

TIGHT MARKET. The San Diego Flex R&D market fundamentals displayed continued signs of tightened supply, with decreasing availability, flat lease rates and a 47% decline in transactions compared with the third quarter of 2015. However, with the steady pace of job growth in the biotech and life sciences industries that drive the Flex R&D market in San Diego, the market will continue to grow at a steady pace.

VACANCY. Direct/sublease space (unoccupied) finished the quarter at 8.02%, a decrease of 13.48% when compared with the same quarter last year, and a decrease of nearly 50% from 2011's rate of 15.62%.

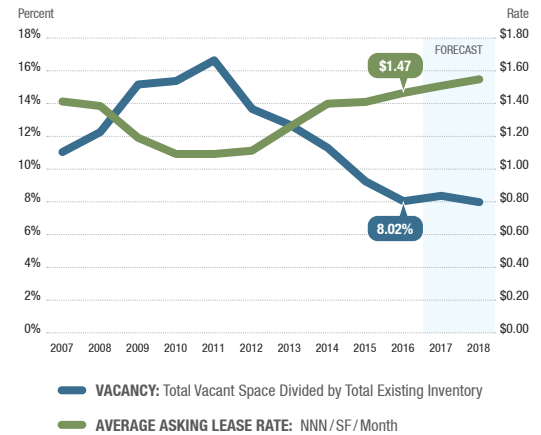
LEASE RATES. The average asking triple net lease rate per square foot per month in San Diego County was \$1.47 at the end of the third quarter, which is unchanged from last quarter's rate of \$1.47. Average asking lease rates have risen a full forty cents since the recession lows seen in the first and second quarters of 2011.

TRANSACTION ACTIVITY. The combined amount of square feet leased and sold in the second quarter totaled 1.1 million square feet, which is less than half of last quarter's total of 2.45 million square feet. 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.

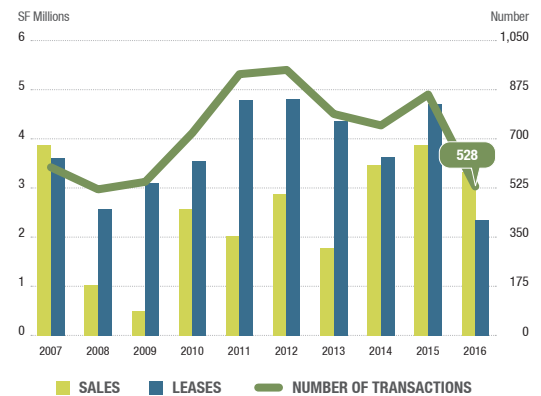
EMPLOYMENT. The unemployment rate in San Diego County was 5.0% in August 2016, down from a revised 5.3% in July 2016 and below the year-ago estimate of 5.2%. This compares with an unadjusted unemployment rate of 5.6% for California and 5.0% for the nation during the same period. According to the State of California Employment Development Department, San Diego County gained 25,100 payroll jobs from August 2015 through 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. Although the San Diego Flex R&D market may be tight, the San Diego region's economy outpaced the rest of the state and the nation growing at 3.1%, and the recovery is still in full swing. The majority of job growth is the result of expansion in the life sciences and biotech sectors which drive the flex R&D product. Because of such a booming industry targeted in San Diego specifically, there is over 1 million square feet under construction that will contribute to increased availability in the coming future.

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	8.02%	8.52%	9.27%	-13.48%
Availability Rate	▼ DOWN	12.78%	13.17%	13.56%	-5.75%
Average Asking Lease Rate	▬ FLAT	\$1.47	\$1.47	\$1.41	4.26%
Sale & Lease Transactions	▼ DOWN	1,103,642	2,447,143	2,092,350	-47.25%
Gross Absorption	▼ DOWN	763,003	772,967	1,460,002	-47.74%
Net Absorption	▲ POSITIVE	129,318	(50,613)	468,773	N/A

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, construction, and real estate, rental and leasing services to lead the way for employment gains in 2016.

CONSTRUCTION. After four years of depressed levels of construction, vacancy rates have fallen so much that developers are moving ahead with new construction. We anticipate increased levels of construction in the coming quarters.

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

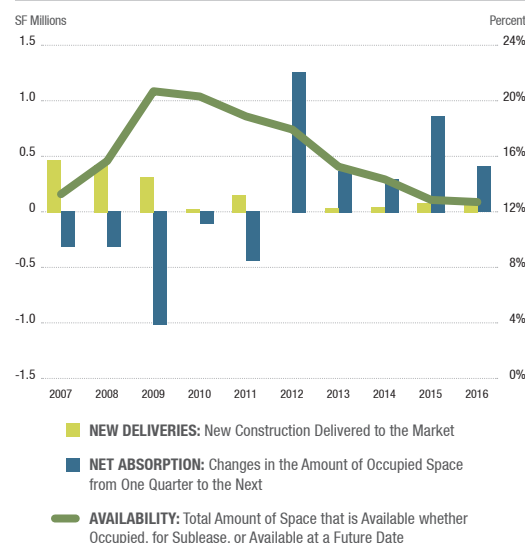
VACANCY. With some new deliveries hitting the market this year, we anticipate vacancy rates to tick up slightly in the coming quarter, to around 8.5% by the end of the year.

CONSTRUCTION. At the end of the third quarter, there were five buildings totaling 1,159,657 square feet under construction in San Diego County's flex market. This is one of the largest numbers of square feet under construction the flex market has seen in more than ten years. Notable projects underway for two prominent biotech companies include Eli Lilly's expansion at Campus Pointe in UTC and the future campus of Illumina, Inc. at i3 Campus, also located in UTC.

AVAILABILITY. Direct/sublease space being marketed was 12.78% at the end of the quarter, a 5.75% decrease from the previous year's rate of 13.56%.

ABSORPTION. The San Diego Flex R&D market posted 129,318 square feet of positive net absorption in the third quarter, giving the market a total of approximately 3.18 million square feet of positive absorption since the first quarter of 2012.

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Significant Transactions

Sales

Property Address	Submarket	Square Feet	Sale Price	Buyer	Seller
4930, 4939, 4955 Directors Pl.	Sorrento Mesa	137,000	\$49,000,000	HCP, Inc.	Kilroy Realty Corporation
9173 & 9177 Sky Park Ct.	Kearny Mesa	65,535	\$13,700,000	Rich Uncles	Equity Commonwealth Management, LLC
1812 Aston Ave.	Carlsbad	65,310	\$10,000,000	RAF Pacifica Group, Inc.	The Blackmore Company
10840 Thornmint Rd.	Rancho Bernardo	43,423	\$7,400,000	Mark McEwen	Colony Realty Partners
3186 Lionshead Ave.	Carlsbad	20,142	\$3,725,000	Gildred Companies	Howard's Rug Company

Leases

Property Address	Submarket	Square Feet	Transaction Date	Tenant	Owner
4955 Directors Pl.	Sorrento Mesa	76,687	Sep-2016	Sorrento Therapeutics	HCP, Inc.
1600 Faraday Ave.	Carlsbad	59,860	Jul-2016	AutoGenomics	Hamann Companies
4215 Sorrento Valley Rd.	Sorrento Valley	24,000	Aug-2016	Precision Toxicology	The Blackstone Group, LP
8572 Spectrum Ln.	Miramar	23,959	Sep-2016	Custom Nutra, Inc.	First Industrial Realty Trust, Inc.
9889 Willow Creek Rd.	Scripps Ranch	19,941	Jul-2016	TechFlow	The Currie Partners, Inc.

	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
Central													
Central City	17	209,273	0	0	8,386	4.01%	8,386	4.01%	\$0.00	6,000	(17,307)	6,000	10,525
East City	3	31,892	0	0	0	0.00%	0	0.00%	\$0.00	0	0	0	0
Southeast City	16	195,280	0	0	0	0.00%	0	0.00%	\$0.00	0	0	0	0
Kearny Mesa	207	5,495,653	0	0	329,827	6.00%	429,693	7.82%	\$1.35	(9,369)	(61,836)	58,436	200,010
Mission Gorge	24	170,168	0	0	8,316	4.89%	8,316	4.89%	\$0.00	8,366	(6,190)	8,366	10,492
Rose Canyon/Morena	38	609,335	0	0	29,543	4.85%	31,957	5.24%	\$0.00	(12,463)	9,872	18,429	71,035
Sports Arena/Airport	30	380,720	0	0	21,048	5.53%	21,048	5.53%	\$0.00	350	(1,350)	350	1,750
Miramar	215	4,645,844	0	11,760	411,703	8.86%	638,101	13.73%	\$1.32	(24,722)	(142,677)	115,616	250,400
Sorrento Mesa	159	5,848,053	0	618,000	784,555	13.42%	947,063	16.19%	\$1.54	86,807	(25,514)	147,104	399,252
Sorrento Valley	103	2,356,338	0	0	142,088	6.03%	330,806	14.04%	\$2.00	(15,422)	41,954	67,444	167,304
Torrey Pines/UTC	66	5,188,458	1,040,952	772,833	523,247	10.08%	797,449	15.37%	\$4.25	49,821	123,993	55,449	206,762
Central County Total	878	25,131,014	1,040,952	1,402,593	2,258,713	8.99%	3,212,819	12.78%	\$1.55	89,368	(79,055)	477,194	1,317,530
East County													
El Cajon	79	860,717	0	0	25,668	2.98%	14,332	1.67%	\$0.85	(15,189)	19,586	5,183	50,819
La Mesa/Spring Valley	42	322,088	0	0	10,668	3.31%	10,668	3.31%	\$0.00	(2,122)	7,666	2,121	20,409
Santee/Lakeside	53	549,202	0	0	0	0.00%	28,312	5.16%	\$0.00	0	11,757	1,942	23,007
East County Total	174	1,732,007	0	0	36,336	2.10%	53,312	3.08%	\$0.85	(17,311)	39,009	9,246	94,235
North County													
Escondido	81	759,211	0	0	49,019	6.46%	68,567	9.03%	\$1.22	(16,020)	(16,527)	1,165	13,061
Oceanside	30	930,710	0	0	15,919	1.71%	18,722	2.01%	\$0.00	(48)	(2,118)	4,073	17,868
San Marcos	59	960,522	0	0	63,657	6.63%	54,095	5.63%	\$0.98	(19,160)	(10,205)	11,690	36,270
Vista	61	1,382,478	0	0	44,497	3.22%	148,316	10.73%	\$0.00	32,494	55,102	32,494	80,614
Carlsbad	243	5,924,340	118,705	0	582,407	9.83%	921,759	15.56%	\$1.44	(10,952)	282,054	102,333	540,235
North Beach Cities	17	142,651	0	0	3,730	2.61%	3,730	2.61%	\$0.00	600	8,288	5,700	45,588
Outlying SD County North	18	137,792	0	0	3,021	2.19%	3,021	2.19%	\$0.00	500	0	500	500
North County Total	509	10,237,704	118,705	0	762,250	7.45%	1,218,210	11.90%	\$1.40	(12,586)	316,594	157,955	734,136
I-15 Corridor													
Poway	60	1,297,858	0	0	12,549	0.97%	95,739	7.38%	\$1.33	563	9,300	5,292	43,032
Rancho Bernardo	86	3,893,606	0	0	390,956	10.04%	773,127	19.86%	\$1.64	33,926	43,402	40,203	141,463
Scripps Ranch	27	713,377	0	264,271	63,261	8.87%	35,403	4.96%	\$1.15	15,078	48,090	34,964	147,520
I-15 Corridor Total	173	5,904,841	0	264,271	466,766	7.90%	904,269	15.31%	\$1.59	49,567	100,792	80,459	332,015
South Bay													
Chula Vista	80	1,473,608	0	0	78,904	5.35%	185,864	12.61%	\$1.15	13,256	26,953	29,424	109,683
National City	23	303,615	0	0	5,501	1.81%	19,262	6.34%	\$0.00	6,064	(1,701)	7,765	12,498
Otay Mesa	8	178,005	0	256,022	12,019	6.75%	119,019	66.86%	\$0.66	0	0	0	0
San Ysidro/Imperial Beach	4	81,972	0	0	0	0.00%	55,000	67.10%	\$0.00	960	2,160	960	2,160
Outlying SD County South	20	78,080	0	0	0	0.00%	0	0.00%	\$0.00	0	0	0	0
South Bay Total	135	2,115,280	0	256,022	96,424	4.56%	379,145	17.92%	\$0.70	20,280	27,412	38,149	124,341
San Diego County Total	1,869	45,120,846	1,159,657	1,922,886	3,620,489	8.02%	5,767,755	12.78%	\$1.47	129,318	404,752	763,003	2,602,257

Lease rates are on a triple-net basis.



Market Update

by **Brian Mulvaney, SIOR, CCIM**

SENIOR VICE PRESIDENT, SAN DIEGO

The San Diego industrial market remains red hot and the overall vacancy decreased 10% this quarter, compared with last quarter. The availability rate has tightened in most markets as a result of positive net absorption and a lack of new product. The Central County multitenant industrial and flex product has seen the most significant gains in occupancy and lease rate increases, outpacing most other markets of the county. North County is seeing new construction with more than 1 million square feet planned, and South Bay has limited new speculative construction either completed or planned.

Most projects are seeing record high activity in virtually every market throughout the county and concessions are at a low point, creating an extremely tight market that is experiencing tremendous rent growth. While this is good for owners and landlords, it is becoming increasingly difficult for industrial tenants to find suitable space for expansion. This is further complicated by the high land values within most of San Diego County markets and even the tertiary markets are experiencing record high leasing costs.

Owner/user sale transactions in the industrial sector have slowed slightly from the second quarter of 2016 and have decreased from the same quarter in 2015, due to the lack of availability, although demand remains high for owner/user purchasers. While velocity is down slightly, we are seeing a definite increase in the owner/user sale prices countywide.

Investment sales activity is still at a brisk pace, however that segment of the market has also slowed slightly from 2015 numbers, due to lower cap rates (higher pricing) and lack of available product. Capital remains abundant and some sellers have been rewarded with peak pricing due to the lack of availability and lack of land for future development, especially in central San Diego. We anticipate seeing an increase in interest rates perhaps in December which may result in slightly higher cap rates.

We anticipate that the industrial market will stay in single digit vacancy and experience historically high rents for the foreseeable future. There is still a lack of new product and land values prohibit the construction of most multitenant industrial, as well as warehouse and distribution space. This is good for the existing land and building owners, but will likely pose a challenge for tenants in the local markets moving forward.

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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