OC Q4 23

FOURTH QUARTER 2023 MARKET REPORT

ORANGE COUNTY OFFICE

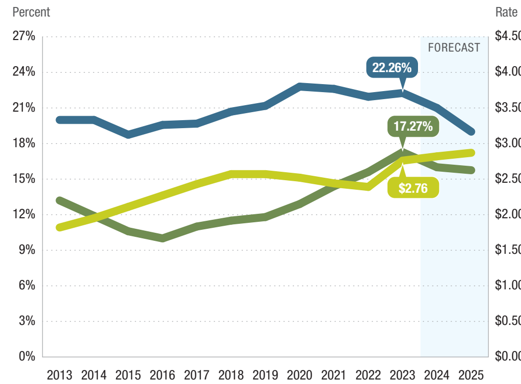
Voit REAL ESTATE SERVICES

OVERVIEW. The Orange County office market treaded water in the final quarter of 2023, but major market metrics point to further struggles heading into the new year. 2023 marked the fourth consecutive year of negative net absorption, despite a moderate net gain in Q4. Vacancy fell slightly but availability ticked up. Lease and sale activity fell, but gross absorption (a measure of total move-ins) was up. Average asking lease rates were up slightly, but the increase does not reflect the true softness in the leasing market after concessions are factored in. The shift in workplace dynamics remains a major hurdle to a recovery in the office sector. Business owners are still unsure of how much space to lease and how to configure it, as employees continue to push back against working full-time in the office. As has been the case since the economy began to emerge from the pandemic, many tenants who are actively seeking space or renewing in place are downsizing, which, in part, explains such consistent and high levels of negative net absorption.

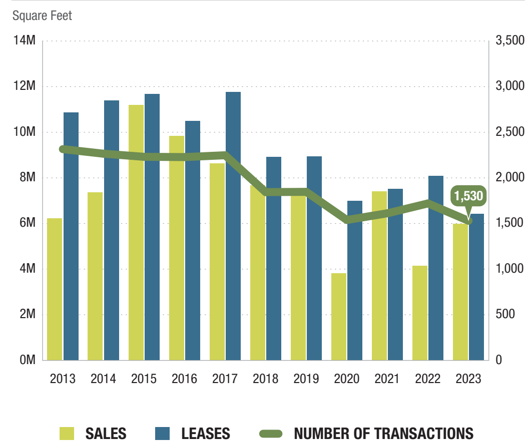
VACANCY & AVAILABILITY. The overall vacancy rate decreased to 17.27% in Q4 from 17.47% in Q3. Year-over-year, overall vacancy has increased by 9.63%, but the extent of the market's difficulty becomes more apparent when it is analyzed by building class. Class A vacancy has risen to 22.96%, while availability, which includes sublease space and available direct space that is still occupied, has increased to 29.11%. Class A vacancy is still highest in the Central County submarket, which ended the year at 27.09%. But the Class A availability rate was highest in North County at 32.07%, a reflection of larger sublease spaces available in the area. Class B and C buildings continue to fare better. Vacancy in Class B countywide is just 13.39% and the availability rate is 17.68%. Class B buildings represent just over half of the county's total inventory. Class C vacancy is stabilized at a scant 6.39%, but Class C represents only 4.5% of the 104.3 MSF office base inventory.

LEASE RATES. The average asking lease rate across all building classes countywide moved up four cents to $2.76 in Q4, but effective rents continued to fall because of increases in free rent, tenant improvement allowances and other concessions. Landlords are digging in to maintain their coupon lease rates, especially when they have loans coming due in the next couple of years. The combination of higher mortgage rates and rising vacancy is making office buildings less attractive to lenders. Consequently, asking rates year over year are actually up by 3.76% despite rising vacancy and lower transaction volume. South County still has the highest asking rate of $2.92, but that is just a single penny ahead of the Airport Area. South County includes the Irvine Spectrum, which is dominated by the Irvine Company which is not dependent on lenders to maintain their operations. As a consequence, the company can adjust rate and terms as necessary to maintain a high occupancy rate within its portfolio. Given the size and scope of the operation, the company also has the ability to move downsizing tenants to other buildings without losing them to competitors. Central County still has the lowest overall asking rate at $2.31 PSF, unchanged during the period. The North and West County submarkets both ended the year up slightly at $2.44.

VACANCY, AVAILABILITY & AVERAGE ASKING LEASE RATES



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



Market Statistics

	Change Over Last Quarter	Q4 2023	Q3 2023	Q4 2022	% Change Over Last Year
Vacancy Rate	DOWN	17.27%	17.47%	15.75%	9.63%
Availability Rate	UP	22.26%	21.94%	21.18%	5.09%
Average Asking Lease Rate	UP	$2.76	$2.72	$2.66	3.76%
Sale & Lease Transactions	DOWN	2,113,216	4,114,406	2,537,280	(16.71%)
Gross Absorption	UP	2,405,733	2,159,730	2,301,891	4.51%
Net Absorption	POSITIVE	366,886	(403,741)	(413,803)	N/A

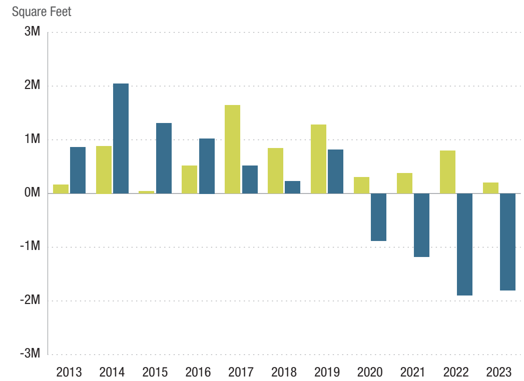
TRANSACTION ACTIVITY. Combined lease and sale activity fell sharply in Q4 to just 2,113,216 SF from 4,114,406 SF in Q3. 295 lease transactions were completed compared to 361 in Q3. Measured by square footage, the quarter's activity fell to 1,176,043 SF, a decrease of over 558,000 SF that will contribute to more negative net absorption in the first half of 2024. Sale transaction activity fell to 11 office buildings sold in Q4 from 26 in Q3. In all just over 937,000 SF was transacted versus almost 2,380,000 SF in Q3. The largest sale of the quarter was Hutton Center 3, a 199,834 SF Class A project in Santa Ana by Cypress Office Properties. The purchase price was just $28,900,000 or $144.63 PSF for a well-located Class A office building. The largest lease deal of the quarter was a 53,476 SF lease from Granite Properties, Inc. to Best Choice Products at 100 Bayview Circle in Newport Beach.

ABSORPTION. Countywide net absorption turned positive in the final quarter after consistent declines over the past few years. The office sector posted a gain in occupied space in Q4 of 366,886 SF. However, year-to-date net absorption ended the year with a loss of 1,798,761 SF after similar annual losses in 2022 and 2021. The Central County submarket was the only major submarket to report a net loss for the period, but it was a modest 46,249 SF concentrated entirely in Santa Ana. Negative absorption was a problem even before the pandemic began, but has accelerated since the middle of 2020.

CONSTRUCTION. Perhaps the best news for existing landlords in 2023 is the fact that there is not a single square foot of first-generation space in the construction queue. As we have been reporting, deteriorating market metrics and the high cost of capital make office development all but impossible, with The Irvine Company as the lone. Just three cities are reporting projects in the planning stages, but we don't expect any to get underway in 2024.

EMPLOYMENT. In November 2023, the unemployment rate in Orange County rose to 3.8%, marking an increase from the revised rate of 3.7% in October 2023 and exceeding the year-ago estimate of 3.0%. The retail trade sector added 4,000 jobs, while warehousing, transportation, and utilities also showed growth, adding 500 jobs. Professional and business services saw the largest decline, with a loss of 3,800 jobs.

NEW DELIVERIES & NET ABSORPTION



NEW DELIVERIES: New Construction Delivered to the Market

NET ABSORPTION: Changes in the Amount of Occupied Space from One Quarter to the Next

Forecast

The office market will be burdened by its current problems throughout 2024. Leasing activity will remain lackluster, as downsizing and ongoing uncertainty over space needs continue. We expect vacancy to inch higher through the year, which will keep a lid on asking lease rates. Net absorption may moderate but will likely remain in negative territory. Because of loans maturing into an interest-rate environment significantly higher than when they initiated, we may see some properties either heading into foreclosure or sold at deeply discounted prices.

Significant Transactions

Sales

* Voit Real Estate Services Deal

Property Address	City	Class	Square Feet	Total Price	Buyer	Seller
3 Hutton Centre Dr.	Santa Ana	A	199,834	$28,900,000	3 Hutton, LLC*	Cypress Office Properties
1065 N. Link	Anaheim	A	95,371	$29,286,500	Easterly Government Properties, Inc.	Hines
3300 Irvine Ave.	Newport Beach	B	77,135	$18,500,000	REDA Newport Irvine LLC	Cress Capital LLC
12966 Euclid St.	Garden Grove	B	64,402	$12,120,500	The City of Garden Grove	LT Properties Company LP
7441 Lincoln Way	Garden Grove	B	42,607	$9,601,824	JYJ Logistics, LLC	HK Ventures

Leases

Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
100 Bayview Cir.	Newport Beach	A	53,478	Oct-2023	Best Choice Products	Granite Properties, Inc.
19500 Jamboree Rd.	Irvine	A	33,614	Nov-2023	N/A	ESRI
5161 California Ave.	Irvine	B	31,720	Dec-2023	N/A	The Irvine Company
19500 Jamboree Rd.	Irvine	A	30,039	Nov-2023	N/A	ESRI
46 Discovery	Irvine	B	22,120	Nov-2023	Proteor USA	The Irvine Company

	INVENTORY				VACANCY & LEASE RATES					ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U / C	Square Feet Planned	Square Feet Vacant	Vacancy Rate Q4 2023	Square Feet Available	Availability Rate Q4 2023	Average Asking Lease Rate	Net Absorption Q4 2023	Net Absorption 2023	Gross Absorption Q4 2023	Gross Absorption 2023
Airport Area													
Costa Mesa	60	6,988,809	0	0	1,522,646	21.79%	2,199,022	31.46%	$3.15	(31,095)	(100,448)	175,458	551,801
Irvine	243	24,167,282	0	420,980	4,260,888	17.63%	5,614,857	23.23%	$2.78	216,985	(321,671)	730,200	2,681,618
Newport Beach	106	9,149,987	0	0	1,205,431	13.17%	1,772,008	19.37%	$3.15	76	(159,731)	263,734	691,286
Santa Ana	9	2,003,987	0	0	525,317	26.21%	668,931	33.38%	$2.42	50,068	(91,490)	68,272	363,891
Tustin	4	418,585	0	0	49,979	11.94%	89,481	21.38%	$4.70	4,248	75,835	4,248	109,628
Airport Area Total	422	42,728,650	0	420,980	7,564,261	17.70%	10,344,299	24.21%	$2.91	240,282	(597,505)	1,241,912	4,398,224
Central County													
Anaheim	21	1,952,808	0	150,000	471,569	24.15%	471,507	24.15%	$2.44	14,011	(31,567)	25,307	143,324
Orange	64	6,181,828	0	0	1,075,239	17.39%	1,534,412	24.82%	$2.24	(8,975)	(160,980)	64,725	314,052
Santa Ana	134	9,571,388	0	0	1,941,745	20.29%	2,206,294	23.05%	$2.40	(61,796)	(132,898)	84,625	516,702
Tustin	38	1,981,506	0	0	163,152	8.23%	226,675	11.44%	$1.74	10,511	62,162	25,370	163,387
Central County Total	257	19,687,530	0	150,000	3,651,705	18.55%	4,438,888	22.55%	$2.31	(46,249)	(263,283)	200,027	1,137,465
North County													
Anaheim Hills	61	4,088,439	0	0	450,175	11.01%	587,069	14.36%	$2.51	(1,130)	(23,642)	19,094	133,313
Brea	39	3,889,565	0	0	588,587	15.13%	965,523	24.82%	$2.60	34,316	71,166	134,708	308,120
Buena Park	17	1,078,748	0	0	47,813	4.43%	99,403	9.21%	$2.21	(2,216)	(33,477)	18,139	47,119
Fullerton	16	867,909	0	0	65,035	7.49%	131,822	15.19%	$2.03	13,033	39,345	28,031	78,947
La Habra	3	115,103	0	0	4,094	3.56%	4,094	3.56%	$1.71	160	(1,940)	160	5,326
La Palma	7	542,913	0	0	95,770	17.64%	115,002	21.18%	$0.00	15,232	(16,994)	41,542	54,078
Placentia	6	199,881	0	0	41,637	20.83%	44,256	22.14%	$2.05	(12,668)	(25,242)	0	12,212
Yorba Linda	5	289,383	0	0	21,360	7.38%	23,197	8.02%	$2.25	1,502	(14,500)	1,502	6,132
North County Total	154	11,071,941	0	0	1,314,471	11.87%	1,970,366	17.80%	$2.44	48,229	(5,284)	243,176	645,247
South County													
Aliso Viejo	36	2,641,812	0	0	1,206,600	45.67%	1,344,102	50.88%	$2.88	(5,875)	(229,015)	34,816	191,690
Dana Point	3	127,999	0	0	4,800	3.75%	4,800	3.75%	$0.00	(4,800)	1,200	0	7,200
Foothill Ranch	8	697,717	0	0	307,668	44.10%	318,753	45.69%	$2.50	(27,778)	(260,731)	9,200	57,774
Irvine Spectrum	170	13,361,229	0	0	2,008,767	15.03%	2,629,913	19.68%	$3.15	151,552	(165,253)	483,226	1,195,813
Laguna Beach	4	124,004	0	0	4,944	3.99%	4,944	3.99%	$0.00	700	(2,472)	700	1,375
Laguna Hills	27	1,301,662	0	465,000	296,546	22.78%	311,638	23.94%	$2.68	17,551	8,175	45,577	150,181
Laguna Niguel	7	395,699	0	0	78,233	19.77%	72,874	18.42%	$2.68	(300)	(22,154)	5,923	21,604
Lake Forest	41	2,202,710	0	0	449,584	20.41%	450,797	20.47%	$2.14	(30,555)	(79,025)	20,282	116,311
Mission Viejo	25	1,317,777	0	0	246,333	18.69%	258,996	19.65%	$2.33	(3,127)	(8,595)	15,689	81,240
Rancho Santa Margarita	5	212,716	0	0	21,114	9.93%	26,514	12.46%	$2.40	0	464	800	9,401
San Clemente	8	411,212	0	0	28,510	6.93%	39,560	9.62%	$2.40	1,722	3,791	11,403	22,939
San Juan Capistrano	20	971,944	0	0	50,318	5.18%	49,708	5.11%	$2.79	(2,782)	(5,266)	5,370	40,268
South County Total	354	23,766,481	0	465,000	4,703,417	19.79%	5,512,599	23.19%	$2.92	96,308	(758,881)	632,986	1,895,796
West County													
Cypress	27	1,904,468	0	0	174,510	9.16%	324,806	17.05%	$2.46	7,428	(54,670)	47,590	86,871
Fountain Valley	25	1,156,301	0	0	39,193	3.39%	39,680	3.43%	$2.15	(1,234)	(8,634)	1,559	18,494
Garden Grove	14	710,490	0	0	69,621	9.80%	71,526	10.07%	$2.12	4,641	(27,454)	6,676	35,568
Huntington Beach	33	1,783,701	0	0	334,900	18.78%	349,955	19.62%	$1.75	3,983	(34,389)	12,289	52,668
Los Alamitos	9	472,574	0	0	2,784	0.59%	5,614	1.19%	$2.29	3,489	3,001	5,009	10,451
Seal Beach	6	452,518	0	0	60,853	13.45%	63,640	14.06%	$3.43	(1,461)	7,024	1,843	39,801
Stanton	4	143,361	0	0	32,080	22.38%	31,800	22.18%	$1.47	6,123	(28,073)	6,123	8,880
Westminster	10	414,019	0	0	60,729	14.67%	65,056	15.71%	$2.39	5,347	(30,613)	6,543	32,129
West County Total	128	7,037,432	0	0	774,670	11.01%	952,077	13.53%	$2.44	28,316	(173,808)	87,632	284,862
Orange County Total	**1,315**	**104,292,034**	**0**	**1,035,980**	**18,008,524**	**17.27%**	**23,218,229**	**22.26%**	**$2.76**	**366,886**	**(1,798,761)**	**2,405,733**	**8,361,594**
Airport Area													
Class A	126	25,967,311	0	420,980	5,657,798	21.79%	7,590,987	29.23%	$3.12	45,908	(430,022)	740,823	2,818,021
Class B	276	15,597,901	0	0	1,849,651	11.86%	2,656,655	17.03%	$2.63	184,713	(167,648)	472,029	1,492,972
Class C	20	1,163,438	0	0	56,812	4.88%	96,657	8.31%	$2.60	9,661	165	29,060	87,231
Central County													
Class A	39	6,843,524	0	150,000	1,853,947	27.09%	2,174,678	31.78%	$2.67	44,656	(171,480)	99,104	518,202
Class B	177	11,082,264	0	0	1,617,132	14.59%	2,042,251	18.43%	$2.19	(60,646)	(48,872)	73,871	533,492
Class C	41	1,761,742	0	0	180,626	10.25%	221,959	12.60%	$1.83	(30,259)	(42,931)	27,052	85,771
North County													
Class A	20	2,417,720	0	0	575,303	23.80%	775,321	32.07%	$2.71	46,751	(25,757)	146,605	286,714
Class B	118	8,023,949	0	0	729,427	9.09%	1,185,654	14.78%	$2.34	(1,220)	25,931	92,392	351,208
Class C	16	630,272	0	0	9,741	1.55%	9,391	1.49%	$2.28	2,698	(5,458)	4,179	7,325
South County													
Class A	68	8,976,951	0	465,000	2,076,333	23.13%	2,307,749	25.71%	$3.27	147,471	33,989	340,088	957,634
Class B	275	14,286,582	0	0	2,596,145	18.17%	3,172,268	22.20%	$2.79	(55,154)	(780,936)	279,443	911,372
Class C	11	502,948	0	0	30,939	6.15%	32,582	6.48%	$2.59	3,991	(11,934)	13,455	26,790
West County													
Class A	12	1,382,111	0	0	303,943	21.99%	422,175	30.55%	$2.57	11,886	(46,623)	22,926	77,454
Class B	102	5,172,473	0	0	458,727	8.87%	517,902	10.01%	$2.35	6,530	(115,335)	54,806	190,158
Class C	14	482,848	0	0	12,000	2.49%	12,000	2.49%	$1.70	9,900	(11,850)	9,900	17,250
Orange County													
Class A	265	45,587,617	0	1,035,980	10,467,324	22.96%	13,270,910	29.11%	$3.04	296,672	(639,893)	1,349,546	4,658,025
Class B	948	54,163,169	0	0	7,251,082	13.39%	9,574,730	17.68%	$2.59	74,223	(1,086,860)	972,541	3,479,202
Class C	102	4,541,248	0	0	290,118	6.39%	372,589	8.20%	$2.09	(4,009)	(72,008)	83,646	224,367
Orange County Total	**1,315**	**104,292,034**	**0**	**1,035,980**	**18,008,524**	**17.27%**	**23,218,229**	**22.26%**	**$2.76**	**366,886**	**(1,798,761)**	**2,405,733**	**8,361,594**

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.

FOURTH QUARTER 2023 MARKET REPORT

ORANGE COUNTY OFFICE

Voit REAL ESTATE SERVICES

The Great Divide: Understanding the Class A Boom and the Obsolescence Phenomenon

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Notwithstanding mixed metrics, the office market began showing much-welcomed signs of life throughout the second half of 2023. We can now somewhat relax our concerns over hybrid and flexible work structures, as we have enough data to conclude that office space is relevant and essential. Two trends picking up steam are "Flight-to-Quality" and "Obsolescence." Class A and trophy assets are performing incredibly well, while the rest of the sector grapples with a variety of issues. Approximately half of all tenants are reducing their footprint by 20–40% and the vast majority are using the savings to access nicer, newer buildings offering first-class amenities. Some office tenants are wondering why they're not seeing better deals and this is why. These tenants are all competing for the same spaces in the most desirable properties. With new construction likely to stay paused for at least another year, the top tier of Class A properties will enjoy increased occupancy and even a little rent growth. This dynamic will cause the gap between Class A & B properties to widen further.

The market has been responding to an increasingly flexible work environment for the last ten or fifteen years, and the rise of operators such as WeWork was a result. Landlords unwilling or unable to adapt have been impacted the most. The more flexible landlords are doing very well because they are offering people what they want — a more frictionless tenancy. They are offering shorter lease terms, move-in-ready space, and furnished options.

The office market decline was not the apocalypse that many forecasted in large part because lenders are increasingly working out loan modifications. This does not mean we are out of the woods just yet, but the pain for many borrowers with maturing debt is being delayed. Lenders learned their lesson back in the Great Recession. They do not want the buildings back, because they realize they have neither the knowledge nor the personnel to handle real estate.

As flight-to-quality benefits the premier properties, obsolescence is degrading the lesser tiers. Mid-tier properties and below will continue to struggle, including the lower echelon of Class A offices. Most of this inventory was constructed before 1990 and fails to meet today's tenant needs. Undesirable architectural characteristics, infrastructure limitations, and the high cost of remedial retrofits are a few of the most common hurdles. In many instances, owners of these properties are eager to dispose of the assets, so we often see these properties marketed at less-than-aggressive prices. We've seen this before in the retail and hotel sectors. Ultimately, this is a massive opportunity for well capitalized and savvy investors. With the correct combination of creativity, vision, and commitment, many previously obsolete properties could be revitalized and returned to the market as essential components of our office inventory.

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

Please Contact Us for Further Information

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