

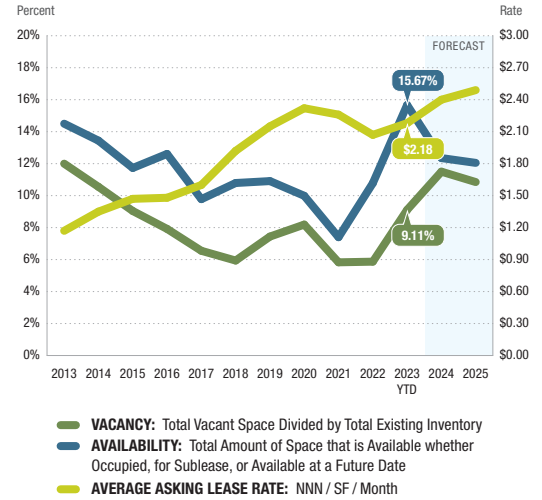
**OVERVIEW.** Following two consecutive years of positive net absorption, the Flex/R&D market is firmly in the red with 1.3 MSF of negative net absorption, and a substantial increase in the vacancy and availability rates. The Flex/R&D market in San Diego is driven by the biotech sector which is showing signs of slowing. Rental rates remain elevated from a long-term perspective. Sales activity was robust in 2022, but leasing and sales volume are both far below historic norms three quarters of the way through 2023.

**VACANCY & AVAILABILITY.** Direct/sublease space (unoccupied) finished 3Q 2023 at 9.1%, a massive increase of 54% from 3Q 2022's vacancy rate of 5.9%. Yet this is still well below the vacancy rate from eleven years ago when the countywide vacancy rate finished 2011 above 16%. Direct/sublease space being marketed was 15.7% at the end of 3Q. The availability rate saw a 91% 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. The segments of the county with the least amount of lab space, East County, the I-15 Corridor, and South County, all have availability rates in the single digits. Since the start of 2022, the sublease vacancy across the county has increased more than fourfold, and finished 3Q 2023 at 3.5%.

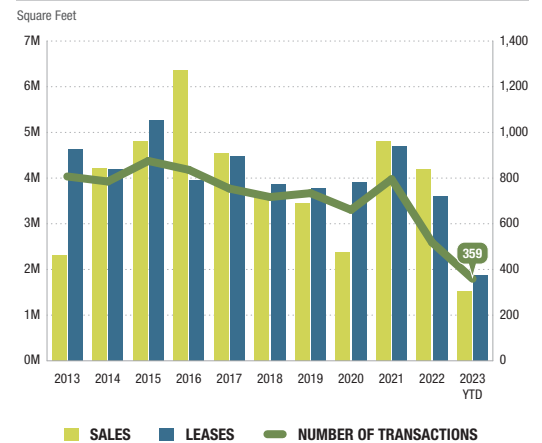
**LEASE RATES.** The average asking triple net lease rate per square foot per month in San Diego County was \$2.18 at the end of 3Q 2023, which is an increase of 12.4% from 3Q 2022. The average asking lease rate has been on a long-term trend of increases, but dramatic changes in the average in recent 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 3Q totaled 521,678 SF, nearly one quarter of the 2.4 MSF transacted in 3Q 2022. There were 433,079 SF of Flex/R&D space leased in 96 transactions recorded in 3Q. These figures were far below the five-year averages of 136 transactions and 953,649 SF leased per quarter. The top lease in the quarter was a sublease, an indicator of the softening fundamentals within the Flex/R&D market. A majority of the slowdown in transaction activity can be laid at the feet of the biotech segment of the market. There was not a single biotech transaction among the top three sales or leases of 3Q, which is a rare occurrence. The large transactions in 3Q were mostly recorded in Kearny Mesa and Rancho Bernardo, home to much of the corporate headquarters' buildings in San Diego.

### VACANCY, AVAILABILITY & AVERAGE ASKING LEASE RATES



### TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



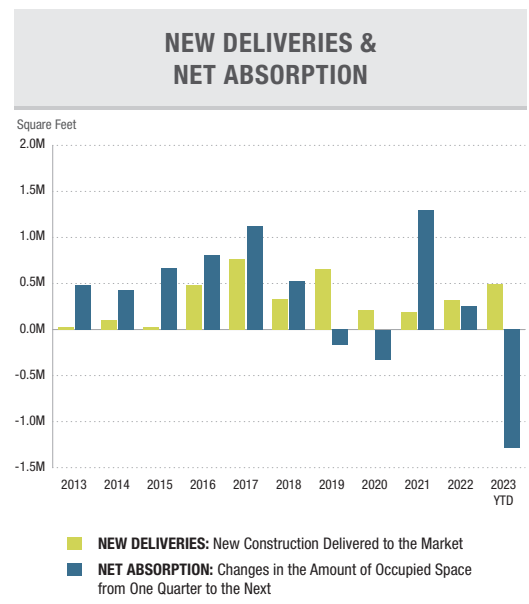
### Market Statistics

	Change Over Last Quarter	Q3 2023	Q2 2023	Q3 2022	% Change Over Last Year
Vacancy Rate	▲ UP	9.11%	8.33%	5.92%	53.75%
Availability Rate	▲ UP	15.67%	13.81%	8.19%	91.20%
Average Asking Lease Rate	▼ DOWN	\$2.18	\$2.36	\$1.94	12.37%
Sale & Lease Transactions	▼ DOWN	521,678	996,702	2,431,551	(78.55%)
Gross Absorption	▬ FLAT	571,459	594,137	704,416	(18.87%)
Net Absorption	▼ NEGATIVE	(418,965)	(339,786)	(24,624)	N/A

**ABSORPTION.** The San Diego Flex/R&D market recorded 418,965 SF of negative net absorption in 3Q. 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 half a million square feet of negative net absorption in the Flex/R&D market in over a decade, but the market has recorded over 1.2 MSF of negative net absorption in the first three quarters 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, and this can move the market statistics rapidly in one direction or the other.

**CONSTRUCTION.** At the end of 3Q there were 2.5 MSF under construction or lab conversion, with 86% of this space still available for lease. 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. All of the properties under construction at the end of 3Q were in the submarkets surrounding UCSD. These conversions do not show up in the new construction totals. The dividing line between office properties and flex properties is becoming less distinct, especially in Sorrento Mesa and Sorrento Valley which have been the epicenter of recent lab conversions. 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 4.3% in August 2023, up from a revised 3.9% in April 2023, and above the year-ago estimate of 3.5%. This compares with an unadjusted unemployment rate of 5.1% for California and 3.9% for the nation during the same period. Over the 12-month period between August 2022 and August 2023, San Diego County employment increased by 33,800 jobs, an increase of 2.2%. With the normal delay in reporting from the California EDD, employment figures from September were unavailable at the time of publishing this report. For the nation as a whole, 336,000 jobs were added in September, the second highest monthly total of the past year.



Forecast

It is evident that the supply of biotech conversions has outpaced tenant demand currently in the market. 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 macroeconomic malaise, but also it will demand higher yields in response to rising interest rates. We anticipate a growing increase in vacancy as the surge of life-science conversions centered around Sorrento Mesa reaches completion.

Significant Transactions

Sales					
Property Address	Submarket	Square Feet	Sale Price	Buyer	Seller
9590 Chesapeake Dr.	Kearny Mesa	23,548	\$9,500,000	Meals on Wheels	JDM Enterprise, LLC, Et Al
1102-1108 Morena Blvd.	Morena	6,000	\$2,650,000	Kilowatt Holdings, LLC	V8 Holdings, LLC
5345 Timlen St.	La Mesa	9,213	\$2,150,000	Timken La Mesa, LP	Floit Properties
Leases					
Property Address	Submarket	Square Feet	Transaction Date	Tenant	Owner
16868 Via del Campo Ct.	Rancho Bernardo	39,979	Aug-2023	Undisclosed	(Sublease)
12230 World Trade Dr.	Rancho Bernardo	29,716	Sep-2023	Medtronic (Renewal)	Cal-Sorrento, Ltd.
10655 Roselle St.	Sorrento Valley	22,275	Sep-2023	Filmetrics (Renewal)	Pick Rentals, LLC
4242 Campus Point Ct.	UTC	21,452	Jul-2023	Undisclosed	Alexandria Real Estate Equities
5183 Mercury Ct.	Kearny Mesa	19,656	Sep-2023	Apex (Renewal)	Piccioni 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 Q3 2023	Square Feet Available	Availability Rate Q3 2023	Average Asking Lease Rate	Net Absorption Q3 2023	Net Absorption 2023	Gross Absorption Q3 2023	Gross Absorption 2023
<b>Central</b>													
Central City	14	188,791	0	0	36,564	19.37%	38,404	20.34%	\$1.80	0	(16,500)	0	0
East City	3	373,020	0	0	0	0.00%	0	0.00%	-	0	346,128	0	0
Southeast City	23	248,050	0	0	6,856	2.76%	6,856	2.76%	\$1.56	(5,931)	(3,856)	0	5,500
Kearny Mesa	206	5,538,312	0	5,400	232,571	4.20%	389,383	7.03%	\$1.47	(53,767)	(69,721)	35,878	156,113
Mission Gorge	28	294,807	0	0	3,700	1.26%	36,202	12.28%	\$2.09	1,306	0	1,306	2,706
Rose Canyon/Morena	41	643,248	0	0	46,815	7.28%	63,564	9.88%	\$1.86	(11,276)	(39,910)	10,736	43,960
Sports Arena/Airport	33	426,507	0	0	68,764	16.12%	79,764	18.70%	\$1.75	0	(3,825)	0	0
Miramar	222	4,908,447	0	0	269,611	5.49%	642,729	13.09%	\$2.25	(30,904)	(65,307)	5,680	124,562
Sorrento Mesa	173	7,830,348	1,630,806	658,524	1,451,146	18.53%	3,331,868	35.22%	\$3.96	34,491	(488,142)	169,541	353,259
Sorrento Valley	112	2,709,654	0	0	472,638	17.44%	553,417	20.42%	\$3.03	(136,621)	(314,668)	51,783	125,869
Torrey Pines/UTC	79	6,864,979	552,966	512,000	643,746	9.38%	1,109,467	14.96%	\$4.26	(166,480)	(342,165)	25,666	130,403
<b>Central County Total</b>	<b>934</b>	<b>30,026,163</b>	<b>2,183,772</b>	<b>1,175,924</b>	<b>3,232,411</b>	<b>10.77%</b>	<b>6,251,654</b>	<b>19.41%</b>	<b>\$2.59</b>	<b>(369,182)</b>	<b>(997,966)</b>	<b>300,590</b>	<b>942,372</b>
<b>East County</b>													
El Cajon	81	919,280	0	0	17,956	1.95%	17,956	1.95%	\$1.50	3,125	3,915	3,125	19,599
La Mesa/Spring Valley	44	310,472	0	0	9,213	2.97%	9,213	2.97%	\$1.69	(6,613)	(6,213)	2,600	5,600
Santee/Lakeside	54	608,723	0	0	17,280	2.84%	14,812	2.43%	\$1.33	(2,468)	(11,720)	4,542	14,946
Rural East County	22	95,520	0	0	0	0.00%	0	0.00%	-	0	0	0	0
<b>East County Total</b>	<b>201</b>	<b>1,933,995</b>	<b>0</b>	<b>0</b>	<b>44,449</b>	<b>2.30%</b>	<b>41,981</b>	<b>2.17%</b>	<b>\$1.49</b>	<b>(5,956)</b>	<b>(14,018)</b>	<b>10,267</b>	<b>40,145</b>
<b>North County</b>													
Escondido	84	787,788	0	0	19,732	2.50%	63,876	8.11%	\$1.42	(98)	5,347	4,996	11,824
Oceanside	33	966,298	0	217,000	11,275	1.17%	17,943	1.86%	\$1.59	(4,181)	(6,057)	0	9,009
San Marcos	56	1,054,187	0	0	72,601	6.89%	73,463	6.97%	\$1.32	(13,036)	(18,349)	35,325	49,949
Vista	63	1,392,579	0	0	130,573	9.38%	221,636	15.92%	\$1.73	(16,246)	47,060	15,867	100,371
Carlsbad	265	7,403,840	0	67,714	770,417	10.41%	1,293,373	17.47%	\$1.80	(31,394)	(125,718)	130,819	341,703
North Beach Cities	19	166,277	0	0	11,441	6.88%	5,240	3.15%	\$2.97	1,194	(14,441)	1,194	1,194
Rural North County	19	139,572	0	0	2,850	2.04%	2,850	2.04%	\$1.00	1,550	350	5,150	5,150
<b>North County Total</b>	<b>539</b>	<b>11,910,541</b>	<b>0</b>	<b>284,714</b>	<b>1,018,889</b>	<b>8.55%</b>	<b>1,678,381</b>	<b>14.09%</b>	<b>\$1.68</b>	<b>(62,211)</b>	<b>(111,808)</b>	<b>193,351</b>	<b>519,200</b>
<b>I-15 Corridor</b>													
Poway	62	2,113,728	0	0	20,252	0.96%	65,901	3.12%	\$1.86	4,986	(6,621)	10,692	12,607
Rancho Bernardo	100	4,711,462	0	0	436,225	9.26%	551,213	11.70%	\$1.86	13,209	(257,824)	31,856	66,817
Scripps Ranch	31	1,011,159	0	100,000	104,891	10.37%	104,891	10.37%	\$1.61	(5,175)	115,228	0	145,000
<b>I-15 Corridor Total</b>	<b>193</b>	<b>7,836,349</b>	<b>0</b>	<b>100,000</b>	<b>561,368</b>	<b>7.16%</b>	<b>722,005</b>	<b>9.21%</b>	<b>\$1.85</b>	<b>13,020</b>	<b>(149,217)</b>	<b>42,548</b>	<b>224,424</b>
<b>South County</b>													
Chula Vista	84	1,481,863	0	0	31,282	2.11%	64,493	4.35%	\$2.17	10,854	(7,411)	24,703	47,373
National City	25	349,013	0	0	9,028	2.59%	9,599	2.75%	\$1.72	(5,490)	(5,028)	0	4,744
Otay Mesa	7	156,362	0	0	0	0.00%	0	0.00%	\$2.88	0	3,130	0	3,130
South San Diego	5	86,361	0	0	0	0.00%	0	0.00%	-	0	0	0	0
<b>South County Total</b>	<b>121</b>	<b>2,073,599</b>	<b>0</b>	<b>0</b>	<b>40,310</b>	<b>1.94%</b>	<b>74,092</b>	<b>3.57%</b>	<b>\$1.86</b>	<b>5,364</b>	<b>(9,309)</b>	<b>24,703</b>	<b>55,247</b>
<b>San Diego County Total</b>	<b>1,988</b>	<b>53,780,647</b>	<b>2,183,772</b>	<b>1,560,638</b>	<b>4,897,427</b>	<b>9.11%</b>	<b>8,768,113</b>	<b>15.67%</b>	<b>\$2.18</b>	<b>(418,965)</b>	<b>(1,282,318)</b>	<b>571,459</b>	<b>1,781,388</b>

Lease rates are on a triple-net basis.



## Conditions Easing

by **Josh West, SIOR**

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As we wrap up the third quarter of 2023, “normal” life seems to be coming back into the picture, and the industrial market is easing off of the boom from the past couple of years. Interest rates are on the rise, while vacancy remains low, and rental rates are still perched at historic levels. This has all combined to create problems for tenants and owner-users in their search for quality space.

The low vacancy has reduced the volume of leases and sales completed as many tenants are deciding to renew in place due to the lack of options. The I-15 Corridor, for example, finished the third quarter of 2023 at a vacancy rate of 2.6%. Much of this demand is driven by e-commerce business. Brick-and-mortar retail has lost a large chunk of business to online shopping, and with that change in habits came a huge rise in demand for warehouse space resulting from increased logistics demand across the board.

Due to high interest rates curtailing purchase options, and limited leasing availability options, lease rates have continued to stay strong. The average lease rate in the San Diego market is \$1.50 per square foot NNN while the Central County average lease rate is closer to \$1.69 per square foot NNN. As of now, there does not seem to be an end in sight for industrial demand. The overall industrial market has remained stable and is still considered one of the safest places to put your money. Cap rates for quality product in the industrial sector remain around 5-6%.

San Diego companies in the market to purchase a building are feeling the squeeze as well. The average price per square foot for quality industrial buildings has remained fairly stable despite the high interest rates. Sellers have not adjusted their expectations to the reality of diminishing market values, and buyers are unwilling or unable to pay the high prices seen during the era of low interest rates.

Overall, the industrial market is healthy and will continue to do well for the foreseeable future. New product will relieve the pressure and will allow occupiers to move within the inventory base.

## 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

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