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Los Angeles Office Market Insight Report

Q2 2021

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Key takeaways

Los Angeles office market

- Overall vacancy has risen to all-time highs, totaling **17.8 percent**.
- Leasing activity has slowed down by **57.9 percent** compared with long-term historical averages.
- The "flight to quality" trend persists, with the Class A and Trophy segment accounting for **81.1 percent** share of post-COVID leasing activity.

Sublease Space

- The sublease market continues to drag aggregate fundamentals down, accounting for a record **9.6 msf** of available space. However, some prospective sublandlords have pulled their space from the market after unsuccessfully capturing demand by subtenants looking to capitalize on discounted rents. A lot of potential sublandlords are also pulling their space off the sublease market because they want to reoccupy their space.

Rental pricing trends

- Net effective rents decreased by **15.2 percent** from pre-pandemic levels as landlords induced tenant commitments through record-setting concession packages and favorable lease provisions, while keeping face rents relatively steady.
- Demand is starting to increase as the economy reopens and tenants that postponed their long-term occupancy strategies re-enter the market. Concessions have begun to plateau as a result of this.

Key takeaways

Capital markets

- The market has entered a risk-pricing crisis despite continued record levels of dry powder. As a result, just **$3.0B** of Los Angeles offices have been sold over the past 18 months, an annualized decrease of **30 percent** from 2019.
- Asset pricing has softened by **10 percent** from 2019 to present, though has showed signs of stabilizing.

Economic conditions

- Reopening efforts and higher vaccination rates have allowed the Los Angeles Metropolitan Area (MSA) unemployment rate to rebound from a high of 17.9 percent to **9.9 percent**.
- Office-using jobs have declined by **8.7 percent** compared with 10.3 percent for other industries' job losses, underscoring the disproportionate impact the pandemic had on the discretionary segments of the local economy.

Post-COVID recovery rate

- The overall U.S. post-COVID rate of recovery is **38.4 percent**.
- The overall rate of recovery of Los Angeles office occupiers is high at **32.7 percent** compared to the U.S. average of 19.2 percent.

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Office occupier conditions

Demand temporarily paused, allowing vacancy to reach record levels. Tenants are navigating the market with more conviction, indicating a potential recovery in select market segments.

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Vacancy rates have reached a record high

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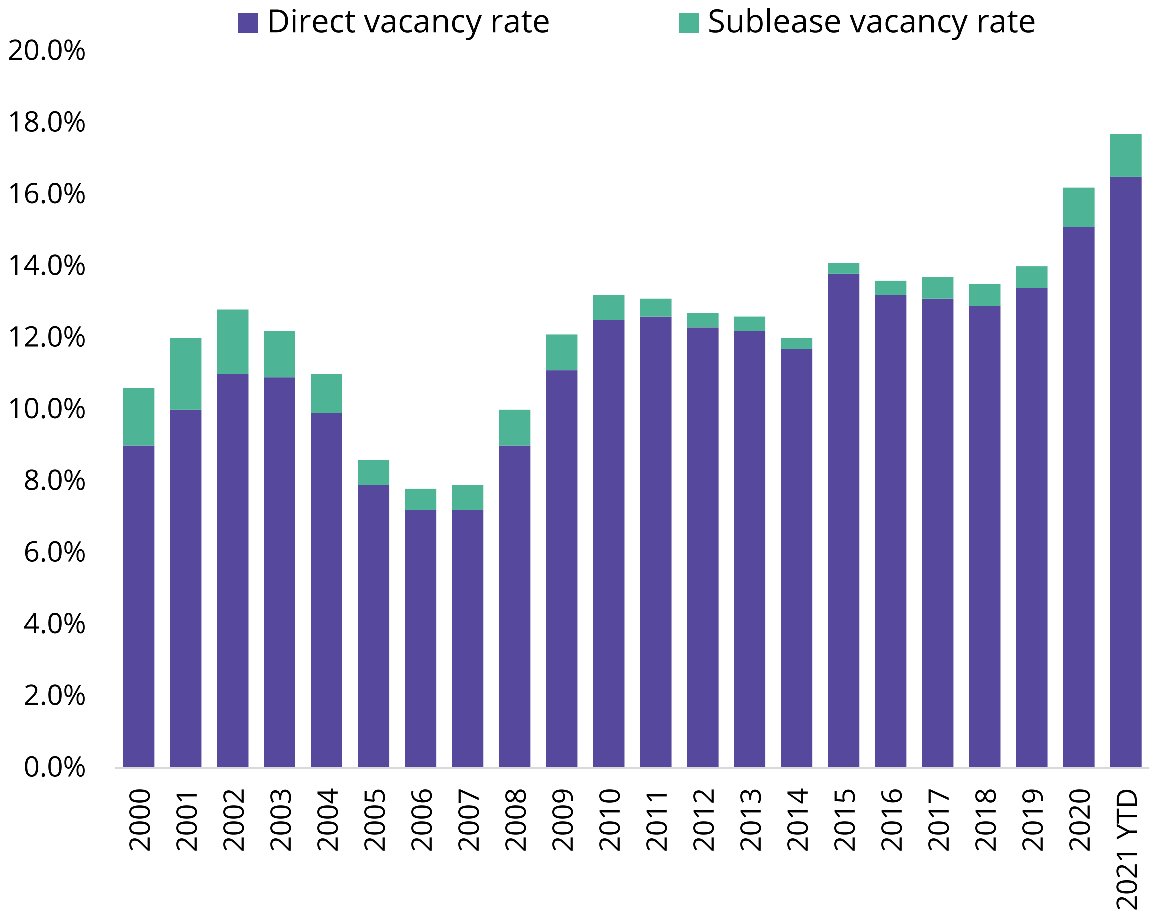
17.8%

Record high Los Angeles Market vacancy as of Q2 2021

The Q2 2021 overall vacancy rate has reached a record high of 17.8%. The ratio of sublease-to-total vacant space is comparatively lower than in other gateway markets such as San Francisco, New York, and Boston. This cycle's elevated vacancy levels are a result of some companies moving out of state and other companies rightsizing their operations in Los Angeles.



Source: Avison Young

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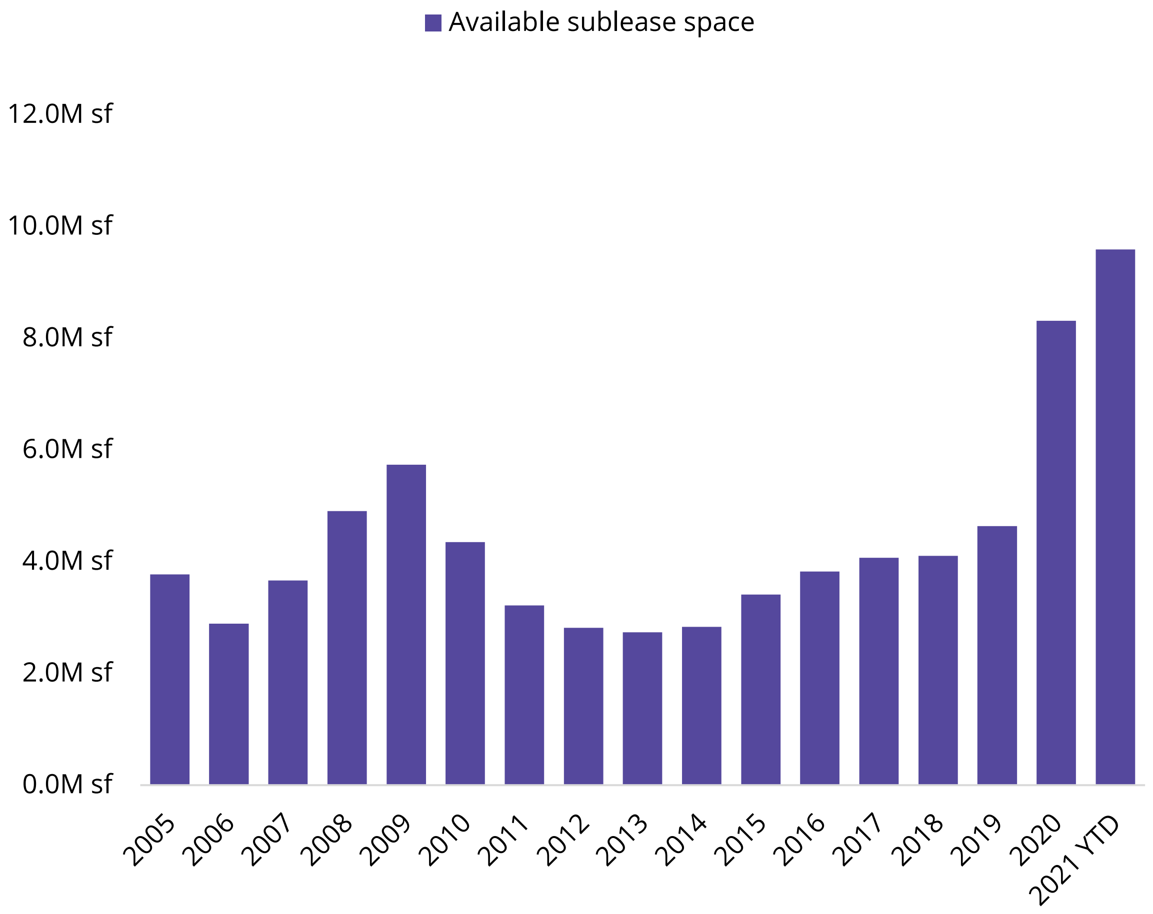
Available sublease space has peaked

9.6 msf

Record level of available sublease space

Available sublease space has doubled from YE 2019 to Q2 2021 as tenants evaluate future occupancy plans due to COVID.



Source: Avison Young

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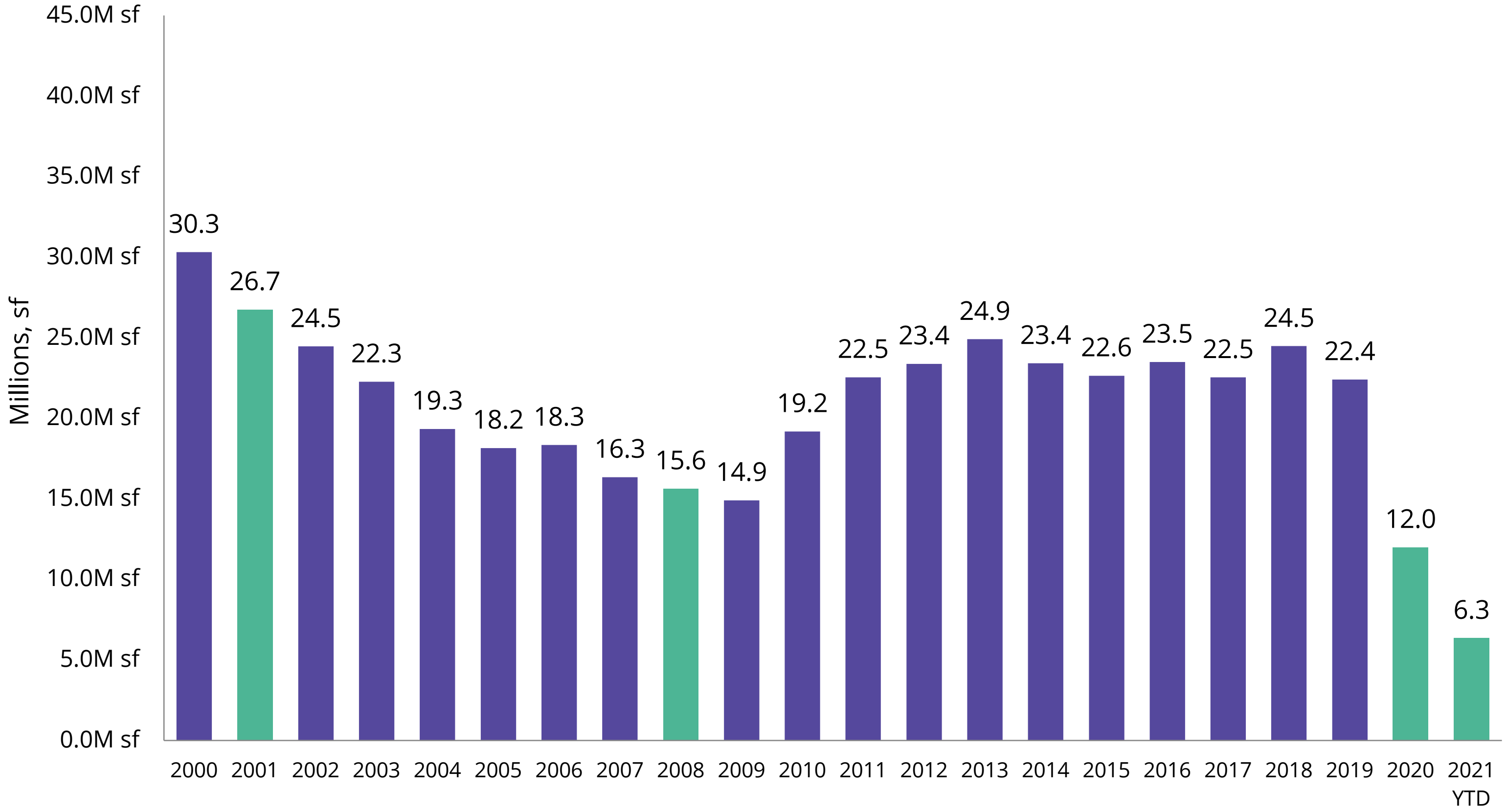
Office leasing activity has weakened

-57.9%

2021-pro-rated and 2020 vs. prior 20-year annual average leasing activity

There is no modern precedent for the post-COVID slowdown in leasing activity—not 2001 nor 2008—due to the sudden change in office occupiers' future workplace strategies.



Source: Avison Young

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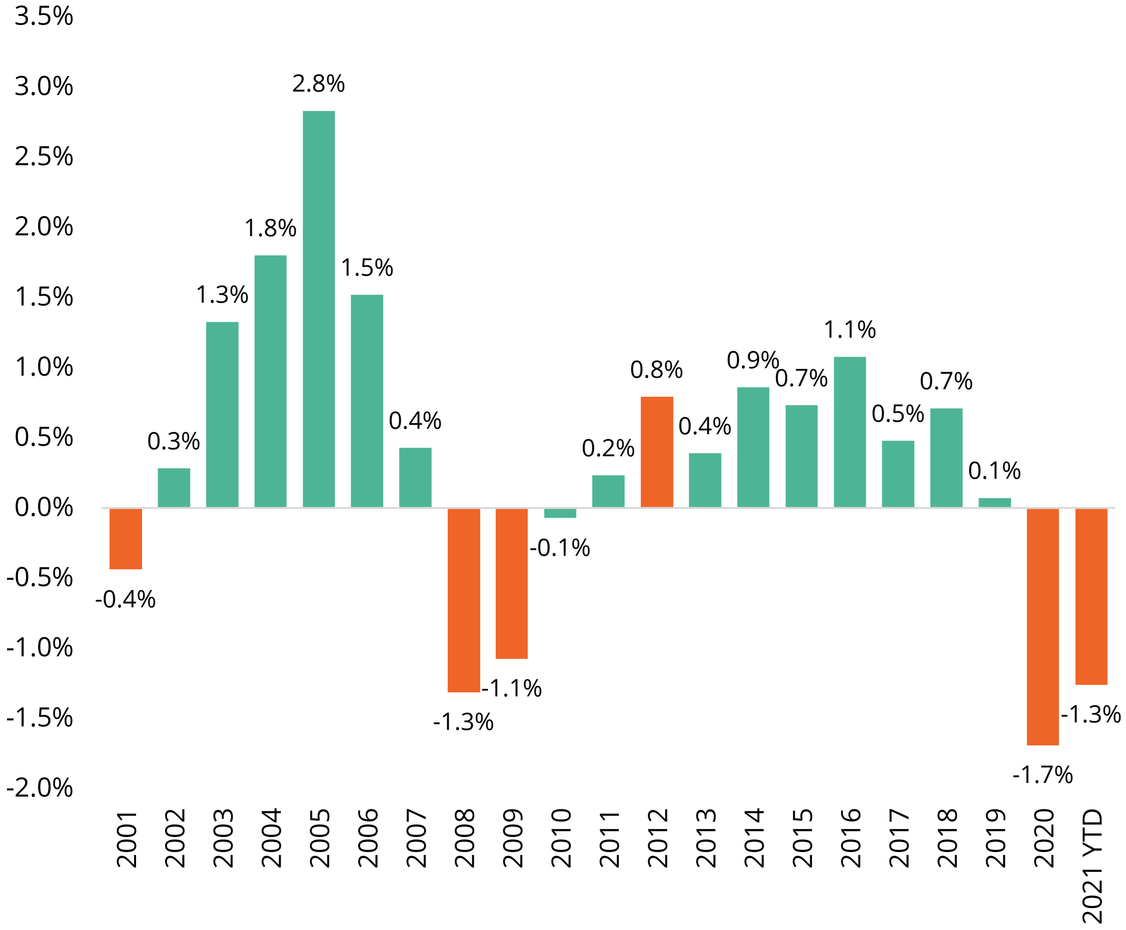
Net absorption is improving

-1.7 to -1.3%

Net absorption as a percentage of inventory in 2020 and 2021 YTD

Occupancy losses from 2020 to 2Q21 have totaled 10.2 million sf. These losses surpass the losses of the early 2000's recession (-0.4%) and global financial crisis (-1.1% and -1.3%).



Source: Avison Young

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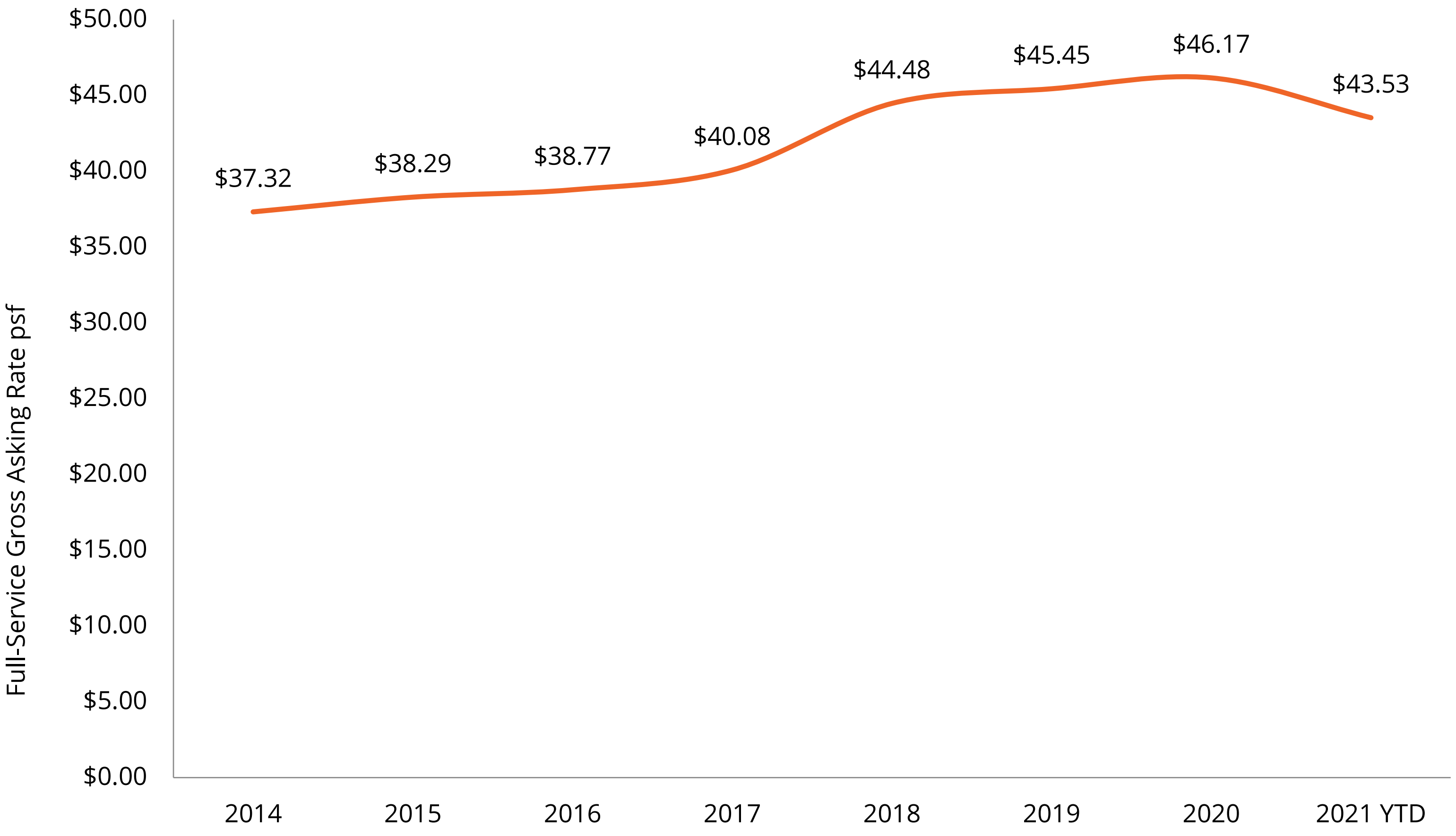
Gross rents continue to soften

-5.7%

Change in rents since the onset of the pandemic

Base rents have incrementally softened following the pandemic and the resultant recession. However, some Trophy Assets held by institutional landlords have held rents at pre-COVID rates.



Source: Avison Young

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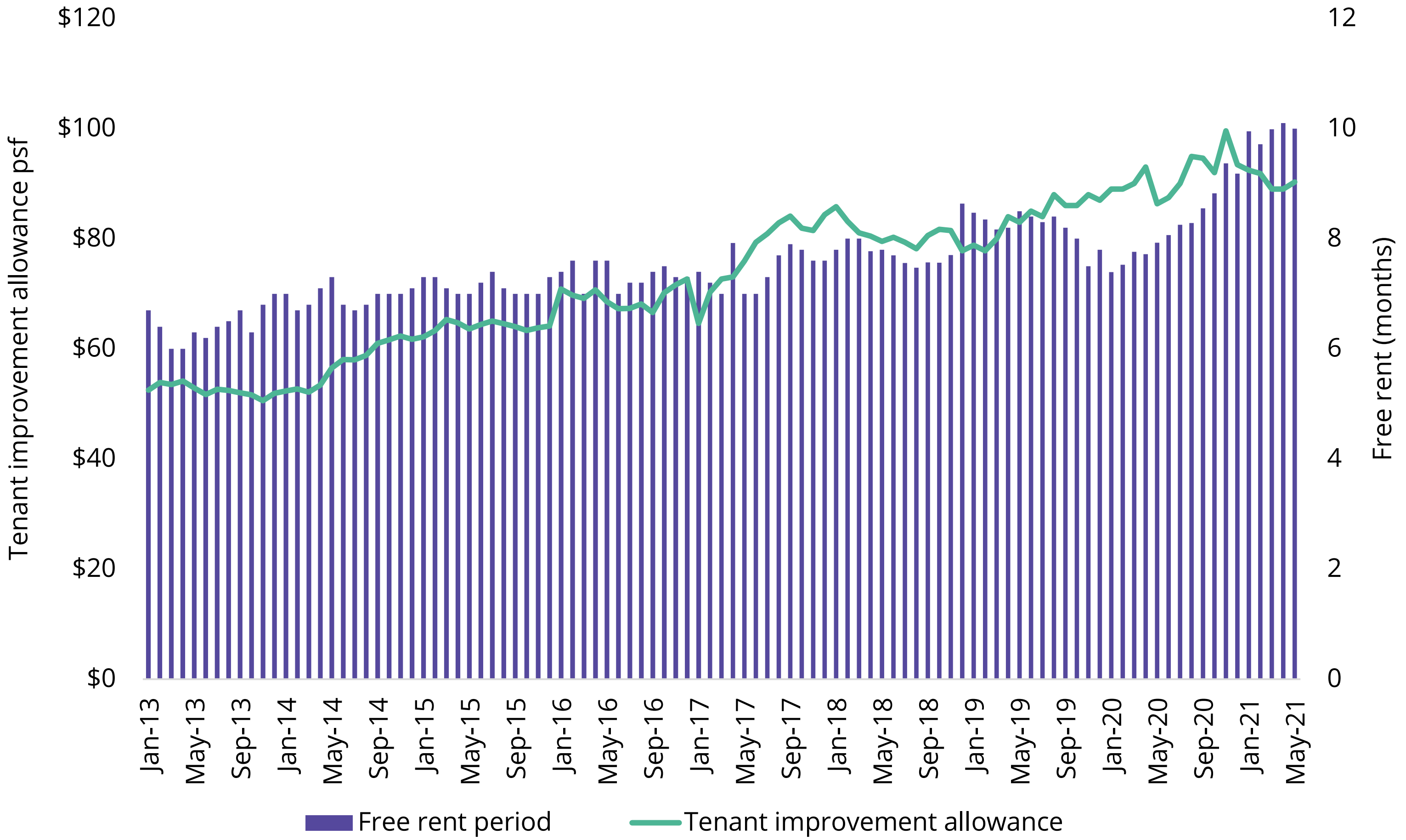
Concessions are still rising

9% increase

In tenant improvement allowance amounts over the past 24 months

Tenant improvement allowances have increased by 9% while free rent periods have increased by 17% over the past 24 months as vacancy has risen to historical highs.



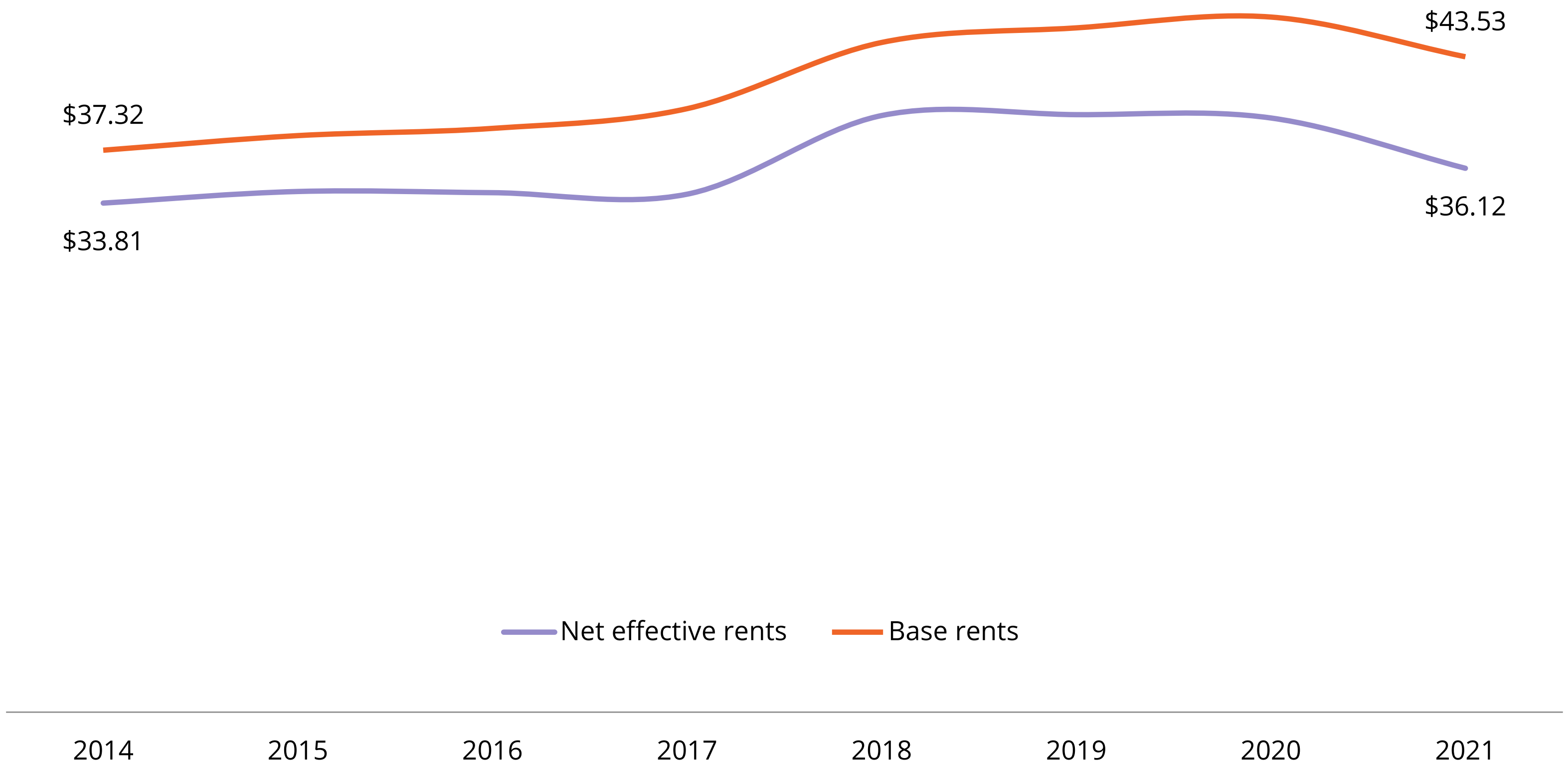
Note: Class A office properties.
Trailing 12-month unweighted averages. Excludes subleases, renewals and expansions.
Normalized to 10-year lease terms. Source: Avison Young

Net effective rents and face rents

10%

Increase in delta between face and net effective rents over 2021 due to increases in concessions

Net effective rents have decreased by 8.5% over 2021 as demand remains limited and vacancy rises.



Note: Class A office properties, new 10-year lease
Source: Avison Young

Class A economics after the pandemic

Period	Average full service gross rent	Average free rent period	Average tenant improvement allowance	Average net effective rent
2018 to 03/2020	$48 psf	7 months	$78 psf	$40 psf
04/2020 to today	$46 psf	10 months	$89 psf	$36 psf

Note: Class A direct relocations only normalized for 10-year lease terms. Source: Avison Young

Class B and C economics after the pandemic

Period	Average full service gross rent	Average free rent period	Average tenant improvement allowance	Average net effective rent
2018 to 03/2020	$36 psf	6 months	$55 psf	$30 psf
04/2020 to today	$32 psf	11 months	$78 psf	$24 psf

Note: Class B and C direct relocations only normalized for 10-year lease terms. Source: Avison Young

Los Angeles office construction and development pipeline

143 properties

proposed or under construction

25.5 msf

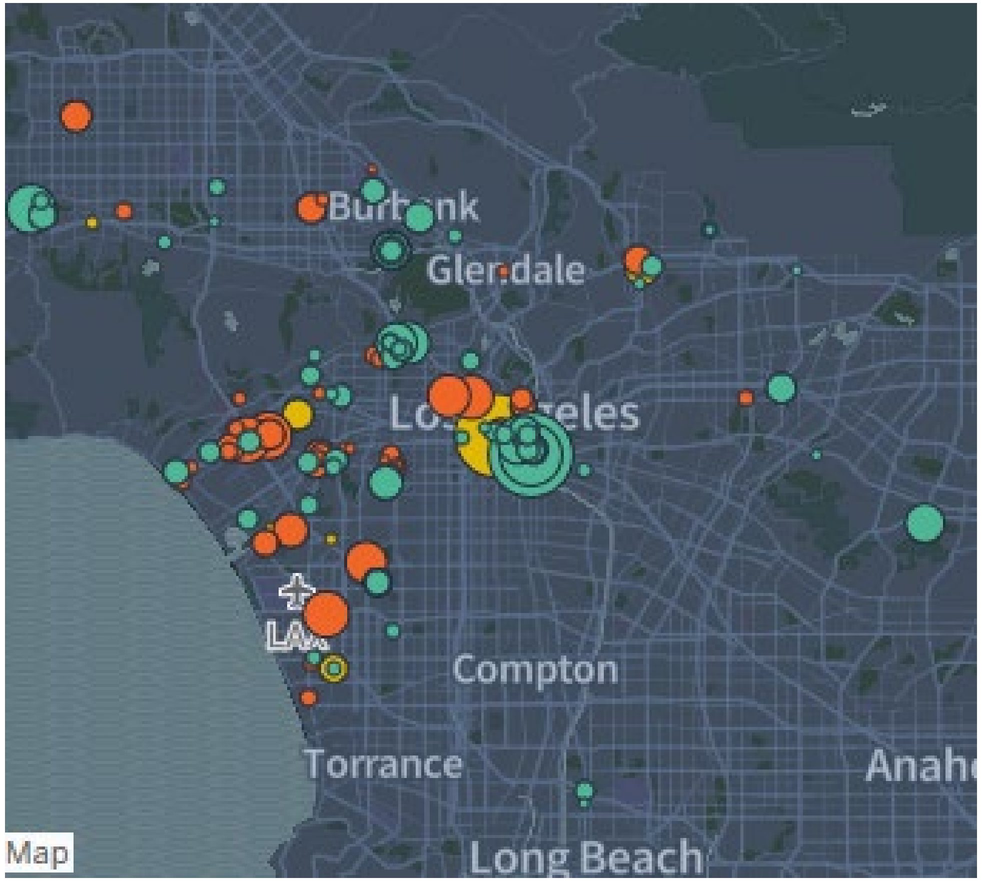
proposed or under construction

8.1%

share of current office inventory

1976

average vintage of existing Los Angeles offices



Under Construction
Under Renovation
Proposed

Source: Avison Young

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Capital market conditions

Investors have encountered a risk pricing crisis as office occupier conditions became strained, raising the prospect for defaults in the commodity market segment.

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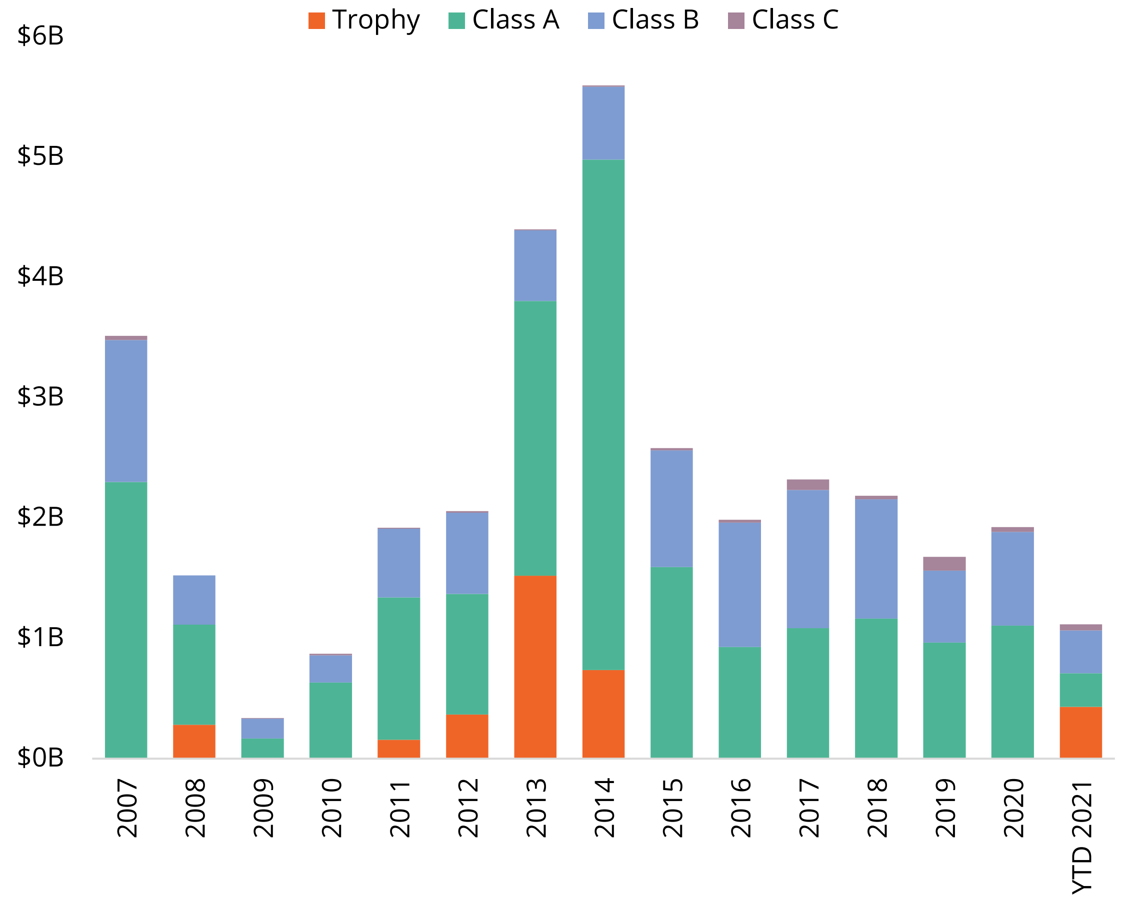
Office investment dollar volume is still well below average

$3.0B

Los Angeles office dollar volume over the past 18 months

Office sales activity has declined during the pandemic due to owners resisting “panic selling,” decreasing by 30% compared to the prior five-year average dollar volume.



Source: Avison Young

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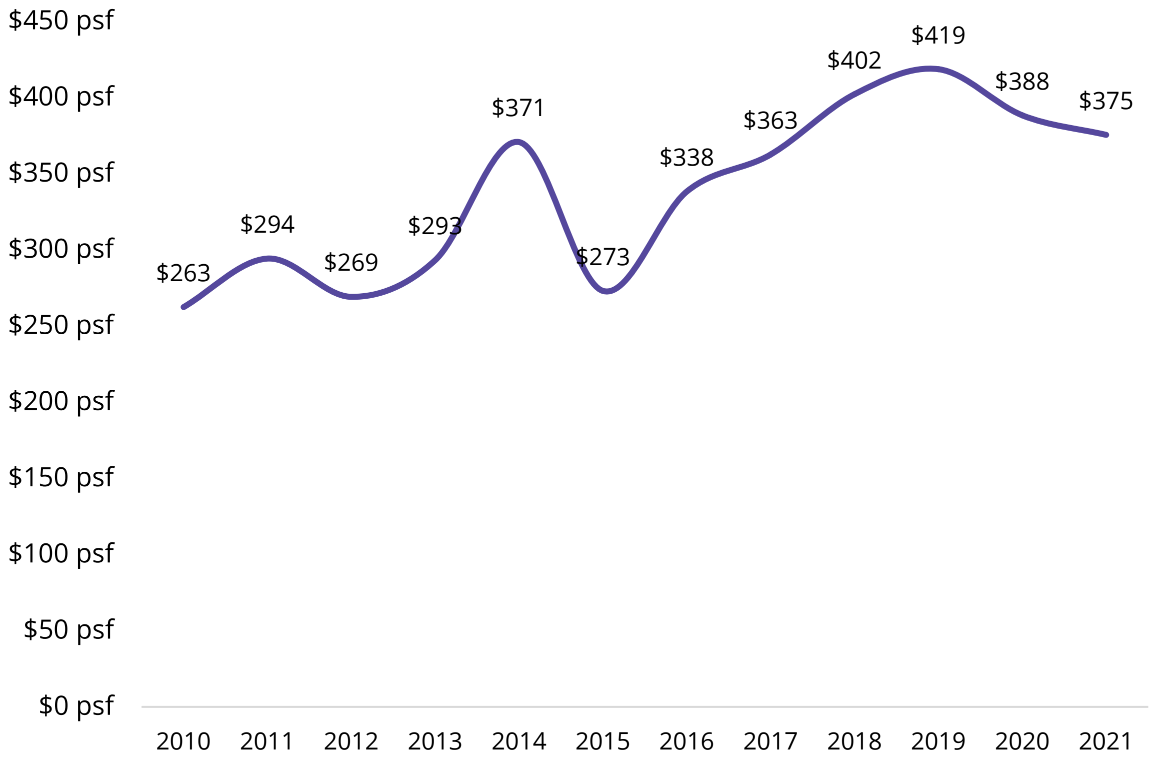
Office asset pricing has stabilized

-10.0%

Los Angeles office pricing from 2019 to present

Pricing has softened during the pandemic as investors have adopted more conservative underwriting approaches, decreasing from $419 psf in 2019 to $375 psf. However, asset pricing has stabilized in recent months, indicating a potential recovery. For example, creative office The Link in Burbank, CA sold for $61.5 million, $485 psf.



Source: Avison Young

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Economic and demographic trends

The pandemic immediately shocked major parts of the Los Angeles economy, though there have been incremental signs of a recovery as the city reopens.

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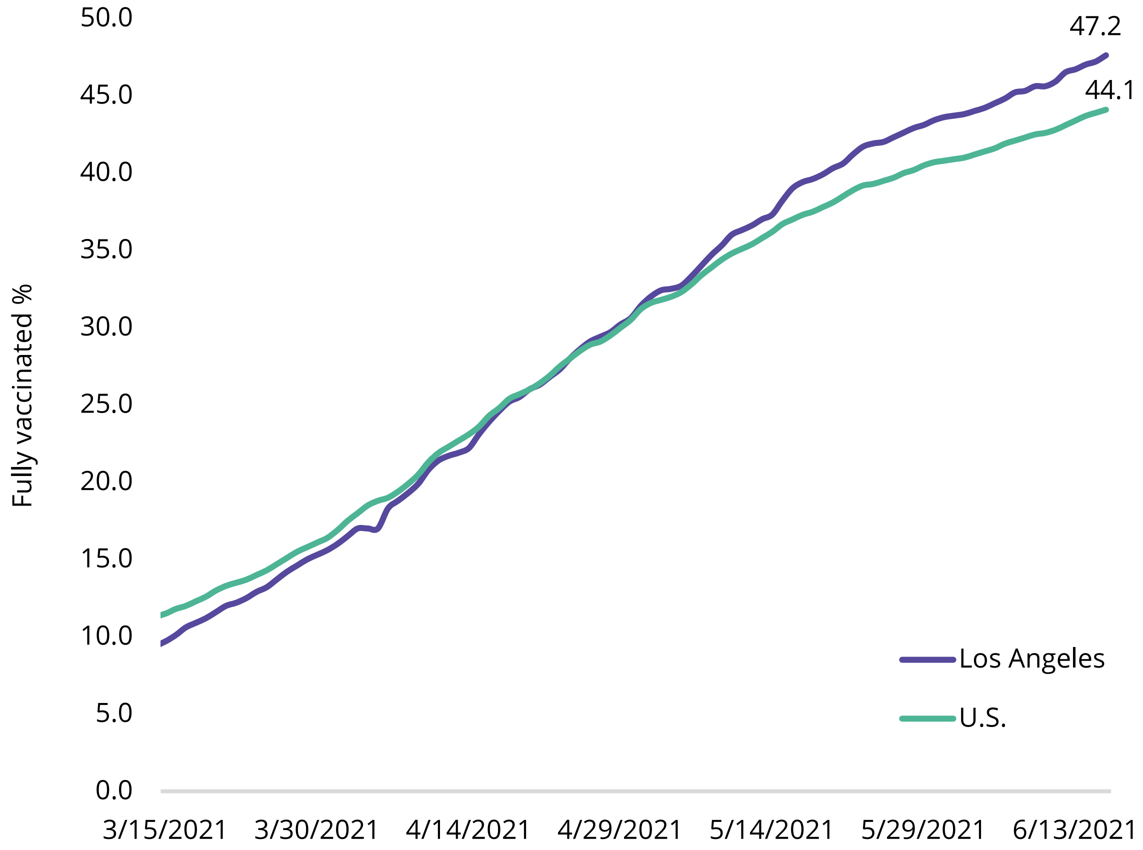
Vaccination rates are increasing but slowing

47.2%

Share of total Los Angeles County population that is fully vaccinated

Los Angeles proportionate vaccination rates have surpassed U.S. averages, an important metric that has allowed the city to loosen restrictions.



Source: CDC

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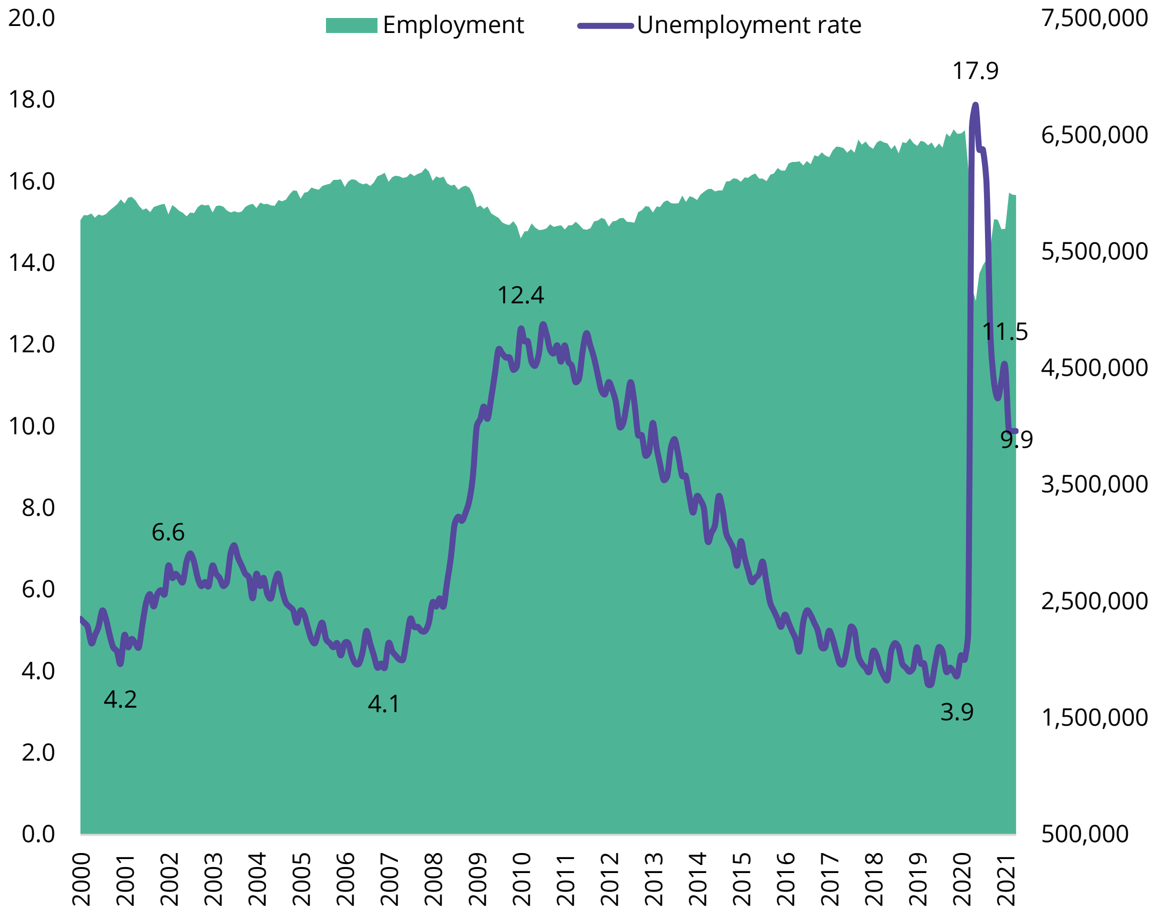
Unemployment rate is falling

9.9%

Los Angeles unemployment rate as of April 2021, dipping below the height of the financial crisis

Historically tightened labor market conditions were halted by the pandemic with nearly 1.5 million job losses between February and May 2020. However, reopening efforts enabled the economy to add 8.0% of jobs since May 2020.



Note: Not seasonally adjusted data.
Source: Bureau of Labor Statistics

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Office-using job losses are less severe

-8.7%

Change in office-using employment during the pandemic

Los Angeles MSA total job losses have declined by 9.7% since the start of the pandemic while office-using jobs contracted by just 8.7%.

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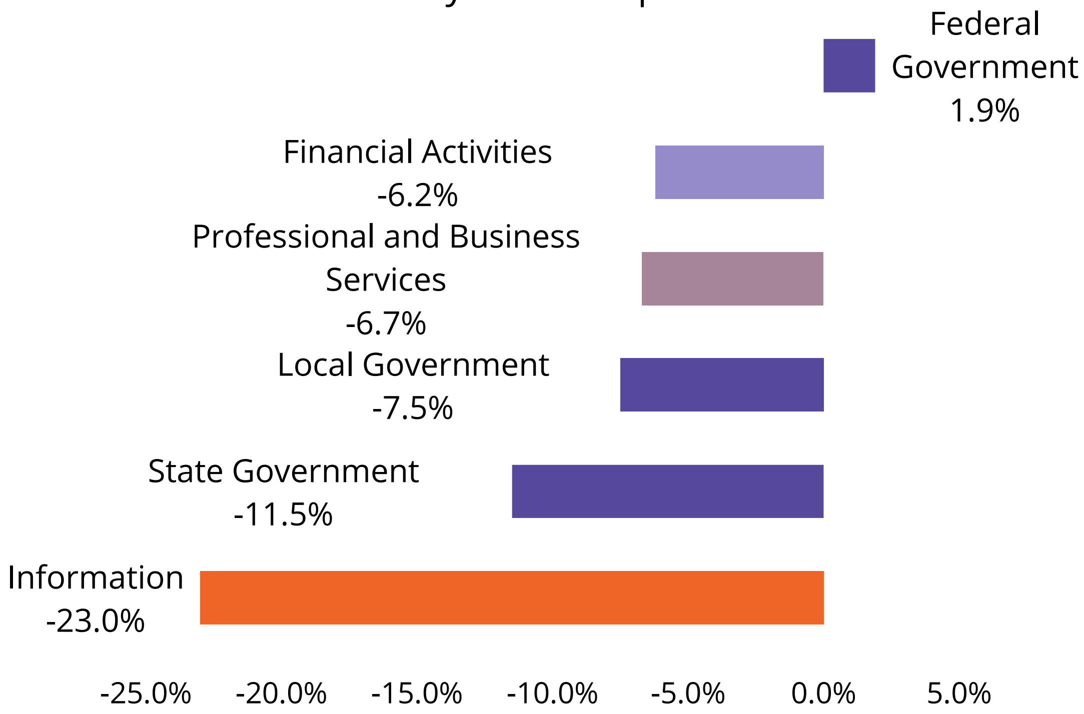
Total change in Los Angeles MSA* job gains/(losses)

February 2020 to April 2021



Note: Not seasonally adjusted data. Metropolitan statistical area.
Source: Bureau of Labor Statistics

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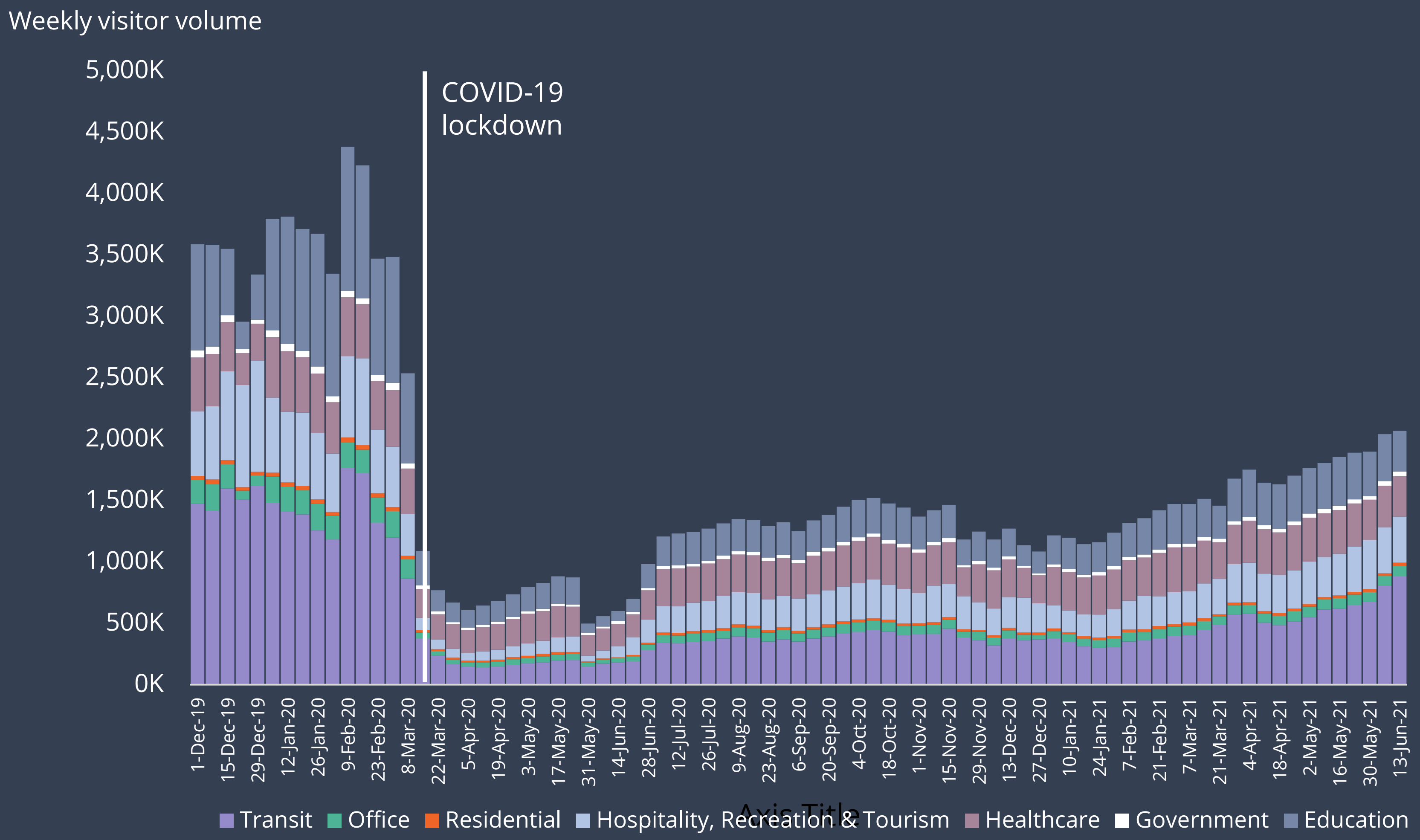
Post-COVID recovery index

38.4%

Post-COVID rate of recovery based on representative locations through 6/13/2021

The residential rate of recovery has increased, measuring 58.4%, as vaccination rates rise and employers expect their employees to return. Retail recovery, which currently sits at 41.6%, is expected to trend upwards following the lifting of COVID restrictions.



Note: Representative areas of interest. Weekdays only.
Pre-COVID period measured as 12/1/2019 to 3/8/2020.
Source: Orbital Insights, Avison Young

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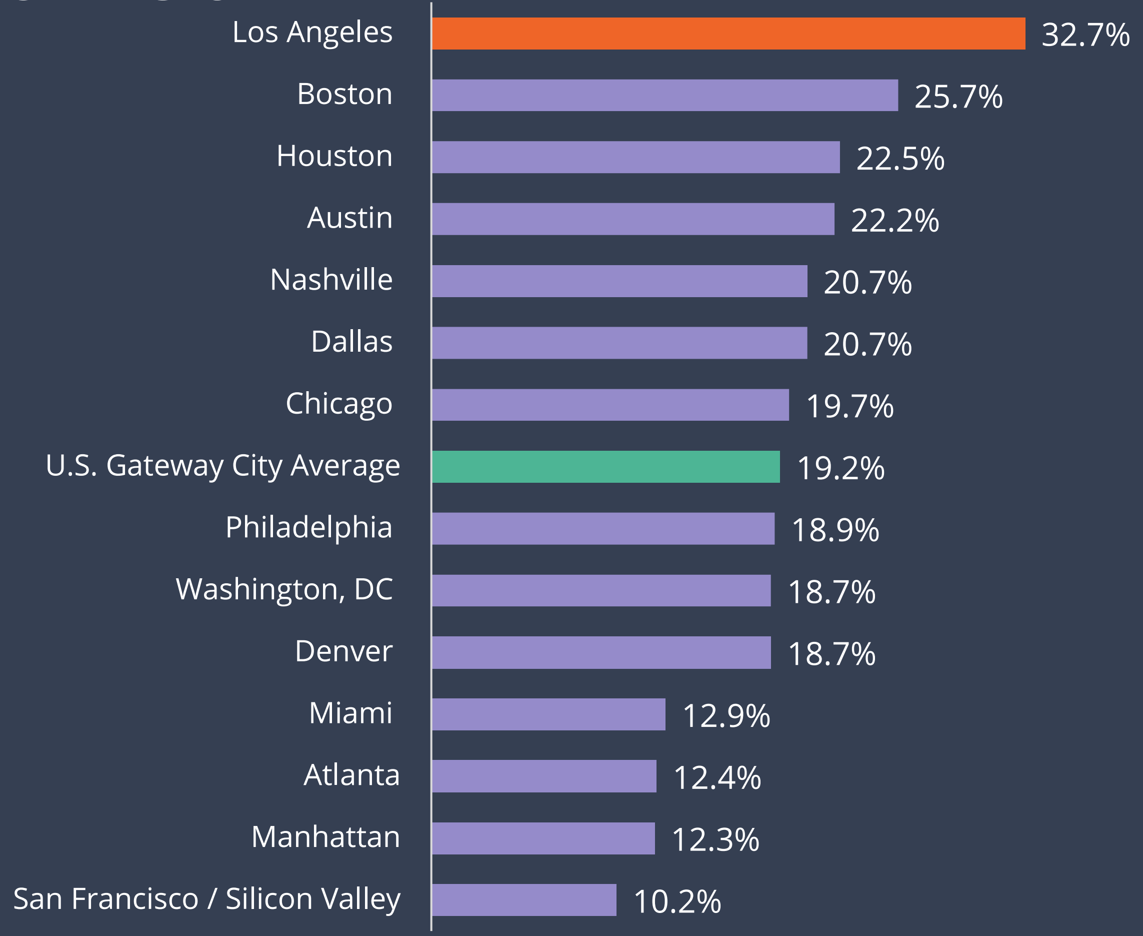
Office occupancy post-COVID recoveries across U.S. gateway cities

32.7%

Post-COVID rate of recovery for representative office employers across the Los Angeles MSA

As measured by the highest recovery rate of 32.7% among U.S. gateway cities, Los Angeles employers remain persistent on returning to the office.



Note: Select, representative occupiers only. Weekdays only.
Pre-COVID period measured as 6/1/2019 to 3/14/2020.
Post-COVID period measured as 3/15/2020 to 6/20/2021.
Source: Orbital Insights, AVANT by Avison Young

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Post-COVID recovery index for select office occupiers

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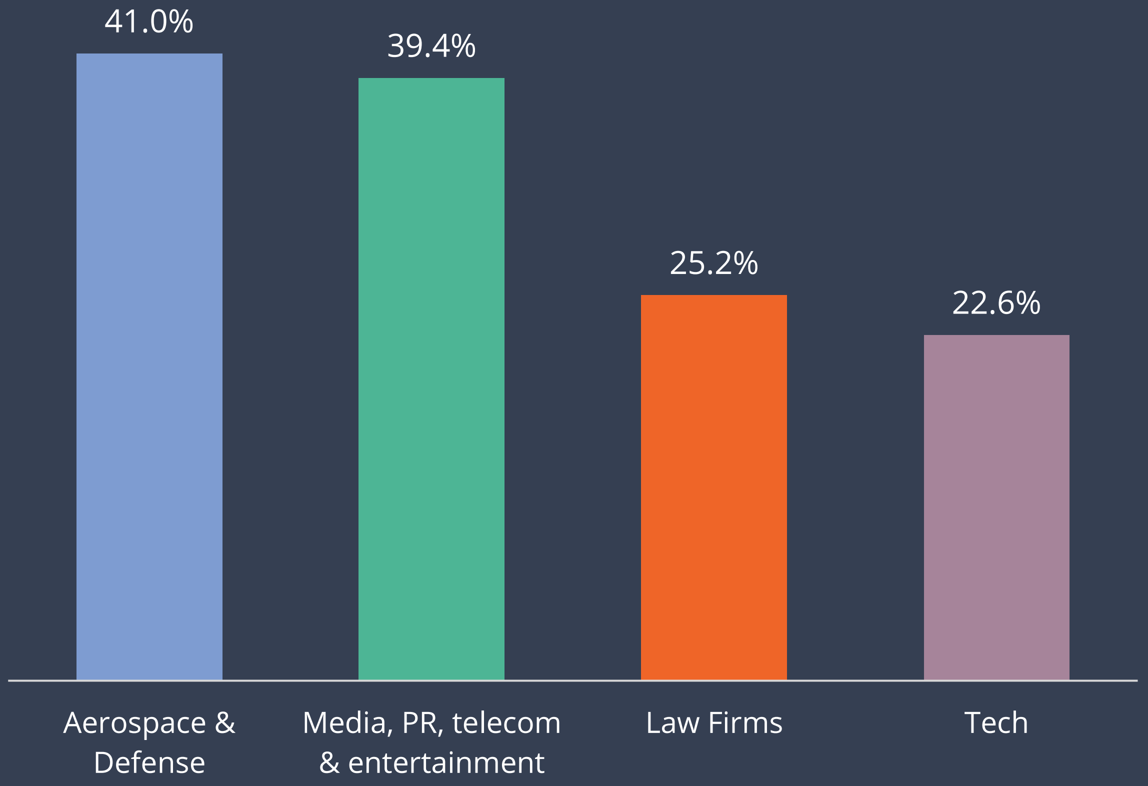
36.2%

Post-COVID rate of recovery for representative Los Angeles office occupiers through 6/13/2021

Media companies are generally returning to the office quicker than other industries, although return-to-work efforts still vary significantly from company to company. Recent long-term commitments by Hulu, Roku, and Snapchat reflect optimism amongst the tech industry.



Note: Select, major occupiers only. Weekdays only.
Pre-COVID period measured as 12/1/2019 to 3/8/2020.
Source: Orbital Insights, Avison Young

Looking forward

Here's what we can expect

- The June 15 lifting of all COVID restrictions in California **is expected to have significant implications on the Los Angeles office market**.
- Bellwether **companies are beginning to return to the office**, a leading indicator for rejuvenated office demand.
- More companies are starting to solidify their future occupancy strategies.
- **Office leasing demand is incrementally rising** as indicated by increasing term lengths, though continued downward momentum is anticipated on net effective rents at commodity properties.
- **Cap rates and asset pricing are poised to remain steady** based on the sizable gap between cap rates and benchmark yields, positive occupier and economic momentum and investors' renewed focus on core transaction profiles.

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Let's talk

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