

MARKET PLATEAUING. The office market continues to show a balance in availability and demand. The overall availability rate has inched lower over the past year, while the vacancy rate increased by an equivalent margin. Lease rates continue to press upward at a modest rate, and speculative office construction is nearly nonexistent.

VACANCY. Direct/sublease space (unoccupied) finished the year at 10.58%, 19 basis points higher than a year prior in the fourth quarter of 2017. Kearny Mesa posted the lowest vacancy rate of any major submarket (minimum of four million square feet of inventory) at 7.49%, with all other major submarkets recording double digit vacancy rates at year end.

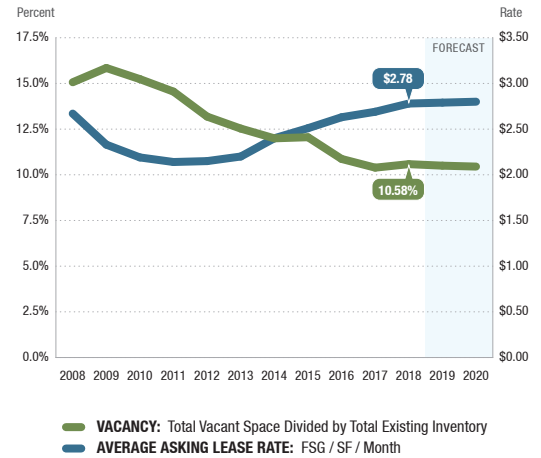
LEASE RATES. The average asking full-service gross (FSG) lease rate per square foot per month in San Diego County was \$2.78 at the end of the fourth quarter, a three cent increase over the previous quarter's rate, and an annual increase of 3.35% from the fourth quarter of 2017's rate of \$2.69. The overall San Diego office market average asking rate is now at an all-time high, surpassing the previous peak of \$2.74 from 2007.

TRANSACTION ACTIVITY. Sale and lease transactions totaled 3.5 million square feet in the fourth quarter, a slight decrease from the 4.1 million square feet which transacted in third quarter. The 6.6 million square feet leased in 2018 was near the annual average since the start of the recovery, while the 7.6 million square feet sold was more than 10% lower than the average annual sales volume since the start of 2010. 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.

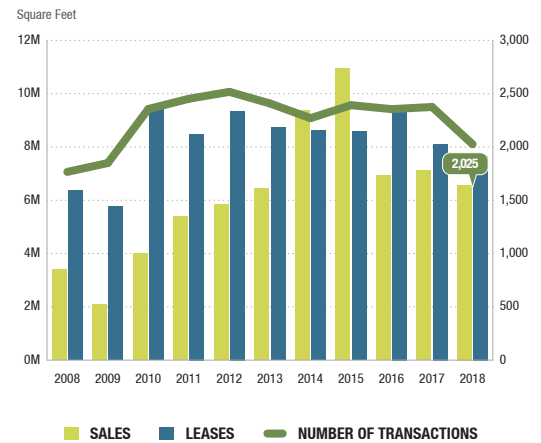
EMPLOYMENT. The unemployment rate in San Diego County was 3.2% in November 2018, down from a revised 3.3% in October 2018, and below the year-ago estimate of 3.5%. This compares with an unadjusted unemployment rate of 3.9% for California and 3.5% for the nation during the same period. According to the State of California Employment Development Department, San Diego County gained 26,400 payroll jobs between November 2017 and November 2018, including 16,500 from professional and business services, which reported the largest overall gain. The manufacturing sector reported a growth of 6,000 jobs the second most among the major employment sectors. The largest year-over-year loss was in trade, transportation, and utilities which reported 3,400 fewer jobs than the prior year.

OVERALL. The San Diego office market has plateaued over the past two years. Net absorption has been flat, while pricing for sales and leases has continued to rise, and transaction volume is down. Construction levels of new speculative office product remain 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	4Q 2018	3Q 2018	4Q 2017	% Change Over Last Year
Vacancy Rate	▲ UP	10.58%	10.40%	10.39%	1.89%
Availability Rate	▲ UP	13.78%	13.64%	14.06%	(1.98%)
Average Asking Lease Rate	▲ UP	\$2.78	\$2.75	\$2.69	3.35%
Sale & Lease Transactions	▼ DOWN	3,506,267	4,140,396	4,261,868	(17.73%)
Gross Absorption	▲ UP	2,389,328	1,898,310	1,770,731	34.93%
Net Absorption	▲ POSITIVE	56,930	79,292	65,623	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 1.0–1.2% increase is projected for 2018. With the local stalwarts of defense and biotech remaining strong, look for these sectors to lead the way for employment gains, followed by healthcare.

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

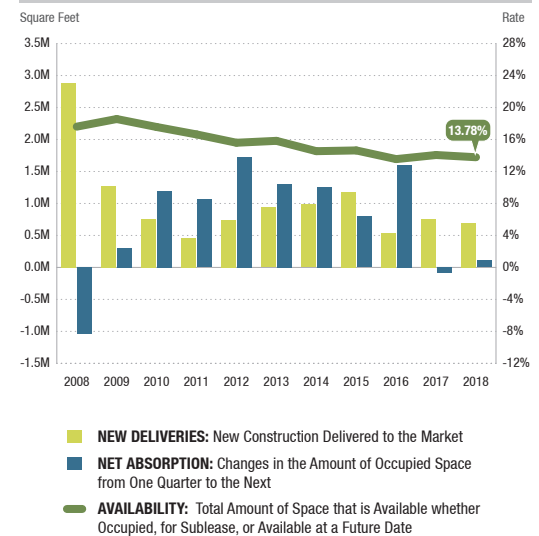
VACANCY. While landlords were happy to see hundreds of thousands of square feet absorbed by co-working companies in the past 12–18 months, these new operators in the market will be competing for tenants, and could act as a headwind to future occupancy gains. Conversely, a number of companies have committed to expanding into build-to-suit office buildings currently underway, which will add to the market’s occupancy level. We anticipate the countywide vacancy to remain relatively stable around the 10–11% range.

CONSTRUCTION. New office development remains weighted towards build-to-suit projects. MedImpact has 160,000 square feet under construction in Scripps Ranch, and there are 177,000 square feet under construction for ViaSat in Carlsbad. Manchester is underway on the Downtown bayfront project which will include a new regional office for the U.S. Navy with additional Class A office towers to follow. More new 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 13.78% at the end of the fourth quarter, a 1.98% decrease from the 14.06% availability rate from one year ago in the fourth quarter of 2017.

ABSORPTION. The San Diego office market recorded 108,949 square feet of positive net absorption in 2018. Between 2010 and 2016 the San Diego office market recorded an annual average of 1.27 million square feet of positive net absorption. Over the past two years the market has seen a total of only 28,000 square feet of net absorption. There are hundreds of thousands of square feet of preleased office space under construction, so this will add significant levels of positive net absorption in the coming quarters, as these new construction projects come online.

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Significant Transactions

Sales

Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
12255–12275 El Camino Real	Del Mar Heights/Carmel Valley	A	232,035	\$166,000,000	The Irvine Company	Metzler Real Estate
12544 High Bluff Dr.	Del Mar Heights/Carmel Valley	A	115,376	\$73,350,000	The Irvine Company	Clarion Partners
4180 La Jolla Village Dr.	UTC	A	94,162	\$39,500,000	Regent Properties	Bollert Lebeau
9909 & 9915 Mira Mesa Blvd.	Scripps Ranch	A	112,269	\$33,550,000	Peregrine Realty Partners	Eagle Realty Group
5825 Oberlin Dr.	Sorrento Mesa	B	60,518	\$24,787,500	TH Real Estate	Locale Advisors

Leases

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
5887 Copley Dr.	Kearny Mesa	A	141,696	Nov-2018	Guild Mortgage	Sudberry Properties
9779 Towne Centre Dr.	UTC	A	96,543	Dec-2018	Undisclosed	The Irvine Company
4760 Eastgate Mall	UTC	B	47,000	Oct-2018	Intercept	The Irvine Company
1420 Kettner Blvd.	Downtown	B	46,102	Oct-2018	Spaces	DivcoWest
350 Camino De La Reina	Mission Valley	B	34,000	Dec-2018	Undisclosed	The Casey Brown 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 4Q2018	Square Feet Available	Availability Rate 4Q2018	Average Asking Lease Rate	Net Absorption 4Q2018	Net Absorption 2018	Gross Absorption 4Q2018	Gross Absorption 2018
Downtown													
Downtown	125	12,707,968	372,000	4,527,617	1,933,732	15.22%	2,412,022	18.98%	\$2.79	(373,879)	(417,990)	235,019	863,819
Downtown Total	125	12,707,968	372,000	4,527,617	1,933,732	15.22%	2,412,022	18.98%	\$2.79	(373,879)	(417,990)	235,019	863,819
Central													
City Heights / University	31	1,216,139	0	0	31,102	2.56%	43,559	3.58%	\$2.47	5,918	13,430	6,029	50,278
Coronado	6	124,831	0	0	6,313	5.06%	6,313	5.06%	\$3.82	6,712	8,898	6,712	11,986
Kearny Mesa	236	10,886,898	0	104,000	815,331	7.49%	1,285,909	11.81%	\$2.31	(134,652)	(224,354)	94,967	621,416
Mission Gorge	20	588,430	0	0	9,929	1.69%	16,729	2.84%	\$1.87	5,811	4,118	10,103	15,842
Mission Valley	128	7,273,767	0	0	761,533	10.47%	955,829	13.14%	\$2.49	77,571	68,603	208,218	658,753
Old Town / Point Loma	83	2,534,694	0	230,000	141,629	5.59%	211,888	8.36%	\$2.62	21,119	2,292	44,599	161,194
Park East	17	273,122	0	0	6,763	2.48%	8,038	2.94%	\$2.26	1,150	(497)	1,150	1,495
Rose Canyon / Morena	52	1,190,226	0	0	62,357	5.24%	73,068	6.14%	\$1.93	(15,544)	(21,444)	10,789	64,413
Uptown / Hillcrest	78	2,217,559	0	0	103,597	4.67%	159,245	7.18%	\$2.58	(13,068)	5,309	16,314	113,442
Central Total	651	26,305,666	0	334,000	1,938,554	7.37%	2,760,578	10.49%	\$2.40	(44,983)	(143,645)	398,881	1,698,819
I-15 Corridor													
Escondido	91	1,968,765	0	121,614	196,272	9.97%	214,351	10.89%	\$2.12	25,049	4,890	74,024	147,279
Poway	30	1,323,600	0	160,000	36,415	2.75%	83,804	6.33%	\$2.33	5,066	35,040	15,851	90,324
Rancho Bernardo	106	6,827,091	0	2,308,747	749,270	10.97%	978,592	14.33%	\$3.02	112,258	91,769	230,256	761,984
Scripps Ranch	51	2,730,671	158,994	137,000	490,245	17.95%	560,084	20.51%	\$2.49	80,027	(109,417)	120,009	262,396
I-15 Corridor Total	278	12,850,127	158,994	2,727,361	1,472,202	11.46%	1,836,831	14.29%	\$2.77	222,400	22,282	440,140	1,261,983
North County Coastal													
Carlsbad	159	6,592,303	231,646	10,000	1,183,495	17.95%	1,539,292	23.35%	\$2.54	199,526	314,628	350,223	967,147
Del Mar Heights / Carmel Valley	76	4,759,218	0	954,458	808,865	17.00%	990,596	20.81%	\$4.29	9,527	(64,442)	139,798	436,144
North Beach Cities	110	2,536,525	24,000	114,933	189,035	7.45%	219,760	8.66%	\$3.54	17,029	(37,776)	42,634	185,968
North County Total	345	13,888,046	255,646	1,079,391	2,181,395	15.71%	2,749,648	19.80%	\$3.35	226,082	212,410	532,655	1,589,259
North City													
Governor Park	20	889,275	0	0	82,335	9.26%	147,276	16.56%	\$2.75	(10,210)	(11,775)	10,258	60,398
La Jolla	46	1,375,264	0	0	105,257	7.65%	204,683	14.88%	\$3.18	18,205	(11,727)	37,928	84,447
Miramar	34	1,591,313	0	0	135,402	8.51%	215,741	13.56%	\$1.79	25,127	26,440	36,935	135,499
Sorrento Mesa	122	9,633,835	0	2,339,446	1,069,089	11.10%	1,286,112	13.35%	\$2.76	122,023	173,944	323,702	838,117
Sorrento Valley	30	808,954	0	0	75,205	9.30%	104,744	12.95%	\$2.42	(34,176)	(8,610)	18,004	85,410
Torrey Pines	43	3,018,906	0	0	101,327	3.36%	286,710	9.50%	\$3.98	(5,206)	174,429	0	194,518
UTC	91	8,629,064	150,000	303,124	960,353	11.13%	1,030,986	11.95%	\$3.29	(42,081)	36,288	216,411	917,739
North City Total	386	25,946,611	150,000	2,642,570	2,528,968	9.75%	3,276,252	12.63%	\$2.80	73,682	378,989	643,238	2,316,128
Southern & Eastern Areas													
Chula Vista	90	2,905,034	0	1,545,100	233,348	8.03%	279,629	9.63%	\$2.49	1,473	19,777	35,446	105,738
National City	15	528,472	0	0	994	0.19%	994	0.19%	\$2.69	0	15,267	0	16,467
Otay Mesa	13	319,824	0	0	4,290	1.34%	38,670	12.09%	\$2.24	0	7,054	0	7,971
Southeast San Diego	13	479,269	0	290,000	59,698	12.46%	59,698	12.46%	\$2.35	6,870	8,870	6,870	8,870
East County	152	3,680,725	0	61,800	139,964	3.80%	147,677	4.01%	\$2.01	(13,486)	(315)	31,011	120,385
Southern & Eastern Areas Total	283	7,913,324	0	1,896,900	438,294	5.54%	526,668	6.66%	\$2.34	(5,143)	50,653	73,327	259,431
Highway 78 Corridor													
Oceanside	62	1,350,464	0	335,249	145,920	10.81%	226,976	16.81%	\$2.06	16,164	(8,047)	24,053	53,934
San Marcos	38	1,394,870	0	1,991,538	104,882	7.52%	138,788	9.95%	\$2.39	2,575	23,891	31,845	85,371
Vista	51	1,238,540	0	0	219,424	17.72%	349,820	28.24%	\$1.79	(59,968)	(9,594)	10,170	104,362
Highway 78 Corridor Total	151	3,983,874	0	2,326,787	470,226	11.80%	715,584	17.96%	\$2.03	(41,229)	6,250	66,068	243,667
Class A	287	36,317,123	857,994	11,767,753	4,745,369	13.07%	5,789,194	15.94%	\$3.31	428,877	170,847	1,200,568	3,459,821
Class B	1,262	52,680,937	78,646	3,766,873	5,285,725	10.03%	7,387,865	14.02%	\$2.52	(240,372)	115,403	1,035,253	4,069,791
Class C	670	14,597,556	0	0	932,277	6.39%	1,100,524	7.54%	\$1.98	(131,575)	(177,301)	153,507	703,494
San Diego County Total	2,219	103,595,616	936,640	15,534,626	10,963,371	10.58%	14,277,583	13.78%	\$2.78	56,930	108,949	2,389,328	8,233,106

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



Balance in the Market

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The San Diego office market just finished its second consecutive year of relative equilibrium. On aggregate, demand and supply remain balanced with net absorption just slightly positive for the past two years. The San Diego office market has seen vacancy stabilize in the 10–11% range since 2016. These solid fundamentals have allowed landlords to push rental rates higher. We are a decade into the recovery and tenants coming off of five-year leases are still getting sticker shock.

Because of the slow and steady nature of the rising occupancy and rental rates over the past decade, it's not uncommon to find occupiers (or sometimes their representatives) who still think it's a tenant's market. Long gone are the days of one month free per each year of term. We are now seeing about two months of free rent for a five-year lease, depending on the specifics of the transaction. It used to be that, outside of The Irvine Company, 3% annual rent increases were ubiquitous. At this point, we are seeing more and more landlords and leases implementing 3.25% or 3.5% annual rent increases, and these are no longer outliers. As far as tenant improvement allowances go, the market continues to command TI packages similar to those in recent years, but landlords are getting tight fisted when it comes to above-standard improvements.

In the investment arena, we are in the latter stages of this cycle, and because of that, investors are really sharpening their pencils and underwriting deals with a lot of scrutiny. Sales volume bottomed out in 2009, and then increased until 2015. While sales volume has slowed down over the past few years, pricing continues to move upward year after year. While some buyers have noted the pull back in sales volume and perceive an opportunity to achieve concessions, sellers have held fast, by and large. This has caused a gap in expectation between buyers and sellers in the market.

Landlords should be capitalizing on current market conditions, but not overplaying their hand. Be aware of the specific market conditions in your submarket, and among competing properties, because this can vary from the overall market.

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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. ©2019 Voit Real Estate Services, Inc. DRE 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