

INDUSTRIAL AT ALL-TIME HIGHS. At the close of the fourth quarter, the San Diego County industrial market ended with occupancy and rental rates both at the highest level on record. The squeaky tight market availability and record rental rates contributed to the lowest level of positive net absorption since 2009. The countywide vacancy rate is now less than half of the level seen just five years ago. Despite the number of projects currently under construction, asking sales prices, asking lease rates and occupancy costs remain high due to demand outpacing the limited supply.

VACANCY. Direct/sublease space (unoccupied) finished the year at 3.50%, a 27 basis point decrease from last year's 3.77%. This was the third consecutive year in which a new record low was reached at year end. The vacancy rate for San Diego County's industrial market is now significantly lower than the best number posted in the last period of economic expansion, which was roughly 6% in 2006. East County posted the lowest vacancy rate at a miniscule 0.68%, with the county's highest vacancy rate being in the South County, which is still fairly tight at 5.09%.

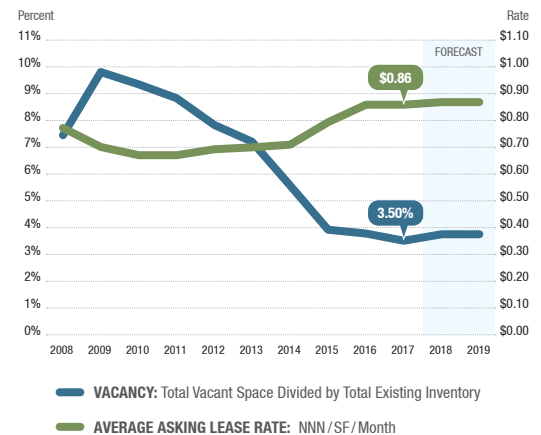
LEASE RATES. The average asking triple-net lease rate checked in at \$0.86 per square foot per month, flat in comparison with the previous year. The average asking rate is still hovering at an all-time high for the San Diego industrial market. While average asking rates didn't move much in 2017, landlords are continuing to squeeze concessions, pushing effective rents higher. The lack of availability has left tenants with limited options in many cases, keeping rental rates high.

TRANSACTION ACTIVITY. The total square feet leased and sold in the fourth quarter was approximately 4.1 million square feet, a strong finish to a low transaction year. The combined total of 13.4 million square feet leased and sold in 2017 was the lowest annual transaction volume since 2011, and the 7.1 million square feet of industrial space leased in 2017 was the lowest annual total since 2009. 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. Details of the largest transactions can be found on the back page of this report.

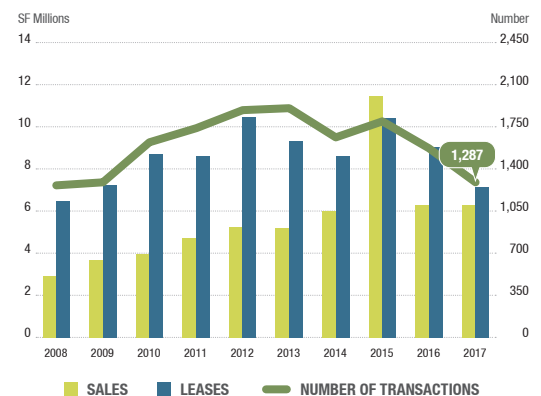
EMPLOYMENT. The unemployment rate in San Diego County was 3.3% in December 2017, unchanged from a revised 3.3% in November 2017 and below the year-ago estimate of 4.1%. This compares with an unadjusted unemployment rate of 4.2% for California and 3.9% for the nation during the same period. According to the State of California Employment Development Department, San Diego County gained 21,100 payroll jobs between December 2016 and December 2017, including 4,900 from leisure and hospitality, which reported the largest overall gain. The educational and health services sector reported a growth of 3,900 jobs, and the government sector reported an increase of 3,800 jobs.

OVERALL. The San Diego industrial market conditions are at record highs in terms of the overall occupancy and rental rates, but this has contributed to lower transaction volume and less net absorption. The depleted development pipeline early in the recovery was a big factor in the vacancy rate compression, and the recent increase in construction activity has yet to push vacancy up significantly. But, that trend is nearing a tipping point with the highest level of industrial real estate under construction in over a decade.

VACANCY vs. AVERAGE ASKING LEASE RATE



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



Market Statistics

	Change Over Last Quarter	4Q 2017	3Q 2017	4Q 2016	% Change Over Last Year
Vacancy Rate	▼ DOWN	3.50%	4.00%	3.77%	(7.17%)
Availability Rate	▼ DOWN	6.70%	7.04%	6.32%	6.06%
Average Asking Lease Rate	▲ UP	\$0.86	\$0.85	\$0.86	0.00%
Sale & Lease Transactions	▲ UP	4,131,260	3,409,625	3,471,614	19.00%
Gross Absorption	▲ UP	2,220,804	1,701,217	2,535,611	(12.42%)
Net Absorption	▲ POSITIVE	713,271	138,539	590,458	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 1.5% increase in total employment, and a 1.6% increase is projected for 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 average asking rates to increase by approximately 2% to 3% over the next four quarters.

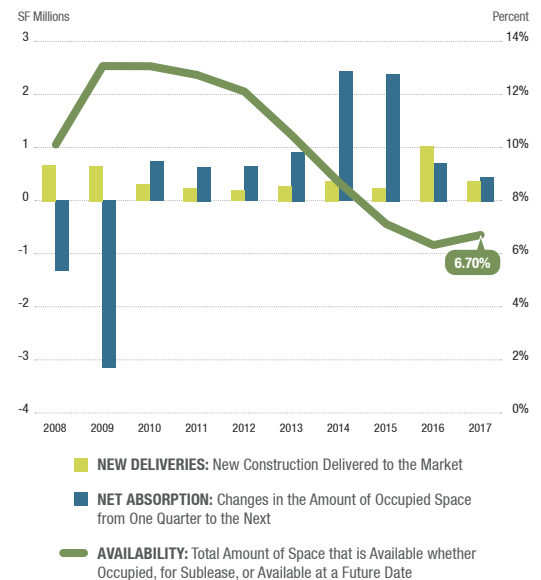
VACANCY. We anticipate the vacancy rate will start to move up from record lows as the vacancy rate is now more than three percentage points lower than availability, with 2.1 million square feet currently under construction.

CONSTRUCTION. The 350,000 square feet of new industrial projects delivered in 2017 was below the 10-year annual average of 420,000 square feet, but the 2.1 million square feet of industrial projects under construction at year end marks the highest total since the year 2000. The current product under construction is largely concentrated in the North County submarket. It remains to be seen how successful these new projects will be in luring tenants out of the tighter Central County area, and how much of the added availability will soften the North County dynamics.

AVAILABILITY. Direct/sublease space being marketed was 6.70% at the end of the second quarter, more than three percentage points higher than the vacancy rate. Much of this availability which is not vacant is in the current construction pipeline.

ABSORPTION. There was 424,886 square feet of positive net absorption in 2017, the eighth consecutive year with positive net absorption, however, 2017 saw the lowest level of positive net absorption in that timespan.

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Significant Transactions

Sales

Property Address	Submarket	Square Feet	Sale Price	Buyer	Seller
9255-9465 Customhouse Plz.	Otay Mesa	517,207	\$56,150,000	TIAA-CREF	IDS Real Estate Group
2495 Faraday Ave.	Carlsbad	109,000	\$24,500,000	BLT Enterprises	Leonard Trust
10895 Thirnmint Rd.	Rancho Bernardo	73,541	\$14,630,000	Grifols, Inc.	Meeting Services, Inc.
10926 Woodside Ave. N.	Santee	91,923	\$14,098,831	Rolle, LLC	Alt Trust
540-550 S. Pacific St.	San Marcos	63,498	\$10,700,000	Hughes SMCC, LLC	Westcore

Property Address	Submarket	Square Feet	Transaction Date	Tenant	Owner
9043 Siempre Viva Rd.	Otay Mesa	257,972	Nov-2017	Imperial Toy	AFL-CIO
1925-2005 Harmony Rd.	Escondido	212,088	Dec-2017	Veritiv	Exeter Property Group
2760 & 2765 Progress St.	Vista	194,734	Dec-2017	JELD-WEN	Barings Real Estate Advisors
2020 Piper Ranch Rd.	Otay Mesa	81,252	Dec-2017	Bee International	Morgan Stanley & Co.
5260 Anna Ave.	Rose Canyon/Morena	46,991	Dec-2017	Saxco	Lincoln Property Co.

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 4Q2017	Square Feet Available	Availability Rate 4Q2017	Average Asking Lease Rate	Net Absorption 4Q2017	Net Absorption 2017	Gross Absorption 4Q2017	Gross Absorption 2017
Central County													
Central City	140	2,196,676	0	0	64,021	2.91%	64,021	2.91%	\$2.52	1,701	(2,021)	15,810	47,710
East City	61	965,347	0	0	0	0.00%	0	0.00%	–	0	1,000	0	1,000
Southeast City	317	3,542,190	0	0	66,988	1.89%	223,324	6.30%	\$0.92	(26,145)	(8,068)	7,000	114,739
Kearny Mesa	427	9,747,029	0	84,400	226,994	2.33%	306,372	3.14%	\$1.23	44,409	(76,725)	130,389	322,144
Mission Gorge	119	1,919,031	0	0	28,310	1.48%	36,805	1.92%	\$1.10	(6,594)	(20,090)	19,009	66,798
Rose Canyon / Morena	133	2,500,226	0	0	33,313	1.33%	10,684	0.43%	\$0.85	26,202	(192,349)	78,057	117,932
Sports Arena / Airport	142	1,624,348	0	0	16,396	1.01%	60,551	3.73%	\$1.35	(700)	6,489	9,800	44,945
Miramar	587	13,243,617	30,000	615,000	437,410	3.30%	928,174	7.01%	\$0.98	(37,866)	83,186	150,424	930,932
Sorrento Mesa	78	3,850,192	0	0	28,173	0.73%	167,411	4.35%	\$1.14	39,048	65,836	51,274	305,017
Sorrento Valley	46	1,036,862	0	0	73,799	7.12%	33,020	3.18%	\$0.97	(39,019)	(61,913)	27,838	41,184
Torrey Pines / UTC	3	104,448	0	149,663	0	0.00%	0	0.00%	–	0	0	0	0
Central County Total	2,053	40,729,966	30,000	849,063	975,404	2.39%	1,830,362	4.49%	\$1.02	1,036	(204,655)	489,601	1,992,401
East County													
El Cajon	448	9,030,289	0	112,126	30,359	0.34%	126,297	1.40%	\$0.67	50,542	195,463	78,810	311,255
La Mesa / Spring Valley	309	2,639,852	0	70,000	37,064	1.40%	143,722	5.44%	\$1.53	4,150	22,225	10,064	105,818
Santee / Lakeside	275	3,625,978	0	262,395	41,632	1.15%	163,586	4.51%	\$0.89	9,325	26,252	15,125	98,724
Outlying SD County South	75	851,956	0	0	1,000	0.12%	40,000	4.70%	–	0	0	0	20,027
East County Total	1,107	16,148,075	0	444,521	110,055	0.68%	473,605	2.93%	\$0.97	64,017	243,940	103,999	535,824
North County													
Escondido	626	7,245,911	212,088	0	91,027	1.26%	291,863	4.03%	\$0.88	51,967	16,814	104,721	367,406
Oceanside	401	8,869,747	124,581	409,519	291,331	3.28%	503,250	5.67%	\$0.84	(18,101)	(75,737)	104,662	503,287
San Marcos	503	7,973,576	222,028	84,000	526,196	6.60%	726,342	9.11%	\$0.75	(595)	(26,133)	174,594	405,951
Vista	496	12,655,985	0	328,015	565,443	4.47%	947,388	7.49%	\$0.79	124,405	(121,288)	274,561	614,846
Carlsbad	230	7,702,255	938,117	171,243	557,200	7.23%	1,507,155	19.57%	\$0.96	29,823	197,073	58,127	681,731
North Beach Cities	43	261,294	0	0	0	0.00%	0	0.00%	–	0	0	0	0
Outlying SD County North	106	1,147,940	0	3,754	27,402	2.39%	245,802	21.41%	\$0.26	(5,200)	(7,526)	7,200	18,340
North County Total	2,405	45,856,708	1,496,814	996,531	2,058,599	4.49%	4,221,800	9.21%	\$0.81	182,299	(16,797)	723,865	2,591,561
I-15 Corridor													
Poway	174	7,193,933	302,500	450,000	57,314	0.80%	334,064	4.64%	\$0.92	229,743	188,535	275,534	650,638
Rancho Bernardo	43	3,176,916	0	0	229,598	7.23%	325,640	10.25%	\$1.36	4,775	66,407	4,775	97,379
Scripps Ranch	29	745,005	0	0	93,363	12.53%	96,673	12.98%	\$1.13	36,215	110,221	40,130	134,196
I-15 Corridor Total	246	11,115,854	302,500	450,000	380,275	3.42%	756,377	6.80%	\$1.17	270,733	365,163	320,439	882,213
South County													
Chula Vista	334	8,641,189	0	0	97,017	1.12%	217,779	2.52%	\$0.91	126,482	75,096	243,108	539,370
National City	245	3,512,833	0	0	52,959	1.51%	67,983	1.94%	\$0.55	(8,240)	(31)	8,764	76,039
Otay Mesa	330	15,399,552	268,454	1,564,172	1,266,673	8.23%	1,969,505	12.79%	\$0.66	67,014	(78,604)	295,198	1,031,963
San Ysidro / Imperial Beach	63	1,409,618	0	24,121	57,023	4.05%	36,930	2.62%	\$0.73	9,930	40,774	35,830	78,396
South County Total	972	28,963,192	268,454	1,588,293	1,473,672	5.09%	2,292,197	7.91%	\$0.74	195,186	37,235	582,900	1,725,768
San Diego County Total	6,783	142,813,795	2,097,768	4,328,408	4,998,005	3.50%	9,574,341	6.70%	\$0.86	713,271	424,886	2,220,804	7,727,767
0–9,999	3,066	15,576,906	0	7,804	225,540	1.45%	475,490	3.05%	\$1.15	81,178	(11,886)	173,154	598,153
10,000–19,999	1,782	25,136,299	0	30,923	522,651	2.08%	882,756	3.51%	\$1.15	73,717	129,276	405,054	1,437,049
20,000–34,999	984	25,204,911	64,854	288,911	723,794	2.87%	1,237,400	4.91%	\$0.92	143,286	128,207	570,262	1,605,435
35,000–49,999	362	14,932,831	37,627	254,550	491,350	3.29%	953,894	6.39%	\$0.84	42,646	48,381	225,246	655,478
50,000–99,999	381	26,362,891	591,734	813,683	907,637	3.44%	2,453,550	9.31%	\$0.83	(71,231)	256,569	252,159	1,580,469
100,000 Plus	208	35,599,957	1,403,553	2,932,537	2,127,033	5.97%	3,571,251	10.03%	\$0.80	443,675	(125,661)	594,929	1,851,183
San Diego County Total	6,783	142,813,795	2,097,768	4,328,408	4,998,005	3.50%	9,574,341	6.70%	\$0.86	713,271	424,886	2,220,804	7,727,767

Lease rates are on a triple-net basis.



San Diego Industrial: Thoughts from the Front Line

by **Josh West**

VICE PRESIDENT, SAN DIEGO

The San Diego Industrial market finished strong in 2017. With market-wide vacancy hitting a rock bottom of 3.5% and demand staying strong, the market should remain steady for 2018. Tenant demand was similar to 2016, with close to 8,000,000 square feet of gross absorption (square footage of leases signed). Net absorption, however, has dropped 41% since 2016, as expected in a tight market. As a result, many tenants are forced to renew in their existing space regardless of functionality or business needs.

Owners are benefiting from the strong market as concessions such as rental abatement have thinned dramatically and, in some cases, disappeared. Leasing activity was similar to 2016 with over 1,000 leases signed; however the total square footage leased was down by approximately 2,000,000 square feet. With rents reaching an average of \$0.86 NNN countywide and leasing velocity at an all-time high, San Diego will remain a “Landlord’s Market” for 2018.

As expected from these strong fundamentals, we are seeing speculative ground-up development in markets such as Carlsbad, Poway, and Otay Mesa. There is currently more than 2,000,000 square feet of product being developed. Developers are counting on the continuously vigorous and pent-up tenant demand for space.

The owner/user market was also strong in 2017 due to increasing rents and historically low interest rates. Values have reached an all-time high, with markets such as Poway cresting \$195 per square foot. The question for 2018 is, will an increase in interest rates have a negative effect on the overall market?

Investments have remained active, but the volume has decreased since 2016. This slowdown is mainly attributed to record low cap rates (higher pricing) and lack of available product, especially in our core market. The market remains flush with capital which will keep the investment market steady for the foreseeable future.

2018 will likely be very similar to 2017 with consistent demand across the board. While it seems this recovery may be “long in the tooth,” all signs continue to point to steady growth and strong fundamentals moving forward.

Product Type

MFG./DIST.

Manufacturing / Distribution / Warehouse facilities with up to 49.9% office space.

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

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