

SAN DIEGO OFFICE

Economic Indicators

	Q2 18	Q2 19	12-Month Forecast
San Diego Employment*	1.49M	1.51M	▲
San Diego Unemployment	2.8%	2.8%	▼
U.S. Unemployment	3.9%	3.6%	▼

May 2018/2019 used to represent Q2 for San Diego.

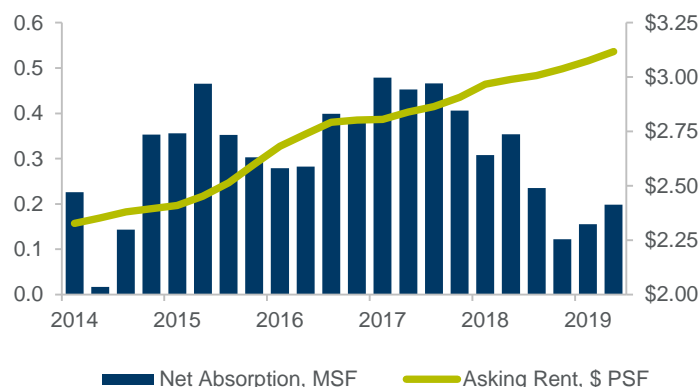
Market Indicators (All Classes)

	Q2 18	Q2 19	12-Month Forecast
Overall Vacancy	12.6%	13.7%	▲
Direct Net Absorption (sf)	276k	448k	▼
Under Construction (sf)	2.3M	1.8M	▲
Average Asking Rent	\$3.02	\$3.19	▲

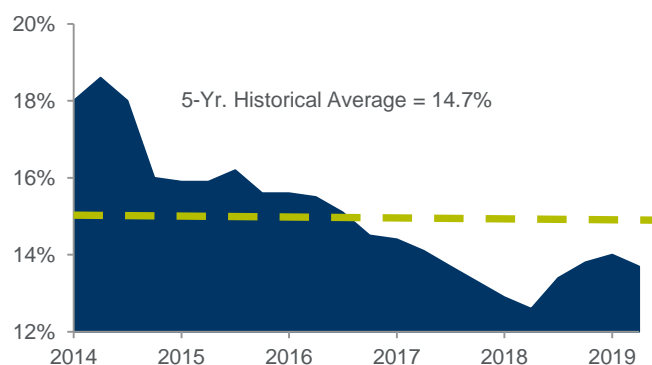
*Rental rates reflect full service asking \$psf/monthly.

Direct Net Absorption/Asking Rent

4-QTR TRAILING AVERAGE



Overall Vacancy



Economic Overview

The San Diego employment market continued to record job growth, adding 25,600 jobs (+1.7%) year-over-year through May 2019.¹ Of the 25,600 jobs added, 7,000 or 27% were in the professional and business services sector, a primary sector driving demand for office space. The unemployment rate remained unchanged at 2.8% from a year ago and is 300 basis points (bps) below the 29-year average of 5.8%.

All employment sectors are forecasted to grow at a combined growth rate of 1.3% in 2019 and 0.9% in 2020. San Diego's economy of \$231.8 billion² as measured by gross regional product is forecasted to grow an additional 1.9% in 2019 and 1.7% in 2020, below its 10-year average of 2.7%.³

Market Overview

San Diego's office vacancy of 13.7%, including sublease, decreased 30 bps from last quarter. This was the first quarter of decreasing vacancy since Q2 2018. However, vacancy increased 110 bps from a year ago due to 1.2 million square feet (msf) being delivered during the last four quarters combined. Tenants absorbed 447,905 sf across all classes in Q2 2019, bringing year-to-date absorption to 646,945 sf – nearly twice as much compared to 342,000 sf absorbed during the first six months last year. With the exception of Q4 2018 when tenants returned 96,000 sf, this was the 19th consecutive quarter of positive occupancy growth, during which tenants have absorbed 7.0 msf combined, averaging 351,000 sf per quarter. Carlsbad, Campus Point, Eastgate and UTC recorded the highest occupancy gains (479,000 sf combined) in Q2 while Kearny Mesa returned 77,000 sf, followed by La Jolla, Downtown, Scripps and Oceanside, returning an additional 132,000 sf combined.

Absorption in Q2 was driven by several large occupancies. The most notable was ViaSat moving into two more buildings, totaling 177,000 sf, at their campus in Bressi Ranch after previously moving into the first two buildings of the project, totaling 180,000, at the beginning of the year. Other notable Carlsbad occupants included DJO (31,000 sf), Arrowhead General Insurance (25,000 sf) and Honma Golf (18,000 sf). In Mission Valley, Amp&rsand's first tenants moved into the project this quarter with Encore Capital taking 96,000 sf and Qdoba taking 34,000 sf across the Tower and Press buildings. In Sorrento Mesa, Sorrento Therapeutics occupied 61,000 sf and Curology moved into 54,000 sf. Furthermore, in Eastgate, Poseida moved into 49,000 sf, and Oracle downsized and relocated into 15,000 sf within the Irvine Company's office portfolio.

This year, the market is expected to see multiple significant vacancies absorbed from leases signed in previous quarters. Sorrento Mesa will continue to benefit from life sciences and pharmaceutical companies as TriLink BioTechnologies will occupy 100,000 sf by the end of the year. Pacira Pharmaceuticals signed a lease to occupy 94,000 sf in Torrey Pines. In Campus Point, AveXis and TruVian Sciences each have signed leases for 34,000 sf. Developers have been eager to purchase and redevelop obsolete office or industrial projects in the Central County submarkets to accommodate life science and biotech companies. The existing available supply has been significantly reduced, while tenant demand from this industry sector remains at all-time high. Nearly one msf of existing office and R&D projects are currently under contract for purchase by biotech and life science owners in Sorrento Mesa alone.

Gathering a lot of headlines, Apple is set to occupy 97,000 sf in Eastgate and has publicly announced their intent to hire 1,200 employees in San Diego with an expectation to grow their footprint in Central County.

At the Terraces in Kearny Mesa, Guild Mortgage continues to expand, claiming the remaining 66,000 sf in the project, which was the last large block of vacant Class A office space in the submarket. In Downtown, coworking provider Spaces will open new locations on the west and eastern ends of Downtown, with 45,000 sf at Kettner & Ash and 30,000 sf in Makers Quarter. In Sorrento Mesa, Brain Corporation has committed to expand by 43,000 sf, Housecall Pro signed a deal for 34,000 sf and Anokiwave will occupy 22,000 sf - all within the Class A office segment of the market.

DEVELOPERS HAVE BEEN EAGER TO PURCHASE AND REDEVELOP OBSOLETE OFFICE OR INDUSTRIAL PROJECTS IN THE CENTRAL COUNTY SUBMARKETS TO ACCOMMODATE LIFE SCIENCE AND BIOTECH COMPANIES

A number of tenants returned significant blocks of space in San Diego County in Q2. The largest was returned by Art Institute of California who vacated 75,000 sf in Mission Valley. Also in Mission Valley, Encore Capital vacated 67,000 sf as they moved into their new larger space at Amp&rsand. In Sorrento Mesa, Samsung vacated 55,000 sf of older space after moving into Enclave Sorrento building. In Kearny Mesa, iHeartMedia downsized out of 36,900 sf at Stonecrest.

Much of future absorption will come from leases signed for projects currently under construction. MedImpact is under construction for another 159,000 sf in their second BTS office building adjacent to their headquarters at the planned Watermark project in Scripps Ranch. CSU San Marcos plans to expand their campus by 155,000 sf at North City in San Marcos. In Del Mar Heights, One Paseo is 59% pre-leased and drawing continued interest.

Of the 12 properties, totaling nearly 1.8 msf, currently under construction countywide, 724,000 sf are expected to be delivered in 2019, followed by 836,000 sf in 2020 and 200,000 in 2021. Nearly 630,000 sf or 36% of total inventory under construction is located in Downtown, driven by the renovation projects of Tower 180, the Paladion and Kettner & Ash. When delivered, these projects could add significant available space to the Downtown submarket, but developers remain bullish on future tenant demand. Additionally, there are three other projects in the Downtown submarket that are anticipated to begin construction over the next 12 months: Kilroy's 2100 Kettner (190,000 sf), Cisterra's 7th & Market (152,000 sf) and Stockdale's Horton Plaza who could begin conversion of the mall into nearly 750,000 sf of creative office space.

The countywide average asking rent for all classes is now \$3.19 per square foot (psf) on a monthly full service basis. This metric increased by 0.6% over the last three months and is up 5.6% from where it stood a year ago, driven by the addition of large class A availabilities. Over the past 12 months, Class A average rent has increased by 6.1% to \$3.64 psf while the Class B rate has increased by 8.9% to \$3.06 psf. Submarkets with highest Class A asking rents in Q2, ranging between \$4.50 and \$5.00, were Campus Point, Torrey Pines and Del Mar. Projects such as One Paseo in Del Mar and DiamondView in Downtown are setting records while achieving highest rents in suburban and CBD submarkets.

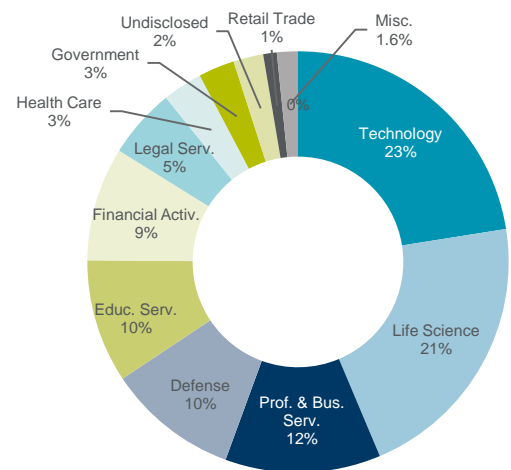
Direct Vacancy vs. Unemployment Rate

DECLINE IN VACANCY CORRELATES DECLINE IN UNEMPLOYMENT



Tenant Demand by Industry Type

TOP 3 INDUSTRY SECTORS ACCOUNT FOR 56% OF TOTAL DEMAND



Outlook

- Continued economic and job growth in combination with increasing tenant demand should provide continued occupancy and rent growth throughout 2019 and into 2020. 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.
- Active tenant requirements of all sizes remain robust at 3.7 msf over the next 24 months countywide. 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 (SF)	OVERALL 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	352	11,552,886	76,914	1,770,079	16.0%	343,487	433,819	155,000	\$2.61	\$3.00
Central County	861	51,347,441	1,465,543	5,539,870	13.6%	155,084	475,202	975,826	\$3.41	\$3.88
South County	319	16,922,794	275,432	1,812,862	12.3%	-50,666	-262,076	629,123	\$3.09	\$3.49
TOTAL	1,532	79,823,121	1,817,889	9,122,811	13.7%	447,905	646,945	1,759,949	\$3.19	\$3.64
Class A	339	34,993,442	840,198	4,110,398	14.1%	480,618	842,684	1,759,949	\$3.64	
Class B	786	34,457,078	941,141	3,969,147	14.3%	-12,502	-250,654	0	\$3.06	
Class C	407	10,372,601	36,550	1,043,266	10.4%	-20,211	54,915	0	\$1.95	
TOTAL	1,532	79,823,121	1,817,889	9,122,811	13.7%	447,905	646,945	1,759,949	\$3.19	

*Rental rates reflect full service asking rents \$psf/monthly. Overall vacancy rate includes direct and sublease. Direct net absorption excludes sublease.

Key Lease Transactions Q2 2019

PROPERTY	SF	TENANT	LANDLORD	TRANSACTION TYPE	SUBMARKET
Kilroy Centre Del Mar	77,242	Retrophin	Kilroy Realty Corporation	New	Del Mar Heights
Sorrento Highlands	73,500	Omniome	HCP, Inc.	New	Sorrento Mesa
La Jolla Commons	73,176	Illumina	American Assets Trust	New	UTC
Del Mar Corporate Centre	70,140	Seismic	Kilroy Realty Corporation	New	Del Mar Heights
701 B St.	60,247	Alliant Insurance Services	EMMES Group of Companies	Renewal	Downtown
One Paseo	32,976	Deloitte	Kilroy Realty Corporation	New	Del Mar Heights

Key Sale Transactions Q2 2019

PROPERTY	SF	BUYER	SELLER	PRICE / \$PSF	SUBMARKET
La Jolla Commons	724,000	American Assets Trust	Hines / JPMorgan Chase	\$513,500,000 / \$709	UTC
Spectrum Corporate Plaza	129,146	Washington Capital Management	Colony Capital	\$39,750,000 / \$308	Kearny Mesa
AXIS 1950	121,541	RAF Pacifica Group	Buchanan Street Partners	\$20,200,000 / \$166	Carlsbad
5785 Oberlin Dr.	61,406	Alvarez & Marsal	Mission Federal Credit Union	\$10,400,000 / \$169	Sorrento Mesa
4075 Sorrento Valley Blvd.	40,000	Alexandria Real Estate Equities	LBA Realty	\$16,000,000 / \$400	Sorrento Valley

Under Construction Q2 2019 – selected projects 10,000 sf +

PROPERTY	SF	PRE-LEASED		ADDRESS	CLASS	ESTIMATED COMPLETION	SUBMARKET
		SF	%				
Tower 180	345,016	0	0%	1010 2nd Ave.	A	2020	Downtown
One Paseo	285,550	169,877	59%	12830-12860 El Camino Real	A	2020	Del Mar Heights
Apex	200,000	0	0%	9775 Towne Centre Dr.	A	2021	Eastgate
9455 TCD	165,000	0	0%	9455 Towne Centre Dr.	A	2020	Eastgate
The Paladion	161,028	0	0%	770 1st Ave.	A	2019	Downtown
The Watermark	158,994	158,994	100%	10159 Scripps Gateway	A	2019	Scripps
North City – CSUSM	155,000	155,000	100%	Twin Oaks Valley Rd.	A	2019	San Marcos
Kettner & Ash	123,079	46,347	38%	1420 Kettner Blvd.	A	2019	Downtown
Alexandria GradLabs™	98,282	6,957	7%	9880 Campus Point Dr.	A	2019	Campus Point
The Collection at UTC	40,000	0	0%	4575 La Jolla Village Dr.	A	2019	UTC
Sorrento Summit	28,000	28,000	100%	7475 Lusk Blvd.	A	2019	Sorrento Mesa

OFFICE SUBMARKETS
 SAN DIEGO

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