

4Q23

NEWMARK

Orange County Office Market Overview



Market Observations

Economy

- Local unemployment across all industries was 3.8% in November, up 80 bps from November 2022. This is just above the U.S. average of 3.7%.
- Despite a rise in unemployment, local office-using employment in November saw no change from 12 months prior at 476,700 jobs.
- The Federal Reserve raised interest rates eleven times from March 2022 to July 2023, bringing today's benchmark rate to the highest level in 22 years. The Fed has signaled its intention to cut rates in 2024, which will likely happen in the latter half of the year. Lower rates historically favor leasing and sales activity.
- For now, higher capital costs continue to weigh on most businesses.

Major Transactions

- In fourth quarter's largest office sale, Greenlaw Partners repurchased the 13-story office building at 2050 Main St in Irvine from AEW Capital Management, who they initially sold the building to in 2011. The \$57.5 million sold price represents a 47% discount from what Greenlaw paid 13 years ago (\$108.5 million).
- Canon USA Signed the largest lease of the quarter for 92,893 SF at the "Google Center" in Irvine with plans to use the office for its camera and printer divisions. The 210,000-SF building was formerly home to the headquarters of Impac Mortgage Holdings, Inc. who terminated its lease earlier this year.
- American fashion retailer St. John Knits signed an 84,493-SF direct lease at 5515 E La Palma Ave in Anaheim. This was North County's biggest lease in 2023.

Leasing Market Fundamentals

- Vacancy and availability rates – flat relative to last quarter – remain elevated. Total vacancy, for instance, is 17.9%, 320-bps above its five-year average.
- Office demand is muted, and nothing is presently under construction in the market for the first time since the Global Financial Crisis in 2008. The Irvine Company scrapped plans for a 532,000-SF life science campus at UCI Research Park and will now build a 1,200-unit apartment complex on the 19-acre site instead.
- 33% of Orange County's office inventory consists of buildings with sub-80% occupancy. Buildings with lower occupancy thresholds tend to struggle to generate positive NOI, which, in turn, makes it difficult to support debt (assuming debt is present on a given building).

Outlook

- Tenants in the market generally fall into one of two camps: 1) those wishing to retain an office presence at the lowest possible rental rate and 2) those seeking trophy-grade space in amenity-rich areas, as they reduce footprints. The latter grouping is using top-shelf space to lure workers back to the office.
- Corporate America is more prepared to execute on real estate decisions, which will hopefully increase leasing activity in 2024.
- Only 11% of aspiring Orange County home buyers can afford a median-priced home (currently \$1.3 million). Tearing down or converting a portion of the metro's surplus office inventory to apartments makes sense, in cases where the numbers pencil out.
- Some obsolete office inventory will be earmarked for industrial development.

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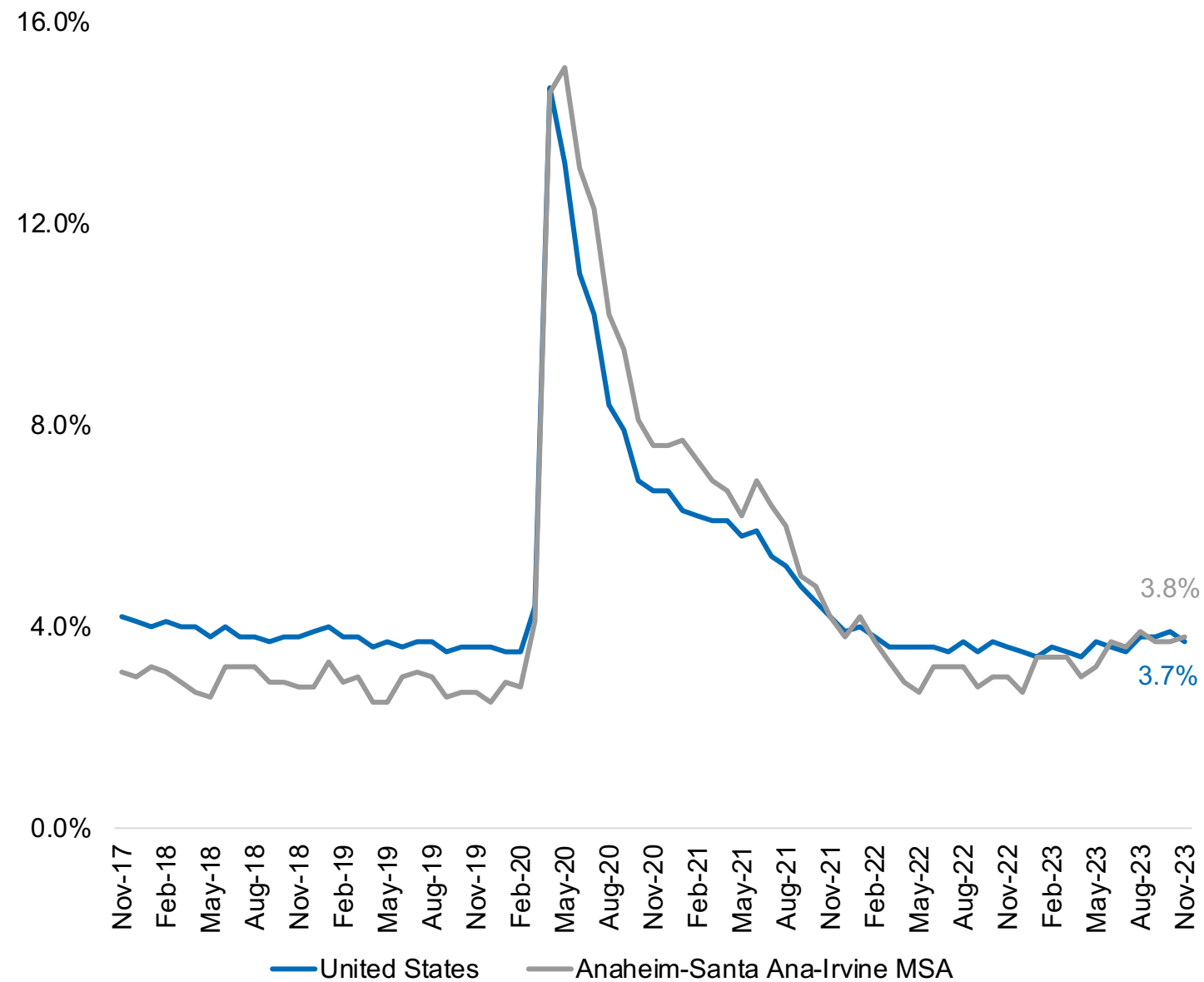
Economy



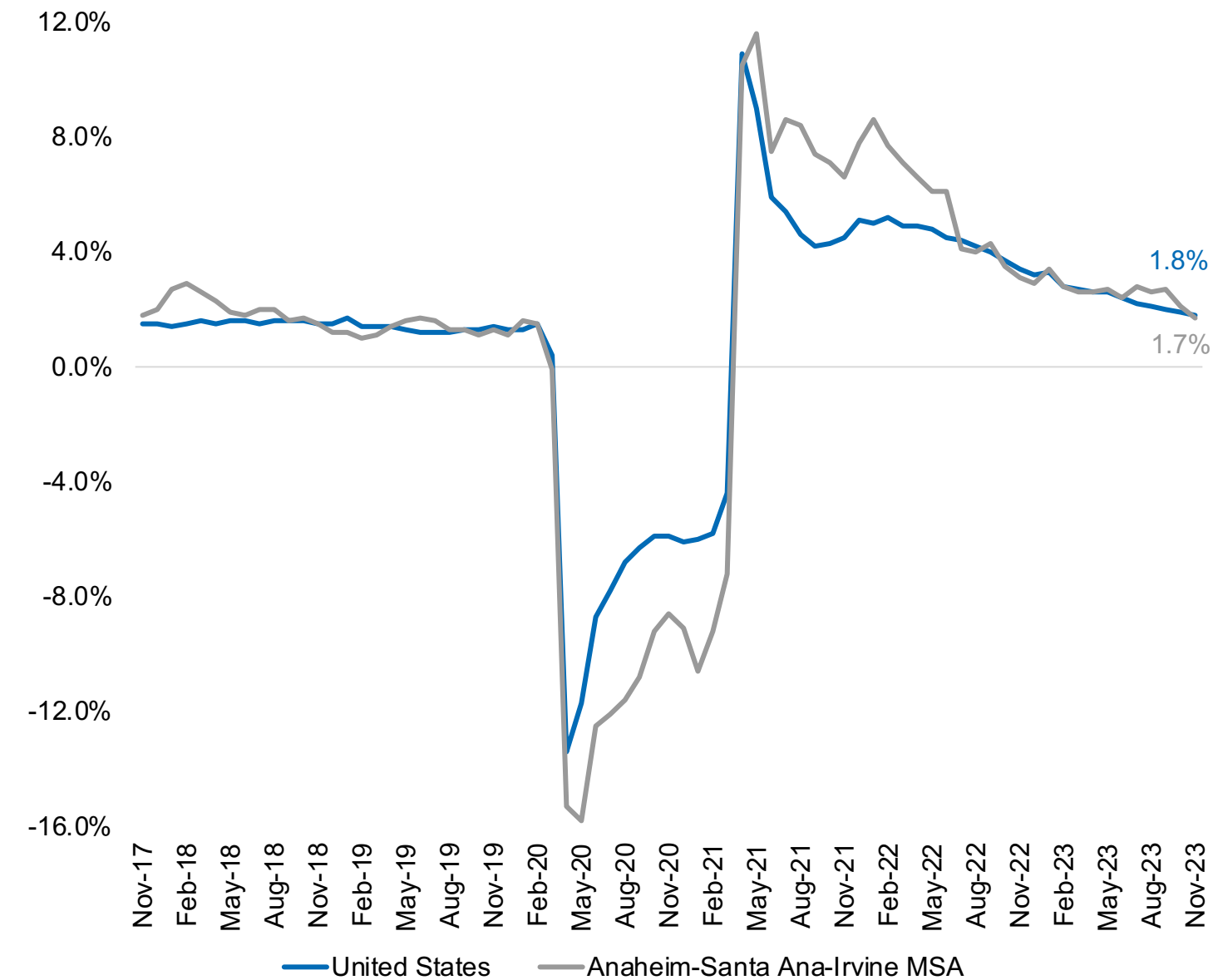
Local Unemployment Inches Above National Average

Orange County unemployment has increased over the last year, going from 3.0% in November 2022 to 3.8% in November 2023. This increase can be attributed to cooling in the economy and cost-cutting measures, such as hiring freezes, enacted by companies in a still-high interest rate environment.

Unemployment Rate, Seasonally Adjusted



Nonfarm Payroll Employment, Non-Seasonally Adjusted, 12-Month% Change

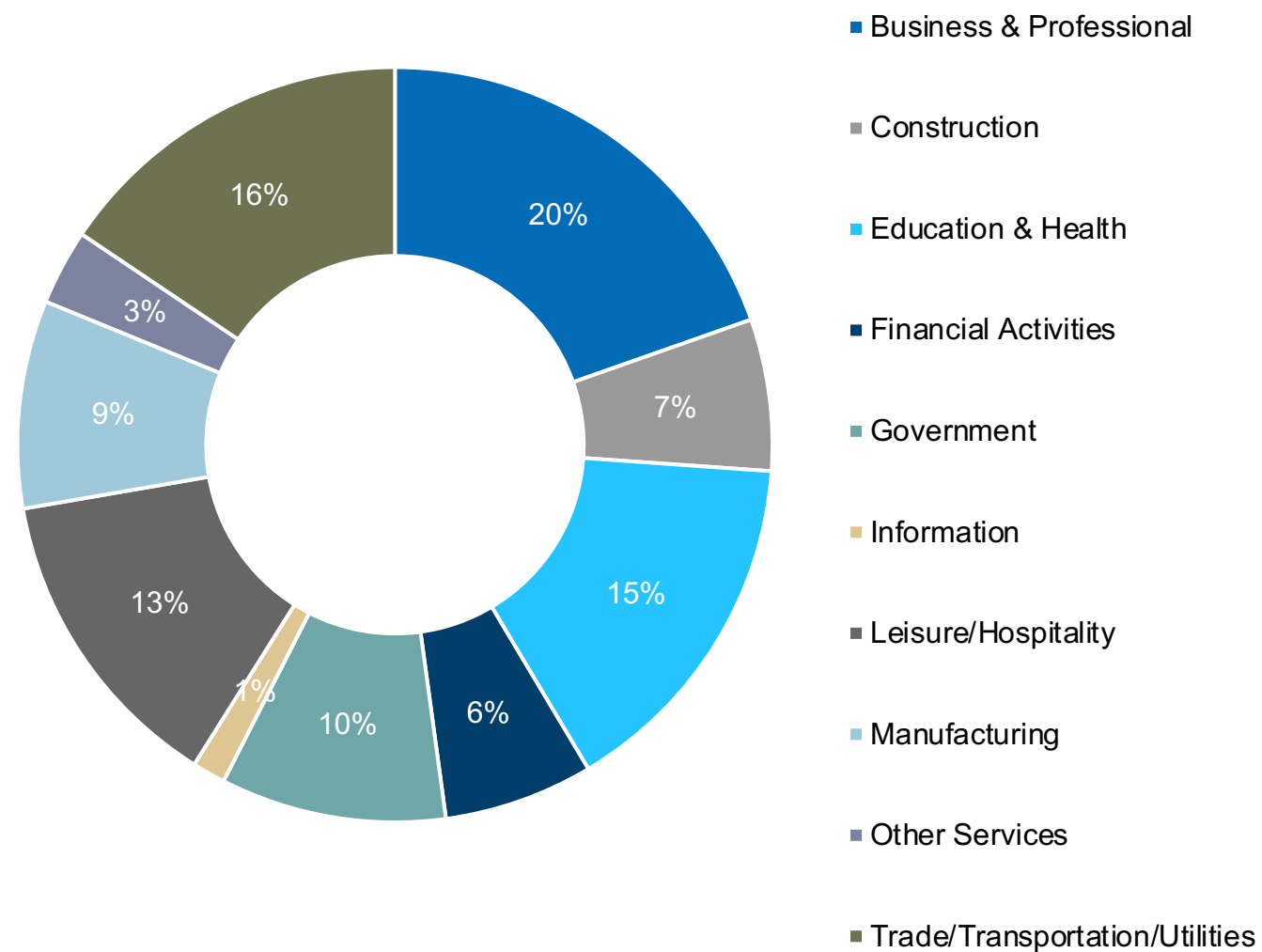


Source: U.S. Bureau of Labor Statistics, Anaheim-Santa Ana-Irvine, CA
 Note: November 2023 data is preliminary.

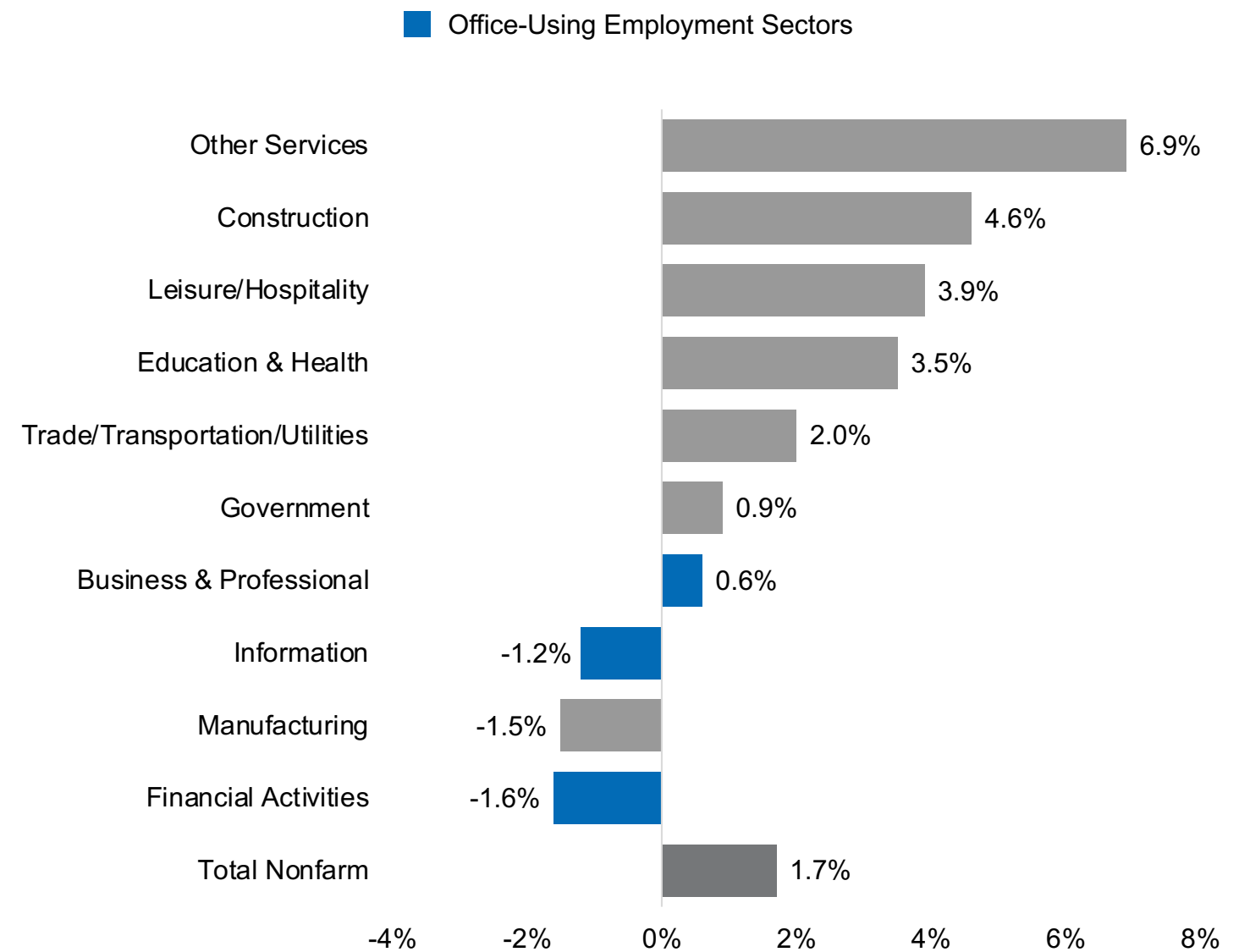
Office-Using Sectors Lead in Job Losses

Financial activities and the information sectors had net job declines over the last twelve months. Tech companies, which are generally grouped under the information sector, continue to focus on cost-cutting moves via shedding unneeded staff and space.

Employment by Industry, November 2023



Employment Growth by Industry, 12-Month % Change, November 2023

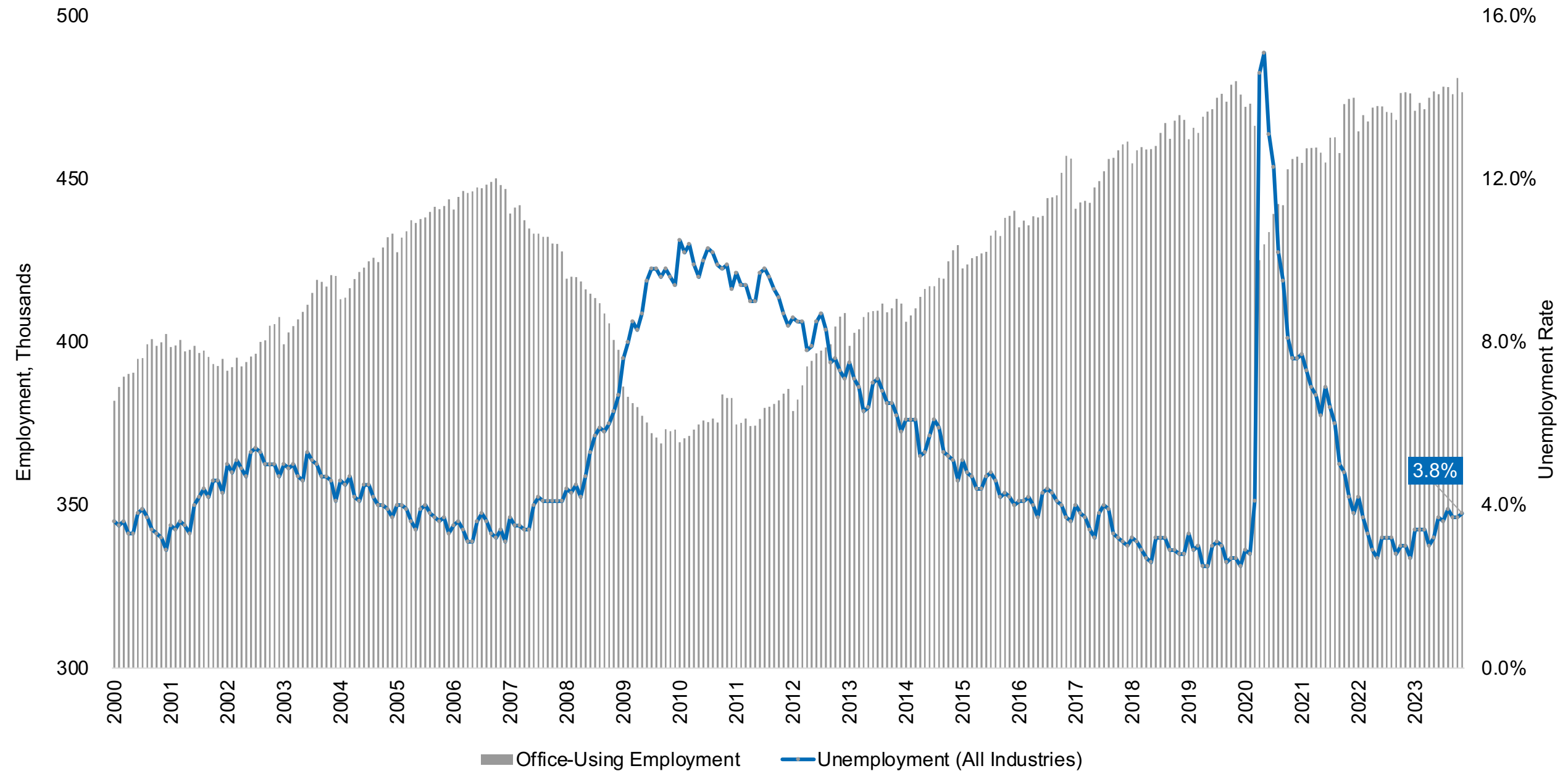


Source: U.S. Bureau of Labor Statistics, Anaheim-Santa Ana-Irvine, CA
 Note: November 2023 data is preliminary.

Office-Using Employment Even Despite Unemployment Growth

Office-using employment in November 2023 was on par with 12 months ago. Flat to modest declines are expected going forward as employers contend with a slow growth macroeconomic environment.

Office-Using Employment* and Unemployment Across All Industries



Source: U.S. Bureau of Labor Statistics, Anaheim-Santa Ana-Irvine, CA

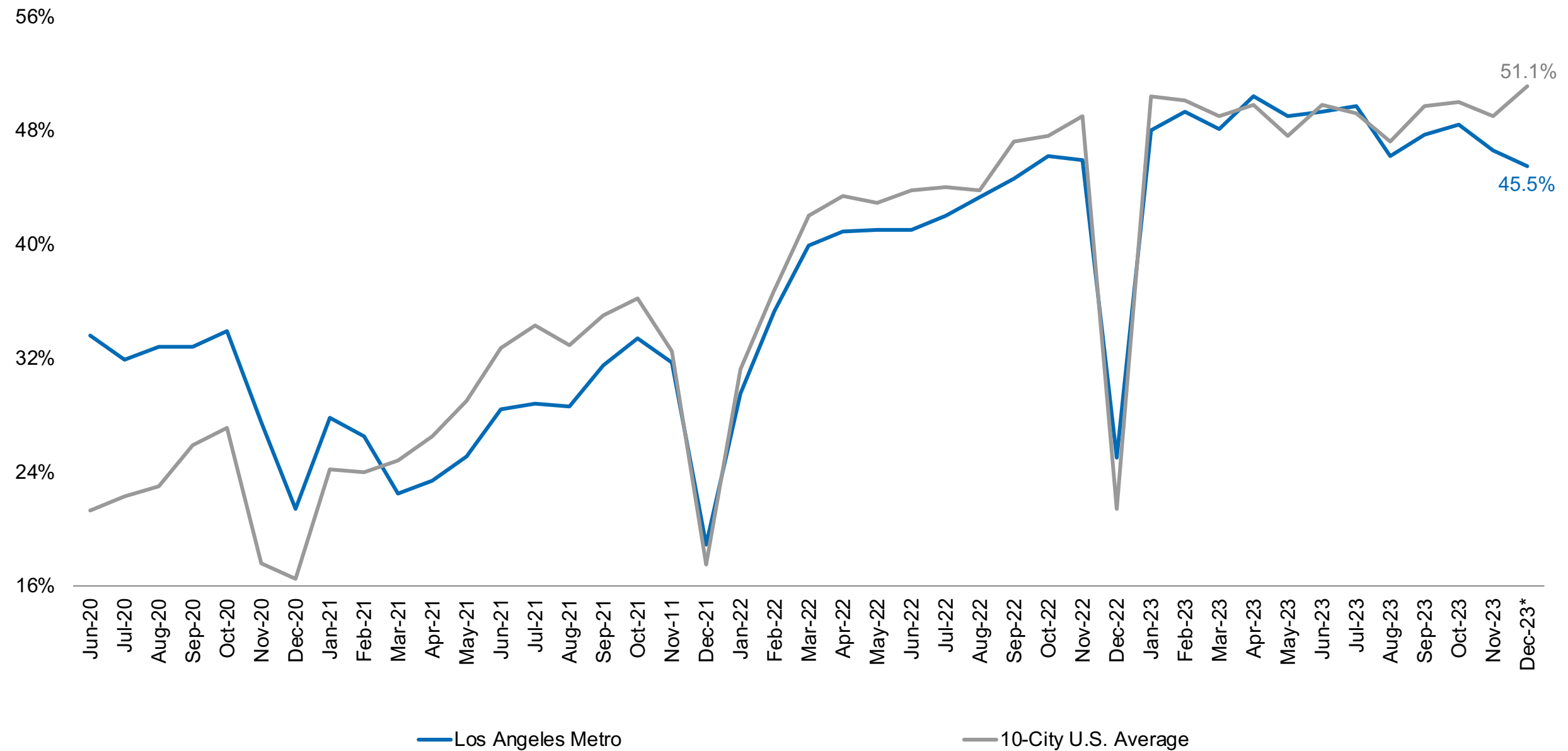
Note: November 2023 data is preliminary.

*Office-using employment includes employment in the following industry sectors: Professional & Business Services, Financial Activities and Information.

Local Office Utilization is Up Since 2020, but Remains Sub-50%

The winter holidays aside, local utilization has generally hovered in the upper 40s since September 2022 as most companies continue to rely on hybrid work schedules.

Los Angeles Metro Office Utilization Rates | Kastle Systems Return-to-Work Data Based on Key FOB Swipes



Source: Newmark Research, Kastle Systems

Note: Each month's percentage reflects the average of its final week. December 2023's average is for the week of 12/18/23.

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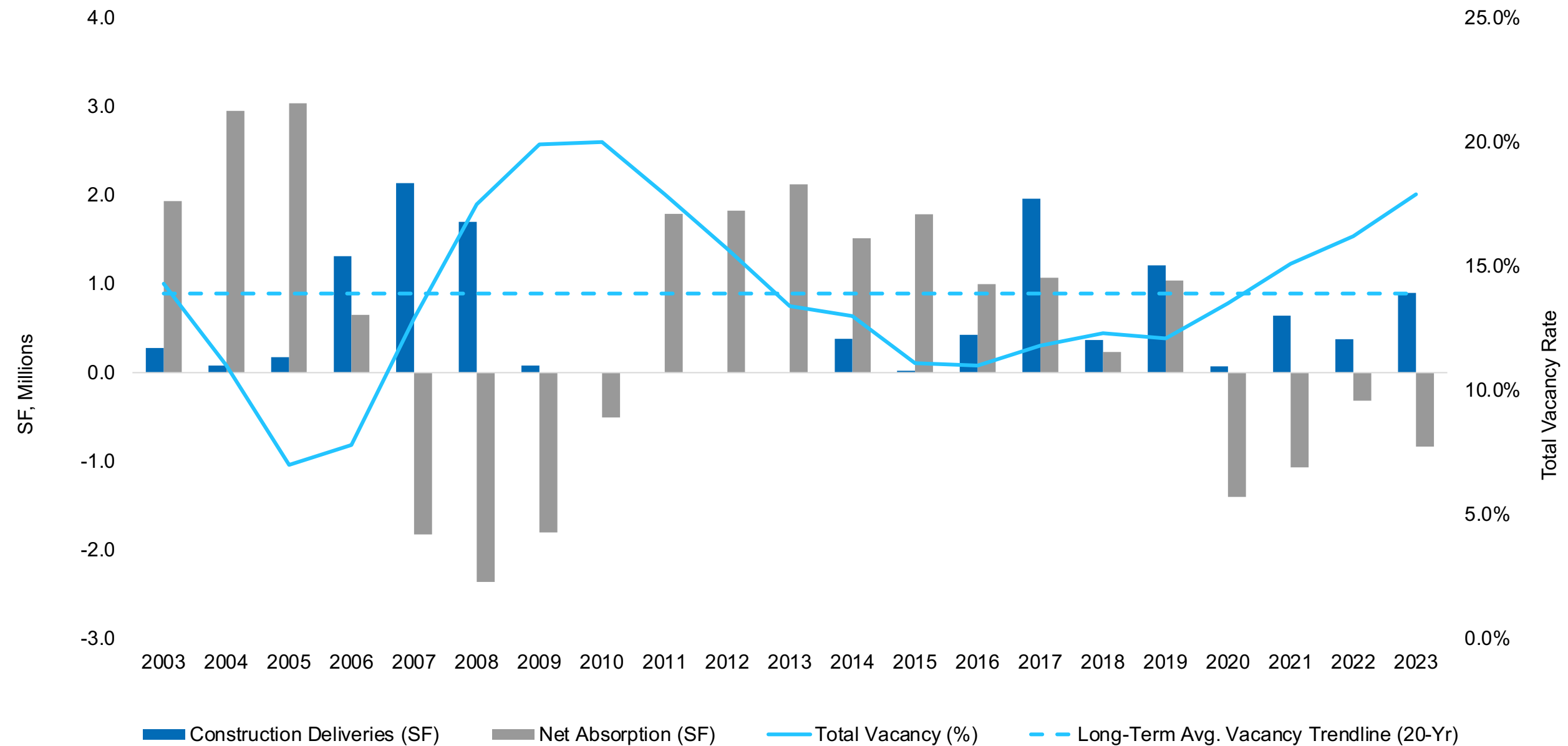
Leasing Market Fundamentals



Vacancy Increases but Remains Under 2010's 20.0% Average

Current vacancy (17.9%) was up 170 bps from 12 months ago and flat compared with three months prior. Tenants are generally opting for smaller spaces at new, low-rise developments or seeking the most affordable option on the market. Vacancy is expected to remain high in the quarters to come.

Historical Construction Deliveries, Net Absorption, and Vacancy

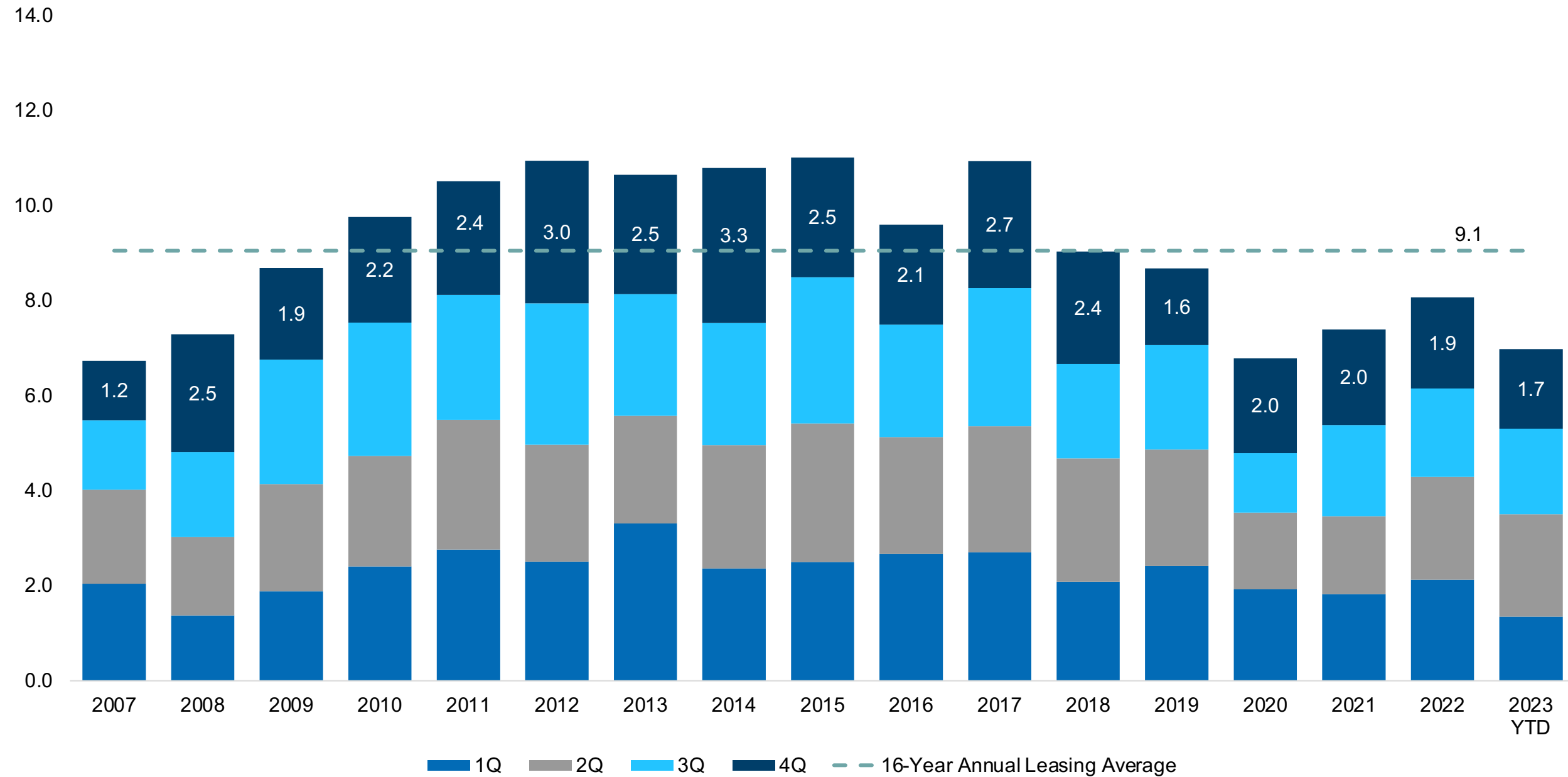


Source: Newmark Research

2023 Leasing Activity Was Muted

Hybrid work models and a cloudy economic outlook are accelerating ongoing space reductions, while hampering overall leasing activity. Leasing activity in 2023 totaled nearly 7.0 MSF, noticeably down from 2022's 8.1 MSF.

Total Leasing Activity (MSF)

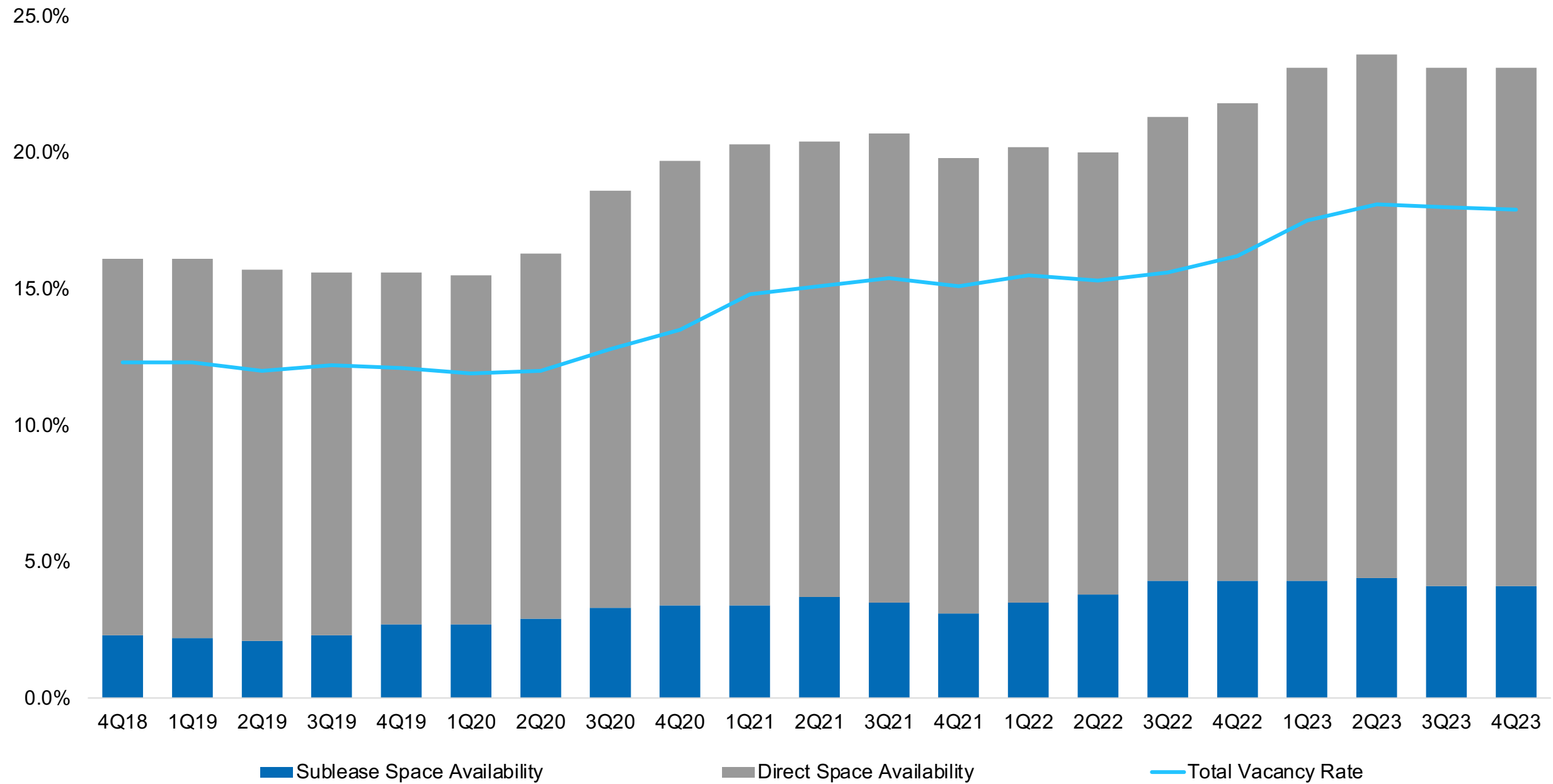


Source: Newmark Research, CoStar

Total Availability Levels Off

The total availability rate for fourth quarter of 23.1% remains unchanged from three months prior. Both direct and sublease availability saw small decreases in the fourth quarter, leaving availability rates for both unchanged.

Available Space and Tenant Demand as Percent of Overall Market



Source: Newmark Research

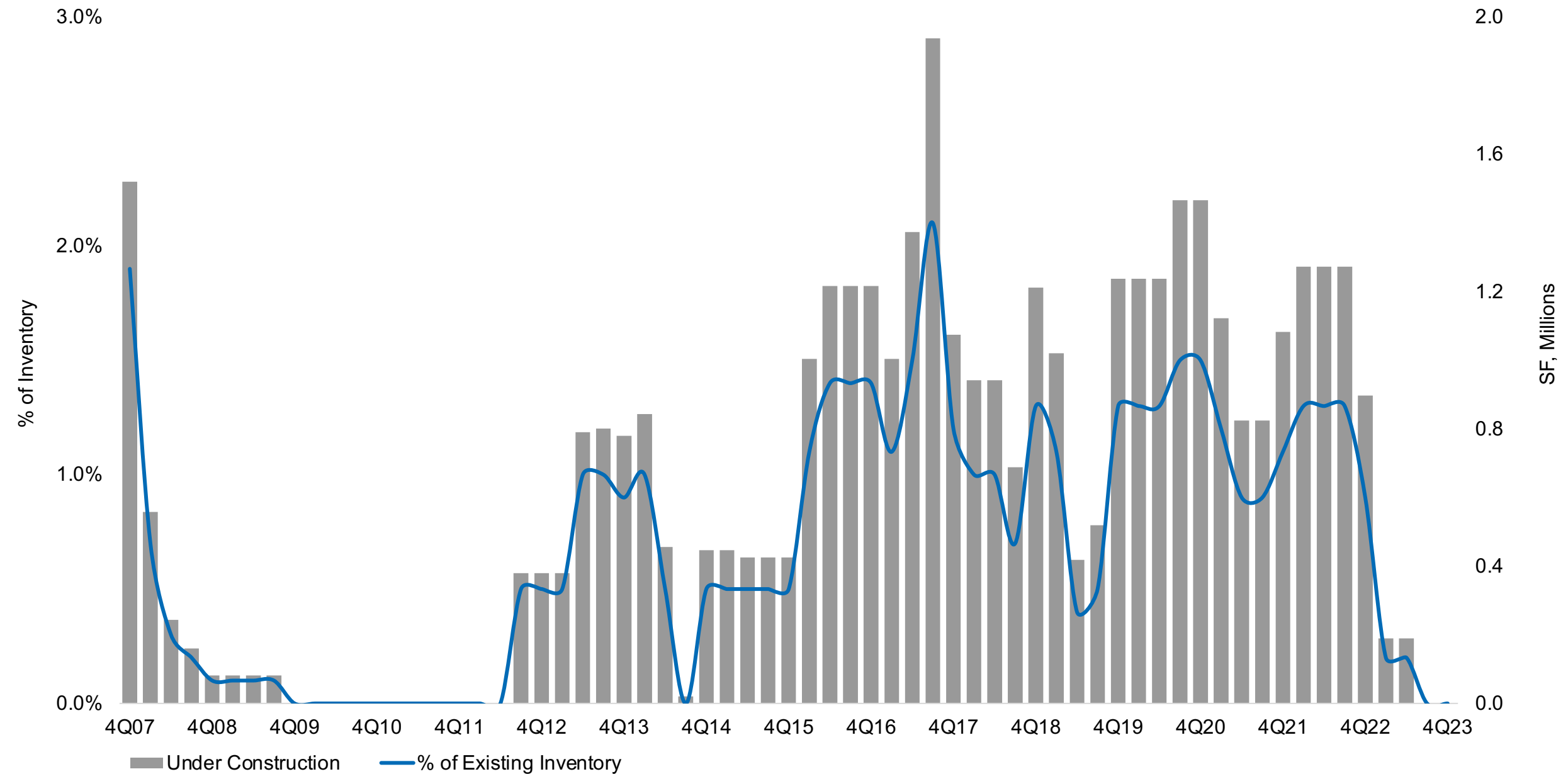
Airport Area has the Bulk of the Metro's Availability

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No Speculative Development Currently Underway

Anduril's 190,000-SF expansion at The Press delivered in the third quarter of this year, bringing under-construction activity to zero for the first time since 2010. It is unlikely a new speculative project will break ground over the next 12 months, based on current market dynamics.

Office Under Construction and % of Existing Inventory

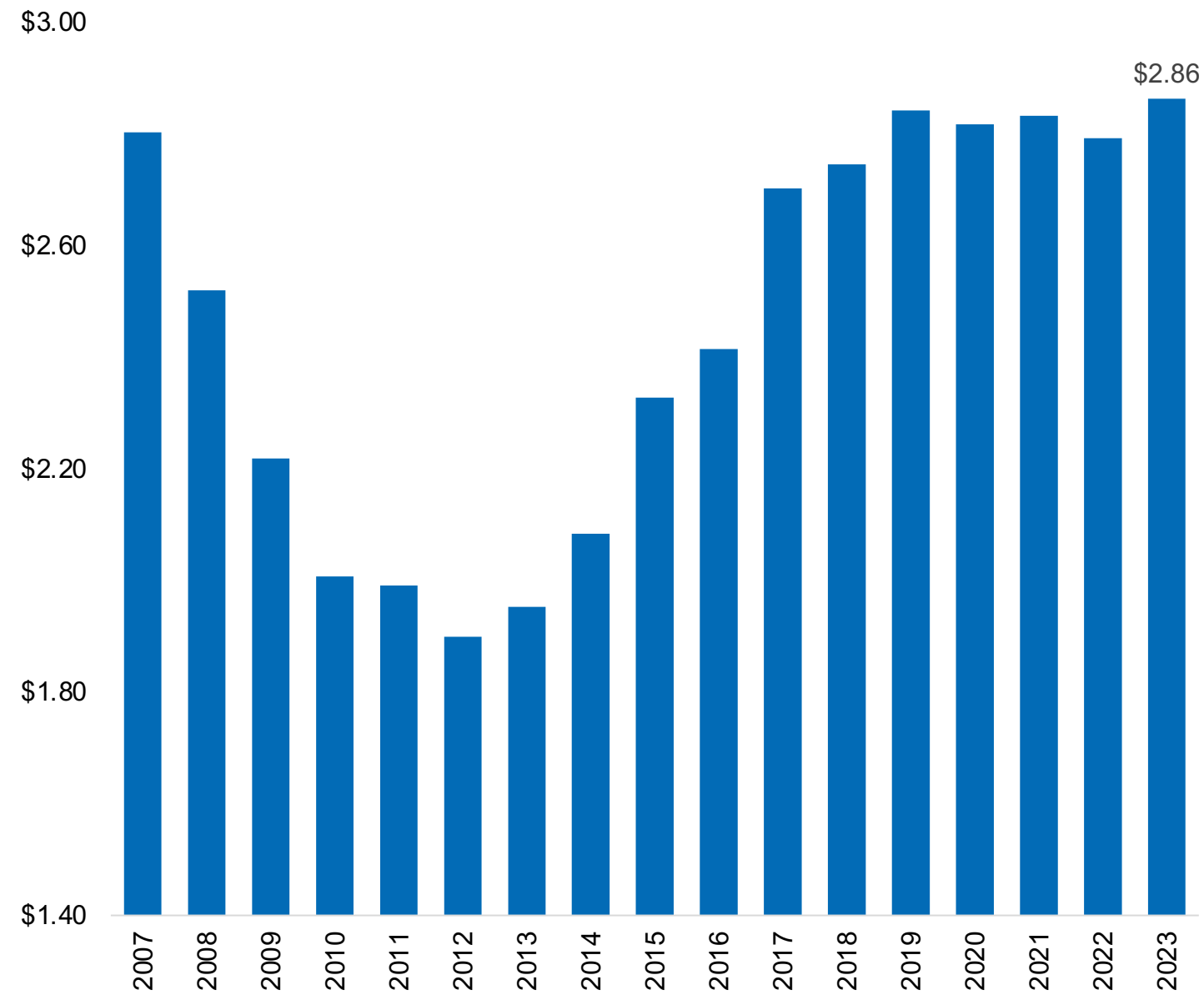


Source: Newmark Research

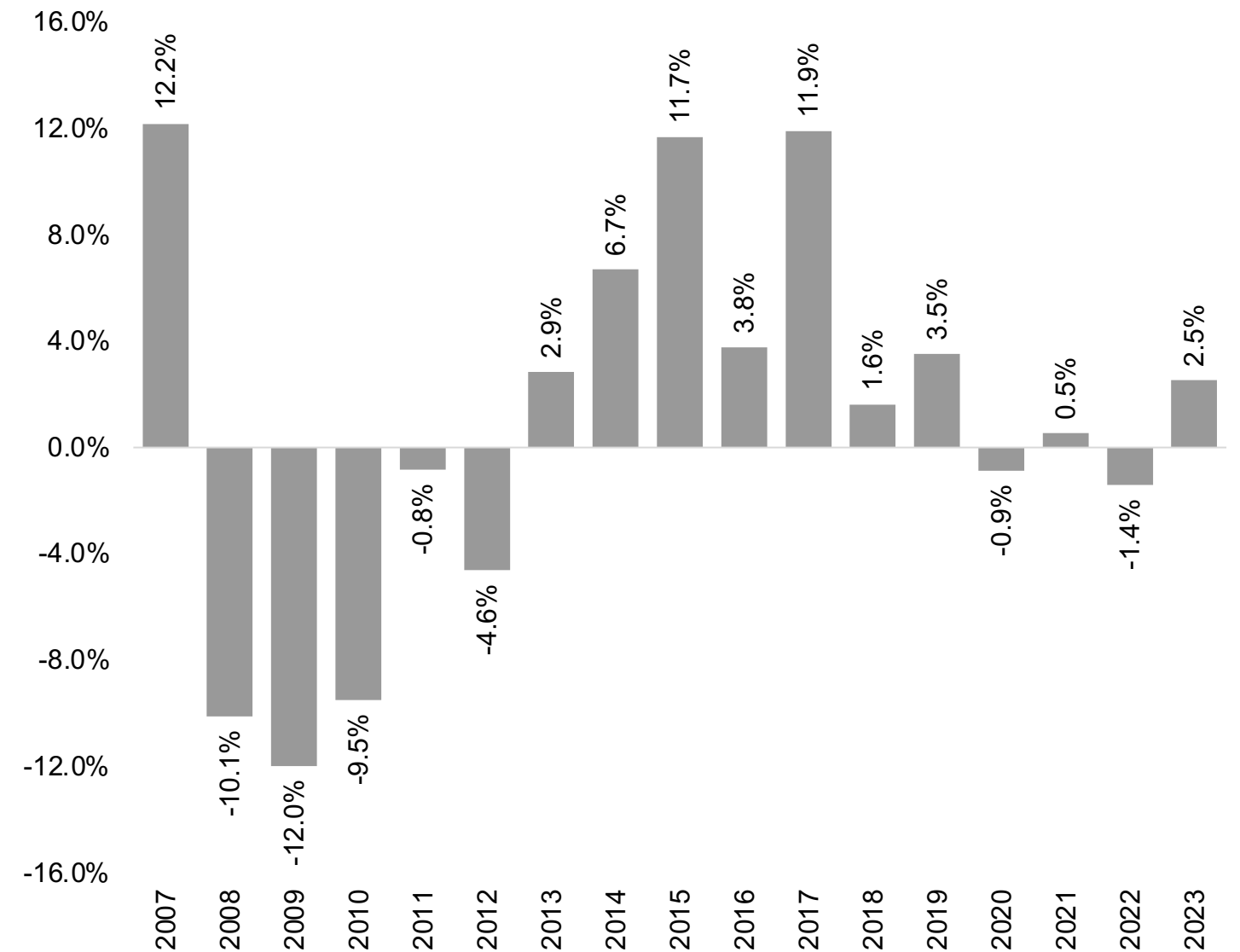
Asking Rents Remain Elevated

Leasing activity may be subdued relative to recent quarters, but this has yet to impact average asking rents. Much of this can be traced to newer Class A listings presently on the market, in addition to inflation, which is keeping tenant improvement allowances elevated.

Office Average Asking Rent, \$/SF/Month, FS



Year-over-Year Asking Rent Growth Rate



Source: Newmark Research

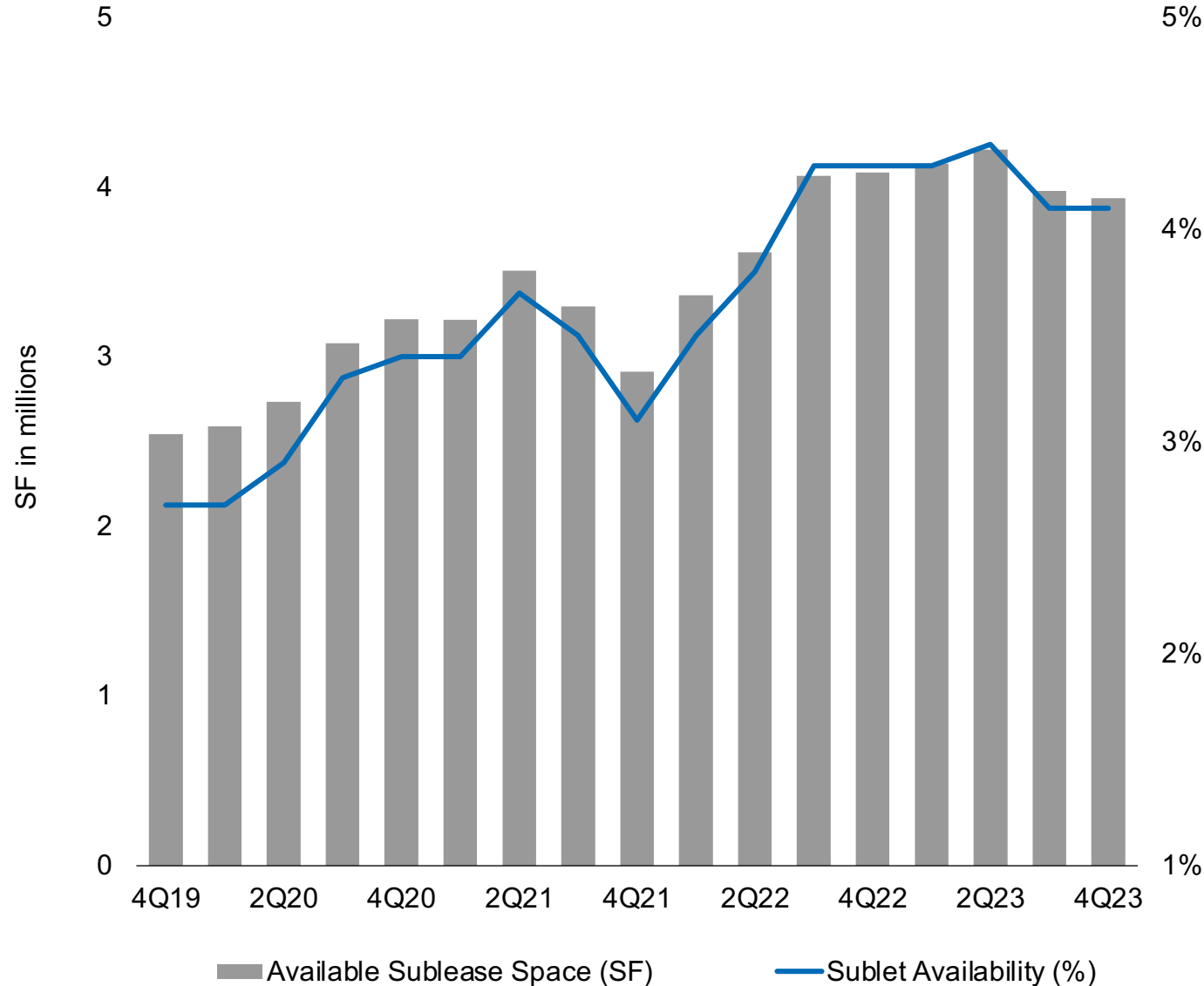
South County Rents Increase Following Delivery of Spectrum Terrace

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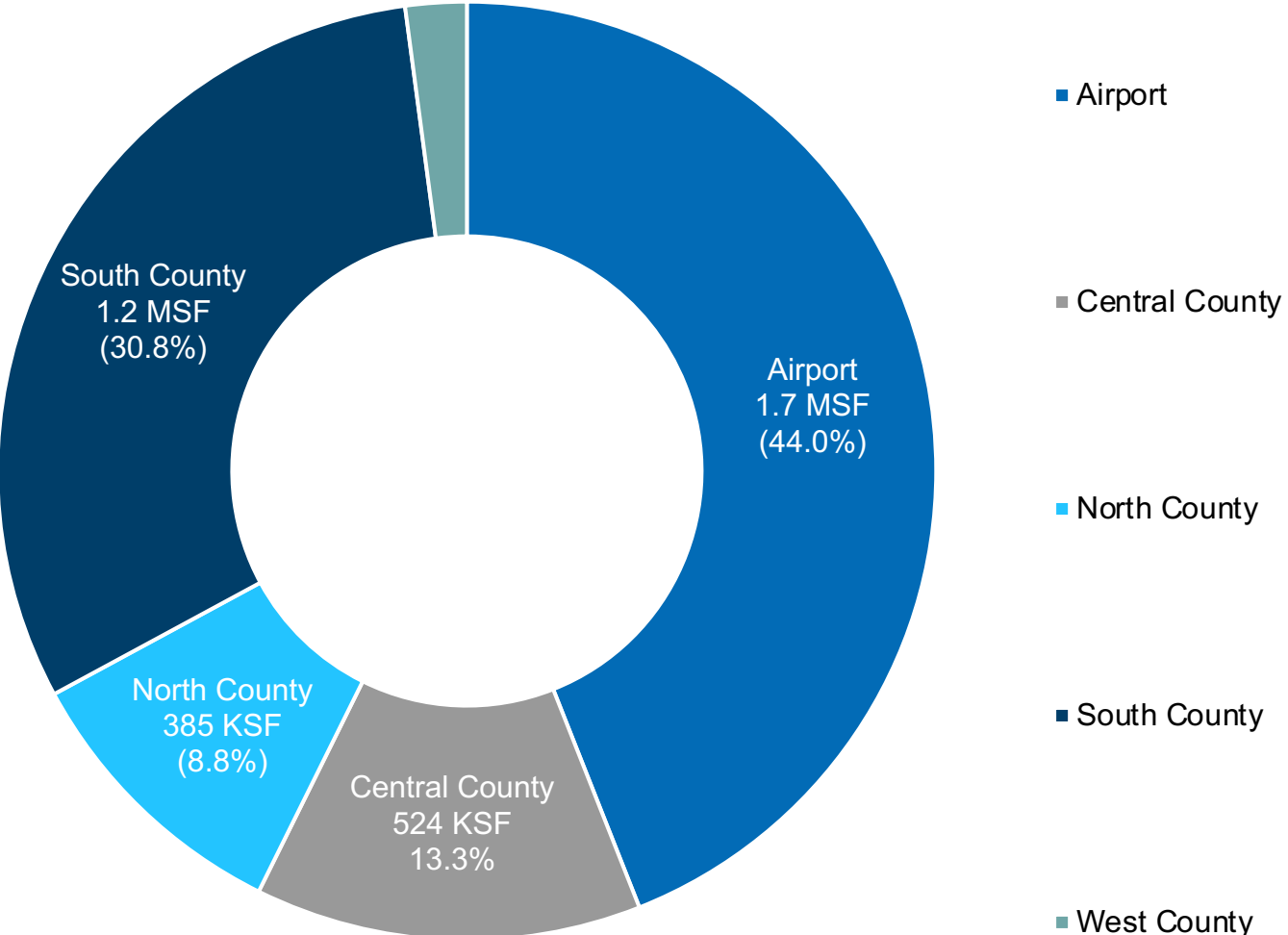
Sublet Availability Plateaus

Orange County's sublet availability remained flat this quarter, with 3.9 MSF (or 4.1% of inventory). At the submarket level, Airport leads others in available sublease space, with 1.7 MSF or 44.0% of Orange County's sublet pool.

Available Sublease Space: Greater Market



Available Sublease Space by Submarket



Source: Newmark Research

New Leases Drive Leasing Activity

Eight out of the top 10 leases signed this quarter were for direct space. Leasing activity as a whole was muted, with no deals reported over 100,000 SF.

Notable 4Q23 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
Canon USA	19500 Jamboree Rd	Airport	Direct Lease	92,893
<i>Canon leased the first three floors of 19500 Jamboree Rd at the "Google Center" in Irvine and plans to use the space for its camera and printer divisions.</i>				
St. John Knits	5515 E La Palma Ave	North County	Direct Lease	84,493
<i>The luxury American fashion brand leased 84,493 SF at Fifty-Five- Fifteen in Anaheim.</i>				
County of Orange	1700 E Saint Andrew Pl	Central County	Direct Lease	70,462
<i>Orange County leased 70,462 SF on the first two floors at the office building in Santa Ana.</i>				
Best Choice Products	100 Bayview Cir	Airport	Direct Lease	53,478
<i>The American retail company signed for 53,478 SF at 100 Bayview in Newport Beach and will be relocating their headquarters from 15101 Red Hill Ave in Tustin.</i>				
Avery Products	50 Pointe Dr	North County	Lease Renewal	51,387
<i>Avery renewed on 51,387 SF in a 10-year deal. In a separate lease, the company signed a short-term renewal for 27,397-SF at the same property in Brea.</i>				

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Office-to-Residential Conversion and Distress



Home Ownership is Out of Reach for 89% of Buyers; Good News for the Rental Market

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35% of the Office Market Obsolete or Unable to Service Debt

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Some Underperforming Office Properties Will Find New Life

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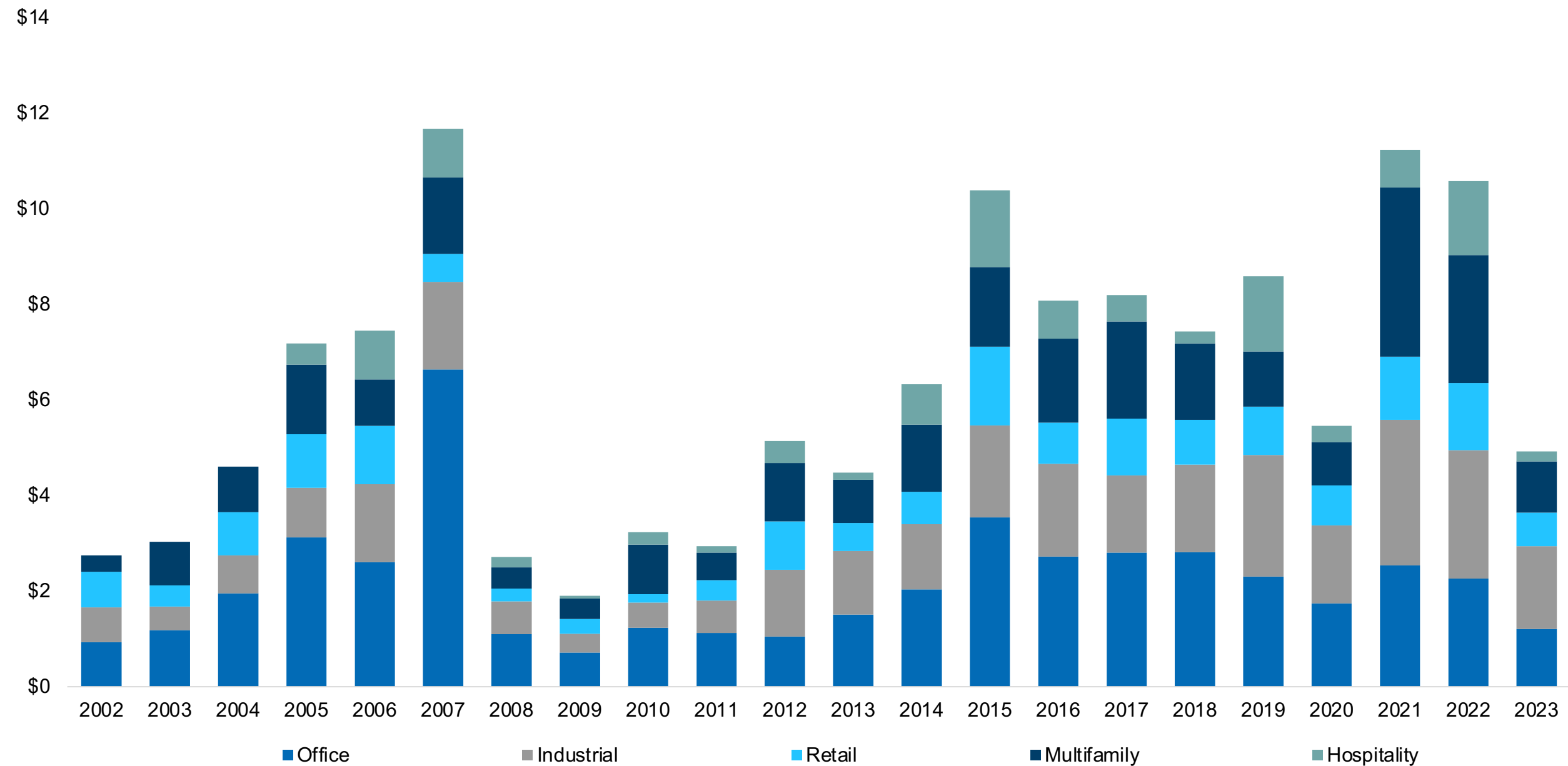
Sales Activity



Office Comprised 24.6% of Total Sales Volume in 2023

This is a noticeable decline from the 34.1% average in 2015. Structural shifts in leasing dynamics since the onset of COVID-19 remains an ongoing challenge for the property segment. This is in contrast to other asset classes, such as industrial and multifamily, which have experienced heated rent growth amid high demand in recent years.

Orange County: Sales Volume Across Commercial Property Segments (\$ in Billions)

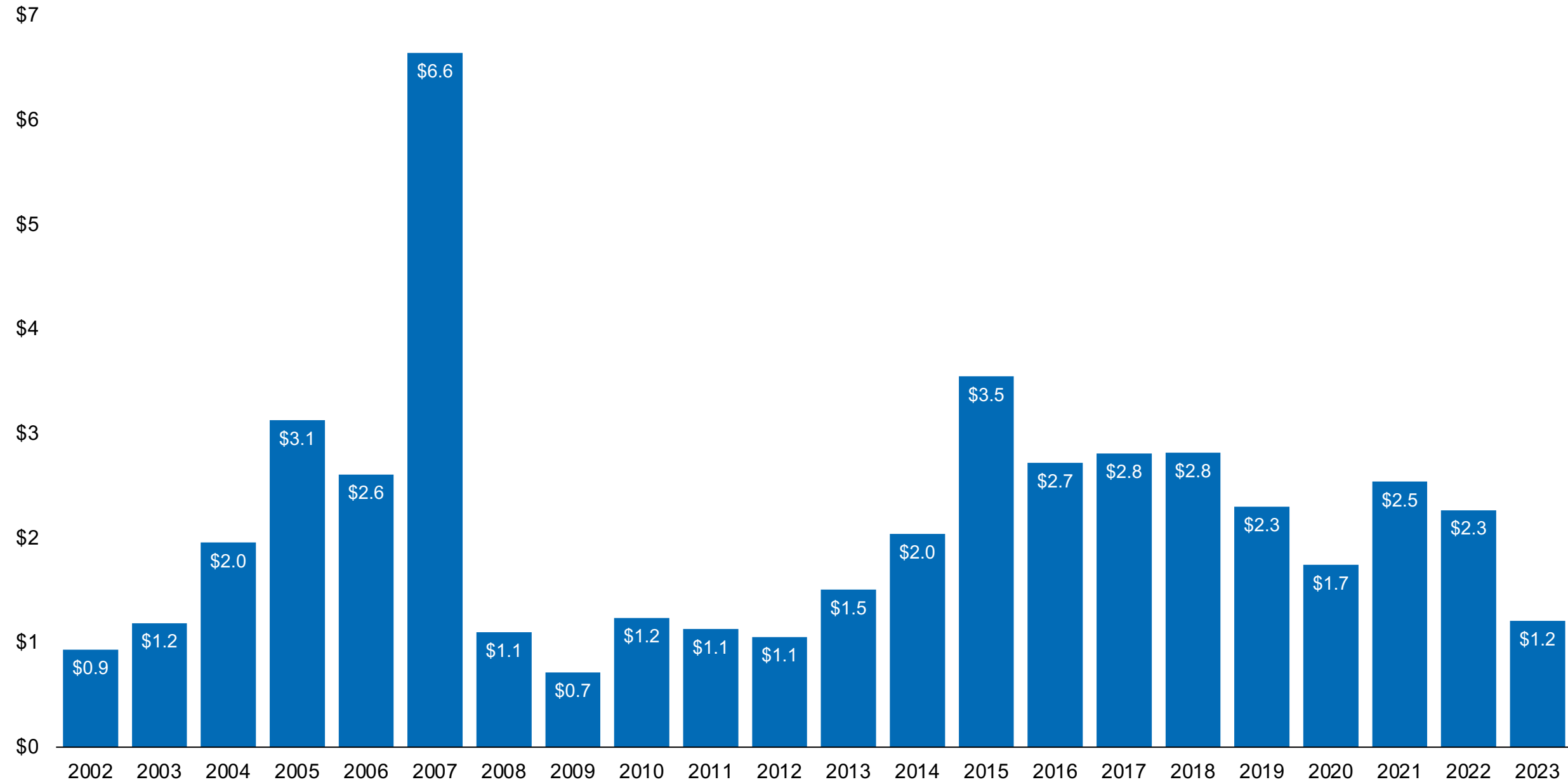


Source: MSCI Real Capital Analytics, Newmark Research
 Note: Preliminary data is cited for the fourth quarter of 2023.

Office Sales Volume: Up Close

Office sales volume totaled just \$1.2 billion in 2023. Economic headwinds, concern regarding long-term adoption of hybrid work models, rising vacancy, looming debt maturities and a higher interest rate environment have most investors taking a wait-and-see approach to the asset class.

Orange County: Office Sales Volume (\$ in Billions)



Source: Newmark Research, MSCI Real Capital Analytics
Note: Preliminary data is cited for the fourth quarter of 2023.

Pricing is Decreasing, While Cap Rates Will Increase

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Office Trades: Private, Opportunistic Buyers Are Active; Institutions Less So

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Submarket Snapshots



Airport

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Central County

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North County

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South County

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West County

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Appendix



Orange County Office Submarket Map and High-level Statistics | 4Q23

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Please reach out to your
Newmark business contact for this information

For more information:

Dain Fedora

*Head of Research
Southwest*

dain.fedora@nmrk.com

Kevin Watson

*Research Manager
Los Angeles*

kevin.watson@nmrk.com

Fahima Dawd

*Research Analyst
Orange County*

fahima.dawd@nmrk.com

Orange County

18401 Von Karman Ave., Suite 150
Irvine, CA 92612
t 949-608-2000

New York Headquarters

125 Park Ave.
New York, NY 10017
t 212-372-2000

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