslamp)	15,000	Jan-2018	Undisclosed	HP Investors
1620 Alpine Blvd.	Outlying SD County	13,435	Mar-2018	Alpine Fitness	Alpine Regional Center, 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 1Q2018	Square Feet Available	Availability Rate 1Q2018	Average Asking Lease Rate	Net Absorption 1Q2018	Net Absorption 2018	Gross Absorption 1Q2018	Gross Absorption 2018
Central South													
General Retail	3,694	20,088,862	35,122	771,439	490,547	2.44%	713,028	3.55%	\$2.30	17,128	17,128	185,443	185,443
Malls	39	4,532,963	0	0	51,264	1.13%	50,964	1.12%	–	(1,608)	(1,608)	0	0
Power Centers	97	3,566,857	0	6,000	61,087	1.71%	47,786	1.34%	\$3.85	(6,610)	(6,610)	925	925
Shopping Centers	713	11,124,104	4,000	22,635	454,729	4.09%	0	0.00%	\$2.02	(16,259)	(16,259)	86,345	86,345
Specialty Centers	7	271,679	0	0	26,288	9.68%	26,288	9.68%	–	(5,500)	(5,500)	0	0
Central South Total	4,550	39,584,465	39,122	800,074	1,083,915	2.74%	838,066	2.12%	\$2.15	(12,849)	(12,849)	272,713	272,713
East County													
General Retail	1,446	7,345,182	3,832	46,570	119,196	1.62%	161,860	2.20%	\$1.44	(4,399)	(4,399)	21,500	21,500
Malls	15	2,929,516	0	0	5,383	0.18%	117,433	4.01%	–	(2,888)	(2,888)	2,183	2,183
Power Centers	60	1,699,138	0	4,800	17,209	1.01%	29,862	1.76%	–	41	41	7,939	7,939
Shopping Centers	560	8,390,849	0	88,854	394,015	4.70%	583,754	6.96%	\$1.70	(10,127)	(10,127)	51,125	51,125
Specialty Centers	2	34,558	0	0	0	0.00%	0	0.00%	–	0	0	0	0
East County Total	2,083	20,399,243	3,832	140,224	535,803	2.63%	892,909	4.38%	\$1.64	(17,373)	(17,373)	82,747	82,747
I-15 Corridor													
General Retail	171	1,645,824	0	60,218	29,412	1.79%	39,958	2.43%	\$2.54	(17,854)	(17,854)	1,500	1,500
Malls	0	0	0	0	0	0.00%	0	0.00%	–	0	0	0	0
Power Centers	24	567,029	0	0	4,914	0.87%	4,914	0.87%	–	0	0	0	0
Shopping Centers	286	4,259,745	0	222,738	189,021	4.44%	218,275	5.12%	\$2.84	27,334	27,334	40,412	40,412
Specialty Centers	0	0	0	0	0	0.00%	0	0.00%	–	0	0	0	0
I-15 Corridor Total	481	6,472,598	0	282,956	223,347	3.45%	263,147	4.07%	\$2.82	9,480	9,480	41,912	41,912
North County													
General Retail	1,699	11,490,532	22,627	456,526	377,951	3.29%	454,261	3.95%	\$1.27	(49,542)	(49,542)	41,987	41,987
Malls	24	3,176,626	0	50,340	8,980	0.28%	10,764	0.34%	–	(2,062)	(2,062)	0	0
Power Centers	110	3,118,612	0	22,315	78,184	2.51%	117,826	3.78%	\$2.38	19,023	19,023	30,204	30,204
Shopping Centers	955	15,172,042	82,656	459,415	990,401	6.53%	1,321,108	8.71%	\$1.63	(2,615)	(2,615)	215,524	215,524
Specialty Centers	5	367,735	0	0	0	0.00%	500	0.14%	–	0	0	0	0
North County Total	2,793	33,325,547	105,283	988,596	1,455,516	4.37%	1,904,459	5.71%	\$1.50	(35,196)	(35,196)	287,715	287,715
Central North													
General Retail	872	7,314,930	0	182,795	234,544	3.21%	347,891	4.76%	\$2.69	212	212	47,943	47,943
Malls	21	1,490,334	0	0	182,500	12.25%	182,500	12.25%	–	0	0	0	0
Power Centers	66	2,094,719	0	101,235	118,760	5.67%	55,914	2.67%	–	(1,440)	(1,440)	9,559	9,559
Shopping Centers	421	6,667,036	11,849	314,836	244,819	3.67%	367,641	5.51%	\$2.41	(55,390)	(55,390)	56,178	56,178
Specialty Centers	9	232,667	0	0	54,129	23.26%	76,261	32.78%	\$1.72	(6,049)	(6,049)	0	0
Central North Total	1,389	17,799,686	11,849	598,866	834,752	4.69%	1,030,207	5.79%	\$2.53	(62,667)	(62,667)	113,680	113,680
South County													
General Retail	1,118	5,948,399	6,705	514,062	156,174	2.63%	211,312	3.55%	\$1.53	(22,455)	(22,455)	29,159	29,159
Malls	42	2,510,639	0	0	15,824	0.63%	123,620	4.92%	–	9,627	9,627	18,451	18,451
Power Centers	28	1,016,929	0	79,900	11,975	1.18%	11,975	1.18%	–	(4,575)	(4,575)	0	0
Shopping Centers	533	9,197,183	104,493	173,974	550,490	5.99%	737,485	8.02%	\$1.97	5,641	5,641	63,065	63,065
Specialty Centers	26	775,350	0	0	3,190	0.41%	41,182	5.31%	\$1.60	0	0	0	0
South County Total	1,747	19,448,500	111,198	767,936	737,653	3.79%	1,125,574	5.79%	\$1.82	(11,762)	(11,762)	110,675	110,675
Outlying Areas													
General Retail	506	2,022,446	0	3,200	48,403	2.39%	54,946	2.72%	\$1.89	179	179	3,729	3,729
Malls	11	145,890	0	0	11,000	7.54%	11,000	7.54%	–	0	0	0	0
Power Centers	0	0	0	0	0	0.00%	0	0.00%	–	0	0	0	0
Shopping Centers	93	1,292,946	0	12,766	41,024	3.17%	88,303	6.83%	\$1.76	7,266	7,266	11,398	11,398
Specialty Centers	1	255,000	0	0	0	0.00%	0	0.00%	–	0	0	0	0
Outlying Areas Total	611	3,716,282	0	15,966	100,427	2.70%	154,249	4.15%	\$1.83	7,445	7,445	15,127	15,127
San Diego Total													
General Retail	13,654	140,746,321	271,284	3,594,618	4,971,413	3.53%	6,208,611	4.41%	\$1.88	(122,922)	(122,922)	924,569	924,569
General Retail	9,506	55,856,175	68,286	2,034,810	1,456,227	2.61%	1,983,256	3.55%	\$1.86	(76,731)	(76,731)	331,261	331,261
Malls	152	14,785,968	0	50,340	274,951	1.86%	496,281	3.36%	\$2.38	3,069	3,069	20,634	20,634
Power Centers	385	12,063,284	0	214,250	292,129	2.42%	268,277	2.22%	\$2.80	6,439	6,439	48,627	48,627
Shopping Centers	3,561	56,103,905	202,998	1,295,218	2,864,499	5.11%	3,316,566	5.91%	\$1.89	(44,150)	(44,150)	524,047	524,047
Specialty Centers	50	1,936,989	0	0	83,607	4.32%	144,231	7.45%	\$1.64	(11,549)	(11,549)	0	0
San Diego Total	13,654	140,746,321	271,284	3,594,618	4,971,413	3.53%	6,208,611	4.41%	\$1.88	(122,922)	(122,922)	924,569	924,569

Lease rates are on a triple-net basis.



San Diego Retail is Adapting

by **Max Stone**

SENIOR ASSOCIATE, SAN DIEGO

858.458.3348 · mstone@voitco.com · Lic. #01944151

In the first quarter of 2018, the market saw rising interest rates and continued rising rental rates in the region. Demand for Class A, quality retail space in San Diego is very high. Notable retail projects such as Uptown Bressi, Del Mar Heights (phase II), Pacific Highland and Watermark developments are all in high demand, achieving rates of \$5.00–\$6.00 NNN per square foot per month and in some cases even higher.

For many smaller businesses, monthly overhead is a growing concern. As a result, these tenants are seeking lower-cost alternatives and are flocking to Class B and C centers. Smaller businesses are willing to sacrifice some exterior modifications and inject more of their own capital to bring their spaces up to speed with their concept and clientele's needs. Landlords at these centers are less likely to take part in supplementing tenants with improvement packages and are more likely to offer free rent in exchange. Not only do the Class B and C properties offer more competitive base rental rates, but the NNN costs are often half (or less) than the newly constructed centers.

Whether Landlords are offering free rent or tenant improvements to create interest in a property, the following payback periods (period in which free rent ends or TI contribution = base rent paid) remain pretty consistent:

- 3 Year Term – Payback in initial year (very little if any concessions)
- 5 Year Term – Payback in beginning year 2 or sooner
- 10 Year Term – Payback in beginning year 3 or sooner

Landlords will make certain exceptions to these timelines if they are recruiting tenants with national credit, or if they have a property with unusually high vacancy, among other reasons.

Moving forward, the San Diego tenant market will continue to change and absorb the punches thrown at it by e-commerce. Gyms, restaurants, medical users and other tenants that demand face-to-face interaction are continuing to absorb vacancy in most retail centers. New companies like Class Pass and Movie Pass are great drivers of traffic to these interactive uses. Both companies offer up monthly memberships to access multiple facilities, rather than paying the full costs associated with these activities. One example of a group coping with these changing times is Westfield. The new Development in UTC has just undergone Phase II of development and they are breaking ground on Phase III. Both phases offer diversity to the project with the first addition of multi-family and office space to the shopping mall. Moving forward we will likely continue to see an evolving retail environment, where grocery anchors may be interchangeable with medical uses, apartment complexes, self-storage, or other creative uses.

Please Contact Us for Further Information

Josh Brant
Regional Director of Research
jbrant@voitco.com

Anaheim, CA
714.978.7880

Carlsbad, CA
760.517.4000

Inland Empire, CA
909.545.8000

Irvine, CA
949.851.5100

Los Angeles, CA
424.329.7500

San Diego, CA
858.453.0505

Submarkets

CENTRAL SOUTH

Central San Diego, Clairemont, Coronado, Downtown, Mission Gorge, Mid City/Southeast San Diego, Mission Valley, Pacific Beach/Morena, Point Loma/Sports Arena

EAST COUNTY

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

I-15 CORRIDOR

Carmel Mountain Ranch, Poway, Rancho Bernardo, Rancho Penasquitos

CENTRAL NORTH

Cardiff/Encinitas, Del Mar Heights, La Jolla/Torrey Pines, Miramar, UTC

NORTH COUNTY

Carlsbad, Escondido, Oceanside, San Marcos, Vista

OUTLYING AREAS

Outlying SD County North, Outlying SD County South

SOUTH COUNTY

Chula Vista, Eastlake, Imperial Beach/South San Diego, National City