OC2Q22

SECOND QUARTER 2022 MARKET REPORT

ORANGE COUNTY OFFICE

Voit REAL ESTATE SERVICES

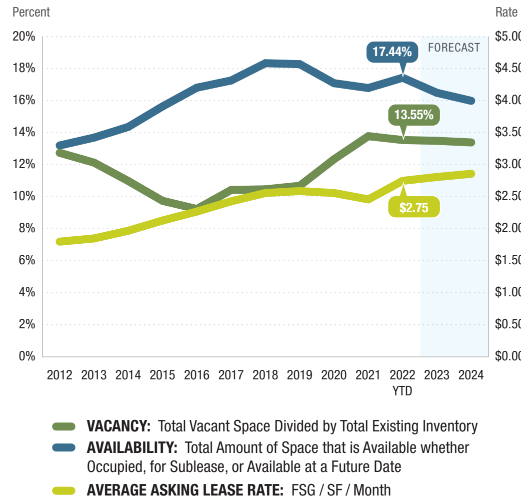
OVERVIEW. The Orange County office market continued to hold its own under difficult economic circumstances in Q2. Vacancy moved up again after posting a moderate decline in Q1. Average asking lease rates held steady while both gross and net absorption levels improved. The office market is still feeling the effects of COVID-19 even though lockdowns are in the rearview mirror. The pandemic has fundamentally changed the way office users do business and decision makers continue to wrestle with how to move forward in terms of hybrid and work-from-home scenarios, and how they will change the size and configuration of office suites in the future. Even today, with the worst of the health crisis behind us, fewer than half of office workers are back at their desks on a regular basis. As we reported last quarter, high-rise and mid-rise buildings are facing the biggest challenge because of employee density and dependence on elevators for access to individual spaces. So, uncertainty over how to proceed in terms of space utilization continues to slow the decision-making process, and that is most certainly impacting market metrics across the board. Thankfully, construction activity is light and is expected to remain so going forward.

VACANCY & AVAILABILITY. The overall rate in Q2 moved back up after a significant decline in the first period. Vacancy stood at 13.55% at the end of Q2, up 31 basis points after Q1's 52-basis-point drop. However, the current vacancy rate is 21 basis points lower than it was in Q2 of 2021, which does indicate that the market is recovering slowly from the worst effects of the pandemic. Class A buildings are still carrying the bulk of the vacancy, due to their bigger price tag, higher employee density, and need for elevator access.

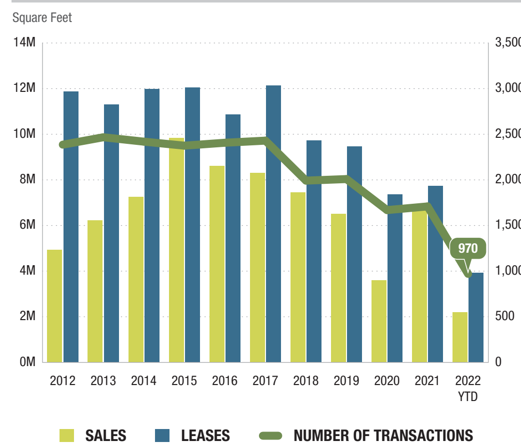
LEASE RATES. The average asking lease rate for all office space countywide was unchanged in Q2 at $2.75. Class A space in the Airport Area is still the most expensive, up slightly again in Q2 to $3.21, followed closely by South County at $2.94. Class B asking rents are highest in South County at $2.81, down 2 cents, and lowest in North County at $2.33, unchanged during the period. On a year-over-year basis, the overall average asking rate is unchanged for the second consecutive period, further evidence that the market has stabilized. However, landlords tend to hold the line on asking rates and become more flexible when negotiating for free rent, parking and tenant improvements. So, the effective rate of each transaction offers a more accurate reflection of true market conditions.

TRANSACTION ACTIVITY. Lease and sale activity by square footage fell to 2.6 MSF in Q2 from 3.5 MSF in Q1, and the number of sale and lease transactions decreased to 463 in Q2 from 507. Countywide, 450 lease transactions and 13 sales were made in the current period. Most of the transactions are in the lower size ranges, as larger tenants who tend to sign longer-term leases are still unsure about their needs for space and remain on the sidelines. Those who are still considering a switch to hybrid work environments over the long term may be able to reduce their need for space, which could impact absorption and transaction activity going forward.

VACANCY, AVAILABILITY & AVERAGE ASKING LEASE RATES



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



Market Statistics

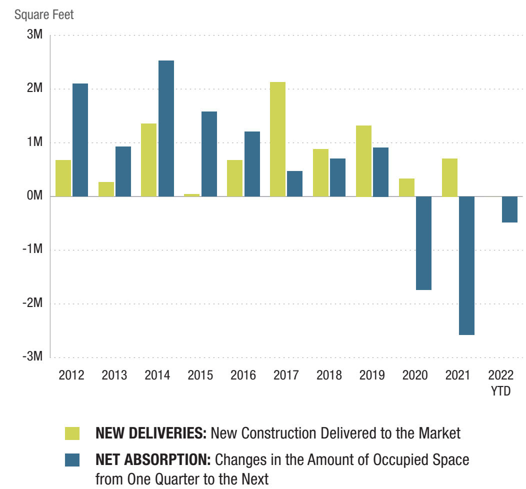
	Change Over Last Quarter		2Q 2022	1Q 2022	2Q 2021	% Change Over Last Year
Vacancy Rate	▲	UP	13.55%	13.24%	13.76%	(1.52%)
Availability Rate	▲	UP	17.44%	16.80%	18.35%	(4.99%)
Average Asking Lease Rate	▬	FLAT	$2.75	$2.75	$2.74	0.36%
Sale & Lease Transactions	▼	DOWN	2,614,010	3,504,071	3,116,776	(16.13%)
Gross Absorption	▲	UP	3,537,622	1,837,972	1,206,229	193.28%
Net Absorption	▼	NEGATIVE	(198,002)	(278,859)	(512,502)	N/A

ABSORPTION. Net absorption was still negative in Q2, as expected, but the net loss in occupied space fell to 198,002 SF during the period from negative 278,859 SF in Q1. That represents a significant improvement on a year-over-year basis when negative net absorption was over 512,000 SF. Year to date, negative net absorption is almost 476,861 SF, but the numbers are moving in the right direction, albeit slower than the county's office landlords would like. Until more business owners make decisions on whether or not to move to hybrid workplaces, net absorption will remain sluggish.

CONSTRUCTION. As we have been reporting, construction activity remains thin, a welcome situation for the owners of existing office buildings. The construction queue is still confined to the same three projects: The Press in Costa Mesa along with Spectrum Terrace and Innovation Office Park in Irvine Spectrum. Those projects add up to just over 993,161 SF. Another 986,408 is in the planning stages, all of which is confined to the cities of Irvine and Laguna Hills.

EMPLOYMENT. The unemployment rate in Orange County was 2.4 % in May 2022, down from a revised 2.7% in April 2022, and below the year-ago estimate of 6.2%. Between May 2021 and May 2022, total nonfarm employment increased by 76,100 jobs, or 4.8%.

NEW DELIVERIES & NET ABSORPTION



Forecast

The unexpected success of the forced work-from-home environment has thrown the office market into a time of uncertainty, which has slowed decision making enough to keep many requirements, large and small, on the sidelines. That has presented a major challenge to building owners who are doing everything possible to encourage their tenants to get their employees back to the office. So far, those efforts have fallen short as fewer than half of all employees are back in the office on a regular basis. We expect this uncertainty to continue into next year, which will keep lease rates near current levels and net absorption near zero.

The new wild card in terms of the overall economy is the rise of inflation to levels not seen in over 40 years. That prompted the Fed to bump its benchmark rate twice during the period to approximately 1.75%. The Fed's actions have sharply increased the cost of capital, specifically mortgage interest rates for office properties. The SBA 504 mortgage has gone from 3.21% to 5.19% since the beginning of the year. Cap rate decompression becomes a very real possibility in the coming quarters, as leverage buyers refuse to pay for a mortgage with an interest rate higher than their cap rate.

Significant Transactions

Sales

Property Address	City	Class	Square Feet	Total Price	Buyer	Seller
15771 Red Hill Ave.	Tustin	B	103,281	$46,000,000	Rexford Industrial	GVI (SW) Red Hill Owner LLC
1801 W. Romneya Dr.	Anaheim	B	87,854	$17,900,000	2751 Chapman LLC	KPM
3111 N. Tustin Ave.	Orange	B	65,460	$15,101,000	Lutheran High School Association of OC	Angelo, Gordon & Co
9800 Muirlands Blvd.	Irvine Spectrum	B	56,773	$18,000,000	Oceans Church	Chapman University
23101 Lake Center Dr.	Lake Forest	A	51,136	$11,500,000	Gulton Court LP	Angelo, Gordon & Co

Leases

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
535 Anton Blvd.	Costa Mesa	A	50,261	May-2022	Siemens	McCarthy Cook & Co.
611 Anton Blvd. – Renewal	Costa Mesa	A	35,699	May-2022	Comerica Bank	The Irvine Company
27442 Portola Pkwy.	Foothill Ranch	A	27,191	May-2022	US Real Estate Services	Barings
2010 Main St. – Renewal	Irvine	A	25,544	Jun-2022	AmWINS Group Inc.	Emmes Realty Services LLC
2020 Main St. – Renewal	Irvine	A	22,539	May-2022	New York Life	PGM Real Estate

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 2Q2022	Square Feet Available	Availability Rate 2Q2022	Average Asking Lease Rate	Net Absorption 2Q2022	Net Absorption 2022	Gross Absorption 2Q2022	Gross Absorption 2022
Airport Area													
Costa Mesa	70	7,267,585	449,206	0	1,232,942	16.96%	1,531,330	21.07%	$3.12	12,360	101,141	237,437	413,524
Irvine	261	25,034,691	0	521,408	4,182,266	16.71%	5,482,248	21.90%	$2.83	(108,315)	(143,659)	1,086,345	2,000,896
Newport Beach	121	9,974,901	0	0	1,183,024	11.86%	1,430,648	14.34%	$3.06	38,855	(113,609)	303,688	412,199
Santa Ana	15	2,486,772	0	0	594,267	23.90%	687,277	27.64%	$2.75	(42,267)	(121,118)	40,211	41,317
Tustin	4	418,585	0	0	190,935	45.61%	177,167	42.33%	$4.41	83,934	14,633	86,643	93,477
Airport Area Total	471	45,182,534	449,206	521,408	7,383,434	16.34%	9,308,670	20.60%	$2.91	(15,433)	(262,612)	1,754,324	2,961,413
Central County													
Anaheim	21	1,947,835	0	0	463,501	23.80%	498,993	25.62%	$2.25	(63,831)	(103,730)	31,905	75,481
Orange	77	7,031,759	0	0	1,043,885	14.85%	2,046,311	29.10%	$2.67	(82,073)	(31,905)	112,539	222,859
Santa Ana	164	12,219,360	0	0	1,893,843	15.50%	2,145,088	17.55%	$2.44	(55,754)	(258,918)	151,669	218,139
Tustin	43	2,375,262	0	0	179,884	7.57%	264,563	11.14%	$1.74	(30,733)	(34,450)	10,091	105,070
Central County Total	305	23,574,216	0	0	3,581,113	15.19%	4,954,955	21.02%	$2.41	(232,391)	(429,003)	306,204	621,549
North County													
Anaheim Hills	80	6,359,976	0	0	436,661	6.87%	437,920	6.89%	$2.16	(11,699)	(71,392)	64,952	106,553
Brea	40	3,925,482	0	0	438,401	11.17%	604,947	15.41%	$2.62	(55,534)	(169,867)	39,640	92,077
Buena Park	16	1,048,740	0	0	20,573	1.96%	22,126	2.11%	$2.16	(11,151)	(131)	200	11,220
Fullerton	29	2,329,741	0	0	141,425	6.07%	160,287	6.88%	$2.70	(1,824)	(10,343)	25,656	51,333
La Habra	5	193,849	0	0	2,447	1.26%	2,447	1.26%	$1.90	(1,531)	3,337	0	5,400
La Palma	10	720,556	0	0	79,919	11.09%	122,923	17.06%	$1.92	(9,614)	(6,439)	2,190	8,178
Placentia	8	267,581	0	0	33,845	12.65%	52,635	19.67%	$2.26	(5,020)	(5,685)	4,770	16,675
Yorba Linda	5	289,383	0	0	7,060	2.44%	21,621	7.47%	$2.27	0	0	0	0
North County Total	193	15,135,308	0	0	1,160,331	7.67%	1,424,906	9.41%	$2.39	(96,373)	(260,520)	137,408	291,436
South County													
Aliso Viejo	45	3,371,202	0	0	725,736	21.53%	907,300	26.91%	$2.55	28,980	2,090	64,303	101,545
Dana Point	4	157,073	0	0	0	0.00%	0	0.00%	$0.00	0	0	0	0
Foothill Ranch	9	735,061	0	0	79,203	10.78%	106,394	14.47%	$3.75	(7,290)	7,956	800	23,618
Irvine Spectrum	180	14,087,001	543,955	0	1,572,104	11.16%	1,940,158	13.77%	$2.94	132,130	506,497	1,029,457	1,564,870
Laguna Beach	6	194,004	0	0	14,883	7.67%	22,988	11.85%	$2.70	980	(1,472)	2,848	3,848
Laguna Hills	33	1,828,152	0	465,000	305,001	16.68%	364,984	19.96%	$2.84	(6,885)	(1,388)	49,679	101,011
Laguna Niguel	11	1,777,473	0	0	73,996	4.16%	94,634	5.32%	$2.13	(1,364)	4,039	3,221	16,649
Lake Forest	41	2,202,827	0	0	357,970	16.25%	538,219	24.43%	$2.24	(39,424)	(64,026)	7,137	14,784
Mission Viejo	37	2,044,691	0	0	349,212	17.08%	387,009	18.93%	$3.01	(2,875)	(24,490)	27,935	41,437
Rancho Santa Margarita	6	252,716	0	0	20,717	8.20%	18,850	7.46%	$2.26	(323)	(323)	3,411	3,411
San Clemente	10	465,252	0	0	47,932	10.30%	47,932	10.30%	$3.01	10,789	10,544	12,226	21,386
San Juan Capistrano	20	971,944	0	0	45,207	4.65%	63,913	6.58%	$2.68	(18,316)	(16,626)	1,873	5,153
South County Total	402	28,087,396	543,955	465,000	3,591,961	12.79%	4,492,381	15.99%	$2.84	96,402	422,801	1,202,890	1,897,712
West County													
Cypress	27	1,903,928	0	0	249,101	13.08%	444,088	23.32%	$2.45	(22,284)	(21,810)	7,737	30,725
Fountain Valley	33	1,999,041	0	0	90,463	4.53%	93,564	4.68%	$1.75	(3,433)	31,368	2,775	37,576
Garden Grove	19	1,474,997	0	0	62,023	4.20%	102,757	6.97%	$1.97	(2,019)	(3,802)	5,780	8,168
Huntington Beach	42	3,162,294	0	0	335,158	10.60%	410,178	12.97%	$2.98	5,665	(8,576)	25,055	70,611
Los Alamitos	12	665,928	0	0	30,092	4.52%	29,799	4.47%	$2.51	28,516	27,734	34,033	37,340
Seal Beach	7	480,612	0	0	62,618	13.03%	43,100	8.97%	$3.42	27,117	11,610	38,558	56,826
Stanton	4	143,361	0	0	7,351	5.13%	7,351	5.13%	$1.97	3,077	5,162	4,184	9,261
Westminster	11	455,385	0	0	10,638	2.34%	10,638	2.34%	$2.43	13,154	10,787	18,674	23,566
West County Total	155	10,285,546	0	0	847,444	8.24%	1,141,475	11.10%	$2.61	49,793	52,473	136,796	274,073
Orange County Total	**1,526**	**122,265,000**	**993,161**	**986,408**	**16,564,283**	**13.55%**	**21,322,387**	**17.44%**	**$2.75**	**(198,002)**	**(476,861)**	**3,537,622**	**6,046,183**
Airport Area													
Class A	137	26,474,513	449,206	238,600	5,078,303	19.18%	6,428,981	24.28%	$3.21	(21,476)	(400,025)	1,118,263	1,799,158
Class B	318	18,001,317	0	282,808	2,260,440	12.56%	2,832,394	15.73%	$2.78	7,755	95,568	596,911	1,115,077
Class C	16	706,704	0	0	44,691	6.32%	47,295	6.69%	$2.85	(1,712)	41,845	39,150	47,178
Central County													
Class A	43	7,307,866	0	0	1,407,256	19.26%	2,038,367	27.89%	$2.80	(50,944)	(72,041)	126,554	213,566
Class B	213	14,251,315	0	0	1,998,121	14.02%	2,642,552	18.54%	$2.24	(199,402)	(369,402)	144,308	362,001
Class C	49	2,015,035	0	0	175,736	8.72%	274,036	13.60%	$2.04	17,955	12,440	35,342	45,982
North County													
Class A	24	2,881,270	0	0	340,199	11.81%	398,114	13.82%	$2.78	(28,208)	(67,276)	2,190	51,553
Class B	147	11,419,646	0	0	793,148	6.95%	1,001,852	8.77%	$2.33	(71,307)	(190,896)	128,084	198,436
Class C	22	834,392	0	0	26,984	3.23%	24,940	2.99%	$2.10	3,142	(2,348)	7,134	41,447
South County													
Class A	82	10,677,878	345,786	465,000	1,641,127	15.37%	1,899,833	17.79%	$2.94	86,007	262,857	642,927	902,951
Class B	307	16,848,856	198,169	0	1,926,348	11.43%	2,532,419	15.03%	$2.81	10,844	174,231	557,379	991,339
Class C	13	560,662	0	0	24,486	4.37%	60,129	10.72%	$2.28	(449)	(14,287)	2,584	3,422
West County													
Class A	14	1,482,154	0	0	368,569	24.87%	578,465	39.03%	$2.72	1,045	(29,372)	10,855	23,155
Class B	127	7,416,121	0	0	475,375	6.41%	559,510	7.54%	$2.54	51,248	83,399	125,941	248,972
Class C	14	1,387,271	0	0	3,500	0.25%	3,500	0.25%	$2.00	(2,500)	(1,554)	0	1,946
Orange County													
Class A	300	48,823,681	794,992	703,600	8,835,454	18.10%	11,343,760	23.23%	$2.90	(13,576)	(305,857)	1,900,789	2,990,383
Class B	1,112	67,937,255	198,169	282,808	7,453,432	10.97%	9,568,727	14.08%	$2.41	(200,862)	(207,100)	1,552,623	2,915,825
Class C	114	5,504,064	0	0	275,397	5.00%	409,900	7.45%	$1.91	16,436	36,096	84,210	139,975
Orange County Total	**1,526**	**122,265,000**	**993,161**	**986,408**	**16,564,283**	**13.55%**	**21,322,387**	**17.44%**	**$2.75**	**(198,002)**	**(476,861)**	**3,537,622**	**6,046,183**

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.

Voit
REAL ESTATE SERVICES

Four-Day Work Week Anyone?

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2022 has presented encouraging signs of a recovery in demand for office space, as we unravel from COVID-19 and negotiate the power struggle between employers and employees over hybrid work policies and the long-term demand for office space. There's no clear sign of a resolution, and there likely never will be unless we can compromise on a new general standard for hybrid work.

Add to this a generous dose of economic uncertainty, and corporate decision makers quickly find themselves in a holding pattern, pending future outcomes. This sounds like a recession in the making to me. We're pretty much talking ourselves into one — some are actually hoping for a "reset." And the Fed is now facing the reality that it may not be able to rein in inflation without creating some significant economic downsides such as stagflation.

That said, the office sector is arguably already in a recession of its own. The metrics say vacancy has somewhat stabilized. However, as leases signed "pre-COVID" are expiring, the possibility of more short-term lease renewals underpins the risk of further vacancy and downward pressure on rents, particularly in less desirable office buildings. The outlook is consequently still cloudy for most office building owners, with many OC landlords openly admitting to trying to make every deal they possibly can. All these talking points are usually reflective of a tenant's market, but where are the tenants?

Something has to give, and it's going to take something impactful enough to equalize the power balance between employers and employees. A recession accompanied by high unemployment may well achieve this, as employees' job security diminishes, and they're forced into self-preservation mode. In this scenario, many will be forced to stand up and be counted, or risk falling into the category of the forgotten, surplus worker, and risk getting downsized. Thus, the office market evolution would continue, and as the power balance stabilizes and the dust settles, the chance of a standard compromise on hybrid work policies could increase.

A four-day work week could be a pretty good compromise. It's a bold, progressive solution, but we do need a solution. We have the technology to succeed with this scenario, and multiple international studies into four-day work weeks have demonstrated higher productivity across the board. Who doesn't enjoy a long weekend anyway?

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

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