Reis Observer

LOS ANGELES OFFICE MARKET

Published February 13, 2012

THE ECONOMY

As the national economy struggles through the economic slowdown, the Los Angeles economy has managed to post some solid numbers. The major indicators of job growth and unemployment are generally favorable. Unemployment has fallen 140 basis points over the past 12 months, but the current rate of 11.5% is still high. Current Employment Survey (CES) data from the U.S. Bureau of Labor Statistics (BLS) show that total non-farm employment in the Los Angeles Metropolitan Division was up 18,600 jobs (0.5%) from November 2010 to November 2011. The Motion Picture and Sound Recording industry, always big in Los Angeles, picked up 5,600 jobs, an increase of 4.3% from November-to-November. According to household-based data from the BLS, the labor force, which counts the number of people working or looking for employment, has declined by 38,100. This figure includes the self-employed and those commuting out to other counties (but not those commuting in from other counties). This drop in the labor force is at least partially driving the fall in the unemployment rate. The increase (by 35,700) in the number of county residents that are employed is also partly responsible.

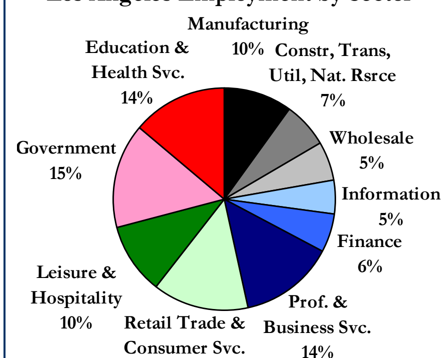
Los Angeles, however, remains an urban destination for many Americans. Moody's *Economy.com* reports the county's population increased by 109,330 from 2010 to 2011, a rise of 1.1%. From 2012 to 2016, this source predicts that population will continue to grow at about the same rate. Household average income, after falling during 2008 and 2009, has rebounded with a gain of 3.2% from fourth quarter 2010 to fourth quarter 2011, according to this source. The economy is not without its weak spots. Manufacturing continues its decline, posting a loss of 3,800 jobs (1.0%), Wholesale trade fell by 2,100 jobs (1.0%). Construction, after losing ground in 2010, saw an increase of 900 jobs (0.9%). On the white collar front, Professional and Business Services lost 1,500 jobs (0.3%), while Financial Activities lost 1,800 jobs (0.9%). Employment Services, which covers the temporary employment industry, saw a decrease of 1,800 jobs (2.1%), meaning companies could be holding off temporary hires. The Retail Trade sector posted a remarkable gain of 6,800 jobs (1.7%), while the Leisure and Hospitality sector saw a gain of 3,400 jobs (0.9%).

The substantially government-funded Educational and Health Services employment sector saw a notable increase of 10,800 jobs (2.0%), but Government employment overall was flat, while local government was up 2,200 jobs (0.5%). Los Angeles, like many other municipalities, has had to

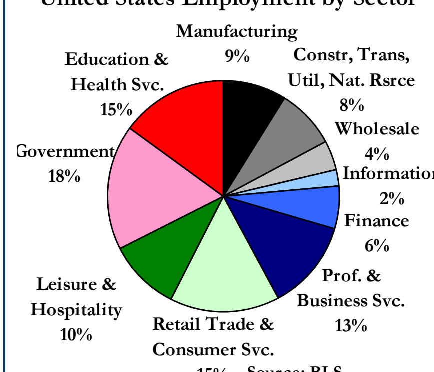
Employment:

- *The BLS reports a seasonally unadjusted unemployment rate of 11.5% in November for the Los Angeles Metropolitan Division, down from 12.9% one year earlier.*
- *Total non-farm employment in Los Angeles was up 0.5% year-over-year in November, according the BLS.*
- *Moody's Economy.com reports a fourth quarter 2011 average household income of $133,585 for Los Angeles. Average household incomes of $122,428 and $126,935 are reported for the top metros in the nation and West region, respectively.*

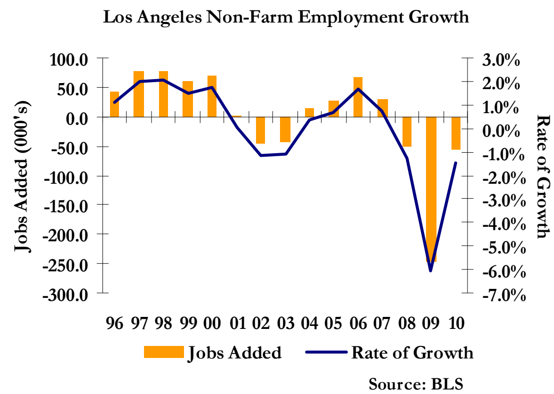
Los Angeles Employment by Sector



United States Employment by Sector



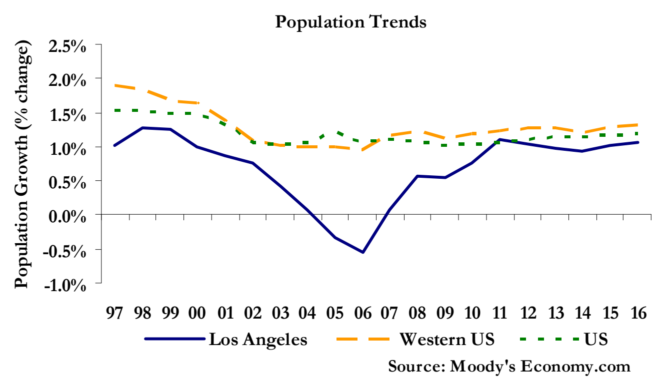
face rising public pension costs at a time when tax increases and other demands have become highly charged political issues.

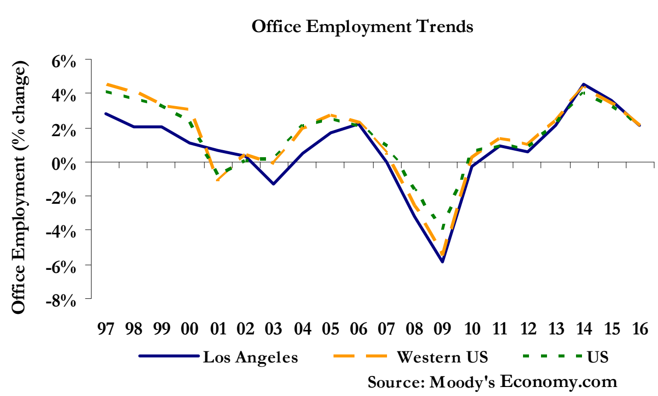


OUTLOOK

Moody's *Economy.com* reports an increase in total employment of nearly 40,000 jobs from 2010 to 2011. Anticipating 39,000 more jobs added in 2012, this source predicts gains of 75,000 in 2013 and over 100,000 in 2014. Population, as noted, will increase, if modestly, in this time span as well.

While the economy works itself out, Los Angeles has managed to still think big. Plans are afoot to revitalize the Los Angeles River's waterfront, which is now essentially a concrete channel that runs through the city. The channel was built to preserve the city from the river's seasonal floods, but has become an eyesore along certain stretches and residents want it improved. Writing in *Planning,* the magazine of the American Planning Association, Christopher Hawthorne, architecture critic of the *Los Angeles Times*, notes the city is "pushing for modest advances toward smart growth without losing sight of the fact that the city in many ways remains tied by a politically powerful sort of nostalgia to its long history as a low-rise, car-friendly, and low-density metropolis."

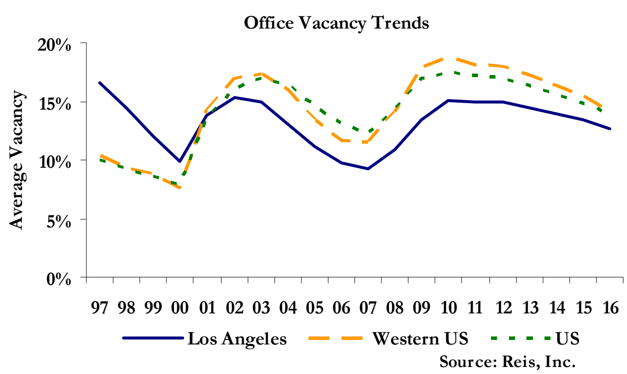




THE REAL ESTATE MARKET

The 196-million-square-foot multi-tenant Los Angeles office market managed to show some improvement in the fourth quarter of 2011, according to Reis data, as net absorption returned to positive territory after a difficult third quarter. Cushman & Wakefield reports the Los Angeles county office market is beginning to show signs of improvement. "Robust leasing activity helped dramatically reduce occupancy losses and stabilize rents," this source noted. Grubb & Ellis notes a "stabilizing trend of improvement in occupancy through the first three quarters of 2011, but the year ended on a downbeat," with a spasm of negative net absorption in the fourth quarter.

OCCUPANCY



Reis reports a fourth quarter 2011 vacancy rate of 14.9%, unchanged for all four quarters of 2011. The 15.1% rate recorded for fourth quarter 2010 remains the cyclical high for the moment; the prior year-end cyclical low had been 9.2% in 2007 (a 15.3% rate had been recorded in 2002). The Class A sector saw a slight increase in the vacancy rate, up 10 basis points over the quarter to 14.6%, but unchanged over the year. Class B space experienced a welcome 20-basis-point drop over the quarter to 15.3%, down 40 basis points year-over-year.

Cushman & Wakefield reports that "overall" vacancy crept up 20 basis points over the year to end 2011 at 18.8%, but dropped from mid-year's height of 19.1%. Grubb & Ellis reports a fourth quarter vacancy of 17.0%, bringing the rate "back up to its historical peak" that was reached in third quarter 2010. Reis predicts the vacancy rate will end 2012 at its current rate and begin a gradual decline in 2013, eventually touching down at 12.7% in 2016. The Los Angeles office vacancy rate is expected to remain considerably lower than the U.S. and West region averages through the duration of the Reis forecast period.

Special Real Estate Factors:

- *"After nearly five years of construction, Charles S. Cohen has announced that the RedBuilding, the 400,000-square-foot office project that completes the iconic West Hollywood Pacific Design Center (PDC) campus, will begin leasing space soon." In an interview with WeHo News (West Hollywood), Cohen, the owner and developer of Pacific Design Center and CEO of Cohen Brothers Realty Corp., "said that his leasing firm would soon be able to entertain serious offers to lease space in the building." "The contractors are installing fixtures to the project, the motor court is being paved, the motor court valet station is being finished, the lighting is going in, the Palm Court is being finished, the landscape is going in," Cohen said.*

- *CurbedLA reports that "the William Morris Endeavor agency has finally settled the legal skirmish over its decision not to move into the big, blue, glassy building that predecessor William Morris commissioned for itself in Beverly Hills." "While MGM made itself at home in Big Blue the last several months, WME was busy appealing an arbitrator's ruling that it was wrong to walk out on developer Comfort. According to the Hollywood Reporter, 'terms of the settlement are not being made public but one source pegged the deal at being in the $30 million range.'"*

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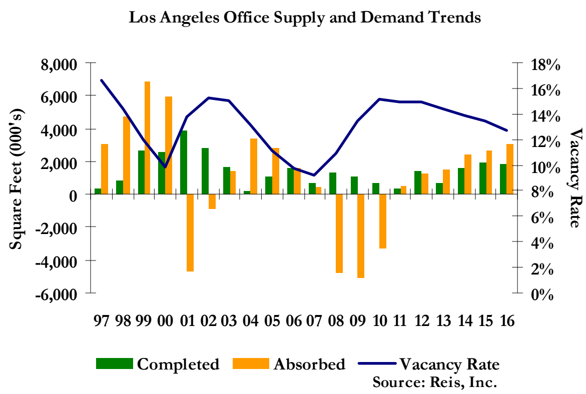
SUPPLY AND DEMAND

Net absorption rebounded in the fourth quarter, according to Reis, which recorded positive 98,000 square feet for the period, after returning 42,000 square feet to the market in the third quarter. Once again, the losses were concentrated in the Class A segment, which posted a reading of minus 83,000 square feet while Class B/C was at plus 179,000 square feet. The annual totals for these property categories were 145,000 square feet for Class A and 371,000 square feet for Class B. The net absorption total for all classes of space for 2011 was 519,000 square feet, quite a change from the 3.3 million square feet of negative absorption that was reported in 2010.



Construction has been limited here, but shows signs of re-birth. Reis reports the fourth quarter addition of 81,000 square feet, increasing the annual total to 309,000 square feet. This is even lower than the 679,000 square feet reported in 2010, but it should be noted that this market entered the economic slowdown with annual completion totals exceeding 1 million square feet in 2008 and 2009, so developers' caution is understandable. Reis, however, predicts 1.4 million square feet of new office space will complete construction in 2012, and, after a slowdown in 2013, a resumption of annual totals clearing the 1-million-square-foot mark. Grubb & Ellis reports 526,000 square feet under construction, mostly in West Los Angeles. Cushman & Wakefield reports a total of 486,112 square feet under construction. Reis forecasts net absorption to go nowhere but up, to 1 million square feet in 2012 and 2013, followed by yearly totals exceeding 2 million, and ultimately 3 million square feet in the years to come. Cushman reports that while "huge improvements in occupancy gains" and leasing activity have helped the office market, it "is far from returning to pre-recession levels. Traditional office space is becoming somewhat obsolete with telecommuting and hoteling, which will add to the challenges of a full-blown recovery." "Over 500,000 square feet of negative net absorption in the fourth quarter brought the year-to-date total into the red with a total negative net absorption of

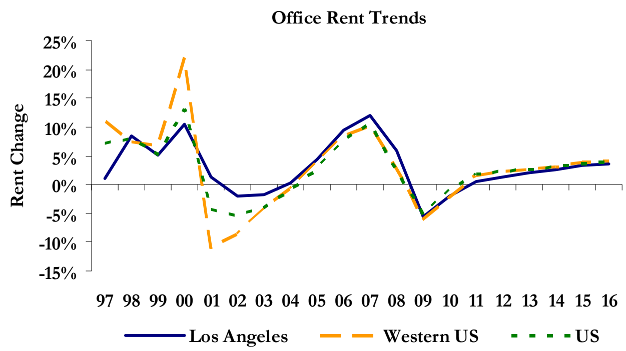
Special Real Estate Factors:
Continued

- *According to Jones Lang LaSalle "vacancy remained stubbornly high at 18.0%" in the fourth quarter. "The wave of 'downsizing' and 'rightsizing' by large corporations seen in Los Angeles over the past three years seems to be waning. Lease renewals continue to characterize much of the leasing activity, but with tenants holding on to their existing footprint rather than just renewing and downsizing," this source notes. "Consequently, the amount of space to come back to the market has dropped dramatically compared to prior years."*

189,272 square feet," Grubb & Ellis reports, citing weak tenant demand going forward.

RENTS

Rents continued their slow but steady increase in the Los Angeles office market in the fourth quarter. The average asking and effective rates increased by 0.2% and 0.3%, respectively, to finish the quarter at $32.09 psf and $26.01 psf. Year-over-year gains are 0.5% and 0.9%. While not impressive, these gains once again represent a recovery, of sorts, from the severe losses of 2009 and 2010. Asking and effective rents are 6.1% and 9.6% lower than the first quarter of 2009, Reis reports. Class A rents finished the year at $37.29 psf, up 0.3% over the year after early losses. Class B rents staged more of a rally, finishing 2012 at $25.63 psf, up 0.7% for the year after also losing ground the first quarter. Grubb & Ellis reports tenants are well-positioned, with "attractive tenants" getting "excellent deals" and less attractive tenants getting "historically good deals at market rents." This source reports fourth quarter 2011 Class A and Class B rents of $34.80 psf and $26.04 psf, respectively, with little increases forecast.



Source: Reis, Inc.

Reis predicts moderate gains of 1.4% asking and 2.2% effective for all of 2012, with more substantial gains to follow. Effective rents are not forecast to break the $29.00 psf mark until 2015. Cushman & Wakefield, reports an overall weighted average of $30.00 psf, including the Central Business District (CBD). For direct weighted average Class A space, this source reports a fourth quarter 2011 rate of $33.48 psf. For the Los Angeles metro excluding the CBD, this source reports a rate of $30.12 psf, down 2.7% over the year. Reis forecasts Los Angeles' rents to more or less keep pace with national rents, after having been a rent leader in years past. For the West region, the forecast is the same, although West region rents may have an edge over Los Angeles going forward.

SUBMARKETS

Los Angeles is one of the nation's largest office markets, with estimates of office stock ranging from 190 to 250 million square feet depending on what types of buildings are included. It is also one of the most decentralized markets in the US, with less than 20.0% of its office stock in Downtown. Other main submarkets of Los Angeles include the Westside, the San Fernando Valley, and the Tri-Cities (Burbank/Glendale/Pasadena).

Westside

Based on their high average asking rents, the Westside submarkets, strung out along Wilshire Boulevard, are Los Angeles County's premier office markets. They add up to 52 million square feet of space, according to Reis.

- The 10.4-million-square-foot Century City submarket has a 12.9% fourth quarter 2011 vacancy rate, Reis reports. The average asking rent is $48.36 psf, remaining the highest among 21 submarkets in Los Angeles County.

- The vacancy rate increased 20 basis points during the quarter on 21,000 square feet of negative net absorption, but is down 60 basis points from a year earlier. The average effective rent rose 0.8% to $42.68 psf during the quarter. The year-to-date increases are 4.1% asking and 4.6% effective.

- In the 11.6-million-square-foot West Los Angeles submarket, Reis reports a fourth quarter vacancy rate of 12.4%, and an average asking rent of $39.75 psf.

- Net absorption finished the year positive at 169,000 square feet, with the biggest gain being posted in the fourth quarter. The vacancy rate fell 140 basis points over the quarter, and 120 over the year.

- The average effective rent increased by 0.3% over the quarter, finishing the year at $32.13 psf. The losses for the year were 2.2% asking and 1.6% effective.

- According to Reis, the 7.7-million-square-foot Santa Monica submarket has a vacancy rate of 10.6%, second lowest among the submarkets, and an average asking rent of $45.77 psf, second highest countywide.

- Santa Monica's vacancy rate fell 40 basis points in the fourth quarter on 31,000 square feet of positive net absorption, and it is down 190 basis points year-over-year. The average asking rent fell 0.5% while the average effective rent fell 0.2% to $36.92 psf. Asking and effective rents fell 0.7% and 0.2% over the year, Reis reports.

- The 7.4-million-square-foot Beverly Hills submarket has the lowest vacancy rate countywide at 9.2%, and the third highest asking rent at $45.75 psf.

- The vacancy rate increased 20 basis points in the fourth quarter despite 59,000 square feet of positive net absorption. The average asking rent and the average effective rent increased 1.1% and 1.4%, respectively, the latter to $37.96 psf. The asking and effective averages are up 1.3% and 2.0% for the year.

- An 80,585-square-foot building at 8767 Wilshire Boulevard completed in November 2011, Reis reports.

- The 14.8-million-square-foot Mid-Wilshire/Miracle Mile/Park Mile submarket has a vacancy rate of 13.3%, and an average asking rent of $27.64 psf, according to Reis.

- The vacancy rate fell 90 basis points during the quarter, and is down 190 from a year earlier. The average asking rent increased 0.3% during the quarter while the average effective rent rose 0.4% to $22.57 psf. The year-to-date gains are 1.8% asking and 2.4% effective.

- The 400,000-square-foot Red-Pacific Design Center is forecast to deliver in February 2012, according to Reis.

- For 50.6 million square feet in Los Angeles West, Cushman & Wakefield reports an overall fourth quarter vacancy rate of 16.3%, unchanged from the previous quarter, and an overall gross rental rate of $38.40 psf, down from one year ago. Net absorption was strongly positive here year-to-date at 443,700 square feet, this source reports.

- "The Los Angeles West submarket gained traction in 2011 as internet-based businesses expanded," Cushman & Wakefield reports. "The search engine company Google moved several hundred of its local employees into its new campus in Venice to join the new wave of internet startups there," this source reports.

Downtown

- For the 36-million-square-foot Downtown submarket, Reis reports a 13.8% vacancy rate, and an average asking rent of $31.21 psf.

- The vacancy rate edged up 20 basis points from the prior quarter as net absorption was negative 212,000 square feet. The average asking rent increased 0.5%, while the average effective rent rose 0.5% to $24.53 psf. The year-to-date gains are 0.7% asking and 1.2% effective.

- Cushman & Wakefield reports an overall fourth quarter vacancy rate of 19.1%, and an overall gross rental rate of $34.56 psf for 27 million square feet in the CBD. Net absorption is given as minus 442,900 square feet for the year.

"Tri-Cities" (Glendale/Burbank/Pasadena)

The Tri-Cities submarkets, home to a concentration of entertainment industry businesses, are collectively home to 21.6 million square feet of multi-tenant office space, according to Reis data.

- In the 6.5-million-square-foot Glendale submarket, Reis reports the vacancy rate at 19.9%, second highest among the submarkets, and the average asking rent at $30.44 psf.

- The vacancy rate increased 10 basis points during the fourth quarter on 6,000 square feet of negative net absorption, extending a negative trend that brought the annual total to negative 90,000 square feet. The average asking and effective rent both declined by 0.1% over the year, the latter to $24.37 psf.

- The 338,000-square-foot second phase of the Grand Central Creative Campus remains under construction for completion in 2012.

- The 7-million-square-foot Burbank submarket has a fourth quarter vacancy rate of 15.9%, and an average asking rent of $33.32 psf, according to Reis.

- The vacancy rate increased 50 basis points from the prior quarter and asking and effective rents were up 0.2% and 0.3%, respectively, with the effective average at $27.99 psf. The vacancy rate is up 20 basis points from a year earlier, with rents down 0.8% to 0.4% over the year.

- For the 8.2-million-square-foot Pasadena submarket, Reis reports a vacancy rate of 14.7%, and an average asking rent of $33.49 psf.

- The vacancy rate increased 20 basis points, while the average effective rent increased by 0.5% to $26.13 psf. The asking average is up 1.3% and the average effective rent is up 1.7% over the year.

- The Tri-Cities submarket finished 2011 with nearly 300,000 square feet of positive net absorption, Cushman & Wakefield reports, a marked contrast to the 803,500 negative square feet sustained in 2010.

- "Burbank only leased 14,714 square feet this quarter but outperformed other submarkets for the year posting 271,617 square feet in positive overall absorption. Pasadena had a strong third quarter with 151 new leases by the end of 2011, which accounts for 49.0% of the leases executed for the TriCities for 2011," Cushman & Wakefield reported.

San Fernando Valley

The San Fernando Valley submarkets sum to 27.5 million square feet of multi-tenant space, according to the Reis database.

- The 14.7-million-square-foot San Fernando Valley West submarket has a fourth quarter vacancy rate of 16.2%, and an average asking rent of $26.22 psf, Reis reports.

- The vacancy rate increased 20 basis points in the fourth quarter, and the asking and effective rent averages edged down 0.6%, the latter to $20.41 psf. The vacancy rate is up 40 basis points over the year, and the asking and effective averages are down 1.6% and 1.4% year-to-date.

- Two small owner-occupied buildings in Agoura Hills totaling 71,800 square feet completed in October and November of 2011, Reis reports.

- In the 9.4-million-square-foot San Fernando Valley Central submarket, the vacancy rate is 13.3%, and the average asking rent is $28.06 psf, according to Reis.

- The vacancy rate decreased 50 basis points during the quarter on 48,000 square feet of positive net absorption. Net absorption for the year was negative 75,000 square feet, however. The asking and effective averages fell 0.2% and rose 0.1% during the quarter, the latter finishing the year at $22.14 psf.

- For the 3.3-million-square-foot San Fernando Valley East submarket, Reis reports a vacancy rate of 11.3%, third lowest among the submarkets, and an average asking rent of $30.83 psf.

- The vacancy rate decreased 80 basis points during the fourth quarter, as both the average asking rent and the average effective rent edged up 0.2%, the latter to $27.32 psf. Asking and effective rents lost ground, falling 0.4% and 0.3%, respectively, over the year.

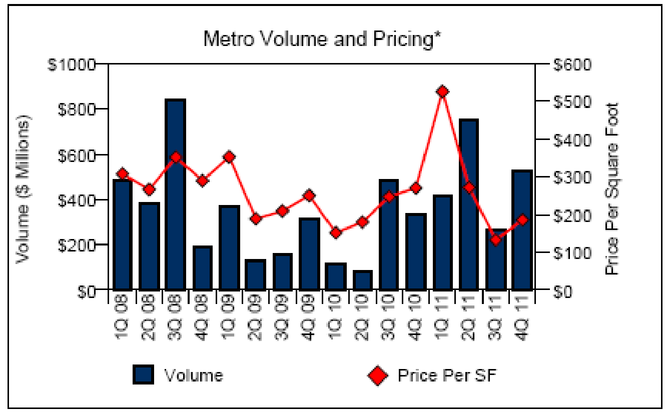
- Cushman & Wakefield reports a vacancy rate of 19.8%, and an overall gross rental rate of $25.92 psf for 30.8 million square feet in its Los Angeles North submarket. Net absorption finished the year positive at 70,500 square feet.

- "Market fundamentals for Los Angeles North remained relatively flat throughout 2011," Cushman & Wakefield reported. This source cites uncertainty in the overall health of the economy "creating only marginal growth for the region."

TRANSACTION ANALYTICS

Metro Volume and Pricing

Single property office investment sales picked up in Los Angeles in the fourth quarter, with 34 deals for $534 million, bringing the annual total for 2011 to 93 deals for a notable $1.97 billion.* This is the second year in a row the market has breached the $1 billion mark, although that mark had been surpassed in 2008, before the recession hit. The mean price for fourth quarter deals was $186 psf, above the third quarter, but still far below the $271 psf average recorded second quarter 2011. In December, the Swig Company sold the Arco Center to Molina HealthCare for $81 million, or $176 psf.



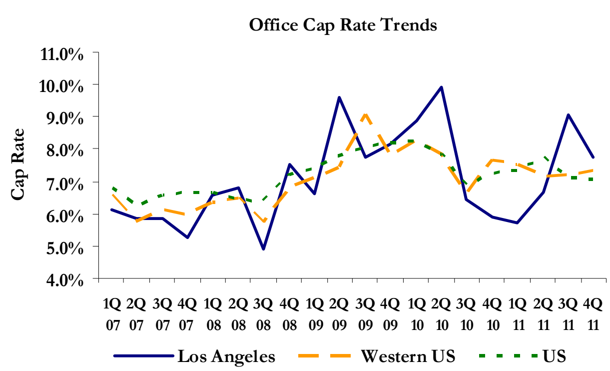
Top Submarkets

Pasadena exceeded downtown Los Angeles for square footage sold in the fourth quarter, although not by much, as the two markets posted 1.3 billion and 1.1 billion square feet sold, respectively. Pasadena also led in Transaction Volume, at $368 million, but the highest priced submarket was LAX/El Segundo, at $438 psf.

Submarket Name	Square Feet Sold	Trans Volume ($ millions)	Price Per SF
Pasadena	1,293,938	$368	$284
LAX/El Segundo	748,418	$328	$438
Downtown	1,035,545	$212	$204
Hollywood/Sunset	639,188	$182	$284
Beverly Hills	455,891	$146	$320
SFV - Central	513,068	$125	$243
Long Beach	679,103	$114	$168

Cap Rate Comparisons and Forecasts

The mean cap rate for fourth quarter sales in Los Angeles was 7.7%, down from the 9.0% rate recorded for the third quarter as deal making picked up pace. The mean cap rate for the year was 7.1%, almost unchanged over the year. The 12-month rolling cap rate of 7.3% is in line with regional and national averages, and is forecast to remain fairly flat over the next few years.



Source: Reis, Inc.

*Reis Transaction Analytics includes single sale transactions, and excludes portfolio sales where pricing of individual buildings cannot be confirmed.

OUTLOOK

Cushman & Wakefield foresees stability in 2012 and a "more measurable recovery in 2013" for the Los Angeles office market. Technology will be a determining factor and those submarkets that can best accommodate burgeoning tech trends will fare better than others. Grubb & Ellis predicts a difficult first half for 2012, with modest improvement beginning later in the year. The source cites "the leveling of available sublease space" in the coming year as a "foundation" for the market's future growth. Reis predicts active building and net absorption for the next few years, with improving rent growth as the modest gains of 2012 eventually give way to more substantial annual gains.