

LOS ANGELES OFFICE MARKET

FOURTH QUARTER 2017

Los Angeles office market ends 2017 with solid fundamentals

In the fourth quarter, the Los Angeles office market again reported strong occupancy gains, more development activity, and average rental rates ending the year at their highest levels ever. Overall, the market remains healthy, with positive absorption for the seventh year in a row, but the slowdown in leasing activity and net absorption compared to 2016 is a sign that the regional economy continues to operate at or near full employment. Combined with the industry trend of most companies continuing to right-size for greater space efficiency, the Los Angeles market enters 2018 with more cautious optimism than at any time since the market began recovering in 2011.

ECONOMY



November seasonally adjusted unemployment rate at 4.5%

The seasonally adjusted unemployment rate for Los Angeles County decreased to 4.5% in November, which remains higher than the national average (4.1%) but lower than the statewide average (4.6%). Year-over-year nonfarm employment increased by 36,900 (0.8%), while office-using employment increased by 13,700 (1.1%), respectively. Compared to a year ago when nonfarm employment and office-using employment in Los Angeles grew at 2.7% and 3.5%, respectively, year-over-year job growth has slowed dramatically as the regional economy has been operating at or very close to full employment.

SUPPLY AND DEVELOPMENT

Over 3.9 million square feet is now under construction or major renovation

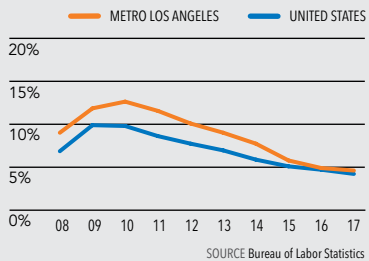
There were no new office projects completed in the fourth quarter, bringing the total amount of new office space delivered to the market in 2017 to 2.9 million square feet, of which 41% of that space is now leased. Nearly 80% of the space delivered in 2017 occurred in just two markets: Downtown Los Angeles and West Los Angeles. Over 3.9 million square feet of new office space is currently underway, constituting just 2.0% of the existing Los Angeles competitive office inventory, of which 10.1% is currently pre-leased. As mentioned in previous reports, the overall market is not in immediate danger of oversupply, although certain submarkets such as the Downtown Los Angeles Arts District and El Segundo bear watching if leasing activity continues to slow over the next year.

TRENDLINES	
5-YEAR TREND	CURRENT QUARTER
VACANCY 	16.3% Vacancy rate down 10 basis points
ABSORPTION 	663,918 SF Absorption positive in 4Q 2017
RENTAL RATE 	\$3.35 PSF Rates up 5.5% year over year
UNDER CONSTRUCTION 	3,962,043 SF 10.1% of office space is pre-leased
CAP RATES 	5.25% Cap rates unchanged from 3Q 2017
JOB GROWTH 	36,900 jobs Growth of just 0.8% year over year

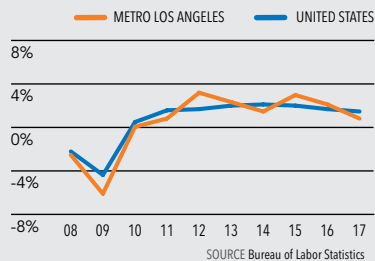
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UNEMPLOYMENT RATE



PAYROLL JOB GROWTH



TREASURY RATES



DEMAND

Total 2017 net absorption is positive but significantly down from 2016

Demand for office space in the fourth quarter was again strongly positive at 663,918 square feet, bringing 2017 total net absorption to 337,089 square feet. This is a sharp slowdown in office space gains compared to nearly 1.7 million square feet of net absorption reported in 2016. In addition, total 2017 leasing activity of 15.0 million square feet was a 20% decline from the 18.6 million square feet of leasing activity reported in 2016. While local companies remain optimistic about the overall economy, softening demand for office space compared to recent years is a by-product of the slowdown in local employment growth, as well as office tenants who are now using space more efficiently. Expect these conditions to hold in 2018 despite a still-favorable economic environment and booming entertainment, media, technology and co-working sectors.

VACANCY

Total vacancy rate ends 2017 at 16.3% (15.3% direct vacancy)

The total vacancy rate decreased 10 basis points over last quarter to end 2017 at 16.3%. While 10.7 million square feet of vacant office space has been absorbed since the beginning of 2012, total vacancy levels have remained high market-wide due to a combination of large corporate right-sizings, consolidations, and high-profile leases inked in brand-new projects instead of existing office properties. While certain submarkets such as Santa Monica, Century City, and El Segundo have reported historically low vacancy levels, other submarkets such as the Downtown LA Financial District and Marina Del Rey/Playa Vista continue to report high vacancy levels. Looking into 2018, expect more corporate consolidations and right-sizings, bringing increased vacancy levels market-wide.

RENTAL RATES

Direct weighted average asking rate ends 2017 at highest level ever

The direct weighted average asking rental rate remained flat to end the year at \$3.35 per square foot per month (up 5.5% year over year). Compared to year-end 2016 and 2015 when year-over-year average rental rate growth was 5.9% and 8.7%, respectively, rental-rate growth has slowed alongside softening leasing activity with some newly delivered vacant office projects recently cutting their quoted asking rental rates by 5-7%. Assuming market conditions hold, expect 3-5% annualized rental-rate growth market-wide in 2018, as well as the fierce competition for deals to continue with hefty landlord concession packages being offered in order to lock in larger tenants at the top of the market.

Metro Los Angeles Office Market Indicators

PROPERTY CLASS	INVENTORY	UNDER CONSTRUCTION	Q4 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Class A	128,342,173	1,960,780	816,878	-95,452	14.8%	1.1%	15.9%	\$3.66
Class B	68,354,571	2,001,263	-152,960	432,541	16.1%	0.7%	16.8%	\$2.80
LA Metro Total	196,696,744	3,962,043	663,918	337,089	15.3%	1.0%	16.3%	\$3.35



INVESTMENT MARKET

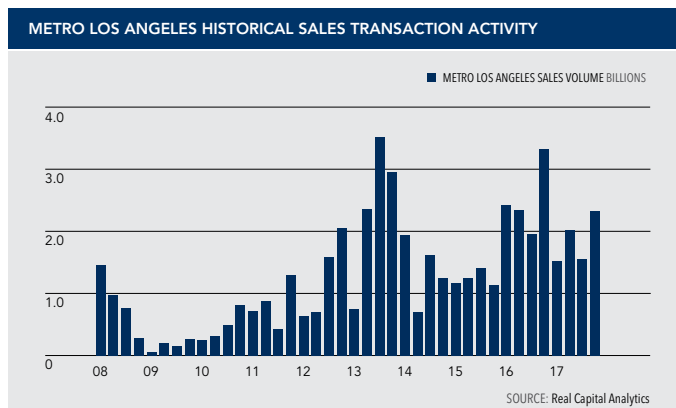
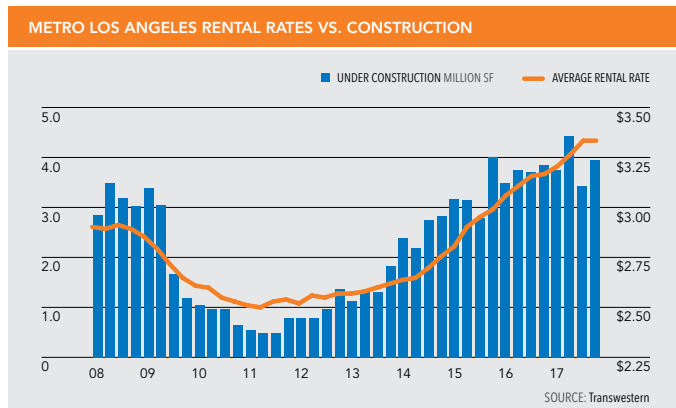
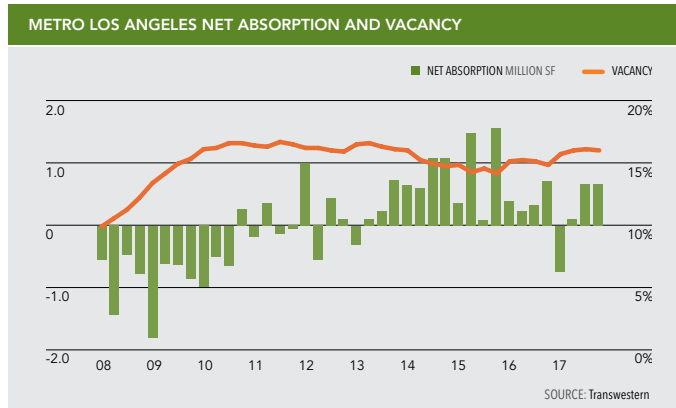
Investment sales remain healthy but volume down from 2016

Over \$2.3 billion in office buildings traded in the fourth quarter, which brought total sale volume in 2017 up to \$7.5 billion (down 26% from the \$10.1 billion in sales volume reported in 2016). The largest sale transaction in the fourth quarter involved PCT in El Segundo, which was acquired by Starwood Capital and Artisan Realty Advisors from Blackrock on behalf of the GM Pension Fund for \$605.5 million (\$382 per square foot). While there has been very little cooling in pricing, especially for office properties in the best-performing submarkets of Los Angeles, most investors have become much more cautious about overpaying at this point in the cycle. With the Federal Reserve recently stating that they will raise interest rates three more times in 2018, expect pricing to remain high but the cap rate compression seen over the past few years to come to an end.

OUTLOOK

LA office market ends 2017 in good shape but enters 2018 with more cautious optimism

The Los Angeles office market continues to see solid market fundamentals as the overall economy continues to show few visible signs of a market correction. Overall, local companies remain optimistic about the economy and recent federal tax reform should help both occupiers and owners of commercial real estate. However, 2017 saw the office market soften relative to previous years as lower levels of employment growth and the region’s continued high cost of living and doing business directly led to lower levels of leasing activity and net absorption. Looking into 2018, expect rental rates and property valuations to remain high but with much more cautious optimism as it relates to leasing activity and speculative development as we move later into this real estate cycle. ■



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MARKET	INVENTORY	UNDER CONSTRUCTION	Q4 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Downtown Los Angeles	35,895,471	1,206,374	63,067	-488,833	22.4%	0.7%	23.1%	\$3.39
Wilshire Corridor/Hollywood	18,244,415	476,458	96,245	358,300	16.0%	0.7%	16.7%	\$3.04
West Los Angeles	52,302,516	1,281,406	468,405	236,734	12.5%	1.3%	13.7%	\$4.97
Tri-Cities	19,832,442	-	-93,054	-244,234	12.2%	1.4%	13.6%	\$3.20
San Fernando Valley	18,973,841	218,267	-40,880	209,917	13.7%	0.4%	14.1%	\$2.66
South Bay	27,869,433	702,288	40,637	140,903	14.2%	1.8%	16.0%	\$2.55
San Gabriel Valley	9,642,350	77,250	68,162	-70,560	18.1%	0.2%	18.3%	\$2.21
Conejo Valley	7,953,867	-	30,100	122,741	14.0%	0.6%	14.6%	\$2.43
Santa Clarita Valley	1,999,139	-	-14,427	252	12.5%	0.1%	12.6%	\$2.48
Mid-Cities/Southeast LA	3,983,270	-	45,663	71,869	10.3%	0.7%	11.0%	\$2.34
LA Office Market Total	196,696,744	3,962,043	663,918	337,089	15.3%	1.0%	16.3%	\$3.35

MAJOR LEASE ACTIVITY

PROPERTY	TENANT	SF	TYPE	MARKET	SUBMARKET
9336 Washington Blvd	Amazon Studios	280,000	Class B New Lease	West Los Angeles	Culver City
1200 W 7th St	City of Los Angeles	222,694	Class A Renewal	Downtown Los Angeles	Greater Downtown (City West)
4729-4755 Alla Rd	Tesla	131,071	Class B New Lease	West Los Angeles	Marina Del Rey/Playa Vista
8531 Fallbrook Ave	Pharmavite	98,397	Class A New Lease	San Fernando Valley	Western San Fernando Valley

MAJOR SALES ACTIVITY

PROPERTY	PRICE	PRICE PSF	BUYER	MARKET	SUBMARKET
100, 200 & 222 N Sepulveda Blvd (3 bldgs)	\$605,454,000	\$382	Starwood Capital & Artisan Realty Advisors	South Bay	El Segundo
DreamWorks Animation Campus (5 bldgs)	\$290,000,000	\$630	Ocean West Capital & Hana Asset Management	Tri-Cities	Glendale
5670 Wilshire Blvd	\$210,063,000	\$471	Rockpoint Group	Wilshire Corridor/Hollywood	Miracle Mile
9401 Wilshire Blvd	\$143,600,000	\$982	Douglas Emmett	West Los Angeles	Beverly Hills

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	299,519	Class A	Hudson Pacific Properties	Wilshire Corridor/Hollywood	Hollywood
555 S Aviation Blvd	259,106	Class B (Creative)	Tishman Speyer	South Bay	El Segundo
8830 National Blvd	252,000	Class A	Lowе Enterprises, AECOM Capital & Rockwood Capital	West Los Angeles	Culver City

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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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