

## MARKET CHANGE

Compared to Previous Quarter:

Vacancy



UP

Net Absorption

NEGATIVE



Lease Rates



FLAT

Transactions

DOWN



Deliveries



UP

## HIGHLIGHTS

- **Slow but Steady** - The San Diego office market continues to show steady growth, however, at a slower pace as compared to the last few years. Transaction activity decreased nearly 40% since the second quarter of 2015, asking lease rates remain unchanged from the first quarter, and net absorption posted slightly negative. New deliveries to the market continue to promote the tenants' flight to quality, and the development pipeline will help to relieve the recent decrease in availability as demand remains strong.
- **Construction** - Office deliveries have averaged 725,000 square feet a year over the past five years. In the second quarter of 2016, approximately 374,626 square feet of new product was delivered including Atlas in Carlsbad and The Oberlin in Sorrento Mesa. This rate of construction is slightly above the historical average which may correlate with the slight uptick in vacancy this quarter. In addition to the new office construction, there has been a noteworthy trend towards property being extensively renovated and built out to creative office use, e.g., IDEA1, a mixed-use project in downtown San Diego that includes a very modern outlook on residential, retail and creative office, estimated to complete in 2018.
- **Vacancy** - Direct/sublease space (unoccupied) finished the quarter at 11.94%, a 34 basis point increase from the previous quarter, and a 329 basis point increase from first quarter 2015. Rancho Bernardo posted the lowest vacancy rate of any submarket (minimum of five million square feet of inventory) at 8.24%.
- **Availability** - Direct/sublease space being marketed was 14.90% at the end of the quarter, a slight increase from the 14.73% availability rate of the previous quarter.
- **Lease Rates** - The average asking full-service gross (FSG) lease rate per square foot per month in San Diego County was \$2.64 at the end of the quarter, unchanged from last quarter's record rate of \$2.64 but still a solid eighteen-cent increase over 2015's second quarter rate of \$2.46.
- **Absorption** - The San Diego office market posted 27,855 square feet of negative net absorption in the second quarter,

which equates to 556,209 square feet of positive net absorption for the first half of 2016. Class B office contributed the highest positive net absorption with 229,196 square feet absorbed in the second quarter, while Class C had a positive net absorption of 47,889 square feet. Class A office contributed to the overall county's negative net absorption, coming in at 304,940 square feet of negative absorption, including Qualcomm vacating more than 120,000 square feet at The Towers in Sorrento Mesa.

- **Transaction Activity** - Sale and lease transactions have totaled 3.2 million square feet in the second quarter, a decrease from the previous quarter's 4.7 million square feet and a decrease from the previous year's 5.17 million square feet. This statistic can have some lag time in being reported, so look for figures to end up somewhat higher in the next report.
- **Employment** - The unemployment rate in San Diego County was 4.2% in May 2016, down from a revised 4.5% in April 2016 and below the year-ago estimate of 5%. This compares with an unadjusted unemployment rate of 4.7% for California and 5.2% for the nation during the same period. According to the State of California Employment Development Department, San Diego County gained 32,200 payroll jobs from May 2015 and May 2016, including 7,600 from education and health services, which reported the largest overall gain. Professional and business services reported a growth of up to 6,500 jobs, followed by the government sector that reported up to 5,700 jobs.
- **Overall** - The San Diego office market is steady for now, but may be seeing a slight shift in market fundamentals as we are in the latter stages of the current recovery. Construction levels of new office product remain relatively low compared to 2005-2008, as developers continue to focus on repositioning projects. Unemployment rates have continued to trend downward since the peak in January 2010. An increase in jobs and minimal speculative construction have set the San Diego office market on firmer footing.

## FORECAST

- **Employment** - We anticipate job growth of around 2.5%, or 35,000 jobs, in San Diego County over the year. Look for sectors like professional, scientific, & technical services, health care & social services, and leisure & hospitality to lead the way for employment gains in 2016.
- **Lease Rates** - Expect the average asking lease rate to increase by 3% to 4% percent over the next four quarters.
- **Vacancy** - While we anticipate vacancy to continue to descend, it will happen at a more moderate pace in coming quarters, dropping to approximately 11.5%, by the end of the fourth quarter of 2016.

## OVERVIEW

	2Q16	1Q16	2Q15	% of Change vs. 2Q15
Total Vacancy Rate	11.94%	11.60%	11.56%	3.29%
Availability Rate	14.90%	14.73%	15.53%	(4.06%)
Average Asking Lease Rate	\$2.64	\$2.64	\$2.46	7.32%
Sale & Lease Transactions	3,217,749	4,758,316	5,169,947	(37.76%)
Gross Absorption	2,064,795	1,869,825	1,571,582	31.38%
Net Absorption	(27,855)	584,064	279,088	N/A

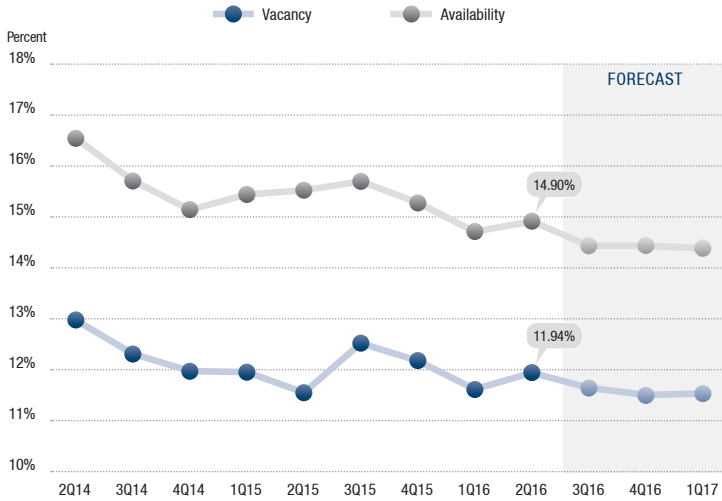
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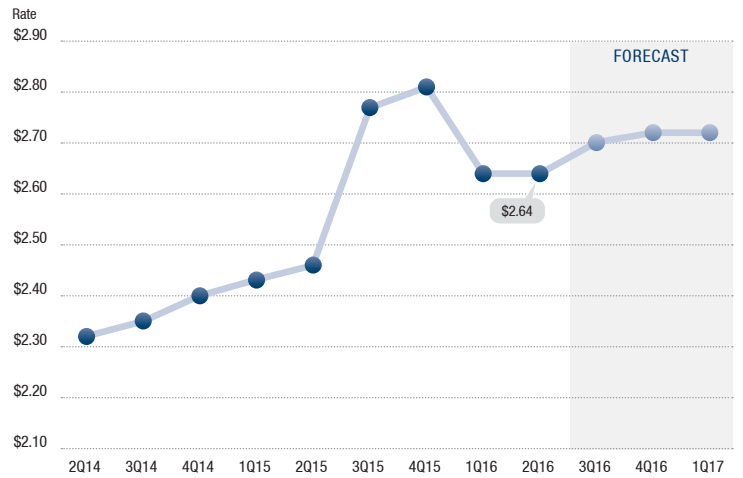
## VACANCY & AVAILABILITY RATE

VACANCY – UNOCCUPIED SPACE | AVAILABILITY – ALL SPACE BEING MARKETED



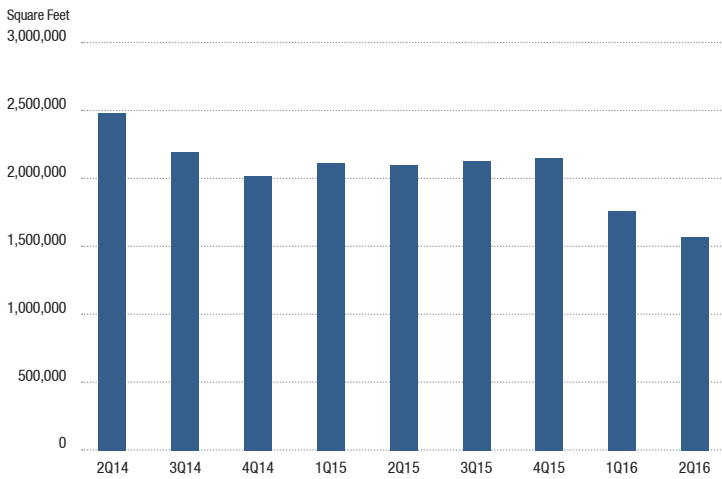
## AVERAGE ASKING FULL-SERVICE LEASE RATE

MONTHLY BASE RENT ON A PER SQ. FT. BASIS



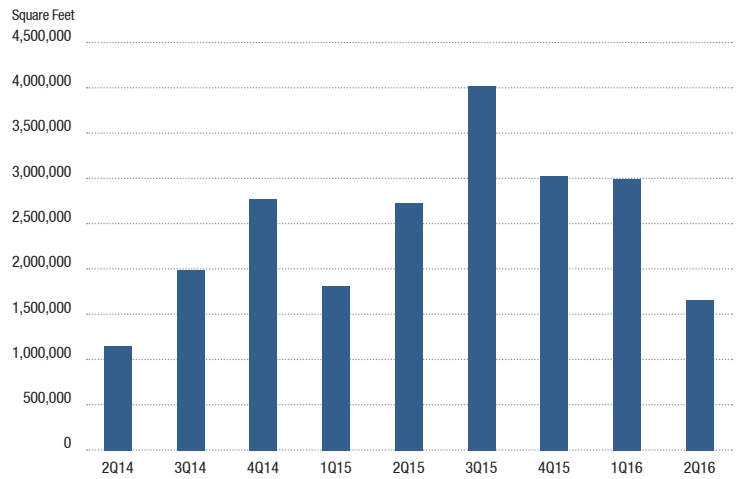
## LEASE TRANSACTIONS

TOTAL AMOUNT OF SPACE THAT LEASED IN A QUARTER



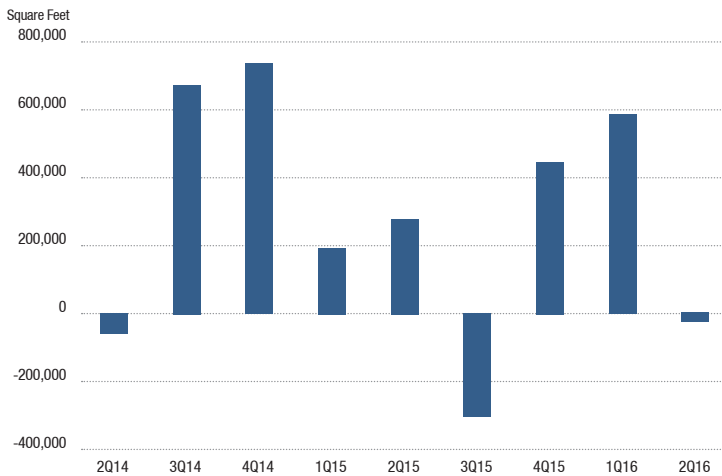
## SALES TRANSACTIONS

TOTAL AMOUNT OF SPACE THAT SOLD IN A QUARTER



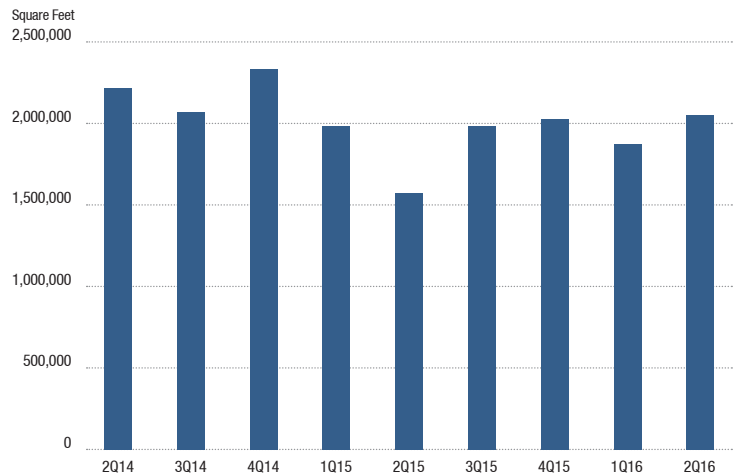
## NET ABSORPTION

CHANGE IN THE AMOUNT OF OCCUPIED SPACE FROM ONE QUARTER TO THE NEXT



## GROSS ABSORPTION

TOTAL AMOUNT OF SPACE THAT BECAME OCCUPIED IN A QUARTER



	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 2Q2016	Square Feet Available	Availability Rate 2Q2016	Average Asking Lease Rate	Net Absorption 2Q2016	Net Absorption 2016	Gross Absorption 2Q2016	Gross Absorption 2016
<b>Downtown</b>													
Downtown	136	13,038,332	0	2,726,244	2,030,448	15.57%	2,474,729	18.98%	\$2.43	25,350	75,512	249,579	458,195
Downtown Total	136	13,038,332	0	2,726,244	2,030,448	15.57%	2,474,729	18.98%	\$2.43	25,350	75,512	249,579	458,195
<b>Central</b>													
City Heights / University	29	1,058,511	0	0	51,770	4.89%	56,141	5.30%	\$0.00	7,648	1,014	20,926	22,582
Coronado	6	124,831	0	0	0	0.00%	11,561	9.26%	\$0.00	0	930	0	930
Kearny Mesa	238	10,592,575	0	690,000	1,091,997	10.31%	1,262,003	11.91%	\$1.99	45,194	138,384	186,563	377,321
Mission Gorge	26	592,926	0	0	37,645	6.35%	40,963	6.91%	\$1.07	1,378	(10,526)	1,378	2,204
Mission Valley	124	6,954,211	0	0	799,861	11.50%	1,050,757	15.11%	\$2.55	(151,676)	(173,622)	183,382	283,918
Old Town / Point Loma	66	2,131,808	0	0	171,137	8.03%	225,180	10.56%	\$0.00	(2,920)	39,130	29,338	96,539
Park East	8	155,884	0	0	4,766	3.06%	4,766	3.06%	\$0.00	979	979	979	3,539
Rose Canyon / Morena	55	1,265,959	0	0	68,157	5.38%	75,296	5.95%	\$1.50	(5,694)	(15,773)	22,824	34,337
Uptown / Hillcrest	106	2,721,842	0	0	167,368	6.15%	205,180	7.54%	\$2.28	43,969	40,648	75,930	109,012
Central Total	658	25,598,547	0	690,000	2,392,701	9.35%	2,931,847	11.45%	\$2.20	(61,122)	21,164	521,320	930,382
<b>I-15 Corridor</b>													
Escondido	91	1,890,494	0	60,000	178,146	9.42%	233,518	12.35%	\$1.51	37,074	51,367	46,363	61,388
Poway	29	1,303,653	0	630,000	78,732	6.04%	98,613	7.56%	\$0.00	1,245	10,120	3,355	24,178
Rancho Bernardo	108	6,763,025	100,000	1,010,002	557,235	8.24%	1,063,409	15.72%	\$0.00	(11,274)	48,625	72,846	191,730
Scripps Ranch	50	2,678,040	0	903,000	260,303	9.72%	298,220	11.14%	\$2.35	44,052	59,622	61,899	119,291
I-15 Corridor Total	278	12,635,212	100,000	2,603,002	1,074,416	8.50%	1,693,760	13.41%	\$2.23	71,097	169,734	184,463	396,587
<b>North County Coastal</b>													
Carlsbad	155	6,323,299	0	338,754	1,286,629	20.35%	1,435,980	22.71%	\$2.10	(3,081)	21,306	121,996	248,495
Del Mar Heights / Carmel Valley	74	4,661,111	92,000	925,059	688,343	14.77%	1,068,399	22.92%	\$3.37	(133,341)	(118,165)	57,095	121,656
North Beach Cities	111	2,523,276	20,461	55,000	121,258	4.81%	187,175	7.42%	\$2.74	645	9,159	41,184	97,819
North County Total	340	13,507,686	112,461	1,318,813	2,096,230	15.52%	2,691,554	19.93%	\$2.88	(135,777)	(87,700)	220,275	467,970
<b>North City</b>													
Governor Park	19	860,055	0	0	73,341	8.53%	89,818	10.44%	\$2.95	76,668	50,472	93,088	106,583
La Jolla	54	1,632,521	0	0	129,674	7.94%	174,700	10.70%	\$2.45	27,491	42,900	64,862	98,185
Miramar	35	1,641,840	0	0	271,044	16.51%	247,666	15.08%	\$2.25	(3,221)	(1,142)	25,847	54,794
Sorrento Mesa	123	9,696,204	0	2,169,063	1,272,668	13.13%	1,540,685	15.89%	\$2.70	14,813	194,659	285,463	554,512
Sorrento Valley	27	785,571	0	0	65,839	8.38%	129,020	16.42%	\$0.00	7,352	47,227	17,203	67,405
Torrey Pines	40	2,549,431	0	0	107,681	4.22%	128,633	5.05%	\$4.05	75,642	57,830	99,979	104,532
UTC	87	8,572,406	96,435	339,684	1,601,870	18.69%	1,901,698	22.18%	\$3.60	(177,537)	(223,626)	148,002	251,150
North City Total	385	25,738,028	96,435	2,508,747	3,522,117	13.68%	4,212,220	16.37%	\$3.46	21,208	168,320	734,444	1,237,161
<b>Southern &amp; Eastern Areas</b>													
Chula Vista	93	2,889,928	0	438,000	296,501	10.26%	303,523	10.50%	\$1.81	(9,283)	17,848	27,210	88,937
East County	147	3,580,540	13,200	181,000	162,994	4.55%	219,484	6.13%	\$1.58	29,705	86,468	52,117	149,129
National City	14	516,904	0	0	15,601	3.02%	15,601	3.02%	\$0.00	1,737	104,549	2,790	106,984
Otay Mesa	12	285,999	0	0	17,649	6.17%	17,649	6.17%	\$1.30	0	8,617	0	8,617
Southeast San Diego	10	391,848	0	0	60,380	15.41%	64,652	16.50%	\$2.20	0	1,800	0	1,800
Southern & Eastern Areas Total	276	7,665,219	13,200	619,000	553,125	7.22%	620,909	8.10%	\$1.71	22,159	219,282	82,117	355,467
<b>Highway 78 Corridor</b>													
Oceanside	61	1,335,657	0	310,249	196,195	14.69%	239,327	17.92%	\$1.57	12,868	(7,675)	22,864	46,986
San Marcos	36	1,332,912	0	1,367,139	144,127	10.81%	152,905	11.47%	\$0.00	22,009	16,512	30,311	35,769
Vista	50	1,263,274	0	11,800	180,930	14.32%	198,668	15.73%	\$1.67	(5,647)	(18,850)	19,422	23,591
Highway 78 Corridor Total	147	3,931,843	0	1,689,188	521,252	13.26%	590,900	15.03%	\$1.65	29,230	(10,013)	72,597	106,346
Class A	272	34,919,367	208,896	9,561,355	4,067,276	11.65%	5,515,482	15.79%	\$3.18	(304,940)	(52,653)	570,994	1,251,726
Class B	1,226	51,372,067	113,200	2,593,639	6,955,589	13.54%	8,143,473	15.85%	\$2.18	229,196	524,546	1,256,165	2,255,886
Class C	722	15,823,433	0	0	1,167,424	7.38%	1,556,964	9.84%	\$1.63	47,889	84,316	237,636	444,496
<b>San Diego County Total</b>	<b>2,220</b>	<b>102,114,867</b>	<b>322,096</b>	<b>12,154,994</b>	<b>12,190,289</b>	<b>11.94%</b>	<b>15,215,919</b>	<b>14.90%</b>	<b>\$2.64</b>	<b>(27,855)</b>	<b>556,299</b>	<b>2,064,795</b>	<b>3,952,108</b>

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

**MAJOR TRANSACTIONS**

**Sales Transactions**

Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
Torrey Pines Court – 5 Properties	Torrey Pines	A	216,476	\$134,100,000	Regents of the University of California	Rockwood Capital, LLC
9360 & 9390 Towne Centre Dr.	UTC	A	144,311	\$55,000,000	BioMed Realty Trust	W.P. Carey, Inc.
610 W. Ash St.	Downtown	A	177,489	\$55,000,000	Gemini Rosemont	The Blackstone Group, LP
1010 2nd Ave.	Downtown	B	324,341	\$54,400,000	Hammer Ventures	Jamison Services, Inc.
10277 Scripps Ranch Blvd.	Scripps Ranch	A	69,900	\$17,840,000	Graymark Capital	Twenty-Seven M H, Inc.

**Lease Transactions**

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
8925 & 8945 Rehco Rd.	Miramar	B	89,488	May-2016	Scripps	LBA Realty
5887 Copley Dr.	Kearny Mesa	A	38,244	May-2016	Guild Mortgage Co.	Sudberry Properties, Inc.
12230 World Trade Dr. – Renewal	Rancho Bernardo	B	23,573	Apr-2016	Nextivity, Inc.	Palisades Equity Partners
701 B St.	Downtown	A	23,468	Jun-2016	Undisclosed	Emmes Group of Companies
5857 Owens Ave.	Carlsbad	A	22,247	Apr-2016	Undisclosed	Wasatch Commercial Management

**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.

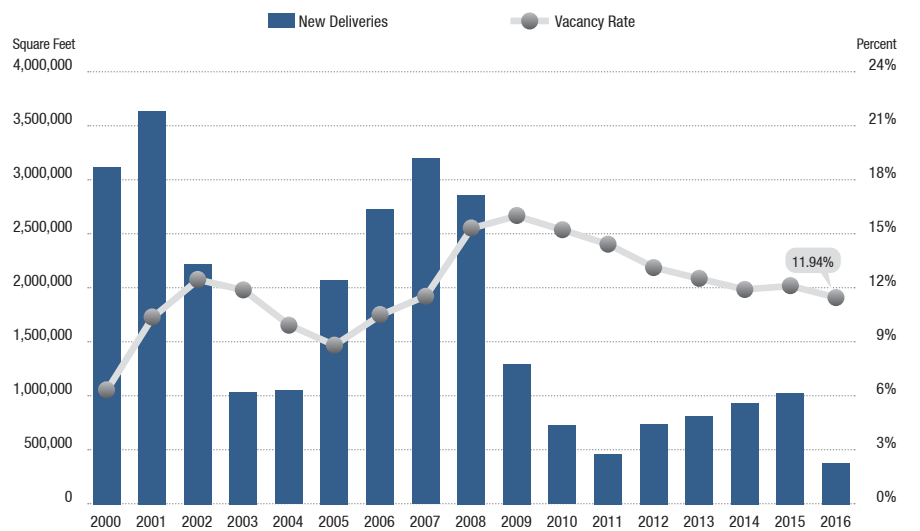
**CLASS B**

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.

**ANNUAL NEW DELIVERIES VS. VACANCY RATE**



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