

MARKETBEAT

San Diego

Industrial Q1 2017



SAN DIEGO INDUSTRIAL

Economic Indicators

	Q1 16	Q1 17	12-Month Forecast
San Diego Employment	1.41M	1.44M	▲
San Diego Unemployment	4.9%	4.2%	▼
U.S. Unemployment	4.9%	4.8%	▼

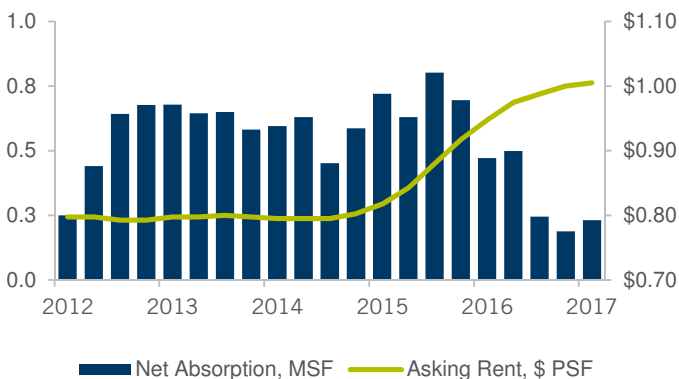
Market Indicators (Overall, All Product Types)

	Q1 16	Q1 17	12-Month Forecast
Vacancy	5.0%	5.1%	▼
Direct Net Absorption (sf)	11K	182K	▲
Under Construction (sf)	0.8M	0.9M	▼
Average Asking Rent	\$0.98	\$1.00	▲

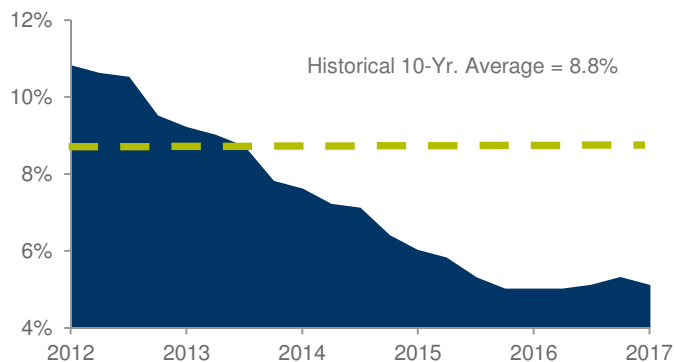
*Rental rates reflect triple net asking \$psf/monthly

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 26,700 jobs (+1.9%) year-over-year through February 2017. During the same time, the unemployment rate decreased 60 basis points (bps), dropping to 4.2%. The current rate is 180 bps below the 26-year average of 6%. All employment sectors are expected to grow at a combined growth rate of 2.1% 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 3.2% - and is forecasted to grow an additional 3.2% in 2017.

Economic activity in the manufacturing sector expanded in March, with an ISM index reading of 57.2%. The overall economy grew for the 94th consecutive month in the U.S. The headlines behind the March manufacturing ISM report were "new orders, production and employment growing, supplier deliveries slowing and inventories contracting". All 18 manufacturing industries reported growth in new orders while the price index increased 2.5 percentage points to 70.5% in March, indicating an increase in the price of raw materials for the 13th consecutive month.

Market Overview

At the close of Q1 2017, industrial vacancy (including sublease) in the San Diego marketplace stood at 5.1%. Vacancy is up only 10 bps from the 5% rate posted a year ago, considering the amount of new space (817,200 SF, 28% pre-leased) delivered during the same time period. Current vacancy of 5.1% reflects a substantial decline (760 bps) from the peak recession vacancy level of 12.7% reported seven years ago. Compared to Q4 2016, total vacancy decreased 20 bps.

Overall vacancy levels were the lowest in Central County at 4.4%, followed by North County (4.9%) and South County (7.0%). Across the region, the market is the tightest for manufacturing space at 4.0%, a decrease of 30 bps from last quarter. Vacancy (including sublease) for incubator multi-tenant space (IMT) now stands at 4.6% countywide; it stood at 4.5% three months ago. Distribution space vacancy currently stands at 4.8%, 30 bps lower than last quarter. Meanwhile, vacancy for R&D product has decreased 30 bps over the last three months and now stands at 7.6%.

The market recorded 182,000 SF of positive net absorption in Q1 2017. This was the 23rd consecutive quarter of industrial expansion. During this time, tenants have absorbed a total of 12.1 million square feet (MSF) of space, an average of 525,000 SF per quarter. 2016 was the 7th consecutive year recording positive net absorption, all product types combined.

With several significant deliveries and move-ins, Carlsbad outperformed all other submarkets and closed the quarter with 232,000 SF of absorption as a result of several large tenants taking occupancy at Elevate. These included Unite Eurotherapy (54,000 SF), B&D Nutritional (10,900 SF) and Hydrogenics USA (5,500 SF). Notably, Building A at Elevate was delivered with 84% occupancy, resulting in the largest single-building absorption of 96,200 SF in Q1. Scripps submarket posted 61,100 SF of occupancy growth in Q1, benefiting from Evergreen Plus Property Management moving into 67,700 SF at 10050 Scripps Ranch Ct. Oceanside, also a top-performing submarket, posted 49,500 SF of absorption thanks to Brixton LLC taking occupancy of their space at First Park @ Ocean Ranch. With the exception of Brixton, the largest move-ins this quarter were all in the manufacturing sector. Manufacturing was the most active sector this quarter with 295,200 SF of absorption.

In contrast, several submarkets reported occupancy losses, including Poway where Cohu, a manufacturer of semiconductor-testing products, vacated 192,600 SF of their corporate headquarters at 12367 Crosthwaite

Cir. Last year, CoHu sold this building for \$34M to CT Realty, who is now in the process of converting the once single-tenant property to multi-tenant. The Chula Vista submarket in South County lost 63,300 SF of occupancy due to multiple smaller move-outs. Sigler Wholesale vacated 33,700 SF at 2425 Auto Park Way in Escondido. This move-out was mitigated by another move-in, resulting in a relatively small total occupancy loss of 52,300 SF in the Escondido submarket. W&W Wholesale, an apparel distribution company, vacated 44,000 SF at 2323 Avenida Costa Este in Otay Mesa.

COUNTYWIDE OVERALL VACANCY AT 5.1%, ELEVATING RENTS AND CONSTRUCTION ACTIVITY

Comparing markets, both South County and Central County recorded a 6.1% increase in average asking rent. Average asking rent in North County increased 5.7% over the last year. At \$1.05 PSF, rent for IMT space continues to increase rapidly, increasing by 8.2% 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.

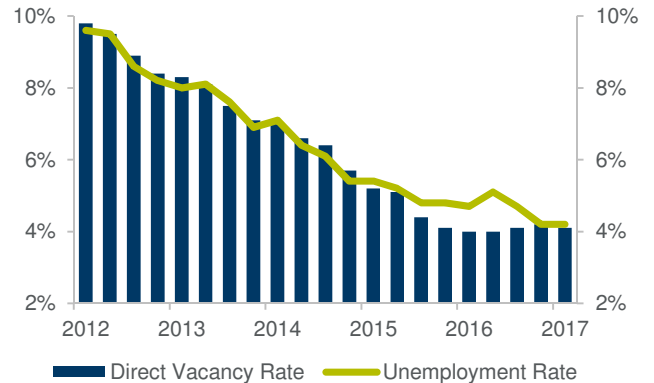
During Q1 2017, three industrial buildings were delivered to the market for a total of 178,300 SF, all in North County: Buildings A and B at Elevate in Carlsbad (115,100 SF and 41,900 SF, respectively) and Extension in Vista (21,400 SF). Of the delivered space, only 33% (58,200 SF) is available.

While there are currently nine industrial buildings, or nearly 1.0 MSF, that are 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 907,700 SF that is currently under construction, 685,100 SF, or 76% is SPEC development. Moreover, 81%, or 1.8 MSF, of planned space in the pipeline is planned as speculative. Nearly 80% of product (five buildings totaling 702,000 SF) currently under construction is located in Carlsbad. In Q1, construction started on three SPEC projects in Carlsbad: Vector, Lot 17 at Carlsbad Oaks North and 2800 Loker Ave., with estimated completion in late 2017 and early 2018. 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.

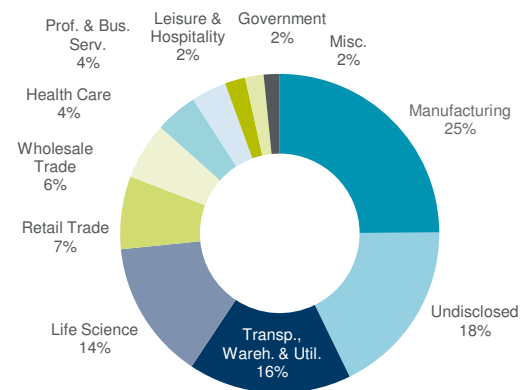
Outlook

- The current expansion is nearly eight years old as of Q1 2017. The longest expansion in American history was a 10-year stretch in the 1990s. The probability of a recession in 2017 is low, ranging between 5% and 25%, depending on the source. Rising mortgage rates may present a bit of a challenge in 2017 and 2018, however continued economic expansion and resulting job and income growth will continue to drive demand for high quality real estate by both users and investors.
- Active tenant requirements stand at 4.3 MSF over the next 24 months countywide. Nearly 70%, or 3.0 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.

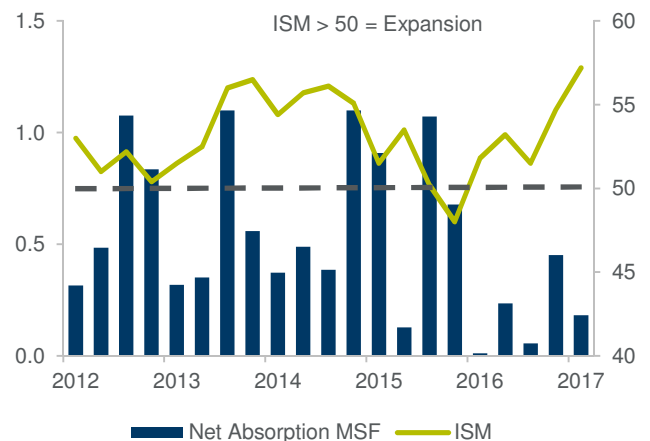
Direct Vacancy vs. Unemployment Rate
DECLINE IN VACANCY CORRELATES DECLINE IN UNEMPLOYMENT



Tenant Demand by Industry Type
TOP 3 INDUSTRY SECTORS ACCOUNT FOR 59% 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	433,937	2,125,116	4.9%	263,279	263,279	701,960	\$0.93
Central County	2,295	81,106,051	901,068	2,649,583	4.4%	(56,142)	(56,142)	82,640	\$1.21
South County	615	30,171,840	226,242	1,915,419	7.1%	(25,105)	(25,105)	123,134	\$0.70
TOTAL	4,935	162,842,066	1,561,247	6,690,118	5.1%	182,032	182,032	907,734	\$1.00
R&D	848	33,887,206	487,235	2,110,720	7.6%	(136,530)	(136,530)	214,300	\$1.44
MFG	2,449	63,835,975	469,090	2,082,898	4.0%	295,210	295,210	447,300	\$0.83
IMT	628	20,522,833	143,099	803,565	4.6%	(9,658)	(9,658)	0	\$1.05
DIST	1,010	44,596,052	461,823	1,692,935	4.8%	33,010	33,010	246,134	\$0.76
TOTAL	4,935	162,842,066	1,561,247	6,690,118	5.1%	182,032	182,032	907,734	\$1.00

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

Key Lease Transactions Q1 2017

PROPERTY	SF	TENANT	LANDLORD	TYPE	SUBMARKET
1320 Air Wing Rd.	99,417	Chipman Relocation	Zurich Asset Management	Direct	Otay Mesa
5830 El Camino Real	73,480	The Upper Deck Company	HG Fenton Company	Direct	Carlsbad
9255 Customhouse Plz.	50,890	Skiva Graphics	IDS Real Estate Group	Direct	Otay Mesa
8515 Miramar	48,800	Allied Building Products	MGM Partnership	Direct	Miramar
4056 Called Platino	47,000	Hobie Cat Company	Professional Plumbing Group, Inc.	Sublease	Oceanside

Key Sale Transactions Q1 2017

PROPERTY	SF	BUYER	SELLER	SALE PRICE	SUBMARKET
2011 & 2055 Sanyo Ave.	538,700	Murphy Development Company	Panasonic Corp. of North America	\$27,759,000 (\$52/SF)	Otay Mesa
2310 & 2320 Camino Vida Roble	86,030	Vida I LLC	RJ Vida Roble Investors LLC	\$20,000,000 (\$232/SF)	Carlsbad
8125-8248 Mercury Ct.	80,411	Mercury Technology Partners LLC	Mercury Tech Center LLC	\$17,300,000 (\$215/SF)	Kearny Mesa
2400-2402 Main St.	162,600	Exeter Property Group	Alpine Creek Center Company	\$16,973,000 (\$104/SF)	Chula Vista
3220 & 3235 Executive Ridge	124,916	Galardo Family Trust	RREF II Palomar LLC	\$12,800,000 (\$102/SF)	Vista

Under Construction Q1 2017

PROPERTY	PRELEASED			ADDRESS	PRODUCT TYPE	ESTIMATED COMPLETION	SUBMARKET
	SF	SF	%				
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	2017	Carlsbad
Carlsbad Oaks North - Lot 17	123,000	0	0%	Lot 17 Whiptail Loop	DIST	2017	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
Continental Commerce Center	44,084	21,875	50%	7155 Camino Maquiladora	DIST	2017	Otay Mesa

INDUSTRIAL SUBMARKETS SAN DIEGO



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