

MARKET OVERVIEW. The San Diego Flex/R&D market is coming off three consecutive years with more than half a million square feet of new construction deliveries, which is more than double the 10-year annual average. This has placed some pressure on the market's overall occupancy rate, and all the new product has pushed the average asking rental rate up significantly. There was negative net absorption in the first quarter, and transaction volume is down. We will be watching to see if these trends continue through the second quarter, because this would surely put the market on a path for increased vacancy at year-end.

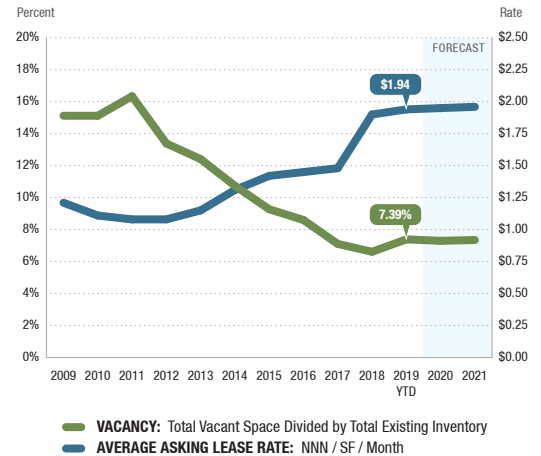
VACANCY. Direct/sublease space (unoccupied) finished the first quarter at 7.39%, a significant increase from the previous quarter's vacancy rate of 6.61%, but 3 basis points lower than the vacancy rate of a year ago. The vacancy rate remains far less than half of the 2010 recession low of 16.12%.

LEASE RATES. The average asking triple net lease rate per square foot per month in San Diego County was \$1.94 at the end of the first quarter, which is a four-cent increase over the fourth quarter of 2018. The average asking lease rate has been on a long-term trend of increases, but recent increases in the average are likely due to a change in the composition of available space. There is now a larger portion of biotech space in the availability, which is pulling the average asking rate up.

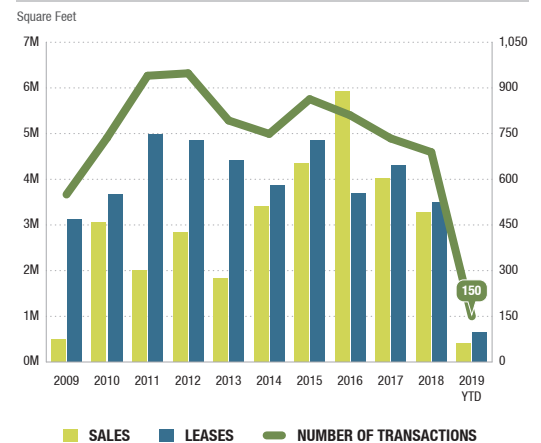
TRANSACTION ACTIVITY. The combined amount of square feet leased or sold in the first quarter totaled 1.0 million square feet, a decrease from the 1.6 million square feet transacted in the first quarter of 2018. Sales transaction volume in 2018 was at the lowest level seen in four years, and the amount of square feet leased was lower than any other year since 2009. 2019 is starting off on the same foot as the past two years, with a low level of transaction volume. This statistic can have some lag time in being reported, so look for this quarter's figures to end up somewhat higher in the next report.

EMPLOYMENT. The unemployment rate in San Diego County was 3.5% in February 2019, down from a revised 3.8% in January 2019, and unchanged from the year-ago estimate of 3.5%. This compares with an unadjusted unemployment rate of 4.4% for California and 4.1% for the nation during the same period. According to the State of California Employment Development Department, San Diego County gained 19,900 payroll jobs between February 2018 and February 2019, including 6,900 from education and health services, which reported the largest overall gain. The professional and business services sector reported a growth of 5,400 jobs, the second most among the major employment sectors. The largest year-over-year loss was in trade, transportation, and utilities which reported 2,600 fewer jobs than the prior year.

VACANCY vs. AVERAGE ASKING LEASE RATE



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



Market Statistics

	Change Over Last Quarter	1Q 2019	4Q 2018	1Q 2018	% Change Over Last Year
Vacancy Rate	▲ UP	7.39%	6.61%	7.41%	(0.30%)
Availability Rate	▼ DOWN	10.46%	11.29%	10.48%	(0.22%)
Average Asking Lease Rate	▲ UP	\$1.94	\$1.90	\$1.46	32.88%
Sale & Lease Transactions	▼ DOWN	1,046,356	2,421,978	1,560,216	(32.94%)
Gross Absorption	▼ DOWN	552,956	874,542	983,130	(43.76%)
Net Absorption	▼ NEGATIVE	(220,093)	(262,257)	(147,867)	N/A

EMPLOYMENT. The labor market in San Diego County will continue to improve, although we anticipate job growth to slow. In 2018 there was a 1.7% increase in total employment, and a 1.0–1.2% increase is projected for 2019. With the local stalwarts of defense and biotech remaining strong, look for these sectors to lead the way for employment gains, followed by healthcare.

LEASE RATES. Despite a decrease in transaction volume, landlords are still pushing asking rental rates up. Expect average asking rates to increase by approximately 2–3% over the next four quarters.

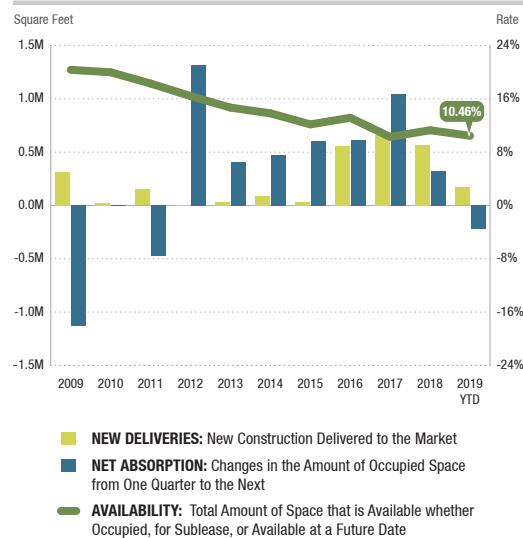
VACANCY. With the relatively large number of deliveries last year, we expect vacancy rates to move back towards the 8% range.

CONSTRUCTION. In the first quarter of 2019 there were 168,000 square feet of new construction completed, which puts the market on pace for the fourth consecutive year of new construction above the 10-year average.

AVAILABILITY. Direct/sublease space being marketed was 10.46%, which is effectively unchanged from the 10.48% availability from the first quarter of 2018.

ABSORPTION. The San Diego Flex/R&D market recorded 220,093 square feet of negative net absorption in the first quarter of 2019. The San Diego market has not seen a calendar year with negative net absorption since 2011.

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Significant Transactions

Sales

Property Address	Submarket	Square Feet	Sale Price	Buyer	Seller
9540 & 9550 Waples St. 6352 & 6354 Corte Del Abeto	Sorrento Mesa / Carlsbad	99,187	\$16,550,000	BKM Capital Partners	3G Properties, LP
5993 & 5999 Avenida Encinas	Carlsbad	68,392	\$23,900,000	RAF Pacifica Group, Inc.	Lincoln Property Company
10575 & 10581 Roselle St.	Sorrento Valley	37,555	\$15,500,000	Longfellow Real Estate Partners	Parallel Capital Partners
2320 & 2330 Faraday Ave.	Carlsbad	40,826	\$12,800,000	RAF Pacifica Group, Inc.	Alvarez & Marsal
1905 Aston Ave.	Carlsbad	48,818	\$12,400,000	RAF Pacifica Group, Inc.	Alvarez & Marsal

Leases

Property Address	Submarket	Square Feet	Transaction Date	Tenant	Owner
10614 Science Center Dr.	Torrey Pines	59,248	Mar-2019	Nitto BioPharma, Inc.	Alexandria Real Estate
9244 Balboa Ave.	Kearny Mesa	45,600	Mar-2019	Columbia Care/Focused Health	9244 Balboa Blvd., LLC
10628 Science Center Dr.	Torrey Pines	24,562	Feb-2019	Regulus Therapeutics	Alexandria Real Estate
4863 Shawline St.	Kearny Mesa	22,621	Feb-2019	Fuse Integration	McGrath
8572 Spectrum Ln.	Kearny Mesa	22,099	Jan-2019	Renewal By Andersen	First Industrial Trust

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 1Q2019	Square Feet Available	Availability Rate 1Q2019	Average Asking Lease Rate	Net Absorption 1Q2019	Net Absorption 2019	Gross Absorption 1Q2019	Gross Absorption 2019
Central													
Central City	12	172,281	0	0	3,737	2.17%	20,557	11.93%	\$1.59	0	0	12,478	12,478
East City	2	26,892	0	0	0	0.00%	0	0.00%	–	0	0	0	0
Southeast City	21	223,879	0	0	0	0.00%	0	0.00%	\$1.44	3,000	3,000	3,000	3,000
Kearny Mesa	205	5,588,565	0	0	522,727	9.35%	0	0.00%	\$1.77	(32,247)	(32,247)	74,177	74,177
Mission Gorge	27	279,740	0	0	8,055	2.88%	9,040	3.23%	\$1.53	(1,572)	(1,572)	2,126	2,126
Rose Canyon/Morena	38	610,312	0	0	50,875	8.34%	50,875	8.34%	\$1.49	(2,917)	(2,917)	2,097	2,097
Sports Arena/Airport	31	397,195	0	0	23,656	5.96%	24,616	6.20%	\$1.37	(10,899)	(10,899)	0	0
Miramar	220	4,775,405	130,000	11,760	377,912	7.91%	623,234	13.05%	\$1.60	(127,516)	(127,516)	36,245	36,245
Sorrento Mesa	153	6,141,867	28,000	618,000	674,741	10.99%	1,075,246	17.51%	\$2.20	2,834	2,834	30,525	30,525
Sorrento Valley	101	2,340,438	0	120,000	192,301	8.22%	272,908	11.66%	\$2.21	10,759	10,759	43,355	43,355
Torrey Pines/UTC	71	6,172,185	235,782	1,104,217	505,251	8.19%	1,030,950	16.70%	\$4.26	(99,739)	(99,739)	14,682	14,682
Central County Total	881	26,728,759	393,782	1,853,977	2,359,255	8.83%	3,107,426	11.63%	\$2.36	(258,297)	(258,297)	218,685	218,685
East County													
El Cajon	77	863,407	0	0	16,243	1.88%	22,351	2.59%	\$1.02	689	689	4,080	4,080
La Mesa/Spring Valley	39	293,035	0	0	1,425	0.49%	10,270	3.50%	\$1.18	0	0	0	0
Santee/Lakeside	54	554,061	0	0	7,525	1.36%	8,415	1.52%	\$1.35	145	145	2,145	2,145
Outlying SD County South	21	92,705	0	0	14,775	15.94%	14,775	15.94%	\$1.41	(9,775)	(9,775)	0	0
East County Total	191	1,803,208	0	0	39,968	2.22%	55,811	3.10%	\$1.17	(8,941)	(8,941)	6,225	6,225
North County													
Escondido	78	747,932	0	0	16,919	2.26%	31,288	4.18%	\$1.07	4,683	4,683	4,683	4,683
Oceanside	33	984,170	0	0	16,133	1.64%	24,074	2.45%	\$1.02	4,773	4,773	7,494	7,494
San Marcos	61	1,094,862	0	0	67,678	6.18%	120,912	11.04%	\$1.19	(9,916)	(9,916)	20,558	20,558
Vista	62	1,392,680	0	0	67,504	4.85%	117,093	8.41%	\$1.15	(24,601)	(24,601)	3,870	3,870
Carlsbad	252	6,371,540	0	0	577,653	9.07%	855,759	13.43%	\$1.30	(7,677)	(7,677)	69,258	69,258
North Beach Cities	19	164,051	0	0	5,846	3.56%	5,846	3.56%	\$2.26	2,055	2,055	3,205	3,205
Outlying SD County North	19	138,287	0	0	704	0.51%	7,538	5.45%	\$1.15	0	0	0	0
North County Total	524	10,893,522	0	0	752,437	6.91%	1,162,510	10.67%	\$1.26	(30,683)	(30,683)	109,068	109,068
I-15 Corridor													
Poway	61	1,847,147	0	0	23,539	1.27%	33,074	1.79%	\$1.23	10,630	10,630	21,476	21,476
Rancho Bernardo	94	4,623,602	0	0	229,958	4.97%	401,444	8.68%	\$1.67	46,821	46,821	126,736	126,736
Scripps Ranch	28	749,217	0	235,227	4,711	0.63%	23,768	3.17%	\$1.19	37,717	37,717	44,879	44,879
I-15 Corridor Total	183	7,219,966	0	235,227	258,208	3.58%	458,286	6.35%	\$1.60	95,168	95,168	193,091	193,091
South County													
Chula Vista	80	1,511,380	0	14,930	156,198	10.33%	166,048	10.99%	\$1.45	(19,840)	(19,840)	17,961	17,961
National City	23	333,628	0	0	925	0.28%	7,504	2.25%	\$1.27	2,500	2,500	7,926	7,926
Otay Mesa	7	166,652	0	197,381	34,443	20.67%	141,443	84.87%	\$0.74	0	0	0	0
San Ysidro/Imperial Beach	5	86,361	0	0	0	0.00%	0	0.00%	–	0	0	0	0
South County Total	115	2,098,021	0	212,311	191,566	9.13%	314,995	15.01%	\$1.10	(17,340)	(17,340)	25,887	25,887
San Diego County Total	1,894	48,743,476	393,782	2,301,515	3,601,434	7.39%	5,099,028	10.46%	\$1.94	(220,093)	(220,093)	552,956	552,956

Lease rates are on a triple-net basis.



Same Story, Different Year...

by Josh West

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The San Diego Industrial market started the year strong. With a market-wide vacancy of 4.28% and demand staying strong, the market should remain steady for 2019. Tenant demand during the quarter remained consistent with approximately 2,000,000 square feet of gross absorption (square footage of tenant move-ins). Net absorption finished above average, at 519,880 square feet which reflected a 54% increase over the same period in 2018. Due to the strong demand in the market, many tenants are forced to renew in their existing space regardless of functionality or business needs.

Owners are benefiting from the strong market as concessions such as rental abatement have thinned dramatically and, in some cases, disappeared. Although the total square footage leased reflected a sizeable increase over 1st quarter 2018, there was a 28% decrease in the total number of leases. With rents reaching an average of \$1.03 per square foot countywide and leasing velocity holding steady, San Diego will remain a “landlord’s market” for 2019.

With these strong fundamentals we are seeing speculative ground-up development in markets such as Carlsbad, Poway, and Otay Mesa. There are currently more than 1,200,000 square feet of product being developed. Developers are counting on the continuously vigorous and pent-up tenant demand for space.

The owner-user market was also strong this quarter due to increasing rents and historically low interest rates. Values have reached an all-time high with markets such as Poway cresting well over \$200 per square foot. The total volume of sale transactions decreased by 26% over the same period in 2018. This was mainly due to a lack of available product.

Investments have also remained active; however, volume has decreased from 2018. This slowdown is mainly attributed to record-low cap rates (higher pricing) and lack of available product, especially in our core market. The market remains flush with capital which will keep the investment market steady for the foreseeable future.

2019 will likely be very similar to 2018 with consistent demand across the board. While it seems this recovery should be losing steam by now, all signs continue to point to steady growth and strong fundamentals moving forward.

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This survey consists of properties representing both single tenant and multi-tenant buildings. The lease rates are based on a triple-net basis. The information contained in this report is gathered from sources that are deemed reliable, but no guarantees are made as to its accuracy. This information is for Voit Real Estate Services' use only and cannot legally be reproduced without prior written consent from the management of Voit Real Estate Services. ©2019 Voit Real Estate Services, Inc. DRE License #01991785.

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Product Type

MFG./DIST.: Flex/Research and Development (R&D) buildings can be one story, one story with a mezzanine, and two story built-out structures with a high ratio of window wall to floor area with lower ceilings. They generally have over 50% built-out office space or laboratory use, with the remaining space being utilized as light manufacturing or warehousing. In addition, the parking ratio must be at least 3 spaces or greater per 1,000 square feet.

Submarkets

CENTRAL COUNTY

Central City, East City, Southeast City, Kearny Mesa, Mission Gorge, Rose Canyon / Morena, Sports Arena / Airport, Miramar, Sorrento Mesa, Sorrento Valley, Torrey Pines / UTC

EAST COUNTY

El Cajon, La Mesa / Spring Valley, Santee / Lakeside, Outlying SD County South

NORTH COUNTY

Escondido, Oceanside, San Marcos, Vista, Carlsbad, North Beach Cities, Outlying SD County North

I-15 CORRIDOR

Poway, Rancho Bernardo, Scripps Ranch

SOUTH BAY

Chula Vista, National City, Otay Mesa, San Ysidro / Imperial Beach