

ORANGE COUNTY | OFFICE Q1 2018

Accelerating success.

» Orange County Rents Grow While Vacancy Rises

Key Takeaways

- > The Orange County office market saw negative demand in the first quarter, recording negative 298,100 square feet of net absorption due to Broadcom moving from the Airport Area to South County.
- > Asking rental rates increased by \$0.02 from last quarter to \$2.80 per square foot (PSF) full service gross (FSG).
- > Vacancy increased by 100 basis points to 14.0% from last quarter's 13.0%.
- > Leasing activity decreased from last quarter's 1.9 million to 1.4 million square feet, falling below the five-year historical average of 1.7 million square feet.
- > Orange County job growth increased by 6,300 jobs in the month of February. Top annual job gains were recorded in educational and health services (9,200 jobs) and professional and business services (8,900 jobs). As of February 2018, the Orange County unemployment rate is still among the lowest in the nation at 3.1%.

Orange County Office Market

The Orange County office market saw negative movement during the first quarter due to Broadcom moving from the Airport Area into the newly constructed campus in South County. This is the largest tenant move the Orange County market has seen in quite some time. Market fundamentals will remain strong as newly built inventory delivers to the market during 2018, giving tenants the opportunity to explore new space options. As tenants seek opportunities to right size and new construction delivers to the market, absorption gains are expected to be limited in coming quarters.

Market Indicators | Relative to prior period

	Q1 2018	Forecast
Vacancy	↑	↑
Net Absorption	↓	→
Construction	→	↑
Rental Rate	↑	↑

Summary Statistics | Orange County, Q1 2018

	Class A	Class B	All Classes
Vacancy Rate	16.4%	11.9%	13.0%
Change from Q4 '17 (Basis Points)	+20	+140	+100
Net Absorption*	363.3	-470.5	-297.1
Construction Completions*	0	0	0
Under Construction*	782.3	284.2	1,066.5

*SF, Thousands

Asking Rents | Orange County, Q1 2018

	Class A	Class B	All Classes
Average Asking Rent	\$3.17	\$2.54	\$2.80
Change from Q4 '17 (\$)	\$0.02	\$0.09	\$0.02
Y.O.Y. Change (%)	3.6%	7.1%	6.9%

Orange County Labor Force | Q1 2018

	Total Nonfarm	Prof. & Business Services	Financial Activities
12-mo Employment Growth (%)	2.0%	3.0%	0.5%
12-mo Actual Employment Change	31,900	8,900	600

Vacancy

- > Direct vacancy for the quarter was 12.9%, while sublease vacancy recorded at 1.1%.
- > Tenants looking for spaces greater than 100,000 square feet have more options given new office construction deliveries. Tenants searching for space options under 10,000 square feet are currently in the best position.
- > West County supplanted North County as the submarket with the tightest vacancy in Orange County at 7.3%.
- > **FORECAST:** Vacancy is expected to trend upward as new office product comes online in coming quarters.

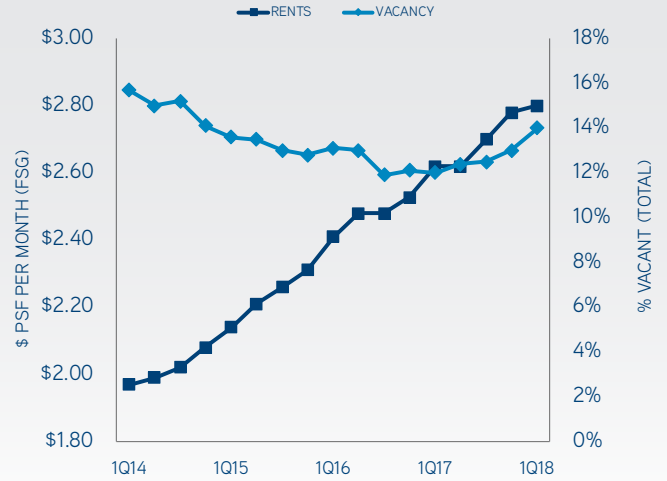
Absorption and Leasing Activity

- > Net absorption fell to negative 298,100 square feet, breaking a streak of 16th consecutive quarters of positive movement. This negative movement stemmed from Broadcom moving from the Airport Area to South County.
- > Large tenant move-ins during the first quarter included Broadcom's remaining move into Five Point Gateway, Cylance Inc. at 400 Spectrum Center Drive and Incipio at Park Place.
- > Leasing activity decreased from last quarter's 1.9 million square feet to 1.4 million, falling below the five-year historical average.
- > **FORECAST:** New construction deliveries could temper absorption demand through 2018.

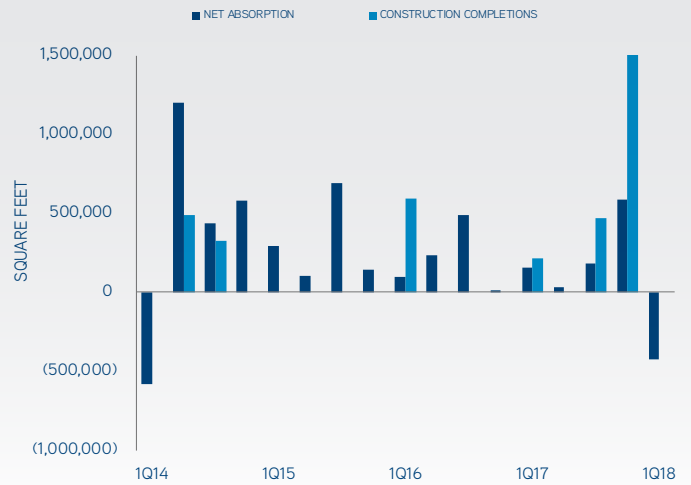
Rental Rates

- > Direct asking rental rates increased 0.7% from last quarter to \$2.80 PSF FSG. This rental rate increase stems from new construction product delivering to the market.
- > Class A rental rates increased by \$0.02 to \$3.17 PSF FSG, Class B increased by \$0.09 to \$2.54 PSF FSG and Class C increased by \$0.03 to \$1.87 PSF FSG.
- > **FORECAST:** Rental rates are expected to increase due to new construction deliveries and will start to stabilize through 2018.

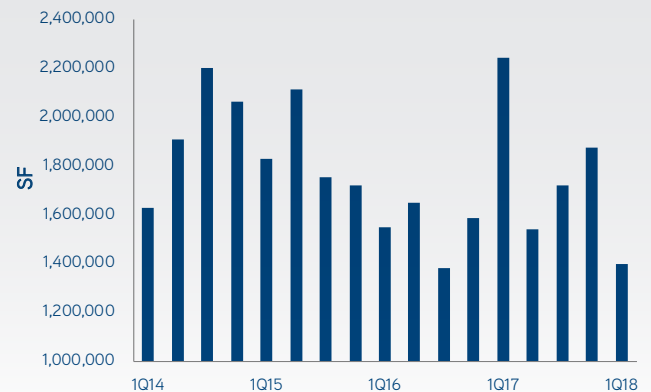
Historical Vacancy v. Rents | O.C. Office Market Q1 '14-'18



Net Absorption by Submarket | O.C. Office Market Q1 '14-'18



Historical Leasing Activity | O.C. Office Market Q1 '14-'18



Construction

- > New construction and projects under renovation in the Airport Area, Central County and South County submarkets totaled 1.1 million square feet.
- > Three office projects currently under construction including 2722 Michelson Drive in Irvine, The Flight at Tustin Legacy and The Quad at Discover Business Center. All are expected to be completed in 2018.
- > **FORECAST:** The Press in Costa Mesa, as well as The Source in Irvine, are expected to start construction mid-2018.

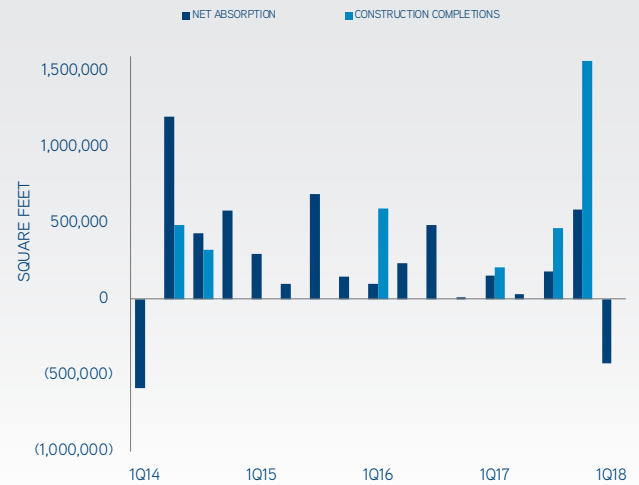
Investment Trends

- > Investment activity fell for properties over 25,000 square feet compared to one quarter ago, totaling \$320.1 million in transaction value. Transaction value increased by 19% compared to the first quarter 2017.
- > The City of Orange witnessed an increase in investment activity during the first quarter. KBS Strategic Opportunity REIT, Inc acquired 333 City Boulevard for \$147.3 million (\$340 PSF) and TA Realty acquired 625 The City Drive South for \$33 million (\$223 PSF).
- > **FORECAST:** Real estate is proving to be a desirable asset as investors continue to look for stable income-producing assets and hedge against perceived upcoming inflation.

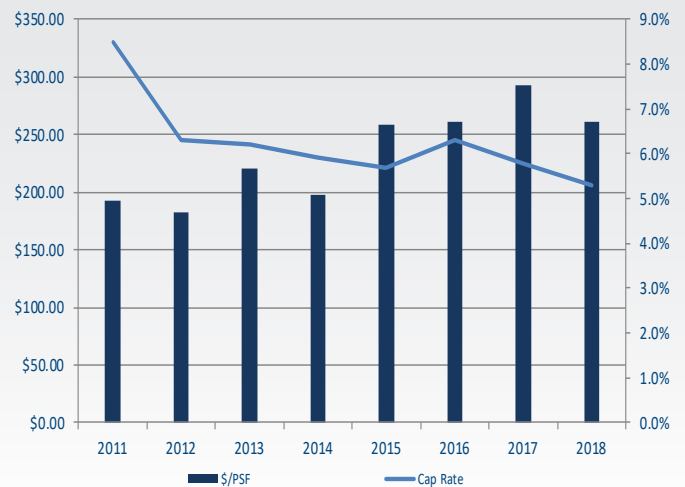
Outlook

Moving into 2018, the Orange County market is expected to maintain positive momentum. Class A asking rental rates have increased as the Airport Area and South County submarkets have reached historical peaks, while Central County, North County and West County submarkets continue to see slow but positive growth. New developments coming online during the year are expected to put upward pressure on asking rental rates.

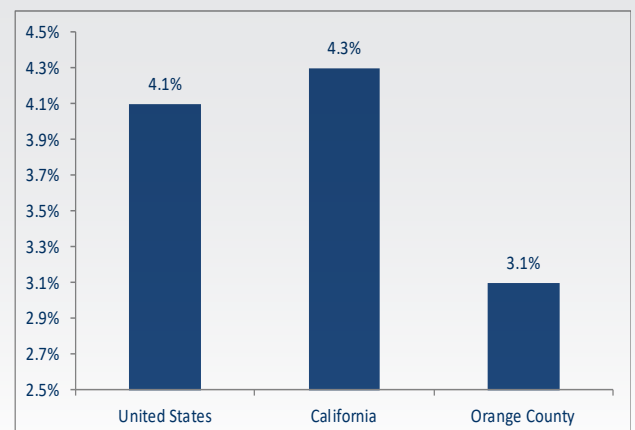
Historical Net Absorption & Construction Completions
O.C. Office Market Q1 '14-'18



Investment Trends Chart
O.C. Office Market 2011-2018



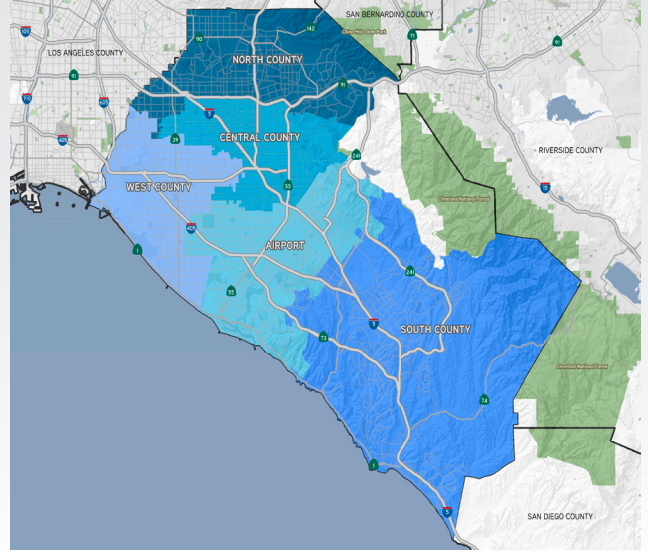
Unemployment Rate | U.S., C.A. & O.C. | February 2018



Market Description

Orange County is a moderately large suburban office market comprised of 85.2 million square feet and represents 29% of the total inventory of office buildings 25,000 square feet and greater in the Los Angeles basin. Orange County is a relatively new and moderately dense market with 41% of the space in Class A buildings. Orange County is home to a broad mix of firms, including significant representation from the finance, insurance, telecommunications, high-tech, real estate, engineering and professional service sectors.

Submarket Map



RECENT TRANSACTIONS & MAJOR DEVELOPMENTS

Orange County Office Market
Q1 2018

SALES ACTIVITY

PROPERTY ADDRESS	SIZE SF	SALE PRICE	PRICE PSF	BUYER	SELLER
333 City Blvd., Orange	431,000 SF	\$147,300,000	\$340 PSF	KBS Strategic Opportunity REIT, Inc.	Torchlight Investors
625 The City Drive S., Orange	148,100 SF	\$33,000,000	\$223 PSF	TA Realty	The Blackstone Group LP
3100-3130 S Harbor Blvd., Santa Ana	201,400 SF	\$34,773,000	\$173 PSF	Kearny Real Estate Company	Colton Family Trust
2415 Campus Dr., Irvine	38,500 SF	\$15,000,000	\$390 PSF	Athens Services	CVK Partners, LP
Corporate Pointe Portfolio (5 Bldgs)	163,700 SF	\$41,700,000	\$254 PSF	Corporate Pointe INVS LLC	PS Business Parks, Inc.

LEASING ACTIVITY

PROPERTY ADDRESS	LEASED SF	LEASE TYPE	BLDG CLASS	LESSEE	LESSOR
14101 Myford Rd, Tustin	66,818 SF	Direct	B	GSA	Harbor Associates, Inc.
12912 Brookhurst St, Garden Grove	61,002 SF	Renewal	B	County of Orange - Social Services	Dolphin Partners, Inc.
41 Discovery, Irvine	44,820 SF	Renewal	B	Ghost Media	The Irvine Company
43 Discovery, Irvine	31,407 SF	Direct - New	B	Ghost Media	The Irvine Company
85 Enterprise, Aliso Viejo	28,719 SF	Direct - New	A	Concerto Healthcare	RREEF

MAJOR DEVELOPMENTS

PROJECT	DEVELOPER	SIZE SF	SUBMARKET	STATUS	ESTIMATED COMPLETION
Flight @ Tustin Legacy, Tustin	Lincoln Property	417,300 SF	Central County	Under Construction	3Q 2018
The Quad at Discovery Business Center	Irvine Company	365,000 SF	South County	Under Construction	2Q 2018
2722 Michelson Dr, Irvine	LBA Realty	155,000 SF	Airport Area	Under Construction	4Q 2018
18552 MacArthur Blvd	The Irvine Company	61,300 SF	Airport Area	Under Renovation	2Q 2018
18650 MacArthur Blvd	The Irvine Company	67,900 SF	Airport Area	Under Renovation	3Q 2018

OFFICE OVERVIEW														
Orange County Office Market														
Q1 2018														
EXISTING PROPERTIES			VACANCY				ACTIVITY		ABSORPTION		CONSTRUCTION		RENTS	
Submarket/Class	Bldgs	Total Inventory SF	Direct Vacancy	Sublease Vacancy	Total Vacancy	Total Vacancy Prior Qtr	Leasing Activity Current Qtr SF	Leasing Activity YTD SF	Net Absorption Current Qtr SF	Net Absorption YTD SF	Completions Current Qtr SF	Under Construction SF	Weighted Avg Asking Lease Rate	
AIRPORT														
A	108	23,037,900	16.7%	1.6%	18.3%	17.6%	444,000	444,000	(160,700)	(160,700)	0	0	\$3.29	
B	243	14,486,300	11.5%	1.6%	13.1%	9.1%	354,000	354,000	(580,000)	(580,000)	0	284,200	\$2.81	
C	57	2,581,800	10.6%	0.2%	10.8%	7.7%	41,100	41,100	(81,900)	(81,900)	0	0	\$2.21	
SUBTOTAL	408	40,106,000	14.4%	1.5%	15.9%	13.8%	839,100	839,100	(822,600)	(822,600)	0	284,200	\$3.10	
CENTRAL														
A	29	5,620,900	10.9%	0.4%	11.4%	10.9%	50,700	50,700	(26,600)	(26,600)	0	417,300	\$2.37	
B	79	6,090,400	15.0%	0.4%	15.4%	15.1%	35,900	35,900	(20,800)	(20,800)	0	0	\$2.19	
C	58	2,281,500	14.4%	0.1%	14.5%	13.0%	25,000	25,000	(32,800)	(32,800)	0	0	\$1.63	
SUBTOTAL	166	13,992,800	13.3%	0.4%	13.6%	12.9%	111,600	111,600	(80,200)	(80,200)	0	417,300	\$2.15	
NORTH														
A	14	1,633,700	7.4%	3.3%	10.6%	11.5%	2,800	2,800	13,400	13,400	0	0	\$2.34	
B	56	4,984,400	11.1%	0.2%	11.3%	10.8%	88,500	88,500	(24,300)	(24,300)	0	0	\$2.12	
C	22	958,500	14.7%	0.1%	14.8%	6.9%	10,100	10,100	(75,600)	(75,600)	0	0	\$1.63	
SUBTOTAL	92	7,576,600	10.8%	0.8%	11.6%	10.5%	101,400	101,400	(86,500)	(86,500)	0	0	\$2.07	
SOUTH														
A	29	5,679,800	15.3%	1.4%	16.8%	26.1%	103,300	103,300	529,500	529,500	0	365,000	\$3.37	
B	219	11,932,400	9.2%	1.1%	10.3%	11.2%	182,900	182,900	101,700	101,700	0	0	\$2.69	
C	15	638,600	22.1%	0.1%	22.2%	21.7%	2,300	2,300	(3,200)	(3,200)	0	0	\$2.04	
SUBTOTAL	263	18,250,800	11.6%	1.2%	12.8%	13.8%	288,500	288,500	628,000	628,000	0	365,000	\$2.93	
WEST														
A	8	1,029,700	6.9%	0.0%	6.9%	7.6%	4,800	4,800	7,700	7,700	0	0	\$2.83	
B	54	2,999,300	6.0%	0.0%	6.0%	7.8%	45,300	45,300	52,900	52,900	0	0	\$2.12	
C	32	1,274,200	10.1%	0.7%	10.8%	11.0%	7,600	7,600	2,600	2,600	0	0	\$1.82	
SUBTOTAL	94	5,303,200	7.2%	0.2%	7.3%	8.1%	57,700	57,700	63,200	63,200	0	0	\$2.15	
MARKET TOTAL														
A	188	37,002,000	15.0%	1.4%	16.4%	16.2%	605,600	605,600	363,300	363,300	0	782,300	\$3.17	
B	651	40,492,800	10.9%	1.0%	11.9%	10.5%	706,600	706,600	(470,500)	(470,500)	0	284,200	\$2.54	
C	184	7,734,600	13.1%	0.2%	13.3%	10.8%	86,100	86,100	(190,900)	(190,900)	0	0	\$1.87	
TOTAL	1,023	85,229,400	12.9%	1.1%	14.0%	13.0%	1,398,300	1,398,300	(298,100)	(298,100)	0	1,066,500	\$2.80	

Note: revisions to the inventory base were made effective Q1 2018, historical data reported here reflect these revisions and may not match data reported in previous quarters.

Definitions of key terms in this report

Total Rentable Square Feet:

Office space in buildings with 25,000 square feet or more of speculative office space, including competitive space in Class A, B and C single-tenant and multi-tenant buildings. Excludes non-competitive owner-occupied buildings, buildings that include 30 percent or greater of medical or retail space, and space that is under construction, under-renovation or off-market.

Class A Space:

Space that an image-conscious company would lease for its headquarters. Typically, this space has a very high level of finish, an excellent location, and commands the highest rents in the market.

Class B Space:

Highly functional, attractive space that is less prestigious than Class A Space, and commands lower rental rates.

Class C Space:

Functional, competitive space with a lower level of finish and/or a less desirable location than Class B Space and commands lower rental rates.

Low-Rise:

Buildings with four or fewer total floors

Mid-Rise:

Buildings with five or 13 total floors.

High-Rise:

Buildings with 14 or more floors.

Direct Vacancy:

Space in existing buildings that is vacant and immediately available during the quarter for direct lease, plus space that is vacant but not available for direct lease or sublease (for example, being held for a future commitment).

Total Vacancy:

Space in existing buildings that is vacant and immediately available during the quarter for direct lease or for sublease, plus space that is vacant but not available for direct lease or sublease.

Net Absorption:

Net change in occupied square feet from one period to the next (including the impact of change in vacant space available for sublease).

Leasing Activity:

Square feet leased from all known transactions completed during the quarter excluding lease renewals.

Weighted Average Asking Rental Rates:

Rental rates weighted by the total square feet available for direct lease and includes all costs associated with occupying the space, including taxes, insurance, maintenance, janitorial service and utilities.

Space Added (Net):

Total square feet added during the quarter via construction completions, including renovated space returned to market, less total square feet taken off-market due to demolitions or conversions.

Under Construction:

Includes buildings that are in some phase of construction, beginning with foundation work and ending with the issuance of a Certificate of Occupancy.

Technical Note:

Colliers International is continuously refining its database. The data shown in the historical tables and graphics in this report have been adjusted to take into account these changes in the database.

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413 offices in 69 countries on 6 continents

United States: 153	> \$2.6 billion in annual revenue
Canada: 29	> 2.0 billion square feet under management
Latin America: 24	
Asia Pacific: 79	> Over 15,400 professionals
EMEA: 111	

UNITED STATES:

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