

OVERVIEW. Leasing and sales volumes were subdued in the first three quarters of 2023. The market registered negative net absorption in each of the first three quarters of the year, and a large surge of sublease availability continues to flood the market. Rental rates are pulling back from all-time highs, and office construction is historically elevated. After two years of recovery from the COVID-19 setbacks, market fundamentals are now receding. The largest submarket in the county, Downtown, has become the poster child for the struggles of the office market in the post-pandemic landscape.

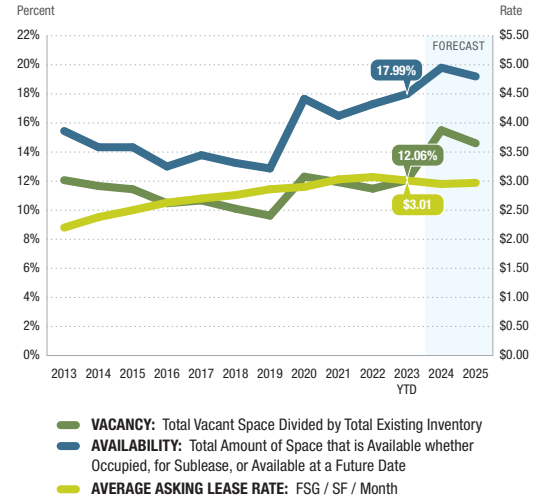
VACANCY & AVAILABILITY. Direct / sublease space (unoccupied) finished Q3 at 12.06%, a 52-basis point increase from the level of a year ago. Available office space being marketed (regardless of occupancy status) was 17.99% of the county's inventory at the end of Q3, an increase of 1.75 percentage points over the prior year. Among the county's major submarkets (minimum of 5 MSF of inventory), Sorrento Mesa had the lowest availability, at 10%. Meanwhile, the availability rate in Downtown is at 38% and the vacancy rate there is greater than 26%. The relatively large amount of new office space that will be completed over the next couple of years will push the vacancy rate higher. Sublease availability increased by 1.5 MSF since the start of 2022, effectively doubling over that span. The 3.1 MSF of available sublease space at the end of Q3 represents the largest level in at least two decades.

LEASE RATES. The average asking full-service-gross (FSG) lease rate per square foot per month in San Diego County was \$3.01 at the end of Q3, a five-cent decrease from the prior quarter's rate, and a 1% decrease from Q3 2022's rate of \$3.04. This decrease in asking rental rates is an indicator of the weakness of the office market, especially in light of the substantial construction pipeline currently underway. Typically, a large amount of new office space coming to the market pushes the average rental rate higher. The average asking rental rate is finally seeing the effects of decreased leasing activity, increased availability, and competition from sublease office space. Landlords are still 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.

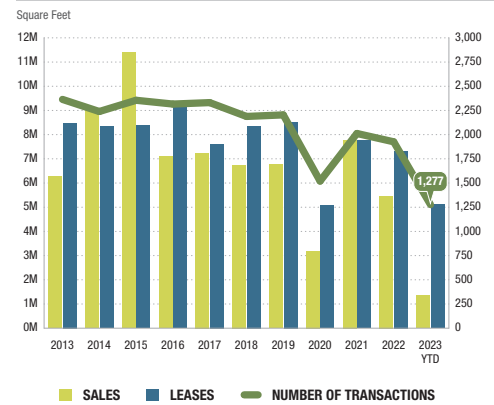
TRANSACTION ACTIVITY. Leasing volume levels were subdued in Q3. The total office square feet leased in Q3 dipped under 1.5 MSF for just the second time since 2020. The number of office leases recorded in Q3 was 368. This was significantly below the quarterly average of 453 transactions recorded over the previous two years. Office sales volume continued its anemic pace in Q3, with barely over \$100 million in sales occurring. This represents the lowest quarterly total since Q2 2011. Three of the top five sale transactions in Q3 were office buildings acquired by owner-users. This is an indication of the dearth of stabilized investment office sales. High interest rates and tight lending standards are acting as headwinds in the current commercial property sales market. The second largest sale of the quarter and the largest lease of the quarter both involved government institutions, indicating that industries which are not as affected by the cyclical nature of the economy are taking a more prominent role in the current office market.

ABSORPTION. There were 36,792 SF of negative net absorption in Q3, bringing the total negative net absorption for the first three quarters of the year to 418,499 SF. The pandemic-induced recession

VACANCY, AVAILABILITY & AVERAGE ASKING LEASE RATES



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



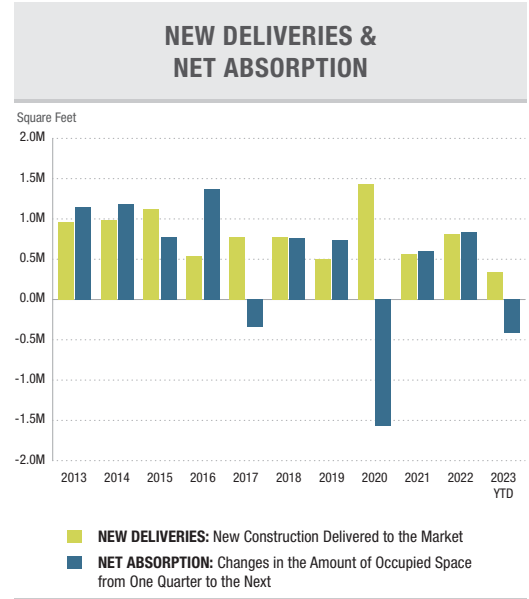
Market Statistics

	Change Over Last Quarter	Q3 2023	Q2 2023	Q3 2022	% Change Over Last Year
Vacancy Rate	▲ UP	12.06%	11.81%	11.54%	4.55%
Availability Rate	▼ DOWN	17.99%	18.54%	16.24%	10.80%
Average Asking Lease Rate	▼ DOWN	\$3.01	\$3.06	\$3.04	(0.99%)
Sale & Lease Transactions	▼ DOWN	1,629,576	1,983,016	3,320,865	(50.93%)
Gross Absorption	▲ UP	1,646,824	1,444,051	1,593,254	3.36%
Net Absorption	▼ NEGATIVE	(36,792)	(305,131)	(407,203)	N/A

inflicted 1,374,082 SF of negative absorption on the market in 2020. In the following two years the market gained back nearly an equivalent measure of positive net absorption. Going into 2023, the local office market was affected by lower leasing volume in 2022 which led to the decrease in the tenant footprint in 2023.

CONSTRUCTION. The office market has 3.7 MSF under construction at the end of Q3, a figure that has remained roughly the same for the past three years. Prior to Q3 2020, the last time there were more than 3.7 MSF of office properties under construction in San Diego County was at the start of 2007. Outside of IQHQ and Stockdale’s massive projects in Downtown San Diego, the largest project under construction in San Diego at the end of Q3 was Breakthrough Properties’ Torrey View project. This three-building, 520,000 SF development has its largest building preleased by medical device company BD. Overall, roughly 78% of the office space under construction remains available. Notably, the mixed-use project currently under construction at 1011 Union Street in Downtown secured an 87,000 SF lease with SANDAG in Q3. Construction projects that recently completed, or are nearing completion, were begun during a period of rapid growth in the technology and life sciences sectors. Those sectors have pulled back, along with their demand for office space, leaving owners of new office buildings jockeying to capture a piece of a smaller pie.

EMPLOYMENT. The unemployment rate in San Diego County was 4.3% in August 2023, up from a revised 3.9% in April 2023, and above the year-ago estimate of 3.5%. This compares with an unadjusted unemployment rate of 5.1% for California and 3.9% for the nation during the same period. Over the 12-month period between August 2022 and August 2023, San Diego County employment increased by 33,800 jobs, an increase of 2.2%. With the normal delay in reporting from the California EDD, employment figures from September were unavailable at the time of publishing this report. For the nation as a whole, 336,000 jobs were added in September, the second highest monthly total of the past year.



Forecast

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. For the county as a whole, we project increased vacancy in the coming quarters. The office sales market has been hit by higher interest rates, tightened lending standards, and paltry demand for offices as the asset category’s fundamentals are currently in a malaise. We do not foresee a sharp change to these underlying factors for the remainder of 2023. The market has passed a tipping point in the average asking rental rate, and we predict the current decrease will beget further decreases.

Significant Transactions

Sales							* Voit Real Estate Services Deal
Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller	
2127 W. Citricado Pkwy.	Escondido	B	75,000	\$60,200,000	Harrison Street Capital	JRMC Real Estate	
9555 Chesapeake Dr.	Kearny Mesa	B	60,000	\$17,752,500	San Diego Unified School District	The Sason Organization	
4933 Paramount Dr.	Kearny Mesa	B	18,752	\$7,650,000	HC Integrated Systems *	American Council on Exercise	
3636 4th Ave.	Uptown	C	26,607	\$6,675,500	Built 4th Ave., LLC	3636, LLC	
1237 Camino Del Mar	North Beach Cities	B	4,820	\$5,000,000	Pemberley Realty	Surfbud, LLC	

Leases						
Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
1011 Union St.	Downtown	A	87,309	Aug-2023	SANDAG	Low / Holland Partner Group / NASH
16705 Via del Campo Ct.	Rancho Bernardo	B	55,227	Aug-2023	ASML	Drawbridge Realty
5600 Avenida Encinas	Carlsbad	A	51,495	Sep-2023	Undisclosed	Alexandria Real Estate Equities
17190 Bernardo Center Dr.	Rancho Bernardo	B	41,092	Aug-2023	Undisclosed	MS Dannin, LLC
15253 Avenue of Science	Rancho Bernardo	B	37,437	Aug-2023	Malin Bioscientific	Ascendas-Singbridge Group

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate Q3 2023	Square Feet Available	Availability Rate Q3 2023	Average Asking Lease Rate	Net Absorption Q3 2023	Net Absorption 2023	Gross Absorption Q3 2023	Gross Absorption 2023
Downtown													
Downtown	128	13,864,954	2,715,518	572,837	3,698,452	26.67%	6,279,576	37.87%	\$2.78	(47,086)	(232,025)	204,724	598,252
Downtown Total	128	13,864,954	2,715,518	572,837	3,698,452	26.67%	6,279,576	37.87%	\$2.78	(47,086)	(232,025)	204,724	598,252
Central													
City Heights / University	32	1,224,665	0	0	44,590	3.64%	56,320	4.60%	\$2.41	(7,561)	(1,833)	783	11,346
Coronado	4	84,540	0	0	1,610	1.90%	0	0.00%	\$3.25	0	0	0	0
Kearny Mesa	243	11,517,562	0	354,087	1,136,110	9.86%	1,552,467	13.48%	\$2.81	18,135	75,873	159,557	502,689
Mission Gorge	21	640,826	0	0	6,765	1.06%	10,832	1.69%	\$1.98	5,117	(726)	5,942	20,314
Mission Valley	128	7,403,847	0	1,130,925	1,302,301	17.59%	1,693,347	22.87%	\$3.00	87,044	16,481	202,523	562,065
Old Town / Point Loma	76	2,309,860	0	230,000	184,929	8.01%	342,636	14.83%	\$2.51	(51,525)	(45,518)	39,229	89,898
Park East	15	218,936	0	0	3,550	1.62%	16,847	7.69%	\$1.97	7,604	4,947	7,604	16,101
Rose Canyon / Morena	53	1,256,358	0	0	93,974	7.48%	116,726	9.29%	\$2.44	(36,018)	12,157	6,291	74,678
Uptown / Hillcrest	77	2,166,232	0	0	147,662	6.82%	248,707	11.48%	\$2.79	(28,479)	13,425	9,482	59,354
Central Total	649	26,822,826	0	1,715,012	2,921,491	10.89%	4,037,882	15.05%	\$2.84	(5,683)	74,806	431,411	1,336,445
I-15 Corridor													
Escondido	74	1,798,276	0	36,614	191,282	10.64%	402,895	22.40%	\$2.32	2,258	(13,893)	39,842	101,885
Poway	31	1,390,271	0	0	99,945	7.19%	100,723	7.24%	\$1.94	(7,489)	(7,497)	10,514	25,846
Rancho Bernardo	100	6,367,784	83,482	165,747	918,289	14.42%	1,079,055	16.73%	\$3.22	29,303	111,956	64,291	397,094
Scripps Ranch	51	2,883,688	0	356,000	410,284	14.23%	512,674	17.78%	\$2.96	18,881	59,813	41,612	197,337
I-15 Corridor Total	256	12,440,019	83,482	558,361	1,619,800	13.02%	2,095,347	16.73%	\$3.00	42,953	150,379	156,259	722,162
North County Coastal													
Carlsbad	164	6,995,045	0	50,000	935,953	13.38%	1,495,795	21.38%	\$2.76	(17,998)	(109,383)	61,893	263,475
Del Mar Heights / Carmel Valley	82	5,695,387	641,318	1,946,218	667,512	11.72%	1,260,225	19.89%	\$4.69	(77,864)	1,565	159,479	465,281
North Beach Cities	112	2,764,186	0	25,456	280,085	10.13%	337,067	12.19%	\$3.83	(27,927)	(9,999)	62,553	150,722
North County Total	358	15,454,618	641,318	2,021,674	1,883,550	12.19%	3,093,087	19.22%	\$3.42	(123,789)	(117,817)	283,925	879,478
North City													
Governor Park	19	768,582	0	0	73,647	9.58%	113,670	14.79%	\$2.87	8,439	10,947	31,924	60,611
La Jolla	45	1,350,578	0	0	162,155	12.01%	278,028	20.59%	\$3.42	1,185	(18,775)	22,447	74,645
Miramar	32	1,474,065	0	0	73,004	4.95%	125,300	8.50%	\$2.32	(3,259)	18,949	17,063	54,159
Sorrento Mesa	107	8,767,400	0	1,232,000	567,349	6.47%	878,219	10.02%	\$3.15	30,626	(120,186)	86,592	271,224
Sorrento Valley	22	626,341	0	0	120,584	19.25%	81,464	13.01%	\$2.80	(324)	(23,295)	0	8,385
Torrey Pines	43	3,252,335	0	309,094	59,482	1.83%	152,211	4.68%	\$4.37	31,667	3,009	32,857	42,290
UTC	92	9,346,654	70,000	427,000	886,469	9.48%	1,580,038	16.78%	\$3.98	77,511	(87,762)	279,588	481,935
North City Total	360	25,585,955	70,000	1,968,094	1,942,690	7.59%	3,208,930	12.51%	\$3.50	145,845	(217,113)	470,471	993,249
Southern & Eastern Areas													
Chula Vista	92	2,892,008	168,000	1,850,000	121,745	4.21%	296,250	9.68%	\$2.63	(11,517)	(23,500)	19,687	84,590
National City	16	583,906	0	0	8,080	1.38%	46,023	7.88%	\$2.22	243	4,247	3,300	27,738
South San Diego	14	355,781	0	0	58,142	16.34%	58,142	16.34%	\$2.83	8,231	(47,492)	10,565	12,765
Southeast San Diego	13	476,159	0	290,000	16,748	3.52%	15,226	3.20%	\$2.33	0	0	0	0
East County	153	3,815,877	0	61,800	144,969	3.80%	189,097	4.96%	\$2.36	(6,801)	2,347	43,564	131,205
Southern & Eastern Areas Total	288	8,123,731	168,000	2,201,800	349,684	4.30%	604,738	7.29%	\$2.39	(9,844)	(64,398)	77,116	256,298
Highway 78 Corridor													
Oceanside	64	1,525,779	0	352,635	100,153	6.56%	132,738	8.70%	\$2.35	2,224	(19,559)	5,689	34,703
San Marcos	38	1,482,054	0	1,488,285	82,275	5.55%	87,706	5.92%	\$2.40	(18,029)	21,288	8,387	66,171
Vista	51	1,257,887	0	0	257,119	20.44%	295,764	23.51%	\$2.36	(23,383)	(14,060)	8,842	56,262
Highway 78 Corridor Total	153	4,265,720	0	1,840,920	439,547	10.30%	516,208	12.10%	\$2.36	(39,188)	(12,331)	22,918	157,136
Class A	316	41,115,444	3,594,836	8,003,770	6,758,100	16.44%	11,776,892	26.34%	\$3.39	127,472	(384,798)	829,396	2,148,315
Class B	1,254	51,607,003	83,482	2,852,091	5,169,898	10.02%	7,105,098	13.75%	\$2.80	(130,245)	4,935	703,710	2,406,836
Class C	622	13,835,376	0	22,837	927,216	6.70%	953,778	6.89%	\$2.23	(34,019)	(38,636)	113,718	387,869
San Diego County Total	2,192	106,557,823	3,678,318	10,878,698	12,855,214	12.06%	19,835,768	17.99%	\$3.01	(36,792)	(418,499)	1,646,824	4,943,020

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



Shining in the Suburbs

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It's hard to believe that it's already been three and a half years since COVID-19 and the accompanying lockdowns that overwhelmed and disrupted society as we knew it. Initially, the office market was devastated by the shock to the system that this unprecedented occurrence created. This was relatively short lived, and in 2021 and 2022 there was a rebound. This was driven in the San Diego market by rapid expansion of the technology and life science sectors, along with growth of the general economy from pent-up demand and government stimulus. Over that period the economy and local office market have been whipsawed back and forth, and through 2023 the market has been ebbing downward. Inflation that ensued with the reopening of the economy and from government stimulus was countered by the Fed raising the key benchmark interest rate to a 22-year high. The macroeconomy has cooled off, and the technology and life science sector expansion in San Diego has all but vanished in recent quarters.

Beyond the broader slowdown in the economy and in the office sector, there exists a clear dichotomy which has formed between the Downtown urban office sector and the suburban office submarkets. This is very evident in the (suburban) Chula Vista submarket which I cover. More than one quarter of the Downtown San Diego office market currently sits vacant, while Chula Vista currently has a vacancy rate below five percent. Five years ago, Chula Vista office vacancy was in the eight percent range, and during the Great Recession it peaked above fifteen percent. In the Eastlake portion of Chula Vista these figures were even higher. This is representative of the shift that tenants are making to the suburbs to be closer to their workforce. While the demand has dwindled nationally in the downtown office markets, the demand for office is still healthy in the suburbs.

Following the Covid shutdowns, the landlords that I work with were mostly focused on retaining and increasing occupancy in their offices. We have now reached a point where these suburban office owners are shifting their emphasis from pushing occupancy to pushing rental rates. Some of this pressure on rates is driven purely by inflation—the cost of tenant improvements has increased dramatically in a short period of time. Even in my quiet suburban submarket of Chula Vista, speculative office buildouts are \$100+ per square foot. Landlords are increasingly seeking tenants without major TI requirements, and oftentimes landlords will look for tenants to share in the TI costs. Overall, Chula Vista is an example that not all is doom and gloom in the office world. There's always opportunity in every market cycle for those with the right perspective. It's time to get creative in order to keep making deals in this ever-changing office landscape. It's a great day to be in commercial real estate.

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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.

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