MARKET REPORT

Office

Orange County Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

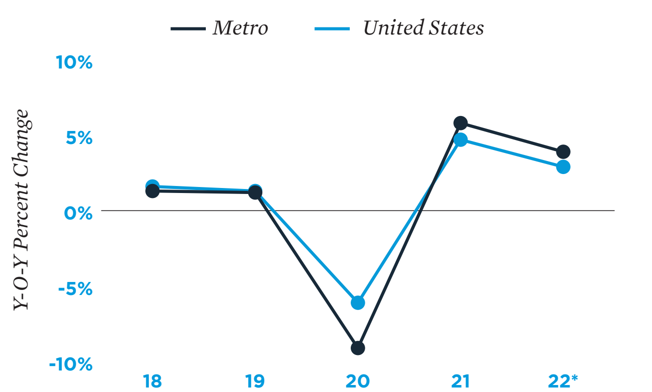
4Q/22

Pair of Submarkets Stand Out on the National Stage, Tempering Local Vacancy Concerns

Office hub joins select group. Orange County showcases pockets of standout demand, despite vacancy increasing overall. After the pandemic period brought 2.4 million square feet to market near John Wayne Airport and adjacent zones, positive net absorption returned to the area during the 12-month span ending in June. This improvement lowered local vacancy by 10 basis points, making it one of only nine major U.S. submarkets with more than 50 million square feet of office inventory that recorded compression during this period. Furthermore, this tightening occurred amid elevated development, suggesting demand for higher-tier office space exists in the area. Since then, ongoing construction here has slowed, likely helping to facilitate demand for local existing stock — specifically for recently renovated floorplans — supporting further near-term compression.

Submarket tightens at nation-leading pace. South County's low-density suburban sprawl has drawn businesses adopting hybrid workplace models to attract and retain talent. Firms absorbed more than 912,000 square feet of local offices on a net basis during the yearlong span ending in June. This surge in demand helped foster a 280-basis-point drop in local vacancy, the largest contraction among major submarkets nationally with more than 30 million square feet of stock. Still, the area hosts a sizable active pipeline, with about 600,000 square feet unaccounted for as of September. This volume of speculative space has the potential to halt recent momentum, if these projects struggle to secure tenants over the near term.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.

Office 2022 Outlook

63,500 JOBS *will be created*

EMPLOYMENT:

Firms recovered an average of 6,140 positions per month year-to-date through August, a pace nearly six times as fast as the monthly long-term mean. Still, growth tempers during the final four months, as the job tally expands by 3.9 percent at year-end.

1,180,000 SQ. FT. *will be completed*

CONSTRUCTION:

Development nears the 2019 level, as builders expand the metro's stock by 0.8 percent. Most of this year's pipeline is slated for second half delivery, with the third phase of the Spectrum Terrace in Irvine accounting for 30 percent of volume.

110 BASIS POINT *increase in vacancy*

VACANCY:

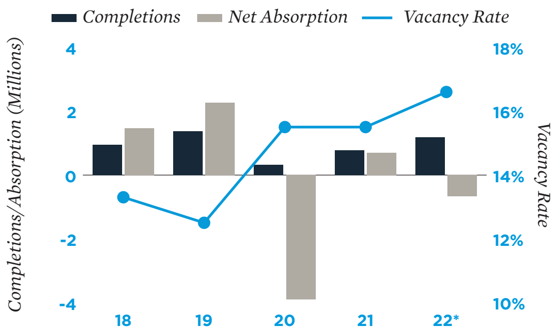
Office availability increases to 16.6 percent, marking a 40-basis-point jump over the midyear rate. Speculative supply additions during the second half will bring vacant stock up to a 10-year high.

1.1% DECREASE *in asking rent*

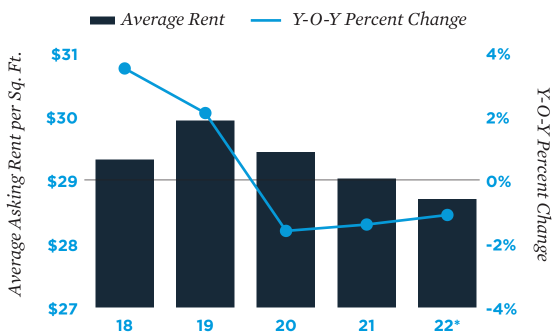
RENT:

Entering July, the average asking rate had receded in all but one of the prior eight quarters. This downward momentum is shifting, however, as the mean marketed rent is projected to lift by 0.6 percent to $28.70 per square foot during the second half.

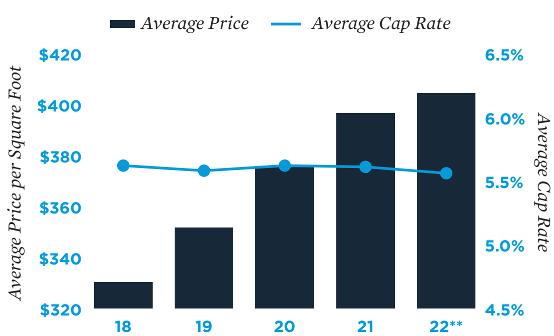
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 2Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

Orange County Office:

Jonathan Giannola *Vice President, Regional Manager*

19800 MacArthur Boulevard, Suite 150

Irvine, CA 92612

Tel: (949) 419-3200 | jonathan.giannola@marcusmillichap.com

Prepared and edited by:

Josh Craft

Research Associate | Research Services

For information on national office trends, contact:

John Chang

Senior Vice President, Director | Research & Advisory Services

Tel: (602) 707-9700 | jchang@ipausa.com

2Q 2022 - 12-Month Period

CONSTRUCTION

381,000 sq. ft. completed

- Developers completed a record 250,000 square feet in Central County during the yearlong span ending in June, with the SchoolsFirst Federal Credit Union office in Tustin Legacy driving the bulk of this volume.
- Ongoing development is concentrated in Irvine Spectrum, with builders currently underway on over 660,000 square feet here.

VACANCY

50 basis point decrease in vacancy Y-O-Y

- Positive 12-month net absorption and slower development helped compress the metrowide vacancy rate to 16.2 percent in June. This marked the first time that conditions have tightened year-over-year since March 2020.
- Vacancy in the Class A segment lifted 110 basis points to 23.5 percent. Conversely, the Class B/C subsector rate fell 130 basis points to 12.5 percent.

RENT

2.1% decrease in the average asking rent Y-O-Y

- Improving tenant demand has somewhat slowed the pace of negative rent growth, placing the average asking rate at $28.52 per square foot.
- North County was the only submarket to record positive rent gains over the past year, with the local average asking rate rising 1.7 percent through 12 months to $25.87 per square foot in June.

Investment Highlights

- Average pricing for office assets in Orange County advanced 4.7 percent to $405 per square foot during the 12-month span ending in June, while the mean cap rate held steady at 5.6 percent.
- Class A assets proximate to John Wayne Airport are generating significant attention from investors. Top-tier offices in the area are mostly trading at low-5 percent yields, with entry costs ranging from $450 to $540 per square foot. Prices, however, tend to be higher on average for assets closer to high-density commercial clusters, such as the Irvine Business Complex.
- Mid-tier offices in South County are driving a substantial chunk of overall deal flow, with the submarket's noteworthy vacancy compression bolstering local investment activity. Lake Forest is accounting for the highest number of these trades, with Class B assets in the area mostly changing hands at $250 to $300 per square foot.
- Local investors are acquiring lower-tier offices around Santa Ana's Historic District, intrigued by the potential economic impact of the OC Streetcar project. Here, entry costs for these assets range from $200 to $230 per square foot, with cap rates often falling in the mid-5 percent band.

Price: $250