

SD RETAIL DOING FINE. In the face of a changing retail landscape, the San Diego retail market has maintained solid fundamentals with availability at 4.96%, and the vacancy rate is still near a ten-year low. In spite of the rise of e-commerce, the San Diego retail real estate market remains robust with tight supply and high average asking rents.

VACANCY. Direct/sublease space (unoccupied) finished the first quarter near an all-time low of 3.64%, 19 basis points higher than last year's 3.45% vacancy rate, and relatively flat quarter-over-quarter. The current vacancy rate is more than 40% below the previous peak levels seen in 2010.

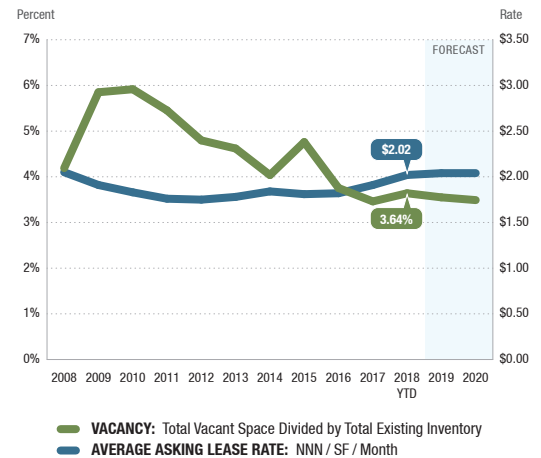
LEASE RATES. The average asking triple-net lease rate per month per square foot in San Diego County was \$2.02, an increase of nine cents, or 4.66%, over the \$1.93 rate of 3Q 2017. The highest average asking rate in the market was in the Central North area, posting \$3.05 per square foot per month, on a triple-net basis.

TRANSACTION ACTIVITY. The combined amount of retail property sold or leased during 3Q was approximately 1.7 MSF, which was an increase from the 1.5 MSF transacted in the prior quarter. This figured was inflated by the sale of Horton Plaza, a 900,000 square foot mall in Downtown San Diego which will be converted into a creative office campus. The transaction activity for 2018 is on pace for the lowest annual total in five years. The transaction activity 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.

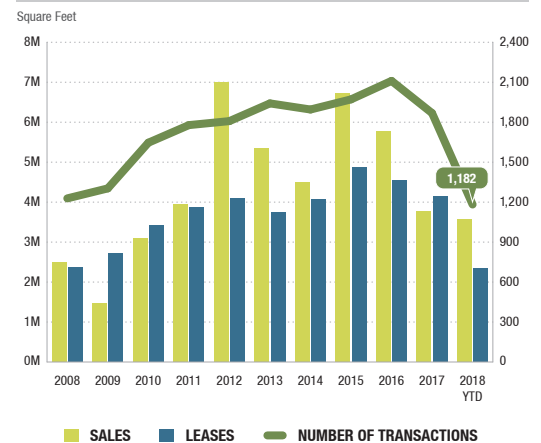
EMPLOYMENT. The unemployment rate in San Diego County was 3.4% in August 2018, down from a revised 3.5% in July 2018, and below the year-ago estimate of 4.3%. This compares with an unadjusted unemployment rate of 4.3% for California and 3.9% for the nation during the same period. According to the State 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. The San Diego retail market continues to remain on solid footing, as market fundamentals exhibited positive growth throughout 2017, and remain in good position through 2018. Vacancy ended the quarter at 3.64%, not that far off from a post-recession record low, despite the negative net absorption through the first three quarters of the year. Following a steady increase in the market's overall occupancy rate from the recession low near 94% in 2009, until 2015's peak just under 97%, the market's availability and vacancy rates have remained fairly flat over the past three years. However, average asking rental rates continue to move upwards. The retail market is not growing in the ways it did initially in the recovery, but remains 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	3.64%	3.59%	3.45%	5.39%
Availability Rate	▼ DOWN	4.96%	5.11%	4.95%	0.04%
Average Asking Lease Rate	▲ UP	\$2.02	\$2.00	\$1.93	4.66%
Sale & Lease Transactions	▲ UP	1,709,221	1,501,437	1,902,340	(10.15%)
Gross Absorption	▲ UP	1,379,041	1,035,264	1,099,916	25.38%
Net Absorption	▲ POSITIVE	16,904	(98,962)	228,774	N/A

CONSTRUCTION. The completion of the renovation and expansion of Westfield’s UTC Mall closes the books on the driving force behind the majority of the recent construction volume. The market has reverted back to a pace of new construction that is near the average output since the recovery began, which is to say a very modest rate.

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 average asking rates to increase by a moderate 2% to 3% over the next four quarters.

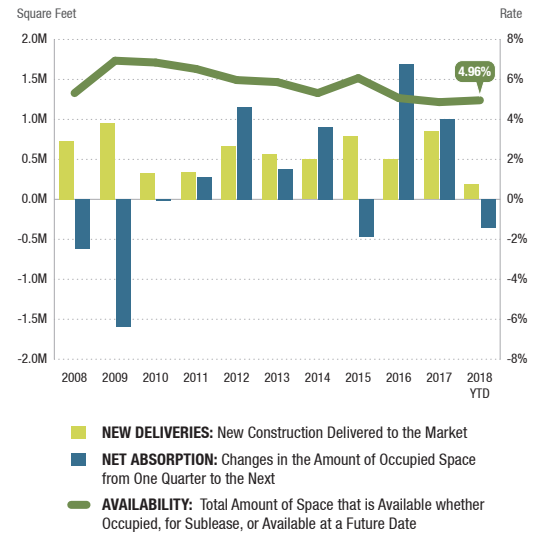
VACANCY. We anticipate the vacancy rate to remain stable and low, with much of the occupancy gains already captured. Availability has been moving upward of late, which will place pressure on the overall occupancy rate.

CONSTRUCTION. Following the 837,453 square feet of new retail projects completed in 2017 (the highest annual total since 2009), there is now 408,003 feet of retail product under construction, which is below the 10-year average of 537,000 square feet under construction per quarter. Currently, the construction pipeline is being driven by infill projects, with few development sites being pursued outside of the built-out areas in the county.

AVAILABILITY. Direct/sublease space being marketed was 4.96% at the end of 3Q. This was a slight decrease from 2Q’s availability rate of 5.1%. The Central South area of the county posted the lowest availability rate in the county, at 3.46%.

ABSORPTION. The San Diego retail market was relatively flat in 3Q, but is solidly in the red for the year, with 359,373 square feet of negative net absorption through the first three quarters of 2018. The Central North area of San Diego County saw the most negative net absorption in 3Q at 130,112 square feet.

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Significant Transactions

Sales

† Plus Excess Land

Property Address	Submarket	Square Feet	Sale Price	Buyer	Seller
100 Horton Plz.	Downtown	895,241	\$175,000,000	Stockdale Capital Partners	Unibail–Rodamco–Westfield
1717 Auto Park Way	Escondido	32,727†	\$17,400,000	Gosch Auto Group, Et Al	Group 1 Automotive Inc.
4060 & 4070 Oceanside Blvd.	Oceanside	37,725	\$8,200,000	Capital Investment Network, Inc.	Aspen Management
1760 Descanso Ave.	San Marcos	73,460	\$7,950,000	C3 Church San Diego	RAF Pacifica Group
7509 Girard Ave.	La Jolla	9,920	\$6,000,000	SixteenFifty Creative Intelligence	YDNL, LLC

Leases

Property Address	Submarket	Square Feet	Lease Term	Buyer	Seller
1055 Wall St.	La Jolla	46,500	Jul-2018	Undisclosed	Madison Marquette
Palomar Airport Rd.	Carlsbad	44,454	Aug-2018	Sprouts	Bressi Retail, LLC
1073–1099 E. Main St.	El Cajon	25,544	Jul-2018	Big Lots	Doerken Properties, LLC
1023 4th Ave.	Downtown	19,054	Jul-2018	Undisclosed	On Broadway SD Partners, LP
NEC La Costa Ave. & Rancho Santa Fe Rd.	Carlsbad	14,820	Aug-2018	Cinopolis	Terramar

	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 South													
General Retail	3,702	20,079,897	18,554	787,725	578,727	2.88%	740,036	3.69%	\$2.37	(111,596)	(46,586)	148,534	489,568
Malls	41	4,552,527	0	0	14,380	0.32%	14,380	0.32%	–	41,000	35,276	41,000	42,608
Power Centers	98	3,595,269	0	6,000	37,370	1.04%	42,986	1.20%	\$3.85	20,017	17,707	20,017	29,142
Shopping Centers	725	11,129,029	0	34,635	419,513	3.77%	557,417	5.01%	\$2.02	31,957	22,957	95,146	287,153
Specialty Centers	7	294,915	0	0	18,609	6.31%	18,609	6.31%	\$5.83	7,895	2,179	7,895	8,934
Central South Total	4,573	39,651,637	18,554	828,360	1,068,599	2.69%	1,373,428	3.46%	\$2.25	(10,727)	31,533	312,592	857,405
East County													
General Retail	1,447	7,331,245	4,503	54,970	170,676	2.33%	267,954	3.65%	\$1.44	8,241	(24,140)	36,327	111,704
Malls	14	2,816,104	0	0	19,868	0.71%	168,709	5.99%	–	(9,180)	(17,373)	2,557	7,470
Power Centers	60	1,702,163	0	4,800	17,864	1.05%	43,380	2.55%	–	(1,843)	(614)	1,157	11,280
Shopping Centers	563	8,310,291	0	160,913	388,775	4.68%	519,711	6.25%	\$1.72	(29,087)	(482)	126,337	261,419
Specialty Centers	2	34,558	0	0	0	0.00%	0	0.00%	–	0	0	0	0
East County Total	2,086	20,194,361	4,503	220,683	597,183	2.96%	999,754	4.95%	\$1.65	(31,869)	(42,609)	166,378	391,873
I-15 Corridor													
General Retail	171	1,638,457	0	55,425	12,376	0.76%	31,037	1.89%	\$2.88	(851)	(818)	3,149	10,258
Malls	0	0	0	0	0	0.00%	0	0.00%	–	0	0	0	0
Power Centers	24	567,029	0	0	4,914	0.87%	112,784	19.89%	–	0	0	0	0
Shopping Centers	287	4,281,831	0	222,738	175,468	4.10%	200,665	4.69%	\$3.00	9,006	40,621	30,578	104,176
Specialty Centers	0	0	0	0	0	0.00%	0	0.00%	–	0	0	0	0
I-15 Corridor Total	482	6,487,317	0	278,163	192,758	2.97%	344,486	5.31%	\$2.99	8,155	39,803	33,727	114,434
North County													
General Retail	1,693	11,415,395	106,699	523,540	426,772	3.74%	526,306	4.61%	\$2.08	65,435	(131,815)	129,984	247,729
Malls	24	3,176,626	0	50,340	8,702	0.27%	10,207	0.32%	–	(1,784)	(1,784)	0	2,062
Power Centers	109	3,101,378	0	18,312	105,842	3.41%	118,170	3.81%	\$2.38	(29,908)	(8,635)	27,022	95,143
Shopping Centers	960	15,175,213	132,094	358,721	946,969	6.24%	1,171,314	7.72%	\$1.59	106,484	119,527	282,336	620,679
Specialty Centers	5	367,735	0	0	1,210	0.33%	1,210	0.33%	–	(1,210)	(1,210)	500	1,710
North County Total	2,791	33,236,347	238,793	950,913	1,489,495	4.48%	1,827,207	5.50%	\$1.71	139,017	(23,917)	439,842	967,323
Central North													
General Retail	865	7,054,174	11,409	85,308	273,022	3.87%	318,344	4.51%	\$3.38	(37,284)	(246,604)	80,410	205,132
Malls	21	1,454,387	0	40,000	327,344	22.51%	327,344	22.51%	–	(130,344)	(144,844)	0	0
Power Centers	66	2,093,744	0	122,535	16,954	0.81%	51,390	2.45%	–	39,774	100,366	49,584	121,667
Shopping Centers	420	6,538,188	15,546	442,529	269,885	4.13%	338,530	5.18%	\$2.83	1,663	(85,606)	67,551	162,178
Specialty Centers	9	232,667	0	0	62,154	26.71%	65,754	28.26%	\$1.75	(3,921)	(14,074)	4,104	4,104
Central North Total	1,381	17,373,160	26,955	690,372	949,359	5.46%	1,101,362	6.34%	\$3.05	(130,112)	(390,762)	201,649	493,081
South County													
General Retail	1,120	5,907,963	14,705	494,457	159,918	2.71%	204,796	3.47%	\$1.59	(8,628)	(29,199)	72,229	137,685
Malls	42	2,510,639	0	0	3,591	0.14%	119,318	4.75%	–	12,233	21,860	12,233	30,684
Power Centers	27	1,025,479	0	79,900	11,975	1.17%	29,289	2.86%	–	(7,400)	(4,575)	0	7,400
Shopping Centers	533	9,217,987	104,493	157,157	500,155	5.43%	756,117	8.20%	\$2.07	36,341	55,976	111,045	269,661
Specialty Centers	26	780,784	0	0	21,955	2.81%	45,963	5.89%	\$2.02	1,590	(18,765)	1,590	3,190
South County Total	1,748	19,442,852	119,198	731,514	697,594	3.59%	1,155,483	5.94%	\$1.91	34,136	25,297	197,097	448,620
Outlying Areas													
General Retail	512	2,043,378	0	13,248	53,684	2.63%	93,227	4.56%	\$1.94	6,554	(11,186)	13,048	19,335
Malls	11	145,890	0	0	11,000	7.54%	11,000	7.54%	–	0	0	0	0
Power Centers	0	0	0	0	0	0.00%	0	0.00%	–	0	0	0	0
Shopping Centers	93	1,290,443	0	12,766	40,122	3.11%	38,480	2.98%	\$1.67	1,750	12,468	14,708	43,903
Specialty Centers	1	255,000	0	0	0	0.00%	0	0.00%	–	0	0	0	0
Outlying Areas Total	617	3,734,711	0	26,014	104,806	2.81%	142,707	3.82%	\$1.78	8,304	1,282	27,756	63,238
San Diego Total													
San Diego Total	13,678	140,120,385	408,003	3,726,019	5,099,794	3.64%	6,944,427	4.96%	\$2.02	16,904	(359,373)	1,379,041	3,335,974
General Retail	9,510	55,470,509	155,870	2,014,673	1,675,175	3.02%	2,181,700	3.93%	\$2.22	(78,129)	(490,348)	483,681	1,221,411
Malls	153	14,656,173	0	90,340	384,885	2.63%	650,958	4.44%	\$2.38	(88,075)	(106,865)	55,790	82,824
Power Centers	384	12,085,062	0	231,547	194,919	1.61%	397,999	3.29%	\$2.80	20,640	104,249	97,780	264,632
Shopping Centers	3,581	55,942,982	252,133	1,389,459	2,740,887	4.90%	3,582,234	6.40%	\$1.91	158,114	165,461	727,701	1,749,169
Specialty Centers	50	1,965,659	0	0	103,928	5.29%	131,536	6.69%	\$2.05	4,354	(31,870)	14,089	17,938
San Diego Total	13,678	140,120,385	408,003	3,726,019	5,099,794	3.64%	6,944,427	4.96%	\$2.02	16,904	(359,373)	1,379,041	3,335,974

Lease rates are on a triple-net basis.



Churn in Market Provides New Opportunities

by **Spencer Kerrigan**

SENIOR ASSOCIATE, SAN DIEGO

858.458.3310 · skerrigan@voitco.com · Lic. #01921490

The San Diego Retail market continues to be generally strong as we near the end of 2018. Economic cycles generally occur about every ten years, so everyone is waiting for the other shoe to drop. However, with strong employment and other market fundamentals continuing to chug along, there is no certainty a major downturn is looming. For investors, interest rates are ticking up slowly but surely, which will directly affect cap rates in the near term. Similar to quarters past, we're singing the same tune this quarter with new construction, and high-end demographic or anchored centers are still commanding high \$3–\$5 per square foot NNN rents. Moreover, even the lower-end product has inched up. The overall average retail asking rent is maintaining north of \$2 per square foot, coming in at \$2.02 per square foot NNN this quarter.

The retail market just got some big news with Mattress Firm filing Chapter 11 bankruptcy at the end of 3Q. However, with retail staying strong, what is one company's trash, may indeed be another's treasure. Many of the Mattress Firm locations are located in strong centers, whether outparcel to malls, high credit community centers, or freestanding buildings with great visibility. With many of their spaces in the 4,000–6,000 square foot range, there will be new opportunities for other uses that continue to flourish in that size range. We continue to see small format, or specialty fitness uses, taking up these spaces. Names like Orange Theory, 9Round Kickboxing, and Anytime Fitness all come to mind.

Dark Toys "R" Us buildings have also provided new opportunities. Though the big box segment is what skews the average rents downward, large boxes are still procuring a healthy \$1.50–\$2.00 per square foot NNN annual rent. Some are large enough to demise, which grows the prospective tenant pool even more. Tenants like Floor and Décor and the major furniture players like Ashley, among others, are stepping up to take down these large availabilities. Additionally, ALDI continues to grow its footprint in San Diego, as well as its pseudo-sister company Trader Joes, and their competitor, Sprouts.

Ultimately, we are continuing to see a lot of the same on positive statistics: absorption, rent growth, and lease-up all continue heading the right direction. The major downturn is unlikely, but a stabilization or plateau is more likely in the coming quarters.

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.

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Submarkets

CENTRAL SOUTH

Central San Diego, Clairemont, Coronado, Downtown, Mission Gorge, Mid City/Southeast San Diego, Mission Valley, Pacific Beach/Morena, Point Loma/Sports Arena

EAST COUNTY

El Cajon, La Mesa, Lemon Grove/Spring Valley, Santee/Lakeside

I-15 CORRIDOR

Carmel Mountain Ranch, Poway, Rancho Bernardo, Rancho Penasquitos

CENTRAL NORTH

Cardiff/Encinitas, Del Mar Heights, La Jolla/Torrey Pines, Miramar, UTC

NORTH COUNTY

Carlsbad, Escondido, Oceanside, San Marcos, Vista

OUTLYING AREAS

Outlying SD County North, Outlying SD County South

SOUTH COUNTY

Chula Vista, Eastlake, Imperial Beach/South San Diego, National City