

LOS ANGELES OFFICE MARKET

SECOND QUARTER 2017

Los Angeles Office Vacancy Up Again at Mid-Year 2017

Year-over-year job growth slows to just 1.3% as development hits 10-year high

At mid-year 2017, the Los Angeles office market continued to see vacancy rise as more space givebacks combined with newly delivered office projects caused the amount of vacant space to increase to levels not seen since 2014. With over 4.4 million square feet of new office space currently under development combined with leasing activity slowing due to the local economy being at or near full employment, expect office vacancy levels to continue to increase in the second half of 2017.

ECONOMY




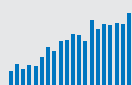
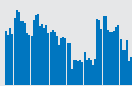
Unemployment rate in Los Angeles County decreases to 4.4% in May

The seasonally adjusted unemployment rate for Los Angeles County decreased to 4.4% in May, which continues to be the lowest unemployment rate reported locally since 2007. Year-over-year nonfarm employment increased by 55,700 (1.3%) while office-using employment increased by 16,000 (1.3%), respectively. Compared to a year ago when both nonfarm employment and office-using employment in Los Angeles grew at 3.2% and 4.4%, respectively, year-over-year job growth has slowed over the past year as the area economy nears full employment.

SUPPLY AND DEVELOPMENT

Nearly 4.5 million square feet of office space now underway

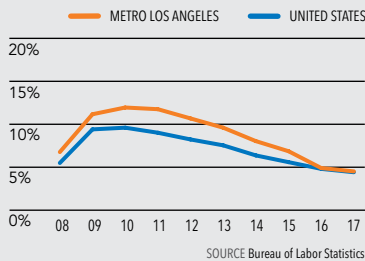
In the second quarter, 604,412 square feet of office space was delivered to the market, including the long-awaited Wilshire Grand Center in Downtown Los Angeles which saw 358,821 square feet of Class A space finally completed. At mid-year 2017, 4,451,058 square feet of new office space is underway, constituting the highest level of new office development reported region-wide in a decade. It should be noted that there is now more space (2,693,110 square feet) under renovation to creative office than there is new ground-up construction (1,757,948 square feet) as developers have been aggressive at finding value-add opportunities in a market that is largely built out. With just 19% of the space underway currently pre-leased, expect vacancy levels to rise as new space is delivered to the market unleashed.

TRENDLINES	
5-YEAR TREND	CURRENT QUARTER
VACANCY 	16.3% Vacancy rate up 30 basis points
ABSORPTION 	103,356 SF Absorption positive in 2Q 2017
RENTAL RATE 	\$3.28 PSF Rates up 5.3% year over year
UNDER CONSTRUCTION 	4,451,058 SF 19% of office space is pre-leased
CAP RATES 	5.3% Cap rates drop 50 basis points
JOB GROWTH 	55,700 jobs Growth of 1.3% year over year

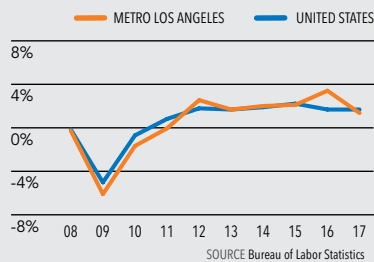
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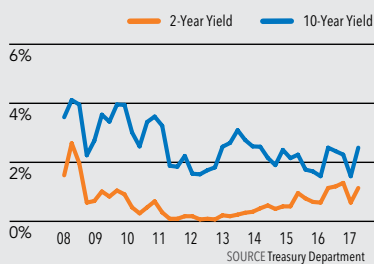
UNEMPLOYMENT RATE



PAYROLL JOB GROWTH



TREASURY RATES



DEMAND

Net absorption positive for the quarter but still negative for the year

Demand for office space was positive at 103,356 square feet, led by overall space gains in West Los Angeles, the Tri-Cities, and the San Fernando Valley. However, most of the space gains market-wide were essentially negated by continued right-sizing and space consolidations in the financial, insurance, and legal services sectors in Downtown Los Angeles, which has lagged the overall market despite all the new investment and residential development seen over the past several years. While local companies remain generally optimistic about the economy, the vast majority of firms remain cautious about leasing more space than they need as the focus on cost efficiency has become paramount. As a result, it is no surprise that nearly 10 million square feet has been absorbed market-wide over the past five years yet overall vacancy has barely decreased.

VACANCY

Total vacancy rate up 30 basis points over previous quarter to 16.3%

The total vacancy rate of 16.3% was a 30-basis-point increase from a total vacancy rate of 16.0% reported last quarter. Sublease space, which is an early indicator of softening demand, again increased to 4.5 million square feet available (up 13% year over year) although sublease vacant space decreased from last quarter to 1.4 million square feet (still up 16% year over year). With the large amount of speculative office development underway in certain markets combined with the general occupier trend of increased space efficiency, it is very likely that office vacancy increases in the second half of 2017.

RENTAL RATES

Direct weighted average asking rental rate up 5.3% year over year

The direct weighted average asking rental rate increased for the fifteenth consecutive quarter to \$3.28 per square foot per month (up 5.3% year over year). As mentioned in previous reports, several office submarkets such as Santa Monica, Hollywood, and El Segundo have seen average office rents hit record levels as occupier demand has been strong and new office space has recently been delivered. Both vacancy levels and average rental rates (mostly due to newer more expensive space expected to be completed) are projected to increase; however, pressure from newly delivered unleased space and increasing sublease space will cause rental rate growth to slow.

Metro Los Angeles Office Market Indicators

PROPERTY CLASS	INVENTORY	UNDER CONSTRUCTION	Q2 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Class A	127,096,211	2,298,612	-88,198	-995,124	15.1%	0.8%	15.9%	\$3.62
Class B	68,470,057	2,152,446	191,554	357,224	16.5%	0.6%	17.1%	\$2.73
LA Metro Total	195,566,268	4,451,058	103,356	-637,900	15.6%	0.7%	16.3%	\$3.28



INVESTMENT MARKET

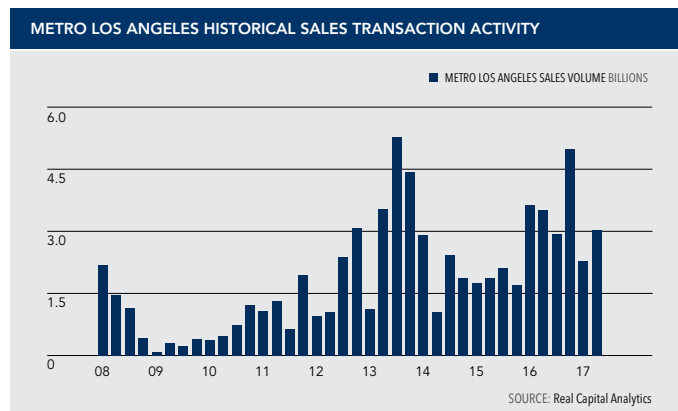
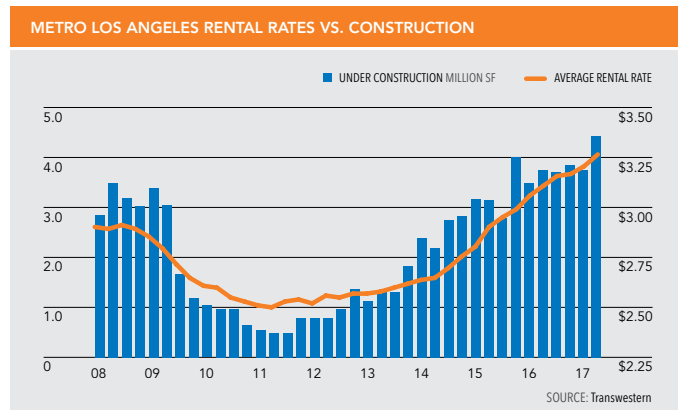
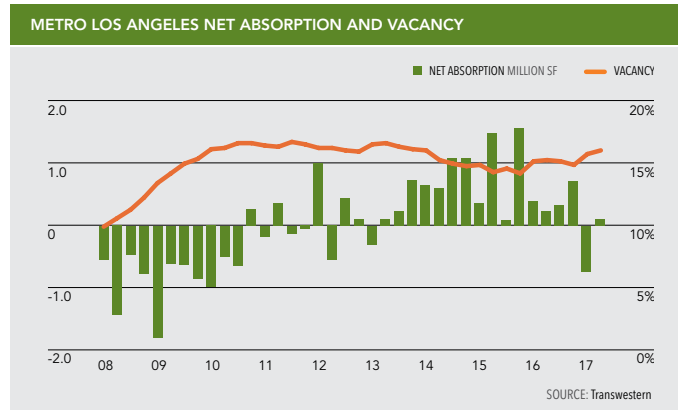
Investment sales volume rebounds in second quarter but still down from last year

In the second quarter, over \$2.0 billion in office buildings traded hands in Los Angeles, which was up 33% from the \$1.5 billion in sales volume reported in the first quarter but down 14% from the \$2.3 billion in sales volume reported in the second quarter of 2016. Year-to-date sale volume of \$3.5 billion is also down 26% from the \$4.8 billion in sales volume reported in the first six months of 2016. The largest office sales of the quarter involved the re-capitalization of 1999 Avenue of the Stars in Century City where JMB Realty re-acquired its 2/3 stake from Blackstone in a deal valuing the building at \$860 million (\$1,042 per square foot), followed by Douglas Emmett and Qatar Investment Authority acquiring 1299 Ocean Ave in Santa Monica from Blackstone for \$285 million (\$1,385 per square foot). As mentioned in previous reports, the Los Angeles office investment market remains fully priced with intense buyer interest and sometimes higher-than-asking pricing for assets in a handful of submarkets while everything else sits on the market. Although interest rates are expected to rise, expect very little cooling at the higher end of the value spectrum moving forward.

OUTLOOK

Los Angeles office market still in good shape, but growth is slowing

The Los Angeles office market continued to see both average rental rates and vacancy levels rise market-wide, although certain submarkets remain healthier than others. As mentioned in previous reports, the increasing amount of available sublease space and relatively high levels of speculative development in certain markets are occurring just as leasing activity and net absorption have been slowing over the past year. Looking into the second half of 2017, the general consensus is that outside of a macroeconomic shock or Black Swan event in the financial markets, no recession is imminent. However, with overall GDP growth recently revised up to just 1.4% on an annualized basis in the first quarter, expect slow growth moving forward as occupiers remain cautious about over-expanding and investors remain cautious about overpaying for non-core assets as the real estate cycle is now widely considered mature. ■



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Metro Los Angeles Office Market Indicators

MARKET	INVENTORY	UNDER CONSTRUCTION	Q2 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Downtown Los Angeles	35,142,887	1,631,157	-387,369	-573,734	21.1%	0.6%	21.7%	\$3.35
Wilshire Corridor/Hollywood	18,242,714	344,562	19,997	278,140	17.5%	0.3%	17.8%	\$3.08
West Los Angeles	51,547,792	1,540,801	272,023	-399,363	12.9%	1.0%	13.9%	\$4.79
Tri-Cities	19,840,758	-	129,240	-22,822	12.3%	0.7%	13.1%	\$3.22
San Fernando Valley	18,928,581	200,000	111,306	195,596	13.7%	0.2%	13.9%	\$2.59
South Bay	28,295,862	657,288	-43,063	76,538	15.6%	1.2%	16.8%	\$2.45
San Gabriel Valley	9,642,887	77,250	-35,458	-166,355	19.2%	0.0%	19.2%	\$2.22
Conejo Valley	7,942,378	-	3,696	-32,075	16.1%	0.5%	16.6%	\$2.44
Santa Clarita Valley	1,999,139	-	-19,531	-28,468	13.8%	0.3%	14.1%	\$2.41
Mid-Cities/Southeast LA	3,983,270	-	52,515	34,643	10.7%	1.2%	11.9%	\$2.25
LA Office Market Total	195,566,268	4,451,058	103,356	-637,900	15.6%	0.7%	16.3%	\$3.28

MAJOR LEASE ACTIVITY

PROPERTY	TENANT	SF	TYPE	MARKET	SUBMARKET
8777 Washington Blvd	HBO	128,000	Class A New Pre-Lease	West Los Angeles	Culver City
12200 W Olympic Blvd	Riot Games	80,000	Class A Expansion	West Los Angeles	Olympic Corridor
633 W 5th St	Marsh & McLennan Cos	71,094	Class A New Lease	Downtown Los Angeles	Financial District
2401 Colorado Ave	Edmunds.com	62,558	Class A Expansion	West Los Angeles	Santa Monica

MAJOR SALES ACTIVITY

PROPERTY	PRICE	PRICE PSF	BUYER	MARKET	SUBMARKET
1999 Avenue of the Stars (re-capitalization)	\$572,850,000 (67% stake)	\$1,042	JMB Realty	West Los Angeles	Century City
300 S Grand Ave	\$459,000,000	\$441	Rising Realty Partners & Colony NorthStar	Downtown Los Angeles	Bunker Hill
1299 Ocean Ave	\$285,000,000	\$1,385	Douglas Emmett & QIA	West Los Angeles	Santa Monica
400 & 450 N Brand Blvd (2 bldgs)	\$144,000,000	\$367	Kennedy Wilson	Tri-Cities	Glendale

DEVELOPMENT ACTIVITY

PROPERTY	SF	TYPE	DEVELOPER	MARKET	SUBMARKET
801 S Broadway	400,000	Class A (Creative)	Waterbridge Capital	Downtown Los Angeles	Greater Los Angeles (Broadway)
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
555 S Aviation Blvd	259,106	Class B (Creative)	Tishman Speyer	South Bay	El Segundo

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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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