

1Q24

NEWMARK

Orange County Office Market Overview



Market Observations

Economy

- Local unemployment across all industries was 4.2% in February, up 80 bps from February 2023. This is just above the U.S. average of 3.9%.
- Despite a rise in unemployment, local office-using employment in February saw relatively little change from 12 months prior, currently totaling 445,900 jobs.
- The Federal Reserve raised interest rates eleven times from March 2022 to July 2023, bringing today's benchmark rate to the highest level in 22 years. The Fed has signaled its intention to cut rates in 2024, which will likely happen in the latter half of the year. Lower interest rates have historically encouraged leasing and sales activity.
- For now, higher capital costs continue to weigh on most businesses.

Major Transactions

- Private investors were the only active buyers during the first quarter as institutional buyers await interest rate cuts. A family foundation purchased 200 East Sandpointe Avenue for \$36.4 million and a local private investor purchased One MacArthur Place for \$31.1 million.
- The top fives leases of the quarter were all located in the Airport submarket.
- Loan agency Symple Lending leased 51,269 SF in the top floor at Park Place in Irvine.
- Clear Start Tax Relief took 45,960 SF of sublease space that had originally been leased to Better Mortgage Corporation at Five Park Place in Irvine.

Leasing Market Fundamentals

- Vacancy and availability rates were flat relative to last quarter but remain elevated by historical standards. Total vacancy was 18.5%, 330 bps above the five-year average.
- Net absorption broke a nine-quarter record high, totaling 188,084 SF in net gains.
- Office demand is muted and there is no office construction in the market for the first time since the Global Financial Crisis in 2008. The Irvine Company scrapped plans for a 532,000-SF life science campus at UCI Research Park and will now build a 1,200-unit apartment complex on the 19-acre site instead. Underperforming office projects are being slated for conversion to other uses.
- 35.2% of Orange County's office inventory consists of buildings with sub-80% occupancy. Buildings with lower occupancy thresholds tend to struggle to generate positive NOI, making it difficult to support debt (if debt is present on a given building).

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.
- Corporate America is more prepared to execute on real estate decisions, which will hopefully increase leasing activity in 2024.
- Only 11% of aspiring Orange County home buyers can afford a median-priced home (currently \$1.3 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.
- Some obsolete office inventory will be redeveloped for in-demand industrial space.

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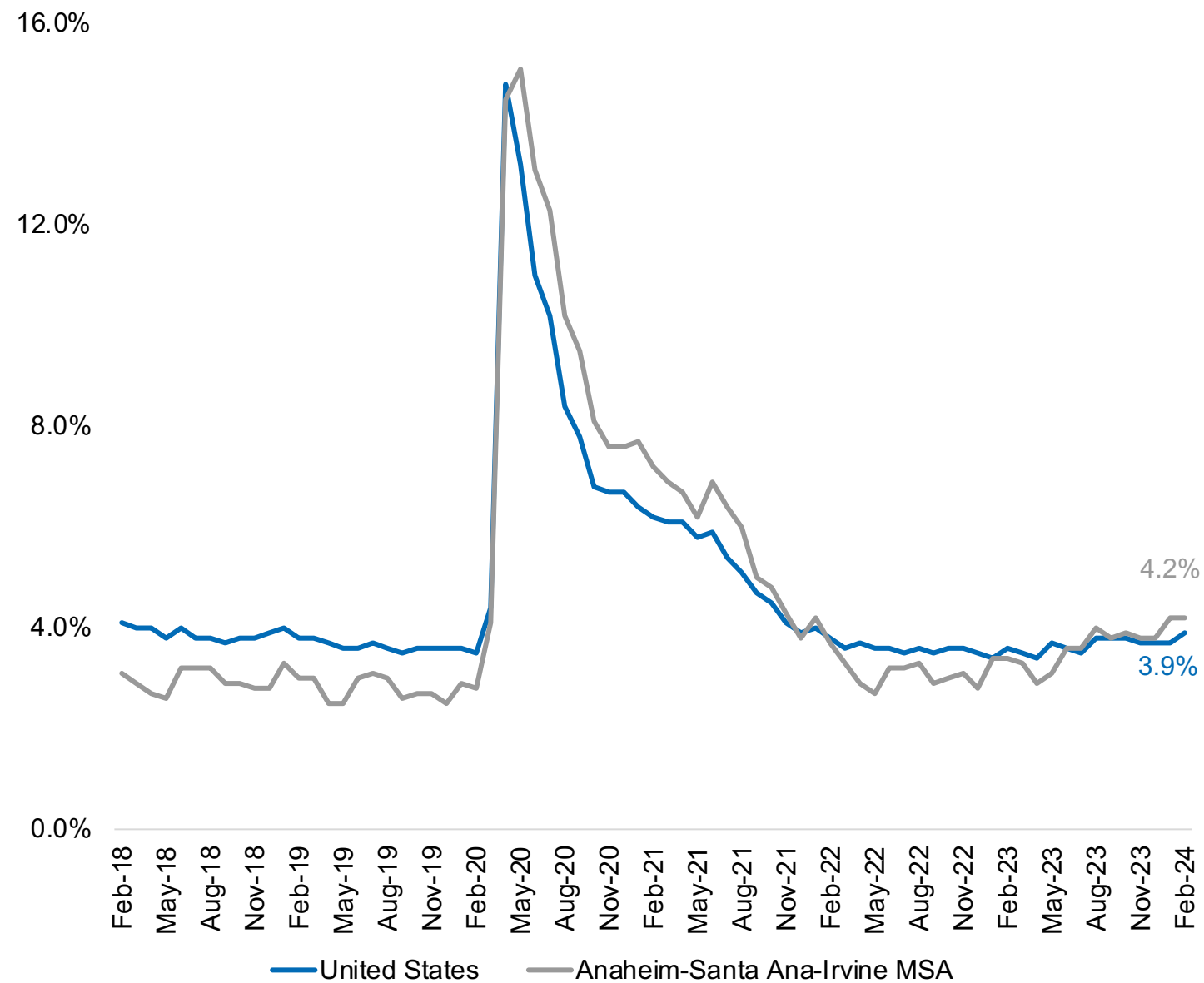
Economy



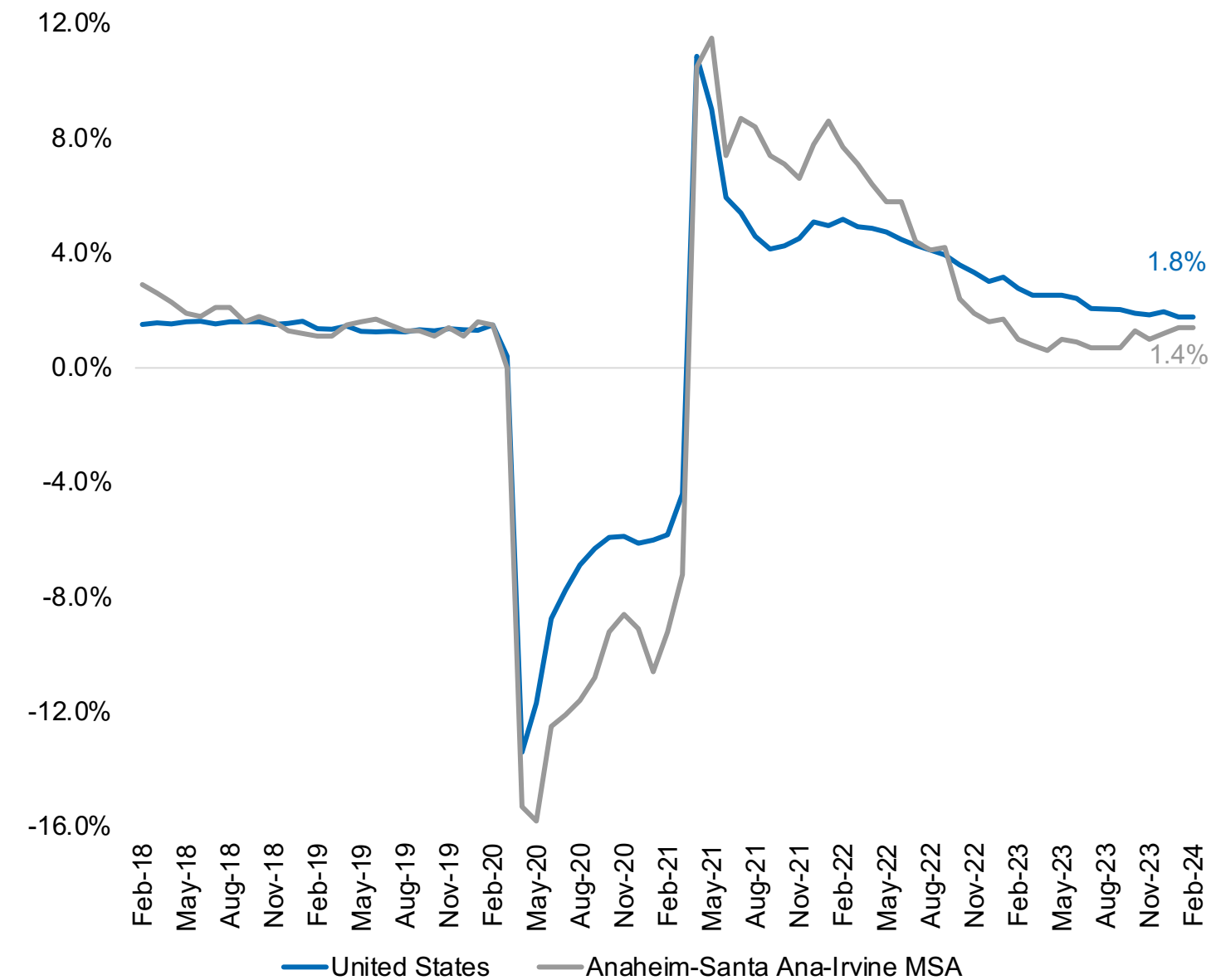
Local Unemployment Inches Above National Average

Orange County unemployment has increased over the last year, going from 3.4% in February 2023 to 4.2% in February 2024. This increase can be attributed to cooling in the labor market and cost-cutting measures, such as hiring freezes, enacted by companies in the current high-interest-rate environment.

Unemployment Rate, Seasonally Adjusted



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

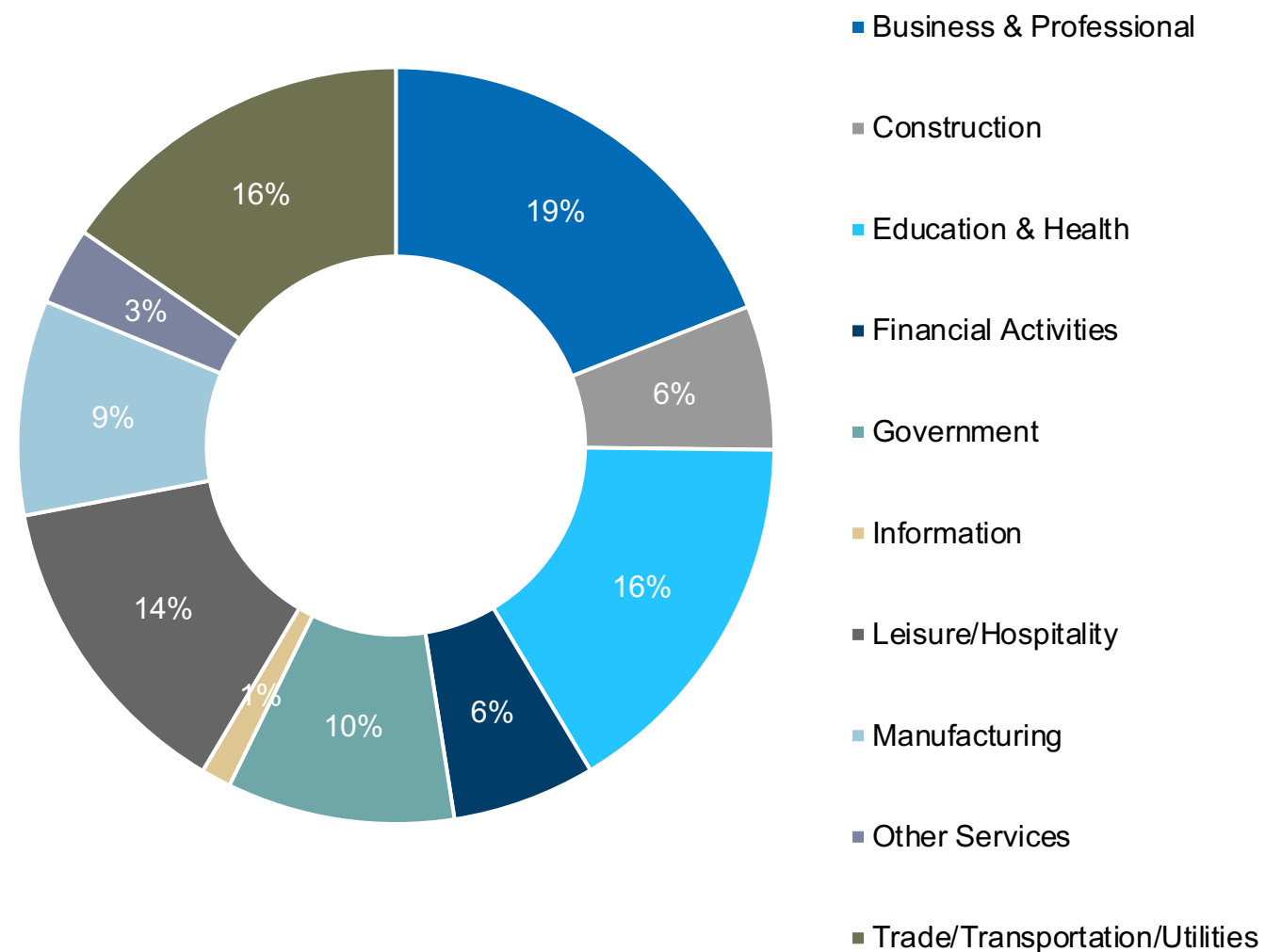


Source: U.S. Bureau of Labor Statistics, Anaheim-Santa Ana-Irvine, CA
 Note: February 2024 data is preliminary.

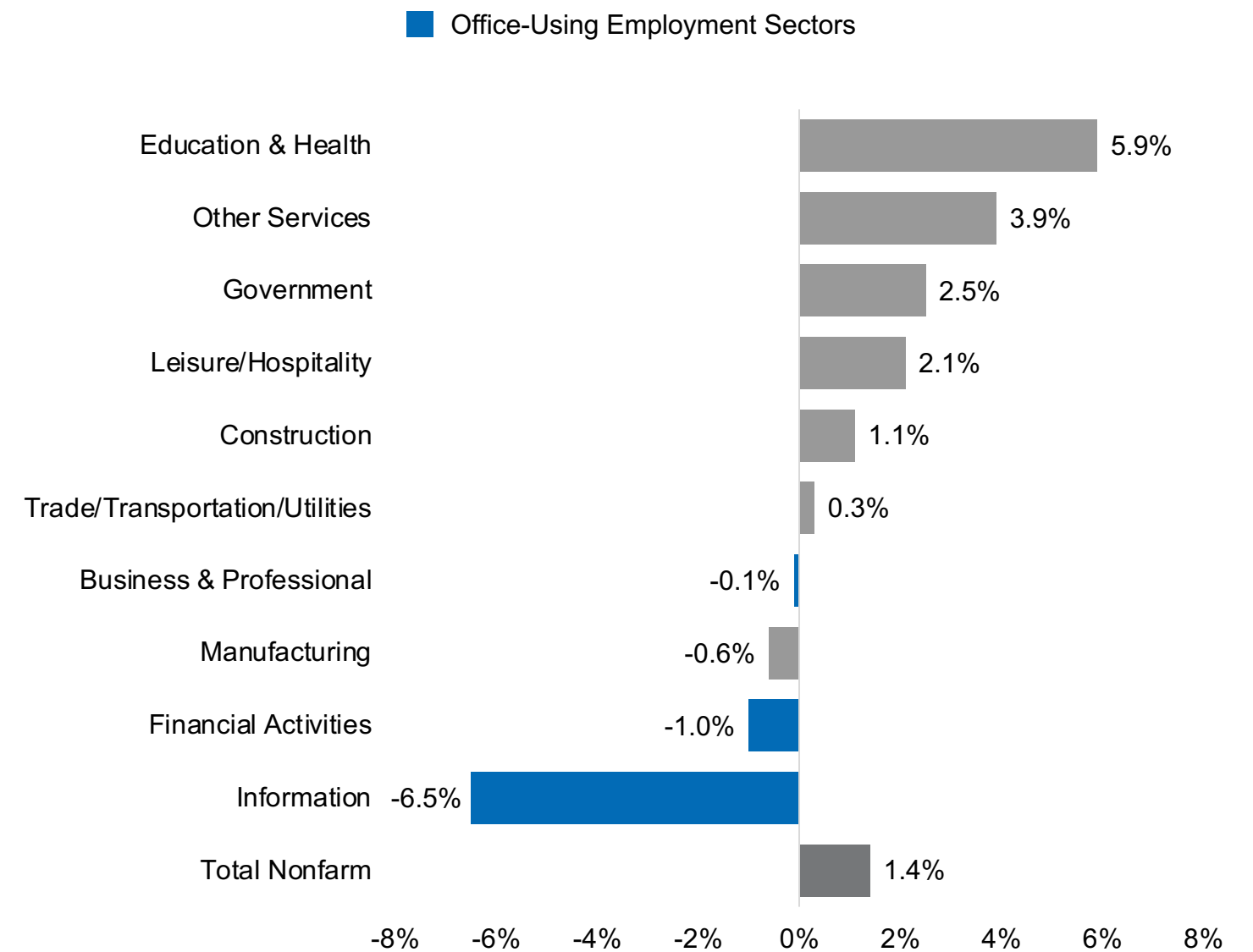
Office-Using Sectors Lead in Job Losses

Financial activities, information and the business and professional sectors all had net job declines over the last 12 months. Tech companies, which are generally classified under the information sector, continue to focus on cost-cutting moves by shedding unneeded staff and space.

Employment by Industry, February 2024



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

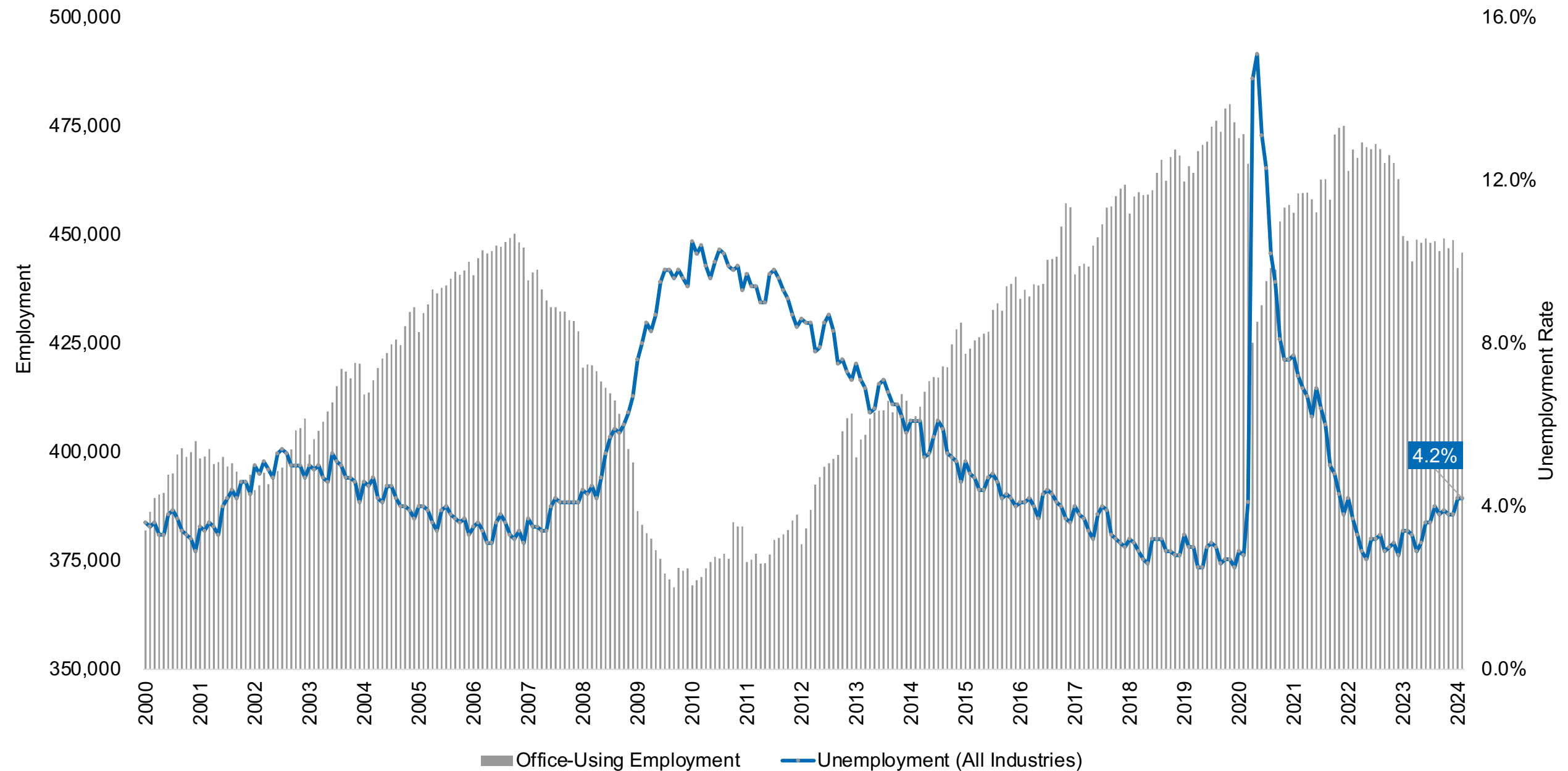


Source: U.S. Bureau of Labor Statistics, Anaheim-Santa Ana-Irvine, CA
 Note: February 2024 data is preliminary.

Office-Using Employment Even Despite Unemployment Growth

Office-using employment in February 2024 was on par with 12 months ago. 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

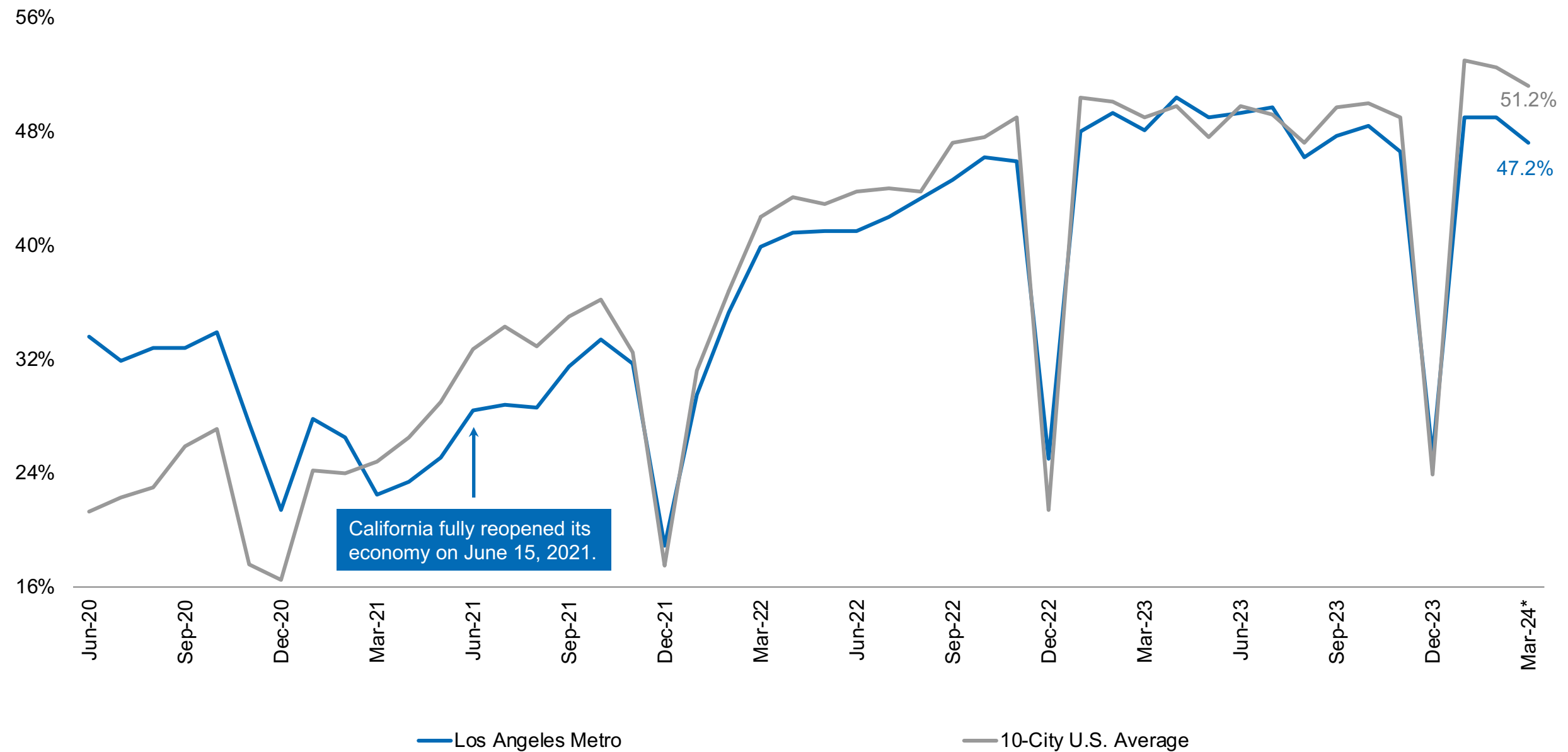
Note: February 2024 data is preliminary.

*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 Below 50%

The winter holidays aside, local utilization has trended upwards over the past three years and has generally hovered in the upper 40s since September 2022 as most companies continue to rely on hybrid work schedules.

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. March 2024's average is for the week of 3/27/24.

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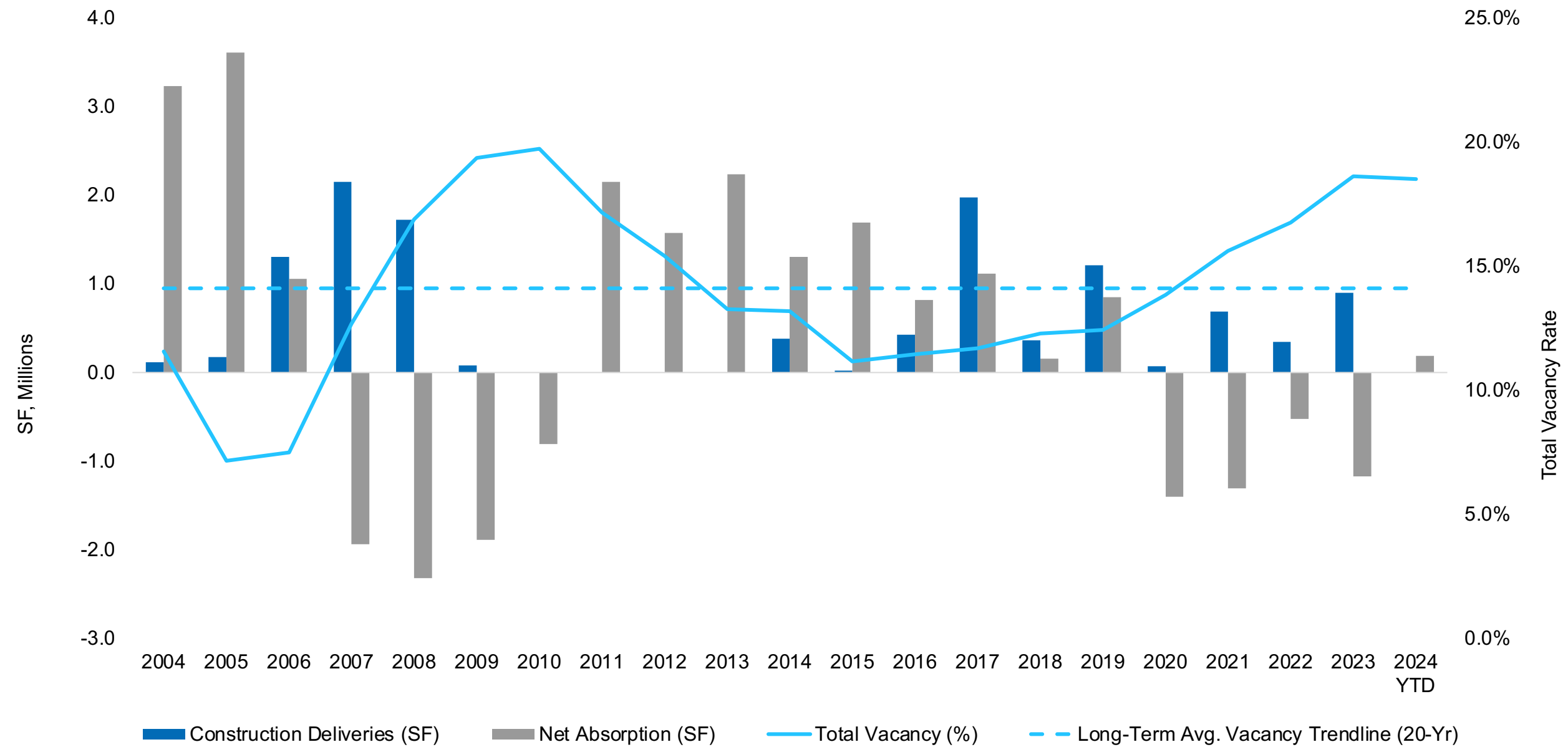
Leasing Market Fundamentals



Vacancy Increases but Remains Under 2010's 20.0% Average

Current vacancy (18.5%) was up 50 bps from 12 months ago and down 10 bps from the end of 2023. Tenants are generally opting for smaller spaces at new, low-rise developments or seeking the most affordable option on the market. Vacancy is expected to remain elevated in the quarters to come.

Historical Construction Deliveries, Net Absorption, and Vacancy

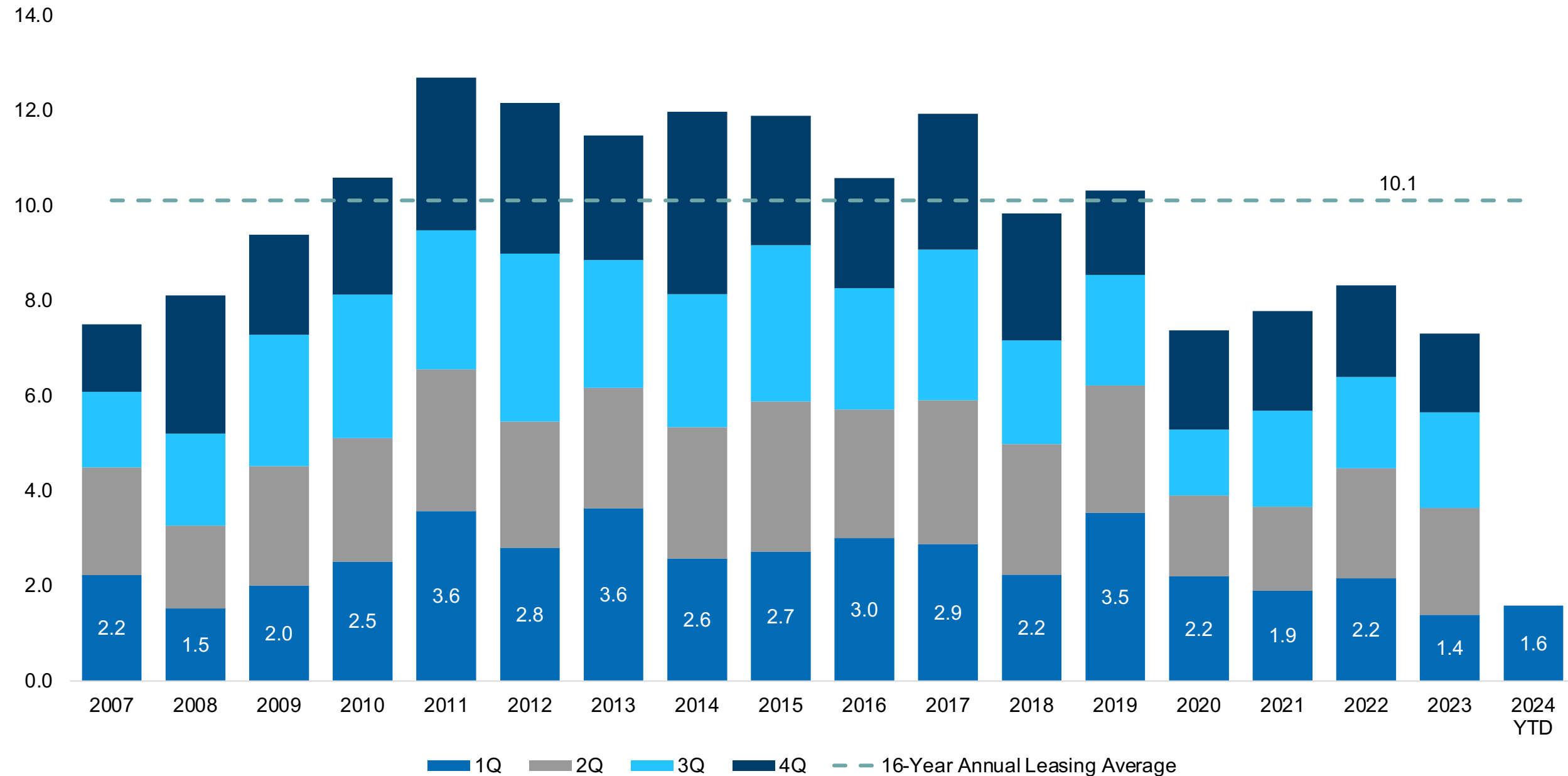


Source: Newmark Research

First Quarter Leasing Activity Picks Up Slightly After a Muted 2023

Hybrid work models and a cloudy economic outlook are accelerating ongoing space reductions, while hampering overall leasing activity. The first quarter of 2024 saw 1.6 MSF of leasing activity, an improvement over the 1.4 MSF in the first quarter of 2023. Leasing activity in 2023 totaled 7.3 MSF, noticeably down from 2022's 8.3 MSF.

Total Leasing Activity (MSF)

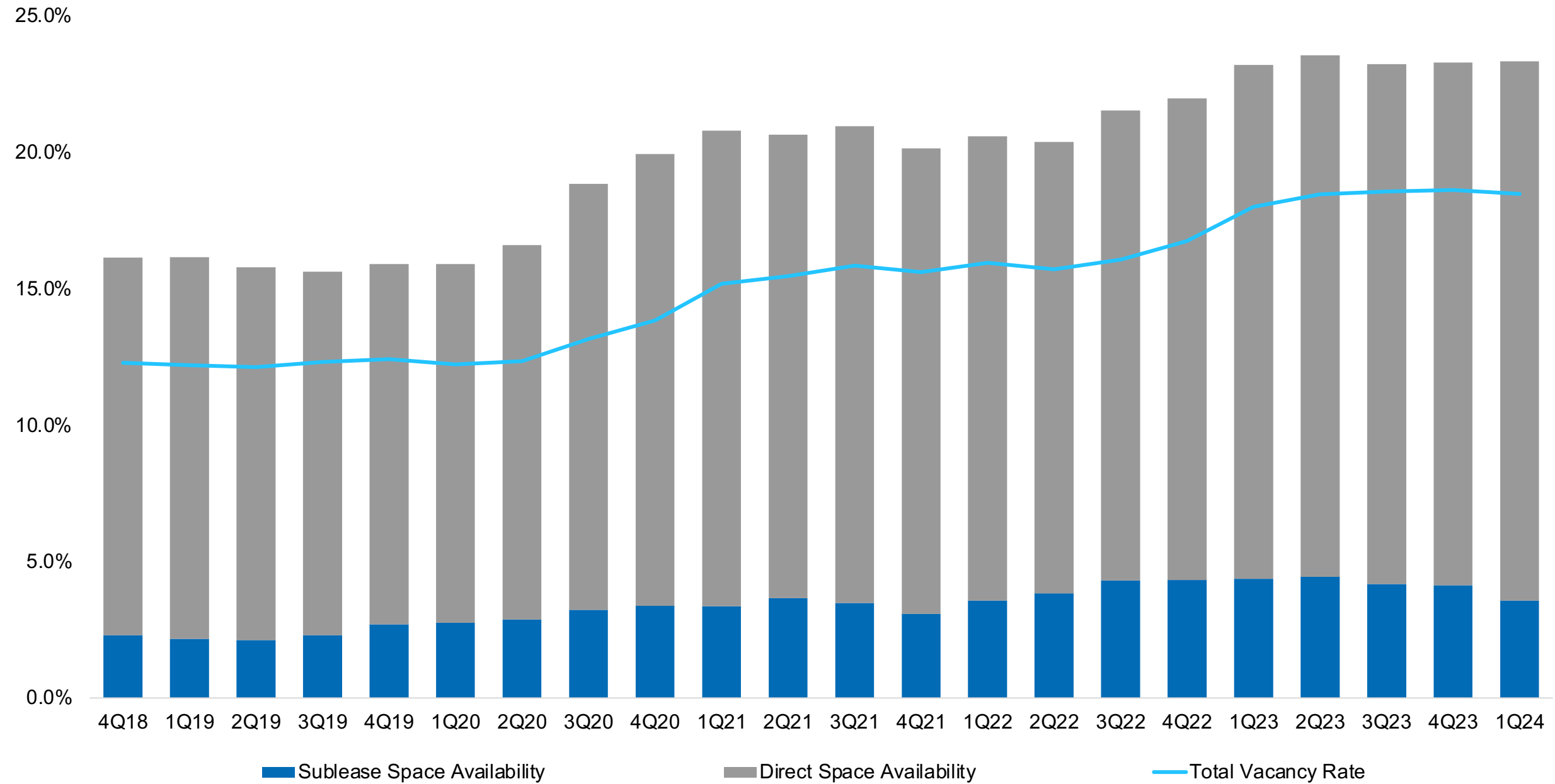


Source: Newmark Research, CoStar

Total Availability Levels Off

The total availability rate of 23.3% for the first quarter was unchanged from the end of 2023. A slight decrease in sublease availability was offset by an increase in direct availability.

Available Space and Tenant Demand as Percent of Overall Market



Source: Newmark Research

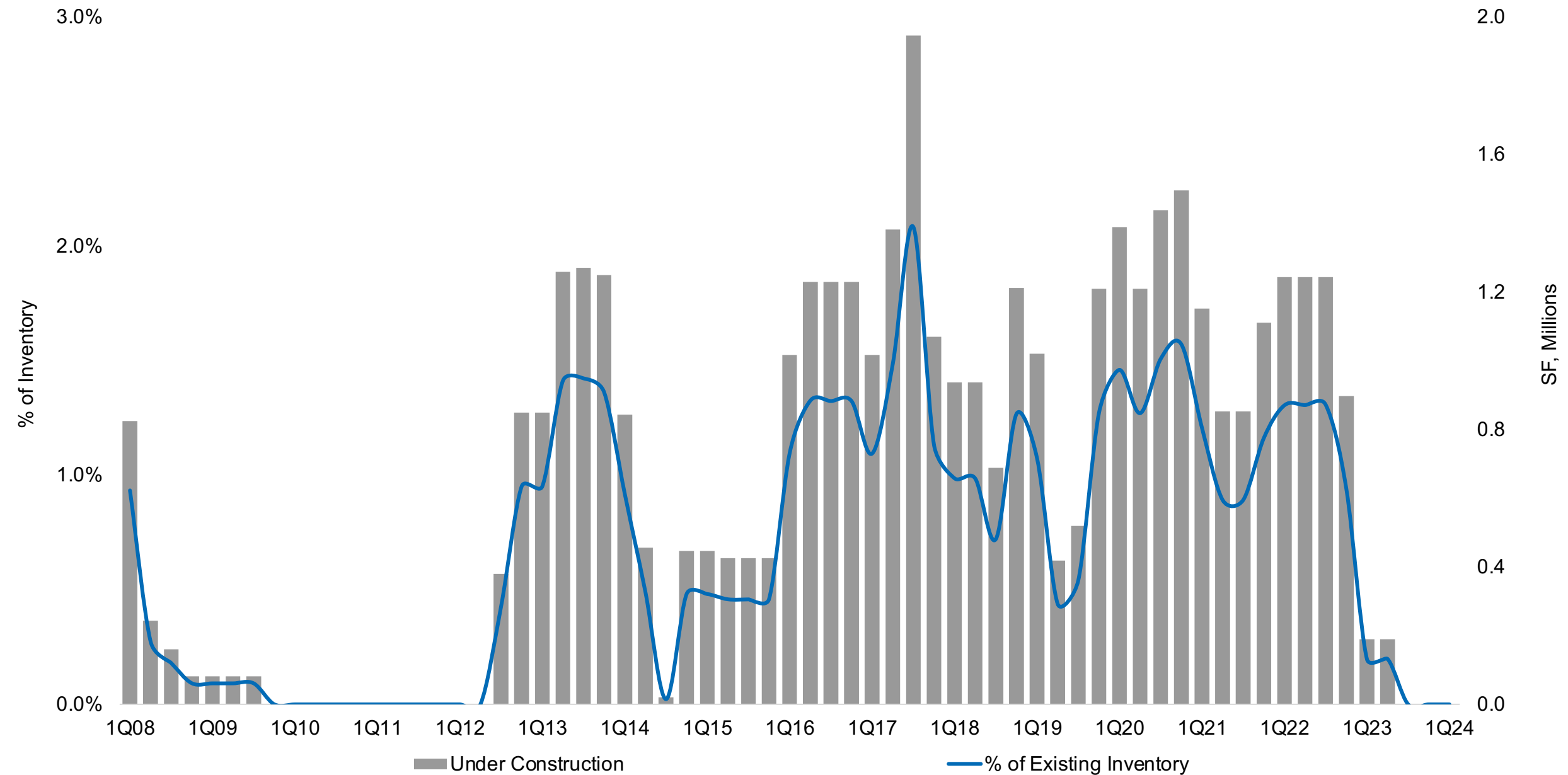
Airport Area has the Bulk of the Metro's Availability

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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

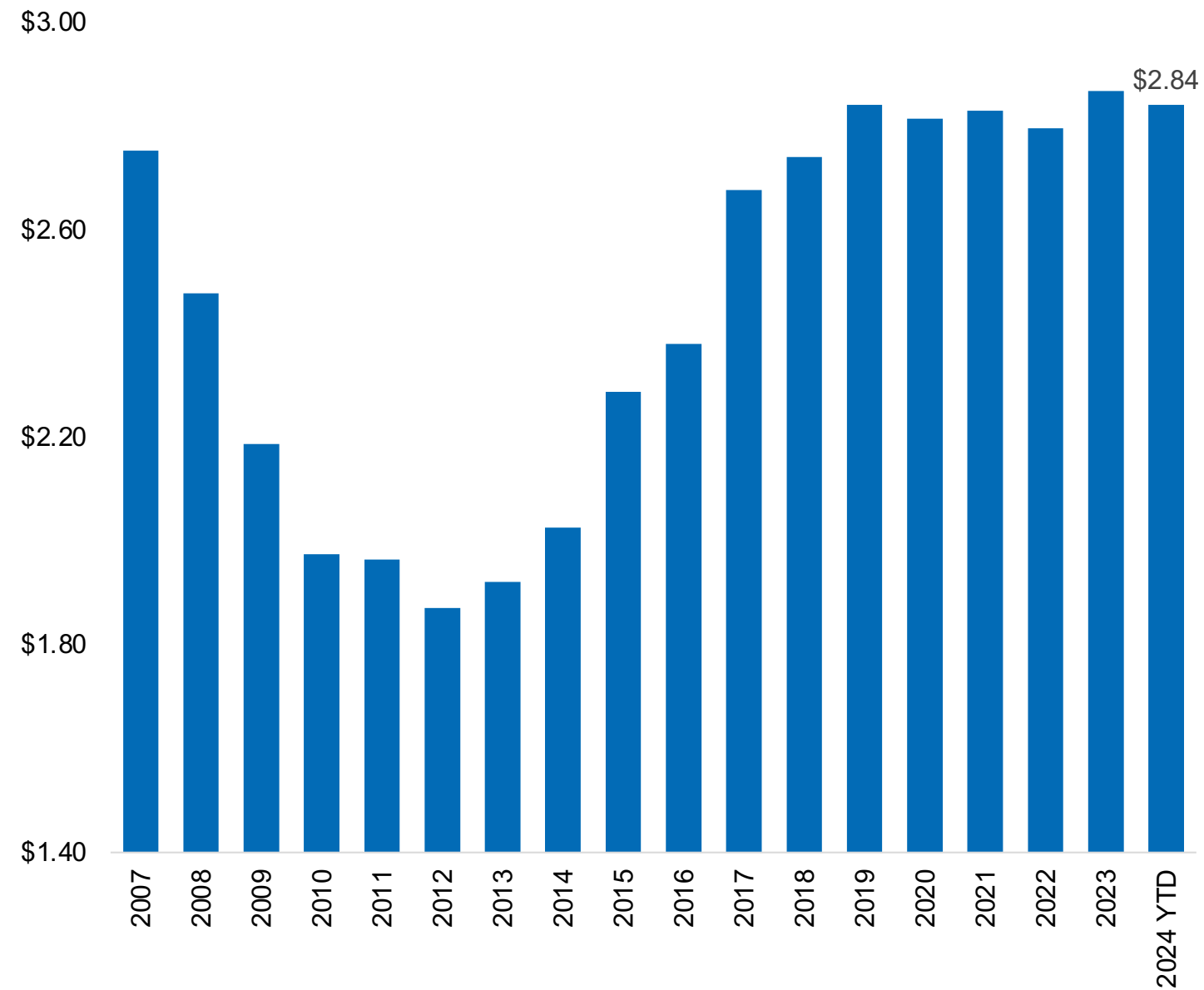


Source: Newmark Research

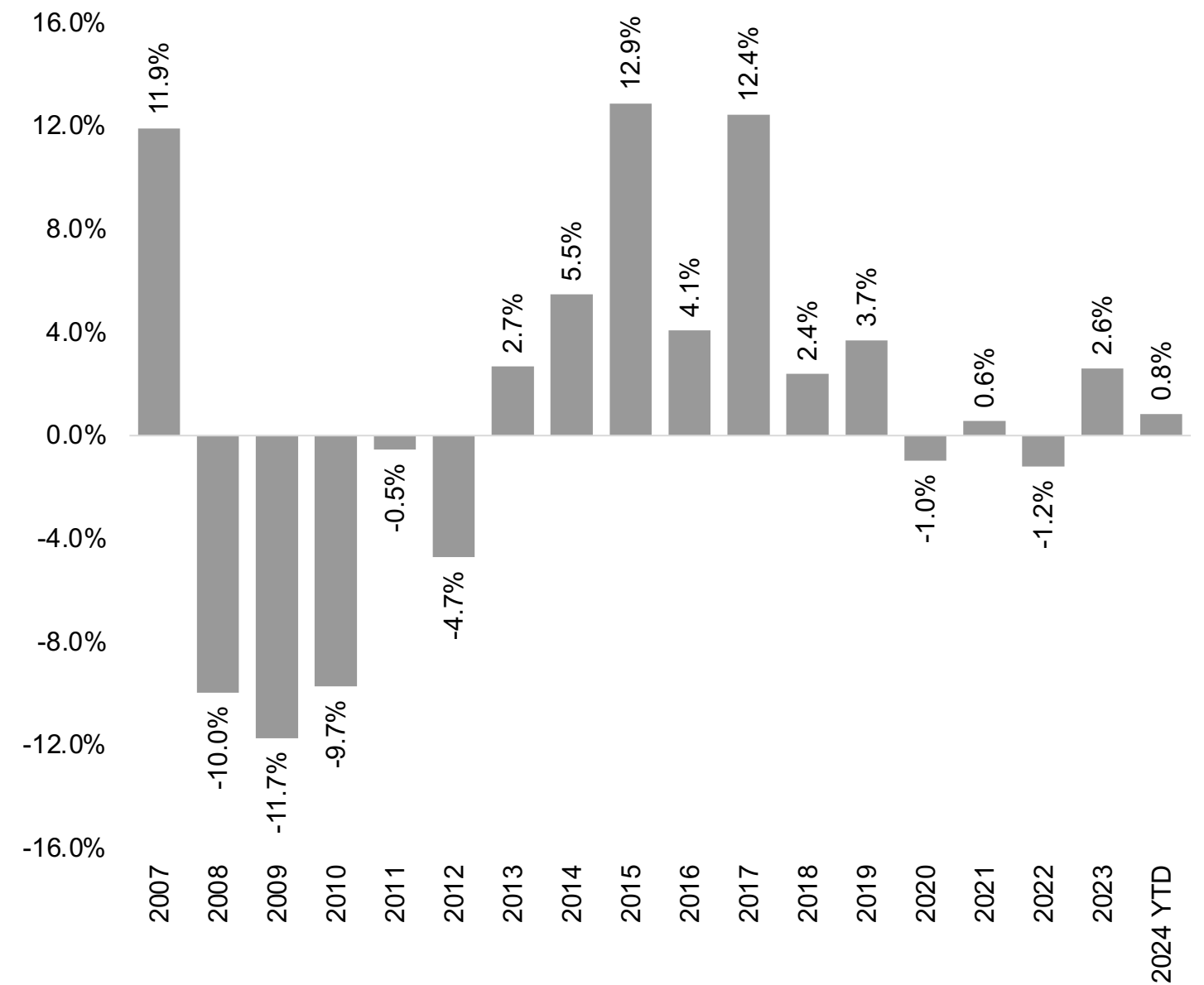
Asking Rents Remain Elevated

Leasing activity has been subdued in recent quarters, which has caused rent growth to stall. The fact that rents have not substantially declined despite slower activity can be attributed 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

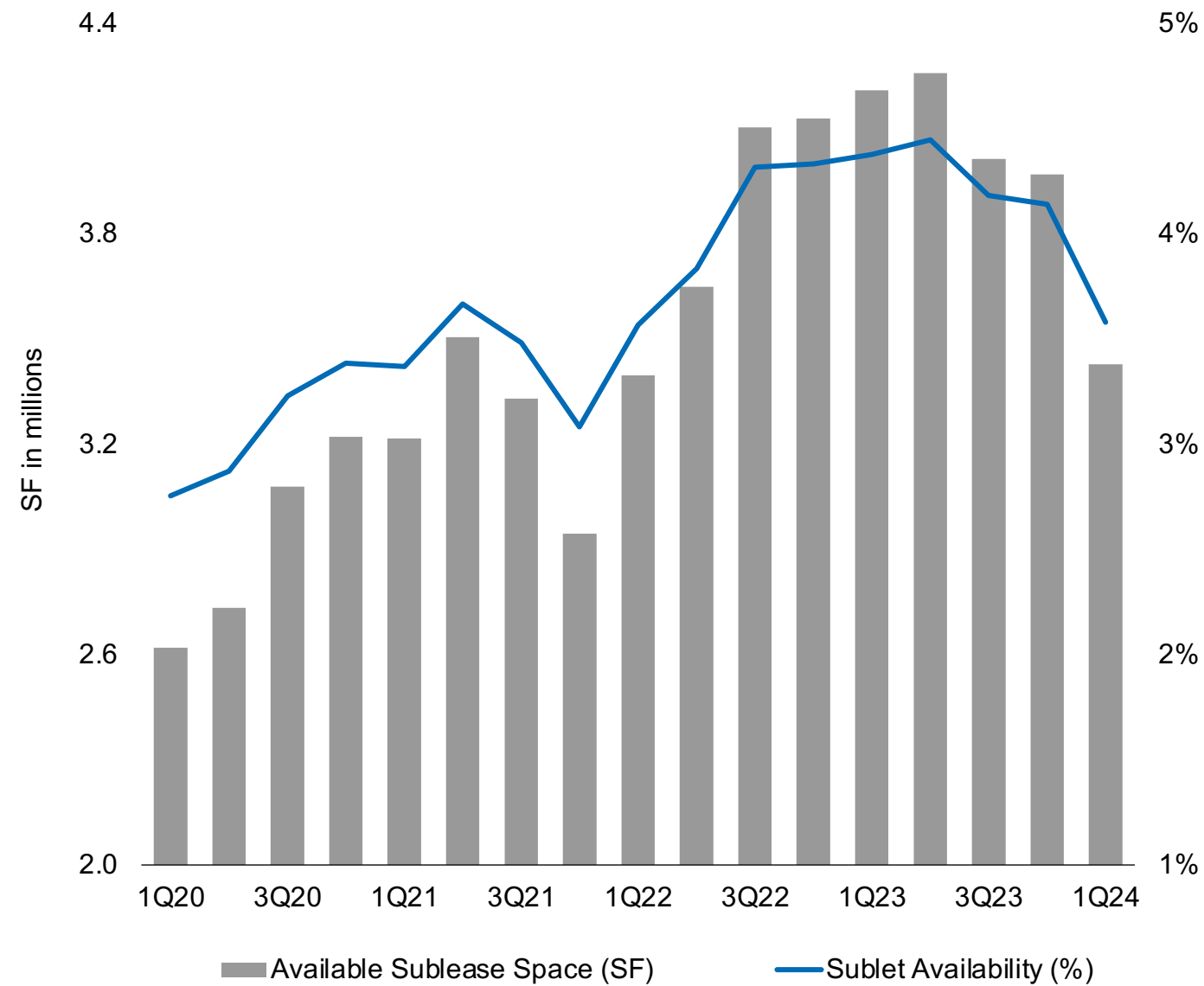
Airport and South County Command the Highest Rents

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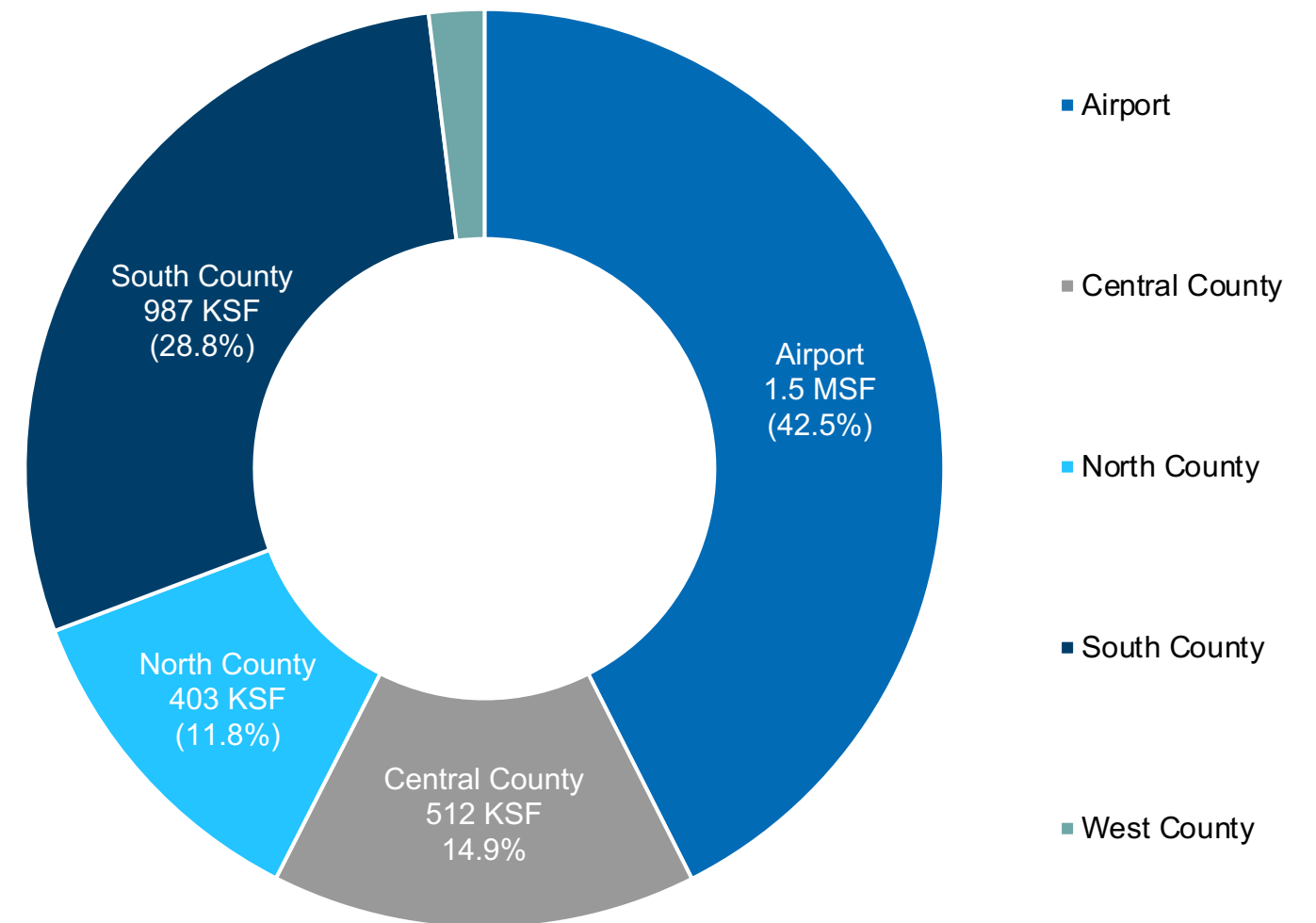
Sublet Availability Falls

Orange County's sublet availability fell this quarter to 3.4 MSF (or 3.6% of inventory), although a nearly equal increase in direct availability suggests that most of this space went direct rather than leasing up. At the submarket level, Airport leads others in available sublease space, with 1.5 MSF or 42.5% of Orange County's sublet pool.

Available Sublease Space: Greater Market



Available Sublease Space by Submarket



Source: Newmark Research

New Leases Drive Leasing Activity

Leasing activity was muted at the start of the year, with no reported deals over 60,000 SF. The largest deals of the quarter were all located in the Airport submarket.

Notable 1Q24 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
Symple Lending	3351 Michelson Dr	Airport	Direct Lease	51,629
<i>A loan agency signed a new lease for the top floor at Park Place.</i>				
Clear Start Tax	5 Park Plz	Airport	Sublease	45,960
<i>A tax relief consultant subleased space that had been formerly occupied by Better Mortgage Corporation.</i>				
Tax Rise	19900 MacArthur Blvd	Airport	Lease Renewal	38,717
<i>A tax consultant renewed space on two floors at Newport Gateway's Tower II.</i>				
Hyundai Capital	3161 Michelson Dr	Airport	Direct Lease	31,196
<i>Hyundai Capital expanded onto the 16th floor, bringing its total footprint in the building to four floors.</i>				
The New Home Company	18300 Von Karman Ave	Airport	Direct Lease	30,269
<i>A home builder signed a new lease for two floors at Irvine Towers.</i>				

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Office Conversions and Distress



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

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35.2% of the Office Market Obsolete or Unable to Service Debt

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Some Underperforming Office Properties Slated for Conversion

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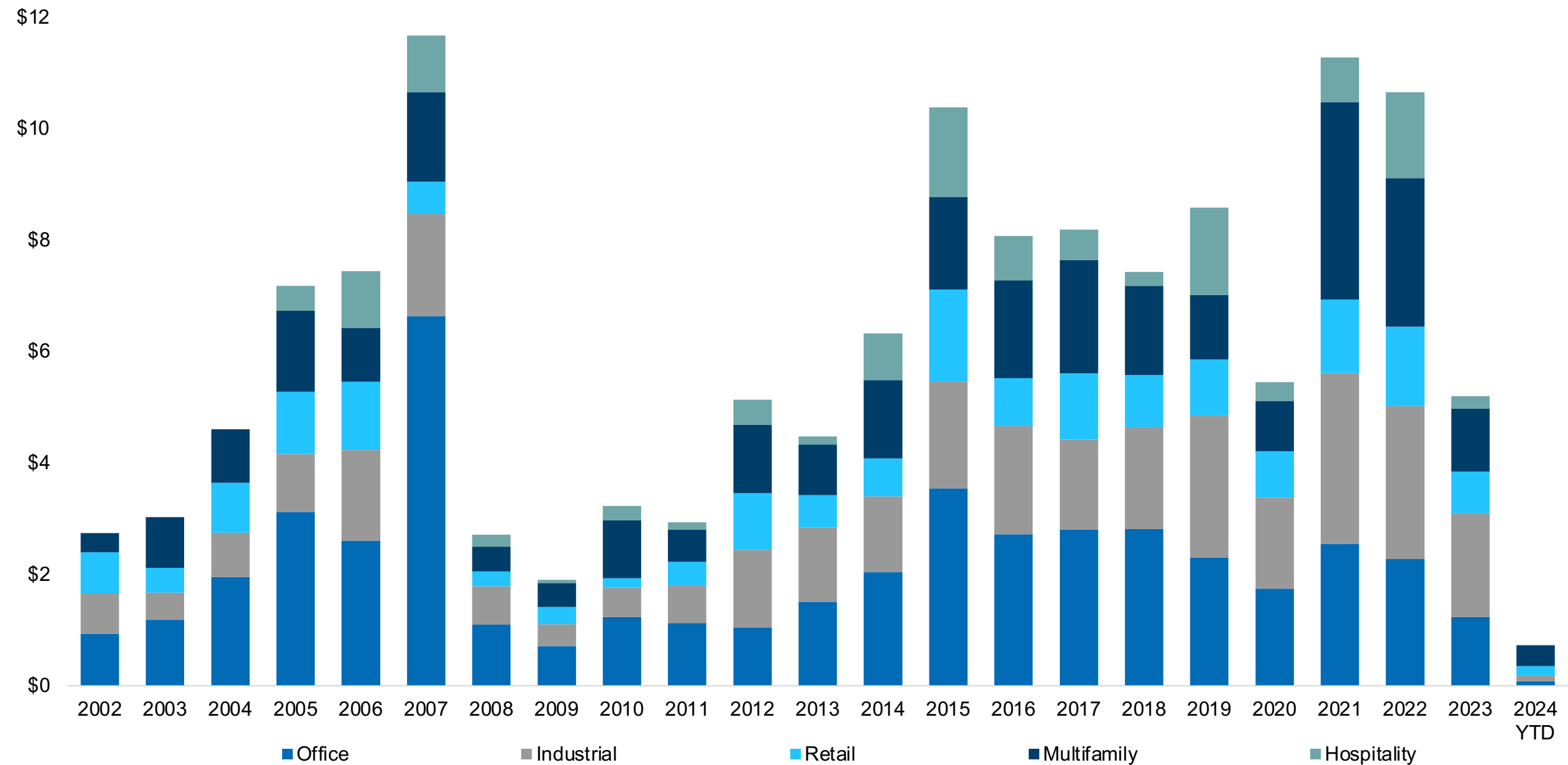
Sales Activity



Office Comprised Just 11.5% of Total Sales Volume in the First Quarter

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)

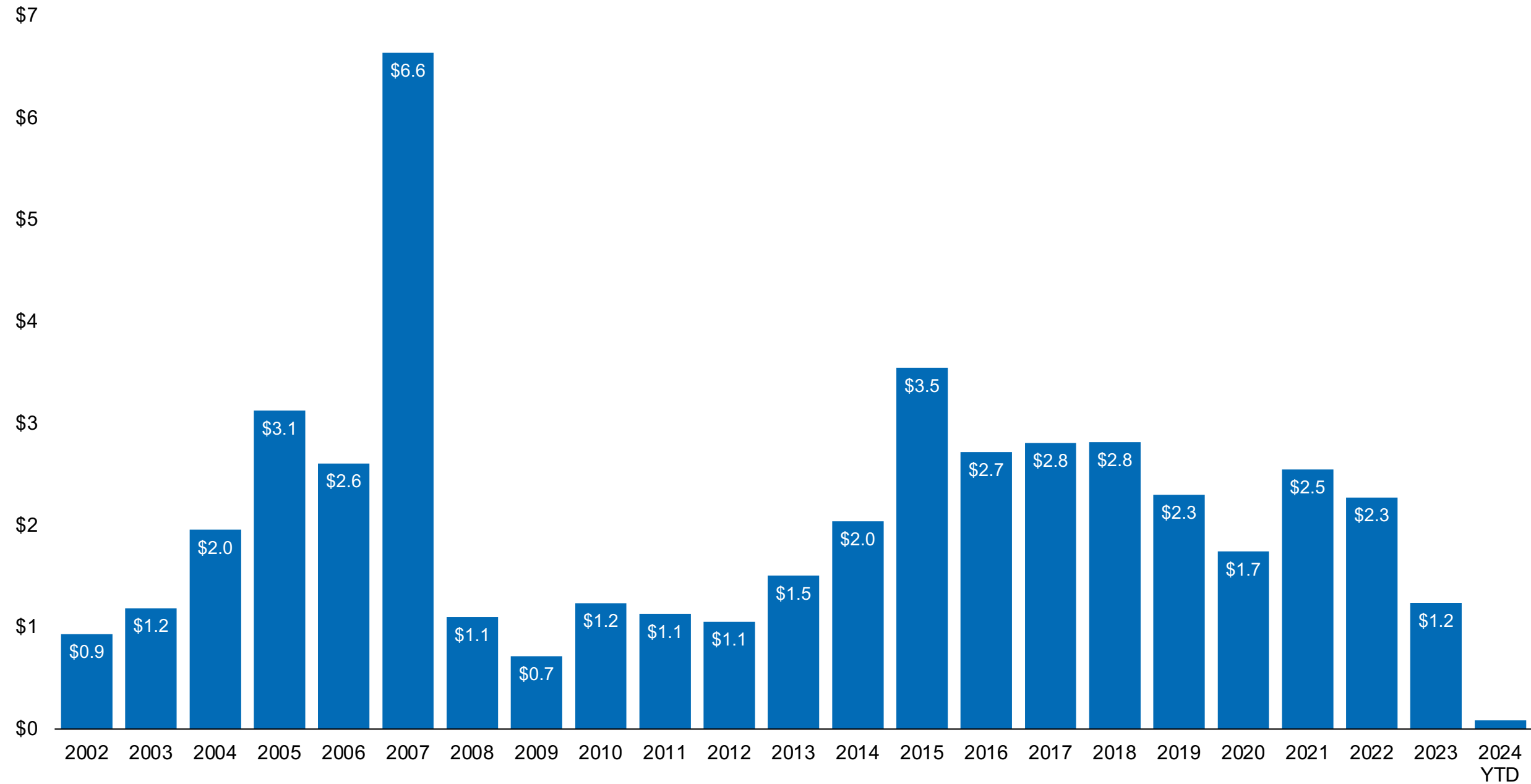


Source: MSCI Real Capital Analytics, Newmark Research
 Note: Preliminary data is cited for the first quarter of 2024.

Office Sales Volume: Up Close

Office sales volume totaled just \$84 million in the first quarter, following \$1.2 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 first quarter of 2024.

Pricing is Decreasing, While Cap Rates Will Increase

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Office Trades: Private, Opportunistic Buyers Are the Only Game in Town

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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 | 1Q24

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Please reach out to your
Newmark business contact for this information

For more information:

Fahima Dawd

*Research Analyst
Orange County*

fahima.dawd@nmrk.com

Brent Don

*Research Manager
San Diego*

brent.don@nmrk.com

Dain Fedora

*Head of Research
Southwest*

dain.fedora@nmrk.com

Orange County

18401 Von Karman Ave., Suite 150

Irvine, CA 92612

t 949-608-2000

New York Headquarters

125 Park Ave.

New York, NY 10017

t 212-372-2000

nmrk.com

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