

LOS ANGELES OFFICE MARKET

FIRST QUARTER 2017

LA Office Vacancy Rises Sharply at the Beginning of 2017

Large space givebacks and delivered projects cause vacancy to increase to 16.0%

In the first three months of 2017, the Los Angeles office market saw several large and long-expected space givebacks which, combined with new office projects being delivered, caused a sharp 90-basis-point increase in vacancy over last quarter to 16.0%. While the regional economy continues to report gains across most employment sectors, the industry trend of companies focusing on office space efficiency has resulted in a slowdown in leasing activity in the first quarter to a level not reported since mid-2010.

ECONOMY

Unemployment rate in Los Angeles County decreases to 4.8% in February

The seasonally adjusted unemployment rate for Los Angeles County decreased to 4.8% in February, which continues to be at levels last seen in 2007 and is just slightly higher than the national unemployment rate of 4.7%. Total February year-over-year nonfarm employment increased by 70,800 (1.6%) while office-using employment increased by 16,800 (1.4%), respectively. Compared to a year ago when nonfarm employment and office-using employment grew year over year at 3.1% and 3.6%, respectively, job growth in Los Angeles has slowed over the past year.

SUPPLY AND DEVELOPMENT

Over 3.7 million square feet of office space now under construction

In the first quarter, 1.1 million square feet of office space was delivered to the market, including high-profile projects such as Tishman Speyer's Brickyard in Playa Vista and Hudson Pacific Properties' Icon at Sunset Bronson Studios in Hollywood, the latter of which was 100% leased to Netflix at completion. Over 3.7 million square feet, or 1.9% of the existing office base, is currently under construction, mostly in Downtown Los Angeles and West Los Angeles, with just 19% of the space underway pre-leased. 2.9 million square feet is projected to be completed between now and the end of 2017, which could cause office vacancy levels to continue to rise this year as new unleased office space is delivered to the market.

TRENDLINES

5-YEAR TREND CURRENT QUARTER

VACANCY



16.0%

Vacancy rate up 90 basis points

ABSORPTION



-741,256 SF

First negative quarter in five years

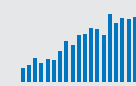
RENTAL RATE



\$3.22 PSF

Rates up 4.9% year over year

UNDER CONSTRUCTION



3,765,677 SF

19% of office space is pre-leased

CAP RATES



5.8%

Cap rates rise 50 basis points

JOB GROWTH



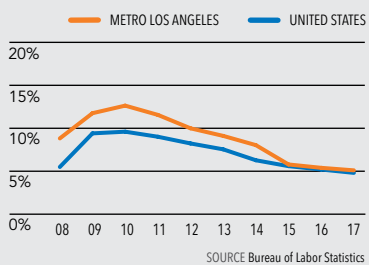
70,800 jobs

Growth of 1.6% year over year

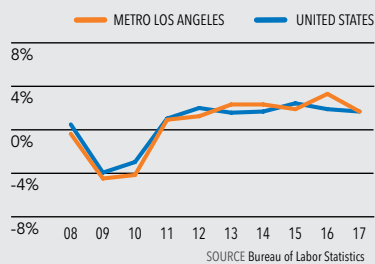
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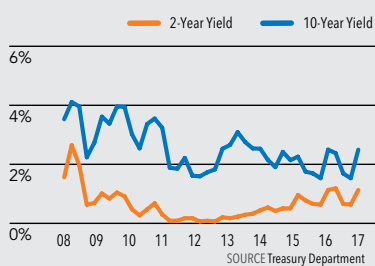
UNEMPLOYMENT RATE



PAYROLL JOB GROWTH



TREASURY RATES



DEMAND

Net absorption finally turns negative after fifteen consecutive quarters of gains

Demand for office space in the first quarter turned sharply negative at -741,256 square feet in the first quarter. Led by long-awaited move-outs from E! Entertainment in the Miracle Mile and Sony Pictures in Culver City, who both consolidated into owned real estate, office net absorption reported its most negative quarter in five years. Despite the large amount of negative net absorption market-wide, local companies remain optimistic about the economy in general. However, outside of the tech and entertainment sectors, most companies continue to exercise caution about expanding too quickly as many corporate occupiers remain focused on space efficiency.

VACANCY

Total vacancy rate up 90 basis points over previous quarter to 16.0%

The total vacancy rate of 16.0% was a 90-basis-point increase from a revised vacancy of 15.1% at year-end 2016. While certain office submarkets such as Hollywood (8.2%), Century City (8.8%), and El Segundo (9.3%) have seen office vacancy drop to historic lows, space givebacks across the region caused the market-wide vacancy rate to rise. In addition, the increase in both sublease availability (4.4 million square feet) and sublease vacancy (1.6 million square feet) continues to bear watching as they are now at their highest levels since 2011. With the large amount of speculative office development underway combined with further space consolidations expected in 2017, it is very likely that LA office vacancy increases as the year goes on.

RENTAL RATES

Direct weighted average asking rental rate up 4.9% year over year

The direct weighted average asking rental rate increased for the fourteenth consecutive quarter to \$3.22 per square foot per month (up 4.9% year over year). As 2017 begins, several office submarkets have seen office rents hit new historical peaks due to strong occupier demand over the past 24 months, as well as many older Class B properties being renovated with higher asking rents. Despite rising vacancy levels, average rental rates are forecasted to continue to increase in 2017, although pressure from newly delivered space and increasing levels of sublease space will cause rental rate growth to slow this year.

Metro Los Angeles Office Market Indicators

PROPERTY CLASS	INVENTORY	UNDER CONSTRUCTION	Q1 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Class A	126,623,854	2,219,918	-906,926	-906,926	14.5%	0.9%	15.4%	\$3.56
Class B	68,471,448	1,545,759	165,670	165,670	16.4%	0.7%	17.0%	\$2.69
LA Metro Total	195,095,302	3,765,677	-741,256	-741,256	15.2%	0.8%	16.0%	\$3.22



INVESTMENT MARKET

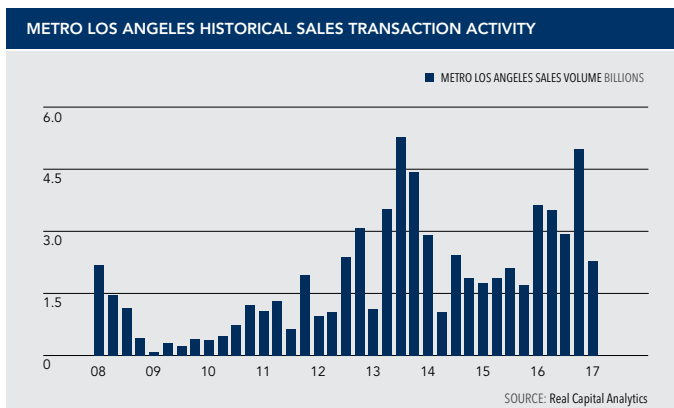
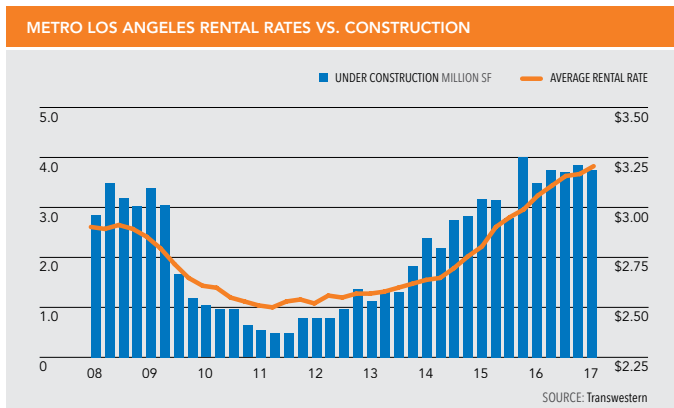
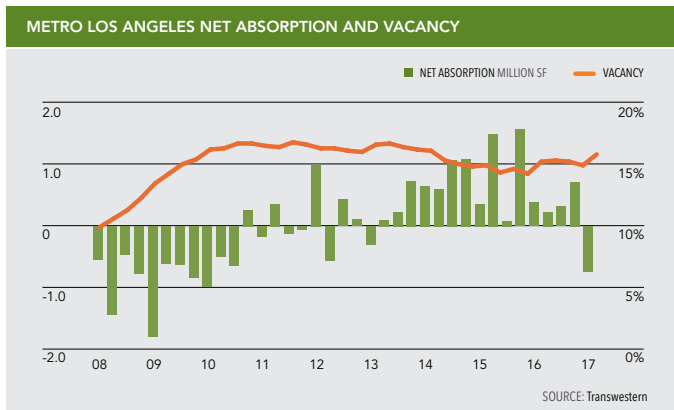
Investment sales market off to slower start compared to last year

In the first quarter, \$1.5 billion worth of office buildings traded hands in Los Angeles, which was down 38% from the \$2.4 billion of sales volume reported in the first quarter of 2016. The largest office sale involved Oaktree Capital Management acquiring the 5-building Hines Warner Center office campus in Woodland Hills from Hines for \$235.5 million (\$291 per square foot). Although investor interest in Los Angeles has by no means subsided, the high asking pricing seen on many properties combined with expected interest rate increases has caused some buyers to push pause on local acquisition activity. However, with several trophy properties being taken out to market this year and a continued investor appetite for yield, expect the region's office investment sales market to remain healthy as the year progresses.

OUTLOOK

Overall office market remains relatively healthy, but office vacancy is rising

The Los Angeles office market saw the sharpest rise in vacancy in nearly eight years in the first quarter of 2017. While some space givebacks were long expected, the high amount of speculative development underway and the steady increase in available sublease space will cause both office occupiers and owners to re-evaluate their real estate decision-making in 2017 to adjust to a business and real estate cycle that is now widely considered mature. In addition, macroeconomic hard data and soft data will continue to be closely watched throughout the year as optimism over the pro-business policies of the new presidential administration hopefully translates into higher business investment and hiring. Overall, the market currently remains relatively healthy, but it will be interesting to see if the high amount of negative net absorption and slowdown in transactional volume reported in the first quarter was a blip or a sign of things to come. ■



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Metro Los Angeles Office Market Indicators

MARKET	INVENTORY	UNDER CONSTRUCTION	Q1 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Downtown Los Angeles	34,749,719	1,561,693	-186,365	-186,365	18.8%	0.6%	19.4%	\$3.21
Wilshire Corridor/Hollywood	18,097,227	418,722	258,143	258,143	15.8%	0.4%	16.2%	\$3.06
West Los Angeles	51,576,038	1,309,830	-671,386	-671,386	13.2%	1.3%	14.5%	\$4.70
Tri-Cities	19,865,419	-	-152,062	-152,062	12.9%	0.8%	13.7%	\$3.19
San Fernando Valley	18,864,021	-	84,290	84,290	14.1%	0.2%	14.3%	\$2.60
South Bay	28,416,362	398,182	119,601	119,601	15.4%	1.0%	16.4%	\$2.37
San Gabriel Valley	9,638,901	77,250	-130,897	-130,897	18.8%	0.1%	18.9%	\$2.22
Conejo Valley	7,905,206	-	-35,771	-35,771	16.1%	0.7%	16.7%	\$2.45
Santa Clarita Valley	1,999,139	-	-8,937	-8,937	11.1%	2.0%	13.1%	\$2.42
Mid-Cities/Southeast LA	3,983,270	-	-17,872	-17,872	11.9%	1.3%	13.3%	\$2.21
LA Office Market Total	195,095,302	3,765,677	-741,256	-741,256	15.2%	0.8%	16.0%	\$3.22

MAJOR LEASE ACTIVITY

PROPERTY	TENANT	SF	TYPE	MARKET	SUBMARKET
222 W 6th St	Molina Healthcare	99,343	Class A New Lease	South Bay	Beach Cities/Palos Verdes
5808 W Sunset Blvd	Netflix	91,953	Class A New Lease	Wilshire Corridor/Hollywood	Hollywood
425 Shatto Pl	County of Los Angeles	81,847	Class B Renewal	Wilshire Corridor/Hollywood	Wilshire Center
2121 Avenue of the Stars	21st Century Fox	61,350	Class A Expansion	West Los Angeles	Century City

MAJOR SALES ACTIVITY

PROPERTY	PRICE	PRICE PSF	BUYER	MARKET	SUBMARKET
Hines Warner Center (5 bldgs)	\$235,500,000	\$291	Oaktree Capital	San Fernando Valley	Woodland Hills
655 N Central Ave	\$179,000,000	\$391	DivcoWest	Tri-Cities	Glendale
5340 Alla Rd	\$95,000,000	\$803	LaSalle Investment Management	West Los Angeles	Playa Vista
611 N Brand Blvd	\$83,000,000	\$210	Onni Group	Tri-Cities	Glendale

DEVELOPMENT ACTIVITY

PROPERTY	SF	TYPE	DEVELOPER	MARKET	SUBMARKET
Wilshire Grand Center (900 Wilshire Blvd)	358,821	Class A	Korean Air	Downtown Los Angeles	Financial District
777 S Aviation Blvd	318,182	Class B (Creative)	Embarcadero Capital Partners	South Bay	El Segundo
C3 (5800 Bristol Pky)	278,247	Class A	IDS Real Estate Group	West Los Angeles	Culver City
Ford Factory (777 S Santa Fe Ave)	257,028	Class A (Creative)	Shorenstein Properties	Downtown Los Angeles	Greater Downtown (Arts District)

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METHODOLOGY

The information in this report is the result of a compilation of information on office properties located in the Los Angeles metropolitan area. This report includes single-tenant and multi-tenant office properties 10,000 SF and larger, excluding condo and medical office facilities and those properties owned and occupied by a government agency.



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