

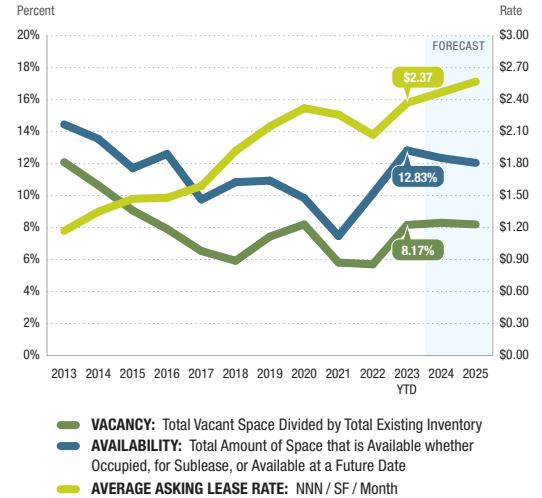
OVERVIEW. On the heels of two consecutive years of positive net absorption, the Flex/R&D market started the year firmly in the red with 750,000 SF of negative net absorption, and a substantial increase in the vacancy and availability rates. The Flex/R&D market in San Diego is driven by the biotech sector which is showing signs of slowing. Rental rates remain elevated from a long-term perspective. Sales activity was robust in 2022, but leasing and sales volume both started the year posting meager totals in the first half.

VACANCY & AVAILABILITY. Direct/sublease space (unoccupied) finished Q2 2023 at 8.2%, a massive increase of 53% from Q2 2022's vacancy rate of 5.3%. Yet this is only half of the vacancy rate from eleven years ago when the countywide vacancy rate finished 2011 above 16%. Direct/sublease space being marketed was 12.8% at the end of Q2. The availability rate saw an 81.6% increase from the prior year. Vacancy measures the amount of space which is unoccupied 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 it is occupied. Since the start of 2022, the sublease vacancy has increased fourfold, and finished Q2 2023 at 3.2%.

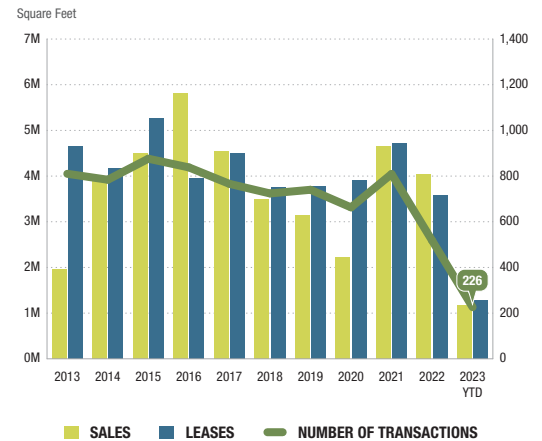
LEASE RATES. The average asking triple net lease rate per square foot per month in San Diego County was \$2.37 at the end of Q2 2023, which is an increase of 17.3% from Q2 2022. The average asking lease rate has been on a long-term trend of increases, but dramatic changes in the average in recent history are likely due to a change in the composition of available space. Over the past seven years the countywide asking rental rate has increased an average of 6% per year, as more space gets built out with expensive biotech laboratories. The Flex/R&D market is relatively small in comparison to the office or industrial markets, and additionally the difference between the rental rates for biotech properties and other Flex/R&D properties is vast. This causes the overall average market statistics to fluctuate periodically.

TRANSACTION ACTIVITY. The combined amount of square feet leased or sold in Q2 totaled 684,439 SF, a 62.3% decrease from the 1.8 MSF transacted in Q2 2022. There were 385,427 SF of Flex/R&D space leased in 80 transactions recorded in Q2. These figures were far below the five-year averages of 142 transactions and 984,187 SF leased per quarter. Two of the top leases in the quarter were subleases, an indicator of the softening fundamentals within the Flex/R&D market. The largest sale of Q2 was the \$86 million sale of 11119 North Torrey Pines Road. Many of the largest life sciences landlords have taken the opportunity to shed non-core assets while pricing remains at all-time highs. Alexandria disposed of this property likely due to the fact that it was geographically separated from their other nearby holdings, which didn't allow for the campus-style redevelopments they favor.

VACANCY, AVAILABILITY & AVERAGE ASKING LEASE RATES



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



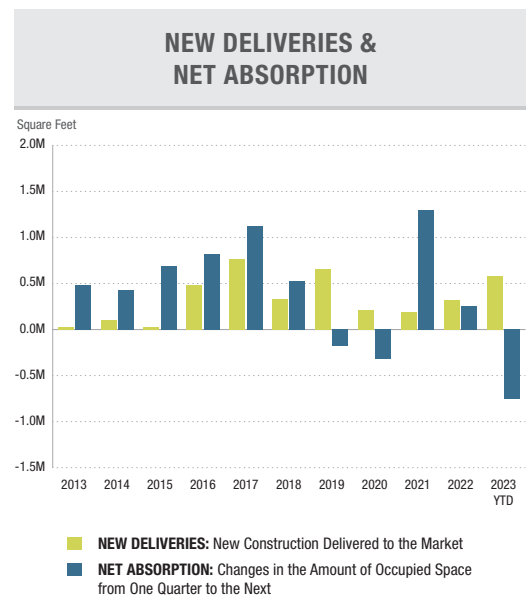
Market Statistics

	Change Over Last Quarter	Q2 2023	Q1 2023	Q2 2022	% Change Over Last Year
Vacancy Rate	▲ UP	8.17%	7.30%	5.33%	53.27%
Availability Rate	▲ UP	12.83%	11.19%	7.06%	81.58%
Average Asking Lease Rate	▲ UP	\$2.37	\$2.17	\$2.02	17.33%
Sale & Lease Transactions	▼ DOWN	684,439	1,773,689	1,816,883	(62.33%)
Gross Absorption	▲ UP	580,644	563,818	851,488	(31.81%)
Net Absorption	▼ NEGATIVE	(244,834)	(524,320)	90,079	N/A

ABSORPTION. The San Diego Flex/R&D market recorded 244,834 SF of negative net absorption in Q2. The negative net absorption was concentrated in the suburban core of the county where the bulk of the biotech properties is located. There has not been a calendar year with more than 0.5 MSF of negative net absorption in the Flex/R&D market in over a decade, but the market has recorded over 750,000 SF of negative net absorption in the first half of 2023. The biotech segment of the Flex/R&D market has a very boom-bust nature dominated by a high percentage of large tenants which can move the market rapidly in one direction or the other.

CONSTRUCTION. At the end of Q2 there were 1 MSF under construction. The lack of available building sites, specifically in the primary biotech submarkets, has led to a steady stream of property conversions and repositioning over the years. These conversions do not show up in the new construction totals. The dividing line between office properties and flex properties is becoming less defined, especially in Sorrento Mesa and Sorrento Valley where there continues to be a large number of capital chasing properties than can be converted for lab space. Additionally, many ground-up developments are positioned towards both office and lab users to fill their new buildings.

EMPLOYMENT. The unemployment rate in San Diego County was 3.5% in May 2023, up from a revised 3.3% in April 2023, and above the year-ago estimate of 2.9%. This compares with an unadjusted unemployment rate of 4.5% for California and 3.4% for the nation during the same period. Over the 12-month period between May 2022 and May 2023, San Diego County employment increased by 42,500 jobs, an increase of 2.8%. With the normal delay in reporting from the California EDD, employment figures from June were unavailable at the time of publishing this report. For the nation as a whole, 209,000 jobs were added in June, the lowest monthly total in the past two and a half years.



Forecast

There are concerns that the supply of biotech conversions has outpaced tenant demand. Growth in the biotech sector is heavily reliant upon large capital infusions, and not only will this capital be more difficult to source during an economic downturn, but also it will demand higher yields in response to rising interest rates. We anticipate an increase in vacancy as the surge of life science conversions centered around Sorrento Mesa reaches completion in the second half of 2023.

Significant Transactions

Sales						* Voit Real Estate Services Deal
Property Address	Submarket	Square Feet	Sale Price	Buyer	Seller	
11119 N. Torrey Pines Rd.	Torrey Pines	72,506	\$86,000,000	Divco West Services, LLC	Alexandria Real Estate Equities	
4205-4247 Ponderosa Ave.	Kearny Mesa	156,079	\$46,500,000	Monro Capital	Canyon Partners, LLC*	
2345 Kettner Blvd.	Central	8,000	\$13,000,000	Inside Voice Ventures, LLC	Menzie Trust	
1900 Aston Ave.	Carlsbad	44,757	\$12,300,000	Equity Oak Ventures, LLC	Providence Real Estate Group	
11225-11245 W. Bernardo Ct.	Rancho Bernardo	42,862	\$10,200,000	Equity Oak Ventures, LLC	Providence Real Estate Group	

Leases					
Property Address	Submarket	Square Feet	Transaction Date	Tenant	Owner
2777 Loker Ave. W.	Carlsbad	32,362	Jun-2023	Specialty Laminations	(Sublease)
11075 Roselle St.	Sorrento Valley	25,302	Jun-2023	Undisclosed	Alexandria RE Equities
1900 Aston Ave.	Carlsbad	22,825	Jun-2023	Argonaut Manufacturing	(Sublease)
6925 Lusk Blvd.	Sorrento Mesa	22,606	Apr-2023	Decipher Biosciences	Healthpeak Properties
5803 Newton Dr.	Carlsbad	22,519	Jun-2023	Undisclosed	Elion

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate Q2 2023	Square Feet Available	Availability Rate Q2 2023	Average Asking Lease Rate	Net Absorption Q2 2023	Net Absorption 2023	Gross Absorption Q2 2023	Gross Absorption 2023
Central													
Central City	12	170,791	0	0	26,564	15.55%	28,404	16.63%	\$2.11	0	(6,500)	0	0
East City	3	373,020	0	0	0	0.00%	0	0.00%	-	0	346,128	0	0
Southeast City	22	241,194	0	0	0	0.00%	0	0.00%	\$1.56	2,500	3,000	2,500	5,500
Kearny Mesa	204	5,420,786	0	5,400	175,263	3.23%	306,948	5.66%	\$1.70	(1,999)	(12,413)	52,722	101,235
Mission Gorge	28	294,807	0	0	5,006	1.70%	37,508	12.72%	\$2.16	94	(1,306)	1,400	1,400
Rose Canyon/Morena	40	638,396	0	0	35,539	5.57%	57,837	9.06%	\$1.85	11,561	(28,634)	27,901	33,224
Sports Arena/Airport	32	418,986	0	0	68,764	16.41%	68,764	16.41%	\$1.75	(3,825)	(3,825)	0	0
Miramar	222	4,891,447	0	0	225,531	4.61%	460,857	9.42%	\$2.27	1,099	(21,227)	67,848	143,706
Sorrento Mesa	170	7,654,785	576,821	1,358,496	1,325,530	17.32%	2,047,326	24.87%	\$4.39	(107,355)	(384,277)	67,403	153,403
Sorrento Valley	111	2,681,339	0	0	320,517	11.95%	491,981	18.35%	\$3.14	(50,449)	(162,547)	39,077	65,241
Torrey Pines/UTC	79	6,866,100	439,872	625,094	521,135	7.59%	1,106,796	15.15%	\$6.70	(144,794)	(219,554)	14,659	85,788
Central County Total	923	29,651,651	1,016,693	1,988,990	2,703,849	9.12%	4,606,421	15.02%	\$2.98	(293,168)	(491,155)	273,510	589,497
East County													
El Cajon	81	919,280	0	0	22,681	2.47%	26,156	2.85%	\$1.40	9,768	(810)	17,693	19,674
La Mesa/Spring Valley	43	301,259	0	0	2,600	0.86%	3,425	1.14%	\$1.97	(2,600)	400	0	3,000
Santee/Lakeside	54	610,718	0	0	14,812	2.43%	19,354	3.17%	\$1.33	38	(9,252)	138	10,404
Rural East County	22	95,520	0	0	0	0.00%	0	0.00%	-	0	0	0	0
East County Total	200	1,926,777	0	0	40,093	2.08%	48,935	2.54%	\$1.49	7,206	(9,662)	17,831	33,078
North County													
Escondido	83	785,388	0	0	19,634	2.50%	73,246	9.33%	\$1.38	3,828	5,445	3,828	6,828
Oceanside	34	1,018,227	0	217,000	42,818	4.21%	60,284	5.92%	\$1.71	(31,933)	(37,600)	3,791	9,009
San Marcos	57	1,041,338	0	0	61,820	5.94%	101,492	9.75%	\$1.32	(9,769)	(7,568)	6,005	12,369
Vista	64	1,395,279	0	0	114,327	8.19%	185,525	13.30%	\$2.03	25,331	63,306	25,331	84,504
Carlsbad	265	7,400,919	0	67,714	749,069	10.12%	1,189,774	16.08%	\$1.80	(15,046)	(104,370)	75,133	204,480
North Beach Cities	19	166,277	0	0	12,635	7.60%	14,745	8.87%	\$2.98	3,880	3,880	3,880	3,880
Rural North County	19	139,572	0	0	4,400	3.15%	4,400	3.15%	\$1.00	0	(1,200)	0	0
North County Total	541	11,947,000	0	284,714	1,004,703	8.41%	1,629,466	13.64%	\$1.70	(23,709)	(78,107)	117,968	321,070
I-15 Corridor													
Poway	62	2,113,728	0	0	25,238	1.19%	27,546	1.30%	\$1.54	(11,607)	(11,607)	1,915	1,915
Rancho Bernardo	99	4,700,585	0	0	441,726	9.40%	521,439	11.09%	\$1.87	(27,197)	(263,325)	3,830	19,961
Scripps Ranch	32	1,042,157	0	100,000	100,824	9.67%	105,999	10.17%	\$1.83	120,403	120,793	145,000	145,390
I-15 Corridor Total	193	7,856,470	0	100,000	567,788	7.23%	654,984	8.34%	\$1.83	81,599	(154,139)	150,745	167,266
South County													
Chula Vista	85	1,498,029	0	0	45,929	3.07%	43,144	2.88%	\$1.90	(17,742)	(21,798)	15,110	23,427
National City	25	349,013	0	0	5,788	1.66%	6,778	1.94%	\$1.74	250	(1,788)	4,750	6,994
Otay Mesa	7	156,362	0	0	0	0.00%	0	0.00%	\$2.88	730	3,130	730	3,130
South San Diego	5	86,361	0	0	0	0.00%	0	0.00%	-	0	0	0	0
South County Total	122	2,089,765	0	0	51,717	2.47%	49,922	2.39%	\$1.86	(16,762)	(20,456)	20,590	33,551
San Diego County Total	1,979	53,471,663	1,016,693	2,373,704	4,368,150	8.17%	6,989,728	12.83%	\$2.37	(244,834)	(753,519)	580,644	1,144,462

Lease rates are on a triple-net basis.



Hangover from Gangbuster Years

by **Randy LaChance**

EXECUTIVE VICE PRESIDENT / PARTNER, SAN DIEGO

858.458.3374 . rlachance@voitco.com . Lic. #00969674

The San Diego industrial market was firing on all cylinders during the pandemic with record leasing activity and development. Investment in industrial /logistic projects was at all-time highs due to historically low interest rates, an abundance of capital and double-digit rent growth, all of which helped to push industrial properties to record property values.

From 2010 to 2020, the San Diego County industrial markets averaged 6.7 MSF of gross leasing transactions per year, while the inventory rose from 142 million to 145 million (only 300,000 a year). In 2021, the county recorded over 10 MSF of leasing activity while the area delivered over 7,000,000 SF in new inventory from 2021 to 2022. But, after ten Fed rate hikes, we have started to see a slowdown in activity and development in 2023. Leasing activity has fallen to 2.7 MSF and just 650,000 SF of new inventory has been delivered.

The vacancy rate sits at just 3.1%, but that is up from 1.7% since the final quarter of 2022, and square footage available has increased by over 3,000,000 SF. We have also seen a spike in sublease space, which has increased by 300,000 SF since the first of the year.

From 2010 to 2020 we saw rent growth of 3% to 4% annually, while the last three years have produced unprecedented annual rent growth of 6% to 20% per year. However, we expect rent growth to moderate or even flatten in the near term, especially if the vacancy rate remains on its current trajectory through the rest of the year.

Industrial investments are still a preferred product type, but if vacancy does keep moving higher and interest rates remain elevated, downward pressure on pricing will mount. For the moment, we are in a transition period when sellers are still seeking peak values from a year or two ago, while many buyers are demanding higher yields in anticipation of further softening in market metrics.

Although the macro-market fundamentals are still really strong for the overall San Diego industrial market, we are experiencing a bit of a “hangover” from the exceptionally strong performance in 2021 and 2022.

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

Please Contact Us for Further Information

Joshua Brant
Regional Director of Research
jbrant@voitco.com

Anaheim, CA
714.978.7880

Carlsbad, CA
760.472.5620

Inland Empire, CA
909.545.8000

Irvine, CA
949.851.5100

Los Angeles, CA
424.329.7500

San Diego, CA
858.453.0505

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