

# MARKETBEAT

## San Diego

### Industrial Q2 2018



#### SAN DIEGO INDUSTRIAL

##### Economic Indicators

|                        | Q2 17 | Q2 18 | 12-Month Forecast |
|------------------------|-------|-------|-------------------|
| San Diego Employment   | 1.51M | 1.53M | ▲                 |
| San Diego Unemployment | 3.7%  | 2.9%  | ▼                 |
| U.S. Unemployment      | 4.3%  | 3.8%  | ▼                 |

May 2017/2018 used to represent Q2 for San Diego

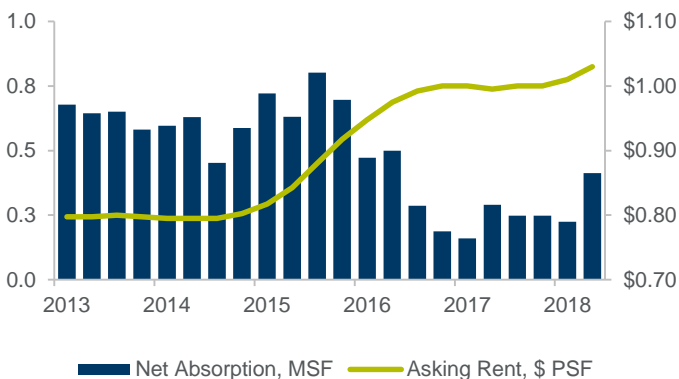
##### Market Indicators (All Product Types)

|                            | Q2 17  | Q2 18  | 12-Month Forecast |
|----------------------------|--------|--------|-------------------|
| Overall Vacancy            | 5.1%   | 4.9%   | ▼                 |
| Direct Net Absorption (sf) | -122K  | 632K   | ▲                 |
| Under Construction (sf)    | 1.2M   | 2.6M   | ▼                 |
| Average Asking Rent        | \$0.98 | \$1.06 | ▲                 |

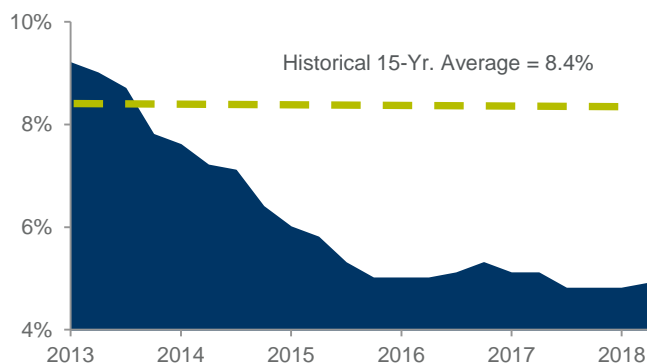
\*Rental rates reflect triple net asking \$psf/monthly

##### Direct Net Absorption/Asking Rent (Triple Net, Monthly)

###### 4-QTR TRAILING AVERAGE



##### Overall Vacancy – All Product Types, incl. Sublease



## Economy

The San Diego employment market continued to record job growth, adding 32,500 jobs (+2.2%) year-over-year through May 2018. During the same time period, the unemployment rate decreased 80 basis points (bps), dropping to 2.9%. The current rate is 300 bps below the 28-year average of 5.9%.

All employment sectors are expected to grow at a combined growth rate of 1.7% in 2018.<sup>2</sup> San Diego's economy of \$215.3 billion as measured by gross regional product is forecasted to grow an additional 4.3% in 2018 and 2.4% in 2019, above its 10-year average of 2.3%.<sup>3</sup>

Continuing to bode well for the industrial marketplace is that economic activity in the manufacturing sector again expanded in June, with an ISM index reading of 60.2% compared to 58.7% in May. An ISM reading above 50% indicates that the manufacturing economy is generally expanding; below 50% indicates that it is generally contracting. The overall economy grew for the 110<sup>th</sup> consecutive month in the U.S. Of the 18 manufacturing industries, 17 reported growth in June of 2018.

## Market Overview

At the close of Q2 2018, industrial vacancy (including sublease) in the San Diego marketplace stood at 4.9%, 10 bps higher than last quarter and 20 bps lower compared to a year ago. Overall vacancy has remained below 5% for the past four consecutive quarters despite the 1.6 million square feet (msf) delivered over the last year.

Across the region, the market is the tightest for manufacturing space with vacancy at 3.3%, a decrease of 50 bps from a year ago. Vacancy (including sublease) for incubator multi-tenant space (IMT) now stands at 4.3% countywide versus 4.7% twelve months ago. Distribution center space vacancy currently stands at 4.4%, a decrease of 40 bps from last year. Meanwhile, vacancy for R&D product has increased 80 bps over the last year and now stands at 8.9%.

After a relatively quiet first quarter, tenant activity in San Diego's industrial sector ramped up aggressively in Q2 2018, bolstered by the construction completion of several large pre-leased projects. This quarter was San Diego's 27<sup>th</sup> of the last 28 quarters showing occupancy gains (all except for Q2 2017). Tenants absorbed 371,000 sf in North County submarkets, 405,400 sf in Central County yet returned 144,300 sf to South County – most of it to the Chula Vista submarket, resulting in an overall positive net absorption of 632,100 sf countywide in Q2 2018.

Poway's occupancy grew nearly 299,000 sf, making it the most active submarket in Q2 2018. General Atomics, taking occupancy of its 303,000 sf space across three new buildings at Ridgeview Business Park, contributed to the growth of the submarket. Escondido's occupancy grew by 245,000 sf mainly due to Veritiv moving into its new 212,000-sf facility. Carlsbad had a strong quarter, absorbing over 184,000 sf; HM Electronics moved into its new 140,000-sf MFG building and Full Swing Golf took occupancy of 29,000 sf. In Q2, several submarkets recorded occupancy gains

of over 100,000 sf: Escondido (+245,000 sf), Carlsbad (+184,000 sf), Torrey Pines (+171,000 sf) and San Marcos (+168,000 sf).

Among submarkets where tenants returned space in Q2 was Vista which recorded a negative (160,000) sf of net absorption as a result of Vista Industrial Products leaving their location at 1395 Park Center Dr. East County returned 154,000 sf, and Chula Vista gave back 133,000 sf to the market.

Average asking rent for all product types combined was \$1.06 per square foot (psf) per month on a triple net basis compared to \$1.04 psf last quarter and \$0.98 psf a year ago. The average rent at \$1.06 psf as of Q2 2018 is at the highest level we have ever tracked and has increased 15.2% since the end of the last recession (\$0.92 psf Q2 2009). Since then, the average rent has increased the most for IMT space (+27.7%) compared to other product types, followed by R&D (+17.6%), distribution (+17.2%) and manufacturing (+14.6%).

Year-over-year, average rent for MFG has increased 10.6% to \$0.94 per month and rent for IMT space has increased 8.1% to \$1.20 psf per month. This trend is driven by the demand for modern and specialized space for manufacturers and small industrial users. In response, we are not only seeing asking rental rates increase but also an increasing trend of renovations of older product to make them more appealing to tenants.

## COUNTYWIDE DIRECT VACANCY AT 4.1% WHILE AVERAGE ASKING RENT INCREASED 8.2% YEAR-OVER-YEAR

There are currently 36 industrial buildings totaling nearly 2.6 msf under construction. However, with a low countywide direct vacancy of 4.1%, it is unlikely that this supply will satisfy demand for new, functional space. According to our calculations, 57% of industrial space countywide was built before 1990 and just 3.0% of space was built after 2010. This means that more than half of leasable industrial buildings in San Diego lack modern design features for today's demanding tenants who require high-functioning and efficiently designed product. This trend has led to an increase in speculative (SPEC) construction as developers and landlords become more bullish on their prospect of leasing new space. Of the space that is currently under construction, 80% (or 2.1 msf) is SPEC development.

Of the nearly 1.2 msf (or nine buildings) of new construction that was delivered in Q2 2018, 70% was pre-leased to tenants. The tenants bolstering this new absorption include General Atomics (302,500 sf), Veritiv (212,000 sf), Scripps Research Institute (171,000 sf) and HM Electronics (140,000 sf). Moreover, an additional 1.7 msf is expected to be completed by the end of 2018, and 920,000 sf is expected to be completed by 2019.

Several projects across the county officially broke ground during Q2 2018. IPT broke ground on 118,000 sf at Pacific Coast Collection and it is expected to be completed by 2019. Also, Techbilt Properties started construction on several buildings in Poway Tech Center totaling 83,000 sf (15,000 sf is pre-leased). Badiee Development started another project at Keystone Victory Industrial Park: two speculative MFG buildings, totaling 78,000 sf. In Otay Mesa, a MFG building pre-leased to Mission Imprintables broke ground this quarter.

Sources: <sup>1</sup>www.bls.gov <sup>2</sup>bea.gov GDP as of 2016. <sup>3</sup>Moody's Analytics economy.com

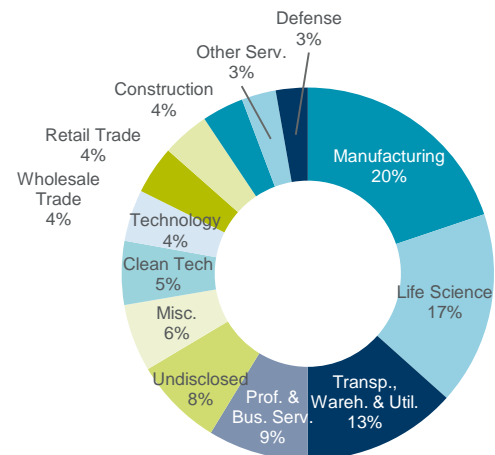
## Direct Vacancy vs. Unemployment Rate

DECLINE IN VACANCY CORRELATES DECLINE IN UNEMPLOYMENT



## Tenant Demand by Industry Type

TOP 3 INDUSTRY SECTORS ACCOUNT FOR 50% OF TOTAL DEMAND



## Outlook

- With just 27% of 2018/2019's expected deliveries pre-leased at this time, we anticipate a momentary uptick in vacancy as those SPEC projects are delivered vacant. However, with the pending deals already being negotiated on these projects and the additional fervent demand we do not expect this new, highly functional space to be vacant long.
- There are 4.1 msf of active tenant requirements for space over the next 24 months. Over 51% or 2.1 msf of these users are in the earliest stages of their pursuit, having opened their search or toured the market. While not all of the tenants in the market will transact in the short-term, these levels provide a barometer of leasing activity in quarters to follow. Additionally, those tenants in early stages of their pursuit may line up their timing with the delivery of new construction.

| SUBMARKET      | TOTAL BLDGS  | INVENTORY (SF)     | SUBLET VACANT (SF) | DIRECT VACANT (SF) | OVERALL VACANCY RATE | CURRENT DIRECT NET ABSORPTION (SF) | YTD DIRECT NET ABSORPTION (SF) | UNDER CNSTR (SF) | AVERAGE ASKING RENT (ALL Types) |
|----------------|--------------|--------------------|--------------------|--------------------|----------------------|------------------------------------|--------------------------------|------------------|---------------------------------|
| North County   | 2,026        | 52,336,010         | 503,117            | 2,574,818          | 5.9%                 | 371,098                            | 492,395                        | 1,445,869        | \$0.96                          |
| Central County | 2,284        | 80,914,278         | 728,801            | 2,616,179          | 4.1%                 | 405,352                            | 311,014                        | 738,382          | \$1.32                          |
| South County   | 621          | 30,246,403         | 75,583             | 1,518,316          | 5.2%                 | (144,372)                          | (82,719)                       | 408,304          | \$0.70                          |
| <b>TOTAL</b>   | <b>4,931</b> | <b>163,496,691</b> | <b>1,307,501</b>   | <b>6,709,313</b>   | <b>4.9%</b>          | <b>632,078</b>                     | <b>720,690</b>                 | <b>2,592,555</b> | <b>\$1.06</b>                   |
| R&D            | 838          | 33,756,483         | 584,269            | 2,444,580          | 8.9%                 | 176,056                            | 17,334                         | 540,426          | \$1.47                          |
| MFG            | 2,458        | 64,451,786         | 269,089            | 1,864,959          | 3.3%                 | (35,407)                           | 176,486                        | 858,674          | \$0.94                          |
| IMT            | 628          | 20,630,944         | 155,677            | 732,317            | 4.3%                 | 11,813                             | (90,016)                       | 0                | \$1.20                          |
| DIST           | 1,007        | 44,657,478         | 298,466            | 1,667,457          | 4.4%                 | 479,616                            | 616,886                        | 1,193,455        | \$0.75                          |
| <b>TOTAL</b>   | <b>4,931</b> | <b>163,496,691</b> | <b>1,307,501</b>   | <b>6,709,313</b>   | <b>4.9%</b>          | <b>632,078</b>                     | <b>720,690</b>                 | <b>2,592,555</b> | <b>\$1.06</b>                   |

Rental rates reflect triple net (NNN) asking rents \$psf/monthly. Vacancy rate includes direct and sublease. Net absorption excludes sublease.

## Key Lease Transactions Q2 2018

| PROPERTY                            | SF      | TENANT                | LANDLORD           | TYPE      | SUBMARKET  |
|-------------------------------------|---------|-----------------------|--------------------|-----------|------------|
| Citracado Pkwy. & Harmony Grove Rd. | 273,000 | Stone Brewing Company | Dentt Properties   | Direct    | Escondido  |
| 655 Gateway Center Way              | 86,254  | BAE Systems           | JTF Enterprises    | Renewal   | Downtown   |
| 14311 Kirkham Way                   | 80,500  | General Atomics       | HCP, Inc.          | Expansion | Poway      |
| 237 Via Vera Cruz                   | 80,257  | NEOTech Manufacturing | Bixby Land Company | Renewal   | San Marcos |
| 14177 Kirkham Way                   | 70,000  | General Atomics       | HCP, Inc.          | Expansion | Poway      |

## Key Sale Transactions Q2 2018

| PROPERTY                         | SF      | BUYER                                | SELLER                              | PRICE / \$PSF        | SUBMARKET     |
|----------------------------------|---------|--------------------------------------|-------------------------------------|----------------------|---------------|
| 10770 Wateridge Cir.             | 180,960 | Bollert Lebeau                       | John Hancock Life Insurance Co.     | \$28,775,000 / \$159 | Sorrento Mesa |
| 260 S. Pacific St.               | 170,685 | Penwood Real Estate Investment Mgmt. | Hager Pacific Industrial Properties | \$21,600,000 / \$127 | San Marcos    |
| 4039 Calle Platino               | 143,274 | Rexford Industrial                   | Cal-Sorrento Ltd.                   | \$20,000,000 / \$140 | Oceanside     |
| 660 & 664 N Twin Oaks Valley Rd. | 96,993  | Rexford Industrial                   | DCT Industrial Trust, Inc.          | \$14,000,000 / \$144 | San Marcos    |
| 1320 Grand Ave.                  | 52,750  | Focus Real Estate LP                 | Palomar Industrial Park Associates  | \$6,885,000 / \$131  | San Marcos    |

## Under Construction Q2 2018 — selected projects 75,000 sf+

| PROPERTY  | RELEASED |         |      | ADDRESS   | PRODUCT TYPE | ESTIMATED COMPLETION | SUBMARKET    |
|---|----------|---------|------|---|--------------|----------------------|--------------|
|   | SF       | SF      | %    |   |              |                      |              |
| Carlsbad Oaks North - Pacific Vista Commerce Ctr. | 405,907  | 116,000 | 29%  | 2800-2821 Whiptail Loop                         | DIST         | 2018/2019            | Carlsbad     |
| Carlsbad Raceway - Distribute                     | 277,351  | 0       | 0%   | 3261 & 3266 Lionshead Ave                       | DIST         | 2018                 | Carlsbad     |
| Otay Logistics Center                             | 268,454  | 24,839  | 9%   | 7110-7112 Enrico Fermi Pl.                      | MFG          | 2018                 | Otay Mesa    |
| BioLegend Campus                                  | 234,719  | 234,719 | 100% | 8928-8959 Terman Ct.                            | R&D          | 2019                 | Miramar      |
| Production  | 222,028  | 0       | 0%   | 2946-2954 Norman Strasse Rd./195 Bosstick Blvd. | MFG          | 2019                 | San Marcos   |
| Carlsbad Oaks North - Create                      | 146,108  | 0       | 0%   | 2827 Whiptail Loop                              | R&D          | 2018                 | Carlsbad     |
| Center for Novel Therapeutics                     | 137,500  | 70,030  | 51%  | 9310 Athena Cir.                                | R&D          | 2019                 | Torrey Pines |
| Pacific Coast Collection                          | 117,528  | 0       | 0%   | 1291 Rocky Point Dr.                            | DIST         | 2019                 | Oceanside    |
| Carlsbad Oaks North - Lot 17                      | 116,097  | 0       | 0%   | 2856 Whiptail Loop                              | DIST         | 2018                 | Carlsbad     |
| 4400 Ruffin Rd.                                   | 106,000  | 0       | 0%   | 4400 Ruffin Rd.                                 | DIST         | 2018                 | Kearny Mesa  |
| Carlsbad Oaks North - San Diego Hat Co.           | 83,000   | 83,000  | 100% | Whiptail Loop                                   | MFG          | 2018                 | Carlsbad     |
| Poway Tech Center                                 | 82,742   | 15,376  | 19%  | Flint Pl./Paine Pl./Dearborn Pl.                | MFG          | 2018                 | Poway        |
| Siempre Viva Business Park - Bldg. 17             | 79,050   | 0       | 0%   | 8500 Kerns St.                                  | DIST         | 2018                 | Otay Mesa    |
| Keystone Victory Industrial Park                  | 77,850   | 0       | 0%   | Keystone Way                                    | MFG          | 2019                 | Vista        |

## INDUSTRIAL SUBMARKETS SAN DIEGO



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