

ORANGE COUNTY OFFICE MARKET

FOURTH QUARTER 2016

OC office market ends 2016 with vacancy at nine-year low Strong rental rate growth of 11.5% year over year among the best in the country

At year-end 2016, the Orange County office market again reported a decrease in vacancy levels with average rental rates now at levels last seen when the market last peaked in early 2008. Led by broad-based employment growth across a variety of economic sectors, the Orange County office market finished 2016 with strongly positive market fundamentals. Despite a relative slowdown in leasing activity compared to 2015, the office market remains in expansion mode with a healthy balance between supply and demand.

ECONOMY

OC employment growth continues to outpace the national average

The seasonally adjusted unemployment rate for Orange County was just 3.7% in November, compared to 5.3% for California and 5.1% for the overall US. Total year-over-year nonfarm employment increased by 38,300 (2.4%) although year-over-year office-using employment growth has grown faster by 12,900 (2.7%). Expect office space demand to remain steady into 2017 as local companies remain optimistic about their business prospects next year, especially with local employers attracted to the area's highly educated workforce and high value-add business clusters.

SUPPLY AND DEVELOPMENT

New office development remains at new nine-year high

Almost 1.6 million square feet of speculative office space is now under construction, constituting 1.8% of the existing office base. The largest office project under construction remains Trammell Crow's 537,258-square-foot Boardwalk project near John Wayne Airport. In addition, The Irvine Company's 400 Spectrum Center Dr, as well as their 4-building Quad at Discovery Business Center and 2-building expansion at Sand Canyon Business Center in Irvine Spectrum are all underway. An estimated 2.5 million square feet remains proposed with construction beginning in early 2017 on long-awaited projects such as Lincoln Property Company and Alcion Ventures' FLIGHT at Tustin Legacy, as well as various creative office conversions around the Greater Airport Area.

TRENDLINES

5-YEAR TREND CURRENT QUARTER

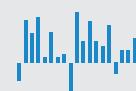
VACANCY



11.9%

Vacancy down 10 basis points over Q3

ABSORPTION



52,161 SF

Space gains led by Central, West County

RENTAL RATE



\$2.63 PSF

Rents remain flat from 3Q

UNDER CONSTRUCTION



1.57 million SF

Development reaches new nine-year high

CAP RATES



5.3%

Cap rates drop 70 basis points

JOB GROWTH



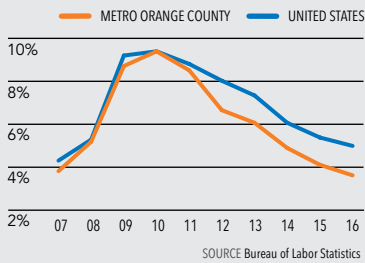
38,300 jobs

Year-over-year growth of 2.4%

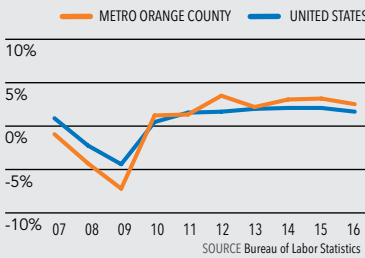
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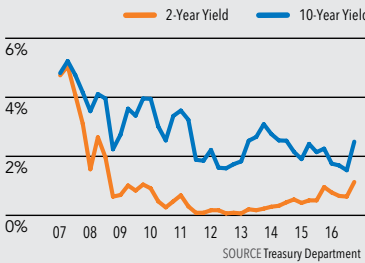
UNEMPLOYMENT RATE



PAYROLL JOB GROWTH



TREASURY YIELDS



DEMAND

Net absorption mostly flat, led by Central and West County

Net absorption in the fourth quarter was 52,161 square feet, which brought total 2016 net absorption to 952,347 square feet. Compared to 2015 where net absorption was 1.2 million square feet, net absorption has slowed by 21% in 2016 due to rising average rental rates, local companies utilizing more efficiency in their real estate leasing strategy and the lack of large blocks of available office space compared to 2-3 years ago. For the year, the largest space gains were in South County (415,669 square feet) and led mostly by the Irvine Spectrum submarket which continues to be an attractive alternative for companies moving down from the traditional corporate office building clusters adjacent to John Wayne Airport.

VACANCY

Total vacancy rate drops 10 basis points to 11.9%

The total vacancy rate decreased 10 basis points from a revised 12.0% in the third quarter to 11.9% at year-end. 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. Although market fundamentals are positive, expect vacancy levels to increase in 2017 if speculative office development currently underway remains unleased at completion.

RENTAL RATES

Direct average asking rental rates flat to end the year

The direct weighted average asking rental rate market-wide was \$2.63 per square foot (still up 11.5% year over year), which effectively ended fourteen consecutive quarters of rising average office rental rates. Average Class A office rental rates ended 2016 at \$3.01 per square foot (up 12.6% year over year) while Class B office rental rates ended 2016 at \$2.24 per square foot (up 12.1% year over year). The market has seen aggressive office rental rate growth over the past two years and this is expected to continue in 2017, although a slowdown in rental rate growth could be possible with so much speculative office development expected to deliver next year.

Metro Orange County Office Market Indicators

PROPERTY CLASS	INVENTORY	UNDER CONSTRUCTION	Q4 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Class A	41,628,166	1,532,154	-145,948	68,013	13.1%	0.6%	13.7%	\$3.01
Class B	43,957,975	37,929	198,109	884,334	9.8%	0.4%	10.2%	\$2.24
OC Metro Total	85,586,141	1,570,083	52,161	952,347	11.4%	0.5%	11.9%	\$2.63



INVESTMENT MARKET

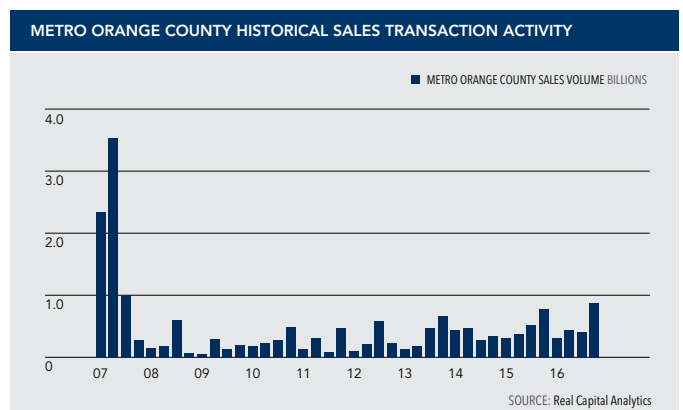
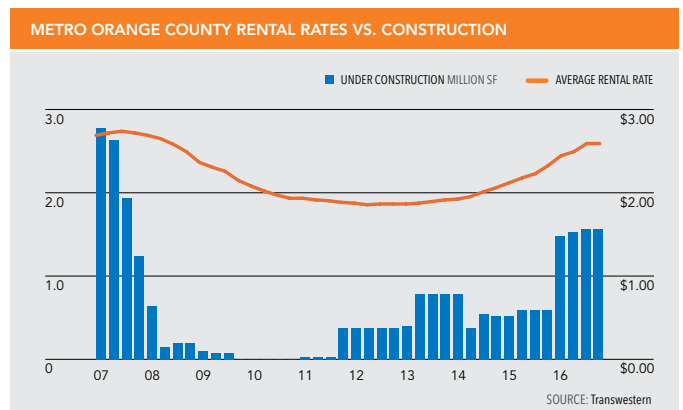
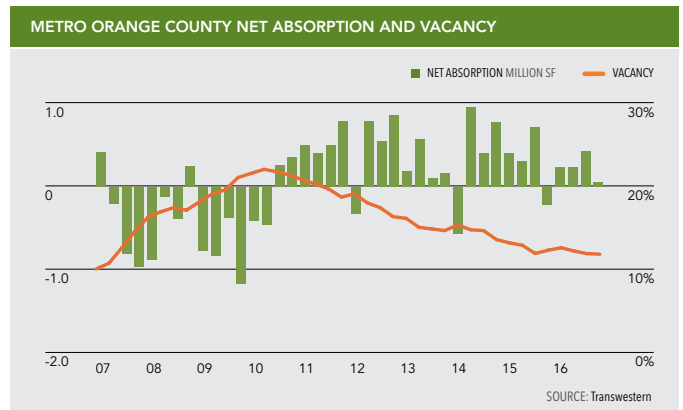
OC office investment sales volume continues to be healthy

Approximately \$886.4 million worth of office sales occurred in the fourth quarter, bringing total 2016 sales volume to just over \$2.0 billion (up 3.1% from 2015). Led by Allianz acquiring a 45% stake in Irvine’s Park Place project for \$387 million from LBA Realty and Principal Financial, as well as Jacaranda Holdings LLC’s reported \$260 million acquisition of Google Center from Scholle Corporation, investor interest in the Orange County office market continues to be strong. With interest rates widely expected 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, especially for buyers priced out of nearby Los Angeles.

OUTLOOK

Local economy and office market healthy going into 2017

Since dealing with serious oversupply issues and literally being ground zero for the national subprime mortgage industry meltdown nearly a decade ago, the Orange County office market has fully recovered from vacancy levels that were over 20% in 2010. With broad-based employment growth that is less dependent on any one economic sector, the Orange County economy is much more diverse and resilient today than it was a decade ago. Combined with occupier demand for more creative office projects and collaborative office space, landlords and developers have responded with some of the highest levels of speculative office development activity in over a decade. While nobody is predicting an oversupply in the market, any slowdown in leasing activity or net absorption could lead to office vacancies increasing in the short term. Despite this minor concern, the Orange County office market remains in great shape and has been one of the best performing in the nation over the past several years. ■



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Metro Orange County Office Market Indicators

MARKET	INVENTORY	UNDER CONSTRUCTION	Q4 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Greater Airport Area	41,618,906	537,258	-190,397	-111,199	12.2%	0.4%	12.7%	\$2.91
Central County	14,925,770	-	123,455	193,934	13.2%	0.4%	13.6%	\$2.20
North County	6,476,184	-	1,500	219,978	10.9%	1.2%	12.1%	\$2.28
South County	18,051,959	1,032,825	-5,469	415,669	7.8%	0.6%	8.4%	\$2.56
West County	4,513,322	-	123,072	233,965	13.2%	0.0%	13.2%	\$1.88
OC Office Market Total	85,586,141	1,570,083	52,161	952,347	11.4%	0.5%	11.9%	\$2.63

MAJOR LEASE ACTIVITY

PROPERTY	TENANT	SF	TYPE	MARKET	SUBMARKET
15485 Sand Canyon Ave	Cavium, Inc. (QLogic)	105,600	Class A New Lease	South County	Irvine Spectrum
1500 S Douglass Rd	Carrington Mortgage	63,875	Class B New Lease	Central County	Anaheim Stadium Area
5 Hutton Centre Dr	Michael Baker International	57,491	Class A New Lease	Greater Airport Area	South Coast Metro
65 Enterprise	TechSpace	57,002	Class A Renewal	South County	Laguna/Aliso Viejo

MAJOR SALES ACTIVITY

PROPERTY	PRICE	PRICE PSF	BUYER	MARKET	SUBMARKET
Park Place (13 bldgs) - 45% stake	\$387,000,000	\$393	Allianz	Greater Airport Area	Airport Area
Google Center (6 bldgs)	\$260,000,000	\$454	Jacaranda Holdings LLC	Greater Airport Area	Airport Area
1525 & 1551 N Tustin Ave (2 bldgs)	\$80,260,000	\$286	Greenlaw Partners	Greater Airport Area	South Santa Ana
5665 & 5757 Plaza Dr (2 bldgs)	\$73,400,000	\$152	DRA Advisors	West County	Cypress

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
15485 & 15495 Sand Canyon Ave (2 bldgs)	211,200	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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