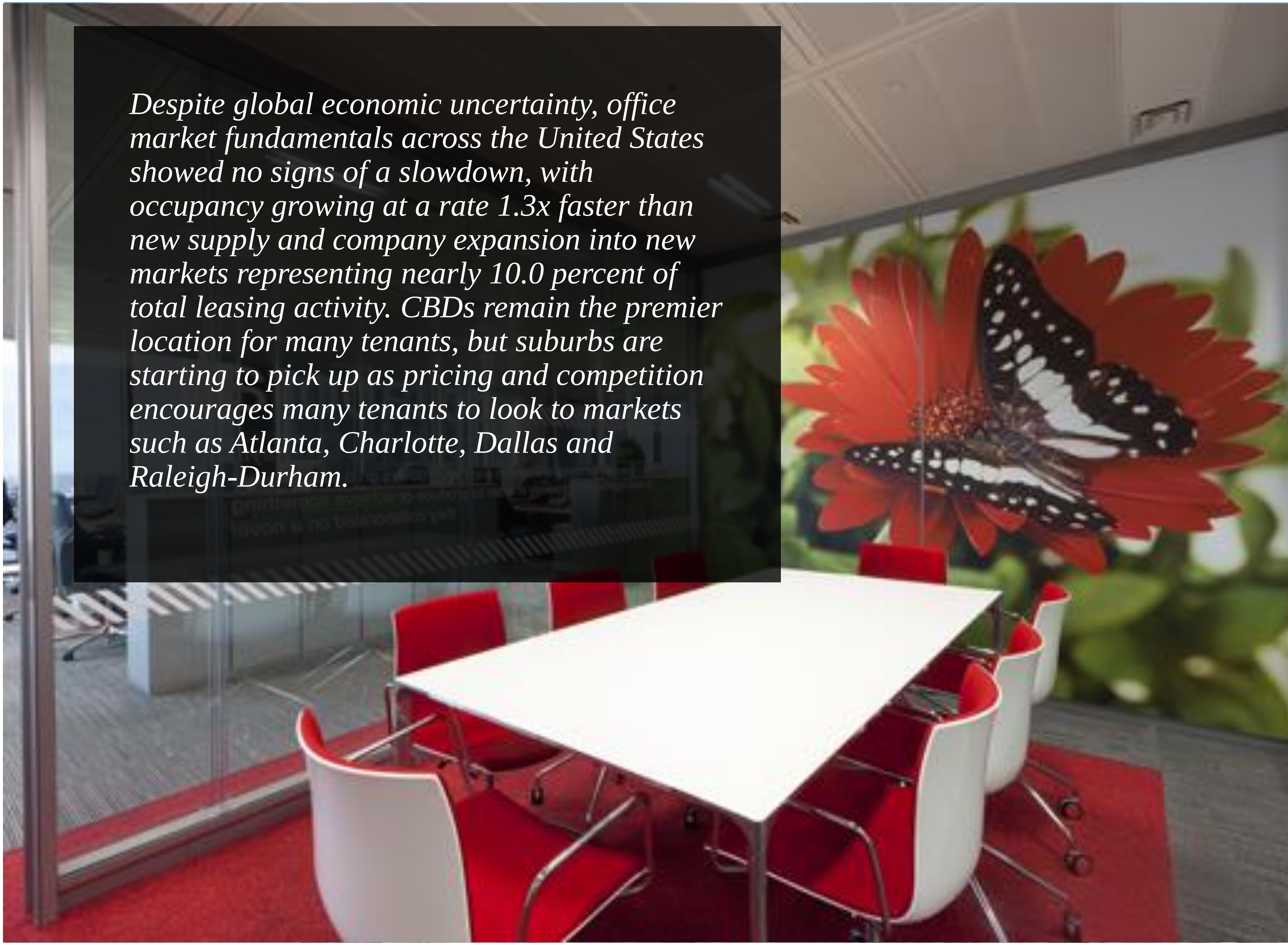
Highest quarterly absorption during the cycle so far further demonstrates healthy demand

United States Office Review

Q4 2015

Despite global economic uncertainty, office market fundamentals across the United States showed no signs of a slowdown, with occupancy growing at a rate 1.3x faster than new supply and company expansion into new markets representing nearly 10.0 percent of total leasing activity. CBDs remain the premier location for many tenants, but suburbs are starting to pick up as pricing and competition encourages many tenants to look to markets such as Atlanta, Charlotte, Dallas and Raleigh-Durham.



Landlord confidence firmly rooted across most U.S. markets, tenants face increasing rents amidst dwindling supply

Leasing activity

- Leasing activity declined slightly by 2.8 percent to 60.5 million square feet, although it remained above the 60-million-square-foot threshold, bringing year-to-date volumes to 241.9 million square feet. This represents a year-over-year gain of 2.4 percent as markets, particularly diversified and mid-sized geographies, continue to demonstrate solid signs of improved demand.

Absorption

- Occupancy growth across the United States totaled 18.7 million square feet in Q4, the highest quarterly figure recorded during the cycle so far. Year-end absorption was equal to 2014's rate of 1.4 percent year-on-year.
- Los Angeles joined other diversified markets, such as Dallas, Chicago, Phoenix, Atlanta and Philadelphia, in being a leader in net absorption over the course of 2015.

Vacancy

- A sharp uptick in absorption helped to propel total vacancy downward by 40 basis points to 14.7 percent, falling below the 15.0-percent mark for the first time this cycle.
- Properties across class and geographies are experiencing declines in vacancy at varying rates, with suburban Class A posting the fastest pace in declines as minimal large CBD options hinder faster take-up of space.

Rents

- Asking rents saw their second-highest level of quarterly growth during Q4 at 2.3 percent, bringing year-over-year gains to 3.5 percent; the U.S. office market has now reached pre-recession rent levels.
- While CBD Class A space continues to surpass all other classes over the course of the cycle, quarterly upticks in other sectors have been faster as rising economic conditions boost much of the overall market.

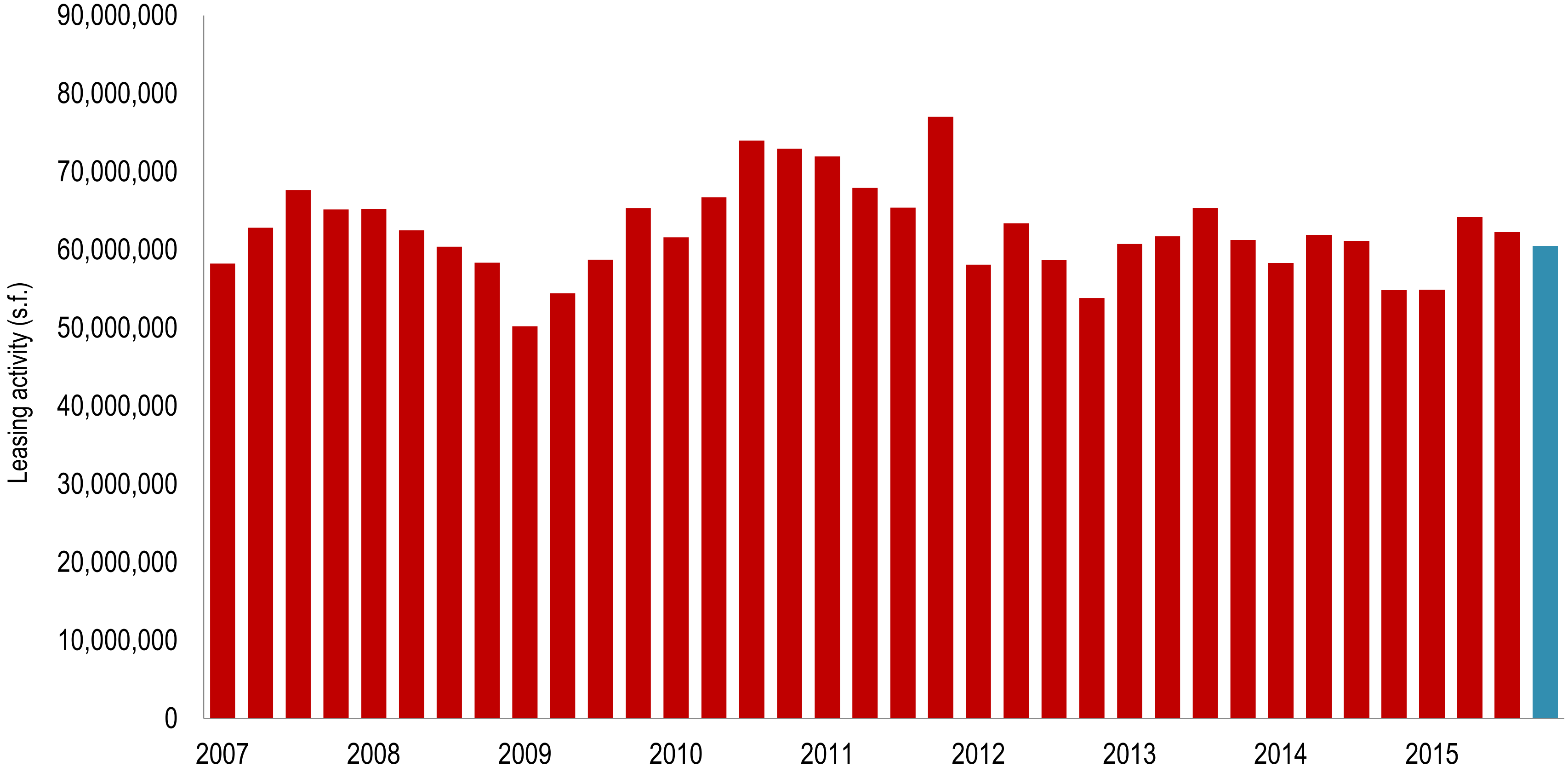
Construction

- Construction activity declined slightly over the quarter to 88.3 million square feet as numerous projects began to deliver, although groundbreakings in Q1 2016 are likely to reverse this trend.
- High preleasing rates of 47.7 and 53.1 percent for developments coming online in 2016 and 2017 mean that relief will be somewhat limited, elevating asking rents for new space even further.

Source: JLL Research

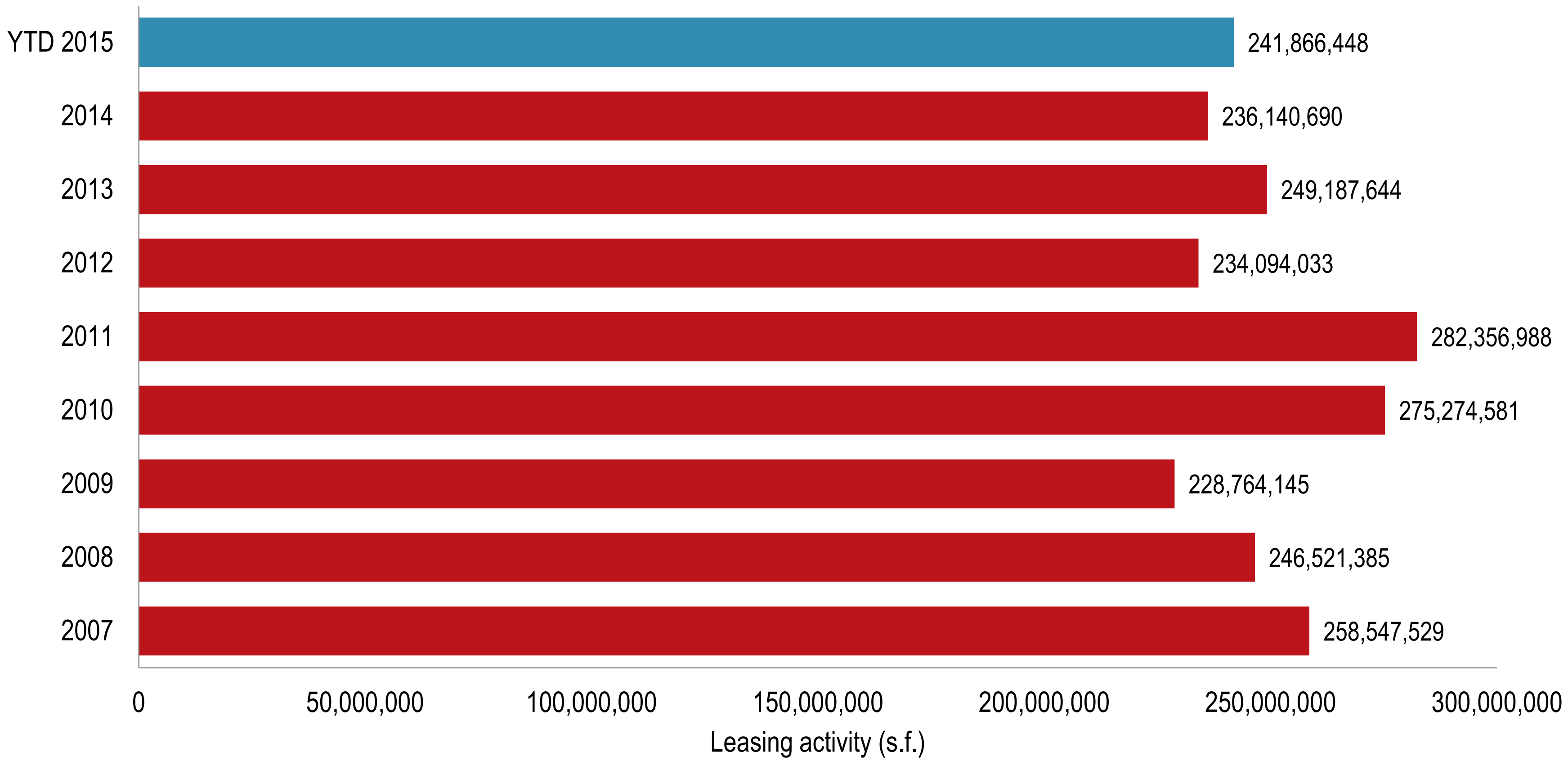
Leasing activity

Leasing activity was slightly slower than Q3, but remained strong at 60.5 million square feet



Source: JLL Research

Annual activity surpassed 2014 by 2.4 percent, with five markets posting more than 3.0 million square feet of transactions



Source: JLL Research

A significant number of large-block activity (> 100,000 s.f.) consisted of renewals, slightly pushing down rate of expansion

35.4 m.s.f.
total square feet leased in Q3 in transactions 20,000 s.f. or larger

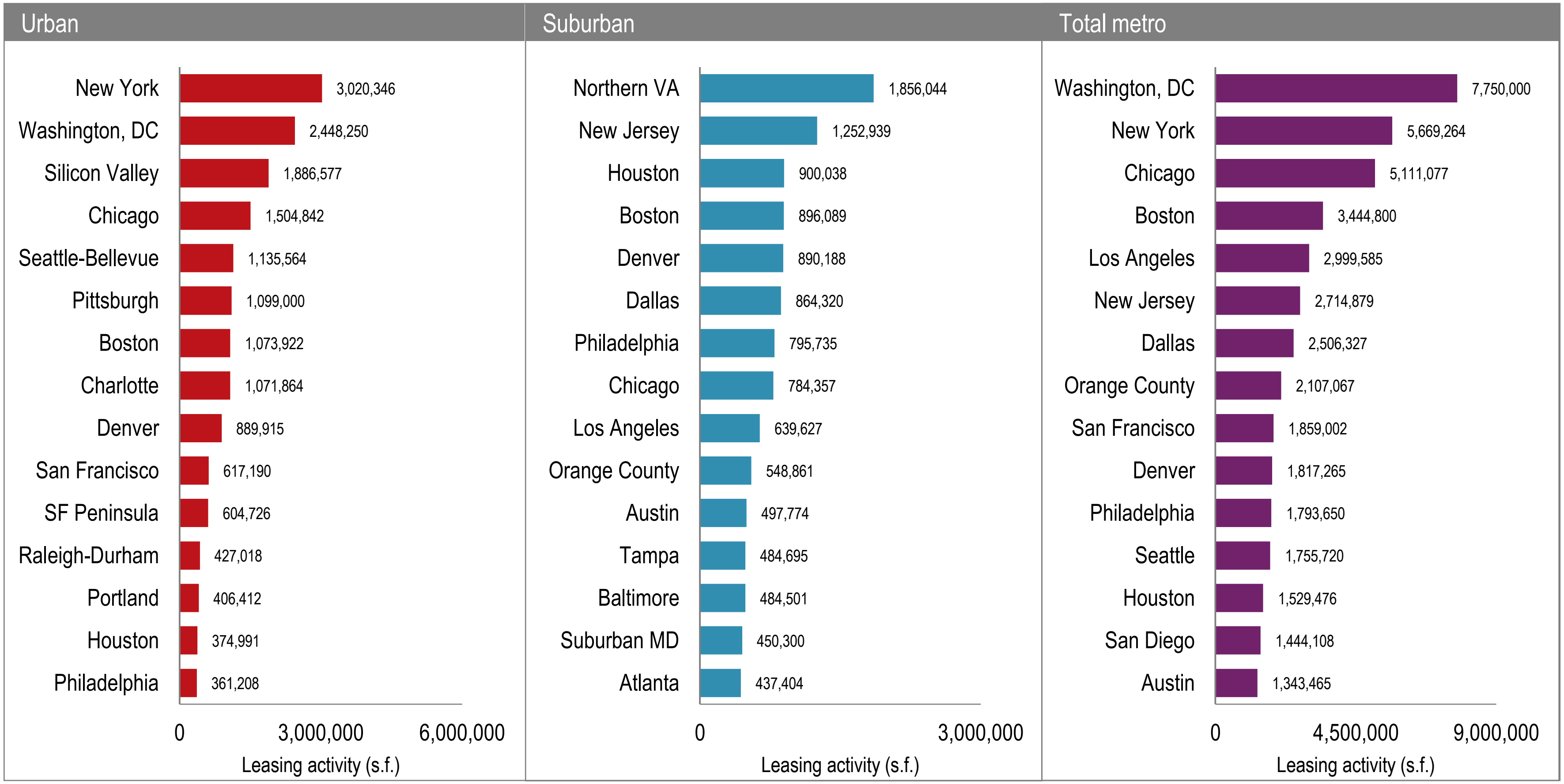
46.7% vs. 53.3%
urban vs. suburban breakdown of Q3 volume

94
average term in months

52% / 41% / 7%
of tenants are growing / shrinking / stable

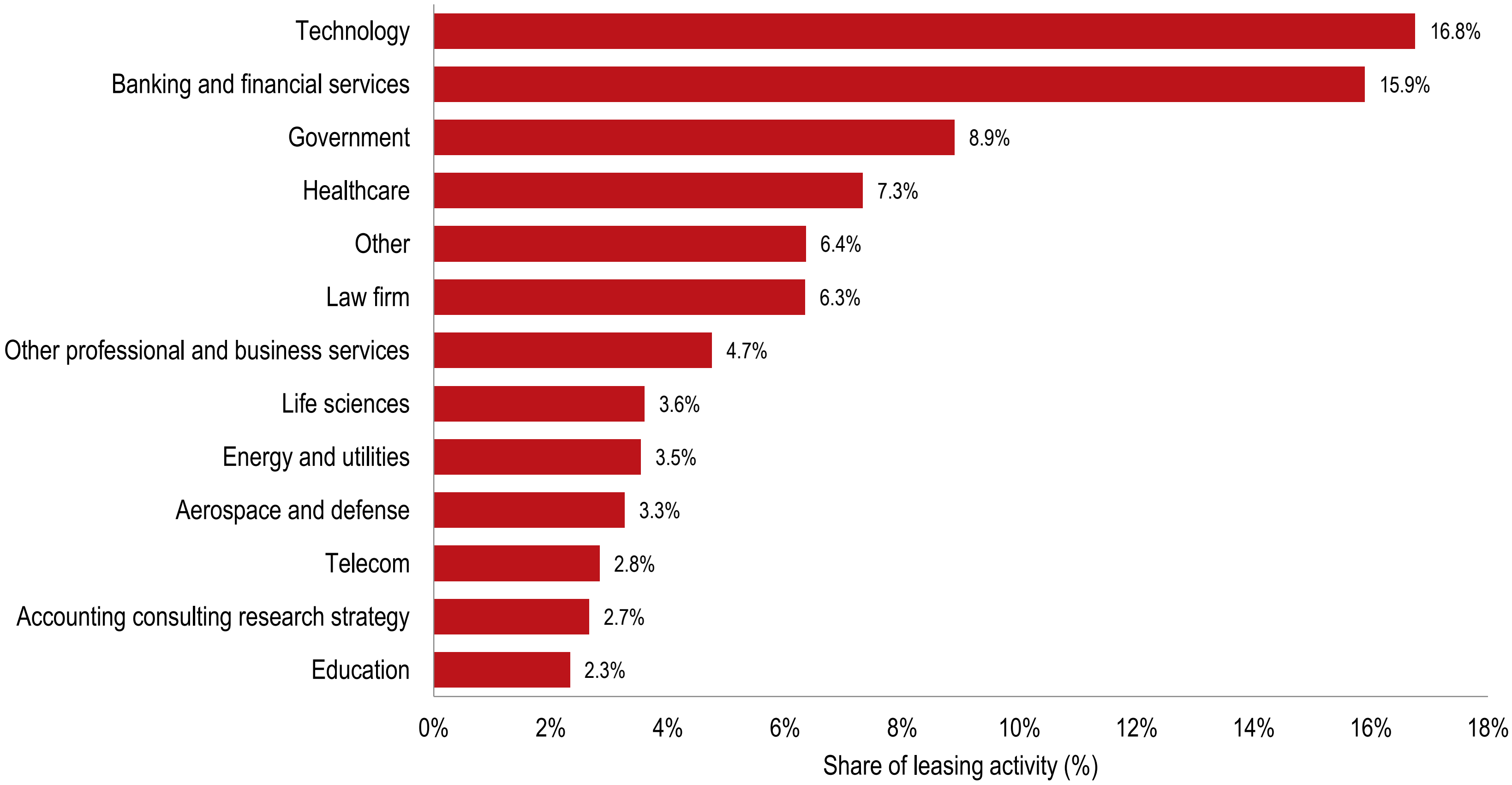
Source: JLL Research – *only for leases larger than 20,000 square feet*

Financial, tech and government activity propelled CBD volumes to more than 1.0 m.s.f. in many geographies



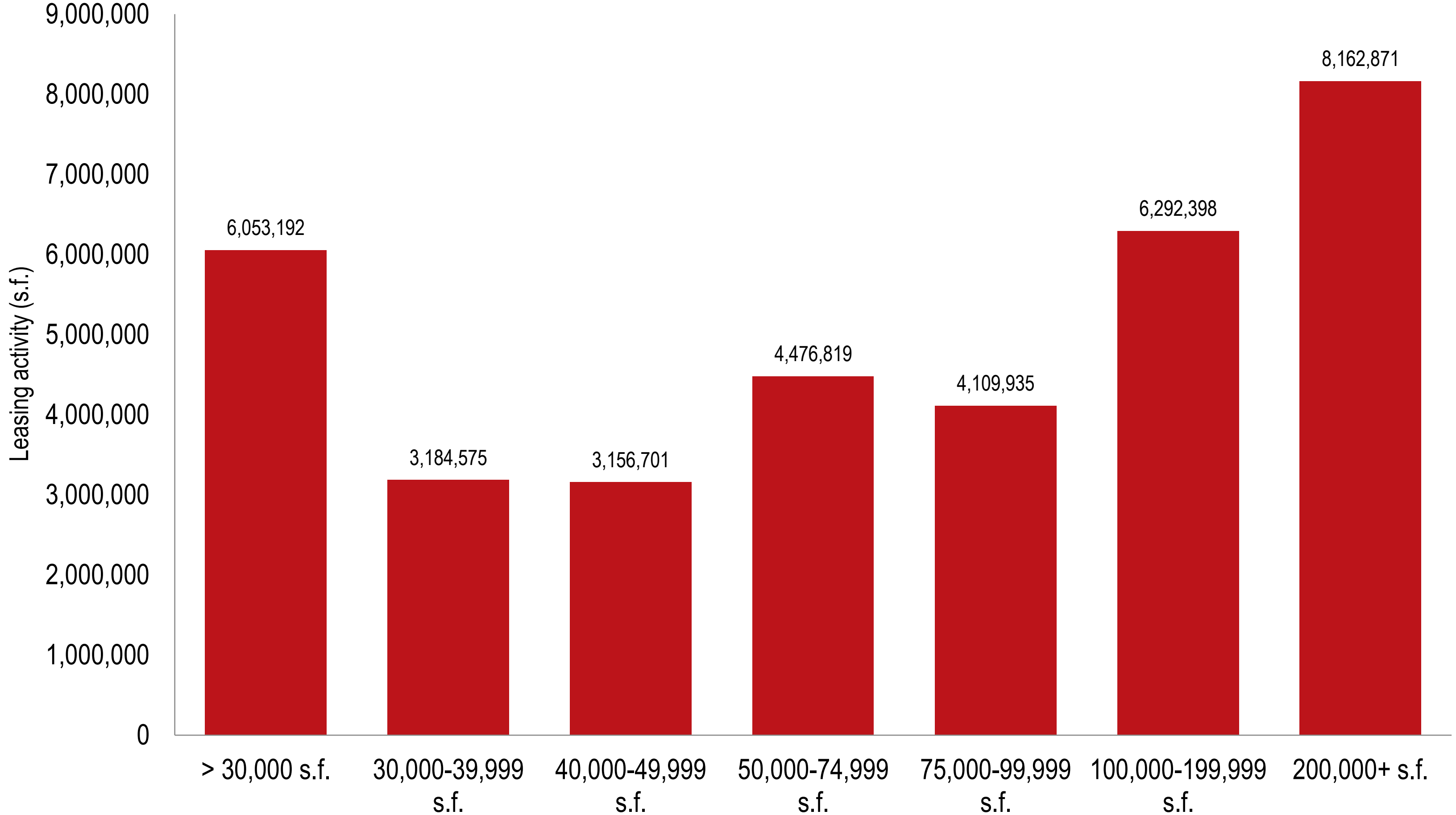
Source: JLL Research – *only for leases larger than 20,000 square feet*

Tech and finance continue to drive occupancy growth across a diversity of markets



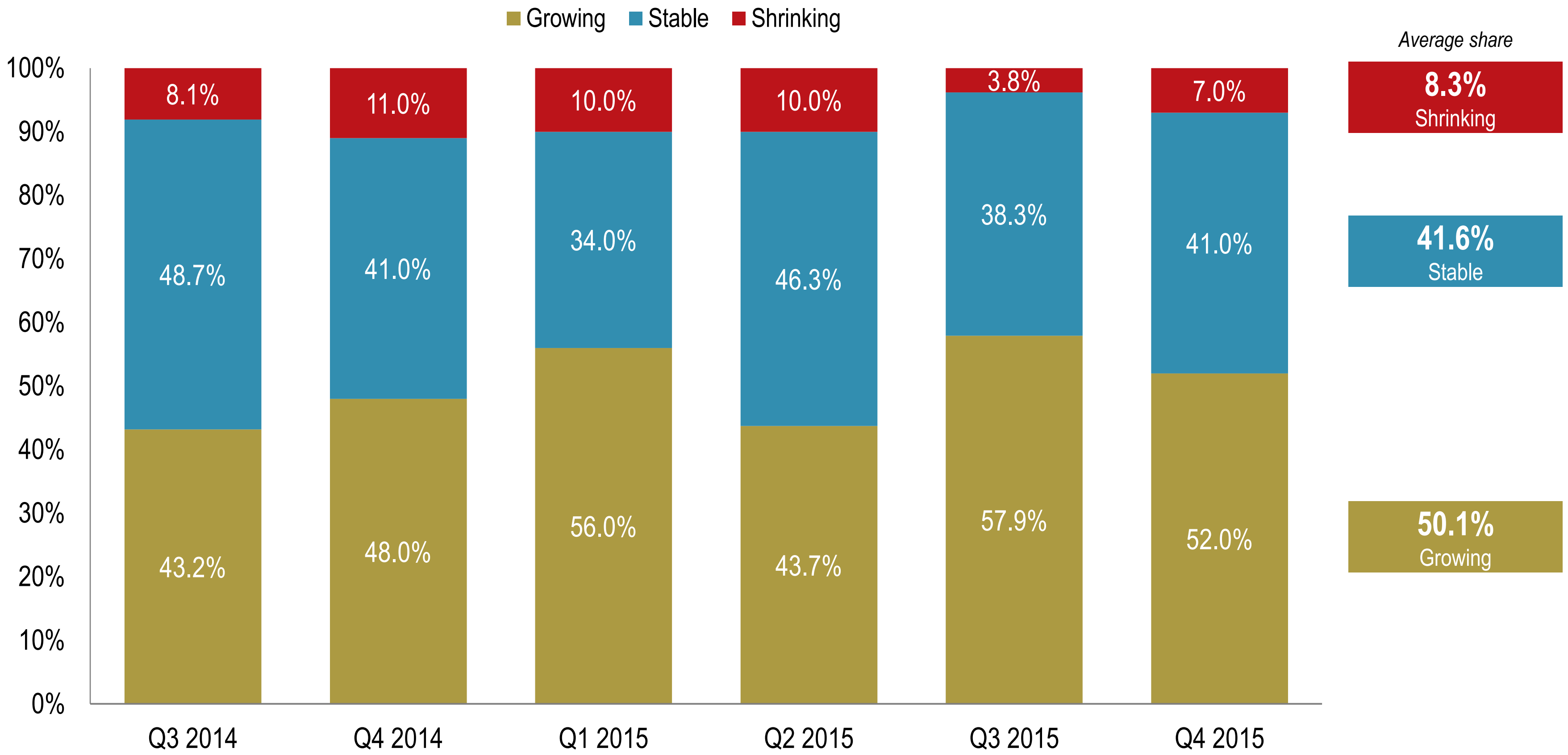
Source: JLL Research – *only for leases larger than 20,000 square feet and industries with more than 2.0 percent share of activity*

More than one-third of activity was comprised of leases smaller than 30,000 s.f. as growth diversifies



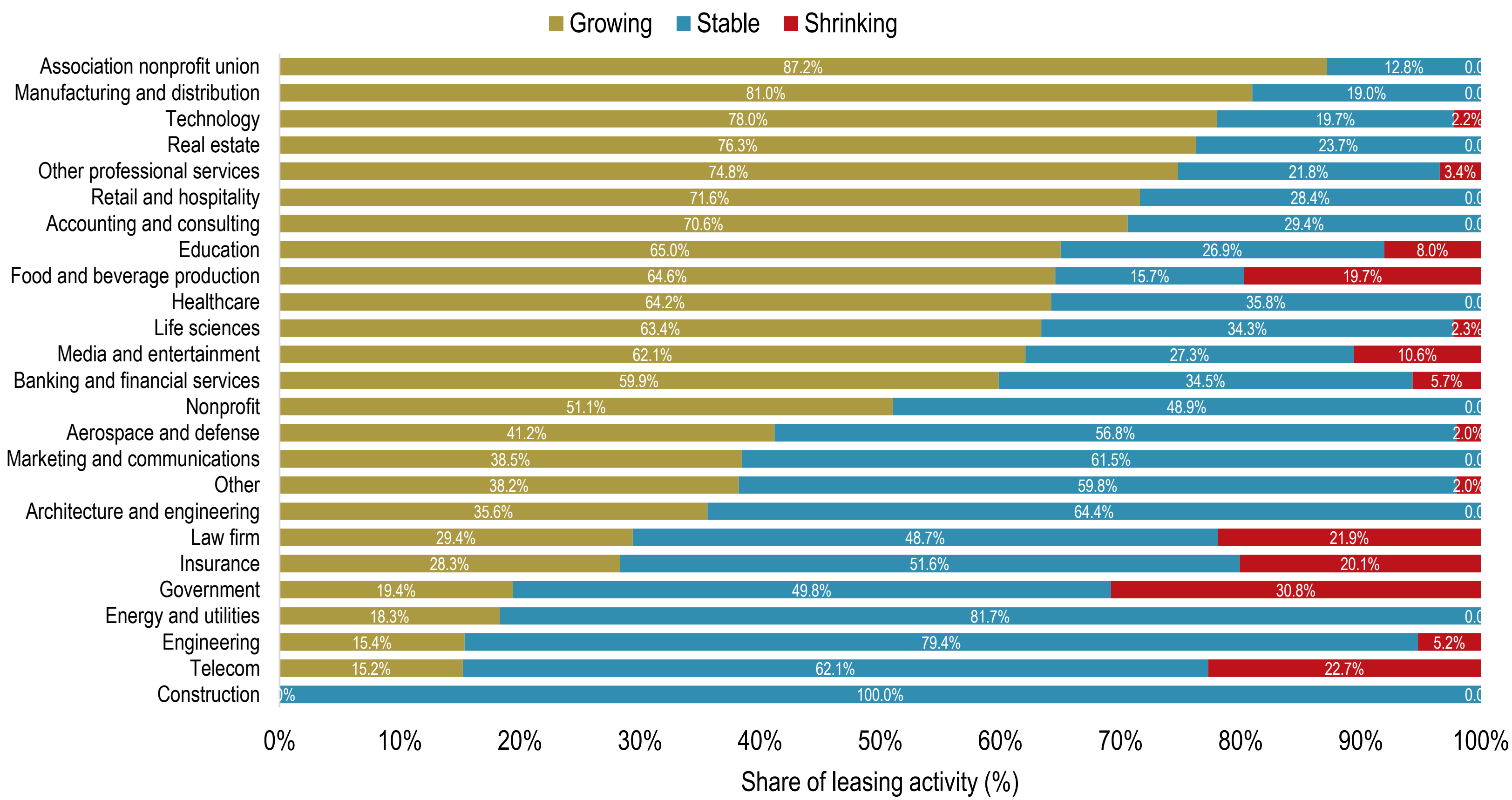
Source: JLL Research

A slight uptick in contraction activity pushed down gains elsewhere, but more than half of activity remains expansionary



Source: JLL Research

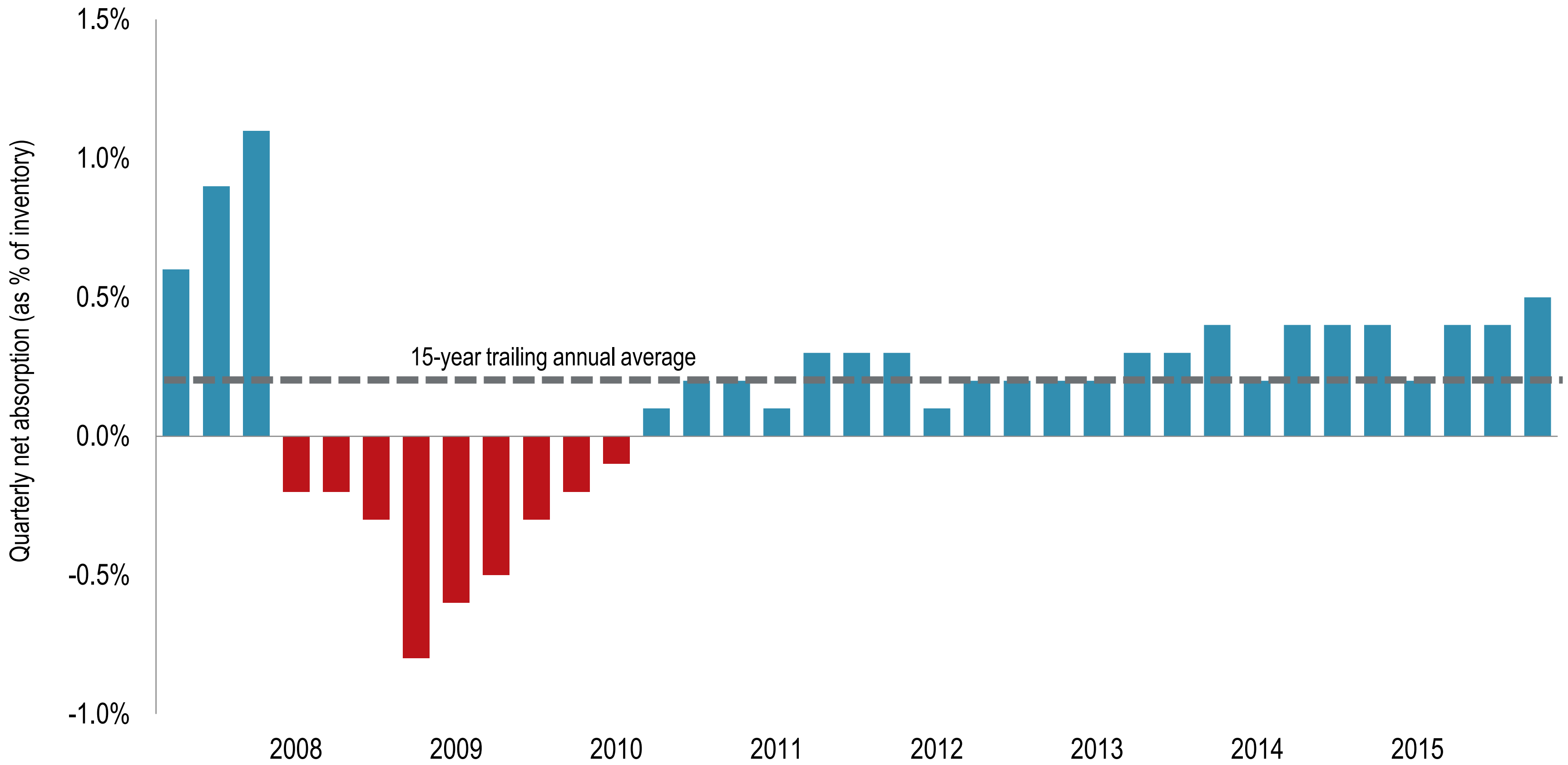
More than 75.0 of associations, manufacturing, technology an real estate companies signed expansionary leases in Q4



Source: JLL Research

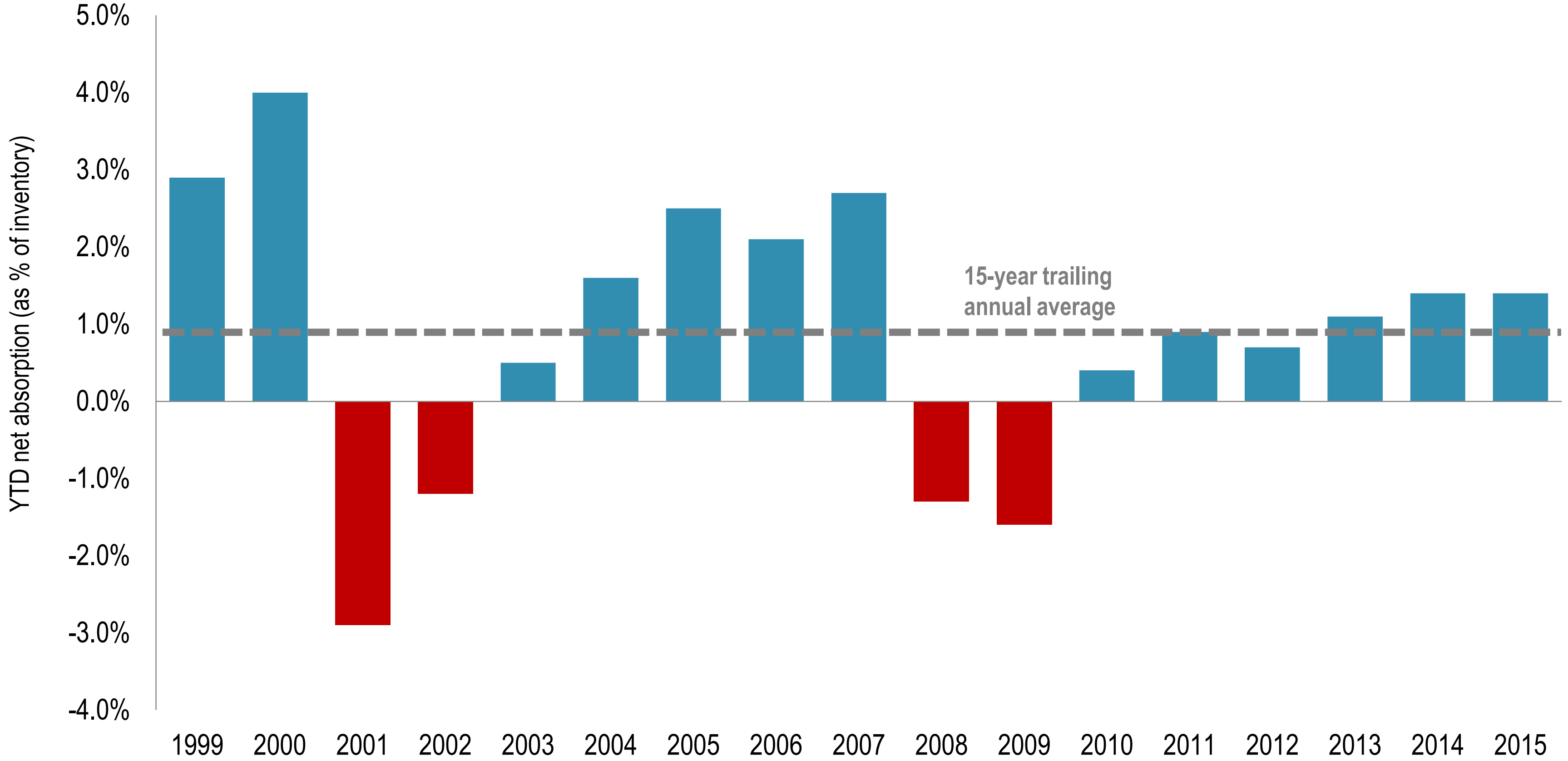
Absorption

For the first time this cycle, quarterly occupancy growth totaled 0.5 percent of inventory



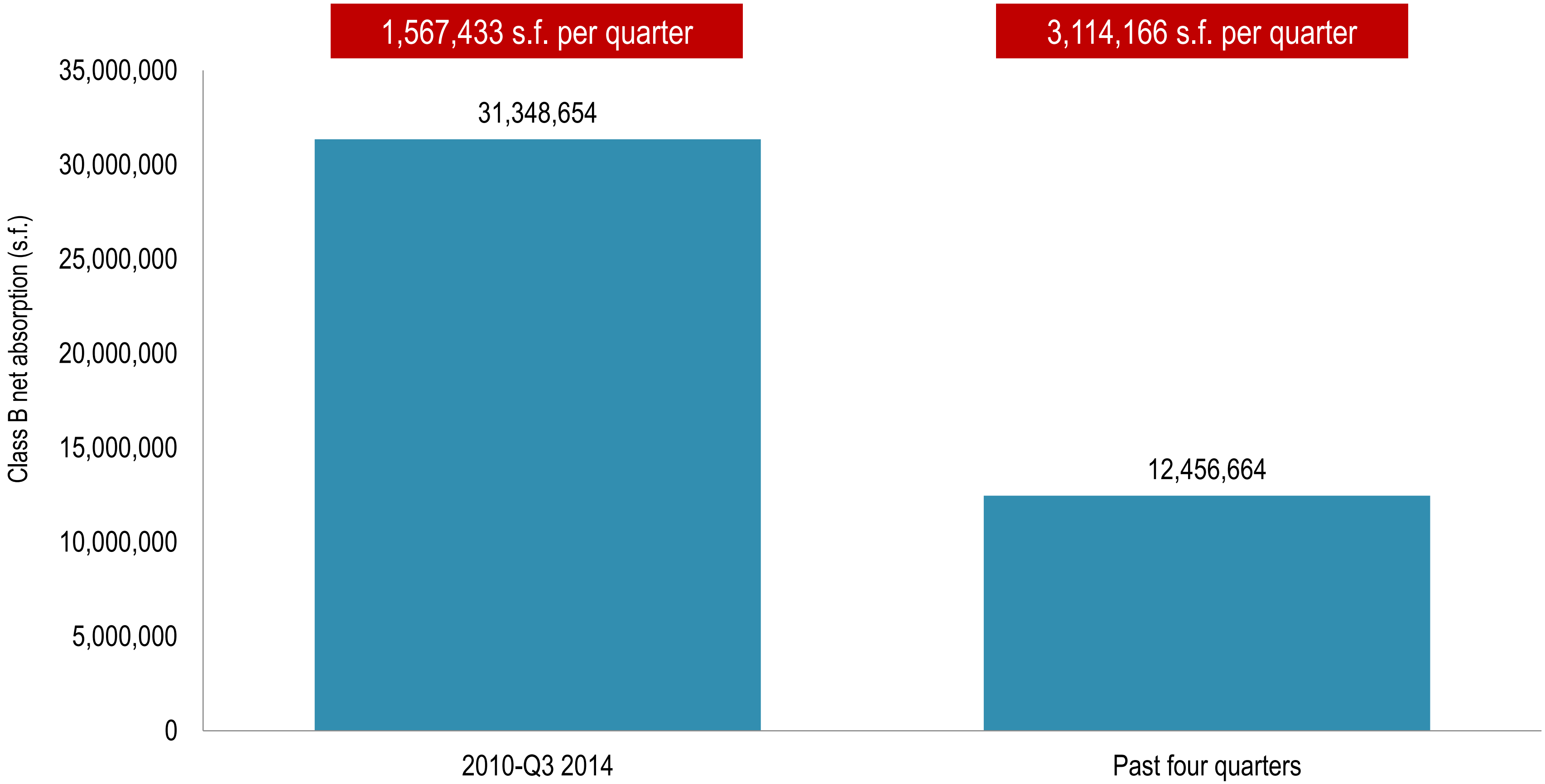
Source: JLL Research

Due to slightly slower uptake in previous quarters, annual absorption remained consistent at 1.4 percent of inventory



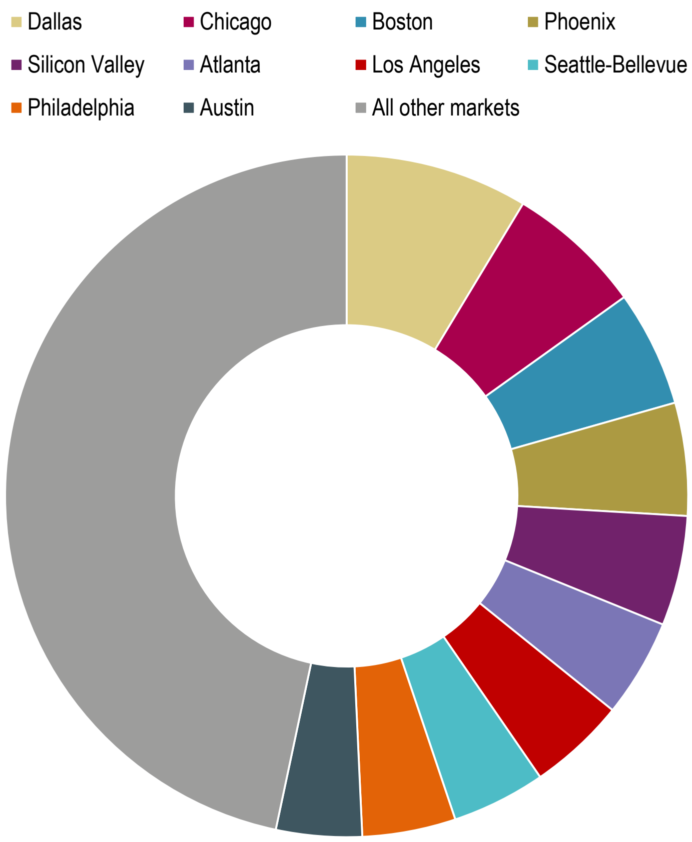
Source: JLL Research

Movement to Class B space as quality options diminish is increasing; quarterly B absorption double rate of early recovery



Source: JLL Research

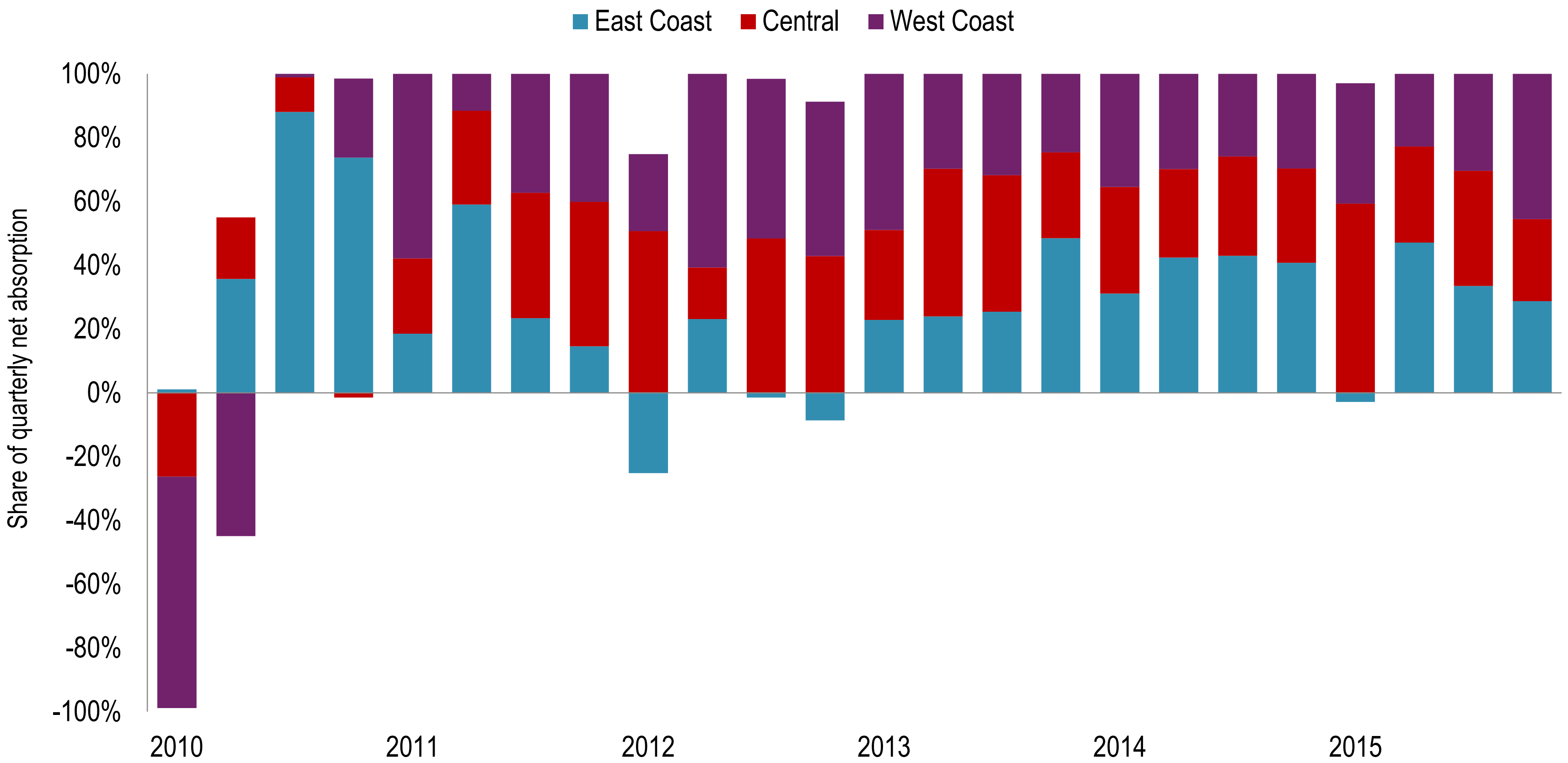
Los Angeles joins other diversified markets (Dallas, Chicago, Phoenix, Atlanta and Philadelphia) as a driver of absorption



Market	YTD net absorption (s.f.)	Share
Dallas	4,794,274	8.6%
Chicago	3,585,989	6.5%
Boston	3,045,721	5.5%
Phoenix	2,965,982	5.3%
Silicon Valley	2,891,738	5.2%
Atlanta	2,578,651	4.6%
Los Angeles	2,557,260	4.6%
Seattle-Bellevue	2,461,440	4.4%
Philadelphia	2,453,633	4.4%
Austin	2,253,197	4.1%
All other markets	**25,893,173**	**46.7%**
United States	**55,481,058**	**100.0%**

Source: JLL Research

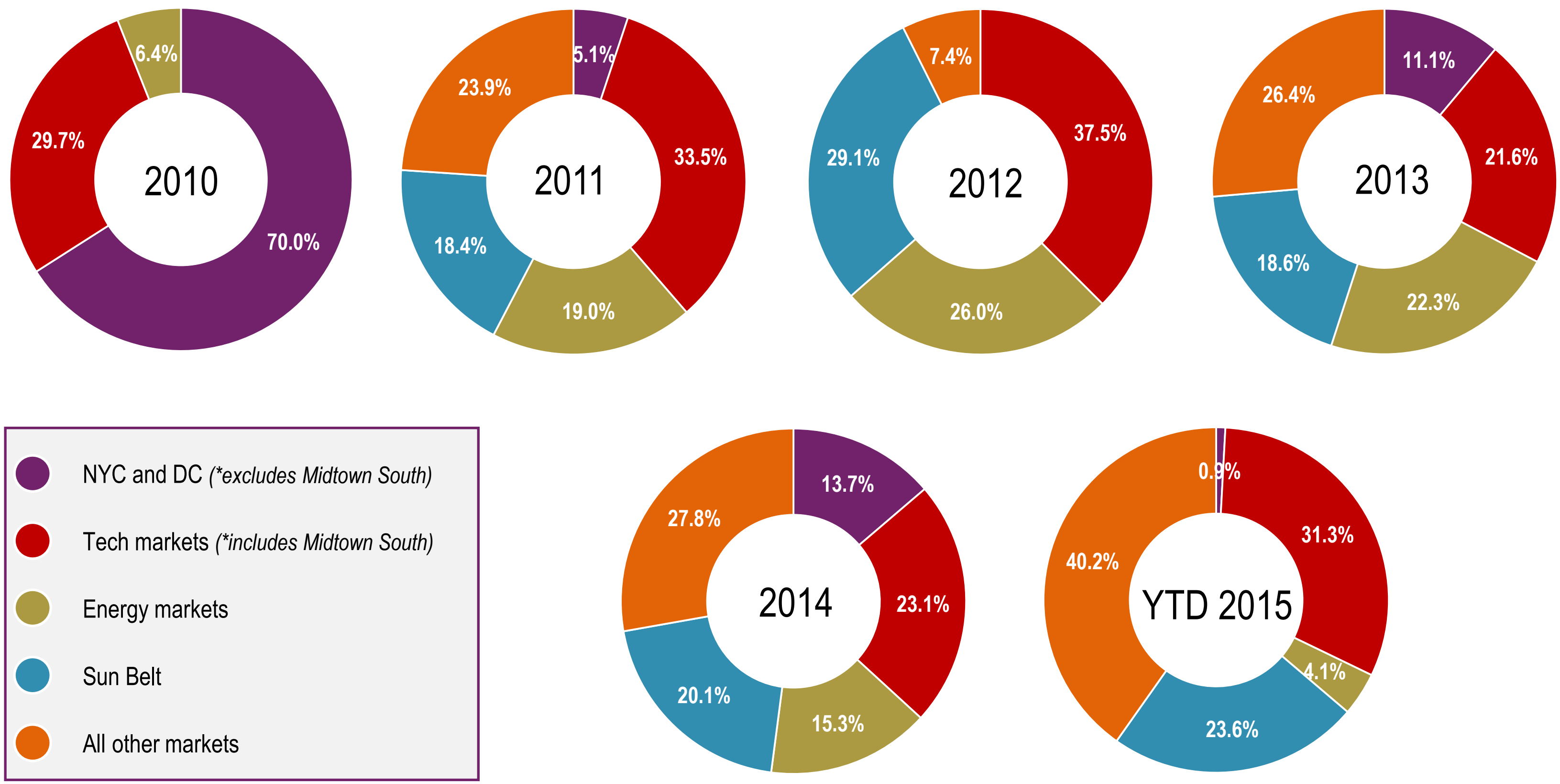
More than 1.0 million square feet of absorption in Los Angeles, the SF Peninsula and Silicon Valley boosted West Coast in Q4



Source: JLL Research

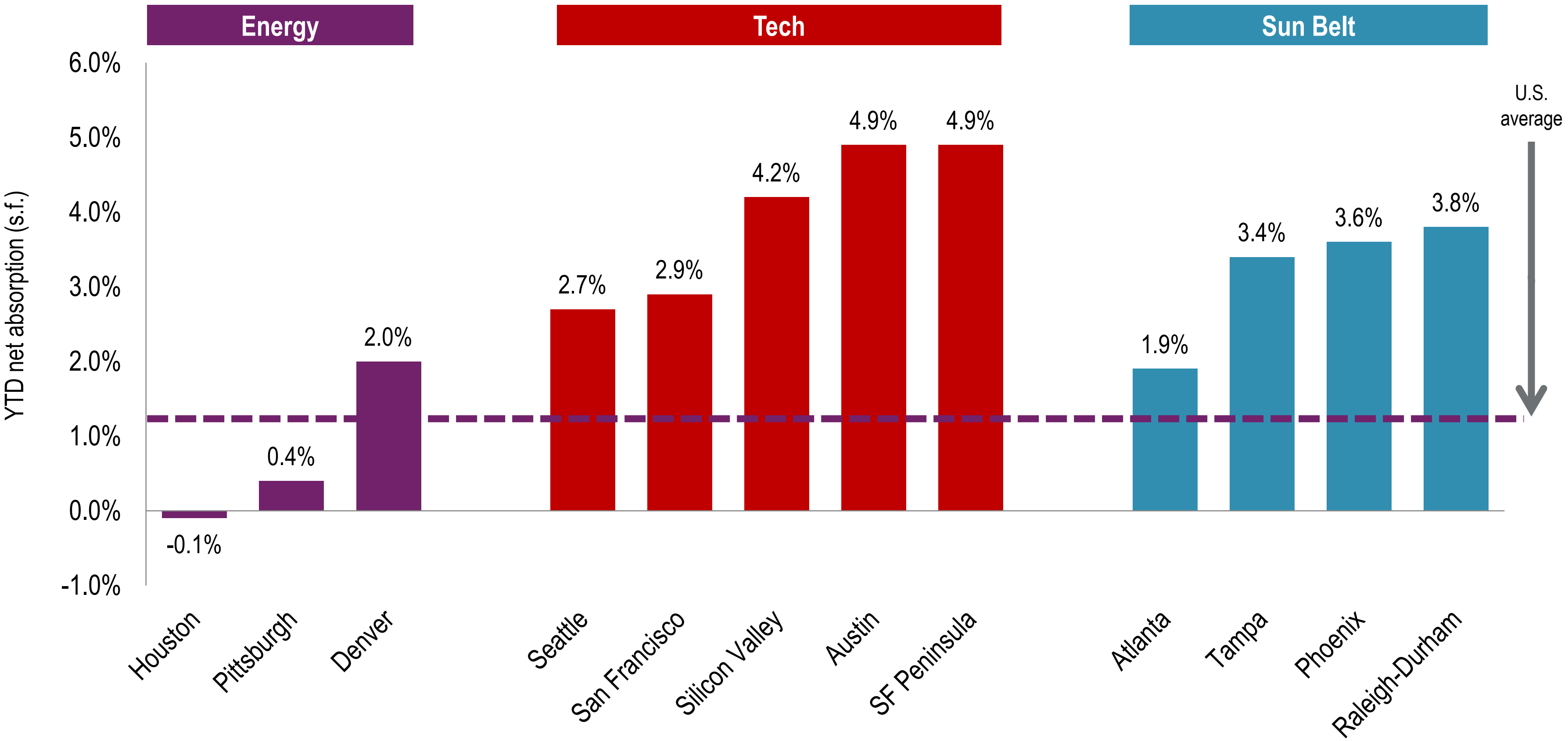
JLL

With 13.1 million square feet of absorption, the Sun Belt continues to gain momentum; tech's share rises by 820bp



Source: JLL Research – *figures denote share of annual net absorption*

Multiple tech markets absorb more than 4.0 percent of inventory, while Sun Belt geographies are approaching that threshold



Source: JLL Research

Earlier flight to quality has kept Class A's share of absorption gains strong, but B and C are approaching the 50-m.s.f. mark

Trophy and Class A net absorption

181.1 m.s.f.

2010-YTD 2015

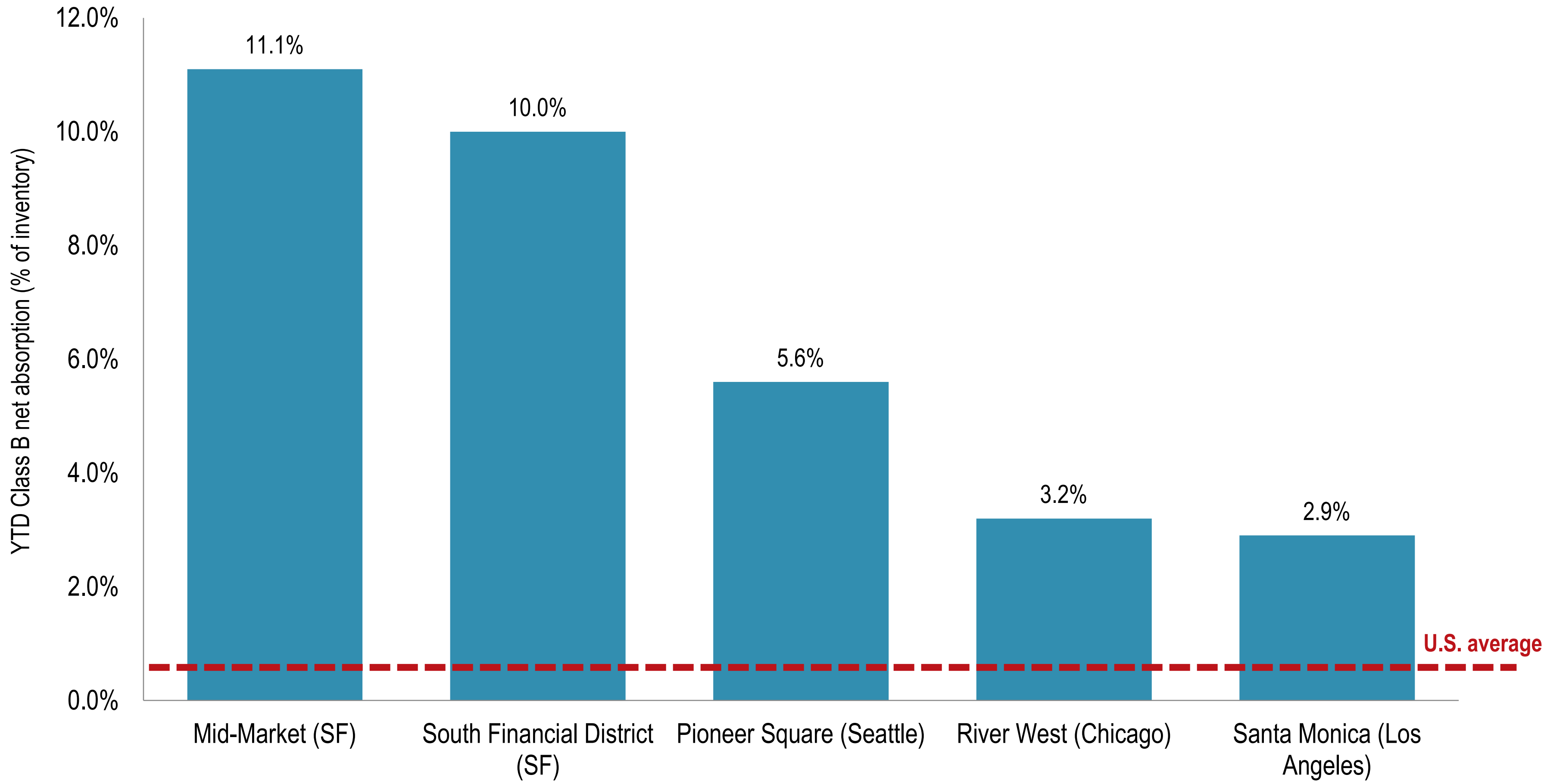
Class B and C net absorption

43.8 m.s.f.

2010-YTD 2015

Source: JLL Research

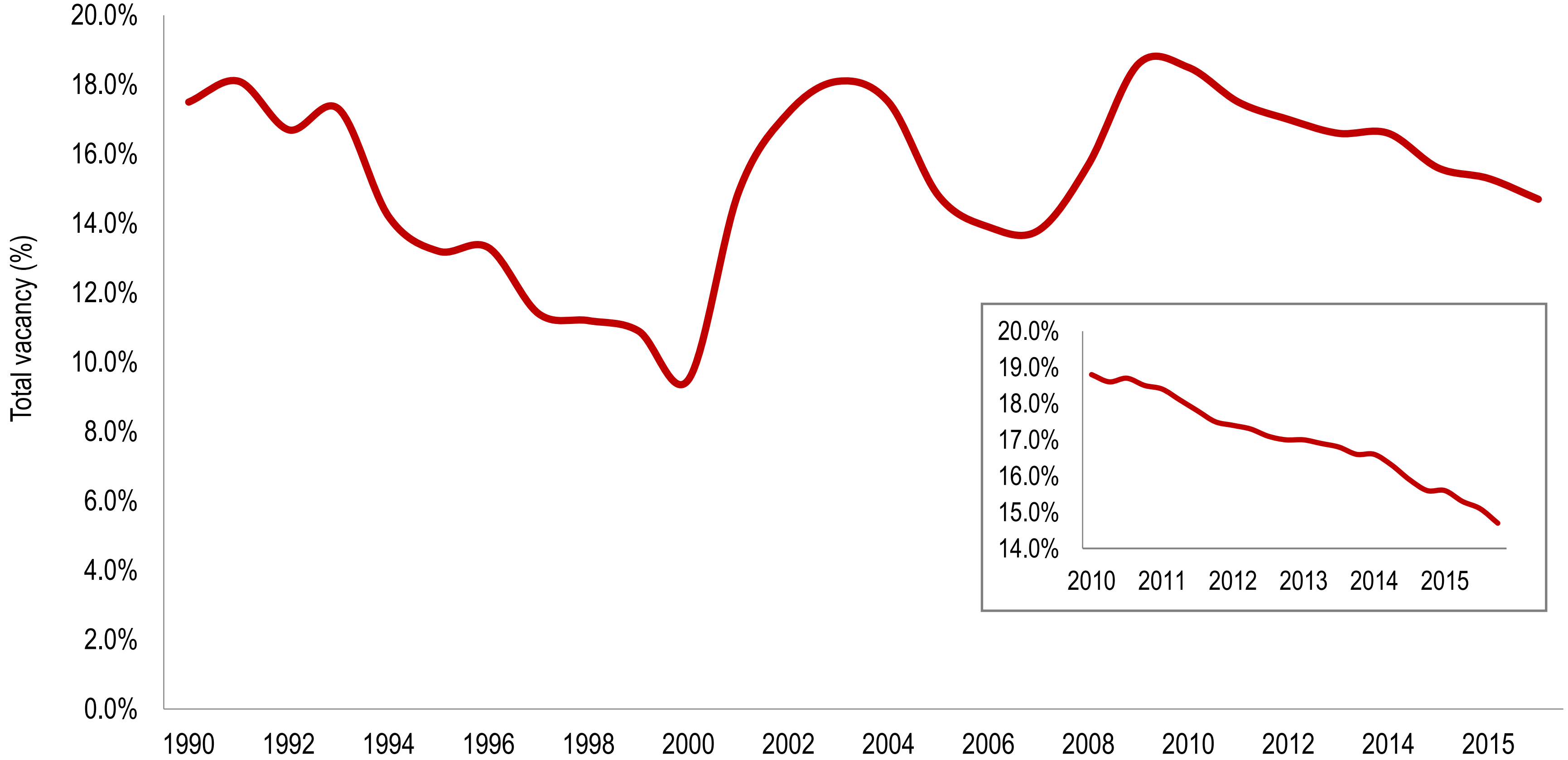
Submarkets with creative and tech-friendly space outperform the national Class B average



Source: JLL Research

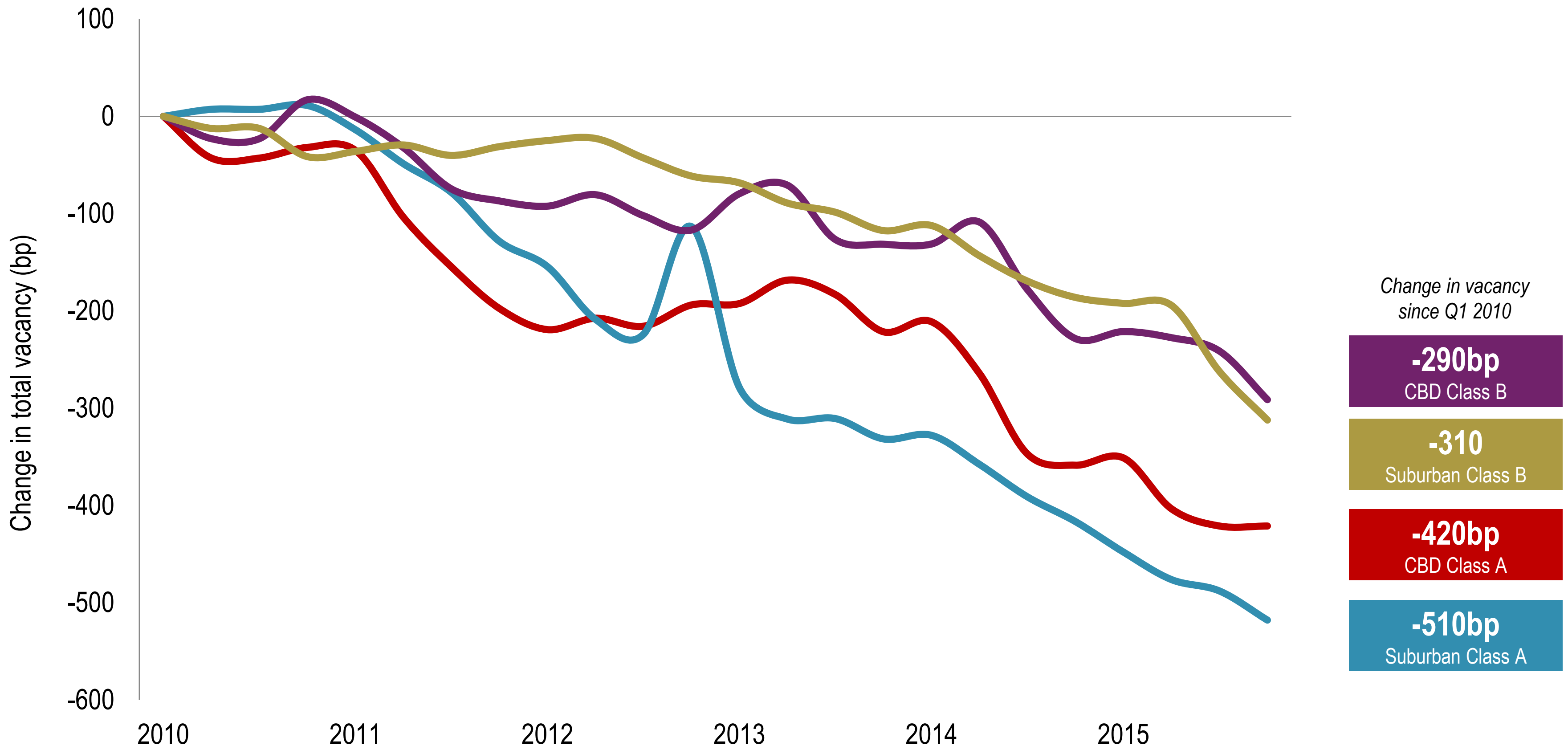
Vacancy

The 18.7 m.s.f. of absorption in Q4 pushed vacancy down sharply by 40bp to 14.7%; first time it has fallen below 15.0% this cycle



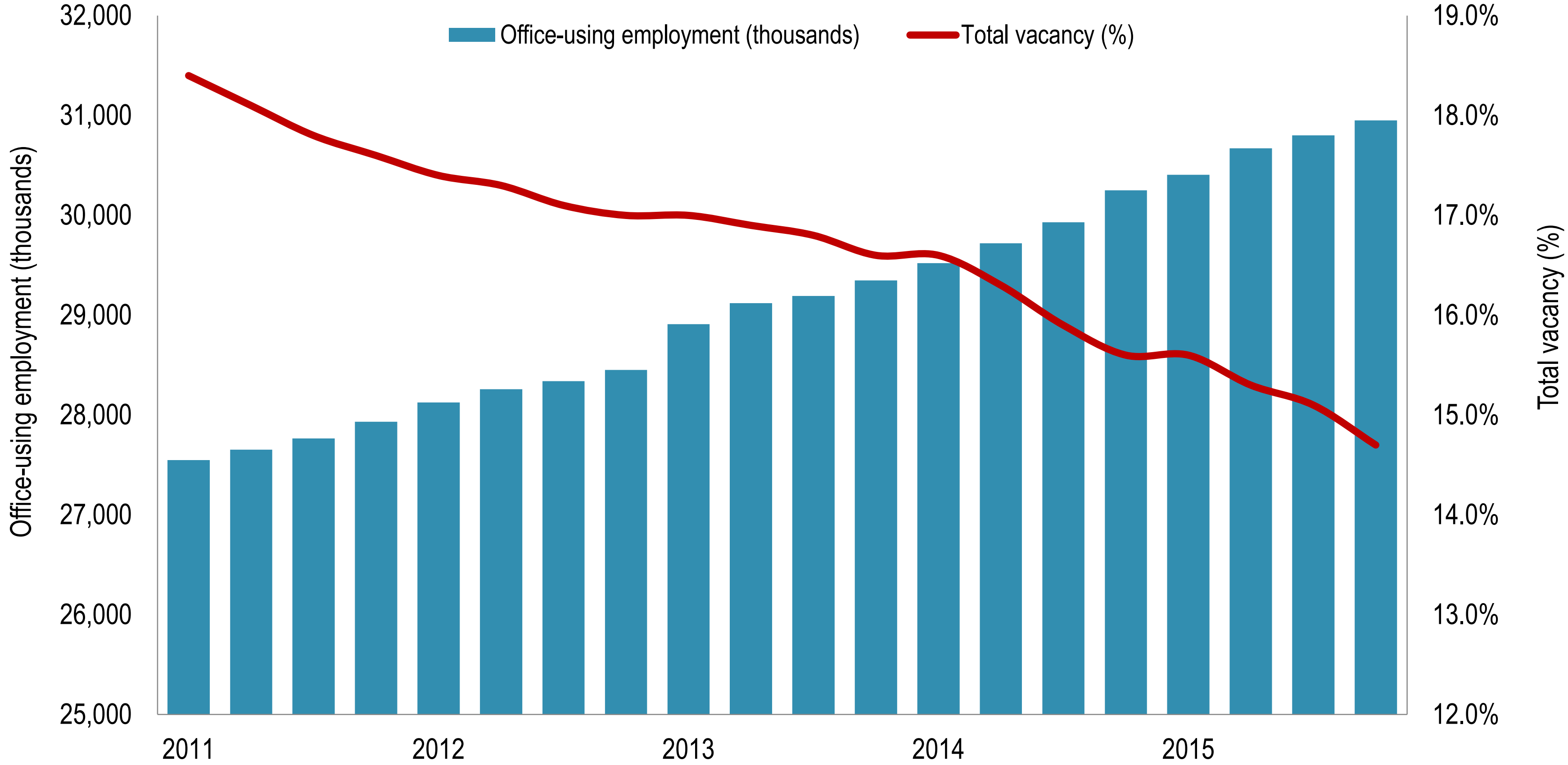
Source: JLL Research

Suburban A and B properties registered sharper downturns in vacancy over the quarter due to lack of space in urban cores



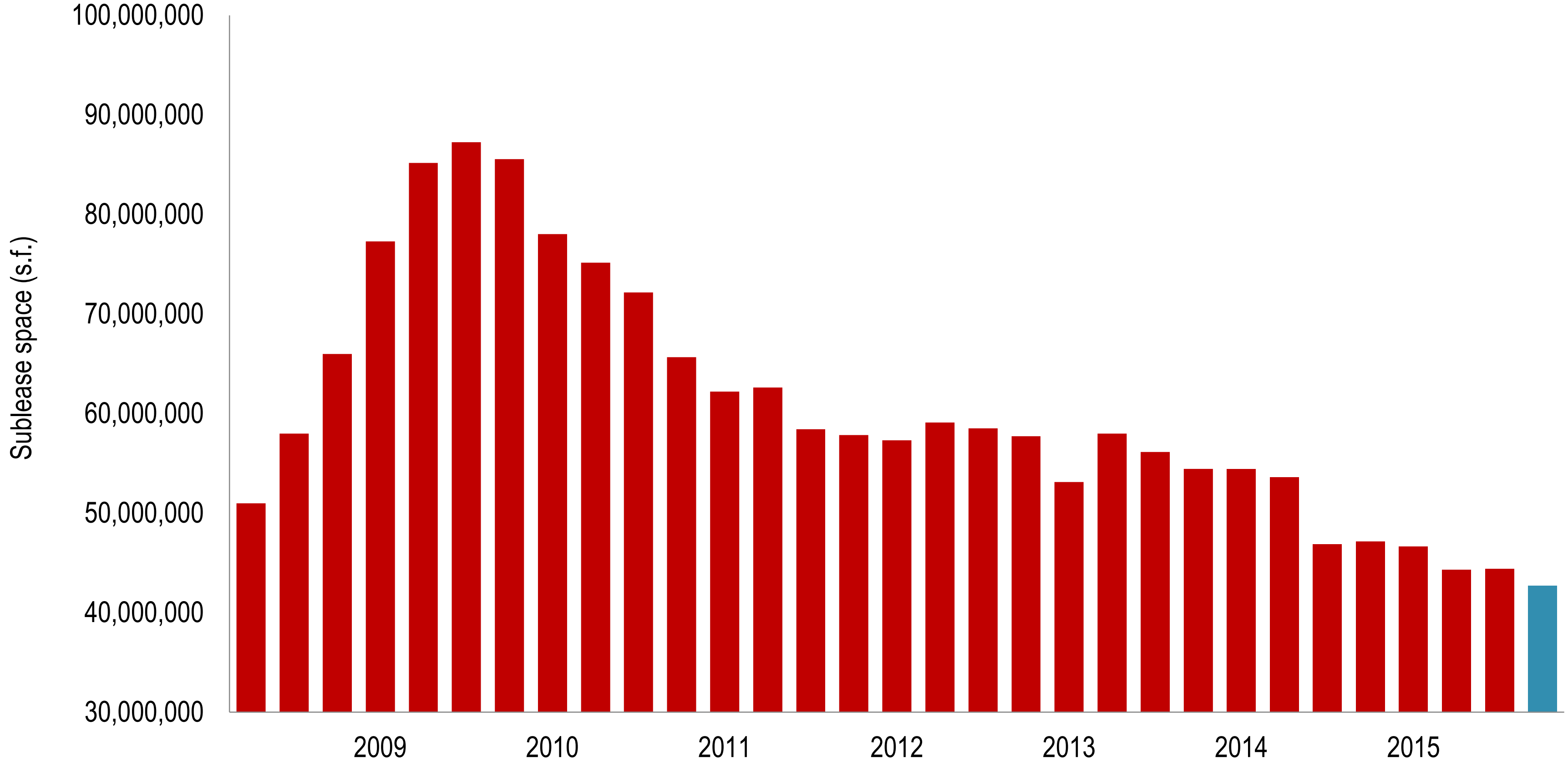
Source: JLL Research

The 149,000 additional office-using jobs added during Q4 were partially responsible for the sharp drop in vacancy



Source: JLL Research

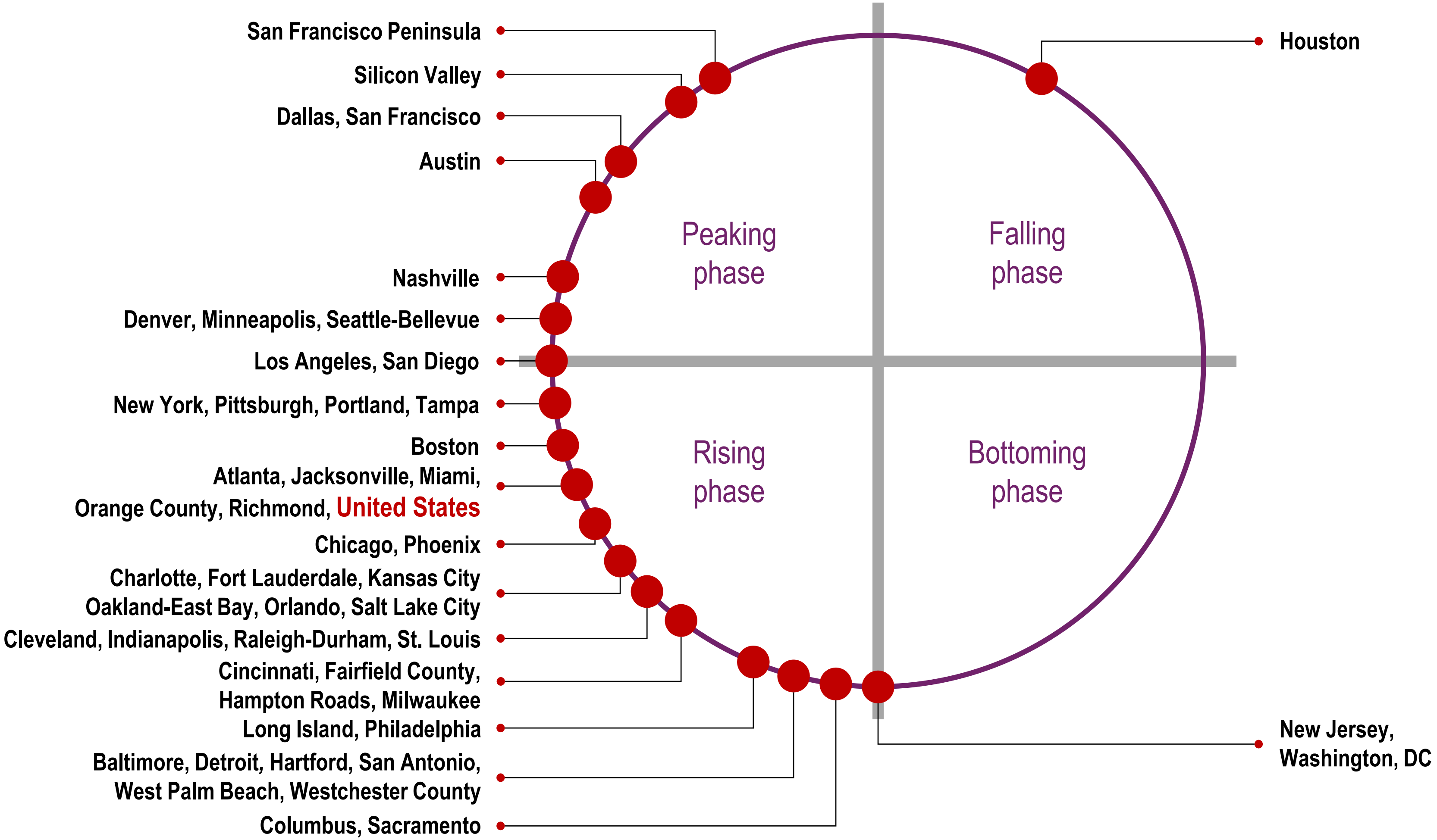
Sublease space continues to fall (currently at 42.7 million square feet) despite increasing in Houston due to stalling conditions



Source: JLL Research

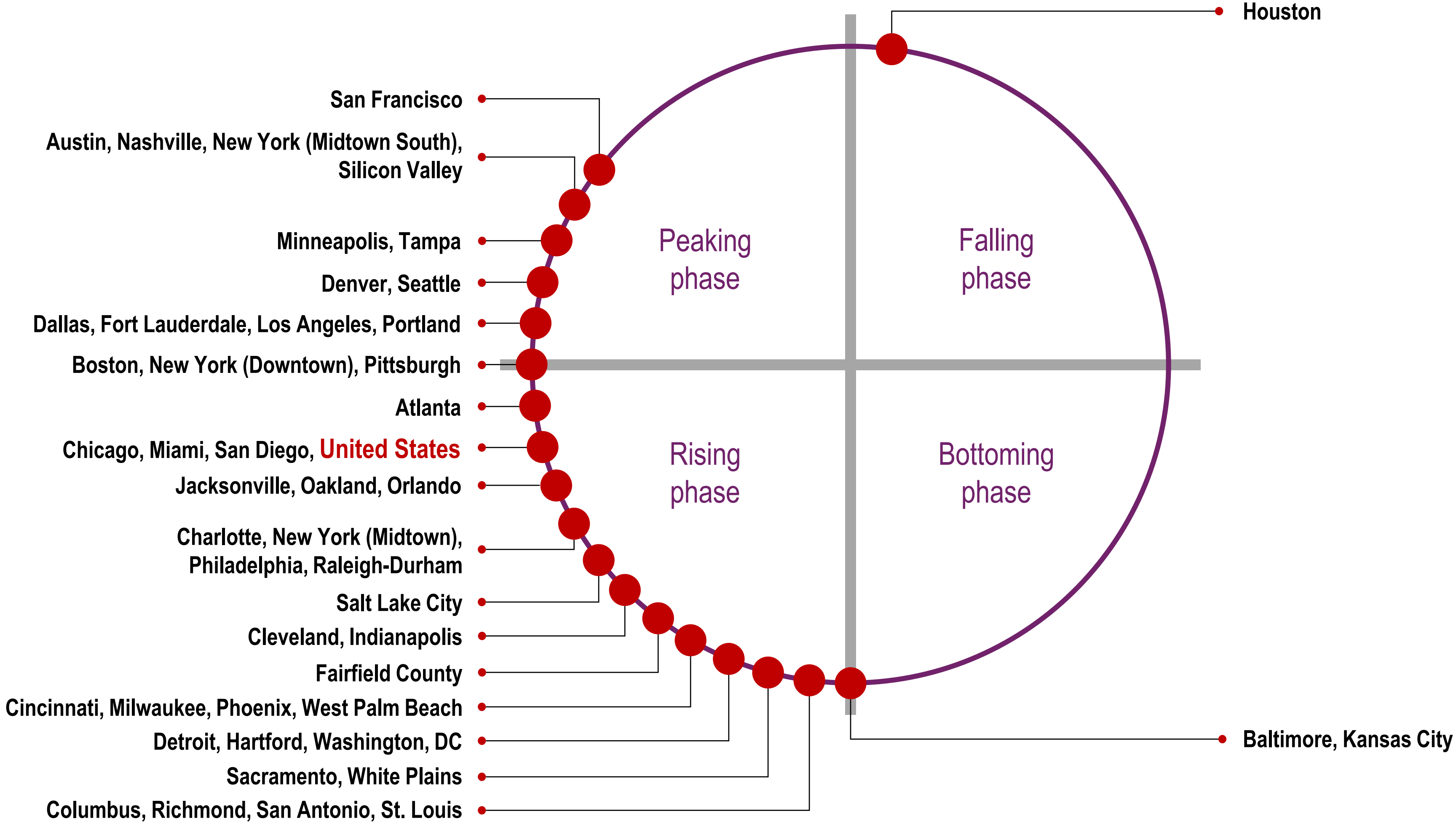
Rents

Sustained rent growth is pushing markets farther along the clock, with Houston being the notable outlier



Source: JLL Research

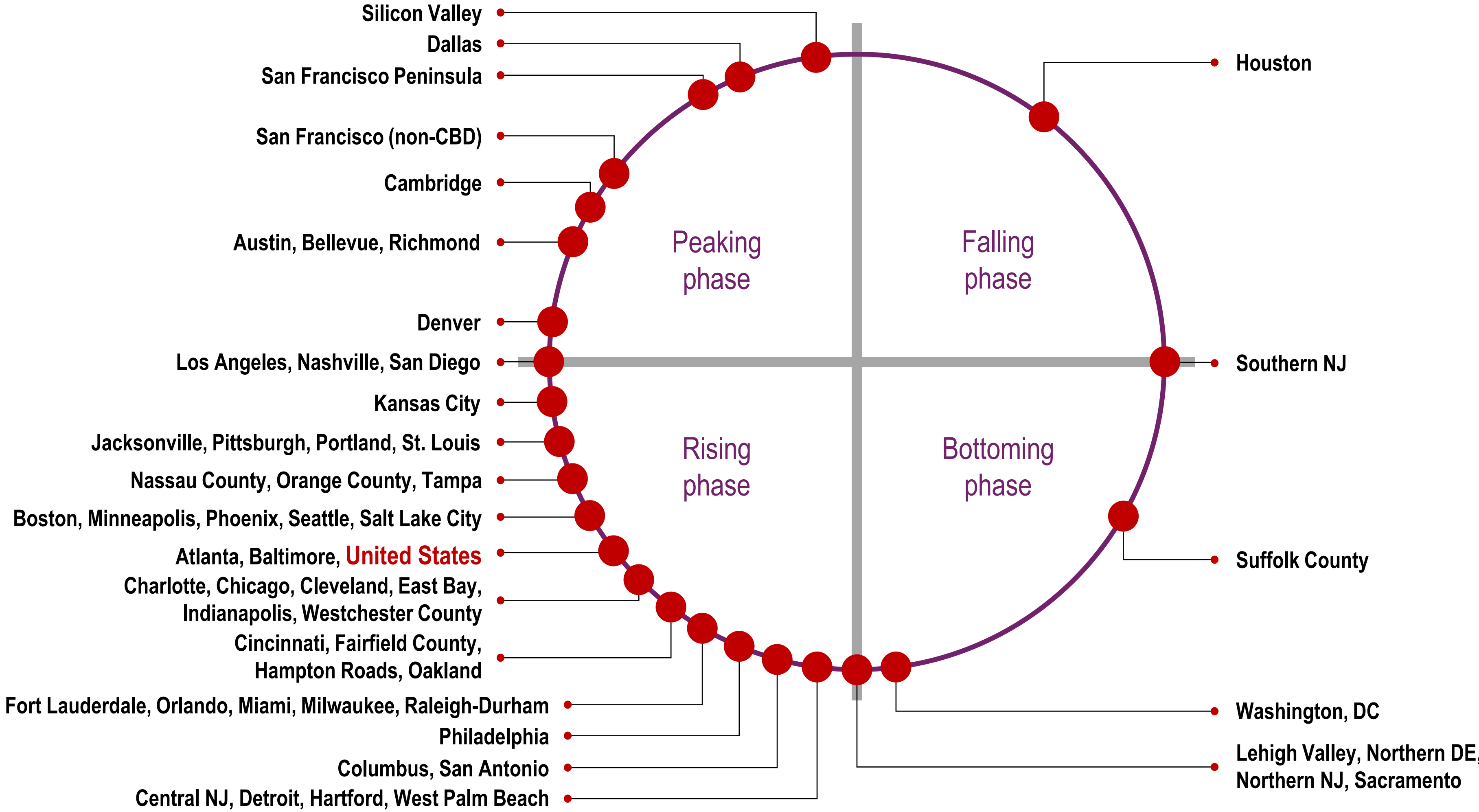
CBDs remain slightly ahead on aggregate, with many approaching cyclical peaks in terms of rent growth



Source: JLL Research

JLL

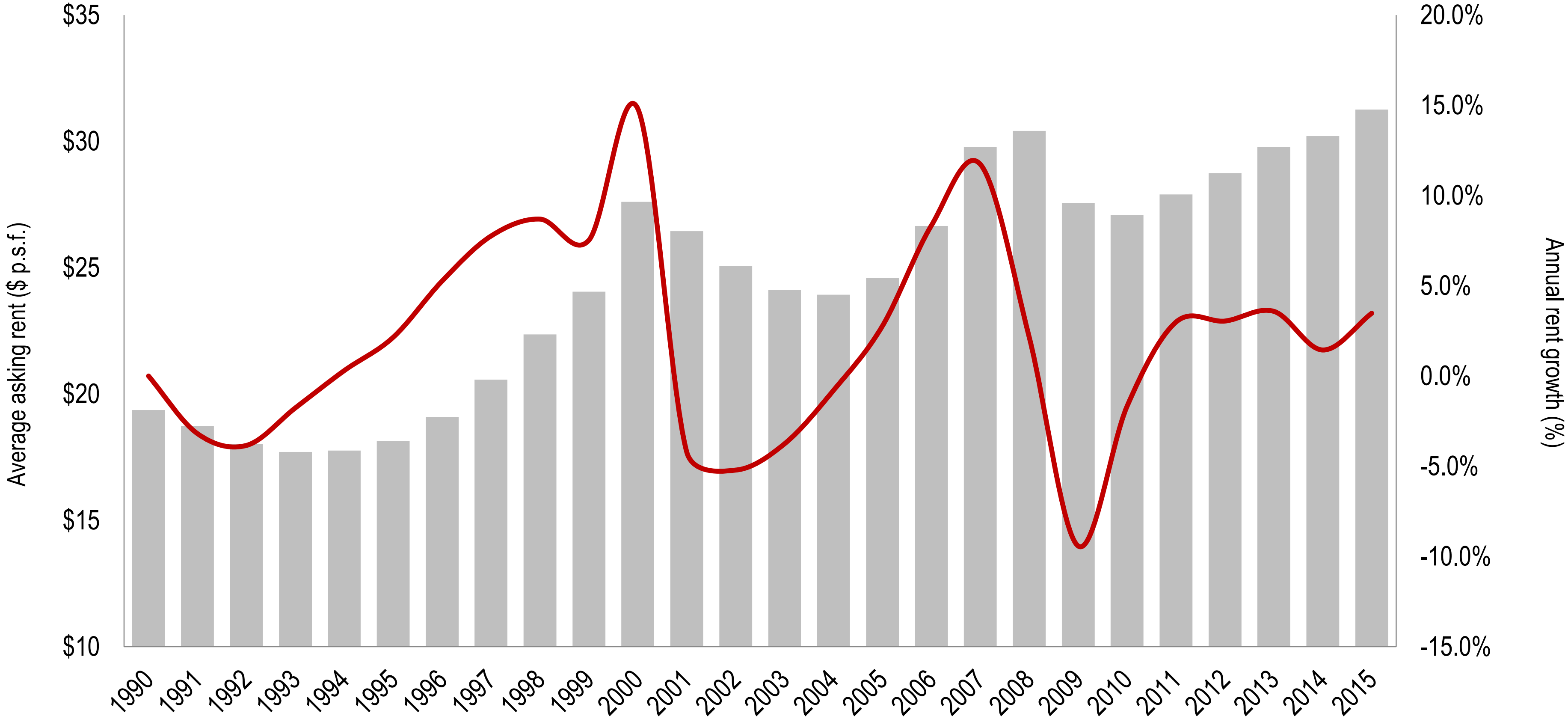
Suburban markets display more variance, from super-hot tech geographies to lagging exurban submarkets



Source: JLL Research

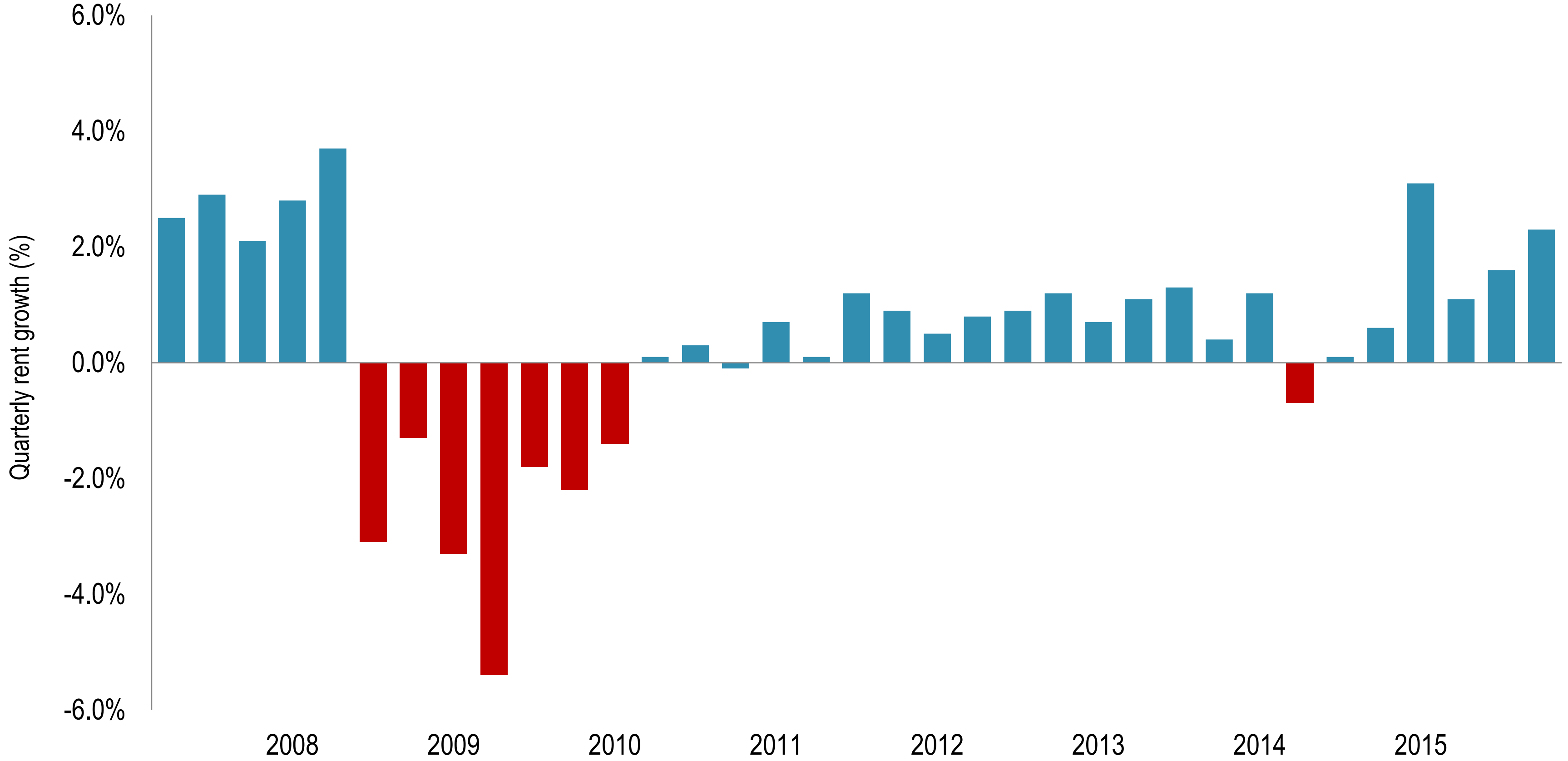
JLL

Annual rent growth remains steady at around 3.5 percent per year, while asking rents are at pre-recession highs



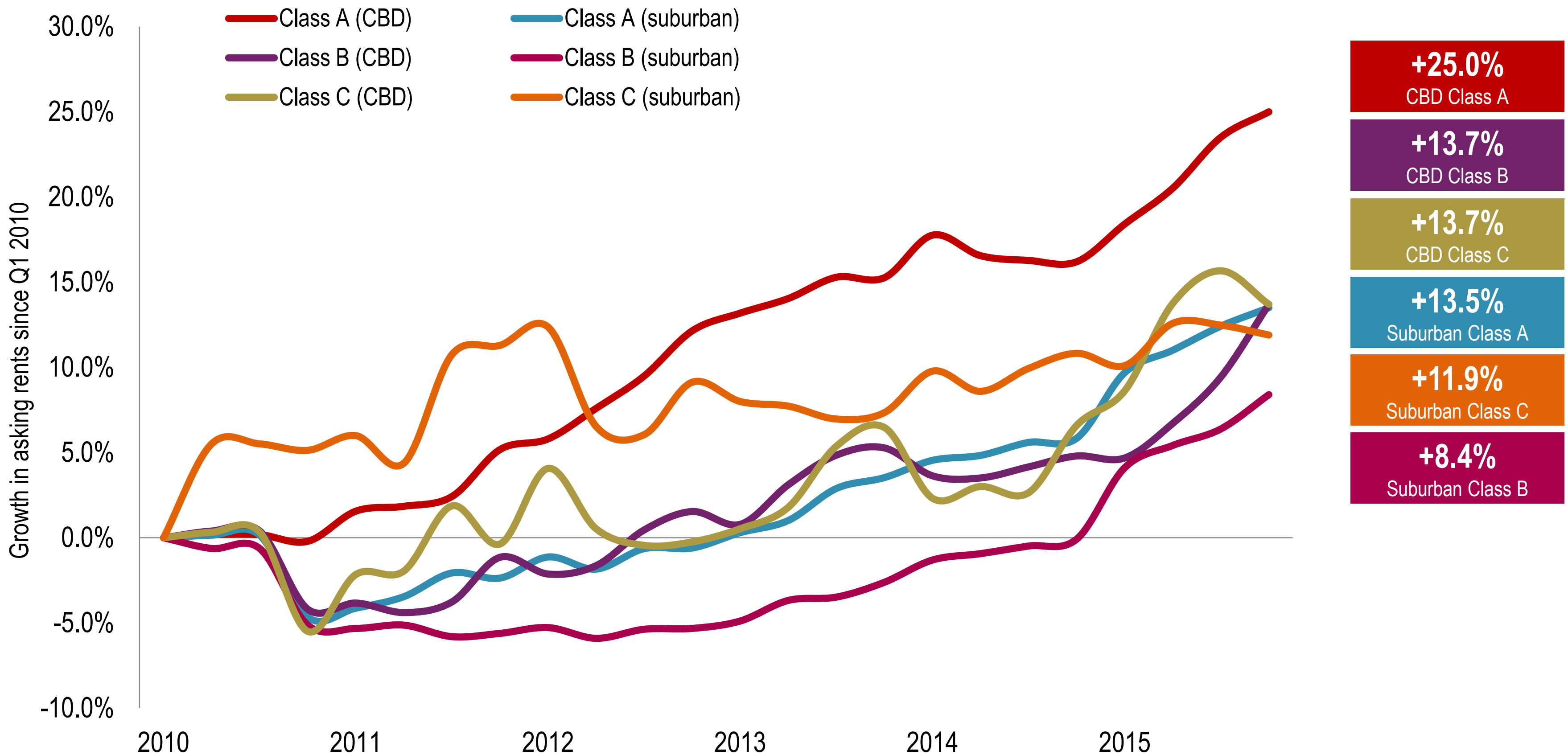
Source: JLL Research

As large blocks diminish and new supply begins to deliver, rents rose at the second-highest rate this cycle so far (+2.3 percent)



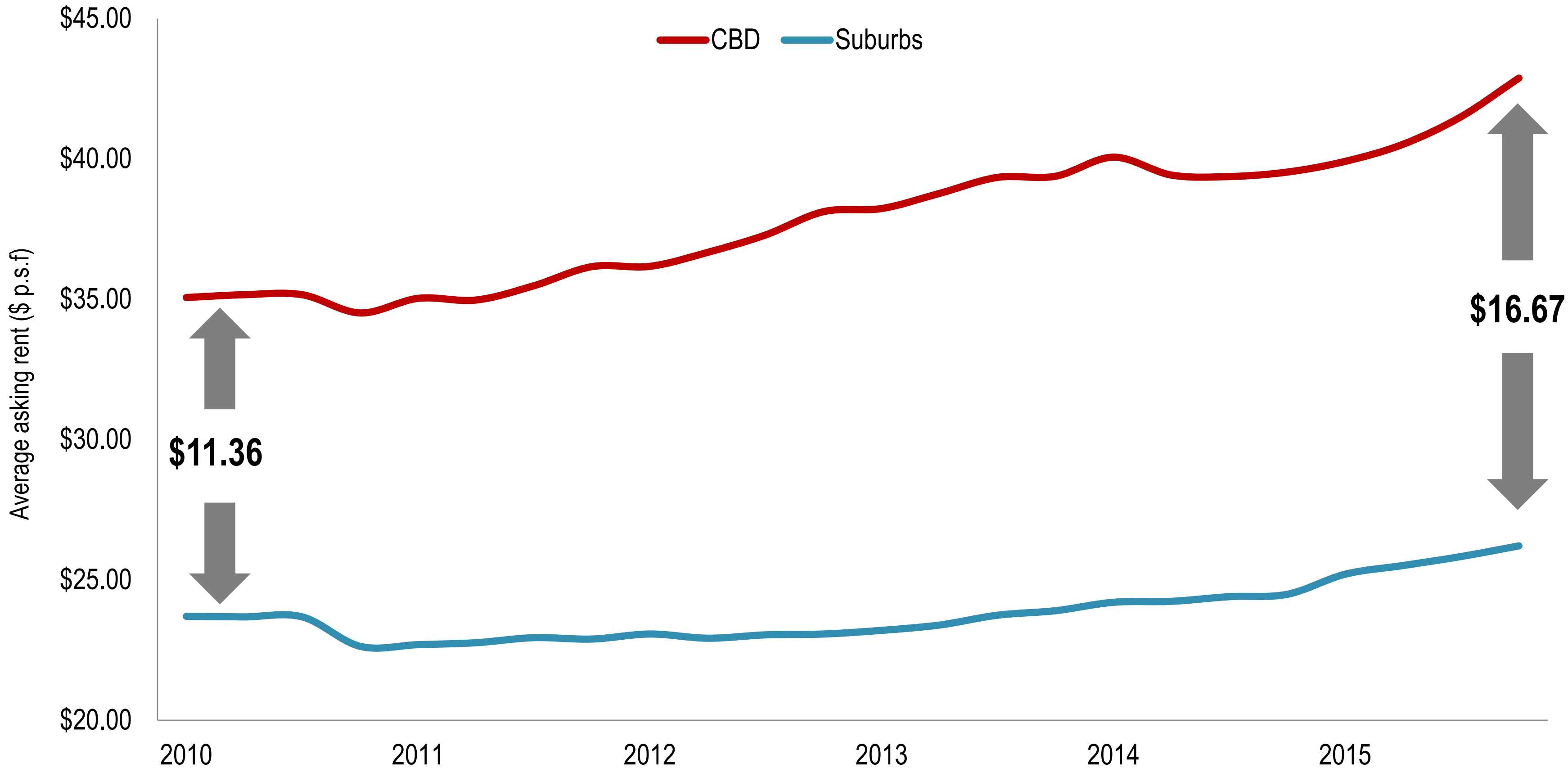
Source: JLL Research

CBD A growth over the course of the cycle remains highest, but suburban A and CBD B posting faster rates of increase of late



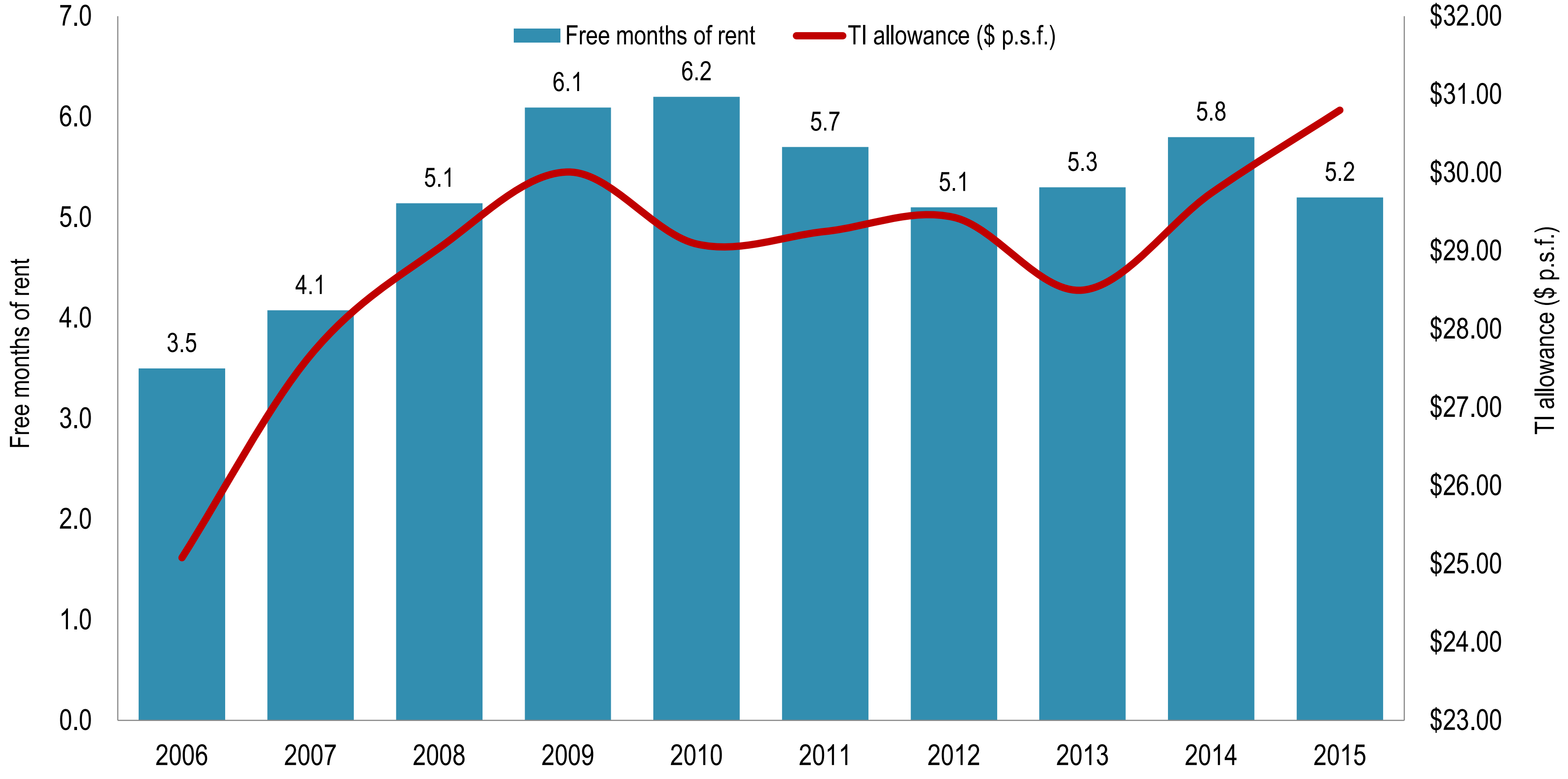
Source: JLL Research

Both CBD and suburban rents are rising appreciably, but the gap between the two grew further to $16.67 per square foot



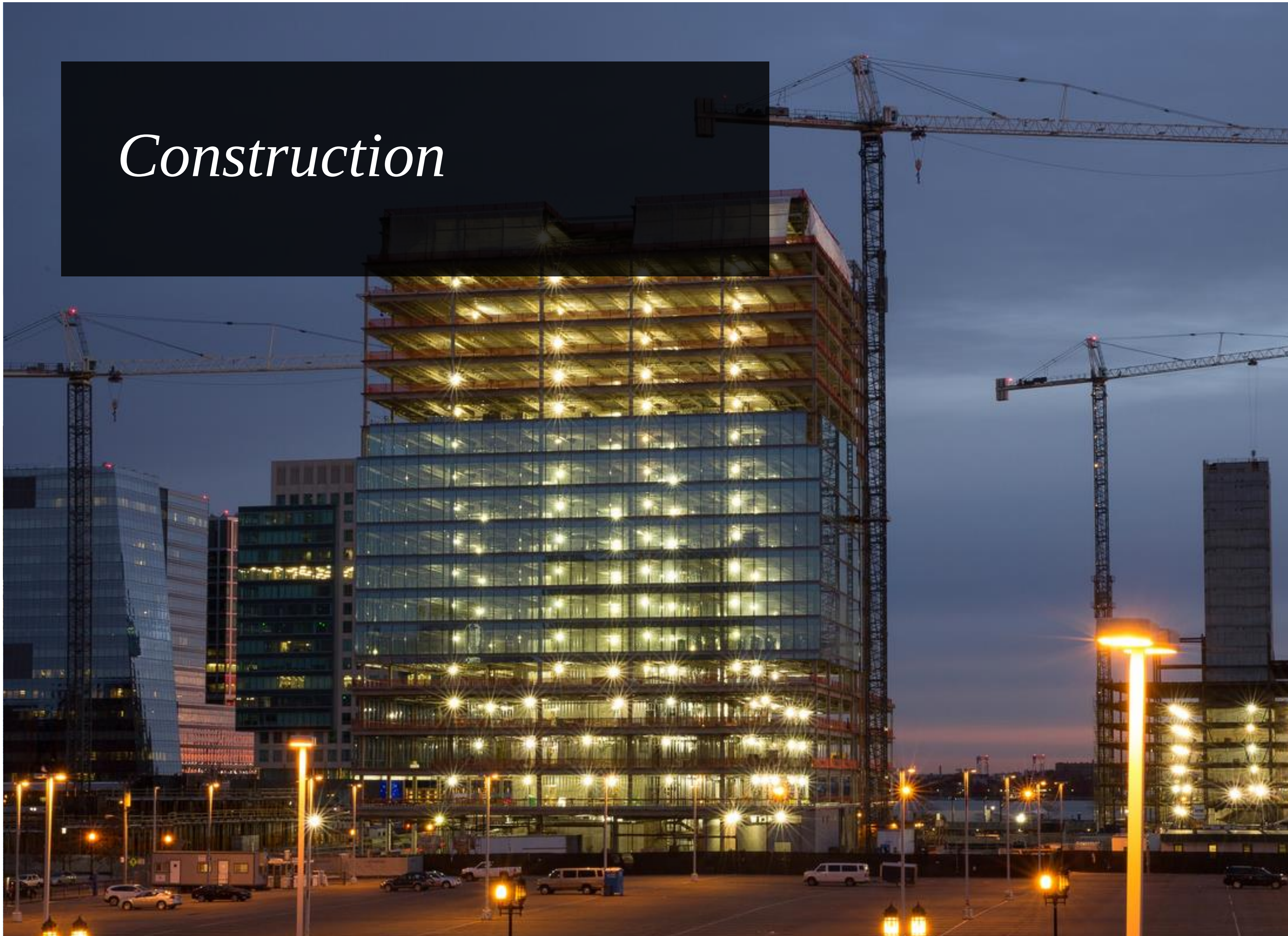
Source: JLL Research

Both TI packages and free months declined once again in Q4, although they are higher than in 2014 as new space delivers

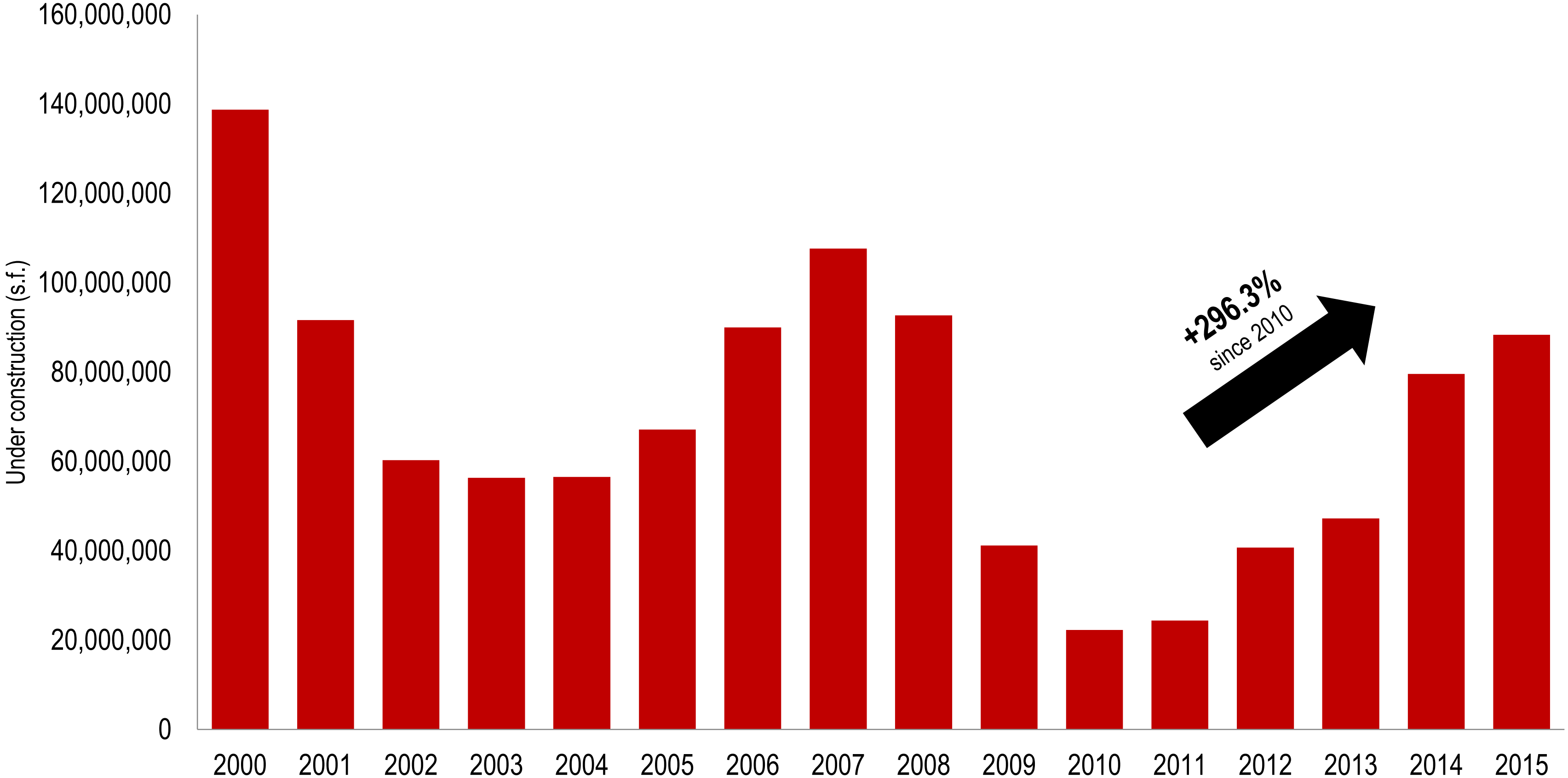


Source: JLL Research

Construction

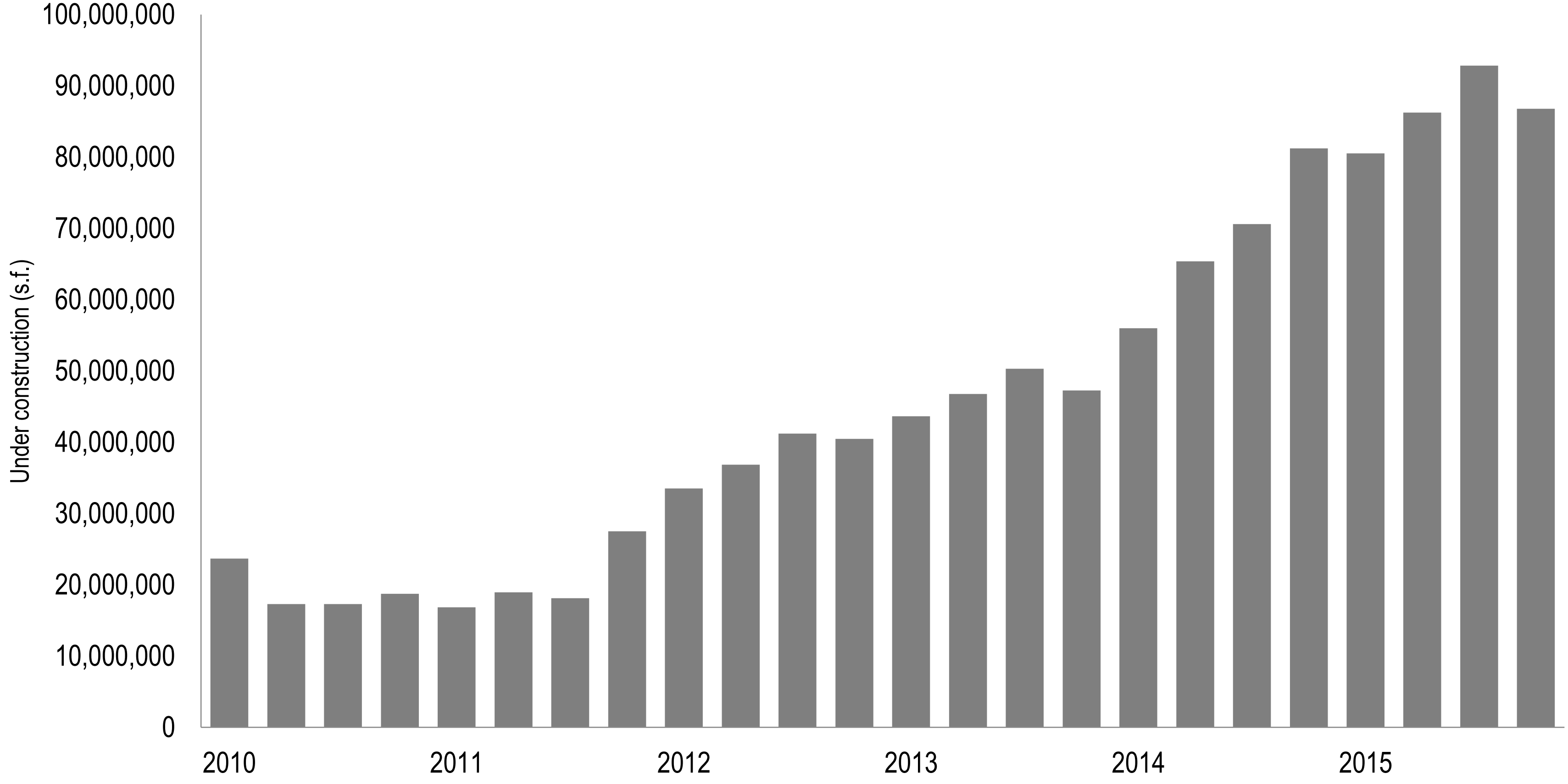


Construction volumes are up 11.0 percent since year-end 2014 to 88.3 m.s.f. in Q4 2015



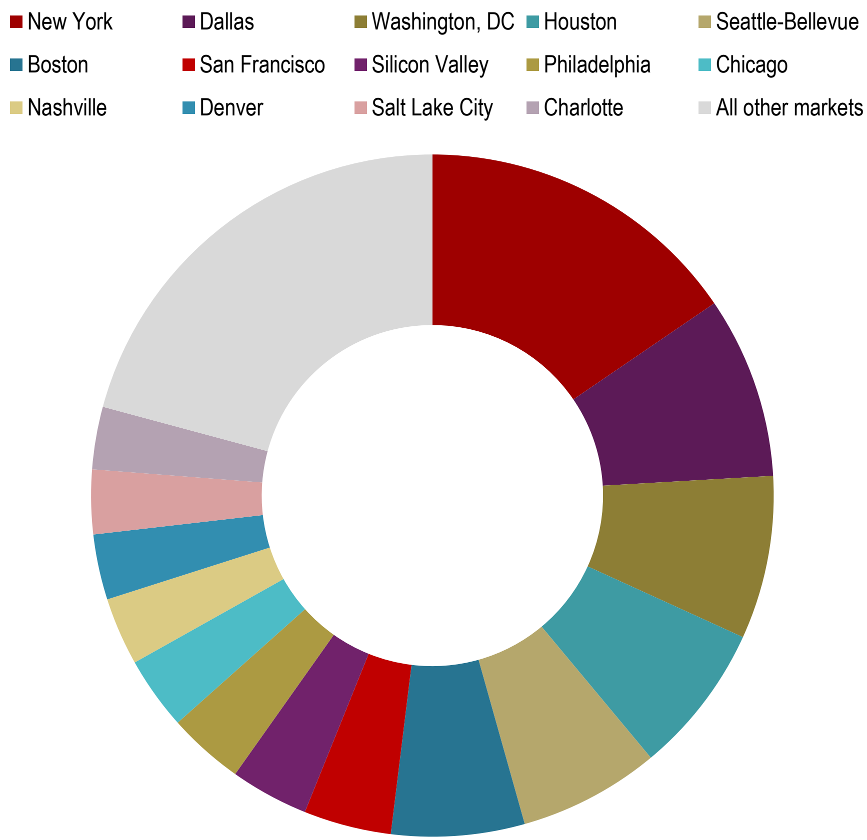
Source: JLL Research

A number of large deliveries and groundbreakings slated for Q1 2016 pushed quarterly activity down in Q4



Source: JLL Research

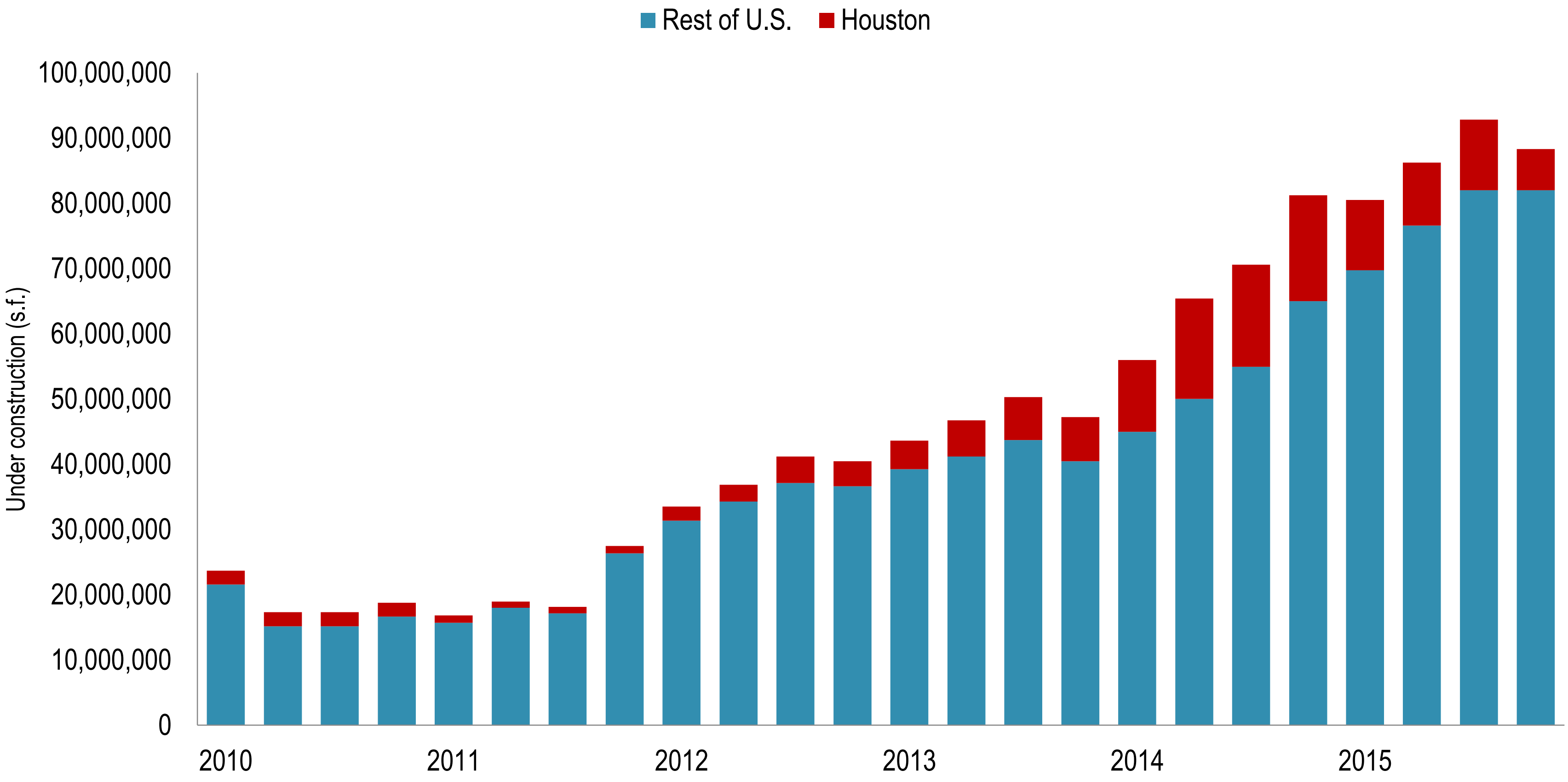
Mid-sized markets such as Nashville, Salt Lake City and Charlotte are becoming more prominent



Market	Under construction (s.f.)	Share
New York	13,666,640	15.5%
Dallas	7,605,715	8.6%
Washington, DC	6,833,786	7.7%
Houston	6,306,180	7.1%
Seattle-Bellevue	5,912,171	6.7%
Boston	5,573,171	6.3%
San Francisco	3,664,519	4.1%
Silicon Valley	3,276,660	3.7%
Philadelphia	3,183,329	3.6%
Chicago	3,055,164	3.5%
Nashville	2,840,446	3.2%
Denver	2,739,079	3.1%
Salt Lake City	2,695,442	3.1%
Charlotte	2,617,222	3.0%
All other markets	**18,384,503**	**20.8%**
United States	**88,328,543**	**100.0%**

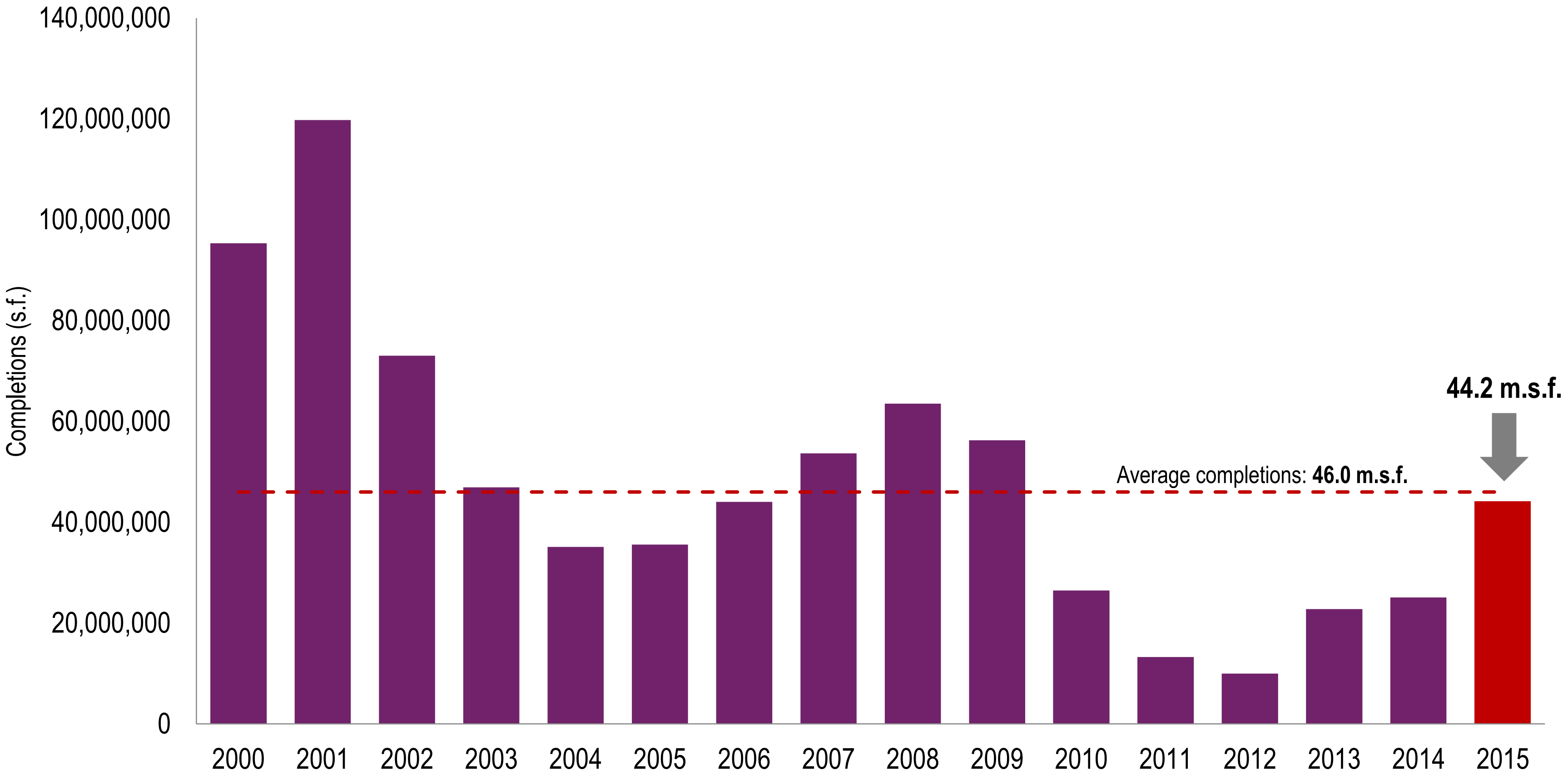
Source: JLL Research

Excluding Houston, development was largely stable quarter-on-quarter at 82.0 m.s.f.



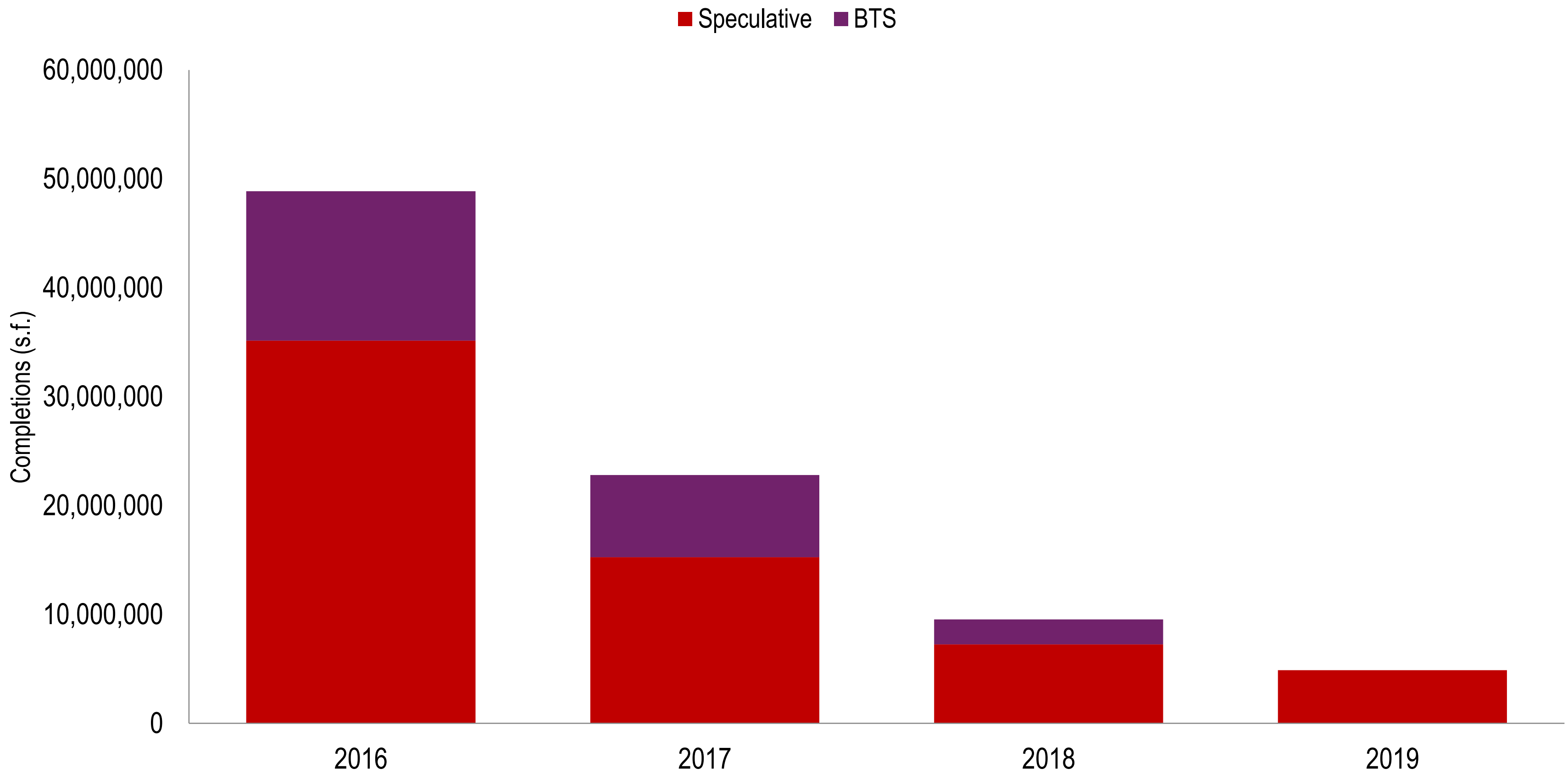
Source: JLL Research

A sharp uptick in completions in Q4 to 44.2 m.s.f. brings 2015 close to the historical average of 46.0 m.s.f.



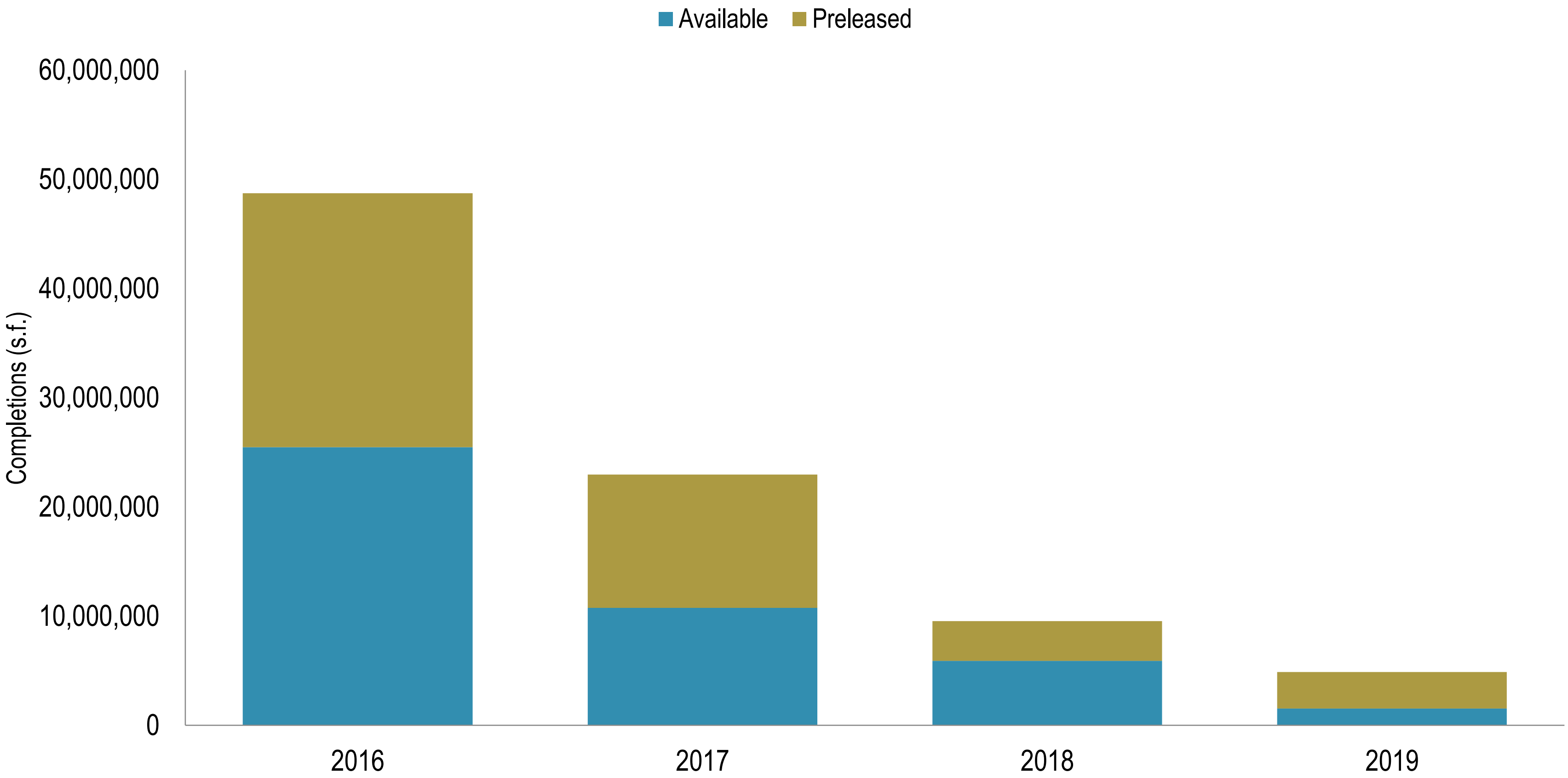
Source: JLL Research

55.2 percent of space currently under construction will come to the market in 2016



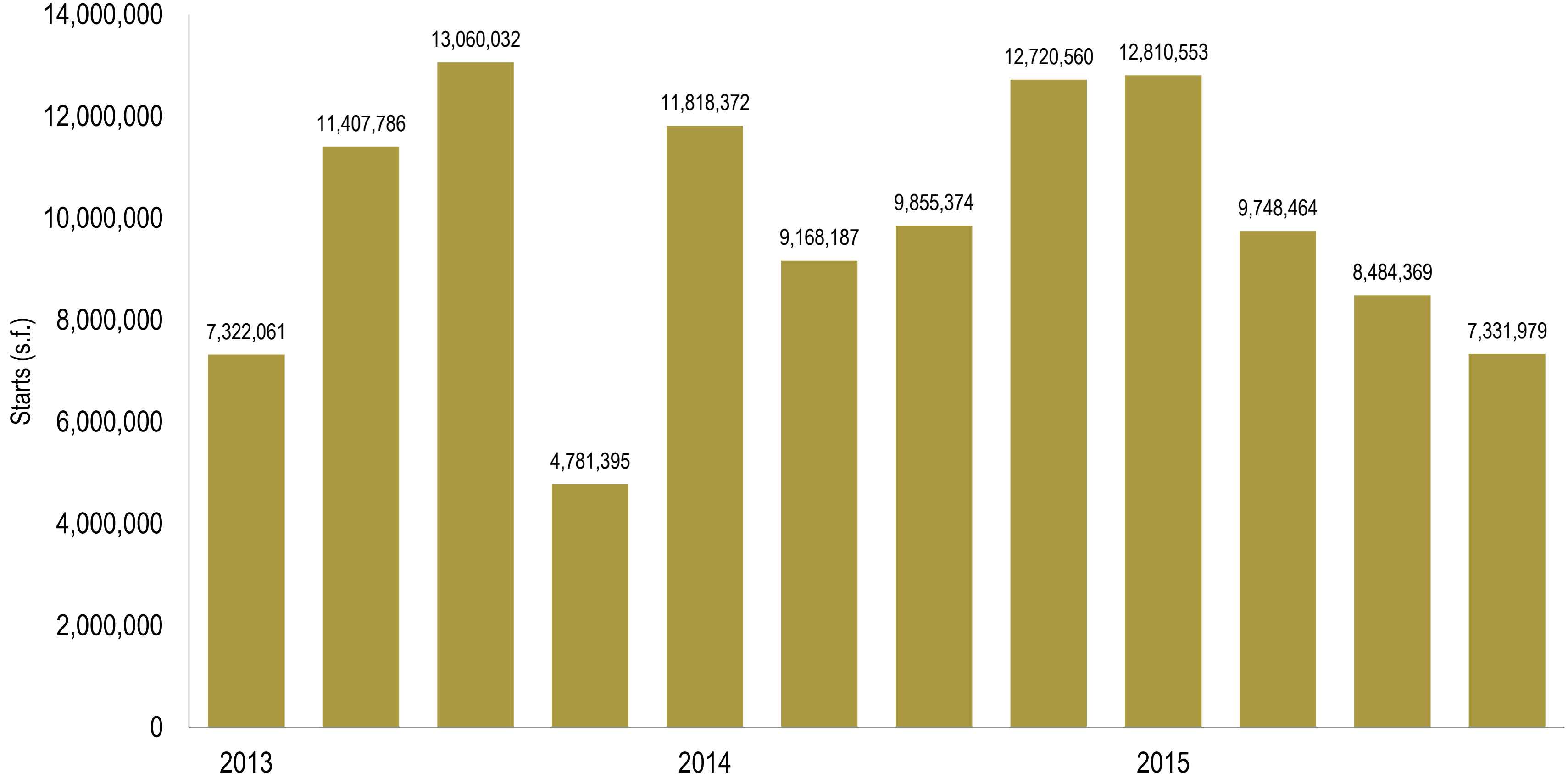
Source: JLL Research

47.7 and 53.1 percent of 2016 and 2017 space has been preleased, respectively, limiting options for tenants and pushing up rents



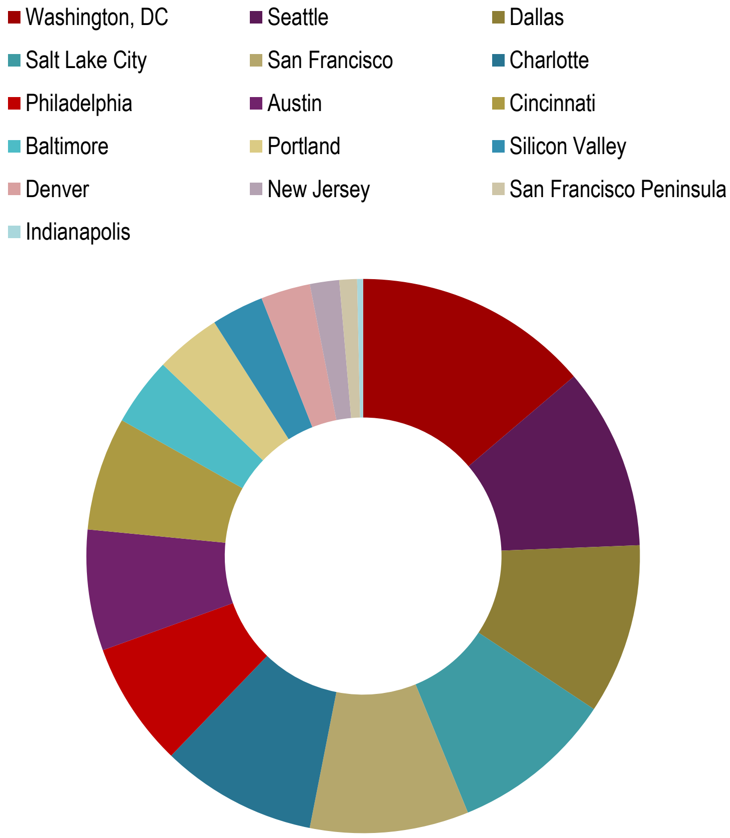
Source: JLL Research

Starts slowed in Q4, although tightening conditions will likely trigger more groundbreakings in 2016



Source: JLL Research

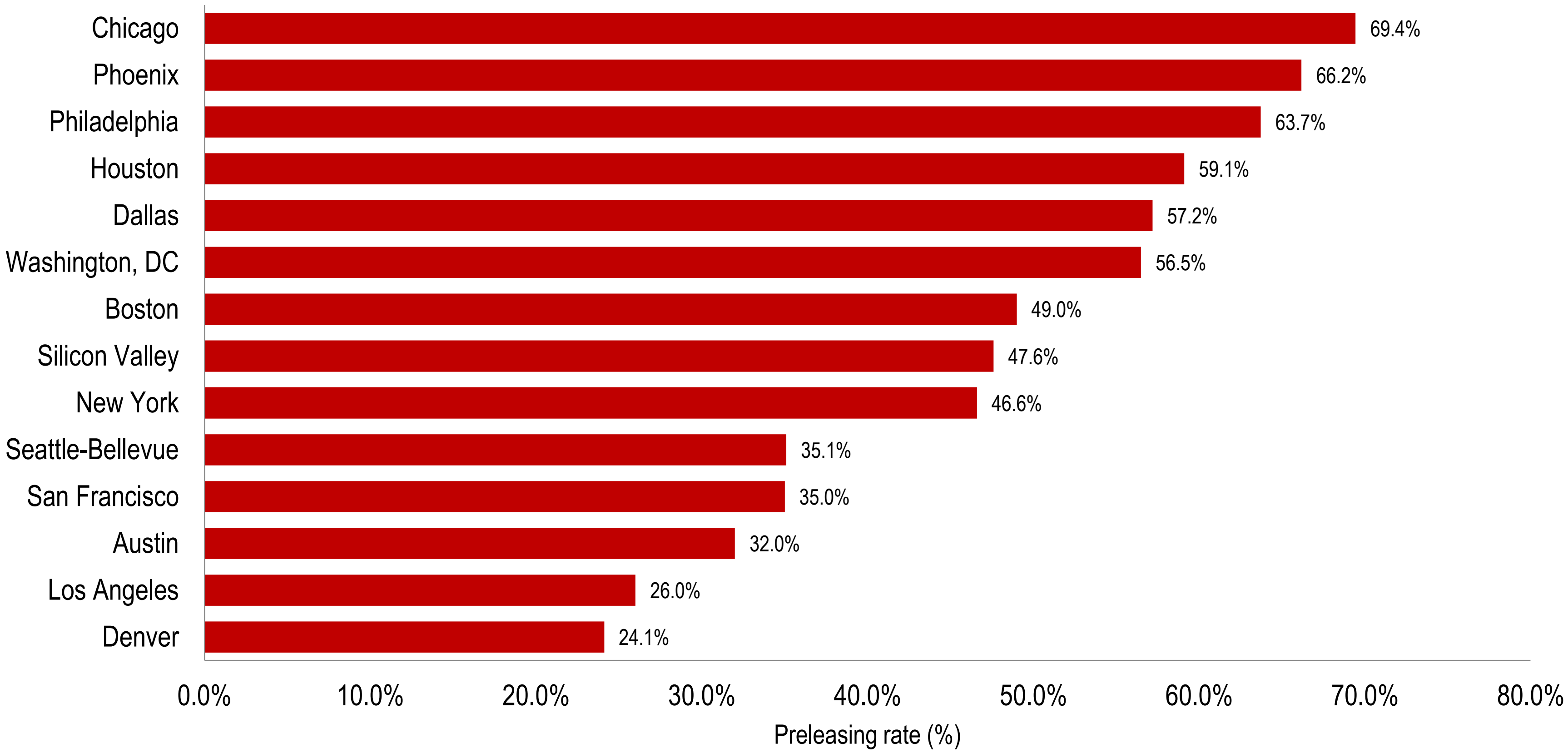
A flurry of new projects in DC, Seattle and Dallas pushed them into leading positions for starts



Market	Starts (s.f.)	Share
Washington, DC	1,010,180	13.8%
Seattle	776,962	10.6%
Dallas	728,455	9.9%
Salt Lake City	697,390	9.5%
San Francisco	680,000	9.3%
Charlotte	667,500	9.1%
Philadelphia	534,000	7.3%
Austin	517,000	7.1%
Cincinnati	485,000	6.6%
Baltimore	292,140	4.0%
Portland	280,907	3.8%
Silicon Valley	224,052	3.1%
Denver	211,879	2.9%
New Jersey	125,445	1.7%
San Francisco Peninsula	75,569	1.0%
Indianapolis	25,500	0.3%
United States	**7,331,979**	**100.0%**

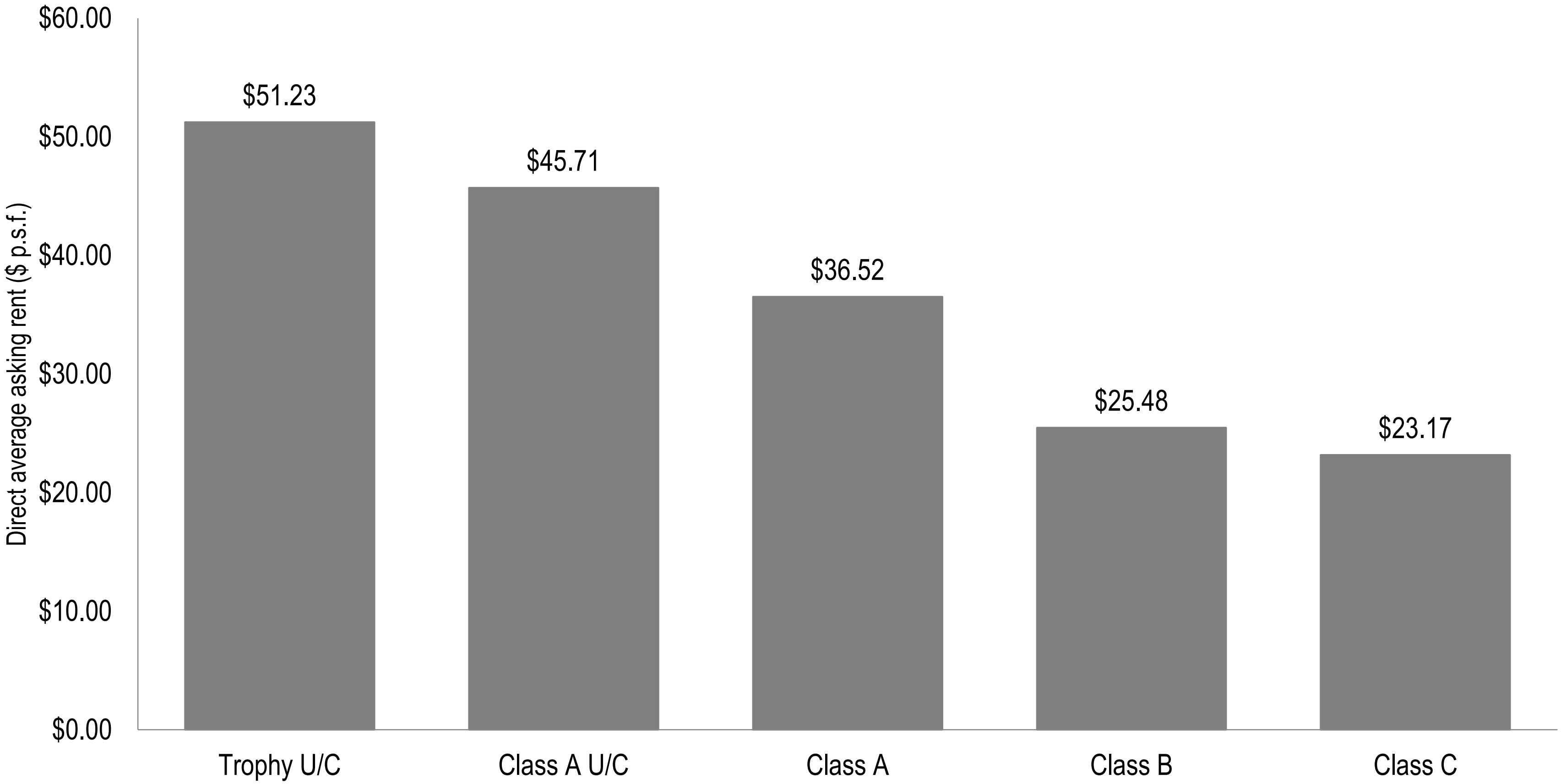
Source: JLL Research

Among top construction markets, BTS-driven geographies are seeing preleasing rates in excess of 60 percent



Source: JLL Research

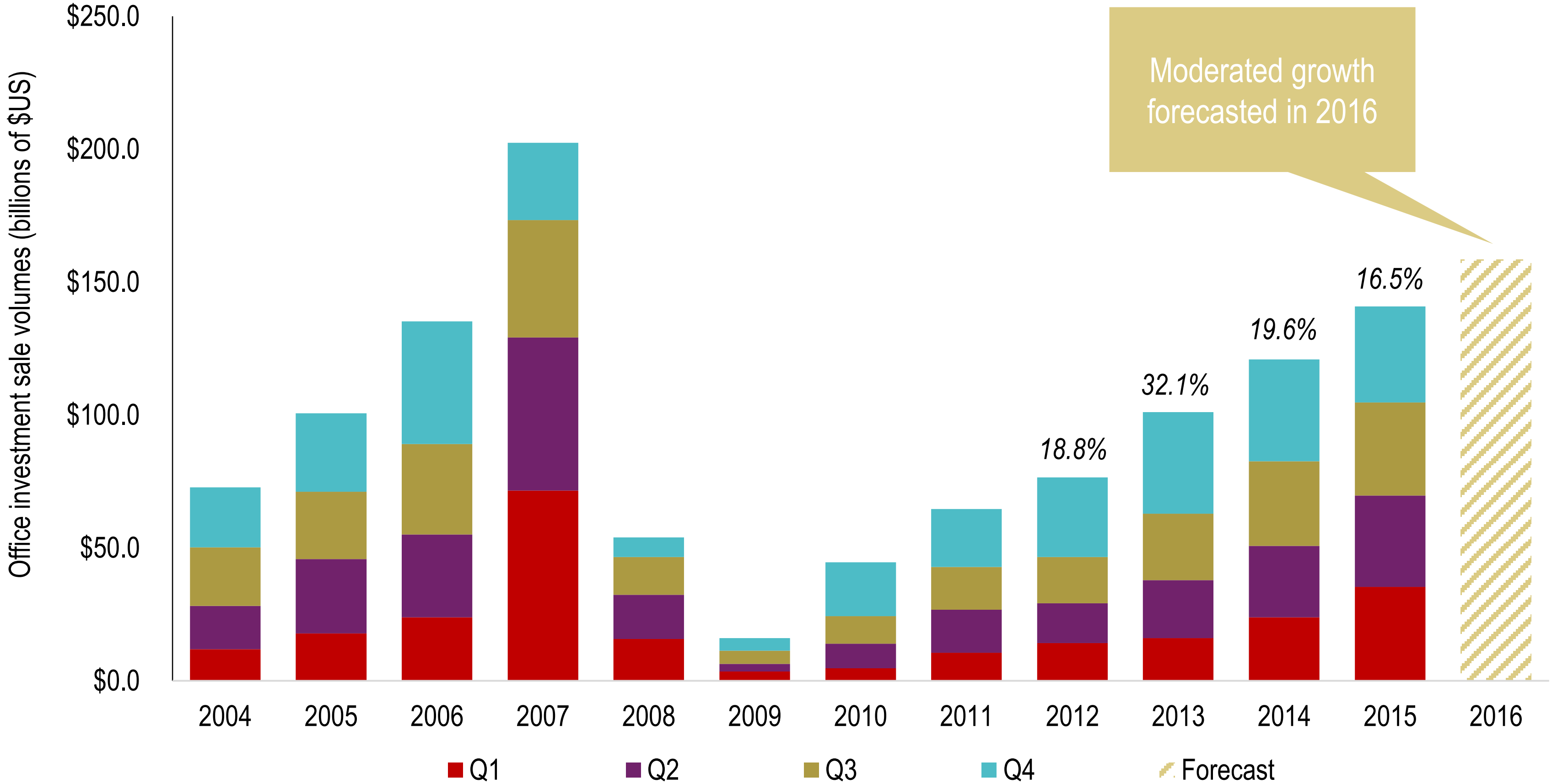
Trophy space under construction is 40.3 percent more expensive than existing Class A properties as demand heats up further



Source: JLL Research

Sales

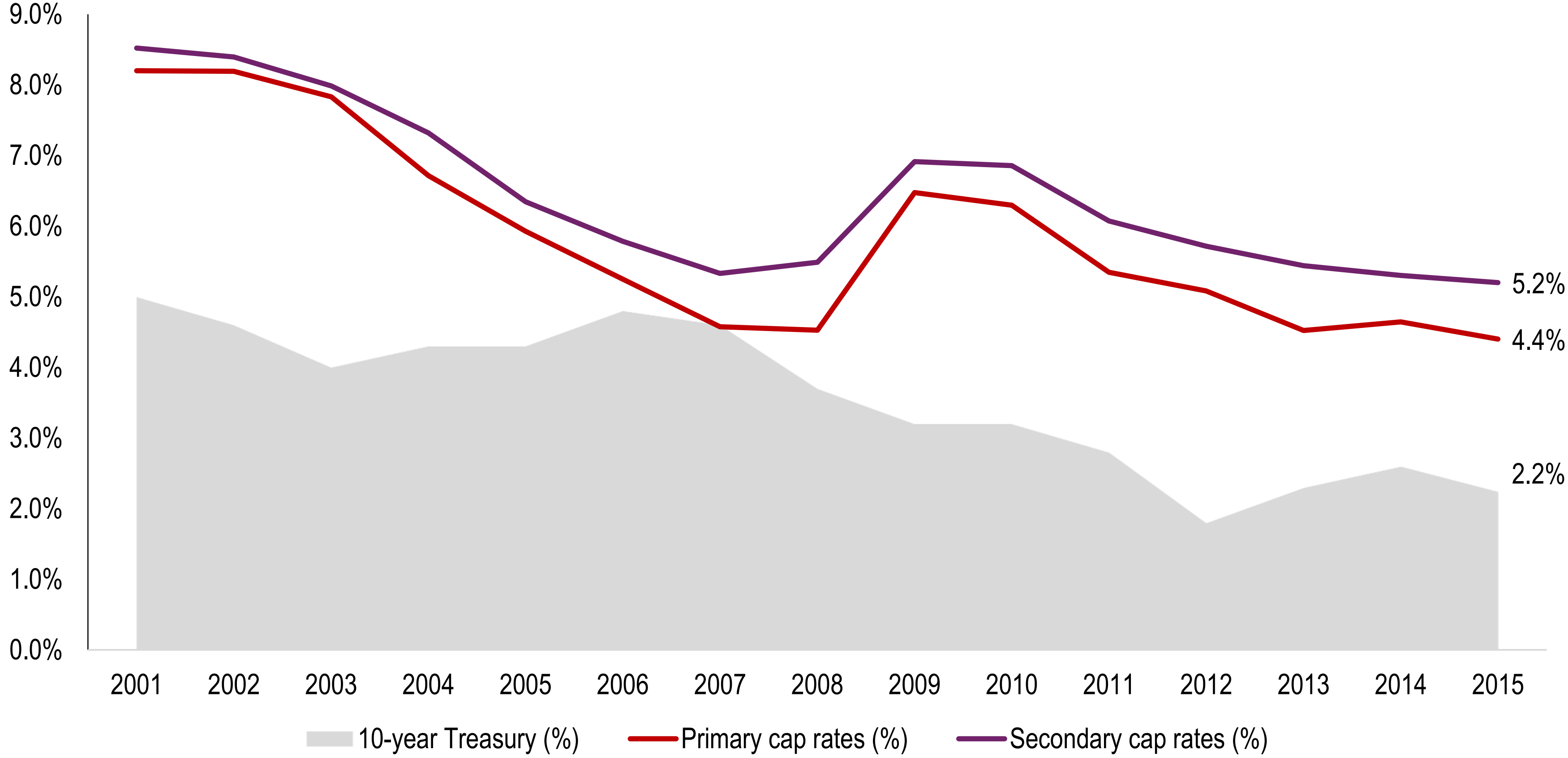
Realized diversification deeper into primary markets, secondary markets and larger transactions spurs 16.5 percent growth in 2015



Source: JLL Research, Real Capital Analytics (Transactions larger than $5.0m)

Primary and secondary cap rates continue to decline

Despite the interest rate hike, the spread between office cap rates and the 10-year Treasury has widened slightly for primary and secondary markets to 219 and 296 basis points, respectively

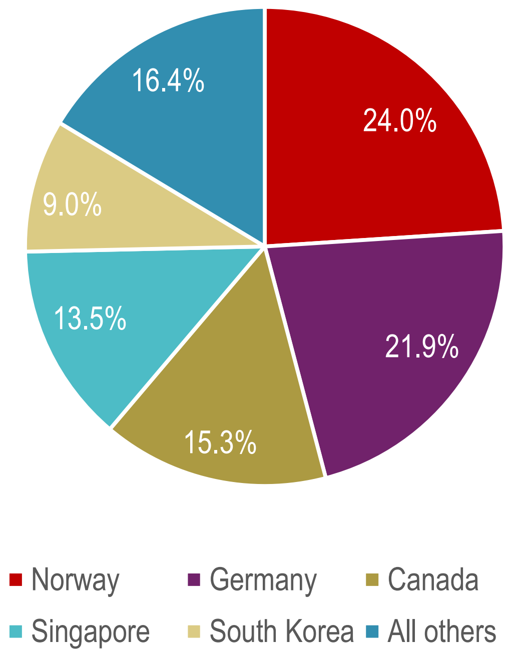


Source: JLL Research, NCREIF, Board of Governors of Federal Reserve

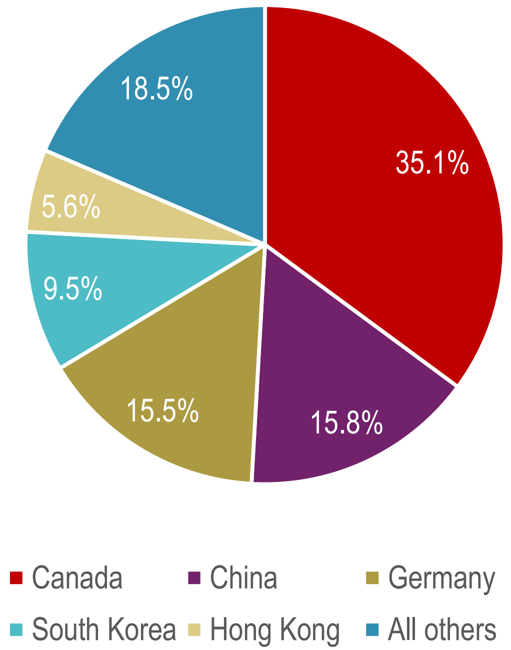
Canadian and Asian capital continue to dominate inbound capital

European and Middle Eastern groups are present, though did not buy at scale in 2015

Most active foreign investors (2014)

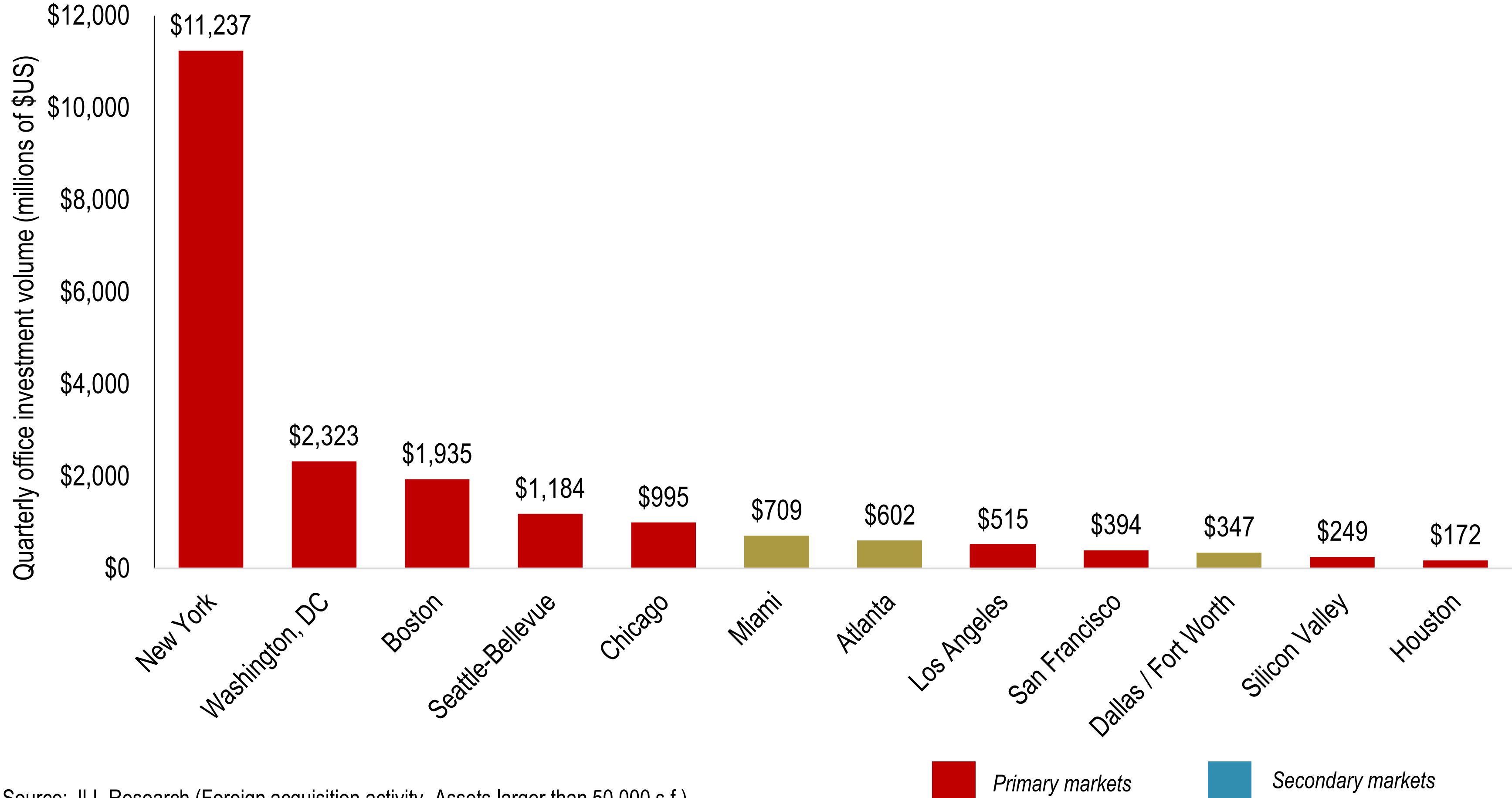


Most active foreign investors (2015)



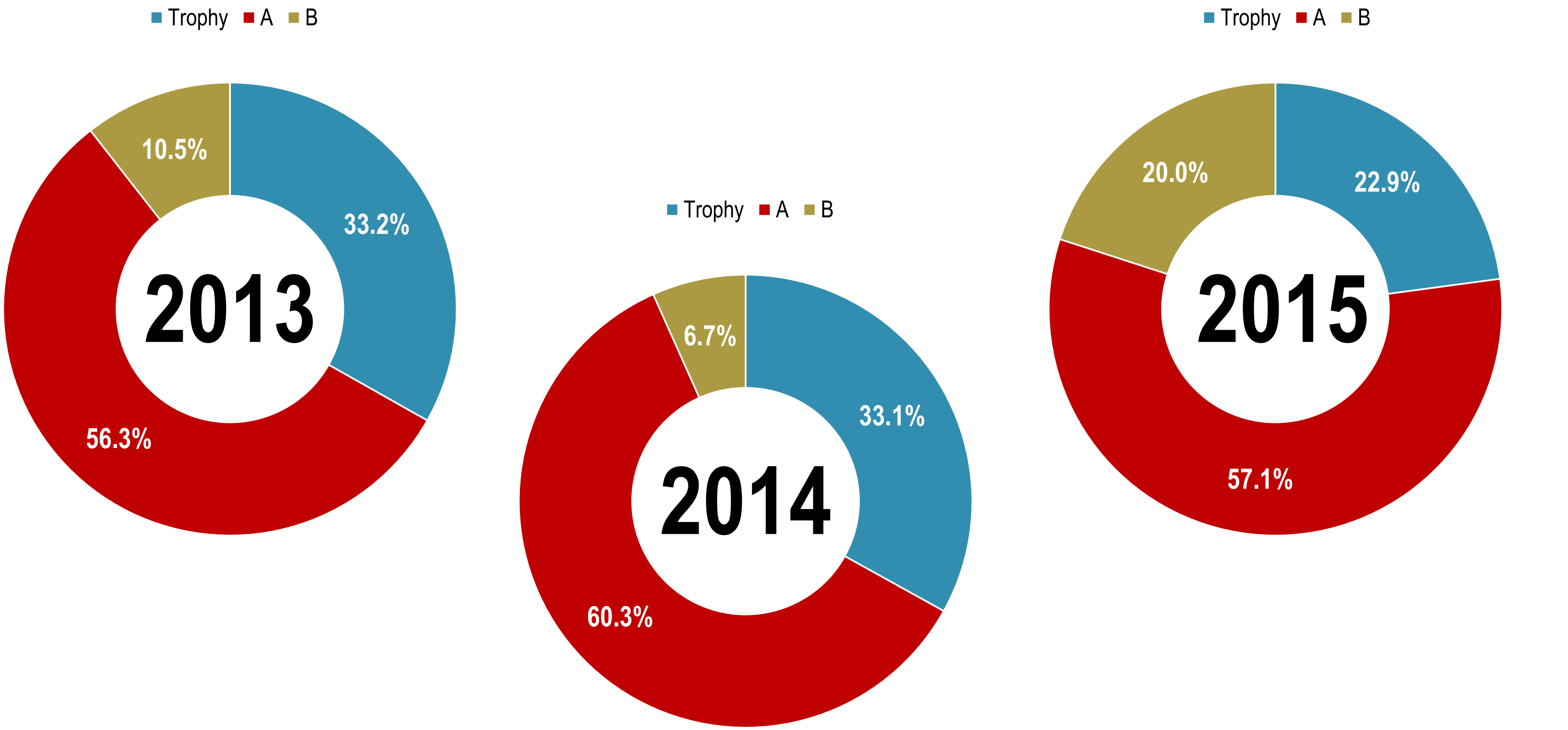
Source: JLL Research (Assets larger than 50,000 s.f.)

Of the top destinations for foreign capital, primary markets remain ahead, though secondary markets emerge



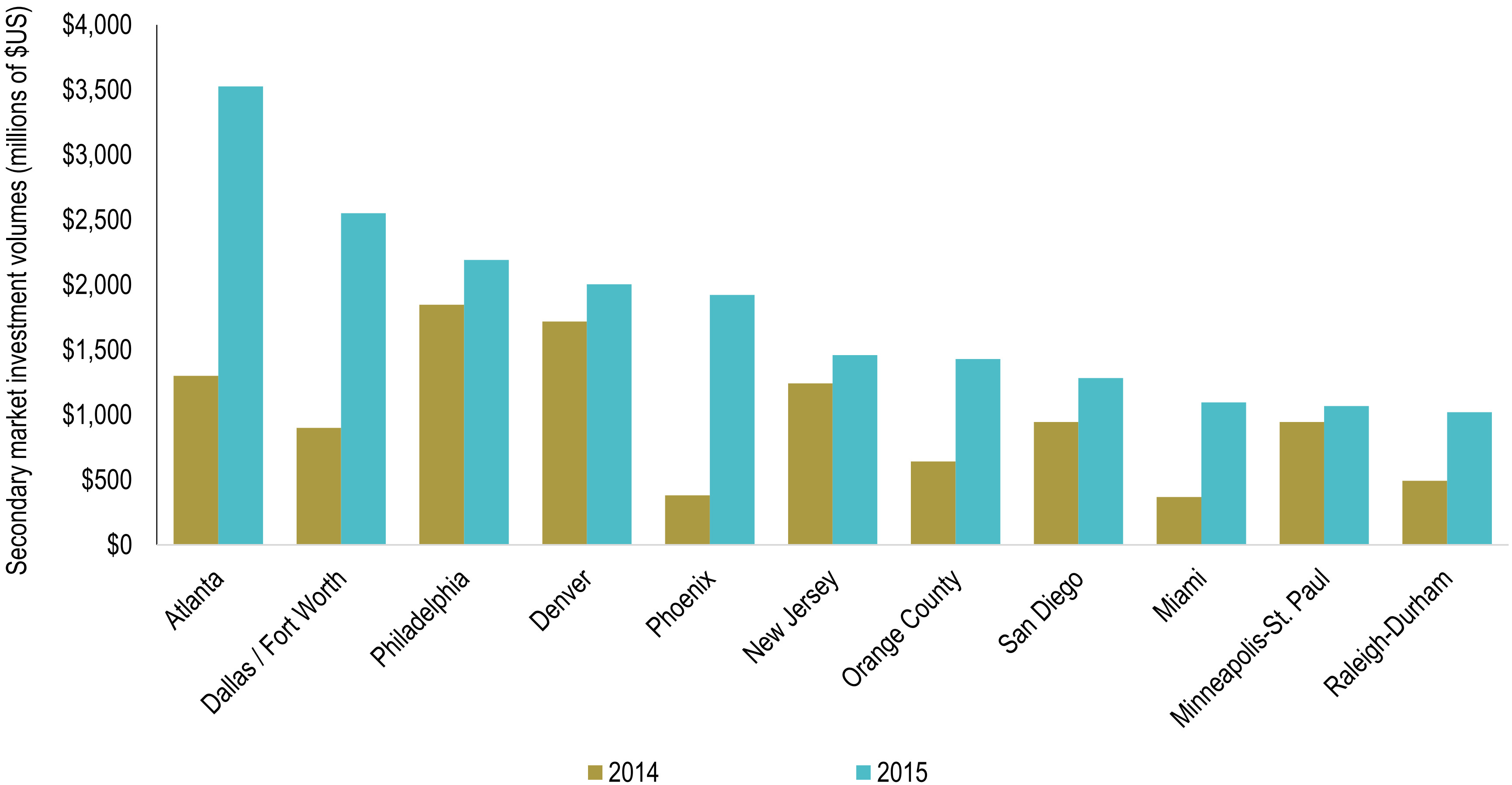
Source: JLL Research (Foreign acquisition activity, Assets larger than 50,000 s.f.)

Foreign activity into Class B increased from $644.5 million in 2014 to $4.1 billion, equating to 20.0 percent of total.



Source: JLL Research (Foreign acquisition activity, Assets larger than 50,000 s.f.)

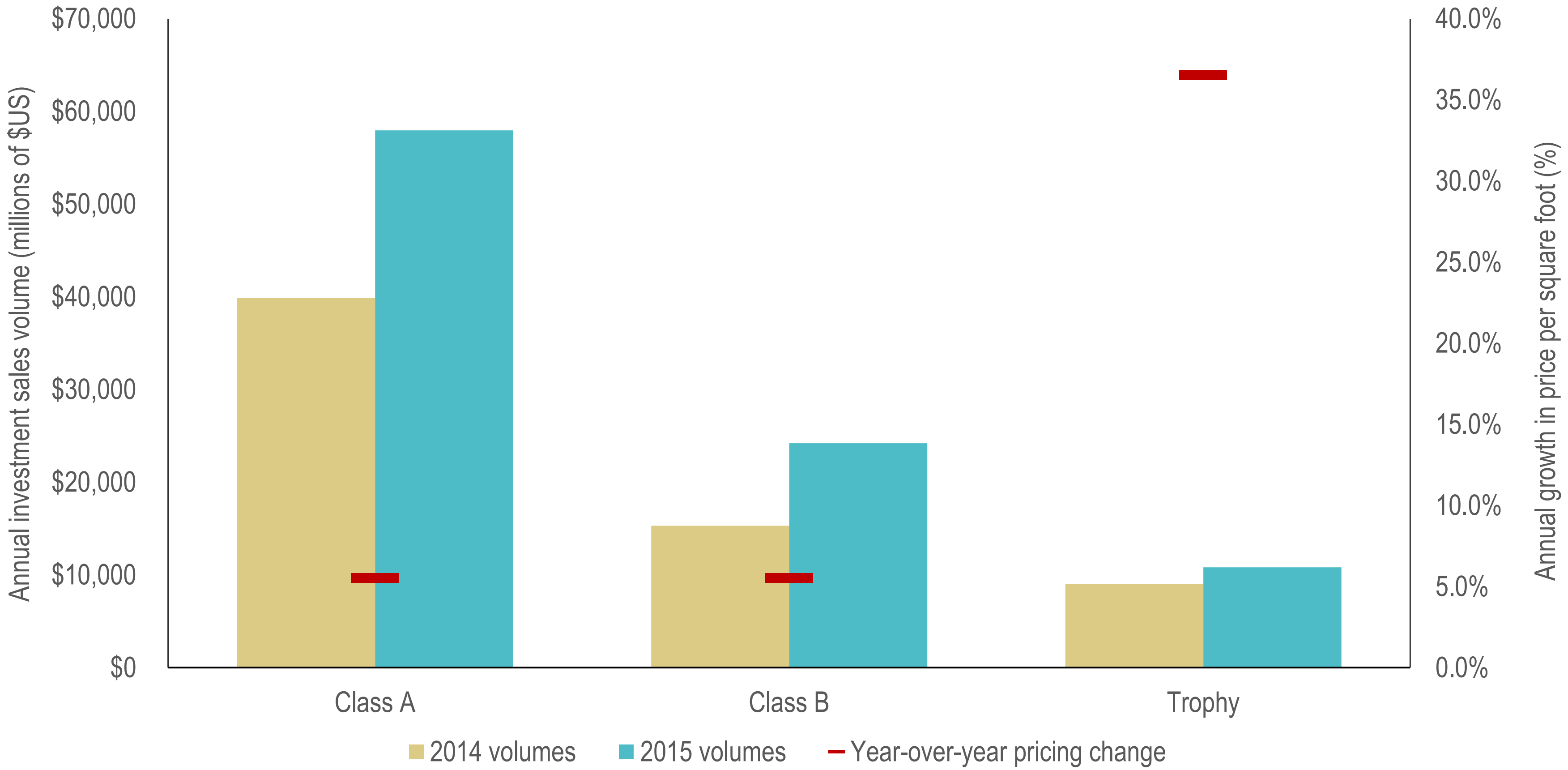
Secondary market momentum realized in 2015 with 11 markets exceeding $1.0b, led by Atlanta, Dallas-Forth and Philadelphia



Source: JLL Research (Assets larger than 50,000 s.f.)

Trophy investment volume was outpaced by Class A & B

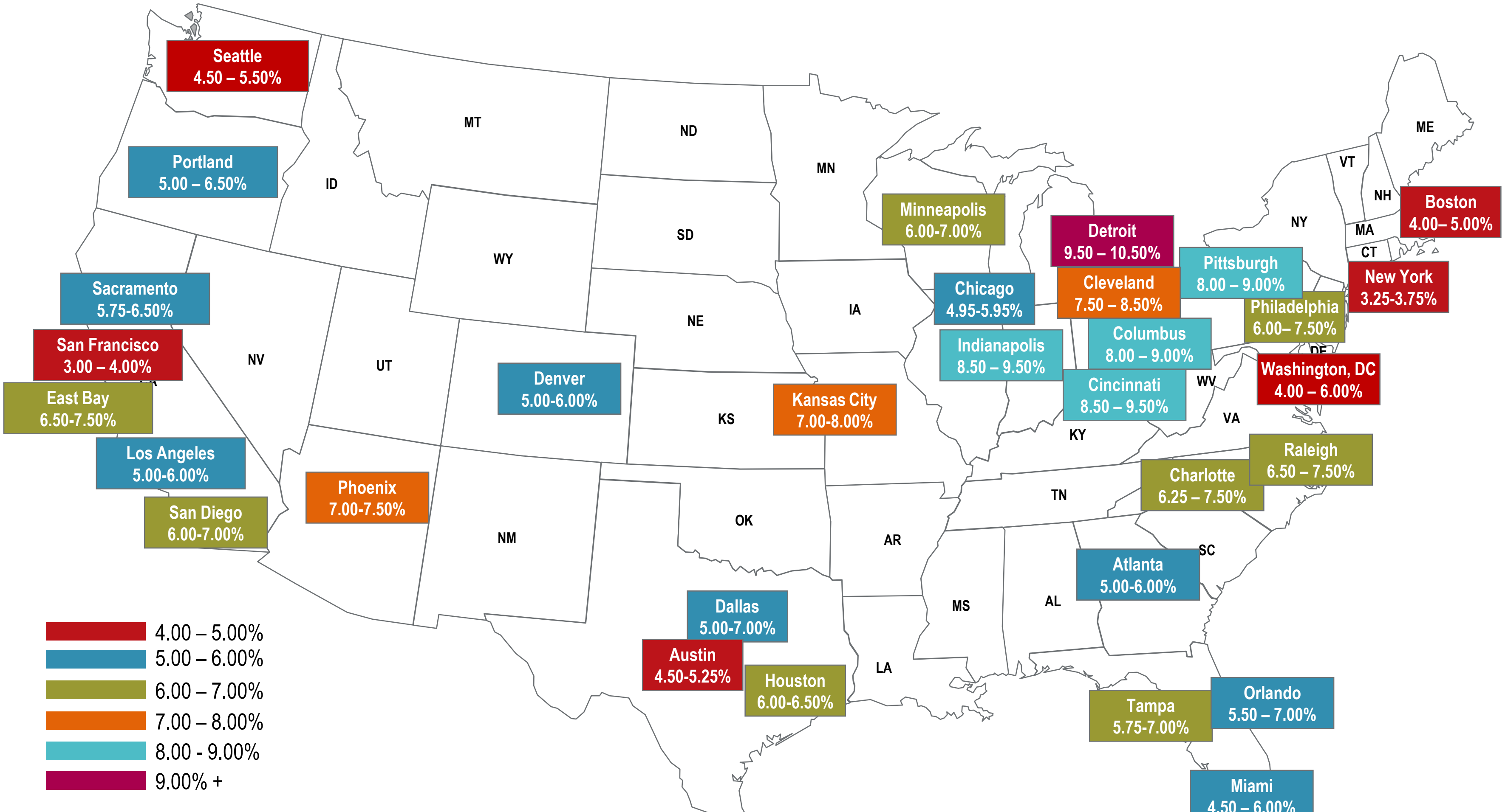
However, supply-demand gap for Trophy product spurred leading per-square-foot pricing appreciation in 2015



Source: JLL Research (Assets larger than 50,000 s.f.)

U.S. core product office CBD cap rates

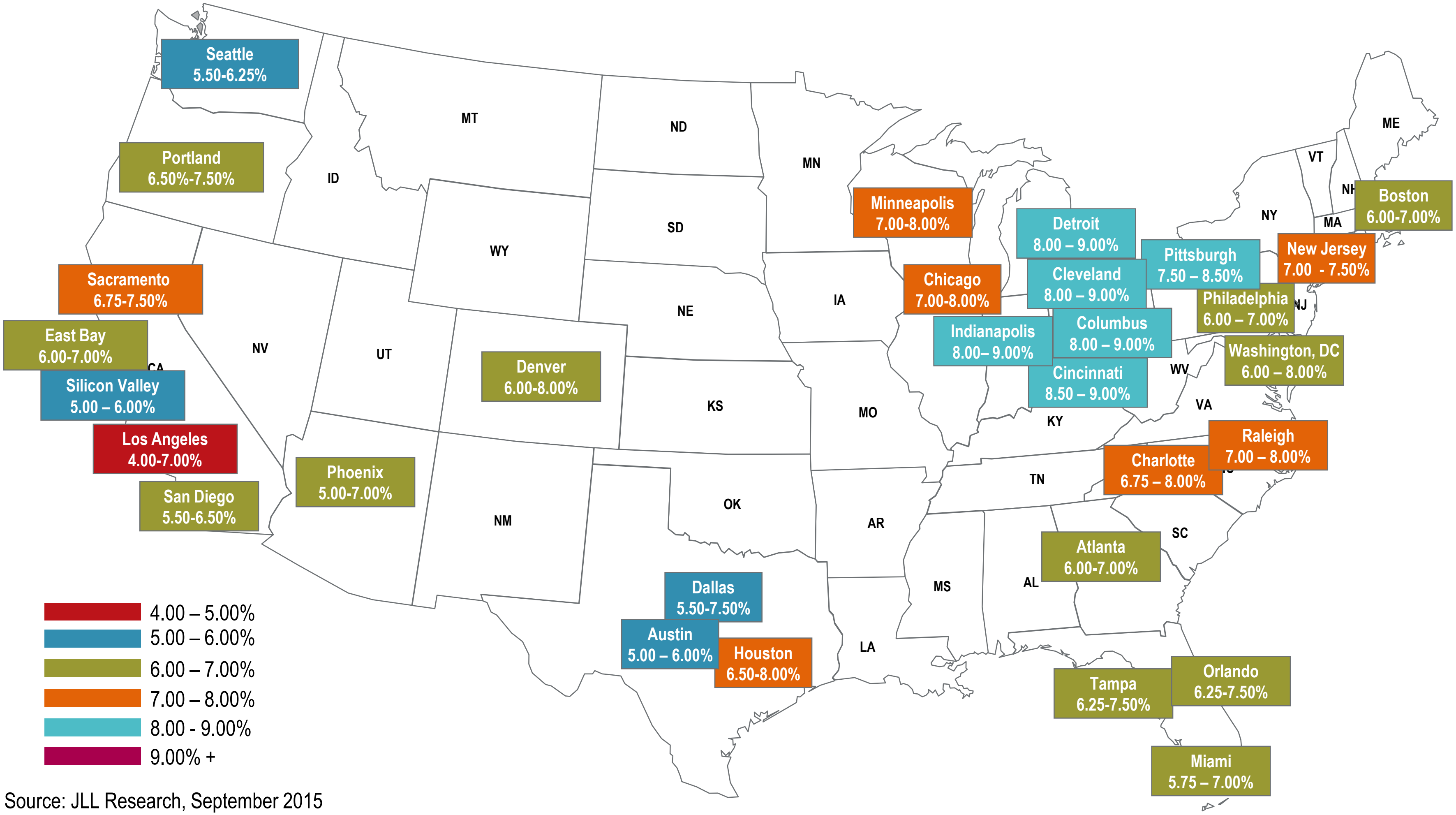
Sub 5-6% level in most primary and rising secondary markets



Source: JLL Research, September 2015

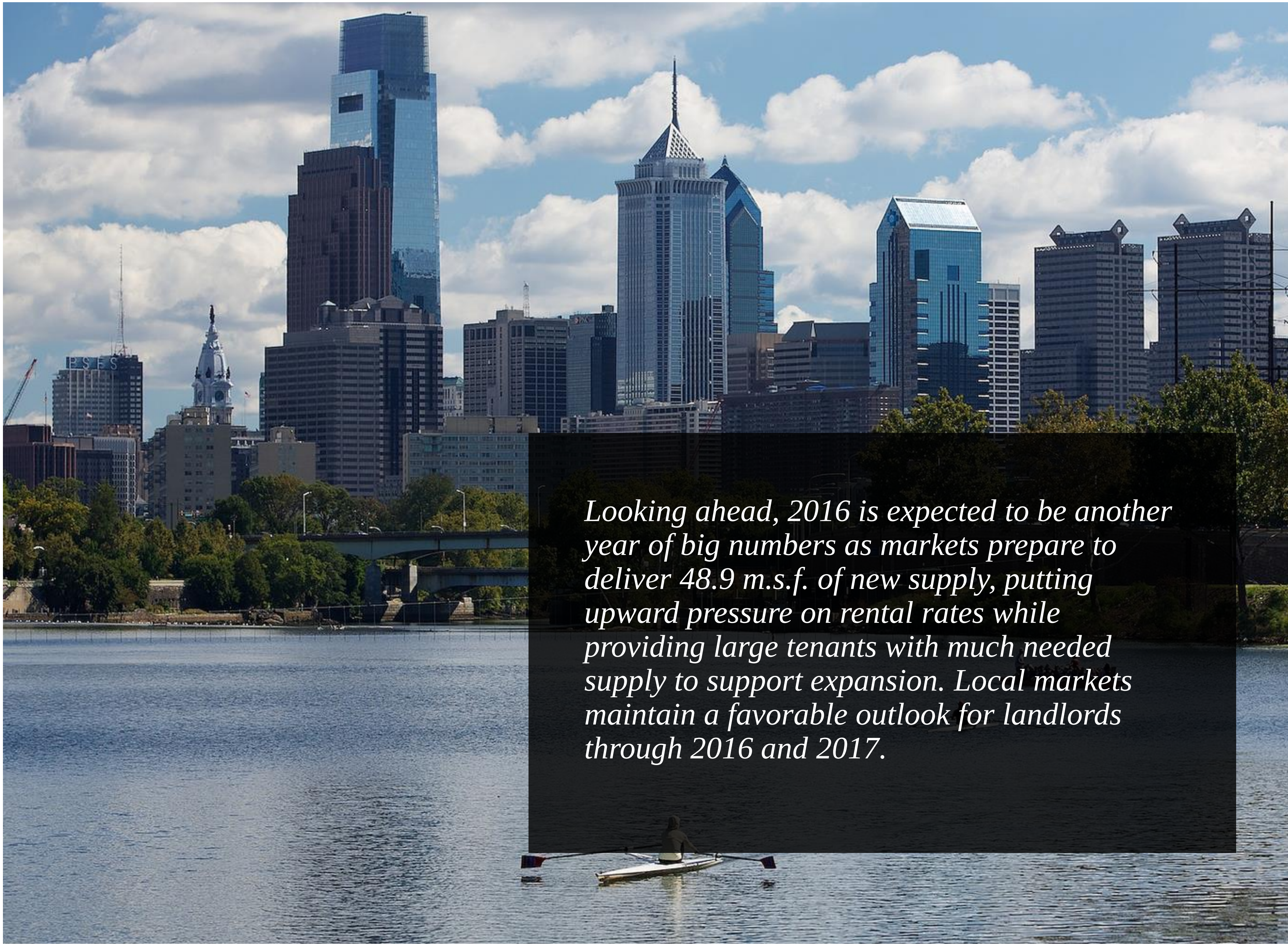
U.S. core product office suburban cap rates

Sub 6-8% level in most primary and rising secondary markets



Source: JLL Research, September 2015

JLL



Looking ahead, 2016 is expected to be another year of big numbers as markets prepare to deliver 48.9 m.s.f. of new supply, putting upward pressure on rental rates while providing large tenants with much needed supply to support expansion. Local markets maintain a favorable outlook for landlords through 2016 and 2017.

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