

CLEVELAND OFFICE MARKET

OFFICE MARKET CLOSES 2018 ON SOLID FOOTING

The Greater Cleveland office market closed 2018 on solid footing after generating 121,117 square feet of positive absorption, having netted two straight quarters and eight of the last nine quarters in the positive. This development helped decrease the overall vacancy rate to 15.8% in the fourth quarter, a drop of 60 basis points from the third quarter, and represented the lowest vacancy rate in 17-plus years since third-quarter 2001's 15.6% vacancy rate. Furthermore, the market absorbed a total of 340,510 square feet over the course of 2018, the largest yearly tally in five years (fourth-quarter 2013 netted 899,862 square feet in the positive), as demand for office space remained steady. Despite the vacancy dip and positive absorption, the overall average asking rent dropped slightly by \$0.10/SF over the fourth quarter, to \$17.97/SF. Nonetheless, rental rates have hovered around \$18.00/SF for a little more than two years.

The Central Business District (CBD) and the East submarket were largely responsible for the solid performance of the office market in 2018 by helping to boost demand through rising Class A asking rents and generating the master share of absorption. For example, the market's overall Class A average asking rental rate was \$21.85/SF in the fourth quarter, the highest since the second quarter of 2010's \$21.98/SF. The East's \$25.00/SF Class A average asking rental rate led the way, followed by the CBD's \$22.87/SF. These were up by \$0.02/SF and \$0.09/SF, respectively, from last quarter.

200 PUBLIC SQUARE TRANSFERS AS CBD ASSETS DOT THE HEADLINES

The CBD led the way in terms of positive net absorption during the fourth quarter, as this submarket recorded 54,796 square feet. The occupancy gain helped push the CBD's vacancy rate down 40 basis points to 18.7%. The CBD ended 2018 with the most absorption, netting 324,659 square feet. Class B asking rents in the CBD decreased by \$0.17/SF from the previous quarter, coming in at \$18.17/SF. This offset the aforementioned Class A increase, enough to cause the overall asking rent in the CBD to drop \$0.04/SF to \$19.11/SF.

A number of high-profile CBD office sales took place in fourth-quarter 2018, led by the 1.2 million-square-foot 200 Public Square, one of Downtown Cleveland's skyline-defining trophy office buildings. The Class A asset sold after 13 years of ownership by Harbor Group International to the New York-based DRA Advisors-led investor group, with Cleveland area real estate developer Scott Wolstein, for an estimated \$187 million, or \$147/SF.

CURRENT CONDITIONS

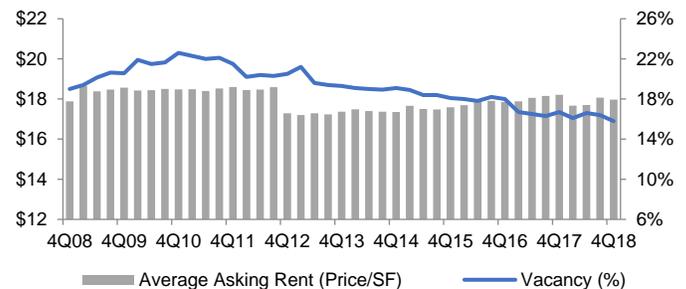
Overall office market dropped to its lowest vacancy rate in over 17 years; netted largest tally of yearly absorption in 5 years

CBD generated several newsworthy developments, including the transfer of the 1.2 million-square-foot trophy building 200 Public Square

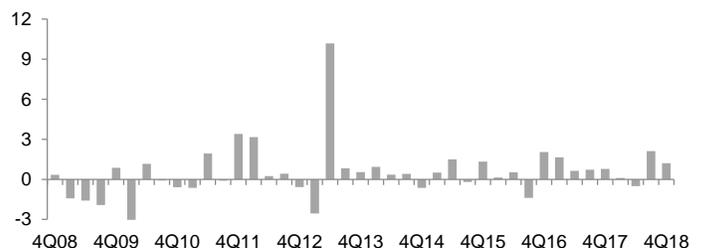
Long-vacant 125,000-square foot former Medical Mutual building in Strongsville sold to owner-user Foundation Software

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	35 MSF	↑
Vacancy Rate	15.8%	16.4%	16.9%	↓
Quarterly Net Absorption	121,117	211,506	32,856	→
Average Asking Rent	\$17.97	\$18.07	\$18.21	↑
Under Construction	235,290	157,642	277,575	↑
Deliveries	22,352	193,000	47,000	↑

Also trading in the CBD was another prominent office tower, 1111 Superior, the current home of the Cleveland Metropolitan School District and former headquarters of Eaton. New York-based Zamir Equities purchased the 597,442-square-foot building in mid-October from American Landmark Properties for \$55.0 million, or \$92/SF.

In a third significant CBD purchase by an out-of-town investor, 1910 Carnegie Avenue, the 33,000-square-foot home to the Ohio Means Jobs workforce initiative, was acquired from Cleveland-based Hemingway Development by Pittsburgh-based Glickman Real Estate Development for \$4.57 million, or \$138/SF. This was Glickman's first investment in a Cleveland asset.

The CBD also saw several key redevelopment initiatives start to materialize in the fourth quarter, led by Downtown Cleveland's largest remaining visual blight, the long-empty 307,654-square-foot John Hartness Brown complex of office buildings located at 1001-1101 Euclid Avenue. The \$90.0 million adaptive reuse project kicked off construction with an anticipated delivery date of 2020 for the apartment/retail development. Next door at 925 Euclid Avenue, the 1.4 million-square-foot behemoth office building that transferred to Millennia Companies earlier in the year, received a new name for its planned \$270.0 million mixed-use renovation, The Centennial. Specific project details have yet to be announced. Two other prospective CBD projects got a kickstart on December 12th, when the state of Ohio awarded its 21st round of state historic tax credits. Nine selected projects fall within Northeast Ohio. Two are slated for conversion from office to another type of use: the 435,000-square-foot Ohio Bell/AT&T Building, located at 750 Huron Road; and the 53,000-square-foot Fidelity Building, also known as the Baker Building, located at 1940 East 6th Street. The Ohio Bell Building earned \$4.2 million in tax credits toward a \$42-million-plus project aimed at converting 13 of the building's 22 floors to a Canopy by Hilton hotel. The Baker Building received \$1.7 million in historic tax credits toward converting the 11-story office building to a proposed hospitality/retail/restaurant mixed-use entity.

The CBD also saw a flurry of lease activity and announcements of forthcoming moves, the most significant of which was PNC Bank announcing the transfer of 500 jobs from its suburban offices to the company's regional headquarters located at Downtown Cleveland's PNC Center, 1900 East 9th Street. The move, which commenced in the fourth quarter and should be completed by the first quarter of 2019, will fill one of the largest empty blocks of space in the CBD, roughly 155,000 square feet that has been vacant since 2016.

North Point Tower, 1001 Lakeside Avenue East, had recent leasing success by luring the U.S. Department of Health and Human Services/General Services Administration away from 200 Public Square. The 45,000-square-foot lease was signed at the end of the third quarter, with a move expected in early 2019. North Point also plucked life insurance software company Proformex from the West submarket. Across town, College Now Greater Cleveland signed a lease for 19,000 square feet at Post Office Plaza, 1500 West 3rd Street. It will occupy that space in early 2019, while enterprise SEO firm BrightEdge occupied 17,000 square feet in fourth-quarter 2018.

On a much smaller scale but with its own intrigue was Progressive Insurance's play to reclaim a CBD presence while building a new office in the East submarket, by signing a 9,000-square-foot lease at 800 West St. Clair Avenue to accommodate a strategy team. Progressive expects to occupy the space in early 2019.

Lastly in the CBD, Downtown Cleveland's marquee skyscraper, Key Tower, could soon be affected space-wise by the high-profile, \$7.0 billion purchase of Forest City Realty Trust by Brookfield Asset Management. Located at 127 Public Square, Key Tower is home to Forest City's world headquarters. Brookfield has announced more than 100 layoffs at that location, which could lead to a chunk of space becoming available there for sublease.

Suburban Submarkets Generate Positive Absorption East Retains Swagelok, and a Big Deal Emerges in the Southwest

The East submarket saw a key corporation decide to stay put and announce expansion plans in the fourth quarter, as Swagelok reached an agreement with the city of Solon to add a new \$30 to \$50 million global headquarters and innovation center at its present location at 29500 Solon Road, where the company has been headquartered since 1965. The new campus is expected to encompass up to 120,000 square feet of new space. On the leasing side, the Offices at Pinecrest, located at 100 and 200 Park Avenue in Orange Village, landed a 33,000-square-foot lease from Philips Healthcare, which will relocate after downsizing and ceasing manufacturing at its 757,000-square-foot manufacturing/R&D facility at 595 Miner Road in Highland Heights. Nearby, construction has commenced on Progressive's aforementioned new office building, which will measure 100,000 square feet and bring hundreds of new jobs.

Rates in the East continued to rise, as the fourth-quarter average asking rental rate increased to \$19.44/SF, up \$0.07/SF from the previous quarter. Coupled with the aforementioned Class A increase, the East's Class B asking rental rate increased by \$0.15/SF to \$16.53/SF. This all took place as the East experienced 40,168 square feet in positive absorption during the fourth quarter, which pushed the vacancy rate down by 50 basis points to 12.9%. For the year, the East generated 127,523 square feet in positive absorption, second only to the CBD.

The South submarket held stable in the fourth quarter, as quarterly net absorption totaled 17,129 square feet. Nevertheless the submarket's annual net absorption stayed underwater through 2018 at negative 37,466 square feet. The South's vacancy rate remained the lowest in the market and decreased by 30 basis points to 10.7%. However, its average overall asking rental rate dipped by \$0.12/SF to \$16.26/SF for all classes.

The West submarket remained flat as vacancy decreased slightly in the fourth quarter to 16.2%, a 10-basis-point drop that was helped by 2,415 square feet of positive absorption. However, this did not aid the 2018 absorption total for the West, which lost more space than any other submarkets, totaling negative 51,984 square feet. The West's overall asking rent still increased from the third quarter, by \$0.07/SF to \$14.60/SF. In a key sale, TravelCenters of America purchased the 90,758-square-foot 24651 Center Ridge Road for \$6.5 million, or \$71.62/SF. The building adjoins its headquarters.

The typically unremarkable Southwest submarket made news in the fourth quarter, as the long-vacant 125,000-square-foot 17800 Royalton Road building in Strongsville traded to new owner/user Foundation Software for \$6.5 million, or \$51/SF. (Foundation Software has another location in Strongsville that it will continue to operate.) As an owner-occupied building, the building's inventory was removed from the submarket, significantly impacting its vacancy rate. As a result, with only 1.3 million square feet of total inventory, along with 6,609 square feet of positive absorption in the fourth quarter, the Southwest's vacancy rate dropped 650 basis points from the third quarter to 16.3%, and its average asking rent decreased by \$1.84/SF to \$13.22/SF.

The overall suburban vacancy rate decreased by 80 basis points in the fourth quarter to 13.0%, lower than the CBD's rate and the market's as a whole. A comparison of the CBD versus the entire suburban office market is interesting in that each has an inventory of more than 18 million square feet, yet the suburban submarkets have a tighter vacancy rate (as shown in the Submarket Statistics table below). Of all of the Cleveland office market cities with at least five properties that are inventoried, the city of Willoughby (East submarket) is the tightest, at a 1.6% vacancy rate. Additional East submarket cities Warrensville Heights (6.0%), Mayfield Heights (6.5%) and Mayfield (6.6%) follow, with Twinsburg (South submarket) rounding out the five tightest cities, with a 7.6% vacancy rate.

SELECT LEASE/USER TRANSACTIONS

Tenant	Building	Submarket	Type	Square Feet
Philips Healthcare	Offices at Pinecrest/100-200 Park Ave.	East	New	33,000
College Now Greater Cleveland	Post Office Plaza, 1500 W. Third St.	CBD	New	19,000
Bellwether Enterprise Real Estate Capital, LLC	One Cleveland Center, 1375 E. 9th St.	CBD	Expansion	10,294
Progressive	800-850 St. Clair Ave.	CBD	New	9,000
Taylor Stone	3601 Green Rd.	East	New	5,476

SELECT SALE TRANSACTIONS

Building	Submarket	Sale Price	Price/SF	Square Feet
200 Public Square	CBD	\$187,000,000	\$146.79	1,273,907
1910 Carnegie Ave.	CBD	\$4,570,000	\$138.48	33,000
1111 Superior Ave.	CBD	\$55,000,000	\$92.06	597,442
24651 Center Ridge Rd.	West	\$6,500,000	\$71.62	90,758
17800 Royalton Rd.	Southwest	\$6,500,000	\$51.00	125,000

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	18,209,631	0	18.7%	54,796	324,659	\$22.87	\$18.17	\$19.11
East	8,108,707	235,290	12.9%	40,168	127,523	\$25.00	\$16.53	\$19.44
South	6,008,548	0	10.7%	17,129	(37,466)	\$20.15	\$14.11	\$16.26
Southwest	1,328,912	0	16.3%	6,609	(22,222)	\$14.69	\$13.80	\$13.22
West	3,196,955	0	16.2%	2,415	(51,984)	\$17.15	\$13.64	\$14.60
Suburban Total	18,643,122	235,290	13.0%	66,321	15,851	\$21.05	\$14.83	\$16.84
Market Total	36,852,753	235,290	15.8%	121,117	340,510	\$21.85	\$16.59	\$17.97

ECONOMIC CONDITIONS

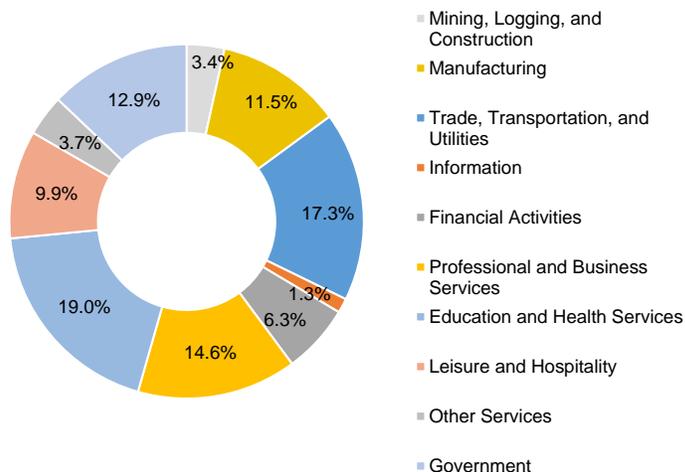
Greater Cleveland payroll employment had a positive return through October 2018. This year's October employment numbers were much higher than those reported for these months over the last several of years. In fact, dating back to 2013, October payroll growth never reached over 1% until this year, which saw a hefty 2.5% increase. Employment growth in 2018 has been over two percent since July.

Industry sectors that saw growth from October 2017 to October 2018, in order from most to least growth, were: manufacturing (4.0% growth); leisure and hospitality (3.4% growth); professional and business services (3.3% growth); trade, transportation and utilities (3.2% growth); education and health services (2.4% growth); government (1.4% growth); mining, logging and construction (1.0% growth); other services (0.5% growth); and financial activities (0.3% growth). Total nonfarm employment also saw an overall increase year-over-year by 2.5%.

Conversely, the information industry was the only one that contracted, by negative 1.4%.

EMPLOYMENT BY INDUSTRY

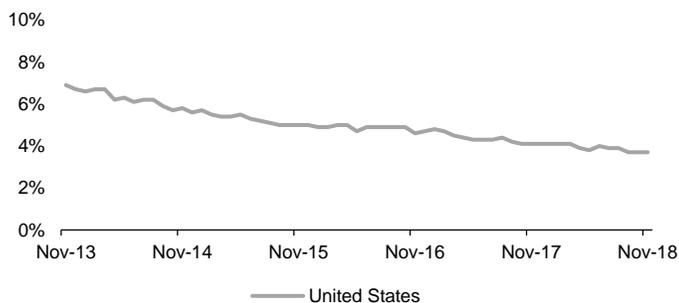
Cleveland-Elyria-Mentor



Source: U.S. Bureau of Labor Statistics

UNEMPLOYMENT RATE

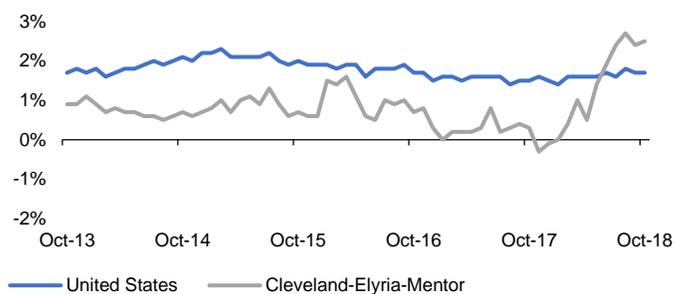
Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

PAYROLL EMPLOYMENT

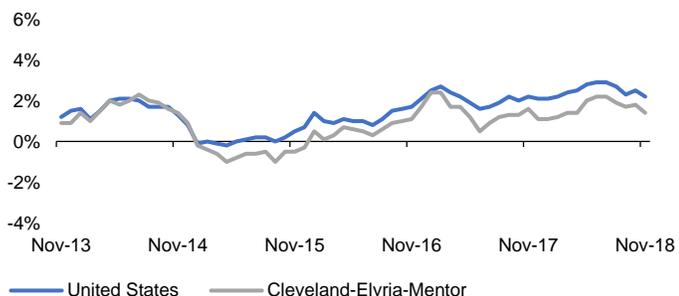
Total Nonfarm, Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics

CONSUMER PRICE INDEX (CPI)

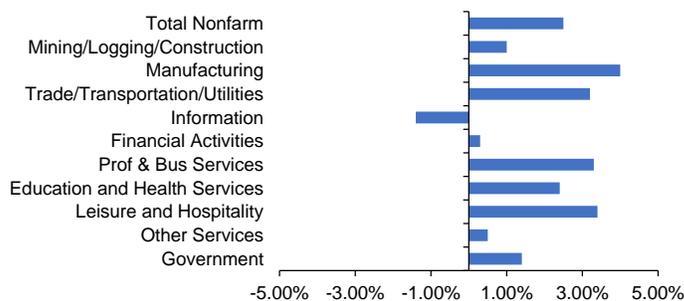
All Items, 12-Month % Change, Not Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

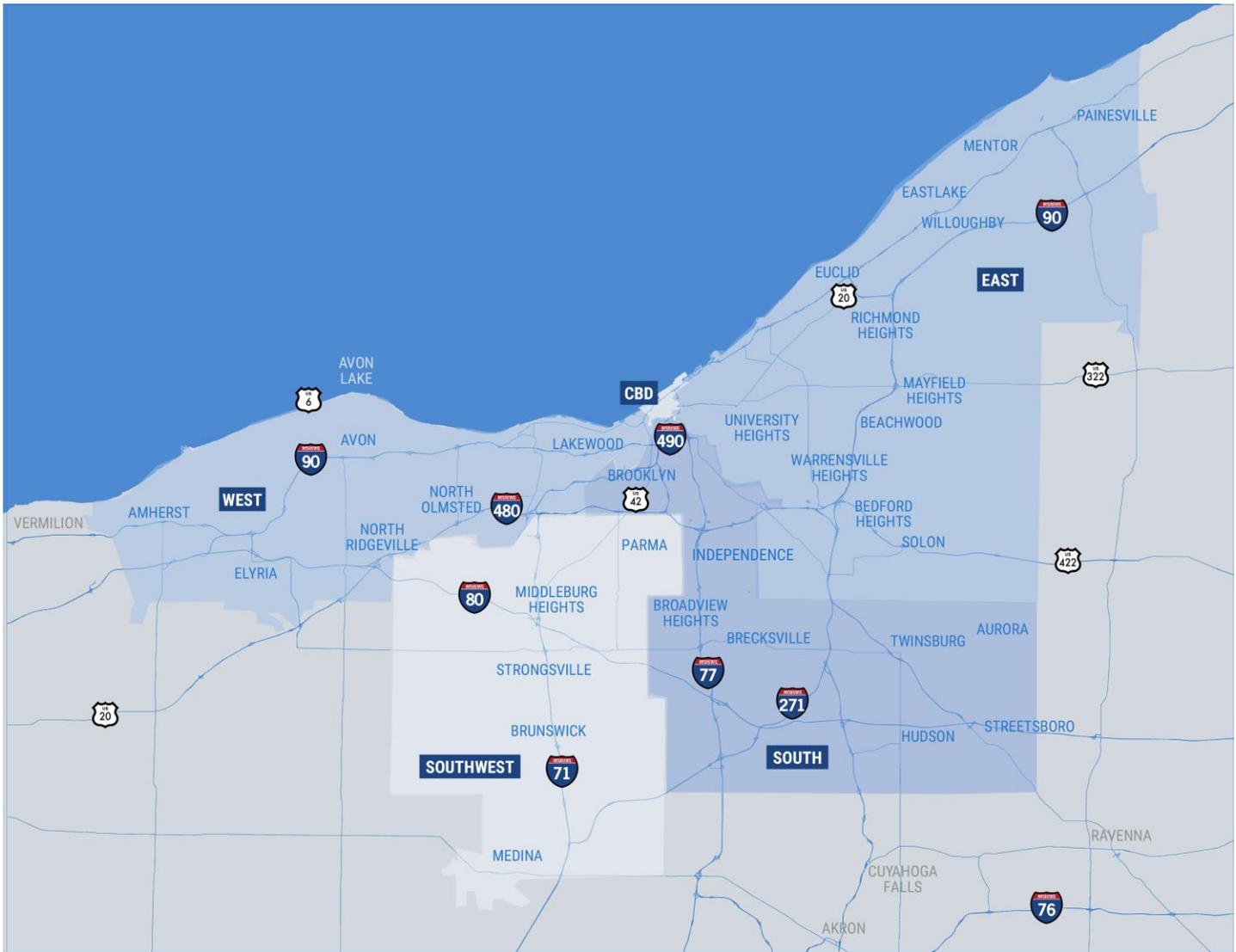
EMPLOYMENT GROWTH BY INDUSTRY

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



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

CLEVELAND OFFICE SUBMARKETS



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