MARKET FORECAST

OFFICE

Ohio Metros

IPA INSTITUTIONAL PROPERTY ADVISORS

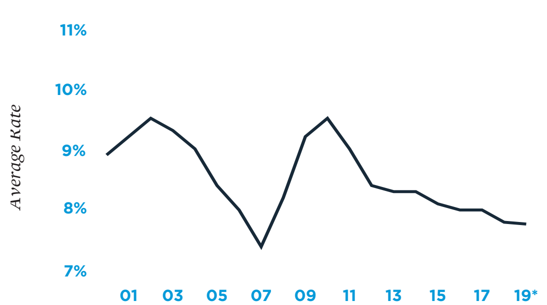
Q2/19

Major Ohio Metros Boast Improving Economies, Supporting Office Price Appreciation

Office space demand advances across Ohio. Continued growth in the state is supporting heightened leasing activity and positive net absorption in all three major markets. Despite having the highest vacancy, Columbus office users are anticipated to occupy more than 1 million square feet of space during 2019, the largest annual gain. The diverse local metro, which includes the state capital and Ohio State University, benefits from government departments and support firms that occupy competitive office buildings. Additionally, stable employment growth is an indication that Columbus firms will need larger footprints in the future. Cincinnati, meanwhile, nearly mirrors the state capital in terms of economic and employment growth, which will support a decline in vacancy this year. The metro also benefits from limited construction that funnels nearly all new demand into existing properties.

Cleveland has mixed office fundamentals this year. Ohio's largest metro is gaining momentum, though gains are misaligned with the office market. Job growth will surge to the highest rate during the current economic expansion, a welcome sign for the local economy. Much of the demand is outside traditional office-using sectors, which will result in a modest increase in office vacancy. Medical office space, however, is benefiting from a strong healthcare sector anchored by the Cleveland Clinic. Nonetheless, a revitalized downtown is attracting educated workers to the area, which should encourage employers to turn to the market as a low-cost alternative.

Local Office Yield Trends



** Cap rates trailing 12 months through 1Q19*
Includes sales $1 million and greater for Cincinnati, Cleveland and Columbus.
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
Cincinnati	11.4%	-50	$16.60	2.3%
Cleveland	11.4%	10	$18.40	2.8%
Columbus	11.7%	-40	$19.05	2.2%

Investment Trends

Cincinnati

- Northern Kentucky and core locations within Cincinnati account for about half of all transactions in the metro. Investors, particularly owner-users, may find opportunities in suburbs, where competition for available properties is limited.
- The metro's bright long-term outlook has tightened average cap rates to the lowest among the major Ohio markets. First-year returns averaged in the mid-7 percent range during the most recent 12-month period.

Cleveland

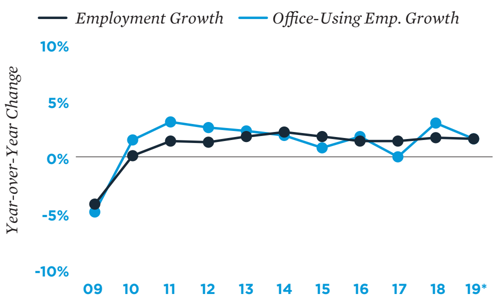
- Investors remain optimistic about the local office market, though creative strategies will help move assets. Buyers with a tenant in tow or the ability to reposition a local office asset can achieve outsized returns in the market.
- At approximately 8 percent, average cap rates are the highest in the state. Nonetheless, average first-year returns are only 70 basis points higher than the pre-recession trough.

Columbus

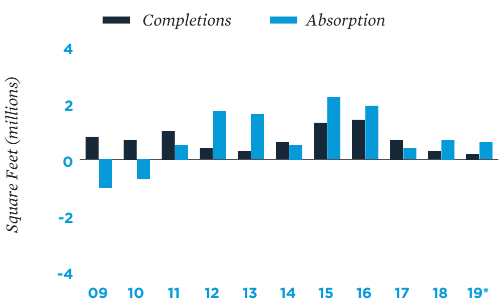
- Columbus remains the most consistent office sales market in Ohio as investors are attracted to the diverse local economy. Another healthy year of investment activity is anticipated this year.
- Buyers acquired office assets in the market at average cap rates in the high-7 percent range during the last year.

1Q19 – 12-Month Trend

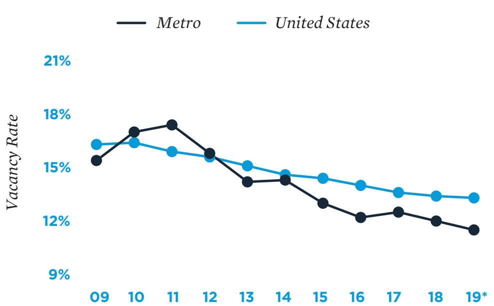
Employment Trends



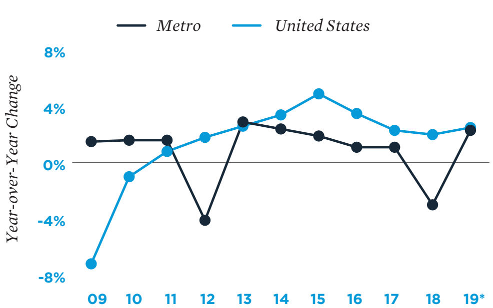
Office Supply and Demand



Vacancy Rate Trends



Asking Rent Trends



* Forecast
Source: CoStar Group, Inc.

EMPLOYMENT

1.9% **increase in total employment Y-O-Y**

- Employers generated 21,100 positions during the 12-month period ending in the first quarter, including 13,300 jobs over the past six months, as local firms accelerated the pace of hiring.
- The largest gains occurred in the professional and business services sector, which added 5,900 spots. Overall, office-using employers added 8,400 jobs, representing an increase of 3.2 percent in the last 12 months.

CONSTRUCTION

280,000 **square feet completed Y-O-Y**

- Less than 300,000 square feet of office space came online during the past year, including approximately 85,000 square feet in the last six months. Over the last five years, inventory growth has averaged approximately 1 percent annually.
- The largest project underway is a 250,000-square-foot build-to-suit project for Medpace scheduled for completion in 2020. Approximately 900,000 square feet is under construction.

VACANCY

40 **basis point decrease in vacancy Y-O-Y**

- Softening construction supported lower vacancy over the past 12 months. In the first quarter, the rate was 11.7 percent. Vacancy declined 30 basis points during the previous yearlong period.
- At 15.9 percent, top-tier vacancy remains significantly higher than the marketwide average despite a 70-basis-point decline over the last 12 months. Class B/C vacancy dipped 30 basis points to 9.2 percent in the first quarter.

RENTS:

0.8% **decrease in the average asking rent Y-O-Y**

- In the last 12 months, the average rent dipped to $16.46 per square foot in Cincinnati. The average rent contracted 0.1 percent in the preceding yearlong period.
- Class A rent dragged the metrowide average rent lower during the last 12 months. In the first quarter, top-tier rent was $17.80 per square foot, down 7.1 percent. In the Class B/C office buildings, average rent advanced 4.0 percent to $15.67 per square foot.

Demographic Highlights

2019 Forecast Job growth

Metro **1.6%**

U.S. Average 1.3%

2019 Office-Using Job growth

Metro **1.6%**

U.S. Average 1.7%

Population Age 20-34*

Metro **19.9%**

U.S. Average 20.6%

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

Metro **31.2%**

U.S. Average 29.9%

Sq. Ft. Per Office Worker*

Metro **291**

U.S. Average 215

Office Square footage*

42.8% *Urban*

U.S. Average 32.0%

57.2% *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
Cincinnati (City)	9.5%	-70	$16.66	-1.2%
Outlying Warren County	9.6%	130	$18.43	-5.4%
Northern Kentucky	10.8%	-230	$17.69	2.2%
Eastern Cincinnati Area	11.0%	-140	$17.38	0.3%
Butler County	11.4%	-80	$16.49	12.7%
Northern Cincinnati Area	15.2%	90	$15.43	-8.2%
Western Cincinnati Area	17.2%	200	$14.98	-1.8%
Overall Metro	**11.7%**	**-40**	**$16.46**	**-0.8%**

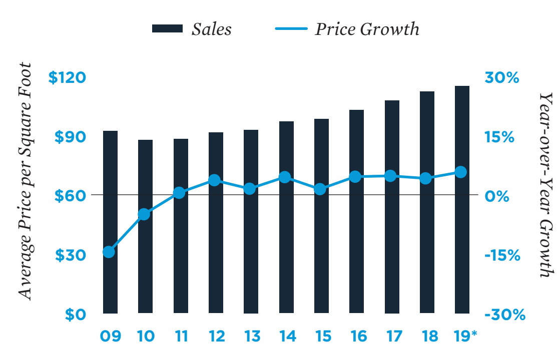
SALES TRENDS

Northern Kentucky/Core Cincinnati Attract Most Buyers; Suburban Opportunities Overlooked

- Office sales velocity inched lower during the most recent 12-month period as a reduction in Class B deals dragged on the overall market. Class C closings remained stable during the period.
- The average price per square foot was $115 during the last year, up 6 percent from the prior year. The increase in valuations supported a 20-basis-point decline in the average cap rate to the mid-7 percent area.

Outlook: Core locations within Cincinnati and Northern Kentucky represent approximately 50 percent of sales in each property class, while Class C deal distribution is the most widely distributed.

Sales Trends



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

CLEVELAND

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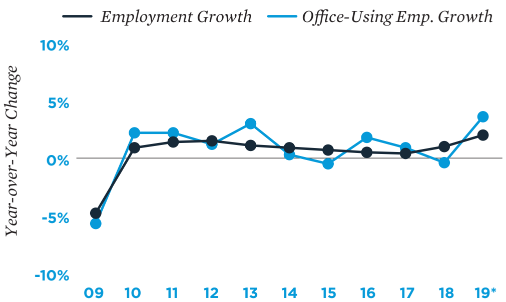
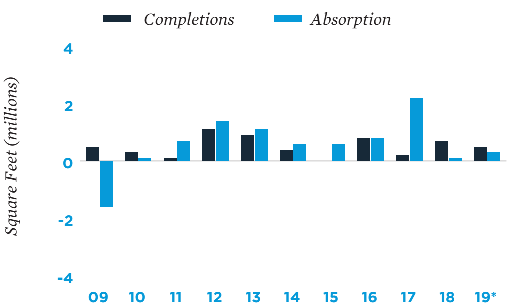
1Q19 – 12-Month Trend

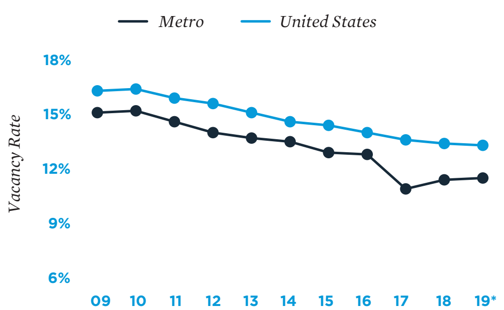
Employment Trends



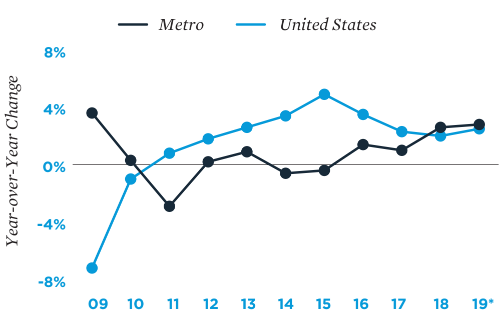
Office Supply and Demand



Vacancy Rate Trends



Asking Rent Trends



* Forecast
Source: CoStar Group, Inc.

EMPLOYMENT

1.5% increase in total employment Y-O-Y

- Over the last year, headcounts in Cleveland grew by 15,700 spots, lifting payrolls at the fastest annual pace since early 2016. Office-using employment was relatively flat year over year.
- The professional and business services sector expanded by 500 jobs year over year, offsetting losses in the other major office-using segments. Construction hiring soared by more than 18 percent as 6,200 workers were added to payrolls.

CONSTRUCTION

585,000 square feet completed Y-O-Y

- Office development remains relatively measured in Cleveland. Over the past 12 months, inventory inched up 0.6 percent as less than 600,000 square feet came online.
- New construction is unlikely to impact operations in the metro this year as the pace of development slows from 2018. Furthermore, more than 80 percent of the underway space is pre-leased.

VACANCY

110 basis point increase in vacancy Y-O-Y

- Negative net absorption of nearly 600,000 square feet resulted in an annual 110-basis-point rise in vacancy to 11.7 percent in the first quarter. The rate inched up 40 basis points in the past six months as the pace of move-outs slowed.
- Class A vacancy dipped 20 basis points to 11.9 percent, bucking the metrowide trend, while the rate at Class B/C buildings jumped 150 basis points.

RENTS:

3.2% increase in the average asking rent Y-O-Y

- Rent growth accelerated to 3.2 percent over the past year as average rents climbed to $18.13 per square foot. Annual rent growth reached the highest level since late 2009.
- In the first quarter, average rent at Class A properties was $23.10 per square foot, up 5.3 percent from the same period last year. Average Class B/C rent inched up 2.3 percent during that time $16.73 per square foot.

Demographic Highlights

2019 Forecast Job growth

Metro **2.0%**

U.S. Average 1.3%

2019 Office-Using Job growth

Metro **3.7%**

U.S. Average 1.7%

Population Age 20-34*

Metro **18.8%**

U.S. Average 20.6%

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

Metro **29.1%**

U.S. Average 29.9%

Sq. Ft. Per Office Worker*

Metro **382**

U.S. Average 215

Office Square footage*

35.7% *Urban*

U.S. Average 32.0%

64.3% *Suburban*

U.S. Average 68.0%

*1Q19
**2018

SUBMARKET TRENDS

Lowest Vacancy Rates 1Q19

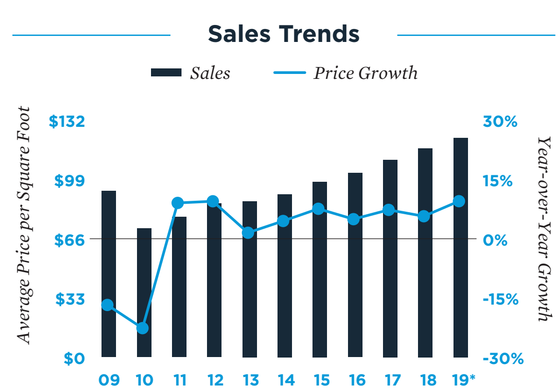
Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Average Asking Rent	Y-O-Y % Change
Erie County	0.9%	-150	$9.28	0.0%
Portage County	3.3%	-730	$14.07	-10.3%
Stark County	6.4%	30	$14.31	-1.0%
Southwest	9.3%	-260	$15.41	-0.6%
Medina County	9.6%	-30	$15.41	0.7%
East	9.8%	60	$21.99	6.1%
Geauga County	9.9%	130	$16.81	3.1%
West	10.0%	130	$15.84	0.1%
Lorain County	11.4%	40	$14.61	1.0%
Downtown Cleveland	13.3%	250	$19.76	4.7%
Overall Metro	**11.7%**	**110**	**$18.13**	**3.2%**

SALES TRENDS

Value-Add, Class C Assets Move to the Top of Investors' Wish Lists

- Buyers modestly decreased their presence during the yearlong period ending in the first quarter. Investors shifted some focus from Class B to Class C properties.
- Despite an increase in the number of Class C deals, the average price increased 8 percent to $105 per square foot. Year over year, the average cap rate tightened 30 basis points to 8 percent.

Outlook: Investors targeted properties with higher vacancy during the past year, an indication that buyers feel confident about the leasing environment in Cleveland.



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

COLUMBUS

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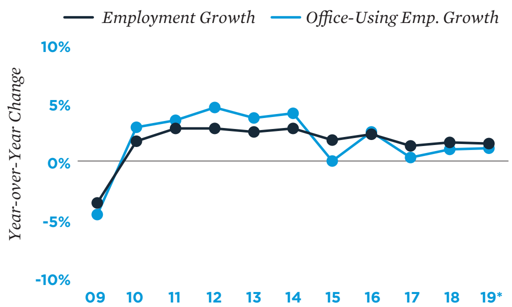
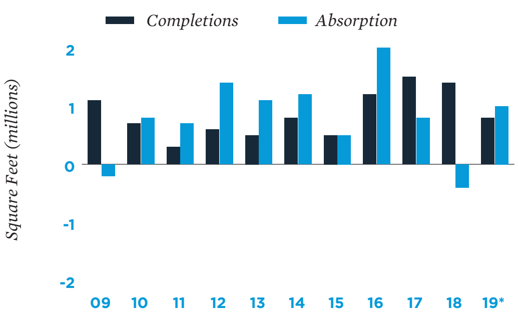
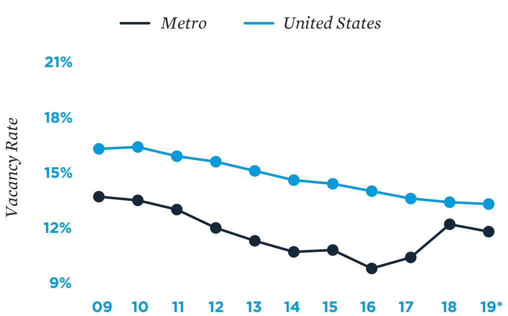
Employment Trends



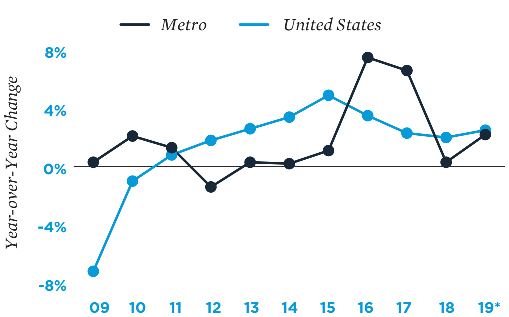
Office Supply and Demand



Vacancy Rate Trends



Asking Rent Trends



** Forecast*
Source: CoStar Group, Inc.

1Q19 – 12-Month Trend

EMPLOYMENT

1.2% increase in total employment Y-O-Y

- Hiring activity slowed during the last six months as 3,000 jobs were created in the metro. Year over year, payrolls increased by 13,200 positions, while the unemployment rate remained steady in the high-3 percent range.
- Office-using employment ticked up 0.2 percent over the last 12 months as less than 1,000 jobs were created. Financial activities employers contributed 700 office-using spots.

CONSTRUCTION

1.2 million square feet completed Y-O-Y

- In the past year, office stock climbed 1.3 percent as 1.5 million square feet came online. However, no new competitive inventory was added in the metro during the past six months.
- Less than 1 million square feet of space is underway, with approximately 50 percent pre-leasing activity. One notable project, the 800 North High development, will be completed in the second half of this year.

VACANCY

160 basis point increase in vacancy Y-O-Y

- An influx of new construction resulted in a sharp rise in vacancy year over year as the rate jumped to 11.8 percent. A break from development supported a 30-basis-point decline in vacancy in this year's opening period.
- Class A vacancy jumped 210 basis points in the past year to 12.7 percent in the first quarter. In the Class B/C segment, average vacancy rose 140 basis points.

RENTS:

1.9% decrease in the average asking rent Y-O-Y

- Average asking rent contracted to $18.32 per square foot, down 1.9 percent annually. During the previous yearlong period, average rent soared 5.6 percent.
- Over the past 12 months, average Class A rent declined 3.1 percent to $20.25 per square foot. In the lower tiers, average rent dipped 1.3 percent to $17.38 per square foot.

Demographic Highlights

2019 Forecast Job growth

Metro **1.5%**

U.S. Average 1.3%

2019 Office-Using Job growth

Metro **1.1%**

U.S. Average 1.7%

Population Age 20-34*

Metro **22.2%**

U.S. Average 20.6%

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

Metro **34.2%**

U.S. Average 29.9%

Sq. Ft. Per Office Worker*

Metro **287**

U.S. Average 215

Office Square footage*

31.6% *Urban*

U.S. Average 32.0%

68.4% *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
Columbus South	5.0%	130	$17.96	6.9%
Fairfield County	6.7%	260	$21.54	3.4%
Columbus West	8.9%	250	$18.59	-5.9%
Licking County	9.9%	60	$14.98	39.1%
Columbus Central	10.3%	200	$18.81	-9.5%
Columbus East	10.7%	-160	$16.41	-1.7%
Delaware County	11.0%	180	$20.39	-0.2%
Columbus North	15.9%	260	$18.26	7.0%
Overall Metro	**11.8%**	**160**	**$18.32**	**-1.9%**

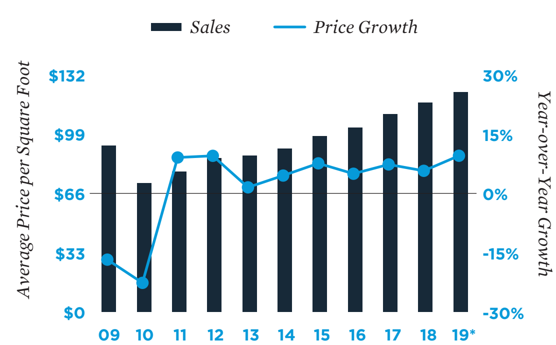
SALES TRENDS

Investors Keen on the Long-Term Outlook for Columbus Office Properties

- Contrary to the other two major Ohio metros, Columbus deal flow inched up in the most recent 12-month period. An increase in Class A and Class C sales supported the increase.
- Average cap rates compressed a modest 10 basis points into the high-7 percent range, nearly matching the low reached during the previous cycle. Investors paid an average of $122 per square foot, up 10 percent year over year.

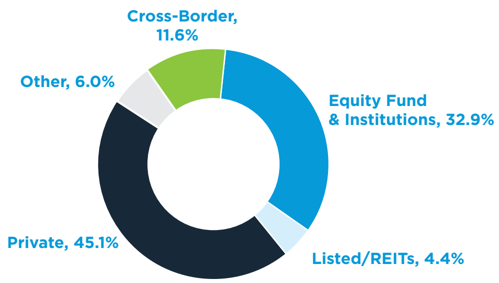
Outlook: Although deal flow increased, buyers did focus on smaller properties over the past year as several owner-user deals transacted for Class B and Class C properties.

Sales Trends

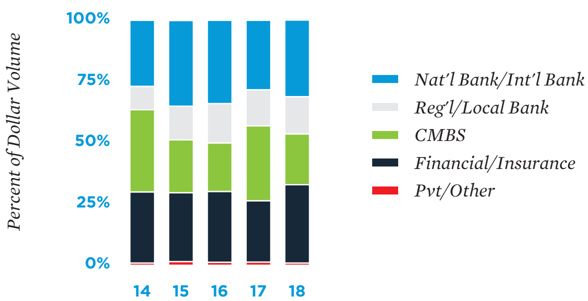


** Trailing 12 months through 1Q19 over previous time period*
Sources: CoStar Group, Inc.; Real Capital Analytics

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.

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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