2Q23

# Inland Empire Office Market Overview

NEWMARK

# Market Observations

## Economy

- The labor market has improved considerably since the pandemic downturn that lasted from 2020 to 2022, but still lags the national average. May's 4.4% unemployment rate was up 100 basis points from a year ago.
- Year-over-year job gains totaled 16,600, representing 1.0% annual growth.
- The best-performing job sectors were education and health services (12,400 jobs added) and government (7,700 jobs added). Population growth is the primary driver of the Inland Empire's office market as private businesses and governments add employees to serve the growing number of residents.

## Leasing Market Fundamentals

- The average asking rent fell $0.02/SF to $2.10/SF/Month from last quarter's all-time high. The average is up 1.6% over the past year and has averaged 4.0% annual growth over the past three years.
- Vacancy climbed 60 basis points to 10.0% as the market registered 178,601 SF in net absorption losses. Total vacancy is lower than a year ago, when it stood at 10.6%.
- Sublease availability, representing only 0.7% of existing inventory, declined from already-low levels.
- Construction activity remains minimal, with three projects totaling 148,000 SF underway.

## Major Transactions

- Most leases executed during the quarter were smaller renewal or extension deals as occupiers gauged economic uncertainty and held off on expansion decisions.
- San Antonio Regional Hospital purchased a 110,000 SF office building in Rancho Cucamonga for $22.0 million with the intention of converting it into medical office.
- In San Bernardino, a private investor purchased a building occupied by the Social Security Administration for $11.8 million.

## Outlook

- The Inland Empire is likely to see vacancy hold, as limited new supply provides little competition and locally focused businesses contribute modest but steady demand.
- New construction and sales activity will remain low as ownership remains dominated by local investors and owner/users.
- Home sales volume fell 23.8% over the past year, as high interest rates have deterred many would-be home buyers. The Inland Empire remains more affordable than adjacent metros, with home prices 22.8% lower than Los Angeles and 54.2% lower than Orange County.

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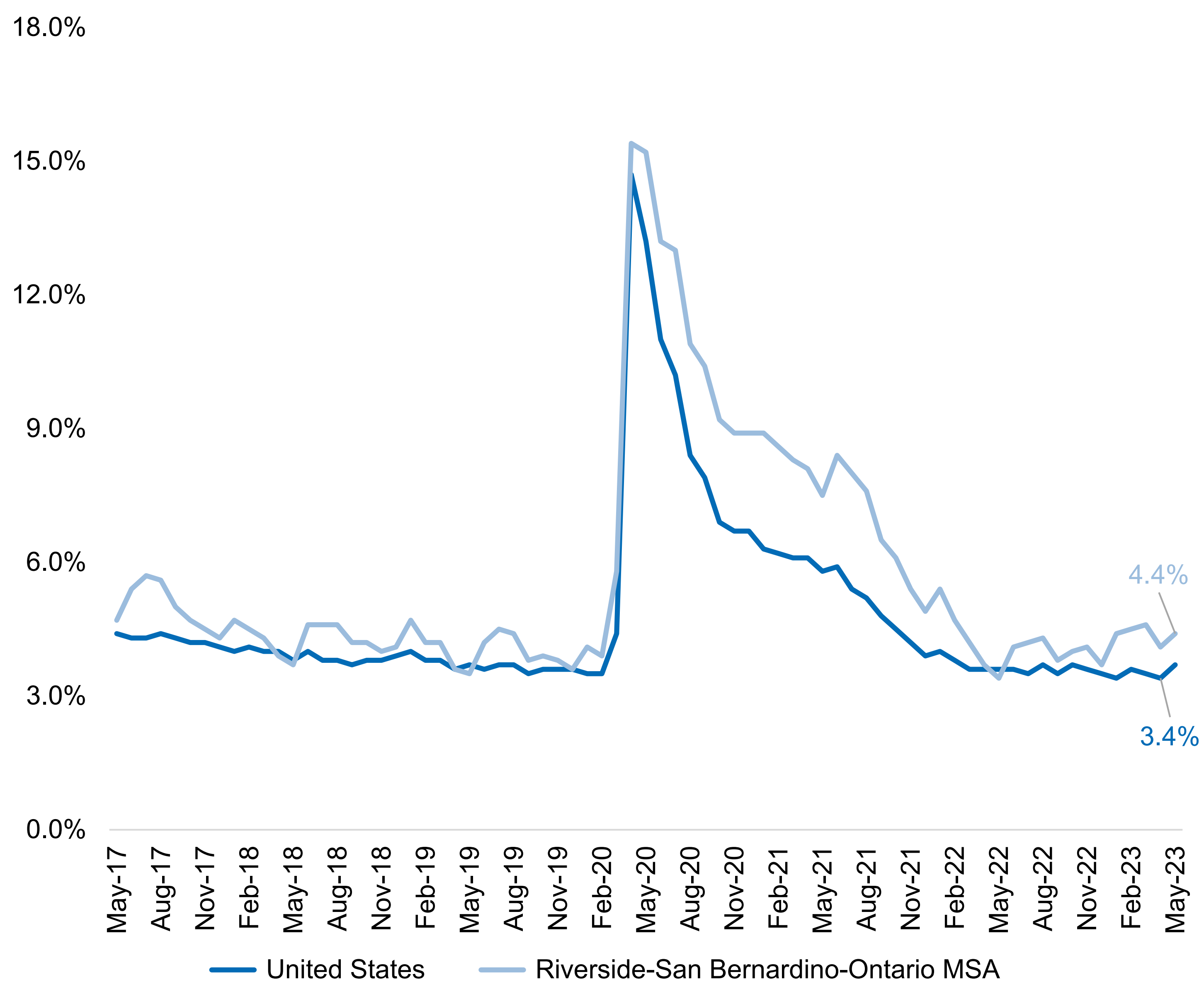
# Economy

# Metro Employment Growth Has Lagged the Nation

The Inland Empire experienced more layoffs and recovered more slowly than the U.S. average in wake of the pandemic. Over the past year the region has enjoyed unemployment rates at roughly the same level as the pre-pandemic average.

## Unemployment Rate, Seasonally Adjusted



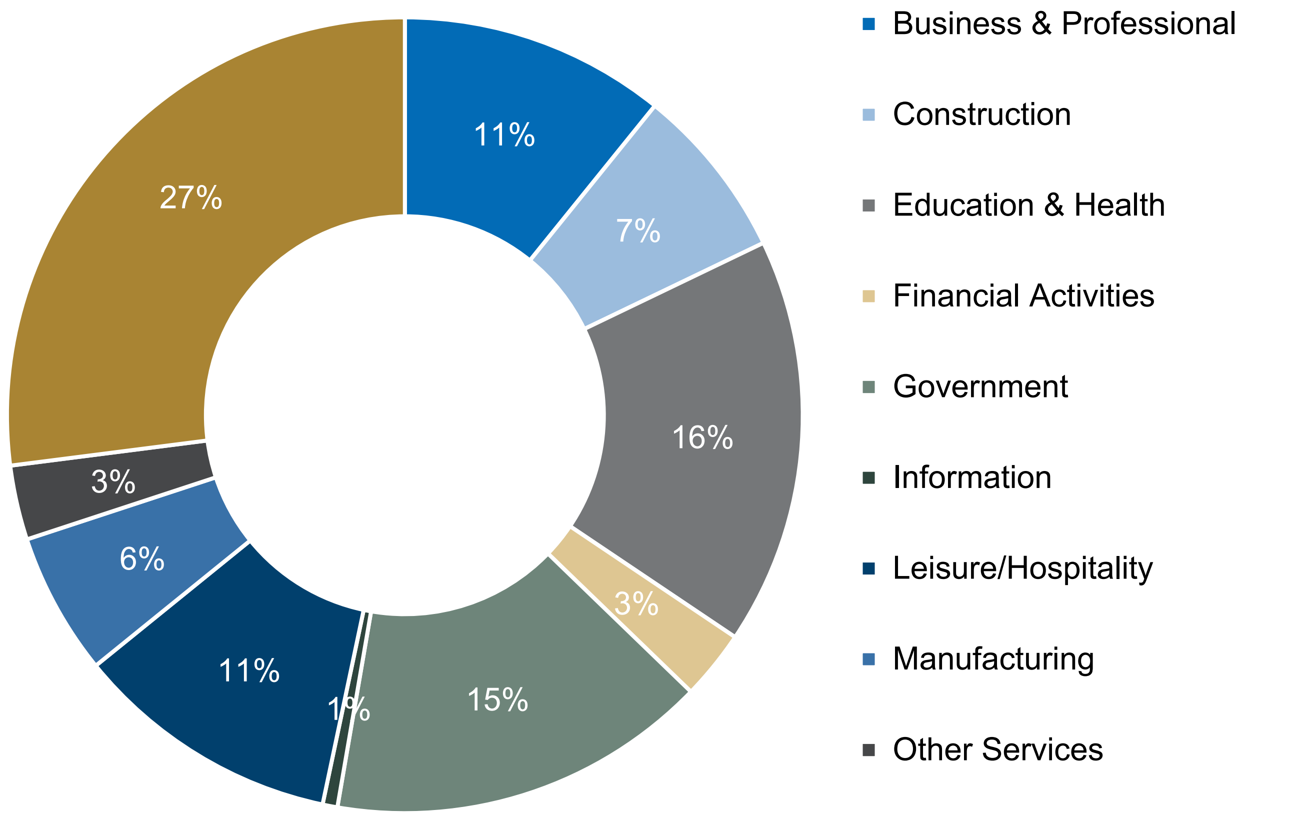

## Nonfarm Payroll Employment, Non-Seasonally Adjusted, 12-Month % Change


Source: U.S. Bureau of Labor Statistics, Riverside-San Bernardino-Ontario MSA

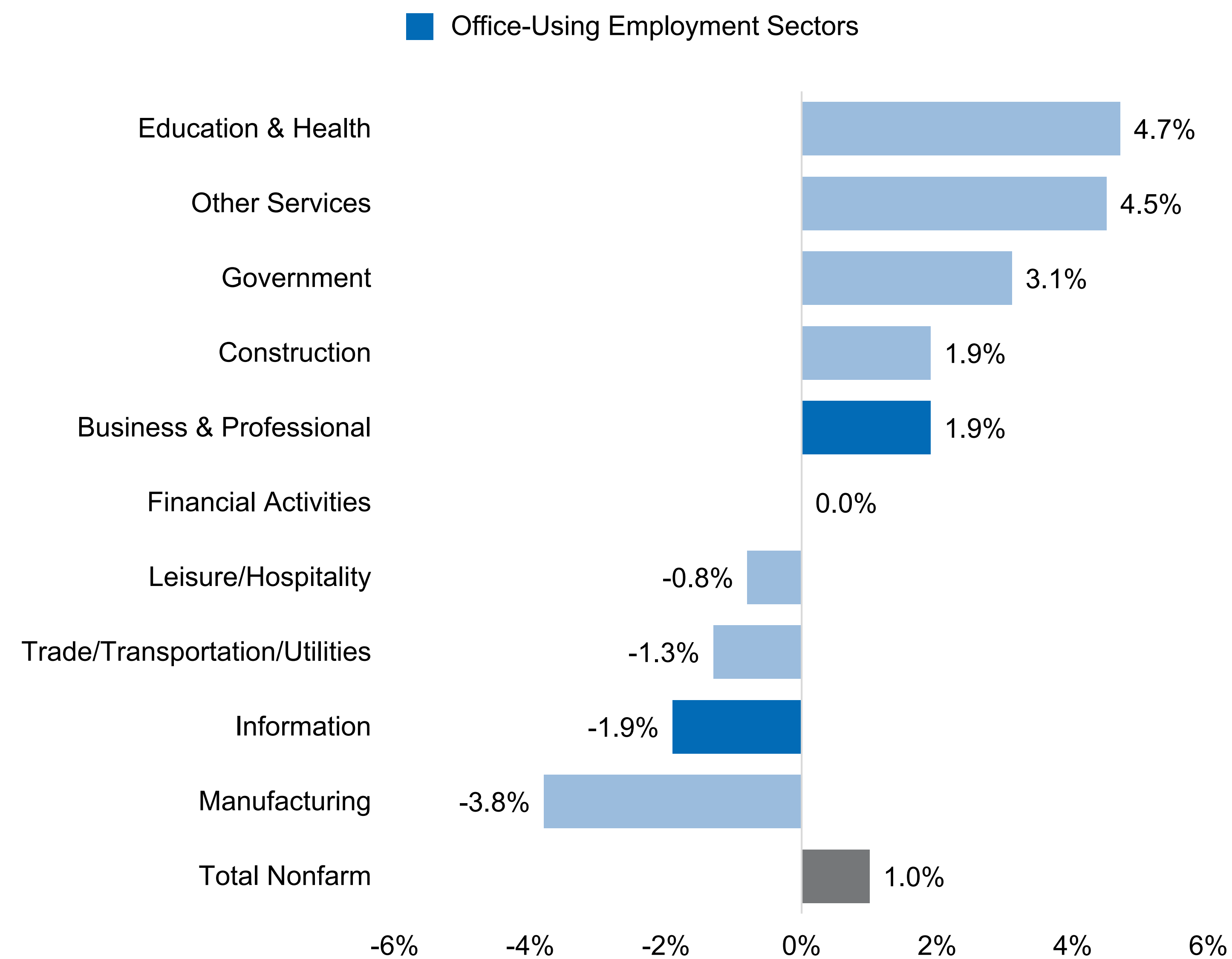
# Job Growth Driven by Services for Local Residents

Population-serving industries led in job growth over the last 12 months. The region added 16,600 jobs over this period, with the education and health sector contributing 12,400 new jobs alone; 7,700 government jobs were also created, which is a boost to the office sector in the Inland Empire, where governments tend to lease rather than own office product.

## Employment by Industry, May 2023




## Employment Growth by Industry, 12-Month % Change, May 2023

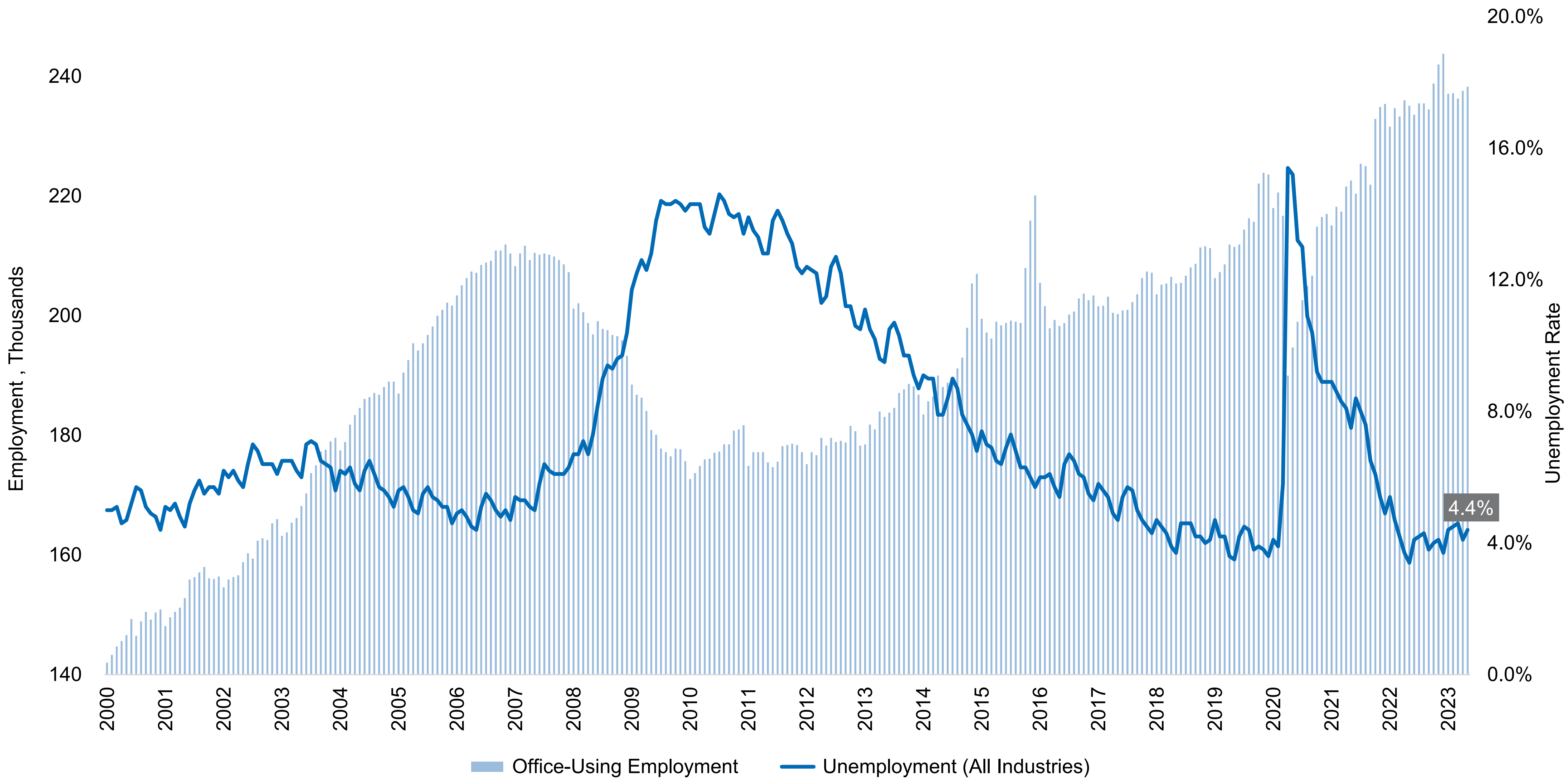



Source: U.S. Bureau of Labor Statistics, Riverside-San Bernardino-Ontario MSA

# Office-Using Employment Stalled After Reaching an All-Time High

Employment in office-using sectors peaked at 243,800 in December 2022 and has declined slightly to 238,300 as of May 2023. Professional and business services represent the largest share of the Inland Empire's office-using jobs, currently numbering 181,000 employees.

**Office-Using Employment* and Unemployment Across All Industries**




Source: U.S. Bureau of Labor Statistics, Riverside-San Bernardino-Ontario MSA
Note: May 2023 data is preliminary.
*Office-using employment includes employment in the following industry sectors: Professional & Business Services, Financial Activities and Information.

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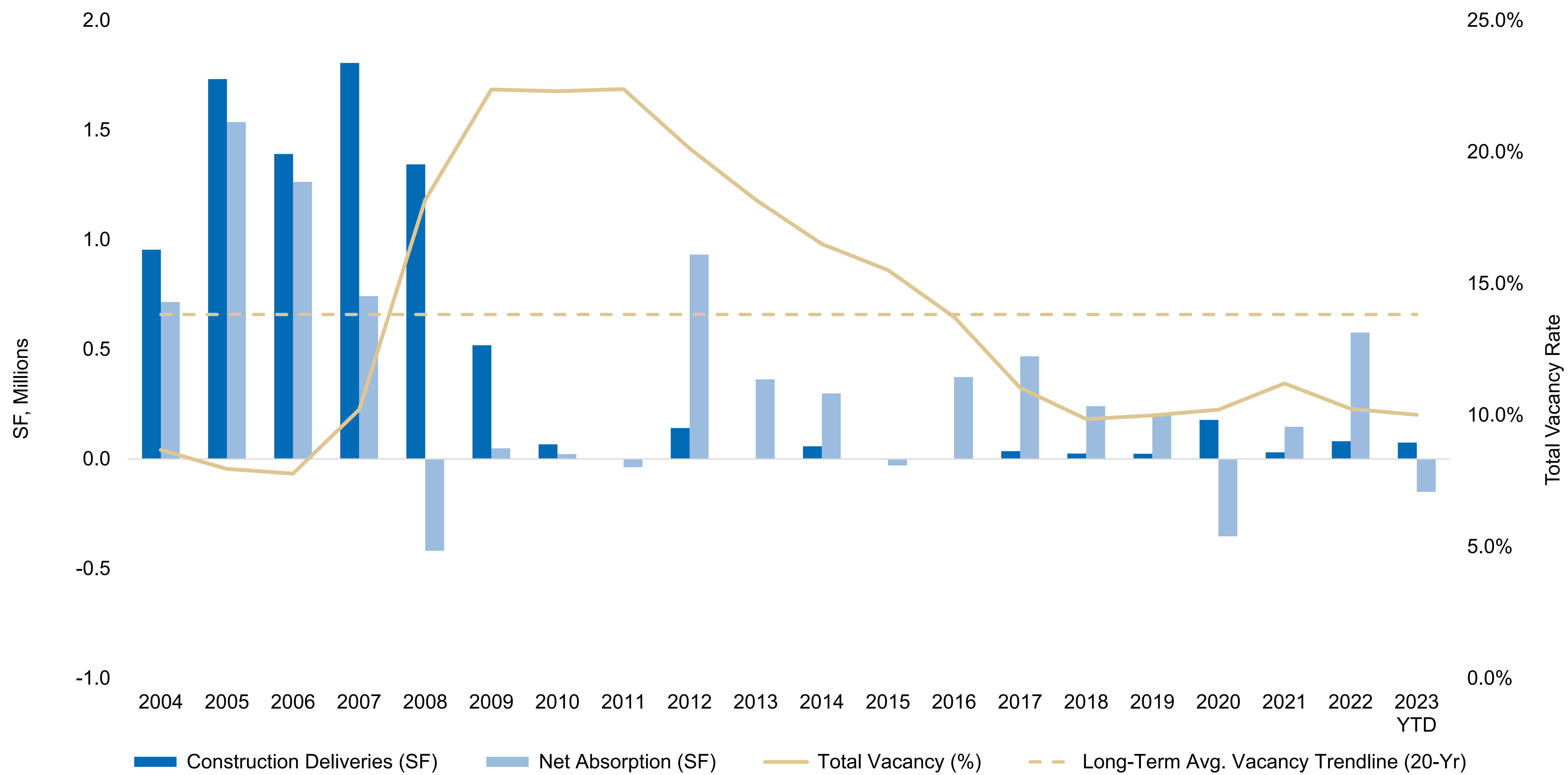
# Leasing Market Fundamentals

# Vacancy Steadily Fell After Construction Dropped Off Over a Decade Ago

In the wake of the Global Financial Crisis, the Inland Empire experienced soaring vacancy due to glut of speculative development that delivered at an inopportune time, peaking at 22.7% in 2011. Office development has been sparse ever since, which has allowed the vacancy rate to steadily fall, reaching a current level of 10.0%. This is considerably lower than the larger Southern California markets of Los Angeles, Orange County and San Diego.

## Historical Construction Deliveries, Net Absorption, and Vacancy

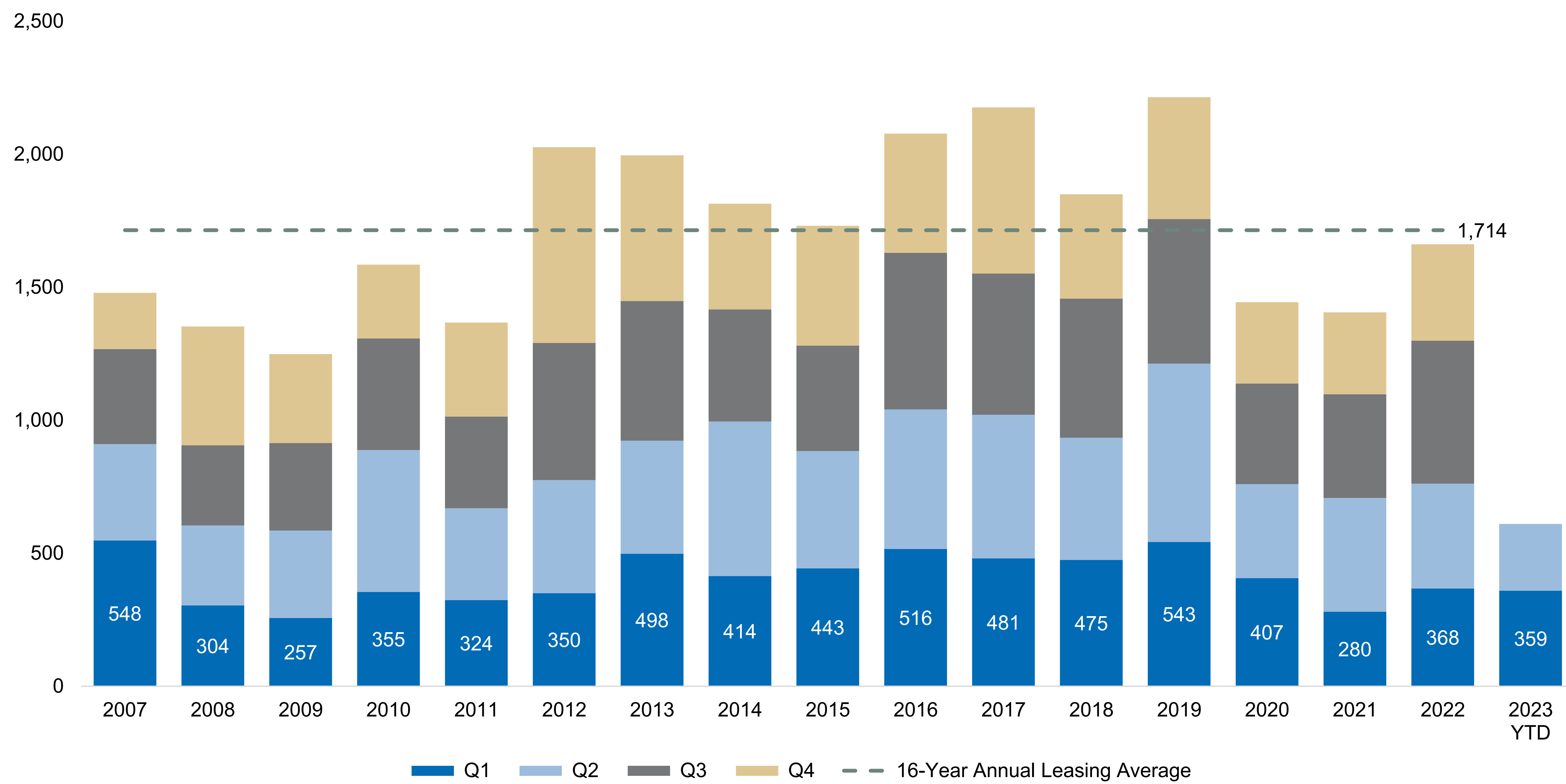



Source: Newmark Research

# Leasing Activity Has Slowed in Recent Years

Leasing was off to a slow start in 2023. By the end of the second quarter, it was on track for the slowest year since 2009; however, the relatively small size of the market and the lack of new speculative development has mitigated this slowdown's effect on vacancy rates.

**Total Leasing Activity (KSF)**

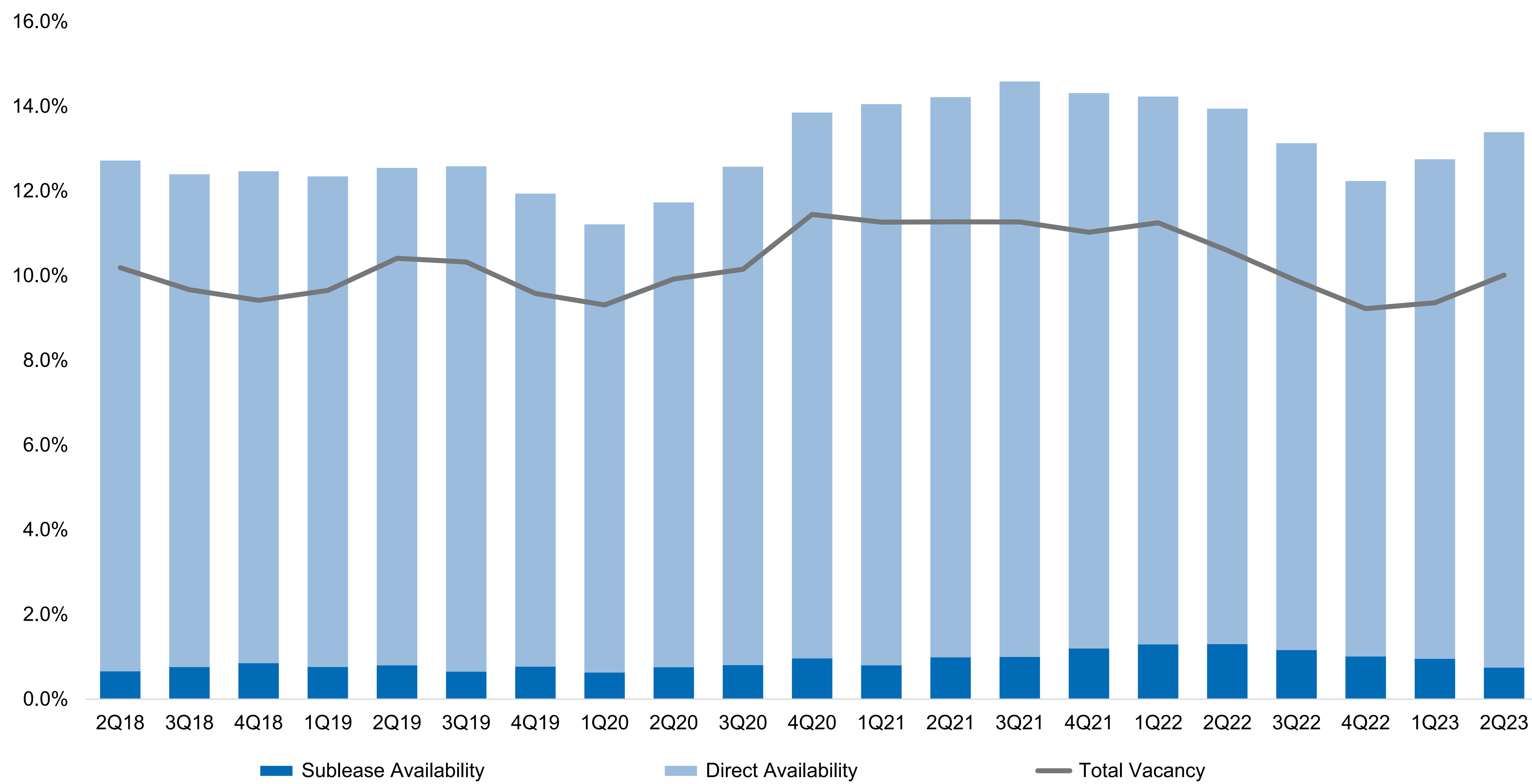



Source: Newmark Research, CoStar

# Availability Starts to Rise Again After Dipping Last Year

The Inland Empire has not seen a surge in sublease availability like the coastal markets, but direct availability has started to climb again after dropping each quarter in 2022. Vacancy has remained steady and healthy, as the office market in the Inland Empire is primarily focused on services for local residents. Additionally, the Inland Empire does not have an established tech base, an industry that has contracted in recent quarters and listed a great deal of sublease space in neighboring markets.

**Available Space and Total Vacancy as Percent of Overall Market**

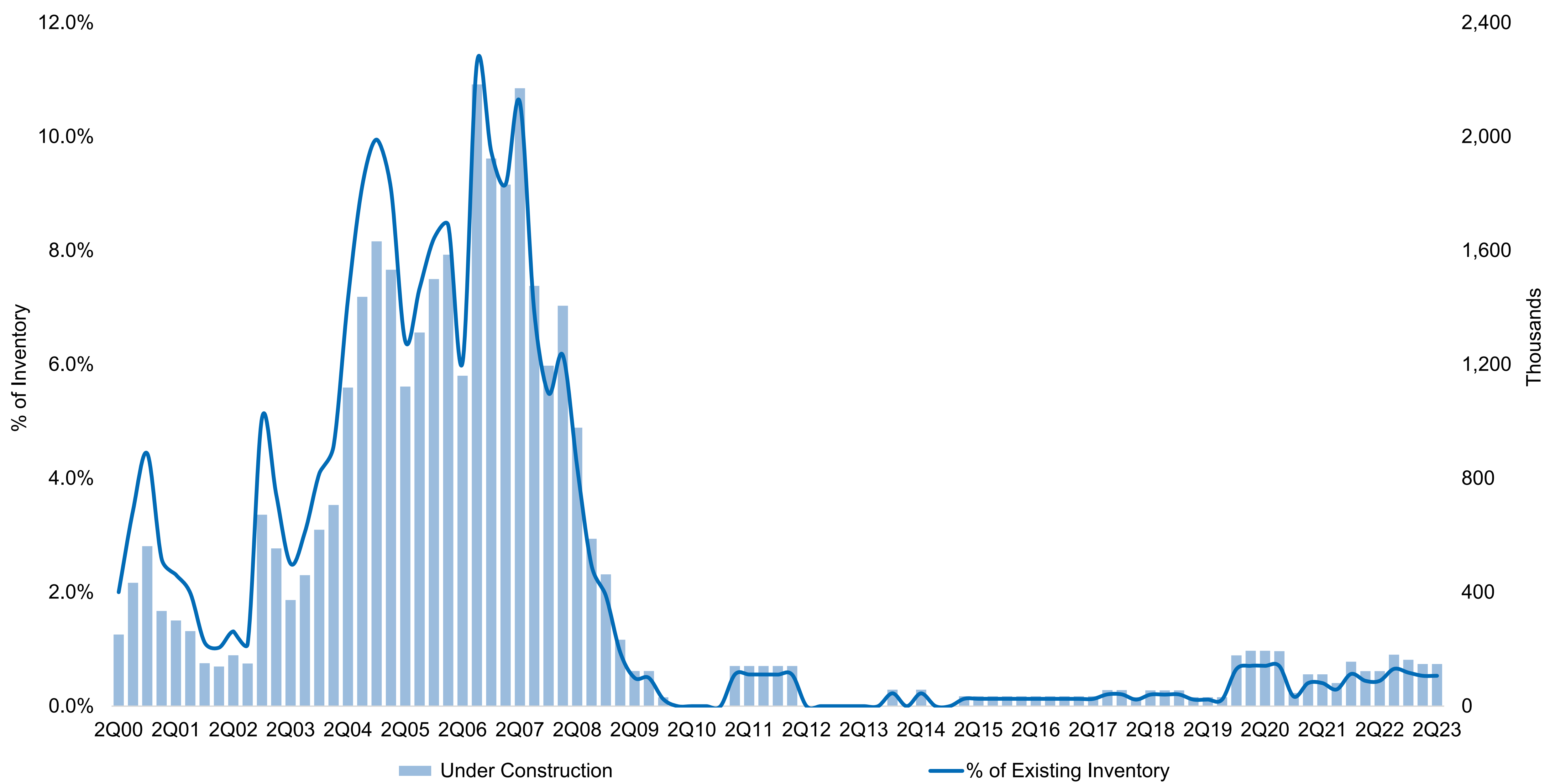



Source: Newmark Research

# Construction Levels Never Rebounded After the Great Recession

Developers produced a lot of speculative office from 2002 to 2008 and suffered losses when occupancy plummeted in the wake of the GFC. Since then, development has been very selective, focused almost exclusively on build-to-suit deals, and construction activity has represented less than 1% of existing inventory for more than a decade.

## Office Under Construction and % of Existing Inventory

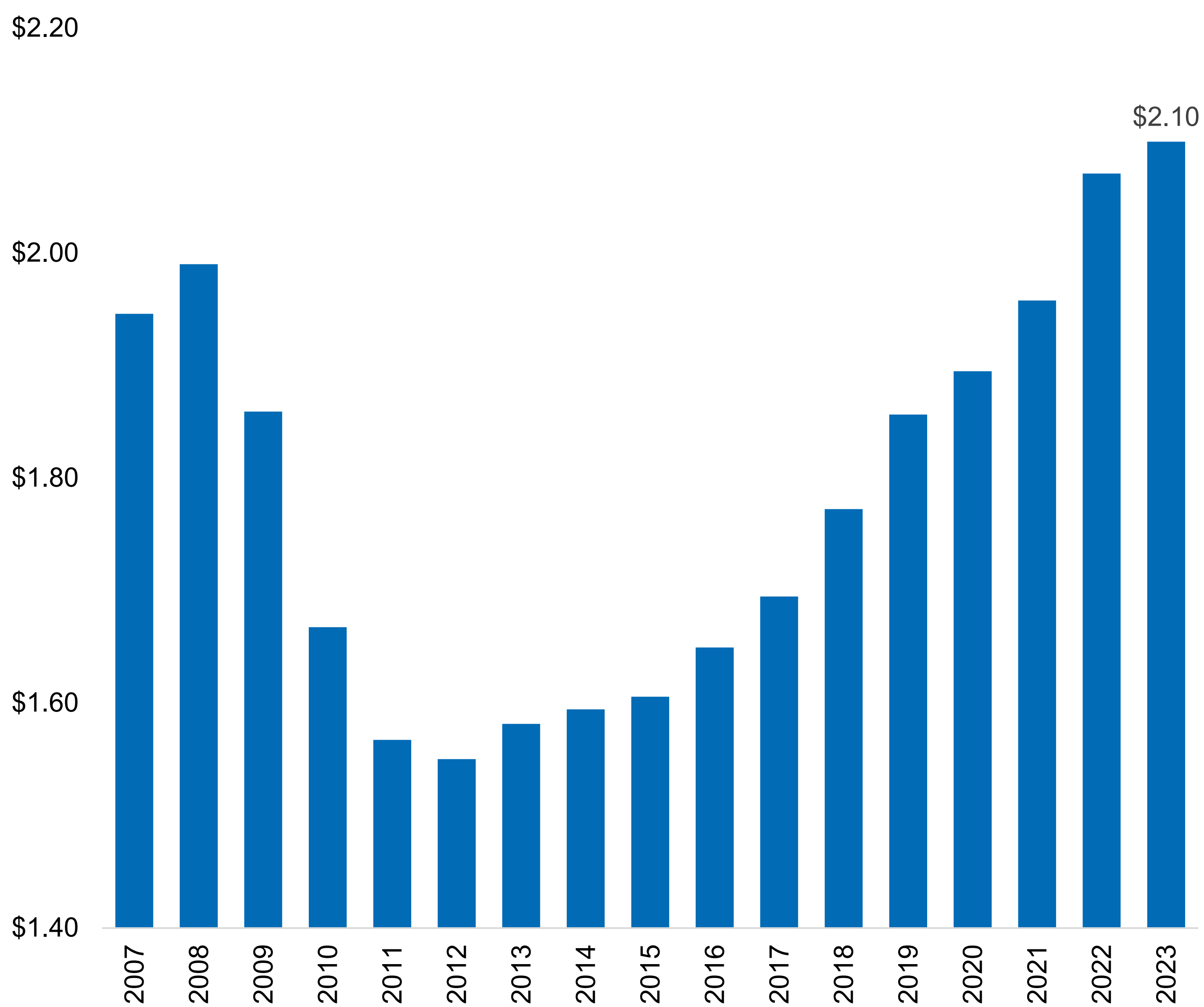



Source: Newmark Research, CoStar

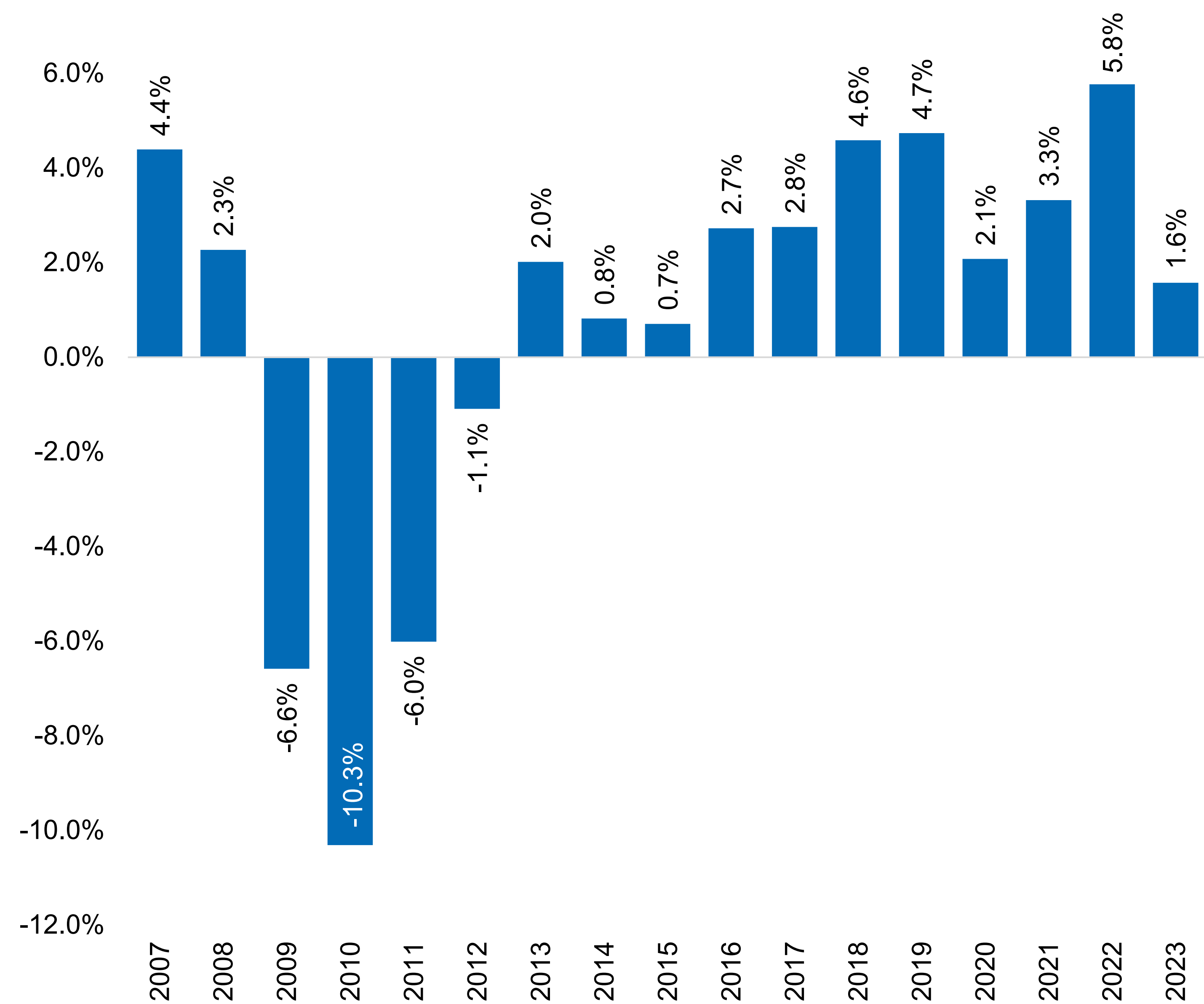
# Rent Growth Continues but Falls Behind Inflation

Asking rents increased every year for more than a decade, but this growth decelerated in the first half of 2023 and is now lower than the rate of inflation. Falling vacancy rates have helped rents to grow.

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




**Year-over-Year Asking Rent Growth Rate**

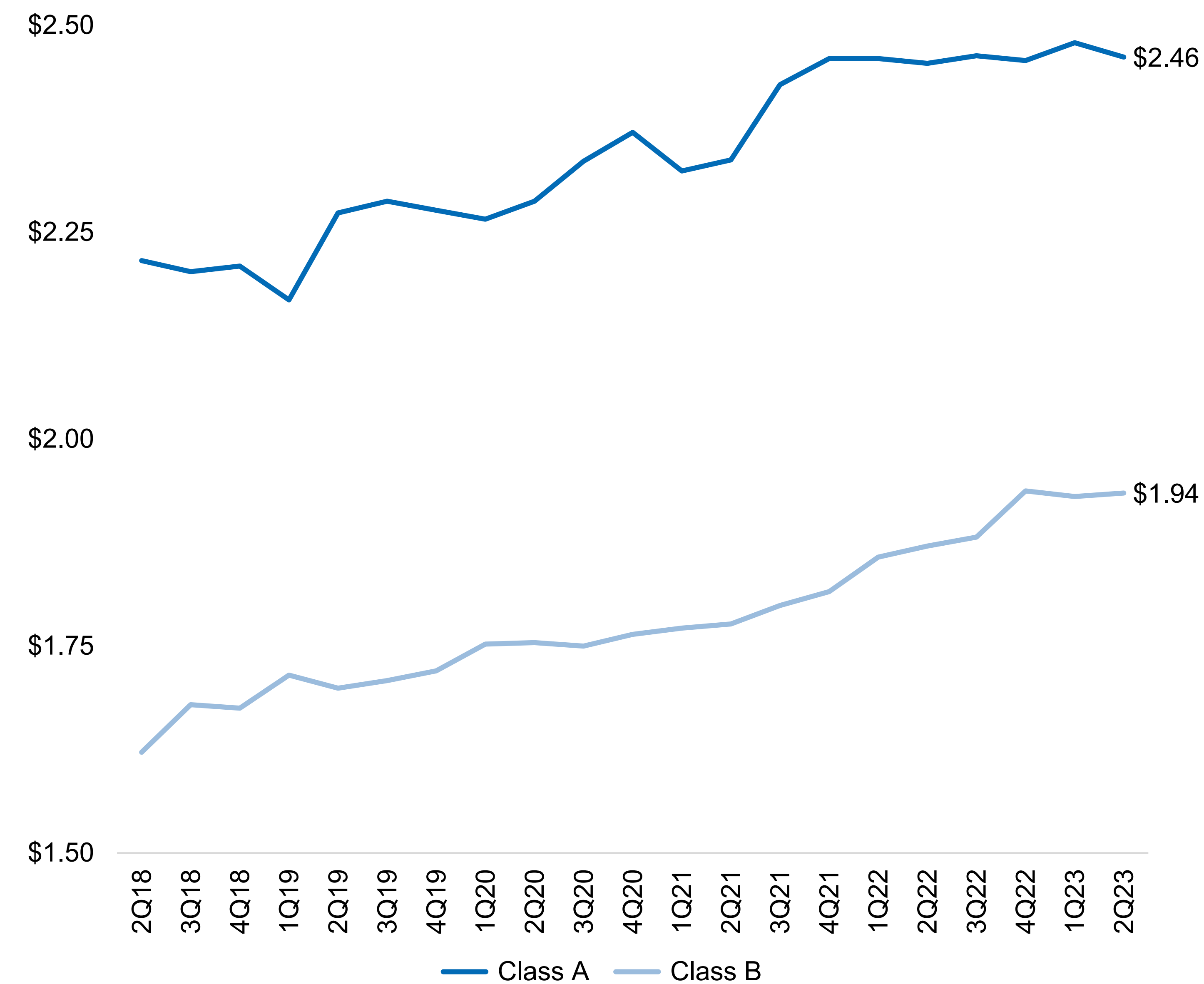



Source: Newmark Research, CoStar

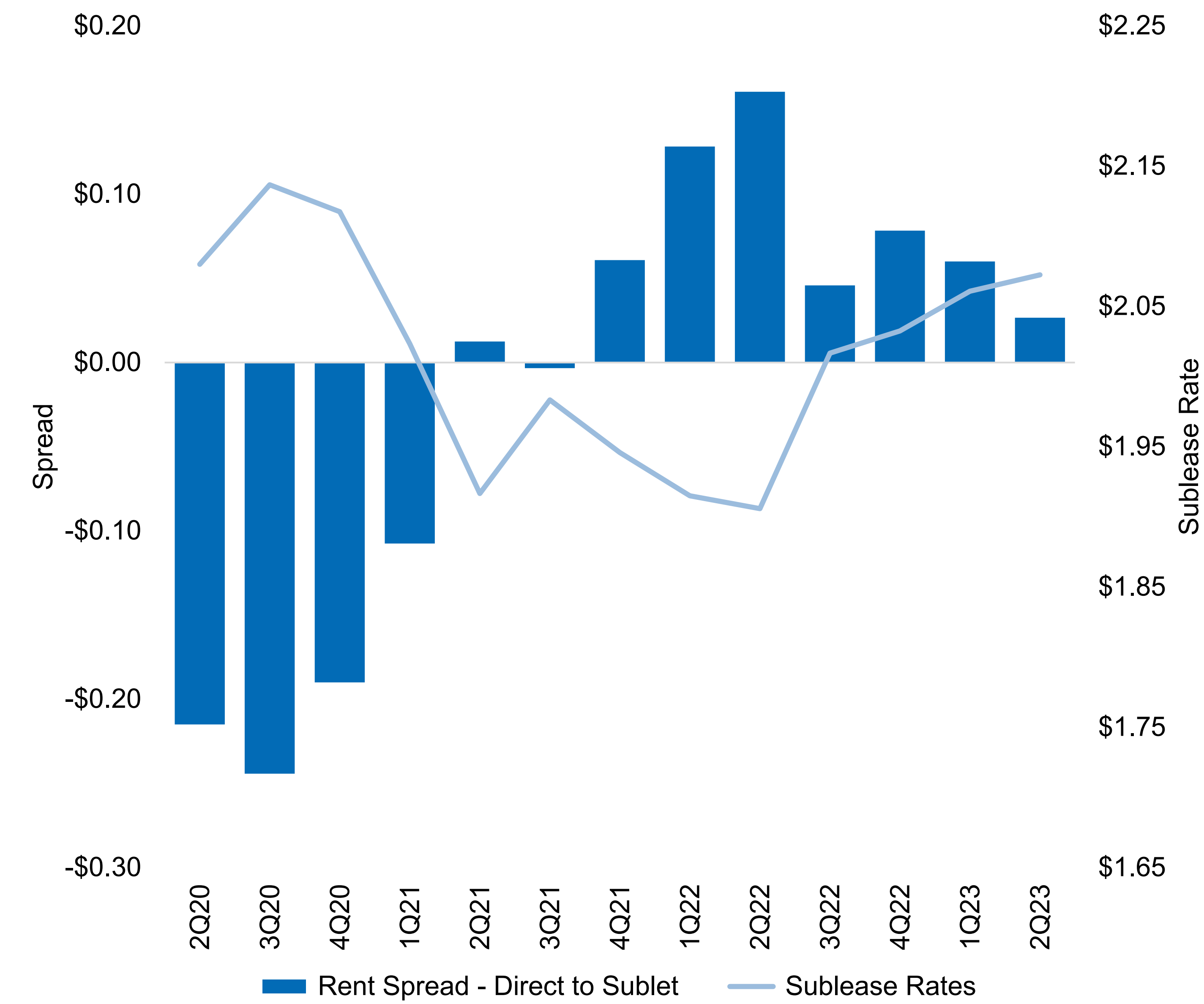
# Class A Premium Holds Steady While Sublease Rates Briefly Surpassed Direct

The spread between Class A and Class B rents has been steady for the past five years. In 2020, after the start of the pandemic, the average sublease rate was higher than the direct average for a while as companies looked to downsize Class A or more expensive space. By the end of 2021, sublease space was once again cheaper than direct space, even after the average sublease rate started climbing again.

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




**Sublease Asking Rates**




Source: Newmark Research, CoStar

# Occupiers Stay in Place as Deals Slow Down

Leasing activity was limited during the quarter, consisting mostly of companies renewing or extending leases for existing space. The largest deal of the quarter was for a realty group with an existing presence in the Inland Empire. It leased new space in Ontario.

## Notable 2Q23 Lease Transactions

| Tenant | Building(s) | Submarket | Type | Square Feet |
|---|---|---|---|---|
| Acevedo Real Estate | 3999 East Inland Empire Boulevard | Airport - Ontario | Direct Lease | 8,479 |
| *Ontario office for a realtor group covering the Inland Empire.* | | | | |
| Inyo Networks | 10630 Town Center Drive | Airport - Rancho Cucamonga | Lease Renewal | 4,685 |
| *Five-year renewal for a high-speed fiber Internet service provider.* | | | | |
| WSP USA | 862 East Hospitality Lane | San Bernardino | Lease Extension | 4,448 |
| *Five-year lease extension with three months of free rent and $36.40/SF TI allowance for an international consulting firm.* | | | | |
| Pacific Dermatology Institute | 545-585 North Mountain Avenue | West - Upland | Lease Renewal | 3,860 |
| *Five-year, as-is renewal for a dermatology group.* | | | | |
| ACES ABA | 1295 Corona Pointe Court | Riverside - Corona | Lease Renewal | 3,824 |
| *Renewal for offices of a child services provider that offers behavioral therapy for children with autism.* | | | | |

Source: Newmark Research

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