

MARKET OVERVIEW. The San Diego Flex/R&D market is on pace for its fourth consecutive year with more than half a million square feet of new construction deliveries, which is more than double the 10-year annual average. This has placed some pressure on the market's overall occupancy rate, and all the new product has pushed the average asking rental rate up significantly. There was negative net absorption in the market through three quarters of the year, and transaction volume is down. The market is heading towards its first calendar year of negative net absorption since 2011.

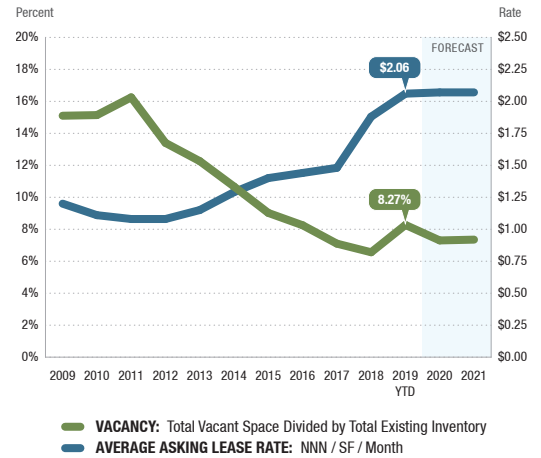
VACANCY. Direct/sublease space (unoccupied) finished the third quarter at 8.27%, an increase of 1.76 percentage points from the third quarter of 2018's vacancy rate of 6.51%. The current vacancy rate is at about half of the 2010 recession low of 16.12%. The Flex/R&D sector is the smallest of the major commercial real estate sectors in San Diego, and as such the metrics often change very rapidly.

LEASE RATES. The average asking triple net lease rate per square foot per month in San Diego County was \$2.06 at the end of the third quarter, which is a nine-cent increase over the second quarter of 2019. The average asking lease rate has been on a long-term trend of increases, but recent increases in the average are likely due to a change in the composition of available space. There is now a larger portion of biotech space in the availability, and a larger portion of new construction in the availability, which are both pulling the average asking rate up.

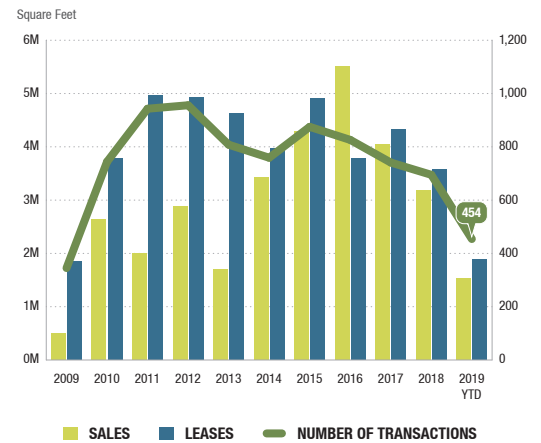
TRANSACTION ACTIVITY. The combined amount of square feet leased or sold in the third quarter totaled 1.0 million square feet, a decrease from the 1.2 million square feet transacted in the second quarter of 2019. Sales and leasing volumes are now on pace for a third consecutive year of decreases. This 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.

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	8.27%	7.37%	6.51%	27.00%
Availability Rate	▲ UP	12.32%	11.91%	10.64%	15.85%
Average Asking Lease Rate	▲ UP	\$2.06	\$1.97	\$1.54	33.77%
Sale & Lease Transactions	▼ DOWN	1,050,189	1,190,943	1,419,353	(26.01%)
Gross Absorption	▼ DOWN	698,996	899,500	698,702	0.04%
Net Absorption	▼ NEGATIVE	(326,068)	258,553	123,780	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. Despite a decrease in transaction volume, landlords are still pushing asking rental rates up. Expect average asking rates to increase by approximately 2–3% over the next four quarters.

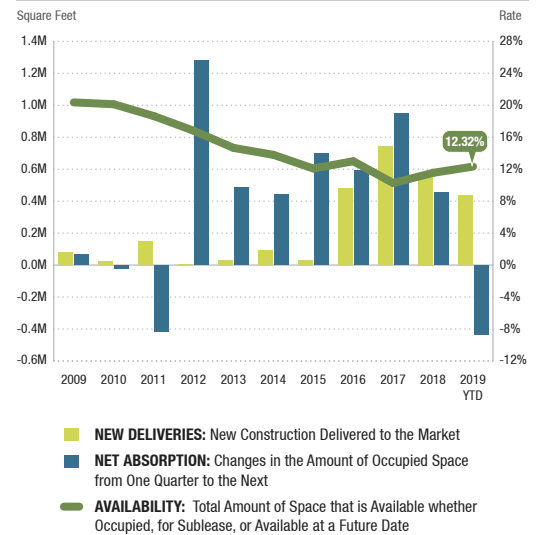
VACANCY. Due to the relatively large number of deliveries in 2018, and the moderate amount of demand, we expect vacancy rates to move upward over the next two to three quarters.

CONSTRUCTION. In the first three quarters of 2019 there was a total of 435,707 square feet of new construction completed, and there were 291,282 square feet under construction at the end of the third quarter of 2019. The biotech subset within the Flex/R&D market continues to be the primary driver of new construction.

ABSORPTION. The San Diego Flex/R&D market recorded 326,068 square feet of negative net absorption in the third quarter of 2019, and the market remains in the red for the year thus far with a total net absorption of negative 436,460 square feet. The negative net absorption is not confined to one area within the county, in fact the I-15 Corridor is the only area within the county which has not seen negative net absorption in the sector since the start of the year.

AVAILABILITY. Direct/sublease space being marketed was 12.32%, which is a significant 15.9% increase year-over-year from the third quarter of 2018 availability rate of 10.64%.

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Significant Transactions

Sales

Property Address	Submarket	Square Feet	Sale Price	Buyer	Seller
4224–4242 Campus Point Ct.	UTC	314,135	\$255,000,000	Alexandria RE Equities	Phase 3 RE Partners
5510–5590 Morehouse Dr.	Sorrento Mesa	171,256	\$37,150,000	Phase 3 RE Partners	Brookfield Office Properties
9877 Waples St.	Sorrento Mesa	62,392	\$10,400,000	Lincoln Property Group	Meridian Companies
10237–10239 Flanders Ct.	Sorrento Mesa	39,388	\$8,235,000	NRSD, LLC	Chang Property Management, LLC
7191 Engineer Rd.	Kearny Mesa	29,988	\$4,800,000	LBA Realty	Gerson Baker & Associates

Leases

Property Address	Submarket	Square Feet	Transaction Date	Tenant	Owner
3545 Cray Ct.	Torrey Pines	64,160	Aug-2019	Mirati Therapeutics	Alexandria Real Estate
7740 Kenamar Ct.	Miramar	33,715	Aug-2019	Undisclosed	(Sublease)
3545–3575 John Hopkins Ct.	Torrey Pines	21,470	Jul-2019	Undisclosed	BioMed Realty
5764 Pacific Center Blvd.	Sorrento Mesa	17,067	Jul-2019	Undisclosed	(Sublease)
5607 Palmer Way	Carlsbad	16,532	Sept-2019	Undisclosed	Zuest Industrial Building

	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
Central													
Central City	12	172,281	0	0	21,446	12.45%	23,286	13.52%	\$1.60	(10,840)	(17,709)	2,660	15,138
East City	2	26,892	0	0	0	0.00%	0	0.00%	–	0	0	0	0
Southeast City	21	223,879	0	0	0	0.00%	0	0.00%	–	0	3,000	5,000	8,000
Kearny Mesa	204	5,491,550	0	0	393,366	7.16%	556,924	10.14%	\$1.77	(7,205)	97,565	33,590	301,291
Mission Gorge	27	279,740	0	0	14,110	5.04%	23,097	8.26%	\$1.64	(4,258)	(7,627)	2,590	8,314
Rose Canyon/Morena	38	610,727	0	0	54,769	8.97%	46,129	7.55%	\$1.47	(11,246)	(6,811)	13,302	22,751
Sports Arena/Airport	32	409,430	0	0	27,796	6.79%	19,046	4.65%	\$1.45	0	(15,039)	4,046	4,046
Miramar	220	4,896,162	0	11,760	389,034	7.95%	598,987	12.23%	\$1.67	64,845	(8,638)	319,425	467,768
Sorrento Mesa	156	6,356,446	28,000	618,000	953,343	15.00%	1,053,899	16.58%	\$2.41	(288,190)	(275,768)	38,141	181,247
Sorrento Valley	101	2,326,945	0	220,180	216,427	9.30%	327,336	14.07%	\$2.67	(39,237)	(13,367)	7,728	94,321
Torrey Pines/UTC	72	6,317,547	263,282	940,190	566,448	8.97%	1,059,611	16.77%	\$4.44	37,581	(23,436)	88,103	264,750
Central County Total	885	27,111,599	291,282	1,790,130	2,636,739	9.73%	3,708,315	13.68%	\$2.54	(258,550)	(267,830)	514,585	1,367,626
East County													
El Cajon	78	865,729	0	40,000	14,258	1.65%	31,462	3.63%	\$1.16	5,102	2,674	15,010	26,185
La Mesa/Spring Valley	41	297,535	0	0	4,121	1.39%	4,121	1.39%	\$1.58	(575)	(2,696)	1,425	1,425
Santee/Lakeside	54	554,061	0	0	2,647	0.48%	7,497	1.35%	\$1.29	2,900	5,023	9,347	24,364
Outlying SD County South	22	96,424	0	0	14,775	15.32%	18,494	19.18%	–	1,200	(9,775)	1,200	1,200
East County Total	195	1,813,749	0	40,000	35,801	1.97%	61,574	3.39%	\$1.33	8,627	(4,774)	26,982	53,174
North County													
Escondido	79	753,224	0	0	25,974	3.45%	26,440	3.51%	\$1.07	12,677	(4,372)	14,477	20,725
Oceanside	33	983,515	0	0	6,875	0.70%	30,457	3.10%	\$1.03	78	14,031	1,853	26,048
San Marcos	61	1,094,684	0	0	68,660	6.27%	101,723	9.29%	\$1.22	(4,598)	(10,898)	16,411	47,642
Vista	61	1,391,998	0	0	61,630	4.43%	316,846	22.76%	\$1.12	2,721	(18,727)	6,150	26,810
Carlsbad	258	6,669,418	0	0	750,851	11.26%	1,011,828	15.17%	\$1.25	(34,619)	(131,690)	56,149	262,692
North Beach Cities	19	164,051	0	0	9,224	5.62%	8,974	5.47%	\$2.45	(264)	(1,323)	1,870	5,141
Outlying SD County North	19	139,230	0	0	1,550	1.11%	6,200	4.45%	\$1.33	(846)	(846)	704	704
North County Total	530	11,196,120	0	0	924,764	8.26%	1,502,468	13.42%	\$1.22	(24,851)	(153,825)	97,614	389,762
I-15 Corridor													
Poway	61	1,847,147	0	0	9,928	0.54%	31,482	1.70%	\$1.23	6,936	24,241	6,936	43,040
Rancho Bernardo	95	4,646,678	0	0	288,079	6.20%	436,016	9.38%	\$1.71	(41,165)	(11,300)	11,312	169,474
Scripps Ranch	28	749,217	0	235,227	4,785	0.64%	7,370	0.98%	\$1.19	251	1,803	21,183	32,482
I-15 Corridor Total	184	7,243,042	0	235,227	302,792	4.18%	474,868	6.56%	\$1.62	(33,978)	14,744	39,431	244,996
South County													
Chula Vista	79	1,496,250	0	14,930	143,340	9.58%	199,610	13.34%	\$1.45	2,225	(6,982)	18,707	43,518
National City	23	333,628	0	0	8,218	2.46%	1,046	0.31%	\$1.10	(6,541)	(4,793)	1,677	16,536
Otay Mesa	7	156,455	0	197,381	37,246	23.81%	144,246	92.20%	\$0.72	(13,000)	(13,000)	0	0
San Ysidro/Imperial Beach	5	86,361	0	0	0	0.00%	0	0.00%	–	0	0	0	0
South County Total	114	2,072,694	0	212,311	188,804	9.11%	344,902	16.64%	\$1.13	(17,316)	(24,775)	20,384	60,054
San Diego County Total	1,908	49,437,204	291,282	2,277,668	4,088,900	8.27%	6,092,127	12.32%	\$2.06	(326,068)	(436,460)	698,996	2,115,612

Lease rates are on a triple-net basis.



Much of the Same

by **Greg Marx**

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Industrial owner / user building values as well as investment sale prices continue to reach record levels due to the overwhelming lack of supply. Industrial distribution rents are in the \$0.90–\$1.10 triple net range depending on location. Vacancy rates remain in the low single digits and rents continue to increase across all of San Diego County. The desire for last-mile space and the conversion of industrial buildings to creative office continues to drive down vacancy. A prime example is Amazon and their developer purchase of 65 acres to build a 2.6 million square foot, four-story fulfillment center in Otay Mesa. Ryan Companies and DWS recently closed escrow on 39 acres in Poway and will construct 530,850 square feet of industrial space on a speculative basis. The partnership expects to break ground in early 2020.

Total net absorption across San Diego County was back in the black following its slight pullback in the second quarter. This slight increase of absorption can be partly attributed to an overall increase in total lease transaction volume, with quarterly transaction volume increasing since the start of the year. The market remains tight with vacancy rates remaining at 4.7% countywide.

The combination of a lack of available space and lack of land has driven average lease rates to a high of \$1.05–\$1.10 per square foot on a triple net basis. Lease rates continue to climb higher and year-over-year industrial rents rose by 8.25%. The market will continue to be a “landlord’s market” for the foreseeable future.

We anticipate that current conditions will continue to place upward pressure on rents, with concessions such as free rent and tenant improvement packages all but disappearing as the occupancy levels continue to remain high. San Diego’s diverse employment base, wonderful climate, and proximity to Mexico and the Pacific Rim, all help support our local economy’s continued growth, with only a lack of existing and new industrial inventory standing in the way.

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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. ©2019 Voit Real Estate Services, Inc. DRE License #01991785.

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Product Type

MFG./DIST.: Flex/Research and Development (R&D) buildings can be one story, one story with a mezzanine, and two story built-out structures with a high ratio of window wall to floor area with lower ceilings. They generally have over 50% built-out office space or laboratory use, with the remaining space being utilized as light manufacturing or warehousing. In addition, the parking ratio must be at least 3 spaces or greater per 1,000 square feet.

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, Outlying SD County South

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