

MARKET REPORT

Office
Orange County Metro Area

IPA
INSTITUTIONAL
PROPERTY
ADVISORS

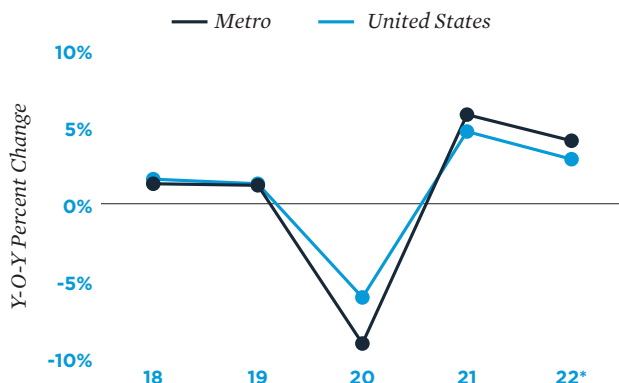
2Q/22

Improved Class B/C Leasing Mitigates Overall Vacancy Increase and Revives Deal Flow

Subsector fundamentals contrast. Hybrid work adoption by major office users and a near record volume of available Class A space has Orange County's office sector in a state of transition. Nevertheless, reasons for optimism are emerging. Demand for lower-cost floor plans has recently improved, with tenants absorbing nearly 1.2 million square feet of Class B/C space during the 12-month period ended in March. Low- and mid-tier leasing has been most pronounced in the Airport Area and South County, activity that has placed subsector availability below its long-term average. An additional positive for the metro, the number of traditional office-using positions is expected to reach a record mark this year. Upcoming staff expansions have the potential to increase some firms' office requirements despite flexible, in-person work schedules.

Cluster of supply additions test submarket's recovery. Home to more than 20 percent of the metro's inventory, South County recently exhibited standout performance. Over the past year, the area accounted for half of the 25,000-square-foot-plus leases inked metrowide, with Twitch Interactive, Sega of America and Cap Diagnostics each committing to notable spaces during early 2022. These executions contributed to the net absorption of nearly 1 million square feet during the last 12 months, activity that equated to a 230-basis-point drop in local vacancy. Still, the submarket may face some near-term headwinds, as 600,000 square feet of unaccounted for space was underway in Irvine Spectrum as of mid-May.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.

Office 2022 Outlook



**66,000
JOBS**

will be created

EMPLOYMENT:

Traditionally office-using roles account for one-fourth of Orange County's annual job creation, driven by professional and technical services hiring. At 3.8 percent in April, unemployment is on pace to match a pre-pandemic rate by year-end.



**1,095,000
SQ. FT.**

will be completed

CONSTRUCTION:

Orange County records its highest delivery volume in the past three years. Still, office inventory expands by less than 1 percent, with The Press, a property fully leased by Anduril, accounting for 40 percent of this year's supply additions.



**80
BASIS POINT**

increase in vacancy

VACANCY:

Office availability is slated to rise during 2022, as larger office users continue to reevaluate their local space requirements amid longer-term hybrid work adoption. At 16.4 percent, Orange County's year-end vacancy rate will represent a 10-year high.



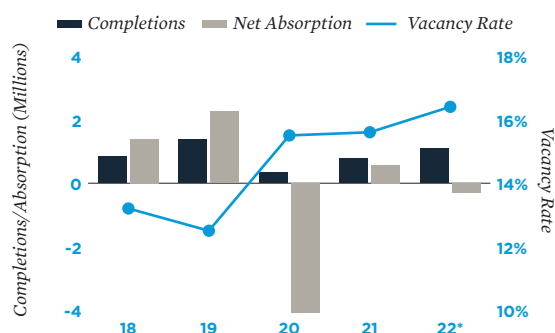
**1.0%
INCREASE**

in asking rent

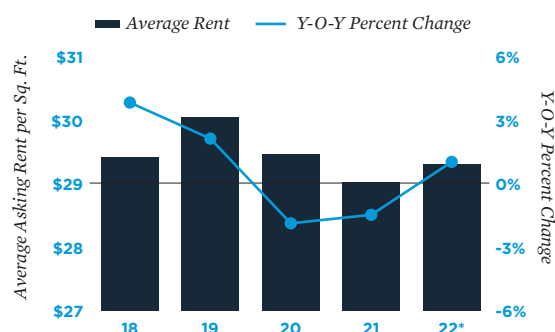
RENT:

After falling by 3.5 percent over the prior two years, the metro's average asking rent inches up to \$29.30 per square foot. Relatively tight conditions in the Class B/C segment and a moderate wave of supply additions support the modest gain.

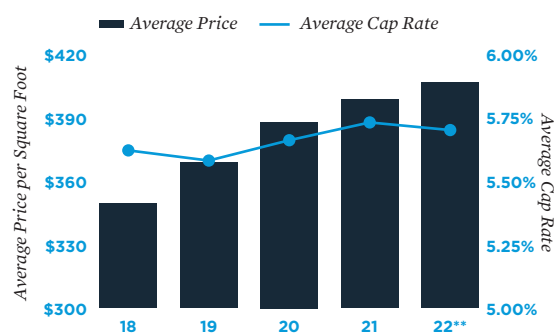
Supply and Demand



Rent Trends



Sales Trends



* Forecast ** Through 1Q

Sources: CoStar Group, Inc.; Real Capital Analytics

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Price: \$250

1Q 2022 - 12-Month Period



CONSTRUCTION

678,000 sq. ft. completed

- Driven by supply additions in the southern and central portions of Orange County, metro inventory expanded by 0.5 percent over the past four quarters ended in March.
- Ongoing construction is concentrated in Irvine Spectrum and Costa Mesa, with roughly 160,000 square feet underway elsewhere as of mid-May.



VACANCY

10 basis point increase in vacancy Y-O-Y

- Vacancy inched up to 16.2 percent in the first quarter. However, tenants absorbed a net of 1.7 million square feet during the final three months of 2021. During the prior yearlong span, availability rose 340 basis points.
- The metro's largest submarket by stock, the Airport Area logged a 90-basis-point rise in availability that heightened local vacancy to 20.3 percent.



RENT

1.5% decrease in the average asking rent Y-O-Y

- Rents declined across all property tiers during the past 12 months, lowering the overall marketed rate to a mean of \$28.85 per square foot.
- Supported by sub-10 percent vacancy, North County was the only submarket to record positive rent growth during the recent yearlong span. Entering April, the area's mean asking rate stood at \$25.61 per square foot.

Investment Highlights

- Sales activity rose by nearly 50 percent during the 12-month stretch ended in March, with year-over-year improvements in trading registered across price tranches. The recent uptick in \$20 million-plus deal flow is indicative of renewed institutional confidence. However, overall trading has yet to return to pre-pandemic levels.
- Investors paid an average of \$407 per square foot for assets during the past year ended in March, roughly a 4 percent year-over-year increase. Despite this rise, the metro's mean cap rate held in the high-5 percent range.
- Class B transactions are accounting for the bulk of deal flow. Many of these buildings are 1980s- or post-2000-built and warrant interior improvements. Minimum first-year returns for these upside-providing assets typically range in the high-4 to low-5 percent span. Despite this, cap rates in the high-5 to 7 percent range are not uncommon for mid-tier properties.
- South County office hubs, including Irvine Spectrum and areas of Newport Beach, Santa Ana and Anaheim, are primary locales for Class B trading, with sub-\$400 per square foot pricing still available. Overall, buyers maintain a preference for assets proximate to Interstate 5 and Interstate 405.

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. 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: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Real Capital Analytics

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