

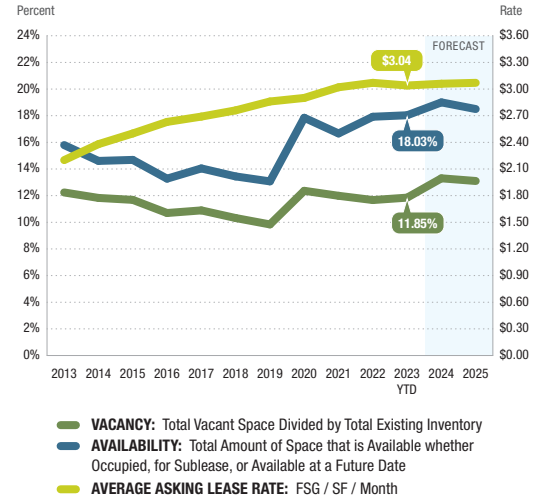
OVERVIEW. Leasing and sales volume were depressed to start 2023. The market registered negative net absorption in Q1 and a surge of sublease availability over the past year. Rental rate increases are slowing, and office construction is historically elevated. The current health of the local office market has been buoyed by the rapid expansion of San Diego's biotech industry which has sent a wave of office tenants into the market from office buildings being cleared for lab conversion.

VACANCY & AVAILABILITY. Direct/sublease space (unoccupied) finished Q1 at 11.9%, a significant increase from the pre-pandemic vacancy rate of 10.3%, but a 14-basis point decrease from the level of a year ago. Available office space being marketed (regardless of occupancy status) was 18% of the county's inventory at the end of Q1. Among the county's major submarkets (minimum of 5 MSF of inventory), Kearny Mesa had the lowest availability, at 12.3%. Meanwhile, the availability rate in Downtown is at 38.2% and the vacancy rate there is greater than 25%. The relatively large amount of new office space that will be completed over the next couple of years will push vacancy higher. Sublease availability increased by 1.3 MSF since the start of 2022, an increase of 85% over that span. The 2.9 MSF of available sublet space at the end of Q1 represents the largest level in over a decade.

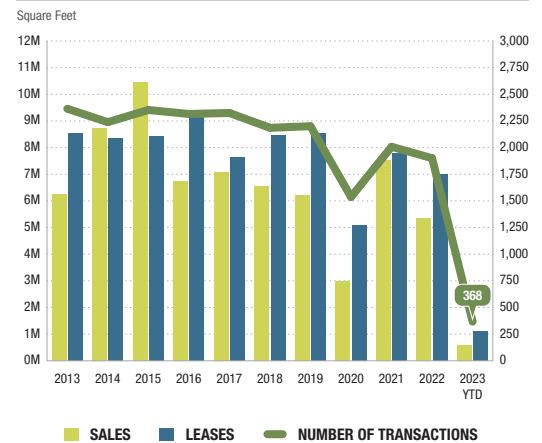
LEASE RATES. The average asking full-service-gross (FSG) lease rate per square foot per month in San Diego County was \$3.04 at the end of Q1, a three-cent decrease from the prior quarter's rate, and a one-cent decrease from Q1 2022's rate of \$3.05. The average asking rate for the county remains near an all-time high, but there are signs that the seemingly perpetual increases in asking rates are slowing. However, landlords are pointing towards the high inflation environment when justifying their posture on holding or pushing rental rates, and there has been a noticeable increase in the annual rent escalations in leases. Landlords are largely prioritizing a strong stance on starting rental rates, while taking a less stringent stance on lease concessions. But the balance of leverage varies across the county.

TRANSACTION ACTIVITY. Leasing volume levels were subdued in Q1. For the third consecutive quarter, the number of office leases recorded and the total area leased both decreased, each time marking their lowest quarterly tallies since Q4 2020. Two of the top five lease transactions recorded in Q1 were subleases, an indicator of the softening fundamentals within the office market. Office sales volume also started the year with a whimper. If the pace of sales doesn't increase over the remainder of 2023, the current projected number of sales and dollar volume would both end up as the lowest annual totals in over a decade. Two of the top five sale transactions in Q1 were office buildings acquired by residential developers. In the coming years, a number of older office buildings

VACANCY, AVAILABILITY & AVERAGE ASKING LEASE RATES



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



Market Statistics

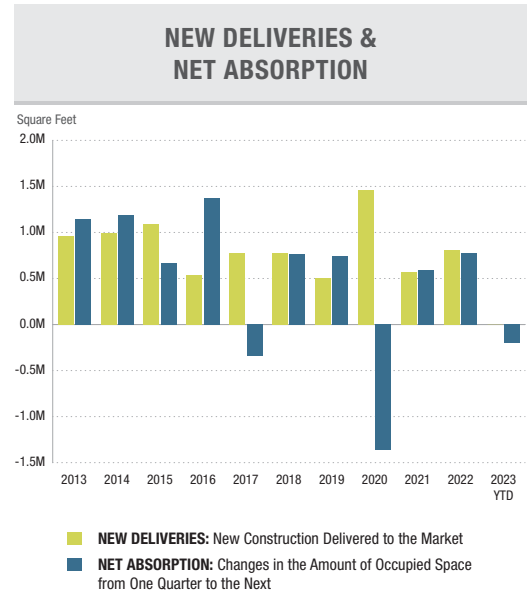
	Change Over Last Quarter	Q1 2023	Q4 2022	Q1 2022	% Change Over Last Year
Vacancy Rate	▲ UP	11.85%	11.67%	11.99%	(1.16%)
Availability Rate	▲ UP	18.03%	17.92%	16.47%	9.52%
Average Asking Lease Rate	▼ DOWN	\$3.04	\$3.07	\$3.05	(0.33%)
Sale & Lease Transactions	▼ DOWN	1,682,197	2,070,501	3,819,298	(55.96%)
Gross Absorption	▬ FLAT	1,848,290	1,808,998	2,167,959	(14.75%)
Net Absorption	▼ NEGATIVE	(200,124)	(1,425)	171,638	N/A

will be redeveloped or converted into higher and better uses more frequently than has occurred in the past.

ABSORPTION. There were 200,124 SF of negative net absorption in Q1, following 787,176 SF of growth in the office-occupying business footprint in 2022. The pandemic-induced recession inflicted 1,365,426 SF of negative absorption on the market in 2020. In the following two years the market gained back slightly more than an equivalent measure of positive net absorption, 1,379,622 SF. Going into 2023, the local office market was affected by lower leasing volume in 2022 which led to the decrease in the tenant footprint to start the year.

CONSTRUCTION. The office market has 4 MSF under construction at the end of Q1, a figure that has remained roughly the same for the past five quarters. Prior to Q4 2021, the last time there were more than 4 MSF of office properties under construction in San Diego County was at the end of 2006. Outside of IQHQ and Stockdale’s massive projects in Downtown San Diego, the largest project under construction in San Diego at the end of Q4 was Breakthrough Properties’ Torrey View project. This three-building, 520,000 SF development has its largest building preleased by medical device company BD. Overall, more than 85% of the office space under construction remains available. Nearly all of the largest projects under construction in the county are being positioned to attract tenants beyond the traditional stalwarts of legal, insurance, and financial sectors. Specifically, life sciences tenants are in the crosshairs of every major developer.

EMPLOYMENT. The unemployment rate in San Diego County was 3.7% in February 2023, unchanged a revised 3.7% in January 2023, and below the year-ago estimate of 4.1%. This compares with an unadjusted unemployment rate of 4.8% for California and 3.9% for the nation during the same period. Over the 12-month period between February 2022 and February 2023, San Diego County employment increased by 52,900 jobs, an increase of 3.5%. With the normal delay in reporting from the California EDD, employment figures from March were unavailable at the time of publishing this report. For the nation as a whole, 236,000 jobs were added in March, the lowest monthly total since December 2020.



Forecast

Venture capital volume has pulled back, and if the rapid growth of the local life sciences industry loses steam in the latter part of 2023, the office market will follow suit. The current surge in office construction will push the vacancy rate up, and that will have the most direct impact on the market for larger tenants. On the sales side, higher interest rates and tightening conditions in the debt markets will weigh down the office sector.

Significant Transactions

Sales

Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
8555 Aero Dr.	Kearny Mesa	B	87,120	\$10,000,000	AAA Management, LLC	Crown Investment Co.
8760 Cuyamaca St.	Santee	B	25,219	\$8,200,000	200 N. Palm Drive, LLC	John Davidson Trust
1070 S. Santa Fe Ave.	Vista	C	31,840	\$6,675,000	Ambient Communities, Inc.	RLS Investments
3969 4th Ave.	Uptown / Hillcrest	C	38,937	\$6,415,000	Ben-Moshe	4-Z Properties, LP
10200 Willow Creek Rd.	Scripps Ranch	C	23,524	\$6,047,000	Cush Enterprises	Willow Creek, LLC

Leases

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
13480 Evening Creek Dr. N.	Rancho Bernardo	A	63,781	Jan-2023	MediaTek	Kilroy Realty Corporation
5880 Oberlin Dr.	Sorrento Mesa	A	30,192	Jan-2023	Undisclosed	LeBeau Realty & Associates
4747 Executive Dr.	UTC	A	18,176	Mar-2023	Undisclosed	(Sublease)
225 Broadway	Downtown	A	15,264	Mar-2023	KNCH	Irvine Company
600 W. Broadway	Downtown	A	15,174	Jan-2023	Commonwealth Financial Network	(Sublease)

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate Q1 2023	Square Feet Available	Availability Rate Q1 2023	Average Asking Lease Rate	Net Absorption Q1 2023	Net Absorption 2023	Gross Absorption Q1 2023	Gross Absorption 2023
Downtown													
Downtown	128	13,862,902	2,715,518	550,000	3,579,315	25.82%	6,338,272	38.23%	\$2.85	(96,112)	(96,112)	223,931	223,931
Downtown Total	128	13,862,902	2,715,518	550,000	3,579,315	25.82%	6,338,272	38.23%	\$2.85	(96,112)	(96,112)	223,931	223,931
Central													
City Heights / University	31	1,213,132	0	0	35,723	2.94%	62,981	5.19%	\$2.33	7,034	7,034	8,262	8,262
Coronado	4	84,540	0	0	1,610	1.90%	1,610	1.90%	\$3.25	0	0	0	0
Kearny Mesa	242	11,406,171	70,000	0	1,102,333	9.66%	1,409,857	12.29%	\$2.65	39,650	39,650	142,144	142,144
Mission Gorge	19	581,130	0	0	6,488	1.12%	14,431	2.48%	\$2.02	(3,566)	(3,566)	0	0
Mission Valley	128	7,422,145	0	1,130,925	1,296,822	17.47%	1,578,656	21.27%	\$2.96	21,960	21,960	203,209	203,209
Old Town / Point Loma	76	2,268,131	0	230,000	125,916	5.55%	340,982	15.03%	\$2.66	13,495	13,495	39,554	39,554
Park East	15	218,936	0	0	19,651	8.98%	19,651	8.98%	\$2.16	(11,154)	(11,154)	0	0
Rose Canyon / Morena	53	1,258,986	0	0	61,196	4.86%	108,928	8.65%	\$2.45	44,935	44,935	50,406	50,406
Uptown / Hillcrest	77	2,166,747	0	0	138,966	6.41%	208,868	9.64%	\$2.77	22,121	22,121	26,321	26,321
Central Total	645	26,619,918	70,000	1,360,925	2,788,705	10.48%	3,745,964	14.04%	\$2.79	134,475	134,475	469,896	469,896
I-15 Corridor													
Escondido	74	1,805,934	0	62,614	209,213	11.58%	393,559	21.79%	\$2.31	(31,824)	(31,824)	31,343	31,343
Poway	31	1,390,271	0	0	81,281	5.85%	100,039	7.20%	\$1.84	11,167	11,167	13,493	13,493
Rancho Bernardo	100	6,362,008	83,482	165,747	921,747	14.49%	1,215,004	18.85%	\$3.23	112,454	112,454	256,135	256,135
Scripps Ranch	49	2,753,182	0	356,000	449,470	16.33%	551,653	20.04%	\$2.93	19,129	19,129	82,857	82,857
I-15 Corridor Total	254	12,311,395	83,482	584,361	1,661,711	13.50%	2,260,255	18.24%	\$3.02	110,926	110,926	383,828	383,828
North County Coastal													
Carlsbad	163	6,967,921	0	50,000	913,528	13.11%	1,378,873	19.79%	\$2.77	(57,540)	(57,540)	91,265	91,265
Del Mar Heights / Carmel Valley	82	5,695,387	519,870	2,067,642	597,251	10.49%	1,297,013	20.87%	\$4.69	71,826	71,826	238,473	238,473
North Beach Cities	113	2,749,134	54,845	25,456	224,883	8.18%	309,613	11.04%	\$3.92	(4,996)	(4,996)	36,418	36,418
North County Total	358	15,412,442	574,715	2,143,098	1,735,662	11.26%	2,985,499	18.67%	\$3.51	9,290	9,290	366,156	366,156
North City													
Governor Park	19	769,855	0	0	76,972	10.00%	105,555	13.71%	\$2.94	7,622	7,622	16,050	16,050
La Jolla	45	1,341,636	0	0	185,434	13.82%	234,306	17.46%	\$3.44	(18,325)	(18,325)	9,004	9,004
Miramar	32	1,474,065	0	0	80,990	5.49%	122,306	8.30%	\$1.78	10,963	10,963	24,485	24,485
Sorrento Mesa	111	9,020,574	316,000	1,529,000	765,983	8.49%	1,311,350	14.05%	\$3.17	(108,695)	(108,695)	81,493	81,493
Sorrento Valley	23	648,668	0	0	97,890	15.09%	74,016	11.41%	\$2.80	(601)	(601)	6,610	6,610
Torrey Pines	44	3,241,075	0	309,094	187,406	5.78%	248,682	7.67%	\$4.38	(124,915)	(124,915)	0	0
UTC	92	9,192,421	282,851	427,000	637,547	6.94%	1,361,588	14.37%	\$4.16	(51,691)	(51,691)	108,848	108,848
North City Total	366	25,688,294	598,851	2,265,094	2,032,222	7.91%	3,457,803	13.15%	\$3.53	(285,642)	(285,642)	246,490	246,490
Southern & Eastern Areas													
Chula Vista	92	2,892,008	0	1,203,000	111,549	3.86%	160,557	5.55%	\$2.58	(13,304)	(13,304)	23,202	23,202
National City	16	550,315	0	0	24,521	4.46%	80,771	14.68%	\$2.19	(12,194)	(12,194)	8,240	8,240
South San Diego	13	319,824	0	0	61,577	19.25%	61,577	19.25%	\$2.70	(51,927)	(51,927)	0	0
Southeast San Diego	13	461,460	0	290,000	16,748	3.63%	16,748	3.63%	\$2.33	0	0	0	0
East County	151	3,788,950	0	61,800	159,766	4.22%	242,474	6.40%	\$2.45	(15,950)	(15,950)	40,399	40,399
Southern & Eastern Areas Total	285	8,012,557	0	1,554,800	374,161	4.67%	562,127	7.02%	\$2.45	(93,375)	(93,375)	71,841	71,841
Highway 78 Corridor													
Oceanside	64	1,524,773	0	352,635	98,622	6.47%	138,093	9.06%	\$2.31	(18,028)	(18,028)	25,617	25,617
San Marcos	38	1,453,715	0	1,488,285	74,931	5.15%	96,144	6.61%	\$2.36	28,632	28,632	37,626	37,626
Vista	52	1,265,121	0	0	233,349	18.44%	288,424	22.80%	\$2.42	9,710	9,710	22,905	22,905
Highway 78 Corridor Total	154	4,243,609	0	1,840,920	406,902	9.59%	522,661	12.32%	\$2.36	20,314	20,314	86,148	86,148
Class A	310	40,528,373	3,889,084	6,890,194	6,367,400	15.71%	11,664,786	26.26%	\$3.52	(142,418)	(142,418)	776,459	776,459
Class B	1,250	51,575,149	153,482	3,409,004	5,258,915	10.20%	7,204,801	13.93%	\$2.78	(12,289)	(12,289)	912,967	912,967
Class C	630	14,047,595	0	0	952,363	6.78%	1,002,994	7.14%	\$2.30	(45,417)	(45,417)	158,864	158,864
San Diego County Total	2,190	106,151,117	4,042,566	10,299,198	12,578,678	11.85%	19,872,581	18.03%	\$3.04	(200,124)	(200,124)	1,848,290	1,848,290

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



San Diego Remains Desirable

by **Connor Wieck**

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As the supply of office space in core areas of the county has decreased, due to life science redevelopments, tenants surveying the market are weighing the pros and cons of relocations both within and outside of their existing submarkets. The bulk of deal velocity remains in the lower size ranges. The limited lead times of smaller tenants leaving their current buildings puts landlords who have “spec” office spaces in a better position than office spaces with dated buildouts. Landlords are facing longer delays on material deliveries and increased costs of construction due to inflation for larger tenants with more substantial improvement requirements. Tenants coming to the market who had previously signed three- to five-year deals, especially those who took advantage of COVID-era deals, are facing sticker shock as landlords have pushed rates and annual base rent increases to account for inflation. Employers are working to cater to the Millennial demographic who see a hybrid work-from-home model as a major benefit to their work-life balance. Additionally, employers have realized in order to attract and retain top talent, they must focus on amenity-rich buildings to entice employees into the office.

While trailing uncertainty from the pandemic remains within the office market, San Diego has been more resilient to the work-from-home model compared with larger metropolitan markets such as San Francisco or New York. The presence of large industry-leading employers, such as Apple, is a testament to the benefit of the work-life balance San Diego offers over other markets in the United States. Additionally, the ongoing expansion of the life sciences sector, led by Alexandria Real Estate Equities, Long Fellow Real Estate Partners and IQHQ REIT, shows that larger investors still see opportunity in San Diego. Traditional office space in San Diego continues to be a net beneficiary of the life sciences sector demand.

From a macroeconomic perspective, a mild recession is being predicted by market analysts and leading economists, caused largely by the rapid increase in the cost of capital, and simmering geopolitical tensions. Overall, we anticipate the office market to soften should we face the predicted mild recession, however there should be a strong recovery once inflation tapers off and the cost of capital decreases.

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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.

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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