

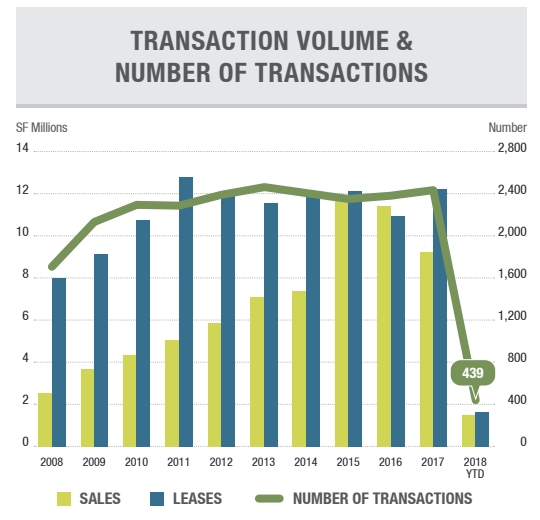
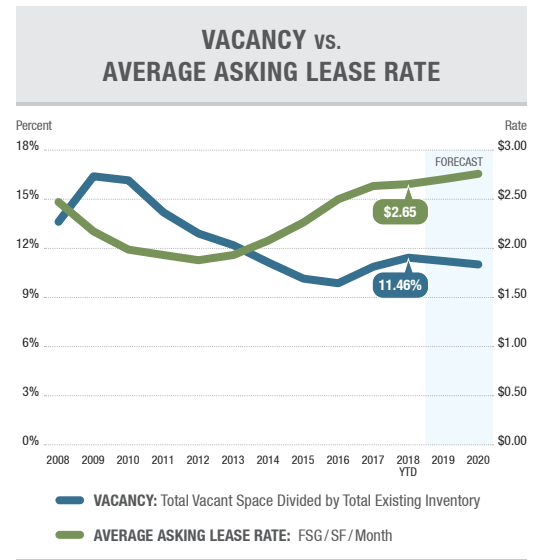
MARKET OVERVIEW. Businesses are increasingly optimistic that the current economic expansion will continue beyond 2018, which would fuel continued growth over the next several years. The slow but steady expansion, which began in 2009, is already the third longest in U.S. history. Rising construction costs and strong demand for premium office space in desirable locations drove average rent up throughout Orange County in the first quarter. A strong employment base maintained by a diverse tech field along with financial and business services provides stability that was not present during the last cycle. An ideal office environment in today's market provides choice and flexibility. The ability to accommodate different working styles, along with promoting learning environments, will be attractive characteristics for an expanding workforce when compared with home offices or communal work environments. Architects suggest that millennials often ask the question "what else?" when it comes to their work environment. Indoor/outdoor spaces are in high demand so employees can be productive while not feeling confined.

VACANCY. Direct vacancy rates in the office market rose slightly from 10.84% in the fourth quarter of 2017 to 11.46% in the first quarter of 2018. Along with The Boardwalk, the recently completed 400 Spectrum Center and Five Point Gateway in the Irvine Spectrum add to the flood of new spec office inventory in Orange County. The Class B office market saw an increase in vacancy in the first quarter, fueled in part by new construction deliveries and many existing tenants opting for newer buildings. Expect vacancy to trend downward in 2018 based on steady job growth and consumer confidence.

LEASE RATES. The average asking full-service gross (FSG) lease rate per month per square foot in the Orange County office market was \$2.65 at the end of the first quarter, a 3.92% increase from this time last year and a 0.76% increase from the fourth quarter. The highest rates were in the Airport Area Class A buildings, where rental rates average \$3.02. Anticipate asking rental rates in Orange County to continue to modestly rise throughout 2018 based on the strong level of current demand from a variety of industries.

TRANSACTION ACTIVITY. The Orange County office market finds itself in a unique position at the start of 2018. South County, and specifically the submarket of Irvine Spectrum, is booming, growing more than 2% annually. Companies are flocking to the innovative hub and have set up headquarters there. Local economic indicators are solid, absorption has been positive year-over-year, and vacancies across the board are declining. However, in the first quarter of 2018, only 3.08 million square feet of total transactions (sale and lease) were recorded, down from just over 4.82 million in the fourth quarter. Investors and developers of office product throughout Orange County continue to provide creative and innovative solutions for office tenants by repositioning older buildings into creative work environments and keeping pace with the latest design trends.

ECONOMY. The unemployment rate in the Orange County was 3.1% in February 2018, down from a revised 3.2% in January 2018, and below the year-ago estimate of 3.8%. This compares with an unadjusted unemployment rate of 4.5% for California and 4.4% for the nation during the same period. Between February 2017 and February 2018, total nonfarm employment increased by 31,900 jobs, or 2%. The major movers were: professional and business services (up 8,900), construction (up 6,300), leisure and hospitality (up 5,600), government (up 2,100), and financial activities (up 600).



Market Statistics

	Change Over Last Quarter	1Q 2018	4Q 2017	1Q 2017	% Change Over Last Year
Vacancy Rate	▲ UP	11.46%	10.84%	986.00%	(98.84%)
Availability Rate	▲ UP	15.30%	14.86%	14.69%	4.15%
Average Asking Lease Rate	▲ UP	\$2.65	\$2.63	\$2.55	3.92%
Sale & Lease Transactions	▼ DOWN	3,080,355	4,825,105	4,576,340	(32.69%)
Gross Absorption	▼ DOWN	2,664,177	3,303,631	2,571,712	3.60%
Net Absorption	▼ NEGATIVE	(310,568)	344,528	161,611	N/A

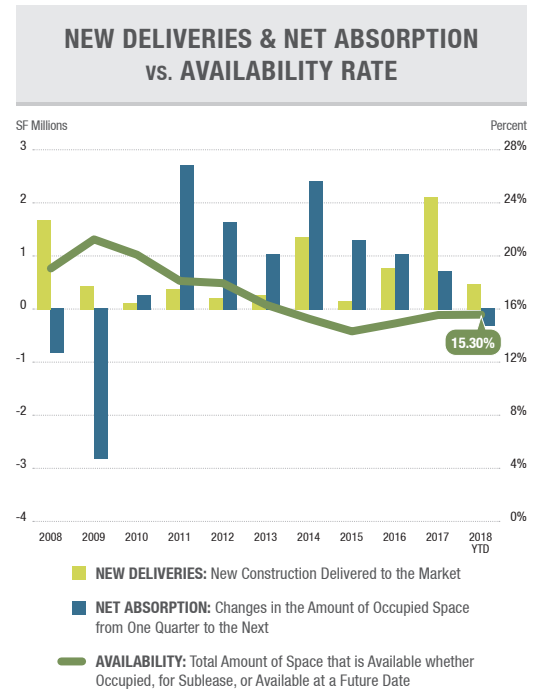
LEASE RATES. New space coming online could hamper growth. Additionally, if leasing continues to be sluggish and if Class A landlords are asking upwards of \$4 per square foot, demand will likely be suppressed. Expect an overall modest increase in pricing in the coming quarters. Lease rates will continue to firm up, and we expect them to slightly increase over the coming year. Additionally, expect the average asking lease rates to increase by 2%.

VACANCY. We are beginning to see an increase in the amount of vacant and available space. As we enter the second quarter of 2018, positive absorption should continue, and with few new deliveries in the pipeline to apply upward pressure on vacancy, the market will continue its stable course.

OVERALL. Office investors/developers are focusing on the coasts where they have access to a large pool of creative talent. Most feel we are seeing a creative class uprising. Technology has mobilized us and the challenge for companies is creating an environment that helps people learn and enjoy themselves. The lines of work and recreation are blurred. The workplace will continue to evolve as an environment to support the growth of young talent in the entertainment, tech and medical fields. Owners of office buildings will further promote the arts, events and wellness. Concierge services in some buildings are being offered as differentiators.

CONSTRUCTION. Total space under construction checked in at 1,066,401 square feet at the end of the first quarter of 2018—most notably The Irvine Company’s 466,696 square foot spec project, The Quad at Discovery Business Center, and Lincoln Property’s Flight @ Tustin Legacy, a spec project that’s expected to begin delivering this year. The completion of construction projects will continue to ease the pressure on vacancy and cause upward pressure on lease rates going forward. In line with the trend of creative office conversions, the redevelopment of the former warehouse at 2722 Michelson in Irvine is expected to wrap up this year, with 155,000 square feet of new space.

ABSORPTION. Net absorption for the county dropped off a bit posting a negative number of 310,568 square feet for the first quarter 2018. Tenants are continuing to expand, but in a more conservative manner. It wasn’t uncommon in the past for companies to lease excessive amounts of space and wait to grow into it. Today’s tenants are more concerned with efficiency, so businesses attempt to put more people into less space. Class A space contributed 278,977 square feet of positive absorption and Class B recorded a negative 591,290 square feet. The Class B office market saw an increase in vacancy in the first quarter, fueled in part by new construction deliveries and many existing tenants opting for newer buildings.



Significant Transactions

Sales * Voit Real Estate Services Deal

Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
333 City Blvd. W.	Orange	A	431,007	\$147,300,000	KBS SOR City Tower, LLC	Torchlight Investors
3100–3130 S. Harbor Blvd.	Santa Ana	A	201,404	\$34,773,000	Kearny Harbor, LLC	Colton Family Trust
2727–2767 Imperial Highway	Brea	B	194,312	\$47,300,000	Healthcare Property Advisors	AEW LT Brea Imperial Center*
1–9 Corporate Park – 5 Bldgs.	Irvine	B	163,744	\$41,700,000	Corporate Pointe Investments, LLC	PS Business Park, LP
625 The City Dr. S.	Orange	B	148,054	\$33,000,000	TA Realty	The Blackstone Group, LP

Leases * Voit Real Estate Services Deal

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
41–43 Discovery – Renew/Expansion	Irvine Spectrum	B	76,227	Jan-2018	Ghost Media	The Irvine Company
14101 Myford Rd.	Tustin	B	66,818	Mar-2018	US Government Service Administration	Harbor Associates, LLC
12912 Brookhurst St. – Renewal	Garden Grove	B	61,002	Feb-2018	County of Orange Social Services	Dolphin Partners, Inc.
85 Enterprise	Aliso Viejo	A	28,719	Jan-2018	Concerto Healthcare	RREEF
3 Park Plaza	Irvine	A	23,461	Mar-2018	Redwitz, Inc.*	The Irvine Company

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 1Q2018	Square Feet Available	Availability Rate 1Q2018	Average Asking Lease Rate	Net Absorption 1Q2018	Net Absorption 2018	Gross Absorption 1Q2018	Gross Absorption 2018
Airport Area													
Costa Mesa	72	7,331,617	0	442,476	1,018,484	13.89%	1,401,180	19.11%	\$3.02	(21,577)	(21,577)	111,437	111,437
Irvine	262	24,840,956	284,162	786,000	3,889,585	15.66%	5,084,299	20.47%	\$2.88	(691,874)	(691,874)	690,302	690,302
Newport Beach	123	10,048,130	0	42,646	936,224	9.32%	1,384,892	13.78%	\$3.48	(54,625)	(54,625)	184,869	184,869
Santa Ana	15	2,451,993	0	0	475,596	19.40%	680,001	27.73%	\$2.57	(9,973)	(9,973)	30,080	30,080
Airport Area Total	472	44,672,696	284,162	1,271,122	6,319,889	14.15%	8,550,372	19.14%	\$3.06	(778,049)	(778,049)	1,016,688	1,016,688
Central County													
Anaheim	17	1,944,289	0	0	247,020	12.70%	395,638	20.35%	\$2.42	1,527	1,527	36,176	36,176
Orange	81	7,113,774	0	386,000	593,206	8.34%	1,080,904	15.19%	\$2.32	(17,645)	(17,645)	107,136	107,136
Santa Ana	166	12,641,643	0	911,765	1,465,171	11.59%	1,592,335	12.60%	\$2.01	(15,229)	(15,229)	178,554	178,554
Tustin	42	2,234,086	417,284	377,262	355,379	15.91%	398,856	17.85%	\$2.28	24,557	24,557	56,074	56,074
Central County Total	306	23,933,792	417,284	1,675,027	2,660,776	11.12%	3,467,733	14.49%	\$2.12	(6,790)	(6,790)	377,940	377,940
North County													
Anaheim Hills	83	5,946,562	0	0	481,123	8.09%	776,725	13.06%	\$1.96	(84,792)	(84,792)	25,178	25,178
Brea	42	4,066,389	0	0	359,764	8.85%	494,556	12.16%	\$2.40	(2,226)	(2,226)	41,225	41,225
Buena Park	17	1,115,193	0	0	143,640	12.88%	173,109	15.52%	\$2.07	38,479	38,479	66,277	66,277
Fullerton	30	2,423,201	0	0	181,365	7.48%	236,566	9.76%	\$1.89	(15,380)	(15,380)	21,709	21,709
La Habra	4	142,069	0	0	6,085	4.28%	11,909	8.38%	\$1.41	(4,218)	(4,218)	1,202	1,202
La Palma	10	712,038	0	0	54,771	7.69%	76,624	10.76%	\$0.00	(8,041)	(8,041)	10,773	10,773
Placentia	8	267,581	0	0	23,017	8.60%	29,329	10.96%	\$1.82	(3,082)	(3,082)	0	0
Yorba Linda	5	288,094	0	0	61,034	21.19%	49,157	17.06%	\$2.15	(1,587)	(1,587)	1,838	1,838
North County Total	199	14,961,127	0	0	1,310,799	8.76%	1,847,975	12.35%	\$2.17	(80,847)	(80,847)	168,202	168,202
South County													
Aliso Viejo	44	3,343,808	0	0	540,321	16.16%	913,275	27.31%	\$3.19	10,140	10,140	68,473	68,473
Dana Point	2	91,876	0	0	0	0.00%	0	0.00%	\$0.00	0	0	0	0
Foothill Ranch	10	798,721	0	0	104,518	13.09%	119,570	14.97%	\$2.50	(12,149)	(12,149)	9,679	9,679
Irvine Spectrum	166	12,571,916	364,955	69,968	1,281,569	10.19%	1,609,986	12.81%	\$3.10	407,282	407,282	680,394	680,394
Laguna Beach	5	192,434	0	0	21,859	11.36%	21,859	11.36%	\$0.00	(800)	(800)	0	0
Laguna Hills	33	1,804,474	0	0	277,643	15.39%	317,021	17.57%	\$2.51	1,998	1,998	46,134	46,134
Laguna Niguel	10	1,749,768	0	0	48,332	2.76%	58,988	3.37%	\$0.00	16,597	16,597	17,296	17,296
Lake Forest	40	2,108,313	0	0	113,389	5.38%	192,377	9.12%	\$2.32	46,482	46,482	69,064	69,064
Mission Viejo	36	2,036,265	0	0	195,109	9.58%	192,807	9.47%	\$2.43	19,053	19,053	31,493	31,493
Rancho Santa Margarita	6	252,716	0	0	10,008	3.96%	19,780	7.83%	\$2.13	2,546	2,546	4,291	4,291
San Clemente	13	523,256	0	0	41,015	7.84%	57,234	10.94%	\$2.37	(10,162)	(10,162)	6,108	6,108
San Juan Capistrano	18	912,583	0	0	144,817	15.87%	149,477	16.38%	\$2.08	14,557	14,557	16,105	16,105
South County Total	383	26,386,130	364,955	69,968	2,778,580	10.53%	3,652,374	13.84%	\$2.89	495,544	495,544	949,037	949,037
West County													
Cypress	28	1,951,875	0	0	159,662	8.18%	153,574	7.87%	\$2.12	8,165	8,165	42,580	42,580
Fountain Valley	33	1,995,993	0	0	62,884	3.15%	66,992	3.36%	\$1.53	(10,010)	(10,010)	2,519	2,519
Garden Grove	19	1,522,437	0	0	27,017	1.77%	33,954	2.23%	\$1.86	8,423	8,423	12,684	12,684
Huntington Beach	43	2,505,073	0	0	165,564	6.61%	267,922	10.70%	\$2.81	1,480	1,480	24,600	24,600
Los Alamitos	12	661,516	0	0	188,844	28.55%	191,858	29.00%	\$2.40	726	726	6,988	6,988
Seal Beach	7	473,787	0	0	12,912	2.73%	42,605	8.99%	\$3.15	12,163	12,163	14,865	14,865
Stanton	4	143,361	0	0	15,127	10.55%	15,127	10.55%	\$0.00	2,160	2,160	5,769	5,769
Westminster	12	484,905	0	0	20,358	4.20%	24,740	5.10%	\$2.10	36,467	36,467	42,305	42,305
West County Total	158	9,738,947	0	0	652,368	6.70%	796,772	8.18%	\$2.48	59,574	59,574	152,310	152,310
Orange County Total	1,518	119,692,692	1,066,401	3,016,117	13,722,412	11.46%	18,315,226	15.30%	\$2.65	(310,568)	(310,568)	2,664,177	2,664,177
Airport Area													
Class A	133	26,176,039	0	786,000	4,317,294	16.49%	5,854,053	22.36%	\$3.22	(104,171)	(104,171)	602,314	602,314
Class B	312	17,196,609	284,162	485,122	1,951,452	11.35%	2,601,848	15.13%	\$2.66	(678,996)	(678,996)	407,532	407,532
Class C	27	1,300,048	0	0	51,143	3.93%	94,471	7.27%	\$1.91	5,118	5,118	6,842	6,842
Central County													
Class A	43	7,268,016	417,284	1,373,027	717,482	9.87%	1,063,951	14.64%	\$2.47	(31,256)	(31,256)	84,725	84,725
Class B	208	14,005,516	0	302,000	1,801,680	12.86%	2,224,850	15.89%	\$2.01	18,387	18,387	257,156	257,156
Class C	55	2,660,260	0	0	141,614	5.32%	178,932	6.73%	\$1.70	6,079	6,079	36,059	36,059
North County													
Class A	27	3,192,282	0	0	488,827	15.31%	599,161	18.77%	\$2.41	(82,177)	(82,177)	30,266	30,266
Class B	149	10,875,513	0	0	808,555	7.43%	1,232,164	11.33%	\$2.07	7,246	7,246	136,194	136,194
Class C	23	893,332	0	0	13,417	1.50%	16,650	1.86%	\$1.77	(5,916)	(5,916)	1,742	1,742
South County													
Class A	69	9,409,522	364,955	0	1,201,997	12.77%	1,582,279	16.82%	\$3.22	489,128	489,128	637,217	637,217
Class B	303	16,457,455	0	69,968	1,536,255	9.33%	2,029,767	12.33%	\$2.54	11,620	11,620	310,251	310,251
Class C	11	519,153	0	0	40,328	7.77%	40,328	7.77%	\$2.03	(5,204)	(5,204)	1,569	1,569
West County													
Class A	19	2,175,151	0	0	136,919	6.29%	175,500	8.07%	\$2.52	7,453	7,453	17,305	17,305
Class B	121	6,850,343	0	0	354,303	5.17%	459,526	6.71%	\$2.46	50,453	50,453	132,837	132,837
Class C	18	713,453	0	0	161,146	22.59%	161,746	22.67%	\$0.00	1,668	1,668	2,168	2,168
Orange County													
Class A	291	48,221,010	782,239	2,159,027	6,862,519	14.23%	9,274,944	19.23%	\$3.02	278,977	278,977	1,371,827	1,371,827
Class B	1,093	65,385,436	284,162	857,090	6,452,245	9.87%	8,548,155	13.07%	\$2.30	(591,290)	(591,290)	1,243,970	1,243,970
Class C	134	6,086,246	0	0	407,648	6.70%	492,127	8.09%	\$1.78	1,745	1,745	48,380	48,380
Orange County Total	1,518	119,692,692	1,066,401	3,016,117	13,722,412	11.46%	18,315,226	15.30%	\$2.65	(310,568)	(310,568)	2,664,177	2,664,177

This survey consists of office properties 25,000 square feet and larger in size, representing both single tenant and multi-tenant buildings. The lease rates are based on a full-service gross basis.



Office Market Continues to Run Supported by Strong Fundamentals and Economic Optimism

by **Chris Drzyzga**

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The Orange County office market remains stable, supported by strong fundamentals and optimism regarding the local and national economies. Rents will continue to increase, but landlord concessions are beginning to reappear as investors and developers push to lease up new projects. We saw a slight uptick in vacancy, but this is primarily due to the delivery of new product in the market including 400 Spectrum Center, Five Point Gateway and The Boardwalk. The most notable and anticipated deliveries of 2018 is “Flight” at Tustin Legacy. The 38.7 acre mixed-use project will provide 870,000 square feet of state-of-the-art creative office space and 2.5 miles of recreational trails, supported by premium on-site amenities.

Additionally, tenants that relocated from Class B to Class A buildings from 2012 to 2014 are experiencing sticker shock as they evaluate renewal and relocation alternatives in a market with sharply higher lease rates. To extract maximum operational value from rising occupancy costs, business owners are taking an even closer look at how building quality, workspace design and access to amenities impact their brand identity and ability to attract and retain top talent.

By now, most business owners and investors have had an opportunity to review and digest the new tax reform. The response from the business world has been exceptionally positive. Major corporations have announced plans for domestic investment, employee bonuses, higher wages and repatriation of overseas profits. Lower income tax rates for C-corporations and pass-through entities, accelerated depreciation on equipment and qualified capital improvements along with continued deductibility of mortgage interest expense all point to businesses keeping more of their profits, resulting in their ability to invest in further growth. To everyone’s relief was the fact that IRC 1031 exchange rules were left untouched. However, there are concerns that a boost in economic growth could trigger a rise in inflation, which has remained stubbornly low throughout the economic recovery that is now in its ninth year. If inflation does spike, the yield on the 10-Year US Treasury, the benchmark for setting commercial property mortgage interest rates, would likely move up, as well. In fact, that yield has already risen by more than 50 basis points in the past few months.

While ground-up developers, value-add investors and existing landlords are looking to attract tenants with new amenities and innovative workspace designs to justify higher rents, an increasing number of business owners are angling to own their own facilities in order to help stabilize long-term occupancy costs. However, available inventory of suitable owner/user properties is running well short of demand and that has driven sales prices to all-time highs.

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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

AIRPORT AREA

Costa Mesa, Irvine, Newport Beach

CENTRAL COUNTY

Anaheim, Orange, Santa Ana, Tustin

NORTH COUNTY

Anaheim Hills, Brea, Buena Park, Fullerton, La Habra, La Palma, Placentia, Yorba Linda

SOUTH COUNTY

Aliso Viejo, Dana Point, Foothill Ranch, Irvine Spectrum, Laguna Beach, Laguna Hills, Laguna Niguel, Lake Forest, Mission Viejo, Rancho Santa Margarita, San Clemente, San Juan Capistrano

WEST COUNTY

Cypress, Fountain Valley, Garden Grove, Huntington Beach, Los Alamitos, Seal Beach, Stanton, Westminster