Kidder Mathews

MARKET TRENDS | WEST COAST

OFFICE

YEAR END

2019

Generally, the office market on West Coast is portrayed by increased capital gains and a better than expected huge scale acquisitions. The principle markets of action are Seattle, San Francisco, Los Angeles and San Diego.

The tech business has changed U.S. urban areas as far as how individuals function and live inside them. Normally, one of the recipients of this flow of capital from tech is the office sector. New businesses and enormous tech firms have perceived that they must set up a solid presence in focal urban areas to continue drawing in millennial specialists. Then again, an absence of talented laborers is turning into an obstacle.

As indicated by the Public Policy Institute of California, the anticipated deficiency of skilled laborers with higher education originates from a mismatch between the portion of the workforce anticipated to have some advanced degree by 2025 (29%) and the portion of occupations that will require laborers with those abilities (36%). This jumble is driven by major instructive and financial patterns. On the training side, laborers entering the workforce are more averse to having finished postsecondary instruction than resigning laborers. The tech business rejuvenation over the West Coast will have solid ramifications on assisting instruction. Thus, future lucrative occupations across the Western markets will more than likely require preparing past secondary school. As occupations are added to the market and more organizations move to the locale, more space to serve them is required. West Coast office markets delighted in a steady second half, as net absorption verged on surpassing development completions and office vacancies held relentless year-over-year New completions this year diminished by 21% every year prior and over half from end of 2018.

Rent growth dropped from a year prior and rental rates have gone up. Cap rates remained stable. So, in a general sense the West Coast office market is steady for new and prepared investors and will yield stability and develop consistently.

Developers all through the area are planning to draw in comparative tech giants Facebook, Amazon, Netflix, and Google (FANG). Also, in spite of the slow development completions, the amount of space under development in the West Coast has just declined 3%. Investors are mindful so as to not oversupply the market. Hence, without getting unreasonably optimistic, developers remain bullish about the pipeline of office performance across the West Coast markets.

As premier markets, for example, Seattle, San Francisco and Los Angeles keep up their quality, other markets are receiving the benefits with improved essentials. For example, net absorption in the Inland Empire keeps on improving, as office tenants migrated out of Los Angeles and Orange County looked for more practical space. In Northern California, Sacramento's office performance is on a six-year run of decreases in vacancy, and this consistent fixing has driven rental rate growth that is greater than the national normal. The widening of the innovation area into new tech, augmented reality, man-made brainpower, transhumanism and independent vehicles offer motivation to accept the continuous flood in the West Coast office division. This is only the start of a significant change on a coast that withstands any enduring business sector up or downswings.

Source: CoStar, Harvard Joint Center for Housing Studies as reported by Urban Land Institute

Market Breakdown

	2019	2018	2017	Annual % Change
Completed Construction	16,665,979	15,220,615	19,780,889	9.50%
Under Construction	40,593,338	40,888,123	37,367,931	-0.72%
Vacancy Rate	9.1%	9.3%	9.9%	-1.90%
Availability Rate	12.1%	12.3%	12.7%	-1.90%
Asking Lease Rate	$38.50	$37.08	$35.28	3.82%
Lease Transactions	90,338,176	114,406,223	109,452,166	-21.04%
Sale Transactions	101,181,865	98,670,757	105,973,517	2.54%
Cap Rates	6.0%	6.0%	6.0%	0.27%
Net Absorption	17,971,063	21,116,800	15,085,195	N/A

Seattle

▲ 6.76 SF UNDER CONSTRUCTION	▼ 5.9% VACANCY
▲ 5.77M SF NET ABSORPTION	▲ $32.23 ASKING LEASE RATE

Expanding deal volume this cycle is a demonstration of the apparent quality of the Seattle market, with a lot of institutional ventures making a mark, particularly in the urban center. Vacancies are in a sound low range. Occupancy levels, new conveyances, and rent growth are in typical solid form. Market rates and sale prices have arrived at new unequaled highs and give no indication of backtracking, considering deal volume is arriving at record highs as well. The Seattle region remains healthy as trade, transportation, and utility industries developed exponentially this cycle. The tech business has been the focal point of consideration for investors and owners alike. Expect further growth to continue for the Seattle Office market in 2020.

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Portland

▲ 2.51M SF UNDER CONSTRUCTION	▼ 7.4% VACANCY
▲ 195,048 SF NET ABSORPTION	▲ $28.08 ASKING LEASE RATE

Portland's solid economy is piquing interest for local and state wide investors. More than 2 million s.f. has been under development since the end of 2016. Vacancies has moved modestly in recent years and ticked up towards year's end. Rent growth is currently similar to national rates, yet to some degree beneath the metro's historical normal. Solid financial markers drive the hearty interest for land in Portland. Salaries and work development far surpass the national normal. The metro's prevalence perseveres among recent college grads searching for inventive, moderate, eco-accommodating spaces near travel center points that allow exploitation of Portland's high caliber lifestyle. Developers recognize the solid relocation as an interest driver for new supply, a number of which are structurally complex.

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Oakland/East Bay

▼ 396,725 SF UNDER CONSTRUCTION	▲ 7.9% VACANCY
▲ 631,765 SF NET ABSORPTION	▲ $48.72 ASKING LEASE RATE

When contrasted with the other significant metros in the Bay Area, the East Bay profited by solid lease development later in the expansion cycle. While rent growth in the East Bay has eased back in the course of recent years, it stays solid and keeps outpacing the national normal. Office space in the East Bay remains abundant at competitive low pricing contrasted by higher end rents in San Francisco and all through the San Jose metro zone. The East Bay Office sector was stable all of 2019, as rental rates pushed higher and occupancy rates dropped. The East Bay office market now has the tenth most elevated year-over-year rent growth in the country.

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San Francisco/Peninsula

▲ 7.99M SF UNDER CONSTRUCTION	▼ 7.1% SF VACANCY
▲ 3.07M SF NET ABSORPTION	▲ $69.72 SF ASKING LEASE RATE

The interest for new office development stays high and landlords are pushing rents higher accordingly. Over 1.7 million sf of new space is coming online in 2020, all completely pre-leased. The interest for new office development stays high; and landlords are pushing rents higher accordingly. Overall, rent growth in San Francisco over the previous year has outpaced many national markets. The amount of sales in 2019 were largely due to ventures from large institutions. With this in mind, portfolio valuations continue to ascend along with potential to increase rents. Considering the subsequent two years, over 24 million square feet is expected to be vacated, resulting in a slight vacancy expansion. Some tenants may find relief from the extensive lease increments.

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Silicon Valley

▲ 7.96M SF UNDER CONSTRUCTION	▼ 9.2% VACANCY
▲ 2.92M SF NET ABSORPTION	▲ $62.40 ASKING LEASE RATE

The Silicon Valley office market continues to be one of the best performing nationally. In 2019, total net absorption is 3.44 million sf and total vacancy has fallen to 9.2%. Asking rents and average sale prices continue to rise year-over-year. Sales volume remained robust in 2019 with 6.6 million sf, nearly matching the 6.7 million sf in 2018. Nearly 8 million sf of office currently under construction is poised to meet the ongoing demand with 20 million more sf approved and awaiting construction. With the robust economy supporting this backlog of supply, the Silicon Valley economy looks to have a great beginning in 2020.

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Sacramento

▲ 1.9M SF UNDER CONSTRUCTION	▼ 9.2% VACANCY
▲ 1.25M SF NET ABSORPTION	▲ $22.44 ASKING LEASE RATE

The Sacramento office market has further tightened as direct vacancy continues to stay low quarter-over-quarter and year-over-year. Asking lease rates remained at an all-time high at $22.44 FS. Through the first half of 2019, leasing and sales activity have been subdued compared with 2018. Despite this softening at the start of 2019, Sacramento was the 8th fastest growing market in the nation in terms of rental rate, year-over-year. In the first half of 2019, 302,000 s.f. of office space was delivered to the market, most of which is already leased. With over 2M s.f. still under construction, the second half did not prove to be as active, as construction timelines experienced a slow down.

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Reno

▼ 7,211 SF UNDER CONSTRUCTION	▼ 8.2% VACANCY
▲ 246,054 SF NET ABSORPTION	▲ $19.44 ASKING LEASE RATE

Reno has diversified its economy beyond tourism and gambling since the recession. This improvement has helped reverse a painful contraction that subsided in 2013 as Reno's job growth is now amongst the strongest in the nation. Job gains have been strong in educational/health services, tech, government, and trade. Low living costs relative to other West Coast cities and a business friendly economy make Reno an attractive destination for businesses. Office vacancies continued to compress in 2019, decreasing by 900+ basis points since 2010, further propelling rental rates past post-recession highs. To accommodate vacancy constraints, construction deliveries reached a peak in 2019, with 128,234 s.f. entering the market. Only 7,211 s.f. is currently under construction and set to deliver mid-year.

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Los Angeles

▲ 7.33M SF UNDER CONSTRUCTION	▲ 10.6% VACANCY
▼ -28,389 SF NET ABSORPTION	▲ $39.48 ASKING LEASE RATE

L.A. remains the media and amusement capital of the world. Information industry tenants experienced moderate employment misfortunes over the previous year. In any case, the expanded interest for digital services and internet based life has added fuel to the L.A. economy. Significant tech firms with expectations to deliver media content have as of late inked enormous office leases, including Facebook, Amazon, Apple, Netflix, and Google–giving investors opportunities and securing similar tenants interest in the growing submarkets. Dynamic cash flow and lease renewals drove the market and are visible in the 28,026,450 s.f. of transaction activity, yet a 42% drop when contrasted with 2018. This is positive as these deals leased at high premiums and high quality availabilities were limited.

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Orange County

▼ 480,815 SF UNDER CONSTRUCTION	▲ 10.6% VACANCY
▲ -73,696 SF NET ABSORPTION	▲ $32.76 ASKING LEASE RATE

The Orange County office market ended 2019 on a high note, as healthy demand fundamentals remained in lock-step with the heavy influx of new supply. Direct net absorption recovered from the negative absorption levels at the start of 2019 to finish the year in positive territory. Although rental rate growth has cooled, asking rental rates remain at post-recession highs and vacancies are relatively stable. In addition, investors have continued to trade trophy properties and office campuses, recording over $1.8B in sales volume for the year. Currently the unemployment rate sits at 2.5%, 120 basis points lower than the state's average of 3.7% and 80 basis points lower than the national average, respectively. As market fundamentals continue to improve, we can expect the Orange County office market to remain healthy in 2020.

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Inland Empire

▲ 787,456 SF UNDER CONSTRUCTION	▼ 7.6% VACANCY
▲ 277,184 SF NET ABSORPTION	▲ $23.16 ASKING LEASE RATE

The Inland Empire office market continued to grow in 2019 as vacancies, which topped 17% in the depths of the recession, have compressed by more than 900 basis points, driving positive rental growth. The Inland Empire is considered an overflow office market, serving primarily as a low-cost alternative for tenants priced out of Los Angeles and Orange County, so its rebound is partially tied to the strong recovery enjoyed by neighboring metros. Additionally, the surge of inbound demand has caused an increase in development efforts. Currently, medical offices have become a primary type of office development, with over 350,000 s.f. looking to be completed in early 2020. As we enter the new year, expect fundamentals to continue to improve for the Inland Empire office market.

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San Diego

▲ 1.62M SF UNDER CONSTRUCTION	▼ 10.1% VACANCY
▲ 798,118 SF NET ABSORPTION	▲ $34.32 ASKING LEASE RATE

The San Diego office market experienced a record breaking year to end the decade with its lowest vacancy rate in 15 years as well as recording an all-time historical high in asking rental rates. San Diego's strong local economy has supported an equally strong local office market. With a solid employment base supported by the tech, life sciences and healthcare sectors, the market has been able to thrive. Occupancy levels continue to remain at the highest they've been in almost 15 years, with strong positive net absorption and low availability rates. In addition, asset pricing for San Diego office sales transactions posted a new record high. With strong fundamentals in place, expect the San Diego office market to remain healthy moving forward.

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Phoenix

▲ 2.84M SF UNDER CONSTRUCTION	▼ 12.7% VACANCY
▲ 2.76M SF NET ABSORPTION	◀▶ $26.76 ASKING LEASE RATE

2019 turned out to be another great year for the Phoenix office market. By any measure, the sector is thriving and performing at the highest levels, with record breaking stats across the board to end the decade. Vacancy rates for the Phoenix office market dipped to a post-recession record low while asking rental rates have continued to soar to all-time highs, making it the 31st consecutive quarter of positive growth. With such strong fundamentals, investors are bullish about the Phoenix office market and remain confident as Phoenix has been one of the top metros in the nation for job growth over the past several years. We can anticipate another strong year for the Phoenix industrial market in 2020.

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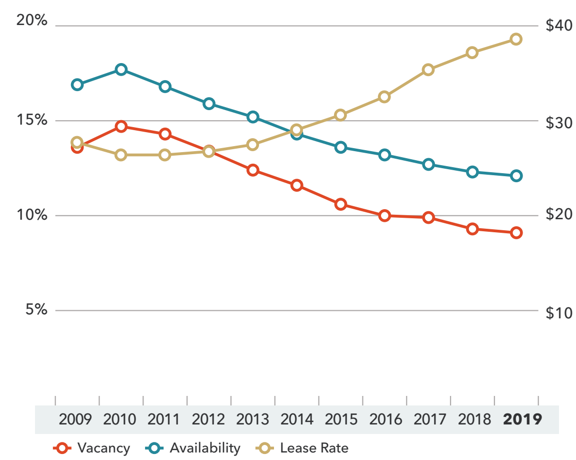
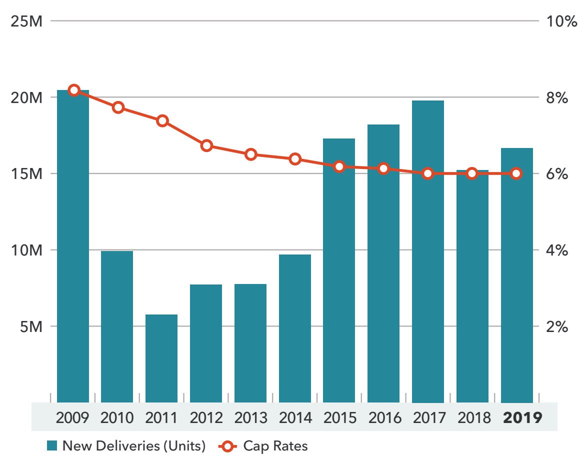
YEAR END 2019 WEST COAST OFFICE STATISTICS

Submarket	Total Inventory	Under Construction	YTD Completed Construction	Total Vacancy	Total Available	YTD Net Absorption	YTD Total Leasing Activity	Avg Cap Rate	Avg Sales Price / SF	Avg Direct Rental Rate (FSG)
Seattle	206,525,028	6,759,130	3,842,392	5.9%	8.3%	5,768,735	9,725,684	6.1%	$519.63	$33.23
Portland	96,828,502	2,514,438	109,845	7.4%	10.4%	195,048	3,736,200	6.1%	$337.69	$28.08
Pacific North West	**303,353,530**	**9,273,568**	**3,952,237**	**6.4%**	**8.9%**	**5,963,783**	**13,461,884**	**6.1%**	**$461.56**	**$31.59**
Oakland/East Bay	51,625,464	396,725	734,720	7.9%	11.8%	631,765	2,490,773	5.5%	$376.15	$48.72
Peninsula/San Mateo	35,642,545	4,679,194	600,258	9.2%	11.5%	815,286	3,279,800	5.6%	$643.81	$73.56
San Francisco	112,374,878	3,314,880	1,768,610	5.0%	9.6%	2,257,372	9,890,228	4.4%	$830.30	$65.87
Silicon Valley	120,567,224	7,960,241	1,730,836	9.2%	11.0%	2,921,838	7,753,512	5.8%	$608.70	$62.40
Sacramento	98,877,077	1,904,759	501,579	9.2%	11.2%	1,250,083	3,630,566	7.1%	$196.43	$22.44
Reno	18,088,421	7,211	128,234	8.2%	9.9%	246,054	764,801	6.2%	$165.58	$19.44
Northern California	**437,175,609**	**18,263,010**	**5,464,237**	**7.9%**	**10.8%**	**8,122,398**	**27,809,680**	**5.7%**	**$529.48**	**$51.77**
Los Angeles	370,355,349	7,325,013	2,253,658	10.6%	13.7%	(28,389)	20,628,566	5.5%	$446.20	$39.48
Orange County	144,915,089	480,815	1,373,672	10.6%	13.7%	73,696	10,048,139	5.8%	$269.20	$32.76
Inland Empire	57,299,836	787,456	162,067	7.6%	9.4%	277,184	2,242,024	7.0%	$182.73	$23.16
San Diego	103,970,818	1,622,366	413,200	10.1%	13.6%	798,118	7,094,699	6.2%	$363.35	$34.32
Phoenix	164,291,245	2,841,110	3,046,908	12.7%	16.1%	2,764,273	9,053,184	7.6%	$193.89	$26.76
South West	**840,832,337**	**13,056,760**	**7,249,505**	**10.7%**	**13.9%**	**3,884,882**	**49,066,612**	**6.2%**	**$338.20**	**$34.09**
West Coast Total	**1,581,361,476**	**40,593,338**	**16,665,979**	**9.1%**	**12.1%**	**17,971,063**	**90,338,176**	**6.0%**	**$414.74**	**$38.50**

VACANCY VS. AVG ASKING RENT



ANNUAL NEW CONSTRUCTION & CAP RATES



Kidder Mathews is the largest, independent commercial real estate firm on the West Coast, with 800 real estate professionals and staff in 22 offices in Washington, Oregon, California, Nevada, and Arizona. We offer a complete range of brokerage, appraisal, property management, consulting, project and construction management, and debt equity finance services for all property types.

COMMERCIAL BROKERAGE

400+ NO. OF BROKERS

$9B ANNUAL TRANSACTION VOLUME

20M ANNUAL SALES SF

40M ANNUAL LEASING SF

VALUATION ADVISORY

1,600+ APPRAISALS ANNUALLY

36/24 TOTAL NO. APPRAISERS/MAI'S

PROPERTY MANAGEMENT

60M+ MANAGEMENT PORTFOLIO SF

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