

Savills Studley Report San Diego office sector

Q2 2018



SUMMARY

Market Highlights

LEASING RISES

Several significant renewals boosted second-quarter activity. However; in the four most recent quarters, deal volume totaled 5.0 million square feet (msf) in the four most recent quarters, well below the long-term average of 6.6 msf.

AVAILABILITY RATE INCHES HIGHER

The region's overall availability rate inched up by 20 basis points, increasing to 15.2%. In contrast, the Class A rate ticked down by 40 basis points to 16.8%.

RENT STABLE

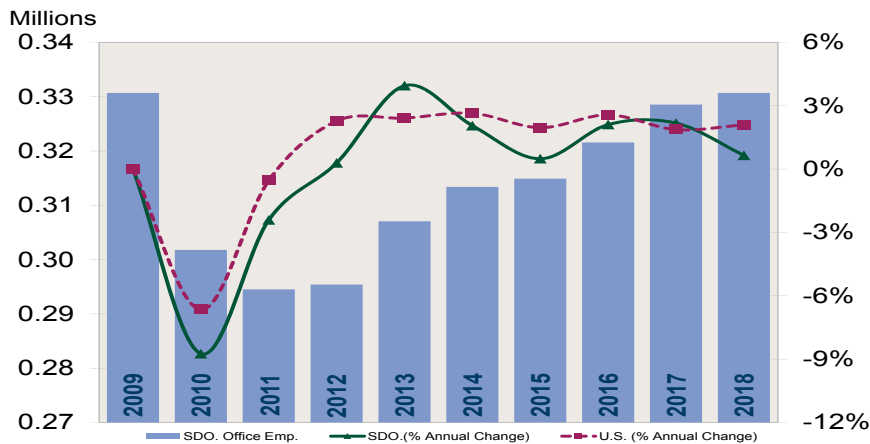
Overall asking rent was essentially unchanged, ticking down by 0.1% to \$32.54 (\$2.71/sf monthly). The Class A average increased by 0.7% to \$36.78 (\$3.07/sf monthly).

SALES INCH LOWER

Office property sales during the last six months (through May 2018) totaled \$1.8 billion, a 14% decrease compared to the previous six-month total of \$2.1 billion.

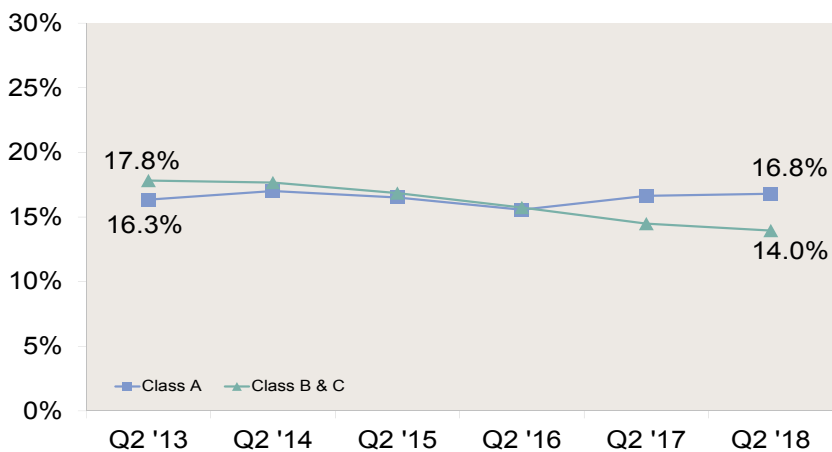
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"With new construction still under control, and very limited supply of quality blocks of space, larger tenants are increasingly opting for renewals. Smaller and mid-sized firms are more mobile, and continue to seek out options across the market, including in Downtown San Diego."

Office-Using Employment Trends

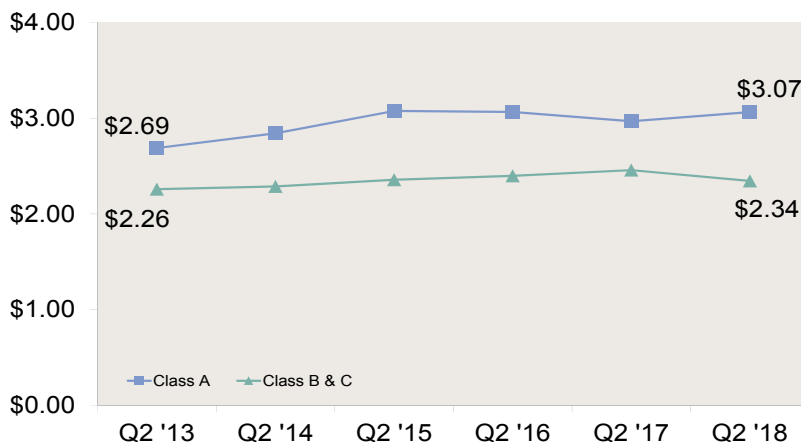


Source: Bureau of Labor Statistics^

Availability Rate Trends



Asking Rent Trends (\$/sf)



Slow but Steady Drop in Space Options

Payroll expansion among a wide variety of sectors continues to sustain demand for office space in San Diego. Relatively steady leasing, coupled with tightly controlled new construction, continues to create tight conditions. Across the entire region, there are only seven properties totaling just under 500,000 sf underway – 60% is pre-leased. San Diego has ample proposed buildings, but most will not proceed until they have an anchor tenant. Steady hiring, sustained leasing and limited construction have created the perfect climate for a slow draw down in space options. The overall availability rate dipped by 20 basis points in the second quarter and has fallen by 150 basis points compared to a year ago.

Downtown's tightening has intensified in the last several quarters as tech startups and a few established mid-sized firms have embraced renovated office product and converted warehouse buildings. Modest growth among banks and real estate has also supplemented activity from the tech sector. As of mid-year 2018, Downtown's Class A availability rate was 14.4%, well below the 16.8% rate regionally. Another area hoping to emulate some of this success is Old Town. Local developer Casey Brown Co. recently completed a renovation of Old Town Plaze, spending \$3 million on upgrades to the two-building 65,000-sf complex. The owner added new common-area corridors, conference room and upgraded lobbies, hoping to attract creative office space users. Nearby, in the Midway District, Hammer Ventures has just started plans for a \$325 million mixed-use project called The Point.

Sublet space has also been held in check. As of mid-year San Diego had 1.6 msf of sublet space available for lease, compared to 1.5 msf as of mid-year 2017. The market is waiting to see how much space Qualcomm places on the market after it implements another round of layoffs, this time totaling more than 1,200 employees. In turn, Qualcomm is expected to eventually put about 222,000 sf of space on the market at its Sorrento Mesa headquarters.

Rare Opportunities

Tenants in University City (UTC) and La Jolla have faced tight conditions for several years. The number of big blocks of available space has been limited. Opportunities to buy quality assets in La Jolla and UTC also rarely come on the market. In turn, investors are aggressive when quality assets or even

value-add opportunities arise. In a strong market, buildings with higher vacancy and below market rents are seen as having a strong upside.

Los Angeles-based GPI Companies paid \$97.1 million for the Campus on Villa La Jolla – the five-building campus totaling 198,453-sf sold for \$489.28/sf. This is the first time that the complex changed hands in the last three decades. Located just a half mile from the beach, the 6.78-acre complex was 83% occupied at time of sale.

Renewals Dominate

Second quarter leasing volume jumped thanks to several significant renewals. With a limited number of big blocks, and construction activity that is still controlled, renewals continue to dominate larger leases. Healthcare, tech and defense contracting have been core drivers of leasing. The healthcare industry employs more than 120,000 in San Diego, accounting for 14% of its employment base. American Specialty Health renewed its nearly 200,000 sf lease at the Elements in Sorrento Mesa. Parallel Capital, which bought the complex in 2014, has made major renovations including upgrades to common areas, landscaping and fitness center. Based in Indianapolis, American Specialty provides technology-enabled benefits management services to employers and insurance carriers.

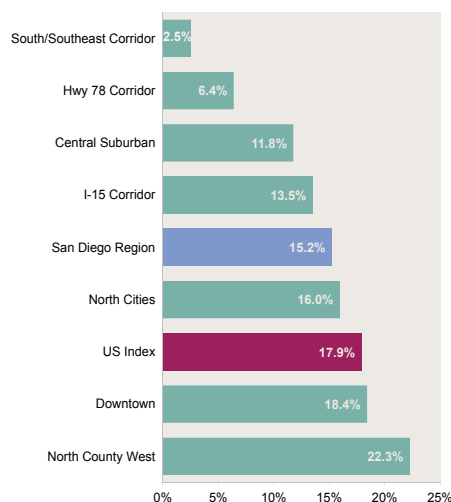
In one of the largest financial sector leases in the last several years, BofI Holding signed a 10-year extension for its 136,000-sf headquarters in University Town Center, pushing this key lease out to 2030. Formed in 2000, the internet bank holds assets in excess of \$10 billion.

Investors Seek Out Value-Add Options

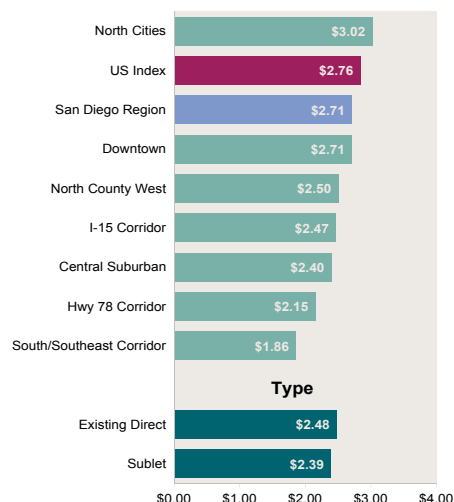
Investment sales fell slightly during the last six months. Even so investors have acquired \$1.8 billion in San Diego office assets during this period, nearly matching the \$1.9 billion in San Francisco. The sales have come from a variety of stabilized Class A assets and value-add properties. Harbor Associates and Bascom Group paid \$15.7 million for 2010 Jimmy Durante Boulevard in Del Mar. The new owners plan to rebrand the building as The Bungalows at Del Mar and add unique features such as bike and surfboard storage, outdoor showers, seating and collaboration areas.

Investors are pushing beyond the prime areas to some older value-add office parks. Examples include Governor's Park.

Availability Rate Comparison



Rental Rate Comparison (\$/sf)



Major Transactions

Tenant	Sq Feet	Address	Market Area
American Specialty Health	198,000	10221 Wateridge Cir	North Cities
General Atomics	153,559	13480 Evening Creek Dr N	I-15 Corridor
BofI Holding	136,000	University Town Center	North Cities
AIG Private Client Group	24,016	9350 Waxie Way	Central Suburban
Dowling & Yahnke	17,271	12265 El Camino Real	North Cities
C & S	13,670	2355 Northside Dr	Central Suburban
Turnstile Capital Magement LLC	13,223	402 W Broadway	Downtown
Commonwealth Equity	9,184	4715 Viewridge Ave	Central Suburban
Seamgen	8,330	185 W F St	Downtown
Retirement Benefits Group	7,770	9276 Scranton Rd	North Cities
Sum of Top 10 Leases	581,023		

Since the start of this year, eight of the 19 properties at the complex have been sold, with a combined value of more than \$125 million. The Regents of the University of California bought 260,000 sf in four buildings for \$83.5 million (\$321/sf). Two more buildings, 5080 and 5090 Shoreham, have reportedly been placed on the market. Most of the product was constructed in the mid-1980s and early 1990s.

Re-invention of the Suburbs

In many markets, including Chicago and Seattle, the current real estate expansion has been very uneven. Demand for office space in central business districts has eclipsed limited activity in suburban locations. Developers of office product have generally followed the move of apartment developers either into the urban core or to close-in suburban infill sites. San Diego has not seen such a stark split – in fact Downtown has lagged the core North Cities and Central Suburban submarkets in terms of demand. However, peripheral suburban

sites are still trying to urbanize their settings. This is particularly apparent in the latest developments seeking approvals such as Merge 56, the \$300-million mixed-use development in the Rancho Penasquitos area. The San Diego City Council approved plans that call for 242 residential units, 160,000 sf of retail, a movie theater, 250,000 to 300,000 sf of office space and a 120-room hotel.

The project was previously approved in 2004, but the latest version abandons a big-box retail oriented project to one that is a more walkable and self-contained village. The new version hopes to compete with Downtown San Diego and University Town Center. A similar effort can be seen in North City – mixed-use community in San Marcos near Cal State San Marcos. The 200-acre community will have new offices, student and market-rate apartments. These suburban town centers hope to snare some millennials from UTC who are seeking more space and amenities. Time will tell if their preferences change as they age.

Map	Submarket	Total	Leasing Activity		Available SF			Availability rate			Asking rents Per SF		
		SF (1000's)	Last 12 Months	Net Absorp Last 12 Mos.	This Quarter	% Change from Last Qtr.	Year Ago	This Quarter	pp Change from Last Qtr. (1)	Year Ago	This Quarter	% Change from Last Qtr.	Year Ago
1	Central Suburban	14,131	1,069	400	1,661	2.8%	1,619	11.8%	0.3%	11.5%	\$2.40	3.4%	\$2.14
	Central Suburban - Class A	4,434	306	72	705	9.5%	655	15.9%	1.4%	14.8%	\$2.80	7.6%	\$2.49
2	Downtown	11,911	639	637	2,193	7.8%	1,892	18.4%	1.3%	15.9%	\$2.71	3.3%	\$2.58
	Downtown - Class A	6,698	459	-79	966	4.6%	747	14.4%	0.6%	11.2%	\$2.94	3.3%	\$2.87
3	Hwy 78 Corridor	1,346	40	60	86	23.4%	96	6.4%	1.2%	7.2%	\$2.15	3.6%	\$2.05
	Hwy 78 Corridor - Class A	585	16	62	50	73.3%	46	8.5%	3.6%	7.9%	\$2.34	-0.8%	\$2.26
4	I-15 Corridor	7,107	704	-55	961	-18.9%	1,426	13.5%	-3.2%	20.1%	\$2.47	0.6%	\$2.20
	I-15 Corridor - Class A	3,270	291	-234	577	-31.2%	800	17.7%	-8.0%	24.5%	\$2.62	-0.2%	\$2.54
5	North Cities	23,447	2,074	89	3,743	2.9%	3,894	16.0%	0.4%	16.6%	\$3.02	-2.2%	\$3.02
	North Cities - Class A	12,667	951	121	2,211	2.5%	2,265	17.5%	0.4%	17.9%	\$3.45	1.3%	\$3.35
6	North County West	6,303	460	28	1,404	-0.6%	1,296	22.3%	-0.1%	20.6%	\$2.50	0.2%	\$2.36
	North County West - Class A	1,833	236	-2	474	-4.4%	420	25.9%	-1.2%	22.9%	\$2.68	0.2%	\$2.69
7	South/Southeast Corridor	2,065	20	23	52	120.5%	26	2.5%	1.4%	1.2%	\$1.86	2.0%	\$1.81
	South/Southeast Corridor -Class A	234	0	0	9	-41.2%	11	3.9%	-2.7%	4.7%	\$2.25	0.0%	\$2.25
1-7	San Diego Region TOTAL	66,334	5,006	1,181	10,101	1.2%	10,250	15.2%	0.2%	15.5%	\$2.71	-0.1%	\$2.71
	San Diego Region TOTAL - Class A	29,720	2,259	-61	4,992	-2.2%	4,945	16.8%	-0.4%	16.6%	\$3.07	0.7%	\$2.97

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(1) Percentage point change for availability rates.

Unless otherwise noted, all rents quoted throughout this report are average asking gross (full service) rents psf.

Statistics are calculated using both direct and sublease information.

Short-term sublet spaces (terms under two years) were excluded.

^Unless otherwise noted, source for data is Savills Studley.

The information in this report is obtained from sources deemed reliable, but no representation is made as to the accuracy thereof. Statistics compiled with the support of The CoStar Group.

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