

MARKETBEAT

San Diego

Industrial Q3 2018



SAN DIEGO INDUSTRIAL

Economic Indicators

| | Q3 17 | Q3 18 | 12-Month Forecast |
|------------------------|-------|-------|-------------------|
| San Diego Employment | 1.52M | 1.53M | ▲ |
| San Diego Unemployment | 4.3% | 3.4% | ▼ |
| U.S. Unemployment | 4.4% | 3.9% | ▼ |

August 2017/2018 used to represent Q3 for San Diego

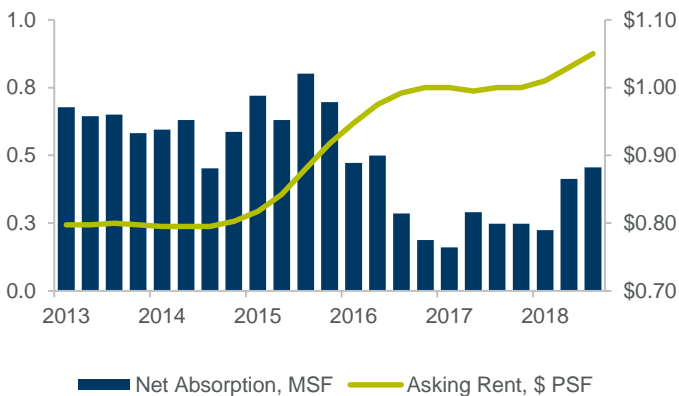
Market Indicators (All Product Types)

| | Q3 17 | Q3 18 | 12-Month Forecast |
|----------------------------|--------|--------|-------------------|
| Overall Vacancy | 4.8% | 5.0% | ▼ |
| Direct Net Absorption (sf) | 649K | 819K | ▲ |
| Under Construction (sf) | 2.4M | 2.3M | ▼ |
| Average Asking Rent | \$0.99 | \$1.07 | ▲ |

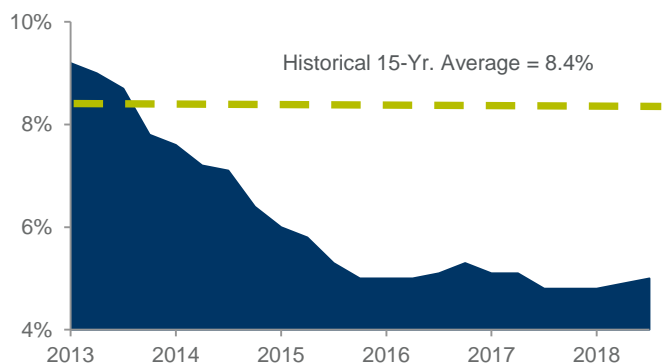
*Rental rates reflect triple net asking \$psf/monthly

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 24,100 jobs (+1.7%) year-over-year through August 2018.¹ During the same time period, the unemployment rate decreased 90 basis points (bps), dropping to 3.4%. Also worth noting, the current rate is 250 bps below the 28-year average of 5.9%.

All employment sectors are expected to grow at a combined growth rate of 1.9% in 2018 and 1.4% in 2019. San Diego's economy of \$231.8 billion² as measured by gross regional product is forecasted to grow an additional 4.2% in 2018 and 2.9% in 2019, above its 10-year average of 2.6%.³

Market Overview

At the close of Q3 2018, industrial vacancy (including sublease) in the San Diego marketplace stood at 5.0%, 10 bps higher than last quarter and 20 bps higher compared to a year ago. Overall vacancy has remained at or below 5% for the past five consecutive quarters despite the 1.9 million square feet (msf) delivered in the last year.

Despite a slight year-over-year increase in the overall vacancy rate, direct vacancy (which represents space for which a landlord receives no rent) has remained the same. In fact, over the last year, all vacancy growth has been due to an increase in sublease availability, which has grown in share by nearly 400,000 square feet (sf) resulting in a 20 bps increase in sublease vacancy.

Across the region, the market is the tightest for manufacturing space with vacancy (including sublease) at 3.3%, an increase of 20 bps from a year ago. Vacancy for incubator multi-tenant space (IMT) now stands at 4.1% countywide versus 4.0% twelve months ago. Distribution space vacancy currently stands at 4.9%, an increase of 10 bps from last year. Meanwhile, vacancy for R&D product has increased 20 bps over the last year and now stands at 8.8%.

After a relatively quiet first quarter, tenant activity in San Diego's industrial sector ramped up aggressively in Q2 and Q3 2018 and was bolstered by the delivery of several large pre-leased construction projects. This quarter was San Diego's 28th of the last 29 quarters showing occupancy gains - all except for Q2 2017. In Q3 2018, tenants absorbed 389,100 sf in North County submarkets, 298,900 in South County and 130,500 sf in Central County.

Demonstrating the county's demand for new, state-of-the-art industrial space, three of this quarter's top four move-ins were at new construction completed this quarter. These include Zucarmex (a sugar producer and distributor), who moved into 199,000 sf at the Otay Logistics Center in Otay Mesa. Additionally, Coleman Worldwide Moving moved into 62,000 sf of distribution space at 13610 Stowe Dr. in Poway.

Other large move-ins at existing buildings included Accutek Packaging Equipment Companies, Inc. (purchased a 127,000-sf R&D building in Vista), VIT Products (leased 55,000 sf of manufacturing space in Escondido) and Ophthonix, Inc. (leased 50,000 sf of manufacturing space in Vista).

Compared to this quarter's move-ins, which consisted of organic expansions as well as pre-leased new construction, this quarter's move-outs were minimal. Machine Vision Products moved out of 60,000 sf in Carlsbad, General Atomics gave back 39,000 sf in Rancho Bernardo (although they have expanded significantly in other areas this year) and Steren Electronics moved out of 38,000 sf in Sorrento Mesa.

Average asking rent for all product types combined was \$1.07 per square foot (psf) per month on a triple net basis compared to \$1.06 psf last quarter and \$0.99 psf a year ago. The average rent at \$1.07 psf as of Q3 2018 is the highest level we have ever tracked and has increased 16.3% since the end of the last recession (\$0.92 psf Q2 2009). Since then, the average rent has increased the most for IMT space (+28.7%) compared to other product types, followed by distribution (+25.0%), R&D (+18.4%) and manufacturing (+15.9%). This trend is driven by the demand for modern and specialized space for 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.

There are currently 33 industrial buildings totaling nearly 2.3 msf under construction. However, with a low countywide direct vacancy of 4.0%, 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, 74% (or 1.7 msf) is SPEC development.

COUNTYWIDE DIRECT VACANCY AT 4.0% WHILE AVERAGE ASKING RENT INCREASED 8.1% YEAR-OVER-YEAR

This quarter nearly 640,000 sf (or six buildings) of new construction received its Certificate of Occupancy, bringing 2018 YTD new deliveries total to over 1.8 msf. An additional 1.3 msf is expected to be completed by the end of 2018, and an additional 949,000 sf or more is expected to be completed in 2019.

Across Q3 2018 deliveries, 58% was pre-leased to tenants. The tenants bolstering this new absorption included previously mentioned Zucarmex, Coleman Worldwide Moving. Additionally, Bedrosians Tile & Stone moved into 30,000-sf distribution building in Miramar, and MSE Express America, Inc. took occupancy of 25,000 sf of distribution space in Otay Mesa. Also delivered was 3261 Lionshead (Distribute) where Reser's Fine Foods pre-leased 56,000 sf.

In Q3 18, the following projects broke ground on construction: 2651 Drucker Ln. within the Frontera Business Park in Otay Mesa will be a 174,000-sf build-to-suit (BTS) for Trident Maritime Systems/US Joiner. Also three buildings, totaling 278,000 sf within the Pacific Coast Collection in Oceanside, will be built speculatively (SPEC).

Sources: ¹www.bls.gov ²bea.gov GDP as of 2017. ³Moody's Analytics economy.com

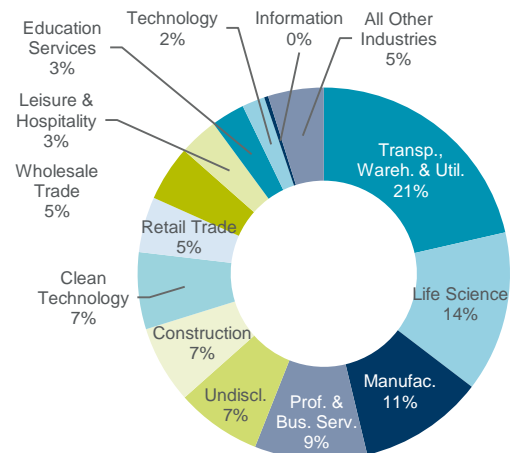
Direct Vacancy vs. Unemployment Rate

DECLINE IN VACANCY CORRELATES DECLINE IN UNEMPLOYMENT



Tenant Demand by Industry Type

TOP 3 INDUSTRY SECTORS ACCOUNT FOR 46% OF TOTAL DEMAND



Outlook

- While we do not expect any dramatic shifts in the near future as direct vacancy remains historically low and the demand for space continues to be strong, the increase in space available for sublease has traditionally been a precursor to market corrections as tenants adjust their footprint. We will continue to watch the changes in overall vacancy.
- There are 3.2 msf of active tenant requirements for space over the next 24 months. Over 50% or 1.6 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 | 2,028 | 52,613,361 | 616,712 | 2,463,046 | 5.9% | 389,123 | 881,518 | 1,335,136 | \$0.98 |
| Central County | 2,282 | 80,931,716 | 816,849 | 2,577,148 | 4.2% | 130,553 | 441,567 | 646,860 | \$1.30 |
| South County | 623 | 30,514,857 | 179,191 | 1,487,824 | 5.5% | 298,946 | 216,227 | 314,050 | \$0.75 |
| TOTAL | 4,933 | 164,059,934 | 1,612,752 | 6,528,018 | 5.0% | 818,622 | 1,539,312 | 2,296,046 | \$1.07 |
| R&D | 838 | 33,756,483 | 685,924 | 2,293,062 | 8.8% | 151,518 | 168,852 | 540,426 | \$1.48 |
| MFG | 2,456 | 64,401,702 | 440,181 | 1,678,151 | 3.3% | 186,808 | 363,294 | 590,095 | \$0.95 |
| IMT | 628 | 20,630,944 | 159,465 | 675,369 | 4.1% | 56,948 | -33,068 | 0 | \$1.21 |
| DIST | 1,011 | 45,270,805 | 327,182 | 1,881,436 | 4.9% | 423,348 | 1,040,234 | 1,165,525 | \$0.80 |
| TOTAL | 4,933 | 164,059,934 | 1,612,752 | 6,528,018 | 5.0% | 818,622 | 1,539,312 | 2,296,046 | \$1.07 |

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

Key Lease Transactions Q3 2018

| PROPERTY | SF | TENANT | LANDLORD | TRANSACTION TYPE | SUBMARKET |
|-----------------------|---------|---|---------------------------------|------------------|-----------|
| 7112 Enrico Fermi Pl. | 198,858 | Zucarmex USA | IPT Otay Logistics Center LLC | Direct | Otay Mesa |
| 2651 Drucker Ln. | 174,200 | Trident Maritime Systems / US Joiner | TIAA-Cref | Direct | Otay Mesa |
| 2600 Melksee St. | 121,970 | BD Biosciences/Carefusion Manufacturing LLC | Murphy Development Company | Direct | Otay Mesa |
| 7130 Miramar Rd. | 114,150 | Northrop Grumman Innovation Systems, Inc. | PPF Industrial Miramar Road, LP | Direct | Miramar |
| 2882 Whiptail Loop | 103,741 | Zodiac Pool Systems, LLC | RAF Pacifica Group | Direct | Carlsbad |

Key Sale Transactions Q3 2018

| PROPERTY | SF | BUYER | SELLER | PRICE / \$PSF | SUBMARKET |
|---|---------|--|------------------------------------|----------------------|---------------|
| Otay Mesa Portfolio | 703,845 | BKM Capital Partners | Stockbridge Capital Group | \$64,905,000 / \$92 | Otay Mesa |
| 5960 Pacific Mesa Ct., 5985 & 5995 Pacific Center Blvd. | 288,652 | Sukut Real Properties LLC | Christopher D Sickels & Associates | \$24,000,000 / \$83 | Sorrento Mesa |
| 2980 Scott St. | 126,715 | Accutek Packaging Equipment Cos., Inc. | Garrison Investment Group | \$12,260,000 / \$97 | Vista |
| 8851-8877 Kerns St. | 115,290 | EastGroup Properties, Inc. | Otay Mesa Sales, Inc. | \$13,834,800 / \$120 | Otay Mesa |
| 3860 Calle Fortunada | 62,280 | Joe Hernon | Carleton Management, Inc. | \$11,075,000 / \$178 | Kearny Mesa |

Under Construction Q3 2018 — selected projects 75,000 sf+

| PROPERTY | PRELEASED | | | ADDRESS | PRODUCT TYPE | ESTIMATED COMPLETION | SUBMARKET |
|---|-----------|---------|------|-----------------------------------|--------------|----------------------|--------------|
| | SF | SF | % | | | | |
| Carlsbad Oaks North Pacific Vista Commerce Ctr. | 412,385 | 116,000 | 28% | 2800-2820 Whiptail Loop | DIST | 2018/2019 | Carlsbad |
| Pacific Coast Collection | 277,793 | 0 | 0% | 1291, 1322 & 1339 Rocky Point Dr. | DIST | 2019 | Oceanside |
| BioLegend Campus - Bldgs. 1-4 | 234,719 | 234,719 | 100% | 8298-8959 Terman Ct. | R&D | 2019 | Miramar |
| Production | 222,028 | 34,701 | 0% | Norman Strasse Rd./Bosstick Blvd. | MFG | 2018 | San Marcos |
| Frontera Business Park | 174,200 | 174,200 | 100% | 2651 Drucker Ln. | DIST | 2018 | Otay Mesa |
| 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 |
| Carlsbad Oaks North - Lot 17 | 116,097 | 116,097 | 100% | 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. / Dearborn Pl. | MFG | 2019 | Poway |
| Siempre Viva Business Park - Bldg. 17 | 79,050 | 0 | 0% | 8500 Kerns St. | DIST | 2018 | Otay Mesa |

INDUSTRIAL SUBMARKETS SAN DIEGO



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Jolanta Campion

Director of Research, San Diego & Nevada
jolanta.campion@cushwake.com

Alexa Kruthers

Research Analyst
alexa.kruthers@cushwake.com

4747 Executive Drive, Suite 900
San Diego, CA 92121
Tel: 858.625.5235
Fax: 858.630.6320
CA License 01880493

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