

# OC Commercial Office Market

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JANUARY 2019 – BY WINDWATER REAL ESTATE



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## CUSTOMIZED REAL ESTATE SERVICES

TRANSACTION. MARKETING. CONSULTING.

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### .01 Transaction

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Branding, Digital Marketing and Lead Generation.



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Portfolio Planning, Asset Underwriting and Strategy Exploration.



# WindWater Real Estate

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Digitally-driven, real estate company

We believe that the valuation component needs to be brought into the conversation much earlier.

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# Overview

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

Multi-Tenant; Historic Districts; Value-Add



# 2019

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# ► What Are We Cautious Of???

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1. BIG BASIS – Replacement Costs / Tenants
2. BIG Loan To Values w/ Lender Restrictions
3. Major renovation and development costs
4. Waning Tenant Demand – Sublease Space
5. The CoWorking Impact
6. Macro Economic Uncertainty



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# Where is it Safe(r)?

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1. Quality Properties where land is scarce with good credit tenants on NNN leases at market rents at prices inline with today's replacement cost – DIFFICULT TO FIND
2. Properties with vacancy of 15% to 30% with smaller suites (< 7,000 SF) that need cosmetic upgrades but not major rehab. – HARD BUT POSSIBLE



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# Notable Trends

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1. Rents are stagnating on Class A Properties
2. Rents have increased ~4% in Class B Properties
3. Property Values are up < 10% YoY
4. Unemployment rate – 2.6% in OC
5. No absorption in 2018 – Net Neutral. \* Partially due to new construction delivered.
6. Vacancy rates have increased from 8.9% to 10 % (Due to new construction).
7. Construction activity is down from 2017 (2.4 M) to 1.3 M.

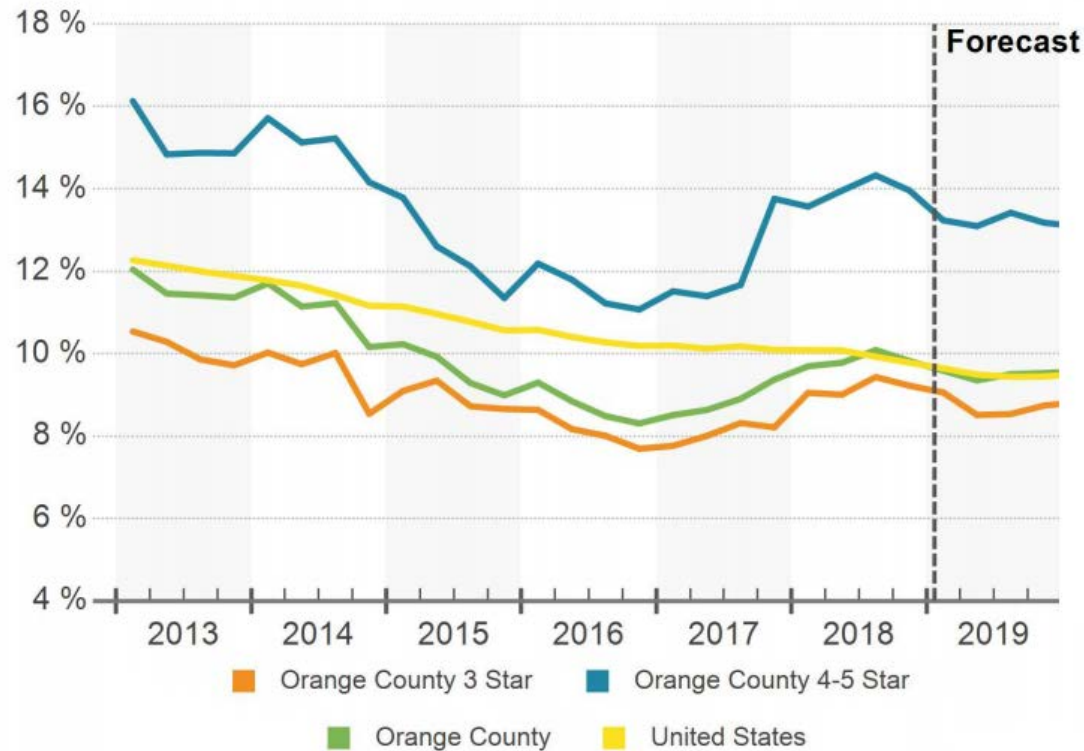


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# Vacancy at 10% (Neutral)

VACANCY RATE





# Tenant – Neutral - Landlord

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## **VACANCY RATES**

>10% = Tenant's Market

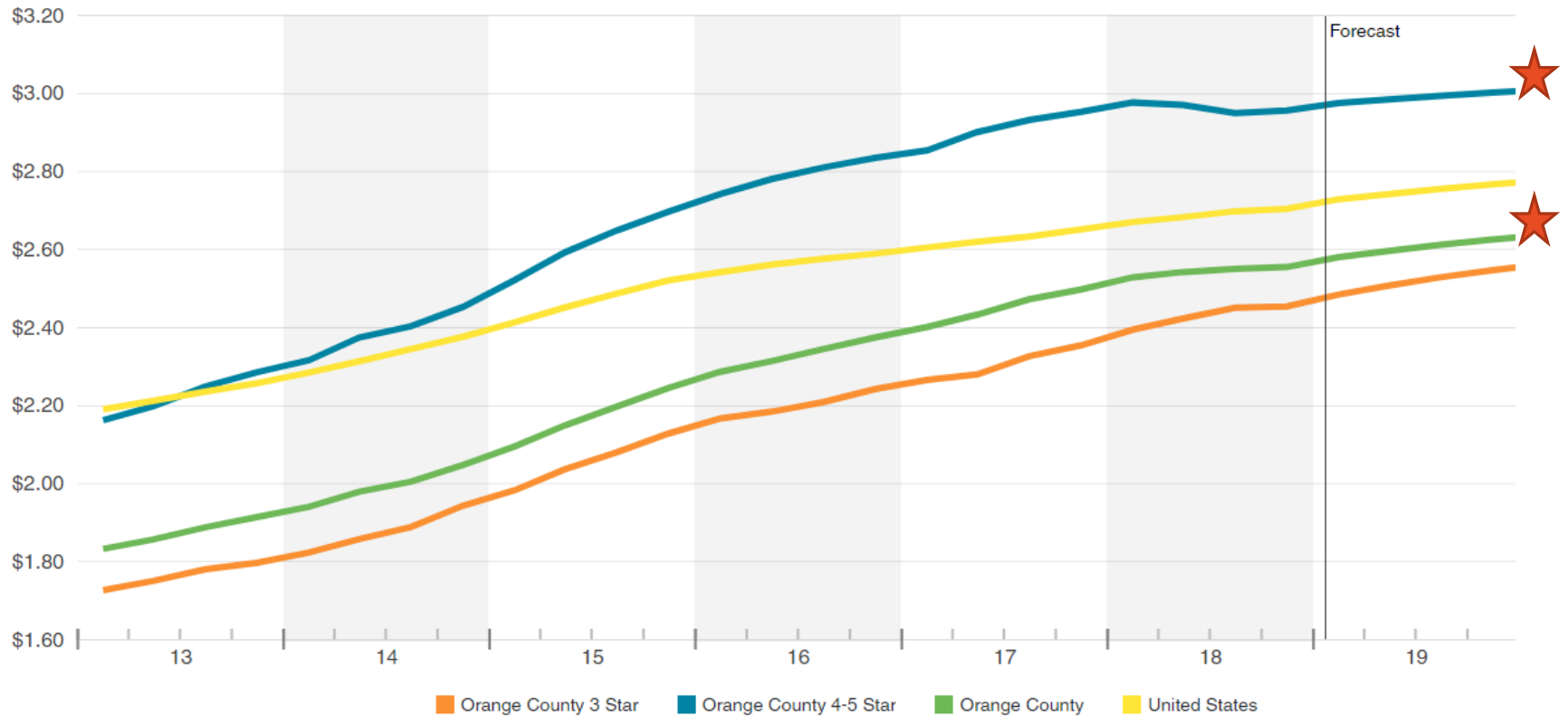
8% to 10% = Neutral Market

< 8% = Landlord's Market



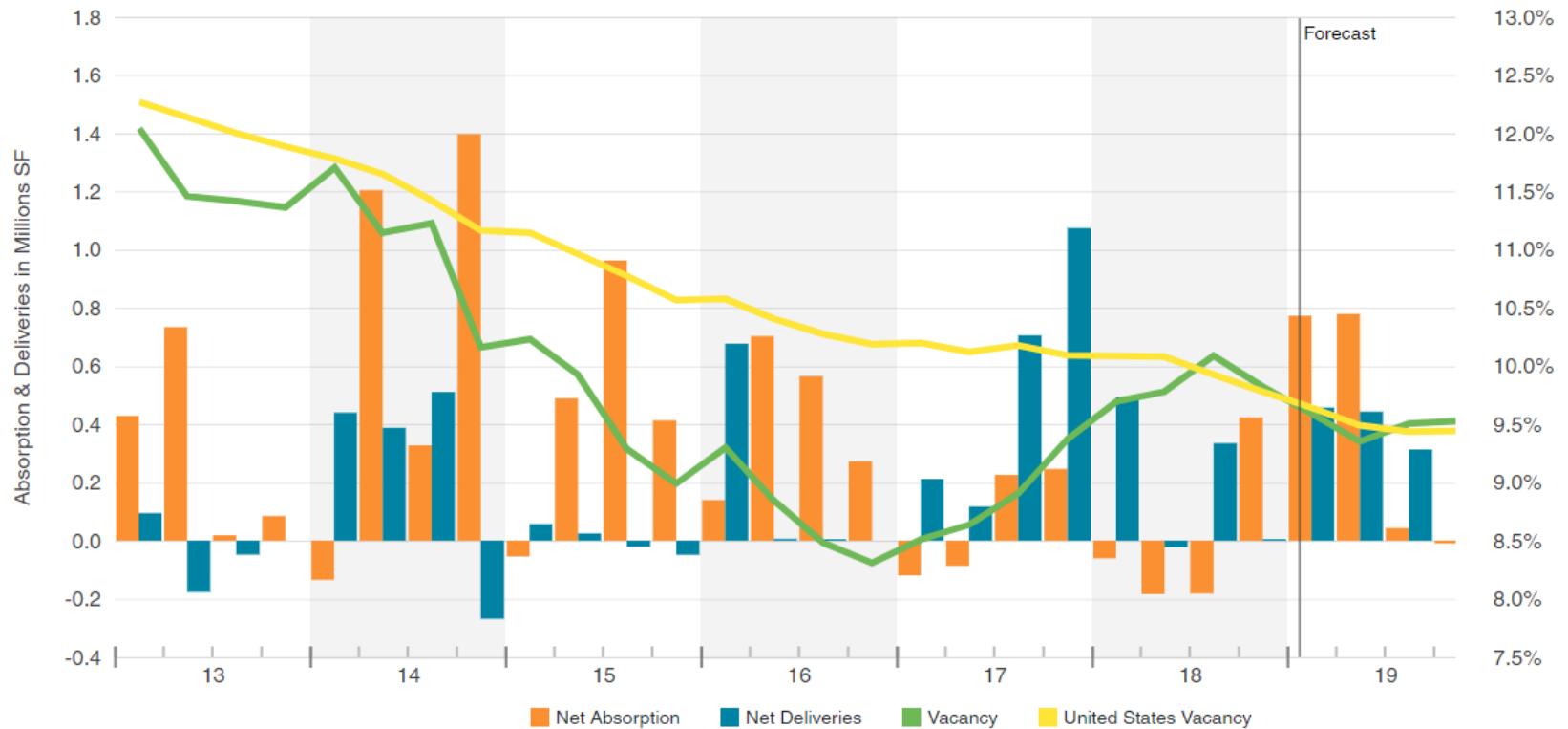
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# Rental Rates



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# Absorption & Deliveries



Properties

18

Square Feet

1,361,596

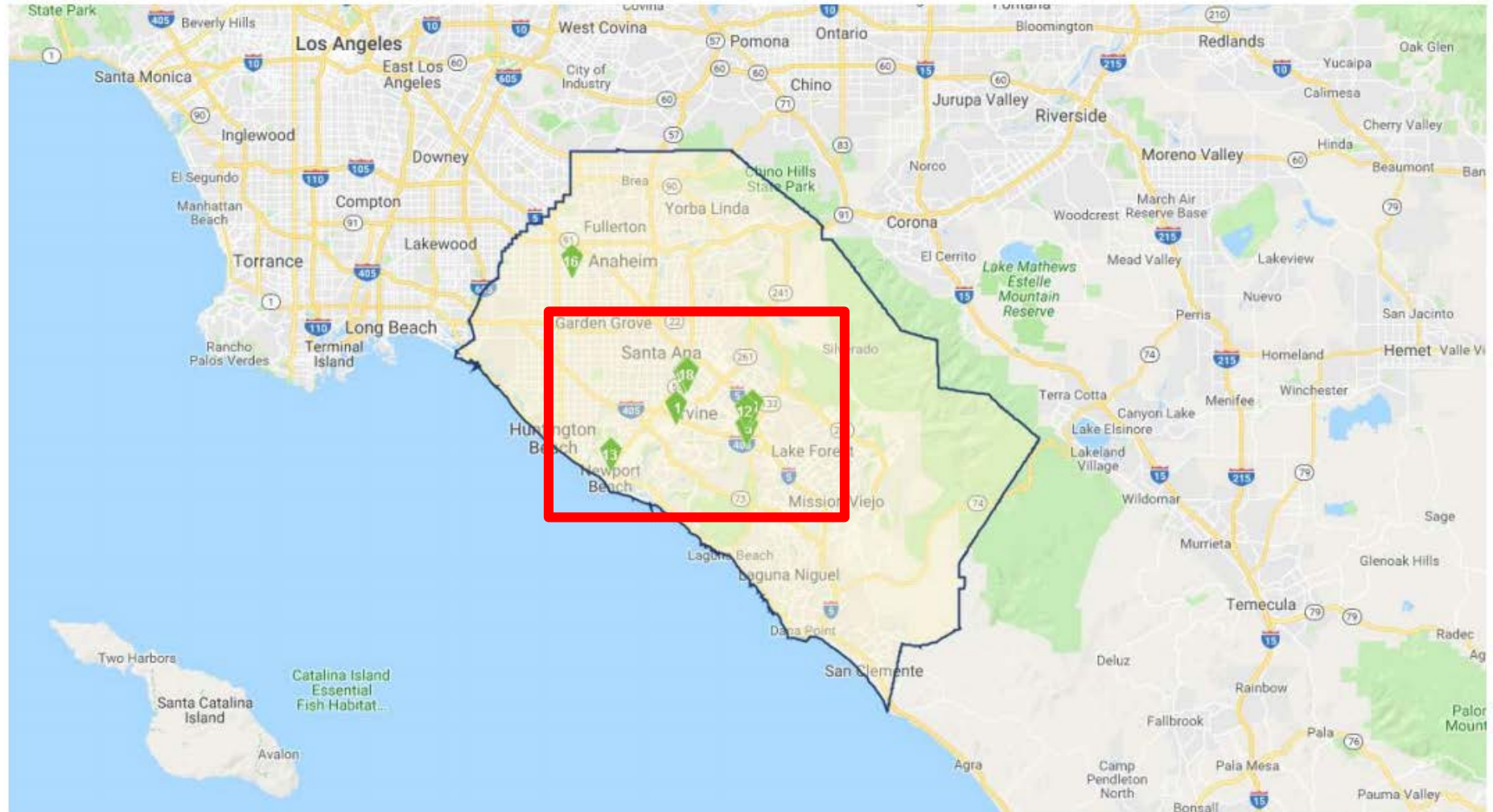
Percent of Inventory

0.9%

Released

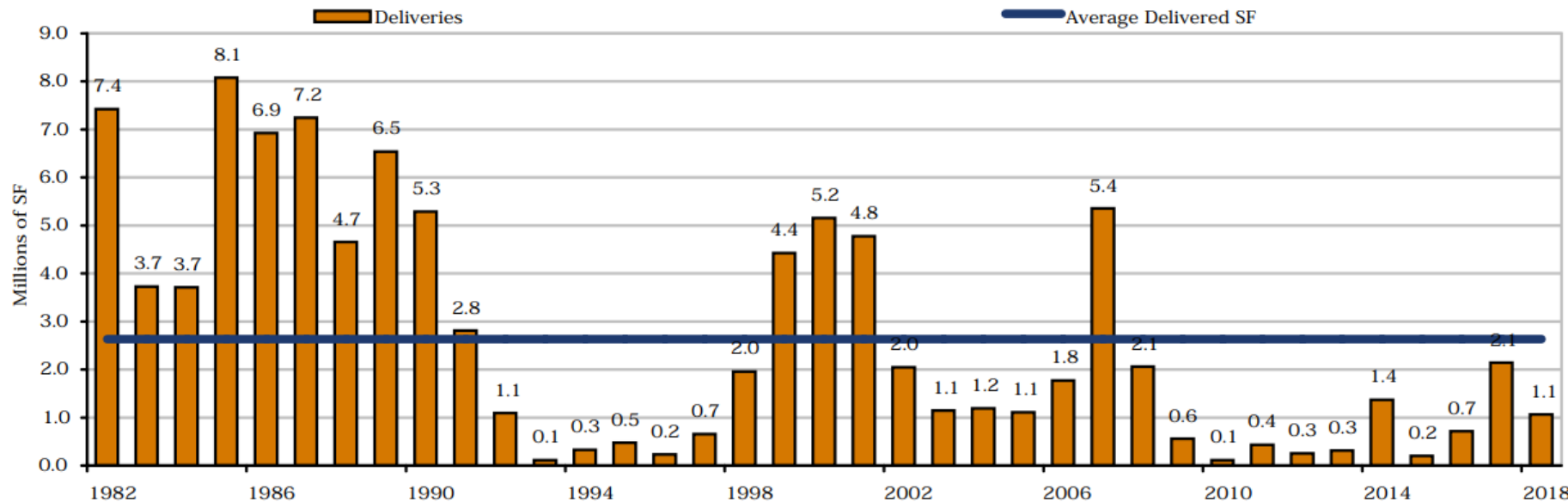
8.7%

## UNDER CONSTRUCTION PROPERTIES



# Historical Deliveries

1982 - 2018



Source: CoStar Property®

\* Future deliveries based on current under construction buildings.



# Lincoln Property's Flight



457,000 SF – 100% Vacant



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# Irvine Company's Spectrum Terrace



353,000 SF (with 706,000 SF entitled) –  
100% Vacant



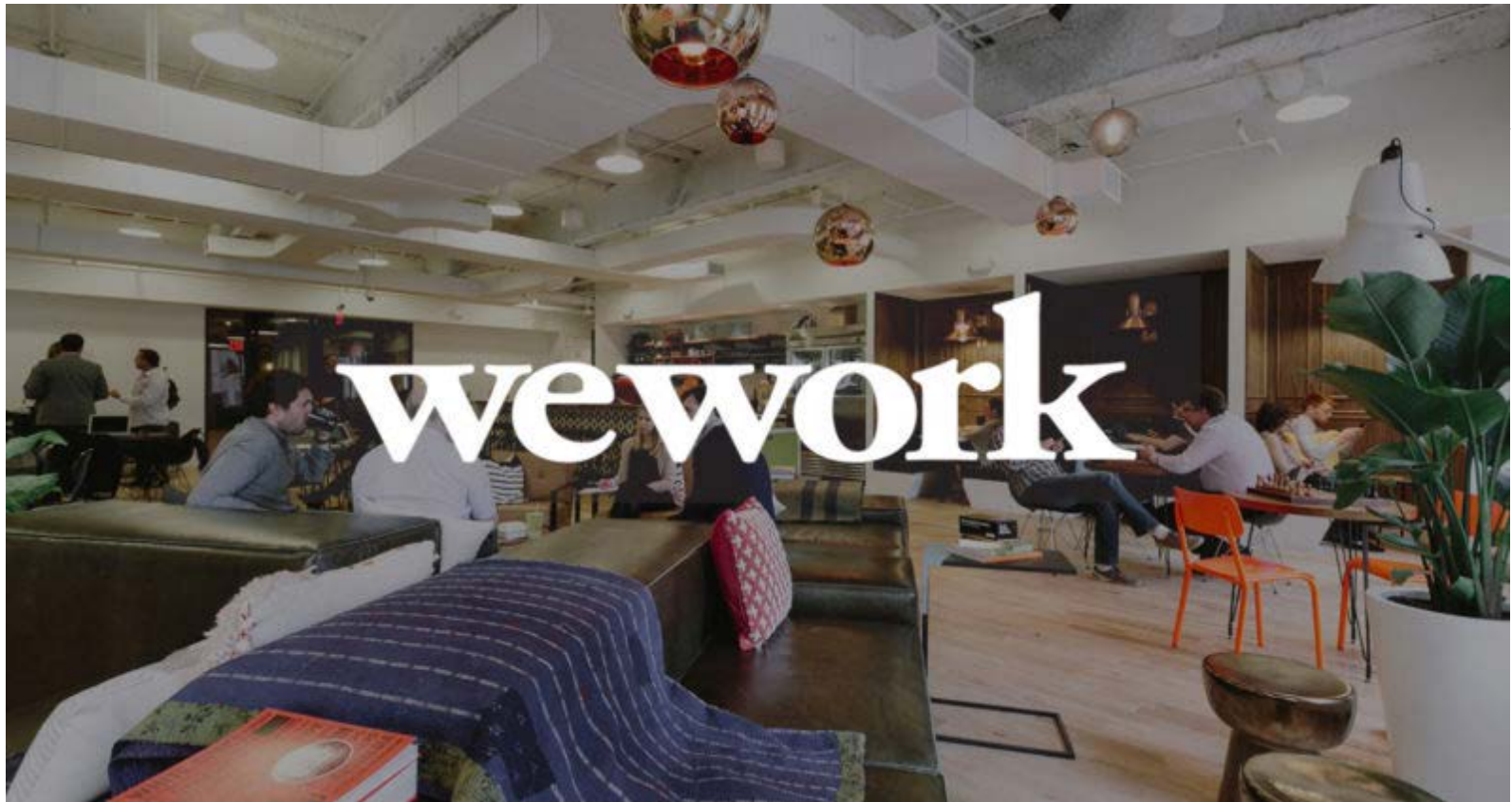
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# Irvine Company's The Quad



365,000 SF – 57.9% Vacant



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# Co-Working Operations

(Since Q1 2017)

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1. WeWork @ 200 Spectrum Center Drive – 25,000 SF
2. WeWork @ 400 Spectrum Center Drive – 50,000 SF
3. WeWork @ 611 Anton Boulevard – 40,000 SF
4. WeWork @ The Boardwalk – 45,000 SF
5. WeWork @ Segerstrom Towers – 48,000 SF
6. WeWork @ Flight at Tustin Legacy - ? SF
7. Industrious @ Park Place Irvine – 40,000 SF
8. Spaces @ Intersect Irvine – 25,000 SF



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# Small Tenant Market

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Over 2,000 leases were executed in 2018

AVG lease size in 2018 was 4,003 SF

80% of tenants are < 7,000 SF

Are TI costs keeping small tenants from moving?

What amenities do small tenants expect as part of their lease?

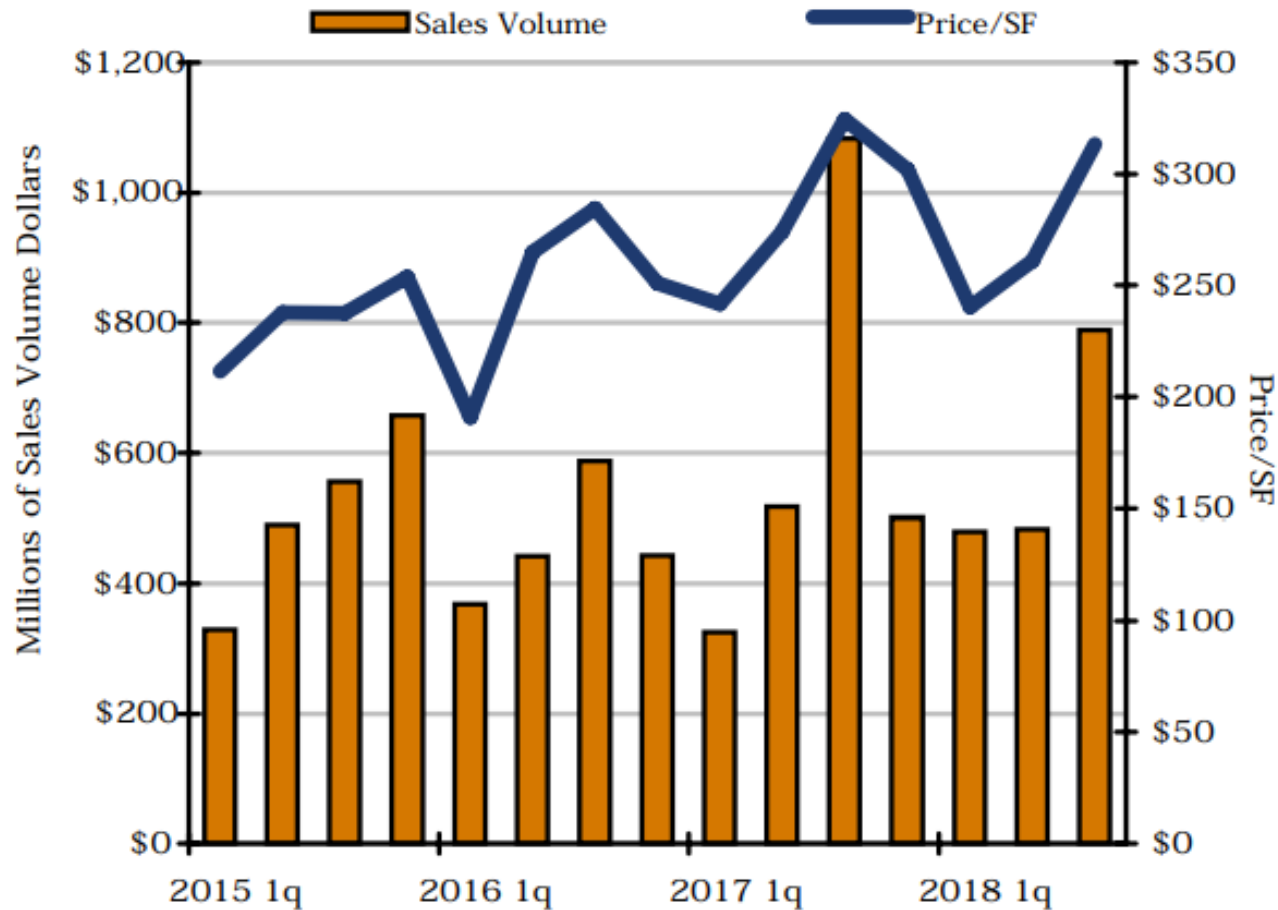


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# Sales Volume & Price

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



Source: CoStar COMPS®

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# Sales Analysis by Building Size

Based on Office Building Sales From Oct. 2017 - Sept. 2018

Bldg Size	#	RBA	\$ Volume	Price/SF	Cap Rate
< 50,000 SF	196	2,242,180	\$671,303,499	\$ 299.40	5.59%
50K-249K SF	28	2,832,039	\$605,302,500	\$ 213.73	5.99%
250K-499K SF	9	3,221,033	\$1,099,337,880	\$ 341.30	5.19%
>500K SF	1	533,118	\$161,000,000	\$ 302.00	-

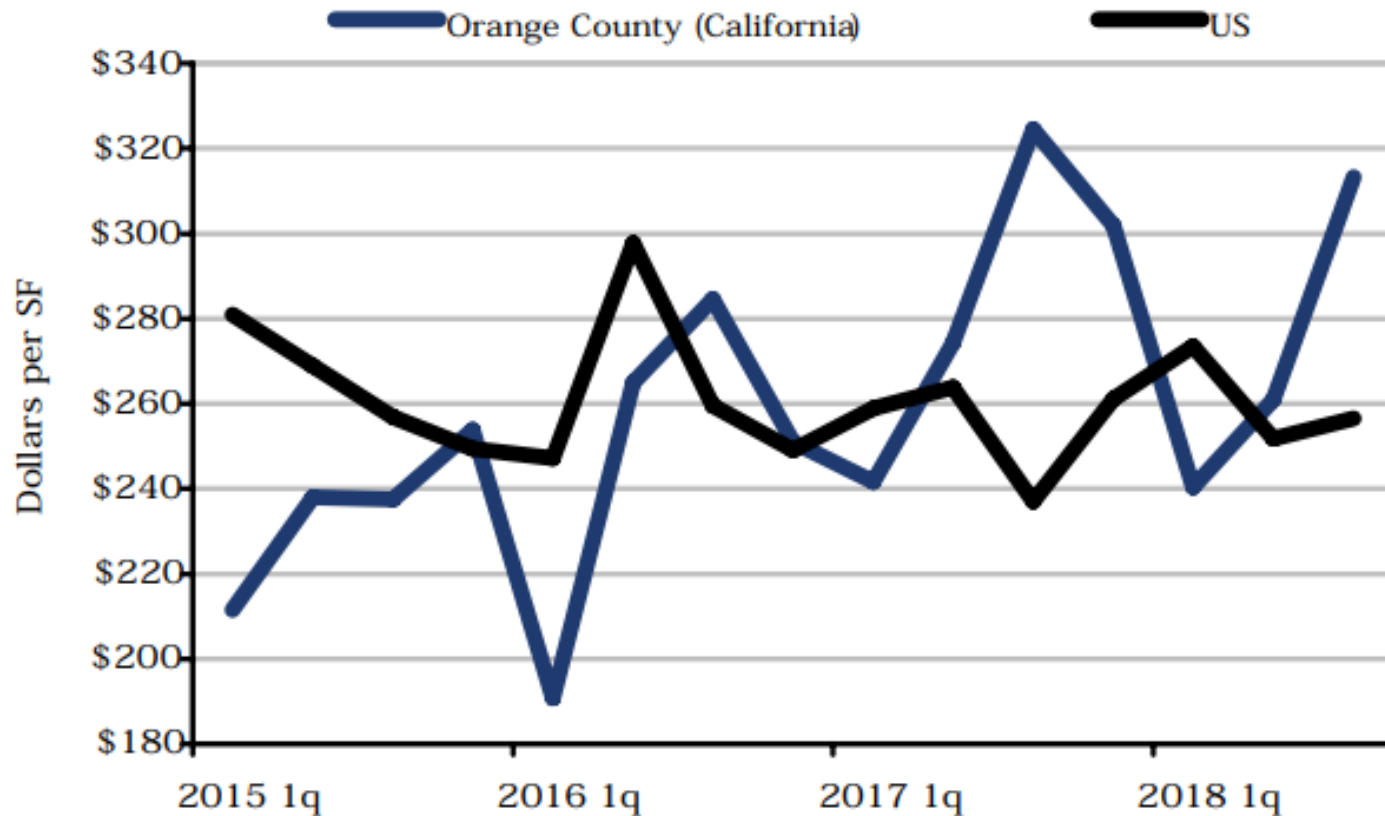
Source: CoStar COMPS®



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# U.S. Price/SF Comparison

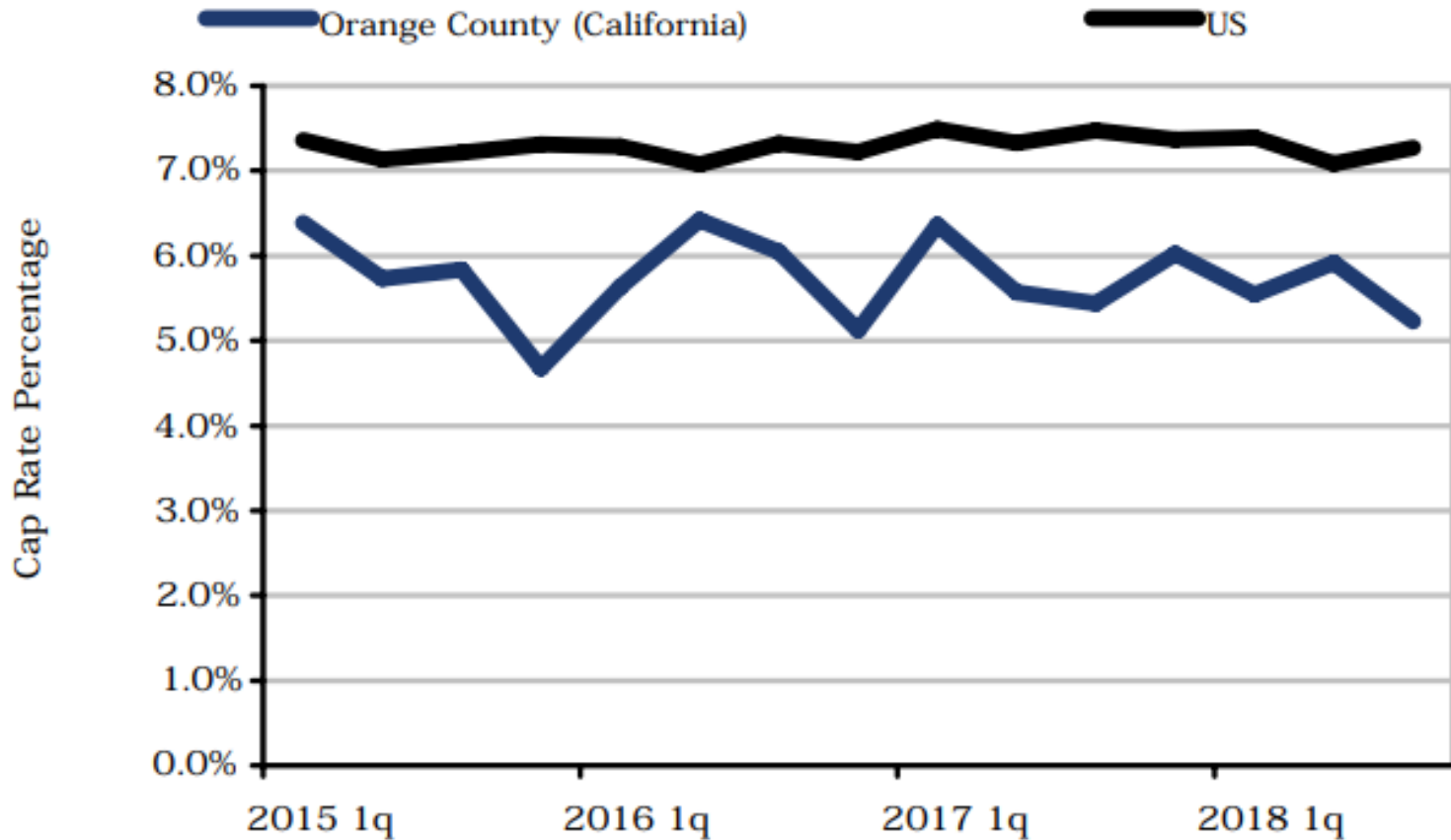
Based on Office Building Sales of 15,000 SF and Larger



Source: CoStar COMPS®

# U.S. Cap Rate Comparison

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



Source: CoStar COMPS®





# 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.



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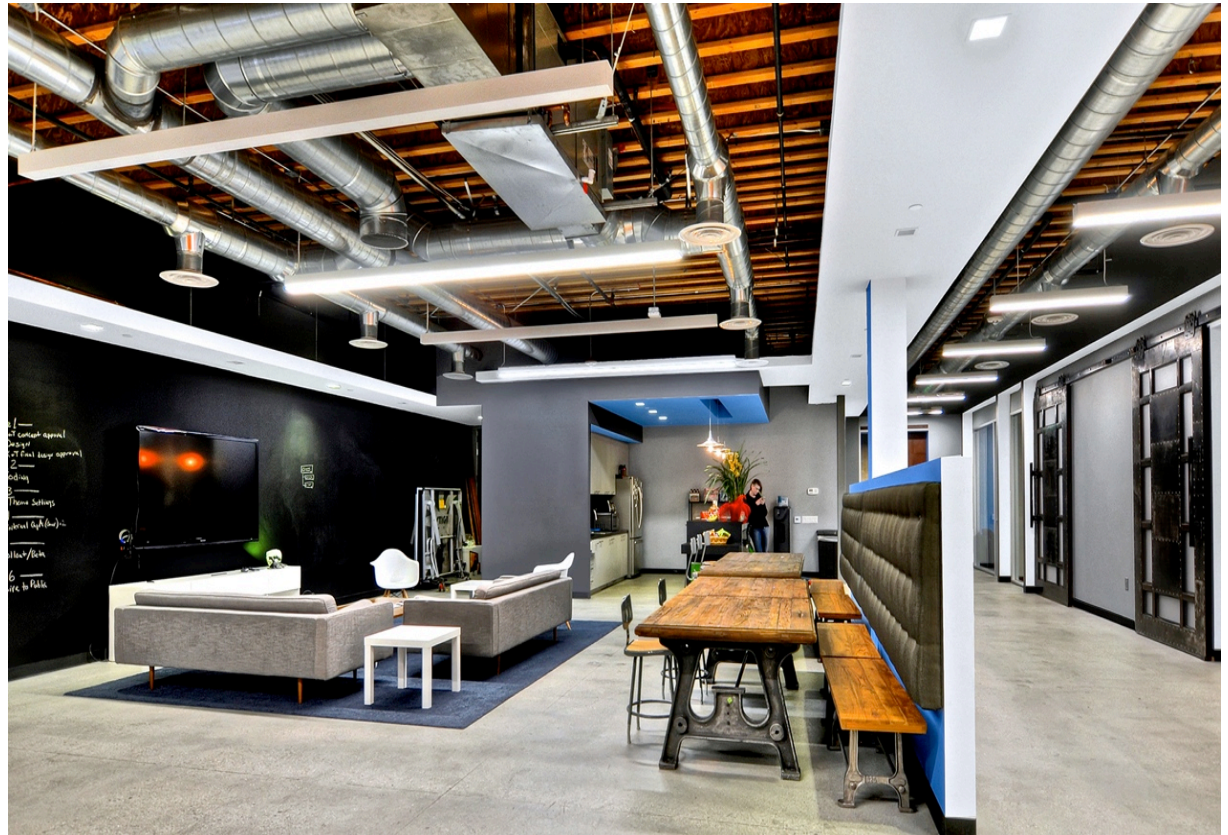
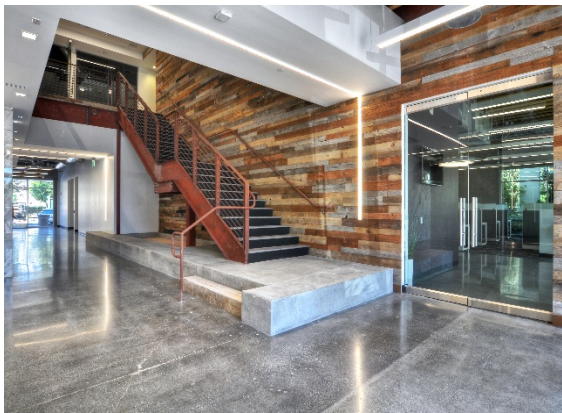
# Class A Product

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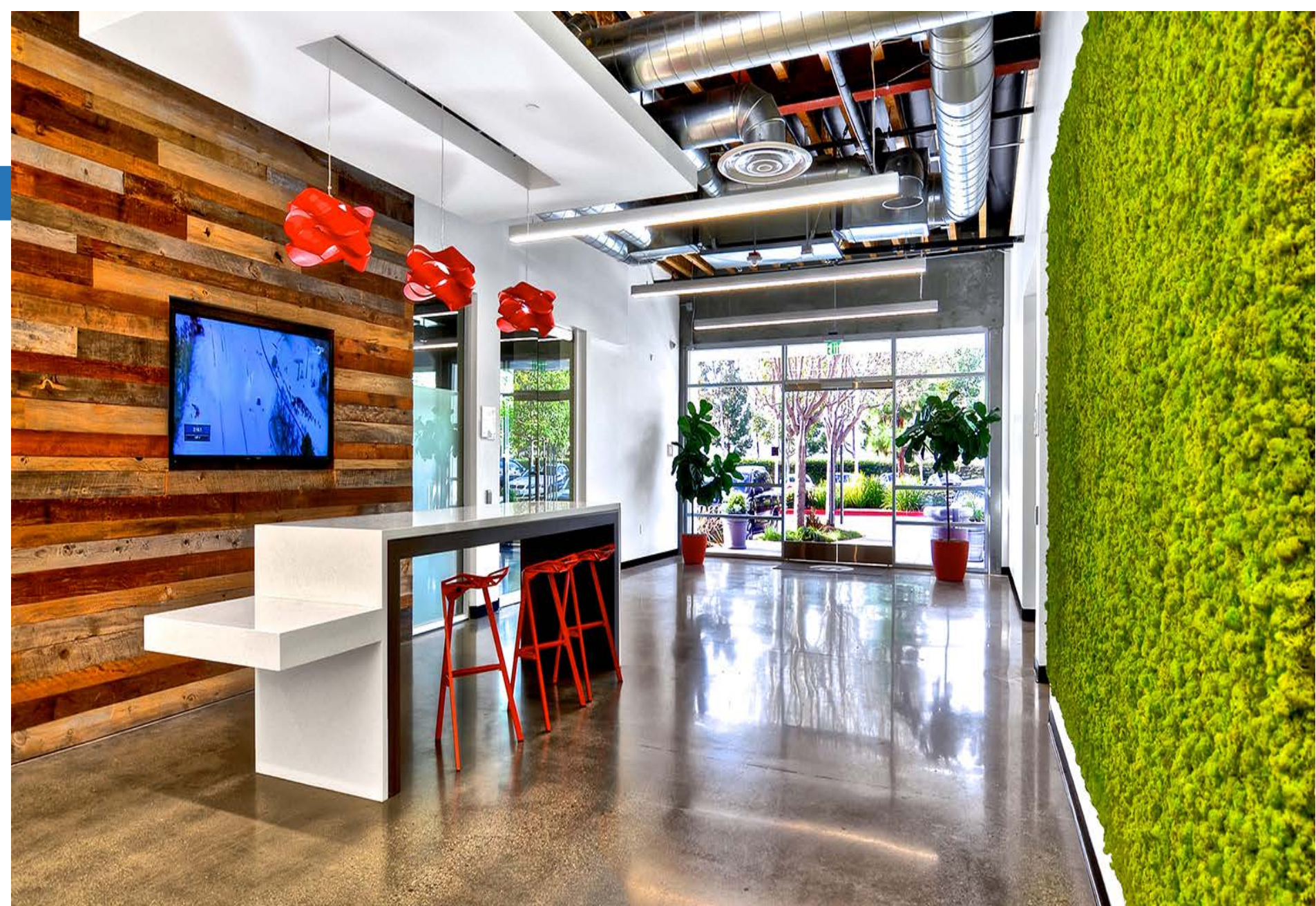


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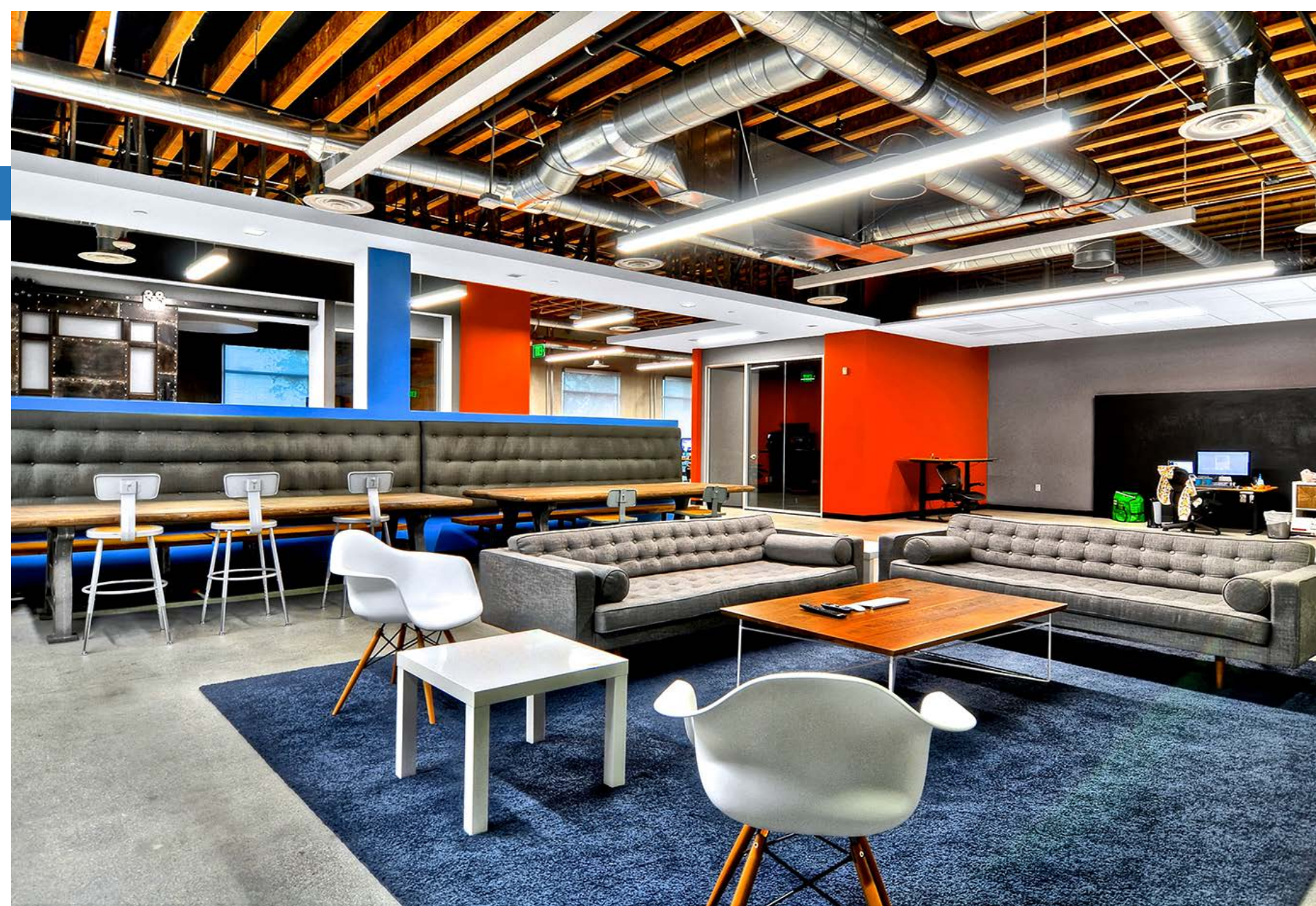
# “Creative” Space







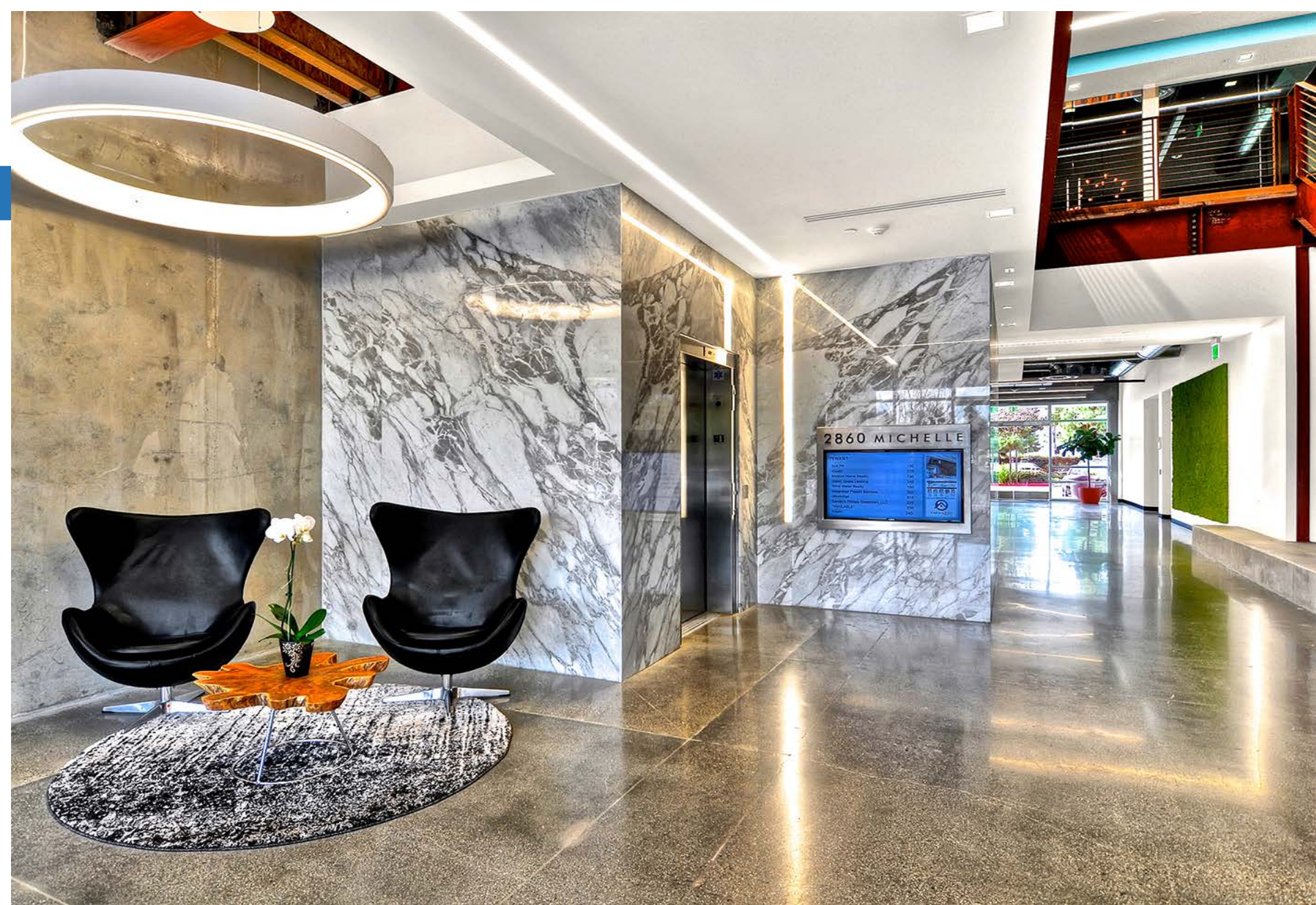














# Class B Product

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More Speculative Investment

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

Utilitarian space

Ordinary design

Average to good maintenance



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# Class B Product



# Office Values & Assumptions

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1. Comparable Sale
2. Income
3. Replacement Cost



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# 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

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



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# Sale Comparables

1. 333 City Blvd W



**Orange**

Price: **\$147,300,000**  
Price/SF: **\$341.76**  
Cap Rate: **4.9%**  
RBA: **431,007**  
Date: **3/7/2018**  
Year Built: **1988**  
Buyer: **KBS Strategic Opportunity REIT, Inc.**  
Seller: **Torchlight Investors**

2. 100 Bayview Cir



**Newport Beach**

Price: **\$125,650,000**  
Price/SF: **\$362.63**  
Cap Rate: **N/A**  
RBA: **346,500**  
Date: **9/12/2018**  
Year Built: **1989**  
Buyer: **Granite Properties, Inc.**  
Seller: **AEW Capital Management**

3. 2600 Michelson Dr



**Irvine**

Price: **\$120,000,000**  
Price/SF: **\$385.95**  
Cap Rate: **5.5%**  
RBA: **310,925**  
Date: **12/31/2017**  
Year Built: **1986**  
Buyer: **CBRE Global Investors LTD**  
Seller: **Dune Real Estate Partners LP**



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# Sale Comparables

4. 2300 Main St



## Irvine

Price: **\$46,600,000**  
Price/SF: **\$348.42**  
Cap Rate: **N/A**  
RBA: **133,745**  
Date: **11/16/2018**  
Year Built: **2002**  
Buyer: **GLL Real Estate Partners GmbH**  
Seller: **Hines Securities, Inc.**

5. 625 The City Dr S



## Orange

Price: **\$33,000,000**  
Price/SF: **\$218.34**  
Cap Rate: **5.4%**  
RBA: **151,140**  
Date: **2/9/2018**  
Year Built: **1990**  
Buyer: **TA Realty**  
Seller: **The Blackstone Group LP**

6. 3851 Katella



## Los Alamitos

Price: **\$32,500,000**  
Price/SF: **\$464.29**  
Cap Rate: **5.6%**  
RBA: **70,000**  
Date: **10/26/2018**  
Year Built: **2014**  
Buyer: **Ventas, Inc.**  
Seller: **PMB Real Estate Services**



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# Sale Comparables

7. 1500 Quail St



## Newport Beach

Price: **\$32,200,000**  
 Price/SF: **\$354.96**  
 Cap Rate: **5.4%**  
 RBA: **90,715**  
 Date: **7/12/2018**  
 Year Built: **1983**  
 Buyer: **Lincoln Property Company**  
 Seller: **New York Life Real Estate Investors**

8. 999 Town & Country



## Orange

Price: **\$32,000,000**  
 Price/SF: **\$323.54**  
 Cap Rate: **6%**  
 RBA: **98,907**  
 Date: **10/4/2018**  
 Year Built: **1976**  
 Buyer: **EverWest Real Estate Investors LLC**  
 Seller: **Westcore Properties**

9. 1325 N Anaheim Blvd



## Anaheim

Price: **\$29,850,000**  
 Price/SF: **\$329.71**  
 Cap Rate: **N/A**  
 RBA: **90,533**  
 Date: **11/21/2018**  
 Year Built: **2009**  
 Buyer: **AltaMed Health Services**  
 Seller: **Quarry Capital**



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# Income Approach

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Everyone is chasing yield and it's all about cash flow.

Think about this as the leading valuation method.

It can reduce your weighting of like for like properties and substantiate your valuation.



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# Income Approach Cont.

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Vacancy and lease expirations are expensive. Verify the “upside.”

Modern TI is more important than green infrastructure when it comes to boosting NOI

Spec suites are better than shell.

If you can derive the NOI and apply a market cap rate of 5.50% to 6.0% then the buyer is getting a market return on their acquisition and the value is substantiated.



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# Funding Lapse



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# Owner / User Market

Period	# of Transactions	Dollar Volume	Avg Price	Building SF	Avg Bldg SF	Avg Price Per Bldg SF	Median Price Per Bldg SF
Survey	2,564	\$4,278,266,270	\$2,003,872	21,824,975	8,555	\$220.04	\$256.49
2018	179	\$397,452,302	\$2,779,387	1,308,745	7,352	\$320.43	\$354.08
2017	172	\$364,618,018	\$2,567,733	1,402,320	8,201	\$269.07	\$295.00
2016	175	\$316,193,118	\$1,928,007	1,094,013	6,252	\$299.67	\$293.62
2015	155	\$330,947,754	\$2,565,486	1,406,521	9,253	\$239.95	\$274.37
2014	143	\$192,491,381	\$1,564,971	1,131,462	7,968	\$214.09	\$254.45
2013	165	\$350,923,474	\$2,403,585	1,846,997	11,331	\$195.76	\$212.74
2012	169	\$255,427,592	\$1,878,144	1,710,419	10,121	\$186.93	\$209.54
2011	164	\$199,779,838	\$1,525,037	1,241,301	7,710	\$176.82	\$220.33
2010	156	\$163,251,217	\$1,285,443	997,237	6,434	\$178.75	\$205.00
2009	101	\$201,379,072	\$2,369,166	1,021,912	10,118	\$203.57	\$239.49
2008	174	\$205,310,088	\$1,532,165	887,264	5,099	\$312.07	\$337.78
2007	260	\$343,052,163	\$1,949,160	1,707,952	6,594	\$249.45	\$320.00
2006	132	\$202,204,100	\$1,889,758	1,069,214	8,100	\$256.03	\$271.52
2005	148	\$301,306,790	\$2,248,558	1,951,105	13,183	\$187.23	\$232.05
2004	125	\$232,266,967	\$1,888,349	1,273,351	10,187	\$183.98	\$196.29
2003	118	\$158,565,808	\$1,378,833	1,135,143	9,620	\$147.37	\$164.84

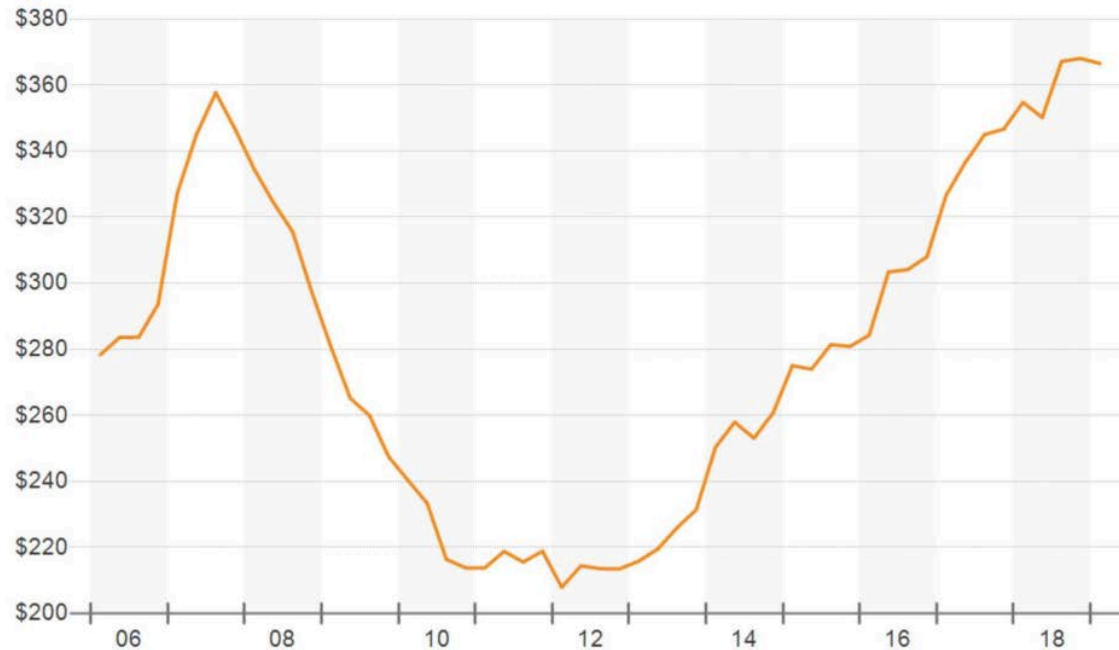


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# Owner / User Market

OC's Owner / User History by the Numbers

Asking Price Per SF

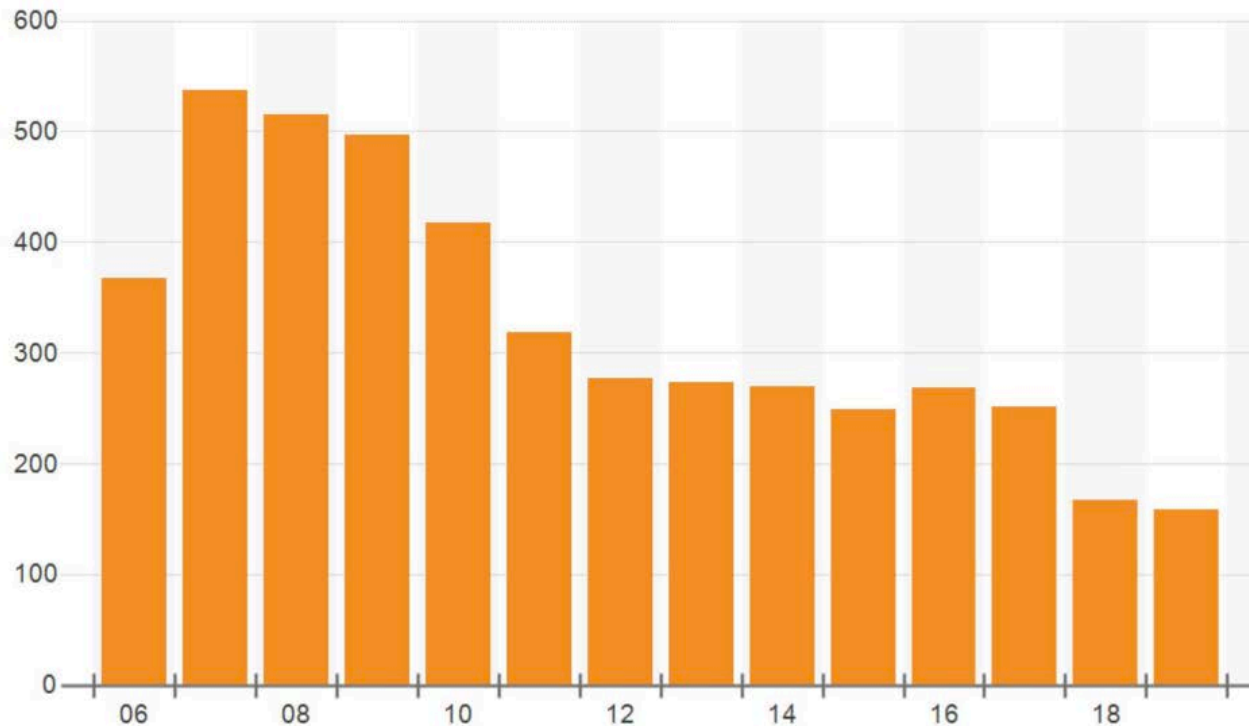


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# Owner / User Market

OC's Owner / User History by the Numbers

For Sale Total Listings



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# Owner / User Market

OC's Owner / User History by the Numbers

## Months to Sale





# Income Assumptions

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Rent Growth – 2.5% 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%



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# 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

\$350 to \$400 PSF Development Cost + Profit



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# Replacement Cost Assumptions

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

Hard Costs - \$130 PSF

Tenant Improvements - \$70

Soft Costs - \$10 PSF

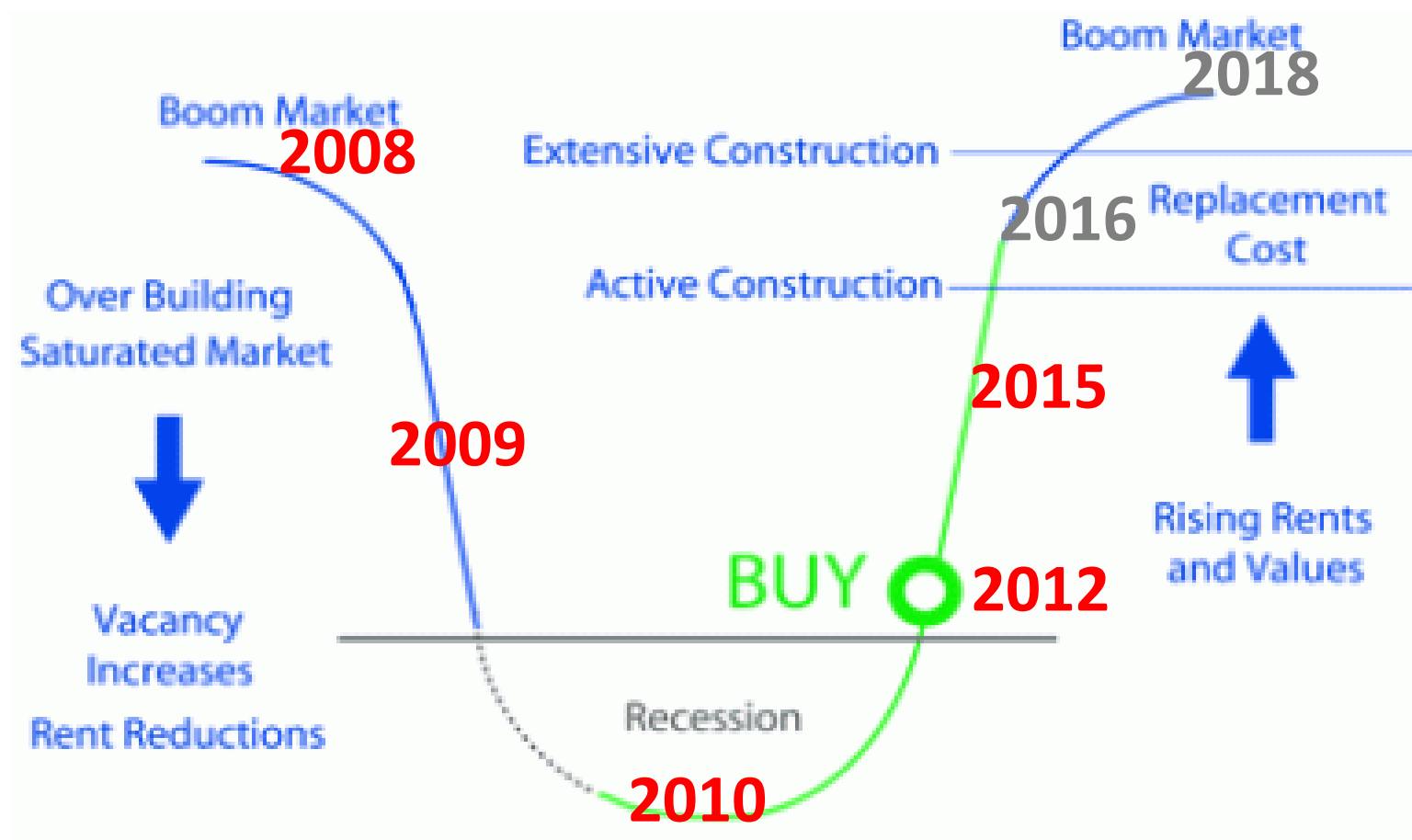
Total costs of \$360 PSF

Necessary income for 9% Cap Rate = \$32.40 PSF,  
NNN (\$2.70 to \$3.00 PSF)



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# Office Real Estate Cycle (2015)



# Forecast

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2019 will be a good year for investment sales

Rents will start to destabilize.

Owner / User sales will slow due to supply.

Cap rates will remain low with underwriting expecting rent growth.

Fractional ownership opportunities expanded.



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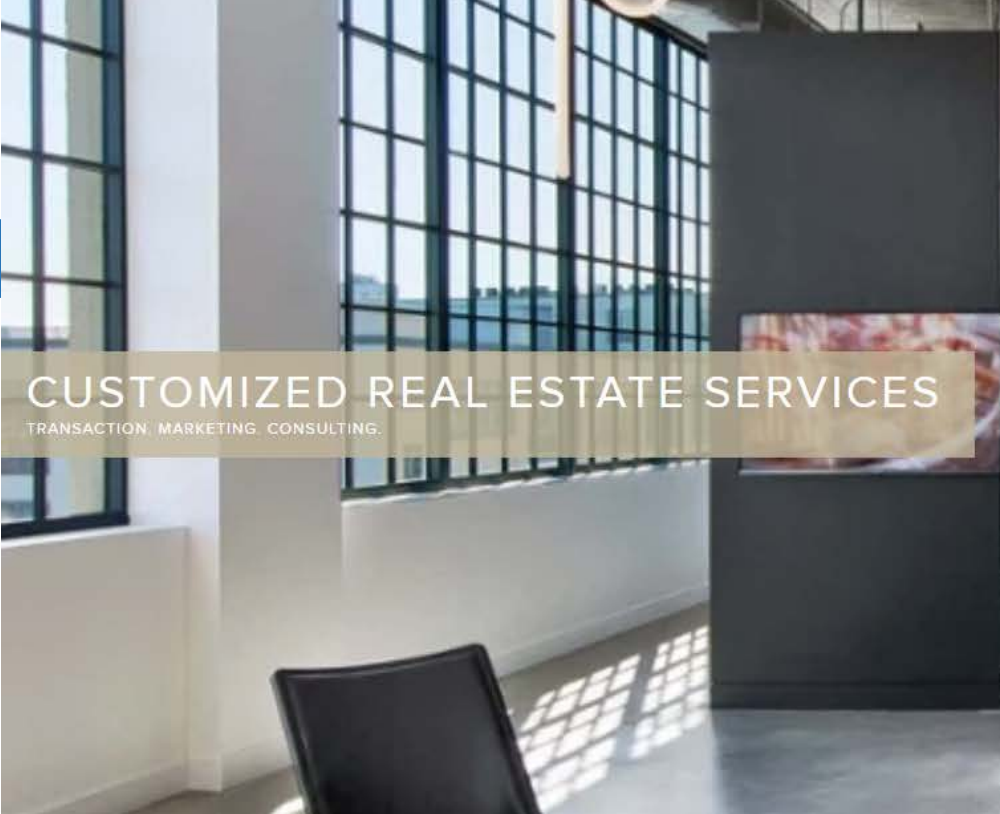


# Uncertainty???

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1. Washington DC
2. The Housing Market
3. Interest Rates ( $> 5\%$ )
4. The length of the current cycle
5. Stock market slow down
6. China, Brexit, Middle East





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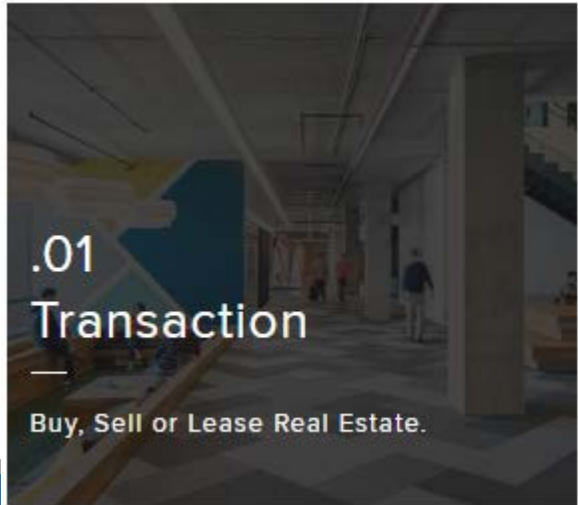
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