

SAN DIEGO OFFICE

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.

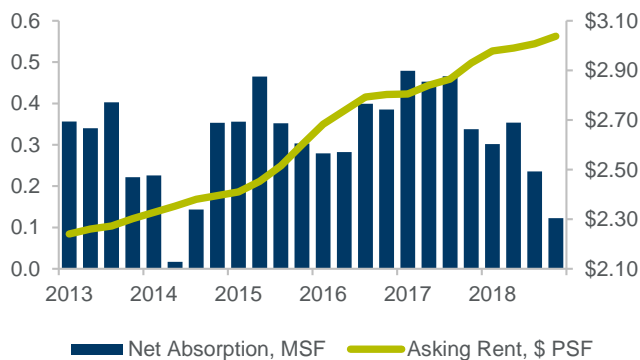
Market Indicators (All Classes)

	Q4 17	Q4 18	12-Month Forecast
Overall Vacancy	13.3%	13.8%	▼
Direct Net Absorption (sf)	356k	-96k	▲
Under Construction (sf)	1.3M	1.7M	▲
Average Asking Rent	\$2.96	\$3.08	▲

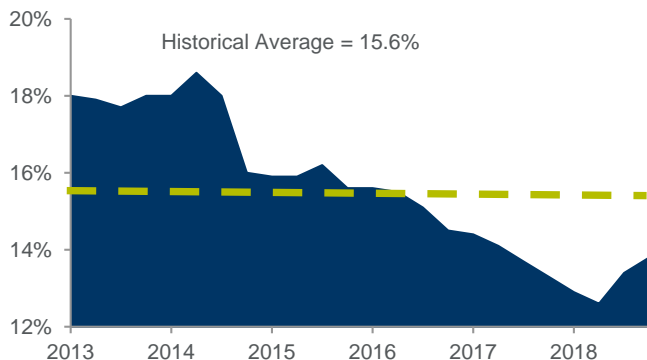
*Rental rates reflect full service asking \$psf/monthly.

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 2018.¹ Of the 26,400 jobs added, 16,500 (or 63%) were in professional and business services sector, a primary sector driving demand for office space. 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 billion² as measured by gross regional product is forecasted to grow an additional 3.1% in 2019, above its 10-year average of 2.7%.³

Market Overview

San Diego's office vacancy was 13.8% in Q4 2018, up 40 bps from last quarter and up 50 bps from a year ago. This is the second consecutive quarter of increasing vacancy as some notable vacancies occurred within the market and 718,600 square feet (sf) were delivered in 2018 (257,400 sf in Q4).

San Diego's office market returned 96,300 sf across all classes, bringing year-to-date direct net absorption to 489,300 sf. The Q4 2018 quarterly activity ended the steady growth seen in Q3 (+243,800 sf), Q2 (+276,400 sf) and Q1 2018 (+65,500 sf). This also ended a streak of seventeen consecutive quarters of occupancy gains during which tenants have absorbed 6.5 million square feet (msf) combined across all classes.

At the end of Q4 2018, overall vacancy was the lowest in South County (10.7%) followed by Central County (14.2%) and North County (16.9%). In Q4 2018, Class A overall vacancy was 15.8% countywide, down 40 bps from last quarter and 110 bps from a year ago. Class B overall vacancy was 12.6%, up 80 bps from last quarter and down 30 bps from a year ago.

While significant office space was returned to the market, there were a number of notable occupancies, led by a couple of build-to-suit projects. The largest instance of positive absorption was Takeda moving into their new 164,000 sf building in Eastgate. Other notable move-ins came from leases signed earlier in the year or prior. Tellisware moved into 47,000 sf at Summit Pointe in Scripps, with another 26,000 sf to be absorbed next year. In Sorrento Mesa, Samsung occupied portions of the two buildings at Enclave Sorrento for 46,000 sf. Bank of Internet occupied two floors of their expansion in UTC totaling 40,200 sf, with an additional floor to occupy in 2019.

This year, the market will see multiple significant vacancies absorbed from leases signed in 2018. In particular, Sorrento Mesa stands to benefit from significant absorption in 2019 from deals signed in 2018. Dexcom leased 84,000 sf at The Towers. Brain Corporation will occupy 59,000 sf. Curology signed a deal for 54,000 sf at the recently renovated 5717 Pacific Center Blvd. Nuvasive is set to expand by 107,000 sf, and Cue is signing a deal for 21,000 sf.

Other submarkets have tenants occupying in the near future. In Mission Valley, Amp&rsand will get its first tenants after renovation with Encore Capital moving into 96,000 sf and Qdoba moving into



34,000 sf. In Rancho Bernardo, Daylight solutions will occupy 68,000 sf. At the Terraces in Kearny Mesa, Guild Mortgage continued to expand, claiming the remaining 66,000 sf in the project to occupy in 2020. In Downtown, coworking provider Spaces will open new locations on the west and eastern ends of Downtown, with 45,000 sf at Kettner & Ash and 30,000 sf in Makers Quarter.

A number of tenants returned significant blocks of space in San Diego County in Q4. The largest was returned by Vertex Pharmaceuticals who vacated 81,000 sf in Torrey Pines as they moved into their new build-to-suit (BTS) project. Amylin Pharmaceuticals' lease in Eastgate expired for 71,000 sf, with 49,000 sf to be occupied by Poseida Pharmaceuticals next year. In Carlsbad, Synteract vacated 67,000 sf. In Downtown, Bank of America moved out of 55,000 sf.

OVER THE LAST FIVE YEARS 5.3 MSF OF NEW SPACE HAS BEEN DELIVERED WITH A 54% AVERAGE PRE-LEASING RATE

A number of projects totaling 257,400 sf were completed this quarter, most notably Takeda's 164,000 sf BTS project in Eastgate. UCSD also moved into a renovated project in Rancho Bernardo for 57,400 sf. Additionally, the renovation of the San Diego Daily transcript building was completed, bringing 22,500 sf of office space to the Uptown market.

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 2019. 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. CSU San Marcos plans to expand their campus by 140,000 sf at North City in San Marcos.

Of the 13 properties, totaling 1.7 msf currently under construction countywide, all are scheduled for completion in 2019. Just over 914,000 sf or 53% 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 1.7 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 2019.

Other future inventory includes the 285,000 sf One Paseo project in Del Mar Heights. It is already over 40% pre-leased, including 67,000 sf leased by ACADIA Pharmaceuticals.

The countywide average asking rent for all classes is now \$3.08 per square foot (psf) on a monthly full service basis. This metric increased by five cents over the last three months and is up 4.1% from where it stood a year ago, driven by the addition of large class A availabilities. Over the past 12 months, Class A average rent has increased by 6.3% to \$3.53 psf while the Class B rate has increased by 1.1% to \$2.87 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: ¹www.bls.gov ²bea.gov GDP as of 2017. ³Moody's Analytics economy.com 11/18.

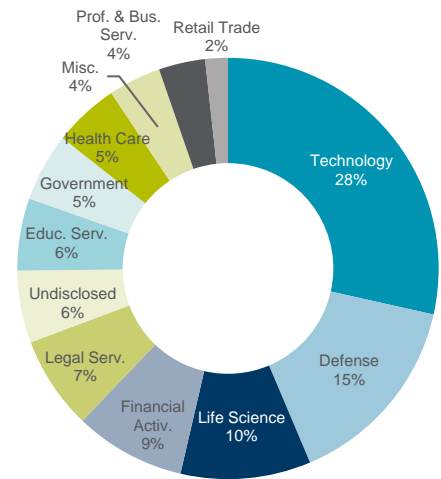
Direct Vacancy vs. Unemployment Rate

DECLINE IN VACANCY CORRELATES DECLINE IN UNEMPLOYMENT



Tenant Demand by Industry Type

TOP 3 INDUSTRY SECTORS ACCOUNT FOR 53% OF TOTAL DEMAND



Outlook

- Continued economic and job growth in combination with increasing tenant demand should provide continued occupancy and rent growth throughout 2019 and into 2020. Leasing within the 5,000 to 50,000 sf range will continue to be the main driver of activity, accounting for 64% of total sf in lease obligations set to expire over the next 18 months.
- Active tenant requirements of all sizes remain robust at 3.2 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	343	10,646,442	155,783	1,645,999	16.9%	-51,570	-84,602	568,794	\$2.59	\$2.87
Central County	838	50,045,581	1,446,393	5,647,722	14.2%	-37,697	430,024	478,215	\$3.25	\$3.73
South County	321	16,883,537	227,951	1,571,411	10.7%	-7,055	143,914	674,448	\$2.95	\$3.32
TOTAL	1,502	77,575,560	1,830,127	8,865,132	13.8%	-96,322	489,336	1,721,457	\$3.08	\$3.53
Class A	330	34,418,490	1,066,415	4,374,970	15.8%	244,056	624,519	1,709,457	\$3.56	
Class B	766	33,020,382	716,236	3,436,913	12.6%	-190,642	-16,132	12,000	\$2.87	
Class C	406	10,136,688	47,476	1,053,249	10.9%	-149,736	-119,051	0	\$1.97	
TOTAL	1,502	77,575,560	1,830,127	8,865,132	13.8%	-96,322	489,336	1,721,457	\$3.08	

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

Key Lease Transactions Q4 2018

PROPERTY	SF	TENANT	LANDLORD	TRANSACTION TYPE	SUBMARKET
Terraces	141,696	Guild Mortgage	Sudberry Properties	Renewal & Expansion	Kearny Mesa
Ocean Ranch	100,000	Health & Human Services Agency	Hamann Construction	New	Oceanside
Kilroy Centre Del Mar	80,475	FICO	Kilroy Realty Corporation	Renewal	Del Mar Heights
One Paseo	67,020	ACADIA Pharmaceuticals	Kilroy Realty Corporation	New	Del Mar Heights
Kettner & Ash	43,540	SPACES	DivcoWest	New	Downtown

Key Sale Transactions Q4 2018

PROPERTY	SF	BUYER	SELLER	PRICE / \$PSF	SUBMARKET
Paseo Del Mar	232,035	The Irvine Company	Metzler Real Estate	\$166,000,000 / \$715	Del Mar Heights
One Del Mar	115,376	The Irvine Company	Clarion Partners	\$73,350,000 / \$636	Del Mar Heights
Regents Park Financial Center	94,162	Regent Properties	Bollert Lebeau	\$39,500,000 / \$419	UTC
Paseo Summit	74,827	NextMed	Davlyn Investments	\$23,000,000 / \$307	Carlsbad
The Yard	60,518	TH Real Estate	Locale Advisors	\$24,825,000 / \$410	Sorrento Mesa

Under Construction Q4 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	2019	Carlsbad
Tower 180	324,341	0	0%	1010 2nd Ave.	A	2019	Downtown
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
North City – CSUSM	155,000	155,000	100%	Twin Oaks Valley Rd.	A	2019	San Marcos
Center for Novel Therapeutics	137,500	70,030	51%	9310 Athena Cir.	A	2019	Torrey Pines
Kettner & Ash	123,079	43,540	35%	1420 Kettner Blvd.	A	2019	Downtown
Gradlabs	109,362	22,351	20%	9880 Campus Point Dr.	A	2019	Campus Point
Park+Market	66,000	66,000	100%	Park Ave. & G St.	A	2019	Downtown
Lift	44,794	19,620	44%	6021-6023 Innovation Way	A	2019	Carlsbad
The Collection at UTC	40,000	0	0%	4575 La Jolla Village Dr.	A	2019	UTC
Sorrento Summit	28,000	28,000	100%	7475 Lusk Blvd.	A	2019	Sorrento Mesa
860 S. Coast 101 Hwy.	12,000	12,000	100%	860 S. Coast 101 Hwy.	B	2019	Encinitas

OFFICE SUBMARKETS
SAN DIEGO



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