

MARKETBEAT

San Diego

Office Q1 2017



SAN DIEGO OFFICE

Economic Indicators

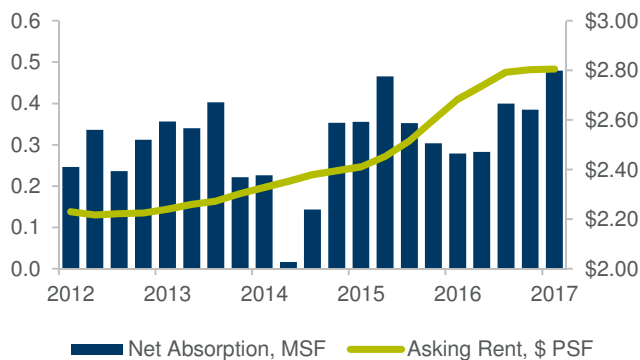
	Q1 16	Q1 17	12-Month Forecast
San Diego Employment	1.41M	1.44M	▲
San Diego Unemployment	4.9%	4.2%	▼
U.S. Unemployment	4.9%	4.8%	▼

Market Indicators (Overall, All Classes)

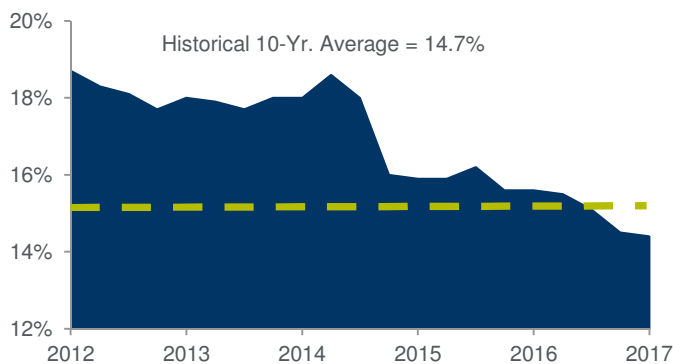
	Q1 16	Q1 17	12-Month Forecast
Vacancy	15.6%	14.4%	▼
Direct Net Absorption (sf)	81K	457K	▼
Under Construction (sf)	1.6M	1.5M	▼
Average Asking Rent	\$2.77	\$2.78	▲

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

Direct Net Absorption/Asking Rent (Full Service, Monthly) 4-QTR TRAILING AVERAGE



Overall Vacancy – All Classes, 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. Of the 26,700 jobs added, 7,400 (or 28%) were office jobs consisting of two sectors: professional and business services and financial activities. During the same time period, 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. Office employment is forecasted to record 2.3% growth in 2017, positively affecting demand for office 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.

Market Overview

Office vacancy (including sublease) fell to 14.4% in Q1 2017, down 120 bps from the 15.6% rate posted a year ago, and reflects a substantial decline (730 bps) from the peak post-recession vacancy level of 21.7%, reported nearly eight years ago. Compared to Q4 2016, total vacancy decreased 10 bps to 14.4% as occupancy grew by 456,700 square feet (SF) across all classes in Q1. Five buildings totaling 488,000 SF were completed in Q1 - all in Central County - of which 366,100 SF had commitments in place.

In Q1 2017, tenants absorbed 212,000 SF of Class A space countywide, the best Q1 performance in 10 years. Class A still remains a prime choice for occupiers as leasing in this class has been positive for 28 of the last 31 quarters. During this stretch, tenants have absorbed a total of 6.4 million square feet (MSF), equating to an average of 207,000 SF per quarter. This growth, however, was disproportionate by region as tenants absorbed 220,800 SF of Class A space in Central County submarkets, 37,500 SF in North County submarkets, but returned 46,400 SF to South County submarkets. Since peaking at 23% seven years ago, Class A vacancy (including sublease) countywide has plummeted 740 bps to 15.6% at the end of Q1 2017.

Two large move-ins drove countywide absorption in Q1 2017. The City of San Diego moved multiple departments into 101 Ash St. Downtown, totaling 304,700 SF. In Campus Point, Eli Lilly, a pharmaceutical company, expanded their operations and moved into its 304,300 SF build-to-suit project, vacating 106,900 SF in another building in the same submarket. The 304,300 SF building, a \$136 million redevelopment of an existing building at 10290 Campus Point Dr., was completed by life science property owner Alexandria Real Estate Equities Inc. who purchased the building last year from Qualcomm Inc. for approximately \$105 million. Among other large move-ins was Otonomy's occupancy of their 62,000 SF newly constructed corporate headquarters at 4796 Executive Drive in Eastgate. The \$42.2 million redevelopment was also completed by Alexandria Real Estate. Also in Eastgate, MCTC took occupancy of 31,900 SF at 4690 Executive Dr., owned by Kilroy Realty Corporation.

In UTC, law firm Jones Day moved into 62,300 SF, vacating 54,500 SF in Del Mar Heights. In Kearny Mesa, the international school Le Lyce Francais occupied 60,500 SF while Guild Mortgage expanded into 37,800 SF. Sorrento Mesa saw two large blocks of space absorbed with USC moving into 40,800 SF and Competitor Group taking 25,600 SF. In Del Mar Heights, Seismic occupied 24,800 SF and BDO occupied 20,000 SF.

A number of large leases were signed in previous quarters that will further boost absorption in future quarters as these tenants begin occupying the space. Northrop Grumman signed a lease to expand into another 220,000 SF at Summit Rancho Bernardo and renewed on an existing 156,000 SF. In Eastgate, ServiceNow signed a lease to occupy a 64,000 building currently subleased by



Kratos and Plaza Home Mortgage. The County of San Diego will occupy 58,000 SF in Kearny Mesa and AVID is planning to occupy approximately 50,000 SF in a building they recently purchased from Bixby. In UTC, Wells Fargo signed a 45,000 lease at One La Jolla Centre. In Sorrento Mesa, Certona signed a lease to occupy 32,000 SF, while APS Solutions and BNBuilders will each take 10,000 SF at the Yard in late 2017.

A number of tenants returned significant blocks of space in San Diego County in Q1. In Scripps Ranch, HD Supply vacated the 151,400 SF building it sold to Newport National Corporation in 2016. In Sorrento Mesa, Novatel Wireless vacated 97,700 SF and in Rancho Bernardo, Broadcom downsized by 66,800 SF. Much of future absorption will come from leases signed for projects currently under construction. After occupying their 295,000 SF campus building in UTC in Q4 2016, Illumina will also occupy 316,000 SF at Biomed Realty's i3 in Eastgate later this year, a positive sign of the impact biotechnology and healthcare companies have on San Diego's economy. ViaSat, which is headquartered and employs nearly 2,000 workers in Carlsbad, is expanding its footprint as well. The company's Bressi Ranch site in Carlsbad is planned for approximately 500,000 SF at build out, with 200,000 SF scheduled to be completed in 2018. Later this year, Renovate America will occupy a 160,000 SF building currently under significant renovation in Rancho Bernardo. Pima Medical Institute will take 40,000 SF at the Icon@North City project in San Marcos, also later this year.

Q1 2017 WAS THE 11TH CONSECUTIVE QUARTER OF POSITIVE OCCUPANCY

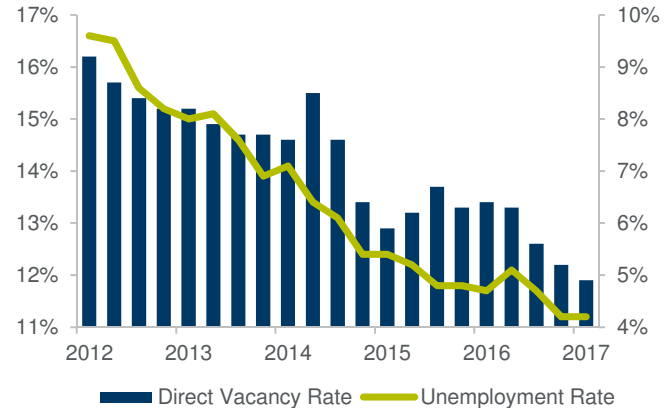
Of the 17 properties totaling 1.5 MSF under construction countywide, 13 are scheduled for completion in 2017. Over half of the square footage under construction is part of build-to-suit projects. Three of the properties under construction are creative office renovations of previously existing buildings, including AMP&RSAND, a 320,000 SF renovation of the old Union-Tribune office and print buildings in Mission Valley and a smaller 34,000 SF renovation of the old San Diego Daily Transcript building in Uptown. Of the total 1.5 MSF of product countywide, 56% already have commitments in place. While we anticipate continued preleasing activity, this will likely result in a modest short-term uptick in vacancy as these projects come online later in the year.

The countywide average asking rent for all classes is now \$2.78 per square foot (PSF) on a monthly full service basis. This metric has decreased 0.4% over the past three months and is up 0.4% from where it stood a year ago. Over the past 12 months, Class A rent has decreased by 1.8% to \$3.20 PSF, while the Class B rate has decreased by 1.9% to \$2.56 PSF. There is still plenty of room for growth in the A market guided by new construction, and the widening gap between the A and B markets will subsequently allow more room for the B market to increase.

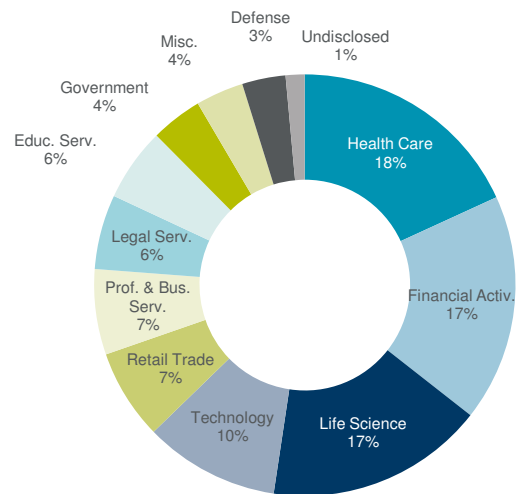
Outlook

- Continued economic growth and resulting job growth will drive occupancy and rent growth in 2017. Leasing within the 5,000 to 50,000 SF range will continue to be the main driver of activity, accounting for 54% of total SF in lease obligations set to expire over the next 18 months. Leases 50,000 SF and larger will account for 24% of activity, while leases 5,000 SF and less will account for 22%.
- Active tenant requirements stand at 3.4 MSF over the next 24 months countywide with 2.3 MSF in Central County, 830,000 SF in North County and 300,000 SF in South County. Forty percent of these tenants have yet to send out proposals and are still in the early 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.

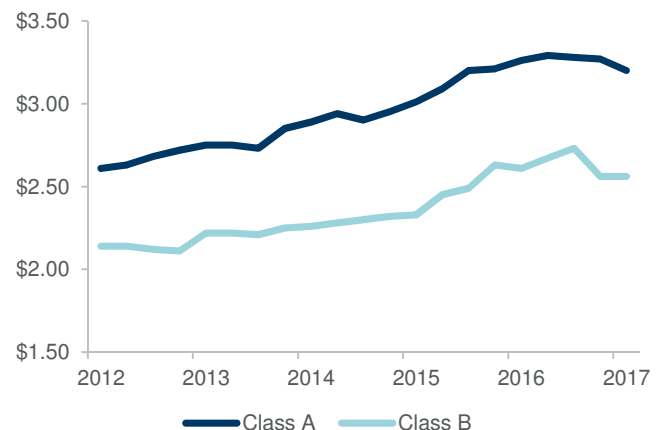
Direct Vacancy vs. Unemployment Rate
DECLINE IN VACANCY CORRELATES DECLINE IN UNEMPLOYMENT



Tenant Demand by Industry Type
TOP 3 INDUSTRY SECTORS ACCOUNT FOR 52% OF TOTAL DEMAND



Average Asking Rate by Class (Full Service)
CLASS A RENT DECREASED 1.8% AND CLASS B DECREASED 1.9% Y/Y



SUBMARKET	TOTAL BLDGS	INVENTORY (SF)	SUBLET VACANT (SF)	DIRECT VACANT	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	340	10,567,475	212,000	1,466,164	15.9%	82,142	82,142	308,954	\$2.41	\$2.72
Central County	836	48,921,053	1,559,376	5,914,565	15.3%	90,549	90,549	1,089,533	\$2.95	\$3.39
South County	320	16,992,932	154,922	1,740,245	11.2%	284,054	284,054	55,125	\$2.57	\$2.87
TOTAL	1,496	76,481,460	1,926,298	9,120,974	14.4%	456,745	456,745	1,453,612	\$2.78	\$3.27
Class A	318	32,146,660	1,043,729	3,971,925	15.6%	211,985	211,985	1,294,162	\$3.20	
Class B	755	33,683,444	786,846	4,210,854	14.8%	(172,647)	(172,647)	159,450	\$2.56	
Class C	423	10,651,356	95,723	938,195	9.7%	417,407	417,407	0	\$1.83	
TOTAL	1,496	76,481,460	1,926,298	9,120,974	14.4%	456,745	456,745	1,453,612	\$2.78	

*Rental rates reflect full service (FS) asking rents \$psf/monthly. Vacancy rate includes direct and sublease. Net absorption excludes sublease.

Key Lease Transactions Q1 2017

PROPERTY	SF	TENANT	LANDLORD	TRANSACTION TYPE	SUBMARKET
Summit Rancho Bernardo	378,731	Northrop Grumman	Jay Paul Company	Renewal & Expansion	Rancho Bernardo
4820 Eastgate Mall	63,532	ServiceNow	The Irvine Company	Expansion	Eastgate
Rio San Diego Plaza	51,428	Union Bank	Prudential	Renewal	Mission Valley
Wateridge Pointe	32,123	Certona	Angelo, Gordon & Co.	New	Sorrento Mesa
DiamondView Tower	15,265	Fox Sports	Cruzan	Renewal	Downtown

Key Sale Transactions Q1 2017

PROPERTY	SF	BUYER	SELLER	SALE PRICE	SUBMARKET
Governor Executive Plaza & Governor Park Plaza	260,421	Regents of the University of California	The Blackstone Group	\$83,560,000 (\$321/SF)	Governor
Peregrine Realty Portfolio	328,943	Westbrook Partners & Casey Brown Company	Peregrine Realty Partners	\$76,950,000 (\$234/SF)	Mission Valley, Kearny Mesa & Old Town
101 Ash St.	314,545	Cisterra Partners	Manchester Financial Group	\$72,440,000 (\$230/SF)	Downtown
9797 Aero Dr.	92,463	AVID	Bixby Land Company	\$30,125,000 (\$326/SF)	Kearny Mesa
Pacific Tech Center	67,832	Montana Avenue Capital Partners	Kilroy Realty Corporation	\$12,100,000 (\$178/SF)	Sorrento Mesa

Under Construction Q1 2017

PROPERTY	SF	PRELEASED		ADDRESS	CLASS	ESTIMATED COMPLETION	SUBMARKET
		SF	%				
AMP&RSAND	318,570	0	0%	350 Camino de la Reina	A	2018	Mission Valley
i3 – Bldgs. 1 - 3	316,262	316,262	100%	4775 - 4785 Executive Dr.	A	2017	Eastgate
Bressi Ranch	200,000	200,000	100%	Town Garden & El Camino Real	A	2018	Carlsbad
16399 W. Bernardo Dr. – Bldg. 66	160,925	160,925	100%	16399 W. Bernardo Dr.	A	2017	Rancho Bernardo
Bernardo Terrace Corp. Center	110,000	0	0%	Rancho Bernardo & Via Tazon	A	2018	Rancho Bernardo
Torrey Point - Bldgs. A & B	88,440	0	0%	3420 - 3430 Carmel Mountain Rd.	A	2017	Del Mar Heights
Spectrum Lab - Bldg. 2	63,000	0	100%	3013 Science Park Rd.	B	2017	Torrey Pines
The Icon @ North City	60,000	40,000	67%	111 Campus Way	A	2017	San Marcos
Carlsbad Research Center	48,954	0	0%	1800 Aston Ave.	B	2018	Carlsbad
Third Avenews	34,296	0	0%	2131 3 rd Ave.	B	2017	Uptown
Westfield UTC	32,336	32,336	100%	4545 La Jolla Village Dr.	A	2017	UTC
Grossmont Summit	13,200	0	0%	9400 Grossmont Summit Dr.	B	2017	East County
I.D.E.A. District	7,629	0	0%	835 12 th Ave.	A	2017	Downtown

OFFICE SUBMARKETS
SAN DIEGO



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