

# MARKETBEAT

## San Diego

### Office Q3 2017



#### SAN DIEGO OFFICE

##### 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%	▼

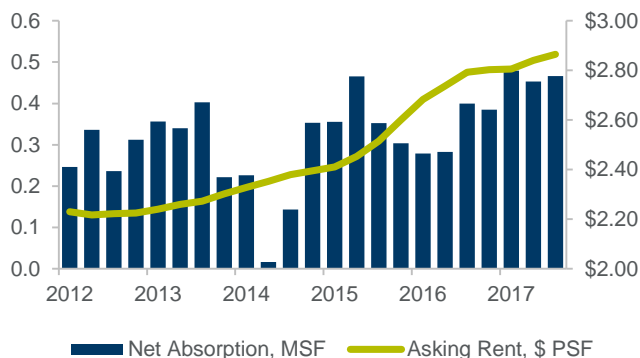
##### Market Indicators (Overall, All Classes)

	Q3 16	Q3 17	12-Month Forecast
Vacancy	15.1%	13.7%	▲
Direct Net Absorption (sf)	665K	717K	▼
Under Construction (sf)	1.4M	1.2M	▲
Average Asking Rent	\$2.86	\$2.96	▲

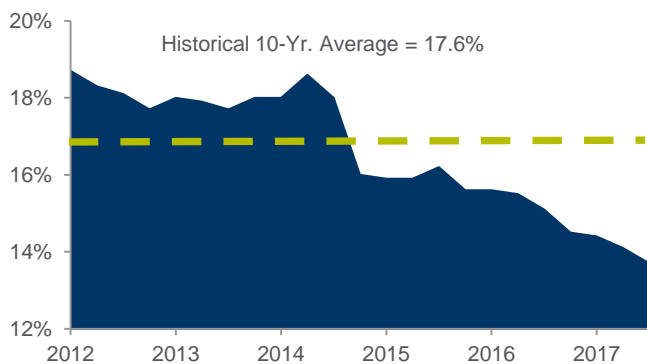
\*Rental rates reflect full service asking \$psf/monthly

##### Direct Net Absorption/Asking Rent (Full Service, Monthly)

###### 4-QTR TRAILING AVERAGE



##### Overall Vacancy – All Classes, 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. Of the 19,200 jobs added, 3,000 (or 16%) were office jobs consisting of two sectors: professional and business services and financial activities. 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. Office employment is forecasted to record a 2.4% growth in 2017, positively affecting demand for office space. 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%.

## Market Overview

Office vacancy (including sublease) decreased to 13.7% in Q3 2017, down 40 bps from last quarter and 140 bps from a year ago. This was the sixth consecutive quarter of decreasing vacancy. Occupancy grew by 716,600 square feet (sf) across all classes in Q3, bringing year-to-date net absorption to 1.3 million square feet (msf). This was the best year-to-date activity since 2005 (1.4 msf absorbed between Q1 and Q3 2005).

Occupancy growth, however, was disproportionate by region as tenants absorbed 670,300 sf across all classes in Central County submarkets, 29,000 sf in South County submarkets and 17,300 sf in North County submarkets. At the end of Q3 2017, overall vacancy was the lowest in South County (10.4%) followed by Central County (14.2%) and North County (16.5%).

In Q3 2017, Class A overall vacancy was 15.4% countywide, up 20 bps from last quarter and down 110 bps from a year ago. Class B overall vacancy was 13.3%, down 120 bps from last quarter and 110 bps from a year ago. Six buildings in Central County submarkets totaling 565,600 sf were completed in Q3, bringing total year-to-date deliveries to 1.1 msf.

Absorption in Q3 2017 was driven by the completion and occupancy of two large projects. Upon delivery, Illumina occupied the 316,300 sf i3 project in Eastgate. And in Rancho Bernardo, Renovate America took occupancy of a 161,000 sf renovation of a former HP campus building. The largest occupancy of an already existing building was Northrop Grumman's expansion into 222,500 sf at Summit Rancho Bernardo. Among other large move-ins in Q3 2017, the California Institute of Art & Technology occupied 44,000 sf in National City, Synteract moved into 37,000 sf in Carlsbad and Certona occupied 32,000 sf in Sorrento Mesa.

A number of large leases were signed in previous quarters that will further boost absorption in future quarters as these tenants begin occupying the space. In Eastgate, La Jolla Pharmaceuticals will occupy 78,000 sf at Axiom and ServiceNow will occupy a 64,000-sf building currently subleased by Kratos and Plaza Home Mortgage. At One La Jolla Centre in UTC, Wells Fargo signed a 45,000-sf lease and KPMG signed a 23,000-sf lease. In Campus Point, Amazon signed an 85,000-sf lease and will occupy early next year.

In Sorrento Mesa, Nuvasive has plans to expand into another 79,000 sf at Sorrento Summit besides building an additional 28,000 sf building located at 7475 Lusk Blvd.



Tsunami ARVR leased 32,000 sf at the recently completed Torrey Point project in Del Mar Heights but will occupy in 2018. A number of tenants returned significant blocks of space in San Diego County in Q3, with the bulk of space returning in the I-15 Corridor. Microsoft Mobile terminated its 197,000-sf lease at Summit Rancho Bernardo. Meanwhile in Scripps, Lockheed Martin vacated 112,000 sf at Horizon Tech Center. Among other notable vacates, multiple tenants vacated a combined 45,000 sf at Bristol Square in Downtown as the project begins to undergo significant renovations. In UTC, Covario vacated 21,000 sf and in Del Mar Heights, Solekai Systems also vacated 20,300 sf.

**Q3 2017 WAS THE 13<sup>TH</sup> CONSECUTIVE QUARTER OF POSITIVE OCCUPANCY**

Much of future absorption will come from leases signed for projects currently under construction. Earlier this year, Takeda Pharmaceuticals signed a build-to-suit lease for over 163,000 sf in Eastgate. ViaSat, which is headquartered and employs nearly 2,000 workers in Carlsbad, is expanding its footprint as well. The company's Bressi Ranch site in Carlsbad is planned for approximately 500,000 sf at build out, with 280,000 sf scheduled to be completed in 2018. Also to be completed in 2018 is the 110,000-sf build-to-suit project for Palomar College in Rancho Bernardo. Pima Medical Institute will take 40,000 sf at the Icon@North City project in San Marcos later this year. UCSD's 66,000-sf build-to-suit at Park + Market will begin construction, also later this year.

Of the 15 properties, totaling 1.2 msf currently under construction countywide, six are scheduled for completion in 2017. Just under 582,000 sf of inventory under construction are part of build-to-suit projects. Three of the properties under construction are creative office renovations of previously existing buildings, including AMP&RSAND, a 339,000-sf renovation of the old Union-Tribune office and print buildings in Mission Valley and a smaller 34,000-sf renovation of the old San Diego Daily Transcript building in Uptown. Makers Quarter Block D in Downtown is planned to be a hub of sustainable live/work/play lifestyle employment center, starting with 51,000 sf of office space initially. Of the total 1.2 msf of product countywide, 54% already have commitments in place. While we anticipate continued preleasing activity, this will likely result in a modest short-term uptick in vacancy as these projects come online later in the year.

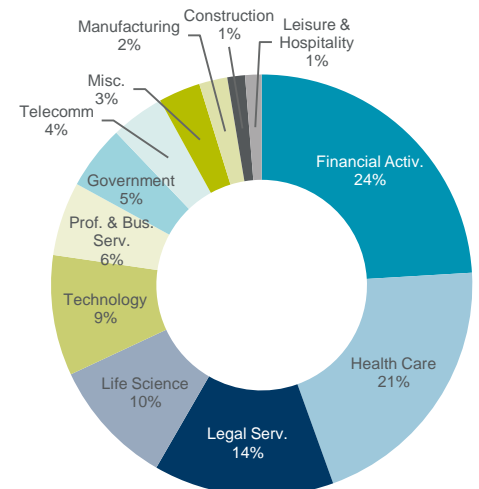
## Outlook

- Continued economic growth and resulting job growth will drive occupancy and rent growth in 2017. Leasing within the 5,000 to 50,000 sf range will continue to be the main driver of activity, accounting for 54% of total sf in lease obligations set to expire over the next 18 months. Leases 50,000 sf and larger will account for 26% of activity, while leases 5,000 sf and less will account for 20%.
- Active tenant requirements remain robust at 2.8 msf over the next 24 months countywide with 1.9 msf in Central County, 389,000 sf in North County and 405,000 sf in South County. A majority of these tenants have sent out proposals and are still in the intermediate stages of their search. While not all of the current tenants in the market will transact in the short term, these levels provide a barometer to leasing activity in quarters to follow.

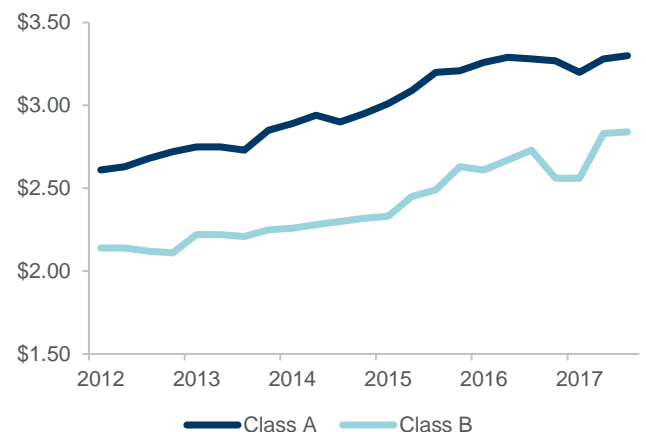
**Direct Vacancy vs. Unemployment Rate**  
DECLINE IN VACANCY CORRELATES DECLINE IN UNEMPLOYMENT



**Tenant Demand by Industry Type**  
TOP 3 INDUSTRY SECTORS ACCOUNT FOR 59% OF TOTAL DEMAND



**Average Asking Rate by Class (Full Service)**  
CLASS A RENT INCREASED 0.6% AND CLASS B INCREASED 4.0% Y/Y



SUBMARKET	TOTAL BLDGS	INVENTORY (SF)	SUBLET VACANT (SF)	DIRECT VACANT	VACANCY RATE	CURRENT DIRECT NET ABSORPTION (SF)	YTD DIRECT NET ABSORPTION (SF)	UNDER CONSTRUCTION (SF)	AVERAGE ASKING RENT* (ALL Classes)	AVERAGE ASKING RENT* (CLASS A)
North County	341	10,572,075	273,085	1,468,184	16.5%	17,319	84,721	447,525	\$2.45	\$2.80
Central County	840	49,405,116	1,239,148	5,794,989	14.2%	670,236	846,606	672,984	\$3.13	\$3.46
South County	318	16,964,555	144,465	1,626,967	10.4%	29,022	336,983	106,405	\$2.80	\$3.08
<b>TOTAL</b>	<b>1,499</b>	<b>76,941,746</b>	<b>1,656,698</b>	<b>8,890,140</b>	<b>13.7%</b>	<b>716,577</b>	<b>1,268,310</b>	<b>1,226,914</b>	<b>\$2.96</b>	<b>\$3.30</b>
Class A	325	32,716,887	856,634	4,189,736	15.4%	325,297	568,252	1,173,811	\$3.30	
Class B	753	33,601,880	727,443	3,741,592	13.3%	401,328	363,084	53,103	\$2.84	
Class C	421	10,622,979	72,621	958,812	9.7%	(10,048)	336,974	0	\$1.87	
<b>TOTAL</b>	<b>1,499</b>	<b>76,941,746</b>	<b>1,656,698</b>	<b>8,890,140</b>	<b>13.7%</b>	<b>716,577</b>	<b>1,268,310</b>	<b>1,226,914</b>	<b>\$2.96</b>	

\*Rental rates reflect full service (FS) asking rents \$psf/monthly. Vacancy rate includes direct and sublease. Net absorption excludes sublease.

### Key Lease Transactions Q3 2017

PROPERTY	SF	TENANT	LANDLORD	TRANSACTION TYPE	SUBMARKET
10850 Via Frontera	257,000	Petco	US Realty Advisors	Sale-Leaseback	Rancho Bernardo
Sorrento Summit	251,941	Nuvasive	HCP, Inc.	Renewal & Expansion	Sorrento Mesa
The Campus at Sorrento Gateway	111,318	TD Ameritrade	Starwood Capital Group	Renewal	Sorrento Mesa
Campus Pointe	84,550	Amazon	Alexandria Real Estate Equities	New	Campus Point
Morehouse Technology Center	25,203	iMatrix	Brookfield Asset Management	New	Sorrento Mesa

### Key Sale Transactions Q3 2017

PROPERTY	SF	BUYER	SELLER	SALE PRICE	SUBMARKET
DiamondView	316,103	DivcoWest	Cigna Investments / Cruzan	\$207,000,000 (\$661/sf)	Downtown
Mission City/Sorrento Mesa Portfolio	675,142	Coast Income Properties	Kilroy Realty Corporation	\$174,500,000 (\$258/sf)	Mission Valley & Sorrento Mesa
600 B St.	359,278	Rockwood Capital	Lincoln Property Company / Angelo, Gordon & Co.	\$109,500,000 (\$305/sf)	Downtown
Township 14	126,560	The Irvine Company	TIAA-CREF	\$86,500,000 (\$683/sf)	Del Mar Heights
530 B St.	232,936	Swift Real Estate Partners	Bosa Development Corporation	\$57,700,000 (\$248/sf)	Downtown

### Under Construction Q3 2017

PROPERTY	SF	PRELEASED SF	%	ADDRESS	CLASS	ESTIMATED COMPLETION	SUBMARKET
AMP&RSAND	339,000	0	0%	350 Camino de la Reina	A	2018	Mission Valley
Bressi Ranch	280,000	280,000	100%	Town Garden & El Camino Real	A	2018	Carlsbad
9625 Towne Centre Dr.	163,648	163,648	100%	9625 Towne Centre Dr.	A	2018	Eastgate
Bernardo Terrace Corp. Center	110,000	110,000	100%	Rancho Bernardo & Via Tazon	A	2018	Rancho Bernardo
The Icon @ North City	60,000	40,000	67%	111 Campus Way	A	2017	San Marcos
Lift	52,964	0	0%	6191 Innovation Way	A	2018	Carlsbad
Makers Quarter – Block D	51,192	0	0%	1501 15 <sup>th</sup> St.	A	2018	Downtown
Aston Point	48,954	0	0%	1800 Aston Ave.	B	2017	Carlsbad
Third Avenews	34,296	0	0%	2131 3 <sup>rd</sup> Ave.	B	2018	Uptown
Westfield UTC	32,336	32,336	100%	4545 La Jolla Village Dr.	A	2017	UTC
Sorrento Summit	28,000	28,000	100%	7475 Lusk Blvd.	A	2019	Sorrento Mesa
Grossmont Summit	13,200	0	0%	9400 Grossmont Summit Dr.	B	2017	East County
IDEA1	7,717	7,717	100%	895 Park Blvd.	A	2017	Downtown
Cedros Collective	5,607	0	0%	435-439 S. Cedros Ave.	B	2018	Del Mar/Solana Beach

**OFFICE SUBMARKETS**  
SAN DIEGO



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