

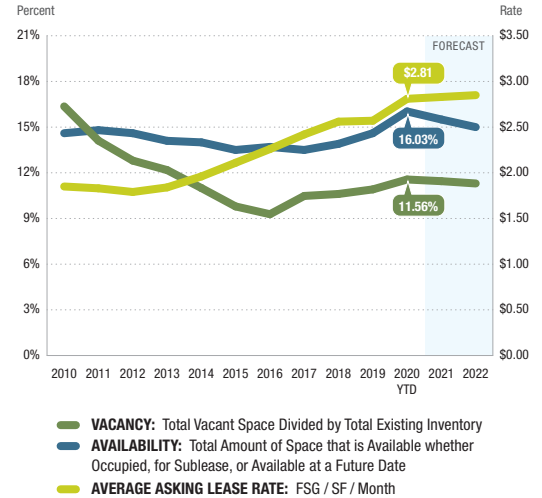
OVERVIEW. 3Q results reflect the ongoing challenges to the Orange County office market caused by the COVID-19 pandemic. Absorption, sale and lease activity and the vacancy/availability rates headed lower again during the period, as tenants held off on big facilities decisions until the near term-future of office occupancy becomes less opaque. An increase in short-term renewals has slowed the number of active relocation requirements and more sublease space is coming to market, which is recalibrating the supply-demand balance. Uncertainty over regulations associated with social distancing has many business operators opting to keep their employees working from home, while other are reevaluating their entire facilities strategies now that the remote work model is getting a thorough vetting.

VACANCY & AVAILABILITY. These two key metrics are becoming more of a concern for landlords as they compete for a shallower pool of tenants actively seeking new space. The overall vacancy rate moved up by 86 basis points during the quarter, a significant bump that can be directly attributed to the pandemic. Rather than move and expand, more tenants are opting to renew in place on a short-term basis until the impact of the virus abates. Class A space is taking the biggest hit due to its higher base rental rates and operating expenses. Class A vacancy is running over 5 percentage points higher than Class B. New construction is concentrated in Class A, which drives vacancy up as speculative space is delivered. The availability rate, which includes vacant space and space that is being marketed as available but is still occupied, moved up by 143 basis points in 3Q as more office users offered their spaces for sublease to cut operating costs and adapt to changes in workplace dynamics.

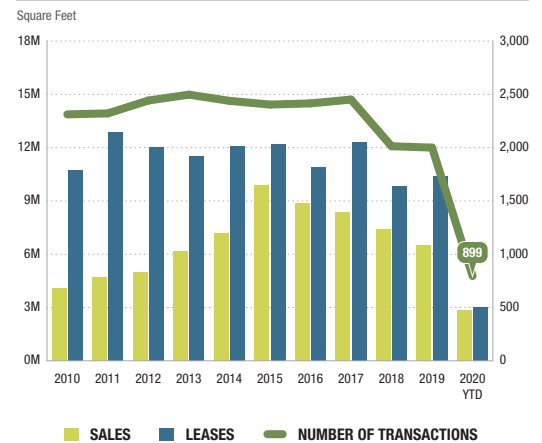
LEASE RATES. Average asking lease rates dipped slightly during the period, but effective rates are being pushed even lower due to a rise in concessions like free rent and tenant improvement allowances. Tenants are gaining the upper hand in lease negotiations as they see rising vacancy rates as an opportunity to take a stronger negotiating posture. South County and the Airport Area posted the highest average lease rates, with both submarkets over \$3.00 PSF. The Central, North and West County submarkets all have an average asking lease rate under \$2.50 PSF. The differential reflects higher levels of Class A development in the Airport and South County markets.

TRANSACTION ACTIVITY. Transaction volume fell again in 3Q to just 1.87 MSF after a significant drop in 2Q. By contrast, the office market saw 4.65 MSF of deals inked in 3Q of 2019. Contributing significantly to the decline is the rise in the number of short-term renewals, which often do not make it into the quarterly statistics. Many tenants have taken a defensive posture due to the uncertainty caused by the pandemic and the upcoming election, which seriously impacts new transaction activity. Most office users are not fully operational in their spaces, either prohibited from resuming in-person operations or, if allowed (essential businesses) opting instead to have their employees continue to work from home.

VACANCY, AVAILABILITY & AVERAGE ASKING LEASE RATES



TRANSACTION VOLUME & NUMBER OF TRANSACTIONS



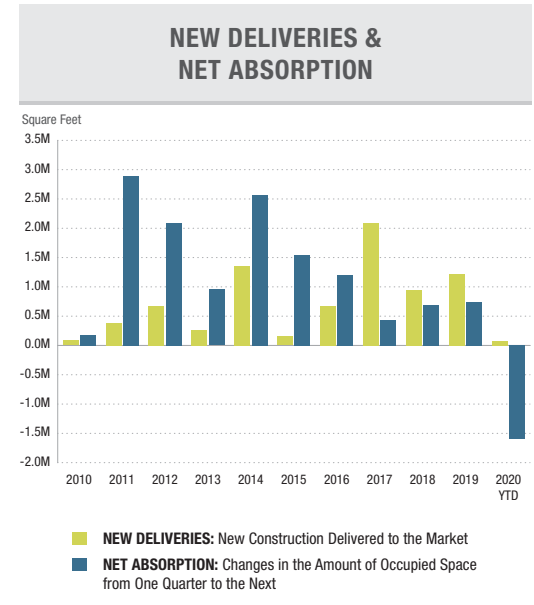
Market Statistics

	Change Over Last Quarter	3Q 2020	2Q 2020	3Q 2019	% Change Over Last Year
Vacancy Rate	▲ UP	11.56%	10.70%	10.70%	7.99%
Availability Rate	▲ UP	16.03%	14.60%	13.70%	17.02%
Average Asking Lease Rate	▼ DOWN	\$2.81	\$2.83	\$2.77	1.44%
Sale & Lease Transactions	▼ DOWN	1,879,221	2,161,274	4,611,783	(59.25%)
Gross Absorption	▬ FLAT	1,376,666	1,371,132	2,087,963	(34.07%)
Net Absorption	▼ NEGATIVE	(992,432)	(85,044)	59,103	N/A

ABSORPTION. Lower transaction volume has exacerbated the office market’s negative net absorption problem that began before the pandemic. In the past few years, fewer companies have been expanding when they move, opting instead to downsize into new space designed to accommodate higher employee density. Compounding that trend is the fact that companies have been forced to operate without using their space at all for two full quarters, and that has opened the eyes of many decision-makers who are finding that their businesses can still operate efficiently with a remote workforce. So far this year, net absorption, the net difference in occupied space in a period, is negative 1.6 MSF, most of which came in 3Q. Gross absorption was on par with 2Q at just under 1.4 MSF, but is down over 34% year-over-year.

CONSTRUCTION. Construction activity has been slowing down, which is helping to rebalance the market as demand is slowed by uncertainty over the pandemic. Two projects being built by the Irvine Company, Spectrum Terrace and Innovation Office Park, account for most of the space in the construction queue at 571,000 SF. The only other significant project underway is The Press, a 380,000 SF redevelopment of the former LA Times production facility. That project is being developed by Steelwave and is scheduled for completion in the first quarter of 2021.

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. Professional and business services decreased by 28,900 jobs over the year with administrative and support and waste services accounting for 76% of the drop (down 22,100 jobs), which includes temporary help firms.



Forecast

In the near term, we expect the office market to stay on its present course. Absorption, both gross and net, are likely to suffer further declines as tenants continue their struggle to return to normal operations. That will cause further increases in vacancy and availability, especially if the current upward trend in available sublease space continues. Office users continue to be burdened by social distancing regulations, which are both cumbersome and expensive to execute. Landlord incentives to secure new tenants are expected to continue and increase over the next several quarters, as those tenants in the market for new space will take advantage of rising vacancy and sluggish rent growth to negotiate more favorable terms. Fortunately, new deliveries will decline after the projects currently underway are delivered. Developers with projects yet to break ground are likely to put their projects on hold until the longer term impact of the pandemic becomes more apparent. Uncertainty over the upcoming election will dampen Q4 transaction activity and more tenants will be rethinking how they utilize their space over the long term, which will put a strain on the office market well into next year.

Significant Transactions

Sales						
Property Address	Submarket	Class	Square Feet	Sale Price	Buyer	Seller
15101 & 15191 Alton Pkwy. - 2 Properties	Irvine Spectrum	B	660,893	\$355,000,000	PRP Real Estate Investment Management	Rockpoint Group LLC
111 Pacifica	Irvine Spectrum	B	68,427	\$26,150,000	Toda America, Inc.	Canopi LLC
3001 Ivy Glenn Dr.	Laguna Niguel	B	42,074	\$10,600,000	HR Investments LLC	PASSCO Companies
101 Columbia	Aliso Viejo	B	38,142	\$7,000,000	Lone Cypress Real Estate & Development	Aacn Property Holdings LLC
51 Columbia	Aliso Viejo	B	34,299	\$16,850,000	KB Property Advisors	Newport Tie Up LLC

Leases						
Property Address	Submarket	Class	Square Feet	Transaction Date	Tenant	Owner
3345-3353 Michelson Dr.	Irvine	A	258,000	Jul-2020	Panasonic Avionics	LBA Realty
2441 W. La Palma Ave.	Anaheim	B	76,449	Jul-2020	West Coast University	Living Stream Ministry
1241 E. Dyer Rd.	Santa Ana	B	66,885	Aug-2020	Executive Office for Immigration Review	Greenlaw Partners
16815 Von Karman Ave.	Irvine	B	26,047	Aug-2020	Beckam Funding Corporation	The Blackstone Group
2461 W. La Palma Ave. - Renewal	Anaheim	B	25,837	Jul-2020	American Career College	Living Stream Ministry



A Gap in Expectations

by **Doug Killian**

SENIOR VICE PRESIDENT / PARTNER, OFFICE
949.263.5322 · dkillian@voitco.com · Lic. #00887784

The Orange County office property market has been significantly affected by the pandemic crisis. Transaction activity has slowed, the vacancy rate has increased, and net absorption has been negative since the onset of COVID-19. The reality of current market factors has driven tenants to be more aggressive in their negotiations for new space. Despite this increasing boldness, landlords are pushing back by upholding asking rents and denying additional concessions. Many landlords view the current market environment as temporary, and as such, are reluctant to sign long-term deals in which terms heavily favor prospective tenants. The gap in expectations has complicated and delayed the leasing process, which has further exacerbated the lull in activity.

It is important to note that every landlord is operating under unique circumstances that will impact their negotiating posture. While it is apparent that concessions are on the rise overall, landlords with high occupancy levels and little expected near-term lease rollover are in better position to take a harder stance. Conversely, those with higher vacancy, significant expected turnover, or substantial debt to service are more inclined to reach for a deal.

A rise in the amount of subleased space has changed the competitive landscape and a growing number of short-term lease extensions has reduced the number of active new requirements. With supply increasing and demand plummeting simultaneously, the gap is likely to continue widening, at least for the near term. Tenants of all size ranges and business sectors are still under-utilizing their existing spaces due to the work-from-home phenomenon. Business owners are uncertain about how long their operations will be interrupted, causing a reevaluation of long-term space usage.

Uncertainty and caution are the primary decision drivers for the time being, especially in light of the contentious upcoming election. In terms of the virus, the availability of a vaccine will certainly help clear things up, as it would likely allow employees back into the workplace under fewer restrictions. A move to higher employee density has been in play for the past few years, but it is in direct conflict with the regulations regarding social distancing. The outcome of the election and COVID-19 regulatory and medicinal advancements will surely impact expansion and contraction decisions heading into next year.

Please Contact Us for Further Information

Tony Tran
Regional Director of Research
ttran@voitco.com

Anaheim, CA
714.978.7880

Carlsbad, CA
760.517.4000

Inland Empire, CA
909.545.8000

Irvine, CA
949.851.5100

Los Angeles, CA
424.329.7500

San Diego, CA
858.453.0505

This survey consists of properties representing both single tenant and multi-tenant buildings. The lease rates are based on a full-service gross basis. The information contained in this report is gathered from sources that are deemed reliable, but no guarantees are made as to its accuracy. This information is for Voit Real Estate Services' use only and cannot legally be reproduced without prior written consent from the management of Voit Real Estate Services. ©2020 Voit Real Estate Services, Inc. DRE License #01991785.

Represented in 150 Markets
Nationally & Internationally.



Product Type

CLASS A: Most prestigious buildings competing for premier office users with rents above average for the area. Buildings have high-quality standard finishes, state-of-the-art systems, exceptional accessibility and a definite market presence.

CLASS B: Buildings competing for a wide range of users with rents in the average range for the area. Building finishes are fair to good for the area, and systems are adequate. However, Class B buildings cannot compete with Class A buildings of the same price.

CLASS C: Buildings competing for tenants requiring functional space at rents below the area average.

Submarkets

AIRPORT AREA

Costa Mesa, Irvine, Newport Beach

CENTRAL COUNTY

Anaheim, Orange, Santa Ana, Tustin

NORTH COUNTY

Anaheim Hills, Brea, Buena Park, Fullerton, La Habra, La Palma, Placentia, Yorba Linda

SOUTH COUNTY

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

WEST COUNTY

Cypress, Fountain Valley, Garden Grove, Huntington Beach, Los Alamitos, Seal Beach, Stanton, Westminster