

MARKET OVERVIEW. Most of the first quarter was in the books by the time that shelter-in-place orders took effect in March. The first quarter will primarily act as a benchmark from which to compare the pandemic effects on the market over the subsequent quarter. The office sector had a good head of steam coming into 2020 following the largest annual total of positive net absorption in the past three years. However, the timing of the current pandemic's disruption on the market is not ideal in terms of the local office construction pipeline which is now at its highest level in more than a decade.

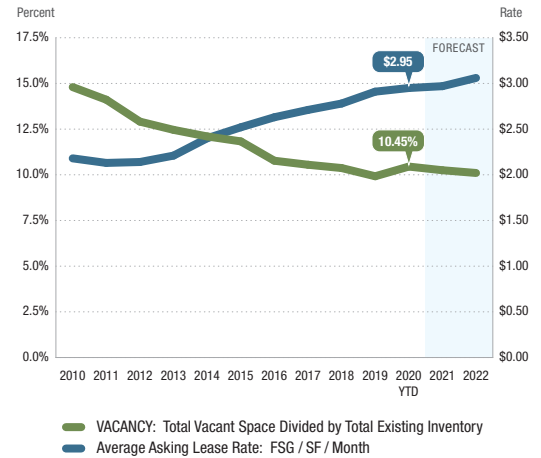
VACANCY. Direct/sublease space (unoccupied) finished the quarter at 10.45%, more than half a percentage point higher than the previous quarter. Among the county's major submarkets (minimum of 4 MSF of inventory), UTC ended the year with the lowest vacancy rate. UTC has come down 13 percentage points since the middle of 2016 and was at 5.7% vacancy at the end of the first quarter.

LEASE RATES. The average asking full-service gross (FSG) lease rate per square foot per month in San Diego County was \$2.95 at the end of the first quarter, which is a four-cent increase over the prior quarter, as well as an annual increase of 4.24% from the first quarter of 2019's rate of \$2.83. The overall San Diego office market average asking rate finished the first quarter at an all-time high, surpassing the previous peak of \$2.74 from 2007 by 7.7%.

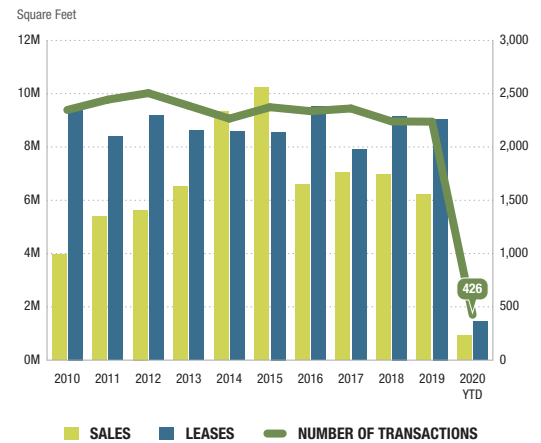
TRANSACTION ACTIVITY. Sale and lease transactions totaled 2.4 MSF in the first quarter, a decrease from the 3.8 MSF which transacted in the fourth quarter. Once again Apple is among the largest leases in the market. Intuit, the maker of Turbo Tax, QuickBooks and Mint, was also among the largest lease transactions of the quarter. It has not been reported whether this expansion is related to their February announcement that they have agreed to the acquisition of Credit Karma. 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 3.2% in February 2020, down from a revised 3.3% in January 2020, and below the year-ago estimate of 3.4%. This compares with an unadjusted unemployment rate of 4.3% 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 26,400 payroll jobs between February 2019 and February 2020. In mid-March the unemployment claims for the nation came in at 3.28 million claims for a single week, setting a record, nearly five times greater than the previous weekly record which was set in 1982. Subsequent weeks have also had a large number of claims. With the normal delay in reporting from the California EDD, employment figures from March were unavailable at the time of publishing this report. Suffice it to say stay-at-home orders related to the COVID-19 pandemic will lead to an increase in local unemployment over the coming months.

VACANCY vs. AVERAGE ASKING LEASE RATE



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



Market Statistics

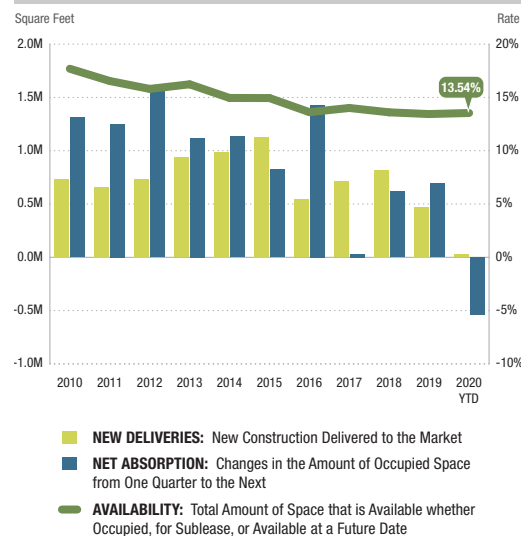
	Change Over Last Quarter	1Q 2020	4Q 2019	1Q 2019	% Change Over Last Year
Vacancy Rate	▲ UP	10.45%	9.92%	10.19%	2.59%
Availability Rate	▲ UP	13.54%	13.44%	13.73%	(1.45%)
Average Asking Lease Rate	▲ UP	\$2.95	\$2.91	\$2.83	4.24%
Sale & Lease Transactions	▼ DOWN	2,356,514	3,788,161	3,079,839	(23.49%)
Gross Absorption	▼ DOWN	1,385,378	1,607,608	1,699,710	(18.49%)
Net Absorption	▼ NEGATIVE	(544,169)	430,491	120,679	N/A

CONSTRUCTION. In contrast to the San Diego retail and industrial markets which have already seen the peak of new construction in the economic cycle pass, the office market has 1.8 MSF under construction at present. This marks the largest amount of office space under construction in San Diego County since 2008.

AVAILABILITY. Direct/sublease space being marketed was 13.54% at the end of the first quarter, roughly equivalent to the fourth quarter rate, and an overall decrease of 1.5% from the previous year.

ABSORPTION. The San Diego office market recorded 544,169 square feet of negative net absorption in the first quarter. There have not been any calendar years of negative absorption since 2008. Interestingly, the North County areas were basically flat in the first quarter, while all other areas of the county recorded negative net absorption.

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Forecast

Last quarter we were most concerned about warnings of a global slowdown, US GDP growth and trade relations between the US and China. But the world has changed, and we are finally able to identify the Black Swan that economists have been hedging their forecasts with for years. The COVID-19 virus, first identified in China, has circled the planet in a matter of weeks, causing leaders around the world to take aggressive steps to stop it. Entire countries are on lockdown and our own federal and state governments have taken steps similar to our neighbors in Asia and Europe.

It's too early to tell what the exact long-term impact the reaction to the virus will have on the San Diego office market, but we do predict a near-term decrease in occupancy rates and transaction volume. We should see the statistical evidence of that in the second quarter numbers. We expect the decrease in occupancy and leasing volume to place downward pressure on office rental rates in the next quarter, and all eyes will be fixed upon the depth of the downturn and the speed of the recovery to formulate forward guidance.

Significant Transactions

Sales

Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
9608-9868 Scranton Rd.	Sorrento Mesa	A	213,098	\$102,250,000	Alexandria RE Equities	Alliance Bernstein
1900-1903 Wright Pl.	Carlsbad	A	177,917	\$34,200,000	Harbor Associates	Wasatch Group
5900-5950 La Place Ct.	Carlsbad	B	81,521	\$17,000,000	Intersection	Swift Real Estate Partners
5405 Morehouse Dr.	Sorrento Mesa	B	51,589	\$14,600,000	Cedar Realty Group	Swift Real Estate Partners
5505 Morehouse Dr.	Sorrento Mesa	B	75,424	\$12,783,000	Alexandria RE Equities	SteelWave

Leases

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
12278 Scripps Summit Dr.	Scripps Ranch	A	198,880	Jan-2020	Fate Therapeutics	Third Palm Capital
16620 W. Bernardo Dr.	Rancho Bernardo	A	196,734	Feb-2020	Apple	Jay Paul Company
16409 W. Bernardo Dr.	Rancho Bernardo	A	53,642	Jan-2020	Undisclosed	Swift Real Estate Partners
13500 Evening Creek Dr. N.	Rancho Bernardo	A	48,835	Feb-2020	Intuit	Kilroy Realty
5541 Fermi Ct.	Carlsbad	B	46,823	Feb-2020	Undisclosed	Regent Properties

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 1Q2020	Square Feet Available	Availability Rate 1Q2020	Average Asking Lease Rate	Net Absorption 1Q2020	Net Absorption 2020	Gross Absorption 1Q2020	Gross Absorption 2020
Downtown													
Downtown	127	13,034,157	576,754	3,978,883	2,343,680	17.98%	2,859,645	21.94%	\$2.88	(123,144)	(123,144)	181,248	181,248
Downtown Total	127	13,034,157	576,754	3,978,883	2,343,680	17.98%	2,859,645	21.94%	\$2.88	(123,144)	(123,144)	181,248	181,248
Central													
City Heights / University	31	1,216,139	0	0	37,281	3.07%	82,039	6.75%	\$2.15	18,672	18,672	22,397	22,397
Coronado	5	111,541	0	0	2,732	2.45%	4,263	3.82%	\$3.83	(1,500)	(1,500)	300	300
Kearny Mesa	238	11,034,577	215,000	125,000	973,581	8.82%	1,234,050	11.18%	\$2.36	(253,095)	(253,095)	63,720	63,720
Mission Gorge	19	588,084	0	0	8,002	1.36%	14,596	2.48%	\$1.89	(1,994)	(1,994)	0	0
Mission Valley	127	7,230,852	0	0	681,657	9.43%	1,062,219	14.69%	\$2.77	86,046	86,046	219,659	219,659
Old Town / Point Loma	79	2,419,442	0	230,000	92,708	3.83%	215,180	8.89%	\$2.98	(39,272)	(39,272)	17,187	17,187
Park East	17	273,122	29,000	0	19,192	7.03%	8,993	3.29%	\$2.07	1,116	1,116	2,594	2,594
Rose Canyon / Morena	55	1,287,492	0	0	62,753	4.87%	107,806	8.37%	\$1.98	7,589	7,589	15,701	15,701
Uptown / Hillcrest	78	2,210,713	0	0	134,080	6.07%	190,340	8.61%	\$2.85	(18,570)	(18,570)	8,508	8,508
Central Total	649	26,371,962	244,000	355,000	2,011,986	7.63%	2,919,486	11.07%	\$2.57	(201,008)	(201,008)	350,066	350,066
I-15 Corridor													
Escondido	74	1,686,007	75,000	46,614	166,455	9.87%	244,130	14.48%	\$2.63	(9,886)	(9,886)	31,883	31,883
Poway	30	1,333,120	0	160,000	31,448	2.36%	74,854	5.61%	\$2.21	(13,018)	(13,018)	5,927	5,927
Rancho Bernardo	105	6,797,845	0	2,740,820	673,766	9.91%	903,033	13.28%	\$3.11	(24,637)	(24,637)	62,914	62,914
Scripps Ranch	52	2,897,815	0	137,000	443,815	15.32%	421,422	14.54%	\$2.75	36,233	36,233	42,925	42,925
I-15 Corridor Total	261	12,714,787	75,000	3,084,434	1,315,484	10.35%	1,643,439	12.93%	\$2.92	(11,308)	(11,308)	143,649	143,649
North County Coastal													
Carlsbad	162	6,806,958	12,074	0	1,110,284	16.31%	1,073,092	15.76%	\$2.66	(39,174)	(39,174)	121,023	121,023
Del Mar Heights / Carmel Valley	77	4,806,276	510,772	416,957	636,168	13.24%	1,122,610	23.36%	\$4.34	34,218	34,218	151,736	151,736
North Beach Cities	114	2,673,535	72,177	140,389	156,740	5.86%	272,328	10.19%	\$3.77	2,777	2,777	54,356	54,356
North County Total	353	14,286,769	595,023	557,346	1,903,192	13.32%	2,468,030	17.27%	\$3.38	(2,179)	(2,179)	327,115	327,115
North City													
Governor Park	20	897,461	0	0	88,359	9.85%	137,611	15.33%	\$2.82	(8,257)	(8,257)	7,400	7,400
La Jolla	45	1,345,938	0	0	188,165	13.98%	260,966	19.39%	\$3.42	(3,003)	(3,003)	18,167	18,167
Miramar	33	1,487,988	0	0	134,294	9.03%	198,928	13.37%	\$1.91	(30,306)	(30,306)	16,013	16,013
Sorrento Mesa	119	9,502,067	0	1,476,500	1,130,080	11.89%	1,280,028	13.47%	\$3.13	(60,725)	(60,725)	168,740	168,740
Sorrento Valley	28	764,604	0	0	124,695	16.31%	150,189	19.64%	\$2.40	(32,912)	(32,912)	7,957	7,957
Torrey Pines	44	3,224,583	0	0	217,316	6.74%	256,092	7.94%	\$4.40	(11,434)	(11,434)	8,313	8,313
UTC	91	8,814,197	165,000	909,124	504,893	5.73%	716,789	8.13%	\$3.59	(25,877)	(25,877)	76,748	76,748
North City Total	380	26,036,838	165,000	2,385,624	2,387,802	9.17%	3,000,603	11.52%	\$3.13	(172,514)	(172,514)	303,338	303,338
Southern & Eastern Areas													
Chula Vista	90	2,841,685	0	1,418,000	207,127	7.29%	260,211	9.16%	\$2.59	(20,681)	(20,681)	22,552	22,552
National City	15	528,493	0	0	4,855	0.92%	11,335	2.14%	\$2.25	(3,861)	(3,861)	0	0
Otay Mesa	13	319,824	0	0	15,861	4.96%	51,875	16.22%	\$2.30	0	0	0	0
Southeast San Diego	13	460,835	0	290,000	85,316	18.51%	85,316	18.51%	\$2.03	(6,907)	(6,907)	0	0
East County	150	3,634,788	86,000	86,800	130,104	3.58%	169,466	4.66%	\$2.12	(7,239)	(7,239)	24,046	24,046
Southern & Eastern Areas Total	281	7,785,625	86,000	1,794,800	443,263	5.69%	578,203	7.43%	\$2.45	(38,688)	(38,688)	46,598	46,598
Highway 78 Corridor													
Oceanside	63	1,349,020	100,000	277,749	108,375	8.03%	166,830	12.37%	\$2.04	15,767	15,767	18,988	18,988
San Marcos	38	1,407,116	0	1,993,218	102,194	7.26%	167,841	11.93%	\$2.58	(12,475)	(12,475)	5,431	5,431
Vista	50	1,241,115	0	0	280,249	22.58%	303,141	24.42%	\$2.07	1,380	1,380	8,945	8,945
Highway 78 Corridor Total	151	3,997,251	100,000	2,270,967	490,818	12.28%	637,812	15.96%	\$2.18	4,672	4,672	33,364	33,364
Class A	297	37,755,740	1,452,526	10,292,302	4,857,719	12.87%	6,141,232	16.27%	\$3.43	(406,912)	(406,912)	550,359	550,359
Class B	1,259	52,175,811	389,251	4,134,752	5,197,361	9.96%	6,816,133	13.06%	\$2.74	(137,998)	(137,998)	701,609	701,609
Class C	646	14,295,838	0	0	841,145	5.88%	1,149,853	8.04%	\$2.17	741	741	133,410	133,410
San Diego County Total	2,202	104,227,389	1,841,777	14,427,054	10,896,225	10.45%	14,107,218	13.54%	\$2.95	(544,169)	(544,169)	1,385,378	1,385,378

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



Now We Know

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At 126 months, the United States had been in its largest economic expansion in history. For years we've all been speculating as to what issue would manifest as the Black Swan and spoil the party. COVID-19 has taken control and sent rippling effects through the economy and industries around the world. Business has come to a screeching halt and economic fundamentals as we know them will need to adapt to accommodate the uncertainty of COVID-19 moving forward.

San Diego ended 2019 with its lowest vacancy in more than a decade. Although that vacancy ticked upward to start 2020, San Diego's office market saw growth as businesses were expanding and nearly keeping up with deliveries, although the market did register 544,169 square feet of negative net absorption. Sales volume continued to trend upward and buildings throughout the San Diego market continued to set record high prices. Then, on March 9th, all three Wall Street indices fell more than 7% making it the worst drop since the Great Recession in 2008. In the following weeks, the Dow Jones Industrial Average had wiped out all gains it had built over the past four years.

As we begin the journey into the unknown, we begin to wonder how this will adversely affect the local economy. From a commercial real estate perspective, investors, tenants and owner users will all be wondering how the virus will change the real estate market. From a lender's standpoint, although debt is still cheap and in high demand, most capital sources have pumped their brakes on distribution of funds for deals. We will see tenants, especially small businesses, struggle to pay their near-term rent and ask landlords for rent relief. Leasing requirements will be paused as tenants contemplate and brainstorm what is best for the business moving forward. Landlords will have to monitor the market and potentially adjust concessions moving forward on new deals. Construction will slow tremendously as vendors slow their output and general contractors are ordered to stay home. These adverse effects will cause the local market to struggle for a while. Projections show that second quarter GDP will be down dramatically, with the expectation of stabilizing in the third quarter and beginning an upward trend again in the fourth quarter.

This global pandemic is one that we are all fighting together.

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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. ©2020 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