Inland Empire Office Team

INLAND EMPIRE OFFICE MARKET REPORT 2016

Appraisal Institute – Office Market Overview

Mid Year 2016

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2016 Office Trends

- 2015 was a disaster for IE office - ±83,000 SF of positive absorption
- However, 2016 started off with a bang – over 200,000 SF of absorption in the first quarter
- All signs indicate we are in an upward market; slow and steady; projected to continue through 2018
- Overall market vacancy is currently 14.6%; down from 15.6% in January 2015
- Class A and B lease rates are up $0.10-0.20 per square foot -Property values continue to increase as lease rates climb, and limited supply of quality opportunities pushes cap rates down
- Interest rates remain historically low, but will rise as a check against inflation
- Entrepreneurial and quasi-institutional capital still eyeing the Inland Empire for value-add opportunities

- Investors still seeking higher cap rates than being offered in the tightening market
- Lending Market is still tight, which has slowed investment sales
- Large blocks of available space >20,000 square feet remain in high demand and short supply
- New office development is still at a halt as true construction costs (reproduction costs) do not justify construction based on current leasing economics
- Developers need to achieve lease rates at approximately $2.35 FSG/ $1.50 NNN before they can build; we are getting closer!
- Lease rates have eclipsed $2.00 FSG in markets closest to LA, Orange, and San Diego Counties

Definitions

- Class A
  - 3 stories or greater
  - Museum quality finishes
  - Highest rates in the market
  - 26.8% of the market

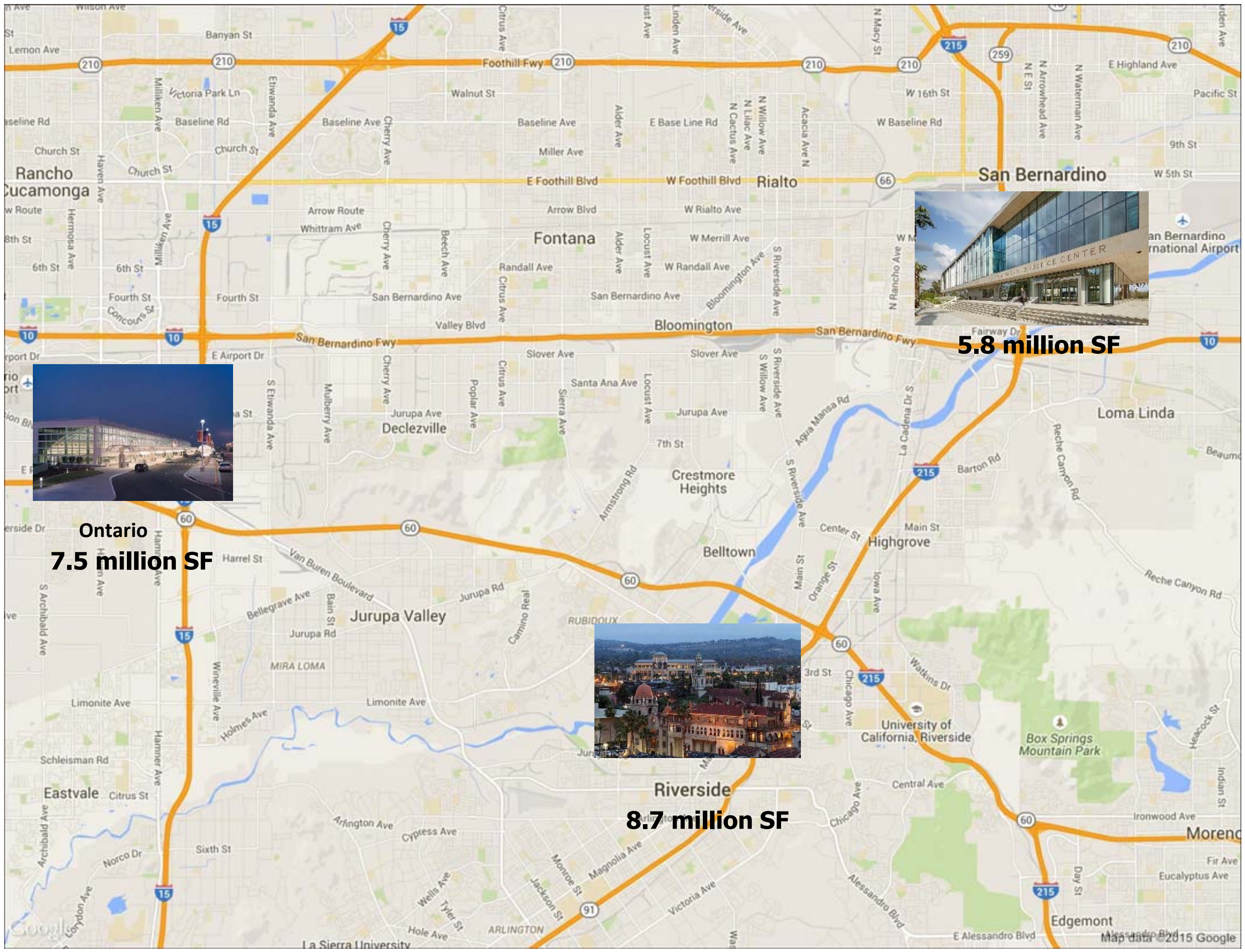
- Class B
  - Older Class A buildings
  - Less than 3 stories
  - No major functional obsolescence
  - 50.2% of the market

Definitions - Continued

- Class C
  - Older Class B buildings
  - Single-story or wood frame and stucco garden style
  - Office space in multi-tenant industrial park
  - 23% of the market

- Small Buildings for Sale
  - New freestanding or condo units
  - Usually tracked as Class C space

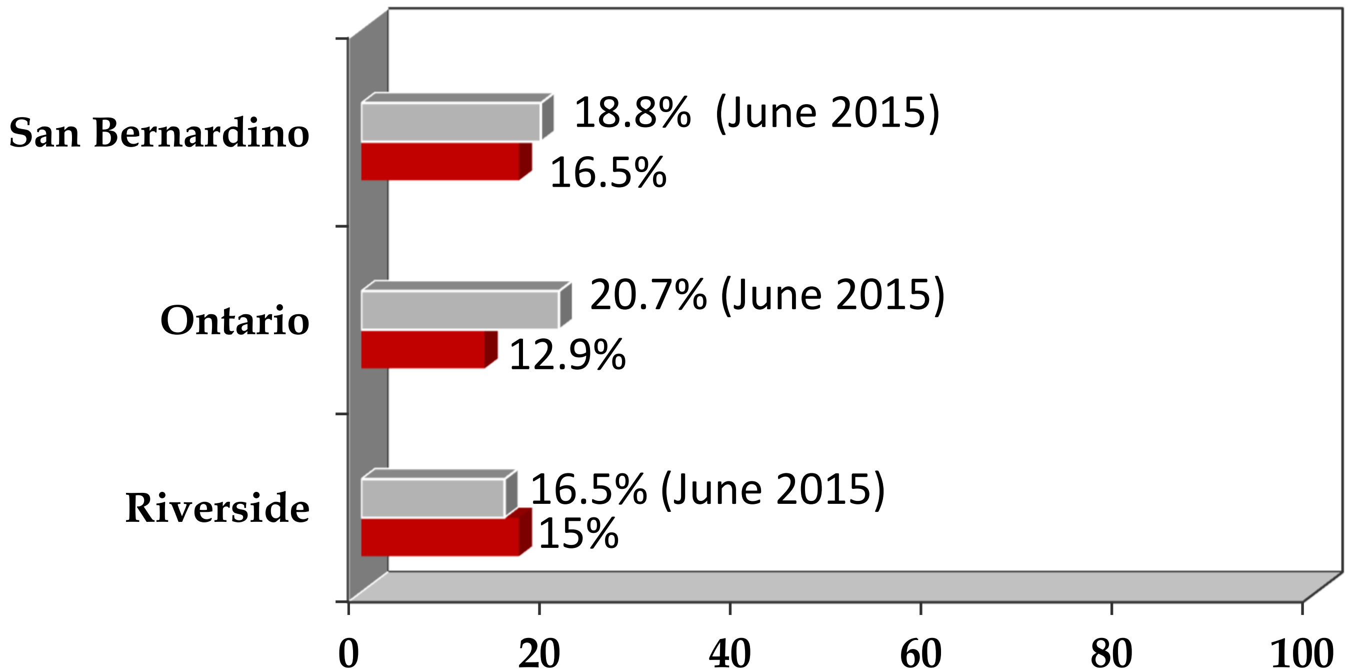
Inland Empire Region



22,717,140 Total Square Feet

14.6% Vacant

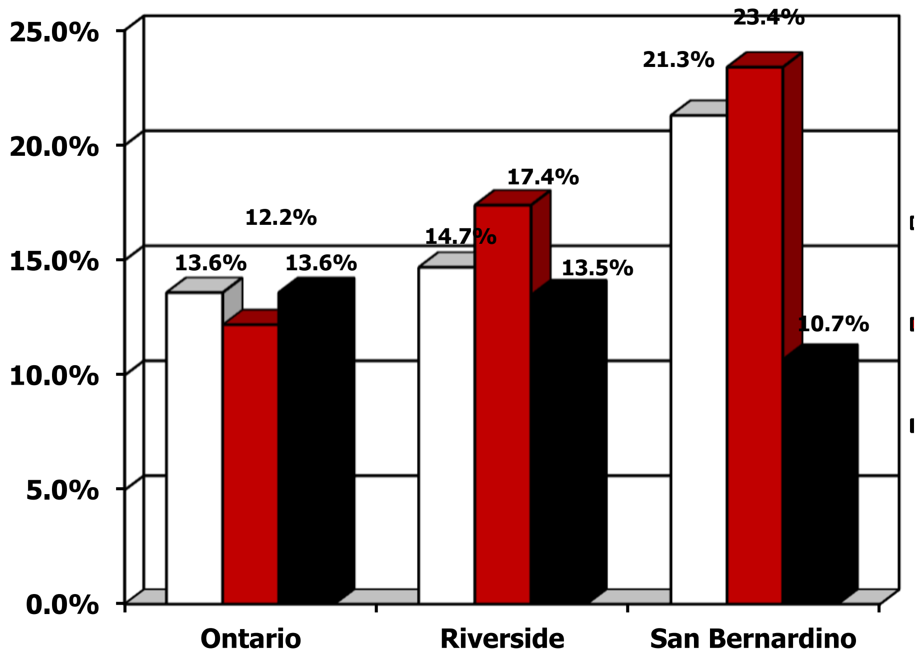
Vacancy by Region



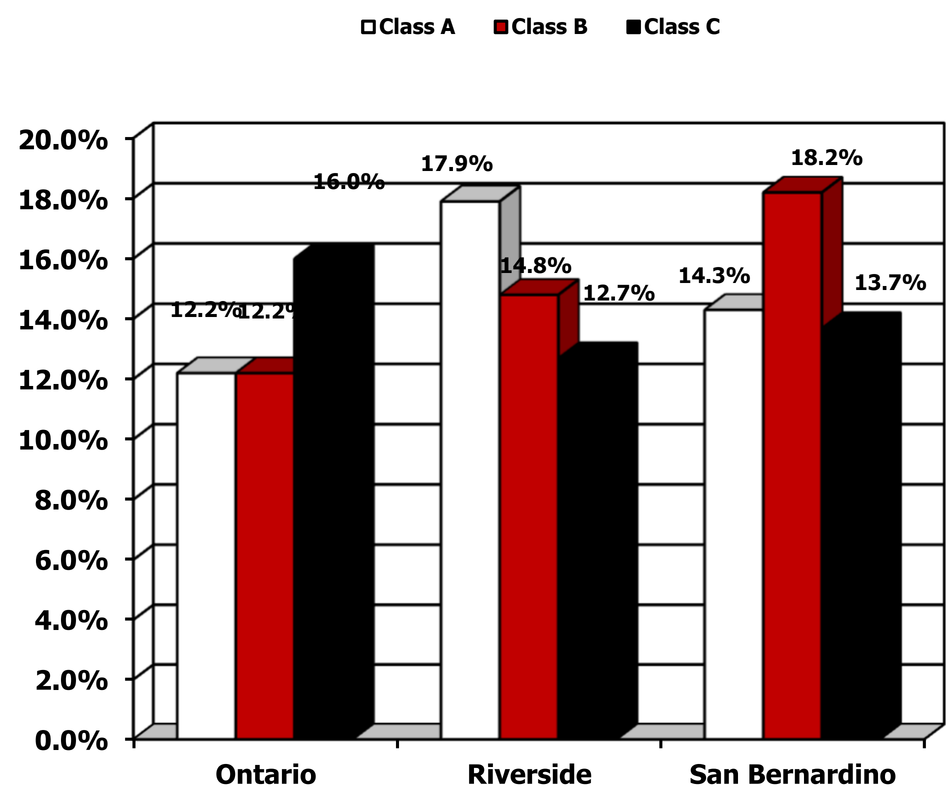
Current Regional Vacancy – 14.6%
Vacancy June 2015 – 15.6%

Vacancy Rate by Major Market

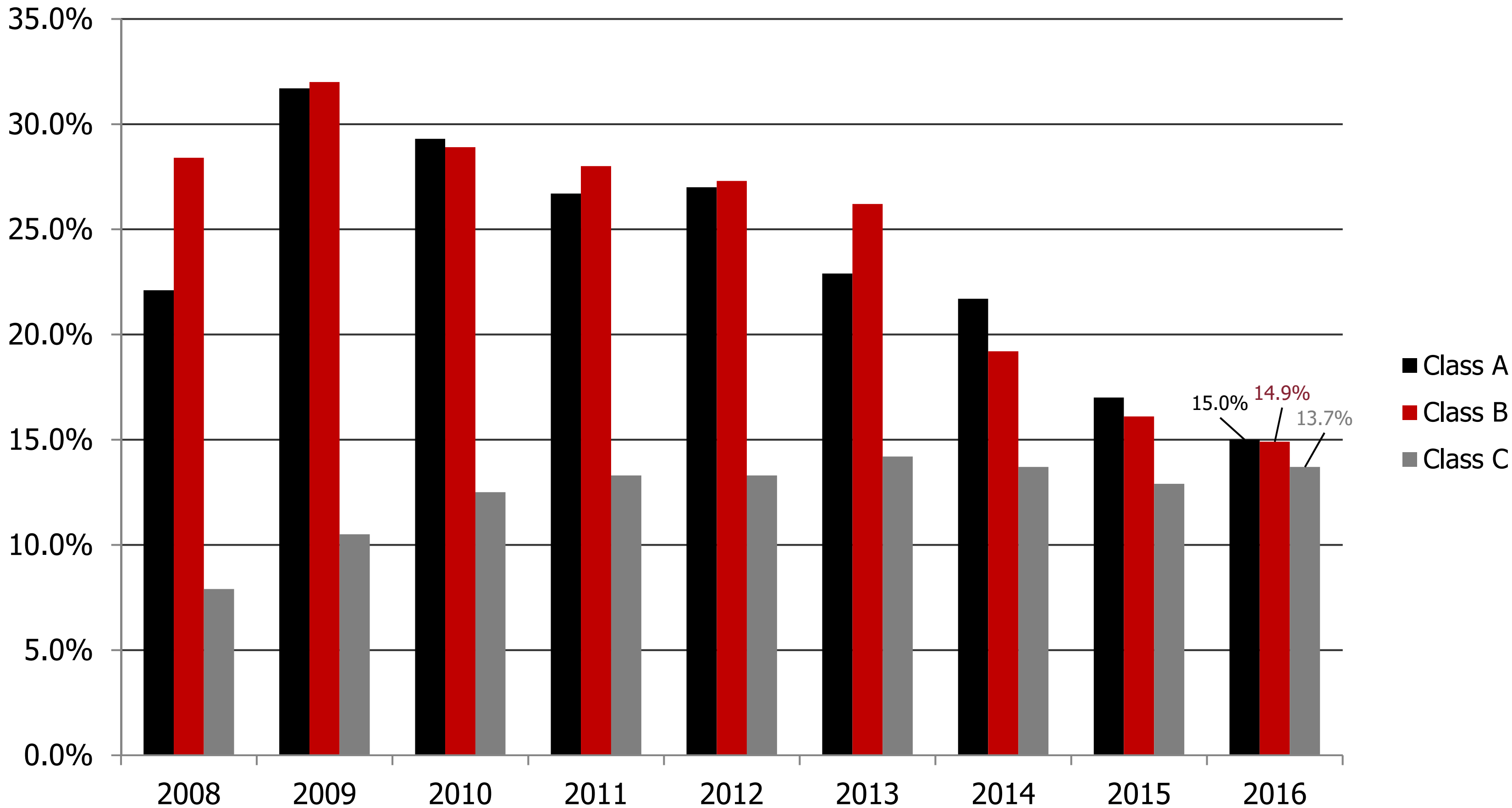
June 2015



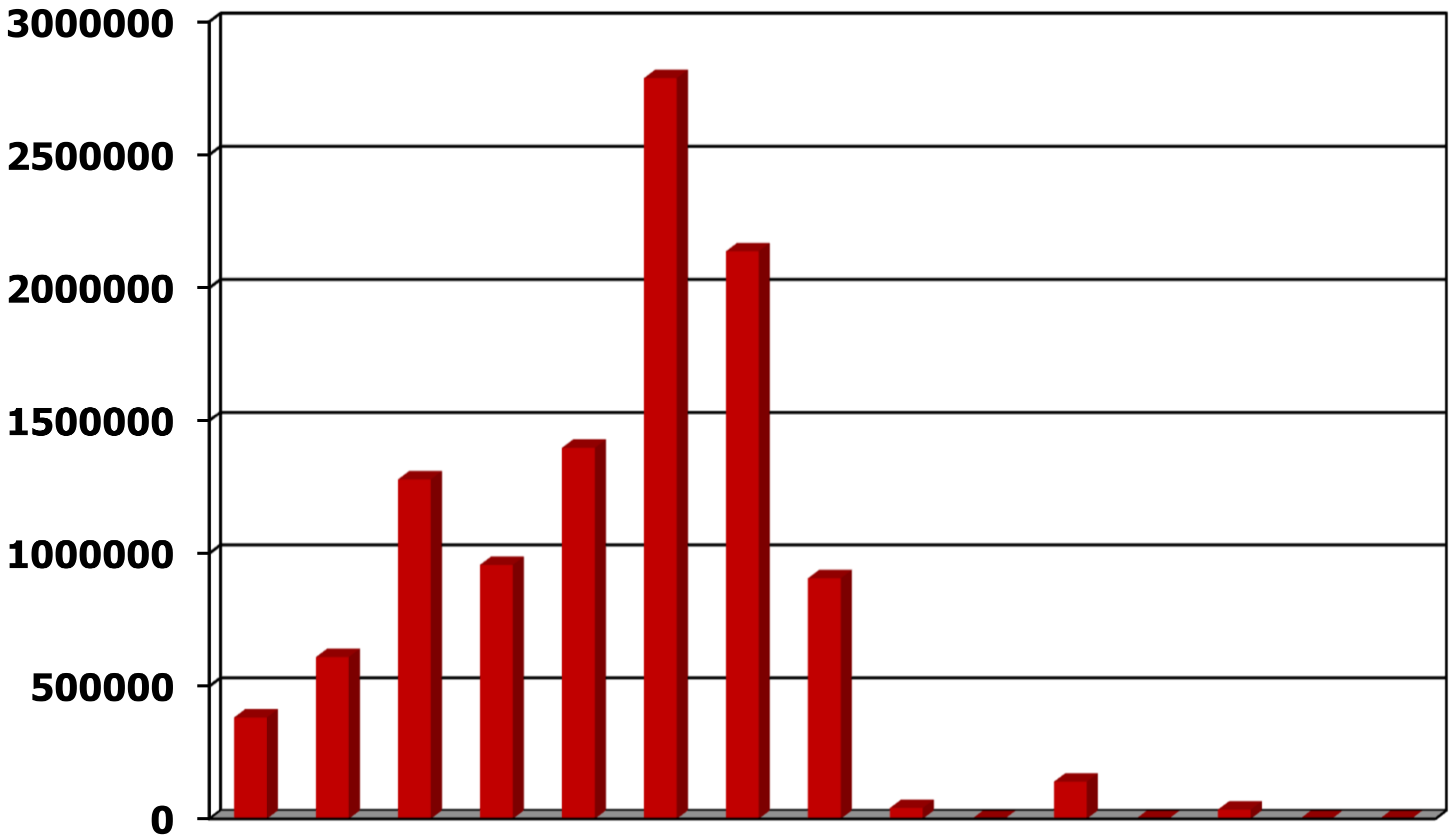
June 2016



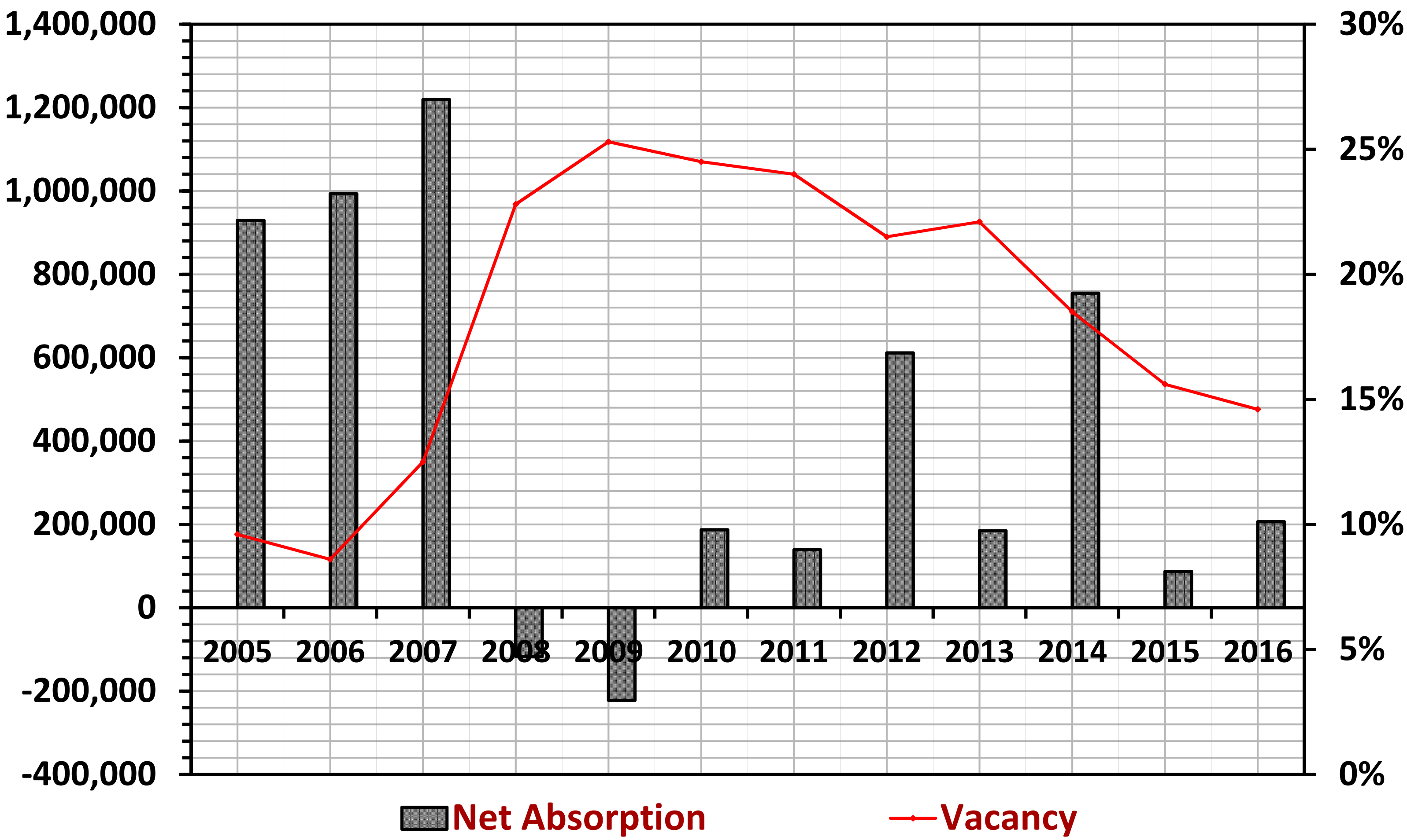
Vacancy Rate by Class



Office Construction (Completed Since 2002)



Vacancy and Absorption Trend Analysis



Average Asking Lease Rates

Riverside	Increase Since 2015	All Time High
Class A $2.25 - $3.10 FSG	10%	$3.10
Class B $1.65 - $1.95 FSG	flat	$1.95
Class C $1.25 – $1.50 FSG	flat	$1.55
Ontario/Rancho Cucamonga		
Class A $1.95 - $2.25 FSG	flat	$2.25
Class B $1.75 - $1.95 FSG	6%	$1.95
Class C $1.25 – $1.50 FSG	flat	$1.60
San Bernardino		
Class A $1.85 - $2.10 FSG	5%	$2.10
Class B $1.65 - $1.85 FSG	15%	$1.80
Class C $1.25 – $1.45 FSG	20%	$1.50

New/Planned Product

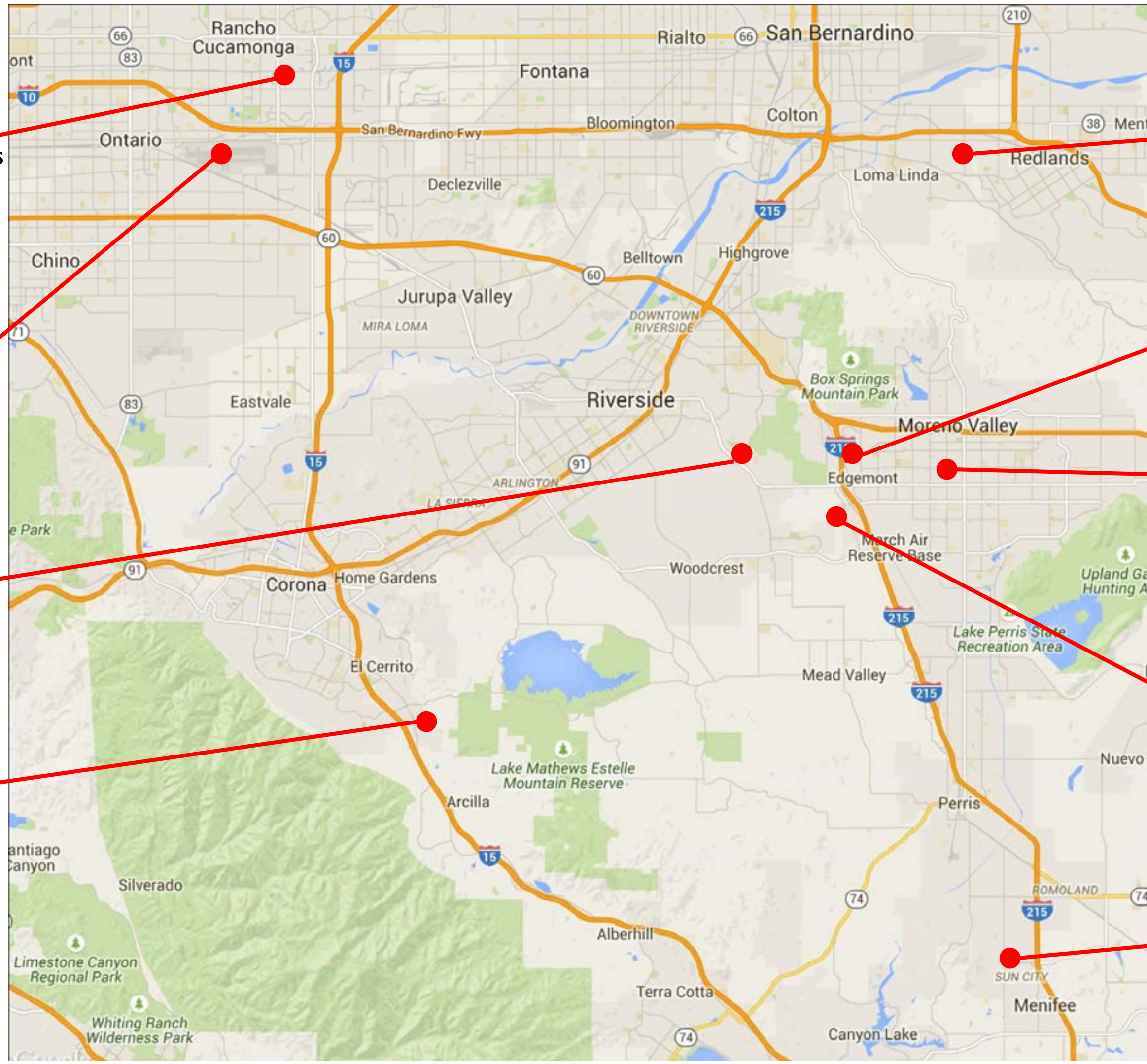
Welcome Back the Build-to-Suit

Victoria Gardens Office Towers
Office pads for planned expansion of Victoria Gardens Regional Lifestyle Center

Former Guast Winery
Multiple office towers
100,000 SF Planned

Mission Grove Corporate Plaza, Phase II
40,000 SF Planned

Lakeshore Plaza, Phase II
146,000 SF Planned



Orange Tree Lane
50,000 SF Planned

Canyon Corporate Center
144,000 SF Planned

Riverside County DPSS
50,000 SF under construction (BTS)

Starwood Properties
Industrial, retail, hospitality planned with supporting office pads

Kaiser Permanente
Planned hospital and support medical office buildings

Large Lease Comps

TENANT	BUILDING	SF	LEASE TERM	LEASE RATE	TIs
State Farm Mutual Automobile Insurance Co.	Empire Lakes Corporate Center	29,665	36	$1.85 FSG	n/a
Monoprice, Inc.	Fairway Business Center	10,605	24	$1.80 FSG	n/a
McCune Wright, LP	One Lakeshore Center	11,404	65	$2.10 FSG	$50.00
Advance Real Estate, Inc.	Rockerfeller Group Professional Center	15,227	84	$1.85 FSG	n/a
ADP, LLC	Fairway Business Center II	17,549	21	$1.60 FSG	n/a
California Mentor Family Home	Haven Commerce Center	9,500	84	$1.40 FSG	n/a
Michael Sullivan & Associates, LLP	Palmbrook Corporate Center	9,909	60	$2.00 FSG	$2.00

Sale Comps

Latham Professional Office Plaza

4351 Latham Street, Riverside

- 21,357 SF
- Built 1990
- $136 PSF; Leased
- Sold August 2015
- User Purchase; Elsworth Plaza, LLC

The Hunts Lane Building

1955 South Hunts Lane, San Bernardino

- 23,706 SF
- Built 2003
- $103 PSF
- Sold March 2016
- Investor Purchase; 1955 Hunts Lane LLC

Sale Comps

Linden Building

27740 Jefferson Avenue, Temecula

- 35,316 SF
- Built in 1990
- $105 PSF
- Sold June 2015
- User Purchase; River Springs Charter School

590 North D Street

590 North D Street, San Bernardino

- 14,894 SF
- Built in 1992
- $91 PSF
- Sold January 2016
- Investor Purchase; DRP Holdings, LLC

Sale Comps

Tishman Building

150 West 5th Street, San Bernardino

- 18,869 SF
- Built 79
- $187 PSF
- User Purchase; County of San Bernardino

Prudential Building

6349 Riverside Avenue, Riverside

- 15,550 SF
- Built 2002
- $177
- Sold December 2015
- User Purchase; Cannon Property Management

Sale Comps

Turner Riverwalk Phase III Building 35

11870 Pierce Street, Riverside

- 40,892 SF
- Built 2006
- $177 PSF
- Sold August 2015
- Investor Purchase; Pacifica Real Estate Group

Chicago Gateway Building A, B & I

1825, 1855, & 1955 Chicago Avenue, Riverside

- 77,136 SF
- Built 2006
- $145 PSF
- Sold September 2015
- Investor Purchase; Northstar Commercial Partners

Sale Comps

Lazar & Lauer

1901 Orange Tree Lane, Redlands

- 23,088 SF
- Built 2004
- $155 PSF
- Sold December 2015
- Investor Purchase; D & D Investments 4, LLC

Mission Square

3750 University Avenue, Riverside

- 127,533 SF
- Built 1984
- $298 PSF
- Sold October 2015
- User Purchase; City of Riverside

Sale Comps

Haven Corporation Center Building 3

8659 & 8667 Haven Avenue, Moreno Valley
- 7,798 SF
- Built 2005
- $256 PSF
- Sold January 2016
- Investor Purchase; Secured Income Group, Inc.

Moreno Corporate Center, Building 7B

22690 Cactus Avenue, Moreno Valley
- 61,124 SF
- Built 1989
- $186 PSF
- Sold April 2016
- Investor Purchase; 2269 Cactus, LLC

Inland Empire Office Market – Report Card

	2013	2014	2015
Landlords			
Tenants			
Sellers			
Buyers			
Developers			

Forecast 2016 – Where are we going?

- Office activity continues to increase as we add jobs
- Absorption strong for 2016 - ±600,000 SF
- Election years typically end up strong
- Larger blocks of space are in short supply
- Lease rates will increase 10% across the board
- Concessions continue to drop as market tightens
- Property values continue their climb as opportunities diminish and lease rates rise. We should see Class A investment values eclipse $200 PSF
- Value add opportunities are still available, but not necessarily on the market
- Financing will drive pace of acquisition

QUESTIONS?

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