

MARKET OVERVIEW. The office market took a hit in the second quarter with sales and leasing activity plummeting. Meanwhile, the construction pipeline has more product than it's had in years. Downtown office fundamentals appear especially vulnerable with high-density locales not having the most appeal under current conditions. Availability increases are far outpacing vacancy increases, pointing to decreased occupancy levels in the coming quarter.

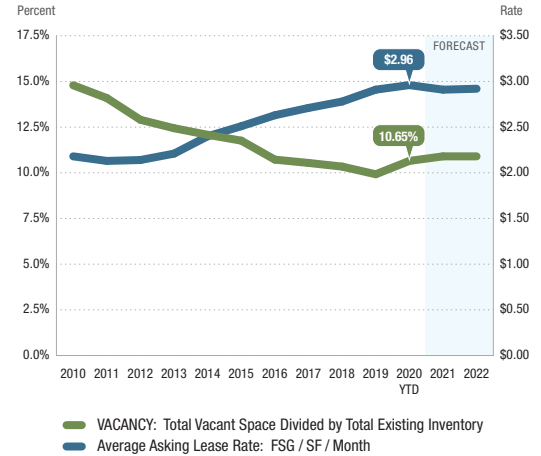
VACANCY. Direct/sublease space (unoccupied) finished the quarter at 10.65%, a 26-basis-point increase. In the first two quarters of 2020 the overall occupancy has retreated back to levels last seen in 2016. Among the county's major submarkets (minimum of 4 MSF of inventory), the two highest vacancy rates can be found in Downtown and Carlsbad, 18.1% and 16.1%. The lowest vacancy rates are in UTC and Kearny Mesa, at 6.5% and 9.4%.

LEASE RATES. The average asking full-service gross (FSG) lease rate per square foot per month in San Diego County was \$2.96 at the end of the second quarter, which is a one-cent increase over the prior quarter, as well as an annual increase of 4.59% from the second quarter 2019's rate of \$2.83. The overall San Diego office market average asking rate finished the second quarter at an all-time high, surpassing the previous peak of \$2.74 set in 2007. Asking rates do not tell the whole story as landlords typically budge on effective rental rates before moving the asking rental rates.

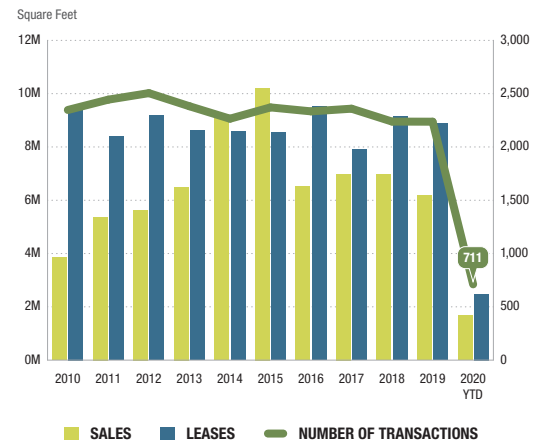
TRANSACTION ACTIVITY. Sale and lease transactions totaled 1.1 MSF in the second quarter, a fraction of the 3.1 MSF which transacted in the first quarter, or the 4.0 million transacted in the second quarter 2019. The transaction activity statistic can have some lag time in being reported, so figures may end up higher in the next report.

EMPLOYMENT. The unemployment rate in San Diego County was 15.0% in May 2020, unchanged from a revised 15.0% in April 2020, and above the year-ago estimate of 2.8%. This compares with an unadjusted unemployment rate of 15.9% for California and 13.0% for the nation during the same period. According to the State of California Employment Development Department, San Diego County lost 195,800 payroll jobs between May 2019 and May 2020 and gained 18,200 jobs between April 2020 and May 2020. In June, the employment data the United States as a whole came in with 4.8 million jobs added which was a record for the most jobs added in a month. With the normal delay in reporting from the California EDD, employment figures from June were unavailable at the time of publishing this report.

VACANCY vs. AVERAGE ASKING LEASE RATE



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



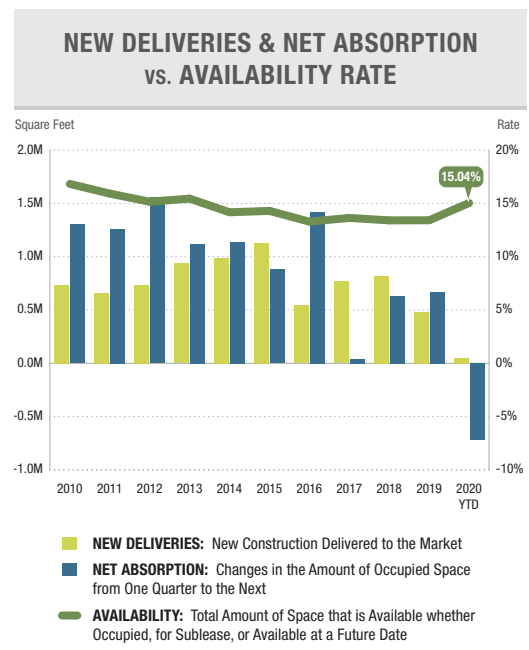
Market Statistics

	Change Over Last Quarter	2Q 2020	1Q 2020	2Q 2019	% Change Over Last Year
Vacancy Rate	▲ UP	10.65%	10.39%	10.06%	5.87%
Availability Rate	▲ UP	15.04%	13.42%	13.90%	8.19%
Average Asking Lease Rate	▲ UP	\$2.96	\$2.95	\$2.83	4.59%
Sale & Lease Transactions	▼ DOWN	1,067,743	3,071,697	3,956,516	(73.01%)
Gross Absorption	▼ DOWN	1,155,259	1,417,046	1,911,650	(39.57%)
Net Absorption	▼ NEGATIVE	(271,223)	(449,845)	265,731	N/A

CONSTRUCTION. The office market has 2.7 MSF under construction at present. Before the second quarter, the construction pipeline had not surpassed 2 MSF since 2008. Downtown has become the focal point of current office construction with the U.S. Navy build-to-suit, the Paladion revamp, and Kilroy’s speculative 2100 Kettner project all under way. Possibly the most ambitious office development in recent San Diego history, the conversion of the regional Horton Plaza mall in Downtown to an office property is also underway. This project aims to attract a large tech tenant into Downtown San Diego.

AVAILABILITY. Direct/sublease space being marketed was 15.04% at the end of the second quarter, a 1.1 percentage point increase over the second quarter 2019’s rate, and a massive 4.4 percentage points higher than the vacancy rate.

ABSORPTION. The San Diego office market recorded 271,223 square feet of negative net absorption in the second quarter. There have not been any calendar years of negative absorption since 2008, and the market is approaching 0.75 MSF of negative net absorption through the first two quarters of 2020.



Forecast

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 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. Early indications are that as the economy opens up and principals feel more comfortable making business decisions, leasing activity will begin to increase.

Based upon the current conditions and outlook, we anticipate a decrease in net effective rental rates in the second half of the year as concessions will increase in a diminished transaction-volume environment. The situation remains fluid and any potential government actions such as further lockdowns or additional economic stimulus can influence the market.

Significant Transactions

Sales							* Voit Real Estate Services Deal
Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller	
7930-8010 Frost St.	Kearny Mesa	C	176,000	\$106,000,000	Sharp HealthCare	Healthpeak Properties	
5796 Armada Dr.	Carlsbad	A	75,000	\$28,250,000	SENTR, Inc.	Miller Global Properties, LLC	
4275-4283 El Cajon Blvd.	College Area	B	65,608	\$14,500,000	The Casey Brown Company	SDSU Research Foundation*	
6405 Mira Mesa Blvd.	Sorrento Mesa	B	37,991	\$8,544,900	BPS Investment, LLC*	Ledcor Group	
3434 Midway Dr.	Sports Arena	B	75,424	\$6,000,000	Synovation Medical Group	Summit Circle Properties, LLC	

Leases						
Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
10265 Science Center Dr.	Torrey Pines	A	74,000	Jun-2020	Cooley LP	Healthpeak Properties
6602 Convoy Ct.	Kearny Mesa	B	40,431	Apr-2020	Undisclosed	(Sublease)
10180 Telesis Ct.	Sorrento Mesa	A	25,628	May-2020	Undisclosed	(Sublease)
4435 Eastgate Mall	UTC	A	22,833	May-2020	Undisclosed	The Irvine Company
404 Camino Del Rio S.	Mission Valley	B	21,354	Jun-2020	T.Y. Lin International	Brookwood Financial Partners

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 2Q2020	Square Feet Available	Availability Rate 2Q2020	Average Asking Lease Rate	Net Absorption 2Q2020	Net Absorption 2020	Gross Absorption 2Q2020	Gross Absorption 2020
Downtown													
Downtown	127	13,136,760	1,215,523	2,407,083	2,374,219	18.07%	3,684,885	28.05%	\$2.88	(34,989)	(153,683)	140,340	321,588
Downtown Total	127	13,136,760	1,215,523	2,407,083	2,374,219	18.07%	3,684,885	28.05%	\$2.88	(34,989)	(153,683)	140,340	321,588
Central													
City Heights / University	31	1,216,139	0	0	57,439	4.72%	93,592	7.70%	\$2.20	(20,158)	(1,486)	3,940	26,337
Coronado	5	111,541	0	0	2,732	2.45%	4,263	3.82%	\$3.83	0	(1,500)	0	300
Kearny Mesa	238	11,010,186	215,000	125,000	1,038,212	9.43%	1,295,919	11.77%	\$2.38	(67,208)	(320,303)	51,936	115,656
Mission Gorge	19	581,130	0	0	10,405	1.79%	11,572	1.99%	\$1.87	(2,403)	(4,397)	0	0
Mission Valley	127	7,268,192	0	0	741,911	10.21%	1,162,479	15.99%	\$2.74	(61,004)	25,792	80,243	299,902
Old Town / Point Loma	80	2,436,620	0	230,000	71,932	2.95%	182,465	7.49%	\$2.94	(2,394)	8,004	7,311	50,998
Park East	16	234,322	0	0	13,197	5.63%	14,502	6.19%	\$2.08	5,995	7,111	12,564	15,158
Rose Canyon / Morena	56	1,297,671	0	0	82,539	6.36%	127,847	9.85%	\$2.16	(18,001)	(12,197)	19,183	34,884
Uptown / Hillcrest	78	2,210,713	0	0	136,276	6.16%	192,843	8.72%	\$2.82	(14,733)	(20,766)	25,805	32,482
Central Total	650	26,366,514	215,000	355,000	2,154,643	8.17%	3,085,482	11.70%	\$2.56	(179,906)	(319,742)	200,982	575,717
I-15 Corridor													
Escondido	74	1,686,007	80,064	46,614	168,805	10.01%	257,241	15.26%	\$2.42	5,480	(12,236)	14,751	46,634
Poway	30	1,333,120	0	0	34,852	2.61%	72,202	5.42%	\$2.11	(3,404)	(16,422)	2,594	8,521
Rancho Bernardo	105	6,801,999	0	2,740,820	675,321	9.93%	889,725	13.08%	\$3.04	(1,555)	(26,192)	123,801	186,715
Scripps Ranch	52	2,897,233	0	251,000	424,880	14.67%	461,872	15.94%	\$2.77	17,435	55,168	30,427	74,852
I-15 Corridor Total	261	12,718,359	80,064	3,038,434	1,303,858	10.25%	1,681,040	13.22%	\$2.86	17,956	318	171,573	316,722
North County Coastal													
Carlsbad	163	6,883,617	12,074	50,000	1,105,032	16.05%	1,127,628	16.38%	\$2.68	15,389	(21,352)	126,641	247,664
Del Mar Heights / Carmel Valley	77	4,806,663	505,719	416,955	619,220	12.88%	1,171,447	24.37%	\$4.34	15,672	51,166	57,996	209,732
North Beach Cities	114	2,673,534	72,177	120,456	187,144	7.00%	314,487	11.76%	\$3.80	(30,404)	(27,627)	25,832	80,188
North County Total	354	14,363,814	589,970	587,411	1,911,396	13.31%	2,613,562	18.20%	\$3.39	657	2,187	210,469	537,584
North City													
Governor Park	20	899,461	0	0	101,841	11.32%	126,627	14.08%	\$2.83	(16,357)	(21,739)	7,730	18,005
La Jolla	46	1,356,344	0	0	205,315	15.14%	285,011	21.01%	\$3.34	(18,394)	(20,153)	3,895	22,062
Miramar	33	1,485,988	0	0	121,176	8.15%	201,736	13.58%	\$1.92	13,118	(17,188)	31,570	47,583
Sorrento Mesa	119	9,505,141	0	1,476,500	1,082,970	11.39%	1,502,402	15.81%	\$3.16	44,886	(13,615)	164,983	335,947
Sorrento Valley	28	764,730	0	0	146,899	19.21%	167,052	21.84%	\$2.44	(22,204)	(55,116)	650	8,607
Torrey Pines	44	3,206,337	78,116	0	230,615	7.19%	251,347	7.84%	\$4.46	(13,299)	(24,733)	12,260	20,573
UTC	91	8,822,361	369,000	705,124	573,066	6.50%	829,209	9.40%	\$3.78	(68,173)	(94,050)	98,768	175,516
North City Total	381	26,040,362	447,116	2,181,624	2,461,882	9.45%	3,363,384	12.92%	\$3.20	(80,423)	(246,594)	319,856	628,293
Southern & Eastern Areas													
Chula Vista	90	2,841,773	0	1,203,000	186,177	6.55%	313,914	11.05%	\$2.55	21,370	269	48,095	70,647
National City	15	528,493	0	0	11,335	2.14%	12,341	2.34%	\$2.25	(6,480)	(10,341)	0	0
South San Diego	13	318,004	0	0	11,663	3.67%	44,223	13.91%	\$2.30	4,198	4,198	4,198	4,198
Southeast San Diego	13	460,835	0	290,000	68,610	14.89%	68,167	14.79%	\$2.03	16,706	9,799	16,784	16,784
East County	151	3,666,012	86,000	61,800	139,646	3.81%	192,625	5.25%	\$2.12	(9,942)	8,219	10,883	35,329
Southern & Eastern Areas Total	282	7,815,117	86,000	1,554,800	417,431	5.34%	631,270	8.08%	\$2.41	25,852	12,144	79,960	126,958
Highway 78 Corridor													
Oceanside	63	1,350,466	100,000	277,749	122,675	9.08%	172,373	12.76%	\$1.98	(14,300)	1,467	4,778	23,766
San Marcos	38	1,464,541	0	1,843,218	107,812	7.36%	162,080	11.07%	\$2.56	(5,618)	(18,093)	23,593	29,024
Vista	50	1,275,252	0	0	280,701	22.01%	329,641	25.85%	\$2.24	(452)	928	3,708	12,653
Highway 78 Corridor Total	151	4,090,259	100,000	2,120,967	511,188	12.50%	664,094	16.24%	\$2.26	(20,370)	(15,698)	32,079	65,443
Class A	303	38,681,921	2,091,306	9,678,552	5,188,563	13.41%	7,695,524	19.89%	\$3.46	105,735	(276,228)	510,915	1,091,343
Class B	1,260	51,662,384	642,367	2,566,767	5,050,634	9.78%	6,840,904	13.24%	\$2.73	(304,296)	(367,858)	535,752	1,240,015
Class C	643	14,186,880	0	0	895,420	6.31%	1,187,289	8.37%	\$2.16	(72,662)	(76,982)	108,592	240,947
San Diego County Total	2,206	104,531,185	2,733,673	12,245,319	11,134,617	10.65%	15,723,717	15.04%	\$2.96	(271,223)	(721,068)	1,155,259	2,572,305

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



Navigating the Storm

by **Tracy Clark**

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Seemingly the whole world has been in various stages of lockdown by COVID-19 and the subsequent response, and office activity was no exception. The number of countywide office leases our firm tracked for the first quarter was the lowest quarterly total number of leases executed since the fourth quarter of 2008. On top of that, the number of office leases we tracked for the second quarter was significantly lower than the first. Needless to say, leasing activity has been depressed in these past three plus months of partial shutdown. Tenants have been exploring all of their options, and one consideration has been subleasing. Indeed, there has been a significant increase in office sublease availability across the county, but it's not yet been a tsunami. Sublease office availability in San Diego County increased by 36 basis points in the first quarter, while direct availability increased by 122 basis points. The overall office occupancy level in the first two quarters of this year has rolled back the past three years of increases. That being said, the market has softened, but the bottom hasn't fallen out. We're still at a stable countywide vacancy rate just above 10 percent.

There has been an uptick in tenant interest over the last few weeks of the quarter, and one can only hope that the pullback in opening back up the economy will not overly suppress this trend. The PPP loans have added to the stability of office tenant businesses, and by extension office property rent rolls, in a major way. This short-term patch appears to have helped office tenants and landlords mitigate some of the damage. The word unprecedented is getting thrown around a lot, and many office tenants and landlords are feeling that sense of uncertainty. Tenants feel it's clear that lease negotiations have swung their way in the current environment, while many landlords don't want to think about coming off of their position until they have to. These things take time to play out. As they do, we are all pushing ahead and navigating this storm.

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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, South San Diego, Southeast San Diego

HIGHWAY 78 CORRIDOR: Oceanside, San Marcos, Vista