

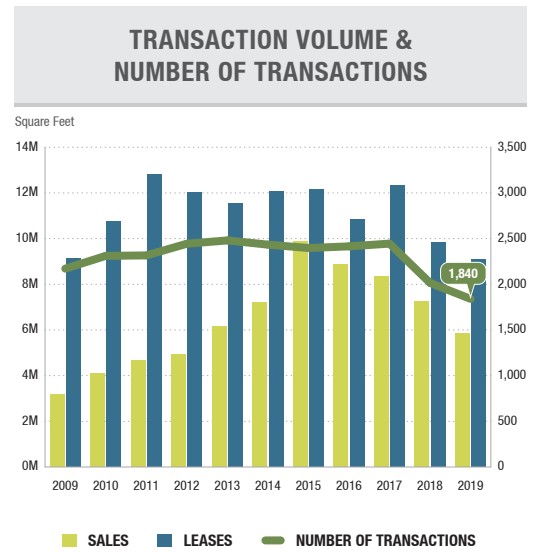
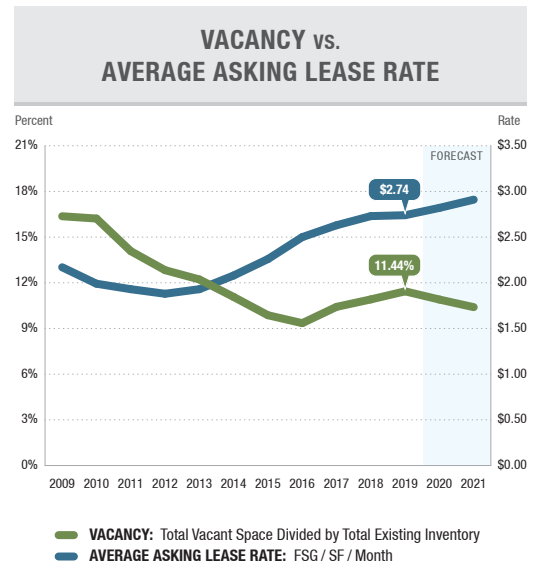
MARKET OVERVIEW. The Orange County office market has stabilized into a relatively strong and stable position. Vacancy remains manageable, but has ticked up slightly in the past year. Technology, Financial Services, and Health Services firms have driven a significant amount of recent leasing activity. However, expanding companies are leveraging new workplace technologies to save money by increasing the number of employees for each square foot of space they lease, and that has had an impact on overall absorption and transaction velocity. Tenants in Class A and B buildings who leased space early in the recovery cycle are getting sticker shock at renewal time, as rent growth, which has moderated in recent quarters, is up substantially over the past 5 years. To mitigate higher per square foot occupancy costs, many tenants are moving down in building class and taking less space by switching to more open workspace designs. The market has seen modest levels of supply additions in recent years compared with previous development cycles, but several of the Class A projects delivered over the past two years are leasing up more slowly than expected. Net absorption, though still in positive territory, has been softening over the past several years. Capital market conditions remain solid, and while sales volume is down from its record level back in 2016 and 2017, it remains robust. Cap rates remain at or near historical lows, especially for high quality Class A and B assets.

VACANCY. Nearly 1.39 MSF of space has been delivered since first quarter 2019, expanding the office base by 1.2%. This has contributed to the uptick in overall vacancy. Direct/sublease space (unoccupied) finished the quarter at 11.44%, up 48 basis point year-over-year. North Orange County posted the lowest vacancy rate at 7.17%, while the Airport Area and Central County had vacancy rates greater than 12% at the end of fourth quarter. Higher vacancy in the Airport Area is mainly due to its concentration of new deliveries still in the initial lease-up phase.

LEASE RATES. Rent growth in Orange County leveled off in 2019. The average asking lease rate in Orange County rose by just 0.37% over the past year compared with 1.7% nationwide. The average asking FSG monthly asking lease rate lost \$0.09 in the fourth quarter, ending the period at \$2.74. The average quoted rental rate for Class A space was \$3.10 per square foot, compared with the Class B asking rate of \$2.47 per square foot.

TRANSACTION ACTIVITY. Slow growth in the region's labor force has resulted in hiring challenges for many firms, and that may be impacting transaction velocity. Orange County's labor market remains historically tight, with the unemployment rate holding at 2.5%. The total square feet leased and sold in the fourth quarter was approximately 3.4 MSF, a significant slowdown from the 5.0 MSF of transactions in the fourth quarter of 2018. Downsizing into more open workspace to increase headcount and appeal to younger workers is also a factor.

EMPLOYMENT. The unemployment rate in the Orange County market was 2.5% in November 2019, unchanged from a revised 2.5% in October, and below the year-ago estimate of 2.7%. This compares with an unadjusted unemployment rate of 3.7% for California and 3.3% for the nation during the same period. Local job growth was evident across all subsectors but financial services (up 1,200 jobs) and Government (up 2,200 jobs) led the way as the year ended.



Market Statistics

	Change Over Last Quarter	4Q 2019	3Q 2019	4Q 2018	% Change Over Last Year
Vacancy Rate	▲ UP	11.44%	11.23%	10.96%	4.38%
Availability Rate	▲ UP	14.26%	14.11%	14.54%	(1.93%)
Average Asking Lease Rate	▼ DOWN	\$2.74	\$2.83	\$2.73	0.37%
Sale & Lease Transactions	▼ DOWN	3,409,896	3,893,846	5,056,355	(32.56%)
Gross Absorption	▼ DOWN	2,156,670	2,531,544	2,954,996	(27.02%)
Net Absorption	▲ POSITIVE	167,558	(104,063)	540,459	N/A

OVERALL. Signs of a global economic slowdown, concerns over US-China trade relations and a decline in the US GDP growth rate motivated the Fed to cut its benchmark Federal Funds Rate 3 times in 2019. That effort to stimulate consumer spending and business investment seems to be working. Equity markets responded by rising to new highs and the spread between short- and long-term US Treasuries widened again after a dangerous inversion earlier in the year. The latest estimates for domestic GDP growth for 2020 are running in the low 2% range, which should be enough to keep the current economic recovery on track.

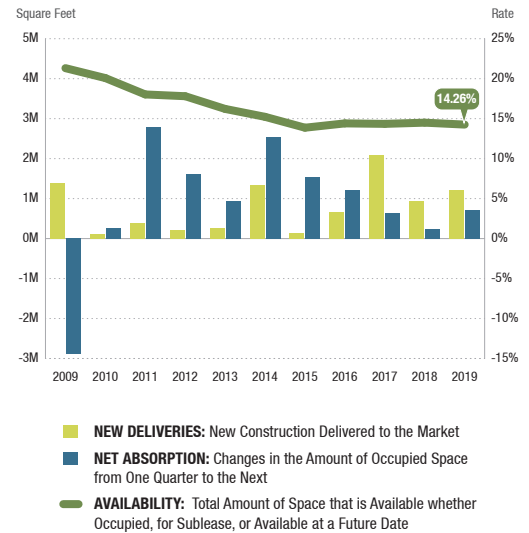
LEASE RATES. Rent growth may pick up again as the absorption of the remaining first generation space gets leased up. With fewer attractive alternatives in the market, rent growth should return to an annualized rate of 2–3% over the course of the year.

VACANCY. We anticipate that the overall vacancy rate will remain in the 11–12% range over the next three quarters, but the Class A sector will run somewhat higher due to its higher concentration of first generation space.

CONSTRUCTION. Total space under construction ended the year at 795,177 square feet. In Costa Mesa, construction is underway at The Press located at 1375 Sunflower Drive. This former L.A. Times printing facility is being converted into more than 300,000 square feet of creative office space to accommodate the shift in demand from businesses looking to recruit and retain a younger workforce. The Source, located in the Irvine Spectrum, offers a two-building concept with common atrium connectivity and more than 70,000 total square feet of rentable space. Irvine Company’s build-to-suit for Alteryx Inc. at Spectrum Terrace 2 is also in the works. The company will occupy the bulk of the project’s 340,000 square foot second phase. The first phase is fully leased.

ABSORPTION. Co-working tenants like WeWork have leased millions of square over the past few years and the current slowdown in that sector is partly responsible for the recent decline in new transaction velocity. Orange County office occupancy grew by 167,588 square feet in the final quarter, bringing the year-to-date gain in occupied space up to 707,160 square feet. The Airport Area submarket accounted for 260,089 square feet of that total. By product type, Class A office led the way with a net gain of 314,790 square feet in just the fourth quarter. Notable transactions included: Avanir Pharmaceuticals (103,879 square feet in Aliso Viejo), County of Orange Assessor (69,151 square feet in Orange), and WeWork (71,076 square feet in Irvine).

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Significant Transactions

Sales

* Voit Real Estate Services Deal

Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
2211 Michelson Dr.	Irvine	A	271,556	\$116,000,000	Greenlaw Partners	Kilroy Realty Corporation
2955–2995 Red Hill Ave.	Costa Mesa	B	229,093	\$72,000,000	SteelWave, Inc.	The Blackstone Group L.P.
4–5 Polaris Way	Aliso Viejo	A	169,332	\$70,800,000	Boyd Watterson Asset Management	Fortress Investment Group, LLC
28202 Cabot Rd.	Laguna Niguel	A	175,268	\$46,950,000	Harbor Associates, LLC	The Blackstone Group, L.P.
14101 Myford Rd.	Tustin	B	66,818	\$36,200,000	Easterly Government Properties, Inc.	Stockbridge Capital Group, LLC

Leases

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
17100–17200 Laguna Canyon Rd.	Irvine Spectrum	A	182,387	Oct-2019	Alteryx	The Irvine Company
17500 Laguna Canyon Rd.	Irvine Spectrum	A	114,875	Oct-2019	TGS	The Irvine Company
15370 Barranca Pky.	Irvine Spectrum	B	47,039	Oct-2019	Sensormatic Electronics	Lakeview Business Center, LLC
27 Technology Dr.	Irvine Spectrum	B	45,362	Oct-2019	Biosence Webster	The Irvine Company
17877 Von Karman Ave.	Irvine	A	34,840	Oct-2019	Westcliff	Hines

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 4Q2019	Square Feet Available	Availability Rate 4Q2019	Average Asking Lease Rate	Net Absorption 4Q2019	Net Absorption 2019	Gross Absorption 4Q2019	Gross Absorption 2019
Airport Area													
Costa Mesa	72	7,338,261	380,856	27,476	939,277	12.80%	1,325,262	18.06%	\$2.62	76,943	7,396	148,994	780,506
Irvine	264	24,951,622	0	684,457	3,020,991	12.11%	3,710,009	14.87%	\$2.75	76,641	650,047	648,321	3,073,412
Newport Beach	120	9,955,526	0	0	744,980	7.48%	1,171,780	11.77%	\$3.27	179,308	170,860	248,046	743,682
Santa Ana	15	2,460,616	0	0	359,435	14.61%	507,332	20.62%	\$2.70	(42,539)	(141,562)	12,040	161,874
Tustin	4	417,609	0	0	396,513	94.95%	310,934	74.46%	\$0.00	(30,264)	(30,264)	0	46,444
Airport Area Total	475	45,123,634	380,856	711,933	5,461,196	12.10%	7,025,317	15.57%	\$2.92	260,089	656,477	1,057,401	4,805,918
Central County													
Anaheim	21	1,947,937	0	0	289,784	14.88%	438,025	22.49%	\$2.82	15,957	(52,265)	29,835	233,800
Orange	80	7,094,945	0	0	864,615	12.19%	1,122,101	15.82%	\$2.41	(44,429)	(89,030)	157,812	388,061
Santa Ana	164	12,591,746	0	1,322,180	1,587,045	12.60%	1,931,366	15.34%	\$2.38	(17,499)	(159,002)	147,802	604,535
Tustin	44	2,392,415	0	180,000	153,359	6.41%	267,650	11.19%	\$2.15	(4,350)	35,072	98,204	410,842
Central County Total	309	24,027,043	0	1,502,180	2,894,803	12.05%	3,759,142	15.65%	\$2.46	(50,321)	(265,225)	433,653	1,637,238
North County													
Anaheim Hills	82	5,936,132	0	0	402,727	6.78%	481,235	8.11%	\$2.14	(13,650)	94,212	23,595	293,213
Brea	42	4,085,855	0	0	247,753	6.06%	396,460	9.70%	\$2.45	(19,243)	(29,350)	28,265	181,252
Buena Park	17	1,114,233	0	0	103,306	9.27%	110,754	9.94%	\$2.23	(6,423)	8,182	5,942	52,608
Fullerton	29	2,356,737	0	0	141,242	5.99%	161,183	6.84%	\$2.13	3,511	14,681	14,404	83,988
La Habra	5	193,850	0	0	4,418	2.28%	4,418	2.28%	\$1.73	1,915	3,342	4,134	15,001
La Palma	10	712,038	0	0	77,204	10.84%	84,159	11.82%	\$1.95	139	(1,832)	148	35,978
Placentia	8	267,581	0	0	36,637	13.69%	37,295	13.94%	\$1.99	(17,880)	(10,472)	900	21,579
Yorba Linda	5	289,383	0	0	59,162	20.44%	59,162	20.44%	\$2.25	1,997	(27,942)	1,997	14,732
North County Total	198	14,955,809	0	0	1,072,449	7.17%	1,334,666	8.92%	\$2.26	(49,634)	50,821	79,385	698,351
South County													
Aliso Viejo	44	3,346,886	0	0	670,287	20.03%	843,752	25.21%	\$3.19	26,056	114,610	20,085	483,509
Dana Point	2	91,876	0	0	1,280	1.39%	1,280	1.39%	\$0.00	0	(1,280)	0	0
Foothill Ranch	10	806,438	0	0	99,014	12.28%	119,836	14.86%	\$2.70	(6,920)	(50,699)	2,027	18,051
Irvine Spectrum	176	13,595,988	414,321	232,522	2,075,252	15.26%	2,262,029	16.64%	\$3.74	89,515	410,605	322,311	1,152,367
Laguna Beach	5	192,434	0	0	13,433	6.98%	24,906	12.94%	\$0.00	(7)	(3,431)	0	1,383
Laguna Hills	33	1,819,631	0	0	228,699	12.57%	344,420	18.93%	\$2.93	(3,393)	19,645	20,612	167,573
Laguna Niguel	10	1,751,348	0	0	69,576	3.97%	82,521	4.71%	\$0.00	1,787	(346)	6,785	30,799
Lake Forest	40	2,115,071	0	0	185,930	8.79%	274,389	12.97%	\$2.30	(81,244)	(81,208)	7,489	67,629
Mission Viejo	37	2,032,775	0	0	337,637	16.61%	303,409	14.93%	\$2.39	57,396	(114,814)	97,348	177,977
Rancho Santa Margarita	6	252,716	0	0	16,371	6.48%	22,163	8.77%	\$2.18	4,919	(1,843)	6,246	19,840
San Clemente	12	498,507	0	0	47,097	9.45%	47,310	9.49%	\$2.40	23,245	26,166	37,778	80,947
San Juan Capistrano	20	971,914	0	0	15,986	1.64%	63,061	6.49%	\$2.29	(6,674)	(12,104)	1,610	8,386
South County Total	395	27,475,584	414,321	232,522	3,760,562	13.69%	4,389,076	15.97%	\$3.16	104,680	305,301	522,291	2,208,461
West County													
Cypress	28	1,955,768	0	0	115,491	5.91%	275,207	14.07%	\$2.31	(33,757)	67,996	0	140,345
Fountain Valley	34	2,032,525	0	0	98,485	4.85%	102,090	5.02%	\$1.84	(943)	(48,097)	2,425	71,092
Garden Grove	20	1,579,361	0	0	82,524	5.23%	74,676	4.73%	\$1.94	(32,260)	(37,509)	12,847	20,020
Huntington Beach	41	3,113,607	0	0	224,616	7.21%	296,960	9.54%	\$1.96	(8,835)	(36,195)	36,557	177,171
Los Alamitos	12	661,970	0	0	183,518	27.72%	45,921	6.94%	\$2.65	2,000	9,947	2,000	17,476
Seal Beach	7	473,787	0	0	24,946	5.27%	45,499	9.60%	\$3.35	919	18,277	6,436	34,488
Stanton	4	143,361	0	0	17,481	12.19%	21,231	14.81%	\$0.00	(967)	(2,811)	0	11,715
Westminster	11	447,969	0	0	24,205	5.40%	24,205	5.40%	\$2.25	(23,413)	(11,822)	3,675	17,700
West County Total	157	10,408,348	0	0	771,266	7.41%	885,789	8.51%	\$2.30	(97,256)	(40,214)	63,940	490,007
Orange County Total	1,534	121,990,418	795,177	2,446,635	13,960,276	11.44%	17,393,990	14.26%	\$2.74	167,558	707,160	2,156,670	9,839,975
Airport Area													
Class A	141	26,865,377	0	426,000	3,856,362	14.35%	4,791,107	17.83%	\$3.09	185,590	310,927	679,926	2,658,757
Class B	314	17,403,018	380,856	285,933	1,544,219	8.87%	2,156,070	12.39%	\$2.75	72,292	344,772	366,409	2,102,906
Class C	20	855,239	0	0	60,615	7.09%	78,140	9.14%	\$2.46	2,207	778	11,066	44,255
Central County													
Class A	43	7,249,292	0	1,322,180	1,166,433	16.09%	1,373,074	18.94%	\$2.81	(67,590)	(184,186)	126,411	397,132
Class B	217	14,621,186	0	180,000	1,568,495	10.73%	2,240,396	15.32%	\$2.21	(17,972)	(107,040)	251,593	1,107,000
Class C	49	2,156,565	0	0	159,875	7.41%	145,672	6.75%	\$1.83	35,241	26,001	55,649	133,106
North County													
Class A	28	3,239,778	0	0	246,612	7.61%	318,278	9.82%	\$2.75	(11,621)	5,691	7,663	159,507
Class B	147	10,822,699	0	0	790,090	7.30%	944,196	8.72%	\$2.19	(39,097)	65,565	67,042	530,744
Class C	23	893,332	0	0	35,747	4.00%	72,192	8.08%	\$2.17	1,084	(20,435)	4,680	8,100
South County													
Class A	82	10,598,232	344,353	232,522	2,098,998	19.81%	2,140,659	20.20%	\$3.55	225,840	238,277	355,614	1,000,856
Class B	302	16,356,258	69,968	0	1,652,379	10.10%	2,215,270	13.54%	\$2.77	(125,086)	65,925	160,976	1,191,311
Class C	11	521,094	0	0	9,185	1.76%	33,147	6.36%	\$2.30	3,926	1,099	5,701	16,294
West County													
Class A	18	1,934,188	0	0	178,629	9.24%	361,231	18.68%	\$2.47	(17,429)	(47,320)	5,796	63,986
Class B	123	7,027,311	0	0	582,412	8.29%	514,333	7.32%	\$2.22	(80,332)	3,723	56,144	406,175
Class C	16	1,446,849	0	0	10,225	0.71%	10,225	0.71%	\$0.00	505	3,383	2,000	19,846
Orange County													
Class A	312	49,886,867	344,353	1,980,702	7,547,034	15.13%	8,984,349	18.01%	\$3.10	314,790	323,389	1,175,410	4,280,238
Class B	1,103	66,230,472	450,824	465,933	6,137,595	9.27%	8,070,265	12.19%	\$2.47	(190,195)	372,945	902,164	5,338,136
Class C	119	5,873,079	0	0	275,647	4.69%	339,376	5.78%	\$2.07	42,963	10,826	79,096	221,601
Orange County Total	1,534	121,990,418	795,177	2,446,635	13,960,276	11.44%	17,393,990	14.26%	\$2.74	167,558	707,160	2,156,670	9,839,975

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.



New Decade Same Cycle

by **Chris Drzyzga**

VICE PRESIDENT, IRVINE

949.263.5303 · chrisd@voitco.com · Lic. #01926212

2019 was another good year for Orange County commercial real estate. A diversified, well-educated employment base continues to keep the office market on firm footing. Consistent demand has kept lease rates and sale prices on an upward trend notwithstanding the significant spike in speculative office development over the past two years.

This year technology tenants are expected to dominate leasing, which isn't surprising because they accounted for 22% of the activity through the first half of 2019. Interest in flexible office space will continue to grow, but at a much slower pace thanks to the recently botched WeWork IPO.

Political activity continues to impact the overall CRE outlook. The House has passed the USMCA (NAFTA 2.0) and it is expected to be signed into law in January. Many believe the new law will strengthen U.S. trade with Canada and Mexico. Tax incentives for energy-efficient commercial buildings have been extended, allowing owners to claim a deduction of up to \$1.80/SF for qualifying systems.

Of great concern going forward is the *California Schools and Local Communities Funding Act*, which will likely be on the ballot in November. This controversial initiative would remove Prop 13 protection for most commercial properties. Beginning with the 2021–22 tax year, commercial property would be subject to periodic reassessment to full market value even if it does not change hands. Tenants subject to operating expense pass-through could be forced to absorb huge tax increases, while investors who cannot pass those increases along would see a decline in property values due to lower NOI.

Looking ahead, I'm keeping an eye on these key market drivers:

#1: Interest rates will remain low. The Fed's three rate cuts in 2019 made clear its intentions to avoid recession. We expect interest rates to remain stable going forward, which makes 2020 a good year to acquire or refinance office properties.

#2: The creative and progressive design trends that have dominated the office sector since 2015 will continue. The latest iteration is the "outdoor" office and developers have taken note. Employees, predominantly millennials and Gen Z, expect an excellent experience at work, which means spaces with high levels of choice, variety and balance.

#3: The alternative investment sector of CRE will remain strong. Data center, self-storage and medical office activity has doubled since 2008, making up approximately 12% of all CRE activity. As this trend continues, expect to see adaptive reuse projects growing in popularity. Old factories, mills, schools, vacant retail boxes and more are being converted into flex space and residential housing. Programs like Opportunity Zones or the Low-Income Housing Tax Credit will further support those efforts.

Barring a catastrophic economic disturbance, 2020 should be another solid year for Orange County's economy and commercial real estate market.

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
-----------------------------	------------------------------	-----------------------------------	----------------------------	---------------------------------	-------------------------------

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