

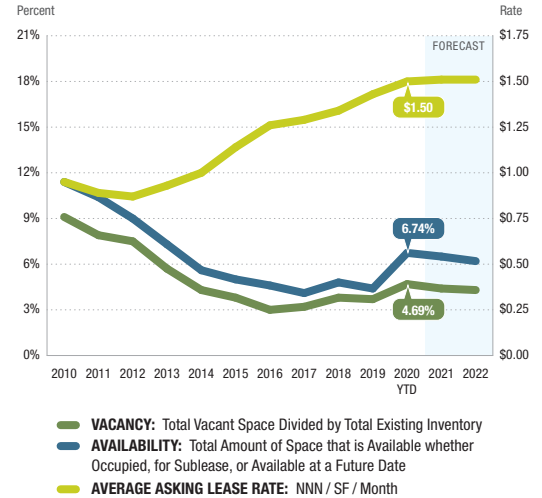
OVERVIEW. After suffering a setback in 2Q, the Orange County Flex/R&D market found enough traction in the third quarter to avoid further damage. The market had been showing signs of softening even before the pandemic crisis, which many thought made it vulnerable to correction once shutdown orders were given. Further cause for concern is the fact that Flex/R&D users tend to be more employee intensive, which makes navigating workplace restrictions more difficult for them than for their industrial counterparts. However, all key market metrics were either flat or showed slight improvement during the third quarter. Vacancy and lease rates were flat, leasing activity and gross absorption were up and net absorption, while still negative, improved substantially. So, Flex/R&D, a hybrid of office and industrial, may experience a soft landing, and return to growth mode sooner rather than later.

VACANCY & AVAILABILITY. The overall vacancy rate actually fell 1 basis point by the end of 3Q to 4.69%. However, the Greater Airport area and South County, the largest of the Flex/R&D submarkets, did see a 100 basis point and 26 point rise, respectively. North County saw a drop of 26 basis points. West County’s vacancy was unchanged at 3.97%. In terms of availability, which includes vacant space plus occupied space offered for lease, the spread between the two narrowed during the quarter, a good indicator that R&D users are not putting more underutilized space up for sublease that could upset the supply/demand balance going forward.

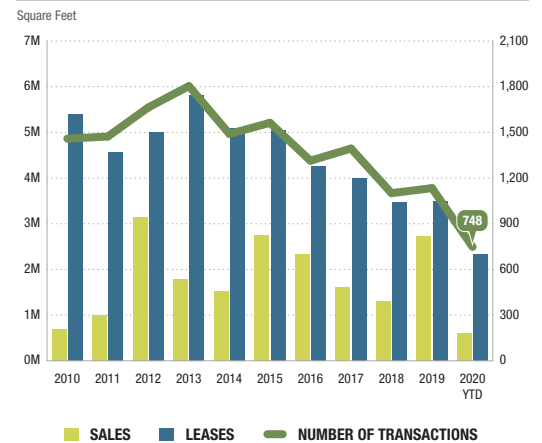
LEASE RATES. The average asking lease rate across all major submarkets was up a penny in 3Q to \$1.50, another good sign for landlords that there is little downward pressure on rates looking ahead. South County’s average rate is highest, mainly because this submarket includes Irvine Spectrum’s 10.4 MSF of base inventory, 442,707 SF of which is available at an average asking rate of \$1.72. In terms of lease rates by square footage, there is very little difference. Just 2 pennies separate the 10,000–25,000 SF range from the 50,000–100,000 SF range, much narrower than the sector’s industrial counterpart.

TRANSACTION ACTIVITY. The square footage leased and sold during 3Q rose in 3Q, up 320,968 SF to 988,759. That signals continuing confidence within the sector that the pandemic crisis will pass and business operations will return to more normal levels. In all, 258 leases and 6 sales were signed during the third quarter, which help gross and net absorption performance over the next two quarters. The largest lease transaction was the Jena Valve deal, a 56,900 SF lease at 4 Cromwell in the South Orange County submarket. The biggest sale was 2392 Morse in Irvine, a \$7,500,000 sale to RiverRock Estate Group.

VACANCY, AVAILABILITY & AVERAGE ASKING LEASE RATES



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



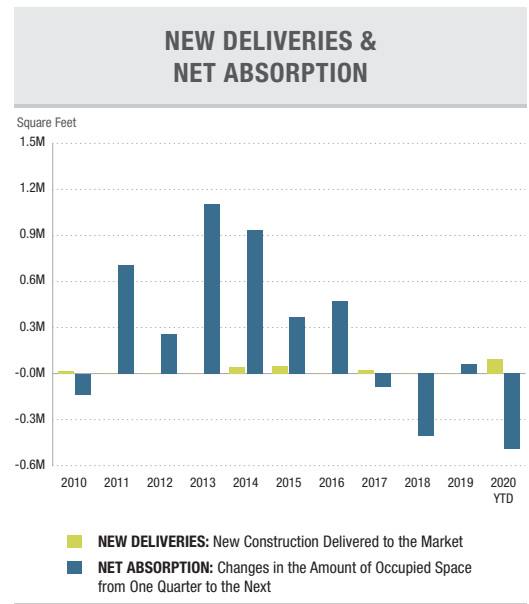
Market Statistics

	Change Over Last Quarter	3Q 2020	2Q 2020	3Q 2019	% Change Over Last Year
Vacancy Rate	▲ UP	4.69%	4.60%	3.30%	42.25%
Availability Rate	▲ UP	6.74%	6.60%	5.80%	16.20%
Average Asking Lease Rate	▲ UP	\$1.50	\$1.49	\$1.41	6.38%
Sale & Lease Transactions	▲ UP	988,759	667,791	2,280,866	(56.65%)
Gross Absorption	▲ UP	985,852	534,207	726,430	35.71%
Net Absorption	▼ NEGATIVE	(82,118)	(291,717)	(3,092)	N/A

ABSORPTION . Gross and net absorption for Flex/R&D space showed marked improvement in 3Q despite a continuation of pandemic restrictions on business activity. Gross absorption, which measures total move-ins, rose by 451,645 SF to over 988,759 SF in the period. Big contributors to that performance included MaxCare Products LLC in Santa Ana and Jena Valve in Irvine. Net absorption, which reflects the change in total occupied space in a given period, remained in negative territory but was much improved. 2Q saw a decline of 291,717 SF, but in 3Q that loss was limited to just over 82,000 SF. Even if negative net absorption continues at current levels, there is little danger of a sharp rise in vacancy that could trigger a substantial correction.

CONSTRUCTION. Construction activity was limited to one building in 3Q, a 239,000 SF build-to-suit for Edwards Life Sciences, scheduled for completion in of 4Q 2020. Just one building, 78,000 SF in Costa Mesa, is in the planning stages, which eliminates the possibility of disrupting the supply / demand balance by over-building, a common occurrence in recessionary times. The Costa Mesa building is being built by TR Funding Company and could commence construction by 4Q 2021. Delivering new product going forward will be difficult, as the price of suitable land is prohibitively high with much of it being re-purposed to high density residential use to meet the growing demand for housing.

EMPLOYMENT. The unemployment rate in Orange County was 9.9% in August 2020, down from a revised 12.4% in July 2020, and above the year-ago estimate of 3.0%. This compares with an unadjusted unemployment rate of 11.6% for California and 8.5% for the nation during the same period. Construction grew by 2,700 payroll jobs with 81% of the increase in specialty trade contractors (up 2,200 jobs). Heavy and civil engineering construction added 300 jobs and construction of buildings gained 200 jobs.



Forecast

We are now optimistic again about the near-term future of the R&D/Flex market heading into next year. The fact that the sector bounced back in Q3 is a good sign. Market performance should stabilize heading into 2021, and as pandemic restrictions ease, space should start moving more quickly. A viable vaccine for the COVID-19 virus would be a game changer. It would allow employee-intensive Flex / R&D users to call more workers back to the office. On the other hand, uncertainty over the national election and the possible passage of California’s Proposition 15, the so-called split roll initiative, is casting a shadow over activity in all product types, including R&D/Flex. Proposition 15 would raise property taxes on commercial property substantially and drive up the cost of occupancy, which, in turn, would impact leasing and sale activity.

Significant Transactions

Sales					
Property Address	Submarket	Square Feet	Sale Price	Buyer	Seller
2392 Morse	Irvine	20,392	\$7,500,000	RiverRock Real Estate Group	SCC Acquisitions, Inc.
1188 N Grove St.	Anaheim	17,250	\$3,310,000	Groovy Grove LLC	TRW LLC
970-972 Calle Negocio	San Clemente	10,914	\$2,870,500	Imburgia Family Trust	Mobile Money
30221 Aventura	Rancho Santa Margarita	10,109	\$3,072,500	Phytogene Corp	Biomedical Research & Longevity Society, Inc.

Leases					
Property Address	Submarket	Square Feet	Transaction Date	Tenant	Owner
4 Cromwell	Irvine Spectrum	56,900	Aug-2020	Jena Valve	The Irvine Company
1202 E. Wakeham Ave.	Santa Ana	35,420	Sep-2020	beyondGREEN biotech, Inc.	Kung Investments, LLC
11100 Hope St.	Cypress	34,050	Jul-2020	ANA	Cypress Land Company
3095 Red Hill Ave.	Costa Mesa	30,287	Sep-2020	Calvary Chapel	Rock Harbor Church
25901 Commercentre Dr.	Lake Forest	29,540	Sep-2020	Lauree, LLC	Donna Kitts

	INVENTORY					VACANCY & LEASE RATES				ABSORPTION			
	Number of Bldgs.	Net Rentable Square Feet	Square Feet U/C	Square Feet Planned	Square Feet Vacant	Vacancy Rate 3Q2020	Square Feet Available	Availability Rate 3Q2020	Average Asking Lease Rate	Net Absorption 3Q2020	Net Absorption 2020	Gross Absorption 3Q2020	Gross Absorption 2020
Airport Area													
Costa Mesa	172	4,006,284	0	78,738	358,024	8.94%	325,784	8.13%	\$1.73	(55,492)	(201,481)	45,801	83,386
Fountain Valley	50	1,467,666	0	0	33,020	2.25%	63,465	4.32%	\$1.05	(1,187)	8,145	15,623	80,030
Irvine	241	6,195,480	239,000	0	411,833	6.65%	516,779	8.34%	\$1.40	(16,972)	107,010	272,433	419,091
Newport Beach	21	582,303	0	0	29,326	5.04%	26,826	4.61%	\$0.00	(3,000)	(7,500)	8,958	16,458
Santa Ana	182	4,691,652	0	0	156,833	3.34%	270,195	5.76%	\$1.33	3,598	(33,244)	68,654	155,945
Tustin	87	3,067,208	0	0	296,277	9.66%	216,877	7.07%	\$1.33	(8,415)	47,483	33,624	144,829
Airport Area Total	753	20,010,593	239,000	78,738	1,285,313	6.42%	1,419,926	7.10%	\$1.50	(81,468)	(79,587)	445,093	899,739
North County													
Anaheim	184	5,144,976	0	0	238,335	4.63%	286,502	5.57%	\$1.91	(8,706)	(117,085)	29,794	140,114
Brea	51	1,490,362	0	0	12,398	0.83%	12,666	0.85%	\$1.16	4,098	14,349	8,237	29,421
Buena Park	29	914,012	0	0	4,130	0.45%	27,630	3.02%	\$0.00	12,051	3,200	17,104	40,235
Fullerton	46	1,819,054	0	0	101,587	5.58%	102,961	5.66%	\$1.03	395	(66,328)	24,602	68,740
La Habra	10	187,013	0	0	2,800	1.50%	1,800	0.96%	\$0.00	2,650	(692)	6,150	18,891
Orange	100	2,267,551	0	0	46,337	2.04%	85,718	3.78%	\$1.81	42	7,652	20,114	70,566
Placentia	26	673,935	0	0	3,140	0.47%	10,838	1.61%	\$0.95	6,221	11,908	11,520	26,568
Yorba Linda	51	1,497,185	0	0	26,634	1.78%	202,698	13.54%	\$1.15	(203)	16,828	8,771	44,804
North County Total	497	13,994,088	0	0	435,361	3.11%	730,813	5.22%	\$1.40	16,548	(130,168)	126,292	439,339
South County													
Aliso Viejo	45	1,118,648	0	0	17,418	1.56%	119,778	10.71%	\$1.40	4,591	(3,237)	4,591	13,853
Foothill Ranch	8	273,620	0	0	0	0.00%	17,789	6.50%	\$0.00	0	0	0	0
Irvine Spectrum	295	10,343,993	0	0	442,707	4.28%	928,999	8.98%	\$1.72	(8,634)	(129,928)	145,294	417,137
Laguna Hills	54	1,269,595	0	0	46,742	3.68%	64,121	5.05%	\$1.25	14,311	(1,567)	29,072	70,567
Laguna Niguel	18	856,360	0	0	3,776	0.44%	3,776	0.44%	\$0.00	0	658	0	3,120
Lake Forest	62	1,394,005	0	0	34,624	2.48%	87,077	6.25%	\$1.31	3,562	1,908	17,454	63,720
Mission Viejo	35	640,707	0	0	28,011	4.37%	36,915	5.76%	\$1.30	(7,790)	(7,746)	2,320	20,486
Rancho Mission Viejo	3	96,942	0	0	96,942	100.00%	96,942	100.00%	\$1.75	0	0	0	0
Rancho Santa Margarita	40	1,432,620	0	0	11,379	0.79%	22,781	1.59%	\$1.51	21,629	13,859	33,008	48,078
San Clemente	59	1,432,899	0	0	122,928	8.58%	113,972	7.95%	\$1.41	(53,626)	(80,705)	6,781	42,471
San Juan Capistrano	41	717,151	0	0	48,526	6.77%	51,626	7.20%	\$1.66	(3,236)	(25,435)	8,514	21,189
South County Total	660	19,576,540	0	0	853,053	4.36%	1,543,776	7.89%	\$1.60	(29,193)	(232,193)	247,034	700,621
West County													
Cypress	53	2,203,831	0	0	25,364	1.15%	193,992	8.80%	\$0.99	31,103	(5,400)	34,050	72,674
Garden Grove	68	1,782,919	0	0	80,628	4.52%	58,057	3.26%	\$1.25	(1,434)	(9,940)	41,721	90,328
Huntington Beach	129	2,632,371	0	0	58,852	2.24%	61,599	2.34%	\$1.84	(20,459)	(16,204)	46,997	143,216
La Palma	1	78,980	0	0	79,980	101.27%	78,980	100.00%	\$0.86	0	0	0	0
Los Alamitos	41	871,797	0	0	69,301	7.95%	68,675	7.88%	\$0.00	(2,681)	(14,596)	26,974	55,460
Stanton	5	104,129	0	0	0	0.00%	0	0.00%	\$0.00	0	4,219	0	4,219
Westminster	16	435,668	0	0	8,150	1.87%	2,000	0.46%	\$0.00	5,466	(8,150)	17,691	22,371
West County Total	313	8,109,695	0	0	322,275	3.97%	463,303	5.71%	\$0.98	11,995	(50,071)	167,433	388,268
Orange County Total	2,223	61,690,916	239,000	78,738	2,896,002	4.69%	4,157,818	6.74%	\$1.50	(82,118)	(492,019)	985,852	2,427,967
Airport Area													
10,000-24,999	516	8,427,024	0	0	488,955	5.80%	653,173	7.75%	\$1.46	(82,186)	(152,275)	161,942	380,968
25,000-49,999	172	5,782,712	0	0	373,177	6.45%	432,595	7.48%	\$1.55	2,913	(178,322)	82,986	187,172
50,000-99,999	48	3,197,408	0	78,738	279,341	8.74%	190,318	5.95%	\$1.51	(2,195)	64,269	13,424	144,858
100,000 Plus	17	2,603,449	239,000	0	143,840	5.52%	143,840	5.52%	\$1.40	0	186,741	186,741	186,741
North County													
10,000-24,999	322	5,164,578	0	0	159,713	3.09%	237,753	4.60%	\$1.58	(615)	(3,345)	75,619	227,189
25,000-49,999	129	4,257,381	0	0	156,401	3.67%	200,774	4.72%	\$1.66	14,626	(16,454)	45,558	180,718
50,000-99,999	30	1,954,829	0	0	51,788	2.65%	51,476	2.63%	\$1.35	1,717	(41,337)	4,295	27,082
100,000 Plus	16	2,617,300	0	0	67,459	2.58%	240,810	9.20%	\$1.15	820	(69,032)	820	4,350
South County													
10,000-24,999	390	6,504,575	0	0	304,517	4.68%	433,491	6.66%	\$1.53	31,217	(92,119)	140,205	338,355
25,000-49,999	198	6,568,396	0	0	429,132	6.53%	651,538	9.92%	\$1.56	(97,687)	(150,421)	47,685	284,272
50,000-99,999	59	3,921,675	0	0	119,404	3.04%	332,250	8.47%	\$1.73	37,277	10,347	59,144	77,994
100,000 Plus	13	2,581,894	0	0	0	0.00%	126,497	4.90%	\$0.95	0	0	0	0
West County													
10,000-24,999	220	3,519,260	0	0	135,775	3.86%	131,133	3.73%	\$1.45	(14,685)	(33,046)	78,668	213,944
25,000-49,999	61	2,062,923	0	0	102,520	4.97%	76,687	3.72%	\$0.92	26,680	(25,813)	85,890	159,786
50,000-99,999	29	1,971,548	0	0	83,980	4.26%	255,483	12.96%	\$0.86	0	8,788	2,875	14,538
100,000 Plus	3	555,964	0	0	0	0.00%	0	0.00%	\$0.00	0	0	0	0
Orange County													
10,000-24,999	1,448	23,615,437	0	0	1,088,960	4.61%	1,455,550	6.16%	\$1.51	(66,269)	(280,785)	456,434	1,160,456
25,000-49,999	560	18,671,412	0	0	1,061,230	5.68%	1,361,594	7.29%	\$1.52	(53,468)	(371,010)	262,119	811,948
50,000-99,999	166	11,045,460	0	78,738	534,513	4.84%	829,527	7.51%	\$1.53	36,799	42,067	79,738	264,472
100,000 Plus	49	8,358,607	239,000	0	211,299	2.53%	511,147	6.12%	\$0.00	820	117,709	187,561	191,091
Orange County Total	2,223	61,690,916	239,000	78,738	2,896,002	4.69%	4,157,818	6.74%	\$1.50	(82,118)	(492,019)	985,852	2,427,967

This survey consists of buildings greater than 10,000 square feet. Lease rates are on a triple-net basis.



Proposition 15 Threatens Owners and Tenants with Higher Property Taxes

by **Seth Davenport**

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As we count down the days to the election, the presidential race gets most of the attention. The coronavirus response, civil unrest and, most recently, an open seat on the US Supreme Court, are the hot-button issues, but Proposition 15 is the big one here in California. Commonly known as the split-roll initiative, the proposition would strip commercial properties of the protections afforded by Proposition 13 and raise up to \$11.5 billion per year in new property tax revenue by reassessing commercial properties to full market value every three years rather than only in the event of a sale. The additional revenue would go to local governments, K-12 schools and community college districts. Collections would begin in the 2022-2023 fiscal year.

The ramifications of passing Proposition 15 are real and could undermine the value structure of all commercial properties. The proponents of the law claim to be going after big corporations and investors who have been using Proposition 13 rules as a loophole to avert paying their fair share of property taxes. Opponents of the measure point to the fact that most property taxes are passed along to the tenants who occupy commercial real estate. Higher property taxes means business owners will either have to raise prices, lay off workers or find other ways to reduce operating costs. The money has to come from somewhere and those who pay higher taxes are not going to just absorb the cost without taking countermeasures.

Those behind Proposition 15 claim to be protecting small businesses by exempting owners who occupy their own properties and who own commercial properties valued under \$3 million. What they don't tell the public is that the \$3 million limit refers to the aggregate value of commercial property owned in the state, and that all principal officers of the business must be California residents. At best, the exemption applies to a tiny fraction of property owners in the state. All non-owner-occupied commercial properties are subject to reassessment to full market value every three years.

So, who gets hurt the worst? The answer is everyone who owns or occupies commercial real estate, but especially long-term owners and their tenants who enjoy an older, lower property tax basis. Consumers will also be hurt by higher prices for everything from food to fuel, and property values will be impacted due to the increased risk of higher operating cost over time.

Since Proposition 13 was passed in 1978, the state has received a 7% average annual increase in property tax revenue despite large fluctuations in property values. If Proposition 15 passes, we believe it would exacerbate an already challenging business climate for our economy. Moreover, it would likely create a reduction in values in the short term and would attenuate the appreciation potential of commercial real estate in the long term.

Please Contact Us for Further Information

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Product Type

R&D OR MID-TECH

30% to 74.9% improved with drop ceiling, minimum parking ratio of 3 to 1, minimum 50% of exterior glassline, dock and/or ground level loading.

Submarkets



NORTH

Anaheim, Brea, Buena Park, Fullerton, La Habra, Orange, Placentia, Yorba Linda

WEST

Cypress, Garden Grove, Huntington Beach, La Palma, Los Alamitos, Stanton, Westminster

AIRPORT

Costa Mesa, Fountain Valley, Irvine, Newport Beach, Santa Ana, Tustin

SOUTH

Aliso Viejo, Foothill Ranch, Irvine Spectrum, Laguna Hills, Laguna Niguel, Lake Forest, Mission Viejo, Rancho Santa Margarita, San Clemente, San Juan Capistrano