

Savills Studley Report

National office sector

Q3 2018



SUMMARY

Market Highlights

AVAILABILITY HOLDS STEADY

The national overall availability rate was unchanged, remaining at 18.1%. The Class A availability rate fell slightly, dipping by 20 basis points to 19.0%. Austin registered a 210 basis point quarter-on-quarter decrease in its Class A rate, falling to 13.3%. The Class A rate also fell sharply in Charlotte, dropping by 140 basis points to 17.4%.

ASKING RENTS STABLE

On a quarterly comparison, the national overall asking rent fell by 0.1% from \$34.39 to \$34.37 but has jumped 2.4% year-on-year. Class A asking rent increased by

0.8% to \$39.08 in the third quarter and has jumped by 4.9% compared to the third quarter of 2017.

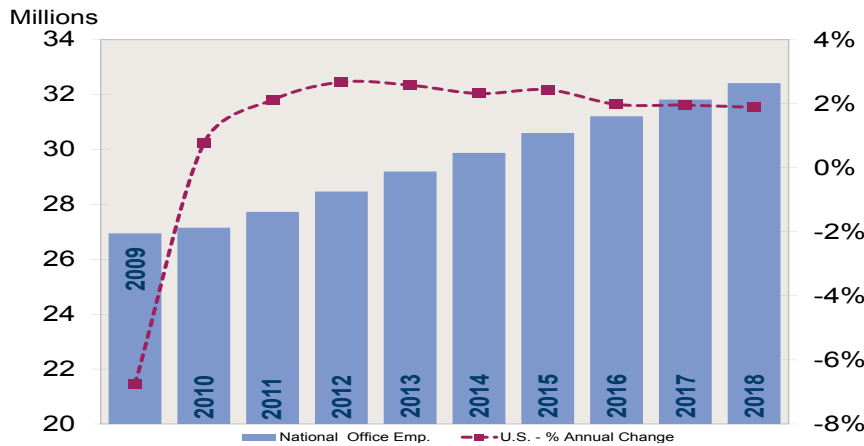
TRAILING LEASING PUSHES HIGHER

National four-quarter trailing leasing (the sum of activity over the last four quarters) totaled 230.7 million square feet (msf), an increase of 11% from the 208.8 msf total in the third quarter of 2017.

"Inflation has been contained throughout much of this recovery cycle. Low borrowing costs, cheap oil and gas and subpar wage growth have kept inflation in check. Controlled costs may be a distant memory by 2019. Interest rates are now rising. Labor shortages boosted construction costs quite some time ago; rising prices for materials such as lumber are eroding the margins of developers."

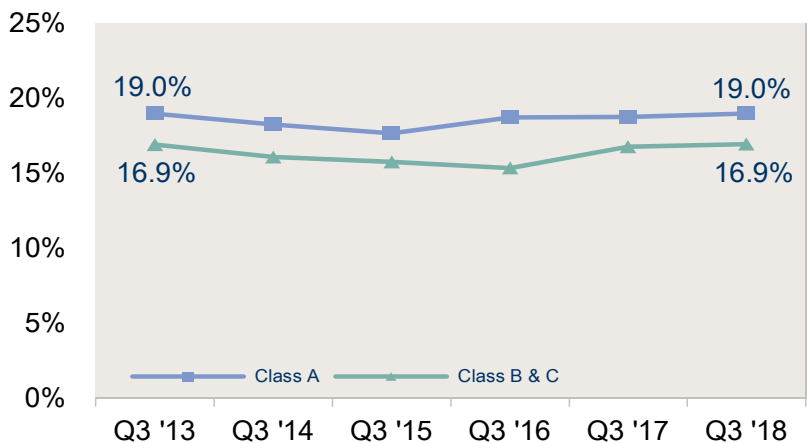
Keith DeCoster, Savills Studley Research

Office-Using Employment Trends

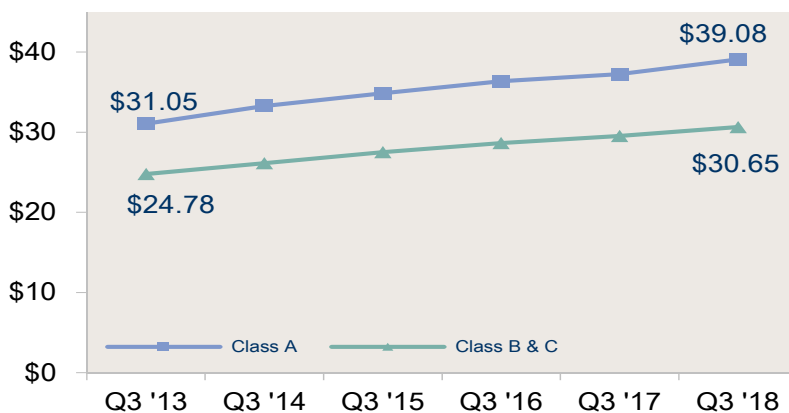


Source: Bureau of Labor Statistics^

Availability Rate Trends



Asking Rent Trends (\$/sf)



Pricing Power Holds On, as Costs Rise

Far from a hazard to avoid, inflation has been an elusive goal since the recovery began back in 2010. This has changed of late, though. In the last several quarters inflation has started to consistently achieve the unofficial 2.0% target set by the Federal Reserve, setting the stage for eight rate hikes – the most recent in late September. A number of factors kept inflation in check for most of this cycle. Wage growth has been slow to gain traction and remains stubbornly subpar, despite unemployment (3.7% in September) that is nearing the lows last seen 50 years ago. Oil and gas prices have rebounded recently, but were well below their peak levels for most of the last three years, helping to pad disposable income. Low borrowing costs have boosted household expenditures on appliances, vehicles and houses, and made record concessions feasible in most markets.

This environment of low costs may be a wistful memory by this time next year. Consumers, tenants and businesses have benefited from some discounts in recent years, but few households, businesses or landlords would have likely ever described the cost of living, running a business or maintaining a building as cheap. Efforts to bend the rising cost curve in health care have been fruitless. Similarly, real estate taxes in most metros continue to mount.

Tariffs' Toll on Lumber

Several sectors with particularly acute labor shortages have been dealing with spiking labor costs for quite some time. The construction sector has struggled with a lack of specialized trades such as electricians. The National Federation of Independent Business recently reported that “labor shortages are clearly restricting the construction of new homes and apartments.” The level of job openings in the construction industry reached nearly 200,000 in 2017 – matching levels seen in 2007.

In the last year, hard costs associated with the steel, lumber, drywall and wiring that go into buildings have been mounting. According to lumber market industry tracker Random Lengths, the price of lumber from Western Canada jumped from less than \$220 per 1,000 board feet in the fall of 2015 to \$350 last summer and then spiked to more than \$650 by June 2018 – an 80% rise in one year. Tariffs, national disasters such as Hurricane Irma and a transportation

worker shortage all contributed to the spike. The increase came a year after the Trump Administration imposed a 20% tariff on Canadian lumber. Orders for semi-trucks jumped by 70% from 22,286 in February 2017 to more than 40,000 as of February 2018. Exorbitant lumber and other building material costs, such as steel, rebar and drywall, are squeezing the margins of commercial property developers and homebuilders. Realtor.com recently estimated that the cost of lumber will add \$9,000 on average to the price of a new home in comparison to January 2017.

As consumer face rising costs from multiple sources — at the grocery store, gas pump, auto dealerships and the realtor's office — they will eventually start to make choices to cut spending somewhere. So far, there are few signs of any such pullback. During July, consumer spending rose by 0.4% as households increased expenditures for hotels and dining out. The most recent University of Michigan consumer sentiment survey rose to 100.8, the second-highest level since March 2004.

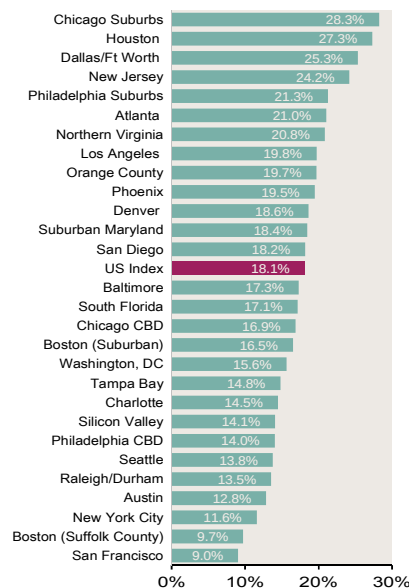
No Consumer Pullback for Now

Consumers and tenants could soon feel the impact of rising commodity and freight costs as landlords, homebuilders and manufacturers pass more of the costs through to them. Pricing power (the ability of producers to maintain sales even as they raise prices) and brand loyalty varies widely from one product or sector to the next. Consumers will swear by brands like Apple and Grey Goose, and pay a premium, but they will bargain shop for consumer goods. Homeowners may start by pulling back on discretionary home improvements, such as a new deck or boat dock. Of note, the luxury condo market and commercial real estate are already feeling the impact of the withdrawal of Chinese investors.

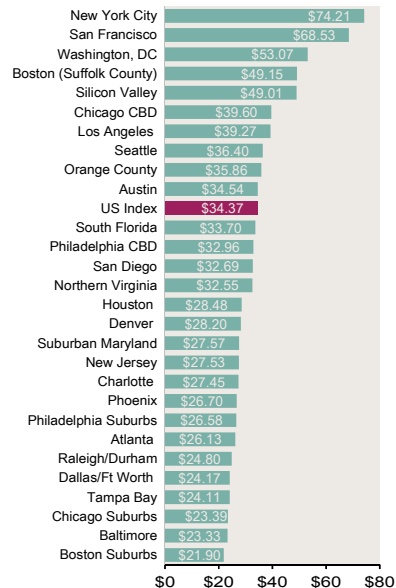
Build Before the Cycle Ends

Material costs like steel are rising even as new office development remains elevated in many markets. Some tech centers such as Silicon Valley, Boston and Raleigh/Durham are near the top of the list for speculative office development. These three markets have a combined 9.8 msf underway. San Francisco has just under 3.0 msf under construction, but more than 90% of it is pre-leased. Development activity is also at high levels in markets that are more dependent on traditional office space users, such as Manhattan and Washington, DC. (20 msf is underway in these markets.)

Availability Rate Comparison



Rental Rate Comparison (\$/sf)



Major Savills Studley Transactions

Tenant	Sq Feet	Address	Market Area
Jefferson Health	194,635	833 Chestnut St	Philadelphia, PA
Blue Cross of California	169,320	21215 Burbank Blvd	Woodland Hills, CA
Honey Science Corporation	130,397	963 E 4th St	Los Angeles, CA
US General Services Administration	120,219	1101 Wootton Pky	Rockville, MD
AIR Worldwide Corporation	115,271	2 Avenue De Lafayette	Boston, MA
Stericycle Inc	103,115	2355 Waukegan Rd	Bannockburn, IL
Crossdocking and Warehouse Systems Inc	100,931	1629 World Trade Center Loop	Laredo, TX
Cohesity Inc	98,675	300 Park Ave	San Jose, CA
American Imaging Management Inc	93,678	540 Lake Cook Rd	Deerfield, IL
Alorica Inc	91,162	727 Saraland Boulevard, (727 US Highway 43)	Saraland, TX

The recovery has gone on so long, and has been strong enough in the tech cities as well as some Sunbelt markets such as Dallas, that some developers are now accelerating work on the next set of mega-projects. Several markets — Austin, Tampa Bay and Seattle — are a year or two away from big jumps in new construction that could significantly boost space options for the first time in several years. These projects could start up just as the economic recovery begins to wind down.

A few developers are now rushing to market as they are eager to catch the tail end of this rally. In Dallas/Fort Worth and Austin, for example, the amount of time it took for massive complexes such as Legacy West and The Domain to lease up was underestimated by several years. Developers are now pushing on with massive mixed-use communities such as Broadmoor or Headquarters Ranch that will add millions of square feet of office space. The problem will arise when tenants put the brakes on expansion, deciding to wait and

see how the economy unfolds. For the time being, most tenants are doing the opposite. Even as many firms are sticking with space efficiency, most are willing to pay for premium space, often in new construction.

A League of Their Own

Tech centers of excellence are in a different league in terms of the inelasticity of demand. For many of the largest tech and creative sector firms, the cost of space is not a stumbling block. In turn, office landlords still have ample pricing power in most tech markets such as San Francisco and Silicon Valley. At the same time, the flow of tech firms either relocating entirely to lower-cost markets or moving portions of their operations to secondary locations is not abating. One thing is certain — in good times and bad, space efficiency is here to stay. Companies have been willing to spend on quality space when the economy is at its strongest. Pricing power could slip if growth slows or if rising costs erode margins even more.

	Submarket	Total	Leasing Activity	Available SF			Availability Rate			Asking Rents Per SF		
		SF (1000's)	Last 12 Months	This Quarter	% Change from Last Qtr.	Year Ago	This Quarter	pp Change from Last Qtr. ⁽¹⁾	Year Ago	This Quarter	% Change from Last Qtr.	Year Ago
	Atlanta	170,647	8,903	35,881	3.3%	35,550	21.0%	0.7%	20.8%	\$26.13	1.2%	\$23.78
	Atlanta - Class A	99,972	6,331	22,091	1.9%	18,767	22.1%	0.4%	18.8%	\$29.28	1.0%	\$27.31
	Austin	59,338	6,127	7,625	-7.8%	7,763	12.8%	-0.7%	12.8%	\$34.54	-3.3%	\$35.79
	Austin - Class A	31,736	4,318	4,217	-11.9%	4,075	13.3%	-2.1%	13.1%	\$38.97	-1.5%	\$40.82
	Baltimore	86,888	3,336	15,043	-1.5%	15,098	17.3%	-0.3%	17.4%	\$23.33	-0.3%	\$22.61
	Baltimore - Class A	42,666	1,806	7,997	-1.4%	7,463	18.7%	-0.3%	17.5%	\$26.40	-2.7%	\$26.61
	Boston (Suffolk County)	87,297	5,961	8,486	-2.8%	10,438	9.7%	-0.3%	12.0%	\$49.15	1.1%	\$44.36
	Boston (Suffolk County) - Class A	53,129	4,463	5,236	3.0%	7,225	9.9%	0.3%	13.6%	\$59.90	1.5%	\$56.70
	Boston (Suburban)	156,265	6,337	25,809	-1.2%	26,701	16.5%	-0.2%	17.1%	\$21.90	2.7%	\$20.29
	Boston (Suburban) - Class A	62,459	3,522	12,709	-2.1%	12,629	20.3%	-0.4%	20.2%	\$23.04	1.4%	\$21.76
	Charlotte	64,138	4,200	9,274	-5.3%	9,572	14.5%	-0.8%	14.9%	\$27.45	2.7%	\$25.06
	Charlotte - Class A	35,614	1,892	6,193	-7.3%	6,351	17.4%	-1.4%	17.8%	\$30.08	2.8%	\$27.99
	Chicago CBD	141,345	12,109	23,858	9.9%	22,650	16.9%	1.4%	16.2%	\$39.60	-1.0%	\$38.84
	Chicago - Class A	72,643	7,692	13,032	20.0%	11,403	17.9%	2.4%	16.3%	\$44.65	-0.7%	\$43.84
	Suburban Chicago	101,475	4,946	28,680	1.0%	27,870	28.3%	1.7%	25.3%	\$23.39	-0.4%	\$22.86
	Suburban Chicago - Class A	56,191	3,153	15,413	-1.8%	16,123	27.4%	0.6%	26.4%	\$26.60	-0.8%	\$25.63
	Dallas/Fort Worth	200,348	14,598	50,774	-0.3%	52,111	25.3%	0.2%	25.7%	\$24.17	0.1%	\$23.73
	Dallas/Fort Worth - Class A	118,045	8,844	29,271	-2.4%	30,273	24.8%	-0.6%	25.6%	\$26.30	0.0%	\$25.95
	Denver	110,270	8,826	20,548	-0.8%	19,906	18.6%	-0.1%	18.1%	\$28.20	2.4%	\$26.59
	Denver - Class A	52,656	5,378	10,183	-1.9%	9,827	19.3%	-0.4%	18.8%	\$31.90	2.3%	\$29.61
	Houston	187,837	13,358	51,245	-3.4%	52,365	27.3%	-0.9%	27.7%	\$28.48	0.2%	\$28.48
	Houston - Class A	109,998	8,619	32,226	-2.8%	32,887	29.3%	-0.9%	29.6%	\$33.16	-0.4%	\$33.14
	Los Angeles	209,916	12,688	41,464	0.7%	36,887	19.8%	0.0%	17.8%	\$39.27	9.3%	\$36.58
	Los Angeles - Class A	142,830	9,032	25,514	-3.5%	25,821	17.9%	-0.5%	18.0%	\$40.82	7.3%	\$38.72
	New Jersey	143,494	6,031	34,727	-5.5%	37,200	24.2%	-1.4%	25.9%	\$27.53	-0.9%	\$28.58
	New Jersey - Class A	114,553	5,315	29,489	-6.0%	31,040	25.7%	-1.7%	27.1%	\$28.18	-1.4%	\$29.48
	New York	434,769	36,969	50,412	-0.5%	48,656	11.6%	-0.1%	11.2%	\$74.21	-0.3%	\$73.76
	New York - Class A	211,194	18,771	25,928	-2.8%	27,068	12.3%	-0.4%	12.9%	\$83.15	-0.1%	\$81.92
	Orange County	81,849	6,872	16,132	7.0%	13,587	19.7%	1.5%	16.5%	\$35.86	1.7%	\$30.67
	Orange County - Class A	43,092	4,010	9,195	6.7%	8,145	21.3%	1.4%	18.8%	\$39.47	0.8%	\$34.31
	Philadelphia CBD	46,845	3,749	6,574	-8.2%	6,821	14.0%	-1.4%	14.7%	\$32.96	0.7%	\$30.19
	Philadelphia - Class A	30,251	2,745	4,345	-6.3%	4,194	14.4%	-1.2%	14.1%	\$35.54	1.9%	\$31.93
	Suburban Philadelphia	49,340	2,729	10,501	0.0%	8,767	21.3%	-0.5%	18.2%	\$26.58	-0.9%	\$26.44
	Suburban Philadelphia - Class A	32,416	1,554	5,716	4.0%	4,962	17.6%	0.2%	15.7%	\$28.44	0.4%	\$27.95
	Phoenix	102,788	6,311	20,017	0.7%	20,824	19.5%	0.1%	20.3%	\$26.70	1.4%	\$24.61
	Phoenix - Class A	45,175	2,814	9,098	5.5%	8,261	20.1%	1.1%	18.3%	\$30.73	-0.2%	\$28.31
	Raleigh/Durham	51,951	2,121	7,037	2.1%	7,627	13.5%	0.7%	14.2%	\$24.80	1.0%	\$22.14
	Raleigh/Durham - Class A	32,514	1,624	4,438	-1.4%	5,060	13.6%	0.2%	15.2%	\$26.66	-0.4%	\$25.95
	San Francisco	76,646	10,006	6,918	-17.6%	7,474	9.0%	-1.9%	9.8%	\$68.53	2.5%	\$70.19
	San Francisco - Class A	48,857	6,597	4,084	-20.8%	4,939	8.4%	-2.2%	10.1%	\$72.42	4.5%	\$70.13
	San Diego	62,158	5,201	11,296	11.8%	10,590	18.2%	1.9%	17.0%	\$32.69	0.5%	\$32.48
	San Diego - Class A	28,707	2,628	5,701	14.2%	5,182	19.9%	2.5%	18.1%	\$37.37	1.6%	\$35.53
	Seattle	112,772	7,948	15,527	4.5%	14,732	13.8%	0.1%	13.6%	\$36.40	2.7%	\$25.50
	Seattle - Class A	58,591	4,606	7,170	9.7%	5,589	12.2%	0.3%	10.4%	\$46.29	-1.4%	\$34.51
	Silicon Valley	82,620	7,890	11,645	-10.9%	13,864	14.1%	-1.7%	16.8%	\$49.01	-3.8%	\$50.29
	Silicon Valley - Class A	29,071	3,554	4,745	-16.8%	6,703	16.3%	-3.3%	23.1%	\$51.74	-1.5%	\$50.95
	South Florida	105,175	6,262	18,029	0.1%	17,629	17.1%	-0.1%	16.9%	\$33.70	1.6%	\$31.47
	South Florida - Class A	50,180	2,759	9,373	0.6%	8,519	18.7%	-0.2%	17.1%	\$38.33	2.1%	\$35.83
	Tampa Bay	50,493	3,923	7,478	0.4%	7,219	14.8%	0.1%	14.4%	\$24.11	1.4%	\$22.65
	Tampa Bay - Class A	22,096	2,196	2,775	-0.3%	2,659	12.6%	-0.1%	12.2%	\$28.78	-0.7%	\$27.44
	Suburban Maryland	75,852	4,024	13,982	4.3%	13,367	18.4%	1.5%	16.4%	\$27.57	3.1%	\$26.37
	Suburban Maryland - Class A	40,532	2,767	9,012	11.5%	8,038	22.2%	2.5%	18.6%	\$28.63	1.9%	\$27.59
	Northern Virginia	164,175	10,581	34,223	0.7%	34,906	20.8%	0.3%	21.0%	\$32.55	0.9%	\$30.96
	Northern Virginia - Class A	99,283	8,315	22,724	4.7%	21,628	22.9%	0.9%	21.9%	\$34.70	0.3%	\$32.78
	Washington, D.C.	124,480	10,287	19,469	-4.2%	18,466	15.6%	-0.6%	14.9%	\$53.07	1.4%	\$50.94
	Washington, D.C. - Class A	75,102	7,113	11,070	-2.7%	9,947	14.7%	-0.5%	13.5%	\$56.68	1.9%	\$54.83
	Savills Studley Major Markets Total	3,341,173	230,747	602,652	-0.4%	598,639	18.1%	0.0%	17.9%	\$34.37	-0.1%	\$33.55
	Savills Studley Major Markets - Class A	1,839,555	143,178	348,947	-0.7%	344,776	19.0%	-0.2%	18.8%	\$39.08	0.8%	\$37.25

Please contact us for further information

Savills Studley
399 Park Avenue
New York, NY 10022
(212) 326-1000

Chairman & CEO
Mitchell S. Steir
msteir@savills-studley.com
(212) 326-1000

Corporate Research Contact
Keith DeCoster
kdecoster@savills-studley.com
(212) 326-1023

(1) Percentage point change for availability rates.

Unless otherwise noted, all rents quoted throughout this report are average asking gross (full service) rents psf.

Statistics are calculated using both direct and sublease information.

Short-term sublet spaces (terms under two years) were excluded.

^Unless otherwise noted, source for data is Savills Studley.

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

Copyright © 2018 Savills Studley