

LOS ANGELES OFFICE MARKET

THIRD QUARTER 2017

Strong Occupancy Gains Market-Wide in the 3rd Quarter

In the third quarter 2017, the Los Angeles office market rebounded with strong occupancy gains, with the highest amount of quarterly net absorption recorded in nearly two years. After a relatively slow first half of the year, which saw long-awaited large space givebacks, demand picked up in the third quarter as area companies remain optimistic about the economy despite job growth slowing over the past 12 months. For the remainder of 2017, expect continued rental rate growth and more large office sales transactions as the market remains a primary target for investors who still need to deploy capital.

ECONOMY

Seasonally adjusted unemployment rate in Los Angeles County at 4.8% in August

The seasonally adjusted unemployment rate for Los Angeles County increased to 4.8% in August, which is higher than the national average (4.4%) but lower than the statewide average (5.1%). Year-over-year nonfarm employment increased by 37,200 (0.8%), while office-using employment increased by 11,800 (1.0%), respectively. Compared to a year ago when nonfarm employment and office-using employment in Los Angeles grew at 2.5% and 3.5%, respectively, year-over-year job growth has slowed as the area economy is now operating at or very close to full employment.

SUPPLY AND DEVELOPMENT

Nearly 3.5 million square feet is now under construction or major renovation

In the third quarter, almost 1.4 million square feet of office space was delivered to the market, including high profile projects such as C3 in Culver City, Ford Factory and At Mateo in the Downtown LA Arts District, and Pen Factory and Santa Monica Gateway in Santa Monica. A total of nearly 3.5 million square feet of new office space is now underway, of which 9.8% is currently pre-leased. Constituting just 1.8% of the Los Angeles competitive office inventory, the overall market is not in danger of oversupply, although some submarkets such as Greater Downtown and El Segundo bear watching if leasing activity slows. With Los Angeles now mostly built out, new office buildings are being developed with much smaller footprints than in the past with an average of just under 80,000 square feet for current ground-up development and an average of just under 131,000 square feet for current creative office conversions.

TRENDLINES

5-YEAR TREND CURRENT QUARTER

VACANCY



16.5%

Vacancy rate up 20 basis points

ABSORPTION



850,853 SF

Absorption positive in 3Q 2017

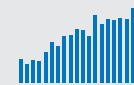
RENTAL RATE



\$3.35 PSF

Rates up 5.7% year over year

UNDER CONSTRUCTION



3,450,382 SF

9.8% of office space is pre-leased

CAP RATES



5.2%

Cap rates drop 10 basis points

JOB GROWTH



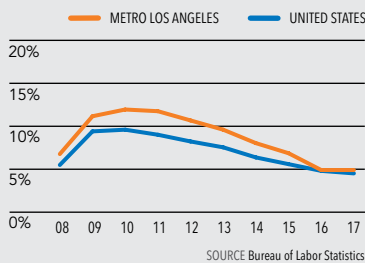
37,200 jobs

Growth of 0.9% year over year

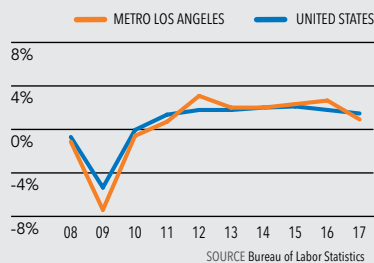
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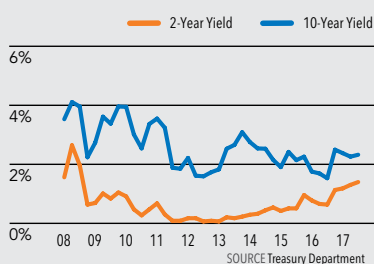
UNEMPLOYMENT RATE



PAYROLL JOB GROWTH



TREASURY RATES



DEMAND

Strong space gains causes year-to-date net absorption to swing positive

Demand for office space in the third quarter was strongly positive at 850,853 square feet. Led again by occupancy gains on the Westside and Hollywood, this caused year-to-date net absorption market-wide to finally swing positive (212,953 square feet) after several large space givebacks occurred in the first half of the year. As mentioned in previous reports, local companies remain optimistic about the economy; however, most remain cautious about leasing more space than they need, which has led to a 17% decrease in year-to-date leasing activity relative to this point last year. For the foreseeable future, expect these conditions to remain steady due to Los Angeles' high rate of entrepreneurship, rising startup ecosystem, and continued hiring in the region's technology, entertainment, and media sectors due to the exponential growth in digital content creation.

VACANCY

Total vacancy rate up 20 basis points over previous quarter to 16.5%

The total vacancy rate of 16.5% was a 20-basis-point increase from last quarter. However, with several large 100,000+ square foot blocks of office space around the market currently leased but not occupied yet, the total available vacancy rate, which does not include vacant space currently encumbered for occupancy, is actually 200 basis points lower at 14.5%. Further, in certain high-profile submarkets such as Century City (9.1%), Burbank (10.1%), and El Segundo (10.7%), vacancy levels are at historically low levels. So while the total vacancy rate of 16.5% in the Los Angeles office market appears high, the overall market is actually much healthier under the surface.

RENTAL RATES

Direct weighted average asking rental rate up 5.7% year-over-year

The direct weighted average asking rental rate increased for the sixteenth consecutive quarter to \$3.35 per square foot per month (up 5.7% year over year). Since bottoming at \$2.50 per square foot in the second quarter 2011, the average office rental rate in Los Angeles has grown 34% market-wide. 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 Class A office space has been delivered to the market. Assuming current market conditions hold, expect continued 5-7% annualized rental-rate growth market-wide with double-digit growth in certain submarkets over the next 12 months.

Metro Los Angeles Office Market Indicators

PROPERTY CLASS	INVENTORY	UNDER CONSTRUCTION	Q3 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Class A	128,454,915	1,509,254	506,671	-488,453	15.6%	0.9%	16.5%	\$3.70
Class B	68,510,118	1,941,128	344,182	701,406	16.1%	0.5%	16.6%	\$2.76
LA Metro Total	196,965,033	3,450,382	850,853	212,953	15.8%	0.7%	16.5%	\$3.35



INVESTMENT MARKET

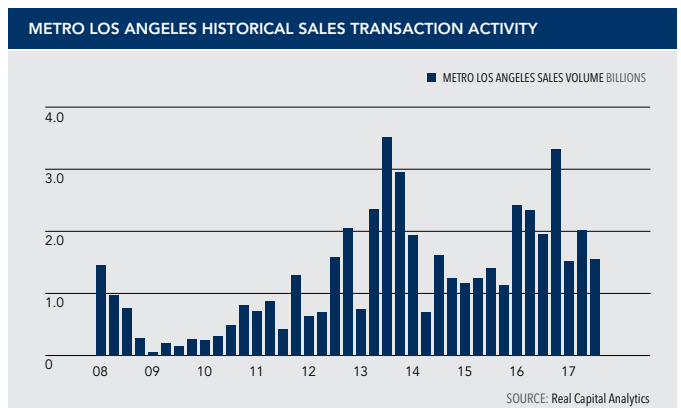
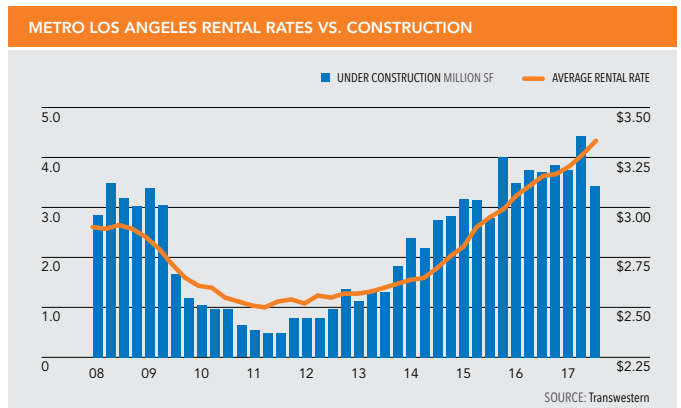
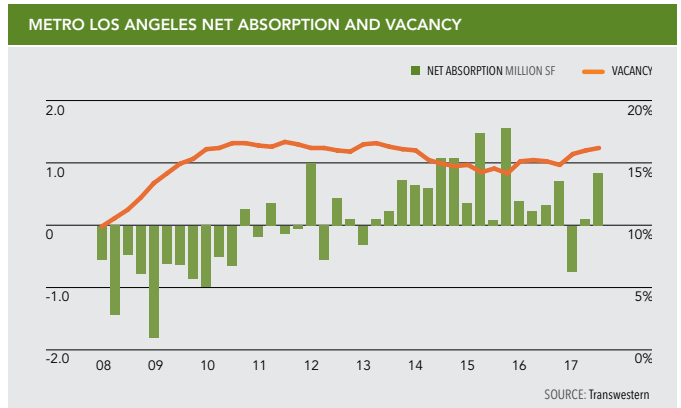
Investment sales volume continues to be healthy as investors look west

Nearly \$1.6 billion in office buildings traded in the third quarter, which brought year-to-date sale volume in 2017 up to \$5.1 billion (down 24% from the \$6.7 billion in sales volume reported through the first nine months of 2016). The largest sales transactions included Douglas Emmett and Qatar Investment Authority acquiring 9665 Wilshire Blvd in the Beverly Hills Triangle from Blackstone for \$177.0 million (\$1,035 per square foot), as well as Blackstone and Worthe Real Estate Group acquiring 3800 W Alameda Blvd in the Burbank Media District for \$172.5 million (\$409 per square foot) in a recapitalization from Centurion Real Estate Partners. With several large deals reported to now be under contract, expect a high amount of sales volume to end the year due to intense buyer interest, especially from overseas, and the still-relatively low cost of capital. As a result, expect very little cooling in pricing moving forward, especially for the best assets in the most well-performing submarkets of Los Angeles.

OUTLOOK

Los Angeles office market closes the third quarter in good shape

Through three quarters of the year, the Los Angeles office market continues to see strong market fundamentals with high rental rates and sale prices. As the overall economy continues to show very few visible signs of a market correction, it now appears that the downside risk to short-term growth is increasingly geopolitical rather than structural. As a result, the \$1 trillion Los Angeles regional economy continues to grow even though it is slow (low-2% range), and the current high cost of housing and doing business increasingly is acting as a primary headwind to faster economic growth. For the remainder of 2017, expect favorable office market fundamentals to continue, albeit with cautious optimism on the part of occupiers, owners, investors, and developers who have all largely avoided the over-exuberance seen a decade ago. ■



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Metro Los Angeles Office Market Indicators

MARKET	INVENTORY	UNDER CONSTRUCTION	Q3 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Downtown Los Angeles	35,591,948	1,190,569	38,584	-535,150	21.9%	0.7%	22.5%	\$3.35
Wilshire Corridor/Hollywood	18,375,265	452,609	208,414	486,554	16.8%	0.4%	17.3%	\$3.04
West Los Angeles	52,365,482	883,458	320,900	-78,463	13.8%	1.0%	14.7%	\$4.95
Tri-Cities	19,840,758	-	-122,919	-145,741	12.9%	0.8%	13.7%	\$3.21
San Fernando Valley	18,928,581	189,208	55,201	250,797	13.3%	0.2%	13.6%	\$2.64
South Bay	28,295,862	657,288	125,602	202,140	15.2%	1.2%	16.4%	\$2.50
San Gabriel Valley	9,642,350	77,250	65,645	-100,710	18.5%	0.1%	18.6%	\$2.21
Conejo Valley	7,942,378	-	124,716	92,641	14.5%	0.5%	15.0%	\$2.44
Santa Clarita Valley	1,999,139	-	43,147	14,679	11.4%	0.5%	11.9%	\$2.47
Mid-Cities/Southeast LA	3,983,270	-	-8,437	26,206	10.9%	1.3%	12.2%	\$2.29
LA Office Market Total	196,965,033	3,450,382	850,853	212,953	15.8%	0.7%	16.5%	\$3.35

MAJOR LEASE ACTIVITY

PROPERTY	TENANT	SF	TYPE	MARKET	SUBMARKET
8942 Wilshire Blvd	Paradigm Talent Agency	82,886	Class A New Lease	West Los Angeles	Beverly Hills
2560 Teller Rd	Frontier Communications	71,402	Class B New Lease	Conejo Valley	Thousand Oaks/Westlake Village
750 San Vicente Blvd	WeWork	69,534	Class A New Lease	West Los Angeles	West Hollywood
2049 Century Park East	Mitchell Silberberg & Knupp LLP	69,396	Class A New Lease	West Los Angeles	Century City

MAJOR SALES ACTIVITY

PROPERTY	PRICE	PRICE PSF	BUYER	MARKET	SUBMARKET
9665 Wilshire Blvd	\$177,000,000	\$1,035	Douglas Emmett & Qatar Investment Authority	West Los Angeles	Beverly Hills
3800 W Alameda Ave (re-capitalization)	\$172,500,000	\$409	The Blackstone Group & Worthe Real Estate	Tri-Cities	Burbank
300 & 400 Continental Blvd (2 bldgs)	\$168,881,500	\$344	Artisan Realty Advisors & Starwood Capital	South Bay	El Segundo
177 E Colorado Blvd	\$161,500,000	\$512	Rockpoint Group	Tri-Cities	Pasadena

DEVELOPMENT ACTIVITY

PROPERTY	SF	TYPE	DEVELOPER	MARKET	SUBMARKET
777 S Aviation Blvd	318,182	Class B (Creative)	Embarcadero Capital Partners	South Bay	El Segundo
5901 W Sunset Blvd	275,000	Class A	Hudson Pacific Properties	Wilshire Corridor/Hollywood	Hollywood
555 S Aviation Blvd	259,106	Class B (Creative)	Tishman Speyer	South Bay	El Segundo
6150 Laurel Canyon Blvd	189,208	Class A (Creative)	Merlone Geier Partners & GPI Companies	San Fernando Valley	North Hollywood

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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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