2021 SAN DIEGO REGION

Real Estate Trends Report

Photo by Scott Murphy

ULI San Diego/ Tijuana

Welcome to the San Diego-Tijuana 2021 Emerging Trends in Real Estate Report.

Brian F. Mooney FAICP

Principal, RICK Engineering Company
District Chair 2020-2022, San Diego/Tijuana ULI

The Urban Land Institute (ULI) is a leading voice in real estate regionally, in the US and throughout major global markets. Our "Emerging Trends in Real Estate" is a trend and forecast publication now in its 42 edition, and it is considered one of the most highly regarded forecast reports in the real estate and land use industry. The year 2020, due to the worldwide pandemic for COVID-19, has reshaped the playing field for multiple industries, which in turn has had a significant impact on the real estate industry. On a national scale, the ULI Emerging Trends Report has focused on "Dealing with Certain Uncertainties," and to better understand these issues and how they affect our local San Diego-Tijuana region, our District Council decided to develop a focused study by local professionals to delve into the market trends that relate to our real estate and land use issues.

The local version of Emerging Trends in Real Estate looks at the key market sectors for Office, Industrial, Hotel/Hospitality, Retail, For-Sale Housing, Rental Housing and Affordable Housing. We have also included a Special Report on State and Local Policy that will affect real estate trends. A review of Tijuana and its regional markets is being produced as a separate report.

Our team at the San Diego-Tijuana ULI has conducted interviews with key leaders, developed a questionnaire to help build on the research and interviews and analyzed the potential trends for 2021 and 2022. The result is a report that critically examines and draws conclusions on what to anticipate in these varying land use categories. I believe it will help both public and private professionals, agencies and businesses make informed decisions relating to potential land use and investment opportunities.

I look forward to learning your comments on this new and important endeavor, and to all the professionals, business leaders and government officials that have helped make this a reality, I thank you.

Brian F. Mooney, FAICP
San Diego-Tijuana ULI, District Chair 2020-2022

ULI San Diego-Tijuana would like to thank and recognize the many people who contributed to this local Real Estate Trends Report.

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2021 SAN DIEGO REGION

Real Estate Trends Report

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Executive Summary

From EVOLUTION TO REVOLUTION

by Gary H. London, Senior Principal, London Moeder Advisors

Oh, what a year it was. Even though forecasting is, at best, a business fraught with failure, the year 2020 started with economic forecasts, including those of ULI, blindingly absent of any real sense of the economic calamity that would play out as a response to global pandemic. Most of those forecasts portrayed 2020 as a mirror image of 2019, with continued economic prosperity showing no real sign of impending recession, and all systems more or less "go".

All systems were not "go" as the world, the U.S. and the San Diego region experienced a full year of economic deep freeze, pending vaccination as the likely solution to end the ravaging of the disease and reopen the economy. The nation has lost nearly ten million jobs in the past year. Over that time, the unemployment rate surged from 3.5% in January 2020 to 6.7% by the end of the year. The high point was 14.8% in April. In San Diego, there still is the sobering reality that the region lost an estimated 70,000 to 105,000 jobs last year, particularly in the lower wage and economically vulnerable sectors, and there is no letup in the region's high cost of living.

The economic salvation of the San Diego region has always been the military, an employer which counts 150,000 persons who always meet their payroll. There are 354,000 military connected jobs accounting for 22 percent of all jobs in the region. But there is also an increasingly diversified mix of tourism, technology, life science, healthcare, manufacturing, and general business (most of which are small). Implication? A deficiency in one sector (tourism, for instance, this past year) does not take down the whole economy.

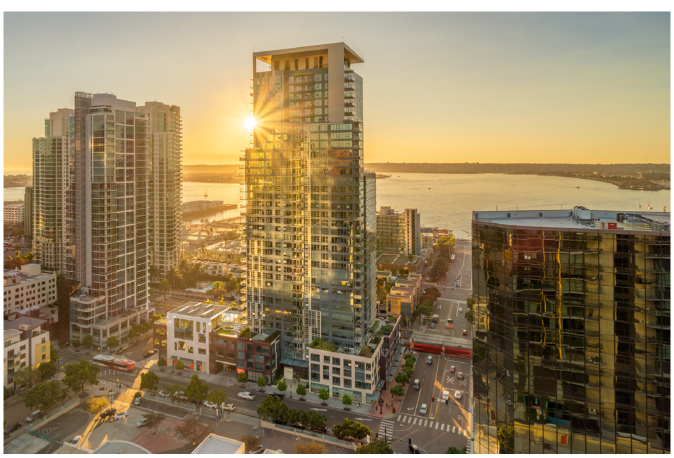


Photo by Scott Murphy

Because real estate is a reflection of the physical places which accommodate all of our activities, persons in the land use and real estate business have only to look to the pace of vaccination to offer some prediction on the pace of recovery of the real estate market.

To be sure, some aspects of real estate were more burdened than others. Those relative burdens are detailed in this Trends report and summarized here. But none of the real estate sectors have been left unscathed. There are both temporary and permanent changes in their use, occupancy and relevancy which will be reflected in their future performance. The more "sticky" changes have been catalyzed by the pandemic. But they were going to happen anyway. What the pandemic wrought was a sooner-than-expected alteration in use and occupancy. That suggests some permanence.

Other changes are not so sticky and are likely to shake off the aftereffects of pandemic as it slips further into our rear-view mirror. There are also silver linings for new types of real estate uses which are accelerating. The challenge for land use professionals is to be able to sort out the sticky from the temporary and make decisions on development,

COVID-19's Impact on Key Trends

Accelerated by COVID-19

- Work from home
- Move to Sun Belt states
- Suburban migration
- Public open space
- Retail sector transformation
- Importance of redundant supply chains
- Proptech shift to WFH & building safety
- Municipal/state fiscal issues
- Safety/health concerns in buildings
- Affordable housing crisis
- Concerns about racial equity
- Federal deficit
- Bikes & scooters

Stopped or slowed by COVID-19 (for now)

- Appeal of CBDs/density
- In-person conferences & meetings
- Experiential retail
- Leisure travel/tourism
- Business travel
- Mass transit use
- Apartment amenity wars
- Tourist-oriented retail
- Live entertainment
- University towns
- Student housing
- Global supply chains

National ULI 2021 Emerging Real Estate Trends Report

OVERALL REAL ESTATE PROSPECTS RANKING

1	Raleigh/Durham
2	Austin
7	Salt Lake City
13	Denver
15	Phoenix
17	Inland Empire
18	Orange County
28	Los Angeles
31	**San Diego-Tijuana**
60	San Francisco

HOMEBUILDING PROSPECTS RANKING

1	Raleigh/Durham
2	Austin
9	Denver
15	Orange County
18	Salt Lake City
24	**San Diego-Tijuana**
26	Phoenix
34	Inland Empire
63	Los Angeles
74	San Francisco

Rankings according to the National ULI 2021 Emerging Real Estate Trends Report

redevelopment, investment, and adaptive reuse in a way which is not over reaction, while not ignoring the long-term consequences.

San Diego's economy of $241.2 billion gross regional product is forecasted to grow by 4.3% in 2021 and 5.5% in 2022, above its 10-year average of 2.7%. The challenge for the real estate and land use sectors is to provide the built environment to accommodate that growth.

To offer perspective, we conducted research comparing San Diego to other major metropolitan areas, confirming that our region is performing well, with obvious relative advantages, including our economic diversification, our coastal location which encourages a "blue" economy, and high quality of life, which portend a healthy economic future. But there are also disadvantages, the most obvious being our high cost of living.

Our saving grace is that other California metropolitan markets (San Francisco-Bay area, Los Angeles, and Orange County) are more expensive and fraught with difficult regulatory frameworks, factors which encourage people and companies to look to us for expansion and relocation.

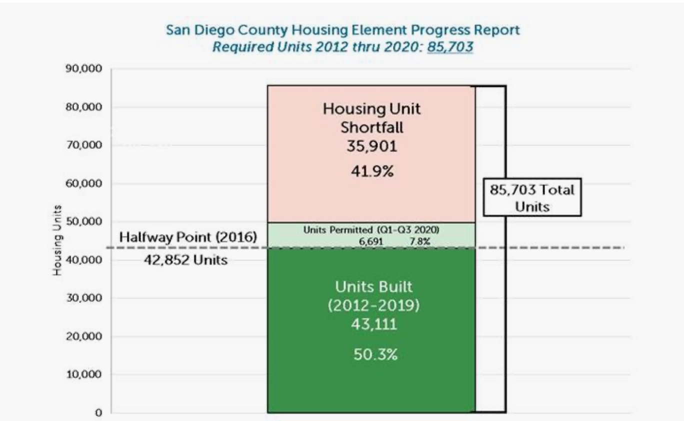
This year will also be unprecedented in the introduction and continuation of big projects and investments, at a level seldom, if ever, envisioned in the San Diego Region. Among these projects include:

- Early phase development of the Port's Chula Vista Bayfront; as well as continued planning for a new Seaport Village.
- San Diego State University's Mission Valley West campus, which is well underway.
- Mega-projects in San Diego's downtown in planning and/or construction including the completion of the conversion of Horton Plaza from predominantly retail to office; the buildout of the RAD project fronting San Diego Bay to create a giant commercial office and life-science footprint, as well as hotels and retail; the deal completion and entitlement of the San Diego Padres Tailgate Park project near Petco Park as a mixed-use, commercial office complex.
- The voter approved elimination of height restrictions in the Midway District and completion of negotiations on City-owned land to initiate the Sports Arena project by Brookfield Properties.
- Solidification of the proposed San Diego Regional Transportation Hub in a deal between the Navy and SANDAG on the old NAVWAR site, which one day could house thousands of housing units and commercial, sitting above multiple levels of transportation hub connected to the airport.

No doubt we neglected to mention a major project that is near and dear to someone including projects underway throughout San Diego's North and South County. In its totality it is a lot to take in, particularly amid a recession.

What follows is a summary of the trends and prospects, by sector. It is a report card on how we are doing.

Residential: The San Diego region housing market remains grossly under supplied in its housing counts, a problem that is likely to remain, perpetual, but has never been worse. Over the past eight years we have amassed a shortage of 36,000 units, with only 6,700 homes constructed in the past year. The need going forward is for the construction of 16,000 homes per year. The deficiencies cannot exclusively be made up in simply adding infill projects. The real world impacts have been a dramatic rise in home prices and rental rates, all of which have been exacerbated by a dramatic drop in resale listings, brought on by low interest rates and pandemic-induced protocols.



Source: London Moeder Advisors, SANDAG, RERC

Office: Vacancy rates have taken a significant jump, from 12% to 17%. Over time offices will reoccupy, but at a low level of near-term absorption, and overall demand will decline on a person per square foot basis as company's downsize and address flexible options. Lease rates are expected to decline at least 8% from 2020 as renewals will account for 42% of transactions. However, Downtown San Diego is expected to experience 3 to 5 million square feet of new construction starting this year, a result of life science and technology cluster expansion.

Retail: Retail employment has declined 13.5% over the past year, and no sector has experienced change as significant as competition from online, coupled with an overabundance of space are now taking their toll on 'sticks and bricks'. Shopping center vacancy was 6.1% at the end of 2020 and is rising. Expect dynamic activity in adaptive reuse, conversions and redevelopment.

Industrial: This sector has remained strong, and new development on Otay Mesa will result in the addition of 5.6 million of the roughly 6 million square feet under construction in the region, the largest project being the completion of a 3 million square foot Amazon facility. Much of this sector has been adapted to serve retail warehousing, high tech and defense related activities.

Hotel: This sector, which is perennially the riskiest in the real estate food chain experienced the perfect storm in 2020. Historic high occupancy of 90% one year ago dropped to 50% today, while rates have declined from $180 to $130 per night. It's pretty simple: if we cannot travel, hold conferences or conventions then hotels do not get occupied. However, our forecast is one of optimism, as post-pandemic travel will dramatically increase during the second half of 2021, although business, conference and convention demand will trail. Overall, the hotel sector will take several years to restabilize.

Capital Markets: As in every recession, opportunity funds will emerge. So called "bottom fishing" is a defined art in the real estate investment world, and capital will be available. However, the level of underwriting scrutiny will be high as developers must defend new projects in the throes of a recession and unprecedented change in real estate demand along all asset classes. Expect no bargains in the apartment sector, but there are likely to be opportunities for investment in the commercial sectors. Supporting new development are the lowest interest rates in modern times, which favor the spectrum of debt lending.

A Word on Land Use Policy, Population Growth, and the Regional Economy

2020 was a Presidential political year, creating a sea change in national leadership. But it was no less a sea change in local leadership, with Democrats achieving solid control in both the City and County of San Diego. The City of San Diego adopted an inclusionary housing ordinance, middle income density bonus program, and two elements of the Complete Communities policy initiative. We expect that there will be an aggressive push to redeveloping and densifying existing communities, all to add housing and to revitalize. The City's Climate Action Plan also supports the efficiencies associated with urban development.

At the County level, things may get more difficult in an already onerous development climate involving San Diego's vast unincorporated lands. Perhaps 2021 is the year that the newly installed Board of Supervisors revisit how and how much housing they should accommodate, not a small challenge given the delicate balance between environmental consciousness and economic sustainability.

LOCAL MARKET PERSPECTIVE:
INVESTOR DEMAND

Austin	4.47
Raleigh/Durham	4.00
Denver	3.97
Inland Empire	3.79
Orange County	3.76
Los Angeles	3.73
Phoenix	3.73
Salt Lake City	3.72
San Diego-Tijuana	**3.70**
San Francisco	3.53

LOCAL MARKET PERSPECTIVE:
DEVELOPMENT/REDEVELOPMENT OPPORTUNITIES

Raleigh/Durham	4.03
Austin	3.75
Inland Empire	3.73
Phoenix	3.73
Salt Lake City	3.64
Orange County	3.55
Denver	3.51
San Diego-Tijuana	**3.39**
Los Angeles	3.30
San Francisco	2.88

The County has dedicated itself to reembark on its carbon offset program which, at the very least, will delay the over 10,000 housing units approved two years ago from starting construction. Who knows how much prospective new development a new Board of Supervisors will allow? But if last year's failure of Newland's large master plan in the form of a ballot measure is any indication, even the transportation rich unincorporated North County lands will remain green. This will paralyze the development of much needed housing for the middle class, young family market, whose heads of households are employed in San Diego, and who jam the I-15 corridor from their homes in faraway Riverside County in their carbon infested commute to their San Diego jobs.

The State of California has been considering and gradually implementing new legislation aimed at encouraging more housing, infrastructure, and transit. There is tension between new and proposed State legislation and local policy, politics, and control. There is also concern that these new policies may add to market interference, and the danger of making things worse, not better. But we do expect to see many new legislative proposals.

Of note is the second Port of Entry at Otay Mesa at the Mexican Border. This and other projects are meant to facilitate movement of people and goods, which heighten the interdependence of the San Diego/Tijuana greater metropolis by facilitating more efficient and greater movement along the various border crossings. It matters because Tijuana and the greater Baja region are experience a growth spurt of their own. An overview of the dynamic Tijuana real estate market will be issued as a separate San Diego-Tijuana ULI District Council Special Report.

The *San Diego Association of Governments* (SANDAG) is also considering its "Five Big Moves" program—Complete Corridors, Transit Leap, Mobility Hubs, Flexible Fleets, and the Next OS which is dedicated to creating policy and funding to integrate the transportation, infrastructure and housing needs of the San Diego Region over the next several decades. 2021 will be the year that the SANDAG Board may move forward with this plan.

A potential new challenge for our region is new growth. While the overall size of the 3.5 million San Diego region grew by a paltry 5,208 persons according to the 2020 U.S. Census, owed only to a natural increase of 15,633 persons, while a total net of 10,425 persons moved away. The San Diego region has historically grown by 20,000 to 40,000 persons each year. However, the rate of growth has slowed over the past four years. This is partially explained by recession, increasing home prices, dearth of new housing starts, and overall high cost of living.

However, something else may be at work. San Diego competes with other high-cost housing markets. Our deficiency is that we have historically been good at incubating companies, then subsequently losing them to other markets where the fruits of incubation are manufactured and brought to market. Local government has been more interested in investing public resources into tourism (such as current efforts to expand the Convention Center) and the military ("birds in the hand" so to speak) and not as aggressive as other regions in promoting the kinds of jobs and industry which generate the sustainable, high paying jobs, or in attracting a richer pool of investment capital. When we keep the firms, we reap the rewards, as with the life science cluster, which mostly incubate and stay.

Ultimately this could cause a slowdown in our regional economy. It is important that our political leadership throughout the region's 18 municipalities, the County and the numerous special districts recognize the marriage between a strong economy and the need to accommodate new growth at a reasonable pace. They can cause change through investment which leads and supports land use mandates, including transportation, communication/connectivity, and capital improvements. Each of the projects detailed in this report were preceded and catalyzed by some form of public investment. Over time these investments paid off. While 2021 represents a fiscal challenge to all, we expect that our policy leaders will be aspirational, and plan accordingly.

What follows is a summary of the trends and prospects, by sector. It is a report card on how we are doing. ULI remains committed to assist policy makers in addressing the challenges ahead for the San Diego Region.

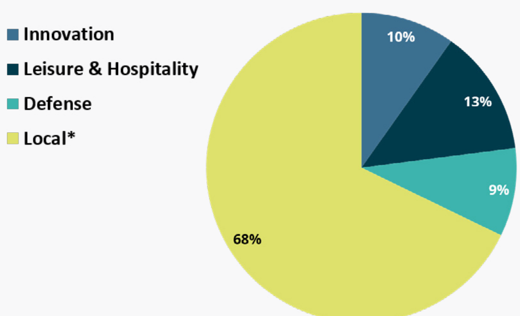
San Diego Region

ECONOMIC DEVELOPMENT PRIORITIES: 2021 & Beyond

by Eduardo Velasquez, Research Director, San Diego Regional EDC

With the largest military concentration in the world, a year-round tourist destination, and home to breakthrough technology companies and top-ranked research organizations, the San Diego region rebounded from the Great Recession, more prosperous than many of our peer regions due to our growing innovation cluster. San Diego is globally recognized as a tech and life sciences hub, leading in everything from medical device manufacturing and genomics to cybersecurity and 5G wireless communications. As a result, we've seen record inflows of venture capital in biotech and healthcare as homegrown companies rise to respond to the global pandemic. The industries that produce these life-changing and life-saving products and services are collectively known as San Diego's "innovation cluster" – they provide 10 percent of all jobs and are an important driver of economic growth. Each job in the innovation cluster supports another two jobs elsewhere in our economy.

JOB SHARE BY TRADED CLUSTER, 2019



Source: CA EDD, SDREDC Calculations.

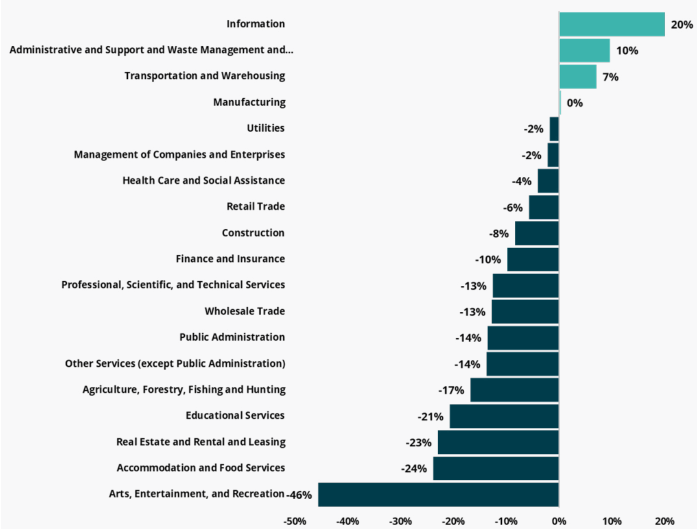
While more prosperous it continues to widen the economic disparities in ways that threaten our competitiveness and resilience. Over the last two decades, San Diego's economy has more than doubled in size. Meanwhile, the typical household has seen its income increase at roughly half that rate. Even before the COVID-19 pandemic, the majority of households did not earn enough to meet region's expected costs of living. To address the competitiveness challenge caused by rising inequality, we must focus on the building blocks of strong economy:

1. A strong local pipeline of skilled talent.
2. Quality jobs, particularly in small businesses, that enable economic mobility.
3. An affordable region with the infrastructure needed so that households can thrive.

Skilled Talent

More than anything else, San Diego companies depend on talent. From software engineers to machinists, and everything in between, innovation companies are always looking to recruit, retain, and develop the best and the brightest. Despite rapid growth and average wages of nearly $155,000 per year, many employers report difficulty filling positions. Rapid technological and demographic changes are likely to grow existing talent shortages. Hispanics are the region's fastest growing population and statistically the least prepared for high-skilled, high-wage jobs; they represent only 16% of current degree holders and almost half of today's seventh graders. The proportion of jobs requiring some form of post-secondary education is only expected to rise.

JOB POSTINGS BY SECTOR, YEAR-AGO CHANGE, DECEMBER 2020



Source: EMSI.

An increasingly high cost of living had made talent attraction and retention more difficult. The pandemic has made the region even more unaffordable even as more than 70,000 people have lost their job. Demand for skilled talent has rebounded while the surge of unemployed are primarily concentrated lower-skill occupations. Solving for this heightened mismatch of skills between employers' needs and available workers will be vital in the short term. In the long run, to meet the demands of San Diego's future economy, we will need to double the local production of skilled workers.

Quality Jobs

Small businesses (those with fewer than 100 employees) play a critical role in our economy. They represent 98 percent of all firms, employ nearly 60 percent of the total workforce – double the national average – and are responsible for nearly half of all job growth in the last five years. Despite their outsized importance to the region's economy, many small businesses report struggling to attract customers and generate new sales and have a lower concentration of quality jobs (those that pay middle-income wages) compared to their larger peers. The pandemic has hit small businesses especially hard. One in three is currently not operating, pushing revenues down 32 percent during the year. This comes after years of slowing new business formation.

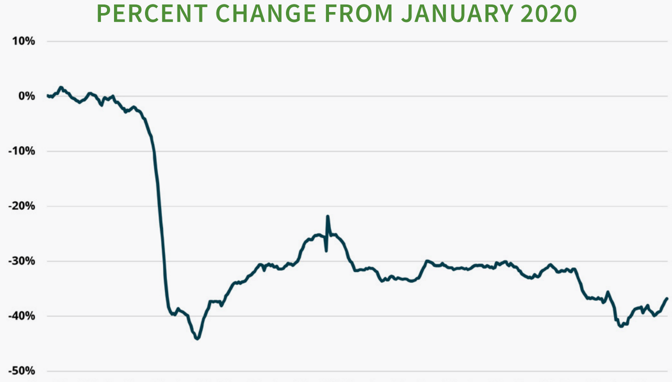
As we move into recovery, stabilizing small businesses and increasing their resilience is critical to the long-term health of the economy. We must expand and diversify small businesses' access to customers. That can be connecting them to international markets and large institutional buyers. For more locally-serving businesses, providing them big business tools such as digital storefronts and electronic payments processing will help them to recover in the short term and insulate them from future shocks. There is also newfound interest in employee ownership, which serves to boost employee retention and wealth creation while preserving the business itself after the retirement of its owner. This can be especially impactful for women and people of color, where rates of ownership remain low. All these strategies will help to grow the number of quality jobs in small businesses.

Thriving Households

Ensuring San Diego is an attractive and affordable place for talent and business is critical to maintaining its regional competitiveness. However, a majority of households in the region are not thriving, meaning their incomes do not meet the typical costs of living. San Diego is roughly 50 percent more expensive than the average metro area. This is driven in large part by the cost of housing, due to housing production not keeping pace with employment growth. As a result, San Diego has the second highest median home price among the 25 largest metros. However, a lack of transportation options and severe shortages in childcare are also major contributors. We must grow household incomes through the development of more skilled workers and the creation of more quality jobs, but we must also invest the infrastructure to meet the demands of our region.

The pandemic impacted every facet of life, from the needs of working families to how businesses operate. Companies in every industry are rapidly evaluating and changing the way they interact with customers, manage supply chains, and where their employees are physically located. This has massive immediate and long-term implications for San Diego's workforce, as well as regional land use decisions and infrastructure investment. Nearly the entire urban core of San Diego is being reimagined over the next decade, with multiple large development projects throughout the region concurrently being planned alongside a new regional transportation plan. Due to their size and timing, these developments have the potential to transform communities and create thousands of newly thriving households, should they provide more housing, better connect people and jobs, and promote transit.

SMALL BUSINESSES OPEN, PERCENT CHANGE FROM JANUARY 2020



Source: Womply.

Looking Ahead

The innovation cluster will lead us out of this pandemic-driven economic downturn—just like it has from each past downturn—but it is not currently accessible to everyone. In fact, high-wage jobs have already more than recovered from the recession. Meanwhile, low-wage jobs ended 2020 down nearly 30 percent. The stakes could not be higher that we get this recovery right. We must rebuild an economy that is more resilient than before, so prosperity reaches more people. It means ensuring that small businesses not only recover but thrive. It means that everyone—no matter the zip code they were born in—has access to opportunities and the education that enables them. It means designing a region where owning a car is not a requirement to access opportunities. For the region to fully recover and remain competitive, an inclusive economic development strategy is needed.

Learn more and get involved at inclusiveSD.org.

How SANDAG's Five Big Moves Could Reshape Our Region.

Q&A with **HASAN IKHRATA**

Executive Director, San Diego Association of Governments

> "Over the next few years the San Diego region will reimagine the future of its transportation."

Q A year into the pandemic, public decision making is obviously in a very different place than it was in early 2020. What are your expectations for the San Diego region over the next few years?

I strongly feel that it is time for San Diegans and our region to reimagine the future of our transportation and urban form throughout San Diego County. It is very challenging for many of our leaders to agree that this is what we need, or at least there are some who feel that we are fine where we are, but a region like San Diego cannot go for a long time without amazing projects, like the ballpark, that catalyze economic growth.

I believe the reimagining of both transportation and land use, the urban form of the future, the application of technology and the future of mobility has to happen. At SANDAG, I am working to advance what we call The Five Big Moves, which is a multimodal land use strategy with economic development emphasis.

In short, I expect that over the next few years the San Diego region will reimagine the future of its transportation.

Q Can you provide a bit more detail on the Five Big Moves?

The Five Big Moves is a plan made up of five strategies working in unison. You cannot pick just one and leave the other four behind.

The first is **Complete Corridors**. Every transportation corridor in San Diego, for example the I-5, should provide choices for people. If you choose to drive, you should not face any safety or congestion problems. If you choose to take transit, it should be as fast and convenient as a car. If you want to bike, you should feel safe with separated bikeways.

The second strategy is the **Transit Leap**. Many of our transit lines exist because a previous generation of leaders found an existing railroad line and decided to make it light rail. It doesn't mean that we did it to best connect communities, or change the urban form, or change our growth pattern. The Transit Leap means that we should be putting transit where the demand is. If that means we put it underground, so be it. If it means we put it elevated above the road, so be it.

The third is what we call **Mobility Hubs**. This is where new thinking about land use comes in. Consider the Navy NAVWAR site: at this location you can build a transportation hub, you can build housing, you can build office space, you can make it walkable and bikeable so that you can go into town, go see a movie or take your family out. The mobility hubs are how we are going to change the urban form and how San Diegans move about the region.

The fourth Big Move is what we call **Flexible Fleet**. Think of this as following the Uber or Lyft model. You don't need a big bus to carry five people around town. We can devise an on demand service in a flexible format, so before leaving home you can order your trip, pay for your trip, and when you walk out your door your ride is ready, and you don't need to worry.

This is a change in thinking to start seeing transportation as a utility. I believe our world is moving that direction whether we like it or not. Right now in Europe, this is becoming a big business. They treat transportation similar to electricity or water: you pay a baseline for basic trips and you pay more than that if you need more.

The fifth, and probably the most important, is the **Next Operating System**. This is how technology, apps and on demand service is going to link the four strategies above. With this we can redefine the future of transportation in California.

It doesn't have to be highway against transit, that is a failed strategy. Rather than pitting one transportation strategy against another, we need to have a strategy that includes all modes. That is how I hope to reimagine the future of transportation in San Diego.

Q Do you feel that San Diego is more supportive of those initiatives today than it was a few years ago? And do you feel like you have the political support?

If you had asked me that question before November 3rd, I would probably have said no. But today I am more optimistic. Today we have a board at SANDAG that believes in these Five Big Moves, especially Mayor Todd Gloria. Supervisor Nathan Fletcher has become the Chair of the Board of Supervisors and he believes in our vision.

It seems clear to me that this strategy will reach the finish line in terms of the support from our leaders. The bigger question to me is - Will the region be willing to pay $177 billion over the next 30 years? That decision is up to San Diegans.

If enough people in our region believe in this vision and believe there is something in it for them, then it will become reality. I am optimistic given my experience in Los Angeles where we got four sales tax measures passed. I believe that next year some time we will be able to go to the voters, and I believe our region's leadership is going to take it to the finish line.

Now, this is a lot of money we're talking about, but this is money over three decades. When you invest in infrastructure you have to do it thinking about many generations to come.

Q Are we ahead of the curve in comparison to other municipalities?

Yes. We have support from Chair of the California Senate Transportation Committee Lorena Gonzalez and Senator Toni Atkins. I think the Governor's office and state agencies are starting to use the Five Big Moves as an example of how the state should move forward, both with an aggressive climate action plan but also an aggressive mobility strategy.

Nationally, we recently spoke to the National Association of Region Councils and had a great response with many regions wanting to come and get more in-depth information.

This is a moment where the stars are aligning for us, in terms of public support and civic leadership. I think in some ways that is because we have never been in more of a crisis in terms of housing and transportation.

Normally, we are a reactionary society. We wait for something to be really bad and then deal with it. The Five Big Moves is giving an alternate path. San Diegans do not want congestion like in LA. Today, in comparison to LA, we are fine. But if we do reach that point it will be ten times harder. We have the luxury of time to be able to make this proactive investment now and do it right.

Blue Line MTS Trolley

Real Estate Outlook

INSIGHTS from District Council Members

by Belinda Sward, Strategic Solutions Alliance

San Diego-Tijuana Emerging Trends in Real Estate Report 2021 reflects the views of the San Diego-Tijuana District Council membership. Approximately one-third of total 500 active members (at the time of the report) participated in the online survey and/or were interviewed as part of the research process for this report. Survey respondents represented membership types, age categories, and geographic markets of the District Council membership. Throughout this publication, the views of the survey respondents and/or those interviewed for this report have been presented in the graphics.

Theme: Dealing with Certain Uncertainties

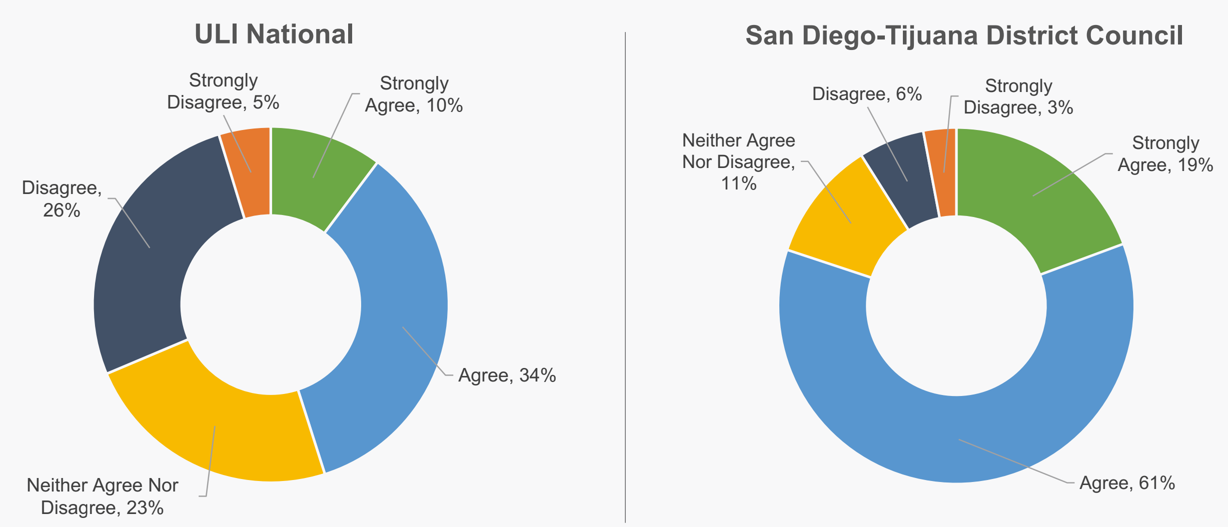
The San Diego-Tijuana regional economy and real estate markets have been disrupted and negatively impacted by COVID-19 and related conditions over the past year. Between social distancing, business closures, travel restrictions, job losses, and fears of getting sick, San Diegans, as most Americans, have faced unprecedented disruption in their everyday lives. Uncertainties remain regarding the length and severity of the coronavirus and possibilities of continued regulations, restrictions, and shutdowns, which have had far-ranging economic consequences.

In real estate, the commercial real estate market, retail and small businesses, hospitality, travel and tourism, academia, and government and civic entities have all been the hardest hit. Housing has been negatively impacted less so as home has become the central hub for multiple aspects of life, including working, schooling, exercising, eating and entertaining to a greater degree.

Consumers remain highly motivated to move and to purchase a home, particularly for greater control of their environment and a need for more space as home-based activities increase. Housing throughout the region has experienced a strong surge in demand, as seen in heightened construction activity, housing sales and above average increases in sales paces, prices, and appreciation rates.

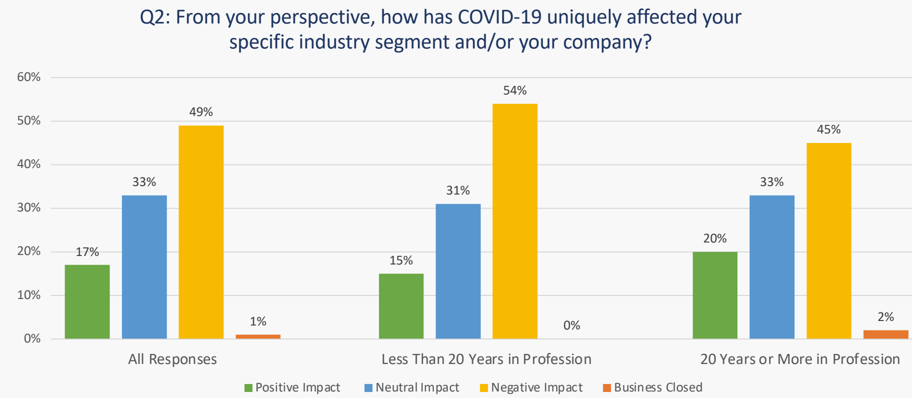
In light of this and similar to the ULI national Emerging Trends in Real Estate, The San Diego-Tijuana District Council trends survey began with a question regarding confidence levels of making real estate decisions in today's environment. Approximately 80% of responses from San Diego-Tijuana indicated they have the confidence to make long-term decisions, compared to only 44% nationally. Not surprisingly, ULI members who have been in their professions longer have somewhat higher confidence to make long-term strategic real estate decisions.

SAN DIEGO-TIJUANA (80%) VS. NATIONAL (44%)
HAVE CONFIDENCE TO MAKE LONG-TERM DECISIONS

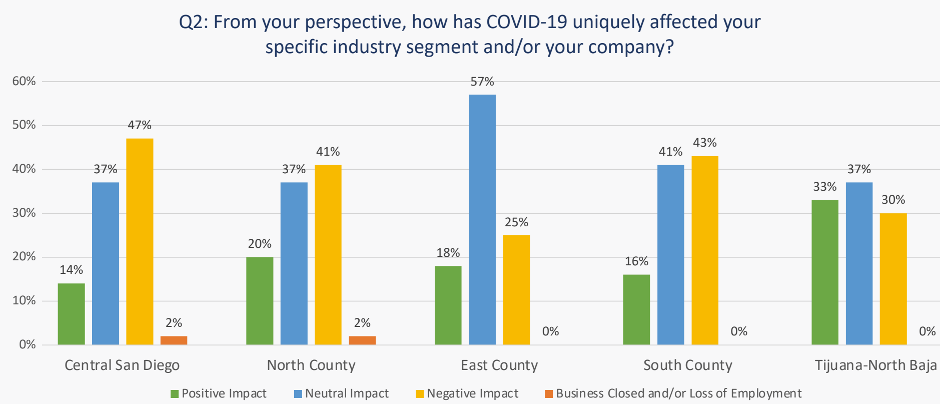


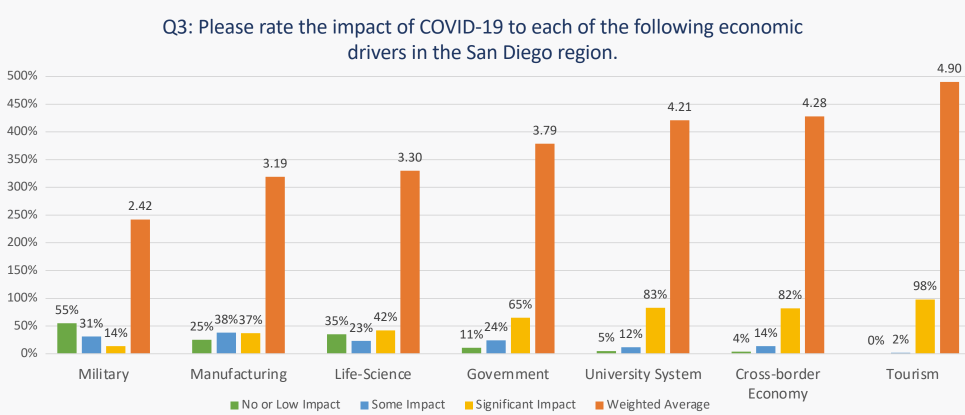
Impacts of COVID-19

We asked how COVID-19 has impacted members in regard to their industry segment and/or their company specifically. Half of respondents indicated that COVID-19 has negatively affected their industry and/or company. As might be expected the impact was less pronounced among those with more than 20 years in their profession.



Respondents working in North and East County as well as Tijuana-North Baja indicated more positive or neutral impacts to their respective industry and/or company. North and East County areas, in particular, are experiencing higher for-sale housing growth and activity.





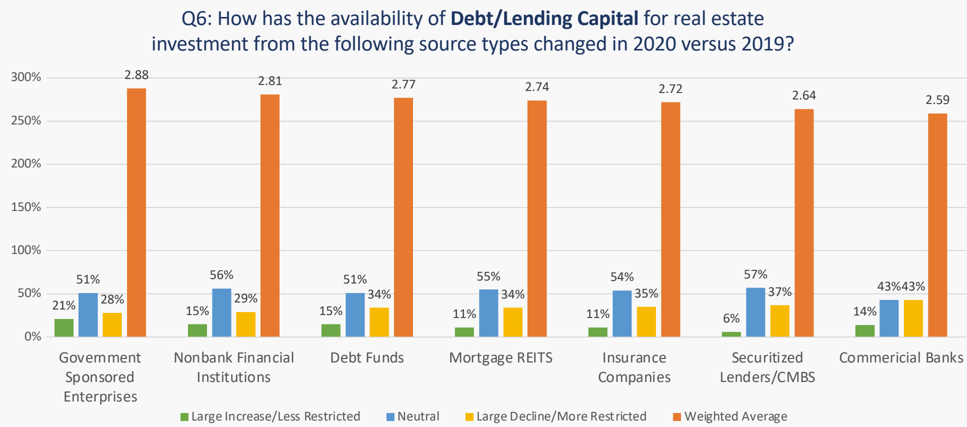
Where has COVID-19's impact been the greatest among the economic drivers in the San Diego region? As shown to the left, respondents rated Military, Manufacturing and Life-Science as least impacted and as can be expected Tourism having been the most impacted by COVID-19.

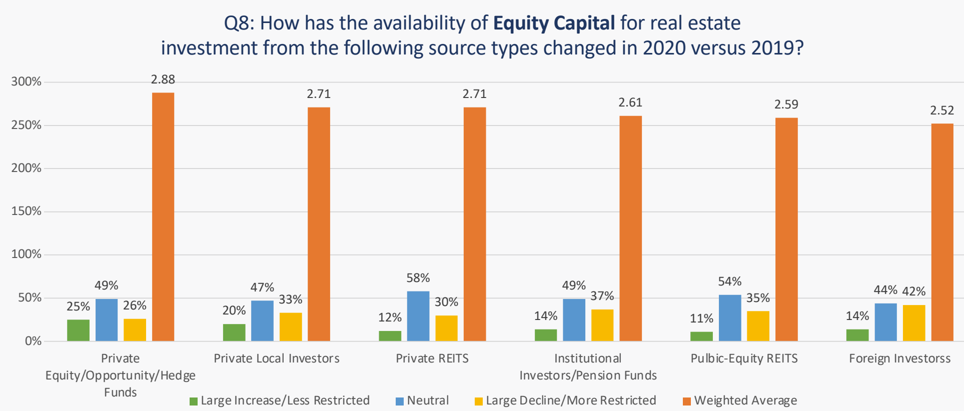
In addition to challenges, respondents rated a list of opportunities from COVID-19 in the San Diego region. Greater adoption of Technology, the Reshuffling of Retail Space, and the Reimagined Use of Streets and Outdoor Spaces were ranked as being the greatest areas of opportunity.

We should note that the reshuffling of commercial office and retail space including renegotiating current lease rates are both trends highlighted by our office and retail experts in this report.

Capital Markets

According to our members, real estate capital markets returned to some level of normalcy by the middle of summer 2020. In regard to the availability of various sources of debt and lending capital for real estate in 2020 as compared to 2019, they identified the greatest availability and increase in **debt and lending capital** is in Government Sponsored Enterprises and Commercial Banks as most restrictive.





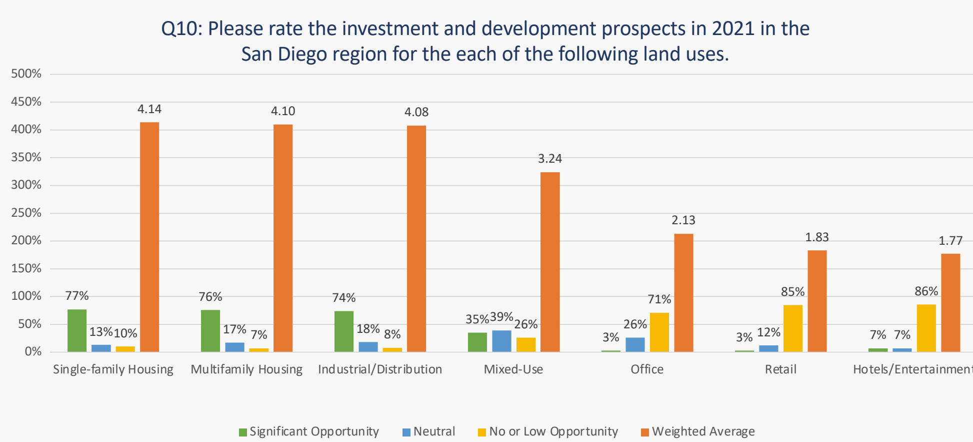
Approximately 52% of respondents believe debt and lending capital will be in balance for real estate development and redevelopment in the San Diego region in 2021.

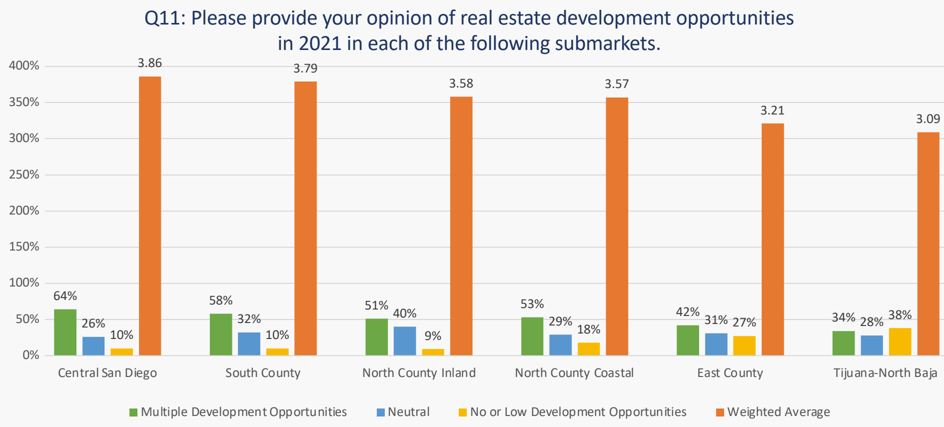
In addition to debt and lending capital, we asked about the availability of various **sources of equity capital** for real estate in 2020 as compared to 2019. As shown right, respondents indicated they believe the greatest availability and increase in equity capital is in Private Equity/Opportunity/Hedge Funds, Private Investors and Private REITS.

Expectations for 2021 indicate higher oversupply of equity capital as compared to debt and lending capital. Even so, almost 50% of respondents believe the equity capital markets will be in balance in 2021.

Investment by Property Type & by Region

To provide an outlook by property type, we asked survey respondents to provide insights regarding investment and development prospects among various land uses in 2021 in the San Diego region. Overwhelmingly and consistent with national trends, respondents indicated they believe that Single-Family Housing, Multifamily and Industrial/Distribution have the greatest investment and development potential over other land uses.



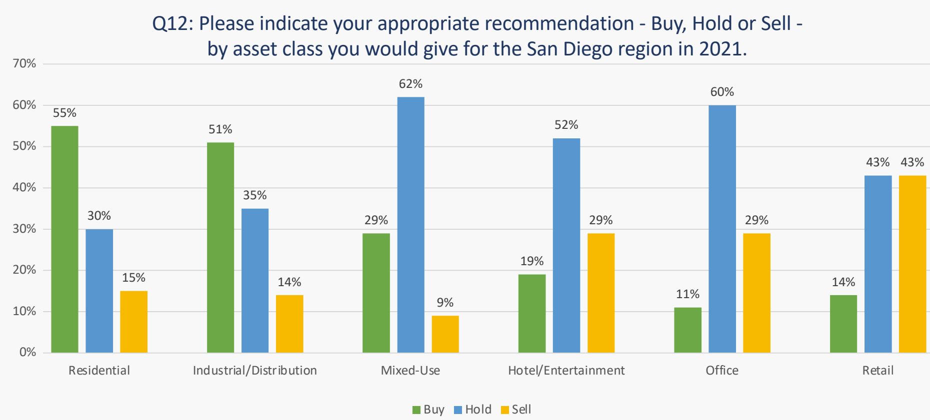


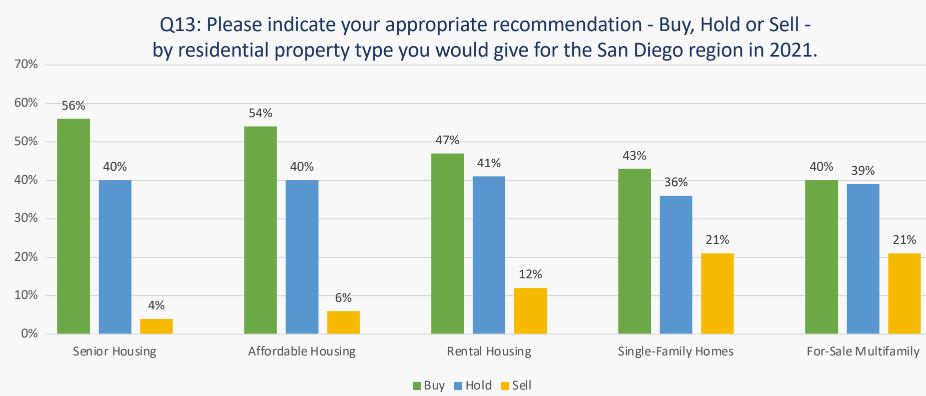
Geographic markets that represent the best opportunities for development include Central San Diego (City of San Diego and Central Business District, and cities of La Jolla and Del Mar), South County (cities of National City, Chula Vista, Imperial Beach, Coronado, and three communities of the City of San Diego: Otay Mesa, Nestor and San Ysidro.), and North County (North of Del Mar/Highway 56, both coastal and inland).

As part of the outlook by property type, we asked survey respondents to provide **Buy, Hold, Sell recommendations** for each land use type in 2021 in the San Diego region.

The greatest **Buy** opportunities included Residential and Industrial. As shown below, **Hold** recommendations included Mixed-Use, Hotel/Entertainment and Office. Recommendations for Retail included Hold or Sell, depending upon retail type, situation, and location.

We asked specifically about **Buy, Hold and Sell recommendations by residential type**. As shown, most recommendations include Buy or Hold, with Senior Housing and Affordable Housing the greatest Buy opportunities.





More About Survey Participants

Respondents closely resemble District Council members by length of time in profession.

Respondents

A member 20 years or less 45%

More than 20 years 55%

Members-at-large

A member 20 years or less 46%

More than 20 years 54%

Ages of respondents exactly match those of the San Diego-Tijuana District Council membership.

Under age 35	18%
Age 35 to 44	20%
Age 45 to 54	24%
Age 55 to 64	24%
Age 65 & older	14%

We had good representation from each of the geographical regions of San Diego County with some representation from Tijuana. These are the geographic areas where the respondents work.

North County (Coastal & Inland)

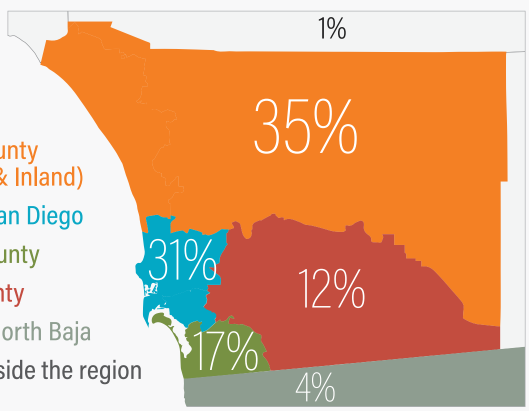
Central San Diego

South County

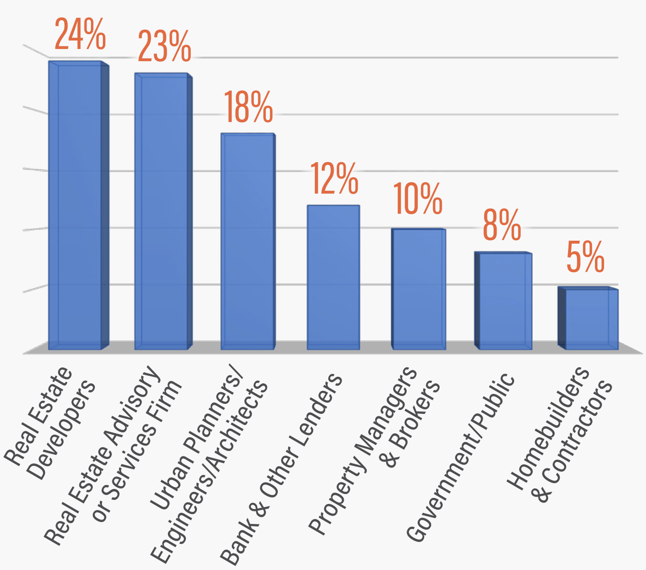
East County

Tijuana-North Baja

Work outside the region



Lastly, participants and interviewees represent a wide range of industry experts, including developers, consultants and advisors, architects, capital providers and investors, property managers, urban planners, lenders, and other.



Property Type Outlook

HOUSING Introduction

by Tony Pauker, Former ULI District Council Chair & Advisory Board Member

San Diego county housing supply is chronically undersupplied to meet the region's housing need. The county is essentially built out so virtually all new housing development is redevelopment. Aside from approximately 30,000-40,000 potential units in the Otay Ranch and Otay Mesa area, the era of green field master plans has ended. Litigation over new housing at scale in the unincorporated county similarly will dissuade major housing development in the unincorporated area. This coupled with lengthy entitlements ensures that the supply of for-sale and rental housing cannot meet existing and future demand.

The City of San Diego has put forth very innovative strategies to encourage housing development and density. It is likely that most of the other municipalities in the county will follow their lead. While these strategies will not create new, large scale communities, there is a positive outcome in that much of the new housing supply will be on smaller parcels distributed county-wide - much of this new housing will be attached. In many cases this may include more middle-income-priced housing. It does, however, suggest that the number of national homebuilders and apartment developers will decrease while smaller scale, infill, and even owner builders will fill the gap. This trend even trickles down to the addition of ADUs added to the existing single family home stock.

This changing dynamic must be considered when looking at housing trends. Nonetheless pressure on supply will clearly result in increased prices and rents. And as we all know this impacts San Diego's ongoing ability to attract and retain a wide cross section of talent and skilled workers to maintain a desired quality of life and dynamic local economy.

We pulled data on housing from the 2021 ULI National Emerging Real Estate Trends Report for markets that we find San Diego most often compared to. Especially those that are growing innovation and life-science centers, known to offer affordable homes and desirable lifestyles.

Other than Austin, San Diego is projected to have a similar growth rate to Phoenix, and well above the Bay Area and the Los Angeles/Orange County juggernaut. And, other than Riverside County, San Diego has the lowest median home price among major California regions. This makes San Diego an attractive place to relocate within the state as long as we can offer housing choice and retain employers/companies focused on future-focused industries like clean energy, life-science, and innovation companies for example.

SAN DIEGO & COMPARATIVE MARKETS HOUSING

	2021 POPULATION		MEDIAN HOME PRICES				2021 SINGLE-FAMILY HOME METRICS AS % OF PREVIOUS CYCLE PEAK			MULTIFAMILY METRICS		
	2021 total (000s)	5-year projected annual growth % change	2020 price	2019-2020 % change	2020 as % of previous cycle peak	Housing Opportunity Index*	Permits	Starts	Completions	Walk Score	Rent/cost of ownership**	Rent as % of household income
US	**125,619.1**	**0.8**	**$300,000**	**7.1**	**135**	**59.6**	**1.0**	**0.9**	**0.7**	**54**	**0.87**	**29.5**
Austin	819.3	2.3	$335,000	3.7	182	59.3	1.4	1.3	1.1	40	0.74	16.5
Denver	1,177.5	1.4	$435,000	5.4	174	57.1	1.7	1.7	1.1	61	0.66	18.7
Inland Empire	1,445.5	1.5	$399,000	5.0	99	32.9	1.1	1.1	0.6	41	0.76	26.3
Los Angeles	4,405.9	0.3	$640,000	11.2	111	10.8	0.9	0.9	0.8	67	0.58	32.0
Oakland	1,021.7	1.0	$735,000	6.3	102	25.7	1.1	1.1	0.8	80	0.57	23.6
Orange County	1,062.5	0.7	$760,000	2.7	107	13.4	1.8	1.9	1.5	45	0.52	25.4
Phoenix	1,873.4	1.7	$304,000	(7.7)	114	64.8	1.1	1.1	0.8	42	0.77	19.6
Salt Lake City	856.6	1.2	$381,000	5.1	164	58.0	1.3	1.3	0.9	30	0.49	13.9
San Diego	873.6	1.7	$594,000	(0.0)	99	20.1	1.3	1.3	1.0	47	0.34	14.1
San Francisco	1,175.4	0.9	$1,400,000	3.1	157	8.5	0.5	0.6	0.6	57	0.26	16.9
San Jose	646.6	0.6	$1,105,000	3.4	132	16.2	1.2	1.3	1.1	38	0.48	24.7
Triangle Region, NC	1,049.9	1.5	$328,000	7.3	182	68.7	0.8	0.8	0.8	53	0.66	15.1

Sources: HIS Markit forecast, U.S. Census Bureau, walkscore.com, CoStar, U.S. Bureau of Econonomic Analysis
**NAHB/Wells Fargo HOI - Share of homes sold that would have been affordable to households earning the median income*
***Market apartment rent divided by the median mortgage payment, including estimated taxes, insurance, and maintenance*

Property Type Outlook

FOR-SALE HOUSING Market Overview

by Peter Dennehy, Vice President Customer & Market Research, Newland

For-Sale Housing Market Overview

As 2021 gets underway, the San Diego new housing market is quite strong, despite the pandemic-crisis job loss in the region. In December 2020, total nonfarm employment in the region is down 6.9% year-over-year, with 105,000 fewer jobs in the region.

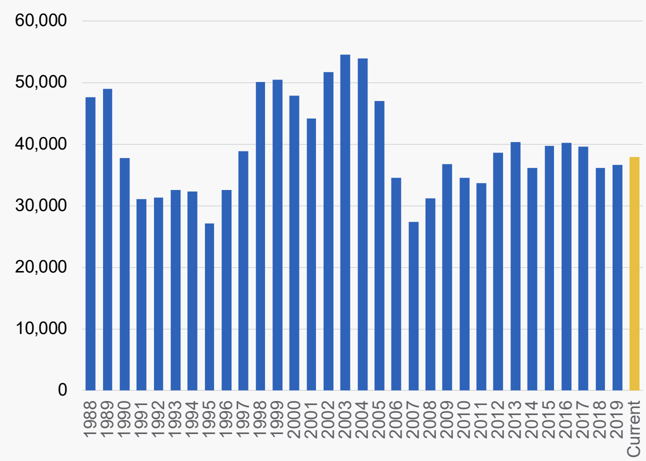
Despite this, new home projects in San Diego County are selling well and a lack of finished homes and lots, in tandem with robust new home sales demand, has encouraged builders to increase new home prices further. That said, the number of actively selling communities has declined from historical levels. This demand stems from a combination of historically low interest rates, a limited supply of new and resale homes on the market and likely some COVID-19 related pent up demand.

As of November 2020, existing home sale closings volume for San Diego County in the past 12 months averages 37,843 homes, with a median home price of $715,800, up 12.9% in the past 12 months. The level of existing home inventory in the County is quite low, with 3,358 listings in December 2020, representing an estimated 1.1 months of supply. Resale inventory has declined 37% in the past 12 months and market time to sell averages just 13 days, down 57% from 30 days last year. The median price per square foot for existing homes is $545 per square foot and 46% of home sales are selling for above list price (it was 28% at the same time last year).

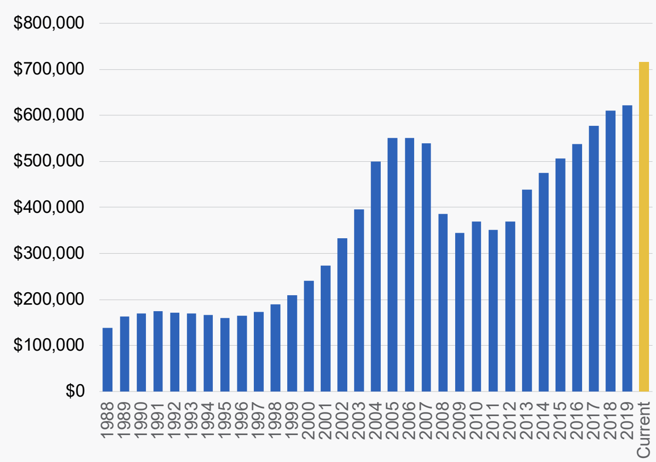
As of November 2020, new home closings in the region are averaging an annualized 3,507 homes, with a median new single-family home closing price of $878,500, up 27% in the past 12 months. The median new attached closing price is $596,000. New home sales volume is up 3% in 2020, but a lack of buildable land and dropping community count will constrain sales going forward. According to Zonda, there are 36 active new detached for-sale projects in the County, down 53% from last year and there are 40 active attached for-sale projects, a decline of 30% from last year.

The lack of for-sale options means all home types are selling well. There is particularly strong demand currently in suburban areas in the I-15 and Highway 78 corridors and in South San Diego County. The Otay Ranch master planned community in Chula Vista was ranked #17 among the top

ANNUAL EXISTING HOME SALES CLOSINGS



ANNUAL MEDIAN EXISTING HOME PRICE



Source: John Burns Real Estate Advisors

50 U.S. Master-Planned Communities in 2020, with 760 total sales. The lack of sales in the central part of the county is primarily driven by a lack of supply rather than a lack of demand. There are growing opportunities for "surban" townhomes, high-density square feet, for-sale condominiums on sites being produced by new state and local policies, new transit development and adaptive reuse of existing land uses.

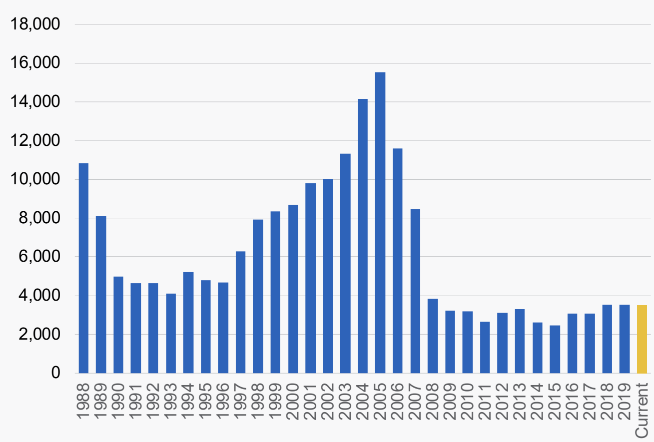
For-sale housing production in the San Diego County region is at the lowest level since World War II. With the exception of Otay Ranch in South County, there are no large-scale master planned communities left in the San Diego County region and new home projects are increasingly being developed as reuse projects on golf courses, etc. or as mixed-use urban infill projects on quarries, retail centers and other reuse opportunities.

Several large-scale projects in the unincorporated County have faced legal challenges based on environmental and fire safety after approval, so supply challenges are unlikely to change. In fact, new housing in the unincorporated county is unlikely to account for any appreciable new supply. There is some increase in supply from a pickup in the redevelopment of existing commercial/residential projects and golf courses, the building of mixed-use projects and developers offering urban/ "surban" infill in all areas of San Diego County.

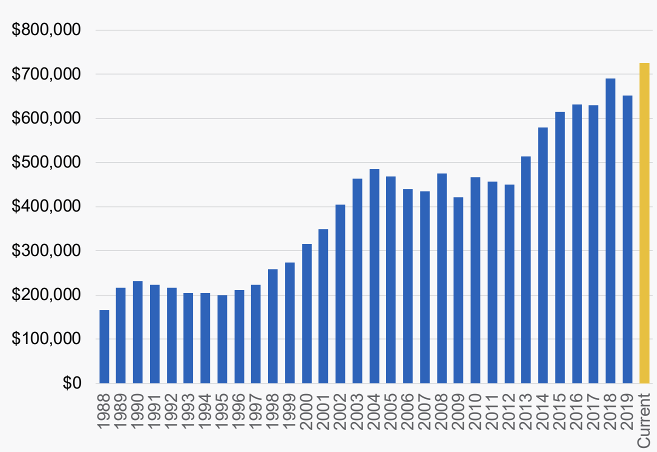
According to Zonda, there are 1,994 vacant developed lots (VDL's) in the San Diego County market, down 28% from a year earlier and equaling just a 6.3-month supply of lots at current sales rates. However, in terms of total annual demand this supply represents less than 20% of the annual demand the region needs to produce in order to meet current housing deficiencies and new demand.

SURBAN
"Surban" is termed coined and trademarked by John Burns Real Estate Consulting to describe a suberban area that has the feel of an urban neighborhood/ community featuring a walkable lifestyle including access to retail from a house or apartment. It is used in this context to describe newer mixed-use development areas, in both suburban and infill areas, that will feature denser and more diverse housing, conveniences, and in some cases close to transit.

ANNUAL NEW HOME SALES CLOSINGS



ANNUAL MEDIAN NEW HOME PRICE



Source: John Burns Real Estate Advisors

Submarket Overview

Central San Diego – *South of Route 56, north of Route 54 and west of I-15:*

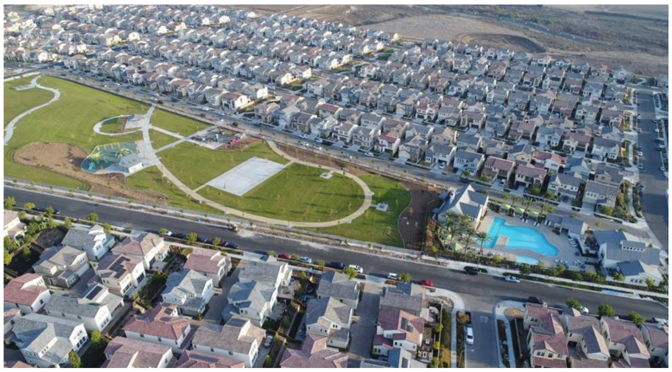
This submarket is the urbanized heart of the region and includes Downtown San Diego, Mission Valley, and the UTC/Sorrento Valley area. New home development in this submarket is primarily infill, and it includes high-density single-family and townhome projects and mid to high-rise condominiums in Downtown and Banker's Hill. New home prices are generally $800,000 to over 1 million. Some large-scale urban mixed-use projects are active or planned in this area, including Civita and Riverwalk in Mission Valley and the 1,800-unit 3Roots in Sorrento Mesa. This area may be the most supply constrained and thus sees the greatest interest in high density solutions, including high-rise in downtown San Diego.

East San Diego – *South of Route 56, north of Route 54 and east of I-15:*

This submarket is transitioning from semi-rural and suburban into a more densely developed area. Close-in areas like La Mesa, Santee and El Cajon are being developed with infill townhome and single-family homes priced in the $500,000s to $800,000s, and large-lot homes in semi-rural areas like Lakeside are in the low $1 million range.

South County – *South of Route 54 to the international border:*

South County is the most affordable area in the County for new homes and has relatively large amounts of developable residential land, primarily in the Otay Ranch area in eastern Chula Vista. However, even if all of these potential lots were able to immediately come to market they would only equate to several years of regional demand. New for-sale townhomes in this area are in the $300,000s to $500,000s, while new detached for-sale homes are priced in the $600,000s to the $800,000s. There is some infill development taking place in older areas of Chula Vista and National City and some formerly industrial zoned land in the Otay Mesa area is being re-entitled for residential development.



The Village of Escaya master planned community by HomeFed Corporation in Chula Vista, South County.

North County Coastal – *North of Route 56 to Camp Pendleton and west of I-I5:*

This submarket is affluent, including coastal suburbs along the Interstate 5 corridor. New home developments in this area are primarily in the Pacific Highlands Ranch area near Del Mar, Carlsbad, and Oceanside. New attached for-sale homes in this market are generally priced in the $500,000s and $600,000s, with new detached for-sale homes priced from the $700,000s to over $1 million. There is limited land in this area for large-scale development and many projects are infill or developed on land formerly zoned for industrial or agricultural uses. The coastal portion of this market to attract some buyers who work in Orange County.

North County Inland – *North of Route 56 to Camp Pendleton/east of I-I5 and I-15:*

This area consists of suburban communities along the 78 and 15 freeway corridors and semi-rural communities north of Escondido like Valley Center and Fallbrook/Bonsall. This is one of the most active areas of the County for new homebuilding and is somewhat more affordable than the North Coastal area. New townhomes in this area are generally in the $500,000s and detached homes are in the $600,000s to 1 million. Development in closer-in areas is primarily attached townhomes and small-lot single-family, with some small master planned communities located in the Bonsall area and on redevelopment sites in Escondido (Canopy Grove) and Carmel Mountain Ranch (Pacific Village). Several large-scale residential projects in this area have been approved by the County Board of Supervisors and then challenged on environmental or traffic concerns. Portions of this market lose potential buyers to more affordable homes in southwest Riverside.

The Highlands at Pacific Highlands Ranch by Tri Pointe Homes.

Opportunities to Increase Housing Production

County General Plan and community plan updates in various cities are focused on increasing housing production of all types, but this is a slow process that requires political leadership and faces local NIMBY and environmental oppositions. Despite good intentions, there has been almost no market-rate "missing middle" attached or detached for-sale housing developed in the central regions of the county that are closest to jobs and services. This jobs/housing imbalance worsens the region's traffic congestion. State and local policy now focused on housing – perhaps there will be more teeth in the Regional Housing Needs Analysis (RHNA) to increase production? The redevelopment of existing commercial/ residential projects and golf courses is bringing new development opportunities. A number of golf courses in all areas of the County are being redeveloped for housing of all types and there are large-mixed-use infill projects underway in the greater Mission Valley area (Sports Arena, Civita, Riverwalk, former Qualcomm stadium redevelopment by SDSU, etc.).

The silver lining may be that while larger home builders and apartment developers may find fewer opportunities, smaller builders, entrepreneurs, owner builders and even just homeowners may start to account for a much larger portion of new supply. This could potentially provide more new housing in neighborhoods typically passed over by production housing providers. It may also provide more middle income housing.

The Heights at Promontory by The New Home Company at Civita, Mission Valley

Housing Affordability

Housing affordability is worsening again in the San Diego County region. With home values having risen by 13% from one year ago, the current housing costs-to-income ratio has risen to 43% and the gap to purchase rather than rent is widening. In San Diego County, the chronic challenge is that limited buildable land supply and affordability patterns are exacerbated by the economic cost of delivering new homes (construction costs, entitlement costs, land costs, timing etc.).

According to John Burns Real Estate Consulting, just one-third of San Diego County households can afford to buy the median priced existing home with a 5% to 20% down payment. The market's FHA loan limit just increased from $702k to $753k, with an existing median home price of $716,000, or $37k below the FHA loan limit.

High and increasing home prices push builders to the outer reaches of the County to provide lower density and more affordable homes. Those areas are typically in the County land planning jurisdiction and governed by a current General Plan that directs housing density to distant areas away from jobs and services that would necessitate long commutes. Projects needing discretionary approvals in those areas are facing environmental/fire-safety challenges and referendums to overturn approvals.

How does San Diego compare to peer metros?

- Higher job resilience.
- Resilient home prices and rental rates from peak to trough during past and current downturns.
- Lack of buildable land limits market expansion for all types of housing.
- Entitlements are signifcantly harder to achieve compared to the overall U.S., which makes it more difficult to make significant progress in increasing overall housing supply.

Traffic congestion has eased in the San Diego region due to COVID-19 but will return and acceptable commutes dictate where housing is needed. Many San Diegans are forced to relocate to Riverside County and to Mexico for more affordable for-sale housing options and price conscious retirees often choose to relocate entirely outside the County in less expensive parts of California or to neighboring states to trade-down.

Mobile and talented young people choose to leave San Diego for more affordable housing and that creates a brain drain in the local community. According to Q4 2020 Redfin migration data, San Diego Redfin users are most often searching for home options in the Pacific Northwest, Denver, Arizona and various cities in Texas (Dallas, Austin).

Encanto by National CORE, a 2020 finalist for ULI's Jack Kemp Excellence in Affordable and Workforce Housing.

Property Type Outlook

RENTAL HOUSING Market Overview

by Richard Gollis, Principal & Co-Founder, The Concord Group & Nicole Sadowsky, Manager, The Concord Group

San Diego is an extremely supply-constrained rental housing market. In the county overall, there is not enough housing to support the employment base. With approx. 2.2 million total jobs and 1.2 million housing units, the jobs to housing ratio is approximately 1.8 jobs/housing unit (ESRI 2020). With San Diego's ratio far above the target of 1.5 jobs/home, the current undersupply of rental housing units equates to approximately 102,000 units.

Exacerbating the existing imbalance, deliveries of new units have not kept pace with demand. San Diego County has averaged only 3,200 rental units built per year over the last ten years. New rental apartment development has been concentrated primarily in Central San Diego and South County, which accounted for 61% of total new inventory of the last 5 years. These tend to be the highest rent markets in the county, thus furthering in imbalance of attainably-priced rentals. Vacancy across the region has hovered around a stable 5% and projected to remain low as demand exceeds supply. Average asking rent has reached $1,875 per month in 2020, up from $1,850 in 2019, with growth of 3% annually pre-COVID-19.

In 2020, even with the impacts of COVID-19, rent growth countrywide has been approximately 1%. However, digging deeper into this most landlords report that COVID-19 related delinquencies are far lower than expected. In the higher priced markets, especially the class A luxury market downtown incentives have driven effective rents down as much as 10-15%. This appears to have benefited centrally located class B and C projects which has seen some actual effective rent appreciation – likely at the expense of class A product.

In terms of sales, historically low interest rates have allowed further cap rate compression pushing values per door. Some builders have expressed concern that continued uncertainty over COVID-19 delinquency, and the extension of state and local eviction moratoria coupled with likely higher interest rates in the next few years. This is starting to dampen some enthusiasm for new projects, especially the luxury segment. However, the chronic level of under supply is supporting new development, the challenge is matching development cost to achievable rents.

A mixed-use downtown project by Holland Partners includes a UCSD satellite and rental housing. Published by Voice of San Diego.

Opportunities & Challenges for Rental Housing

San Diego County is a high resiliency, yet generally low growth market. San Diego's high resiliency stems from a strong and diverse employment base with a track record of outperforming the US during economic downturns and rebounding faster than other major metropolitan areas. For example, during the current economic downturn, Class A apartment rents in Downtown San Diego have suffered, but are still more resilient (peak to trough) compared to peer metro areas on the West Coast including Downtown Seattle, San Francisco, and Downtown LA.

Low growth is due to challenges developers face in terms of the high and increasing costs of land, construction labor and materials, and lengthy entitlement. Given this challenge, there is an opportunity to look towards suburban corridors along I-15 and SR-125 for lower density, less expensive apartment products targeting moderate income, value-oriented renters. It is also an opportunity for smaller scale builders, owner-builders and other small scale entrepreneurs to fill in the void of small sized projects that are not compatible with regional or national builders target metrics.

San Diego is essentially built out, with much of that development having come from post WWII expansion of the region. We are now experiencing the sum of this development becoming functionally obsolete and paving the way for the second wave of regional suburban growth.

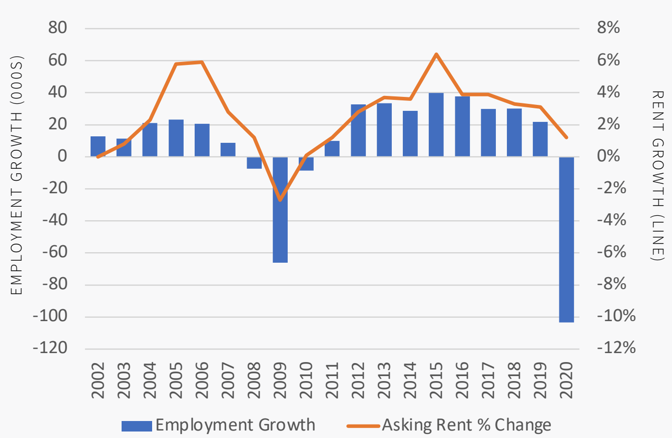
However, San Diego is ahead of the curve on redeveloping existing commercial projects and revitalizing rental housing into mixed-use communities. Salient examples include Horton Plaza redevelopment (in process), University Town Center redevelopment and expansion, and Otay Ranch Town Center (in process) in Chula Vista. This bodes well for opportunities to transform underutilized single-use commercial areas into walkable, economically viable neighborhoods. Due to the land constraints and limited development capacity eastward, San Diego has not experienced significant moves of renters to farther out suburban areas during the current pandemic. San Diego stands out compared to peer metros as its employment base is already dispersed, so unemployment was not a driving force for fleeing the urban areas.

Rammy Infill, Photo by Adrian Mique
Example of small-scale infill for-rent housing being built in central San Diego neighborhoods, close to jobs, transit, and conveniences.

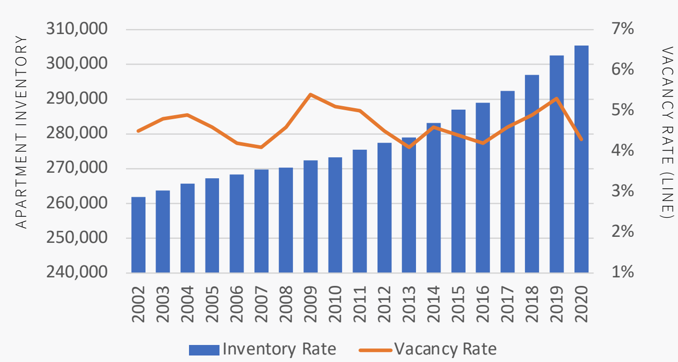
Miller Hull Partnership, Malick Infill Development 130,000 S.F. mixed-use building, downtown National City -127 residential apartments, communal spaces, and commercial uses. Opening summer 2021.

Demographic shifts in San Diego have impacted the target renters for the upper end of multifamily housing. San Diego has become more attractive to young professionals seeking new job opportunities in burgeoning biotech and business employment nodes in Central San Diego. Office development and the expansion of companies have drawn many young professionals with high incomes to the area. While also continuing to retain older, established households unwilling to migrate out of California despite the high "sunshine tax" and cost of living. A growing segment of the Baby Boomer demographic is expected to downsize into turnkey age-targeted apartments near to restaurants, retail, and health/wellness destinations that provide a sense of liveliness, community, and connectivity.

**SAN DIEGO COUNTY
EMPLOYMENT GROWTH & RENT CHANGE**



**SAN DIEGO COUNTY
APARTMENT INVENTORY & VACANCY RATES**



Source: Stream Realty Partners

With the demographic and economic demand drivers, rental demand has remained strong through all regions of the county. There emerge clear regional and product type differences with B and C stock maintaining high occupancy rates while new luxury projects remain in demand, but markets like downtown which have seen the greatest number of new deliveries has experienced the highest COVID-19 incentives. Over the next several years Mission Valley will receive a significant number of new units. The biggest challenge that San Diego County is facing is affordability patterns with the economic structure of delivering apartment units. The construction, entitlement, and land costs constrain supply, and push much of the new supply to focus on luxury units and rents. Production costs simply require very high revenues to justify new development.

Affordable Housing Outlook

There is a mismatch between demand for Affordable/ workforce housing and affordable supply in San Diego. The bulk of institutional apartment supply rents for between $1,500 and $3,500 per month, while the peak of demand is approximately $2,500 per month. This lack of units below the peak of demand targeted towards low-income households' accounts for the undersupply of affordable housing in the market. On the graph, 100% and 120% AMI restricted rents for a 2-person household are $1,850 and $2,225. While this is being filled by existing B and C class stock, very little new construction is viable in this price band.

San Diego County's 6th Cycle Housing Needs Assessment Report (SANDAG July 2020) determined a need for 171,685 housing units from 2021 – 2029 to address the shortage. Approximately 40% of the units are allocated towards Very Low and Low income households (approx. 69,000 units), yet there are constraints on the ability to build that many LIHTIC units and unsubsidized units are not economically viable at these rent levels given production costs.

The City of San Diego is trying to reduce entitlement and density barriers to fill some of this need. It will likely be filled by smaller one-off builders. This sector of the market could also benefit from other Federal and State programs to subsidize the cost of Affordable housing. This includes a joint powers authority that can issue tax-exempt debt, and California has established this through various programs for workforce and Affordable housing. It is most likely this space would be filled by traditional low income housing providers as opposed to regional and national builders.

Property Type Outlook

RETAIL Market Overview

by Michael Combs, Associate Director, CBRE

Looking Back at 2020

COVID-19 and the subsequent government action to curb the spread of the virus severely impacted retailers across San Diego county. More than 43,000 retail and food service jobs were lost in San Diego County, a decline of 13.5%, with food service and personal services being the worst hit. While economic indicators and well-publicized retail closures paint a struggling retail sector, shopping center real estate fundamentals were mixed. Shopping center vacancy rose to 6.1% at the end of 2020, compared to 5.2% in 2019—approximately 660,000 square feet of newly vacated space—but lease rates were virtually flat year over year. New leasing activity was down 16.1% year over year, but many retailer types were particularly active, including grocery and discount outlets.

Despite the relative stability of the local retail market given the circumstances, investment interest for retail centers dropped dramatically. After nearly a billion dollars in retail investment sales in 2019, only $288 million of retail assets traded in 2020.

Investment activity fell off dramatically in the second half, reaching only $40 million. Single-tenant net-leased properties, suburban neighborhood and grocery-anchored centers have proved the most resilient and will likely be the first to garner interest from buyers as the market rebounds. For property owners and retailers alike, the recovery will likely come with some lessons learned in 2020 which underscored the need to quickly adapt to the rise of e-commerce and shifting attitudes of consumers.

E-Commerce & the Rise of Omnichannel Solutions

E-commerce has been the single largest disruptor to the retail and industrial sectors over the past decade as it evolved from a niche, high-tech service to a mainstream retail offering. Online sales have grown by an average of 16.4% annually since 2010, outpacing average annual brick-and-mortar retail sales growth of 3.1% over the same period. This trend has been driven by both online and traditional retailers expanding their e-commerce offerings to accommodate changing consumer behavior. As e-commerce gained traction, the avenue for growth in retail clearly became digital over physical, and retailers began moving faster than ever to build their e-commerce platforms.

Neighborhood Shopping Center 4S Ranch.

One of the most important takeaways for retailers during the COVID-19 era is that physical stores are an important component of their omnichannel strategies. Whether used as distribution hubs for last-mile fulfillment of digital sales or for introducing new in-store experiences. As the pandemic subsides and consumer traffic gradually returns, it is evident brick-and-mortar can serve a key role in the multichannel consumer purchase journey.

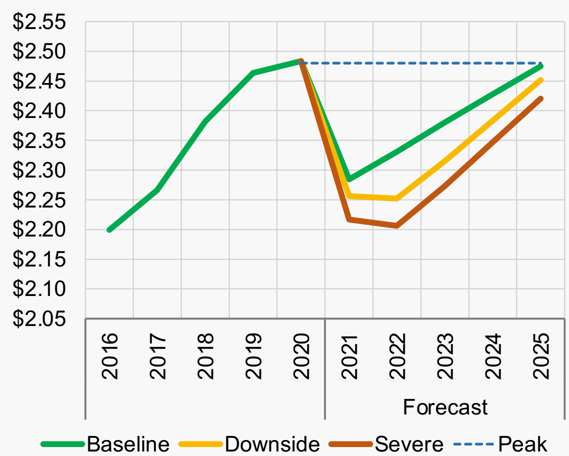
San Diego's hybrid store of the future will be an omnichannel site that allows consumers to engage and purchase seamlessly in-store and online across a wide range of retail categories and product lines. The new hybrid model will preserve the store experience for physical shopping while leveraging logistics capabilities for the fulfillment of online stores.

Revamp of Nordstrom Stores for online pick-up.

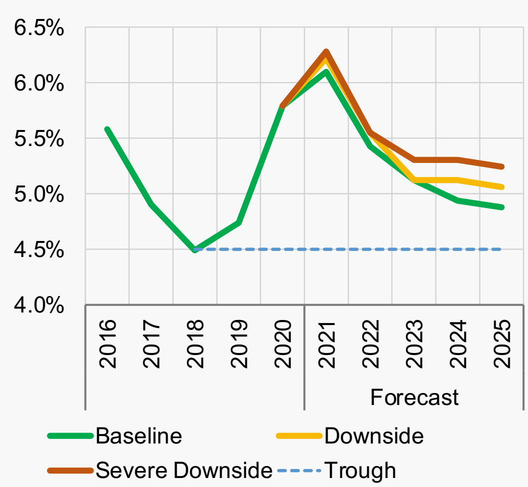
Adaptive Re-Use & the Role of Placemaking

The introduction of the hybrid store regionally will be gradual. In the near-term, San Diego is likely to see accelerated reinvention of retail properties, such as adapting former retail space into something entirely different. Adaptive reuse projects have ranged from full-scale redevelopments of retail properties to creative reuses of the existing structures for non-traditional tenants such as industrial users. The disruption of the pandemic is already catalyzing accelerated adaptive reuse of regional retail space. There are certain advantages to upcycling recently vacated retail space, such as creating desperately sought-after space in high-density submarkets, and addressing regional shortages like housing.

SAN DIEGO COMMUNITY / NEIGHBORHOOD CENTER ASKING LEASE RATES (NNN) PER MONTH



SAN DIEGO COMMUNITY / NEIGHBORHOOD CENTER VACANCY RATE



Source: CBRE Research, CBRE Econometric Advisors

Clairemont Square Shopping Center – Photo published by Merlone Geier Partners. Prime example of adaptive re-use opportunity.

Many shopping center owners have and will continue to focus on placemaking as a way to attract foot traffic. A renewed focus on food, fashion, fun and fitness will draw consumers to experiences that are unavailable in an e-commerce world. Co-tenancy with other uses like office and medical can drive a consistent presence to a retail center and capitalize on the desire for these tenants to be near retail amenities. This may require repositioning of some assets but may work within the existing structure of many shopping centers. Finally, by making shopping centers great public spaces, retailers are able to keep guests in the center longer and attract new shoppers by becoming a center of community life.

San Diego has several examples of re-use and placemaking in the pipeline. Regency Centers and Alexandria Real Estate will move forward on their plans for Costa Verde Center in UTC. The 178,000-square-foot center is slated for a significant renovation/expansion to begin in Spring 2021. The expansion will include a 400,000-square-foot lab facility and a 200-room hotel, all located along the Mid-Coast Trolley extension. The $330 million redevelopment of Horton Plaza Mall is also moving along and expected to deliver in 2022. The project will add 700,000 square feet of office and 300,000 square feet of retail with a focus on food and beverage and health and wellness operators. Smaller-scale investments will likely

Reimagining the Costa Verde Shopping Center into a mixed-use village with retail, office and hotel. Regency Centers and Alexandria Real Estate.

become the norm for your typical shopping center and can range from creative uses of excess parking space for fitness and other community events to redevelopments of parts of the center to attract unique tenants.

Looking Ahead

While the pandemic was a principal catalyst of the slowdown in 2020, it underscored some challenges and opportunities that will linger beyond COVID-19. Leasing and retail sales should pick up in late 2021 and surge in 2022 due to pent up demand, but many large, big box operators will struggle with the shifting retail landscape and there will likely be more national chain bankruptcies. COVID-19 also highlighted the stability of grocery-anchored centers, which will remain attractive. Discount and outlet retailers are likely to remain resistant to E-Commerce and should continue to expand their footprint, likely backfilling big box spaces vacated by other large chains. If the public health situation improves with the vaccine roll-out, food & beverage and fitness retailers are expected to bounce back quickly.

Retail real estate fundamentals are unlikely to have bottomed out in 2020, meaning increased vacancy and softening lease rates are likely to continue in the first half of 2021 and it could take years to reach pre-pandemic levels. CBRE Econometric Advisors expects it will take until at least 2025 for retail rents and vacancy to get back to where they were in 2019, but significant gains are expected to be made in the latter half of 2021.

Property Type Outlook

OFFICE Market Overview

by Derek Hulse, Managing Director, Cushman Wakefield

The events and restrictions surrounding COVID-19 created a lot of uncertainty throughout 2020. 2021 looks to be a challenging year, with reductions in occupancy and lease rates in several submarkets throughout San Diego. It will certainly take some time to restore confidence in the San Diego office market. Even as employees gradually return to the office, it is likely to be at a lower occupancy levels in the near term. This will be a year in which companies can begin to reassess their short and long-term real estate strategies, something that was absent during the majority of 2020.

The saving grace for the office market will be employment growth. Essentially, reductions in space requirements by companies now realizing they can gain efficiencies through flexible or hybrid work programs (sometimes at home, sometimes in the office) can be made up by expansions in the employment sector. All employment sectors are expected to grow at a combined rate of 1.3% in 2021 and 2.8% in 2022. San Diego's economy of $241.2 billion, as measured by gross regional product, is forecasted to grow by 4.3% in 2021 and 5.5% in 2022, above its 10-year average of 2.7%.

While the office market slowly recovers, we will continue to see robust demand in the life sciences sector. COVID-19 acted as an accelerator for the life science industry in San Diego, attracting a record level of investment ($4 billion) and increasing tenant demand. The capital investment in the San Diego Life Science community coupled with the unprecedented level of Life Science tenant demand has fueled developers' appetite for life science development and conversions, which is now being pursued outside of the core Life Science submarkets of Torrey Pines, Campus Point/Eastgate and Sorrento Mesa/Valley. For example, the Downtown submarket now has 1 million square feet of life science development in the pipeline with another 1 million square feet of proposed development.

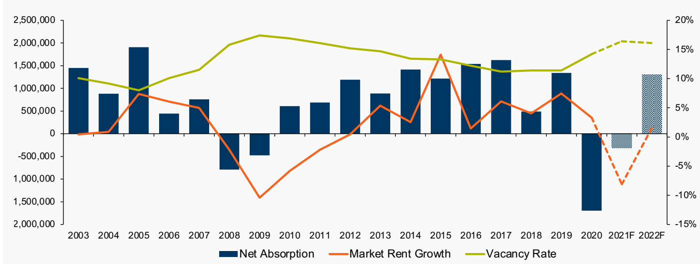
Some topline takeaways:

1. Renewals will comprise the majority of leasing activity as companies seek convenient, short-term solutions while assessing their long-term real estate strategies.
2. Leasing within the 10,000 to 50,000 square feet range will continue to be the main driver of activity, accounting for 42% of total square feet in lease obligations set to expire over the next 18 months.
3. Many companies will seek to reduce their office square footage due to extended work-from-home policies or hybrid schedules, which will lead to an increase in office supply, both direct and sublease.

Vacancy, Absorption & Growth

In Q4 2020, Countywide average weighted asking rents across all classes increased slightly to $3.42 per square foot on a monthly full-service basis. However, it should be noted that large blocks of vacancy at higher asking rents buoy this overall figure and many projects actually reduced their asking rents to attract a smaller pool of tenants during the pandemic. This metric increased by $0.03 over the last three months (+0.9% QOQ) and $0.11 over the last 12 months (+3.3% YOY). Over the past 12 months, Class A average rent has increased by 1.9% to $3.78 per square feet, while the Class B rate has increased by 3.4% to $3.36 per square feet, largely benefitting from significant acquisitions and conversions of older office product to lab space. An abundance of vacancy and sublease availability is expected to significantly push rents down in 2021, up to 8.1%.

SAN DIEGO COUNTY OFFICE ABSORPTION, RENT GROWTH, VACANCY



The San Diego direct office vacancy is currently 14.2% and is expected to increase throughout the year as lease terms expire, sublease space inventory increases and some tenants simply returning their space to the landlord. This is sizing up to be a situation which will be highly favorable for tenants to renegotiate, or relocate, at significantly discounted rates. In fact, we anticipate the office vacancy rate to increase by 100 to 150 basis points throughout 2021.

2021 will experience negative net absorption, although less than realized in 2020, which was 1,695,130 square feet, the highest recorded since this statistic has been tracked in San

Diego. The increase in absorption will largely be the result of 1.6 million square feet of leases commencing that were signed in 2020, or prior, but not officially recorded until the tenant occupies their premises. Of this 1.6 million square feet, Apple's leases comprise 696,000 square feet of the total, while life science companies total another 817,000 square feet.

Countywide, active tenant requirements of all sizes remain robust at 5.5 million square feet over the next 24 months, led by Apple's search for a 1 million square feet San Diego campus and continued demand from tenants in the life science sector. While many of these tenants paused their plans due to COVID-19, a majority have activated their requirement or begun exploring the market. While not all the current tenants in the market will transact in the short term, these levels provide a barometer to leasing activity in quarters to follow.

Demand by Region & Business Sector

Life Sciences vacancy is historically low, with a combined rate of just 1.5% in the core suburban submarkets of Torrey Pines and UTC/Eastgate. And while neighboring Sorrento Mesa/Valley acts as a relief valve for these areas, and has a higher vacancy rate of 11.6%, much of its vacancy is in adaptive reuse Class B projects.

Venture Capital investment in San Diego Life Sciences remains robust as an unprecedented amount of capital continues to be infused into this sector. 2020 saw a record $6.1 billion in overall VC startup funding in 2020, with more than $4 billion coming to the Life Sciences/Biotech sector, according to National Venture Capital Association and PitchBook. This compares to $3.5 billion overall and more than double the $1.5 billion level for Life Sciences/Biotech in 2019.

Of the 23 properties, totaling nearly 3.9 million square feet, currently under construction countywide, 29% are pre-leased and 1.3 million square feet (14 projects) are expected to be delivered by the end of 2021. The majority, or 85% of inventory, is speculative with the remaining 15% build-to-suit (BTS). Over 53%, or 2.1 million square feet, of inventory currently under construction is located in the Downtown submarket without any current pre-leasing.

These projects are expected to add significantly to the Downtown vacancy in a near future until they are absorbed. In addition, phase one of IQHQ's Research and Development District, planning to attract life sciences companies to Downtown from the suburbs, broke ground this quarter, totaling approximately 800,000 square feet.

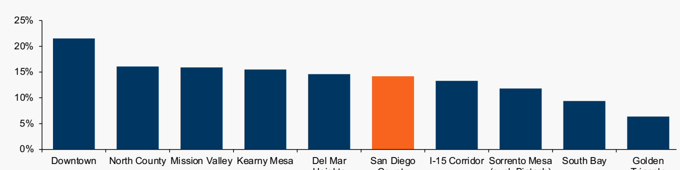
A Look at Specific Office Sectors

Since the beginning of 2020, over 1.6 million square feet of speculative life sciences product has broken ground. In Torrey Pines, Cooley leased 73,776 square feet, an entire building at The Boardwalk, while Zentalis Pharmaceuticals took the remaining two buildings, totaling 117,929 square feet. Element Biosciences leased 101,179 square feet for a new Building at Alexandria Tech Center that broke ground in Q3 2020.

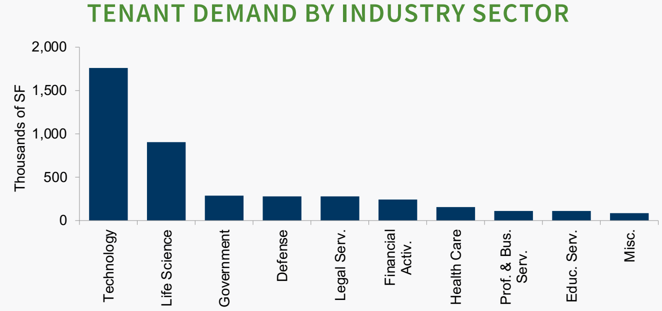
A bioscience hub for Vertex Pharmaceuticals by Alexandria Real Estate Equities, located in the Spectrum IV, Torrey Pines.

Most of the expected future absorption from previously signed leases will come from the biotech sector and from leases signed for projects currently under construction. In Eastgate, Apple leased two buildings for over 364,000 square feet due early 2021. In Oceanside, a 100,000-square-foot BTS project for the County of San Diego Health & Human Services department is estimated to be completed in 2021.

SAN DIEGO COUNTY OFFICE SUBMARKET VACANCY RATES



TENANT DEMAND BY INDUSTRY SECTOR



Source: Cushman & Wakefield

Apple has nearly 600,000 square feet of leases for existing and under construction product they are expected to occupy over the next 12 months, with further plans for a major San Diego campus totaling over 1 million square feet.

What to watch moving forward toward a recovery

Beyond the numbers, which may have significantly changed from the time of our research to the moment of publication, lies much decision-making by companies who are reflecting on their future. Most firms will participate in some downsizing of their space needs in response to changing employee needs and demands.

Also apparent is that many firms will be reconfiguring their spaces to accommodate the changes brought about through the COVID-19 crisis. Hybrid style of working with more flexibility of choice for employees has been proven a workable paradigm for some, if not most firms. This could impact the design (or redesign) of existing floorplans including the expansion of conferencing space both indoor and outdoor with more robust meeting technology for virtual communications. Other factors destined to continue include the attention to air quality and public health concerns and this will drive the need for enhanced technology to address a wide range of human-to-building connections.

All of these new phenomena are starting now and will not just stop in 2021. What we are witnessing is a makeover in the office sector in terms of how much we need, how we pay for it, where it is located and how it will look. Change in this sector is not a new phenomenon, it's just that there is a lot of change happening in a short period.

There will be both winners and losers in this sector. Ultimately the sector will shakeout in terms of overall demand going forward, what works and what doesn't work. There will also be a probable shakeout in ownership and capital invested. Some owners will want to shed their assets while others will buy at likely low-price points relative to the recent past. We think that the transaction sector will be quite robust during this year, and beyond, as assets and inventory change ownership.

Class B and C buildings are certain to continue to bear the brunt of the distress. Many of these buildings will be targets of adaptive reuse or upgrades as we have seen in several buildings in Downtown San Diego over the past several of years.

In many cases, particularly along San Diego's older corridors, such as El Cajon Blvd. and University Avenue, family-owned legacy properties will be gradually sold off to development entrepreneurs who will renovate or demolish and rebuild mostly residential dominant projects with first floor commercial, a progression which is now being encouraged by the City of San Diego development codes and which is also reflected in various community plan updates.

There is also significant movement to efficiency in terms of the relationship of work to home. Firms have shown that they are willing and able to locate office space close to where people live. This was a major contributing factor in the growth of north city's Carmel Valley market, which now accommodates over 4 million square feet, and where employees mostly live in the same zip code or an adjacent one.

Reuse of the San Diego Union-Tribune HQ site into a modern indoor-outdoor office campus in Mission Valley by C.W. Driver Co. Opened at the end of 2018.

Property Type Outlook

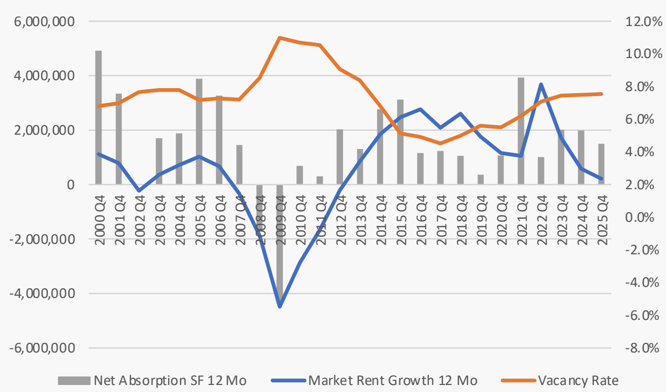
INDUSTRIAL Trends & Investment Prospects

by Bret Morriss, Managing Director, Stream Realty, Contributions from Steve Williams, Partner, SENTRE

There is no doubt that despite the impacts of COVID-19 on the commercial real estate (CRE) industry, industrial assets and development continue to thrive. While uncertainty in the second quarter of 2020 resulted in a short slowdown in both leasing and sales transaction volume, the pandemic further ignited the San Diego industrial market. Absorption has continued to pace new delivery and rent growth has continued to hover above historical averages.

To understand industrial trends, we must first examine the largest economic sectors in the region and how industrial properties are utilized. Ecommerce and distribution, defense, life science and manufacturing provide for the vast majority of industrial demand. Also critical is San Diego's relationship with Mexico and its efforts to increase technology, policy and efficiency at the border has and will continue to increase demand for industrial space in South County.

SAN DIEGO COUNTY INDUSTRIAL LEASING STATS



Source: Stream Realty Partners

Ecommerce & Distribution

In addition to the more than 3 million square feet that Amazon has under construction as a build-to-suit in Otay Mesa, the ecommerce company also led the region in industrial leasing in 2020. Amazon pre-leased in excess of 500,000 square feet in Poway and leased more than 140,000 in Rancho Bernardo, 72,000 in Rose Canyon, 62,000 in Kearny Mesa and an additional 175,000 in Carlsbad amounting to a total of almost 1 million square feet. Iron Mountain, Bose and Hillebrand (Heineken distribution contract) represented three of the top five industrial tenants taking over 100,000 square feet each and all in Otay Mesa. As of Q4 2020, 5.6 million of the roughly 6 million square feet of industrial under construction are in Otay Mesa and are primarily distribution and logistics focused. Walmart signed a new lease for 90,000 square feet in Santee and many smaller 3PLs have been riding the giant's coat tails, taking down space throughout Southern California to feed into the Amazon and Walmart systems.

Another growing national trend is the retail to distribution conversion. There are a few reasons why this is not expected to be impactful in San Diego including the relative strength of existing retail in San Diego County. Except for some big box stores which have become obsolete, retail is still the highest and best use for most of these properties. Secondly, municipalities are slow to allow changes in zoning and face the loss of retail tax revenue and potentially upset residents.

We do however anticipate a future trend in cold storage demand in big box distribution, including more storage, and last mile considerations.

As more and more consumers move to grocery delivery services, there is a need for full and partial-use cold storage buildings. Unfortunately, it is difficult to prepare for future demand as specifications vary and improvements are expensive. This results in most cold storage supply being purpose built, not speculative. Redevelopment of existing industrial to cold storage require specially designed foundations to prevent freezing, cracking and bubbling. For more information on cold storage and distribution trends contact Kate Lyle with Ware Malcomb at klyle@waremalcomb.com who specializes in this niche.

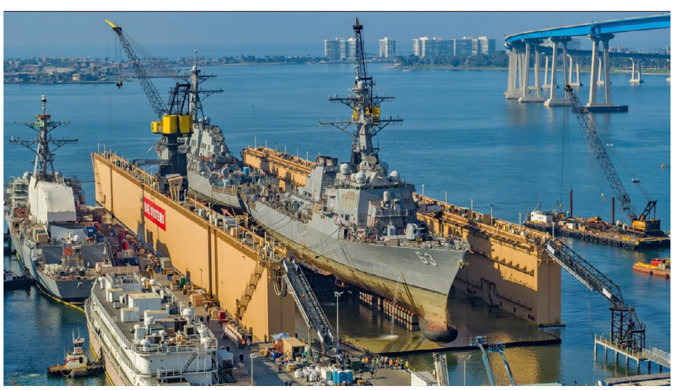
One of San Diego's largest industrial building by Co-star.

Defense

According to the San Diego Regional EDC and San Diego Military Advisory Council (SDMAC), almost $30 billion in defense industry spending contributes approximately 22% to regional domestic product. Manufacturing, R&D and maintenance facilities are the asset types in most demand by the defense industry.

Geographically, the defense industry is sprawled throughout the region with a large aerospace manufacturing presence on the I-15 corridor; services and consulting operations throughout Midway with close proximity to NAVWAR; and ship building and maintenance contractors throughout Barrio Logan, National City, Chula Vista, and Otay Mesa. General Atomics was awarded a number of large contracts this year including up to $950 million for development of the Joint All Domain Command and Control (JADC2) and a $93 million contract to develop enhanced AI for its Reaper remotely piloted aircraft (RPA).

The NAVWAR Old Town redevelopment project has executed a partnership with SANDAG with plans to further explore partnerships with the City of San Diego, the San Diego Airport Authority, and private developers to redevelop the existing dated warehouse site into a world class, mixed-use, center of excellence. At this facility, the Navy anticipates recruiting, retaining, training, and executing high-tech missions within a Class A development space tailored for its engineers and programmers working on the U.S. Department of Defense networks, software and cyber security.



BAE Systems Ship Repair National City.

The Brown Airfield redevelopment in Otay Mesa presents an interesting opportunity for aerospace-oriented defense contractors offering up to 1.3 million square feet of R&D commercial space with direct access to the 7,900-foot runway and controlled access to the future technology business park.

Life Science

With more than 2 million square feet of conversions underway in Central San Diego and more than 2 million square feet of Life Science requirements as of the 4th quarter 2020, this sector is having a monumental effect on industrial absorption, rent growth and low vacancy rates. Central San Diego is largely void of new development land but caters to demand from a very diversified set of users and properties. The highest and best use on many dated industrial and office buildings is now for lab and other life science purposes. While the conversion cost and tenant improvements are in the upper echelon of all asset classes, the achievable rent almost doubles office rents and quadruples industrial rents making the investments thus far very successful.

Most notably Alexandria, Phase 3 and Longfellow have been very active in the Sorrento Valley and Sorrento Mesa areas, acquiring properties to redevelop. One successful case study was the recent reposition and exit for BPI of 10770 Wateridge Circle. The project was a former antiquated industrial property in North Sorrento Mesa. After an extensive $20 million renovation project, BPI substantially leased up the property and sold the 185,000-square-foot R&D project to Harrison Street for $135.9 million.

Users and investors are both re-imagining the importance of concentration in Central San Diego and looking at areas in North County and Downtown. Millipore Sigma, GenMark, Azzur Clean Rooms and Cue Health are among others setting up substantial operations in Carlsbad and Vista. Downtown IQHQ has broken ground on a projected 1.7 million speculative square feet of life science space on the waterfront at the former Manchester Pacific Gateway site and Phase 3 is underway on converting 1155 Island, the former Thomas Jefferson Law School building in the East Village.

Manufacturing

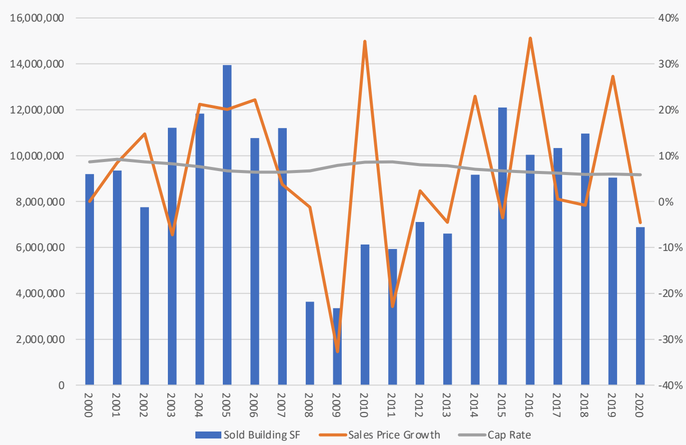
While the overall manufacturing market may continue to be impacted by wage hikes, work visa restrictions and inefficiencies caused by COVID-19, there are still a plethora of successful manufacturing companies in San Diego. The area is touted as the #1 most patent-intense region in the U.S., producing high-tech and complex products for companies like Qualcomm, Solar Turbines, Thermo Fisher and ViaSat, not to mention the many other defense and life science/pharma manufactures previously discussed.

Domestic manufacturing in high-wage San Diego tends to involve products requiring tight quality assurance, complex processes, expensive capital equipment and proprietary intellectual property making it more difficult to offshore our outsource to other countries or regions.

We expect that some of the updated regulations in the new US – Mexico – Canada Agreement (USMCA) will provide additional incentives for companies to manufacture on both sides of the US/Mexico border.

Wage requirements include an hourly wage above $16 per hour on either side to qualify for exemptions from tariffs. Smart borders integrated into the new commercial crossing will allow for more efficient collaboration between San Diego and Baja Mexico.

SAN DIEGO COUNTY INDUSTRIAL SALES STATS



Source: Stream Realty Partners

Cross Border Opportunities

The relationship between San Diego and Tijuana is often the most important overlooked feature of the region. The Tijuana border crossing is the busiest land border crossing in the world with 70,000 vehicles crossing into San Diego every morning for work and another 30,000 pedestrians crossing at San Ysidro and the eastern Port of Entry in Otay. More than 3,500 trucks cross through the Otay Mesa commercial Port of Entry everyday with border delays for these trucks estimated to cost both economies $7 billion per year.

Tijuana has approximately 75 million square feet of industrial with a 1% vacancy rate. If we think about Otay Mesa as a "Port of entry" similar to how we think about the Ports of Los Angeles and Long Beach, the growth potential is incredible.

The trend toward "nearshoring" where the U.S. will rely more heavily on our neighboring countries than Asia has continued to grow in the shadow of COVID-19, regulatory risk and port strikes which have massively disrupted supply chains. For reference, all of San Diego County is roughly a 200 million square foot industrial market with Otay Mesa accounting for about 17 million square feet and 5.6 million more square feet under construction while the Inland Empire market, serving primarily as a distribution hub for the LA ports measures 700 million square feet. The potential growth of southern San Diego County as an international distribution and import/export hub is massive.

The ability to capitalize on the advantages within the new USMCA and the Foreign Trade Zones (FTZ) of Otay Mesa should allow for exponentially better cross border operations and utilizations of the most effective labor, facilities, and distribution processes from each country.

Future of Value and Cap Rates

We predict that San Diego Cap Rates will continue to compress on industrial product across the board with the most compression on Class A, investment grade credit tenancy. Relative to the rest of Southern California, San Diego trades at a discount averaging a 5.6% cap rate over the past two years on an average annual sales volume of over $550 million. Los Angeles averaged a 4.7% cap rate on an average annual sales volume of over $2.1 billion, Orange County averaged 5.1% cap rate on average annual sales volume of $550 million and the Inland Empire averaged 5.0% cap rate on average annual sales volume of over $1.6 billion.

Property Type Outlook

HOTEL Hospitality Forecast

by Robert Rauch, Hotel Entrepreneur, RAR Hospitality

Hospitality industry performance is measured by supply, demand, occupancy, average rate and RevPAR, the combination of occupancy and rate. Short-term, the outlook remains a bit grim. When Q1 2021 results are in, they will be down dramatically from Q1 2020, the beginning of the COVID-19 Era. Payroll Protection Program (PPP) dollars will be coming in through the quarter, followed by an improved Q2, a fairly robust Q3 and strong growth in Q4 if group business and events return.

Supply & Demand in San Diego

In 2021, supply will increase about 2% from new properties plus the re-opening of 6% of hotels that were closed in 2020. In addition to new supply of hotels, in 2021, we will see a number of short-term rentals on the market that grew in popularity during 2020. These rentals add to the market supply, particularly during peak periods. Demand fell apart by the end of March, 2020 and has yet to pick up steam. Since that time, groups have either cancelled or postponed all of their events in California. Business travel shut down at that time as well.

Hotel Del Coronado reopened in June 2020 after closing for the first time in its 132-year history due to the COVID-19 pandemic.

Leisure travel has remained the only market to be on the road, however, they have faced stay-at-home orders that limit their desire to travel. Air travel has been extremely light with the San Diego "drive-to" market being the only viable market to move the needle an inch or two. The forecast assumes no group business at all through Q2 of 2021 since it is currently not permitted, 25% capacity constraints in Q3 and Q4 and a limited recovery of business travel through the end of the year.

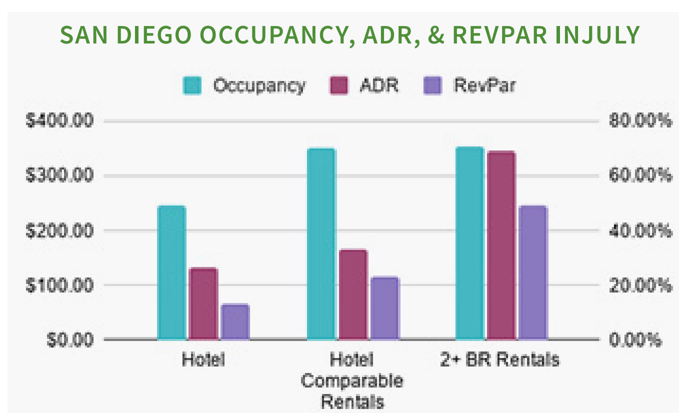
Competition from Short-Term Rentals (STR)

AirDNA, the leading provider of short-term rental data and analytics, analyzed room nights to show that occupancy and average rate declined much more severely among hotels than Airbnb hotel comparables (studio and 1-bedroom). As an example, looking specifically at the San Diego market, one that has a strong short-term rental market, here were the results for July, 2020: Short-term rentals reported higher occupancy, ADR and RevPAR compared to hotels for the month of July. Hotel occupancy declined from 90% to 50% while rates dropped from $180 to $130. That RevPAR decline is $162 to $62, a 62% drop. During that period, RevPAR declines at hotel comparables (short-term rental units that are studio or 1-bedroom) was only 14%.

This past winter, hotel RevPAR declines were 50% while STRs were up 16%. The addition of new supply, coupled with loss of market share from STRs will put pressure on hotel performance going forward, likely through 2021.

Challenges Facing the Industry in 2021 & beyond

Airbnb and Vrbo are not the only challenges on the horizon. What's needed for a strong recovery from COVID-19 includes a return of the business traveler, a return of meetings and a return of the international traveler. Further, new supply that was in the pipeline will continue to open and for at least another year, large convention hotels will be competing with smaller properties every single day, keeping rate growth to zero in 2021.



Additionally, in 2021, the customer will be calling the shots unless hotel operators can differentiate their products and brands for travelers. This will require both some top-notch digital marketing and new operational service levels that wow the guests with sanitization, cleanliness, creativity, value and more.

Yes, these challenges can be faced head-on. Enhanced hygiene tools can differentiate one hotel from another and the hotels from vacation rentals. Vaccine delivery will have an enormous impact on travel. First, travelers will feel more comfortable making trips they would not even consider before taking the vaccine. Second, corporations will allow their team members to travel to events, conventions and on sales calls. Third, consumer confidence will jump to new heights due to pent-up travel demand. 2021 will be much better as we approach summer.

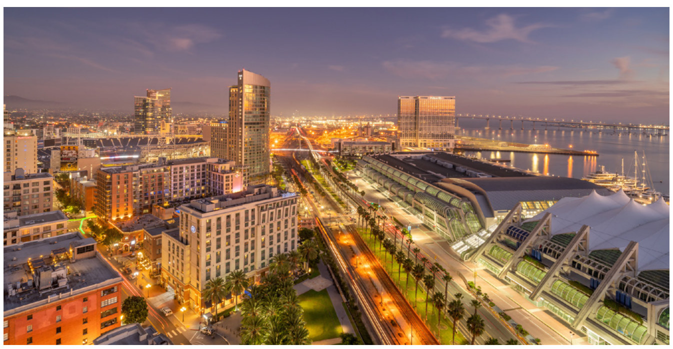


Photo by Scott Murphy

Our forecast calls for 52% occupancy at an average rate of $129 for 2021. This is up from 48% occupancy but down $1 to $129 for 2021. RevPAR dropped over 50% (occupancy times average rate) from 2019 to 2020. We expect occupancy to increase in 2022 to 71% at an average rate of $147. It will likely take a full 5 years to recover to 2019 levels. Here is a graphic depiction of tourism numbers in San Diego from 2019-2022:

LODGING MARKET SAN DIEGO – 2019-2022

	2019	2020	2021	2022
Supply	+2%	-6%	+8%	+1%
Demand	+2%	-41%	+16%	+11%
Occ	77%	48%	52%	71%
ADR	$167	$130	$129	$147
RevPAR	$129	$62	$67	$104

Return to 2019 numbers will likely take 5 years

Source: STR & Tourism Economics

The bottom line is that the pandemic has caused a great deal of uncertainty for travelers and suppliers of travel services. Attractions remain closed here in California and meetings are not permitted in the state. This is not in sync with the rest of the country as California remains the only state to not allow meetings or conferences. San Diego might fare better than other cities that do not have access to millions of travelers via automobile. That said, state restrictions have and will continue to crush downtown and large meeting hotels. The loss of jobs is crippling and the loss of small businesses, particularly restaurants, is way beyond any previous crisis.

The Impact of COVID-19 on Hospitality and Tourism.

Q&A WITH **JULIE COKER**

President & CEO San Diego Tourism Authority

"Tourism is an industry with lots of space for career growth for a diverse cross-section of people."

Q What changes made due to COVID-19 do you think will stick as trends?

After the COVID-19 pandemic, meetings and conventions will likely change. Face-to-face meetings will continue but meeting and convention planners will use technology to diversify the experience and the access. They will be more cognizant of online possibilities than in the past.

COVID-19 brought to light the importance of access to the Internet and other meeting technology. On a regional and national level, we need to stay focused on equity when growing and facilitating this access, especially since many jobs may stay, or become, remote. Despite having less face-to-face interaction with staff, employers also have a new or increased appreciation for encouraging and providing access to wellness – both physical and mental wellness – through their companies.

The pandemic has emphasized the importance of outdoor spaces, too. We can expect to see more outdoor dining and a reimagining of public streets. I think people will also have a greater appreciation for travel – both domestic and international.

Vistal Bar + Restaurant terrace, InterContinental Hotel, downtown San Diego

Q How might those trends impact the hotel, hospitality, and entertainment sector?

The pandemic has been tough for hospitality workers. Of the approximately 200,000 travel-related jobs in San Diego before the pandemic, 40% of those are gone or furloughed. It's not easy for those who are unemployed to pivot into another job or industry.

Lost revenue from hotels also impacts local governments, many of which rely on transient occupancy tax (TOT) to fund myriad public programs. TOT tax generated $295 million in San Diego last fiscal year. Government entities will have to make painful budget cuts that could have long-term effects and take years to reverse.

Convention centers are often funded by hotel tax, too, so meeting planners may have to grapple with shuttered meeting spaces or reduced services in the indefinite future. Planners may not have as many resources available from destination marketing associations either if their budgets are cut. Many of these groups are examining how to modify their objectives, target audiences, operations, and funding options.

Tourism is a major economic driver for our state and region, and it's an industry with lots of space for career growth for a diverse cross-section of people.

Special Report

POLICY Round-up

by Daniel Reeves, Juniper Strategic Advisory

Just like everything else in 2020, land-use policy had a mixed year. We had some hard losses, and some novel challenges, but we also had some wins. And just like everything else in 2020, it's important to take stock of what we learned and put it to use to ensure 2021 brings progress towards a brighter future.

We saw some big things get done locally last year, like the City of San Diego's adoption of an inclusionary housing ordinance, middle income density bonus program, and of course, two elements of the Complete Communities policy initiative. The Governor also signed Assemblymember Gonzalez' AB 2345, a bill crafted to expand the success of San Diego's Affordable Housing Density Bonus program statewide. But along with everything else, COVID-19 made the act of legislating particularly hard last year as well. A truncated session in Sacramento limited time to get things done and, as a result, some important housing bills died at the literal 11th hour due to procedural rules, and some political shenanigans. That's where we'll start our 2021 roundup.

Senate President Pro Tem Atkins' SB 995 and 1120, both of which expired in transit to the Senate for concurrence, live again in the form of SB 7 and SB 9 respectively.

SB 7 — Jobs and Economic Improvement Through Environmental Leadership Act of 2021 (Atkins)

> SB 7 would extend the Governor's ability to certify "Environmental Leadership Development Projects," as defined, for streamlining benefits related to CEQA until Jan 1, 2024 (bill sunsets Jan 1, 2026 by which time jurisdictions must have approved projects certified under the bill).
>
> Adds "housing" projects, as defined, to those that may be certified by the Governor for streamlining.

SB 9 — California Housing Opportunity & More Efficiency (HOME) Act (Atkins, Caballero, Rubio, Wiener)

> SB 9 would allow for development of 2-unit projects in single-family residential zones to be processed ministerially, and be exempt from CEQA. No public hearing would be required for Coastal Development Permits (CDP).
>
> It would also allow urban lot splits in residential zones that create 2 new parcels of equal size (minimum 1200 square feet) to be processed ministerially, and be exempt from CEQA. No public hearing would be required for CDPs.
>
> Senate Bills 7 and 9 are part of a larger package of housing legislation brought forward by Pro Tem Atkins and her colleagues, Senators Caballero, Skinner, and Wiener, called the "Building Opportunities for All" Senate Housing Package, with Senate Bills 5, 6, 8 and 10 rounding out the six-piece package.

SB 5 — Housing: Bond Act (Atkins, Caballero, McGuire, Rubio, Skinner, Wiener)

> AB 5 lays the groundwork for the issuance of bonds, the proceeds from the sale of which would be used to finance housing-related programs that serve homeless, extremely low income, and very low income individuals.

SB 6 — Neighborhood Homes Act (Caballero, Eggman, Rubio)

> SB 6 would allow local government to expedite residential development in commercial office and retail zones, think big box retail and strip malls, as long as residential units are built to a minimum density (30 units/acre in San Diego) to accommodate lower income households.

SB 10 — (Wiener)

> Gives local jurisdictions the right to pass an ordinance to rezone a parcel for up to 10 units of residential density per parcel, without the ordinance triggering CEQA review if the parcel is located in transit or jobs-rich area, or an urban infill site, as defined.

On the State Assembly side, at time this was originally drafted, things were a little quieter on the land-use legislation front, the most notable items being a pair of COVID-related bills (AB 15 and 16) and a bill requiring jurisdictions to allow housing to be developed on land zoned for commercial uses (AB 115). Since that time, Assemblymember Ward has introduced a couple of housing-related bills as have some of his colleagues.

AB 482 (Ward)

> AB 482 would extend until January 1, 2026, the sunset of a pilot program allowing a housing authority, such as the San Diego Housing Commission, to develop and finance middle-income housing projects if the project receives gap financing.

AB 950 (Ward)

> AB 950 would authorize CalTrans to sell excess real property to a local jurisdiction at the price originally paid by CalTrans if that jurisdiction agrees to use the property solely to build affordable housing, and would exempt these sales from CEQA.

AB 617 (Davies)

> AB 617, not to be confused with the widely-known air pollution control bill from 2018, would authorize local jurisdictions to transfer all or a portion of their Regional Housing Needs Assessment (RHNA) allocations to another city or county for a negotiated fee. This may be interesting to our regional cities grappling with the prospect of adding density.

AB 682 (Bloom)

> This bill would require any City with over 400,000 residents to permit the building of co-housing, as defined, in any multifamily zone, and on the same basis as multifamily dwelling units, and requires a certain percentage of co-housing units be set aside for affordable housing.

While this list offers a glimpse at a few interesting pieces of legislation, with a focus on what our local delegation is working on in the land-use arena, with over 2500 bills already introduced this session, we clearly can't touch on each one of significance to our readers. For a closer look at some of these bills, and others of interest, follow this link to a more detailed, although still not comprehensive, list of legislation on which to keep our collective eye.

One might note, from the legislation thus far introduced in Sacramento, that there is a theme influencing the various initiatives. With a few exceptions, they all fall into predictable buckets – boosting or incentivizing housing production, responding to COVID, creating funding streams for affordable and permanent supportive housing, and, ever present and looming, the battle between state and local control.

This battle will likely continue to rage in smaller towns and different regions across the state, but, fortunately for us, San Diego and our regional neighbors tend to be trend setters in land use policy, whereas others are far more likely to take exception to mandates coming out of Sacramento. Illustrating that point, statewide legislation is often written to emulate policy created right here at home. I mentioned last year's AB 2345; let's take a look at what other policy initiatives we can expect to come forward this year in our own (Yes In My) backyard.

SAN DIEGO

Complete Communities

Picking up where we left off in 2020, the Complete Communities initiative, partially adopted at the end of last year, will continue to make progress. The initiative's remaining two elements, Play Everywhere and Infrastructure Now will make their way to a City Council decision. For Play Everywhere, this will be its return to the dais for consideration, as it didn't enjoy sufficient Council support last year to achieve adoption. We'll see what components may be adjusted to ensure Play Everywhere's success at Council, although, with five new councilmembers installed since the last time it was heard, it may have the support to pass without significant changes. Both Play Everywhere and Infrastructure Now propose changes to how development impact fees are calculated and how they are allocated to various project throughout the City, with a major emphasis on promoting equity in how locations and types of projects are prioritized for funding.

Community Plan Updates

The City will continue its charge forward in completing a couple community plan updates each year. This year we can expect the Barrio Logan, and Clairemont Mesa community plans to receive their overhauls, for which both are overdue. The Mayor has stated his intent to continue efforts to further streamline the community plan update process so that more of our communities have a plan that fits their needs and those of the region.

Non-residential Parking Standards

The continued march towards decreased residential parking standards has become very familiar to those doing work in San Diego in the last few years. In 2021, we'll see that effort cross over into non-residential projects as well. Commercial projects that fit certain requirements and are located in Transit Priority Areas will soon have the option to reduce the number of parking spaces per square foot and, instead, provide parking or mobility amenities that encourage the use of alternative modes of transportation.

COVID

The City took quick action last year to implement temporary changes to allow for additional outdoor restaurant seating, use of park space for classes and gatherings, and instituted eviction moratoria to address significant impacts from the global pandemic. This year the City will be working to make a number of these changes permanent, and will formalize additional protections for tenants. In January, the City Council voted to implement a residential and commercial tenant eviction moratorium that, as of this writing, will expire 60 days following the end of the local emergency declaration, or, in the case of commercial evictions, on June 30, whichever comes sooner.

Environmental Justice

Sometimes state law creates a planning mandate that obligates cities to reach a minimum standard with regard to a policy priority. This is the case with the City's introduction of an environmental justice element to the City's General Plan. That said, as is often the case in San Diego, our planners and policy makers will take that mandate a step further this year and introduce an Environmental Justice element that goes beyond state requirements to promote equity in our planning processes and works to prevent and address the inequitable environmental burdening of communities of concern.

Climate Resilience

Similarly, we can look forward to the debut of Climate Resilient SD this year, a climate resiliency and adaptation plan that will influence future planning efforts and ensure that future projects meet minimum standards to ensure they can survive an uncertain climate future. If one were not careful, one might conflate this with the City's Climate Action Plan, a set a programs and policies designed to reduce greenhouse gas emissions to minimize our contribution to global climate change. Climate Resilient SD, on the other hand, is a plan for how we, as a city, will address the inevitable consequences of an already changing climate. The plan will set policy to ensure that we can adapt and recover from more intense precipitation events, longer droughts, rising sea levels, and increased wildfire risk.

NOFA

As funding for affordable and permanent supportive housing is one of the obvious trends in policy this year, the City wouldn't want to be left out. The City announced that it will be using the proceeds from the sale of former Redevelopment Agency assets, combined with state and federal resources, to support the development of affordable housing. The funds will be distributed by way of a Notice of Funding Availability, so if you're an affordable housing developer, you had until the end of January to get your proposals in. Hope you made it.

SAN DIEGO LAND USE & HOUSING COMMITTEE

While the initiatives discussed thus far under the City of San Diego's jurisdiction are important, they are all also within the Mayoral purview – that is, they are either departmental efforts, or priorities outlined by the Mayor himself. They are, therefore, not necessarily illustrative of the priorities of San Diego's legislative body, which, arguably, is equally equipped to shake up the land-use policy world. As such, it's worth taking a look at what our City Council may have up its sleeve this year. It's still very early to have a comprehensive look at all the potential areas where the City Council may enact policy changes, especially with more than half of the body made up of freshman members sworn in in December, but here are some of the priorities laid out in the Land Use & Housing Committee's recently-adopted work plan:

- Meet RHNA allocations and facilitate development of housing affordable to people experiencing homelessness, low, and middle-income residents.
- Protect tenants impacted by COVID-19.
- Implement a Rental Assistance Program to provide relief to renters and landlords.
- Preserve existing Affordable Housing stock.
- Conduct study of vacant home stock and consider vacancy fee.
- Explore allowing development of, or conversion to, Affordable Housing in office and commercial zones.
- Identify publicly-owned lands available for housing development.
- Explore an incentive-based approach to preserving SROs.
- Implement policies to increase housing stock for seniors, families, and residents with special needs.
- Simplify and streamline review and approval of housing development.
- Review in-lieu fee policy and consider ways to promote on-site affordable housing.
- Incentivize Affordable Housing development near transit and employment hubs.
- Revisit Council Policy on Community Planning Groups.
- Explore establishment of Community Land Trust.

SAN DIEGO CITY COUNCIL

Of course, the ultimate decider on many issues of great importance to the land-use industry is not the Committee but the City Council. This was very much on display in February when Council President Campbell brought forward a proposal to finally address the ongoing short term vacation rental dispute. With an 8-1 vote on the first reading of the new ordinance, it appears that we will soon have clear rules on how this segment of the industry will be regulated. Assuming the second reading goes the same way, here's what we can expect:

- STRs capped at 1% of housing stock (except Mission Beach).
- Capped at 30% of dwelling units in Mission Beach.
- Limited to one license per individual.
- Licenses to be distributed by lottery.
- Future consideration of prioritization of "good actors" for licenses.
- Homes available fewer than 20 days per year and home sharing not subject to caps.
- License fees that vary based on how frequently homes are rented.
- New ordinance to take effect July 1, 2022.

SAN DIEGO COUNTY

The big news on the County of San Diego front this year is a renewed effort to write a legally-binding Climate Action Plan. One might recall that this is not their first attempt. Multiple CAPs have been previously thrown out when challenged in court. With a new Democratic majority on the Board of Supervisors, with Supervisor Fletcher in the driver's seat as Chair, we can expect a more aggressive commitment to electric fleets, reduced sprawl into the backcountry, and GHG emissions reductions, not just offsets. In fact, in January, the Board unanimously approved a proposal which commits the County to zero carbon emissions by 2035. As apparently the largest county in the nation to commit to such an audacious goal, it will be interesting to see how the County gets there – presumably by overhauling key sectors such as transportation, energy, and, importantly to this audience, land use.

In summary, 2021 is shaping up to be an ambitious year for land-use policy. With so many unknowns still looming such as when COVID will be under control, if there will be any new interruptions to the legislative sessions in Sacramento, and what new leadership in Washington might mean at the local level (will federal programs such as Opportunity Zones and New Markets Tax Credits be up for debate?), it's still too early to claim it's a new day for industry-changing policy. But, as with so many other things, expectations are high that 2021 is going to be a better, more productive year for land-use policy.

For a more complete list of statewide bills, click here for a downloadable PDF.

2021 SAN DIEGO REGION

Real Estate Trends Report

San Diego/
Tijuana