

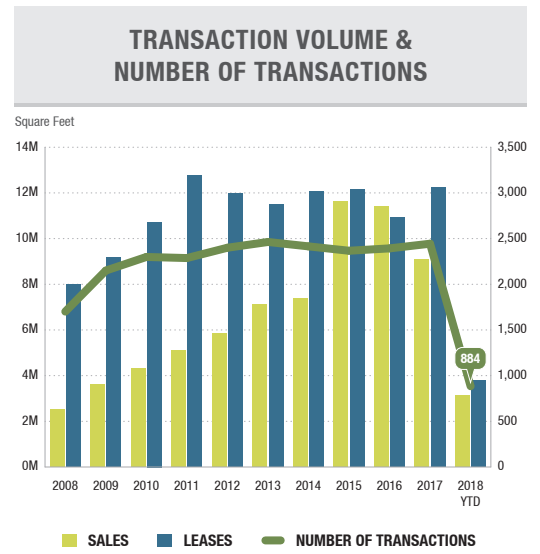
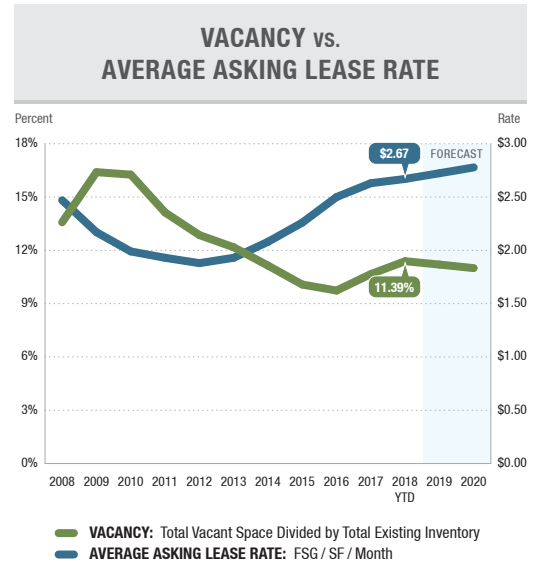
**MARKET OVERVIEW.** While limited availability of quality space in the Orange County office market will continue through the remainder of 2018 and beyond, the market still has a diverse range of products to meet the needs of professional services, technology, and medical businesses. In 2Q, occupancy of Class A office space in Orange County increased by 12.33% compared with last year, and we saw a 3.03% increase in the average asking lease rate per square foot. As more vacant office space continues to be converted into creative office and larger spaces are renovated to meet the needs of growing companies, Orange County continues to position itself as one of the best places to start and grow your business in the state.

**VACANCY.** After four quarters of increases, the vacancy rate in the Orange County office market reversed its upward trend to sit at 11.39% in 2Q 2018. This is down from 11.46% in 1Q 2018, but up from 9.84% in 2Q 2017. The large amount of new supply that came online coincided with weak net absorption. Expect vacancy to trend downward in 2018, based on steady job growth and consumer confidence coupled with many tenants currently in the market shopping for space.

**LEASE RATES.** The average asking full-service gross (FSG) lease rate per month per SF in the Orange County office market was \$2.67 at the end of 2Q, a 3.49% increase from this time last year and a two-cent increase from 1Q. The highest rates were in the Airport Area Class A buildings, where rental rates averaged \$3.06. 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.** Local economic indicators are solid, absorption has been positive year-over-year, and vacancies across the board are declining. However, in 2Q 2018, only 3.23 million square feet of total transactions (sale and lease) were recorded, down from just over 3.68 million in 1Q. The healthy level of activity during the first two quarters of 2018 offers a reminder that the Orange County office market fundamentals remain on solid footing. Demand is healthy for Class A product and major employers continue to increase their footprint.

**ECONOMY.** The unemployment rate in Orange County was 2.6% in May 2018, unchanged from a revised 2.6% in April 2018, and below the year-ago estimate of 3.2%. This compares with an unadjusted unemployment rate of 3.7% for California and 3.6% for the nation during the same period. Year-over-year declines were reported in manufacturing (down 3,100 jobs), financial activities (down 1,200 jobs), trade, transportation and utilities (down 1,100 jobs), and in other services (down 800 jobs). Local government posted the largest month-over-month increase, expanding by 1,400 jobs, with most of the gain in local government education. Other sectors reporting employment increases included: leisure and hospitality (up 700 jobs), professional and business services (up 600 jobs), educational and health services (up 400 jobs), and information (up 100 jobs).



Market Statistics

	Change Over Last Quarter	2Q 2018	1Q 2018	2Q 2017	% Change Over Last Year
Vacancy Rate	▼ DOWN	11.39%	11.46%	9.84%	15.75%
Availability Rate	▲ UP	15.40%	15.30%	14.92%	3.22%
Average Asking Lease Rate	▲ UP	\$2.67	\$2.65	\$2.58	3.49%
Sale & Lease Transactions	▼ DOWN	3,233,418	3,688,487	5,835,609	(44.59%)
Gross Absorption	▼ DOWN	2,476,423	2,601,952	2,639,947	(6.19%)
Net Absorption	▲ POSITIVE	92,427	(310,568)	(33,187)	N/A

**LEASE RATES.** New space coming online could hamper growth in rental rates. Additionally, if leasing continues to be sluggish and Class A landlords are asking upwards of \$4.00 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. Expect the average asking lease rates to increase by less than 3%.

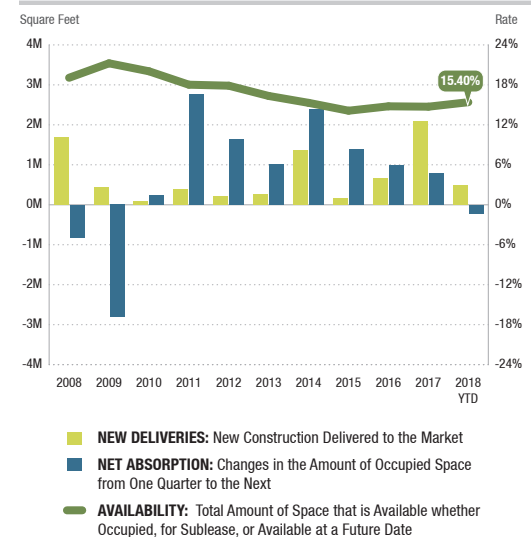
**VACANCY.** With increased market activity, building conversions and upgrades have added new, higher quality space to the market. Continued low vacancy and competition for space will result in higher rents across most submarkets. With the availability of existing office space declining, we expect the vacancy rate to drop to 11.20% by year end. The last time Orange County vacancy rates were below 10% was in 2Q 2017.

**OVERALL.** With Orange County office activity gaining momentum in the first half of 2018, positive absorption should continue, and with few new deliveries in the pipeline to apply upward pressure on vacancy, the market will continue to stabilize. Tenants in the market looking for 25,000 to 50,000 square feet will continue to be the market movers. Activity in the Orange County's office market shows little signs of slowing, as companies continue to expand their footprint by taking up space in the Airport Area and South County submarkets. Records for sale prices per square foot for commercial buildings continue to be set, and net absorption figures continue to increase. We should also see an increase in leasing activity as many short-term deals come up for renewal. As job creation continues and consumer confidence stabilizes, the office market will continue to recover.

**CONSTRUCTION.** Total space under construction checked in at 937,239 square feet at the end of 2Q 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 expected to begin delivering later this year. Creative office repurposing is still active, including the redevelopment of the former warehouse at 2722 Michelson in Irvine which is expected to wrap up this year, creating 155,000 square feet of new space.

**ABSORPTION.** Net absorption increased in 2Q, finishing at 92,427 square feet. This compares with the negative 310,568 square foot loss from 1Q and brings the 2018 annual total to a negative 218,141 square feet. 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, but current pricing has made this strategy less popular. During the balance of 2018, expect demand for office space to remain steady due to new hiring demands offset by implementation of more efficient layouts. Today's tenants are more concerned with efficiency, so businesses attempt to put more people into less space.

**NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE**



Significant Transactions

Sales

Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
85-101 Enterprise – 5 Properties	Aliso Viejo	A	481,771	\$157,000,000	Rockpoint Group, LLC	RREEF Management, LLC
1221-1251 E. Dyer Rd. – 5 Properties	Santa Ana	B	436,791	\$74,250,000	Greenlaw Partners	PS Business Parks, Inc.
27401 Los Altos	Mission Viejo	B	72,233	\$21,600,000	Bolour Associates	Bixby Land Company
500 S. Kraemer Blvd.	Brea	B	94,492	\$20,125,000	Alamitos Associates	PRES Companies
3822 Campus Dr.	Newport Beach	B	23,258	\$12,275,000	Chapman Investment Company, LP	Redwood West

Leases

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
2722 Michelson Dr.	Irvine	B	155,000	Jun-2018	Andurill	LBA Realty
2 MacArthur Court	Santa Ana	A	118,830	Jun-2018	State of California	Equity Office
5290 California Ave.	Irvine Spectrum	B	101,964	Apr-2018	Covidien dba Medtronic	The Irvine Company
5300 California Ave	Irvine	B	90,900	May-2018	Acorns	The Irvine Company
2975 Red Hill Ave.	Costa Mesa	B	40,358	May-2018	Hoag Memorial Presbyterian	Equity Office

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 2Q2018	Square Feet Available	Availability Rate 2Q2018	Average Asking Lease Rate	Net Absorption 2Q2018	Net Absorption 2018	Gross Absorption 2Q2018	Gross Absorption 2018
<b>Airport Area</b>													
Costa Mesa	73	7,366,265	0	442,476	1,100,705	14.94%	1,425,406	19.35%	\$2.88	12,033	(113,823)	232,847	335,456
Irvine	263	24,885,409	155,000	786,000	3,980,315	15.99%	5,303,304	21.31%	\$3.00	83,338	(682,383)	755,884	1,453,164
Newport Beach	123	10,039,979	0	42,646	947,668	9.44%	1,310,754	13.06%	\$3.50	(16,779)	(79,577)	260,844	460,209
Santa Ana	15	2,451,993	0	0	458,045	18.68%	509,409	20.78%	\$2.58	17,551	7,578	138,757	168,837
<b>Airport Area Total</b>	<b>474</b>	<b>44,743,646</b>	<b>155,000</b>	<b>1,271,122</b>	<b>6,486,733</b>	<b>14.50%</b>	<b>8,548,873</b>	<b>19.11%</b>	<b>\$3.08</b>	<b>96,143</b>	<b>(868,205)</b>	<b>1,388,332</b>	<b>2,417,666</b>
<b>Central County</b>													
Anaheim	17	1,944,289	0	0	164,518	8.46%	306,979	15.79%	\$2.47	(18,055)	84,029	5,472	122,835
Orange	81	7,125,712	0	386,000	770,827	10.82%	1,296,305	18.19%	\$2.37	(142,064)	(159,709)	49,204	156,340
Santa Ana	166	12,629,718	0	911,765	1,272,707	10.08%	1,610,165	12.75%	\$2.21	14,419	(73,297)	199,868	331,258
Tustin	42	2,235,183	417,284	287,000	326,851	14.62%	367,486	16.44%	\$2.27	26,212	53,085	38,884	96,127
<b>Central County Total</b>	<b>306</b>	<b>23,934,902</b>	<b>417,284</b>	<b>1,584,765</b>	<b>2,534,903</b>	<b>10.59%</b>	<b>3,580,935</b>	<b>14.96%</b>	<b>\$2.25</b>	<b>(119,488)</b>	<b>(95,892)</b>	<b>293,428</b>	<b>706,560</b>
<b>North County</b>													
Anaheim Hills	83	5,948,769	0	0	433,087	7.28%	736,672	12.38%	\$2.55	(992)	(62,405)	90,108	115,286
Brea	41	4,040,355	0	0	316,875	7.84%	339,711	8.41%	\$2.48	42,889	40,663	85,808	127,033
Buena Park	17	1,114,233	0	0	129,957	11.66%	138,027	12.39%	\$2.10	(20,701)	17,778	2,354	68,631
Fullerton	29	2,378,201	0	0	184,563	7.76%	235,275	9.89%	\$1.87	(3,198)	(18,578)	10,479	32,188
La Habra	4	142,069	0	0	10,774	7.58%	11,104	7.82%	\$1.48	(4,689)	(8,907)	1,867	3,069
La Palma	10	712,038	0	0	45,002	6.32%	82,833	11.63%	\$1.95	155	1,728	5,944	16,717
Placentia	8	267,581	0	0	28,265	10.56%	33,952	12.69%	\$1.88	(5,248)	(8,330)	4,500	4,500
Yorba Linda	5	288,094	0	0	57,916	20.10%	57,916	20.10%	\$2.07	3,118	1,531	14,611	16,449
<b>North County Total</b>	<b>197</b>	<b>14,891,340</b>	<b>0</b>	<b>0</b>	<b>1,206,439</b>	<b>8.10%</b>	<b>1,635,490</b>	<b>10.98%</b>	<b>\$2.18</b>	<b>11,334</b>	<b>(36,520)</b>	<b>215,671</b>	<b>383,873</b>
<b>South County</b>													
Aliso Viejo	44	3,348,128	0	0	576,793	17.23%	1,007,785	30.10%	\$3.13	(13,174)	(26,332)	21,483	89,956
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	99,465	12.45%	116,776	14.62%	\$2.50	5,053	(22,494)	22,842	32,521
Irvine Spectrum	166	12,561,364	364,955	171,121	1,215,794	9.68%	1,637,591	13.04%	\$3.22	102,182	433,211	325,385	999,292
Laguna Beach	5	192,434	0	0	20,636	10.72%	19,836	10.31%	\$0.00	0	423	800	2,023
Laguna Hills	33	1,826,428	0	0	259,371	14.20%	315,169	17.26%	\$2.67	10,803	20,270	32,035	78,199
Laguna Niguel	10	1,749,768	0	0	71,940	4.11%	65,381	3.74%	\$0.00	(23,608)	(7,011)	1,173	18,469
Lake Forest	40	2,108,641	0	0	116,249	5.51%	149,100	7.07%	\$2.08	6,310	43,622	29,074	88,968
Mission Viejo	36	2,038,733	0	0	186,095	9.13%	242,085	11.87%	\$2.38	9,014	28,067	19,306	50,799
Rancho Santa Margarita	6	252,716	0	0	10,008	3.96%	18,752	7.42%	\$2.15	1,230	2,546	4,630	8,921
San Clemente	12	494,706	0	0	41,072	8.30%	48,879	9.88%	\$2.35	(1,700)	(13,102)	0	4,868
San Juan Capistrano	18	912,583	0	0	137,446	15.06%	144,868	15.87%	\$1.65	1,743	16,300	8,827	20,726
<b>South County Total</b>	<b>382</b>	<b>26,376,098</b>	<b>364,955</b>	<b>171,121</b>	<b>2,734,869</b>	<b>10.37%</b>	<b>3,766,222</b>	<b>14.28%</b>	<b>\$2.92</b>	<b>97,853</b>	<b>475,500</b>	<b>465,555</b>	<b>1,394,742</b>
<b>West County</b>													
Cypress	28	1,951,875	0	0	142,157	7.28%	190,097	9.74%	\$2.21	17,123	25,670	28,699	71,661
Fountain Valley	33	1,995,232	0	36,700	55,568	2.79%	58,890	2.95%	\$0.00	7,316	(2,694)	13,873	16,392
Garden Grove	20	1,567,219	0	0	27,943	1.78%	74,888	4.78%	\$1.84	(926)	7,497	5,089	17,773
Huntington Beach	43	2,505,214	0	0	185,590	7.41%	323,478	12.91%	\$2.40	(10,335)	(18,546)	35,356	59,956
Los Alamitos	12	661,516	0	0	179,919	27.20%	181,250	27.40%	\$2.75	8,925	9,651	16,392	23,380
Seal Beach	7	473,787	0	0	29,020	6.13%	40,035	8.45%	\$3.18	(16,108)	(3,945)	2,834	17,699
Stanton	4	143,361	0	0	17,138	11.95%	7,123	4.97%	\$1.25	(589)	149	10,015	15,784
Westminster	11	446,944	0	0	30,835	6.90%	25,203	5.64%	\$2.14	1,179	25,990	1,179	31,828
<b>West County Total</b>	<b>158</b>	<b>9,745,148</b>	<b>0</b>	<b>36,700</b>	<b>668,170</b>	<b>6.86%</b>	<b>900,964</b>	<b>9.25%</b>	<b>\$2.39</b>	<b>6,585</b>	<b>43,772</b>	<b>113,437</b>	<b>254,473</b>
<b>Orange County Total</b>	<b>1,517</b>	<b>119,691,134</b>	<b>937,239</b>	<b>3,063,708</b>	<b>13,631,114</b>	<b>11.39%</b>	<b>18,432,484</b>	<b>15.40%</b>	<b>\$2.67</b>	<b>92,427</b>	<b>(481,345)</b>	<b>2,476,423</b>	<b>5,157,314</b>
<b>Airport Area</b>													
Class A	133	26,170,614	0	786,000	4,385,795	16.76%	5,779,960	22.09%	\$3.31	(42,216)	(154,839)	888,987	1,493,109
Class B	315	17,312,950	155,000	485,122	2,044,908	11.81%	2,662,504	15.38%	\$2.62	148,234	(713,597)	487,339	900,721
Class C	26	1,260,082	0	0	56,030	4.45%	106,409	8.44%	\$2.38	(9,875)	231	12,006	23,836
<b>Central County</b>													
Class A	43	7,253,158	417,284	1,282,765	860,777	11.87%	1,288,323	17.76%	\$2.66	(191,534)	(244,560)	79,049	144,453
Class B	209	14,052,270	0	302,000	1,525,308	10.85%	2,114,891	15.05%	\$2.09	82,363	154,426	204,189	518,780
Class C	54	2,629,474	0	0	148,818	5.66%	177,721	6.76%	\$1.60	(10,317)	(5,758)	10,190	43,327
<b>North County</b>													
Class A	27	3,194,489	0	0	355,757	11.14%	395,818	12.39%	\$2.39	73,037	20,843	81,517	111,783
Class B	147	10,803,519	0	0	834,335	7.72%	1,221,540	11.31%	\$2.10	(58,773)	(48,517)	132,434	268,628
Class C	23	893,332	0	0	16,347	1.83%	18,132	2.03%	\$1.81	(2,930)	(8,846)	1,720	3,462
<b>South County</b>													
Class A	69	9,440,072	364,955	0	1,199,254	12.70%	1,569,313	16.62%	\$3.17	(30,014)	483,432	101,604	750,640
Class B	302	16,416,873	0	171,121	1,525,190	9.29%	2,187,954	13.33%	\$2.62	99,198	(32,631)	331,194	609,746
Class C	11	519,153	0	0	10,425	2.01%	8,955	1.72%	\$1.80	28,669	24,699	32,757	34,356
<b>West County</b>													
Class A	19	2,175,151	0	0	149,775	6.89%	269,471	12.39%	\$2.92	(11,821)	(5,403)	19,302	36,607
Class B	121	6,856,544	0	36,700	357,394	5.21%	476,604	6.95%	\$2.49	18,261	47,362	85,263	206,826
Class C	18	713,453	0	0	161,001	22.57%	154,889	21.71%	\$2.33	145	1,813	8,872	11,040
<b>Orange County</b>													
Class A	291	48,233,484	782,239	2,068,765	6,951,358	14.41%	9,302,885	19.29%	\$3.06	(202,548)	99,473	1,170,459	2,536,592
Class B	1,094	65,442,156	155,000	994,943	6,287,135	9.61%	8,663,493	13.24%	\$2.32	289,283	(592,957)	1,240,419	2,504,701
Class C	132	6,015,494	0	0	392,621	6.53%	466,106	7.75%	\$1.80	5,692	12,139	65,545	116,021
<b>Orange County Total</b>	<b>1,517</b>	<b>119,691,134</b>	<b>937,239</b>	<b>3,063,708</b>	<b>13,631,114</b>	<b>11.39%</b>	<b>18,432,484</b>	<b>15.40%</b>	<b>\$2.67</b>	<b>92,427</b>	<b>(481,345)</b>	<b>2,476,423</b>	<b>5,157,314</b>

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.

Strong. Creative. Diverse.

by The Harrington Group



**Carter E. Harrington**  
VICE PRESIDENT / PARTNER  
IRVINE  
949.263.5396  
charrington@voitco.com  
Lic. #01762924



**Josh Samuels**  
ASSOCIATE  
IRVINE  
949.263.5330  
jsamuels@voitco.com  
Lic. #02034678

The Orange County office market continues to show strength as we quickly approach the benchmark for the longest economic recovery in history. Strong market fundamentals and a diverse tenant base make Orange County one of the nation’s most attractive destinations for investors, developers, and businesses. Expect to see rents continue to climb as older buildings get brought back to life and office owners find creative ways to offer their tenants more amenities. Absorption took a slight negative turn in 2Q, which can be attributed to the influx of new product delivered in the last two quarters along with the finishing touches being put on local redevelopment.

Regarding redevelopment, the next few quarters will see a surge of new and revitalized creative projects hitting the market. Lincoln Property Company marches forward with Flight in Tustin and prepares to break ground on the Culture /Yard in Costa Mesa, while Equity Office Properties finalizes its 24-acre creative campus in Irvine, VKCC. In addition, the 150,000 SF creative project at 2722 Michelson was recently leased in its entirety to Oculus VR founder Palmer Luckey and presumably his new venture Andruil. Some other repositions to keep an eye on are the recent acquisitions of Orange County Business Center in Santa Ana and Corporate Pointe in Irvine by Greenlaw Partners and Keleman Caamano, respectively.

In addition to the substantial amount of creative product recently delivered or on the way, we have seen a steady stream of Class A buildings county-wide take on new capital improvements. High-rise owners from Anaheim to Santa Ana to Laguna Hills and everything in between have rethought their approach to attracting tenants and have invested heavily in new amenities for their assets. With a large portion of Equity Office Properties’ Orange County portfolio on the market, and a number of other Class A buildings expected to trade in the near future, we can expect more of the same.

The market is strong by many measures, and it looks to continue that momentum in the foreseeable future. There are, however, uncertainties both politically and economically that have people proceeding cautiously. The hot topics of discussion are the rising cost of capital and the emerging threat of a global trade war and its effect on construction costs. While a global trade war is real cause for concern worth keeping a close eye on, the Federal Reserve has recently raised interest rates twice and expects to do so two more times before year’s end. However, even with said increases, interest rates remain at historical lows and the market is still flush with both foreign and domestic capital continually driving sales prices county-wide to new heights.

Please Contact Us  
for Further Information

**Tony Tran**  
Regional Director of Research  
ttran@voitco.com

Anaheim, CA 714.978.7880	Carlsbad, CA 760.517.4000	Inland Empire, CA 909.545.8000	Irvine, CA 949.851.5100	Los Angeles, CA 424.329.7500	San Diego, CA 858.453.0505
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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