

# OFFICE MARKET TRENDS

## Orange County

FOURTH QUARTER 2007

## Reversal of Fortune for OC Landlords

The overall office vacancy rate in Orange County jumped in 2007 to 11.36% and space availability soared to 17% due to the double-whammy of office givebacks from the residential mortgage meltdown coupled with this year's completion of 4.2 million square feet of new Class-A space.

We predicted a significant year-over-year increase in office vacancy in our fourth-quarter report of 2006, singling out the Class-A sector to be hardest hit. In the last quarter of 2006, the weighted Class-A vacancy rate was 8.14% countywide. The Class-A vacancy rate closed out in 2007 at 14.3% with approximately 1.1-million-square-foot negative absorption in the fourth quarter for the overall office sector.

This represents a dramatic and unprecedented one-year swing from landlord market to tenant market caused by a broadening economic weakness brought on by the housing downturn and credit turmoil. Even if the U.S. economy is able to skirt a recession, landlords are bracing for tougher times ahead.

In January, two top executives from leading office development firms with Orange County interests asserted that the softening in office demand will continue for 12 months to two years.

Speaking at a UC Irvine-sponsored session on the county office market, Lang Cottrell, president of LNR Property Corporation's Western Region, predicted that 2008 will see negative absorption of 1 million square feet.

Doug Holte, senior vice president of Hines, which is trying to lease up its new 267,000-square-foot building on Michelson Drive in Irvine, called the spike in office space a "mild correction." He said he sees a five-year boom starting in 2010 as "lower housing prices will help corporate in-migration."

Holte said the correction also signals a "return to fundamentals" for investors in office product. But a return to fundamentals won't be welcomed by investors who have been structuring their highly leveraged office acquisitions in the past several years with pro-formas that assume steadily climbing rents. With softening demand, rents are falling. This means the near-term pressure will be greater for some landlords than others, depending on the submarket and level of debt on each asset.

On average, today's rents are \$2.75 per square foot versus \$3 one year ago. Additionally, tenant improvement allowances have become increasingly generous. The one exception to this is in the Newport Center submarket, which has an inventory of 2 million square feet and a vacancy rate of less than 3%. Rents in this submarket have been checking in at a healthy \$5 per square foot and more for the past year. In fact, a new Irvine Company 10-year lease to Merrill Lynch for 7,500 square feet is believed to have been struck at \$6 a square foot.

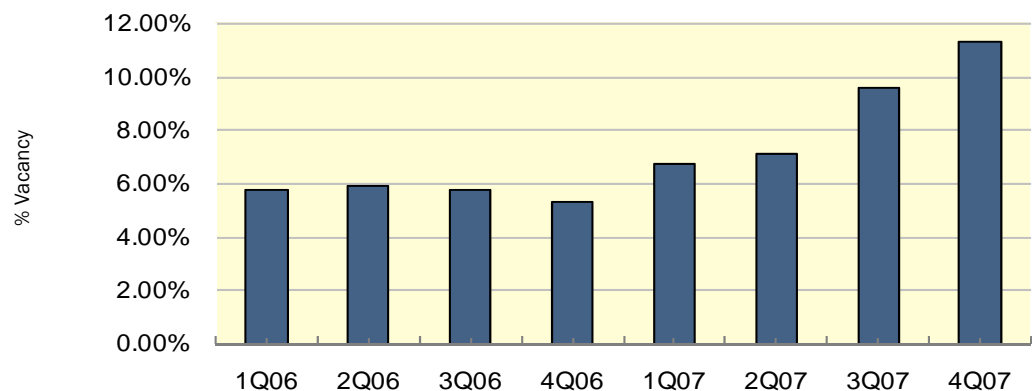
On the flip side, the 1.8-million-square-foot inventory in The City submarket in Orange has a 21.3% vacancy rate and an availability rate estimated at 42%.

*"With softening demand, rents are falling. This means the near-term pressure will be greater for some landlords than others, depending on the submarket and level of debt on each asset."*

### 4TH QUARTER INDICATORS

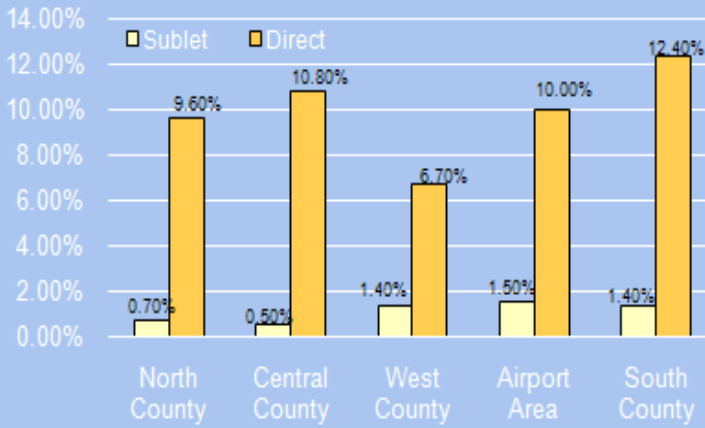
Orange County	4th Qtr.	Change from last Qtr.
Vacancy	11.36%	↑
Net Absorption	-1,092,984 SF	↓
Avg. Lease Rate	\$2.55 FSG	↔

### VACANCY RATE

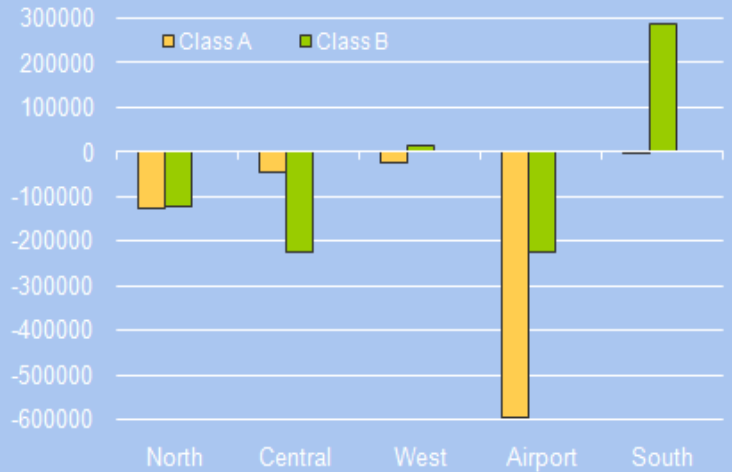


# OFFICE MARKET REPORT

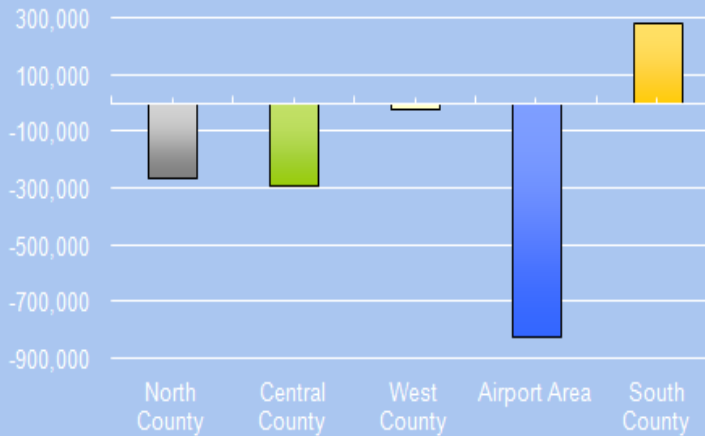
VACANCY BY SUBMARKET  
(DIRECT SPACE VS SUBLET SPACE)



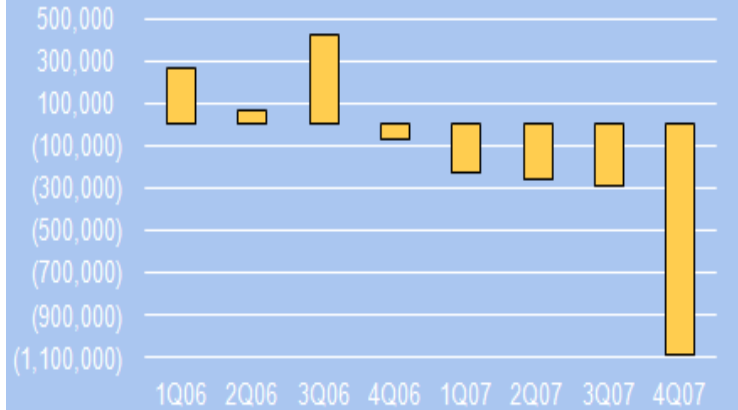
FOURTH QUARTER NET ABSORPTION BY  
SUBMARKET & CLASS



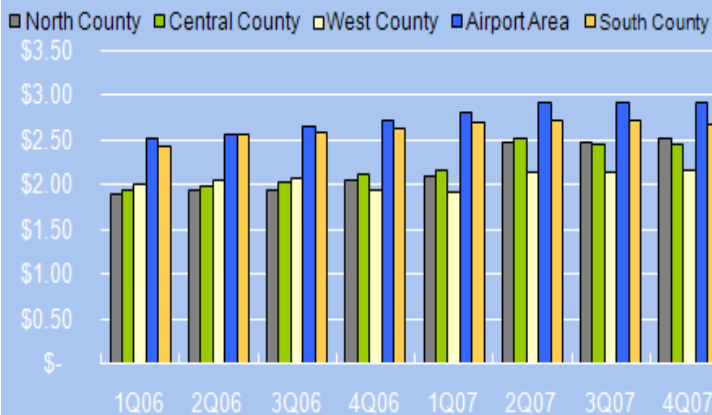
FOURTH QUARTER NET ABSORPTION  
(BY SUBMARKET, INCLUDING SUBLET SPACE)



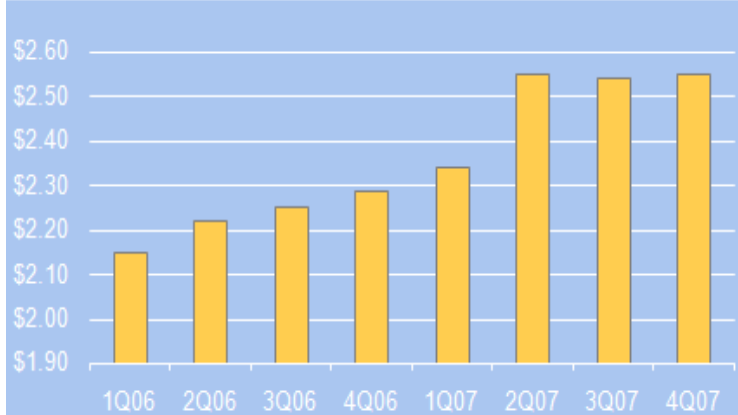
COUNTY-WIDE NET ABSORPTION  
(BY QUARTER, INCLUDING SUBLET SPACE)



YTD LEASE RATES  
(NOT INCLUDING SUBLET SPACE)



AVG. OC QUARTERLY LEASE RATES



# M ARKET FORECAST

Decision-makers will have a plethora of opportunities to lease space at favorable rates in all office categories in most submarkets in 2008. Landlords should focus on financial and wealth-management firms as the probable growth business sector.

## RECENT LEE TRANSACTIONS

7012 Belgrave Ave.



44,000 SF | Sale | Garden Grove  
S. Smith

1601 Saint Andrew



28,502 SF | Sale | Santa Ana  
G. Diab | J. Haley

1149 Patt Street



18,446 SF | Sale | Anaheim  
B. Gilmer

2372 Morse



11,249 SF | Sale | Irvine  
D. Romero

2211 Michelson



37,497 SF | Lease | Irvine  
D. Whitney

121 Innovation



13,278 SF | Lease | RSM  
K. Ahlberg

2400 S. Garney Street, #B



47,566 SF | Lease | Santa Ana  
P. Cohen

17532



8,343 SF | Sale | Irvine  
M. Jerue | C. Fitterer

16632 Hale



19,821 SF | Sale | Irvine  
B. Garbutt

**ABOUT Lee & Associates**

As a group of independently owned and operated companies, Lee & Associates currently has more than 34 offices in California, Arizona, Nevada, Michigan, Missouri, New Jersey, Illinois, Texas and Wisconsin.

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 nearly \$4 billion last year, alone.

**Office Brokerage Services**

The firm’s office brokers negotiate various transactions, including mid- and high-rise properties, business and office parks, mixed-used projects, office land for development, multi-tenant buildings and commercial investments. Our brokers analyze the financial arrangements to streamline transactions, and use innovative marketing efforts and unique transaction structuring to provide creative solutions to meet the client’s needs.

Our comprehensive service line includes owner and tenant leasing, acquisition and sales, along with marketing and consulting capabilities. We focus on strategic counseling, rather than merely the transaction, in order to execute the best possible real estate strategies for our clients. This includes building strong relationships within the brokerage community overall. As a result, our clients are assured of the broadest exposure possible.

**MARKET DEFINITIONS**

**Average Asking Lease Rate:** The rate determined by multiplying the lease rate for each building in the summary by its associated available space, summing the products then dividing by the sum of the available spaces with gross lease rates for all buildings in the summary. Direct leases only; excludes sublease space and parking charges.

**Full Service Gross (FSG):** Lease type whereby the landlord assumes responsibility for all the operating expenses and taxes for the property.

**Inventory:** Office inventory includes all multi-tenant and single tenant buildings at least 20,000 square feet. Owner-occupied, government, medical buildings are not included.

**Occupied Square Feet:** NRA not considered vacant.

**Vacancy Rate:** The percentage of the total amount of physically vacant space divided by the total amount of existing inventory.

**Gross Absorption:** The total amount of space leased or sold in a specified period of time.

**Net Absorption:** The change in total occupied square feet from one period to the next. Positive absorption is reflected when a lease is signed, which may not coincide with the date of occupancy.

**Net Rentable Area (NRA):** The gross building square footage minus the elevator core, pipe shafts, vertical ducts, balconies and stairwell areas.

**Vacancy Rate:** Vacant square feet divided by the NRA.

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