

ORANGE COUNTY OFFICE MARKET

THIRD QUARTER 2016

Strong net absorption as market enters second half of 2016

Orange County total office vacancy rate now at nine-year low

As the Orange County office market has entered the second half of 2016, strong net absorption has seen vacancy levels reach a nine-year low. Such low vacancy has resulted in average rental rates continuing to increase around the region and speculative development returning to the market. Assuming steady economic growth, the Orange County office market is expected to continue to be one of the better performing markets in Southern California as market fundamentals remain strongly positive.

ECONOMY

OC employment growth continues to outpace the national average

The seasonally adjusted unemployment rate for Orange County was 4.4% in August compared to 5.5% and 4.9% for California and the US, respectively. Total year-over-year nonfarm employment increased by 39,000 (2.5%) although year-over-year office-using employment growth was a bit lower at 10,400 (2.2%). While concerns remain over lower corporate earnings growth, weaker overseas economic growth and the continued high cost of housing and doing business locally, the Orange County economy remains on an upward trajectory as local employers are attracted to the area's highly educated workforce and high value-add business clusters.

SUPPLY AND DEVELOPMENT

New office development at nine-year high

Almost 1.6 million square feet of speculative office space is now under construction in Orange County, constituting 1.8% of the existing office base. Led by The Irvine Company's projects at 200 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. An estimated 2.5 million square feet is in the planning stages as developers look to add newer, creative office-focused buildings to the market.

TRENDLINES

5-YEAR TREND CURRENT QUARTER

VACANCY



11.6%

Vacancy down 70 basis points over Q2

ABSORPTION



433,804 sf

Led by Greater Airport Area, South County

RENTAL RATE



\$2.63 PSF

Rents rise for 14 straight quarters

UNDER CONSTRUCTION



1.57 million sf

Development reaches nine-year high

CAP RATES



6.0%

Cap rates up 20 basis points

JOB GROWTH



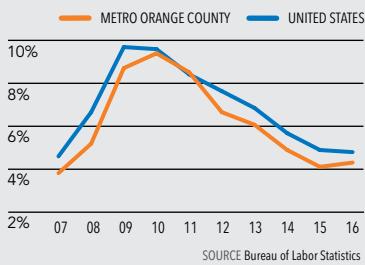
39,000 jobs

Year-over-year growth of 2.5%

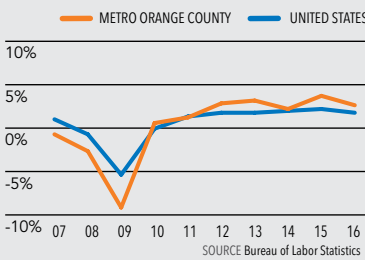
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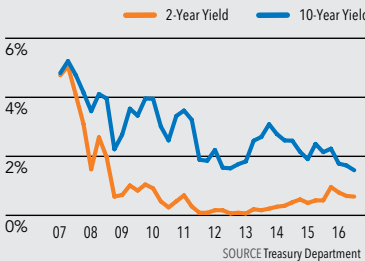
UNEMPLOYMENT RATE



PAYROLL JOB GROWTH



TREASURY YIELDS



DEMAND

Office space gains again led by General Airport Area and South County

Net absorption in the third quarter was 433,804 square feet, which brought total year-to-date net absorption in the first nine months of 2016 to 900,186 square feet. Compared to the first nine months of 2015 where net absorption was just over 1.4 million square feet, net absorption has slowed by 35% due to rising average rental rates as well as area companies becoming a bit more cautious in leasing space. With the local economy forecasted to grow over the next 12 months, expect leasing activity and net absorption to remain steady.

VACANCY

Total vacancy rate drops 70 basis points to 11.6%

The total vacancy rate decreased in the third quarter to 11.6%. Compared to just five years ago when the total vacancy rate for Orange County was over 20%, the lack of new office supply and strong leasing activity has caused the market to become mostly a landlord's market with rising rental rates and decreasing concessions compared to just a few years ago. 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 early 2017.

RENTAL RATES

Rental rates increase for the fourteenth consecutive quarter

The direct weighted average asking rental rate market-wide increased for the fourteenth consecutive quarter to \$2.63 per square foot (up 16.3% year over year). This is the highest reported average asking rental rate in nine 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 6% off peak 2007 levels. Expect average asking rental rates to continue 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 Orange County.

Metro Orange County Office Market Indicators

PROPERTY CLASS	INVENTORY	UNDER CONSTRUCTION	Q3 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Class A	41,628,166	1,532,120	215,804	213,961	12.5%	0.6%	13.1%	\$3.00
Class B	43,957,975	37,929	218,000	686,225	9.8%	0.4%	10.3%	\$2.24
OC Metro Total	85,586,141	1,570,049	433,804	900,186	11.1%	0.5%	11.6%	\$2.63



INVESTMENT MARKET

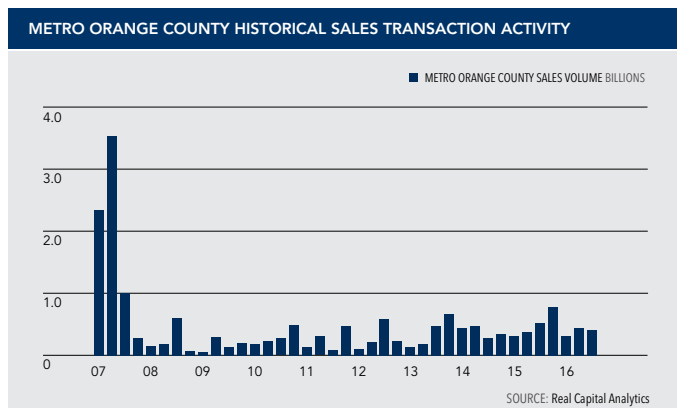
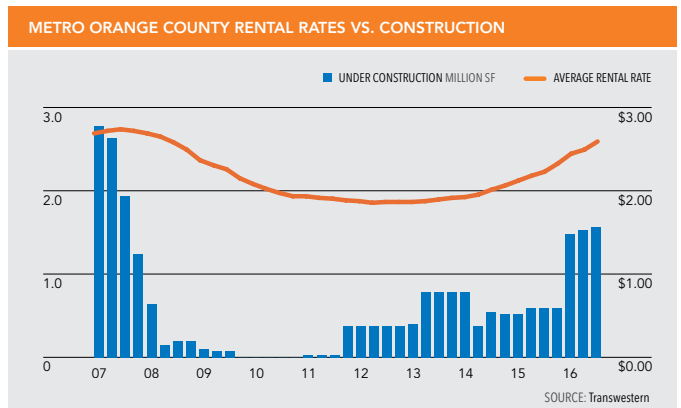
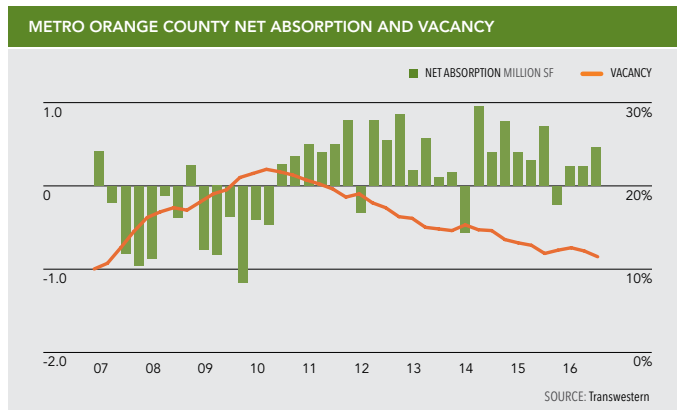
Sales volume healthy despite deals taking longer due to high bid-ask spread

Approximately \$419.1 million worth of office sales occurred in the third quarter, bringing year-to-date sales volume to just under \$1.2 billion (down 3.6% from last year). As mentioned in previous reports, Class B and value-add office buildings have remained on the market longer this year due to the bid-ask spread between buyers and sellers, as well issues in the CMBS market earlier this year. As a result, the market has recently seen a slow uptick in average cap rates despite interest rates remaining at historic lows. Nevertheless, expect a high amount of sales volume by year-end as several Class A trophy assets around the market are widely expected to trade possibly at record pricing.

OUTLOOK

Orange County office market continues to be in good shape going into year-end

The Orange County office market has been one of the best performing on the West Coast since the Great Recession. Since cratering due to its being ground zero of the subprime mortgage industry meltdown combined with rampant speculative overbuilding nearly a decade ago, the local economy has fully recovered with healthy job growth and a higher level of industry diversity, including an under-the-radar technology startup ecosystem. Overall, the Orange County office market continues to be in good shape although some cautious optimism remains, especially with speculative office development returning to the market. ■



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Metro Orange County Office Market Indicators

MARKET	INVENTORY	UNDER CONSTRUCTION	Q3 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Greater Airport Area	41,618,906	537,224	171,730	79,198	11.6%	0.5%	12.1%	\$2.90
Central County	14,925,770	-	2,528	70,479	13.4%	0.4%	13.8%	\$2.20
North County	6,476,184	-	89,138	218,478	9.9%	1.3%	11.2%	\$2.18
South County	18,051,959	1,032,825	181,206	421,138	8.0%	0.4%	8.4%	\$2.59
West County	4,513,322	-	-10,798	110,893	13.3%	0.0%	13.3%	\$1.91
OC Office Market Total	85,586,141	1,570,049	433,804	900,186	11.1%	0.5%	11.6%	\$2.63

MAJOR LEASE ACTIVITY

PROPERTY	TENANT	SF	TYPE	MARKET	SUBMARKET
9950 Jeronimo Rd	Karma Automotive	262,000	Class A New Lease	South County	Irvine Spectrum
1600 E Saint Andrew Pl	Nationstar Mortgage Holdings	152,828	Class B New Lease	Greater Airport Area	South Santa Ana
26210 Enterprise Ct	Apria Healthcare	50,006	Class B Renewal	South County	Lake Forest
200 Spectrum Center Dr	Crown Castle International	44,239	Class A New Lease	South County	Irvine Spectrum

MAJOR SALES ACTIVITY

PROPERTY	PRICE	PRICE PSF	BUYER	MARKET	SUBMARKET
5 & 6 City Pkwy West & 3800 W Chapman Ave (Re-capitalization)	\$107,365,000	\$243	CIGNA & Greenlaw Partners	Central County	The City Area
1733 & 1833 Alton Pky (2 bldgs)	\$64,000,000	\$306	GI Partners	Greater Airport Area	Irvine
23807-23811 Aliso Creek Rd	\$53,693,000	\$229	Dunhill Partners	South County	Laguna/Aliso Viejo
24422 Avenida de le Carlota	\$30,000,000	\$250	Angelo Gordon & Company	South County	Laguna/Aliso Viejo

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

CONTACT

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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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