

SAN DIEGO OFFICE MARKET

FIRST QUARTER 2017

Office vacancy levels continue to drop in San Diego

Direct weighted average rental rates market-wide hits nine-year high

In the first quarter, the San Diego office market continued to report healthy market fundamentals with positive net absorption, declining vacancy levels, rising average rental rates and increased construction levels. With the unemployment rate in San Diego now at a ten-year low, the area office market has directly benefited as local companies have been in expansion mode with 5.2 million square feet of office space absorbed since the beginning of 2011. Outside of a macroeconomic shock, expect the San Diego office market to remain healthy in 2017.

ECONOMY




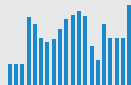


Unemployment rate at just 4.2% in San Diego to begin 2017

The seasonally adjusted unemployment rate for San Diego County was just 4.2% in February compared to 5.0% for California and the national unemployment rate of 4.7%. Total year-over-year nonfarm employment in increased by 26,700 (1.9%) while year-over-year office-using employment growth has grown by 9,400 (2.5%). Both nonfarm and office-using employment growth has slowed from 2.9% and 2.7% reported in February 2016, respectively. Hopefully, employment growth picks up as the year progresses and as local employers remain attracted to the area’s well-educated labor pool and high quality of life.

SUPPLY AND DEVELOPMENT

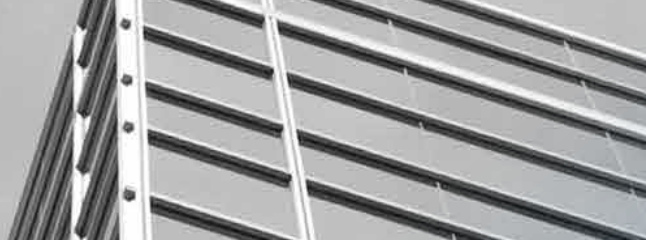
1.4 million square feet of new office space now underway

The San Diego office market again saw no new office space delivered in the first quarter, while 1.4 million square feet or 2.4% of the existing office base is now under construction. Major projects include the creative office renovation of the former Union-Tribune headquarters re-branded as Ampersand in Mission Valley (318,570 square feet), One Paseo in Carmel Valley (280,000 square feet), and the i3 campus in UTC (316,262 square feet) which is 100% leased to Illumina Pharmaceuticals. Of the 1.4 million square feet underway, over 37% is pre-leased. Depending on leasing activity, expect some other high-profile office projects to break ground around the region this year.

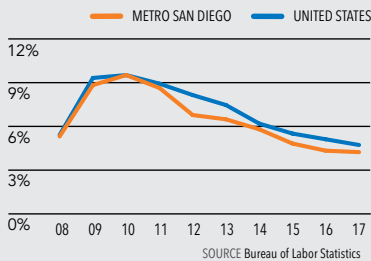
TRENDLINES	
5-YEAR TREND	CURRENT QUARTER
VACANCY 	14.2% Vacancy down 40 basis points from 4Q
ABSORPTION 	252,620 SF Six straight quarters of positive absorption
RENTAL RATE 	\$2.75 PSF Highest reported rate in nine years
UNDER CONSTRUCTION 	1.4 million SF Over 37% is pre-leased
CAP RATES 	6.1% Cap rates rise 30 basis points from 4Q
JOB GROWTH 	26,700 jobs Year-over-year growth up 1.9%

SAN DIEGO OFFICE MARKET

FIRST QUARTER 2017



UNEMPLOYMENT RATE

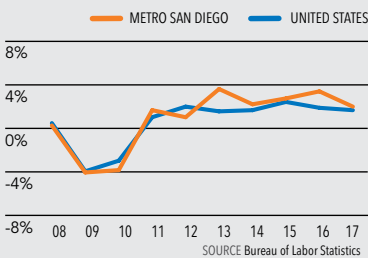


DEMAND

Net absorption positive for the sixth straight quarter

In the first quarter, office space demand was 252,620 square feet, led by Downtown San Diego (258,934 square feet). While the region's life science and high-tech industries garner much media attention, office space demand has come from a variety of industries, showing that the market is not overly dependent on a single business cluster. Assuming leasing activity continues to be healthy, expect net absorption gains for the rest of 2017.

PAYROLL JOB GROWTH

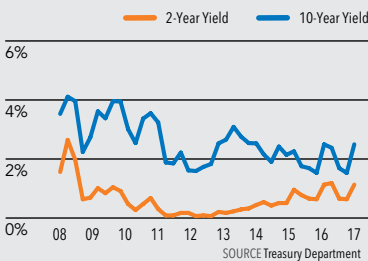


VACANCY

Total vacancy rate of 14.2% now the lowest since the beginning of 2007

The total vacancy rate decreased 40 basis points over a revised vacancy last quarter to 14.2% in the first quarter. Downtown San Diego total vacancy decreased to 12.7% while Central County (14.2%) and the I-15 Corridor (11.5%) continue to see vacancy levels last reported a decade ago during the last market peak. Class A vacancy ticked up to 13.5%, while Class B vacancy decreased to 14.8%. Expect office vacancy rates to continue to decrease in 2017 assuming no slowdown in the overall economy.

TREASURY YIELDS



RENTAL RATES

Direct weighted average asking rental rate now at \$2.75 per square foot

The direct weighted average asking rental rate market-wide increased to \$2.75 per square foot (up 5.0% year over year). This is now the highest reported average asking rental rate in nine years. Of the major office markets that make up San Diego, the highest reported average rental rate continued to be in Central County (\$2.95 per square foot) with submarkets such as Del Mar Heights/Carmel Valley (\$4.07 per square foot) continuing to see record rates. For the rest of 2017, rents are forecasted to continue to grow, although at a slower rate relative to last year.

Metro San Diego Office Market Indicators

PROPERTY CLASS	INVENTORY	UNDER CONSTRUCTION	Q1 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Class A	26,259,374	1,148,661	-164,001	-164,001	11.5%	1.9%	13.5%	\$3.23
Class B	33,326,261	267,316	416,621	416,621	13.4%	1.3%	14.8%	\$2.40
Metro SD Total	59,585,635	1,415,977	252,620	252,620	12.6%	1.6%	14.2%	\$2.75



INVESTMENT MARKET

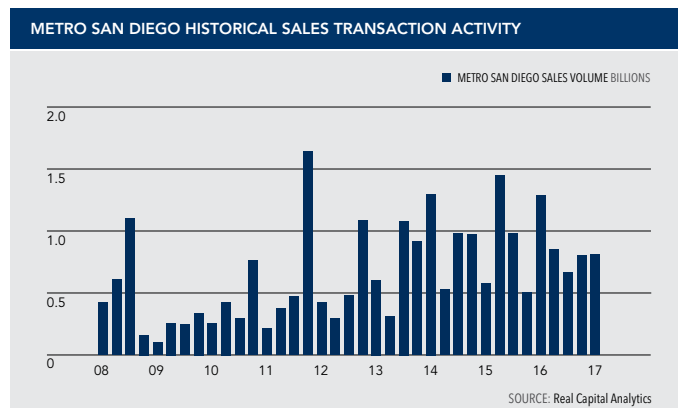
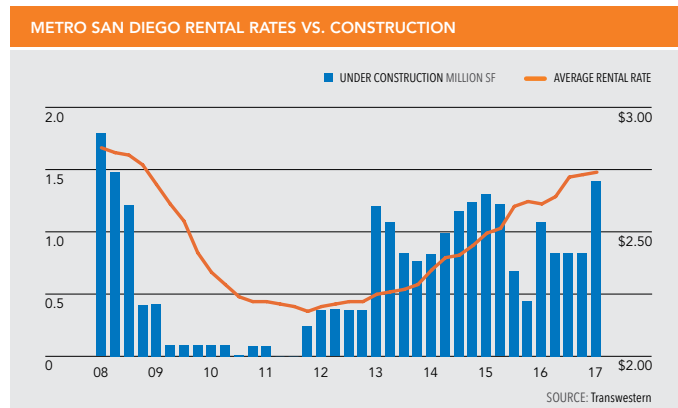
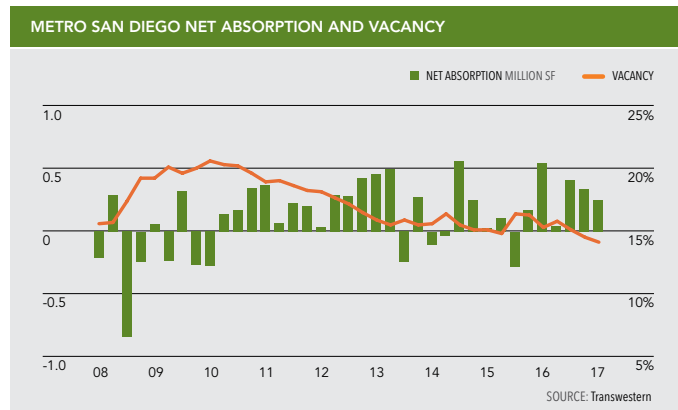
Office investment sales volume down compared to 12 months ago

Approximately \$407.8 million worth of office sales occurred in the first quarter 2017, which was down 37% from the \$646.2 million worth of office sales reported in the first quarter 2016. While investor interest in the San Diego office market remains high, the bid-ask spread appears to be widening as rising interest rates are causing many buyers to be more cautious in their acquisition underwriting. As a result, expect pricing to cool as average cap rates tick back up. Regardless, San Diego remains a sought-after office investment market with healthy underlying fundamentals, especially in the region’s primary life science clusters located in UTC and Torrey Pines, as well as submarkets in close proximity to executive housing such as Del Mar Heights/Carmel Valley.

OUTLOOK

San Diego office market in good shape to start 2017

With area companies expanding, it appears that the San Diego office market is in good shape at the beginning of 2017. Despite the region’s high cost of living and doing business, the local economy is believed to be approaching full employment. This has greatly benefited the region’s office market which saw vacancy approach nearly 20% just six years ago. Expect solid market fundamentals to continue in 2017, assuming no slowdown in the overall economy. ■



SAN DIEGO OFFICE MARKET

FIRST QUARTER 2017

Metro San Diego Office Market Indicators

SUBMARKET	INVENTORY	UNDER CONSTRUCTION	Q1 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Downtown San Diego	9,615,944	-	258,934	258,934	12.2%	0.6%	12.7%	\$2.65
Central County	33,696,378	1,132,898	6,362	6,362	12.5%	1.6%	14.2%	\$2.95
I-15 Corridor	6,285,682	160,925	-92,168	-92,168	8.3%	3.3%	11.5%	\$2.43
North County	7,879,225	108,954	54,711	54,711	17.5%	1.7%	19.2%	\$2.37
South Bay	1,486,885	-	26,506	26,506	13.8%	0.4%	14.2%	\$2.45
East County	621,521	13,200	-1,725	-1,725	1.0%	0.0%	1.0%	\$1.90
SD Office Market Total	59,585,635	1,415,977	252,620	252,620	12.6%	1.6%	14.2%	\$2.75

MAJOR LEASE ACTIVITY

PROPERTY	TENANT	SF	TYPE	MARKET	SUBMARKET
2022 University Dr	Brightwood College	51,806	Class B Renewal	North County	San Marcos/Vista
8954 Rio San Diego Dr	Union Bank	51,428	Class A Renewal	Central County	Mission Valley
3611 Valley Centre Dr	Acadia Pharmaceuticals	26,437	Class A Sublease	Central County	Del Mar Heights/Carmel Valley
450 B St	LevitZacks	14,424	Class A New Lease	Downtown San Diego	Downtown San Diego

MAJOR SALES ACTIVITY

PROPERTY	PRICE	PRICE PSF	BUYER	MARKET	SUBMARKET
6165, 6256, 6333 & 6363 Greenwich Dr (4 bldgs)	\$83,560,000	\$321	Regents of the University of California	Central County	Governor Park
101 Ash St (re-capitalization)	\$72,440,000	\$230	Cisterra Partners & Shapery Enterprises	Downtown San Diego	Downtown San Diego
591 Camino De La Reina & 9665 Chesapeake Dr (2 bldgs)	\$63,125,000	\$235	Casey Brown Company & Westbrook Partners	Central County	Kearny Mesa/Mission Valley
9797 Aero Dr	\$30,125,000	\$326	AVID	Central County	Kearny Mesa

DEVELOPMENT ACTIVITY

PROPERTY	SF	TYPE	DEVELOPER	MARKET	SUBMARKET
Ampersand - 350 Camino De La Reina - (2 bldgs)	318,570	Class A (Creative)	Casey Brown Company	Central County	Mission Valley
i3 - 4775, 4785 & 4795 Executive Dr - (3 bldgs)	316,262	Class A	BioMed Realty Trust	Central County	UTC
One Paseo (2 bldgs)	280,000	Class A	Kilroy Realty Corp.	Central County	Del Mar Heights/Carmel Valley
16399 W Bernardo Dr	160,925	Class B (Creative)	Swift Real Estate Partners	I-15 Corridor	Rancho Bernardo

CONTACT

Michael Soto
 Research Manager, Southern California
 213.430.2525
 michael.soto@transwestern.com

METHODOLOGY

The information in this report is the result of a compilation of information on office properties located in the San Diego metropolitan area. This report includes single-tenant and multi-tenant office properties 10,000 SF and larger, excluding condo and medical office facilities and those properties owned and occupied by a government agency.



6815 Flanders Drive, Suite 100
 San Diego, California 92121

T 858.452.8668 F 858.452.2585
 www.transwestern.com/sandiego