

GROWTH IS SLOWING. 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 positive net absorption in 3Q, but no movement in the availability rate. With more than half a million square feet currently under construction, there may be some softening in the Flex/R&D market this year.

VACANCY. Direct/sublease space (unoccupied) finished 3Q at 6.67%, a decrease from the previous quarter's vacancy rate of 7.03%. The vacancy rate remains far less than half of the 2010 recession low of 16.12%.

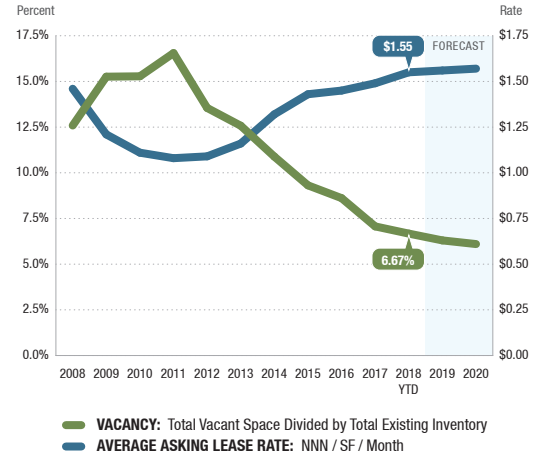
LEASE RATES. The average asking triple net lease rate per square foot per month in San Diego County was \$1.55 at the end of 3Q, which is a 4% increase, year-over-year. The average asking lease rates have risen more than \$0.45 per square foot since the recession lows seen in 2011, and are continuing their upward long-term trend.

TRANSACTION ACTIVITY. The combined amount of square feet leased or sold in 3Q totaled 1.2 MSF, a slight increase from the previous quarter's total. Conspicuously, there were not any biotech building sales among the largest Flex R&D transactions of 3Q. At the current pace, 2018 will have the lowest level of sales and leasing volume in at least five years. 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.

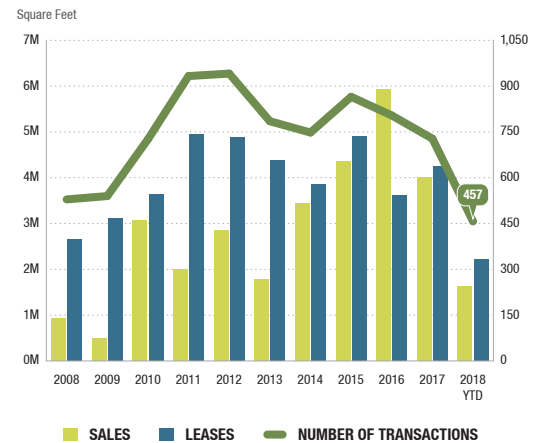
EMPLOYMENT. The unemployment rate in San Diego County was 3.4% in August 2018, down from a revised 3.5% in July 2018, and below the year-ago estimate of 4.3%. This compares with an unadjusted unemployment rate of 4.3% for California and 3.9% for the nation during the same period. According to the State 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. From 2011 through 2017 the San Diego Flex R&D market cut its vacancy rate in half, while the asking rental rate increased almost 40%. This year looks to be a bit more balanced with net absorption positive year to date, while the availability rate hasn't moved downward. There remains demand in this sector, but 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	3Q 2018	2Q 2018	3Q 2017	% Change Over Last Year
Vacancy Rate	▼ DOWN	6.67%	7.03%	7.05%	(5.30%)
Availability Rate	▬ FLAT	10.98%	11.02%	10.78%	1.81%
Average Asking Lease Rate	▲ UP	\$1.55	\$1.49	\$1.49	4.03%
Sale & Lease Transactions	▲ UP	1,213,283	1,155,902	2,325,629	(47.83%)
Gross Absorption	▼ DOWN	692,099	1,034,362	1,136,044	(39.08%)
Net Absorption	▲ POSITIVE	108,177	443,288	617,688	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.

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. Despite a decrease in transaction volume, landlords are still pushing asking rental rates up. Expect average asking rates to increase by approximately 2–3% over the next four quarters.

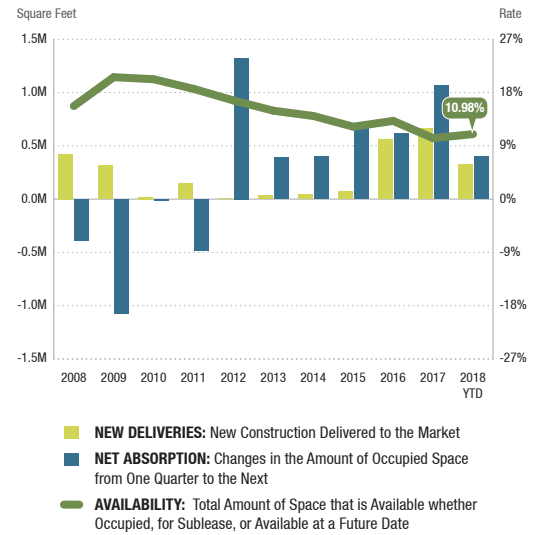
VACANCY. With the relatively large number of deliveries last year, we expect vacancy rates to move back towards the 8% range.

CONSTRUCTION. In the second quarter, 170,523 square feet of new projects were delivered, for the first construction completions in a year. There is 522,970 square feet still under construction. Notably, most of the construction projects are in the Central County area, which is in contrast to the purely industrial construction concentrated on the edges of the county.

AVAILABILITY. Direct/sublease space being marketed was 10.98%, effectively no change from the previous quarter, and a 20 basis point increase from the previous year’s rate of 10.78%.

ABSORPTION. The San Diego Flex R&D market recorded 108,177 square feet of positive net absorption in the 3Q 2018. The market is now firmly in the positive for the year, with 397,852 square feet of net absorption, overcoming a significant level of negative net absorption from 1Q 2018.

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Significant Transactions

Sales

* Voit Real Estate Services Deal

Property Address	Submarket	Square Feet	Sale Price	Buyer	Seller
3860 Calle Fortunada	Kearny Mesa	60,711	\$11,075,000	Hernon Fortunada	Carlton Management*
9320 & 9340 Hazard Way	Kearny Mesa	46,548	\$7,716,000	American Sunroof Corp.	Pajama Properties, LLC
6740 Top Gun St.	Sorrento Mesa	29,706	\$7,426,000	Ingold Family Investments, LLC	Jaguar Properties, LLC
9155 Brown Deer Rd.	Miramar	34,080	\$5,513,000	PV Brown Deer, LLC	SN Brown Deer, LLC
6349 Paseo Del Lago	Carlsbad	19,462	\$5,050,000	Marosi Trust	@PALOMAR Carlsbad, LLC

Leases

Property Address	Submarket	Square Feet	Lease Term	Buyer	Broker
10770 Wateridge Cir.	Sorrento Mesa	95,000	Jul-2018	Maravai LifeSciences	Bollert Lebeau
10390 Pacific Center Ct.	Sorrento Mesa	68,400	Jul-2018	Undisclosed	(Sublease)
3193 Lionshead Ave.	Carlsbad	34,755	Jul-2018	Undisclosed	Vinturi
3554–3558 Ruffin Rd. S.	Kearny Mesa	22,428	Aug-2018	SDPD	H.G. Fenton
3545–3575 John Hopkins Ct.	Torrey Pines	20,508	Jul-2018	aTyr Pharma	BioMed 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 3Q2018	Square Feet Available	Availability Rate 3Q2018	Average Asking Lease Rate	Net Absorption 3Q2018	Net Absorption 2018	Gross Absorption 3Q2018	Gross Absorption 2018
Central													
Central City	12	172,281	0	0	17,619	10.23%	38,129	22.13%	\$2.25	0	(8,177)	0	7,920
East City	2	26,892	0	0	0	0.00%	0	0.00%	–	0	0	0	0
Southeast City	21	222,469	0	0	0	0.00%	0	0.00%	\$1.44	2,500	0	2,500	2,500
Kearny Mesa	206	5,694,528	0	0	480,530	8.44%	609,641	10.71%	\$1.56	45,230	166,292	119,355	277,089
Mission Gorge	27	279,740	0	0	17,549	6.27%	18,068	6.46%	\$1.42	(14,797)	(6,169)	1,400	36,463
Rose Canyon/Morena	38	609,335	0	0	45,230	7.42%	42,841	7.03%	\$1.14	(5,529)	(25,640)	1,800	25,340
Sports Arena/Airport	30	380,720	0	0	9,590	2.52%	9,590	2.52%	\$1.25	0	(2,590)	1,400	8,400
Miramar	220	4,789,131	130,000	33,859	301,127	6.29%	514,537	10.74%	\$1.54	(42,817)	(21,048)	53,136	282,358
Sorrento Mesa	153	6,149,032	0	646,000	568,519	9.25%	929,741	15.12%	\$2.24	(20,282)	(9,432)	82,004	239,152
Sorrento Valley	100	2,342,801	0	0	214,213	9.14%	275,211	11.75%	\$1.81	(633)	(57,841)	33,515	195,327
Torrey Pines/UTC	72	6,226,459	246,862	980,843	429,578	6.90%	1,022,492	16.42%	\$2.52	(31,043)	351,618	59,484	619,496
Central County Total	881	26,893,388	376,862	1,660,702	2,083,955	7.75%	3,460,250	12.87%	\$1.80	(67,371)	387,013	354,594	1,694,045
East County													
El Cajon	77	851,324	0	0	7,132	0.84%	9,859	1.16%	\$1.07	4,175	(5,462)	5,400	10,200
La Mesa/Spring Valley	39	293,035	0	0	6,425	2.19%	3,925	1.34%	\$0.98	0	14,735	0	21,368
Santee/Lakeside	54	564,061	0	0	1,300	0.23%	3,242	0.57%	\$1.07	0	2,008	0	6,548
Outlying SD County S	20	77,930	0	0	0	0.00%	0	0.00%	–	0	0	0	0
East County Total	190	1,786,350	0	0	14,857	0.83%	17,026	0.95%	\$1.02	4,175	11,281	5,400	38,116
North County													
Escondido	78	744,979	0	0	16,408	2.20%	14,934	2.00%	\$0.97	(6,143)	1,360	1,359	14,039
Oceanside	33	985,977	0	0	14,053	1.43%	28,093	2.85%	\$0.98	17,187	18,910	19,222	32,753
San Marcos	60	1,059,862	0	0	62,019	5.85%	104,894	9.90%	\$1.21	(9,292)	(3,468)	16,838	49,919
Vista	62	1,393,694	0	0	58,411	4.19%	75,343	5.41%	\$1.13	7,663	(9,197)	12,763	39,836
Carlsbad	252	6,217,710	146,108	0	434,498	6.99%	771,104	12.40%	\$1.33	63,952	107,427	127,347	478,634
North Beach Cities	19	164,051	0	0	6,263	3.82%	4,053	2.47%	\$2.07	(873)	(5,408)	1,255	4,375
Outlying SD County North	19	137,615	0	0	2,144	1.56%	2,144	1.56%	\$1.15	1,940	(822)	2,644	2,644
North County Total	523	10,703,888	146,108	0	593,796	5.55%	1,000,565	9.35%	\$1.29	74,434	108,802	181,428	622,200
I-15 Corridor													
Poway	60	1,830,757	0	0	32,656	1.78%	50,899	2.78%	\$1.21	(8,094)	(1,666)	14,298	48,760
Rancho Bernardo	94	4,603,110	0	0	314,227	6.83%	411,274	8.93%	\$1.50	97,204	27,247	118,396	190,462
Scripps Ranch	28	749,217	0	233,741	42,428	5.66%	42,428	5.66%	\$1.13	(4,325)	(39,843)	0	23,407
I-15 Corridor Total	182	7,183,084	0	233,741	389,311	5.42%	504,601	7.02%	\$1.42	84,785	(14,262)	132,694	262,629
South County													
Chula Vista	80	1,434,216	0	14,850	124,599	8.69%	140,108	9.77%	\$1.34	11,879	(103,025)	16,783	41,104
National City	23	333,628	0	0	925	0.28%	2,218	0.66%	\$1.08	(925)	6,843	0	33,948
Otay Mesa	7	166,652	0	256,022	34,443	20.67%	154,443	92.67%	\$0.75	0	0	0	3,000
San Ysidro/Imperial Beach	5	86,361	0	0	0	0.00%	55,000	63.69%	–	1,200	1,200	1,200	1,200
South County Total	115	2,020,857	0	270,872	159,967	7.92%	351,769	17.41%	\$1.04	12,154	(94,982)	17,983	79,252
San Diego County Total	1,891	48,587,567	522,970	2,165,315	3,241,886	6.67%	5,334,211	10.98%	\$1.55	108,177	397,852	692,099	2,696,242

Lease rates are on a triple-net basis.



Industrial 2018: If You Own It, They Will Come

by **Weston Yahn**

SENIOR ASSOCIATE, SAN DIEGO

805.458.3321 · wyahn@voitco.com · Lic. #01975469

Since 2014, industrial occupancy in Central San Diego County has sustained occupancy levels between 95%–98%. Geographically land locked by Mexico to the south and Camp Pendleton to the north, limited areas for new development continue to constrain growth for new industrial product in San Diego. As of October 2018, the new construction pipeline for industrial product in San Diego was 2.34 million square feet. Local innovation, historically high levels of venture capital, and the rise of e-commerce are among the leading factors that are driving vacancy for both flex and industrial product to all-time lows.

San Diego landlords have reaped the benefits of historically high lease rates, critically low vacancy, and moderate to low supply. But how much runway is left? That is the question for investors considering San Diego industrial properties today. Favorable tax reform and unwavering demand has enticed developers to seek value-add opportunities. Cap rates for industrial product also compressed to historic lows in 2018, currently at an average of 5.8% for the year. RAF Pacifica, a local developer, sold one of the largest portfolios of industrial product in San Diego history at just over 1 million square feet.

Although some have enjoyed the benefits of a booming flex and industrial market, multi-tenant industrial occupants are not celebrating. The average small business owner operating a warehouse in a premier industrial submarket like Kearny Mesa is experiencing sticker shock with their lease renewal. These business owners are facing increases in occupancy costs, up to 50% higher than their lease rate of 5 years ago. In addition to increased lease rates, little to no concessions are being offered on renewals or even new deals. Alternatively, the small business owner that purchased an industrial building or condo years ago is reaping the reward of controlled occupancy cost and soaring appreciation.

As industrial lease rates and sales prices continue to set new records, one thing is certain: it pays to own industrial real estate in San Diego. San Diego is and will always be a supply-constrained market. As property owners and investors seek higher returns, traditional industrial will be slowly replaced and repositioned by product types that can yield higher returns. World-renowned research institutions, coupled with investor confidence in San Diego's innovation economy, will continue to gentrify our local industrial market.

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 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.

Represented in 150 Markets
Nationally & Internationally.



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