Savills Studley Report
National office sector

Q2 2016

SUMMARY

Market Highlights

AVAILABILITY RATES INCH HIGHER

The national overall availability rate ticked up to 17.0%. Most markets registered only minor changes in their rates. However, the rate jumped by 1.4 pp in Houston and dropped by 1.2 pp in Philadelphia's CBD. The Class A availability rate rose by 0.3 pp to 18.4%. The rate jumped by 1.3 pp in Dallas/Fort Worth but dropped by 2.5 pp in Philadelphia's CBD to 11.9%.

MODEST RISE IN ASKING RENTS

On a quarterly comparison, national overall asking rent rose by 0.7% to $33.06. Asking rent increased somewhat in the majority of markets, most significantly in Atlanta (+5.8%) and Chicago CBD (+3.0%). National Class A asking rent climbed by 1.0% to $37.14. The most notable increases took place in Silicon Valley (+8.3%) and Chicago CBD (+4.0%).

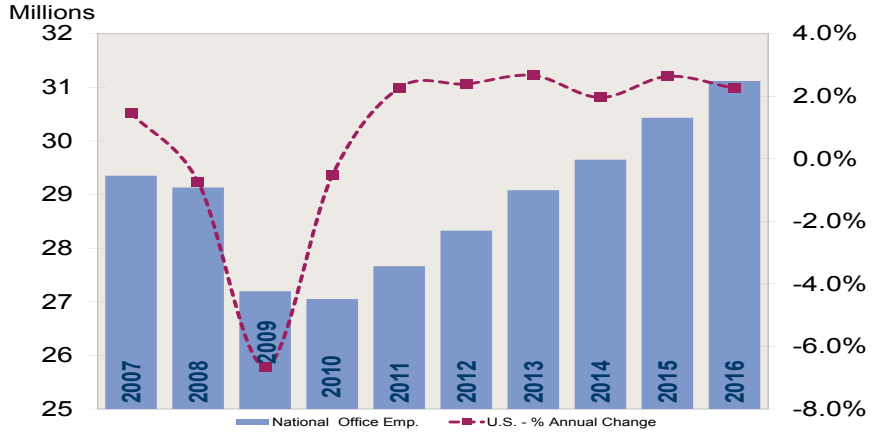
TRAILING LEASING SLOWS

National four-quarter trailing leasing (the sum of activity over the last four quarters) declined quarter-on-quarter by 2.4% to 229.9 msf. Tenants have leased 10.4 msf in Orange County during the last four quarters, a 30.6% increase from second quarter of 2015. In contrast, San Diego's leasing volume during the last four quarters dropped by 42.3% to 4.0 msf over the last year.

"Considering the see-saw of equity markets, contraction in business investment and fears about slowing global growth, the U.S. labor market has shown quite a bit of resilience. In turn, demand for office space has been sustained in the majority of markets, giving a boost to rent and net operating income. That said, some of the top-performng markets of a year ago are showing signs of weakening."

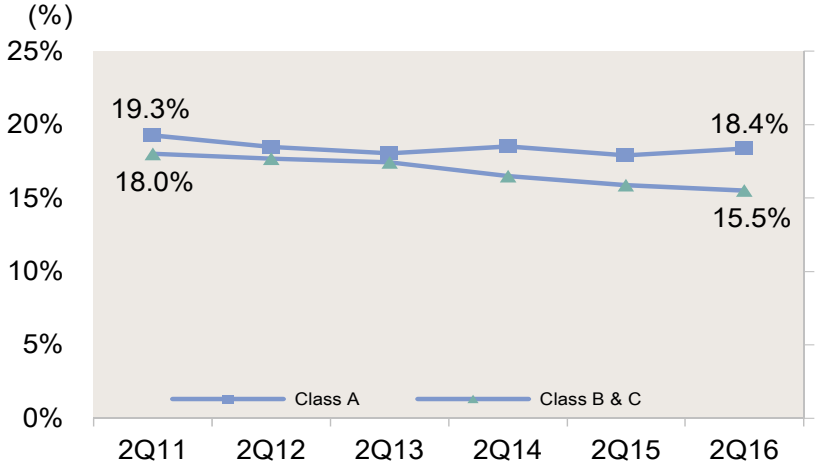
Keith DeCoster, Savills Studley Research

Office-Using Employment Trends

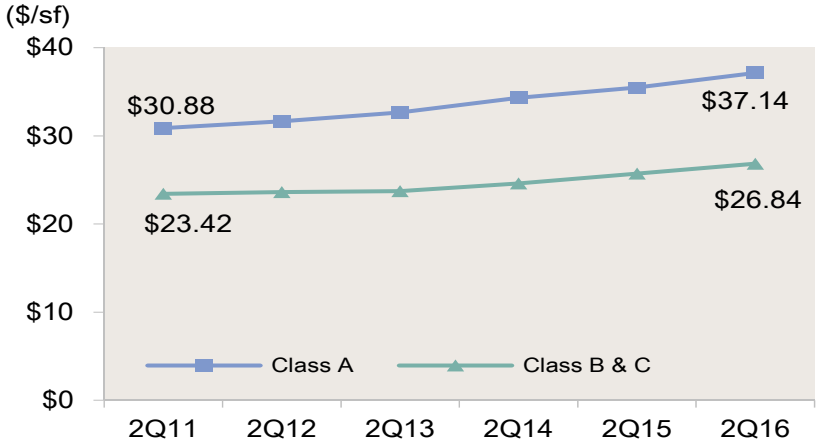


Source: Bureau of Labor Statistics

Availability Rate Trends



Asking Rent Trends



Six Trillion Dollar Blip?

It has been a wild ride for global equity markets in 2016, with two multi-trillion dollar selloffs already this year. After the January correction – triggered by fears of a hard landing in the Chinese economy and the rout in commodity prices – it took global exchanges several months to recover. Markets rebounded much more rapidly following the three-day post-Brexit sell-off – as of early July the S&P 500 had already hit a new record high.

Set against the seesawing equity markets, the tangible value of income-generating assets such as commercial real estate holds a great deal of appeal to investors. Most office landlords in major U.S. metros have enjoyed increased net operating income in the last two years as occupancy and rental rates have slowly risen. What holds true in the broader economy has also been true in office markets, though: growth has varied widely from one market to the next, some have described it as "a multi-speed recovery."

As recently as a year ago, the energy and tech-driven markets were still outperforming nearly all others in terms of hiring, office space demand and rental rate growth. Energy-sector driven markets started to tank more than a year ago. Tenants in Houston now have more than 10.0 msf of available sublet space to consider and availability rates have jumped by more than 400 basis points from a year ago. Even Denver, which has a relatively diversified economy, is seeing softening in its CBD as oil and gas firms cut production and give back space.

Reality Check for Tech Sector

Pullback in the tech sector has been a bit more recent. In contrast to an energy sector pummelled by oversupply, the tech sector is not seeing a wholesale pullback – the intensity of contraction varies from one company and region to the next. In general, more tech companies are abandoning the "growth at all costs" strategy. Tougher funding requirements and weakening investment sentiment are forcing some fledgling tech companies to put the brakes on planned expansions and additional hiring. A few of the most promising startups of a year ago are dying on the vine. On the other hand, the biggest tech firms are still chasing talent and pursuing space at a rapid pace.

Tight labor markets, limited space options and soaring costs of doing business have pushed the likes of Google and SalesForce to set up operations in secondary tech markets such as San Diego and Raleigh/Durham. Silicon

Valley-based WalkMe selected Raleigh for its first expansion market. Most companies can absorb the high cost of office space in Silicon Valley or San Francisco, but the employees they are trying to recruit might not be able to bear the price for local housing. As growing companies seek out talent they must also consider the cost of housing for employees. San Jose-based CloudGenix, for example, announced that it has chosen Raleigh for its first East Coast outpost. A company spokesperson noted that lower housing costs were a contributing factor in their selection of Raleigh/Durham.

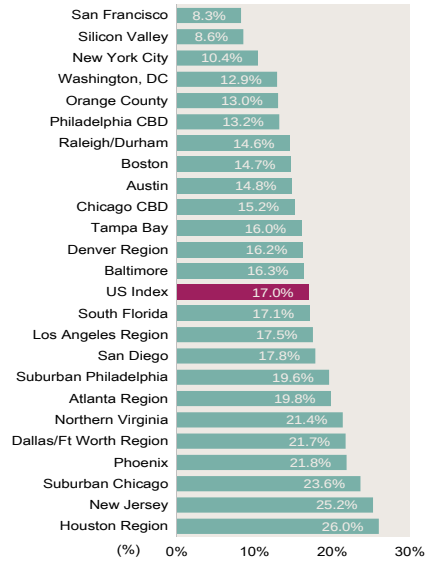
Recovery on Shaky Ground

Even before the Brexit vote of late June, the U.S. economy was sending mixed signals, stoking fears that the recovery could be reaching its limits. Hopes for a breakout year, with GDP growth pushing above the 2.0% - 2.5% range of the last few years, have once again been dashed. In the latest survey of Wall Street Journal economists, conducted in June, the average forecast for GDP was lowered to 2.3%.

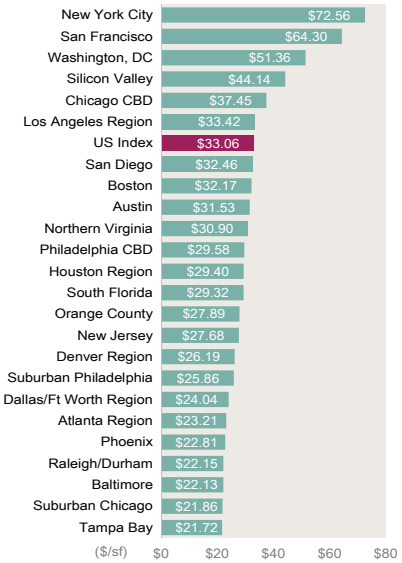
The labor market has been a steadying force, providing a reassuring counterweight to the gyrations in commodity prices and equity markets. Hiring activity also wobbled in April and May, but provided a much needed boost in June with 287,000 jobs gained. It is too soon to say what has caused the recent volatility in hiring activity – it could be a reflection of how little slack there is in the labor market or it could be due to companies pulling back. Several sectors such as tech, construction and healthcare have been facing skill shortages. Some economists speculate employment could be slowing due to a sheer lack of qualified workers in the fastest growing sectors. Unfilled jobs totaled 5.8 million in April, the highest level on record, but then dropped to 5.5 million in May. On the other hand, the slowing payroll growth in April and May appears more troubling in light of a multi-quarter contraction in business investment. Business investment contracted by 6.2% in the fourth quarter, its worst quarterly reading since mid-year, and dropped by 5.9% in the first quarter. The sharp pullback by oil and gas producers may be inflating the dropoff.

With business expenditures lower and the manufacturing sector under pressure, GDP growth rests squarely on the backs of consumers. If job growth reverts to its anemic pace of this spring, it will stem nascent income growth that has emerged in recent quarters. Consumers have been spending more. Retail sales rose by 0.5% in May following a very strong 1.3% advance in April. Bloomberg estimates that auto sales are on track to hit a record mark of 17.8 million in 2016.

Availability Rate Comparison



Rental Rate Comparison



Major Savills Studley Transactions

Tenant	Sq Feet	Address	Market Area
First Solar Inc	391,662	959 Fifth St, Perrysburg, OH	Toledo
US General Services Administration	347,922	11545 Rockville Pike, North Bethesda, MD	Washington, DC
Fitbit Inc	311,166	215 Fremont St, San Francisco, CA	San Francisco
Continental Casualty Company (CCA)	275,000	151 North Franklin, Chicago, IL	Chicago
Board of Governors of Federal Reserve	218,552	1850 K St NW, Washington, DC	Washington, DC
Aetna Life Insurance Company	130,885	9000 Southside Blvd, Jacksonville, FL	Jacksonville
Sentinel Properties Inc	115,878	750 W Ventura Blvd, Camarillo, CA	Los Angeles
Porter Wright Morris & Arthur LLP	107,200	41 S High St, Columbus, OH	Columbus
Mulberry Health Inc	93,317	615 S River Dr, Tempe, AZ	Phoenix
Ardelyx Inc	72,500	34175 Ardenwood Blvd, Fremont, CA	San Jose

Top of the Market Wavering

The Case Shiller 20 city index shows that home prices are up by 5.0% year-on-year. Luxury home sales in markets that are highly dependent on high net-worth households, IPO exits and foreign investors have been flagging. Luxury sales volume in Manhattan, for example, was down 25 percent in the first 20 weeks of 2016 compared to the same period last year. Investment sales, much like luxury residential markets, have been also losing momentum, due largely to a decrease in massive portfolio sales. According to Real Capital Analytics, transaction activity was down by 16% in the first half of this year compared to 2015. Maintaining the investment sales volume registered in commercial markets was going to be a challenge due to the high number of portfolio sales in 2015.

There may be a hint of schadenfreude in some recent analysis speculating that residential and commercial real estate in Manhattan and Continental Europoe stands to benefit from Brexit. There is no disputing that havens will do well – the question is whether the flight from risk will push investors to bonds and cash or to take a long-term stake in real estate. As of early July, some of the investor skittishness seems to have abated.

The impact on investor appetite is not the only concern. Lenders who feel as though the cycle is past its halfway point may be reluctant to extend loans on mixed-use and development projects. Of note, commercial estate assets are not immune to fears that prices have become disconnected from reality. In June the Fed said that valuations in commercial real estate appear vulnerable to negative shocks, noting that pricing has run ahead of the rise in rents. There are few signs of an imminent fallout in the commercial sector, however; some landlords who paid at the top of the market in the last two years may find themselves in a situation akin to the down-round predicament of some tech investors, holding an asset with diminishing value.

Submarket	Total	Leasing Activity	Available SF			Availability Rate			Asking Rents Per SF		
	SF (1000's)	Last 12 Months	This Quarter	% Change from Last Qtr.	Year Ago	This Quarter	pp Change from Last Qtr. (1)	Year Ago	This Quarter	% Change from Last Qtr.	Year Ago
Atlanta	165,742	6,022	32,879	1.8%	31,871	19.8%	0.4%	19.2%	$23.21	5.8%	$21.64
Atlanta - Class A	98,555	3,711	18,027	2.2%	16,372	18.3%	0.4%	16.6%	$26.64	2.3%	$24.89
Austin	63,105	6,176	9,349	-3.1%	9,169	14.8%	-0.5%	15.0%	$31.53	0.1%	$30.28
Austin - Class A	29,471	3,978	4,972	-5.4%	5,399	16.9%	-1.0%	19.6%	$36.16	-0.2%	$34.52
Baltimore	105,895	4,183	17,314	-1.0%	17,543	16.3%	-0.3%	16.6%	$22.13	0.3%	$21.49
Baltimore - Class A	43,171	2,015	8,217	0.3%	7,703	19.0%	-0.1%	18.1%	$25.32	0.8%	$23.88
Boston	381,778	23,652	56,032	-1.6%	56,677	14.7%	-0.2%	15.0%	$32.17	2.1%	$29.46
Boston - Class A	185,837	13,443	29,397	-2.0%	29,131	15.8%	-0.3%	16.0%	$47.62	10.7%	$36.75
Chicago CBD	147,122	13,333	22,291	3.6%	23,042	15.2%	0.5%	15.9%	$37.45	3.0%	$35.44
Chicago - Class A	68,687	7,026	11,118	9.6%	10,294	16.2%	1.4%	15.5%	$41.87	4.0%	$39.14
Suburban Chicago	119,410	6,324	28,212	1.5%	24,433	23.6%	0.3%	20.7%	$21.86	-1.8%	$21.95
Suburban Chicago - Class A	62,914	4,211	16,660	2.0%	13,232	26.5%	0.5%	21.2%	$24.29	-4.1%	$24.71
Dallas/Fort Worth	212,571	13,607	46,168	2.1%	45,688	21.7%	0.4%	22.0%	$24.04	2.4%	$22.20
Dallas/Fort Worth - Class A	109,170	8,374	25,889	6.0%	24,628	23.7%	1.3%	23.5%	$25.87	2.1%	$24.76
Denver	121,135	8,927	19,623	1.5%	18,808	16.2%	0.2%	16.0%	$26.19	1.3%	$24.56
Denver - Class A	51,016	5,017	9,225	3.5%	8,084	18.1%	0.6%	16.8%	$30.51	0.6%	$28.92
South Florida	112,796	6,497	19,245	0.4%	19,356	17.1%	0.1%	17.2%	$29.32	0.8%	$28.41
South Florida - Class A	51,718	3,370	9,103	1.7%	8,608	17.6%	0.3%	16.6%	$34.21	0.9%	$33.36
Houston	193,101	8,678	50,182	5.9%	41,333	26.0%	1.4%	21.7%	$29.40	-1.2%	$29.79
Houston - Class A	104,444	4,552	30,465	10.0%	23,301	29.2%	2.6%	22.7%	$35.08	-1.8%	$36.13
Los Angeles	210,950	18,231	36,932	-1.3%	37,792	17.5%	-0.2%	17.7%	$33.42	2.8%	$31.49
Los Angeles - Class A	149,106	13,537	27,969	-1.4%	29,317	18.8%	-0.3%	18.9%	$35.46	3.0%	$32.47
New Jersey	147,425	9,144	37,212	0.2%	37,754	25.2%	0.0%	25.6%	$27.68	1.7%	$26.16
New Jersey - Class A	120,262	8,211	30,008	2.2%	29,714	25.0%	0.5%	24.7%	$28.81	1.5%	$27.18
New York	447,666	29,130	46,727	-0.2%	45,812	10.4%	0.0%	10.2%	$72.56	-2.6%	$72.15
New York - Class A	212,816	14,878	24,525	-0.4%	24,752	11.5%	0.0%	11.5%	$79.65	-4.2%	$80.71
Orange County	94,531	10,427	12,301	1.0%	12,566	13.0%	0.1%	13.3%	$27.89	0.3%	$25.99
Orange County - Class A	50,060	5,979	8,771	-0.3%	8,650	17.5%	0.0%	17.3%	$30.01	1.0%	$27.56
Philadelphia CBD	47,260	2,904	6,228	-8.2%	6,655	13.2%	-1.2%	14.1%	$29.58	-2.2%	$27.11
Philadelphia - Class A	29,559	2,170	3,520	-17.4%	4,349	11.9%	-2.5%	14.8%	$32.38	-3.3%	$29.31
Suburban Philadelphia	54,610	3,858	10,699	-3.8%	10,000	19.6%	-0.8%	18.5%	$25.86	-0.4%	$24.82
Suburban Philadelphia - Class A	39,135	3,099	6,795	-5.3%	6,983	17.4%	-1.0%	17.9%	$26.93	-0.2%	$25.78
Phoenix	136,769	10,111	29,862	0.5%	30,321	21.8%	0.0%	22.7%	$22.81	1.0%	$21.52
Phoenix - Class A	41,885	4,048	8,746	-3.2%	8,549	20.9%	-0.9%	21.9%	$27.69	2.1%	$25.87
Raleigh/Durham	51,982	3,940	7,565	2.2%	7,908	14.6%	0.3%	15.4%	$22.15	-0.5%	$21.50
Raleigh/Durham - Class A	30,929	3,020	4,376	3.8%	4,363	14.1%	0.5%	14.4%	$24.51	-1.5%	$23.63
San Diego	66,418	4,010	11,842	-1.5%	12,259	17.8%	-0.2%	18.5%	$32.46	1.6%	$32.26
San Diego - Class A	29,192	1,631	4,827	-1.1%	5,089	16.5%	-0.3%	17.4%	$37.49	1.9%	$36.82
San Francisco	81,401	5,942	6,725	7.2%	6,029	8.3%	0.6%	7.4%	$64.30	0.4%	$61.12
San Francisco - Class A	49,179	3,812	4,545	8.9%	4,038	9.2%	0.8%	8.2%	$66.12	0.9%	$62.94
Silicon Valley	75,821	5,943	6,492	13.7%	6,578	8.6%	0.9%	9.0%	$44.14	0.9%	$42.05
Silicon Valley - Class A	22,873	2,010	2,411	72.8%	1,946	10.5%	3.7%	10.3%	$46.62	8.3%	$40.97
Tampa Bay	54,440	3,387	8,732	-3.7%	9,210	16.0%	-0.6%	17.3%	$21.72	1.4%	$21.47
Tampa Bay - Class A	23,675	1,772	3,026	6.4%	3,130	12.8%	0.8%	13.2%	$26.35	0.4%	$25.34
Northern Virginia	168,582	10,267	35,996	-0.8%	36,831	21.4%	-0.2%	21.8%	$30.90	0.9%	$30.74
Northern Virginia - Class A	97,094	6,011	22,219	1.2%	22,322	22.9%	0.3%	23.0%	$32.75	1.2%	$32.52
Washington, D.C.	130,518	10,945	16,837	3.6%	18,276	12.9%	0.4%	14.0%	$51.36	0.3%	$49.79
Washington, D.C. - Class A	73,527	7,929	9,706	4.5%	10,580	13.2%	0.6%	14.4%	$56.58	0.5%	$55.05
Savills Studley Major Markets Total	**3,471,325**	**229,940**	**590,047**	**0.7%**	**580,244**	**17.0%**	**0.1%**	**16.9%**	**$33.06**	**0.6%**	**$31.77**
Savills Studley Major Markets - Class A	**1,814,489**	**176,295**	**333,296**	**1.9%**	**319,494**	**18.4%**	**0.3%**	**17.9%**	**$37.14**	**1.0%**	**$35.45**

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(1) Percentage point change for availability rates.
Unless otherwise noted, all rents quoted throughout this report are average asking gross (full service) rents psf.
Statistics are calculated using both direct and sublease information.
Short-term sublet spaces (terms under two years) were excluded.

The information in this report is obtained from sources deemed reliable, but no representation is made as to the accuracy thereof. Statistics compiled with the support of The CoStar Group.
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