

MARKET OVERVIEW. The office market saw some negative net absorption in the third quarter but remains solidly in the positive for the year overall. The negative net absorption edged the county vacancy rate up, but the availability rate continues to decrease. Overall, lease rates continue to press upward at a modest rate, and new office construction is at a moderate level, both of which are indicative of a market which is on firm footing and growing at a very steady pace.

VACANCY. Direct/sublease space (unoccupied) finished the quarter at 10.59%, a minor 9 basis point increase over the rate of a year ago. Among the county's major submarkets (minimum of four million square feet of inventory), Kearny Mesa and UTC were both below 9% vacancy, while Downtown and Carlsbad both had vacancy rates above 15%.

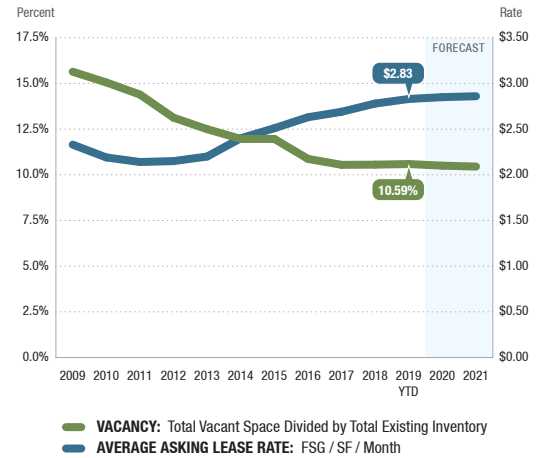
AVAILABILITY. Direct/sublease space being marketed was 13.54% at the end of the third quarter, a decrease of 38 basis points from the second quarter, and an overall decrease of 1.1% from the previous year.

LEASE RATES. The average asking full-service gross (FSG) lease rate per square foot per month in San Diego County was \$2.83 at the end of the third quarter, which is a one-cent increase over the prior quarter, and an annual increase of 2.9% from the third quarter of 2018's rate of \$2.75. 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.

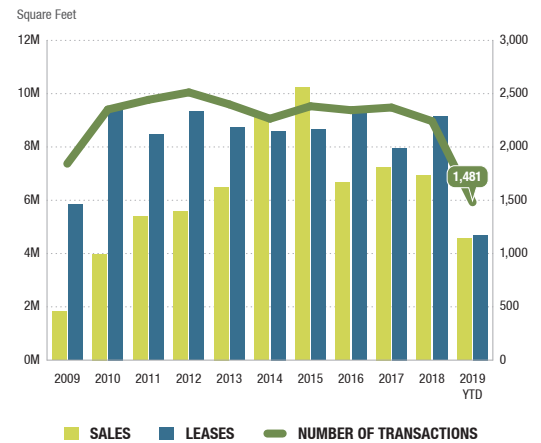
TRANSACTION ACTIVITY. Sale and lease transactions totaled 2.9 million square feet in the third quarter, a decrease from the 3.6 million square feet which transacted in the second quarter. The transaction activity statistic can have some lag time in being reported, so look for figures to end up even higher in the next report.

EMPLOYMENT. The unemployment rate in San Diego County was 3.4% in August 2019, down from a revised 3.6% in July 2019, and below the year-ago estimate of 3.5%. This compares with an unadjusted unemployment rate of 4.2% for California and 3.8% for the nation during the same period. According to the State of California Employment Development Department, San Diego County gained 27,400 payroll jobs between August 2018 and August 2019, including 8,400 from the government sector, which reported the largest overall gain. The professional and business services sector reported a growth of 6,600 jobs, the second most among the major employment sectors. The largest year-over-year loss was in trade, transportation, and utilities which reported 2,900 fewer jobs than the prior year.

VACANCY vs. AVERAGE ASKING LEASE RATE



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



Market Statistics

	Change Over Last Quarter	3Q 2019	2Q 2019	3Q 2018	% Change Over Last Year
Vacancy Rate	▲ UP	10.59%	10.33%	10.51%	0.79%
Availability Rate	▼ DOWN	13.54%	13.91%	13.69%	(1.14%)
Average Asking Lease Rate	▲ UP	\$2.83	\$2.82	\$2.75	2.91%
Sale & Lease Transactions	▼ DOWN	2,877,194	3,653,415	4,390,474	(34.47%)
Gross Absorption	▬ FLAT	1,917,612	2,055,384	1,901,199	0.86%
Net Absorption	▼ NEGATIVE	(127,453)	232,502	76,902	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.

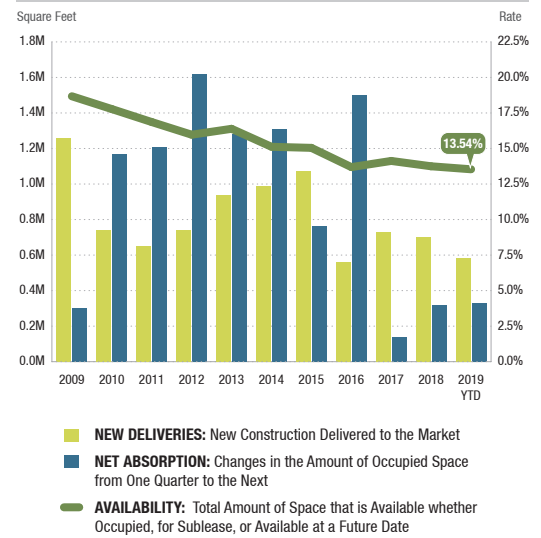
LEASE RATES. Expect the average asking lease rate to increase by a modest 2.0–2.5% over the next four quarters.

VACANCY. Vacancy has been very stable since dropping below 11% in 2016. Although the vacancy rate has been moving up by the smallest of margins, the availability rate continues to decrease. We anticipate the countywide vacancy to remain relatively stable around the 10–11% range as it has for the past couple of years.

CONSTRUCTION. Speculative construction remains minimal. Moreover, only 83,000 square feet, or 7.7%, of the current 1.1 million square feet of office under construction is available for lease. Kilroy’s One Paseo project in Del Mar Heights/ Carmel Valley is the largest spec project currently under construction, and preleasing in the project has been very strong. As for the build-to-suit activity, 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. The relative lack of speculative office construction has been a stabilizing factor for the market.

ABSORPTION. The San Diego office market recorded 127,453 square feet of negative net absorption in the third quarter, and the year-to-date total is currently at 327,031 square feet of positive net absorption. This total surpasses the annual totals 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.

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Significant Transactions

Sales

Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
9333 & 9339 Genesee Ave.	UTC	A	161,184	\$90,000,000	JLL Income Property Trust	Polidev Investments
9275 & 9325 Sky Park Ct.	Kearny Mesa	A	203,258	\$50,600,000	Parallel Capital Partners	Blackstone
10421 & 10431 Wateridge Cir.	Sorrento Mesa	B	125,276	\$41,500,000	BioMed Realty	Angelo, Gordon & Co.
3870–3890 Murphy Canyon Rd.	Kearny Mesa	B	133,668	\$28,450,000	Peregrine Realty Partners	TriGate Capital, LLC
4921 Directors Pl.	Sorrento Mesa	B	57,215	\$16,100,000	HCP, Inc.	John Hancock Real Estate

Leases

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
4747 Executive Dr.	UTC	A	48,785	Jul-2019	Illumina	American Assets Trust
2548 Campbell Pl.	Carlsbad	A	47,500	Aug-2019	ViaSat	Sir Campbell Place, Inc.
10182 Telesis Ct.	Sorrento Mesa	A	43,052	Jul-2019	Undisclosed	Manulife Investment Mgmt.
9710 Scranton Rd.	Sorrento Mesa	B	25,669	Aug-2019	Undisclosed	Barings
12830 El Camino Real	Del Mar Heights	A	22,870	Aug-2019	Undisclosed	Kilroy 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 3Q2019	Square Feet Available	Availability Rate 3Q2019	Average Asking Lease Rate	Net Absorption 3Q2019	Net Absorption 2019	Gross Absorption 3Q2019	Gross Absorption 2019
Downtown													
Downtown	128	13,024,034	372,000	3,611,605	2,260,274	17.35%	2,699,793	20.73%	\$2.87	(130,696)	(159,573)	157,120	654,329
Downtown Total	128	13,024,034	372,000	3,611,605	2,260,274	17.35%	2,699,793	20.73%	\$2.87	(130,696)	(159,573)	157,120	654,329
Central													
City Heights/University	31	1,216,139	0	0	49,902	4.10%	98,014	8.06%	\$2.39	(7,132)	(9,204)	7,334	14,455
Coronado	6	124,831	0	0	7,527	6.03%	10,385	8.32%	\$4.13	(300)	(1,214)	0	0
Kearny Mesa	238	11,006,451	90,000	354,000	796,829	7.24%	1,233,846	11.21%	\$2.25	(4,886)	7,284	116,520	432,038
Mission Gorge	19	567,430	0	0	13,335	2.35%	16,194	2.85%	\$1.96	2,464	(3,406)	2,464	17,422
Mission Valley	127	7,221,846	0	0	808,465	11.19%	991,793	13.73%	\$2.72	(10,936)	(110,271)	178,301	536,279
Old Town/Point Loma	79	2,411,291	0	230,000	100,102	4.15%	124,695	5.17%	\$2.62	39,116	28,260	57,621	88,329
Park East	17	273,122	0	0	22,701	8.31%	22,701	8.31%	\$2.26	(8,435)	(15,938)	1,323	7,654
Rose Canyon/Morena	54	1,233,791	0	0	47,318	3.84%	60,069	4.87%	\$2.08	13,866	16,543	25,944	79,347
Uptown/Hillcrest	78	2,212,048	0	0	118,333	5.35%	186,112	8.41%	\$2.74	1,995	3,495	25,432	75,387
Central Total	649	26,266,949	90,000	584,000	1,964,512	7.48%	2,743,809	10.45%	\$2.46	25,752	(84,451)	414,939	1,250,911
I-15 Corridor													
Escondido	74	1,685,940	0	121,614	139,217	8.26%	191,796	11.38%	\$2.06	(5,693)	37,475	24,859	108,827
Poway	30	1,325,923	0	160,000	23,331	1.76%	62,672	4.73%	\$2.33	3,373	11,727	8,113	32,002
Rancho Bernardo	105	6,796,745	0	2,295,747	726,582	10.69%	1,088,029	16.01%	\$3.08	(51,016)	14,546	79,216	291,094
Scripps Ranch	52	2,896,434	0	137,000	442,824	15.29%	612,018	21.13%	\$2.65	211,106	206,416	257,781	386,484
I-15 Corridor Total	261	12,705,042	0	2,714,361	1,331,954	10.48%	1,954,515	15.38%	\$2.82	157,770	270,164	369,969	818,407
North County Coastal													
Carlsbad	162	6,809,620	0	10,000	1,086,908	15.96%	1,292,770	18.98%	\$2.59	3,713	326,673	143,053	709,659
Del Mar Heights/Carmel Valley	76	4,758,981	288,484	679,648	645,515	13.56%	975,279	20.49%	\$4.38	39,094	153,807	156,728	457,202
North Beach Cities	111	2,558,193	172,362	114,933	163,242	6.38%	257,390	10.06%	\$3.63	1,755	55,813	55,429	170,482
North County Total	349	14,126,794	460,846	804,581	1,895,665	13.42%	2,525,439	17.88%	\$3.36	44,562	536,293	355,210	1,337,343
North City													
Governor Park	20	889,275	0	0	87,283	9.82%	111,023	12.48%	\$2.69	9,131	(4,948)	16,697	48,167
La Jolla	46	1,371,188	0	0	149,127	10.88%	188,821	13.77%	\$3.48	50,450	(48,179)	79,201	121,539
Miramar	33	1,487,988	0	0	105,376	7.08%	152,938	10.28%	\$1.74	(16,560)	(10,034)	15,113	66,622
Sorrento Mesa	123	9,747,032	0	2,340,500	1,249,822	12.82%	1,417,249	14.54%	\$2.70	(18,914)	(173,884)	176,471	517,375
Sorrento Valley	29	800,871	0	0	97,247	12.14%	104,958	13.11%	\$2.74	(31,442)	(22,042)	13,894	28,029
Torrey Pines	44	2,964,680	0	0	233,307	7.87%	322,959	10.89%	\$4.39	(136,011)	(144,977)	33,222	43,864
UTC	91	8,814,742	0	243,124	725,776	8.23%	694,346	7.88%	\$3.44	(121,384)	187,176	100,955	619,514
North City Total	386	26,075,776	0	2,583,624	2,647,938	10.15%	2,992,294	11.48%	\$2.89	(264,730)	(216,888)	435,553	1,445,110
Southern & Eastern Areas													
Chula Vista	90	2,840,906	0	1,428,151	185,645	6.53%	263,917	9.29%	\$2.48	8,456	40,287	42,767	138,275
National City	15	528,472	0	0	7,474	1.41%	15,515	2.94%	\$1.73	(5,645)	(6,480)	1,806	1,806
Otay Mesa	13	319,824	0	0	12,797	4.00%	47,177	14.75%	\$2.09	(2,448)	(8,507)	0	1,002
Southeast San Diego	12	444,085	0	290,000	53,000	11.93%	53,000	11.93%	\$2.35	0	6,698	0	6,698
East County	150	3,609,149	86,000	86,800	144,508	4.00%	158,435	4.39%	\$2.09	(17,695)	(9,345)	48,377	128,229
Southern & Eastern Areas Total	280	7,742,436	86,000	1,804,951	403,424	5.21%	538,044	6.95%	\$2.35	(17,332)	22,653	92,950	276,010
Highway 78 Corridor													
Oceanside	63	1,349,020	0	302,749	139,070	10.31%	206,769	15.33%	\$2.10	25,072	6,850	47,434	79,905
San Marcos	38	1,407,116	0	2,041,538	92,158	6.55%	97,143	6.90%	\$2.39	9,504	12,724	18,465	49,351
Vista	51	1,243,540	0	0	270,967	21.79%	312,843	25.16%	\$1.72	22,645	(60,741)	25,972	92,194
Highway 78 Corridor Total	152	3,999,676	0	2,344,287	502,195	12.56%	616,755	15.42%	\$2.00	57,221	(41,167)	91,871	221,450
Class A	293	37,273,343	660,484	10,758,529	4,524,818	12.14%	5,773,889	15.49%	\$3.41	29,009	844,075	790,945	2,972,270
Class B	1,262	52,482,441	348,362	3,688,880	5,645,362	10.76%	7,184,567	13.69%	\$2.57	(146,114)	(553,107)	941,735	2,472,156
Class C	650	14,184,923	0	0	835,782	5.89%	1,112,193	7.84%	\$2.09	(10,348)	36,063	184,932	559,134
San Diego County Total	2,205	103,940,707	1,008,846	14,447,409	11,005,962	10.59%	14,070,649	13.54%	\$2.83	(127,453)	327,031	1,917,612	6,003,560

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



Certainly Uncertain

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Is coworking as we know it going to change? Amid a quick exit from WeWork's CEO, Adam Neumann, one of the biggest office tenants in the world is looking into an uncertain future. The We Company, which cancelled their IPO following a devaluation of the company's stock, is now scrambling to cut costs in an effort to save the forward momentum of the company. So, what is the moral of the story? The future, not just for coworking, is uncertain.

On a local level, San Diego's office market saw a negative net absorption of 127,453 square feet in Q3 of 2019. Uncertainty, as a byproduct of the longest economic recovery in U.S. history, is causing companies to take a closer look at their short vs. long term commercial office approach. Capable buyers are reconsidering their desire for purchasing versus leasing as we sit at the top of a market that showcases record lease rates over and over again. Tenants are taking a closer look at their 5–10 year forecasts as they hesitate to sign leases with gross office rents up 22.5% over the past five years. The general perspective is that there is an economic correction that will inevitably happen sooner or later.

Landlords, however, continue to operate in a very competitive environment. On one hand, they are pushing rates and limiting concessions, and on the other hand they are enhancing building amenities and creating an environment and experience for the tenants. Landlords, such as The Irvine Company, are focused on spec suites that leave a great first impression and are in ready condition for smaller tenants. That being said, Irvine has limited their rental abatement concessions and holds firm at their 4.5% annual increases. This is an example of how landlords are taking advantage of the competitive market conditions while also differentiating their approach.

Overall, the market conditions resemble those of the past few years. Growth is expected to continue, and we expect the year to end with positive net absorption as the fourth quarter is typically a strong quarter. With political uncertainty and an election coming up in just over a year, it remains important to keep a close eye on which way the commercial real estate market trends.

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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