

CLEVELAND OFFICE MARKET

CBD ACTION DOMINATED 3Q AS MARKET'S HEALTH REBOUNDED

History repeated itself for the third year in a row during the third quarter of 2018, as a handful of prominent Central Business District (CBD) office buildings were involved in various stages of ownership transfers. Four CBD buildings were sold in the third quarter of 2016. The following year, more than a half-dozen CBD buildings either changed hands or became available to purchase. This quarter, another half-dozen or so CBD office properties and proposed projects figured heavily in the news.

The most prominent recent sale transaction in the CBD, albeit at the very end of the second quarter, was the purchase of the 575,000-square-foot AECOM Centre, located at 1300 East 9th Street, by New Jersey investor Rugby Realty for \$36.9 million, or \$64/SF. Rugby has already begun to aggressively market the building's existing vacancy and intends to initiate a \$10 million-plus overhaul of the building to completely reposition this asset. The plan includes a total lobby renovation, addition of a new fitness center for tenants, renovated shared conference facility, repairs to the attached parking garage, elevator modernization, bathroom upgrades and more.

Another notable CBD sale took place across the street from AECOM Centre in mid-August. The Tower at Erieview, located at 1301 East 9th Street, sold to local investor group KRA Management for approximately \$16.7 million, or \$22/SF. This 760,339-square-foot asset was part of a portfolio sale that also included the transfer of The Galleria at Erieview, an attached retail mall/mixed-use property, for an additional \$992,310. KRA intends to renovate the property by converting 12 of the tower's floors to luxury apartments. Renovations are also planned for the building's lobby, which will expand and add access and valet services to the complex's parking garage as well as make several common area and mechanical improvements.

One pending deal for which negotiations began in the third quarter could have major implications for the Downtown Cleveland office landscape moving forward: the 1.3-million-square-foot, iconic 200 Public Square is reportedly under contract to DRA Advisors, an out-of-state investor, in partnership with local developer Scott Wolstein. Other developments in the CBD were the city council's approval of incentives to help expedite the redevelopment of the vacant John Hartness Brown complex, a 307,654-square-foot facility located at 1001-1101 Euclid Avenue. The property sold to Alto Partners last year for \$9.1 million, or \$31/SF. After several years of sale and redevelopment rumors and

CURRENT CONDITIONS

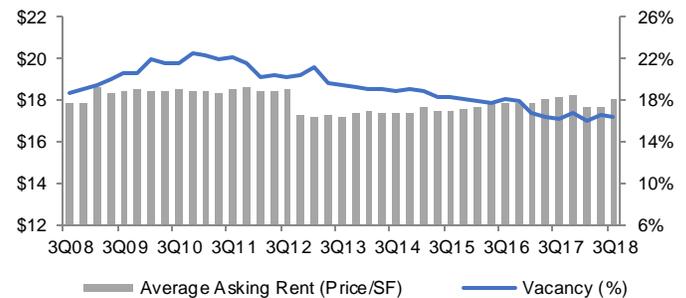
Overall office market rebounded with a tightening in vacancy percentage due to significant absorption; rental rates continued to climb

CBD activity was robust once again with completed and pending sales and a host of other newsworthy developments

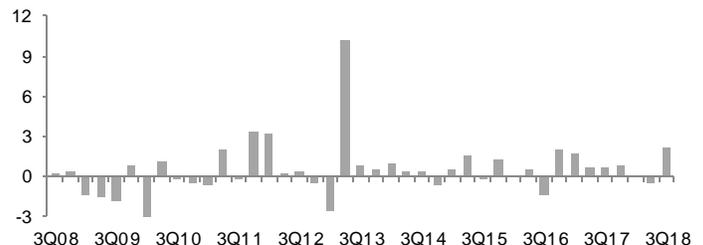
The Offices at Pinecrest delivered, which sparked an increase in rental rates in not only the East, but throughout the market

MARKET ANALYSIS

Asking Rent and Vacancy



Net Absorption (SF, Hundred Thousands)



MARKET SUMMARY

| | Current Quarter | Prior Quarter | Year Ago Period | 12 Month Forecast |
|--------------------------|-----------------|---------------|-----------------|-------------------|
| Total Inventory | 36 MSF | 36 MSF | 36 MSF | ↑ |
| Vacancy Rate | 16.4% | 16.6% | 16.4% | ↓ |
| Quarterly Net Absorption | 211,506 | (50,490) | 72,337 | ↑ |
| Average Asking Rent | \$18.07 | \$17.70 | \$18.15 | ↑ |
| Under Construction | 157,642 | 327,352 | 324,575 | ↑ |
| Deliveries | 193,000 | 127,575 | 0 | ↑ |

continued disrepair, the complex is slated for redevelopment into apartments, retail, a hotel and parking.

The announcements of two new prominent mixed-use projects on the western edge of the CBD, each with an office component, also provided an extra jolt of enthusiasm to an already solid third quarter. Kenect Cleveland, a forthcoming Wolstein-Akara Flats East Bank venture slated for the corner of West 11th Street and Main Avenue, is expected to be a 12-story mixed-use facility that will encompass over 300 apartments, a luxury movie theater and restaurant, an additional 30,000 square feet of retail and two floors of co-working office space. Just 1.5 miles to the south in Ohio City, Chicago-area developer Harbor Bay Real Estate Advisors announced a two-building mixed-use project for the corner of West 25th Street and Lorain Avenue. One building will be a 265-unit residential structure; the other an 11-story office building with approximately 138,000 square feet of office space. Both buildings are expected to feature ground-level retail.

Key CBD leases either began or were signed this quarter, including: Sherwin-Williams' renewal of 51,810 square feet at Skylight Office Tower, 1660 West 2nd Street; GSA's lease of approximately 45,000 square feet at North Point Tower, located at 1001 Lakeside Avenue, and Insight Global's expansion to 10,482 square feet at Key Tower, located at 127 Public Square.

OVERALL VACANCY DOWN; RENTS & ABSORPTION UP

The Greater Cleveland office market tightened in third-quarter 2018, as positive net absorption was realized for the seventh time out of the last eight quarters after rebounding from a slight underperformance last quarter. With a net 211,506 square feet positively absorbed, the overall vacancy rate fell 20 basis points to 16.4%, marking the office market's second-lowest vacancy rate since the third quarter of 2001 (tied with third-quarter 2017 and below first-quarter 2018's 16.1% vacancy rate). This was the largest quarterly absorption recorded since the second quarter of 2013, when 1,018,576 square feet was absorbed. This quarter's absorption brought the year-to-date absorption to positive 219,393 square feet.

The market's average overall asking rental rate increased, mostly because of increased demand and the addition of the top-of-the-market asking rental rate carried by the Offices at Pinecrest in the East submarket. The overall market finished the third quarter at \$18.07/SF for all classes, up \$0.37/SF after topping out below \$18.00/SF for the past two quarters. Market-wide, Class A asking rental rates increased \$0.61/SF from last quarter to \$21.76/SF, the highest overall Class A rate since the second quarter of 2010. The CBD's third-quarter vacancy of 19.1%, down 30 basis points, precipitated a \$0.23/SF increase in the average asking rent to \$19.15/SF. The CBD's Class A average asking rental rate jumped up as well, to \$22.78/SF, an increase of \$0.75/SF.

PINECREST DEVELOPMENT NOW IN FULL SWING

150,000 Square Feet of Office Space Came Online at Pinecrest

The aforementioned office component of the Pinecrest development delivered 150,000 square feet of Class A office space to the East submarket this past quarter. This made up the majority of the new office space that came online in the third quarter, totaling 193,000 square feet, which is also the most office space delivered in a single quarter since the second quarter of 2013, when 500,000 square feet came online.

In the suburban office submarkets, overall average asking rental rates increased \$0.43/SF to \$16.98/SF despite vacancy remaining flat at 13.8%. Once again, the suburban submarket with the highest overall asking rent was the East submarket with \$19.37/SF, up \$0.88/SF from first-quarter 2018. This was another indicator of the impact the Offices at Pinecrest's addition had on the market. The South's overall asking rent was up \$0.44/SF to \$16.38/SF from the prior quarter, while the Southwest's rental rate decreased \$0.08/SF to \$15.06/SF, and the West's rent decreased \$0.28/SF, the largest drop this past quarter, to \$14.53/SF, the lowest rental rate in the market. The West was the only submarket in the third quarter to post negative absorption, giving back 14,840 square feet of space and prompting a 40-basis-point increase in vacancy to 16.3%.

Although the East's vacancy rate increased slightly to 13.4%, partly because The Offices at Pinecrest added vacant inventory to the market, it was still the second-tightest submarket in the area and recorded a healthy positive absorption figure of 158,630 square feet. The East also continued to boast the highest Class A asking rental rate in the area. The Offices at Pinecrest's addition to the market made the East's asking rental rate jump to \$24.98/SF, a \$1.67/SF increase from last quarter. Also of note in the East is the current construction of The CUBE, a 10,000-square-foot office and retail building at 3723 Park East Drive in Beachwood. ORG Portfolio Management is the investment company behind this property, which boasts high ceilings, an all-glass façade and freeway visibility along I-271. Nearby at 3900 Park East Drive, Supply Side Investments signed a 15,608-square-foot lease.

The South submarket, which netted 16,249 square feet of positive absorption, was again the tightest submarket in the area with an 11.0% vacancy rate. This marked a 30-basis-point decrease in vacancy from the previous quarter. The South also continued to grab the attention of businesses and developers, as evidenced by two proposed projects that include new office space. One project is slated to take place in Downtown Hudson as a part of a development that will include 63 townhomes, 80 multi-family homes and approximately 138,000 square feet of office space at the corner of Owen Brown Street and Morse Road. Additionally, a new mixed-use development was announced in Independence. Patriots Village is a project being developed by Industrial Realty Group for the apex of Oak Tree Boulevard, Patriots Way and Lombardo Center and will include shopping, dining, a 120-room business service hotel and up to 290,000 square feet of Class A office space.

CO-WORKING CONTINUES TO EMERGE

After conducting site visits and research as well as reviews of the current office market and media reports on co-working in Cleveland, office market, occupying 180,641 square feet. It is reasonable to conclude there are enough current offerings to fulfill current demand for co-working space. However, there is also adequate evidence to suggest that there is a large market for more options in Greater Cleveland. As of the third quarter, there were nearly 30 co-working locations in the Cleveland

Even though co-working space comprises just 0.5% of overall inventory, demand is expected to grow, as regional and national entities are either entering the market or seriously considering it. Additionally, price comparisons have become a regular task for tenant reps in advising clients that are either searching for new space, staying put or expanding. For example, in the co-working arena, the average monthly price per desk in the Cleveland market is \$236, and the average monthly price per office is \$436. Even office users that have typically considered traditional space are looking at all options.

SELECT LEASE/USER TRANSACTIONS

| Tenant | Building | Submarket | Type | Square Feet |
|---|----------------------------------|-----------|-----------|-------------|
| Sherwin-Williams | 1660 West 2nd St. (Skylight) | CBD | Renewal | 51,810 |
| GSA | 1001 Lakeside Ave. (North Point) | CBD | New | ~45,000 |
| Supply Side Investments | 3900 Park East Dr. | East | New | 15,608 |
| Insight Global | 127 Public Square (Key Tower) | CBD | Expansion | 10,482 |
| Greater Cleveland Automobile Dealers' Association | 9150 South Hills Blvd. | South | New | 5,974 |

SELECT SALE TRANSACTIONS

| Building | Submarket | Sale Price | Price/SF | Square Feet |
|--|---------------------------------|--------------|----------|-------------|
| 1300 East 9th St. (AECOM Centre) | CBD (took place at end of 2Q18) | \$36,875,000 | \$64.13 | 575,000 |
| 24165 Detroit Rd. | West | \$800,000 | \$50.00 | 16,000 |
| 5755 Granger Rd. | South | \$2,800,000 | \$31.18 | 89,790 |
| *1301 East 9th St. (Tower at Erieview) | CBD | \$16,722,450 | \$21.99 | 760,339 |
| 1701 East 13th St. | CBD | \$550,000 | \$16.51 | 33,302 |

*Sold as part of a portfolio along with the Galleria at Erieview; the price and square footage in this table represent just the office tower

SUBMARKET STATISTICS

| | Total Inventory (SF) | Under Construction (SF) | Total Vacancy Rate | Qtr Absorption (SF) | YTD Absorption (SF) | Class A Asking Rent (Price/SF) | Class B Asking Rent (Price/SF) | Total Average Asking Rent (Price/SF) |
|-----------------------|----------------------|-------------------------|--------------------|---------------------|---------------------|--------------------------------|--------------------------------|--------------------------------------|
| CBD Total | 18,161,035 | 0 | 19.1% | 49,476 | 269,863 | \$22.78 | \$18.34 | \$19.15 |
| East | 8,108,707 | 135,290 | 13.4% | 158,630 | 87,355 | \$24.98 | \$16.38 | \$19.37 |
| South | 6,008,548 | 0 | 11.0% | 16,249 | (54,595) | \$20.31 | \$14.14 | \$16.38 |
| Southwest | 1,431,560 | 22,352 | 22.8% | 1,991 | (28,831) | \$18.08 | \$13.06 | \$15.06 |
| West | 3,196,955 | 0 | 16.3% | (14,840) | (54,399) | \$17.14 | \$13.63 | \$14.53 |
| Suburban Total | 18,745,770 | 157,642 | 13.8% | 162,030 | (50,470) | \$21.05 | \$14.77 | \$16.98 |
| Market Total | 36,906,805 | 157,642 | 16.4% | 211,506 | 219,393 | \$21.76 | \$16.73 | \$18.07 |

ECONOMIC CONDITIONS

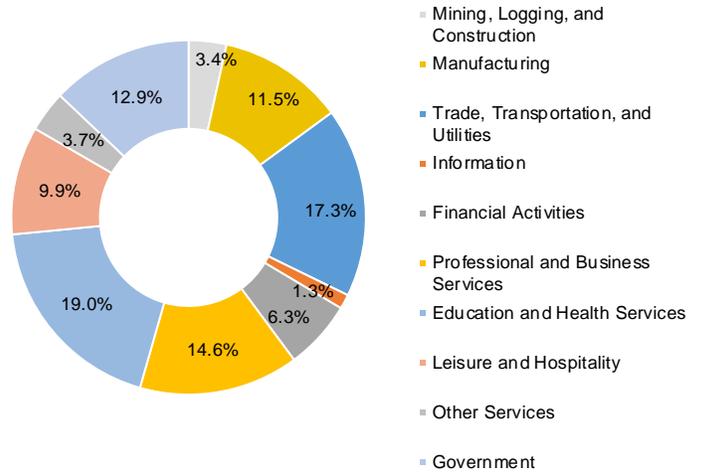
The Greater Cleveland economy added more jobs at a near-historic pace throughout the third quarter of 2018, as total payroll employment grew in July by 2.4% year-over-year and in August by 2.5% year-over-year. The August number ties the highest year-over-year increase in Greater Cleveland since June of 2012. Overall payroll employment for the United States also grew in May, by 1.7% year-over-year.

Most industry sectors saw growth from August 2017 to August 2018, including: mining, logging and construction (3.6% growth); manufacturing (3.3% growth); trade/transportation/utilities (2.8% growth); professional and business services (4.4% growth); education and health services (1.9% growth); leisure and hospitality (5.0%, the largest amount of growth); other services (0.03% growth); and government (0.1% growth). Total nonfarm employment also saw an overall increase year-over-year by 2.5%.

Conversely, the information industry contracted the most, by a negative 1.4%. The only other industry to report a negative change over the past year was the financial activities industry (negative 0.1%).

EMPLOYMENT BY INDUSTRY

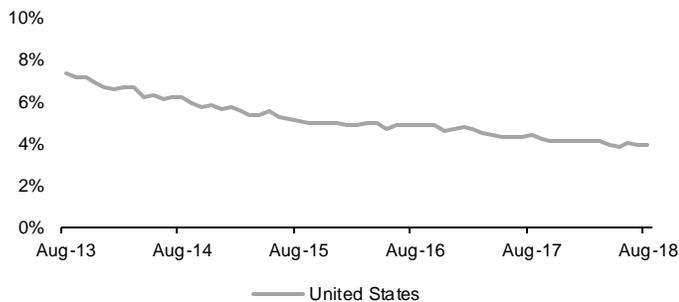
Cleveland-Elyria-Mentor



Source: U.S. Bureau of Labor Statistics

UNEMPLOYMENT RATE

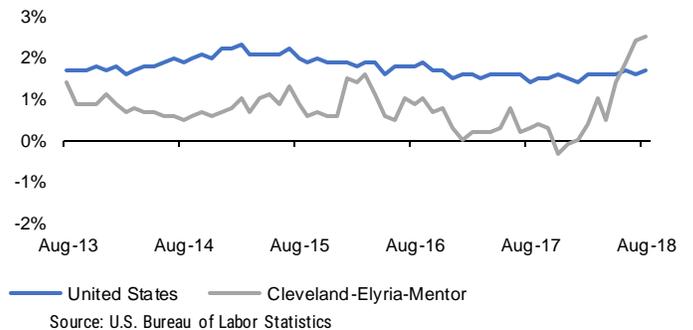
Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

PAYROLL EMPLOYMENT

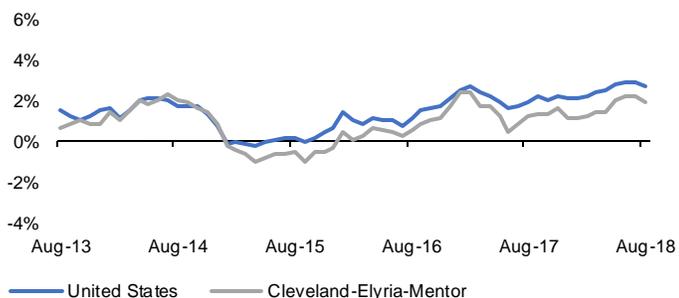
Total Nonfarm, Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics

CONSUMER PRICE INDEX (CPI)

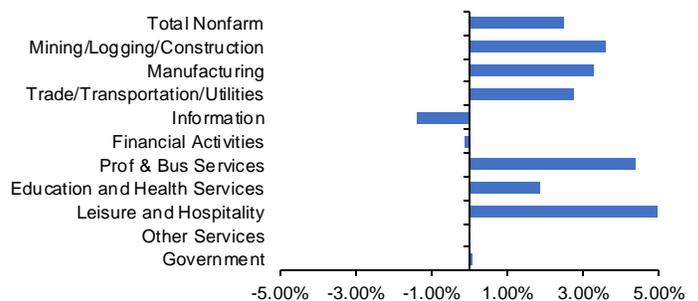
All Items, 12-Month % Change, Not Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

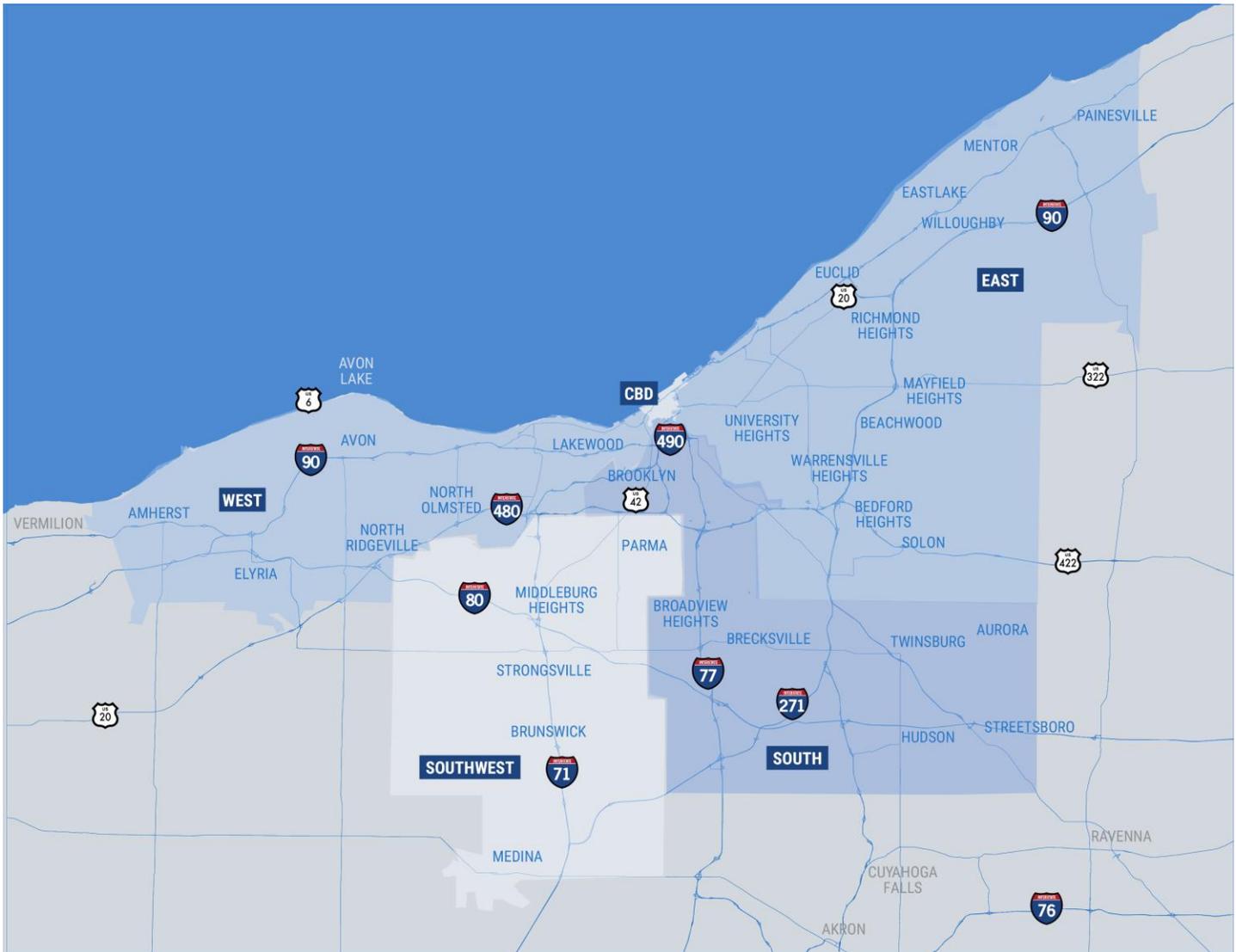
EMPLOYMENT GROWTH BY INDUSTRY

Cleveland-Elyria-Mentor, August 2018*, 12-Month % Change, Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics (*preliminary)

CLEVELAND OFFICE SUBMARKETS



MATTHEW ORGOVAN

Research and Marketing Manager
216.453.3027
morgovan@ngkf.com

NATHANIEL HOOVER

Research Coordinator
216.453.3052
nathaniel.hoover@ngkf.com

Newmark Knight Frank has implemented a proprietary database and our tracking methodology has been revised. With this expansion and refinement in our data, there may be adjustments in historical statistics including availability, asking rents, absorption and effective rents. Newmark Knight Frank Research Reports are available at www.ngkf.com/research

All information contained in this publication is derived from sources that are deemed to be reliable. However, Newmark Knight Frank (NKF) has not verified any such information, and the same constitutes the statements and representations only of the source thereof, and not of NKF. Any recipient of this publication should independently verify such information and all other information that may be material to any decision that recipient may make in response to this publication, and should consult with professionals of the recipient's choice with regard to all aspects of that decision, including its legal, financial, and tax aspects and implications. Any recipient of this publication may not, without the prior written approval of NGKF, distribute, disseminate, publish, transmit, copy, broadcast, upload, download, or in any other way reproduce this publication or any of the information it contains.