San Diego Industrial Continues to Normalize as Vacancies Rise

4.2%
Vacancy Rate

(525,516)
SF Net Absorption

2,191,449
SF Under Construction

$1.38 NNN
Low-finish Lease Rate

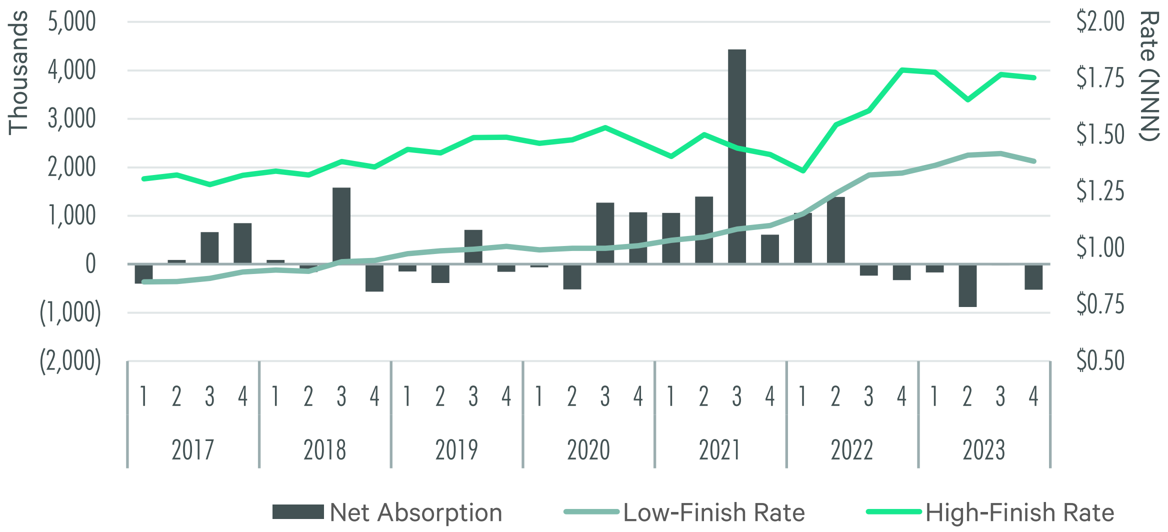
$1.75 NNN
High-finish Lease Rate

Note: Arrows indicate change from previous quarter.

HIGHLIGHTS

- While both vacancies and availabilities remained tight compared to the pre-pandemic norm, the total vacancy rate grew in Q4, at 4.2%, and total availability rose by 40 bps, to 6.6%.
- Net absorption landed in the red for a sixth consecutive quarter down from Q3 to (525,516) sq. ft.
- Leasing activity totaled just over 1.5 million sq. ft., lower compared to the activity seen in previous quarters of 2022.
- The average low-finish asking rate dropped for the first time since 2020, decreasing by $0.04 to $1.38 NNN, and high-finish rents remained subject to quarter-over-quarter (Q-o-Q) volatility, dropping by $0.02 to $1.75 NNN.
- The county gained several new industrial projects in 2023, with over 2 million sq. ft. now under construction, still slightly below the peak levels of 2020-21. The fourth quarter also saw the delivery of 684,152 sq. ft. of new construction.

FIGURE 1: Net Absorption vs. Asking Lease Rate



Source: CBRE Research, Q4 2023

Market Overview

The San Diego industrial market experienced a pullback in 2023, following the unsustainable levels of activity that came during the height of the COVID-19 pandemic. While vacancies increased and demand softened, fundamentals remained healthy in the fourth quarter and, in most cases, are continuing to outperform their respective historical averages. One of the most notable indications that the market remains strong was in the ongoing growth of asking rents throughout the year.

Looking ahead, San Diego will benefit from a relatively finite supply of industrial product. Most submarkets have little room for growth, which will stunt new construction and keep supply-driven pressure to a minimum. The only supply relief seen in Q4 mainly came from South San Diego submarket, as six new deliveries came to the market. San Diego also has the advantage of a diverse employment market that appears to be on firm footing, despite the more than year-long predictions of a nationwide recession. Industrial hiring, even if not on par with some recent quarters, continued through the fourth quarter of the year. The local industrial market is well positioned for the future and, though vacancies could move higher, modest inventory expansion and a growing economy should hold fundamentals in check.

UNEMPLOYMENT

San Diego's unemployment rate compressed by 10 basis points (bps) in November, to 4.2%. Slightly down from the previous high in August and a 130-bp hike from the 12-month low of 2.9%. Unemployment in San Diego was lower than the state norm, but like the previous five months, it was higher than the U.S. average. Job growth in 2023 has slowed, including for industrial-using employment. However, over the 12-month period ending in November, the number of county industrial jobs increased by 3.4%.

LEASE RATE ANALYSIS

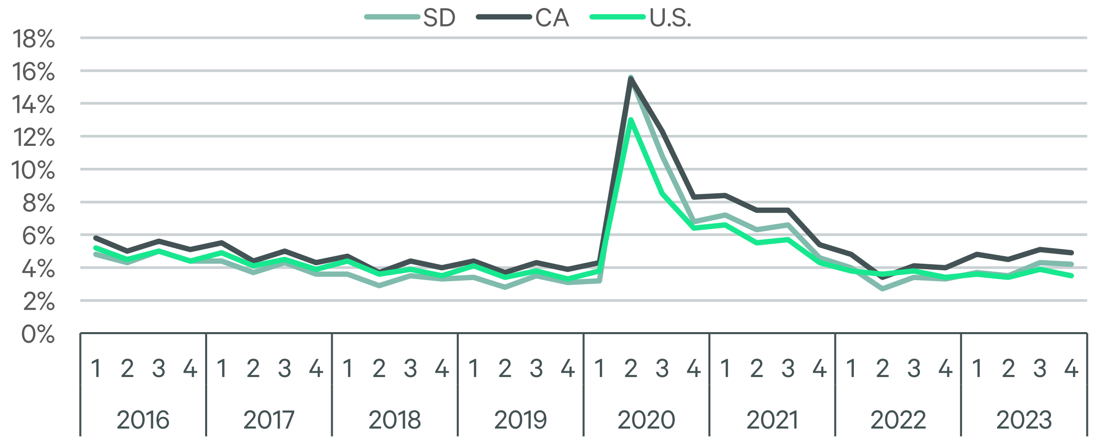
Industrial demand has softened, but lease rates have shown consistent resiliency in 2023. Although average asking rents went down in Q4, their annual growth has provided strength for the industrial market. Low-finish rents especially were a source of stability. Low-finish asking rates rose to $1.38 a nearly 4% hike Y-o-Y.

High-finish product, despite fluctuating Q-o-Q due to market volatility, saw rents decrease in Q4, to $1.75. That was only 1.1% lower from Q3, but still on par with previous quarters reporting a slight decrease of 2.2% Y-o-Y.

As a result of higher negative net absorption and increased vacancies, asking rates in the five major submarkets of San Diego have fluctuated in the fourth quarter. Central San Diego and South County saw asking rates hold steady from Q3 whereas North County and SW Riverside saw marginal decreases in rates.

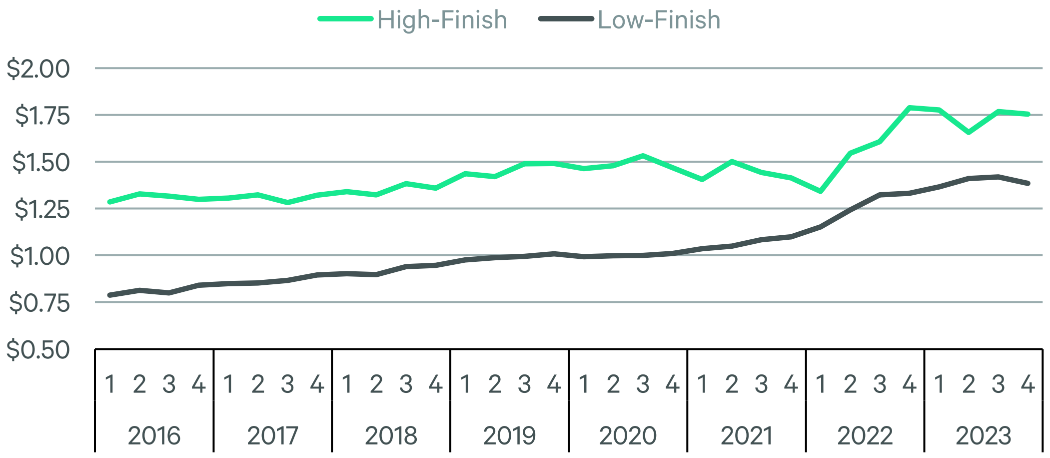
While South San Diego's average lease rate went unchanged in Q3, Otay Mesa, its largest territory, saw rents grow by nearly 7% Y-o-Y. Much of San Diego's recent construction has been concentrated in Otay Mesa and with recent deliveries in Q3 total availabilities in the region rose by 290 bps to 11.8%.

FIGURE 2: Unemployment Rate (%)



Source: U.S. Bureau of Labor Statistics, Q4 2023

FIGURE 3: Average Asking Lease Rate ($PSF/MO/NNN)



Source: CBRE Research, Q4 2023

VACANCY & AVAILABILITY

After four consecutive quarters of rising vacancies, San Diego's total vacancy rose in Q4 at 4.2%. Additionally, the total availability rate expanded 20-bp Q-o-Q to 6.6%. Those levels, however, are on par with the market's historical norms. San Diego's average industrial vacancy rate from 2018-22 was 3.8%, and for the three years preceding the pandemic (2017-19), total vacancies averaged 4.1%.

Historical availability rates similarly show that the market remains healthy, and especially compared to pre-COVID levels. From 2017-19, the average total availability rate was 6.9%, 30 bps higher than Q4's figure.

Among product types, low-finish vacancies grew to 4.2%, while high-finish decreased by 10 bps Q-o-Q, ending the quarter at 3.7%.

The vacancy rate increased in four out of the five submarkets, with the largest upturn coming in South San Diego; vacancies moved from 5.6% to 7.2%. In contrast, North County, East County, and SW Riverside all saw vacancies rise marginally, while Central San Diego held steady unchanged at 3.3%.

As a result of expanding vacancies in 2023, sublease availabilities have continued to grow this quarter. Sublease availabilities rose throughout 2023 with several large blocks of space being added to the market in previous quarters. In Q4, sublease availability increased by 10 bps with thirteen subleases between 50,000 – 100,000 sq. ft. currently still on the market ready for activity.

NET ABSORPTION & LEASING ACTIVITY

San Diego's industrial market continued to correct in Q4 following the COVID-era surge. Demand was negative for a sixth-consecutive quarter, with net absorption totaling (525,516) sq. ft., while leasing activity totaled just over 1.5 million sq. ft.

Demand throughout San Diego has been normalizing, with three submarkets landing close to net zero and two reporting the bulk of move-outs in Q4. Of the two submarkets, Central San Diego reported (234,800) sq. ft. of absorption and South San Diego saw (221,428) sq. ft. of space return to the market.

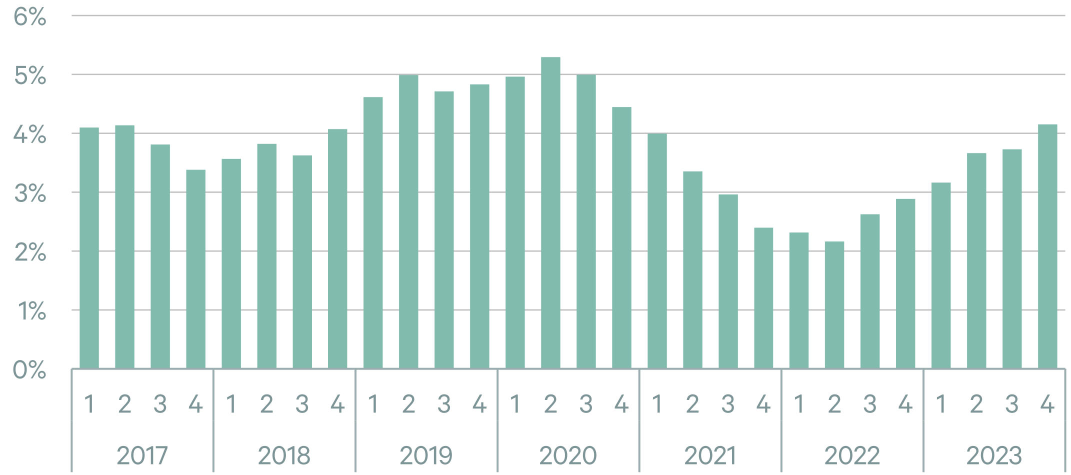
Still, South San Diego was home to one of Q4's largest new leases. In Otay Mesa, DC Logistics signed a lease at 9050 Airway Rd., for the full RBA of 59,905 sq. ft.

Low-finish space makes up nearly 85% of industrial product, and it likewise accounted for the bulk of negative demand, with net absorption totaling (424,147) sq. ft. Of the subtypes, warehouse/distribution was the strongest in terms of leasing activity with 686,809 sq. ft. of activity in Q4.

One reason Q4 activity did not match most recent quarters was a lack of large deals. No new leases 100,000 sq. ft. or greater were signed.

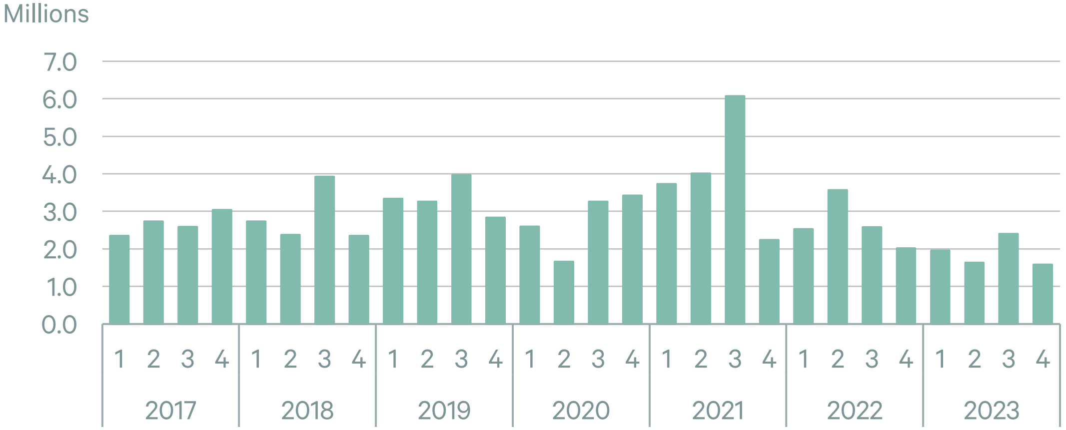
The negative absorption of recent quarters may provide a potential benefit. Many occupiers have struggled to meet their space needs due to a lack of availabilities, but the recent uptick could provide a boost to those tenants, particularly in the most impacted submarkets.

FIGURE 4: Vacancy Rate (%)



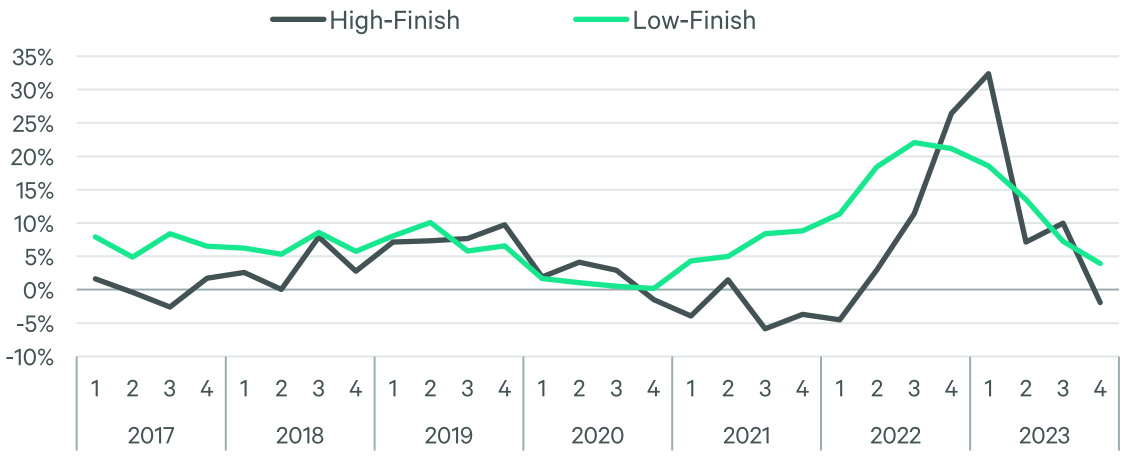
Source: CBRE Research, Q4 2023

FIGURE 5: Leasing Activity (SF in millions)



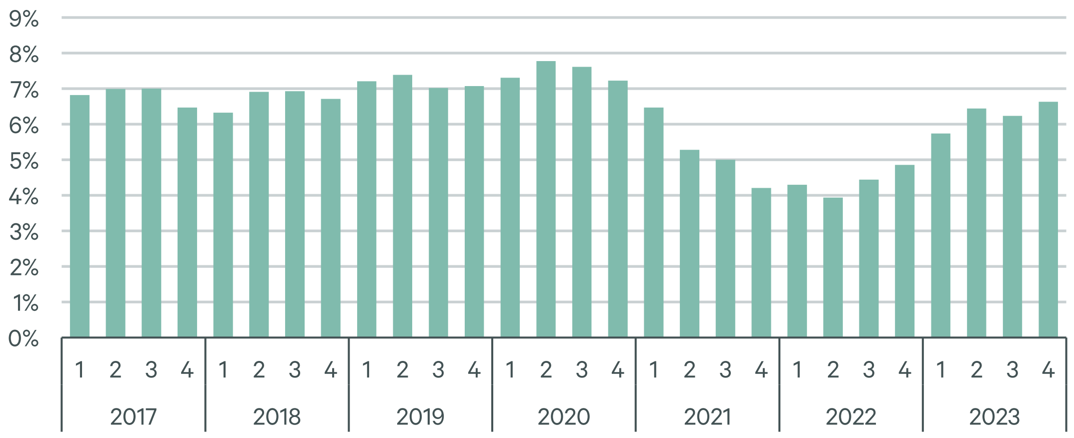
Source: CBRE Research, Q4 2023

FIGURE 1: Historical Avg. Asking Lease Rate Growth (%)



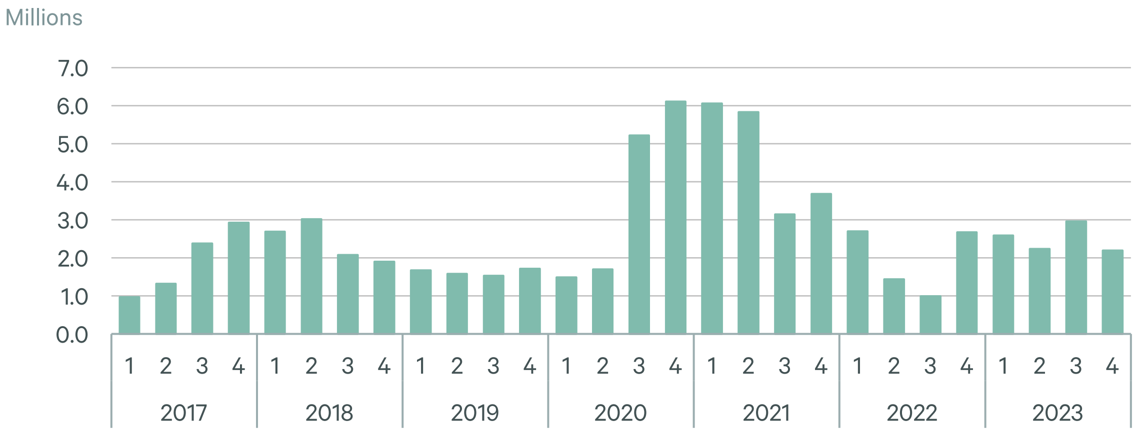
Source: CBRE Research, Q4 2023

FIGURE 2: Historical Availability (%)



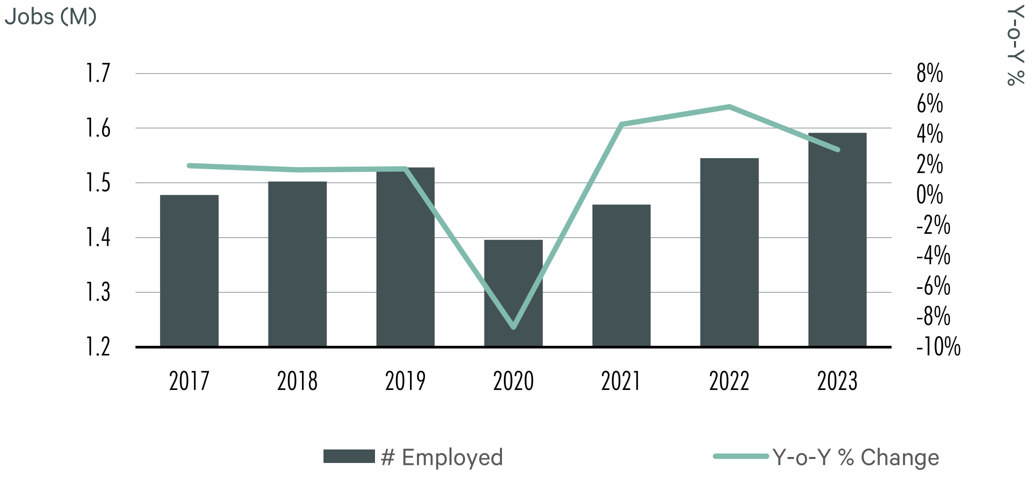
Source: CBRE Research, Q4 2023

FIGURE 3: Historical Under Construction (SF)



Source: CBRE Research, Q4 2023

FIGURE 4: Year-Over-Year Job Growth



Source: CBRE Research, Q4 2023

FIGURE 5: Market Statistics

	RBA	Total Vacant	Total Available	Net Absorption	Under Construction	Construction Deliveries	Asking Rate Low Finish	Asking Rate High Finish	Leasing Activity
Central San Diego	64,369,310	3.2%	5.4%	(234,131)	216,800	0	$1.65	$1.99	347,943
East County	15,108,154	1.1%	2.4%	(39,217)	384,501	0	$1.33	$1.41	37,735
North County	50,656,191	4.0%	7.2%	(2,139)	254,118	0	$1.36	$1.62	618,667
South San Diego	38,939,427	7.2%	9.5%	(221,428)	1,277,445	684,152	$1.29	$1.44	474,832
Southwest Riverside	15,043,833	4.0%	7.1%	(28,601)	58,585	0	$1.09	$1.08	101,409
San Diego Totals	**184,116,915**	**4.2%**	**6.6%**	**(525,516)**	**2,191,449**	**684,152**	**$1.38**	**$1.75**	**1,580,586**
High-Finish	**31,659,937**	**3.7%**	**7.4%**	**(101,369)**	**0**	**0**	**$0.00**	**$1.75**	**128,779**
Business Park R&D	8,574,440	3.8%	5.4%	(26,219)	0	0	$0.00	$1.55	67,882
R&D	23,085,497	3.7%	8.1%	(75,150)	0	0	$0.00	$1.84	60,897
Low-Finish	**152,456,978**	**4.2%**	**6.5%**	**(424,147)**	**2,191,449**	**684,152**	**$1.38**	**$0.00**	**1,451,807**
Business Park Ind	25,748,157	3.4%	4.8%	(18,878)	0	0	$1.46	$0.00	328,109
Warehouse / Distribution	60,273,053	6.7%	9.5%	(357,967)	2,191,449	684,152	$1.41	$0.00	686,809
Manufacturing	66,435,768	2.3%	4.4%	(47,302)	0	0	$1.31	$0.00	436,889

FIGURE 6: Key Lease Transactions

Occupier	Industry Sector	Location	Subtype	Total Sq. Ft.
Mad Engine	Consumer Products & Services	Otay Mesa	Warehouse/Distribution	104,180 (R)
K-1 Speed	Other	Carlsbad	Light Manufacturing	70,224 (R)
Westlake Royal Roofing	Consumer Products & Services	Oceanside	Warehouse/Distribution	66,780 (R)
DHL	Transportation / Logistics	Otay Mesa	Warehouse/Distribution	61,433 (R)
DC Logistics	Transportation / Logistics	Otay Mesa	Warehouse/Distribution	59,905

Source: CBRE Research, Q4 2023

Renewal = (R)

FIGURE 7: Key Sale Transactions

Property	Buyer	Location	Total Price	$/Sq. Ft.	RBA
Britannia Tech Park	Hines	Otay Mesa	$60.9M	$299	203,244
Cabrillo Business Park	H. G. Fenton Company	Kearny Mesa	$39.5M	$359	110,033
Palomar Corp. Center	Chandru Wadhwani	Vista	$29.4M	$287	102,239
15330 Avenue of Science	Helix Electric	Rancho Bernardo	$26.3M	$357	73,756
5801 & 5807 Van Allen Way	Harbor Associates	Carlsbad	$21.2M	$207	102,360

Source: CBRE Research, Q4 2023

Source: CBRE Research, Q4 2023

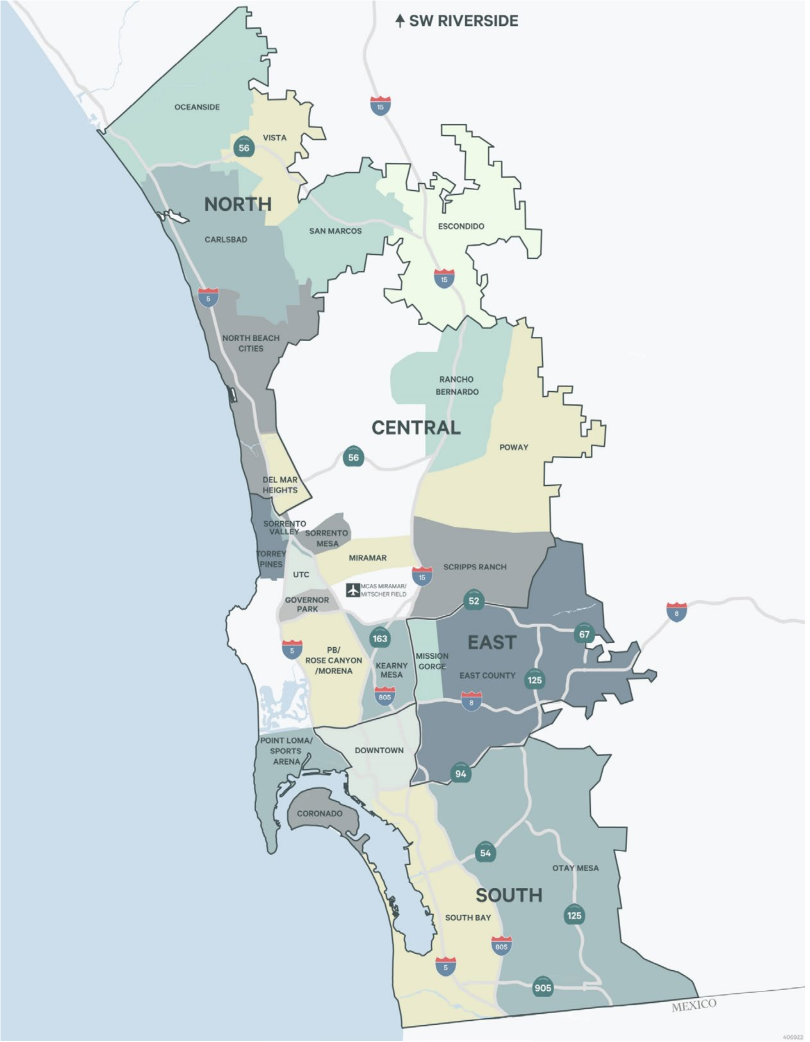
Market Area Overview

Definitions

Net Rentable Area The gross building square footage minus the elevator core, flues, pipe shafts, vertical ducts, balconies and stairwell areas. Available Sq. Ft. Space Available for lease which is either physically vacant or occupied. Includes Subleases. Vacant Sq. Ft. Portion of Available sq. ft. which is either physically vacant or immediately available. Includes Subleases. Direct Vacancy Sq. Ft. Portion of Available sq. ft. which is either physically vacant or immediately available. Excludes subleases. Vacancy Rate Vacant sq. ft. divided by the NRA. Occupied Sq. Ft. NRA not considered vacant. Net Absorption The change in Occupied sq. ft. from one period to the next. Positive absorption is reflected when a lease is signed, which may not coincide with the date of occupancy. Average Asking Lease Rate The rate determined by multiplying the asking gross lease rate for each building in the summary by its associated available space, summing the products, then dividing by the sum of the available spaces with gross lease rates for all buildings in the summary. Direct leases only; excludes sublease space and parking charges. Full Service Gross (FSG) Lease Type whereby the landlord assumes responsibility for all of the operating expenses and taxes for the property. Normalization Due to a reclassification of the market, the base, number and square footage of buildings for previous quarters have been adjusted to match the current base. Availability and Vacancy figures for those buildings have been adjusted in previous quarters.

Inventory Update

Effective Q1 2022, Lab space has been removed from the Industrial inventory and will be reported as a separate property type. Lab space has been removed from historical data so figures reported previously may have changed.



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