The Commercial Office Market

JANUARY 2017 – BY ROB RADER

WIND WATER REALTY

Rob Rader

Broker, focusing on Orange County office space

2014 – Present: Wind Water Realty, Vice President

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

2002 – 2014: Associate at Grubb & Ellis

1998 – 2002: University of Southern California, Economics Degree

General Experience

Completed over 1,000 lease transactions representing landlords and tenants in OC.

Represented buyers and sellers of office buildings from 1,000 to 100,000 SF.

Currently, I focus on executing value-add business plans for investors including acquisitions, leasing and disposition.

My mission is to smooth out the drastic lows of the office market.

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Overview

1. Market Overview ***New Development***
2. Appraisal Methods
3. Forecast
4. Questions

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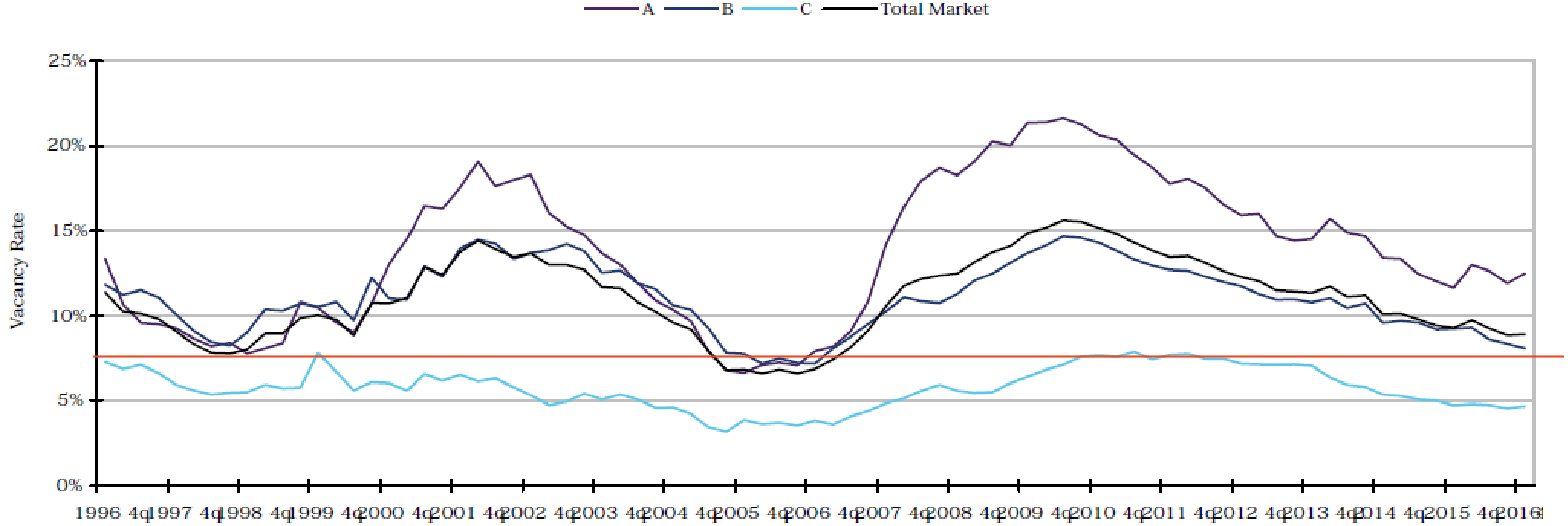
2017 Notable Trends

The economy and office markets are healthy through 2016.

1. Rents are up 4% to 8%
2. Property Values are up 20%
3. Unemployment rate continues to drop – 3.9% in OC
4. Continued absorption – 1.2M SF
5. Vacancy rates are low – 8.9%
6. Construction activity is up – 2.4M SF under construction
7. Still below peak rents and values

Vacancy hits 8.9%

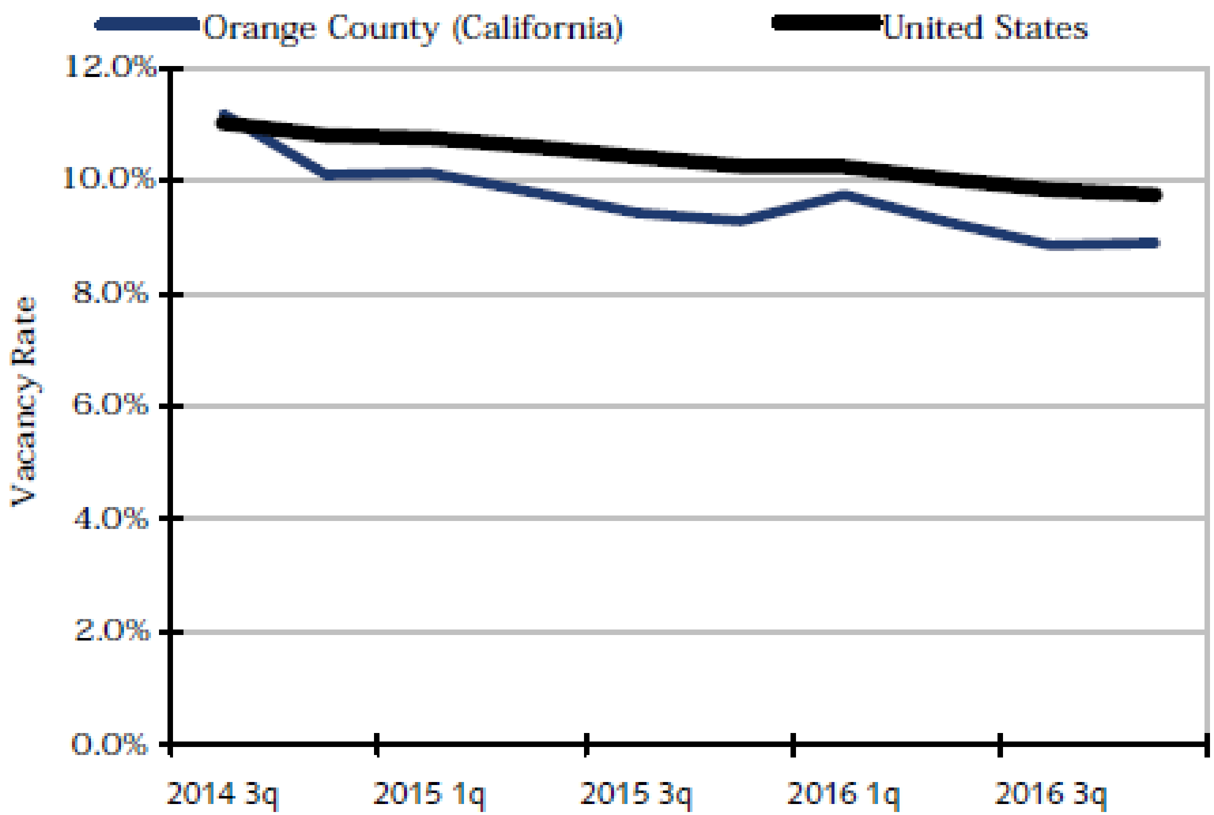
Vacancy Rates by Class 1996-2016



Source: CoStar Property®

U.S. Vacancy Comparison

Past 10 Quarters



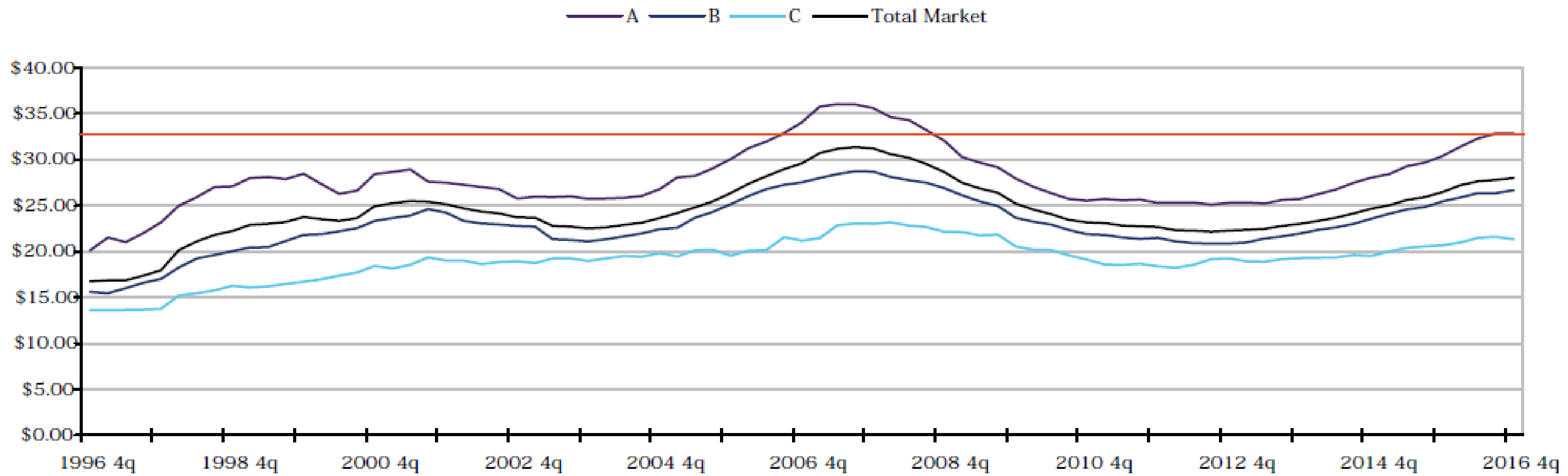
Source: CoStar Property®

OC Rental Rates

Rental Rates continue to trend upwards but still below the last peak.

Historical Rental Rates

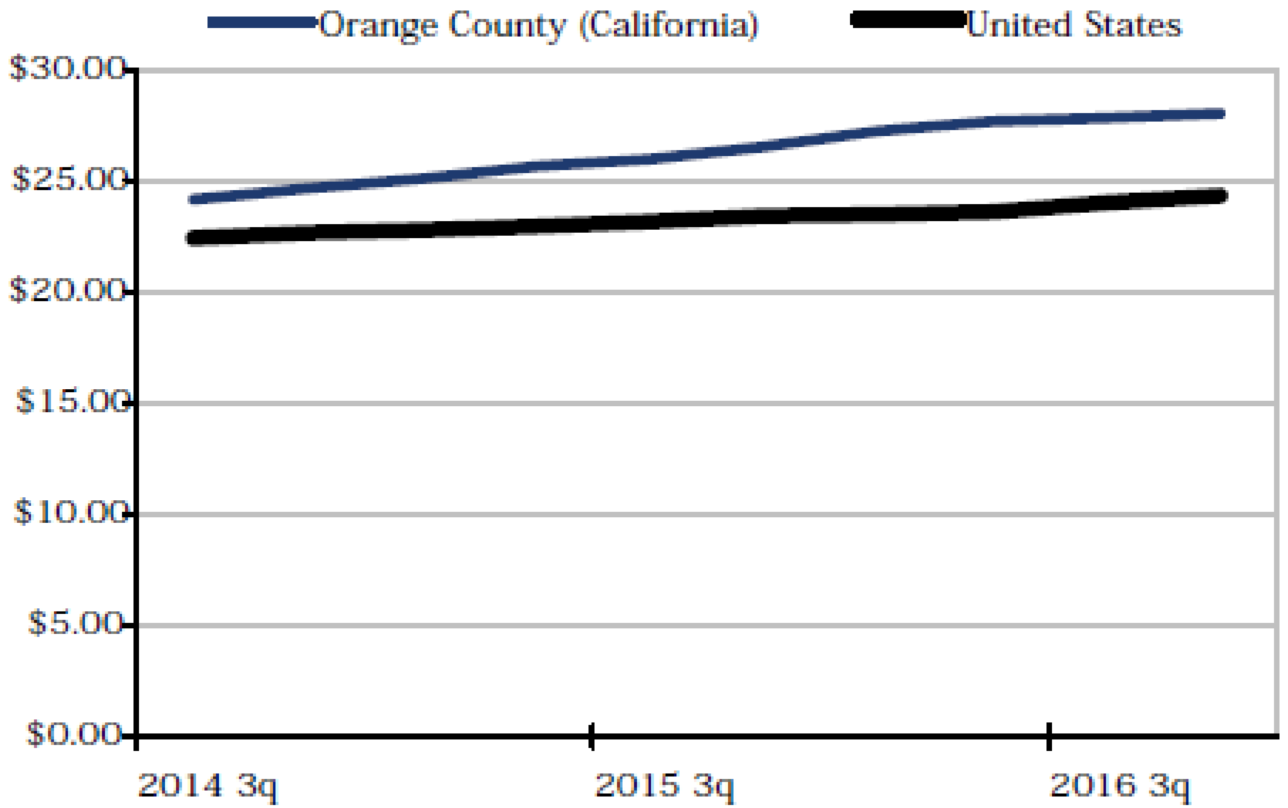
Based on Full-Service Equivalent Rental Rates



Source: CoStar Property®

U.S. Rental Rate Comparison

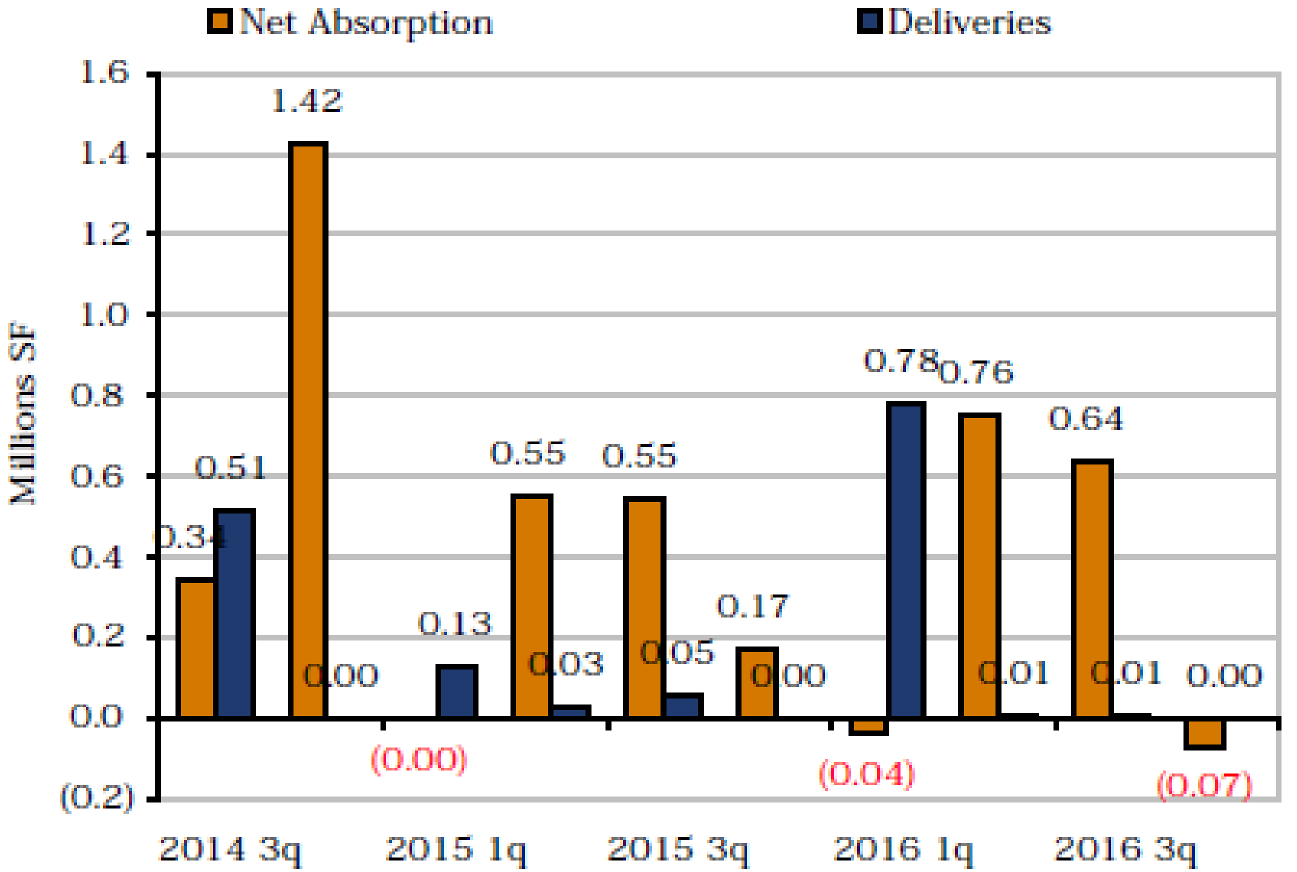
Based on Full-Service Equivalent Rental Rates



Source: CoStar Property®

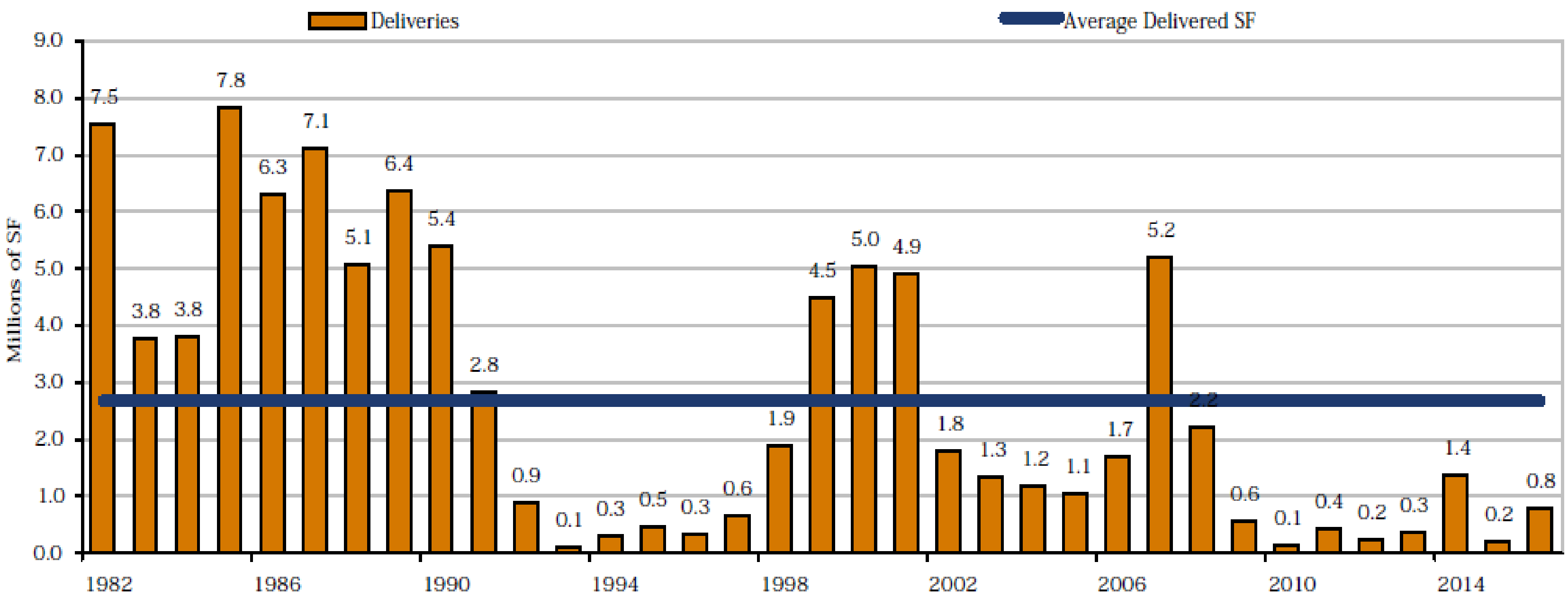
Absorption & Deliveries

Past 10 Quarters



Source: CoStar Property®

Historical Deliveries 1982 - 2016



Source: CoStar Property® * Future deliveries based on current under construction buildings.

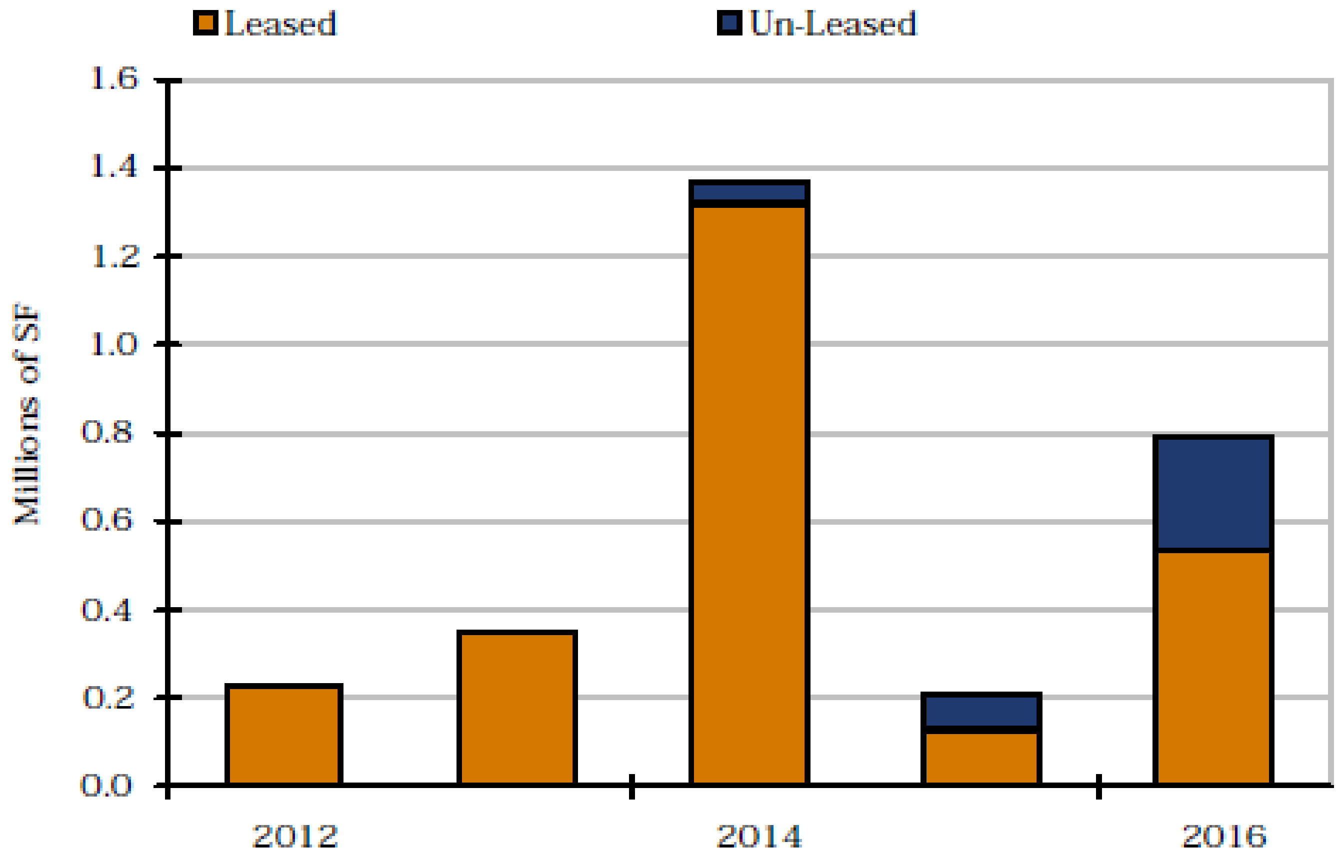
Construction Activity **Markets Ranked by Under Construction Square Footage**

Market	Under Construction Inventory				Average Bldg Size	
	# Bldgs	Total RBA	Preleased SF	Preleased %	All Existing	U/C
South County	8	1,763,796	1,269,471	72.0%	23,865	220,474
Airport Area	4	614,004	6,101	1.0%	40,903	153,501
West County	2	53,111	39,160	73.7%	18,935	26,555
Central County	1	7,891	2,131	27.0%	22,138	7,891
North County	0	0	0	0.0%	18,214	0
Totals	15	2,438,802	1,316,863	54.0%	25,358	162,587

Source: CoStar Property®

Recent Deliveries

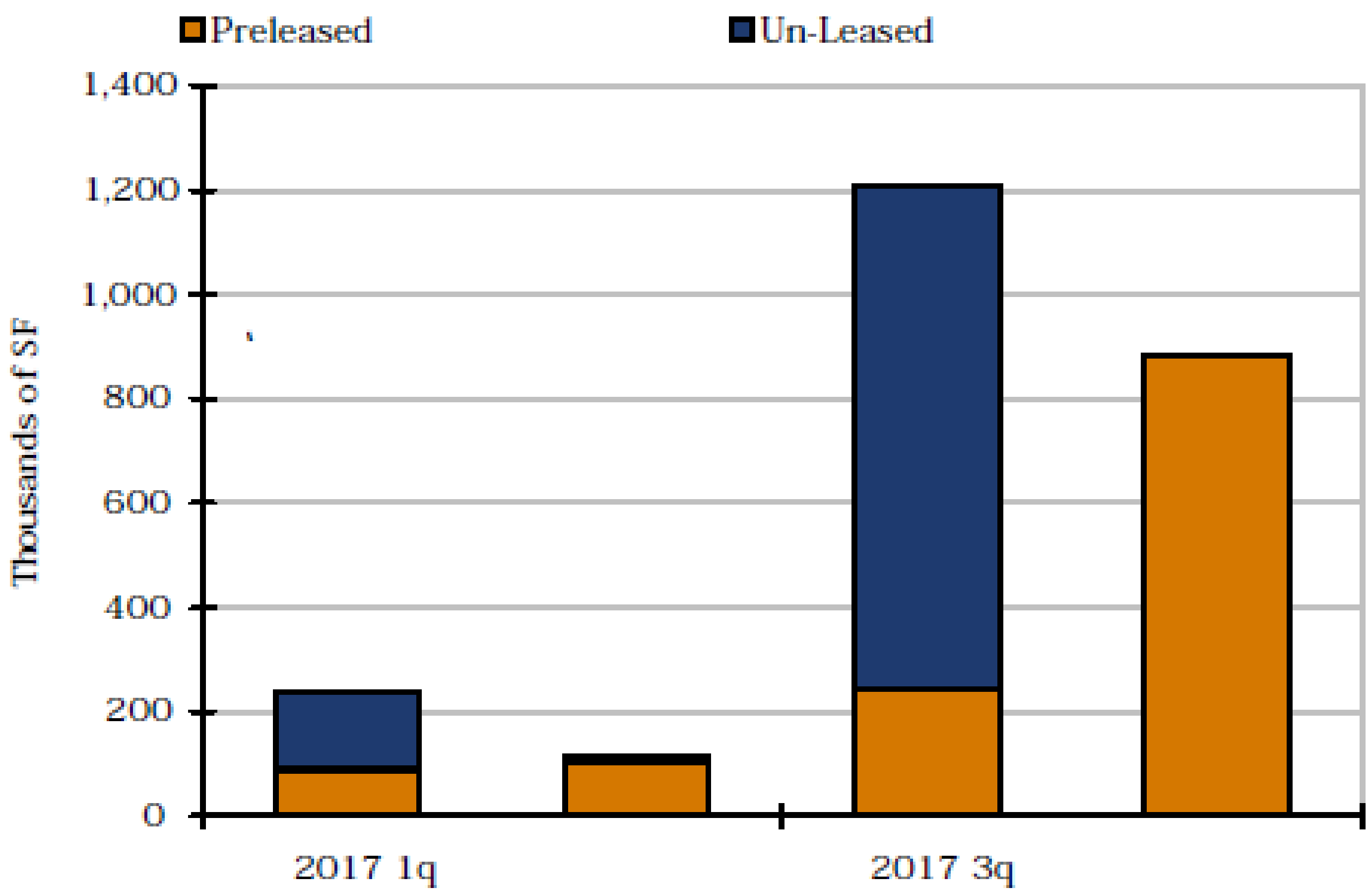
Leased & Un-Leased SF in Deliveries Since 2012



Source: CoStar Property®

Future Deliveries

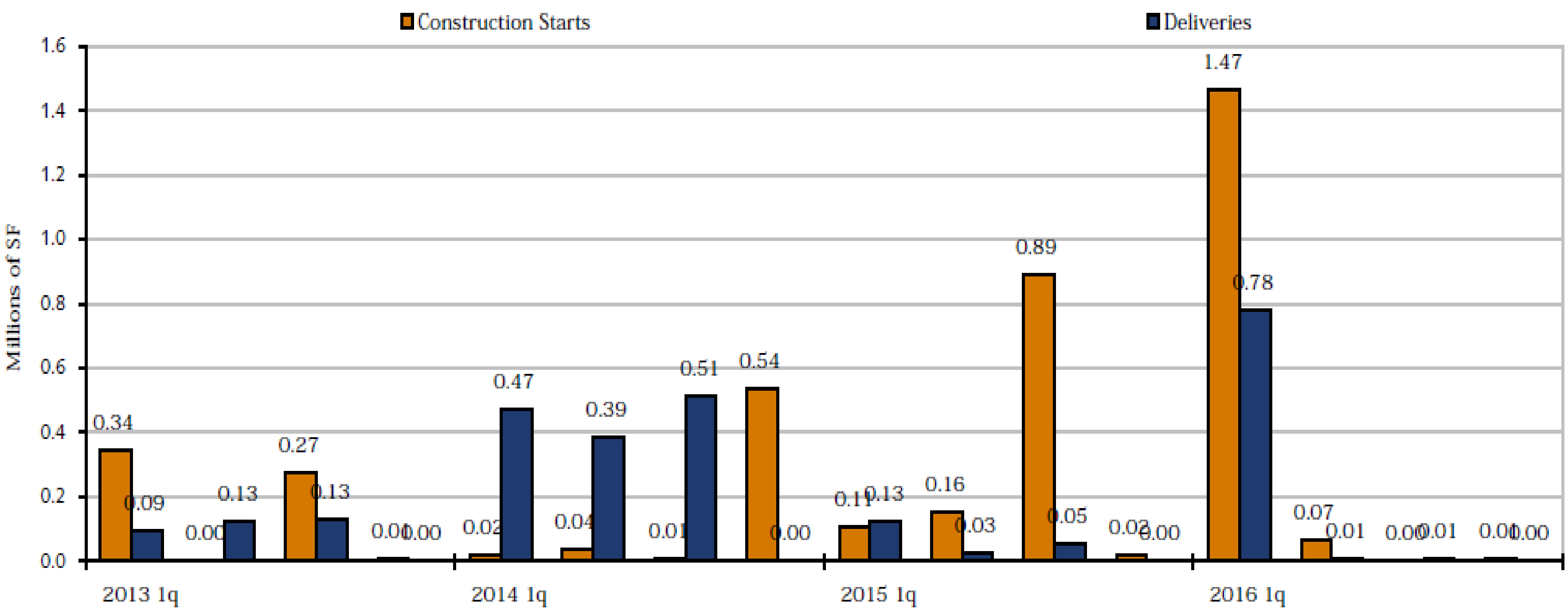
Preleased & Un-Leased SF in Properties Scheduled to Deliver



Source: CoStar Property®

Historical Construction Starts & Deliveries

Square Footage Per Quarter Starting and Completing Construction



Source: CoStar Property®

Recent Deliveries by Project Size **Breakdown of Year-to-Date Development Based on RBA of Project**

Building Size	# Bldgs	RBA	SF Leased	% Leased	Avg Rate	Single-Tenant	Multi-Tenant
< 50,000 SF	4	21,200	18,200	85.8%	$0.00	16,200	5,000
50,000 SF - 99,999 SF	5	342,865	164,400	47.9%	$36.00	0	342,865
100,000 SF - 249,999 SF	0	0	0	0.0%	$0.00	0	0
250,000 SF - 499,999 SF	1	425,044	348,536	82.0%	$63.00	0	425,044
>= 500,000 SF	0	0	0	0.0%	$0.00	0	0

Source: CoStar Property®

2004 - 2008 Construction

3161 Michelson – Irvine
Built in 2007
BTS for New Century Funding
533,581 SF

200 Spectrum Center Dr

Delivered 2016

Submarket:	**South County**
RBA:	**425,044**
# Floors:	**21**
Class:	**A**
Occupied:	**82%**
Quoted Rate:	**$63.00**
Grnd Brk Date:	**Fourth Quarter 2014**
Deliv Date:	**First Quarter 2016**
Leasing Co:	**The Irvine Company**
Developer:	**The Irvine Company**
Architect:	**Pei, Cobb, Freed & Partners**

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Jamboree & Dupont Dr

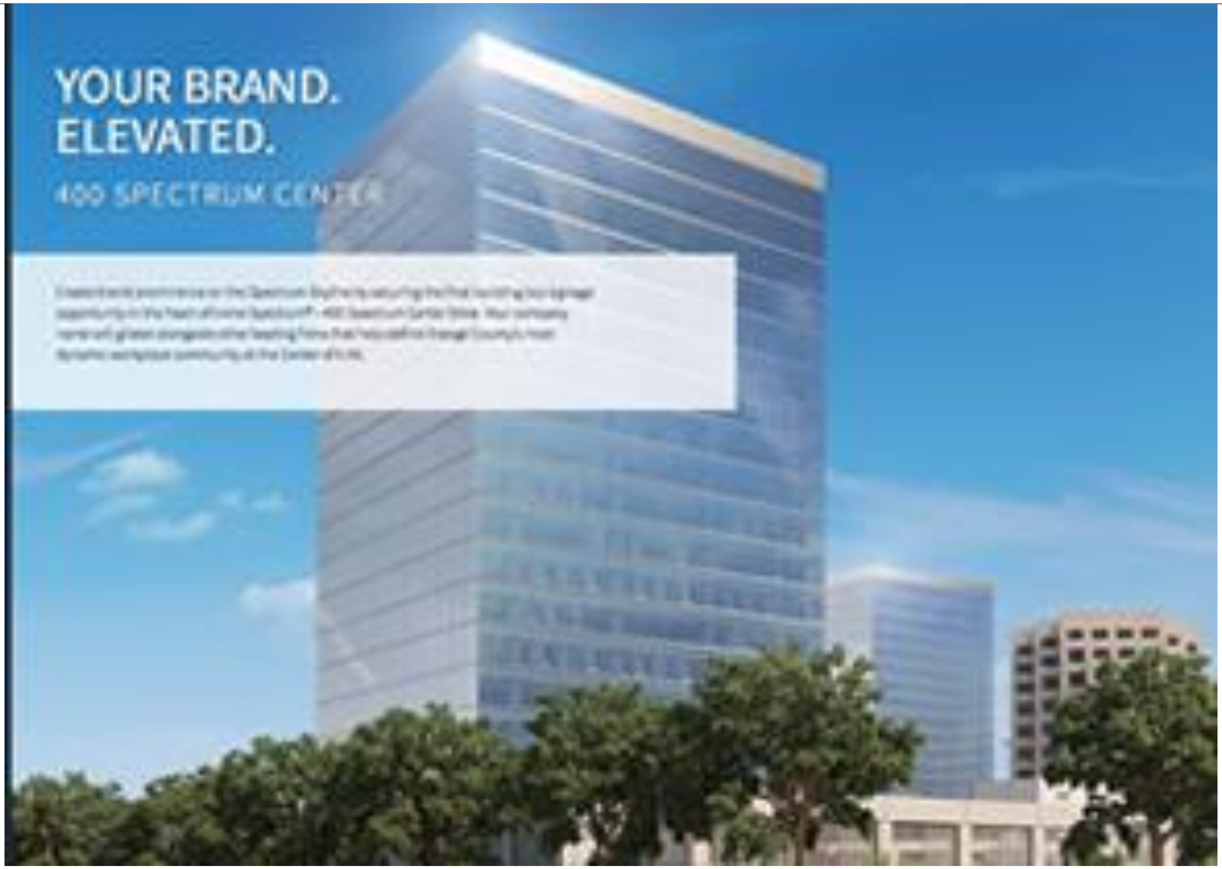
Submarket:	**Airport Area**
RBA:	**537,258**
# Floors:	**9**
Class:	**A**
Preleased:	**0%**
Quoted Rate:	**Negotiable**
Grnd Brk Date:	**First Quarter 2016**
Deliv Date:	**Third Quarter 2017**
Leasing Co:	**CBRE**
Developer:	**Trammell Crow Company**
Architect:	**Gensler**

Boardwalk - Irvine

400 Spectrum Center Dr

Submarket:	**South County**
RBA:	**466,696**
# Floors:	**20**
Class:	**A**
Preleased:	**8%**
Quoted Rate:	**Negotiable**
Grnd Brk Date:	**First Quarter 2016**
Deliv Date:	**Third Quarter 2017**
Leasing Co:	**The Irvine Company**
Developer:	**The Irvine Company**
Architect:	**Pei, Cobb, Freed & Partners**

400 Spectrum Center



Under Construction

The Broadcom Campus – Now Avago

South Orange County

880,000 SF – “100% Leased” but for Sale

Vacating similar SF in University Research Park in Irvine

Unfortuantely, Silicon Valley is acquiring companies and consolidating up North.

Broadcom BTS – For Sale

44,240-836,000 SF CAMPUS OFFICE OPPORTUNITY

Cutting-edge research and development comes together in a vibrant hub of entrepreneurs and visionaries within University Research Park. This state-of-the-art ecosystem provides valuable access to UC Irvine, countless opportunities for valuable partnerships and access to resources and talent.

Now leasing for mid-2018 occupancy

ND WATER
E A L T Y

55 Enterprise

Submarket:	**South County**
RBA:	**205,000**
# Floors:	**4**
Class:	**A**
Preleased:	**100%**
Quoted Rate:	**N/A**
Grnd Brk Date:	**First Quarter 2016**
Deliv Date:	**Third Quarter 2017**
Leasing Co:	**CBRE**
Developer:	**Parker Properties, LP**
Architect:	**Ware Malcomb**

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MicroVention
TERUMO

8. 15495 Sand Canyon Ave

Submarket:	**South County**
RBA:	**106,500**
# Floors:	**4**
Class:	**A**
Preleased:	**39%**
Quoted Rate:	**Negotiable**
Grnd Brk Date:	**First Quarter 2016**
Deliv Date:	**First Quarter 2017**
Leasing Co:	**The Irvine Company**
Developer:	**The Irvine Company**
Architect:	**LPA**

9. 15485 Sand Canyon Ave

Submarket:	**South County**
RBA:	**105,600**
# Floors:	**4**
Class:	**A**
Preleased:	**100%**
Quoted Rate:	**N/A**
Grnd Brk Date:	**First Quarter 2016**
Deliv Date:	**Second Quarter 2017**
Leasing Co:	**The Irvine Company**
Developer:	**The Irvine Company**
Architect:	**LPA**

Flight – Tustin; +/- 870,000 SF

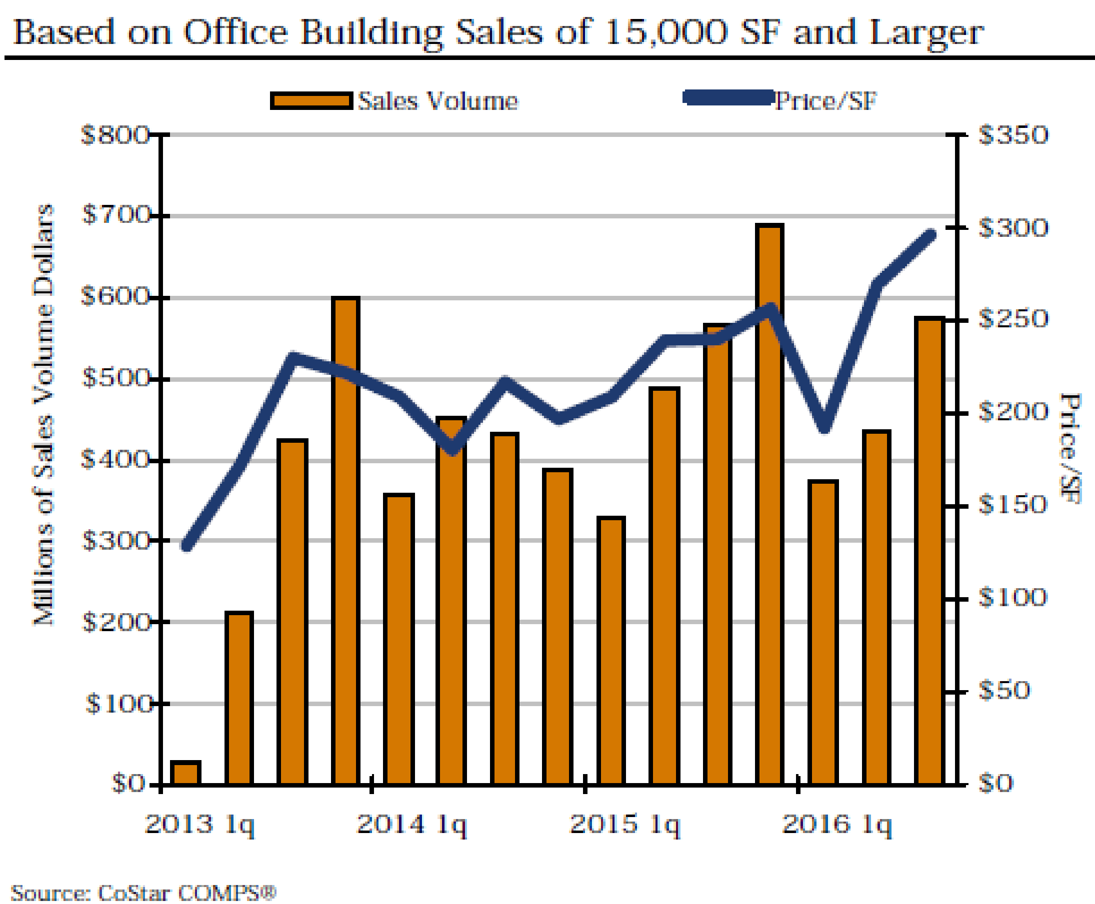
Small Tenant Market

34 of the top 40 leases signed in 2016 were 24,000 SF to 90,000 SF.

80% of tenants are under 7,000 square feet.

Despite efforts by municipalities and large landlords, out of market corporations are not coming to OC to take substantial amounts of space.

Sales Volume & Price



Sales Analysis by Building Size

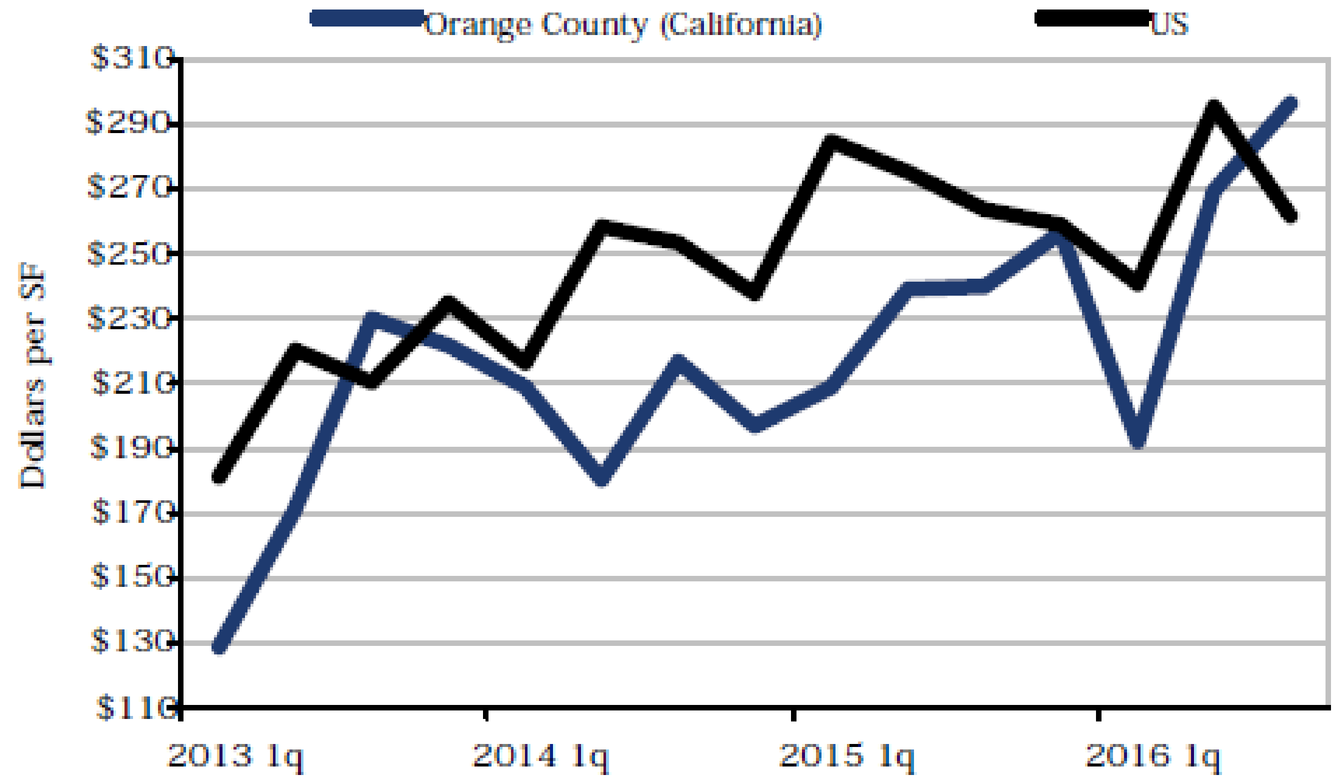
Based on Office Building Sales From Oct. 2015 - Sept. 2016

Bldg Size	#	RBA	$ Volume	Price/SF	Cap Rate
< 50,000 SF	228	2,481,586	$665,487,702	$ 268.17	6.25%
50K-249K SF	45	5,574,584	$1,325,279,000	$ 237.74	5.95%
250K-499K SF	3	1,001,768	$361,866,000	$ 361.23	4.00%
>500K SF	-	-	-	$ -	-

Source: CoStar COMPS®

U.S. Price/SF Comparison

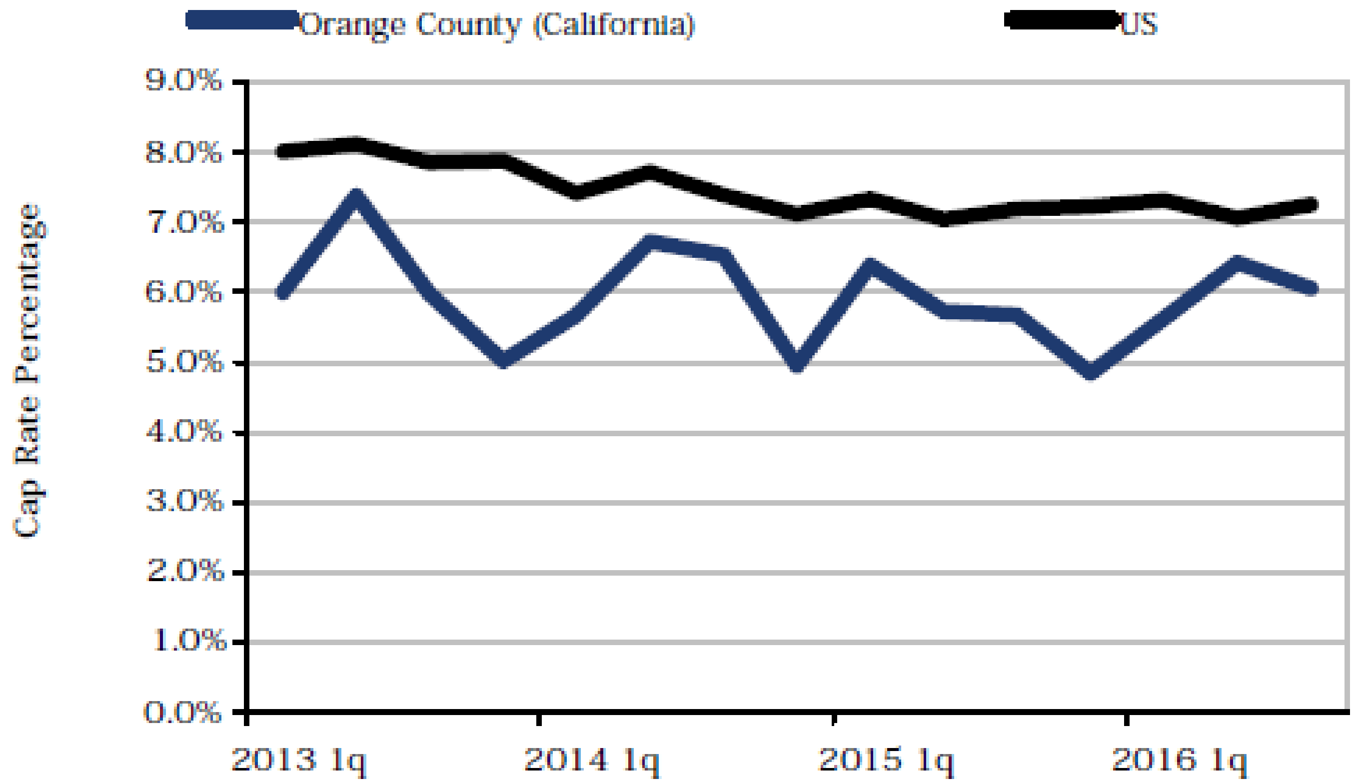
Based on Office Building Sales of 15,000 SF and Larger



Source: CoStar COMPS®

U.S. Cap Rate Comparison

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



Source: CoStar COMPS®

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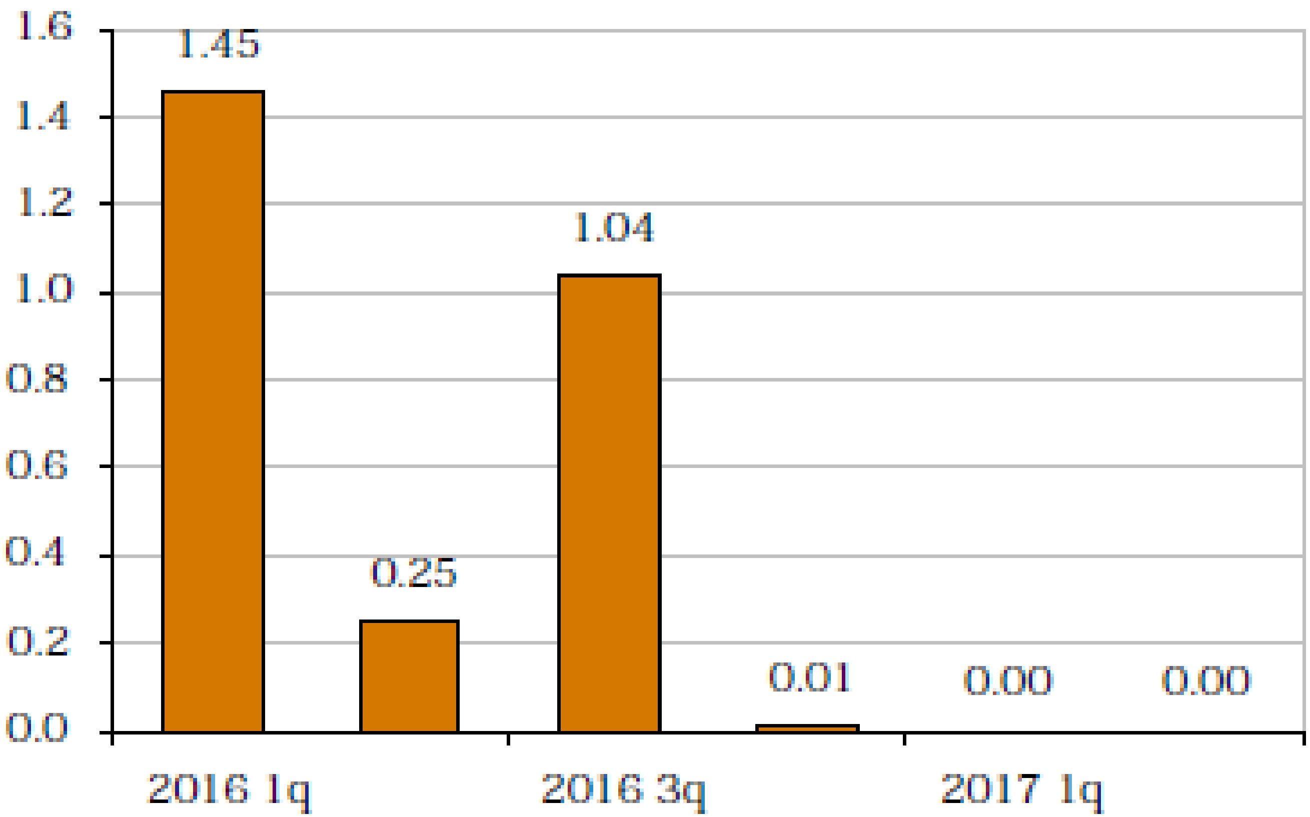
Future Space Available

Space Scheduled to be Available for Occupancy*



* Includes Under Construction Spaces

Source: CoStar Property®

Class A Product

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.

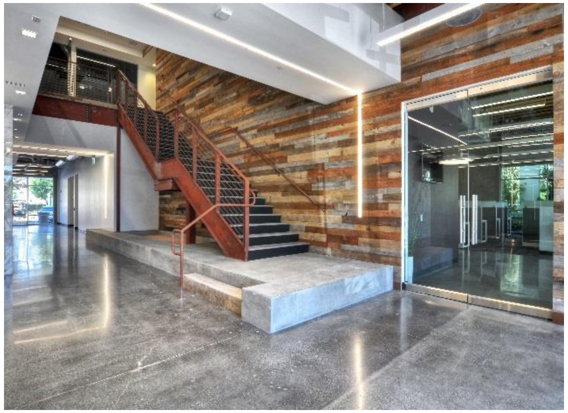
Class A Product

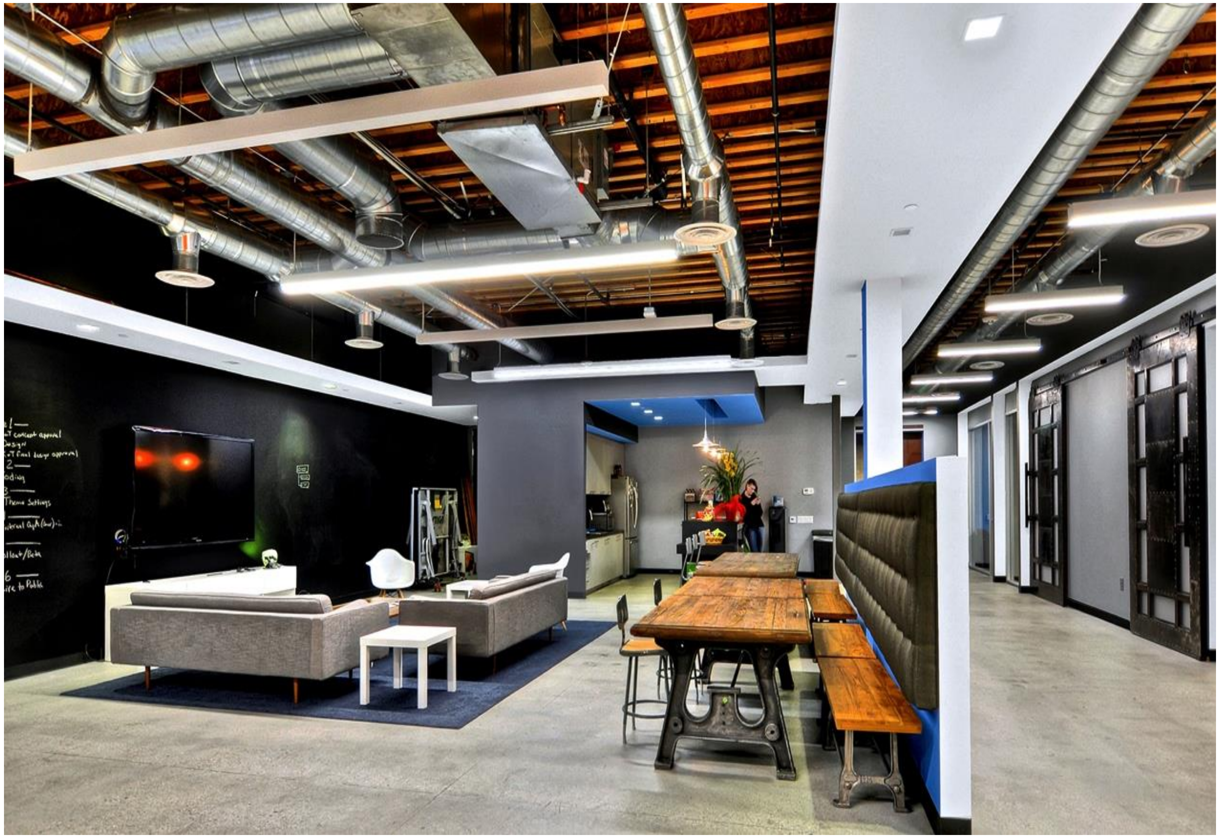
Class A Market Statistics

Year-End 2016

Period	Existing Inventory		Vacancy			Net	Deliveries		UC Inventory		Quoted
	# Blds	Total RBA	Direct SF	Total SF	Vac %	Absorption	# Blds	Total RBA	# Blds	Total RBA	Rates
2016 4q	283	45,786,216	5,480,574	5,721,247	12.5%	(277,584)	0	0	11	2,366,054	$32.87
2016 3q	283	45,786,216	5,205,114	5,443,663	11.9%	352,503	0	0	11	2,366,054	$32.89
2016 2q	283	45,786,216	5,464,123	5,796,166	12.7%	158,609	0	0	11	2,366,054	$32.32
2016 1q	283	45,786,216	5,582,944	5,954,775	13.0%	(173,685)	2	521,044	10	2,345,054	$31.45
2015 4q	281	45,265,172	4,929,231	5,260,046	11.6%	179,054	0	0	6	1,401,044	$30.40
2015 3q	281	45,265,172	5,086,810	5,439,100	12.0%	238,798	1	40,252	6	1,401,044	$29.66
2015 2q	280	45,224,920	5,308,731	5,637,646	12.5%	399,904	0	0	3	561,296	$29.28
2015 1q	280	45,224,920	5,807,500	6,037,550	13.4%	31,926	0	0	3	561,296	$28.42
2014	280	45,224,920	5,796,480	6,069,476	13.4%	1,200,867	3	814,761	3	561,296	$28.04
2013	277	44,410,159	6,241,651	6,455,582	14.5%	612,251	0	0	4	910,761	$25.75
2012	277	44,410,159	6,873,918	7,067,833	15.9%	888,672	1	81,600	1	380,000	$25.32
2011	276	44,328,559	7,564,928	7,874,905	17.8%	1,267,366	0	0	2	461,600	$25.31
2010	276	44,328,559	8,682,114	9,142,271	20.6%	331,399	0	0	0	0	$25.56
2009	276	44,328,559	8,705,716	9,473,670	21.4%	(1,315,155)	1	82,596	0	0	$27.95
2008	275	44,245,963	7,353,147	8,075,919	18.3%	(793,364)	9	1,174,716	1	82,596	$32.10
2007	266	43,071,247	5,396,479	6,107,839	14.2%	(749,050)	9	2,115,717	9	1,174,716	$35.64

“Creative” Space





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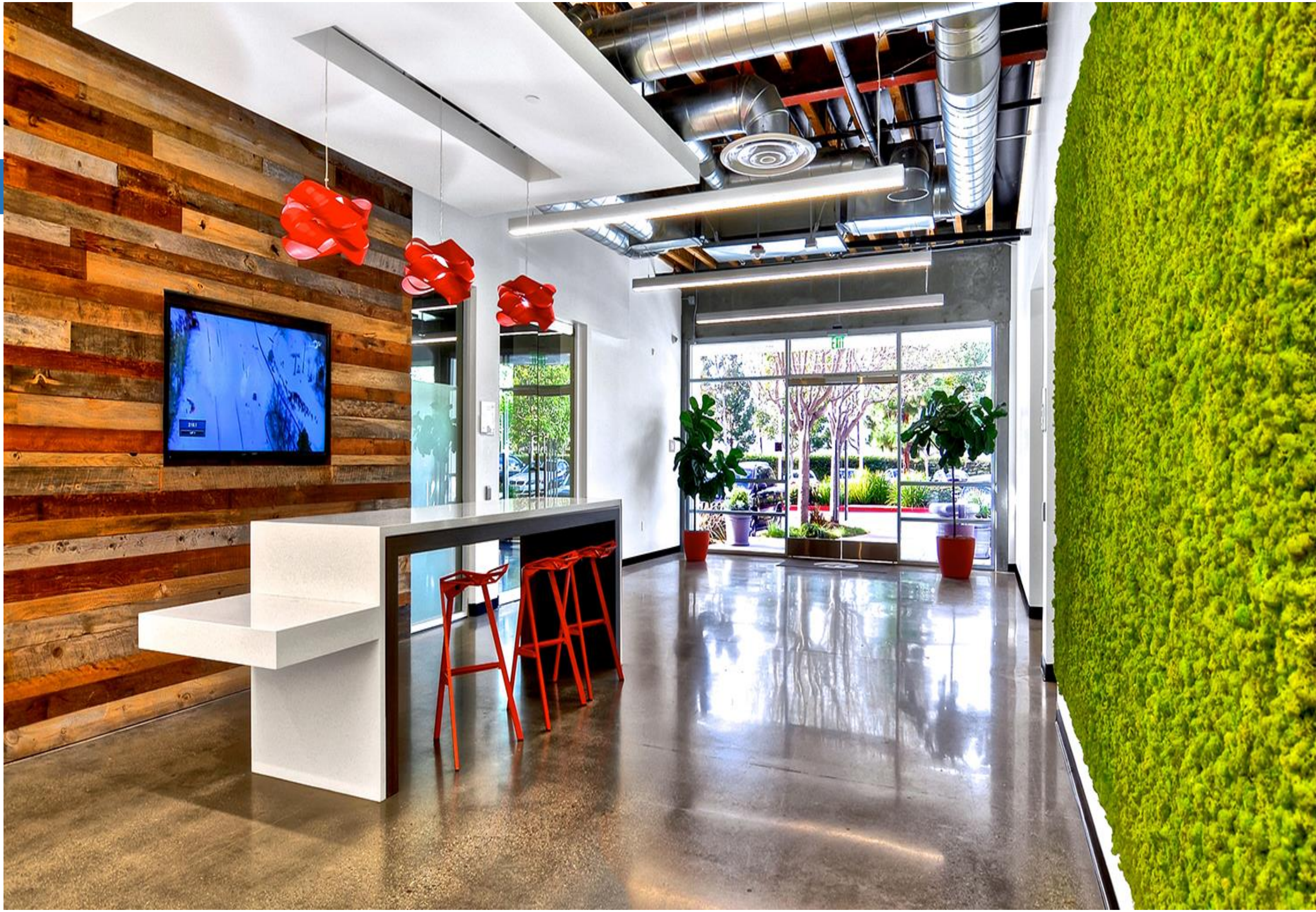
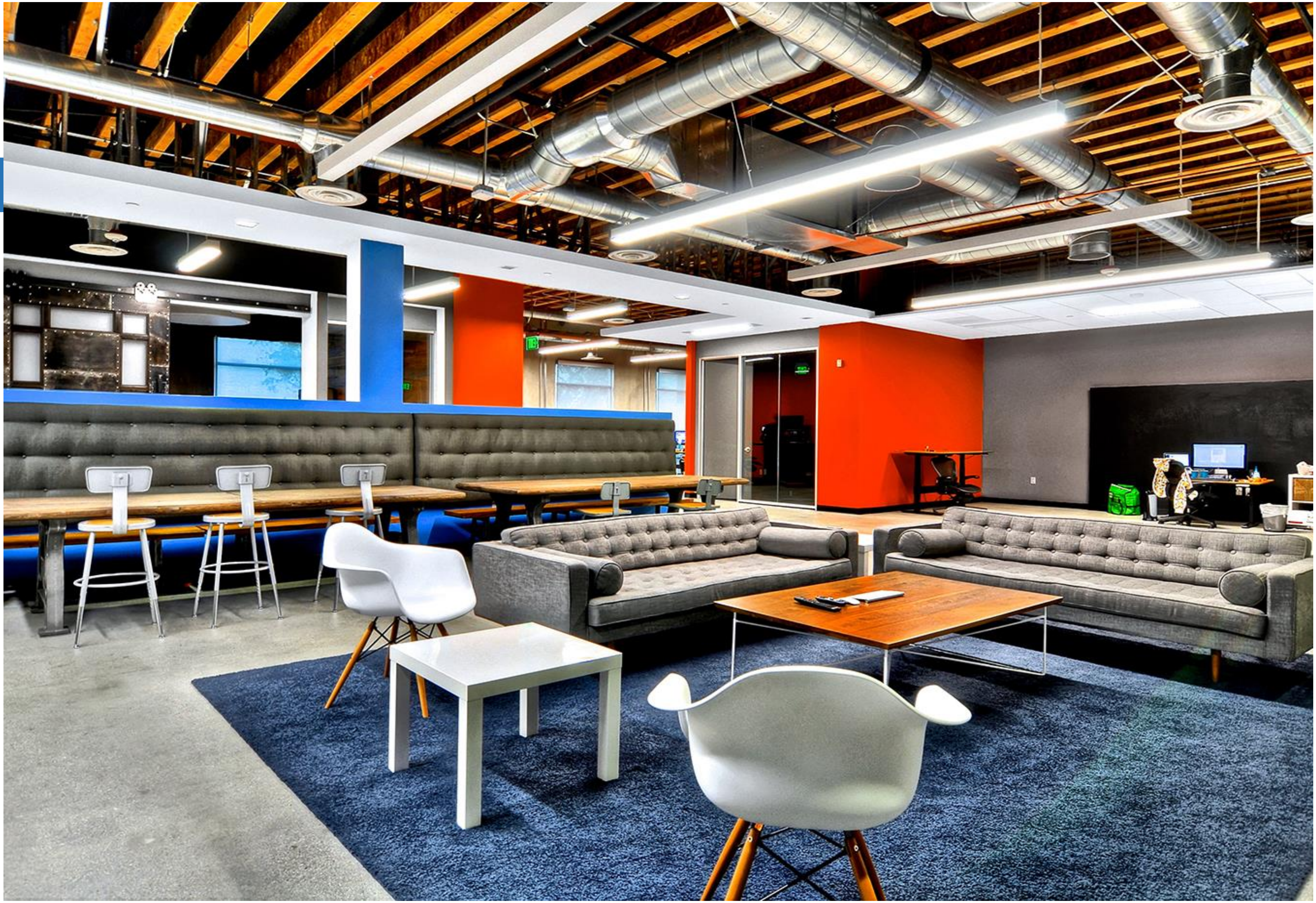





2860 MICHELLE

Class B Product

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

Class B Market Statistics

Year-End 2016

Period	Existing Inventory		Vacancy			Net	Deliveries		UC Inventory		Quoted
	# Blds	Total RBA	Direct SF	Total SF	Vac %	Absorption	# Blds	Total RBA	# Blds	Total RBA	Rates
2016 4q	2,977	85,732,493	6,703,984	6,920,382	8.1%	234,517	0	0	4	72,748	$26.70
2016 3q	2,977	85,732,493	6,940,807	7,154,899	8.3%	243,287	1	5,000	3	64,137	$26.37
2016 2q	2,976	85,727,493	7,223,091	7,393,186	8.6%	583,178	1	6,000	4	69,137	$26.35
2016 1q	2,975	85,721,493	7,836,814	7,970,364	9.3%	154,224	6	257,065	4	30,637	$25.92
2015 4q	2,970	85,487,978	7,706,193	7,891,073	9.2%	(74,330)	0	0	10	287,702	$25.47
2015 3q	2,972	85,536,664	7,521,339	7,865,429	9.2%	316,047	2	13,080	7	267,611	$24.87
2015 2q	2,972	85,566,450	7,947,084	8,211,262	9.6%	113,771	2	27,767	7	271,691	$24.57
2015 1q	2,970	85,538,683	7,987,014	8,297,266	9.7%	(54,460)	2	126,000	5	143,878	$24.09
2014	2,970	85,483,795	7,944,292	8,187,918	9.6%	1,281,636	5	552,871	5	161,267	$23.56
2013	2,973	85,223,249	9,090,484	9,209,008	10.8%	700,477	7	349,052	7	576,371	$21.98
2012	2,968	85,310,417	9,723,102	9,996,653	11.7%	924,883	5	140,744	10	833,223	$20.89
2011	2,966	85,224,868	10,647,219	10,835,987	12.7%	1,572,403	9	431,003	5	336,348	$21.51
2010	2,959	84,977,256	11,948,111	12,160,778	14.3%	(415,470)	6	141,409	8	501,564	$21.91
2009	2,954	84,852,847	11,225,301	11,620,899	13.7%	(1,629,391)	16	481,090	6	173,026	$23.68
2008	2,939	84,382,877	8,876,063	9,521,538	11.3%	51,093	58	1,025,057	17	559,500	$26.90
2007	2,881	83,357,820	7,755,372	8,547,574	10.3%	174,111	141	3,095,163	58	1,110,097	$28.70

Source: CoStar Property®

WIND WATER REALTY

Total Office Market Statistics

Year-End 2016

Period	Existing Inventory # Blds	Existing Inventory Total RBA	Vacancy Direct SF	Vacancy Total SF	Vacancy Vac %	Net Absorption	Deliveries # Blds	Deliveries Total RBA	UC Inventory # Blds	UC Inventory Total RBA	Quoted Rates
2016 4q	6,064	153,768,311	13,201,609	13,677,828	8.9%	(69,425)	0	0	15	2,438,802	$28.01
2016 3q	6,064	153,768,311	13,148,197	13,608,403	8.8%	635,107	1	5,000	14	2,430,191	$27.79
2016 2q	6,063	153,763,311	13,728,807	14,238,510	9.3%	755,034	1	6,000	15	2,435,191	$27.67
2016 1q	6,062	153,757,311	14,473,122	14,987,544	9.7%	(36,811)	8	778,109	14	2,375,691	$27.22
2015 4q	6,055	153,002,752	13,672,514	14,196,174	9.3%	171,025	0	0	16	1,688,746	$26.50
2015 3q	6,057	153,051,438	13,705,278	14,415,885	9.4%	546,720	3	53,332	13	1,668,655	$25.95
2015 2q	6,058	153,067,542	14,374,811	14,978,709	9.8%	554,076	2	27,767	10	832,987	$25.63
2015 1q	6,057	153,043,021	14,962,472	15,508,264	10.1%	(1,443)	2	126,000	8	705,174	$25.06
2014	6,057	152,988,133	14,920,608	15,451,933	10.1%	2,854,647	8	1,367,632	8	722,563	$24.64
2013	6,058	151,917,826	16,895,015	17,236,273	11.3%	1,332,248	7	349,052	11	1,487,132	$23.01
2012	6,054	152,011,994	18,156,361	18,662,689	12.3%	1,925,158	7	226,844	11	1,213,223	$22.29
2011	6,051	151,846,738	19,893,235	20,422,591	13.4%	2,816,326	9	431,003	8	802,448	$22.67
2010	6,045	151,620,336	22,316,502	23,012,515	15.2%	(363,953)	6	141,409	8	501,564	$23.16
2009	6,040	151,495,927	21,323,585	22,524,153	14.9%	(3,145,469)	17	563,686	6	173,026	$25.22
2008	6,026	150,963,011	17,460,122	18,845,768	12.5%	(933,901)	67	2,199,773	18	642,096	$28.65
2007	5,962	148,784,380	14,203,155	15,733,236	10.6%	(850,412)	150	5,210,880	67	2,284,813	$31.22

Source: CoStar Property®

Office Values & Assumptions

1. Comparable Sale
2. Income
3. Replacement Cost

Comparable Sale

More off market sales could start happening.

More transactions to compare with.

Additional Features are Important (TI, Amenities, Furniture, Energy Savings, retail proximity, housing options.)

Sale Comps

1. 1901 Main St	2. 1750 E 4th St	3. 4000 Metropolitan Dr
		
Irvine	Santa Ana	Orange

1. 1901 Main St — Irvine

Price:	$66,000,000
Price/SF:	$382.02
Cap Rate:	N/A
RBA:	172,767
Date:	5/4/2016
Year Built:	2002
Buyer:	J+R Group LLC
Seller:	Piedmont Office Realty Trust, Inc.

2. 1750 E 4th St — Santa Ana

Price:	$64,000,000
Price/SF:	$278.27
Cap Rate:	N/A
RBA:	229,989
Date:	11/29/2016
Year Built:	1994
Buyer:	Boyd Watterson Asset Management
Seller:	Hines Securities, Inc.

3. 4000 Metropolitan Dr — Orange

Price:	$61,000,000
Price/SF:	$323.20
Cap Rate:	6.5%
RBA:	188,739
Date:	4/22/2016
Year Built:	1985
Buyer:	Boyd Watterson Asset Management
Seller:	Spaulding & Slye Investments

Sale Comps

4. 23807 Aliso Creek Rd

Laguna Niguel

Price:	**$53,693,000**
Price/SF:	**$229.46**
Cap Rate:	**5.94%**
RBA:	**233,996**
Date:	**7/28/2016**
Year Built:	**1985**
Buyer:	**Dunhill Partners, Inc.**
Seller:	**The Colton Company**

5. 3 Hutton Centre Dr

Santa Ana

Price:	**$50,500,000**
Price/SF:	**$254.84**
Cap Rate:	**5.3%**
RBA:	**198,161**
Date:	**11/16/2016**
Year Built:	**1985**
Buyer:	**Cypress Office Properties**
Seller:	**TIAA**

6. 1120 W La Veta Ave

Orange

Price:	**$43,950,000**
Price/SF:	**$245.15**
Cap Rate:	**2.97%**
RBA:	**179,279**
Date:	**1/8/2016**
Year Built:	**1985**
Buyer:	**CRC Real Estate Corp**
Seller:	**Hankey Investment Company**

Sale Comps

7. 1700 E Saint Andrew Pl

Santa Ana

Price:	**$37,000,000**
Price/SF:	**$215.96**
Cap Rate:	**7%**
RBA:	**171,330**
Date:	**5/13/2016**
Year Built:	**1991**
Buyer:	**Drawbridge Realty Trust**
Seller:	**Del Mar Partnerships, Inc.**

8. 2401 N Glassell St

Orange

Price:	**$35,850,000**
Price/SF:	**$187.57**
Cap Rate:	**8%**
RBA:	**191,127**
Date:	**3/9/2016**
Year Built:	**1984**
Buyer:	**Hines**
Seller:	**Volt Information Sciences, Inc.**

9. 23961 Calle de la Magdalena

Laguna Hills

Price:	**$34,500,000**
Price/SF:	**$253.86**
Cap Rate:	**N/A**
RBA:	**135,904**
Date:	**1/29/2016**
Year Built:	**1980**
Buyer:	**Greenlaw Partners**
Seller:	**Lillibridge Healthcare Services, Inc.**

WIND WATER REALTY

96 Corporate Park, Irvine

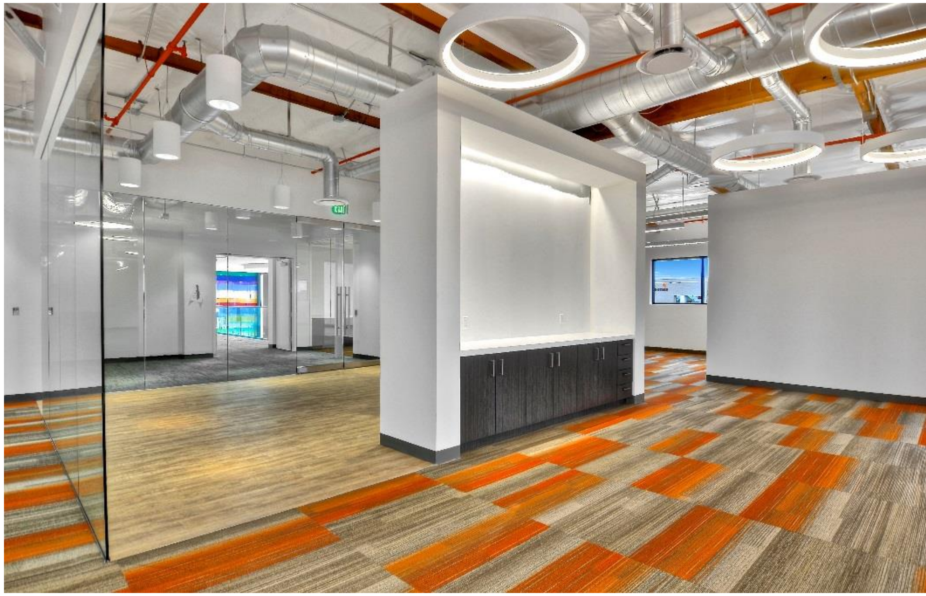
Size: 41,545 SF

Sold: $15.05M / $362 PSF

Date: August 16, 2016

Notes: 20,000 SF was vacant, shell condition.

Owner/User Sale



2860 Michelle Drive, Irvine

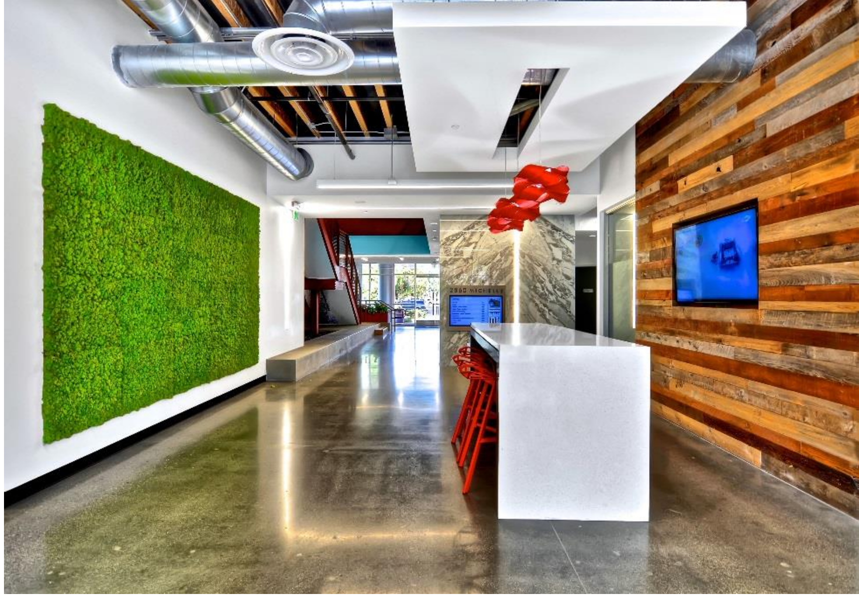
Size: 41,064 SF

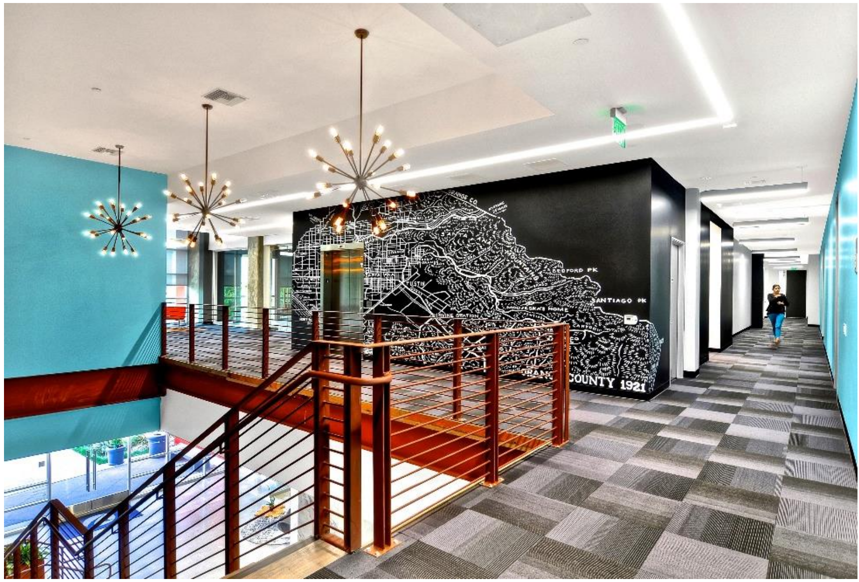
Sold: $15.7M / $382 PSF

Date: August 19, 2016

Notes: 5.8% cap; 100% leased

Exchange Buyer





Centerpointe, Irvine

Size: 4 buildings (105,578 SF)

Sold: $27M / $257 PSF

Date: January 20, 2017

Notes: 99% leased

Private Equity Group

WIND WATER REALTY

Income Approach

Everyone is chasing yield and certainty of cash flow is important.

Great method to use right now to create or substantiate your valuation.

Owner / users take a lot of risk out of the equation and can boost property value day 1 by signing a lease for all vacancy.

Income Approach Cont.

Vacancy and lease expirations are expensive. Verify the "upside."

Lack of 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 when it comes to boosting NOI

Spec suites are better than shell.

Lease Comparables

Property Address City ZIP	Leased SF	Term Months	Free Rent Months	Start Date	Expiration Date	Start Rate PSF	Type
9281 Research Dr Irvine, CA 92618	2,568	48	2.0	02/01/16	01/31/20	$ 2.15	NNN
2860 Michelle Dr Ste230 Irvine 92606	6,342	60	3.0	05/15/16	05/14/21	$ 2.15	NNN
15440 Laguna Canyon, Irvine	8,156	24	0.0	03/01/17	02/28/19	$ 2.05	NNN
15440 Laguna Canyon, Irvine	3,491	36	0.0	05/01/17	04/30/19	$ 2.30	NNN
26840 Aliso Viejo Parkway, Aliso Viejo, 92656	6,264	64	0.0	09/01/16	12/31/21	$ 2.14	NNN

Lease Comps Cont.

47 Discovery, Suite 200 Irvine 92618	3,158	24		01/01/16	12/31/18	$	2.10	NNN
17922 Fitch Ste 100 Irvine 92614	10,264	62	2.0	11/24/16	12/23/21	$	2.15	NNN
26840 Aliso Viejo Pkwy, Ste 120 Aliso Vijeo 92656	3,735	63	0.0	01/01/17	12/31/22	$	2.20	NNN

WIND WATER REALTY

30,364	SF	
Mos	Rate	Period Rent
12	1.32	480,000
12	1.75	638,008
12	1.80	657,149
12	1.86	676,863
12	1.91	697,169
12	1.97	718,084
12	2.03	739,627
4	2.09	253,938
88	1.82	4,860,838
Mutually agreed TI	(30.00)	(910,920)
Commission		(267,346.09)
Total Cost*		(1,178,266)
Net Consideration		3,682,572
Building Value (PSF)	5.5% Cap	382
Building Value (PSF)	6.0% Cap	350
*Two year pay back not including vacancy.		

WIND WATER REALTY

Income Assumptions

Rent Growth – 5% p/yr for next 2 years.

Escalations – 3.0%

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

Down Time – 6 months if ready for occupancy; 9 - 12 months if it is shell or needs a lot of work.

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

Improvements - $15 - $65 PSF on vacant space; $10 - $15 on renewal

Vacancy – 10%

WIND WATER REALTY

Replacement Cost

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

Land Cost - $60 PSF of useable land area ($150 PSF on building area)

Hard Costs - $130 PSF

Tenant Improvements - $70

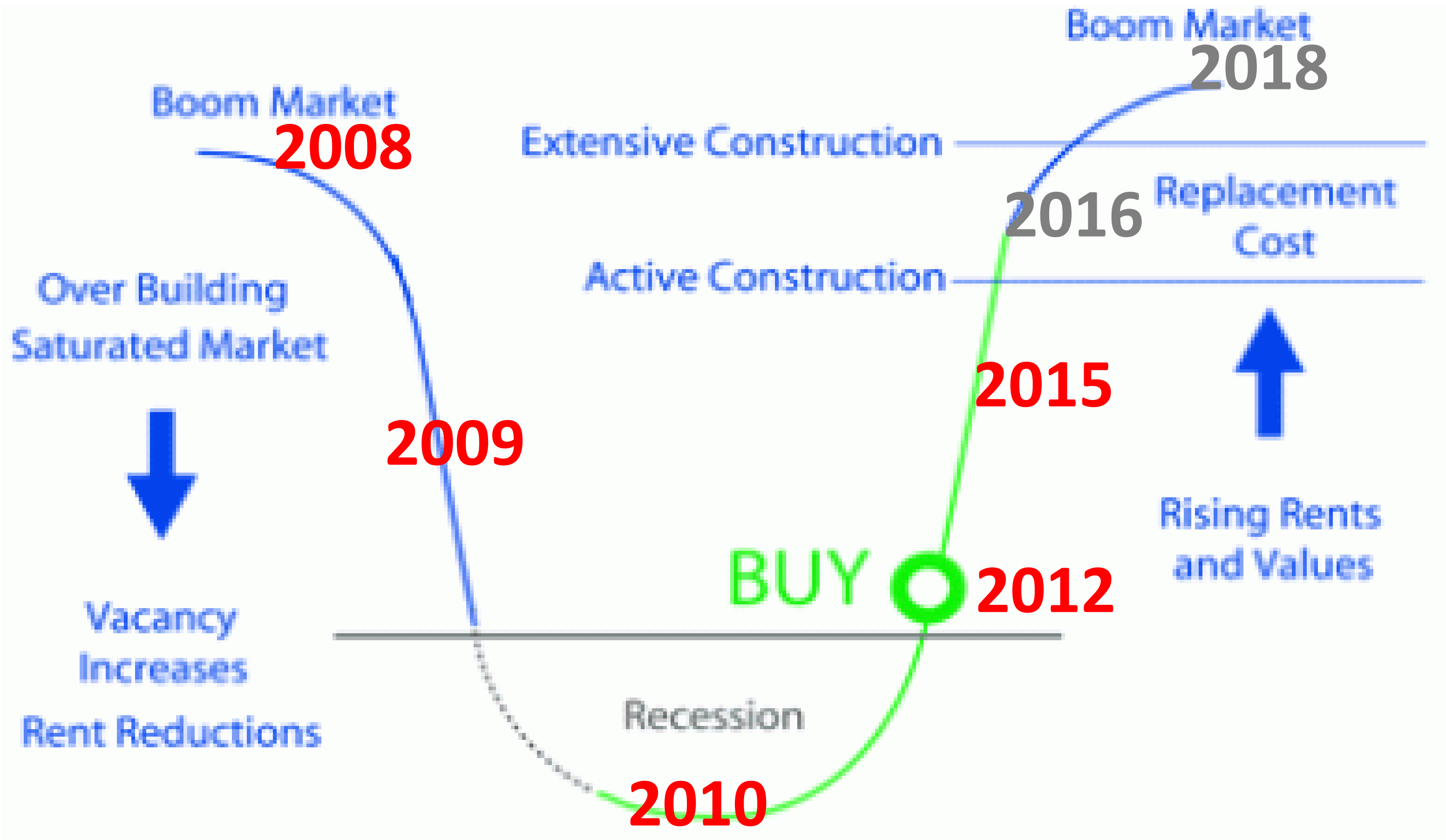
Soft Costs - $10 PSF

Total costs of $360 PSF

Necessary income for 9% Cap Rate = $32.40 PSF, NNN

WIND WATER REALTY

Office Real Estate Cycle



Forecast

2017 will be another growth year for office

New development will continue push rents.

Owner / User sales will increase.

More off market sales will start to occur.

Cap rates will remain low with underwriting expecting rent growth.

Uncertainty???

1. The man with the itchy Twitter finger
2. Interest Rates
3. Corporate Acquisitions (Broadcom, Qlogic)
4. The length of the current cycle
5. Stock market at record high
6. China, Brexit, Middle East

WIND WATER REALTY

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