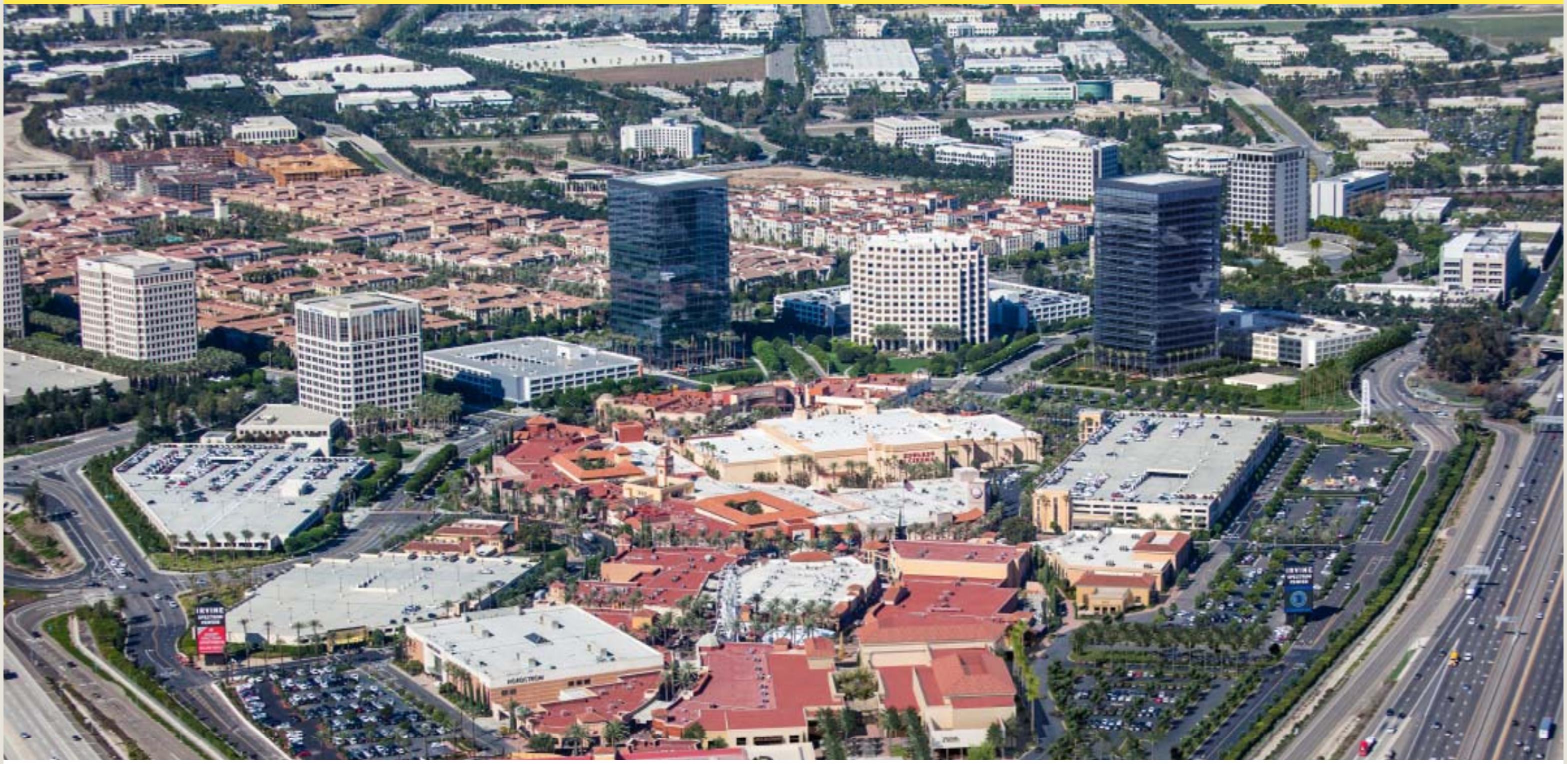
Savills Studley Research
Orange County

Savills Studley Report
Orange County Office Sector
Q2 2017



SUMMARY

Market Highlights

LEASING ACTIVITY REMAINS SUBPAR
Overall quarterly leasing activity rose from 1.6 msf to 1.7 msf, but once again fell well short of 2.2 msf - the market's long-term historical average. Deal volume in the four most recent quarters decreased to 8.5 msf, just below the term average of 8.8 msf in the last five years.

BIG JUMP IN AVAILABILITY
Overall availability in Orange County registered its largest increase since 1Q 2015 spiking by 150 basis points from 15.9% to 17.4%. The Class A rate jumped by 90 basis points from 18.6% to 19.5% and has increased by 150 basis points year-on-year.

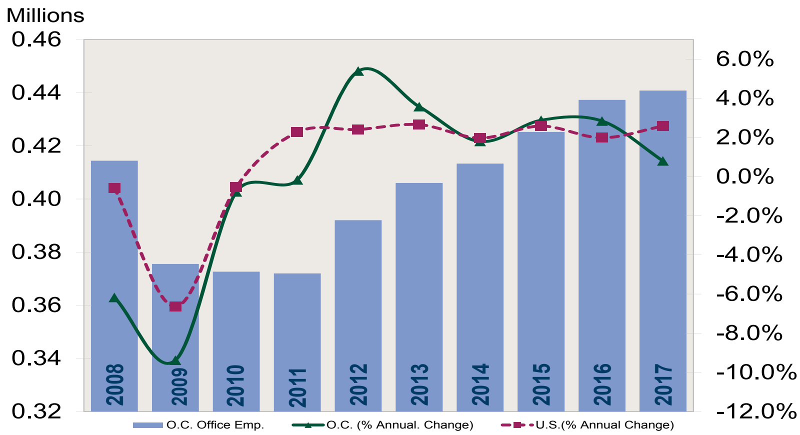
ASKING RENT FLAT
Class A average asking rent ticked up by only 0.2% from $33.93 to $33.99.

SALES DOWN FROM A YEAR AGO
Year-to-date office property sales totaled $707 million falling by 23.1% compared to the $919 million sold during the same period in 2016.

"Availability continues to nudge up slightly. For the second quarter in a row leasing fell short of the market's long-term average. The shortage of larger quality blocks of space, and elevated rents, may be putting the brakes on some tenant's expansion plans."

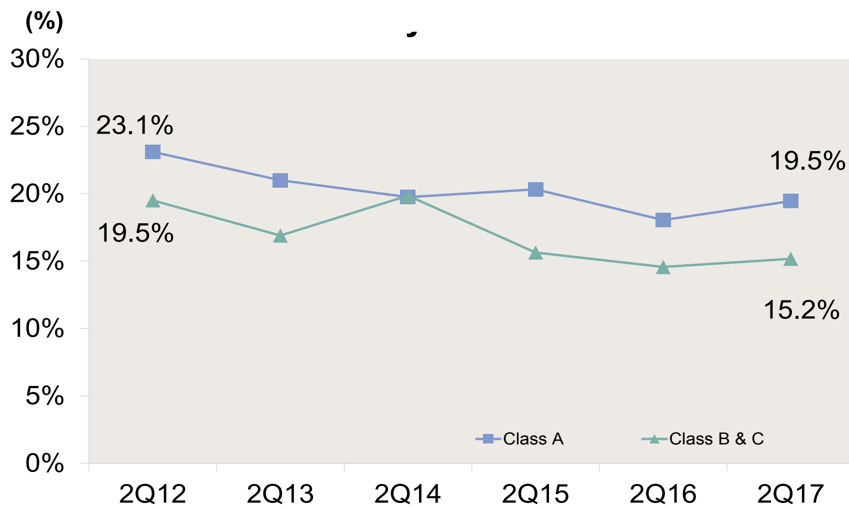
Taylor Wood,
Corporate Managing Director

Office-Using Employment Trends

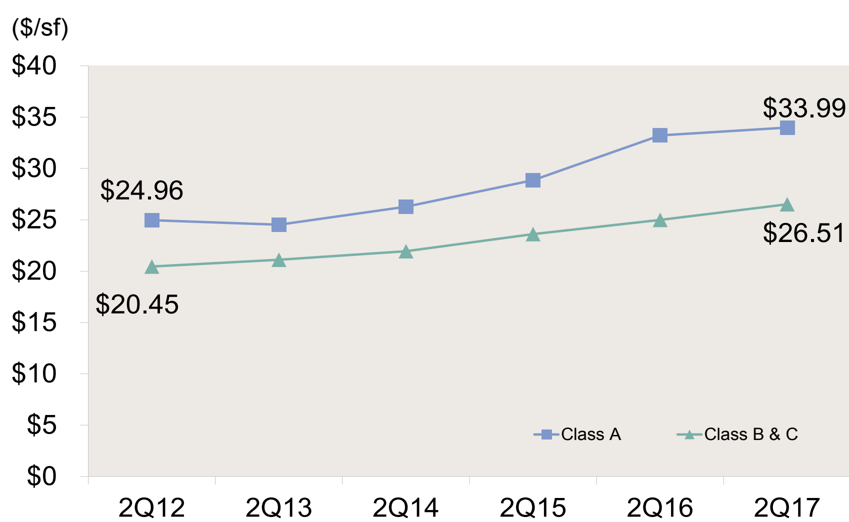


Source: Bureau of Labor Statistics

Availability Rate Trends



Asking Rent Trends



Tight Market Conditions, but Peak on the Horizon?

Orange County continues to benefit from expansion in a diverse array of sectors ranging from tech and healthcare, to real estate and general professional business services. Steady hiring has supported steady demand, particularly from mid-sized and larger tenants who are aware that conditions have become progressively tighter in the last several quarters.

There are some signs that leasing may be finally moderating. Tenants leased less than 2.0 msf in both the first and second quarters, the first time that deal volume has failed to reach 2.0 msf two quarters in a row since 2014. The recent moderation could be an indication of price resistance as well as a lack of quality space options.

Availability Rising, but Big Blocks Still in Short Supply

It remains to be seen whether leasing will reverse directions and rebound in the second half of the year. In the meantime, availability rates, while still low in the most sought after areas, have also started to increase. Orange County's Class A availability rate jumped by 90 basis points to 19.5% in the second quarter and has spiked by 150 basis points year-on-year.

The supply of bigger blocks of quality office space remains very limited, though. As of June, there were only 20 existing buildings offering a contiguous block of space over 100,000 sf for lease, and only six were Class A properties.

Large Tenants Staying Aggressive

Larger tenants have remained aggressive. Tech firms in particular have been willing to pay top dollar for new space, even taking space at Irvine Spectrum where rent is well above $4/sf (approaching $50/sf per year). In the largest lease year to date, Cylance leased 133,500-sf at 400 Spectrum Center. They absorbed nearly a third of the 470,000-sf building scheduled to open later this summer, making a significant dent in new space options across the market. Cylance is just the latest tech firm to make a significant move in the region – Houzz and CareerBuilder have also signed notable leases in the last couple of years.

Professional/business services have traditionally been a bit more conservative in their leasing patterns than tech companies. Nevertheless, they too are expanding and are supplementing aggressive demand from tech and healthcare.

Rent and Build-Out Costs Mount

Regardless of what sector they are in, all tenants in Orange County are experiencing the challenges associated with rental rate growth and elevated build out costs. Construction costs have posted double-digit increases in the last two to three years. A few landlords are boosting tenant improvement allowances in an effort to offset some of the costs to tenants.

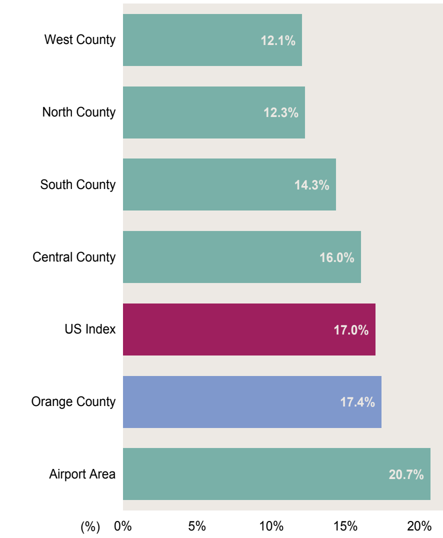
Amenities a Key Differentiator

These allowances still typically do not fully cover escalating build-out costs. Given the cost and effort associated with leasing office space, companies are wise to invest ample time considering the best use of their facility. More firms are embracing workplace strategy as a critical step after they have signed a lease. Careful planning and build out of space with features and amenities that enhance the comfort and experience of their staff will boost retention rates and improve productivity. In turn, many area firms are loading their space with amenities and services as they see an intangible return on their investment in the form of engaged and healthy employees.

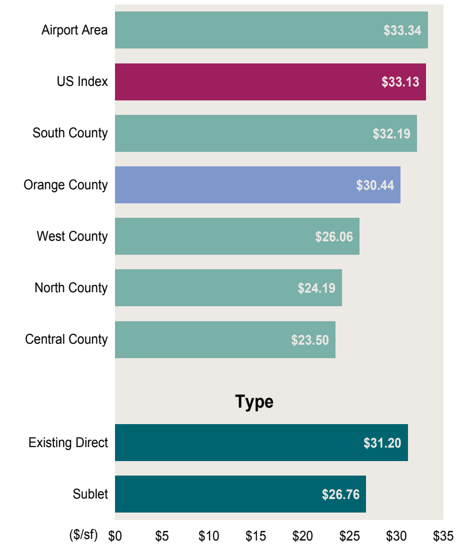
In addition to in-building amenities, tenants prefer proximity to retail and residential product. Fashion Island and Irvine Spectrum continue to set the highest standard in terms of access to retail and prime residential product. Tustin Legacy will add another such town center with walkable access to retail, lifestyle and restaurant offerings.

These amenity-laden locations have traditionally been home to professional service firms, but tech companies have been taking space in new office buildings as well. In contrast to San Francisco, Los Angeles or San Diego, Orange County does not have the stock of older loft and warehouse product that can be converted to the hip and trendy office space that many creative sector firms prefer. They also can not replicate the trendy setting of SoMa in San Francisco or Santa Monica in West Los Angeles. However, they can make substantial changes to building interiors that will better cater to creaitve sector firms. A few landlords are trying to fill this gap in the market. Irvine Company, for example is redesigning suburban office buildings with open floor plans and exposed ceilings.

Availability Rate Comparison



Overall Rental Rate Comparison



Major Transactions

Tenant	Sq Feet	Address	Market Area
Cylance	133,400	400 Spectrum Center Dr	South County
Accurate Background	34,612	7555 Irvine Center Dr	South County
Agilon Health	27,648	2121-2190 S Towne Centre Pl	Central County
Monoprice, Inc.	22,812	1 Pointe Dr	North County
Digital Map	22,120	5201 California Ave	Airport Area
SendGrid	22,000	400 Spectrum Center Dr	South County
Amazon	21,960	125 Technology Dr	South County
Savills Studley	17,765	520 Newport Center Dr	Airport Area
Marriott International	15,435	17872 Gillette Ave	Airport Area
Pulte Homes	13,798	27401 Los Altos	South County
Sum of Top 10 Transactions	**331,550**	**Sum of 2nd Qtr Leasing Activity**	**1.7 MSF**

Sluggish Sales

Office property sales have been slow to start the year. The supply of institutional-grade assets on the market for sale is limited. The Golden State Foods building in Irvine sold to an investment group that included Monster Beverage Group and Greenlaw Partners for $85.8 million ($380/sf). This is the third property in Von Karman Towers that Greenlaw Partners now has a stake in. The building and the market has come a long way from several years ago. The sellers paid $67.9 million in 2014, and in 2010 KBR Reit unloaded the building for only $41.25 million.

Looking Forward

Orange County will likely remain a top consideration for tech firms either priced out of markets such as San Francisco or Manhattan or unable to find adequate talent in similar markets. Other firms are making a bit of a lifestyle choice, deciding to give up the congestion and competition in major metros such as Los Angeles or Chicago.

The second half of the year may bring some of the proposed projects off the shelf. Big blocks of quality space remain very limited and new construction would bring some much needed relief. It could take a few more quarters before new product finally starts to more dramatically impact availability, but new buildings will open up more quality modern space options and create blocks of space in existing buildings. For the time being, larger tenants looking for big blocks of quality space will need to enter the market early and line up multiple options. There are no major indicators of a slowdown in the next quarter or two, but recent slowdowns in leasing bear monitoring.

Map	Submarket	Total Inventory	Leasing Activity	Available SF			Availability Rate			Asking Rents Per SF		
		SF (1000's)	Last 12 Months	This Quarter	% Change from Last Qtr.	Year Ago	This Quarter	pp Change from Last Qtr. (1)	Year Ago	This Quarter	% Change from Last Qtr.	Year Ago
1	**North County**	7,318	623	898	-2.4%	1,044	12.3%	-0.3%	12.7%	$24.19	-5.6%	$24.92
	North County - Class A	2,275	283	338	-12.7%	457	14.9%	-2.2%	16.9%	$26.39	-7.4%	$26.16
2	**West County**	3,814	254	460	0.1%	637	12.1%	0.0%	15.3%	$26.06	2.4%	$24.92
	West County - Class A	1,414	90	190	4.2%	299	13.5%	0.5%	18.4%	$30.73	3.3%	$27.09
3	**Central County**	13,266	1,251	2,127	0.0%	2,672	16.0%	0.0%	15.9%	$23.50	-7.4%	$23.69
	Central County - Class A	6,862	478	909	-1.3%	1,047	13.3%	-0.2%	13.3%	$25.67	-8.2%	$26.07
4	**Airport Area**	39,155	4,469	8,115	19.7%	7,279	20.7%	3.4%	18.1%	$33.34	-0.6%	$32.20
	Airport Area - Class A	24,483	2,818	5,633	11.8%	5,216	23.0%	2.4%	19.6%	$36.04	1.4%	$34.68
5	**South County**	16,968	1,920	2,435	-3.8%	2,433	14.3%	-0.6%	14.6%	$32.19	-6.3%	$30.89
	South County - Class A	7,437	948	1,191	-12.7%	1,136	16.0%	-2.3%	17.5%	$35.83	-5.5%	$31.80
1-5	**Orange County Total**	**80,520**	**8,517**	**14,035**	**9.5%**	**14,065**	**17.4%**	**1.5%**	**16.4%**	**$30.44**	**-2.0%**	**$29.77**
	Orange County Total - Class A	**42,470**	**4,617**	**8,262**	**4.6%**	**8,156**	**19.5%**	**0.9%**	**18.0%**	**$33.99**	**0.2%**	**$33.23**

Please contact us for further information

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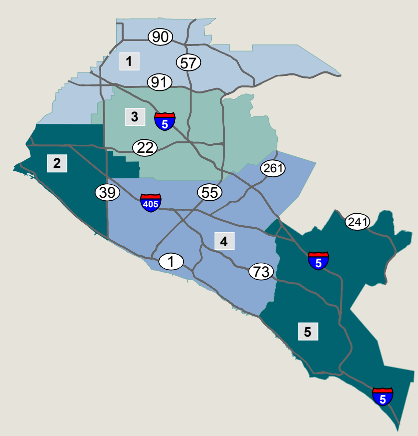

(1) Percentage point change for availability rates.
Unless otherwise noted, all rents quoted throughout this report are average asking gross (full service) rents psf.
Statistics are calculated using both direct and sublease information.

The information in this report is obtained from sources deemed reliable, but no representation is made as to the accuracy thereof. Statistics compiled with the support of The CoStar Group.