Office Perspective: The NERDS

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Uncovering the next hotspot

We're often asked by clients and industry insiders where they should be looking to tap into that next hotspot, that next hidden gem that hasn't yet registered on the national commercial real estate scene. With the secret out on markets like Austin and Portland, which have become uber-popular with corporates and investors recently as Millennials and fast-growing tech companies arrive in droves, do any other markets exist today with the right mix of value, appeal, and growth potential?

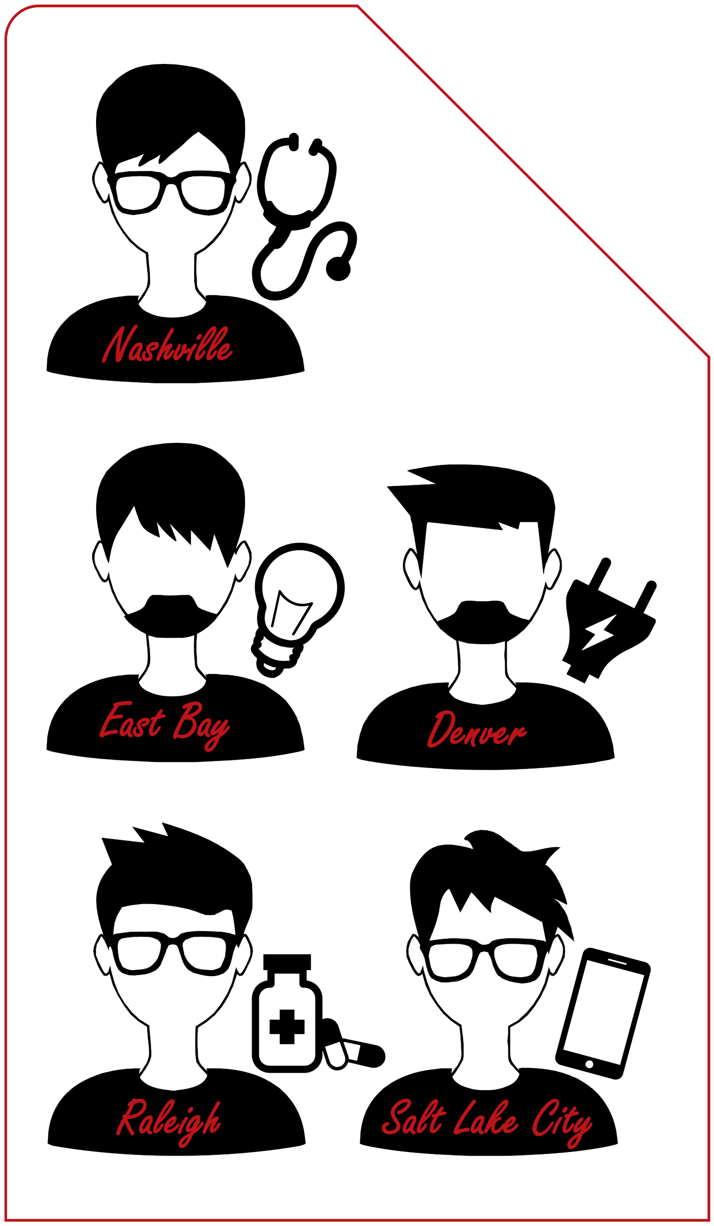
To find these elusive markets we went on the hunt for markets with rents and vacancy levels below the national average, absorption rates above the national average, and employment and demographic movements growing or forecast to grow at 1.5 to 2.0 times the rate of the US. Also, we were striving to find locations where there is a significant availability of millennial talent, a cluster of universities, and a higher combined tech, education, healthcare, and energy component than most other markets in the US.

Enter the NERDS!

Nashville, ***E***ast Bay, ***R***aleigh-Durham, ***D***enver, and ***S***alt Lake City have always been appealing on a regional scale, but as the economy expands and larger metros either over-heat or tap out from a talent perspective, investors and occupiers alike are looking around the country and asking where they can go next, but still remain profitable and competitive—and cool.

If you want to know what's cool, just look at where the people are going. Offering things like affordable homes, affordable office space, and a high quality of life that makes you feel good about leaving the bright city lights, the NERDS are growing. Since 2010 these markets have grown by 5.1 percent, nearly double (1.8x) the national rate. And while headlines keep telling us that everyone wants to live in an urban area, a recent survey conducted by the Demand Institute reported that out of 1,000 respondents, 48.0 percent of Millennials actually prefer the suburbs for their next home.

And why not? The cost of living is, on average, 36.0 percent less than San Francisco, 41.0 percent less than Brooklyn, and even 16.0 percent less than Austin, with the big ticket item of housing as much as 75.0 percent lower in some cases.



Population growth is a great indicator, but where we're really seeing promise in the NERDS is in the generation of gross metropolitan product (GMP), which currently stands at $589 billion, having more than tripled since 1990 alone. Its 14.0 percent increase over the past three years is 2.7 times faster than its population growth.

So was it the chicken or was it the egg?

It's hard to say which came first, the talent or the jobs, but we do know that these markets have another thing going for them. They're embracing the innovation and scientific engine that's driving the economy. Over the past 12 months, employment in the professional and business services industry super-sector, which includes sectors like computer systems design, engineering, scientific research, and other scientific and technical services, added 41,000 new jobs in the NERDS markets, comprising 31.0 percent of NERDS job growth. Additionally, health & education and leisure & hospitality made up 15.0 and 14.0 percent, respectively, of all job growth over the past 12 months. So not only do people want to live and work here, they want to visit these places.

With corporate expansion by Goldman Sachs into Salt Lake City, a growing tech hub in the East Bay because of San Francisco's high prices, economic incentives for energy company relocations to Denver, Raleigh-Durham's long-standing reputation for research, and a healthy economy in Nashville, there's a lot of untapped potential still waiting to be realized.

Opportunity for investors ***and*** occupiers

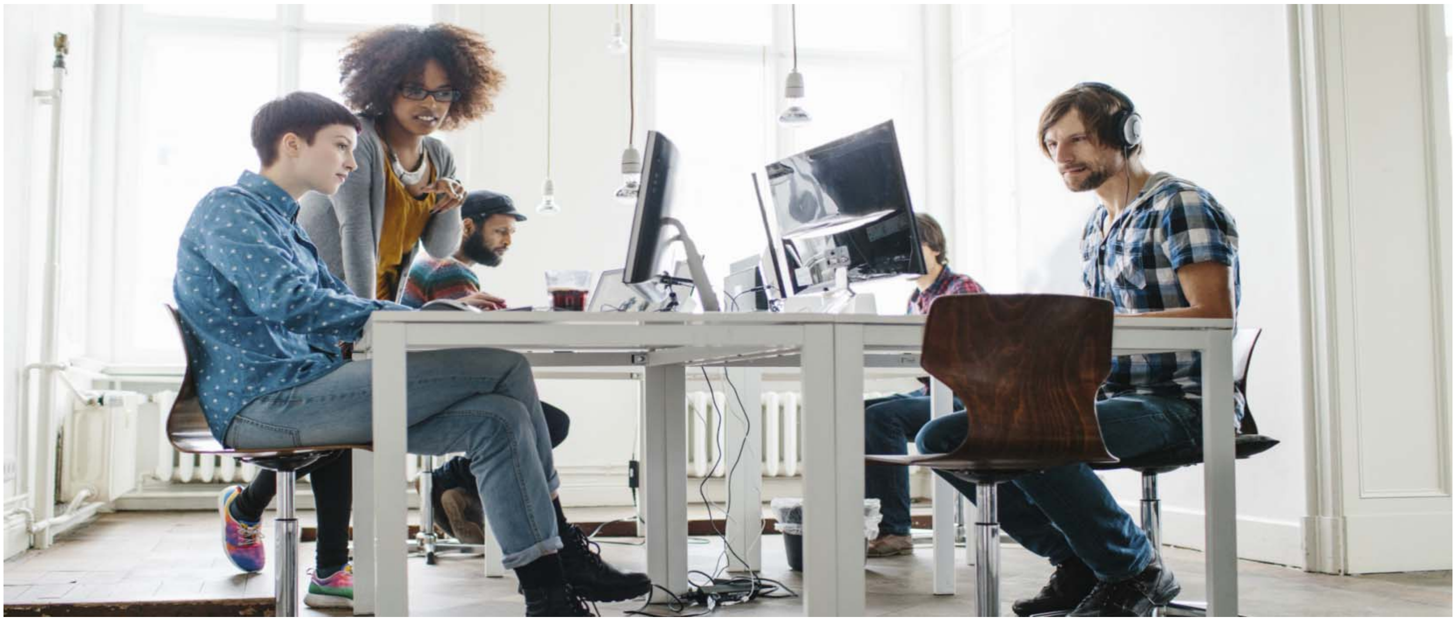
Within the NERDS, average direct asking rates are 21.1 percent lower than the U.S. average, and far below markets such as New York ($64.91 per square foot), San Francisco ($60.91 per square foot), Washington, DC ($51.20 per square foot) and Boston ($51.18 per square foot), corporate occupiers can grow into the NERDS markets for a fraction of the price. Not only that, but corporate occupiers thinking of relocating or opening satellite locations in the NERDS can enjoy a Class A rental rate that's on average 35.0 percent lower than the overall U.S.

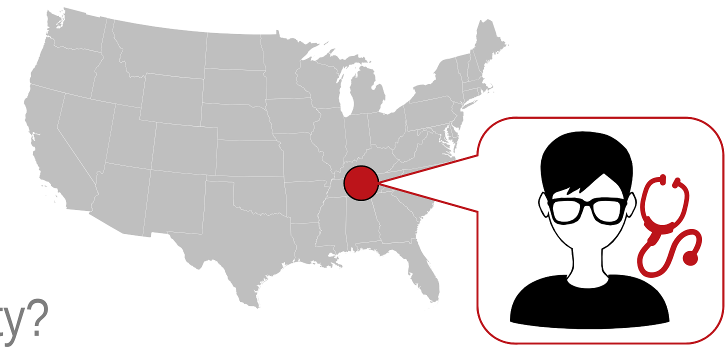
They can also look to schools like University of Colorado, Vanderbilt, Duke, University of California, Berkeley, and BYU for talent, some of which are among the top-ranked in the country.

For investors, the same is true. Pricing per square foot for Trophy buildings in these markets averages between $200 and $400 per square foot, whereas similar properties in gateway markets can fetch deals as high as $1,563 per square foot in New York and $1,100 per square foot in Washington, DC. It's also easier to buy into these markets since there's less competition, which keeps prices low.

Cap rates are also looking better for investors in these markets. Forget San Francisco these days, with cap rates between 3.0 and 5.0 percent at an average of $750 per square foot. The NERDS are offering a higher return in general with cap rates conservatively ranging anywhere from 5.5 to 7.5 percent. With new supply and renovation activity taking place in all by the East Bay, there's opportunity for both core plus acquisitions as well as value-add.

But let's face it: value alone does not a market make. What's happening in these markets is driven as much by their value and industry growth as it is by the amenities and lifestyle they have to offer. Portland didn't rise to fame because it was run-of-the-mill—it's got too many micro-breweries for that—and no one's complaining about a lack of artisan food trucks and live music in Austin.





Nashville

Music City…or the Eds-and-Meds City?

Famed as the epicenter of country music, Nashville is an emerging, high-growth market and a hub for education, healthcare/healthcare-related technology and leisure, with a rapidly-increasing professional services contingent. The metro area's low cost of living, labor and doing business all contribute to its above-average rate of job growth, which was 1.6x faster than the national average last year, and lend to its attractiveness for corporate expansion and relocation. Additionally, both Millennials and families find below-average housing and transportation costs advantageous.

The metro area's output, like job growth, is also on the up. Currently standing at $100.8 billion, gross metropolitan product has doubled since 1999 alone. Output is not solely from the office-using sectors: manufacturing contributes $10.7 billion to the metro economy and is up 23.1 percent compared to 2010. Other high-growth segments include education and healthcare ($15.0 billion) and finance ($20.5 billion).

Education and health is also a major source of employment, with 130,100 metro-wide workers, or 15.5 percent of jobs. Even other segments of the economy such as leisure and hospitality are up 11.5 percent compared to 2011 levels. As a result of this rapid rate of growth, unemployment has fallen by 110 basis points to 5.3 percent.

A concentration of highly regarded universities, in particular Vanderbilt, keep Nashville's talent pool disproportionately strong compared to its 1.8-million-person size. Whereas many graduates would have moved to larger metro areas for jobs in previous cycles, the high barriers to entry such as cost of living as well as the increasing pool of employers in the Nashville metro area have kept skilled employees in the region, contributing even more to its economy and longer-term growth.

For occupiers: Asking rents, despite rising by 6.1 percent over the past year, still rest at $21.37 per square foot, a nearly 30.0 percent discount compared to the overall US average.

For investors: Nashville offers attractive discounted sales pricing (currently averaging in the low-$200s per square foot for core space) enabling owners access to a high-growth and in-demand secondary market.

Economy and demographics stats

Population	Education	Office employment	Living and income
1,757,912	32.3%	208,100	$398,470
Metro population (2013)	Bachelor's or higher	PBS + finance + info	Median home value
+5.2%	+380bp	24.7%	$51,996
Growth since 2010	vs. U.S. average	% of total employment	Median household income

Office stats

Inventory	Vacancy	Cost ($ p.s.f.)	Development
25,176,722	8.6%	$21.37	628,695
Overall inventory (s.f.)	Overall total vacancy rate	Overall asking rent	Under construction (s.f.)
12,842,106	3.7%	$24.94	46.5%
Class A inventory (s.f.)	Class A vacancy rate	Class A asking rent	Share in CBD

Strengths
- Low-cost market
- Strong job growth
- Class A rent growth of 8.9 percent year-on-year

Weaknesses
- Few space options
- Limited inventory
- Low construction-to-inventory ratio.

Opportunities
- Demand spurring construction
- Discount vs. top markets
- Non-cyclical anchors of education and health care

Threats
- Competition from other low-cost metros
- Increasing rents may reduce attractiveness

East Bay

Not the next Brooklyn—the next East Bay

Comprised of Alameda and Contra Costa counties and anchored by Oakland along the 580 Corridor and Walnut Creek in the suburbs, the East Bay market lies just across the Bay Bridge from San Francisco. The market made a name for itself during the housing boom when developers took advantage of its ample land and relied on the great weather, relatively affordable home prices, and pristine streets in the suburbs, to create a refuge for city workers looking for a quieter life within a short commute to the city.

However, as a local economy unto itself, the East Bay also offers plenty of employment opportunity within its own confines and is home to some of the biggest household brands in the country, namely Ross Stores, Clorox, Safeway, and Chevron. In addition to Fortune 500 headquarters, there's also a growing presence of technology companies locating in the East Bay, as tenants take advantage of the lower cost of real estate as well as employees.

With companies like Electronic Arts and Pixar in Emeryville, and Workday and Ellie Mae in Pleasanton, the East Bay is becoming a veritable location for new companies while remaining a smart option for long-standing occupiers like AAA and John Muir Health and AT&T.

What's most remarkable about the East Bay, though, is its ability to maintain a lower cost amid the frenzy of activity taking place in San Francisco and Silicon Valley. Despite the mere 10-mile geographical divide provided by the Bay, rents on average are nearly 54.0 percent less than in San Francisco and 30.0 percent less than in Silicon Valley, despite the fact that virtually no new supply has been added to the market during this cycle.

Although it's often believed to act as supply relief to San Francisco, that theory has never really become a reality until recently, but the market still maintains a quiet distance from its neighbors as well.

For occupiers: As San Francisco and Silicon Valley over-heat with tenant demand and face significant supply shortages, more and more companies are looking to the East Bay as a lower-cost option, as well as a new location to capture talent.

For investors: It's a hidden gem for investors. The market may be just miles from uber-hot San Francisco, but investors haven't yet turned their sights on the East Bay in a real way, so competition isn't as stiff.

Economy and demographics stats

Population	Education	Office employment	Living and income
2,673,096	39.9%	248,200	$474,400
Metro population (2013)	Bachelor's or higher	PBS + finance + info	Median home value
+4.4%	+1,140bp	23.4%	$74,852
Growth since 2010	vs. U.S. average	% of total employment	Median household income

Office stats

Inventory	Vacancy	Cost ($ p.s.f.)	Development
54,771,740	14.8%	$28.20	0
Overall inventory (s.f.)	Overall total vacancy rate	Overall asking rent	Under construction (s.f.)
21,326,289	14.8%	$32.76	0.0%
Class A inventory (s.f.)	Class A vacancy rate	Class A asking rent	Share in CBD

Strengths

- Conveniently located in proximity to San Francisco and Silicon Valley
- Lowest-cost option in Bay Area

Weaknesses

- Complete lack of new construction
- Low supply of large blocks reduces relocation opportunity

Opportunities

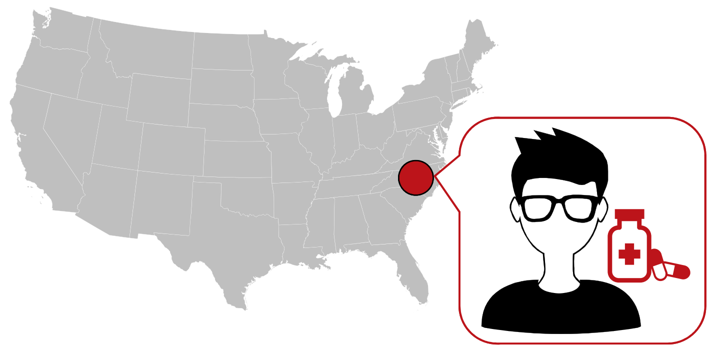
- Significantly lower construction costs than San Francisco
- Relocations from San Francisco due to cost

Threats

- Oakland's safety
- Must compete with San Francisco and Silicon Valley

Raleigh-Durham

The research love triangle



Home to Duke University, the University of North Carolina at Chapel Hill and North Carolina State University, Raleigh-Durham is an education and health powerhouse, with more 128,400 people employed in the sector. Besides being anchor employers, particularly in an anti-cyclical industry, these universities continue to keep the metro area fresh with new, educated students with degrees in a variety of fields. The Research Triangle Park (RTP), a pioneer in the concept of research parks, remains a focal point of the metro area's flourishing economy.

In previous decades, many of these graduates left for brighter pastures in major markets, but a surge in local hiring due to Raleigh-Durham's increasing attractiveness for corporations looking to relocate and expand has kept them active in the market. In turn, this demand is spurring growth across sectors, from professional services to tech to biomedical research.

Population growth of 7.0 percent since 2010, faster even than the Houston and Dallas, is placing pressure on the housing market, leading to a construction boom. Similarly, professional and business services jobs have increased by a whopping 30.4 percent since 2011. All of this means the need for more workplaces, pushing down office vacancy, increasing rents and spurring new construction.

For a metro area of only 1.7 million people, Raleigh-Durham's demographics are appealing: its college-educated population is double the national average and incomes are high due to the demand for skilled tech, science and research workers. Robust domestic migration and low occupancy costs will only increase the corporate and investor interest placed on the market. It's no surprise then that the Urban Land Institute named Raleigh-Durham one of its newly minted top-10 markets for investment on all three fronts: investment, development, and homebuilding.

For occupiers: Asking rents, despite rising by 5.4 percent over the past year (6.0 percent for Class A space), still rest at $20.87 per square foot, or 30.5 percent below the national average.

For investors: The low cost-per-square-foot that's buoyed by a growing economy is priming the market for increased values moving forward. It's East Coast location also put it in proximity to other major metros. Additionally, there's plenty of vacant, buildable land.

Economy and demographics stats

Population	Education	Office employment	Living and income
1,749,094	42.0%	218,800	$286,833
Metro population (2013)	Bachelor's or higher	PBS + finance + info	Median home value
+7.0%	+1,350bp	25.5%	$61,670
Growth since 2010	vs. U.S. average	% of total employment	Median household income

Office stats

Inventory	Vacancy	Cost ($ p.s.f.)	Development
43,867,120	12.8%	$20.87	1,450,048
Overall inventory (s.f.)	Overall total vacancy rate	Overall asking rent	Under construction (s.f.)
25,992,040	10.3%	$22.70	16.3%
Class A inventory (s.f.)	Class A vacancy rate	Class A asking rent	Share in CBD

Strengths

- Low-cost market
- Strong job growth
- Class A rent growth of 6.0 percent year-on-year

Weaknesses

- Limited "live, work, play"
- Lack of amenities in CBD
- Limited mixed-use walkable developments

Opportunities

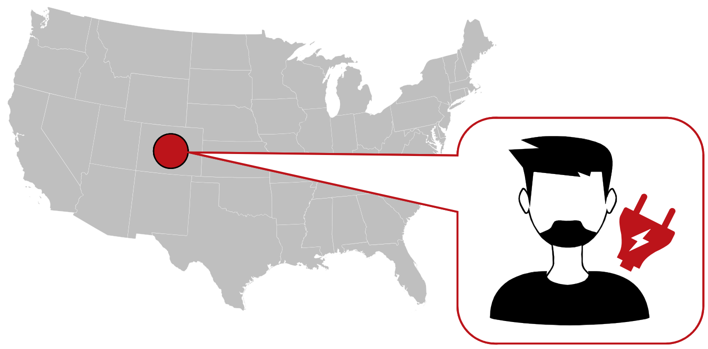
- Demand spurring construction
- Discount vs. top markets
- Anti-cyclical anchors of education and health care

Threats

- Competition from other low-cost metros
- Increasing rents may reduce attractiveness

Denver

The mile-high city



Where big city meets big mountains you'll find Denver. Long admired for its high-quality of life, low business costs, and access to the slopes, Denver is one of those places that sounds great both on and off of paper. Buoyed by a well-established energy industry and anchored by life sciences, aerospace, and technology, Denver is a leading Mountain State market that's embracing an innovation economy and seeking new ways in which it can perpetuate that growth.

The region currently ranks in the top 20 largest US metro areas. Population growth is forecast to keep pace with past trends. By 2017, population is expected to grow by 19.0 percent and will total nearly 3.5 million. Additionally, net domestic migration since 2011 has totaled 70,700 new residents, by far the highest of the NERDS. A well-educated and diverse work force, covering traditional industries like finance, continues to evolve into emerging industries in technology and health care. An excellent university system provides Denver an ample supply of new graduates across all areas of study.

Located in close proximity to equally appealing Boulder and within driving distance to some of the world's best skiing, Denver is not just a winter locale but offers a year-round lifestyle that's made the area an appealing place to live, and offers corporates a significant talent pool to choose from as a result.

In addition to lifestyle, Denver is investing significant resources into enhancing its infrastructure, including the continued development of commuter and light rail. Newly renovated Union Station, located in LoDo, has become a central hub for companies and employees and rightly so. Starting in 2016 it will service stops on more than 70 miles of commuter and light rail and provide incentives to attract new companies to the market. Additionally, Colorado is also offering incentives for corporate relocations and expansion, touting tax credits as one way in which corporate occupiers can benefit. As the economy and market continue to expand and improve, Denver's prospects continue to increase.

For occupiers: With nearly 15 million square feet of vacancy and more than 1.5 million square feet currently under construction, the office market is still ripe with opportunity for tenants relocating or expanding in the market.

For investors: A business-friendly environment with low barriers to entry as well as pricing ranging from $250 to $400 per square foot for core investment office product is driving investors to park capital in Denver.

Economy and demographics stats

Population	Education	Office employment	Living and income
2,697,476	38.7%	384,100	$246,900
Metro population (2013)	Bachelor's or higher	PBS + finance + info	Median home value
+6.1%	+1,020bp	28.5%	$61,453
Growth since 2010	vs. U.S. average	% of total employment	Median household income

Office stats

Inventory	Vacancy	Cost ($ p.s.f.)	Development
104,582,046	14.1%	$24.15	1,539,784
Overall inventory (s.f.)	Overall total vacancy rate	Overall asking rent	Under construction (s.f.)
50,574,346	13.0%	$28.82	38.2%
Class A inventory (s.f.)	Class A vacancy rate	Class A asking rent	Share in CBD

Strengths

- Business-friendly state
- Low cost of real estate for both lease- and buy-side
- Great quality of life

Weaknesses

- Reputation as a center for business and commerce still growing
- Far from other major hubs

Opportunities

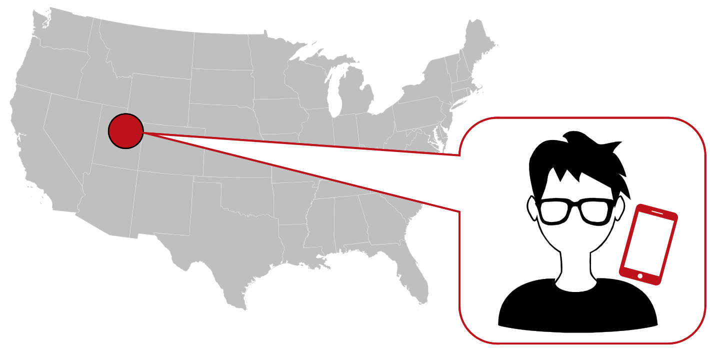
- Infrastructure/transportation increase accessibility
- Corporate relocations to Denver boost growth

Threats

- Instability of energy industry
- Significant amount of spending comes from GSA/Federal government

Salt Lake City

You can ski on the Silicon Slopes



Probably the least-known of the NERDS markets, Salt Lake City has emerged as a sort of best-kept-secret in recent years as its reputation as the “Silicon Slopes” intensifies as high-tech hubs like San Francisco and Silicon Valley begin to overheat. Taking advantage of the high quality of life and the low cost of real estate and business, high-tech companies have begun to cluster in the market in recent years as competition increased in more prominent hubs.

It’s not just high-tech that’s generating a buzz, however. Over the past 10 years, Goldman Sachs has been building its employment base in the city and currently employs nearly 2,000 people, having increased more rapidly following the last recession as corporate occupiers sought ways to cut costs from its two largest line items: payroll and real estate. Enticing employees with relocating to a lower cost market and a high quality of life has been a welcome departure from the hustle and bustle of life on Wall Street.

To entice even more business growth in the market, both Utah and Salt Lake City offer companies relocating to the city or locating in enterprise zones numerous tax breaks and benefits for actions such as job creation and building renovations.

The growing business sector, while a boon to the currently employed, has also generated new opportunity for new talent. As home to universities like BYU, Utah State, University of Utah and Weber State, growth in high-tech and finance is creating a two-way benefit: companies locating to the market have talent to hire and recent grads have increased job prospects upon graduation.

For occupiers: Nearly one million square feet of new construction will present tenants with new opportunity to grow, while still paying relatively low rental rates.

For investors: Above average employment growth is resulting in steady office occupancy that’s paired with low pricing. However, as a small market, opportunity is limited and faces competition with a locals-only ownership profile.

Economy and demographics stats

Population	Education	Office employment	Living and income
1,140,483	30.8%	185,800	$254,754
Metro population (2013)	Bachelor’s or higher	PBS + finance + info	Median home value
+4.8%	+230bp	27.0%	$61,520
Growth since 2010	vs. U.S. average	% of total employment	Median household income

Office stats

Inventory	Vacancy	Cost ($ p.s.f.)	Development
36,124,684	11.7%	$19.24	991,924
Overall inventory (s.f.)	Overall total vacancy rate	Overall asking rent	Under construction (s.f.)
13,903,846	10.7%	$23.24	60.0%
Class A inventory (s.f.)	Class A vacancy rate	Class A asking rent	Share in CBD

Strengths

- Low-cost market
- Strong job growth
- High quality of life

Weaknesses

- Small market and economy
- Lacks prominent businesses to promote continued growth

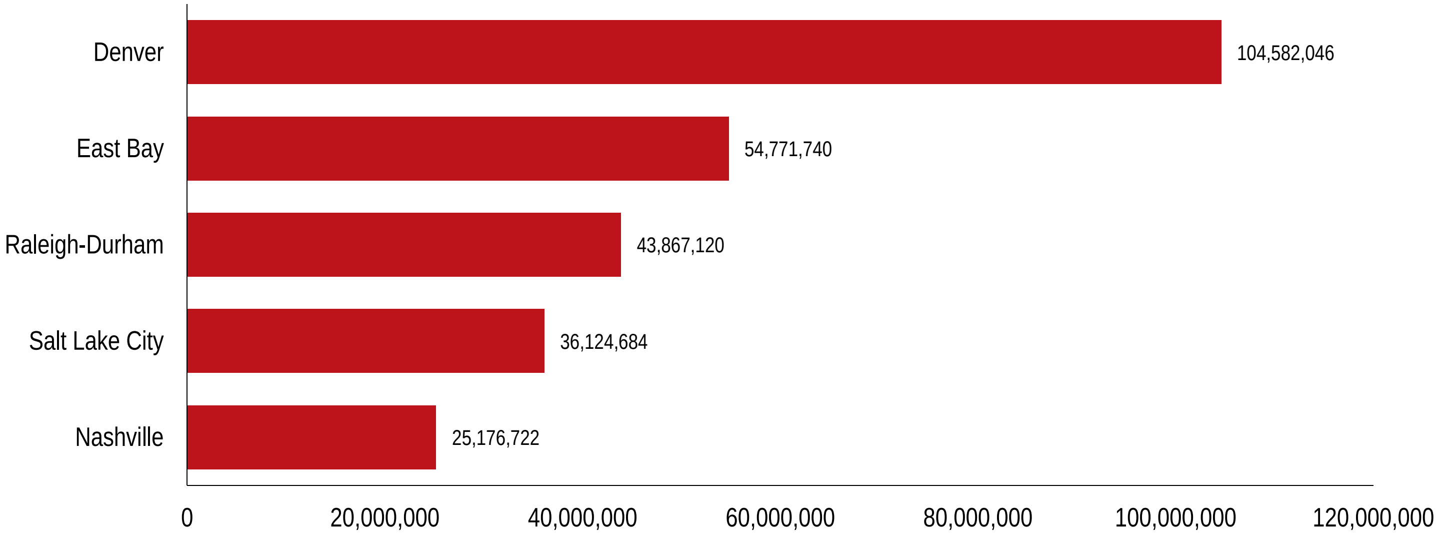
Opportunities

- Low barriers to entry make it easy to create new businesses or relocate existing operations

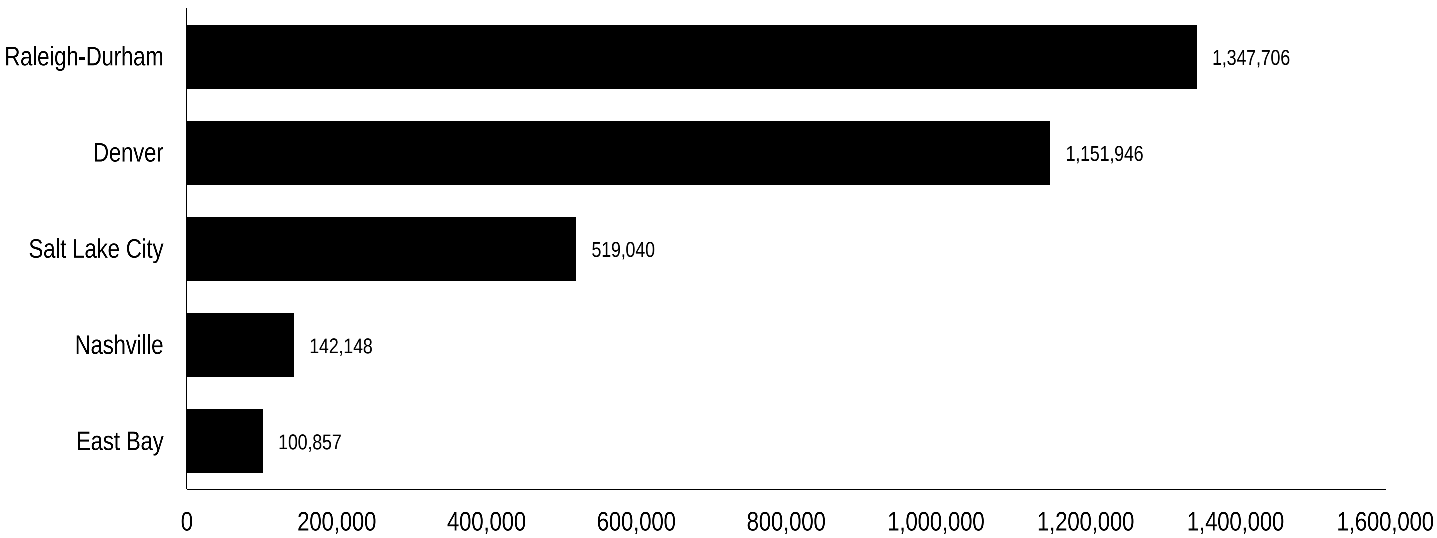
Threats

- Lack of visibility on the national stage could prevent capital flow and business growth

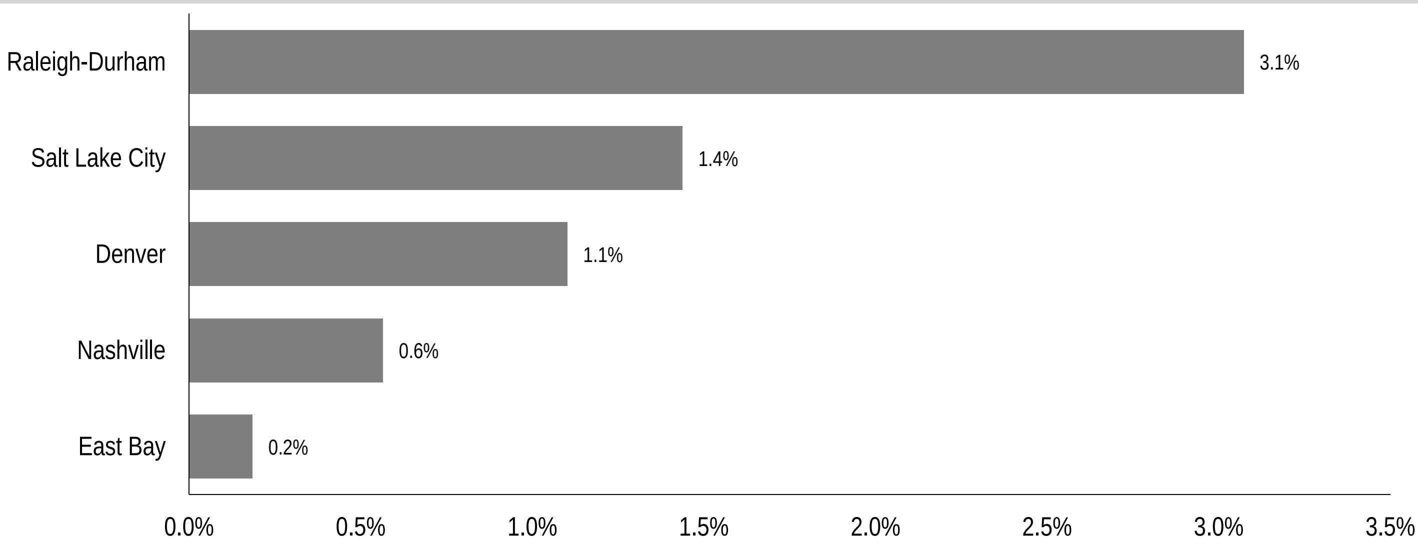
Inventory (s.f.)



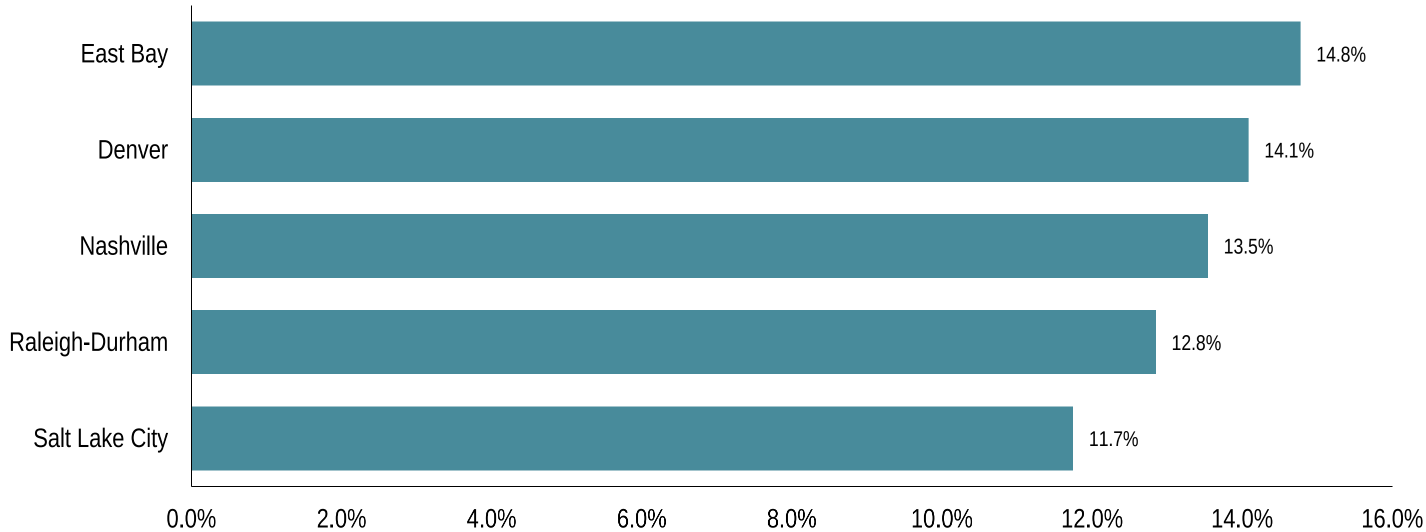
YTD net absorption (s.f.)



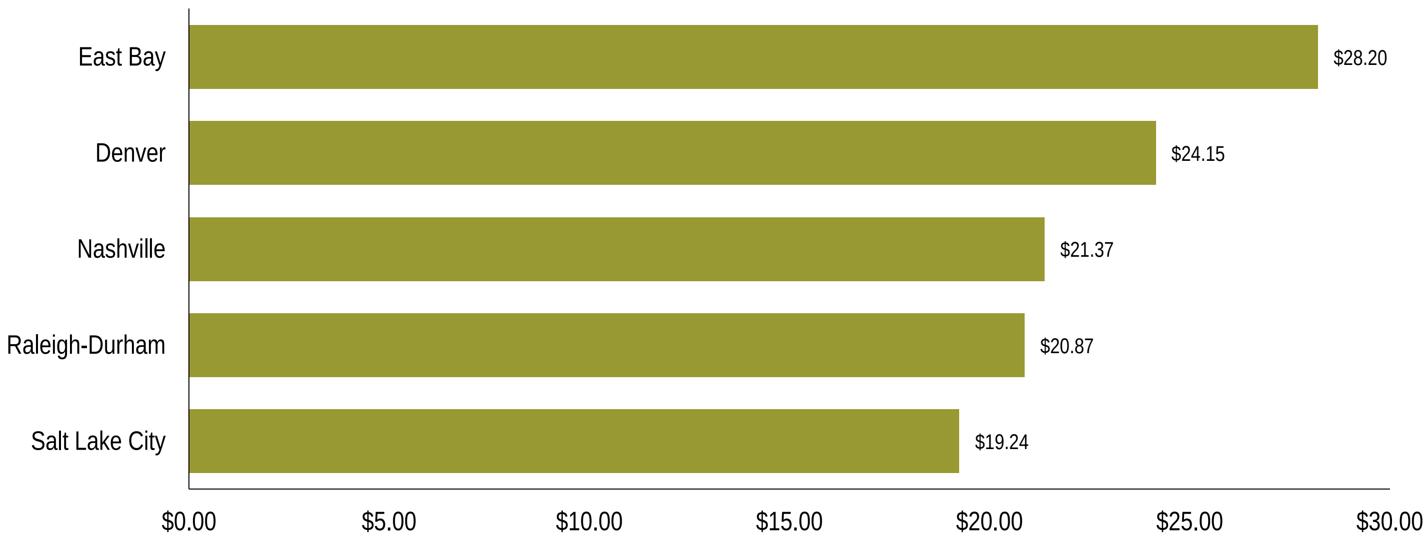
YTD net absorption (% of inventory)



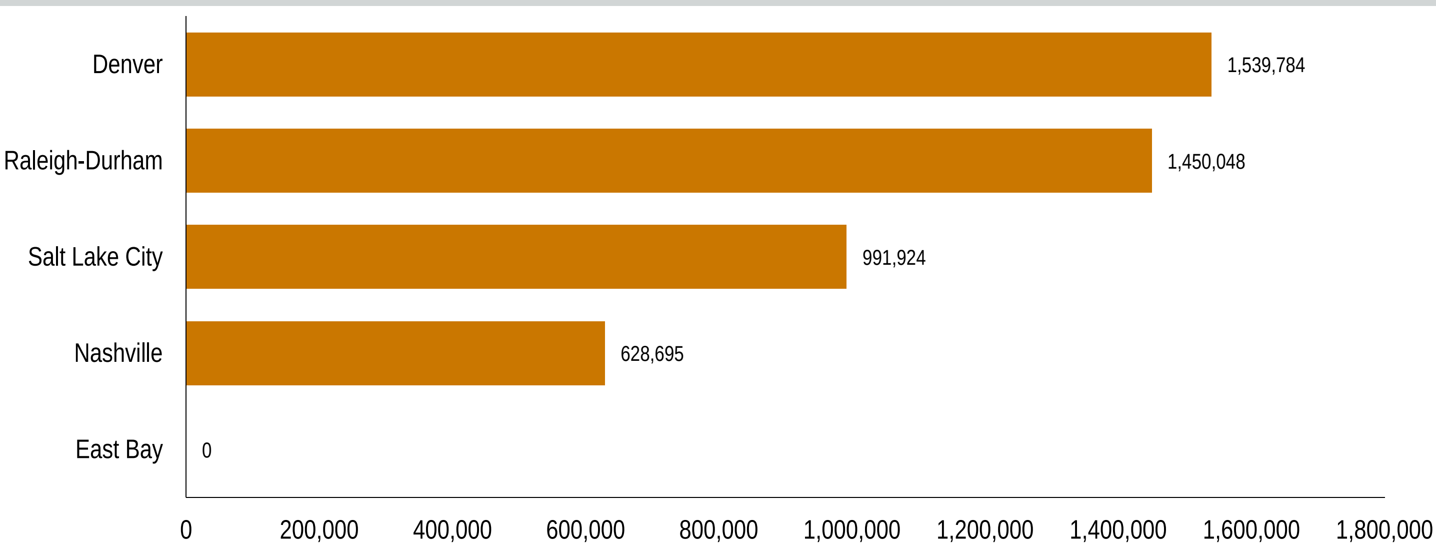
Total vacancy (%)



Average direct asking rent ($ p.s.f.)



Under construction (s.f.)



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For more information, please contact:

John Sikaitis
Managing Director – Office Research
+1 202 719 5839
John.Sikaitis@am.jll.com

Julia Georgules
Associate Director – Office Research
+1 415 354 6908
Julia.Georgules@am.jll.com

Phil Ryan
Research Analyst, Office and Economy Research
+1 202 719 6295
Phil.Ryan@am.jll.com

www.us.jll.com/research