

Savills Studley Report

Northern New Jersey office sector Q1 2018



SUMMARY

Market Highlights

LEASING DOWN SLIGHTLY

Leasing activity fell from 1.2 million square feet (msf) in the fourth quarter of 2017, to 1.1 msf in the first quarter. Tenants have leased 4.9 msf in the four most recent quarters, 50.5% below the long-term market average.

OVERALL AVAILABILITY FALLS

The market's overall availability rate decreased by 40 basis points from 22.8% to 22.4%. The Class A availability rate increased by 40 basis points to 24.3%.

RENTS RISE

Average asking rent for the region rose by 2.9%, to \$29.78. Rent has increased as the availability of quality Class A space in submarkets such as Hudson Waterfront remains elevated, and older obsolete properties are removed from inventory.

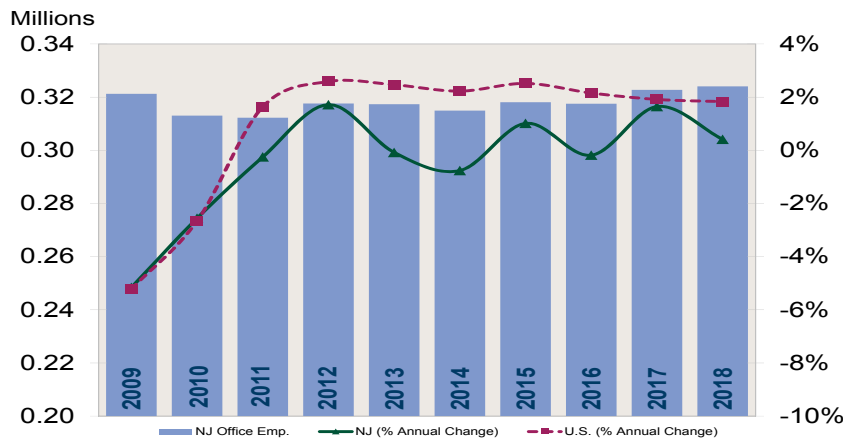
SALES DOWN

Office property sales in the last six months (through February of 2018) decreased by 33%—totaling \$1 billion, down from \$1.5 billion in the previous six months.

"Demand has slipped well below long-term averages in Northern New Jersey. Tenants have a lot of leverage across the market. Landlords in some areas continue to repurpose obsolete office product as industrial or residential product when and where it is feasible."

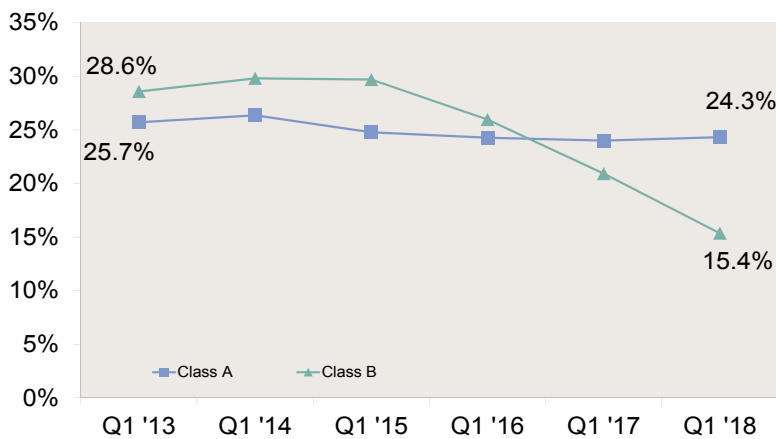
Chip Conklin,
Senior Managing Director

Office-Using Employment Trends

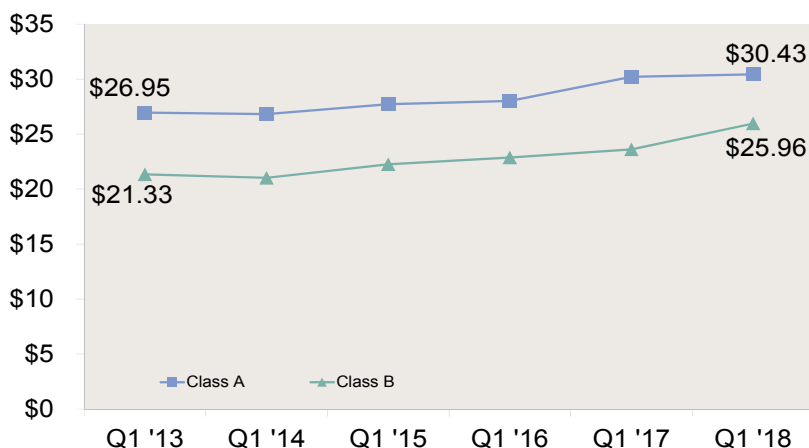


Source: Bureau of Labor Statistics[^]

Availability Rate Trends



Asking Rent Trends (\$/sf)



The Short End of the Stick

This has been an uneven recovery across the U.S. with much stronger growth in top tech centers and high-growth SunBelt metros. New Jersey has often been on the short end of the stick. High-cost suburban locations in the Northeast and Midwest suffered multiple blows during the last recession. Office markets like Suburban Chicago and Philadelphia as well as Fairfield, Connecticut, have only partially recovered – if at all.

Northern New Jersey also provides a prime example of the lopsided recovery and the extensive efforts suburban landlords must take to be competitive in a market with oversupply and waning demand. Within Northern New Jersey, relocations of businesses from suburban parks stretching from Morristown to Princeton, to transit-oriented projects in Jersey City and Summit – furthered the hollowing out of many office parks. Additionally, as the broader U.S. economy rebounded, the long-term movement of households and businesses from North to South to lower-cost and warmer climates resumed.

Stemming the Flow

New Jersey has had few weapons to combat the loss of businesses – but expertise is a key one. New Jersey's highly skilled and educated workforce in finance and pharmaceuticals has been a critical weapon to stem the flow. It has not stopped the leakage entirely, though, and New Jersey cannot take it for granted that top employers and the talent will stay. Rising labor costs pushed many of New Jersey's top pharmaceuticals to adopt a tried and true process of either offshoring (Novartis laying off hundreds in East Hanover and shifting them to India) or nearshoring. (Gerber Product Co., for example, moved its U.S. headquarters to Rosslyn, Virginia).

Markets such as Atlanta and Dallas/Fort Worth have become much more potent competitors for businesses. In a cycle dominated by the pursuit for talent, the cities can no longer be characterized as being primarily back-office locations, they have developed their own expertise. Atlanta also offers an extensive college and university network in a vibrant urban setting.

On the Back End of the Cycle

New Jersey's economy likely peaked in late 2016 or early 2017. Office-using employment has been going through a rough patch in New Jersey during the last 24 months – falling by 1.3% in 2016 and then by 0.4% in 2017. In contrast, office-using employment in New York City rose by 2.2%, up slightly from the 1.8% increase in the last 12 months.

Weak demand drivers coupled with ample available space options create very favorable

conditions for tenants in Northern New Jersey. This includes businesses choosing to redesign their workplace, those staying put in their current location as well as companies shedding space. Asking rents have increased slightly as landlords have pushed concessions higher.

Tenant Retention Campaign

Landlords are intensifying their tenant recruitment and retention efforts by raising concessions. This includes areas like the Hudson Waterfront that were more challenging to tenants as recently as a few quarters ago. Available Class A space in this submarket has jumped by more than 20% from a year ago, ending the first quarter at just under 3.8 msf. Several buildings have significant lease rollovers in the next few quarters. Landlords in Northern New Jersey face the added challenge of competing with reduced rent and generous lease terms in Manhattan. Meanwhile, questions about potential changes to the Grow NJ tax; Incentive program hang over the market.

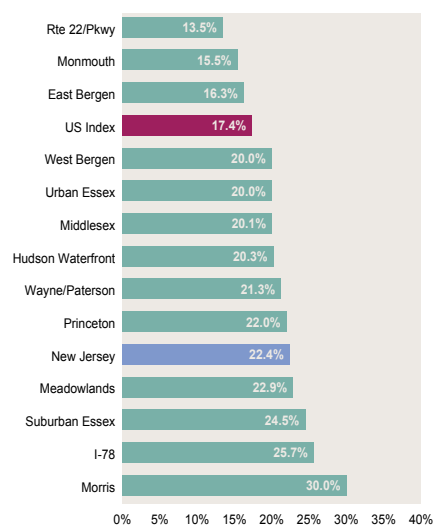
Leasing activity also appears to have peaked more than a year ago. A flurry of larger leases were signed during 2015 and 2016 as many tenants took advantage of the extensive building renovations scattered across the market. In the last few quarters, the number of larger leases exceeding 100,000 sf has dropped sharply. There have only been four leases over 100,000 sf signed since mid-year 2017 and none so far in 2018. Additionally, tenants have become less mobile. In the first quarter, renewals accounted for most of the bigger deals including Standard Chartered Bank's 72,000-sf renewal at 2 Gateway in Newark and Kuehne + Nagel's 70,531-sf lease at 10 Exchange Place.

Adaptive Re-use as a Tactic

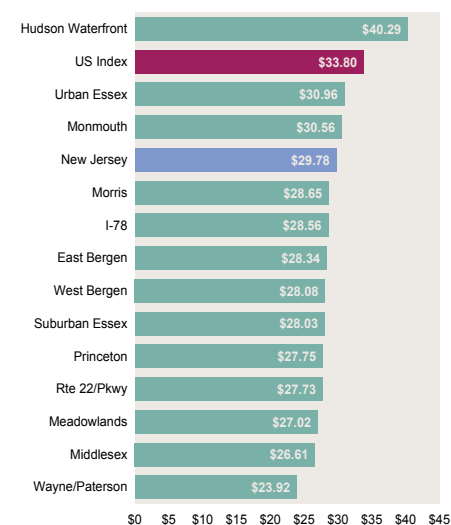
In the absence of demand, some owners are repurposing office buildings as industrial or multifamily product. In turn, availability has come down in spots—falling year-on-year by more than 500 basis points in East Bergen to 17.1% and by 400 basis points in Monmouth to 12.7%. Two buildings totaling just under 290,000 sf at 1515 Route 10 in Parsippany are among those being converted. Others such as 210 Clay Avenue in Lyndhurst will be demolished. Government agencies have also absorbed some properties. The process of securing rezoning from commercial to industrial or residential is often very challenging and costly, though. It is also time consuming, typically taking 18 to 36 months.

Other investors have had more success repositioning older Class B and A- properties. Most have applied a familiar blueprint: buy below replacement cost, load the building with amenities and highly efficient floorplates and then offer aggressive lease terms. A few additional buildings changed hands in early 2018. In the first quarter, Signature Acquisitions

Availability Rate Comparison



Overall Rental Rate Comparison (\$/sf)



Major Transactions

Tenant	Sq Feet	Address	Market Area
AXA Equitable Life Insurance	91,235	500 Plaza Dr	Meadowlands
Lonza America Inc	74,659	412 Mt. Kemble Ave	Morris
Standard Chartered PLC	72,000	2 Gateway Ctr	Urban Essex
Kuehne + Nagel	70,531	10 Exchange Pl	Waterfront
Momentum Solar	61,239	3096 Hamilton Blvd	Middlesex
Merrill Lynch, Pierce, Fenner and Smith	47,843	115 W Century Rd	West Bergen
McLaren Engineering Group	45,359	530 Chestnut Ridge Rd	West Bergen
Michael Baker	40,000	100 American Metro Blvd	Princeton
AeroTek	22,468	2174 State Route 27 S	Middlesex
Scynexis	19,275	1 Evertrust Plz	Waterfront

paid \$74.5 million (\$141.52/sf) for The Offices at Liberty Corner in Basking Ridge.

Short Term Upside

In the short term, Northern New Jersey's economy could actually get a bit better, before it gets worse. The national economy remains strong and New Jersey is benefitting from a recent burst in corporate investment by some local businesses. Following the passage of the corporate tax reform bill in the fourth quarter, a few firms have made commitments to invest locally. Johnson & Johnson, based in New Brunswick, said it will increase spending on healthcare R&D through the use of repatriated funds. Verizon and Bank of America have already given their workers one-time stock bonuses.

The banking sector appears to be in a bit of a sweet spot of late. Banks are capturing higher margins thanks to corporate tax reform and rising interest rates. On the flip side, volatility in equity markets is a downside risk that has become more apparent as investors react to

continued fears of overvaluation, the impact of rising rates and recent fears of a trade war. Financial sector employment has fallen slightly in five of the last eight months with a very weak overall increase of several hundred jobs during this period. In contrast, New York City has gained several thousand financial sector jobs in the last eight months.

Long-Term Downside

What the new tax law gives with one hand - increased corporate profitability - it may take away with the other. The new tax law decreases the value of mortgage and property tax deductions, increasing the property tax burden for homeowners. Moody's estimates that house prices will fall up to 10% by 2019 in New Jersey, the biggest such decrease for any state in the U.S. The increased costs could give added impetus to movement out of New Jersey. The state is projected to lose more than 20,000 residents per year by 2019. This will likely increase the dependence of luxury home markets on the highest-paying industries such as finance and pharmaceuticals.

Map	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
1	East Bergen	6,000	427	977	-14.4%	1,345	16.3%	-2.3%	22.0%	\$28.34	4.0%	\$26.94
	East Bergen - Class A	4,601	357	800	-7.4%	1,146	17.4%	0.4%	22.5%	\$28.38	7.5%	\$27.75
2	West Bergen	11,140	356	2,230	0.3%	2,189	20.0%	-1.6%	21.2%	\$28.08	1.7%	\$28.04
	West Bergen - Class A	6,041	226	1,347	-2.2%	1,419	22.3%	-1.1%	24.1%	\$28.47	1.3%	\$28.89
3	Wayne/Paterson	4,715	185	1,003	-2.6%	1,175	21.3%	-1.1%	25.5%	\$23.92	3.6%	\$22.23
	Wayne/Paterson - Class A	3,233	109	872	2.1%	990	27.0%	0.2%	31.0%	\$23.93	4.4%	\$22.72
4	Meadowlands	5,486	218	1,255	7.2%	1,184	22.9%	3.1%	20.0%	\$27.02	6.4%	\$26.13
	Meadowlands - Class A	4,263	187	1,064	8.3%	947	24.9%	3.5%	20.7%	\$27.00	3.7%	\$27.17
5	Hudson Waterfront	19,173	298	3,885	0.0%	3,970	20.3%	0.4%	20.3%	\$40.29	1.3%	\$42.55
	Hudson Waterfront - Class A	17,798	296	3,778	0.0%	3,893	21.2%	0.8%	21.1%	\$40.54	1.4%	\$43.03
6	Urban Essex	12,651	449	2,536	3.0%	2,614	20.0%	0.4%	20.8%	\$30.96	1.9%	\$28.72
	Urban Essex - Class A	9,067	349	1,843	0.4%	2,158	20.3%	0.5%	23.3%	\$31.32	2.3%	\$30.53
7	Suburban Essex	5,964	84	1,462	3.1%	1,575	24.5%	0.2%	27.0%	\$28.03	4.7%	\$28.61
	Suburban Essex - Class A	4,887	64	1,394	2.4%	1,387	28.5%	0.8%	28.2%	\$28.41	5.8%	\$29.24
8	Morris	25,314	688	7,601	0.7%	8,046	30.0%	0.3%	31.7%	\$28.65	2.7%	\$26.82
	Morris - Class A	20,144	585	6,531	0.6%	6,398	32.4%	0.9%	31.0%	\$29.37	1.8%	\$27.63
9	I-78	14,291	484	3,668	4.1%	3,255	25.7%	1.1%	22.7%	\$28.56	3.2%	\$28.49
	I-78 - Class A	12,959	464	3,525	4.4%	3,129	27.2%	1.5%	23.8%	\$28.84	3.8%	\$28.69
10	Route 22/Parkway Corridor	1,878	22	253	4.9%	418	13.5%	-0.3%	23.9%	\$27.73	-0.4%	\$27.72
	Route 22/Parkway Corridor - Class A	1,173	21	189	4.4%	353	16.1%	0.5%	30.4%	\$28.06	0.1%	\$28.07
11	Middlesex	17,620	1,004	3,536	-6.7%	4,014	20.1%	-0.9%	22.2%	\$26.61	1.9%	\$26.50
	Middlesex - Class A	14,112	948	3,186	-7.4%	3,568	22.6%	0.4%	22.9%	\$27.48	3.0%	\$27.38
12	Monmouth	6,834	214	1,056	-10.7%	1,269	15.5%	-4.0%	20.9%	\$30.56	10.3%	\$28.12
	Monmouth - Class A	4,544	45	579	-19.9%	698	12.7%	-4.6%	16.7%	\$36.86	26.2%	\$30.76
13	Princeton	16,454	437	3,618	-2.1%	3,162	22.0%	-1.9%	20.4%	\$27.75	0.7%	\$28.37
	Princeton - Class A	13,520	379	3,189	-1.7%	2,546	23.6%	-0.9%	19.2%	\$28.89	1.4%	\$29.00
1-13	New Jersey Total	147,519	4,865	33,081	-0.7%	34,216	22.4%	-0.4%	23.4%	\$29.78	2.9%	\$29.10
	New Jersey Total - Class A	116,343	4,030	28,295	-0.8%	28,631	24.3%	0.4%	24.0%	\$30.43	3.0%	\$30.20

Please contact us for further information

Rutherford Office

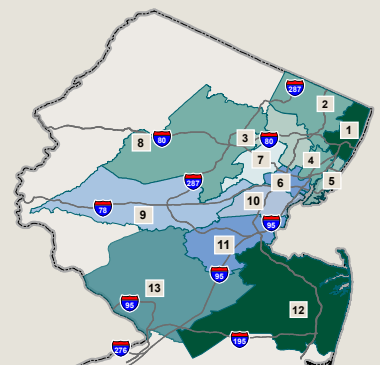
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(1) Percentage point change for availability rates.

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

Statistics are calculated using both direct and sublease information.

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.

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