MARKET REPORT

Office

San Diego Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

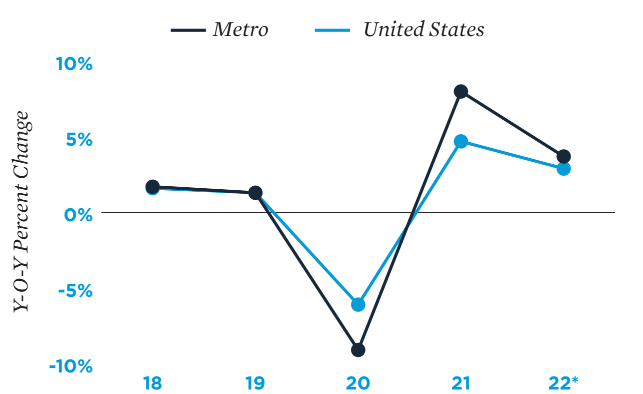
4Q/22

Spotlighted by Suburban Leasing, Local Office Demand Far Exceeds Regional Counterparts

Metro's tech hub status elevates. Following a historic stretch of demand, San Diego's office sector entered the second half of 2022 in a position of strength. During the past year ended in June, tenants absorbed a net of nearly 3.2 million square feet across the county, the largest four-quarter tally on record — one that exceeded the combined absorption total for the other three Southern California markets. Leasing by biotech and life science firms remains the primary driver of office demand; however, big tech is also playing a role. This June, Google signed on for a sizable floorplan in Sorrento Mesa, while Amazon leased more than 120,000 square feet earlier this year in nearby UTC. Apple has been extremely active since last August, committing to roughly 780,000 square feet across five buildings. Preliminary leasing data for the third quarter shows these trends continuing, with a list of notable commitments executed, highlighted by Crinetics Pharmaceuticals signing on for 94,000 square feet.

Tenants prefer areas of reduced density. San Diego is home to the second-lowest suburban vacancy in California at 11.6 percent, outdone only by the Inland Empire, which lacks a traditional central business district. Three of San Diego's four largest suburban locales noted vacancy declines of at least 290 basis points over the past year, signaling heightened demand for space outside the CBD. Near-term demand for renovated space is likely to remain strong across these areas — North San Diego, as well as the I-5 and I-15 Corridors — with just 160,000 square feet slated for second half delivery here.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.

Office 2022 Outlook

55,500 JOBS *will be created*

EMPLOYMENT:

After the addition of 39,600 positions in the first eight months of 2022, San Diego is on pace to notch a 3.4 percent annual rate of employment growth. Strong office absorption suggests the metro may close out this year with a bump in higher-paying job creation.

1,560,000 SQ. FT. *will be completed*

CONSTRUCTION:

For just the third time in the past 13 years, developers finalize more than 1 million square feet, expanding local inventory by 1.5 percent. Three deliveries at The Campus at Horton in Downtown San Diego highlight the list of 2022 completions.

70 BASIS POINT *decrease in vacancy*

VACANCY:

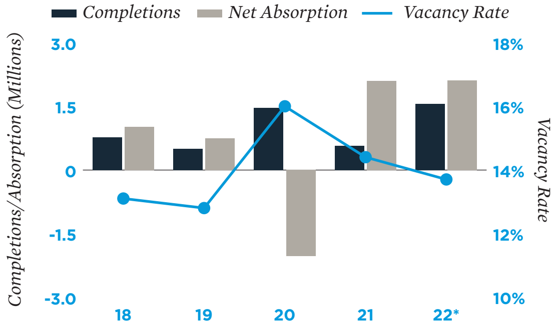
Traditional office-using firms absorb a net of 2.1 million square feet of space for a second straight year, lowering vacancy to 13.7 percent. This rate is 130 basis points below the metro's long-term average.

3.3% INCREASE *in asking rent*

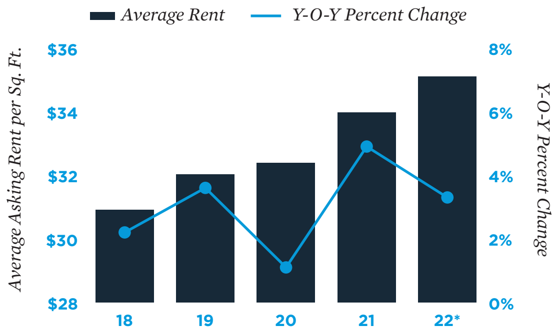
RENT:

Consistently strong demand for available space enables the metro to register an 11th consecutive year of positive asking rent growth. San Diego's year-end rate of $35.10 per square foot is the eighth-highest average among major U.S. markets.

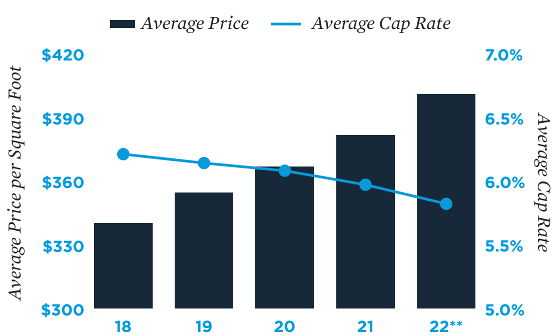
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 2Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

San Diego Office:

Damon Wyler *Vice President, Regional Manager*

12544 High Bluff Drive, Suite 100

San Diego, CA 92130

Tel: (858) 373-3100 | damon.wyler@marcusmillichap.com

Prepared and edited by:

Erik Pisor

Research Analyst | Research Services

For information on national office trends, contact:

John Chang

Senior Vice President, Director | Research & Advisory Services

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

2Q 2022 - 12-Month Period

CONSTRUCTION

1,038,000 sq. ft. completed

- Inventory grew by 1.0 percent during the 12-month span ended in June, with additions largely split between North San Diego and Downtown.
- The metro's active pipeline comprised more than 3.9 million square feet as of August, equating to 3.7 percent of existing stock. Of this space, approximately 70 percent is in Downtown San Diego.

VACANCY

210 basis point decrease in vacancy Y-O-Y

- San Diego was one of two major U.S. markets to record a 200-basis-point-plus decline in vacancy over the past year, as demand more than tripled supply additions. This activity lowered availability to 13.8 percent in June.
- Class A vacancy fell 290 basis points to 17.2 percent during the 12-month span, while Class B/C availability dipped 180 basis points to 11.7 percent.

RENT

5.2% increase in the average asking rent Y-O-Y

- Apart from Florida metros, San Diego witnessed the strongest rent growth among major U.S. markets, as a span of robust net absorption lifted the local average marketed rent to a record $34.68 per square foot.
- Paralleling recent vacancy compression, Class A rent rose 6.9 percent, while the mean asking rate in the Class B/C sector jumped up 3.6 percent.

Investment Highlights

- Standout absorption and notable rent growth are enhancing the attractiveness of San Diego office investment. Recent deal flow reflects this, as sales velocity improved by nearly 30 percent during the 12-month interval ended in June. Activity was highlighted by the second quarter of 2022, which ranked as one of the best three-month periods for closings on record.
- Class B trading accounted for nearly half of all recent transactions, with a number of these properties built within the past 20 years. The high volume of mid-tier sales raised the metro's average price point by 7 percent to $401 per square foot in June. Concurrently, the mean cap rate fell 20 basis points to 5.8 percent, a yield 110 basis points above that of Los Angeles.
- Investors targeting properties with upside potential are active in the I-5 and I-15 Corridors. Here, buyers are acquiring mid- and select larger Class B and C properties that require notable interior upgrades to secure new tenants. The traditional office hubs of Carlsbad, Scripps Ranch and Rancho Bernardo represent prime areas for this strategy, as some newly-renovated properties in these neighborhoods have received noteworthy lease commitments from larger office-using firms. Across these locales, returns in the high-5 to low-6 percent range remain available.

Price: $250