The Lee Office Brief

Q2 2017

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LEE & ASSOCIATES

COMMERCIAL REAL ESTATE SERVICES

62% increase in transaction volume over 5 years

$11.6 billion transaction volume 2016

Ranked 2nd june 2016 Commercial Property Executive (2016 Top Brokerage Firms)

890 agents and growing nationwide

LOCAL EXPERTISE. NATIONAL REACH. WORLD CLASS.

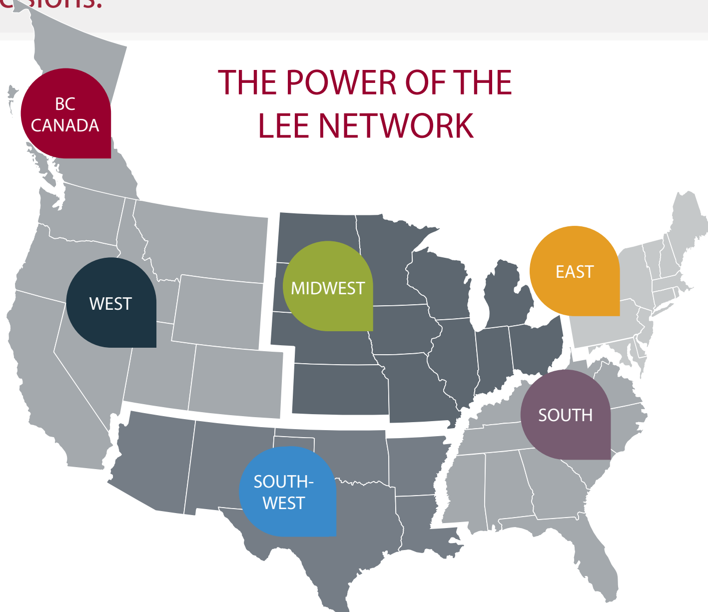
At Lee & Associates® our reach is national but our expertise is local market implementation. This translates into seamless, consistent execution and value driven market-to-market services.

Our agents understand real estate and accountability. They provide an integrated approach to leasing, operational efficiencies, capital markets, property management, valuation, disposition, development, research and consulting.

We are creative strategists who provide value and custom solutions, enabling our clients to make profitable decisions.

OFFICE
INDUSTRIAL
RETAIL
INVESTMENT
APPRAISAL
MULTI-FAMILY
LAND
PROPERTY MANAGEMENT
VALUATION & CONSULTING

THE POWER OF THE LEE NETWORK



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St. Louis, MO
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Madison, WI
Indianapolis, IN
Greenwood, IN
Cleveland, OH
Columbus, OH
Twin Cities, MN

Atlanta, GA
Greenville, SC
Fort Myers, FL
Orlando, FL
Charleston, SC
Valuation, Atlanta, GA

Elmwood Park, NJ
Manhattan, NY
Edison, NJ
Chesapeake Region
LI/Queens, NY
Eastern Pennsylvania

Vancouver, BC
Canada

US OFFICE MARKET

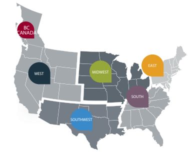
Office Market Treads Water in Q2

Last quarter we reported that the US office market was showing signs of fatigue, and from a macro perspective, things didn't change much in Q2. Vacancy was unchanged for the third straight quarter, average rental rates were done a penny, deliveries were flat and net absorption was just slightly higher than it was in Q1. Sublease inventory also moved up again, continuing its steady rise.

ECONOMIC DRIVERS

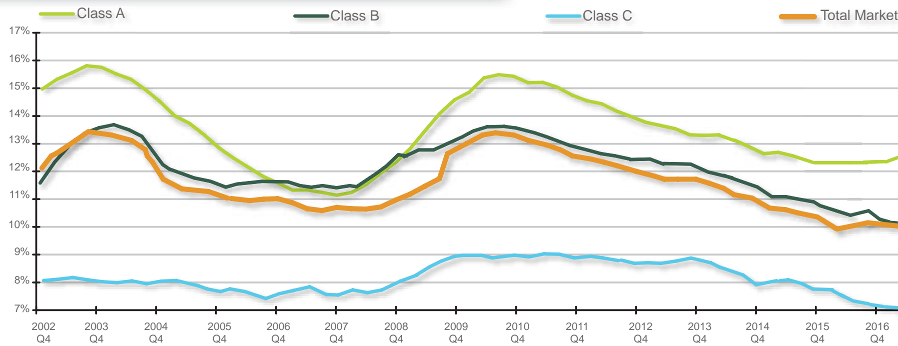
Click below for info on...

A LOOK AHEAD
GDP GROWTH
EMPLOYMENT



MONETARY POLICY

VACANCY RATES BY CLASS 2002-2016

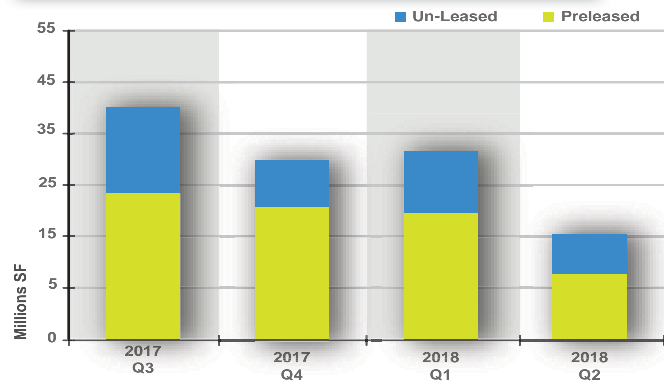


We also reported that major markets including New York City, Los Angeles and San Francisco posted significant negative net absorption in Q1, as did Houston and Hartford. Year-to-date, those same markets remain in negative territory at the mid-year point. The South Bay/San Jose market leads the pack in net absorption so far this year at over 3.5 million square feet of net gain in occupied space, but that has a lot to do with the fact that Apple moved into its new 2.8-million-square-foot headquarters in the second quarter.

Taking a closer look at net absorption, another 16.7 million square feet was added to occupied space in Q2, which is up from 14.7 million square feet in Q1, but well off the pace of the two preceding periods. Changes in workplace design may be partly to blame for the reduction in net absorption, as employers respond to higher rates and leverage new communications and mobile technologies that allow for higher employee density. It isn't just the tech startups who are jumping on this bandwagon, even our own commercial real estate services industry is looking for ways to attract and retain younger workers and save on occupancy costs at the same time. Only four markets posted net absorption in excess of 2 million square feet by the middle of 2017. Major markets posting

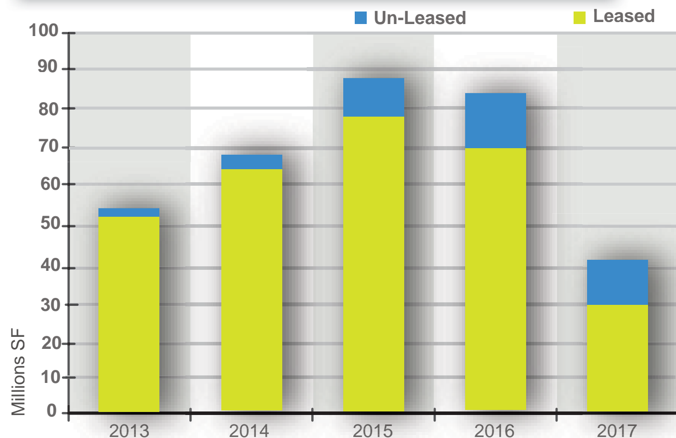
FUTURE DELIVERIES

PRE-LEASED & UN-LEASED SF IN PROPERTIES SCHEDULED TO DELIVER



RECENT DELIVERIES

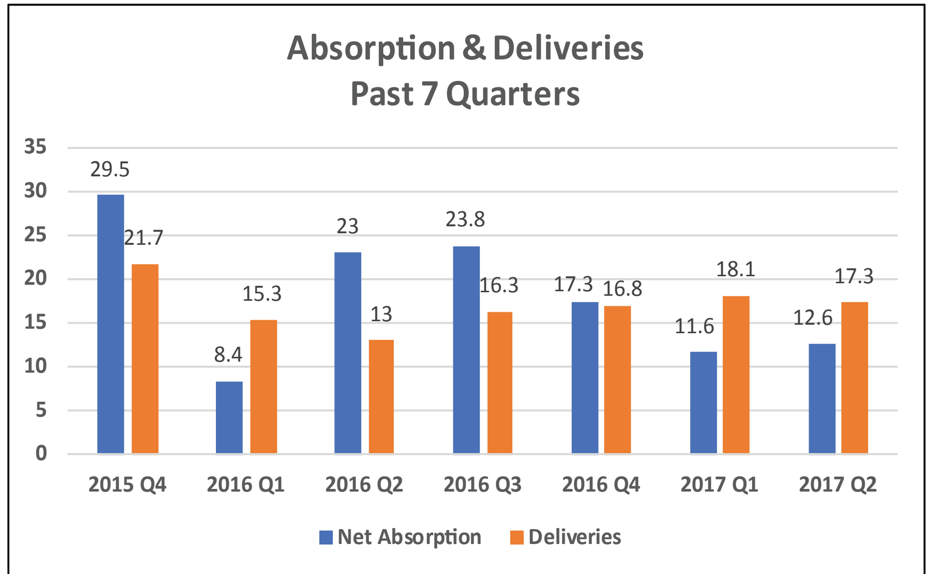
LEASED & UN-LEASED SF DELIVERIES LAST 5 YEARS



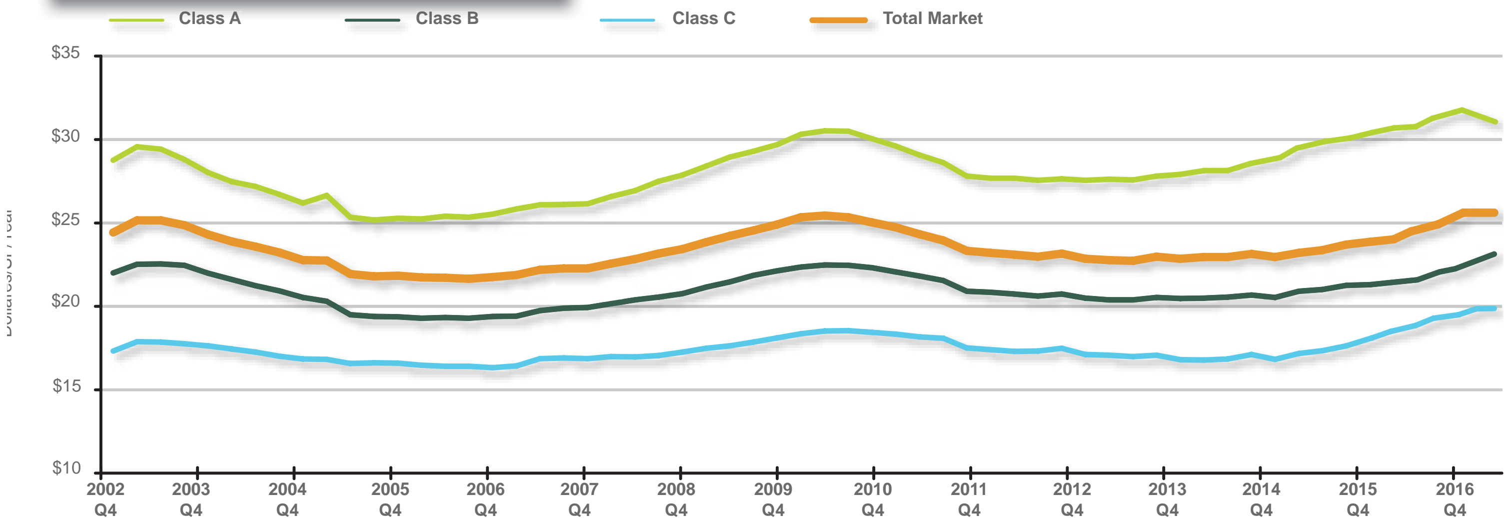
disappointing year-to-date results included New York City at negative 1.47 million square feet and Houston at negative 1.77 million square feet.

By building class, net absorption remains relatively well-balanced, as Class A and B product reported gains of 13.67 million and 16.65 million square feet respectively. In terms of Suburban versus Central Business District (CBD) performance, the difference is still huge. CBD markets have posted just 930,000 square feet of occupancy gains year-to-date, while suburban markets have increased occupancy by over 12.7 million square feet. Urbanized hubs in suburban areas that are amenity-rich and tout high-density housing near public transportation are outperforming traditional suburbs and core CBDs. Employers choose to locate in these areas to attract and retain younger workers who prefer the convenience of walking to work and entertainment venues.

ABSORPTION & DELIVERIES PAST 7 QUARTERS



HISTORICAL RENTAL RATES 2002 - 2016



The vacancy rate, which stood at 9.7% a year ago, finished just 10 basis points lower at 9.6%. Vacancy for Class A is up 30 basis points over the past four quarters, while Class B vacancy has declined by the same margin year-over-year. To really understand the vacancy trend requires a more local perspective, as separating the winners and losers becomes apparent at the individual market level. Owners of older office product further from amenities and public transportation are being hit particularly hard. Vacancy in those buildings tends to run higher, which makes it more difficult for those owners to reinvest in their properties to make them more competitive. Northern New Jersey, with its high concentration of legacy corporate headquarters properties located in suburban areas, is a good example of this phenomenon.

Average asking lease rates were flat in Q2, losing a penny to $24.40 per square foot. However, looking at rents on average is misleading, as the disparity in rent levels and rent growth rates varies drastically depending on local amenities. Cost-conscious tenants who signed leases on Class A space early in the economic recovery, are facing stiff enough rent increases to consider migrating back to Class B properties.

Conversely, users looking to create top notch work environments are paying the premium for superior locations, but mitigate the cost by decreasing their space footprint and increasing employee density. Markets with more active tech sectors like San Francisco, Silicon Valley (San Jose/South Bay) and Seattle have experienced the steepest rent increases, but the slowdown in tech employment growth has flattened the rent growth curve. Tech hotspots also tend to have higher costs of living, especially for housing, which means employers have to pay more to find and keep good people.

The level of new deliveries has been remarkably consistent in recent quarters. In Q2, 20.97 million square feet of new office space was delivered, compared to 21.1 million square feet in Q1, 20.75 million square feet in Q4 of 2016 and 21.3 million square feet in Q3 of 2016. Throughout the recovery, net absorption has been strong enough to prevent overbuilding. A notable exception is the office market in Houston, but that's understandable given the high level of build-to-suit space that was committed to prior to the collapse of oil prices back in mid-2014. Many of those projects could not be stopped and a good chunk of that space showed up as sublease space once it was completed. However, the oil industry has responded by becoming more efficient and reducing the break-even price point for oil extraction.

The quarter ended with just under 159 million square feet of space under construction, with most of that total concentrated in the nation's major metro areas. New York City has the two largest projects under construction; the 3 World Trade Center building at 2.86 million square feet and the 30 Hudson Yards building at 2.6 million square feet. New York City has the highest amount of construction activity at 15.5 million square feet underway. Washington DC passed Dallas/Fort Worth in Q2 with a total of 11.67 million square feet of construction activity, compared to 11.3 million square feet. Development activity remain concentrated in mixed-use projects in urbanized, amenity-rich areas that will encourage tenants to pay the premium required to cover rising land, construction and entitlement costs.

A LOOK AHEAD

The US office market didn't get a needed boost in Q2, and conjuncture continues by some that the market might be reaching its peak in this real estate cycle. Office-using employment growth remains sporadic and its job growth that drives net absorption in all product types. While big industrial tenants are in expansion mode, many office tenants are looking for ways to further reduce their space footprints to offset high lease rates in prime submarkets. This is bound to limit net growth in occupied space going forward.

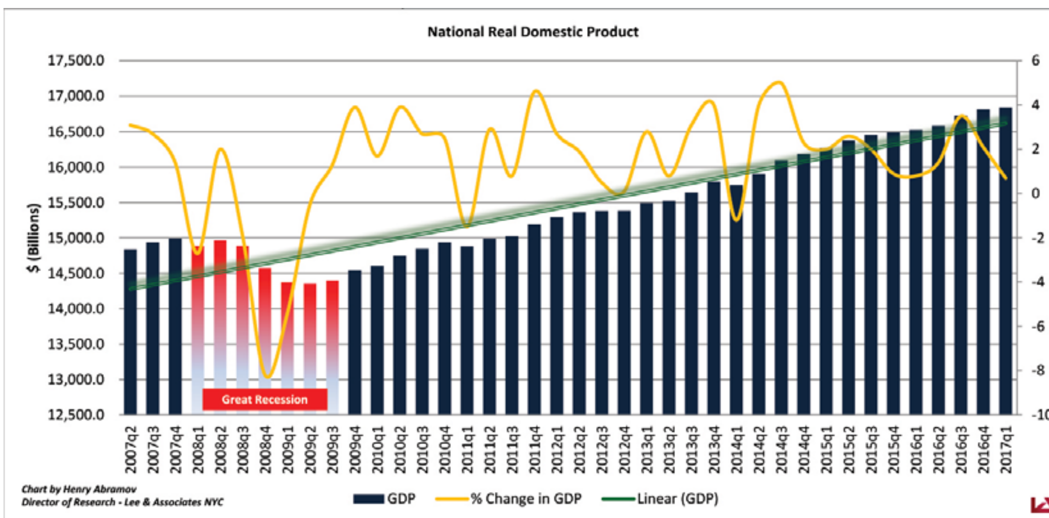
Rent growth will continue for prime space, but the rate of rent growth will continue to level off in the coming quarters. Owners of older properties not in proximity to preferred amenities and public transportation, will face further challenges as the age of the average worker continues to decline and the pressure on employers to provide a more exciting work environment increases.

Construction levels will remain near current levels, as lenders and developers grow even more cautious of a potential correction as the recovery moves into its ninth year

GDP GROWTH

US GDP, the primary metric for tracking the total output of our country's goods and services, is closely scrutinized by economists around the world who saw more of the same out of the US economy in Q2. After another disappointing first quarter that saw US growth at an annualized rate of just 1.2%, growth picked up as it has in Q2 as it has been doing in recent years. The first estimate for the period came in at 2.6%, compared to 2.1% in the same period last year after a weak first quarter. That has given rise to more talk about taking a new look at the current GDP model to more accurately reflect seasonal changes.

QUARTER-TO-QUARTER GROWTH IN REAL GDP



Total GDP growth for all of 2016 was up just 1.6%, and it looks like the US economy is in for another year in the same range. Once thought to be anemic, 2% growth seems to be the new normal these days, and the Trump administration's goal of sustained 3% growth is looking lofty, at least until a tax reform or infrastructure bill becomes a reality. The prospects for either or both remain questionable.

Corporate earnings in the first quarter of 2017 were mixed, but generally good. More companies reported revenue increases rather than cost-cutting measures as a reason for improved profitability. That means more hiring, more consumer spending and hopefully, a bump in GDP performance going forward.

Concerns regarding the performance of the automotive sector continue. After several years of robust sales increases, consumers have put the brakes on auto purchases, especially small sedan-type cars. With gas prices down, consumers are opting for expensive trucks and SUV's, but fewer consumers can afford to make those purchases. In the final quarter of 2016, incentive-driven car sales accounted for a disproportionate share of GDP growth, but through the first half of the year, sales are down, and inventories are swelling, and that is having a negative impact on GDP. Automotive manufacturers have responded with production cutbacks of slow-selling models, but have not yet resorted to deep discounting to rental companies as a means of reducing over-supply as they have done in the past. Overall sales volume is down substantially through the first half of the year, and used car lots are swelling with formerly leased vehicles, which is exacerbating the problem. Also, auto loan defaults have been rising as of late.

Ongoing aggressive monetary policy in Europe has kept the EU growing faster than the US. The EU posted another decent quarter of 2.2% growth in Q2, after Q1's 2.1% mark. The European Central Bank has been running full steam ahead with its bond-buying program and has taken drastic monetary and fiscal measures to keep the European Union member countries from sliding into recession. a lot of experts wondering what the result would have been without all the meddling by central bankers.

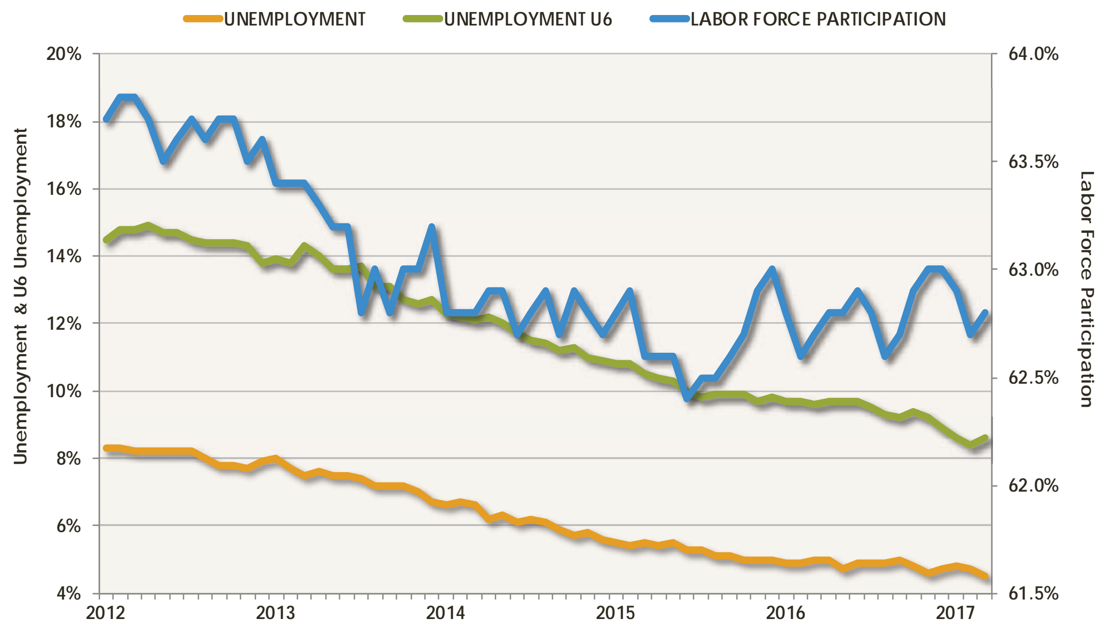
GDP GROWTH

As we reported last quarter, the “Trump Bump” after the election sent equities markets soaring on the expectation of lower corporate and personal income tax rates, reduced regulations and a huge infrastructure spending program. But, the nation waits while Republicans and Democrats in both houses of Congress continue to do battle with little or no result. That might not be all bad in terms of GDP growth, however. Businesses dislike uncertainty and will live with a less than optimum economic environment, as long as they know what to expect in terms of laws and regulations. If that remains the case, GDP growth should chug along near current levels for the rest of the year.

EMPLOYMENT

Job growth statistics remain difficult to make sense of. Here's what we said last quarter, and we stand by it in Q2: The U3 unemployment rate, the most widely quoted in the media, includes those who are employed and those of the unemployed who have actively sought employment in the most recent five weeks. We are still not sure who came up with U3, but we wish they hadn't because it quite often produces counter-intuitive results. When job creation is good, those who have not been looking for work, re-engage in their search and are added to the total of those who are actively looking, increasing the number of unemployed workers and thereby raising the unemployment rate. June of 2017 is a great example. Over 222,000 jobs were created, one of the best months in over a year, yet the unemployment rate rose by 10 basis points to 4.4%. These anomalies have caused many to discount the validity of the Bureau of Labor Statistics' U3 metric.

The U6 unemployment rates counts those working part time in their field of choice, who would prefer to be working full time, as unemployed. Many believe that U6 offers a more accurate employment picture. It does make clearer the frustration of many in the middle class who still feel like the recession never ended. They are technically employed, but don't feel the impact of higher income. The U6 unemployment rate is still double that of U3, at 8.6%.



Job creation slowed in 2016, with the 12 month rolling average of new positions falling by over 50,000. But that pace has picked up again through the first half of 2017, as the 12 month average is back on the rise. The second quarter of 2017 ended with a strong performance in June, when over 222,000 private sector jobs were added, much better than in March when an unexpectedly low 98,000 new jobs were created to end Q1. Wild swings in job growth impact consumer spending and business expansion. Companies large and small tend to be more cautious in making long term decisions that have a big impact on hiring. Of significant import is the fact that tech sector job growth, which had been leading the way in terms of job

EMPLOYMENT

creation, has slowed substantially this year. Even tech hotspots like San Francisco are cooling off, raising concerns over the impact on commercial real estate occupancy going forward.

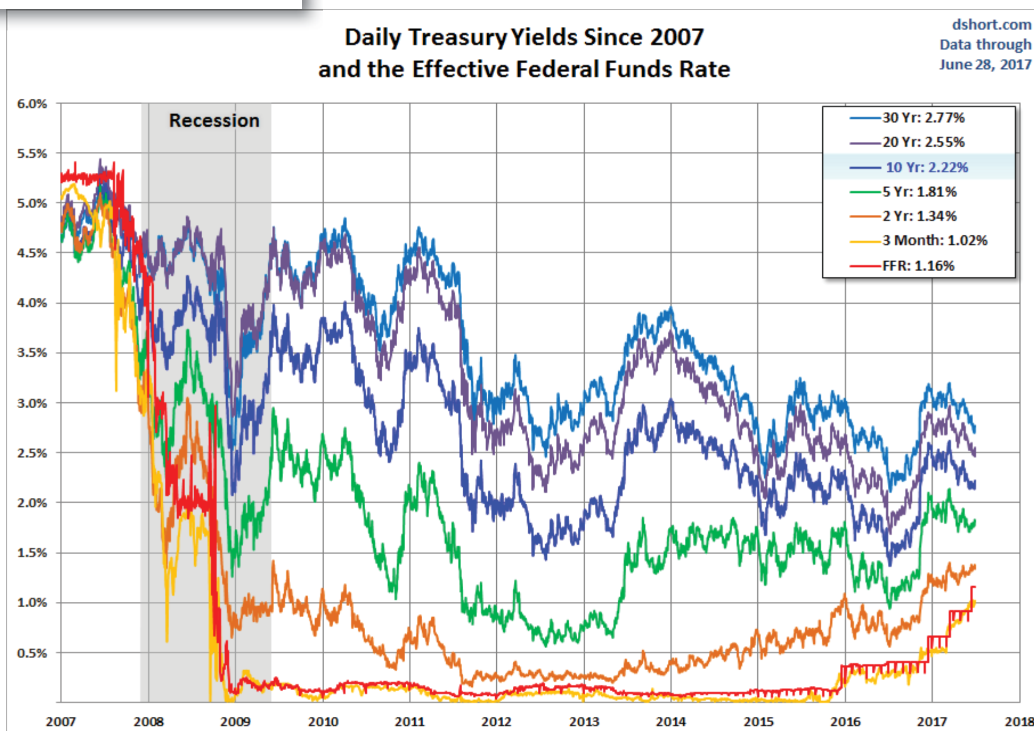
The Labor Participation Rate, the metric that measures the percentage of those eligible for employment between the ages of 16 and 64 who are currently working, also remains near a four-decades low. A loss of job growth momentum and the early retirement of Baby Boomers, have combined to keep just 62.8% of potential workers in active production.

Lagging wage growth is still tightening the drag on US economic growth. Full-time, high-paying jobs are available, but remain unfilled for lack of qualified applicants. Lower-skilled workers are still having a harder time getting ahead. Wage growth has seen some improvement, but remains under 3%. In June, wages grew by 2.8% on a year-over-year basis. For workers at the lower end of the wage scale, where most of the new jobs are, income growth in the low single digits has little impact on their spending habits.

MONETARY POLICY

As the saying goes, "be careful what you wish for." Calls for the Fed to reverse its easy money policy were finally heeded and after a preliminary move back in December of 2015, our central bankers have clearly changed their tune. In the past six months, the Fed has moved its Fed Funds rate up three times, with the most recent in the middle of June. Currently, that benchmark rate is set in a range of 1% to 1.25%, still low by historical standards. However, Ms. Yellen and friends have clearly drawn the line in the sand in terms of their intentions, despite up-and-down job numbers, tepid inflation and weak wage growth. It will take a sustained series of quarter-point increases to fully neutralize the activist posture of our central bank, which began ten years ago. As we have been reporting for the past two year, critics are vocal in their belief that Fed policy is

US TREASURY RATES
IN PERCENTAGE



largely responsible for what could be a bubble in the equities and commercial property markets, as both have seen disproportionate gains throughout the economic recovery.

Fed rate hikes generally strengthens the US dollar making exports more expensive and effectively raises the debt service on dollar-denominated loans for borrowers around the world. However, dollar gains have been pared back recently, as economic growth around the world has gained momentum. What may become big news soon is the potential impact of reducing the Fed's balance sheet, which swelled to over $4.5 trillion after several years of bond-buying. Money created in a computer on an as-needed basis, has to go back into the computer to be removed from circulation at some point or inflation will be sure to spike. In recent weeks, the Fed has been discussing plans to gradually reduce its holdings by not reinvesting in maturing US Treasuries and Residential Mortgage Backed Securities. It is unknown how the bond markets will react to the change,

MONETARY POLICY

but many are concerned that it will drive up bond yields, which would exacerbate the effects of expected further rate hikes by pushing borrowing costs up too quickly.

Despite the Fed's more robust monetary stance, central banks around the world are still in activist mode. The European Central Bank is still buying bonds at a 65 billion euro-per-month clip and holding interest rates in the zero bound. Though, there is more talk of backing off that aggressive stance given the recent improvements in European Union GDP and employment metrics. The Bank of Japan can't seem to wean itself off of central bank meddling. Its appetite for bond purchases is so voracious, it is running out of government debt to buy back.

Concerns of a near term recession here in the US remain muted, but other than a low unemployment rate, the Fed has little to point to support the case for a more robust recovery. The surprise that was Donald Trump is now a daily reality and not much has changed since he was sworn in as our President other than a daily dose of juicy headlines.

Trump's promises of a big infrastructure investment and tax reform would give the Fed a little help if either came to pass, but that is not likely. Deficit hawks on the political right are pushing back and Democrats appear united in blocking anything and everything the new President puts on the negotiating table.

Mortgage rates started to move higher as T-bill yields, the benchmark for commercial property loans, made a move up. However, the Fed has made two interest rate moves this year, and the yield on the 10 Year T-Bill has actually fallen. Clearly, that anomaly reflects further uncertainty about the US economy going forward, as investors are willing to pay more for the safety of US sovereign debt. So, it remains a good time to borrow, but borrowers are facing stricter loan underwriting from increasingly cautious lenders.

GLOBAL ECONOMY

Until the end of last year, we were describing the global economic outlook as troublesome. We still remained concerned, but the global picture has definitely brightened in the first half of 2017. The panic over the Brexit vote is over, though the UK is still in for some rough road ahead. The actual process of extricating itself is now underway, and it should make for some interesting sausage making before it is complete. The British Pound remains under siege and other players will be making their plays to replace the UK as a financial services hub, but there is no clear indication of that happening in the near term

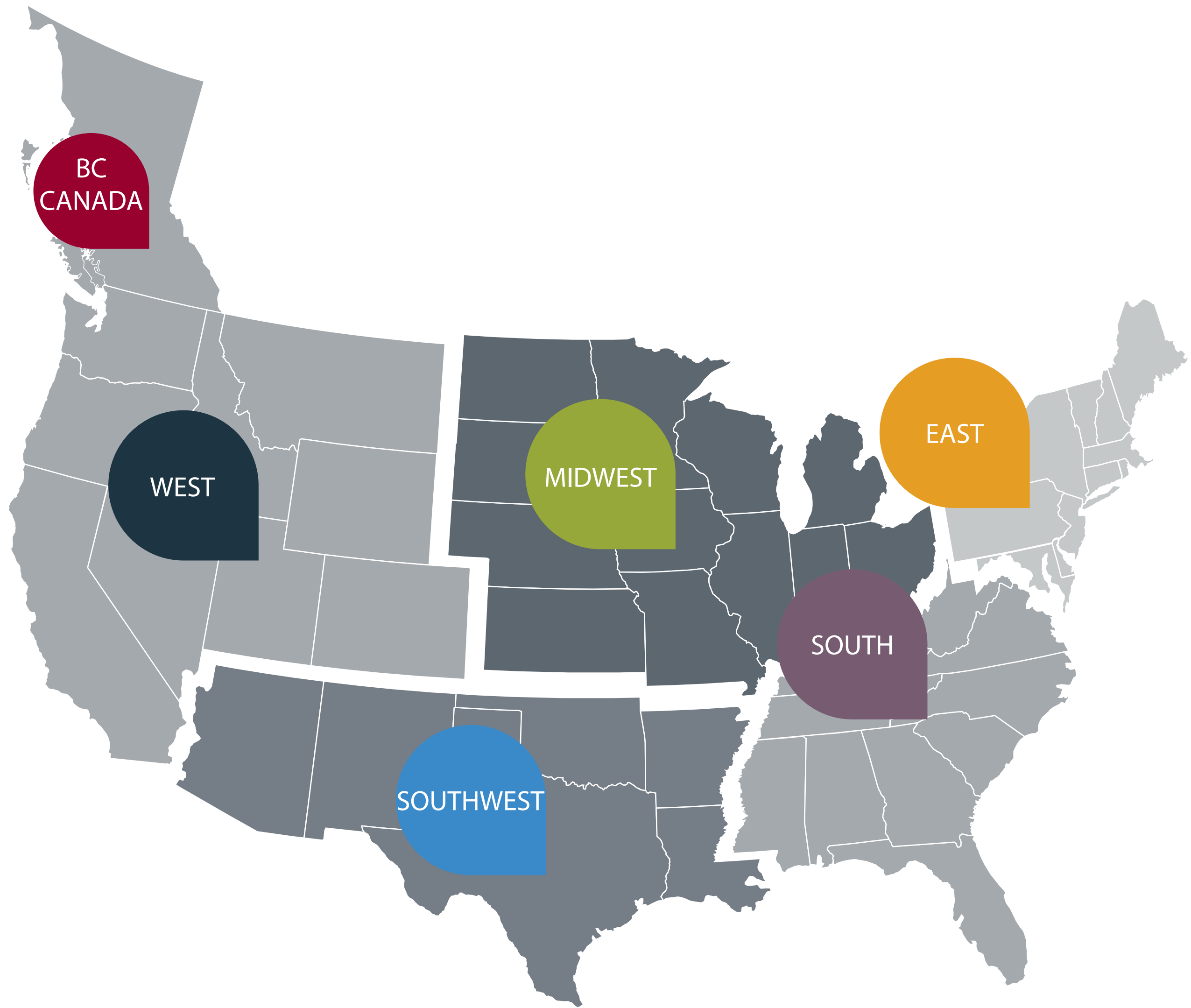
While Europe's political union is still not certain, GDP growth there is steadily improving. In 2016, GDP was up 1.8%, 20 basis points higher than the US growth rate, and that has more experts questioning why Mr. Draghi and his fellow central bankers at the ECB still have the monetary throttle wide open.

China's economy has stabilized and its stock markets have become less volatile. In fact, trade throughout Asia has improved in 2017 despite the fact that the US pulled out of the Trans Pacific Partnership trade agreement after Donald Trump took the reins as President. The recent OPEC agreement to cap production helped to stabilize the price of a barrel of oil above $50 in Q1, but an increase in US oil production in recent months sent the price of oil back into the low $40 range again by the end of Q2. Supply is still running ahead of demand and without more robust economic growth around the world, oil prices are likely to remain near current levels.

EURO AREA REAL GDP[2]
(QUARTER-ON-QUARTER PERCENTAGE CHANGES)

In June, Qatar, still a big oil player, was snubbed by other Middle Eastern countries for alleged ties to financing terror-related groups, and that has frayed nerves throughout the region that is already tense over the conflict with ISIS in Syria and Iraq. The fact that so much attention is on the Middle East right now without a resulting spike in oil prices is proof positive that there is more oil coming out of the ground than is currently needed. Fears over "peak supply" have given way to the potential global impact of "peak demand" instead.

Key Market Snapshots



LOS ANGELES NORTH
ORANGE COUNTY
DENVER

PHOENIX
DALLAS/FORT WORTH
HOUSTON

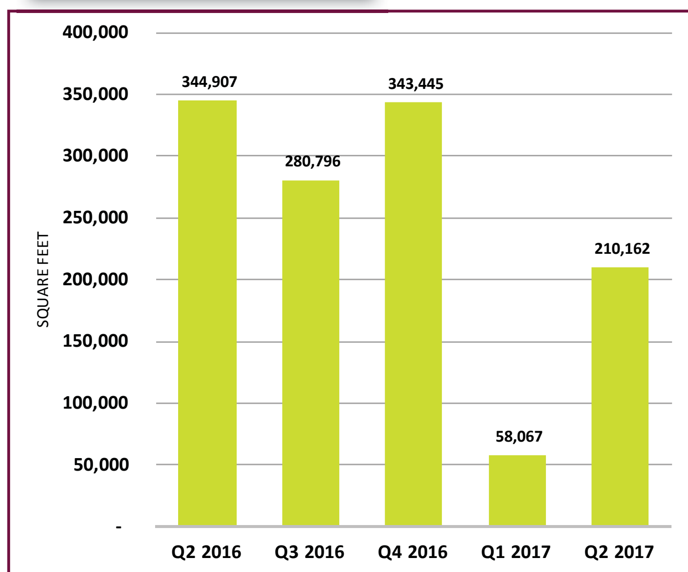
ST. LOUIS
MINNEAPOLIS

ATLANTA
GREENVILLE/SPARTANBURG
CHARLESTON

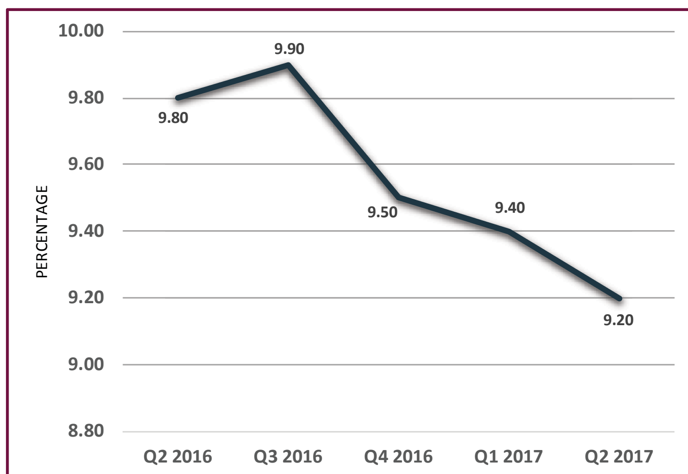
NORTHERN NEW JERSEY
COLUMBIA/MARYLAND
MANHATTAN

LOS ANGELES - NORTH

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

Fundamentals have been improving in the Los Angeles North office market, but growth moderated and activity slowed in the second quarter. The trend is consistent with what is occurring in major cities across the country. A recent Wall Street Journal report noted that, while tepid job growth has limited the office market recovery in past quarters, the current slowdown can be traced to uncertainty coming out of Washington, D.C., as businesses await clear direction on tax reform and infrastructure investment. Unfortunately, progress on both issues is moving slower than originally expected.

Office leasing activity in the Los Angeles North region slowed to 1,163,455 square feet in Q2, as compared to 1,433,967 square feet in Q1. However, the half year comparison tells a different story. Nearly 1 million fewer square feet of office space was leased in the first half of 2017 (2,597,422 square feet) compared to the first half of 2016 (3,412,123 square feet). Class A properties have performed with more consistency this year as a total of 1,220,419 square feet was leased in the first half compared with 1,497,576 square feet of leasing activity in the first half of 2016. Net growth in occupied space remains at modest levels, as well. In Q2, net growth in occupied space improved to 210,162 square feet after a gain of just 58,067 square feet in the first quarter.

Despite the slower activity level, vacancies have continued to decline for the office market overall and for Class A space, in particular. Overall, vacancies have declined 60 basis points year-over-year to 9.2%, while Class A space vacancy levels are down 100 basis points in the same period to 11.1%,

Perhaps the greatest vote of confidence for the local office market outlook can be found in the number of development projects currently being proposed.

* buildings with a minimum of 10,000 square feet

9.2%	$29.04	210,162	80,940,347	263,480
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	SF INVENTORY	SF UNDER CONSTRUCTION

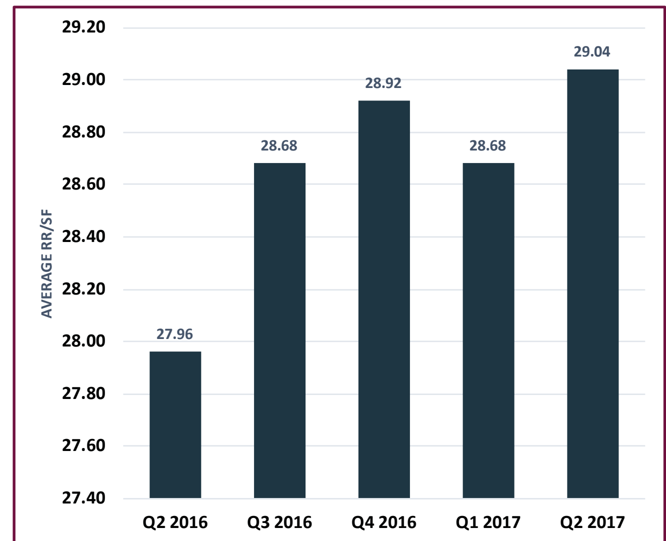
LA NORTH - TRENDING NOW (continued)

A 26-acre parcel that surrounds the Anthem Blue Cross headquarters building in the West San Fernando Valley has gone un-used for decades, but was just listed for sale. The parcel could accommodate up to 5 million square feet of development. Another local investment company is planning to demolish a 350,000-square-foot office park in the same West San Fernando Valley submarket and replace it with a proposed 1 million square feet of new office space.

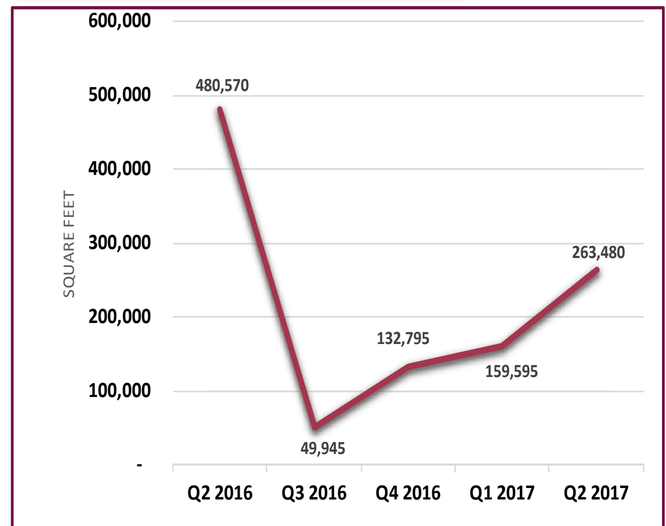
A flurry of office sales in the quarter may also reflect this optimism as well as a sense by sellers that the market may be topping out. A case in point is the sale of a 197,000-square-foot North Hollywood office building to Beacon Capital Partners. Kennedy-Wilson sold the property for $69 million, 54% more than the $45 million paid to purchase the asset in 2013.

Other heavy hitters that have been active in the market include New York Life Real Estate Investors which purchased a 351,301-square-foot office building in the Tri-Cities submarket of Burbank, and Credit Suisse, which acquired a 190,000-square-foot office building in the Tri-Cities submarket of Glendale. In all, $524 million of sales were transacted in the quarter at a median price of $349.29 per square foot. That compares with $198.3 million worth of transactions at a median price of $261.82 per square foot in the same period last year.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION

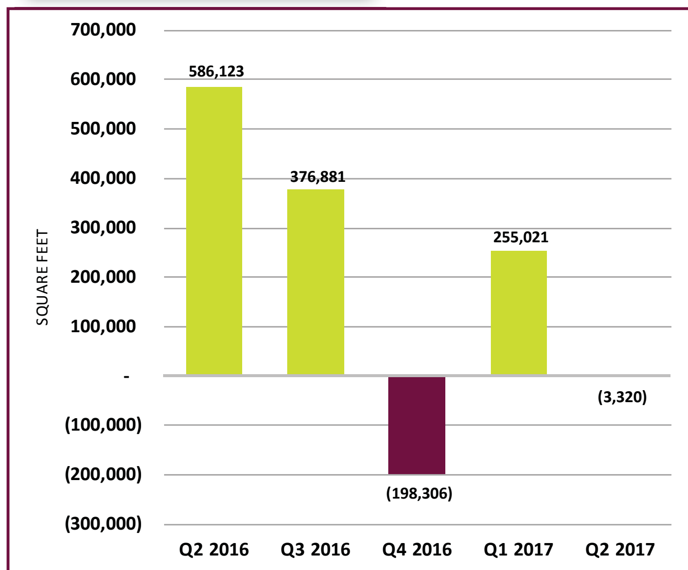


A LOOK AHEAD

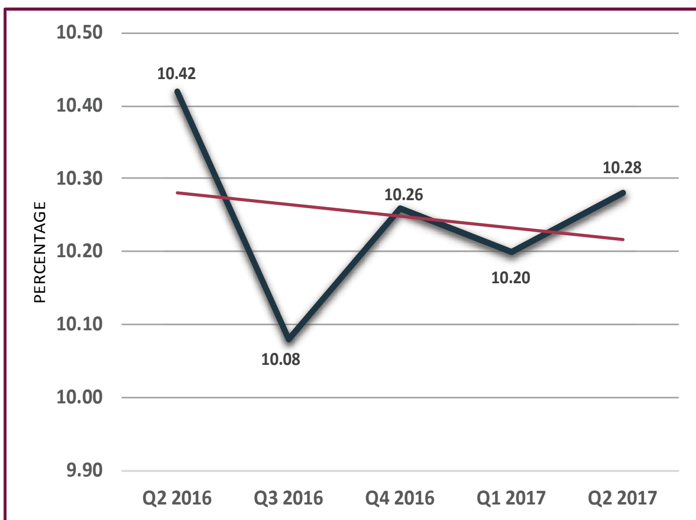
- Leasing activity should continue to exceed 1 million square feet per quarter
- Market velocity will fluctuate as employers seek greater transparency in the economic outlook
- Vacancy rates will continue to decline this year, but at a slower pace than 2016
- The pace of increases for asking lease rates will slow to low single digits
- Construction is likely to ramp up, especially in West San Fernando Valley submarkets where zoning restrictions have been lightened
- Net absorption will moderate

ORANGE COUNTY

NET SF ABSORPTION*



VACANCY RATE*



* buildings with a minimum of 30,000 square feet

TRENDING NOW

After opening 2017 with healthy absorption, the office market leveled off in the 2nd Quarter as demand for space lagged behind the pace of Class A deliveries. The latest data indicates net absorption in all office buildings for four quarters ending June 30, 2017 totaled 530,276 square feet, the lowest net occupancy gain for any four consecutive quarters since 2010. Moreover, the vacancy rate which had been in steady decline from 17% through the post-recession period, has remained between 10.2% - 11% for the last nine quarters.

The softness in demand is most noticeable in the 42.6-million-square-foot Airport Area submarket, which contains 38% of the total office inventory in Orange County. In the last six quarters, 872,351 square feet of space became available, increasing the vacancy rate there to 11.5%. Approximately 1.1 million square feet of new space has been added in the last eight quarters, and later this year, 545,000 square feet of premium space is due for completion near the airport. The Irvine Company recently began marketing 836,000 square feet of soon-to-be-vacated space in the University Research Park, while developers plan to break ground in the next 18 months on another 1.25 million square feet of office space, primarily in the Airport, Central County and Irvine Spectrum submarkets.

The Central County submarket is faring somewhat better. The second-largest of the county's office submarkets posted its fifth straight quarterly absorption gain and is up 415,839 square feet for the first half of 2017. The vacancy rate in this 22-million-square-foot submarket that includes the Civic Center of Santa Ana and Angel Stadium area of Anaheim, fell to 11.9% by midyear.

Investors remained enthusiastic about office assets as buildings are trading for increasingly higher prices.

10.28%	$29.88	(3,320)	17,457,836	2,458,722
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	SF INVENTORY	SF UNDER CONSTRUCTION

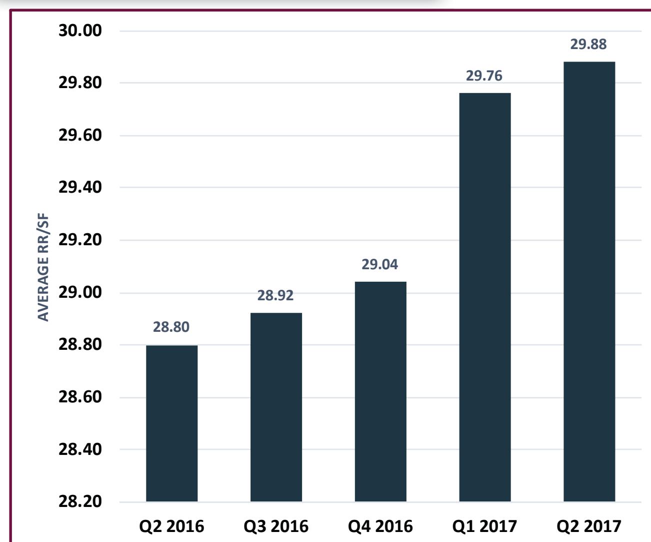
ORANGE COUNTY - TRENDING NOW (continued)

A 43,247-square-foot building in Corporate Park was recently listed for $375 per square foot by owners who paid $237per square foot three years ago. Last fall, an investor paid roughly $260 million, or $440 per square foot, for the five-building Google complex on MacArthur Boulevard in Newport Beach. Two towers opposite the Google property are reportedly being acquired by Goldman Sachs for $475 per square foot, a 50% increase over their sale price in 2014.

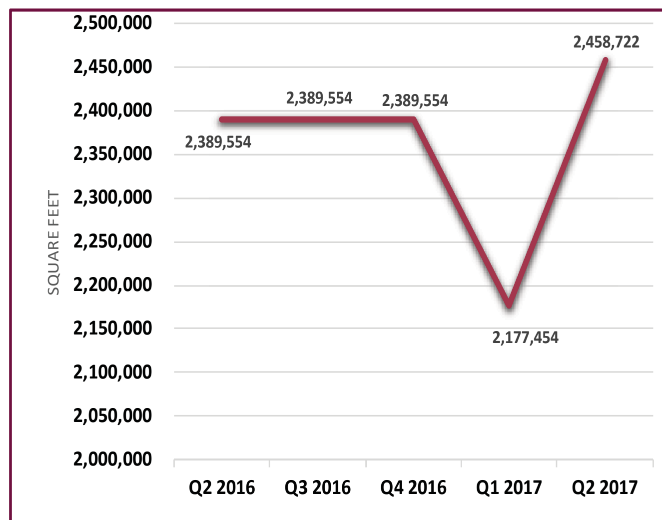
Average asking rents have continued to rise, but the rate of growth has slowed. Between July 2014 and June 2016 asking rents jumped 16.4%, but in the last four quarters rent growth averaged just 3.3%. Rent growth has been strongest in buildings offering so-called creative space that feature more open workspaces that give employers the ability to increase employee density and still offer a more attractive work environment. So far, creative space opportunities have been concentrated in the Airport submarket, but the trend is working its way into the Central County submarket, as well. That trend should continue as tenants who signed leases four and five years ago get a bit of sticker shock as they look to renew or relocate in the Airport area. That has Class B product getting more attention from more cost-conscious tenants finishing up leases in Class A buildings.

Even though net absorption and leasing activity has slowed, multiple tenants are still competing to secure the best Class A space that becomes available. So, those tenants need to act quickly when they find a space that works well.

AVERAGE SF RENTAL RATES*



SF UNDER CONSTRUCTION*



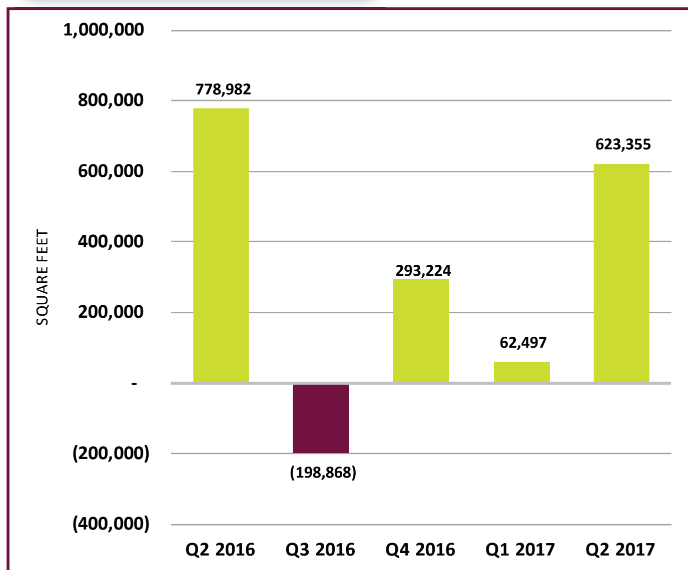
* buildings with a minimum of 30,000 square feet

A LOOK AHEAD

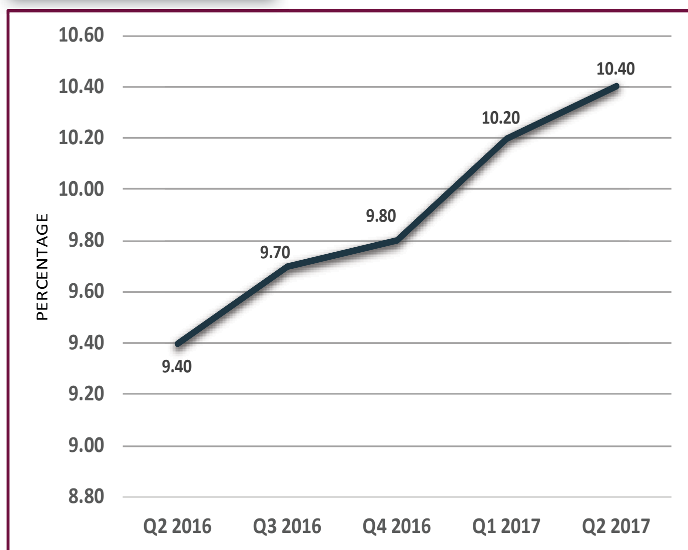
- Lease and sale activity should remain near current levels for the balance of the year
- Many value-add projects acquired in the past few years will be disposed of in the next few quarters
- Sales prices should keep moving up, as demand is still running ahead of supply
- Average asking lease rates will move up by 3% to 5% in 2017
- Construction activity will be mainly limited to retrofit projects, as very few sites are offered for ground-up development
- Net absorption will be moderate but steady

DENVER

NET SF ABSORPTION



VACANCY RATE



* buildings with a minimum of 30,000 square feet

TRENDING NOW

Fallout from the energy sector slowdown has significantly impacted Denver's office market over the past two years despite otherwise healthy economic growth. Net absorption levels have declined, the vacancy rate has moved higher for five consecutive quarters and the average asking rental rate for Class A space declined over the past year. The amount of space offered for sublease has also risen, climbing by over 500,000 to 1.85 million square feet by midyear. Landlords marketing direct space are offering concessions and adding amenities to compete with sublease opportunities and tenants are faced with rising tenant improvement costs and landlord insistence on longer leases.

Upstream oil sector businesses in the Denver area began reducing capital budgets and operating budgets more than two years ago in response to a collapse in oil prices in 2014. Now, three years later, the price of oil is still under $50/bbl, after many thought it had stabilized above that level before slipping again early in the second quarter, dashing hopes for a sustainable rebound. Fortunately, a growing tech sector picked up a lot of the slack and helped rank Denver seventh of the nation's 51 largest metro areas in terms of job growth in 2016 behind the likes of Dallas, Seattle and Salt Lake City. In the 12 months ending in December of 2016, Denver's workforce expanded by 44,800 or 3.2%. By the end of May 2017, the unemployment rate for the Denver area was a scant 2.3%, one of the lowest in the nation, despite the woes of the energy sector. Office-using sectors leading the way in terms of job growth have been in business and professional services along with education and health services.

Net absorption picked up in Q2 after a sluggish start to the year. For the period, a 623,355-square-foot gain in occupied space was recorded, the best

10.4%	$25.84	623,355	199,031,017	4,820,922
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	SF INVENTORY	SF UNDER CONSTRUCTION
▲	▲	▲	▲	▼

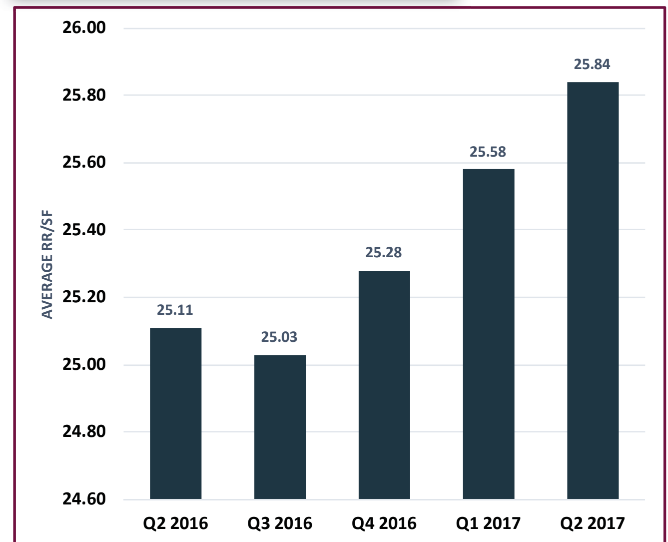
DENVER - TRENDING NOW (continued)

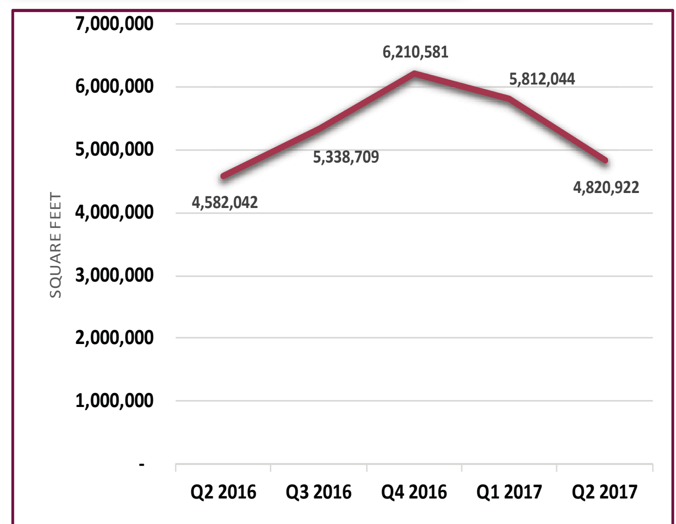
rebounded from a 482,300-square-foot loss in Q1 to record a modest gain of 65,000 in Q2. Class B added over 512,000 square feet in the second quarter, bringing year-to-date absorption in that category to over 1,070,000 square feet. Suburban submarkets continue to outperform the CBD, which is running a slight deficit year to date.

Average asking rental rate for all building classes still managed to gain $.26 in Q2, to hit $25.84 by midyear. Year-over-year, overall asking rents have grown by $.73 per square foot, or 2.9%. Class A rents also moved higher, ending Q2 up $.15 to $29.57. However, Class A rents are currently $.31 lower than they were a year ago, which was not unexpected given the decline in oil sector leasing activity. Class B rents rose again in Q2, adding another $.25 to a new high of 23.23.

Vacancy has been moving up for the past year, adding 20 basis points in Q2 to 10.4%, right where it was at the end of 2014. The overall rate had fallen to a post-recession low of 9.4% in Q2 of 2016. Despite that increase, Denver's vacancy is lower than in many major metro areas of the US. Class A vacancy in the CBD remains highest at 16.1%, but did decline by 20 basis points in the quarter. The combined Class C market posted the lowest vacancy rate, unchanged in Q2 at 4.1%.

Over 1.8 million square feet of new office space was delivered in the first half of 2017 and an additional 4.8 million square feet is still under construction, which makes it that much more difficult to get vacancy back on the decline. Two major Class A projects downtown are both slated for delivery next year, will put further pressure on vacancy. The first, a 670,000-square foot building at 1144 15th Street, is currently 35% preleased and the other, a 428,000-square foot project at 2001 16th Street, is 81.1% preleased.



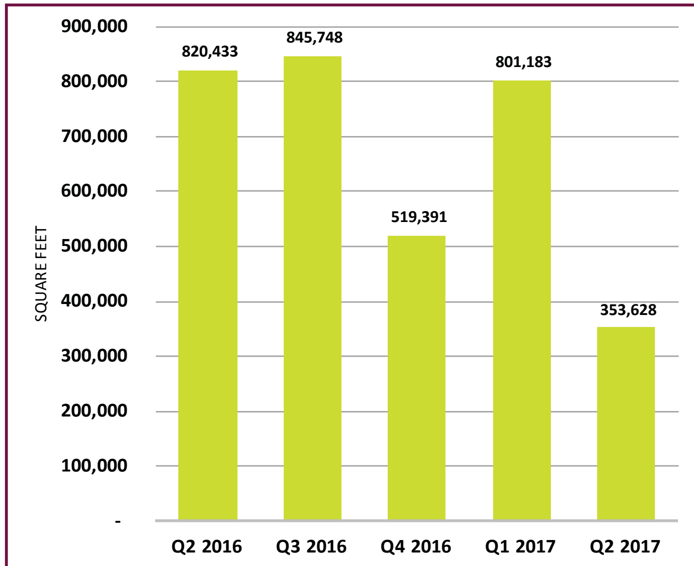


A LOOK AHEAD

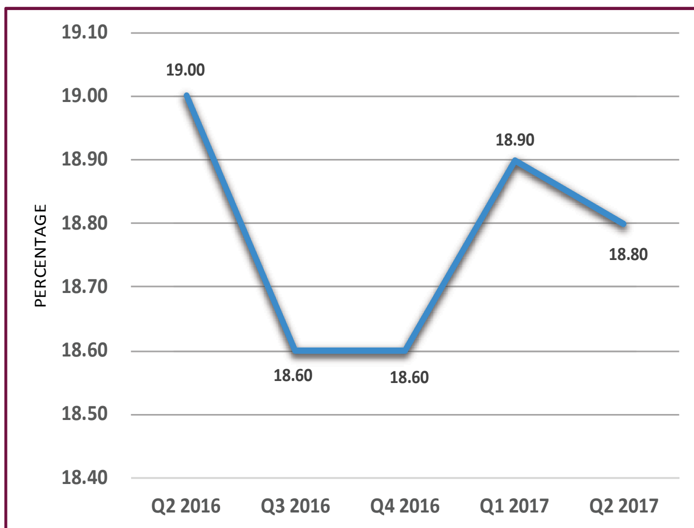
- Lease and sale activity will stay on current track for the balance of 2017
- Overall average asking rent growth is leveling off
- Vacancy will keep moving up slowly for the rest of the year
- Job creation in the tech and business services sectors will continue
- New construction will slow down in the near term
- Net absorption will be slightly negative for the balance of the year

PHOENIX

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

The Phoenix office market posted modest gains in Q2 after a more robust Q1. The pace in this sector has been slow and steady with occasional speed bumps. This is in contrast to the fast pace of the office market that crashed in 2008. Many believe the unsustainable growth during that period led to a longer recovery and the excesses of that era are still influencing the office market today.

Another factor affecting the office market is the growth in space offered for sublease. While on the surface sublease vacancies are running at historical norms, total available subleases are at 2.2% of total inventory. This illustrates a growing issue as those tenants, while still in the space, will be vacating at a later date, adding market pressure related to higher anticipated vacancy going forward.

Lease activity and rental rates were muted this quarter as overall market momentum slowed markedly. This comes at a time when the office sector continues to be in transition. Changes in requirements, flight to quality and a changing workforce have all contributed to a more complex leasing environment. Still, regional fundamentals are strong and point to further growth and investment. Existing tech, banking and medical firms are expanding and new ones are relocating to the area. A strong, educated workforce continues to lure these companies away from higher cost of living cities on both coasts, but California in particular.

On a positive note, speculative construction remains in full swing. Several new projects including Camelback Collective at 118,090 square feet (Camelback Corridor submarket), Block 23 at 220,000 square feet (Downtown submarket), The Watermark at 253,181 square feet (Tempe submarket) and Rivulon, a two building

18.8%	$24.86	353,628	88,078,030	1,402,067
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	SF INVENTORY	SF UNDER CONSTRUCTION

PHOENIX - TRENDING NOW (continued)

project totaling 120,000 square in Gilbert (Chandler submarket). These projects are an example of new building trends featuring Class A amenities, location, and flexible, hi-tech work environments.

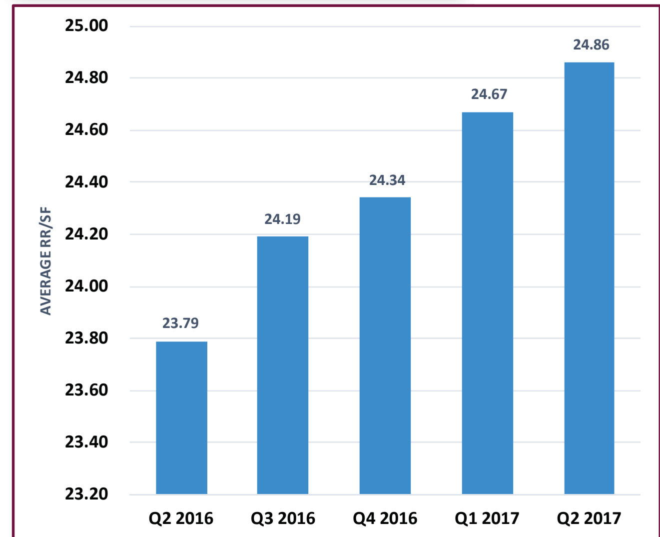
Overall Phoenix office vacancy fell 1 basis point to 18.8% for the quarter. Tempe, Central Scottsdale, and Scottsdale Airpark submarkets all have lower vacancy rates, while the Midtown and Camelback Corridor submarket vacancy is substantially higher.

A total net absorption of 353,628 square for recorded in the second period, bringing the year-to-date net gain of occupied space up to 1,215,290 square feet. Tempe posted the highest increase for the year at 505,059 square feet. Midtown Phoenix posted the highest negative net absorption for the year at (79,961) square feet.

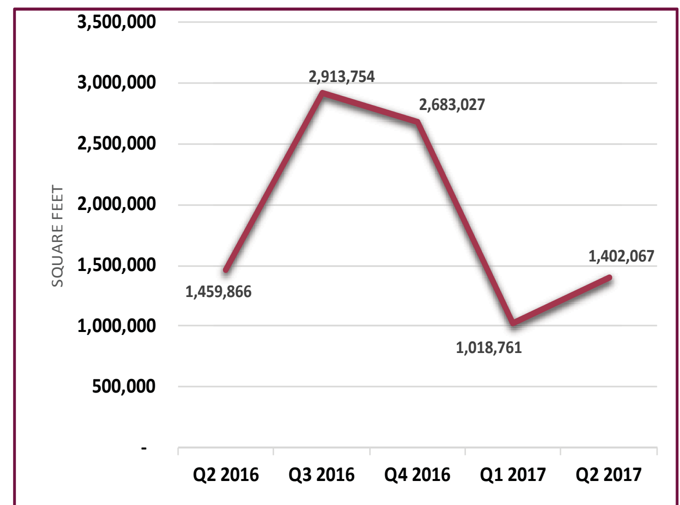
Asking rental rates moved up by 0.7% in Q2 to $24.86. Downtown Phoenix, Scottsdale South and Camelback Corridor submarkets have the highest asking rents.

In the largest sale for the quarter, Goldman Sachs & Co. purchased a two-building, 295,401-square-foot, Class A office building at 3131 E. Camelback Rd., Phoenix for $81,750,000 square feet or $276.74 per square feet. The largest lease transaction for the quarter was Freedom Financial's commitment for 300,000 square feet at Rio 2100, 2100 E. Rio Salado Pkwy., Tempe. The company is expected to occupy half the space in Q2 2018 and the other half in 2019. Construction is expected to begin in Q3 of 2017.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION

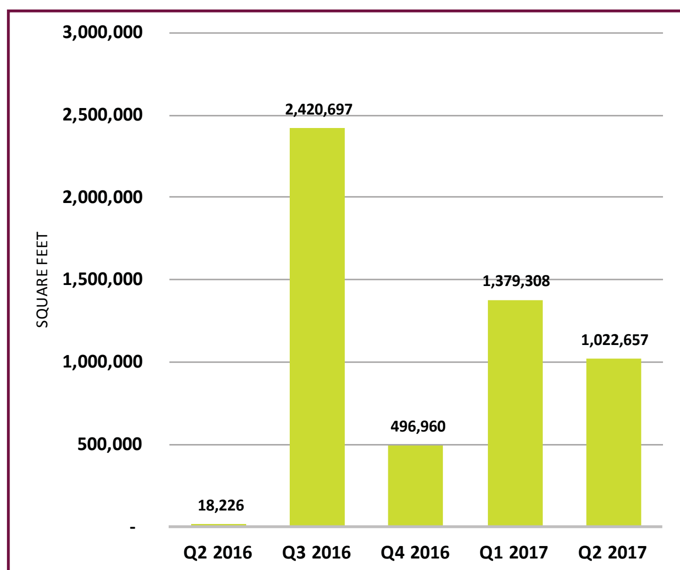


A LOOK AHEAD

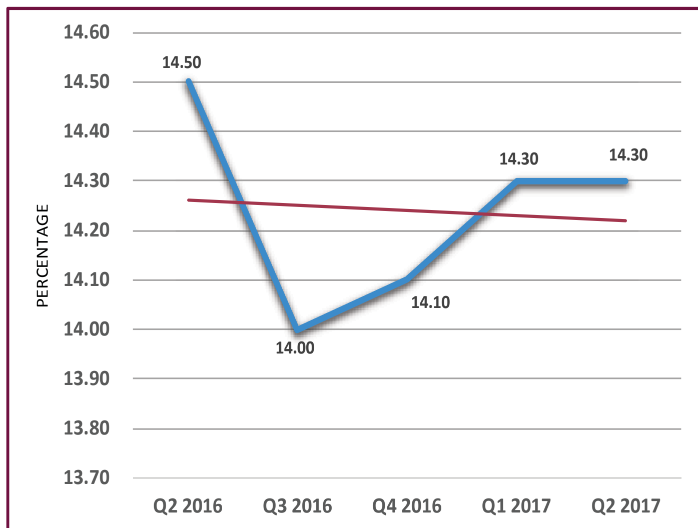
- Leasing Activity is expected to remain consistent over the next year
- Net Absorption will slow for the year, but should stay in positive territory
- Average Asking Lease Rates are still below the previous market peak, but top tier markets are seeing rents rise faster
- Vacancy should drop 2-5 basis points per quarter
- Sales prices continue to rise due to limited inventory of quality product
- Development activity is concentrated in Class A product in locales favored by millennial-aged workers

DALLAS/FORT WORTH

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

More than 300 people per day move to the Dallas/Fort Worth (DFW) area and the regional economy is still experiencing significant growth. Corporate users like Toyota, Boeing, Liberty Mutual and JP Morgan Chase chose the area as a place to grow because they need access to the large and expanding labor pool, and welcome the pro-business attitude and economic incentives offered by the local and state governments. The bottom line is that businesses want to do business in Texas, in general, and in DFW, in particular because of its central location, highly developed infrastructure and low-cost/high-quality lifestyle. The area has a wide variety of housing alternatives, land for long term growth and a less restrictive regulatory structure.

After years of such prolific economic growth, office landlords and third-party investors are becoming wary of the possibility that the economic boom may be getting long in the tooth. Tenants are less inclined to sign long leases while landlords push hard for them, as both hedge against a potential office market correction. Developers are even tapping the brakes as they focus on reading the tea leaves looking for signs of trouble ahead. The pain associated with overbuilding is something they and their bankers, haven't and shouldn't, forget. Even so, another 1.4 million square feet of space in 45 buildings was added to base inventory in the second quarter. That brought the total office inventory up to 364.2 million square feet. Another 11.36 million square feet is still underway, with a good mix of preleased and speculative projects. In lieu of new ground up development in the CBD, older Class B product is being acquired for retrofitting by add-value developers.

So far, overall activity has kept pace with new deliveries, but that has stalled the vacancy rate in a range from 14.0%

14.3%	$24.64	1,022,657	364,280,781	11,366,335
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	SF INVENTORY	SF UNDER CONSTRUCTION

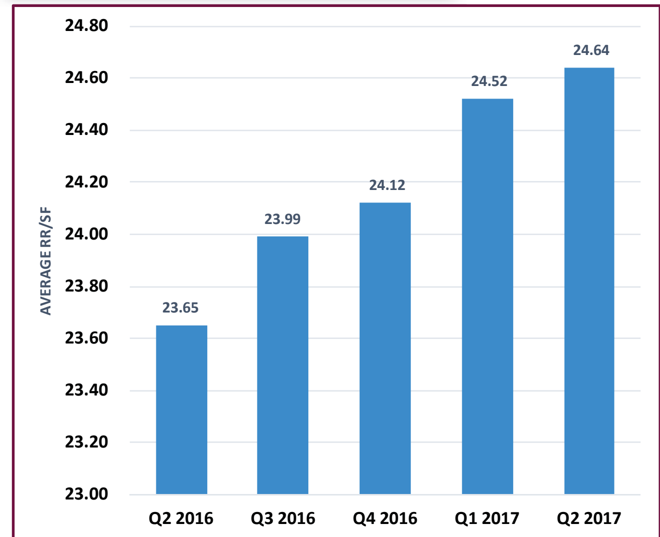
DALLAS/FORT WORTH - TRENDING NOW (continued)

to 14.6% since 2014. Through the first half of 2017, vacancy is unchanged at 14.3%. Class A vacancy is running ahead of Class B at the mid-year point with a rate of 17.1%, versus 13.8% for Class B. Suburban product accounts for nearly 319 million square feet of the 364 million square foot inventory of office buildings, but vacancy is still substantially lower in suburban product.

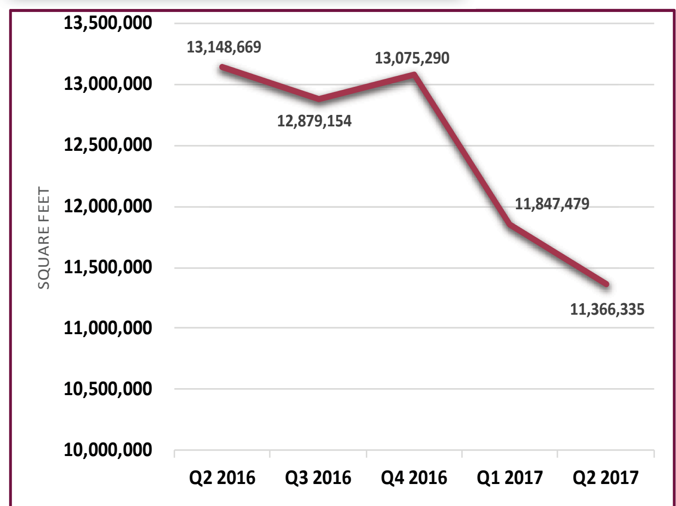
A total of 1,022,657 square feet of net absorption was recorded in the second quarter, bringing year-to-date growth in occupied space to just over 2.4 million square feet. Class A had a net gain of 424,501 square feet, while Class B saw a swell in occupancy of nearly 630,000 square feet. Absorption in the suburbs is running well ahead of the CBD with year-to-date gain in occupancy of over 2.2 million square feet compared to just 127,000 square feet in the CBD. The disparity is due to the preference for suburban locales by major corporate users. Suburban submarkets, where the biggest corporations are locating, are posting the biggest net absorption gains. As we have been reporting, Class B suburban space continues to benefit from the herd effect, as smaller businesses that service big corporations locate near their biggest customers.

Average asking rents continued their modest but steady rise in Q2 by moving up another $.12 to 24.64. Class A asking rates fell two pennies to $28.10, but Class B space moved up $.20 to $21.20. However, tenants are just as worried about the passing through of operating expenses related to higher taxes as they are higher lease rates. Texas does not have a state income tax, and must therefore rely more on property taxes to fund the public sector, which leads to frequent valuation reassessments.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION

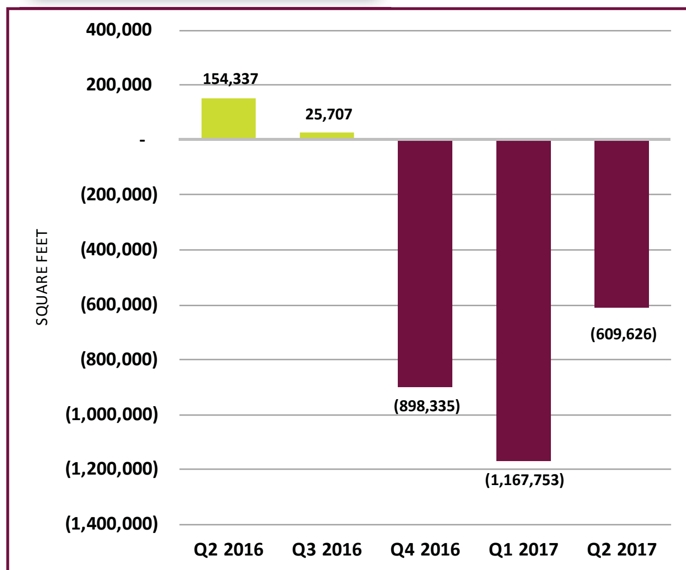


A LOOK AHEAD

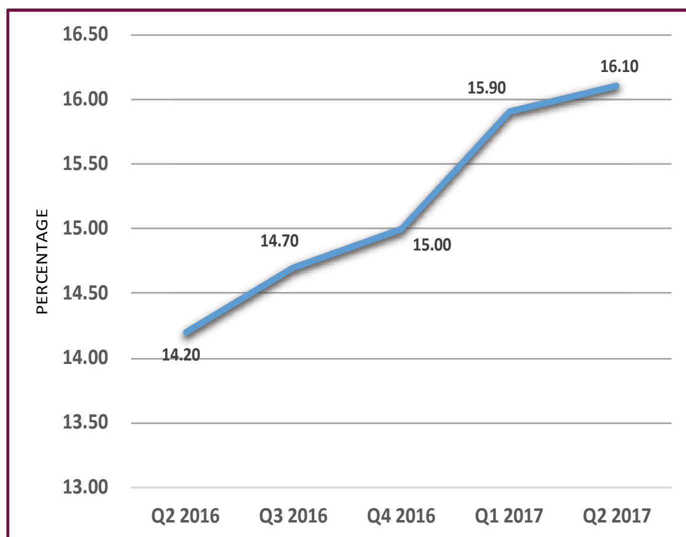
- Lease and sale activity will remain strong for the next 12 months due to current market momentum
- Rent growth will flatten out as tenant concerns over a market correction increase
- Vacancy will see only modest declines going forward due to ongoing delivery of new space
- Net absorption will slow down but remain positive
- Sales prices will keep moving higher due to imbalance of supply versus demand
- Construction activity will begin to slow as developers and lenders tighten up on underwriting new deals

HOUSTON

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

Oil drillers increased rig count and domestic oil production after OPEC and other producers agreed to production cutbacks. That caused further worldwide supply excesses and the price of a barrel of oil fell sharply early in Q2 before rebounding late in the period. Houston is home to the energy sector and the region's dependence on fossil fuel production is an undeniable fact. So, despite gains in other sectors like healthcare, the region's office market still faces significant challenges.

The downtown office market has become more exposed as the impact of the energy sector slowdown has made its mark. High demand from energy related businesses drove historic price increases on Class A downtown space as well as a wave of development not seen since the early 1980's. In turn, unsustainable growth coupled with the downsized energy business formed a correction in the office market that has been unfolding for almost three years.

In the world of $40-$50/bbl oil, tenants remain in command. Non-oil and gas related tenants are taking advantage of the decline in office demand. This layered market is expected to continue into 2018, but when the energy markets stabilize, the additional capital flow should rapidly improve office market conditions.

But, for the time being, the struggle is ongoing and rising vacancy remains a problem. The overall vacancy rate across all building classes moved up just 20 basis points during the period after a 90 basis point rise in Q1. At mid-point of 2017, the overall vacancy rate stood at 16.1%, up from just 14.2% a year ago. Class A vacancy is highest at 19.4%, while Class B vacancy current stands at 15.2%.

16.1%	$27.70	(609,626)	305,191,135	3,096,080
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	SF INVENTORY	SF UNDER CONSTRUCTION

HOUSTON - TRENDING NOW (continued)

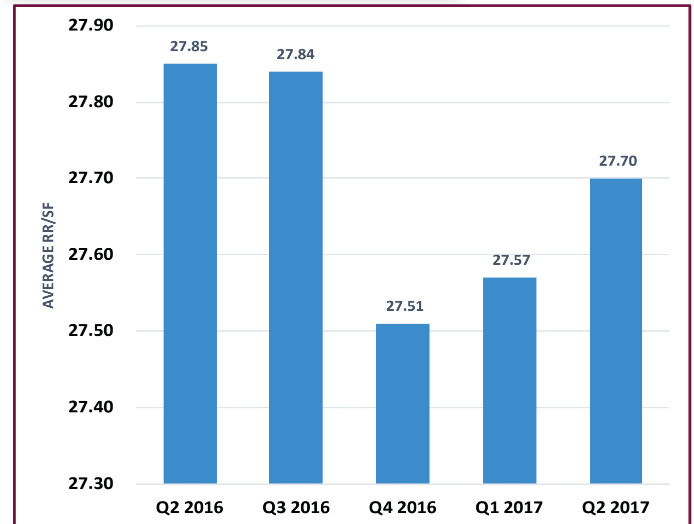
Subleases account for roughly one-third of current leasing activity, which exacerbates the vacancy problem. Tenants are being hotly pursued with promises of lower start rates, rent abatement and lease term flexibility. With so many options, tenants are taking longer to make decisions, which only makes matters worse.

The overall average asking rental rate actually moved up again for the second straight quarter, increasing by $0.13 to end Q2 at $27.70. On a year-over-year basis, the average asking rate has slipped by just $0.15, which is a surprisingly small decline given the increase in available sublease space and ongoing struggles in the energy sector. The Class A asking rate rose by $0.27 in Q2 to $33.47, and Class B managed an increase of $0.11 to $21.60. Rates in the CBD for Class A and B combined now average $40.14, compared to $26.18 in suburban areas. However, effective rates are somewhat lower due to high levels of tenant concessions.

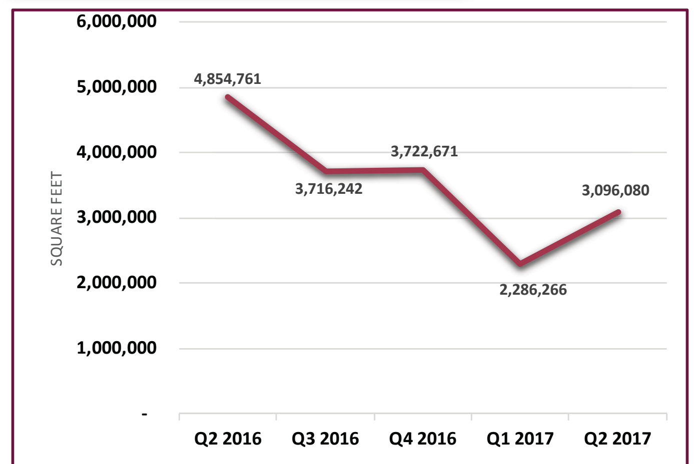
Net absorption remained negative in Q2, but the decline stabilized to 609,626 square feet compared to the 1,167,753 square feet recorded in the first period. That makes three consecutive quarterly net losses in occupancy throughout the region. In the past four quarters Houston's total decline in occupied space exceeded 2.6 million square feet. Tenants are able to take more time to decide and end up with more flexible lease terms and richer tenant improvement packages.

After a decline in the first quarter, construction activity rose by over 800,000 square feet in Q2 to a total of 3,096,080 square feet, but new deliveries fell sharply to 350,424 square feet. Year-to-date, 19 buildings totaling nearly 2 million square feet of space have been delivered. However, projects that can be put on hold, will be until a big chunk of the stale vacancy is absorbed.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION

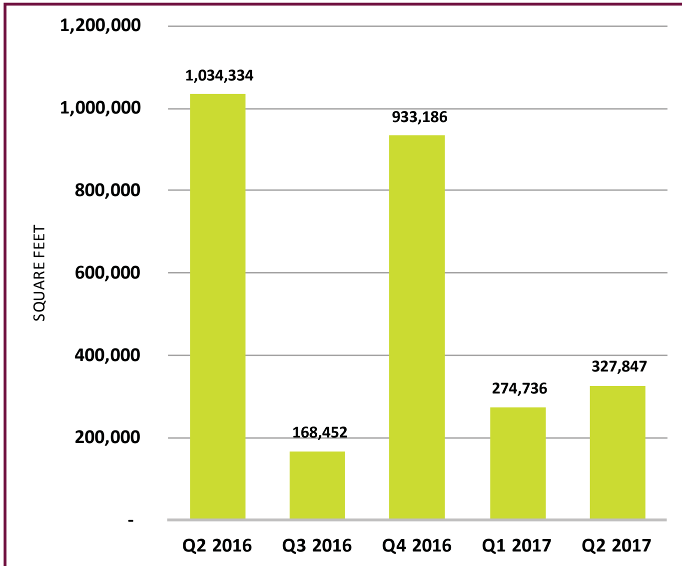


A LOOK AHEAD

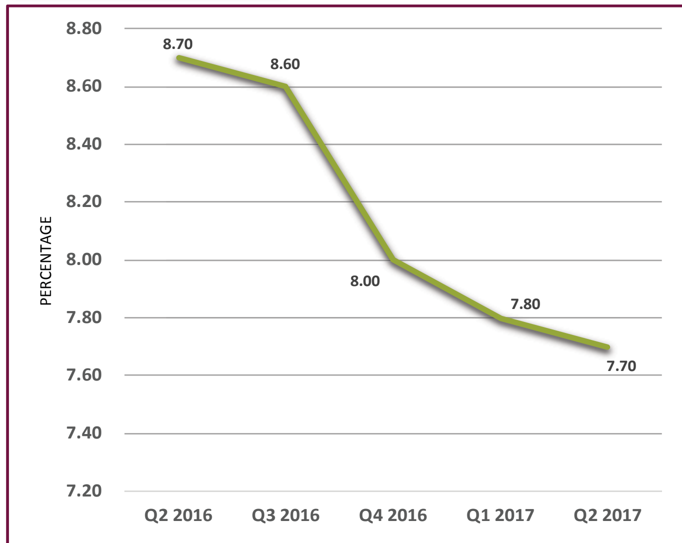
- Average rental rates may move slightly higher with new deliveries, however effective rental rates will decline due to generous tenant concessions
- The rise in the vacancy rate will stabilize as new deliveries decline
- Sublease inventory is leveling off
- Net absorption will remain negative before we see any major improvements
- Leasing activity will remain sluggish through the end of the year

ST. LOUIS

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

The St. Louis office market continued on its course of modest but steady improvement in the first half of 2017. The local economy continues to benefit from big moves completed by the likes of Boeing and General Motors. Recently, Anheuser-Busch announced over $2 billion in upgrades to St. Louis area breweries that will support a 20% increase in employment and send a clear message of its commitment to the region. Technology jobs continue to drive business growth and new leasing activity for local companies, as well. KPMG is completing a $5 million renovation of office/tech space that will result in 175 new jobs. As we previously reported, the professional business services sector in the St. Louis area now employs over 500,000 workers, a 23% increase since 2010.

Leasing activity has been strongest in suburban markets. Clayton landlords, emboldened by the region's lower vacancy rate, continue to pursue higher rates and longer lease terms, but continue to show a willingness to provide healthy tenant improvement allowances. Tenants in need of more than 20,000 square feet have fewer options this year, especially in light of Centene Corporation's decision to take down another 104,000 square feet after committing to two other spaces of 84,000 and 80,000 square feet in the Clayton submarket.

The St. Louis City CBD will be facing some significant challenges later this year as AT&T completes the balance of its move out of its 1.1 million-square-foot headquarters facility, which will leave the building nearly 100% empty. Also, Anisra Partners, a marketing company, will be vacating its 98,000-square-foot space as they relocate to Dallas, Texas.

7.7%	$18.28	327,847	134,371,840	1,521,401
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	SF INVENTORY	SF UNDER CONSTRUCTION
▼	▲	▲	▼	▲

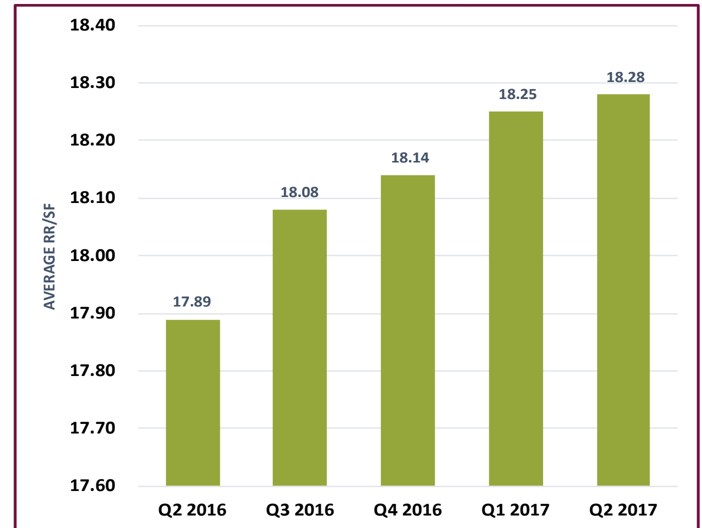
ST. LOUIS - TRENDING NOW (continued)

Construction activity is on the rise. As Q2 ended, over 1,521,000 square feet was underway, almost double the amount in the construction queue in the same period last year. Deliveries have been light, as just 153,600 square feet of new space was delivered in 2016, but that is about to change as several projects will soon be completed. The West County submarket is particularly active in terms of new construction. Delmar Gardens, a $45 million, Class A, 125,000-square-foot development, which is more than 50% preleased, is giving tenants in West St. Louis County the chance to secure first generation space. In the St. Louis City CBD submarket, Hudson Holdings is leading the way with its $250 million multi-use renovation of the former Famous Barr department store. Another 210,000-square-foot office headquarters building for World Wide Technologies is due for delivery in late 2017. Fully-speculative development throughout the region is only being done on a smaller scale. Currently, the office base inventory stands at 134,372,000 square feet.

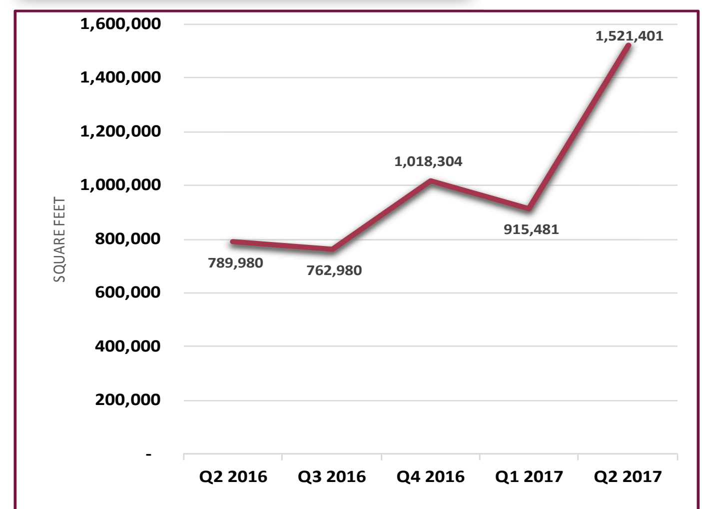
Given the modest pace of new deliveries, the vacancy rate has been steadily declining. In Q2, the overall vacancy rate fell to 7.7%, down 10 basis points in the period and 100 basis points lower year-over-year. This time last year, vacancy was 8.7%. Despite such low vacancy, rents only managed to move up by $.03 in the second quarter to $18.28 and just over 2% year-over-year basis.

Investor interest in the region remains strong. Sara Investment Real Estate and Bamboo Equity Partners continue their acquisition push. Sara reached $85 million in assets with the acquisition of a $20 million Class A building in West County, and Bamboo increased its activity by committing to another $20 million fund to acquire smaller assets.

AVERAGE SF RENTAL RATES



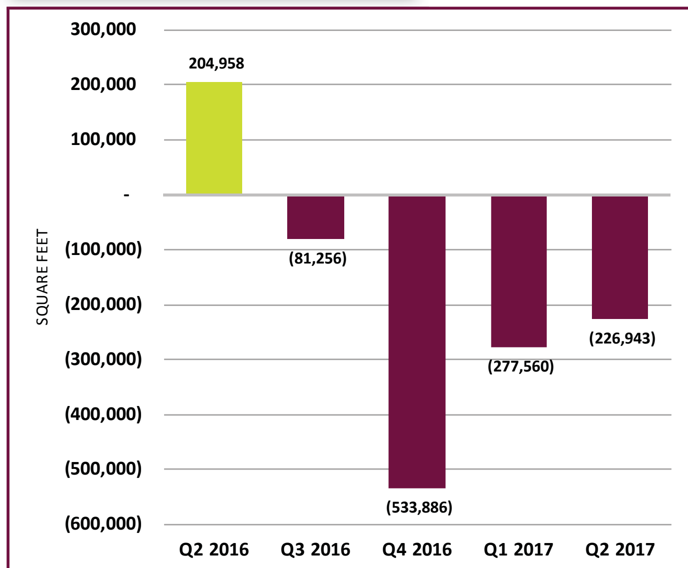
SF UNDER CONSTRUCTION

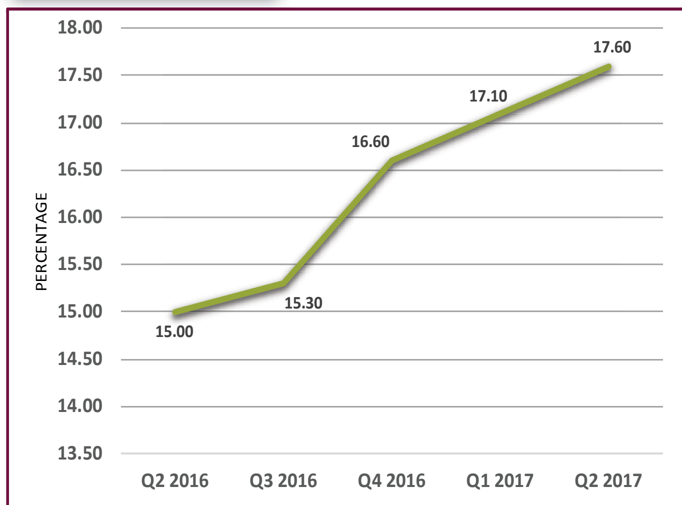


A LOOK AHEAD

- Leasing activity should remain steady in 2017, which will attract even more interest from institutional investors
- Vacancy will stay in the mid-7% range through the end of the year
- Absorption will be positive and should stay ahead of new deliveries throughout the year
- Speculative development of major projects will be limited, but owner-occupied BTS activity should remain strong
- Rents should keep moving up at current 2% annualized pace
- The professional business services sector will continue to be the main job generator going forward

MINNEAPOLIS





TRENDING NOW

This moderately sized metro area is home to 17 Fortune 500 companies including 3M, United Health Group, Target, Medtronic and General Mills. A highly educated labor force attracts and retains these industry leaders and the thousands of office-using operations who do business with them. The office property market has benefitted from employment growth concentrated in professional and business services, financial services, information and healthcare, which helped to lower the regional unemployment rate to just 3.2% in May, well below the US rate of 4.3%.

Though the overall regional economy is in generally good health, office property metrics have been negatively impacted by several major corporate moves from multi-tenant facilities into new corporate headquarters. Wells Fargo is a good example. The major bank has been consolidating into its new home and vacating major blocks of space over the past few quarters. In Q2, Wells moved out of another 109,000 square feet. However, this trend may be playing itself out, as fewer big moves are expected going forward.

The vacancy rate moved up again in Q2, adding another 50 basis points to end the first half of the year at 17.6%, as compared to the national vacancy rate of just 9.6%. Year-over-year, vacancy has moved up by 250 basis points despite the fact that new deliveries have been light. In Q2, no new space was delivered to inventory, which currently stands at 80.3 million square feet. There is another 1.9 million square feet of new space under construction.

Net absorption was negative for the fourth consecutive quarter and that is putting the pressure on landlords to

17.60%	$25.26	(226,943)	80,312,442	1,990,887
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	SF INVENTORY	SF UNDER CONSTRUCTION

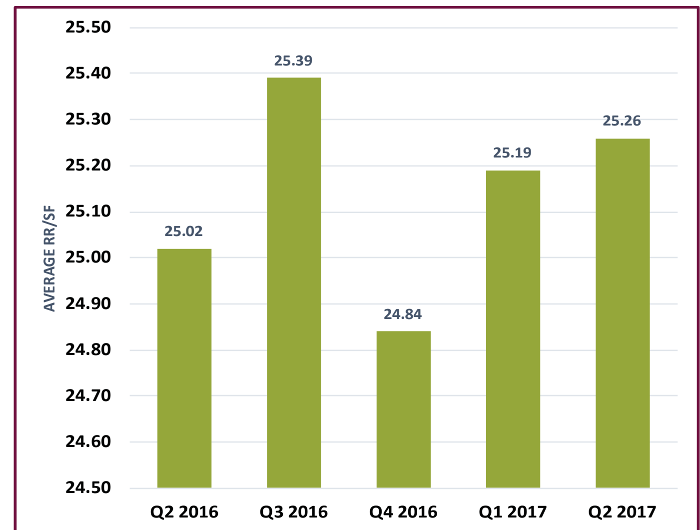
MINNEAPOLIS - TRENDING NOW (continued)

forego higher rents and increase incentives to attract tenants. The second quarter's net loss in occupied space of almost 227,000 square feet was slightly lower than it was in Q1, but in the last year, the regional office market has recorded negative net absorption exceeding 1.1 million square feet. Significant tenant move-outs contributing to the decline in Q2 include Cargill's departure from 255,000 square feet in the Southwest market and Ecolab's move from 77,300 square feet in the St. Paul CBD. The Minneapolis CBD helped offset those losses with two major move-ins for the quarter; Jack Links moved into 78,500 square feet, while the Ryan Companies occupied its new 55,000-square-foot facility.

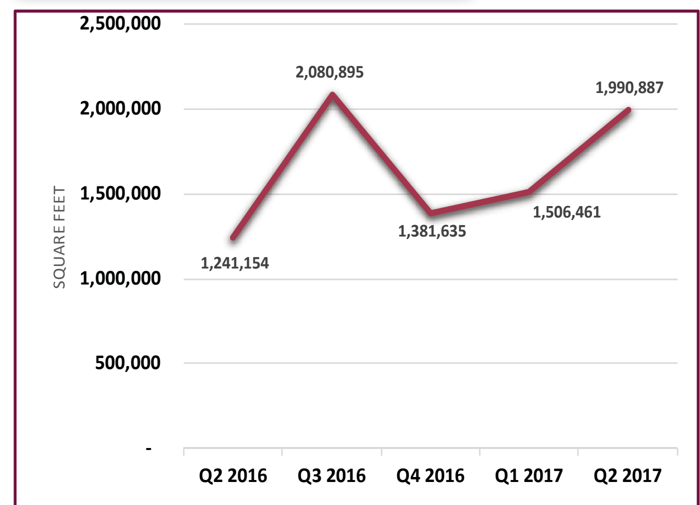
Average asking rental rates continue to move up and down within a very narrow range. The rate for direct space has moved $.24 lower since the second quarter of 2016, but ended Q2 up $.07 to $25.26. However, asking rents for premium Class A properties run much higher, as demand is strongest in those properties. Changing workspace designs to allow for higher employee density is becoming more prevalent in the local market, mirroring the national trend of increasing employee density to mitigate the cost of Class A space.

As we reported last quarter, there is a definite suburban-to-urban shift underway. Employers are focusing on locales that have the walkable amenities preferred by today's younger workers. So, landlords of Class A buildings in the CBD are seeing the strongest leasing action, while older Class B property owners are under increasing pressure to make significant reinvestments to compete for tenants that need to recruit and retain millennial-aged workers.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION

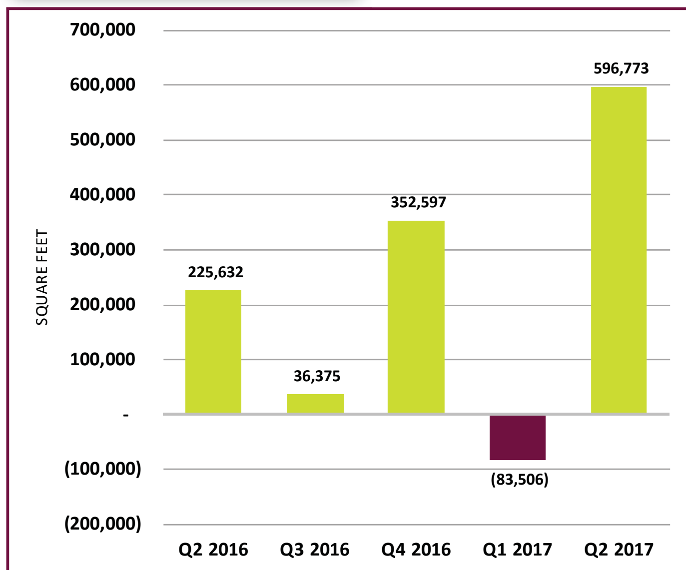


A LOOK AHEAD

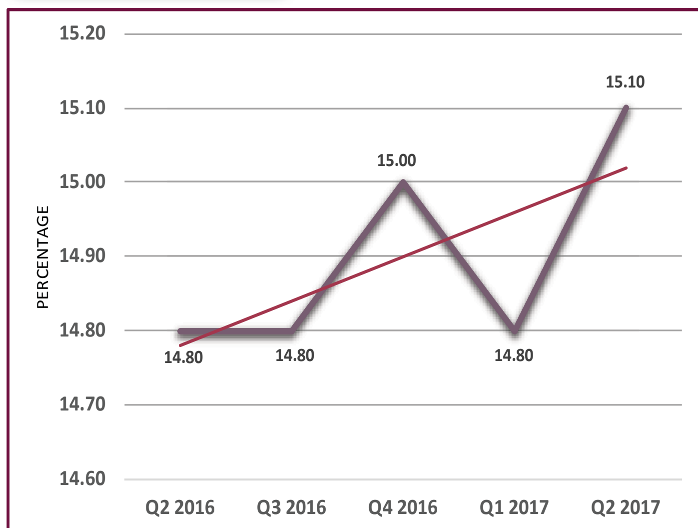
- Leasing activity may begin to slow down for the remainder of 2017
- Net absorption will remain negative, but will moderate with a decline in major corporate moves
- Construction activity will be focused on upgrading of existing projects as owners look to become more competitive
- Vacancy will move even higher in the second half of the year
- Average asking lease rates will remain steady as higher vacancy puts the pressure on landlords
- Strong investor interest in the region will keep supply of investment-grade product well short of demand

ATLANTA

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

The Atlanta metro area added 63,000 jobs in 2016, two thirds of all the job gains in Georgia. The unemployment rate for the area fell to 4.5% in April, well below the statewide rate. TAMI and STEM sector employment continues, but is expected to moderate going forward. Transportation and infrastructure improvement is on the public's radar more than ever in light of the I-85 bridge collapse. Economic and public support for infrastructure spending is on the rise, as evidenced by Gwinnett County's GRETA bus system and a new property tax referendum there that is specifically directed at mass transit, including light rail.

Growing companies are attracted to Atlanta's business friendly environment and focus on meeting the needs of a workforce that is getting younger by the day. Unique live/work/play environments created in areas like Buckhead are expanding and that increases leasing interest from those firms who are looking to attract and retain millennial generation workers. As in other major metro areas around the country, office-using businesses are adapting to new workspace designs in response to the "sticker shock" associated with rising rental rates.

Quoted lease rates for all building classes combined spiked in Q2, to $23.86, a $.47 increase in just three months. Class A rates also rose by $.47 to $27.63. That rate is $1.53, or 5.9% higher than it was just one year ago. However, rates run as high as high as $45.47 for the best space in prime submarkets. The Class B asking rental rate also rose by $.47 in Q2 and now stands at $19.27. Class B asking rents are up by 6.2% year-over-year.

As we reported last quarter, tenant improvement costs are also on the rise. So far, landlords are showing

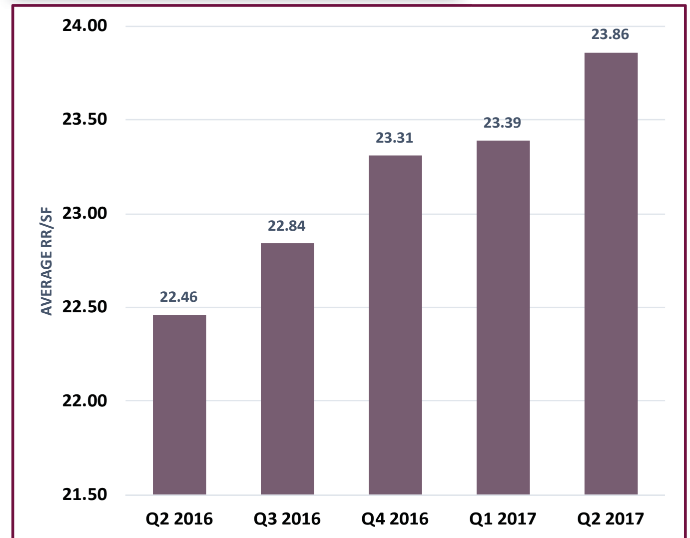
15.1%	$23.86	596,773	212,537,276	4,896,518
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	SF INVENTORY	SF UNDER CONSTRUCTION

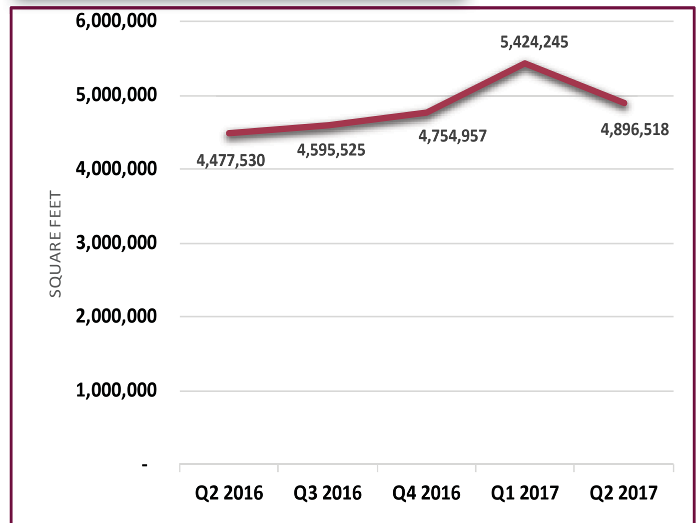
ATLANTA - TRENDING NOW (continued)

a willingness to invest more in their buildings, but they want higher rental rates to cover the cost. In some cases, tenants are coming out of pocket to get the finish they desire. As a result of these higher costs, ground-up office build-to-suits are competitive economically with speculative space deals. A good example is the Serta Simmons commitment to build a new 210,000-square-foot headquarters building on the site of a former General Motors assembly plant. The City of Doraville offered the company $16.8 million in tax abatement to commit to the mixed-use development, appropriately named "Assembly." Serta will be consolidating its Chicago and Atlanta operations and spend $65 million on the project.

In Q1, Atlanta's office market posted a net loss of 83,506 square feet in occupied space, but bounced back into positive territory by midyear by posting a net gain of 596,733 square feet in the second quarter. Class A buildings fared best, posting an increase in occupancy o 586,375 square feet after a Q1 decline of almost 356,000 square feet. Class B net absorption slowed to just 31,657 square feet after a net gain of over 288,000 square feet in the first period. The vacancy rate of 15.1% is 30 basis points higher than it was last quarter and a year ago.

New deliveries were back up in Q2, due mainly to the completion of two major projects, Three Alliance Center at 506,647 square-foot, 66% occupied building, and 200 Riverwood an 82% occupied, 300,000-square-foot project. The challenge for developers going forward is that it takes approximately $25-$35 in net rental income and 50% preleasing to bring a project out of the ground. Only three submarkets in the entire metro area are achieving those rates.



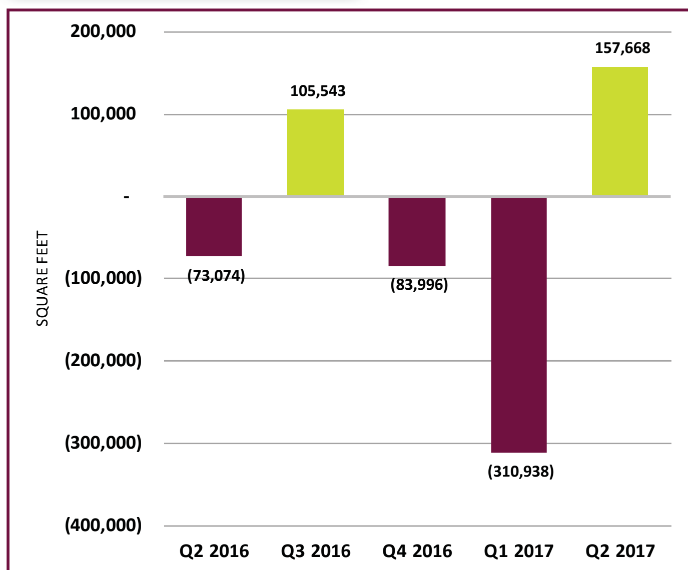


A LOOK AHEAD

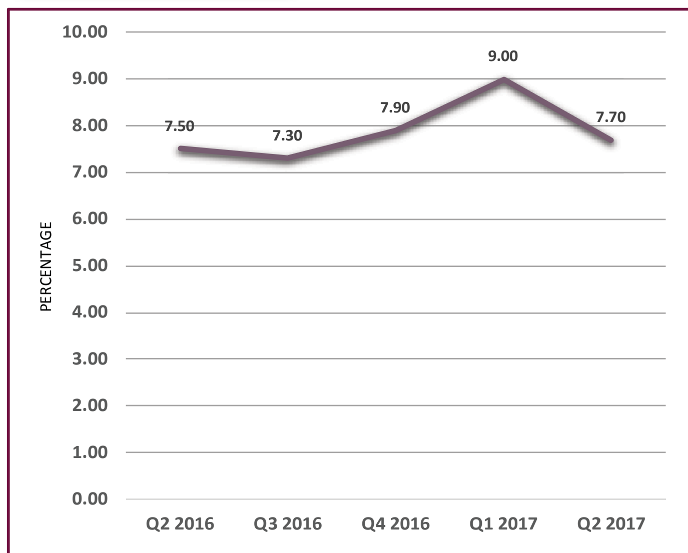
- Both gross sale and lease activity are expected to remain steady
- Higher incidence of lease renewals and downsizing will reduce net absorption for the balance of the year
- Rent growth will slow to 2%-3% in 2017
- The construction industry will keep running at or near capacity throughout 2017
- Expect another 2.5 to 3 million square feet in new deliveries by the end of 2017
- Sales prices for office buildings will be flat as activity shifts away from trophy Class A properties to suburban office buildings

GREENVILLE/SPARTANBURG

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

According to the US Census Bureau, the City of Greenville, which is part of the Greenville/Spartanburg metro region, was named the fourth fastest growing city in the nation. Investors and occupiers in a variety of business sectors remain drawn to the area because of strong overall population growth, affordable housing stock, low cost of living and overall quality of life. That combination has attracted a well-educated and trained workforce that companies need to execute long term growth strategies. Proximity to a convenient airport and interstate transportation corridors has also increased interest from major employers like BMW and Michelin to call the region home.

Downtown Greenville has been experiencing an ongoing transformation in recent years, and is considered to be one of the true urban gems of the South. Development in the CBD continues to thrive, mostly in mixed-use projects that include retail, office and multifamily housing. Regional demand for office space is concentrated in Downtown Greenville, where older buildings are being demolished in favor of new projects that contain a significant Class A office space component. Each new project adds to the eclectic urban core that promotes the live-work-play lifestyle that has become so popular with today's younger workers.

Net absorption was back in positive territory in Q2, adding another 157,668 square feet after a substantial occupancy decline in the first quarter. Significant downtown move-ins in Q2 include a 38,700-square-foot space for Erwin Penland at 110 East Court Street, and a new 28,000-square-foot home for the Greenville News at 32 East Broad Street. Uneven quarterly results can be expected given the size of the relatively

7.7%	$16.36	157,668	38,200,638	276,333
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	SF INVENTORY	SF UNDER CONSTRUCTION

GREENVILLE/SPARTANBURG - TRENDING NOW (continued)

small office base, and the fact that some projects are being vacated and demolished to make way for new projects. Gains for the quarter were split evenly between Class A and Class B space.

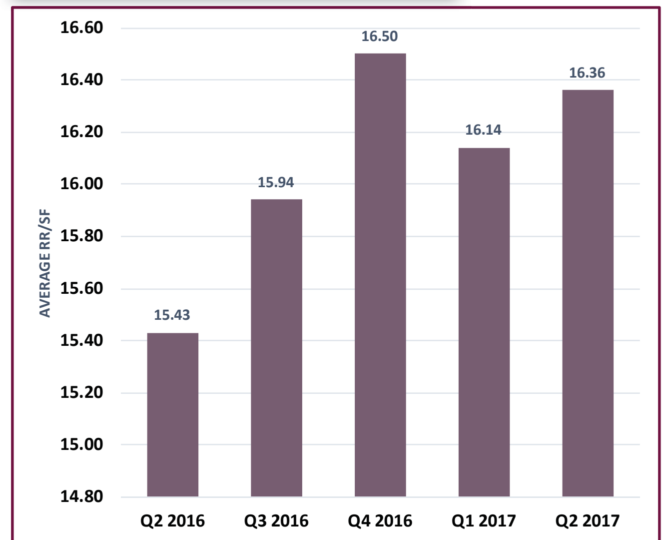
Overall market vacancy fell sharply in Q2, shedding 130 basis points to end the period at 7.7%. Year-over-year vacancy is up 20 basis point. Class A vacancy fell 120 basis points to 9.2%, while Class B dropped by 210 basis points to 8.3%, where it stood the same time last year. Here again, uneven results in a small market as active as Greenville are anticipated.

Average asking rental rates have been steadily increasing since 2012, and the current period was no exception. The overall rate rose $.22 to end the period at $16.36. Class A rents slipped two pennies during the quarter after an $.83 rise in Q1. Class B rates rose $.21 to a post-recession high of $15.23.

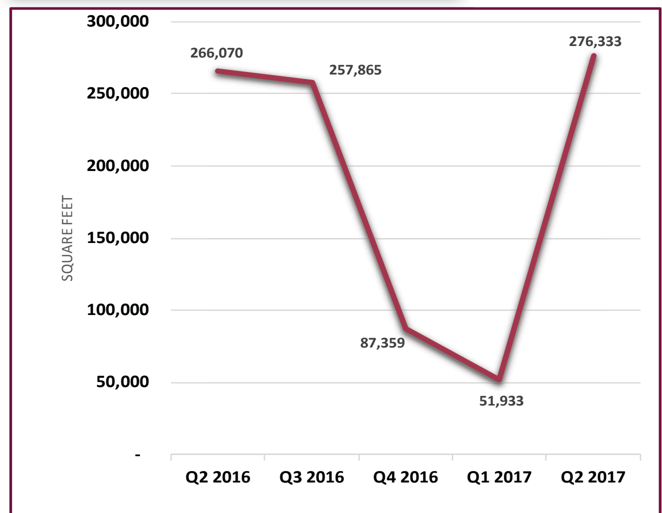
New deliveries have been light so far this year. In the second quarter, just two buildings totaling 8,600 square feet were added to a base inventory that stands at just over 38.2 million square feet. So far this year, 60,026 square feet of new space has been completed, but another 276,333 square feet is under construction. The largest projects underway include the 188,000-square-foot building at 701 Easley Bridge Road, which is 0% preleased, and another 60,000-square-foot building on Marue Road that is 50% leased to Jervey Eye Group.

Significant lease signings this year include a 55,698-square-foot space for Concentrix Corporation at 2000 Wade Hampton Blvd., and a 33,111-square-foot lease signed by The Merit Group at 1310 Union in Spartanburg.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION

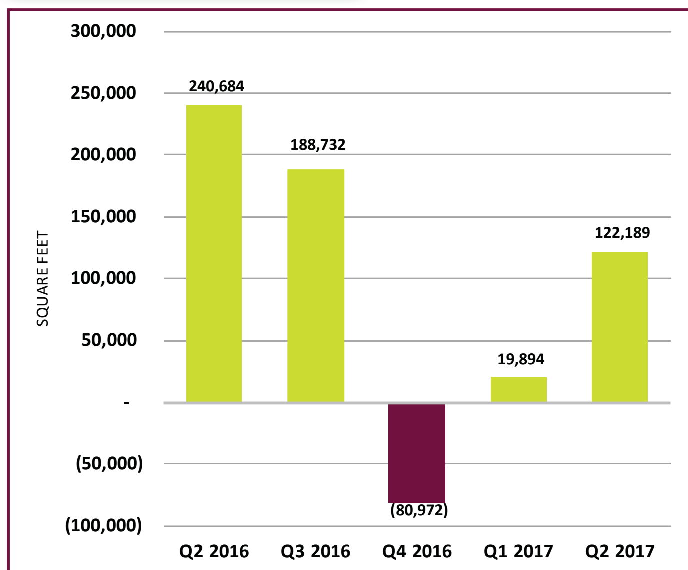


A LOOK AHEAD

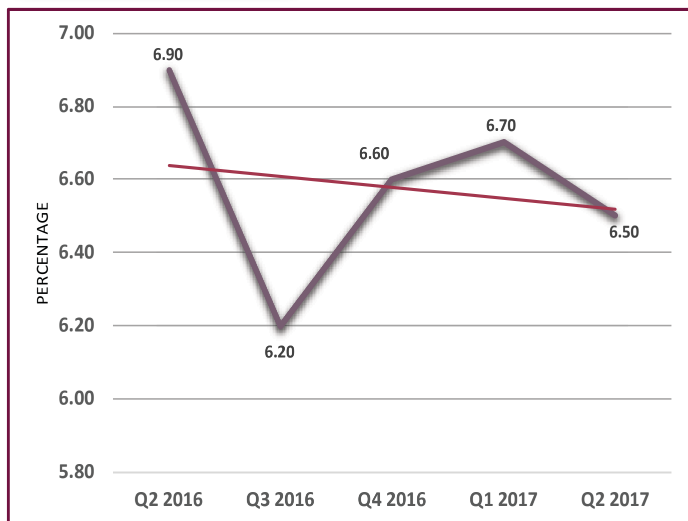
- Leasing activity will remain steady but sale activity may decline due to lack of inventory
- Annual net absorption will be positive, but expect occasional swings into negative territory
- Average asking rental rates will keep moving higher due to higher construction costs and a decline in quality space in prime areas
- Vacancy will stabilize near current levels as leasing activity stays in relative balance to new deliveries
- Sales prices will move higher, but available inventory will remain thin
- Development of build-to-suit projects is likely to increase, as larger tenants insist on space built specific to their needs

CHARLESTON

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

Charleston's economy is leading the Southeast in job creation, and the area is experiencing strong and consistent population growth. Job growth has been robust, especially in the professional services, technical and life sciences sectors. The massive new Volvo manufacturing facility, still in the construction phase, has already had a positive impact in the local economy. That, combined with the efforts of South Carolina Ports Authority to expand the Port of Charleston, already hailed as North America's most productive, bodes well for continued economic expansion for years to come.

A strong economy has led to shortening of supply of quality office space and a corresponding increase in rents, especially for first generation space. Construction costs are moving up, as well, and that has increased the cost of tenant uplifts. What used to cost $30 to $40 to build now costs $50 to $60, and supply is running short; landlords are less inclined to absorb the increase. So, expanding businesses will continue to face higher occupancy costs going forward.

Since 2013, vacancy has been moving up and down in a narrow range due to an increase in leasing activity combined with sporadic new deliveries. With total inventory of 28.4 million square feet, significant fluctuations in vacancy are expected even with limited new deliveries. In Q2, vacancy declined by 20 basis points after increasing by 50 basis points over the past two quarters. By the end of Q2, the overall vacancy rate settled at 6.5%, well below the level of the most active office markets around the country. Class B space, which includes nearly 15 million square feet of space, saw a 10 basis point rise in vacancy to finish Q2 at 9%, while the

6.5%	$21.71	122,189	28,404,923	713,917
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	SF INVENTORY	SF UNDER CONSTRUCTION

CHARLESTON - TRENDING NOW (continued)

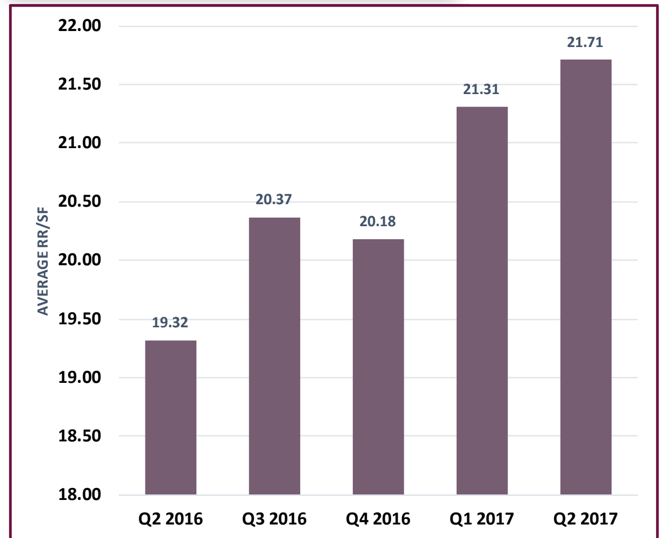
5.7-million-square-feet of Class A space saw at 60-basis-point decline in vacancy to end the period at 8.9%. Just 1.9% of Charleston's 7.7 million square feet of Class C space inventory remains vacant.

In the second quarter, five new Class B buildings were delivered, adding another 80,051 square feet to base inventory. However, that is substantial decline compared to deliveries of 359,122 square feet in the same period last year. Almost all of the space delivered this year has been preleased, along with the two largest projects that are under construction. As the quarter ended, over 713,000 square feet was underway, most of it categorized as Class A space. To the relief of currently expanding tenants, several new projects being built still have space available. In recent years, current requirements have been forced into second generation space, but current high levels of leasing interest has given developers the confidence to build speculative projects.

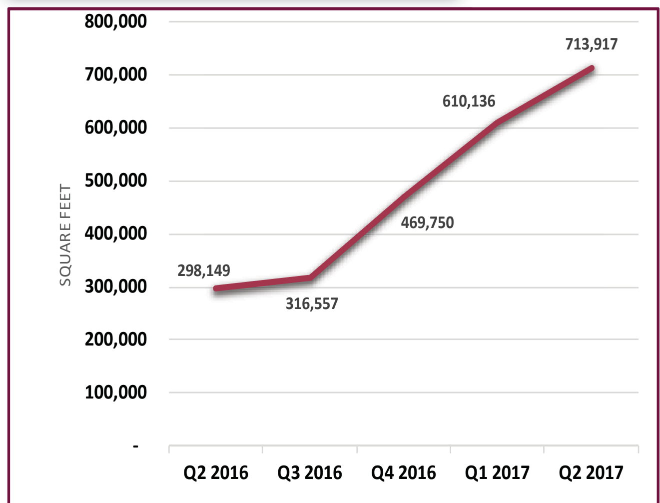
The average asking rental rate moved up another $.40 in Q2 after a sharp rise of $1.16 in Q1, mainly due to new Class A projects that are under construction. As Q2 ended, the overall asking rate hit a post-recession high of $21.71.

Net absorption bounced back in the second quarter. Net occupancy was up by 122,189 square feet after a sluggish first quarter. All three building classes experienced gains, led by Class B at 57,317 square feet. Absorption should move higher, though, for the rest of the year, as several of the preleased projects under construction are due for delivery by the end of the year.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION

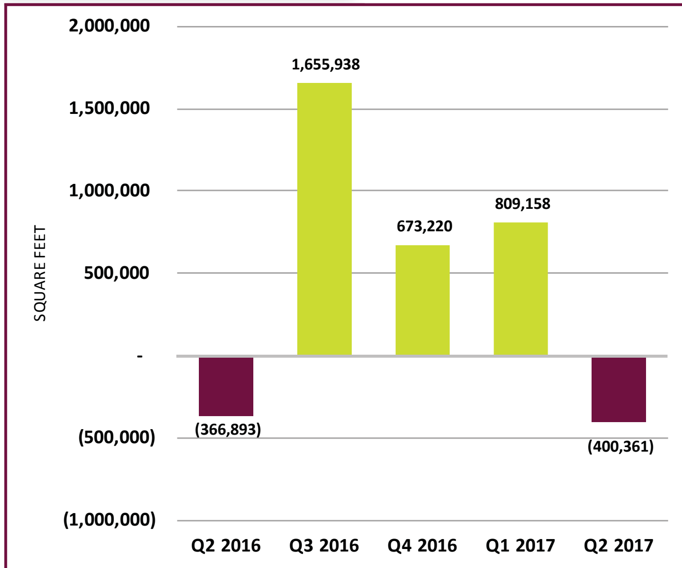


A LOOK AHEAD

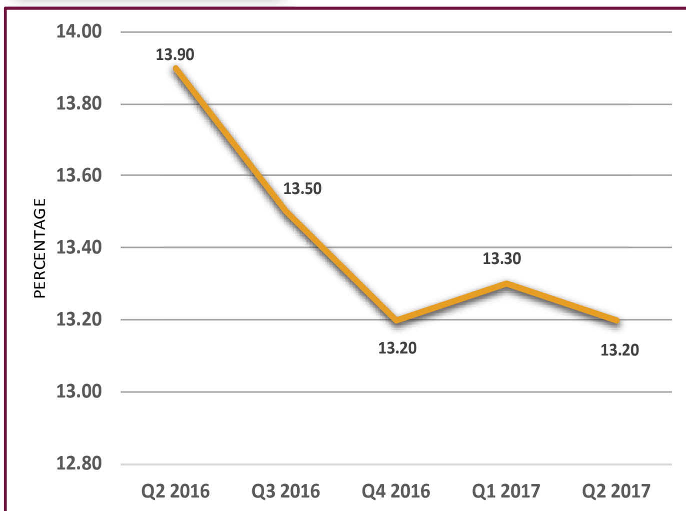
- Expect more sales as a result of a lack of lease inventory
- Vacancy will remain at current levels as absorption should stay in balance with new deliveries
- Lack of inventory will slow pace of net absorption
- Sales prices will keep moving higher until interest rates make a more significant move up
- Average lease rates will keep moving higher with a wide gap between rates for new and existing space
- Construction activity will accelerate

NORTHERN NEW JERSEY

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

Northern New Jersey's office market dynamics continue to favor tenants over their landlords, unlike other major metro locations across the country. The region has a disproportionate share of functionally obsolete legacy corporate headquarters properties located in suburban submarkets that lack the amenities and ready access to public transportation that are favored by today's growing businesses. Too much of the inventory remains stuck in the 20th century and property owners are either unable or reluctant to upgrade their spaces in a way that will attract tenant interest.

Even though New Jersey's U3 unemployment rate is at a ten-year low of just 4.1%, the economic recovery has been the least kind to office-using businesses. A closer look at the employment picture through the U6 unemployment rate, paints a more realistic picture of office sector employment. That rate remains over 9%, as too many people are stuck in part-time positions that don't lead to the need for more space and the resulting positive net absorption. In Q2, net absorption declined by over 400,000 square feet, and that was the third significant quarterly decline since the beginning of 2016.

The absorption problem is compounded by the facts that office users are having more employees work from home and workspace designs are being changed to accommodate more employees in less space. Employers see these strategies as a way to mitigate the higher cost of Class A space and still satisfy the preference of the younger workers for the amenities offered in Class A projects.

While that bodes well for the owners of those buildings, it exacerbates the problem for the owners of Class B suburban projects where vacancy is highest.

13.2%	$25.30	(400,361)	365,819,323	2,647,699
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	SF INVENTORY	SF UNDER CONSTRUCTION
▼	▲	▼	▼	▲

NORTHERN NEW JERSEY - TRENDING NOW (continued)

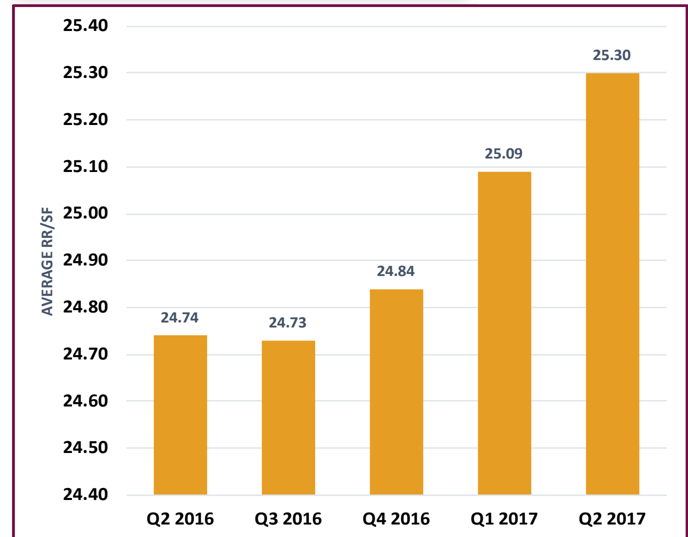
The resulting bifurcation of the market has created outsized disparity in vacancy, leasing activity, asking rents and net absorption depending on location and building class. As we reported last quarter, the overall vacancy rate of 13.2% is the same as it was back in 2010, due mainly to the lack of activity in the larger suburban properties. Unfortunately, the bulk of the vacancy is concentrated in the least desirable properties, which means a near-term shift in current market conditions is unlikely.

In Q2, the overall average asking rental rate still managed to move up another $.21 to $25.30, but that reflects rate hikes for the best Class A space and in older buildings in prime areas that have been substantially upgraded with new interior improvements and amenity packages. To achieve higher rates and risk-reducing longer lease terms, landlords are being forced to offer full TI packages of $30 to $50 per square foot.

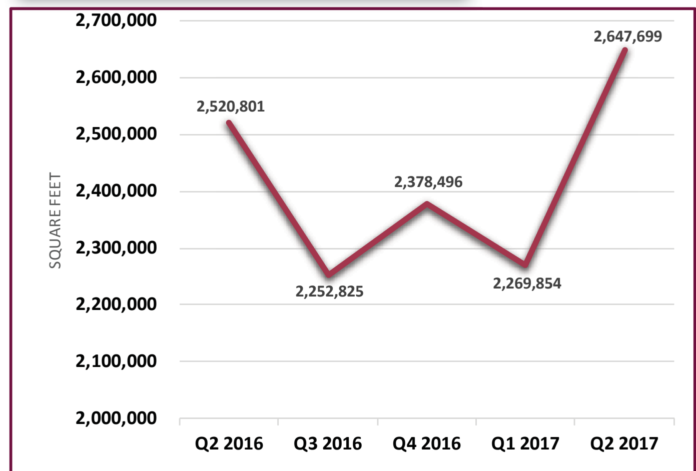
Construction of new office buildings remains limited to build-to-suit transactions and remodeling projects in prime areas. The Edison Properties Ironside Newark project, a repositioning of a 456,000-square-foot warehouse project is a good example. The Downtown Newark property, located across from Penn Station, is being converted into modern Class A open-loft office space with two floors of retail.

Foreign investors continue to exert more influence on the New Jersey office market. Some of these buyers are willing to pay a premium for good quality assets to position themselves for an eventual upturn in market momentum similar to what occurred in the late 1990's and early 2000's. A good example is Morristown office investor, Normandy Partners' sale of a 15% equity interest in its portfolio of office buildings to Japan-based NTT Urban Development Corporation.

AVERAGE SF RENTAL RATES



SF UNDER CONSTRUCTION

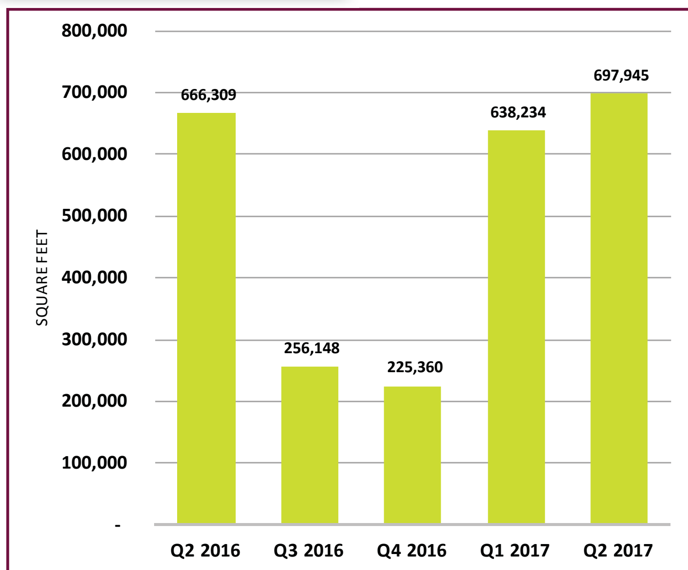


A LOOK AHEAD

- Leasing activity will get a further boost from the medical office sector
- Net absorption should exceed 2.1 million square feet in 2017
- Vacancy should end the year in the mid-12% range
- Average asking rents will range from $25.25 to $25.55 through the end of the year
- Ground up construction starts will decline further, but rehabilitation of existing projects will increase
- Flight to quality among credit tenants, additionaly focused on wired certified buildings with superior connectivity, back-up power, and high-speed internet

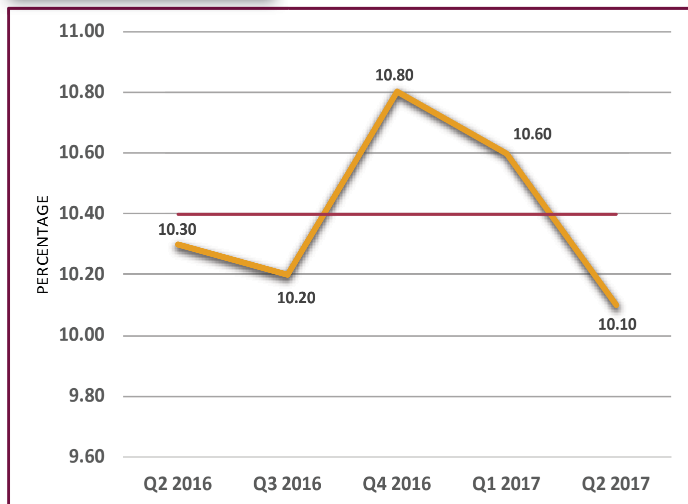
COLUMBIA, MARYLAND

NET SF ABSORPTION



*numbersreflectthegreaterBaltimoreregion

VACANCY RATE



*numbersreflectthegreaterBaltimoreregion

TRENDING NOW

The Columbia office market, which includes downtown Columbia through Maple Lawn in Howard County, is strategically located between the cities of Baltimore and Washington DC. The area has long been home to government security agencies and their subcontractors that keep thousands of highly educated workers in good-paying, full-time jobs. Columbia/Ellicott City was recently named the No. 1 place to live in America by Money Magazine and remains one of the nation's most affluent areas.

The Columbia South Downtown area is the primary CBD outside of Baltimore itself, and is the destination of choice for medium to large office-using employers. It contains several existing Class A office properties and accounts for most of the local market construction activity. Most recently, Howard Hughes Corporation's Merriweather District project has become the new home for MedStar and Pearson PLC. Downtown Columbia's high concentration of walkable amenities continue to draw office tenants who need to recruit and retain the younger workers who prefer the increasingly popular live/work/play lifestyle. Recent increases in activity have boosted rent growth in the area.

Columbia South ended Q2 with just 6.2% of its 9.82 million square foot base unoccupied, a 20-basis-point increase for the period. Neighboring Columbia Downtown's vacancy fell 40 basis points to 13.0%, while, Columbia North posted a rate of 8.3%, up 30 basis points. The overall vacancy rate for all building classes in the Baltimore region declined by 50 basis points in Q2 to a post-recession low of stood at 10.1%.

Landlords are struggling against the current trend of companies looking to limit their commitment to office space both in terms of space and lease term. Workspace design has shifted to more open floor plans that offer tenants more flexibility and higher employee density.

10.1%	$22.52	697,945	140,368,273	1,023,692
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	INVENTORY (MSF)	SF UNDER CONSTRUCTION
▼	▲	▲	▲	▲

COLUMBIA, MARYLAND - TRENDING NOW (continued)

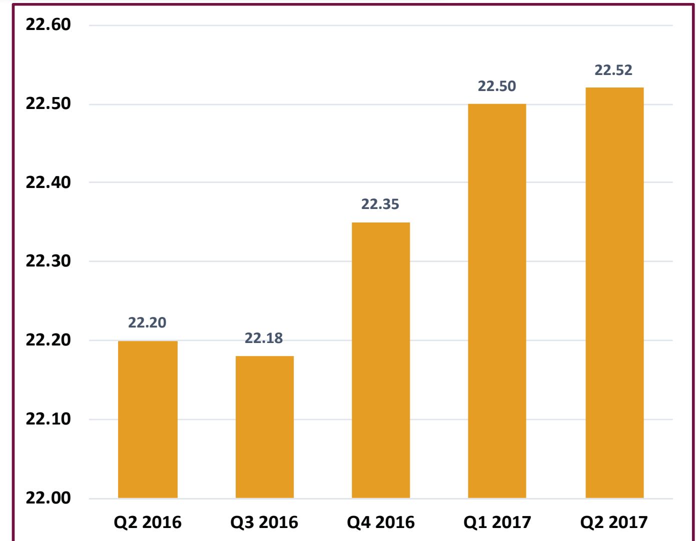
Also, workers are spending more time working from home or other remote locations by leveraging new communication technologies, including cloud-based access to information platforms.

Average asking rates have moved up region-wide. Year-over-year, the Greater Baltimore area has seen a rental rate increase of $.32 ending Q2 at $22.52, but the local market rent growth has been sporadic. The asking rate in Columbia Downtown is $25.51 down $.54 since the end of Q1. That submarket had 367,000 square feet of new space delivered in 2016 and another 155,900 square feet has been completed this year. Another 128,000 square feet of space is still underway. Columbia North ended the quarter with average asking rates of $26.83, down a nickel, Columbia South fell $.14 to $25.03.

Columbia Downtown also posted the highest absorption in the local market again in Q2 with a 140,000-square-foot net gain in occupied space, highest of all submarkets except the BWI North/Linthicum submarket, which added 165,712 square feet of occupied space in the period. Columbia South increased total occupancy by just 28,100 square feet, while Columbia North added 55,928 square feet to occupied space. Tenants continue to leverage new workplace and mobile technologies in order to utilize less space when they relocate, which has dampened net absorption results.

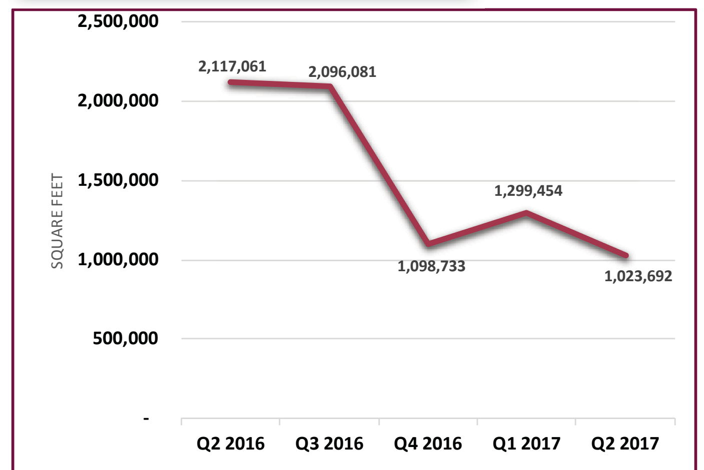
The Columbia area market is dominated by six large commercial developers. Though they are well-capitalized with strong local experience, they are challenged by the lack of available land, difficult zoning restrictions and the area's proximity to the Chesapeake Bay, which has raised environmental run-off concerns.

AVERAGE SF RENTAL RATES



*numbers reflect the greater Baltimore region

SF UNDER CONSTRUCTION



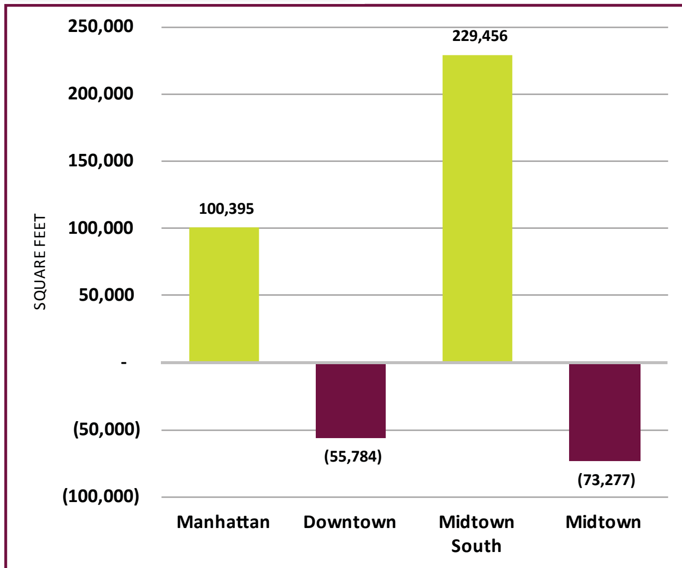
*numbers reflect the greater Baltimore region

A LOOK AHEAD

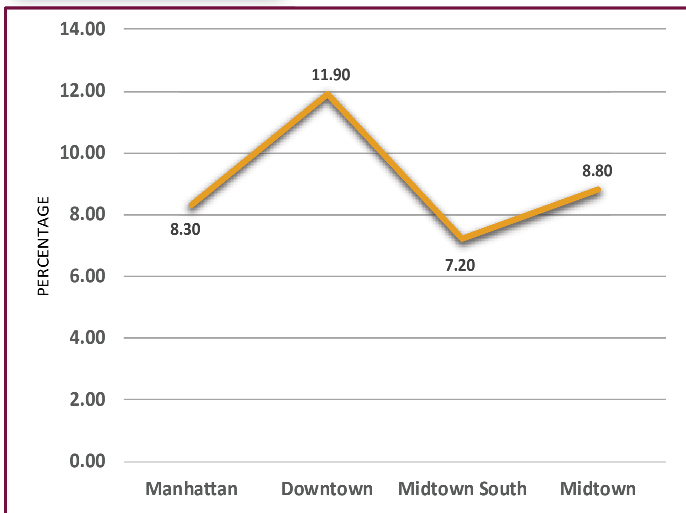
- Net absorption will get a further boost from larger employers looking to expand or relocate in the local market
- Asking rents for Class A space are as the mid-$30 range for premium properties
- As long as amenity-rich space remains available, current leasing trends should hold steady for the next 12 to 24 months
- Vacancy in the Columbia Downtown area is decreasing, in large part due to the occupancy of new buildings for Medstar and Pearson Publishing
- New construction activity will remain concentrated in the Columbia Downtown submarket

MANHATTAN

NET SF ABSORPTION



VACANCY RATE



TRENDING NOW

Manhattan has three major market areas, Midtown, Midtown South and Downtown, each with distinct characteristics that attract particular user types. In essence, Manhattan's story is a tale of three cities. So, it is important to look at all three together and then each alone to develop a clear picture. Lee & Associates tracks buildings with at least 100,000 rentable square feet throughout the city, except for SoHo and NoHo, where buildings greater than 50,000 square feet are quantified.

Midtown, famous for being home to many of the country's largest companies, experienced a 3.3% decline in overall leasing activity for the quarter, but is down by over 48% year-over-year. Midtown East got a big boost in Q2, posting 312,080 square feet of activity, up 254% over Q1. Leasing activity in the Times Square submarket declined by over 50% to 375,496 square feet. Grand Central saw the strongest leasing action for the quarter at 1,450,949 square feet, but that is 45.6% compared to Q2 of last year. Average asking rents also slipped the final quarter. The Plaza District submarket still commands the highest rate, at $109.37, but that represents a decline of $2.82 in the period. For all of Midtown, the average asking rate moved lower again in Q2, declining by 3% to $77.68 and 5.9% year-over-year. Net absorption remained in negative territory in Q2, posting a small loss of 73,277 square feet. However, the year-to-date decline in occupancy in Midtown now stands at 688,602 square feet. By the end of Q2, the vacancy rate fell to 8.8%, slightly above its five year average of 8.6%. The largest transaction in Midtown for the quarter was a 471,210-square-foot lease to New York-Presbyterian Hospital at 237 Park Avenue in the Grand Central submarket.

8.3%	$69.48	100,395	481,000,000	15,068,377
VACANCY	AVG. SF RENTAL RATES	NET SF ABSORPTION	SF INVENTORY	SF UNDER CONSTRUCTION
▼	▲	▼	▼	▲

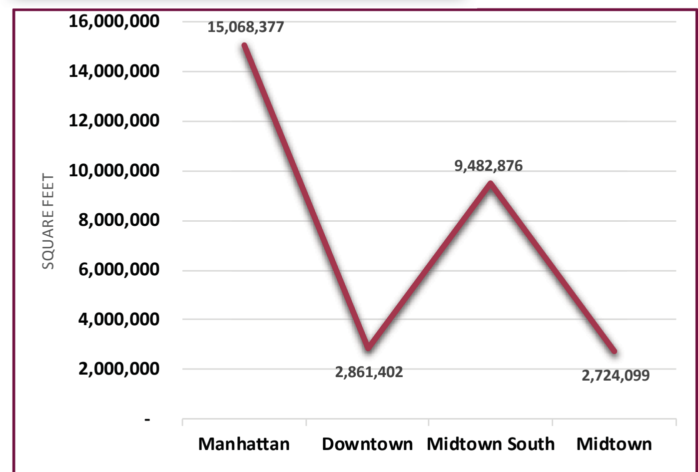
MANHATTAN - TRENDING NOW (continued)

Midtown South, also known as "TAMItown" because of the growing number of technology, advertising, media and information companies, accounted for 46.4% of Manhattan's leasing activity in the second period. Total activity rose 69.1% quarter-to-quarter to 3,527,027 square feet. Midtown South also has over 9,482,000 square feet of space under construction, which is nearly 63% of Manhattan's construction pipeline. The average asking rate in Midtown South fell by another 2.5%, or $1.61 in Q2 to $62.82. Year-over-year, the average rate has fallen by 6.7%. Of the three main market areas in Manhattan, only Midtown South posted a net gain in occupied space (229,456 square feet). The Penn Station/Garment District submarket saw a strong gain of 321,384 square feet, but that was offset by a declines in the Chelsea, Murray Hill and Soho/Noho areas. The total vacancy rate fell 10 basis points to 7.2% in Q2, but availability spiked again, rising by 80 basis points and finishing the period at 11.1%.

Downtown, which includes the World Trade Center, is a hybrid market, offering a variety of product types that attract users from both Midtown and Midtown South. Leasing activity was sharply lower in Q2 to 843,824 square feet, a 63.2% decline. On a year-over-year basis, leasing activity is off by almost 38%. In Q2, the overall asking rate managed a .2% increase to $60.90, but net absorption was in negative territory with a modest decline of 55,784 square feet, mainly due to a lack of activity in the World Trade Center submarket. The City Hall and Insurance District posted a 76.9% increase in leasing activity and reported the largest transaction for the Downtown area in Q2, a 216,100-square-foot, 21 year lease to New York Human Resources Administration.

AVERAGE SF RENTAL RATES

SF UNDER CONSTRUCTION



A LOOK AHEAD

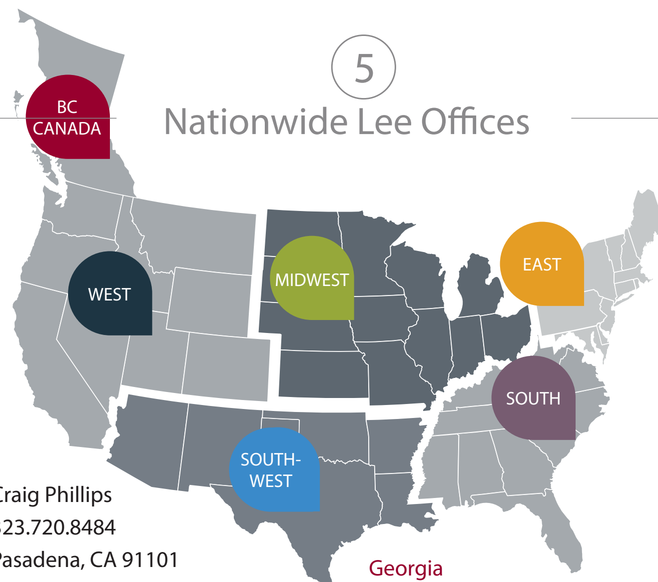
- Manhattan's vacancy rate is on par with its five-year average of 8.3% and its availability rate 20 basis points higher than its five-year average of 11.5%
- Leasing activity is the lowest it's been since Q2 2009
- 11.8 million square feet of proposed office space
- New construction in Hudson Yards continues to attract top tenants throughout Midtown
- Sublet availability highest in five years at 10,534,816 square feet
- There were 810 lease signings in Q2 2017

SELECT TOP OFFICE LEASES Q2 2017

BUILDING	MARKET	SF	TENANT NAME
452 Fifth Ave	New York City	548,000	HSBC Bank
Hughes Tower	Chicago	533,210	Bank of America
F5 Tower	Seattle/Puget Sound	515,000	F5 Networks, Inc.
One Dulles Tower	Washington	400,677	Amazon Web Services
5 Manhattan West	New York City	306,000	J.P. Morgan Chase & Co.
2100 E. Rio Salado Pkwy	Phoenix	300,000	Freedom Financial
30 Knightsbridge Rd	Northern New Jersey	252,500	AT&T, Inc.
802 Delaware Ave	Philadelphia	240,780	Capital One
375 Pearl St	New York City	216,100	New York City Human Resources Admin

SELECT TOP OFFICE SALES Q2 2017

BUILDING	MARKET	SF	PRICE PSF	CAP RATE	BUYER	SELLER
Park Avenue 245	New York City	1,787,000	$1,236.71	4.66%	HNA Group No. America LLC	NY State Teachers Retirement System
SunAmerica Center	Los Angeles	825,200	$1,042,17	4.0%	JMB Financial Advisors, LLC	The Blackstone Group, LP
44 Montgomery St	San Francisco	688,902	$690.08	3.9%	Beacon Capital Partners	State Teachers Ret System of Ohio
Waterview Tower	Washington	647,243	$710.71	5.11%	Morgan Stanley's Prime Property Fund LLC	Paramount Group, Inc.
Midtown 21	Seattle/Puget Sound	373,458	$884.17	4.35%	Union Investment Real Estate GmbH	Trammell Crow Company
BB&T Tower	Atlanta	541,789	$335.92	5.9%	Lionstone Investments	CBRE Global Investors, Ltd



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