MARKET REPORT

OFFICE

Indianapolis Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

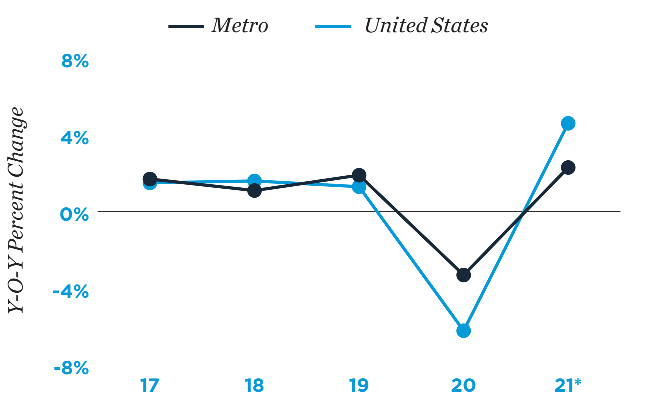
2Q/21

Pre-Pandemic Performance Bolsters Sentiment, But Upward Pressure on Vacancy Mounting

Leasing activity geared toward new builds and smaller spaces. Availability will continue rising in Indianapolis this year as larger properties are vacated and demand for existing buildings lags. The majority of leases signed recently were for offices smaller than 20,000 square feet, with a 72,000-square-foot commitment by Software Engineering Professionals in Carmel being one of the few exceptions. Firms targeting larger floor plans are focused on new builds. A pair of 120,000-square-foot developments in Midtown and Fishers are mostly leased by Indiana Biosciences Research Institute and First Internet Bank, respectively. Meanwhile the first phase of Infosys' campus near the airport will finalize this summer, representing another example of the preference toward built-to-suit spaces in Indianapolis.

Momentum carried into crisis buffers demand disruption. Prior to the 70-basis-point jump in availability in 2020, the metro posted a strong performance during the past few years. Vacancy tied a decade low of 10.4 percent in the first quarter of 2020 off five consecutive years of positive absorption greater than 400,000 square feet. Entering the pandemic with a vacancy rate that was 250 basis points below the U.S. has provided a cushion during the near-term disruption as well as underpinned optimism that Indianapolis will regain positive momentum. Nevertheless, with the sector undergoing a transition period and firms reevaluating their workplace models, some turbulence is expected.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.

Office 2021 Outlook

24,900 JOBS *will be created*

EMPLOYMENT:

The headcount decline of 3.3 percent last year was much better than the 6.2 percent national reduction. Fewer jobs to be recovered in Indianapolis will temper growth in 2021. Still, the personnel total will reach within 2 percent of the pre-pandemic level.

530,000 SQ. FT. *will be completed*

CONSTRUCTION:

Deliveries will fall slightly below the 605,000-square-foot total recorded in 2020 as metro stock expands by less than 1 percent for the third straight year. Additionally, fewer than 50,000 square feet will finalize without a tenant already signed on.

140 BASIS POINT *increase in vacancy*

VACANCY:

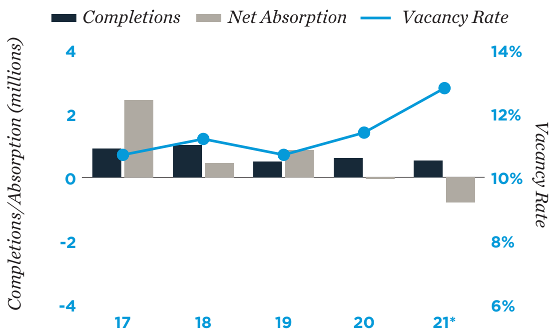
Net absorption will remain negative for the second consecutive year as firms reevaluate space needs in the new environment and sublease stock grows. At year-end the vacancy rate will be 12.8 percent, still 400 basis points below the U.S. level.

1.1% INCREASE *in asking rent*

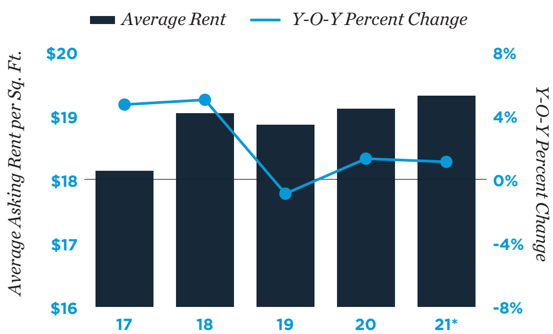
RENT:

Similar to the 1.3 percent annual gain that occurred last year amid rising availability, higher-quality space returning to the market will boost market rates in 2021. The average asking rent will inch up to $19.32 per square foot.

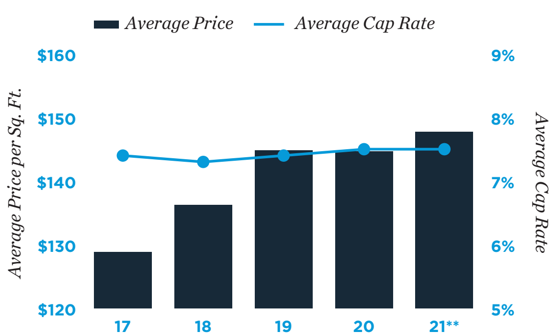
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 1Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

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1Q21 — 12-Month Period

CONSTRUCTION

507,000 square feet completed

- Metro stock grew by 0.6 percent over the past year ended in March as at least 130,000 square feet was finalized in each of the last three quarters.
- Downtown Indianapolis added the largest share of space over the past 12 months, highlighted by the 120,000-square-foot 16 Tech building, which is fully occupied by the Indiana Biosciences Research Institute.

VACANCY

190 basis point increase in vacancy Y-O-Y

- Availability reached 12.3 percent in the first quarter, marking the highest level since 2016. Suburban vacancy jumped 200 basis points as nearly 1.2 million square feet returned to the market.
- Class A noted a 270-basis-point rise year over year to 17.9 percent, while Class B/C recorded a 130-basis-point increase to 9.6 percent.

RENT

0.2% decrease in the average asking rent Y-O-Y

- A marginal decline over the past year brought the average asking rent to $19.20 per square foot in March. Average rates in the CBD dropped by a larger margin as vacant Class B/C stock here grew 36 percent.
- In the East County submarket, rent dropped significantly despite vacancy falling, suggesting operators are using concessions to lure tenants.

Investment Highlights

- Over the past year ended in March trading activity in Indianapolis fell by roughly 36 percent from the previous period. Transactions have trended up recently after bottoming in the second quarter of 2020; however, deal flow has yet to return to the level recorded prior to the health crisis. Class B/C assets accounted for more than 90 percent of trades recorded over the past 12 months.
- Offices that changed hands during the past four quarters transacted for an average of $148 per square foot, 2 percent higher on an annual basis. The mean first-year return lifted 10 basis points to 7.5 percent.
- Buyers seeking assets higher on the quality-scale typically set their sights on northern suburbs like Carmel and Fishers. Meanwhile, south suburbs such as Greenwood attract investment in Class C properties.
- Medical office deal flow has been less interrupted as investors remain confident in the long-term outlook for the property type. These typically trade near $210 per square foot on average in the metro.