INVESTMENT FORECAST

OFFICE

Chicago Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

2019

Office Investors Shift to Stabilized Mid-Tier Properties in Chicago Amid Elevated Construction

Class A Chicago office market shines while Class B/C assets search for footing. Vacancy increases moving down the quality scale as demand for office space is focused on top-tier properties in the city core. Last year, 12 of the 16 largest leases were in the West Loop. In fact, the sole renewal among the dozen large leases in the area included a 50,000-square-foot expansion as United Airlines committed to 816,000 square feet in the Willis Tower. Smaller footprints in the area also remain attractive, which has pushed pre-leasing to 70 percent, much stronger than the market average of 40 percent. Outside of the West Loop, speculative development will weigh on overall vacancy this year as construction levels remain near the cyclical high, curbing backfill opportunities in Class B/C buildings. Several announced expansions should aid in absorption in the coming years, however, as Google, Amazon and Facebook begin expanding headcounts.

Investors undeterred by negative absorption in Class B sector. Deal flow for mid-tier properties increased as a percentage of total transactions last year, a trend that should continue in the upcoming months. However, investors are drawn to stabilized Class B properties with tenants secured under multiyear leases rather than value-add acquisitions. The average size of mid-tier deals decreases as investors position their portfolios defensively. Average cap rates for Class B properties are in the high-7 percent range, which attracts out-of-state capital, though the spread between core and suburban assets can be noteworthy. At the lower end of the spectrum, Class C buyers remain active, particularly in areas where mid-tier properties also transact. Average first-year returns for these deals are above 8 percent, proving investors with an elevated risk tolerance significant potential upside. Class A properties in major office-using districts transact at an average cap rate in the mid-7 percent area.

2019 Market Forecast

Employment up 0.6% — Job growth slows for the third consecutive year as 30,500 positions are generated. Office-using employment advances 0.7 percent, or by 8,300 jobs.

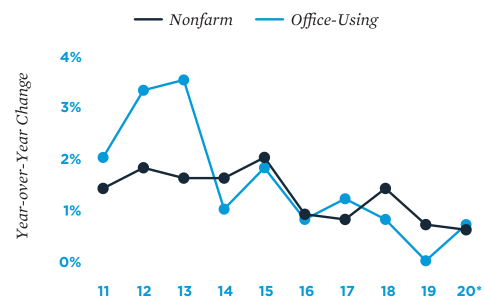
Construction 4.0 million sq. ft. — Developers bring 4 million square feet online this year, increasing existing stock by 0.9 percent. Last year, 4.8 million square feet was delivered in the metro.

Vacancy up 20 bps — Vacancy rises to 15.9 percent in 2020 as the market takes time to absorb new space. Last year, vacancy fell 20 basis points.

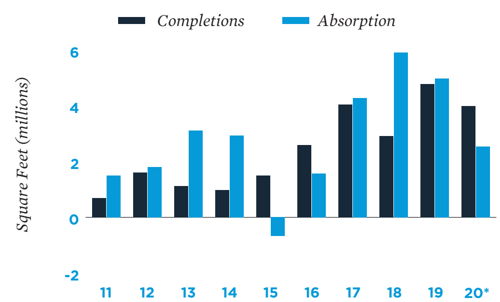
Rent up 3.4% — The average asking rent climbs to $27.09 per square foot by year end, largely attributable to new stock.

Investment — Risk aversion will permeate through much of the office investment market this year, providing an opening for buyers with a tenant-in-tow or owner/users to acquire discounted Class B and C properties.

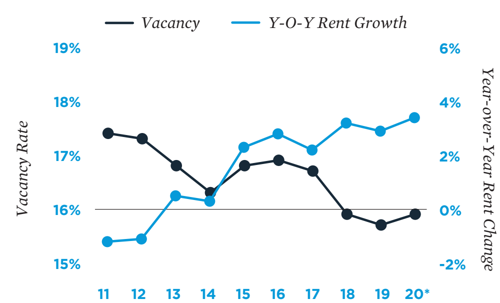
Employment Trends



Office Supply and Demand



Vacancy and Rent Trends



* Forecast
Sources: CoStar Group, Inc.; Real Capital Analytics

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Metro-level employment, vacancy and asking rents are year-end figures and are based on the most up-to-date information available as of December 2020. Asking rent is based on the full-service marketed rental rate. Average prices and cap rates are a function of the age, class and geographic area of the properties trading and therefore may not be representative of the market as a whole. Sales data includes transactions valued at $1,000,000 and greater unless otherwise noted. Forecasts for employment and office data are made during the fourth quarter and represent estimates of future performance. No representation, warranty or guaranty, express or implied may be made as to the accuracy or reliability of the information contained herein. This is not intended to be a forecast of future events and this is not a guaranty regarding a future event. This is not intended to provide specific investment advice and should not be considered as investment advice.