

4Q24

NEWMARK

Orange County Office Market Overview



Market Observations

Economy

- Local unemployment dropped from 4.5% in August to 4.0% in November ahead of the busy holiday season. Total non-farm jobs experienced modest growth over the last year, specifically in the education and health sector, while information and construction jobs declined over the same period.
- Office-using employment saw a modest gain of 3,300 jobs from a year ago 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 made a second cut to interest rates by 25 basis points in December 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

- The Irvine Company’s Spectrum Terrace business park is faring well relative to older inventory, and accounts for two of this quarter’s top deals. Becton, Dickinson and Company subleased Alteryx’s 116,261-SF space, marking the largest quarterly deal, while Tarsus Pharmaceuticals signed a direct lease for 59,626 SF.
- Tustin Financial Plaza, a five-building office property totaling 185,180 SF, has sold for \$27.5 million in a joint venture between Kelemen Caamano Investments and Kingsbarn Realty. The last recorded sale of the property was in 2006 for \$32.6 million, a 55.2% discount after adjusting for inflation.
- Owner-users are taking advantage of the discounted office inventory and purchasing properties at a fraction of their cost. This quarter, Orange County Transportation Authority acquired 2677 N Main Street, a 220,452-SF office building in Santa Ana, for \$54.5 million in the largest sale of the quarter.

Leasing Market Fundamentals

- Vacancy dropped to 17.5% this quarter but remains elevated by historical standards. Total vacancy is 140 bps above the five-year average.
- Quarterly net absorption is positive for the sixth quarter in a row, totaling 62,373 SF in net gains. The largest move-in of the quarter was by Hyundai Glovis occupying its new 53,282-SF space in Irvine.
- 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 12% 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
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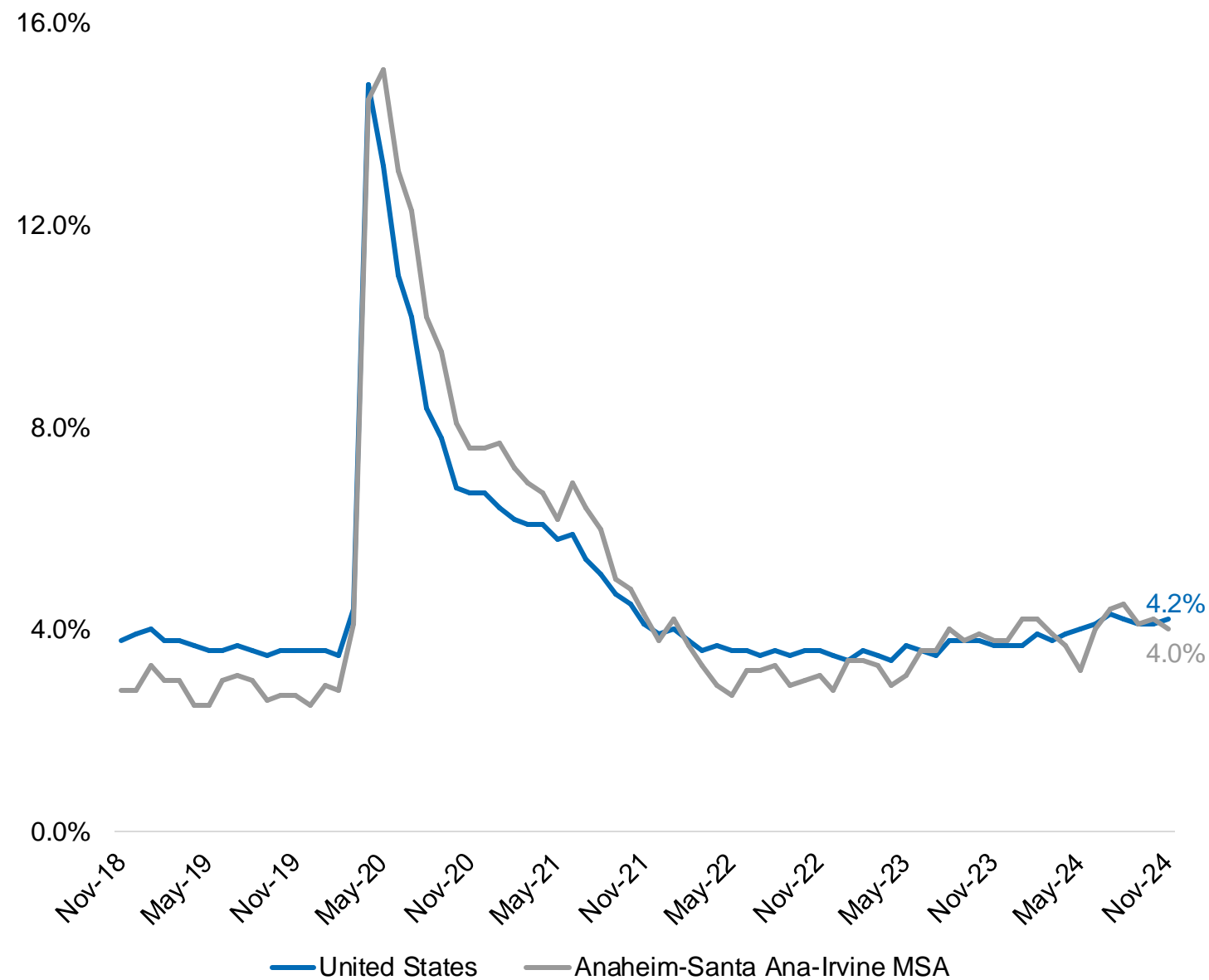
Economy



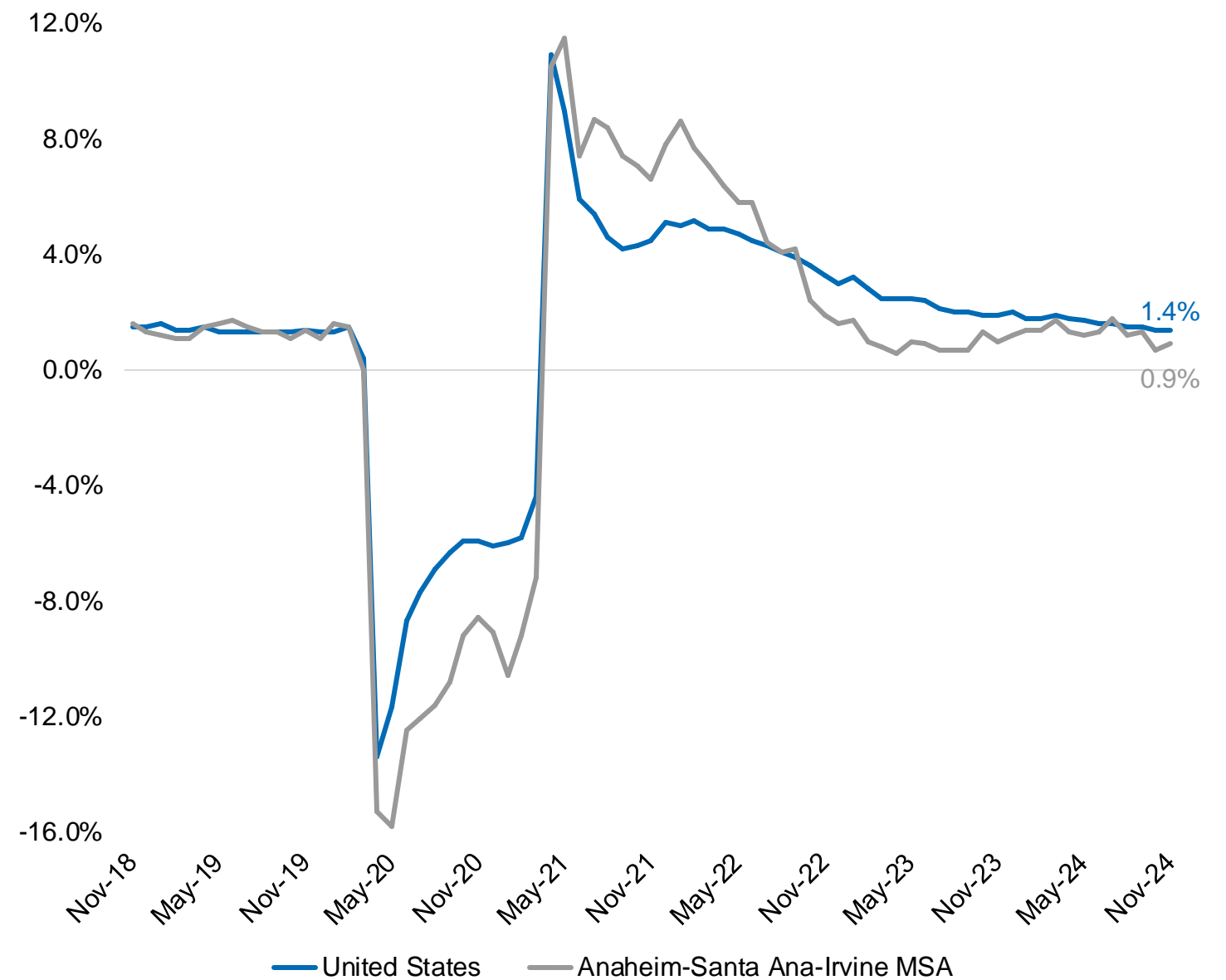
Cyclical Drop In Local Unemployment Ahead Of Holiday Season

After reaching a three-year peak of 4.5% in August, local unemployment dropped 50 basis points as retailers gear up for the holiday season. In the months ahead, unemployment will continue to fluctuate as companies reassess business needs, especially in the manufacturing and information technology sectors. Year-over-year nonfarm employment growth has held steady despite these fluctuations.

Unemployment Rate, Seasonally Adjusted



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

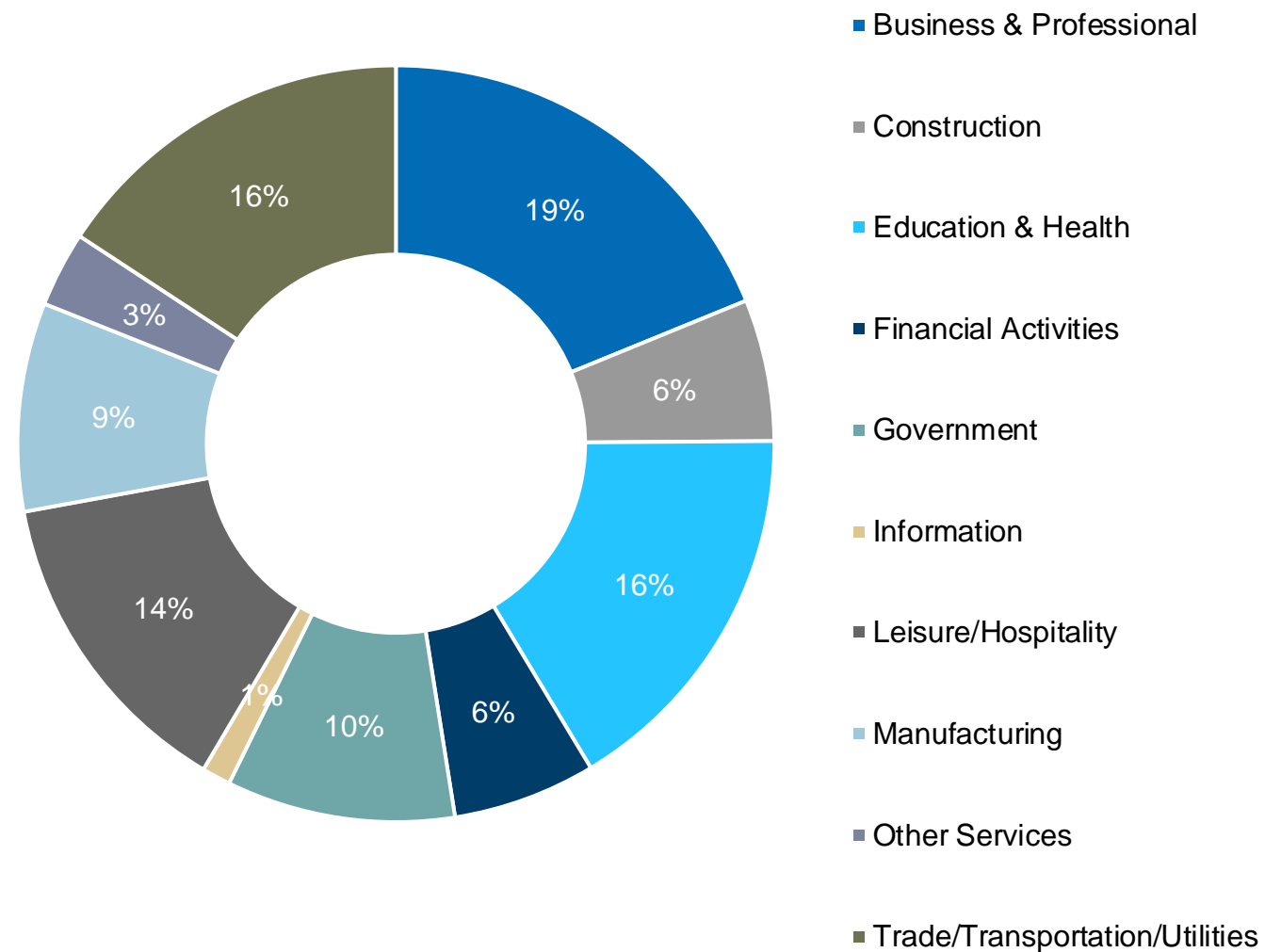


Source: U.S. Bureau of Labor Statistics, Anaheim-Santa Ana-Irvine, CA
 Note: November 2024 data is preliminary.

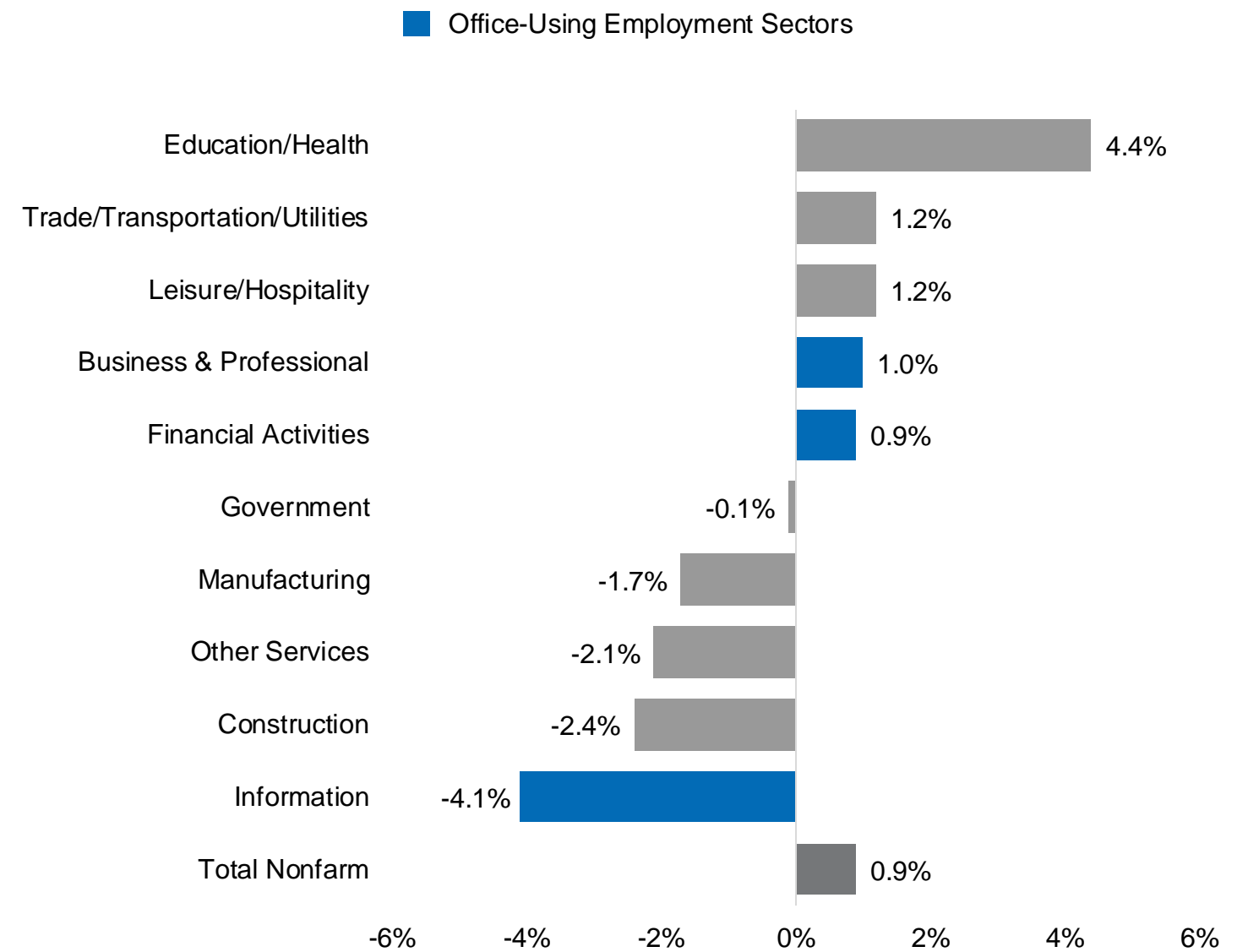
Information And Construction Sectors Lead In Job Losses

Tech companies, which are generally classified under the information sector, continue to focus on cost-cutting moves by shedding unneeded staff and space, while construction companies grappling with elevated costs of doing business are also downsizing.

Employment by Industry, November 2024



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

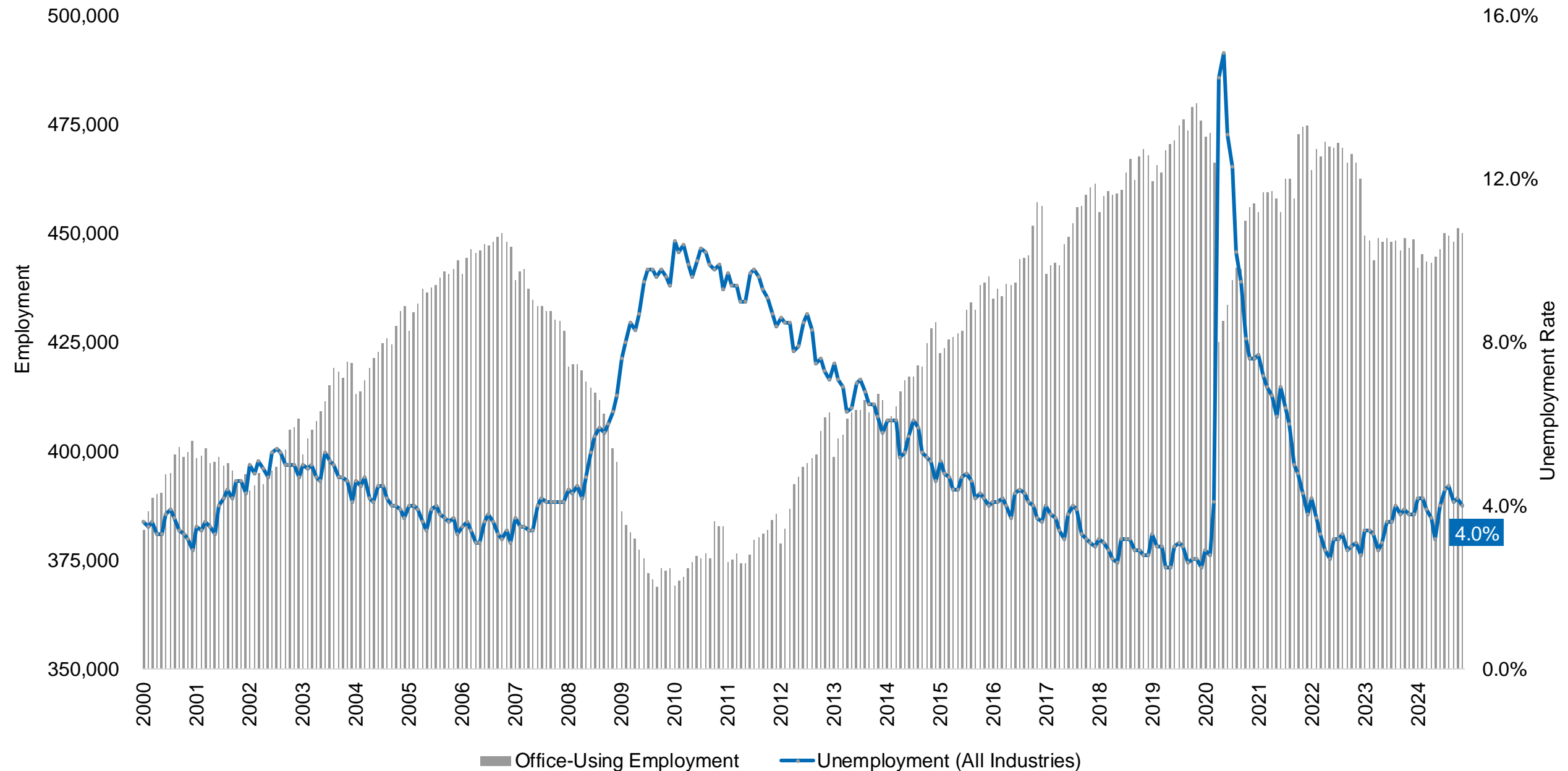


Source: U.S. Bureau of Labor Statistics, Anaheim-Santa Ana-Irvine, CA
 Note: November 2024 data is preliminary.

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. 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

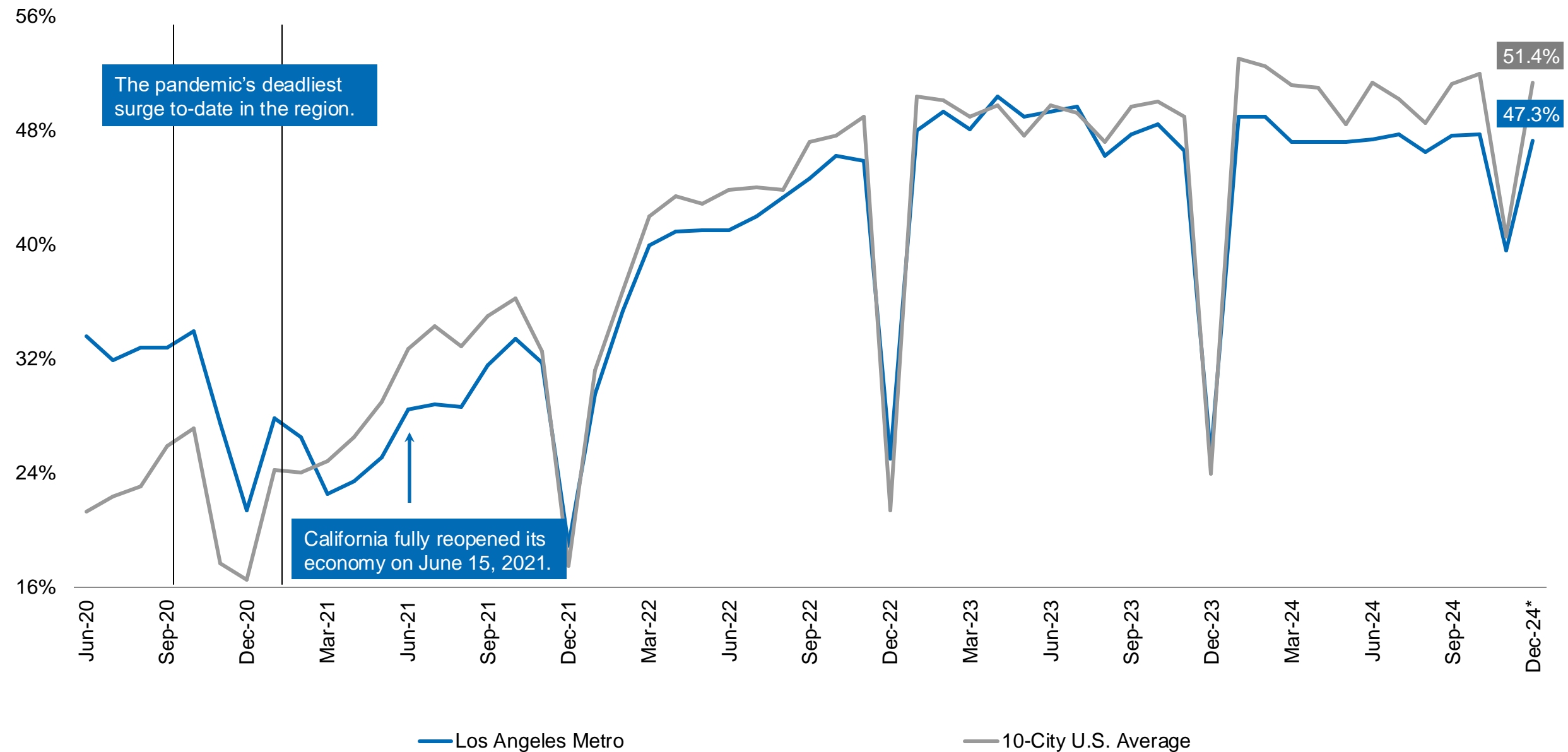
Note: November 2024 data is preliminary.

*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. December 2024's average is for the week of 12/18/24

Return-to-Office Outlooks are Improving; Leasing Activity Stands to Benefit

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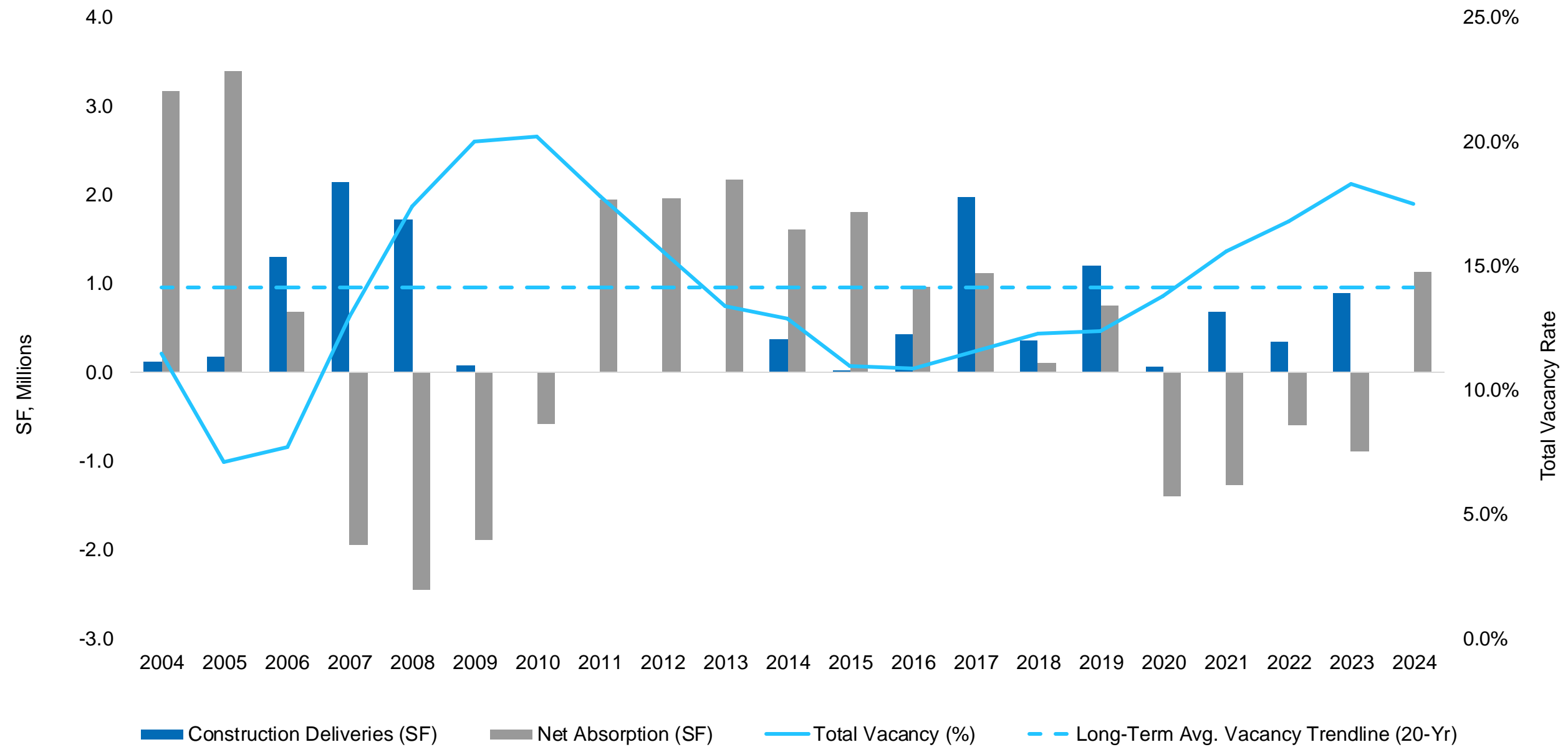
Leasing Market Fundamentals



Annual Net Absorption Reminiscent of Pre-Pandemic Levels

Vacancy dropped from 18.3% to 17.5% over the last year as the metro boasted positive absorption for six 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

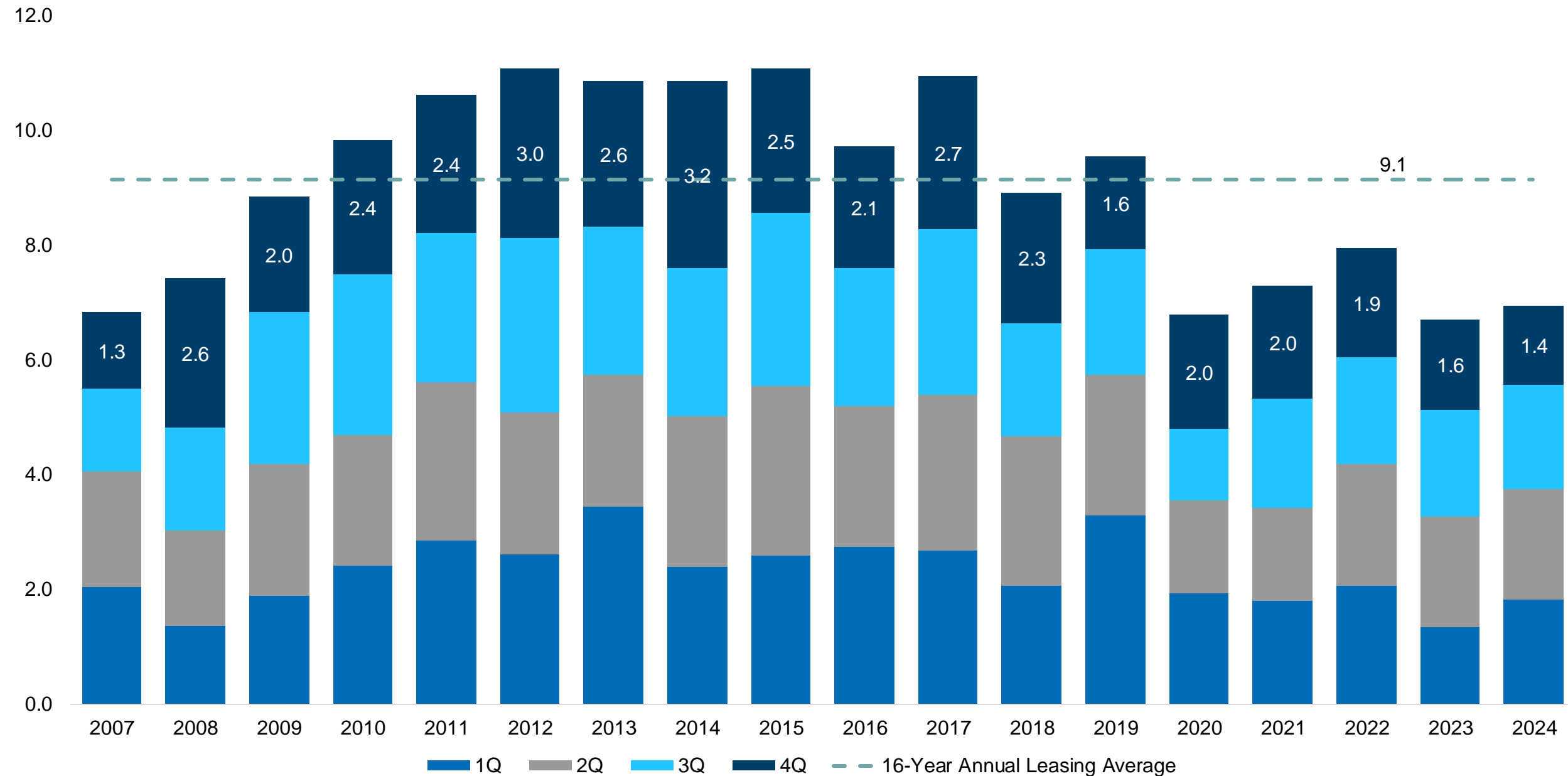


Source: Newmark Research

Leasing Activity Improving But Still Below 16-Year Average

Activity reached 7.0 MSF in 2024, a slight improvement from the previous year but well below the long-term average of 9.1 MSF. 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 hampering overall leasing activity.

Total Leasing Activity (MSF)

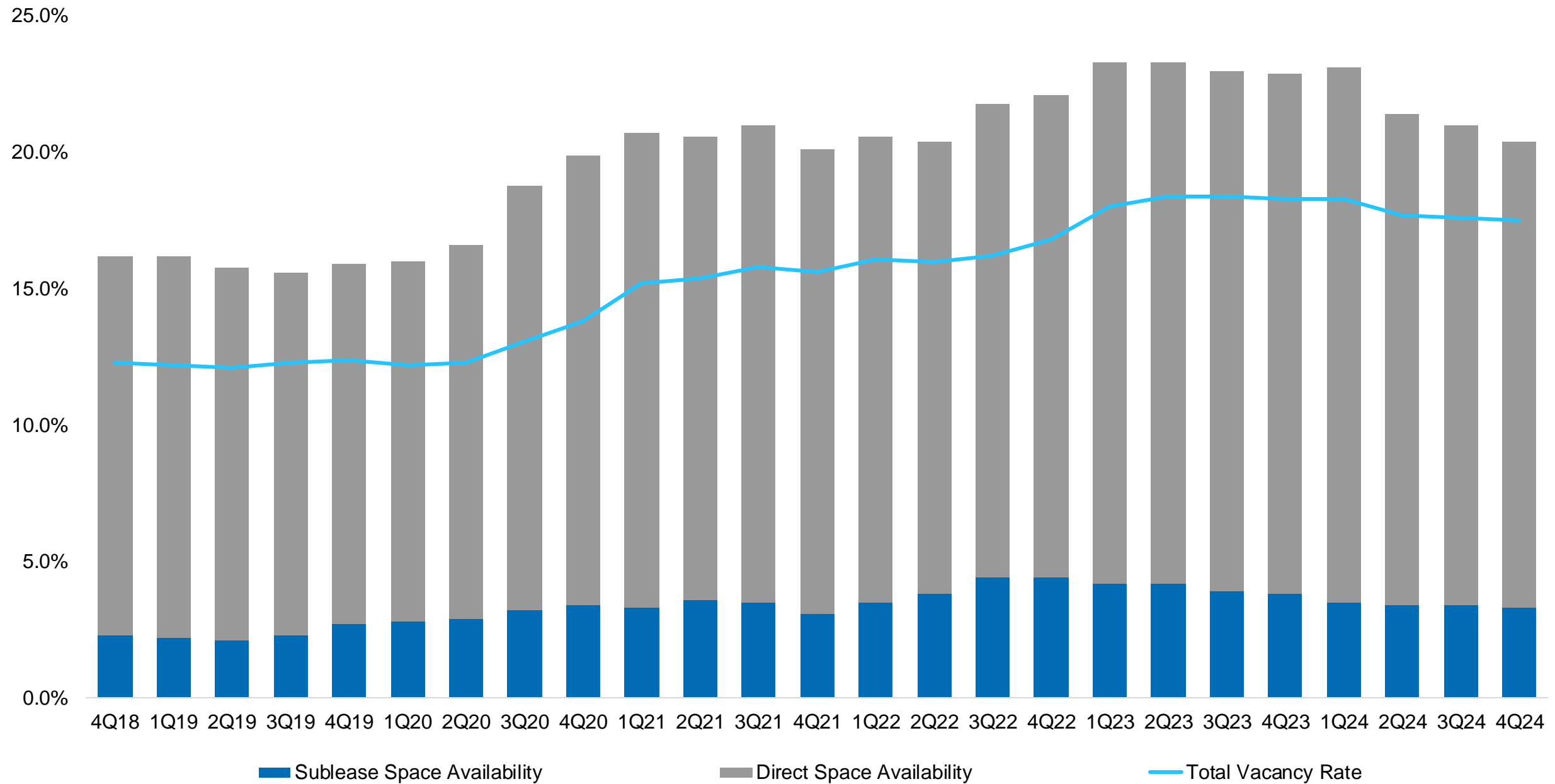


Source: Newmark Research, CoStar

Total Availability At Its Lowest Level In Three Years

Total availability dropped to its lowest level in 13 quarters, down to 20.4% 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

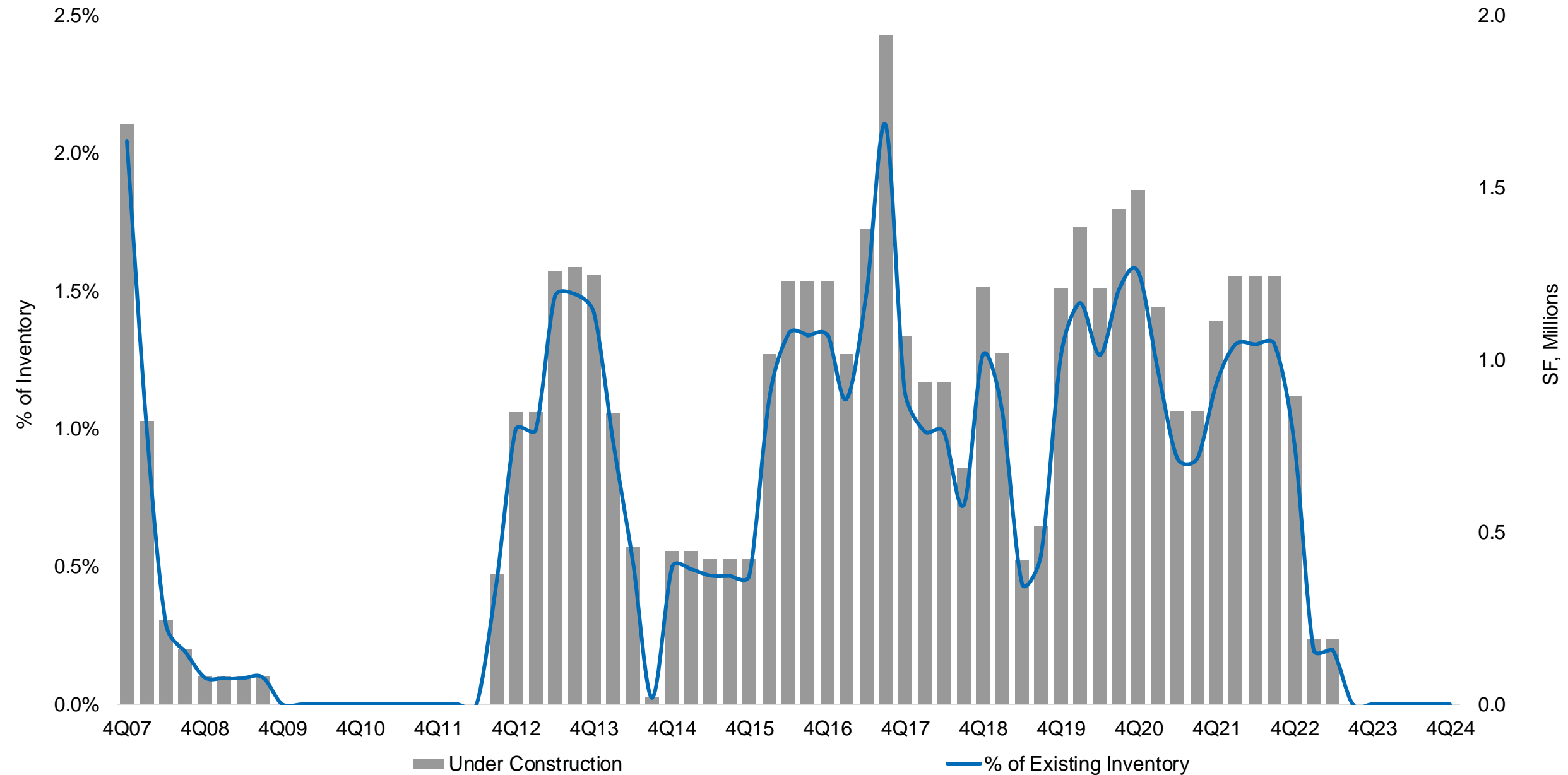
Total Availability Fluctuating Across All Submarkets

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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

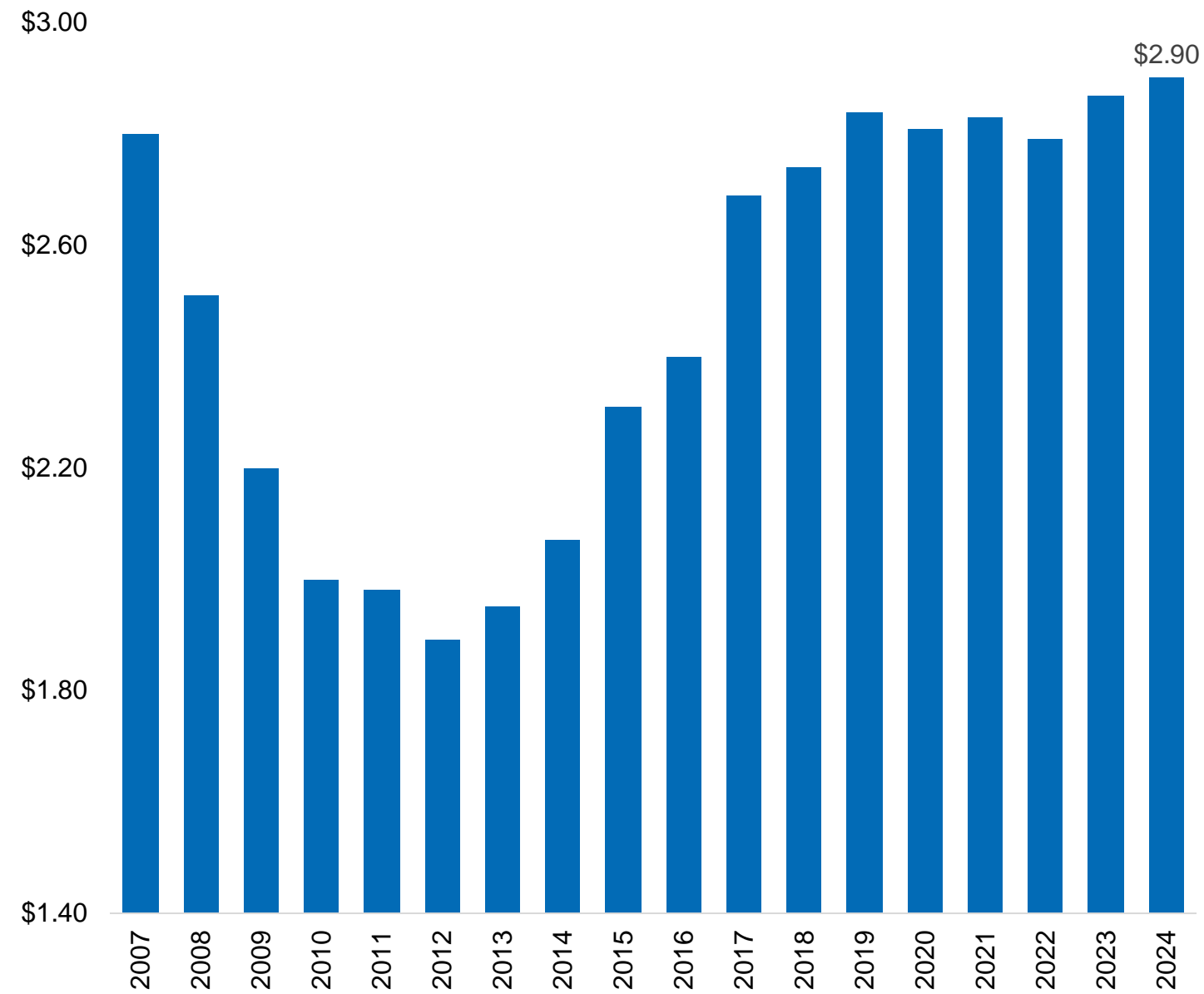


Source: Newmark Research

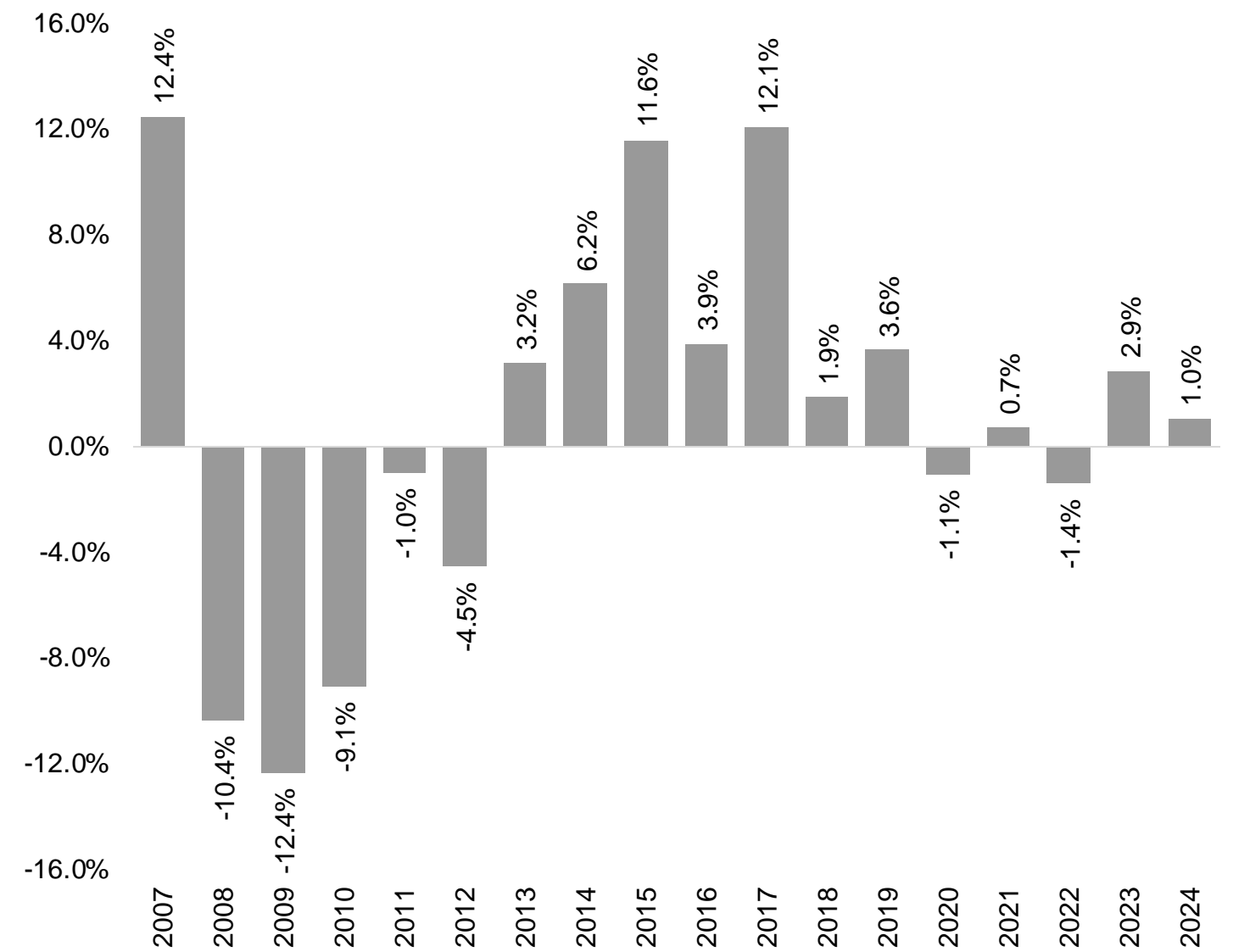
Asking Rents Remain Elevated

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

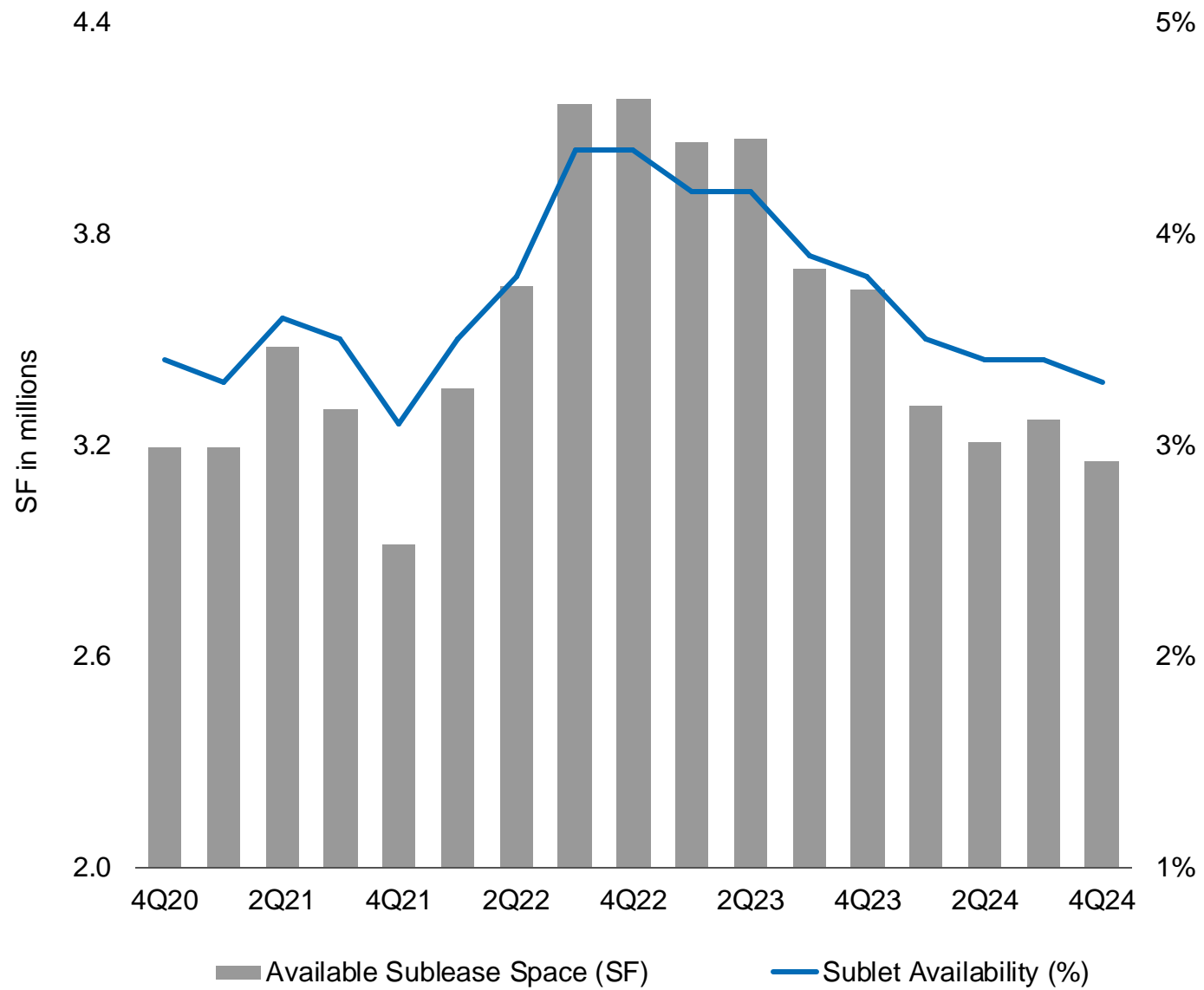
Airport and South County Command the Highest Rents

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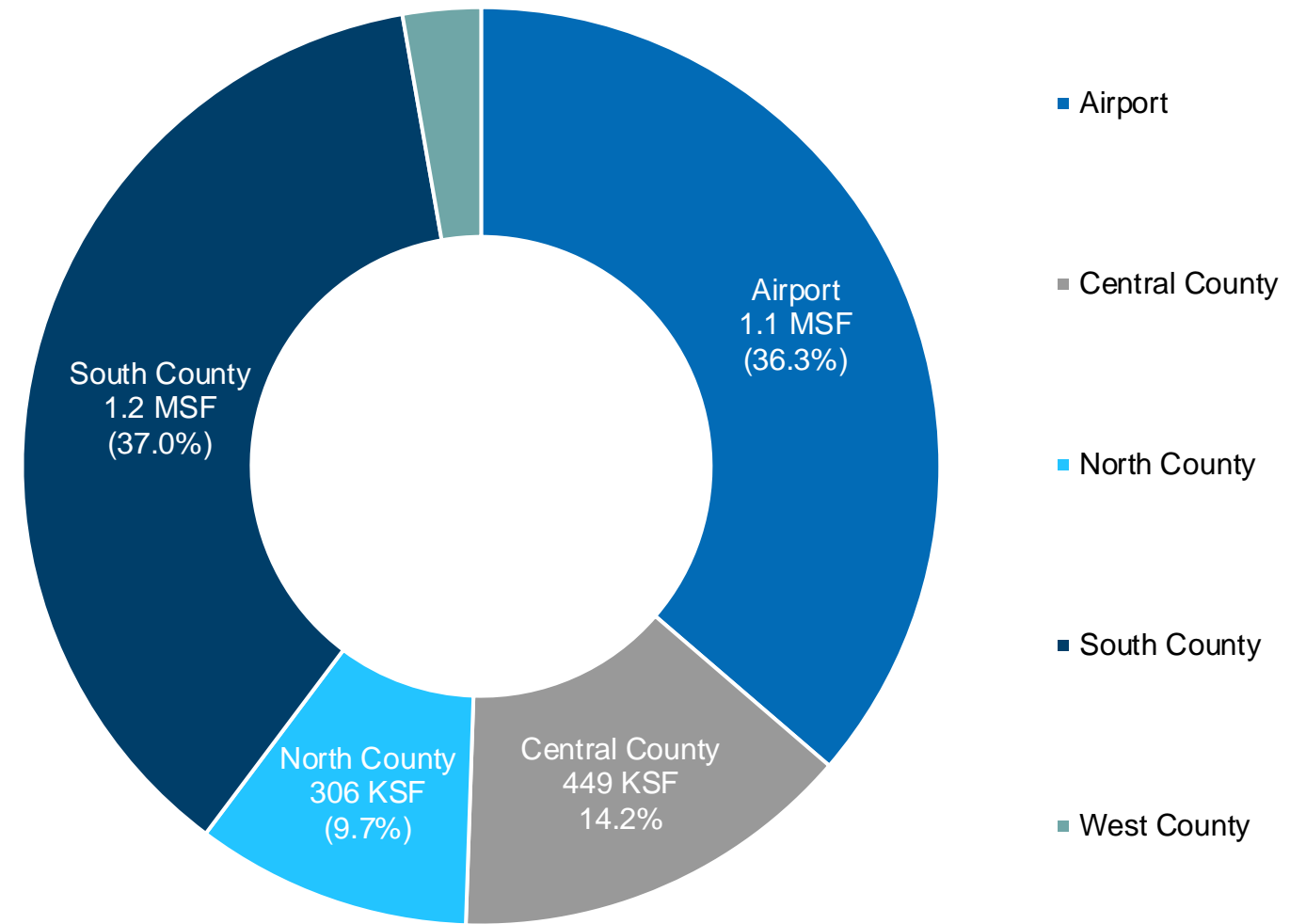
Sublet Availability In Downward Trajectory

Since hitting an all-time high in the fourth quarter of 2022, sublet availability has dropped by 1.0 MSF and has been gradually declining. At the submarket level, South County leads others in available sublease space, with 1.2 MSF or 37.0% of Orange County's sublet pool.

Available Sublease Space: Greater Market



Available Sublease Space by Submarket



Source: Newmark Research

Airport Area And South County Dominate Top Leasing Activity

Leasing activity in South County is picking up after the Airport Area dominated top activity for a few quarters in a row. Both submarkets are recognized for their supply of Class A product, and notable occupiers seeking trophy spaces continuously seek properties in those areas.

Notable Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
Becton, Dickinson and Company	17200 Laguna Canyon Rd	South County	Sublease	116,261
<i>The medical device company is taking over Alteryx's lease at the Spectrum Terrace, which expires in 2027.</i>				
Bank of America	520 Newport Center Dr	Airport	Lease Renewal	105,000
<i>The financial services provider has been at this location since 1998.</i>				
Willow Laboratories	121 Theory Dr	Airport	Direct Lease	63,440
<i>The Irvine-based telehealth company occupies the entirety of the building, which is down the street from UCI Health.</i>				
Tarsus Pharmaceuticals, Inc.	17700 Laguna Canyon Rd	South County	Direct Lease	59,626
<i>This is the tenant's second location, which serves as an expansion to its headquarters in Discovery Park.</i>				
Acrisure of California LLC	611 Anton Blvd	Airport	Direct Lease	59,409
<i>Insurance-provider Acrisure signed its largest lease and fourth location in Orange County.</i>				

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Office Conversions and Distress



Home Ownership is Out of Reach for 88% of Buyers; Good News for the Rental Market

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35.8% of the Region's Office Market Obsolete or Unable to Service Debt

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Some Underperforming Office Properties Slated for Conversion

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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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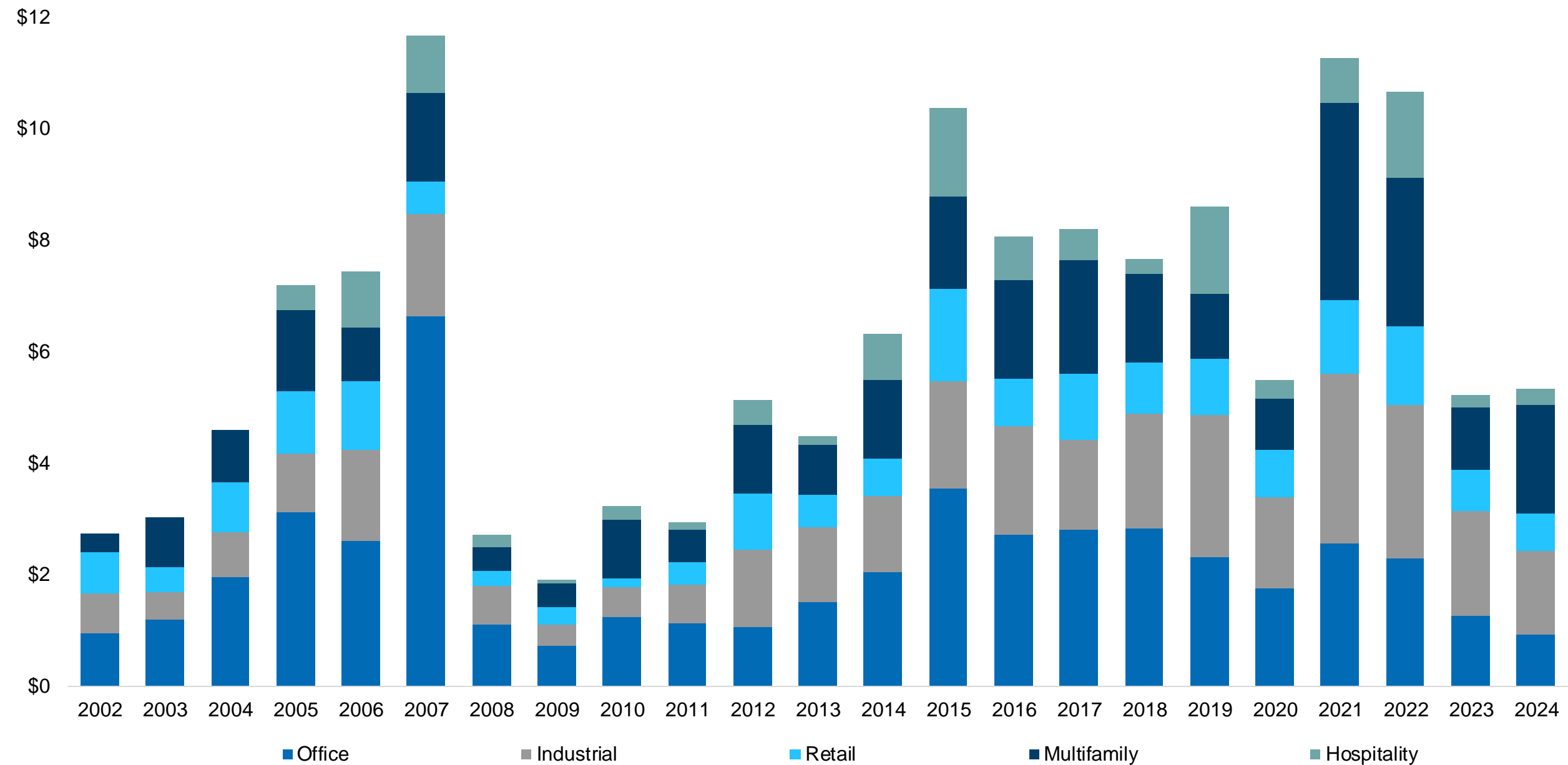
Sales Activity



Office Comprised Just 17.4% of Total Sales Volume This Year

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)

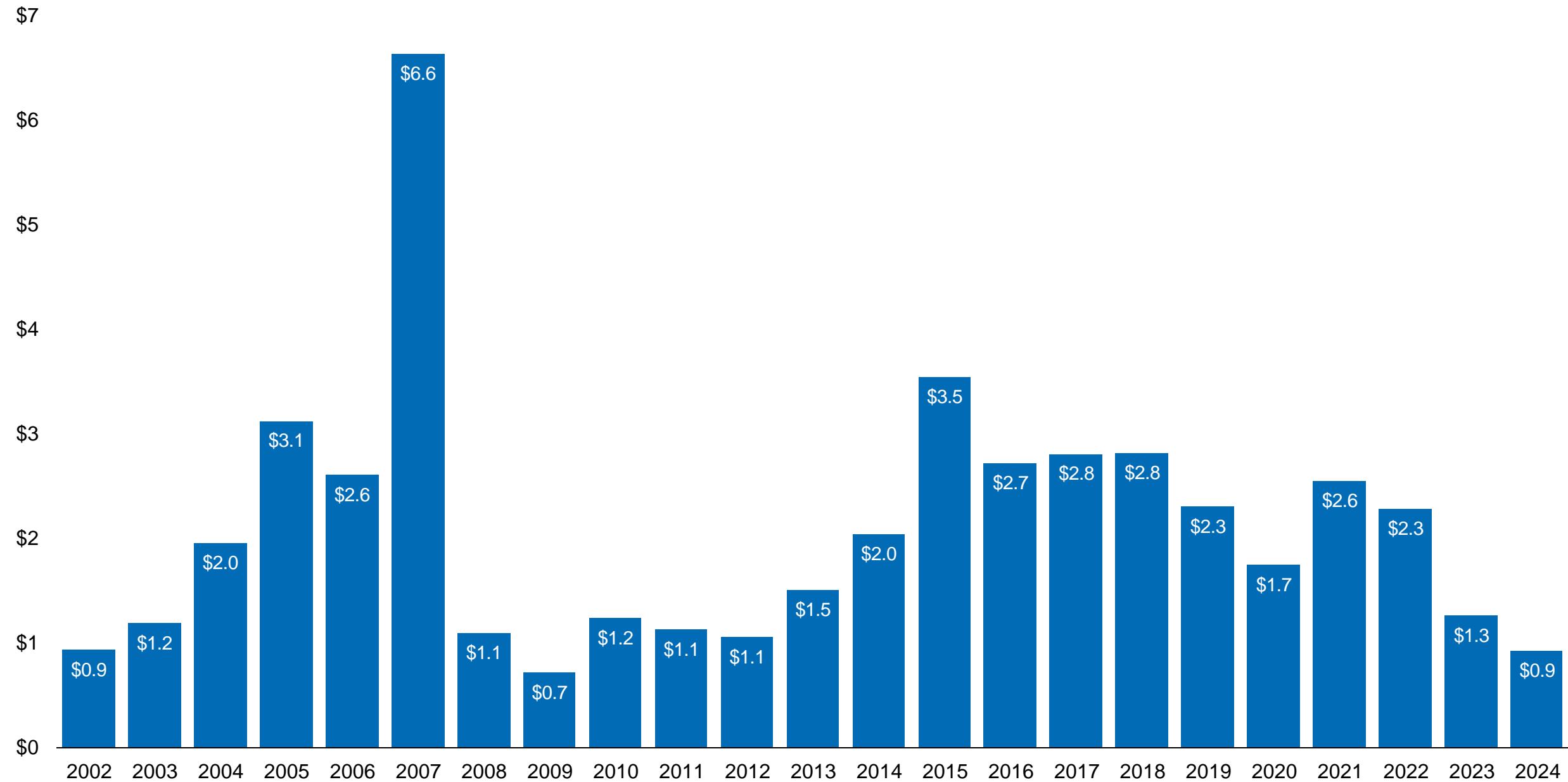


Source: MSCI Real Capital Analytics, Newmark Research
 Note: Preliminary data is cited for the fourth quarter of 2024.

Office Sales Volume: Up Close

Office sales volume totaled just \$927 million this year, compared to \$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 fourth quarter of 2024.

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



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



Orange County Office Submarket Map and High-level Statistics | 4Q24

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