Savills Studley Report
San Diego office sector

Q4 2016

SUMMARY

Market Highlights

AVAILABILITY RATES FALL

The region's overall availability rate declined by 0.9 pp to 16.9% - its lowest mark since 2006. The Class A rate decreased by 0.5 pp to 17.7%, but was unchanged from a year ago.

RENT PUSHES HIGHER

Overall asking rent rose by 2.0% in the final quarter of the year, averaging $2.84 across the San Diego market. Class A average rent inched up by merely 0.3% to $3.13, but the average rent in Class B and C buildings jumped by % to $2.53.

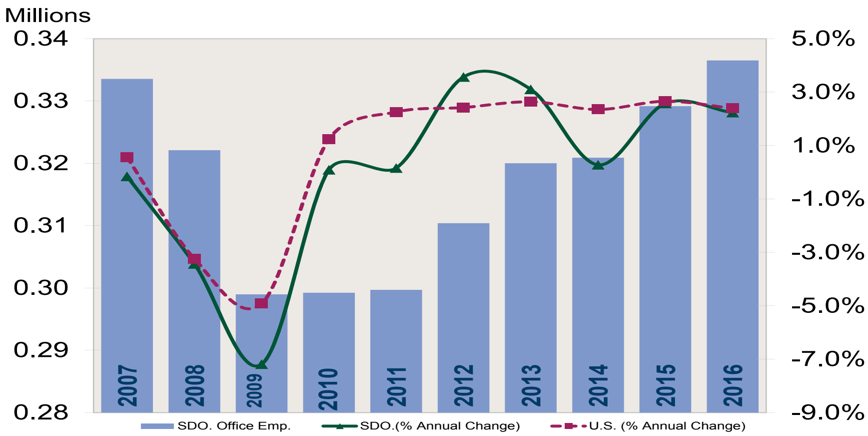
LEASING SLIDES LOWER

Quarterly leasing volume has been running about 15.0% below its long-term historical pace since the start of 2016. Tenants have leased 6.0 msf in the four most recent quarters, falling short of the long-term average of 6.5 msf by 16.5%.

"Although the number of larger leases has declined, mid-sized tech and life science firms were active in the fourth quarter. For the first time in years, tenants face tighter availability in both Downtown San Diego and North Cities locations."

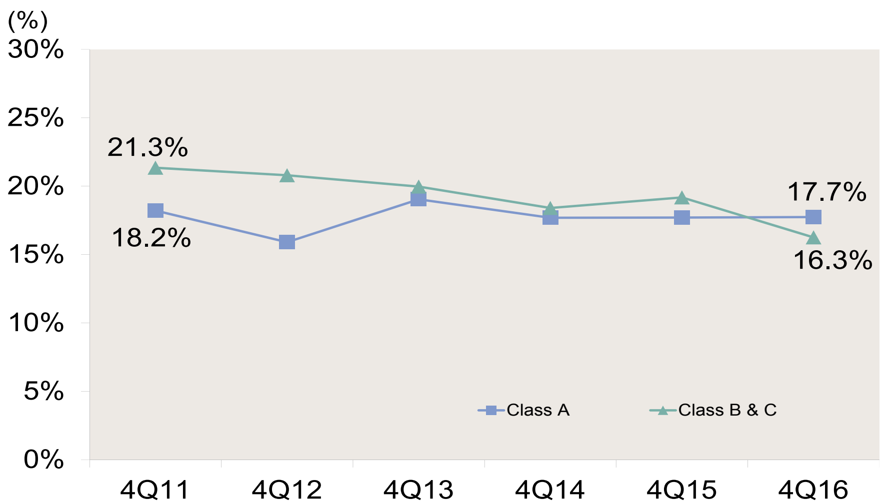
Savills Studley Research

Office-Using Employment Trends

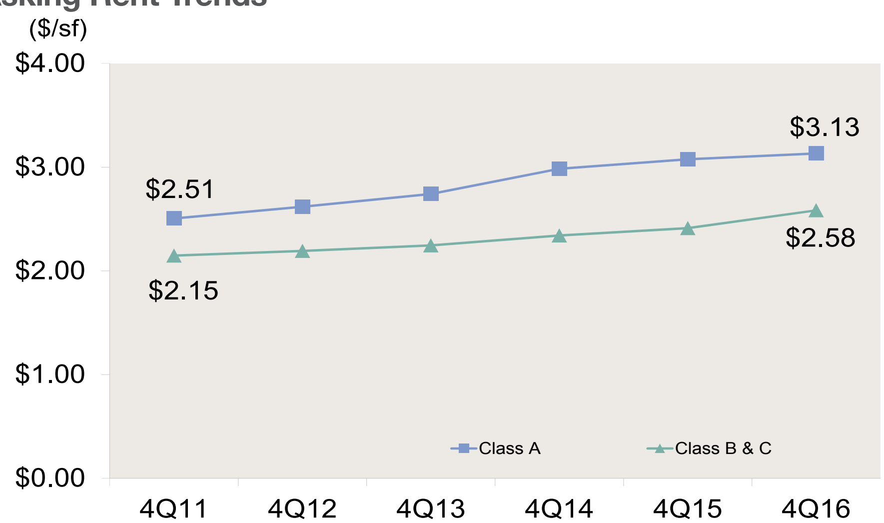


Source: Bureau of Labor Statistics

Availability Rate Trends



Asking Rent Trends



Availability Falls to 10-year Low, Leasing Slows Slightly

Tenants will face tight conditions across much of the San Diego market in 2017. Despite a recent increase in availability within North Cities, the familiar hot spots – Torrey Pines, UTC and La Jolla – will continue to set a high bar for asking rent. Tenants may be able to find a few more options next year, but they will need to engage the market early. For the first time in several years, Downtown San Diego also registered a material reduction in availability as leasing gained some momentum.

Momentum in Downtown Leasing

Downtown San Diego posted a sharp drop in availability during 2016. Tenants leased 1.2 msf Downtown during 2016, exceeding last year's total by nearly 10.0% and well above the long-term annual average of 908,000 sf. Downtown's availability rate fell sharply, dropping by nearly 500 basis points year-on-year to 15.5%.

The two largest leases in Downtown San Diego during the last five years have both involved the same building – the SDG&E/ Sempra Energy Building at 101 Ash Street. Sempra leased the 300,000-sf building in 2013 but moved last year to their new headquarters near Petco Park. It appears the building will stay off the market for quite some time. In October, the City Council approved a 20-year, $130-million plus lease for the building. The city will relocate approximately 1,100 employees from other buildings scattered across Downtown into the building. Of note, the Manchester Financial Group, which occupies space at the building and also owns a 49% interest in the property, bought the Fifth Avenue Financial Center for $71.5 million. They will move their headquarters to the property.

San Diego's overall availability rate dropped by 90 basis points to 16.9% at year's end, its lowest mark since 2006. Availability has decreased despite a deceleration in leasing over the course of the last four quarters. Deal volume totaled 6.0 msf in 2016, falling by nearly 15.0% from the 7.0 msf leased in 2015 and slipping below the long-term annual average of 6.5 msf. Some tenants are taking longer to finalize space-use decisions and a few are displaying price resistance to elevated asking rents.

Fewer Blockbuster Leases, but Mid-Sized Firms are Active

While a tight market is keeping many larger firms from making moves, smaller and mid-sized companies were active. Pharmaceutical and biotech firms have remained active in the second half of the year, but the number of leases exceeding 50,000 sf has declined. Other than Fate Therapeutics' expansion of nearly 50,000 sf at Nautilus Three (3535 General Atomics) in Torrey Pines, there were few larger life science deals in the second half of the year. Several mid-sized tenants committed to space, though. Acadia Pharmaceuticals leased 26,437 sf at Kilroy Centre Del Mar (3611 Valley Centre Drive). (Heron Therapeutics leased 28,275 sf at 4242 Campus Point in UTC. Finally, in Miramar, Arena Pharmaceuticals took 15,500 sf at 6118 Nancy Ridge Drive.

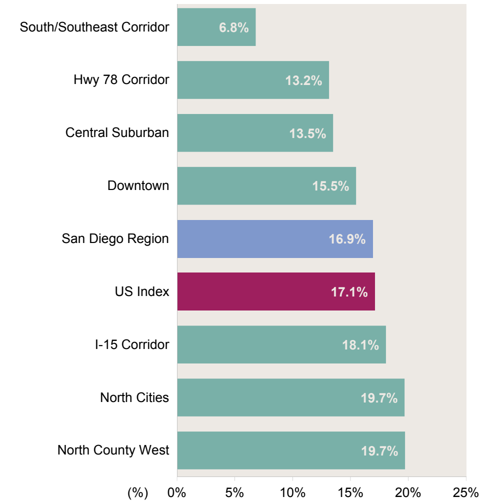
Leasing from other sectors such as telecommunications, defense and healthcare have also become a bit more sporadic. The aforementioned City of San Diego lease is the only lease over 100,000 sf completed since the first quarter. Tech firms accounted for several of the larger transactions late in the year. As rents continue to rise, sublet space is in strong demand. GreatCall sublet 61,772 sf in Carlsbad. In Downtown San Diego, video game developer Psyonix leased just under 40,000 sf at 401 W A Street. This is a big jump from the 9,000 sf they currently occupy at 707 Broadway. Both buildings are owned by Emmes.

Rent Pushes Higher

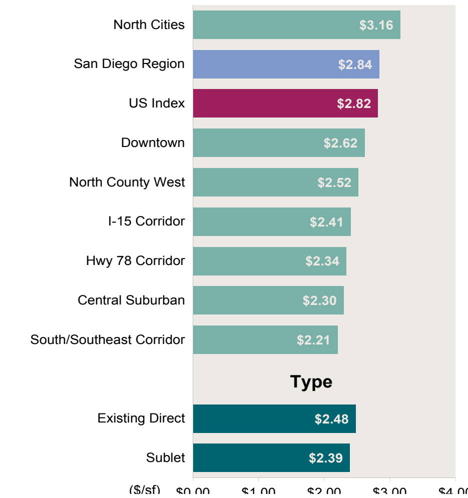
Landlords remain bullish, particularly in Torrey Pines, UTC and other North Cities locations. In turn, they have pushed asking rent higher across much of the market and pulled back slightly on concessions. The overall average asking rent spiked by 2.0% to $2.84 in the fourth quarter and has jumped by 5.3% year-on-year. The Class A asking rent for the region posted a more moderate 1.8% year-on-year jump to $3.13/sf. Face rent in the highest-caliber North Cities markets has continued to spike and is approaching $4.50/sf. Rent has increased even though the availability rate in North Cities is hovering around 20.0%. The headline rate is elevated but the number of quality blocks of space is limited – only six existing Class A buildings offer a block of 50,000 sf or more.

Negligible new construction activity is keeping availability low even as leasing activity decelerates in select areas. Construction activity has remained remarkably controlled in San Diego. During the prior decade (2000-2009) more than 18.0 msf of new office stock delivered in San Diego. In contrast, only 3.5 msf has delivered since 2010.

Availability Rate Comparison



Rental Rate Comparison



Major Transactions

Tenant	Sq Feet	Address	Market Area
City of San Diego	315,000	101 Ash St	Downtown
GreatCall, Inc	61,772	2200 Faraday Ave	I-5 Corridor/Carlsbad
3D Systems	45,109	16550 W Bernardo Dr	I-15 Corridor
Psyonix	39,600	401 W A St	Downtown
Heron Therapeutics	28,275	4242 Campus Point	North Cities
On-Ramp Wireless	27,855	10301 Meanley Dr	I-15 Corridor
Acadia Pharmaceuticals	26,437	3611 Valley Centre Dr	I-5 Corridor/Del Mar Hts
Optec Fuel Technologies	20,329	2721 Loker Ave W	I-Corridor/Carlsbad
County of San Diego	17,522	3609 Ocean Ranch Blvd	SR 78-Corridor
Arena Pharmaceuticals	15,500	6118 Nancy Ridge Dr	Mira Mesa/Miramar
Sum of Top 10 Leases	**597,399**		

Tenants have responded positively to amenity-rich new buildings and conversions. Kilroy Realty's set of amenities has become a key part of its distinctive brand. It is embarking on one of its most ambitious projects yet – El Camino Real. Just a short drive from many of the prime North Cities residential communities the 200,000-sf building will be set amidst a mixed-use development that will include luxury retail, multi-family product and movie theater. Other properties take advantage of amazing natural surroundings by integrating interior and outdoor amenities. Eastgate Terrace, a 96,345-sf building in UTC delivering this Spring features canyon and ocean views and will have a 4/1,000 sq ft parking ratio.

Looking Forward

The regional and U.S. economy is expected to continue on its course of moderate economic growth in 2017. There is some optimism regarding the potential for "pro-growth" legislation such as a major infrastructure bill or reduced banking regulation has some market observers predicting a boost in economic growth next year. Even if Congress enacts any of these measures it would take until late 2017 for any material impact to emerge.

Particular metro areas and industries stand to gain or potentially lose if the new Administration decides to take very selective approaches to spending – prioritizing military spending at the expense of a long list of discretionary spending that could include medical research. San Diego could gain from some of these budgetary choices but lose from others.

Asking rent which firmed up in 2016, is likely to see a moderate increase next year, Companies that last negotiated a lease in 2009 or 2010, when the market had ample sublet space may be taken aback by pricing and stingier concession packages. The range of options has dwindled as well. Firms requiring quality view space in prime location must engage the market early.

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**	13,992	1,315	311	1,889	-5.1%	2,221	13.5%	-0.7%	15.9%	$2.30	0.5%	$2.26
	Central Suburban - Class A	4,202	304	30	670	-3.9%	658	15.9%	-0.6%	15.7%	$2.89	1.3%	$2.88
2	**Downtown**	11,946	1,187	290	1,850	-14.6%	2,439	15.5%	-2.7%	20.4%	$2.62	2.5%	$2.45
	Downtown - Class A	6,689	555	31	888	-2.6%	942	13.3%	-0.3%	14.1%	$2.96	2.0%	$2.76
3	**Hwy 78 Corridor**	1,346	106	44	177	-21.5%	228	13.2%	-3.6%	16.9%	$2.34	-0.4%	$2.36
	Hwy 78 Corridor - Class A	585	61	28	77	-36.4%	121	13.2%	-7.6%	20.8%	$2.67	0.0%	$2.67
4	**I-15 Corridor**	7,129	456	259	1,288	7.2%	1,124	18.1%	1.2%	15.8%	$2.41	2.0%	$2.29
	I-15 Corridor - Class A	3,311	174	130	651	-3.8%	517	19.7%	-0.8%	15.6%	$2.77	-0.4%	$2.47
5	**North Cities**	22,977	2,354	109	4,523	-2.3%	4,586	19.7%	-0.5%	20.0%	$3.16	0.6%	$3.03
	North Cities - Class A	12,224	942	-87	2,387	-1.4%	2,370	19.5%	-0.3%	19.4%	$3.47	-0.6%	$3.50
6	**North County West**	6,562	489	10	1,294	-7.4%	1,412	19.7%	-1.6%	22.3%	$2.52	0.4%	$2.47
	North County West - Class A	1,826	157	37	475	2.0%	518	26.0%	0.5%	28.4%	$2.68	-0.4%	$2.69
7	**South/Southeast Corridor**	2,044	71	65	139	-11.5%	162	6.8%	-0.9%	7.9%	$2.21	15.8%	$1.75
	South/Southeast Corridor -Class A	234	0	0	11	0.6%	21	4.7%	0.0%	9.0%	$2.57	8.4%	$2.46
1-7	**San Diego Region TOTAL**	**65,996**	**5,977**	**1,087**	**11,160**	**-5.2%**	**12,172**	**16.9%**	**-0.9%**	**18.5%**	**$2.84**	**2.0%**	**$2.69**
	San Diego Region TOTAL - Class A	**29,071**	**2,194**	**170**	**5,158**	**-2.7%**	**5,148**	**17.7%**	**-0.5%**	**17.7%**	**$3.13**	**0.3%**	**$3.08**

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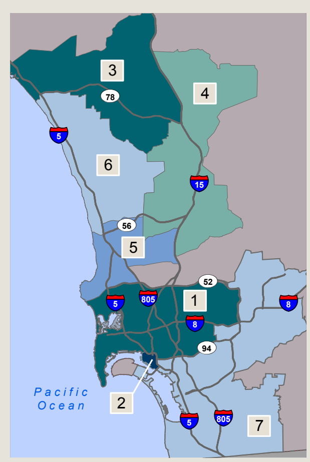

(1) Percentage point change for availability rates.
Unless otherwise noted, all rents quoted throughout this report are average asking gross (full service) rents psf.
Statistics are calculated using both direct and sublease information.
Short-term sublet spaces (terms under two years) were excluded.

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.