

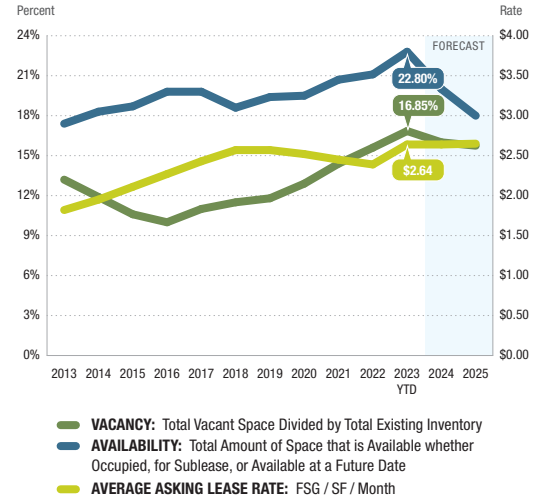
OVERVIEW. The Orange County office market slipped again in Q1, continuing a pattern that has challenged market stability. While the market had been softening before the pandemic, the initial lockdown in 2020 accelerated the downward trend, which is now being driven by the high percentage of employees working from home for all or part of the workweek. Vacancy made another substantial move up, transaction activity and gross absorption slipped and negative net absorption spiked. Average asking lease rates dipped slightly. Construction activity fell to zero, as the last projects in the development queue are now complete. This is welcome news for existing building owners, many of whom are busy adding amenities to their projects to attract interest from tenants looking to update their workspaces that reflect the “new normal.”

VACANCY & AVAILABILITY. In Q1, the overall vacancy rate increased to 16.85%, up from 15.75% in Q4. Class A buildings, with their premium rates, employee density, and reliance on elevator access, faced the most significant impact, with the countywide Class A vacancy rate rising to 22.36%. Class A space constitutes nearly 44% of the county’s base inventory. Class B buildings, representing just under 52% of the base, experienced a vacancy rate increase to 13.80%. The availability rate across all building classes, which includes occupied space offered for lease or sublease, rose by 170 basis points to 22.8%. This trend suggests that business owners with significant lease terms remaining are opting to sublease their space to adapt to the new work environment and reduce occupancy costs.

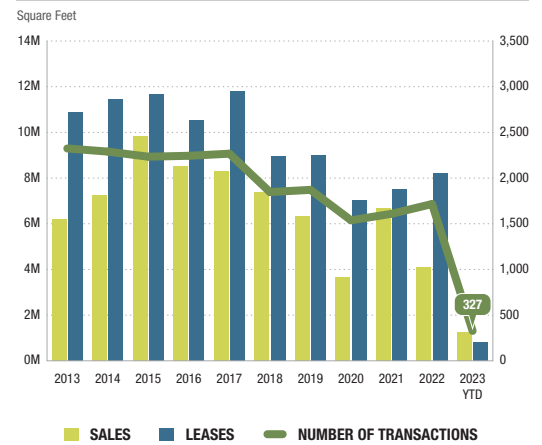
LEASE RATES. The average asking lease rate for all office space across the county decreased slightly in Q1, down by \$0.02 to \$2.64. However, effective rents have fallen more rapidly, as landlords maintain asking rates while offering concessions such as free rent and generous improvement allowances to attract tenants. The Airport Area’s highest asking rate remained unchanged from Q4 of last year at \$3.07. South County’s rate dropped \$0.06 to \$2.69, Central County decreased \$0.03 to \$2.43, and North County fell \$0.06 to \$2.44. Year over year, the overall average asking rate has declined by 8 cents, but increased concessions have caused effective rates to drop more significantly. Downsizing is becoming increasingly prevalent as businesses reevaluate their office spaces in terms of size and layout.

TRANSACTION ACTIVITY. Lease and sale activity continued to decrease in Q1, falling to just 2,079,000 SF from 2,547,000 SF in Q4 and 2,624,000 SF in Q3. Year over year, total lease and sale activity has fallen by almost 42%. The number of sale and lease transactions fell to 327 in Q1 from 350 in Q4. Countywide, 307 lease transactions and 20 sales were made in the first period, but sales were up from 9 in Q4. Lower activity levels continue to reflect the uncertainty of many tenants caused by changes in workspace design and ongoing headwinds fueled by persistent inflation and higher interest rates. The largest lease deal of the quarter was a 55,635 SF lease from The Irvine Company to SeneGence International at 141 Innovation Drive in the Irvine Spectrum area. The largest sale of the period was a 450,000 SF acquisition by IRA Capital, Inc. from Blackstone Inc.

VACANCY, AVAILABILITY & AVERAGE ASKING LEASE RATES



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



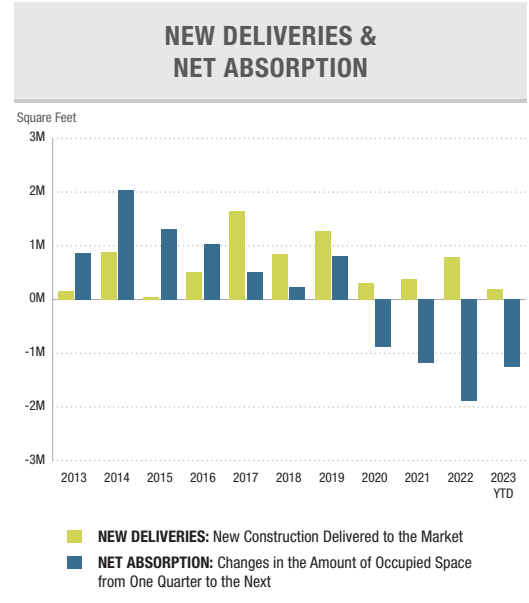
Market Statistics

	Change Over Last Quarter	Q1 2023	Q4 2022	Q1 2022	% Change Over Last Year
Vacancy Rate	▲ UP	16.85%	15.75%	14.70%	14.61%
Availability Rate	▲ UP	22.80%	21.10%	19.40%	17.53%
Average Asking Lease Rate	▼ DOWN	\$2.64	\$2.66	\$2.72	(2.94%)
Sale & Lease Transactions	▼ DOWN	2,079,483	2,547,596	3,567,725	(41.71%)
Gross Absorption	▼ DOWN	1,990,437	2,301,891	2,248,977	(11.50%)
Net Absorption	▼ NEGATIVE	(1,262,288)	(413,803)	(364,433)	N/A

ABSORPTION. In Q1, Orange County experienced a significant decrease in net absorption, posting a loss of 1,262,288 SF following a 413,000 SF loss in Q4 and a 364,000 SF loss in Q3. The Airport Area saw the largest dip at 720,518 SF, mainly in Irvine (519,036 SF) and Costa Mesa (172,059 SF). South County lost 325,377 SF in net occupancy, with 9 of the 11 cities in the submarket experiencing declines. North County performed best, losing only 21,674 SF. The largest move-out for the quarter was Impac Mortgage vacating 120,000 SF, reflecting the challenges posed by higher mortgage rates that have doubled since last year. Impac relocated to an 18,750 SF space on MacArthur Boulevard in Newport Beach.

CONSTRUCTION. Perhaps the best news for existing building owners struggling to lease their space is the fact that construction activity fell to zero during the first quarter. The last projects in the queue, which include The Press in Costa Mesa along with Spectrum Terrace and Innovation Office Park in Irvine Spectrum, are now complete and have been added to the base inventory. The Press project is preleased to Anduril, who will take occupancy of 400,000 SF soon. That expansion move will provide a boost to net absorption later in the year. While there are another 1,363,818 SF of space planned in two major projects, we probably won't see those projects getting underway until market conditions improve.

EMPLOYMENT. The unemployment rate in Orange County remained at 3.4% in February 2023, unchanged from a revised 3.4% in January 2023 and lower than the 3.7% rate a year ago. Employment increased in six sectors: government (adding 2,800 jobs), private education and health services (1,900 jobs), construction (1,800 jobs), other services (1,500 jobs), professional and business services (1,100 jobs), and financial activities (600 jobs).



Forecast

The office market faces significant challenges in the near term. With the work-from-home phenomenon still unresolved, approximately half of all office employees work onsite either full or part-time, making it difficult for companies to consider expanding their space. We anticipate more companies downsizing and demanding major interior improvements reflecting changes in space utilization. Average asking lease rates are expected to decrease, and negative net absorption is likely to persist throughout the year. Effective rates, particularly for Class A spaces, may drop further as landlords offer more concessions to attract tenants.

Another potential obstacle is rising interest rates. Many property owners who have existing debt at lower interest rates will soon be required to refinance their properties at higher rates in a rising vacancy rate environment that has already caused a tightening in lender underwriting criteria. Consequently, we foresee a growing number of distressed assets across all size ranges and building classes going forward.

Significant Transactions

Sales

Property Address	City	Class	Square Feet	Total Price	Buyer	Seller
5-6 Hutton Centre Dr.	Santa Ana	A	580,086	\$82,000,000	Barker Pacific Group	Blackstone Inc.
16969-16755 Von Karman Ave. & 2121 Alton Pkwy.	Irvine	B	450,000	\$100,000,000	IRA Capital, LLC	Blackstone Inc.
4 Hutton Centre Dr.	Santa Ana	A	216,864	\$82,000,000	Ares Asset Management LLC	LaSalle Investment Magament
27422-27442 Portola Pkwy.	Foothill Ranch	A	210,902	\$31,500,000	Global Edge Holdings & Management	Cref X Foothill Plaza LLC
16355 Laguna Canyon Rd.	Irvine	B	113,882	\$43,500,000	Concordia University Irvine	Chapman University

Leases

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
141 Innovation Dr.	Irvine	B	55,635	Feb-2023	SeneGence International	The Irvine Company
2441 W. La Palma Ave.	Anaheim	B	34,798	Jan-2023	Anaheim Clinical Trials, LLC	Living Stream Ministry
17911 Von Karman Ave. - Renewal	Irvine	B	32,334	Jan-2023	KTGY	John Hancock Life Ins Co USA
3535 Harbor Blvd. - Renewal	Costa Mesa	B	29,881	Feb-2023	El Pollo Loco Inc.	C.J. Segerstrom & Son, LLC
3545 Howard Way	Costa Mesa	B	23,125	Jan-2023	Hyundai AutoEver America	Davies Torrance Trust

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate Q1 2023	Square Feet Available	Availability Rate Q1 2023	Average Asking Lease Rate	Net Absorption Q1 2023	Net Absorption 2023	Gross Absorption Q1 2023	Gross Absorption 2023
Airport Area													
Costa Mesa	59	6,798,809	0	0	1,409,843	20.74%	2,071,197	30.46%	\$3.00	(172,059)	(172,059)	80,185	80,185
Irvine	243	24,167,282	0	898,818	4,610,828	19.08%	6,663,174	27.57%	\$2.78	(519,036)	(519,036)	573,613	573,613
Newport Beach	106	9,149,987	0	0	1,068,350	11.68%	1,523,146	16.65%	\$3.01	(34,983)	(34,983)	135,621	135,621
Santa Ana	9	2,003,987	0	0	572,523	28.57%	775,930	38.72%	\$2.75	(73,190)	(73,190)	1,832	1,832
Tustin	4	418,585	0	0	47,064	11.24%	33,795	8.07%	\$4.25	78,750	78,750	78,750	78,750
Airport Area Total	421	42,538,650	0	898,818	7,708,608	18.12%	11,067,242	26.02%	\$2.85	(720,518)	(720,518)	870,001	870,001
Central County													
Anaheim	21	1,952,808	0	0	482,523	24.71%	528,834	27.08%	\$2.47	(36,420)	(36,420)	10,146	10,146
Orange	64	6,181,828	0	0	1,109,545	17.95%	1,645,340	26.62%	\$2.38	(106,880)	(106,880)	95,988	95,988
Santa Ana	134	9,571,388	0	0	1,901,040	19.86%	2,312,583	24.16%	\$2.49	(16,399)	(16,399)	171,237	171,237
Tustin	38	1,981,506	0	0	144,986	7.32%	176,685	8.92%	\$1.74	71,105	71,105	88,594	88,594
Central County Total	257	19,687,530	0	0	3,638,094	18.48%	4,663,442	23.69%	\$2.41	(88,594)	(88,594)	365,965	365,965
North County													
Anaheim Hills	61	4,088,439	0	0	473,394	11.58%	489,751	11.98%	\$2.52	(20,396)	(20,396)	53,182	53,182
Brea	39	3,889,565	0	0	637,243	16.38%	824,488	21.20%	\$2.60	48,537	48,537	87,641	87,641
Buena Park	17	1,078,748	0	0	33,509	3.11%	85,065	7.89%	\$2.26	(17,746)	(17,746)	9,582	9,582
Fullerton	16	867,909	0	0	93,133	10.73%	124,218	14.31%	\$2.28	2,929	2,929	16,502	16,502
La Habra	3	115,103	0	0	5,126	4.45%	3,602	3.13%	\$1.93	(532)	(532)	1,524	1,524
La Palma	7	542,913	0	0	92,598	17.06%	139,403	25.68%	\$1.68	(13,822)	(13,822)	0	0
Placentia	6	199,881	0	0	23,183	11.60%	32,087	16.05%	\$2.06	(5,606)	(5,606)	8,508	8,508
Yorba Linda	5	289,383	0	0	22,098	7.64%	20,887	7.22%	\$2.27	(15,038)	(15,038)	638	638
North County Total	154	11,071,941	0	0	1,380,284	12.47%	1,719,501	15.53%	\$2.44	(21,674)	(21,674)	177,577	177,577
South County													
Aliso Viejo	37	2,884,518	0	0	827,204	28.68%	926,596	32.12%	\$2.57	(69,645)	(69,645)	51,631	51,631
Dana Point	3	127,999	0	0	0	0.00%	0	0.00%	\$0.00	6,000	6,000	7,200	7,200
Foothill Ranch	8	697,717	0	0	143,141	20.52%	298,624	42.80%	\$2.51	(86,771)	(86,771)	39,141	39,141
Irvine Spectrum	170	13,361,229	0	0	1,940,461	14.52%	2,833,201	21.20%	\$2.82	(89,693)	(89,693)	250,853	250,853
Laguna Beach	4	124,004	0	0	5,619	4.53%	4,944	3.99%	\$3.45	(3,147)	(3,147)	0	0
Laguna Hills	27	1,301,662	0	465,000	305,206	23.45%	321,110	24.67%	\$2.71	(32,334)	(32,334)	19,281	19,281
Laguna Niguel	7	395,699	0	0	68,974	17.43%	83,945	21.21%	\$1.84	(5,788)	(5,788)	2,362	2,362
Lake Forest	41	2,202,710	0	0	370,351	16.81%	420,232	19.08%	\$2.20	(31,111)	(31,111)	62,653	62,653
Mission Viejo	25	1,317,777	0	0	249,802	18.96%	272,696	20.69%	\$2.41	(14,402)	(14,402)	9,309	9,309
Rancho Santa Margarita	5	212,716	0	0	22,492	10.57%	29,538	13.89%	\$2.24	(1,481)	(1,481)	5,389	5,389
San Clemente	8	411,212	0	0	27,863	6.78%	36,234	8.81%	\$2.20	5,482	5,482	9,170	9,170
San Juan Capistrano	20	971,944	0	0	41,465	4.27%	35,385	3.64%	\$2.55	(2,487)	(2,487)	21,916	21,916
South County Total	355	24,009,187	0	465,000	4,002,578	16.67%	5,262,505	21.92%	\$2.69	(325,377)	(325,377)	478,905	478,905
West County													
Cypress	27	1,904,468	0	0	310,274	16.29%	496,272	26.06%	\$2.43	(60,034)	(60,034)	9,358	9,358
Fountain Valley	25	1,156,301	0	0	39,987	3.46%	34,105	2.95%	\$1.86	(900)	(900)	13,224	13,224
Garden Grove	14	710,490	0	0	49,826	7.01%	71,725	10.10%	\$2.01	(5,258)	(5,258)	7,100	7,100
Huntington Beach	33	1,783,701	0	0	329,193	18.46%	349,116	19.57%	\$2.27	(26,798)	(26,798)	16,554	16,554
Los Alamitos	9	472,574	0	0	4,339	0.92%	2,578	0.55%	\$2.25	2,417	2,417	4,652	4,652
Seal Beach	6	452,518	0	0	53,740	11.88%	63,899	14.12%	\$3.42	11,495	11,495	34,590	34,590
Stanton	4	143,361	0	0	5,877	4.10%	4,007	2.80%	\$1.97	0	0	1,870	1,870
Westminster	10	414,019	0	0	57,163	13.81%	57,163	13.81%	\$2.40	(27,047)	(27,047)	10,641	10,641
West County Total	128	7,037,432	0	0	850,399	12.08%	1,078,865	15.33%	\$2.43	(106,125)	(106,125)	97,989	97,989
Orange County Total	1,315	104,344,740	0	1,363,818	17,579,963	16.85%	23,791,555	22.80%	\$2.64	(1,262,288)	(1,262,288)	1,990,437	1,990,437
Airport Area													
Class A	125	25,777,311	0	898,818	5,502,869	21.35%	7,846,032	30.44%	\$3.07	(447,962)	(447,962)	589,026	589,026
Class B	276	15,597,901	0	0	2,151,802	13.80%	3,127,122	20.05%	\$2.74	(263,361)	(263,361)	267,089	267,089
Class C	20	1,163,438	0	0	53,937	4.64%	94,088	8.09%	\$2.86	(9,195)	(9,195)	13,886	13,886
Central County													
Class A	39	6,843,524	0	0	1,789,995	26.16%	2,351,450	34.36%	\$2.75	(152,407)	(152,407)	181,771	181,771
Class B	177	11,082,264	0	0	1,694,314	15.29%	2,118,309	19.11%	\$2.26	68,194	68,194	163,902	163,902
Class C	41	1,761,742	0	0	153,785	8.73%	193,683	10.99%	\$1.94	(4,381)	(4,381)	20,292	20,292
North County													
Class A	20	2,417,720	0	0	559,831	23.16%	660,371	27.31%	\$2.60	(16,863)	(16,863)	73,651	73,651
Class B	118	8,023,949	0	0	815,039	10.16%	1,048,243	13.06%	\$2.41	(3,680)	(3,680)	103,576	103,576
Class C	16	630,272	0	0	5,414	0.86%	10,887	1.73%	\$2.01	(1,131)	(1,131)	350	350
South County													
Class A	69	9,219,657	0	465,000	1,892,056	20.52%	2,322,823	25.19%	\$2.82	(187,276)	(187,276)	173,347	173,347
Class B	275	14,286,582	0	0	2,087,291	14.61%	2,912,298	20.38%	\$2.64	(128,602)	(128,602)	300,890	300,890
Class C	11	502,948	0	0	23,231	4.62%	27,384	5.44%	\$2.53	(9,499)	(9,499)	4,668	4,668
West County													
Class A	12	1,382,111	0	0	462,479	33.46%	605,717	43.83%	\$2.57	(70,386)	(70,386)	21,611	21,611
Class B	102	5,172,473	0	0	359,720	6.95%	444,948	8.60%	\$2.39	(9,689)	(9,689)	74,228	74,228
Class C	14	482,848	0	0	28,200	5.84%	28,200	5.84%	\$1.52	(26,050)	(26,050)	2,150	2,150
Orange County													
Class A	265	45,640,323	0	1,363,818	10,207,230	22.36%	13,786,393	30.21%	\$2.90	(874,894)	(874,894)	1,039,406	1,039,406
Class B	948	54,163,169	0	0	7,108,166	13.12%	9,650,920	17.82%	\$2.61	(337,138)	(337,138)	909,685	909,685
Class C	102	4,541,248	0	0	264,567	5.83%	354,242	7.80%	\$2.13	(50,256)	(50,256)	41,346	41,346
Orange County Total	1,315	104,344,740	0	1,363,818	17,579,963	16.85%	23,791,555	22.80%	\$2.64	(1,262,288)	(1,262,288)	1,990,437	1,990,437

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.



Is Office the New Retail?

by **Chris Drzyzga**

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The office market is still trying to find a balance between remote and in-office work. As long-term leases expire, office tenants are getting their first opportunity to redesign and right-size their workplace environment. This is occurring against the backdrop of a “tenant’s market,” a dynamic office tenants haven’t experienced for the better part of the last decade. Landlords have done a good job holding firm on asking rates and buying down the effective rent with various concessions, but I foresee this changing as we progress through 2023 and into 2024.

The office is far from “dead,” and the vast majority of business leaders agree that not only does office space play a vital role, but they strongly prefer employees to be in the office at least part of the time. Office properties are in a transition similar to that which retail experienced throughout the 2010’s with the rise of e-commerce and the “Amazon Effect.” Some assets will live to see another cycle, while others will not. This will be a much-needed cleansing for the sector and will pave the way for alternative uses and new investment strategies.

“Flight to quality” has been the dominant theme, beating out “convenience” and “work from home.” Initially, I hypothesized that suburban offices would be the big winners because of their proximity to residential neighborhoods, accessibility, open-air environments, and density, to name a few advantages. Fast forward three years, and office properties that have performed the best and retained the highest occupancies are those in which the ownership proactively maintained and renovated to accommodate the latest trends. In past cycles, tenants have used down markets to secure better locations they otherwise couldn’t afford. This time around, tenants have all their options on the table, and the common denominator is “quality.” Properties that offer a full suite of amenities, such as cafés, fitness areas, conference centers, outdoor areas, and car wash & dry-cleaning services are doing just fine and will live to see the next cycle.

The current banking crisis has added another layer of risk and uncertainty. The Fed, in conjunction with the six largest global banks, took swift action and appears to have backstopped this from becoming a broader systemic issue; however, the medium- and long-term implications have yet to materialize. Community and regional banks play a critical role in the commercial real estate market, both locally and nationally, and their health is closely tied to the overall health of the market. The events of the past couple of weeks have businesses and investors alike questioning the creditworthiness of their counterparties, reevaluating their loan maturities, and diversifying their depository relationships.

The office market is and will be in a period of transition and uncertainty for the foreseeable future. In light of these challenges, it is important for tenants and landlords to adopt a proactive approach. For tenants, this means starting to evaluate their lease well in advance, even if they plan to renew it. Time is your best friend and your biggest enemy. For investors, this means retaining existing tenants, paying down debt and considering opportunities that offer value and flexibility.

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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