

2Q24

**NEWMARK**

# Orange County Office Market Overview



# Market Observations

## Economy

- Local unemployment dropped from 3.7% in April to 3.2% in May, falling below the national average for the first time since last year. A boost in non-farm jobs, specifically in the hospitality and leisure sector, brought down unemployment as local businesses gear up for summer tourism.
- Despite the drop in unemployment, local office-using employment continues to lead in year-over-year job losses. Over the last 12 months, 4,600 office-using jobs were lost.
- The Fed raised rates 11 times since March 2022, bringing the benchmark interest rate to its highest level in 22 years on July 26, 2023. There have been no increases since, while most economists believe the Fed will marginally cut rates by December. Lower interest rates have historically encouraged leasing and sales activity.
- For now, higher capital costs continue to weigh on most businesses.

## Major Transactions

- The largest lease of the year was signed by Latham & Watkins LLP at 650 Town Center Dr in the Airport Area to renew its 65,825-SF space.
- MGR Real Estate, the company that acquired Canvas office park last year, has purchased 2020 Main in Airport Area for \$54 million, marking the region's largest sale year-to-date.
- Owner-users are taking advantage of discounted pricing. This quarter, medical device-maker MicroVention paid \$44 million for a 242,706-SF office tower at 45 Enterprise in Aliso Viejo in a move to expand its Orange County presence. Hampton Tedder Electric also purchased 999 Town & Country, a 98,907-SF Class A office building, for \$18 million and will occupy the top floor. Newmark represented the seller.

## Leasing Market Fundamentals

- Vacancy experienced its largest quarter-over-quarter drop since the pandemic but remains elevated by historical standards. Total vacancy was 18.0%, 260 bps above the five-year average.
- Net absorption was positive for the fourth quarter in a row, totaling 265,662 SF in net gains. The largest move-in of the quarter was by Axonics Inc. occupying its new 145,960-SF space in the Irvine Spectrum.
- Muted office demand is prompting developers to scrap planned office projects, leaving the construction pipeline empty for the first time since the Global Financial Crisis in 2008. The Irvine Company changed course from building a 532,000-SF life science campus at UCI Research Park to a 1,200-unit apartment complex, while the owners of OCV!be, the mixed-use mega-development in Anaheim, recently revised plans to replace office structures with additional housing.

## Outlook

- Tenants in the market generally fall into one of two camps: 1) those wishing to retain an office presence for the lowest possible rent and 2) those seeking financially stable, trophy-grade space in amenity-rich areas, as they reduce footprints. The latter group is using top-shelf space to lure workers back to the office.
- Only 11% of aspiring Orange County home buyers can afford a median-priced home (currently \$1.4 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.
- The office market is still in a state of correction as investors and employers wait for economic conditions to improve. Vacancy will begin to normalize as obsolete office inventory is removed from overall inventory and leasing activity picks up.

1. Economy
2. Leasing Market Fundamentals
3. Office Distress and Redevelopment to Other Uses
4. Sales Activity
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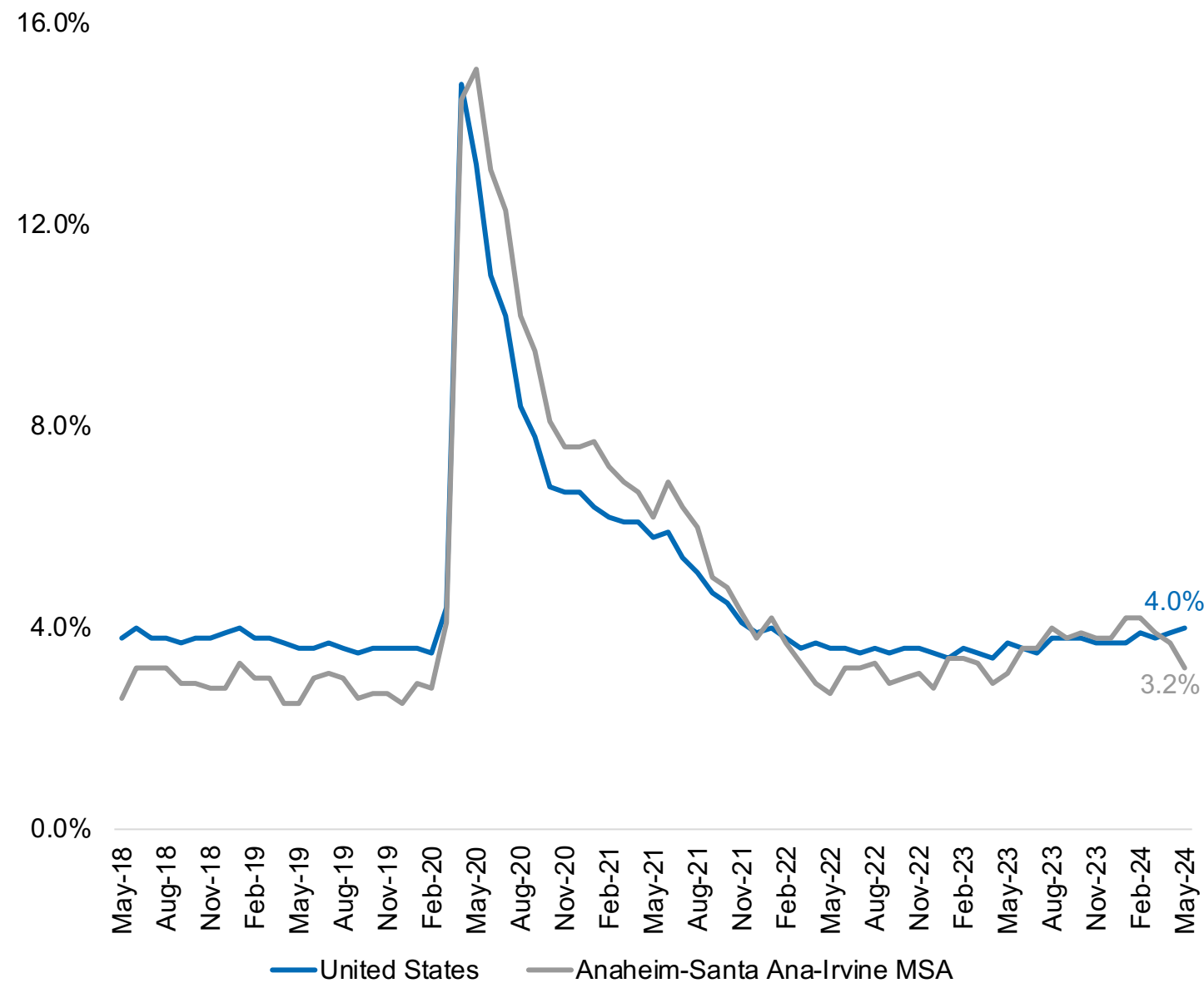
# Economy



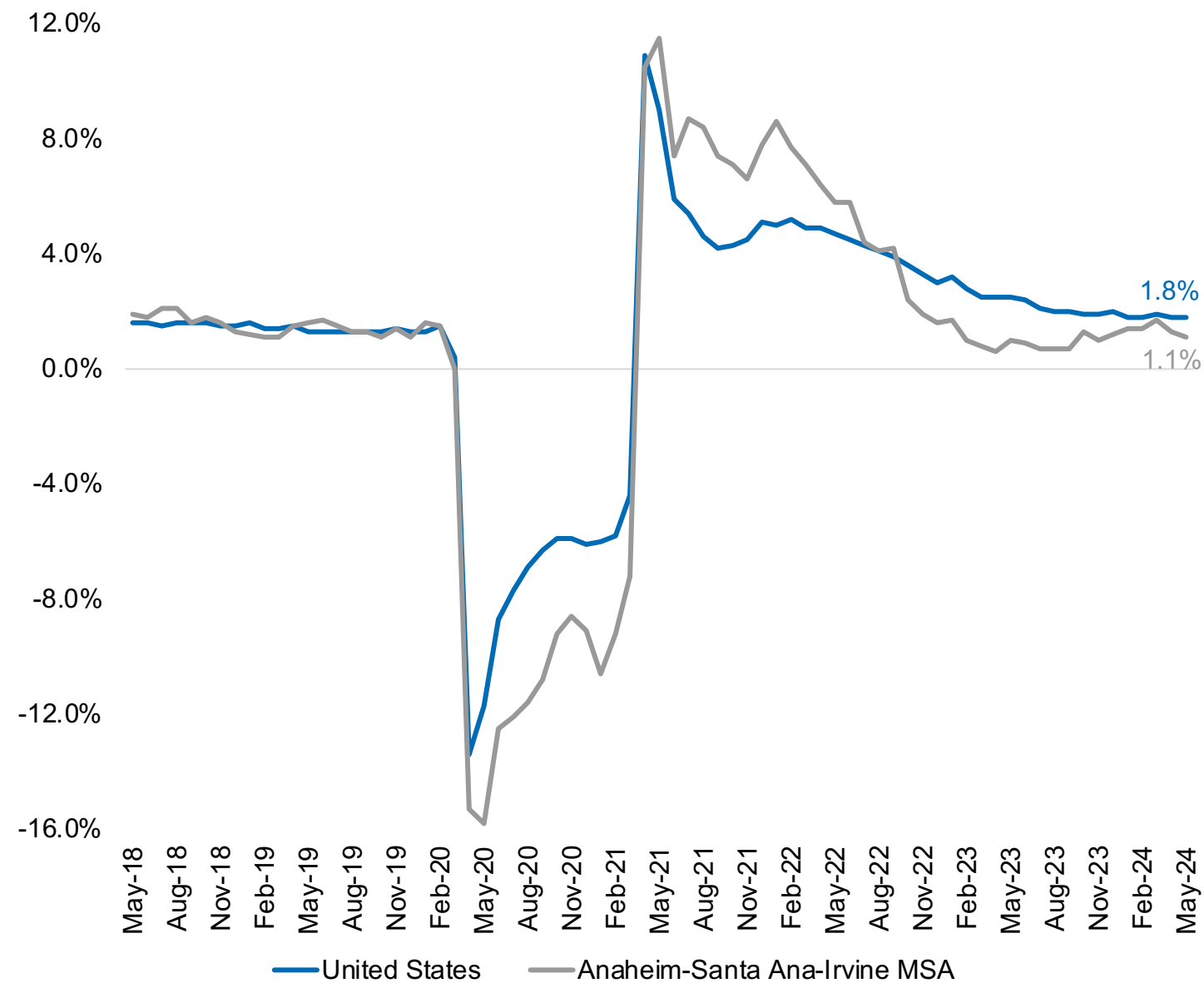
# Local Unemployment Drops Below National Average

Orange County unemployment dropped by 100 bps since the start of the year despite an increase nationally. A rise in total nonfarm employment is a factor, where 6,000 jobs were added from April to May. Total nonfarm employment reached record-high levels at the end of 2023 and has remained elevated since.

Unemployment Rate, Seasonally Adjusted



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

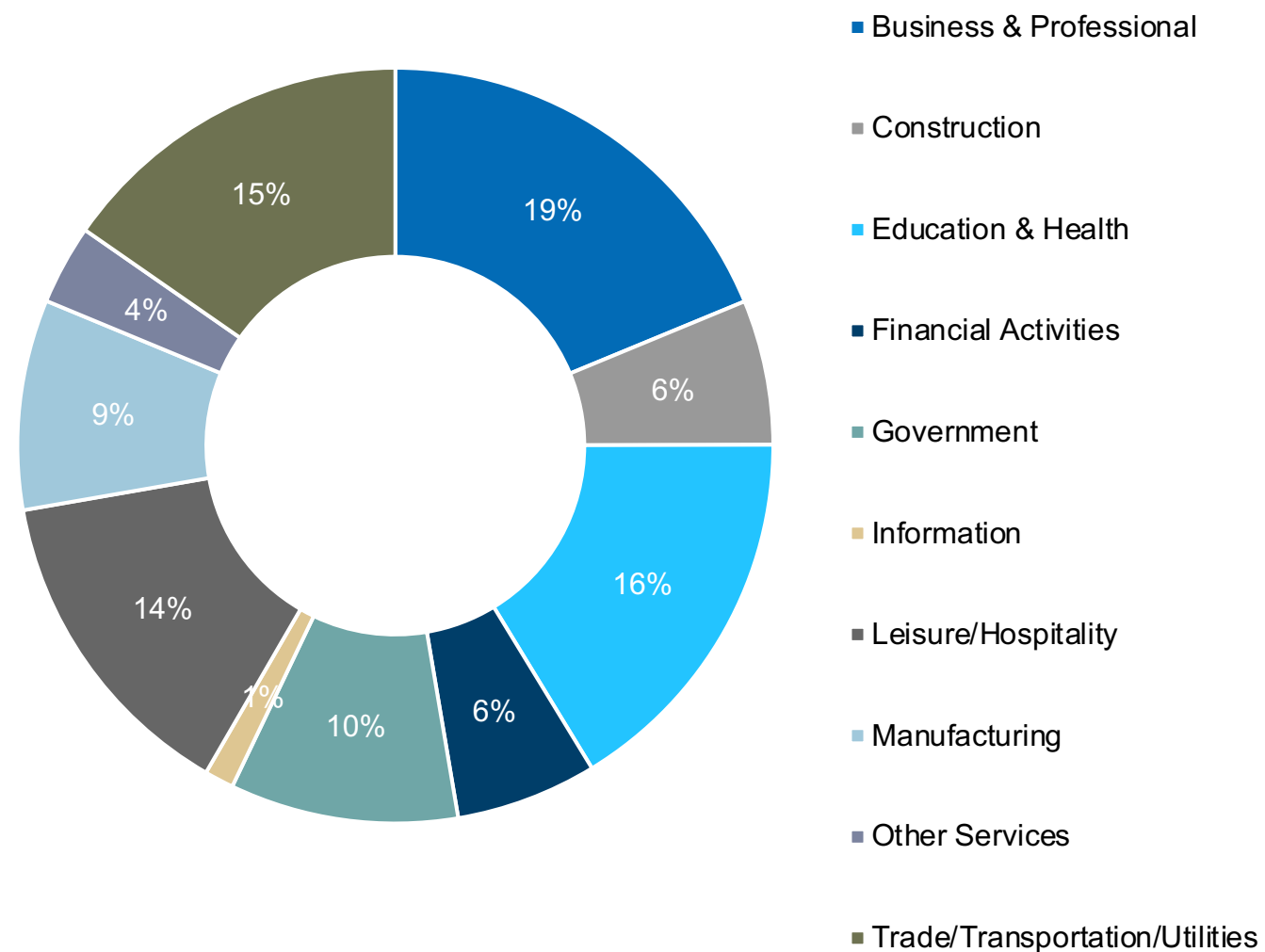


Source: U.S. Bureau of Labor Statistics, Anaheim-Santa Ana-Irvine, CA  
 Note: May 2024 data is preliminary.

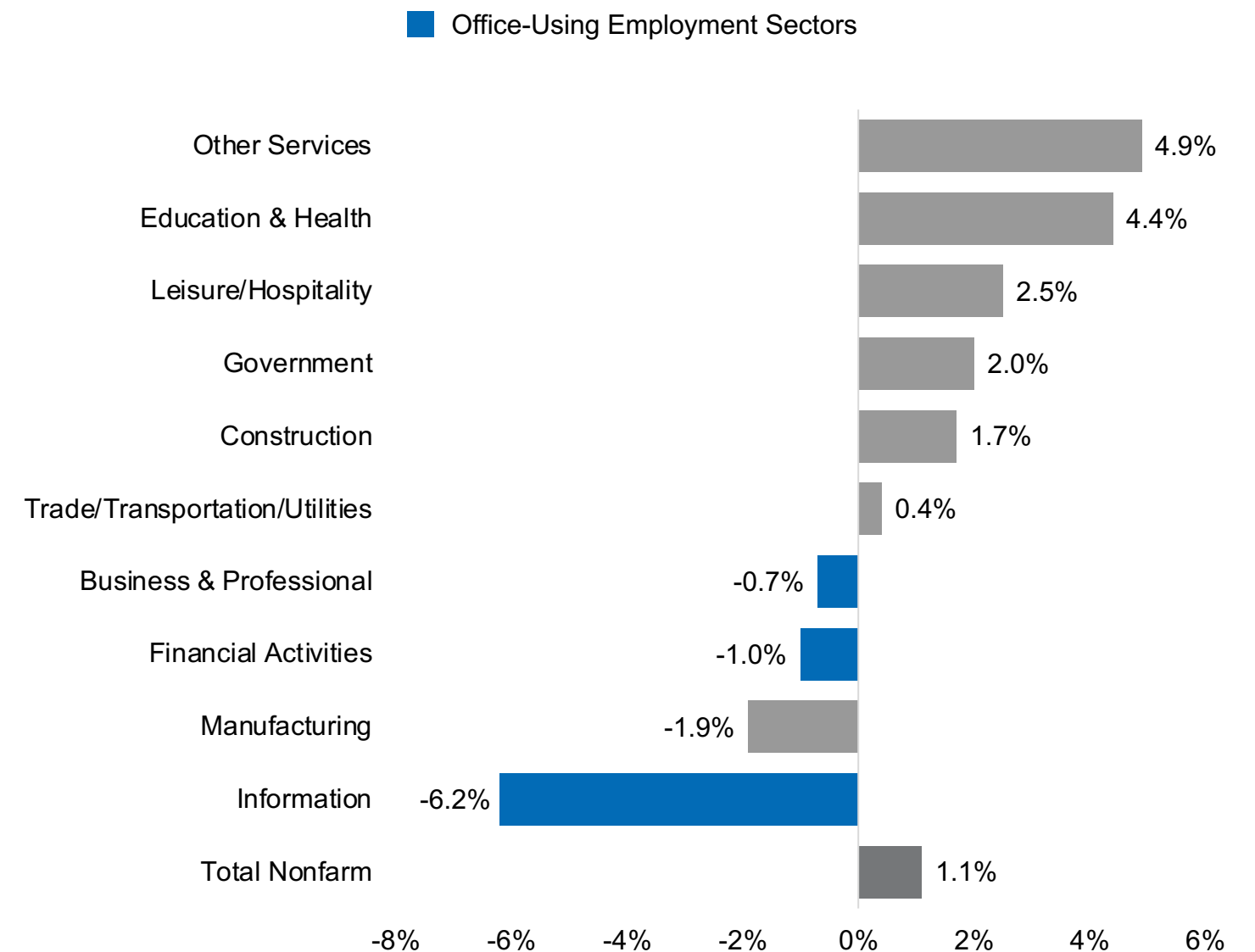
# Office-Using Sectors Lead in Job Losses

All three office-using sectors had net job declines over the last 12 months. Tech companies, which are generally grouped under the information sector, continue to focus on cost-cutting moves by shedding unneeded staff and space. Since last year, a handful of tech companies, including Activision Blizzard, ITC Federal and Ericsson, collectively laid off 1,308 workers.

Employment by Industry, May 2024



Employment Growth by Industry, 12-Month % Change, May 2024

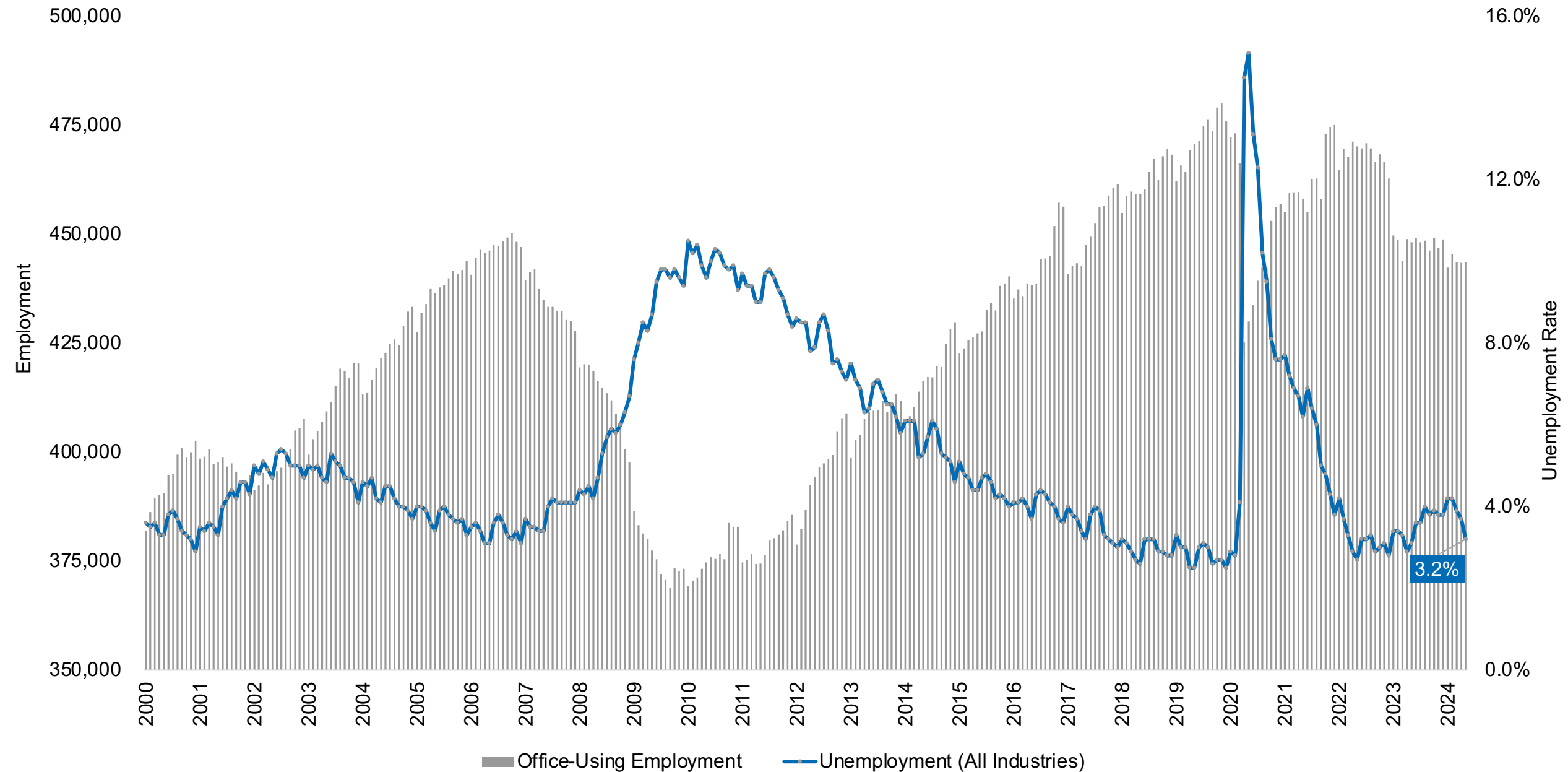


Source: U.S. Bureau of Labor Statistics, Anaheim-Santa Ana-Irvine, CA  
 Note: May 2024 data is preliminary.

# Office-Using Employment Even Despite Unemployment Drop

Office-using employment has yet to recover from the drop in January 2023 when a string of tech employers laid off hundreds of workers. Since then, office-using employment has fluctuated in a downward trajectory. Jobs in these sectors are expected to remain flat or decline modestly 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

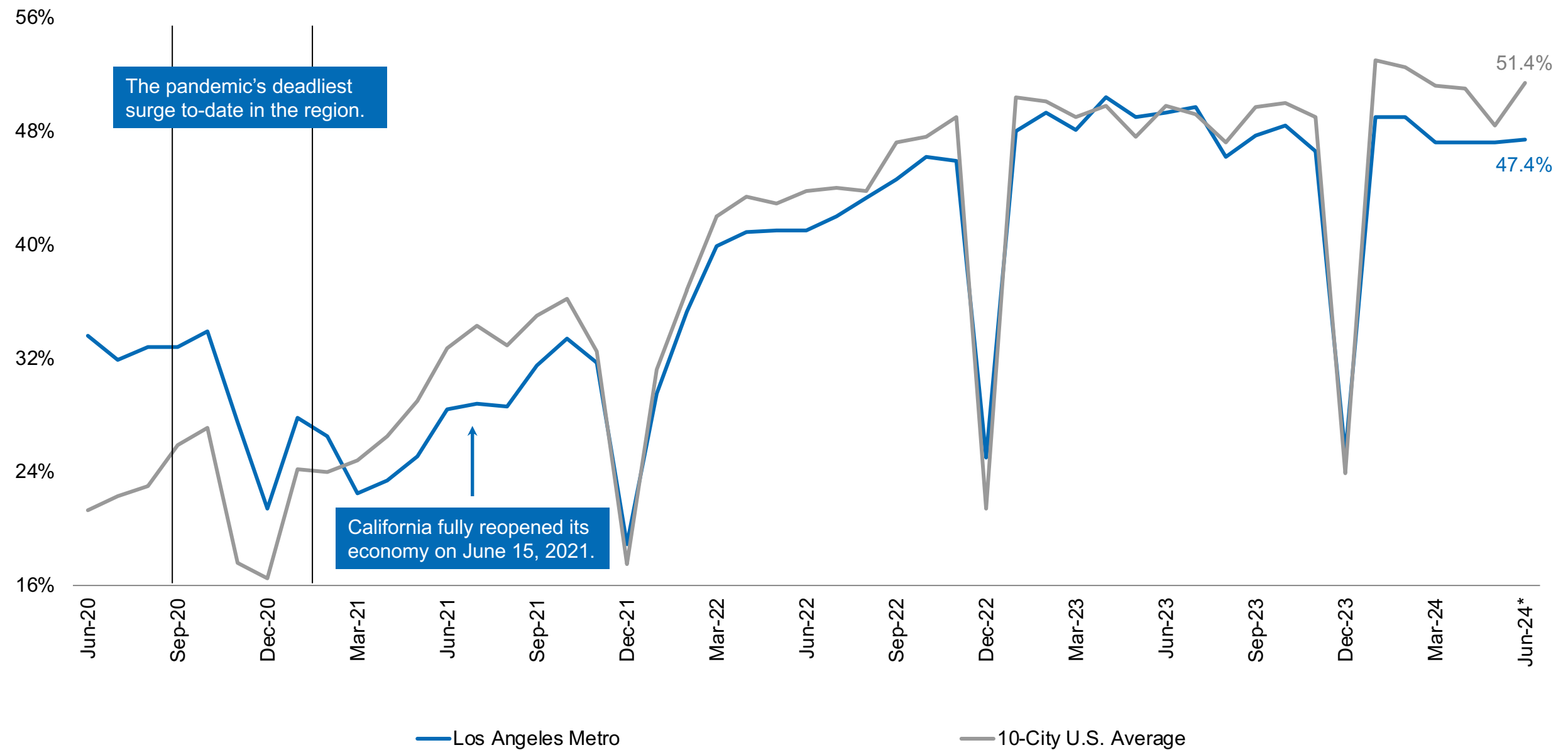
Note: May 2024 data is preliminary.

\*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 despite employers' concerted efforts in bringing workers back to the office.

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. June 2024's average is for the week of 06/26/24.



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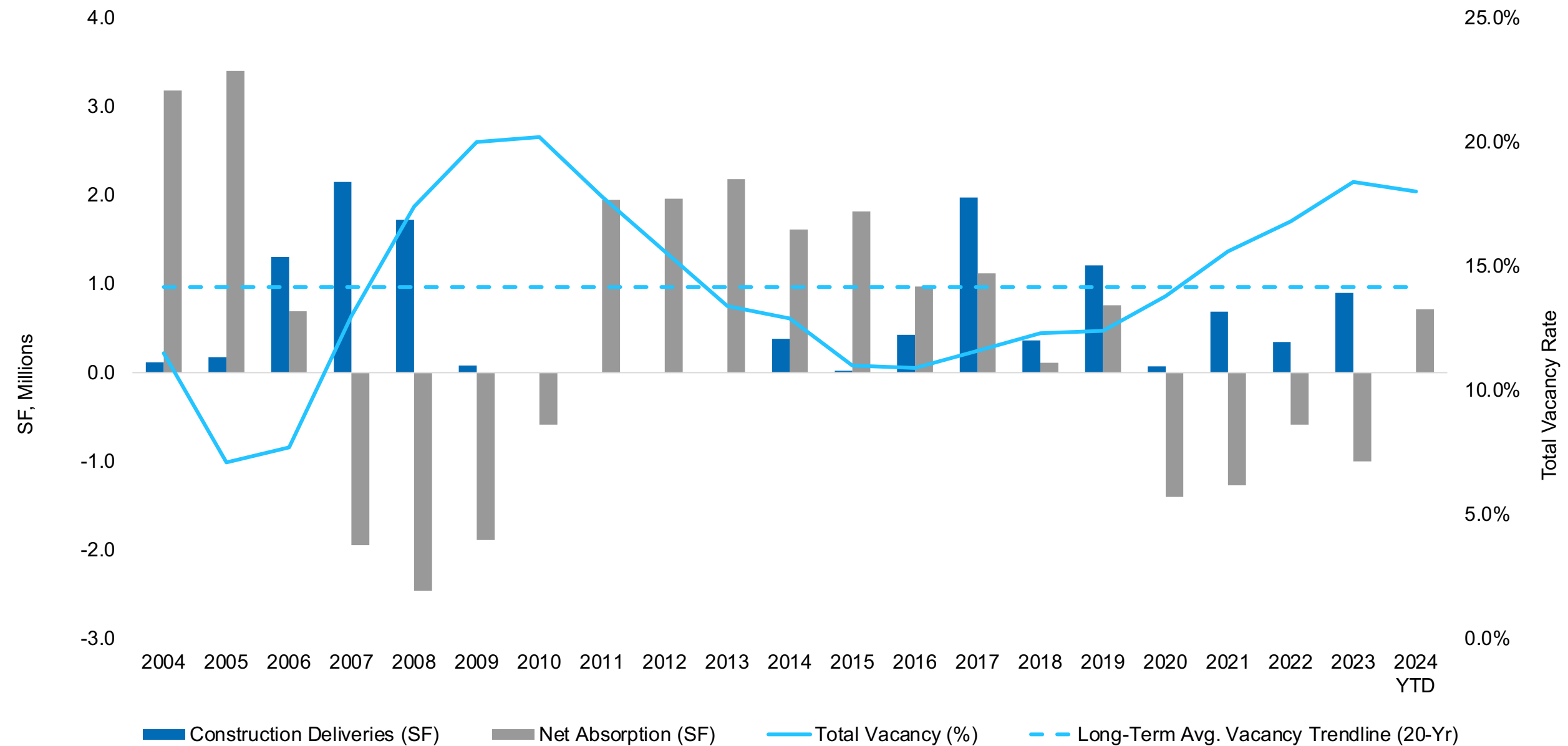
# Leasing Market Fundamentals



# Vacancy Drops After Net Absorption Boosts to 2019 Levels

Vacancy held steady at 18.4% for three quarters straight in 2023 and 18.3% in the first quarter of 2024, before ultimately dipping to today's 18.0%. As more obsolete and vacant properties get removed from overall inventory, market fundamentals are expected to normalize. In the meantime, vacancy is expected to remain elevated in the quarters to come.

## Historical Construction Deliveries, Net Absorption, and Vacancy

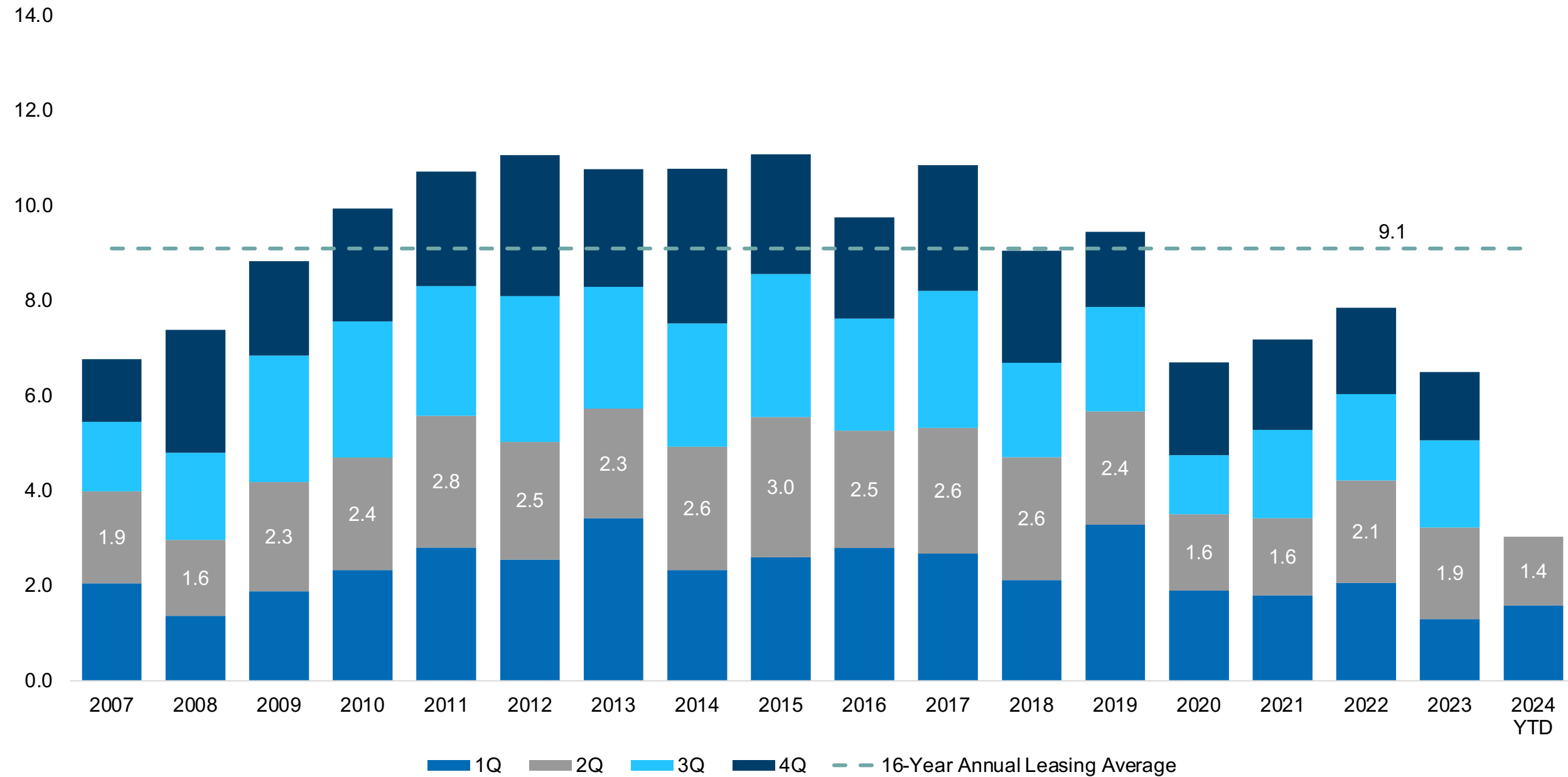


Source: Newmark Research

# Muted Leasing Activity Persists

Hybrid work models are here to stay despite employers' concerted efforts in bringing workers back to the office. That, combined with a cloudy economic outlook, are accelerating ongoing space reductions, while hampering overall leasing activity.

## Total Leasing Activity (MSF)

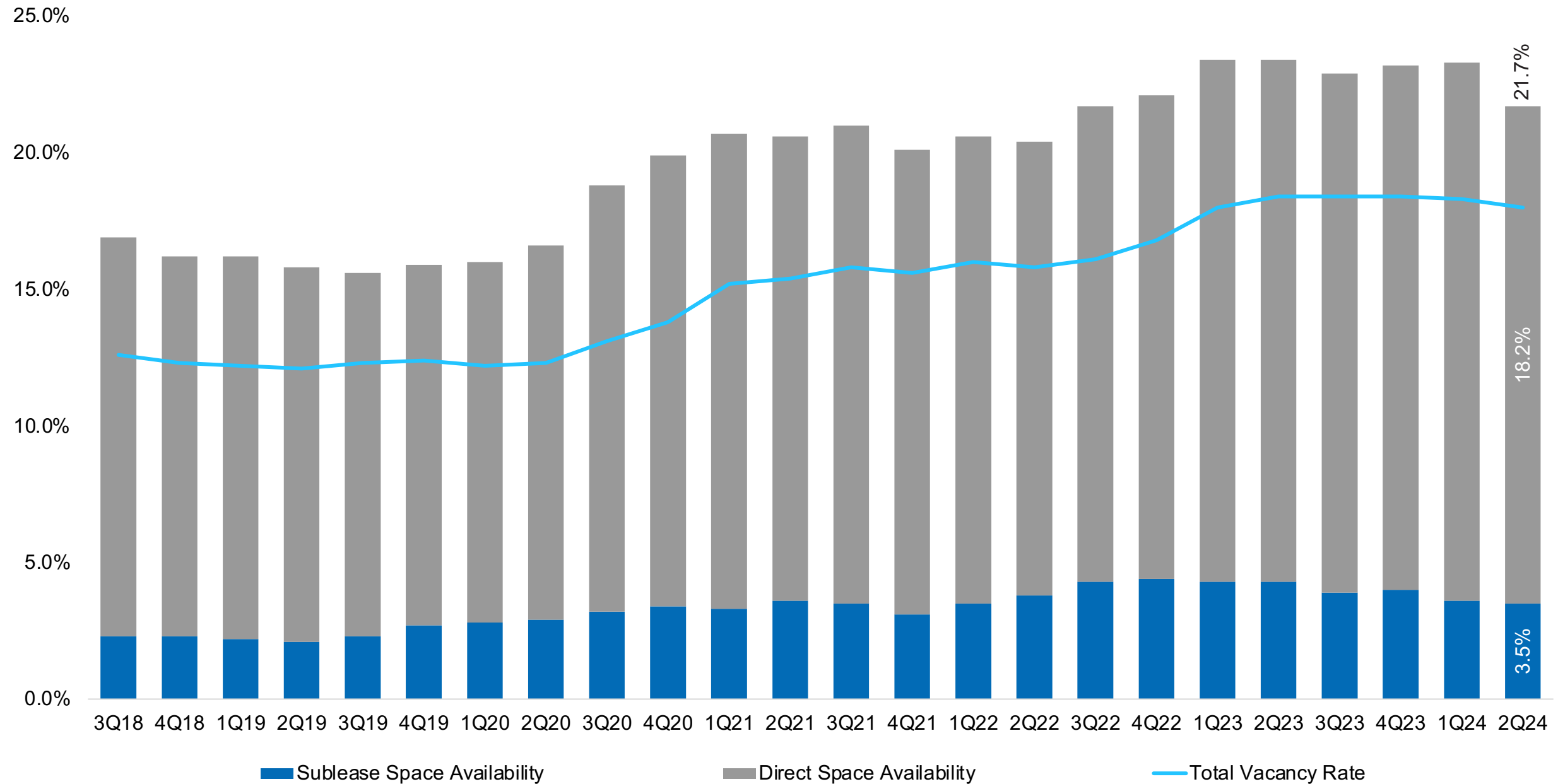


Source: Newmark Research, CoStar

# Total Availability Takes A Dip

Total availability dropped to its lowest level in eight quarters and is down to 21.7% of total inventory. The decrease in availability does not necessarily indicate an uptick in leasing activity, as some properties had listings withdrawn while others were removed from inventory.

Available Space and Total Vacancy as Percent of Overall Market



Source: Newmark Research

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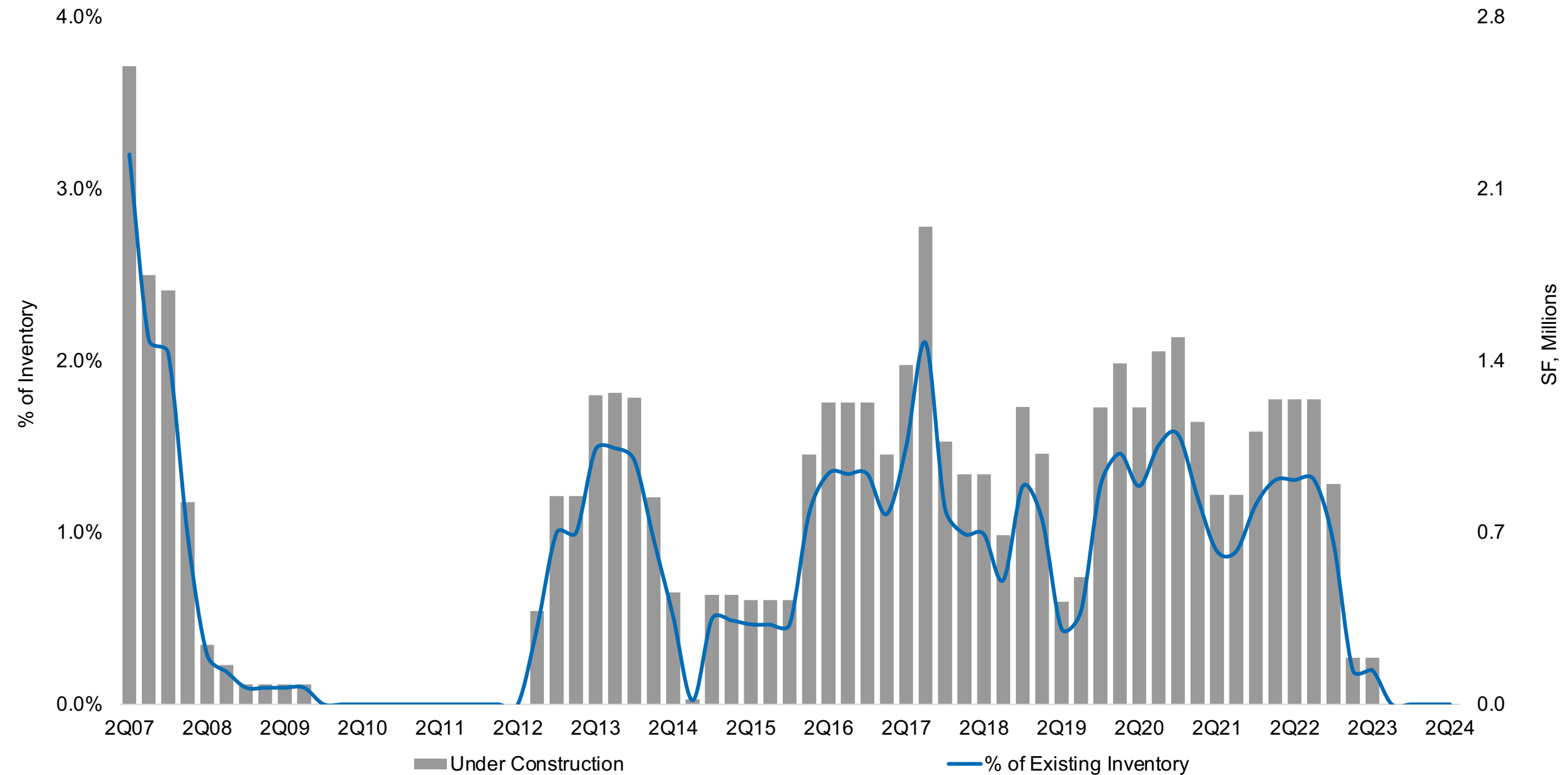
## Availability Drops Across All Submarkets

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# No Speculative Development Currently Underway

Anduril's 190,000-SF expansion at The Press delivered in the third quarter of 2023, 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

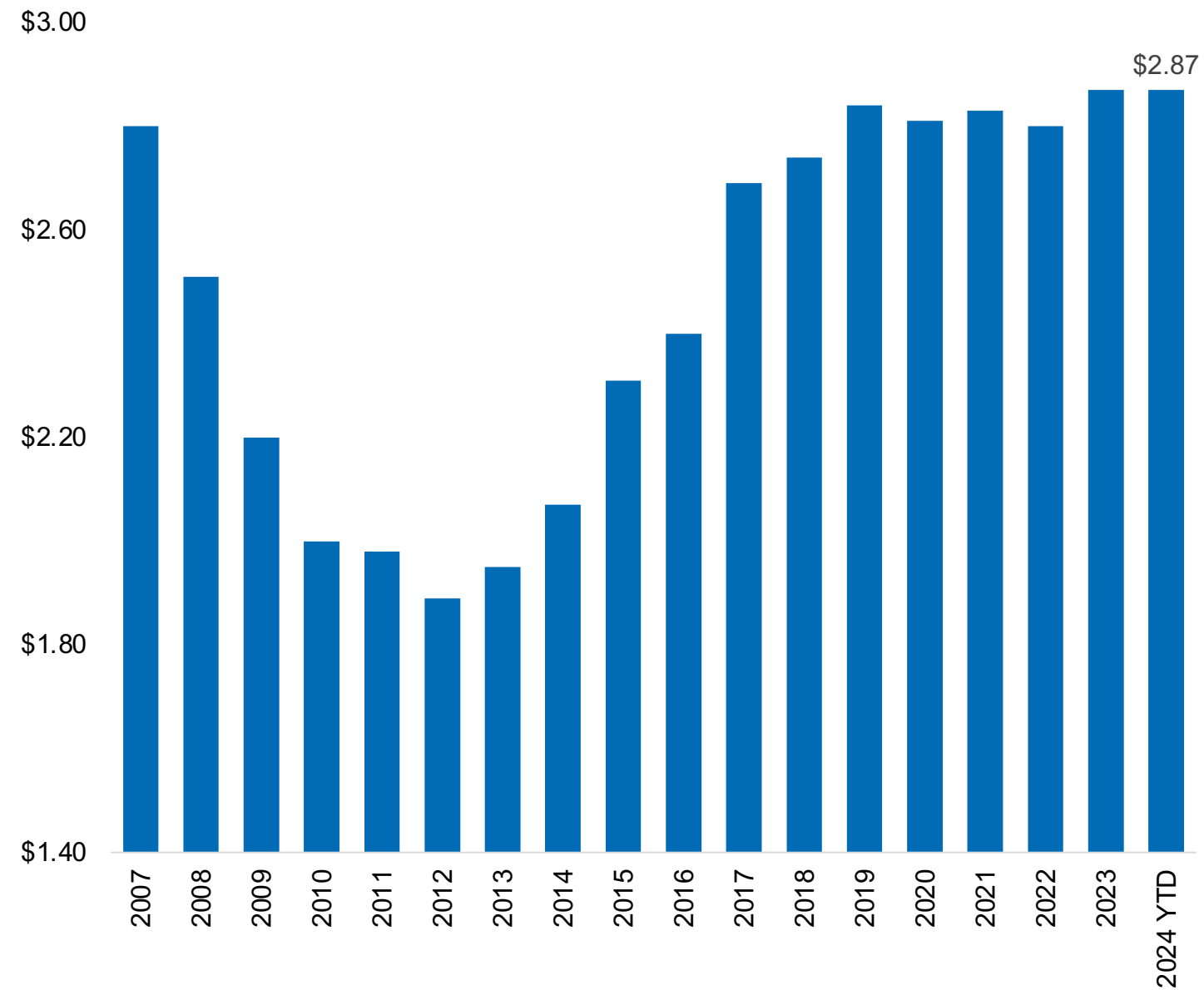


Source: Newmark Research

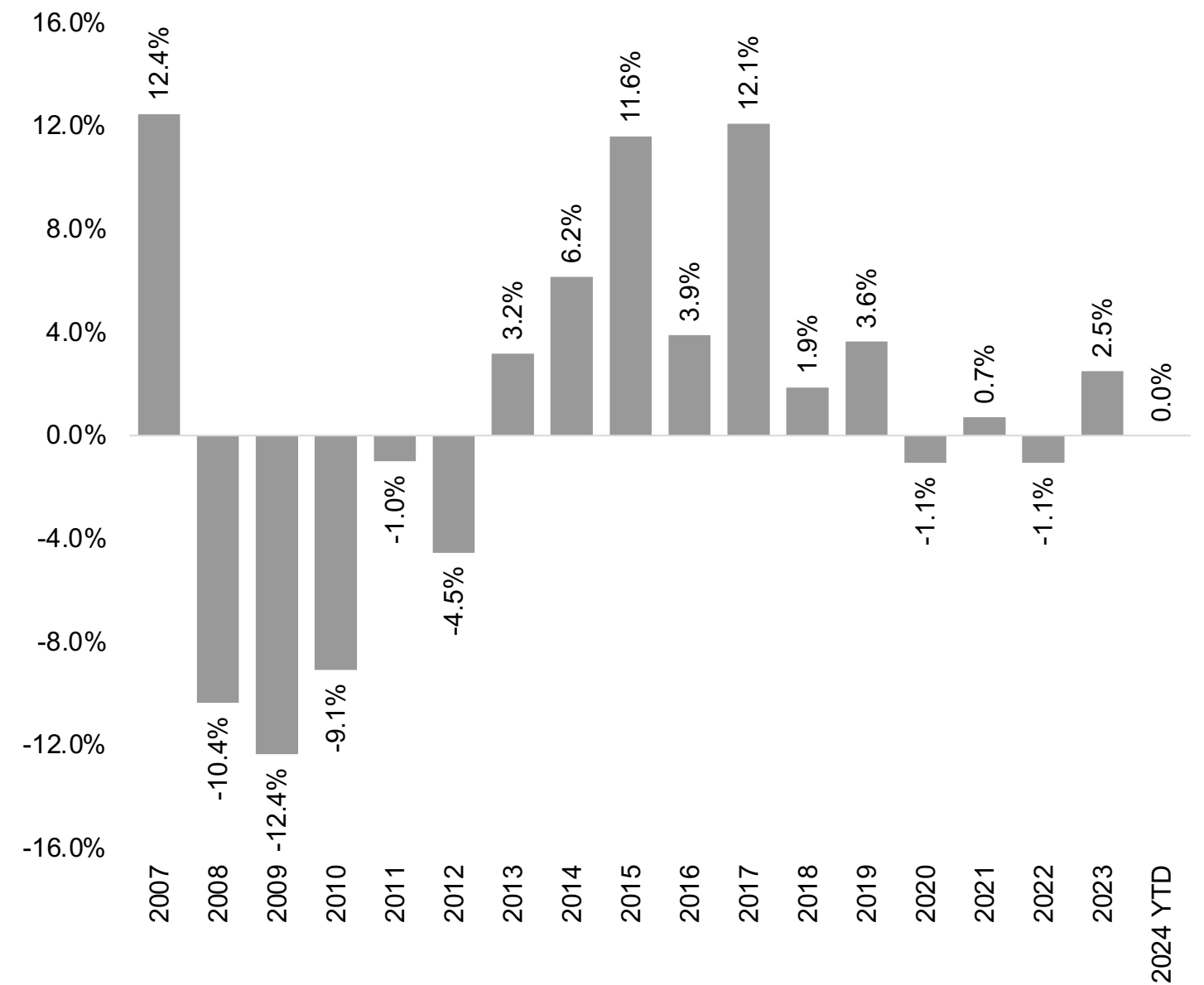
# Asking Rents Remain Elevated

Leasing activity has been subdued in recent quarters, which has caused rent growth to stall. Rents have not substantially declined despite slower activity due 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

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## Airport and South County Command the Highest Rents

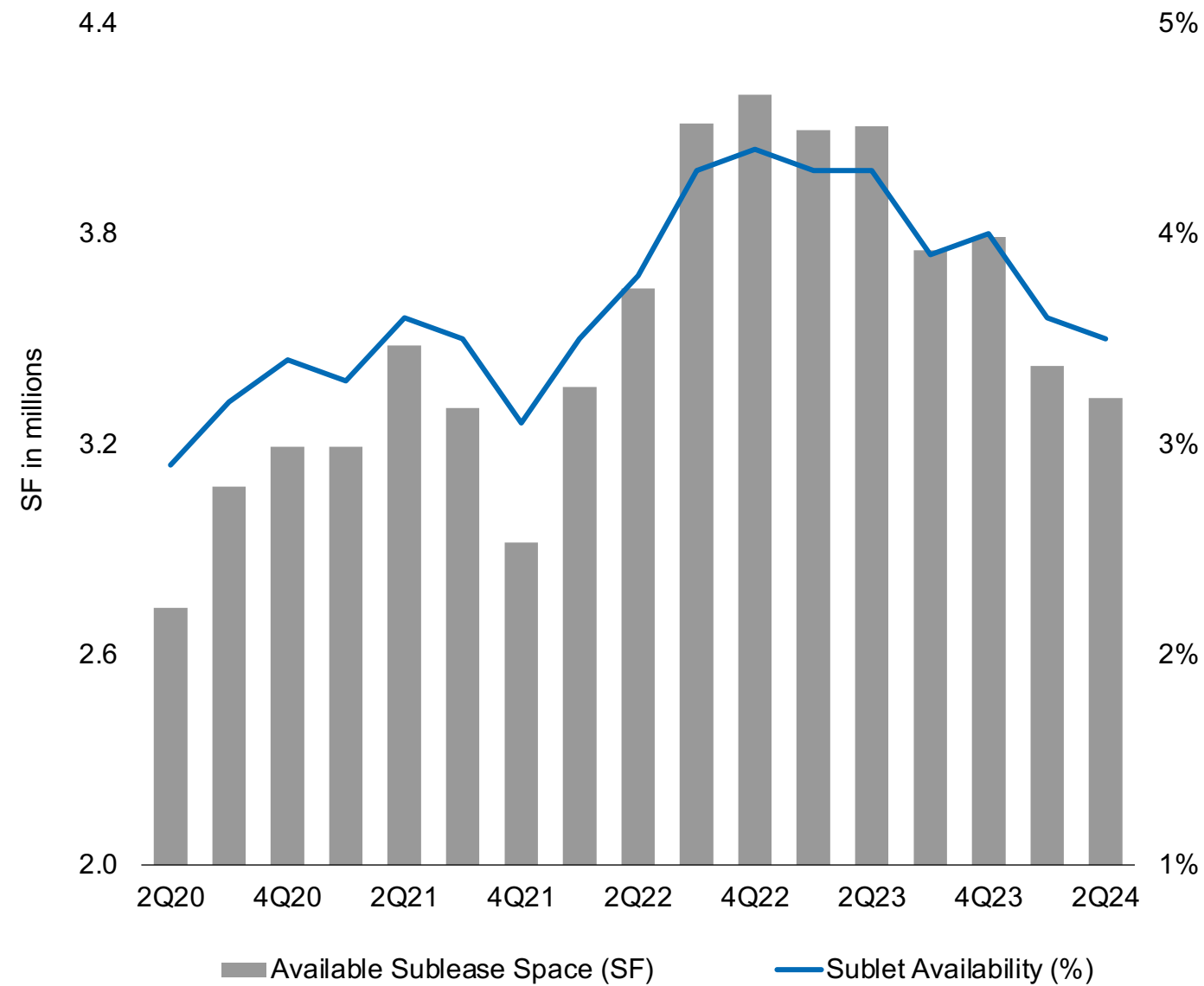
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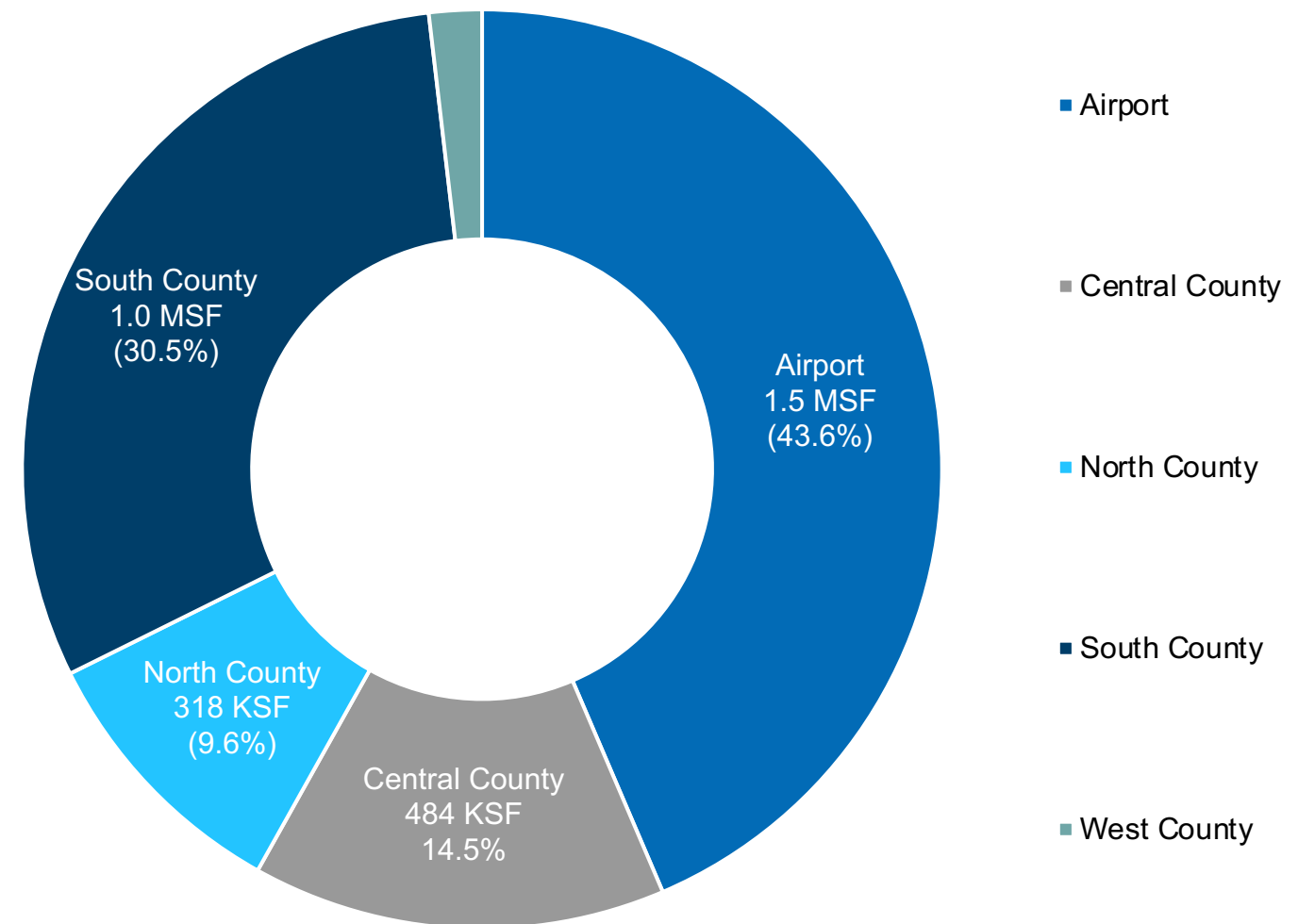
# Sublet Availability In Downward Trajectory

Since hitting an all-time high in the fourth quarter of 2022, sublet availability has since dropped by 864,076 SF. At the submarket level, Airport leads others in available sublease space, with 1.5 MSF or 43.6% of Orange County's sublet pool.

Available Sublease Space: Greater Market



Available Sublease Space by Submarket



Source: Newmark Research

# Airport Area Dominates Top Leasing Activity Once Again

For the second quarter in a row, the greater market's top five leases were signed in the Airport Area. The submarket's central location and trophy space options makes it a top choice for corporate occupiers aiming to bring their workers back to the office.

## Notable 2Q24 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
Latham & Watkins LLP	650 Town Center Dr	Airport	Lease Renewal	65,825
<i>The law office has been at its current location for over 25 years.</i>				
Bonfire Studios	18600 MacArthur Blvd	Airport	Lease Renewal/Expansion	45,920
<i>The video game developer expanded its office footprint more than five times at a Class A building it has been at since 2018.</i>				
Fisher & Phillips LLP	2050 Main St	Airport	Lease Extension	44,304
<i>The tenant plans to commit to its existing space for an additional 10 years.</i>				
Liberated Brands	555 Anton Blvd	Airport	Sublease	41,055
<i>The apparel company, whose headquarters is less than ten miles away in Costa Mesa, will take over Synchrony Financial's lease. The sublease runs through 2027.</i>				
California Pizza Kitchen	575 Anton Blvd	Airport	Direct Lease	37,875
<i>California Pizza Kitchen signed a new lease at its existing space at The MET after its sublease from 2021 expired.</i>				

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# Office Distress and Redevelopment to Other Uses



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

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35.1% of the Office Market Obsolete or Unable to Service Debt

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## Some Underperforming Office Properties Slated for Redevelopment

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## Obsolete Office Properties Dropped From Total Inventory

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Removal Of Undesirable Product From Inventory Will Recalibrate Office Vacancy

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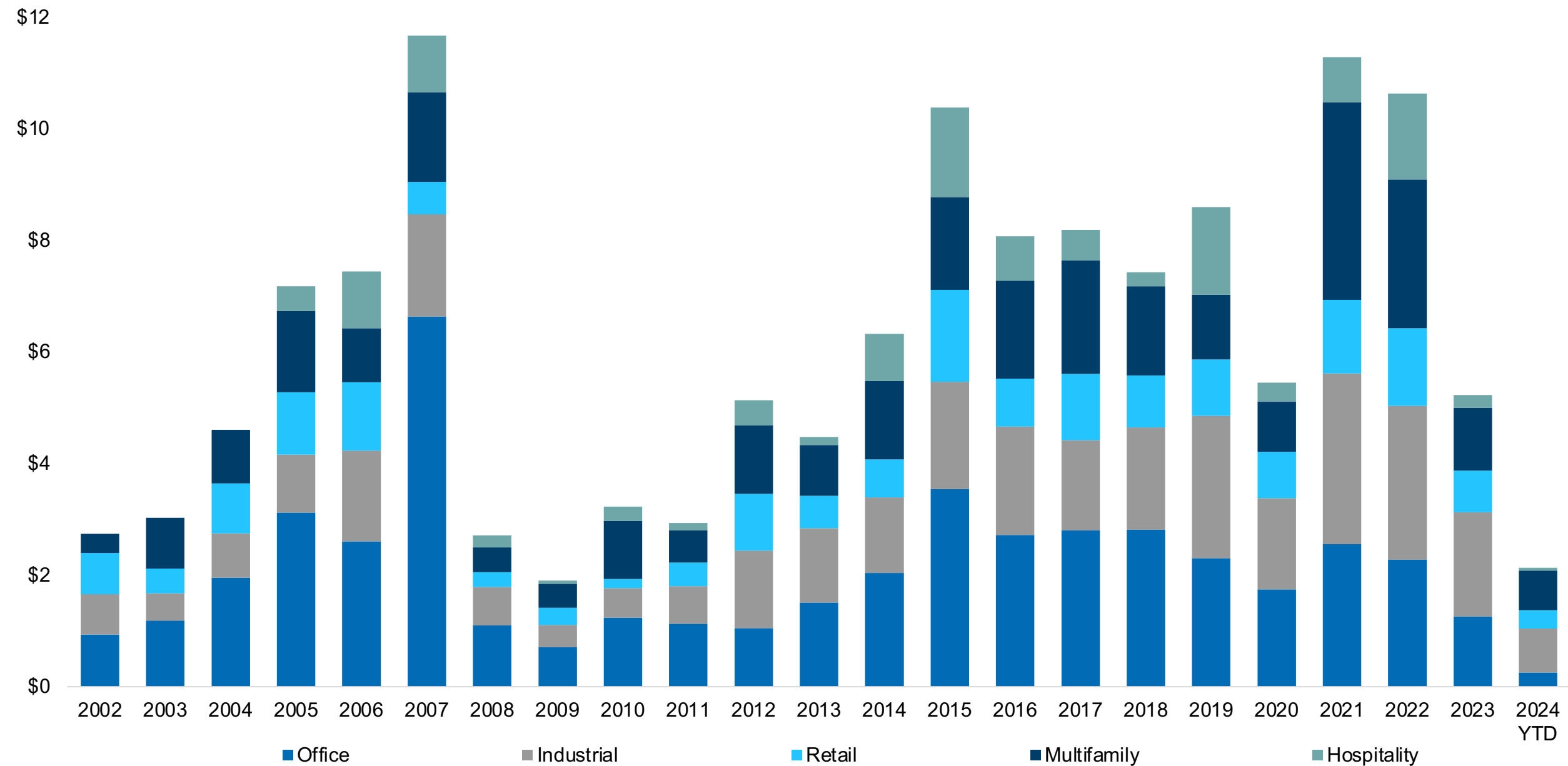
# Sales Activity



# Office Comprised Just 11.9% of Total Sales Volume in the First Half Of The Year

This is a significant decline from 2018, when office comprised 37.9% of total volume. Structural shifts in leasing dynamics since the onset of COVID-19 remain an ongoing challenge for the property segment. This contrasts with 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)

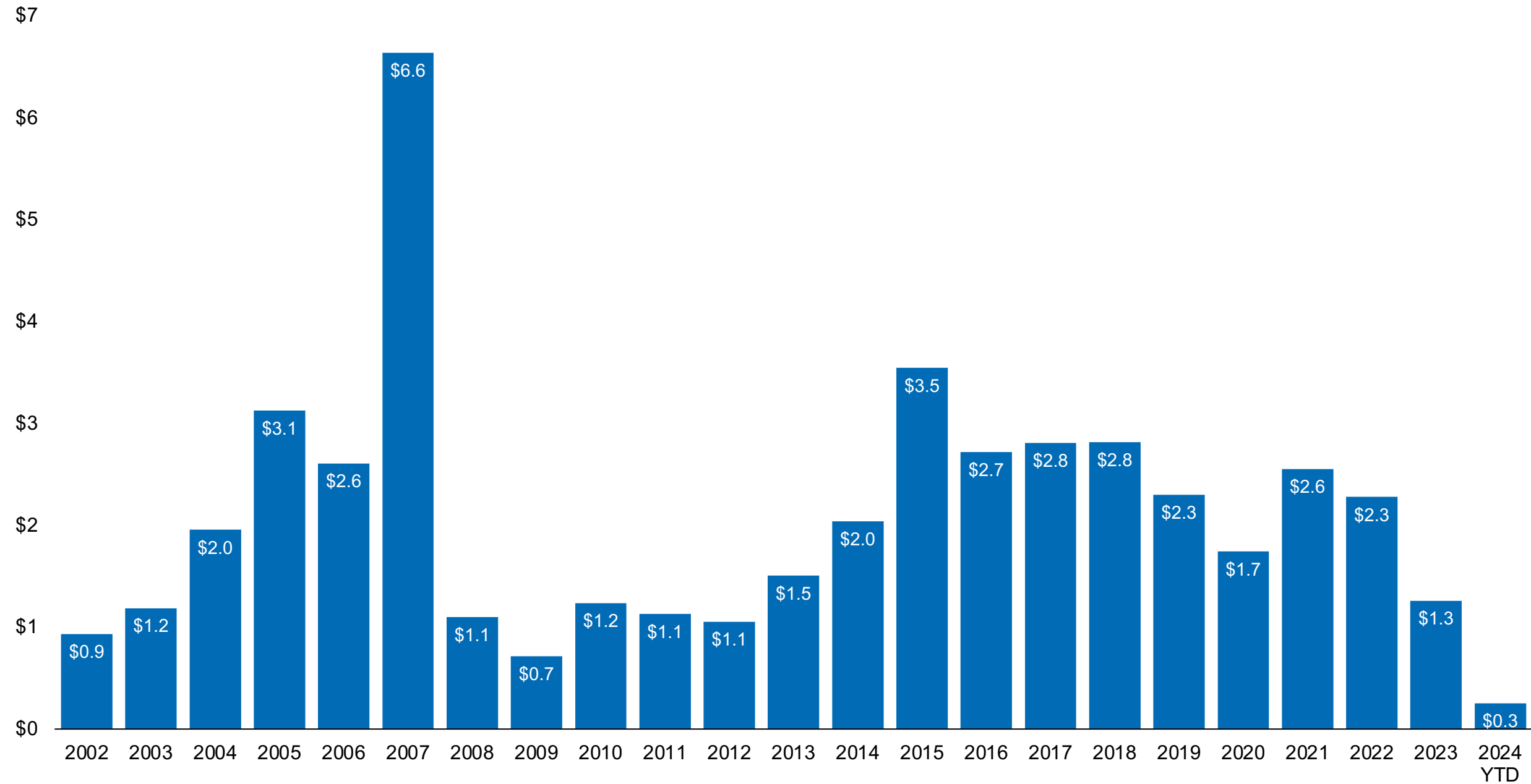


Source: MSCI Real Capital Analytics, Newmark Research  
 Note: Preliminary data is cited for the second quarter of 2024.

# Office Sales Volume: Up Close

Office sales volume totaled just \$254 million in the first half of the year, following \$1.3 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. Others are shifting capital to different asset classes, such as industrial.

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



Source: Newmark Research, MSCI Real Capital Analytics  
Note: Preliminary data is cited for the second quarter of 2024.

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Pricing is Decreasing, While Cap Rates Will Increase

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## Opportunistic User Buyers Take Advantage Of Discounted Office Market

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# Submarket Snapshots



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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



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# Orange County Office Submarket Map and High-level Statistics | 2Q24

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