

MARKET REPORT

OFFICE

Orange County Metro Area

IPA
INSTITUTIONAL
PROPERTY
ADVISORS

4Q/21

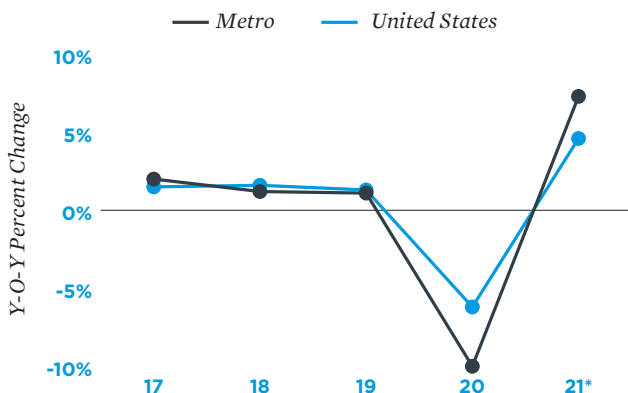
Office Sector Trails Neighboring Metros, Yet Lower Rents and Central Location Attract Tenants

Regionally discounted asking rates offer potential upside.

Orange County has the lowest unemployment rate among Southern California markets; nevertheless, its office sector continues to struggle. While all neighboring markets recorded positive absorption in the second quarter of 2021, Orange County did not. Instead, the metro registered its sixth consecutive quarter of negative absorption. During this stretch, the local vacant stock expanded by 6.4 million square feet, with availability in the metro's largest submarket, Airport Area, nearing 20 percent. Assistance could emerge in the form of companies seeking regionally lower cost office space. Entering the second half, the metro's average asking rent was 25 percent below Los Angeles County's mean and 10 percent under that of San Diego.

Reasons for optimism surface during the second half. Preliminary data from the third quarter of 2021 suggests Orange County's office sector could be turning the corner. During the three-month window, at least 45 leases were executed for spaces larger than 10,000 square feet, matching the prior six-month total. Activity was strongest in Irvine, where satellite manufacturer Terran Orbital agreed to sublease 89,000 square feet and Bandai Namco inked a 70,000-square-foot commitment. The improvement in leasing and the minimal volume of available space slated for near-term delivery has the potential to usher in the return of positive office demand prior to the end of this year.

Employment Trends



* Forecast
Sources: BLS; CoStar Group, Inc.

Office 2021 Outlook



**110,000
JOBS**

will be created

EMPLOYMENT:

Orange County employers are on pace to bolster staffs by 7.3 percent in 2021, allowing the metro to recover half of the jobs lost last year. Traditional office-using positions will account for one-fourth of this year's employment growth.



**875,000
SQ. FT.**

will be completed

CONSTRUCTION:

Deliveries will expand the metro's office inventory by 0.6 percent this year. A building for SchoolsFirst Federal Credit Union in Tustin and the expansion of Vans' headquarters in Costa Mesa account for 30 percent the space completed in 2021.



**160
BASIS POINT**

increase in vacancy

VACANCY:

Comparable volumes of Class A and Class B/C space re-enter the market during 2021, pushing metro vacancy up to 17.4 percent. Still, office demand improves over last year, when availability rose by 330 basis points.



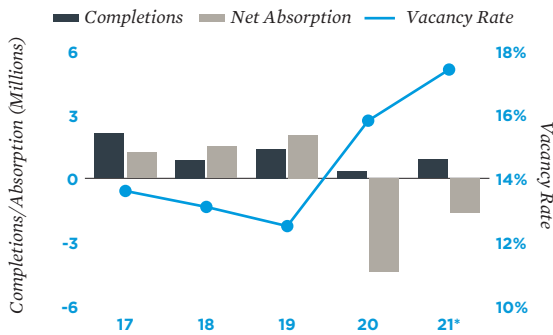
**2.2%
DECREASE**

in asking rent

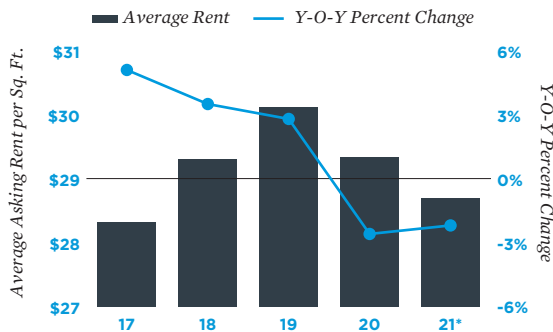
RENT:

Rising vacancy and the high volume of space available for sublease will maintain concessions usage and hinder rent growth. For a second straight year, the average asking rent will fall by more than 2 percent, ending 2021 at \$28.70 per square foot.

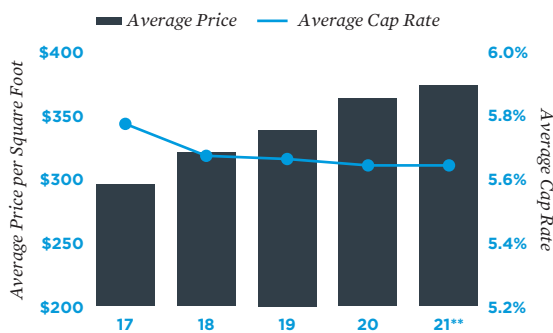
Supply and Demand



Rent Trends



Sales Trends



* Forecast ** Through 2Q

Sources: CoStar Group, Inc.; Real Capital Analytics

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2Q21 – 12-Month Period



CONSTRUCTION

774,000 sq. ft. completed

- Driven by completions in Irvine Spectrum, Orange County's inventory grew by 0.5 percent over the past 12 months ended in June. Recent delivery volume exceeded the prior yearlong total by 150,000 square feet.
- As of mid-September, construction was underway on 970,000 square feet with roughly 60 percent of this space accounted for.



VACANCY

340 basis point increase in vacancy Y-O-Y

- The metro's vacant stock swelled by 5 million square feet during the past year, pushing availability up to 16.9 percent.
- Class A vacancy rose 470 basis points to 23.0 percent, while Class B/C availability climbed 270 basis points to 13.7 percent. Both sectors' vacant inventories expanded by more than 2 million square feet.



RENT

5.1% decrease in the average asking rent Y-O-Y

- Each of the metro's three largest submarkets registered a 5 percent-plus decline in asking rent over the past four quarters, lowering Orange County's mean marketed rate to \$28.86 per square foot.
- Notable declines occurred across property tiers as the average Class A rate fell 5.5 percent and the Class B/C sector noted a 4.9 percent drop.

Investment Highlights

- Transaction velocity slowed by more than 10 percent during the yearlong period ended in June. Recent investment activity, however, is showing signs of improvement as nearly 40 percent of the closings recorded over the past 12 months occurred in the second quarter of 2021.
- Class B property trades have supported recent deal flow, lifting the metro's average price point 6 percent to \$373 per square foot. The mean cap rate dipped slightly over the past year yet remained in the high-5 percent range, where it has hovered since 2016.
- Buyers have been most active in South County, focusing on mid-tier assets in Irvine and to a lesser extent Lake Forest. Since July of last year, post-2000-built properties have accounted for half of the transactions closed in the submarket, with these buildings trading for an average of \$385 per square foot. Minimum first-year returns for these assets can fall into the high-3 percent band.
- Investors focused on medical office buildings are targeting 1970s- and 1980s-built assets with upside potential. Properties in North County cities and locales south of Irvine are changing hands most frequently, with returns often falling in the 5 percent to low-6 percent range.

The information contained in this report was obtained from sources deemed to be reliable. Every effort was made to obtain accurate and complete information; however, no representation, warranty or guarantee, express or implied, may be made as to the accuracy or reliability of the information contained herein. Note: Metro-level employment growth is calculated based on the last month of the quarter/year. Sales data includes transactions sold for \$1 million or greater unless otherwise noted. This is not intended to be a forecast of future events and this is not a guaranty regarding a future event. This is not intended to provide specific investment advice and should not be considered as investment advice. Sources: IPA Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Real Capital Analytics

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