MARKET REPORT

Office

Riverside-San Bernardino Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

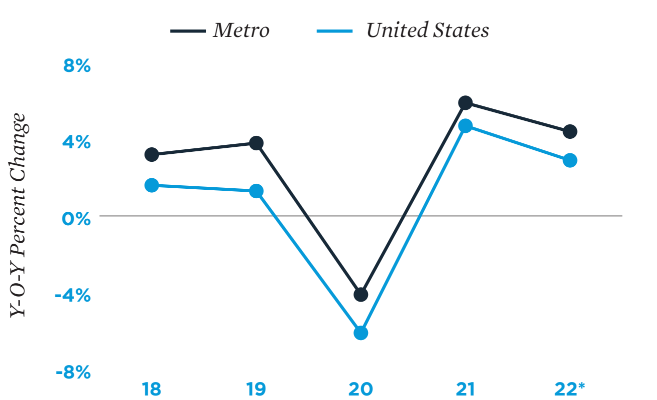
2Q/22

Demand for Low-Cost and Medical Office Space Supports West Coast's Lowest Vacancy

Inland rents and expanding labor pool appeal to thrifty firms. Riverside-San Bernardino entered April as one of two major U.S. markets with a sub-10 percent vacancy rate. On the surface, the metro's regionally discounted asking rents are attracting more smaller and mid-sized businesses intent on lowering their operating costs. This movement translated to strong Class B/C leasing. During the past year ended in March, tenants absorbed a net of 780,000 square feet, dropping subsector vacancy to a record low. Additionally, the Inland Empire has a significantly smaller volume of inventory per traditional office-using employees than most metros. This limits options for expanding firms and those with upcoming lease expirations, a boon for renewal activity and vacant floorplans. Looking ahead, the metro's growing labor pool represents an additional attractant, allowing conditions to remain among the nation's tightest.

Medical office conditions reflect growing populace. The growth of Riverside-San Bernardino's health services sector represents a supplementary driver of office demand. Notable in-migration during the pandemic and expectations for the local populace to expand by 200,000 residents over the next five years are fueling medical office leasing. Entering April, vacancy in the subsector sat at 6.4 percent, following the net absorption of nearly 300,000 square feet during the prior 12 months. Near-term leasing is poised to remain healthy as less than 200,000 square feet is being built and several major hospital expansions will stoke demand for adjacent medical office space.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.

Office 2022 Outlook

70,000 JOBS
will be created

EMPLOYMENT:

Positive job creation was noted across nearly all sectors during the first four months of 2022, highlighted by the addition of 7,500 traditional office-using positions. Diverse hiring is slated to continue, supporting a 4.4 percent annual rate of employment growth.

230,000 SQ. FT.
will be completed

CONSTRUCTION:

Developers increase the Inland Empire's inventory by 0.4 percent for a second consecutive year. Most of the space finalized during 2022 is in Riverside County, with San Bernardino County slated to added roughly 40,000 square feet.

50 BASIS POINT
decrease in vacancy

VACANCY:

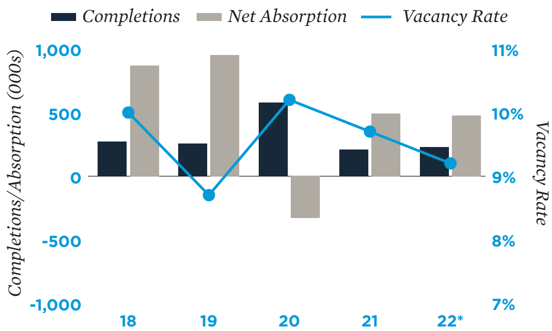
Tenant demand for available office space is comparable to last year, supporting the net absorption of nearly 500,000 square feet during 2022. The metro's year-end vacancy of 9.2 percent will rank as the second-lowest rate among major U.S. markets.

1.9% INCREASE
in asking rent

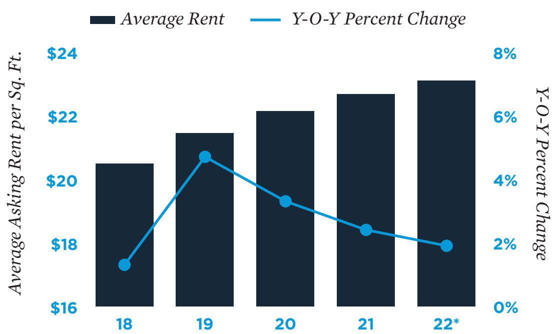
RENT:

Strong Class B/C leasing activity and a higher proportion of available Class A space will push Riverside-San Bernardino's mean asking rent to $23.10 per square foot. This year-end marketed rate will be more than 20 percent below the national average.

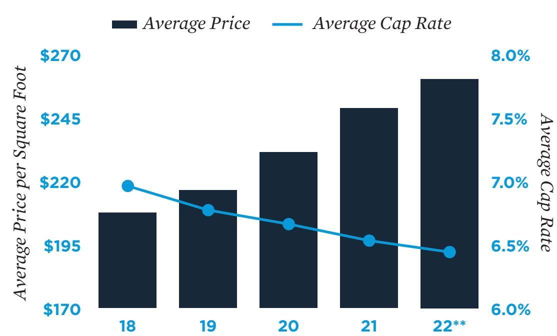
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 1Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

Inland Empire Office:
Adam Christofferson
Senior Vice President, Division Manager
Tel: (909) 456-3400 | adam.christofferson@marcusmillichap.com

For information on national office trends, contact:
John Chang
Senior Vice President, Director | Research & Advisory Services
Tel: (602) 707-9700 | jchang@ipausa.com

Price: $250

1Q 2022 - 12-Month Period

CONSTRUCTION

242,000 sq. ft. completed

- Supply additions were relatively sparse over the past 12 months ended in March, with medical office properties accounting for more than half of the space finalized across the Inland Empire.
- A 75,000-square-foot medical building in Riverside proper highlights the metro's active pipeline, which totaled 190,000 square feet as of mid-May.

VACANCY

70 basis point decrease in vacancy Y-O-Y

- The Inland Empire noted positive absorption in each of the last four quarters. This leasing activity lowered vacancy to 9.5 percent in March, partially offsetting the prior 12-month period's 140-basis-point increase.
- Property tiers are trending in opposite directions. Class B/C availability fell 120 basis points, while Class A vacancy rose by 130 basis points.

RENT

2.0% increase in the average asking rent Y-O-Y

- An increase in higher quality space available for lease supported a moderate boost in asking rents. Entering April, the metro's average marketed rate sat at $22.72 per square foot, a record mark.
- Asking rates in the Class B/C segment minimally adjusted over the past year, inching up 0.8 percent to $21.11 per square foot.

Investment Highlights

- Regionally discounted pricing and sub-10 percent vacancy has heightened demand for Inland Empire office properties, with the metro's record number of traditional office-using positions further bolstering buyers' confidence. Over the four quarters ended in March, sales activity elevated by nearly 50 percent, with Southern California-based investors exhibiting a preference for late 1980s- to early 2000s-built Class B properties.
- Competition for listings and a high volume of mid-tier trades lifted average pricing 10 percent to $260 per square foot, with the double-digit gain lowering the mean cap rate to 6.4 percent. Still, the metro's average yield exceeds Los Angeles County's mean rate by more than 200 basis points.
- Medical office trades accounted for one-third of all deal flow over the past year. Home to a sizable 55 and older cohort, the Coachella Valley has been the most active locale for these sales. However, buyers are scanning the entire Inland Empire during a period of robust population growth.
- Private investors are also pursing traditional office buildings in the metro's largest cities and near Ontario International Airport. Here, smaller and mid-sized assets are obtainable at high-5 percent to mid-7 percent returns.