

EQUILIBRIUM IN THE FIRST HALF. The San Diego Flex/R&D market fundamentals have been somewhat flat over the first half of the year, in effect taking a breather following six years of fast-paced occupancy and rental rate gains. There was more than 460,000 square feet of positive net absorption to offset the negative net absorption from 1Q. With more than 400,000 square feet currently under construction, there may be some softening in the Flex/R&D market this year.

VACANCY. Direct/sublease space (unoccupied) finished 2Q at 7.34%, a slight decrease from 1Q's vacancy rate of 7.72%. The vacancy rate remains at less than half of the 2010 recession low of 16.12%.

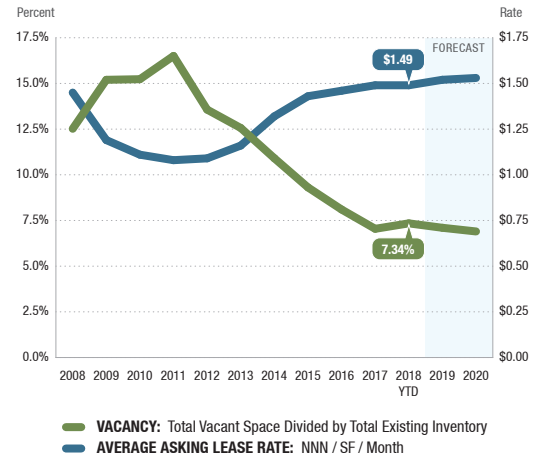
LEASE RATES. The average asking triple net lease rate per square foot per month in San Diego County was \$1.49 at the end of 2Q, which is about a 3% increase, year-over-year. The average asking lease rates have risen more than forty cents per square foot since the recession lows seen in 2011, and are continuing their upward long-term trend.

TRANSACTION ACTIVITY. The combined amount of square feet leased or sold in 1Q totaled 1.1 million square feet, a decrease from the previous quarter's total. 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.

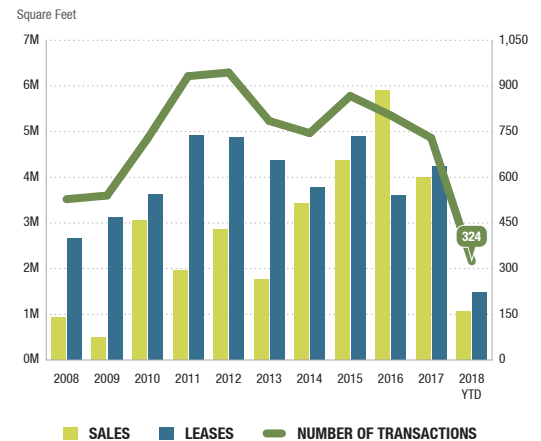
EMPLOYMENT. The unemployment rate in San Diego County was 2.9% in May 2018, unchanged from a revised 2.9% in April 2018, and below the year-ago estimate of 3.7%. This compares with an unadjusted unemployment rate of 3.7% for California and 3.6% for the nation during the same period. According to the State of California Employment Development Department, San Diego County gained 32,500 payroll jobs between May 2017 and May 2018, including 15,500 from professional and business services, which reported the largest overall gain. The construction sector reported a growth of 5,200 jobs, and the manufacturing sector reported an increase of 4,600 jobs.

OVERALL. From 2011 through 2017 the San Diego Flex R&D market cut its vacancy rate in half, while the asking rental rate increased almost forty percent. This year looks to be a bit more balanced with net absorption marginally positive for the first half of the year, and the asking rental rate at the same level as year-end 2017. While there remains demand in this sector, the current construction pipeline should balance that out, and we are projecting that the market will not achieve the large occupancy percentage gains seen in recent years.

VACANCY vs. AVERAGE ASKING LEASE RATE



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



Market Statistics

	Change Over Last Quarter	2Q 2018	1Q 2018	2Q 2017	% Change Over Last Year
Vacancy Rate	▼ DOWN	7.34%	7.72%	8.73%	(15.94%)
Availability Rate	▲ UP	11.44%	11.09%	12.21%	(6.29%)
Average Asking Lease Rate	▲ UP	\$1.49	\$1.46	\$1.45	2.76%
Sale & Lease Transactions	▼ DOWN	1,080,359	1,413,281	1,665,857	(35.15%)
Gross Absorption	▲ UP	1,039,162	898,271	1,082,630	(4.02%)
Net Absorption	▲ POSITIVE	466,277	(326,852)	447,329	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 1.0–1.5% 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, and hospitality and leisure.

CONSTRUCTION. Construction in the Flex/R&D sector has been largely concentrated in the biotech subset of properties. For the remainder of the Flex/R&D market, there has been remarkably little new construction. We expect this to change with the “creative industrial” trend migrating into the Flex/R&D market.

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

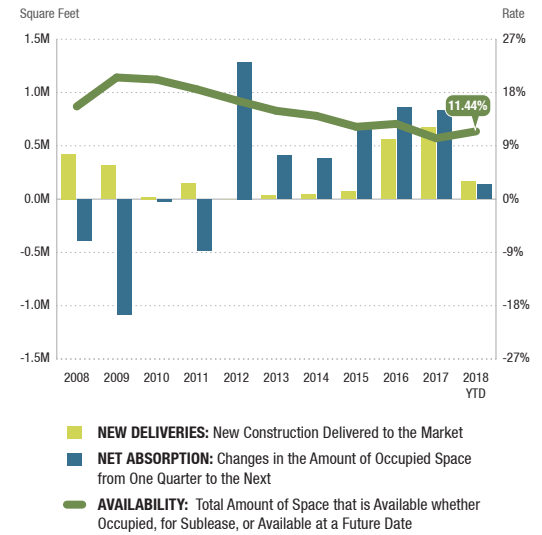
VACANCY. With the relatively large number of deliveries last year, we expect vacancy rates to move back towards the 8% range.

CONSTRUCTION. In 2Q, 170,523 square feet of new projects were delivered, for the first construction completions in a year. There is 413,608 square feet still under construction. Notably, most of the under construction projects are in the Central County area, which is in contrast to the purely industrial construction which is concentrated on the edges of the county.

AVAILABILITY. Direct/sublease space being marketed was 11.44% at the end of the quarter, a 6.29% decrease from the previous year’s rate of 12.21%, but a slight increase, quarter-over-quarter.

ABSORPTION. The San Diego Flex R&D market recorded 466,277 square feet of positive net absorption in 2Q 2018. This more than equalized the 326,852 square feet of negative net absorption in 1Q to put the market into marginally positive territory for the year.

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Significant Transactions

Sales

Property Address	Submarket	Square Feet	Sale Price	Buyer	Seller
10770 Wateridge Cir.	Sorrento Mesa	180,961	\$28,775,000	Bollert Lebeau CRE	John Hancock
9303–9323 Chesapeake Dr.	Kearny Mesa	160,943	\$6,450,000	Kane Development, LLC	Pajama Properties, LLC
9850 Businesspark Ave.	Scripps Ranch	27,801	\$6,166,500	Cushman Foundation	Hill Properties
7955–7975 Raytheon Rd.	Kearny Mesa	19,540	\$3,150,000	Youngdug Shin	Raytheon Property, LLC
8141 Center St.	La Mesa	8,820	\$2,175,000	East County Holding Co, LLC	Global Disposal, LLC

Leases

Property Address	Submarket	Square Feet	Transaction Date	Tenant	Owner
3535 General Atomics Ct.	Torrey Pines	72,121	May-2018	Fate Therapeutics	Alexandria RE Equities
16990 Goldentop Rd.	Rancho Bernardo	31,360	May-2018	Undisclosed	Cymer
10222 Barnes Canyon Rd.	Sorrento Mesa	29,500	Apr-2018	Undisclosed	Bollert Lebeau CRE
4242 Campus Point Ct.	UTC	23,873	May-2018	Undisclosed	Phase 3
3568–3574 Ruffin Rd. S.	Kearny Mesa	22,598	May-2018	Asplundh Construction	Sublease

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 2Q2018	Square Feet Available	Availability Rate 2Q2018	Average Asking Lease Rate	Net Absorption 2Q2018	Net Absorption 2018	Gross Absorption 2Q2018	Gross Absorption 2018
Central													
Central City	12	172,281	0	0	17,619	10.23%	34,809	20.20%	\$1.93	4,183	(8,177)	7,920	7,920
East City	2	26,892	0	0	0	0.00%	0	0.00%	–	0	0	0	0
Southeast City	21	222,430	0	0	2,500	1.12%	2,500	1.12%	\$1.44	(2,500)	(2,500)	0	0
Kearny Mesa	205	5,536,456	0	0	640,178	11.56%	767,063	13.85%	\$1.53	140,075	6,644	138,505	157,734
Mission Gorge	27	279,740	0	0	2,752	0.98%	19,413	6.94%	\$1.43	8,291	8,628	11,743	35,063
Rose Canyon/Morena		609,335	0	0	16,422	2.70%	48,852	8.02%	\$1.11	10,566	3,168	10,566	27,540
Sports Arena/Airport	30	380,720	0	0	9,590	2.52%	10,990	2.89%	\$1.35	(8,750)	(2,590)	0	7,000
Miramar	219	4,766,230	130,000	33,859	258,310	5.42%	494,762	10.38%	\$1.52	54,280	21,769	144,408	229,222
Sorrento Mesa	153	6,146,970	0	646,000	607,348	9.88%	995,869	16.20%	\$1.83	(63,590)	(48,261)	33,726	157,148
Sorrento Valley	101	2,349,342	0	0	198,694	8.46%	245,372	10.44%	\$1.82	4,232	(57,208)	59,150	162,612
Torrey Pines/UTC	72	6,261,254	137,500	640,843	470,045	7.51%	778,768	12.44%	\$2.45	288,933	382,661	329,086	488,502
Central County Total	842	26,751,650	267,500	1,320,702	2,223,458	8.31%	3,398,398	12.70%	\$1.67	435,720	304,134	735,104	1,272,741
East County													
El Cajon	77	851,324	0	0	11,307	1.33%	14,034	1.65%	\$1.09	(3,327)	(9,637)	4,800	4,800
La Mesa/Spring Valley	39	306,088	0	0	6,425	2.10%	8,925	2.92%	\$0.98	3,426	14,735	6,633	21,368
Santee/Lakeside	54	564,061	0	0	1,300	0.23%	1,300	0.23%	\$1.05	(1,300)	2,008	0	6,548
Outlying SD County S	20	78,080	0	0	0	0.00%	0	0.00%	\$1.10	0	0	0	0
East County Total	190	1,799,553	0	0	19,032	1.06%	24,259	1.35%	\$1.02	(1,201)	7,106	11,433	32,716
North County													
Escondido	78	744,979	0	0	10,265	1.38%	17,423	2.34%	\$0.90	2,647	7,503	4,698	12,680
Oceanside	33	985,977	0	0	31,240	3.17%	40,313	4.09%	\$0.97	8,709	1,723	10,681	13,531
San Marcos	60	1,059,862	0	0	52,727	4.97%	94,231	8.89%	\$1.16	10,386	5,824	22,538	33,081
Vista	62	1,393,694	0	0	66,074	4.74%	63,267	4.54%	\$1.08	22,434	(16,860)	27,073	27,073
Carlsbad	252	6,205,483	146,108	0	498,450	8.03%	936,444	15.09%	\$1.33	57,442	43,475	149,063	351,287
North Beach Cities	20	167,179	0	0	5,390	3.22%	15,717	9.40%	\$2.47	(3,335)	(4,535)	1,200	3,120
Outlying SD County North	18	136,911	0	0	4,084	2.98%	4,084	2.98%	\$1.00	(1,440)	(2,762)	0	0
North County Total	523	10,694,085	146,108	0	668,230	6.25%	1,171,479	10.95%	\$1.29	96,843	34,368	215,253	440,772
I-15 Corridor													
Poway	60	1,830,757	0	0	24,562	1.34%	45,559	2.49%	\$1.16	7,357	6,428	10,472	34,462
Rancho Bernardo	94	4,596,110	0	0	411,431	8.95%	500,567	10.89%	\$1.46	(30,820)	(69,957)	43,374	72,066
Scripps Ranch	28	749,217	0	233,741	38,103	5.09%	40,168	5.36%	\$1.13	(35,518)	(35,518)	2,585	23,407
I-15 Corridor Total	182	7,176,084	0	233,741	474,096	6.61%	586,294	8.17%	\$1.39	(58,981)	(99,047)	56,431	129,935
South County													
Chula Vista	80	1,434,216	0	14,935	136,478	9.52%	149,391	10.42%	\$1.34	(9,529)	(114,904)	16,116	24,321
National City	23	333,628	0	0	0	0.00%	1,293	0.39%	\$1.08	3,425	7,768	4,825	33,948
Otay Mesa	7	166,652	0	256,022	34,443	20.67%	156,743	94.05%	\$0.75	0	0	0	3,000
San Ysidro/Imperial Beach	5	86,361	0	0	1,200	1.39%	56,200	65.08%	–	0	0	0	0
South County Total	115	2,020,857	0	270,957	172,121	8.52%	363,627	17.99%	\$0.91	(6,104)	(107,136)	20,941	61,269
San Diego County Total	1,852	48,442,229	413,608	1,825,400	3,556,937	7.34%	5,544,057	11.44%	\$1.49	466,277	139,425	1,039,162	1,937,433

Lease rates are on a triple-net basis.



If You Build It, They Will Come...

by Brian Mulvaney

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The San Diego industrial market remains hot and the overall vacancy decreased 7.7% compared with last year. The availability rate has tightened in most central submarkets as a result of positive net absorption and a lack of new product. In the North County, and to a lesser extent the South County, availability rates have moved higher with the new development that is finally coming online. It took six years of positive net absorption following the recession in 2010 for new industrial development to resume. 2016 was the first year of the recovery to see more than one million square feet of new deliveries. Now the market has a million square feet of product under construction in Carlsbad alone. The more than 2 million square feet under construction in San Diego County at the end of 2Q 2018 is a level we haven't seen in ten years.

The market is more than ready for this new construction. The overall average asking rental rate for the county reached a record high at the end of 2015 and hasn't stopped climbing. The current average rate of \$0.96 per square foot per month is up more than 5% over last year's rate. The big caveat here is that the new development is concentrated in the northern and southern ends of the county. There has still been nearly no new construction in the central county areas, and what construction there has been is largely build-to-suit activity for General Atomics in Poway, which does little to relieve the low vacancy constraints for other Central County occupiers. In the North County it remains to be seen how fast the new construction will be absorbed. The availability rate for Carlsbad is above 18% halfway through 2018. We don't see that getting back to single digits any time this year.

There has been a slowdown in transaction volume with many areas of the county still under 4% vacancy, and some submarkets below 2% vacancy—options for tenants in these submarkets are slim to none. Additionally, the record high rental rates are a headwind to leasing activity. Sales volume started the first half of the year slow as well. The \$385 million of San Diego industrial real estate that traded through the first two quarters puts the market on a pace for the least amount of industrial sales in four years. This may be a breather after the frantic sales levels of the past three years, though. After the summer lull, we should see increased sales activity to finish the year.

We anticipate that the overall San Diego industrial market will stay well in single digit vacancy rates and experience historically high rents for the foreseeable future, even with this new wave of construction. It remains to be seen how much pressure in the Central County will be alleviated from the construction at the edges of the county, and how much of the brunt submarkets like Carlsbad, and Otay Mesa will bear from all this new vacant space.

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This survey consists of properties representing both single tenant and multi-tenant buildings. The lease rates are based on a triple-net 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. ©2018 Voit Real Estate Services, Inc. License #01991785.

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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