

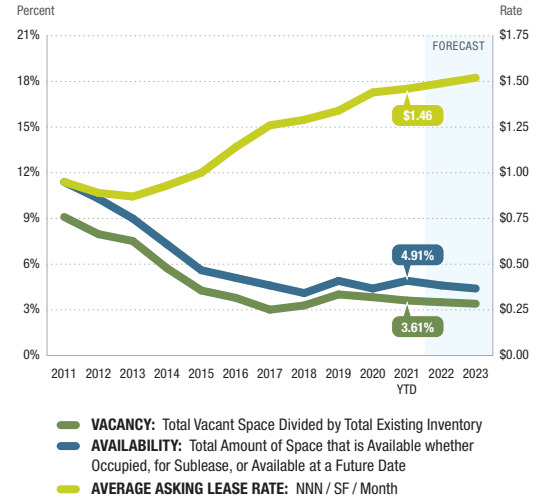
OVERVIEW. Orange County R&D/Flex market conditions were little changed in 3Q. Net absorption declined but remained in positive territory, while vacancy fell modestly. Average asking rents were slightly lower, and construction of new R&D/Flex space remained at zero. Transaction activity and move-ins indicate a stable market with moderate velocity. The R&D/Flex market had been slowing prior to the pandemic but made a comeback as work rules regarding masks and social distancing were eased. R&D/Flex product generally attracts users with high employee density, which made the pandemic lockdown rules more difficult to work through than for traditional industrial space.

VACANCY / AVAILABILITY. The overall vacancy rate fell 9 basis points in 3Q to 3.61% after a much steeper drop in 2Q. On a year-over-year basis vacancy has declined by over 23%. The Greater Airport area, the largest submarket, saw another significant dip in vacancy again in 3Q, falling another 37 basis points to just 3.82%. South County actually experienced a rise in vacancy, climbing 27 basis points to end the period at 4.61%. North County was the biggest mover as its vacancy fell 88 basis points to a scant 1.58%. The consistent overall decline in vacancy indicates that R&D/Flex users are getting back to growing their businesses after a very tough 18 months. Orange County’s decision not to reinstitute a mask mandate and social distancing guidelines has been helpful for R&D/Flex users and their pure office counterparts. The overall availability rate, which includes sublease space and direct lease space that is still occupied, rose slightly to 4.91%, but is still down by over 22% year-over-year.

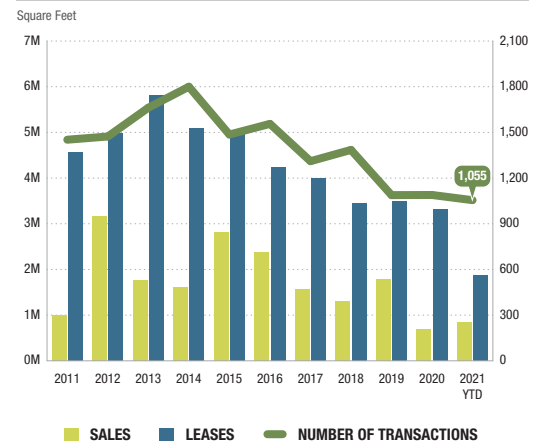
LEASE RATES. The average asking lease rate across all major submarkets was relatively flat during 3Q, gaining a penny to \$1.46, but was down \$0.04 year-over-year. The fact that rates did not fall faster during the pandemic came as a surprise to many, especially due to the higher employee density associated with R&D/Flex tenants. South County’s average rate is still the highest at \$1.60, up \$0.04 during the period. This submarket includes Irvine Spectrum’s 10.5 MSF of generally newer inventory. West County still has the lowest average rate at \$0.94 after falling \$0.11 on very light leasing activity. West County is the smallest of the major submarkets with total inventory of just over 8 MSF. The Airport Area, the largest of the R&D/Flex submarkets, saw asking rents increase by \$0.03 to \$1.55 in 3Q while North County fell 2 cents to \$1.28.

TRANSACTION ACTIVITY. The square footage leased and sold fell to 918,296 SF in 3Q, down from 1,416,920 in 2Q. 598,583 SF of lease space went under contract in 205 transactions in 3Q. Another 319,713 SF of space was sold in 12 separate transactions. Year-over-year sale and lease activity is down 24.8%, not surprising given the complexities of dealing with the pandemic. The largest transaction in 3Q was a 32,933 SF lease by Sparton Corporation to Pacific Palace at 2802 Kelvin Avenue in Irvine. Although leasing transactions were down, the number of sales rose from 8 in 2Q to 12 in 3Q. The largest of those transactions was a 47,000 SF property purchased by Purpose Driven Connection at 23182 Arroyo Vista in Rancho Santa Margarita.

VACANCY, AVAILABILITY & AVERAGE ASKING LEASE RATES



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



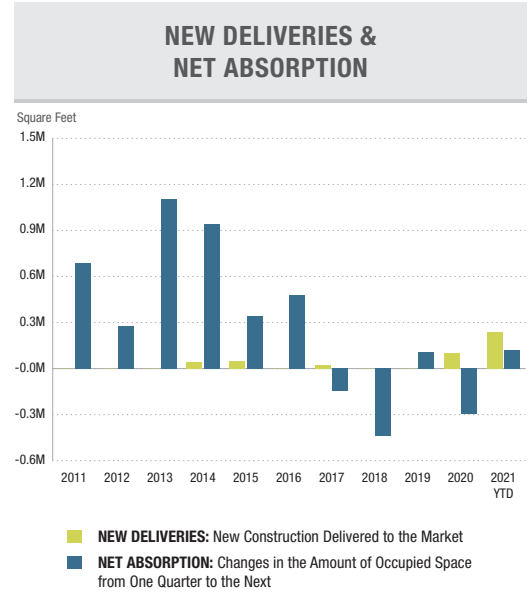
Market Statistics

	Change Over Last Quarter	3Q 2021	2Q 2021	3Q 2020	% Change Over Last Year
Vacancy Rate	▼ DOWN	3.61%	3.70%	4.69%	(23.03%)
Availability Rate	▲ UP	4.91%	4.79%	6.34%	(22.60%)
Average Asking Lease Rate	▲ UP	\$1.46	\$1.45	\$1.51	(3.31%)
Sale & Lease Transactions	▼ DOWN	918,296	1,416,920	1,221,874	(24.85%)
Gross Absorption	▲ UP	941,559	818,935	944,205	(0.28%)
Net Absorption	▲ POSITIVE	16,268	97,411	97,159	N/A

CONSTRUCTION. Construction activity for R&D/Flex product fell to zero in 2Q after Edwards Life Science’s 239,000 SF building, the only project under construction, was delivered. No space whatsoever was in the construction queue or in the planning stages as 3Q ended. Without new product coming on line, vacancy will continue to fall as long as lease and sale activity remains near current levels, and that should put upward pressure on average asking rental rates. However, we don’t expect to see a resurgence in R&D/Flex development, as any suitable site that became available would most likely be developed into a multi-family or mixed-use project.

ABSORPTION. Net absorption for R&D/Flex space eased but remained in positive territory in 3Q. Net absorption, which reflects the change in total occupied space in a given period, totaled just 16,268 SF in the period, down from 97,411 SF in 2Q. Gross absorption, which measures total move-ins, was up slightly in the third period to 941,559 SF. The largest move-in of the period was 23,627 SF, a lease to EMIKO Holding 1901 Ritchey Street in Santa Ana. KONE, Inc. also moved into 21,517 SF at 1540 Scenic Avenue in Costa Mesa.

EMPLOYMENT. The unemployment rate in Orange County was 6.0% in August 2021, down from a revised 6.3% in July 2021, and below the year-ago estimate of 10.7%. Professional and business services grew by 2,700 jobs, with administrative and support (up 2,000 jobs), which includes temporary help firms, accounting for 74% of the increase. Three other sectors grew over the month, including leisure and hospitality (up 2,100 jobs), educational and health services (up 1,000 jobs), and construction (up 400 jobs).



Forecast

The R&D/Flex market will probably remain little changed heading into 2022. Leasing activity, lease rates and absorption will temper and no new inventory will be delivered. That should lead to a modest but steady decline in vacancy. Activity may pick up in Q4 as more operations return to full strength and C-suite decision makers reevaluate their real estate facilities strategies.

Of concern from a general economic perspective is the major spending bill currently being debated in the US Congress. The Build Back Better Plan contains several proposed tax hikes to cover the cost of new social spending initiatives. If passed, capital gains tax rates would increase, the estate tax exemption would decrease substantially, and limitations would be placed on the Qualified Business Income (QBI) deduction for pass-through entities. The C-Corp tax rate would also move back up to 26.5% from the current 21%. The legislation is yet to pass, and it is too early to tell how the negotiations will play out, but all property owners and occupiers are advised to keep a close eye on the issue.

Significant Transactions

Sales

Property Address	Submarket	Square Feet	Sale Price	Buyer	Seller
23182 Arroyo Vista	Rancho Santa Margarita	47,000	\$9,000,000	Purpose Driven Connection	Unity Holdings LLC
7373-7391 Lincoln Way	Garden Grove	45,048	\$15,225,000	United Trust Realty Corporation	Crowsnest Properties LLC
15161-15165 Triton Ln.	Huntington Beach	32,814	\$8,503,500	15161 Triton Ln	Subherwal Family Trust
1800 Carnegie Ave.	Santa Ana	31,680	\$10,000,000	George Chacopulos Trust	Port Street Partners LLC
25741 Atlantic Ocean Dr.	Lake Forest	24,871	\$7,561,000	25741 Atlantic Ocean Drive LLC	Audio and Visual Inc.

Leases * Voit Real Estate Services Deal

Property Address	Submarket	Square Feet	Transaction Date	Tenant	Owner
2802 Kelvin Ave.	Irvine	32,933	Sept-2021	Pacific Palace	Sparton Corporation
1 Vanderbilt	Irvine Spectrum	25,665	Sept-2021	Savage Enterprises	Western State Technologies*
1000 Calle Amanacer	San Clemente	15,323	Jul-2021	Beach Kids Therapy Center	Christian L Fletcher Trust
1945 Placentia Ave.	Costa Mesa	14,322	Jul-2021	Electric Bike Company, LLC*	Ocean Business Park, LLC*
1881 Langley Ave.	Irvine	12,880	Sept-2021	Hanger, Inc.	Kline Miller Investment Co

	INVENTORY				VACANCY & LEASE RATES				ABSORPTION				
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U/C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 3Q2021	Square Feet Available	Availability Rate 3Q2021	Average Asking Lease Rate	Net Absorption 3Q2021	Net Absorption 2021	Gross Absorption 3Q2021	Gross Absorption 2021
Airport Area													
Costa Mesa	171	4,016,969	0	0	233,222	5.81%	281,928	7.02%	\$1.69	39,197	124,222	66,833	286,968
Fountain Valley	49	1,426,272	0	0	5,150	0.36%	18,487	1.30%	\$1.05	3,908	22,058	9,091	50,360
Irvine	240	6,417,723	0	0	259,211	4.04%	359,843	5.61%	\$1.37	(45,940)	86,370	104,119	421,794
Newport Beach	21	582,303	0	0	19,011	3.26%	29,211	5.02%	\$1.75	3,253	3,997	5,000	10,880
Santa Ana	182	4,631,134	0	0	86,327	1.86%	91,703	1.98%	\$0.93	24,959	(3,870)	61,968	212,078
Tustin	86	2,925,801	0	0	160,611	5.49%	74,004	2.53%	\$1.30	11,109	29,902	37,768	124,806
Airport Area Total	749	20,000,202	0	0	763,582	3.82%	855,176	4.28%	\$1.55	36,486	262,679	284,779	1,106,886
North County													
Anaheim	178	5,142,831	0	0	105,420	2.05%	198,022	3.85%	\$1.91	22,684	13,086	62,787	177,787
Brea	52	1,502,172	0	0	18,667	1.24%	25,576	1.70%	\$1.18	2,558	(1,219)	22,287	68,434
Buena Park	29	915,580	0	0	23,500	2.57%	42,530	4.65%	\$1.05	1,791	(1,702)	1,959	10,522
Fullerton	46	1,819,054	0	0	21,795	1.20%	60,114	3.30%	\$1.10	72,190	65,890	91,326	122,666
La Habra	10	187,013	0	0	0	0.00%	0	0.00%	\$0.00	0	1,800	0	1,800
Orange	99	2,244,537	0	0	6,865	0.31%	44,618	1.99%	\$1.65	8,054	15,346	16,107	71,440
Placentia	26	673,935	0	0	15,571	2.31%	15,571	2.31%	\$1.13	(534)	(7,388)	8,842	16,061
Yorba Linda	51	1,500,910	0	0	28,705	1.91%	198,729	13.24%	\$1.15	(4,355)	213	12,318	66,052
North County Total	491	13,986,032	0	0	220,523	1.58%	585,160	4.18%	\$1.28	102,388	86,026	215,626	534,762
South County													
Aliso Viejo	44	1,117,776	0	0	29,206	2.61%	88,530	7.92%	\$1.07	(21,676)	(38,433)	12,986	28,881
Foothill Ranch	8	273,620	0	0	17,789	6.50%	17,789	6.50%	\$1.29	0	(17,789)	0	0
Irvine Spectrum	295	10,570,561	0	0	600,187	5.68%	800,150	7.57%	\$1.66	6,643	(149,217)	256,289	579,189
Laguna Hills	53	1,252,546	0	0	32,674	2.61%	33,486	2.67%	\$1.37	(3,475)	7,870	32,479	89,459
Laguna Niguel	18	882,685	0	0	11,786	1.34%	11,786	1.34%	\$0.00	(7,000)	(6,185)	0	815
Lake Forest	64	1,433,690	0	0	31,598	2.20%	34,840	2.43%	\$1.31	(6,642)	(866)	19,010	80,321
Mission Viejo	35	653,821	0	0	29,490	4.51%	25,071	3.83%	\$1.44	(18,502)	(18,165)	8,551	15,048
Rancho Mission Viejo	3	99,200	0	0	25,945	26.15%	25,945	26.15%	\$1.75	6,620	31,100	6,620	42,165
Rancho Santa Margarita	39	1,438,168	0	0	450	0.03%	6,709	0.47%	\$1.42	657	6,965	4,557	22,157
San Clemente	60	1,432,949	0	0	98,660	6.89%	127,138	8.87%	\$1.55	14,520	1,812	18,293	51,425
San Juan Capistrano	42	738,718	0	0	39,856	5.40%	36,963	5.00%	\$1.74	3,725	8,715	11,694	65,309
South County Total	661	19,895,734	0	0	917,641	4.61%	1,208,407	6.07%	\$1.60	(25,130)	(174,193)	370,479	974,769
West County													
Cypress	51	2,088,611	0	0	129,577	6.20%	165,089	7.90%	\$1.12	(77,268)	(85,601)	11,104	20,349
Garden Grove	68	1,822,975	0	0	78,865	4.33%	70,680	3.88%	\$1.00	(17,961)	(16,060)	19,447	51,102
Huntington Beach	127	2,607,002	0	0	17,933	0.69%	58,498	2.24%	\$1.14	(341)	32,458	13,681	141,265
La Palma	1	78,980	0	0	78,980	100.00%	78,980	100.00%	\$0.76	0	0	0	0
Los Alamitos	42	889,337	0	0	30,545	3.43%	19,614	2.21%	\$0.00	(3,346)	9,761	25,003	63,877
Stanton	5	104,129	0	0	0	0.00%	0	0.00%	\$0.00	0	0	0	0
Westminster	17	464,238	0	0	0	0.00%	0	0.00%	\$0.00	1,440	2,440	1,440	5,090
West County Total	311	8,055,272	0	0	335,900	4.17%	392,861	4.88%	\$0.94	(97,476)	(57,002)	70,675	281,683
Orange County Total	2,212	61,937,240	0	0	2,237,646	3.61%	3,041,604	4.91%	\$1.46	16,268	117,510	941,559	2,898,100
Airport Area													
10,000-24,999	518	8,449,319	0	0	335,034	3.97%	427,973	5.07%	\$1.39	(11,528)	120,527	135,265	535,242
25,000-49,999	164	5,522,756	0	0	222,003	4.02%	332,037	6.01%	\$1.42	(2,472)	18,004	90,876	387,701
50,000-99,999	50	3,338,095	0	0	69,705	2.09%	78,326	2.35%	\$1.66	50,486	124,148	58,638	183,943
100,000 Plus	17	2,690,032	0	0	136,840	5.09%	16,840	0.63%	\$0.00	0	0	0	0
North County													
10,000-24,999	317	5,073,689	0	0	95,240	1.88%	172,851	3.41%	\$1.49	11,912	775	72,735	243,737
25,000-49,999	128	4,223,106	0	0	107,245	2.54%	202,151	4.79%	\$1.32	24,987	19,762	66,483	209,267
50,000-99,999	30	1,959,949	0	0	15,764	0.80%	39,800	2.03%	\$1.05	(1,269)	(1,269)	3,082	4,377
100,000 Plus	16	2,729,288	0	0	2,274	0.08%	170,358	6.24%	\$0.00	66,758	66,758	73,326	77,381
South County													
10,000-24,999	389	6,467,450	0	0	174,825	2.70%	240,292	3.72%	\$1.39	(34,173)	14,968	95,876	367,921
25,000-49,999	198	6,581,182	0	0	424,878	6.46%	502,923	7.64%	\$1.64	8,830	(21,351)	136,533	411,784
50,000-99,999	61	4,071,244	0	0	317,938	7.81%	338,695	8.32%	\$1.69	213	(167,810)	11,040	68,034
100,000 Plus	13	2,775,858	0	0	0	0.00%	126,497	4.56%	\$0.00	0	0	127,030	127,030
West County													
10,000-24,999	219	3,515,686	0	0	77,579	2.21%	81,461	2.32%	\$1.10	(17,654)	(7,692)	47,448	179,292
25,000-49,999	62	2,104,669	0	0	122,175	5.80%	121,114	5.75%	\$1.05	(29,614)	(25,744)	20,227	62,916
50,000-99,999	27	1,878,953	0	0	136,146	7.25%	190,286	10.13%	\$0.78	(50,208)	(23,566)	3,000	39,475
100,000 Plus	3	555,964	0	0	0	0.00%	0	0.00%	\$0.00	0	0	0	0
Orange County													
10,000-24,999	1,443	23,506,144	0	0	682,678	2.90%	922,577	3.92%	\$1.76	(51,443)	128,578	351,324	1,326,192
25,000-49,999	552	18,431,713	0	0	876,301	4.75%	1,158,225	6.28%	\$1.54	1,731	(9,329)	314,119	1,071,668
50,000-99,999	168	11,248,241	0	0	539,553	4.80%	647,107	5.75%	\$1.28	(778)	(68,497)	75,760	295,829
100,000 Plus	49	8,751,142	0	0	139,114	1.59%	313,695	3.58%	\$0.00	66,758	66,758	200,356	204,411
Orange County Total	2,212	61,937,240	0	0	2,237,646	3.61%	3,041,604	4.91%	\$1.46	16,268	117,510	941,559	2,898,100

This survey consists of buildings greater than 10,000 square feet. Lease rates are on a triple-net basis.

Finishing Strong but Stay Alert
by Alton Burgess and Dane Olson



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After yet another quarter of historic results, the Orange County industrial market continues to exceed the expectations set by many at the start of the year. Owner-user and investor demand for industrial product is through the roof, which is the primary driver of the rapid increase in lease rates and sale prices. The general economy is heading in the right direction and many industrial businesses are on pace to have record-setting years.

However, there is some cause for concern regarding the revenue component of the \$3.5 trillion American Families Plan currently being debated in Washington. On September 13, the House Ways and Means Committee released its recommendations to raise federal revenues through a series of tax increases that could be disruptive to the industrial property market. The committee voted to:

- Increase the capital gains tax rate from 20% to 25%
- Raise the top individual income tax rate from 37% to 39.6%
- Lower the estate tax exemption threshold from \$11.7 Million to \$5 Million
- Raise the corporate income tax rate from the current 21% to a graduated system starting at 18% for the first \$400,000 of income, 21% for \$400,000 — \$5 Million and 26.5% thereafter

The encouraging news is that the elimination of 1031 Exchange provisions appears to be off the negotiating table. This 100-year-old rule allowing for the deferral of capital gains taxes is utilized in up to 40% of all commercial property transactions in California, and if removed, would instantly reduce transaction volume and make commercial real estate ownership less attractive. Also, the elimination of the step-up rule is being left out of the bill, which is a huge win for investors who hold property for a lifetime to build generational wealth.

If the committee's recommendations find their way into the new law, they will impact the market to a certain degree, but it would not be as significant as it would have been if passed as originally proposed. Assuming the bill either fails or a scaled-down version of it passes, we expect the local industrial market to finish the year on a high note and maintain its momentum into 2022.

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Product Type

R&D OR MID-TECH

30% to 74.9% improved with drop ceiling, minimum parking ratio of 3 to 1, minimum 50% of exterior glassline, dock and/or ground level loading.

Submarkets



NORTH

Anaheim, Brea, Buena Park, Fullerton, La Habra, Orange, Placentia, Yorba Linda

WEST

Cypress, Garden Grove, Huntington Beach, La Palma, Los Alamitos, Stanton, Westminster

AIRPORT

Costa Mesa, Fountain Valley, Irvine, Newport Beach, Santa Ana, Tustin

SOUTH

Aliso Viejo, Foothill Ranch, Irvine Spectrum, Laguna Hills, Laguna Niguel, Lake Forest, Mission Viejo, Rancho Santa Margarita, San Clemente, San Juan Capistrano