

MARKETBEAT

San Diego

Industrial Q3 2017



SAN DIEGO INDUSTRIAL

Economic Indicators

	Q3 16	Q3 17	12-Month Forecast
San Diego Employment	1.49M	1.50M	▲
San Diego Unemployment	4.9%	4.7%	▼
U.S. Unemployment	4.9%	4.4%	▼

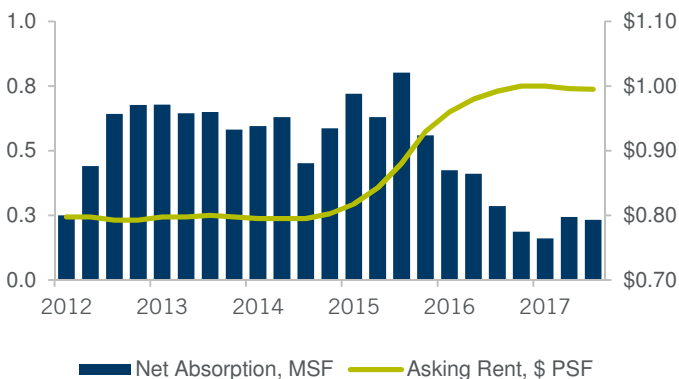
Market Indicators (Overall, All Product Types)

	Q3 16	Q3 17	12-Month Forecast
Vacancy	5.1%	4.8%	▼
Direct Net Absorption (sf)	56K	649K	▲
Under Construction (sf)	0.64M	2.4M	▼
Average Asking Rent	\$1.00	\$0.99	▲

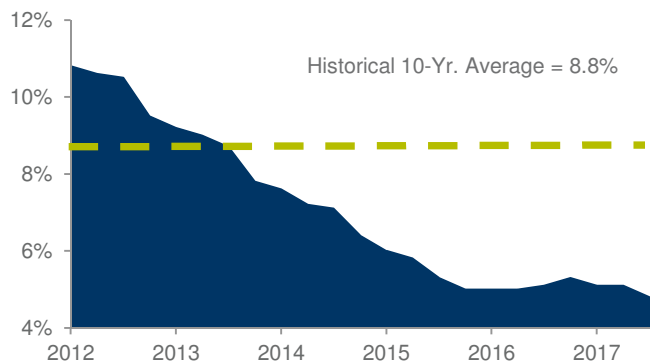
*Rental rates reflect triple net asking \$psf/monthly

Direct Net Absorption/Asking Rent (Triple Net, Monthly)

4-QTR TRAILING AVERAGE



Overall Vacancy – All Product Types, incl. Sublease



Economy

The San Diego employment market continued to record job growth, adding 19,200 jobs (+1.3%) year-over-year through August 2017. During the same time period, the unemployment rate decreased 20 basis points (bps), dropping to 4.7%. The current rate is 130 bps below the 27-year average of 6%. All employment sectors are expected to grow at a combined growth rate of 1.6% in 2017, according to Moody's Analytics. San Diego's economy of \$215.3 billion as measured by gross regional product in 2016 is forecasted to grow an additional 2.7% in 2017 and 2.7% in 2018 - consistent with its 10-year average growth rate of 2.5%.

Economic activity in the manufacturing sector expanded in September, with an ISM index reading of 60.8%, an increase of 2 percentage points from the August reading of 58.8%. Last time the index was at 60.8% was in January 2004. The overall economy grew for the 100th consecutive month in the U.S. Of the 18 manufacturing industries, 17 reported growth in September.

Market Overview

At the close of Q3 2017, industrial vacancy (including sublease) in the San Diego marketplace stood at 4.8%, a 30 bps decrease from last quarter and a year ago. Overall vacancy has been hovering around 5% for the last nine quarters, indicating consistent demand for industrial product countywide and now stands at the lowest level we have ever tracked in 15 years.

Across the region, the market is the tightest for manufacturing space with vacancy at 3.1%, a decrease of 70 bps from last quarter. Vacancy (including sublease) for incubator multi-tenant space (IMT) now stands at 4.0% countywide; it stood at 4.7% three months ago. Distribution space vacancy currently stands at 4.8%, unchanged from last quarter. Meanwhile, vacancy for R&D product has increased 50 bps over the last three months and now stands at 8.6%.

The market recorded 649,021 sf of positive net absorption in Q3 2017, bringing year-to-date net absorption to 709,394 sf. Four buildings totaling 319,098 sf were completed in Q3, bringing total year-to-date deliveries to 497,434 sf. Two projects were delivered in Carlsbad: first, owner Regent Properties completed the first phase of renovations at Atlas at Carlsbad, part of a repositioning of the office campus at 5909 Sea Otter Place. Second, Badi Development completed 55,000 sf within the Carlsbad Raceway Business Park at 3248 Lionshead Avenue. Both projects were constructed on a speculative basis and were delivered 100% vacant and available. The other two projects were 100% pre-leased upon completion and registered among largest move-ins in Q3. The delivery of General Atomics' build-to-suit (BTS) MFG building located at 11905 Community Rd. in Poway resulted in 82,640 sf of positive net absorption. The 44,084-sf distribution building located at 7155 Camino Maquiladora in Otay Mesa was delivered 100% pre-leased to MSE and ProTrans International, Inc.

Miramar was one of the most active markets this quarter, absorbing a total of 126,000 sf of space. This chunk of newly occupied space was primarily comprised of Allied Building Products, which moved from Kearny Mesa into 48,800 sf at 8515 Miramar Pl., and Vivint Solar, which moved into 24,267 sf at 8090 Arjons Dr. Otay Mesa was one of the submarkets recording occupancy losses and returned 128,769 sf to the market. The majority of this occupancy change can be attributed to one large block of space becoming available: earlier this year, Panasonic (formerly Sanyo) sold back its San Diego Business Park campus in Otay Mesa to the original developer and owner, Murphy Development Company (MDC).

While Panasonic remains in operation in a portion of its campus, it gave back approximately 209,000 sf of DIST product at 2055 Sanyo Ave. to the landlord. MDC plans to invest \$15 million to upgrade the building and market the space for lease as The Campus at San Diego Business Park. In Vista, Earthlite Massage Tables relocated from a 67,000-sf R&D space at 3210 Executive Ridge and expanded into 83,000 sf of MFG space at 990 Joshua Way. This transaction resulted in a net occupancy increase of approximately 16,000 sf. However, this expansion was offset by GE Water & Power, which allowed its 109,000-sf lease to expire at 760 Shadowridge Dr.

COUNTYWIDE DIRECT VACANCY AT 4.0% IS AT A 15-YEAR LOW

Average asking rent for all product types combined was \$0.99 psf per month on a NNN basis compared to \$0.98 psf last quarter and \$1.00 psf a year ago. The average rent has been ranging between \$0.96 and \$1.01 for the last two years and has increased 11.2% since the end of the last recession (\$0.89 psf 2009). Since the end of the last recession, the average rent has increased the most for IMT space (+24.7%) compared to other product types.

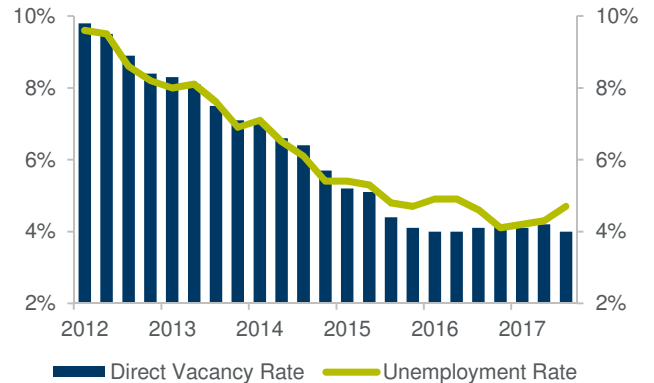
Year-over-year, average rent for MFG space has increased 7.3% to \$0.88 psf per month, and rent for IMT has increased 5.7% to \$1.11 psf per month. This trend is driven by the demand for modern and specialized space for manufacturers and small industrial users. In response, we are not only seeing asking rental rates increase but also an increasing trend of renovations of older product to make them more appealing to tenants.

There are currently 23 industrial buildings totaling nearly 2.4 million square feet (msf) under construction, the highest level in 10 years (2.7 msf in Q1 2007). With a low countywide direct vacancy of 4%, it is unlikely that this level will satisfy demand for new, functional space. According to our calculations, 57% of industrial space countywide was built before 1990 and barely 3.0% of space was built after 2010. This means that more than half of leasable industrial buildings in San Diego are lacking modern design features for today's demanding tenants who require high-functioning and efficiently designed product. This trend has led to an increase in speculative (SPEC) construction. Of the space that is currently under construction, 69%, or 1.6 msf, is SPEC development. Moreover, 60%, or 950,000 sf, of planned space in the pipeline is planned as SPEC.

Many projects across the county officially broke ground during Q3 2017. Redevelopment and new construction of the BioLegend campus in Miramar began. Totalling 235,000 sf, the project scope includes 128,000 sf of new space and three buildings that will be completely redeveloped to accommodate the life sciences company. A pedestrian bridge will connect lab space to administrative buildings and 250,000 sf of amenities, such as, a fitness center, locker room, kitchen, wellness bar, yoga room, game room and outdoor spaces.

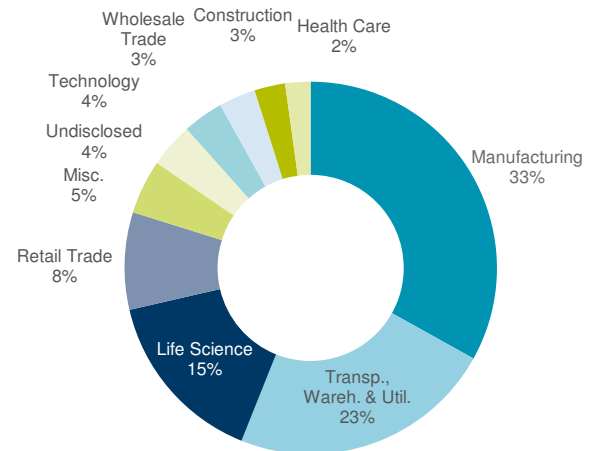
Developer RAF Pacifica began construction on several North County projects in Q3 2017, including the 219,000-sf Production project in San Marcos and two projects in Carlsbad – the 277,000-sf Distribute and the 144,000-sf Create. Among other notable projects breaking ground in Q3 were: 302,500-sf Ridgeview Business Park in Poway; 267,000-sf IPT Otay Logistics Park in Otay Mesa and 125,000-sf at Pacific Coast Collection in Oceanside. Carlsbad continues to experience the highest level of construction activity or 40% of the total inventory currently under construction due to its proximate location to a large skilled employee base and availability of developable land.

Direct Vacancy vs. Unemployment Rate
DECLINE IN VACANCY CORRELATES DECLINE IN UNEMPLOYMENT



Tenant Demand by Industry Type

TOP 3 INDUSTRY SECTORS ACCOUNT FOR 63% OF TOTAL DEMAND



Outlook

- San Diego's industrial market will welcome 501,334 sf of new inventory in 2017 once the 64,000-sf project at 2800 Loker Ave. in Carlsbad is completed in Q4, an annual total consistent with the 10-year average of 523,000 sf completed. In 2018, over 2.0 msf is scheduled for delivery, of which 0.5 msf is BTS. Since the remaining SPEC space currently under construction has no commitments in place, an uptick in vacancy may occur over the next 12 months.
- There are 3.2 msf of active tenant requirements for space over the next 24 months. Nearly 40% or 1.3 msf of these users are in the earliest stages of their pursuit, having opened their search or toured the market. While not all of the 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)	VACANCY RATE	CURRENT DIRECT NET ABSORPTION (SF)	YTD DIRECT NET ABSORPTION (SF)	UNDER CNSTR (SF)	AVERAGE ASKING RENT (ALL Types)
North County	2,027	51,756,549	459,040	2,459,259	5.7%	(76,337)	154,272	1,266,921	\$0.96
Central County	2,291	80,937,551	572,073	2,494,908	3.8%	444,416	209,914	737,742	\$1.25
South County	616	30,215,924	195,338	1,590,414	5.9%	280,942	345,208	347,504	\$0.69
TOTAL	4,934	162,910,024	1,226,451	6,544,581	4.8%	649,021	709,394	2,352,167	\$0.99
R&D	847	33,955,346	518,932	2,397,514	8.6%	19,597	(199,488)	613,603	\$1.39
MFG	2,449	63,806,809	226,507	1,695,368	3.1%	475,474	795,413	799,003	\$0.88
IMT	628	20,522,833	137,707	681,188	4.0%	147,565	112,727	0	\$1.11
DIST	1,010	44,625,036	343,305	1,770,511	4.8%	6,385	742	939,561	\$0.74
TOTAL	4,934	162,910,024	1,226,451	6,544,581	4.8%	649,021	709,394	2,352,167	\$0.99

Rental rates reflect triple net (NNN) asking rents \$psf/monthly. Vacancy rate includes direct and sublease. Net absorption excludes sublease.

Key Lease Transactions Q3 2017

PROPERTY	SF	TENANT	LANDLORD	TYPE	SUBMARKET
16550 Via Esprillo	180,946	Amazon	Greenlaw Partners	Direct	Rancho Bernardo
2020 Piper Ranch Rd.	99,800	Atlas Freight	Morgan Stanley & Co. LLC	Direct	Otay Mesa
990 Joshua Way	82,944	Earthlite Massage Tables	Barings Real Estate	Direct	Vista
2055 Sanyo Ave.	59,617	kSARIA	Murphy Development Co.	Direct	Otay Mesa
4000 Ruffin Rd.	57,642	Cal-State Auto Parts, Inc.	IDS Real Estate	Renewal	Kearny Mesa

Key Sale Transactions Q3 2017

PROPERTY	SF	BUYER	SELLER	SALE PRICE	SUBMARKET
10850 Via Frontera	260,000	US Realty Advisors	PETCO Animal Supplies	\$110,000,000 (\$423 PSF)	Rancho Bernardo
2855 Gazelle Ct. & 2282 Faraday Ave.	204,704	Ionis Pharmaceuticals	Biomed Realty	\$93,400,000 (\$456 PSF)	Carlsbad
10450 Pacific Center Ct.	134,000	RND Alta Vista Associates LLC	GPT TPG 10450 Pacific LP	\$44,000,000 (\$328 PSF)	Sorrento Mesa
960 Sherman St.	184,000	LBA Realty	Sears Holding Corporation	\$23,800,000 (\$129 PSF)	Morena
6759-6779 Mesa Ridge Rd.	133,840	Jewell Capital LLC	CW Capital Asset Management LLC	\$20,100,000 (\$150 PSF)	Sorrento Mesa

Under Construction Q3 2017

PROPERTY	PRELEASED			ADDRESS	PRODUCT TYPE	ESTIMATED COMPLETION	SUBMARKET
	SF	SF	%				
Ridgeview Business Park - Bldgs. A-C	302,500	152,000	50%	Kirkham Way	DIST	2018	Poway
Carlsbad Raceway, Distribute	277,410	0	0%	Lionshead Ave.	DIST	2018	Carlsbad
IPT Otay Logistics Park - Bldgs. A & B	268,454	0	0%	NEC. Enrico Fermi & Siempre Viva Rd.	MFG	2018	Otay Mesa
BioLegend Campus - Bldgs. 1-4	234,719	234,719	100%	8928-8959 Terman Ct.	R&D	2019	Miramar
Production - Buildings A-D	219,451	0	0%	Bosstick Blvd.	MFG	2018	San Marcos
Carlsbad Oaks North - Vector	171,098	0	0%	2882 Whiptail Loop	MFG	2018	Carlsbad
La Jolla Spectrum Tech Park - Bldg. B	170,523	170,523	100%	3215 Merryfield Row	R&D	2018	Torrey Pines
Carlsbad Oaks North - Create	144,461	0	0%	Lot 24 Whiptail Loop	R&D	2018	Carlsbad
HM Electronics - Lots 18 & 19	140,000	140,000	100%	Lots 18 & 19 Whiptail Loop	MFG	2018	Carlsbad
Carlsbad Oaks North - Lot 17	126,020	0	0%	Lot 17 Whiptail Loop	DIST	2018	Carlsbad
Pacific Coast Collection	124,581	0	0%	1319 Rocky Point Dr.	DIST	2018	Oceanside
Siempre Viva Business Park - Bldg. 17	79,050	0	0%	8500 Kerns St.	DIST	2018	Otay Mesa
Carlsbad Oaks East - Lot 24	63,900	0	0%	2800 Loker Ave.	R&D	2017	Carlsbad
Bedrosian Tile & Stone	30,000	30,000	100%	7120 Miramar Rd.	DIST	2018	Miramar

INDUSTRIAL SUBMARKETS SAN DIEGO



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