

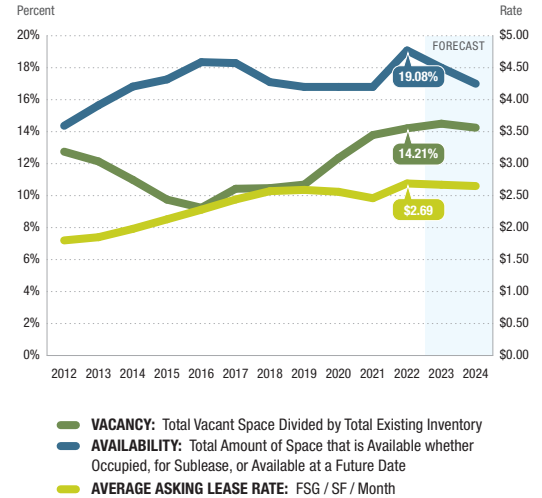
OVERVIEW. Orange County office market metrics softened again in 4Q, as the market continued to struggle with changes in the workplace that resulted from the pandemic. Vacancy and availability both moved up, transaction activity and gross absorption slipped and net absorption fell further into negative territory. Average asking lease rates were little changed and, fortunately, construction activity is nearly shut down. The pandemic has had a lasting effect on the way traditional office users utilize their space and it is really showing up in the numbers. Hybrid and work-from-home business models represent the new normal and many workers are insisting on maintaining their new work/life balance. National studies show that over half the country's office workforce is still not in the office full time. However, we are seeing more employers insist on seeing their workers in the office. With such a high level of uncertainty on how they will utilize office space going forward, business owners are increasingly unwilling to commit to new long-term leases, opting instead to remain flexible until the biggest change in office use in modern history sorts itself out.

VACANCY & AVAILABILITY. The overall vacancy rate in 4Q moved sharply higher, ending the period at 14.21% up from 13.32%, in 3Q. Year-over-year, vacancy has risen by 42 basis points. Class A buildings are still experiencing the highest vacancy due to their higher price tag, employee density and dependence on elevator access. The Class A vacancy rate countywide broke through the 20% barrier to 20.05%, up from 18.50% in 3Q. Across all building classes, the availability rate, which includes occupied space offered for lease or sublease, rose by 228 basis points to 19.08% during the period, up from 16.8% in 3Q. That spike is further indication of the increase in sublease activity and a decrease in long-term renewals.

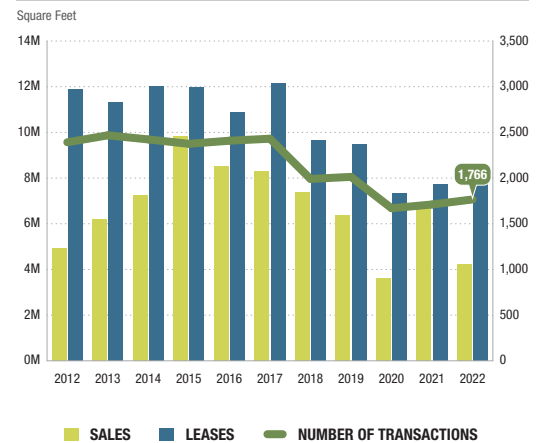
LEASE RATES. The average asking lease rate for all office space countywide was nearly flat in 4Q, down a penny to \$2.69. The Airport Area is still the most expensive, but the average asking rate there fell \$0.02 to end the period at \$2.84, followed closely by South County, also down \$0.02 to \$2.75. Central County was also lower by \$0.02, while North County managed an increase of a penny to end the year at \$2.52. On a year-over-year basis, the overall average asking rate is down by just 5 cents. Considering the degree to which the in-office work model has been challenged, and the wage/price spiral impacting business growth, the office market has shown considerable resilience.

TRANSACTION ACTIVITY. Lease and sale activity by square footage fell to 2.27 MSF in 4Q from over 2.6 MSF in 3Q. The number of sale and lease transactions decreased to 339 in 4Q from 380 in 3Q. Countywide, 328 lease transactions and 11 sales were made in the final quarter of 2022. Lower activity levels continue to reflect the uncertainty of many tenants who are delaying major lease commitments while they struggle with workplace changes and battle the highest inflation since the 1980's. The largest lease deal of the quarter was a 115,290 SF lease from The Irvine Company to Apple at 17900 Laguna Canyon Road in Irvine Spectrum. The largest sale of the period was a 288,088 SF acquisition by Healthcare Property Advisors from AdelFi.

VACANCY, AVAILABILITY & AVERAGE ASKING LEASE RATES



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



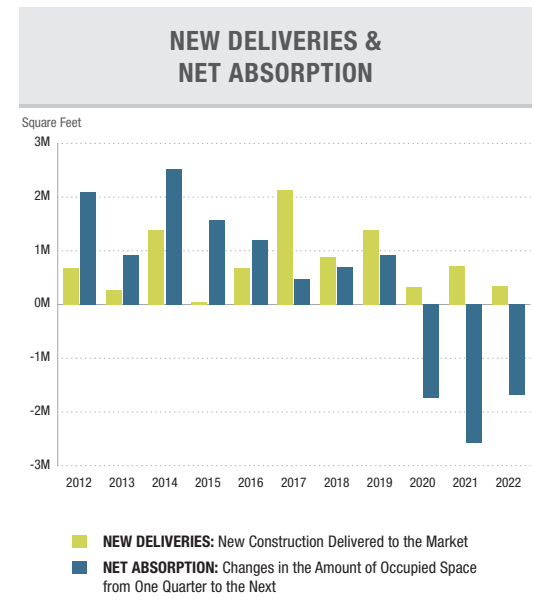
Market Statistics

	Change Over Last Quarter	4Q 2022	3Q 2022	4Q 2021	% Change Over Last Year
Vacancy Rate	▲ UP	14.21%	13.32%	13.79%	3.08%
Availability Rate	▲ UP	19.08%	16.80%	17.10%	11.59%
Average Asking Lease Rate	▼ DOWN	\$2.69	\$2.70	\$2.74	(1.82%)
Sale & Lease Transactions	▼ DOWN	2,269,579	2,624,916	4,673,978	(51.44%)
Gross Absorption	▼ DOWN	2,062,547	2,274,113	2,647,987	(22.11%)
Net Absorption	▼ NEGATIVE	(787,025)	(413,803)	(224,290)	N/A

ABSORPTION. Net absorption, the net difference in occupied space quarter-to-quarter, fell further into negative territory in 4Q with a net loss of 787,025 SF, almost double the loss of 413,803 SF in 3Q. The biggest loss was suffered in Central County again in 4Q. The submarket lost almost 249,000 SF in occupied space, primarily due to the vacating of a 119,682 SF space by Cash Call at 1 City Boulevard in Orange. All five major submarkets posted negative absorption, with West County recording the smallest loss of 62,769 SF. South County, the Airport Area and North County all posted losses in excess of 140,000 SF in the final quarter.

CONSTRUCTION. The construction queue in 4Q reduced to 614,061 SF with the completion of Spectrum Terrace. There are only two projects currently under construction. The Press in Costa Mesa has been preleased to Anduril and is expected to be delivered early in 2023. Innovation Office Park in Irvine Spectrum is being built by the Irvine Company. Until there is further clarification on the current debate on where employees will work from going forward, construction activity should remain thin. Less than 1.7 MSF of space is even in the planning stages. The lack of new product gives existing landlords a better chance to get their occupancy levels up and keep leasing incentives in check.

EMPLOYMENT. The unemployment rate in Orange County was 3.0% in November 2022, up from a revised 2.8% in October 2022, and below the year-ago estimate of 4.1%. Three sectors gained employment: Educational and health services (up 3,500 jobs), government (up 500 jobs), and professional and business services (up 100 jobs).



Forecast

The office market will soften further and continue to face uncertainty over changing work habits and workplace design. As we have been reporting, the unexpected consequences of the forced work-from-home environment has slowed decision making enough to keep requirements of all sizes on the sidelines. We see no change in this trend in the near term that will give the office market a much-needed boost. Average asking lease rates should remain flat and net absorption is likely to move further into negative territory in 2023. Effective rates are likely to move lower, especially for Class A space, as landlords increase concessions to attract tenants to their vacant spaces.

On the economic front, inflation is forcing businesses to cut costs wherever possible, including office rent, which, is historically one of the largest expenses for office-based businesses. This will likely cause further declines in Class A rents, as that's where the bulk of the vacancy is.

Significant Transactions

Sales

Property Address	City	Class	Square Feet	Total Price	Buyer	Seller
915–975 W. Imperial Hwy.	Brea	B	288,058	\$80,000,000	Healthcare Property Advisors	AdelFi
23422–23382 Mill Creek Dr. & 24411–24461 Ridge Route Dr.	Laguna Hills	B	223,974	\$63,750,000	Kingbarn Realty Capital	Cigna Corporation
24422 Avenida De La Carlota	Laguna Hills	B	119,927	\$28,100,000	Buchanan Street Partners	Angelo, Gordon & Co.
23172 Plaza Pointe Dr.	Laguna Hills	B	35,437	\$7,000,000	TA Partners	Comerica Inc.

Leases

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
17900 Laguna Canyon Rd.	Irvine Spectrum	A	115,290	Nov-2022	Apple, Inc.	The Irvine Company
675 Placentia Ave.	Brea	A	61,406	Nov-2022	County of Orange	Nuveen Real Estate
1730 Flight Way	Tustin	A	45,244	Dec-2022	99 Cent Store	Lincoln Property Company
18301 Von Karman Ave. - Renewal	Irvine	A	41,949	Nov-2022	Golden State Foods	Greenlaw Partners
4400 W MacArthur Blvd. - Renewal	Newport Beach	A	36,672	Oct-2022	Bank of the West	4400 MacArthur Property Holdings

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 4Q2022	Square Feet Available	Availability Rate 4Q2022	Average Asking Lease Rate	Net Absorption 4Q2022	Net Absorption 2022	Gross Absorption 4Q2022	Gross Absorption 2022
Airport Area													
Costa Mesa	70	7,267,585	449,206	0	1,288,136	17.72%	1,762,296	24.25%	\$3.00	(49,851)	75,743	166,059	814,605
Irvine	261	25,034,691	0	1,215,304	4,223,263	16.87%	5,843,581	23.34%	\$2.78	(181,620)	(316,109)	477,403	2,973,039
Newport Beach	121	9,974,901	0	0	1,052,482	10.55%	1,468,362	14.72%	\$2.96	47,490	(134,749)	207,460	799,715
Santa Ana	15	2,486,772	0	0	587,398	23.62%	670,575	26.97%	\$2.75	14,469	(140,912)	76,553	118,788
Tustin	4	418,585	0	0	160,076	38.24%	55,082	13.16%	\$4.40	16,941	45,492	52,835	160,230
Airport Area Total	471	45,182,534	449,206	1,215,304	7,311,355	16.18%	9,799,896	21.69%	\$2.84	(152,571)	(470,535)	980,310	4,866,377
Central County													
Anaheim	21	1,947,835	0	0	446,103	22.90%	482,216	24.76%	\$2.42	(27,666)	(126,054)	49,074	130,011
Orange	77	7,031,759	0	0	1,109,007	15.77%	1,701,526	24.20%	\$2.56	(122,273)	(234,563)	88,841	449,625
Santa Ana	164	12,219,360	0	0	2,052,840	16.80%	2,817,474	23.06%	\$2.49	(105,687)	(532,504)	143,101	624,441
Tustin	43	2,375,262	0	0	178,131	7.50%	220,283	9.27%	\$1.79	7,040	(43,441)	39,850	155,591
Central County Total	305	23,574,216	0	0	3,786,081	16.06%	5,221,499	22.15%	\$2.44	(248,586)	(936,562)	320,866	1,359,668
North County													
Anaheim Hills	80	6,359,976	0	0	567,221	8.92%	561,503	8.83%	\$2.49	(18,985)	(254,937)	39,836	239,507
Brea	40	3,925,482	0	0	664,264	16.92%	781,873	19.92%	\$2.66	(168,091)	(358,786)	58,742	194,440
Buena Park	16	1,048,740	0	0	15,763	1.50%	17,316	1.65%	\$2.14	25	4,679	2,500	19,630
Fullerton	29	2,329,741	0	0	128,034	5.50%	127,280	5.46%	\$2.71	3,579	3,478	24,307	115,365
La Habra	5	193,849	0	0	4,594	2.37%	4,594	2.37%	\$1.81	(2,312)	1,190	173	5,738
La Palma	10	720,556	0	0	92,352	12.82%	130,694	18.14%	\$1.91	(2,001)	1,260	62	41,606
Placentia	8	267,581	0	0	21,952	8.20%	43,742	16.35%	\$2.09	7,337	3,765	7,337	29,395
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	1,501,240	9.92%	1,688,623	11.16%	\$2.52	(180,448)	(599,351)	132,957	645,681
South County													
Aliso Viejo	45	3,371,202	0	0	756,580	22.44%	915,137	27.15%	\$2.56	(30,090)	(80,504)	62,311	210,240
Dana Point	4	157,073	0	0	6,000	3.82%	2,400	1.53%	\$0.00	(6,000)	(6,000)	0	0
Foothill Ranch	9	735,061	0	0	56,370	7.67%	237,106	32.26%	\$2.52	27,191	57,980	27,191	100,833
Irvine Spectrum	180	14,087,001	197,855	0	1,771,805	12.58%	2,684,120	19.05%	\$2.83	(53,396)	545,596	287,601	2,236,066
Laguna Beach	6	194,004	0	0	15,720	8.10%	22,704	11.70%	\$2.81	(2,705)	(4,177)	0	3,848
Laguna Hills	33	1,828,152	0	465,000	327,097	17.89%	372,764	20.39%	\$2.74	(38,478)	(23,779)	26,568	171,728
Laguna Niguel	11	1,777,473	0	0	67,508	3.80%	84,670	4.76%	\$1.97	16,923	12,165	28,333	55,991
Lake Forest	41	2,202,827	0	0	345,693	15.69%	387,207	17.58%	\$2.22	(24,020)	(60,158)	38,838	125,504
Mission Viejo	37	2,044,691	0	0	378,067	18.49%	410,343	20.07%	\$2.99	(21,397)	(51,745)	14,090	88,517
Rancho Santa Margarita	6	252,716	0	0	21,011	8.31%	32,736	12.95%	\$2.28	(1,452)	(4,324)	0	3,411
San Clemente	10	465,252	0	0	67,862	14.59%	74,172	15.94%	\$2.97	(19,011)	(10,566)	1,000	28,025
San Juan Capistrano	20	971,944	0	0	38,978	4.01%	57,831	5.95%	\$2.53	9,784	(10,397)	13,924	27,664
South County Total	402	28,087,396	197,855	465,000	3,852,691	13.72%	5,281,190	18.80%	\$2.75	(142,651)	364,091	499,856	3,051,827
West County													
Cypress	27	1,903,928	0	0	266,949	14.02%	568,799	29.88%	\$2.48	(28,324)	(49,735)	50,462	82,886
Fountain Valley	33	1,999,041	0	0	111,127	5.56%	123,895	6.20%	\$1.84	(9,957)	8,934	2,991	40,983
Garden Grove	19	1,474,997	0	0	44,751	3.03%	45,882	3.11%	\$2.05	16,324	13,280	25,088	44,356
Huntington Beach	42	3,162,294	0	0	359,360	11.36%	446,160	14.11%	\$3.08	(30,208)	(25,382)	40,380	150,573
Los Alamitos	12	665,928	0	0	39,601	5.95%	37,230	5.59%	\$2.64	(7,637)	15,516	9,637	46,977
Seal Beach	7	480,612	0	0	65,235	13.57%	60,997	12.69%	\$3.43	0	7,362	0	59,896
Stanton	4	143,361	0	0	5,877	4.10%	5,877	4.10%	\$1.97	(695)	3,384	0	10,053
Westminster	11	455,385	0	0	30,116	6.61%	47,675	10.47%	\$2.39	(2,272)	(8,691)	0	23,566
West County Total	155	10,285,546	0	0	923,016	8.97%	1,336,515	12.99%	\$2.62	(62,769)	(35,332)	128,558	459,290
Orange County Total	1,526	122,265,000	647,061	1,680,304	17,374,383	14.21%	23,327,723	19.08%	\$2.69	(787,025)	(1,677,689)	2,062,547	10,382,843
Airport Area													
Class A	137	26,474,513	449,206	932,496	5,244,807	19.81%	6,720,772	25.39%	\$3.07	(132,030)	(692,011)	567,591	2,873,395
Class B	318	18,001,317	0	282,808	2,028,050	11.27%	2,944,944	16.36%	\$2.73	(17,074)	182,634	395,487	1,889,610
Class C	16	706,704	0	0	38,498	5.45%	134,180	18.99%	\$2.96	(3,467)	38,842	17,232	103,372
Central County													
Class A	43	7,307,866	0	0	1,758,419	24.06%	2,477,163	33.90%	\$2.80	(161,268)	(484,456)	111,156	442,941
Class B	213	14,251,315	0	0	1,846,012	12.95%	2,462,638	17.28%	\$2.30	(82,199)	(460,681)	194,480	836,308
Class C	49	2,015,035	0	0	181,650	9.01%	281,698	13.98%	\$2.01	(5,119)	8,575	15,230	80,419
North County													
Class A	24	2,881,270	0	0	586,725	20.36%	651,080	22.60%	\$2.71	(48,731)	(283,196)	17,625	127,273
Class B	147	11,419,646	0	0	888,089	7.78%	1,011,117	8.85%	\$2.47	(131,905)	(312,491)	114,404	474,963
Class C	22	834,392	0	0	26,426	3.17%	26,426	3.17%	\$2.10	188	(3,664)	928	43,445
South County													
Class A	82	10,677,878	197,855	465,000	1,772,762	16.60%	2,356,184	22.07%	\$2.88	(75,301)	210,894	137,951	1,358,583
Class B	307	16,848,856	0	0	2,066,197	12.26%	2,906,032	17.25%	\$2.70	(66,350)	156,238	358,990	1,671,036
Class C	13	560,662	0	0	13,732	2.45%	18,974	3.38%	\$2.53	(1,000)	(3,041)	2,915	22,208
West County													
Class A	14	1,482,154	0	0	428,439	28.91%	732,237	49.40%	\$2.67	(74,814)	(80,589)	30,481	87,408
Class B	127	7,416,121	0	0	492,427	6.64%	603,378	8.14%	\$2.57	10,795	46,461	96,827	368,686
Class C	14	1,387,271	0	0	2,150	0.15%	900	0.06%	\$0.00	1,250	(1,204)	1,250	3,196
Orange County													
Class A	300	48,823,681	647,061	1,397,496	9,791,152	20.05%	12,937,436	26.50%	\$2.88	(492,144)	(1,329,358)	864,804	4,889,600
Class B	1,112	67,937,255	0	282,808	7,320,775	10.78%	9,928,109	14.61%	\$2.48	(286,733)	(387,839)	1,160,188	5,240,603
Class C	114	5,504,064	0	0	262,456	4.77%	462,178	8.40%	\$1.97	(8,148)	39,508	37,555	252,640
Orange County Total	1,526	122,265,000	647,061	1,680,304	17,374,383	14.21%	23,327,723	19.08%	\$2.69	(787,025)	(1,677,689)	2,062,547	10,382,843

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.



Shifting to a Flexible Office Model

by **Doug Killian**

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With the pandemic finally in the rearview mirror, I believe it is important to address and acknowledge how the health crisis impacted the Orange County submarket and to analyze its lasting effects. Global shutdowns and the resulting changes to the expectations of workplace presence have provided keen insight into what the modern-day workforce perceives it needs to optimize productivity. The pandemic highlighted the ability to produce quality work from home and may have shifted the paradigm of work-life balance indefinitely, highlighting the following trends:

- Increased emphasis on work-life balance that ultimately leads to greater employee retention and less burnout
- A renewed emphasis on self-care as part of maintaining good overall health
- Quick adaptation to new technology that enhances work-from-home communications
- Convenience/efficiency of online health assistance
- Recalibrated priorities

Moving forward, the Orange County office market will continue to be shaped by the shift to a hybrid/flexible business model. While 50% of the workforce reports being equally productive from the comfort of their homes, it comes at a great price as they also feel less connected to their colleagues and company culture. This sentiment will continue to impact the square footage that office users require and also shift the functionality of office usage. Office layouts are already transforming to reflect larger conference rooms, collaborative open floor plans and outdoor workspaces. Some companies are set to benefit from the work-from-home model in perpetuity, but the sector that is reliant on collaboration, culture or hands-on experience and tutelage is issuing back-to-office directives. It's not one size fits all, but emerging trends indicate a return to the office in some capacity is broadly expected.

Orange County vacancies continue to trend upwards, which then places downward pressure on rents and encourages more concessions. Major economic indicators point to an impending recession, albeit a shallow one due to strong underlying market fundamentals. As such, we can expect a flight to quality with a subtle shift in negotiating power to tenants.

The Fed's interest rate hikes and new collateral requirements have made things especially difficult for Class A office product, which is now trading well under replacement cost (\$150 psf vs \$400+ psf less than 12 months ago). Rising interest rates and lack of financing options have greatly deterred sellers and buyers alike, especially for value-add opportunities. Recession expectations have caused cap rate softening for all product types, with the greatest impact seen on unstabilized product having shorter weighted-average lease terms.

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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.

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