

SUSTAINABLE GROWTH. The Inland Empire's steady economic growth will keep its office market moving forward and continuing strong through 2016. Both vacancy and availability dropped compared to the second quarter 2015, and net absorption was positive with 242,993 square feet for the quarter as well. While these are all positive trends, job growth will need to stay strong in coming quarters for the Inland Empire office market to keep its momentum.

VACANCY. The Inland Empire has long been an "overflow" office market, the low-cost alternative for tenants priced out of Orange County and LA. As a result, its rebound will depend heavily on the office markets in those metro areas. Though the market saw solid absorption in the third quarter, there is still plenty of high quality space available and ready for lease. Vacancy ended the second quarter at 11.23%, below the recent historical average—a decrease of 61 basis points from last quarter and 122 basis points from one year ago.

LEASE RATES. Demand has been strong to push vacancy rates to such a low level, yet we haven't seen rent growth of the magnitude we would normally expect. The average asking full-service gross (FSG) lease rate was \$1.81 per square foot per month in the third quarter of 2016, up \$0.04 from the same quarter last year. Rent growth should stay solid for the near term.

TRANSACTION ACTIVITY. Despite rising rental rates, occupancy levels remain consistently strong, with many tenants continuing to take up space in today's market. In the third quarter, office leases covered 410,760 square feet, and combined sales and lease transactions for the quarter was 1,128,141 square feet.

EMPLOYMENT. The unemployment rate in the Riverside-San Bernardino-Ontario MSA was 6.6% in August 2016, down from a revised 6.9% in July 2016, and below the year-ago estimate of 6.8%. This compares with an unadjusted unemployment rate of 5.6% for California and 5.0% for the nation during the same period. The unemployment rate was 6.9% in Riverside County, and 6.2% in San Bernardino County.

OVERALL. Demonstrating the continued strength of the office market, rents in the market have trended upward, with an average increase of 3% from a year ago. With the expected continued growth in employment, demand for office space should remain strong through the rest of the year. The office market has witnessed five quarters of positive absorption and a decline in vacancy. The outlook for Inland Empire's office market is positive.

VACANCY vs. AVERAGE ASKING LEASE RATE



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



Market Statistics

| | Change Over Last Quarter | 3Q 2016 | 2Q 2016 | 3Q 2015 | % Change Over Last Year |
|---------------------------|--------------------------|-----------|-----------|-----------|-------------------------|
| Vacancy Rate | ▼ DOWN | 11.23% | 11.84% | 12.45% | -9.80% |
| Availability Rate | ▼ DOWN | 13.70% | 14.39% | 15.94% | -14.05% |
| Average Asking Lease Rate | ▼ DOWN | \$1.81 | \$1.83 | \$1.77 | 2.26% |
| Sale & Lease Transactions | ▼ DOWN | 1,128,141 | 1,259,462 | 1,655,074 | -31.84% |
| Gross Absorption | ▼ DOWN | 606,033 | 712,834 | 560,984 | 8.03% |
| Net Absorption | ▲ POSITIVE | 242,993 | 194,805 | 218,858 | N/A |

EMPLOYMENT. Employment should expand by an additional 3.1% or 41,000 job in 2016, and another 3.0% in 2017, with annual wage and salary employment expected to hit a new high this year. As the region’s industries grow over the balance of this year and next, the unemployment rate should fall from 6.6% in 2015 to 5.6% this year and 5.1% in 2017, well below the 8.8% average since 2002.

LEASE RATES. Expect average asking lease rates to increase by another 2% to 3% over the next three quarters due to stagnant supply and declining vacancies.

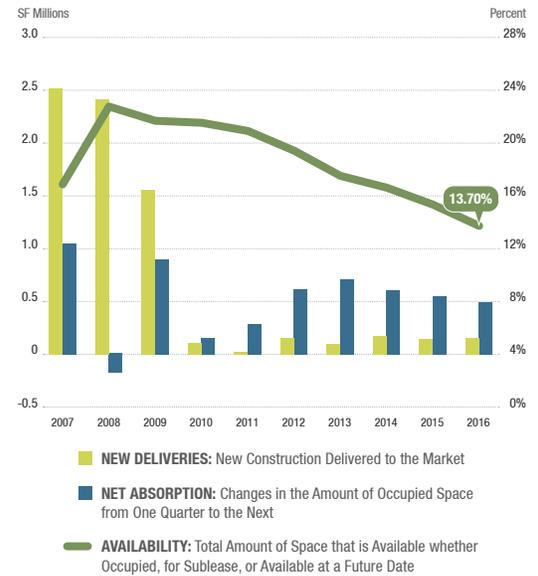
VACANCY. We anticipate vacancy rates continuing to decrease in coming quarters, dropping by 80 basis points, to around 10.43%, by the end of the first quarter of 2017.

CONSTRUCTION. There was 219,312 square feet of new office product delivered in the third quarter, with Dos Lagos Regional Center in Corona accounting for almost all it. Nearly two dozen separate projects are in the proposal stages or are already under construction.

AVAILABILITY. Direct/sublease space being marketed was 13.70% at the end of the third quarter, down from 2016’s second quarter rate of 14.39% and a 14.05% decline from the 15.94% we saw in the third quarter of 2015.

ABSORPTION. The Inland Empire’s office employment has grown at a faster rate than the U.S. average since 2012, and 2016 is no exception. As a result, the Inland Empire office market posted 242,993 square feet of positive net absorption for the third quarter of 2016, giving the Inland Empire office market an average of 150,000 square feet of absorption over the past nine quarters.

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Significant Transactions

Sales

| Property Address | Submarket | Class | Square Feet | Sale Price | Buyer | Seller |
|---------------------|------------------|-------|-------------|--------------|---------------------------|---|
| 9500 Cleveland Ave. | Rancho Cucamonga | A | 241,292 | \$44,300,000 | Inland Empire Health Plan | Utah Retirement Systems |
| 9680 Haven Ave. | Rancho Cucamonga | B | 75,141 | \$16,456,000 | Graphic Ideas | Buchanan Street Partners |
| 12625 Heacock St. | Moreno Valley | B | 52,500 | \$14,500,000 | Isaac Alchalel | Capital Partners Development Company, LLC |
| 4150 Concours St. | Ontario | B | 44,086 | \$7,550,000 | Leftbank Art Company | Bahram Bahremand |
| 15342 El Prado Rd. | Chino | B | 22,100 | \$4,862,000 | Curtis Nixon | Sukut Construction, Inc. |

Leases

| Property Address | Submarket | Class | Square Feet | Transaction Date | Tenant | Owner |
|------------------------------------|-------------|-------|-------------|------------------|--------------------------|-------------------------------|
| 10750 4th St. | Chino Hills | B | 21,798 | Sep-2016 | N/A | Omninet Capital |
| 27368 Via Terrace Corporate Center | Temecula | B | 7,166 | Sep-2016 | Wildan | Starwood Property Trust, Inc. |
| 15345 Fairfield Ranch Rd. | Chino Hills | A | 5,879 | Jul-2016 | Port Plastics | Chino Hills Business Park, LP |
| 4100 Latham St. | Riverside | B | 4,605 | Aug-2016 | Advantage Health Systems | Sunny Hills-Palladium |
| 15325 Fairfield Ranch Rd. | Chino Hills | A | 3,840 | Jul-2016 | Movement Real Estate | Chino Hills Business Park, LP |

| | INVENTORY | | | | VACANCY & LEASE RATES | | | | | ABSORPTION | | | |
|------------------------------|------------------|--------------------------|-------------------|---------------------|-----------------------|---------------------|-----------------------|--------------------------|---------------------------|-----------------------|---------------------|-------------------------|-----------------------|
| | Number of Bldgs. | Net Rentable Square Feet | Square Feet U / C | Square Feet Planned | Square Feet Vacant | Vacancy Rate 3Q2016 | Square Feet Available | Availability Rate 3Q2016 | Average Asking Lease Rate | Net Absorption 3Q2016 | Net Absorption 2016 | Gross Absorption 3Q2016 | Gross Absorption 2016 |
| West | | | | | | | | | | | | | |
| Chino/Chino Hills | 37 | 1,149,505 | 0 | 203,824 | 100,772 | 8.77% | 107,544 | 9.36% | \$1.68 | 16,389 | 3,757 | 32,851 | 66,452 |
| Fontana | 38 | 2,418,916 | 0 | 65,000 | 100,710 | 4.16% | 117,550 | 4.86% | \$1.21 | (2,988) | 5,042 | 3,362 | 17,742 |
| Montclair | 12 | 228,316 | 0 | 40,134 | 14,988 | 6.56% | 20,704 | 9.07% | \$1.27 | 1,015 | 3,268 | 3,697 | 35,162 |
| Ontario | 109 | 4,344,783 | 0 | 314,298 | 562,901 | 12.96% | 692,212 | 15.93% | \$1.87 | 85,334 | 76,300 | 117,278 | 242,003 |
| Rancho Cucamonga | 143 | 4,454,111 | 0 | 100,000 | 530,668 | 11.91% | 535,206 | 12.02% | \$1.96 | (8,624) | 68,834 | 65,718 | 273,837 |
| Upland | 71 | 1,546,880 | 0 | 0 | 172,888 | 11.18% | 221,987 | 14.35% | \$1.42 | 16,774 | 43,942 | 49,640 | 138,812 |
| Class A | 29 | 2,394,190 | 0 | 145,092 | 370,424 | 15.47% | 290,284 | 12.12% | \$2.10 | 12,018 | 33,095 | 44,083 | 128,748 |
| Class B | 282 | 9,793,133 | 0 | 578,164 | 974,755 | 9.95% | 1,251,161 | 12.78% | \$1.84 | 95,566 | 83,086 | 195,899 | 488,517 |
| Class C | 99 | 1,955,188 | 0 | 0 | 137,748 | 7.05% | 153,758 | 7.86% | \$1.09 | 316 | 84,962 | 32,564 | 156,743 |
| West Total | 410 | 14,142,511 | 0 | 723,256 | 1,482,927 | 10.49% | 1,695,203 | 11.99% | \$1.86 | 107,900 | 201,143 | 272,546 | 774,008 |
| East | | | | | | | | | | | | | |
| Banning | 7 | 130,461 | 0 | 175,774 | 16,200 | 12.42% | 16,200 | 12.42% | \$0.00 | (15,000) | (16,200) | 15,000 | 19,000 |
| Beaumont | 3 | 151,918 | 0 | 150,000 | 0 | 0.00% | 0 | 0.00% | \$0.00 | 0 | 0 | 0 | 0 |
| Corona/Norco | 95 | 3,516,833 | 205,232 | 363,325 | 356,302 | 10.13% | 396,975 | 11.29% | \$1.89 | 45,310 | 65,596 | 99,595 | 248,078 |
| Colton/Grand Terrace | 48 | 1,048,331 | 0 | 32,600 | 186,171 | 17.76% | 274,524 | 26.19% | \$1.11 | 15,954 | 14,610 | 24,418 | 54,489 |
| Moreno Valley | 41 | 1,049,153 | 0 | 93,967 | 71,339 | 6.80% | 91,426 | 8.71% | \$1.33 | (2,992) | (40,871) | 4,670 | 15,047 |
| Perris | 10 | 398,702 | 14,080 | 0 | 3,671 | 0.92% | 4,833 | 1.21% | \$0.00 | 1,571 | 1,571 | 1,571 | 1,571 |
| Redlands/Loma Linda | 90 | 2,329,463 | 0 | 60,000 | 264,054 | 11.34% | 285,817 | 12.27% | \$1.68 | (1,885) | 13,999 | 13,518 | 83,256 |
| Rialto | 11 | 303,882 | 0 | 0 | 23,428 | 7.71% | 33,428 | 11.00% | \$1.45 | 2,240 | 2,530 | 2,240 | 11,950 |
| Riverside | 304 | 9,246,219 | 0 | 374,081 | 1,065,052 | 11.52% | 1,422,308 | 15.38% | \$2.03 | 78,616 | 45,791 | 107,424 | 266,754 |
| San Bernardino/Highland | 210 | 8,248,644 | 0 | 0 | 1,086,106 | 13.17% | 1,334,290 | 16.18% | \$1.60 | 11,279 | 209,561 | 78,076 | 387,514 |
| Class A | 42 | 4,584,802 | 0 | 391,081 | 491,288 | 10.72% | 629,420 | 13.73% | \$2.18 | 36,673 | 26,727 | 58,355 | 146,272 |
| Class B | 516 | 15,580,488 | 219,312 | 858,666 | 1,969,190 | 12.64% | 2,484,180 | 15.94% | \$1.62 | 91,769 | 188,192 | 228,444 | 731,470 |
| Class C | 261 | 6,258,316 | 0 | 0 | 611,845 | 9.78% | 746,201 | 11.92% | \$1.09 | 6,651 | 81,668 | 59,713 | 209,917 |
| East Total | 819 | 26,423,606 | 219,312 | 1,249,747 | 3,072,323 | 11.63% | 3,859,801 | 14.61% | \$1.79 | 135,093 | 296,587 | 346,512 | 1,087,659 |
| Inland Empire Total | 1,229 | 40,566,117 | 219,312 | 1,973,003 | 4,555,250 | 11.23% | 5,555,004 | 13.69% | \$1.81 | 242,993 | 497,730 | 619,058 | 1,861,667 |
| Inland Empire | | | | | | | | | | | | | |
| Class A | 71 | 6,978,992 | 0 | 536,173 | 861,712 | 12.35% | 919,704 | 13.18% | \$2.16 | 48,691 | 59,822 | 102,438 | 275,020 |
| Class B | 798 | 25,373,621 | 219,312 | 1,436,830 | 2,943,945 | 11.60% | 3,735,341 | 14.72% | \$1.70 | 187,335 | 271,278 | 424,343 | 1,219,987 |
| Class C | 360 | 8,213,504 | 0 | 0 | 749,593 | 9.13% | 899,959 | 10.96% | \$1.09 | 6,967 | 166,630 | 92,277 | 366,660 |
| Inland Empire Total | 1,229 | 40,566,117 | 219,312 | 1,973,003 | 4,555,250 | 11.23% | 5,555,004 | 13.69% | \$1.81 | 242,993 | 497,730 | 619,058 | 1,861,667 |
| High Desert | | | | | | | | | | | | | |
| Adelanto | 3 | 65,531 | 0 | 0 | 0 | 0.00% | 0 | 0.00% | \$0.00 | 0 | 0 | 0 | 0 |
| Apple Valley | 34 | 642,790 | 0 | 79,060 | 26,809 | 4.17% | 32,443 | 5.05% | \$0.00 | 2,832 | 495 | 6,032 | 16,145 |
| Barstow | 15 | 253,840 | 0 | 0 | 20,727 | 8.17% | 27,147 | 10.69% | \$0.00 | (6,278) | 9,874 | 2,000 | 21,115 |
| Hesperia | 24 | 549,898 | 0 | 36,000 | 15,730 | 2.86% | 15,730 | 2.86% | \$0.00 | 7,108 | (15,730) | 8,000 | 8,000 |
| Victorville | 90 | 1,789,727 | 0 | 54,298 | 115,443 | 6.45% | 132,728 | 7.42% | \$1.86 | 11,556 | 41,795 | 17,524 | 71,774 |
| High Desert Total | 166 | 3,301,786 | 0 | 169,358 | 178,709 | 5.41% | 208,048 | 6.30% | \$1.86 | 15,218 | 36,434 | 33,556 | 117,034 |
| Temecula Valley | | | | | | | | | | | | | |
| Hemet | 44 | 847,066 | 0 | 0 | 112,049 | 13.23% | 127,455 | 15.05% | \$1.38 | 1,402 | (19,878) | 1,402 | 2,565 |
| Lake Elsinore | 12 | 274,642 | 0 | 0 | 39,836 | 14.50% | 41,456 | 15.09% | \$0.00 | 0 | 1,032 | 0 | 10,412 |
| Menifee | 9 | 317,837 | 80,000 | 133,000 | 0 | 0.00% | 0 | 0.00% | \$0.00 | 3,022 | 4,174 | 3,022 | 5,868 |
| Murrieta | 51 | 1,493,801 | 0 | 370,074 | 125,293 | 8.39% | 170,153 | 11.39% | \$0.00 | 15,833 | 14,111 | 23,743 | 52,377 |
| San Jacinto | 4 | 96,365 | 0 | 0 | 40,955 | 42.50% | 40,955 | 42.50% | \$0.00 | 1,840 | (35,650) | 4,728 | 4,728 |
| Temecula | 115 | 3,082,069 | 25,000 | 24,000 | 343,049 | 11.13% | 421,675 | 13.68% | \$1.45 | 3,145 | 65,002 | 80,780 | 216,796 |
| Wildomar | 7 | 272,783 | 0 | 44,000 | 31,337 | 11.49% | 34,931 | 12.81% | \$0.00 | (3,168) | 1,885 | 5,108 | 10,161 |
| Temecula Valley Total | 242 | 6,384,563 | 105,000 | 571,074 | 692,519 | 10.85% | 836,625 | 13.10% | \$1.41 | 22,074 | 30,676 | 118,783 | 302,907 |

This survey consists of office properties 10,000 square feet and larger in size, representing both single tenant and multi-tenant buildings. Lease rates are on a full-service gross basis.



Market Update

by **Stefan Rogers**

SENIOR VICE PRESIDENT, IRVINE

The Orange County economy and office market showed continued strength in Q3 2016 with more than 850,000 square feet of net absorption (an increase of more than 100,000 compared with Q3 2015) and a 0.41% increase in asking office rents. Over 1.3 million square feet of absorption and 2.95% of rental growth has been recorded in 2016 and office rents are now at or above record highs in core submarkets.

Typically, this data would indicate signs of an anticipated correction or softening in the office market, however strong economic and demographic fundamentals suggest the contrary. While some uncertainty exists over the timing of an interest rate increase and the results of the upcoming general election, we expect the impact to be fairly minimal in Orange County given the diversity of our local economy.

This trend is attributed primarily to continued job growth in the automotive, technology, financial services, medical, and construction sectors. Developers are responding with exciting new projects including 400 Spectrum Center, The Press (the former LA Times site) in Costa Mesa, and The Boardwalk in Irvine. Orange County is increasingly viewed as a highly desirable place to do business due to the educated workforce, attractive Southern California lifestyle and relative affordability of office space compared with many other suburban markets (Los Angeles & San Francisco).

The current landscape presents opportunities for developers/investors, landlords, tenants, buyers and sellers alike. Developers have a unique window to focus on tenant demand and workplace trends while continuing to seek viable, value-add and adaptive reuse opportunities. Landlords have an opportunity to push rents and improve tenant retention by enhancing onsite amenities and services, while consulting closely with tenants to deliver more functional, customized workplaces to help their customers boost their bottom line. Tenants are now looking at longer leases, allowing them to extract maximum economic concessions and control their overall occupancy costs. They are focused on efficiency and intelligent workspace design to maximize recruitment, retention and productivity. Flexibility to expand and contract over time is a key driver for tenants right now as they leverage technology to minimize their real estate footprint.

Buyers, both investors and users, have been taking advantage of the low cost of capital to acquire stabilized long-term investments and we anticipate this trend to continue. Although the capital markets are showing some signs of a correction, sellers are continuing to take advantage of the tremendous flow of capital targeting commercial real estate. Foreign investors, trade buyers and institutional investors continue to compete for a very limited number of quality buildings. While a temporary gap exists in the "bid versus ask" figures on product listed for sale, we expect pricing to hold based on the overall supply/demand imbalance and the strength shown by corporate occupiers as well as local, entrepreneurial firms.

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This survey consists of properties representing both single tenant and multi-tenant buildings. The lease rates are based on a full-service gross basis. The information contained in this report is gathered from sources that are deemed reliable, but no guarantees are made as to its accuracy. This information is for Voit Real Estate Services' use only and cannot legally be reproduced without prior written consent from the management of Voit Real Estate Services.

Product Type

CLASS A

Most prestigious buildings competing for premier office users with rents above average for the area. Buildings have high-quality standard finishes, state-of-the-art systems, exceptional accessibility and a definite market presence.

CLASS B

Buildings competing for a wide range of users with rents in the average range for the area. Building finishes are fair to good for the area, and systems are adequate. However, Class B buildings cannot compete with Class A buildings of the same price.

CLASS C

Buildings competing for tenants requiring functional space at rents below the area average.

Submarkets

WEST

Chino/Chino Hills, Fontana, Montclair, Ontario, Rancho Cucamonga, Upland

EAST

Banning, Beaumont, Corona/Norco, Colton/Grand Terrace, Moreno Valley, Perris, Redlands/Loma Linda, Rialto, Riverside, San Bernardino/Highland

HIGH DESERT

Adelanto, Apple Valley, Barstow, Hesperia, Victorville

TEMECULA VALLEY

Hemet, Lake Elsinore, Menifee, Murrieta, San Jacinto, Temecula, Wildomar