

MARKET OVERVIEW. The San Diego Flex/R&D market recorded its fourth consecutive year with more than 0.5 MSF of new construction deliveries, which is more than double the 10-year 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, and transaction volume is down. Overall the market remains healthy and steady with no change in the availability rate versus the previous year.

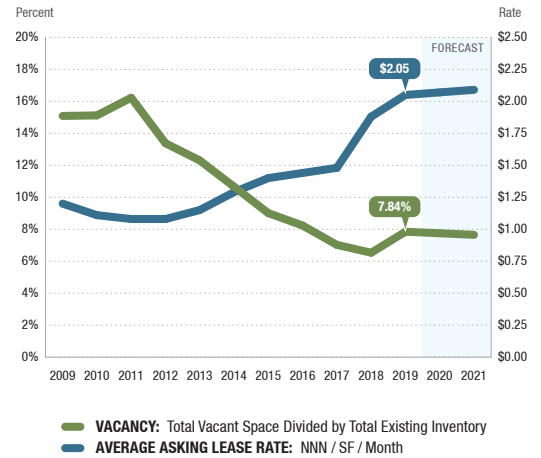
VACANCY. Direct/sublease space (unoccupied) finished the fourth quarter at 7.84%, a substantial increase of 1.31 percentage points from the fourth quarter of 2018's vacancy rate of 6.53%. The current vacancy rate is at about half of the 2010 recession low of 16.12%. The Flex R&D sector is the smallest of the major commercial real estate sectors in San Diego, and as such the metrics often change very rapidly.

LEASE RATES. The average asking lease rate per square foot per month in San Diego County was \$2.05 at the end of the fourth quarter, which is a dramatic \$0.17 increase over the fourth quarter of 2018. 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.

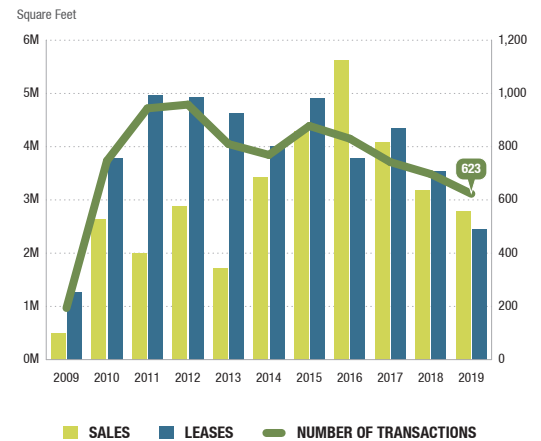
TRANSACTION ACTIVITY. The combined amount of square feet leased or sold in the fourth quarter totaled 1.5 MSF, a slight increase from the 1.4 MSF transacted in third quarter of 2019. Sales and leasing volume recorded their third consecutive year of decreases, with 2016 being the most recent year with an increase in transaction volume. 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 2.9% in November 2019, unchanged from a revised 2.9% in October 2019, and below the year-ago estimate of 3.1%. This compares with an unadjusted unemployment rate of 3.7% for California and 3.3% for the nation during the same period. According to the State of California Employment Development Department, San Diego County gained 34,300 payroll jobs between November 2018 and November 2019, including 8,200 from the professional and business sector, which reported the largest overall gain. The government sector reported a growth of 7,800 jobs, the second most among the major employment sectors. The largest year-over-year loss was in trade, transportation, and utilities which reported 1,000 fewer jobs than the prior year.

VACANCY vs. AVERAGE ASKING LEASE RATE



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



Market Statistics

	Change Over Last Quarter	4Q 2019	3Q 2019	4Q 2018	% Change Over Last Year
Vacancy Rate	▼ DOWN	7.84%	8.26%	6.53%	20.08%
Availability Rate	▼ DOWN	11.60%	11.85%	11.51%	0.78%
Average Asking Lease Rate	▲ UP	\$2.05	\$2.01	\$1.88	9.04%
Sale & Lease Transactions	▬ FLAT	1,469,052	1,439,410	2,400,266	(38.80%)
Gross Absorption	▲ UP	909,277	698,996	860,910	5.62%
Net Absorption	▲ POSITIVE	250,462	(326,598)	(40,314)	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, and closer to 1% growth is projected in 2020. With the local stalwarts of Defense and Biotech remaining strong, look for these sectors to lead the way for employment gains, along with Technology.

LEASE RATES. Despite a decrease in transaction volume, landlords are still pushing asking rental rates up. Moreover, the new deliveries in the sector continue to push for rents higher than the existing average which includes older properties. Expect average asking rates to increase by approximately 2–3% over the next four quarters.

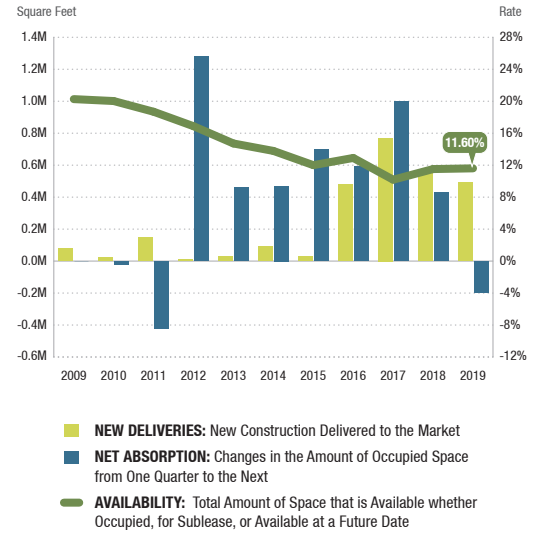
VACANCY. The Flex/R&D sector saw a vacancy spike in 2019 due in large part to the relatively large amount of new property deliveries. In contrast the availability rate remained flat year-over-year. This is often a leading indicator of the future vacancy. With this in mind, we expect vacancy to move lower by 20–30 basis points over the next 2–3 quarters.

CONSTRUCTION. In 2019 there was a total of 485,707 square feet of new construction completed, and there were 126,000 square feet under construction at the end of the fourth quarter. 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 250,462 square feet of positive net absorption in the fourth quarter to end the year on a good note. Overall, there was 196,371 square feet of negative net absorption for 2019. This was the first calendar year with negative net absorption since 2011.

AVAILABILITY. Direct/sublease space being marketed was 11.6%, which is a small increase from the fourth quarter of 2018 rate of 11.5%. The availability rate did trend lower at the end of the year decreasing 25 basis points in the last quarter.

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Significant Transactions

Sales

Property Address	Submarket	Square Feet	Sale Price	Buyer	Seller
5555–5627 Oberlin Dr.	Sorrento Mesa	105,771	\$40,300,000	BioMed Realty	Cypress Office Properties
4181 Ruffin Rd.	Kearny Mesa	148,488	\$23,750,000	IDS Real Estate Group	Office Properties Income Trust
10060–10100 Willow Creek Rd.	Scripps Ranch	94,309	\$23,200,000	Dollinger Properties	Hill Properties
2232–2236 Rutherford Rd.	Carlsbad	83,212	\$23,100,000	Nelli–Regen Three, LLC	Alvarez & Marsal
15822 Bernardo Center Dr.	Rancho Bernardo	60,313	\$14,250,000	SENTRE	The Blackstone Group, LP

Leases

Property Address	Submarket	Square Feet	Transaction Date	Tenant	Owner
7625 Panasonic Way	Otay Mesa	107,000	Dec-2019	Undisclosed	Auerbach Trust
6146 & 6166 Nancy Ridge Dr.	Miramar	62,368	Nov-2019	PCI Pharma	New Mountain Capital
4570 Executive Dr.	UTC	46,991	Nov-2019	Undisclosed	BioMed Realty
10540 Heater Ct.	Sorrento Mesa	36,936	Dec-2019	Resonetics, LLC	Miller Family Trust
4242 Campus Point Ct.	UTC	21,180	Dec-2019	Heron Therapeutics	Alexandria RE Equities

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 4Q2019	Square Feet Available	Availability Rate 4Q2019	Average Asking Lease Rate	Net Absorption 4Q2019	Net Absorption 2019	Gross Absorption 4Q2019	Gross Absorption 2019
Central													
Central City	13	224,781	0	0	26,446	11.77%	26,139	11.63%	\$1.78	45,000	27,291	49,000	64,138
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	0	8,000
Kearny Mesa	204	5,489,343	0	10,200	406,937	7.41%	502,507	9.15%	\$1.79	(13,571)	83,994	40,269	341,560
Mission Gorge	27	279,740	0	0	11,844	4.23%	3,770	1.35%	\$1.64	2,266	(5,361)	11,253	19,567
Rose Canyon/Morena	38	597,194	0	0	44,503	7.45%	38,029	6.37%	\$1.39	10,266	3,455	18,730	41,481
Sports Arena/Airport	32	409,430	0	0	65,779	16.07%	70,079	17.12%	\$1.45	(37,983)	(53,022)	26,956	31,002
Miramar	220	4,893,845	0	130,510	321,047	6.56%	623,213	12.73%	\$1.59	67,987	59,349	113,394	581,162
Sorrento Mesa	156	6,358,919	28,000	618,000	778,253	12.24%	966,492	15.20%	\$2.45	172,963	(100,678)	203,958	385,205
Sorrento Valley	103	2,377,120	0	220,180	243,514	10.24%	368,748	15.51%	\$2.93	(27,087)	(40,454)	35,937	130,258
Torrey Pines/UTC	72	6,339,239	98,000	1,466,965	460,660	7.27%	881,190	13.90%	\$4.36	105,788	82,352	202,942	467,692
Central County Total	888	27,220,382	126,000	2,445,855	2,358,983	8.67%	3,480,167	12.79%	\$2.48	325,629	59,926	702,439	2,070,065
East County													
El Cajon	78	865,729	0	40,000	11,941	1.38%	24,350	2.81%	\$1.21	2,317	4,991	4,427	30,612
La Mesa/Spring Valley	41	296,306	0	0	15,174	5.12%	15,174	5.12%	\$1.43	(11,053)	(13,749)	0	1,425
Santee/Lakeside	54	554,061	0	0	4,497	0.81%	10,297	1.86%	\$1.29	(1,850)	3,173	150	24,514
Outlying SD County South	22	96,424	0	0	0	0.00%	3,719	3.86%	–	14,775	5,000	14,775	15,975
East County Total	195	1,812,520	0	40,000	31,612	1.74%	53,540	2.95%	\$1.34	4,189	(585)	19,352	72,526
North County													
Escondido	80	754,617	0	0	25,676	3.40%	28,931	3.83%	\$1.10	298	(4,074)	5,508	26,233
Oceanside	33	983,515	0	0	25,448	2.59%	52,062	5.29%	\$0.96	(18,573)	(4,542)	3,112	29,160
San Marcos	62	1,115,708	0	0	72,390	6.49%	97,641	8.75%	\$1.18	(830)	(9,838)	14,197	63,729
Vista	62	1,393,198	0	0	73,318	5.26%	301,993	21.68%	\$1.06	(11,688)	(30,415)	13,309	40,119
Carlsbad	259	6,694,538	0	0	810,038	12.10%	983,576	14.69%	\$1.28	(61,166)	(204,589)	83,952	334,832
North Beach Cities	19	164,051	0	0	9,611	5.86%	7,411	4.52%	\$2.66	(637)	(1,710)	234	5,375
Outlying SD County North	19	139,572	0	0	1,550	1.11%	6,200	4.44%	\$1.03	0	(846)	0	704
North County Total	534	11,245,199	0	0	1,018,031	9.05%	1,477,814	13.14%	\$1.23	(92,596)	(256,014)	120,312	500,152
I-15 Corridor													
Poway	61	1,847,147	0	0	13,034	0.71%	34,758	1.88%	\$1.22	(3,106)	21,135	7,647	50,687
Rancho Bernardo	95	4,646,678	0	0	263,901	5.68%	388,103	8.35%	\$1.87	27,085	12,878	38,875	208,349
Scripps Ranch	28	749,217	0	235,227	14,214	1.90%	20,990	2.80%	\$1.18	(9,429)	(7,626)	0	32,482
I-15 Corridor Total	184	7,243,042	0	235,227	291,149	4.02%	443,851	6.13%	\$1.78	14,550	26,387	46,522	291,518
South County													
Chula Vista	79	1,499,311	0	14,930	151,822	10.13%	255,713	17.06%	\$1.46	(8,482)	(15,464)	13,480	56,998
National City	23	333,628	0	0	1,046	0.31%	1,046	0.31%	\$1.10	7,172	2,379	7,172	23,708
Otay Mesa	7	156,455	0	0	37,246	23.81%	40,153	25.66%	\$0.72	0	(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	2,075,755	0	14,930	190,114	9.16%	296,912	14.30%	\$1.14	(1,310)	(26,085)	20,652	80,706
San Diego County Total	1,915	49,596,898	126,000	2,736,012	3,889,889	7.84%	5,752,284	11.60%	\$2.05	250,462	(196,371)	909,277	3,014,967

Lease rates are on a triple-net basis.



Market Moves Forward Amid Concerns

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While 2019 certainly had its fair share of distractions, from the inverted yield curve, the tariff battles and the Presidential impeachment debacle, nothing seemed to have a major negative impact on the economy or the industrial commercial real estate markets around the country or, specifically, in San Diego.

The San Diego combined Industrial market net absorption did slow to just 500,000 square feet in 2019, down from 1,000,000 square feet in 2018. Though that decline can be explained, in part, by the lack of supply of quality functional product. The vacancy rate remained historically low throughout the year, ending 2019 at just 4.8%. Another reason for this reduction in absorption could be that higher rents are causing tenants to find ways to postpone expansion plans by running extra shifts, increasing the frequency of incoming shipments or becoming more efficient in their use of space. As the old saying goes, “necessity is the mother of invention.” As a result, asking rent growth slowed a bit in 2019, but still posted a solid 4% increase, down from 9% in 2018.

Since 2017, there have been more than 5,000,000 square feet of new industrial and R&D product built in San Diego County, 25% of which remains vacant, and this accounts for 10% of the vacancy countywide. Most this product has been built in the perimeter submarkets and is slower to absorb due to its location and higher asking rents.

A major contributor to the strength of the Flex market in San Diego had been the strong performance of the biotech sector. San Diego has become one of the top biotech hubs in the country and has experienced tremendous growth in the last two years, both in new developments and in the conversion of traditional flex buildings to biotech/lab buildings.

2020 should be more of the same. Barring a true ‘black swan’ event, the biggest wildcard will likely be our upcoming presidential election. Markets do not like uncertainty and if the run-up to November creates a situation in which it is unclear who our next President will be, it could potentially cause businesses to delay long-term decisions and capital investments, which, in turn, would slow down the real estate markets.

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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. ©2020 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