

SAN DIEGO OFFICE

Economic Indicators

	Q1 17	Q1 18	12-Month Forecast
San Diego Employment	1.43M	1.46M	▲
San Diego Unemployment	4.4%	3.5%	▼
U.S. Unemployment	4.7%	4.1%	▼

Feb 2017/2018 used to represent Q1 for San Diego

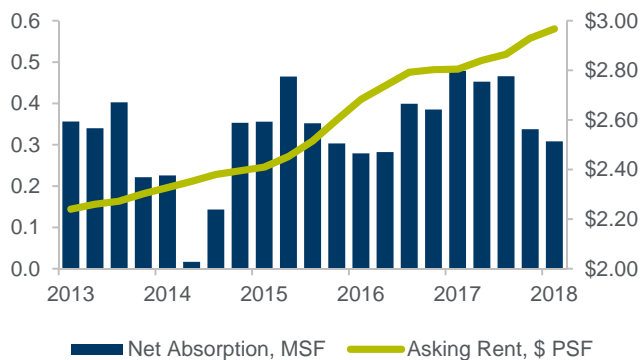
Market Indicators (All Classes)

	Q1 17	Q1 18	12-Month Forecast
Overall Vacancy	14.4%	12.9%	▼
Direct Net Absorption (sf)	457K	65K	▼
Under Construction (sf)	1.5M	1.9M	▲
Average Asking Rent	\$2.78	\$3.02	▲

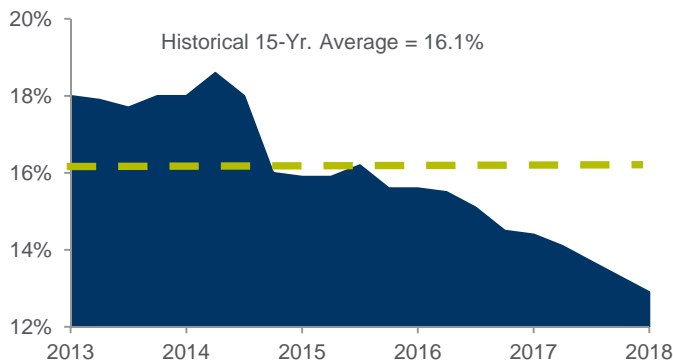
*Rental rates reflect full service asking \$psf/monthly

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 27,900 jobs (+1.9%) year-over-year through February 2018. Of the 27,900 jobs added, 9,400 (or 34%) were office jobs consisting of two sectors: professional and business services and financial activities. During the same time period, the unemployment rate decreased 90 basis points (bps), dropping to 3.5%. Also worth noting, the current rate is 250 bps below the 28-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. Office employment is also forecasted to record a 1.6% growth in 2018, positively affecting demand for office space.

Market Overview

San Diego's office market kicked off 2018 on stable footing as vacancy continued to decline while occupancy showed further improvement. Countywide vacancy shed another 40 bps since year-end 2017 and 150 bps from a year ago to close the first quarter of 2018 at 12.9%, its first appearance below 13% since the Q3 2006. Sublease vacancy decreased 40 bps from last quarter and 80 bps from a year ago to 1.7% in Q1 2018 and is currently at the lowest level on record.

After achieving one million sf of occupancy growth in the latter half of 2017, fueled by a remarkable third quarter, San Diego's office sector throttled a bit during the opening months of 2018 but still maintained its positive momentum - representing its 15th consecutive quarter of occupancy gains. The Q1 2018 quarterly activity was moderate (+65,500 sf) compared to the last quarter's activity when tenants absorbed five times as much space across all classes (+356,000 sf) or Q1 of last year which was the best Q1 activity (+456,700 sf) since 2012.

The majority of Q1 2018 gains recorded in Class A (+126,200 sf) were negated by tenants returning nearly the same amount of Class B space (-125,800 sf) to the market in Q1. Occupancy growth, however, was disproportionate by region as tenants absorbed 70,200 sf across all classes in South County submarkets, 30,100 sf in Central County submarkets yet returned 34,800 sf to North County submarkets. Consequently, overall vacancy was the lowest in South County (10.6%) followed by Central County (12.9%) and North County (16.3%) at the end of Q1 2018.

In Q1 2018, Class A overall vacancy stood at 14.4% countywide, down 30 bps from last quarter and down 120 bps from a year ago. Class B overall vacancy was 12.3%, down 60 bps from last quarter and 250 bps from a year ago.

Although absorption in the first quarter was modest, there were still a few notable mid-sized occupancies. The most significant was WeWork moving into its second San Diego location at the Aventure in UTC totaling 52,000 sf. Another co-working provider, Avanti Workspace, expanded by 11,300 sf at their location in Carlsbad. Co-working is gaining popularity among tech startups and creatives such as marketing and web design companies along with freelancers and independent contractors from FIRE employment sector. Physical and financial flexibility are becoming the new "normal" for the twenty-first century workforce and co-working supports these needs.

Meanwhile, in Sorrento Mesa, iMatrix moved into a 25,000 sf at the Morehouse Tech Center. Entercom migrated out of Mission Valley into 18,000 sf in Kearny Mesa. In UTC, KPMG moved a short distance, to a new 25,000 sf space at One La Jolla.

Throughout the rest of 2018, a number of large tenants are expected to occupy, bolstering absorption in future quarters. In Kearny Mesa, UCSD signed a lease to occupy 82,000 sf. This quarter, Trellisware agreed to occupy 72,000 sf at the newly renovated Summit Pointe in Scripps. In Eastgate, ServiceNow signed a direct deal to expand into a 64,000-sf building, currently subleased by Kratos and Plaza Home Mortgage. Kratos will be moving from Eastgate to 26,000 sf in Scripps in Q4 2018.

AbacusNext leased the 65,000 sf Eastgate Summit building completed in 2016. In Del Mar Heights, GreatCall signed a lease to move into a larger space of 56,000 sf and Tsunami ARVR, another new tenant to San Diego, leased 34,000 sf at Torrey Point. In Sorrento Mesa, Nuvasive has plans to expand into another 107,000 sf, including the construction of a new building. Tocagen signed a lease to occupy 39,000 in Campus Point while InhibiRX signed for 34,000 sf in Torrey Pines.

Q1 2018 WAS THE 15TH CONSECUTIVE QUARTER OF POSITIVE OCCUPANCY

A number of tenants returned significant blocks of space in San Diego County in Q1. The largest was returned by Websense downsizing in Sorrento Valley for 37,000 sf. KPMG vacated 29,000 sf while moving to UTC. Entercom vacated 23,000 sf in Mission Valley to move to Kearny Mesa. In Torrey Pines, Fate Therapeutics vacated 24,000 sf and Interpreta moved out of 19,000 sf.

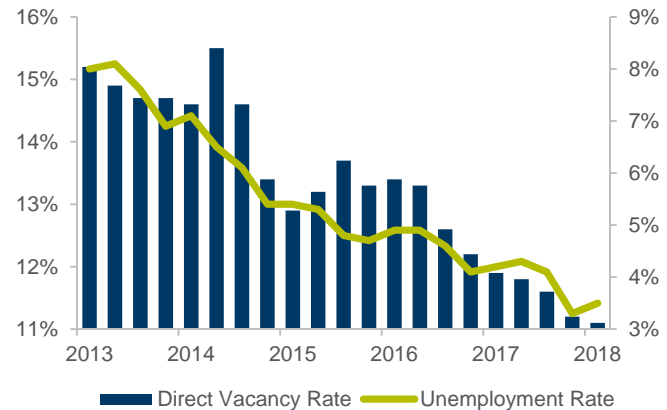
Much of future absorption will come from leases signed for projects currently under construction. ViaSat, which is headquartered in Carlsbad and employs nearly 2,000 workers, is expanding its footprint. The company's Bressi Ranch site is planned for approximately 792,000 sf at build out, with 280,000 sf scheduled to be completed in 2018. In Eastgate, Takeda Pharmaceuticals has a build-to-suit (BTS) lease for over 163,000 sf. Also to be completed in 2018 is the 110,000-sf BTS project for Palomar College in Rancho Bernardo.

Additionally, MedImpact will occupy the first of three buildings at the Watermark in Scripps for 159,000 sf, and UCSD has two projects currently under construction, a 57,000 sf project in Rancho Bernardo and a 53,000 sf project at Park + Market Downtown.

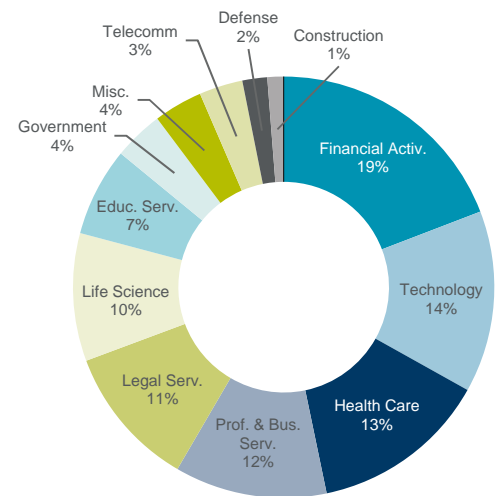
Of the 20 properties, totaling 1.9 msf currently under construction countywide, 17 (totaling 1.6 msf) are scheduled for completion in 2018. Just over 798,000 sf or 43% of the inventory under construction are part of BTS projects. Three of the properties under construction are creative office renovations of previously existing buildings, including AMP&RSAND, a 339,000-sf renovation of the old Union-Tribune office and print buildings in Mission Valley.

Other projects include Makers Quarter Block D in Downtown, planned to be a hub of sustainable live/work/play lifestyle employment center, starting with 50,000 sf of office space initially. Of the total 1.9 msf of product countywide, 47% already have commitments in place. While we anticipate continued pre-leasing activity, this will likely result in a modest short-term uptick in vacancy as these projects come online later in 2018.

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



Tenant Demand by Industry Type
TOP 3 INDUSTRY SECTORS ACCOUNT FOR 46% OF TOTAL DEMAND



Outlook

- Continued economic growth and resulting job growth in combination with increasing tenant demand should provide continued occupancy and rent growth throughout 2018 and into 2019. Leasing within the 5,000 to 50,000 sf range will continue to be the main driver of activity, accounting for 60% of total sf in lease obligations set to expire over the next 18 months.
- Active tenant requirements remain robust at 3.3 msf over the next 24 months countywide. 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.

SUBMARKET	TOTAL BLDGS	INVENTORY (SF)	SUBLET VACANT (SF)	DIRECT VACANT (SF)	OVERALL 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	340	10,583,048	187,420	1,532,782	16.3%	-34,779	-34,779	402,588	\$2.55	\$2.95
Central County	835	49,630,958	937,403	5,466,962	12.9%	30,074	30,074	862,062	\$3.20	\$3.57
South County	318	16,793,384	209,559	1,567,632	10.6%	70,166	70,166	590,573	\$2.85	\$3.20
TOTAL	1,493	77,007,390	1,334,382	8,567,376	12.9%	65,461	65,461	1,855,223	\$3.02	\$3.42
Class A	325	33,865,899	634,400	4,234,028	14.4%	126,244	126,244	1,746,309	\$3.42	
Class B	762	33,004,803	606,621	3,456,206	12.3%	-125,842	-125,842	108,914	\$2.80	
Class C	406	10,136,688	93,361	877,142	9.6%	65,059	65,059	0	\$1.95	
TOTAL	1,493	77,007,390	1,334,382	8,567,376	12.9%	65,461	65,461	1,855,223	\$3.02	

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

Key Lease Transactions Q1 2018

PROPERTY	SF	TENANT	LANDLORD	TRANSACTION TYPE	SUBMARKET
Lightwave Corporate Center	82,153	UCSD	GI Partners	New	Kearny Mesa
Summit Pointe	72,566	Trellisware	Newport National Corporation	New	Scripps
The Towers South	40,667	PayLease	PGIM, Inc.	Renewal & Expansion	Sorrento Mesa
1200 4 th Ave.	22,486	American Addiction Centers	Himel Capital	New	Downtown
Stonecrest	19,222	Mercury Insurance	TIAA-CREF	Renewal	Kearny Mesa

Key Sale Transactions Q1 2018

PROPERTY	SF	BUYER	SELLER	PRICE / \$PSF	SUBMARKET
Gateway at Torrey Hills	197,832	The Irvine Company	PGIM, Inc.	\$105,000,000 / \$531	Del Mar Heights
Two & Five Governor Park	76,047	Equinvest Capital	FPA Multifamily	\$21,500,000 / \$283	Governor
Pacific Gateway Towers	69,432	Charles & Janine Jadallah	Fenway Properties	\$14,940,000 / \$215	Oceanside
Governor Plaza	38,617	Performance Wealth Investments	Palisades Equity Partners	\$10,825,000 / \$280	Governor
Mission Corporate Center	57,729	Monro Capital	Parma Management	\$7,300,000 / \$126	East County

Under Construction Q1 2018 – selected projects 10,000 sf+

PROPERTY	SF	PRELEASED		ADDRESS	CLASS	ESTIMATED COMPLETION	SUBMARKET
		SF	%				
AMP&RSAND	339,000	0	0%	350 Camino de la Reina	A	2018	Mission Valley
Tower 180	324,341	0	0%	1010 2nd Ave.	A	2018	Downtown
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
The Watermark	158,994	158,994	100%	10133 Scripps Gateway	A	2018	Scripps
1420 Kettner Blvd.	123,079	0	0%	1420 Kettner Blvd.	A	2018	Downtown
Bernardo Terrace Corp. Center	110,000	110,000	100%	Rancho Bernardo & Via Tazon	A	2018	Rancho Bernardo
16950 Via Tazon	57,420	57,420	100%	16950 Via Tazon	B	2018	Rancho Bernardo
Park+Market	53,000	53,000	100%	Park Ave. & G St.	A	2019	Downtown
Makers Quarter – Block D	50,000	0	0%	1501 15 th St.	A	2018	Downtown
Aston Point	48,954	0	0%	1800 Aston Ave.	B	2018	Carlsbad
Lift – Bldg. A	33,304	0	0%	6023 Innovation Way	A	2018	Carlsbad
Sorrento Summit	28,000	28,000	100%	7475 Lusk Blvd.	A	2019	Sorrento Mesa
2131 3 rd Ave.	22,499	0	0%	2131 3 rd Ave.	B	2018	Uptown
Corner@2Oaks	14,400	0	0%	158 N. Twin Oaks Valley Rd.	B	2018	San Marcos
Grossmont Summit	13,200	0	0%	9400 Grossmont Summit Dr.	B	2018	East County

OFFICE SUBMARKETS
SAN DIEGO



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