MARKET FORECAST

OFFICE

North Carolina Metros

IPA INSTITUTIONAL PROPERTY ADVISORS

Q2/19

Economic and Demographic Tailwinds Among the Best in Nation, Supporting Local Office Market

Healthy demand buttressing more robust fundamentals in Charlotte. The local economy is significantly stronger than the national average in terms of new jobs, household growth and population gains. The relative affordability of the market makes Charlotte a destination for companies looking to expand operations outside of more costly coastal markets. Financial services firms, in particular, are drawn to the area due to the deep talent pool and concentration of banking institutions. Charlotte will benefit from the addition of another Fortune 500 headquarters when the BB&T-SunTrust merger is complete. Although new supply is rising this year, vacancy will compress closer to the single-digit threshold by year end as nearly 4 million square feet of space is absorbed.

Raleigh-Durham and Greensboro/Winston-Salem/High Point poised to improve through year end. Raleigh-Durham's relatively young and educated workforce makes the area a prime target for companies in technology and pharmaceuticals sectors. Home to several universities and the Research Triangle business park, the metro is expanding at close to double the national rate. Pendo, for example, is adding nearly 600 jobs at its downtown Raleigh location. Greensboro/Winston-Salem/High Point, meanwhile, is gaining traction after job cuts during 2016 and 2017 erased a few thousand office-using positions. Approximately half of those jobs have been recouped, and further gains will help shore up the office market, pulling down the state's highest vacancy rate.

Local Office Yield Trends

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

Office 2019 Outlook

Metro	Vacancy	Y-O-Y Basis Point Change	Average Asking Rent	Y-O-Y Change
Charlotte	10.2%	-70	$26.91	5.7%
Raleigh-Durham	9.9%	-10	$25.39	4.9%
Greensboro/ Winston-Salem/ High Point	11.7%	-70	$16.40	0.9%

Investment Trends

Charlotte

- The financial hub remains a draw for local and out-of-state capital as investors search for rapidly growing markets with attractive entry prices. Class B assets are at the top of buyers' wish lists.
- Average cap rates are in the mid-6 percent range, by far the lowest in the state. Investors will target South Charlotte and Midtown, though activity will remain relatively strong across the metro.

Raleigh-Durham

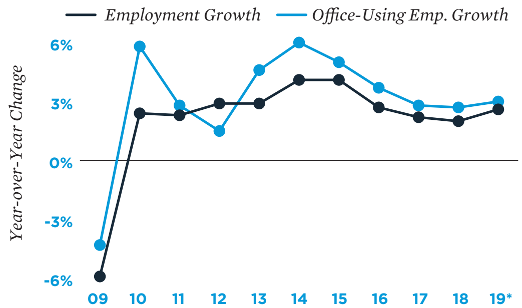
- Buyers are targeting smaller, mid-tier properties across the market, where pent-up demand exists. Extremely tight vacancy in the bottom of market offer investors an opportunity to lift rents.
- In the first half of the year, average cap rates are in the low-7 percent range, making local properties attractive for owner-users and debt funds looking to acquire office assets.

Greensboro/Winston-Salem/High Point

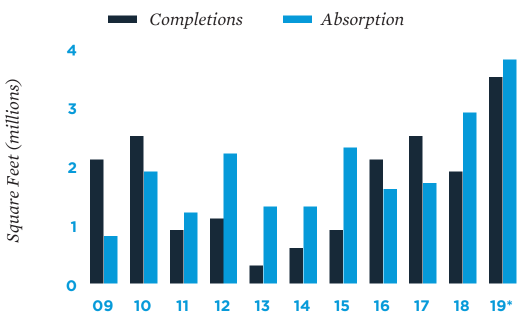
- Contrary to the other large markets in North Carolina, buyers in Greensboro/Winston-Salem/High Point are focused on Class C assets. As more capital flows into the market, the number of mid-tier properties that change hands should rise.
- Investors find average cap rates in the low-7 percent range, making the market a magnet from investors that have been priced out of larger markets where cap rates have declined further.

1Q19 – 12-Month Trend

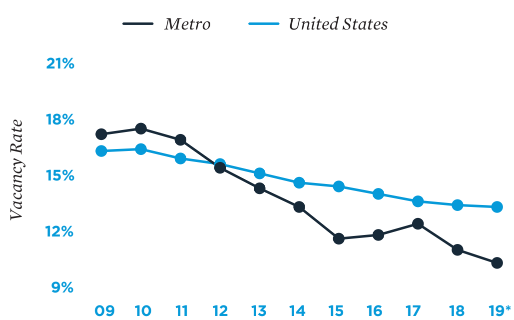
Employment Trends



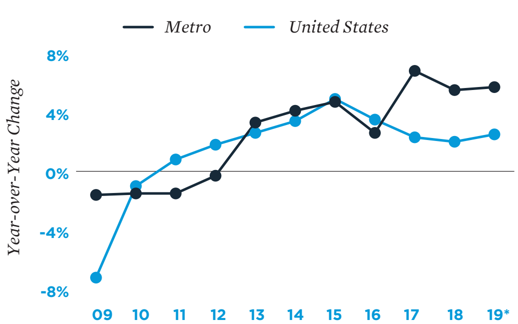
Office Supply and Demand



Vacancy Rate Trends



Asking Rent Trends



*Forecast
Source: CoStar Group, Inc.*

EMPLOYMENT

2.5% increase in total employment Y-O-Y

- Employers added 30,100 jobs over the past year, including 16,100 spots during the last six months as firms accelerated their pace of hiring. Office-using sectors expanded 3.4 percent year over year with the addition of 11,200 spots.
- Both the leisure and hospitality and professional and business services segments increased by 4.2 percent in the past 12 months, pulling down the unemployment rate to 3.7 percent.

CONSTRUCTION

1.8 million square feet completed Y-O-Y

- Developers expanded office stock 1.9 percent in the last year as 1.8 million square feet came online. The pace of construction slowed from 2.5 million square feet during the previous year.
- Nearly 5 million square feet of space was underway at the end of the first quarter, with pre-leasing activity hovering north of 60 percent. The largest project scheduled for delivery this year is the 850,000-square-foot Legacy Union.

VACANCY

100 basis point decrease in vacancy Y-O-Y

- In the first quarter, vacancy was 10.8 percent, the lowest rate since the last recession and 100 basis points below one year ago. Vacancy ticked up 10 basis points during the prior year.
- Space demand for Class A buildings supported a 170-basis-point decline in vacancy to 12.6 percent over the past year. Class B/C vacancy edged down 20 basis points to 9.4 percent.

RENT:

5.8% increase in the average asking rent Y-O-Y

- Rent gains have been robust in the Charlotte market, including a 5.8 percent jump to $25.86 per square foot in the last 12 months. The average rent soared 7.1 percent in the previous yearlong period.
- The average rent for Class A space was $29.90 per square foot during the first quarter, up 4.3 percent annually. Low vacancy in Class B/C properties supported a 7.8 percent advance in the average asking rent to $22.47 per square foot.

Demographic Highlights

2019 Forecast Job growth

Metro **2.6%**

U.S. Average 1.3%

Population Age 20-34*

Metro **20.5%**

U.S. Average 20.6%

Sq. Ft. Per Office Worker*

Metro **252**

U.S. Average 215

2019 Office-Using Job growth

Metro **3.0%**

U.S. Average 1.7%

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

Metro **32.3%**

U.S. Average 29.9%

Office Square footage*

22.7% *Urban*

U.S. Average 32.0%

77.3% *Suburban*

U.S. Average 68.0%

**1Q19*
***2018*

SUBMARKET TRENDS

Lowest Vacancy Rates 1Q19**

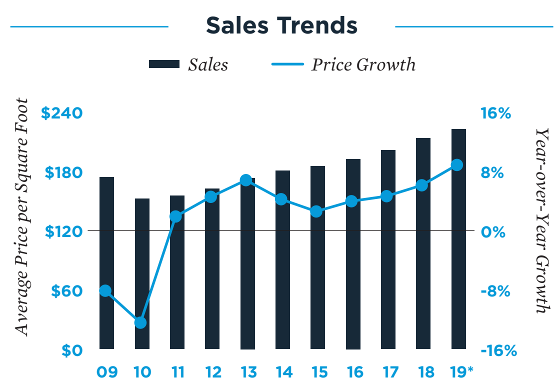
Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Average Asking Rent	Y-O-Y % Change
Rowan County	2.4%	-410	$12.50	22.1%
Lancaster County	4.2%	-880	$25.50	37.2%
Union County	6.3%	-210	$20.10	0.3%
Gaston County	7.2%	110	$16.83	3.4%
Charlotte Midtown	8.0%	70	$29.67	9.2%
Cabarrus County	8.1%	-130	$18.72	-2.4%
York County	9.3%	50	$21.24	-2.3%
South Charlotte	9.8%	-360	$30.93	3.4%
Iredell County	10.3%	280	$21.78	0.0%
Northeast Charlotte	10.7%	-120	$23.32	6.3%
Overall Metro	**10.8%**	**-100**	**$25.86**	**5.8%**

SALES TRENDS

Rising Interest in Class C Assets Boosts Office Property Deal Flow

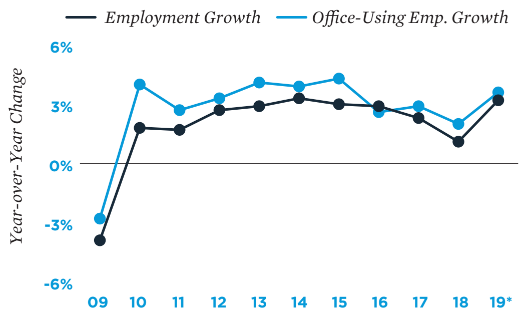
- Transaction velocity held relatively steady in both the Class A and Class B markets, while higher interest in Class C assets supported a 13 percent rise in sales.
- Cap rates trended lower as prices continued to climb year over year. First-year returns declined 20 basis points to the mid-6 percent range as the average price increased 9 percent $222 per square foot.

Outlook: Lower-tier properties in core submarkets will garner significant interest from investors seeking value-add opportunities. Midtown will be a favorite among buyers.

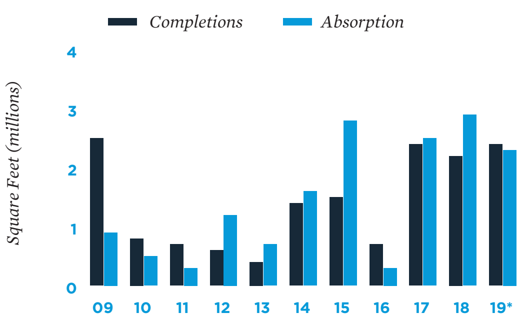


** Trailing 12 months through 1Q19 over previous time period*
***Includes submarkets with more than 1 million square feet*
Sources: CoStar Group, Inc.; Real Capital Analytics

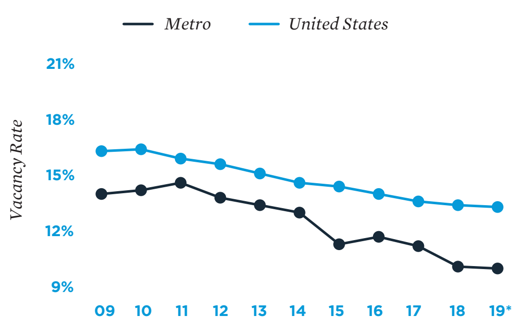
Employment Trends



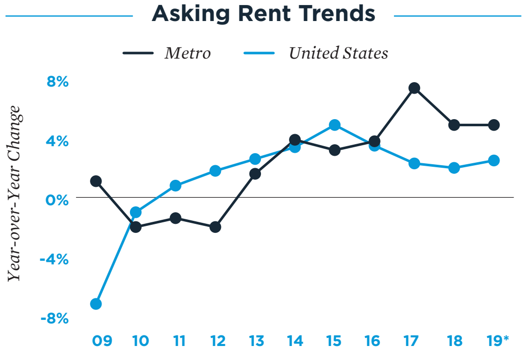
Office Supply and Demand



Vacancy Rate Trends



Asking Rent Trends



* Forecast
Source: CoStar Group, Inc.

1Q19 – 12-Month Trend

EMPLOYMENT

1.3% increase in total employment Y-O-Y

- After a 2.8 percent increase during the previous year, employers expanded headcounts by 12,100 positions in the last 12 months. Office-users were a primary source of growth as 5,900 jobs were generated, representing a 2.5 percent gain.
- The professional and business services segment advanced 2.9 percent with the addition 4,800 spots. Financial services contributed 800 jobs.

CONSTRUCTION

3.0 million square feet completed Y-O-Y

- Construction jumped to 3.0 million square feet during the 12-month period ending in the first quarter, well above the 1.8 million square feet delivered in the previous period.
- Of the 2.6 million square feet of space underway, 2 million square feet is on the Raleigh side of the market. Pre-leasing in Raleigh is modestly below 50 percent, whereas the leasing commitments are trending above 60 percent in Durham.

VACANCY

40 basis point decrease in vacancy Y-O-Y

- Vacancy dipped to 10.3 percent in this year's opening period, though an influx of new development pushed the rate higher in the last two quarters. The rate jumped 130 basis points in the last six months.
- Top-tier vacancy soared 100 basis points year over year to 12.8 percent as new space awaits absorption. Class B/C vacancy tightened 130 basis points to 8.6 percent.

RENT:

5.3% increase in the average asking rent Y-O-Y

- After a 7.0 percent rise in average asking rent during the prior year, the average rent soared another 5.3 percent in the last 12 months to $24.74 per square foot.
- Driven by the higher costs of new space, the average Class A rent advanced 3.6 percent to $27.51 per square foot. Healthy demand boosted the Class B/C average rent 6.1 percent over the past year to $22.82 per square foot.

Demographic Highlights

2019 Forecast Job growth
Metro **3.2%**
U.S. Average 1.3%

Population Age 20-34*
Metro **21.5%**
U.S. Average 20.6%

Sq. Ft. Per Office Worker*
Metro **340**
U.S. Average 215

2019 Office-Using Job growth
Metro **3.6%**
U.S. Average 1.7%

Population of Age 25+ Percent with Bachelor Degree+**
Metro **44.1%**
U.S. Average 29.9%

SUBMARKET TRENDS

Lowest Vacancy Rates 1Q19**

Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Average Asking Rent	Y-O-Y % Change
East Wake County	3.2%	-50	$14.86	10.8%
Glenwood/Creedmoor	5.3%	-220	$22.97	9.7%
Raleigh	6.9%	-10	$28.27	6.5%
West Wake County	9.0%	-130	$25.33	2.6%
North Raleigh	9.4%	-120	$24.15	1.8%
Durham County	11.5%	40	$24.08	6.4%
Orange County	14.4%	-380	$28.38	-1.0%
RTP/RDU	15.2%	80	$22.80	7.8%
Overall Metro	**10.3%**	**-40**	**$24.74**	**5.3%**

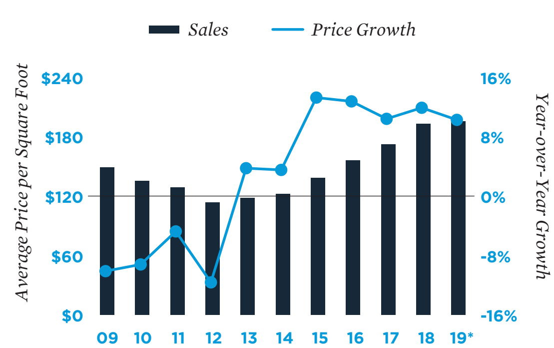
SALES TRENDS

Cap Rates Hold Stable as Buyers Shift Focus to Class B Deals

- Buyers increased the pace of acquisition in the Raleigh-Durham metro year over year as investors gravitated toward the middle of the quality spectrum.
- Average cap rates, which are in the low-7 percent range, have remained relatively steady over the past few years. The average price per square foot, meanwhile, was $196 during the yearlong period ending in the first quarter, up 10 percent.

Outlook: Investors are targeting Raleigh and North Raleigh, which recorded the greatest increase in deal flow over the past year. Durham submarkets have experienced a decline in activity.

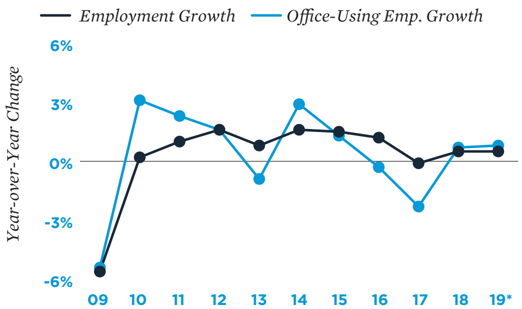
Sales Trends



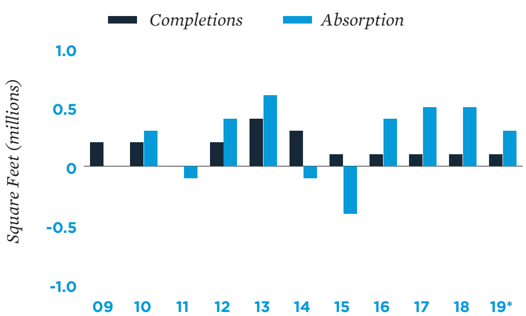
Trailing 12 months through 1Q19 over previous time period
*** Includes submarkets with more than 700,000 square feet*
Sources: CoStar Group, Inc.; Real Capital Analytics

1Q19 – 12-Month Trend

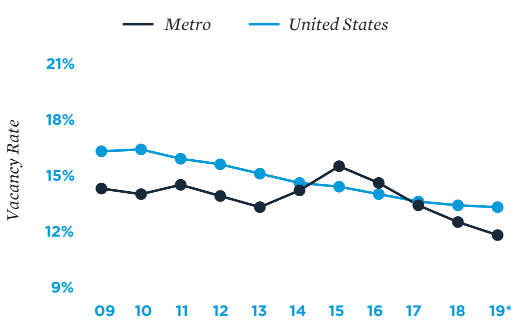
Employment Trends



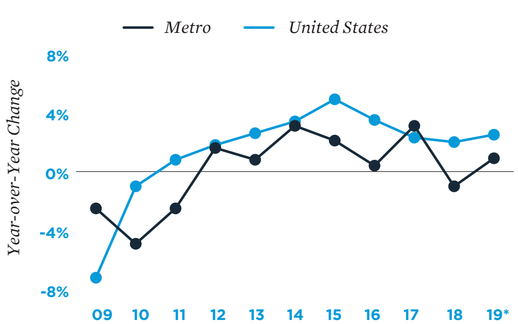
Office Supply and Demand



Vacancy Rate Trends



Asking Rent Trends



* Forecast

EMPLOYMENT

1.0% increase in total employment Y-O-Y

- Job growth has been relatively modest over the past year as 6,000 spots were created. Office users accounted for 500 spots, representing a 0.4 percent gain.
- Home development supported a 1,200 job increase in the construction sector, a 4.6 percent gain. The unemployment rate measured 4 percent in the first quarter.

CONSTRUCTION

115,000 square feet completed Y-O-Y

- During the past year, developers completed a modest 115,000 square feet of office space, up from 94,000 square feet in the prior annual period. Office supply inched up 0.3 percent.
- Less than 100,000 square feet is under construction in the market, which will limit pressure from new supply. Nearly all of the space has leasing commitments, indicative of pent-up demand for office space in the metro.

VACANCY

80 basis point decrease in vacancy Y-O-Y

- Healthy space demand supported tightening vacancy during the last 12 months. In the first quarter, the rate was 12.3 percent, after an 80-basis-point decline built upon a 130-basis-point dip.
- Most of the weakness in vacancy rests in core Class A properties. In one of the largest submarkets, the Winston-Salem CBD recorded a vacancy rate of 23.1 percent in the first quarter, while largest Class B/C submarket had a vacancy rate of 8.0 percent.

RENT:

0.3% decrease in the average asking rent Y-O-Y

- The average rent dipped 0.3 percent year over year to $16.32 per square foot in the first quarter. Over the past several quarters, the average rent for available space has been relatively stable, though improvement in the Class A sector could return upward pressure to rent.
- CBD rent has outperformed during the last 12 months, inching up 1.6 percent. In suburban office properties, the asking rent retreated 0.9 percent year over year.

Demographic Highlights

2019 Forecast Job growth

Metro **0.5%**

U.S. Average 1.3%

2019 Office-Using Job growth

Metro **0.8%**

U.S. Average 1.7%

Population Age 20-34*

Metro **19.3%**

U.S. Average 20.6%

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

Metro **26.6%**

U.S. Average 29.9%

Sq. Ft. Per Office Worker*

Metro **285**

U.S. Average 215

Office Square footage*

24.9% *Urban*

U.S. Average 32.0%

75.1% *Suburban*

U.S. Average 68.0%

**1Q19*
***2018*

SUBMARKET TRENDS

Lowest Vacancy Rates 1Q19

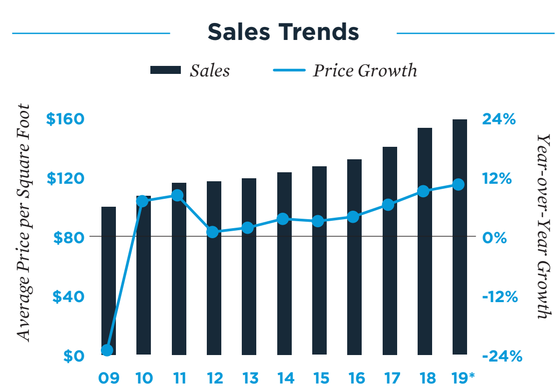
Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Average Asking Rent	Y-O-Y % Change
East Winston-Salem/ Forsyth County	5.0%	200	$9.19	-16.8%
Hanes Mall/ South Winston-Salem	6.2%	-290	$16.73	-5.1%
North Greensboro/ Guilford County	8.4%	0	$18.97	-0.1%
Greensboro CBD	9.5%	150	$18.62	6.5%
High Point/ Southwest Guilford City	10.3%	20	$14.15	2.5%
West Winston-Salem/ Forsyth County	10.5%	-120	$16.79	-2.0%
Piedmont Triad Airport/ West Guilford County	11.0%	-300	$15.68	0.8%
Winston-Salem CBD	16.6%	120	$15.32	-1.5%
West Greensboro	24.6%	-330	$15.21	-6.5%
SE Greensboro/ Guilford County	55.0%	-20	$15.00	-6.2%
Overall Metro	**12.3%**	**-80**	**$16.32**	**-0.3%**

SALES TRENDS

Smaller Class B Deals Move to the Top of Investors' Wish List

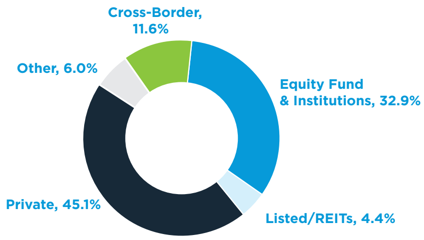
- As investors scoured the nation to place capital over the past year, transaction velocity jumped 17 percent. Investors increased their footprint in all classes.
- The average price was $159 per square foot during the most recent 12-month period, up 10 percent year over year. Average cap rates ticked down 20 basis points to the low-7 percent area.

Outlook: Investors hedged their risk modestly over the last 12 months as the average size of office properties than changed hands declined decreased 25 percent.

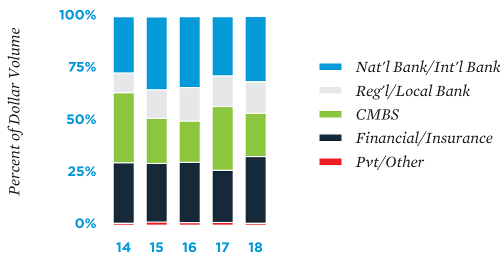


** Trailing 12 months through 1Q19 over previous time period*
Sources: CoStar Group, Inc.; Real Capital Analytics

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.

National Office and Industrial Group

Alan L. Pontius
Senior Vice President, National Director | IPA Office and Industrial Group
Tel: (415) 963-3000 | apontius@ipausa.com

For information on national office trends, contact:
John Chang
Senior Vice President, National Director | Research Services
Tel: (602) 707-9700 | john.chang@ipausa.com

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