

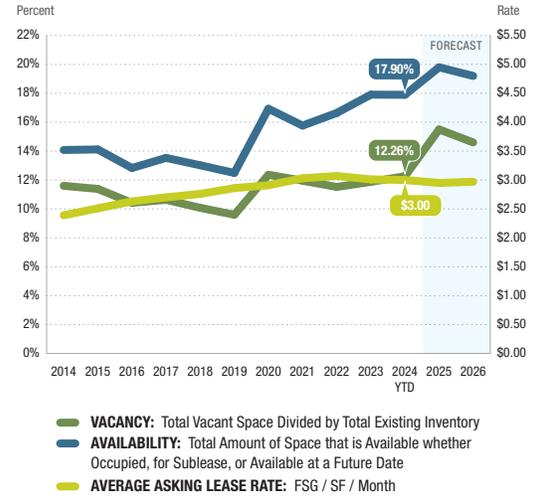
**OVERVIEW.** Leasing and sales volumes remained at low levels compared to historical norms in Q1. The market registered negative net absorption to start the year, and sublease availability in the market remains elevated. The average asking rental rate for the county continues to decrease, and office construction is historically elevated. The shift in workplace dynamics continues to unfold across the office market, and the uncertainty it causes is not expected to dramatically change any time soon.

**VACANCY & AVAILABILITY.** Direct/sublease space (unoccupied) finished Q1 at 12.26%, a 62-basis point increase from the level of a year ago. Available office space being marketed (regardless of occupancy status) was 17.9% of the county's inventory at the end of Q1, an increase of 0.64 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 12.1%. Meanwhile, the availability rate in Downtown is at 38% and the vacancy rate there is greater than 28%. 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 1.4 MSF since Q3 2021, effectively doubling over that span. There were 2.87 MSF of available sublease space at the end of Q1, which represents no significant change over the previous two quarters.

**LEASE RATES.** The average asking full-service-gross (FSG) lease rate per square foot per month in San Diego County was \$3.00 at the end of Q1, a one-cent decrease from the prior quarter's rate, and a 1% decrease from Q1 2024'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. Average asking lease rates have now been decreasing for over a year, as landlords with less-desirable office buildings, or in lower-demand submarkets, are realizing they need to be more aggressive in the way they position their vacancies. But the balance of leverage varies across the county.

**TRANSACTION ACTIVITY.** Leasing volume levels were subdued in Q1. The total office square feet leased in Q1 dipped under 1.2 MSF for the first time since 2020. The number of office leases recorded in Q1 was 369. This was below the quarterly average of 442 transactions recorded between 2022 and 2023, and significantly below the 482 quarterly average of the preceding five years. Office sales volume continued its anemic pace in Q1, with less than \$100 million in sales occurring. This compares to a quarterly average of \$280 million in office sales over the past two years. One of the five largest office sales in Q1 was

### VACANCY, AVAILABILITY & AVERAGE ASKING LEASE RATES



### TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



### Market Statistics

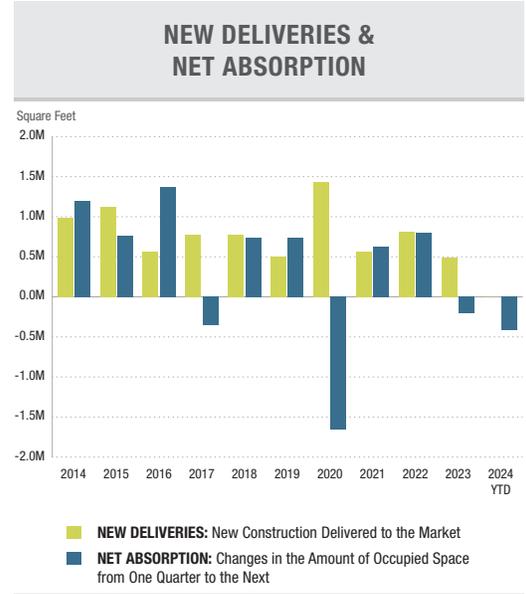
	Change Over Last Quarter	Q1 2024	Q4 2023	Q1 2023	% Change Over Last Year
Vacancy Rate	▲ UP	12.26%	11.87%	11.64%	5.38%
Availability Rate	▬ FLAT	17.90%	17.90%	17.26%	3.70%
Average Asking Lease Rate	▼ DOWN	\$3.00	\$3.01	\$3.04	(1.32%)
Sale & Lease Transactions	▼ DOWN	1,560,188	2,518,535	2,831,789	(44.90%)
Gross Absorption	▼ DOWN	1,432,593	1,920,223	1,735,721	(17.46%)
Net Absorption	▼ NEGATIVE	(414,349)	386,362	(178,618)	N/A

an acquisition of two small office buildings in the Uptown area which were sold to a residential developer for land value. In this lighter demand environment, there is an ongoing trend of obsolete office buildings getting acquired for higher-and-better uses. High interest rates, tight lending standards, and concerns about future demand are acting as major headwinds in the current office sales market.

**ABSORPTION.** There were 414,349 SF of negative net absorption in Q1, more than double the 205,865 SF of negative net absorption recorded in 2023. Going into 2024, the local office market is continuing to be affected by lower leasing volume in 2023 which led to the decrease in the tenant footprint to start this year. The decrease in occupied office space was across all office classes, with the largest portion coming from Class A office buildings.

**CONSTRUCTION.** The office market has 4.4 MSF under construction at the end of Q1, a figure that has remained above 3.5 million for the past three and a half years. Prior to 2020, the last time there were more than 3.5 MSF of office properties under construction in San Diego County was at the start of 2007. Much of the 4.4 MSF under construction at the end of the Q1 will come to the market in 2024, producing the largest annual total in well over a decade. 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. Among the flood of speculative office projects being constructed without prior tenant commitments, Alexandria is under way on a new 131,509 SF build-to-suit office for Scripps Health in the heart of UTC.

**EMPLOYMENT.** The unemployment rate in San Diego County was 4.7% in February 2024, unchanged from a revised 4.7% in April 2023, and above the year-ago estimate of 3.7%. This compares with an unadjusted unemployment rate of 5.6% for California and 4.2% for the nation during the same period. Over the 12-month period between February 2023 and February 2024, San Diego County employment increased by 13,600 jobs, an increase of 0.9%. 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, 303,000 jobs were added in March, exceeding consensus expectations.



## 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 high interest rates, tight lending standards, and paltry demand for offices as the asset category's fundamentals are currently working through a paradigm shift. We do not foresee a significant change to these underlying factors in the coming quarters.

## Significant Transactions

Sales							* Voit Real Estate Services Deal
Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller	
9040 & 9050 Friars Rd.	Mission Valley	B	161,068	\$24,000,000	Intracorp	Westbrook Partners	
9577 Chesapeake Dr.	Kearny Mesa	B	54,000	\$17,000,000	Dyer 18, LLC*	Providence Chesapeake, LLC*	
17075 Camino San Bernardo	Rancho Bernardo	B	26,481	\$8,000,000	Dominguez Channel, LLC	Coseo Trust	
1111 6th Ave.	Downtown	B	70,602	\$7,850,000	1111 Downtown, LLC	1111 6th Ave., LLC	
3714 & 3720 4th Ave.	Uptown/Hillcrest	C	5,422	\$6,825,000	CEDARst Companies	Hilinski Trust	

Leases							* Voit Real Estate Services Deal
Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner	
2385 Northside Dr.	Mission Valley	A	22,266	Jan-2024	CoreLogic	City Office REIT	
101 W. Broadway	Downtown	A	20,788	Feb-2024	Undisclosed	Irvine Company	
1111 Bay Blvd.	Chula Vista	C	19,867	Mar-2024	SD Workforce Partnership	Inland Industries*	
5740 Fleet St.	Carlsbad	B	17,134	Feb-2024	Undisclosed	Regent Properties	
1540 E. Valley Pkwy.	Escondido	C	15,000	Mar-2024	Undisclosed	SD County Farm Bureau	

	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 2024	Square Feet Available	Availability Rate Q1 2024	Average Asking Lease Rate	Net Absorption Q1 2024	Net Absorption 2024	Gross Absorption Q1 2024	Gross Absorption 2024
<b>Downtown</b>													
Downtown	128	13,885,273	2,715,518	550,000	3,947,033	28.43%	6,284,903	37.86%	\$2.70	(145,625)	(145,625)	124,662	124,662
Downtown Total	128	13,885,273	2,715,518	550,000	3,947,033	28.43%	6,284,903	37.86%	\$2.70	(145,625)	(145,625)	124,662	124,662
<b>Central</b>													
City Heights / University	32	1,252,233	0	0	49,948	3.99%	62,472	4.99%	\$2.40	(2,672)	(2,672)	1,500	1,500
Coronado	4	84,540	0	0	0	0.00%	0	0.00%	\$3.25	0	0	0	0
Kearny Mesa	241	11,407,145	0	354,087	907,958	7.96%	1,553,403	13.62%	\$2.93	21,446	21,446	142,559	142,559
Mission Gorge	19	584,866	0	0	3,780	0.65%	7,980	1.36%	\$2.11	(1,478)	(1,478)	0	0
Mission Valley	129	7,498,385	0	1,130,925	1,119,824	14.93%	1,529,310	20.40%	\$2.95	212,972	212,972	382,315	382,315
Old Town / Point Loma	75	2,306,544	0	230,000	234,513	10.17%	291,960	12.66%	\$2.67	(31,787)	(31,787)	23,648	23,648
Park East	15	221,094	0	0	1,385	0.63%	17,113	7.74%	\$1.98	(400)	(400)	0	0
Rose Canyon / Morena	52	1,236,898	0	0	123,665	10.00%	138,575	11.20%	\$2.48	(41,722)	(41,722)	13,567	13,567
Uptown / Hillcrest	77	2,167,183	0	0	126,105	5.82%	190,209	8.78%	\$2.95	19,130	19,130	35,571	35,571
Central Total	644	26,758,888	0	1,715,012	2,567,178	9.59%	3,791,022	14.17%	\$2.88	175,489	175,489	599,160	599,160
<b>I-15 Corridor</b>													
Escondido	73	1,740,262	0	36,614	247,757	14.24%	436,231	25.07%	\$2.33	(36,065)	(36,065)	22,565	22,565
Poway	32	1,402,303	0	0	89,661	6.39%	95,811	6.83%	\$1.97	9,991	9,991	16,787	16,787
Rancho Bernardo	101	6,454,144	0	165,747	883,932	13.70%	1,014,556	15.72%	\$3.19	(54,135)	(54,135)	89,386	89,386
Scripps Ranch	49	2,732,782	0	356,000	442,984	16.21%	343,785	12.58%	\$2.91	(15,331)	(15,331)	10,802	10,802
I-15 Corridor Total	255	12,329,491	0	558,361	1,664,334	13.50%	1,890,383	15.33%	\$2.93	(95,540)	(95,540)	139,540	139,540
<b>North County Coastal</b>													
Carlsbad	165	7,062,290	0	50,000	961,930	13.62%	1,555,220	22.02%	\$2.78	(90,914)	(90,914)	69,913	69,913
Del Mar Heights / Carmel Valley	82	5,708,049	963,138	1,635,627	758,590	13.29%	1,038,376	15.57%	\$4.66	(125,622)	(125,622)	52,016	52,016
North Beach Cities	112	2,757,739	0	25,456	257,752	9.35%	331,598	12.02%	\$3.98	(29,412)	(29,412)	38,343	38,343
North County Total	359	15,528,078	963,138	1,711,083	1,978,272	12.74%	2,925,194	17.74%	\$3.40	(245,948)	(245,948)	160,272	160,272
<b>North City</b>													
Governor Park	19	768,583	0	0	78,215	10.18%	85,239	11.09%	\$2.85	(156)	(156)	8,669	8,669
La Jolla	44	1,350,248	0	0	184,419	13.66%	235,992	17.48%	\$3.54	14,243	14,243	33,895	33,895
Miramar	33	1,508,065	0	0	96,819	6.42%	609,185	40.40%	\$2.37	(22,400)	(22,400)	22,307	22,307
Sorrento Mesa	106	8,729,290	0	1,232,000	579,258	6.64%	1,056,311	12.10%	\$3.02	(52,183)	(52,183)	27,955	27,955
Sorrento Valley	21	610,215	0	0	131,738	21.59%	75,105	12.31%	\$2.70	(28,392)	(28,392)	0	0
Torrey Pines	43	3,252,658	0	309,094	40,505	1.25%	158,992	4.89%	\$4.30	9,806	9,806	15,506	15,506
UTC	91	9,236,630	558,183	400,000	1,019,522	11.04%	1,678,002	17.13%	\$3.89	(53,638)	(53,638)	157,995	157,995
North City Total	357	25,455,689	558,183	1,941,094	2,130,476	8.37%	3,898,826	14.99%	\$3.46	(132,720)	(132,720)	266,327	266,327
<b>Southern &amp; Eastern Areas</b>													
Chula Vista	92	2,967,536	168,000	1,850,000	126,977	4.28%	291,962	9.31%	\$2.61	(6,930)	(6,930)	21,658	21,658
National City	16	583,906	0	0	5,007	0.86%	53,859	9.22%	\$2.41	2,148	2,148	4,884	4,884
South San Diego	14	350,710	0	0	55,082	15.71%	54,299	15.48%	\$4.72	1,120	1,120	5,358	5,358
Southeast San Diego	13	481,066	0	290,000	2,235	0.46%	2,235	0.46%	\$2.33	18,226	18,226	18,226	18,226
East County	153	3,813,809	0	0	99,832	2.62%	225,755	5.92%	\$2.28	27,048	27,048	48,372	48,372
Southern & Eastern Areas Total	288	8,197,027	168,000	2,140,000	289,133	3.53%	628,110	7.51%	\$2.40	41,612	41,612	98,498	98,498
<b>Highway 78 Corridor</b>													
Oceanside	62	1,491,916	0	352,635	168,422	11.29%	181,752	12.18%	\$2.54	(16,646)	(16,646)	14,868	14,868
San Marcos	38	1,482,054	0	1,488,285	68,709	4.64%	79,333	5.35%	\$2.37	(1,778)	(1,778)	13,441	13,441
Vista	51	1,255,156	0	0	232,471	18.52%	146,921	11.71%	\$2.30	6,807	6,807	15,825	15,825
Highway 78 Corridor Total	151	4,229,126	0	1,840,920	469,602	11.10%	408,006	9.65%	\$2.41	(11,617)	(11,617)	44,134	44,134
Class A	302	40,258,652	4,404,839	7,666,179	6,487,119	16.11%	10,658,097	23.86%	\$3.37	(283,529)	(283,529)	534,789	534,789
Class B	1,258	52,123,492	0	2,790,291	5,623,548	10.79%	8,020,650	15.39%	\$2.79	(115,243)	(115,243)	755,067	755,067
Class C	622	14,001,428	0	0	935,361	6.68%	1,147,697	8.20%	\$2.24	(15,577)	(15,577)	142,737	142,737
<b>San Diego County Total</b>	<b>2,182</b>	<b>106,383,572</b>	<b>4,404,839</b>	<b>10,456,470</b>	<b>13,046,028</b>	<b>12.26%</b>	<b>19,826,444</b>	<b>17.90%</b>	<b>\$3.00</b>	<b>(414,349)</b>	<b>(414,349)</b>	<b>1,432,593</b>	<b>1,432,593</b>

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



## Too Broad a Brush?

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The end of Q1 marked the four-year anniversary of the first COVID-19 shutdown and concerns over the ailing health of the office market persist. But we must be careful not to paint the office market with too broad a brush, lest we fail to acknowledge the cyclical nature of markets and the variability in market performance depending upon building class and location. This is particularly true in San Diego given its wide variety of office product in distinct submarkets.

San Diego's diverse tenant base in the "innovation" sectors and the ongoing conversion of office buildings to accommodate the growing life sciences industry are major elements that will contribute to the market recovery over the long term. Conversely, landlords downtown and in less-desirable suburban submarkets find themselves in the hot seat due to rising vacancy and the looming increase in the number of loan maturities (scheduled for 2024 and 2025). This has motivated landlords to offer more generous incentives and to build out new amenities to attract quality tenants. They also have increased their marketing efforts to the brokerage community through open houses and bonus compensation, hoping to generate traffic at their projects.

This trend is expected to persist as vacancy in 2024 is expected to rise further due to lower transaction velocity coupled with the delivery of another 1.5 MSF of new space downtown. The situation is further complicated by the fact that many active tenants are downsizing and opting for shorter lease terms due to the uncertainty created by the hybrid work model that is so popular with employees looking for more work/life balance.

The anticipation of an economic boost from multiple Fed rate cuts has waned, as the central bank has maintained its restrictive monetary policy due to persistent inflation. Thus, landlords and tenants will need to confront the reality of current circumstances to move forward. Landlords must acknowledge that leaving their properties vacant and waiting for better times is not a feasible approach. Depending on their circumstances, they will be pushed to drop rates, offer more "spec" suites to capture immediate requirements, invest in popular amenities and upgrade common areas to stay competitive. Those tenants who are clear on their needs will benefit from executing longer-term leases and using their negotiating advantage to push for even more concessions.

Painting with too broad a brush overlooks the opportunities amidst the challenges. Through an informed and thorough decision-making process, both landlords and tenants can position themselves to successfully navigate the evolving office landscape.

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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