

# The Commercial Office Market

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JANUARY 2016 – BY ROB RADER





# Rob Rader

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Broker / Operator, focusing on Orange County office space

2014 – Present: Wind Water Realty, Director

2004 – 2014: Senior Vice President / Principal / Board Member at Lee & Associates – Irvine.

University of Southern California, Economics



# David Black-Vice President Investments

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1993-Present Marcus & Millichap,  
Focused on sales of Office and Medical  
Building LA/OC

1982-1992 Publisher, Black's Office  
Leasing Guide for LA/OC

Marcus & Millichap

# David Black-Recent Closings



Marcus & Millichap



# Overview

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1. Trends
2. Markets
3. Product
4. Replacement Cost
5. Comparable Sales
6. Income Approach
7. Forecast
8. Questions

# Trends

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Web presence is more important than a physical presence.

Mobility and lifestyle has reshaped the way office is used.

Now 150 to 200 SF per employee vs. 250 SF

Landlords are dealing with a significant increase in construction costs.

New development is coming on line and few opportunities for value-add left.



# Orange County Snapshot

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Over 1.2 million square feet of positive net absorption.

Under 10% Vacancy Rate (Landlord's Market)

Asking Rents are above \$2.20 PSF, FSG (10% higher YOY)

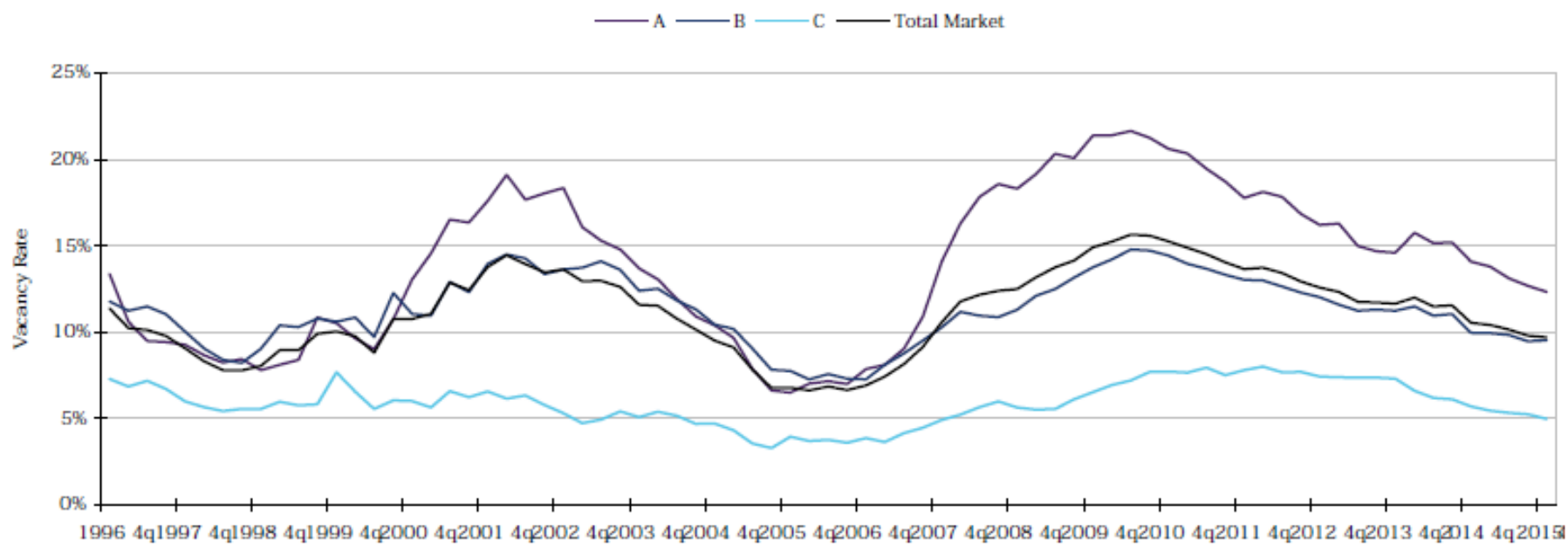
Technology based companies are driving the expansion

Sale Activity is Up

Unemployment is below National and State Levels (4.4%)

Subleasing and Distressed Property Sales are Negligible

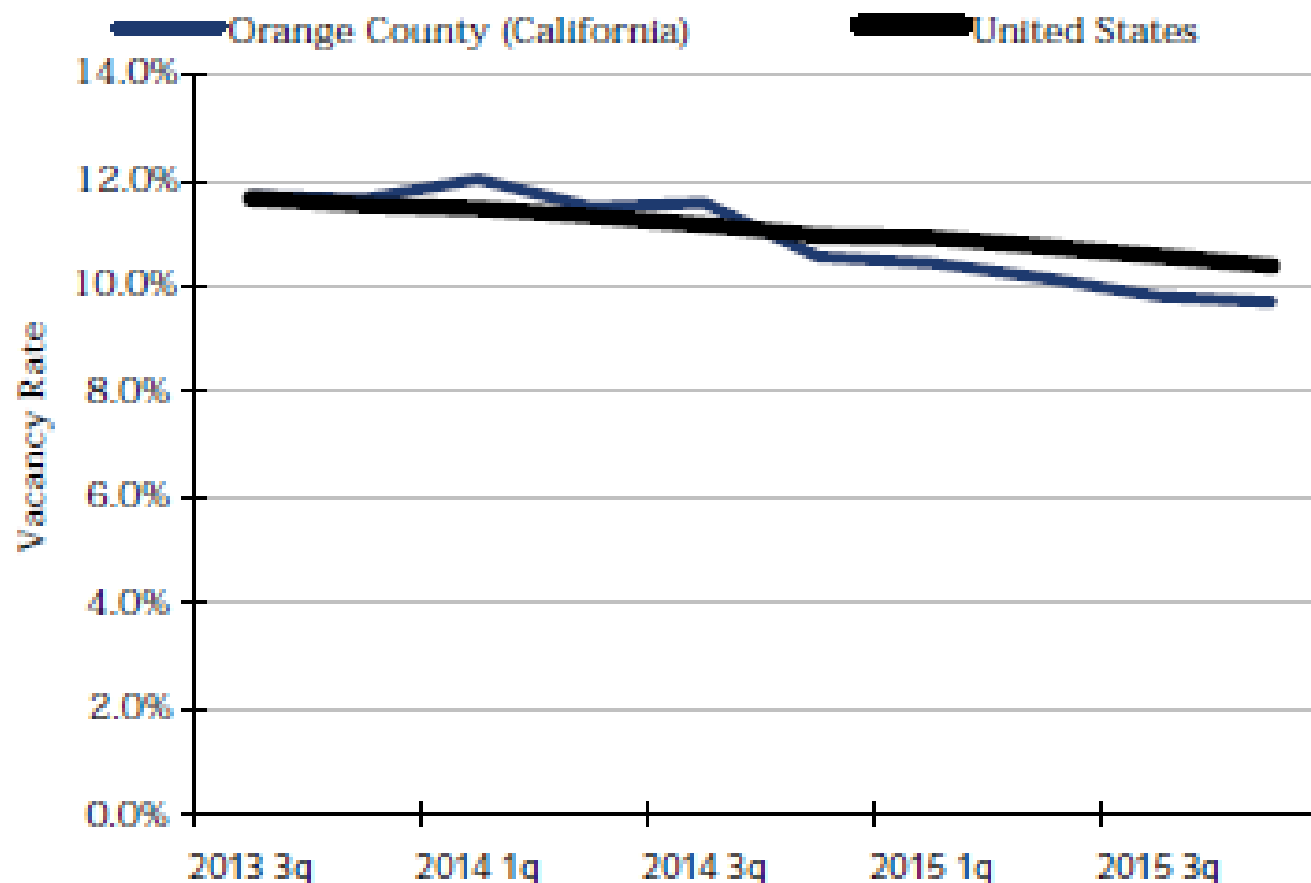
## Vacancy Rates by Class 1996-2015



Source: CoStar Property®

# U.S. Vacancy Comparison

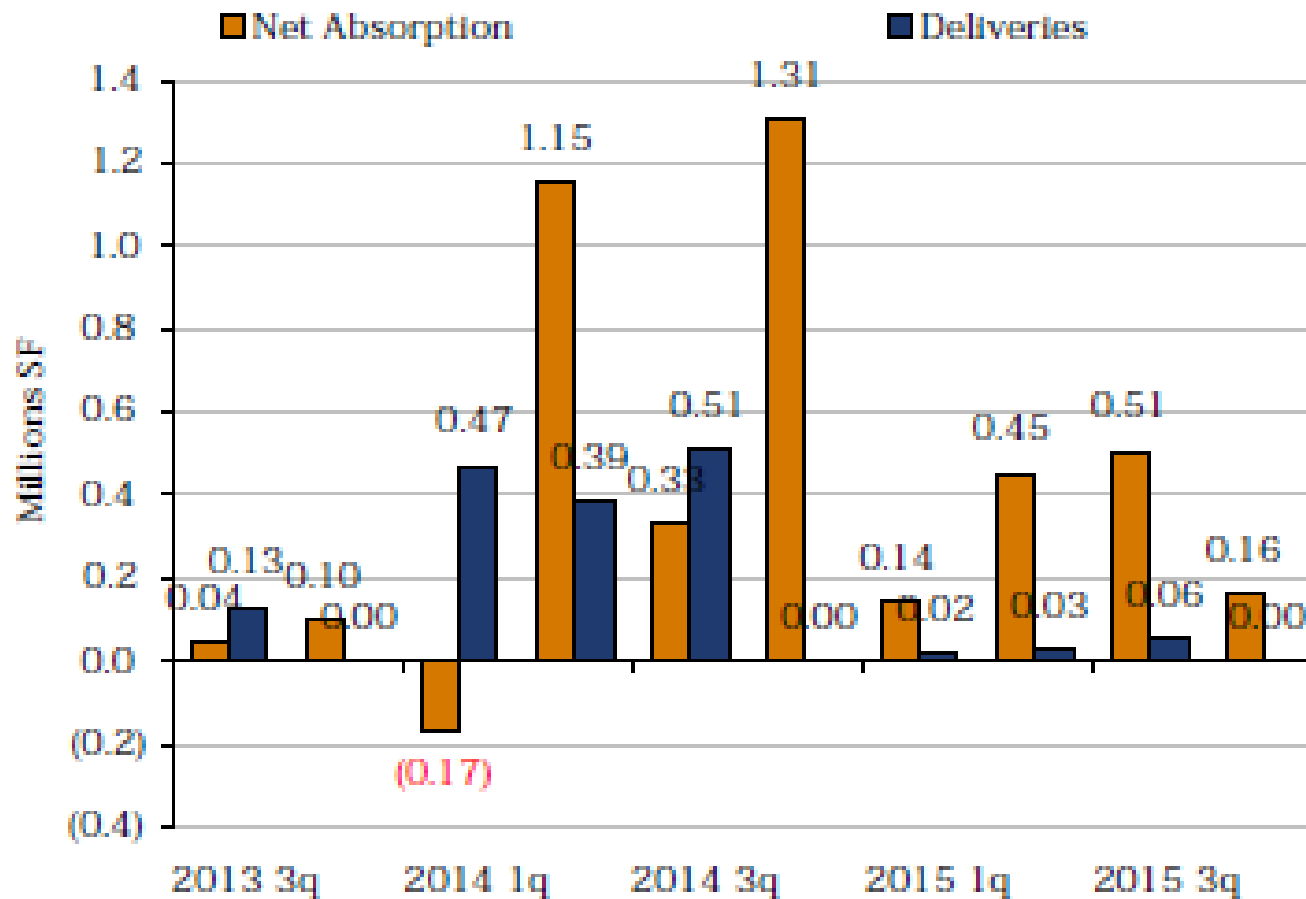
Past 10 Quarters



Source: CoStar Property®

# Absorption & Deliveries

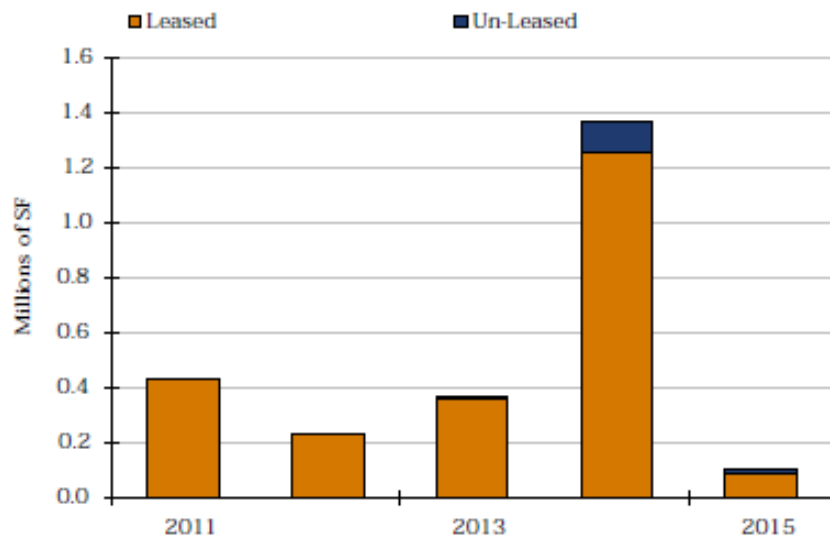
Past 10 Quarters



Source: CoStar Property®

## Recent Deliveries

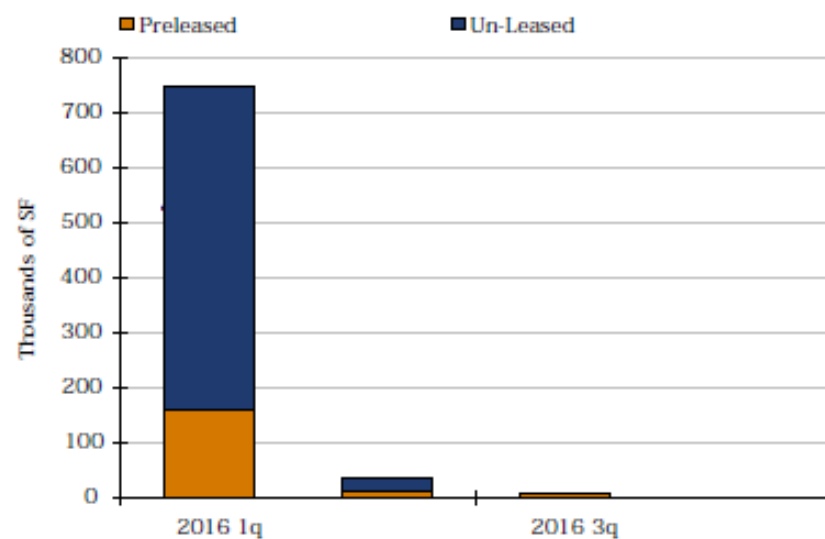
Leased & Un-Leased SF in Deliveries Since 2011



Source: CoStar Property®

## Future Deliveries

Preleased & Un-Leased SF in Properties Scheduled to Deliver



Source: CoStar Property®

## Class A Market Statistics

Year-End 2015

Period	Existing Inventory		Vacancy			Net Absorption	Deliveries		UC Inventory		Quoted Rates
	# Blds	Total RBA	Direct SF	Total SF	Vac %		# Blds	Total RBA	# Blds	Total RBA	
2015 4q	280	45,114,813	5,232,981	5,566,145	12.3%	157,986	0	0	8	1,604,587	\$30.26
2015 3q	280	45,114,813	5,369,492	5,724,131	12.7%	231,451	1	42,551	7	1,597,387	\$29.53
2015 2q	279	45,072,262	5,581,767	5,913,031	13.1%	315,461	0	0	3	539,938	\$29.16
2015 1q	279	45,072,262	5,998,442	6,228,492	13.8%	125,506	0	0	3	539,938	\$28.32
2014 4q	279	45,072,262	6,081,002	6,353,998	14.1%	504,514	0	0	3	539,938	\$27.94
2014 3q	279	45,072,262	6,660,515	6,858,512	15.2%	346,036	2	434,761	2	114,894	\$27.41
2014 2q	277	44,637,501	6,561,182	6,769,787	15.2%	583,915	1	380,000	4	549,655	\$26.52
2014 1q	276	44,257,501	6,720,415	6,973,702	15.8%	(504,975)	0	0	4	887,104	\$26.04
2013	276	44,257,501	6,254,796	6,468,727	14.6%	712,176	0	0	4	887,104	\$25.52
2012	276	44,257,501	6,986,988	7,180,903	16.2%	759,694	1	81,600	1	380,000	\$25.33
2011	275	44,175,901	7,567,998	7,858,997	17.8%	1,253,743	0	0	2	461,600	\$25.33
2010	275	44,175,901	8,652,583	9,112,740	20.6%	333,827	0	0	0	0	\$25.59
2009	275	44,175,901	8,708,484	9,446,567	21.4%	(1,288,052)	1	82,596	0	0	\$27.99
2008	274	44,093,305	7,353,147	8,075,919	18.3%	(857,285)	9	1,174,716	1	82,596	\$32.16
2007	265	42,918,589	5,343,959	6,043,918	14.1%	(727,928)	9	2,105,979	9	1,174,716	\$35.71
2006	256	40,812,610	2,372,976	3,210,011	7.9%	(89,057)	3	493,359	11	2,573,950	\$34.16

Source: CoStar Property®

## Class B Market Statistics

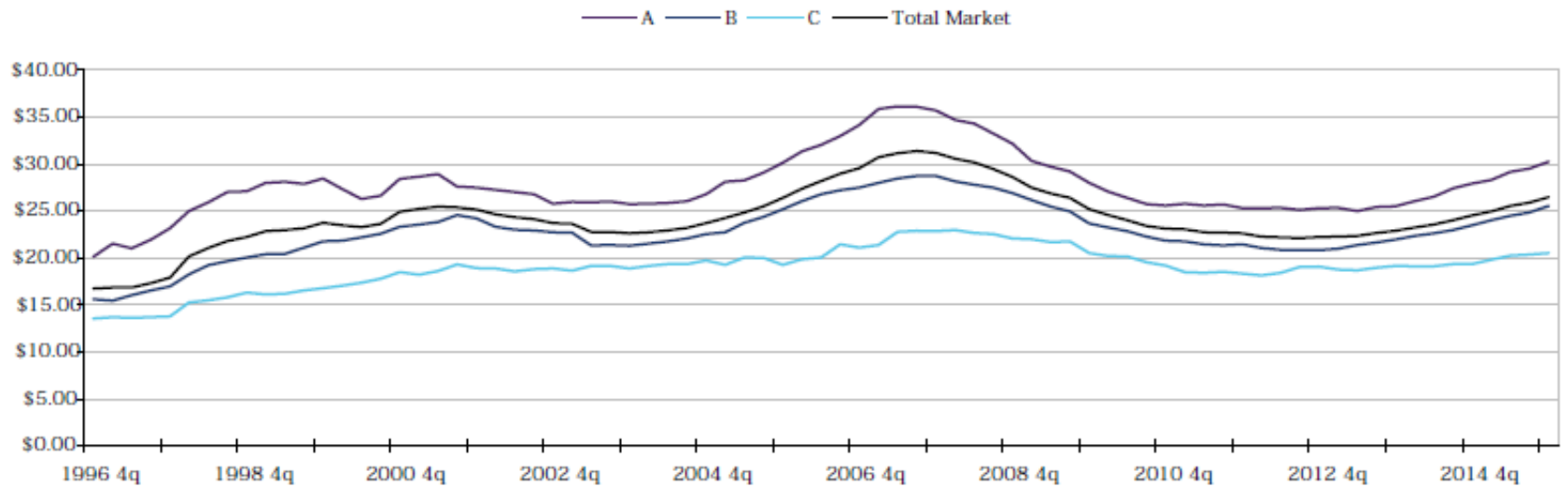
Year-End 2015

Period	Existing Inventory		Vacancy			Net Absorption	Deliveries		UC Inventory		Quoted Rates
	# Blds	Total RBA	Direct SF	Total SF	Vac %		# Blds	Total RBA	# Blds	Total RBA	
2015 4q	2,970	85,735,292	7,968,897	8,185,417	9.5%	(53,597)	0	0	8	286,565	\$25.54
2015 3q	2,970	85,735,292	7,756,090	8,131,820	9.5%	279,893	2	13,080	6	255,865	\$24.85
2015 2q	2,970	85,765,078	8,177,321	8,441,499	9.8%	112,562	2	27,767	6	259,945	\$24.50
2015 1q	2,968	85,737,311	8,216,042	8,526,294	9.9%	(31,824)	1	16,000	4	132,132	\$24.03
2014 4q	2,969	85,792,423	8,305,956	8,549,582	10.0%	710,635	0	0	4	51,267	\$23.49
2014 3q	2,976	86,060,858	9,294,321	9,528,652	11.1%	(31,466)	3	76,200	4	51,267	\$22.97
2014 2q	2,973	85,984,658	9,142,880	9,420,986	11.0%	480,128	1	7,671	6	121,011	\$22.64
2014 1q	2,972	85,976,987	9,720,385	9,893,443	11.5%	182,510	1	469,000	7	128,682	\$22.36
2013	2,972	85,531,877	9,512,319	9,630,843	11.3%	607,890	8	364,012	7	576,371	\$21.97
2012	2,966	85,604,085	10,035,890	10,310,941	12.0%	962,499	5	140,744	11	848,183	\$20.84
2011	2,962	85,481,354	10,942,963	11,150,709	13.0%	1,418,978	9	431,003	5	336,348	\$21.45
2010	2,955	85,233,742	12,109,408	12,322,075	14.5%	(476,716)	6	141,409	8	501,564	\$21.83
2009	2,950	85,109,333	11,295,481	11,720,950	13.8%	(1,667,269)	17	496,425	6	173,026	\$23.68
2008	2,934	84,624,028	8,922,901	9,568,376	11.3%	52,321	58	1,014,469	18	574,835	\$26.89
2007	2,876	83,609,559	7,806,001	8,606,228	10.3%	201,676	140	3,074,929	59	1,113,309	\$28.73
2006	2,738	80,677,067	5,188,481	5,875,412	7.3%	1,508,969	73	1,238,004	172	3,360,931	\$27.48

Sources: CoStar Property®

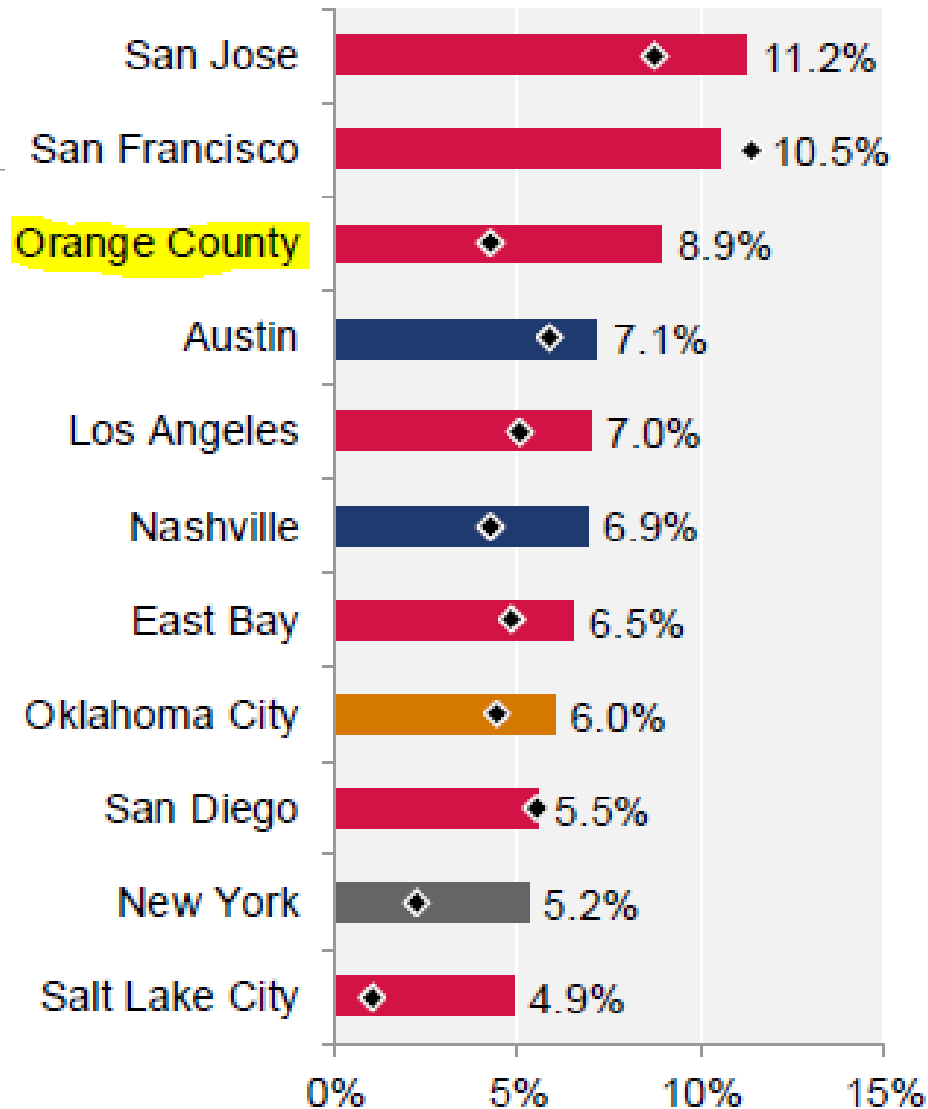
# Historical Rental Rates

Based on Full-Service Equivalent Rental Rates



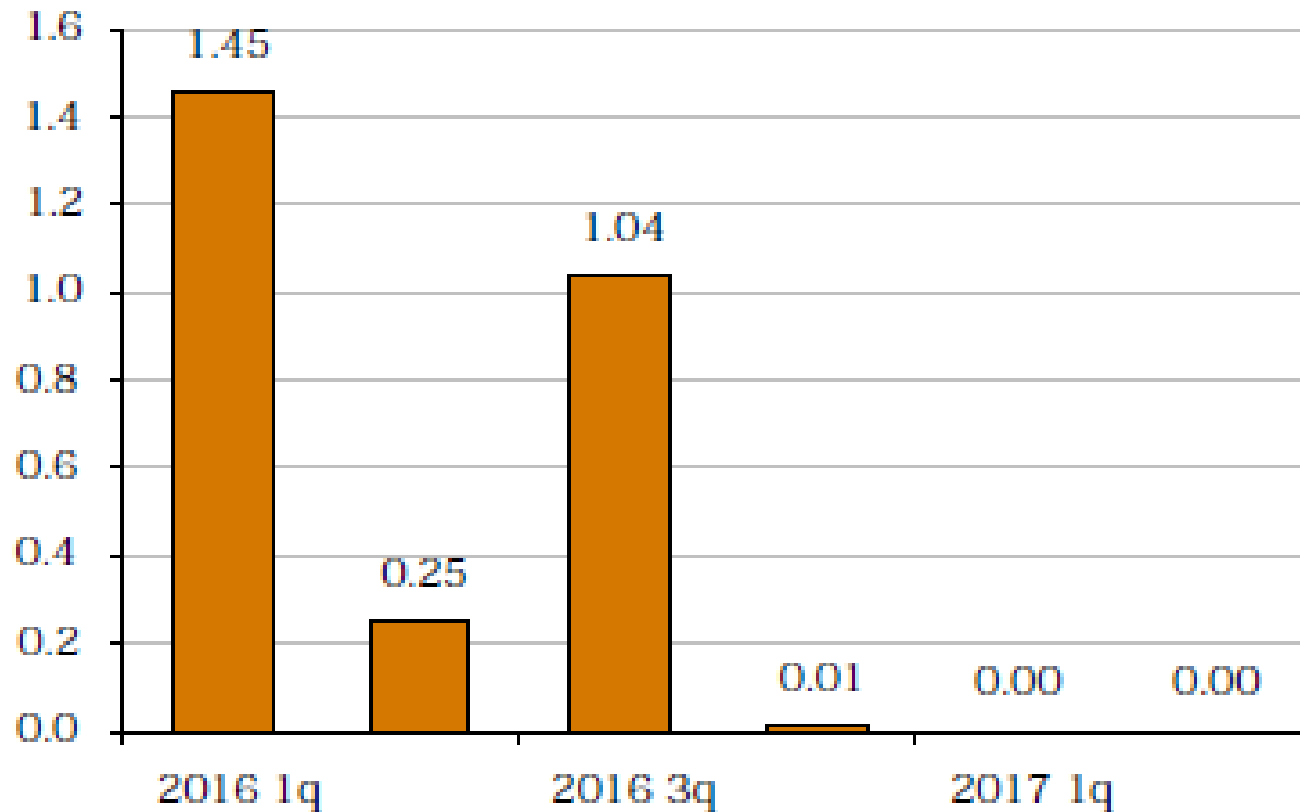
Source: CoStar Property®

## Suburban



# Future Space Available

Space Scheduled to be Available for Occupancy\*

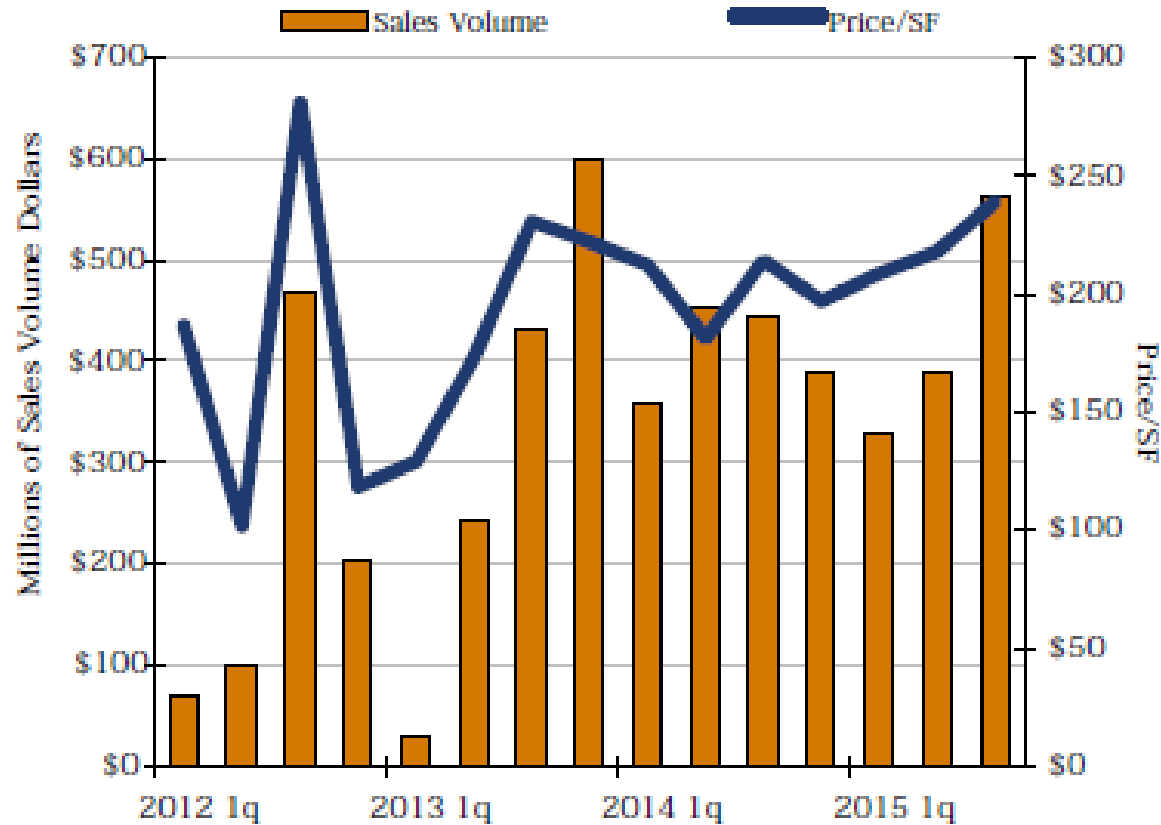


\* Includes Under Construction Spaces

Source: CoStar Property®

# Sales Volume & Price

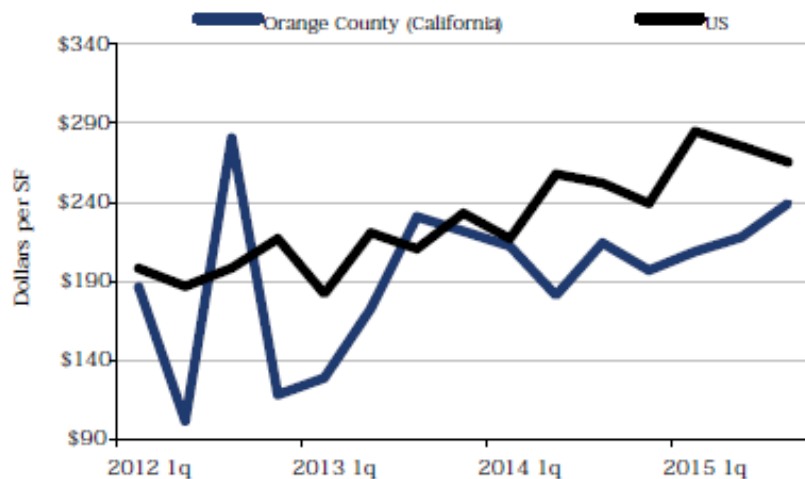
Based on Office Building Sales of 15,000 SF and Larger



Source: CoStar COMPS®

## U.S. Price/SF Comparison

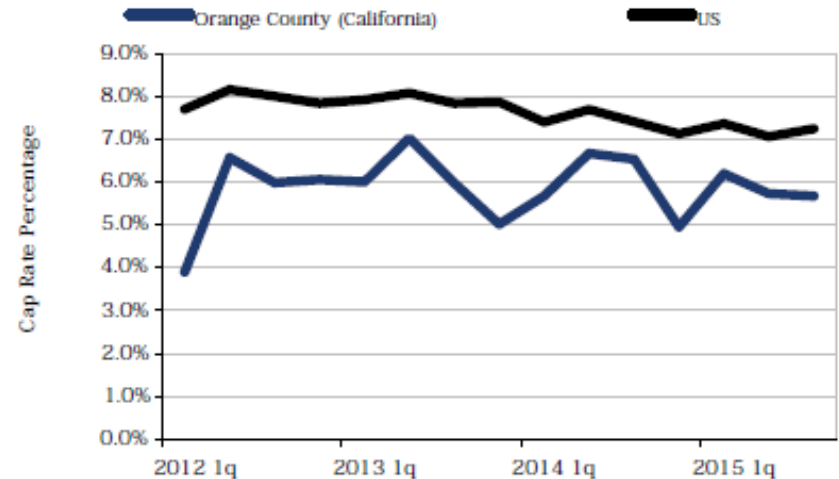
Based on Office Building Sales of 15,000 SF and Larger



Source: CoStar COMPS®

## U.S. Cap Rate Comparison

Based on Office Building Sales of 15,000 SF and Larger



Source: CoStar COMPS®



# Los Angeles Snapshot

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Over 3 Million Square Feet of Positive Absorption

Vacancy is under 13%

Construction has been focused more on Redevelopment

Lease Rates Over \$2.50 PSF, FSG / Nearing the Peak Levels of 2008

West LA is at almost \$4.00 PSF, FSG

8.0% Unemployment is lower but still above Macro Levels

Subleasing and Distressed Property Sales are Negligible

# Class A Product

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Investment-grade

Modern Mechanical Systems

Highly Desirable Location, Finishes and Layouts

Command the Highest Rent or Sale Prices

“Creative” space has made its own classification.

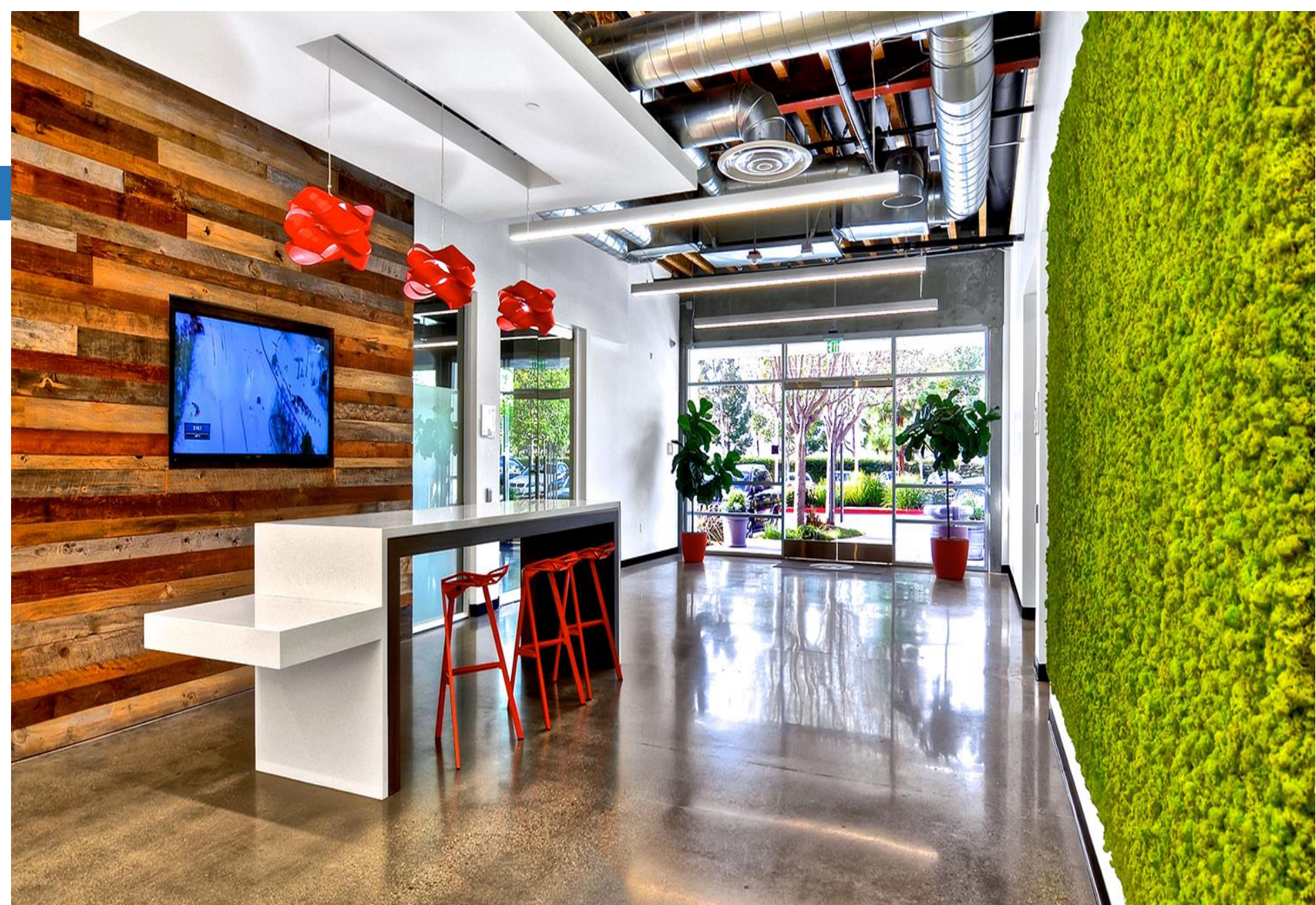
# Class A Product

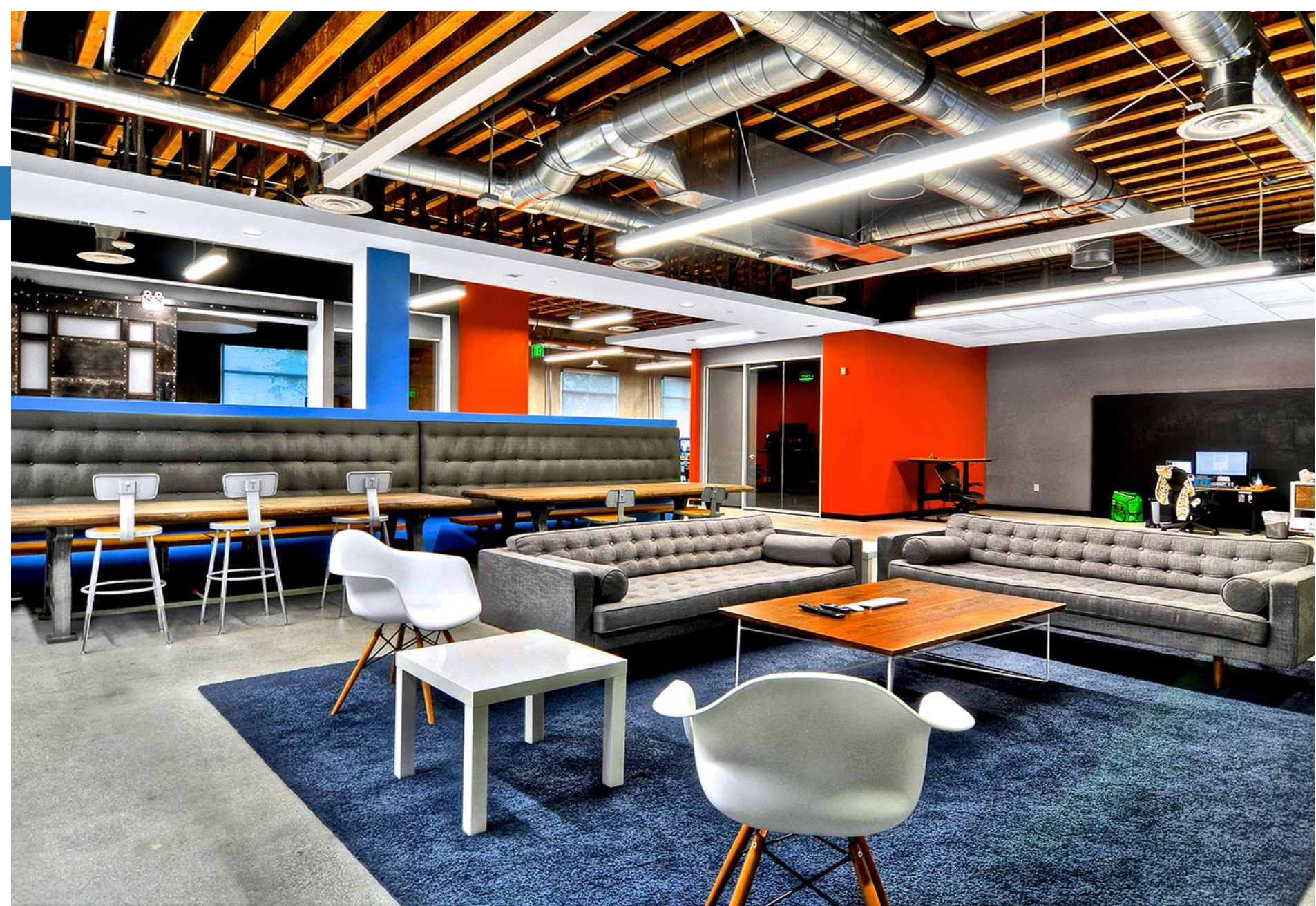
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# “Creative” Space













# Class B Product

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More Speculative Investment

Depend on lower rents or sale prices to attract tenants or buyers

Utilitarian space

Ordinary design

Average to good maintenance

# Class B Product

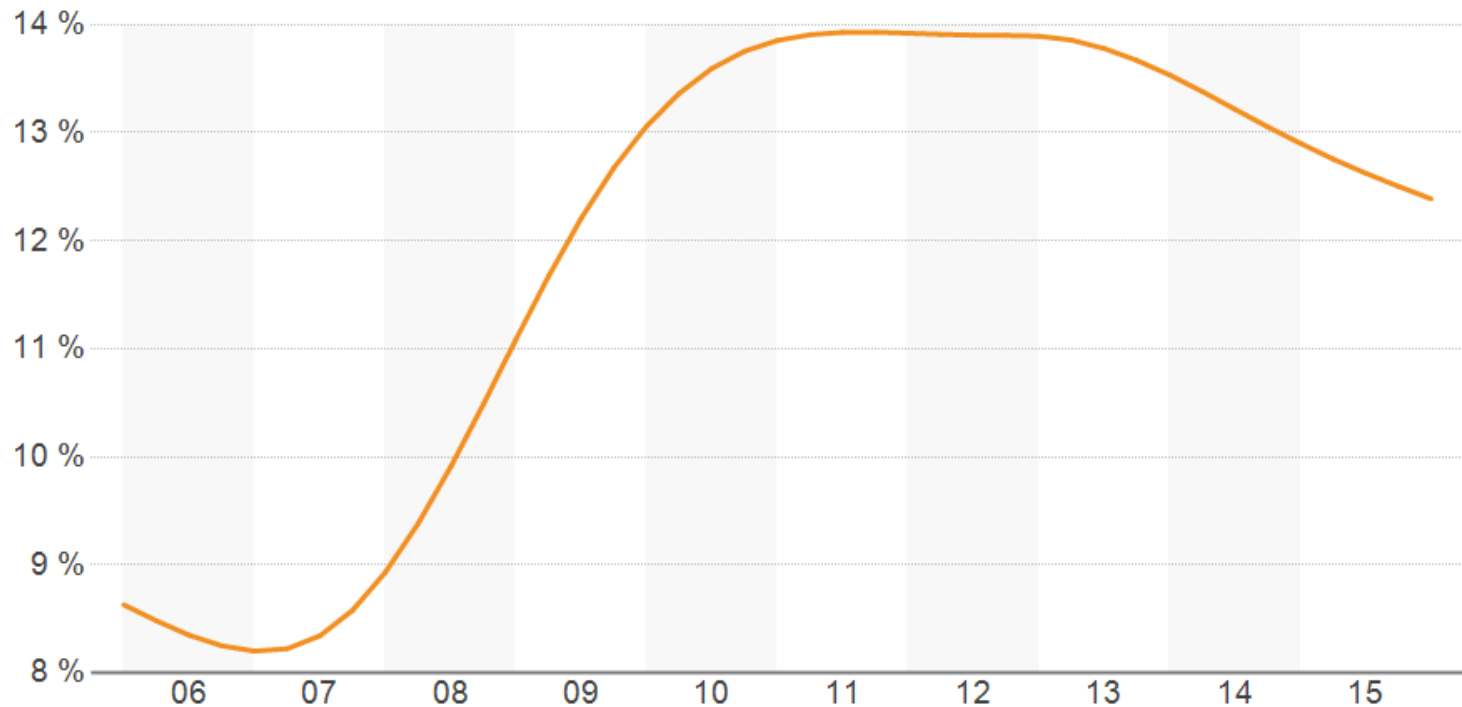


# LA County Office By Cluster

Market	Total SF	Vacancy	% Vacancy	Asking Rent
Antelope Valley	714,888	205,710	28.8%	\$1.92
Burbank/Glendale/Pasadena	22,925,488	3,434,059	15.0%	\$2.71
Downtown Los Angeles	45,551,125	7,146,750	15.7%	\$3.02
Mid-Cities	2,381,537	366,499	15.4%	\$2.12
Mid-Wilshire	21,049,762	4,137,479	19.7%	\$2.92
San Fernando Valley	19,154,183	2,877,747	15.0%	\$2.25
San Gabriel Valley	9,025,669	2,025,283	22.4%	\$2.09
Santa Clarita Valley	2,048,955	441,842	21.6%	\$2.41
South Bay	27,569,006	6,215,267	22.5%	\$2.16
Southeast Los Angeles	2,463,483	380,677	15.5%	\$1.92
Ventura South	3,741,040	606,998	16.2%	\$2.27
West Los Angeles	<u>43,519,956</u>	<u>4,805,566</u>	<u>11.0%</u>	<u>\$4.19</u>
	200,145,092	32,643,877	16.3%	\$2.50

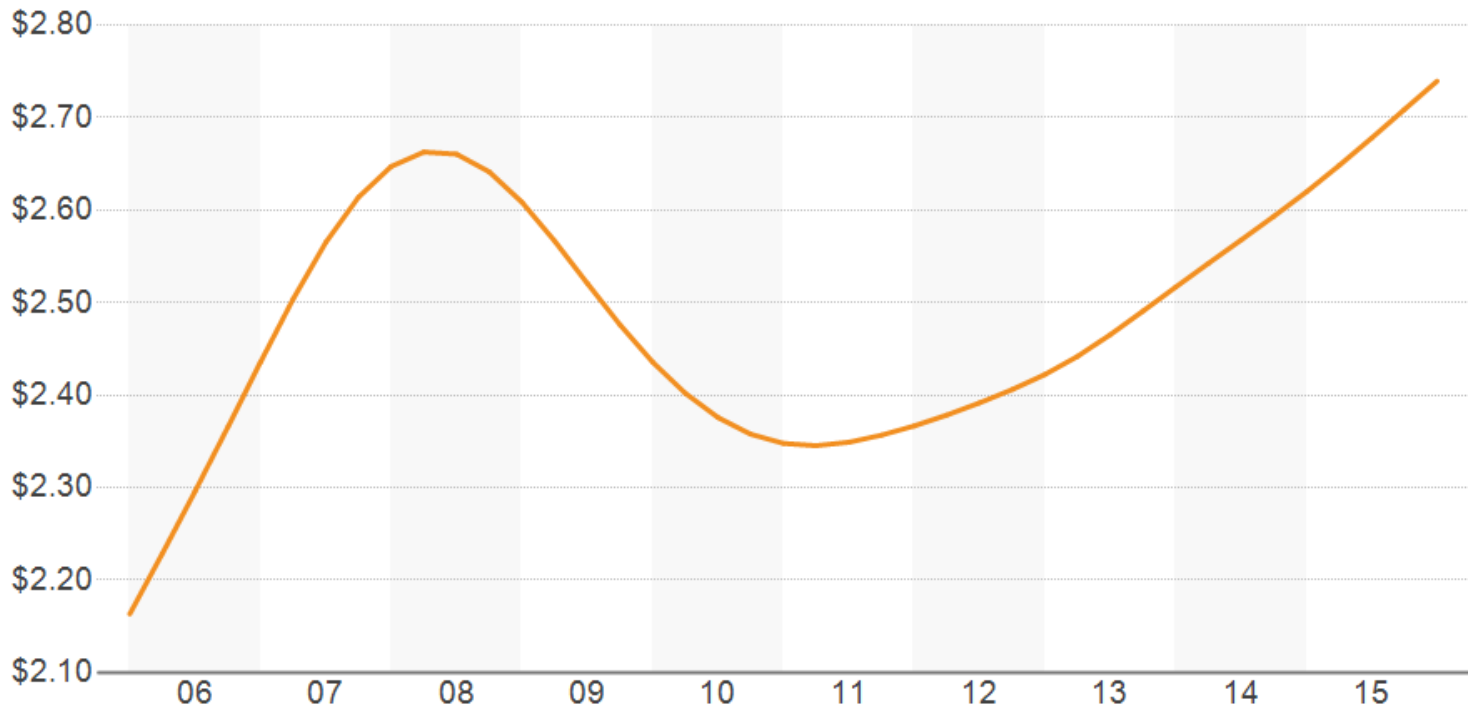
Marcus & Millichap

# LA County Office-Vacancy



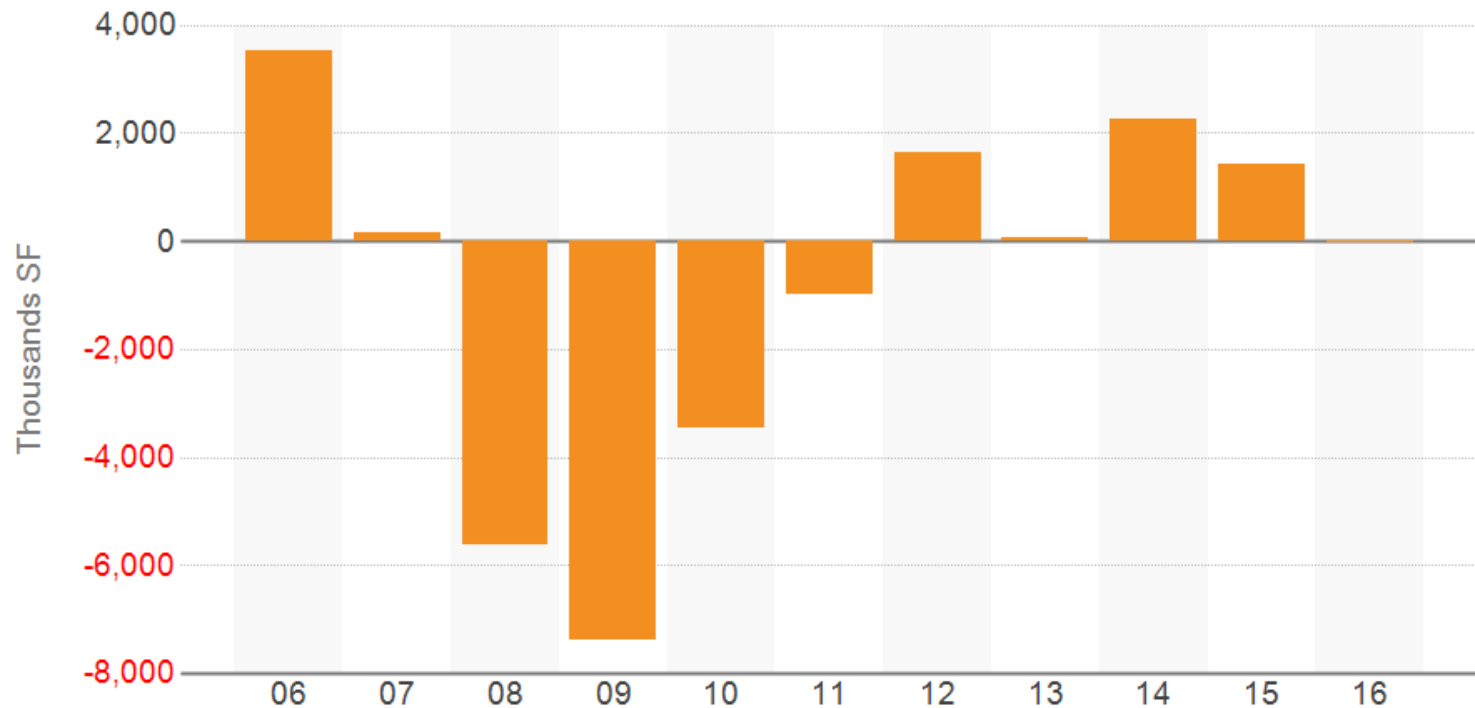
Marcus & Millichap

# LA County Office-Asking Rents



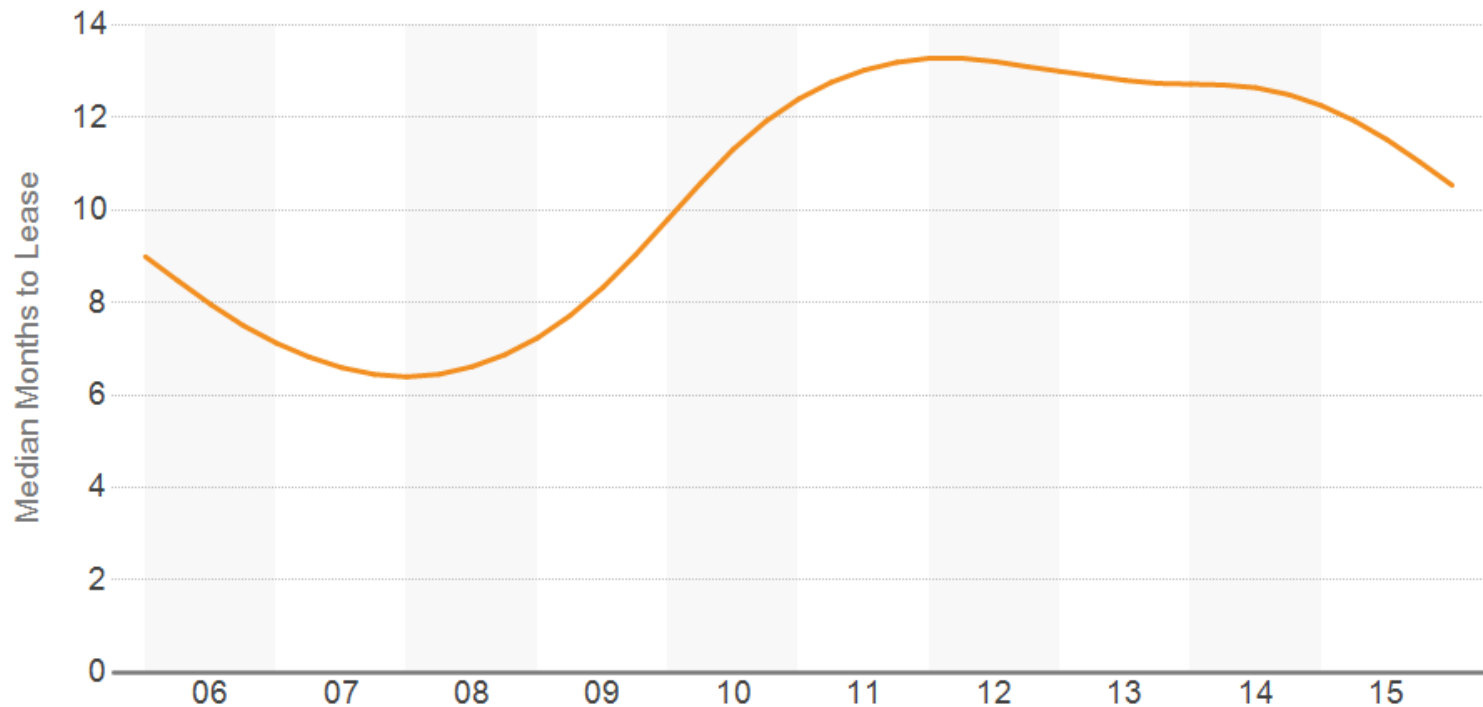
Marcus & Millichap

# LA County Office Absorption



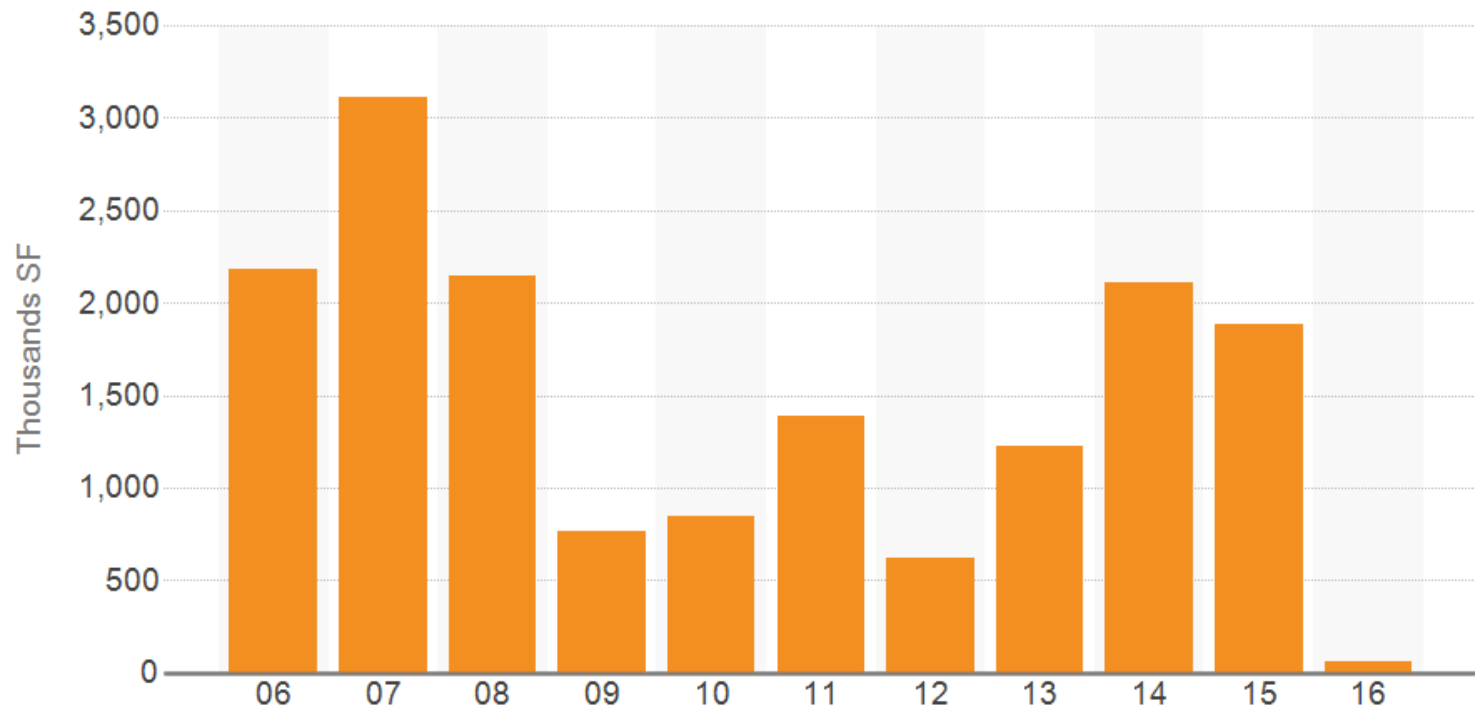
Marcus & Millichap

# LA County Office-Months To Lease



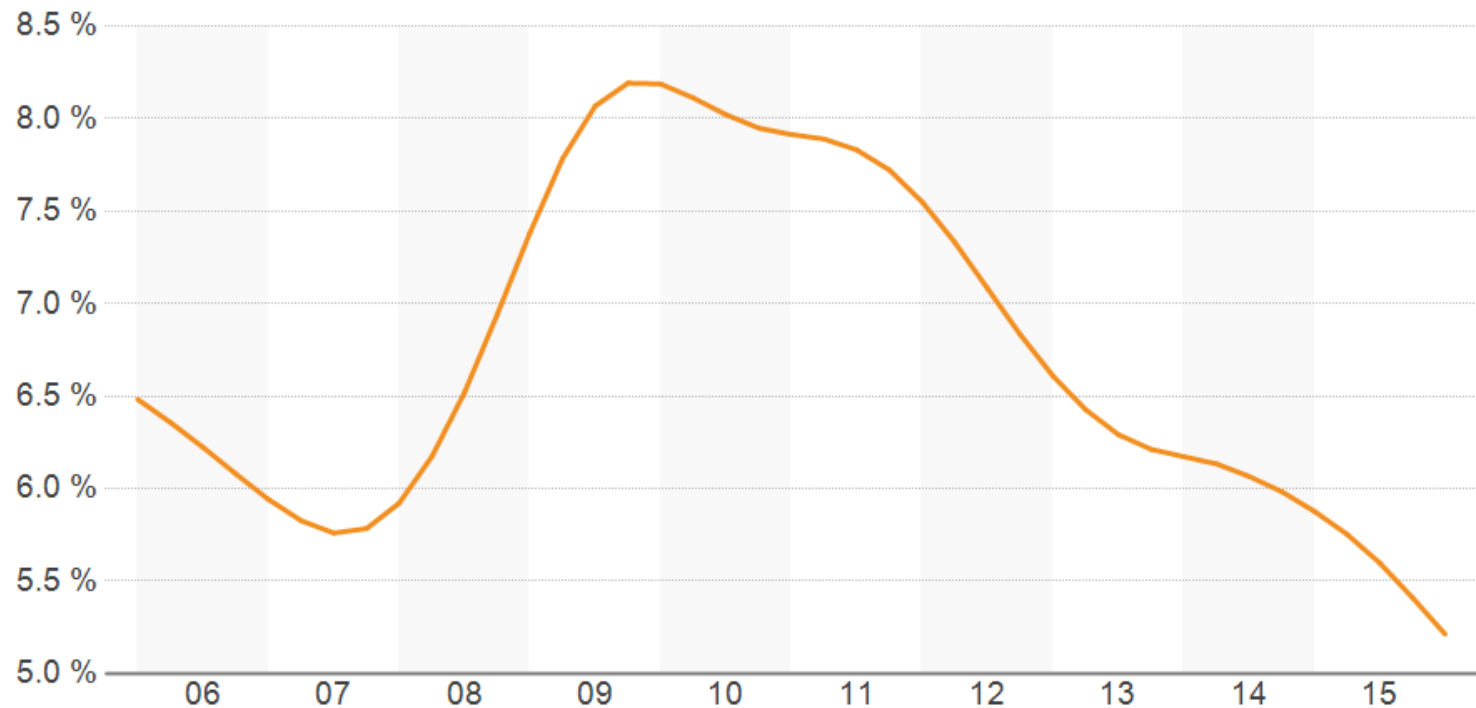
Marcus & Millichap

# LA County Construction Starts



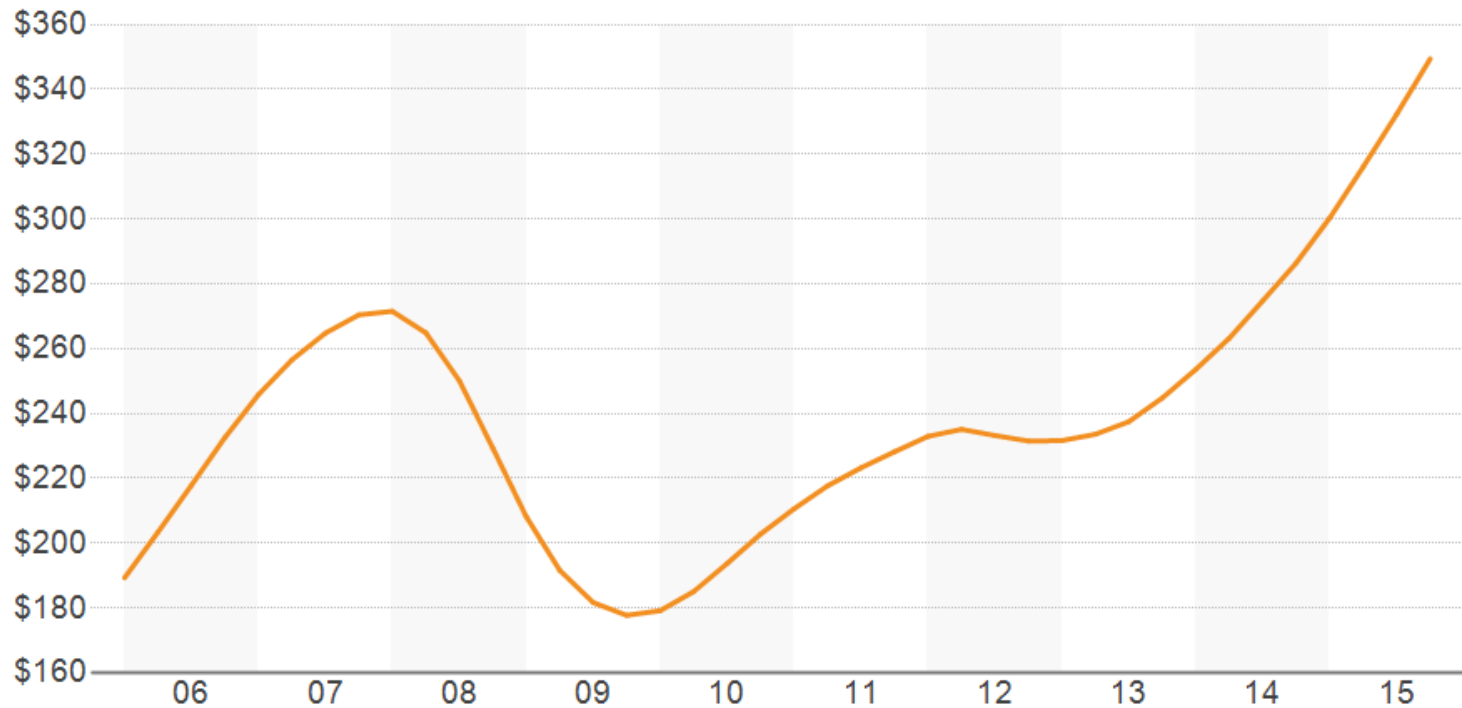
Marcus & Millichap

# LA County Office-Cap Rates



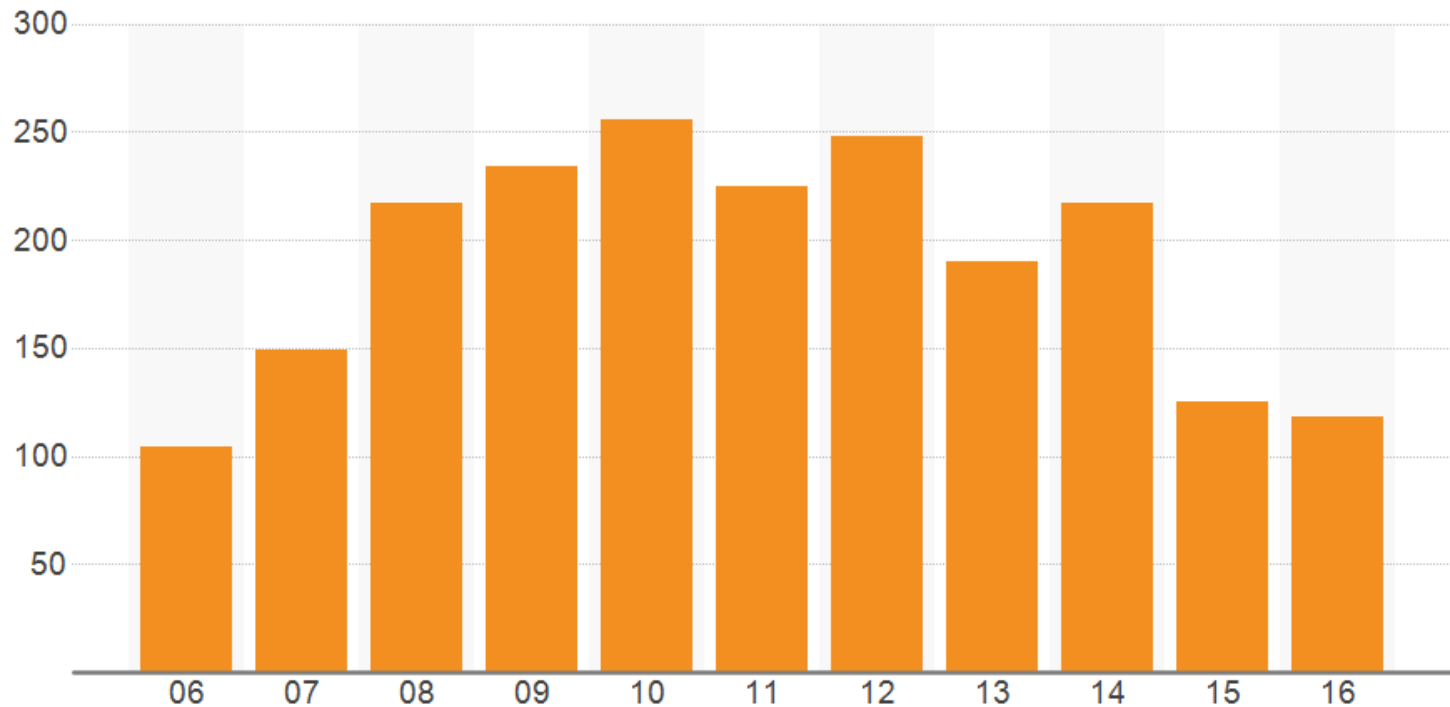
Marcus & Millichap

# LA County Office PPSF



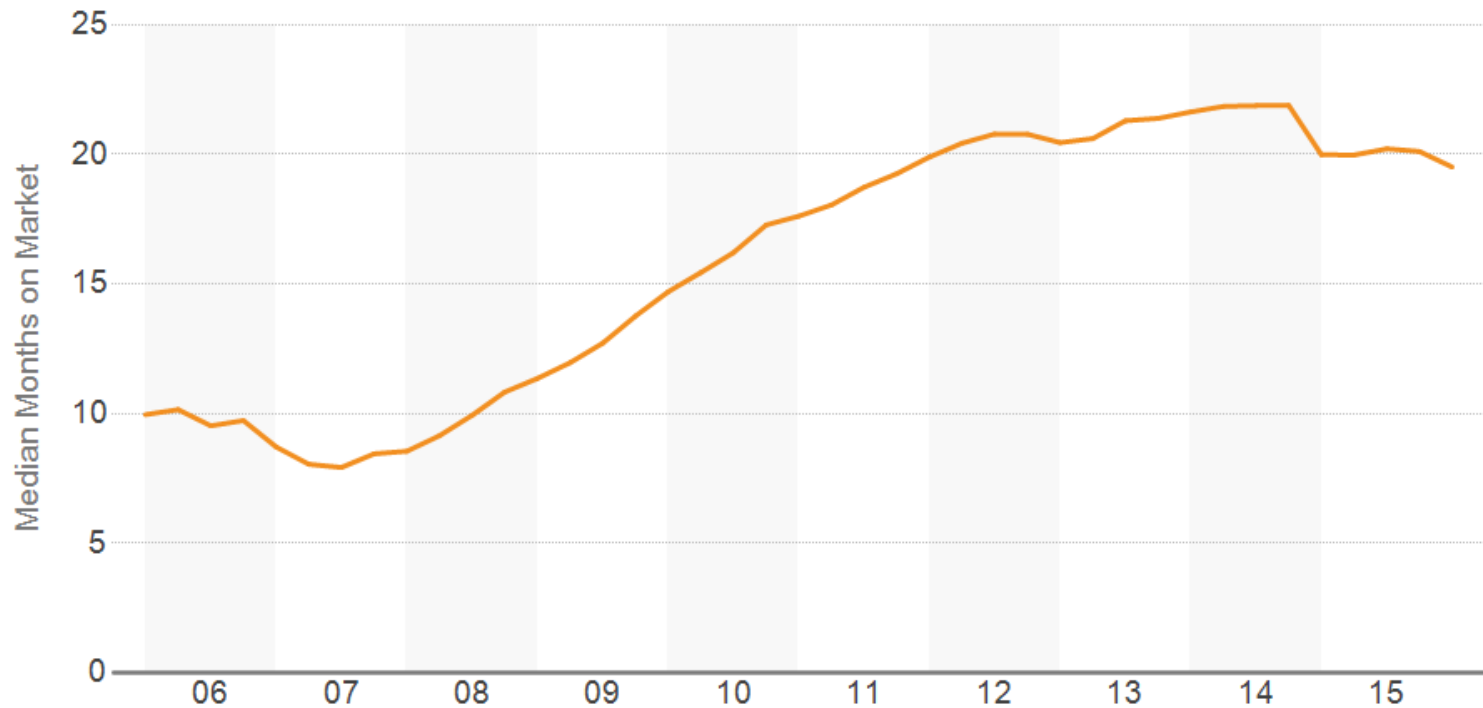
Marcus & Millichap

# LA County Office-On Markets



Marcus & Millichap

# LA County Office-Months To Market



# MOB Overview

## LA County Overview

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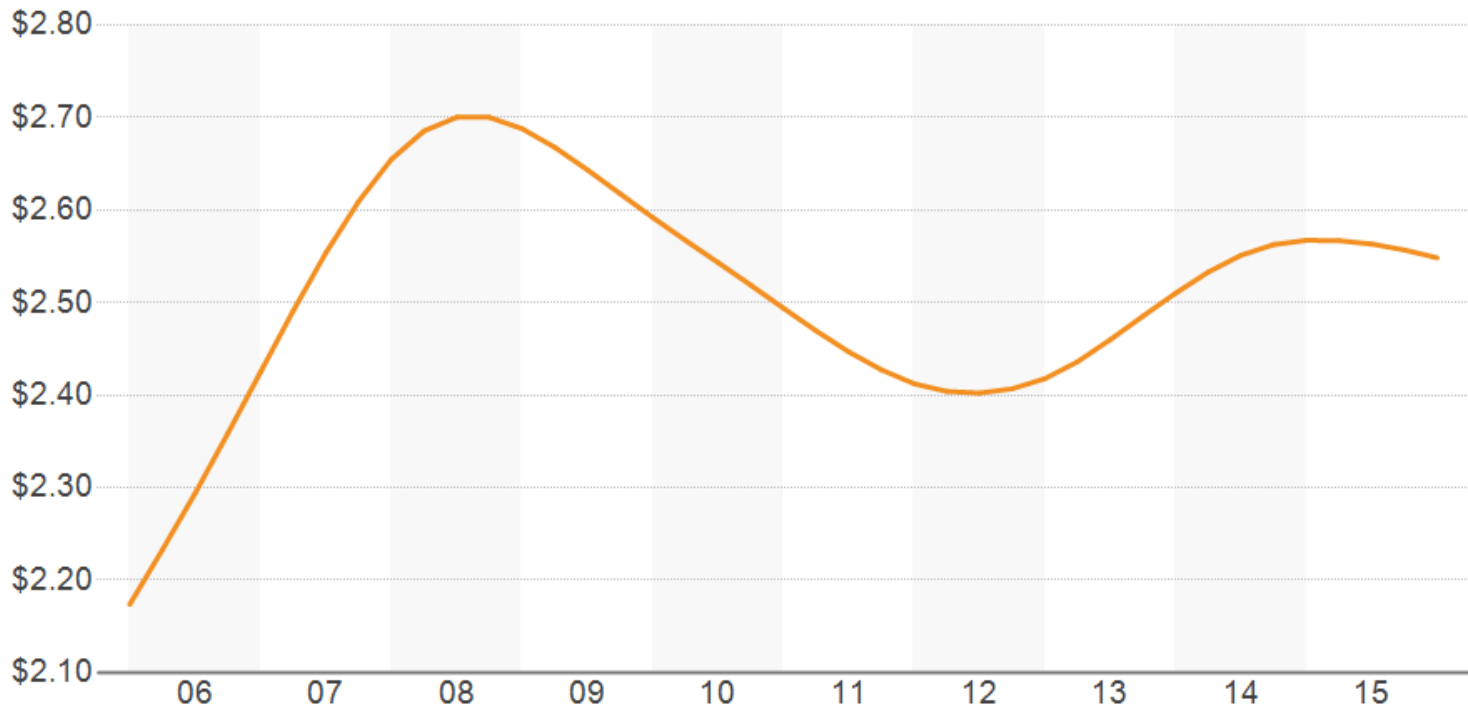
Marcus & Millichap

# LA County MOB Asking Rent & Vacancy

Market	Total SF	Vacancy	% Vacancy	Asking Rent
Antelope Valley	1,028,927	201,360	19.6%	\$1.79
Burbank/Glendale/Pasadena	4,130,295	219,524	5.3%	\$2.76
Downtown Los Angeles	2,101,553	125,103	6.0%	\$2.35
East LA County Outlying	62,434	12,251	19.6%	\$1.65
Mid-Cities	1,542,035	147,694	9.6%	\$1.92
Mid-Wilshire	2,775,616	256,277	9.2%	\$2.26
San Fernando Valley	5,130,875	393,631	7.7%	\$2.40
San Gabriel Valley	2,720,061	158,885	5.8%	\$1.92
Santa Clarita Valley	674,225	83,991	12.5%	\$2.82
South Bay	6,029,065	661,878	11.0%	\$2.70
Southeast Los Angeles	1,431,766	136,191	9.5%	\$1.73
Ventura South	271,917	55,790	20.5%	\$2.21
West Los Angeles	<u>5,610,243</u>	<u>341,946</u>	<u>6.1%</u>	<u>\$4.10</u>
	33,509,012	2,794,521	8.3%	\$2.35

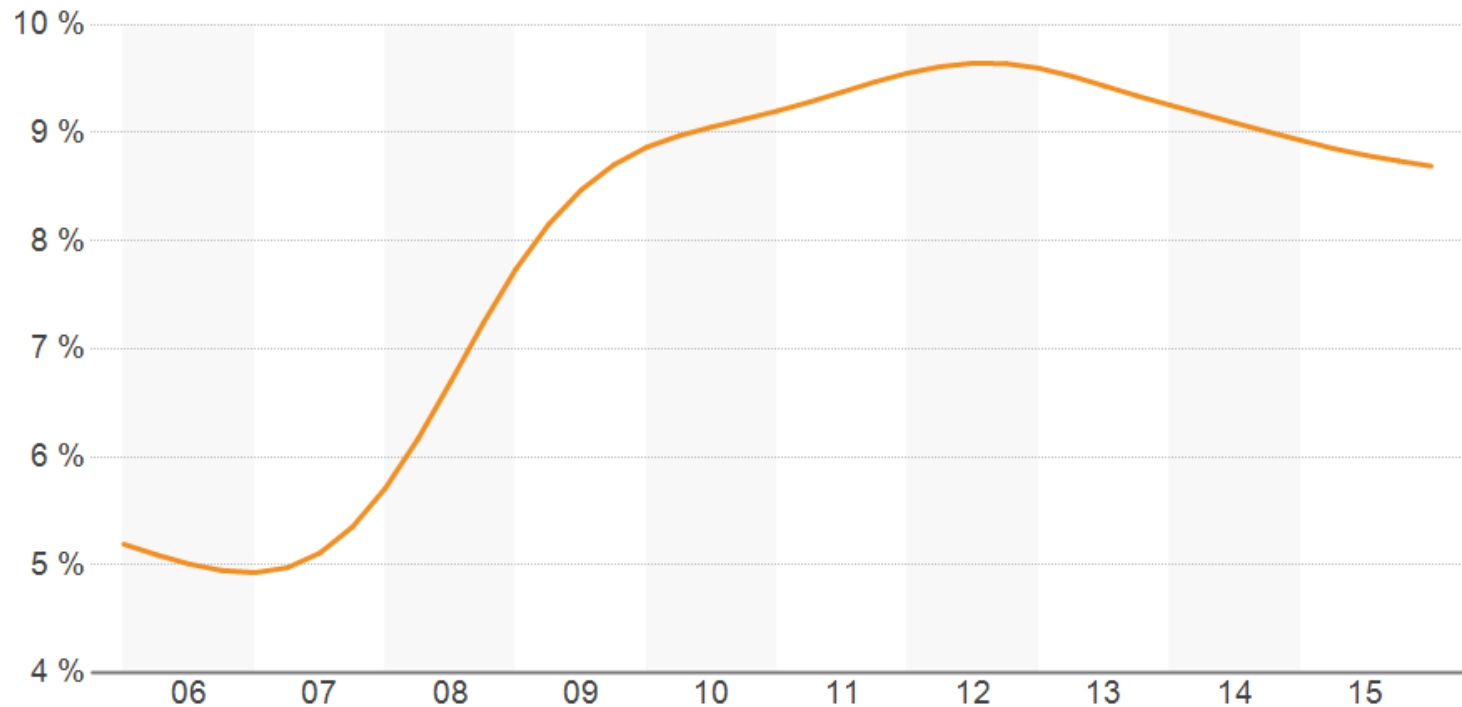
Marcus & Millichap

# LA County MOB Asking Rents



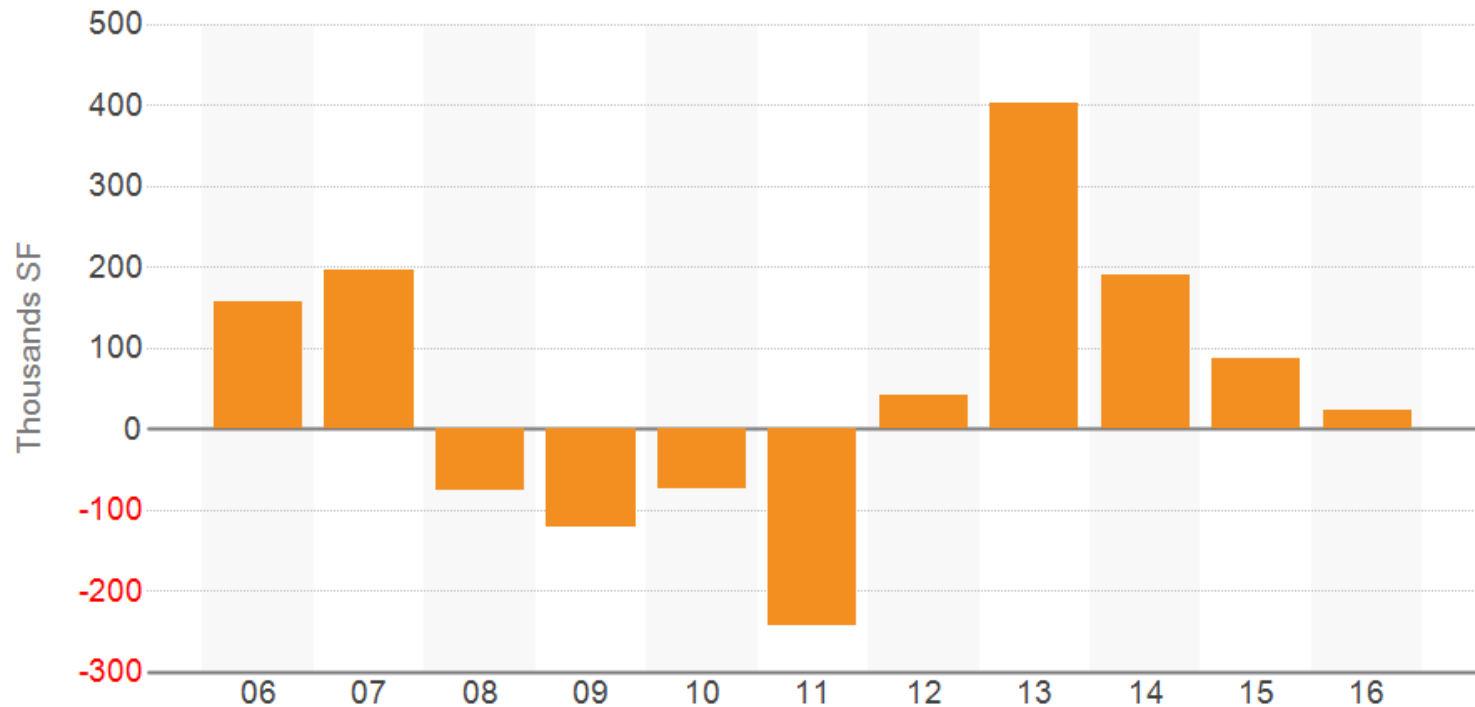
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# LA County MOB-Vacancy



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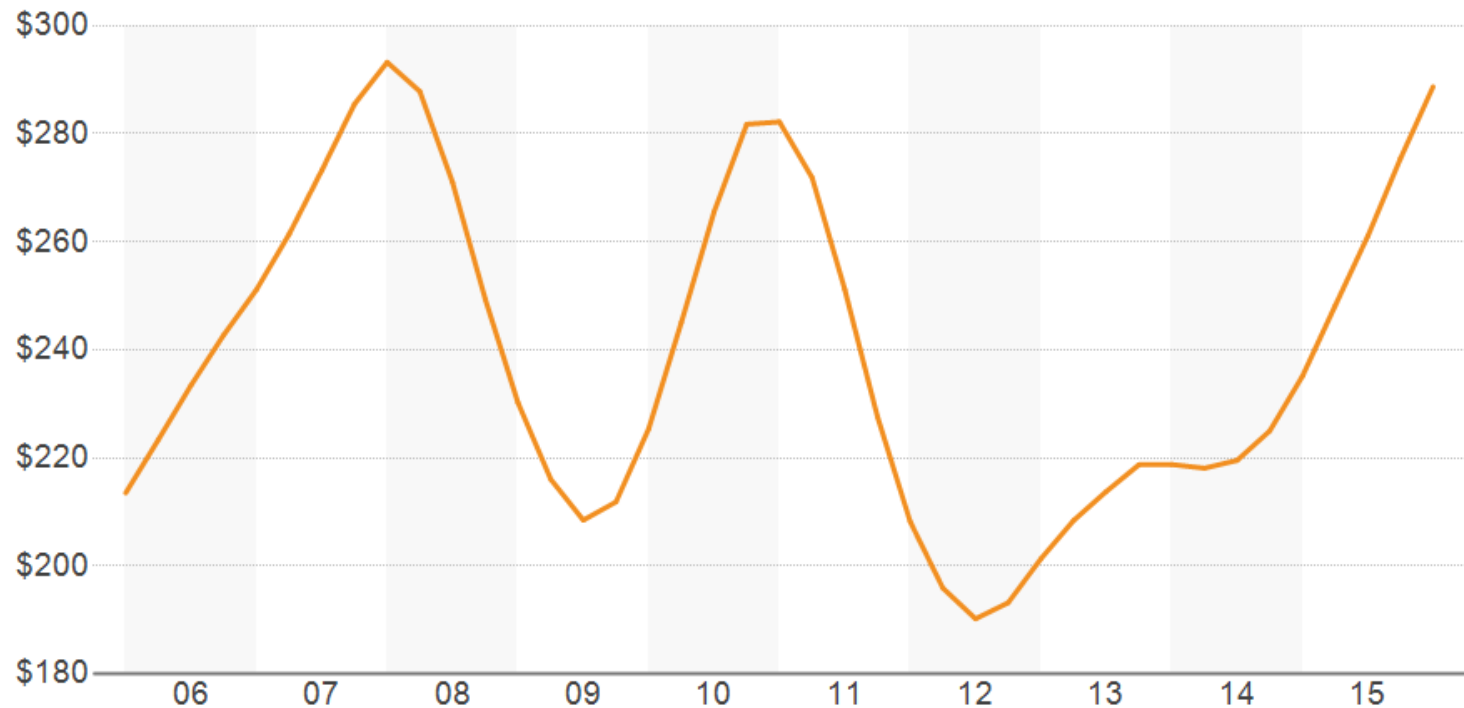
# LA County MOB-Absorption



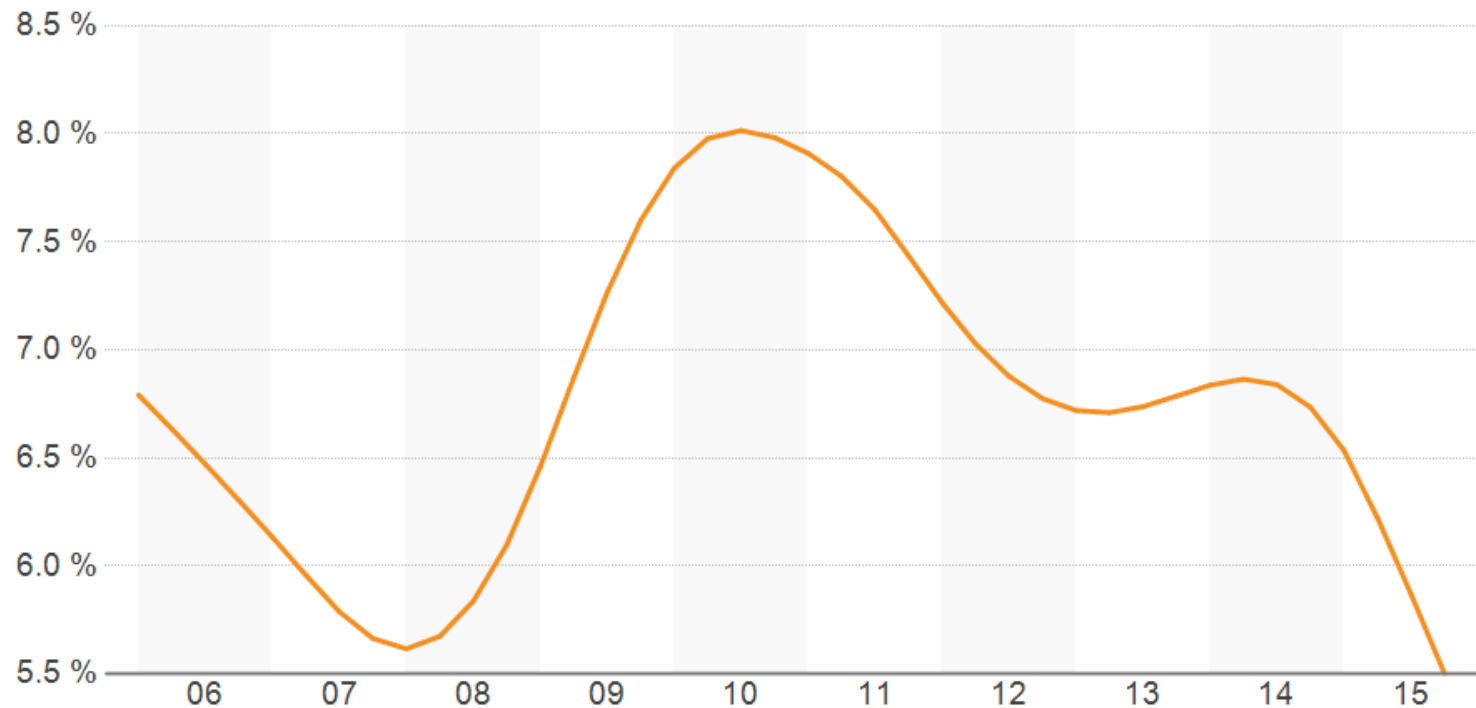
Marcus & Millichap



# LA County MOB-PPSF



# LA County MOB-CAP Rate



Marcus & Millichap

# Office Values & Assumptions

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1. Comparable Sale
2. Income
3. Replacement Cost

# Comparable Sale

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Institutional investors will take out private equity and owner/user competition.

Businesses are looking for flexibility in growth.

Foreign investors are playing in the smaller sandbox with minimal management.

More transactions to compare with

Features and Intangibles are Important (TI, Amenities, Furniture, Energy Savings.)

# Sale Comps

1. 275 Valencia Ave



**Brea**

Price: \$110,000,000  
Price/SF: \$172.55  
Cap Rate: 5.43%  
RBA: 637,500  
Date: 12/3/2014  
Year Built: 1982  
Buyer: Greenlaw Partners  
Seller: Lexington Realty Trust

2. 17901 Von Karman Ave



**Irvine**

Price: \$94,250,000  
Price/SF: \$345.38  
Cap Rate: 4.2%  
RBA: 272,887  
Date: 10/24/2014  
Year Built: 1985  
Buyer: John Hancock Real Estate  
Seller: LBA Realty

3. 18201 Von Karman Ave



**Irvine**

Price: \$82,500,000  
Price/SF: \$364.87  
Cap Rate: 3.6%  
RBA: 226,105  
Date: 11/19/2015  
Year Built: 1985  
Buyer: New York Life Insurance Company  
Seller: American Realty Advisors

# Sale Comps

**4. 1301 Dove St**



**Newport Beach**

Price: **\$72,275,000**  
 Price/SF: **\$357.48**  
 Cap Rate: **3.5%**  
 RBA: **202,178**  
 Date: **8/6/2015**  
 Year Built: **1980**  
 Buyer: **Prudential Real Estate Investors**  
 Seller: **MetLife**

**5. 1900 S State College Blvd**



**Anaheim**

Price: **\$71,100,000**  
 Price/SF: **\$259.84**  
 Cap Rate: **7.17%**  
 RBA: **273,632**  
 Date: **7/17/2015**  
 Year Built: **2001**  
 Buyer: **GEM Realty Capital, Inc.**  
 Seller: **Kennedy-Wilson Properties LTD**

**6. 17885 Von Karman Ave**



**Irvine**

Price: **\$58,460,000**  
 Price/SF: **\$380.44**  
 Cap Rate: **4.85%**  
 RBA: **153,664**  
 Date: **6/11/2015**  
 Year Built: **2008**  
 Buyer: **Clarion Partners**  
 Seller: **Oaktree Capital Management LP**

# Sale Comps

**7. 1588 S Coast Dr**



**Costa Mesa**

Price: **\$52,250,000**  
Price/SF: **\$289.95**  
Cap Rate: **N/A**  
RBA: **180,202**  
Date: **6/25/2015**  
Year Built: **1975**  
Buyer: **VF Services LLC**  
Seller: **Banc of California**

**8. 333 S Anita Dr**



**Orange**

Price: **\$41,481,000**  
Price/SF: **\$195.70**  
Cap Rate: **N/A**  
RBA: **211,960**  
Date: **9/30/2015**  
Year Built: **1986**  
Buyer: **PRES Companies**  
Seller: **TA Realty**

**9. 3800 W Chapman Ave**



**Orange**

Price: **\$29,800,000**  
Price/SF: **\$176.02**  
Cap Rate: **6.85%**  
RBA: **169,300**  
Date: **3/30/2015**  
Year Built: **1984**  
Buyer: **Greenlaw Partners**  
Seller: **Starwood Capital Group**

Source: CoStar COMPS®



# Income

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Absorption continues.

Vacant Space Will Cost More to Lease – Title 24

Competition and Captive Tenants Increase Lease Rates

Creative space continues to get 30% higher rents than its previous classification

Modern TI is more important than green infrastructure can boost NOI

# Income Assumptions

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Rent Growth – 8% p/yr for next 2 years.

Escalations – 3.5%

Free Rent – 1 month for every 2 years of Lease Term

Down Time – 6 months

Commissions – 7% on NNN and 6% on FSG leases

Improvements - \$15 - \$55 PSF on vacant space; \$10 - \$15 on renewal

Vacancy – 10%

# Replacement Cost

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Prices are at 2006 levels which is pushing for a development cycle

Land Cost in Urban Areas has Held its Value

Higher Finish Levels and Infrastructure is Required by Occupants

Local & State Politics are Increasing Costs

\$300 to \$400 PSF Development Cost + Profit

# Replacement Cost Assumptions

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Land Cost - \$45 PSF of useable land area (\$130 PSF on building area)

Construction Costs - \$200 PSF

Soft Costs - \$10 PSF

# Office Real Estate Cycle



# Forecast

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2016 will be another growth year for office  
New development will continue push rents.

More sales as business plans are executed  
and previous peak values are hit.

Cap rates will remain low with underwriting  
expecting rent growth.



# Potential Headwinds

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Stretching to find a problem

China / Foreign Markets

Oil

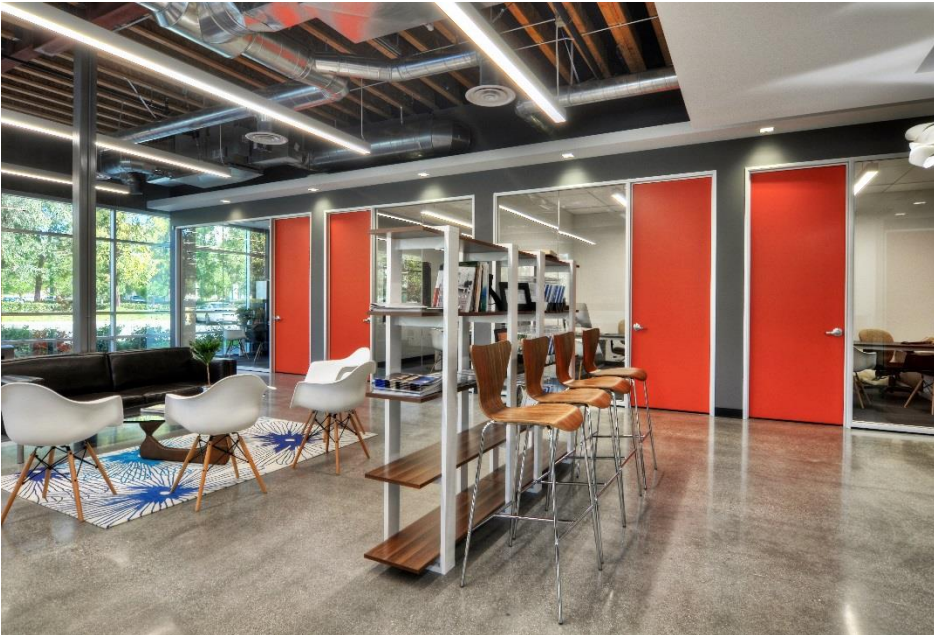
US Equities

Fee Chasing – Too much leverage with low return

Too much new development vs. redevelopment

# Wind Water Realty, Inc.

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