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3Q24

# San Diego Office Market Overview



NEWMARK

# Market Observations

## Economy

- The region’s unemployment rate stood at 5.0% in August 2024, up 60 basis points over the past year, and higher than the national average of 4.2%.
- Total nonfarm employment grew by 10,800 jobs over the past year, while office-using sectors cumulatively shed 5,000 jobs.
- Cost of living increases have caused an increasing number of residents to work multiple jobs.
- The consumer price index for all urban customers in the San Diego metropolitan area was up 3.5% over the past year as of July 2024. Inflation has eased but the lingering effects of high housing costs have weighed on the regional economy.

## Major Transactions

- BH Properties acquired the mixed-use Hazard Center project in Mission Valley for \$68.3M, which includes a 270,000-SF office tower and a 135,000-SF shopping center.
- Symphony Towers in Downtown sold to private investor Joe Wen for \$45.7M, a substantial discount to the \$134.3M the seller paid for it in 2003.
- General Dynamics signed the largest lease deal of quarter, renewing 67,000 SF of office space for its NASSCO ship-building division in Mission Valley.
- Drug discovery company Mirador Therapeutics, which was founded this year, leased 66,000 SF of space in Headquarters Point, which is under construction by Bioscience Property Investments.

## Leasing Market Fundamentals

- The average monthly asking rate was \$3.40/SF, down 0.6% from a year ago.
- Net absorption was positive this quarter, posting 180,928 SF in gains, and year-to-date absorption turned positive with 165,517 SF in gains.
- Total vacancy climbed to 17.3%, up from 15.9% a year ago, as new deliveries continued to outpace demand.
- 408,154 SF delivered in new projects as current construction levels fell to 5.2 MSF. 1.7 MSF of new product has delivered year-to-date.
- Sublease availability remained stable at 4.2%, representing 3.2 MSF of available sublease space.

## Outlook

- Vacancy will continue to climb next year as leasing activity falls short of the still-robust delivery pipeline.
- The development pipeline will continue to shrink as projects underway deliver and future projects remain on hold until demand recovers sufficiently.
- Underperforming office buildings will continue to be sold at a discount, acquired for conversion to apartments or other uses or, in rare cases, be taken back by the lender.
- Investors have been eagerly anticipating interest rate cuts and the Federal Reserve’s first, jumbo-sized 50-basis-point cut is expected to give investment activity a boost.

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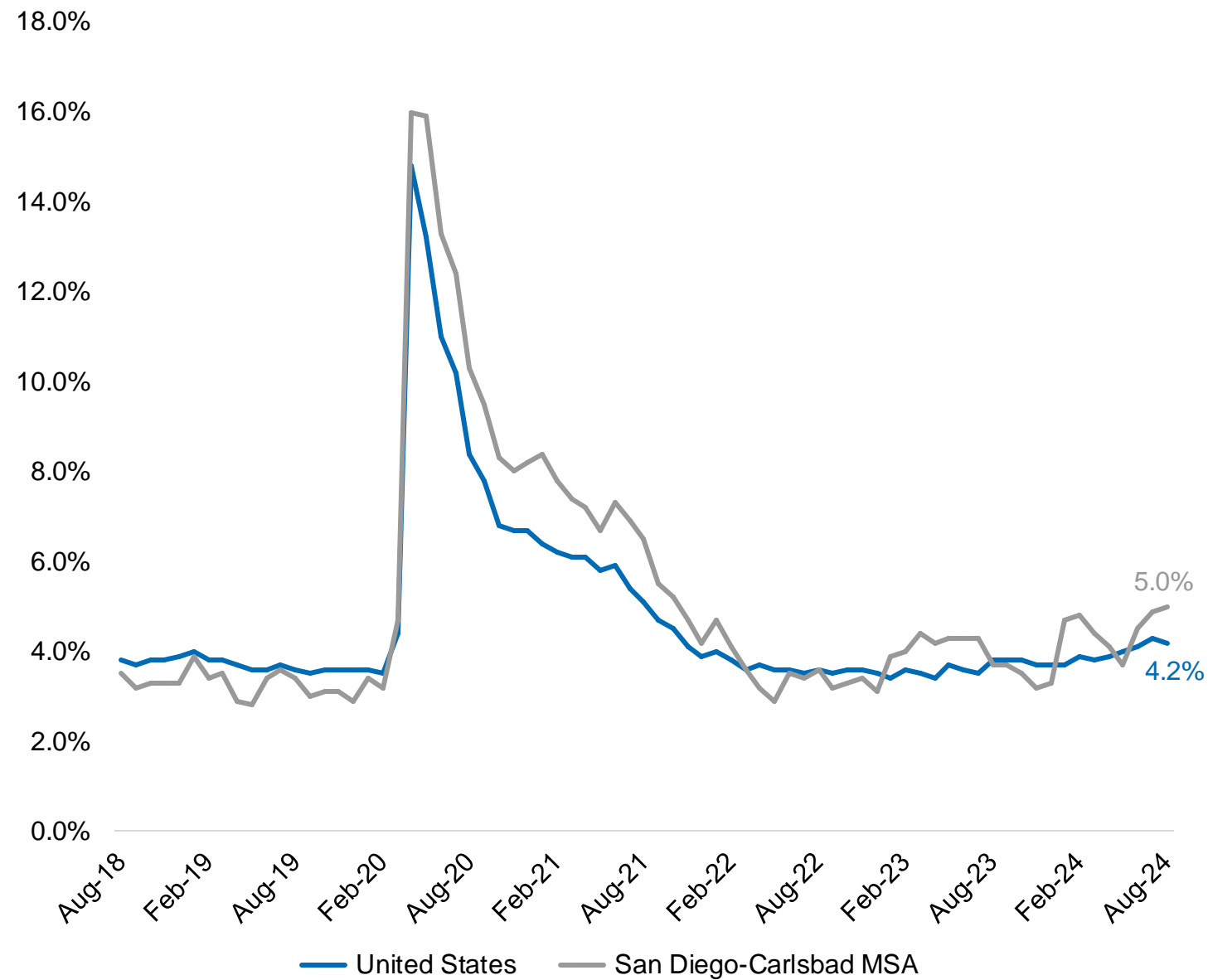
# Economy



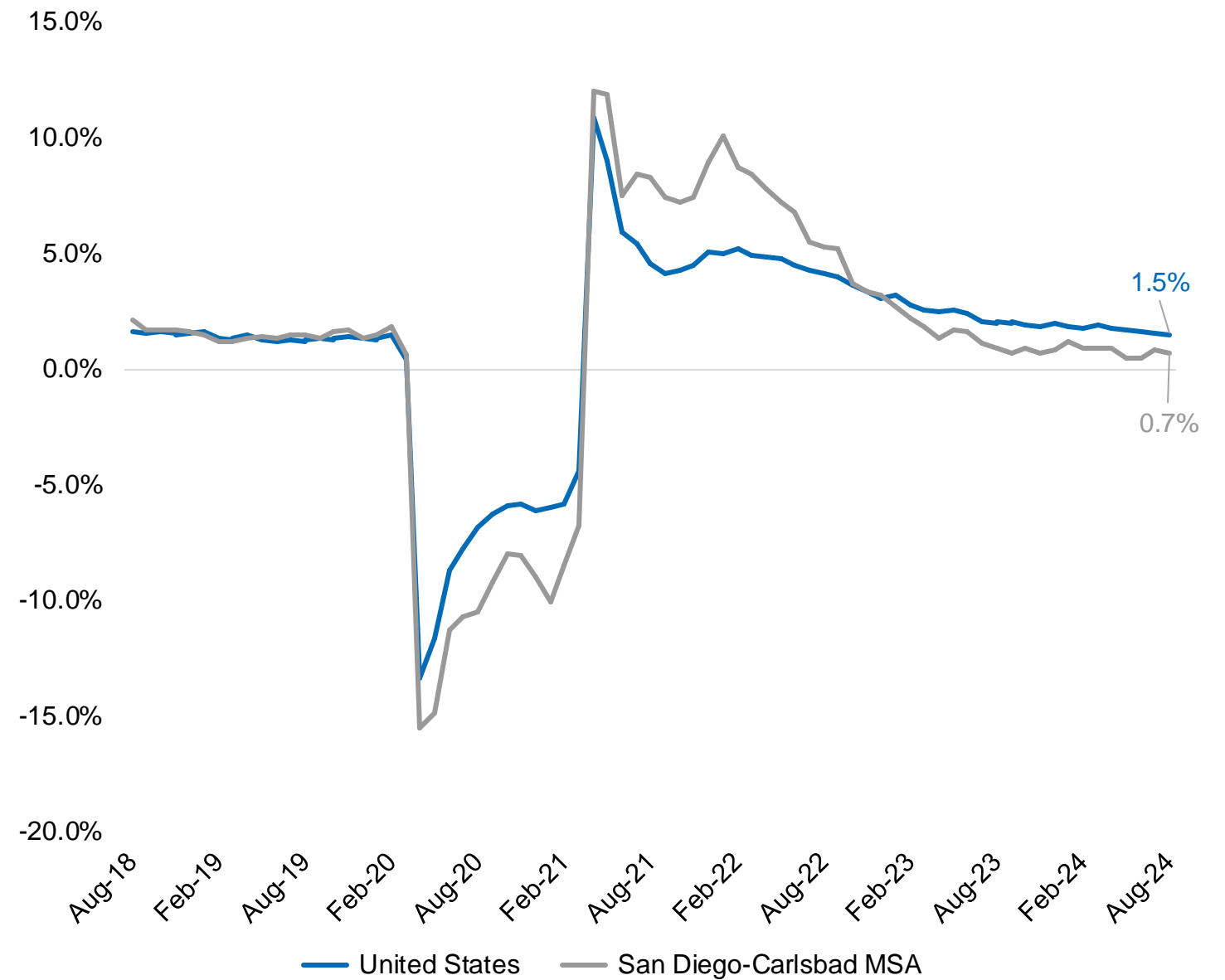
# Unemployment Ticks Up to a Three-Year High

The local unemployment rate reached 5.0% in August 2024, up 60 basis points over the past year. Nonfarm employment, however, has continued to post modest but positive gains as employers reported an additional 10,800 jobs over the past year, representing growth of 0.7%, trailing the national average of 1.5%. The disparity between these two metrics shows that more residents are rejoining the labor force even as employers continue to add new jobs.

Unemployment Rate, Seasonally Adjusted



Nonfarm Payroll Employment, Non-Seasonally Adjusted, 12-Month % Change

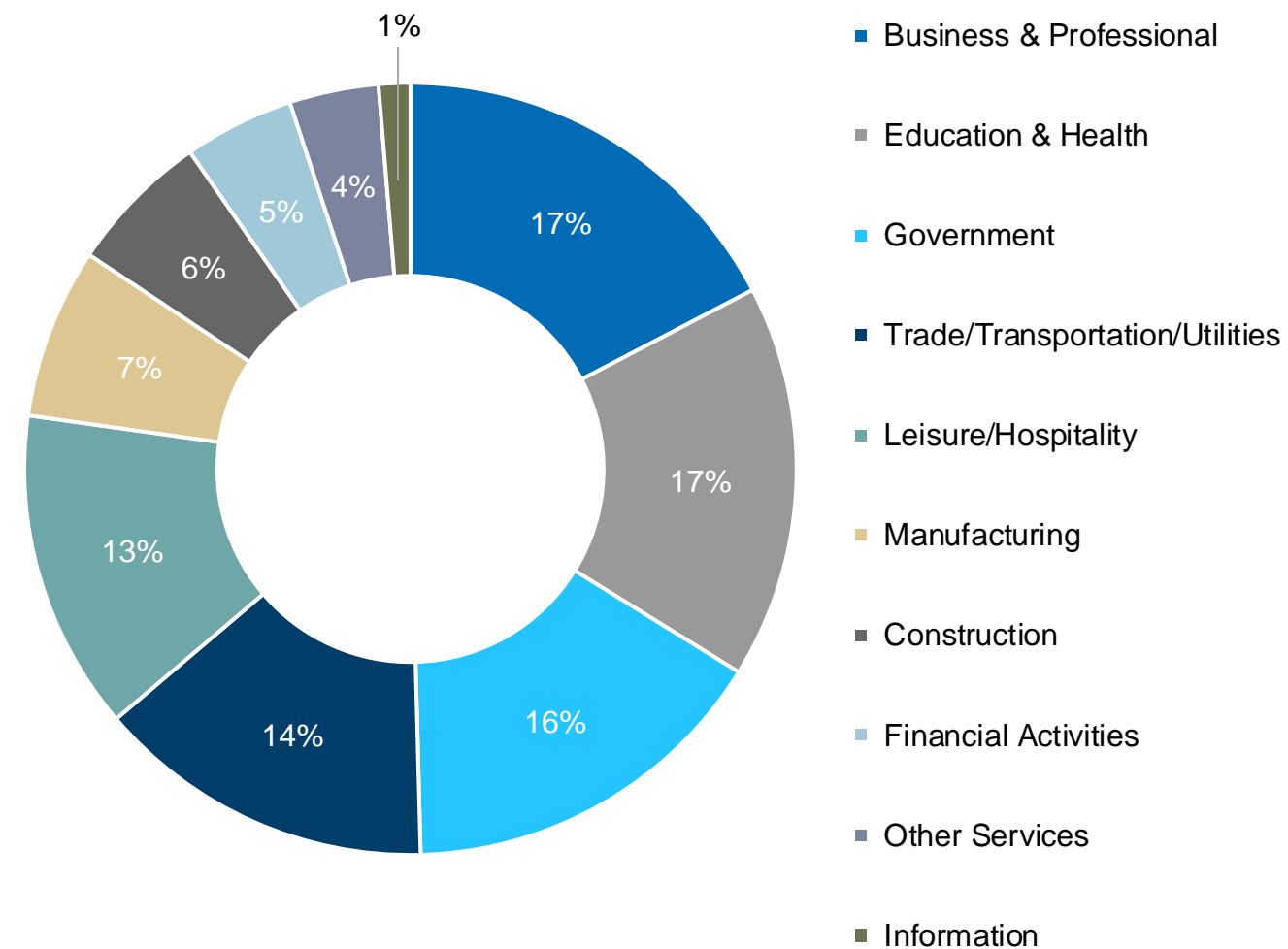


Source: U.S. Bureau of Labor Statistics, San Diego-Carlsbad MSA

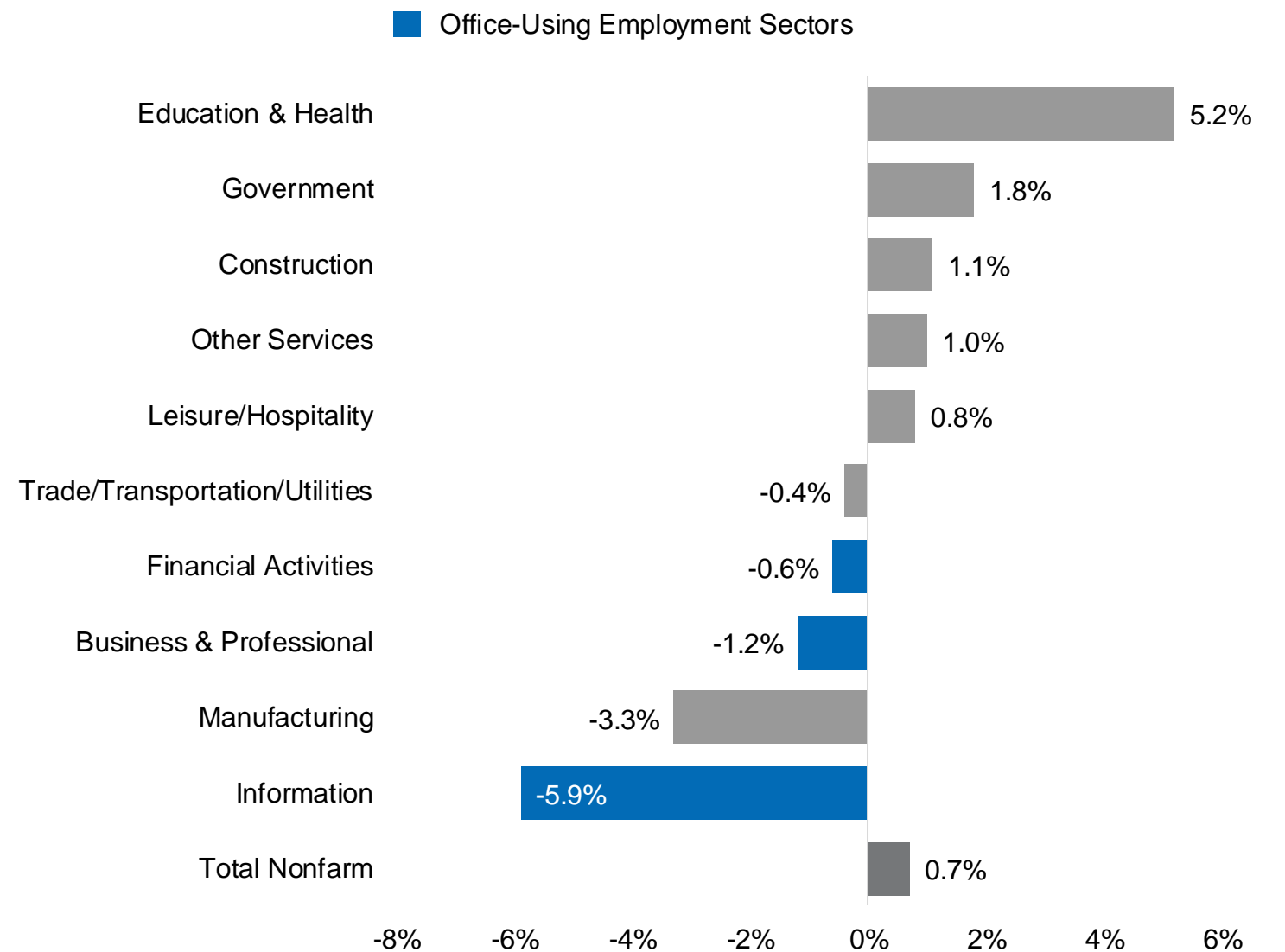
# Primary Office-Using Job Sectors Decline

Business and professional services is the single largest employment sector in the region, fueling white-collar jobs and office demand, but the industry has contracted by 1.2% over the past year. The government and education and health sectors, meanwhile, have grown to be nearly as large in terms of the total number of jobs. Office-using jobs in the smaller financial activities and information industries contracted by 0.6% and 5.9% respectively over the same period.

Employment by Industry, August 2024



Employment Growth by Industry, 12-Month % Change, August 2024

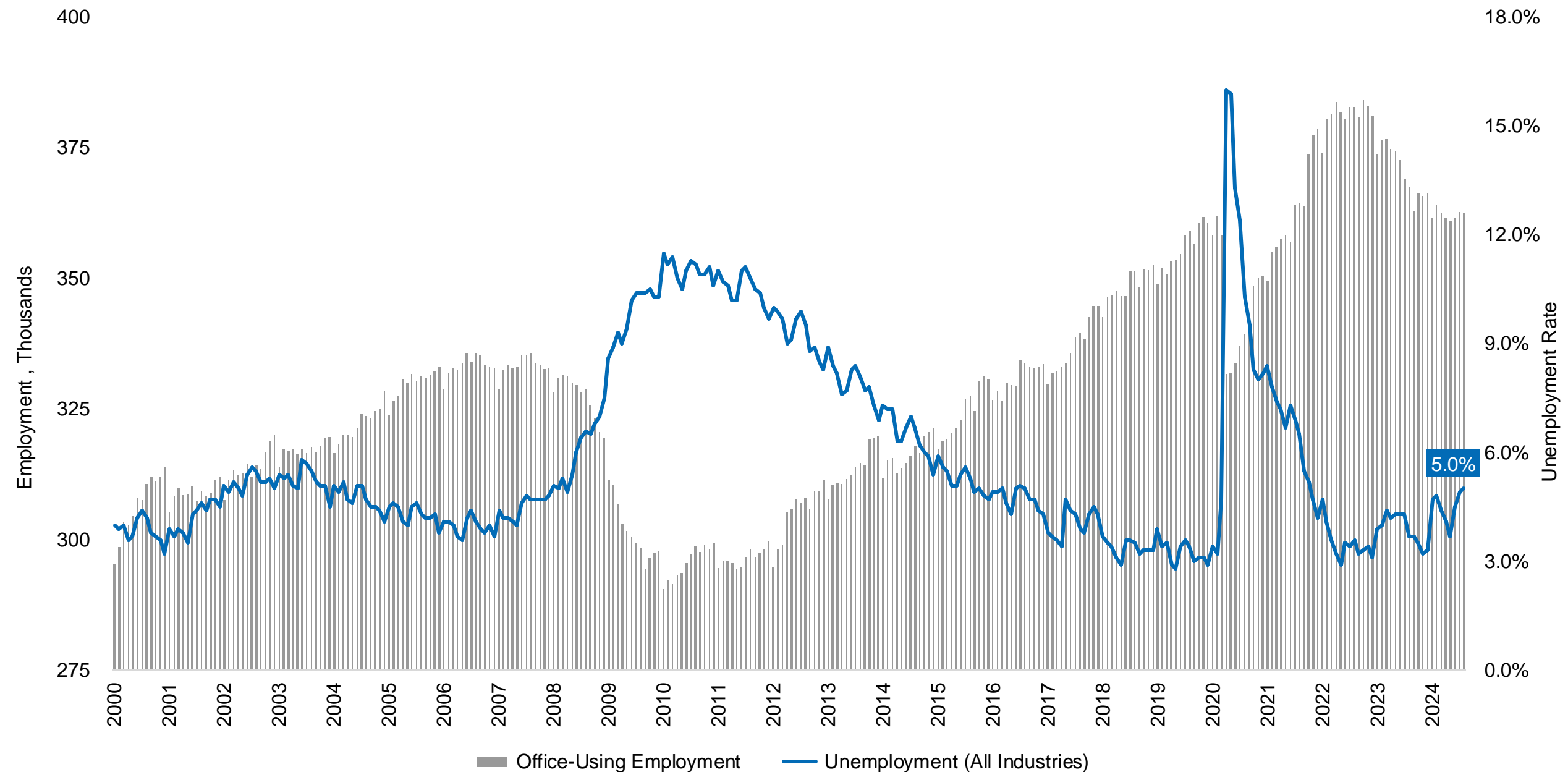


Source: U.S. Bureau of Labor Statistics, San Diego-Carlsbad MSA

# Office-Using Employment Declines From Peak At the End of 2022

In 2022 San Diego reached a peak of office-using jobs, but employment in these sectors has since fallen even as others grew. Professional and business services had the worst performance of any sector over the past year, shedding 3,300 jobs. Education and health services had the best performance, adding 12,800 jobs. Current office-using employment seems to have stabilized at pre-pandemic levels last seen in early 2020.

## Office-Using Employment\* and Unemployment Across All Industries



Source: U.S. Bureau of Labor Statistics, San Diego-Carlsbad MSA

Note: August 2024 data is preliminary.

\*Office-using employment includes employment in the following industry sectors: Professional & Business Services, Financial Activities and Information.

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# Leasing Market Fundamentals

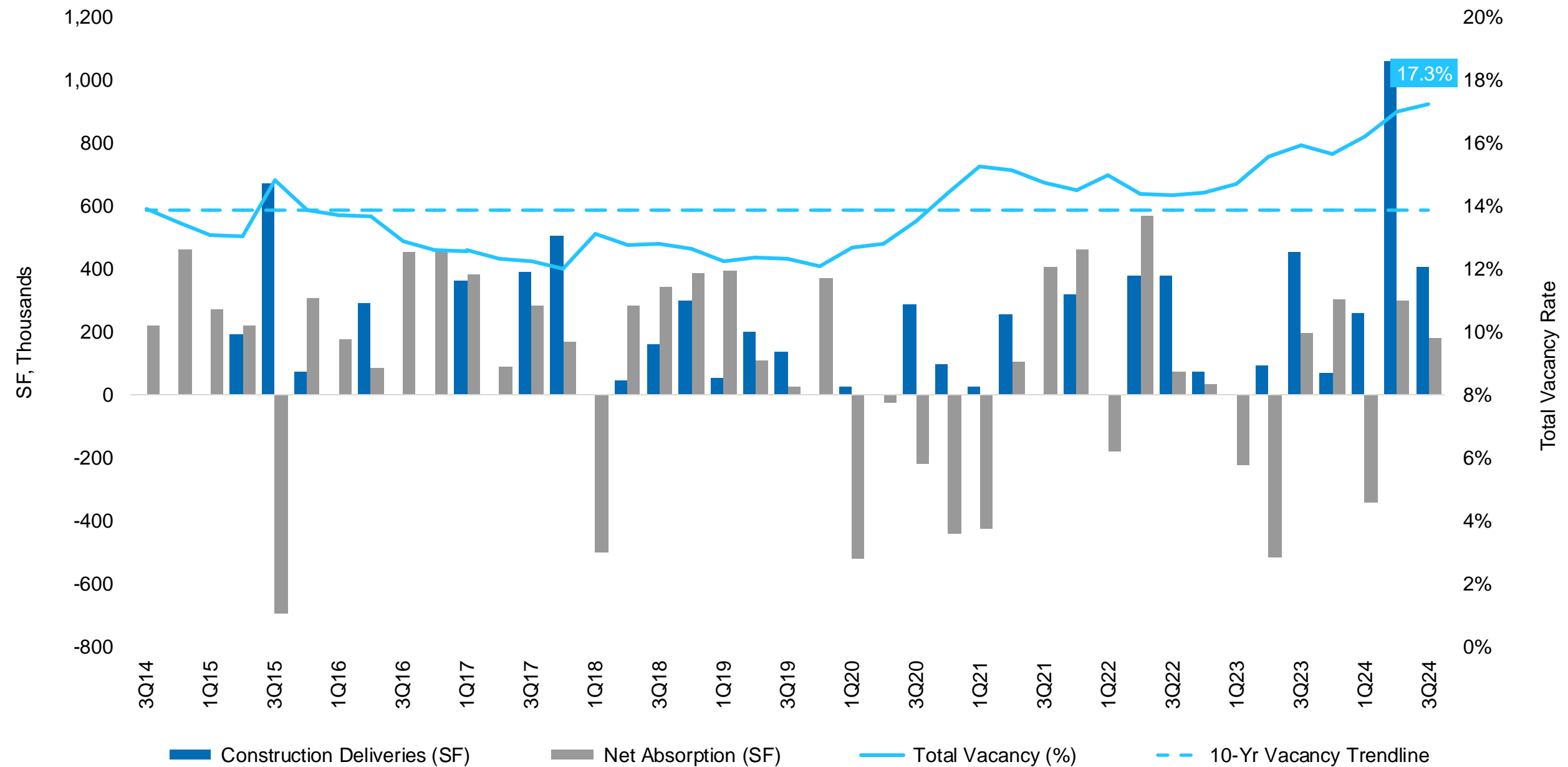




# Large New Deliveries Drive Positive Absorption But Also Increase Vacancy

The first three quarters of 2024 saw 1.7 MSF in construction deliveries, the largest amount of new space in over a decade. Although the market has posted 165,517 SF of positive net absorption so far this year, the large volume of new product has still caused total vacancy to climb to its highest level in a decade, currently at 17.3%. Vacancy will continue to climb over the short-term as 5.2 MSF in current construction projects continue to deliver.

Historical Construction Deliveries, Net Absorption and Vacancy

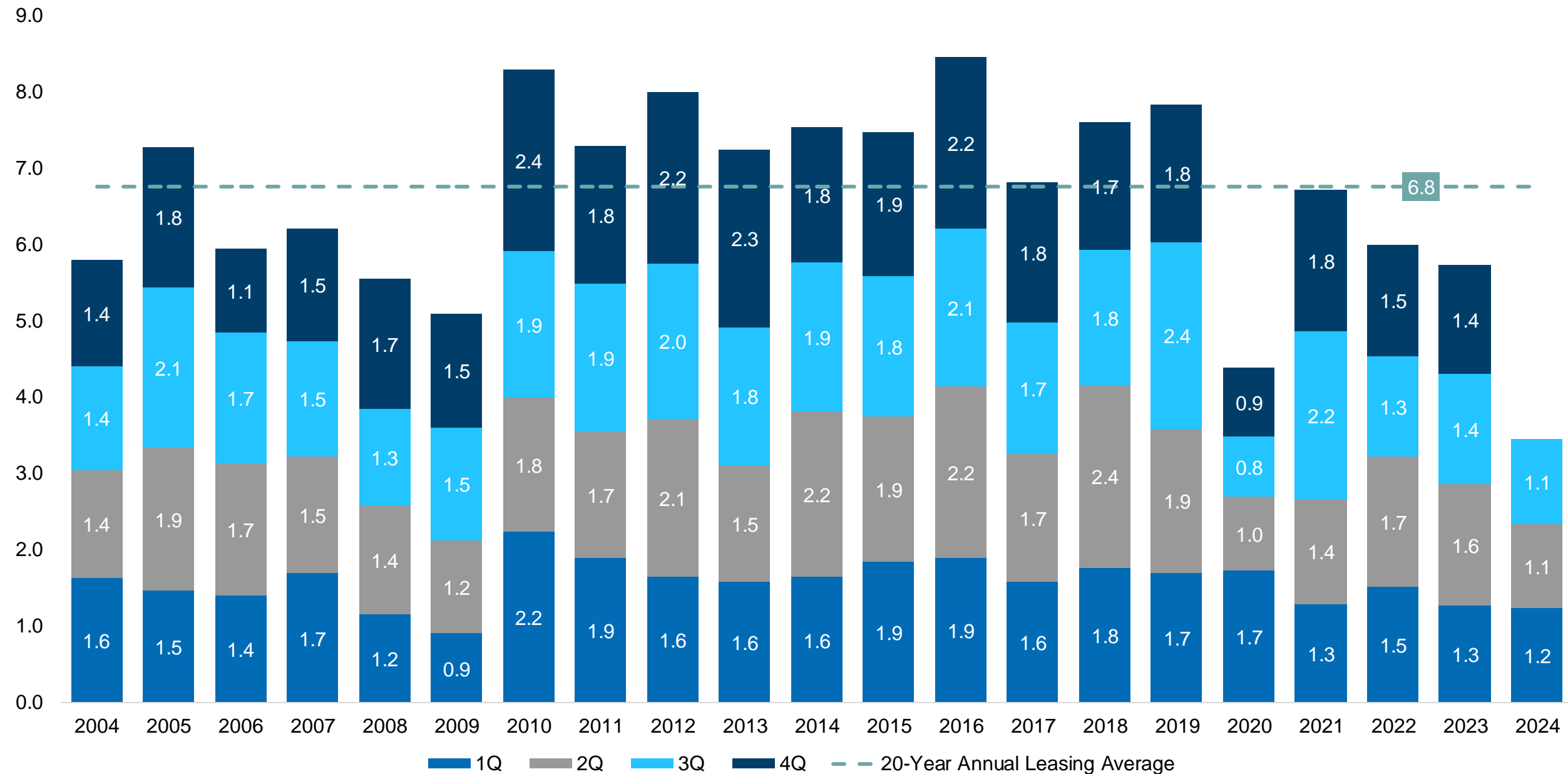


Source: Newmark Research

# Leasing Activity Continues to Slow

Leasing activity has lagged the historical annual average of 6.8 MSF every year since 2019 and has steadily decreased every year since 2021. The third quarter of 2024 saw 1.1 MSF in leasing activity and the first three quarters of the year have logged the lowest year-to-date leasing activity (3.4 MSF) in at least 20 years. Demand has softened amid office-using job declines and economic shifts to other employment sectors.

Total Leasing Activity (MSF)

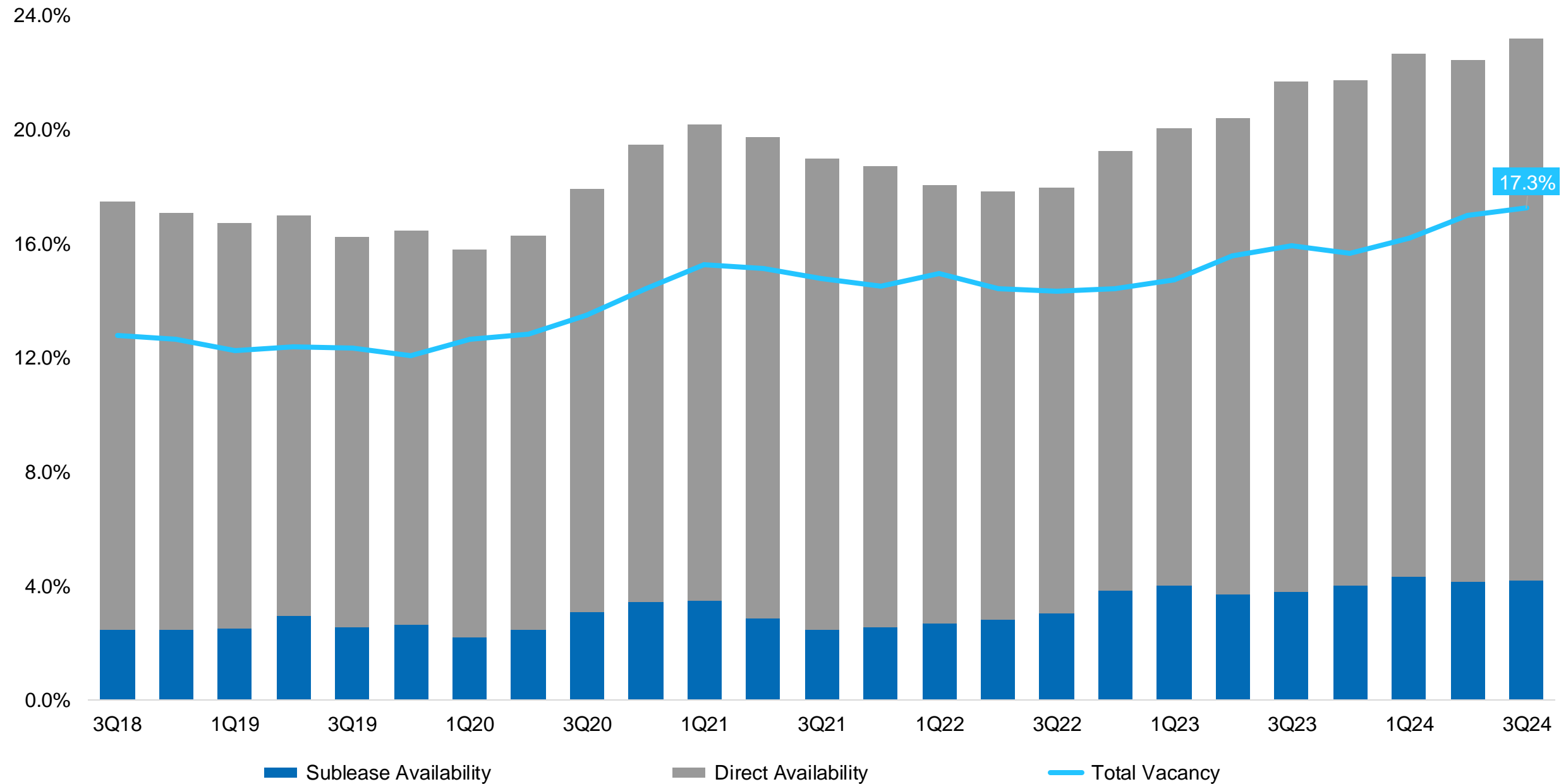


Source: Newmark Research, CoStar

# Vacancy and Availability Remain Elevated

Vacancy has climbed from 14.9% two years ago to 17.3% as supply has consistently outstripped demand for new space. Sublease availability has remained relatively stable over the past year, currently at 4.2%, but direct availability has steadily increased during the same period. Most of this new direct availability has not come from newly delivered projects but former sublease spaces being taken directly to market by landlords after failing to find subtenants.

Available Space and Total Vacancy as Percent of Overall Market

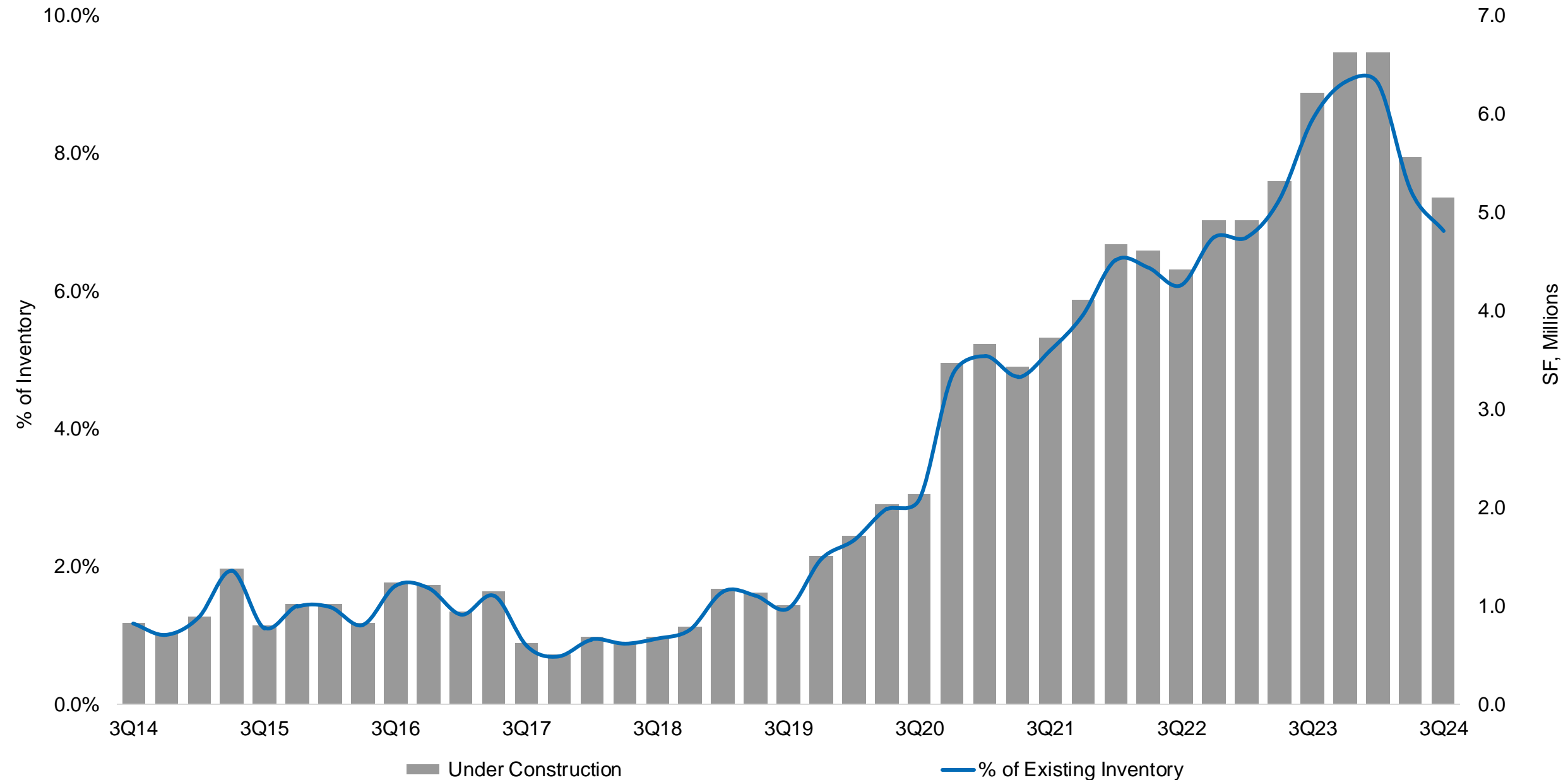


Source: Newmark Research

# Construction Falls From Record High With New Deliveries

Office construction boomed during the recovery and is now tapering off as market conditions soften. There are currently 5.2 MSF in projects under construction, down from last quarter after 1.1 MSF delivered. Downtown has the most construction activity, including IQHQ's Research and Development District (a ground-up, 1.7-MSF life science and office campus) and Stockdale Capital's Horton Plaza (a 700,000-SF creative-office conversion of an obsolete shopping mall).

## Office Under Construction and % of Existing Inventory

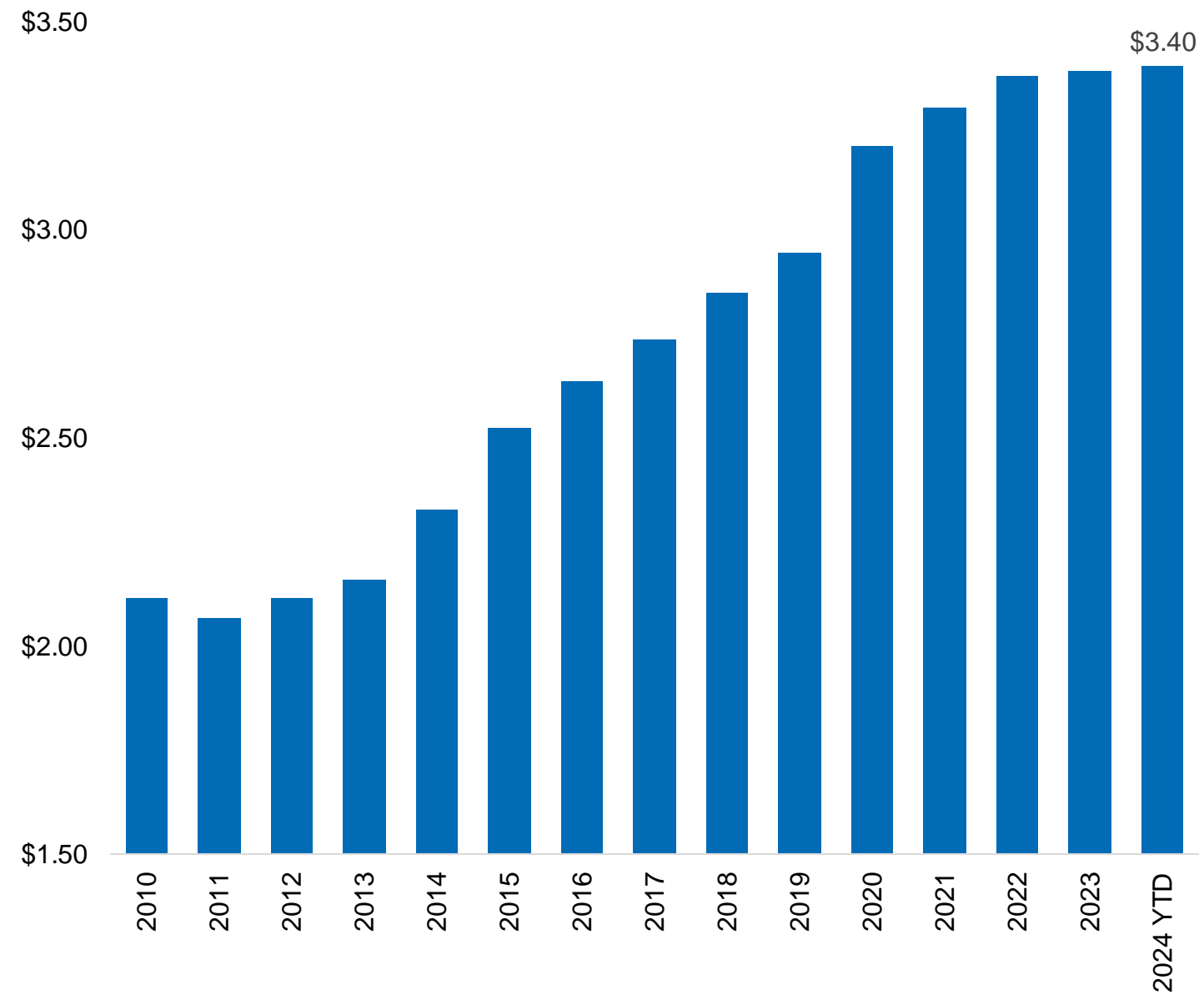


Source: Newmark Research, CoStar

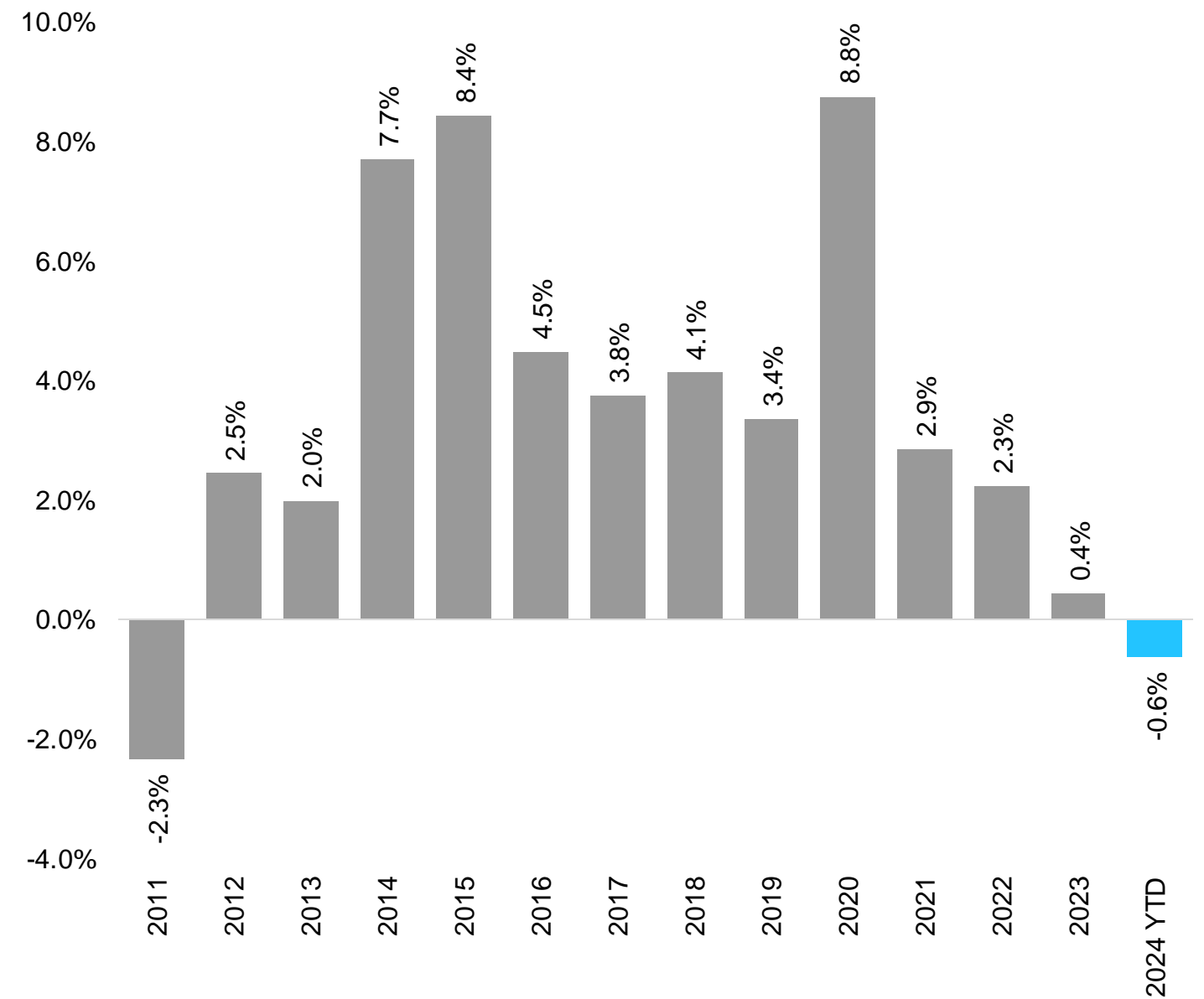
# Rent Growth Levels Off After a Decade of Steady Increases

Rising vacancy and declining demand have taken their toll on asking rates, which have stalled out and climbed to \$3.40/SF from \$3.39/SF last year. Modest annual rent growth since 2022 has underperformed the rate of inflation. Landlords who had long held to high asking rates are starting to cut prices in the face of persistent vacancy; asking rents have fallen 0.6% over the year-ago quarter.

Office Average Asking Rent, \$/SF/Month, FS



Year-over-Year Asking Rent Growth Rate

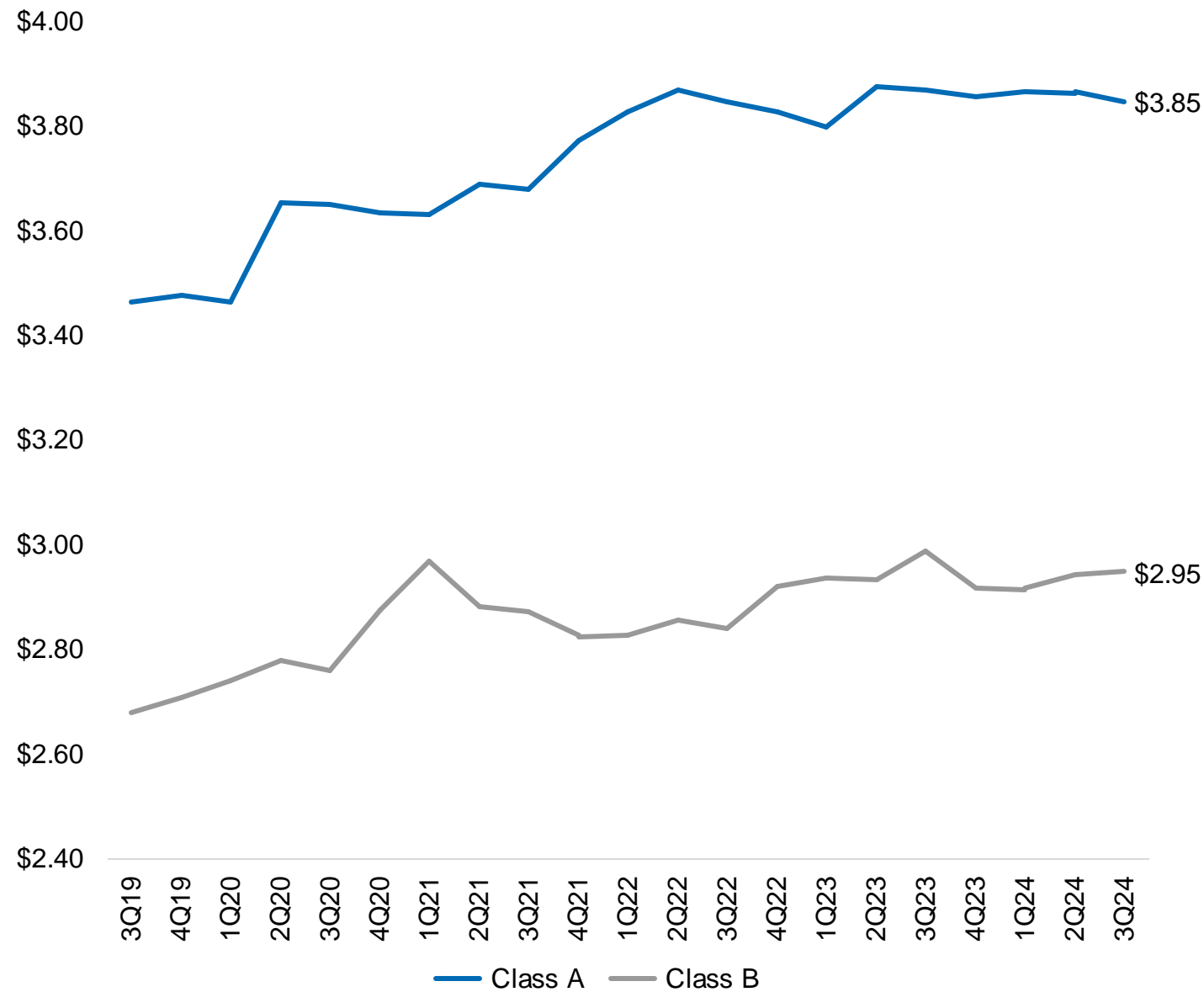


Source: Newmark Research, CoStar

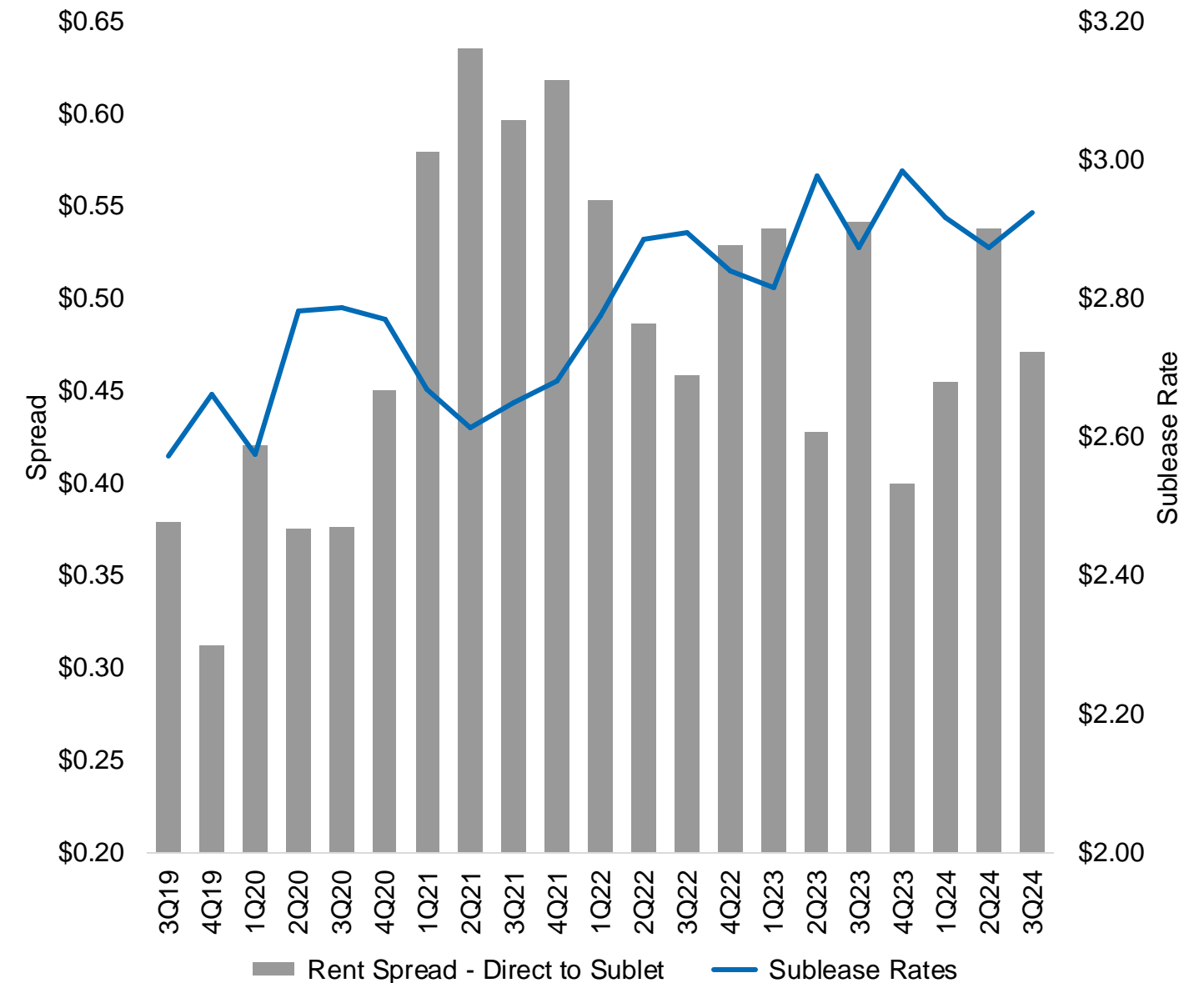
# Class A and B Rents Flatten Out

Asking rates have softened across the board, although Class A rents have been under more pressure than Class B projects over the past year as tenants look for more affordable space. Sublease rates have fluctuated as large blocks of modern space periodically hit the market. The spread between sublease and direct rates has widened since 2019, when it was unusually low, and sublease space currently averages a \$0.47/SF discount to direct space.

**Class A and Class B Asking Rents, \$/SF/Month, FS**



**Sublease Asking Rates**



Source: Newmark Research, CoStar

# Notable Lease Transactions

Life science tenants accounted for two of the five largest lease deals of the third quarter, with Mirador Therapeutics and Genesis Therapeutics leasing spaces at under-construction and recently delivered projects. Ship builder NASSCO renewed its space in Mission Valley and the City of San Diego signed a lease to relocate the rest of the Development Services Department to 550 W C Street as it vacates the aged City Operations Building.

## Notable 3Q24 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
General Dynamics	7470 Mission Valley Rd	Mission Valley	Renewal	67,346
<i>General Dynamics renewed office space for its NASSCO ship-building division.</i>				
Mirador Therapeutics	4902 Headquarters Pt	Sorrento Mesa	New Lease	66,569
<i>Drug discovery company founded in 2024 leased half a building in the under-construction Headquarters Point project.</i>				
City of San Diego	550 W C St	Downtown	New Lease	43,460
<i>The City will relocate the Development Services Department from the old City Operations Building.</i>				
Genesis Therapeutics	4930 Directors Pl	Sorrento Mesa	New Lease	37,400
<i>Genesis Therapeutics took one floor of Healthpeak's Directors Science Park project, which delivered last year.</i>				
Lennar	13520 Evening Creek Dr N	Rancho Bernardo	New Lease	23,973
<i>Home builder Lennar leased a full floor at Kilroy Sabre Springs.</i>				

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## Available Spaces Becoming Larger with New Construction

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# Submarkets



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Downtown Has the Highest Vacancy, Del Mar Heights the Highest Asking Rent

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## Sublease Availability by Submarket

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Downtown Has the Most Construction, Portending More Vacancy to Come

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## Downtown Also Has a Large Pipeline of Ground-Up Multifamily Projects

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# Capital Markets & Life Science



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## Office Sales Volume Has Declined Significantly

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## Sales Volume for Other Product Types Has Recovered From Last Year

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# Private and Institutional Buyers Account for the Bulk of Investment

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## Price Per Square Foot Has Fallen as Cap Rates Have Recovered

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## Life Science Continues to Attract Funding

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# Life Science Mergers and Acquisitions Continue Strong

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*For more information:*

**Brent Don**

*Research Manager  
San Diego*

brent.don@nmrk.com

**Dain Fedora**

*Head of Research  
Southwest*

dain.fedora@nmrk.com

**San Diego**

4655 Executive Dr, Suite 800  
San Diego, CA 92121  
t 858-875-3600

**New York Headquarters**

125 Park Ave.  
New York, NY 10017  
t 212-372-2000

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