

3Q24

NEWMARK

# Orange County Office Market Overview





# Market Observations

## Economy

- Local unemployment increased from 3.2% in May to 4.5% in August, reaching its highest level since 2021. A drop in non-farm jobs, specifically in the information and manufacturing sectors, is a factor as businesses continue to scale back.
- Since the start of the year, office-using employment saw a modest gain of 7,100 jobs despite an increase in unemployment in the same period. Office-using employment is still recovering jobs that were lost in January 2023 after a series of tech companies laid off thousands of workers.
- The Fed finally cut to its benchmark interest rate by 50 basis points in September after raising it eleven times and bringing it to its highest level in 22 years. Lower interest rates have historically encouraged leasing and sales activity.

## Major Transactions

- Google Inc. renewed its 197,506-SF space at the Google Center in Irvine, marking the largest lease of the year. This quarter's top leases were primarily renewals.
- TGS Management, a hedge fund company that purchased a pair of office buildings in Irvine with plans for a warehouse conversion, sold 1 and 3 Banting to Bridge Industrial for \$60 million. The new owner is expected to take over the project, which would be one of the largest office-to-industrial conversions in the Irvine Spectrum.
- Owner-users are taking advantage of the discounted office inventory and purchasing properties at a fraction of their cost. This quarter, electronics manufacturer TP-Link paid \$41 million for 5 Peters Canyon Rd, a 157,279-SF office building in Irvine. The City of Irvine also purchased 17101 Armstrong Ave, a 57,301-SF office property, in the same area for \$13 million.

## Leasing Market Fundamentals

- Vacancy dropped to 17.9% this quarter but remains elevated by historical standards. Total vacancy is 200 bps above the five-year average.
- Net absorption is positive for the fifth quarter in a row, totaling 54,269 SF in net gains. The largest move-in of the quarter was by St. John Knits International Inc. occupying its new 84,493-SF headquarters in Anaheim.
- 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.
- Some underperforming office properties will find new life as multifamily, industrial or medical developments. This, along with owner-user sales, will exert downward pressure on the region's office inventory, vacancy and availability.

## 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 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.
- Following the Fed's long-awaited reduction in interest rates, investors and employers are expected to focus on expansion efforts as economic conditions continue to improve in the quarters ahead. 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. Distress and Office Conversions
4. Sales Activity
5. Submarket Snapshots
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# Economy

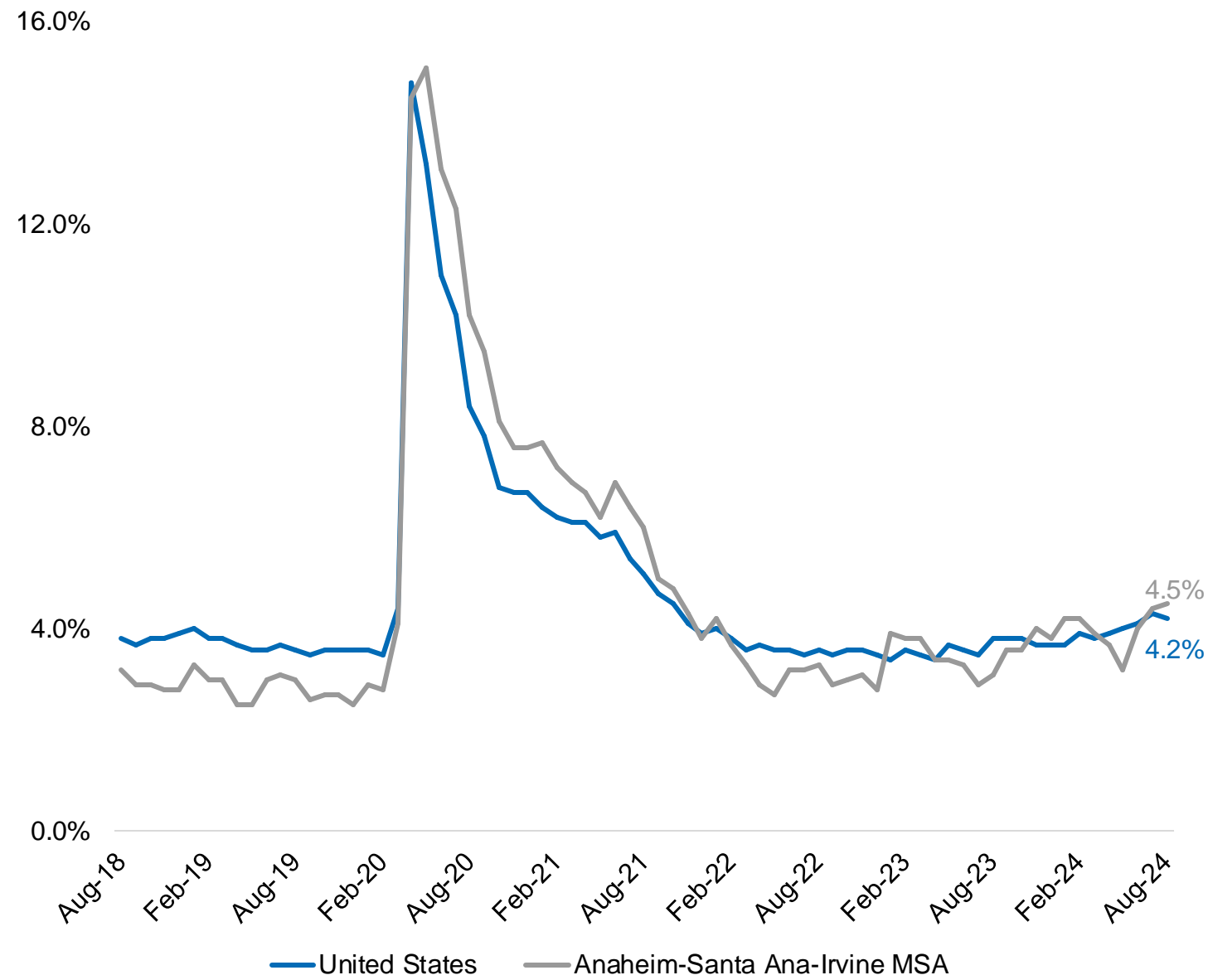




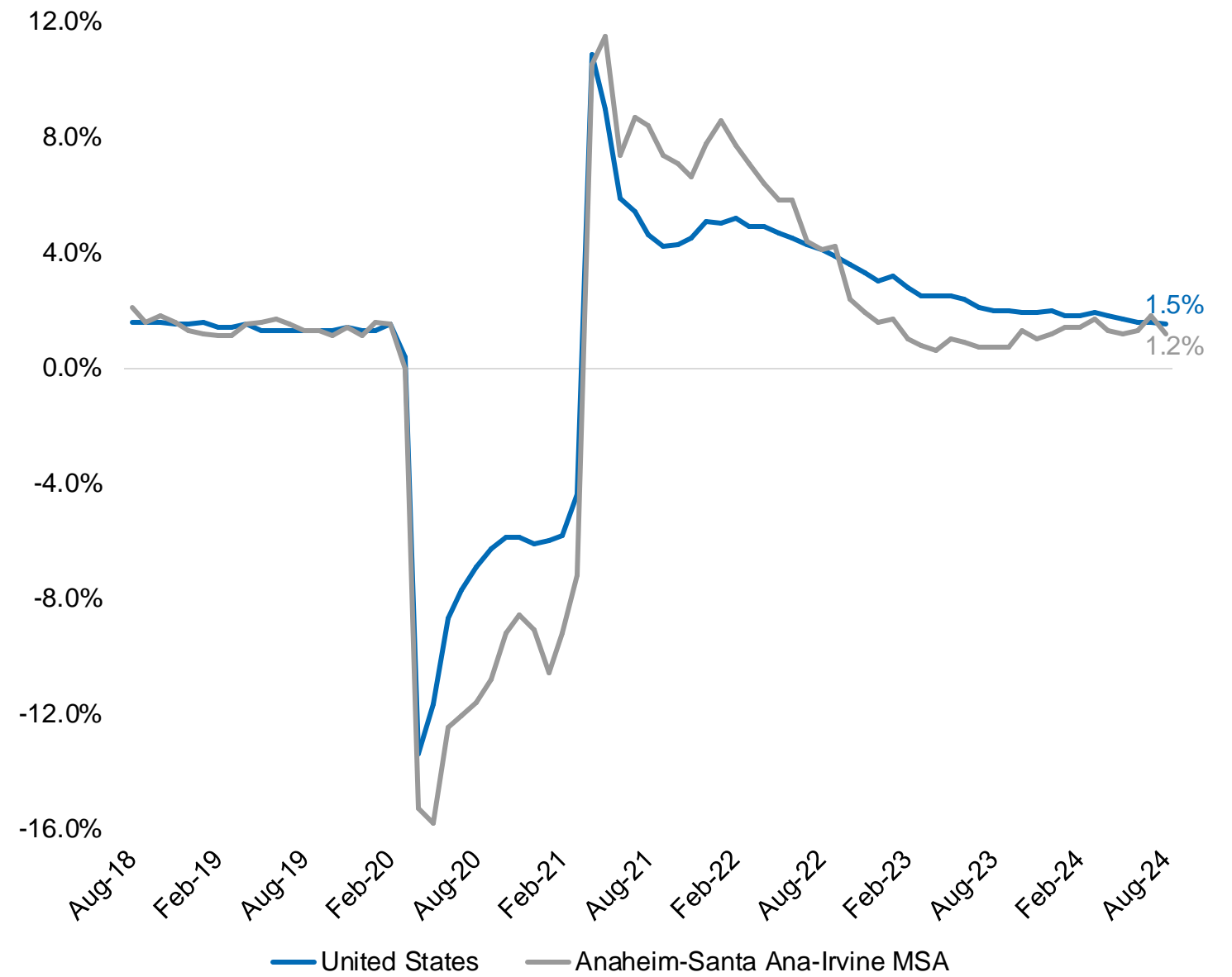
# Local Unemployment Reaches Its Highest Level Since 2021

Orange County's unemployment rate increased by 140 basis points from August 2023 to August 2024 primarily due to businesses implementing workforce reductions as a cost-cutting measure, especially in the manufacturing and information technology sectors. Year-over-year nonfarm payroll employment growth is ongoing despite increases in unemployment.

Unemployment Rate, Seasonally Adjusted



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

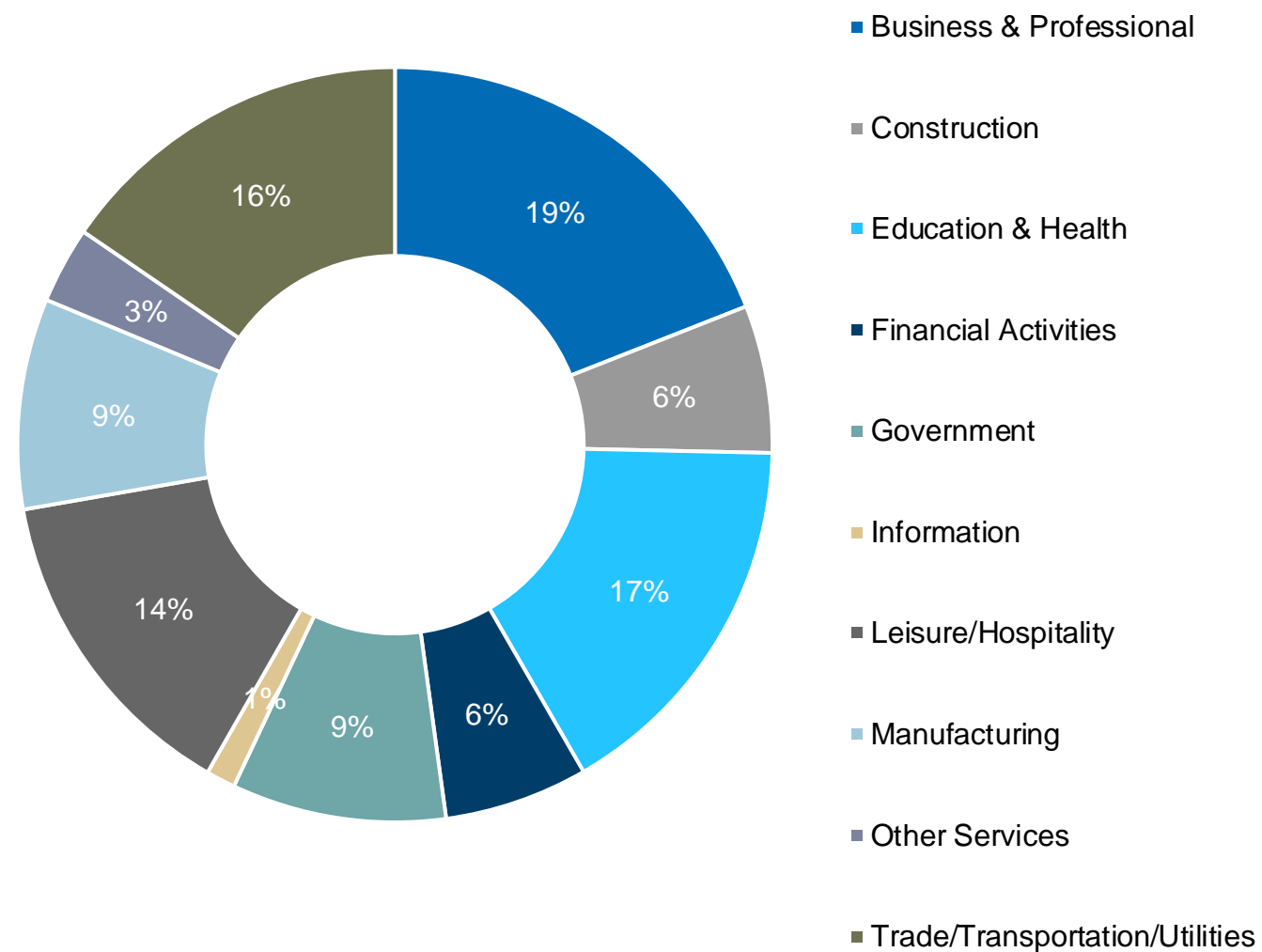


Source: U.S. Bureau of Labor Statistics, Anaheim-Santa Ana-Irvine, CA  
 Note: August 2024 data is preliminary.

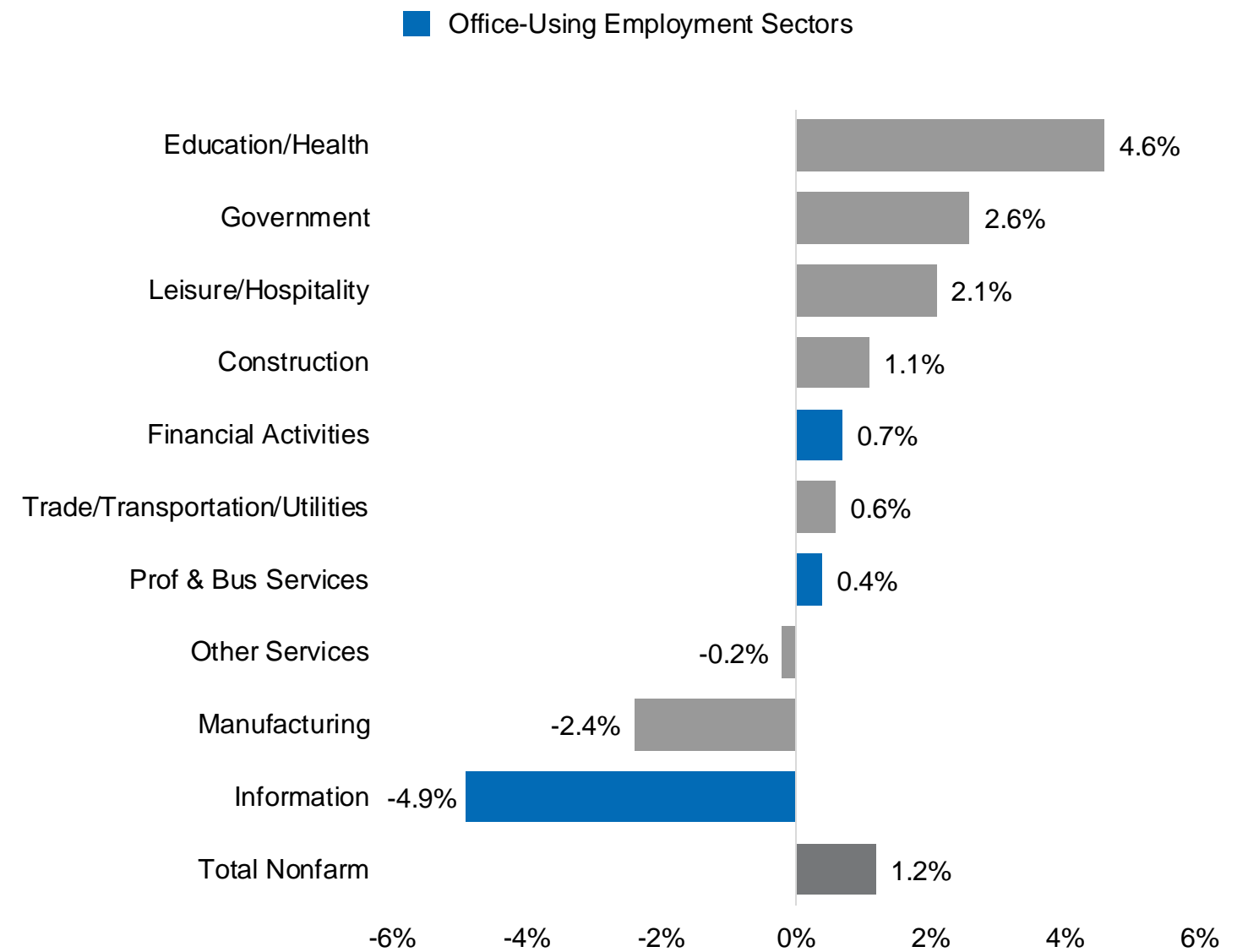
# Information and Manufacturing Sectors Lead in Job Losses

Tech companies, which are generally classified under the information sector, continue to focus on cost-cutting moves by shedding unneeded staff and space. Automation of jobs combined with elevated costs of doing business are also pressuring manufacturing companies to downsize. Just over the last quarter a handful of tech and manufacturing companies, including Activision Blizzard, ITC Federal, UKG Inc., Edwards Lifesciences and Jabil Inc., collectively laid off 680 workers.

Employment by Industry, August 2024



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

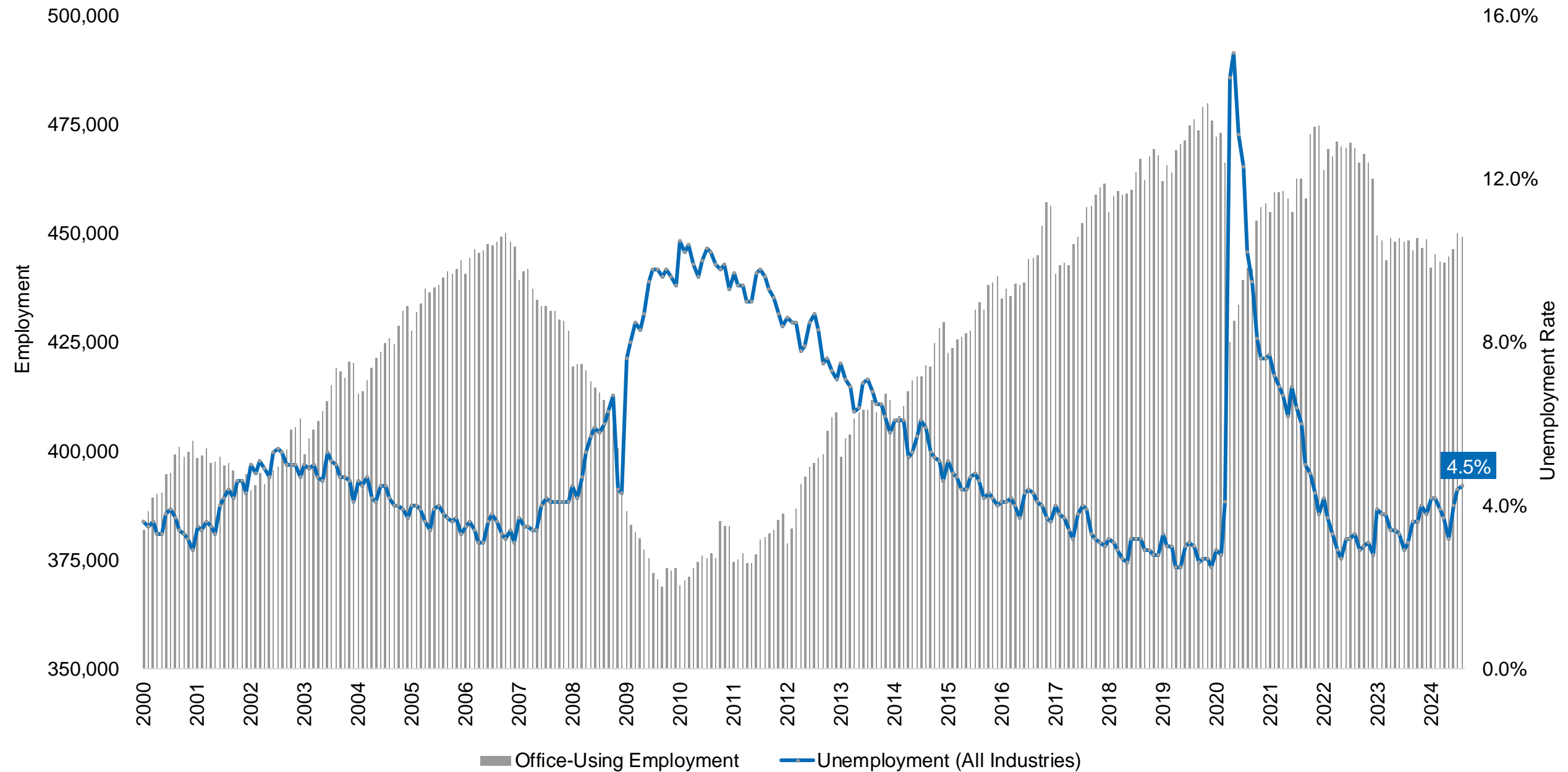


Source: U.S. Bureau of Labor Statistics, Anaheim-Santa Ana-Irvine, CA  
 Note: August 2024 data is preliminary.

# Office-Using Employment Still In Recovery Mode

Office-using employment has yet to recover from the drop in January 2023 after a string of tech employers laid off thousands of workers. Since then, office-using employment has fluctuated. 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

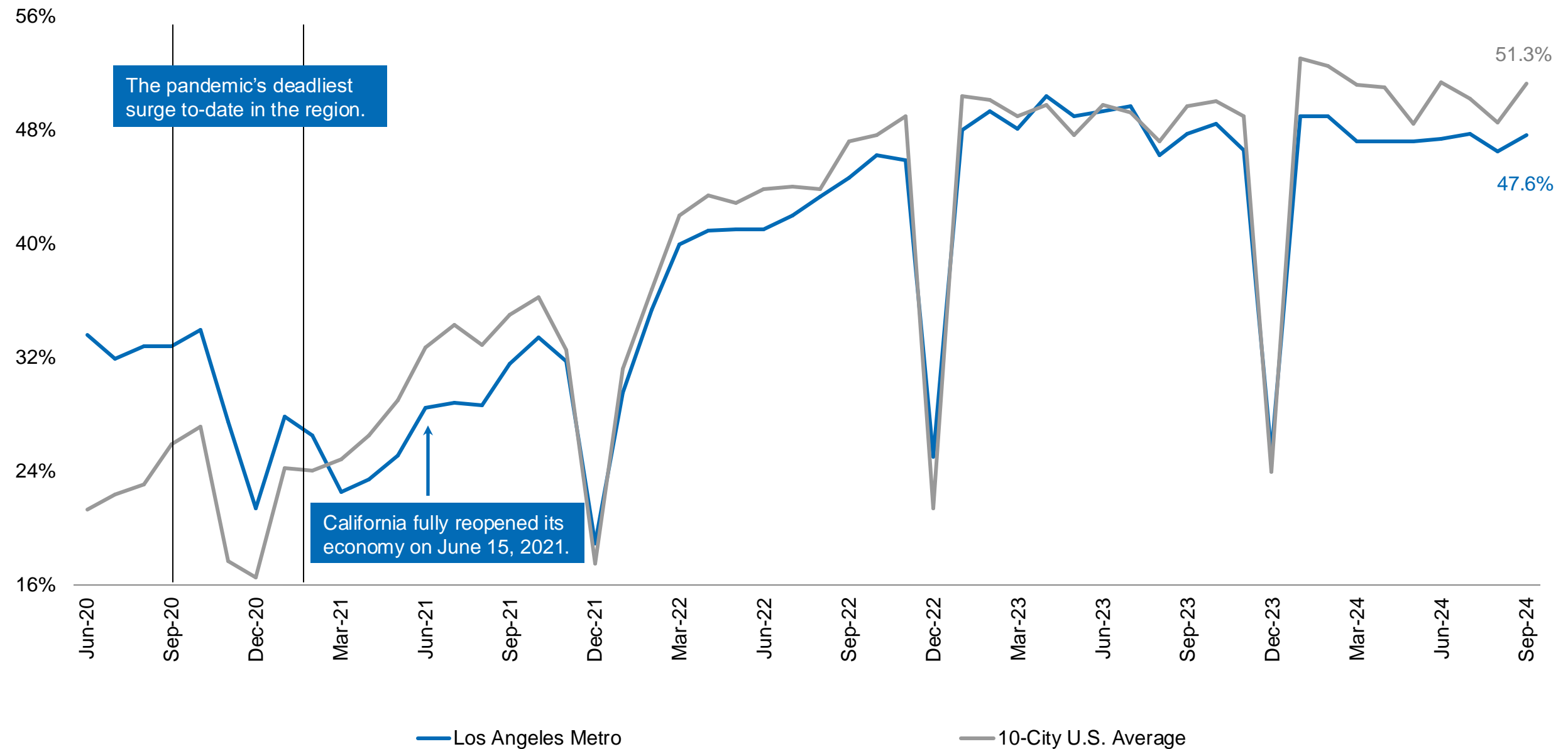
Note: August 2024 data is preliminary.

\*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.



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# Leasing Market Fundamentals

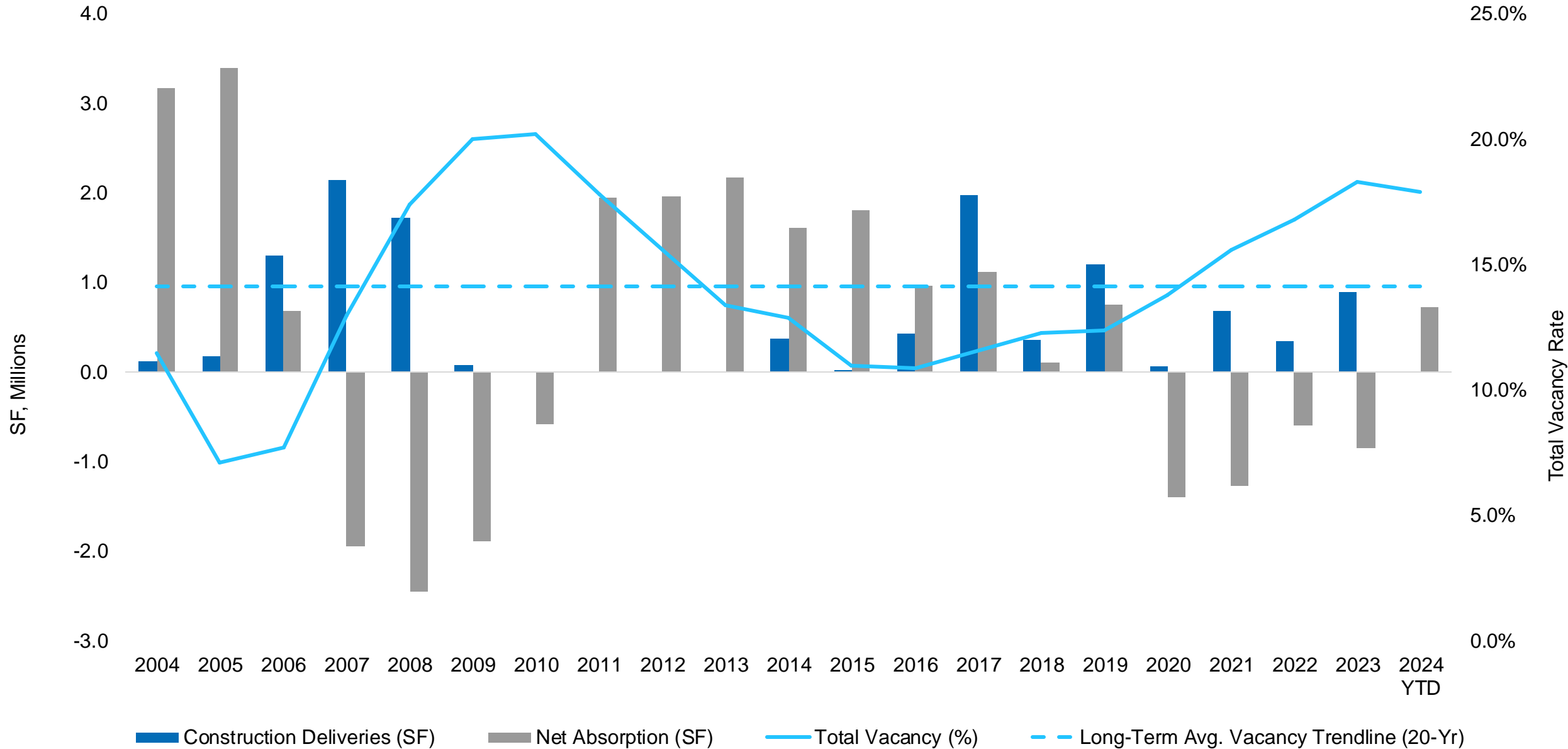




# Year-To-Date Net Absorption Is Positive For the First Time Since The Pandemic

Vacancy dropped from 18.4% to 17.9% over the last year as the metro boasted positive absorption for five consecutive quarters. 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



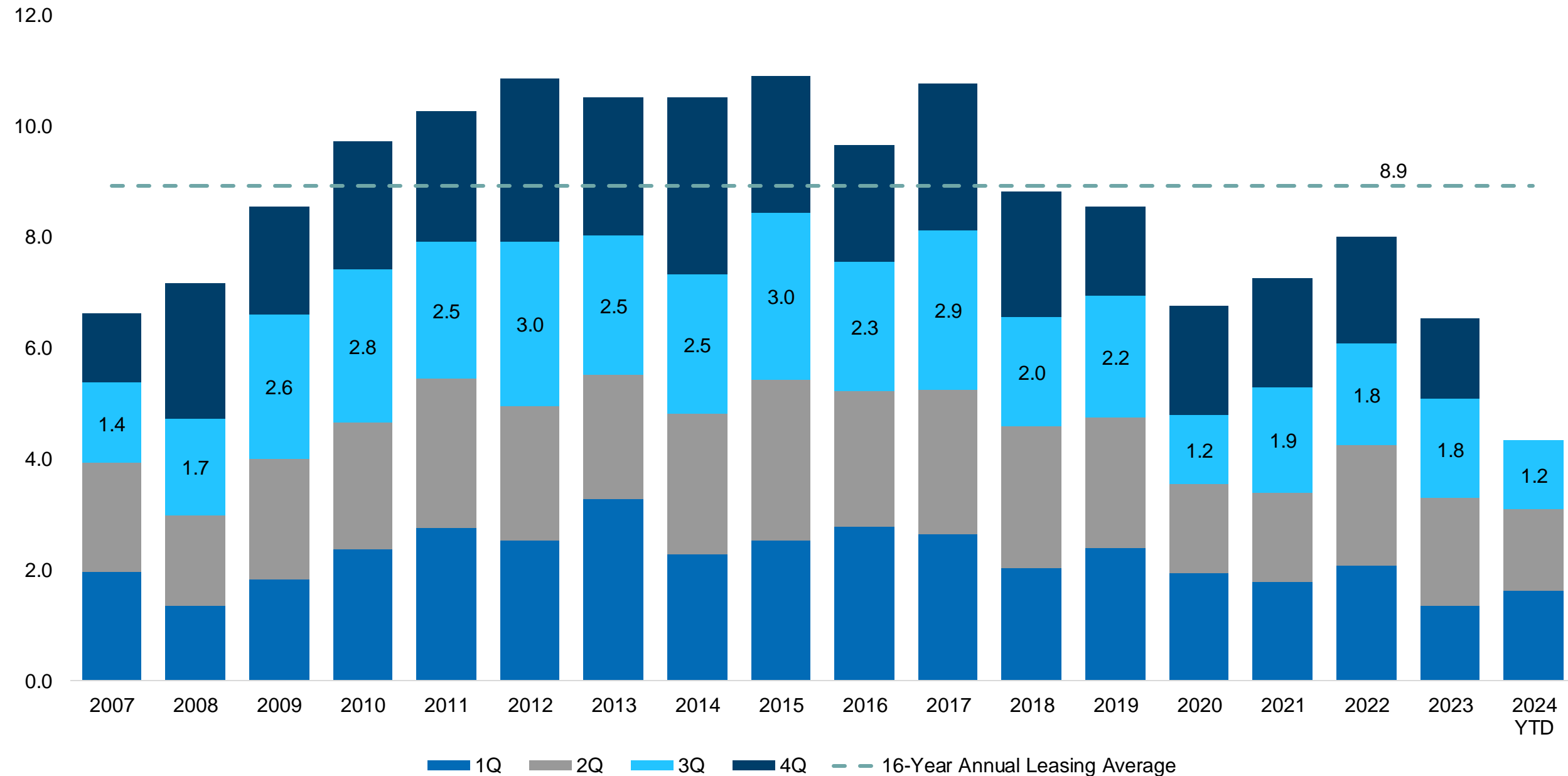
Source: Newmark Research



# Slowed Third Quarter Leasing Activity Hampers Year-To-Date Totals

Hybrid work models remain the general norm 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)

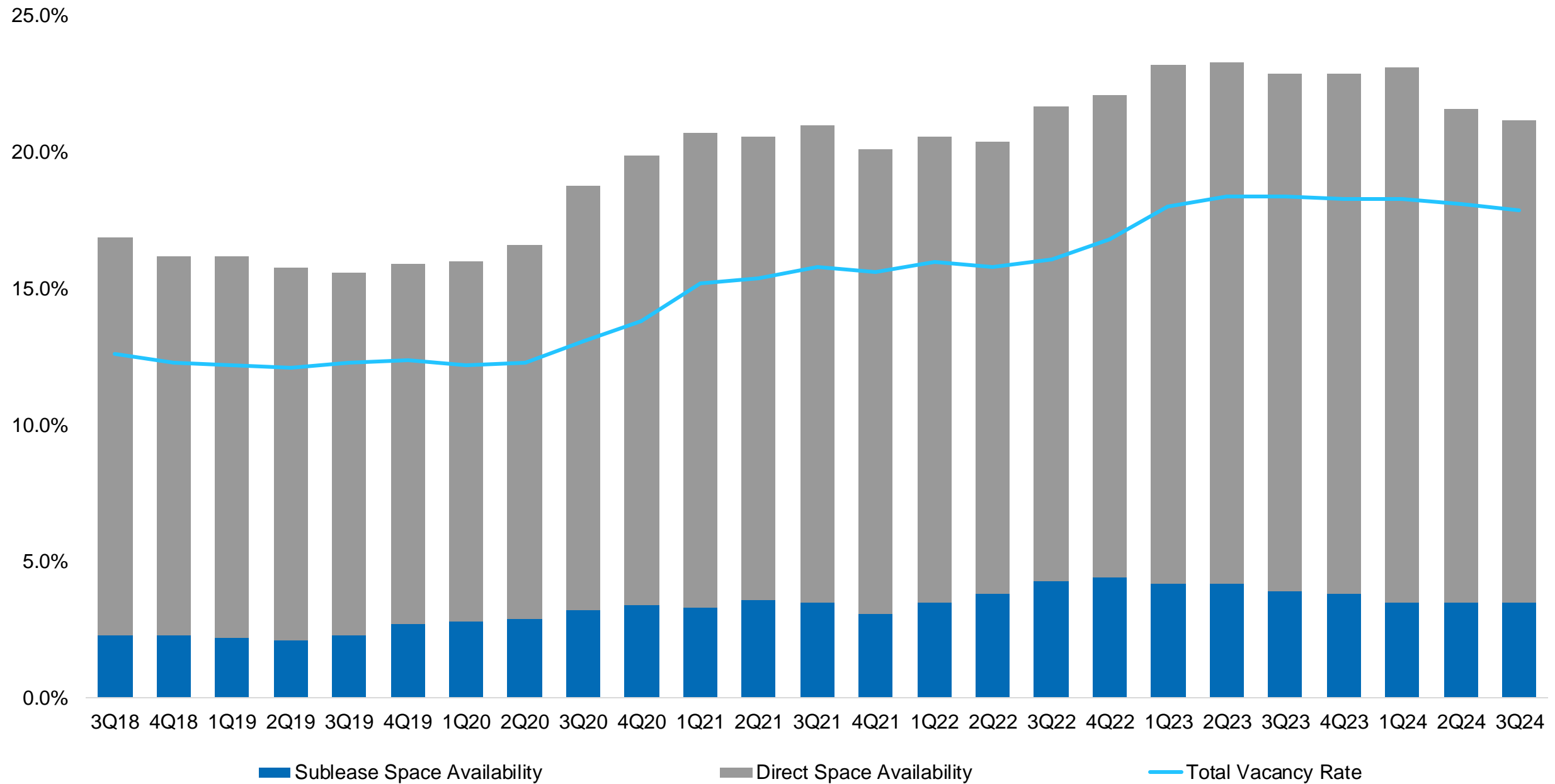


Source: Newmark Research, CoStar

# Total Availability At Its Lowest Level In Two Years

Total availability dropped to its lowest level in nine quarters and is down to 21.2% 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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## Total Availability Fluctuating Across All Submarkets

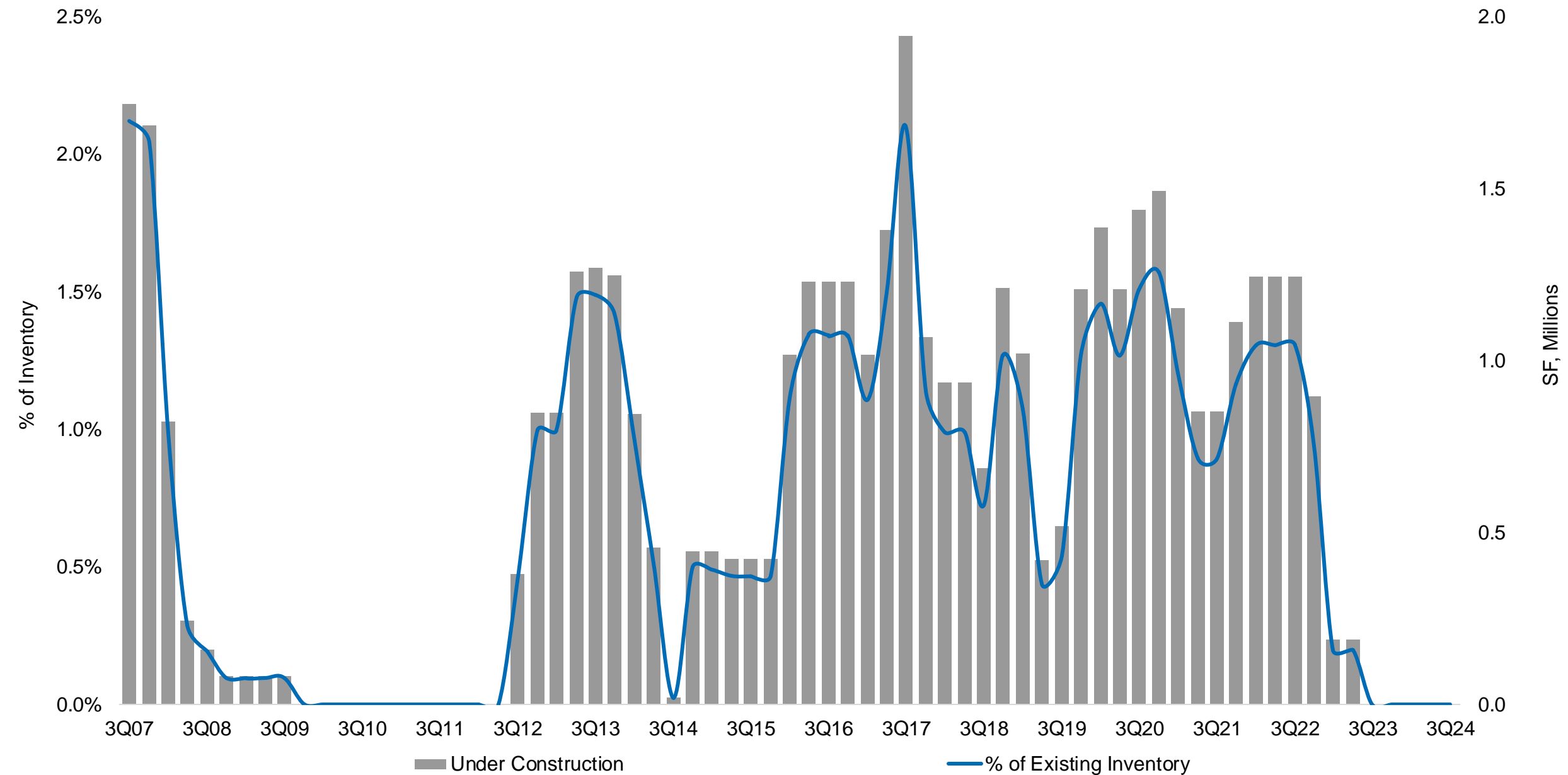
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# No Speculative Development Currently Underway

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



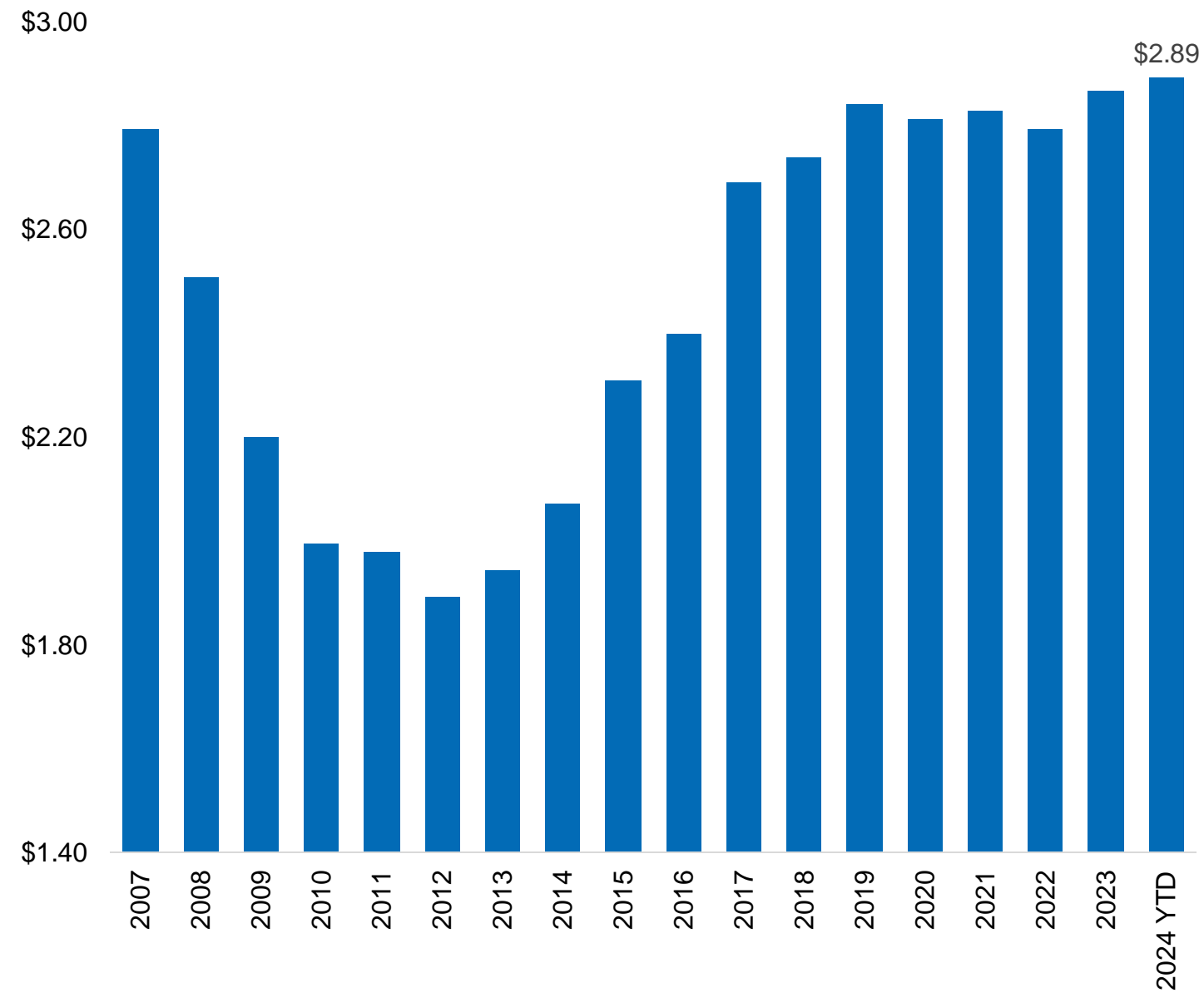
Source: Newmark Research



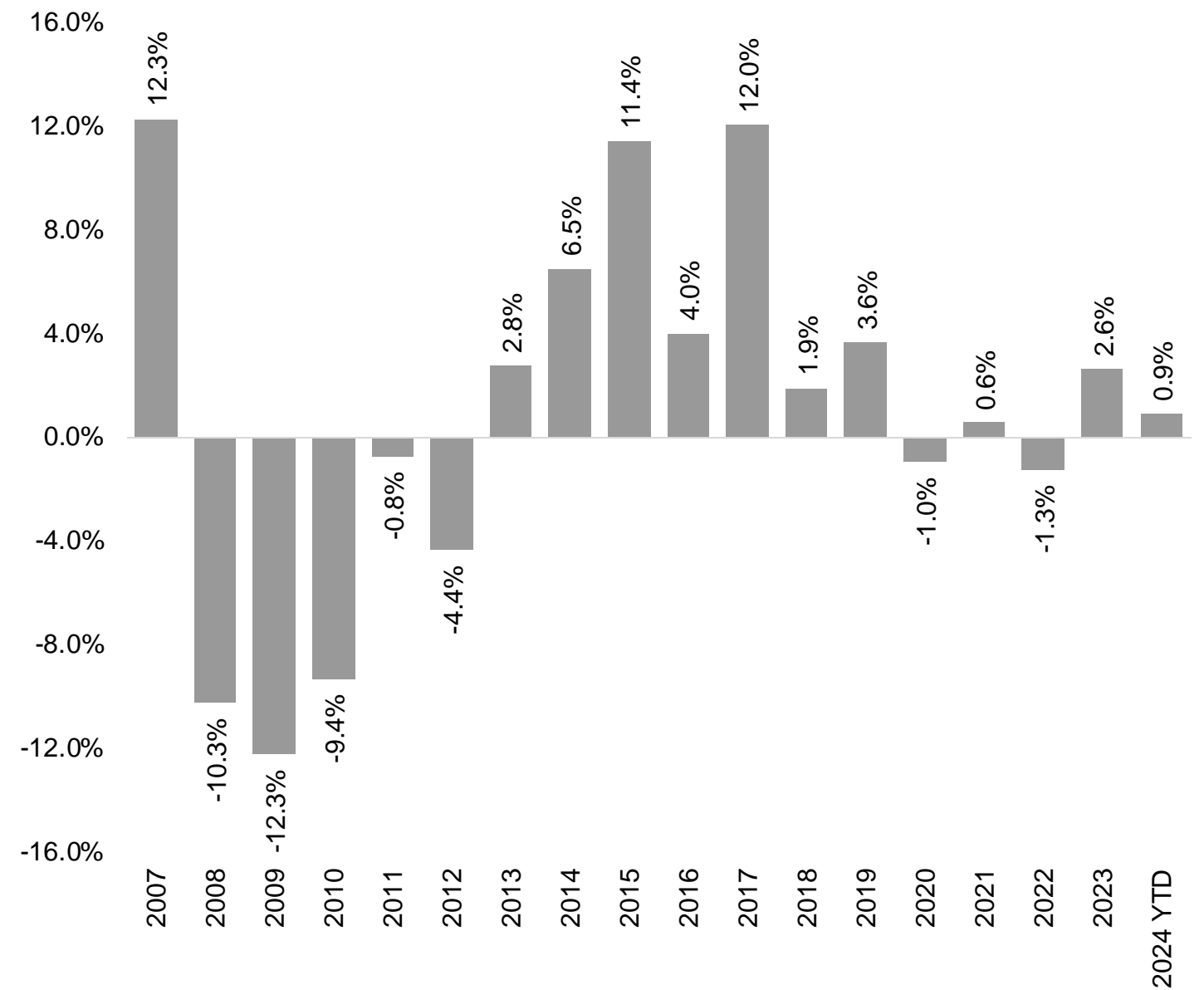
# Asking Rents Remain Elevated

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

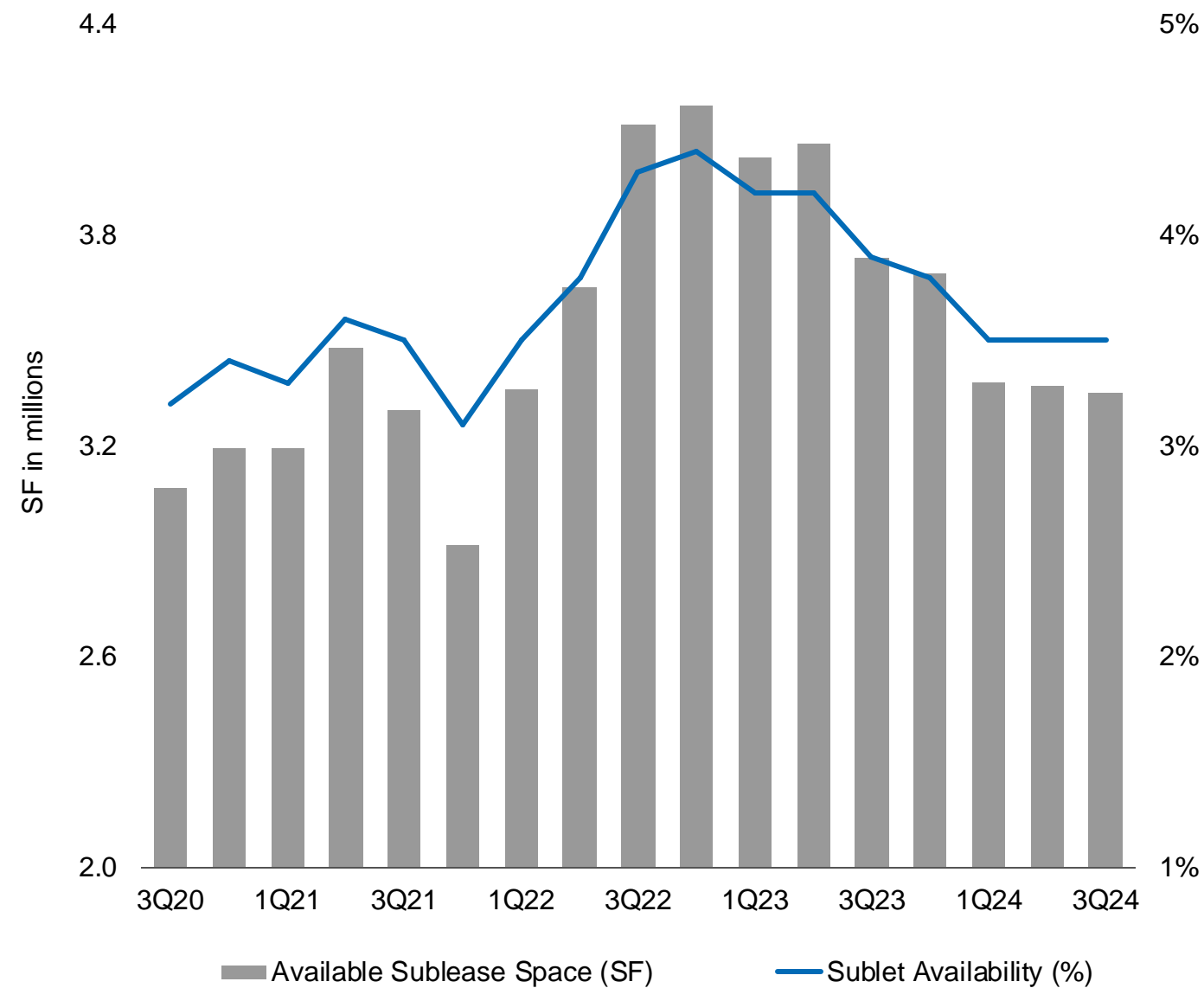
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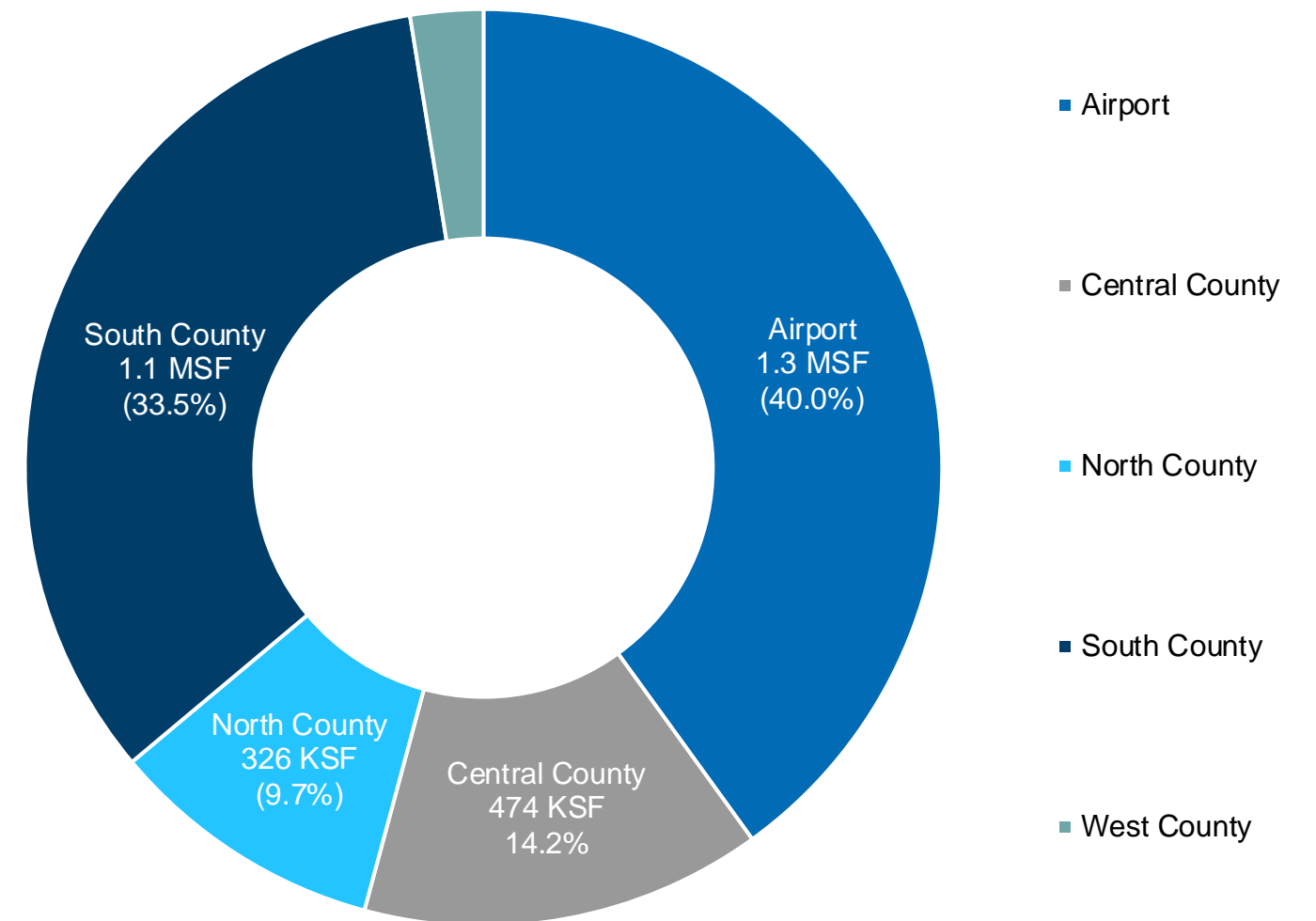
# Sublet Availability In Downward Trajectory

Since hitting an all-time high in the fourth quarter of 2022, sublet availability has dropped by 821,949 SF and has been gradually declining. At the submarket level, Airport leads others in available sublease space, with 1.3 MSF or 40.0% of Orange County's sublet pool.

Available Sublease Space: Greater Market



Available Sublease Space by Submarket



Source: Newmark Research

# Renewals Make Up the Bulk of Top Leasing Activity

The Airport Area continues to generate the bulk of leasing activity in the market, with renewals dominating the top leases for the quarter. Its central location and inventory of trophy spaces makes it a top choice for notable tenants aiming to keep workers in the office.

## Notable 3Q24 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
Google	19510-19520 Jamboree Rd	Airport	Lease Renewal	197,506
<i>The tech giant has been occupying one of the buildings at Google Center in Irvine since 2014 and later expanded its footprint to a second building in 2017.</i>				
JPMorgan Chase	3 Park Plaza	Airport	Lease Renewal	96,211
<i>The financial services provider has been at this location since 2013 and is the anchor tenant for the large office building.</i>				
Ventura Foods LLC	17800 Laguna Canyon	South County	Direct Lease	56,626
<i>Headquartered in Brea, the food solutions company opened its third office location in the Irvine Spectrum.</i>				
Pepperdine University	18111 Von Karman Ave	Airport	Lease Renewal	54,703
<i>The tenant is committing to an additional five years at its current location.</i>				
Wells Fargo	2030 Main St	Airport	Lease Renewal	52,598
<i>This location is the bank's largest across the greater market and has been occupied for over 20 years.</i>				



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# Office Conversions and Distress





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

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35.5% 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 Vacancy

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# Sales Activity

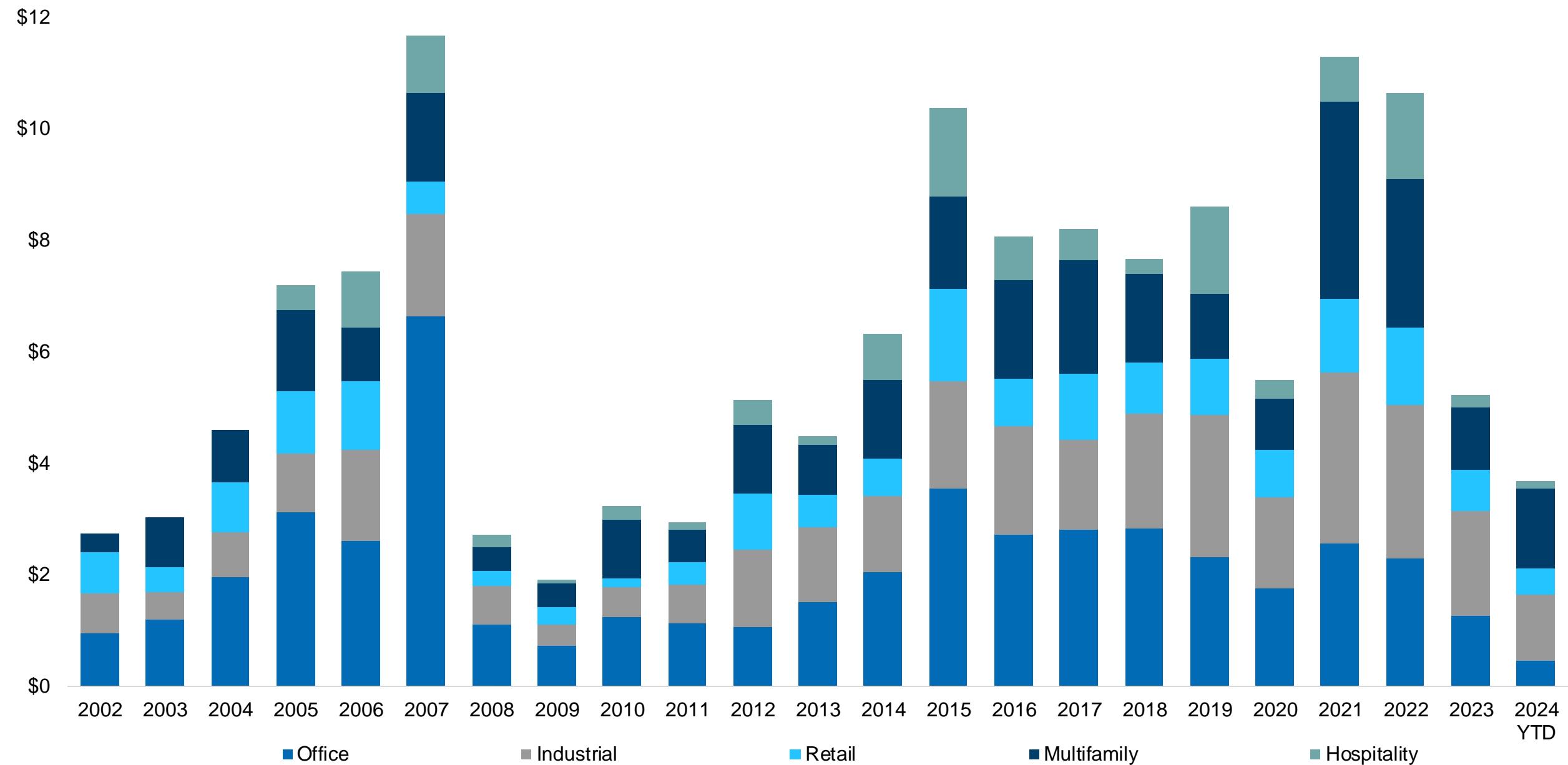




# Office Comprised Just 12.2% of Total Sales Volume Year-to-Date

This is a significant decline from 2018, when office comprised 36.8% 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)



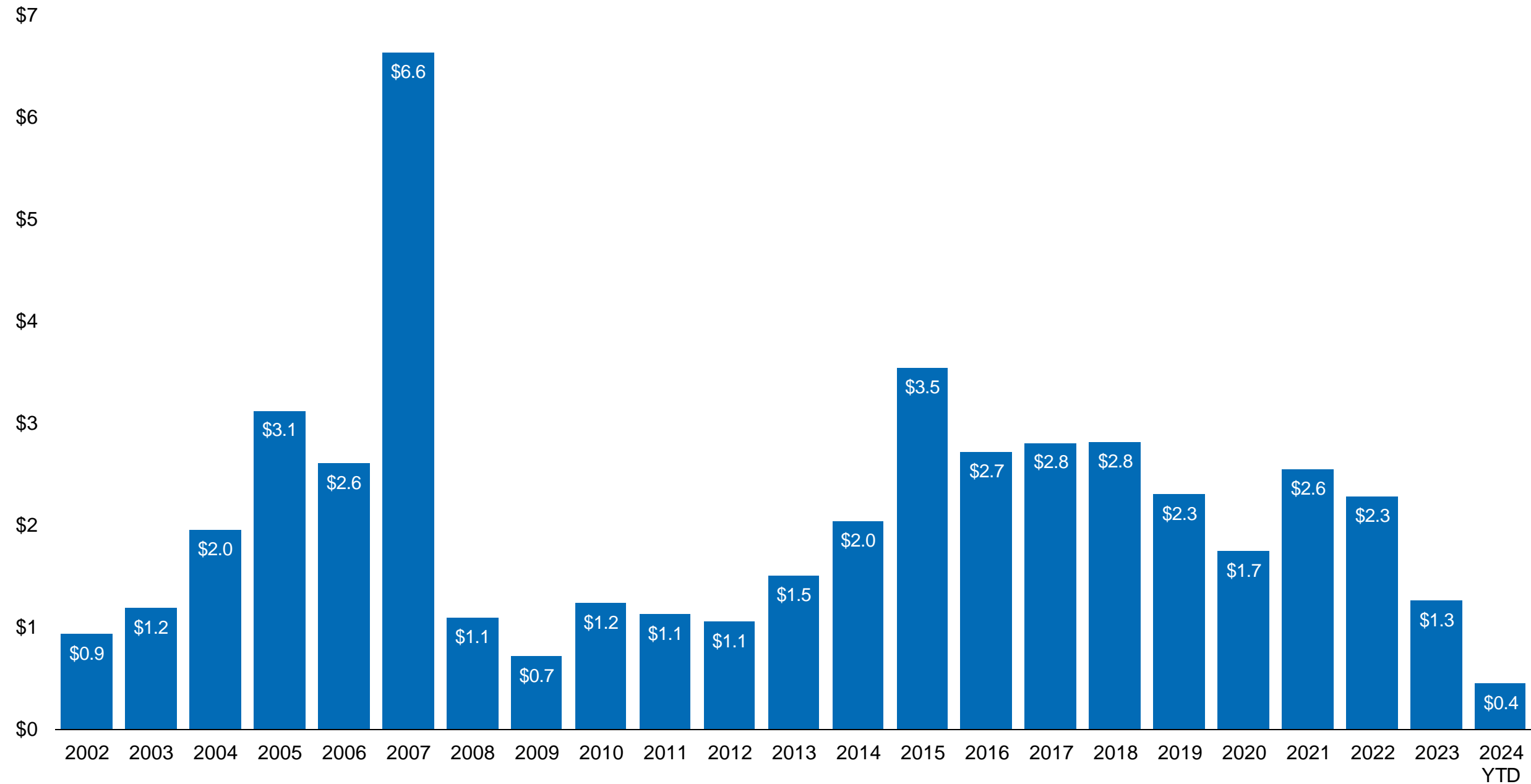
Source: MSCI Real Capital Analytics, Newmark Research  
 Note: Preliminary data is cited for the third quarter of 2024.



# Office Sales Volume: Up Close

Office sales volume totaled just \$448 million in three quarters, 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.

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



Source: Newmark Research, MSCI Real Capital Analytics  
Note: Preliminary data is cited for the third 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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## Steep Discounts For Owner-User Buyers

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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 | 3Q24

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