

Savills Studley Report Orange County office sector

Q3 2018



SUMMARY

Market Highlights

LEASING DECLINES

Overall quarterly leasing activity fell from 1.9 million square feet (msf) to 1.3 msf, well below the long-term quarterly average of 2.1 msf. Tenants have leased 6.9 msf in the four most recent quarters.

AVAILABILITY JUMPS

Orange County's overall availability rate posted a significant quarter-on-quarter increase, rising by 150 basis points from 18.3% to 19.7%. The Class A rate rose by 140 basis points to 21.3%.

RENT JUMPS

The overall average asking rent increased to \$35.86, a quarter-on-quarter spike of 1.7%. Class A rent also pushed higher, jumping by 0.8% quarter-on-quarter to \$39.47.

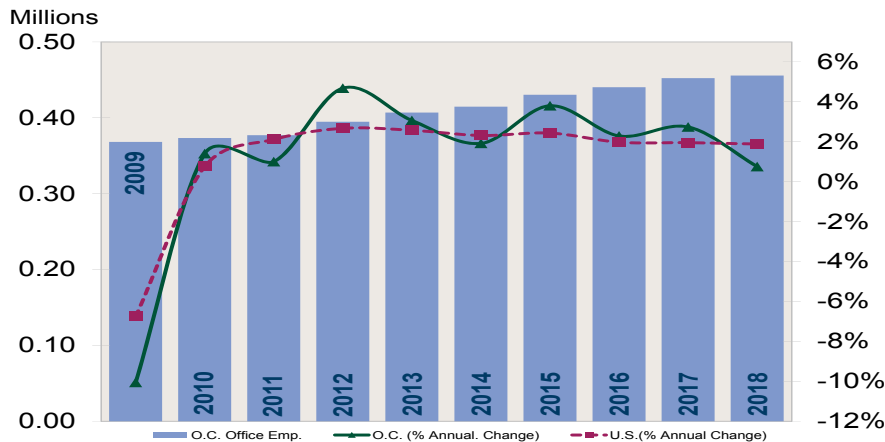
SALES ALMOST UNCHANGED

Office property sales during the first seven months of the year totaled \$1.2 billion, a 0.7% increase compared to the first seven months of 2017.

"Rent growth has begun to stabilize in Orange County - leasing activity in several submarkets remains strong, with numerous large transactions likely to be completed in Q4. The Class A Airport submarket continues to see rent growth, however at a slower pace than previous quarters. South Orange County's rent growth has slowed after numerous quarters of significant increase; however, new projects recently delivered or under construction are commanding some of the highest rents in Orange County."

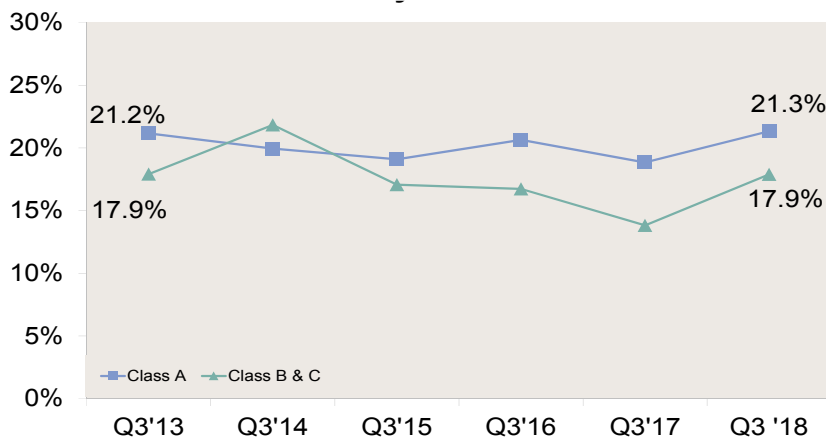
Randall S. Parker,
Senior Managing Director

Office-Using Employment Trends

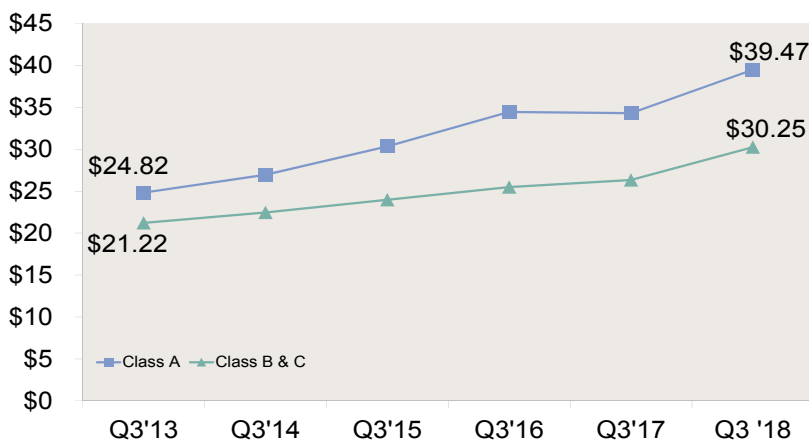


Source: Bureau of Labor Statistics^

Availability Rate Trends



Asking Rent Trends



Tenants Seek Lower-Cost Alternatives

For the first time in the past several years rent growth has begun to slow in South Orange County and the Airport area. The leasing of premier product in top buildings has left the market with a higher percentage of outdated Class A and B product. These buildings do not command similar rent to newer more amenity-rich product. Older properties are forced to lower lease rates due to rising availability, and to incentivize tenants away from the newer product coming to market.

Although net absorption in the Airport area has decreased significantly since last quarter, leasing in core sectors such as the mortgage industry continues to drive positive absorption. Consumer debt firm Americor leased 22,000 sf at 18201 Von Karman. Located across the street from its 18200 Von Karman site, the new operations center will house 250 employees. Americor plans to move 125 support staff from 18200 Von Karman to the new location, and then hire another 125 people by the end of 2018 in an effort to effectively consolidate. Leasing in the real estate sector has also rebounded. Landsea Homes recently announced that it will move its corporate headquarters to 660 Newport Center Drive in Fashion Island. It will keep a Southern California division in Irvine.

Labor Market Headwinds

The U.S. economy continues to roll along, but there are some concerns that growth could soon run into more significant headwinds. Employers are already dealing with a lack of qualified labor. Employment growth may be hitting some limits. Orange County's hiring activity has slowed, gaining only 5,100 jobs in the last 12 months (a 1.8% increase), down from 2.4% in the prior 12 months. Orange County's unemployment rate increased to 3.3%, a big spike from the 2.6% rate in May, but nevertheless remains very low. Professional/business services, in large part due to a surge in temporary help agency employment, rose by 8,255 jobs in the last 12 months—but losses in both the financial and information sectors offset some of these gains.

While Orange County continues to register modest growth in the banking, mortgage and real estate sectors, many of these companies are becoming more efficient as they lease space – densifying as they renew or relocate. Merger and acquisition activity, which also often spurs consolidation, has

heated up of late. TD Services, for example was recently acquired by First American Corporation. After being folded into First American Mortgage Services group, TD Services downsized from its current 47,191 sf to roughly 30,000 sf on First American's corporate campus at First American Way in Santa Ana.

KSJG LLP is currently working to reduce its footprint by approximately 4,500 sf while also maintaining the same headcount and functionality in a redesigned floorplan. The reduction and restructure will likely save the company over \$850,000 over the new five-year lease term, compared to a status quo renewal. It will also improve the company's office productivity with more efficient, collaborative space. Kimley Horn is experiencing a similar restructuring of space at 765 The City Drive South, maintaining the same headcount and reducing its rentable square feet from 14,066 to 9,500 sf generating significant savings.

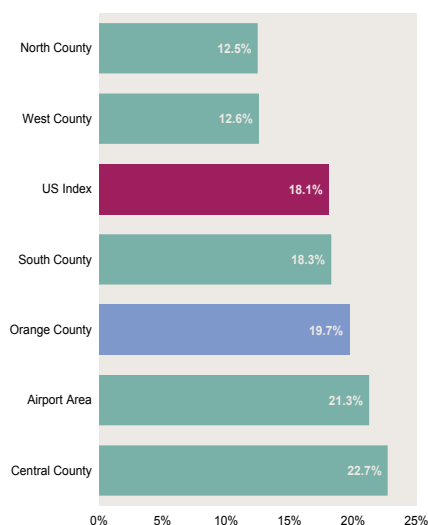
Lower-Cost Areas Gaining Ground

As smaller and mid-sized firms struggle to find reasonably priced space in Irvine Spectrum, activity is picking up in Central, West and North Orange County. Matles & Associates opened a second branch in Central Orange County, expanding from 17662 Irvine Blvd in Tustin to an additional space at 1601 E Lincoln Ave in Orange. Edward Jones is among the group of financial service firms expanding within the Central Orange County submarket. Real estate firms such as Keller Williams Realty and other service-related industries are also growing. Most are signing smaller sub-10,000-sf leases, but these transactions continue to contribute to positive net absorption and moderate rental rate growth.

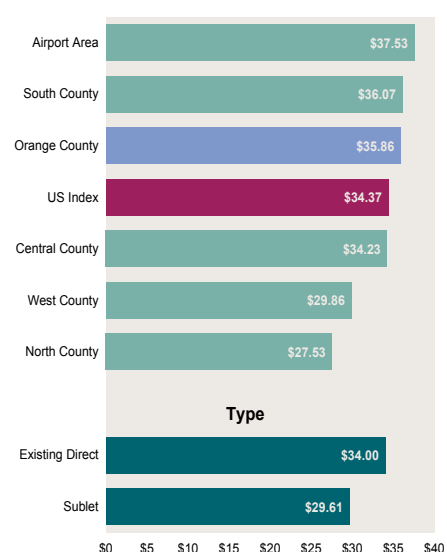
With bullish landlords, and rents at a historical peak in submarkets like the Irvine Spectrum and Airport Area, some startup firms are pushed to emerging submarkets, such as West Orange County. eSmart Technologies (11125 Knott Ave), iRhythm Technologies (11095 Knott Ave), and Zebra Technologies (11570 Trask Ave), are among a few to recently ink leases in West Orange County. They ultimately pay less, encounter less competition for space and have some breathing room for future expansion options.

North Orange County (NOC) has seen a similar volume of technology and service companies seeking cheaper alternatives for headquarters space. L3 Technologies signed a 30,000-sf lease on the 1st floor at 2461 W La Palma Ave in Anaheim. They expect to

Availability Rate Comparison



Overall Rental Rate Comparison



Major Transactions

Tenant	Sq Feet	Address	Market Area
Carrington Mortgage Services	61,588	25 Enterprise	South County
LPA Inc.	55,450	5301 California Ave	Airport Area
County of Orange	47,191	4000 W Metropolitan Dr	Central County
DaVita Medical Management	34,149	3390 Harbor Blvd	Airport Area
Intel Corporation	26,897	111 Theory Dr	Airport Area
RED Technologies	26,798	15 Cushing	South County
Chipotle	22,667	610 Newport Center Dr	Airport Area
Google	22,159	19520 Jamboree Rd	Airport Area
Americor, Inc.	22,000	18201 Von Karman Ave	Airport Area
LensGen	21,960	15310 Barranca Pky	South County
Sum of Top 10 Transactions	340,859	Sum of 3rd Qtr Leasing Activity	1.3 MSF

move into the space in late December of this year. Reborn also just signed a 13,050-sf lease on the second floor at 5515 E La Palma Ave in Anaheim.

Meanwhile, rent growth has slowed in prime Class A submarkets such as Newport Center, the Airport Area and Irvine Spectrum. These areas registered strong leasing and steady rent growth over the last several quarters, but increased leasing of high-caliber space has left lower-rent outdated Class A and B options as the core of available space, bringing down the pace of rent growth. Demand for new space seems to have found some limits. Vacancy has ticked up with projects that have yet to realize their leasing potential. The Boardwalk, a Class A development in the heart of the Airport Area that commands top market rents, sits only 25% leased at the end of the third quarter.

Looking Forward

Increased demand and competition for space in primary markets like Irvine Spectrum and the Airport continues to drive healthy demand into cheaper submarkets like North Orange County where tenants can find comparable space for a significantly reduced price. WOC, NOC, and Central OC are still seeing positive year-over-year rent growth hovering around 4%. These markets should continue to see positive rent growth. The delta between Class A rent in Irvine and the surrounding markets like Orange, Santa Ana, Anaheim, and Tustin (south of I-5), is still very wide – leaving room for higher rent growth in these areas. That being said, some larger corporations and tenants will continue to seek space in Irvine Spectrum, Newport Beach, and primary markets as a branding methodology and in an effort to attract and retain top talent in a region where competition for space is fierce.

Map	Submarket	Total Inventory	Leasing Activity	Available SF			Availability Rate			Asking Rents Per SF		
		SF (1000's)	Last 12 Months	This Quarter	% Change from Last Qtr.	Year Ago	This Quarter	pp Change from Last Qtr. ⁽¹⁾	Year Ago	This Quarter	% Change from Last Qtr.	Year Ago
1	North County	6,976	567	871	0.5%	847	12.5%	0.1%	12.1%	\$27.53	4.2%	\$24.35
	North County - Class A	2,265	260	333	12.9%	329	14.7%	1.7%	14.5%	\$29.85	7.8%	\$26.23
2	West County	3,663	245	461	-0.5%	387	12.6%	-0.1%	10.6%	\$29.86	6.7%	\$27.35
	West County - Class A	1,385	148	215	-12.5%	230	15.5%	-2.2%	16.6%	\$32.44	3.9%	\$31.42
3	Central County	14,069	592	3,197	14.2%	2,179	22.7%	2.7%	15.6%	\$34.23	5.9%	\$25.29
	Central County - Class A	7,245	282	1,653	12.9%	951	22.8%	2.6%	13.1%	\$40.75	7.9%	\$27.42
4	Airport Area	38,709	3,863	8,231	4.2%	7,909	21.3%	1.3%	20.0%	\$37.53	0.5%	\$33.27
	Airport Area - Class A	23,999	2,411	5,358	4.8%	5,442	22.3%	1.1%	22.6%	\$39.89	0.0%	\$36.17
5	South County	18,432	1,605	3,370	10.6%	2,266	18.3%	1.8%	12.3%	\$36.07	1.7%	\$32.46
	South County - Class A	8,197	909	1,636	9.2%	1,193	20.0%	1.7%	14.6%	\$40.04	-1.9%	\$36.31
1-5	Orange County Total	81,849	6,872	16,132	7.0%	13,587	19.7%	1.5%	16.5%	\$35.86	1.7%	\$30.67
	Orange County Total - Class A	43,092	4,010	9,195	6.7%	8,145	21.3%	1.4%	18.8%	\$39.47	0.8%	\$34.31

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(1) Percentage point change for availability rates.
 Unless otherwise noted, all rents quoted throughout this report are average asking gross (full service) rents psf.
 Statistics are calculated using both direct and sublease information.
 ^Unless otherwise noted, source for data is Savills Studley.,
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