

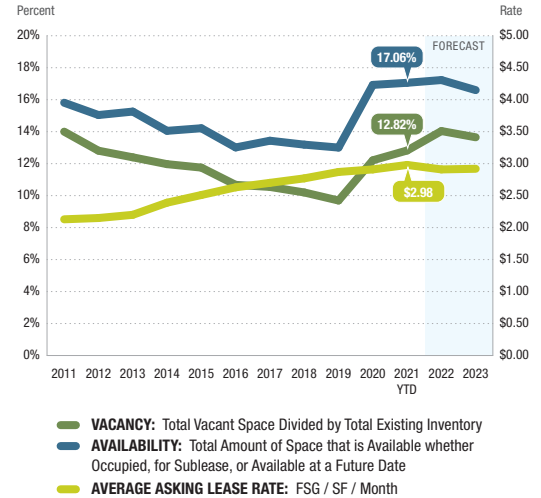
**OVERVIEW.** 2Q was the first quarter without negative net absorption in the San Diego office market since the start of 2020. Leasing activity is starting to trend upward, but there is a long way to go to get back to activity levels that would be considered normal just 18 months ago. Average asking rental rates have not gone down on the top line, but net effective rental rates are certainly depressed as leasing concessions have increased across the board. The market appears to have begun its recovery, but it was a rapid descent in 2020. Much like (and not unrelated to) the employment levels, the climb back to where things were is not happening at the same pace as the decline.

**VACANCY & AVAILABILITY.** Direct/sublease space (unoccupied) finished the quarter at 12.82%, a hefty 2.42 percentage-point increase from the prior year's total. The post-pandemic office market saw the past seven years' worth of occupancy gains wiped out in 2020. Among the county's major submarkets (minimum of 4 MSF of inventory), Sorrento Mesa is now the only submarket with a vacancy rate below 10%, a result of the growth of biotech companies since the onset of COVID-19. Meanwhile the vacancy rate in Downtown is now greater than 20% and the availability rate there is greater than 30%. Available office space being marketed (regardless of occupancy status) was 17.06% of the county's inventory at the end of 2Q, a substantial 4.9 percentage points higher than the vacancy rate. Sublease availability increased by 763,023 SF since in 2020 but has actually decreased by 249,540 SF since the start of this year.

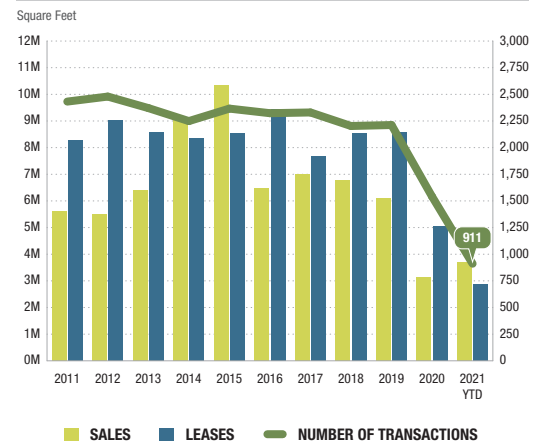
**LEASE RATES.** The average asking full-service-gross (FSG) lease rate per square foot per month in San Diego County was \$2.98 at the end of 2Q, which is a 2.1% increase from 2Q 2020's rate of \$2.92. Asking rates do not tell the whole story, as landlords are offering more lease concessions which lower the effective rental rates without affecting the asking rates. The surge in new construction also increases the proportion of high-end office space, pushing up the county's average asking rental rate. Landlords face the daunting prospect of operating in an environment of decreased demand for office space, while also competing with sublease availability. This is a very competitive environment, and the net effective rates are reflecting that.

**TRANSACTION ACTIVITY.** Sale and lease transactions totaled 4.6 MSF in 2Q, a large increase over last quarter's 2.0 MSF leased and sold. Much of this past quarter's total came from the 1.5 MSF portfolio of offices in Downtown that Regent Properties acquired. The leasing activity in both 1Q and 2Q exceeded 1.4 MSF, in contrast to the preceding three quarters, none of which exceeded 1.15 MSF. This is a sign that the market has started trending upward, but the leasing volume is far from recovered. The market averaged 2.1 MSF in quarterly leasing volume in 2017–2019. Business owners remain uncertain about how they should adapt their operations to reflect what could be long-term changes in the way they do business. Until that becomes clearer, transaction activity will be negatively impacted.

### VACANCY, AVAILABILITY & AVERAGE ASKING LEASE RATES



### TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



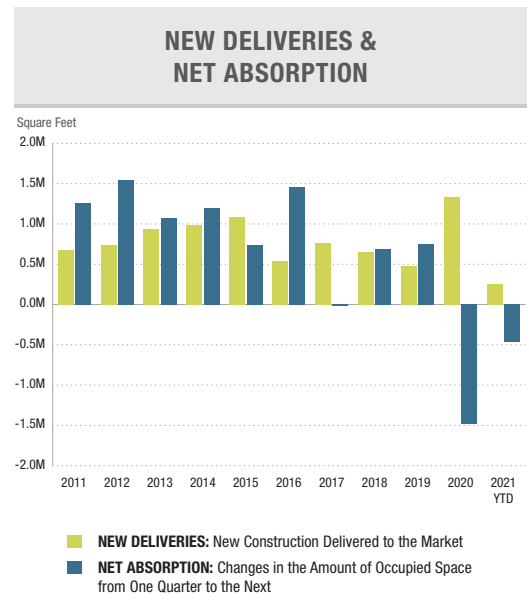
### Market Statistics

	Change Over Last Quarter	2Q 2021	1Q 2021	2Q 2020	% Change Over Last Year
Vacancy Rate	■ FLAT	12.82%	12.62%	10.40%	23.34%
Availability Rate	■ FLAT	17.06%	17.27%	14.68%	16.21%
Average Asking Lease Rate	▲ UP	\$2.98	\$2.92	\$2.92	2.05%
Sale & Lease Transactions	▲ UP	4,563,558	2,017,769	1,549,613	194.50%
Gross Absorption	▲ UP	1,647,831	1,162,792	1,092,250	50.87%
Net Absorption	■ FLAT	4,826	(472,600)	(340,543)	N/A

**ABSORPTION.** Following five consecutive quarters of significant negative net absorption, the bleeding may have stopped in 2Q. The market was effectively flat, with 4,826 SF of positive net absorption recorded. The effects by submarket were mixed—seven of San Diego’s eight largest office submarkets recorded negative net absorption. Interestingly, the offsetting factor was not found among the largest office submarkets. Fate Therapeutics took occupancy of 200,000 SF in Scripps Ranch, demonstrating how the Biotech sector has helped buoy the local office market.

**CONSTRUCTION.** The office market has 1.8 MSF under construction at the end of 2Q. The largest ground-up speculative office projects under construction include Lincoln Property Company’s 217,000 SF phase one of “Aperture Del Mar” on the Highway 56 Corridor and Kilroy Realty’s 234,000 square foot “2100 Kettner” project in Little Italy. The slow lease-up at 2100 Kettner has not deterred Kilroy’s long-term outlook for the Little Italy area, as evidenced by their \$42M acquisition of an adjacent 1.3-acre site at the end of 2Q.

**EMPLOYMENT.** The unemployment rate in San Diego County was 6.4% in May 2021, down from a revised 6.7% in April 2021, and below the year-ago estimate of 15.6%. This compares with an unadjusted unemployment rate of 7.5% for California and 5.5% for the nation during the same period. Over the 12-month period between May 2020 and May 2021, San Diego County employment increased by 119,500 jobs, or 9.3%. With the normal delay in reporting from the California EDD, employment figures from March were unavailable at the time of publishing this report. The jobs report for the U.S. overall showed a gain of 850,000 jobs in June, and total U.S. employment remains 7.13 million jobs below the February 2020 level.



## Forecast

During the second quarter all California adults became eligible to get a COVID-19 vaccine, and California lifted most COVID-19 restrictions. The free-fall in the office market appears to be over, and the road forward has begun. As the market is embarking on its recovery, many questions remain. Office tenants and landlords are still in a discovery phase, trying to project how office utilization will look in the post COVID-19 world. There are still many companies who are yet to figure out how to move forward operationally, and that impacts their willingness to make long-term space commitments. The pandemic was a game changer in terms of managing a workforce. We do anticipate some portion of office employees will continue to work remotely even as everything opens back up. This will likely lead to less demand for office space over the next couple of years as leases roll over. However, we expect the effect of potential downsizing to be substantially offset in the coming quarters by overall growth in the economy.

## Significant Transactions

### Sales \* Voit Real Estate Services Deal

Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
707 Broadway, 401 W. A St., 701 B St., & 1230 Columbia St.	Downtown	A/B	1,529,687	\$420,000,000	Regent Properties	Emmes
10935-10955 Vista Sorrento Pkwy.	Carmel Valley	A	217,902	\$123,100,000	Breakthrough Properties	Nuveen Real Estate
15611 Pomerado Rd. (Ground Leasehold)	Poway	A	163,094	\$102,700,000	Healthcare Realty Trust, Inc.	Ventas, Inc.
10641 Scripps Summit Ct.	Scripps Ranch	A	146,626	\$68,350,000	Rockwood Capital, LLC	Newport National Corporation
5910 Pacific Center Blvd. & 9985 Pacific Heights Blvd.	Sorrento Mesa	B	102,143	\$43,300,000	Clarity Real Estate	DRA Advisors, LLC

### Leases

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
16470 W. Bernardo Dr.	Rancho Bernardo	A	92,442	May-2021	Undisclosed	Menlo Equities
350 10th Ave.	Downtown	A	36,446	Apr-2021	ClickUp	Divco West
2365 Northside Dr.	Mission Valley	A	32,806	May-2021	Willis Towers Watson	City Office REIT
12544 High Bluff Dr.	Del Mar Heights/ Carmel Valley	A	31,372	May-2021	Undisclosed	The Irvine Company
110 W. A St.	Downtown	A	31,196	Apr-2021	Commonwealth Financial Network	Forester 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 2Q2021	Square Feet Available	Availability Rate 2Q2021	Average Asking Lease Rate	Net Absorption 2Q2021	Net Absorption 2021	Gross Absorption 2Q2021	Gross Absorption 2021
<b>Downtown</b>													
Downtown	129	13,608,975	984,198	2,402,000	2,855,282	20.98%	4,599,458	33.80%	\$2.88	(51,608)	(214,618)	186,022	315,654
Downtown Total	129	13,608,975	984,198	2,402,000	2,855,282	20.98%	4,599,458	33.80%	\$2.88	(51,608)	(214,618)	186,022	315,654
<b>Central</b>													
City Heights / University	30	1,202,320	0	0	71,145	5.92%	92,685	7.71%	\$2.21	(3,882)	(1,717)	9,614	18,339
Coronado	6	133,926	0	0	2,542	1.90%	2,542	1.90%	\$3.89	2,400	190	2,400	2,400
Kearny Mesa	242	11,401,504	0	60,186	1,456,229	12.77%	1,535,982	13.47%	\$2.57	(29,984)	(80,427)	89,239	193,808
Mission Gorge	19	581,130	0	0	3,139	0.54%	16,913	2.91%	\$2.08	(1,346)	1,282	0	2,628
Mission Valley	126	7,274,353	0	1,130,925	1,117,158	15.36%	1,251,502	17.20%	\$2.89	(8,752)	(16,853)	140,415	264,950
Old Town / Point Loma	76	2,346,410	0	230,000	140,128	5.97%	316,475	13.49%	\$2.72	11,985	(25,130)	34,190	51,104
Park East	16	234,322	0	0	5,016	2.14%	4,565	1.95%	\$2.34	1,985	8,924	1,985	10,469
Rose Canyon / Morena	56	1,297,671	0	0	94,386	7.27%	150,264	11.58%	\$1.98	(7,796)	(17,048)	7,079	15,617
Uptown / Hillcrest	79	2,238,561	0	0	208,792	9.33%	262,116	11.71%	\$2.65	(14,443)	(14,360)	32,280	49,489
Central Total	650	26,710,197	0	1,421,111	3,098,535	11.60%	3,633,044	13.60%	\$2.68	(49,833)	(145,139)	317,202	608,804
<b>I-15 Corridor</b>													
Escondido	75	1,760,383	75,000	36,614	206,846	11.75%	250,676	14.24%	\$2.08	3,820	(3,229)	31,967	100,106
Poway	31	1,388,007	0	0	45,754	3.30%	93,020	6.70%	\$2.21	4,393	5,115	9,095	30,409
Rancho Bernardo	104	6,894,695	0	2,835,094	1,026,261	14.88%	1,216,719	17.65%	\$2.95	(19,511)	(7,769)	32,648	110,436
Scripps Ranch	52	2,875,843	0	356,000	336,299	11.69%	544,565	18.94%	\$2.92	222,236	197,392	254,658	261,261
I-15 Corridor Total	262	12,918,928	75,000	3,227,708	1,615,160	12.50%	2,104,980	16.29%	\$2.85	210,938	191,509	328,368	502,212
<b>North County Coastal</b>													
Carlsbad	164	6,909,458	0	50,000	1,128,001	16.33%	1,433,581	20.75%	\$2.70	(43,273)	(76,438)	196,930	254,667
Del Mar Heights / Carmel Valley	79	5,104,145	228,662	418,833	778,322	15.25%	1,374,754	26.93%	\$4.32	46,140	(74,728)	124,063	185,316
North Beach Cities	112	2,662,929	72,177	75,456	251,392	9.44%	311,041	11.68%	\$3.65	(8,656)	(24,046)	45,613	95,769
North County Total	355	14,676,532	300,839	544,289	2,157,715	14.70%	3,119,376	21.25%	\$3.38	(5,789)	(175,212)	366,606	535,752
<b>North City</b>													
Governor Park	20	899,234	0	0	164,818	18.33%	183,548	20.41%	\$2.64	(10,505)	(19,830)	2,607	18,261
La Jolla	45	1,331,621	0	0	234,527	17.61%	236,540	17.76%	\$3.27	4,141	26,576	22,940	81,287
Miramar	32	1,451,242	0	1,007,050	126,238	8.70%	174,538	12.03%	\$2.07	(15,294)	(47,707)	12,256	19,001
Sorrento Mesa	113	8,998,761	194,910	1,843,000	877,798	9.75%	1,298,818	14.43%	\$3.13	(21,373)	17,051	90,095	201,658
Sorrento Valley	25	658,534	0	0	167,629	25.45%	120,931	18.36%	\$2.08	(9,553)	(18,120)	9,282	11,782
Torrey Pines	44	3,195,684	74,000	0	226,027	7.07%	120,736	3.78%	\$4.42	8,231	33,433	8,231	33,512
UTC	92	8,905,560	204,000	705,975	1,048,151	11.77%	1,245,217	13.98%	\$3.88	(67,544)	(152,016)	146,289	195,446
North City Total	371	25,440,636	472,910	3,556,025	2,845,188	11.18%	3,380,328	13.29%	\$3.26	(111,897)	(160,613)	291,700	560,947
<b>Southern &amp; Eastern Areas</b>													
Chula Vista	91	2,850,836	0	1,035,000	206,097	7.23%	292,156	10.25%	\$2.40	(11,054)	(13,009)	32,909	60,642
National City	15	528,493	0	0	5,160	0.98%	4,784	0.91%	\$2.00	5,017	5,753	6,480	7,216
South San Diego	13	319,824	0	0	8,064	2.52%	8,064	2.52%	\$2.03	2,911	2,911	2,911	2,911
Southeast San Diego	13	460,835	0	290,000	63,266	13.73%	63,266	13.73%	\$2.06	0	4,901	0	4,901
East County	152	3,767,329	0	300,300	155,086	4.12%	181,891	4.83%	\$2.19	(2,043)	18,189	36,388	69,278
Southern & Eastern Areas Total	284	7,927,317	0	1,625,300	437,673	5.52%	550,161	6.94%	\$2.30	(5,169)	18,745	78,688	144,948
<b>Highway 78 Corridor</b>													
Oceanside	64	1,464,560	0	250,749	120,012	8.19%	139,770	9.54%	\$2.22	24,247	18,177	31,254	42,409
San Marcos	38	1,465,135	0	1,447,462	129,478	8.84%	192,276	13.12%	\$2.52	(15,710)	(5,551)	7,943	36,580
Vista	52	1,257,793	0	0	266,033	21.15%	271,992	21.62%	\$2.19	9,647	4,928	40,048	63,317
Highway 78 Corridor Total	154	4,187,488	0	1,698,211	515,523	12.31%	604,038	14.42%	\$2.31	18,184	17,554	79,245	142,306
Class A	306	39,584,570	1,481,770	10,612,971	6,400,145	16.17%	9,180,211	23.19%	\$3.48	176,390	(38,745)	834,912	1,220,830
Class B	1,266	51,978,920	351,177	3,861,673	6,225,099	11.98%	7,757,989	14.93%	\$2.71	(160,104)	(433,922)	665,866	1,298,039
Class C	633	13,906,583	0	0	899,832	6.47%	1,053,185	7.57%	\$2.10	(11,460)	4,893	147,053	291,754
<b>San Diego County Total</b>	<b>2,205</b>	<b>105,470,073</b>	<b>1,832,947</b>	<b>14,474,644</b>	<b>13,525,076</b>	<b>12.82%</b>	<b>17,991,385</b>	<b>17.06%</b>	<b>\$2.98</b>	<b>4,826</b>	<b>(467,774)</b>	<b>1,647,831</b>	<b>2,810,623</b>

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



## Optimism Gaining Momentum

by **Jon Boland**

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At the midpoint of 2021, we are in a whole new world versus the midpoint of 2020. Things are no longer spiraling downward into despair. However, uncertainty remains. Market sentiment started to swing towards optimism with the rollout of the COVID vaccines in the spring, with all adults in California becoming eligible to receive the vaccine April 15th. Then on June 15th, California lifted most COVID restrictions, and this was a real turning point for sentiment in the office market. Both catalysts occurred during the second quarter, with the latter coming just two weeks before the end of the quarter. It remains to be seen how this will play out.

The truth is, no one has a crystal ball, and no one is 100% clear on how the office market will perform in the coming months. Landlords and tenants alike are still trying to determine the ramifications. Thus far, the doom and gloom headlines have not played out and there is no apocalypse in the office market. Vacancy has certainly increased substantially since the start of 2020, but rental rates have not fallen off a cliff. Landlords have instead increased their concession packages, while holding rental rates as much as possible. We are seeing an increase in leases structured with lower initial rates, followed by stepped rental rate increases to get tenants comfortable with the near-term financial obligations, while securing a long-term rental rate to satisfy owners. Another trend is short-term leases, as some tenants are not comfortable making long-term commitments in this unprecedented environment. The short-term renewals allow tenants more time to get a handle on where the market and their business are going, while landlords are able avoid significant concessions and reduced NOI. Both sides of the table get a chance to buy time in order to get a clearer picture of where things stand.

On the sales side, demand from occupier purchasers remains strong. There is still a price disconnect for both user and investor sales, and that predates the COVID outbreak. There is also a degree of pent-up demand following last year's freeze in the sales market. San Diego continues to be a preferred target for capital. One sign of optimism and capital coming to the San Diego market is the recent purchase by Regent Properties, a \$420 million acquisition of Emmes' portfolio in Downtown. This is one of the highest-price office sales in the history of Downtown, and this is coming on the heels of COVID, during a time when Downtown office fundamentals are in a very bad place. So, there is certainly optimism and capital in the market.

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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. ©2021 Voit Real Estate Services, Inc. DRE License #01991785.

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**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