

AT THE PEAK. The third quarter of 2017 continued to show trends of a healthy market, with vacancy rates near a post-recession low of 10.49%, while conversely availability moved upward to 14.19%. Overall, vacancy continues its gradual downward trend for the first half of the year, while lease rates are continuing on a fairly stable path at some of the highest rates this market has seen—\$2.67 at the end of the quarter.

VACANCY. Direct/sublease space (unoccupied) finished the quarter at 10.49%, more than half a percentage point decrease from the previous quarter, and a roughly one percentage point decrease from the third quarter 2016. Kearny Mesa posted the lowest vacancy rate of any submarket (minimum of five million square feet of inventory) at 6.33%.

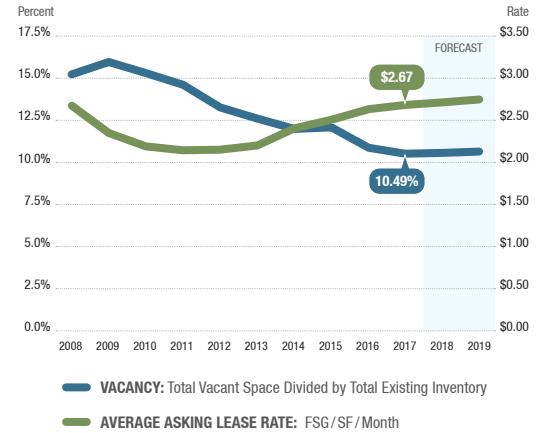
LEASE RATES. The average asking full-service gross (FSG) lease rate per square foot per month in San Diego County was \$2.67 at the end of the quarter, no change from last quarter's rate, but a notable increase from 2016's third quarter rate of \$2.59. The overall average asking rate in San Diego County has increased 25% since 2011.

TRANSACTION ACTIVITY. Sale and lease transactions totaled 4.0 million square feet in the third quarter, a major increase from the previous quarter's 2.4 million square feet. This was in large part due to a number of large office properties changing hands, including DiamondView Tower in Downtown San Diego which sold for \$207 million. This statistic can have some lag time in being reported, so look for figures to end up even higher in the next report.

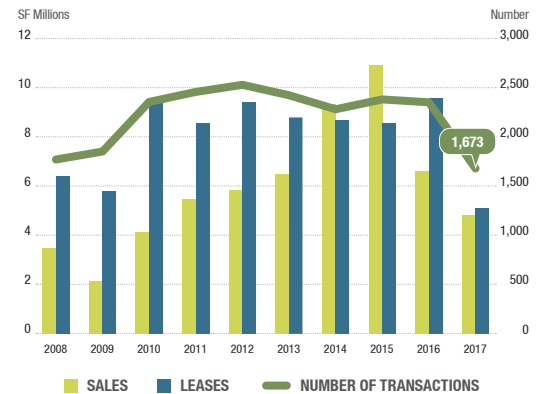
EMPLOYMENT. The unemployment rate in San Diego County was 4.7% in August 2017, unchanged from a revised 4.7% in July 2016 and below the year-ago estimate of 4.9%. This compares with an unadjusted unemployment rate of 5.4% for California and 4.5% for the nation during the same period. According to the State of California Employment Development Department, San Diego County gained 19,200 payroll jobs between August 2016 and August 2017, including 5,600 from education and health services, which reported the largest overall gain. The other services sector reported a growth of 5,000 jobs, and the government sector reported an increase of 4,900 jobs.

OVERALL. The San Diego office market is steady for now and still showing definite signs of growth, but we are starting to see 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. The stable trend of the increase in jobs and minimal speculative construction will help set the San Diego office market on firm footing in the coming year.

VACANCY vs. AVERAGE ASKING LEASE RATE



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



Market Statistics

	Change Over Last Quarter	3Q 2017	2Q 2017	3Q 2016	% Change Over Last Year
Vacancy Rate	▼ DOWN	10.49%	11.04%	11.47%	(8.59%)
Availability Rate	▲ UP	14.19%	13.97%	14.44%	(1.71%)
Average Asking Lease Rate	▬ FLAT	\$2.67	\$2.67	\$2.59	3.09%
Sale & Lease Transactions	▲ UP	4,002,939	2,420,668	3,646,649	9.77%
Gross Absorption	▲ UP	2,098,070	1,802,388	1,862,608	12.64%
Net Absorption	▲ POSITIVE	74,690	(635,444)	415,789	N/A

EMPLOYMENT. The labor market in San Diego County will continue to improve, although we anticipate job growth to slow to 1.8% for this year, and 1.6% in 2018. With an expected growth in tourism and local economy in general, look for sectors like leisure and hospitality to lead the way for employment gains, followed by health care and biotech, and government employment.

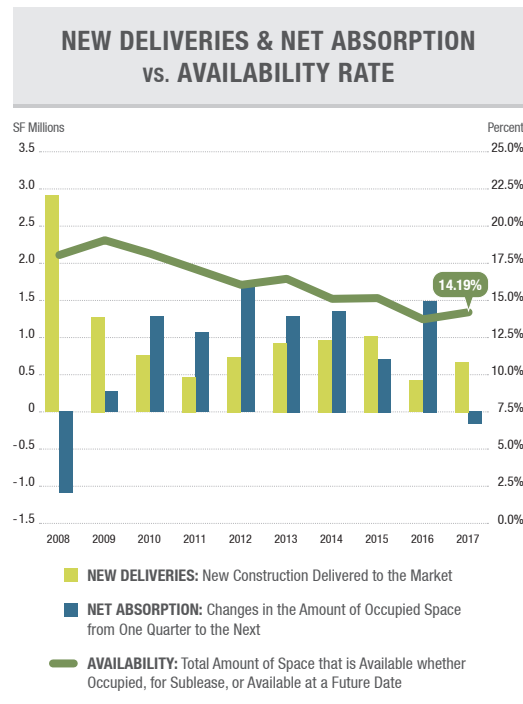
LEASE RATES. Expect the average asking lease rate to increase by a marginal 1% over the next four quarters, and round into the same range for the calendar year.

VACANCY. We anticipate vacancy to continue to follow the increase in availability and move up into the 11% range in 2018.

CONSTRUCTION. Ground up spec office construction finally reached Downtown San Diego, for the first time since the recession, with the Makers Quarter Block D building which is currently underway in East Village. The building is only 60,000 square feet, but on the other end of Downtown, Manchester has finally begun the Gateway Pacific development which will include hundreds of thousands of square feet of office. Office deliveries have averaged 825,000 square feet a year over the past five years, but last year’s deliveries were below average, at approximately 400,000 square feet, and 2017 is expected to follow in the same trend of below average deliveries. This low rate of construction for two consecutive years has contributed to the significant reduction in vacancy. To augment the new office construction, there has been an increasing trend towards property being extensively renovated and repositioned to creative office use, e.g., AMP&RSAND in 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 14.19% at the end of the quarter, an increase of 50 basis points from the 13.69% availability rate at the end of 2016.

ABSORPTION. The San Diego office market posted 74,690 square feet of positive net absorption in the third quarter. There has been approximately 8.8 million square feet of positive net absorption for the overall San Diego market since the start of 2010.



Significant Transactions

Sales

† Estimated allocation from portfolio sale

Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
350 10th Ave.	Downtown	A	313,103	\$207,000,000	DivcoWest	Cigna Investments
10850 Via Frontera	Rancho Bernardo	B	260,000	\$110,000,000	U.S. Realty Advisors	PETCO
600 B St.	Downtown	B	359,278	\$109,500,000	Rockwood Capital, LLC	Lincoln Property Company
2355–2385 Northside Dr.	Mission Valley	A	285,095	\$108,000,000 †	City Office REIT, Inc.	Kilroy Realty Corporation
4510 & 4520 Executive Dr.	UTC	B	201,905	\$97,000,000	The Carlyle Group	Equity Office Properties

Leases

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
10300 Camus Point Dr.	UTC	A	84,550	Sep-2017	Amazon	Alexandria
10240 Sorrento Valley Rd.	Sorrento Valley	B	64,117	Jul-2017	Forcepoint	Creekside Property Holdings
12220 Scripps Summit Dr.	Scripps Ranch	A	31,501	Jul-2017	Intel Corporation	(Sublease)
5550 Morehouse Dr.	Sorrento Mesa	B	25,203	Aug-2017	Undisclosed	Brookfield Asset Management
4655 Executive Dr.	UTC	A	22,853	Sep-2017	Undisclosed	The Irvine 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 3Q2017	Square Feet Available	Availability Rate 3Q2017	Average Asking Lease Rate	Net Absorption 3Q2017	Net Absorption 2017	Gross Absorption 3Q2017	Gross Absorption 2017
Downtown													
Downtown	130	12,929,636	60,000	3,733,060	1,540,867	11.92%	2,309,119	17.86%	\$2.58	(105,020)	159,856	244,061	1,034,360
Downtown Total	130	12,929,636	60,000	3,733,060	1,540,867	11.92%	2,309,119	17.86%	\$2.58	(105,020)	159,856	244,061	1,034,360
Central													
City Heights / University	29	1,058,511	0	0	34,169	3.23%	48,911	4.62%	\$2.18	(1,039)	15,884	3,935	30,217
Coronado	6	124,831	0	0	17,349	13.90%	17,349	13.90%	\$3.00	0	(5,788)	0	0
Kearny Mesa	234	10,612,199	0	690,000	671,748	6.33%	1,009,408	9.51%	\$2.21	75,036	211,783	202,002	640,892
Mission Gorge	24	554,826	0	0	26,584	4.79%	26,584	4.79%	\$1.16	2,658	13,636	5,191	17,449
Mission Valley	129	7,093,362	163,000	0	659,501	9.30%	1,073,968	15.14%	\$2.50	112,656	99,860	278,084	634,423
Old Town / Point Loma	64	2,099,739	0	0	113,784	5.42%	157,367	7.49%	\$2.26	9,425	26,875	21,449	99,013
Park East	8	155,884	0	0	6,266	4.02%	6,266	4.02%	-	(750)	(1,500)	0	0
Rose Canyon / Morena	53	1,202,150	0	0	41,578	3.46%	74,110	6.16%	\$1.78	2,091	10,414	11,645	48,114
Uptown / Hillcrest	102	2,626,155	0	0	170,871	6.51%	203,869	7.76%	\$2.56	(12,504)	20,000	29,100	107,033
Central Total	649	25,527,657	163,000	690,000	1,741,850	6.82%	2,617,832	10.25%	\$2.31	187,573	391,164	551,406	1,577,141
I-15 Corridor													
Escondido	90	1,908,461	0	195,014	174,644	9.15%	203,618	10.67%	\$1.80	(33,370)	(39,511)	18,195	67,153
Poway	30	1,324,065	0	160,000	87,850	6.63%	117,528	8.88%	\$2.19	(15,005)	(11,008)	1,814	36,499
Rancho Bernardo	108	6,991,432	0	2,103,595	769,874	11.01%	988,598	14.14%	\$2.70	(153,818)	(214,597)	62,007	290,369
Scripps Ranch	51	2,715,218	0	409,994	501,959	18.49%	536,718	19.77%	\$2.34	(86,745)	(277,439)	86,500	333,782
I-15 Corridor Total	279	12,939,176	0	2,868,603	1,534,327	11.86%	1,846,462	14.27%	\$2.38	(288,938)	(542,555)	168,516	727,803
North County Coastal													
Carlsbad	154	6,318,019	79,586	147,015	1,200,708	19.00%	1,574,173	24.92%	\$2.45	(26,881)	142,056	162,485	588,944
Del Mar Heights / Carmel Valley	76	4,754,820	0	940,000	820,286	17.25%	1,043,330	21.94%	\$4.03	55,824	28,172	106,147	354,234
North Beach Cities	112	2,546,579	0	19,933	152,912	6.00%	229,935	9.03%	\$3.46	(11,690)	(19,083)	41,543	111,164
North County Total	342	13,619,418	79,586	1,106,948	2,173,906	15.96%	2,847,438	20.91%	\$3.18	17,253	151,145	310,175	1,054,342
North City													
Governor Park	20	890,555	0	0	76,720	8.61%	96,028	10.78%	\$2.71	7,151	(19,208)	36,182	49,921
La Jolla	48	1,404,107	0	0	112,332	8.00%	154,147	10.98%	\$3.31	5,108	(58,511)	37,563	94,662
Miramar	33	1,610,914	0	0	147,544	9.16%	194,383	12.07%	\$1.87	17,470	(8,194)	40,784	115,709
Sorrento Mesa	121	9,497,795	0	1,999,063	1,140,339	12.01%	1,380,725	14.54%	\$2.78	41,193	47,185	172,985	470,195
Sorrento Valley	31	838,908	0	0	68,170	8.13%	125,937	15.01%	\$2.11	5,219	15,686	87,793	127,829
Torrey Pines	38	2,511,334	0	0	66,961	2.67%	71,332	2.84%	\$3.63	24,686	33,958	26,967	36,239
UTC	89	8,247,225	150,000	303,124	1,122,699	13.61%	1,658,844	20.11%	\$3.47	67,937	(431,682)	171,832	637,373
North City Total	380	25,000,838	150,000	2,302,187	2,734,765	10.94%	3,681,396	14.73%	\$2.96	168,764	(420,766)	574,106	1,531,928
Southern & Eastern Areas													
Chula Vista	91	2,923,117	0	1,545,100	275,033	9.41%	340,632	11.65%	\$2.52	11,350	22,505	43,640	122,125
National City	14	508,388	0	0	2,135	0.42%	4,881	0.96%	\$2.09	46,021	64,787	46,856	69,163
Otay Mesa	13	318,004	0	0	15,450	4.86%	15,450	4.86%	\$2.08	(3,273)	123	1,783	6,957
Southeast San Diego	9	381,826	0	0	63,650	16.67%	63,650	16.67%	\$2.20	(3,000)	(6,300)	0	0
East County	151	3,706,841	13,200	61,800	139,291	3.76%	170,641	4.60%	\$1.78	(16,222)	(8,617)	24,564	84,122
Southern & Eastern Areas Total	278	7,838,176	13,200	1,606,900	495,559	6.32%	595,254	7.59%	\$2.26	34,876	72,498	116,843	282,367
Highway 78 Corridor													
Oceanside	63	1,356,830	0	335,249	124,080	9.14%	177,925	13.11%	\$1.87	36,985	56,292	57,665	126,453
San Marcos	36	1,315,278	60,000	1,991,538	104,762	7.97%	133,223	10.13%	\$2.34	(500)	3,359	8,685	33,237
Vista	50	1,220,084	11,800	0	218,609	17.92%	229,968	18.85%	\$1.85	23,697	(26,347)	66,613	90,546
Highway 78 Corridor Total	149	3,892,192	71,800	2,326,787	447,451	11.50%	541,116	13.90%	\$1.96	60,182	33,304	132,963	250,236
Class A	275	35,282,624	421,954	10,802,003	4,131,810	11.71%	5,681,489	16.10%	\$3.23	(50,794)	(223,009)	704,011	2,281,666
Class B	1,240	51,507,049	115,632	3,832,482	5,643,139	10.96%	7,602,979	14.76%	\$2.45	148,547	60,933	1,166,625	3,475,139
Class C	692	14,957,420	0	0	893,776	5.98%	1,154,149	7.72%	\$1.88	(23,063)	6,722	227,434	701,372
San Diego County Total	2,207	101,747,093	537,586	14,634,485	10,668,725	10.49%	14,438,617	14.19%	\$2.67	74,690	(155,354)	2,098,070	6,458,177

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



Thoughts from the Front Line

by **Connor Wieck**
ASSOCIATE, SAN DIEGO

The San Diego office market continues its theme of musical chairs. With Tenants “right sizing” workspace to offset increases in rental rates, as well as leveraging new communication technologies to reduce their footprint, Landlords are scrambling to make the traditional office space relevant. Additionally, the office market has experienced an increase in presence by executive suites, co-working suites, and incubator-space operators that work as an alternative to traditional office space. To combat the transition within the market for office Tenants, Landlords are focused on providing on-site amenities such as upscale showers and lockers, basketball courts, bocce ball court, bistro/café and bicycles and indoor/outdoor common space.

Generally speaking, San Diego County provides a lot of opportunity for companies that need 10,000 square feet or less. However, San Diego has recently maintained a competitive stance for larger companies looking for an office environment north of 50,000 square feet — Amazon taking 84,550 square feet in UTC being the most notable example of the third quarter.

The San Diego office market has seen a decrease in availability over the past ten years — 18.04% in 2008 down to 14.19% 2017 YTD. Low vacancy, coupled with minimal deliveries to the market, has driven many San Diego submarkets to experience peak rents. With the continued increase of rents throughout the county, tenants have become increasingly settling with relocating to more economical submarkets.

From an investment standpoint, the two most notable transactions of the third quarter were DivcoWest’s purchase of DiamondView Tower for \$207 million or \$661 per square foot — 313,103 square feet of Class A office product in Downtown San Diego — and The Irvine Company’s purchase of Township 14 in Del Mar Heights for \$86.5 million. Many Class B assets have cycled on and off the market throughout 2017 due to disconnect between seller and buyer.

Overall, San Diego’s market continues with strength, marching toward the environment it saw prior to the 2008 crash. Although the anticipated runway of this market cycle seems to have much more life, tenants, owners, and investors alike are keeping a close watch on the market and the fundamentals that are driving it.

Please Contact Us for Further Information

Josh Brant
Regional Director of Research
jbrant@voitco.com

Anaheim, CA
714.978.7880

Carlsbad, CA
760.517.4000

Inland Empire, CA
909.545.8000

Irvine, CA
949.851.5100

Los Angeles, CA
424.329.7500

San Diego, CA
858.453.0505

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