

SAN DIEGO OFFICE

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

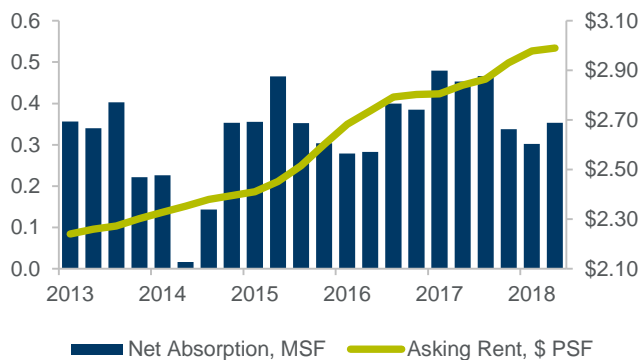
Market Indicators (All Classes)

	Q2 17	Q2 18	12-Month Forecast
Overall Vacancy	14.1%	12.6%	▼
Direct Net Absorption (sf)	95k	276k	▲
Under Construction (sf)	1.6M	2.3M	▲
Average Asking Rent	\$2.93	\$3.02	▲

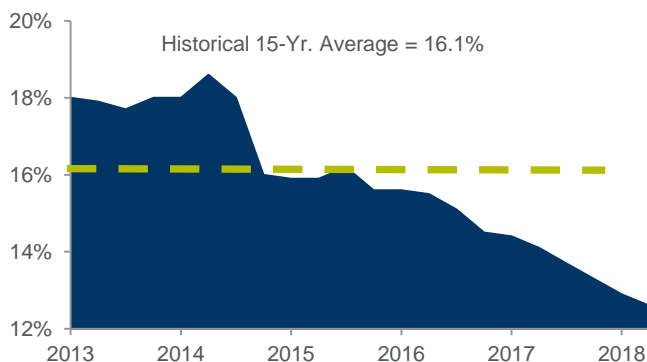
\*Rental rates reflect full service asking \$psf/monthly

Direct Net Absorption/Asking Rent (Full Service, Monthly)

4-QTR TRAILING AVERAGE



Overall Vacancy – All Classes, 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.<sup>1</sup> Of the 32,500 jobs added, 14,900 (or 46%) were office jobs consisting of two sectors: professional and business services and financial activities. During the same time period, the unemployment rate decreased 80 basis points (bps), dropping to 2.9%. Also worth noting, 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. San Diego's economy of \$215.3 billion<sup>2</sup> as measured by gross regional product is forecasted to grow an additional 4.3% in 2018, above its 10-year average of 2.3%.<sup>3</sup>

Market Overview

San Diego's office vacancy was 12.6% in Q2 2018, down 30 bps from last quarter and 150 bps from a year ago. This was the ninth consecutive quarter of decreasing vacancy.

Occupancy grew by 276,400 square feet (sf) across all classes, bringing year-to-date net absorption to 342,000 sf. The Q2 2018 quarterly activity was the best Q2 in five years (+276,400 sf) and much stronger compared to the Q1 2018 activity (+65,500 sf). This was the 16<sup>th</sup> consecutive quarter of occupancy gains.

Occupancy growth, however, was disproportionate by region as tenants absorbed 252,000 sf across all classes in Central County submarkets, 71,000 sf in South County submarkets, but returned 46,600 sf to North County submarkets.

At the end of Q2 2018, overall vacancy was the lowest in South County (10.0%) followed by Central County (12.6%) and North County (17.1%). In Q2 2018, Class A overall vacancy was 14.2% countywide, down 20 bps from last quarter and 100 bps from a year ago. Class B overall vacancy was 12.0%, down 30 bps from last quarter and 250 bps from a year ago.

Absorption in the second quarter was driven by a number of mid-size occupancies. The largest instance of positive absorption was AbacusNext moving into 65,000 sf at Eastgate Summit. A few biotech tenants contributed significantly to absorption with Tocagen (39,000 sf) and Celgene (27,000 sf) occupying space at Genesis in Campus Point, and InhibiRX (34,000 sf) absorbing space in Torrey Pines, beginning their new leases. In Del Mar Heights, GreatCall moved into their new space at Pacific Plaza occupying 56,000 sf while vacating their previous 29,000 sf space in the building next door. Other notable occupancies include Southwest Antennas occupying 16,000 sf in Rancho Bernardo, Interdigital moving into 14,000 sf in Sorrento Mesa, and Robbins Arroyo's purchase of a 24,000 sf office building in Governor Park.

Throughout the rest of 2018, a number of large tenants are expected to occupy, bolstering absorption in future quarters. In Kearny Mesa, UCSD signed a lease to occupy 82,000 sf. Trellisware agreed to occupy 72,000 sf at the newly renovated Summit Pointe in Scripps. In Eastgate, ServiceNow signed a direct deal to expand into a 64,000-sf building, currently subleased by Kratos and Plaza Home Mortgage. Kratos will be moving from Eastgate to 26,000 sf in Scripps in Q4



2018 while Plaza Home Mortgage will occupy 55,000 sf at Verge in Sorrento Mesa. In Sorrento Mesa, Nuvasive has plans to expand into another 107,000 sf, including the construction of a new building. Neurocrine Biosciences leased a 45,000 sf building in Del Mar Heights. Bank of Internet renewed their lease at the Plaza in UTC, but will also expand by 60,000 sf over the next year. Fate Therapeutics also signed a lease to expand at their location in Torrey Pines by 24,000 sf.

A couple of tenants returned significant blocks of space in San Diego County in Q2. The largest was returned by Bridgepoint Education in Rancho Bernardo for 140,000 sf, though a portion of the space was soon occupied by Corptax. The next largest vacate was in Carlsbad, where Nortek vacated 53,000 sf.

Much of future absorption will come from leases signed for projects currently under construction. ViaSat, which is headquartered in Carlsbad and employs nearly 2,000 workers, is expanding its footprint. The company's Bressi Ranch site is planned for approximately 800,000 sf at build out, with 357,000 sf scheduled to be completed in 2018. In Eastgate, Takeda Pharmaceuticals has a build-to-suit (BTS) lease for over 163,000 sf. Also to be completed in 2018 is the 110,000-sf BTS project for Palomar College in Rancho Bernardo.

## Q2 2018 WAS THE 16<sup>TH</sup> CONSECUTIVE QUARTER OF POSITIVE OCCUPANCY

Additionally, MedImpact will occupy the first of three buildings at the Watermark in Scripps for 159,000 sf, and UCSD has two projects currently under construction, a 57,000 sf project in Rancho Bernardo and a 66,000 sf project at Park + Market Downtown.

And another major construction topic during the Q2 was Manchester Pacific Gateway, committing to break ground in August, starting with a new 372,000 sf office tower for the U.S. Navy. In total, this new project plans to deliver more than 1.1 million square feet (msf) of Class A office space across a mixed-use campus environment that also features additional retail space and hotel lodging.

Of the 20 properties, totaling 2.3 msf currently under construction countywide, 13 (totaling 1.2 msf) are scheduled for completion in 2018. Just over 1.3 msf or 57% of the inventory under construction are part of BTS projects. Speculative projects include Makers Quarter Block D in Downtown, planned to be part of a hub of sustainable live/work/play lifestyle employment center, starting with 50,000 sf of office space initially, and Lift in Carlsbad, a new ground-up creative project totaling nearly 45,000 sf. Of the total 2.3 msf of product countywide, 60% already have commitments in place. While we anticipate continued pre-leasing activity, this will likely result in a modest short-term uptick in vacancy as these projects come online later in 2018.

The countywide average asking rent for all classes is now \$3.02 per square foot (psf) on a monthly full service basis. This metric was unchanged over the past three months and is up 3.1% from where it stood a year ago. Over the past 12 months, Class A average rent has increased by 4.6% to \$3.43 psf while the Class B rate has decreased by 0.7% to \$2.81 psf. There is still plenty of room for growth in the A market guided by new construction, and the widening gap between the A and B markets will subsequently allow more room for the B market to increase.

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

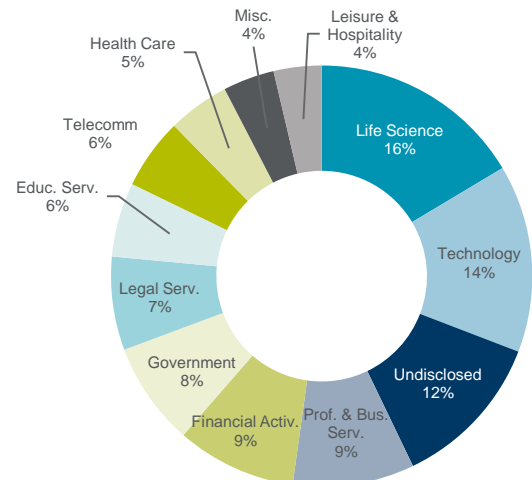
## Direct Vacancy vs. Unemployment Rate

DECLINE IN VACANCY CORRELATES DECLINE IN UNEMPLOYMENT



## Tenant Demand by Industry Type

TOP 3 INDUSTRY SECTORS ACCOUNT FOR 42% OF TOTAL DEMAND



## Outlook

- Continued economic and job growth in combination with increasing tenant demand should provide continued occupancy and rent growth throughout 2018 and into 2019. Leasing within the 5,000 to 50,000 sf range will continue to be the main driver of activity, accounting for 58% of total sf in lease obligations set to expire over the next 18 months.
- Active tenant requirements remain robust at 3.6 msf over the next 24 months countywide. A majority of these tenants have sent out proposals and are still in the intermediate stages of their search. While not all of the current tenants in the market will transact in the short term, these levels provide a barometer to leasing activity in quarters to follow.

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 CONSTRUCTION (SF)	AVERAGE ASKING RENT* (ALL Classes)	AVERAGE ASKING RENT* (CLASS A)
North County	341	10,632,002	191,476	1,628,297	17.1%	-46,561	-81,340	430,634	\$2.52	\$2.91
Central County	834	49,559,448	1,030,647	5,215,066	12.6%	251,978	282,052	862,062	\$3.19	\$3.56
South County	318	16,793,384	175,954	1,496,698	10.0%	70,995	141,161	975,572	\$2.91	\$3.27
<b>TOTAL</b>	<b>1,493</b>	<b>76,984,834</b>	<b>1,398,077</b>	<b>8,340,061</b>	<b>12.6%</b>	<b>276,412</b>	<b>341,873</b>	<b>2,268,268</b>	<b>\$3.02</b>	<b>\$3.43</b>
Class A	325	33,843,343	670,785	4,126,871	14.2%	156,126	282,370	2,159,354	\$3.43	
Class B	762	33,004,803	628,802	3,329,995	12.0%	126,309	467	108,914	\$2.81	
Class C	406	10,136,688	98,490	883,195	9.7%	-6,023	59,036	0	\$1.90	
<b>TOTAL</b>	<b>1,493</b>	<b>76,984,834</b>	<b>1,398,077</b>	<b>8,340,061</b>	<b>12.6%</b>	<b>276,412</b>	<b>341,873</b>	<b>2,268,268</b>	<b>\$3.02</b>	

\*Rental rates reflect full service (FS) asking rents \$psf/monthly. Vacancy rate includes direct and sublease. Net absorption excludes sublease.

## Key Lease Transactions Q2 2018

PROPERTY	SF	TENANT	LANDLORD	TRANSACTION TYPE	SUBMARKET
The Elements at Wateridge	195,490	American Specialty Health	Parallel Capital Partners	Renewal	Sorrento Mesa
The Plaza	136,313	Bank of Internet	The Irvine Company	Renewal & Expansion	UTC
The Park	118,850	Sony	Lionstone Investments   Locale Advisors	New	Sorrento Mesa
701 B St.	56,338	Thomas Jefferson School of Law	EMMES Group of Companies	New	Downtown
Verge	55,138	Plaza Home Mortgage	Invesco Advisors   Cruzan	New	Sorrento Mesa

## Key Sale Transactions Q2 2018

PROPERTY	SF	BUYER	SELLER	PRICE / \$PSF	SUBMARKET
Stonecrest	327,234	Pendulum Property Partners	TIAA-CREF	\$100,300,000 / \$307	Kearny Mesa
The Campus on Villa La Jolla	196,940	Goldstein Planting Investments	La Jolla Village Professional Center Associates	\$97,100,000 / \$493	La Jolla
1450 Frazee Rd.	140,476	DRA Advisors   Hill Properties	Menlo Equities	\$33,050,000 / \$235	Mission Valley
12230 World Trade Dr.	61,227	Cal-Sorrento, Ltd.	Palisades Equity Partners	\$17,900,000 / \$292	Rancho Bernardo
The Bungalows at Del Mar	39,000	The Bascom Group   Harbor Associates, LLC	Turner & Associates	\$15,700,000 / \$403	Del Mar / Solana Beach

## Under Construction Q2 2018 – selected projects 10,000 sf+

PROPERTY	SF	PRELEASED		ADDRESS	CLASS	ESTIMATED COMPLETION	SUBMARKET
		SF	%				
Manchester Pacific Gateway – US Navy	372,000	372,000	100%	Harbor Dr. & Pacific Hwy.	A	2021	Downtown
Bressi Ranch	357,000	357,000	100%	Town Garden Rd.	A	2018	Carlsbad
AMP&RSAND	339,000	0	0%	350 Camino de la Reina	A	2018	Mission Valley
Tower 180	324,341	0	0%	1010 2nd Ave.	A	2019	Downtown
9625 Towne Centre Dr.	163,648	163,648	100%	9625 Towne Centre Dr.	A	2018	Eastgate
The Watermark	158,994	158,994	100%	10133 Scripps Gateway	A	2019	Scripps
1420 Kettner Blvd.	123,079	0	0%	1420 Kettner Blvd.	A	2019	Downtown
Bernardo Terrace Corp. Center	110,000	110,000	100%	Rancho Bernardo & Via Tazon	A	2018	Rancho Bernardo
Park+Market	66,000	66,000	100%	Park Ave. & G St.	A	2019	Downtown
16950 Via Tazon	57,420	57,420	100%	16950 Via Tazon	B	2018	Rancho Bernardo
Makers Quarter – Block D	50,000	6,897	14%	845 15 <sup>th</sup> St.	A	2018	Downtown
Lift	44,794	19,620	44%	6021-6023 Innovation Way	A	2018	Carlsbad
Sorrento Summit	28,000	28,000	100%	7475 Lusk Blvd.	A	2019	Sorrento Mesa
Foley Financial Center	22,498	0	0%	2131 3 <sup>rd</sup> Ave.	B	2018	Uptown
Grossmont Summit	17,654	5,587	32%	9400 Grossmont Summit	B	2018	East County
Corner@2Oaks	14,400	0	0%	158 N. Twin Oaks Valley Rd.	B	2018	San Marcos

**OFFICE SUBMARKETS**  
SAN DIEGO



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