MARKET REPORT

Office

San Diego Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

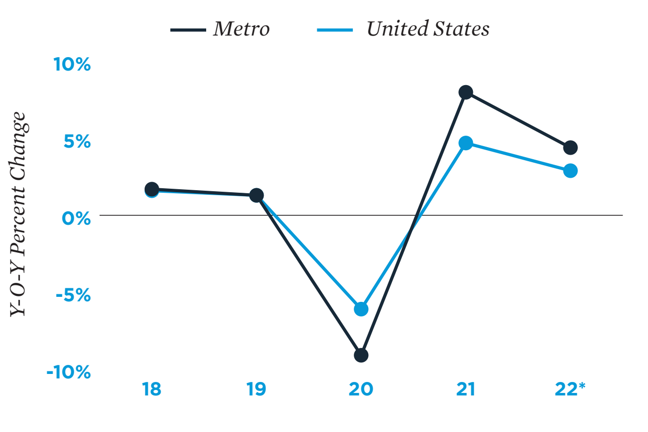
2Q/22

Demand in Biotech Centers and Coastal Hubs Swells, Producing Wave of Absorption

County is a regional standout. San Diego led all West Coast markets in office performance over the past four quarters, as tenants absorbed nearly 3.2 million square feet of space and local rent growth exceeded 6.0 percent. The metro's burgeoning biotech sector is supporting mid- and large-scale leasing in locales with clusters of higher-quality space. Spanning the past 12 months, a combined 2.1 million square feet was absorbed across the North San Diego and I-5 Corridor submarkets. This demand compressed vacancy in both areas to record lows and supported above-average rent gains. Sparse near-term deliveries in each locale suggest notable demand for available space will persist in the coming quarters, enabling San Diego to maintain its standing as the regional leader in office demand.

Core vacancy skews metro's strong performance. In a welcomed sign for Downtown San Diego, tenants absorbed nearly 600,000 square feet of space over the 12 months ended March, lowering local vacancy 250 basis points. Still, the metro entered April with the highest CBD availability among major U.S. markets at 27.0 percent. Construction activity downtown suggests vacancy will remain elevated for the foreseeable future, as the submarket's pipeline equates to 18 percent of existing inventory. This total comprises sizable speculative properties, including the Campus at Horton — a redevelopment project that is slated to deliver 742,000 square feet later this year. Most of this space is available for lease, likely placing near-term upward pressure on local availability.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.

Office 2022 Outlook

65,000 JOBS
will be created

EMPLOYMENT:

San Diego employers added 23,000 jobs during the first four months of 2022, putting the metro on track to record a 4.4 percent annual rate of employment growth. Traditional office-using positions will account for one-fourth of this year's job creation.

1,570,000 SQ. FT.
will be completed

CONSTRUCTION:

Delivery volume increases by 1 million square feet on an annual basis, as San Diego records the largest inventory growth among Southern California markets at 1.5 percent. Half of the space slated for finalization by year-end was available as of mid-May.

100 BASIS POINT
decrease in vacancy

VACANCY:

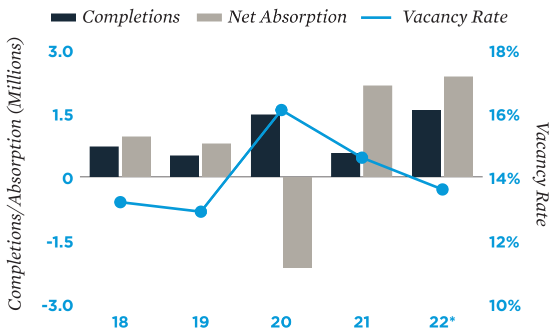
The metro represents one of three major U.S. markets to record triple-digit vacancy compression during 2022, as tenants absorb more than 2 million square feet. At 13.6 percent, year-end availability is 150 basis points below the long-term average.

3.7% INCREASE
in asking rent

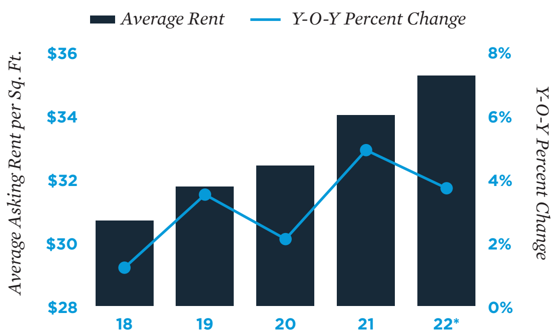
RENT:

Positive tenant demand across all property tiers allows San Diego to register an 11th consecutive year of rent growth. Still, at $35.25 per square foot, the metro's average marketed rate trails Los Angeles County's mean by 10 percent.

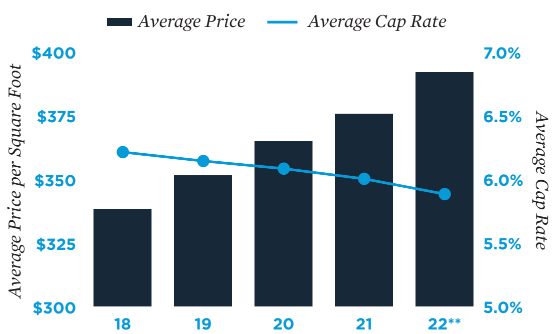
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 1Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

1Q 2022 - 12-Month Period

CONSTRUCTION

837,000 sq. ft. completed

- Developers increased San Diego County's office inventory by 0.8 percent during the 12-month period ended in March. Two completions at Aperture Del Mar in Carmel Valley accounted for 289,000 square feet.
- Ongoing projects in Downtown San Diego represent 60 percent of the active pipeline, which comprised 4.1 million square feet as of mid-May.

VACANCY

240 basis point decrease in vacancy Y-O-Y

- Tenants absorbed more than 500,000 square feet in each of the past four quarters, lowering vacancy to 14.1 percent. Recent compression partially offset the 380-basis-point gain recorded during the prior yearlong span.
- The Class A sector noted the most pronounced decline among property tiers, as vacancy fell 360 basis points to 17.6 percent.

RENT

6.2% increase in the average asking rent Y-O-Y

- Vacancy compressed across all submarkets with at least 10 million square feet of inventory. This widespread demand supported a strong pace of rent growth that elevated the average marketed rate to $34.50 per square foot.
- The absorption of 2 million square feet of Class A space over the past year lifted the sector's mean rate 7.7 percent to $42.23 per square foot.

Investment Highlights

- Deal flow rose by nearly 50 percent over the 12-month period ended in March, as improving fundamentals across property tiers fortified investors' confidence in San Diego's long-term prospects. The recent yearlong span was one of the strongest on record for local sales activity, with the metro ranking third among U.S. secondary markets in total transactions.
- Sales velocity improved across price tranches, with deals above the $10 million threshold accounting for roughly 30 percent of all trades. This proportion of deal flow is indicative of increased institutional and out-of-state investor activity, as well as a rise in multi-property transactions.
- Class B properties are trading most frequently, with buyers exhibiting a preference for Sorrento Mesa, Carlsbad and other areas proximate to Interstate 5. Here, midsized buildings, including some fit for conversion to lab space, are available at high-4 to low-5 percent returns, with assets typicaly trading above the metro's average price point of $392 per square foot.
- Private investors that pursue smaller, sub-$5 million properties are most active in neighborhoods adjacent to Balboa Park and East County. In both locales, medical office properties are trading above $400 per square foot.

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