

HOLDING STEADY. The office market continues to show a balance in availability and demand. The overall availability rate has inched lower, while net absorption for 2018 is flat, following a pullback in the market's occupancy level in 3Q. Lease rates continue to press upward at a modest rate, and speculative office construction is minimal.

VACANCY. Direct/sublease space (unoccupied) finished the quarter at 10.51%, half a percentage point higher than the previous quarter, but still 14 basis points lower than a year prior in 3Q 2017. Kearny Mesa posted the lowest vacancy rate of any major submarket (minimum of 4 MSF of inventory) at 6.27%, with all other major submarkets recording double digit vacancy rates in 3Q.

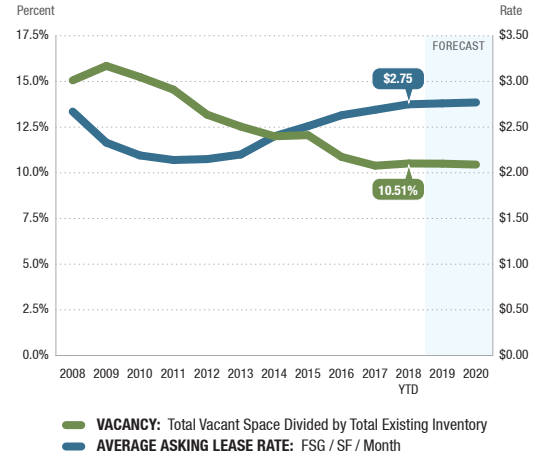
LEASE RATES. The average asking full-service gross (FSG) lease rate per square foot per month in San Diego County was \$2.75 at the end of 3Q, a two cent increase over the previous quarter's rate, and an annual increase of 2.61% from 3Q 2017's rate of \$2.68. The overall average asking rate in San Diego County has increased 28.5% since 2011.

TRANSACTION ACTIVITY. Sale and lease transactions totaled 4 MSF in 3Q, a slight increase from the 3.9 MSF which transacted in 2Q. Leasing volume for 2018 is on pace to exceed 2017's total, while office sales volume is maintaining a slower pace than the past few years. The transaction activity statistic can have some lag time in being reported, so look for figures to end up even higher in the next report.

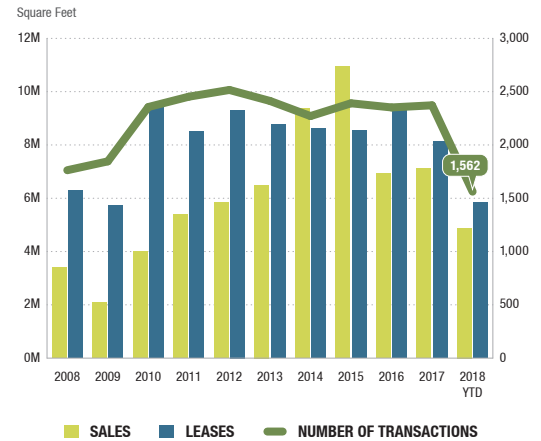
EMPLOYMENT. The unemployment rate in San Diego County was 3.4% in August 2018, down from a revised 3.5% in July 2018, and below the year-ago estimate of 4.3%. This compares with an unadjusted unemployment rate of 4.3% for California and 3.9% for the nation during the same period. According to the State of California Employment Development Department, San Diego County gained 24,100 payroll jobs between August 2017 and August 2018, including 13,000 from professional and business services, which reported the largest overall gain. The education and health services sector reported a growth of 5,800 jobs, and the manufacturing sector reported an increase of 5,800 jobs. The largest year-over-year loss was in leisure and hospitality which reported 4,500 fewer jobs than the prior year.

OVERALL. The San Diego office market is steady for now, but it's been a fairly flat start to the year, as we are in the latter stages of the current recovery. Construction levels of new speculative office product remain low, 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.

VACANCY vs. AVERAGE ASKING LEASE RATE



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



Market Statistics

	Change Over Last Quarter	3Q 2018	2Q 2018	3Q 2017	% Change Over Last Year
Vacancy Rate	▲ UP	10.51%	9.98%	10.65%	(1.35%)
Availability Rate	▬ FLAT	13.92%	13.84%	14.10%	(1.25%)
Average Asking Lease Rate	▲ UP	\$2.75	\$2.73	\$2.68	2.61%
Sale & Lease Transactions	▲ UP	4,014,856	3,901,070	4,640,165	(13.48%)
Gross Absorption	▬ FLAT	1,873,192	1,981,670	2,358,805	(20.59%)
Net Absorption	▼ NEGATIVE	(403,956)	610,013	87,357	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.

LEASE RATES. Expect the average asking lease rate to increase by a modest 2.0–2.5% over the next four quarters.

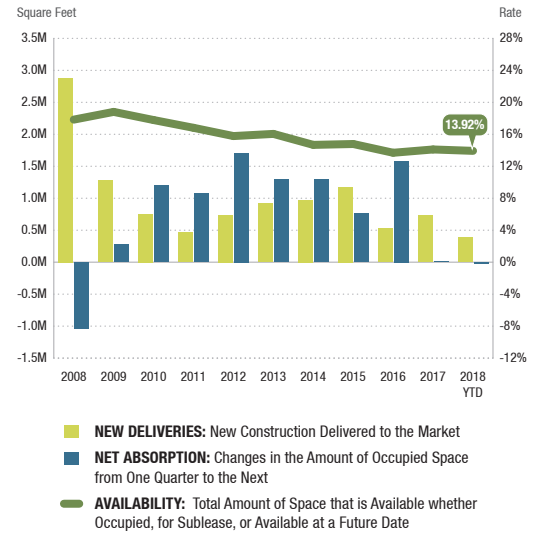
VACANCY. While landlords were happy to see hundreds of thousands of square feet absorbed by co-working companies in the past 12–18 months, these new operators in the market will be competing for tenants, and could act as a headwind to future occupancy gains. Conversely, a number of companies have committed to expanding into build-to-suit office buildings currently under way, which will add to the market’s occupancy level. We anticipate the countywide vacancy to remain relatively stable around the 10–11% range.

CONSTRUCTION. New office development remains weighted towards build-to-suit projects. MedImpact has 160,000 square feet under construction in Scripps Ranch, and there is 357,000 square feet under construction for ViaSat in Carlsbad. Manchester is underway on the Downtown bay front project which will include a new regional office for the U.S. Navy with additional Class A office towers to follow. More new office space is coming to market via extensive renovations and the repositioning of older projects. The most notable current example of this is AMP&RSAND, 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 13.92% at the end of the 3Q, a 1.25% decrease from the 14.10% availability rate from one year ago in 3Q 2017.

ABSORPTION. The San Diego office market has recorded 18,617 square feet of negative net absorption for the year thus far, which is no significant change. The market saw 403,956 square feet of negative net absorption in 3Q. There are hundreds of thousands of square feet of preleased office space under construction, so this will add significant levels of positive net absorption in the coming quarters, as these new construction projects come on line.

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Significant Transactions

Sales

Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
12651 & 12671 High Bluff Dr.	Del Mar Hts / Carmel Vly	B	73,325	\$43,000,000	EverWest Real Estate Investors	Cruzan
9444 Balboa Ave.	Kearny Mesa	A	120,992	\$36,375,000	Admiral Capital Group	The Blackstone Group
3910 University Ave.	East San Diego	B	82,236	\$29,900,000	San Diego Unified School District	Castlake, LP
3702 & 3790 Via De La Valle	North Beach Cities	B	57,153	\$27,500,000	Lincoln Property Company	Plaza Partners
5469–5473 Kearny Villa Rd.	Kearny Mesa	B	140,600	\$27,480,000	Vista Investment Group, LLC	LLJ Ventures

Leases

Property Address	Submarket	Class	Square Feet	Lease Term	Buyer	Seller
350 Camino de la Reina	Mission Valley	B	95,936	Aug-2018	Encore Capital	The Casey Brown Co.
5375 Mira Sorrento Pl.	Sorrento Mesa	A	94,293	Aug-2018	Undisclosed	PGIM
16465 Via Esprillo	Rancho Bernardo	A	67,792	Aug-2018	Undisclosed	Drawbridge Realty Trust
10182 Telesis Ct.	Sorrento Mesa	A	59,259	Aug-2018	Undisclosed	John Hancock RE
9242 Lightwave Ave.	Kearny Mesa	A	48,000	Aug-2018	Epsilon Systems	Colony Capital

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 3Q2018	Square Feet Available	Availability Rate 3Q2018	Average Asking Lease Rate	Net Absorption 3Q2018	Net Absorption 2018	Gross Absorption 3Q2018	Gross Absorption 2018
Downtown													
Downtown	124	12,627,189	60,000	3,783,009	1,811,838	14.35%	2,437,399	19.30%	\$2.63	(330,406)	(310,596)	230,741	631,219
Downtown Total	124	12,627,189	60,000	3,783,009	1,811,838	14.35%	2,437,399	19.30%	\$2.63	(330,406)	(310,596)	230,741	631,219
Central													
City Heights / University	31	1,216,139	0	0	37,020	3.04%	49,477	4.07%	\$2.41	23,790	7,512	29,409	39,949
Coronado	6	124,831	0	0	13,025	10.43%	13,025	10.43%	\$3.61	0	2,186	0	5,274
Kearny Mesa	235	10,765,884	0	690,000	675,261	6.27%	941,581	8.75%	\$2.37	(57,146)	(84,284)	212,955	526,099
Mission Gorge	20	588,430	0	0	15,740	2.67%	17,734	3.01%	\$1.84	(2,638)	(1,693)	887	5,739
Mission Valley	128	7,273,762	0	0	859,264	11.81%	1,056,279	14.52%	\$2.50	(170,542)	(29,128)	143,106	423,621
Old Town / Point Loma	83	2,534,694	0	230,000	135,402	5.34%	182,456	7.20%	\$2.47	33,313	8,519	42,228	129,878
Park East	17	273,122	0	0	7,913	2.90%	9,188	3.36%	\$2.17	345	(1,647)	345	345
Rose Canyon / Morena	53	1,202,150	0	0	47,344	3.94%	88,175	7.33%	\$1.92	10,767	(6,431)	25,898	53,624
Uptown / Hillcrest	78	2,210,058	0	0	121,120	5.48%	172,828	7.82%	\$2.56	(4,726)	(12,214)	34,786	92,379
Central Total	651	26,189,070	0	920,000	1,912,089	7.30%	2,530,743	9.66%	\$2.41	(166,837)	(117,180)	489,614	1,276,908
I-15 Corridor													
Escondido	89	1,880,838	75,000	121,614	146,323	7.78%	217,657	11.57%	\$2.08	(12,762)	(20,161)	31,121	73,255
Poway	30	1,324,065	0	160,000	39,284	2.97%	79,557	6.01%	\$2.25	9,726	32,171	23,178	74,473
Rancho Bernardo	107	6,888,519	0	1,858,747	861,456	12.51%	989,431	14.36%	\$3.01	77,568	(3,756)	129,776	548,389
Scripps Ranch	51	2,723,530	158,994	137,000	356,558	13.09%	552,278	20.28%	\$2.48	(15,470)	9,436	27,689	142,387
I-15 Corridor Total	277	12,816,952	233,994	2,277,361	1,403,621	10.95%	1,838,923	14.35%	\$2.74	59,062	17,690	211,764	838,504
North County Coastal													
Carlsbad	157	6,413,669	411,646	60,000	1,153,312	17.98%	1,508,187	23.52%	\$2.52	109,142	164,811	201,902	616,924
Del Mar Heights / Carmel Valley	76	4,755,012	0	985,722	802,320	16.87%	965,652	20.31%	\$4.28	(75,941)	(57,897)	47,460	296,346
North Beach Cities	110	2,537,674	24,000	114,933	206,150	8.12%	262,413	10.34%	\$3.63	(45,288)	(54,891)	43,953	135,070
North County Total	343	13,706,355	435,646	1,160,655	2,161,782	15.77%	2,736,252	19.96%	\$3.33	(12,087)	52,023	293,315	1,048,340
North City													
Governor Park	20	889,275	0	0	72,125	8.11%	138,721	15.60%	\$2.71	(831)	(1,565)	12,865	50,140
La Jolla	47	1,393,485	0	0	130,343	9.35%	205,395	14.74%	\$3.28	(16,747)	(18,483)	12,256	46,519
Miramar	34	1,590,751	0	0	163,481	10.28%	242,020	15.21%	\$1.81	(28,699)	(1,639)	17,650	98,564
Sorrento Mesa	122	9,634,836	0	2,339,446	1,196,481	12.42%	1,294,809	13.44%	\$2.76	(12,336)	47,549	208,145	506,022
Sorrento Valley	30	808,922	0	0	48,449	5.99%	110,116	13.61%	\$2.45	(7,939)	18,146	14,387	59,502
Torrey Pines	44	3,097,906	0	0	96,121	3.10%	281,504	9.09%	\$3.69	(5,232)	179,635	4,396	194,518
UTC	90	8,552,784	150,000	303,124	980,880	11.47%	1,357,442	15.87%	\$3.23	46,527	15,718	230,757	701,328
North City Total	387	25,967,959	150,000	2,642,570	2,687,880	10.35%	3,630,007	13.98%	\$2.82	(25,257)	239,361	500,456	1,656,593
Southern & Eastern Areas													
Chula Vista	90	2,905,034	0	1,545,100	233,742	8.05%	272,199	9.37%	\$2.50	16,726	19,383	27,579	70,292
National City	15	528,472	0	0	994	0.19%	994	0.19%	\$2.69	1,300	15,267	1,300	16,467
Otay Mesa	13	319,824	0	0	4,290	1.34%	38,670	12.09%	\$2.14	(917)	7,054	0	7,971
Southeast San Diego	13	479,269	0	290,000	66,568	13.89%	66,568	13.89%	\$2.44	0	2,000	0	2,000
East County	152	3,680,725	0	61,800	126,478	3.44%	193,542	5.26%	\$1.95	11,157	13,171	24,186	89,374
Southern & Eastern Areas Total	283	7,913,324	0	1,896,900	432,072	5.46%	571,973	7.23%	\$2.32	28,266	56,875	53,065	186,104
Highway 78 Corridor													
Oceanside	62	1,349,734	0	335,249	160,181	11.87%	212,655	15.76%	\$2.09	(8,749)	(21,740)	15,051	29,881
San Marcos	37	1,375,278	0	1,991,538	108,963	7.92%	135,661	9.86%	\$2.38	(1,955)	16,810	15,787	50,326
Vista	51	1,238,540	0	0	161,690	13.05%	273,994	22.12%	\$1.81	54,007	48,140	63,399	94,192
Highway 78 Corridor Total	150	3,963,552	0	2,326,787	430,834	10.87%	622,310	15.70%	\$2.04	43,303	43,210	94,237	174,399
Class A	283	35,947,546	800,994	11,121,625	4,630,290	12.88%	5,825,875	16.21%	\$3.30	(134,517)	(43,908)	721,115	2,239,927
Class B	1,257	52,547,409	78,646	3,885,657	5,394,825	10.27%	7,379,872	14.04%	\$2.50	(280,626)	19,232	952,462	3,013,520
Class C	675	14,689,446	0	0	815,001	5.55%	1,161,860	7.91%	\$1.99	11,187	6,059	199,615	558,620
San Diego County Total	2,215	103,184,401	879,640	15,007,282	10,840,116	10.51%	14,367,607	13.92%	\$2.75	(403,956)	(18,617)	1,873,192	5,812,067

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



Steady As She Goes

by **Greg Kipnis**

ASSOCIATE, SAN DIEGO

858.458.3301 · gkipnis@voitco.com · Lic. #01991789

The San Diego office market continues to remain on firm footing, relatively unchanged from 2Q 2018. Vacancy ticked up by roughly 25 basis points to 10.51%. This number is just off the 10-year post-recession low of 10.39% from 2017. Among the core submarkets of Central County, Kearny Mesa posted the lowest vacancy rate at just 6.3%. Average asking lease rates also remain nearly unchanged, creeping up by \$0.02 to \$2.75 full-service gross per square foot per month. Net absorption for the year thus far remains almost flat at just a negative 18,600 square feet. Leasing volume remains flat as well compared to this time last year.

The unemployment rate for the county stands at 3.5%. This number still places San Diego as the seventh lowest in unemployment among the top 25 largest metro areas, and we are still below the state average of 4.3% and the national average of 3.9%. As a result, San Diego is experiencing, to even greater effect, the national trend of a tightening job market as companies compete to attract talent. This quarter marked the highest influx of venture capital to the region in over 8 years with nearly \$600 million in investment. The top three sectors of growth were healthcare, life science, and technology.

Despite rising construction costs, and cumbersome Title 24 regulations, landlords are continuing to offer some concessions in order to attract office tenants, as many of these tenants still have other viable options within the marketplace. In tightening markets such as Kearny Mesa and Governor Park, we have seen a decrease in concessions. Generally though, in the major submarkets, tenants can still expect to see several months of free rent in addition to TI packages of \$25–\$45 per square foot on second generation class B space and \$60–\$80 per square foot for class A space. The leasing market remains competitive with time on market for vacant spaces at 9.3 months under the national index of 11.2 months.

In the investment realm, private equity has dominated the office market with sales offering around a 6% yield, higher than both industrial and multi-family. The Irvine Company continues to expand its footprint in core markets such as UTC with the purchase of 300,000 SF Sunroad Corporate Center (\$595 per square foot). With the cost of capital increasing and minimal construction starts underway, asking prices continue to rise. Overall, the office market continues to trek on. How much runway is left remains to be seen.

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

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. ©2018 Voit Real Estate Services, Inc. License #01991785.

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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