

ORANGE COUNTY OFFICE MARKET

FIRST QUARTER 2017

Office vacancy continues to decrease in Orange County

Year-over-year office rental rate growth of 7.3% confirms health of the market

In the first quarter 2017, the Orange County office market again reported solid fundamentals with increased average rental rates, decreased vacancy levels and an uptick in leasing activity over the previous quarter. Due to Orange County's strong local business environment, area companies have been in expansion mode for the past three years now. This has directly benefited the Orange County office market, which has seen vacancy decrease from 20% in 2010 to levels last seen a decade ago. Expect more of the same in 2017, although the delivery of some high-profile speculative office projects could result in an uptick in vacancy later this year.

ECONOMY

Unemployment rate at just 3.7% in Orange County to begin 2017

The seasonally adjusted unemployment rate for Orange County was just 3.7% in February compared to 5.0% for California and the national unemployment rate of 4.7%. Total year-over-year nonfarm employment in Orange County increased by 17,000 (1.1%) while year-over-year office-using employment growth has grown by 8,500 (1.8%). Both nonfarm and office-using employment growth has slowed from 3.0% and 3.4% reported in February 2016, respectively. Hopefully, employment growth picks up as the year progresses as local employers remain attracted to the area's well-educated labor pool and high quality of life.

SUPPLY AND DEVELOPMENT

Over 1.3 million square feet is currently under construction

A total of 211,200 square feet was delivered to the market in the first quarter, and over 1.3 million square feet of office space is now under construction, of which all has not been pre-leased yet. Compared to a decade ago when quarterly office construction averaged over 3 million square feet, developers this cycle have mostly been cautious about starting larger office projects speculatively. However, with larger speculative projects such as FLIGHT at Tustin Legacy, as well as creative office renovation projects such as The Press in Costa Mesa imminent, expect the amount of office development to increase significantly over the next few months.

TRENDLINES

5-YEAR TREND CURRENT QUARTER

VACANCY



12.2%

Vacancy down 20 basis points over Q4

ABSORPTION



185,984 SF

Space gains led by Greater Airport Area

RENTAL RATE



\$2.66 PSF

Rents tick up slightly from Q4

UNDER CONSTRUCTION



1.35 million SF

Development reaches new nine-year high

CAP RATES



5.6%

Cap rates rise 30 basis points

JOB GROWTH



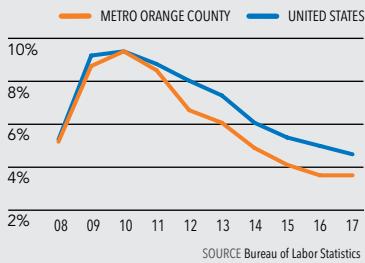
17,000 jobs

Year-over-year growth of 1.1%

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UNEMPLOYMENT RATE

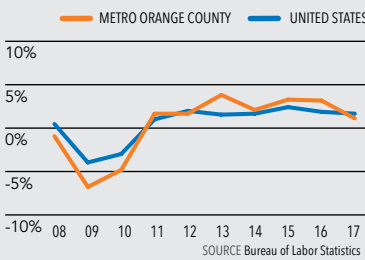


DEMAND

Net absorption solid yet again, led by the Greater Airport Area

Net absorption in the first quarter was 185,984 square feet, led mostly by the Greater Airport Area, which saw net absorption of 119,530 square feet. Since the beginning of 2011 when the Orange County office market began to recover, a total of 7.7 million square feet has been absorbed as much of the office space that was vacated during the subprime mortgage industry collapse and subsequent Great Recession has been re-tenanted with a healthy mix of different companies in a variety of industries. With leasing activity ticking back up to nearly 2.5 million square feet, expect net absorption to remain relatively strong throughout 2017.

PAYROLL JOB GROWTH

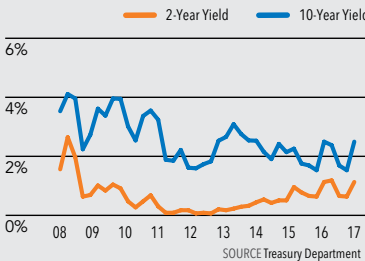


VACANCY

Total vacancy rate decreases 20 basis points to 12.2%

The total vacancy rate decreased 20 basis points from a revised 12.4% in the fourth quarter 2016 to 12.2% in the first quarter 2017. Compared to 2010 when the total vacancy rate for Orange County was over 20%, the lack of new office space delivered to the market combined with steady leasing activity and net absorption has caused vacancy levels to drop substantially. However, expect vacancy to tick up as the year goes on if speculative office projects continue to be delivered to the market unleased.

TREASURY YIELDS



RENTAL RATES

Direct average asking rental rates now up to \$2.66 per square foot

The direct weighted average asking rental rate market-wide was at \$2.66 per square foot (up 7.3% year-over-year) which is the fifteenth quarter out of the past sixteen quarters that average rental rates have increased. Average Class A office rental rates increased to \$3.02 per square foot (up 5.4% year-over-year) while Class B office rental rates increased to \$2.31 per square foot (up 13.0% year-over-year). The market continues to see aggressive rental rate growth and this is expected to continue in 2017, especially in Class B properties where the direct vacancy rate is now below 10%.

Metro Orange County Office Market Indicators

PROPERTY CLASS	INVENTORY	UNDER CONSTRUCTION	Q1 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Class A	41,828,729	1,320,954	46,194	46,194	13.4%	0.8%	14.2%	\$3.02
Class B	44,360,101	37,929	139,790	139,790	9.7%	0.6%	10.3%	\$2.31
OC Metro Total	86,188,830	1,358,883	185,984	185,984	11.5%	0.7%	12.2%	\$2.66



INVESTMENT MARKET

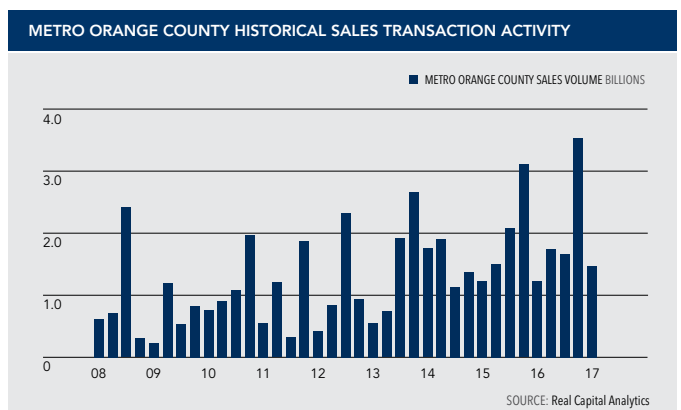
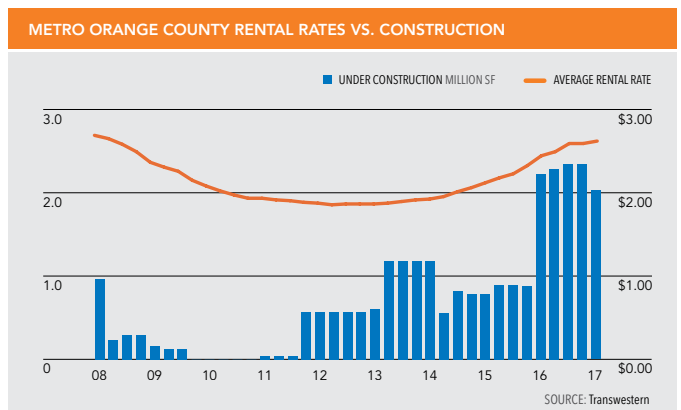
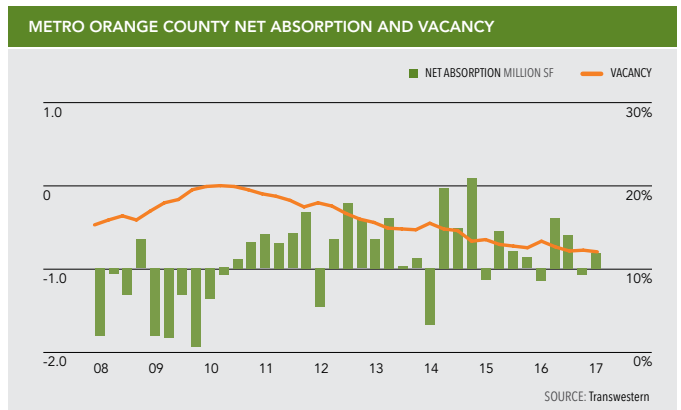
Office investment sales volume increases over 12 months ago

Approximately \$369.3 million worth of office sales occurred in the first quarter 2017, which was up 19% from the \$309.2 million worth of office sales reported in the first quarter 2016. Investor interest in the Orange County office market remains high as many buyers feel they can get better value and deal with less competition than what is currently on the market for sale in nearby LA, especially amongst trophy assets in LA which have attracted global investor interest. With interest rates forecasted to continue to rise in 2017, expect some cooling in pricing as average cap rates tick up. Nevertheless, Orange County remains an increasingly sought-after office investment market with strong underlying fundamentals, especially for private investors priced out of LA.

OUTLOOK

Office market remains in good shape at the start of 2017

As mentioned in previous reports, broad-based employment growth that is less dependent on any one economic sector has resulted in an Orange County economy that is now more diverse and resilient today than it was a decade ago. With area companies expanding and forward-looking metrics such as sublease availability remaining low, it appears that the Orange County office market is in great shape at the beginning of 2017. Quietly, the Orange County office market has become one of the best performing in the nation over the past few years and it would not be surprising to see new players entering the market at this stage of the real estate cycle despite the area's high cost of living and doing business. ■



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Metro Orange County Office Market Indicators

MARKET	INVENTORY	UNDER CONSTRUCTION	Q1 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Greater Airport Area	41,909,548	537,258	119,530	119,530	12.4%	0.6%	13.0%	\$2.94
Central County	14,724,020	-	45,908	45,908	13.0%	0.3%	13.3%	\$2.24
North County	6,482,841	-	18,068	18,068	10.4%	1.4%	11.8%	\$2.28
South County	18,438,287	821,625	-32,635	-32,635	8.6%	1.0%	9.6%	\$2.58
West County	4,634,134	-	35,113	35,113	12.1%	0.2%	12.3%	\$1.95
OC Office Market Total	86,188,830	1,358,883	185,984	185,984	11.5%	0.7%	12.2%	\$2.66

MAJOR LEASE ACTIVITY

PROPERTY	TENANT	SF	TYPE	MARKET	SUBMARKET
3333 Susan St	Los Angeles Chargers	101,831	Class B New Lease	Greater Airport Area	Costa Mesa
5231 & 5241 California Ave (2 bldgs)	Toshiba America	96,000	Class B New Lease	Greater Airport Area	Irvine
15253 Bake Pky	Blizzard Entertainment	65,006	Class B New Lease	South County	Irvine Spectrum
1610 E Saint Andrew Pl	Collectors Universe	62,444	Class B New Lease	Greater Airport Area	South Santa Ana

MAJOR SALES ACTIVITY

PROPERTY	PRICE	PRICE PSF	BUYER	MARKET	SUBMARKET
7755 Irvine Center Dr	\$42,000,000	\$332	ThreeSixty Group	South County	Irvine Spectrum
5 Peters Canyon Rd	\$41,650,000	\$266	Pendulum Property Partners	Greater Airport Area	Irvine
26632, 26642 & 26672 Towne Centre Dr (3 bldgs)	\$40,000,000	\$195	Pinnacle Asset Management	South County	Foothill Ranch
4 Polaris Way	\$34,750,000	\$384	Invesco	South County	Laguna/Aliso Viejo

DEVELOPMENT ACTIVITY

PROPERTY	SF	TYPE	DEVELOPER	MARKET	SUBMARKET
The Boardwalk (Jamboree & Dupont)	537,258	Class A Office	Trammell Crow	Greater Airport Area	Airport Area
400 Spectrum Center Dr	466,696	Class A Office	The Irvine Company	South County	Irvine Spectrum
500, 510, 520 & 530 Technology Dr (4 bldgs)	317,000	Class A Office	The Irvine Company	South County	Irvine Spectrum
3 Burroughs	37,929	Class B Creative Office	Harbor Associates	South County	Irvine Spectrum

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METHODOLOGY

The information in this report is the result of a compilation of information on office properties located in the Orange County metropolitan area. This report includes single-tenant and multi-tenant office properties 10,000 SF and larger, excluding condo and medical office facilities and those properties owned and occupied by a government agency.



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