

**APPROACHING THE PEAK.** The year-end 2017 office market indicators were mostly reflective of a healthy office market, with vacancy rates at a post-recession low of 10.24%. However, availability moved upward to 13.95% in 2017. Overall, vacancy continues its gradual downward trend, while asking lease rates are continuing on a fairly stable path at some of the highest rates this market has seen — \$2.70 at the end of the year.

**VACANCY.** Direct/sublease space (unoccupied) finished the year at 10.24%, a 63 basis point decrease from the previous year. Kearny Mesa posted the lowest vacancy rate of any major submarket (minimum of four million square feet of inventory) at 5.89%.

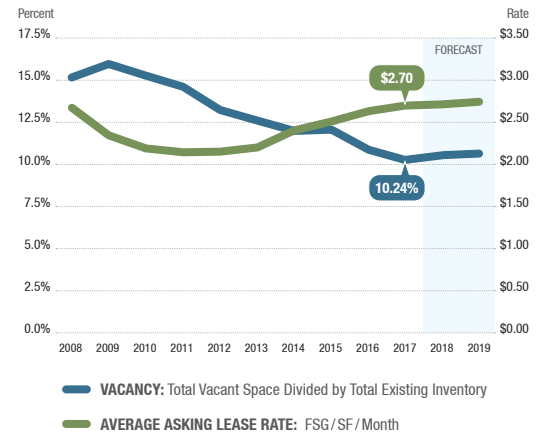
**LEASE RATES.** The average asking full-service gross (FSG) lease rate per square foot per month in San Diego County was \$2.70 at the end of the year, a three cent increase over the previous quarter's rate, and an annual increase of 2.66% from 2016's year-end rate of \$2.63. The overall average asking rate in San Diego County has increased 26% since 2011.

**TRANSACTION ACTIVITY.** Sale and lease transactions totaled 4 million square feet in the fourth quarter, a slight increase from the fourth quarter total of the prior year, which was 3.7 million square feet. 2017 ended much the same as 2016 with regards to a large office space being leased by coworking giant WeWork. In 2016 WeWork leased 85,000 square feet in downtown San Diego, and at the end of 2017 WeWork expanded into UTC with a 43,000 square foot lease at The Aventine. 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.

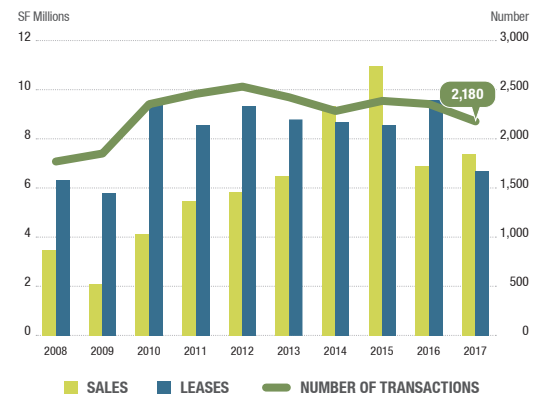
**EMPLOYMENT.** The unemployment rate in San Diego County was 3.3% in December 2017, unchanged from a revised 3.3% in November 2017 and below the year-ago estimate of 4.1%. This compares with an unadjusted unemployment rate of 4.2% for California and 3.9% for the nation during the same period. According 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 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, 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	4Q 2017	3Q 2017	4Q 2016	% Change Over Last Year
Vacancy Rate	▼ DOWN	10.24%	10.52%	10.87%	(5.74%)
Availability Rate	▼ DOWN	13.95%	14.19%	13.69%	1.92%
Average Asking Lease Rate	▲ UP	\$2.70	\$2.67	\$2.63	2.66%
Sale & Lease Transactions	▼ DOWN	3,972,371	4,181,682	3,675,711	8.07%
Gross Absorption	▼ DOWN	1,961,003	2,355,857	2,637,502	(25.65%)
Net Absorption	▲ POSITIVE	271,223	325,977	575,627	N/A

**EMPLOYMENT.** The labor market in San Diego County will continue to improve, with a continuation of steady job growth. 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 the average asking lease rate to increase by a marginal 1.5–2.5% over the next four quarters, and round into the same range for the calendar year.

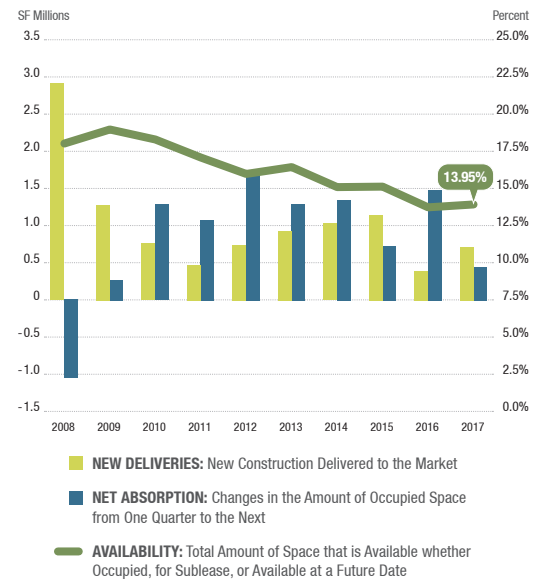
**VACANCY.** While landlords were happy to see hundreds of thousands of square feet absorbed by co-working companies in the past 12–18 months, these new operators in the market will be competing for tenants, and could act as a headwind to future occupancy gains. We anticipate vacancy to follow the increase in availability and move up towards the 11% range in 2018.

**CONSTRUCTION.** Ground-up “spec” office construction finally reached downtown San Diego in 2017, 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 is moving forward on the Gateway Pacific development which will include hundreds of thousands of square feet of office. Office deliveries have averaged 838,000 square feet a year since 2009. 2017’s office deliveries were below that level, at approximately 716,000 square feet, and significantly below the annual average of 2,400,000 square feet seen from 2000 through 2008. This low rate of construction for 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 13.95% at the end of the fourth quarter, an increase of more than a quarter percentage point from the 13.69% availability rate at the end of 2016.

**ABSORPTION.** The San Diego office market finished 2017 strong with 271,233 square feet of positive net absorption in the fourth quarter. There has been approximately 9.3 million square feet of positive net absorption for the overall San Diego market since the start of 2010.

### NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



## Significant Transactions

### Sales

Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
10301–10343 Meanley Dr.	Scripps Ranch	B	157,902	\$39,515,500	Mission Federal Credit Union	KBS REIT II, Inc.
5333–5353 Mission Center Rd. & 7947 Mission Center Ct.	Mission Valley	B	183,692	\$39,275,000	Omninet Capital	Kearny Real Estate Company
488 E. Valley Pkwy. & 4033 3rd Ave.	Escondido/Hillcrest	B	101,663	\$34,800,000	Kanye Anderson RE	Clarion Partners
15255 Innovation Dr.	Rancho Bernardo	B	68,496	\$21,500,000	SWK Properties, LLC	Pearlmark Real Estate Partners
8925 & 8945 Rehco Rd.	Miramar	B	89,490	\$21,000,000	Scripps Health	LBA

### Leases

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
5919 Sea Otter Pl.	Carlsbad	B	88,858	Nov-2017	Undisclosed	Regent Properties
9305 Lightwave Ave.	Sorrento Mesa	B	82,000	Dec-2017	UCSD	GI Partners
10945 Vista Sorrento	Del Mar Heights	A	56,153	Dec-2017	GreatCall	TIAA-CREF
15073 Avenue of Science	Rancho Bernardo	B	48,324	Oct-2017	Undisclosed	Starwood Capital Operations
8910 University Center Ln.	UTC	A	43,032	Oct-2017	WeWork	Rockpoint Group, LLC

	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
<b>Downtown</b>													
Downtown	130	12,936,660	60,000	3,905,060	1,439,349	11.13%	2,272,346	17.57%	\$2.60	123,868	276,165	346,833	1,381,193
Downtown Total	130	12,936,660	60,000	3,905,060	1,439,349	11.13%	2,272,346	17.57%	\$2.60	123,868	276,165	346,833	1,381,193
<b>Central</b>													
City Heights / University	31	1,110,005	0	0	44,532	4.01%	47,930	4.32%	\$2.22	(9,863)	6,121	2,830	33,147
Coronado	6	124,831	0	0	15,211	12.19%	15,211	12.19%	\$3.00	2,138	(3,650)	2,138	2,138
Kearny Mesa	235	10,622,159	0	690,000	625,665	5.89%	1,005,082	9.46%	\$2.19	33,071	257,866	140,077	785,969
Mission Gorge	23	545,432	0	0	14,047	2.58%	16,705	3.06%	\$1.31	12,537	26,173	20,773	38,222
Mission Valley	129	7,117,704	163,000	0	696,531	9.79%	1,108,764	15.58%	\$2.35	(32,380)	62,830	122,938	750,581
Old Town / Point Loma	66	2,118,111	0	0	89,533	4.23%	125,174	5.91%	\$2.38	34,851	62,032	61,462	161,781
Park East	8	155,884	0	0	6,266	4.02%	6,266	4.02%	-	0	(1,500)	0	0
Rose Canyon / Morena	53	1,202,150	0	0	40,913	3.40%	57,369	4.77%	\$1.85	665	11,079	25,187	73,301
Uptown / Hillcrest	104	2,666,747	0	0	160,591	6.02%	212,119	7.95%	\$2.54	11,780	14,533	34,916	142,149
Central Total	655	25,663,023	163,000	690,000	1,693,289	6.60%	2,594,620	10.11%	\$2.26	52,799	435,484	410,321	1,987,288
<b>I-15 Corridor</b>													
Escondido	90	1,908,721	76,400	118,614	161,962	8.49%	266,470	13.96%	\$2.12	12,682	(26,829)	27,407	94,560
Poway	30	1,324,065	0	160,000	71,455	5.40%	143,771	10.86%	\$2.15	16,395	5,387	26,831	63,330
Rancho Bernardo	107	6,974,441	0	2,183,595	839,846	12.04%	980,257	14.05%	\$2.86	(69,972)	(284,569)	59,340	349,709
Scripps Ranch	51	2,705,218	150,000	409,994	365,994	13.53%	464,909	17.19%	\$2.34	97,755	(141,474)	142,379	514,371
I-15 Corridor Total	278	12,912,445	226,400	2,872,203	1,439,257	11.15%	1,855,407	14.37%	\$2.55	56,860	(447,485)	255,957	1,021,970
<b>North County Coastal</b>													
Carlsbad	155	6,334,168	82,258	290,786	1,275,153	20.13%	1,494,974	23.60%	\$2.46	(90,517)	93,653	95,827	671,424
Del Mar Heights / Carmel Valley	76	4,754,750	0	949,790	730,226	15.36%	1,093,797	23.00%	\$4.13	80,345	96,873	137,304	470,247
North Beach Cities	111	2,535,878	0	45,389	151,259	5.96%	208,378	8.22%	\$3.43	(8,432)	(17,430)	47,072	158,236
North County Total	342	13,624,796	82,258	1,285,965	2,156,638	15.83%	2,797,149	20.53%	\$3.25	(18,604)	173,096	280,203	1,299,907
<b>North City</b>													
Governor Park	20	890,493	0	0	72,540	8.15%	111,154	12.48%	\$2.74	4,180	(15,028)	9,685	59,606
La Jolla	47	1,374,565	0	0	111,860	8.14%	151,869	11.05%	\$3.32	2,648	(58,039)	24,851	119,513
Miramar	33	1,610,914	0	0	180,604	11.21%	198,747	12.34%	\$1.82	(33,060)	(41,254)	40,092	155,801
Sorrento Mesa	121	9,497,713	0	1,971,063	1,227,030	12.92%	1,452,961	15.30%	\$2.75	(52,602)	(39,588)	49,994	498,988
Sorrento Valley	31	838,908	0	0	66,595	7.94%	128,786	15.35%	\$2.14	(323)	17,261	9,629	137,458
Torrey Pines	38	2,511,334	0	0	106,156	4.23%	99,153	3.95%	\$3.63	(20,157)	(5,237)	17,423	34,624
UTC	92	8,590,052	150,000	303,124	1,008,921	11.75%	1,485,128	17.29%	\$3.39	113,778	(1,642)	334,238	1,287,873
North City Total	382	25,313,979	150,000	2,274,187	2,773,706	10.96%	3,627,798	14.33%	\$2.92	14,464	(143,527)	485,912	2,293,863
<b>Southern &amp; Eastern Areas</b>													
Chula Vista	91	2,923,484	0	1,425,100	265,340	9.08%	302,656	10.35%	\$2.55	5,565	32,198	28,904	143,347
National City	14	508,388	0	0	4,046	0.80%	4,046	0.80%	\$2.11	42,089	62,876	44,835	69,998
Otay Mesa	13	318,004	0	0	11,344	3.57%	11,344	3.57%	\$2.14	4,106	4,229	5,978	12,935
Southeast San Diego	9	381,826	0	0	63,650	16.67%	63,650	16.67%	\$2.20	0	(6,300)	0	0
East County	151	3,706,841	13,200	61,800	121,995	3.29%	159,267	4.30%	\$1.75	17,296	8,679	46,754	130,876
Southern & Eastern Areas Total	278	7,838,543	13,200	1,486,900	466,375	5.95%	540,963	6.90%	\$2.33	69,056	101,682	126,471	357,156
<b>Highway 78 Corridor</b>													
Oceanside	63	1,349,948	0	335,249	146,574	10.86%	185,662	13.75%	\$1.96	(22,494)	33,798	17,352	143,805
San Marcos	37	1,375,278	0	1,991,538	150,067	10.91%	172,527	12.54%	\$2.30	(25,305)	18,054	8,138	81,375
Vista	51	1,231,884	0	0	209,830	17.03%	216,896	17.61%	\$1.86	20,579	(5,768)	29,816	103,569
Highway 78 Corridor Total	151	3,957,110	0	2,326,787	506,471	12.80%	575,085	14.53%	\$2.00	(27,220)	46,084	55,306	328,749
Class A	276	35,097,222	571,954	10,881,259	4,006,927	11.42%	5,696,146	16.23%	\$3.25	108,347	178,170	655,597	3,225,735
Class B	1,251	52,306,463	122,904	3,959,843	5,523,479	10.56%	7,354,219	14.06%	\$2.47	233,225	328,694	1,161,579	4,607,215
Class C	689	14,842,871	0	0	944,679	6.36%	1,213,003	8.17%	\$1.91	(70,349)	(65,365)	143,827	837,176
<b>San Diego County Total</b>	<b>2,216</b>	<b>102,246,556</b>	<b>694,858</b>	<b>14,841,102</b>	<b>10,475,085</b>	<b>10.24%</b>	<b>14,263,368</b>	<b>13.95%</b>	<b>\$2.70</b>	<b>271,223</b>	<b>441,499</b>	<b>1,961,003</b>	<b>8,670,126</b>

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



## The Upward March Continues

by **Ryan King**

VICE PRESIDENT / PARTNER, SAN DIEGO

With 2017 coming to a close, the office market in the fourth quarter continued its trend of growth and stability, nearing single digit vacancy at 10.24%. Net absorption increased to 440,000 square feet for the year, although 2017 was not nearly as strong as the 1.6 million square feet we saw in 2016. The office market continues to gain momentum, but not quite at the pace we saw over the last several years.

The two submarkets having had the strongest year from a net absorption standpoint were Downtown and the Central San Diego markets which include Kearny Mesa and Mission Valley. Downtown saw Net Absorption rise 276,165 square feet in 2017, with 123,868 square feet absorbed in the fourth quarter alone. Central San Diego, which is almost twice as large a market as Downtown, absorbed 435,484 square feet with Kearny Mesa contributing 257,866 square feet of that tally.

On the office leasing front, we are seeing a continued trend of the coworking environment and the shared office space concepts. WeWork, a national coworking company, continues to be on a roll with a new valuation of over \$20 billion, a figure only exceeded by Uber & Airbnb among U.S. startups. The company now has more than 150 locations and recently signed their second lease in San Diego, for over 40,000 square feet in UTC at the Aventine at 8910 University Center. Another significant lease was for UCSD signing 82,000 square feet in Kearny Mesa at 9305 Lightwave Avenue.

Quite notably, office lease rates continue to rise, finishing 2017 averaging \$2.70 per square foot, up almost 3% from 2016. The office market is seeing some of the highest effective rental rates we have experienced, as some buildings (Downtown & Del Mar Heights) are inching closer and closer to \$5.00 per square foot per month. Lease concessions are down and have created an optimum situation for landlords owning quality product. Title 24 requirements continue to push the cost of tenant improvements, forcing landlords to heavily scrutinize tenant financials.

Overall, the San Diego office market continues to march along and remains strong. The market appears to have more runway thanks to a relatively low interest rate environment, positive job growth, and a new corporate tax structure. We are now approaching year 10 of the recovery and although we are optimistic, it is still best to proceed with caution. There is little evidence that the commercial real estate market is headed for a correction in 2018, but don't expect to see tumbling vacancy rates and soaring investment sales activity.

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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