4Q23

NEWMARK

Los Angeles Office Market Overview

Market Observations

Economy

- Unemployment across all industries was 5.0% in November, up 50 bps from November 2022. While total nonfarm employment is strong, job gains are slowing.
- Local office-using employment in November was down by 27,100 jobs compared to 12 months prior, a 2.4% decline. Most losses came from the information sector where tech and media companies are generally grouped.
- The Federal Reserve raised interest rates eleven times from March 2022 to July 2023, bringing today's benchmark rate to the highest level in 22 years. The Fed has signaled its intention to cut rates in 2024, which will likely happen in the latter half of the year. Lower rates historically favor leasing and sales activity.
- For now, higher capital costs continue to weigh on most businesses.

Leasing Market Fundamentals

- Sidley's leases hint at a few trends shaping the greater market. Namely, traditional tenants are committing to larger trophy space in Century City while downsizing footprints and exiting distressed buildings in Downtown LA. Century City is emerging as Los Angeles' preferred CBD.
- Total vacancy and availability continued to climb to new highs, reaching 22.8% and 27.8% respectively.
- Sublet availability fell by 10bps for the second consecutive quarter, settling at 5.0%.
- 46% of Greater Los Angeles' office inventory consists of buildings with sub-80% occupancy. Buildings with lower occupancy thresholds tend to struggle to generate positive NOI, which, in turn, makes it difficult to support debt (assuming debt is present on a given building).

Major Transactions

- Aon Center (707 Wilshire Blvd, 1,110,264 SF) sold to Carolwood LP (in a JV with Daniel Abrams) from Shorenstein Properties for $153.5M ($134/SF). The building was 64% leased and sold at a 45% discount relative to what the seller paid for the asset in 2014. This was a Newmark represented, lender-facilitated sale.
- The Los Angeles County Department of Public Social Services signed a 15-year, 207,289-SF lease at 1500 Hughes Way in Long Beach; a consolidation move.
- Sidley Austin LLP signed two deals in Century City; a 75,000-SF pre-lease at Century City Center (CCC) and a 66,604-SF short-term renewal at 1999 Avenue of the Stars until the CCC space is ready. The deals follow a 57,148-SF lease earlier this year at 2Cal in Downtown LA, a downsize from 152,413 SF at The Gas Company Tower.

Outlook

- Corporate America will be more active next year, and leasing activity will increase. Most companies have a handle on how they want their employees to work, have charted out their space needs and are in better positions to execute.
- Tenants will generally downsize, and the flight-to-quality trend will persist.
- The entertainment industry will be more active since the actor and writer strikes were resolved, but profitability pressures—especially, in the streaming segment—will be a constraint. Still-high interest rates and inflation are ongoing headwinds for entertainment as well, like most other industries.
- Cash-rich private buyers will continue to dominate sales activity. There will be more distress sales in 2024.

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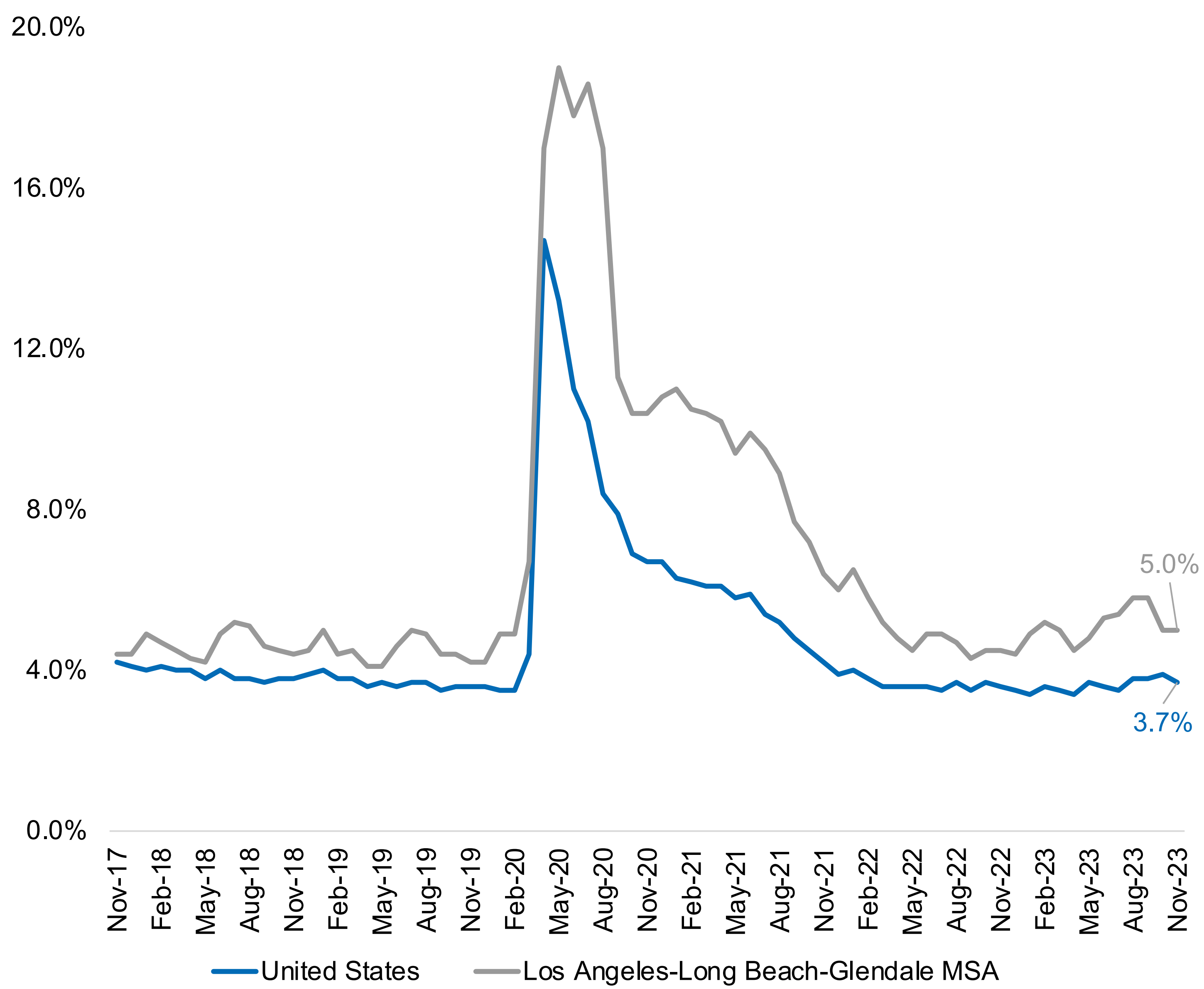
Economy

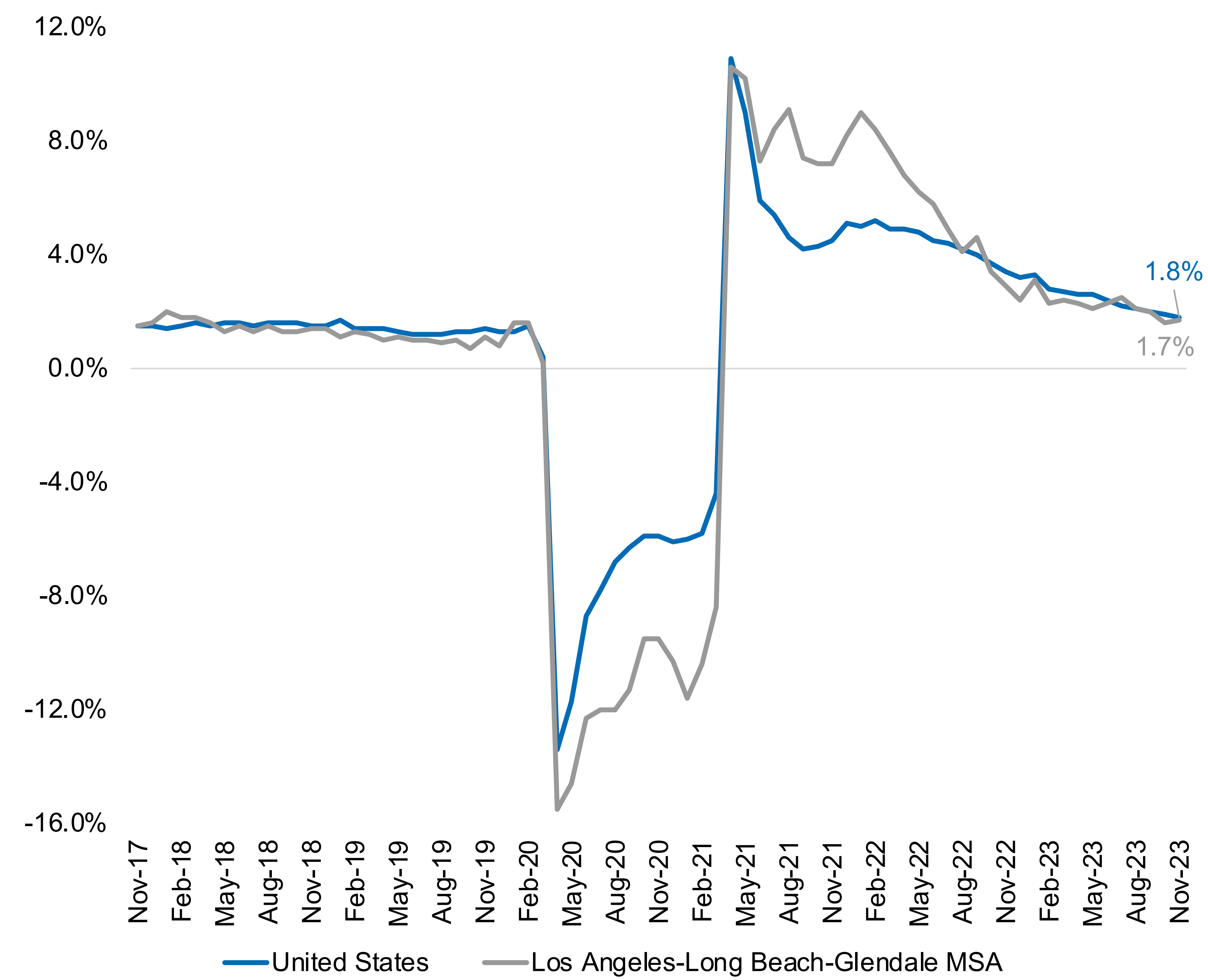
Unemployment Fluctuates as Job Growth Slows

Local unemployment is down from the summer but up from this time last year, while 12-month job growth has been decelerating since late 2022. The Fed's target policy interest rate is at the highest level in 22 years. Elevated interest rates affect companies' bottom lines and generally lead to job reductions, especially in higher-paying industries. Eventual cuts in interest rates will benefit the labor market.

Unemployment Rate, Seasonally Adjusted



Nonfarm Payroll Employment, Non-Seasonally Adjusted, 12-Month% Change

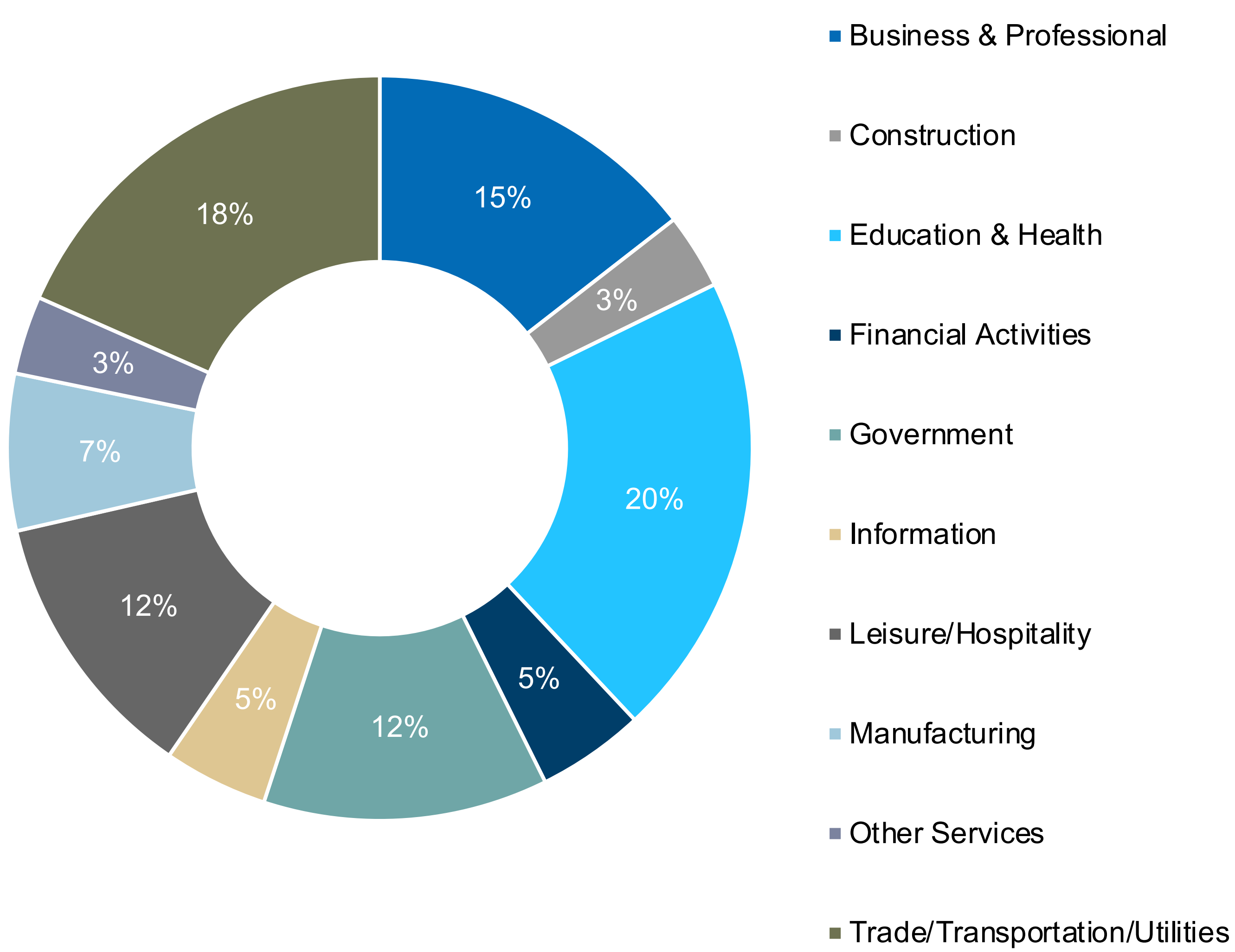


Source: U.S. Bureau of Labor Statistics, Los Angeles-Long Beach-Glendale MSA

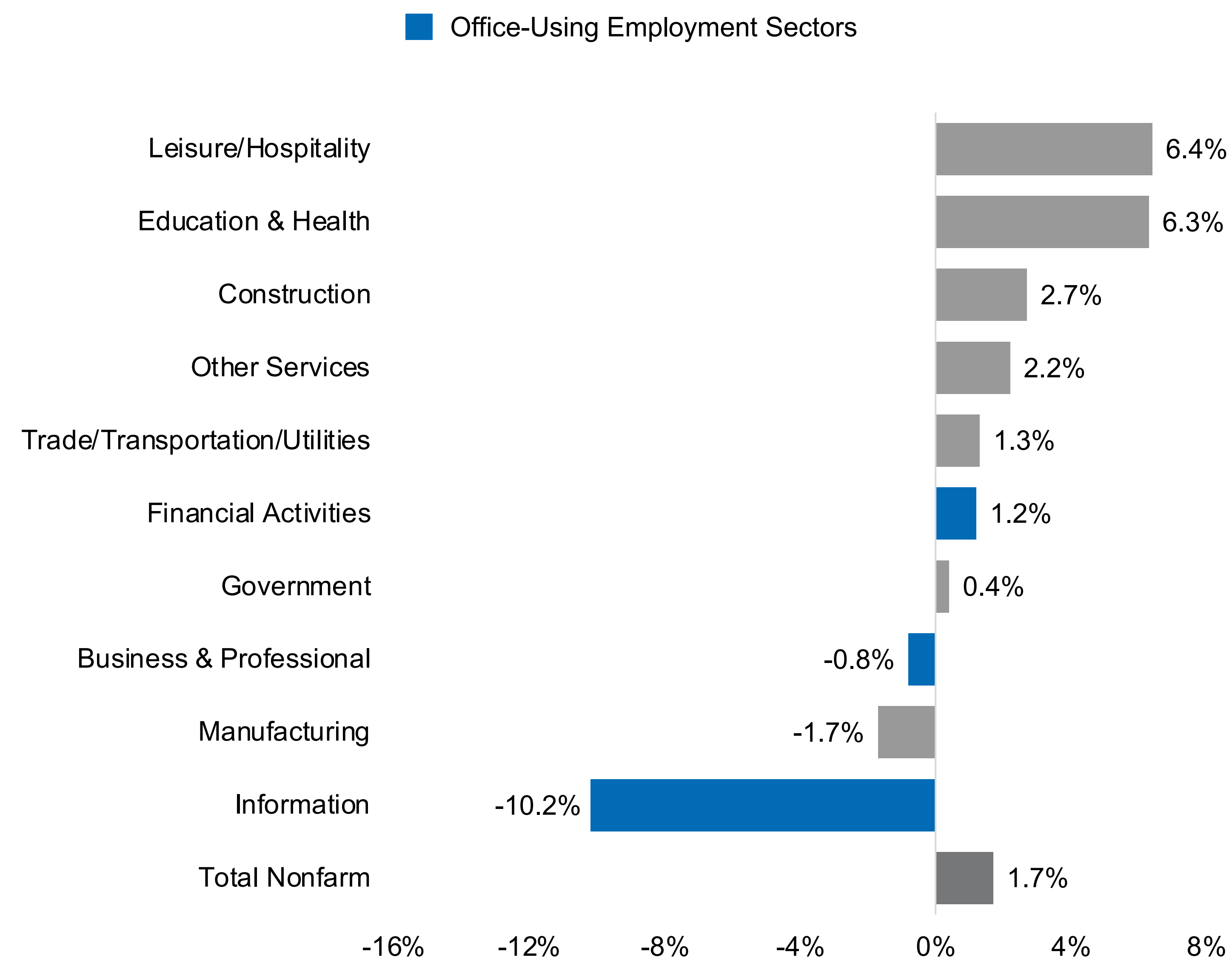
Tech Companies Drive Employment Losses in Office-Using Sectors

The information sector, where technology companies are generally grouped, led employment losses in the region with a 10.2% decline over the last 12 months. Meta, Hulu, Netflix, Amazon, Google, Roku and Spotify are a sampling of companies with layoffs in 2023.

Employment by Industry, November 2023



Employment Growth by Industry, 12-Month% Change, November 2023

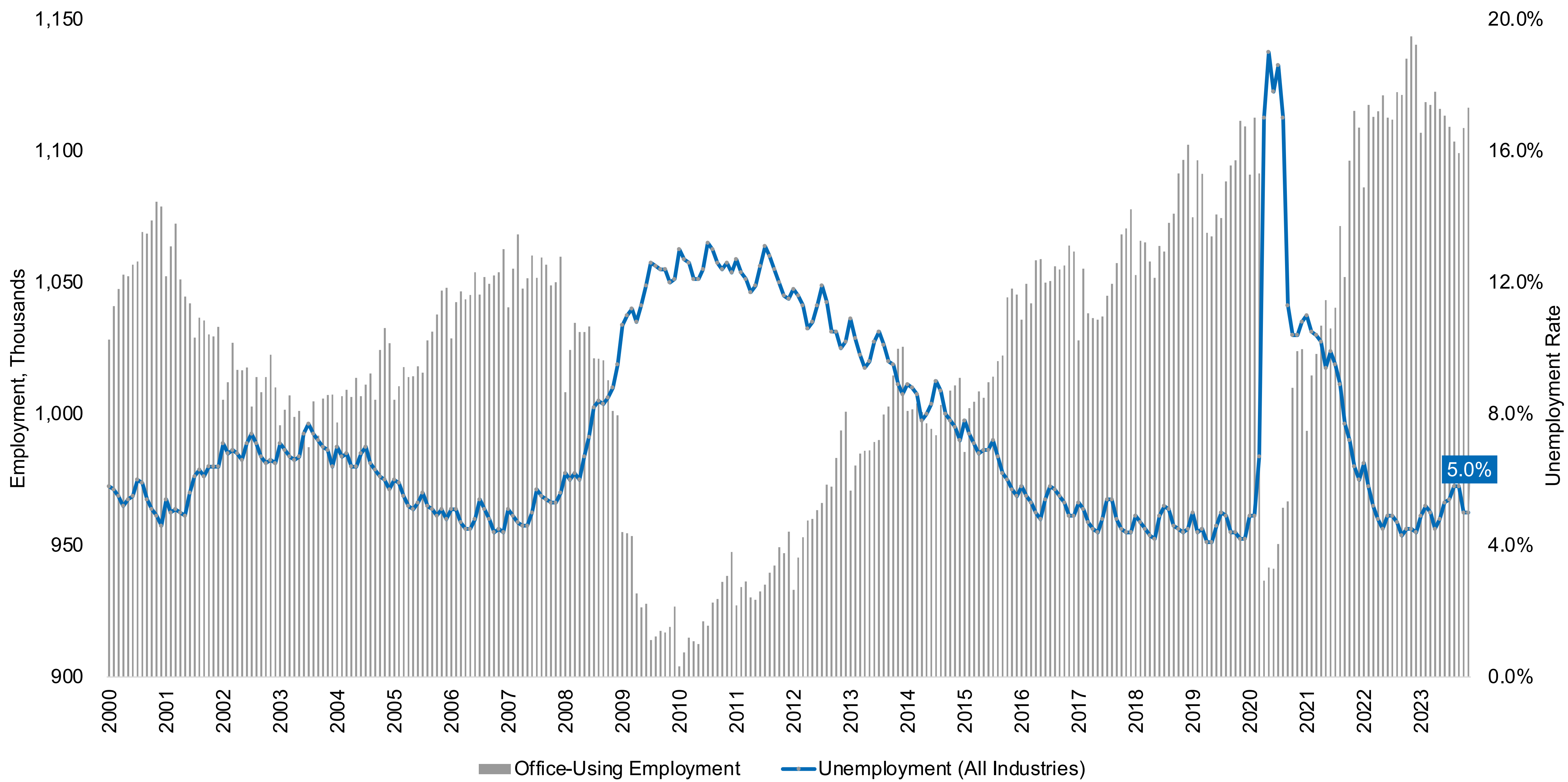


Source: U.S. Bureau of Labor Statistics, Los Angeles-Long Beach-Glendale MSA

Overall Office-Using Employment Down Year Over Year

Local office-using employment in November was down by 27,100 jobs compared to the same month in 2022, a 2.4% decline that is primarily from job losses in the tech sector. Current office-using employment has however been trending upwards the last few months.

Office-Using Employment* and Unemployment Across All Industries

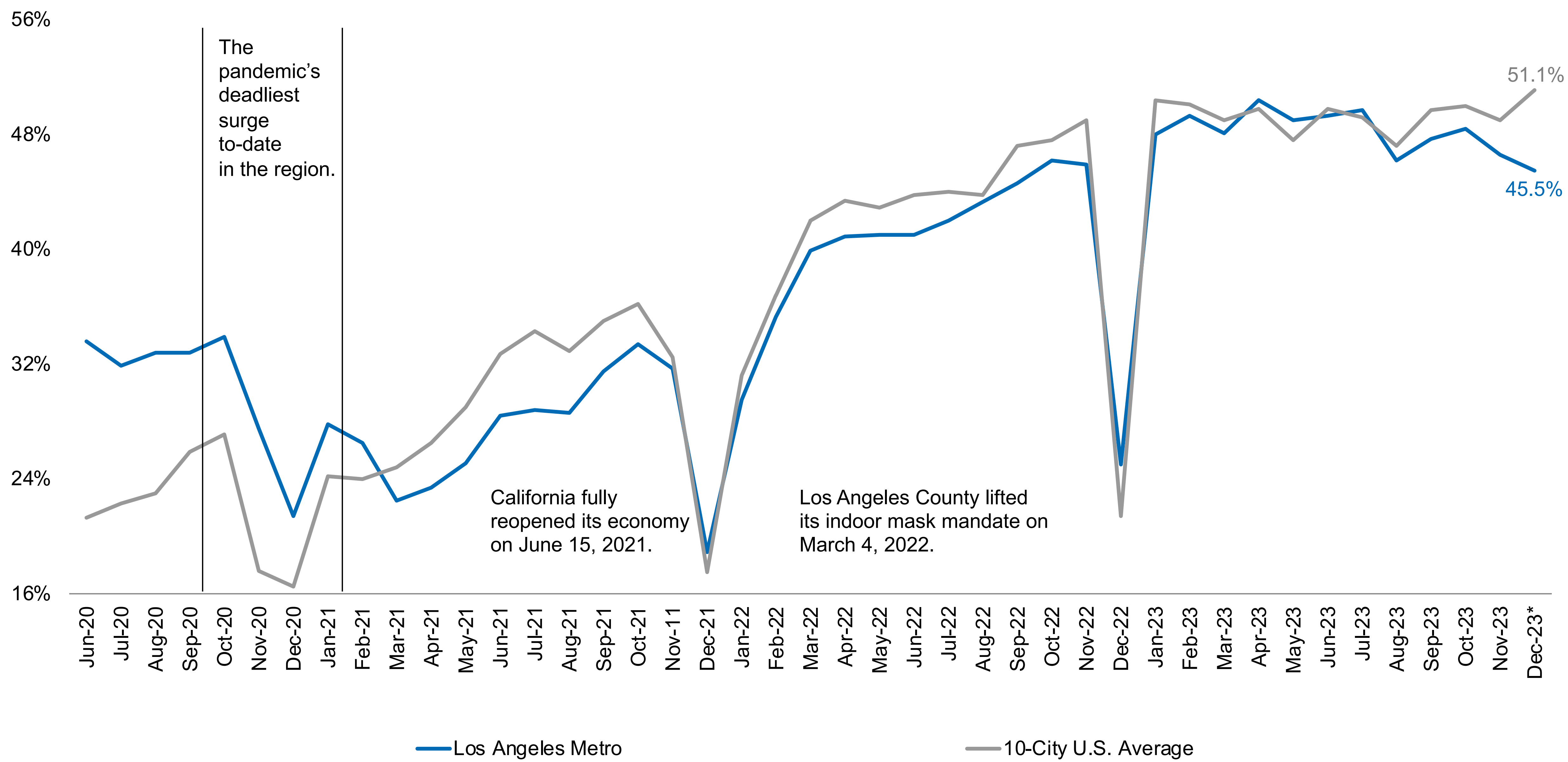


Source: U.S. Bureau of Labor Statistics, Los Angeles-Long Beach-Glendale, CA
Note: May 2023 data is preliminary.
*Office-using employment includes employment in the following industry sectors: Professional & Business Services, Financial Activities and Information.

Local Office Utilization is Up since 2020, but Remains Sub-50%

The winter holidays aside, local utilization has generally hovered in the upper 40s since September 2022 as most companies continue to rely on hybrid work schedules. Anecdotally, office lunch traffic in Downtown Los Angeles is noticeably less than West Los Angeles market areas, such as Century City. Downtown's safety concerns are a primary factor.

Los Angeles Metro Office Utilization Rates | Kastle Systems Return-to-Work Data Based on Key FOB Swipes



Source: Newmark Research, Kastle Systems
Note: Each month's percentage reflects the average of its final week. December 2023's average is for the week of 12/18/23.

Three Days in the Office, Two from Home is the Most Common Work Model

However, not all companies are strictly enforcing their return-to-work mandates due to still-low unemployment and concerns over staff retention. A noticeable rise in unemployment (if it happens) is expected to shift leverage from employees to employers. Tech has led other industries in layoffs and companies such as Apple and Meta now have firmer work mandates.

Select Return to Office Policies

Google	updated its hybrid work policy in June 2023 by requiring most employees to physically come to the company's offices at least 3 days a week.
amazon	Corporate employees required to spend at least 3 days a week in the office starting May 1, 2023.
Apple	Employees returned 3 days a week post-Labor Day 2022. Apple has reportedly escalated enforcement of this policy.
BANK OF AMERICA	Employees returned to the office in early June 2022; a 4 day per week minimum.
Disney	Any Disney staff member working "in a hybrid fashion" will need to return to Disney's offices four days a week.
COMCAST	Office-based employees have been expected to come in on Tuesdays, Wednesdays, and Thursdays since September. The new policy requires four days in.
Meta	employees are back in the office 3 days a week as part of new mandate that went into effect post-Labor Day 2023.
Microsoft	In April 2022. made 50% attendance at the office mandatory for all employees that don't have an exception from their managers.
Morgan Stanley	Encouraging employees to return full-time. Limits most of its sales force to 90 days of remote work per year.
NETFLIX	Most teams are working onsite Tuesday, Wednesday and Thursday, with remote work allowed on Monday and Friday.
WARNER BROS. DISCOVERY	Employees returned 3 days a week in early June 2022.
WELLS FARGO	Returned to the office in mid-March 2022 in a hybrid capacity, 3 days per week.
Snapchat	Revised office mandate in early 2023 which told workers to be in the office for at least 80% of the time.

Source: Newmark Research

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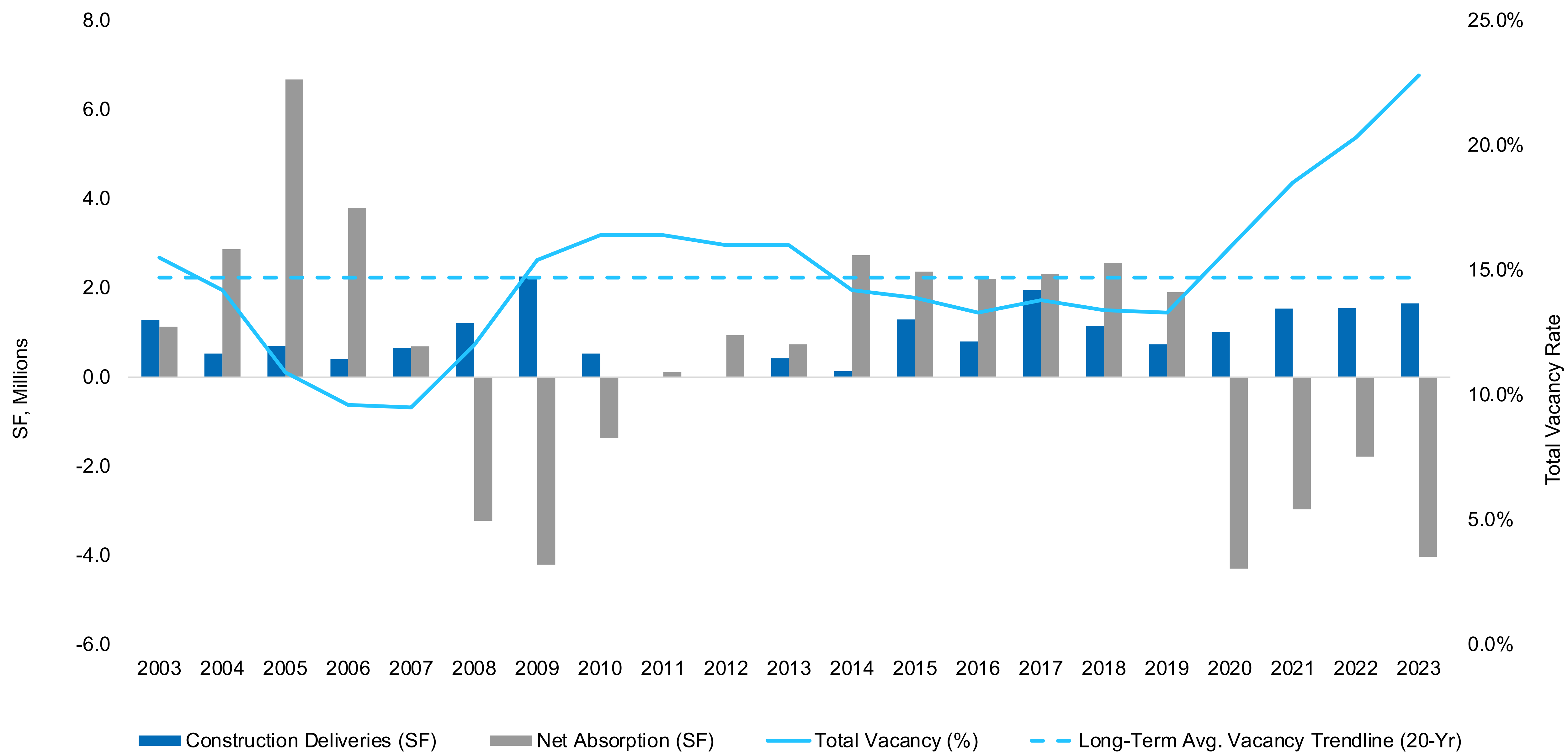
Leasing Market Fundamentals

Vacancy Rises Again in Fourth Quarter

Total vacancy increased to a new high of 22.8%, a 40-bps increase from the third quarter of 2023. Direct vacancy increased by over 720 KSF, while sublease vacancy saw a 252 KSF decrease over this three-month period. This is evidence of sublease listings coming to term or being given back to the landlord through termination as sublease transitions to direct.

Historical Construction Deliveries, Net Absorption, and Vacancy

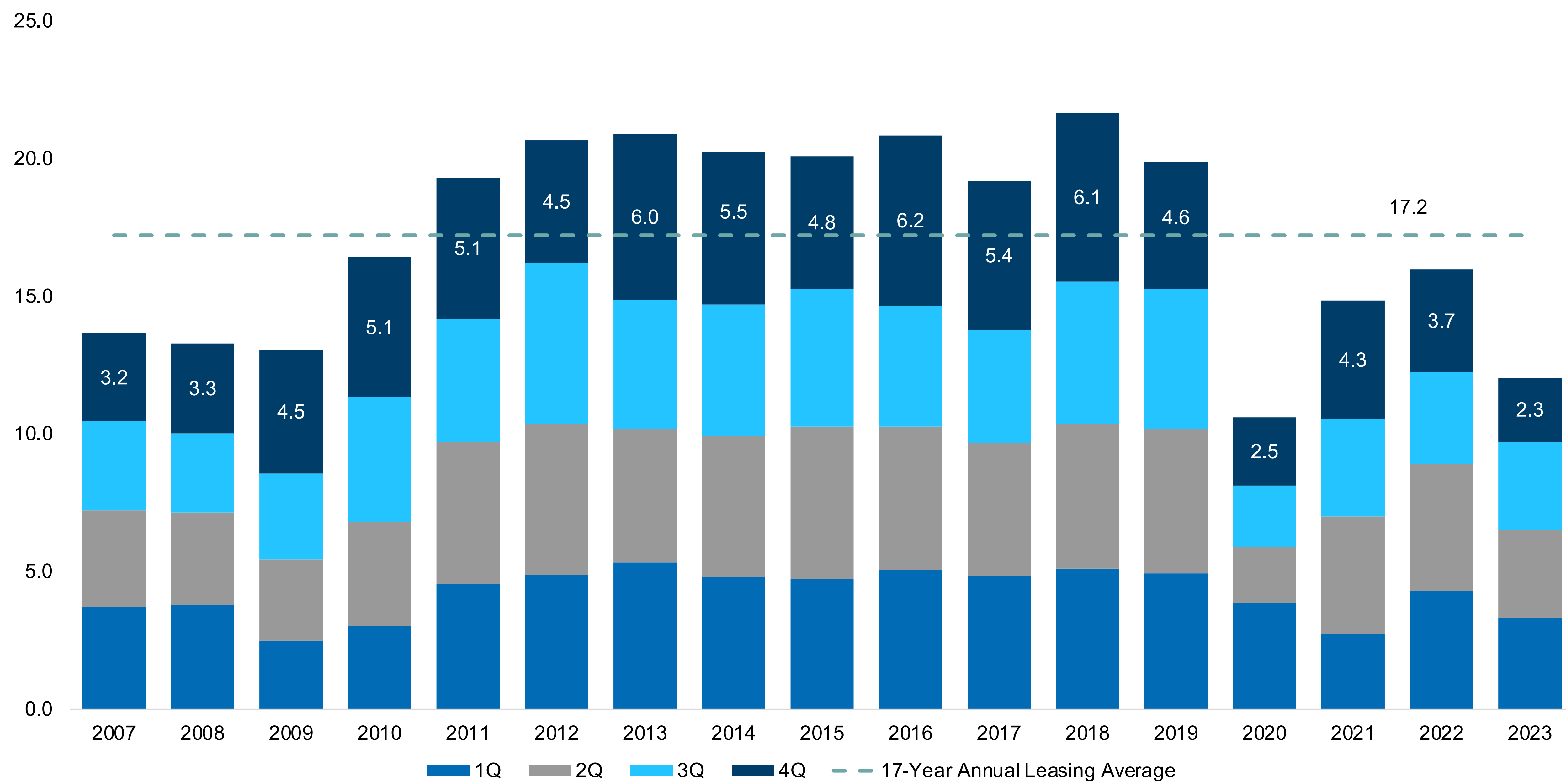


Source: Newmark Research

Leasing Activity Continues to Decelerate

An uncertain economic outlook, still-high interest rates and hybrid work models are reducing office space requirements. Most tenants continue to pursue trophy-grade Class A space as they scale down their footprints to cut costs and maximize efficiencies. From a historical perspective, this quarter's leasing activity of 2.3 MSF is nominal.

Total Leasing Activity (MSF)

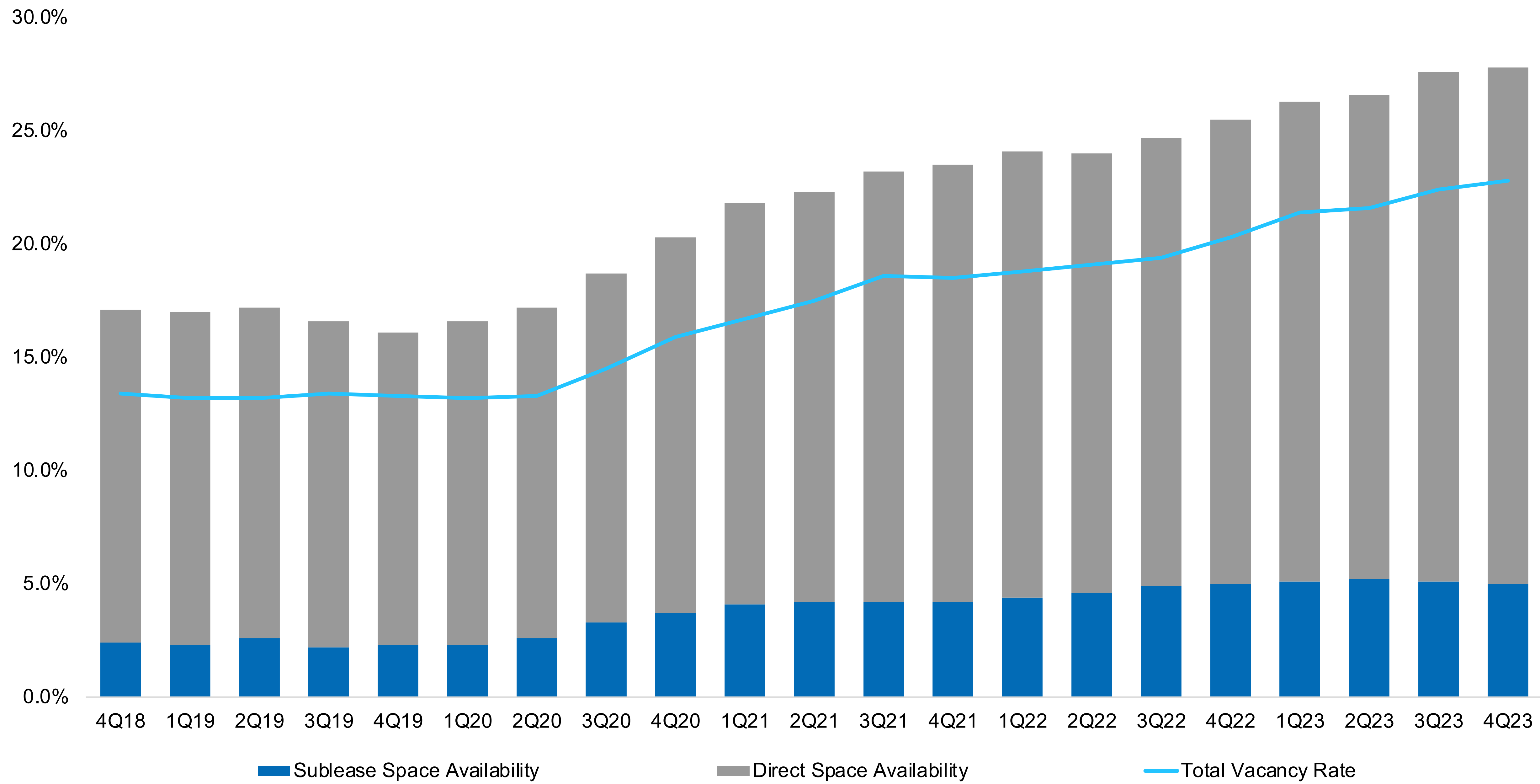


Source: Newmark Research, CoStar

Direct Space Pushing Total Availability Up

Total availability passed 61.5 MSF during the fourth quarter of 2023, a record high for the market. While sublease availability decreased from last quarter, direct availability drove total increases with 720 KSF coming online over the last three months for a net gain. General economic conditions and telework, which are causing tenant downsizes and consolidations, along with sublease availability shifting to direct space, are contributing to the gains.

Available Space and Tenant Demand as Percent of Overall Market

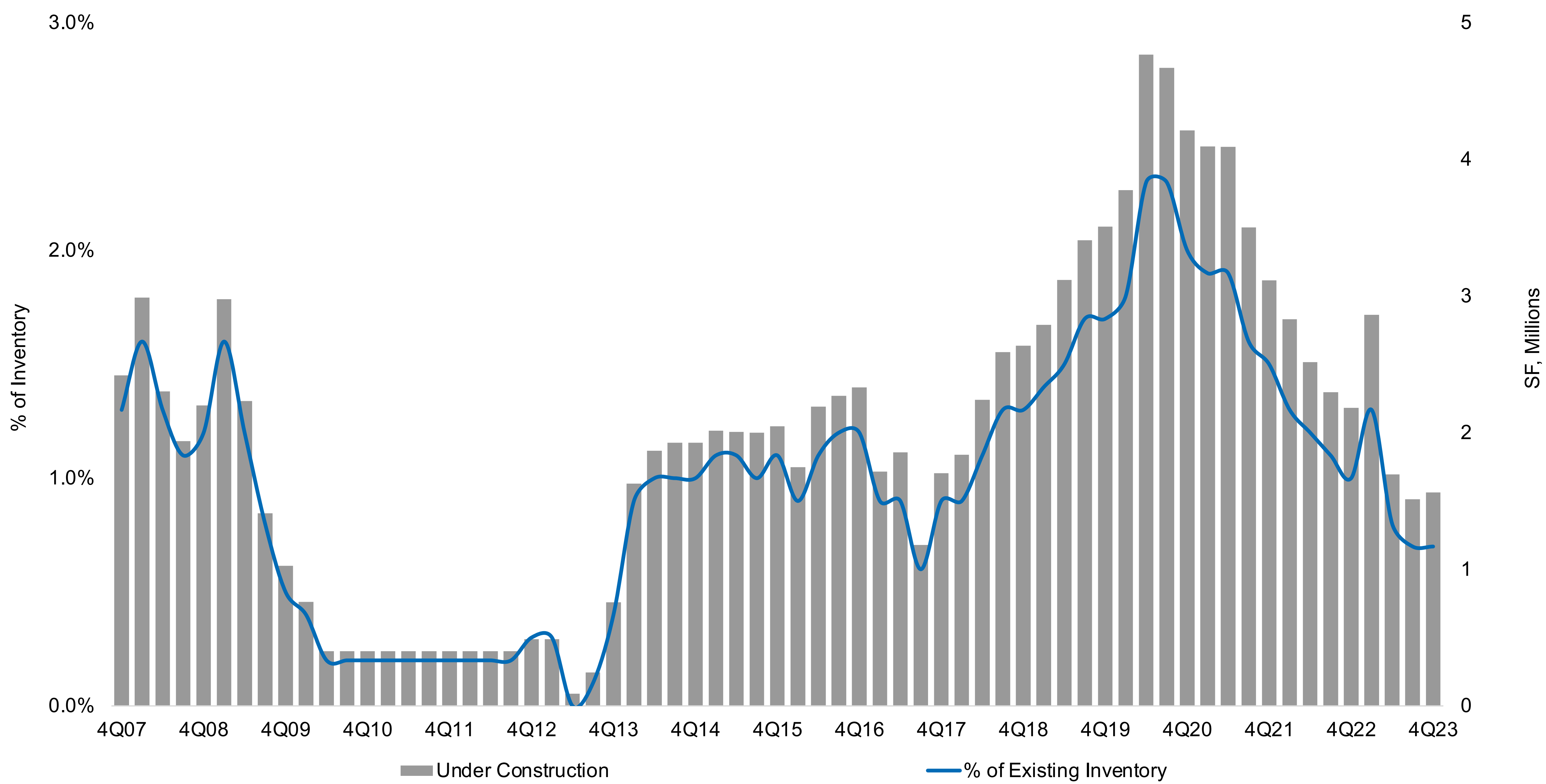


Source: Newmark Research

Construction Volume Remains Measured

While construction volume of 1.6 MSF remains well below the market's five-year average of 3.1 MSF, there was an increase in fourth quarter totals with the groundbreaking of 83,500 SF at 717 Seward St in Hollywood. While certain market areas with strong fundamentals are seeing new construction starts, current demand for new office supply is low. Part of this is due to a lingering glut of available space, a portion of which is comprised of trophy space offered at discounted rental rates.

Office Under Construction and% of Existing Inventory

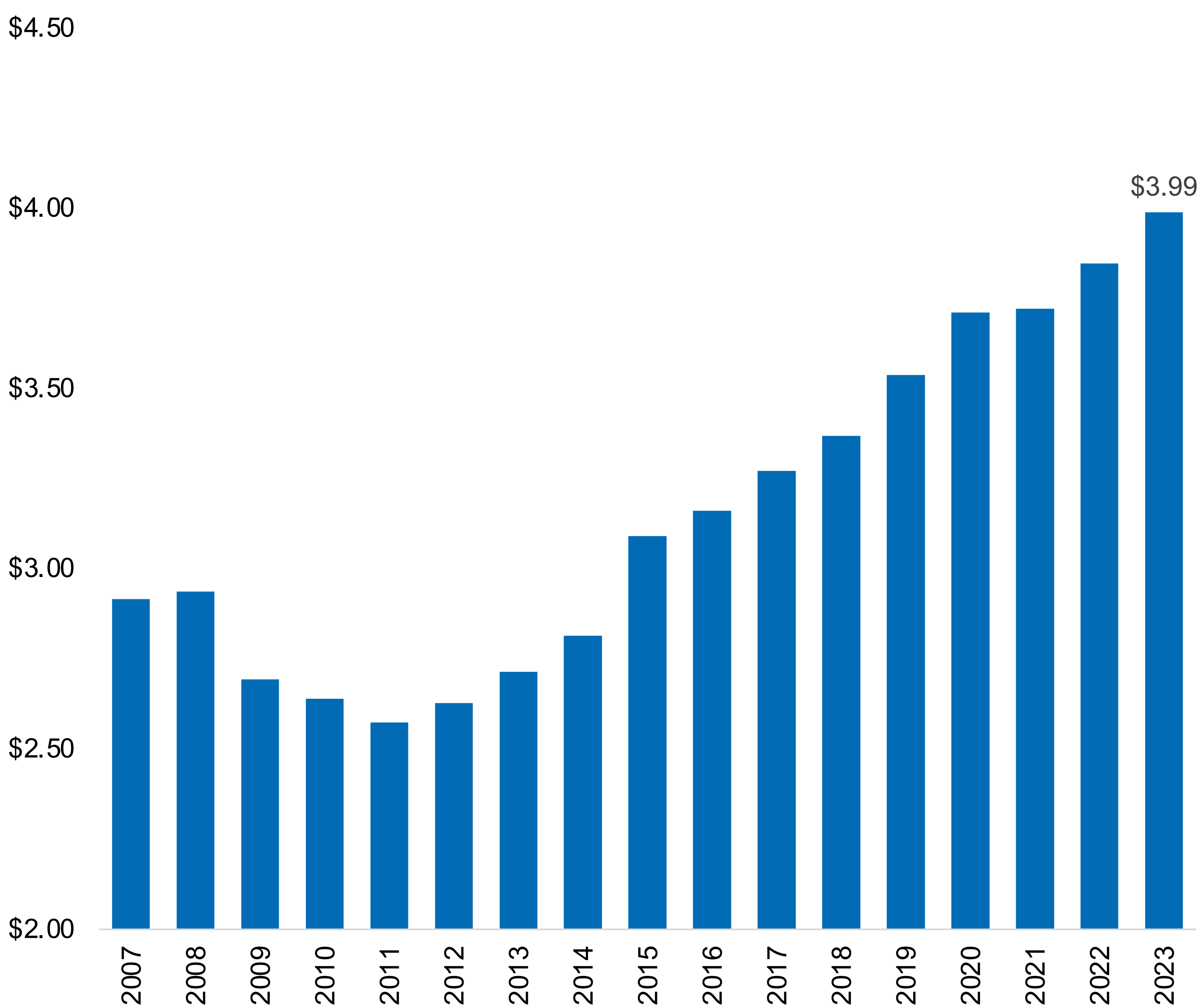


Source: Newmark Research

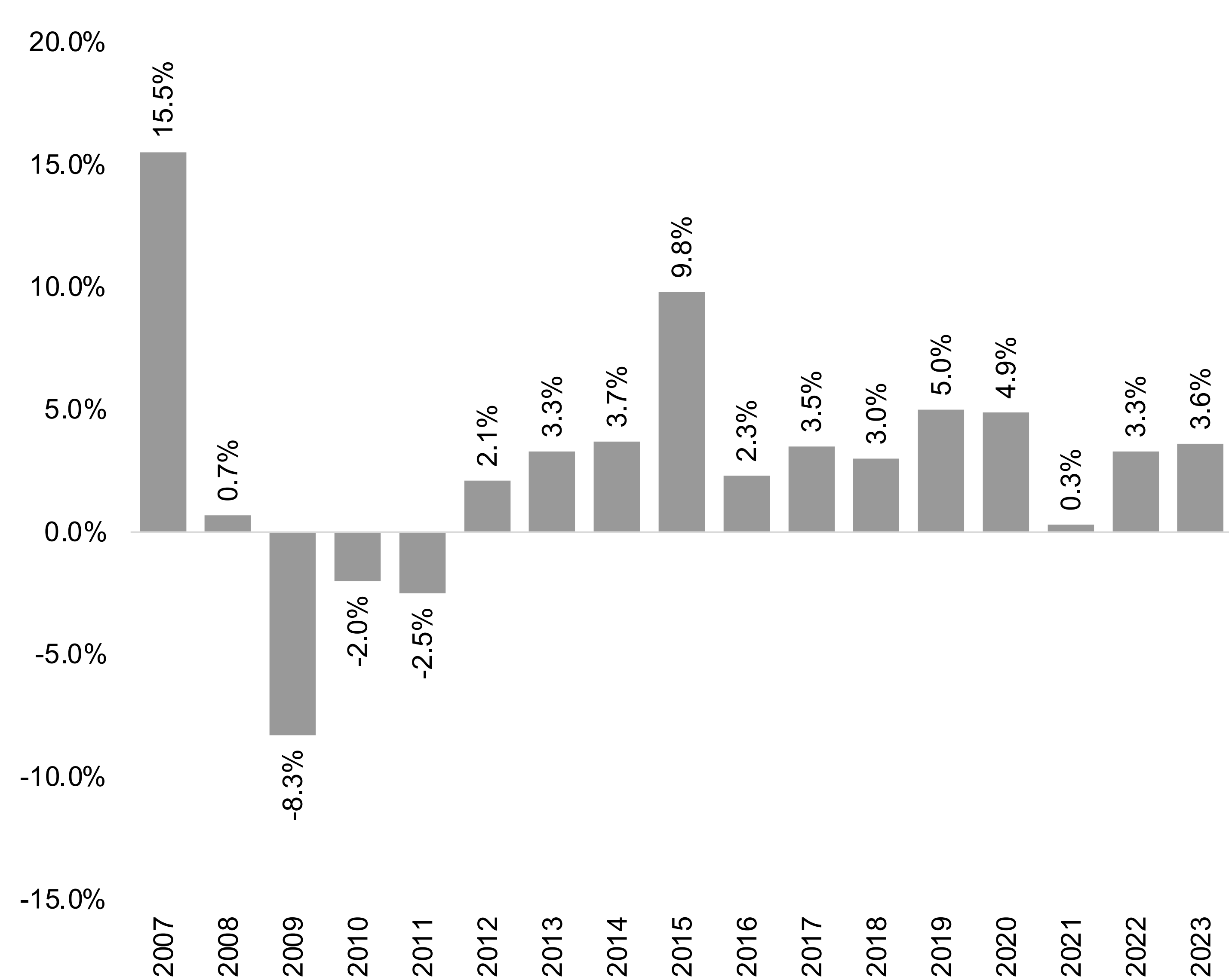
Landlords Hold Firm on Rents

Leasing activity may be subdued relative to recent quarters, but this has yet to impact average asking rents. Much of this can be traced to Class A listings presently on the market in addition to inflation, which is keeping tenant improvement allowances elevated.

Office Average Asking Rent, $/SF/Month, FS



Year-over-Year Asking Rent Growth Rate

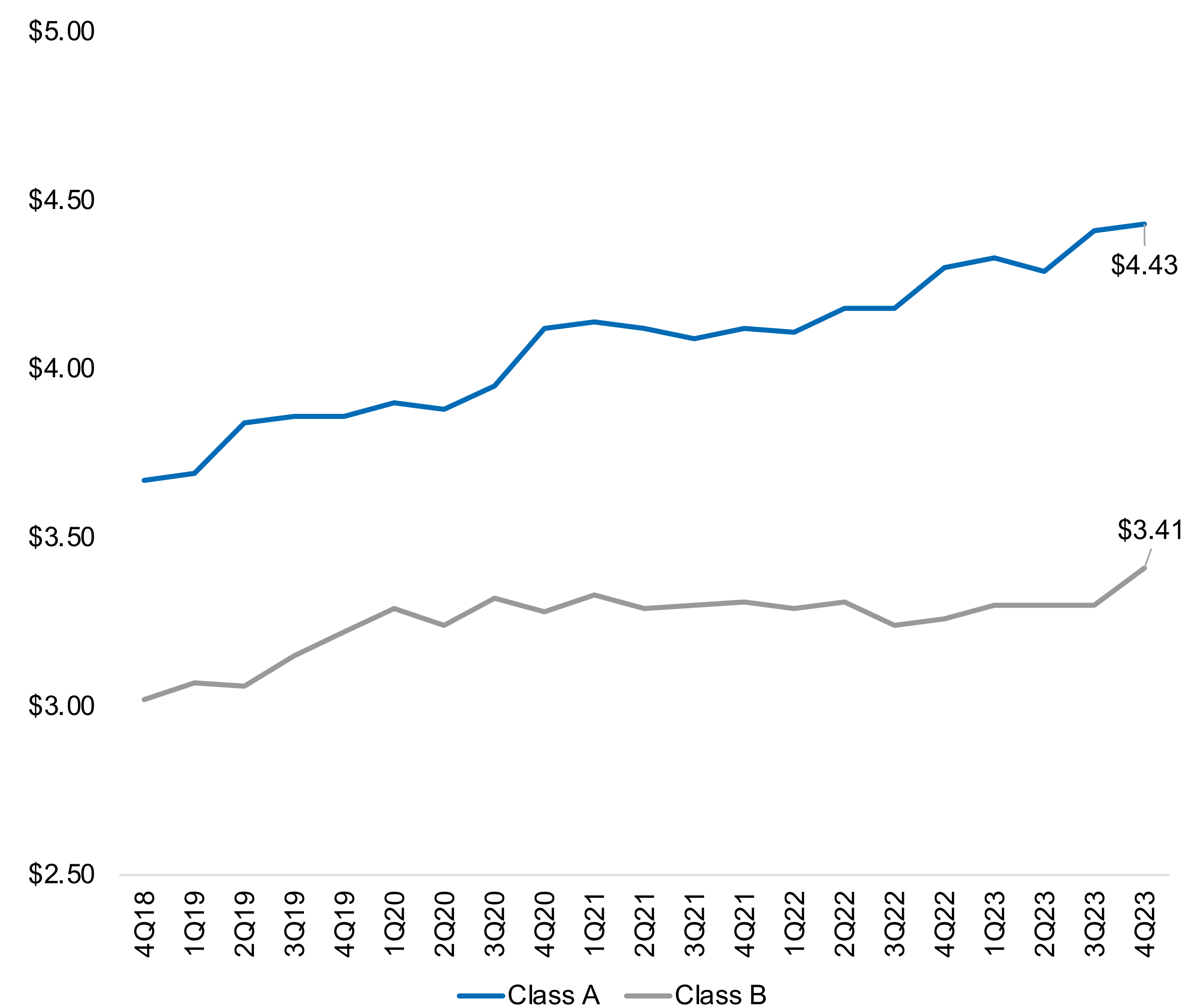


Source: Newmark Research

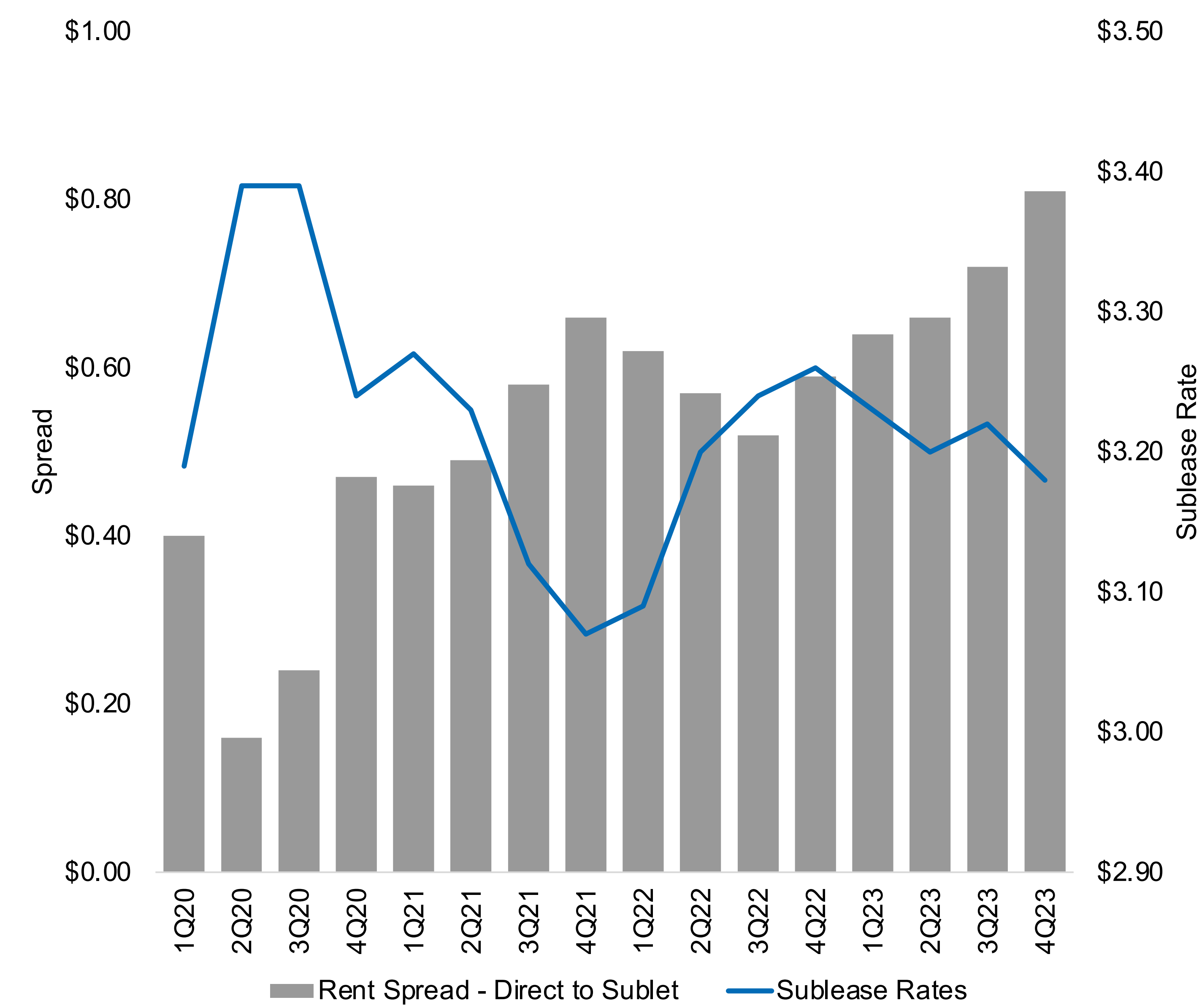
Office Asking Rents in All Classes Reach New Highs

While Class A rates modestly rose, Class B saw the sharpest gain with a 3.3% increase in the fourth quarter to reach $3.41/SF. Sublease asking rents, meanwhile, remain elevated. This is from tech companies that leased excess trophy space prior to the pandemic and now have overcapacity to shed.

Class A and Class B Asking Rents, $/SF/Month, FS



Sublease Asking Rates



Source: Newmark Research, CoStar

Sublease Availability Decreases

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Removals of Sublease Space Outpace New Listings

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A Tech Tenant Up Close: Netflix

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Government and Law Firms Propel Leasing Activity

Two of the top five leases for the fourth quarter were signed by the County Of Los Angeles. There is optimism leasing activity will increase in the media and technology sectors in 2024 following the end of the Hollywood strikes.

Notable 4Q23 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
County of Los Angeles	1500 Hughes Way	South Bay: Long Beach Suburban	Direct Lease	207,289
The Department of Public Social Services signed a 15-year lease in a consolidation move.				
Sheppard Mullin	350 S Grand Ave	Downtown Los Angeles	Direct Lease	119,217
The law firm signed the largest lease in Downtown LA for 2023 for its headquarters' relocation to 2Cal from Brookfield's Bank of America Plaza. Sheppard Mullin will reduce its footprint by 33% when it moves in mid-2025..				
Sidley Austin LLP	1950 Avenue of the Stars	West Los Angeles: Century City	Pre-lease	75,000
The law firm signed a 75,000-SF pre-lease at Century City Center, which is slated to deliver in 2026.				
Sidley Austin LLP	1999 Avenue of the Stars	West Los Angeles: Century City	Lease Renewal	66,604
Sidley also signed a renewal for the 17th and 19th floors at 1999 Avenue of the Stars, which will house the company until its new trophy space at Century City Center is complete.				
County of Los Angeles	3179 Temple Ave	San Gabriel Valley: Eastern SGV	Lease Renewal	50,756
The Department of Child Support Services renewed its lease at the University Tech Center in Pomona.				

Source: Newmark Research

Leased SF Averages are Lower Than the Number of Leases Signed

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Downtown Los Angeles vs. Century City

In Downtown LA’s CBD, Crime is Prevalent South of 6th Street

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Trophy Vacancy and Rent Dynamics are Night and Day When Comparing Downtown LA to Century City

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Sidley Austin LLP's Leases in 2023 Reinforce Several Themes from This Year

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Office-to-Residential Conversion and Distress

Home Ownership is Out of Reach for 89% of Buyers: Good News for the Rental Market

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46% of the Office Market Obsolete or Unable to Service Debt

Downtown LA’s Adaptive Reuse Ordinance Could Be Modified and Expanded City-wide

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Office Loan Defaults are Growing; So are the Number of Vulnerable Properties

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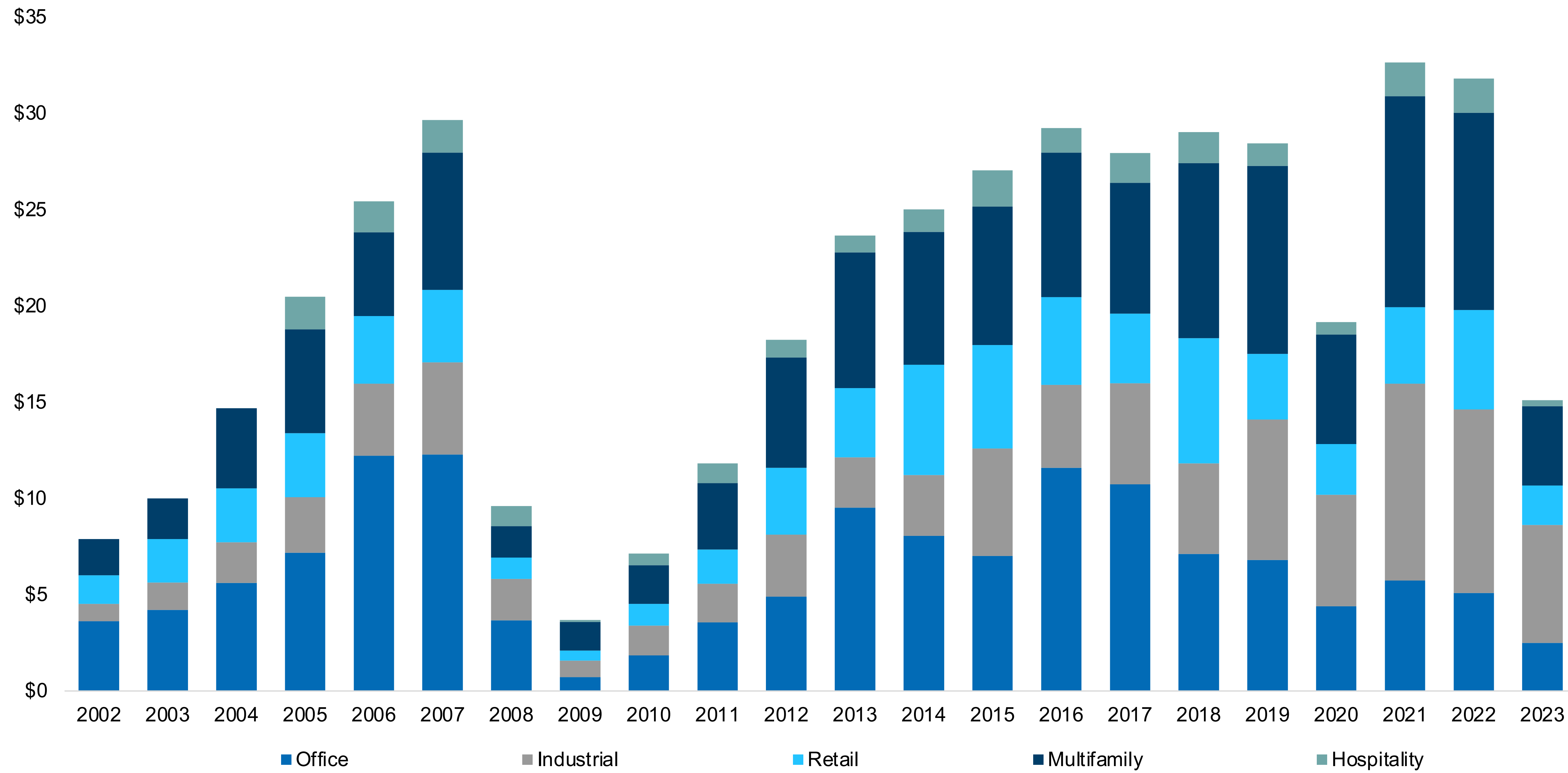
Sales Activity

Office Comprised 16.5% of Total Sales Volume in 2023

This is a steep decline from the 39.6% average in 2016. Structural shifts in leasing dynamics since the onset of COVID-19 remains an ongoing challenge for the property segment. This contrasts with other asset classes, such as industrial and multifamily, which experienced heated rent growth amid high demand in recent years. Growth that is now moderating.

Los Angeles: Sales Volume Across Commercial Property Segments ($ in Billions)

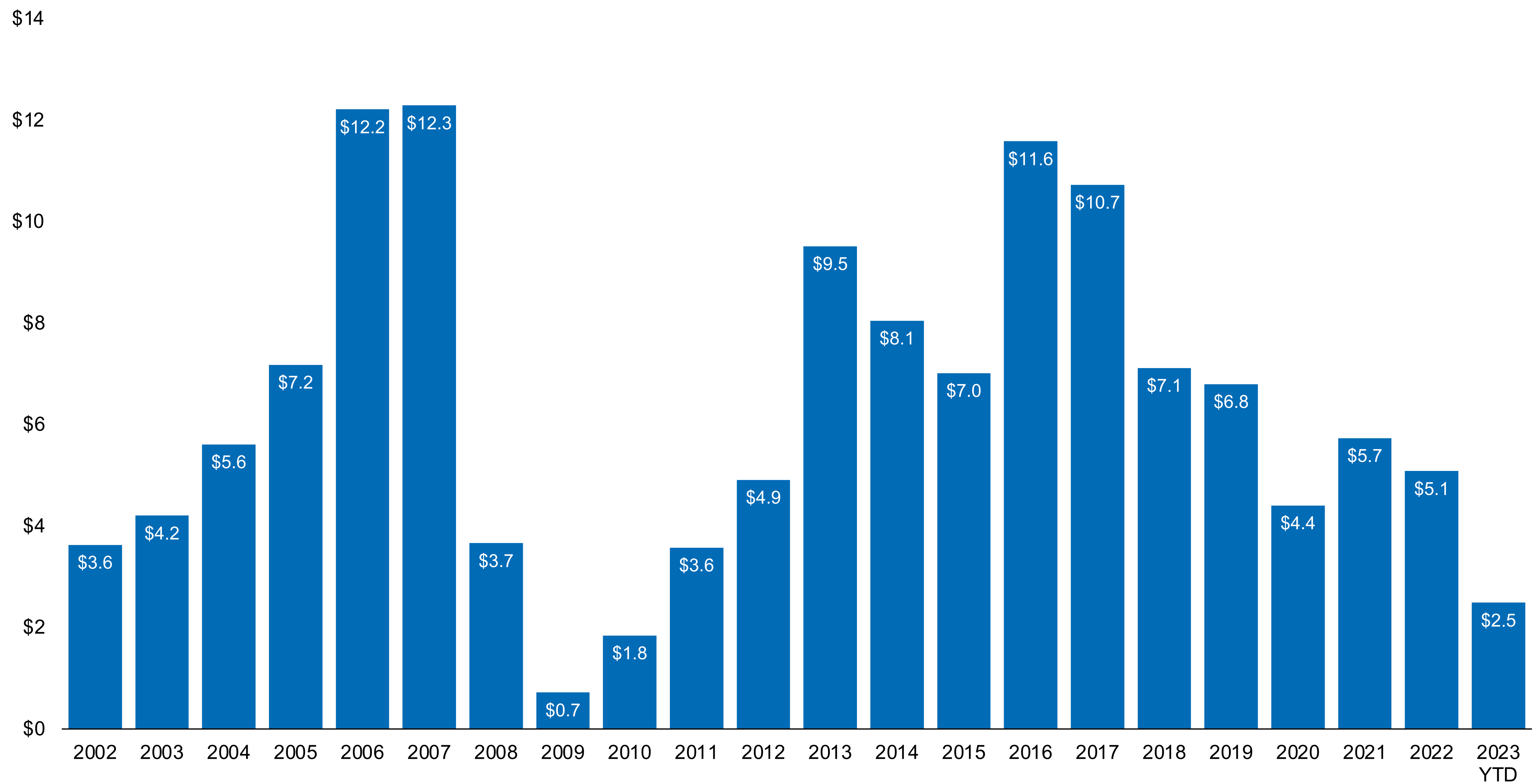


Source: Newmark Research, MSCI Real Capital Analytics
Note: Preliminary data is cited for the fourth quarter of 2023

Office Sales Volume: Up Close

Office sales volume totaled just $2.5 billion in 2023. Economic headwinds, concern regarding long-term adoption of hybrid work models, rising vacancy, looming debt maturities, new transfer taxes in the City of Los Angeles and a still-high interest rate environment have most investors taking a “wait-and-see” approach to the asset class.

Los Angeles: Office Sales Volume ($ in Billions)



Source: Newmark Research, MSCI Real Capital Analytics
Note: Preliminary data is cited for the fourth quarter of 2023

Pricing Decreases, While Cap Rates Increase

Opportunistic Buyers Are Taking Advantage of Discounted Pricing

Private, Opportunistic Buyers Are Active; Institutions Less So

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Submarket Snapshots

Downtown Los Angeles

Los Angeles North

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South Bay

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Tri-Cities

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West Los Angeles

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Appendix

Los Angeles Office Submarket Map and High-level Statistics | 4Q23

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Los Angeles Office Submarket Statistics | 4Q23 (page 1 of 3)


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High-Level Stats and Sublease Figures, By Submarket | 4Q23

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