

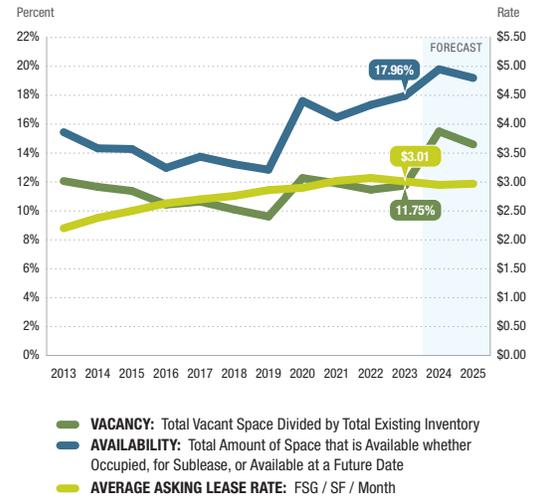
OVERVIEW. Leasing and sales volumes were thin in 2023. The market registered negative net absorption, and a large surge of sublease availability continues to flood the market. Rental rates are pulling back from all-time highs, and office construction is historically elevated. After two years of recovery from the COVID-19 setbacks, market fundamentals are now receding.

VACANCY & AVAILABILITY. Direct / sublease space (unoccupied) finished Q4 at 11.75%, a 28-basis point increase from the level of a year ago. Available office space being marketed (regardless of occupancy status) was 17.96% of the county's inventory at the end of Q4, an increase of 63 basis points over the prior year. Among the county's major submarkets (minimum of 5 MSF of inventory), Sorrento Mesa had the lowest availability, at 11.9%. Meanwhile, the availability rate in Downtown is at 38.6% and the vacancy rate there is nearly 27%. The relatively large amount of new office space that will be completed over the next couple of years will push the vacancy rate even higher. Sublease availability has increased by 1.4 MSF since Q3 2021, doubling the amount of sublease space on the market over that span.

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 Q4, unchanged from the prior quarter's rate, and a 2% decrease from Q4 2022's rate of \$3.07. This decrease in asking rental rates is an indicator of the weakness of the office market, especially given the substantial construction pipeline. 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. The number of office leases recorded in Q4 was 360. This was significantly below the quarterly average of 442 transactions recorded over the previous two years. Total leasing volume levels were subdued in 2023 as well. The 6.5 MSF leased in 2023 marked the second lowest annual tally since 2009. Only 2020 saw less office space leased during that timeframe. Office sales volume also continued its slow pace in 2023, with less than \$1 billion in sales occurring. This represents the first time San Diego County annual office sales dollar volume failed to reach a billion dollars since 2010. The two largest office sales in Q4 were properties sold for conversion and redevelopment, and the next three largest sale transactions of the quarter were office buildings acquired by owner-users. This highlights the scarcity of stabilized investment office sales. High interest rates, tight lending standards, and concerns about future demand are acting as major headwinds in the current office sales market. Two of the five largest leases of the quarter involved a government institution and a healthcare group, 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.

VACANCY, AVAILABILITY & AVERAGE ASKING LEASE RATES



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



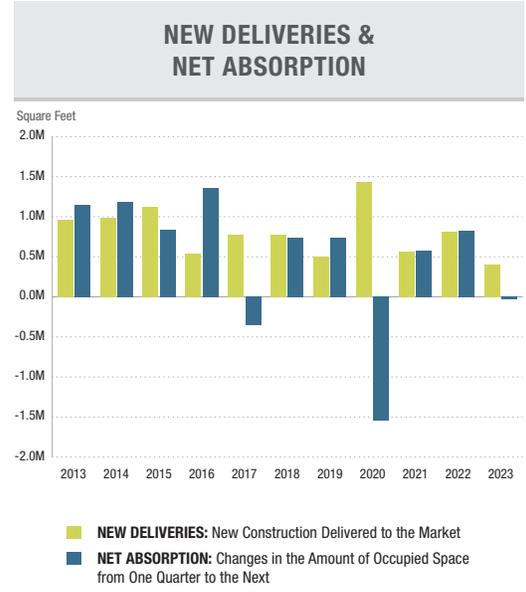
Market Statistics

| | Change Over Last Quarter | Q4 2023 | Q3 2023 | Q4 2022 | % Change Over Last Year |
|---------------------------|--------------------------|-----------|-----------|-----------|-------------------------|
| Vacancy Rate | ▼ DOWN | 11.75% | 12.11% | 11.47% | 2.46% |
| Availability Rate | ▼ DOWN | 17.96% | 18.65% | 17.33% | 3.60% |
| Average Asking Lease Rate | ▬ FLAT | \$3.01 | \$3.01 | \$3.07 | (1.95%) |
| Sale & Lease Transactions | ▲ UP | 1,902,484 | 1,862,769 | 2,426,385 | (21.59%) |
| Gross Absorption | ▲ UP | 2,072,292 | 1,638,782 | 1,836,538 | 12.84% |
| Net Absorption | ▲ POSITIVE | 442,850 | (60,143) | 909 | N/A |

ABSORPTION. The office market finished 2023 with a modest 33,561 SF of negative net absorption. This was no small feat after starting the year with three consecutive quarters of negative net absorption. The professional and business services sector saw the greatest number of job losses (6,600) in San Diego County over the last 12 months. This reduction in an employment sector with high office usage correlates to a reduction in the amount of occupied office space.

CONSTRUCTION. The office market recorded 407,696 SF of new construction completions in 2023, the lowest annual total in over a decade. Much of the 4 MSF currently under construction at the end of the year will come to the market in 2024, producing the largest annual total in well over a decade. 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. This project is achieving rental rates near \$7.00 PSF for lab tenants. Overall, roughly 76% of the office space under construction remains available. 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 4.2% in November 2023, unchanged from a revised 4.2% in October 2023, and above the year-ago estimate of 3.3%. This compares with an unadjusted unemployment rate of 4.9% for California and 3.5% for the nation during the same period. Over the 12-month period between November 2022 and November 2023, San Diego County employment increased by 21,900 jobs, an increase of 1.4%. With the normal delay in reporting from the California EDD, employment figures from December were unavailable at the time of publishing this report. For the nation as a whole, 216,000 jobs were added in December, and weekly new jobless benefit claims finished the year at their lowest level in two months.



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 weak demand for offices, which do not combine well with an excess of supply. We do not foresee a sharp change to these underlying factors at the start of 2024. The market has passed a tipping point in the average asking rental rate, and we predict the current decrease will be followed by further decreases.

Significant Transactions

Sales

* Voit Real Estate Services Deal

| Property Address | Submarket | Class | Square Feet | Sale Price | Buyer | Seller |
|-----------------------------|------------------|-------|-------------|--------------|-----------------------------|---------------------------------|
| 180 Broadway | Downtown | A | 387,627 | \$61,000,000 | J Street Space | Hammer Ventures |
| 3914-3954 Murphy Canyon Rd. | Kearny Mesa | B | 158,118 | \$38,000,000 | San Diego Food Bank | Link Logistics Real Estate |
| 3998 Vista Way | Oceanside | B | 37,488 | \$12,500,000 | TrueCare | Camelot Investments, LLC |
| 3043 4th Ave. | Uptown/Hillcrest | B | 17,300 | \$9,440,000 | Integrated Consultants Inc. | System Property Development Co. |
| 4700 Spring St. | La Mesa | B | 41,129 | \$8,675,000 | Spring Street Holdings, LP* | Pacific View |

| Property Address | Submarket | Class | Square Feet | Transaction Date | Tenant | Owner |
|------------------------|----------------|-------|-------------|------------------|---------------------|---------------------------|
| 401 Mile of Cars Way | National City | B | 25,886 | Oct-203 | County of San Diego | Bosa Development |
| 1081 Camino Del Rio S. | Mission Valley | B | 23,400 | Nov-2023 | Undisclosed | 1081 Camino, LLC |
| 655 W. Broadway | Downtown | A | 21,837 | Oct-2023 | Northwestern Mutual | MetLife Real Estate |
| 401 W. A St. | Downtown | A | 20,293 | Oct-2023 | Undisclosed | Regent Properties |
| 3880 Murphy Canyon Rd. | Kearny Mesa | B | 19,962 | Dec-2023 | Rady Children’s | Peregrine Realty 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 Q4 2023 | Square Feet Available | Availability Rate Q4 2023 | Average Asking Lease Rate | Net Absorption Q4 2023 | Net Absorption 2023 | Gross Absorption Q4 2023 | Gross Absorption 2023 |
| Downtown | | | | | | | | | | | | | |
| Downtown | 128 | 13,777,496 | 2,715,518 | 572,837 | 3,712,249 | 26.94% | 6,360,680 | 38.57% | \$2.75 | (13,797) | (305,957) | 256,115 | 809,541 |
| Downtown Total | 128 | 13,777,496 | 2,715,518 | 572,837 | 3,712,249 | 26.94% | 6,360,680 | 38.57% | \$2.75 | (13,797) | (305,957) | 256,115 | 809,541 |
| Central | | | | | | | | | | | | | |
| City Heights / University | 32 | 1,244,762 | 0 | 0 | 47,276 | 3.80% | 58,300 | 4.68% | \$2.41 | (2,686) | (4,519) | 4,172 | 15,518 |
| Coronado | 4 | 84,540 | 0 | 0 | 0 | 0.00% | 0 | 0.00% | \$3.25 | 1,610 | 1,610 | 1,610 | 1,610 |
| Kearny Mesa | 243 | 11,509,401 | 0 | 354,087 | 974,760 | 8.47% | 1,452,948 | 12.62% | \$2.90 | 161,350 | 237,223 | 221,376 | 724,065 |
| Mission Gorge | 20 | 629,890 | 0 | 0 | 3,552 | 0.56% | 10,619 | 1.69% | \$2.06 | 3,213 | 2,487 | 3,213 | 23,527 |
| Mission Valley | 129 | 7,463,656 | 0 | 1,130,925 | 1,335,724 | 17.90% | 1,649,107 | 22.10% | \$3.00 | (33,423) | (16,942) | 207,599 | 769,664 |
| Old Town / Point Loma | 76 | 2,316,744 | 0 | 230,000 | 203,726 | 8.79% | 294,541 | 12.71% | \$2.57 | (18,797) | (64,315) | 29,953 | 119,851 |
| Park East | 15 | 218,936 | 0 | 0 | 985 | 0.45% | 14,282 | 6.52% | \$1.98 | 2,565 | 7,512 | 2,565 | 18,666 |
| Rose Canyon / Morena | 53 | 1,257,086 | 0 | 0 | 89,634 | 7.13% | 132,595 | 10.55% | \$2.43 | 4,340 | 16,497 | 16,158 | 90,836 |
| Uptown / Hillcrest | 77 | 2,166,232 | 0 | 0 | 147,328 | 6.80% | 191,949 | 8.86% | \$2.91 | 334 | 13,759 | 67,694 | 127,048 |
| Central Total | 649 | 26,891,247 | 0 | 1,715,012 | 2,802,985 | 10.42% | 3,804,341 | 14.15% | \$2.87 | 118,506 | 193,312 | 554,340 | 1,890,785 |
| I-15 Corridor | | | | | | | | | | | | | |
| Escondido | 74 | 1,798,276 | 0 | 36,614 | 211,692 | 11.77% | 411,558 | 22.89% | \$2.32 | (20,410) | (34,303) | 27,053 | 128,938 |
| Poway | 31 | 1,390,271 | 0 | 0 | 99,652 | 7.17% | 102,240 | 7.35% | \$1.96 | 293 | (7,204) | 9,814 | 35,660 |
| Rancho Bernardo | 100 | 6,367,784 | 83,482 | 165,747 | 746,315 | 11.72% | 959,133 | 14.87% | \$3.21 | 171,974 | 283,930 | 235,320 | 632,414 |
| Scripps Ranch | 51 | 2,881,137 | 0 | 356,000 | 269,653 | 9.36% | 390,522 | 13.55% | \$2.94 | 140,631 | 200,444 | 200,927 | 398,264 |
| I-15 Corridor Total | 256 | 12,437,468 | 83,482 | 558,361 | 1,327,312 | 10.67% | 1,863,453 | 14.88% | \$2.97 | 292,488 | 442,867 | 473,114 | 1,195,276 |
| North County Coastal | | | | | | | | | | | | | |
| Carlsbad | 165 | 7,053,045 | 0 | 50,000 | 873,113 | 12.38% | 1,513,266 | 21.46% | \$2.74 | 62,840 | (46,543) | 174,606 | 438,081 |
| Del Mar Heights / Carmel Valley | 82 | 5,706,773 | 963,138 | 1,635,627 | 685,707 | 12.02% | 1,250,617 | 18.75% | \$4.65 | (18,195) | (16,630) | 104,008 | 569,289 |
| North Beach Cities | 112 | 2,765,220 | 0 | 25,456 | 229,300 | 8.29% | 289,693 | 10.48% | \$3.87 | 50,785 | 40,786 | 77,793 | 228,515 |
| North County Total | 359 | 15,525,038 | 963,138 | 1,711,083 | 1,788,120 | 11.52% | 3,053,576 | 18.52% | \$3.37 | 95,430 | (22,387) | 356,407 | 1,235,885 |
| North City | | | | | | | | | | | | | |
| Governor Park | 19 | 768,583 | 0 | 0 | 78,059 | 10.16% | 93,921 | 12.22% | \$2.86 | (4,412) | 6,535 | 4,912 | 65,523 |
| La Jolla | 45 | 1,353,342 | 0 | 0 | 200,604 | 14.82% | 253,919 | 18.76% | \$3.47 | (38,449) | (57,224) | 23,017 | 97,662 |
| Miramar | 32 | 1,474,065 | 0 | 0 | 74,419 | 5.05% | 654,476 | 44.40% | \$2.39 | (1,415) | 17,534 | 6,706 | 60,865 |
| Sorrento Mesa | 106 | 8,718,806 | 0 | 1,232,000 | 588,732 | 6.75% | 1,033,582 | 11.85% | \$3.21 | (31,648) | (149,611) | 57,861 | 321,043 |
| Sorrento Valley | 21 | 610,215 | 0 | 0 | 103,346 | 16.94% | 63,346 | 10.38% | \$2.75 | 17,238 | (6,057) | 20,538 | 28,923 |
| Torrey Pines | 43 | 3,252,613 | 0 | 309,094 | 50,311 | 1.55% | 149,897 | 4.61% | \$4.37 | 9,171 | 12,180 | 10,163 | 52,453 |
| UTC | 93 | 9,416,567 | 558,183 | 400,000 | 1,011,861 | 10.75% | 1,519,564 | 15.23% | \$3.97 | (55,392) | (143,154) | 148,974 | 630,909 |
| North City Total | 359 | 25,594,191 | 558,183 | 1,941,094 | 2,107,332 | 8.23% | 3,768,705 | 14.41% | \$3.54 | (104,907) | (319,797) | 272,171 | 1,257,378 |
| Southern & Eastern Areas | | | | | | | | | | | | | |
| Chula Vista | 92 | 2,892,008 | 168,000 | 1,850,000 | 120,047 | 4.15% | 282,043 | 9.22% | \$2.63 | 1,698 | (21,802) | 21,722 | 106,312 |
| National City | 16 | 583,906 | 0 | 0 | 7,155 | 1.23% | 52,946 | 9.07% | \$2.25 | 925 | 5,172 | 925 | 28,663 |
| South San Diego | 14 | 355,781 | 0 | 0 | 56,202 | 15.80% | 57,702 | 16.22% | \$4.72 | 1,940 | (45,552) | 2,340 | 15,105 |
| Southeast San Diego | 13 | 481,066 | 0 | 290,000 | 20,461 | 4.25% | 20,461 | 4.25% | \$2.33 | (3,713) | (3,713) | 1,522 | 1,522 |
| East County | 153 | 3,815,877 | 0 | 61,800 | 129,725 | 3.40% | 168,960 | 4.43% | \$2.35 | 15,244 | 17,591 | 59,293 | 190,498 |
| Southern & Eastern Areas Total | 288 | 8,128,638 | 168,000 | 2,201,800 | 333,590 | 4.10% | 582,112 | 7.02% | \$2.43 | 16,094 | (48,304) | 85,802 | 342,100 |
| Highway 78 Corridor | | | | | | | | | | | | | |
| Oceanside | 64 | 1,531,606 | 0 | 352,635 | 151,776 | 9.91% | 172,566 | 11.27% | \$2.54 | 5,851 | (13,708) | 22,986 | 57,689 |
| San Marcos | 38 | 1,482,054 | 0 | 1,488,285 | 66,931 | 4.52% | 93,340 | 6.30% | \$2.41 | 15,344 | 36,632 | 22,971 | 89,142 |
| Vista | 51 | 1,255,156 | 0 | 0 | 239,278 | 19.06% | 252,786 | 20.14% | \$2.33 | 17,841 | 3,781 | 28,386 | 84,648 |
| Highway 78 Corridor Total | 153 | 4,268,816 | 0 | 1,840,920 | 457,985 | 10.73% | 518,692 | 12.15% | \$2.36 | 39,036 | 26,705 | 74,343 | 231,479 |
| Class A | 314 | 40,952,266 | 4,404,839 | 7,666,179 | 6,240,471 | 15.24% | 11,147,208 | 24.58% | \$3.37 | 559,934 | 162,050 | 1,181,112 | 3,301,271 |
| Class B | 1,256 | 51,768,819 | 83,482 | 2,852,091 | 5,444,375 | 10.52% | 7,872,491 | 15.18% | \$2.80 | (220,858) | (256,347) | 693,533 | 3,078,707 |
| Class C | 622 | 13,901,809 | 0 | 22,837 | 844,727 | 6.08% | 931,860 | 6.70% | \$2.27 | 103,774 | 60,736 | 197,647 | 582,466 |
| San Diego County Total | 2,192 | 106,622,894 | 4,488,321 | 10,541,107 | 12,529,573 | 11.75% | 19,951,559 | 17.96% | \$3.01 | 442,850 | (33,561) | 2,072,292 | 6,962,444 |

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



It's Slow

by **Jon Boland**

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As anyone who works in the office real estate market can tell you, it's slow. In San Diego County, over the past 15 years, the only year with fewer office leases recorded than 2023 was 2020. In San Diego County, over the past 15 years, the only year with fewer total square feet of office space leased than 2023 was 2020. In other words, the only year in the past decade and a half which had less office leasing activity than 2023, was the year in which the California government mandated people to stay at home.

These low activity levels have made a discernable change to the behavior of the players in the market. Landlords are noticeably hungrier to make deals. More introductory teaser rates are being offered. More open houses and broker incentives are popping up. Landlords are becoming more generous with concessions. Landlords have been motivated to make a deal when it comes to larger tenants, but we have yet to see dramatic rent decreases sweep across the market. Rental rates are the last line item that landlords budge on. Tenants will actually send me national news articles about how the market is in terrible condition, and they are expecting the landlords to give away the space. But, deep discounts in contract rents across the market just haven't materialized. Overall average asking rental rates in the county have certainly dipped, and office rent is currently being outpaced by inflation, but the bottom has yet to fall out. Of course, this is the big picture view, and your results may vary. If you are a tenant in the market for office space in Downtown San Diego, you will have a lot of options, and a lot of leverage. If you are in the market for medical office space in UTC, your options and leverage are limited.

How's the office investment sales market? What office investment sales market? The office investment sales market in 2023 was slower even than 2020. There are still some buyers out there for office investments, but they want a steal. How many office owners are willing to sell in this market where the cost of financing and the concerns about the health of the office sector have weighed down the market so much? Very few. Owner-user sales have slowed as well, though certainly not to the extent that investment sales have slowed. The owner-user market sales volume dipped from the levels of the prior two years, but the biggest difference is that there are more owner-user sale options on the market now, which affected the balance of supply and demand over the second half of 2023. With the Fed signaling multiple rate cuts in 2024, we expect lower interest rates to bolster the overall economy and add to acquisition demand from owner-users as well as investors.

The office market is going through a period of transition, and we are still in the process of discovering where the office market will level out.

Please Contact Us for Further Information

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|-----------------------------|------------------------------|-----------------------------------|----------------------------|---------------------------------|-------------------------------|
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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