

# MARKETBEAT

## San Diego

### Industrial Q1 2019



#### SAN DIEGO INDUSTRIAL

##### Economic Indicators

	Q1 18	Q1 19	12-Month Forecast
San Diego Employment	1.47M	1.49M	▲
San Diego Unemployment	3.5%	3.5%	▼
U.S. Unemployment	4.1%	3.8%	▼

February 2018/2019 used to represent Q1 for San Diego.

##### Market Indicators (All Product Types)

	Q1 18	Q1 19	12-Month Forecast
Overall Vacancy	4.8%	5.4%	▲
Direct Net Absorption (sf)	89k	-18k	▼
Under Construction (sf)	3.3M	2.0M	▼
Average Asking Rent	\$1.04	\$1.10	▲

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

##### Direct Net Absorption/Asking Rent

###### 4-QTR TRAILING AVERAGE



##### Overall Vacancy



## Economic Overview

The San Diego employment market continued to record job growth, adding 19,900 jobs (+1.4%) year-over-year through February 2019.<sup>1</sup> The unemployment rate remained unchanged at 3.5% from a year ago and is 230 basis points (bps) below the 29-year average of 5.8%. All employment sectors are expected to grow at a combined growth rate of 1.6% in 2019. San Diego's economy of \$231.8 billion<sup>2</sup> as measured by gross regional product is forecasted to grow an additional 2.9% in 2019, above its 10-year average of 2.7%.<sup>3</sup>

Continuing to bode well for the industrial marketplace is that economic activity in the manufacturing sector expanded in March, with an ISM index reading of 55.3% compared to 54.2% in February. An ISM reading above 50% indicates that the manufacturing economy is generally expanding; below 50% indicates that it is generally contracting. The overall economy grew for the 119<sup>th</sup> consecutive month in the U.S. Of the 18 manufacturing industries, 16 reported growth in March of 2019.

## Market Overview

In the first quarter of 2019, industrial vacancy, including sublease, of 5.4% remained unchanged from last quarter yet increased 60 bps from a year ago and is currently in line with the five year quarterly average vacancy of 5.4%. Although Q1 2019 was the second consecutive quarter of overall vacancy above the 5% threshold, this was expected as 3.3 million square feet (msf) have been delivered over the last four quarters, a level more than four times the 10-year completion average of 724,000 sf. This increase in SPEC development is a welcome addition to San Diego's rapidly aging inventory: only 4% of current existing inventory was built in 2010 or after. At this level, there is not enough new supply to satisfy tenant demand for new and modern industrial space.

Across the region, the market is the tightest for incubator multi-tenant (IMT) space with overall vacancy at 4.3% compared to 4.4% a year ago. Vacancy for manufacturing space now stands at 4.5% countywide versus 2.8% twelve months ago. Distribution space vacancy currently stands at 5.6%, an increase of 100 bps from last year. Meanwhile, vacancy for R&D product has decreased 160 bps over the last year and now stands at 7.7%.

The large increases in vacancy within the manufacturing and distribution sectors can be largely attributed to 3.3 msf of new development over the previous 12 months, which was proportionately allocated to 67% distribution, 21% manufacturing and 12% R&D. The elevated vacancy rates can be expected to diminish as the new product is rapidly absorbed.

Though the San Diego industrial market had significant tenant activity, net absorption reflected a small amount of space (17,667 sf) returned to the market in Q1 2019. This was just the second quarter in addition to Q2 2017 in nearly eight years (or since mid-2011) when the San Diego industrial market experienced negative occupancy growth. Among the different San Diego regions, tenants absorbed 255,000 sf in South County submarkets, but returned 165,000 sf to North County and 107,000 sf to Central County during Q1 2019, resulting in an overall countywide net absorption of negative 17,667 sf.

The largest vacates both occurred in the Vista submarket with Denso Wireless Systems vacating 222,000 sf and Zodiac Pool Systems moving from Vista to Carlsbad while decreasing their occupancy from 197,000 sf to 103,000 sf. Other notable move outs included Meridian Auto Parts vacating 53,000 sf in Sorrento Mesa and San Diego Hat Company vacating 48,000 sf, while relocating to their new 80,205 sf built-to-suit facility in Vista, gaining overall occupancy.

As in the previous quarter, new industrial product was the primary beneficiary of occupancy gains in Q1 2019, particularly in Otay Mesa. Trident Maritime Systems vacated 112,000 sf to move into a new 183,000-sf project located at 2651 Drucker Ln. and completed in Q4 2018. BD Biosciences moved into the 122,000-sf building located at 2600 Melksee St. and delivered in Q2 2016, while Mainfreight occupied 33,000 sf at 8500 Kerns St. and delivered in Q1 2019. Other large move-ins at existing buildings included ShipCalm (leased 159,000 sf at 1395 Park Center Dr.) and General Atomics (purchased a 66,000 sf at 16275 Technology Dr.).

Average asking rent for all product types combined was \$1.10 per square foot (psf) per month on a triple net basis compared to \$1.11 psf last quarter (-0.9%) and \$1.04 psf a year ago (+5.8%). The average rent at \$1.10 psf in Q1 2019 has increased 20% since the end of the last recession (\$0.92 psf Q2 2009). Since then, the average rent has increased the most for distribution space (+45%) compared to other product types, followed by IMT (+31%), manufacturing (+24%) and R&D (+14%). This trend is driven by the demand for and availability of modern and specialized space for industrial users. In response, we are not only seeing asking rental rates increase for existing buildings but also in new construction buildings that command the highest rental rates.

### 3.3 MSF WERE DELIVERED OVER THE LAST FOUR QUARTERS COMPARED TO THE 10-YEAR ANNUAL AVERAGE OF 724,000 SF

There are currently 32 industrial buildings totaling nearly 2 msf under construction. However, with a low countywide direct vacancy of 4.5%, it is unlikely that this supply will satisfy demand for new, functional space. According to our calculations, 56% of industrial space countywide was built before 1990 and just 4% of space was built in 2010 and after. This means that more than half of leasable industrial buildings in San Diego lack modern design features for today's demanding tenants who require high-functioning and efficiently designed product. This trend has led to an increase in SPEC construction as developers and landlords become more bullish on their prospect of leasing new space. Of the space that is currently under construction, 81% (or 1.6 msf) is SPEC development with developers continuing to break ground on new projects.

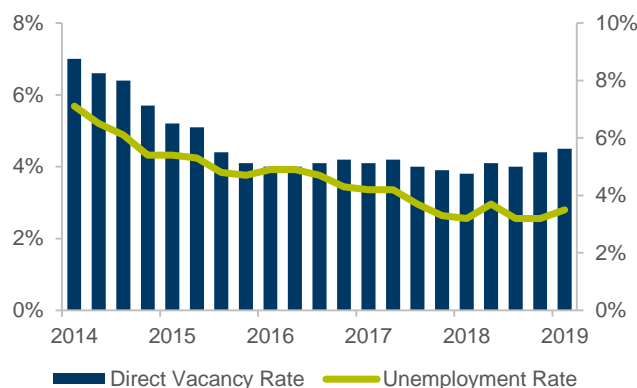
In Q1 2019, over 397,000 sf (or 4 buildings) of new construction received its Certificate of Occupancy. An additional 1.1 msf or more is expected to be completed in 2019 of which 28% pre-leased.

Across Q1 2019 deliveries, 14% of inventory had prior commitments in place. Among tenants contributing to occupancy gains included previously mentioned Mainfreight as well as Renewals by Andersen. Two SPEC projects at Pacific Vista Commerce Center in Carlsbad were delivered fully available, adding 296,000 sf to existing inventory.

Sources: <sup>1</sup>[www.bls.gov](http://www.bls.gov) <sup>2</sup>bea.gov GDP as of 2017. <sup>3</sup>Moody's Analytics economy.com 2/2019.

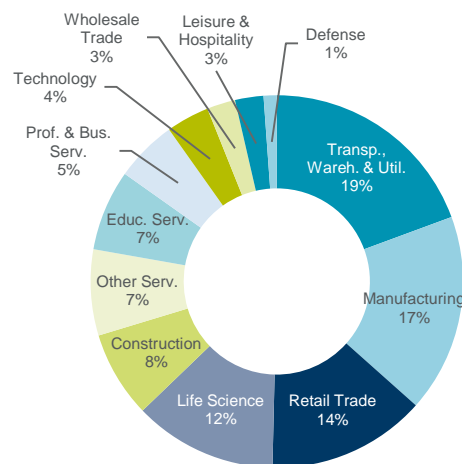
### Direct Vacancy vs. Unemployment Rate

DECLINE IN VACANCY CORRELATES DECLINE IN UNEMPLOYMENT



### Tenant Demand by Industry Type

TOP 3 INDUSTRY SECTORS ACCOUNT FOR 50% OF TOTAL DEMAND



### Outlook

- While we do not expect any dramatic shifts in the near future as direct vacancy remains historically low and the demand for space continues to be strong, the increase in newly constructed space will continue to cause vacancy and availability to increase slightly and Hoover at a healthy equilibrium with demand.
- There are 2.6 msf of active tenant requirements for space in the market over the next 24 months. Nearly 50% or 1.3 msf of these users are in the earliest stages of their pursuit, having opened their search or toured the market. While not all of the tenants in the market will transact in the short-term, these levels provide a barometer of leasing activity in quarters to follow. Additionally, those tenants in early stages of their pursuit may line up their timing with the delivery of new construction.

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 CNSTR (SF)	AVERAGE ASKING RENT (ALL Types)
North County	2,042	53,500,819	694,644	3,146,292	7.2%	-165,200	-165,200	496,457	\$1.01
Central County	2,259	80,186,088	714,517	2,724,272	4.3%	-107,315	-107,315	954,559	\$1.35
South County	627	30,897,854	115,859	1,520,693	5.3%	254,848	254,848	527,268	\$0.77
<b>TOTAL</b>	<b>4,928</b>	<b>164,584,761</b>	<b>1,525,020</b>	<b>7,391,257</b>	<b>5.5%</b>	<b>-17,667</b>	<b>-17,667</b>	<b>1,978,284</b>	<b>\$1.10</b>
R&D	823	32,726,702	695,703	1,844,014	7.7%	111,911	111,911	338,219	\$1.43
MFG	2,453	64,763,101	516,235	2,411,429	4.5%	-352,368	-352,368	144,369	\$1.02
IMT	632	20,877,121	94,492	790,801	4.3%	-155,655	-155,655	65,000	\$1.23
DIST	1,020	46,217,837	218,590	2,345,013	5.6%	378,445	378,445	1,430,696	\$0.93
<b>TOTAL</b>	<b>4,928</b>	<b>164,584,761</b>	<b>1,525,020</b>	<b>7,391,257</b>	<b>5.4%</b>	<b>-17,667</b>	<b>-17,667</b>	<b>1,978,284</b>	<b>\$1.10</b>

Rental rates reflect triple net asking rents \$psf/monthly. Overall vacancy rate includes direct and sublease. Net absorption excludes sublease.

## Key Lease Transactions Q1 2019

PROPERTY	SF	TENANT	LANDLORD	TRANSACTION TYPE	SUBMARKET
17066 Goldentop Rd.	110,190	Northrop Grumman	Sun Life Investment Management	Renewal	Rancho Bernardo
1424 Corporate Center Dr.	60,596	HNRY Logistics	Morgan Stanley	New	Otay Mesa
2251 Faraday Ave.	46,969	Alere San Diego	The Wonderful Company	Renewal	Carlsbad
9244 Balboa Ave.	45,600	Columbia Care / Focused Health	MacDonald Trust	New	Kearny Mesa
8825-8885 Rehco Rd.	37,269	ATX San Diego	Hazard Construction Company	Renewal	Miramar

## Key Sale Transactions Q1 2019

PROPERTY	SF	BUYER	SELLER	PRICE / \$PSF	SUBMARKET
Trolley Industrial Center	105,465	Washington Capital Management	Comstock Realty Partners	\$13,600,000 / \$129	San Ysidro
3G Portfolio	99,187	BKM Capital Partners	3G Properties	\$16,550,000 / \$167	Carlsbad / Sorrento Mesa
Avenida Crossing	68,392	RAF Pacifica Group	Lincoln Property Company	\$23,900,000 / \$349	Carlsbad
6305 El Camino Real	67,528	RAF Pacifica Group	First Industrial Realty Trust	\$10,500,000 / \$155	Carlsbad
1905 Aston Ave.	48,818	RAF Pacifica Group	Alvarez & Marsal	\$12,400,000 / \$254	Carlsbad

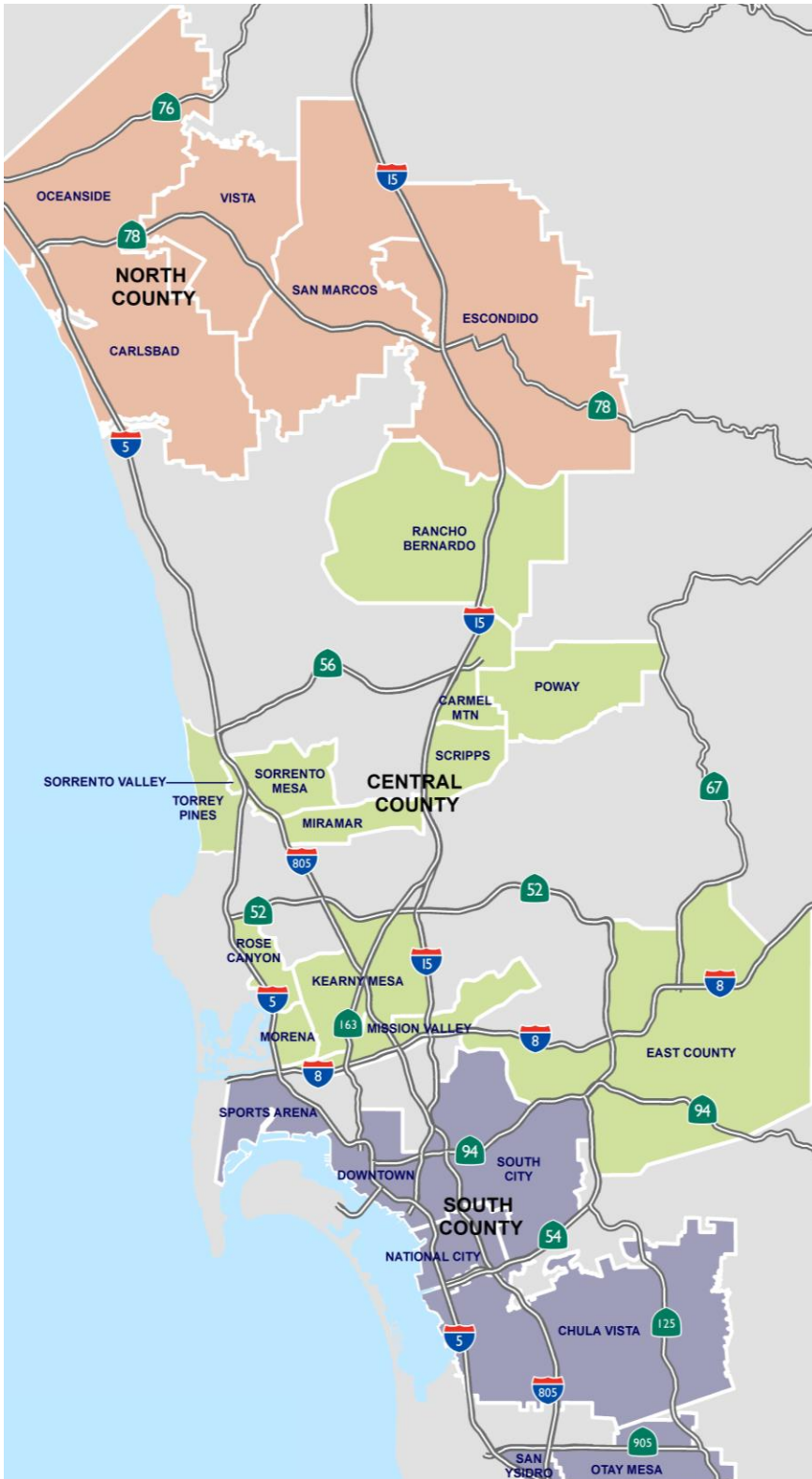
## Under Construction Q1 2019 — selected projects 50,000 sf +

PROPERTY	PRE-LEASED			ADDRESS	PRODUCT TYPE	ESTIMATED COMPLETION	SUBMARKET
	SF	SF	%				
Vantage Point	530,850	0	0%	14400-14500 Kirkham Way	DIST	2020	Poway
Pacific Coast Collection	277,793	0	0%	1291-1339 Rocky Point Dr.	DIST	2019	Oceanside
BioLegend Campus	234,719	234,719	100%	8928-8959 Terman Ct.	R&D	2019	Miramar
Majestic Sunroad Center	227,268	0	0%	Saint Andrews Ave.	DIST	2019/2020*	Otay Mesa
Otay River Business Park	163,000	0	0%	1771 Broadway	DIST	2020	Chula Vista
The Campus at San Diego Business Park	137,000	0	0%	2065 Sanyo Rd.	DIST	2019	Otay Mesa
480 N. Spruce & 455 Quince St.	103,500	0	0%	480 N. Spruce & 455 Quince St.	R&D	2019	Escondido
Poway Tech Center	82,742	15,376	19%	Flint Pl. / Dearborn Pl. / Paine Pl.	MFG	2019	Poway
Keystone Victory Industrial Park	77,725	31,499	41%	1347-1359 Keystone Way	DIST	2019	Vista

\*Multiple Buildings

## INDUSTRIAL SUBMARKETS

### SAN DIEGO



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