

MARKET OVERVIEW. The office market looks to have a nice bounceback this year following two years of decreasing occupancy gain rates. With nearly half a million square feet of positive net absorption in the first half of the year, the market has already seen more absorption than either of the previous two calendar years. Overall, lease rates continue to press upward at a modest rate, and new office construction is at a moderate level.

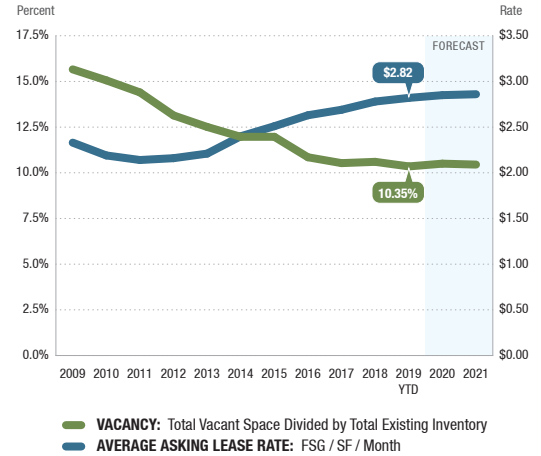
VACANCY. Direct/sublease space (unoccupied) finished the quarter at 10.35%, 15 basis points lower than a year prior quarter, and down 1.3% from the rate of a year ago. Among the county's major submarkets (minimum of 4 MSF of inventory), Kearny Mesa and UTC were both near 7% vacancy, while Downtown and Carlsbad both had vacancy rates above 15%.

LEASE RATES. The average asking full-service gross (FSG) lease rate per square foot per month in San Diego County was \$2.82 at the end of the second quarter, which is unchanged from the prior quarter, and an annual increase of 3.3% from the second quarter of 2018's rate of \$2.73. The overall San Diego office market average asking rate is now at an all-time high, surpassing the previous peak of \$2.74 from 2007.

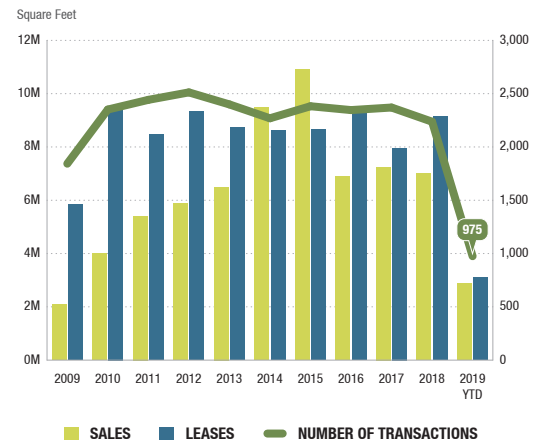
TRANSACTION ACTIVITY. Sale and lease transactions totaled 3.3 MSF in the second quarter, an increase from the 2.7 MSF which transacted in the first quarter. The transaction activity statistic can have some lag time in being reported, so look for figures to end up even higher in the next report.

EMPLOYMENT. The unemployment rate in San Diego County was 2.8% in May 2019, down from a revised 3.0% in April 2019, and unchanged from the year-ago estimate of 2.8%. This compares with an unadjusted unemployment rate of 3.5% for California and 3.4% for the nation during the same period. According to the State of California Employment Development Department, San Diego County gained 25,600 payroll jobs between May 2018 and May 2019, including 8,700 from education and health services, which reported the largest overall gain. The professional and business services sector reported a growth of 7,000 jobs, the second most among the major employment sectors. The largest year-over-year loss was in trade, transportation, and utilities which reported 3,200 fewer jobs than the prior year.

VACANCY vs. AVERAGE ASKING LEASE RATE



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



Market Statistics

	Change Over Last Quarter	2Q 2019	1Q 2019	2Q 2018	% Change Over Last Year
Vacancy Rate	▼ DOWN	10.35%	10.50%	10.48%	(1.29%)
Availability Rate	▬ FLAT	13.92%	13.97%	14.06%	(1.04%)
Average Asking Lease Rate	▬ FLAT	\$2.82	\$2.82	\$2.73	3.30%
Sale & Lease Transactions	▲ UP	3,296,116	2,687,180	4,220,394	(21.90%)
Gross Absorption	▲ UP	2,099,019	2,015,401	1,968,962	6.61%
Net Absorption	▲ POSITIVE	275,587	200,383	359,774	N/A

EMPLOYMENT. The labor market in San Diego County will continue to improve, although we anticipate job growth to slow. In 2018 there was a 1.7% increase in total employment, and a 1.0–1.2% increase is projected for 2019. 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.

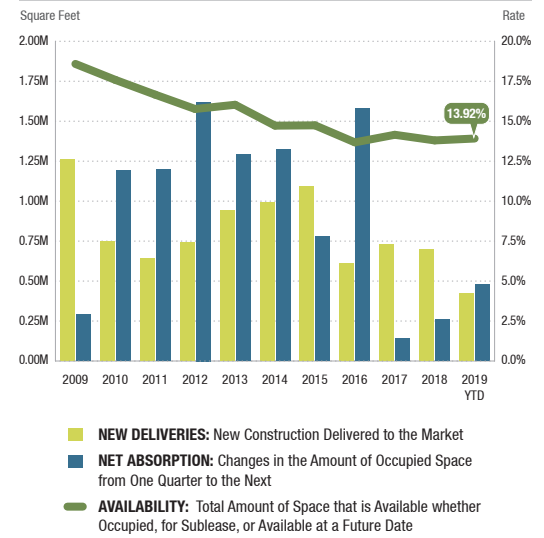
VACANCY. While landlords were happy to see hundreds of thousands of square feet absorbed by co-working companies in the past 12–18 months, these new operators in the market will be competing for tenants and could act as a headwind to future occupancy gains. Conversely, a number of companies have committed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

CONSTRUCTION. Kilroy is moving ahead on their One Paseo project which will add some speculative development to the mix in the construction pipeline. This will complement the build-to-suit construction which has been the dominant trend in recent quarters, including MedImpact’s 160,000 square feet under construction in Scripps Ranch, ViaSat’s recent campus expansions in Carlsbad. Additionally, Manchester is underway on the downtown bayfront project which will include a new regional office for the U.S. Navy with additional Class A office towers to follow.

ABSORPTION. The San Diego office market recorded 275,582 square feet of positive net absorption in the second quarter, for a total of just under half a million square feet of positive net absorption for the first half of the year. This total from the first half of 2019 surpasses the annual total from both 2017 and 2018. 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 online.

AVAILABILITY. Direct/sublease space being marketed was 13.92% at the end of the second quarter, a decrease of 5 basis points from the first quarter, and an overall decrease of 1% from the previous year.

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Significant Transactions

Sales						
Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
4707 & 4747 Executive Dr.	UTC	A	724,000 [†]	\$513,500,000	American Assets Trust	JP Morgan Chase & Co
450& & 480 4th Ave. CV; 959 & 971 Lane Ave. CV; 225 E. 2nd Ave. Esc.	Various	B	181,119 [‡]	\$106,607,878 [‡]	Welltower, Inc.	CNL Healthcare Properties, Inc.
9242 & 9246 Lightwave Ave.	Kearny Mesa	B	129,146	\$39,750,000	Washington Capital Management	Colony Capital, Inc.
1950 Camino Vida Roble	Carlsbad	B	121,541	\$20,200,000	RAF Pacifica Group, Inc.	Buchanan Street Partners
2411 Boswell Rd.	Chula Vista	B	59,322	\$20,200,000	Boyd Watterson Asset Management	Easterly Government Properties, Inc.

Leases						
Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
2411 Boswell Rd.	Chula Vista	B	59,322	May-2019	US Customs and Border	Boyd Watterson Asset Management
2544 Campbell Pl.	Carlsbad	B	47,500	May-2019	Undisclosed	Office Properties Income Trust
12390 El Camino Real	Del Mar Heights / Carmel Valley	A	39,308	May-2019	Undisclosed	Kilroy Realty Corp.
12830 El Camino Real	Del Mar Heights / Carmel Valley	A	33,315	Apr-2019	Undisclosed	Kilroy Realty Corp.
2200 Faraday Ave.	Carlsbad	B	29,313	Jun-2019	Undisclosed	Hill Companies, 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 2Q2019	Square Feet Available	Availability Rate 2Q2019	Average Asking Lease Rate	Net Absorption 2Q2019	Net Absorption 2019	Gross Absorption 2Q2019	Gross Absorption 2019
Downtown													
Downtown	127	12,962,911	372,000	3,611,605	2,146,714	16.56%	2,690,186	20.75%	\$2.78	(35,200)	(35,913)	194,270	496,709
Downtown Total	127	12,962,911	372,000	3,611,605	2,146,714	16.56%	2,690,186	20.75%	\$2.78	(35,200)	(35,913)	194,270	496,709
Central													
City Heights / University	31	1,216,139	0	0	42,770	3.52%	78,938	6.49%	\$2.43	(4,507)	(2,072)	3,411	7,121
Coronado	6	124,831	0	0	7,227	5.79%	10,085	8.08%	\$4.13	(914)	(914)	0	0
Kearny Mesa	237	10,988,508	90,000	104,000	791,943	7.21%	1,248,424	11.36%	\$2.34	(33,546)	12,170	161,791	315,518
Mission Gorge	19	567,430	0	0	15,799	2.78%	16,340	2.88%	\$1.97	3,317	(5,870)	7,667	14,958
Mission Valley	127	7,218,259	0	0	802,592	11.12%	1,034,053	14.33%	\$2.72	38,356	(104,398)	233,841	352,915
Old Town / Point Loma	81	2,438,630	0	230,000	139,218	5.71%	173,615	7.12%	\$3.11	(8,001)	(10,856)	13,422	30,708
Park East	17	273,122	0	0	14,266	5.22%	23,519	8.61%	\$2.29	4,736	(7,503)	6,331	6,331
Rose Canyon / Morena	54	1,233,791	0	0	61,184	4.96%	59,923	4.86%	\$1.98	(4,600)	2,677	18,704	53,403
Uptown / Hillcrest	78	2,212,048	0	0	120,328	5.44%	176,739	7.99%	\$2.74	1,248	1,500	30,527	49,955
Central Total	650	26,272,758	90,000	334,000	1,995,327	7.59%	2,821,636	10.74%	\$2.52	(3,911)	(115,266)	475,694	830,909
I-15 Corridor													
Escondido	74	1,685,940	0	121,614	133,524	7.92%	203,355	12.06%	\$2.14	50,931	43,168	62,542	83,968
Poway	30	1,325,923	0	160,000	26,704	2.01%	66,687	5.03%	\$2.31	9,207	8,354	20,820	23,889
Rancho Bernardo	105	6,795,102	0	2,308,747	675,566	9.94%	1,053,967	15.51%	\$3.07	(18,063)	65,562	55,358	211,878
Scripps Ranch	51	2,737,439	158,995	137,000	494,935	18.08%	541,498	19.78%	\$2.59	(29,951)	(4,690)	68,113	128,703
I-15 Corridor Total	260	12,544,404	158,995	2,727,361	1,330,729	10.61%	1,865,507	14.87%	\$2.81	12,124	112,394	206,833	448,438
North County Coastal													
Carlsbad	163	6,828,658	0	10,000	1,090,621	15.97%	1,340,423	19.63%	\$2.60	279,232	322,960	370,931	566,606
Del Mar Heights / Carmel Valley	76	4,759,680	288,484	654,192	684,609	14.38%	1,053,950	22.14%	\$4.32	72,916	114,713	159,754	300,474
North Beach Cities	110	2,546,539	60,000	151,561	164,997	6.48%	226,611	8.90%	\$3.65	28,663	44,058	58,075	105,053
North County Total	349	14,134,877	348,484	815,753	1,940,227	13.73%	2,620,984	18.54%	\$3.36	380,811	481,731	588,760	972,133
North City													
Governor Park	20	889,275	0	0	96,414	10.84%	110,047	12.37%	\$2.70	(3,542)	(14,079)	15,205	31,470
La Jolla	46	1,369,624	0	0	201,382	14.70%	247,617	18.08%	\$3.37	(94,229)	(97,629)	15,982	42,338
Miramar	34	1,591,313	0	0	88,816	5.58%	183,342	11.52%	\$1.66	39,990	30,272	64,611	88,111
Sorrento Mesa	122	9,643,668	0	2,340,500	1,230,908	12.76%	1,479,230	15.34%	\$2.76	(229,413)	(180,166)	73,464	304,302
Sorrento Valley	29	799,045	0	0	65,805	8.24%	115,148	14.41%	\$2.64	10,409	9,400	12,613	14,135
Torrey Pines	43	2,994,356	0	0	97,296	3.25%	373,831	12.48%	\$4.38	4,993	(8,966)	10,642	10,642
UTC	91	8,814,742	0	303,124	604,392	6.86%	716,679	8.13%	\$3.16	183,660	352,595	273,621	562,594
North City Total	385	26,102,023	0	2,643,624	2,385,013	9.14%	3,225,894	12.36%	\$2.85	(88,132)	91,427	466,138	1,053,592
Southern & Eastern Areas													
Chula Vista	90	2,904,836	0	1,428,151	194,101	6.68%	255,212	8.79%	\$2.48	5,305	31,831	45,250	95,508
National City	15	528,472	0	0	1,829	0.35%	16,350	3.09%	\$1.73	(835)	(835)	0	0
Otay Mesa	13	319,824	0	0	10,349	3.24%	44,729	13.99%	\$2.09	(2,703)	(6,059)	0	1,002
Southeast San Diego	12	446,619	0	290,000	53,000	11.87%	53,000	11.87%	\$2.35	0	6,698	0	6,698
East County	150	3,610,510	86,000	86,800	126,813	3.51%	179,933	4.98%	\$2.02	(6,344)	8,350	34,646	79,852
Southern & Eastern Areas Total	280	7,810,261	86,000	1,804,951	386,092	4.94%	549,224	7.03%	\$2.29	(4,577)	39,985	79,896	183,060
Highway 78 Corridor													
Oceanside	62	1,350,464	0	302,749	164,142	12.15%	226,036	16.74%	\$2.10	(8,283)	(18,222)	18,166	32,471
San Marcos	38	1,403,340	0	1,991,538	101,662	7.24%	116,514	8.30%	\$2.36	4,294	3,220	29,507	30,886
Vista	51	1,243,540	0	0	293,612	23.61%	331,232	26.64%	\$1.76	18,461	(83,386)	39,755	66,222
Highway 78 Corridor Total	151	3,997,344	0	2,294,287	559,416	13.99%	673,782	16.86%	\$2.02	14,472	(98,388)	87,428	129,579
Class A	293	37,200,269	819,479	10,568,529	4,418,168	11.88%	5,933,383	15.95%	\$3.33	446,004	808,530	1,115,055	2,181,325
Class B	1,253	52,361,455	236,000	3,663,052	5,481,058	10.47%	7,309,110	13.96%	\$2.56	(155,348)	(380,316)	827,486	1,557,498
Class C	655	14,249,879	0	0	844,292	5.92%	1,204,720	8.45%	\$2.04	(15,069)	47,756	156,478	375,597
San Diego County Total	2,202	103,824,578	1,055,479	14,231,581	10,743,518	10.35%	14,447,213	13.92%	\$2.82	275,587	475,970	2,099,019	4,114,420

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



Bounceback First Half

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The San Diego office market is off to a strong start in the first half of 2019 with 476,000 square feet of positive net absorption, already exceeding the level of net absorption seen in 2017 and 2018 combined. Rental rates continue to press upwards, and the vacancy rate is flirting with single digits as the market saw occupancy rates north of 89.5% at the end of the first half.

WeWork continues to be the face of the nascent coworking trend that has blossomed in recent years. WeWork is gearing up for an IPO and continues to take on additional billions of dollars in debt, and the fact they reported a loss of \$1.9 billion in 2018 has not dissuaded other players from joining the arena. The coworking outfit “Industrious” is one of the various other national companies trying to carve out a niche in the San Diego area. Industrious has a new 28,000-square-foot location coming online in the 1 Columbia Place office building in downtown. Additionally, Industrious has a partnership with Seritage to take space in former Sears locations that are being redeveloped. The former Sears location in the Westfield UTC mall is currently being redeveloped with a mixed-use project that will be anchored by Industrious and the luxury gym franchise Equinox. There will be additional retail and entertainment space, along with some planned second floor office space that is currently being marketed for lease during construction.

The sales volume of office buildings in San Diego peaked in 2015 when the market saw nearly 11 MSF of offices transact, which was more than 10% of the office building inventory in the entire county. In the three subsequent years, sales volume averaged right around 7 MSF a year, and the market is on track to reach a similar mark this year, barring any major shocks to the economy. This is not at the elevated levels seen in 2014 and 2015, but still exceeds the average office sales volume of 2011–2013 of 6 MSF a year in San Diego County. At this point in the economic cycle, San Diego has seen institutional buyers move out of their comfort zone in order to acquire quality assets. In the second quarter American Assets branched out from their local area of focus for office buildings which is the Del Mar Heights / Carmel Valley submarket, and they acquired the 724,000-square-foot La Jolla Commons office development in the UTC submarket for \$513.5 million. This contrasts with The Irvine Company which holds most of the office buildings in UTC. In 2018 The Irvine Company branched out of UTC and into Del Mar Heights / Carmel Valley in a major way with the acquisition of One Del Mar, Paseo Del Mar, and Gateway at Torrey Hills, a total of 546,000 square feet of offices.

Overall, the market seems to have pulled back from the frenzy seen in 2014 and 2015 but has been steadily advancing with moderate levels of new construction, continued increases in rental rates, and a countywide occupancy level that remains steady, barely below 90%. This year looks to be another year of solid fundamentals in line with the past couple of years. 2019 is off to a good start.

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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. ©2019 Voit Real Estate Services, Inc. DRE 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