MARKETBEAT

San Diego

Office Q4 2016

SAN DIEGO OFFICE

Economic Indicators

	Q4 15	Q4 16	12-Month Forecast
San Diego Employment	1.40M	1.43M	▲
San Diego Unemployment	5.0%	4.8%	▼
U.S. Unemployment	5.0%	4.8%	▼

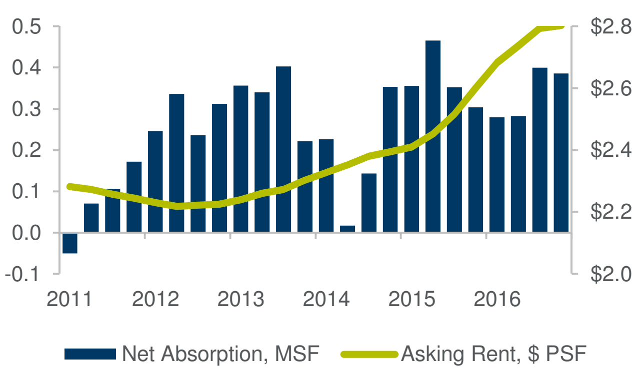
Market Indicators (Overall, All Classes)

	Q4 15	Q4 16	12-Month Forecast
Vacancy	15.6%	14.5%	▼
Direct Net Absorption (sf)	651k	595K	▼
Under Construction (sf)	1.4M	1.1M	▼
Average Asking Rent	$2.75	$2.79	▲

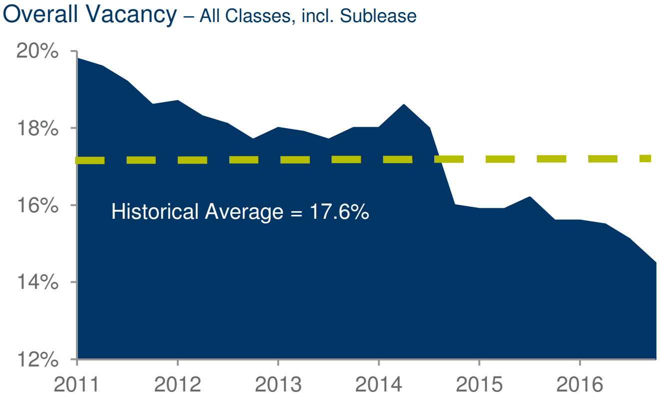
*Rental rates reflect full service asking $psf/monthly

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 30,900 jobs (+2.2%) year-over-year through November 2016. Of the 30,900 jobs added, 7,100 (or 23%) were office jobs consisting of two sectors: business & professional services and financial activities. During the same time period, the unemployment rate decreased 70 basis points (bps), dropping to 4.3% in November of 2016. The current rate is 170 bps below the 26-year average of 6%. All employment sectors are expected to close out 2016 at a combined growth rate of 2.5% and grow an additional 2.3% in 2017. Office employment is forecasted to record 4.0% growth in 2016 and 4.2% in 2017, positively affecting demand for office space. San Diego's economy grew 3.6% in 2016 to $204 billion – nearly tripling its 10-year average growth rate of 1.3% - and is forecasted to grow 3.8% in 2017, according to Moody's Analytics economy.com forecast. The innovation economy accounted for almost $52 billion of San Diego's GRP impacting 404,000 jobs (30% of total private sector) and 1,650 new jobs were created by 405 San Diego innovation startups, according to a recent report from CONNECT (using 2015 stats).

Market Overview

Office vacancy (including sublease) fell to 14.5% in Q4 2016, down 110 bps from the 15.6% rate posted a year ago, and reflects a substantial decline (720 bps) from the peak post-recession vacancy level of 21.7% reported seven years ago. Compared to Q3 2016, total vacancy decreased 60 bps to 14.5% as occupancy grew by 595,000 square feet (SF) across all classes.

The office market achieved more than 1.5 MSF of positive annual net absorption (change in occupancy) in 2016, its highest level since 2005 when it absorbed over 1.9 MSF.

Whereas occupancy growth used to be driven predominately by Class A space, we are now seeing a more balanced split between Class A and Class B product. In 2016, tenants absorbed 771,400 SF of Class A space countywide, while tenants absorbed 647,000 SF of Class B space. Class A still remains a prime choice for occupiers as leasing in this class has been positive for 27 of the last 30 quarters. During this stretch, tenants have absorbed a total of 6.2 million square feet (MSF), equating to an average of 207,000 SF per quarter.

Class A performance in Q4 was robust at 488,400 SF driven by Illumina's 295,000 SF occupancy of its sixth build-to-suit building at their campus. The growth, however, was disproportionate by region as tenants absorbed 445,000 SF of Class A space in Central County submarkets, 31,000 SF in North County submarkets and 12,000 SF in South County submarkets. Since peaking at 23% seven years ago, Class A vacancy including sublease has plummeted 750 bps to 15.5%.

As availability of Class A space in key submarkets has become more constricted and asking rents have increased, Class B leasing has picked up notably. As a result Class B vacancy now stands at 13.7%, its lowest level in ten years. One year ago overall Class B vacancy stood at 16.3%.

Class B occupancy growth in Q4 2016 was 153,000 SF, slightly above the quarterly average of 141,000 SF over the last two years. Tenants absorbed 647,000 SF of Class B space in 2016 which was the fifth consecutive year of positive net absorption. Class B had struggled for six years returning 2.2 MSF combined between 2006 and 2011. Since 2012, tenants have backfilled close to 2.0 MSF of Class B space, recovering 91% of space returned to the market during the Great Recession.

Illumina constituted the largest Q4 move-in, with the commencement of their 295,000 SF build-to-suit in UTC. Second was Ignyta, who occupied 104,000 SF at Axiom in Eastgate, followed by WeWork, who commenced their 88,000 SF lease at 600 B St. in Downtown San Diego.

Other large move-ins featured UCSD moving into 70,000 SF in Governor, Verve Mobile into 30,000 SF at MAKE in Carlsbad, and Retrophin into 23,000 SF in Del Mar Heights.

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 Downtown, the City of San Diego will occupy 315,000 SF at 101 Ash St., decreasing Downtown office vacancy by over 300 bps. The City will also occupy another 58,000 SF in Kearny Mesa. Also in Kearny Mesa, Guild Mortgage expanded their current lease to occupy another 38,000 SF at the Terraces. In Rancho Bernardo, Renovate America will occupy 160,000 SF and 3D Systems will occupy 45,000 SF. In UTC and Eastgate, Jones Day will occupy 62,000 SF at One La Jolla Centre early next year, while MCTC, the organization developing the trolley expansion, will occupy 32,000 SF in Eastgate.

Much of future absorption comes from leases signed for projects under construction. After occupying their 295,000 campus building, Illumina will also occupy 316,000 SF at Biomed Realty's i3 in Eastgate, a positive sign of the impact biotechnology and healthcare companies have on San Diego's economy. Additionally, Eli Lilly is expanding into 304,000 SF in Campus Point. Otonomy will occupy a 62,000 SF build-to-suit building for their new headquarters at 4796 Executive Dr. in Eastgate. The second Spectrum Lab building in Torrey Pines is expected to be completed at 3013 Science Park Rd. and occupied by the Medicine Company later this year. Sharp will occupy a 100,000 SF building in Rancho Bernardo in 2017.

ANNUAL OFFICE ABSORPTION IN SAN DIEGO REACHED ITS HIGHEST MARK SINCE 2005.

Of 15 buildings totaling 1.1 MSF under construction countywide, all are scheduled for completion in 2017. Forty-two percent of the projects will be delivered in the Eastgate submarket, consisting of five buildings totaling 474,000 SF. Campus point has one 304,000 SF project, Del Mar Heights has three projects totaling 110,000 SF and Sharp has a 100,000 SF build-to-suit in Ranch Bernardo. Among the projects in the pipeline, seven are 100% preleased. Of the total 1.1 MSF of product countywide, more than 75% 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.

The countywide average asking rent for all classes is now $2.79 per square foot (PSF) on a monthly full service basis. This metric has decreased 2.4% over the past three months and is up 1.5% from where it stood a year ago. Over the past 12 months, Class A rent has increased by 1.9% to $3.27 PSF while the Class B rate has decreased by 2.7% to $2.56 PSF. There is still plenty of room for growth in the A market guided by new construction, and the widening gap between the A and B markets will subsequently allow more room for the B market to increase.

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 57% of total SF in lease obligations set to expire over the next 18 months. Leases 50,000 SF and larger will account for 20% of activity, while leases 5,000 SF and less will account for 23%.

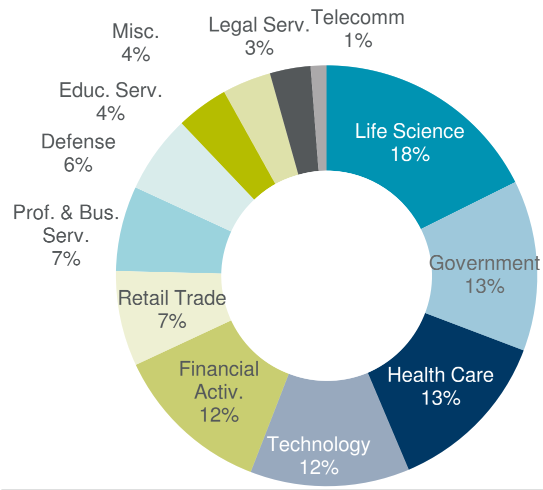
Tenant demand stands at 4.4 MSF over the next 24 months countywide with 3 MSF in Central County, 690,000 SF in North County and 670,000 SF in South County. While not all of the current tenants in the market will transact in the short-term, these levels provide a barometer to leasing activity in quarters to follow.

Direct Vacancy vs. Unemployment Rate

DECLINE IN VACANCY PARALLELS DECLINE IN UNEMPLOYMENT

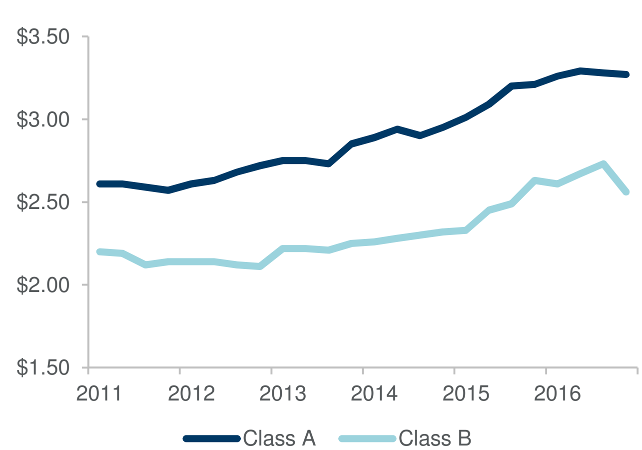
Tenant Demand by Industry Type

TOP 3 INDUSTRY SECTORS ACCOUNT FOR 44% OF TOTAL DEMAND



Average Asking Rate by Class (Full Service)

CLASS A RENT INCREASED 1.9% AND CLASS B DECREASED 2.7% Y/Y



MARKETBEAT

San Diego

Office Q4 2016

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	323	10,012,885	55,001	1,534,279	15.9%	42,952	216,714	48,954	$2.41	$2.68
Central County	793	46,983,707	1,535,205	5,450,469	14.9%	495,396	1,094,675	1,051,801	$2.95	$3.50
South County	320	17,050,073	130,731	2,028,727	12.7%	56,649	229,332	28,925	$2.54	$2.85
TOTAL	**1,436**	**74,046,665**	**1,720,937**	**9,013,475**	**14.5%**	**594,997**	**1,540,721**	**1,129,680**	**$2.79**	**$3.27**
Class A	303	30,685,855	1,117,488	3,638,977	15.5%	488,426	771,400	1,004,526	$3.27	
Class B	710	32,757,237	521,438	3,959,144	13.7%	152,748	646,589	125,154	$2.56	
Class C	423	10,603,573	82,011	1,415,354	14.1%	(46,177)	122,732	0	$1.76	
TOTAL	**1,436**	**74,046,665**	**1,720,937**	**9,013,475**	**14.5%**	**594,997**	**1,540,721**	**1,129,680**	**$2.79**	

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

Key Lease Transactions Q4 2016

PROPERTY	SF	TENANT	LANDLORD	TRANSACTION TYPE	SUBMARKET
101 Ash St.	315,000	City of San Diego	Shapery Enterprises & Manchester Financial Group	New	Downtown
16399 W. Bernardo Dr.	160,925	Renovate America	Swift Real Estate Partners	New	Rancho Bernardo
The Terraces	75,968	Guild Mortgage	Sudberry Properties	Renewal & Expansion	Kearny Mesa
Studio 2200	61,772	GreatCall	Hill Companies	New	Carlsbad
Verge	26,590	Competitor Group	Cruzan	New	Sorrento Mesa

Key Sale Transactions Q4 2016

PROPERTY	SF	BUYER	SELLER	SALE PRICE	SUBMARKET
Emerald Plaza	364,160	Kearny Real Estate Company	Deutsche Asset & Wealth Management	$91,670,000 ($252/SF)	Downtown
Fifth & Laurel	161,430	Manchester Financial Group	Westbrook Partners	$71,500,000 ($443/SF)	Uptown
10641 Scripps Summit Ct.	151,400	Newport National Corporation	HD Supply	$31,300,000 ($207/SF)	Scripps
7777 Fay Ave.	54,291	The Price Group	China Times	$24,503,500 ($451/SF)	La Jolla
Scripps Collection	47,302	JFK Family Trust	HighBrook Investors	$10,000,000 ($211/SF)	Scripps
Torrey Hills Corporate Center	23,595	ROIC	HighBrook Investors	$9,850,000 ($417/SF)	Del Mar Heights

Under Construction Q4 2016

PROPERTY	SF	PRELEASED SF	PRELEASED %	ADDRESS	CLASS	ESTIMATED COMPLETION	SUBMARKET
i3 – Bldgs. 1 - 3	316,262	316,262	100.0%	4775 - 4785 Executive Dr.	A	2017	Eastgate
Campus Point Corporate Center	304,326	304,326	100.0%	10290 Campus Point Dr.	A	2017	Campus Point
16909 W. Bernardo Dr.	100,000	100,000	100.0%	16909 W. Bernardo Dr.	A	2017	Rancho Bernardo
Eastgate Terrace	96,435	0	0.0%	9779 Towne Centre Dr.	A	2017	Eastgate
Torrey Point - Bldgs. A & B	93,733	0	0.0%	3420 - 3430 Carmel Mountain Rd.	A	2017	Del Mar Heights
Spectrum Lab - Bldg. 2	63,000	0	100.0%	3013 Science Park Rd.	B	2017	Torrey Pines
Otonomy Headquarters	61,755	61,755	100.0%	4796 Executive Dr.	A	2017	Eastgate
Carlsbad Research Center	48,954	0	0.0%	1800 Aston Ave.	B	2017	Carlsbad
Merge	16,290	9,502	58.3%	5550 Carmel Mountain Rd.	A	2017	Del Mar Heights
Grossmont Summit	13,200	0	0.0%	9400 Grossmont Summit Dr.	B	2017	East County
The Promenade at Point Loma	8,096	0	0.0%	4960 N. Harbor Dr.	A	2017	Point Loma
I.D.E.A. District	7,629	0	0.0%	835 12th Ave.	A	2017	Downtown

MARKETBEAT

San Diego

Office Q4 2016

OFFICE SUBMARKETS
SAN DIEGO

About Cushman & Wakefield

Cushman & Wakefield is a global leader in commercial real estate services, helping clients transform the way people work, shop, and live. The firm's 43,000 employees in more than 60 countries provide deep local and global insights that create significant value for occupiers and investors around the world. Cushman & Wakefield is among the largest commercial real estate services firms in the world with revenues of $5 billion across core services of agency leasing, asset services, capital markets, facilities services (branded C&W Services), global occupier services, investment management (branded DTZ Investors), tenant representation and valuations & advisory. To learn more, visit www.cushmanwakefield.com or follow @Cushwake on Twitter.

.

Jolanta Campion
Director of Research, San Diego Region
jolanta.campion@cushwake.com

Justin Balagtas
Research Analyst
justin.balagtas@cushwake.com

4747 Executive Drive, Suite 900
San Diego, CA 92121
Tel: 858.625.5235
Fax: 858.630.6320
CA License 01880493