RESEARCH

NATIONAL
3Q17 OFFICE MARKET

ABSORPTION STRONG AS DEMAND OUTPACES COMPLETIONS

The national office market posted strong absorption during the third quarter as demand outpaced completions for the first time in four quarters. Comparatively, demand was tepid in the first half of the year. Asking rents continue to tick upward as the delivery of newer product elevates pricing and fundamentals are sturdy. Meanwhile, the vacancy rate was unchanged from the previous quarter.

Third Quarter Yields Stout Absorption

Tenants absorbed 10.8 million square feet in the third quarter, up from 6.3 million square feet in the second quarter of 2017 and comparable to the quarterly average in 2016. Tenants in many major markets continue efforts to consolidate and find ways to reduce their occupancy costs through densification. Larger metros such as Seattle, Manhattan, Dallas, Los Angeles, Silicon Valley, Washington, and Chicago led the nation in demand. Comparatively, the second quarter office performance was led by mid-size markets like Atlanta, Austin, Charlotte, and Phoenix, which have consistently generated jobs during this economic cycle.

Of the 56 office markets tracked by NKF, 12 markets recorded negative third-quarter absorption. Laggards included Houston, Oakland/East Bay, and Salt Lake City. Fairfield County, CT, in particular, catalogued negative absorption for a fifth straight quarter and had the nation's poorest performance, with negative 666,731 square feet of absorption. Job growth there is limited, with some firms relocating to markets where they have access to a larger talent pool. Office-using industries responsible for driving market demand—such as the Professional and Business Services sector—shed jobs in Fairfield County for the eleventh straight quarter.

During the third quarter, two lease transactions greater than 450,000 square feet occurred in New York. The workers' union 1199SEIU United Healthcare Workers East's 580,000 square foot lease at 498 Seventh Avenue represented one of the largest deals in the nation. Another public sector entity—the New York City Housing Authority—signed for 461,000 square feet at 90 Church Street.

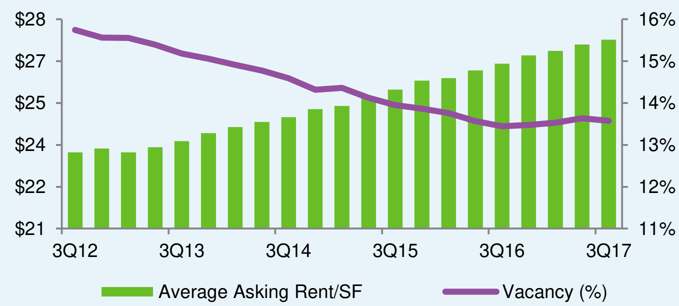
Third quarter absorption nearly doubled the second quarter's performance and outperformed absorption in the first half of the year. The vacancy rate remained unchanged from the previous quarter, though, as new product delivered. Vacancy rose 20 basis points from one year ago.

Current Conditions

- Third quarter absorption was strong compared to the relatively tepid totals in the first half of the year, as demand outpaced completions for the first time in four quarters.
- The construction pipeline remains robust, though lenders are becoming more cautious.
- Vacancy remained unchanged during the third quarter.
- Rents continued to tick up during the quarter.

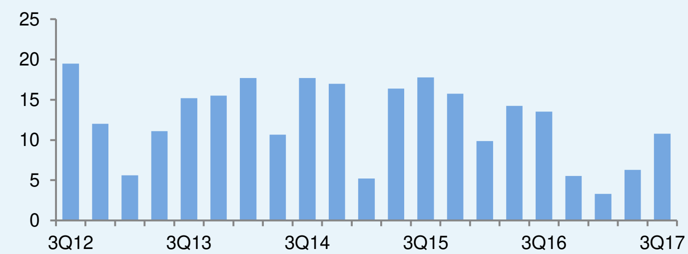
Market Analysis

Asking Rent and Vacancy



Net Absorption

Square Feet, Millions



Market Summary

	Current Quarter	Prior Quarter	Year Ago Quarter	12-Month Forecast
Vacancy Rate	13.6%	13.6%	13.4%	↔
Net Absorption*	10.8	6.3	13.5	↔
Average Asking Rent/SF	$27.32	$27.16	$26.51	↑
Under Construction*	78.2	70.8	75.7	↑
Deliveries*	9.9	9.3	10.0	↑

* Square feet, millions

Construction Persists

For the first time since the third quarter of 2016, absorption outpaced completions, which totaled 9.9 million square feet. So far in 2017, completions total 31.6 million square feet. However, space under construction remains significant, at 78.2 million square feet, up from 75.7 million square feet in the third quarter of 2016. Typically, construction remains robust as a cycle matures. Regulators would like to see construction reigned in to create a better supply/demand balance in the years ahead.

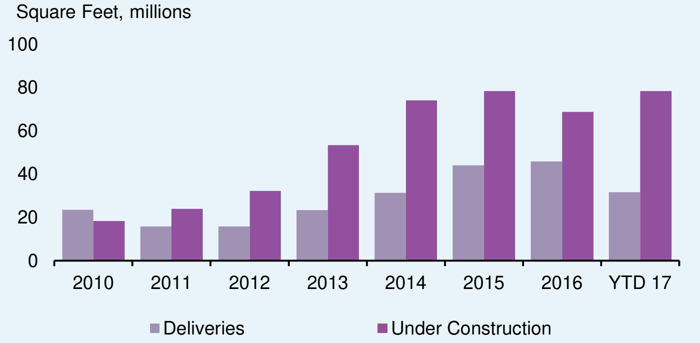
FOR THE FIRST TIME SINCE THE THIRD QUARTER OF 2016, ABSORPTION OUTPACED COMPLETIONS

Overall, U.S. office construction remains under control, at 1.6% of standing inventory. However, some markets exceed this threshold and bear watching, including Manhattan, San Francisco, and Silicon Valley—markets whose construction pipeline relative to total inventory tops 3%.

Manhattan continues to lead all markets with 13.9 million square feet in the pipeline, followed by Washington, DC, San Francisco and Dallas. A number of notable projects are ongoing, including Salesforce Tower in downtown San Francisco; the expansion of Amazon's downtown Seattle campus; and several towers and boutique buildings in Manhattan.

While much has been made of the millennial workforce preferring downtown work environments, some suburban markets are succeeding by creating walkable, active office settings. Some financial services firms, in particular, are locating operations outside traditional downtown areas in order to reduce occupancy costs. For more information on this trend, please see our recent NKF white paper on the evolution of the financial services industry and its impact on U.S. office space.

Construction and Deliveries



Source: CoStar, NKF

Vacancy Remains Unchanged

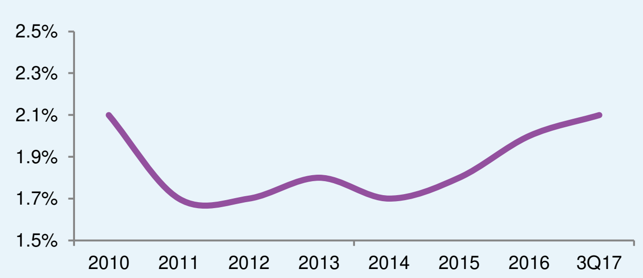
The vacancy rate was unchanged from the 13.6% posted in the previous quarter. While third quarter absorption was strong, it is still down from the peak of the cycle in 2014-16. Orlando recorded the lowest vacancy rate, at 7.0%, while Northern New Jersey posted the nation's highest vacancy rate at 22.5%. Many pharmaceutical companies there are shedding office space. A recent NKF white paper explores the options for property owners in Northern New Jersey who may be seeking to repurpose or raze obsolete space. Two other markets had 20%-plus vacancy rates: Oklahoma City and Houston.

There has been little fluctuation in vacancy over the past five quarters, suggesting the market has been near equilibrium for some time. Absorption may be past its peak, but construction starts may also have peaked. Importantly, office jobs (primarily the sectors of information, technology, finance, and professional/business services) continue to grow steadily in the aggregate. Overbuilding is not yet a concern in a macro sense since construction relative to existing inventory is less than 2%, however some markets may soon be challenged if demand falls below the pace of new supply and groundbreakings persist.

U.S. OFFICE CONSTRUCTION REMAINS UNDER CONTROL, AT 1.6% OF STANDING INVENTORY

The third quarter ended with 101.6 million square feet of available sublease space, equal to 2.1% of the total office inventory. This is up from the cyclical low of 1.7% of inventory in 2014. However, the sublet vacancy rate remains low relative to the 2.7% peak during the financial crisis and the 5.4% peak after the dot-com bust. Manhattan has the largest supply of available sublease space on an absolute basis, at 11.8 million square feet, but Silicon Valley has the most on a percent-of-inventory basis, at 5.5%.

Sublet Vacancy Rate



Source: CoStar, NKF

Asking Rents Continue to Tick Upward

Rent growth continues to tick upward, supported by sturdy demand. The average asking rent across the U.S. ended the quarter at $27.32/SF gross, up 0.6% from the second quarter. Year-over-year growth was 3.1%. Notably, Oklahoma City, Oakland/East Bay, and Orange County, CA each experienced double-digit rent growth during the past four quarters. Oklahoma City, in particular, has benefitted from citywide revitalization efforts such as the Metropolitan Area Projects (MAPS) public works capital improvement program, which has allowed rents and property values to rise. Long Island stands out among major markets for its asking rent year-over-year decline; the average is down 1.5%. However, asking rents increased slightly during the third quarter.

The Outlook

The overall macroeconomic outlook for the U.S. remains uncertain. In September, the federal government temporarily bypassed a shutdown and default with the passage of the *Continuing Appropriations Act and Supplemental Appropriations for Disaster Relief Requirements Act, 2017.* The measure suspends the federal debt ceiling and funds the government through early December, while concurrently approving emergency aid for the recent Hurricane Harvey and Hurricane Irma disasters. Houston and Miami, in particular, are likely to face some headwinds in the office market. The construction industries, however, are likely to remain busy with rebuilding efforts.

A potential year-end interest rate hike and the Congressional decision on the FY 2018 budget are both likely to impact domestic spending. Despite this, if the labor market can sustain its current level of hiring, it will support leasing activity and absorption as the year progresses.

In the second quarter, GDP growth was healthy, at 3.1% on an annualized basis. Notably, second quarter GDP was the highest since the first quarter of 2015. These conditions point to a strengthened economy and were reflected in this quarter's office market performance. However, economic growth may moderate with the impending year-end Congressional and Federal Reserve Bank decisions.

Tighter lending standards had been keeping new supply in line with demand, but construction is once again elevated, which is likely to slow rent growth. Some markets are experiencing high levels of construction, but others are experiencing a reduction of their construction pipelines, as deliveries outpace groundbreakings. The overall balance between supply and demand suggests the U.S. office market still has room to expand.

Of particular note, Amazon announced plans to add a second North American headquarters, sparking interest among metros across the nation. The tech firm requires a minimum of 500,000 square feet of existing space in the near term for a move anticipated for 2019, with the potential to expand into 8 million square feet through 2027. The new headquarters would be a boost to Amazon's chosen jurisdiction, as a projected 50,000 jobs would be added, potentially spurring investment and driving activity to the winning market.

.

Select Leasing Transactions

Tenant	Market	Building	Type	Square Feet
1199SEIU United Healthcare Workers East	New York, NY	498 Seventh Avenue	Direct New	580,000
Ally Financial Inc.	Charlotte, NC	601 S. Tryon Street	Direct New	542,000
New York City Housing Authority	New York, NY	90 Church Street	Direct New	461,000
Facebook Inc.	San Francisco, CA	181 Fremont Street	Direct New	432,000
NRG Energy	Houston, TX	910 Louisiana Street	Sublease New	431,307

Select Sales Transactions

Building	Market	Sale Price	Price/SF	Square Feet
375 Hudson Street	New York, NY	$580,000,000	$533	1,088,126
1900-2000 University Avenue	San Mateo, CA	$540,000,000	$1,197	451,000
333 Market Street	San Francisco, CA	$500,000,000	$763	655,398
222 Second Street	San Francisco, CA	$487,600,000	$1,078	452,418
300 E Street SW	Washington DC	$359,572,400	$593	605,897

www.ngkf.com

Market Statistics

Market	Inventory SF	SF Under Construction	SF Absorbed This Quarter*	SF Absorbed YTD*	% Vacant	Average Asking Rent/SF
Atlanta	145,266,656	3,731,893	79,304	240,322	17.2%	$25.07
Austin	59,610,887	366,746	-96,225	825,510	10.8%	$33.45
Baltimore	80,353,716	1,207,551	-36,188	695,617	12.5%	$23.07
Boston	182,936,626	3,214,492	238,508	531,554	11.60%	$34.23
Broward County, FL	33,931,108	127,068	87,190	145,049	11.8%	$26.47
Charleston, SC	13,973,163	205,000	10,161	190,321	8.8%	$22.30
Charlotte	70,865,195	1,876,913	337,316	1,252,536	11.4%	$24.62
Chicago	253,067,158	1,958,206	620,715	1,027,427	17.8%	$27.43
Cincinnati	37,240,586	264,000	-83,026	-310,799	18.5%	$19.46
Cleveland	36,223,060	324,575	155,715	379,178	16.2%	$18.14
Columbia, SC	16,277,316	51,773	83,153	118,142	8.5%	$17.32
Columbus	56,993,806	254,000	147,074	418,261	9.9%	$18.10
Dallas	230,435,358	5,225,818	836,948	1,350,281	19.2%	$24.62
Delaware	16,453,875	160,000	-47,410	35,606	16.1%	$24.96
Denver	95,550,016	3,566,699	338,494	692,228	15.1%	$26.07
Detroit	74,988,230	0	180,234	386,823	17.0%	$19.38
Fairfield County, CT	41,492,665	0	-666,731	-422,211	15.1%	$38.08
Fresno	19,691,125	74,436	-56,745	37,715	12.1%	$28.42
Greenville, SC	16,538,938	55,000	2,140	-147,741	9.7%	$19.50
Houston	203,659,358	1,974,381	-499,034	-2,070,254	21.8%	$28.04
Indianapolis	62,247,401	365,500	202,367	848,734	9.3%	$18.62
Inland Empire, CA	31,211,134	56,500	4,236	250,003	11.0%	$19.90
Jacksonville	31,560,352	45,000	117,117	460,574	11.9%	$19.13
Kansas City	81,392,372	150,000	567,314	1,259,570	9.6%	$19.08
Las Vegas	36,378,913	124,900	18,506	231,453	17.4%	$20.27
Long Island	54,499,037	61,968	226,515	239,723	9.2%	$26.38
Los Angeles	197,667,029	1,510,033	959,655	1,705,076	14.4%	$38.03
Manhattan	442,104,814	13,895,268	1,039,357	-2,867,498	7.5%	$75.87
Memphis	34,142,813	150,571	106,550	493,302	15.0%	$16.82
Miami	47,167,457	879,094	241,782	678,887	11.0%	$35.06
Milwaukee	46,626,682	22,000	1,825	126,464	9.6%	$17.05
Minneapolis	115,615,108	1,316,715	50,047	102,127	12.5%	$18.45
Nashville	53,072,730	1,288,998	103,489	221,002	7.3%	$26.27
New Jersey Northern	168,749,767	769,929	162,459	-836,981	22.5%	$28.59
New Jersey Southern	16,715,724	472,376	-16,412	-92,038	15.8%	$20.99
Oakland/East Bay	72,993,497	596,767	-343,659	-504,261	10.2%	$34.62
Oklahoma City	13,772,307	692,520	127,480	-333,414	21.3%	$18.22
Orange County, CA	91,875,657	1,945,992	406,944	921,260	10.6%	$31.83
Orlando	68,542,974	134,000	254,793	980,009	7.0%	$21.47
Palm Beach	25,877,196	84,300	138,509	238,582	14.5%	$30.94
Philadelphia	108,387,821	2,553,853	-292,799	-582,080	14.6%	$27.66
Phoenix	86,708,485	1,173,613	427,769	2,056,467	19.2%	$25.18
Pittsburgh	53,911,765	268,500	110,002	444,862	16.3%	$23.23
Portland	58,009,475	1,232,962	233,692	373,729	10.0%	$27.33
Raleigh/Durham	54,100,005	2,029,140	397,910	820,854	10.3%	$24.18
Sacramento	61,751,671	138,850	568,148	678,544	13.3%	$22.12
Salt Lake City	63,298,819	573,840	-181,610	-184,597	8.2%	$21.01
San Antonio	36,413,589	942,000	-52,111	179,926	12.6%	$21.85
San Diego	70,969,154	188,771	385,118	741,758	12.4%	$32.60
San Francisco	125,060,147	5,419,093	87,159	-105,383	8.8%	$58.22
Seattle	125,607,129	1,603,375	1,111,220	1,472,974	9.9%	$31.77
Silicon Valley	78,530,158	4,389,511	803,926	1,707,969	12.0%	$43.36
St. Louis	79,051,546	260,000	18,572	382,087	10.4%	$18.98
Tampa/St. Petersburg	64,201,581	169,150	24,611	167,606	10.9%	$23.18
Washington, DC	363,031,701	8,009,138	677,304	1,037,015	16.3%	$37.87
Westchester County, NY	27,918,285	0	449,588	289,104	16.3%	$27.29
National	**4,834,713,137**	**78,152,778**	**10,768,966**	**18,978,974**	**13.6%**	**$27.32**

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

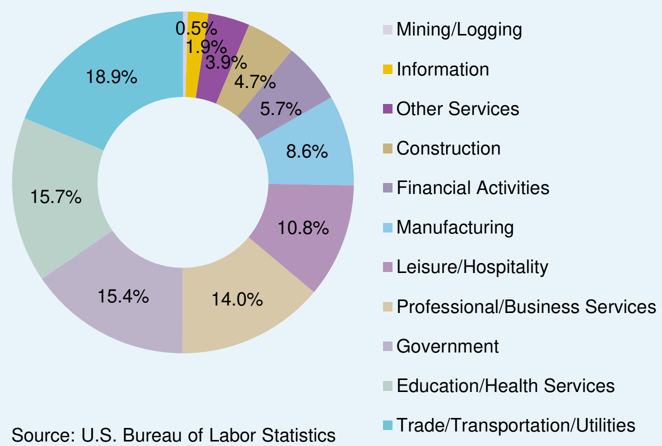
ECONOMIC CONDITIONS

The U.S. economy grew at an annual rate of 3.1% during the second quarter, according to the Bureau of Economic Analysis' third estimate, released in September. Notably, second quarter GDP was the highest since the first quarter of 2015. Steady job growth has underpinned the nation's recent economic performance. The unemployment rate has remained mostly unchanged since April, holding between 4.3% and 4.4% over the past five months, reflecting an economy near full employment. Employers added 169,000 new jobs in August 2017 and an average of 187,000 per month for the first eight months of the year. September data reflected a loss of 33,000 jobs, but the data was heavily impacted by Hurricanes Harvey, Irma, and Maria, and should be set aside for now.

As was widely expected, the Federal Reserve raised the federal funds rate at its June meeting, with another hike likely in December even with inflation remaining weak. Congressional decisions on the FY 2018 budget have been deferred until December, which may impact domestic spending in 2018.

Employment By Industry

United States, 2016 Annual Average

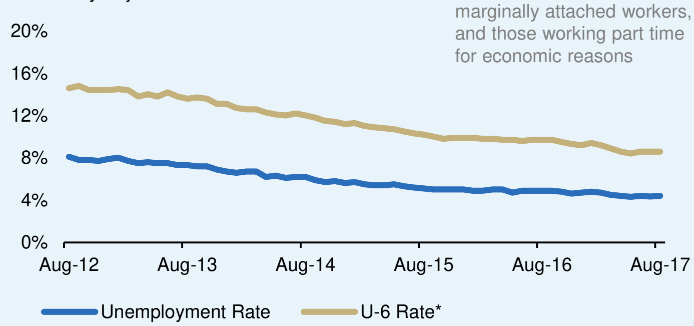


Source: U.S. Bureau of Labor Statistics

Unemployment Rate

Seasonally Adjusted

* Includes total unemployed, marginally attached workers, and those working part time for economic reasons

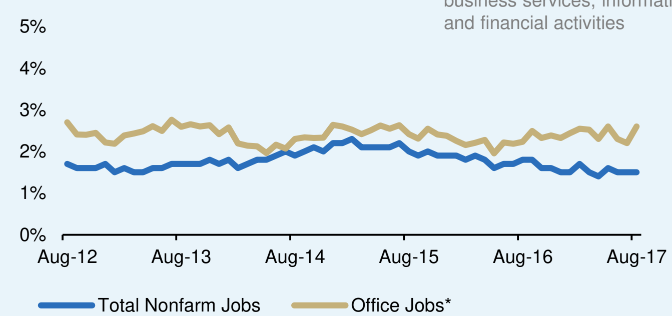


Source: U.S. Bureau of Labor Statistics

Payroll Employment

12-Month % Change, Not Seasonally Adjusted

* Includes professional and business services, information, and financial activities

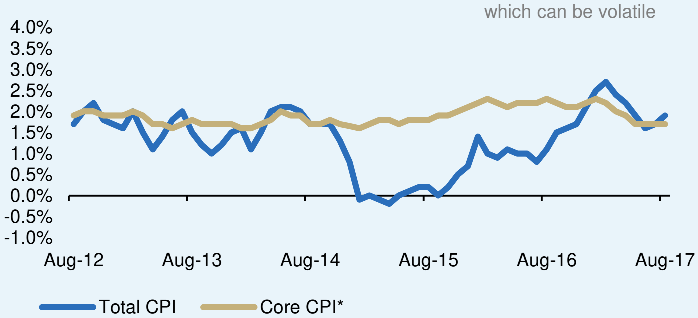


Source: U.S. Bureau of Labor Statistics

Consumer Price Index (CPI)

12-Month % Change, Not Seasonally Adjusted

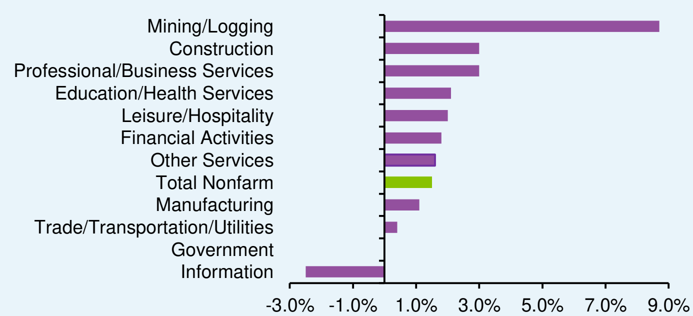
* Excludes food and energy, which can be volatile



Source: U.S. Bureau of Labor Statistics

Employment Growth by Industry

August 2017, 12-Month % Change, Not Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

RESEARCH

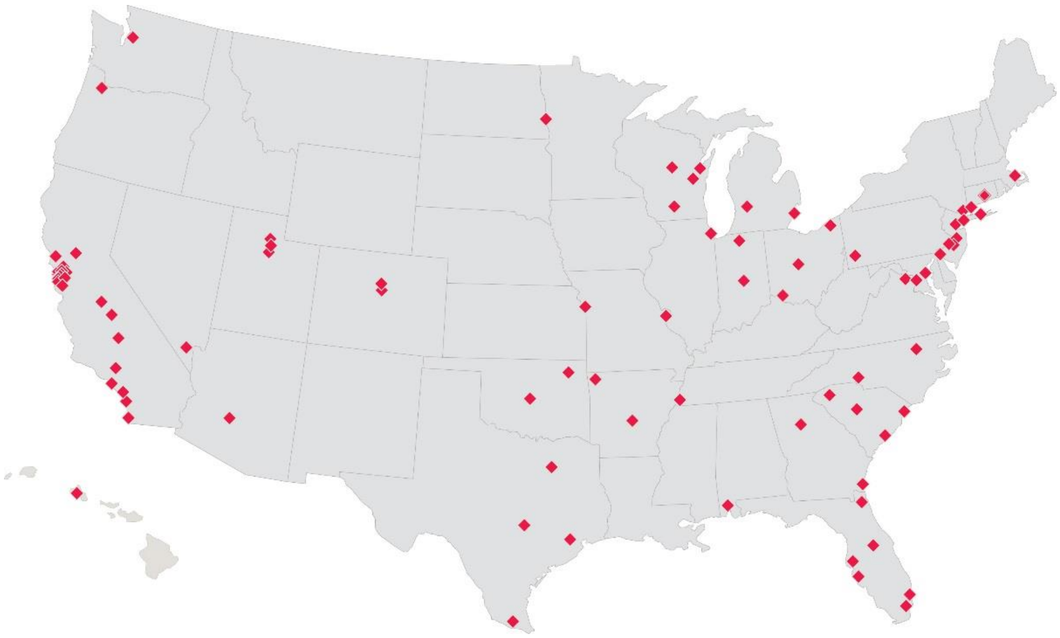
Newmark Knight Frank

New York Headquarters
125 Park Avenue
New York, NY 10017
212.372.2000

Jonathan Mazur
Senior Managing Director
212.372.2154
jmazur@ngkf.com

Alexander (Sandy) Paul, CRE, LAI
Senior Managing Director
202.312.5783
apaul@ngkf.com

Newmark Knight Frank United States Office Locations



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 also available at **www.ngkf.com/research**