2022 SAN DIEGO REGION
Real Estate Trends Report

Photo by Autumn Murphy

ULI San Diego/ Tijuana

Welcome to the San Diego-Tijuana 2022 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 land use and real estate development regionally, in the US and throughout major global markets. Our "Emerging Trends in Real Estate" is a research and forecast publication now in its 43rd edition, and it is considered one of the most highly regarded reports in the real estate and land use industry.

This year's national report identified three major themes: Surprising Resilience, Booming Economy and Worrying Risks. While these themes are equally true for the local San Diego-Tijuana region, the District Council Trends Report also focuses on initiatives and government policies that will shape land use decisions at the local and state level. We asked some of the region's best and brightest to share their insights on key market sectors for Office, Industrial, Hotel/Hospitality, Retail, For-Sale Housing, Rental Housing and Affordable Housing. Then we interviewed leaders on the economy, consumer trends, and emerging industries/projects to provide their observations on market forces that will affect real estate in the future.

Thank you to all of you who participated in the advance local Trends Survey. We got a resounding response, and you will see your responses reflected here and incorporated into the various sections. 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 your comments on this version of San Diego's Emerging Trends in Real Estate. I also want to thank all the professionals, business leaders and government officials that have helped make this report a reality.

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

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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Notice to Readers

This report is a forecast publication produced by ULI San Diego-Tijuana with the support of industry members from throughout the region. It is inspired by the Urban Land Institute's Emerging Trends in Real Estate report and based on the best available information at the time of writing.

The San Diego-Tijuana Trends Report seeks to provide an informed outlook on real estate investment and development as understood by ULI San Diego-Tijuana and our contributing authors. The analysis, views and opinions expressed herein are those of the contributing authors and not necessarily their employers, the Urban Land Institute, or the ULI San Diego-Tijuana chapter.

The material that follows was developed from a number of sources: interviews, research by individual contributing authors, surveys, and forecasting. Contributing authors to this report are identified at the beginning of each section and are responsible for the content of their chapters.

While the information contained in this report represents informed analysis of the San Diego-Tijuana real estate market, it should not be used to make business decisions in lieu of professional consultation.

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Executive Summary

How Do We *Grow* Forward?

by Gary H. London Senior Principal, London Moeder Advisors

The biggest surprise of the past year is how quickly the economy recovered after a near economic shutdown. Those who predicted a "V" recovery were mostly right. Notwithstanding the continued up and down scourge of the COVID variants, supply chain chokeholds and political uneasiness, 2021 was characterized by a surprisingly strong economic recovery.

From a real estate point of view, it was as if the players were waiting on the sidelines for the field to be cleared. And then BOOM (my ode to the recently departed John Madden), most everyone returned to the game.

This Trends report is a tale of two stories: one is the rapidity of the recovery, the availability and the bargain of capital, the eagerness of public agencies to entitle, and the willingness of consumers to come out of their hiding places and spend.

The other story is the rapid adjustment, stemming from a presumed post-COVID environment, in how entrepreneurs intend to respond to the changing marketplace for the built environment. How we work, reside and shop were all up for redefinition throughout the past year, resulting in experimentations on what the new built environment can look like.

Throughout 2021 it felt like people were stumbling over one another to get back to making deals, to tear down something, to build something else. And to do it in a way that is unprecedented in terms of the sheer volume, and type of, activity.

Last year I suggested that the economic recovery begins with the inoculations. That was mostly right, except that the recovery began with the mere prospect of the vaccine being stuck in most of our arms. We never did convince everyone (although in San Diego County the vaccination rate has been significantly higher than in most other places), but enough persons have received the vaccines that the markets reacted as if COVID was over.

It wasn't and it isn't. But the prospect that there is a path to endemic, or a tolerance to just live with it, was sufficient for most to charge forward. The "end of pandemic" in June was followed by the more serious Delta variant in August and, as of this writing, the presumed less serious but more contagious Omicron variant. In our own particular and disparate ways, we have decided as a society that we are going to cope with it and get back to business as normal. Or at least as 'normal' redefined.

The Challenges

Amidst the prosperity, our region continues to be challenged in many ways. Here are a few that stick out:

- The Approval by the SANDAG Board of Directors to a new, forward thinking, transportation plan, but with the significant uncertainty of how to finance it (e.g., no new taxes) and a proposed Mobility Hub without an actual location because the Navy and SANDAG haven't yet come to a deal on the proposed site.
- Continued trauma at San Diego City Hall where a one step forward, two steps backward melody continues to play out. Case in point is the drama, and now litigation and finger pointing, around the Ash Street deal, the result of which is inadequate office space for City staff, and an overall staff shortage, something most everyone has forgotten to mention. An obvious result is that the City cannot function up to par. For instance, permit processing seems slower than ever, from simple home remodels to complicated new construction. I shudder to think about what the costs of these delays are to our economy, and the spillover loss in private sector construction jobs, retail sales, etc.
- The proposed new development of the Sports Arena promises to be stymied by further delays and litigation. Failure to address the State of California's Surplus Lands Act resulted in the going-back-to-the-drawing-board, rejecting the approval of a Brookfield redevelopment proposal (after winning an RFP contest) and the issuance of a new RFP to

developers to present proposals to address the new housing delivery and affordability rules on the 48 acre Midway District site, only to be cut off by a Superior Court ruling which rejected the voter approved initiative to eliminate the 30-foot height limitation. Stay tuned on that for 2022.

- An international Border that has finally reopened, but with gut wrenching wait times often reminiscent of cars stuck in a snowstorm, such that the usual border crossings for jobs and commerce remains significantly hampered. The condition at the Border is both untenable and unsustainable for either the Tijuana or San Diego regional economies.
- The seemingly unsolvable homelessness problem, which is festering throughout San Diego County. It just feels that civic leaders can't sufficiently step up to address the obvious issues of health, safety and instability that homelessness confers, or have the courage to fully address it. It's intolerable to everyone and is holding back the progress that the City of San Diego and the development community should otherwise be able to boast.

San Diego Trolley Blue Line opening, KUSI News

A specific highlight during 2021 was the opening of the Blue Line of the San Diego Trolley, a north to south track that connects University Town Center and UCSD with metro San Diego. After $2 billion, it is viewed as the completion of a much-needed transportation accessory to our mostly freeway and auto approach to moving around. The supporters say that UCSD students and medical workers will greatly benefit, and that transit-oriented developments can proceed. The detractors say that very few persons currently or will ever ride the trolley, and that this is unlikely to change.

A Region Redefining Itself

All that remains to be seen. But as you look around San Diego, pause, and wind back your mental time capsule to the last half of the 20th Century. It is unmistakable how much this region has changed. It has urbanized, densified, verticalized and congested in ways that have remarkably altered the definition of our region.

We have grown from a suburban-dominated network of villages to a budding urban metropolis. The real estate development sector has responded to the new demands of the market, with the nudging of public policy, to build up and densify with a mix of land uses in most every project. Suburban and master plan green field development has been replaced by infill. Even the old suburbs, such as Clairemont and others east of the I-5, are following the lead of the beach communities and are beginning to be the focus of a makeover.

This has been enabled by the past two-year COVID induced throw-it-against-the-wall-and-see-what-sticks approach to land use development, and public policy decision making. It's exciting to be living in an era where this great experiment in regional redefinition can occur.

That redefinition is not just occurring in the private sector. A clear indicator of a maturing metropolis, San Diego has invested through public and private investment in arts and culture with three expanded or renovated venues opening in 2021 and 2022. The $85 million Rady Shell, the San Diego Symphony's outdoor concert venue along San Diego Bay, opened to much acclaim in the summer of 2021. The venue, along with the adjacent Jacob's Park, has added a distinctive sculptural shape to the downtown skyline. The Shell along with the Central Library are now possibly the two most distinctive structures in downtown.

The $55 million, 3-year, renovation of the Mingei Museum in Balboa Park opened in late 2021, and the $105 million, 5-year, expansion of the Museum of Contemporary Art San Diego ("MCASD") at their La Jolla campus headquarters will open in spring 2022. The expansion, by internationally-renowned Selldorf Architects, has doubled its size and quadrupled its gallery area, added outdoor space, and gracefully incorporates the historic Irving Gill home he designed for Ellen Browning Scripps, which has long been part of the museum.

San Diego Symphony's Rady Shell. Photo by Darren Bradley

One of the great challenges to our region is how we *grow* forward. Clearly, population growth has slowed, as it has throughout the State, the resultant combination of COVID-enabled relocations, lowering fertility rate, and a notable slowdown in domestic and foreign immigration, as revealed by the recent U.S. Census. Limited housing deliveries has fostered a perpetual supply/demand imbalance in housing which, in turn, continues to bid up housing prices. Housing is not alone, although arguably the most significant culprit in San Diego's every increasing cost of living, a factor that is feeding a demographic shift in a region that is swinging to haves and have nots, and less middle-income working-class affordability. Even the new year minimum wage increases will not keep up with those costs.

This will undoubtedly result in a soul-searching moment for our region, one in which we decide who we want to be as we grow up. The year was marked by continuing experimentation in forcing developers to build affordable, yet the challenge of developers to make affordable "pencil out".

But perhaps the bigger tension in the region that has been brought out through the Pandemic is the inequity between the haves and have nots. The greatest sickness and death rates were shouldered by the lower income, least educated rungs of our local society who are, not coincidentally, the same persons who work in the so called "front line" service industries which are also the backbone to the hospitality, construction and public service sectors, many of whom provide essential services.

Our Institute cannot afford to abdicate on this discussion. It is the core issue of living in San Diego, and of perpetuating a thriving economy: **how do we foster economic growth amidst a backdrop of economic stress to its working class?**

Summary of the Sectors

So, it is from that perching point where we visit, sector by sector, the State-of-the-Market, as further detailed in this report:

The backdrop of what is happening in housing can be seen in a recent study conducted by the California Policy Lab on movement throughout California. In San Diego as of third quarter 2021 there were 31,384 exits, which is a percentage change of 8.1% since first quarter 2020. The number of entrances was 13,819, a percent change of -31.2% over that same period. The number of net entrances was -17,565, a percent change of 179.7%.

So, even though housing deliveries are down, so has been demand. To some extent this is a chicken-or-egg question: which came first, lower deliveries or lower housing demand? It's not just an intellectual conundrum. It is an issue which will define our region for years to come. The essential question is how do we sustain a prosperous economy if it is slowing in growth and ever more unaffordable? Slowing growth is not a natural occurrence. Company CEO's look at these numbers carefully, and their actions of whether to stay here, or grow here, will provide the compass to what this region is to be in those coming years.

Housing Top Trends & Findings

Brookfield Properties' Peter Dennehy revisited the housing market again this year, finding that San Diego's new housing market is robust, driven by low inventory, record-low interest rates and an influx of Millennials into the market. There is limited new inventory, new home prices are up 15% and the resale housing market in San Diego County has been on a tear. See (**link**)

Current State of Rental Housing

Rentals are experiencing the most robust market conditions in two decades as occupancies have increased, rent growth has surged, and the number of available units has fallen to low levels, and the current pipeline is unlikely to put much upward pressure on the region's vacancy rate. Expect continued increases in rental rates and low vacancies, as persons increasingly find it difficult to make the jump to homeownership. See (**link**)

Office Top Trends & Findings

The office market in 2021 was in compression, and with spotty results as companies delayed their return to the office. And it is anticipated that when they do, they will require less space. Office demand will continue from expanding new clusters and companies into San Diego, such as the push to bring life science to downtown San Diego. Not surprisingly, lease rates hovered at $3.18 per square foot, while vacancies ranged from 13% to 14%, not counting empty space that might be available for sublease, from the analysis provided by CBRE's Zach DiSalvo. See (**link**)

Retail Top Trends & Findings

Pent-up demand for services and retail experiences, coupled with flush consumers has driven retail sales to levels above pre-pandemic norm, a trend that is expected to continue through 2022 according to Don Moser of Retail Insite. Retail leasing rebounded aggressively in 2021 as vacancy in the San Diego region moved to below 6%. Repositioning of portions of several malls will continue as many properties have tremendous potential for mixed-use applications. See (**link**)

Industrial Top Trends & Findings

Ecommerce and logistics continue as the catalysts to strong absorption and rent growth according to Bret Morriss from Stream Realty. Despite historical high new supply numbers, logistics demand continued to outpace supply, particularly in Otay Mesa. This year's market will see many life science conversions, mostly in the central markets, which is also bidding up property values and putting downward pressure on vacancy county wide. See (**link**)

Hotel Hospitality Top Trends & Findings

The biggest rebound of all the sectors was in hospitality, with performance levels well above the previous years, principally on the strength of increased domestic leisure travel by persons deferred from restricted international travel. San Diego benefitted. Rates & occupancy were way up, at average occupancy levels of 76% at average rates of $168. That is expected to be sustained in 2022. However, there were only modest gains in business/meeting travel, a pandemic hangover that should evaporate in 2022 as conferences, meetings and general business travel returns. Robert Rauch predicts that it will take business travel until the end of 2022 to reach pre-pandemic levels. See (**link**)

Public Policy

Last year our public policy contributor Daniel Reeves of Juniper Strategic Advisory outlined several state and local policy priorities and legislative items to keep an eye on and, true to form, 2021 delivered mixed results. At the state level, Senate President Pro Tem Atkin's Housing Package was largely passed and signed into law. Senate Bills 7, 9 and 10 were all signed by the Governor. SB 10 gives local jurisdictions the right to pass an ordinance to rezone transit or job rich area parcels up to 10 units of residential density per parcel, Mayor Gloria has announced that he plans to act on SB 10 and will include plans for implementing this law. Locally, the long-awaited and highly debated Barrio Logan Community Plan Update was adopted, while other plans are in the process of updates, both in the City of San Diego as well as other municipalities, all of which will reflect the urbanizing trends throughout the region. See (**link**)

A Final Word

The backdrop of all of this activity is the availability and the relative bargain of capital, which has continued to eye San Diego as an investment opportunity. This will continue, probably increase, in San Diego in 2022. The cost of money will rise as the Feds have signaled an increase in Discount rates, which will spillover in all sources of funding and return expectations. But this should not dampen overall the projects that are underway and proposed.

It is becoming clearer that 2022 is the year where San Diegans will come out of their COVID induced shell and a return to normalcy will be the prevailing theme of the year. Real estate investment and development, and land use decision making, will also reflect this coming out year.

Inflation, Interest Rates & the Economy.

Q&A *with* Dr. Norm Miller

Hahn Chair of Real Estate Finance, USD

> The combination of supply chain shortages and the money that's flooded the economy, that is still circulating, not as fast as it used to, will result in one to two years of higher-than-normal inflation.

Q: So, what's happening with inflation? Is it temporary? Or is it going to be with us for a while?

Let's start with defining inflation. It's a rise in prices, including labor costs, and is generally caused by too much money chasing too few goods and services. Normally, the kind of stimulus that we've had in the last two years would cause inflation and drive interest rates up. That is, when you have inflation, interest rates move up in parallel. In December of 2021 our inflation rate was running at 7% annually. But the government has interfered with market dynamics by buying mortgages and treasuries and artificially keeping interest rates down. As a result, it is truly a unique time to have higher inflation and relatively low interest rates, although mortgage rates have moved over 50 basis points up in the past few months. In terms of whether it's going to stick around, that is a function of what's driving it. Most of what is driving inflation now has nothing to do with this week or this month, but what happened six months to a year ago. The combination of supply chain shortages and the money that's flooded the economy, that is still circulating, not as fast as it used to, will result in one to two years of higher-than-normal inflation. In the long run, we know the Fed's target is closer to 2-2.5 percent, and we can assume that they're going to drive us towards that, but for a while we will exceed this target range by 1.5 to 2.0%, with 4%+ likely for a few years. Despite pleas for government interference to control inflation, there's not a whole lot they can do about the next year, because the cat's out of the bag.

Q: Will interest rates increase?

With respect to what will drive interest rates over the next year, the question is whether the government (Feds), as they have announced, will taper the buying of treasuries and mortgage-backed securities. Now they plan to buy less and less and less and less each month - targeting mid-2022 for total withdrawal of supporting the mortgage market with lower rates. If they don't buy the mortgage-backed securities, the private sector will have to come up with up 540 billion dollars unless the volume of mortgage demand falls off significantly. Private money is not going to ignore inflation, they will not accept negative real yields. If tapering really happens, and it seems certain now that it will, interest rates are likely to go up further; perhaps in spring 2022 by another 25 to 50 basis points. This will significantly hinder housing affordability, when 30-year mortgage rates cross 4%.

Q: Is inflation good or bad for real estate? How does inflation affect cap rates and real estate?

Inflation makes real estate more attractive relative to other assets and investments because it's a great inflation hedge, especially in assets like multifamily, where leases are shorter term. At the same time, inflation should drive up interest rates, so there are two different effects, one pushing prices up and one pushing prices down. Prices will rise from the higher inflation-induced growth in income, and this growth actually lowers cap rates and increases values. And yet higher treasury and mortgage rates will increase cap rates based on higher mortgage rates and equity yields and this will lower prices. The net effect of these two forces is somewhat indeterminate. If interest rates move up quickly while many leases remain in place, the short-term impact is negative on prices. If interest rates move up slowly, prices will be steady or increase from the higher rents expected.

If you have short-term leases, inflation is a positive force. If you have long term leases it will be negative. For example, if you have a 20-year fixed rate lease and it's not indexed to inflation, it's a bad thing for owners, but if you bought a property and locked it in at 3.5 percent debt long term, when inflation rates are at 4 percent, that represents a transfer of wealth from mortgage investors to the borrowers of the debt. In that case, inflation is tremendously beneficial. If you have fixed rate debt locked in right now, inflation is a great thing for real estate, and again, it is going to create a great amount of wealth transfer over the next several years for those with locked in debt.

Net, net, net I would expect cap rates to go up a little. And at the same time, I expect growth and income to go up as well. So, real estate is going to benefit more than other assets. That's probably why pension funds and institutional investors are talking about allocating more money to real estate right now precisely because of these inflation fears.

Q: Speaking about lease terms, will there be a trend toward shorter-term leases in office and retail, which have traditionally been financed on long-term lease deals?

I don't see the trend towards shorter-term leases reversing. Businesses want flexibility, and one of the reasons landlord-investors wanted long-term leases is because of the pressure from lenders; lenders look for long-term leases before they commit to financing. The real dilemma of shorter-term leases is that it makes financing properties more difficult, including requiring more equity. If everybody has to put more equity in as a percentage of the asset, it will make the capital stack used to buy real estate more expensive. However, I don't see a reversal in the office market of this shorter-term lease trend. Part of it is accounting based, where you must now disclose liabilities including future lease payments. That's one of the reasons why for 10 plus years, we've seen a move towards shorter leases. Lenders and banks are going to have to figure out if they're willing to accept shorter-term lease deals. It seems they will have no choice.

That being said, pension funds and institutional investors have sought long-term leases and long-term investments, and they love it when leases are indexed. With respect to office, we probably will see cap rates go up more so than the other asset classes. That is because we don't yet know how much the work from home trend will impact office demand. If we all worked 20% at home on average that is a huge decrease in space required, so expect office lease footprints to shrink.

Q: What about retail?

Retail is a mixed bag. A lot of the value is in the sites – if it's in a good location the underlying value holds up as the option value for other uses remains high. At the same time, traditional retailers are evolving and changing. We see a lot of demand for things like micro-fulfillment centers. The conversion of retail to multifamily or medical clinics or ghost kitchens, pop-ups and other uses are springing up. Expect more services and less products in retail spaces, which has been the trend for a decade now. We're certainly going to see traditional retail footprints modify with survival of the hybrid tenants – those that use their space for e-commerce, as well as on-site retailing.

Q: The passing of the recent infrastructure bill – how do you see that impacting San Diego?

Anytime we have funds for infrastructure, I always wonder how many shovel-ready projects we have because in California it takes so long to get approval for anything. I hope that in anticipation of this, we have some ready-to-approve infrastructure projects, but clearly throughout the country, the roads, the bridges, the infrastructure needs improvement. Pittsburgh lost a major bridge in late January, just as President Biden was going there to talk about infrastructure. I don't see anything happening fast because the funds are going to be doled out slowly and with lots of government approvals. But I applaud rebuilding bridges and sewers and infrastructure.

Q: What is your outlook on the overall San Diego economy? Are we well-positioned?

All in all, we are well-positioned. We are lucky that we have the defense industry and the businesses that support it. Life sciences, UCSD and all the universities that nurture that sector. And the blue economy. All three of those are likely to stick around and are tremendously beneficial to our economic stability. We will do better than the U.S. as a whole. Our Achilles heel is tourism. Tourism is the least resilient industry – supporting the lowest wage jobs by far – a fraction, just a fraction of what they pay at a firm like Illumina (life science).

I was on a task force once for a national group that looked at "gazelle" and fast-growth cities. There were a couple of interesting things that came out of the study. One is that cities like Vancouver, B.C. did well because they served their residents first rather than focusing on tourists. Other cities like Phoenix were doing well because the employers and universities (especially community colleges) worked together, had good recruiting and they got rid of government red tape. There are some things that well-managed cities can do to make life better for its residents, but the key thing was putting the residents' interest centerstage. Good management and public policy also matter a lot.

We're doing all the right things and should thank the private sector for making investments in places like Downtown that could result in more high-paying jobs. We're pretty darn lucky aside from having the most perfect climate in the in the country, if not the world.

Real Estate Outlook

INSIGHTS *from* District Council Members

by Belinda Sward, Strategic Solutions Alliance

This year's San Diego-Tijuana Emerging Trends Report reflects the views of the District Council membership. Approximately two-thirds of selected active members (representing one-third of total membership) 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.

KEY THEMES:
Flexibility, Repurpose & Mixed (or Multi) Use

The key themes that emerged during the Emerging Trends interviews, including input from San-Diego-Tijuana District Council ULI membership, are the concepts of continued flexibility, repurposing of assets, and an emphasis on mixed (or multi) use and collaborations. These themes were expressed throughout responses to varying questions and open-ended comments provided as part of this process. They show up in impacts to the business and the workplace from COVID-19 and in lingering variants; proposed infrastructure investments; impacts to commercial real estate, particularly office space; development and investment opportunities; and proposed affordable and attainable workforce housing solutions. These themes are expected to continue and even accelerate into 2022 given expressed economic uncertainties and concerns.

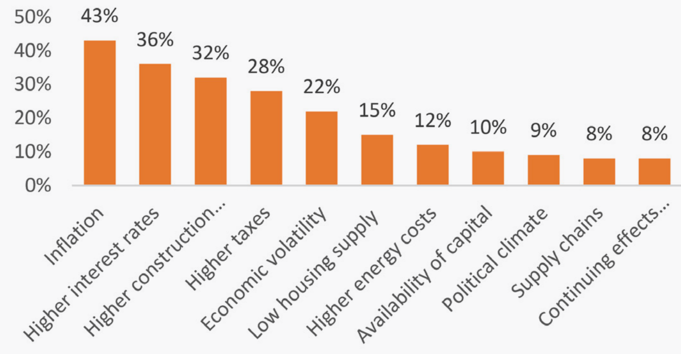
Council membership noted improvements in real estate investments and development opportunities regionally over the past year, particularly in multifamily, mixed-use, industrial and hotel/entertainment real estate sectors as well as slight improvements in retail. Office showed no change and was not rated favorably. While housing sales paces, prices and appreciation rates remain high, single-family housing was viewed slightly lower compared to other real estate sectors given lack of new construction opportunities in the San Diego region, particularly for attainably priced housing.

Membership expressed uncertainties about the potential impacts the economy might have to continued investment and development opportunities in 2022. Weathering the storm in 2020 brought about by COVID and related conditions, San Diegans are now being impacted by lingering COVID variants and spillovers and economic volatilities.

The majority of our members have turned from concerns about not only COVID to include economic concerns, fearing negative impacts to real estate in 2022 regionally. Most expressed concerns about growing inflation, projected higher interest rates, construction and development cost increases, and higher taxes. These concerns were expressed as impacting their ability to make long-term strategic real estate decisions.

> "We are broaching a highly inflated market where any movement in interest rates can upset real estate underwriting.

In light of this, the San Diego-Tijuana District Council trends survey asked a question regarding confidence levels of making real estate decisions in today's environment. Even with concerns, approximately 62 percent of responses from San Diego-Tijuana indicated they have at least some confidence to make long-term decisions. While high, this is lower compared to 80 percent having confidence projected for 2021. The question posed and responses to the question are below.



Impacts of COVID-19

We asked members how spillovers from COVID (and lingering variants) might impact their industry segment and/or their company into 2022. Members indicated top impacts are related to:

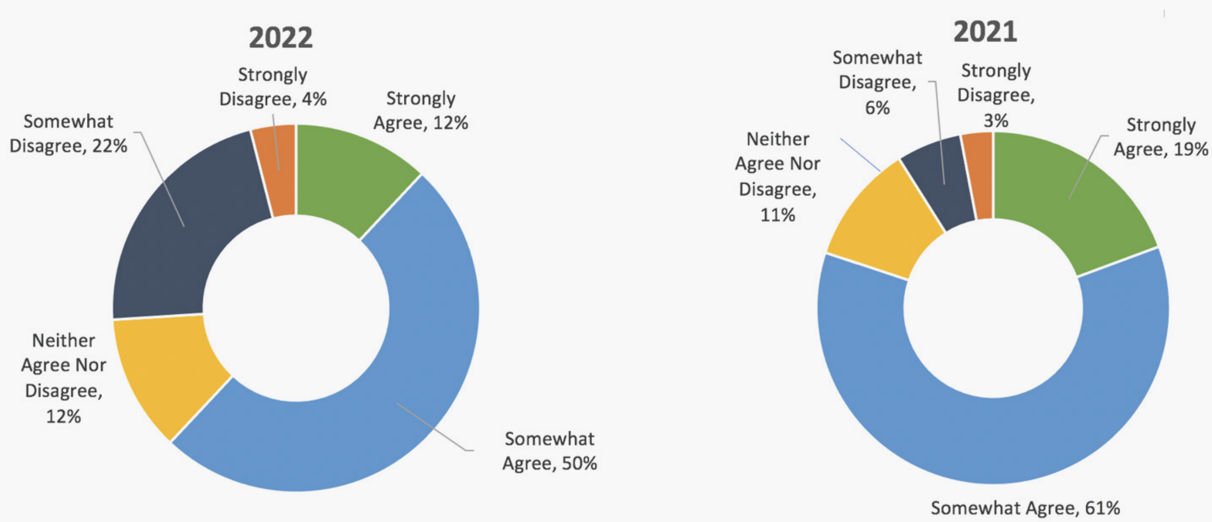
1. **Continued disruptions and flexibility in the workplace.**
2. **The demand for a mixing of uses.**
3. **Adapting to new ways of working (as well as new ways of living, shopping, socializing and educating children).**

As shown, these include a hybrid business working model, continued workplace regulation and travel restrictions, and impacts to hiring, layoffs and/or hiring delays. Other notable impacts include disrupted supply chains, new technologies, delayed acquisitions or investments, and greater mixing of tenants, real estate uses and other. Younger (age 44 and younger) ULI member respondents viewed disruptions to supply chains as the biggest impact from COVID-19 spillovers, while older ULI member respondents view a hybrid business working model as the biggest impact, which makes sense when one considers older members may have the responsibility for making decisions about leases and/or ownership positions in commercial assets.

Infrastructure Investments

With the passage of the recent infrastructure legislation and the discussion around infrastructure expenditures, we asked members to identify the types of infrastructure investment they believe would provide the greatest benefit to real estate. Almost all respondents, 83 percent, indicated that greater housing supply and housing attainability would have the biggest benefit to real estate and the region. In comments provided by members, housing shortages were noted as top-of-mind concerns.

Q1: To what extent do you agree or disagree with this statement?
"I am confident making long-term strategic real estate decisions in today's environment."

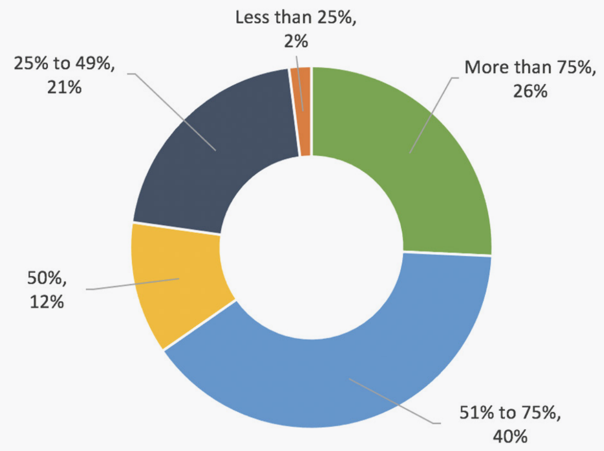


This was followed by investments in mass transit (light rail, bus lines, etc.) and technology (broadband availability, smart cities network, etc.) as being beneficial to real estate. There were no notable variations in responses by age, location, or other factors.

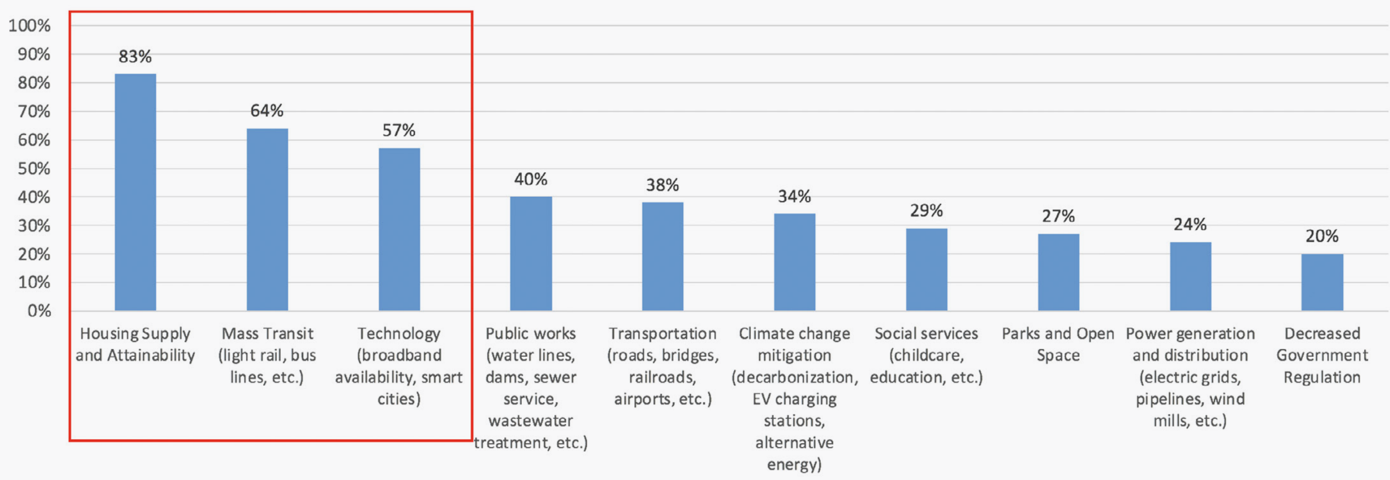
Workforce in Workplace

We asked members to indicate the percentage of the workforce they anticipate would be working in the workplace at least three days a week in 2022. As shown, members indicated remote working will continue for at least some of the workforce, and at least during some of the work week. Even so, 78 percent of respondents indicated they anticipate at least 50 percent or more of the workforce will be working in the workplace at least three days a week in 2022.

Q5: In 2022, what percentage of the workforce do you anticipate will be working in the workplace at least 3 days a week?



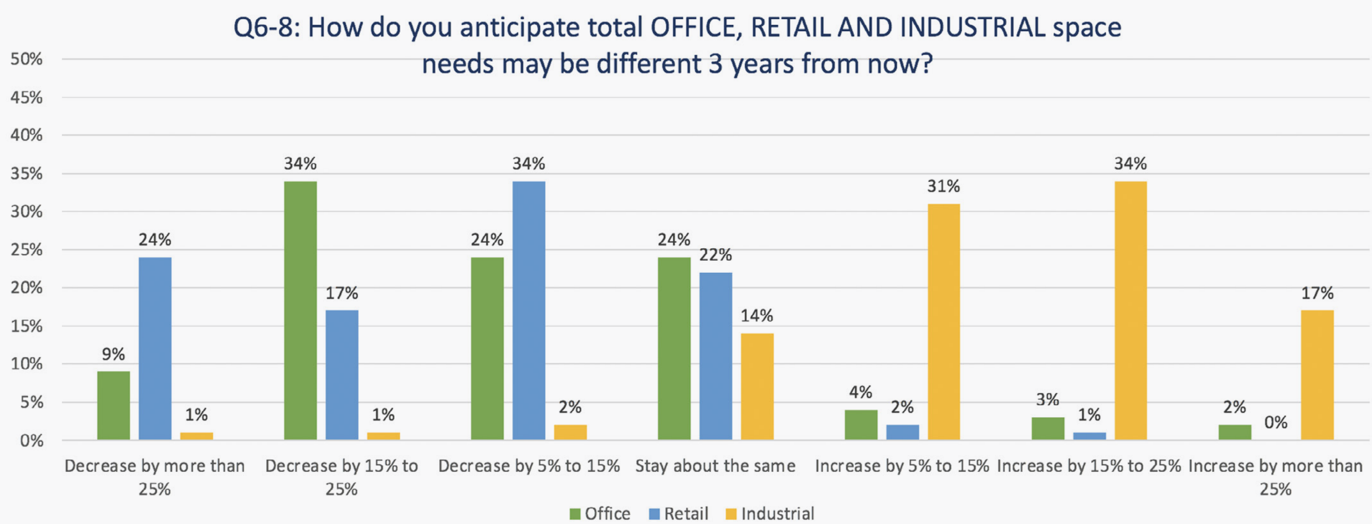
Q4: What type(s) of infrastructure do you feel would provide the greatest benefit to real estate? *(Please select **all that apply.**)*



Office, Retail & Industrial Space Needs

In light of changes to the work environment and expected reduction of a percentage of the workforce, office space demand will be lower in 2022. COVID has had a particularly negative impact on office and retail space. On the other hand, the industrial sector has maintained strong growth.

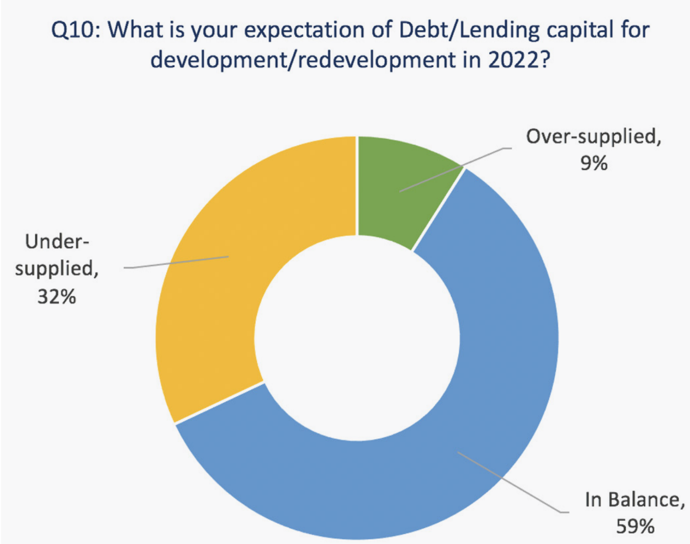
We asked members to indicate their expectations of office, retail and industrial space needs over the next three years. As shown below, members expect further decreases in office and retail space needs, and conversely expect industrial space needs to continue to expand over the next three years.



Debt & Lending Capital

As indicated in our 2021 Trends Report, our members indicated that 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 2021 as compared to 2020, members indicated moderate change. Largest increases were indicated in debt funds and nonbank financial institutions.

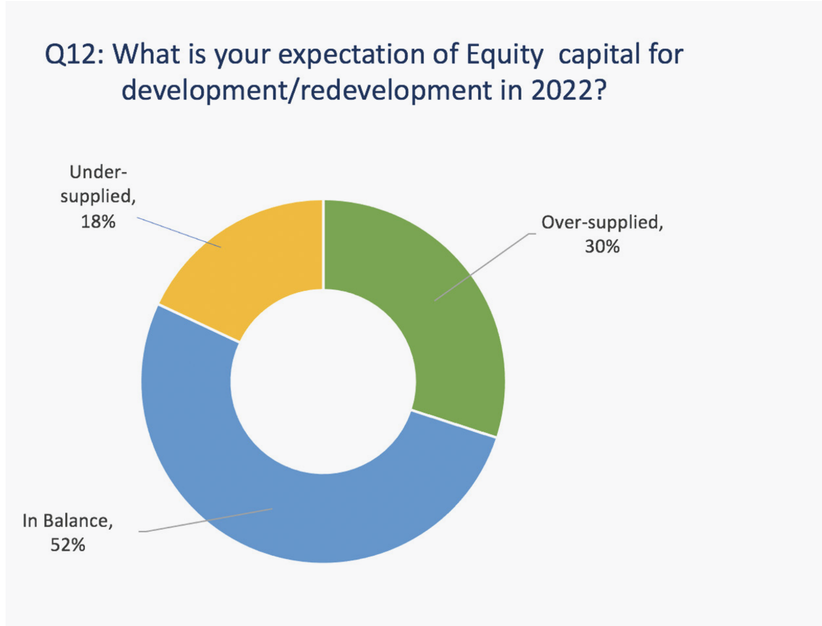
Approximately 59 percent of members believe debt and lending capital will be in balance for real estate development and redevelopment in the San Diego region in 2022 (relatively unchanged from 2021).



Equity Capital

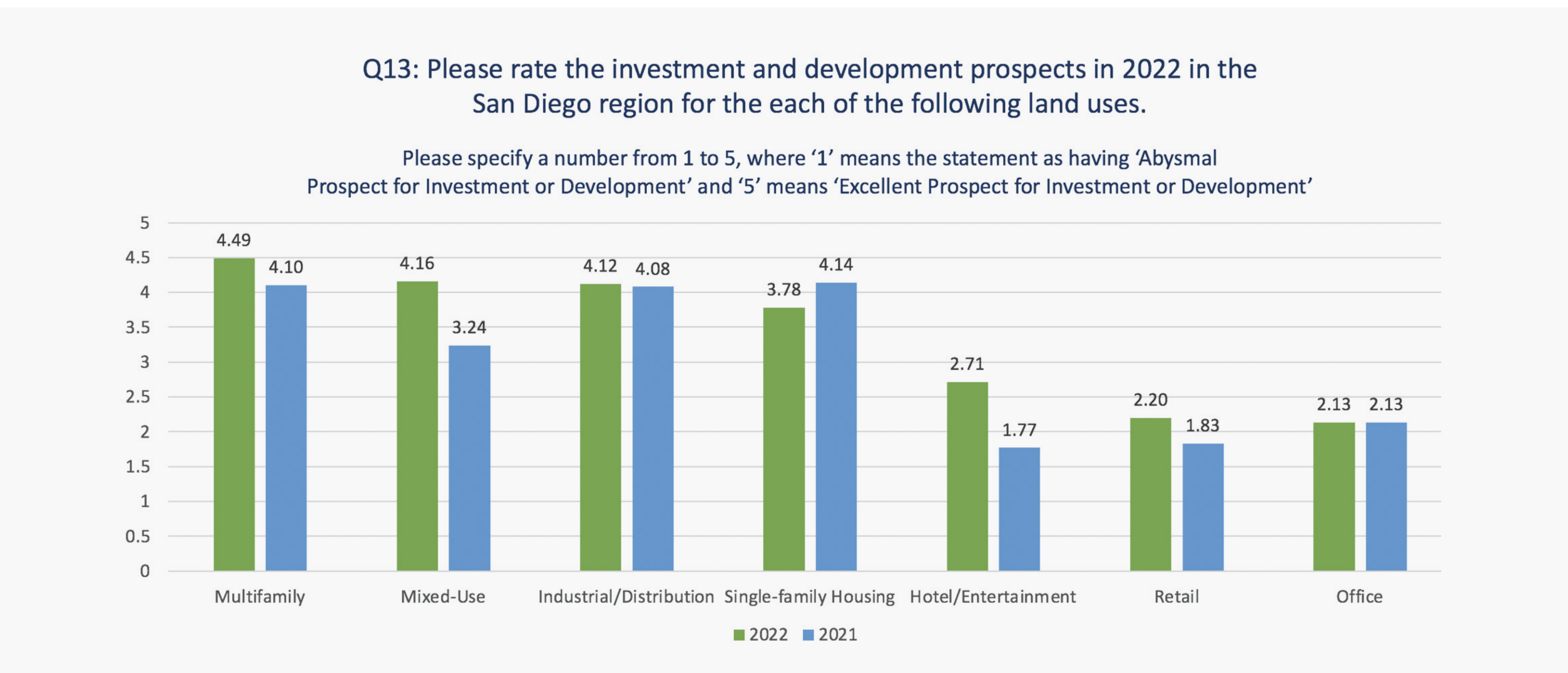
In addition to debt and lending capital, we asked members about the availability of various sources of equity capital for real estate in 2021 as compared to 2020. As shown below, similar to last year, members indicated they believe the greatest availability and increase in equity capital is in Private Investors, Private Equity/Opportunity/Hedge Funds and Private REITS.

Expectations for 2022 indicate higher oversupply of equity capital as compared to debt and lending capital. Even so, 52 percent of members believe the equity capital markets will be in balance in 2022 (again similar to 2021).



Investment & Development Prospects by Use

To provide an outlook by property type, we asked members their opinions regarding investment and development prospects among various land uses in 2022 in the San Diego region. Members indicated the top three opportunities by land use include Multifamily, Mixed-use and Industrial/Distribution, giving each of these a higher rating compared to 2021. Single-family Detached was given a lower rating as a result of fewer development opportunities locally.

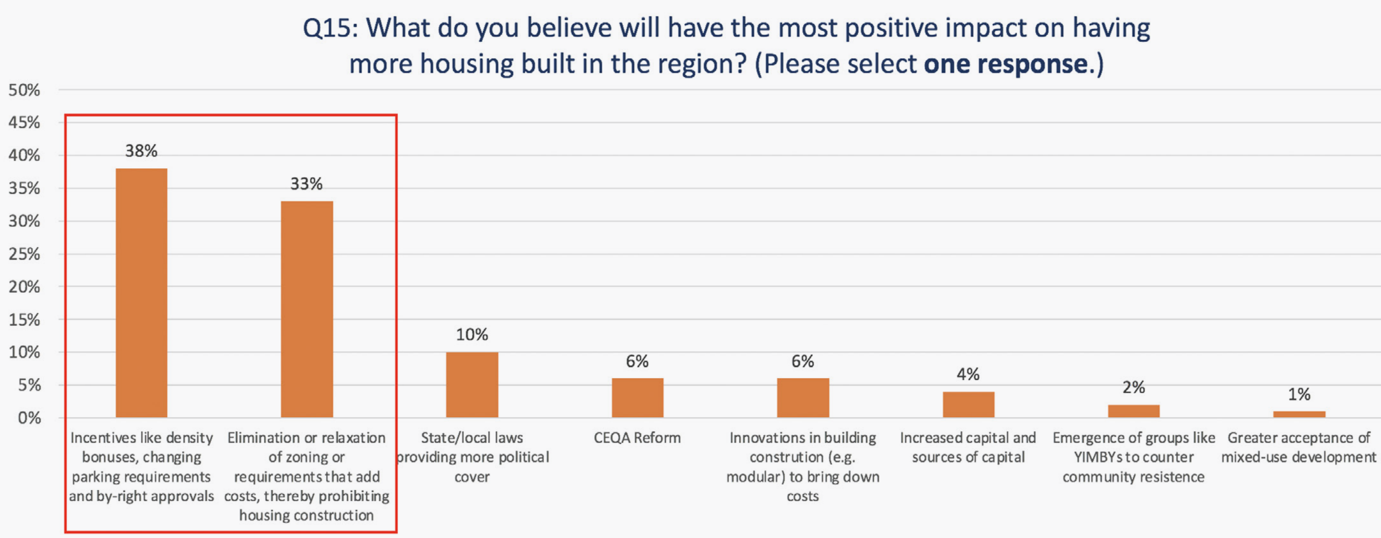


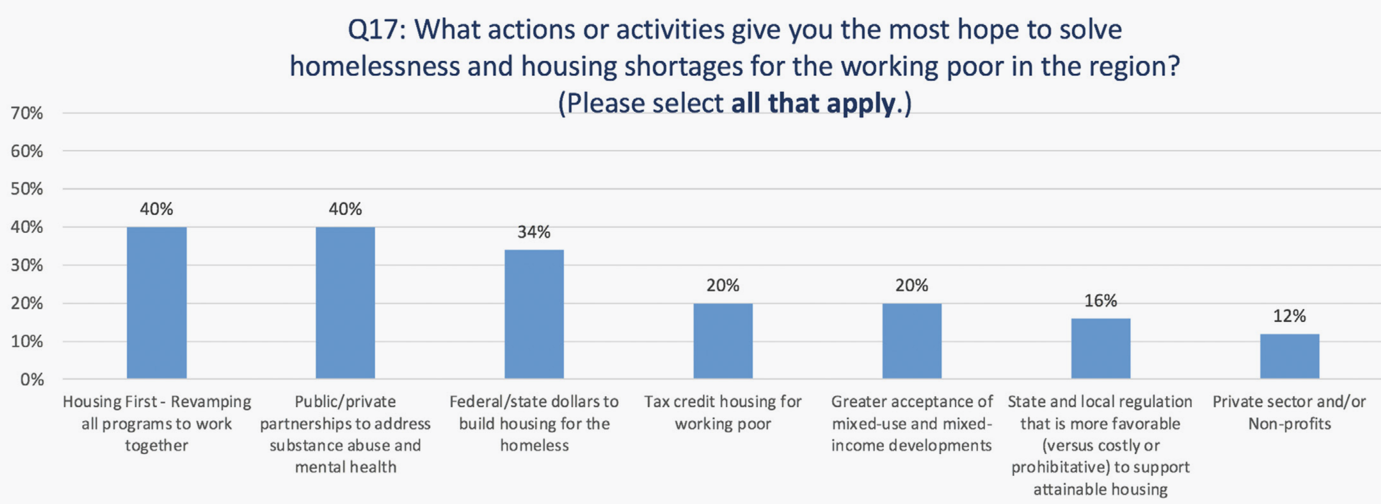
Housing

Given housing supply concerns, we asked members to provide opinions regarding what they believe would have the most positive impact to increase housing in the San Diego region. Overwhelmingly, they believe offering incentives to developers and builders in the form of density bonuses, changes to parking requirements and by-right approvals would have the greatest positive impact. This is closely followed by eliminating or relaxing zoning or other requirements that add costs and thereby prohibit housing construction.

Additionally, members provided opinions regarding what they believe is the largest obstacle to having more housing built in the San Diego region. They offered four top obstacles, including rising land and construction costs, opposition from community and other groups, entitlement process and associated costs, and state and local regulations.

Specific to solving homelessness and housing shortages for the working poor, members indicated implementation of collaborative efforts as having the most hope. These included a Housing First program (revamping all programs to work together rather than competitive or duplication of efforts) and addressing substance abuse and mental health through public-private partnerships. One-third of members suggested federal and state dollars being used directly to build housing for the homeless (and working poor).

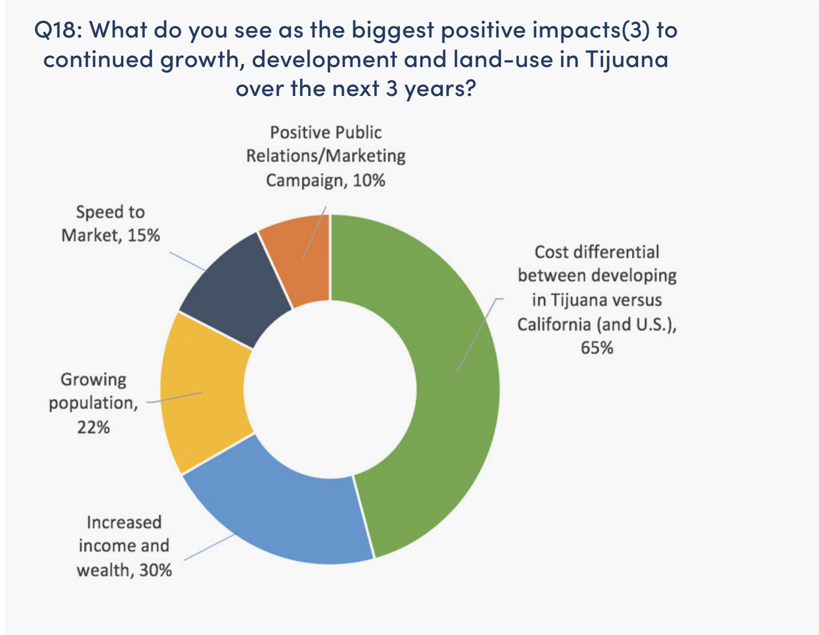


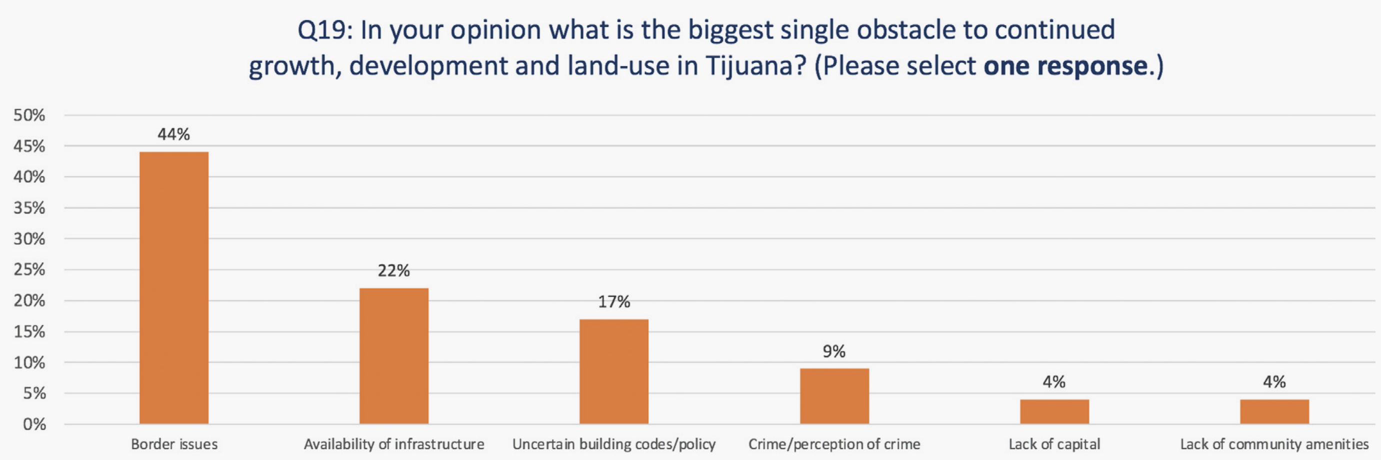


Tijuana

We invited members, especially those working in Mexico, to provide opinions regarding opportunities in Tijuana. To begin, we asked members to provide opinions regarding the biggest positive impacts to continued growth, development and land-use in Tijuana. Approximately two-thirds of responses indicated that maintaining a cost differential between developing in Tijuana and California would have the biggest positive impact. Another 52 percent of responses were related to a population in Tijuana that is growing in size, income and wealth.

In term of obstacles to mitigate, members indicated the biggest obstacle to continued growth, development and land-use is border-related issues. As shown below, this is followed by infrastructure availability and uncertain (or unclear) building codes and policies.





More About Survey Participants

Approximately one-third of a 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. The survey respondents represented the membership types, age categories, and geographic markets of the District Council membership.

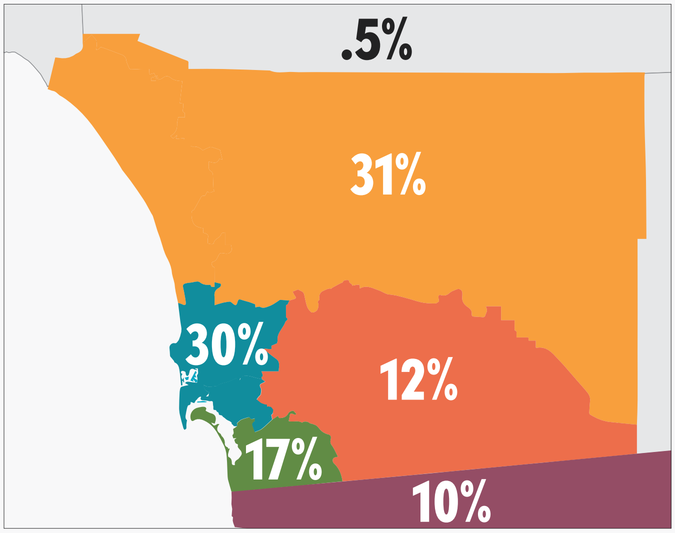
Respondents closely resemble District Council members by length of time in profession.

Length of time	Respondents	Members
20 years or less	45%	46%
More than 20 years	55%	54%

Ages of respondents are a close match of the San Diego-Tijuana District Council membership.

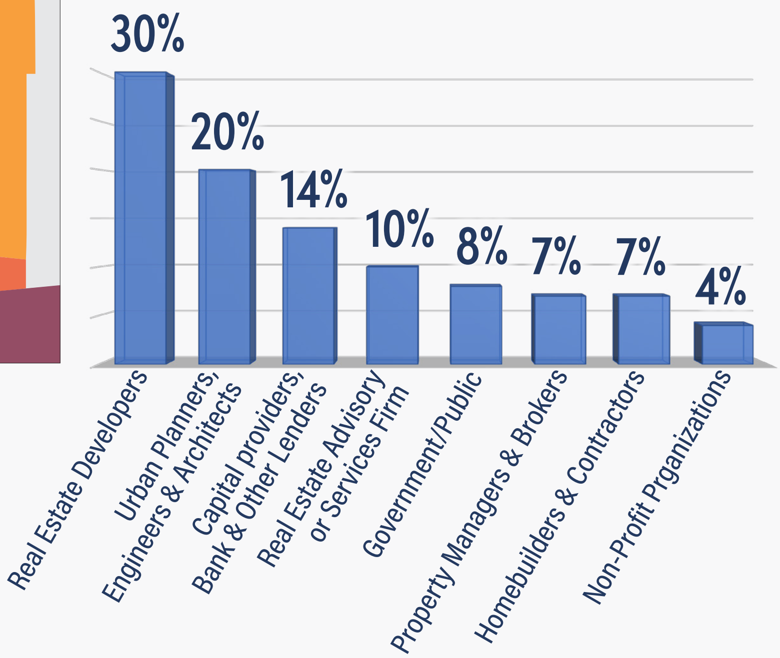
Ages	Respondents	Members
Under age 45	26%	36%
Age 45 to 54	26%	24%
Age 55 to 64	26%	24%
Age 65 and older	22%	16%

Survey respondents included good representation from each of the geographical regions of San Diego County and 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

In addition, survey participants and interviewees also represent a wide range of industry experts, including developers, architects, urban planners, capital providers and investors, consultants and advisors, government and public agencies, property managers, lenders, homebuilders and non-profits. Company affiliations of the survey respondents are shown below by industry.



New attitudes about Work-Life Balance will drive the future of real estate.

Q&A *with* J Walker Smith

Knowledge Lead, Consulting Division of Kantar

> I think people were surprised that collaborative creative work can be done remotely to a much greater extent than previously imagined.

With all the news about the changing nature of work, the workplace, and the "great resignation" (and importantly its impact on real estate), we turned to J Walker Smith, one of the country's leading futurists and an expert at helping businesses/industry understand the deeper meaning of which consumer trends are here to stay and why.

Q: We see a hybrid of work-from-home (WFH) and the office in the future, but there also seems to be a powerful underlying shift in people's relationship to work – think of it as the work/reward contract. Can you help us better understand this?

We were just forced to undergo a global mass involuntary experiment. The economy shut down and every job that could be worked at home was, and jobs that couldn't were restricted for a while, then people went right back into them. A lot of our assumptions about work were disproven. We found out, in fact, that collaborative creative work can be done remotely to a much greater extent than previously imagined. I think people were surprised.

We were also reminded that no matter how much the knowledge economy drives the marketplace, 60% of all jobs are jobs that people do in-person. They are hands-on things that may not be amenable to a change in how they are performed, at least not in the short-run.

As we look to the future, though, I think we should be cautious about over-predicting change. People are not going to go from one way of working to the complete opposite overnight. But I think we are seeing changes in expectations about work. Part of this is tied to other things going on in peoples' lives, things that the pandemic put a spotlight on. Mental health is one; family relationships another.

People now know there is an alternative way of doing things. So, there will be changes, and these changes, even if small, will have a major impact. People are not ready to go back to the way things used to be. They want their new expectations to be recognized, appreciated, and accommodated within work. They like the flexibility they have discovered that they can have in their day. It is a new attitude about time. The challenge is that we don't know how to operate in these new ways. We're going to be making up as we go along. We don't know what the specifics will be right now, but all of this is occurring within a broader ecosystem of changes.

In particular, the percentage of WFH vs. in-office working will vary by region of the country, industry, company, and task. We are seeing this unfold in real-time and we're not quite sure where this is going to wind up. It will continue to gain steam across many industries that we might not even suspect today. Over the near-term, and certainly over the investment window of developers and real estate professionals that we're talking about here, there might be shifts but not big reversals in the marketplace. People will still go to the office. They just won't go as much or as many days, and while that might be a small change in terms of total workdays, it is likely to be a very big change in terms of critical mass. For business planning, it's about critical mass. The shift of even a small percentage of workdays could be just enough to tip business models into unprofitability.

Q: How is mental health impacting the willingness for people to return to work?

Mental health has become a bigger and bigger deal, and I don't think we fully appreciated it before the pandemic. Contrast with the financial crisis of 2008. After 2008 we had a six-year employment recession. A lot of people went upside down on their houses. Many people found themselves in deep financial distress. One consequence was that the suicide rate went up.

However, now we have not experienced a severe employment recession, if any at all. Jobs are plentiful. Along with a quick snapback in the job market, we had all kinds of governmental financial support for people—extra unemployment benefits, rent relief, forgivable loans for small businesses, and more. Much more than after 2008. So, we haven't a bump in suicides, thank goodness. In fact, total suicides have gone down over the past two years. But that is not to say that we haven't had mental health issues. Anxiety and depression rates have skyrocketed, and this is from the volatility, uncertainty, and mortal danger people have been dealing with for two years.

These two things—financial cushion and anxiety and depression—have created a unique situation. People who hated their jobs to start with and then had the added stress and anxiety of the pandemic have apparently decided, "Well, I have a little extra money and there are lots of jobs out there, so I'm not going back yet. I'm not ready and I've got plenty to hold me over until I can find something better." Eventually, of course, they will be forced to come back into the economy, but people are taking this moment to reassess their priorities about what is important in their lives and what they want their new goals in life to be.

I think it is important to remember that people are not going to forget what they learned during this forced global experience in new ways of living and working. People are remembering a lot of things about work that they don't want to go back to in the future. And I keep saying people—it's every one of us, you and me and everybody in moments of disruption like the pandemic, people don't aspire to a new normal; they aspire to getting back to normal. They want to feel safe. They want to feel stable. They will change only if the changes are worth the risk and added uncertainty. Otherwise, people just want less change, not more. The unique thing going now is the sense of financial security people have had, has enabled them to respond to this period in ways that they might not have done so before. People can aspire to a new normal right now because their financial situations have given them the security and stability to put the lessons they've learned into action.

Q: Recent articles have highlighted the disconnect of attitudes/outlook between company owners and management and employees when it comes to a new hybrid work models. Can you elaborate?

In the past there was a lot of talk about WFH, but nobody had really invested in the technology or took it seriously. There was an unspoken belief that certain kinds of jobs could only be done face-to-face. Not to mention that companies have built their business models with certain kinds of hard infrastructure or IP or embedded cultures. These things cannot change in a flash, and companies are going to resist abandoning these investments. I call it the clash between putting people first and putting assets first. Many companies are going to be slow to adapt because they are invested in assets like real estate. Or equally important they designed work processes that are specifically created for people to coming together in a single location. Assets are going to drive management decisions for a while, for sure.

Over time, though, companies will learn that they don't need as much office space as they actually think. They will come around on their assets, particularly as they get time to pivot in affordable ways. For example, it may turn out that the tasks that need in-person collaboration are really a smaller set of things than previously realized. Especially as new tech-solutions come to market. This will take a few years to shake out. But the near-term predictions are converging around a shift from a nearly universal workforce in the office five days a week to something on the order of two days a week at home, at least for knowledge work. Obviously, some companies won't have any WFH days, and others will go completely virtual. But the typical knowledge-work company is likely to be somewhere in the middle.

Let me add a note about the number of new technologies in development. Last year saw an enormous spike in patent applications for work-at-home technologies. Before the pandemic it was very hard to get people to try new ways of meeting and working. Now, everybody's done it. The pandemic forced people to try something that they never would have tried on their own. The trial problem has been solved. It's just a matter of fixing the glitches. Things like virtual reality will change the whole experience of remote meetings and remote work. It's going to shift more and more away from an office locations to something else.

Q: When you think about our city centers and commercial districts (CBDs), knowledge workers and business travelers have traditionally driven an ecosystem of businesses – restaurants, services, hotels, etc. How does the current disruption play out when one thinks about the future of CBDs?

The current economics of cities are based on where the jobs are. So, if you're a planner for a major metro area going forward, you've got to consider how to reinvent the attraction that will bring people into the city if the new type of work is bringing fewer people there. As I like to say, cities will be in the experience business as opposed to the employment and housing business. Obviously, people will still work in the city. But remember that it's a matter of critical mass when it comes to planning and investing.

This also affects residences in city centers. If jobs are not the primary reason for people to live there, then there have to be other reasons— that's the innovation challenge.

By the way, the new structure of work doesn't necessarily have to be centered at home. For example, a business could determine they have clusters of employees in specific geographic areas, so it could open an outpost in that location. A pandemic lesson is about eliminating the commute. People want to be closer to home, but not necessarily home at the kitchen table. Just closer to home. That's why companies might say, we'll follow them to the suburbs as opposed to make them come into the city.

In short, it's a new attitude about work-life balance. The old model, around which a lot of investment has been made in the past in things like high-rises and commuter routes, will become less and less popular. We're going to see some of that critical mass flow elsewhere. There won't be less spending overall, but there will definitely be a relocation of where the money is spent. It will be spent where people are spending their time, with ripple effects on the micro-economies centered around these places.

Property Type Outlook

HOUSING Market Overview

By Peter Dennehy, Vice President Customer & Market Research, Brookfield Properties

Contributions by Stephen Russell, President & CEO, San Diego Housing Federation and Tony Pauker, Former Chair of the San Diego-Tijuana District Council

Housing Top Trends & Findings

1. San Diego's new housing market is driven by **low inventory, record-low interest rates and an influx of Millennials** into the market. The pandemic has also driven more people to seek more space and to leave rentals in the hopes of buying a home.
2. **New home prices are up** 15% YOY on average, slightly lower than the 18% national average, reflecting the higher home prices in the region. The majority (60%) of new home builders in a recent John Burns Real Estate Consulting survey are still increasing prices month-to-month given the low level of product available and robust demand.
3. As of 3Q 2021, new home closings in the region are averaging an annualized 3,414 homes, with a median new single-family home closing price of $1,070,000 (Zonda). The median new attached closing price is $568,000 (Zonda).
4. The resale housing market in San Diego County has been on a tear in 2021. Existing home sale closings volume for San Diego County in the past 12 months averages 45,570 homes, **the highest level in 15 years**. The median existing-home price of $830,500, up 16.2% in the past 12 months. Less than one-third of San Diego County households can afford to buy the median-priced existing home with a 5% to 20% down payment. With limited supply, new and existing home prices will remain high.
5. Those few developers that own entitled sites throughout the county will continue to build-out those locations, but **most new opportunities will be located on infill and repurposed/underutilized property**. To maximize limited land and keep pricing in line, dense urban design and attached homes will most likely be the “new normal” except in the very high-end luxury market. The majority of new home options are in suburban areas of North and South County with virtually no new housing being planned in the unincorporated County due the threat of environmental litigation. A lack of buildable land had led to a 41% drop in new home community counts in the past year.
6. The number of buildable sites that can deliver 50 or more new attached or detached homes is limited. Public and large private builders typically require sites that can deliver at least 50 homes to achieve economies of scale. A **big part of new housing supply will be created by smaller builders and entrepreneurs** delivering from one to a couple dozen homes. These builders tend to operate in very small trade areas and opportunistically look for infill locations where density can be increased.
7. 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. The economics of for-sale, “missing middle” housing in the San Diego market is not currently feasible. State efforts to supersede local limitations on housing production are just now going into effect, but some of these efforts will continue to face organized opposition.
8. Subsidized, below-market affordable housing production will continue to be **limited by the availability of local resources to leverage growing State and Federal funding sources**. Upward rent pressures will continue to make it profitable to purchase, improve, and upmarket existing naturally affordable housing, further exacerbating the region’s affordable housing crisis.
9. San Diego is on track to deliver 10,000 new housing units in 2021 (for sale and rental), the highest number since 2006. However, this **production will not replenish the existing housing deficit** or even start to supply future unmet demand.

For-Sale Housing Market Overview

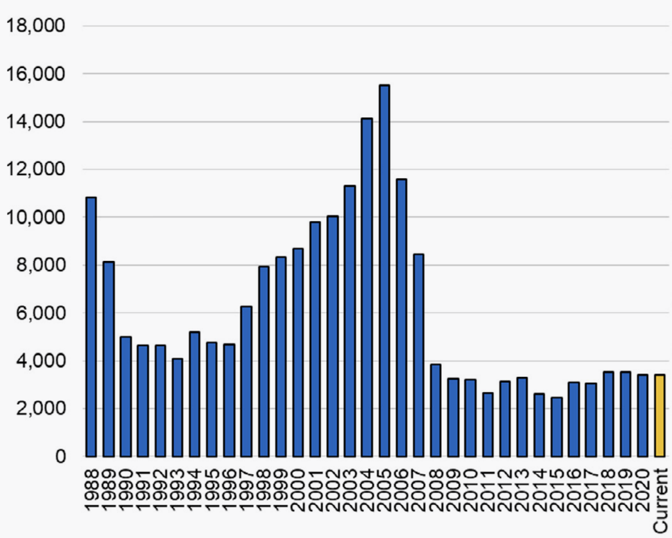
As 2021 came to a close, San Diego County's new home builders averaged 3 to 5 sales per community in October 2021. New home prices are up 15% YOY on average, slightly lower than the 18% national average, reflecting the higher home prices in the region. The majority (60%) of new home builders in the John Burns Real Estate Consulting survey are still increasing prices month-to-month given the low level of product available and robust demand.

As of 3Q 2021, new home closings in the region are averaging an annualized 3,414 homes, with a median new single-family home closing price of $1,070,000. The median new attached closing price is $568,000. New home sales volume is down 5% in 2021, with a lack of buildable land and dropping community count constraining sales. According to John Burns, there are 51 active new for-sale projects in San Diego County in 3Q 2021, down 41% from last year. According to Zonda, the top five new home builders in San Diego County are Lennar, TriPointe, Cornerstone, DR Horton and Pacific Coast Communities.

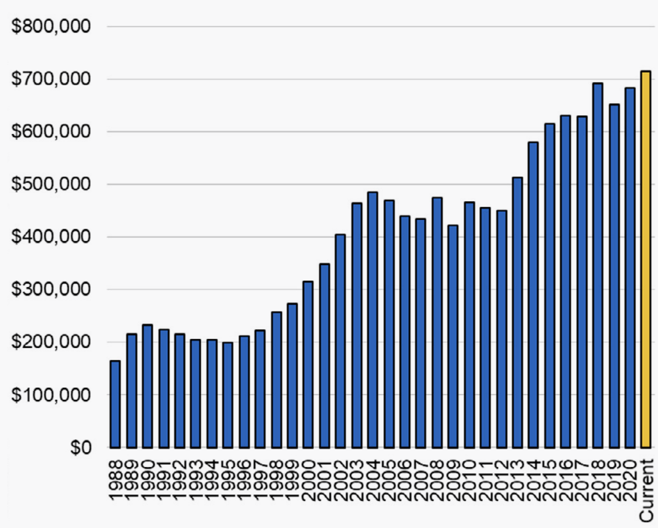
According to Zonda, there are 2,752 vacant developed lots (VDL's) in the San Diego County market in Q3 2021, up 4.5% from a year earlier and equaling just a 9.5-month supply of lots at current sales rates. The new 3Roots project in the Sorrento Valley area is bringing much-needed supply to the market, but total volume is still low due to a lack of buildable land. San Diego County, the fifth-most-populous County in the U.S., is the 83rd ranking U.S. metropolitan area in terms of annualized single-family permit issuance in the past 12 months.

The lack of for-sale options means all home types are selling well. There is solid demand in suburban areas in the I-15 and Highway 78 corridors and South San Diego County. In eastern Chula Vista, the Otay Ranch master-planned community in Chula Vista was ranked #17 among the top 50 U.S. Master-Planned Communities in 2020, with 760 total sales.

ANNUAL EXISTING HOME SALES CLOSINGS



ANNUAL MEDIAN EXISTING HOME PRICE



Source: John Burns Real Estate Advisors

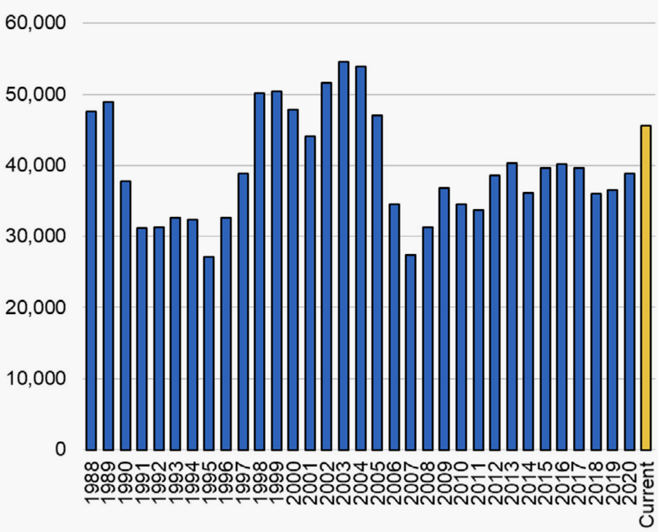
For-sale housing production in the San Diego County region is now at the lowest level since World War II. Aside from Otay Ranch in South County, there are few large-scale master-planned communities. New home projects are being developed as reuse projects on golf courses, mixed-use urban infill projects on quarries, etc.

Several large-scale projects in the County's outlying areas have faced environmental and fire safety challenges after approval, so supply challenges are unlikely to improve going forward. 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.

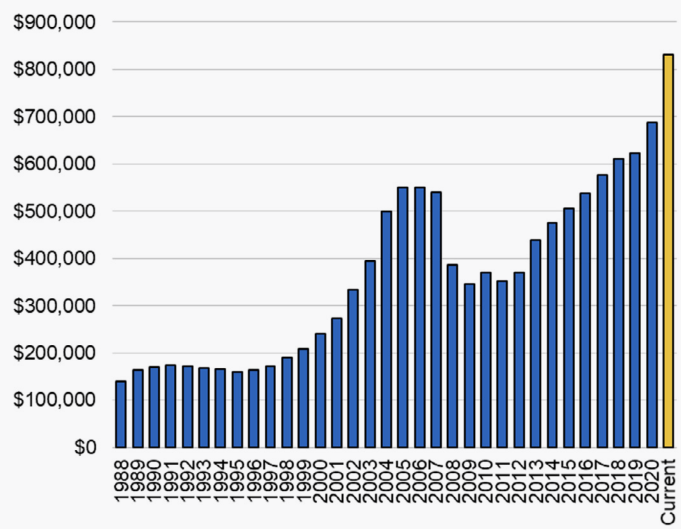
After slowing considerably in mid-2020 as much of the San Diego economy shut down, the resale housing market in San Diego County has been on a tear in 2021. As of November 2021, existing home sale closings volume for San Diego County in the past 12 months averages 45,570 homes, the highest level in 15 years. The median existing-home price is $830,500, up 16.2% in the past 12 months. The County's existing home inventory level is relatively low, with 3,704 listings in October 2021, representing an estimated 1.0 months of supply.

Resale inventory has declined 20.8% in the past 12 months, and market time to sell averages just 13 days, down from 15 days at the same time last year. The median price per square foot for existing homes is $593 per square foot, and 58% of home sales are selling above the list price (it was 45% at the same time last year).

ANNUAL EXISTING HOME SALES CLOSINGS



ANNUAL MEDIAN EXISTING 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 projects. They consist of high-density single-family and townhome projects and mid to high-rise condominiums in Downtown and Banker's Hill. New home prices are generally $700,000 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. With demand for close-in housing near tech job hubs, the 3Roots project opened for sales by appointment in Summer 2021 with no models and has sold over 200 homes to date with average single-family prices averaging $996,000 and attached prices averaging $772,000.

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 developing with infill townhome and single-family homes priced in the $600,000s to $800,000s, and large-lot homes in semi-rural areas like Rancho San Diego in the mid $1 million range. There are no active master-planned communities in this area, but HomeFed plans the 3,000-unit Fanita Ranch project in Santee.

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. New for-sale townhomes in this area sell in the $400,000s to $600,000s. New detached for-sale homes are typically priced in the $600,000s to the $800,000s. There is some infill development in older areas of Chula Vista and National City. Formerly industrial zoned land in the Otay Mesa area is being re-entitled for residential development. HomeFed's new Cota Vera master plan in eastern Chula Vista opened in fall 2021, with 2,400 for sale and 2,400 for lease apartments.

North County Coastal – North of Route 56 to Camp Pendleton and west of I-15: This submarket is an affluent, coastal suburbs along the Interstate 5 corridor. New home development in this area is primarily in the Pacific Highlands Ranch area near Del Mar, as well as to the north in Carlsbad and Oceanside. New attached for-sale product in this market is priced in the $600,000s and $700,000s, with new detached for-sale products 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.

North County Inland – North of Route 56 to Camp Pendleton/east of 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 submarket is one of the most active areas of the County for new home building and is somewhat more affordable than the North Coastal area. New townhomes in this area are generally in the $500,000s and $600,000s,

3-Roots master planned community by Shea Homes underway and selling briskly on a former quarry site.

Example of attached homes by Lennar, trying fill the need for more attainable new homes at the 3Roots master planned community.

and detached homes are $600,000s to $1 million. Development in more developed areas close to Highway 78 is primarily attached townhomes and small-lot single-family.

Some small master planned communities are located in the Valley Center and Bonsall area and on redevelopment sites in Escondido (Canopy Grove) and Carmel Mountain Ranch (Pacific Village). Several large-scale residential projects were approved by the County Board of Supervisors and then challenged on environmental or traffic concerns. Touchstone's Park Circle master plan in Valley Center has townhomes in the $400,000s and single-family homes in the $600,000s to $800,000s. In Poway, the Poway Commons project is delivering 97 market-rate townhomes and flats priced in the $600,000s to $800,000s, and 44 affordable apartments for seniors being built by Chelsea Investment Corporation. The site will include 2.2 acres for future retail and is a good example of a “surban” infill project on a former commercial parcel on Poway Road.

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 is focused on housing –perhaps there will be more teeth in the Regional Housing Needs Analysis (RHNA) to increase production?

Recent actions by the State’s Department of Housing and Community Development show signs of determination. They have resourced its Housing Accountability Unit to implement the requirements of the Housing Accountability Act (limiting the number of public hearings that a project must undergo before it is automatically deemed “approved,” for instance) and enforcing the provisions of municipalities’ General Plan Housing elements under threat of superseding local land use approval. This newly-enforced legislation has the potential to increase infill housing production once the market fully understands and gains confidence in these efforts.

The redevelopment of existing commercial/residential projects and golf courses brings new development. Some golf courses in all areas of the County are being developed for housing of all types, and there are numerous mixed-use infill projects underway in the greater Mission Valley area (Sports Arena, Civita, Town & Country, Riverwalk, former Qualcomm stadium redevelopment by SDSU, etc.).

A creative infill development on a 28,000 square foot sloped site offering both for-sale and for-rent housing in Banker’s Hill by Nakhshab Development & Design. They were able to realize 40 rental units including those in Truax Lofts (white building on left - a Gold Nugget Grand Award winner) and the refurbished historic home. Leon Townhomes pictured on right included 4 for-sale townhomes with elevators. Rentals targeted workforce housing (100% AMI).

Housing Affordability & Out-migration

Housing affordability is worsening again in the San Diego County region. With home values having risen by 15% from one year ago, the current housing cost-to-income ratio has increased to 49%, and the gap between purchasing rather than renting is widening. In San Diego County, the chronic challenge is that limited buildable land supply and affordability patterns is exacerbated by the economic cost of delivering new homes (construction costs, entitlement costs, land costs, timing, etc.)

According to John Burns Real Estate Consulting, less than 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 $753,000 to $858,000, with a current median existing home price of $830,000.

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 regions away from jobs and services that would necessitate long commutes. Projects needing discretionary approvals in those areas face environmental/fire-safety legal challenges and referendums to overturn approvals.

Traffic congestion eased in the San Diego region due to employees working at home during COVID-19 but have returned to pre-pandemic levels, and acceptable commutes will again dictate where housing is needed.

Many San Diegans opt to relocate to Riverside County and Mexico for more affordable for-sale housing options.

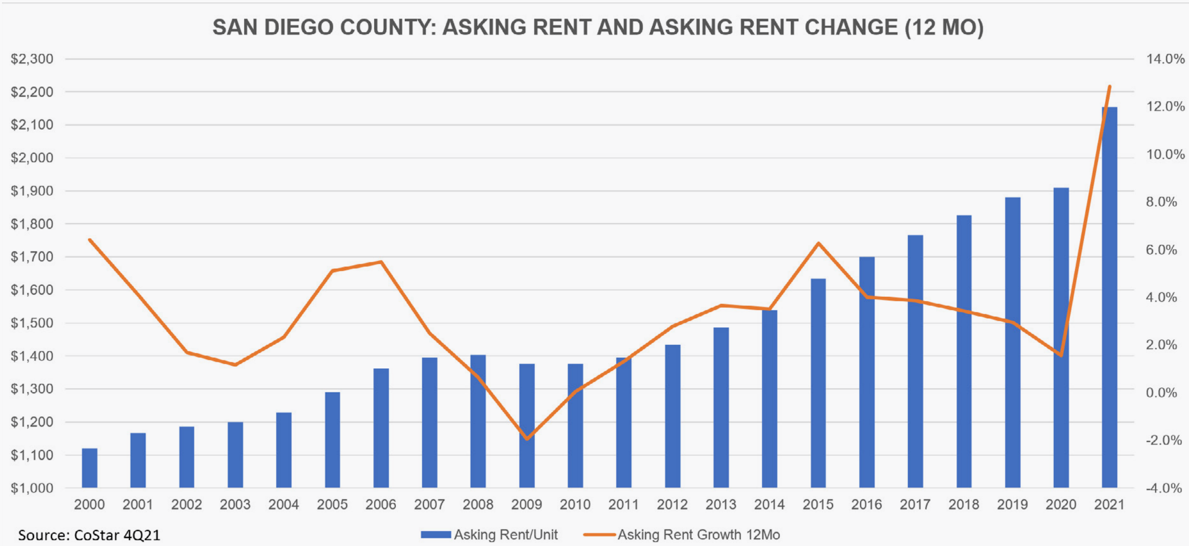
Mobile and talented young people choose to leave San Diego for more affordable housing, which creates a brain drain in the local community. Price-conscious retirees also often decide to relocate entirely outside the County in less expensive parts of California or to neighboring states to trade down.

According to Q3 2021 Redfin migration data, San Diego Redfin users are most often searching for home options in the Pacific Northwest (Seattle/Portland), Arizona (Phoenix), Las Vegas, Denver, and various cities in Texas (Dallas, Austin).

Rental Housing Overview

The San Diego County market has been enjoying the most robust market conditions in two decades as occupancies have increased, rent growth has surged, and the number of available units has fallen to low levels. According to CoStar, the annualized absorption of nearly 10,000 units has reached an all-time high in 2021, and the 3Q 2021 vacancy rate is just 2.2%.

With strong demand for units, asking market rent growth is soaring, with 13.0% asking rent growth in the past 12 months, and average rent levels in the San Diego County region sit at roughly $2,160 per month (CoStar 3Q 2021). Those gains are driven by luxury and mid-tier properties, with annualized rent gains of 17.4% and 15.5%, respectively. The level of concessions has leveled off over the past few quarters, and they are offered almost exclusively on new inventory only.



Source: CoStar 4Q21

Fewer than one in ten rental projects in San Diego County reported using incentives in 3Q 2021.Rent growth has seen at record levels in North County and the UTC areas but is not only experienced in the expensive coastal submarkets. More than half of the San Diego submarkets recorded double-digit rent growth in the past 12 months. As the pandemic worsened, the increase in demand focused on suburban areas. Suburban submarkets like Chula Vista and East County recorded strong demand, and availability rates fell to less than 2%. But renters have also returned to Downtown San Diego in 2021, with the vacancy rate falling into single digits (7.4%) for the first time since a recent development wave hit the submarket.

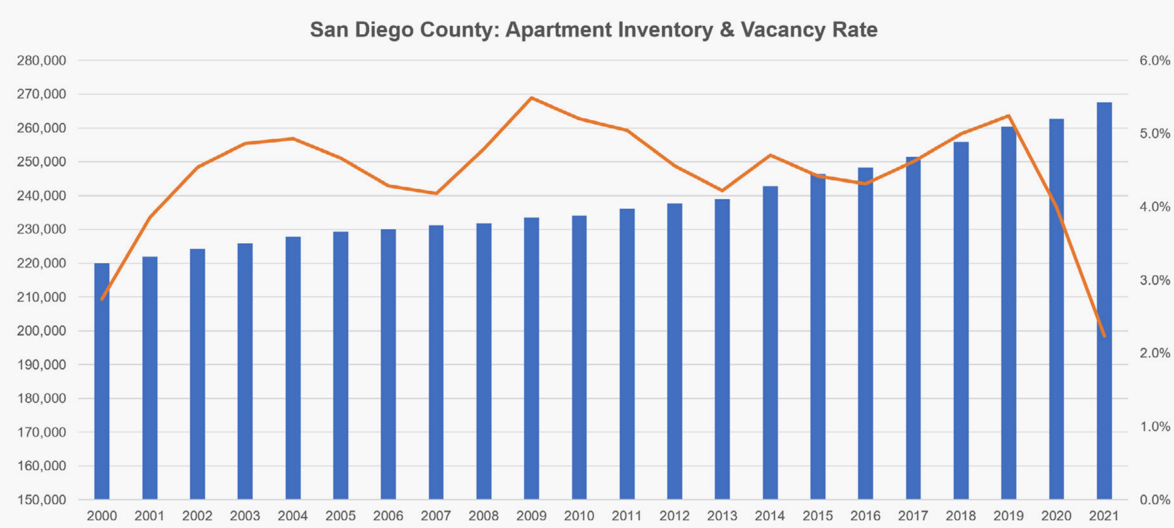
The current pipeline of 6,900 units is unlikely to put much upward pressure on the region's vacancy rate. Mission Valley and Downtown remain at the forefront of development activity and deliveries, highlighted by Holland Partner Group's The Society Bradbury project at the Town & Country Resort in Mission Valley (455 units) and Bosa's 41-story Diega project in Downtown (617 units), with both delivered in 2Q 2021.

The recent strong performance is a departure for San Diego, typically a stable but not dynamic rental performer. With a heavy presence of military, defense, and education institutions, the metro's economy limits downsides in recessions but typically does not boom.

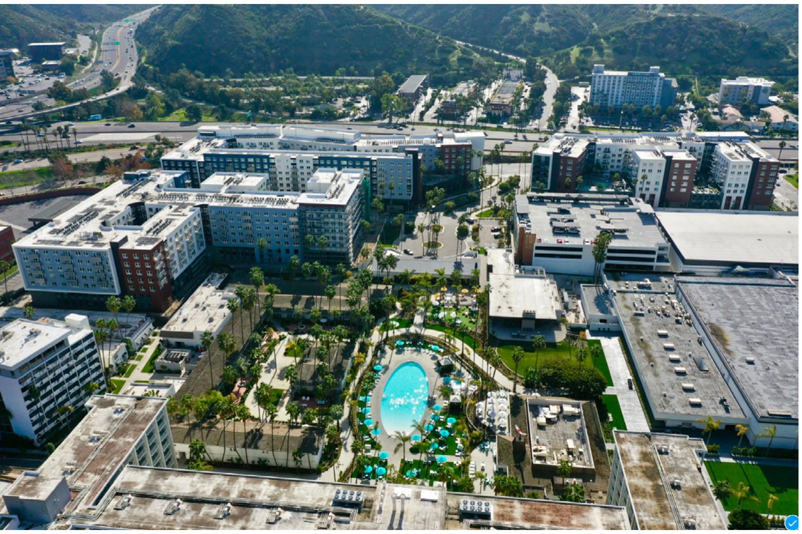
Several factors are driving San Diego County's rental demand. For starters, the for-sale inventory remains historically low, while demand is high. That has led to San Diego home prices rising by 25% over the past 12 months, according to the November 2021 S&P Case-Shiller Home Price index. These home price gains keep people locked into the rental market. Additionally, with more people working remotely during the pandemic, San Diego is attracting people from higher-cost areas such as Los Angeles and the San Francisco Bay area. The eviction moratorium lifted at the end of 3Q 2021 also kept units filled.

Workers of all ages are attracted to San Diego because it is a bastion of high-tech and life science research. Firms like Amazon and Apple are expanding here and will add hundreds of new tech positions, particularly in the UTC area. San Diego also has roughly 140,000 active-duty military personnel, many of whom rent market-rate apartments in North County and the National City and Chula Vista areas in South County.

Recent deliveries have not been able to meet the new demand for rental housing. San Diego County has averaged only 3,359 rental units built per year over the last ten years. New rental apartment development has been concentrated primarily in Mission Valley and Downtown San Diego, but there has been an increase in development in the South I-15 Corridor (Scripps Ranch, Carmel Mountain Ranch), areas close to the Sorrento Mesa tech and life science node, and in the urban neighborhoods around Balboa Park. A new focus on dense housing zoned near transit should provide more units as long as local governments can stay firm against community opposition.



Source: CoStar 4Q21



Developer LOWE added 840 apartment units (at build out) in four separate buildings when they redeveloped Town and Country from single use hotel and conference center into a mixed use community.

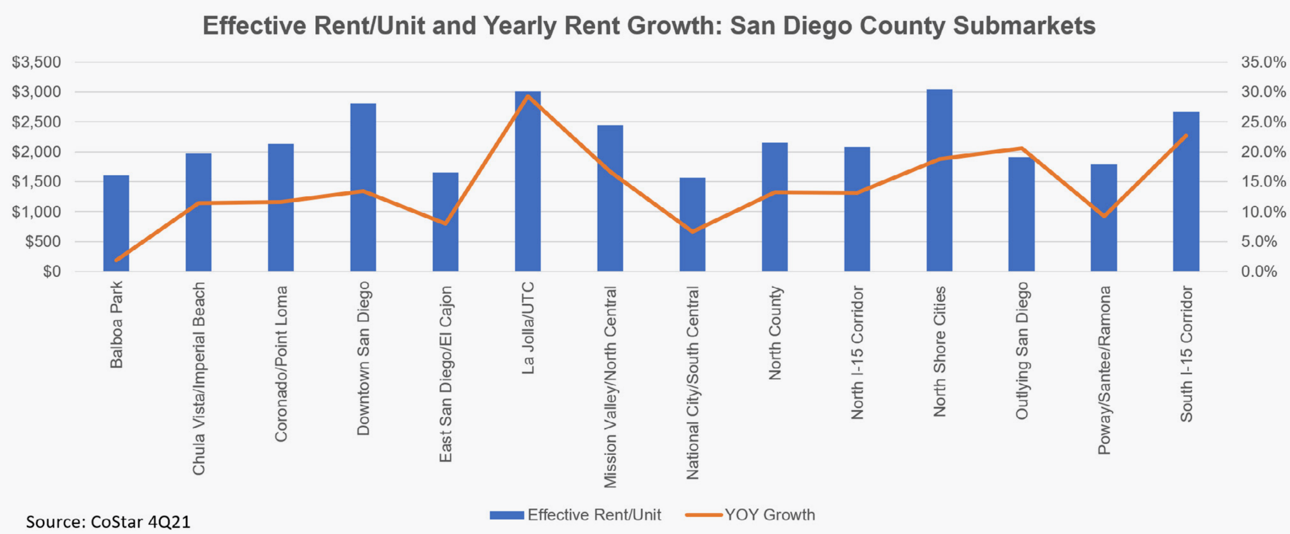
Opportunities & Challenges for Rental Housing

San Diego is ahead of the curve for redeveloping existing commercial projects and revitalizing rental housing into mixed-use communities. Salient examples include Chula Vista Center (planned), Horton Plaza redevelopment (in process), University Town Center redevelopment and expansion (complete), 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 San Diego's employment base is dispersed, therefore unemployment was not a driving force for fleeing the urban areas.

Demographic shifts in San Diego have impacted the target renters for 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. The office development and expansion have drawn many young professionals with high incomes to the area. San Diego continues to retain older, established households unwilling to migrate out of California despite the increased "sunshine tax" and cost of living. A growing segment of the Baby Boomer demographic plan to downsize into turnkey age-targeted apartments near restaurants, retail, and health/wellness destinations that provide a sense of liveliness, community, and connectivity.

With the demographic and economic demand drivers, rental demand has remained strong in Downtown San Diego. Demand has been growing for suburban locations within the county, including East San Diego, South County, and North County Inland. The biggest challenge that San Diego County is facing is affordability patterns with the economic structure of delivering apartment units. The construction, entitlement, and last costs make it very difficult to build enough rental apartments to meet demand at affordable rent.



Source: CoStar 4Q21

Single-family rental projects are one of the hottest sectors in real estate, and homebuilders and institutional investors are eager to build new communities of rental homes. The foreclosure crisis in the late 2000s created a vast supply of unsold homes that investors pooled as rentals. In today's robust housing market, investors do not have pools of homes to buy, so the action has shifted to "ground-up" development of brand-new rental single-family neighborhoods. Given high development costs in San Diego County, the built-to-rent projects are all townhome style (+/-3 stories). At least four San Marcos, Chula Vista, and Mission Valley projects were completed between 2008 and 2020, although most of them were initially intended as for-sale units.

Recent state laws intended to increase housing production have recently passed. In September 2021, Governor Gavin Newsom signed bipartisan legislation to expand housing production in California, streamline housing permitting, and increase density to create more inclusive and vibrant neighborhoods. The suite of bills also will help address the interrelated problems of climate change and housing affordability by promoting denser housing closer to major employment hubs – a critical element in limiting California's greenhouse gas emissions.

The first bill was California State Senate President pro Tempore Toni G. Atkins' SB 9, the California Housing Opportunity and More Efficiency (HOME) Act. The HOME Act facilitates the process for homeowners to build a duplex or split their current residential lot, expanding housing options for people of all incomes that will create more opportunities for homeowners to add units to their existing properties. It includes provisions to prevent the displacement of existing renters and protect historic districts, fire-prone areas, and environmental quality.

The second bill was SB 10 by Senator Scott Wiener (D-San Francisco), which creates a voluntary process for local governments to access a streamlined zoning process for new multi-unit housing near transit or in urban infill areas, with up to 10 units per parcel. The legislation simplifies the CEQA requirements for upzoning, giving local leaders another tool to voluntarily increase density and provide affordable rental opportunities to more Californians.

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, making market-rate units unaffordable for workforce households.

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 this number of affordable units. San Diego requires policy initiatives to solve the issue. San Diego County will benefit from using Federal and State programs to subsidize the cost of Affordable housing, but access to these funds will be limited by the availability of local resources to match the outside funds, and local production will continue recent trends of 1000-1500 units per year. A significant portion of this will continue to be in the category of Permanent Supportive Housing for recently homeless individuals.

A joint powers authority can issue tax-exempt debt, and California has established this through various programs for workforce and Affordable housing. The California Housing Finance Agency (CalHFA) and California Statewide Community Development Authority (CSCDA) are just two examples. CalHFA has had some local successes with its Mixed Income Program (MIP) in various local municipalities, financing projects with a mix of affordable and middle-income housing. CSCDA has just facilitated the purchase of market rate apartments using tax-exempt debt to rent-restrict the units to middle-income levels, the first such transaction in San Diego County. ("Waterford Properties Pays $157 million for 3 Apartment Complexes," San Diego Business Journal, January 17, 2022)

Sources:
Target Jobs to Housing Ratio: https://enviroatlas.epa.gov/enviroatlas/DataFactSheets/pdf/Supplemental/Employmenthousingratio.pdp
6th Cycle Regional Housing Assessment Sandag: https://www.sandag.org/uploads/projectid/projectid_189_27782.pdf

Examples of recent Affordable housing executed in San Diego County.

The Link in downtown San Diego by Affirmed Housing 88 units of permanent supportive housing

The Grove, Vista, Wakeland Housing & Development Corporation, 81 affordable homes for low-income seniors

Homelessness

Homelessness is a larger and more complex issue than can be covered in three paragraphs in the annual real estate trends report. But housing supply and local economics sits at its core. It impacts residents of our communities, despite increased resources directed toward addressing the crisis. The primary driver of homelessness continues to be economic – as the housing shortage drives rental prices up, individual wages and benefits have stagnated. Homelessness is surging in particular amongst the local senior population, whose fixed incomes cannot begin to match the rising rental market. While there is increased attention to short-term shelter and outreach activities, the lasting solution to homelessness – the creation of permanent homes affordable at incomes of 30% of the local Area Median Income - remains a great challenge.

Any increase in new market-rate or middle income homes will reduce upward pressure on rents if production levels of 16,000 units per year or more can be sustained. However, it needs to be acknowledged that production forces alone are never going to solve the needs of the lowest income residents in our communities. Absent a catastrophic economic crisis, once the market has adjusted rents upward on formerly affordable rentals, they are never going to fall to their former levels of affordability.

Much of how we define "the homeless" is based on our observations of those who have been living on the streets for an extended period of time and exhibit signs of trauma from that experience. One can hope that we can prevent homelessness through a significant increase in rental subsidies and the creation of new, deed-restricted affordable housing. This topic will be addressed in greater depth by ULI in the future.

Property Type Outlook

OFFICE Market Overview

by Zach DiSalvo, Field Research Manager, CBRE | San Diego, Hawaii

Office Top Trends & Findings

1. Lingering uncertainty for office users across the country has resulted in **larger companies delaying their return to the office in 2021**, and making the length of the office recovery longer than anticipated.
2. However, central San Diego office submarkets, like UTC, Sorrento Mesa, Torrey Pines, and Del Mar Heights, have been **extremely active due to increased competition from life sciences users**, a decreased supply of traditional office buildings due to Life Science conversions, and Tech Giants quickly absorbing space.
3. Massive increases in constructions costs and extended delivery timelines are **causing many occupiers to sign defensive leases**, not because they need the space now, but out of fear expansion space will not be available once it is needed.
4. **Leasing velocity has increased rapidly and is nearly back to pre-pandemic levels**. Leasing activity has increased roughly 27% on average, quarter-over-quarter since the start of the year.
5. Venture Capital activity in San Diego County has **continued to surge in 2021**, with total funding of roughly $6.6 billion by the end of Q3 already exceeding total funding of $5.2 billion in all of 2020. Life Science companies have accounted for over 66% of the total funding in 2021 and Tech companies have accounted for roughly 28% of the total funding.
6. **San Diego ranks first in office to lab Conversion activity** and second in Construction square footage in the nation. Within the past 18 months, roughly 2 million square feet of office-to-lab conversions have been planned, primarily in Sorrento Mesa.
7. At the end of the day, the workplace is still essential to the way most businesses operate, and while many Occupiers are embracing hybrid work environments, **most believe that the in-person office environment is essential to drive collaboration, innovation, culture, and new ideas**. However, as identified in the national ULI Trends Report, there is a disconnect between the employer and employee in terms of ideas about what WFH "flexibility" looks like.
8. In 2022 we see Occupiers continuing to **evaluate their future needs and react to the fluid situation** that the Delta variant, and now Omicron, is creating, while owners will continue to invest in the workplace and likely look to increase lease rates in places where availabilities are dwindling.

Overview

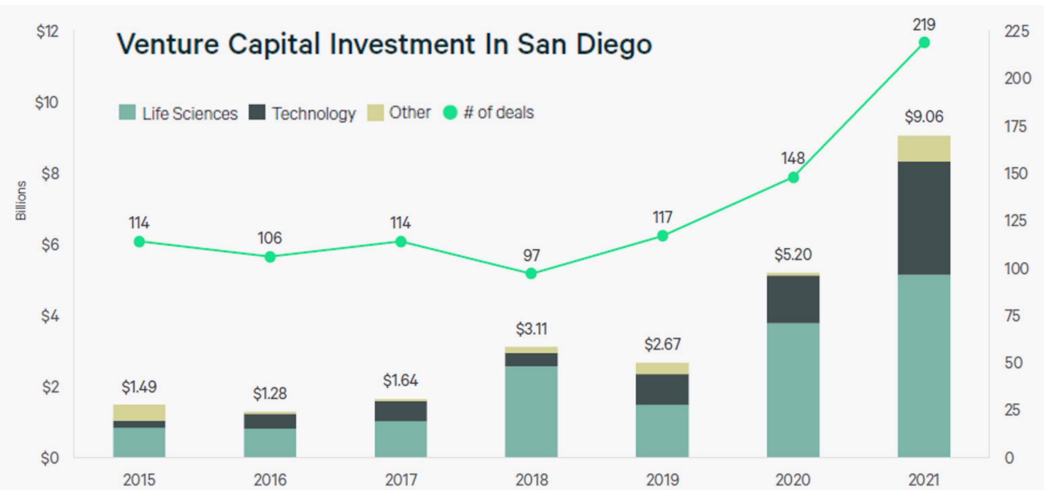
While many believed that 2021 would be a return to normal, first the Delta variant and now the Omicron variant, have continued to cause uncertainty for office users across the country. Larger companies delayed their return to the office in 2021, and the length of the office recovery has been longer than anticipated. However, the return is slowly happening. While San Diego's latest numbers show payroll jobs have declined by 72,100 jobs in October (-5.7%) since 2019, our forecast predicts growth of 2.3% in the San Diego area in the next five years. San Diego's hospitality and leisure employment sector is expected to post the best job performance over the next five years. Office users were still down -16,500 jobs (-4.7%) since 2019, but up 10,800 jobs (+3.4%) since 2020.

Although the timing on returning to the office is still unclear, the unique circumstances have not translated to slow leasing activity for San Diego. Central San Diego office submarkets, like UTC, Sorrento Mesa, Torrey Pines, and Del Mar Heights, have been extremely active due to increased competition. This heightened activity is a result of a variety of factors, such as increased competition from life sciences users, decreased supply of traditional office buildings due to Life Science conversions, and Tech Giants quickly absorbing space. Record setting venture capital activity has created jobs and demand for office space, and especially high-quality space that will incentivize employees to come back to the office. Massive increases in constructions costs and extended delivery timelines are causing many occupiers to sign defensive leases, not because they need the space now, but out of fear expansion space will not be available once it is needed.

The tech and life sciences industries will continue to lead the office recovery. COVID-19 drastically increased the need for laboratory and manufacturing space in San Diego, as tenant demand increased astronomically over the past six quarters. YTD laboratory leasing activity totals 2.1 million square feet, 24% more than last year's record annual total of 1.7 million square feet. Despite heightened leasing activity, there is still about 3.75 million square feet of life science demand in the market; San Diego demand historically tracks in the range of 800,000 – 1 million square feet. This has pushed lease rates to an all-time high and encouraged the surge of new and conversion development.

with the majority of tenant concessions coming in the form of improvement allowances or free rent. At the end of Q3 2021, the weighted average asking rate was $3.18 per square feet, the same rate that it was at the end of Q1 2020. That being said, during Q4 2021, the Irvine Company has started increasing asking rates by 5-10% in UTC as a result of the area's positive demand dynamics. This is a trend we expect to continue in Central San Diego as other owners follow suit.

2021 Q2 and Q3 were the first consecutive quarters of positive net absorption in the market since 2019 2Q, with both quarters seeing over 300,000 square feet of positive net absorption. Central San Diego, specifically UTC and Del Mar Heights were the largest drivers of positive net absorption over the year, as many tenants continue to see the value on being centrally located for their workforce. The short-term forecast calls for overall positive growth in office workers through year-end 2022. Total net absorption is forecasted to be positive 1.8 million square feet, out-pacing supply during the same period.



Vacancy, Lease Rates, and Net Absorption Slowly Recovering

Vacancy, Lease Rates, & Net Absorption Slowly Recovering

The vacancy rate across the San Diego market continues to tick down as people begin returning to the office and companies look to grow their footprint. The vacancy rate at the end of 2020 was 14.0% across the county; however, by the end of Q3 2021, the vacancy rate had already decreased to 13.2%. Although the vacancy rate has yet to return to pre-pandemic levels (10.7% at the end of Q1 2020), two consecutive quarters of decreasing vacancy, and large leases that will be counted in absorption in the upcoming quarters, are positive signs for the road ahead.

Weighted average asking lease rates have seen minimal change over the course of the pandemic,

What is driving uncertainty about total office space needs in next three years?

Office Space Concerns	Nation	San Diego
Lack of understanding about how a hybrid work model will affect office space needs	93.2%	88.9%
Too early to know how long physical distancing may be required in the workplace	56.2%	48.1%
Standard leases are of long duration and challenging to exit	30.2%	22.2%
Ability to sublease excess space remains uncertain	37.9%	40.7%

Source: Emerging Trends in Real Estate 2022 survey.

Two new projects targeting the tech market. On the left is in Rancho Bernardo and the right on Kettner in downtown San Diego.

Leasing Activity Ramps Up

Although uncertainty caused by the Delta Variant is still playing a role in decision making, office users continue to place big bets on the importance of the workplace and having a space for their people to collaborate. Leasing velocity has increased rapidly and is nearly back to pre-pandemic levels. Leasing activity has increased roughly 27% on average, quarter-over-quarter since the start of the year. 2021 Q3 was the first time since 2019 Q3 that San Diego Country saw over 2 million square feet of leases signed. This trend is expected to continue into Q4, with roughly 5 million square feet of demand in the marketplace and many large leases close to being inked.

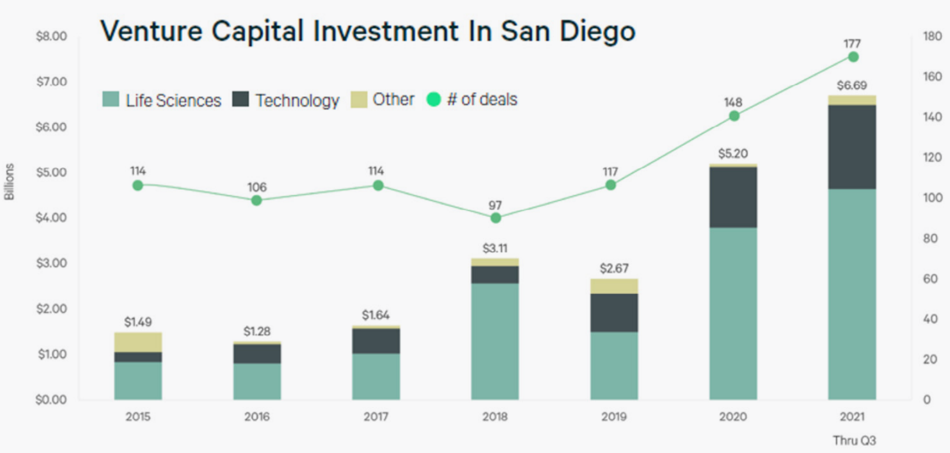
Of that demand, just over 52% of the active requirements are for life sciences usage. Technology companies are the next most in-demand users, representing over 11% of the market's total active office requirements. When it comes to location, the majority of tenants are looking in Central San Diego, specifically in UTC, Torrey Pines, Del Mar Heights, and Sorrento Mesa, where large blocks of space are few and far between. As of late November 2021, there were only 12 available spaces greater than 100,000 square feet in San Diego County, none of which were located in UTC, Torrey Pines, Del Mar Heights, or Sorrento Mesa. There were only two blocks of available space larger than 50,000 square feet in those submarkets.

VC Funding Skyrocketing & Big Tech's Impacts

Venture Capital activity in San Diego County has continued to surge in 2021, with total funding of roughly $6.6 billion by the end of Q3 already exceeding total funding of $5.2 billion in all of 2020. Life Science companies have accounted for over 66% of the total funding in 2021 and Tech companies have accounted for roughly 28% of the total funding. Most of these highly funding companies are continuing to grow their footprints in UTC, Del Mar Heights, and Sorrento Mesa, which play a significant role in the shrinking available space in those submarkets.

Tech venture capital funding reached historic highs in Q3 2021, at over $1 billion, and is expected to continue to grow by the end of 2021. With a large inflow of capital, companies will need to hire talent and grow their office space. Office users grew by 10,800 jobs in October and will have to continue to increase to meet demand. Many firms are facing a tech labor shortage and in fact, several local employers are offering signing bonuses and raising wages to entice workers.

Tech Giants have signed significant office leases during Q3, proving San Diego's future remains bright. One large tech user signed approximately 500,000 square feet of new leases this year, bringing their total footprint to 1 million square feet in just UTC. The tech user also has leased roughly 608,000 square feet in Rancho Bernardo. As more tech firms choose to expand their presence in San Diego, the demand for skilled talent in the region continues to surge. Over the past few years Tech Giants have taken on nearly 3 million square feet of office space in San Diego County, bolstering what the Milken Institute calls the "Most Diverse Tech Sector in the Nation."



Source: CBRE

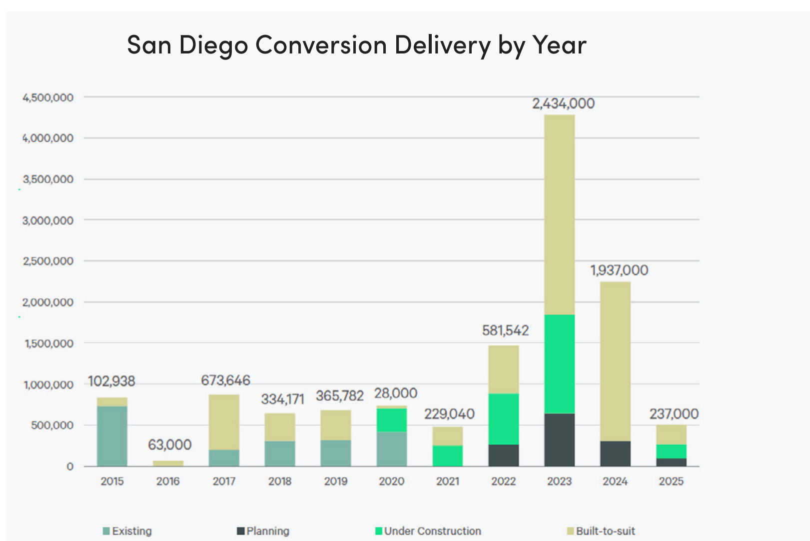
Lab Conversion Trajectory Continues

San Diego ranks first in Conversion activity and second in Construction square footage in the nation. Within the past 18 months, roughly 2 million square feet of office-to-lab conversions have been planned, primarily in Sorrento Mesa. With the continuing tightening of biotech submarkets and traditional lab buildings, life science space is now emerging into and impacting the availability of large blocks of Class A office space in the submarkets of Del Mar Heights and UTC. Life sciences space is also emerging in markets such as the Highway 56 Corridor, Scripps Ranch and Downtown San Diego. This lab tenant demand and conversion trend is also leading to the displacement of certain office tenants. Notably, there has been approximately $2.5 billion of acquisitions by life science developers since 2019.

The San Diego market has 2.4 million square feet of new construction currently underway, 543,000 square feet of which is in build-to-suit projects that are 100% preleased. The remaining 1.9 million square feet is speculative development.

This unprecedented demand for Lab space, coupled with rising demand for industrial space thanks to e-commerce, is having a massive impact on the office and industrial markets. Some owners are converting Class A office space into Lab or industrial space, further dwindling an already limited supply. And land that is suited for lab development has seen prices skyrocket 2X-3X will almost certainly be leased before construction is complete.

Conversion of the Thomas Jefferson School of Law into Genesis – offering life-science office and lab space in downtown by Phase 3 Real Estate, completed Q1 2022



Source: CBRE

The New Downtown & Other Emerging Markets

Downtown San Diego is also emerging as a life sciences hub, with 191,500 square feet of available space. With 1.2 million square feet of life sciences construction, downtown accounts for the vast majority of existing or ready-to-deliver large blocks of life science space in the County.

During Q3, under construction activity was at its highest level of the past decade, totaling 1.97 million square feet. Downtown continued to have the highest construction activity among all submarket at 1.3 million square feet. The 270,000- square feet WEST – Office at 1011 Union St started construction while the 750,000 square feet development at The Campus at Horton Plaza and 2100 Kettner signal continued interest in the area's development into a life sciences and tech hub for the region. Several major projects are still upcoming, including the much-anticipated life science/office waterfront development Research and Development District (RaDD) by IQHQ and the mixed-use Tailgate Park/East Village Quarter by Tishman Speyer and Ascendant Capital Partners. Kilroy Realty's 2100 Kettner project is nearing completion and will add 219,000 square feet of office and 15,000 square feet of retail in Little Italy.

In addition to the revitalization of Downtown, other submarkets such as Carlsbad, Scripps Ranch, and others along the 56 corridor are also trending in a positive direction. In terms of Net Absorption, Carlsbad was one of the strongest performing submarkets in Q3 2021 and Big Tech companies continue to take on large blocks of space along I-15. As space becomes less available and more expensive in submarkets like UTC, Del Mar Heights, and Sorrento Mesa due to lab conversions and large tech users entering the market, tenants will need to consider looking in other submarkets like Downtown, Carlsbad, Scripps Ranch, or Mission Valley where options are more abundant and lease rates are expected to remain fairly stable in the short term.

San Diego as a Gateway Market

At the end of the day, the workplace is still essential to the way most businesses operate, and while may Occupiers are embracing hybrid work environments, most believe that the in-person office environment is an essential tool to drive collaboration, innovation, culture, and new ideas within their organizations.

Buyers are not backing off of the workplace. As of November, Office transactions have accounted for over $850 million in assets traded, or roughly 25% of total commercial real estate transaction volume year-to-date.

Ownership groups continue to place massive bets on San Diego, as the city is transitioning to being seen as a Gateway market. This is largely due to San Diego being backed by massive inflows of Venture Capital, Life Science's dominating presence, and the emerging Tech backstop that creates a dynamic economy.

Opportunity for Office Users

2021 resulted in many companies evaluating how they operate and what is important to their organization and culture. It's crucial for business leaders to think on a deeper level than ever before about new and creative ways to keep their workforce engaged and fulfilled.

During the pandemic, record breaking influxes of sublease space was added to the market as occupiers tried to quickly offset costs. Since then, much of the sublease space has come off the market. While many expected to see sublease-space continue to rise and office users try to reduce their footprint, most office users are not drastically downsizing their space. In fact, in the rare cases where a user does decide to downsize, sublease space is often leased up faster than it can be marketed at favorable rates that allow the lessor to offset costs, and in some cases make money. We are starting to see this in UTC, Del Mar Heights, Sorrento Mesa, or other desirable submarkets where there is little direct space available.

In a dynamic and changing office market like San Diego, Office users need to have access to the best market intel to drive their decision making. Occupiers should be planning 2-3 years in advance and taking a variety of factors into consideration before making commitments that could impact their business. It is vital that business leaders work with trusted advisors to navigate through a dynamic, and rapidly changing market, like we have in San Diego.

An entrepreneurial environment is critical to spur future innovation and growth.

Q&A *with* Tracy Murphy

President & Founder, IQHQ

> San Diego is already the third largest life science market in the United States.

Q: Why is IQHQ so bullish on the San Diego market for life sciences and how has that evolved over the past couple of years?

San Diego is a great place to live, work and play, and it is poised to be the next iconic life science market in the United States. With an 82 percent increase in life science employees over the last decade – including significant growth over the last few years – San Diego is already the third largest life science market in the United States and is experiencing a dramatic increase in demand for new Class A office and lab space. San Diego has the labor market, academic institutions and a growing life science community to support new and dynamic commercial real estate and lab environments.

We believe that biotech, pharmaceutical and life science companies will continue investing in downtown to access the top talent, be close to cutting-edge amenities, and offer employees higher quality of life. In addition, San Diego has a deep pipeline of talent and resources given our depth of research institutions and leading colleges, universities and academic centers of excellence. San Diego is well positioned for the future given the leadership of our local elected officials and business community – that are committed to attract the life science industry and new companies while fostering an entrepreneurial environment that is critical to spurring future innovation and growth.

At IQHQ, we are dedicated to 'giving progress a home' so taking on transformational commercial real estate projects such as the Research and Development District (RaDD) is part of our DNA. By embodying our approach, RaDD will invigorate downtown and elevate San Diego's life science market to be competitive with the Seaport District in Boston and Mission Bay in San Francisco.

Q: We see life science and tech continue to grow in San Diego, but historically there has been resistance to locating in downtown. What is IQHQ doing to address those concerns at RaDD?

We view RaDD as an opportunity to capture the innovative spirit of San Diego and expand the existing ecosystem in a more urban format. In particular, given RaDD's proximity to transit that connects it to over 80 residential communities with diverse, local talent, it will attract top employers to downtown and it will enhance the experience of working in life sciences with a premier, urban, mixed-use waterfront campus that will include laboratory, office, retail and open space. RaDD will transform downtown San Diego's waterfront into an iconic life science district that combines industry opportunities with lifestyle amenities.

We believe that this development will accommodate progressive, growing companies in a way that hasn't been offered in San Diego before. In other words, we're building to meet the needs of the industry and we think that looks like RaDD going forward, especially given the changing needs and expectations of labor. If employers want to fill seats and jobs, you need to think differently here. This will spark and drive sustained growth in San Diego's downtown by drawing top employers and employees through a premier work-live-play district that will feature easy access to transit, housing, dining and top amenities – unlike any other life science development in San Diego.

For example, on the transit front, the recently completed Blue Line Trolley extension now connects downtown to UC San Diego and UTC/Torrey Pines – in turn, great access for future tenants to the region's top talent and labor market. Now, downtown is just a quick, single-seat ride away from prominent life science markets, making RaDD and other developments more accessible to San Diego's growing life science industry than ever before. In addition, with best-in-class retail, event space, public attractions and rooftop restaurants with unbeatable views – along with considerable open, green space. RaDD will not only draw in great employers and talent – it will also be a boon for the surrounding area by featuring over 1.5-acres open space and lifestyle amenities open to tenants, visitors, and the community at-large to enjoy for generations to come.

Q: The pandemic caught us all by surprise. You are embarking on one of the largest real estate developments to be realized in downtown San Diego or West Coast or anywhere! during a time of significant change, how is your team thinking differently about it today than you did a year ago?

Just over two years ago, we founded IQHQ around the mission to empower the life science community to thrive and succeed by creating and developing environments that inspire progress and give innovation a home to grow. To support our mission and vision, we are developing a completely new and innovative approach to life science developments to meet the meteoric demand for laboratory space that will only continue to expand in the years ahead.

Beyond the development of iconic life science districts, IQHQ is dedicated to creating vibrant spaces where the convergence of lifestyle and premier life science environments are brimming with amenities, retail, open space and access to public transportation in desirable urban locations. The pandemic has further fueled our mission, as it is clear that both tenants and talent want and expect dynamic districts and working environments as companies return to working in person. Finally, it is worth noting that our strategy has been further validated by successful equity raises to support our development pipeline that now includes more than 10 million square feet in the innovation hubs of Boston, San Francisco, San Diego and most recently, the United Kingdom.

Q: Considering the unique needs of life science companies, can you talk about IQHQ's approach to RaDD? Looking ahead, what is your long-term vision for future projects and life science development in San Diego?

In many ways, RaDD is the poster child for our innovative district approach – the $1.6 billion project will transform downtown San Diego's skyline into an iconic life science district. Situated on more than ten acres and occupying six blocks, RaDD represents the largest urban commercial waterfront site along California's Pacific coast, and we strongly believe that it will extend and accelerate the commercial life science market in San Diego for years and decades to come. Our long-term vision for San Diego includes more vibrant, dynamic, downtown campus environments, such as RaDD, to fuel positive change by creating exciting and inspiring places for scientific progress. Some have referred to RaDD as a pioneering move. We see this as a direct response to market demands and reflects a shift from decades of suburbanization to the growing *Urban Renaissance*. We believe that San Diego will ultimately become one of the largest biotech clusters in the world.

Property Type Outlook

RETAIL Market Overview

by Don Moser, Partner, Retail Insite

Retail Top Trends & Findings

1. Pent-up demand for services and retail experiences, coupled with flush consumers, has driven **retail sales to levels above pre-pandemic norm**, and 2022 will see that tapering off but still strong.
2. 2021 has seen a resurgence of retail investment in San Diego. **Sales demand has been extremely healthy with small and large properties receiving multiple offers**. Even non-descript retail properties are trading quickly as investors chase yield and perceive San Diego as a very stable environment.
3. Retail development in 2022 will be **led by densifying existing retail sites** where the term "covered land "is trending strongly in the retail lexicon.
4. **Retail leasing rebounded aggressively** in 2021 as vacancy in the San Diego region moved to below 6% (Source: CBRE 3rd Quarter 2021 Vacancy Report). While leasing has been robust, tenant improvement costs have gone up due to shortages in skilled workers and materials making some deals painful for landlords/ property owners.
5. During the pandemic entrepreneurs found a way to produce, deliver and meet consumer needs in creative and unforeseen ways. 2022 will continue to see the **progression of retailers using an omnichannel strategy** to meet customer preferences.
6. Look for **continued investment in automation initiatives** by the biggest players to drive the incremental costs of fulfillment down; especially delivery which has resulted in significant profitability issues.
7. San Diego will see the exciting **repositioning of portions of several malls** including Grossmont Center, Parkway Plaza, Horton Plaza (in process), North County Fair and Shops at Carlsbad. Starting with department stores who cease operations, these properties have tremendous potential for mixed-use applications given their strategic locations.
8. 2021 saw the **successful IPOs of a number of retail/restaurant and fitness concepts**, including Warby Parker, Dutch Brothers, Xponential Fitness and Encinitas hometown favorite Vuori. 2022 will see the entry of several new retailers who see potential for new growth here locally.
9. The specialty retail segment, where culture meets retail, has the potential to remake S**an Diego into a city with great street front retail and F&B** as consumers want more compelling experiences close to home. Digitally native retailers are looking for brand-building locations in affluent trade areas.

Overview

Where is San Diego retail headed in 2022? A simple question with complex answers considering the many facets of retail's expression; from commodity retail to specialty and streets; from an ever-changing food & beverage scene to the health & fitness industry. The answers can best be found from the street up, where innovation moves swiftly by design or in response to external challenges.

Multiple government support packages benefitted retailers directly, including the payroll protection program, which allowed many to survive shutdowns. Even more impressive was the innovation of entrepreneurs who found a way to produce, deliver and meet consumer needs in creative and unforeseen approaches. Unfortunately, many small businesses that were not positioned to withstand the impact of government shutdowns were damaged and 2020 retail bankruptcies exceeded great recession levels. However, 2021 brought a reduced number of bankruptcies, more in line with historical standards. Overall, the pent up demand for services and retail experiences, coupled with flush consumers, is driving retail sales to levels above pre-pandemic norm, and 2022 will see that tapering off but still remaining strong.

San Diego has long experienced significant barriers to entry for retail development. These barriers, which may frustrate during the boom times, insulate the market during difficult ones. The post-pandemic landscape has again demonstrated that resilience, and while many opine on the retail apocalypse and the doom of brick and mortar, please don't tell the market makers as they are quite busy right now making new deals! San Diego retail rebounded aggressively in 2021 as vacancy in the San Diego region moved to below 6% (CBRE 3rd Quarter 2021 Vacancy Report).

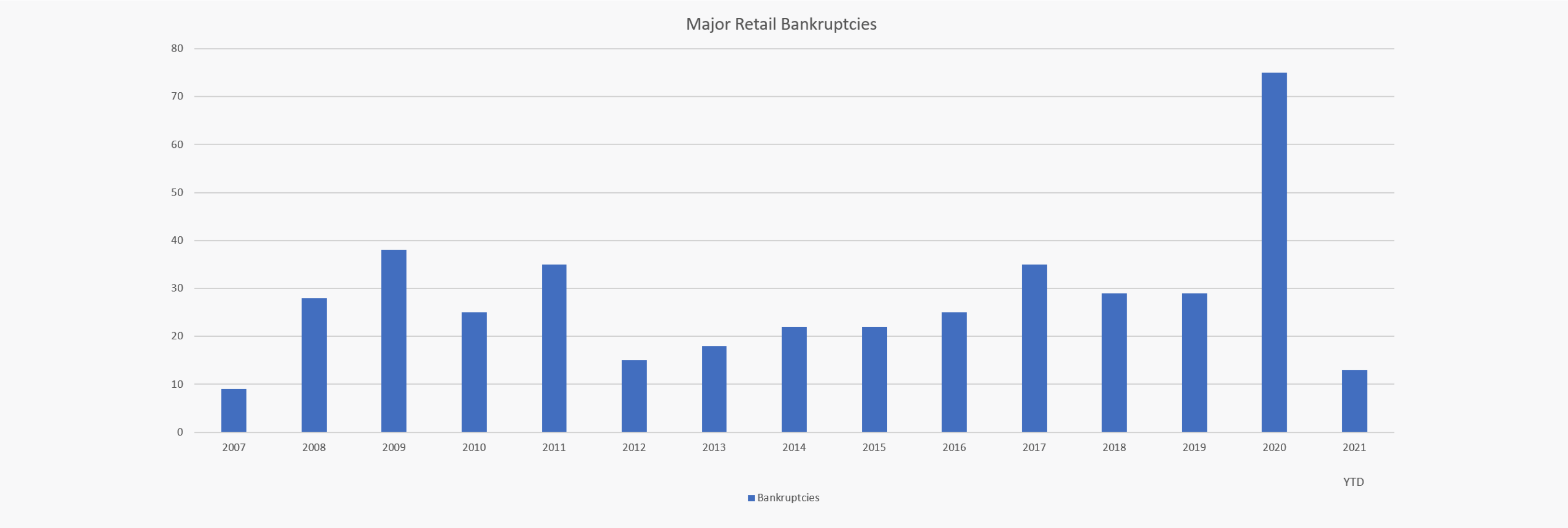
This macro vacancy factor only tells a fraction of the story. Well positioned retail sees multiple bidders on both the leasing and the investment front, however small mom-and-pop shops continue to remain relatively flat. 2021 saw a very brisk leasing market. San Diego is once again extremely tight where finding good space is difficult and rents are on the rise.

Successful retail by its definition is in constant evolution and its very DNA contains the blueprints to quickly adapt to meet ever-morphing consumer needs and desires. The regulations and consumer changes brought on and accelerated by the pandemic were a catalyst for a quickened pace of change to those with capital, position, and paradigm to make them. From this positive rebound, where will 2022 lead us? Mark Twain wisely noted "prediction is difficult – particularly when it involves the future!" Humbly, let's zoom into the key segments of the San Diego retail spectrum and peer into what lies ahead in 2022.

2022 will continue to see the progression of retailers meeting their customers using an omnichannel strategy. The debate of on-line vs brick and mortar is old news, and the question now is focused on profitability. Many brick and mortar founded companies are heavily investing in on-line methods while e-commerce founded merchants are continuing to grow in physical presence. Consumers spent more than 18% in on-line purchases (of their total retail purchases) in the third quarter remaining higher than pre-pandemic levels (15%) (US Department of Commerce).

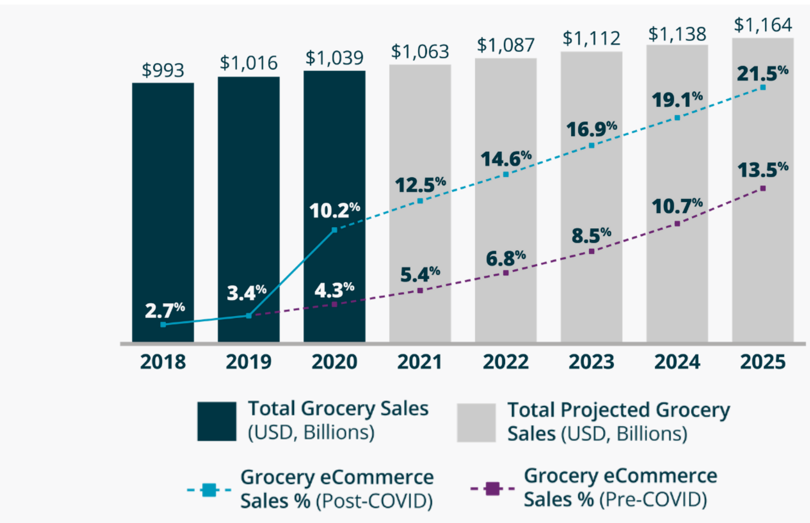
The competition is intense and not for the faint of heart! The "retail heartbeat" of the best retailers is that they know their customers and provide the products they desire in the way customers want it delivered. Now more than ever, successful retail investors understand this and should place their bets on those retailers most adept at this discipline.

A critical aspect that will continue to bear down in 2022 is the cost of delivery/return and its effects on profitability. We all know intuitively that when you order a single item and receive a single box or ask a grocer to "pick" your items and bring it to your door, that this must cost someone. You are right, it does! Factoring in this cost affects all segments, including food. Companies like Door Dash have yet to be profitable. The race to deliverability still has significant profitability issues, and there is a huge investment being made in multiple automation initiatives by the biggest players (including grocery) to drive the incremental cost of fulfillment down. Who sorts this out will be a tremendous winner 2022 and will also shed further light on the "real" rate of consumer adoption of on-line coming out of COVID.



Source: Lockehouse Retail Group

Ecommerce Grocery Platforms are the New Norm



Source: Mercatus

Commodity Retail

Commodity Retail – "think of it as the stuff you need" - is healthy and retail sales are expected to remain strong into 2022. Illustrating this; comp sales in 3rd Quarter 2021 were very strong Target (12.7%), Wal-Mart (9.2%), Home Depot (9.8%) and Costco (9.4%), all great leaders in providing incredible value to the consumer.

85% of retail sales in the US are commodity sales and although impacted by internet sales, their business model is alive and well and able to efficiently deliver products in an extremely profitable way. These retailers have a tremendous voice to middle and lower income customers where price is paramount. Many readers of ULI whitepapers may be in somewhat of a bubble where on-line purchasing and delivery is normative. Driving this home, when is the last time you may have shopped at a Wal-Mart or a Family Dollar store/Dollar Tree store? Family Dollar/Dollar Tree have over 15,000 stores in the United States with an astounding 1,600 stores opening in both 2021 and projected for 2022 (Convenience Store News). Overall 9 of 10 Americans shop in Dollar Stores.

San Diego consumers are shopping physically in stores at significant levels. From Costco that skews to a higher income customer, to Wal-Mart/Dollar Stores that provide products at a price-driven offering, there are extreme barriers to entry in Sab Diego County. This success has created retail strength in every sub-market from Chula Vista to Escondido.

Leasing in the mid-size and anchor box (spaces above 15,000 square feet) segment will remain strong, as San Diego has always had a major lack of anchor supply. Given the rent and cost, we will not see many new developments underwritten on mid-size boxes making backfilling of these spaces strong. In 2020/2021 - 30 boxes were leased or under negotiation. 2022 will see a proportionate and similar number of deals.

Examples of active players in this segment are TJ Maxx, HomeGoods, Burlington, Ross, Nordstrom's Rack, Joann Stores, Harbor Freight, Dollar Tree, REI, fitness users, Ashley, La-Z-Boy, and others. Rents are holding to pre-Covid levels. However, the cost for tenant improvements is often in the $70-90 per square foot range making deals capital intensive.

Retail sales have grown. The middle-and-upper income consumer is very omnichannel in desire and shopping pattern, creating a race to get to the significant portion of the population that has yet to embrace online due to access, credit, etc., and this will continue to play out in 2022. The volume of sales is putting physical pressure on the successful box retailers throughout the county.

Specialty Retail

Let's call it "all the stuff you may not need but want" and has historically been delivered in the mall environment or in streets/specialty centers.

2022 will continue to be the year of reading about the demise of the department store due to internet sales. Don't let that tag line deceive you, as the Power Center category killers like Best Buy, TJ Maxx, Bed Bath & Beyond have been ravaging department store sales for years, and the death has been slow and anticipated.

San Diego will see the exciting repositioning of portions of several malls including Grossmont Center, Parkway Plaza, Horton Plaza (in process), North County Fair and Shops at Carlsbad. Starting with repositioning department stores that cease operations, these properties have tremendous potential for mixed-use applications given their strategic locations. Iconic malls like UTC/Fashion Valley are continuing to evolve into the very "best of breed" retail offerings with mixed-use and courting luxury retailers into their mix.

Exciting properties like One Paseo in Carmel Valley, Forum Shops in Carlsbad, streets like 101 Highway in Encinitas, Carlsbad, Little Italy and Oceanside are attracting the "brand aware retailers" and the most innovative food and beverage players. Rents in several of these areas for special spaces are hitting and, many times, exceeding $100 gross with very limited space opportunity.

New Development

San Diego has several significant retail/mixed use projects on the horizon. Three of these game changing projects are in Downtown. Horton Plaza (700,000 square feet with 300,000 square feet of retail) is under construction and experiencing strong leasing activity. RADD/IQHQ on Harbor Drive with 150,000 square feet of retail square feet, and the Seaport Redevelopment, a 2.5-billion-dollar mixed-use project.

Other projects being planned across the county:

- Watermark in Scripps Ranch will break ground in summer 2022 with a mixed-use line up including Whole Foods, HomeGoods, and TJ Maxx totaling 175,000 square feet.
- Grossmont Center, purchased by Federal, is being re-envisioned for future retail redevelopment.
- In Otay Ranch two sites are vying for a grocery anchor to kick off development.
- Mission Valley has the proposed Aztec Stadium retail component, Civita and Riverwalk San Diego in planning stages.

Source: Watermark, Scripps Ranch, Sudberry Properties

Due to the lack of retail space and the long-term entitlement timelines, many of these projects moved through the last 24 months purposely. Several of these projects took advantage of the "pandemic pause" and revamped their mixes to meet a post-Covid world.

2022 Retail development will be led by densifying existing retail sites where the term "covered land" is trending strongly in the retail lexicon. Key properties that have had long entitlement lead times will come back to activity as will the repositioning of existing centers. Due to the cost of construction, these new developments can only be afforded by high-quality grocers and high-volume retailers/food and beverage players. Specific challenges to new developments are cost of construction and the ever-slowing permit process which is an ongoing obstacle for all segments.

New Retailers

2021 saw successful IPOs of a number of retail/restaurant and fitness concepts, including Warby Parker, Dutch Brothers Coffee, Xponential Fitness and Encinitas hometown favorite Vuori activewear. 2022 will see the entry of several new retailers that see potential here for new growth, including:

- Amazon Fresh (under construction in Poway).
- Total Wine will enter San Diego with recently completed deals in Mission Valley, Carmel Mountain Ranch and Encinitas.
- Yeti, an iconic retailer, is completing a new store in North County.
- Malibu Farms is under construction in Seaport Village.
- Sweetgreen is making multiple restaurant commitments across the county.

These are a few examples of new entries to the San Diego market. In addition, existing retailers are active in new store growth complementing existing networks. Given the lack of developable large box land in San Diego, we expect to see only a few new big box stores in 2022, including Costco Business Center in the former Frys in San Marcos, Home Depot's new Mission Valley store at the Scottish Rite Property and a new Target store in East Village Downtown. Several vacated department stores have active repurposing or re-tenanting in the works.

Retail Investment

2021 has seen a resurgence of retail investment in San Diego. Sales demand has been extremely healthy with small and large properties receiving multiple offers many times before the properties are widely broadcasted. Even non-descript retail properties are trading quickly as investors chase yield and perceive San Diego as a very stable environment.

The overall market consideration was $1.16 billion in 2019, $751 million in 2021 and is back up to $915 million

(YTD) in 2021, with a strong year end anticipated to push above 2019 levels. This is a strong vote of support for the future of retail assets in the region and is under-pinned by an abundance of capital and favorable financing terms. Investors are seeing strong repositioning plays and rent growth except for small non-credit shop users still trying to get their feet back under them.

Notable transactions include the purchase of a 60% interest in Grossmont Center (La Mesa) by Federal Realty Investment Trust, which proposes a significant redevelopment of a very strategic location. The Forum Shops was purchased by Northwood Retail/ Nuveen for $180 million, with well-founded plans to take this successful retail center to another level in merchandising.

2022 will see a continued competitive exchange of retail properties with sales prices breaking previous records. Investors look to a very healthy asset class with predictable competitive intrusions.

San Diego Retail Investment Sales

Sales	2019	2020	2021 YTD
Volume $	$1,116,026,931	$751,461,489	$951,792,384
Properties (#)	96	71	82
Sqft	3,403,890	2,796,471	3,424,793

Source: JLL Capital Markets/Crexi

Food & Beverage

The restaurants that showed incredible ingenuity, guts and innovation the past two years are experiencing a tremendous and deserved rebound in demand. Never without a new challenge, restaurants face labor, supply chain disruption and inflation obstacles in 2022 that threaten to derail the rebound.

2022 will continue to bring a re-tenanting of stale concepts that are hanging on with new and innovative operations. Many F&B operators are succeeding by truly becoming omnichannel through in-location dining, pick-up, and third-party delivery. Quality retail locations have seen these operators exceed 2019 (same month) sales since May of 2021 and success should continue, knock on wood, with the risk of variant strains and responses always in play.

Fitness

The pandemic turned the fitness world upside-down and forced closures of studios challenged operators in San Diego. 2021 started the recovery and now, not only are gym-users returning to fitness centers, but on-line is trending more than ever.

The high value-low price models like Planet Fitness, Chuze, and EOS are seeing significant member retention and opening facilities as fast as they can find them in San Diego.

Boutique offerings are anticipated to experience a strong resurgence in 2022 with high-value customers accessing personal live stream classes and workouts on demand while also attending in person clubs. Xponential Fitness headquartered in Irvine, a curator of leading boutique fitness brands like Club Pilates, Pure Barre, Cycle Bar, Stretch Lab, Row House, and Yoga Six, completed an IPO this year, showing the markets belief in a 2022 rebound. The fitness segment should bring back welcome new life to many retail centers in 2022.

In Conclusion

Retail in 2022 is expected to remain strong. 2022 will bring continued innovation and challenges as retailers contend with labor, inflation, supply change and the risk of covid strains and government regulation. These hurdles bring forth opportunities for new concepts and existing brands that rise to meet them. The customer who wants to shop in many and varied ways brings heightened awareness that retail is one of the commercial real estate segments that is most alive and requires the most finesse and understanding to navigate its nuances.

Don't be afraid of good retail as the commodity segment is doing well and supply is constrained. The specialty segment is where culture meets retail and San Diego has the potential to become a city with great street front retail and F&B as consumers want more proximate experiences to home. 2022 will continue to bring headlines about the poor performance of department stores, which is typically blamed on "on-line vs brick and mortar," however this simple headline could not be further from the truth, as retail is multi-faceted and extremely resilient.

Property Type Outlook

INDUSTRIAL Market Overview

by Bret Morriss, Managing Partner, CAST Capital Partners

Industrial Top Trends & Findings

1. **Life science conversions are having a huge impact on available industrial space** – conversions are outpacing the time to construct new industrial space.
2. Institutional capital **investments are compressing cap rates**.
3. There is **record low vacancy** despite record high new speculative supply.
4. **Record rent growth** year on year.
5. **New automated distribution facilities** are on the horizon.

Overview

In last year's inaugural San Diego emerging trends report we focused on highlighting e-commerce and logistics as the catalyst to continued absorption and rent growth. Despite historical high new supply numbers, logistics demand continued to outpace supply. Nowhere was this more apparent than in Otay Mesa where we predicted that despite the 5.6 million square feet of new construction in the submarket, demand would outpace that 30% increase in gross supply. Our predictions if anything were understated, the perfect storm of increases in cross-border trade, onshoring, and a need for affordable, new construction warehouses county-wide met with record institutional capital deployment and development efforts leading to even more supply planned and under construction for 2021 and 2022 deliveries.

The elephant in the room this year is the impact that millions of feet of life science conversions, mostly in the central markets of Sorrento Valley, Sorrento Mesa, and Mira Mesa had on the rest of the industrial market and supply. This phenomenon had the single greatest impact on overall property values in those markets and a downward pressure on vacancy county-wide as traditional users are scrambling to find affordable warehouses after dislocations caused by life science conversions.

This year we again dissect the industrial market into the major demand segments and discuss how each of those user types has affected the market and how each has been affected by a constrained industrial market with record-breaking rent growth numbers year over year. By the numbers, the San Diego industrial market starts 2022 with over 204 million square feet of inventory, with over 2 million under construction, less than 3.5% vacancy with over 8 million square feet absorbed in the last 12 months at an annual rent growth of over 8%.

E-commerce & Distribution

It is no surprise that Amazon has continued to lead the charge on both absorbing and developing distribution space throughout the County over the past 24 months. Including their new 3.4 million square foot custom-built distribution center recently delivered in Otay Mesa, Amazon has absorbed over 5.4 million square feet of new space in the past 2 years in San Diego County with another 700,000 square feet already pre-leased in Otay Mesa across from their new facility.

Even excluding Amazon from consideration, distribution and traditional warehouse demand has been high for big blocks of newer construction space primarily in the Otay Mesa and North County submarkets. Some examples of large new leases include M2 Ingredients full building lease of 155,000 square feet in Vista, RL Jones Customhouse's lease of 153,000 square feet in Otay Mesa, and Stone Distributing's move into 113,500 square feet in San Marcos.

While distribution automation has remained fairly light throughout San Diego relative to larger regional distribution centers in other primary hubs, we are beginning to see much more and expect that 2022 will be the year that automation and highly technical distribution buildouts become more prevalent in the region. Rumor is that Amazon is under contract on another facility in San Diego that will deliver cutting-edge technology only fielded in a handful of new facilities nationally.

Expansion near the US-Mexico border in Otay Mesa.

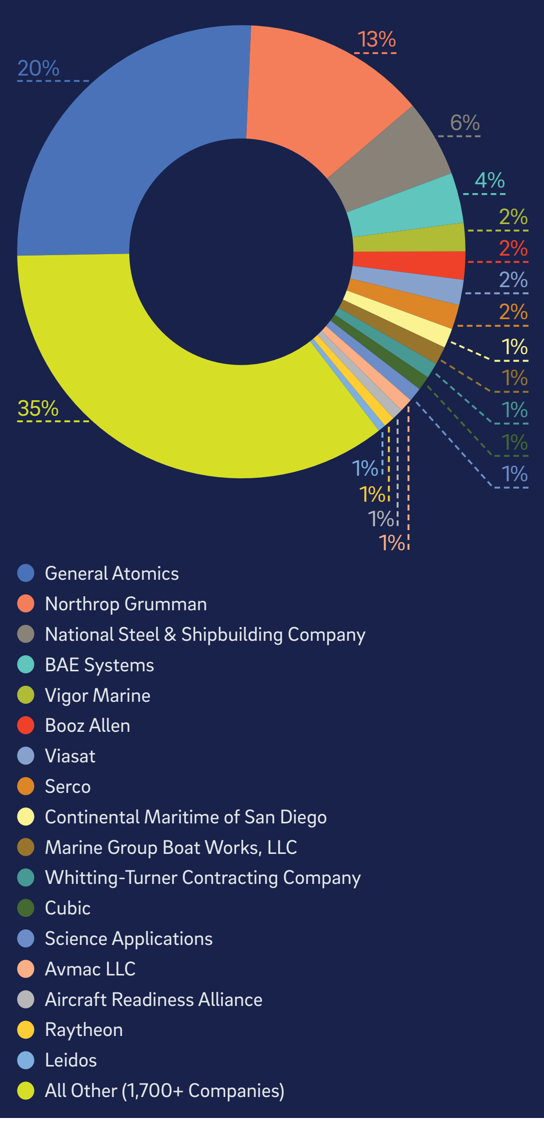
Defense

While new defense industry absorption in 2021 was light relative to other sectors, government contracts and activity from the large aerospace industries have been robust. We expect 2022 to bring in an increase in aerospace and defense requirements needed to execute on those large contracts won by General Atomics, General Dynamics, Raytheon, Northrop Grumman, Kratos, and others. Beyond 2022, the NAVWAR redevelopment in the Midway District is sure to bring the region to the next level in cyber intelligence, drone and defense technology which will help defense continue to support the local economy with its almost 25% direct economic impact.

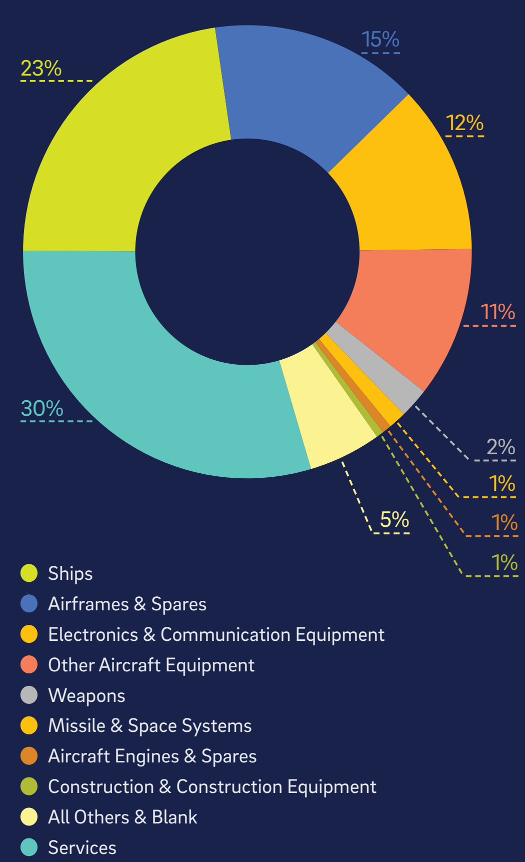
New Contracts in 2021

- BAE Systems wins $165 million U.S. Navy contract
- Collins Aerospace lands $674 million contract to supply planes to U.S. Air Force
- General Atomics awarded $103 million U.S. Army aircraft contract - ships world's most powerful magnet
- U.S. Navy awards General Dynamics NASSCO $25.6 million to study oiler construction
- Northrop Grumman secures $99 million U.S. Navy contract
- Viasat authorized to use U.S. government classified cyber threat intelligence

DoD Contract Dollars Obligated to San Diego



DoD Funds Obligated | Program Descriptions



2021 SDMAC Military Impact Report (www.SDMAC.org)

Life Science

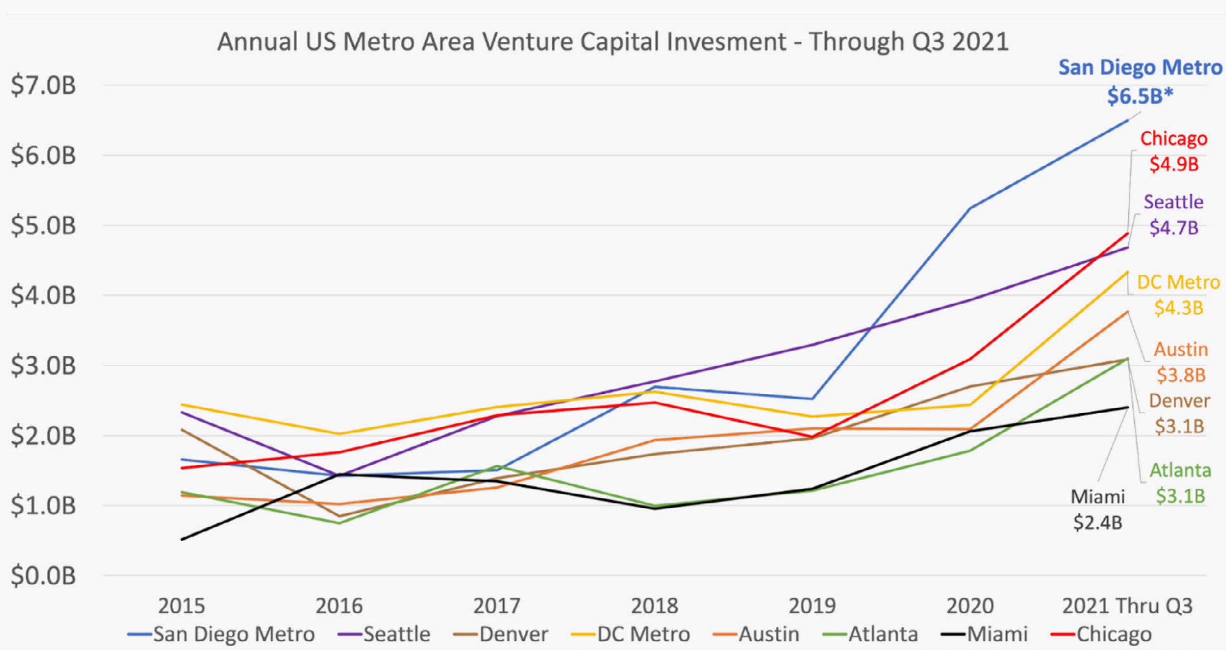
Life Science demand in San Diego is absolutely on fire. With current life science tenant requirements now exceeding 5 million square feet with an average size of well over 100,000 square feet, supply is struggling to keep up throughout the main clusters in the County with the strongest spanning from Torrey Pines to Sorrento Mesa in the central submarkets.

Sorrento Mesa has seen over 3 million square feet of conversions in the last 2 years from both industrial and office properties broadly pushing conventional industrial users out of those clusters where new owners won't even entertain leases from conventional users.

Both VC and institutional real estate capital have flooded the life science markets creating a perfect storm of new development activity and demand. The historically active Life Science players including Biomed, Alexandria and Healthpeak have now been augmented by additional capital tied to operators including Phase 3, Longfellow, Daybreak Properties, Gemdale, Harrison Street and Sterling Bay.

While most of the highest priced space would probably be considered more of an office campus than industrial, the crossover is beginning to be tough to define and the sizes of these leases are approaching those of the largest industrial leases but at the prices per square foot of class A office. Some examples are the BD lease signed at Torrey View for 220,000 square feet, The Tandem Diabetes lease for over 182,000 square feet and the rumored Bristol Myers Squibb lease that will likely take a massive piece of the 780,000 square foot Aperture project planned for delivery from Gemdale and Lincoln Property Company in 2022.

North County has benefited from Life Science in a slightly different way. Instead of providing clusters of expensive lab space typically used by startups through high tech research and development activities, North County has catered to those companies that need to scale production and large-scale R&D. Diagnostics activities from companies including CUE Health, Quidel, and DCN Diagnostics along with pharma and medical device companies including Merck and Thermo Fisher have rounded out the demand for big blocks of higher-tech manufacturing and research throughout Carlsbad, Vista, and San Marcos. While these high-tech manufacturers benefit from the higher education talent-based throughout the County and concentrated in North County, they have also run into challenges in staffing lower demographic blue-collar employees, who find it hard to access affordable housing, suffer from a high cost of living, and in some cases have rejected the vaccine mandates that most companies now have strict adherence to.



All Data from CB Insights State of Venture Report except San Diego data from Connect.org and PwC/Cb Insights MoneyTree Report

* 2021 San Diego data from Connect.org funding data Airtable

Cross Border

Foreign trade continues to drive much of the Otay Mesa submarket, now San Diego's most active industrial area. Otay Mesa provides the busiest land port of entry (POE) from Mexico to California and will boast a third entry within the next couple of years dedicated entirely to demand-priced toll crossings for commercial vehicles. The recently implemented USMCA free trade agreement which replaces NAFTA provides new tax benefits looking to manufacture products or phases of products on both sides of the border without the burden of multiple tariffs and excise taxes. Further benefits are available in the Foreign Trade Zones (FTZ) located throughout the Otay Mesa submarket. COVID and supply chain issues have further increased the importance of "nearshoring" where goods are brought in from Mexico instead of via the backed-up ports from Asia.

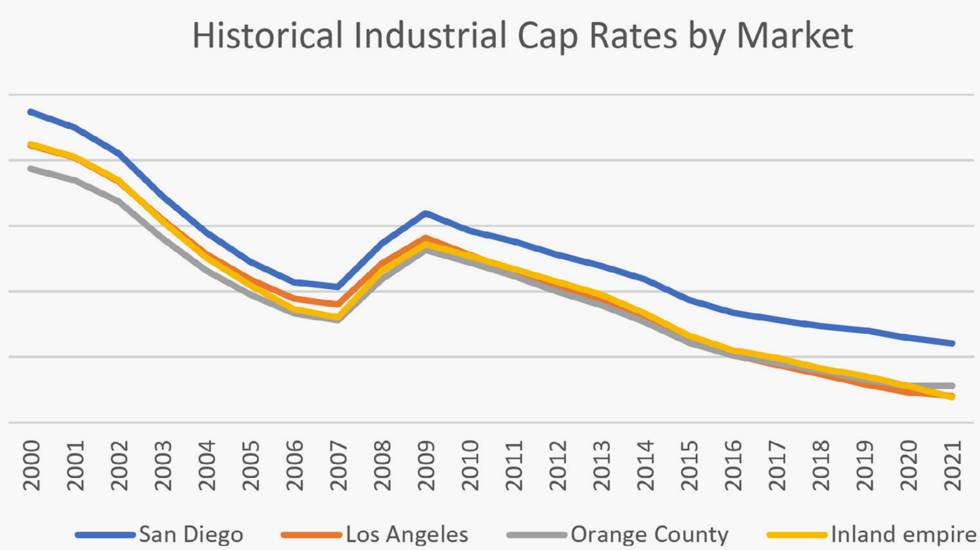
According to Bureau of Transportation data, truck trips across the border have increased approximately 20% over the past 10 years to almost 1 million trips per year making Otay Mesa the second busiest Mexican POE in the nation for truck traffic and San Ysidro and Otay Mesa taking the number 1 and 3 spots as busiest crossings by total commercial and personal travel, combining for over 50 million crossings annually compared to the number 2 spot, El Paso at less than half that number.

Capital Markets

Last year we predicted more cap rate compression and higher sales prices relative to the other SoCal markets due to some discounts in San Diego as a result of the region's historical perception as a secondary market. While Cap Rates have only slightly compressed, sales prices per square foot have skyrocketed.

This is due to three major factors:

1. Rent growth has continued to outpace most proforma underwriting. Despite predicting 4 to 5% rent growth in 2021, we saw an average of over 8%
2. Many properties were sold vacant either underwritten on aggressive pro forma rents or based on life science conversion plans
3. Institutional capital has entered the market competitively applying upward pressure on vacant properties and subsequently on higher rents based on their acquisitions underwriting. We expect to see a continued trend of upward pressure on rents, institutional net inflows to the market and will likely see cap rates continue to compress to match those of LA, Inland Empire and Orange County, where similar product trades for 75 to 100 basis points tighter.



Property Type Outlook

HOTEL Hospitality Overview

by Robert Rauch, Hotel Entrepreneur, RAR Hospitality

Hotel Development & Hospitality Top Trends & Findings

1. **Leisure travel saved the day** in 2021 and is actually above 2019 levels as of Q4. This bodes well as international travel is going to pick up with the Biden Administration approval of flights from abroad.
2. Rates & Occupancy – 2019 occupancy and **average rate levels were at 76% at $168**. We should hit over 70% in 2022 at very close to the $168 achieved in 2019.
3. This is countered by **slow gains in business/meeting travel** which fills hotels mid-week and provides higher, per-person spending. Most pundits are predicting it will take business travel until the end of 2022 to reach pre-pandemic levels. Full-service convention hotels downtown will remain under their 2019 levels until at least 2023.
4. Bookings for conventions and meetings are proceeding at a good pace but **are still well below their pre-pandemic levels**; 2022 will be the biggest challenge in this regard. We anticipate it will take until 2023 for the room nights to be consumed.
5. The **spillover effect on the impact on the conventions and meeting business ecosystem**, including restaurants, destination providers, local watering holes, transportation companies, and other related businesses will recover more slowly but should be fully recovered by 2024.
6. There are **simply not enough workers**. Many do not want to come back or are not eligible to come back due to their legal status. The long-term closure of the border also negatively impacted the ability of workers to come back to work. Now that the border has reopened, it will take well into 2022 to determine how many employees will return or whether they have found alternative employment elsewhere.
7. **Wages have increased dramatically** in light of current labor shortages. This has already resulted in increased pricing, particularly in San Diego where strong leisure demand exists.
8. There have been exciting **resort properties open along the coast in 2021** including Alila Morea in Encinitas and Seabird and Mission Pacific resorts in Oceanside. These will stimulate demand in these markets and are soft-brand resorts, powered by Hyatt.

Outlook for Hotel Development

Supply – there are pockets where supply and demand are not yet in balance, those over supplied include Carlsbad and downtown San Diego. Other areas in the county remain strong and the report from Lodging Econometrics shows the steady flow of hotel development.

Product segment growth – suburban locations are growing, and there is a need for reasonably-priced properties in Chula Vista, East County, Central San Diego County and eventually, there will be a need for more properties in North County.

Downtown – most of the hotels planned for downtown will get built but on a slower timeline.

Development Pipeline	U.S. Rank	Projects	Rooms
Total Construction Pipeline	**(18)**	**37**	**7,978**
Under Construction		3	1,485
Start Next 12 Months		15	3,574
Early Planning		19	2,919

Recent Real Estate Activity	Hotels	Rooms
Total Transactions	**19**	**2,725**

San Diego Region as of Q3 2021; Source: Lodging Economics

Conversion of older properties to new uses – we will continue to see older properties converted to alternate uses – housing for the homeless being one example - but not at the price recently paid for by the City of San Diego. Newer properties will be supplanting older ones that will be converted to other uses.

Access to Capital

During most recessions, there is a significant reduction in value of hotel assets as the demand for lodging is normally in direct relation to the asset value. During the pandemic, this has not been the case. Values have largely held as the fundamentals have improved so rapidly that values are being based on 2023 earnings. If you doubt the values of hotels, take a look at the stock prices and you will see that Wall Street values hotel companies on 2023 numbers. Interest rates are still low, and debt and equity are readily available for lodging.

Open & Operating Hotels (Census)	U.S. Rank	Hotels	Rooms
Total Open & Operating Hotels	**(11)**	**505**	**66,671**
Chain Scale			
Luxury, Upper Upscale & Upscale		113	29,383
Upper Midscale, Midscale & Economy		195	19,254
Unbranded		197	18,034

Market Metrics		
Hotel Size		
Greater than 200 Rooms	89	32,475
200 Rooms or Less	416	34,196
Leading Brands		
Motel 6	20	2,089
Best Western	15	1,591
Leading Ownership & Mgmt Groups (Hotels in the Market)		
Excel Hotel Group	15	1,521
G6 Hospitality LLC	11	1,438
National Ownership & Mgmt Groups (Resident in Market)		
Pacifica Host Hotels	49	6,536
Kalthia Group Hotels	32	3,888

San Diego Region as of Q3, 2021; Source: Lodging Economics

The Monsaraz, Tapestry Collection by Hilton. Newly opened in Pt. Loma March 2021.

Wages – Is this a low-wage reckoning?

In many areas, hotels and restaurants have completely reopened but with limited service and long wait times for dining in some cases. Many workers do not want to come back, have found different employment opportunities, or have out-of-date I-9 verification which allows them to work in the US without being a citizen.

Travelers are now demanding value as they adjust to the new normal. The spending of dollars is now done with the excitement of living again, but travelers have a high expectation of the experience attached to that dollar. Ergo, they will not accept mediocrity.

Perhaps large companies have turned this service industry into a spreadsheet-driven industry, but hospitality workers have begun to use their power. It is time for hospitality operators to be more creative with operations that please both guests and employees and design that competes favorably with alternative lodging. The guest expects an experience at a resort or boutique hotel or an "error-free, minimal disruption" experience at limited-service hotels with fast, free Internet, a hot breakfast, and smiles.

Company culture has become extremely important in retaining good talent and trust is developed through this positive company culture. Jumping ship is easy to do unless employees are truly engaged and supportive of the mission. While job benefits are always a positive, they are now so commonplace that they cannot stand alone when it comes to employee retention. Further, wages have increased dramatically in light of current labor shortages. This has already resulted in increased pricing, particularly in San Diego where there exists strong leisure demand.

At the end of the day, honest, caring, and hard-working hoteliers can begin to build the trust needed to drive an organization. Being both a teacher and a mentor allows employees to feel like they have a "go to" source for advice. The greatest assets are team members and customers. If both are treated honestly with care and attention to detail, hotels and other hospitality businesses will have helped to create a "unique selling proposition" that differentiates it from the competition.

Technological Innovation

Technology needs to be seen an investment, not an expense, and AI enhanced guest communications, customer service robots and automation in the front and back of the house will improve profits both short and long term. As an industry, hoteliers need to embrace automation, not because it will reduce labor but because it will drive revenue and automate manual, repetitive tasks. Given the labor shortages and increased cost of labor, automation provides a bonus.

Constant, rapid technological advancements within the industry will make all the difference when competing for today's traveler. There is a need to compare today's distribution channels with those that were in existence over the past few years to become aware of at least one of the significant differences. The dominance of a mobile web, blossoming social media markets, always emerging disruptors and development in digital marketing are all pivotal in staying ahead of the curve.

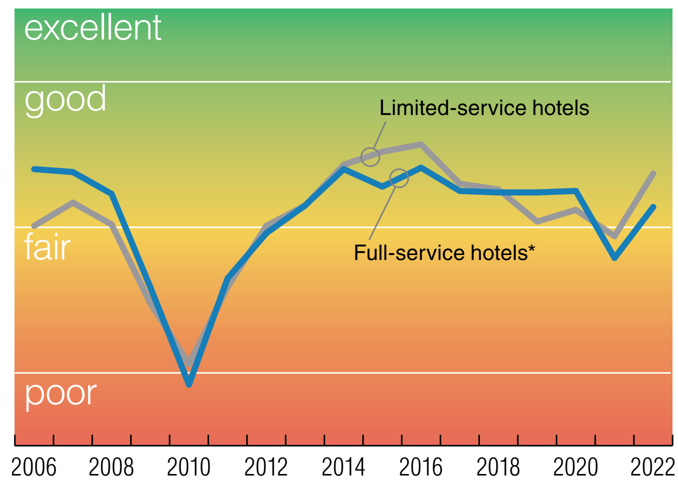
San Diego as a Destination Value Proposition

San Diego has a rich array of arts, attractions, beaches, baseball, breweries, climate, conventions, educational institutions, gaming, great hotels, meeting venues, restaurants, shopping, wine and much more. There is no destination in the US with a package more complete than San Diego.

Hotels could potentially be at a competitive disadvantage to vacation rental properties with greater in-room amenities (like kitchens and a larger guest space).

This could have a long-lasting impact on traveler perception, but hotels have endured through 9/11, recessions, pandemics and more. The value proposition will likely remain strong, particularly in San Diego.

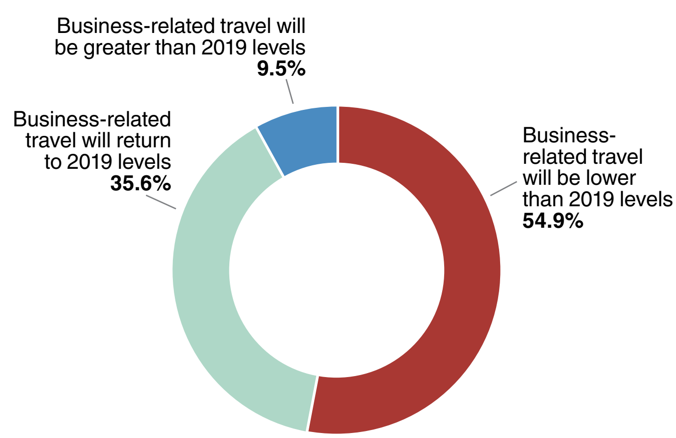
Exhibit 3-12 **Hotel Investment Prospect Trends**



Source: *Emerging Trends in Real Estate* surveys.

*Starting in 2017, results are the average of investment prospects for three categories—luxury, upscale, and midscale hotels. Previous years' results are based on investment prospects for a single category—full-service hotels.

Exhibit 3-13 **How do you anticipate business-related travel to be different three years from now?**



Source: *Emerging Trends in Real Estate 2022* survey.

Special Report

POLICY Round-up

by Daniel Reeves, Juniper Strategic Advisory

Introduction

As we look ahead to a new year, we often expect a clean break and a fresh start. Out with the old and in with the new. That is especially true when coming off a year like 2021, which, with so much optimism, we eyed as a departure from the COVID lockdowns and social distancing of 2020, only to find ourselves even more isolated and uncertain than the year before.

So, will 2022 really be so different? Thankfully, from a policy-making standpoint, we're in a much better place than the preceding two years. We've learned a lot about how to live with this pandemic so we can count on a pretty normal legislative session without closures or major interruptions. Likewise, we are largely through the emergency orders and legislative responses to COVID and can expect much of the business-as-usual issues to come back to the fore, such as climate change, economic recovery, and, of course, housing.

So, while we are certainly not out of the woods from an everyday life perspective, chances are good that 2022 will offer a little more normalcy from a policy-making standpoint. Before we take a look ahead at what's to come in 2022, though, let's see how we did with our 2021 predictions.

2021 In Review

Last year we outlined a number of state and local policy priorities and legislative items to keep an eye on and, true to form, 2021 delivered mixed results. At the state level, Senate President Pro Tem Atkin's Housing Package was largely passed and signed into law. Senate Bills 7, 9 and 10 were all signed by the Governor. We'll take a look at what the latter two mean locally in a moment. Senate Bills 5 and 6 are still awaiting their fate in the second of this two-year legislative session, as are Assembly Assistant Majority Leader Ward's Assembly Bills 482 and 950.

Locally, the long-awaited and highly debated Barrio Logan Community Plan Update was unanimously adopted, though, it still requires Coastal Commission approval. This comes almost ten years after the last community plan update for this community was passed and ultimately referended. This version will be a change maker for this community and CPUs that follow for many reasons. Perhaps most notably, because it is the first to implement anti-displacement policies requiring current residents to receive priority when existing housing is redeveloped. Additionally, as anticipated, non-residential parking standards were successfully loosened, the City of San Diego adopted Climate Resilient SD, its set of climate change adaptation policies, and, at the end of the year, made permanent the ability for businesses and other interested parties to improve the public right-of-way (think parking spots) to allow for active uses such as dining, strolling, and sitting, under the name Spaces as Places.

While we endeavored to see ahead to all that we might have accomplished in 2021, there was one notable policy initiative that we did not include in last year's report but is worth a mention. A long-awaited and relatively substantial change to the Downtown Employment Overlay Zone was adopted as part of the City's annual Land Development Code Update (see section 156.0307 (b)(6), and Table 156-0309-A). As anyone who has dabbled in Downtown land use policy for any number of years will attest, this is an overdue and impactful, if not anticlimactic in the way it was implemented, change to the development rules in the City Center and Columbia District neighborhoods of Downtown.

A Look Ahead

While it is tempting to dig deeper into all that 2021 brought us in the way of land-use policy and dissect what it all means, the value we provide here is in a look ahead at what the ULI community might anticipate from the legislative priorities on our horizon. This is, after all, the 2022 Trends Report, so let's dig into the year ahead.

City of San Diego

The mayor's major land use policy initiative this year is, in fact, a package of many different policy initiatives aimed at incentivizing the construction of more housing at income levels that all San Diegans can afford. It is called, Homes For All of Us, and it consists of three components: Blueprint San Diego, Housing Action Package, and the Middle Income Housing Working Group.

1. Blueprint San Diego

According to the mayor's team, "Blueprint SD is a new approach for the City of San Diego's General Plan and community planning that will align with climate and housing goals and promote sustainable growth." It is, in laymen's terms, a set of revisions to the General Plan to incorporate the City's soon-to-be-updated Climate Action Plan (more on this in a moment), build in the SANDAG Regional Plan's vision for development in the City of San Diego, modify the community plan update process to allow for more community plan updates in less time, and adopt a programmatic EIR (what Downtown has benefited from since 2006) to expedite adoption of future community plans and development projects that conform with it.

2. Housing Action Package

As a component of the mayor's Homes For All of Us initiative, the Housing Action Package is, itself, a collection of subcomponents aimed at making housing more accessible to all San Diegans. Here's a look at what is included in this proposal.

Implementation of State Law

Let's start with Senate Bills 9 and 10. Of course, as mentioned, these bills were introduced and signed into law last year, however, these state laws are now subject to local interpretation and implementation. SB 9, the bill that energized both the YIMBY and NIMBY sides of the housing debate, allows for a single residential lot to be split into two lots, with up to 2 units allowed to be built on each of the newly-formed lots. All handled ministerially. The mayor's proposal builds on the state-mandated rules by adding regulations for setbacks, tree planting and preservation, parking, and development impact fees. Importantly, the mayor's proposal will preclude the development of additional accessory dwelling units on a lot if that lot has been developed with additional units under SB 9.

Another component of the mayor's plan would amend current accessory dwelling unit regulations to provide consistency with the additional SB 9 rules with regard to setbacks, trees, and development impact fees. Specifically, it introduces a four-foot setback for two-story ADUs adjacent to residential lots, adds requirements for street trees for all ADU development and on-site trees when three or more ADUs are built, and requires payment of development impact fees for market rate units if three or more units larger than 750 square feet are built.

Like SB 9, Senator Wiener's SB 10 lays out statewide rules, but then hands those rules over to local jurisdictions for further refinement. It is slightly different, however, in that it allows cities to choose whether or not to implement it. For those who read last year's report, you might recall that SB 10 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 a transit or jobs-rich area, or an urban infill site. The mayor has announced that he plans to act on SB 10 and will include plans for implementing this law in the second Housing Action Package due to be made public and go to City Council for consideration later this year.

Affordable Housing

The Housing Action Package includes a number of proposals aimed at increasing development of affordable units. Among them are a change in rules that would allow for affordable units built through the City's Density Bonus Program to be built not onsite, or in the same community, but anywhere in the city that is identified as "highly resourced," and within a Transit Priorty Area and Community Planning Area where less than 5% deed restricted affordable housing currently exists, allowing these units to be spread more evenly throughout the city, and, according to the Mayor's team, furthering fair housing and locating affordable housing where it's most needed. The Housing Action Package would also provide for a change that would allow non-residential projects in Transit Priority Areas to pay into the Affordable Housing Trust Fund or build affordable units in exchange for, yet-to-be-defined incentives. This package also proposes to allow development of affordable and middle-income housing by-right on City-owned sites, regardless of how the area is zoned.

Incentive Programs

The balance of the proposed actions in the Housing Action Package are focused on creating incentives for developers to build the types of units that will allow for greater inclusion in housing for all types of people. These include incentives for developing projects with units of three or more bedrooms to allow for housing opportunities for larger families and intergenerational households near jobs and transit, and incentives to build projects that include more accessible housing than is required by the California Building Code to ensure residents with disabilities have more equitable choices for where to live.

Housing Action Package 2.0

While the policy priorities listed above may seem lofty, especially for those who are used to a more tempered pace out of our local jurisdictions, the above-mentioned proposals are just the first half of the Housing Action Package. Before a single vote has been cast on the above priorities, the mayor has already signaled what his next set of priorities will be in the way of the second Housing Action Package due to come forward before the end of the year. This Housing Action Package 2.0 is likely to include things like anti-displacement protections for low-income residents, allowances for affordable and middle-income housing to be built on underperforming commercial sites and sites owned by non-profits, incentives to build and preserve SROs, and incentives to redevelop existing auto-oriented uses with housing in Transit Priority Areas to put more people in proximity to walkable neighborhoods and transit options. These are just the start for the second Housing Action Package, and the mayor's team is looking for feedback from residents by way of a survey, to identify more strategies to address San Diego's housing crisis.

3. Middle Income Housing Working Group

The third component of the Homes For All of Us initiative is a working group consisting of experts, practitioners, and residents whose charge is to identify and analyze more options for incentivizing the construction of more housing affordable to families earning between 80% and 120% of the Area Median Income. This group, in a dazzling display of naming appropriateness, has been dubbed, the "Middle Income Housing Working Group."

Complete Communities

Complete Communities precedes the mayor's Homes For All of Us initiative and has been partially voted into law by the City Council. An effort started last year to implement the "Infrastructure Now" element will continue into this year. As reported last year, this element, which is now called "Build Better SD," proposes 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. It is also said to result in projects getting funded and completed faster.

Climate Action Plan

A policy package that was born under Mayor Gloria during his interim term as Mayor, the Climate Action Plan is due to be updated this year. According to the Mayor's team, the update will eliminate the CAP consistency checklist and replace it with a code update which, when passed alongside the CAP update, will codify the rules for compliance with the CAP. The CAP update will include several strategies that seek to promote land use and building technologies that align with the City's emissions reduction targets. Namely, Strategy 1: Decarbonization of the Built Environment, and Strategy 3: Mobility & Land Use.

Community Plan Updates

Rounding out the City of San Diego's land use priority areas for the coming year is the expected completion of three Community Plan Updates – Clairemont Mesa, Mira Mesa, and University. It is not common to complete three CPUs in one year, so this is ambitious and may illuminate whether or not the mayor's existing streamlining efforts are effective, or if further reforms (such as those outlined above) are necessary.

San Diego Land Use & Housing Committee

The mayor, as the chief executive of the City, has a broad set of tools for enacting his land-use vision, however, in many cases, his policy proposals require concurrence from the City Council by way of committee and full-council votes. So, we would be remiss to exclude a look at the priorities of the chair of the Council Committee responsible for reviewing and advising on land-use policy. With an unexpected shakeup in the Council President's office, the committee structure saw some shifts in leadership as well. The Land Use and Housing Committee (LU&H), which is charged with developing and analyzing land use policy proposals before passing them along to

> Land use decisions are among the most important responsibilities of local government. Land use is at the center of the biggest policy issues we face – the climate crisis, housing affordability, public safety and quality of life. My administration is taking bold steps to revamp outdated and inequitable policies to ensure San Diego works for all of us.
>
> *– Mayor, Todd Gloria*

the full council for consideration, has a new leader this year in Councilmember Vivian Moreno. This turns out to be good news for the mayor, as it appears she has many of the same priorities as he does, and, according to her team, is excited about much of what the Homes For All of Us initiative proposes to put forward. In particular, Chair Moreno is excited to see more proactive policies offered, such as the proposal to use City-owned land to develop low-income housing more quickly, and the proposed incentives to develop larger units for families and intergenerational households near jobs and transit.

Perhaps a more interesting question, however, is which of her own priories Chair Moreno intends to pursue by way of her committee. While it is still early in the year and the committee has yet to officially set it's workplan, here is a sneak peek at what we may see come forward at LU&H this year.

Unsurprisingly, affordable housing production nears the top of her list. She has indicated that she will spend time on policies that will advance the preservation of affordable housing and will work with MTS on ways to encourage the use of land near transit to incentivize more affordable transit-oriented developments. Perhaps, more notable, though, is that the chair will also use her committee to make an impact on the viability of developing middle income housing. The "missing middle" as everyone has come to know it, is a bit of a passion for Chair Moreno, and finding ways to close this market gap is a challenge she is eager to tackle with her committee. She will take a closer look at what bottle necks might exist in the approval process for middle-income projects at the Development Services Department and find ways to increase efficiencies to get more of these projects approved more quickly. She will also take a close look at the current low- and middle-income density bonus programs to see how they are truly performing and what efficiencies might be gained by making some tweaks there. Perhaps most notably, Chair Moreno is looking to pursue a first-time homebuyer program aimed at middle-income individuals and families – proposed as those earning between 80% and 110% of the area median income. The details of this program are still being worked out, but it will likely leverage state and federal dollars and look in some ways similar to first-time homebuyer programs that have been created targeting low-income earners. This program, making homeownership more attainable for more people in this income range, could lead to more demand for a for-sale middle-income housing product, making those projects more feasible. We'll be keeping a close eye on how this proposed program develops.

Finally, a proposal that has come from another Councilmember, Joe LaCava, is finding its way through the LU&H committee early this year. Perhaps taking a cue from the mayor's proposal to rethink the community planning process, Councilmember LaCava has taken a bold step towards tackling the issue of community planning groups (CPG) and bringing them into compliance with the City Charter. His proposal would make community planning groups independent of the City and, while they will still be recognized advisory bodies, they will be, effectively, an optional step in the approval process where developers can present their projects for support, if desired. While the Councilmember has amended his original proposal to ensure ongoing City staff participation in CPG meetings and create a "friendly" relationship between the City and these groups, the proposal is still a departure from the current, more formal arrangement, which provides staff time and resources from the City, and has historically resulted in more of an expectation of CPG support for projects going before Planning Commission or City Council. This will be a very interesting one to watch as it could meaningfully change how these groups weigh in on development in their communities. Supporters of the change argue that this is a necessary reset and will bring a needed rebalance to how CPGs influence development. Detractors argue that this would limit community control over what gets built in their backyard.

> Housing is a human right. This principle must be embedded within our land use and housing policies if we are serious about providing housing stability for all and ending chronic homelessness. Throughout 2022, we will no doubt be faced with challenges in recovering from the COVID-19 pandemic, but we must remain steadfast in increasing housing supply locally, protecting vulnerable tenants, and providing for homeownership opportunities.
> *– San Diego City Council President, Sean Elo-Rivera*

State of California

It is often said that real estate is a highly localized industry. Land use decisions are made locally and most policy is created and enforced at the local level. And while real estate is still all about location, location, location, statewide lawmakers also have an opinion on how to manage land use matters more efficiently. This is especially true in a state with an ongoing housing crisis and a wide spectrum of local opinions on how to manage the problem (and in some cases, whose problem it actually is). Last year we took a deep dive into housing policy going through Sacramento. As we are in the second year of a two-year legislative session, and in an election year to boot, we are not likely to see the same sort of headline-catching housing legislation as we may have been getting used to. That said, there are still notable proposals coming forward. In fact, last fall Assembly Assistant Majority Leader Ward hosted a local roundtable for the Assembly Housing Working Group where stakeholders discussed our local and statewide housing challenges and potential policy ideas for addressing them. From that came a report outlining stakeholder policy ideas for increasing the supply of housing and improving affordability statewide. While some of the concepts included are not groundbreaking, some of the ideas, such as converting all commercial zoning to mixed-use zoning statewide, disincentivizing frivolous litigation, statewide ministerial approval of affordable housing near transit-rich areas, reducing or eliminating parking minimums statewide, prohibiting the use of VMT except in transit-rich areas in favor of a different measurement of greenhouse gas emissions, and creating permanent allocations for state funding for the development of affordable housing, if translated into bills and laws, could make a sizeable impact on the industry.

Over on the state Senate side, this year we are taking a more targeted look at the priorities of the most powerful statewide lawmaker in our region, Senate President Pro Tem Atkins. We've touched on the Pro Tem's housing package introduced last year, some of which is still under consideration and will be decided by this fall. This year, according to her team, she is continuing to take strong actions to address chronic challenges including housing and homelessness and climate change. On the latter, her focus will be on issues such as wildfire mitigation, and drought and water resiliency solutions across the state and here in San Diego. This will include enacting the provisions of SB 1, a bill introduced by Pro Tem Atkins and signed into law last year that requires the Coastal Commission and other state and regional agencies to anticipate, plan for, and minimize the adverse environmental and economic effects of sea level rise within the coastal zone.

Especially of note, and seemingly on trend, Pro Tem Atkins is working to advance a first-time homebuyer program, the "California Dream for All" program. As of this writing, it is still early in the session, so the details are still being worked out. It hasn't even yet been assigned a bill number, however, the early details from the Pro Tem's team indicate that this would be a collaborative program between the State of California and private investors designed to help more first-time homebuyers access their first home, increasing the opportunity for Californians to begin building assets that they can pass on to their kids and grandkids. Whether proposed at the state or local level, how these first-time homebuyer programs ultimately work, and therefore, how much impact they will have on land use in the San Diego region, are still yet to be determined. More people with the ability to access the housing market is presumably a good thing for the industry. The challenge, as always, is whether or not the industry is able to keep up with that added demand.

Which brings us back to the local policy landscape, which, this year, appears to be highly focused on moving the needle on production and meeting the housing crisis head on. It will likely take years of positive movement in this direction to see a meaningful difference, however, the policies outlined here seem to offer that needed first step.

INTERVIEW *with the* Port of San Diego

The Blue Economy

Jason Giffen, Vice President, Planning and Environment, Paula Sylvia, Program Director for Aquaculture and Blue Technology and Shaun Sumner, Vice President of Business Operations

A Water-First Approach Grows the Blue Economy

Lately, we've been hearing more about the blue economy, which generates high-paying jobs and new potential land-use opportunities. The San Diego-North Baja region is uniquely positioned to grow and lead in this sector.

To better understand its potential, we interviewed professionals at the Port of San Diego leading their Blue Economy initiatives, including Jason Giffen, vice president, planning and environment, and Paula Sylvia, the program director for aquaculture and blue technology. Adding his real estate acumen to the conversation was Shaun Sumner, vice president of business operations who oversees real estate, development services, and guest experiences for the Port.

Q: What is the Blue Economy?

Most people are more familiar with the green economy, and what that means related to traditional economic activities in and around the environment. When we're talking about the blue economy, we are generally speaking about any types of sustainable use of ocean resources. For us it is a focus on the waterfront, the marine environment and the coastal environment for economic growth, improved livelihoods, and jobs, while preserving the health of the ocean ecosystem.

A great blue heron forages on an ECOncrete tidepool along Harbor Island

Q: What sort of activities are involved in the Blue Economy?

When you think about it, the Port has been involved in the blue economy since its inception. We already support established industries and businesses, they're all the activities that you see, for the most part, around the Port today. This includes shipyards, marinas, marine terminals, the sport and commercial fishing fleets, coastal access, and visitor-serving types of uses, but we made a pivot to expand the portfolio by adding emerging industries related to the blue economy. This includes things like marine technology, aquaculture, and environmental remediation to name a few.

It's fair to say the most significant pivot started in 2013, when we initiated the visioning process for the Port of San Diego master plan update. A big focus of that process was to re-orient our thinking -- instead of "land and water," it became the "water and land" use plan. It may seem like a small thing, but this change in perspective enabled us to focus on both the established and traditional Port businesses and industries while it challenged us to identify new opportunities. For example, how could we improve access for testing new products in a marine environment, whether it be marine technology or environmental remediation or those related to aquaculture? We're now on our third iteration of the plan, which will be presented to our Board later this year.

The next big milestone was in 2015 when we officially started our aquaculture and blue technology program and in early 2016, we launched the "first of its kind" blue economy incubator. The incubator attracted a variety of companies that were looking to launch their businesses or test product innovations in a marine environment. We now have nine companies that we've partnered with, and we've received literally hundreds of inquiries and initial proposals to partner on a variety of technologies with different companies from across the country and internationally.

While there are a lot of accelerators and incubators around the globe, we are apparently the only organization in the world that facilitates pilot projects through offering support services such as permitting, providing a location for a pilot, assistance with deployment, execution, marketing and communications. We are always surprised by that, but it is its unique value proposition that we bring not just to the region, but to advancing technologies worldwide - 40% of the companies in our portfolio are international.

Q: Can you give us some specific examples?

The portfolio is generally focused on four key areas:

1. technology
2. infrastructure
3. aquaculture
4. environmental remediation

As an example, we launched the first commercial shellfish and seaweed aquaculture projects in San Diego Bay that also measure associated environmental benefits like water quality and carbon sequestration. We've launched a pilot project of an innovative and scalable bio-enhancing shoreline stabilization technology, which are modular tidepools to replace traditional concrete and rock (rip-rap) on Harbor Island.

As part of our remediation focus, we sponsored a marine debris vessel for a year that removed over 33,000 pounds of marine debris from San Diego Bay while developing a database for key variables influencing the accumulation of that debris. We're particularly excited about new technologies designed to absorb heavy metals and other contaminants like polychlorinated biphenyls (PCBs) to mitigate the challenges of working waterfronts here and across the globe.

On the technology front, we've tested an advanced smart marina management technology that will result in potential benefits for Port tenants to increase their revenues and enhance customer experiences.

To accomplish this, we've established collaborative partnerships with numerous local, state, and federal governmental agencies like the U.S. Navy and U.S. Coast Guard, academia, non-governmental organizations (NGOs), industry and the local community. The businesses in the incubator have made us more attuned to what we need do make the pie of the blue economy larger from an economic standpoint while shrinking environmental liability and supporting the community. We're fortunate to have a ton of expertise to leverage here locally, whether with universities like UC San Diego's Scripps Institute of Oceanography, the military, industry, or NGOs.

Q: What is its potential for growth at the Port of San Diego?

We believe a sign of our success is the addition of 8,300 acres of primarily submerged lands in the center of San Diego Bay, recently granted to the Port of San Diego by the state legislature (passed into law in January 2020). This more than doubles the size of the Port's acreage to over 14,000 acres and we're at the beginning stage of putting together a water-use plan that will center on blue economy initiatives. It will take at least a couple of years before it's completed.

We're thinking about new ways to use this resource for commercial and environmental benefit – for example, leasing areas for seaweed production related to food production, bioremediation, carbon sequestration, and new products like bioplastics and biofuels. The waterside used to be considered as a means to access the land side; now it will have an opportunity to expand its own portfolio. We haven't even begun to realize the ways in which we can grow. Things like marine spatial planning will help us unlock new opportunities. While on the land side, as the blue economy grows, there are traditional opportunities like office space, processing facilities, and other landside amenities needed to support emerging companies and organizations.

The thing that is unique about the Port are all the ways we engage with this cluster -- we're an operator, a landlord, a regulator, and an environmental steward, and when you wear all those hats at once it really makes you look at the spectrum of the blue economy and its opportunities through multiple lenses.

Q: The life-science and tech clusters are often lauded for bringing high-paying jobs to our region, what is the potential for the blue economy cluster? Further, how do we grow the number of skilled workers to fill the pipeline of jobs?

We already have a terrific blue economy workforce in San Diego. According to the reports out there, about 46,000 people are employed in the maritime and blue economy industries. It's worth noting the blue economy is a $14 billion (direct sales) industry cluster. We've been working with local universities and organizations like TMA BlueTech to research how, from an education standpoint, we can make sure that San Diego has the workforce that's prepared to tackle tomorrow's problems, today. Everyone who is in the education system from elementary school, all the way through essentially postgraduate education has a role to play in the future and it's not just one narrow aspect or one apprenticeship, this is key to our identity that's uniquely San Diego.

Q: When you think about the blue economy nationally or globally, would you say that San Diego is recognized as a leader in this space?

The San Diego region is recognized as a leader in the blue economy. San Diego's existing port infrastructure, burgeoning scientific community, growing technology economy, and geographic location have all contributed to the region's blue economy and have created a unique maritime and blue tech cluster. Situated along a vast natural harbor, San Diego is a true maritime city with a rich history as a commercial port and center of international trade. San Diego's blue economy is diverse, with robust traditional industries, as well as emerging activities.

The strength of the region's blue tech cluster is rooted in its history as one of the most technologically advanced naval communities, as well as home to one of the top-rated oceanographic institutions in the world, the Scripps Institution of Oceanography. These existing institutions have made San Diego a birthplace of multiple maritime technologies and disciplines and a leader in emerging blue economy activities, which has created momentum for further growth and innovation within the blue economy. Just like Silicon Valley is known as the home of the microchip and big tech, we are working to one day have San Diego be colloquially known as the blue technology bay.


Photo by Autumn Murphy

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Real Estate Trends Report

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