

MARKETBEAT

San Diego

Office Q4 2017



SAN DIEGO OFFICE

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%	▼

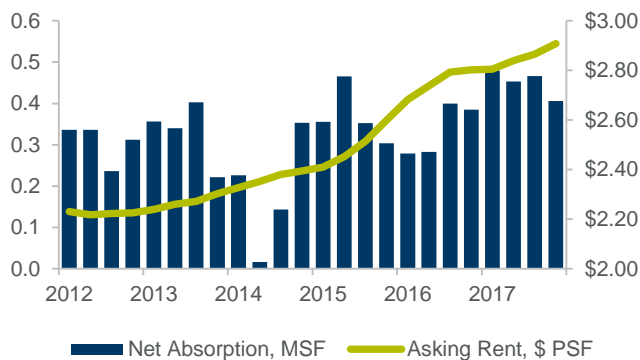
Market Indicators (Overall, All Classes)

	Q4 16	Q4 17	12-Month Forecast
Vacancy	14.5%	13.3%	▲
Direct Net Absorption (sf)	595K	356K	▼
Under Construction (sf)	1.1M	1.3M	▲
Average Asking Rent	\$2.79	\$2.96	▲

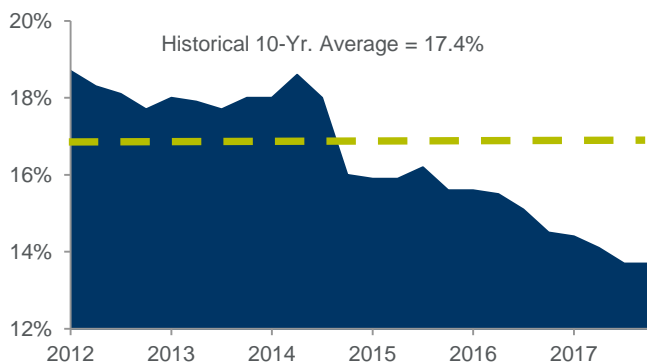
*Rental rates reflect full service asking \$psf/monthly

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 20,800 jobs (+1.4%) year-over-year through November 2017. Of the 20,800 jobs added, 2,200 (or 11%) were office jobs consisting of two sectors: professional and business services and financial activities. 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. Office employment is also forecasted to record a 1.4% growth in 2018, 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 2.9% in 2018 – above its 10-year average growth rate of 2.3%.

Market Overview

Office vacancy (including sublease) decreased to 13.3% in Q4 2017, down 40 bps from last quarter and 120 bps from a year ago. This was the seventh consecutive quarter of declining vacancy. Occupancy grew by 355,600 square feet (sf) across all classes in Q4, bringing year-to-date net absorption to 1.6 million square feet (msf). This was the greatest annual total since 2005 (1.9 msf absorbed in 2005).

Occupancy growth, however, was disproportionate by region as tenants absorbed 345,000 sf across all classes in Central County submarkets, 33,000 sf in North County submarkets yet returned 22,400 sf to South County submarkets. At the end of Q4 2017, overall vacancy was the lowest in South County (10.6%) followed by Central County (13.6%) and North County (16.1%).

In Q4 2017, Class A overall vacancy stood at 14.7% countywide, down 70 bps from last quarter and down 80 bps from a year ago. Class B overall vacancy was 12.9%, down 40 bps from last quarter and 80 bps from a year ago. Three buildings totaling 100,000 sf were completed in Q4, bringing total year-to-date deliveries to 1.2 msf.

Absorption in Q4 2017 was bolstered by a few significant move-ins. In Scripps, Mission Federal Credit Union purchased Horizon Tech Center in November, occupying two of the three buildings for 112,000 sf. Entering the San Diego market, Amazon moved into its 84,500 sf lease in Campus Point. La Jolla Pharmaceuticals occupied 78,500 sf at Axiom in Eastgate. In the UTC submarket, Wells Fargo moved into 45,000 sf at One La Jolla Center. In San Marcos, PIMA Medical Institute moved into 40,000 sf at The Icon, where construction was completed this quarter.

A number of large leases were signed that will further boost absorption in future quarters as these tenants begin occupying the space. 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 UTC, WeWork is expanding into their second San Diego location with a 52,000 sf lease at The Aventine and KPMG will move into 26,000 sf at One La Jolla Center. 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. Hub International and iMatrix leased roughly 25,000 sf each.

A number of tenants returned significant blocks of space in San Diego County in Q4, with the largest in Sorrento Mesa. The Active Network's lease finally expired, returning 124,000 sf to the market. The company moved to Dallas and was subleasing space to multiple tenants. In Carlsbad, GreatCall vacated 48,500 sf at Axis 1950 after moving into Studio 2200 earlier this year.

Q4 2017 WAS THE 14TH 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 (BTS) 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 BTS project for Palomar College in Rancho Bernardo. MedImpact will occupy the first of three buildings at the Watermark in Scripps. Construction on the project began in the Q4 2017.

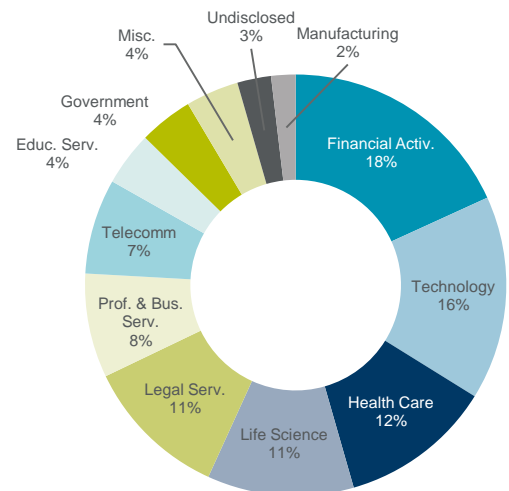
Of the 15 properties, totaling 1.3 msf currently under construction countywide, 14 are scheduled for completion in 2018. Just over 740,000 sf of inventory under construction are part of BTS projects. Three of the properties under construction are creative office renovations of previously existing buildings, including AMP&RSAND, a 339,000-sf renovation of the old Union-Tribune office and print buildings in Mission Valley and a smaller 34,000-sf renovation of the old San Diego Daily Transcript building in Uptown.

Other projects include Makers Quarter Block D in Downtown, 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 1.3 msf of product countywide, 58% 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.

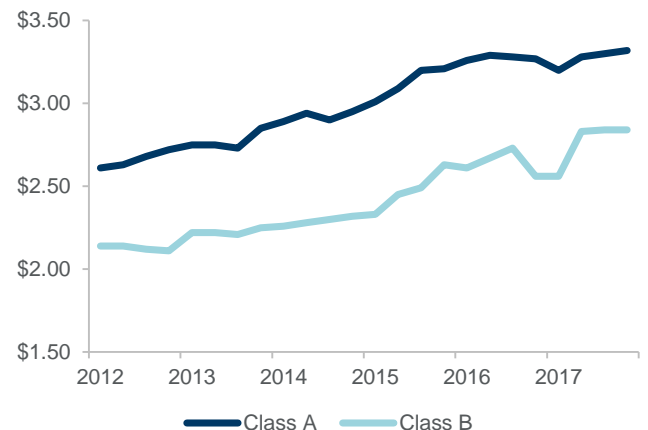
Direct Vacancy vs. Unemployment Rate
DECLINE IN VACANCY CORRELATES DECLINE IN UNEMPLOYMENT



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



Average Asking Rate by Class (Full Service)
CLASS A RENT INCREASED 1.5% AND CLASS B INCREASED 10.9% Y/Y



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 61% of total sf in lease obligations set to expire over the next 18 months. Leases 50,000 sf and larger will account for 16% of activity, while leases 5,000 sf and less will account for 23%.
- Active tenant requirements remain robust at 3.2 msf over the next 24 months countywide with 2.4 msf in Central County, 366,000 sf in North County and 408,000 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.

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	342	10,632,075	217,050	1,495,197	16.1%	32,987	117,708	382,265	\$2.42	\$2.78
Central County	841	49,437,452	1,257,765	5,478,058	13.6%	345,043	1,191,649	804,642	\$3.16	\$3.50
South County	319	16,972,272	143,965	1,657,085	10.6%	(22,401)	314,582	97,496	\$2.79	\$3.08
TOTAL	1,502	77,041,799	1,618,780	8,630,340	13.3%	355,629	1,623,939	1,284,403	\$2.96	\$3.32
Class A	328	32,816,940	764,921	4,074,944	14.7%	216,260	784,512	1,211,900	\$3.32	
Class B	753	33,601,880	751,385	3,581,475	12.9%	154,478	517,562	72,503	\$2.84	
Class C	421	10,622,979	102,474	973,921	10.1%	(15,109)	321,865	0	\$1.90	
TOTAL	1,502	77,041,799	1,618,780	8,630,340	13.3%	355,629	1,623,939	1,284,403	\$2.96	

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

Key Lease Transactions Q4 2017

PROPERTY	SF	TENANT	LANDLORD	TRANSACTION TYPE	SUBMARKET
Eastgate Summit	64,833	AbacusNext	The Irvine Company	New	Eastgate
The Aventine	52,371	WeWork	Rockpoint Group	New	UTC
Hazard Center	20,345	Century 21	Principal Financial Group	Renewal	Mission Valley
The Plaza	13,059	Andrews, Lagasse, Branch & Bell	The Irvine Company	Renewal & Expansion	UTC
Park Terrace	11,268	UBS Financial Services	SH Realty Partners	Renewal	Rancho Bernardo

Key Sale Transactions Q4 2017

PROPERTY	SF	BUYER	SELLER	PRICE / \$PSF	SUBMARKET
7337 Trade St.	499,402	Mapletree US Management	Carter Validus Mission Critical REIT II	\$217,935,228 / \$436	Miramar
Mission City / Sorrento Mesa Portfolio	675,142	City Office REIT	Kilroy Realty Corporation	\$174,500,000 / \$258	Mission Valley & Sorrento Mesa
Horizon Tech Center	157,902	Mission Federal Credit Union	KBS REIT II	\$39,515,500 / \$250	Scripps
Mission Center Office Park	183,692	Omninet Capital	Kearny Real Estate Company	\$39,275,000 / \$214	Mission Valley
15255 Innovation Dr.	68,496	SWK Properties	Hill Properties	\$21,500,000 / \$314	Rancho Bernardo

Under Construction Q4 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
The Watermark	158,994	158,994	100%	10133 Scripps Gateway	A	2018	Scripps
Bernardo Terrace Corp. Center	110,000	110,000	100%	Rancho Bernardo & Via Tazon	A	2018	Rancho Bernardo
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
Third Avenews	34,296	0	0%	2131 3 rd Ave.	B	2018	Uptown
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
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
Cedros Collective	5,607	0	0%	435-439 S. Cedros Ave.	B	2018	Del Mar/Solana Beach
The Millenium	5,000	0	0%	655 Camino de la Reina	B	2018	Mission Valley

OFFICE SUBMARKETS
SAN DIEGO



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