

Seven-Year Itch Hits Office Demand; Slowing Absorption and Lease Rates

Demand for Orange County office space in 2017 has fallen by half compared to earlier in the economic recovery, and rates of rent growth also have slowed dramatically this year, according to Lee & Associates' third-quarter survey of Orange County's 112.4-million-sq.-ft. office market.

Net absorption through the first three quarters still is in positive territory, totaling 593,968 sq. ft., but the volume of space coming off the market so far this year is 49.8% less than in the average of first three quarters of each year since 2011.

Additionally, steady quarterly gains in lease rates have slowed, especially for Class A office space. New data shows that Class A asking rents have increased 3% this year compared to the 10.2% average increase for the same nine-month period in the last three years.

Plenty of economists have prophesied about eight-year real estate and economic cycles to help explain the softening of office markets nationwide that has been widely reported this year. It's clear that local office demand has lost some steam despite a still solid local recovery and a strong national economy that in Q3 grew at a 3% annual rate.

Locally, the sudden downshift in demand is altering expectations for landlords, particularly those in the Airport and South Orange County submarkets, where new premium buildings are hitting the market. Two buildings totaling 671,696 sq. ft. were delivered in Q3 and eight buildings totaling 1.4 million sq. ft. are underway.

Buildings in South County and around John Wayne Airport comprise nearly 60% of existing county office space as well as the county's newest Class A buildings. But the two submarkets have gone in different directions this year. South County's net absorption year to date totals 385,265 sq. ft. versus a negative 328,959 sq. ft. through Q3 in the Airport submarket. The South County vacancy rate is 9.4% compared to 11.4% at the Airport, where a 537,000-sq.-ft. office building is slated for completion early next year with no major tenants announced, so far.

The vacancy rate in the small 8.9-million-sq.-ft. West County submarket settled at 7.3% on 44,613 sq. ft. of net absorption in Q3.

The 22.3-million-sq.-ft. Central County submarket, which includes Orange, Anaheim, Garden Grove, Santa Ana and Tustin, ended Q3 with an 11.5% vacancy rate. Net absorption was negative by 74,198 sq. ft. in Q3 but is up 420,960 sq. ft. for the year.

The 14.2-million-sq.-ft. North County office market posted a 9.5% vacancy rate in Q3 with net absorption of 43,968 sq. ft.

FORECAST

Orange County businesses aim to invest in more equipment and employees in the fourth quarter, according to Cal State Fullerton's latest quarterly survey of local companies. The survey showed that overall optimism is down from the first quarter but higher than a year ago.

ORANGE COUNTY OFFICE

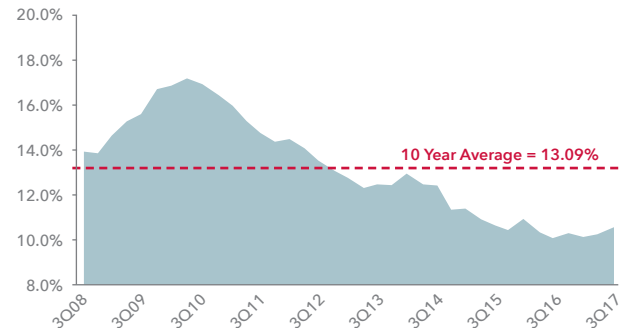
ECONOMIC INDICATORS

	Current Quarter	Prior Quarter
OC Unemployment	4.1%	3.4%
California Unemployment	5.2%	4.5%
US Unemployment	4.5%	4.4%

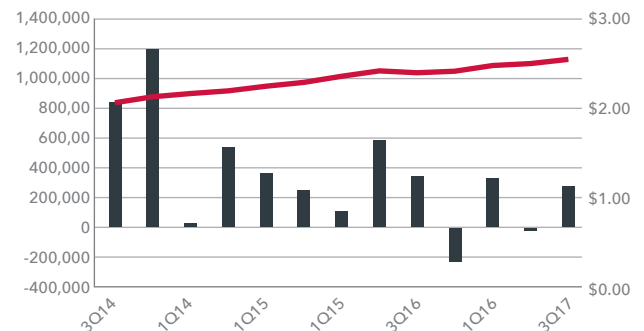
MARKET INDICATORS

	Current Quarter	Prior Quarter
Total Inventory (SF)	15.8%	15.6%
Vacancy Rate (%)	10.4%	10.3%
Net Absorption (SF)	278,991	(3,320)
Average Asking Rent (\$/SF)	\$2.61	\$2.49
Under Construction (SF)	2,397,703	2,458,722

OVERALL VACANCY



NET ABSORPTION VS ASKING RATES



ORANGE COUNTY

THIRD QUARTER 2017 MARKET REPORT

ORANGE COUNTY MARKET STATISTICS - 3Q 2017

BY AREA

	Bldg Count	SF RBA	Total SF Available	Avail. Rate	Total SF Vacant	Total Vac. Rate	Net Absorption	YTD Net Absorption	Avg Asking Lease Rate	SF Under Construction
North Orange County	172	14,226,321	1,875,183	13.1%	1,352,358	9.5%	43,968	(64,936)	\$2.10	38,313
Central Orange County	256	22,311,733	3,431,700	15.1%	2,555,369	11.5%	(74,198)	420,960	\$2.05	417,284
West Orange County	126	8,900,796	882,744	9.9%	646,407	7.3%	44,613	181,638	\$2.22	- 0 -
Greater Airport Area	418	42,511,780	8,024,655	18.6%	4,838,108	11.4%	69,702	(328,959)	\$2.82	537,258
South Orange County	342	24,423,941	3,577,121	13.8%	2,289,976	9.4%	194,906	385,265	\$2.67	1,404,848
TOTALS	1,314	112,374,571	17,791,403	15.8%	11,682,218	10.4%	278,991	593,968	\$2.61	2,397,703

ORANGE COUNTY MARKET STATISTICS - 3Q 2017

BY SUBMARKET

	Bldg Count	SF RBA	Total SF Available	Avail. Rate	Total SF Vacant	Total Vac. Rate	Net Absorption	YTD Net Absorption	Avg Asking Lease Rate	SF Under Construction
Class A	288	46,816,680	9,654,102	19.6%	5,968,535	12.7%	491,023	471,697	\$2.82	2,359,390
Class B	930	60,684,351	7,757,483	12.8%	5,430,283	8.9%	(217,486)	63,675	\$2.32	38,313
Class C	96	4,873,540	379,818	7.8%	283,400	5.8%	5,454	58,596	\$1.75	- 0 -
TOTALS	1,314	112,374,571	17,791,403	15.8%	11,682,218	10.4%	278,991	593,968	\$2.61	2,397,703

LEASE TRANSACTIONS 3Q 17

PROPERTY	SF	TENANT	LANDLORD	REPRESENTING BROKERS
17850 Fitch, Ste 100 Irvine, CA	15,446	Taylor & Associates Architects, Inc	KP Airport Professional Center, LLC	Gary McArdell represented the Tenant.
330 E. Lambert #100, 120 & 125 Brea, CA	13,268	PharMed Quest Pharmacy	Brea Metro, LLC	Marshal Vogt & Erik Thompson represented the Landlord.
16735 Von Karman Ave., Suite 250, Irvine, CA	10,475	Fast Track Financials, LLC	Equity Office	Mia Pham presented the Tenant.

SALE TRANSACTIONS 3Q 17

PROPERTY	SF	BUYER	SELLER	REPRESENTING BROKERS
16802 Aston St. Irvine, CA	65,108	ALFA IDG, LLC	BTC Acquisitions Partners, LLC	Brian Garbutt represented the Buyer.
18002 Cowan Irvine, CA	18,074	The Gossen Group, LLC	JVK-CA LLC	David Romero represented the Seller.
910 W. 17th Street Units A&B Santa Ana, CA	2,065	Rodney & Pam Hopkins	Chuck Orapeza	Erik Thompson & Jaimeson Hearne represented the Seller.

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With a broad array of regional, national and international clients - ranging from individual investors and small businesses to large corporations and institutions - Lee & Associates has successfully completed transactions with a total value of more than \$11 billion last year, alone.

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