

MARKETBEAT

San Diego

Industrial Q4 2017



SAN DIEGO INDUSTRIAL

Economic Indicators

	Q4 16	Q4 17	12-Month Forecast
San Diego Employment	1.44M	1.46M	▲
San Diego Unemployment	4.3%	3.3%	▼
U.S. Unemployment	4.6%	4.1%	▼

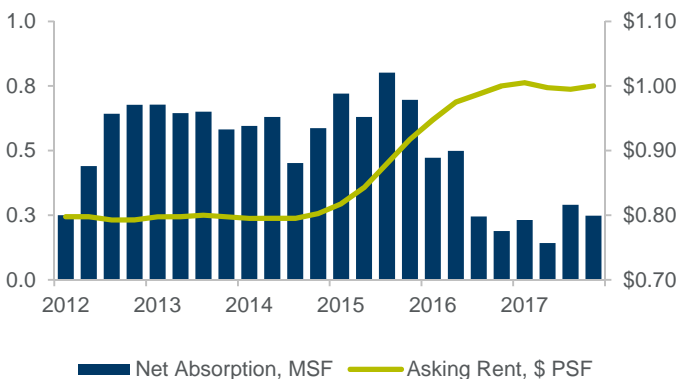
Market Indicators (Overall, All Product Types)

	Q4 16	Q4 17	12-Month Forecast
Vacancy	5.3%	4.8%	▼
Direct Net Absorption (sf)	452K	282K	▲
Under Construction (sf)	0.72M	3.1M	▼
Average Asking Rent	\$1.01	\$1.03	▲

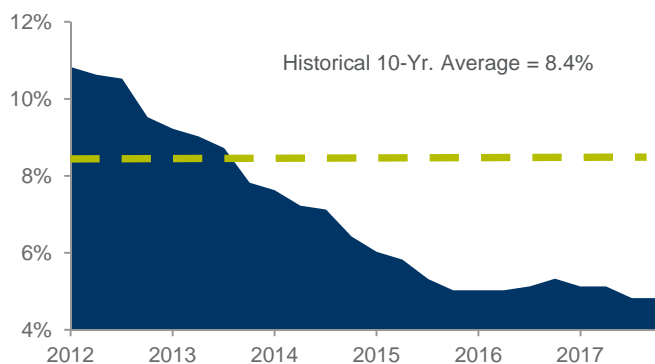
*Rental rates reflect triple net asking \$psf/monthly

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 20,800 jobs (+1.4%) year-over-year through November 2017. During the same time period, the unemployment rate decreased 100 basis points (bps), dropping to 3.3%. Also worth noting, the current rate is 270 bps below the 27-year average of 6%.

All employment sectors are expected to grow at a combined growth rate of 1.4% in 2018, 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 2.9% in 2018 – above the 10-year average growth rate of 2.3%.

Economic activity in the manufacturing sector expanded in December, with an ISM index reading of 59.7%, an increase of 1.5 percentage points from the November reading of 58.2%. The overall economy grew for the 103rd consecutive month in the U.S. Of the 18 manufacturing industries, 16 reported growth in December of 2017.

Market Overview

At the close of Q4 2017, industrial vacancy (including sublease) in the San Diego marketplace stood at 4.8%, unchanged from last quarter and 50 bps lower compared to a year ago. Overall vacancy has been hovering around 5% for the past 10 consecutive quarters and now stands at the lowest level we have ever tracked (15 years).

Across the region, the market is the tightest for manufacturing space with vacancy at 3.0%, a decrease of 10 bps from last quarter. Vacancy (including sublease) for incubator multi-tenant space (IMT) now stands at 3.9% countywide; versus 4.0% three months ago. Distribution center space vacancy currently stands at 4.6%, a decrease of 20 bps from last quarter. Meanwhile, vacancy for R&D product has increased 10 bps over the last three months and now stands at 8.7%.

The market recorded 282,000 sf of positive net absorption in Q4 2017, bringing year-to-date net absorption to 991,300 sf. Furthermore, 2017 will mark the eighth consecutive year of occupancy growth and decreasing vacancy.

With 239,200 sf of positive absorption, Poway was the most active submarket this quarter. General Atomics purchased a multi-tenant building at 12367 Crosthwaite Cir., taking occupancy of a 192,000-sf building. Another active submarket this quarter was East County, where this submarket experienced 134,000 sf of positive absorption. In Santee, a city within East County, an aluminum glazing system manufacturer called Vision Systems took occupancy of its new 89,000-sf build-to-suit (BTS) manufacturing headquarters located at 11322 N. Woodside Ave. This project, which was approved by the city of Santee in February 2016, was delivered in Q4 2017.

Another notable move-in this quarter was Atlas Freight's expansion into nearly 100,000 sf at 2020 Piper Ranch Rd. in Otay Mesa, space formerly occupied by Factory 2-U. This large move-in was offset by some negative absorption in the submarket, including 71,000 sf that US Concrete gave back at 2735 Cactus Rd.



While other parts of the I-15 Corridor experienced large swings of positive absorption, Rancho Bernardo saw nearly 210,000 sf of negative absorption this quarter due to HP's move-out at 16101 W. Bernardo Dr., its former San Diego campus. Additionally, Iso Nano terminated its lease early, moving out of 65,800 sf at 16275 Technology Dr. In Carmel Mountain Ranch, Carvin Audio moved out of 82,000 sf at 12340 World Trade Dr., a building it once owned but sold to an investor in 2016.

Average asking rent for all product types combined was \$1.03 psf per month on a NNN basis compared to \$0.99 psf last quarter and \$1.01 psf a year ago. The average rent at \$1.03 psf as of Q4 17 is at the highest level we have ever tracked and has increased 15.7% since the peak of this past recession (\$0.89 psf 2009). Since the end of the last recession in 2009, the average rent has increased the most for IMT space (+24.7%) compared to other product types, followed by manufacturing (+19.2%), distribution (+17.2%) and R&D (+12.7%).

Year-over-year, average rent for MFG space has increased 9.4% to \$0.93 psf per month, and rent for IMT has increased 7.8% 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.

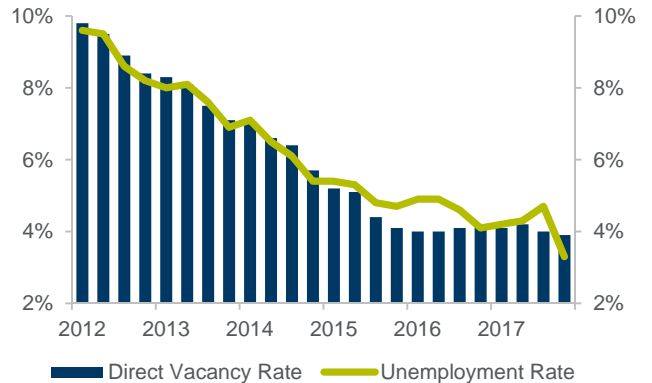
COUNTYWIDE DIRECT VACANCY AT 3.9% IS AT A 15-YEAR LOW

There are currently 29 industrial buildings totaling over 3.1 million square feet (msf) under construction, the highest level in 12 years (3.6 msf in Q4 2006). However, with a low countywide direct vacancy of 3.9%, it is unlikely that this supply 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 lack 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 as developers and landlords become more bullish on their prospect of leasing new space. Of the space that is currently under construction, 73% (or 2.3 msf) is SPEC development.

Several projects across the county officially broke ground during Q4 2017. Ryan Companies began construction on the 411,000-sf Pacific Vista Commerce Center within Carlsbad Oaks North. Also breaking ground this quarter is the 212,000-sf Exeter Distribution Center in Escondido, a BTS project for Veritiv, a business-to-business packaging company. Badiiee Development is developing the project and expects completion in summer of 2018.

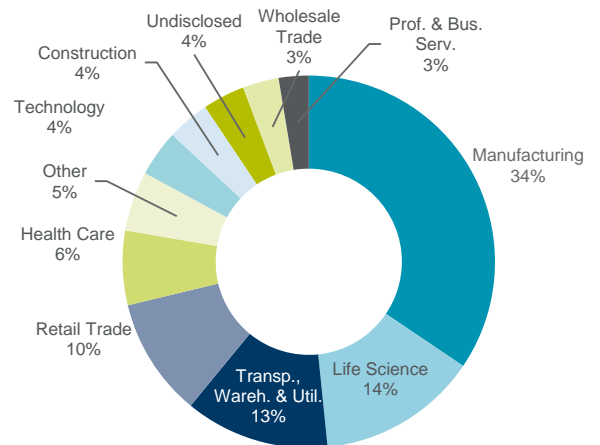
Construction of San Diego Hat Company's new 83,000-sf headquarters began within Carlsbad Oaks North, designed and developed by RAF Pacifica. The project is expected to be completed in the second half of 2018. RAF Pacifica is the largest SPEC developer in the county with over 818,000 sf of industrial product under construction, mostly in North County.

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



Tenant Demand by Industry Type

TOP 3 INDUSTRY SECTORS ACCOUNT FOR 61% OF TOTAL DEMAND



Outlook

- With over 3.1 msf under construction at year-end, we expect nearly 2.9 msf of new, state-of-the-art industrial space to be delivered to the market in 2018. With just 29% of 2018's expected deliveries pre-leased at this time, we anticipate a momentary uptick in vacancy as those SPEC projects are delivered vacant. However, we do not expect this new, well-equipped space to be vacant long due to fervent demand.
- There are 2.8 msf of active tenant requirements for space over the next 24 months. Over 46% 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 of leasing activity in quarters to follow. Additionally, those tenants in early stages of their pursuit may line up their timing with the delivery of new construction.

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	374,651	2,408,866	5.4%	50,393	204,665	1,978,731	\$0.98
Central County	2,291	81,001,880	798,450	2,424,035	4.0%	159,873	369,787	799,264	\$1.29
South County	616	30,215,924	231,880	1,518,772	5.8%	71,642	416,850	347,504	\$0.70
TOTAL	4,934	162,974,353	1,404,981	6,351,673	4.8%	281,908	991,302	3,125,499	\$1.03
R&D	847	33,955,346	566,644	2,369,067	8.7%	28,447	(171,041)	615,250	\$1.42
MFG	2,450	63,895,809	223,002	1,712,581	3.0%	71,787	867,200	886,137	\$0.93
IMT	628	20,522,833	147,200	650,009	3.9%	31,179	143,906	0	\$1.11
DIST	1,009	44,600,365	468,135	1,620,016	4.6%	150,495	151,237	1,624,112	\$0.75
TOTAL	4,934	162,974,353	1,404,981	6,351,673	4.8%	281,908	991,302	3,125,499	\$1.03

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

Key Lease Transactions Q4 2017

PROPERTY	SF	TENANT	LANDLORD	TYPE	SUBMARKET
9043 Siempre Viva Rd.	257,972	Imperial Toy LLC	AFL-CIO Buildings Investment Trusts	Renewal	Otay Mesa
1925-2005 Harmony Grove Rd.	212,088	Veritiv	Exeter Property Group	Direct	Escondido
2760-2765 Progress St.	194,734	Jeld-Wen, Inc.	Barings Real Estate Advisers LLC	Renewal	Vista
2020 Piper Ranch Rd.	81,252	Bee International	Morgan Stanley & Co LLC	Direct	Otay Mesa
7550 Ronson Rd.	51,400	IMS	McGrath Ronson Road	Direct	Kearny Mesa

Key Sale Transactions Q4 2017

PROPERTY	SF	BUYER	SELLER	PRICE / \$PSF	SUBMARKET
16550 Via Esprillo	180,946	Realterm US, Inc.	Greenlaw Part. & Walton St. Capital	\$60,500,000 / \$334	Rancho Bernardo
9255 Customhouse Plz., Portfolio	517,207	TIAA-CREF	IDS Real Estate Group	\$56,150,000 / \$109	Otay Mesa
6815 Flanders Dr., Portfolio	204,028	Centerpark Plaza Owner LLC	IPERS Centerpark Plaza I & II	\$45,750,000 / \$224	Sorrento Mesa
10307-10309 Pacific Center Ct.	103,830	Klein Family Trust	CDCFC III Pacific Center San Diego	\$33,750,000 / \$325	Sorrento Mesa
2495 Faraday	109,000	BLT Enterprises	Luanne L Leonard 1988 Living Trust	\$24,500,000 / \$225	Carlsbad

Under Construction Q4 2017

PROPERTY	PRELEASED			ADDRESS	PRODUCT TYPE	ESTIMATED COMPLETION	SUBMARKET
	SF	SF	%				
Carlsbad Oaks North - Pacific Vista Com. Ctr.	411,000	0	0%	2800-2820 Whiptail Loop	DIST	2018	Carlsbad
Ridgeview Business Park - Bldgs. A - C	302,500	152,000	50%	14177-14311 Kirkham Way	DIST	2018	Poway
Carlsbad Raceway - Distribute	277,351	0	0%	Lionshead Ave.	DIST	2018	Carlsbad
IPT Otay Logistics Park - Bldgs. A & B	268,454	0	0%	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	222,028	0	0%	Bosstick Blvd.	MFG	2018	San Marcos
Exeter Distribution Center	212,088	212,088	100%	1925-2005 Harmony Grove Rd.	DIST	2018	Escondido
Carlsbad Oaks North - Vector	172,655	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	146,108	0	0%	Lot 24 Whiptail Loop	R&D	2018	Carlsbad
HM Electronics - Lots 18 & 19	140,000	140,000	100%	2848 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
Carlsbad Oaks North - San Diego Hat Co.	83,000	83,000	100%	Whiptail Loop	MFG	2018	Carlsbad
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%	2820 Loker Ave.	R&D	2018	Carlsbad
Covan/Coleman Worldwide	61,522	61,522	100%	13610 Stowe Dr.	DIST	2018	Poway
Bedrosian Tile & Stone	30,000	30,000	100%	7120 Miramar Rd.	DIST	2018	Miramar

INDUSTRIAL SUBMARKETS

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