

MARKET FORECAST

OFFICE
Tennessee Metros

IPA
INSTITUTIONAL
PROPERTY
ADVISORS

Q2/19

Corporate Relocations and Expansions in Tennessee Bolster Space Demand

New companies filling Nashville office space. AllianceBernstein and Amazon are two of the largest firms to announce plans to expand in the Music City. AllianceBernstein is relocating its headquarters and 1,000 workers from Manhattan to 205,000 square feet in the Fifth + Broadway project in 2020. In the meantime, the firm is locating in the WeWorks building. Amazon has committed to opening its 1 million-square-foot Operations Center of Excellence in the Nashville Yards development downtown. Roughly 5,000 office workers will occupy the space when completed in 2021. Robust leasing activity and steady rent growth have encouraged a wave of speculative buildings to begin construction. These additions will likely bump Nashville's vacancy up in the near term.

Office development slows in Memphis. Vacancy hovering in the 14 percent span has reduced the pace of construction in the metro this year. Rent growth has also diminished as owners delay rent increases to try to fill empty spaces. Downtown Memphis will benefit from the FedEx decision to renovate and move at least 600 workers to the Gibson Guitar Building during 2020.

Vacancy remains tight in Knoxville. A restrained construction pace over the past several years funneled expanding firms into existing space, keeping the vacancy rate in the single digits. Although deliveries will rise this year, Sitel has leased a large portion of the new inventory in Knoxville for a call center. During 2019, companies moving out of older buildings for new digs will keep asking rent growth suppressed.



* 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
Nashville	10.7%	20	\$27.16	2.4%
Memphis	14.4%	-10	\$17.91	1.0%
Knoxville	7.6%	-40	\$15.50	-0.8%

Investment Trends

Nashville

- New inventory is drawing a wider range of investors, including institutions to the market. Class A office towers can exchange hands above \$300 per square foot at cap rates in the low-5 percent range.
- While assets in Nashville remain in robust demand, greater competition and rising valuations in the core are drawing more buyers to properties in cities such as Goodlettsville, Brentwood and Columbia.

Memphis

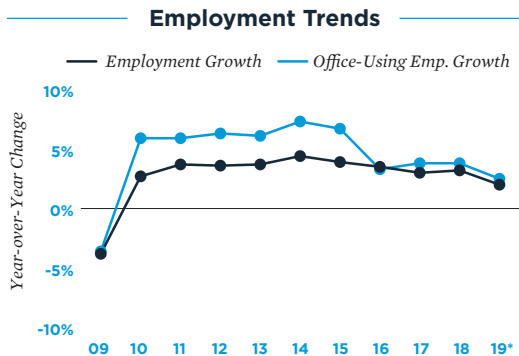
- FedEx committing to refurbishing the Gibson Guitar Building in downtown Memphis should bring increased investor attention to office properties nearby.
- Local private buyers may find opportunities in smaller assets in the employment hub around the intersection of Poplar Avenue and Interstate 240 in East Memphis.

Knoxville

- Trading activity remains strong along the Interstate 40/75 corridor southeast of Knoxville and extending to Farragut. Local investors were active in this area targeting Class B/C assets at an average of \$100 per square foot.
- During the past four quarters many out-of-state buyers focused on medical office buildings. Well-tenanted newer assets can trade above \$350 per square foot.

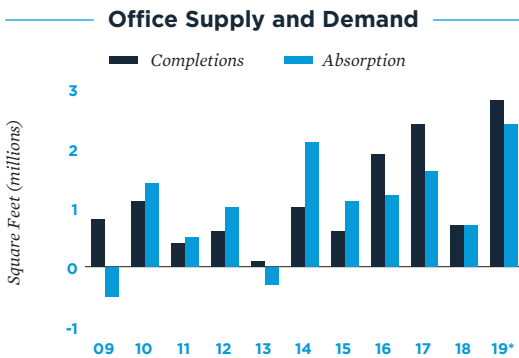
1Q19 - 12-Month Trend

EMPLOYMENT



2.6% increase in total employment Y-O-Y

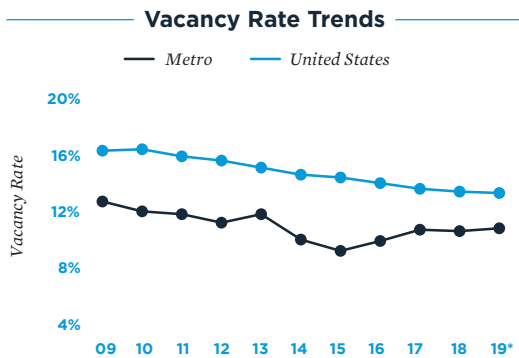
- Following the creation of 31,500 jobs one year ago, employers added 25,800 people to payrolls during the past four quarters, including 6,600 office-using workers. The hiring kept unemployment below 3 percent for the eighth consecutive quarter.
- The lack of available employees is making it more difficult for organizations to find and retain qualified workers, leaving many available slots unfilled.



CONSTRUCTION

874,000 square feet completed Y-O-Y

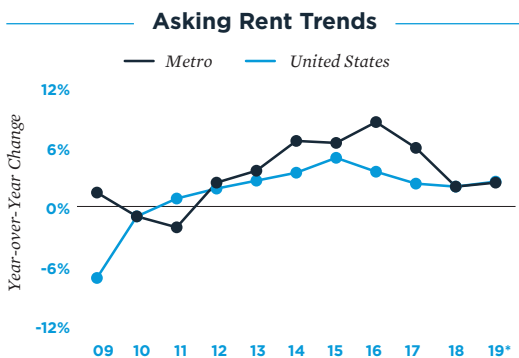
- Roughly 874,000 square feet of space was added during the past four quarters, less than half of the prior period's 2 million square feet. After a temporary lull, deliveries are set to resume as developers have more than 5.5 million square feet underway with completions scheduled into 2022.
- Builders are on track to finalize 2.8 million square feet of office space in 2019. This total includes 500,000 square feet of medical offices.



VACANCY

10 basis point increase in vacancy Y-O-Y

- An escalation in deliveries in the first three months of 2019 nudged vacancy up 10 basis points since March of last year to 10.3 percent. The rate in Class A space was higher at 13.4 percent in the first quarter. The marketwide vacancy rate has risen 120 basis points from the cyclical trough in 2015.
- Elevated construction during 2019 will push vacancy to 10.7 percent at year end, up an annual 20 basis points.



RENTS

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

- The average asking rent climbed an annual 1.9 percent to set a new high of \$26.86 per square foot in the first quarter. This is down from the previous year when a 5.4 percent jump was posted.
- During the past four quarters, Class B/C buildings led rent growth. The rate in these properties rose at a clip of 2.1 percent to \$24.43 per square foot, while the rent in Class A offices advanced 1.4 percent to \$31.36 per square foot.

* Forecast
Source: CoStar Group, Inc.

Demographic Highlights



2019 Forecast Job growth

Metro **2.0%**
U.S. Average 1.3%



2019 Office-Using Job growth

Metro **2.5%**
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 **32.1%**
U.S. Average 29.9%



Sq. Ft. Per Office Worker*

Metro **257**
U.S. Average 215

Office Square footage*



19.5% Urban
U.S. Average 32.0%



80.5% 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
MetroCenter	5.4%	-260	\$23.76	8.3%
West End	5.5%	70	\$31.32	3.8%
Greenhill/Music Row	6.4%	-220	\$30.88	3.3%
Rutherford County	6.6%	190	\$23.82	-4.5%
Downtown	8.1%	-210	\$30.45	4.2%
Rivergate/Hendersonville	8.4%	-10	\$18.77	-11.3%
Airport South	11.1%	-190	\$20.69	-2.2%
Brentwood	12.5%	70	\$28.74	2.2%
Airport North	16.8%	400	\$21.89	11.0%
Cool Springs	17.5%	250	\$29.38	1.0%
Overall Metro	10.3%	10	\$26.86	1.9%

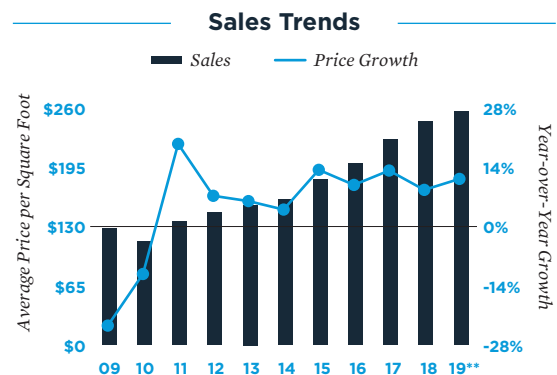
* Includes submarkets with more than 2 million square feet of inventory

SALES TRENDS

Dynamic Economy Draws Investors; Buyers Target Assets Near Large Employment Hubs

- Sales activity soared 54 percent year over in the first quarter, as both in-state and out-of-state investors increased purchasing. Buyers targeted assets in employment centers south of the airport, in downtown Nashville and in the Cool Springs area.
- Strong competition for available listings during the past 12 months ending in March resulted in the average price jumping 11 percent to \$256 per square foot. The average cap rate, meanwhile, compressed 50 basis points to into the mid-6 percent span.

Outlook: The metro's robust economic growth and strong office market performance will continue to lure a number of investors to office assets.



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

1Q19 - 12-Month Trend

EMPLOYMENT

1.1% increase in total employment Y-O-Y

- Memphis organizations added 7,400 new positions in the past 12 months ending in March, up from 5,400 one year earlier. The hiring dropped the unemployment rate below 4 percent.
- Job growth was led by the trade, transportation and utilities sector, which accounted for nearly 2,000 workers. FedEx, one of the region's largest employers, is set to begin a \$1 billion upgrade to its facilities in Memphis in 2019. The project will be completed in 2025.



CONSTRUCTION

220,000 square feet completed Y-O-Y

- Over the past four quarters developers completed 220,000 square feet, down from 678,000 square feet in the previous 12 months. Construction will remain limited as there is just 204,000 square feet underway that is expected to be completed in 2019.
- The majority of this year's new inventory is pre-leased, limiting the impact on vacancy. A 120,000-square-foot addition to the Campbell Clinic in Germantown is the largest project due by year end.



VACANCY

20 basis point decrease in vacancy Y-O-Y

- Net absorption outpaced deliveries over the past four quarters, contracting vacancy 20 basis points to 14.8 percent. This follows a 90-basis-point reduction in the previous 12-month period.
- Robust demand for Class A space cut the vacancy rate 100 basis points to 14.0 percent year over year in March. The rate in Class B/C buildings rose 20 basis points to 15.2 percent during the same time frame.



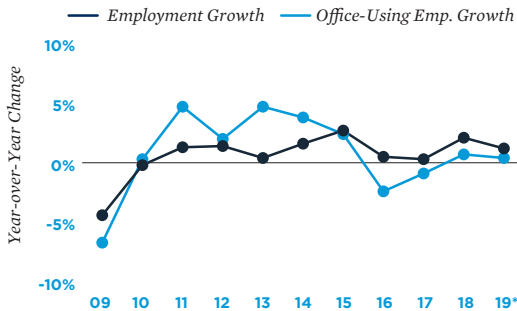
RENTS

0.5% decrease in the average asking rent Y-O-Y

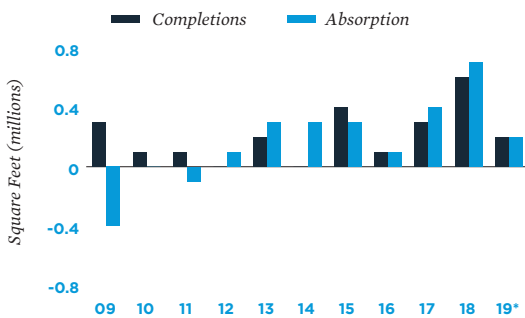
- Marketwide, the average asking rent dipped 0.5 percent to \$17.65 per square foot over the past 12 months. One year earlier, a 4.7 percent surge was recorded.
- Rising vacancy in Class B properties dampened overall rent growth. The average rate in this class was reduced 0.8 percent to \$16.50 per square foot during the past four quarters. Asking rent in Class A buildings, meanwhile, inched up 0.2 percent to \$20.67 per square foot.



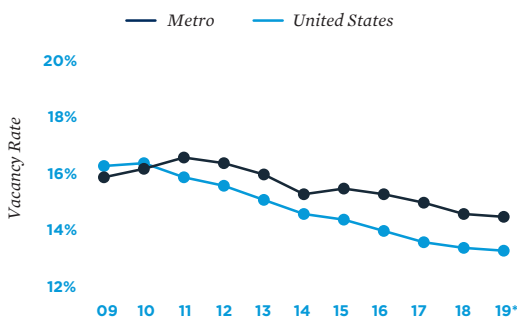
Employment Trends



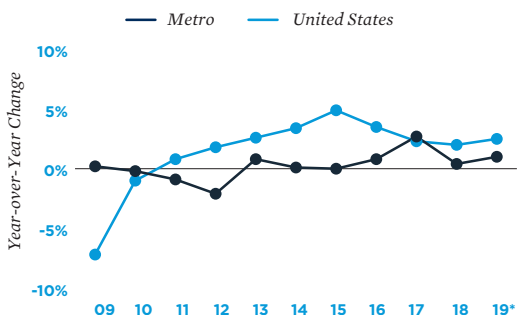
Office Supply and Demand



Vacancy Rate Trends



Asking Rent Trends



* Forecast
Source: CoStar Group, Inc.

Demographic Highlights



2019 Forecast Job growth

Metro **1.2%**
U.S. Average 1.3%



2019 Office-Using Job growth

Metro **0.4%**
U.S. Average 1.7%



Population Age 20-34*

Metro **20.8%**
U.S. Average 20.6%



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

Metro **26.4%**
U.S. Average 29.9%



Sq. Ft. Per Office Worker*

Metro **286**
U.S. Average 215

Office Square footage*

23.8% Urban
U.S. Average 32.0%

76.2% Suburban
U.S. Average 68.0%

*1Q19
**2018

SUBMARKET TRENDS

Lowest Vacancy Rates 1Q19*

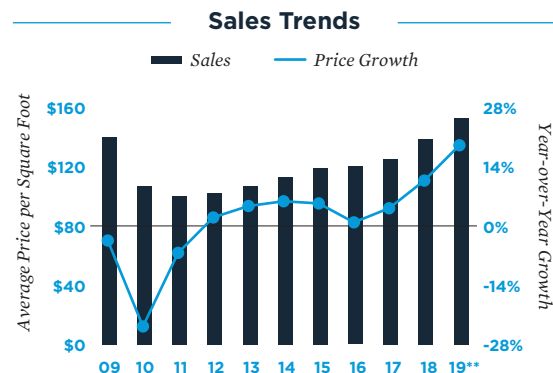
Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Average Asking Rent	Y-O-Y % Change
North	10.3%	-520	\$16.11	-3.5%
DeSoto County	11.6%	420	\$19.27	-4.1%
Midtown	12.0%	-130	\$15.67	2.9%
385 Corridor	13.0%	230	\$18.90	0.2%
East	13.0%	-70	\$20.81	-0.3%
Northeast	16.7%	110	\$18.94	4.6%
Airport	17.1%	-290	\$13.61	-3.5%
Downtown	18.4%	80	\$15.39	-1.3%
Overall Metro	14.8%	-20	\$17.65	-0.5%

SALES TRENDS

Older Properties in 385 Corridor Keep Private Buyers Active

- Transaction velocity remained steady from this time last year and was down only slightly from the previous annual period. Class A and B properties in the 385 Corridor submarket were especially desired.
- Over the past four quarters, the average price jumped 19 percent to \$153 per square foot, while the average cap rate contracted 40 basis points into the low-7 percent range.

Outlook: Private investors seeking lower price points and higher returns than the metro average may find opportunities in older properties along State Route 385 and in downtown Memphis.

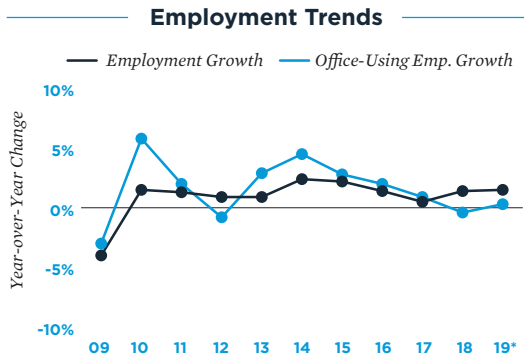


* Includes submarkets with more than 300,000 square feet of inventory

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

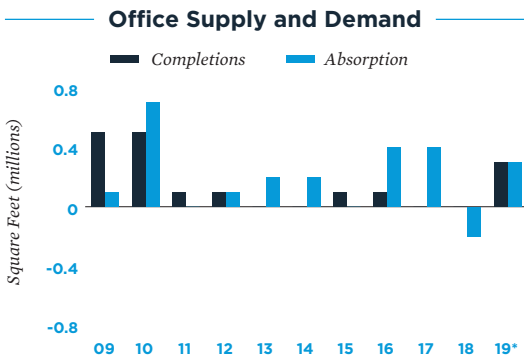
1Q19 - 12-Month Trend

EMPLOYMENT



1.9% increase in total employment Y-O-Y

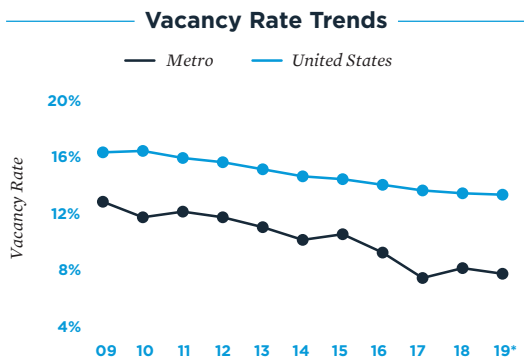
- Since the first quarter of last year, Knoxville employers added 7,400 workers to payrolls, including 420 in office-using positions. This is more than double the prior period's 3,200 slots.
- The leisure and hospitality sector accounted for the largest portion of job creation during the past year with 2,100 positions. The hike in hiring lowered the unemployment rate to 3.0 percent in March, the lowest rate since 1990.



CONSTRUCTION

163,000 square feet completed Y-O-Y

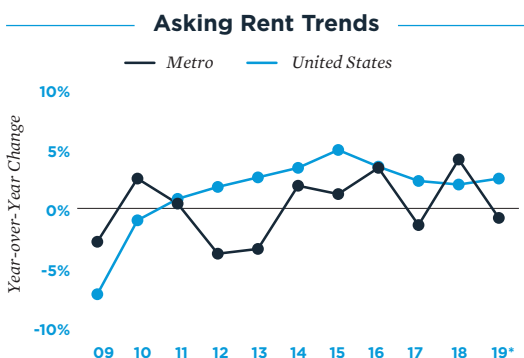
- Developers finalized 163,000 square feet in the first quarter of 2019, accounting for all of the new inventory in the past 12 months. This is more space than what was completed in the prior three years. There is also 117,000 square feet underway and due for delivery in 2019.
- The largest building to come online in this year is Outlet Corporate Center in Knoxville. It is the conversion of a former At Home store into a 162,800-square-foot Class A building. It is 45 percent leased.



VACANCY

10 basis point decrease in vacancy Y-O-Y

- The new inventory outpaced absorption inching vacancy up an annual 10 basis points to 8.0 percent in the first quarter. The vacancy rate has declined 330 basis points from the five-year peak reached in 2014.
- Additional inventory drove Class A vacancy up 200 basis points year over year to 15.7 percent in March, while the rate in Class B/C properties dipped 30 basis points to 6.2 percent.



RENTS

2.0% increase in the average asking rent Y-O-Y

- The average asking rent ticked up 2.0 percent to \$15.09 per square foot over the past 12 months ending in March. This follows a 1.7 percent cut in the prior period.
- Higher vacancy in Class A space resulted in a 1.4 percent trim in asking rent to \$17.95 per square foot during the past four quarters. Rent in Class B/C buildings rose 2.9 percent to \$14.39 per square foot on average during the same time frame.

Demographic Highlights



2019 Forecast Job growth

Metro **1.5%**

U.S. Average 1.3%



2019 Office-Using Job growth

Metro **0.3%**

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 **27.3%**

U.S. Average 29.9%



Sq. Ft. Per Office Worker*

Metro **231**

U.S. Average 215

Office Square footage*



21.5% Urban

U.S. Average 32.0%



78.5% Suburban

U.S. Average 68.0%

*IQ19

**2018

SUBMARKET TRENDS

Lowest Vacancy Rates 1Q19*

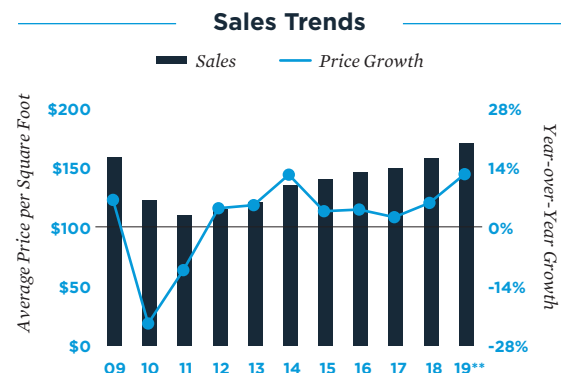
Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Average Asking Rent	Y-O-Y % Change
Roane County	0.7%	-220	-	-
North/Broadway	4.0%	-700	\$15.67	2.4%
Blount County	4.8%	120	\$11.28	6.3%
South	4.9%	20	\$12.00	-8.3%
Cedar Bluff/Walker Springs	6.3%	-50	\$15.34	0.9%
Downtown	6.3%	40	\$12.51	-14.4%
Pellissippi/Lovell	10.6%	500	\$19.22	22.8%
Anderson County	14.7%	140	\$13.37	4.8%
Campbell Station/Farragut	15.9%	-160	\$19.32	2.3%
Bearden/Papermill/West Town	16.6%	-120	\$19.81	-5.8%
Overall Metro	8.0%	10	\$15.09	2.0%

SALES TRENDS

Buyers Move into Oak Ridge for Higher Return Potential as Competition Intensifies

- Transaction activity soared 18 percent since the first quarter of 2018, up slightly from the one year earlier. Class B assets were most often targeted during the period.
- The average sale price vaulted 12 percent to \$170 per square foot year over year in the first quarter, while the cap rate dipped 20 basis points during that time to an average of 7.5 percent.

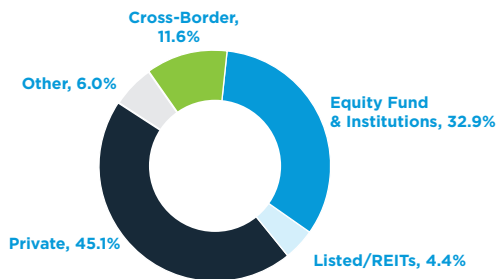
Outlook: Yields above the metro average can be found in Class B/C assets in Anderson County, especially in Oak Ridge, where buildings are receiving increased investor attention.



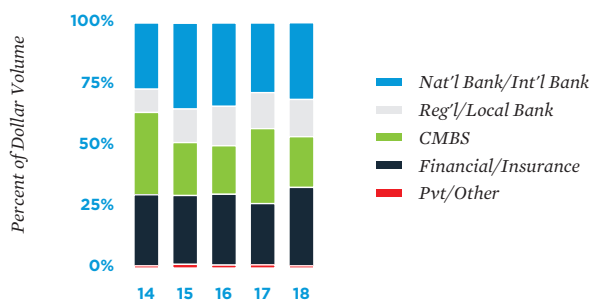
* Includes submarkets with more than 500,000 square feet of inventory

** 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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 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