MARKET REPORT

OFFICE

Orange County Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

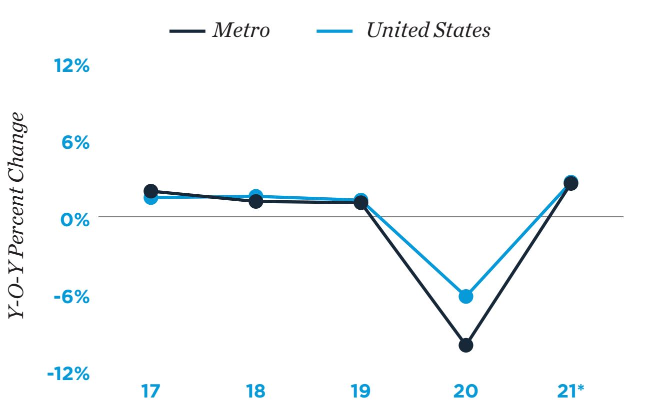
2Q/21

Early-Year Uptick in High-Paying Job Creation and Leasing Activity Brighten Office Outlook

Catalysts for improvement emerge. After a year of extended office closures and remote work that triggered a sharp rise in vacancy, Orange County has recorded several advancements in early 2021 that if sustained would aid long-term fundamentals. During the first quarter, the metro added 9,400 professional and business services positions. While some of these jobs may initially be accomplished at home, many of these employees will transition to in-office work or a hybrid schedule following widespread vaccination and the complete reopening of California's economy in June. These factors and continued payroll expansions would require companies to maintain their real estate footprints or occupy additional space. This trend may already be underway as firms plan their returns. Initial data shows leasing activity up by more than 10 percent in the first quarter when compared with the prior three-month period, marked by a rise in 10,000-square-foot-plus commitments.

Redevelopment and open-air design drive construction. Two projects that will account for the bulk of supply additions this year may provide a glimpse into the future of Orange County office development. Fully leased by defense contractor Anduril this February, The Press in Costa Mesa features creative office space combined with a 50,000-square-foot food hall, a park and other outdoor space. In Irvine Spectrum, eight low-rise, open-air buildings will be finalized at Innovation Office Park. The property's owner is reportedly offering short-term leases starting at six months.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.

Office 2021 Outlook

40,000 JOBS
will be created

EMPLOYMENT:

Additions by professional services firms and leisure and hospitality companies support job creation this year, enabling Orange County to recover nearly 25 percent of the 167,000 positions lost last year.

1,006,000 SQ. FT.
will be completed

CONSTRUCTION:

Following a year of subdued office development, supply additions exceed the 1 million-square-foot mark in 2021. Properties slated for delivery are concentrated in Irvine Spectrum, Costa Mesa and Tustin.

140 BASIS POINT
increase in vacancy

VACANCY:

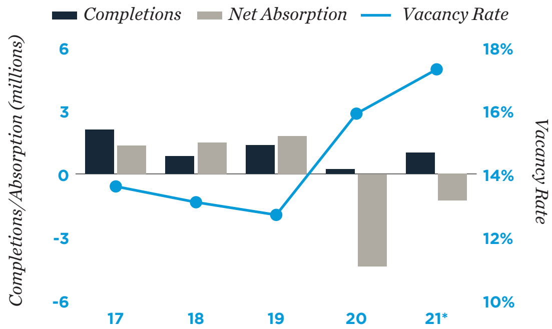
Office availability climbs for a second consecutive year to 17.3 percent as some companies decline lease renewals or avoid expanding their footprint while they evaluate their future real estate needs.

2.8% DECREASE
in asking rent

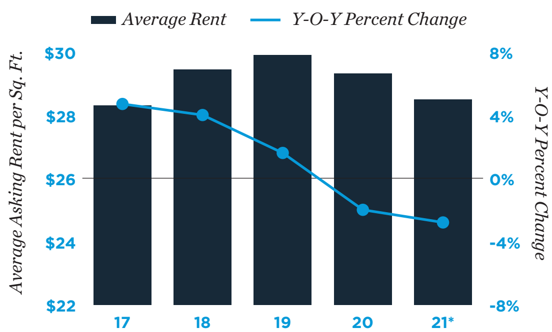
RENT:

The volume of space on the leasing market reaches a 10-year high, prompting some operators to offer concessions or discounted rents when marketing available properties. These decisions lower the metro's average asking rate to $28.50 per square foot.

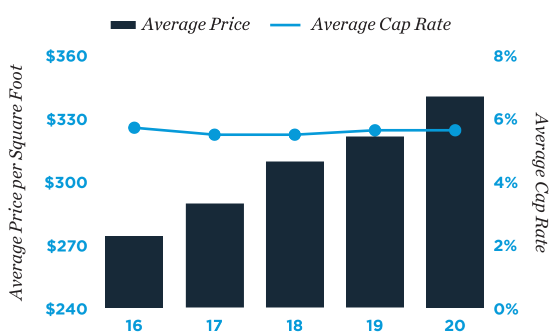
Supply and Demand



Rent Trends



Sales Trends



* Forecast

Sources: CoStar Group, Inc.; Real Capital Analytics

IPA Office

Alan L. Pontius

Senior Vice President, National Director

Tel: (415) 963-3000 | apontius@ipausa.com

For information on national office trends, contact:

John Chang

Senior Vice President, National Director | Research Services

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

Jay Lybik

Vice President, IPA Research Services

Tel: (602) 687-6700 | jlybik@ipausa.com

2020

CONSTRUCTION

215,000 square feet completed

- Orange County's office inventory expanded by just 0.1 percent in 2020 with deliveries concentrated in Irvine Spectrum. During the prior four years, a total of 5 million square feet was finalized countywide.
- Entering 2021, construction was underway on nearly 1.2 million square feet of space, three-fourths of which had leases in place.

VACANCY

320 basis point increase in vacancy Y-O-Y

- Office availability elevated to 15.9 percent in 2020 as the metro's vacant stock swelled by 4.6 million square feet. An equal volume of Class A and B/C space entered the leasing market last year.
- All major submarkets noted triple-digit vacancy increases. The Airport Area recorded the largest gain at 500 basis points.

RENT

2.0% decrease in the average asking rent Y-O-Y

- Sizable vacancy increases across Orange County's largest submarkets encouraged operators' to reduce rents last year, lowering the average marketed rate to $29.32 per square foot.
- Driven by a 450-basis-point rise in vacancy, average Class A asking rent fell 3.0 percent. The Class B/C marketed rate dipped 1.4 percent.

Investment Highlights

- Sales activity dropped by 20 percent last year, driven by a more pronounced drop in $10 million-plus transactions. Amid the decline, average pricing rose 6 percent to $340 per square foot as Class B transactions accounted for a larger percentage of total deal flow.
- Investors have been most active in South County since the onset of the health crisis, acquiring properties in Irvine Spectrum and areas off the Highway 73 Toll Road where numerous Fortune 500 companies occupy space. These locales accounted for most of the 100,000-square-foot-plus transactions metrowide, with buyers accepting first-year returns in the high-3 to low-4 percent range.
- Investors seeking higher returns have targeted Central County cities off Interstate 5 where minimum yields are roughly 50 basis points below the metro's 5.6 percent average cap rate.
- In contrast to overall sales velocity, medical office trading has risen since last March aided by the segment's contracting vacancy and positive absorption. South and Central County cities including Tustin and Anaheim have represented popular locales, with buildings trading at a mid-5 percent average return.