RESEARCH **3Q 2019**

Newmark Knight Frank

# NATIONAL OFFICE MARKET

## OFFICE MARKET UNEVEN DURING THIRD QUARTER

The U.S. office market tightened during the third quarter of 2019. Absorption decelerated compared with the nation's performance last quarter and was down markedly over the third quarter of 2018. Asking rents rose 2.6% compared with the third quarter of 2018. Vacancy declined 40 basis points over the past 12 months. Approximately 8.9 million square feet of new product delivered during the third quarter of 2019. The amount of space under construction remains robust and is an indicator to watch during the balance of the year. However, overall market conditions suggest the cyclical expansion will continue at least through the end of 2019.

### ABSORPTION DECELERATES

Tenants absorbed 7.5 million square feet during the third quarter of 2019, down from 13.9 million square feet during the third quarter of 2018. During the third quarter of 2019, absorption was positive in 39 of the 56 markets tracked by Newmark Knight Frank, led by Chicago, where absorption approached 1.3 million square feet, driven by tech and coworking tenants. San Francisco and Seattle also registered at least 1.0 million square feet of occupancy gains. Other markets with a strong third-quarter performance include Charlotte, Dallas and Los Angeles, each of which registered more than 600,000 square feet of positive absorption.

In the San Francisco Bay Area, available space is scarce. Led by the San Francisco market, the region has seen vacancy decline over the past year. San Francisco's vacancy is down 110 basis points to 2.8%, thanks to almost 2.0 million square feet of absorption year-to-date. Silicon Valley has absorbed almost 1.0 million square feet through the third quarter and Oakland has totaled over 700,000 square feet of positive absorption in 2019. The region has delivered just under 6.0 million square feet year to date, much of it pre-leased, leading to some of the highest rental rates in the nation. Conversely, during the third quarter of 2019, Manhattan registered negative absorption for the second time this year, and its performance has been uneven over the past three years. With more than 17.0 million square feet currently under construction, it remains a market where significant gross leasing activity overlaps with the arrival of a substantial amount of new supply.

### ASKING RENTS RISE DURING THIRD QUARTER

Rental rate growth has slowed since reaching a cyclical peak of 3.8% during the fourth quarter of 2015. Still, rents continue to increase, albeit at a more moderate pace, supported by new demand. The average asking rent across the U.S. ended the third quarter of 2019 at $29.29/SF gross full service, an increase of 2.6% over the past year.

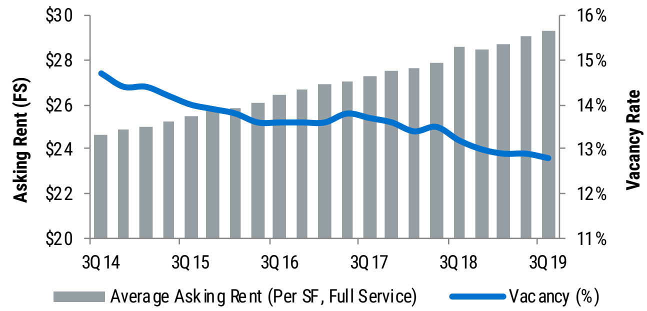
Notably, two markets – San Francisco (8.9%) and Seattle (7.4%) – have experienced rent growth of greater than 7.0% during the past 12 months. By contrast, Fairfield County, Connecticut (negative 3.3%) and Boston (negative 1.6%) stand out for their annual declines in average rent.

## CURRENT CONDITIONS

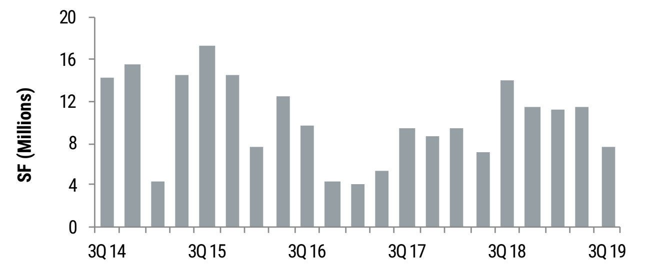
- Office absorption was down in the third quarter of 2019 compared with the same period in 2018
- The vacancy rate of 12.8% declined 40 basis points from one year ago.
- The average asking rent rose by 2.6% over the past year.
- The construction pipeline remains robust at 99.7 million square feet.

## MARKET ANALYSIS

### Asking Rent and Vacancy Rate




### Net Absorption




## MARKET SUMMARY

| | Current Quarter | Prior Quarter | Year Ago Period | 12-Month Forecast |
|---|---|---|---|---|
| Total Inventory | 4.9 BSF | 4.9 BSF | 4.9 BSF | ↑ |
| Vacancy Rate | 12.8% | 12.9% | 13.2% | ↑ |
| Quarterly Net Absorption | 7.5 MSF | 11.4 MSF | 13.9 MSF | ←→ |
| Average Asking Rent | $29.29 | $29.09 | $28.55 | ↑ |
| Under Construction | 99.7 MSF | 97.4 MSF | 84.1 MSF | ↓ |
| Deliveries | 8.9 MSF | 12.9 MSF | 5.6 MSF | ↑ |

## VACANCY DECLINES DURING THIRD QUARTER

The vacancy rate edged down 40 basis points over the past year to 12.8%, even as 8.9 million square feet of new product delivered during the quarter—following 33.8 million square feet of deliveries during the previous four quarters. Third-quarter 2019 absorption decelerated significantly, as the office market saw a decrease of approximately 6.4 million square feet of absorption compared with third-quarter 2018. Despite having the nation's largest construction pipeline, Manhattan recorded one of the lowest vacancy rates at 5.9%, while two southwestern markets recorded the highest vacancy rates in the nation, with Oklahoma City at 24.7% and Houston at 21.5%. These markets traditionally maintain higher-than-average vacancy rates because of the availability of land.

Chicago, spurred by corporate and tech tenants, had the largest net absorption in the nation, registering an occupancy gain of more than 1.3 million square feet during the third quarter of 2019. This led to a decrease in vacancy of 70 basis points compared with third-quarter 2018. Other markets seeing a large decrease in vacancy include Silicon Valley, which saw vacancy decrease 310 basis points to 9.1% and Las Vegas, which saw a decrease of 230 basis points to 13.0%. Jacksonville, Florida saw one of the largest annual increases in vacancy, as the market's rate rose 150 basis points to 13.0%, closely followed by Austin, Texas, where vacancy increased 130 basis points to 11.3%.

## CONSTRUCTION PIPELINE GROWS

The office construction pipeline totals a robust 99.7 million square feet. Tenants continue to show strong interest in new, efficient trophy projects, but backfilling older, obsolete space is a challenge across the country. Deliveries outpaced absorption during the quarter, which will lead to some concerns about overbuilding late in the expansion cycle.

Overall, U.S. office construction remains under control, at 2.0% of standing inventory. Some markets exceed this threshold and warrant monitoring, including Silicon Valley, Salt Lake City, Seattle, Nashville and Atlanta—markets where the construction pipeline relative to total inventory exceeds 4.0%.

The national development pipeline has a number of notable projects underway, including the St. John's Terminal redevelopment located at 550 Washington Street in New York, a 1.3 million-square-foot building that will deliver in 2023. The property is 100% preleased to Google. Additionally, The Spiral, a 1,005-foot-tall office project located at 66 Hudson Boulevard in Manhattan's Hudson Yards development, will deliver 2.8 million square feet in late 2022. In Chicago, 110 North Wacker Drive will include 55 stories and approximately 1.5 million square feet of office space in the West Loop submarket. It is expected to deliver in early 2020.

## SUBLEASE AVAILABILITY RATE STABLE

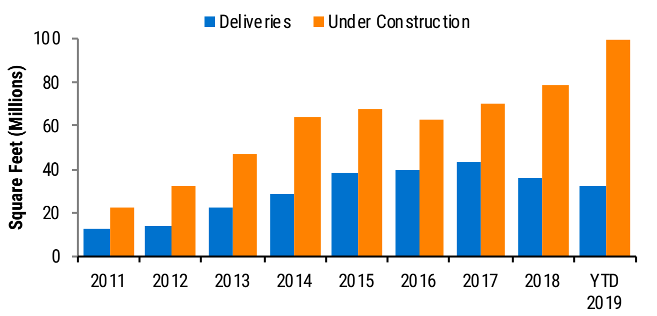
The third quarter ended with 98.4 million square feet of sublease space available, equal to 2.0% of the total office inventory, a decrease of 10 basis points from one year ago. This is up from the cyclical low of 1.7% of inventory in 2014. However, the sublet availability rate remains low relative to the 2.9% peak during the financial crisis and the 5.4% peak after the dot-com bust. Rather than putting sublease space on the market, many tenants are retaining that space and using it to accommodate new hires in an expanding economy. Still, there are some markets that require monitoring. Fairfield County, Connecticut, for example, is faced with a significant amount of sublease space on the market, at 4.7% of inventory. Similarly, New Jersey Southern counts 4.1% of inventory as sublease space.

## MARKET HIGHLIGHT: TEXAS

The four markets within the state of Texas that are tracked by Newmark Knight Frank have very different market fundamentals. Texas includes the third and fourth largest markets by inventory in Dallas and Houston, respectively. These two markets also have the second and third-highest vacancy rates in the nation, with Houston at 21.5% and Dallas at 19.2%. Only the Oklahoma City market is higher, at 24.7%. Houston's vacancy rate has risen 870 basis points since a cyclical low of 12.8% at the end of 2014. Since the start of 2015, Houston has seen negative absorption in 10 of 19 quarters, totaling 4.5 million square feet. However, buoyed by the delivery of top-quality space, the average rental rate in Houston has grown by 23.6% since the start of the decade.

## CONSTRUCTION AND DELIVERIES

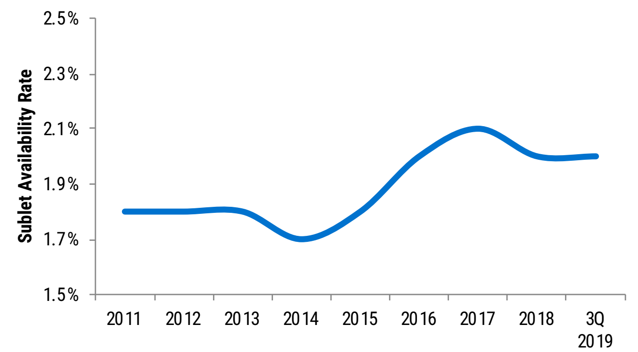
**United States Office Market**




Source: CoStar, NKF Research

## SUBLET AVAILABILITY RATE

**United States Office Market**




Source: CoStar, NKF Research

Dallas' fundamentals have been more uneven. Vacancy rates have remained in the same elevated range over the past decade, only 160 basis points higher today than the cyclical low of 17.6% in 2015. Absorption in Dallas has been positive in 32 of the last 39 quarters, adding 23.0 million square feet of occupied space. However, this figure has been outpaced by the 26.7 million square feet delivered during the same period.  Rental rates have increased by almost one-third since the start of the decade.

Texas' smaller markets of Austin and San Antonio, on the other hand, have seen different trends. Austin's vacancy rate has decreased by 680 basis points since the beginning of 2010, when it stood at 18.1%. Absorption has been positive in 34 of 39 quarters, adding nearly 11.5 million square feet of occupancy in that period, and rental rates have risen 40%. San Antonio has grown at a more modest pace, as vacancy is down 100 basis points to 13.2% and rental rates have increased almost 24.0%. The city has seen positive absorption in 31 of 39 quarters this decade and has added 5.3 million square feet of occupied space.

## WEWORK'S TROUBLES RATTLE OFFICE MARKET

The recent failed IPO bid for coworking giant WeWork has spawned some concern in the commercial real estate industry, especially among office asset owners, as the largest private sector tenant in some of the nation's core office markets is on shaky footing. A prospectus filed with investors led to blowback over the company's corporate structure and valuation. The CEO has been replaced, and the company is facing a capital shortfall due, in part, to an untenable pace of scaling. Office markets such as Manhattan, where coworking tenants currently make up 3.6% of total inventory, will be keeping a close eye on WeWork's trajectory. Coworking tenants have played a major role in positive absorption levels in many markets, including Washington, DC, where leasing has outpaced losses from law firm densification and a shrinking federal government workforce.

## U.S. OFFICE MARKET OUTLOOK

The national office market continues to experience methodical growth, which reflects the continuing, and now record-length, economic expansion cycle. Notably, consensus points to a gradual slowing of the economy over the next 12 to24 months, and the Federal Reserve has lowered near-term expectations. This comes at a time when the economy has been experiencing some stress caused by political disagreement and trade disputes. There is potential for additional interest rate cuts over the remainder of the year, after two cuts during the third quarter. A recent history of stock market volatility suggests that real estate will continue to offer relatively good value for investors on a risk-adjusted basis.

On the supply side, construction totals are an indicator to watch, with 95.8 million square feet currently under construction. This figure represents 1.9% of total inventory, still a controlled figure for this late point in the cycle, but a bit concerning as the U.S. economy decelerates.

Employment growth remains sturdy, with the third quarter of the year averaging 157,000 new jobs, although this figure is down from last year's third-quarter average of 189,000 new jobs. If the labor market can sustain this level of hiring, it will support healthy leasing activity and absorption through the balance of 2019.  Projected unemployment rates for both year-end 2019 and 2020 is 3.7%, according to the Federal Reserve Bank of St. Louis—very low by historical standards. However, the densification of office space— placing more workers into less space—persists, exerting downward pressure on absorption. Densification may slow soon because of pushback from employees who are seeking more privacy and fewer distractions in a competitive labor market. Continued job creation in office-using sectors, particularly professional and business services, ultimately will continue to impact demand more than any other factor.  Overall, the U.S. office market is likely to maintain its current path of methodical growth through the balance of 2019.

## NOTABLE 3Q 2019 LEASE TRANSACTIONS

| Tenant | Market | Building | Type | Square Feet |
|---|---|---|---|---|
| Google Inc. | New York, NY | 550 Washington Street | Direct New | 1,295,800 |
| Publicis Groupe | New York, NY | 375 Hudson Street | Lease Renewal/Expansion | 960,222 |
| Uber | Chicago, IL | 433 West Van Buren Street | Direct New | 450,000 |
| Southwestern Energy Company | Houston, TX | 10000 Energy Drive | Sublease New | 282,214 |
| GSA – Central Intelligence Agency | Washington, DC | 499 Grove Street | Lease Renewal | 257,400 |

## NOTABLE 3Q 2019 SALES TRANSACTIONS

| Building | Market | Sale Price | Price/SF | Square Feet |
|---|---|---|---|---|
| 620 National Avenue | Silicon Valley, CA | $190,000,000 | $1,250 | 151,998 |
| 10000 Energy Drive | Houston, TX | $188,000,000 | $340 | 552,446 |
| 180 Grand Avenue | Oakland, CA | $175,000,000 | $628 | 278,596 |
| 1041 Route 202/206 | New Jersey Northern | $152,000,000 | $194 | 783,501 |
| Three Constitution Center* | Boston, MA | $114,000,000 | $639 | 178,318 |

*Three building portfolio transaction

## MARKET STATISTICS (CONTINUED ON NEXT PAGE)

| | Total Inventory (SF) | SF Under Construction | SF Absorbed This Quarter | SF Absorbed Year-to-Date | Vacancy Rate | Average Asking Rent (Price/SF) |
|---|---|---|---|---|---|---|
| **National** | **4,924,527,302** | **99,684,157** | **7,525,934** | **29,677,909** | **12.8%** | **$29.29** |
| Atlanta | 149,499,986 | 6,720,622 | 13,251 | 622,516 | 17.9% | $27.66 |
| Austin | 66,125,659 | 918,251 | -1,198,559 | -402,805 | 11.3% | $35.13 |
| Baltimore | 81,997,927 | 838,737 | 4,013 | 141,483 | 12.6% | $24.24 |
| Boston | 182,145,280 | 5,839,891 | 47,627 | 1,642,923 | 11.4% | $36.19 |
| Broward County, FL | 34,032,047 | 1,050,092 | 104,993 | 393,574 | 9.7% | $29.76 |
| Charleston, SC | 14,245,817 | 186,998 | -19,935 | -99,722 | 9.0% | $26.75 |
| Charlotte | 72,875,747 | 114,469 | 604,109 | 2,056,326 | 9.7% | $27.82 |
| Chicago | 236,211,258 | 6,003,558 | 1,265,167 | 1,561,055 | 15.9% | $29.85 |
| Cincinnati | 36,245,388 | 30,000 | 23,092 | 16,217 | 16.4% | $19.35 |
| Cleveland | 37,289,537 | 60,000 | -192,923 | -380,793 | 17.3% | $18.38 |
| Columbia, SC | 16,224,568 | 0 | -134,432 | -219,974 | 9.3% | $17.84 |
| Columbus | 58,120,783 | 145,160 | -264,732 | -392,908 | 10.7% | $18.67 |
| Dallas | 264,544,739 | 1,823,049 | 700,480 | 1,928,540 | 19.2% | $26.24 |
| Delaware | 18,041,486 | 32,000 | 21,548 | -254,926 | 16.6% | $26.05 |
| Denver | 99,367,326 | 2,116,626 | 406,079 | 1,328,112 | 14.4% | $28.82 |
| Detroit | 77,626,315 | 624,000 | 110,576 | 281,646 | 15.0% | $19.98 |
| Fairfield County, CT | 39,722,393 | 0 | -92,903 | -159,824 | 17.1% | $35.69 |
| Fresno | 19,870,720 | 207,058 | 66,876 | 161,153 | 10.0% | $31.17 |
| Greenville, SC | 21,899,773 | 0 | -115,669 | -53,808 | 8.5% | $20.45 |
| Houston | 238,519,141 | 2,466,391 | 128,700 | -457,317 | 21.5% | $29.35 |
| Indianapolis | 61,964,069 | 81,000 | -234,062 | -581,084 | 11.0% | $19.37 |
| Inland Empire, CA | 30,974,735 | 145,036 | 109,940 | -111,781 | 9.1% | $22.19 |
| Jacksonville | 32,728,108 | 0 | -97,548 | -130,068 | 13.0% | $20.11 |
| Kansas City | 76,337,844 | 285,028 | -244,926 | 37,624 | 8.3% | $20.85 |
| Las Vegas | 38,808,312 | 144,944 | 276,750 | 1,005,048 | 13.0% | $22.87 |
| Long Island | 54,998,254 | 0 | -85,005 | 20,717 | 8.2% | $26.45 |
| Los Angeles | 201,979,098 | 3,456,098 | 610,278 | 2,024,250 | 13.7% | $41.55 |
| Manhattan | 456,078,962 | 17,477,462 | -219,434 | 267,226 | 5.9% | $79.25 |

Note: Absorption is the net change in occupied space over a period of time. Data may not match totals in some NKF metro reports due to different local methodologies. Asking rents are quoted on a full service basis.

## MARKET STATISTICS (CONTINUED FROM PREVIOUS PAGE)

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|---|---|---|---|---|---|---|
| **National** | **4,924,527,302** | **99,684,157** | **7,525,934** | **29,677,909** | **12.8%** | **$29.29** |
| Memphis | 33,587,385 | 0 | 345,781 | 155,054 | 13.3% | $18.43 |
| Miami | 48,445,984 | 1,531,287 | -130,783 | 35,448 | 11.9% | $36.48 |
| Milwaukee | 35,868,137 | 991,082 | 177,468 | 545,856 | 16.3% | $20.87 |
| Minneapolis | 119,279,595 | 1,413,791 | 260,131 | 939,675 | 10.9% | $28.50 |
| Nashville | 54,198,007 | 2,555,000 | 87,803 | 286,164 | 7.2% | $27.42 |
| New Jersey Northern | 166,602,602 | 550,200 | 266,593 | 1,170,373 | 17.5% | $29.65 |
| New Jersey Southern | 16,703,617 | 0 | 236,253 | 259,271 | 16.3% | $20.71 |
| Oakland/East Bay* | 75,622,601 | 948,167 | -60,451 | 722,016 | 11.1% | $38.99 |
| Oklahoma City | 15,054,208 | 207,000 | -79,521 | -235,106 | 24.7% | $19.94 |
| Orange County, CA | 95,753,258 | 450,824 | 114,241 | 620,497 | 12.5% | $32.64 |
| Orlando | 68,962,301 | 242,000 | 32,676 | 248,340 | 6.0% | $22.84 |
| Palm Beach | 25,547,649 | 411,972 | 28,037 | 28,356 | 11.4% | $33.79 |
| Philadelphia | 109,184,026 | 778,000 | 258,996 | 245,729 | 13.6% | $29.58 |
| Phoenix | 90,559,249 | 2,138,312 | 242,451 | 3,122,075 | 14.6% | $26.58 |
| Pittsburgh | 54,947,985 | 1,059,200 | 190,435 | 415,749 | 16.3% | $23.96 |
| Portland | 60,761,855 | 987,488 | 352,591 | 506,382 | 10.2% | $30.17 |
| Raleigh/Durham* | 52,522,206 | 1,726,276 | 36,422 | 1,478,996 | 10.1% | $25.61 |
| Sacramento* | 69,652,540 | 643,000 | 197,968 | 621,605 | 10.8% | $23.64 |
| Salt Lake City | 65,111,770 | 4,372,325 | 79,746 | -98,099 | 7.4% | $21.29 |
| San Antonio | 45,901,481 | 179,940 | 439,387 | 310,742 | 13.2% | $22.90 |
| San Diego | 71,604,556 | 990,479 | -84,584 | 472,900 | 12.3% | $35.15 |
| San Francisco* | 83,342,071 | 3,255,000 | 1,046,941 | 1,935,608 | 2.8% | $86.23 |
| Seattle | 124,525,486 | 6,894,764 | 1,210,759 | 2,952,630 | 7.7% | $39.43 |
| Silicon Valley* | 88,536,443 | 7,245,802 | 409,683 | 993,855 | 9.1% | $51.92 |
| St. Louis | 75,469,418 | 30,841 | -231,588 | -505,636 | 10.8% | $20.59 |
| Tampa/St. Petersburg | 64,159,095 | 550,000 | 49,582 | 148,559 | 9.1% | $24.75 |
| Washington, DC | 367,002,871 | 8,764,937 | 433,004 | 1,936,365 | 16.2% | $39.49 |
| Westchester County, NY | 27,145,634 | 0 | 22,562 | 121,105 | 16.4% | $26.79 |

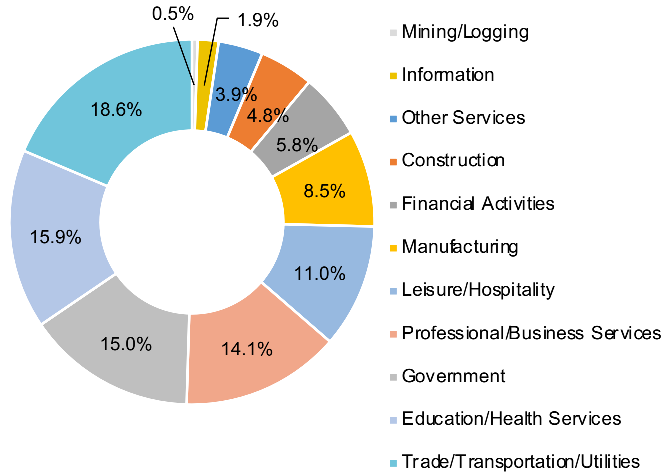
*Note: Data source has changed.
Note: Absorption is the net change in occupied space over a period of time. Data may not match totals in some NKF metro reports due to different local methodologies. Asking rents are quoted on a full service basis.

## ECONOMIC CONDITIONS

The U.S. economy grew at an annual rate of 2.0% during the second quarter of 2019, according to the Bureau of Economic Analysis' revised estimate, which was released in September 2019. The inflation rate was 2.4% (not seasonally adjusted) for the 12 months ending in September 2019. The unemployment rate declined 20 basis points from one year ago, reaching 3.5% in September 2019, reflecting an economy near full employment, though one in which job openings and the skills of available labor are not well aligned. Employers added 136,000 new jobs in September 2019, an acceleration from the 108,000 added in September 2018 but a deceleration from this year's earlier performance. Education and Health, Professional and Business Services, and Construction are among the notable growth sectors. Trade tensions with China and political volatility remain; however, two interest rate cuts during the third quarter and the potential for another this year may provide developers with the confidence to pursue projects late in the economic cycle. Though the chance of an economic downturn in the next 12 to 24 months is rising, a steadily low unemployment rate and ongoing job growth suggest further economic expansion is likely during the balance of 2019.

## EMPLOYMENT BY INDUSTRY

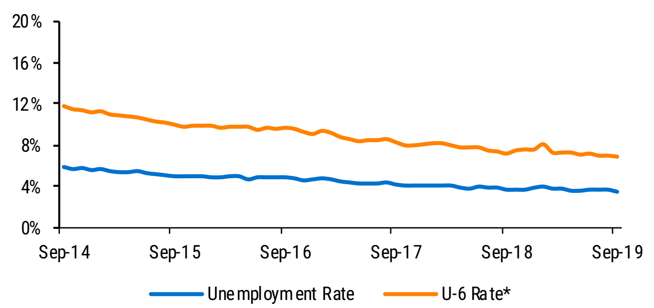
### United States, 2018 Annual Average




Source: U.S. Bureau of Labor Statistics, NKF Research; October 2019

## UNEMPLOYMENT RATE

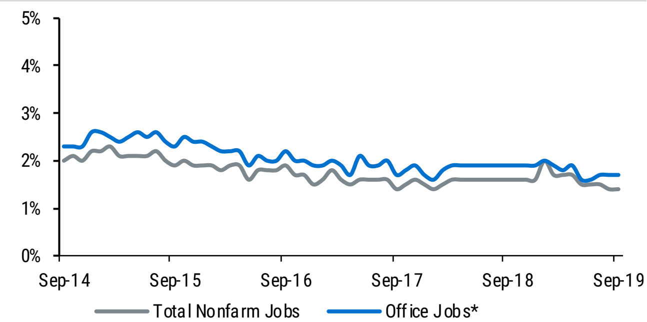
### United States, Seasonally Adjusted




* Includes total unemployed, marginally attached workers, and those working part time for economic reasons
Source: U.S. Bureau of Labor Statistics, NKF Research; October 2019

## PAYROLL EMPLOYMENT

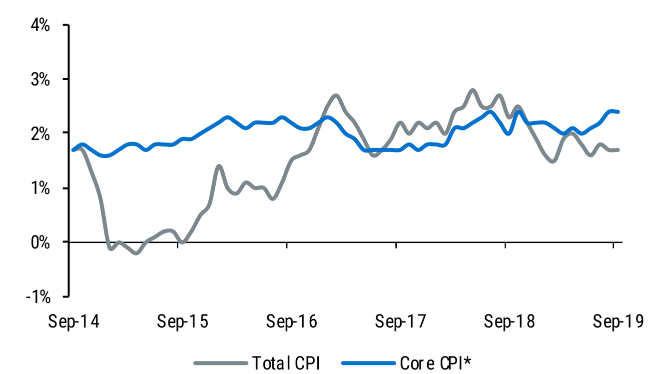
### United States, 12-Month % Change , Not Seasonally Adjusted




* Includes Professional and Business Services, Information, Financial Activities, Other Services and Government
Source: U.S. Bureau of Labor Statistics, NKF Research; October 2019

## CONSUMER PRICE INDEX (CPI)

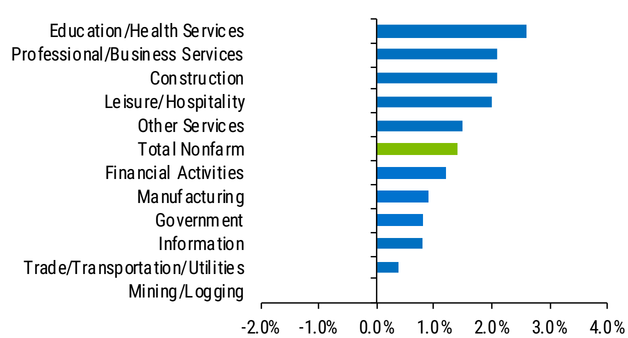
### United States, 12-Month % Change, Seasonally Adjusted




*Excludes food and energy, which can be volatile; 1982-84=100
Source: U.S. Bureau of Labor Statistics, NKF Research; October 2019

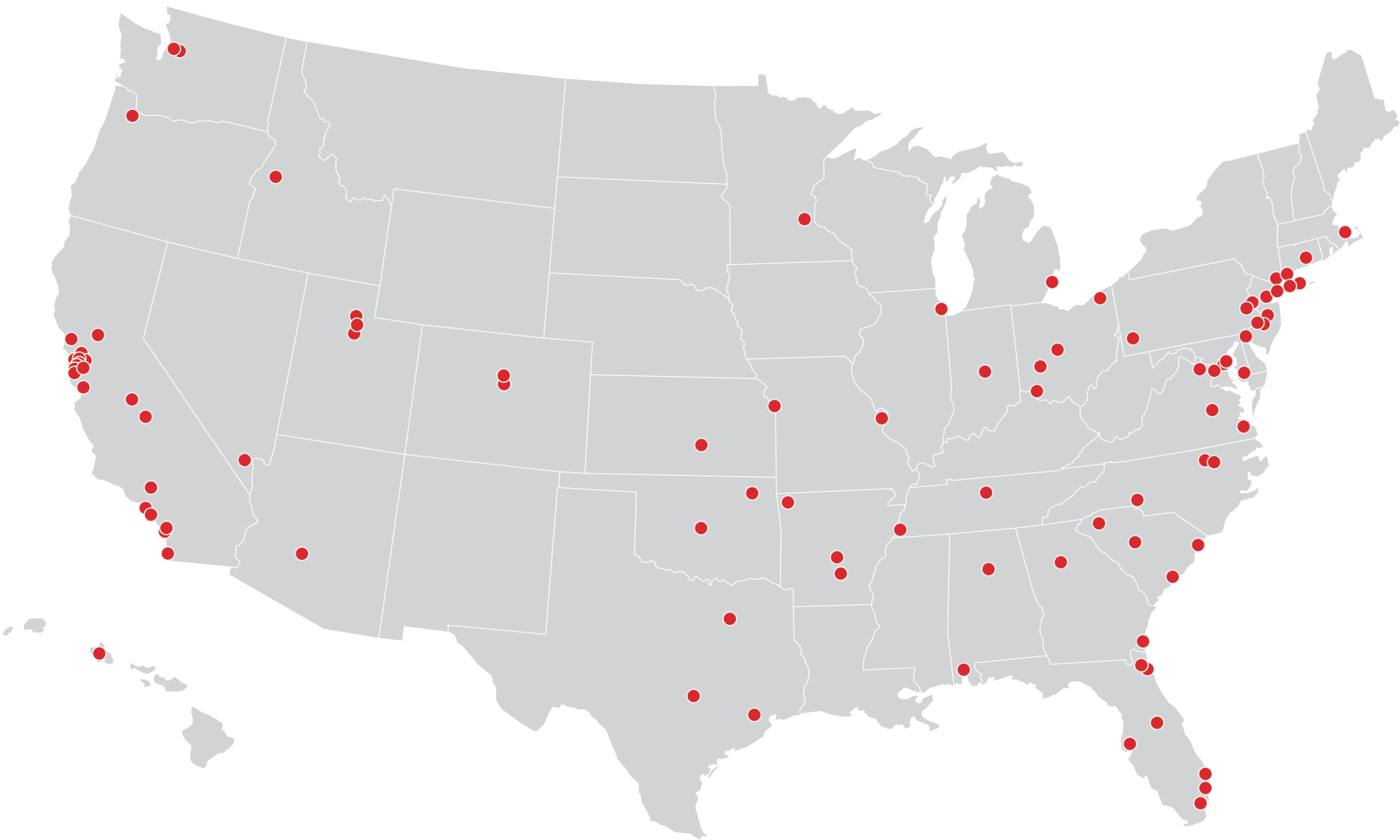
## EMPLOYMENT GROWTH BY INDUSTRY

### U.S., September 2019, 12-Month % Change, Not Seas. Adj.




Source: U.S. Bureau of Labor Statistics, NKF Research; October 2019

## NEWMARK KNIGHT FRANK UNITED STATES OFFICE LOCATIONS



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Newmark Knight Frank has implemented a proprietary database and our tracking methodology has been revised. With this expansion and refinement in our data, there may be adjustments in historical statistics including availability, asking rents, absorption and effective rents. Newmark Knight Frank Research Reports are available at www.ngkf.com/research