

OVERVIEW. In the last three months, Orange County has gone from full lockdown to a substantial economic reopening to another surge in new cases that could put the brakes on the whole process. That resulted in a mixed performance for the Orange County office market in the second quarter. Leasing activity and net absorption were well off the pace, but average asking lease rates and vacancy held steady under very difficult conditions. Speculation about a resurgence in the popularity of Class B suburban low-rise buildings is on the rise, as business leaders review the suitability of their Class A high-rise workplaces now that employee safety has become their new priority. The premium placed on employee interaction in workspaces designed for higher density in urban cores is suddenly being challenged, but it's still too early to predict any long-term impact on market metrics.

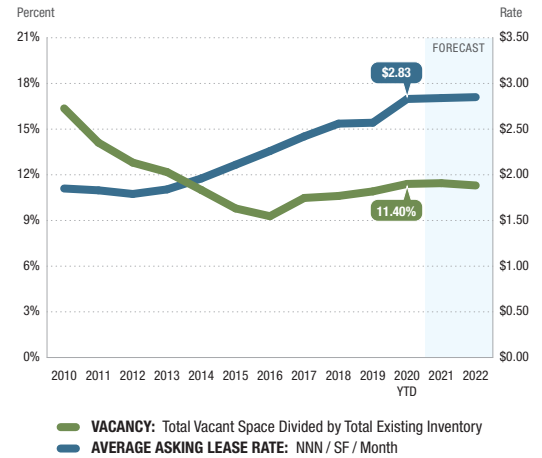
VACANCY. The vacancy rate for all building classes combined changed little during the second quarter, ending the period just 66 basis points higher at 11.4%. This is significant considering that COVID-19 protocols made every step of the leasing process more complex, which was expected to delay occupancies. Class A continues to see the highest vacancy with the Airport Area, Central County and South County all running in the 14% to 15% range. This has been the case for some time as new ground-up development is concentrated in these submarkets. North County vacancy is still running lowest at 8.79% and there are no new projects in the construction queue.

LEASE RATES. Unexpectedly, average asking lease rates across building classes managed to increase in all five major submarkets in the second quarter, with the overall rate moving up \$0.04 to \$2.83 per square foot. However, concessions are on the rise, as landlords prefer to offer free rent and more generous tenant improvements in lieu of lowering their coupon rates. Some landlords are showing a willingness to agree to shorter lease terms in order to get income from their empty space as soon as possible. Creditworthy tenants with immediate requirements now have the upper hand and stand a good chance of obtaining favorable terms on an "effective" basis.

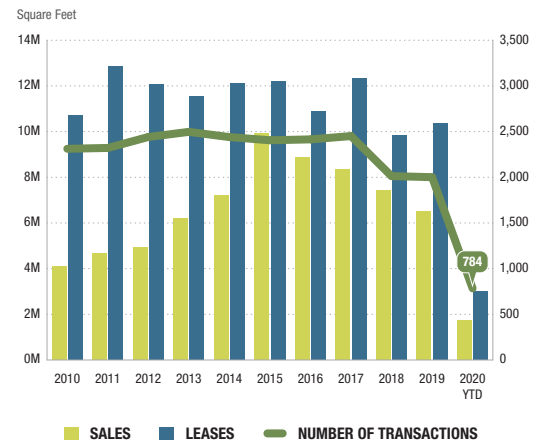
TRANSACTION ACTIVITY. The volume of sale and lease deals inked during the quarter fell by almost half in the second quarter. Office users operate with higher employee density than typical industrial operations, making it more of a challenge to reopen a business or plan and execute a move. Most office-based companies are running at less than full capacity, employing a variety of methods to limit close contact between employees. Sale activity fell during the quarter because buyers are reluctant to move forward on new acquisitions with so many unknowns. Moreover, commercial lenders are tightening up on their own underwriting, which is eroding borrowing power.

EMPLOYMENT. The unemployment rate in Orange County was 14.5% in May 2020, up from a revised 13.8% in April 2020, and above the year-ago estimate of 2.4%. This compares with an unadjusted unemployment rate of 15.9% for California and 13.0% for the nation during the same period. Professional and business services decreased by 41,200 jobs with 75% of the loss in administrative and support services (down 31,100 jobs), which includes temporary help firms.

VACANCY vs. AVERAGE ASKING LEASE RATE



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



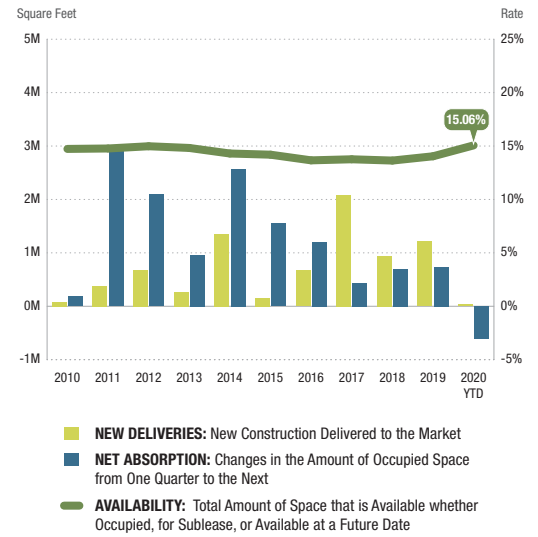
Market Statistics

	Change Over Last Quarter	2Q 2020	1Q 2020	2Q 2019	% Change Over Last Year
Vacancy Rate	▲ UP	11.40%	10.74%	10.60%	7.57%
Availability Rate	▲ UP	15.06%	14.04%	13.66%	10.26%
Average Asking Lease Rate	▲ UP	\$2.83	\$2.79	\$2.81	0.71%
Sale & Lease Transactions	▼ DOWN	1,640,443	3,099,566	4,172,058	(60.68%)
Gross Absorption	▼ DOWN	1,943,855	2,239,625	2,190,984	(11.28%)
Net Absorption	▼ NEGATIVE	(450,519)	(154,301)	549,811	N/A

CONSTRUCTION. Total space under construction, just over 975,000 square feet, was unchanged in the second quarter. The Press, a 300,000-square-foot retrofit of the old LA Times printing facility, is underway in Costa Mesa. That creative office project is scheduled for completion in the fourth quarter of 2020. Irvine Company's build-to-suit for Alleryx Inc. at Spectrum Terrace 2 is set to be delivered in the fourth quarter of 2020. The company will be occupying the bulk of the 340,000-square-foot second phase. The first phase is fully leased. A headquarters campus for SchoolsFirst Federal Credit Union, including 180,000 square feet of office and a four-level parking structure, is underway in Tustin.

ABSORPTION. Orange County posted negative absorption in the first quarter and followed it up with an even bigger decline in the second quarter. The biggest hit this quarter was Western Digital's vacating 152,000 square feet on Michelson Drive in Irvine. Other significant move-outs include Pacific Care's 60,663-square-foot space on Lake Center Drive in Costa Mesa and Stern Lending's 30,337-square-foot space at 4 Hutton Center in Santa Ana. In all, the county lost 450,000 square feet in net occupancy in the second quarter. That brought the total loss for the first half of 2020 to almost 605,000 square feet. Consecutive quarters of negative net absorption signal trouble for the office market. Current space requirements are concentrated in the lower size ranges, as smaller companies scramble to minimize the impact of the economic shock to their businesses.

NEW DELIVERIES & NET ABSORPTION vs. AVAILABILITY RATE



Forecast

The office market will likely be in a state of flux until there is some kind of medical breakthrough that reduces the need for current physical distancing protocols. In fact, the industry is abuzz with speculation that the way we use office space may change forever. Low-rise office buildings in the suburbs are starting to attract attention again. If that trend materializes, the Orange County office market may be its direct beneficiary, as it has a significant stock of low-rise buildings near attractive residential areas with strong retail support. For the second half of the year, we expect rent growth to be flat, absorption slightly positive at best, and landlords will continue to offer leasing concessions to hold rental rates flat.

Significant Transactions

Sales

Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
15161 Alton Pkwy.	South Orange County	B	189,000	\$89,278,719	City of Hope	Five Point Office Venture I, LLC
26600-26700 Aliso Viejo Pkwy.	South Orange County	B	159,746	\$73,500,000	IRA Capital, LLC	CrossHarbor Capital Partners LLC
26521-26541 Rancho Pkwy. S.	South Orange County	B	155,665	\$38,816,500	Menlo Equities	EverWest Real Estate Investors, LLC

Leases

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
15360 Barranca Pkwy. - Sublease	South Orange County	B	39,060	Apr-2020	American Home Loans	Lennar
500 City Pkwy.	Central Orange County	B	34,009	May-2020	Orange County Health Care Agency	CGGL City Parkway Holding VII
7535 Irvine Center Dr. - Renewal	South Orange County	B	26,897	May-2020	Lantronix	The Irvine Company
7711 Center Ave. - Renewal	West Orange County	A	26,019	Apr-2020	Confie Administrative Services Inc.	One Pacific Plaza Owner, LLC
1920 Main St.	Airport Area	A	24,097	May-2020	Bryan Cave	Emmes Realty Services

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 2Q2020	Square Feet Available	Availability Rate 2Q2020	Average Asking Lease Rate	Net Absorption 2Q2020	Net Absorption 2020	Gross Absorption 2020	Gross Absorption 2020
Airport Area													
Costa Mesa	71	7,272,624	380,856	118,508	1,017,532	13.99%	1,493,245	20.53%	\$3.09	(60,521)	(135,889)	50,416	123,989
Irvine	264	24,961,242	0	679,437	3,089,752	12.38%	4,143,872	16.60%	\$2.91	(163,033)	(101,226)	387,692	1,008,121
Newport Beach	122	10,066,366	0	0	870,966	8.65%	1,376,364	13.67%	\$3.34	(21,419)	(88,443)	73,728	221,092
Santa Ana	15	2,484,008	0	0	325,925	13.12%	448,661	18.06%	\$2.74	(12,006)	12,986	76,538	123,699
Tustin	4	417,609	0	0	297,825	71.32%	297,825	71.32%	\$4.50	13,922	98,688	13,922	124,849
Airport Area Total	476	45,201,849	380,856	797,945	5,602,000	12.39%	7,759,967	17.17%	\$3.02	(243,057)	(213,884)	602,296	1,601,750
Central County													
Anaheim	21	1,947,937	0	0	287,648	14.77%	399,898	20.53%	\$2.75	978	(4,068)	4,232	17,479
Orange	80	7,130,722	0	140,000	819,474	11.49%	1,258,305	17.65%	\$2.72	(40,992)	(35,389)	71,721	250,317
Santa Ana	162	12,123,222	0	1,322,180	1,665,267	13.74%	2,129,737	17.57%	\$2.36	34,138	(6,561)	260,323	424,501
Tustin	44	2,393,421	180,000	0	168,065	7.02%	216,894	9.06%	\$2.22	(1,107)	(14,201)	16,184	31,008
Central County Total	307	23,595,302	180,000	1,462,180	2,940,454	12.46%	4,004,834	16.97%	\$2.49	(6,983)	(60,219)	352,460	723,305
North County													
Anaheim Hills	82	5,953,746	0	0	461,534	7.75%	535,163	8.99%	\$2.19	(37,693)	(81,036)	58,852	95,031
Brea	42	4,099,555	0	0	242,703	5.92%	506,299	12.35%	\$2.51	(1,063)	(9,577)	37,418	108,595
Buena Park	17	1,114,233	0	0	96,089	8.62%	100,592	9.03%	\$2.25	0	7,217	0	11,169
Fullerton	29	2,356,737	0	0	131,766	5.59%	139,715	5.93%	\$2.56	(40)	4,028	21,049	36,100
La Habra	5	193,850	0	0	5,967	3.08%	2,801	1.44%	\$1.70	(2,342)	(1,948)	3,339	4,418
La Palma	10	712,038	0	0	81,732	11.48%	89,852	12.62%	\$1.94	(11,048)	(4,528)	2,155	18,909
Placentia	8	267,581	0	0	37,281	13.93%	37,029	13.84%	\$2.07	(10,308)	(644)	9,883	32,456
Yorba Linda	5	289,383	0	0	57,501	19.87%	57,501	19.87%	\$3.59	(1,004)	1,661	1,420	4,085
North County Total	198	14,987,123	0	0	1,114,573	7.44%	1,468,952	9.80%	\$2.41	(63,498)	(84,827)	134,116	310,763
South County													
Aliso Viejo	45	3,371,646	0	0	578,859	17.17%	867,228	25.72%	\$3.12	27,430	42,953	40,848	105,738
Dana Point	2	91,876	0	0	7,868	8.56%	7,868	8.56%	\$0.00	0	(6,588)	0	0
Foothill Ranch	10	806,438	0	0	82,122	10.18%	109,313	13.56%	\$2.82	100	2,980	20,746	45,851
Irvine Spectrum	176	13,590,677	414,321	232,522	1,797,949	13.23%	2,052,323	15.10%	\$3.27	(65,546)	(159,884)	460,910	816,187
Laguna Beach	5	192,434	0	0	12,043	6.26%	22,016	11.44%	\$2.61	0	0	1,500	2,890
Laguna Hills	33	1,801,029	0	465,000	253,798	14.09%	316,621	17.58%	\$2.94	824	(29,526)	41,949	65,945
Laguna Niguel	10	1,751,348	0	0	60,916	3.48%	103,441	5.91%	\$3.01	(1,816)	3,140	1,092	9,945
Lake Forest	40	2,117,647	0	0	201,014	9.49%	298,533	14.10%	\$2.30	(3,935)	(388)	5,033	38,182
Mission Viejo	37	2,032,775	0	0	270,978	13.33%	300,166	14.77%	\$2.76	22,672	66,106	43,122	105,068
Rancho Santa Margarita	6	252,716	0	0	20,130	7.97%	19,431	7.69%	\$2.23	(6,946)	(3,759)	2,144	7,198
San Clemente	11	480,615	0	0	62,932	13.09%	61,815	12.86%	\$2.80	(21,657)	(24,831)	8,391	20,406
San Juan Capistrano	20	971,944	0	0	13,578	1.40%	57,287	5.89%	\$2.35	(35)	2,142	1,200	6,977
South County Total	395	27,461,145	414,321	697,522	3,362,187	12.24%	4,216,042	15.35%	\$3.09	(48,909)	(107,655)	626,935	1,224,387
West County													
Cypress	27	1,935,928	0	0	186,943	9.66%	203,927	10.53%	\$2.31	(51,156)	(75,441)	14,417	18,258
Fountain Valley	34	2,032,625	0	0	96,694	4.76%	107,976	5.31%	\$1.95	(4,073)	1,791	7,268	34,338
Garden Grove	19	1,476,936	0	0	68,208	4.62%	68,208	4.62%	\$1.92	1,250	311	1,250	1,955
Huntington Beach	41	3,143,082	0	0	246,326	7.84%	329,790	10.49%	\$2.36	(12,301)	(50,967)	21,268	54,309
Los Alamitos	12	664,180	0	0	177,652	26.75%	40,354	6.08%	\$2.40	(5,989)	(4,434)	151,092	163,697
Seal Beach	7	480,612	0	0	38,602	8.03%	61,246	12.74%	\$3.42	(15,803)	(13,656)	32,753	34,900
Stanton	4	143,361	0	0	13,320	9.29%	17,070	11.91%	\$1.00	0	4,161	0	4,161
Westminster	11	455,385	0	0	12,449	2.73%	28,325	6.22%	\$2.40	0	0	0	11,657
West County Total	155	10,332,109	0	0	840,194	8.13%	856,896	8.29%	\$2.34	(88,072)	(138,235)	228,048	323,275
Orange County Total	1,531	121,577,528	975,177	2,957,647	13,859,408	11.40%	18,306,691	15.06%	\$2.83	(450,519)	(604,820)	1,943,855	4,183,480
Airport Area													
Class A	139	26,591,814	0	512,012	3,756,935	14.13%	5,288,813	19.89%	\$3.28	(132,030)	18,860	424,207	1,030,551
Class B	317	17,740,172	380,856	285,933	1,795,996	10.12%	2,395,193	13.50%	\$2.86	(108,624)	(235,226)	177,593	561,445
Class C	20	869,863	0	0	49,069	5.64%	75,961	8.73%	\$2.72	(2,403)	2,482	496	9,754
Central County													
Class A	43	7,261,806	0	1,462,180	1,110,830	15.30%	1,678,891	23.12%	\$2.82	(52,381)	(32,681)	68,613	270,948
Class B	214	14,239,932	180,000	0	1,676,674	11.77%	2,154,941	15.13%	\$2.39	67,814	(31,883)	265,849	399,324
Class C	50	2,093,564	0	0	152,950	7.31%	171,002	8.17%	\$1.89	(22,416)	4,345	17,998	53,033
North County													
Class A	28	3,239,778	0	0	284,648	8.79%	313,016	9.66%	\$2.68	(22,194)	(54,203)	25,475	54,230
Class B	147	10,854,013	0	0	810,460	7.47%	1,102,364	10.16%	\$2.38	(43,688)	(33,215)	104,513	248,047
Class C	23	893,332	0	0	19,465	2.18%	53,572	6.00%	\$2.03	2,384	2,591	4,128	8,486
South County													
Class A	82	10,595,312	0	697,522	1,530,901	14.45%	2,013,027	19.00%	\$3.45	(15,284)	(1,174)	372,221	702,177
Class B	302	16,344,739	344,353	0	1,821,526	11.14%	2,173,121	13.30%	\$2.92	(36,113)	(104,581)	250,752	515,564
Class C	11	521,094	69,968	0	9,760	1.87%	29,894	5.74%	\$2.38	2,488	(1,900)	3,962	6,646
West County													
Class A	18	1,934,188	0	0	214,357	11.08%	278,093	14.38%	\$2.47	(3,924)	(58,567)	14,560	37,596
Class B	122	6,977,072	0	0	623,237	8.93%	576,203	8.26%	\$2.31	(85,143)	(85,947)	211,243	277,400
Class C	15	1,420,849	0	0	2,600	0.18%	2,600	0.18%	\$2.23	995	6,279	2,245	8,279
Orange County													
Class A	310	49,622,898	0	2,671,714	6,897,671	13.90%	9,571,840	19.29%	\$3.18	(225,813)	(127,765)	905,076	2,095,502
Class B	1,102	66,155,928	905,209	285,933	6,727,893	10.17%	8,401,822	12.70%	\$2.71	(205,754)	(490,852)	1,009,950	2,001,780
Class C	119	5,798,702	69,968	0	233,844	4.03%	333,029	5.74%	\$2.21	(18,952)	13,797	28,829	86,198
Orange County Total	1,531	121,577,528	975,177	2,957,647	13,859,408	11.40%	18,306,691	15.06%	\$2.83	(450,519)	(604,820)	1,943,855	4,183,480

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.



Too Soon To Say...

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In my fourth quarter of 2019 editorial I concluded with, “Barring a true ‘black swan’ event, 2020 should be another good year for Orange County’s economy and commercial real estate market.” Fast forward six months and... WOW! Overnight we found ourselves conducting business in an alternate reality. A remote reality, a digital reality. A reality where bedrooms and kitchens double as home offices, Zoom calls are the new norm, kids and pets are allowed to crash a “meeting,” and happy hour gets earlier by the day.

The first quarter data does not reflect a pandemic response, since there were only two weeks left in the quarter when the crisis began, and we spent most of the second quarter in lockdown as evidenced by the second quarter numbers. When “stay-at-home” orders are easing, it is important that we get back to work as quickly and safely as possible to minimize the damage.

The office sector will take a hit but it’s likely to fare better than its retail counterpart. Industrial should be least affected. Office pricing will decline but not as dramatically as some have been forecasting. In February, the underlying fundamentals were strong, demand was outpacing supply and office rent collection has remained in the 90th percentile each month since the pandemic started. That said, we expect landlords to soften their stance on up-front concessions and show more willingness to accept shorter-term leases. Sublease inventory is expected to rise, as businesses hit the hardest look to shed excess space.

In the short term, it’s all about your own “re-entry strategy.” There is no one-size-fits-all protocol and it’s important that landlords and tenants work together. As a rule of thumb, each tenant is responsible for their specific space while landlords are responsible for the building and its common areas.

The crisis has also given a boost to the split-roll property tax initiative, now known as Proposition 15, which would mandate that commercial properties be reassessed to full market value at least every three years. If passed by California voters on November 3rd, Prop 15 would raise property taxes by up to \$11.5 billion per year in support of local governments and school districts. Opponents believe this would thwart the state’s economic recovery and result in more business closures, more lost jobs, lower property values and a loss in local sales tax and state income tax revenues.

It’s too soon to know the long-term impacts but one thing is for sure — this is not the end of commercial office space as we know it. Our work-from-home experience has shown that we are social beings and that the office remains relevant. In the months and years to come, we are going to see a rise in demand for “healthy” buildings, remote work will become a business strategy, technology & innovation will explode, and leadership style and company cultures will transform. These are trends that our industry has been talking about for years and the silver lining is that COVID will accelerate their widespread adoption. Remember, disruption creates opportunity, and this is an opportunity for you as a business owner to re-examine your priorities and reset your corporate vision. Focus on building a better office with the ability to evolve and consider how your real estate can best support your employees, customers and long-term objectives.

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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.

Represented in 150 Markets
Nationally & Internationally.



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