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Orange County Office Insight Report

Q3 2021

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Crystal Cove State Park

Huntington Beach

Irvine Spectrum

Fashion Island

Downtown Disney

Downtown Laguna Beach

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Key Orange County office takeaways

Economic conditions

- Orange County's unemployment rate has dipped from 7.3 percent in January 2021 to **6.3 percent** in July 2021. The local labor market has been less affected by the pandemic than the Great Recession, when the unemployment rate peaked at 10.5 percent.
- Office-using employment in Orange County has increased by **4.7 percent** in the past twelve months.
- Orange County 's economy is positioned to improve further as international travel restrictions are set to be loosened.

Recovery rate

- Orange County's full vaccination rate surpasses the U.S. average, allowing the market to loosen restrictions. The vaccination rate increased from 50.4 percent in the second quarter to **61.1percent** in the third quarter.

Office demand

- The 2021 pro-rated tally of lease activity is projected to be down **30.7 percent** from pre-Covid leasing volumes, this is largely due to the sudden change in office occupiers' future workplace strategies and utilization.
- The number of leases year-to-date has increased by 5.2 percent from the same period one year prior but remains **35.0 percent lower** than 2019 levels.

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Key Orange County office takeaways

Office supply

- The total vacancy in Orange County was **13.6 percent** in the third quarter of 2021, slightly higher than the previous quarter of 13.5 percent and above its twenty-year historical average of 12.1 percent.
- The quarter-over-quarter sublease availability rate decreased for the first time following six-quarters of sublease additions. In the third quarter, **200,000 square feet** of sublease space was absorbed.

Pricing trends

- Base rents have decreased by **4.3 percent** from 2019 to 2021. The year-to-date decrease in base rents of **$0.84 psf** is attributable to tenant-favorable market conditions, especially in the Class A market segment.

Capital markets

- Asset pricing has dipped by **9.4 percent** since 2020, reflecting investors' uncertainty when underwriting office demand in the context of new workplace strategies that remain undetermined.
- Prorated annual average investment dollar volume of **$3.0B** from 2020 to Q3 2021 represents a decrease of **72.1 percent** compared with 2015 to 2019 levels.

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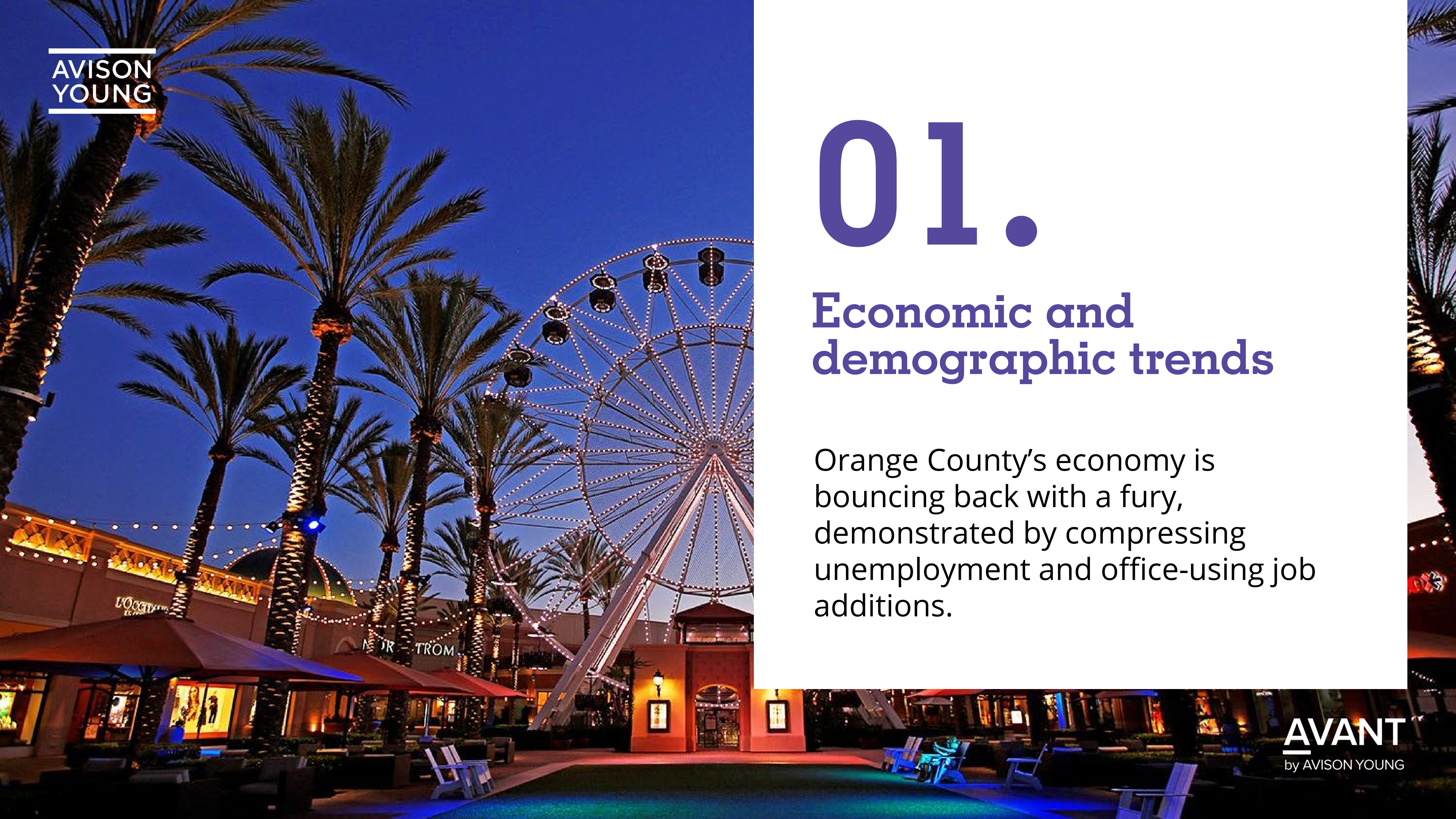


01.

Economic and demographic trends

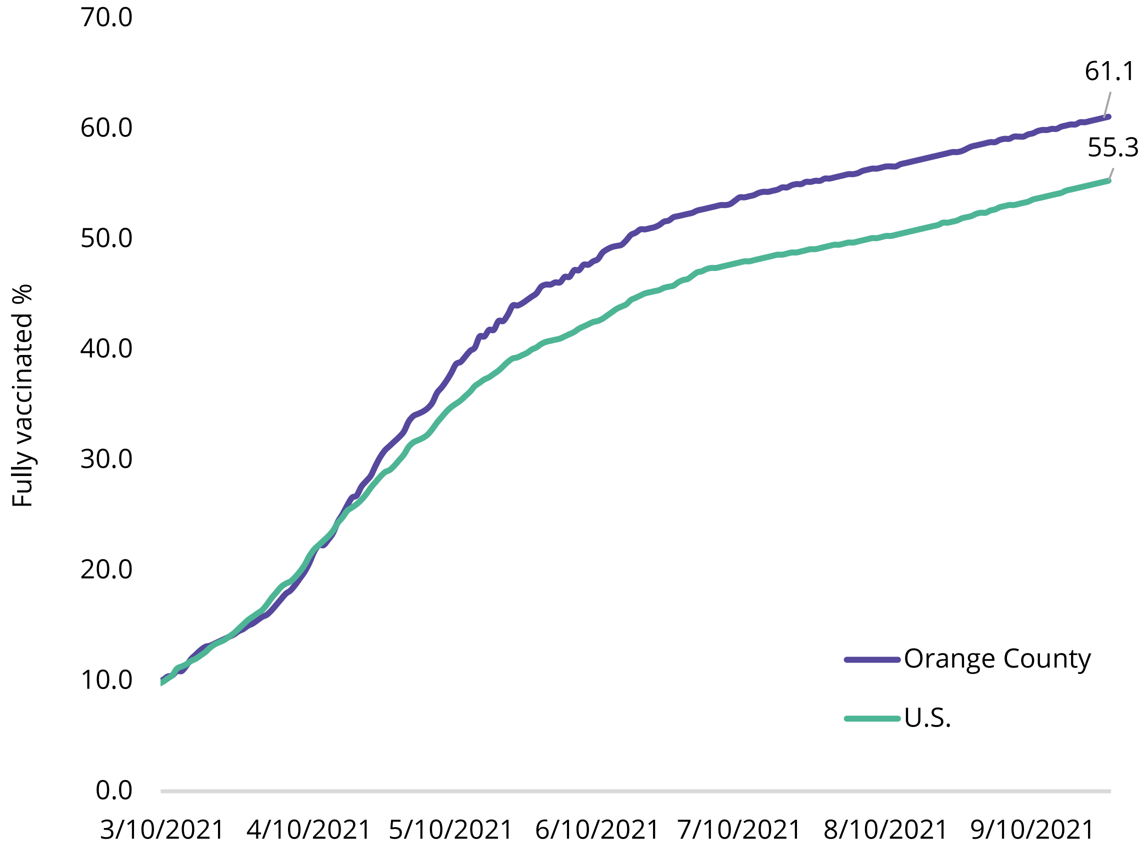
Orange County's economy is bouncing back with a fury, demonstrated by compressing unemployment and office-using job additions.

Vaccination rates

61.1%

Share of total Orange County population that is fully vaccinated

Orange County's full vaccination rate surpasses the U.S. average, allowing the market to loosen restrictions. The vaccination rate increased from 50.4% in the second quarter to 61.1% in the third quarter.



Source: CDC

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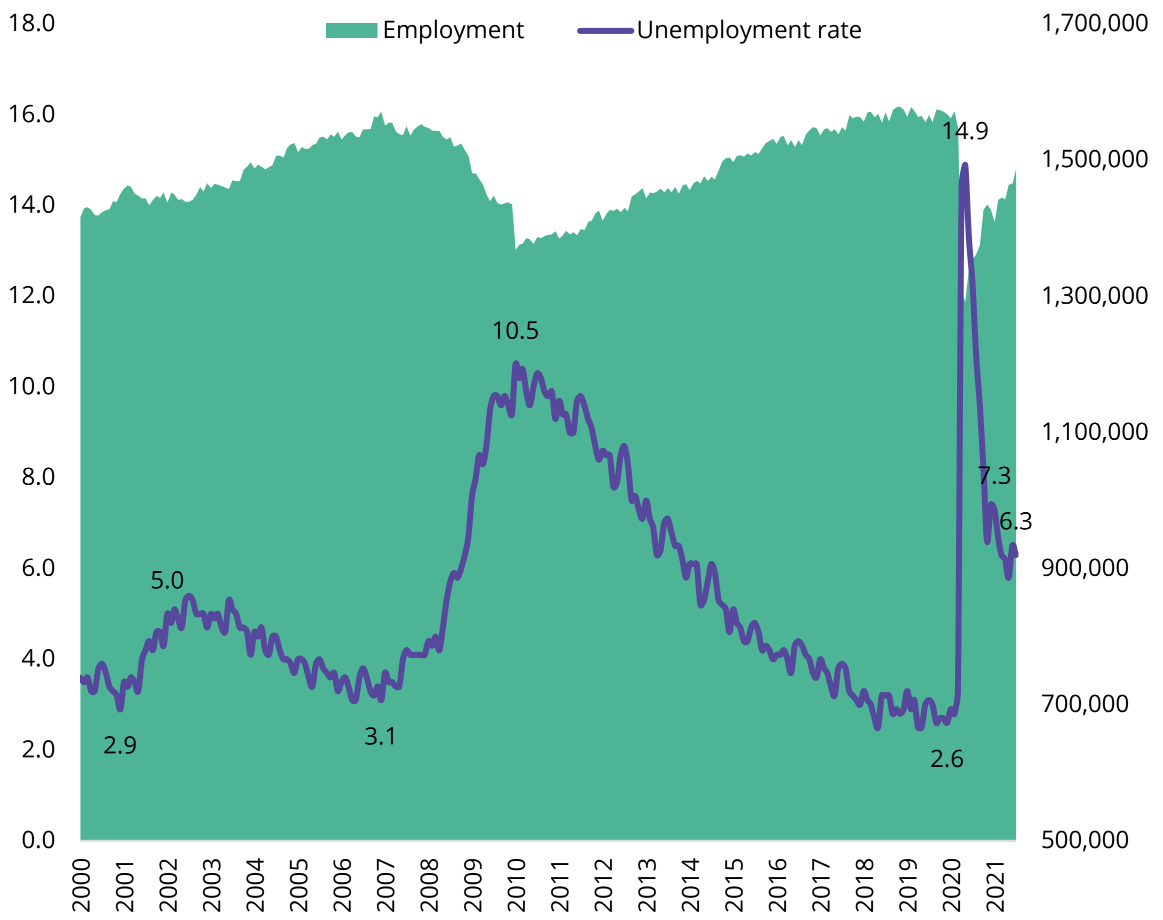
Employment and unemployment rate

6.3%

Orange County unemployment rate as of July 2021, below the height of the financial crisis

Orange County companies, especially in the leisure and hospitality sector, are hiring. Reopening efforts have applied downward pressure on the unemployment rate, which is down 860bp since the pandemic high of 14.9% reported in May 2020.



Note: Not seasonally adjusted data.
Source: Bureau of Labor Statistics

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Office-using job gains and losses

+4.7%

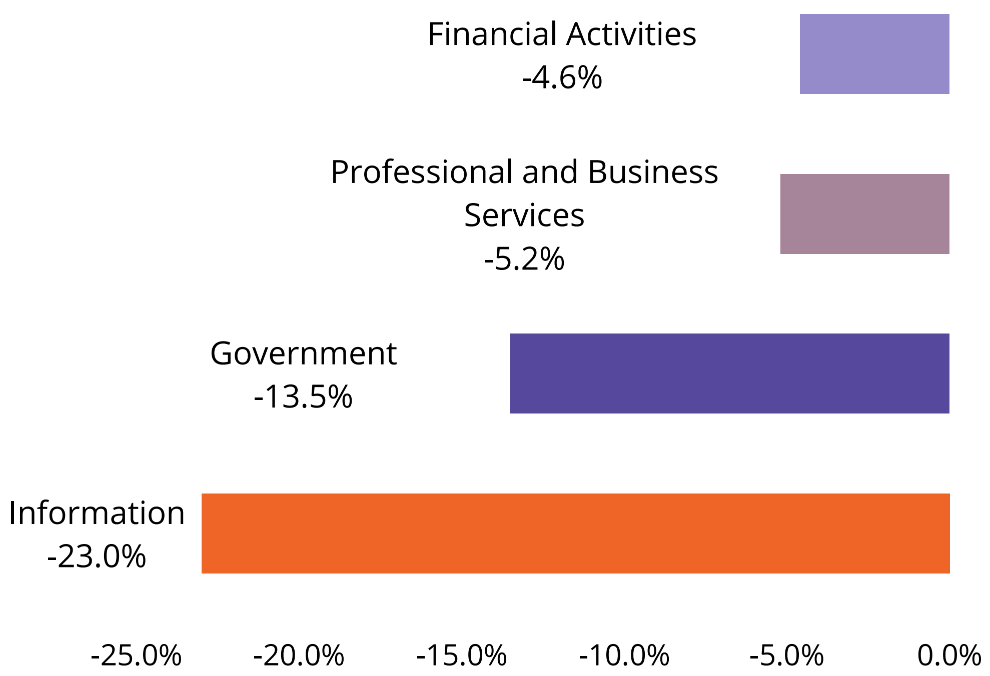
12-month change in office-using employment

Orange County MSA job losses have declined by 9.8% since the start of the pandemic, February 2020, though office-using jobs contracted by just 5.1% during the same time period.

VIEW DASHBOARD

Total change in Orange County MSA* job gains/(losses)

February 2020 to July 2021



Note: Not seasonally adjusted data. Metropolitan statistical area.
Source: Bureau of Labor Statistics

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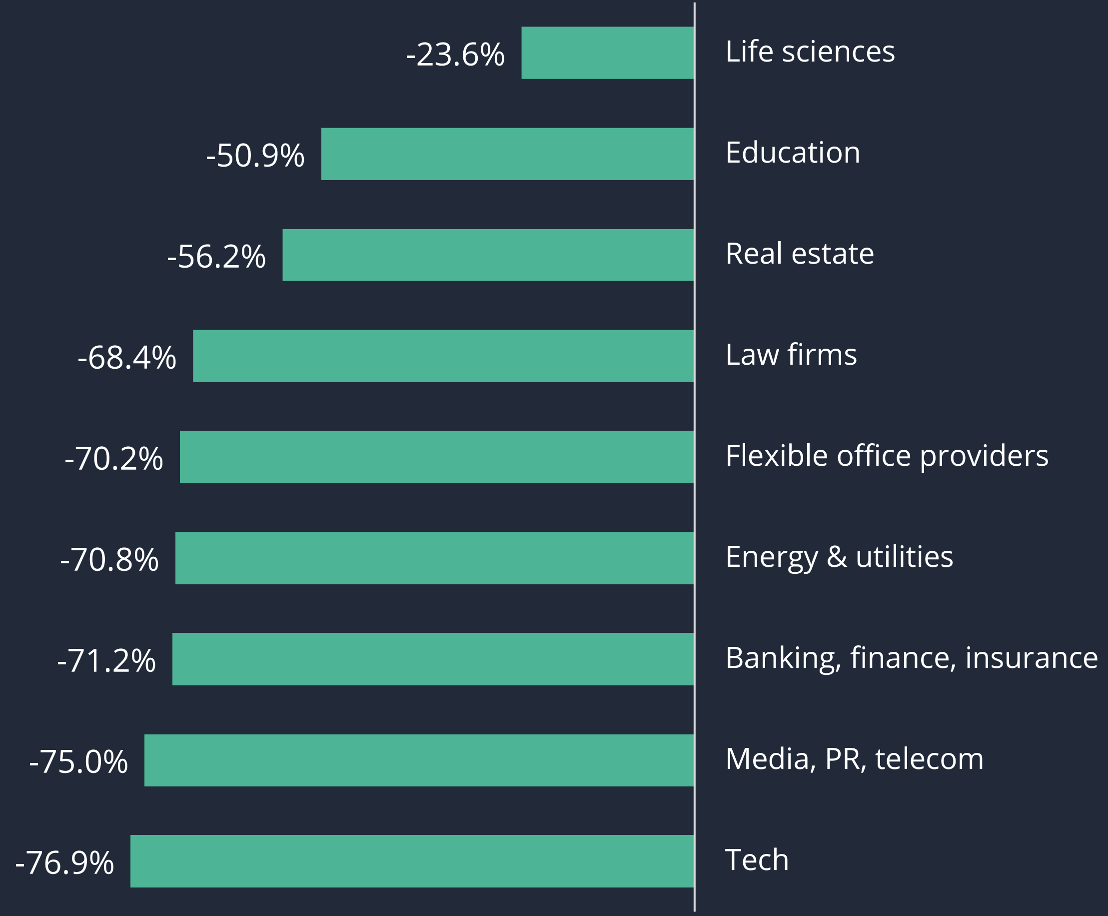
U.S. return-to-work rates since start of COVID

-76.9%

Average tech office visitor volumes across U.S. gateway cities, March 2, 2020 vs. September 20, 2021

Tech companies have adopted remote work strategies more than most major office-occupying industries, while life sciences and real estate companies have embraced flexible in-office and remote working arrangements.

VIEW VITALITY INDEX



Note: Based on cell phone data for representative full-building office occupiers only. Weekdays only. March 2, 2020 is the week preceding the quarantine. Data as of September 20, 2021.
Source: Orbital Insight, AVANT by Avison Young

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Office occupier conditions

Tenants continue to navigate an evolving return-to-work and work-from-home environment, causing leasing demand to sputter.

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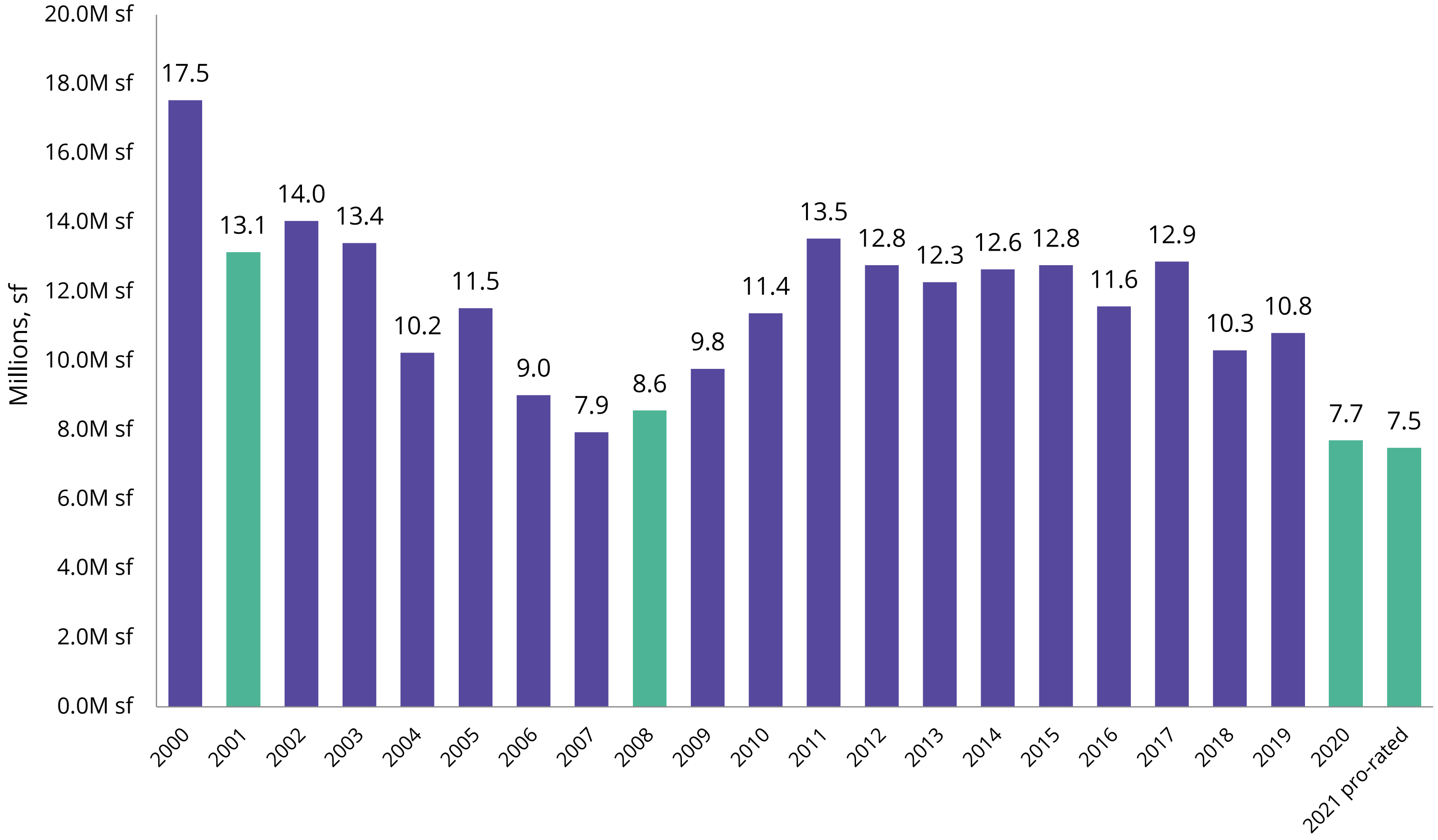
Office leasing activity

-30.7%

2020-pro-rated 2021 vs. prior 20-year annual average leasing activity

Leasing activity was slow first half of 2021, going from 1.8 msf in Q1 2021 to 1.8 msf in Q2 2021 to 2.1 msf in Q3 2021. The annualized pace of closed deals remains the weakest going back over two decades.



Source: AVANT by Avison Young, CoStar

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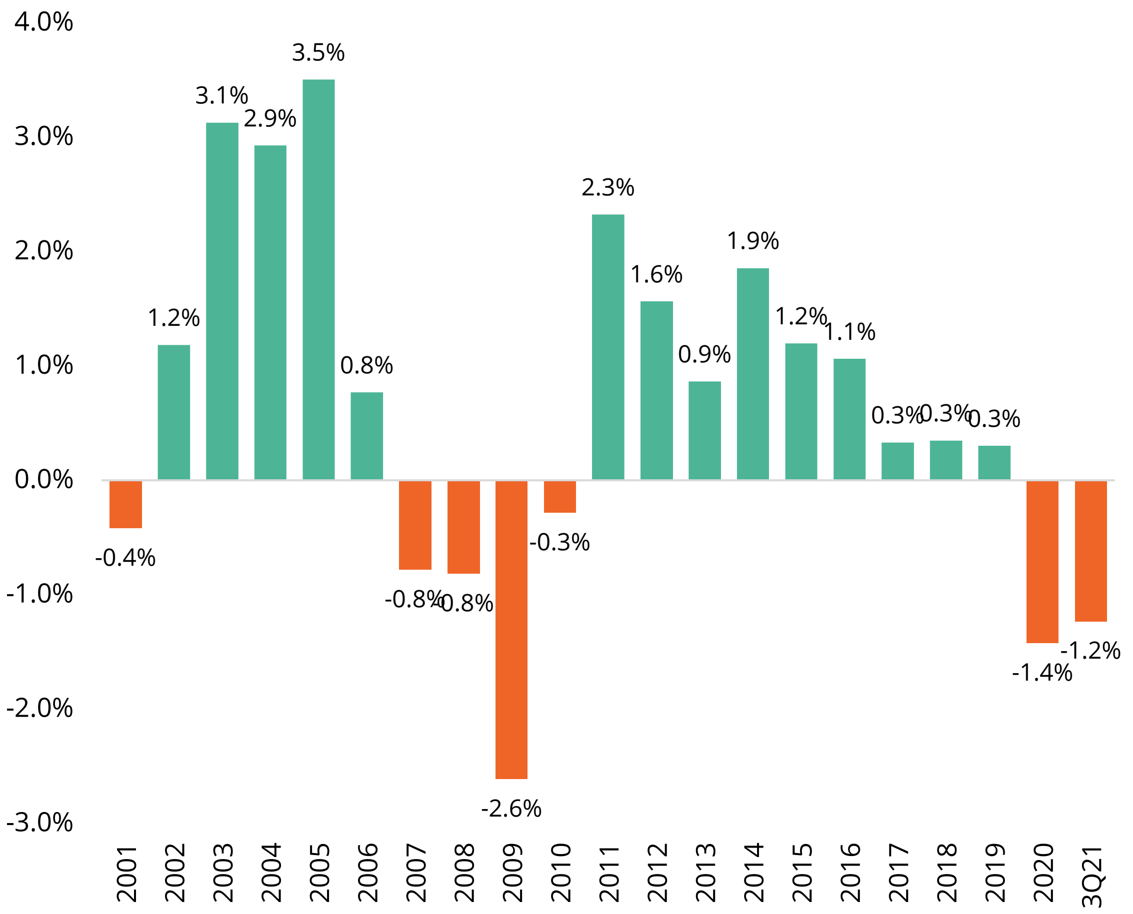
Absorption

-2.6%

Net absorption as a percentage of inventory, 2020 through 3Q 2021

Absorption from 2020 to 3Q 2021 has totaled 3.5 msf or -2.6% of the existing stock. Net absorption in the third quarter continued to trend negatively, though not at the rates experienced in prior recessionary quarters.



Source: AVANT by Avison Young, CoStar

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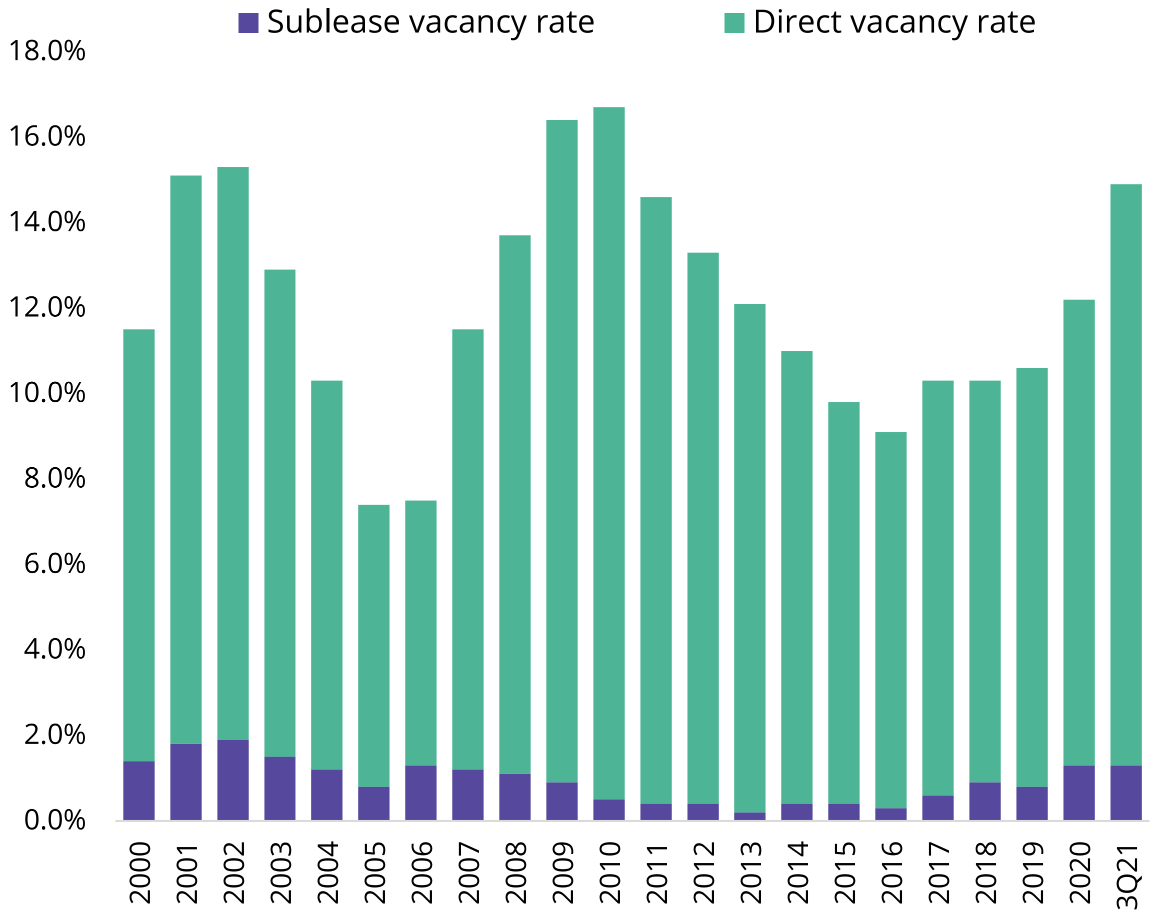
Vacancy rate

13.6%

Post-2010 high Orange County vacancy as of Q3 2021

The direct vacancy rate of 12.3% in Q3 2021 remained at a post-2010 peak. The current sublease vacancy rate of 1.3% represents a post-2006 peak but has not reached 2003 (1.5%) nor 2002 (1.9%) levels.



Source: AVANT by Avison Young, CoStar

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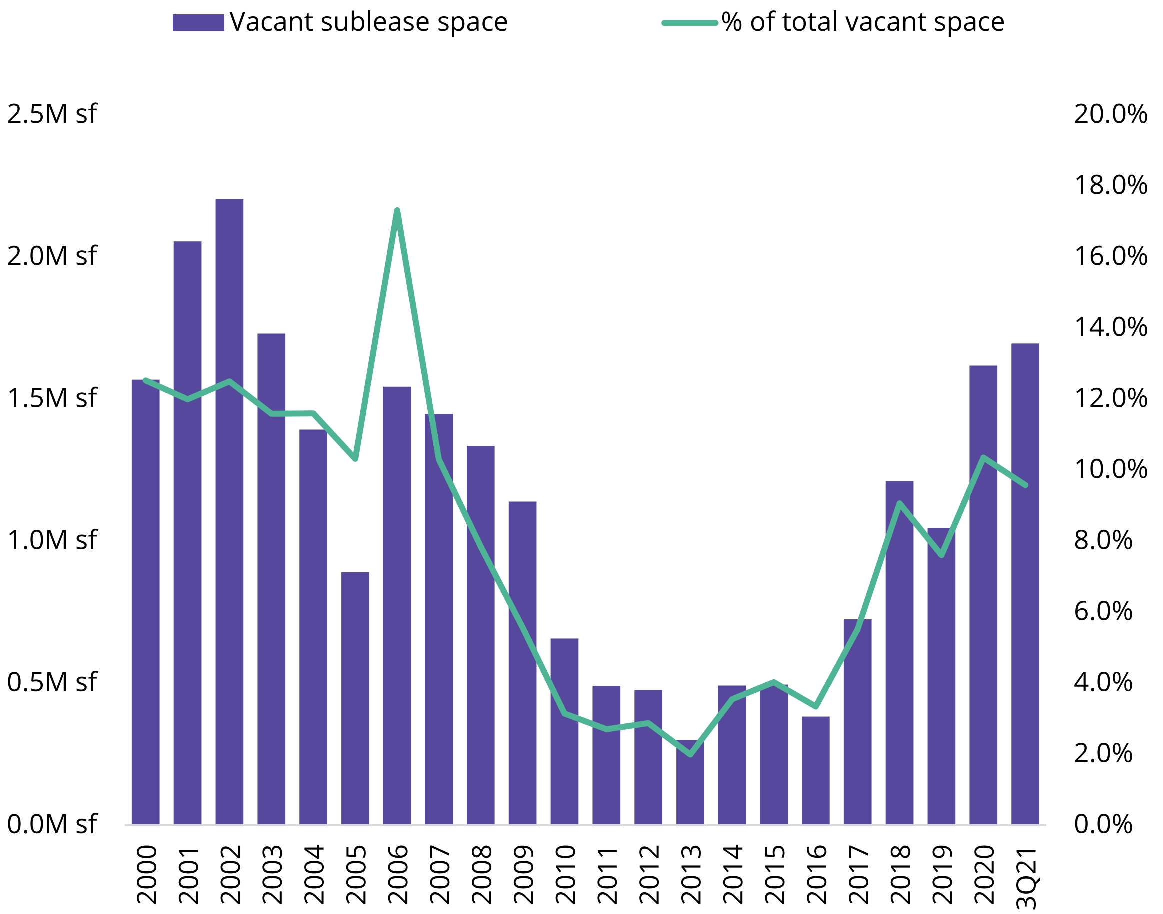
Vacant sublease space

1.7 msf

Post-2002 high vacant sublease space as of Q3 2021

Tenants have a greater selection of sublease options in terms of square feet available in the current environment compared with the Financial Crisis. The proportionate share of vacant sublease space, however, has not kept pace with Financial Crisis or Dot-Com Crisis levels due to the unprecedented post-COVID slowdown in demand.



Source: AVANT by Avison Young, CoStar

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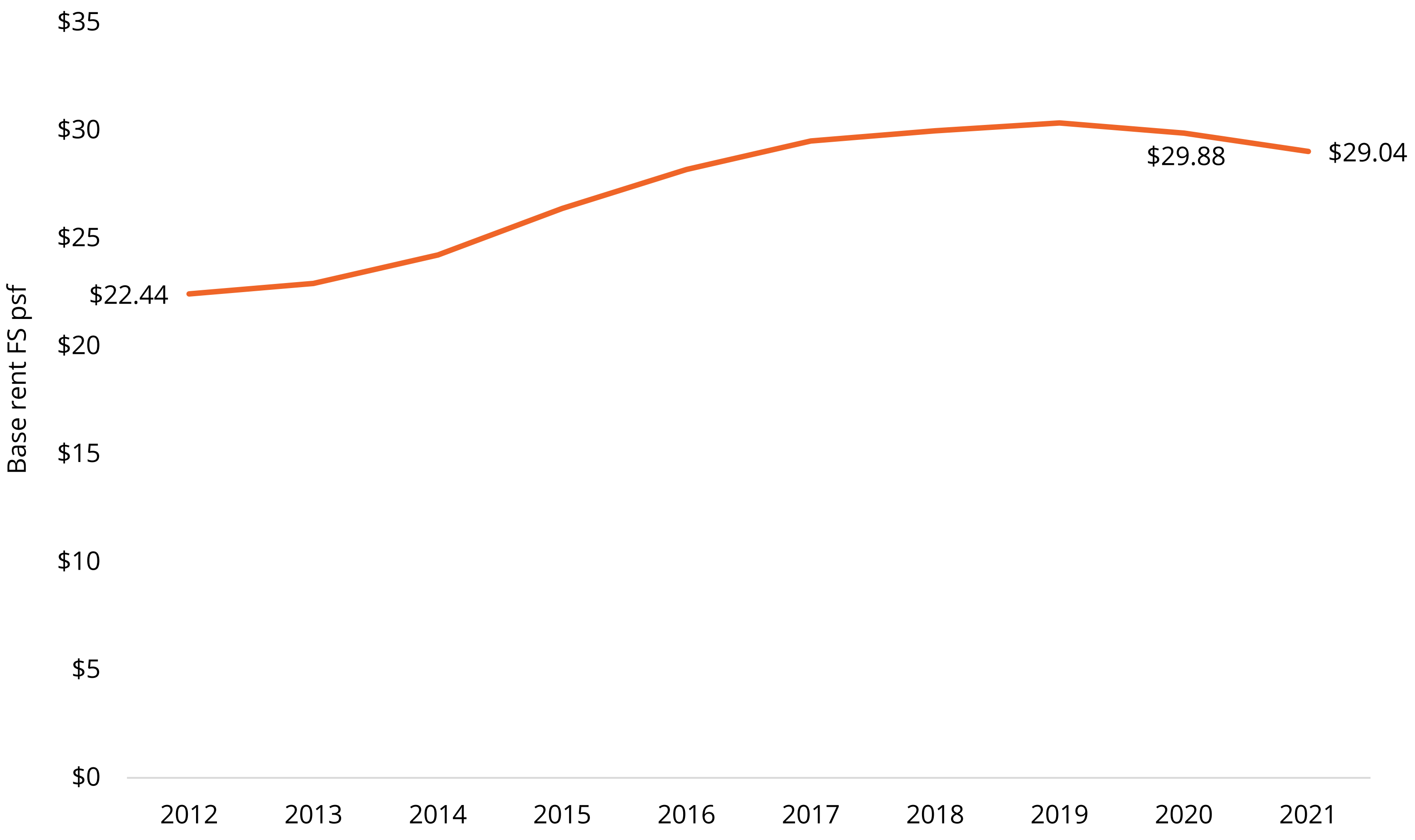
Base rents

-4.3%

Change in base rents, 2019 to 2021

The year-to-date decrease in base rents of $0.84 psf can be attributed to tenant-favorable market conditions in Class A market segment, demonstrated by elevated sublease and direct vacancies and historically low demand.



Note: Direct relocations for Trophy, Class A, Class B and Class C properties.
Excludes subleases, expansions and renewals.
Source: AVANT by Avison Young

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Orange County office construction pipeline

28 properties

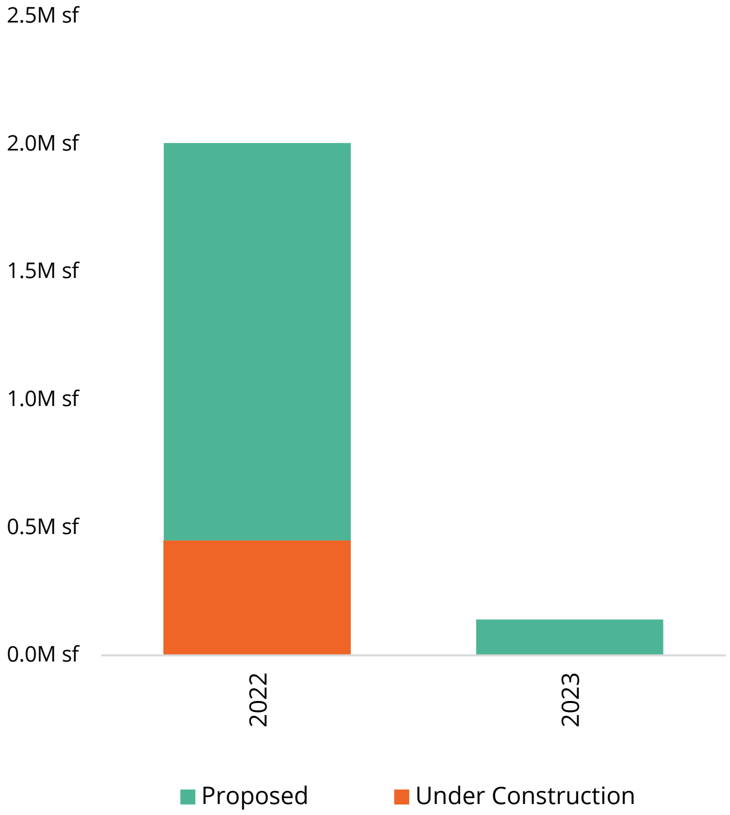
proposed or under construction

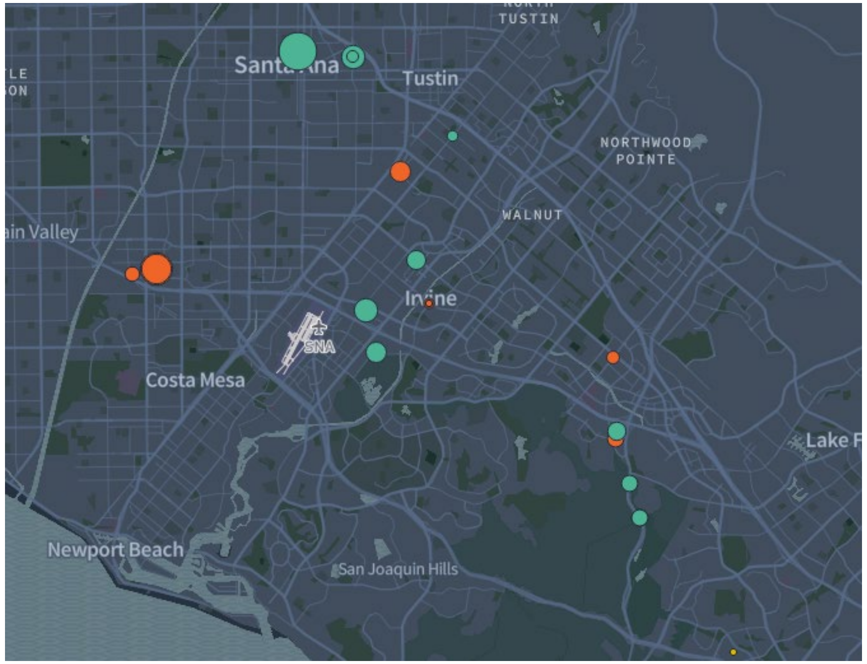
4.6 msf

proposed or under construction

3.8%

share of office inventory





Source: AVANT by Avison Young

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Capital market conditions

Sale activity is on pace to surpass 2020 levels after a temporary pause in investor demand paused by the pandemic.

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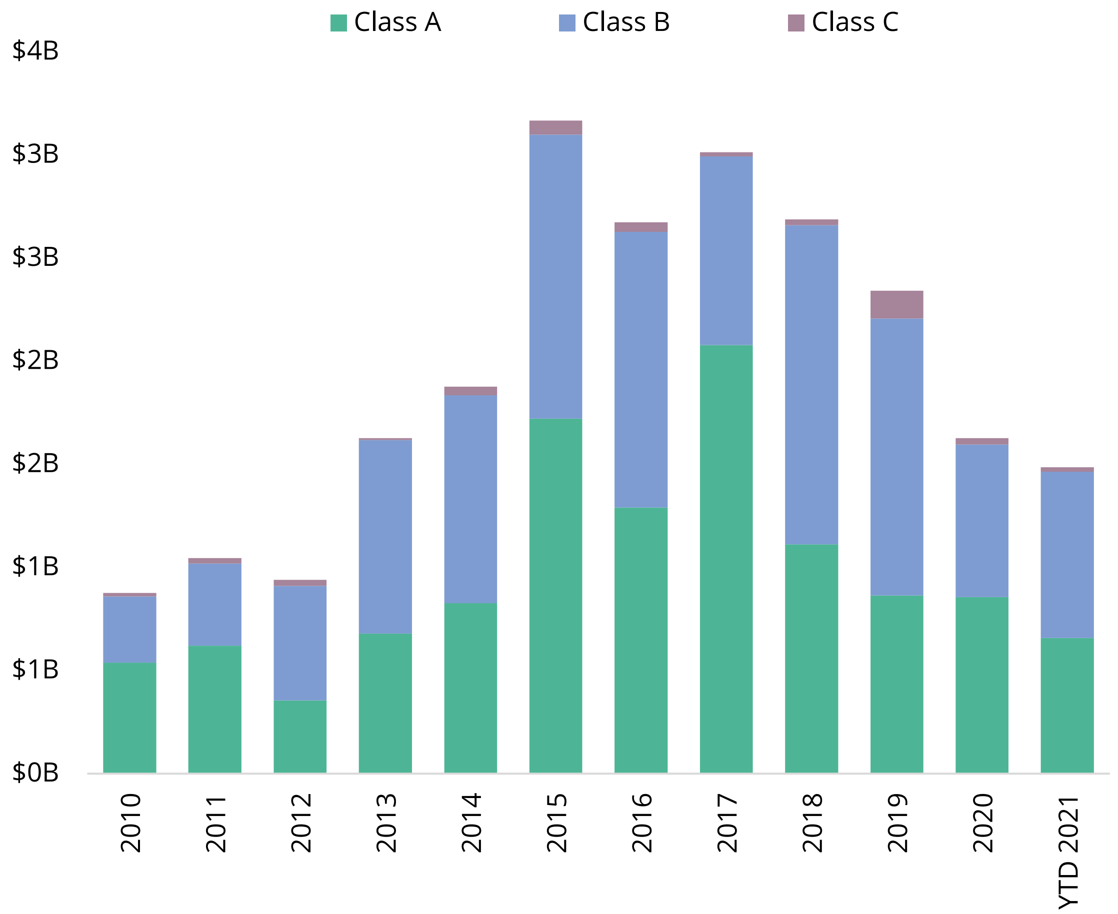
Office investment dollar volume

$3.1B

Orange County office dollar volume 2020 to September 2021

Prorated annual average investment dollar volume of $3.0B from 2020 to Q3 2021 represents a decrease of 72.1% compared with 2015 to 2019 levels. The slowdown in transaction activity is partly attributable to underwriting difficulties given prevailing occupier uncertainties, despite ample uncommitted capital.



Source: AVANT by Avison Young, RCA, CoStar

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Office asset pricing

-9.4%

Orange County office pricing from 2020 to September 2021

Although Orange County office asset pricing turned downward by 9.4% in Q3 2021, pricing remains above pre-COVID levels. The recent slump in third quarter asset pricing is attributable to a decrease in Class A office investment and increase in Class B and C properties.

Source: AVANT by Avison Young, CoStar, RCA

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Looking forward

Here’s what we can expect

- Major office employers have, and are likely to continue to, shed excess space in Orange County as they have adopted hybrid work strategies. These occupied space contractions should cause **supply risk to continue to escalate**. A total of **3.3 msf of sublet space** remains on the market, with Class A options accounting for **2.2 msf**.
- **Top-tier properties have witnessed the greatest rent losses**, with elevated vacancies and a flood of sublease space coming online. Falling rents in mid-tier and high-end space could create opportunities for tenants looking to move up in class.
- **Loosening international travel restrictions** in November should positively influence the broader Orange County economy.
- Despite the improving labor market, **vacancy should continue to rise** as companies continue to navigate their post-pandemic workplace occupancy strategies.

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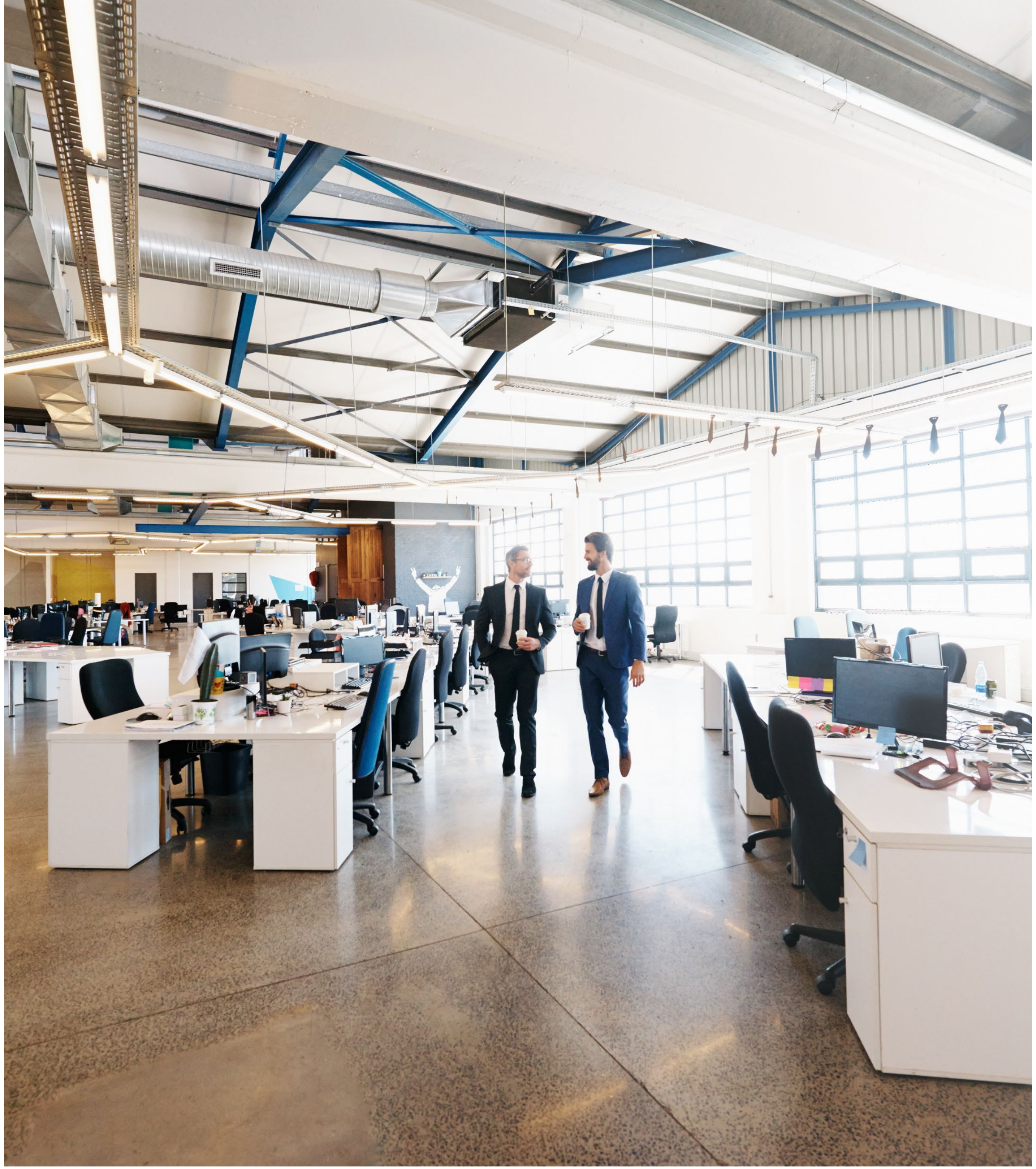

Let's talk

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