

STEADY GROWTH. The San Diego office market had a great third quarter, posting over 470,000 square feet of positive net absorption, compared with negative net absorption last quarter. This gives the market a total of approximately 3 million square feet of positive absorption for the last ten quarters. Vacancy continued its downward trend and lease rates increased by nearly \$.20 per square foot compared with last quarter.

VACANCY. Direct/sublease space (unoccupied) finished the quarter at 11.47%, a 46 basis point decrease from the previous quarter, and a 105 basis point decrease from third quarter 2015. Rancho Bernardo posted the lowest vacancy rate of any submarket (minimum of five million square feet of inventory) at 6.93%.

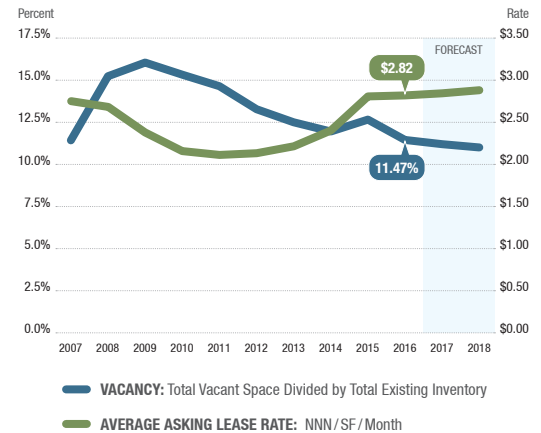
LEASE RATES. The average asking full service gross (FSG) lease rate per square foot per month in San Diego County was \$2.82 at the end of the quarter, an almost 20 cent increase from last quarter's record rate of \$2.64 and still an increase from 2015's third quarter rate of \$2.77.

TRANSACTION ACTIVITY. Sale and lease transactions have totaled 2.59 million square feet in the third quarter, a decrease from the previous quarter's 3.38 million square feet and over a 55% decrease from the previous year's 6.15 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.

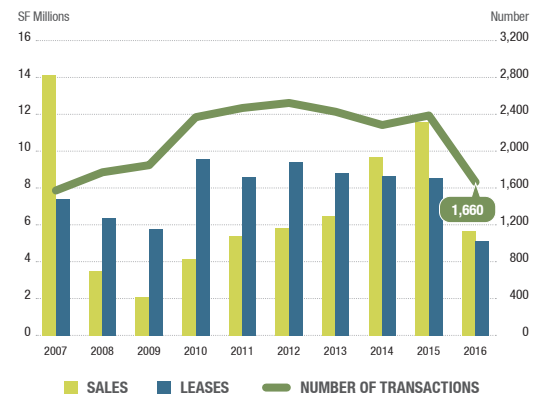
EMPLOYMENT. The unemployment rate in San Diego County was 5.0% in August 2016, down from a revised 5.3% in July 2016 and below the year-ago estimate of 5.2%. This compares with an unadjusted unemployment rate of 5.6% for California and 5.0% for the nation during the same period. According to the State of California Employment Development Department, San Diego County gained 25,100 payroll jobs from August 2015 and August 2016, including 6,200 from government services, which reported the largest overall gain. Leisure and hospitality services reported a growth of up to 6,100 jobs, followed by the educational and health services that reported up to 6,000 jobs.

OVERALL. The San Diego office market is steady for now and still showing definite signs of growth, but we 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.

VACANCY vs. AVERAGE ASKING LEASE RATE



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



Market Statistics

	Change Over Last Quarter	3Q 2016	2Q 2016	3Q 2015	% Change Over Last Year
Vacancy Rate	▼ DOWN	11.47%	11.93%	12.52%	-8.39%
Availability Rate	▲ UP	14.82%	14.62%	15.69%	-5.54%
Average Asking Lease Rate	▲ UP	\$2.82	\$2.64	\$2.77	1.81%
Sale & Lease Transactions	▼ DOWN	2,586,699	3,377,129	6,146,719	-57.92%
Gross Absorption	▼ DOWN	1,880,175	2,055,606	1,971,076	-4.61%
Net Absorption	▲ POSITIVE	470,443	(57,327)	(291,438)	N/A

EMPLOYMENT. We anticipate job growth of around 2.5%, or 35,000 jobs, in San Diego County over the next twelve months. Look for sectors like professional, scientific, & technical services, construction, and real estate, rental and leasing services 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.

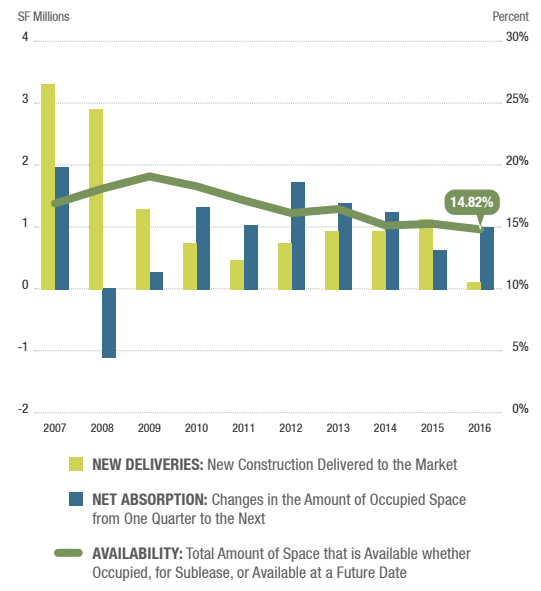
VACANCY. We anticipate vacancy to continue to descend this quarter at the same pace as last quarter, resulting in a vacancy of approximately 11% by the end of 2016.

CONSTRUCTION. Office deliveries have averaged 725,000 square feet per year over the past five years, but the deliveries through three quarters are only around 400,000 square feet, with no expected deliveries for the fourth quarter. This low rate of product delivery for 2016 is helping to push vacancy down. There are 352,728 square feet currently under construction planned to be completed in 2017. In addition to the new office construction, there has been a noteworthy trend towards property being extensively renovated and built into creative office use, e.g., IDEA1, a mixed use project downtown that includes a very modern combination of residential, retail and creative office (estimated delivery 2018).

AVAILABILITY. Direct / sublease space being marketed was 14.82% at the end of the quarter, a slight increase from the 14.62% availability rate of the previous quarter.

ABSORPTION. The San Diego office market posted 470,443 square feet of positive net absorption in the third quarter, which equates to 997,199 square feet of positive net absorption year to date. Class A office contributed the highest positive net absorption with 226,280 square feet absorbed in the third quarter, while Class B had a positive net absorption of 220,141 square feet, and Class C contributed with 24,022 square feet of positive net absorption.

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Significant Transactions

Sales

Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
12396 World Trade Dr., 11545 W. Bernardo Ct., & 5120 Shoreham Pl.	Portfolio	B	145,768	\$30,500,000	Omninet Capital	The Blackstone Group, LP
10421 & 10431 Wateridge Cir.	Sorrento Mesa	B	125,424	\$28,000,000	Angelo, Cordon, & Co.	SteelWave, Inc.
2530 Campbell Pl.	Carlsbad	B	41,000	\$13,000,000	Testa Family, LP	Oddo Family Trust
3444 Kearny Villa Rd.	Kearny Mesa	B	38,665	\$12,450,000	Michael R. Lenihan, MD	Nikou Investment Corporation
7300 Girard Ave.	La Jolla	C	14,055	\$11,526,000	Coppel Corporation	Sean Levi

Leases

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
600 B St.	Downtown	B	88,273	Jul-2016	WeWork	Angelo, Gordon, & Co.
3666 Kearny Villa Rd.	Kearny Mesa	B	58,222	Jul-2016	County of San Diego	Pacifica Real Estate Services, Inc.
9605 Scranton Rd.	Sorrento Mesa	A	41,383	Jul-2016	Novatel Wireless	Sublease
9860 Mesa Rim Rd.	Sorrento Mesa	B	40,754	Aug-2016	USC	Washington Capital Management, Inc.
2305 Historic Decatur Rd.	Point Loma	A	33,821	Sep-2016	Corelation, Inc.	Kilroy Realty

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 3Q2016	Square Feet Available	Availability Rate 3Q2016	Average Asking Lease Rate	Net Absorption 3Q2016	Net Absorption 2016	Gross Absorption 3Q2016	Gross Absorption 2016
Downtown													
Downtown	134	13,004,618	0	3,450,644	1,853,159	14.25%	2,290,347	17.61%	\$2.65	92,081	227,813	290,391	808,330
Downtown Total	134	13,004,618	0	3,450,644	1,853,159	14.25%	2,290,347	17.61%	\$2.65	92,081	227,813	290,391	808,330
Central													
City Heights / University	29	1,058,511	0	0	45,944	4.34%	49,342	4.66%	\$0.00	(1,020)	(863)	200	22,782
Coronado	6	124,831	0	0	11,561	9.26%	11,561	9.26%	\$0.00	(11,561)	(10,631)	0	930
Kearny Mesa	236	10,632,067	0	690,000	1,001,455	9.42%	1,138,199	10.71%	\$1.97	78,827	246,410	186,014	605,249
Mission Gorge	26	592,926	0	0	38,842	6.55%	43,538	7.34%	\$1.11	0	(11,723)	0	2,204
Mission Valley	123	6,909,392	0	0	745,032	10.78%	1,027,942	14.88%	\$2.69	49,412	(144,507)	195,839	474,435
Old Town / Point Loma	66	2,131,808	0	0	155,598	7.30%	191,383	8.98%	\$1.85	(4,979)	40,151	29,063	120,509
Park East	8	155,884	0	0	4,766	3.06%	4,766	3.06%	\$0.00	0	979	0	3,539
Rose Canyon / Morena	54	1,224,021	0	0	71,724	5.86%	74,603	6.09%	\$2.00	(3,136)	(19,340)	15,390	50,277
Uptown / Hillcrest	106	2,759,177	0	28,500	215,108	7.80%	229,906	8.33%	\$2.94	15,567	17,517	41,293	127,253
Central Total	654	25,588,617	0	718,500	2,290,030	8.95%	2,771,240	10.83%	\$2.35	123,110	117,993	467,799	1,407,178
I-15 Corridor													
Escondido	91	1,888,816	0	60,000	162,085	8.58%	239,706	12.69%	\$1.82	13,008	67,428	28,853	93,123
Poway	29	1,303,653	0	610,000	71,777	5.51%	96,059	7.37%	\$0.00	6,955	17,075	17,141	41,319
Rancho Bernardo	106	6,727,761	100,000	1,900,000	466,060	6.93%	1,001,452	14.89%	\$2.30	54,208	102,422	109,290	338,398
Scripps Ranch	51	2,704,529	0	1,153,000	222,104	8.21%	417,212	15.43%	\$2.35	43,075	107,620	67,434	192,624
I-15 Corridor Total	277	12,624,759	100,000	3,723,000	922,026	7.30%	1,754,429	13.90%	\$2.30	117,246	294,545	222,718	665,464
North County Coastal													
Carlsbad	155	6,323,837	30,632	218,754	1,254,152	19.83%	1,480,345	23.41%	\$2.10	31,344	53,783	192,961	436,888
Del Mar Heights / Carmel Valley	74	4,663,227	92,000	940,000	677,797	14.53%	1,066,827	22.88%	\$3.54	20,437	(107,619)	73,633	195,289
North Beach Cities	112	2,643,777	20,461	55,000	123,310	4.66%	176,750	6.69%	\$2.86	388	7,107	27,843	125,752
North County Total	341	13,630,841	143,093	1,213,754	2,055,259	15.08%	2,723,922	19.98%	\$2.82	52,169	(46,729)	294,437	757,929
North City													
Governor Park	19	860,055	0	0	62,398	7.26%	99,294	11.55%	\$3.05	79,466	61,415	88,305	129,633
La Jolla	54	1,644,565	0	0	149,646	9.10%	201,801	12.27%	\$3.88	(27,741)	6,933	34,475	116,922
Miramar	35	1,641,840	0	0	263,610	16.06%	268,927	16.38%	\$0.00	7,434	6,292	33,883	88,677
Sorrento Mesa	122	9,617,550	0	2,169,063	1,279,329	13.30%	1,610,984	16.75%	\$2.37	8,946	187,998	114,017	671,979
Sorrento Valley	29	821,537	0	0	84,189	10.25%	129,808	15.80%	\$0.00	4,146	64,420	9,108	89,560
Torrey Pines	40	2,548,373	0	0	106,048	4.16%	184,406	7.24%	\$4.05	1,633	59,463	11,500	116,032
UTC	87	8,572,406	96,435	346,684	1,633,775	19.06%	1,912,238	22.31%	\$3.50	(40,225)	(255,531)	172,384	423,534
North City Total	386	25,706,326	96,435	2,515,747	3,578,995	13.92%	4,407,458	17.15%	\$3.45	33,659	130,990	463,672	1,636,337
Southern & Eastern Areas													
Chula Vista	89	2,787,619	0	438,000	260,646	9.35%	301,384	10.81%	\$2.03	30,120	53,043	46,177	135,114
East County	151	3,681,816	13,200	10,000	147,797	4.01%	200,436	5.44%	\$1.80	13,891	102,325	33,419	184,514
National City	14	508,388	0	0	28,088	5.52%	28,088	5.52%	\$0.00	(13,322)	91,972	705	108,524
Otay Mesa	12	288,004	0	0	16,986	5.90%	16,986	5.90%	\$1.30	663	9,280	7,704	16,321
Southeast San Diego	9	381,826	0	0	57,350	15.02%	57,350	15.02%	\$0.00	3,030	4,830	3,030	4,830
Southern & Eastern Areas Total	275	7,647,653	13,200	448,000	510,867	6.68%	604,244	7.90%	\$1.83	34,382	261,450	91,035	449,303
Highway 78 Corridor													
Oceanside	61	1,338,122	0	310,249	182,724	13.66%	236,703	17.69%	\$1.57	5,393	5,796	12,098	54,574
San Marcos	36	1,332,912	0	1,367,139	136,956	10.27%	146,588	11.00%	\$0.00	11,895	23,683	23,881	59,650
Vista	50	1,264,442	0	11,800	180,422	14.27%	202,880	16.05%	\$1.67	508	(18,342)	14,144	37,735
Highway 78 Corridor Total	147	3,935,476	0	1,689,188	500,102	12.71%	586,171	14.89%	\$1.65	17,796	11,137	50,123	151,959
Class A	275	35,369,368	208,896	11,447,694	3,838,391	10.85%	6,036,424	17.07%	\$3.22	226,280	220,939	669,290	2,040,557
Class B	1,227	51,185,553	143,832	2,311,139	6,773,423	13.23%	7,647,281	14.94%	\$2.28	220,141	649,986	1,014,328	3,176,158
Class C	712	15,583,369	0	0	1,098,624	7.05%	1,454,106	9.33%	\$1.67	24,022	126,274	196,557	659,785
San Diego County Total	2,214	102,138,290	352,728	13,758,833	11,710,438	11.47%	15,137,811	14.82%	\$2.82	470,443	997,199	1,880,175	5,876,500

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



Market Update

by **Brian Mulvaney, SIOR, CCIM**

SENIOR VICE PRESIDENT, SAN DIEGO

The San Diego office market experienced a significant decrease in availability over the prior quarter and is nearing single-digit vacancy. In fact, the San Diego office market is close to having the lowest vacancy in almost 25 years. The lack of new construction over the past ten years has led to peak rents in certain submarkets. There were only two new high-rise office buildings added to the inventory in the past twelve months. One of the projects was a build-to-suit for Sempra Energy downtown adjacent to Petco Park. The second was One La Jolla Center in the heart of UTC, with one of the highest asking rental rates in the submarket, averaging \$4.40 per square foot.

The regional office market is constrained by the scarcity of land, so we are now seeing owners reposition their office properties by completing lobby and common area renovations, landscape improvements, and adding outdoor amenities. This trend has even occurred in the downtown and urban core areas, where older office buildings have been demolished and repositioned as open plan, creative office, inspiring collaboration and attracting tenants looking for alternative work environments. Amenities for this type of space are completely different from the standard lockers, showers and gymnasiums, instead providing for ping-pong and foosball tables, clustered work stations, areas to “kick back” and collaborate—anything to create an atmosphere which millennials will perceive as cool and different.

The office market has posted reasonably positive net absorption for the third quarter, and we anticipate seeing this trend to continue into the foreseeable future. Experts are cautious to note that organic growth has been the majority of the market expansion with the creation of new startup and technology-based businesses. Some markets are still recovering from downsizing by companies like Qualcomm and SAIC, however the bulk of mid-city markets have recovered from the reductions by these large employers.

Office lease rates are up significantly from 2015, with an average countywide lease rate of \$2.82 per square foot. The marketplace is seeing the highest effective rental rates we have experienced with some markets exceeding \$4.25 per square foot per month. Lease concessions are down, creating an optimum situation for landlords owning quality product.

The investment market for the office sector is still rolling along at a healthy pace, though transaction volume is down slightly from the same period in 2015. We are seeing an increase in asset prices and we are right back to and exceeding peak pricing levels, creating another historical high point in local markets.

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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. ©2016 Voit Real Estate Services, Inc. License #01333376.

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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