

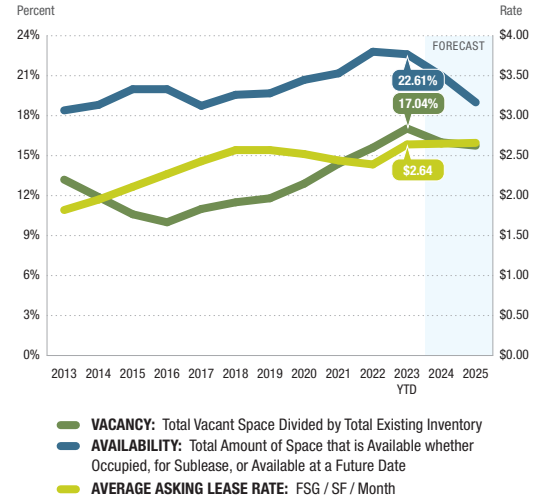
OVERVIEW. The Orange County office market struggled again in Q2 to recover from the shift in workplace dynamics. The market had already been softening before the pandemic, but the initial lockdown hit hard, accelerating the downward trend, and area businesses are still struggling with the hybrid / work-from-home phenomenon three years later. Vacancy and availability both moved higher again in Q2. Average asking lease rates fell slightly, and another new project broke ground in Costa Mesa. Net absorption remained in negative territory, but the net loss in occupied space softened. Leasing activity increased both in deal count and square footage leased, but the number of sales fell by two thirds, as investors shied away from office projects due to a softening outlook for the economy, higher borrowing costs and stricter loan underwriting.

VACANCY & AVAILABILITY. The overall vacancy rate increased to 17.04%, up from 16.85% in Q1. Year over year, vacancy has increased by 17.55%, but the whole story is revealed when looking at vacancy by building class. Class A vacancy has risen to 22.53% and availability, which includes sublease space and available direct space that is still occupied, has increased to 29.71%. Class A availability in the Airport Area rose to 30.47% in Q2, and that submarket has 25.7 MSF of Class A space, more than all other submarkets combined. By comparison, the Class B availability rate held steady in Q2 at just 17.85%. Class C product is faring best with an availability rate of only 8.03%, but Class C makes up only 4.35% of the county's total office inventory.

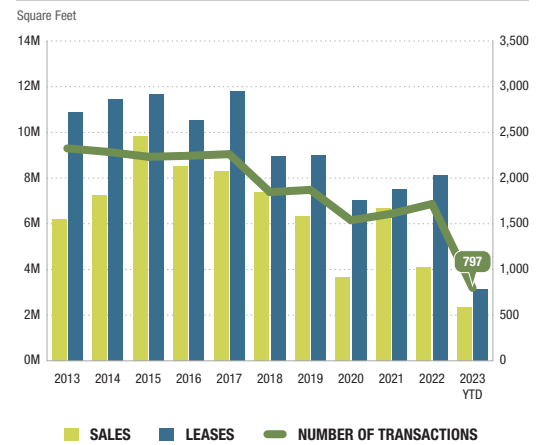
LEASE RATES. The average asking lease rate for all office space across the county decreased by two cents in Q2 to \$2.64. However, as we have been reporting, effective rents are falling more rapidly, as landlords tend to hold the line on asking rates while offering concessions such as free rent and tenant improvement allowances to attract and retain tenants. Consequently, year-over-year asking rates have fallen by just 2.94%, or \$0.08, despite a 17.55% year-over-year increase in vacancy. The Airport Area has the highest asking rate at \$2.84, as it has a high concentration of Class A product.

TRANSACTION ACTIVITY. Lease and sale activity was relatively flat in Q2, rising from 2,641,732 SF in Q1 to 2,798,712 SF currently. Year-over-year, total lease and sale activity measured by footage has fallen by almost 22%. However, the number of sale and lease transactions rose to 432 in Q2 from 365 in Q1. 425 lease transactions were completed in Q2, up from just 344 in Q1. Total square footage leased was also up 630,000 SF to 1,872,000 SF. However, it was much a different quarter on the sale side of the equation. Only seven sales were completed, down from 21 in Q1. Of particular note was the sale of 5 and 6 Hutton Center in Santa Ana from Blackstone to Barker Pacific Group. The 560,163 SF project sold for \$82 million, or only \$146 per square foot, pricing we have not seen in decades for a Class A office project. The largest new lease deal of the quarter was a 145,960 SF lease from The Irvine Company to Axonics at 15515-15525 Sand Canyon in Irvine Spectrum.

VACANCY, AVAILABILITY & AVERAGE ASKING LEASE RATES



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



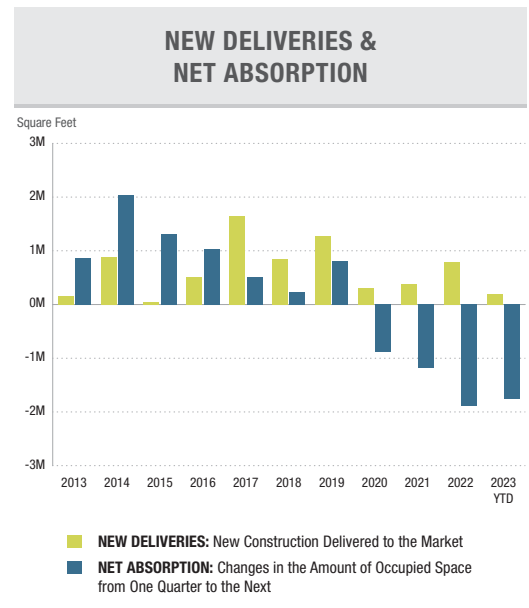
Market Statistics

	Change Over Last Quarter	Q2 2023	Q1 2023	Q2 2022	% Change Over Last Year
Vacancy Rate	▲ UP	17.04%	16.85%	14.50%	17.55%
Availability Rate	▬ FLAT	22.61%	22.80%	19.68%	14.91%
Average Asking Lease Rate	▼ DOWN	\$2.64	\$2.66	\$2.72	(2.94%)
Sale & Lease Transactions	▲ UP	2,798,712	2,641,732	3,586,360	(21.96%)
Gross Absorption	▼ DOWN	1,805,694	1,990,437	2,827,733	(36.14%)
Net Absorption	▼ NEGATIVE	(499,618)	(1,262,288)	227,126	N/A

ABSORPTION. Countywide net absorption remained in negative territory, posting another loss of 499,618 SF, after losing 1,262,288 SF in net occupancy in Q1. The Airport Area recorded another decline of 349,371 SF following a 720,518 SF decline in the first quarter. Costa Mesa, Irvine, Newport Beach and Santa Ana all posted substantial net losses in occupancy. Tustin was the only city in the Airport submarket to post a net gain. South County saw Fluor move out of three buildings totaling 201,000 SF in Aliso Viejo and Foothill Ranch, but that was largely offset by Apple’s move into 170,000 SF in Irvine Spectrum. Overall, South County lost 81,021 SF of net occupancy by the end of Q2.

CONSTRUCTION. Thankfully, construction activity has been winding down over the last year and most of the space that has been built recently is owned by the Irvine Company, which is best equipped to handle difficult market conditions. The only building underway at this time is the second phase of the Press project in Costa Mesa. The 190,000 SF building got underway in Q2 is now the only project under construction countywide. Another 1,516,438 SF is in the planning stages, but those projects will probably be delayed unless they are substantially released, which is unlikely at this point. The lack of new construction is helpful to existing building owners who are struggling, along with potential tenants, with how to adjust to the hybrid / work-from-home phenomenon.

EMPLOYMENT. The unemployment rate in Orange County was 3.2% in May 2023, up from a revised 3.0% in April 2023 and above the year-ago estimate of 2.7%. Eight sectors contributed an additional 33,600 jobs, accounting for 74% of the total nonfarm year-over-year increase. Private education and health services experienced an increase of 10,300 jobs, followed by trade, transportation, and utilities (up 6,800), professional and business services (up 4,600), government (up 4,200), and information (up 700).



Forecast

The office market will continue to struggle for the foreseeable future. Uncertainty in the office-using sector will persist as decision-makers grapple with the ongoing challenge of the hybrid / work-from-home dynamic. The amount of space needed and how it will be configured is still a major unknown for many office tenants. Downsizing and short-term lease renewals will keep net absorption in negative territory, particularly in Class A buildings. Average asking lease rates are expected to decrease, but effective rates, particularly for Class A spaces, are likely to fall even faster due to the increase in concessions required to attract and retain tenants. Landlords face another challenge as debt matures. If refinancing is necessary, new loans will be at higher rates and lower loan-to-value ratios due to rising vacancy, lower net operating income and stricter underwriting from lenders. This could lead to a decrease in borrowing power and force owners to sell at discounted prices to avoid further cash investment.

Significant Transactions

Sales

Property Address	City	Class	Square Feet	Total Price	Buyer	Seller
5-6 Hutton Centre Dr.	Santa Ana	A	560,163	\$82,000,000	Barker Pacific Group	Blackstone Inc.
625 The City Dr. S.	Orange	B	150,161	\$22,500,000	Watermarker Properties, Inc.	TA Realty
17900 Von Karman Ave.	Irvine	B	70,964	\$16,900,000	FinFare	Wilshire Capital Partners
23041 Avenida de la Carlota	Laguna Hills	B	67,587	\$15,529,500	View Pointe LLC	Lincoln Property Company
8 Hughes	Irvine	B	41,563	\$11,866,000	Thomas Giancursio	Stivers Investment Company

Leases

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
15515-15525 Sand Canyon	Irvine Spectrum	A	145,960	Apr-2023	Axonics	The Irvine Company
10600 Valley View St. - Renewal	Cypress	B	91,506	Jun-2023	DRS Sensors & Targeting Systems, Inc.	Warland Investment Company
200 W. Santa Ana Blvd. - Renewal	Santa Ana	A	81,882	Apr-2023	County of Orange Health Care Agency	Boyd Watterson Asset Management
17800 Laugna Canyon Rd.	Irvine Spectrum	A	55,664	May-2023	Apple, Inc.	The Irvine Company
50 Pointe Dr. - Renewal	Brea	A	51,387	May-2023	Avery Dennison	Olen Properties

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate Q2 2023	Square Feet Available	Availability Rate Q2 2023	Average Asking Lease Rate	Net Absorption Q2 2023	Net Absorption 2023	Gross Absorption Q2 2023	Gross Absorption 2023
Airport Area													
Costa Mesa	59	6,798,809	190,000	0	1,523,079	22.40%	2,182,792	32.11%	\$3.04	(127,038)	(299,097)	125,588	205,773
Irvine	243	24,167,282	0	1,051,438	4,695,133	19.43%	6,176,252	25.56%	\$2.74	(96,410)	(615,446)	556,975	1,130,588
Newport Beach	106	9,149,987	0	0	1,150,622	12.58%	1,729,684	18.90%	\$3.04	(83,338)	(118,321)	138,643	274,264
Santa Ana	9	2,003,987	0	0	692,433	34.55%	691,511	34.51%	\$2.75	(69,215)	(142,405)	142,154	143,986
Tustin	4	418,585	0	0	20,434	4.88%	80,368	19.20%	\$4.70	26,630	105,380	26,630	105,380
Airport Area Total	421	42,538,650	190,000	1,051,438	8,081,701	19.00%	10,860,607	25.53%	\$2.84	(349,371)	(1,069,889)	989,990	1,859,991
Central County													
Anaheim	21	1,952,808	0	0	464,782	23.80%	493,917	25.29%	\$2.47	4,953	(31,467)	41,150	51,296
Orange	64	6,181,828	0	0	1,074,191	17.38%	1,611,348	26.07%	\$2.33	4,139	(102,741)	106,591	202,579
Santa Ana	134	9,571,388	0	0	1,975,673	20.64%	2,342,371	24.47%	\$2.47	(103,360)	(119,759)	91,939	263,176
Tustin	38	1,981,506	0	0	131,130	6.62%	207,718	10.48%	\$1.72	4,146	75,251	26,817	115,411
Central County Total	257	19,687,530	0	0	3,645,776	18.52%	4,655,354	23.65%	\$2.39	(90,122)	(178,716)	266,497	632,462
North County													
Anaheim Hills	61	4,088,439	0	0	460,670	11.27%	468,643	11.46%	\$2.49	(8,032)	(28,428)	41,932	95,114
Brea	39	3,889,565	0	0	553,152	14.22%	879,200	22.60%	\$2.62	59,467	108,004	52,799	140,440
Buena Park	17	1,078,748	0	0	19,650	1.82%	76,068	7.05%	\$2.28	11,438	(6,308)	13,987	23,569
Fullerton	16	867,909	0	0	81,579	9.40%	113,661	13.10%	\$2.30	11,554	14,483	18,679	35,181
La Habra	3	115,103	0	0	3,874	3.37%	2,958	2.57%	\$1.71	(272)	(804)	1,877	3,401
La Palma	7	542,913	0	0	98,977	18.23%	149,956	27.62%	\$1.68	(6,379)	(20,201)	4,196	4,196
Placentia	6	199,881	0	0	21,936	10.97%	40,131	20.08%	\$2.04	1,247	(4,359)	3,081	11,589
Yorba Linda	5	289,383	0	0	19,050	6.58%	20,887	7.22%	\$2.26	2,648	(12,390)	2,648	3,286
North County Total	154	11,071,941	0	0	1,258,888	11.37%	1,751,504	15.82%	\$2.44	71,671	49,997	139,199	316,776
South County													
Aliso Viejo	37	2,884,518	0	0	893,298	30.97%	996,951	34.56%	\$2.50	(58,272)	(127,917)	64,707	116,338
Dana Point	3	127,999	0	0	0	0.00%	0	0.00%	\$0.00	0	6,000	0	7,200
Foothill Ranch	8	697,717	0	0	287,539	41.21%	298,624	42.80%	\$2.50	(144,398)	(231,169)	0	39,141
Irvine Spectrum	170	13,361,229	0	0	1,744,836	13.06%	2,808,085	21.02%	\$2.80	139,352	49,659	195,766	446,619
Laguna Beach	4	124,004	0	0	4,944	3.99%	4,944	3.99%	\$3.45	675	(2,472)	675	675
Laguna Hills	27	1,301,662	0	465,000	286,309	22.00%	295,978	22.74%	\$2.68	17,517	(14,817)	49,969	69,250
Laguna Niguel	7	395,699	0	0	76,888	19.43%	79,118	19.99%	\$2.47	(24,132)	(29,920)	4,355	6,717
Lake Forest	41	2,202,710	0	0	415,434	18.86%	449,141	20.39%	\$2.16	(13,764)	(44,875)	8,196	70,849
Mission Viejo	25	1,317,777	0	0	249,869	18.96%	267,942	20.33%	\$2.43	(2,101)	(16,503)	17,966	27,275
Rancho Santa Margarita	5	212,716	0	0	19,280	9.06%	31,409	14.77%	\$2.25	3,212	1,731	3,212	8,601
San Clemente	8	411,212	0	0	27,148	6.60%	34,109	8.29%	\$2.15	715	6,197	2,366	11,536
San Juan Capistrano	20	971,944	0	0	36,284	3.73%	52,524	5.40%	\$2.53	175	(2,312)	4,080	25,996
South County Total	355	24,009,187	0	465,000	4,041,829	16.83%	5,318,825	22.15%	\$2.67	(81,021)	(406,398)	351,292	830,197
West County													
Cypress	27	1,904,468	0	0	179,463	9.42%	380,672	19.99%	\$2.42	(3,962)	(63,996)	22,287	31,645
Fountain Valley	25	1,156,301	0	0	33,064	2.86%	34,210	2.96%	\$2.08	(1,005)	(1,905)	3,411	16,635
Garden Grove	14	710,490	0	0	52,413	7.38%	70,341	9.90%	\$2.04	(5,798)	(11,056)	6,218	13,318
Huntington Beach	33	1,783,701	0	0	343,161	19.24%	356,195	19.97%	\$2.17	(12,420)	(39,218)	13,885	30,439
Los Alamitos	9	472,574	0	0	4,723	1.00%	6,273	1.33%	\$2.28	(1,355)	1,062	790	5,442
Seal Beach	6	452,518	0	0	57,551	12.72%	65,068	14.38%	\$3.43	(1,169)	10,326	2,588	37,178
Stanton	4	143,361	0	0	38,295	26.71%	38,295	26.71%	\$1.80	(34,288)	(34,288)	315	2,185
Westminster	10	414,019	0	0	47,941	11.58%	59,598	14.39%	\$2.40	9,222	(17,825)	9,222	19,863
West County Total	128	7,037,432	0	0	756,611	10.75%	1,010,652	14.36%	\$2.45	(50,775)	(156,900)	58,716	156,705
Orange County Total	1,315	104,344,740	190,000	1,516,438	17,784,805	17.04%	23,596,942	22.61%	\$2.64	(499,618)	(1,761,906)	1,805,694	3,796,131
Airport Area													
Class A	125	25,777,311	190,000	932,496	5,943,530	23.06%	7,853,875	30.47%	\$3.17	(295,891)	(743,853)	647,934	1,236,960
Class B	276	15,597,901	0	118,942	2,093,725	13.42%	2,929,055	18.78%	\$2.68	(62,971)	(326,332)	324,019	591,108
Class C	20	1,163,438	0	0	44,446	3.82%	77,677	6.68%	\$2.89	9,491	296	18,037	31,923
Central County													
Class A	39	6,843,524	0	0	1,858,235	27.15%	2,363,174	34.53%	\$2.75	(30,224)	(182,631)	114,809	296,580
Class B	177	11,082,264	0	0	1,645,912	14.85%	2,081,977	18.79%	\$2.23	(63,418)	4,776	134,173	298,075
Class C	41	1,761,742	0	0	141,629	8.04%	210,203	11.93%	\$1.93	3,520	(861)	17,515	37,807
North County													
Class A	20	2,417,720	0	0	530,242	21.93%	742,718	30.72%	\$2.61	42,377	25,514	48,097	121,748
Class B	118	8,023,949	0	0	718,890	8.96%	999,030	12.45%	\$2.40	33,636	29,956	89,231	192,807
Class C	16	630,272	0	0	9,756	1.55%	9,756	1.55%	\$1.99	(4,342)	(5,473)	1,871	2,221
South County													
Class A	69	9,219,657	0	465,000	1,640,727	17.80%	2,144,696	23.26%	\$2.88	238,948	51,672	227,302	400,649
Class B	275	14,286,582	0	0	2,368,404	16.58%	3,136,221	21.95%	\$2.62	(316,529)	(445,131)	121,893	422,783
Class C	11	502,948	0	0	32,698	6.50%	37,908	7.54%	\$2.48	(3,440)	(12,939)	2,097	6,765
West County													
Class A	12	1,382,111	0	0	310,445	22.46%	457,255	33.08%	\$2.57	17,261	(53,125)	29,821	51,432
Class B	102	5,172,473	0	0	417,066	8.06%	524,297	10.14%	\$2.42	(67,136)	(76,825)	28,895	103,123
Class C	14	482,848	0	0	29,100	6.03%	29,100	6.03%	\$1.52	(900)	(26,950)	0	2,150
Orange County													
Class A	265	45,640,323	190,000	1,397,496	10,283,179	22.53%	13,561,718	29.71%	\$2.89	(27,529)	(902,423)	1,067,963	2,107,369
Class B	948	54,163,169	0	118,942	7,243,997	13.37%	9,670,580	17.85%	\$2.54	(476,418)	(813,556)	698,211	1,607,896
Class C	102	4,541,248	0	0	257,629	5.67%	364,644	8.03%	\$2.02	4,329	(45,927)	39,520	80,866
Orange County Total	1,315	104,344,740	190,000	1,516,438	17,784,805	17.04%	23,596,942	22.61%	\$2.64	(499,618)	(1,761,906)	1,805,694	3,796,131

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.



Empty Office Buildings / Adapt or Perish

by **Stefan Rogers**

SENIOR VICE PRESIDENT / PARTNER, IRVINE
949.263.5362 · srogers@voitco.com · Lic. #01376946

The adoption of technology-driven hybrid work patterns has transformed office utilization and hammered tenant demand for office space over the past few years. A preference towards less space, shorter lease terms, decentralized locations and a flight to quality has now generally solidified as a broad new standard across most office-based business types. As technological advances in communication and collaboration continue, including the advent of artificial intelligence’s impact on human resources needs, we can expect continued contraction in the strategic demand for office space as leases signed prior to 2020 continue to expire.

After almost three years of failed “Return to Office” pushes by corporate America, the workforce has consolidated its position, and hybrid work is here to stay. While there are plenty of exceptions to the rule, the consensus is that we’re all generally better off embracing this model. “Communicate” is the new “commute.”

Locally and nationally, office vacancy rates are in the 20-25% range with physical office occupancy per head remaining stubbornly at the 50% mark. Which poses a question — with pre-pandemic new leases expiring over the next few years, and continued pressure from hybrid work policies, will average vacancy rates eventually align with average physical occupancy levels per head and reach the 50% range? The outlook for office landlords is troubling.

Notwithstanding the persistent storm clouds, the results to date have been mixed. Although tenant demand has contracted across all office building types and locations, newer, well located projects with good amenities have fared best, with some new projects becoming quite successful. The consolidation of demand into these preferred properties presents new challenges. As old and obsolete office building values fall, and high interest rates and stricter underwriting standards prevail, many landlords face short sales or even foreclosures when their loans expire, if they are unable to refinance. Adaptive re-use and redevelopment of older buildings is already well underway as an alternative where viable. Cities are rezoning for residential and mixed use, and developers are scooping up distressed office buildings for as low as one third of the previous sale price. The development of new office space is, as expected, almost nil.

The ripple effect of these changes across the institutional markets and pension funds will be noticeable, as fund managers struggle to balance their portfolios and offset office-related losses. While there is a lot of talk in the media about a looming commercial real estate crash, it’s important not to generalize, but to understand the focus is on the office sector. And within the office sector, it is the participants who fail to adapt who are at the greatest risk.

**Please Contact Us
for Further Information**

Tony Tran
Regional Director of Research
ttran@voitco.com

Anaheim, CA 714.978.7880	Carlsbad, CA 760.472.5620	Inland Empire, CA 909.545.8000	Irvine, CA 949.851.5100	Los Angeles, CA 424.329.7500	San Diego, CA 858.453.0505
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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