

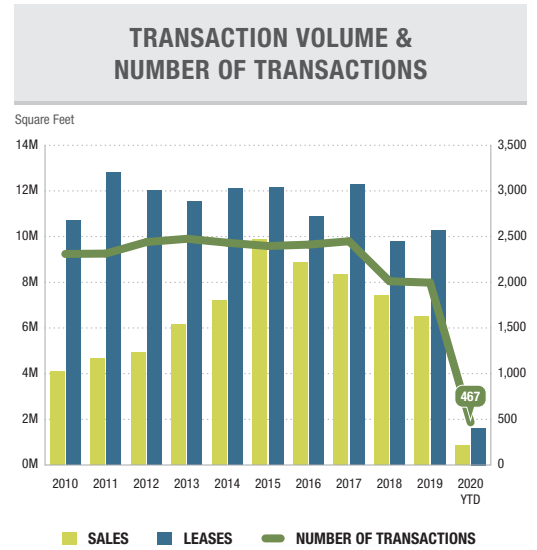
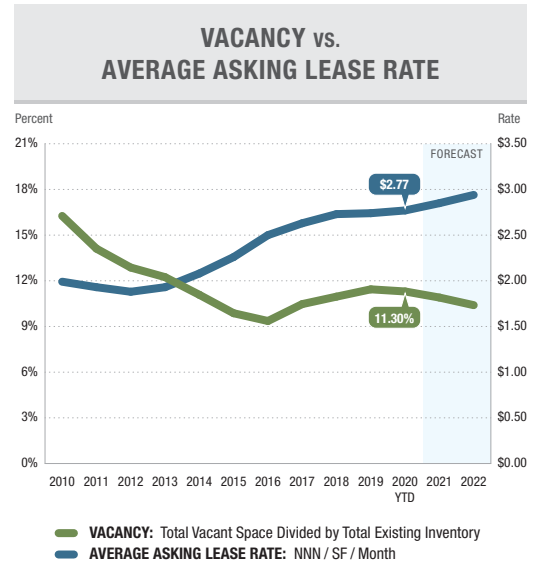
**OVERVIEW.** It's too early to predict the statistical impact of the current virus scare on the Orange County office market. First quarter metrics just don't reflect any change in decision-making, as the shelter-in-place order from the Governor was announced with just two weeks left in the period. However, the Orange County office market has been showing signs of sluggishness for the past year. We have seen an uptick in sublease space and a greater share of occupied space not being used to its full potential. Rent growth and vacancy have both leveled off, but it is important to look at both metrics by building class and submarket to get a clear picture. The last couple of years have also brought a flurry of new Class A deliveries, primarily in the Airport and Spectrum submarkets. Growth of asking rent has been concentrated in those Class A buildings due to their location and premier amenities. Yet, those building owners have seen slower-than-expected activity and they are getting more pushback from today's more cost-conscious tenants who are increasingly resistant to signing long-term leases at record-high prices.

**VACANCY.** Overall, the vacancy needle has moved up just 12 basis points since the first quarter of 2019, ending the current period at 11.30%. Given all the new deliveries over the course of last year, that rate reflects the fact that the market is not significantly overbuilt. However, new product has contributed to a spike in vacancy as it relates to Class A space, which now stands at 14.50%, versus 9.53% for Class B space and a scant 3.82% for Class C. The South County submarket, which includes Irvine Spectrum, has the highest vacancy rate at 12.98%, mainly due to new deliveries, while North County vacancy stands at just 7.20%. Vacancy in the Central County and the Greater Airport areas is stabilized in the 12% range.

**LEASE RATES.** Across all building classes, the average asking lease rate grew by just \$0.02 in the past year, and with overall demand relatively flat, we may have hit a peak in this cycle, even without factoring in the potential impact of the COVID-19 crisis. Landlords have been pushing hard to meet their coupon rate targets and that has led to an increase in free rent and other concessions. To offset today's expensive Class A rents, office users are doing everything they can to leverage communications technology and efficient workspace designs to reduce their space footprints.

**TRANSACTION ACTIVITY.** The total square footage transacted in the first quarter fell sharply on both a quarter-to-quarter and year-over-year basis. Just over 2.4 MSF of space changed hands in the first quarter, compared to more than 4 MSF in the fourth quarter of 2019. This reflects the fact that tenants are increasingly concerned about their occupancy cost, but is also the result of a shortage of office properties offered for sale. Strong buyer demand has been driven by the lowest mortgage interest rates in US history. In March, the SBA 504 debenture rate fell to just 2.876% for a 25-year, fully-amortized owner/user loan.

**EMPLOYMENT.** The unemployment rate in Orange County was 2.9% in January 2020, up from a revised 2.4% in December 2019, and below the year-ago estimate of 3.3%. This compares with an unadjusted unemployment rate of 4.3% for California and 4.0% for the nation during the same period. Educational and health services reported the largest year-over-year employment growth with a gain of 5,700 jobs. Health care and social assistance accounted for 63% of the increase, adding 3,600 jobs.



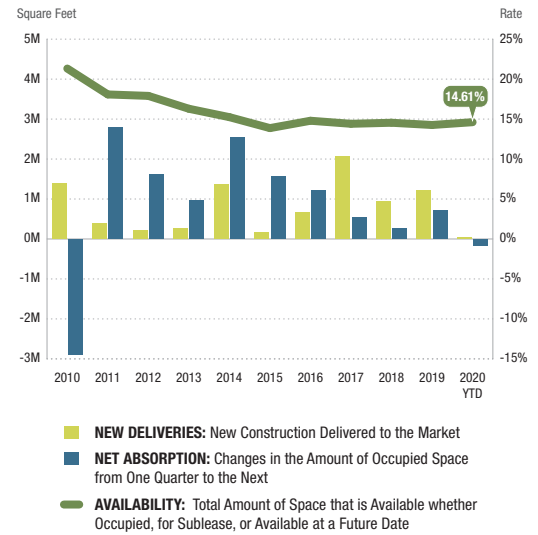
Market Statistics

	Change Over Last Quarter	1Q 2020	4Q 2019	1Q 2019	% Change Over Last Year
Vacancy Rate	▲ UP	11.30%	11.15%	11.18%	1.07%
Availability Rate	▲ UP	14.61%	14.26%	14.37%	1.67%
Average Asking Lease Rate	▲ UP	\$2.77	\$2.74	\$2.75	0.73%
Sale & Lease Transactions	▼ DOWN	2,453,322	4,065,134	4,004,203	(38.73%)
Gross Absorption	▲ UP	2,239,625	2,156,670	2,423,515	(7.59%)
Net Absorption	▼ NEGATIVE	(154,301)	167,558	294,525	N/A

**CONSTRUCTION.** Total space under construction ended the year at 975,177 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 current 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.** Net absorption slipped into negative territory in the first quarter, ending the period with a net decrease on occupied space of 154,301 square feet. A single quarter of negative growth is not, in itself, a cause for alarm. Small negative growth quarters are often attributable to a few larger move-outs, as tenants move into first generation space. In the first quarter, we saw Thales USA Inc vacate 53,840 square feet in Irvine Spectrum, and also Gateway One Lending & Finance vacated 39,306 square feet in Anaheim.

## NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



## Forecast

The extraordinary steps being taken to bring the COVID-19 virus under control are impacting all of us. As of this writing, 41 states are under a shelter-in-place order and there's just no way to ignore the fact that our entire economy is taking a huge hit. The Black Swan now has a name and it will most certainly be driving decision-making in the coming quarters. We are expecting sale and lease activity to drop sharply across all commercial property types, at least through the third quarter. Many of the transactions in progress during the last few weeks of Q1 have been postponed, as buyers, sellers, landlords and tenants all assess their situations and search for a way forward. The truth is, we don't have enough facts at this point to forecast the breadth, depth and length of the slowdown. One thing we are sure of is that the viability of working from home will finally be rigorously tested, as all business owners look for a way to maintain momentum and productivity.

Federal and State governments, along with the US Federal Reserve and US Department of Treasury, are taking unprecedented actions to offset what is sure to be a major hit to GDP, both here at home and around the world. So far, those efforts have not been enough to shift consumer and business sentiment, but with our activities under such severe restrictions, that is not unexpected. We will do our best to keep you up to speed on how real estate is being impacted.

## Significant Transactions

### Sales

Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
16842 Von Karman Ave.	Irvine	A	101,161	\$25,400,000	Dayani Partners	KBS Growth A Income REIT, Inc.
2406-2445 McCabe Way	Irvine	A	90,670	\$20,000,000	McCabe Group, LLC	Swift Real Estate Partners
3150 Bear St.	Costa Mesa	B	65,652	\$25,500,000	EF Education First	Alliance South Coast Properties
1400-1420 Bristol St. N.	Newport Beach	B	42,697	\$11,500,000	Buchanan Street Partners	Davis Property Management, Inc.
1200 N. Tustin Ave.	Santa Ana	B	29,047	\$9,967,500	OC Employees Retirement System	Singh Family Trust

### Leases

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
12421 E. Dyer Rd. – Renewal	Santa Ana	B	67,412	Jan–2020	County of Orange, HCA	Greenlaw Partner
2742 Dow Ave. – Sublease	Tustin	B	51,588	Feb–2020	Kingdomway USA	Memorial Care Medical Group
1100 Town & Country Rd.	Orange	A	48,477	Jan–2020	Kimley Horn & Associates	Mullrock Executive Tower
165 Technology Dr.	Irvine Spectrum	B	43,920	Jan–2020	Microchip Technology, Inc.	The Irvine Company
333 City Blvd. W.	Orange	A	38,269	Jan–2020	SPACES	KBS Realty Advisors

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 1Q2020	Square Feet Available	Availability Rate 1Q2020	Average Asking Lease Rate	Net Absorption 1Q2020	Net Absorption 2020	Gross Absorption 1Q2020	Gross Absorption 2020
<b>Airport Area</b>													
Costa Mesa	71	7,272,989	380,856	118,508	912,601	12.55%	1,435,622	19.74%	\$2.57	(75,368)	(75,368)	73,573	73,573
Irvine	265	24,957,544	0	684,457	2,982,104	11.95%	3,721,486	14.91%	\$2.88	61,807	61,807	620,429	620,429
Newport Beach	121	10,007,900	0	0	816,433	8.16%	1,234,497	12.34%	\$2.76	(67,024)	(67,024)	147,364	147,364
Santa Ana	15	2,460,616	0	0	313,919	12.76%	458,923	18.65%	\$2.75	24,992	24,992	47,161	47,161
Tustin	4	417,609	0	0	311,747	74.65%	297,825	71.32%	\$0.00	84,766	84,766	110,927	110,927
<b>Airport Area Total</b>	<b>476</b>	<b>45,116,658</b>	<b>380,856</b>	<b>802,965</b>	<b>5,336,804</b>	<b>11.83%</b>	<b>7,148,353</b>	<b>15.84%</b>	<b>\$2.94</b>	<b>29,173</b>	<b>29,173</b>	<b>999,454</b>	<b>999,454</b>
<b>Central County</b>													
Anaheim	21	1,947,934	0	0	294,830	15.14%	451,245	23.17%	\$2.60	(5,046)	(5,046)	13,247	13,247
Orange	81	7,144,952	0	0	813,927	11.39%	1,077,640	15.08%	\$2.48	5,603	5,603	178,596	178,596
Santa Ana	162	12,229,303	0	1,322,180	1,705,810	13.95%	2,167,404	17.72%	\$2.45	(40,699)	(40,699)	164,178	164,178
Tustin	44	2,393,421	180,000	0	167,420	7.00%	224,233	9.37%	\$2.23	(13,094)	(13,094)	14,824	14,824
<b>Central County Total</b>	<b>308</b>	<b>23,715,610</b>	<b>180,000</b>	<b>1,322,180</b>	<b>2,981,987</b>	<b>12.57%</b>	<b>3,920,522</b>	<b>16.53%</b>	<b>\$2.46</b>	<b>(53,236)</b>	<b>(53,236)</b>	<b>370,845</b>	<b>370,845</b>
<b>North County</b>													
Anaheim Hills	82	5,943,888	0	0	436,828	7.35%	517,583	8.71%	\$2.32	(43,343)	(43,343)	36,179	36,179
Brea	42	4,099,520	0	0	253,583	6.19%	489,185	11.93%	\$2.53	(8,514)	(8,514)	71,177	71,177
Buena Park	17	1,114,233	0	0	96,089	8.62%	100,592	9.03%	\$2.25	7,217	7,217	11,169	11,169
Fullerton	29	2,356,737	0	0	131,726	5.59%	140,642	5.97%	\$2.16	4,068	4,068	15,051	15,051
La Habra	5	193,850	0	0	4,024	2.08%	3,625	1.87%	\$2.00	394	394	1,079	1,079
La Palma	10	712,038	0	0	72,514	10.18%	90,548	12.72%	\$1.93	6,520	6,520	16,754	16,754
Placentia	8	267,581	0	0	26,973	10.08%	28,293	10.57%	\$2.07	9,664	9,664	22,573	22,573
Yorba Linda	5	289,383	0	0	56,497	19.52%	55,077	19.03%	\$2.25	2,665	2,665	2,665	2,665
<b>North County Total</b>	<b>198</b>	<b>14,977,230</b>	<b>0</b>	<b>0</b>	<b>1,078,234</b>	<b>7.20%</b>	<b>1,425,545</b>	<b>9.52%</b>	<b>\$2.36</b>	<b>(21,329)</b>	<b>(21,329)</b>	<b>176,647</b>	<b>176,647</b>
<b>South County</b>													
Aliso Viejo	44	3,346,886	0	0	617,336	18.45%	865,732	25.87%	\$3.19	15,523	15,523	64,890	64,890
Dana Point	2	91,876	0	0	7,868	8.56%	7,868	8.56%	\$0.00	(6,588)	(6,588)	0	0
Foothill Ranch	10	806,438	0	0	96,134	11.92%	100,753	12.49%	\$2.70	2,880	2,880	25,105	25,105
Irvine Spectrum	175	13,532,414	414,321	232,522	1,935,685	14.30%	2,282,378	16.87%	\$3.74	(94,338)	(94,338)	355,277	355,277
Laguna Beach	5	192,434	0	0	13,433	6.98%	23,516	12.22%	\$0.00	0	0	1,390	1,390
Laguna Hills	33	1,807,063	0	0	259,756	14.37%	310,717	17.19%	\$2.84	(30,350)	(30,350)	23,996	23,996
Laguna Niguel	10	1,751,348	0	0	64,620	3.69%	102,605	5.86%	\$0.00	4,956	4,956	8,853	8,853
Lake Forest	40	2,115,071	0	0	193,468	9.15%	270,500	12.79%	\$2.32	3,547	3,547	33,149	33,149
Mission Viejo	37	2,032,775	0	0	294,203	14.47%	286,905	14.11%	\$2.55	43,434	43,434	61,946	61,946
Rancho Santa Margarita	6	252,716	0	0	13,184	5.22%	19,299	7.64%	\$2.20	3,187	3,187	5,054	5,054
San Clemente	11	473,038	0	0	43,478	9.19%	61,106	12.92%	\$2.40	(3,174)	(3,174)	12,015	12,015
San Juan Capistrano	20	971,944	0	0	14,589	1.50%	59,449	6.12%	\$2.29	2,177	2,177	5,777	5,777
<b>South County Total</b>	<b>393</b>	<b>27,374,003</b>	<b>414,321</b>	<b>232,522</b>	<b>3,553,754</b>	<b>12.98%</b>	<b>4,390,828</b>	<b>16.04%</b>	<b>\$3.17</b>	<b>(58,746)</b>	<b>(58,746)</b>	<b>597,452</b>	<b>597,452</b>
<b>West County</b>													
Cypress	27	1,935,928	0	0	137,862	7.12%	222,771	11.51%	\$2.31	(24,285)	(24,285)	3,841	3,841
Fountain Valley	34	2,032,625	0	0	92,621	4.56%	114,135	5.62%	\$1.95	5,864	5,864	27,070	27,070
Garden Grove	20	1,579,361	0	0	74,421	4.71%	74,421	4.71%	\$1.94	(939)	(939)	705	705
Huntington Beach	41	3,113,607	0	0	255,883	8.22%	330,300	10.61%	\$2.31	(38,666)	(38,666)	33,041	33,041
Los Alamitos	12	661,970	0	0	171,663	25.93%	34,066	5.15%	\$0.00	1,555	1,555	12,605	12,605
Seal Beach	7	473,787	0	0	22,799	4.81%	73,609	15.54%	\$3.45	2,147	2,147	2,147	2,147
Stanton	4	143,361	0	0	13,320	9.29%	17,070	11.91%	\$0.00	4,161	4,161	4,161	4,161
Westminster	11	447,969	0	0	12,449	2.78%	12,449	2.78%	\$2.25	0	0	11,657	11,657
<b>West County Total</b>	<b>156</b>	<b>10,388,608</b>	<b>0</b>	<b>0</b>	<b>781,018</b>	<b>7.52%</b>	<b>878,821</b>	<b>8.46%</b>	<b>\$2.35</b>	<b>(50,163)</b>	<b>(50,163)</b>	<b>95,227</b>	<b>95,227</b>
<b>Orange County Total</b>	<b>1,531</b>	<b>121,572,109</b>	<b>975,177</b>	<b>2,357,667</b>	<b>13,731,797</b>	<b>11.30%</b>	<b>17,764,069</b>	<b>14.61%</b>	<b>\$2.77</b>	<b>(154,301)</b>	<b>(154,301)</b>	<b>2,239,625</b>	<b>2,239,625</b>
<b>Airport Area</b>													
Class A	141	26,879,823	0	517,032	3,712,082	13.81%	4,934,486	18.36%	\$3.12	150,890	150,890	606,344	606,344
Class B	315	17,381,596	380,856	285,933	1,571,267	9.04%	2,140,343	12.31%	\$2.80	(126,602)	(126,602)	383,852	383,852
Class C	20	855,239	0	0	53,455	6.25%	73,524	8.60%	\$2.46	4,885	4,885	9,258	9,258
<b>Central County</b>													
Class A	43	7,251,550	0	1,322,180	1,103,251	15.21%	1,532,177	21.13%	\$2.76	19,700	19,700	202,335	202,335
Class B	215	14,255,940	180,000	0	1,749,747	12.27%	2,254,782	15.82%	\$2.29	(99,697)	(99,697)	133,475	133,475
Class C	50	2,208,120	0	0	128,989	5.84%	133,563	6.05%	\$1.81	26,761	26,761	35,035	35,035
<b>North County</b>													
Class A	28	3,239,778	0	0	280,451	8.66%	329,154	10.16%	\$2.70	(32,009)	(32,009)	28,755	28,755
Class B	147	10,844,120	0	0	773,543	7.13%	1,039,200	9.58%	\$2.27	10,473	10,473	143,534	143,534
Class C	23	893,332	0	0	24,240	2.71%	57,191	6.40%	\$2.17	207	207	4,358	4,358
<b>South County</b>													
Class A	82	10,589,902	344,353	232,522	1,907,081	18.01%	2,129,601	20.11%	\$3.53	14,110	14,110	329,956	329,956
Class B	300	16,263,007	69,968	0	1,633,035	10.04%	2,225,919	13.69%	\$2.77	(68,468)	(68,468)	264,812	264,812
Class C	11	521,094	0	0	13,638	2.62%	35,308	6.78%	\$2.30	(4,388)	(4,388)	2,684	2,684
<b>West County</b>													
Class A	18	1,934,188	0	0	233,272	12.06%	306,673	15.86%	\$2.48	(54,643)	(54,643)	23,036	23,036
Class B	123	7,033,571	0	0	542,805	7.72%	570,048	8.10%	\$2.30	(804)	(804)	66,157	66,157
Class C	15	1,420,849	0	0	4,941	0.35%	2,100	0.15%	\$0.00	5,284	5,284	6,034	6,034
<b>Orange County</b>													
Class A	312	49,895,241	344,353	2,071,734	7,236,137	14.50%	9,232,091	18.50%	\$3.11	98,048	98,048	1,190,426	1,190,426
Class B	1,100	65,778,234	630,824	285,933	6,270,397	9.53%	8,230,292	12.51%	\$2.53	(285,098)	(285,098)	991,830	991,830
Class C	119	5,898,634	0	0	225,263	3.82%	301,686	5.11%	\$2.10	32,749	32,749	57,369	57,369
<b>Orange County Total</b>	<b>1,531</b>	<b>121,572,109</b>	<b>975,177</b>	<b>2,357,667</b>	<b>13,731,797</b>	<b>11.30%</b>	<b>17,764,069</b>	<b>14.61%</b>	<b>\$2.77</b>	<b>(154,301)</b>	<b>(154,301)</b>	<b>2,239,625</b>	<b>2,239,625</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.



## Record Low Interest Rates... Again

by **Russ Smith**

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The US Federal Reserve lowered its Fed Funds rate twice in March, sending it back down to 0% in reaction to growing concern over the potential economic impact of the COVID-19 virus outbreak. That and the rush by equity investors seeking the safety of US bonds, after the Dow declined into bear territory, combined to send the yield on the benchmark 10-Year Treasury bond (the index by which most commercial property mortgage rates are set) down to an all-time low. As of this writing, that yield remains under 1%.

The question for all of us in the commercial office sector is how will this affect the market? To be sure, building owners and would-be buyers of office buildings should think seriously about taking advantage of this silver lining to the COVID-19 disruption. For current owners, this could be the best refinancing opportunity in a lifetime. Owners can either free up equity to acquire other assets or lower debt service to improve annual cash flow for up to 25 years. We will talk through how a 1% change in interest rates affects monthly payments and borrowing ability in a moment.

For owners who have been contemplating a disposition, this low rate environment may also make it a great time to sell and realize their gains. Cap rates remain compressed, inventory is still low, new construction has been limited to larger "legacy" type projects and lease rates have continued to climb, although negligibly so in 2019. Selling should be a serious consideration, especially if your building no longer fits your needs, or if your business could benefit from a cash infusion. The all-important question is: Could you be putting the equity in your building to better use somewhere else?

For would-be buyers, the Fed and the COVID-19 virus just presented you a surefire way of lowering your monthly payment or allowing you to borrow more money to buy a bigger/better building. Owner/users can lock in 25-year, fixed-rate financing at a rate below 3% through SBA loan programs. If your company has stable cash flow and predictable needs in terms of office space, and you are currently leasing, then this may be an opportune time to start benefitting from owning your office building.

As an example, if you financed a \$1,000,000 building with a \$900,000 loan (90% LTV through an SBA loan program), using 25-year amortization, this interest rate drop has a dramatic affect. At a 4% interest rate, which is where we sat in February, your monthly payment would be \$4,750. With current rates around 3%, that same purchase now comes with a \$4,268 per month payment. That 1% differential in rate just cut your occupancy cost by 10%, and over the life of that loan, you would save \$144,789 in interest cost.

Your other option is to buy a bigger or better building. Instead of using the change in interest rates to lower your monthly payment, you set the payment at the same \$4,750 as in the example above, which would allow you to finance an additional \$101,775, and only requires another \$11,308 in down payment.

We'll see what effect these historically low interest rates have on other sectors, and the overall economy. But for now, buyers and sellers of commercial office buildings have some interesting options to consider.

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This survey consists of properties representing both single tenant and multi-tenant buildings. The lease rates are based on a full-service gross basis. The information contained in this report is gathered from sources that are deemed reliable, but no guarantees are made as to its accuracy. This information is for Voit Real Estate Services' use only and cannot legally be reproduced without prior written consent from the management of Voit Real Estate Services. ©2020 Voit Real Estate Services, Inc. DRE License #01991785.

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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