U.S. Research Report

TOP OFFICE METROS SNAPSHOT

Q2 2018

Colliers INTERNATIONAL

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Solid Leasing Across Major Office Markets in Q2 2018

New Supply Will Test Demand in Several Markets

Featured Highlights

- All but one of the top 10 U.S. office markets posted positive absorption in Q2 2018 — an encouraging shift from Q1 2018 when four markets registered negative absorption. Rents rose or held firm in nine out of 10 markets, though vacancy rose in four of the markets.
- Several core locations are seeing an influx of new supply, which will test the strength of tenant demand and developers' ability to achieve their pro-forma rents.
- Coworking providers rule the market with more major leasing in Q2 2018 and aggressive expansion plans. Landlords are responding with their own flexible workspace offerings.
- The San Francisco Bay Area leads the top 10 markets and the gap is widening. The second quarter saw outsized rental growth and a fall in vacancy to sub-5%. Top rents in core San Francisco and Silicon Valley locations are in striking distance of $100 per square foot.
- Manhattan held firm in Q2 2018 and leasing volume is on par with 2017. The establishment of Hudson Yards as a premier location was underlined by an 800,000-square-foot lease to Pfizer.
- Boston is on a roll. Several major leases were signed in Q2 2018, and there is six million square feet of known demand in the market. The Back Bay is leading the charge.
- Washington, D.C. saw a sharp uptick in vacancy in its downtown core. Over 1.5 million square feet of new space was delivered in the second quarter and more is on the way.
- Los Angeles is also facing supply pressures. New supply is starting to deliver in West LA and is mostly vacant. Downtown LA will face a large influx of new space in early 2019.

MARKET 1-YR OUTLOOK	METRO CORE CBD INVENTORY (SF)	CORE SUBMARKETS	ABSORPTION (SF)	AVG RENT ($)*	VACANCY RATE
	Manhattan, NY 503,295,206	Manhattan: Midtown, Midtown South, Downtown	458,221 ▲	$73.89 ▼	6.1% ▬
	Washington, D.C. 186,795,196	CBD (DC), East End (DC), Capitol Hill (DC), NoMa (DC), Capitol Riverfront (DC), Carlyle (DC), R-B Corridor (NOVA), Tysons Corner (NOVA), Bethesda (SubMD)	271,404 ▼	$48.27 ▬	14.7% ▲
	Chicago, IL 132,528,968	West Loop Central Loop River North East Loop	50,794 ▲	$40.72 ▲	13.3% ▲
	Houston, TX 117,562,801	CBD, Katy Freeway, West Loop (Galleria), Westchase	785,119 ▲	$35.16 ▬	20.9% ▼
	Los Angeles, CA 114,681,600	Dowtown Los Angeles, West Los Angeles, Tri-Cities	389,900 ▲	$46.06 ▬	15.5% ▬
	Atlanta, GA 102,151,391	Midtown Buckhead Central Perimeter Cumberland/Galleria	181,354 ▼	$29.35 ▲	13.6% ▬
	San Francisco Bay Area, CA 99,958,119	Financial District (North Financial District & South Financial District), SOMA (West SOMA & East SOMA), Palo Alto, Mountain View, Sunnyvale	1,704,778 ▲	$88.11 ▲	4.9% ▼
	Dallas, TX 75,976,465	Uptown, Preston Center & Far North Dallas	-288,946 ▼	$31.32 ▬	15.2% ▲
	Boston, MA 69,556,442	Back Bay, Financial District, Charlestown, Crosstown, Fenway/ Kenmore, South Station, North Station, Seaport	410,695 ▼	$57.34 ▲	9.5% ▬
	Seattle, WA 62,464,340	Seattle CBD, Lake Union, Pioneer Square, Belltown, Queen Anne, Ballard	271,404 ▼	$40.65 ▲	8.0% ▼

* A quarterly rent change of +/-1% or less is judged to be flat.

* A quarterly vacancy rate change of +/-20 basis points or less is deemed to be flat

- River North, formerly a lesser fringe location, is the center of attention in Chicago, with a 2.5-million-square-foot project now underway. Chicago is seeing a major influx of coworking firms.
- Seattle saw a healthy drop in vacancy in Q2 2018 and now has the third-lowest vacancy rate of the top 10 markets. Amazon and WeWork continue to lead leasing activity. Two large fully-speculative projects are well underway and should act as an indicator of wider demand in central Seattle.
- Houston's vacancy rate dropped by 70 basis points (BPS) in Q2 2018 but is still by far the highest among the top 10 markets. Tenant interest in the CBD is on the rise ahead of an anticipated upturn in the market.
- Dallas saw a slight reversal of fortunes in Q2 2018, as net absorption was negative — the only metro in the top 10 to lose ground — and the vacancy rate rose by 40 BPS to 15.2%, with more uncommitted construction set to deliver by year-end.

LOCAL INSIGHTS

Manhattan

- While the **Manhattan** office market continues to post healthy leasing volume, this is not necessarily translating into improved market indicators. Leasing volume in the first half of 2018 was 17.9 million square feet, on par with the corresponding period in 2017. While net absorption returned to the black in Q2 2018 at positive 458,220 square feet, this is minimal in a market with a total inventory of 503.3 million square feet.
- Average asking rates stand at $73.90 per square foot, representing a decline of 2.8% over the first quarter. Midtown still has the highest average asking rates at $80.60 per square foot, followed by $74.30 per square foot in Midtown South and $63 per square foot in Downtown. The pattern is reversed in terms of Class A rates, with Midtown South Class A space commanding average asking rents of $90.05 per square foot as opposed to $83.65 per square foot in Midtown.
- Fashionable neighborhoods in Midtown South, namely Chelsea and Greenwich Village, have Class A asking rates of $130.40 and $122.30 per square foot, respectively, with growth, in part, being driven by new Class A product in traditionally underserved locations. Rents continue to rise in Hudson Yards now that the project has reached critical mass.
- Manhattan's vacancy rate effectively held flat in Q2 2018, and at 6.1% is comfortably the second lowest among the top 10 office markets, bettered only by the San Francisco Bay Area. Although there is 15 million square feet of office space under construction in Manhattan, supply-side concerns are limited. Over 80% of space scheduled for delivery in the remainder of 2018 and 2019 is pre-leased. A further 7.8 million square feet is set to follow between 2020 and 2022, but with 28% already pre-committed, significant lead-in times and strong tenant demand for new space, the majority should lease ahead of delivery.
- In the second largest lease signed at Hudson Yards to date, Pfizer committed to 800,000 square feet at 66 Hudson Boulevard. The next largest leases signed in the quarter involved Latham & Watkins taking 407,000 square feet at 1271 Avenue of the Americas and Discovery Channel leasing 362,000 square feet at 230 Park Avenue South. Coworking firms continue to expand in Manhattan accounting for nearly 10% of leasing volume in the first half of 2018.

Washington, D.C.

- While rents held firm and there was positive, albeit modest, absorption in the **Washington, D.C.** market, the office vacancy rate jumped by 50 BPS in Q2 2018 to 14.7%. Previously-voiced concerns about the impact of new supply are becoming a reality. Over 1.6 million square feet of new space was delivered in the District alone in the quarter — greater than the sum of the prior five quarters. Vacancy in the District itself jumped from 12.1% to 12.9%.
- Average asking rates held steady at $48.30 per square foot. Average Class A asking rates stand at $61.40 per square foot in the District, but can be up $5 per square foot higher in the core locations of the central business district (CBD) and East End. However, there is a significant delta between rents in the District and those in Northern Virginia, particularly for Class A space. In the principal Northern Virginia locations of the Rosslyn-Ballston Corridor and Tysons Corner, they stand at $45.60 per square foot and $39.30 per square foot respectively.
- With rents being bolstered by new product entering the market at high asking rates, it is a challenge to estimate where effective rents stand for existing product. Washington, D.C. reports the most generous tenant incentive packages among the major U.S. office markets. With a further 4.8 million square feet of Class A space underway in the District, landlords will have to drop rents or increase incentives to remain competitive. Construction is also elevated in Tysons Corner at 1.6 million square feet, but this includes the one-million-square-foot new headquarters of Capitol One, which should come online before year-end.
- Second-quarter leasing activity in the District was led by the Carlyle Group's 200,000-square-foot lease at 1001 Pennsylvania Avenue NW, increasing their footprint by 70,000 square feet in the process. In addition, four leases totaling 192,000 square feet were signed by coworking firms.

Chicago

- **Chicago's** key indicators showed mixed fortunes in Q2 2018. Average asking rates moved up slightly to $40.70 per square foot and net absorption was (just) positive at 50,800 square feet. Disconcertingly, the vacancy rate moved up by 80 BPS to 13.3%, which was the greatest increase among the 10 markets addressed in this report, as demand did not keep pace with the rise in new product.
- Vacancy rates are highest in the three Loop submarkets, ranging from 13.5% in the West Loop to 14.2% in the Central Loop. The West Loop has the highest rents and most prestigious inventory. Average asking rates in the West Loop stand at $44.45 per square foot, but premier space can achieve $55 to 60 per square foot.
- Three trends are driving the Chicago office market: continued relocations to the CBD from the suburbs, the rapid growth of coworking and the emergence of former fringe locations. Fulton Market and River North have become genuine competitors to downtown Chicago's traditional core. Leasing in these locations is being driven by the tech sector and River North now has the second highest asking rates in Chicago at $42.75 per square foot.
- The 2.5-million-square-foot redevelopment of the Old Main Post Office site presents the most compelling evidence of developer confidence in River North and is scheduled to complete in 2019. The project secured a major tenant in Q2 2018 with Walgreens taking 200,000 square feet.
- The amount of coworking space in Chicago's CBD has risen to 2.6 million square feet, equivalent to a 250% increase over the past four years. The coworking market is highly competitive in Chicago. As elsewhere, WeWork is the largest player but its market share is relatively modest at 23%, followed by Regus & Regus Spaces with a combined 21%. Other coworking operators making inroads in to the downtown Chicago market include Level Office, Amata and Convene.

Houston

- The **Houston** office market made progress in Q2 2018 with a sharp turnaround in demand. Net absorption totaled 785,000 square feet in the second quarter after almost negative one million square feet in Q1 2018. Average asking rents held firm while the vacancy rate fell by 70 BPS to 20.9%. However, this is still the highest vacancy rate among the top 10 markets by a margin of over 500 BPS.
- While vacancy remains high, due to a surfeit of sublease space, the CBD is gaining traction. Class A vacancy in the CBD dropped by 90 BPS in Q2 2018 to 18.9% and a series of prominent leases were signed. The largest of these occurred at 500 Jefferson where Harris County Veterans Service Office took 118,000 square feet. Also, in the CBD, Talos Energy leased 101,070 square feet at Three Allen Center, while law firm Sidley Austin renewed its lease at 1000 Louisiana, expanding its footprint from 50,000 to 80,000 square feet in the process.
- Average asking rates stand at $35.15 per square foot, effectively unchanged since the first quarter. Asking rates across the four core submarkets range from $30.25 per square foot in The Woodlands to $38 per square foot in the CBD. The CBD is the only submarket with Class A asking rents in excess of $40 per square foot.
- Construction activity is centered on the City Place project in The Woodlands and Capitol Tower in the CBD. Patrinely Group Inc. is developing four properties at City Place totaling 850,000 square feet. The majority of this space is pre-leased including two 189,000 square feet properties being built for Hewlett Packard. Capitol Tower, totaling 778,345 square feet is by far the largest individual property underway in Houston. Due for completion in Q2 2019, the project is currently 36% pre-leased.

Los Angeles

- The **Los Angeles** office market saw little change in Q2 2018, with asking rents and vacancy holding steady. Second quarter net absorption was 389,900 square feet. While this is almost double the Q1 2018 total, it's a modest amount for a market with almost 115 million square feet of office inventory.
- Average asking rents remain at $46 per square foot. West LA has the highest rates by a significant margin at $56.90 per square foot compared with $40.80 per square foot Downtown and $36.60 per square foot in Tri-Cities. In West LA's most prestigious submarkets of Beverly Hills and Santa Monica, average asking rates stand at $66.60 per square foot.
- Downtown office vacancy, while down by 60 BPS in the second quarter, stands at 19.3%, significantly higher than the market average of 15.5%. Vacancy rates in Tri-Cities and West LA stand at 13.4% and 14% respectively. Burbank, at 12.1%, has the lowest vacancy rate of the three Tri-Cities submarkets. Burbank received a boost in Q2 2018 with Warner Bros. Studios renewing its 421,000-square-foot lease at 3400 W. Riverside Drive. Vacancy rates across West LA's 11 submarkets range from 4.9% in Olympic Corridor to 22.8% in Culver City. Century City, at 8%, is the only high-end location in West LA with a sub-10% vacancy rate.
- Supply concerns persist. There is 4.3 million square feet of office construction underway in LA County, of which a combined 3.1 million square feet is located in Downtown and West LA. Despite their prestigious locations, the West LA properties are seeing limited leasing traction. The 200,000-square-foot 2834 Colorado Avenue in Santa Monica was delivered 70% vacant this quarter. Downtown is similarly challenged. Two major projects are set to deliver in early 2019: 801 S. Broadway (500,000 square feet) and 757 S. Alameda Street (425,100 square feet) with no space pre-leased at either property.

Atlanta

- Demand remained positive in the **Atlanta** office market in Q2 2018 with 181,350 square feet of net absorption. However, this represents a drop of over half-a-million square feet from the prior quarter. Average asking rents remained relatively flat and vacancy moved up slightly to 13.6% during the quarter. The positive absorption was largely attributable to one move-in: Mercedes Benz took occupancy of its new 225,000-square-foot headquarters in Central Perimeter, doubling its Atlanta footprint in the process.
- Average asking rates stand at $29.35 per square foot, representing an increase of 1.5% over the prior quarter. Midtown has the highest average asking rate among the core submarkets at $35.50 per square foot, followed by Buckhead at $32.90 per square foot. Average asking rents in Central Perimeter are 15 to 20% lower at $27.80 per square foot but Class A rents in the submarket have reached $30 per square foot due to new high-end product being delivered.
- Following 330,000 square feet of positive absorption in Q1 2018, demand turned negative in Midtown in the second quarter due to AT&T vacating 200,000 square feet at 657 W. Peachtree Street, with a further 310,000 square feet to follow in the remainder of this year. The communications giant is set to leave behind 2.5 million square feet across the wider Atlanta market as it consolidates operations in Dallas.
- There are 10 properties of 100,000 square feet or greater under construction in Atlanta. Six of these are in Midtown where there is almost two million square feet of office space underway. Two of these projects, 740 W. Peachtree Street (352,000 square feet) and 864 Spring Street (277,000 square feet), are fully pre-leased to Anthem Technology and NCR respectively. Elsewhere in Midtown, the 760,000-square-foot Coda at 711 Spring Street is set to deliver in Q1 2019 and is 65% pre-leased to tenants including Georgia Tech, We Work and Keysight Technologies. As in other major cities, WeWork has an aggressive expansion plan in Atlanta, looking to add 20 more locations over the next 24 months.

San Francisco

- The **San Francisco** Bay Area office continues to post stellar performance and is the strongest of the 10 markets highlighted in this report, with the highest average asking rates (at $88.10 per square foot) and the lowest vacancy rate (at 4.9%). For the second successive quarter, the Bay Area posted the largest amount of net absorption of the major office markets with a total of 1.7 million square feet.
- The Bay Area saw exceptional rent growth in the second quarter at 10.8%. Unlike most other markets, rent growth in the Bay Area is being driven by transactions being struck, rather than new space entering the market with higher asking rates. There were five major leases signed in San Francisco in the quarter, with rents in the mid-$90s per square foot. A major contributor to this growth was Facebook's lease of the 763,100-square-foot Park Tower at 250 Howard Street. This was the largest lease ever signed in downtown San Francisco, making Facebook the fourth-largest private sector tenant in the market; only last September Facebook had signed for 436,000 square feet at 181 Fremont Street two blocks away.
- Four office projects totaling 1.3 million square feet delivered in San Francisco in Q2 2018, with all the space pre-leased. Although there is an additional 4.9 million square feet underway, most of this space is pre-committed. When combined with a dearth of large-block availability, the factors are in place for further rent growth. This is also driving up Class B rents which average $84.45 per square foot in San Francisco's Financial District.
- Silicon Valley presents a similar picture, with 4.7 million square feet of new office space under construction, 70% of which is pre-leased. The Big Four (Amazon, Apple, Facebook and Alphabet, Google's parent company) continue to take up large amounts of space forcing other users to plan ahead to satisfy their growth requirements. Amazon leased an additional 385,000 square feet at Moffett Towers I in Sunnyvale in the second quarter, bringing its footprint in that immediate area alone to 1.7 million square feet.
- Asking rates in the core locations of Mountain View and Palo Alto are on a par with those in downtown San Francisco. Average Class A asking rates in Palo Alto are the highest in the Bay Area at approaching $100 per square foot.

Dallas

- The **Dallas** office market saw a slight reversal of fortunes in Q2 2018. While average asking rates held firm, net absorption was negative, and vacancy rose by 40 BPS to 15.2%. The shift in absorption was modest at negative 288,945 square feet, but Dallas was the only market in the Top 10 to post negative absorption in the quarter. Dallas' net absorption in Q1 2018 was a healthy 973,175 square feet.
- Quarterly statistics are often subject to volatility and the Q2 2018 performance should not be viewed as cause for concern. Nonetheless, vacancy rates rose in all three core submarkets tracked by this report, most notably from 11.9% to 13.1% in Uptown/Turtle Creek. Average asking rents are on a par in Preston Center and Uptown/Turtle Creek at $40.50 per square foot, significantly above the $28.40 per square foot average in Far North Dallas.
- The principal shift in the Dallas market is the continued decline in the amount of space being developed and its changing location. Office space under construction across the Metroplex has dropped by over three million square feet since Q2 2017, and there has been a marked shift away from Far North Dallas. Liberty Mutual's 1.1 million square feet campus, which delivered earlier in 2018, was the last of the recent phase of major build-to-suit projects in Far North Dallas.
- Attention has now shifted to Uptown/Turtle Creek with three developers going head to head on some of the last few development sites in the submarket. Totaling a combined 1.2 million square feet, all of which is scheduled to deliver in the remainder of this year, this space is 56% available. The largest of the three developments is Trammel Crow Company's 494,300-square-foot project at 2121 Pearl Street. PwC is the anchor tenant, and has naming rights on the building, which stands at 45% pre-leased.

Boston

- The healthy performance of the **Boston** office market continues apace. Absorption remained firmly positive in Q2 2018 at 410,000 square feet and average asking rates, which are edging toward $60 per square foot, rose by 2.4%. This was the second-highest quarterly rental growth rate among the 10 cities covered in this report. Vacancy stands at 9.5%, having fallen by 10 BPS in the second quarter.
- Reflecting strong and sustained tenant demand, Class A vacancy in Boston fell by 220 BPS to 9.2%. The resurgence of the Back Bay continues with vacancy down to 6.3%. Less than two years ago, Back Bay vacancy stood at almost 15%. Back Bay's compelling amenities and emergence as a tech hub are helping fuel demand to the tune of 790,000 square feet of absorption in the first half of 2018. In the quarter's largest lease transaction, Wayfair finalized its 400,000-square-foot lease at 222 Berkeley/500 Boylston Street. The online home décor retailer is rumored to be in the market to lease more space in its headquarters city.
- With over 225 active tenant requirements in the Boston market totaling six million square feet, strong leasing activity looks set to continue, limited only by available supply. Firms with major requirements include Salesforce and State Street Bank, each seeking 500,000 square feet, and Oath — the digital content arm of Verizon — which is looking for 400,000 square feet. Coworking remains a highly competitive and growing market segment. WeWork is projected to have one million square feet of space in Boston by the end of 2018.
- Average asking rents in Boston stand at $57.35 per square foot making them the third-highest among the 10 markets covered in this report. Looking at the principal submarkets, Back Bay's average asking rates stand at $64.25 per square foot, followed by $61.65 per square foot in Seaport and $56.10 per square foot in the Financial District. Premier high-rise space can command rents in the mid-$80s per square foot. With strong demand and a shortage of readily available large blocks, landlords should have the ability to push rents further.

Seattle

- The **Seattle** office market posted healthy performance in Q2 2018. Absorption remained positive and rents inched upward. Most significantly, there was a 70-basis-point drop in the vacancy rate to 8%. Seattle now has the third-lowest vacancy rate among the markets covered in this report. The decrease was boosted by two major move-ins: Amazon took occupancy of 400,000 square feet at 300 Pine Street, while WeWork moved in to 115,000 square feet at 1201 Third Avenue in the CBD.
- The coworking giant continues to make major inroads in the Seattle market, accounting for the two largest leases signed in the second quarter, led by taking 120,000 square feet at Met Park East, also in the CBD. This activity has taken the amount of coworking space in Seattle-Puget Sound to above two million square feet. Three quarters of this space is in the CBD and its adjacent submarkets. WeWork is by far the dominant player with a 63% market share, followed by Regus and Regus Spaces with a combined 16%.
- Average asking rates in the Seattle market stand at $40.65 per square foot led by the CBD at $46.35 per square foot and Lake Union at $40.55 per square foot. These are the only downtown locations with rents above $40 per square foot and the delta between the CBD and less in-demand downtown locations can be as high as $18 per square foot. New construction and premier skyline space in the CBD are seeking rents of up to $55 per square foot.
- There is 6.5 million square feet of office construction underway in Seattle. The largest three projects, totaling 2.7 million square feet, are fully committed to Amazon. Amazon Towers III and IV in Belltown/Denny Regrade will provide a combined two million square feet, while a 720,000-square-foot tower is underway at Rainier Square in the CBD. All three are set to deliver in early 2020. However, there are two fully available major projects scheduled for delivery in the first half of 2019 that could test the strength of tenant demand: the 650,000 square feet 2+U project in the CBD and 333 Dexter Avenue in Lake Union, which will provide 600,000 square feet.

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