MARKET REPORT

Office

Northern New Jersey Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

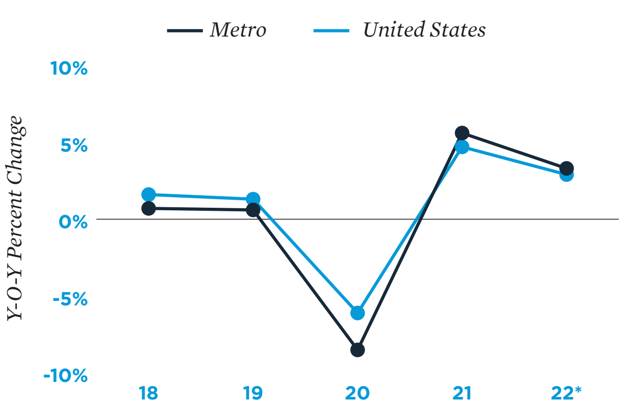
2Q/22

Commuter-Friendly Stock an Edge; Proactive State Policy Drawing Class A Tenants

Market bolstered by a mix of suburban and urban offices. The proximity of inland commercial districts to residential suburban zones is drawing employers looking to attract workers seeking reduced commute times. Builders are confident in future demand for space in these locales, with over two-thirds of the construction pipeline set to be delivered to portions of Morris and Passaic counties. However, vacancy rates are early on the path to recovery here, with the highest vacancy compression and rent growth observed in the more centrally-located Union and Essex counties. With nearly all pandemic-related restrictions dropped, recovery in core urban areas is sparking more leasing in these submarkets.

Room for optimism surfaces in high-tier sector. Entering the second quarter, the recovery of Northern New Jersey's Class A segment has been modest when compared to lower-tier properties. Still, upper-tier vacancy may be mitigated moving forward, via aggressive tax incentives offered to new corporate arrivals. Fiserv, one of 2022's largest move-ins, was awarded over $100 million in tax concessions to establish a financial hub in Berkeley Heights. A government initiative to establish a Fintech innovation center in the region should draw in additional firms to backfill Class A inventory vacated during the pandemic. At the end of March, nearly a quarter of the market's amenity-rich stock remained unoccupied. In contrast, availability in the Class B/C segment was at its lowest level since at least 2007 — an indication tenants are exhibiting a preference for lower cost space.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.

Office 2022 Outlook

70,000 JOBS *will be created*

EMPLOYMENT:

Relocations spurred by proactive tax policies should support a gain of 10,000 jobs in traditional office-using sectors this year. Segment employers surpassed pre-pandemic payroll counts in late 2021.

530,000 SQ. FT. *will be completed*

CONSTRUCTION:

Completions are up from last year, yet delivery volume trails the pre-2020 decade-long average by 200,000 square feet. Roughly half of the square footage to be delivered this year will come online in downtown Morristown and Jersey City.

60 BASIS POINT *decrease in vacancy*

VACANCY:

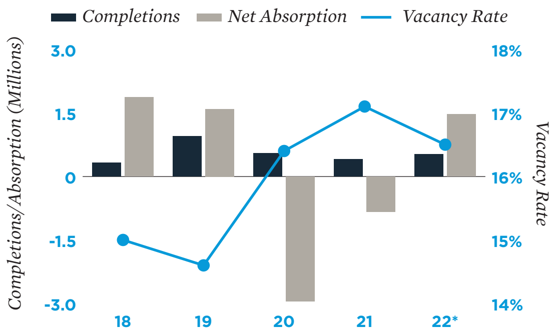
The market will post a positive year-end net absorption figure for the first time since the onset of the health crisis. At 16.5 percent, fourth quarter vacancy will be 90 basis points above the year-end 2019 rate.

1.0% INCREASE *in asking rent*

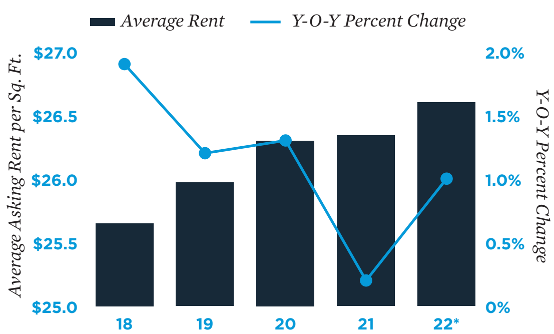
RENT:

The return of positive net absorption, in tandem with a relatively modest construction schedule, will support an increase in the average marketed rent to $26.60 per square foot — the highest year-end level on record.

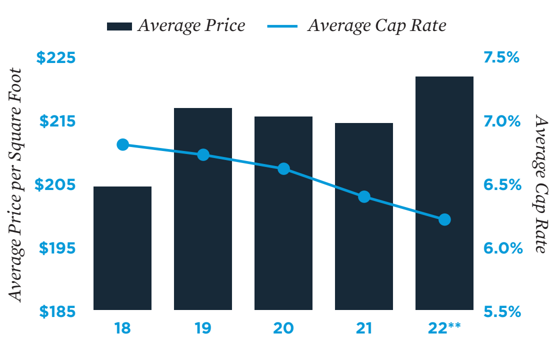
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 1Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

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Price: $250

1Q 2022 - 12-Month Period

CONSTRUCTION

313,000 sq. ft. completed

- The volume of space delivered during the 12-month period ended in March was the lowest completion total during a yearlong span since 2014.
- The recent period's deliveries comprised a small number of projects across five counties. The largest facility finalized was a 125,000-square-foot office complex on the Hoboken waterfront.

VACANCY

40 basis point decrease in vacancy Y-O-Y

- After peaking in mid-2021, vacancy fell 90 basis points over the next three quarters to 16.8 percent, as 1.7 million square feet was absorbed.
- A 70-basis-point decline year-over-year in Class B/C vacancy translated to an end-of-March availability rate of 9.2 percent, a multidecade low. The equivalent Class A figure fell by 20 basis points to 24.8 percent.

RENT

0.2% decrease in the average asking rent Y-O-Y

- A slight decline in overall asking rents was driven by a 1.1 percent decrease in Class B/C marketed rates. Entering April, the metro's mean asking rent stood at $26.18 per square foot.
- Asking rents for lower-tier floorplans have remained largely stagnant since 2007. However, record-low vacancy could generate upward movement.

Investment Highlights

- The ongoing economic recovery brought investors back to the table, supporting an increase in trading velocity. While a slowdown in Class A deals was observed as larger investors waited for a more certain recovery, Class B and C deal flow returned to pre-pandemic norms. Bidding for these assets drove the mean sale price across all property tiers up to $222 per square foot during the yearlong period ending this first quarter.
- As elevated inflation persists, trades of Class B and C office buildings could be negatively impacted, due to some difficulty reported in raising marketed rents over the past decade. However, owners and prospective buyers looking for a higher return on investment may employ capital improvement strategies to command higher rents.
- Competition for active listings drove the average cap rate down 40 basis points in four quarters, ending March at 6.2 percent. A 12-month yield compression of this magnitude was last observed in 2012, when the local office sector was recovering from the effects of the financial crisis.
- Medical office deals hit a six-year high during the 12-month span ended March, buoyed by solid fundamentals during the health crisis. Yields on typical trades were seen dipping into the mid- to high-5 percent zone.