

# MARKETBEAT

## San Diego

### Office Q3 2018



#### SAN DIEGO OFFICE

##### 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

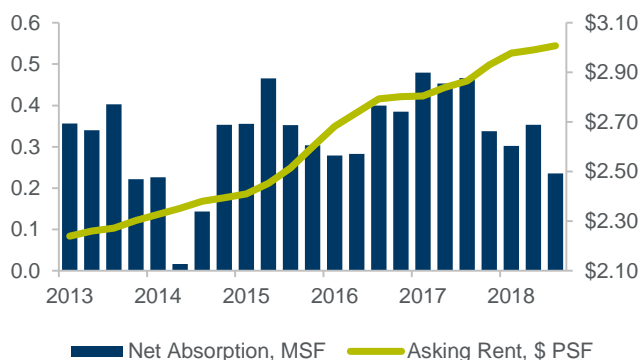
##### Market Indicators (All Classes)

	Q3 17	Q3 18	12-Month Forecast
Overall Vacancy	13.7%	13.4%	▼
Direct Net Absorption (sf)	717k	244k	▲
Under Construction (sf)	1.2M	1.6M	▲
Average Asking Rent	\$2.96	\$3.03	▲

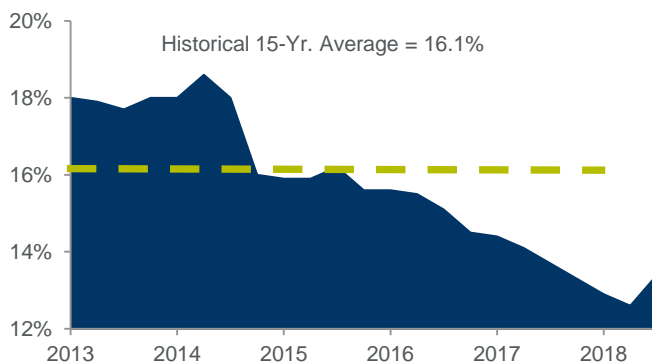
\*Rental rates reflect full service asking \$psf/monthly

##### 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 24,100 jobs (+1.7%) year-over-year through August 2018.<sup>1</sup> Of the 24,100 jobs added, 12,800 (or 53%) were office jobs consisting of two sectors: professional and business services and financial activities. 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 billion<sup>2</sup> 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%.<sup>3</sup>

## Market Overview

San Diego's office vacancy was 13.4% in Q3 2018, up 80 bps from last quarter and down 30 bps from a year ago. This ended the streak of nine consecutive quarters of decreasing vacancy as significant new construction was delivered.

Occupancy grew by 243,800 square feet (sf) across all classes, bringing year-to-date direct net absorption to 585,700 sf. The Q3 2018 quarterly activity continued the steady growth seen in Q2 (+276,400 sf) and Q1 2018 (+65,500 sf). This was the 17<sup>th</sup> consecutive quarter of occupancy gains during which tenants have absorbed 6.5 million square feet (msf) combined across all classes. Occupancy growth, however, was disproportionate by region as tenants absorbed 186,000 sf across all classes in Central County submarkets, 48,300 sf in North County submarkets and just 9,800 sf in South County submarkets.

At the end of Q3 2018, overall vacancy was the lowest in South County (10.4%) followed by Central County (13.8%) and North County (16.6%). In Q3 2018, Class A overall vacancy was 16.2% countywide, up 200 bps from last quarter and 80 bps from a year ago. Class B overall vacancy was 11.8%, down 20 bps from last quarter and 150 bps from a year ago.

Absorption in the third quarter was driven by a number of mid-size occupancies. The largest instance of positive absorption was Neurocrine Biosciences moving into 45,000 sf at Junction at Del Mar. In Rancho Bernardo, Crown Bio moved into 32,000 sf. Walmart Online moved into 32,000 sf at MAKE in Carlsbad. Plaza Home Mortgage moved into 55,000 sf at Verge in Sorrento Mesa, taking on Competitor Group's former space for a net 28,000 sf absorption. Other notable occupancies included Fate Therapeutics expanding by 24,000 sf in Torrey Pines, HUB International moving into 24,000 sf in Sorrento Mesa and ICW moving into 23,000 sf in Rancho Bernardo.

Throughout the rest of 2018, a number of large tenants are expected to occupy, bolstering absorption in future quarters. 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. Nuvasive has plans to expand into another 107,000 sf, including the construction of a new 28,000 sf building. Bank of Internet renewed their lease at the Plaza in UTC, but will also expand by 60,000 sf over the next year for a total of 136,000 sf. Sorrento Mesa stands to benefit from



significant absorption by next year from deals signed in the third quarter and prior. Dexcom leased 84,000 sf at The Towers. Brain Corporation will occupy 59,000 sf, and First Associates will take 22,000 sf at Seaview Corporate Center. Curology signed a deal for 54,000 sf at the recently renovated 5717 Pacific Center Blvd., and Samsung will take 46,000 sf at Enclave Sorrento.

A couple of tenants returned significant blocks of space in San Diego County in Q3. The largest was returned by Genoptix in Carlsbad for 54,000 sf. Multiple tenants vacated The Towers project set to be back-filled by Dexcom in Sorrento Mesa. Black and Veatch also vacated over 30,000 sf in Scripps.

**Q2 2018 WAS THE 17<sup>TH</sup> CONSECUTIVE QUARTER OF POSITIVE OCCUPANCY**

A number of projects totaling 412,300 sf were completed this quarter, most notably AMP&RSAND in Mission Valley (339,000 sf). Next year, Encore Capital will occupy 96,000 sf of the 339,000 sf renovation of the former San Diego Union-Tribune buildings. Makers Quarter – Block D also delivered this quarter in Downtown. Co-working company Spaces signed a deal for three floors, while marketing agency Basic will take one floor, leaving one floor remaining at the East Village project.

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.

Additionally, MedImpact is under construction for another 159,000 sf in their second BTS office building adjacent to their headquarters, at the planned Watermark project in Scripps Ranch. 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 recently purchased an additional land site in Rancho Bernardo for future development.

Another major construction topic during the Q3 was Manchester Pacific Gateway, committing to break ground in August and 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 msf of Class A office space across a mixed-use campus environment that also features additional retail space and hotel lodging.

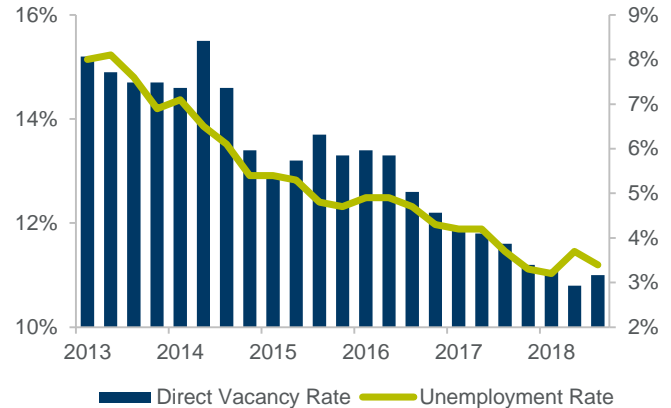
Of the 14 properties, totaling 1.6 msf currently under construction countywide, 7 (totaling 659,000 sf) are scheduled for completion in 2018. Just over 831,000 sf or 51% of the inventory under construction are part of BTS projects. Speculative projects include Lift in Carlsbad, a new ground-up creative project, totaling nearly 45,000 sf. Of the total 1.6 msf of product countywide, 53% 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 \$3.03 per square foot (psf) on a monthly full service basis. This metric increased by just one cent over the last three months and is up 2.4% from where it stood a year ago. Over the past 12 months, Class A average rent has increased by 5.2% to \$3.47 psf while the Class B rate has decreased by 0.7% to \$2.82 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 2017. <sup>3</sup>Moody's Analytics economy.com

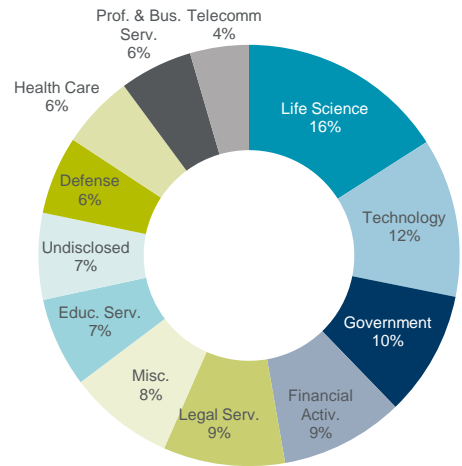
**Direct Vacancy vs. Unemployment Rate**

DECLINE IN VACANCY CORRELATES DECLINE IN UNEMPLOYMENT



**Tenant Demand by Industry Type**

TOP 3 INDUSTRY SECTORS ACCOUNT FOR 38% 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 63% of total sf in lease obligations set to expire over the next 18 months.
- Active tenant requirements remain robust at 2.8 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	342	10,637,598	178,958	1,585,585	16.6%	48,308	-33,032	410,638	\$2.55	\$2.85
Central County	836	49,898,448	1,505,106	5,383,315	13.8%	185,669	467,721	522,464	\$3.20	\$3.65
South County	320	16,861,038	192,860	1,554,569	10.4%	9,808	150,969	696,946	\$2.93	\$3.29
<b>TOTAL</b>	<b>1,498</b>	<b>77,397,084</b>	<b>1,876,924</b>	<b>8,523,469</b>	<b>13.4%</b>	<b>243,785</b>	<b>585,658</b>	<b>1,630,008</b>	<b>\$3.03</b>	<b>\$3.47</b>
Class A	328	34,232,343	1,098,086	4,432,618	16.2%	98,093	380,463	1,558,744	\$3.47	
Class B	764	33,028,053	711,892	3,179,280	11.8%	174,043	174,510	71,264	\$2.82	
Class C	406	10,136,688	66,946	911,571	9.7%	-28,351	30,685	0	\$1.93	
<b>TOTAL</b>	<b>1,498</b>	<b>77,397,084</b>	<b>1,876,924</b>	<b>8,523,469</b>	<b>13.4%</b>	<b>243,785</b>	<b>585,658</b>	<b>1,630,008</b>	<b>\$3.03</b>	

\*Rental rates reflect full service (FS) 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
AMP&RSAND	95,936	Encore Capital	The Casey Brown Company	New	Mission Valley
The Towers – North	87,423	DexCom	PGIM	New	Sorrento Mesa
Seaview Corporate Center	59,259	Brain Corporation	John Hancock Life Insurance	New	Sorrento Mesa
Civic View Corporate Centre	55,810	Welk Resort Group	Brookwood Financial Partners	Renewal & Expansion	San Marcos
5717 Pacific Center Blvd.	54,232	Curology	Montana Avenue Capital Partners	New	Sorrento Mesa

## Key Sale Transactions Q3 2018

PROPERTY	SF	BUYER	SELLER	PRICE / \$PSF	SUBMARKET
Starwood Capital Portfolio – San Diego	1,055,715	Ascendas-Singbridge	Starwood Capital Group	\$356,000,000 / \$337	Rancho Bernardo, Sorrento Mesa
Sunroad Corporate Centre	304,310	The Irvine Company	Sunroad Enterprises	\$180,000,000 / \$592	UTC
Balboa Executive Center	120,992	Admiral Capital Group	The Blackstone Group	\$36,375,000 / \$301	Kearny Mesa
35 North	94,701	CIF Group	Cypress Office Properties	\$19,750,000 / \$209	Mission Valley
DMcp	73,325	EverWest Real Estate Investors	Cruzan	\$43,000,000 / \$586	Del Mar Heights

## Under Construction Q3 2018 – selected projects 10,000 sf+

PROPERTY	SF	PRELEASED		ADDRESS	CLASS	ESTIMATED COMPLETION	SUBMARKET
		SF	%				
Bressi Ranch	357,000	357,000	100%	Town Garden Rd.	A	2018	Carlsbad
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
777 Front St.	161,028	0	0%	777 Front St.	A	2019	Downtown
The Watermark	158,994	158,994	100%	10133 Scripps Gateway	A	2019	Scripps
Kettner & Ash	123,079	0	0%	1420 Kettner Blvd.	A	2019	Downtown
Gradlabs	109,362	0	0%	9880 Campus Point Dr.	A	2019	Campus Point
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
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

**OFFICE SUBMARKETS**  
SAN DIEGO



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**Jolanta Campion**

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

**Justin Balagtas**

Research Analyst  
justin.balagtas@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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