

ORANGE COUNTY OFFICE MARKET

SECOND QUARTER 2016

Market fundamentals remain positive as area economy grows

Average asking rental rate market-wide now at its highest level since early 2008

At mid-year 2016, the Orange County office market again saw average rental rates increase as net absorption remained positive. With vacancy levels continuing to decrease around the region to levels last seen before the recession, it is no surprise that speculative office development has returned to Orange County with a total of 1.5 million square feet now underway and another 2.5 million square feet proposed. While concerns about potential oversupply have been muted for now, it is definitely worth watching, especially if leasing activity slows over the next 12 months.

ECONOMY







OC unemployment rate a full percentage point lower than US average

The seasonally adjusted unemployment rate for Orange County decreased to 3.6% in May, which is the lowest unemployment rate seen in the region since early 2007. Total year-over-year nonfarm employment increased by 53,500 (3.5%) although year-over-year office-using employment increased by just 11,000 (2.3%), respectively. Led by growth in the area's construction sector, local employment growth has been stronger in the first half of 2016. However, concerns remain over lower corporate earnings growth, weaker overseas growth especially in the wake of the UK's decision to leave the EU, and the continued high cost of housing and doing business locally.

SUPPLY AND DEVELOPMENT

New office development now at nine-year high

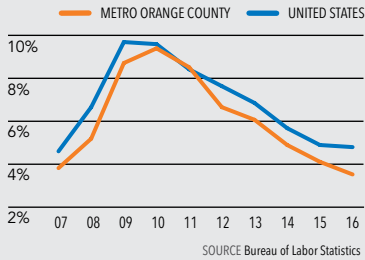
As mentioned above, just over 1.5 million square feet of speculative office space is now under construction, which is a nine-year high for Orange County. Led by The Irvine Company's projects at 400 Spectrum Center Dr, as well as their 4-building Quad at Discovery Business Center and 2-building expansion at Sand Canyon Business Center, 65% of all current development is in the Irvine Spectrum, which has seen single digit vacancy rates for over a year. In addition, Trammell Crow is now underway on the 537,224-square-foot Boardwalk project near John Wayne Airport. While all this speculative office space constitutes just 1.8% of Orange County's existing office base, expect concerns about potential oversupply should the 2.5 million square feet currently proposed break ground and leasing activity slows.

TRENDLINES	
5-YEAR TREND	CURRENT QUARTER
VACANCY 	12.3% Vacancy down 40 basis points over Q1
ABSORPTION 	236,716 SF Space gains led by Central County
RENTAL RATE 	\$2.53 PSF Rents rise for 13 straight quarters
UNDER CONSTRUCTION 	1.53 million SF Development reaches nine-year high
CAP RATES 	5.8% Cap rates tick up in second quarter
JOB GROWTH 	53,500 jobs Year-over-year growth of 3.5%

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SECOND QUARTER 2016

UNEMPLOYMENT RATE

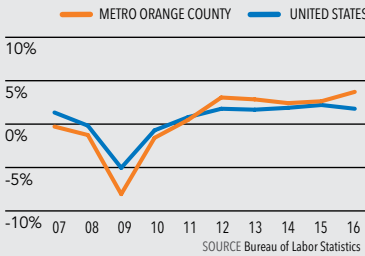


DEMAND

Positive net absorption led by space gains in Central County this quarter

Demand for office space in the second quarter was 204,860 square feet, which brought total year-to-date net absorption in the first six months of 2016 to 466,382 square feet. Compared to the first six months of 2015 where net absorption was 716,464 square feet, net absorption has slowed by 35% over the past 12 months due to rising average rental rates as well as the relative lack of larger office requirements compared to 2-3 years ago which have already signed. With the area economy forecasted to slowly grow over the next 12 months, expect leasing activity and net absorption to remain steady although not spectacular compared to 2 years ago.

PAYROLL JOB GROWTH

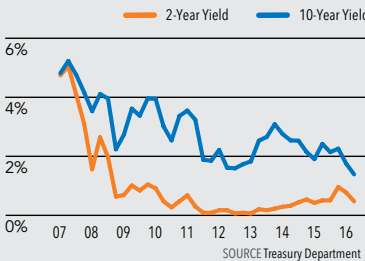


VACANCY

Total vacancy rate drops 40 basis points to 12.3%

The total vacancy rate decreased in the second quarter to 12.3%. This was a 40 basis point decrease from a total vacancy rate of 12.7% reported in the first quarter. Compared to just five years ago when the total vacancy rate for Orange County was 20.5%, a combination of very little speculative office construction and strong leasing activity since then has caused the market to become a landlord's market in many submarkets such as the Airport Area, Newport Center and Irvine Spectrum. With vacancy low in these submarkets, expect tenant spillover into surrounding submarkets. For the remainder of 2016, vacancy levels are expected to continue to slowly decrease as no new office space is projected to be delivered to market until next year.

TREASURY YIELDS



RENTAL RATES

Average asking rental rates increase for the thirteenth straight quarter

The direct weighted average asking rental rate market-wide increased for the thirteenth consecutive quarter to \$2.53 per square foot (up 14.5% year over year). This is the highest reported average asking rental rate in eight years. While the growth in Orange County office rental rates has been impressive since bottoming out at \$1.88 per square foot in 2012, the average rental rate market-wide still remains 9% off peak-2007 levels. Expect average asking rental rates to grow over the next 12 months as landlords remain aggressive in pushing up rental rates in what is firmly now a landlord's market in most of the Greater Airport Area, South County, and portions of Central County.

Metro Orange County Office Market Indicators

PROPERTY CLASS	INVENTORY	UNDER CONSTRUCTION	Q2 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Class A	41,628,166	1,532,920	50,849	-1,843	13.0%	0.9%	13.9%	\$2.95
Class B	43,957,975	-	185,867	468,225	10.5%	0.4%	10.9%	\$2.03
OC Metro Total	85,586,141	1,532,920	236,716	466,382	11.7%	0.6%	12.3%	\$2.53



INVESTMENT MARKET

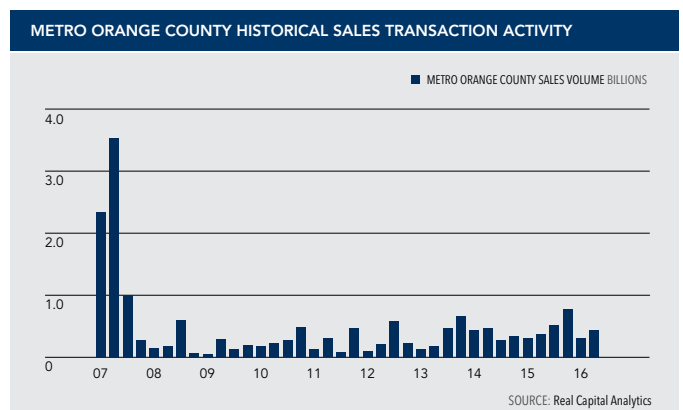
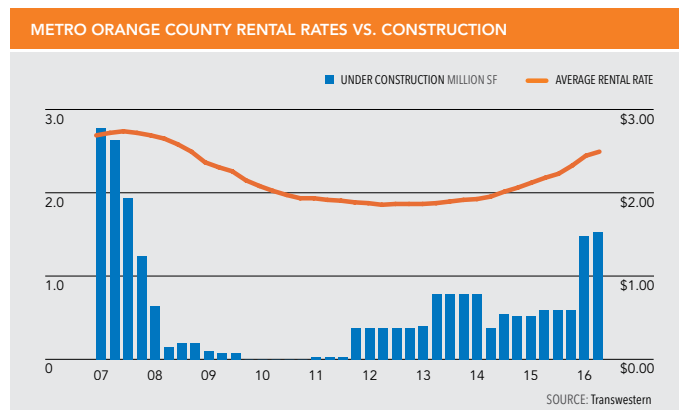
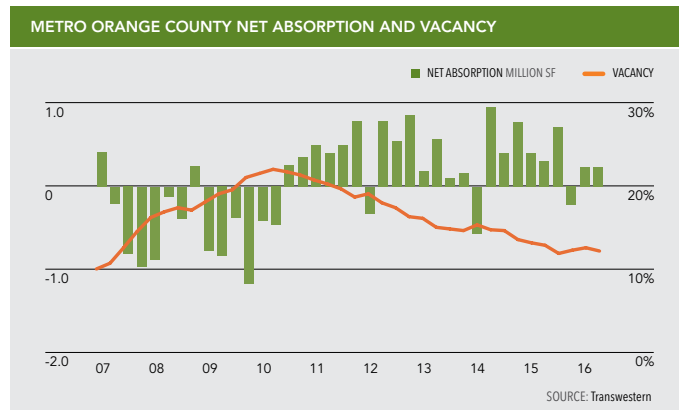
Sellers remain aggressive on pricing as cost of capital continues to be low

Approximately \$439.6 million worth of office sales transactions occurred in the second quarter bringing year-to-date sales volume to \$748.8 million (up 9% from last year). Led by J&R Group’s acquisition of 1901 Main St in Irvine from Piedmont Office Realty Trust for \$66.0 million (\$382 per square foot), the office investment market has remained steady although Class B and value-add office buildings have remained on the market longer due to the pricing disconnect between buyers and sellers. As a result, the market has recently seen a rise in average cap rates despite interest rates remaining at historic lows. Nevertheless, expect a high amount of sales volume in the second half of 2016 as several Class A trophy assets around the market will test buyer appetite for yield.

OUTLOOK

Large amount of speculative new office construction now underway

The Orange County economy remains solidly in expansion mode and, as a result, the area office market has been one of the best performing on the West Coast since the recession. Despite strong market fundamentals seen over the past few years, Orange County has not seen a large amount of speculative office construction until now, indicating tenant demand, especially from the local technology sector, for newer state-of-the-art office space. As a result, the Orange County office market remains in good shape at mid-year 2016 and, absent a macroeconomic shock, will continue to be in good shape through the end of the year. ■



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Metro Orange County Office Market Indicators

MARKET	INVENTORY	UNDER CONSTRUCTION	Q2 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Greater Airport Area	41,618,906	537,224	-193,799	-92,532	12.3%	0.7%	13.0%	\$2.79
Central County	14,925,770	-	174,525	67,951	13.5%	0.3%	13.8%	\$2.14
North County	6,476,184	-	12,214	129,340	11.4%	1.2%	12.6%	\$2.13
South County	18,051,959	995,696	93,605	239,932	8.7%	0.7%	9.4%	\$2.50
West County	4,513,322	-	118,315	121,691	13.0%	0.1%	13.0%	\$1.94
OC Office Market Total	85,586,141	1,532,920	204,860	466,382	11.7%	0.6%	12.3%	\$2.53

MAJOR LEASE ACTIVITY

PROPERTY	TENANT	SF	TYPE	MARKET	SUBMARKET
26220 Enterprise Ct	Apria Healthcare	50,006	Class B Renewal	South County	Lake Forest/Foothill Ranch
5665 Plaza Dr	Toyo Tires	45,949	Class A Renewal	West County	Los Alamitos/Cypress
120 Theory Dr	UC Irvine	44,240	Class B New Lease	Greater Airport Area	Irvine
18200 Von Karman Ave	Nationstar Mortgage	42,988	Class A New Lease	Greater Airport Area	Irvine

MAJOR SALES ACTIVITY

PROPERTY	PRICE	PRICE PSF	BUYER	MARKET	SUBMARKET
1901 Main St	\$66,000,000	\$382	J&R Group	Greater Airport Area	Irvine
4000 Metropolitan Dr	\$61,000,000	\$333	Boyd Watterson Asset Management	Central County	The City Area
Main & Redhill Center (15 bldgs)	\$44,800,000	\$220	Olen Commercial Properties	Greater Airport Area	Irvine
1700 E Saint Andrew Pl	\$37,000,000	\$216	Drawbridge Realty	Greater Airport Area	South Santa Ana

DEVELOPMENT ACTIVITY

PROPERTY	SF	TYPE	DEVELOPER	MARKET	SUBMARKET
18691 Jamboree Rd	537,224	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
15485 & 15495 Sand Canyon Ave (2 bldgs)	212,000	Class A Office	The Irvine Company	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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