MARKET REPORT

Office

Los Angeles Metro Area

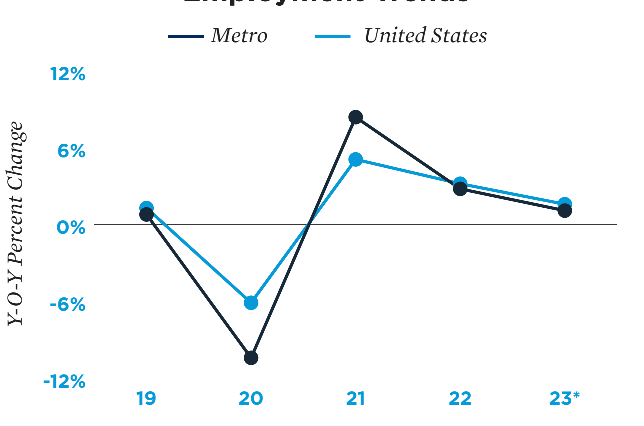
4Q/23

Facing Broad Headwinds, Los Angeles' Office Sector May Require Stock Removal to Reduce Vacancy

Conversion proposals may rise. As of June, 75 million square feet of office space sat vacant across the metro. Moving forward, adaptive reuse will represent one avenue to remove some of this space from inventory. Already regarded as the top city for apartment conversions in 2022, Los Angeles should see additional projects take shape, including the potential conversion of the 600,000-square-foot former ARCO Tower. The city's decision to update its adaptive reuse ordinance is fueling this expectation. If approved, properties built prior to 2008 would be eligible for the program.

Among office clusters, one area stands out. Vacant stock is historically elevated across Los Angeles' six largest submarkets, which together comprise 86 percent of the metro's total office stock. Entering the second half, vacancy in these areas ranged from 18.1 percent to a high of 24.4 percent in West Los Angeles. Against this broad trend, one of these submarkets, Mid-Wilshire, has recently exhibited positive momentum. Here, tenants absorbed a net of 450,000 square feet in the first six months of 2023, move-ins that lowered local vacancy by 100 basis points. Class A floor plans accounted for the entirety of newly-occupied space, impressive considering the submarket's average upper-tier rent is the third highest in the county. Moving forward, Mid-Wilshire lacks near-term additions, with just 140,000 square feet underway as of September. This scant pipeline may set the stage for additional local absorption, should demand hold up.

Employment Trends



** Forecast*

Sources: BLS; CoStar Group, Inc.

Office 2023 Outlook

50,000 JOBS
will be created

EMPLOYMENT:

A notable decline in the number of traditional office-using positions this year is offset by solid hospitality, food and health services-related hiring. This combination fuels a 1.1 percent annual rate of employment growth.

2,650,000 SQ. FT.
will be completed

CONSTRUCTION:

Developers expand office inventory by 0.7 percent in 2023, matching the prior five-year average. The first building of Warner Bros.' expansion in Burbank is the largest addition this year at 445,000 square feet.

160 BASIS POINT
increase in vacancy

VACANCY:

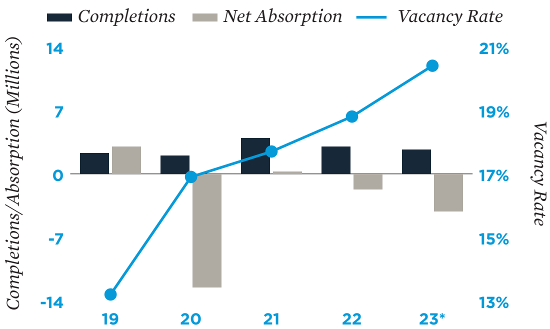
Accounting for nearly half of total stock, the Class A sector significantly impacts overall vacancy, which is expected to end the year at 20.4 percent. This rate will be 570 basis points above the long-term average.

1.4% DECREASE
in asking rent

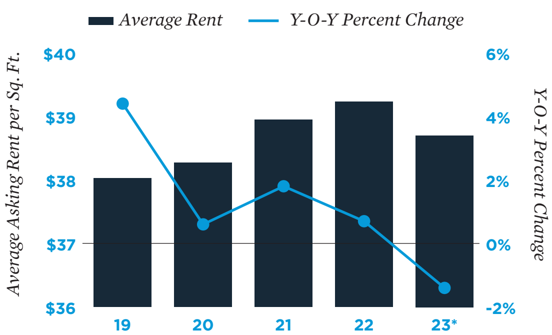
RENT:

Record-high vacancy requires a larger percentage of operators to lower asking rents when marketing space. This dynamic ends a 12-year streak of growth, placing the metro's average at $38.70 per square foot.

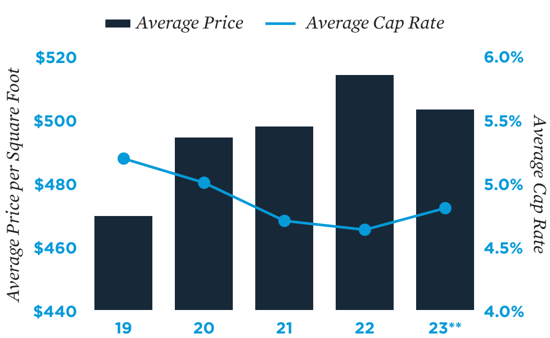
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 2Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

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Price: $250

2Q 2023 - 12-Month Period

CONSTRUCTION

2,373,000 sq. ft. completed

- The county's office inventory grew by 0.6 percent over the past 12 months ending in June. However, just 73,000 square feet was added during the final three months of this interval, the lowest quarterly total since late 2018.
- As of September, projects in West Los Angeles and Burbank-Glendale-Pasadena accounted for half of the space in the metro's active pipeline.

VACANCY

120 basis point increase in vacancy Y-O-Y

- Seven of 11 submarkets noted vacancy increases of at least 100 basis points over the past year, raising the metrowide rate to 19.4 percent in June.
- Mid-Cities and Antelope Valley noted compression of 100 and 70 basis points, respectively, during the four-quarter span. Unfortunately, the two areas collectively account for just 3 percent of total stock.

RENT

0.5% decrease in the average asking rent Y-O-Y

- Average asking rent retreated in six submarkets over the recent yearlong stretch, slightly lowering the metro's mean rate to $39.00 per square foot.
- Historically high Class A vacancy required operators to drop their upper-tier asking rates by an average of 0.7 percent. Class B/C owners tackled a similar situation, equating to the sector's mean rent falling 0.3 percent.

Investment Highlights

- Los Angeles recorded the most closings among major U.S. markets by a wide margin during the 12-month span ending in June, despite a 30 percent year-over-year decline in local transaction activity.
- The enactment of Measure ULA is adversely impacting commercial deal flow in Los Angeles proper. Spanning April through August, office transactions exceeding $5 million accounted for less than 20 percent of citywide sales activity, compared to 65 percent during the prior five months.
- Class B/C deal flow has been driven by closings in the suburbs this year. Buyers seeking post-2000-built Class B assets have targeted the San Gabriel, San Fernando and Santa Clarita valleys. Those focused on Class C properties are acquiring in these areas, along with South Bay and Burbank-Glendale-Pasadena, with the average price point for lower-tier buildings in these two areas ringing in at $560 per square foot.
- One-fourth of recent trading has involved medical office assets. The subsector's lack of recent and upcoming deliveries, and a vacancy rate well below the traditional office segment, are fueling investor demand. South Bay and San Gabriel Valley have noted the most sales of late.