

# MARKETBEAT

## San Diego

### Industrial Q4 2018



#### SAN DIEGO INDUSTRIAL

##### Economic Indicators

	Q4 17	Q4 18	12-Month Forecast
San Diego Employment	1.54M	1.57M	▲
San Diego Unemployment	3.5%	3.2%	▼
U.S. Unemployment	4.1%	3.7%	▼

November 2017/2018 used to represent Q4 for San Diego.

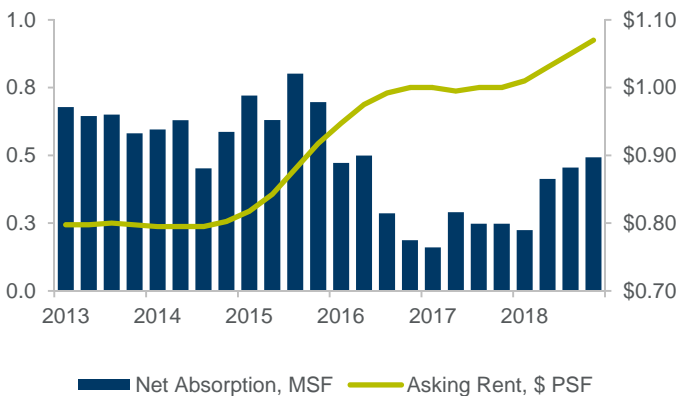
##### Market Indicators (All Product Types)

	Q4 17	Q4 18	12-Month Forecast
Overall Vacancy	4.8%	5.4%	▼
Direct Net Absorption (sf)	282k	431k	▲
Under Construction (sf)	3.1M	1.4M	▼
Average Asking Rent	\$1.03	\$1.11	▲

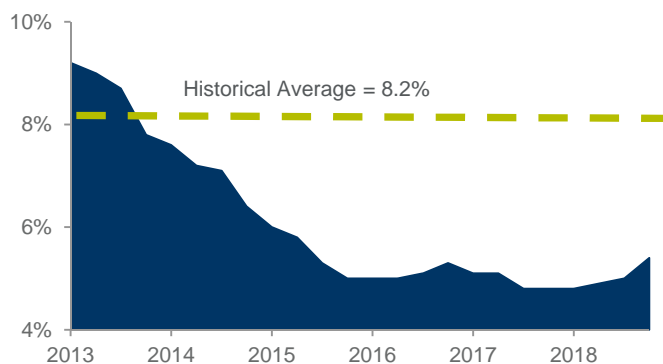
\*Rental rates reflect triple net asking \$psf/monthly

##### Direct Net Absorption/Asking Rent

###### 4-QTR TRAILING AVERAGE



##### Overall Vacancy



## Economy

The San Diego employment market continued to record job growth, adding 26,400 jobs (+1.8%) year-over-year through November 2018.<sup>1</sup> During the same time period, the unemployment rate decreased 30 basis points (bps), dropping to 3.2%. Also worth noting, the current rate is 270 bps below the 28-year average of 5.9%.

All employment sectors are expected to grow at a combined growth rate of 1.3% 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 3.1% in 2019, above its 10-year average of 2.7%.<sup>3</sup>

Continuing to bode well for the industrial marketplace is that economic activity in the manufacturing sector again expanded in December, with an ISM index reading of 54.1% compared to 59.3% in November. 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 116<sup>th</sup> consecutive month in the U.S. Of the 18 manufacturing industries, 11 reported growth in December of 2018.

## Market Overview

At the close of 2018, industrial vacancy (including sublease) in the San Diego marketplace stood at 5.4%, 40 basis points (bps) higher than last quarter and 60 bps higher compared to a year ago. Q4 2018 is the first quarter in the past five consecutive quarters that overall vacancy has surpassed the 5% threshold. This slight increase in vacancy was expected due the large amount of speculative (SPEC) construction that was delivered this quarter: 1.1 million square feet (msf).

Across the region, the market is the tightest for incubator multi-tenant (IMT) space with vacancy (including sublease) at 3.9%, which has remained flat compared to a year ago. Vacancy for manufacturing space now stands at 4.0% countywide versus 3.0% twelve months ago. Distribution space vacancy currently stands at 5.4%, an increase of 80 bps from last year. Meanwhile, vacancy for R&D product has increased 100 bps over the last year and now stands at 8.8%.

This year, tenant activity in San Diego's industrial sector ramped up aggressively was bolstered by the delivery of several large pre-leased construction projects. This quarter was San Diego's 29<sup>th</sup> of the last 30 quarters showing occupancy gains - all except for Q2 2017. In Q4 2018, tenants absorbed 454,000 sf in North County submarkets, 72,700 in South County but returned 95,000 sf in Central County.

Demonstrating the county's demand for new, state-of-the-art industrial space, six of this quarter's top ten move-ins were at new construction completed during this quarter. These include Camston Wrather (116,000 sf at 2856 Whiptail Loop), PODS (116,000 sf at 2820 Whiptail Loop), Tires Warehouse (106,000 sf at 4400 Ruffin Rd.) and San Diego Hat Co. (83,000 sf at 2875 Whiptail Loop).

Other large move-ins at existing buildings included Vista Industrial Products (leased 67,000 sf at 3210 Executive Ridge) and Boral Roofing (leased 67,000 sf at 3817 Ocean Ranch Blvd.).



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. Hay House moved out of 110,000 sf in Vista, Covan Worldwide moved out of 106,000 sf in Sorrento Mesa (they have already taken occupancy of another building in Poway), and Coleman college moved out of 85,000 sf in Kearny Mesa.

Average asking rent for all product types combined was \$1.11 per square foot (psf) per month on a triple net basis compared to \$1.07 psf last quarter and \$1.03 psf a year ago. The average rent at \$1.11 psf as of Q4 2018 is the highest level we have ever tracked and has increased 20.7% since the end of the last recession (\$0.92 psf Q2 2009). Since then, the average rent has increased the most for IMT space (+30.9%) compared to other product types, followed by distribution (+29.7%), R&D (+24%) and manufacturing (+20.7%). This trend is driven by the demand for and availability modern and specialized space for industrial users. In response, we are not only seeing asking rental rates increase for existing buildings but also in new construction buildings that command the highest rental rates.

There are currently 26 industrial buildings totaling nearly 1.4 msf under construction. However, with a low countywide direct vacancy of 4.4%, it is unlikely that this supply will satisfy demand for new, functional space. According to our calculations, 56% of industrial space countywide was built before 1990 and just 4% 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 SPEC construction as developers and landlords become more bullish on their prospect of leasing new space. Of the space that is currently under construction, 73% (or 994,000 sf) is SPEC development.

**COMPLETIONS TOTALLED 2.9 MSF THIS YEAR, COMPARED TO 10-YEAR ANNUAL AVERAGE OF 532,000 SF.**

In Q4 2018, over 1.1 msf (or 13 buildings) of new construction received its Certificate of Occupancy, bringing 2018 annual new deliveries total to over 2.9 msf. This compares to the average annual deliveries of the previous 10 years (2008-2017) of just 532,000 sf. An additional 1.4 msf or more is expected to be completed in 2019 of which 23% pre-leased.

Across Q4 2018 deliveries, 48% was pre-leased to tenants or owner-users. The tenants bolstering this new absorption included previously mentioned Camston Wrather, PODS, Tires Warehouse and San Diego Hat Co. Additionally, Mission Imprintables took occupancy of 61,000-sf 1604 Cactus Rd., a building they purchased in Q4 2018. Also, 55,000-sf 195 Bosstick Rd. was delivered occupied by Bernardo Moving & Storage and Redline Express/IEX Delivery.

In Q4 2018, nearly 297,000 sf (or six buildings) broke ground on construction. The largest was 137,000-sf 2065 Sanyo Rd. in Otay Mesa. This project is being built speculatively and is estimated to be completed in 2019.

Sources: <sup>1</sup>www.bls.gov <sup>2</sup>bea.gov GDP as of 2017. <sup>3</sup>Moody's Analytics economy.com 11/2018.

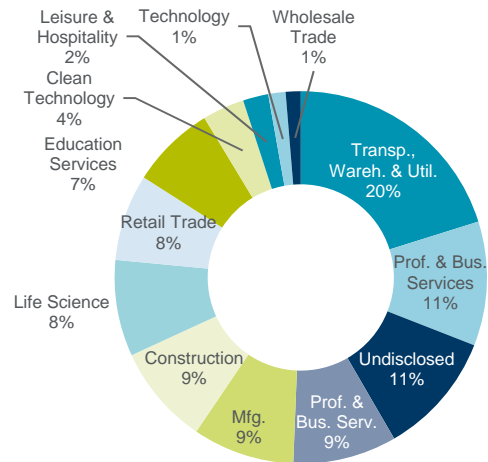
**Direct Vacancy vs. Unemployment Rate**

DECLINE IN VACANCY CORRELATES DECLINE IN UNEMPLOYMENT



**Tenant Demand by Industry Type**

TOP 3 INDUSTRY SECTORS ACCOUNT FOR 42% OF TOTAL DEMAND



**Outlook**

- 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 newly constructed space will continue to cause vacancy and availability to increase.
- There are 2.5 msf of active tenant requirements for space over the next 24 months. Over 60% or 1.5 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	2,036	53,296,594	710,438	2,692,563	6.4%	453,716	1,335,234	790,403	\$1.00
Central County	2,285	81,137,431	817,119	2,878,126	4.6%	(95,256)	346,311	360,862	\$1.39
South County	625	30,749,857	180,260	1,650,081	6.0%	72,744	288,971	216,050	\$0.76
<b>TOTAL</b>	<b>4,946</b>	<b>165,183,882</b>	<b>1,707,817</b>	<b>7,220,770</b>	<b>5.4%</b>	<b>431,204</b>	<b>1,970,516</b>	<b>1,367,315</b>	<b>\$1.11</b>
R&D	840	33,938,506	638,186	2,339,108	8.8%	135,984	304,836	360,318	\$1.55
MFG	2,462	64,770,530	609,387	2,024,403	4.0%	22,576	385,870	216,769	\$0.99
IMT	628	20,630,944	163,154	640,415	3.9%	34,955	1,887	0	\$1.23
DIST	1,016	45,843,902	297,090	2,216,844	5.4%	237,689	1,277,923	790,228	\$0.83
<b>TOTAL</b>	<b>4,946</b>	<b>165,183,882</b>	<b>1,707,817</b>	<b>7,220,770</b>	<b>5.4%</b>	<b>431,204</b>	<b>1,970,516</b>	<b>1,367,315</b>	<b>\$1.11</b>

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

## Key Lease Transactions Q4 2018

PROPERTY	SF	TENANT	LANDLORD	TRANSACTION TYPE	SUBMARKET
4400 Ruffin Rd.	106,451	Tire Warehouse, Inc.	LBA Realty	Direct	Kearny Mesa
760 Shadowridge Dr.	71,574	United States Postal Service	Comstock Realty Partners	Direct	Vista
3817 Ocean Ranch Blvd.	66,780	Boral Roofing, LLC	First Industrial Realty Trust	Direct	Oceanside
4939 Directors Pl.	61,207	Sorrento Therapeutics	HCP	Direct	Sorrento Mesa
South Sorrento Business Center	35,617	Westpak, Inc.	Sonico Associates Ltd.	Renewal	Sorrento Valley

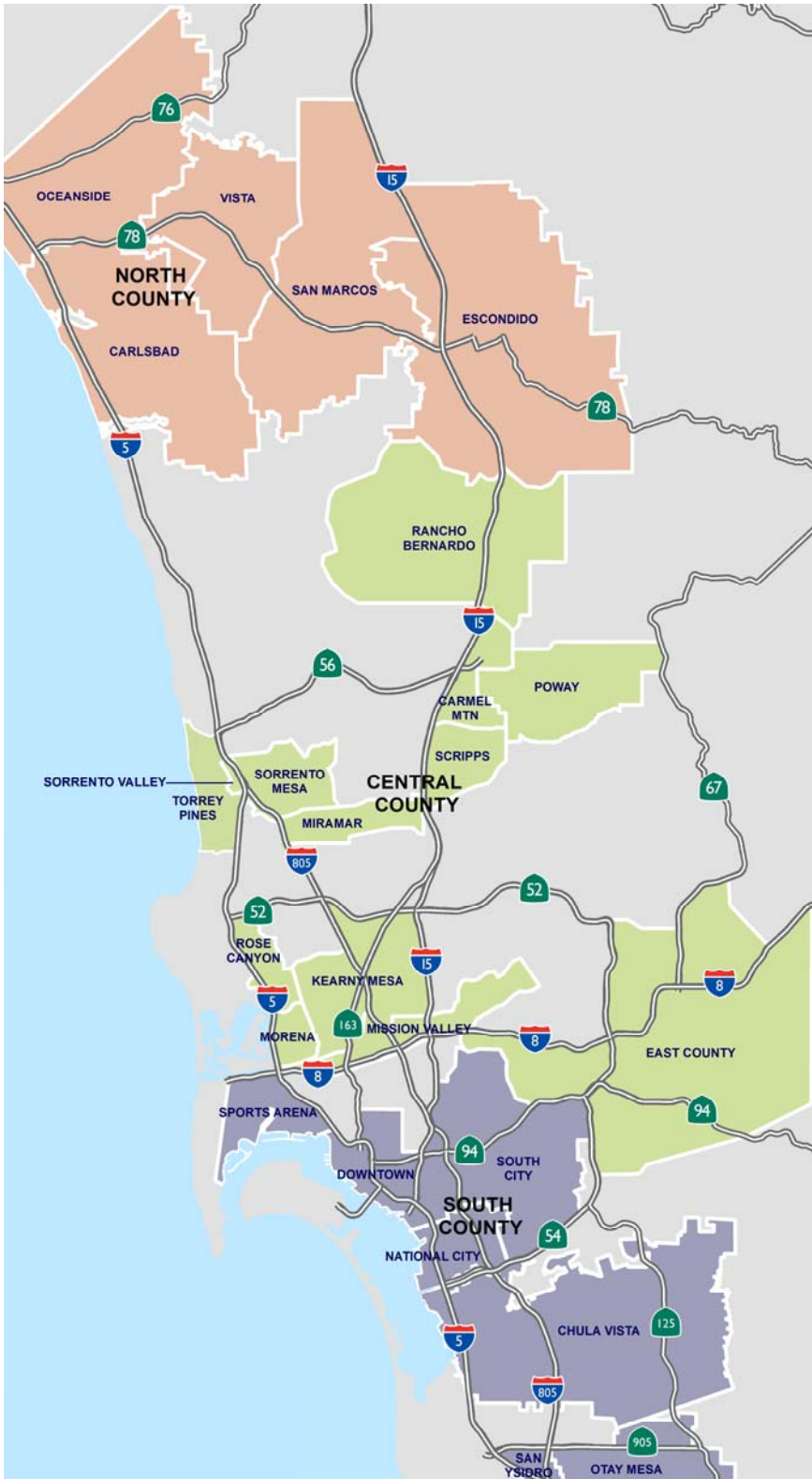
## Key Sale Transactions Q4 2018

PROPERTY	SF	BUYER	SELLER	PRICE / \$PSF	SUBMARKET
Siempre Viva Rd. & Sarnen St. Portfolio	544,643	IDS Real Estate Group	AFL-CIO Building Investment Trust	\$67,500,000 / \$124	Otay Mesa
Sorrento Centre	318,969	Longfellow Real Estate Partners	Parallel Capital Partners	\$112,000,000 / \$351	Sorrento Valley
2695 Customhouse Ct. & 8830 Siempre Viva Rd.	264,679	TIAA-CREF Investment Management LLC	BKM Capital Partners	\$28,500,000 / \$108	Otay Mesa
3250 Business Park Dr.	204,285	BLT Enterprises	DENSO Wireless Systems America	\$31,500,000 / \$154	Vista
2051 Palomar Airport Rd.	195,942	SteelWave, Inc.	Hines Securities, Inc.	\$35,025,000 / \$179	Carlsbad

## Under Construction Q4 2018 — selected projects 50,000 sf+

PROPERTY	RELEASED			ADDRESS	PRODUCT TYPE	ESTIMATED COMPLETION	SUBMARKET
	SF	SF	%				
Carlsbad Oaks North - Pacific Vista Commerce Ctr. (portion of total project)	296,385	0	0%	2800 & 2810 Whiptail Loop	DIST	2019	Carlsbad
Pacific Coast Collection	277,793	0	0%	1291-1339 1291, 1322 & 1339 Rocky Point Dr.	DIST	2019	Oceanside
BioLegend Campus	234,719	234,719	100%	8928-8959 Terman Ct.	R&D	2019	Miramar
The Campus at San Diego Business Park - Ph. III	137,000	0	0%	2065 Sanyo Rd.	DIST	2019	Otay Mesa
480 N. Spruce & 455 Quince St.	103,500	0	0%	480 N. Spruce & 455 Quince St.	R&D	2019	Escondido
Poway Tech Center	82,742	15,376	19%	Flint Pl. / Dearborn Pl. / Paine Pl.	MFG	2019	Poway
Siempre Viva Business Park - Bldg. 17	79,050	33,116	42%	8500 Kerns St.	DIST	2019	Otay Mesa
Keystone Victory Industrial Park	77,725	0	0%	Keystone Way	MFG	2019	Vista

## 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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