Jones Lang LaSalle

Real value in a changing world

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Americas Research

Los Angeles Office Insight Q3 2009

Economy

The Los Angeles economy struggled with additional job loses during the third quarter as the August unemployment rate reached 12.6 percent, significantly higher than the national 9.7 percent average, and more than double the 6.0 percent unemployment figure recorded at the onset of the economic crisis. manufacturing and construction led declines with more than 56,800 jobs lost over the last 12 months. Budgetary pressures forced local government to shed nearly 10,000 jobs in August alone. Only education and health services posted year-to-date employment gains of 2.5 percent.

Market conditions

Los Angeles leasing fundamentals deteriorated further during the third quarter as tenants reduced occupancy and returned excess space to the market, driving vacancies up to 16.6 percent from 13.9 percent at the beginning of the year. The market experienced a negative 758,571 square feet of net absorption at the end of the third quarter representing seven consecutive quarters of negative absorption in the Los Angeles market. Additional sublease space emerged in all asset classes, albeit at a lower rate than previous quarters, and totaled 3.8 million square feet at the end of September.

Capital markets activity showed little improvement during the third-quarter with only a handful of Los Angeles suburban assets trading. Similar to the rest of the nation, the overall lack of available financing limited building sales in the Los Angeles market.

Outlook

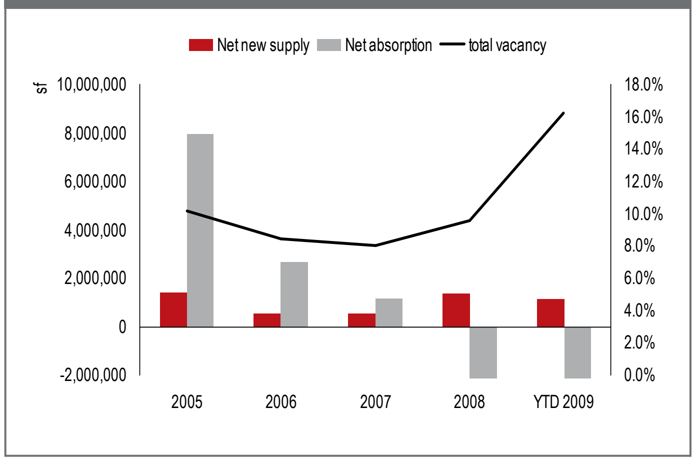
Recent gains in the economy, coupled with large tenant rolls in the next two years in the CBD and Westside submarkets, could lead to an up-tick in leasing velocity, as tenants try to lock-in favorable rates and attractive concession packages. However, if the high unemployment rate proves to be structural in some industry segments, future demand for space may be hindered and offset an increase in leasing activity.

The region's chief economic drivers, which include manufacturing, international trade, professional services and entertainment are all are projected to experience negative growth over the remainder of the year as executives reduce capacity to reflect more conservative growth projections. Los Angeles vacancies are anticipated to exceed 17.0 percent rate at the end of the fourth quarter and expected to stabilize during the first quarter of 2010.

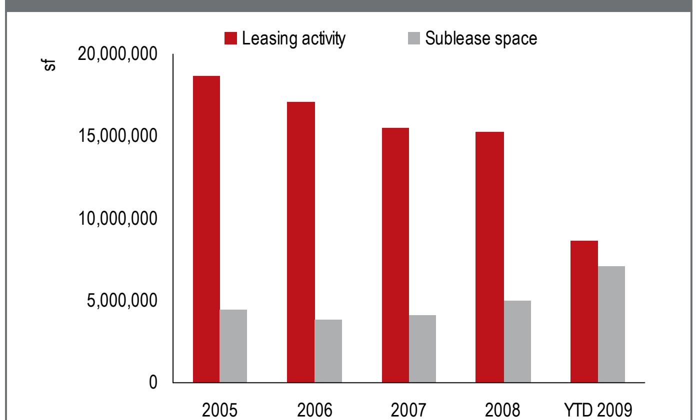
Key market indicators

	Key market indicators		12-month forecast
Supply	Supply	179,154,756 sf	→
	Direct vacancy rate	14.5%	↑
	Total vacancy rate	16.2%	↑
	Under construction (% preleased)	1.7 msf (15%)	↓
Demand	Leasing activity 12 mo. % change	-17.2%	↓
	YTD net absorption	-3.3 msf	→
Pricing	12-month overall rent % change	-6.7%	↓
	Class A overall asking rent	$36.15 psf	↓
	Class B overall asking rent	$28.12 psf	↓

Net new supply, net absorption and total vacancy



Leasing activity vs. sublease vacant space



Sublease space only includes vacant space

Tenant perspective

Many Los Angeles tenants continued to delay real estate decisions until more concrete evidence indicates that the economy is on the path to recovery. Although rents may decrease further, tenants are currently benefiting from available concessions on direct leases, such as increased rent abatement and tenant improvement allowances. Start rents decreased further during the third quarter.

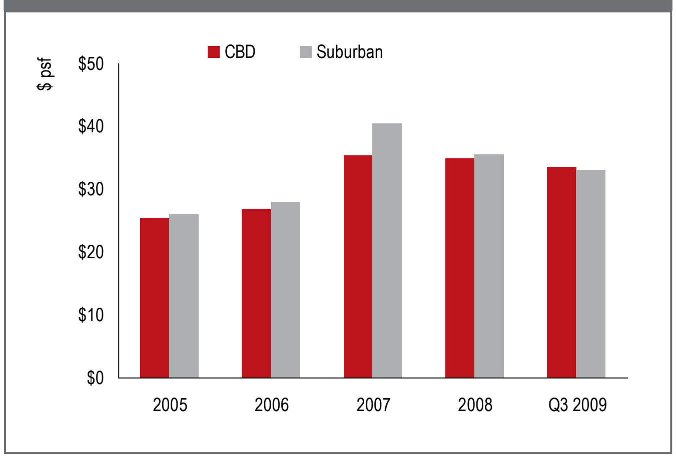
The increase of available sublease space – especially those with high-end build-outs offered by professional and services firms remains a more cost-effective way for tenants to upgrade their location.

Landlord perspective

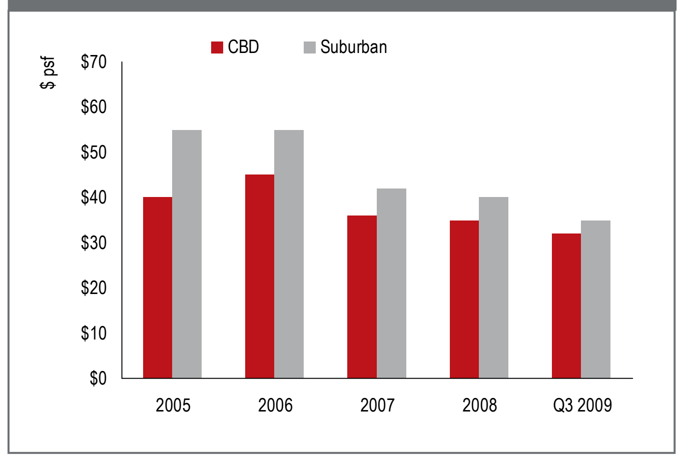
Los Angeles-based landlords experienced additional declines in net operating incomes as rents eroded further and vacancy increased. Tenant retention continues to be a primary goal of building owners, as evidenced through larger concession packages, including generous amounts of free rent, which in itself does not represent an upfront cost to the landlord, but ultimately lowers net average effective rents. Since liquidity is an industry-wide problem, many owners are limited in the actual number of tenant improvement dollars they can fund.

Although market conditions continue to favor the tenant, Los Angeles' equilibrium tends to lean toward a neutral/landlord-favorable environment. As soon as economic conditions signal that the worst is over, there will likely be a noticeable increase in demand, as tenants will be more inclined to make leasing decisions. Until then, however, landlords will find themselves signing tenants up for short-term occupancies at the current below-average rental rates. As market conditions shift with the eventual economic rebound, and these short-term tenants find themselves up for renewal, landlords will have the opportunity to reset base rents to match future, higher values.

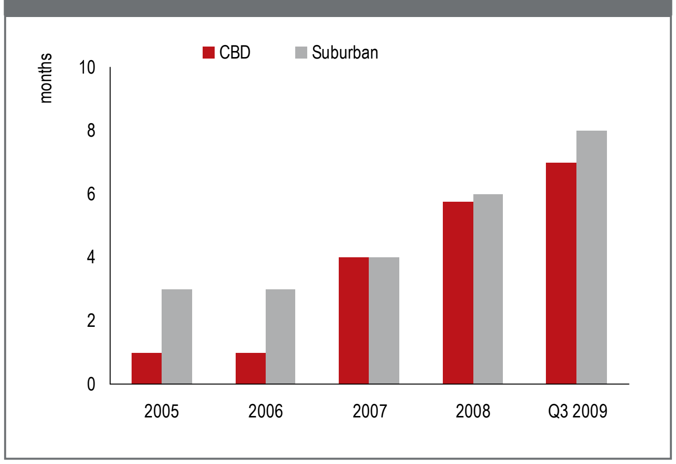
Class A overall asking rents



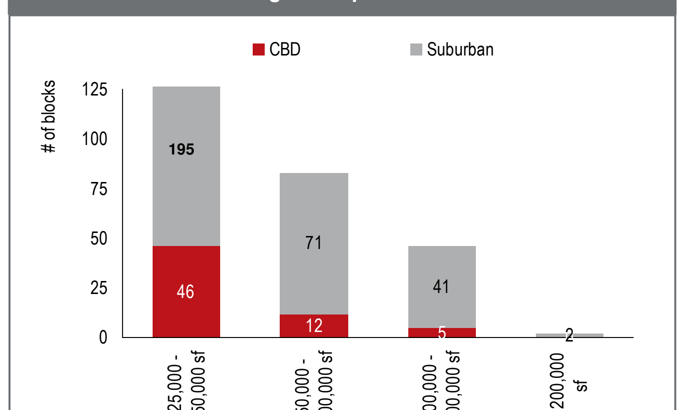
Class A tenant improvement allowance



Class A free rent

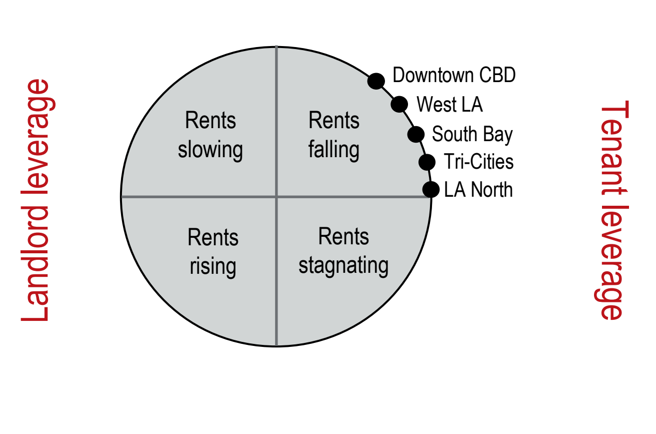


Class A blocks of contiguous space



Includes available existing and UC/UR blocks

Property clock – current market conditions



Submarket leverage – market history and forecast

Completed lease transactions

Tenant	Address	Submarket	sf	Type
Advanced Bionics Corporation	28515 Westinghouse	Los Angeles North	146,385	New
Lionsgate	2700 Colorado Avenue	West Los Angeles	127,000	Renewal
Blue Shield	6300 Canoga Avenue	Los Angeles North	115,000	Renewal
Deluxe Digital Studios	2350 Empire Avenue	Tri-Cities	65,235	Renewal
McKenna, Long & Aldridge	300 South Grand Avenue	CBD	62,418	New
Expeditors International of Washington	5757 West Century Boulevard	South Bay	42,000	Renewal
Perkowitz and Ruth Architects	111 West Ocean Boulevard	South Bay	38,000	Renewal

Completed sale transactions

Address	Submarket	Buyer / Seller	sf	$ psf
5959 Topanga Canyon Boulevard	Los Angeles North	Younan Properties / Value Topanga LLC	62,510	$190 (Estimated)
9300 Wilshire Boulevard	Westside	RP Properties / RP Realty Partners	58,484	$188 (Estimated)

Methodology: Inventory includes all Class A & B office properties greater than 30,000 square feet, and excludes all office condo, medical, government and owner occupied buildings

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