

MARKET FORECAST

OFFICE

Milwaukee Metro Area

IPA INSTITUTIONAL
PROPERTY
ADVISORS

Q2/19

Major Companies Absorb Space; Investors Seek Value-Add Opportunities Around the Metro

Companies sign new leases, keeping pressure on local office market.

Milwaukee's office performance was bolstered by corporate expansion in the finance and insurance industry. The planned Foxconn manufacturing campus and the economic impact a project of that scope will bring to the area has also benefited the overall outlook. Local office space demand is increasing as back-office and service-oriented companies are moving to the metro to be near other major corporations like Fiserv, Northwestern Mutual and Rockwell Automation, all headquartered in the area. The impact of Fortune 500 companies having a large footprint in a city like Milwaukee is that it creates value-add opportunities in older properties in the nearby areas. Class B/C space operates with tight vacancy, 370 basis points below the Class A rate of 15.5 percent, and renovating these spaces will allow owners to increase marketed rents.

The metro's corporate growth has spurred further development.

Construction levels are set to rebound this year after a modest deposit in 2018. The largest project under construction is the BMO Harris Tower in downtown Milwaukee. East of Interstate 41 and north of Wisconsin Avenue is an 80,000-square-foot office project that is scheduled to finalize late this year. Of that space, 30,000 square feet is currently pre-leased. The Pointe at East Mequon Corporate Center is another large project expected by the end of the year. This will add approximately 75,000 square feet to the corporate park just off Interstate 43 about 15 miles north of downtown Milwaukee.

Office 2019 Outlook



**615,000
SQ. FT.**

will be completed

CONSTRUCTION:

Construction will increase from last year's 400,000 square feet. The pipeline has 615,000 square feet of office space set to be delivered in 2019.



**20 BASIS
POINT**

increase in vacancy

VACANCY:

Vacancy will inch up to 12 percent in 2019. Last year vacancy fell 110 basis points to 11.8 percent.



**1.6%
INCREASE**

in asking rents

RENTS:

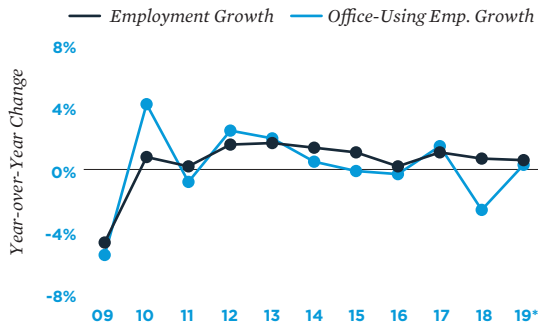
The average asking rent climbs to reach \$17.53 per square foot in 2019. Last year, average rents increased 3.7 percent.



Investment Trends

- Trade velocity over the past 12 months ended in March increased by nearly 30 percent as buyers were actively scouting the market in search of value-add opportunities.
- Though last year's trading activity was strong overall, it was driven by competition for limited listings. Office properties have been performing well in the market, attracting investors with the tightening vacancies and a disciplined construction pipeline.
- First-year yields in Milwaukee vary from the mid-7 to mid-9 percent zone. Stabilized office assets are typically trading in the high-8 to low-9 percent range, drawing investors from other regional metros.
- Brookfield's strong office market frequently draws buyers to the corporate corridor. Shorewood is also an attractive area, with the University of Wisconsin-Milwaukee campus located in the submarket.

Employment Trends



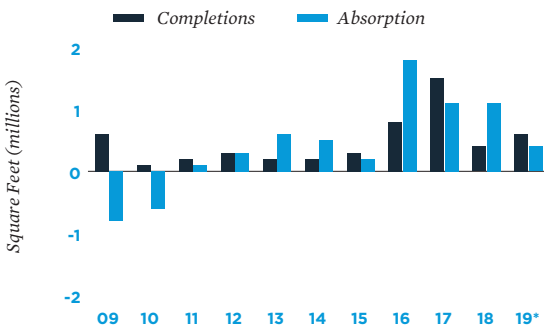
1Q19 - 12-Month Trend

EMPLOYMENT

0.4% increase in total employment Y-O-Y

- Employment growth in Milwaukee slowed over the past 12 months ending in March. Payrolls expanded by a modest 0.4 percent, or 3,700 positions.
- The market had a drop in office-using employment for the third consecutive quarter, down almost 2,000 positions since March 2018. Losses came in the business and professional services and financial activities sectors.

Office Supply and Demand

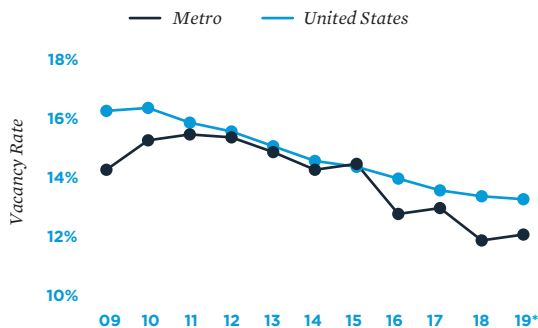


CONSTRUCTION

480,000 square feet completed Y-O-Y

- Construction moderated to 480,000 square feet of new office space in the past year ended in March. In the previous year, nearly 1.5 million square feet was finalized.
- The BMO Tower, currently under construction on Water Street just southeast of the new Fiserv Forum, is the largest office project currently underway. The new office tower will deliver roughly 380,000 square feet of office inventory.

Vacancy Rate Trends

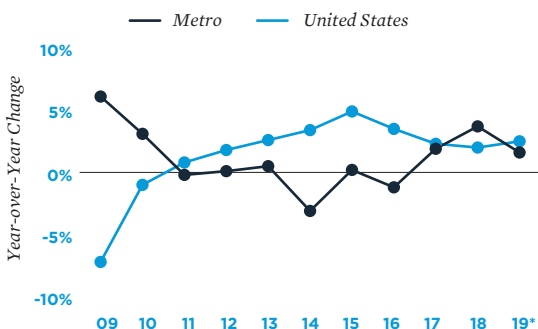


VACANCY

50 basis point decrease in vacancy Y-O-Y

- The office vacancy rate slipped to 12.7 percent over the past four quarters, a slightly steeper fall than the average drop of 40 basis points per year since 2015.
- Operations tightened 90 basis points to 11.8 percent in suburban areas despite the increased construction delivered here during the period. The CBD posted a 20-basis-point rise to 14.5 percent.

Asking Rent Trends



RENTS

2.8% increase in the average asking rent Y-O-Y

- Rental growth remained consistent over the past 12 months, increasing 2.8 percent to \$17.02 per square foot, modestly better than last year's pace of 2.7 percent.
- Racine County and Ozaukee County posted the strongest average asking rent over the past four quarters, with double-digit growth of 10.2 and 11.8 percent, respectively.

Demographic Highlights



2019 Forecast Job growth

Metro **0.6%**

U.S. Average 1.3%



2019 Office-Using Job growth

Metro **0.3%**

U.S. Average 1.7%



Population Age 20-34*

Metro **20.0%**

U.S. Average 20.6%



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

Metro **33.4%**

U.S. Average 29.9%



Sq. Ft. Per Office Worker*

Metro **324**

U.S. Average 215

Office Square footage*



32.0% Urban

U.S. Average 32.0%



68.0% Suburban

U.S. Average 68.0%

*1Q19
**2018

SUBMARKET TRENDS

Lowest Vacancy Rates 1Q19

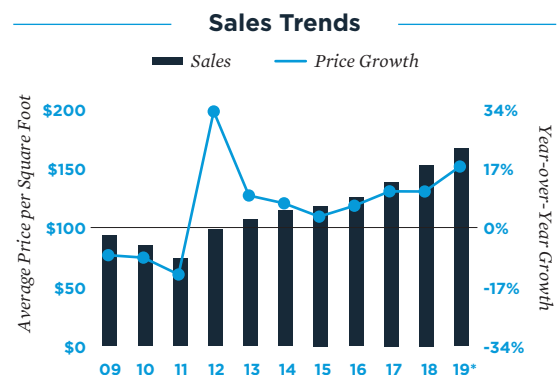
Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Average Asking Rent	Y-O-Y % Change
Washington County	5.5%	-420	\$17.04	1.8%
Racine County	5.7%	-700	\$14.46	10.2%
Ozaukee County	10.8%	80	\$15.25	11.8%
Milwaukee County	12.2%	-60	\$15.55	2.0%
Waukesha County	13.2%	-10	\$16.29	0.2%
Downtown	14.5%	20	\$19.66	4.0%
Overall Metro	12.7%	-50	\$17.02	2.8%

SALES TRENDS

Inventory Shortage Drives Competition Among Buyers, Price Appreciation

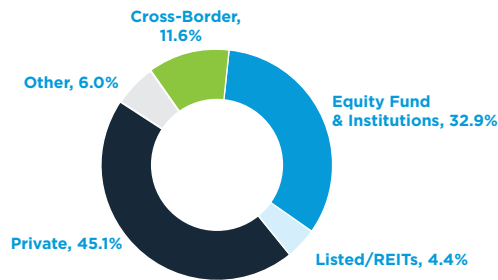
- Class B assets were heavily traded in 2018, bolstering the year-over-year growth seen in the metro's overall deal flow. Limited Class C trades caused a steep increase in average pricing of nearly 30 percent.
- Milwaukee powered through limited listings last year with a highly competitive bidding market. Pricing appreciated almost 18 percent, bringing the average price per foot to the high-\$160 range.

Outlook: Milwaukee's competitive office market is likely to hold steady as investors continue their search for available assets with high upside. Strong initial yields are attracting regional investors, though the limited inventory in Milwaukee may impact overall deal flow.

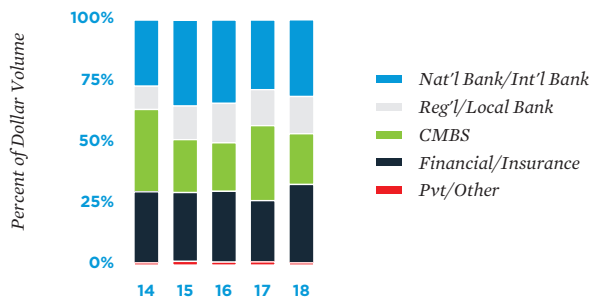


* Trailing 12 months through 1Q19 over previous time period
Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

**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

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.

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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