

MARKET REPORT

OFFICE

San Diego Metro Area

IPA

INSTITUTIONAL
PROPERTY
ADVISORS

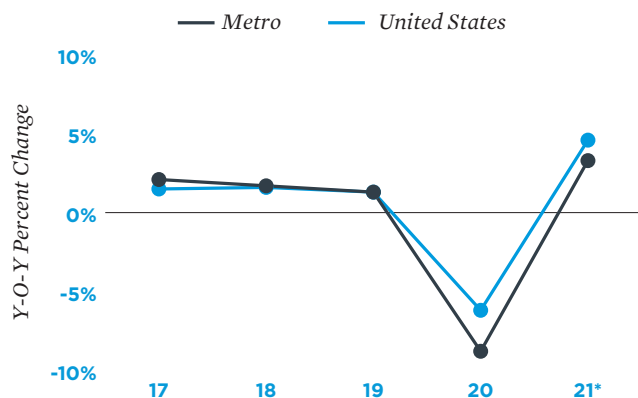
4Q/21

Biotech Hubs Support Positive Absorption; Investors Exhibit Confidence in Long-Term Demand

Metro takes initial steps toward recovery. Spring and summer leasing activity suggests office demand has turned positive in San Diego. From April through June, 540,000 square feet of space was absorbed, with preliminary data from the third quarter showing nearly 30 lease executions for floor plans larger than 10,000 square feet. Demand has been strongest in North San Diego, where Element Biosciences recently agreed to occupy 38,000 additional square feet in Sorrento Mesa and Apple subleased 73,000 square feet in UTC. Moreover, three leases totaling 140,000 square feet were executed this summer at nearby Eastgate Mall. While leasing has improved, hurdles toward a broader recovery remain. Entering September, metro vacancy was significantly above the prior five-year average and the number of office-using jobs trailed the total recorded at the onset of 2021.

Life science companies pivot to growing market. Located northeast of UTC and Sorrento Mesa, the Del Mar Heights/Carmel Valley area is attracting more biotech firms. Part of the I-5 Corridor, the locale notched sizable leases this summer. In July, DermTech and Tandem Diabetes committed to 96,000- and 182,000-square-foot spaces at redeveloped office properties in Del Mar Heights. These leases bode well for the I-5 Corridor as it entered the second half with a vacancy rate near 20 percent. Increased demand locally may also aid several speculative properties in Carmel Valley that have yet to secure tenants.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.

Office 2021 Outlook



46,000

JOBS

will be created

EMPLOYMENT:

San Diego County recaptures one-third of the 133,800 jobs lost last year with the metro's sizable biotech sector supporting office-using job creation. Still, the metro's 3.3 percent rate of employment growth in 2021 will trail the national rate of increase.



1,025,000

SQ. FT.

will be completed

CONSTRUCTION:

Annual supply additions exceeded the 1 million-square-foot mark for a second consecutive year, expanding the metro's inventory by 1.0 percent. Of the space slated for 2021 completion, roughly half was available for lease as of September.



20

BASIS POINT

increase in vacancy

VACANCY:

Improving office demand offsets the impact of speculative deliveries, supporting positive absorption in 2021. Still, metro vacancy rises moderately this year to 16.3 percent, the highest rate since 2011.



2.5%

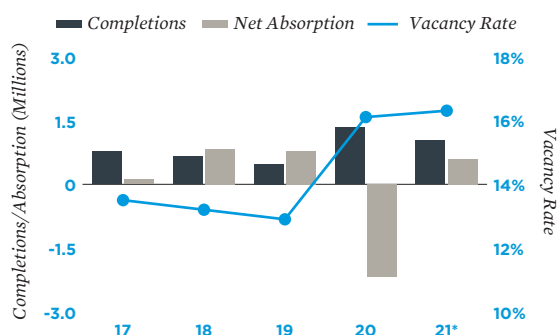
INCREASE

in asking rent

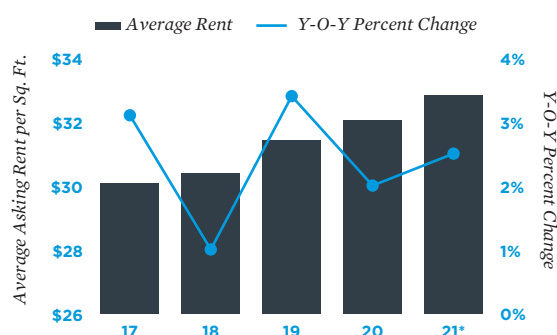
RENT:

Positive absorption in the metro's largest submarkets and a high volume of available Class A space pushes the average asking rent to \$32.85 per square foot. The uptick registered in 2021 represents the tenth consecutive year of marketed rate growth.

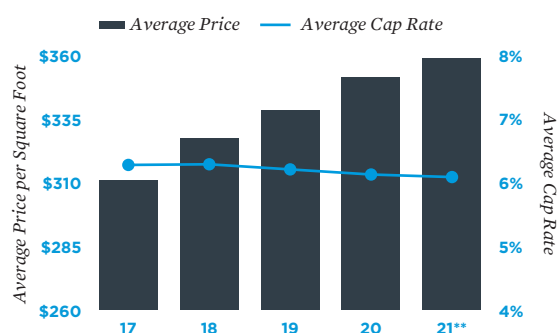
Supply and Demand



Rent Trends



Sales Trends



* Forecast ** Through 2Q

Sources: CoStar Group, Inc.; Real Capital Analytics

IPA Office

Alan L. Pontius

Senior Vice President, National Director

Tel: (415) 963-3000 | apontius@ipausa.com

For information on national office trends, contact:

John Chang

Senior Vice President, National Director | Research Services

Tel: (602) 707-9700 | jchang@ipausa.com

2Q21 — 12-Month Period



CONSTRUCTION

1,545,000 sq. ft. completed

- Supply additions over the past year ended in June increased San Diego's inventory by 1.5 percent; however, less than 300,000 square feet was finalized during the first half of 2021.
- Construction is underway on 1.8 million square feet with the redevelopment of Horton Plaza accounting for 40 percent of this space.



VACANCY

220 basis point increase in vacancy Y-O-Y

- Vacant stock grew by nearly 2.6 million square feet over the past four quarters, raising office availability to 16.0 percent. Four of the metro's five largest submarkets noted increases of more than 200 basis points.
- Class A availability rose sharply, up 370 basis points to 20 percent. Class B/C vacancy elevated 140 basis points to 13.7 percent.



RENT

1.6% increase in the average asking rent Y-O-Y

- Positive rent growth in Central and North San Diego, which together account for half of the metro's inventory, allowed the overall asking rent to rise moderately to a record average of \$32.67 per square foot.
- The mean Class A asking rate climbed 2.7 percent to \$39.57 per square foot. In contrast, Class B/C rent rose by just 0.4 percent.

Investment Highlights

- Diverging from the national trend, San Diego realized a slight increase in sales activity during the 12-month period ended in the second quarter. A notable improvement in local and Southern California-based investor activity was recorded from April through June of 2021 with the period representing the strongest three-month stretch for transaction velocity in more than two decades.
- Properties changed hands for an average of \$358 per square foot during the last 12 months, marking a 4 percent year-over-year gain. Meanwhile, the metro's average cap rate remained in the low-6 percent range, where it has hovered since 2016.
- Carlsbad and neighborhoods adjacent to Balboa Park represented some of the most active locales for Class B/C deal flow over the past year. Here, pricing below \$400 per square foot was rare, with first-year returns in the 5 to 6 percent range common.
- Investors seeking Class C assets priced below \$300 per square foot pursued listings in East County cities and Escondido. While 6 percent returns are obtainable in these areas, yields below the 5 percent mark have recently been recorded.

The information contained in this report was obtained from sources deemed to be reliable. Every effort was made to obtain accurate and complete information; however, no representation, warranty or guarantee, express or implied, may be made as to the accuracy or reliability of the information contained herein. Note: Metro-level employment growth is calculated based on the last month of the quarter/year. Sales data includes transactions sold for \$1 million or greater unless otherwise noted. This is not intended to be a forecast of future events and this is not a guaranty regarding a future event. This is not intended to provide specific investment advice and should not be considered as investment advice. Sources: IPA Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Real Capital Analytics

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