

MARKETBEAT

San Diego

Industrial Q4 2016



SAN DIEGO INDUSTRIAL

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%	▼

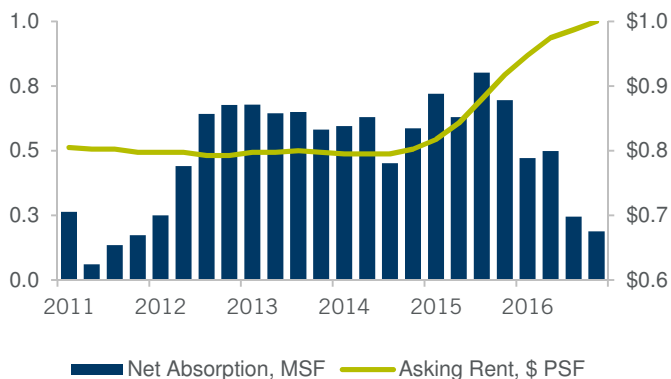
Market Indicators (Overall, All Product Types)

	Q4 15	Q4 16	12-Month Forecast
Vacancy	5.0%	5.3%	▲
Direct Net Absorption (sf)	677K	452K	▼
Under Construction (sf)	1.2M	727K	▼
Average Asking Rent	\$0.96	\$1.01	▲

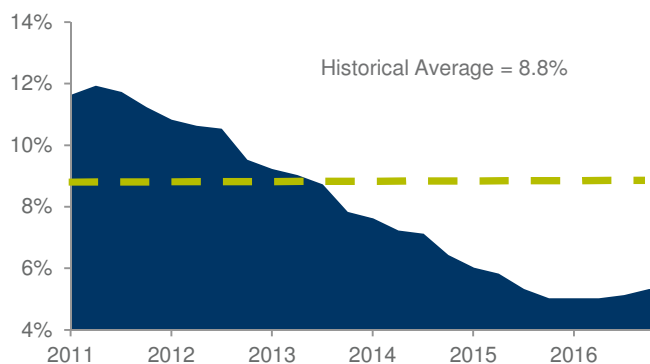
*Rental rates reflect triple net asking \$psf/monthly

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 30,900 jobs (+2.2%) year-over-year through November 2016. The unemployment rate decreased 70 basis points (bps) from a year ago, 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, positively affecting demand for commercial real estate space. San Diego's economy grew 3.6% in 2016 - above the 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.

Economic activity in the manufacturing sector expanded from 53.2% in November to 54.7% in December, indicating growth in manufacturing for the fourth consecutive month and a new high reading in 2016. Eleven of the 18 industries reported an increase in new orders in December. The overall economy grew for the 91st consecutive month in the U.S.

Market Overview

At the close of Q4 2016, industrial vacancy (including sublease) in the San Diego marketplace stood at 5.3%. Vacancy is up 30 bps from the 5% rate posted a year ago and reflects a substantial decline (740 bps) from the peak post-recession vacancy level of 12.7% reported seven years ago. Compared to Q3 2016, total vacancy increased 20 bps, primarily due to the departure of two tenants: Sweetwater Union High School District vacated 261,244 SF of manufacturing space at 652-664 L St. in Chula Vista; and AutoGenomics, Inc. vacated 126,715 SF of R&D space at 2980 Scott St. in Vista.

Overall vacancy levels were the lowest in Central County at 4.3% followed by North County (5.5%) and South County (7%). Across the region, the market is the tightest for manufacturing space at 4.3%, an increase of 60 bps from a year ago. Vacancy including sublease for incubator multi-tenant space (IMT) now stands at 4.5% countywide; it stood at 4.4% a year ago. Distribution space currently stands at 5.1%, up 100 basis points over the past 12 months. Meanwhile, vacancy for R&D product has decreased 90 bps over the past year and now stands at 7.9%.

The market recorded 451,870 SF of positive net absorption in Q4 2016. This was the 22nd consecutive quarter of industrial expansion. During this time, tenants have absorbed a total of 11.9 million square feet (MSF) of space, an average of 540,000 SF per quarter. 2016 was the 7th consecutive year recording positive net absorption, all product types combined.

The best performing submarkets by square feet absorbed in Q4 2016 were Oceanside (363,910 SF), East County (190,177 SF), and Carlsbad (108,510 SF). The top three largest move-ins of the quarter occurred in Central County: Sigler (Carrier) moved into 134,727 SF at 1900 Weld Blvd. in East County, Ballast Point moved into 85,147 SF at 7606 Trade St. in Miramar, and Sorrento Therapeutics/Heron moved into 75,325 SF at 4955 Directors Pl. in Sorrento Mesa.

In contrast, two submarkets had significant move outs: Chula Vista saw the deepest level of occupancy loss of any submarket with negative 282,121 SF of net absorption and Vista lost 261,172 SF of occupancy.

This deep loss was the result of Sweetwater Union High School District vacating 261,244 SF of MFG space at 652-664 L St. in Chula Vista and AutoGenomics, Inc. vacating 126,715 SF of R&D at 2980 Scott St. in Vista.

The overall average asking rent for industrial product on a triple net basis was \$1.01 per square foot in Q4, up 5.2% from a year ago. The last time

rents averaged \$1.00 was nearly nine years ago (Q3 2008). Ten of 24 industrial submarkets recorded double digit year-over-year gains in average rent. Comparing markets, combined South County submarkets recorded a 15% increase in average annual rent followed by a 7.9% increase in Central County. North County average rent remained unchanged year-over-year. Average rent for IMT product type recorded a double digit increase across all counties: North (up 10%), Central (up 14%), South (up 10%) and Countywide (up 12%). This trend is being driven by modern industrial facilities, which remain in short supply but in high demand. As a result, we are also seeing an increasing trend of renovations of older product - the modernization of dated industrial and R&D buildings - to make them more appealing to tenants.

This has been another factor contributing to industrial rent growth as the increased cost of construction compared to the previous cycle warrants higher rental rates. In terms of product type, asking rents countywide have climbed by 12% for IMT space (\$1.03) over the past year, 8.7% for distribution space (\$0.75), 2.9% for R&D/Flex product (\$1.43), yet remained unchanged for manufacturing space (\$0.85).

COUNTYWIDE OVERALL VACANCY AT 5.3%, PUSHING AVERAGE ANNUAL RENT UP 5.2%.

Though we are now tracking 726,791 SF of product (nine buildings) under construction in Carlsbad, Vista, Poway, and Otay Mesa submarkets, this will likely not be enough to satisfy existing demand. With overall availability down to 8.0% and overall vacancy down to just 5.3%, there is just 13.0 MSF (out of total inventory of 161.4 MSF) of available space remaining in the marketplace.

Sixty nine percent (five buildings or 499,658 SF) of product currently under construction is located in Carlsbad. HM Electronics began construction of their 140,000-SF Build-to-Suit (BTS) project in Carlsbad in Q4. The other four projects which total 227,133 SF are: Poway Corporate Center, Continental Commerce Center, Siempre Viva Building 17 in Otay Mesa and ex*ten*sion in Vista, all scheduled for delivery in 2017.

Until recently, developers have been reluctant to build without committed tenants in place. We saw this dynamic shift in late 2015 when under construction activity reached 1.2 MSF - the highest level recorded since 2007. Currently, seven (or 565,432 SF) of the nine buildings that are under construction are speculative, with overall preleasing activity at 32.0% (including BTS projects). With vacancy at record lows, demand on the upswing and rents on the rise, market conditions are ideal for speculative development. This, coupled with the fact that more than 60% of the county's industrial inventory was built before 1990, bodes well for continued strong demand of new, functional facilities.

Further exemplifying the stability and desirability of the San Diego industrial market, nearly 1.2 MSF of new industrial product has been developed in 2016, the majority of which was delivered occupied. Last time we saw deliveries reaching this level was in 2008 (one MSF with 0% pre-leased).

Outlook

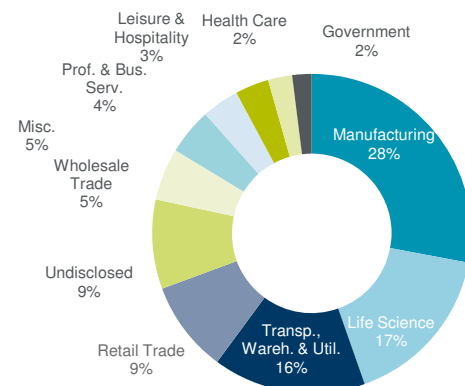
Continued economic expansion and resulting job growth will drive decreased vacancy through 2017. Leasing of spaces 40,000 SF or less will continue to be the main driver of activity, accounting for 64% of total SF in lease obligations set to expire in 2017.

Tenant demand stands at 4.5 MSF countywide over the next 24 months with 1.6 MSF in North County, 2.6 MSF in Central and South Counties combined and 300,000 SF with no geographic preference. Until new speculative construction is delivered, the steady absorption of existing inventory will continue to drive vacancy rates lower.

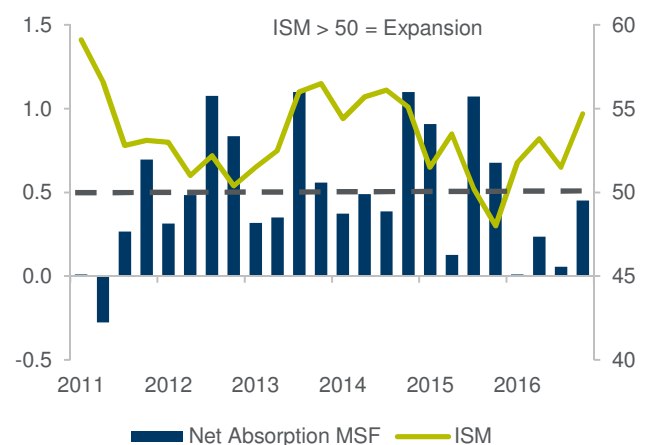
Direct Vacancy vs. Unemployment Rate
DECLINE IN VACANCY PARALLELS DECLINE IN UNEMPLOYMENT



Tenant Demand by Industry Type
TOP 3 INDUSTRY SECTORS ACCOUNT FOR 60% OF TOTAL DEMAND



Net Absorption vs. ISM Manufacturing Index
MANUFACTURING REGISTERED GROWTH IN JUNE, INDEX AT 51.5%



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	2,030	51,608,396	619,415	2,234,599	5.5%	321,558	643,619	521,017	\$0.94
Central County	2,254	79,447,417	888,847	2,577,518	4.3%	515,982	479,775	82,640	\$1.23
South County	617	30,311,697	201,689	1,899,911	7.0%	(385,670)	(369,800)	123,134	\$0.69
TOTAL	4,901	161,367,510	1,709,951	6,712,028	5.3%	451,870	753,594	726,791	\$1.01
R&D	826	31,780,032	509,814	1,996,637	7.9%	160,993	216,024	304,085	\$1.43
MFG	2,450	64,769,897	488,102	2,246,963	4.3%	(92,437)	(100,204)	299,572	\$0.85
IMT	625	20,331,091	141,898	779,668	4.5%	67,561	154,883	0	\$1.03
DIST	1,000	44,486,490	570,137	1,688,760	5.1%	315,753	482,891	123,134	\$0.75
TOTAL	4,901	161,367,510	1,709,951	6,712,028	5.3%	451,870	753,594	726,791	\$1.01

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

Key Lease Transactions Q4 2016

PROPERTY	SF	TENANT	LANDLORD	TYPE	SUBMARKET
6650 Top Gun St.	121,496	Meggitt (Cobham)	GFP Alliance San Diego	Direct	Sorrento Mesa
1900 Weld Blvd.	112,168	Sigler (Carrier)	RCD Suspension	Direct	East County
2020 Piper Ranch Rd.	98,500	Balboa Water Group	Morgan Stanley	Direct	Otay Mesa
901 Bay Marina Dr.	91,541	Amazon	BlueLinx Corporation	Direct	National City
11905 Community Rd.	82,640	General Atomics	Techbilt	Direct	Poway

Key Sale Transactions Q4 2016

PROPERTY	SF	BUYER	SELLER	SALE PRICE	SUBMARKET
16399 W. Bernardo Dr.	782,211	Swift Real Estate Partners	Hewlett-Packard Company	\$69,000,000 (\$88/SF)	Rancho Bernardo
11535 Sorrento Valley Rd., etc.	391,020	Parallel Capital Partners	Angelo, Gordon, & Co.	\$68,400,000 (\$175/SF)	Sorrento Valley
5775 Roscoe Ct., etc.	132,685	Klein Investments Family LP	Gramercy Property Trust, Inc.	\$37,950,770 (\$286/SF)	Kearny Mesa
9879 Hibert St., etc.	209,315	Emerald Interests Corp.	American General Life Insurance Company	\$31,850,000 (\$152/SF)	Scripps
4400 Ruffin Rd.	235,812	LBA Realty	United Technologies Corporation	\$25,250,000 (\$107/SF)	Kearny Mesa

Under Construction Q4 2016

PROPERTY	PRELEASED			ADDRESS	PRODUCT TYPE	ESTIMATED COMPLETION	SUBMARKET
	SF	SF	%				
Carlsbad Oaks North - Elevate	154,085	71,000	63%	2870 Whiptail Loop	2018	R&D	Carlsbad
Atlas at Carlsbad - Beta	150,000	0	0%	5909 Sea Otter Pl.	2017	R&D	Carlsbad
HM Electronics - Lots 18 & 19	140,000	140,000	100%	Lots 18 & 19 Whiptail Loop	2017	MFG	Carlsbad
Poway Corporate Center	82,640	0	0%	11905 Community Rd.	2017	MFG	Poway
Siempre Viva Business Park	79,050	0	0%	8500 Kerns St.	2017	DIST	Otay Mesa
Lionshead Avenue	55,573	0	0%	3248 Lionshead Ave.	2017	MFG	Carlsbad
Continental Commerce Center	44,084	0	0%	7155 Camino Maquiladora	2017	DIST	Otay Mesa
ex*ten*sion	21,359	21,359	100%	1125 Joshua Way	2017	MFG	Vista

INDUSTRIAL SUBMARKETS SAN DIEGO



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