



NATIONAL 1Q17 OFFICE MARKET

WAITING FOR ANIMAL SPIRITS

The animal spirits¹ visible in the stock market after President Trump's election have not yet shown up in the office market, which recorded a second consecutive quarter of subdued absorption. Other indicators were more bullish, however.

Demand Recedes

Tenants absorbed 4.3 million square feet in the first quarter, down from 6.2 million square feet in the fourth quarter of 2016 and well below the quarterly average of 12.5 million square feet over the previous five years. Not since the first half of 2011 has the market posted two consecutive quarters of absorption below 10 million square feet.

The absorption leaders and laggards did not follow the usual patterns in the first quarter. Washington, DC, which has been struggling with the government budget sequester and related cutbacks among private sector tenants, led all markets with 1.1 million square feet, already matching its total for all of 2016. Phoenix, Dallas, Detroit and Las Vegas rounded out the top five markets. Of that group, only Dallas has been a perennial market leader. Phoenix, Detroit and Las Vegas all suffered disproportionately during the recession but are now catching up.

ABSORPTION SOFTENS FOR TWO CONSECUTIVE QUARTERS

Nineteen of the 56 office markets tracked by NGKF recorded negative first-quarter absorption. Silicon Valley balanced out Washington, DC, on the downside by shedding 1.2 million square feet of occupancy, as technology tenants exercised caution. Following Silicon Valley were three New York area markets: Northern New Jersey, Manhattan and Fairfield County, Connecticut, all of which felt the effects of office densification and corporate restructuring. Houston, which continued to lose energy industry tenants, rounded out the bottom five.

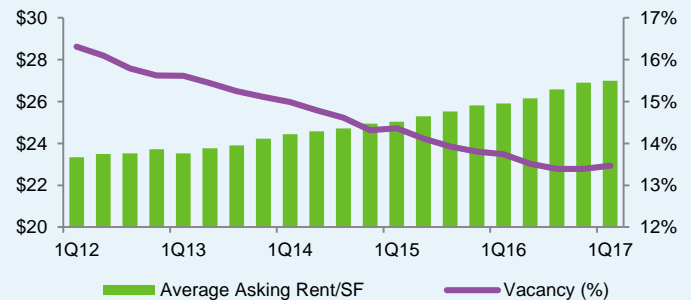
Firms engaged in professional and business services, including technology companies, signed slightly more than half of all first-quarter leases, while financial firms took 15%, with the remainder going to a wide range of other sectors. Twenty-First Century Fox/News Corp. signed the largest lease of the quarter, a renewal and expansion for 1.2 million square feet in Manhattan. Oracle, the Federal Communications Commission, Royal Bank of Canada and Outcome Health also signed large leases of between 400,000 and 600,000 square feet. The average term of all first-quarter deals was 4.7 years, with landlords giving 3.9 months of free rent.

Current Conditions

- Absorption started the year on a subdued note, registering its lowest quarterly total in four years.
- The construction pipeline dropped noticeably as lenders have turned more conservative.
- Vacancy ticked higher as completions outpaced absorption for a second consecutive quarter.
- Rents continued their steady march higher.

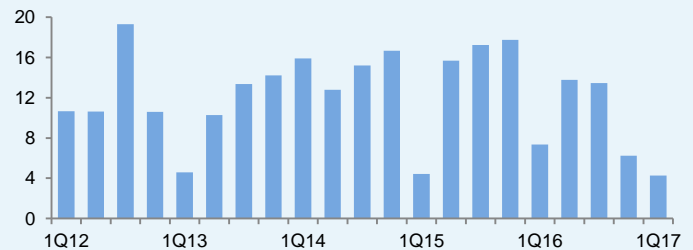
Market Analysis

Asking Rent and Vacancy



Net Absorption

Square Feet, Millions



Market Summary

	Current Quarter	Prior Quarter	Year Ago Quarter	12 Month Forecast
Vacancy Rate	13.5%	13.4%	13.7%	↔
Net Absorption*	4.3	6.2	7.3	↔
Average Asking Rent/SF	\$26.99	\$26.90	\$25.90	↑
Under Construction*	80.4	92.6	83.6	↔
Deliveries*	12.2	12.4	9.6	↔

* Square feet, millions

¹ A term coined by economist John Maynard Keynes in 1936, referring to the willingness of households and businesses to spend and invest.



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Construction Takes a Breather

Completions outpaced absorption for a second consecutive quarter, totaling 12.2 million square feet, which was on par with recent quarters. However, there was a noticeable drop in space under construction, which ended the quarter at 80.4 million square feet, down from 92.6 million square feet in the fourth quarter. It was the lowest level since the fourth quarter of 2015 and suggests that caution among construction lenders is having the effect desired by regulators.

LENDER CAUTION IS IMPACTING CONSTRUCTION STARTS

The number of markets where construction increased or decreased was balanced from the fourth quarter to the first quarter, with construction falling in 20 markets, rising in 21 markets and remaining stable in 15 markets. However, six markets saw construction drop by 1 million square feet or more, while no markets saw construction increase by that amount. The markets with the biggest declines in the construction pipeline were Denver, Dallas, Silicon Valley, Chicago, Phoenix and Houston.

Manhattan continued to lead all markets with 11.3 million square feet in the pipeline, followed by Silicon Valley, Washington, DC, San Francisco and Dallas rounding out the top five. A number of high-visibility projects are underway across the U.S., including Apple’s futuristic headquarters in Cupertino, California (opening in April); Salesforce Tower in downtown San Francisco; the expansion of Amazon’s downtown Seattle campus; several corporate campuses in suburban Dallas; and several towers and boutique buildings in Manhattan.

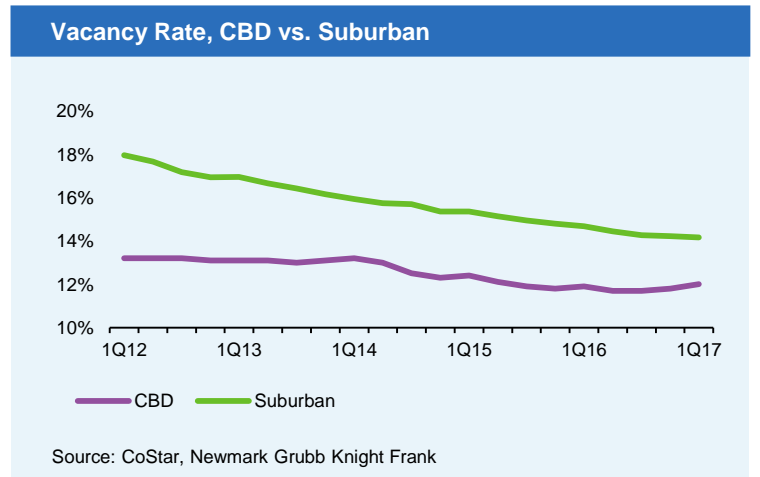
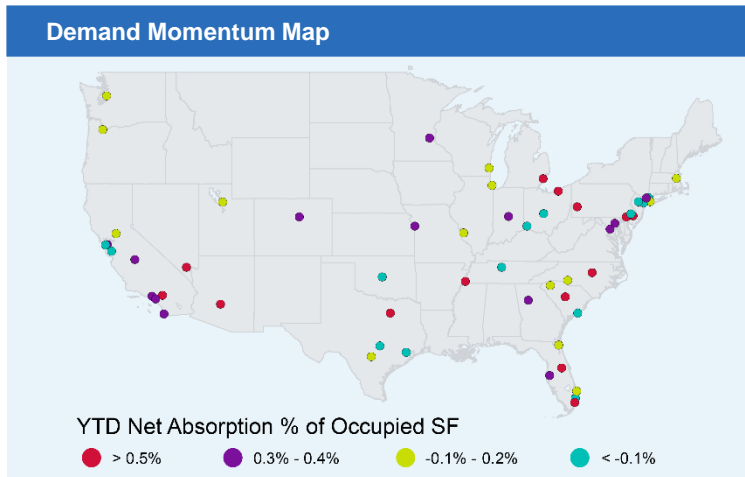
Vacancy Ticks Higher

With absorption trailing completions for a second consecutive quarter, the vacancy rate moved up by 10 basis points to end the first quarter at 13.5%. Thirteen markets recorded single-digit vacancies, led by San Francisco at 6.2%, while Northern New Jersey posted the nation’s highest vacancy rate at 22.5%, followed by three other markets with 20%-plus rates: Oklahoma City, Houston and Phoenix. A recent [NGKF white paper](#) explores how property owners in Northern New Jersey have turned to the wrecking ball as a solution to the market’s surplus of space.

The 10-basis-point increase in the first-quarter vacancy rate does not necessarily mark the beginning of a steady increase. There has been little movement in vacancy over the past four quarters, suggesting the market has been near equilibrium for some time. Moreover, vacancy increased by 10 basis points in the first quarter of 2015 before reeling off seven consecutive quarterly declines. Absorption may be past its peak, but construction starts may also have peaked. Moreover, office jobs (the sectors of information, finance, and professional and business services) continue to grow robustly, and measures of business confidence are improving. Thus, general overbuilding is not yet a concern.

VACANCY INCREASE MOST LIKELY A BLIP, NOT A TREND

Another hopeful sign is the sublease market. The first quarter ended with 96.9 million square feet of available sublease space, equal to 2.0% of the total office inventory. This is up from the cyclical low of 82.1 million square feet, or 1.7% of inventory, in the second quarter of 2014, but it has been level for the past three quarters and remains low relative to the 2.6% peak during the financial crisis and the 5.4% peak after the dot-com bust. Houston has the largest supply of available sublease space on both an absolute and percent-of-inventory basis, at 11.1 million square feet and 5.4%.





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Central business district (CBD) markets remain tighter than their suburban counterparts, as they have for several decades, but the gap has narrowed substantially since the end of the recession. CBD and suburban vacancies ended the first quarter at 12.0% and 14.2%, respectively, a gap of 2.2 percentage points, down from a peak of 5.7 points in the fourth quarter of 2009 shortly after the recession. The trend reflects the delayed recovery in the suburbs, which suffered disproportionately from the housing crisis.

Rents Continue to Rise

The uptick in the vacancy rate combined with the deceleration in absorption may have carried over into rent growth. The average asking rent across the U.S. ended the quarter at \$26.99/SF gross, up a paltry 0.3% from the fourth quarter. Year-over-year growth showed no falloff, however, registering a solid 4.2%. Silicon Valley and Charleston, South Carolina, were the only markets showing double-digit rent gains over the past four quarters, while eight markets posted declines, led by Houston's drop of 3.3%. Houston property owners are offering significant concessions, pushing effective rents 20% to 25% below asking rents on larger leases.

MARKET BALANCED; MORE GROWTH AHEAD

The Outlook

The optimism in the business community following Donald Trump's election victory has faded somewhat with the realization that his pro-business agenda will take time to implement, likely pushing benefits into 2018 and 2019. Nevertheless, employment growth remains strong, with the first quarter of the year averaging 178,000 new jobs, on par with last year's monthly average of 187,000. If the labor market can sustain this level of hiring, it will support leasing activity and absorption as the year progresses. On the supply side, tighter lending standards appear to be keeping new supply in line with demand, lifting rents at a moderate pace in the low single-digits. Several markets are seeing bumps in construction, but others are seeing a thinning in their construction pipelines, as deliveries outpace starts. The overall balance between supply and demand suggests the market still has room to expand.

Select Leasing Transactions

Tenant	Market	Building	Type	Square Feet
21st Century Fox/News Corp	New York, NY	1211 Avenue of the Americas	Renewal/Expansion	1,224,000
Oracle	Austin, TX	2300 Cloud Way	Direct New	550,750
Federal Communications Commission	Washington, DC	45 L Street NE	Direct New	473,000
Royal Bank of Canada	New York, NY	200 Vesey Street	Direct Renewal	402,000
Outcome Health	Chicago, IL	515 N State Street	Direct New	400,000

Select Sales Transactions

Building	Market	Sale Price	Price/SF	Square Feet
Vertex Pharmaceuticals HQ	Boston, MA	\$1,200,000,000	\$1,058	1,133,723
Deutsche Bank HQ	New York, NY	\$1,040,000,000	\$645	1,612,000
10 Saint James	Boston, MA	\$673,000,000	\$816	824,772
Waterview Office Tower	Arlington, VA	\$460,000,000	\$726	633,908
Fan Pier	Boston, MA	\$447,000,000	\$868	515,000


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Market Statistics

Market	Inventory SF	SF Under Construction	SF Absorbed This Quarter*	SF Absorbed YTD*	% Vacant	Average Asking Rent/SF
Atlanta	143,875,551	3,772,731	478,260	478,260	16.0%	\$24.13
Austin	58,066,071	1,009,693	-138,269	-138,269	10.2%	\$33.28
Baltimore	79,551,610	1,162,796	225,927	225,927	12.9%	\$22.75
Boston	182,886,863	2,250,906	104,786	104,786	11.8%	\$33.97
Broward County, FL	33,159,782	507,710	-54,534	-54,534	11.3%	\$26.19
Charleston, SC	28,267,258	620,359	-89,756	-89,756	7.1%	\$21.31
Charlotte	69,787,689	1,539,678	56,104	56,104	11.7%	\$23.98
Chicago	251,790,660	2,291,574	346,499	346,499	17.3%	\$27.46
Cincinnati	36,899,307	266,000	-283,375	-283,375	18.3%	\$19.25
Cleveland	36,131,398	47,000	275,957	275,957	16.5%	\$17.88
Columbia, SC	32,494,584	73,460	186,160	186,160	6.5%	\$15.79
Columbus	56,463,167	724,602	-91,178	-91,178	10.0%	\$18.14
Dallas	229,268,371	4,867,188	850,449	850,449	19.2%	\$24.48
Delaware	16,453,875	248,016	89,000	89,000	15.9%	\$24.62
Denver	94,418,807	2,114,699	190,196	190,196	14.5%	\$25.87
Detroit	74,406,664	91,220	697,310	697,310	16.5%	\$19.21
Fairfield County, CT	41,492,665	0	-680,510	-680,510	15.1%	\$38.08
Fresno	19,633,832	114,955	49,668	49,668	11.7%	\$19.32
Greenville, SC	38,520,371	91,913	-45,519	-45,519	8.2%	\$16.13
Houston	204,360,716	1,532,782	-667,377	-667,377	20.6%	\$27.92
Indianapolis	57,102,281	718,000	116,390	116,390	7.0%	\$16.15
Inland Empire, CA	31,211,134	0	224,948	224,948	11.8%	\$19.77
Jacksonville	31,796,249	0	-2,496	-2,496	13.3%	\$18.72
Kansas City	73,049,513	376,650	246,221	246,221	11.6%	\$19.03
Las Vegas	35,259,671	207,151	558,837	558,837	16.8%	\$20.74
Long Island	55,300,301	353,199	-49,030	-49,030	9.8%	\$26.09
Los Angeles	194,116,892	1,719,668	363,795	363,795	14.0%	\$37.83
Manhattan	441,860,601	11,317,439	-697,540	-697,540	8.1%	\$76.50
Memphis	34,400,148	150,571	551,371	551,371	13.8%	\$16.79
Miami	47,328,450	941,247	203,974	203,974	12.2%	\$34.93
Milwaukee	46,361,313	22,000	11,279	11,279	10.4%	\$16.94
Minneapolis	130,456,848	187,200	425,866	425,866	9.0%	\$19.63
Nashville	50,999,605	1,623,749	-454,661	-454,661	6.9%	\$26.34
New Jersey Northern	168,950,167	859,000	-836,398	-836,398	22.5%	\$27.95
New Jersey Southern	16,682,660	472,376	65,036	65,036	15.0%	\$20.97
Oakland/East Bay	73,051,519	0	135,071	135,071	9.8%	\$32.65
Oklahoma City	13,772,307	692,520	-376,843	-376,843	22.2%	\$18.41
Orange County, CA	91,791,413	1,216,020	268,958	268,958	10.5%	\$30.39
Orlando	68,434,254	269,000	467,290	467,290	7.9%	\$20.62
Palm Beach	25,848,196	0	-6,916	-6,916	15.5%	\$29.97
Philadelphia	108,051,978	2,865,324	-464,424	-464,424	14.5%	\$27.18
Phoenix	87,086,613	735,063	919,222	919,222	20.1%	\$24.58
Pittsburgh	54,286,921	233,000	252,533	252,533	16.5%	\$22.95
Portland	57,713,542	1,200,155	28,740	28,740	10.5%	\$25.91
Raleigh/Durham	59,490,827	1,754,766	526,996	526,996	8.0%	\$22.29
Sacramento	68,839,484	126,650	83,448	83,448	15.5%	\$21.72
Salt Lake City	38,536,595	1,552,833	41,805	41,805	7.2%	\$23.61
San Antonio	44,198,627	1,086,023	46,097	46,097	12.7%	\$21.07
San Diego	70,421,924	338,966	109,920	109,920	13.4%	\$32.09
San Francisco	78,962,807	6,161,185	-244,592	-244,592	6.2%	\$70.66
Seattle	124,948,444	2,628,907	-15,148	-15,148	10.3%	\$31.73
Silicon Valley	81,074,077	8,937,623	-1,165,993	-1,165,993	11.6%	\$51.36
St. Louis	74,975,698	845,000	75,418	75,418	11.2%	\$18.76
Tampa/St. Petersburg	64,178,280	0	214,887	214,887	10.9%	\$22.60
Washington, DC	362,998,173	7,526,560	1,073,884	1,073,884	16.1%	\$36.89
Westchester County, NY	27,670,122	0	76,524	76,524	16.6%	\$26.91
National	4,819,136,875	80,445,127	4,274,267	4,274,267	13.5%	\$26.99

* Absorption is the net change in occupied space over a period of time. These numbers may not match totals in some NGKF metro reports due to different local methodologies.



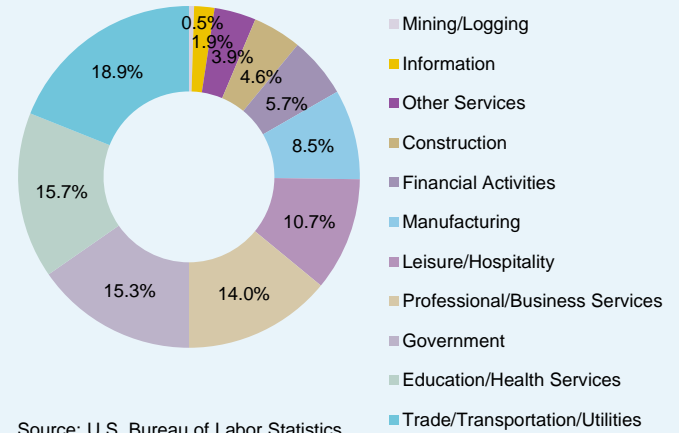
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ECONOMIC CONDITIONS

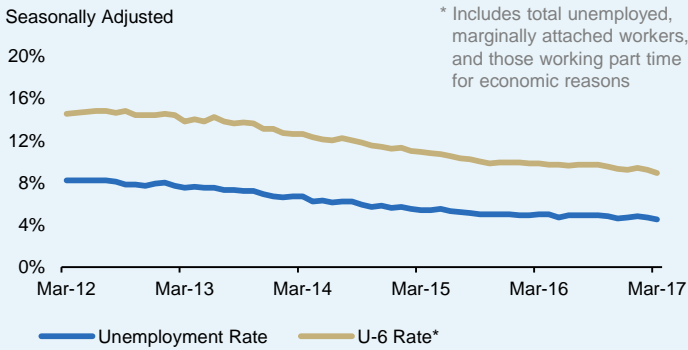
The economy is believed to have grown at a seasonally adjusted annualized rate of 0.6% in the first quarter, according to the Federal Reserve Bank of Atlanta, down from 1.6% for all of 2016. Despite sluggish GDP growth, hiring has been brisk considering the expansion is well into its eighth year and the jobless rate, 4.5% in March, is near full employment. Employers added a monthly average of 178,000 new jobs in the first quarter, on par with last year's pace of 187,000. Fed officials felt confident enough to raise short-term interest rates by a quarter point in March and have penciled in two more increases this year, though rates remain low by historic standards. The Trump administration has been slow to tackle key campaign promises that will lift the economy, specifically tax cuts and infrastructure, but consumer and business confidence remains high. The administration has backed away from the threat of trade restrictions, a relief for most businesses.

Employment By Industry

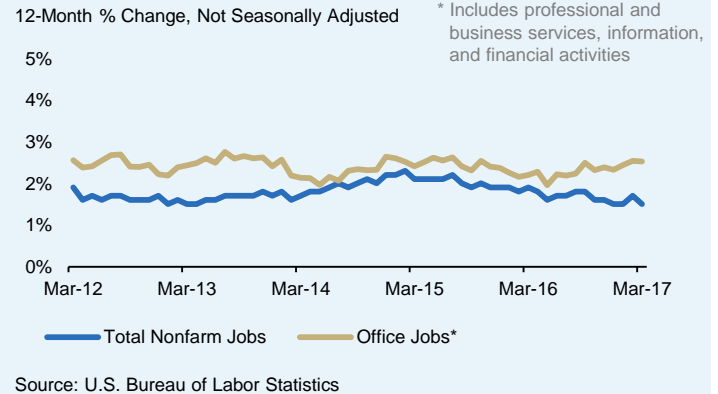
United States, 2016 Annual Average



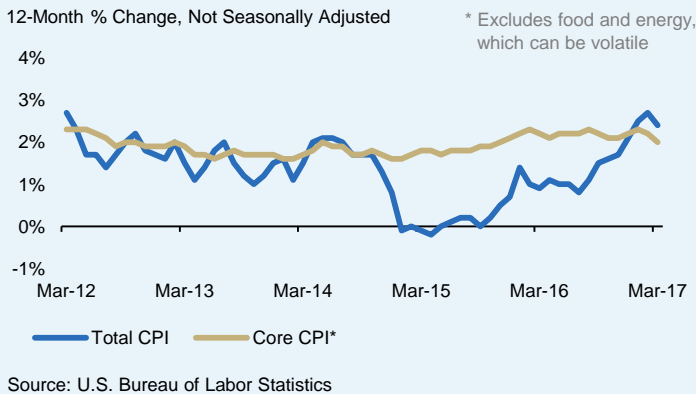
Unemployment Rate



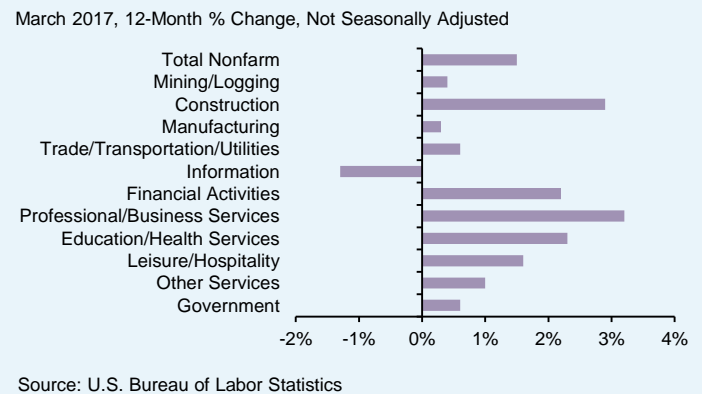
Payroll Employment



Consumer Price Index (CPI)



Employment Growth by Industry





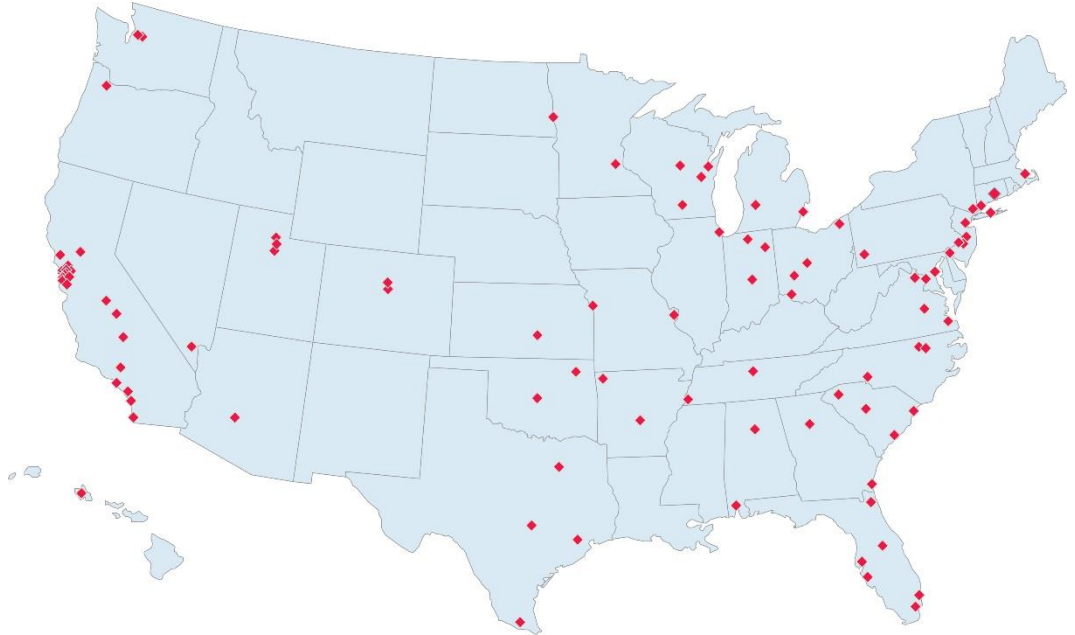
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Newmark Grubb Knight Frank United States Office Locations



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