THE ECONOMY

As 2012 draws to a close, the economic news for Los Angeles is just as much on the development front as the economic front. Big projects in both size and scope are getting off the ground. "The Cornfield" is a "660-acre area approximately two miles north of Downtown Los Angeles that abuts the communities of Chinatown, Solano Canyon, Lincoln Heights, and Cypress Park," according to the City Planning Commission. In an editorial that ran January 31st, *The Los Angeles Times* noted that, at long last, the city council's Planning Committee had passed an initial measure called the Cornfield Arroyo Seco Specific Plan. This plan will turn the "neglected neighborhoods and underused industrial properties next to the former Southern Pacific Railroad yard," the editorial states, "into a collection of new urban zones."

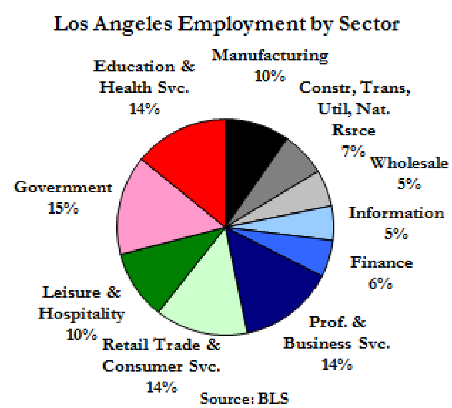
According to city planning documents, "the proposed project will guide the future development" by creating a series of "mixed-use zoning districts that allow private, public, and non-profit sector developers to combined retail, residential, commercial, civic and industrial uses" for a "human scale, engaging urban fabric." *The Los Angeles Times* editorial calls the move "a model for LA planning." The plan will be put before the entire city council for a regular vote in the near future.

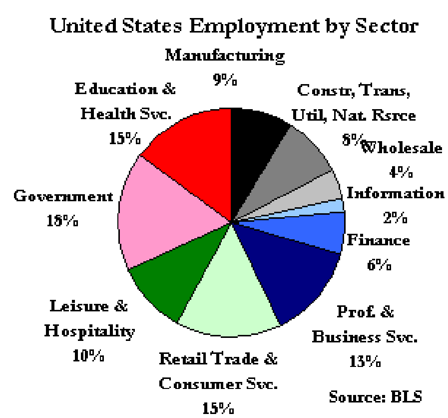
There is more on the development front, even to the extent of changing the Los Angeles skyline, or at least part of. On January 8th, city officials held a groundbreaking ceremony for the beginning of construction on the $1 billion Gerald Desmond Bridge Replacement Project. The Gerald Desmond Bridge connects Terminal Island to Downtown Long Beach and is the major bridge for the port of Long Beach. Originally built in 1968, the current structure is in poor repair and cannot handle its current traffic load, and will be replaced. The construction project will last about five years and will generate, on average, about 3,000 jobs per year, according to information posted on the project's website. The presence of the Ports of Long Beach and Los Angeles means a large Transportation and Warehousing sector, which employs about 139,000. However, this sector has posted an increase of only 400 jobs (0.3%) in the 12 months ending in November 2012, according to Current Employment survey data from the U.S. Bureau of Labor Statistics (BLS). Thus, the development of port facilities is a major issue for this metro.

Jobs are, of course, of prime concern as 2012 winds down and 2013 begins, and the employment news from the U.S. Department of Labor is

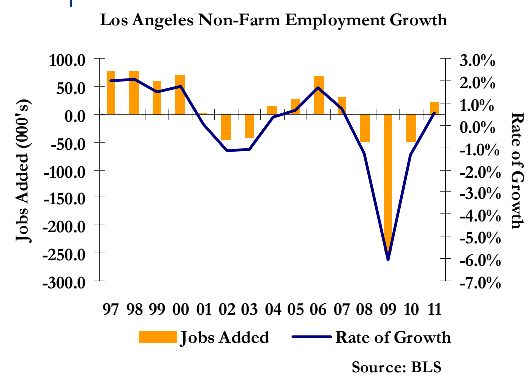
Employment:

- *The BLS reports a seasonally unadjusted unemployment rate of 9.8% in November for the Los Angeles Metropolitan Division, down from 11.6% one year earlier.*
- *Total non-farm employment in Los Angeles was up 1.9% year-over-year in November, according the BLS.*
- *Moody's Economy.com reports a fourth quarter 2012 average household income of $133,474 for Los Angeles. Average household incomes of $125,057 and $127,162 are reported for the top metros in the nation and West region, respectively.*

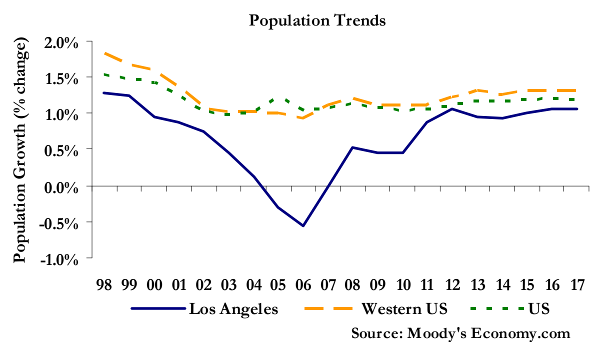




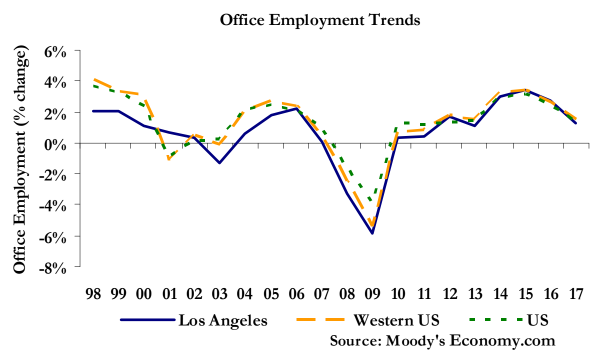
generally positive. For the 12 months ending in November 2012, total non-farm employment in the Los Angeles metropolitan division increased by 72,500 jobs (1.9%). This is not as large as the increase noted in the previous *Reis Observer*, but is an increase nonetheless. Construction increased by 2,100 jobs (2.0%), but Manufacturing continues to struggle here, losing 3,600 jobs (1.0%). Wholesale Trade, another employment sector keyed to port activity, was down 700 jobs (0.3%), while Retail Trade employment increased by 13,700 jobs (3.4%).



Yet again, Long Beach is in the news as the home of a developing street level retail renaissance. The *Los Angeles Business Journal* reported in late January that "a flood of development has poured into the city, much of it in response to an updated, more developer-friendly zoning plan adopted last January," this source reports. "Projects planned or under construction are expected to add up to 1,750 new residences, 533,000 square feet of office space, 400 hotel rooms and 53,200 square feet of retail space as well as a half-million square feet of civic space," according to the *Business Journal*.



As for Los Angeles itself, its employment mainstays were in good shape as the year ended. The ever-critical Motion Picture and Sound Recording Industries, for which Los Angeles is justly renowned, saw a substantial increase of 9,000 jobs (7.0%). Financial Activities, which employs over nearly 220,000, saw an increase of 9,300 jobs (4.4%). Professional and Business Services saw a strong increase of 18,900 jobs (3.5%) while Employment Services grew by 4,800 jobs (5.4%). The substantially government–funded Education and Health Services sector saw employment increase by 11,300 jobs (2.1%). The increase of 20,600 jobs in the Leisure and Hospitality sector indicates that tourism, once slow during the recession, could be making a comeback.



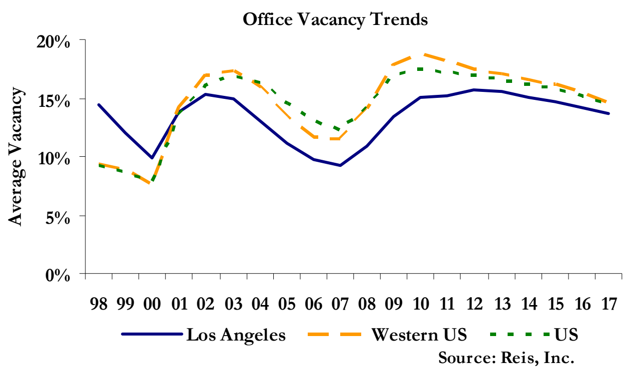
OUTLOOK

Moody's Economy.com reports that Total Employment in Los Angeles increased by 58,100 jobs (1.5%) in 2012 and is on tap to increase by 43,230 jobs (1.1%) in 2013. Office employment rose by 1.7% in 2012, and is estimated to rise by 12,200 jobs in 2013. These are not hefty gains but Los Angeles continues to gain in population (106,000 in 2012, 96,000 expected in 2013) so it is still a metro that attracts businesses and residents.

THE REAL ESTATE MARKET

The 196-million-square–foot Los Angeles general purpose, multi-tenant office market staged a recovery of sorts as 2012 ended. Vacancy remained high, but has not changed much since the beginning of the year. Rents have struggled but finished 2012 on a positive note, but demand remains a problem. Newmark Grubb Knight Frank notes negative net absorption, but adds that the negative trend is "softening."

OCCUPANCY



Reis reports a fourth quarter 2012 vacancy rate of 15.7%, unchanged from the prior quarter. The rate was 15.6% the first quarter, and has changed little since. The rate has not exceeded 20.0% since the early 1990s. This is not the best quality an office market can boast, but if nothing else, the vacancy rate has changed very little the past few years, indicating stability in this market, if nothing else. The Class A rate of 14.9% is up 10 basis points for the quarter and up 10 basis points over 12 months; the Class B/C rate of 16.7% is down 20 basis points over the quarter but up 100 over 12 months.

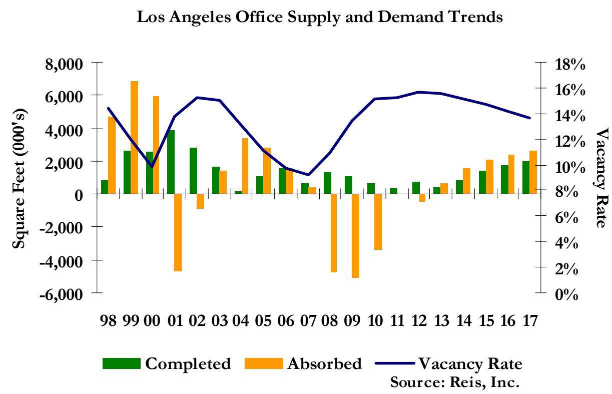
Reporting on the Greater Los Angeles area, Studley, Inc. gives an "overall availability" rate of 19.1%. The rate fell by 20 basis points over the quarter and 40 basis points over the year. The Class A availability rate of 20.3%, according to this source, dropped 40 basis points "on a quarterly comparison" and by 10 basis points annually. "One reason that availability has not fallen significantly is that tenants remain very conscious of real estate expenses, causing renewals to remain prevalent; companies continue to downsize, reducing the square footage they occupy as they renew or even when they relocate." Newmark Grubb Knight Frank reports vacancy increased 10 basis points over the quarter to 16.7%, "but remained 30 basis points below the peak of 17.0% reached in the fourth quarter of 2011." Reis forecasts slight declines in the rate through 2013 and 2014, after which the rate should fall below the 14.0% mark by 2017.

Special Real Estate Factors:

- *Los Angeles has long been a fashion Mecca, but now some people want to make it official. LA Downtown News reported in January that "a Fashion District property owner is in the very early stage of planning a transformation of 10 acres of mostly unused produce warehouses into a $1 billion hub of housing, office space, hotel rooms, and a college campus." This source reported that "the proposal to reinvent the 1909 produce mart known as City Market is in its infancy, project organizers say. It would require an environmental impact report and, at the earliest, an initial phase of the project could break ground in mid-2014, said Peter Fleming, president and CEO of City Market of Los Angeles. The project site comprises the blocks bounded by Ninth, San Pedro, San Julian, and 12th streets. The plan calls for a campus anchored by a college-level institution that focuses on fashion, architecture, design, culinary arts, or another creative industry, Fleming said. It would also include 945 housing units, 210 hotel rooms, 225,000 square feet of retail and 295,000 square feet of creative office space." The plan was first reported by the Los Angeles Times.*

- *New York had Silicon Alley, the West Coast has Silicon Valley, and now Los Angeles has…Silicon Beach? According to LA Observed, "there's no denying the growth of media and technology businesses in Santa Monica, Venice, El Segundo, and Culver*

SUPPLY AND DEMAND



Poor net absorption remains the bane of the Los Angeles office market. Negative quarters alternated with positive performances in 2012, although the negative side won out in the end. After nearly 800,000 square feet on the negative side was recorded in the first quarter, second quarter followed with positive 211,000, third quarter with negative 517,000, and fourth quarter followed with positive 636,000 square feet. The total for the year was negative 466,000 square feet. Continuing a pattern noted in prior reports, net absorption remains weighted towards better space. For 2012, Class A space registered 544,000 square feet of positive demand, while Class B/C space saw negative 1,010,000 square feet. For the five years ending in 2012, net absorption totaled negative 13.7 million square feet, averaging negative 2.7 million square feet per year. Market inventory has remained stable, but demand could not gain the upper hand.

As noted in the introduction, Newmark Grubb Knight Frank reports that the negative demand trend is diminishing, posting negative 43,864 in the fourth quarter, for a 2012 total of negative 913,246 square feet. This source notes "weak tenant demand from traditional professional services occupiers" downtown leading to increased vacancy there, while the Tri-Cities saw a stronger quarter with move-ins from Green Dot Corp. and others. According to Studley Inc., "the office market has been moving sideways." This source notes that "strong demand for office space has been concentrated in very limited areas that have a high concentration of tech, media and creative-sector tenant—the Westside and Santa Monica (Silicon Beach) in particular." Reis reports the completion of two multi-tenant office projects in 2012: the Red-Pacific Design Center, at 400,000 square feet, which completed in December in the Mid-Wilshire submarket, and the Grand Central Creative Campus, at 338,000 square feet, which completed in November in the Glendale submarket. Looking forward, Reis' latest construction data lists eight projects under construction for completion in 2013, totaling 437,560 square feet. From

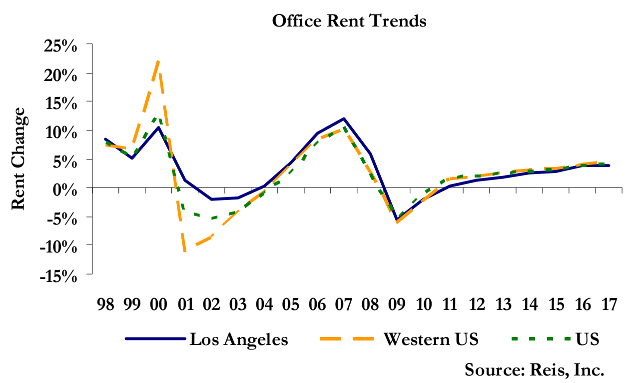
Continued

City. A rough-but-telling barometer of economic impact is westbound traffic along the 10 during morning rush hours. Many of these commuters are working at software houses, Web designers, ad agencies, and videogame publishers. It's part of the digital melding that's taking place before our eyes." That observation was made by a reporter for KPCC, who also took his observations to airwaves in early February, noting that "Tech and media companies head to the Southland." "All these media and technology companies form the basis of what's being called Silicon Beach. And besides rush-hour traffic, the activity is also reflected in the office market. The vacancy rate in Santa Monica was running at 11.0%—that's compared with 18.0% for downtown L.A. Asking rents in Santa Monica are way more expensive, as well. That assumes you can find what you need—businesses wanting to expand there have found it hard to find large amounts of office space, especially the creative type space that these companies say they need," according to this source.

- *"The Los Angeles County office market finished 2012 on a strong note," Cushman & Wakefield reported in the fourth quarter. "Occupancy gains, decreased vacancy, and robust leasing activity marked the highly-anticipated end of a long downhill slide. While each submarket faced challenges, the turning point has arrived. Overall vacancy decreased 0.4 percentage points year-over-year to 18.4%, the first meaningful decrease since 2006,* 2012 to 2017, new construction will add 7.1 million square feet, while net absorption is forecast to finally outstrip it at 9.0 million, Reis forecasts.

RENTS

The year 2012 was a quiet one for rents. The average asking rent and the average effective rent increased 0.9% and 1.0%, respectively, in the fourth quarter, to $32.53 psf and $26.40 psf. The asking and effective averages are up 1.4% and 1.5% from 12 months earlier. The Class A asking average of $37.84 psf, is up 1.0% for the quarter and 1.5% over 12 months. The Class B/C asking average is up 0.7% for the quarter and 1.0% over 12 months to $25.89 psf. These are not large gains, but look good in comparison to some of the changes this market has experienced. Gains were basically flat in 2011, posting minimal increases (below 1.0%) for both the asking and effective rates. Heavy losses were incurred in 2009 and somewhat lighter declines in 2010. All in all, the current asking rent is 5.6% lower than that recorded at year-end 2008, and the current effective rent fell 9.9% in that time span. Any gains over the 1.0% mark, for both rental categories no less, is therefore indicative of a possible turnaround, but certainly not quite a rally.



According to Studley, Inc., "overall asking rent in Greater Los Angeles, $28.79 psf, grew by 0.3% from last quarter and by 0.9% from last year. Class A asking rent, $30.29 psf, increased by 0.5% quarter-over-quarter and by 1.1% year-over-year." This source expects little change in market trends during 2013, but notes that "larger tech, media and creative-sector companies with particular requirements for space in the high-demand Westside submarkets may encounter higher rents and tightening concessions, but most tenants, particularly creditworthy tenant willing to commit to space, will be able to negotiate below-market rates and generous concessions." According to Newmark Grubb Knight Frank, asking rents in Los Angeles were "inching away from the bottom at a very slow pace with virtually no change over the previous quarter" at $31.08 psf by Reis' reckoning. "In hot submarkets like Santa Monica and

Special Real Estate Factors:
Continued

when vacancy began ballooning." "Asking rental rates, which did not erode as much as in previous recessions, increased in some submarkets where vacancy tightened," according to this source. "This activity resulted in the first annual increase in direct rent since 2008, a year-over-year 0.4% increase to $2.51 psf/per month." This translates to $30.12 psf by Reis' reckoning. "Rents decreased a total of 11.9% since the start of the recession." "The challenges of 2012, weak job growth, the election, and the cliff, hindered the office market, but it still managed to begin recovery," Cushman & Wakefield asserted. "Los Angeles is always a mixed bag of performance among submarkets and the anemic job growth thwarted a significant turnaround, but the next twelve months should yield stronger market fundamentals."

Hollywood/West Hollywood the increases in average asking rent is driven by demand for Class A space." Reis forecast annual gains of around 2.0% in 2013, with larger annual gains to follow, reaching 3.8% asking and 4.7% effective in 2017.

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% 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 to 52 million square feet of space, according to Reis.

- The 10.4-million-square-foot Century City submarket has a 13.0% fourth quarter 2012 vacancy rate, Reis reports. The average asking rent is $48.25 psf, the highest among 21 submarkets in Los Angeles County.

- The vacancy rate fell 10 basis points during the quarter and is up 10 basis points from one year earlier. The average asking rent rose 0.4% during the quarter, as did the average effective rent. These rates are down 0.2% and 0.3%, respectively, over 12 months.

- In the 11.6-million-square-foot West LA submarket, Reis reports a fourth quarter vacancy rate of 14.1%, and an average asking rent of $40.04 psf.

- The vacancy rate rose 20 basis points during the quarter on 23,000 square feet of negative net absorption, and is 170 basis points higher than one year earlier. The average asking rent and the average effective rent dipped 0.2% and 0.3% during the quarter, the latter to $32.39 psf. The year-over-year gains are 0.7% and 0.8%.

- According to Reis, the 7.7-million-square-foot Santa Monica submarket has a vacancy rate of 10.0%, second lowest among the submarkets, and an average asking rent of $47.14 psf, second highest.

- Santa Monica's vacancy rate rose 40 basis points in the fourth quarter on 31,000 square feet of negative net absorption, but it is down 60 basis points year-over-year. The average asking rent rose 1.1% and the average effective rent increased 0.9% during the quarter, the latter to $37.99 psf. The increases over 12 months are 3.0% and 2.9%, respectively.

- The 7.4-million-square-foot Beverly Hills submarket has the lowest vacancy rate countywide at 7.8%, with an asking rent of $46.55 psf.

- The vacancy rate fell 90 basis points in the fourth quarter on 67,000 square feet of positive net absorption. It is down 140 basis points from one year earlier. In the fourth quarter the average asking and the average effective rent decreased 0.2%, the latter to $38.72 psf. The asking and effective averages are up 1.7% and 2.0% year-over-year.

- The 15.1-million-square-foot Mid-Wilshire/Miracle Mile/Park Mile submarket has a vacancy rate of 14.0%, and an average asking rent of $28.52 psf, according to Reis.

- The 400,000-square-foot Red Pacific Design Center completed construction, as noted in the *Supply and Demand* section of this report, but the vacancy rate fell 60 basis points during the quarter on 427,000 square feet of positive net absorption. It is still up 70 basis points from a year earlier. Reis predicts a 13.7% vacancy rate here at year-end 2013.

- The average asking rent increased 1.7%, the effective rent was up 2.1%, to $23.32 psf. The year-over-year gains are 3.2% and 3.3%, respectively.

- For 56 million square feet in Los Angeles West, Colliers reports a total vacancy rate of 15.9%, up from 15.2% in the third quarter. "Direct weighted average asking rental rates increased to $3.31 psf ($39.72 psf) from $3.30 psf ($39.60 psf)." This source reports that vacancy increased on the delivery of 481,600 square feet of vacant space.

- Net absorption in West Los Angeles was 417,000 square feet in 2012, compared with 725,700 square feet in 2011, according to Colliers.

Downtown

- For the 36-million-square-foot Downtown submarket, Reis reports a 15.1% vacancy rate and an average asking rent of $31.93 psf. There was 54,000 square feet of positive net absorption in the fourth quarter, but the year's total was negative 465,000 square feet, after a poor showing in the first quarter.

- The average effective rent, at $25.20 psf, is up 3.2% over the quarter. The asking average is up 2.8%. Asking and effective rents are up 2.4% and 2.8%, respectively, over the year.

- "In the fourth quarter of 2012, total vacancy in the Central Los Angeles office market increased 30 basis points over the last quarter to 19.3%. In the Downtown office submarket, total vacancy increased 50 basis points over the last quarter to 19.0%. Demand for space in the Hollywood submarket was strong as total vacancy continued to decrease to 9.3% at year-end," according to Colliers.

- "Direct weighted average asking rental rates remained flat at $2.44 psf ($29.28 psf by Reis' reckoning)." "Net absorption in the fourth quarter was minus 130,200 square feet primarily due to Downtown (negative 178,200 square feet). On a year-to-date basis net absorption in the Central Los Angeles office market in 2012 was negative 562,700 square feet with negative 433,500 square feet deriving from Downtown LA. The Central LA market continues to be challenged by space givebacks," according to Colliers.

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

The Tri-Cities submarkets, home to a concentration of entertainment industry businesses, are collectively home to 21.9 million square feet of multi-tenant office space, according to Reis data.

- In the 6.8-million-square-foot Glendale submarket, Reis reports the vacancy rate at 20.0%, and the average asking rent at $30.14 psf.

- The vacancy rate fell 70 basis points during the fourth quarter but is up 10 basis points from a year earlier. The average asking rent rose 0.9% during the quarter, the average effective rent rose 1.1% to $24.37 psf. Asking rents fell 0.1% over 12 months while effective rents were unchanged.

- The 338,000-square-foot Grand Central Creative Campus completed in November, as noted in the *Supply and Demand section*. Reis predicts positive net absorption here in 2013 and 2014, although vacancy will decline only slightly. Asking and effective rents are forecast to grow by 0.9% and 1.4% in 2013, Reis reports.

- The 7.0-million-square-foot Burbank submarket has a fourth quarter vacancy rate of 13.8%, and an average asking rent of $33.36 psf, according to Reis.

- The vacancy rate fell 60 basis points from the prior quarter and the average asking rent fell 0.1%, and the average effective rent was unchanged at $28.03 psf. The vacancy rate is down 210 basis points from one year earlier.

- For the 8.2-million-square-foot Pasadena submarket, Reis reports a vacancy rate of 13.7%, and an average asking rent of $33.77 psf.

- The vacancy rate was down 70 basis points from the prior quarter on 53,000 square feet of positive net absorption. Asking and effective rents rose 0.6% during the quarter, the latter to $26.35 psf. These rates are up 0.8% over 12 months.

- According to Colliers, "in the fourth quarter of 2012, total vacancy in the Tri-Cities office market decreased for the sixth consecutive quarter to 16.0%." This source reports that the area office market saw positive 249,900 square feet of net absorption in the fourth quarter which brought total net absorption for all of 2012 to positive 352,400 square feet. "In 2012, the Tri-Cities office market benefited from the growth of entertainment, technology, engineering, and financial services companies. This demand for space resulted in a decrease in office vacancy by 160 basis points from just a year ago," Colliers reported.

- "Direct weighted average asking rental rates remained flat at $2.64 psf ($31.68 psf according to Reis). Leasing activity in Class A space in Pasadena and Burbank has been strong, thus landlords in those submarkets are beginning to increase asking rents," Colliers 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 $26.79 psf, Reis reports.

- The vacancy rate rose 110 basis points in the fourth quarter on 162,000 square feet of negative net absorption, but is unchanged from a year earlier. The average asking rent and the effective rent were both up 1.1% over the quarter, the latter at $20.92 psf. The year-over-year increases are 2.2% asking and 2.5% effective.

- In the 9.4-million-square-foot San Fernando Valley Central submarket, the vacancy rate is 12.8% and the average asking rent is $28.20 psf, according to Reis. The vacancy rate decreased 20 basis points during the quarter and is down 50 from a year earlier. The asking and effective averages increased 0.4% during the quarter with the effective average at $22.25 psf. Asking and effective rents are up 0.5% from a year earlier.

- For the 3.3-million-square-foot San Fernando Valley East submarket, Reis reports a vacancy rate of 16.8%, and an average asking rent of $31.10 psf. The vacancy rate increased 220 basis points during the fourth quarter, as asking and effective rents increased 0.3% and 0.2%, respectively. The latter is reported at $27.53 psf. Asking and effective rents are up 0.9% and 0.8% over 12 months.

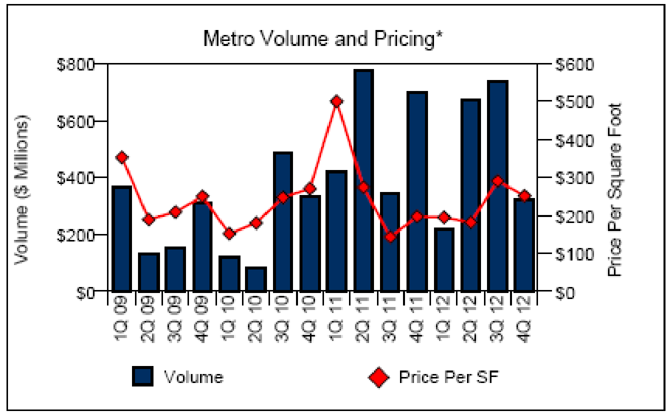
- In the fourth quarter of 2012, total vacancy in the San Fernando Valley & Ventura County office market decreased to 19.6%. Net absorption was positive 75,200 square feet in the fourth quarter, according to Colliers, and 311,700 square feet for all of 2012. This source reports a weighted average asking rental rate of $25.92 psf.

- "Landlords are witnessing an improvement in market fundamentals; however, available space remains heightened. Until the amount of available space decreases substantially rental rates are not expected to shift much from $2.16 psf. A single industry is not expected to dominate the performance of the market, thus an improvement in the general economy should slowly provide business confidence and allow tenants to seek space in the market," according to Colliers.

TRANSACTION ANALYTICS

Metro Volume and Pricing

Los Angeles single property office investment sales had an active fourth quarter in 2012. Reis reports 20 qualifying deals for $320 million at a mean price of $251 psf.* For all of 2012, there were 116 transactions totaling $1.95 billion at a mean price of $226 psf. The mean sales price was $16.8 million. In October, Reis reports the $80 million sale ($667 psf) of a 120,0000-square-foot office property on North Crescent Drive in Beverly Hills. The seller was Clarity Realty Partners LLC, the buyer was Clarion Partners. Also in October, Tribeca Plaza, at 150,000 square feet, sold for $73 million ($487 psf). The seller was Ocean West Capital Partners, the buyer was Kilroy Realty Corp.



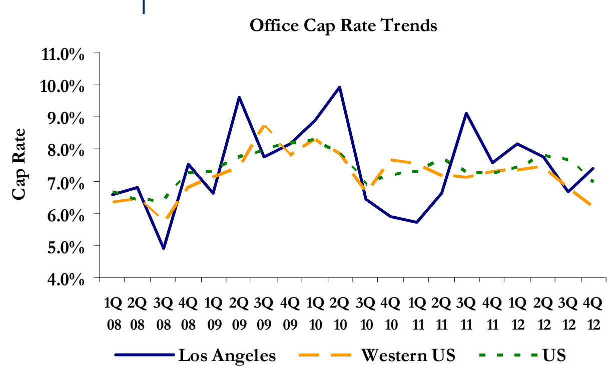
Top Submarkets

Downtown was ahead of all the submarkets in square feet sold in 2012, at 2.2 million, and in transaction volume, at $495 million. The mean price here is low at $222 psf. The highest price among submarkets with a large volume of sales was in the Santa Monica submarket, at $526 psf, followed by Mid-Wilshire at $417 psf.

Submarket Name	Square Feet Sold	Trans Volume ($ millions)	Price Per SF
Downtown	2,231,768	$495	$222
West LA	588,217	$228	$387
Beverly Hills	395,661	$162	$410
Santa Monica	277,144	$146	$526
Glendale	396,167	$120	$303
Hollywood/Sunset	411,856	$113	$274
Mid-Wilshire	259,843	$108	$417

Cap Rate Comparisons and Forecasts

The mean cap rate for fourth quarter sales in Los Angeles is 7.8%, up 110 basis points from the prior quarter. The mean cap rate reached 8.1% in the first quarter of 2012 and 9.1% in third quarter 2011. The fourth quarter rate is up 20 basis points from the one recorded 12 months earlier. The 12-month rolling cap rate, at 7.5%, is down 20 basis points over the quarter but up 20 basis points year-over-year. It is forecast to rise to 7.6% by year-end 2013 and then gradually fall to 6.9% by 2017.



Source: Reis, Inc.

OUTLOOK

With modest rental gains in the works, the Los Angeles office market is in a holding pattern until an economic recovery truly takes hold. Office using employment is up, although not enough, just yet, to make serious inroads into the volume of vacant stock. Vacancy is high, but has not changed much recently, giving landlords a measure of stability. "Little change is expected in trends in 2013," Studley, Inc. notes, as businesses and consumers observe an unsteady political situation at the end of 2012 and the beginning of 2013.