

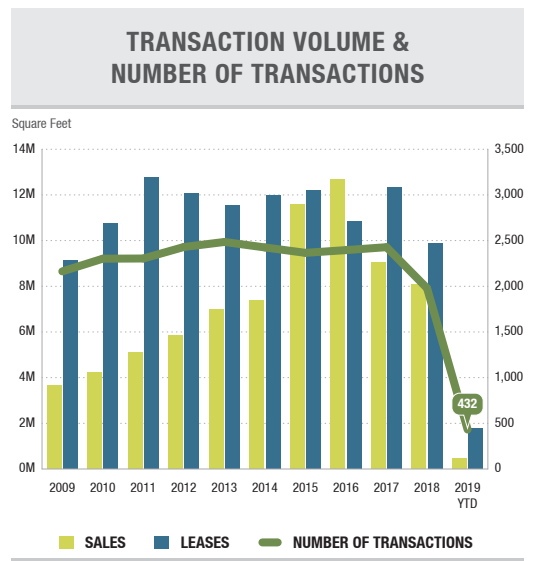
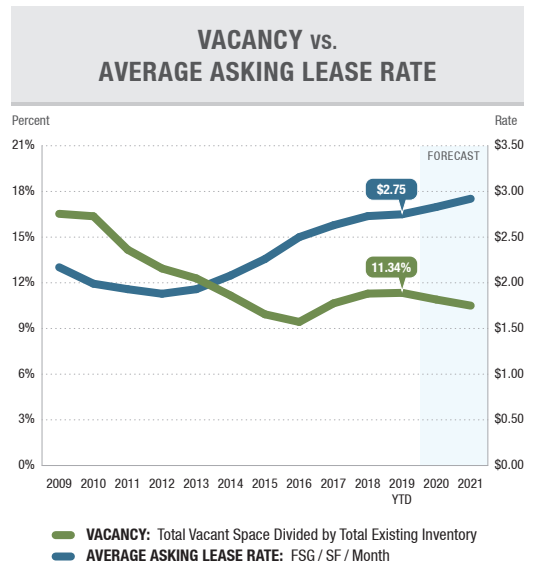
MARKET OVERVIEW. The Orange County office market rally is extending into 2019. Rent growth has slowed but remains positive, and occupancy levels are elevated. Institutional investors continue to target Orange County, regularly trading trophy properties and office campuses. Landlords have reason to be optimistic, with strong tenant demand across the market and creative space in renovated and newly constructed properties providing leasing flexibility. While vacancy remains below the highs observed in Orange County in the past 4 years, it has slowly been on the rise. With little speculative construction in the pipeline, availability rates remain on a downward trend. All of this suggests that the market will remain tight, with rents continuing to rise into 2019–20 if the U.S. economy can keep out of recession.

VACANCY. Occupancy is being driven by changing consumer preferences. Tenants have reduced their physical footprint despite having a greater number of employees. Net absorption has picked up after a sluggish start to the year, helping to mitigate supply pressures. Vacancy in the Orange County office market was 11.34% at the end of the first quarter of 2019, up 5 basis points from the prior quarter, and up 2.62% compared with the previous year. Expect vacancy to trend downward throughout 2019, based on steady job growth and consumer confidence, coupled with many tenants in the market currently shopping for space.

LEASE RATES. With vacancies holding near the 10-year average of 12% so far during 2019, rent gains have grown modestly in recent months. The average asking full-service gross (FSG) lease rate per month per square foot in the Orange County office market was \$2.75 at the end of the first quarter, a 3.77% increase from this time last year and a \$0.02 increase from the fourth quarter of 2018. Should the national economy fall into recession, office rents will likely fall less than other major markets.

TRANSACTION ACTIVITY. In the first quarter of 2019, 2.22 million square feet in total transactions (sale and lease) were recorded, down from 5.40 million square feet the previous quarter. The rising cost of leasing office space has led tenants to consider co-working spaces, particularly for satellite locations. With this trend continuing to grow, in more and more cases, communal offices are competing with traditional commercial office space for the same tenants. So far in 2019, five co-working firms have leased a combined 267,521 square feet.

ECONOMY. The unemployment rate in Orange County was 3.0% in February of 2019, down from a revised 3.3% in January of 2019, and below the year-ago estimate of 3.1%. This compares with an unadjusted unemployment rate of 4.4% for California and 4.1% for the nation during the same period. Between January and February of 2019, total nonfarm employment increased from 1,642,700 to 1,650,300, an increase of 7,600 jobs. Professional and business services added 3,500 jobs, with 74% of the growth in administrative and support services (up 2,600 jobs), which included temporary help firms.



Market Statistics

	Change Over Last Quarter	1Q 2019	4Q 2018	1Q 2018	% Change Over Last Year
Vacancy Rate	▲ UP	11.34%	11.29%	11.05%	2.62%
Availability Rate	▲ UP	15.00%	14.77%	14.83%	1.15%
Average Asking Lease Rate	▲ UP	\$2.75	\$2.73	\$2.65	3.77%
Sale & Lease Transactions	▼ DOWN	2,224,929	5,404,143	3,980,360	(44.10%)
Gross Absorption	▼ DOWN	2,423,515	2,835,757	3,098,444	(21.78%)
Net Absorption	▲ POSITIVE	339,045	472,039	(45,302)	N/A

OVERALL. Although uncertainties remain within the Orange County office market, tenants and landlords have been able to remain optimistic. Co-working is a separate office space market segment that has developed rapidly over the past couple of years in Orange County. The growth rate of the flexible or creative office space and its impact cannot be ignored. However, in 2019, we are keeping one eye on the macroeconomic cycle with the expectation that another recession isn't a matter of if, but a matter of when—and how severe. Also, we are basically at full employment so absorption will most likely be muted in the foreseeable future.

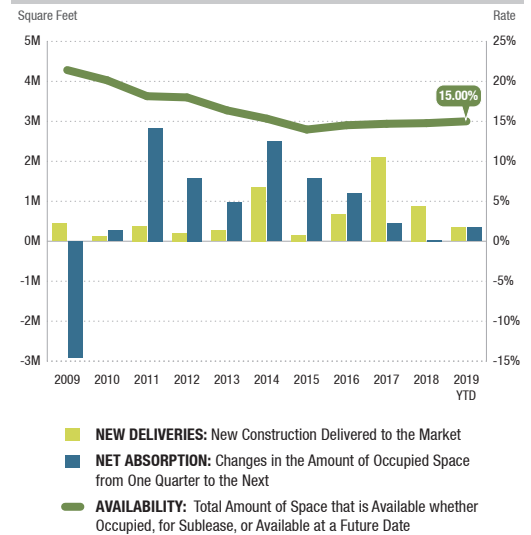
LEASE RATES. Despite slightly elevated vacancies due to new supply, rent growth continues its upward trend. Expect lease rates to continue to climb 3–4% annualized growth in the coming year.

VACANCY. Demand is solid, lease rates have increased, and unemployment is down. This foundation of strong economic fundamentals has contributed to the strengthening of the Orange County economy. We expect more of the same in 2019, with anticipated vacancy rates in the 10–11% range over the next three quarters.

CONSTRUCTION. The construction pipeline remains slow and steady, continuing the trend of minimal development. Since the first quarter of 2018, supply additions have averaged around 240,000 square feet per quarter. Total space under construction checked in at 1,377,860 square feet at the end of the first quarter with the most notable from Lincoln Property's Flight @ Tustin Legacy, a spec project that is expected to start delivering any day now. In Irvine, creative office conversions will compete directly with ground-up development. In Costa Mesa, work is underway on The Press, a planned conversion of the former Los Angeles Times printing plant into more than 300,000 square feet of creative office space. In Irvine, Spectrum Terrace, a 1.1 million square foot ultra-modern office campus nestled on 73 acres of open space in the heart of SoCal's innovation hub is slated to deliver phase 1 mid-year.

ABSORPTION. Absorption gains are being created by co-working operators, and by tenants moving in Orange County, with net absorption at 339,045 square feet, which totals approximately 11 million square feet of positive net absorption since 2010. Strong market fundamentals and leasing momentum carried from the end of last year into the first quarter. Class B office contributed the highest positive net absorption, with 203,512 square feet absorbed in the first quarter. Class A had a positive net absorption of 141,925 square feet, and Class C finished the first quarter with 6,392 square feet of negative net absorption.

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Significant Transactions

Sales

Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
5515 E. La Palma Ave.	Anaheim	B	155,880	\$40,648,000	Klein Investments Family, LP	Hines
765 The City Dr. S.	Orange	B	99,835	\$18,727,500	Angelo, Gordon & Co.	The CC
3350 E. Birch St.	Brea	B	70,618	\$14,000,000	Alamitos Associates	Dmiri Novkiov
2 Corporate Park	Irvine	B	43,373	\$13,601,000	2 Corporate Park, LLC	Nikken, Inc.
23041 Avenida de la Carlota	Laguna Hills	B	67,588	\$13,013,000	Angelo, Gordon & Co.	The CC

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
3131 Katella Ave.	Los Alamitos	B	150,342	Mar-2019	Epson	Lincoln Property Company
3161 Michelson Dr. – Renewal	Irvine	A	97,621	Jan-2019	Hyundai Motor Finance Company	Manulife US Real Estate
520 California Ave.	Irvine	B	84,380	Jan-2019	UCI Applied Innovation	The Irvine Company
2211 Michelson Dr.	Irvine	A	71,076	Jan-2019	WeWork	Kilroy Realty, LP
3349 Michelson Dr.	Irvine	A	60,400	Mar-2019	Hana	LBA Realty

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 1Q2019	Square Feet Available	Availability Rate 1Q2019	Average Asking Lease Rate	Net Absorption 1Q2019	Net Absorption 2019	Gross Absorption 1Q2019	Gross Absorption 2019
Airport Area													
Costa Mesa	73	7,376,629	432,495	459,971	1,042,426	14.13%	1,303,639	17.67%	\$2.90	43,981	43,981	158,038	158,038
Irvine	263	24,844,792	0	1,007,305	3,503,612	14.10%	4,422,163	17.80%	\$3.01	137,245	137,245	963,606	963,606
Newport Beach	121	10,002,626	0	42,646	905,112	9.05%	1,193,830	11.94%	\$3.25	(14,960)	(14,960)	182,452	182,452
Santa Ana	15	2,429,284	0	0	286,107	11.78%	405,221	16.68%	\$2.66	(41,254)	(41,254)	48,265	48,265
Tustin	0	0	417,609	287,000	0	0.00%	0	0.00%	\$0.00	0	0	0	0
Airport Area Total	472	44,653,331	850,104	1,796,922	5,737,257	12.85%	7,324,853	16.40%	\$3.07	125,012	125,012	1,352,361	1,352,361
Central County													
Anaheim	21	1,947,056	0	0	284,075	14.59%	615,682	31.62%	\$2.76	22,811	22,811	55,970	55,970
Orange	80	7,130,266	0	386,000	808,176	11.33%	1,097,986	15.40%	\$2.64	(29,137)	(29,137)	65,326	65,326
Santa Ana	165	12,367,905	0	940,325	1,611,239	13.03%	1,838,174	14.86%	\$2.25	(191,259)	(191,259)	153,454	153,454
Tustin	43	2,325,377	0	0	334,646	14.39%	297,170	12.78%	\$2.36	666	666	24,266	24,266
Central County Total	309	23,770,604	0	1,326,325	3,038,136	12.78%	3,849,012	16.19%	\$2.35	(196,919)	(196,919)	299,016	299,016
North County													
Anaheim Hills	83	5,944,729	0	0	405,892	6.83%	555,614	9.35%	\$2.06	108,677	108,677	128,861	128,861
Brea	42	4,078,742	0	0	211,581	5.19%	451,667	11.07%	\$2.47	8,414	8,414	39,768	39,768
Buena Park	17	1,114,233	0	0	115,407	10.36%	125,100	11.23%	\$2.19	(281)	(281)	21,039	21,039
Fullerton	29	2,356,737	0	0	166,862	7.08%	180,315	7.65%	\$2.59	2,309	2,309	14,779	14,779
La Habra	5	193,186	0	0	12,129	6.28%	13,361	6.92%	\$1.60	(3,667)	(3,667)	450	450
La Palma	10	712,038	0	0	55,841	7.84%	63,471	8.91%	\$2.48	14,260	14,260	24,186	24,186
Placentia	8	267,581	0	0	23,196	8.67%	22,667	8.47%	\$1.87	2,395	2,395	3,818	3,818
Yorba Linda	5	288,195	0	0	91,494	31.75%	89,616	31.10%	\$2.14	(37,474)	(37,474)	3,995	3,995
North County Total	199	14,955,441	0	0	1,082,402	7.24%	1,501,811	10.04%	\$2.27	94,633	94,633	236,896	236,896
South County													
Aliso Viejo	44	3,349,461	0	0	638,648	19.07%	745,857	22.27%	\$3.10	67,191	67,191	114,271	114,271
Dana Point	2	91,876	0	0	0	0.00%	0	0.00%	\$0.00	0	0	0	0
Foothill Ranch	10	802,939	0	0	91,811	11.43%	110,609	13.78%	\$2.65	(31,345)	(31,345)	4,992	4,992
Irvine Spectrum	171	13,080,849	527,756	0	1,664,248	12.72%	2,068,097	15.81%	\$3.11	296,322	296,322	239,109	239,109
Laguna Beach	5	192,434	0	0	10,119	5.26%	10,119	5.26%	\$2.61	(117)	(117)	1,383	1,383
Laguna Hills	33	1,824,745	0	0	276,743	15.17%	408,869	22.41%	\$2.84	(24,232)	(24,232)	36,756	36,756
Laguna Niguel	10	1,749,768	0	0	76,291	4.36%	79,305	4.53%	\$3.30	(2,523)	(2,523)	8,957	8,957
Lake Forest	40	2,108,778	0	0	116,090	5.51%	349,382	16.57%	\$2.26	(1,148)	(1,148)	21,175	21,175
Mission Viejo	36	1,917,148	0	0	128,956	6.73%	302,936	15.80%	\$2.70	(3,245)	(3,245)	22,507	22,507
Rancho Santa Margarita	6	252,716	0	0	20,657	8.17%	31,833	12.60%	\$2.22	(6,129)	(6,129)	0	0
San Clemente	12	496,782	0	0	82,454	16.60%	92,838	18.69%	\$2.38	(1,182)	(1,182)	5,435	5,435
San Juan Capistrano	19	950,679	0	0	7,557	0.79%	52,209	5.49%	\$2.45	(3,675)	(3,675)	0	0
South County Total	388	26,818,175	527,756	0	3,113,574	11.61%	4,252,054	15.86%	\$2.92	289,917	289,917	454,585	454,585
West County													
Cypress	28	1,951,757	0	0	129,691	6.64%	342,881	17.57%	\$2.28	33,365	33,365	3,683	3,683
Fountain Valley	34	2,051,524	0	0	55,990	2.73%	128,885	6.28%	\$1.68	(11,448)	(11,448)	1,139	1,139
Garden Grove	20	1,567,219	0	0	34,544	2.20%	47,622	3.04%	\$1.98	4,086	4,086	5,743	5,743
Huntington Beach	43	2,512,419	0	0	186,027	7.40%	324,962	12.93%	\$2.65	(19,902)	(19,902)	38,472	38,472
Los Alamitos	12	661,970	0	0	182,160	27.52%	180,699	27.30%	\$2.65	(1,491)	(1,491)	2,064	2,064
Seal Beach	7	473,787	0	0	30,013	6.33%	31,857	6.72%	\$3.33	13,944	13,944	15,652	15,652
Stanton	4	143,361	0	0	9,789	6.83%	12,991	9.06%	\$1.25	6,017	6,017	10,431	10,431
Westminster	11	445,584	0	0	10,552	2.37%	8,017	1.80%	\$2.32	1,831	1,831	3,473	3,473
West County Total	159	9,807,621	0	0	638,766	6.51%	1,077,914	10.99%	\$2.46	26,402	26,402	80,657	80,657
Orange County Total	1,527	120,005,172	1,377,860	3,123,247	13,610,135	11.34%	18,005,644	15.00%	\$2.75	339,045	339,045	2,423,515	2,423,515
Airport Area													
Class A	139	26,525,874	417,609	1,082,305	3,845,440	14.50%	4,703,256	17.73%	\$3.30	98,823	98,823	710,456	710,456
Class B	310	17,182,921	432,495	714,617	1,845,076	10.74%	2,499,922	14.55%	\$2.69	11,299	11,299	627,015	627,015
Class C	23	944,536	0	0	46,741	4.95%	121,675	12.88%	\$2.33	14,890	14,890	14,890	14,890
Central County													
Class A	43	7,246,707	0	1,236,325	1,130,987	15.61%	1,391,640	19.20%	\$2.80	(90,468)	(90,468)	67,498	67,498
Class B	215	14,230,835	0	90,000	1,727,077	12.14%	2,266,303	15.93%	\$2.19	(86,851)	(86,851)	197,556	197,556
Class C	51	2,293,062	0	0	180,072	7.85%	191,069	8.33%	\$1.81	(19,600)	(19,600)	33,962	33,962
North County													
Class A	27	3,196,654	0	0	226,710	7.09%	308,591	9.65%	\$2.54	27,050	27,050	62,580	62,580
Class B	149	10,865,455	0	0	844,935	7.78%	1,176,454	10.83%	\$2.17	67,214	67,214	172,821	172,821
Class C	23	893,332	0	0	10,757	1.20%	16,766	1.88%	\$0.00	369	369	1,495	1,495
South County													
Class A	77	10,024,753	457,788	0	1,645,613	16.42%	2,087,590	20.82%	\$3.19	123,535	123,535	189,493	189,493
Class B	300	16,274,269	69,968	0	1,458,048	8.96%	2,154,551	13.24%	\$2.65	165,791	165,791	262,098	262,098
Class C	11	519,153	0	0	9,913	1.91%	9,913	1.91%	\$1.80	591	591	2,994	2,994
West County													
Class A	19	2,181,615	0	0	137,150	6.29%	407,587	18.68%	\$2.70	(17,015)	(17,015)	21,824	21,824
Class B	123	7,028,567	0	0	494,453	7.03%	663,164	9.44%	\$0.00	46,059	46,059	58,083	58,083
Class C	17	597,439	0	0	7,163	1.20%	7,163	1.20%	\$2.46	(2,642)	(2,642)	750	750
Orange County													
Class A	305	49,175,603	875,397	2,318,630	6,985,900	14.21%	8,898,664	18.10%	\$3.12	141,925	141,925	1,051,851	1,051,851
Class B	1,097	65,582,047	502,463	804,617	6,369,589	9.71%	8,760,394	13.36%	\$2.42	203,512	203,512	1,317,573	1,317,573
Class C	125	5,247,522	0	0	254,646	4.85%	346,586	6.60%	\$1.86	(6,392)	(6,392)	54,091	54,091
Orange County Total	1,527	120,005,172	1,377,860	3,123,247	13,610,135	11.34%	18,005,644	15.00%	\$2.75	339,045	339,045	2,423,515	2,423,515

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.



There's Really Nothing Much to Worry About

by **Stefan Rogers**

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The Orange County Office Market still offers opportunities on all sides. Capital costs remain low, fueling steady institutional demand for office buildings, even amid record high pricing and fewer value-add opportunities. Speculative development remains steady, with numerous adaptive reuse projects like The Press in Costa Mesa. Landlords continue driving up rents wherever possible; however, tenant retention remains steady due to onsite enhancement of amenities / services and flexible workspaces. Tenants can still strike great deals with an intelligent and creative approach to leasing. And lease expirations offer the perfect opportunity for businesses to realign their workspace with their rapidly changing needs and embrace current office space trends focused on people-recruitment, retention, and productivity. Owner / occupiers are well situated to execute sale / leasebacks as a convenient and untraditional way of raising capital or “cashing out” at a profit. Or tenants may still be able to buy a building, if they can find one, with very affordable SBA programs and relatively low pricing when compared to current leasing rates.

Rental growth slowed marginally in the first quarter, trending with the nominal increase in vacancy, although it is too early to tell if this indicates a permanent shift. The average asking full service gross office rent was \$2.79 per square foot per month in the first quarter of 2019, a nominal increase over the fourth quarter of 2018, furthering the slow and steady rental growth we've been enjoying. While this would indicate we're perhaps reaching the top of the bell curve, the continuing tight supply, coupled with steady tenant demand from small businesses and co-working, and historically cheap debt, is likely to sustain further growth through 2019.

It would be reasonable to expect a muted recession/office market slowdown within a couple of years, with all the political turmoil and some recently shaky economic indicators, including the recently inverted yield curve, the “hands-off” Fed, and our simmering trade war with China. However, short-term economic fundamentals remain strong in most areas, and most commercial real estate players remain bullish about the sector.

The economy is strong. The office market is strong (for now). While no one knows for sure, it could certainly continue. There's nothing wrong with “slow and steady!”

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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