

# MARKETBEAT

## San Diego

### Industrial Q2 2017



#### SAN DIEGO INDUSTRIAL

##### Economic Indicators

	Q2 16	Q2 17	12-Month Forecast
San Diego Employment	1.42M	1.44M	▲
San Diego Unemployment	4.8%	3.6%	▼
U.S. Unemployment	4.9%	4.4%	▼

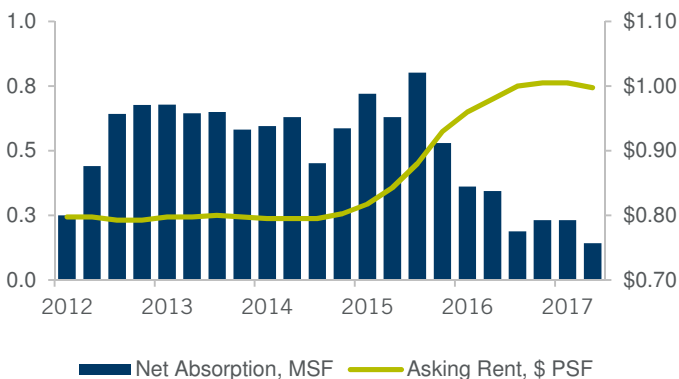
##### Market Indicators (Overall, All Product Types)

	Q2 16	Q2 17	12-Month Forecast
Vacancy	5.0%	5.1%	▼
Direct Net Absorption (sf)	235K	-122K	▲
Under Construction (sf)	0.9M	1.2M	▼
Average Asking Rent	\$1.01	\$0.98	▲

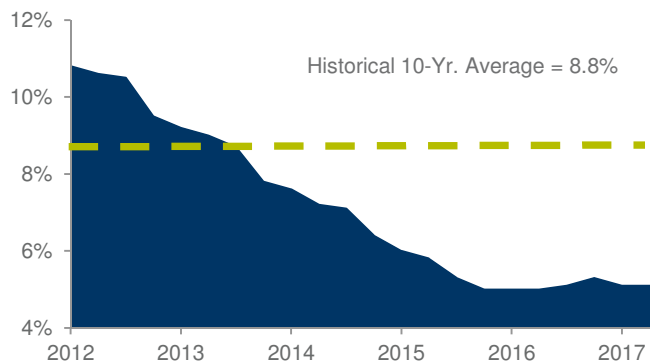
\*Rental rates reflect triple net asking \$psf/monthly

##### 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 20,300 jobs (+1.4%) between May 2016 and May 2017. During the same time period, the unemployment rate decreased 70 basis points (bps), dropping to 3.6%. Last time the unemployment rate was this low was 11 years ago in May of 2006. This current rate is 240 bps below the 27-year average of 6%. All employment sectors are expected to grow at a combined growth rate of 1.6% in 2017, according to Moody's Analytics, positively affecting demand for commercial real estate space. San Diego's economy of \$220.6 billion as measured by gross regional product grew an estimated 3.2% in 2016 - consistent with its 10-year average growth rate of 3.1% - and is forecasted to grow an additional 2.7% in 2017.

Economic activity in the manufacturing sector expanded in June, with an ISM index reading of 57.8% - its highest level since August 2014. The overall economy grew for the 97<sup>th</sup> consecutive month in the U.S. The headlines behind the June manufacturing ISM report were "New orders, production, backlog of orders and employment growing, supplier deliveries slowing and inventories contracting." Of the 18 manufacturing industries, 15 reported growth in new orders.

## Market Overview

At the close of Q2 2017, industrial vacancy (including sublease) in the San Diego marketplace stood at 5.1%, unchanged from last quarter. Vacancy is up only 10 bps from the 5% rate posted a year ago, considering the amount of new space (695,000 SF, 37% pre-leased) delivered during the same time period. Overall vacancy has been hovering around 5% for the last nine quarters, indicating consistent demand for industrial product countywide. Overall vacancy levels were lowest in Central County (4.5%), followed by North County (5.0%) and South County (6.8%).

Across the region, the market is the tightest for manufacturing space with vacancy at 3.8%, a decrease of 20 bps from last quarter. Vacancy (including sublease) for incubator multi-tenant space (IMT) now stands at 4.7% countywide; it stood at 4.6% three months ago. Distribution space vacancy currently stands at 4.8%, unchanged from last quarter. Meanwhile, vacancy for R&D product has increased 50 bps over the last three months and now stands at 8.1%.

The market recorded 121,700 SF of negative net absorption in Q2 2017, reversing the trend of 23 consecutive quarters (Q3 11 to Q1 17) of industrial expansion. Despite that, there were several notable move-ins in Q2 across the county. The best performing submarkets by square feet absorbed were Otay Mesa, Escondido, Poway, Oceanside and Vista. Combined, these five submarkets absorbed 271,000 SF in Q2 2017. Year-to-date, tenants have absorbed the most space (230,600 SF) across North County submarkets combined outperforming Central and South Counties.

General Atomics purchased and occupied 14145 Danielson St., a 52,200-SF R&D building in Poway, resulting in the largest absorption this quarter. Two other large move-ins this quarter occurred in Otay Mesa distribution buildings where Skiva Graphics expanded into an additional 50,900 SF at 9255 Customhouse Pl. and On-Time Logistics occupied 44,000 SF at 2323 Avenida Costa Este. In North County, PODS moved into 43,200 SF of MFG space at 2450 Business Park Dr. in Vista.

In contrast, negative absorption was recorded in Carlsbad, followed by Carmel Mountain, Sorrento Valley, San Marcos and Kearny Mesa. Tenants returned a combined 300,700 SF to these markets, off-setting the quarterly gains (+271,000 SF) of the top five growth submarkets. Multiple move-outs and downsizing by tenants contributed to shrinking market activity this quarter. For example, Ardea Biosciences, Inc. moved out of 61,400 SF at

4939 Directors Pl. in Sorrento Mesa. Pulse Electronics vacated a building they own at 12220 World Trade Dr. in Carmel Mountain and put it up for sale. They downsized their corporate headquarters footprint and leased just over 16,000 SF at a newly-renovated creative office building in Sorrento Mesa. Global Experience Specialists downsized by 49,600 SF at 491 C St., a building they own in Chula Vista. FedEx downsized in their Miramar location at 8515 Miramar Pl. by 47,200 SF; however, Allied Building Products will move into the same space in Q3 2017.

### COUNTYWIDE OVERALL VACANCY AT 5.1%, UNCHANGED FROM Q1 2017

Average asking rent for all product types combined was \$0.98 NNN per month, a three percent decrease from a year ago. At \$1.11 PSF, rent for IMT space continues to increase rapidly, up 6.7% over the last year. At \$0.85, rent for manufacturing space increased 2.4% over the last year. This trend is being driven by the availability of 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.

While no industrial buildings were delivered during Q2 2017, there has been a total of 178,300 SF of new space delivered to the market as of mid-year 2017: Buildings A and B at Elevate in Carlsbad (115,000 SF and 42,000 SF, respectively) and Extension in Vista (21,400 SF).

While there are currently 12 industrial buildings totaling nearly 1.2 MSF under construction, it is unlikely that this level will satisfy demand for new, functional space. According to our calculations, 57% of industrial space countywide was built before 1990 and only 2.3% of space was built after 2010. This means that more than half of leasable industrial buildings in San Diego are lacking modern design features for today's demanding tenants who require high-functioning and efficiently designed product. This trend has led to an increase in speculative (SPEC) construction.

Of the space that is currently under construction, 66% (or 776,000 SF) is SPEC development. Moreover, 91%, or 1.9 MSF, of planned space in the pipeline is planned as SPEC. In Q2, construction started on two SPEC buildings at the Escondido Victory Industrial Park, totaling 90,500 SF. Nearly 60% of product (five buildings totaling 702,000 SF) currently under construction is located in Carlsbad. Carlsbad continues to experience the highest level of construction activity due to its proximate location to a large skilled employee base and availability of developable land.

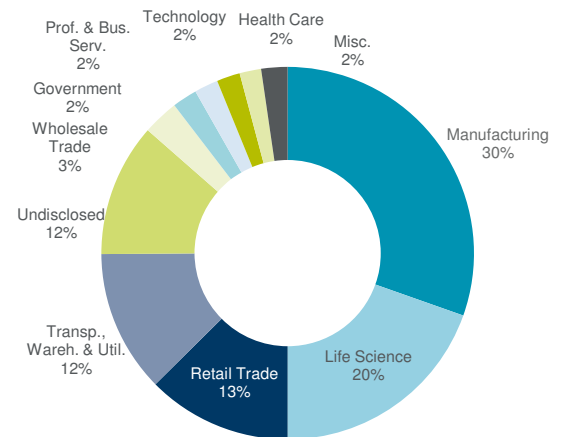
## Outlook

- Our brokers have noted that "summer came early" this year for the San Diego industrial market; translated, this means that Q2 2017 was characterized by slow-moving deals and construction projects. Despite the dip this quarter, the overarching economic expansion occurring at a national and local level as well as pent-up demand from tenants, will boost activity in the second half of the year. Absorption, leasing, and construction are all expected to pick-up as the summer winds down and tenants, who have been waiting for new, functional space, are able to occupy newly-delivered space.
- Currently, there is 3.7 MSF of active tenant requirements for space over the next 24 months. Nearly 60%, or 2.1 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 current tenants in the market will transact in the short-term, these levels provide a barometer to leasing activity in quarters to follow.

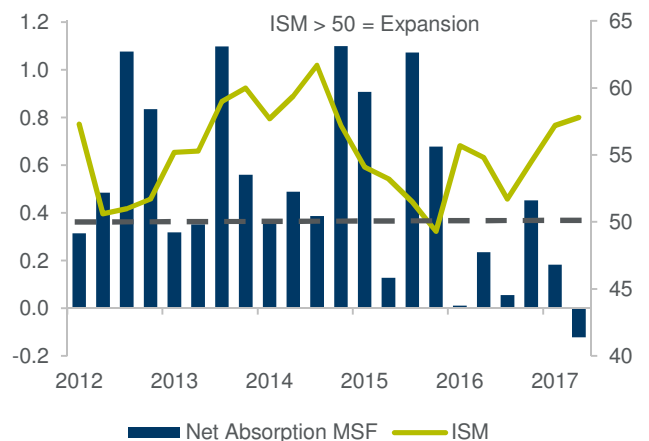
### Direct Vacancy vs. Unemployment Rate DECLINE IN VACANCY CORRELATES DECLINE IN UNEMPLOYMENT



### Tenant Demand by Industry Type TOP 3 INDUSTRY SECTORS ACCOUNT FOR 63% OF TOTAL DEMAND



### Net Absorption vs. ISM Manufacturing Index MANUFACTURING GREW IN MARCH, INDEX AT 57.2%



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	2,025	51,564,175	400,790	2,190,548	5.0%	(32,670)	230,609	792,460	\$0.98
Central County	2,295	81,002,447	803,632	2,827,943	4.5%	(178,360)	(234,502)	253,163	\$1.21
South County	615	30,171,840	217,648	1,826,869	6.8%	89,371	64,266	123,134	\$0.69
<b>TOTAL</b>	<b>4,935</b>	<b>162,738,462</b>	<b>1,422,070</b>	<b>6,845,360</b>	<b>5.1%</b>	<b>(121,659)</b>	<b>60,373</b>	<b>1,168,757</b>	<b>\$0.98</b>
R&D	848	33,887,206	520,369	2,251,577	8.1%	(82,555)	(219,085)	384,823	\$1.43
MFG	2,449	63,732,371	357,056	2,032,629	3.8%	24,729	319,939	537,800	\$0.85
IMT	628	20,522,833	140,300	828,745	4.7%	(25,180)	(34,838)	0	\$1.11
DIST	1,010	44,596,052	404,345	1,732,409	4.8%	(38,653)	(5,643)	246,134	\$0.73
<b>TOTAL</b>	<b>4,935</b>	<b>162,738,462</b>	<b>1,422,070</b>	<b>6,845,360</b>	<b>5.1%</b>	<b>(121,659)</b>	<b>60,373</b>	<b>1,168,757</b>	<b>\$0.98</b>

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

### Key Lease Transactions Q2 2017

PROPERTY	SF	TENANT	LANDLORD	TYPE	SUBMARKET
12270 World Trade Dr.	88,000	Castle Access, Inc. dba RedIT US & Zayo Group LLC	CLPF – Carmel Mountain LP	Renewal	Carmel Mountain
9255 Customhouse Plz.	50,069	Skiva Graphics Screenprinting, Inc.	First Industrial Development Services, Inc.	Renewal	Otay Mesa
6122-6126 Nancy Ridge Dr.	49,294	WuXi	Blackstone Group/Biomed Realty Trust	Sublease	Sorrento Mesa
3205 Lionshead Ave.	46,441	Aethercomm, Inc.	Lionshead LLC	Sale-leaseback	Carlsbad
5940 Darwin Ct.	46,009	Machine Vision Products, Inc.	BLT Enterprises	Sale-leaseback	Carlsbad

### Key Sale Transactions Q2 2017

PROPERTY	SF	BUYER	SELLER	SALE PRICE	SUBMARKET
Scripps Ranch Business Park	186,157	Hill Properties	LA County Employees Retirement Assoc.	\$31,400,000 (\$169 PSF)	Scripps
Ponderosa Technology Park	155,529	BKM Properties	Granite Peak Partners, Inc.	\$28,525,000 (\$183 PSF)	Kearny Mesa
2777 Loker Ave. West	123,454	First Industrial Realty Trust, Inc.	BLT Enterprises	\$21,500,000 (\$174 PSF)	Carlsbad
Miramar Trade Business Center	118,457	Robert Carter	Colony Northstar, Inc.	\$21,250,000 (\$179 PSF)	Miramar
14145 Danielson St.	117,354	General Atomics	Farkash Family Trust	\$20,000,000 (\$170 PSF)	Poway

### Under Construction Q2 2017

PROPERTY	PRELEASED			ADDRESS	PRODUCT TYPE	ESTIMATED COMPLETION	SUBMARKET
	SF	SF	%				
La Jolla Spectrum Tech Park - Bldg. B	170,523	170,523	100%	3215 Merryfield Row	R&D	2018	Torrey Pines
Carlsbad Oaks North - Vector	169,087	0	0%	Lot 8 Whiptail Loop	MFG	2018	Carlsbad
Atlas at Carlsbad - Beta	150,000	0	0%	5909 Sea Otter Pl.	R&D	2017	Carlsbad
HM Electronics - Lots 18 & 19	140,000	140,000	100%	Lots 18 & 19 Whiptail Loop	MFG	2018	Carlsbad
Carlsbad Oaks North - Lot 17	123,000	0	0%	Lot 17 Whiptail Loop	DIST	2018	Carlsbad
Poway Corporate Center	82,640	82,640	100%	11905 Community Rd.	MFG	2017	Poway
Siempre Viva Business Park - Bldg. 17	79,050	0	0%	8500 Kerns St.	DIST	2017	Otay Mesa
Carlsbad Oaks East - Lot 24	64,300	0	0%	2800 Loker Ave.	R&D	2017	Carlsbad
Lionshead Avenue	55,573	0	0%	3248 Lionshead Ave.	MFG	2017	Carlsbad
Escondido Victory Industrial Park Bldgs. 1 & 2	90,500	0	0%	2005 Harmony Grove Rd.	MFG	2018	Escondido

## INDUSTRIAL 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](http://www.cushmanwakefield.com) or follow @Cushwake on Twitter.

### Jolanta Campion

Director of Research, San Diego Region  
[jolanta.campion@cushwake.com](mailto:jolanta.campion@cushwake.com)

### Alexa Kruthers

Research Analyst  
[alexa.kruthers@cushwake.com](mailto:alexa.kruthers@cushwake.com)

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

Copyright © 2017 Cushman & Wakefield. All rights reserved. The information contained within this report is gathered from multiple sources considered to be reliable. The information may contain errors or omissions and is presented without any warranty or representations as to its accuracy.