

OVERVIEW. The Orange County office market struggled again in 2Q. It had already been slowing before the pandemic hit, and by virtue of the higher employee density and multi-tenant configuration of office product, the office sector was hit harder by COVID than other sectors. Vacancy and availability both moved higher, and net absorption remained in negative territory. Average asking lease rates were relatively flat, but they alone do not tell the full story, as landlord concessions have risen sharply and are not reflected in market metrics. Office tenants are still trying to sort out how to fold their workforces back into the office, and that has delayed decision-making regarding relocations and renewals. The work-from-home strategy worked better than expected for many business enterprises, so employers are now formulating how they expect to utilize their space in the future. Many are seeing their emergence from the pandemic as an opportunity to re-imagine the workplace to reflect not only a new way of doing business, but also an opportunity to reduce occupancy costs.

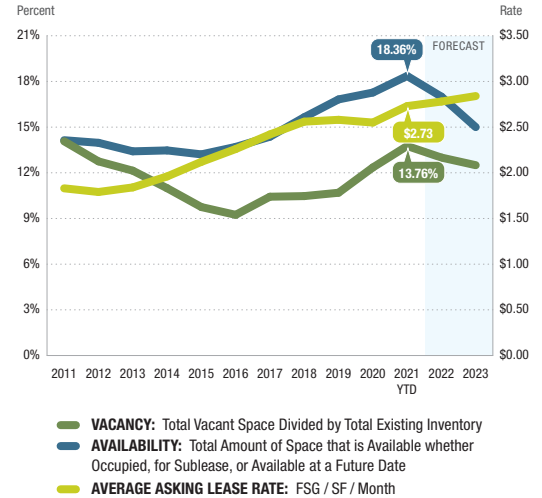
VACANCY & AVAILABILITY. The vacancy rate in Orange County rose to 13.76%, up 61 basis points in 2Q. That came on top of a 116-basis-point spike in 1Q. The increase was expected given how many moves have been put on hold to re-evaluate space utilization. Class A product is under the most stress. Vacancy in those buildings rose to 18.28% in 2Q, compared with 10.96% for Class B and just 8.75% for Class C. The availability rate, which includes vacant and occupied space offered for lease or sublease, is at 23.67% for Class A, 15.19% for Class B and 8.69% for Class C. The spread between vacancy and availability reflects the increase in space offered for sublease.

LEASE RATES. The average asking lease rate for office space countywide was relatively flat in 2Q, falling just \$0.02 to \$2.73 per square foot. Again, however, this does not tell the whole story. Landlords are holding the line on asking rates, but concessions like free rent, free parking and tenant improvement allowances have risen sharply, which means effective rates are significantly lower for new leases, standard renewals, and so-called “blend and extend” deals. Landlords must also compete with space offered for sublease in their own properties, which puts additional pressure on them to yield further concessions.

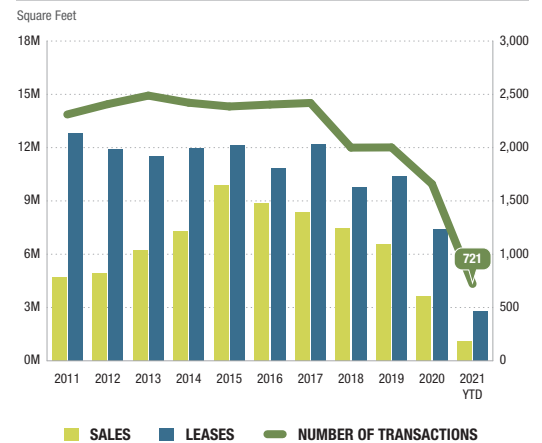
TRANSACTION ACTIVITY. Transaction volume both in terms of square footage and number of transactions managed to edge higher in 2Q despite challenging market conditions. Countywide, 351 lease transactions were signed and 15 sales were recorded for a net gain of 11 transactions over the 1Q total. As we reported last quarter, near-term uncertainty from tenants has caused a rise in short-term renewals versus relocations, and many of these transactions do not make it into the quarterly statistics.

ABSORPTION. Fewer relocations and an increase in short-term renewals significantly impacted net absorption in 1Q, and the same held true in 2Q. Net absorption was in negative territory again in 2Q, posting a net loss of 512,502 SF, after recording a loss of more than

VACANCY, AVAILABILITY & AVERAGE ASKING LEASE RATES



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



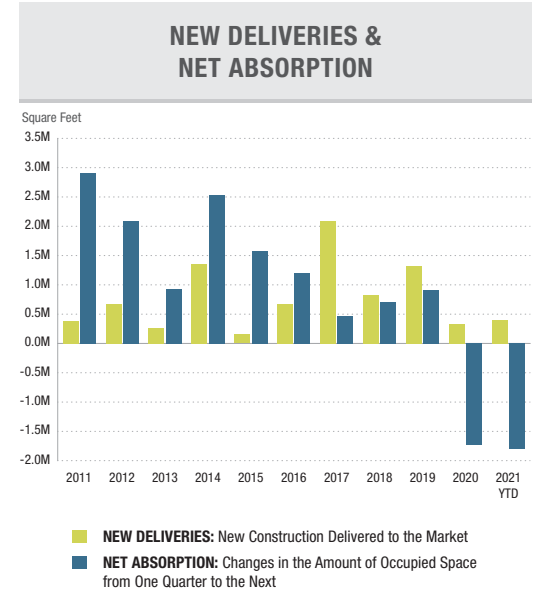
Market Statistics

	Change Over Last Quarter	2Q 2021	1Q 2021	2Q 2020	% Change Over Last Year
Vacancy Rate	▲ UP	13.76%	13.15%	10.58%	30.01%
Availability Rate	▲ UP	18.36%	17.27%	14.37%	27.78%
Average Asking Lease Rate	▼ DOWN	\$2.73	\$2.75	\$2.84	(3.87%)
Sale & Lease Transactions	▲ UP	2,082,151	1,809,340	2,269,148	(8.24%)
Gross Absorption	▲ UP	1,689,000	1,670,869	1,375,048	22.83%
Net Absorption	▼ NEGATIVE	(512,502)	(1,287,167)	(83,613)	N/A

1.2 MSF in the opening quarter. Consistent negative absorption points to a future increase in vacancy. The Airport Area suffered the biggest loss in occupied space at 318,157 SF followed by South County's 79,521. North County posted a loss of just 24,156 SF, in part because inventory there is predominately Class B and C, which was less impacted by the pandemic. Most B and C buildings are low-rise with exterior entrances, which makes for easier and safer access to individual office suites.

CONSTRUCTION. The good news is that construction activity has all but stopped for the moment, which gives the market a chance to reabsorb existing unoccupied space and clear off some of the lower-priced sublease space. Just 439,206 SF of office space was in the construction queue as 2Q ended, all of it in one project in Costa Mesa, The Press. Another 1.7 MSF of space is in the planning stage but is not expected to get underway until market conditions improve.

EMPLOYMENT. The unemployment rate in Orange County was 5.9% in May 2021, down from a revised 6.2% in April 2021, and below the year-ago estimate of 14.9%. Employment increased in five other sectors: professional and business services (up 2,700 jobs), manufacturing (up 1,500 jobs), trade, transportation, and utilities (up 1,300 jobs), government (up 400 jobs), and other services (up 200 jobs).



Forecast

The office market has a bumpy road ahead. Hit hard by the pandemic along with its retail counterpart, the office market needs time to recover. There are still many companies struggling with how to move forward operationally, and uncertainty lingers around long-term space utilization plans. The pandemic was a game changer in terms of managing a workforce and we expect there to be more questions than answers in many C-suites for the time being, especially in the service, financial and tech sectors. Even before the pandemic, the office sector was going through a lot of change, as new communication technologies were being integrated into a workplace populated by younger employees who spent their formative years immersed in the world of technology.

Increasing concern over potential changes to the tax code could impact the recovery of the office market, as well. The new administration's American Families Plan calls for capital gains to be taxed as ordinary income, limiting 1031 exchanges to the first \$500,000 of gain and taxing capital gains at death even if properties are not sold. Any one of these alone would be harmful, but in combination they could seriously impact property values going forward.

Significant Transactions

Sales

Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
25521-25541 Commercentre Dr	Lake Forest	B	155,795	\$41,000,000	KB Property Advisors	Bailard
26200 Enterprise Way	Lake Forest	B	384,940	\$34,900,000	Western Realco	Menlo Equities
26110-16160 Enterprise Way	Lake Forest	B	149,184	\$30,500,000	Western Realco	Menlo Equities
2501 S. Pullman & 1700 E. Carnegie Ave.	Santa Ana	B	128,766	\$21,000,000	BH Properties, LLC	TA Realty
217 N. Main St.	Santa Ana	B	36,161	\$6,000,000	217 North Main Investments LLC	Dgwb Ventures LLC

Leases

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
3500 Sunflower Ave.	Santa Ana	C	110,000	Apr-2021	Autonomous Medical Devices, Inc.	Codan Us Corp
3121 Michelson Dr.	Irvine	A	51,915	May-2021	US Bank	LBA Realty
4675 MacArthur Ct. - Renewal	Newport Beach	A	49,034	Apr-2021	Clean Energy	The Irvine Company
18100 Von Karman Ave.	Irvine	A	48,944	Jun-2021	Alliant Insurance Services	The Irvine Company
48 Discovery	Irvine Spectrum	B	26,920	Apr-2021	Midas Technologies	The Irvine Company

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 2Q2021	Square Feet Available	Availability Rate 2Q2021	Average Asking Lease Rate	Net Absorption 2Q2021	Net Absorption 2021	Gross Absorption 2020/21	Gross Absorption 2021
Airport Area													
Costa Mesa	69	7,166,912	449,206	190,000	1,201,023	16.76%	1,598,228	22.30%	\$3.38	(61,975)	(78,026)	110,510	259,828
Irvine	263	25,049,175	0	679,437	4,124,383	16.47%	5,985,056	23.89%	\$2.84	(226,177)	(562,211)	388,723	796,761
Newport Beach	121	10,006,455	0	0	1,195,579	11.95%	1,589,154	15.88%	\$3.05	(28,286)	(181,423)	124,719	226,784
Santa Ana	15	2,484,797	0	0	445,581	17.93%	572,244	23.03%	\$2.75	1,841	21,011	46,049	85,121
Tustin	4	418,585	0	0	228,536	54.60%	300,546	71.80%	\$4.41	(3,560)	44,679	0	48,239
Airport Area Total	472	45,125,924	449,206	869,437	7,195,102	15.94%	10,045,228	22.26%	\$3.29	(318,157)	(755,970)	670,001	1,416,733
Central County													
Anaheim	21	1,947,937	0	0	311,427	15.99%	596,005	30.60%	\$2.45	1,678	16,169	22,686	59,064
Orange	77	7,061,863	0	0	1,014,212	14.36%	1,501,017	21.26%	\$2.75	(63,266)	(336,176)	52,940	220,435
Santa Ana	163	12,199,576	0	0	1,741,225	14.27%	2,251,223	18.45%	\$2.32	86,650	(69,280)	194,819	317,130
Tustin	45	2,423,515	0	0	188,836	7.79%	273,694	11.29%	\$2.35	(68,860)	(79,460)	24,376	56,391
Central County Total	306	23,632,891	0	0	3,255,700	13.78%	4,621,939	19.56%	\$2.46	(43,798)	(468,747)	294,821	653,020
North County													
Anaheim Hills	80	6,358,625	0	0	412,807	6.49%	485,198	7.63%	\$2.29	(19,276)	(8,692)	28,177	104,192
Brea	41	4,048,512	0	0	370,261	9.15%	409,962	10.13%	\$2.54	(13,009)	(111,905)	13,912	19,852
Buena Park	16	1,048,740	0	0	39,872	3.80%	44,375	4.23%	\$2.19	1,438	(3,663)	8,114	10,519
Fullerton	29	2,299,957	0	0	130,199	5.66%	166,169	7.22%	\$2.63	3,501	31,977	17,540	72,717
La Habra	5	1,933,850	0	0	3,656	1.89%	3,249	1.68%	\$1.64	(961)	410	0	3,510
La Palma	10	712,038	0	0	72,336	10.16%	92,824	13.04%	\$1.93	(2,568)	12,177	1,841	17,685
Placentia	8	267,581	0	0	37,123	13.87%	55,540	20.76%	\$1.97	(5,038)	(6,447)	3,270	3,270
Yorba Linda	5	289,383	0	0	5,130	1.77%	19,691	6.80%	\$2.24	11,757	14,456	11,930	14,629
North County Total	194	15,218,686	0	0	1,071,384	7.04%	1,277,008	8.39%	\$2.38	(24,156)	(71,687)	84,784	246,374
South County													
Aliso Viejo	45	3,380,348	0	0	790,566	23.39%	935,780	27.68%	\$2.61	(96,851)	(125,763)	8,353	83,309
Dana Point	3	127,999	0	0	7,868	6.15%	7,868	6.15%	\$0.00	0	1,200	0	1,200
Foothill Ranch	10	806,438	0	0	119,470	14.81%	136,803	16.96%	\$2.62	(18,336)	(29,817)	11,617	27,327
Irvine Spectrum	181	14,127,903	0	374,638	2,155,092	15.25%	2,624,008	18.57%	\$3.00	16,399	(65,075)	389,361	550,177
Laguna Beach	5	192,434	0	465,000	16,805	8.73%	26,778	13.92%	\$2.63	(1,000)	(1,000)	0	0
Laguna Hills	32	1,791,108	0	0	307,358	17.16%	330,907	18.47%	\$2.81	(990)	(39,252)	31,948	47,500
Laguna Niguel	10	1,751,507	0	0	100,555	5.74%	108,750	6.21%	\$4.03	10,646	(900)	17,364	19,588
Lake Forest	40	2,121,391	0	0	510,369	24.06%	638,562	30.10%	\$2.16	(7,333)	(137,652)	9,663	51,064
Mission Viejo	36	1,995,550	0	0	309,455	15.51%	352,219	17.65%	\$3.05	(11,816)	(29,696)	20,742	42,420
Rancho Santa Margarita	6	252,716	0	0	14,928	5.91%	20,825	8.24%	\$2.25	1,745	(2,259)	1,745	2,045
San Clemente	10	455,615	0	0	87,632	19.23%	98,993	21.73%	\$2.84	(4,296)	(25,696)	2,563	9,301
San Juan Capistrano	20	971,944	0	0	29,219	3.01%	56,221	5.78%	\$2.71	32,311	29,961	38,112	53,098
South County Total	398	27,974,953	0	839,638	4,449,317	15.90%	5,337,714	19.08%	\$2.88	(79,521)	(425,949)	531,468	887,029
West County													
Cypress	27	1,935,928	0	0	156,078	8.06%	212,870	11.00%	\$2.36	18,603	13,621	38,319	41,341
Fountain Valley	34	2,032,625	0	0	118,045	5.81%	103,540	5.09%	\$1.87	(13,694)	(13,567)	10,382	12,555
Garden Grove	19	1,476,936	0	0	73,431	4.97%	65,032	4.40%	\$1.92	(9,561)	(12,921)	2,510	10,210
Huntington Beach	42	3,186,301	0	0	349,165	10.96%	453,753	14.24%	\$2.49	(11,855)	(32,222)	22,457	130,238
Los Alamitos	12	664,033	0	0	53,954	8.13%	153,867	23.17%	\$2.52	(10,262)	(11,327)	0	4,195
Seal Beach	7	480,612	0	0	83,178	17.31%	145,303	30.23%	\$3.44	(24,126)	(17,478)	11,009	17,657
Stanton	4	143,361	0	0	7,903	5.51%	10,555	7.36%	\$1.64	1,236	856	1,236	6,108
Westminster	11	455,385	0	0	15,934	3.50%	27,844	6.11%	\$2.44	2,789	(4,278)	22,013	22,013
West County Total	156	10,375,181	0	0	857,688	8.27%	1,172,768	11.30%	\$2.62	(46,870)	(77,316)	107,926	244,317
Orange County Total	1,526	122,327,635	449,206	1,709,075	16,829,191	13.76%	22,454,657	18.36%	\$2.73	(512,502)	(1,799,669)	1,689,000	3,447,473
Airport Area													
Class A	140	26,752,734	449,206	420,980	5,083,915	19.00%	6,823,611	25.51%	\$3.26	(185,462)	(510,907)	413,481	867,754
Class B	314	17,582,205	0	448,457	2,094,786	11.91%	3,142,126	17.87%	\$2.80	(133,799)	(247,076)	254,441	545,991
Class C	18	790,985	0	0	16,401	2.07%	79,491	10.05%	\$3.61	1,104	2,013	2,079	2,988
Central County													
Class A	44	7,378,485	0	0	1,357,831	18.40%	1,880,984	25.49%	\$2.71	(30,421)	(152,498)	57,466	205,267
Class B	211	14,131,540	0	0	1,633,053	11.56%	2,474,458	17.51%	\$2.38	(24,046)	(202,293)	210,024	409,681
Class C	51	2,122,866	0	0	264,816	12.47%	266,497	12.55%	\$2.05	10,669	(113,956)	27,331	38,072
North County													
Class A	27	3,204,402	0	0	413,289	12.90%	437,784	13.66%	\$2.66	(10,221)	(63,013)	15,345	54,862
Class B	144	11,120,952	0	0	596,442	5.36%	777,203	6.99%	\$2.35	(14,165)	23,672	64,614	183,292
Class C	23	893,332	0	0	61,653	6.90%	62,021	6.94%	\$2.14	230	(32,346)	4,825	8,220
South County													
Class A	85	10,972,510	0	839,638	2,015,736	18.37%	2,289,806	20.87%	\$3.09	(35,725)	(130,276)	255,354	412,230
Class B	302	16,488,487	0	0	2,392,948	14.51%	2,960,592	17.96%	\$2.81	(37,608)	(278,628)	271,460	469,571
Class C	11	513,956	0	0	40,633	7.91%	87,316	16.99%	\$2.42	(6,188)	(17,045)	4,654	5,228
West County													
Class A	17	1,752,748	0	0	279,806	15.96%	414,957	23.67%	\$2.51	(36,556)	(50,430)	12,472	51,801
Class B	124	7,200,834	0	0	574,004	7.97%	753,933	10.47%	\$2.65	(11,016)	(29,338)	94,752	190,064
Class C	15	1,421,599	0	0	3,878	0.27%	3,878	0.27%	\$0.00	702	2,452	702	2,452
Orange County													
Class A	313	50,060,879	449,206	1,260,618	9,150,577	18.28%	11,847,142	23.67%	\$2.98	(298,385)	(907,124)	754,118	1,591,914
Class B	1,095	66,524,018	0	448,457	7,291,233	10.96%	10,108,312	15.19%	\$2.48	(220,634)	(733,663)	895,291	1,798,599
Class C	118	5,742,738	0	0	387,381	6.75%	499,203	8.69%	\$2.03	6,517	(158,882)	39,591	56,960
Orange County Total	1,526	122,327,635	449,206	1,709,075	16,829,191	13.76%	22,454,657	18.36%	\$2.73	(512,502)	(1,799,669)	1,689,000	3,447,473

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.



Flexibility Takes Center Stage

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The office sector is coming out of a major shock, having gone from booming demand for new space at the end of 2019 to the current state in which companies are meticulously reevaluating their real estate needs.

As California is reopening, many office environments are slowly returning to normal. Leasing activity for the first half of the year is up substantially, but an excess of sublease space remains on the market and vacancies are well above the historical average. Low occupancy has resulted in falling rents, hitting the high end of the market the hardest, and investors have mostly remained on the sidelines since the end of last year. Recent notable transactions in the OC office market included redevelopment plays and a medical office building.

“Flexible,” “agile,” and “hybrid” workplaces are front and center in both tenant and landlord decision-making. One thing is certain — workplace design is highly nuanced and there is no single solution. Every transaction is industry-specific and company-specific. We are going to see minimal impact among some sectors like legal services, financial services, and wealth management. But the extent to which most companies are walking around to “kick the tires” and consider their options before signing leases is significant.

On the other hand, the office users who are planning to reduce or even eliminate a physical footprint entirely are not able to flip a switch and make that happen overnight because many leases are still running for another three to ten years.

The greatest unknown is where demand is going, as many companies are indeed looking to significantly reduce their overall space and enhance flexibility for their workforces. The two, however, are not always correlated. Instead of justifying getting rid of much or even all their office space, tenants may do better to reimagine how they utilize space and create an environment that benefits their people, productivity, and culture. Landlords who help their tenants execute this vision will differentiate themselves and will have more tenants willing to pay a premium. For example, in a recent Pipeline article, the Irvine Company disclosed that from April 2020 through March 2021, more than 200 companies expanded, renewed, or signed new leases throughout their portfolio, totaling more than 6.7 MSF. Many business owners say the workplace is more important than ever when it comes to fostering collaboration, innovation, and productivity. A healthy and vibrant workplace helps innovative companies create a winning culture and contributes significantly to growth, success, and employee satisfaction.

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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. ©2021 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