

OVERVIEW. The San Diego Flex R&D market was a bright spot among the major commercial real estate property sectors last quarter, with a transaction volume that actually exceeded the prior quarter (which was before the COVID-19 outbreak.) It also was one of the only property sectors to see positive net absorption. The Flex R&D market came back down to earth a bit in 3Q with negative net absorption, a decrease in transaction volume, and lower average asking rental rates. Approximately 75% of the Flex R&D buildings currently under construction or in renovation have been leased, which should add positive net absorption in the coming quarters.

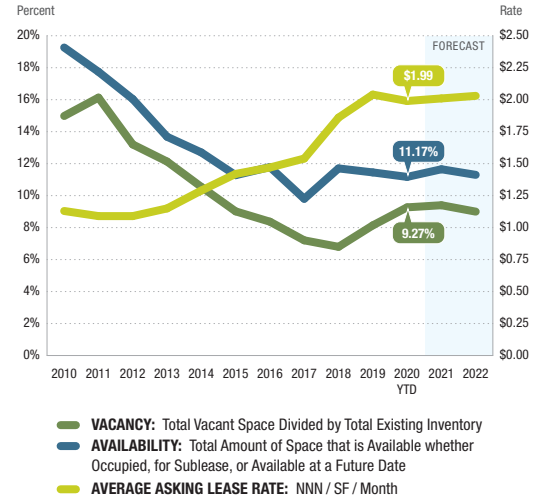
VACANCY & AVAILABILITY. Direct/sublease space (unoccupied) finished 3Q at 9.27%, an increase of 63 basis points over 3Q 2019's vacancy rate of 8.64%. The vacancy rate is on pace for a second consecutive year of increases, following seven straight years of decreases. Incredibly, while vacancy has increased, availability has decreased for two consecutive years. Vacancy measures the amount of space which is occupied regardless of whether it is being marketed for sale or lease. Availability measures the amount of space which is on the market, regardless of whether or not it is occupied. Direct/sublease space being marketed was 11.17%, which is a 17 basis point decrease year-over-year from the 3Q 2019 availability rate of 11.34%.

LEASE RATES. The average asking triple net lease rate per square foot per month in San Diego County was \$1.99 at the end of 3Q, which is a five-cent decrease from 3Q 2019. The average asking lease rate has been on a long-term trend of increases, but dramatic increases in the average each of the past two years are likely due to a change in the composition of available space. The decrease of the average asking rental rate in 3Q was the third consecutive quarter of decreases following only one quarterly decrease in the past seven years.

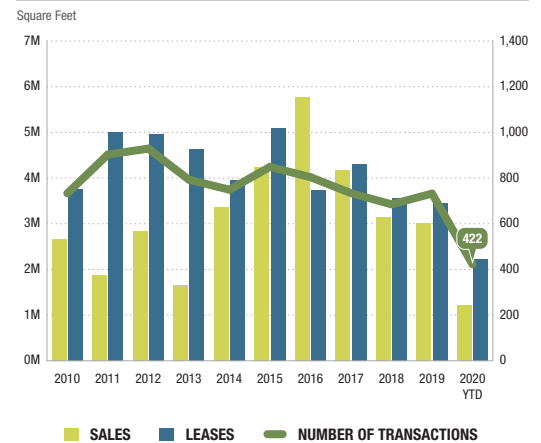
TRANSACTION ACTIVITY. The combined amount of square feet leased or sold in 3Q totaled 0.8 MSF, a decrease from the 1.5 MSF transacted in 2Q 2020. The leasing volume through three quarters is on pace to exceed 3 MSF for the year, roughly in the range of a normal year if 4Q can sustain the tenant demand we are seeing now. Conversely, the sales volume for 2020 is on pace for 1.6 MSF of transactions, just over half the 3 MSF sold in 2019, and a far cry from the 5.8 MSF sold in 2016. The 120 lease transactions in 3Q was within the low end of a normal range of leasing activity. This suggests that there was a high proportion of smaller leases. 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. The largest sale of the quarter was Longfellow's \$42.75 million acquisition of 10220-10260 Sorrento Valley Road. Longfellow remains active with two acquisitions this year, notching five since 2018.

ABSORPTION. The San Diego Flex/R&D market recorded 495,582 SF of negative net absorption in 3Q 2020, and the market remains in the red for the year thus far with a total net

VACANCY, AVAILABILITY & AVERAGE ASKING LEASE RATES



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



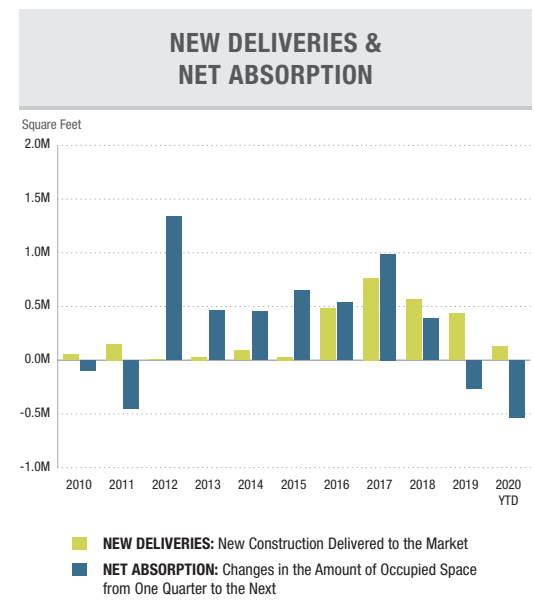
Market Statistics

	Change Over Last Quarter	3Q 2020	2Q 2020	3Q 2019	% Change Over Last Year
Vacancy Rate	▲ UP	9.27%	8.28%	8.64%	7.34%
Availability Rate	▲ UP	11.17%	10.92%	11.34%	(1.46%)
Average Asking Lease Rate	▼ DOWN	\$1.99	\$2.00	\$2.04	(2.45%)
Sale & Lease Transactions	▼ DOWN	801,640	1,463,342	1,701,101	(52.88%)
Gross Absorption	▼ DOWN	488,585	526,120	585,497	(16.55%)
Net Absorption	▼ NEGATIVE	(495,582)	208,967	(342,147)	N/A

absorption of negative 537,972 SF for the first three quarters of 2020. The two smallest Flex/R&D segments of the county, East County and Central County, both have slightly positive absorption for the year thus far, while the remainder of the county is significantly into negative territory.

CONSTRUCTION. In the first three quarters of 2020 there were a total of 126,282 SF of new construction completed, and there were 124,302 SF under construction at the end of 3Q. The biotech sector within the Flex R&D market continues to be the primary driver of new construction. The lack of available building sites in the primary biotech submarkets has led to a steady stream of property conversions and repositioning over the years. There is currently a total of 224,310 SF of Flex/R&D under renovation, almost double the amount under construction. All of the buildings currently under construction are in Torrey Pines and Sorrento Mesa. There are 2.4 MSF of new planned or proposed Flex/R&D buildings in San Diego County, of which more than 80% are located in the core biotech submarkets surrounding UCSD.

EMPLOYMENT. The unemployment rate in San Diego County was 9.9% in August 2020, down from a revised 12.4% in July 2020, and substantially greater than the year-ago estimate of 3.4%. This compares with an unadjusted unemployment rate of 11.6% for California and 8.5% for the nation during the same period. According to the State of California Employment Development Department, San Diego County gained 20,500 jobs between July 2020 and August 2020. With the normal delay in reporting from the California EDD, employment figures from September were unavailable at the time of publishing this report. In September, the employment data for the United States as a whole came in with 661,000 jobs added which was the fifth straight month of net job gains.



Forecast

The road forward heavily depends on factors outside of traditional free market considerations, including COVID-19 vaccine development, state and local government restrictions on business operations, and economic stimulus actions. Based upon the current conditions and outlook, we anticipate the vacancy rate will stay relatively stable over the next quarter or two. With the gap between availability and vacancy narrowing, this suggests that vacancy will trend downwards. There is likely enough angst regarding the broader economy to keep rental rates from increasing at the rapid pace seen over the past few years, but the relative health of the Flex/R&D market should prevent significant decreases in the nominal rents.

Significant Transactions

Sales

Property Address	Submarket	Square Feet	Sale Price	Buyer	Seller
10220-10260 Sorrento Valley Rd.	Sorrento Valley	124,473	\$42,750,000	Longfellow Real Estate Partners	The Blackstone Group, LP
10907-10939 Technology Pl.	Rancho Bernardo	137,695	\$39,000,000	Dollinger Properties	Menlo Equities
6059 Cornerstone Ct. W.	Sorrento Mesa	51,690	\$20,600,000	6059 Cornerstone Partners, LLC	Buchanan Street Partners
1900 Aston Ave.	Carlsbad	44,757	\$11,568,750	Providence RE Group	Diversified Properties
6349 Palomar Oaks Ct.	Carlsbad	27,904	\$6,779,650	Grand Prairie Isuzu Parkway, LLC	B&C, LP

Leases

Property Address	Submarket	Square Feet	Transaction Date	Tenant	Owner
10421 Pacific Center Ct.	Sorrento Mesa	77,177	Aug-2020	Tanvex	City Office REIT
6221 El Camino Real	Carlsbad	73,057	Jul-2020	GenMark Diagnostics	The Blackstone Group
5590 Morehouse Dr.	Sorrento Mesa	35,284	Sep-2020	Neomorph	Phase 3 RE Partners
11010 Torreyana Rd.	Torrey Pines	27,068	Sep-2020	Undisclosed	BioMed Realty
1709 La Costa Meadows Dr.	San Marcos	21,800	Sep-2020	Spinergy	Nordic Naturals

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 3Q2020	Square Feet Available	Availability Rate 3Q2020	Average Asking Lease Rate	Net Absorption 3Q2020	Net Absorption 2020	Gross Absorption 3Q2020	Gross Absorption 2020
Central													
Central City	12	174,781	0	0	25,884	14.81%	35,577	20.36%	\$1.49	2,062	2,062	2,062	2,062
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%	-	0	0	0	0
Kearny Mesa	205	5,564,704	0	10,200	470,945	8.46%	496,119	8.92%	\$1.66	(52,344)	(57,066)	42,728	69,615
Mission Gorge	27	279,740	0	0	6,048	2.16%	8,008	2.86%	\$1.62	3,122	5,796	5,970	17,814
Rose Canyon/Morena	39	598,837	0	0	29,790	4.97%	36,866	6.16%	\$1.48	5,210	14,713	11,004	38,187
Sports Arena/Airport	32	407,790	0	0	70,239	17.22%	70,239	17.22%	\$1.98	840	(4,460)	840	840
Miramar	220	4,828,732	0	130,510	399,830	8.28%	543,444	11.25%	\$1.84	(41,125)	(78,814)	67,172	193,315
Sorrento Mesa	163	6,872,997	0	618,000	1,048,471	15.25%	910,373	13.25%	\$2.62	(32,819)	(63,669)	106,195	336,924
Sorrento Valley	103	2,406,096	0	220,180	297,093	12.35%	468,850	19.49%	\$3.01	(30,495)	(44,080)	18,037	117,152
Torrey Pines/UTC	72	6,340,213	124,302	1,052,312	481,466	7.59%	558,336	8.81%	\$4.39	(39,239)	(6,977)	66,547	226,464
Central County Total	896	27,724,661	124,302	2,031,202	2,829,766	10.21%	3,127,812	11.28%	\$2.44	(184,788)	(232,495)	320,555	1,002,373
East County													
El Cajon	78	875,372	0	40,000	8,431	0.96%	49,722	5.68%	\$1.20	(7,541)	3,510	0	14,867
La Mesa/Spring Valley	41	295,786	0	0	4,083	1.38%	15,233	5.15%	\$1.81	(2,083)	11,091	2,000	22,410
Santee/Lakeside	56	634,728	0	0	7,372	1.16%	8,872	1.40%	\$1.17	(322)	(2,875)	15,350	22,997
Rural East County	22	96,534	0	0	0	0.00%	0	0.00%	-	0	0	0	0
East County Total	197	1,902,420	0	40,000	19,886	1.05%	73,827	3.88%	\$1.34	(9,946)	11,726	17,350	60,274
North County													
Escondido	79	741,915	0	0	28,045	3.78%	41,477	5.59%	\$1.11	7,073	(3,534)	7,073	8,673
Oceanside	33	983,643	0	0	25,556	2.60%	57,998	5.90%	\$1.09	3,770	(108)	3,770	12,014
San Marcos	58	1,061,571	0	0	81,684	7.69%	93,274	8.79%	\$1.21	(6,463)	(13,940)	10,073	30,483
Vista	63	1,414,425	0	0	321,269	22.71%	343,504	24.29%	\$1.11	(223,725)	(247,951)	25,150	56,799
Carlsbad	259	6,753,099	0	0	842,399	12.47%	955,780	14.15%	\$1.34	(16,689)	(32,369)	68,023	306,101
North Beach Cities	18	158,801	0	0	2,660	1.68%	2,660	1.68%	\$3.50	240	2,951	240	5,751
Rural North County	19	139,572	0	0	2,900	2.08%	2,900	2.08%	\$0.50	(50)	(1,350)	1,550	1,550
North County Total	529	11,253,026	0	0	1,304,513	11.59%	1,497,593	13.31%	\$1.27	(235,844)	(296,301)	115,879	421,371
I-15 Corridor													
Poway	60	1,841,067	0	0	32,422	1.76%	41,859	2.27%	\$1.29	(8,076)	(19,388)	6,751	14,786
Rancho Bernardo	97	4,683,038	0	0	269,418	5.75%	592,886	12.66%	\$1.83	(38,902)	(5,517)	835	75,295
Scripps Ranch	28	757,413	0	339,400	19,496	2.57%	32,478	4.29%	\$1.37	(10,067)	(5,282)	6,890	11,675
I-15 Corridor Total	185	7,281,518	0	339,400	321,336	4.41%	667,223	9.16%	\$1.81	(57,045)	(30,187)	14,476	101,756
South County													
Chula Vista	79	1,501,626	0	66,860	151,705	10.10%	194,045	12.92%	\$1.33	(9,514)	117	17,845	48,840
National City	23	332,197	0	0	1,971	0.59%	22,522	6.78%	\$1.01	1,555	(925)	2,480	2,480
Otay Mesa	7	156,362	0	0	27,153	17.37%	29,553	18.90%	\$0.73	0	10,093	0	13,000
South San Diego	5	86,361	0	0	0	0.00%	0	0.00%	-	0	0	0	0
South County Total	114	2,076,546	0	66,860	180,829	8.71%	246,120	11.85%	\$1.08	(7,959)	9,285	20,325	64,320
San Diego County Total	1,921	50,238,171	124,302	2,477,462	4,656,330	9.27%	5,612,575	11.17%	\$1.99	(495,582)	(537,972)	488,585	1,650,094

Lease rates are on a triple-net basis.



Standing Steady

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Through the third quarter of 2020, industrial real estate remains the one pillar of stability when it comes to the major regional sectors of commercial real estate. Despite the economic shock that has reverberated around the U.S. since March, and the tremendous loss of jobs, there is not a single submarket in San Diego County with a double-digit vacancy rate. The county overall had a vacancy rate north of ten percent as recently as 2013, and yet it sits currently under five percent (4.93%) even with the wave of recent construction that has delivered over the past five years.

Among the larger industrial and Flex/R&D buildings, two sectors have really been doing the heavy lifting when it comes to the growth in the tenant base we have seen in 2020. Everyone knows of the rise of e-commerce, vis-à-vis Amazon and other third-party logistics companies, but also the life sciences and biotechnology sectors are going gangbusters. For larger industrial requirements, the current pool of active tenants shrinks significantly beyond those sectors. Talking about the growth of Amazon has become the broken record that we keep hearing quarter after quarter, but they are leasing hundreds of thousands of square feet, all while a multi-million square foot new development for them in Otay Mesa is underway.

The e-commerce growth speaks to the key position that industrial real estate currently holds. Many office tenants can telecommute, drawing down the current demand for office space. Many retailers have been restricted or hampered by the public nature of their business. Companies that operate in industrial and R&D properties tend to be less conducive to telecommuting, while most do not have the restrictions and risks that come along with businesses that are open to the general public.

On the multi-tenant business park side of things there has been an increase in availability. However, in many areas this has provided an opportunity for tenants to have more options in contrast to this time last year when some areas of the county had vacancy rates under 2% or 3%. Rental rates are not pulling back yet. It should be noted that concessions and negotiations are softening up throughout the county.

Industrial and R&D real estate has felt some effects from the COVID-19 shutdowns, but overall things have remained more stable than the other sectors. Hopefully, we may have seen the worst of it already from an industrial and R&D property perspective.

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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. ©2020 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, Rural East County

NORTH COUNTY

Escondido, Oceanside, San Marcos, Vista, Carlsbad, North Beach Cities, Rural North County

I-15 CORRIDOR

Poway, Rancho Bernardo, Scripps Ranch

SOUTH BAY

Chula Vista, National City, Otay Mesa, South San Diego