MARKET FORECAST

OFFICE

Jacksonville Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

Q2/19

Suburban Office Space Remains Highly Sought After; Construction Hits Cyclical High

Corporate footprints support sustained strength of suburban office markets. Tightening vacancy and steady rent growth will remain staples of the Jacksonville office market this year. An expanding healthcare sector and increasing number of professional services jobs will keep office space demand robust, especially in the southern parts of the metro, where the majority of the area's high-profile businesses operate. Companies like Fidelity Investments and Southeastern Grocers support office demand throughout the I-95 corridor as businesses seek space in prime locations near industry heavyweights. Mandarin is also expected to witness vigorous demand moving forward as the area's quickly expanding population helps attract more companies, giving them a growing talent pool from which to recruit. Here, asking rents will sit on a gradual incline, staying aligned with the overall metro average.

Developers follow tenant demand to suburbia. The bulk of this year's delivery total will consist of three completions sitting adjacent to St. Johns Town Center. This area is progressing into a more prominent employment hub as close proximity to luxury housing and upscale shopping make it easier for organizations to attract new workers. A strong millennial growth rate is popularizing this live-work-play dynamic in Jacksonville, particularly as young professionals firmly embrace this concept. Most of the market's remaining development will be situated in outlying submarkets, stretching from Fruit Cove to Yulee.

Office 2019 Outlook

780,000 SQ. FT.
will be completed

CONSTRUCTION:

Office development reaches its highest point since 2008 when 1.3 million square feet was completed. This year's construction will be concentrated in the metro's southern sections.

50 BASIS POINT
decrease in vacancy

VACANCY:

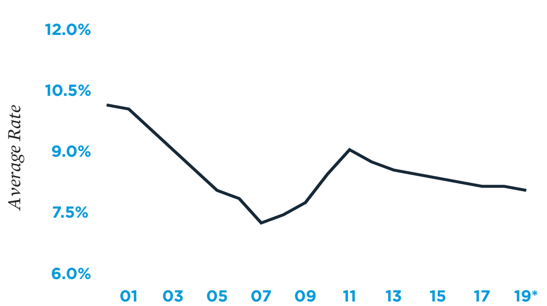
Building on last year's 70-basis-point drop, market vacancy is on track to plunge another 50 basis points in 2019, pushing the rate down to 11.9 percent.

3.3% INCREASE
in asking rents

RENTS:

Jacksonville's average asking rent is scheduled to increase steadily this year, climbing to $20.69 per square foot. In 2018, the figure rose 2.2 percent.

Local Office Yield Trends

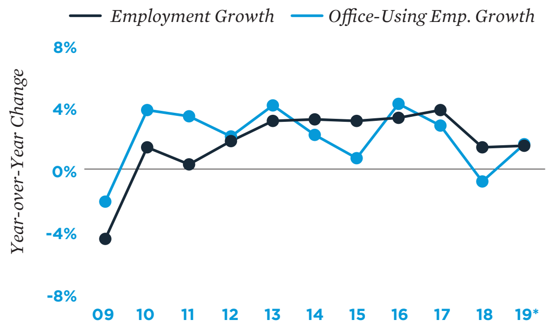


** Cap rates trailing 12 months through 1Q19*
Sources: CoStar Group, Inc.; Real Capital Analytics

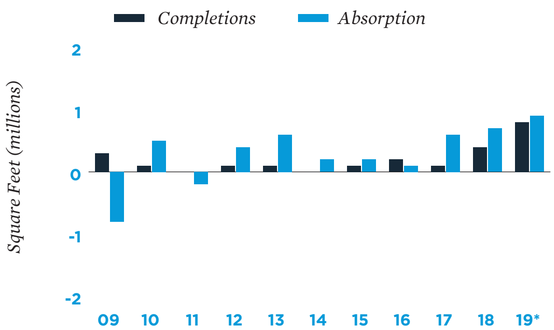
Investment Trends

- Neighborhoods surrounding the I-95/State Route 202 interchange were highly targeted over the past year. Stabilized assets selling between $65 and $95 per square foot attracted a long list of suitors; however, most investors scouring these areas were institutional grade. Capital came from a variety of major markets along the East Coast, with the majority arriving from Boston, Miami and New York City.
- Older office buildings in downtown Jacksonville are beginning to see more investor interest. Urban renewal efforts are producing many viable options for entry-level buyers or those with high-yield strategies as numerous properties changed hands for under $1 million. Cap rates generally sat in the upper-8 to lower-9 percent band for these assets, well above the metro average.
- Private and institutional investors homed in on the Deerwood and Windy Hill neighborhoods, targeting the areas' wide array of properties. Cap rates ranged from the low-7 percent realm for Class A assets to the high-9 percent territory for Class C buildings.

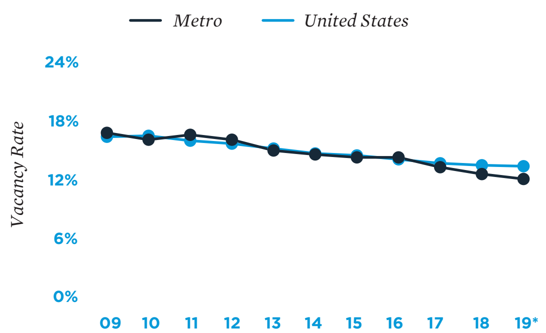
Employment Trends



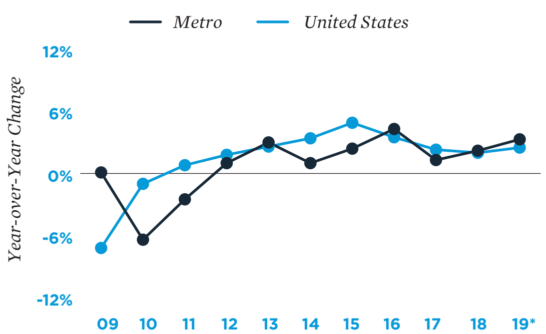
Office Supply and Demand



Vacancy Rate Trends



Asking Rent Trends



** Forecast*
Source: CoStar Group, Inc.

1Q19 – 12-Month Trend

EMPLOYMENT

1.0% increase in total employment Y-O-Y

- As unemployment tightens closer to 3 percent, hiring activity has become increasingly limited over the past several months. Since March of last year, Jacksonville organizations added 6,900 workers to payrolls.
- Professional and business services, education and health services, and leisure and hospitality each added more than 2,000 employees during the past 12 months.

CONSTRUCTION

400,000 square feet completed Y-O-Y

- After approximately 90,000 square feet was completed during the previous period, 400,000 square feet was finalized over the past 12 months.
- Development was mostly in southern submarkets and the Southside and Butler-Baymeadows submarkets accounted for more than half of the metro total.

VACANCY

160 basis point decrease in vacancy Y-O-Y

- Vacancy collapsed 160 basis points on an annual basis, moving the market rate down to 12.1 percent. One year earlier, the measure edged up 30 basis points.
- While demand for Class B/C space remained consistent, availability among luxury floor plates significantly tightened, moving Class A vacancy down 290 basis points to 12.2 percent.

RENTS:

2.6% increase in the average asking rent Y-O-Y

- Rent growth was on par with the previous five-year average as the average asking rent increased to $20.38 per square foot, still more than $10 below the national average.
- Outerlying submarkets posted the strongest rental gains in the metro, headlined by Beaches, Nassua and St. Johns County. This contributed to an overall suburban growth rate of 4.6 percent, bumping the area's average price per square foot up to $20.15.

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Demographic Highlights

2019 Forecast Job growth

Metro **1.5%**

U.S. Average 1.3%

2019 Office-Using Job growth

Metro **1.6%**

U.S. Average 1.7%

Population Age 20-34*

Metro **20.6%**

U.S. Average 20.6%

Population of Age 25+ Percent with Bachelor Degree+**

Metro **28.9%**

U.S. Average 29.9%

Sq. Ft. Per Office Worker*

Metro **237**

U.S. Average 215

Office Square footage*

28.4% *Urban*

U.S. Average 32.0%

71.6% *Suburban*

U.S. Average 68.0%

**1Q19*
***2018*

SUBMARKET TRENDS

Lowest Vacancy Rates 1Q19*

Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Average Asking Rent	Y-O-Y % Change
Northeast Jacksonville	3.0%	-490	$18.04	-0.9%
Mandarin	5.2%	-460	$20.95	1.4%
Beaches	5.7%	-50	$28.54	8.3%
Riverside	5.8%	-70	$18.89	1.5%
Downtown Southbank	8.0%	-750	$22.37	3.9%
Downtown Northbank	9.7%	-20	$20.62	2.3%
San Marco	10.4%	-1,730	$17.37	7.1%
Arlington	13.8%	-30	$17.25	0.1%
Orange Park-Clay County	14.2%	-130	$20.94	-1.2%
Southside	15.1%	-250	$19.78	2.3%
Overall Metro	**12.1%**	**-160**	**$20.80**	**2.6%**

** Includes submarkets with more than 100,000 square feet of inventory*

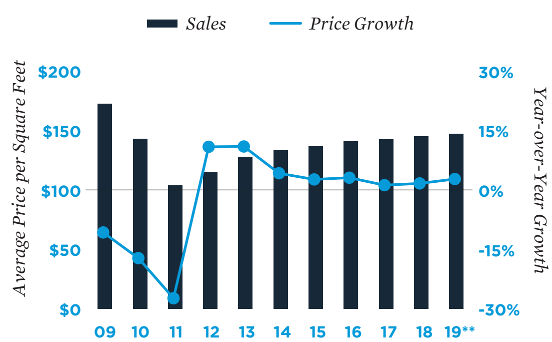
SALES TRENDS

Favorable Returns, More Office-Using Jobs Keeping Buyer Interest Steady

- Substantially stronger yields than most other major Southeastern metros kept deal flow and price appreciation stable. Over the past year, Jacksonville's average price per square foot increased roughly 3 percent to $147.
- The market's average cap rate slid 10 basis points to 8 percent year over year. This measure has trickled down steadily during the current business cycle.

Outlook: The south suburban office market will remain a focal point for investors as Jacksonville continues to diversify its industrial-heavy economy with more white-collar jobs.

Sales Trends



*** Trailing 12 months through 1Q19 over previous time period*
Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

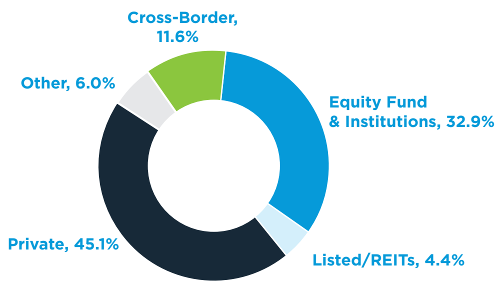
Capital Markets

By DAVID G. SHILLINGTON, President, Marcus & Millichap Capital Corporation

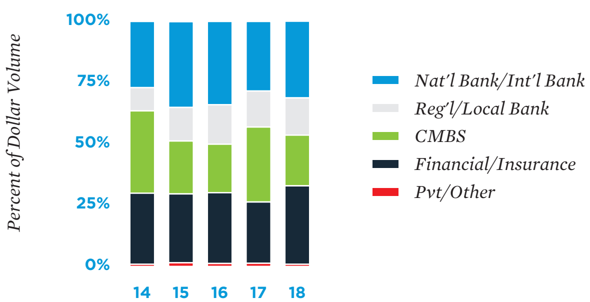
- **Ongoing trade concerns weigh on growth outlook; Fed plots next steps.** Amid rising trade tensions between the U.S. and China and slowing global growth, the outlook has turned more cautious. Market volatility, along with a flight to safety trade, has flattened the yield curve dramatically, with the 10-Year Treasury trading below 2.2 percent. This has pushed the broader yield curve into inversion, a closely watched precursor to a potential recession. Meanwhile, many measures of the domestic economy remain buoyant, including continued job and wage growth, historically low unemployment and muted inflationary pressure. These conditions have prompted a dichotomy, with Federal Reserve officials signaling more accommodative policies. The impending end of quantitative tightening in September, coupled with potential cuts to the Fed funds rate in the second half of the year, highlight the shift in Fed policy. As a result, long-term interest rates are likely to remain subdued, with Fed policy leaning toward accommodation.

- **Conservative underwriting balances abundant marketplace liquidity.** While debt availability for office assets remains widely available from a wide range of sources including local, regional and national banks and insurance companies, sentiment surrounding the health of the economy has fallen somewhat in recent months. Lenders remain broadly cautious in underwriting, with loan-to-value (LTV) ratios typically in the 55 to 70 percent range, depending on the borrower, asset and location. The conservative approach has filtered into a focus on proven property results, with much less willingness to lend against pro forma rents. This has prompted investors to turn toward short-term mezzanine debt and bridge loans to cover capital improvements, while seeking long-term solutions once returns have been solidified. Construction origination remains muted, with lenders focusing on core locations with proven demand.

1Q19* Office Acquisitions By Buyer Type



Office Mortgage Originations By Lender



** Trailing 12 months through 1Q19*
Include sales $2.5 million and greater
Sources: CoStar Group, Inc.; Real Capital Analytics

National Office and Industrial Group

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Price: $250

Sources: IPA Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Experian; Moody's Analytics; Real Capital Analytics; TWR/Dodge Pipeline; U.S. Census Bureau