

# CLEVELAND OFFICE MARKET

## OFFICE MARKET REBOUNDED TO END YEAR ON POSITIVE NOTE

The Greater Cleveland office market closed 2019 on solid footing by generating 243,535 square feet of positive absorption in the fourth quarter, after netting three straight quarters in the negative. In fact, all five office submarkets posted positive absorption this past quarter, which helped decrease the overall vacancy rate to 16.7% in the fourth quarter, a drop of 60 basis points from the third quarter.

The market righted itself via this rebound, as the fourth quarter's vacancy rate equaled that of the first quarter. However, the market negatively absorbed a total of 137,258 square feet over the course of 2019.

Despite the vacancy dip and positive absorption, the overall average asking rent stayed pretty flat, having dropped slightly by \$0.04/SF over the fourth quarter, to \$18.34/SF. Nonetheless, rental rates have been \$18.00/SF or higher for eight of the last 10 quarters.

The East submarket was largely responsible for keeping the office market afloat in 2019 by generating 240,430 square feet of positive absorption, by far the most of any office submarket. By contrast, the Central Business District (CBD) netted 312,249 square feet in negative absorption for 2019.

However, the CBD led the way in terms of positive net absorption during the fourth quarter, as this submarket recorded 105,171 square feet. The occupancy gain helped push the CBD's vacancy rate down 60 basis points to 20.6%. Class B asking rents in the CBD increased by \$0.02/SF from the previous quarter, coming in at \$18.19/SF. This was insufficient, however, to offset a Class A decrease of \$0.09/SF to \$23.90/SF, or a poor \$14.20/SF showing by Class C assets, which recorded a \$0.48/SF decrease from the third quarter to \$14.20/SF. As a result, the overall asking rent in the CBD dropped \$0.24/SF to \$19.08/SF.

### Sherwin-Williams' HQ Search Dominates Industry Talk

The CBD also saw a flurry of articles, blog posts and water cooler fodder regarding the future of Sherwin-Williams' headquarters and research and development facility. Sherwin-Williams has been a staple of Cleveland for more than 150 years, and media and insider sources have widely reported that the paint, stain, coating and finishes company has committed to remaining in the region. The prevailing conversation has centered on the company narrowing down its search to a couple of sites in Downtown Cleveland. Purchase agreements for nearly seven acres of parking lots in the CBD's Public Square, along with crews taking soil and groundwater samples on those sites, have led many to deduce that the company will build on that combined site. However, a riverfront site adjacent to Sherwin-Williams' current R&D facility along the Cuyahoga River remains in play. An official decision on the search process is expected in early 2020.

## CURRENT CONDITIONS

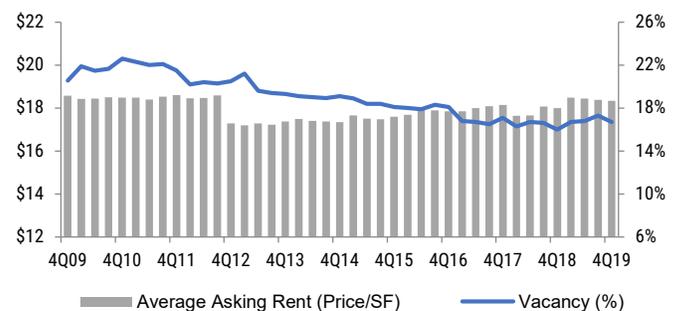
Vacancy decreased for the first time this year, while the overall average asking rental rate remained largely unchanged.

Will they stay in Cleveland? The Sherwin-Williams corporate headquarters search dominated the headlines throughout the fourth quarter.

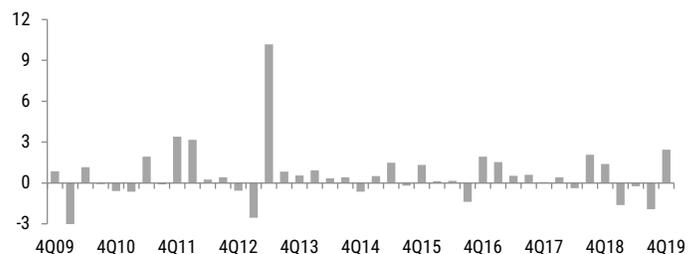
Office sale transactions of note all took place in the suburbs. Office building transfers in the CBD have been scarce in 2019.

## 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	37.3 MSF	37.3 MSF	36.6 MSF	↑
Vacancy Rate	16.7%	17.3%	15.7%	→
Quarterly Net Absorption	243,535	(192,923)	139,721	→
Average Asking Rent	\$18.34	\$18.38	\$17.91	↑
Under Construction	160,000	60,000	235,290	↑
Deliveries	0	0	22,352	↑

The Sherwin-Williams “factor” is huge for the future of Cleveland. Thousands of jobs, many millions of dollars in real estate transactions, increased hospitality, multifamily and retail developments nearby and a potentially altered skyline are all on the line.

The CBD also saw the announcement in early December of two corporate juggernauts, Cleveland-Cliffs Inc., a former Fortune 500 company, and AK Steel Holding Corporation, a current Fortune 500 company, entering into a \$1.1 billion stock merger agreement, in which Cliffs will acquire all of the issued and outstanding shares of AK Steel common stock. According to a news release issued by Cliffs, the transaction is expected to close in the first half of 2020, subject to approval by the shareholders of both companies, receipt of regulatory approvals and satisfaction of other customary closing conditions.

Cleveland-Cliffs’ headquarters is located in Downtown Cleveland’s 200 Public Square, a 1.2 million-square-foot skyscraper where the company leases well over 100,000 square feet, spanning the majority of four floors. Additional details about staff relocations and office space allocations are still to come, but this merger could have a significant impact on the Cleveland CBD office space market in 2020.

On a much smaller scale but with its own intrigue was the announcement in late October of the London Stock Exchange Group’s Elite initiative selecting Cleveland for its North American headquarters. Although a specific headquarters site has yet to be announced, the CBD is the likely submarket for this 2020 office lease. It is anticipated that the group could be in the market for approximately 30,000 square feet of prime office space.

There were several other goings-on in the CBD that could have a major impact on the office market going forward. One such item is the redevelopment of The Centennial at 925 Euclid Avenue. This property remains one of the last large pieces of the downtown puzzle that stands largely vacant and dormant. The adaptive mixed-use reimagining of this nearly 1.3 million-square-foot behemoth has largely been focused around a multifamily, retail and office mix. However, with the Cleveland office market’s stagnation of late, the nearly 400,000-square-foot office component might be in jeopardy in lieu of additional multifamily units. The future is also uncertain for the Global Center for Health Innovation, located at 1 St. Clair Avenue, which lost key tenant BioEnterprise, the marketer of the facility, at the end of the year. The struggling building is in the midst of identifying a sustainable and long-term best use plan.

### The Suburban Office Submarkets Help Carry 2019

The overall suburban vacancy rate decreased by 70 basis points in the fourth quarter to 13.2%, lower than the CBD’s rate and the market as a whole. In total, the suburbs absorbed 138,364 square feet in the fourth quarter while netting 174,991 square feet for the entire year.

The East submarket saw the largest office building transfer of the quarter, as 1 Allen Bradley Drive in Mayfield Heights sold for \$61.1 million, or approximately \$133/SF. Home to Rockwell Automation, this 460,000-square-foot property was purchased by ETCL Rockwell OH

LLC, an affiliate of ElmTree Funds, a private equity investor from St. Louis.

Staying in the East, several notable developments took place in the MidTown and Opportunity Corridor sections of Cleveland, just a few miles from the CBD. Although it is not a traditional office play, Cleveland Mayor Frank Jackson’s office recommended that the long-sought-after new Cleveland Police Headquarters be built on 12 city-owned acres near Kinsman Road and East 79th Street along the forthcoming Opportunity Corridor road project. The project’s costs are yet to be determined but could range from \$54 million to more than \$100 million based on early estimates. The endeavor could entail a multi-story campus-style headquarters consisting of approximately 180,000 square feet of office space, in addition to parking, storage, garage and supporting facilities. A preliminary timetable indicates design in 2020, construction in 2021 and a finished product by 2022. Interest groups have voiced concerns, so the project isn’t a given yet.

Just northwest of the Opportunity Corridor project in Cleveland’s MidTown district, the Cleveland Foundation purchased a 1.2-acre parcel of land on East 66th Street between Euclid and Chester avenues. The foundation, currently located in Playhouse Square’s Hanna Building, 1422 Euclid Avenue, intends to build a three-story, 50,000-square-foot new headquarters on the site once a lawsuit involving the transfer is settled. The Cleveland Foundation, along with other nonprofits, is also in the proposal stage for a 100,000-square-foot “Center for Innovation” that will be located next to the eventual new foundation headquarters. Other organizations involved in this \$40 million project include MidTown Cleveland Inc., Jumpstart Inc., Cleveland State University and Case Western Reserve University.

Despite performing well in 2019, rates in the East dipped once again, as the fourth-quarter average asking rental rate decreased \$0.24/SF from the previous quarter to \$18.69/SF. The East was paced by a decrease of \$0.02/SF in the Class A asking rental rate, which ended the quarter at \$23.74/SF, and of \$0.18/SF in the Class B asking rental rate, which closed at \$16.37/SF. These declines took place as the East experienced 49,280 square feet in positive absorption during the fourth quarter, which pushed the vacancy rate down by 60 basis points to 11.0%.

The South submarket performed better than it did earlier in the year, as its net absorption for the fourth quarter totaled 63,786 square feet. Nevertheless, the submarket’s annual net absorption stayed under water through 2019 at negative 119,677 square feet. The South’s vacancy rate remained in the middle of the pack and decreased by 90 basis points to 14.5%. Its average overall asking rental rate increased by \$0.21/SF to \$18.03/SF for all classes. Several sales took place in this submarket in the fourth quarter, the most notable of which involved 6500 Rockside Road (Metro Center). The 55,799-square-foot sale property sold to Metrocenter RLF, LLC, a Fairview Park, Ohio-based affiliate of real estate investment company Realife Real Estate Group, for \$5.47 million, or \$98/SF. Metro Center is a Class A, multitenant office building best known for its reflective glass windows and spacious offices. It was 89.0% leased at the time of the sale.

The West submarket kept with the trend of the overall market as vacancy decreased in the fourth quarter to 14.8%, a 60-basis-point drop that was helped by 18,857 square feet of positive absorption. This did aid the 2019 absorption total for the West, which gained a modest 47,250 square feet of space. The West's overall asking rent increased more than any other submarket from the third quarter, by \$0.64/SF to \$15.17/SF. This was paced by a large increase of \$1.21/SF in the Class B asking rental rate to \$15.51/SF, which is more in line with the overall suburban total for this asset class. A new mixed-use development adjacent to Westlake's Crocker Park lifestyle center was announced in November. Initial plans call for approximately 63,000 square feet of office as well as a retail and restaurant component, with construction due to begin in late 2020.

The Southwest submarket, which has the highest suburban vacancy despite the least amount of inventory, also kept with the overall market trend as vacancy dropped in the fourth quarter to 17.0%, a 60-basis-point decrease precipitated by 6,441 square feet of positive absorption. With only 1.25 million square feet of total inventory, this seemingly trivial amount of absorption had an impact on vacancy. For the year, the Southwest stayed in the positive by a small amount of space totaling 6,988 square feet. However, this submarket's overall asking rent increased decreased from the third quarter, by \$0.06/SF to \$14.02/SF, by far the lowest in the entire Cleveland market.

The overall suburban asking rental rate increased by \$0.06/SF to \$17.40/SF, paced by strong increases in the West and South.

### SELECT LEASE/USER TRANSACTIONS

Tenant	Building	Submarket	Type	Square Feet
Exacta Land Surveyors	1500 W. 3rd St.	CBD	New	19,000
Konica Minolta	6000 Lombardo Center	South	New	12,000
Outerbox Solutions Inc.	175 Montrose West Ave.	Akron	Sublease	10,407
Genomonology, LLC	1138 W. 9th St.	CBD	New	10,000
CliftonLarsonAllen	388 S. Main St.	Akron	Extension	7,522

### SELECT SALE TRANSACTIONS

Building	Submarket	Sale Price	Price/SF	Square Feet
1 Allen Bradley Drive	East	\$61,126,154	\$132.88	460,000
200 Treeworth	South	\$800,000	\$104.88	7,628
6500 Rockside Rd.	South	\$5,470,000	\$98.03	55,799
9525-9655 Sweet Valley Dr.	South	\$2,000,000	\$86.88	23,020
6400 Rockside Rd.	South	\$2,650,000	\$78.31	33,840

### 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)
<b>CBD Total</b>	<b>17,500,848</b>	<b>0</b>	<b>20.6%</b>	<b>105,171</b>	<b>(312,249)</b>	<b>\$23.90</b>	<b>\$18.19</b>	<b>\$19.08</b>
East	8,665,396	0	11.0%	49,280	240,430	\$23.74	\$16.37	\$18.69
South	6,528,561	0	14.5%	63,786	(119,677)	\$20.23	\$14.86	\$18.03
Southwest	1,252,673	0	17.0%	6,441	6,988	\$14.42	\$14.41	\$14.02
West	3,342,059	160,000	14.8%	18,857	47,250	\$16.80	\$15.51	\$15.17
<b>Suburban Total</b>	<b>19,788,689</b>	<b>160,000</b>	<b>13.2%</b>	<b>138,364</b>	<b>174,991</b>	<b>\$20.53</b>	<b>\$15.64</b>	<b>\$17.40</b>
<b>Market Total</b>	<b>37,289,537</b>	<b>160,000</b>	<b>16.7%</b>	<b>243,535</b>	<b>(137,258)</b>	<b>\$22.01</b>	<b>\$17.21</b>	<b>\$18.34</b>

## ECONOMIC CONDITIONS

Greater Cleveland payroll employment had a positive return through October 2019. This year's October employment numbers were higher than those reported for these months over the last several years. October payroll growth saw a 0.9% increase. In fact, payroll employment growth in 2019 has been over 0.9% every month from January to October.

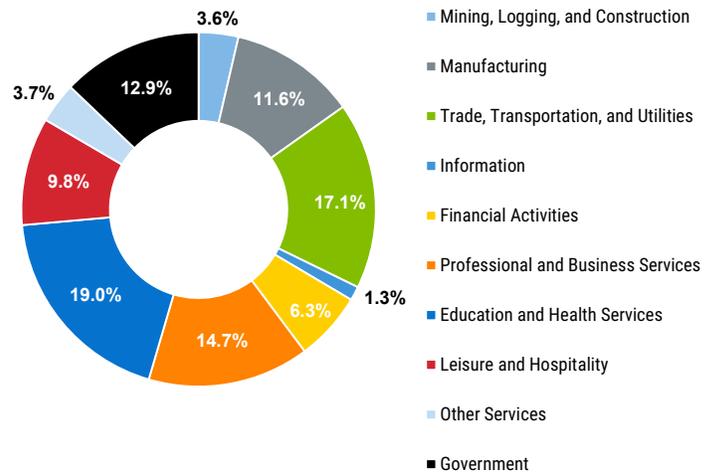
Industry sectors that saw growth from October 2018 to October 2019, in order from most to least growth, were: professional and business services (5.6% growth); education and health services (2.6% growth); government (0.4% growth); and leisure and hospitality (0.3% growth). Total nonfarm employment also saw an overall increase year-over-year by 0.9%.

The mining, logging and construction and the financial activities sectors stayed flat year-over-year.

Conversely, industries that contracted were: other services (-3.0%); trade, transportation and utilities (-2.1%); information (-1.5%); and manufacturing (-0.1%).

## EMPLOYMENT BY INDUSTRY

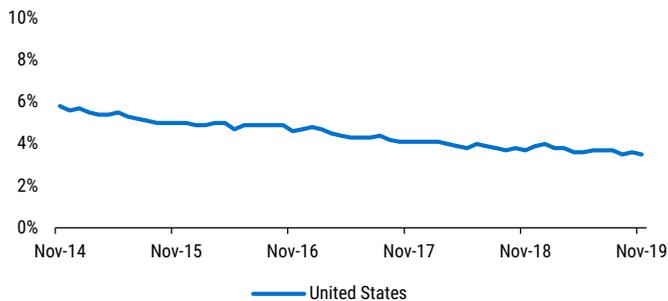
### Cleveland-Elyria-Mentor



Source: U.S. Bureau of Labor Statistics

## UNEMPLOYMENT RATE

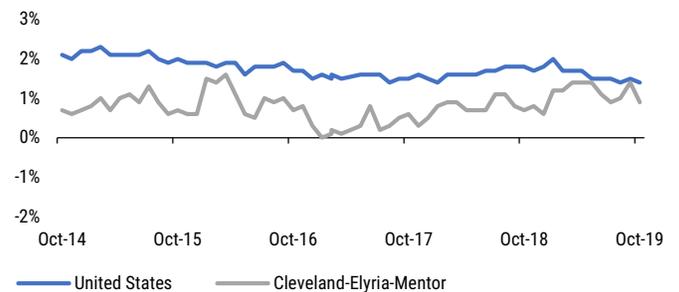
### Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

## PAYROLL EMPLOYMENT

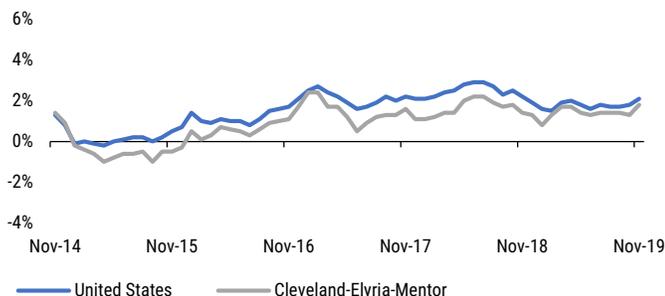
### Total Nonfarm, Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics

## CONSUMER PRICE INDEX (CPI)

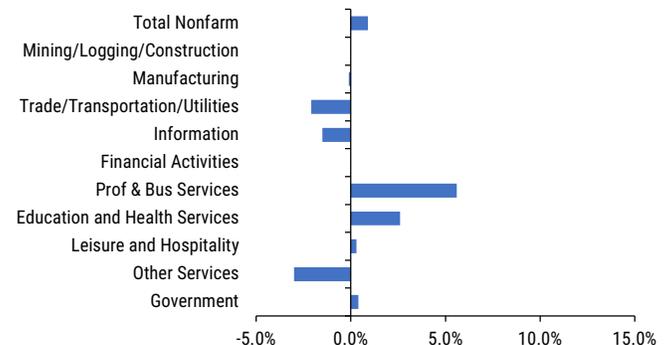
### All Items, 12-Month % Change, Not Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

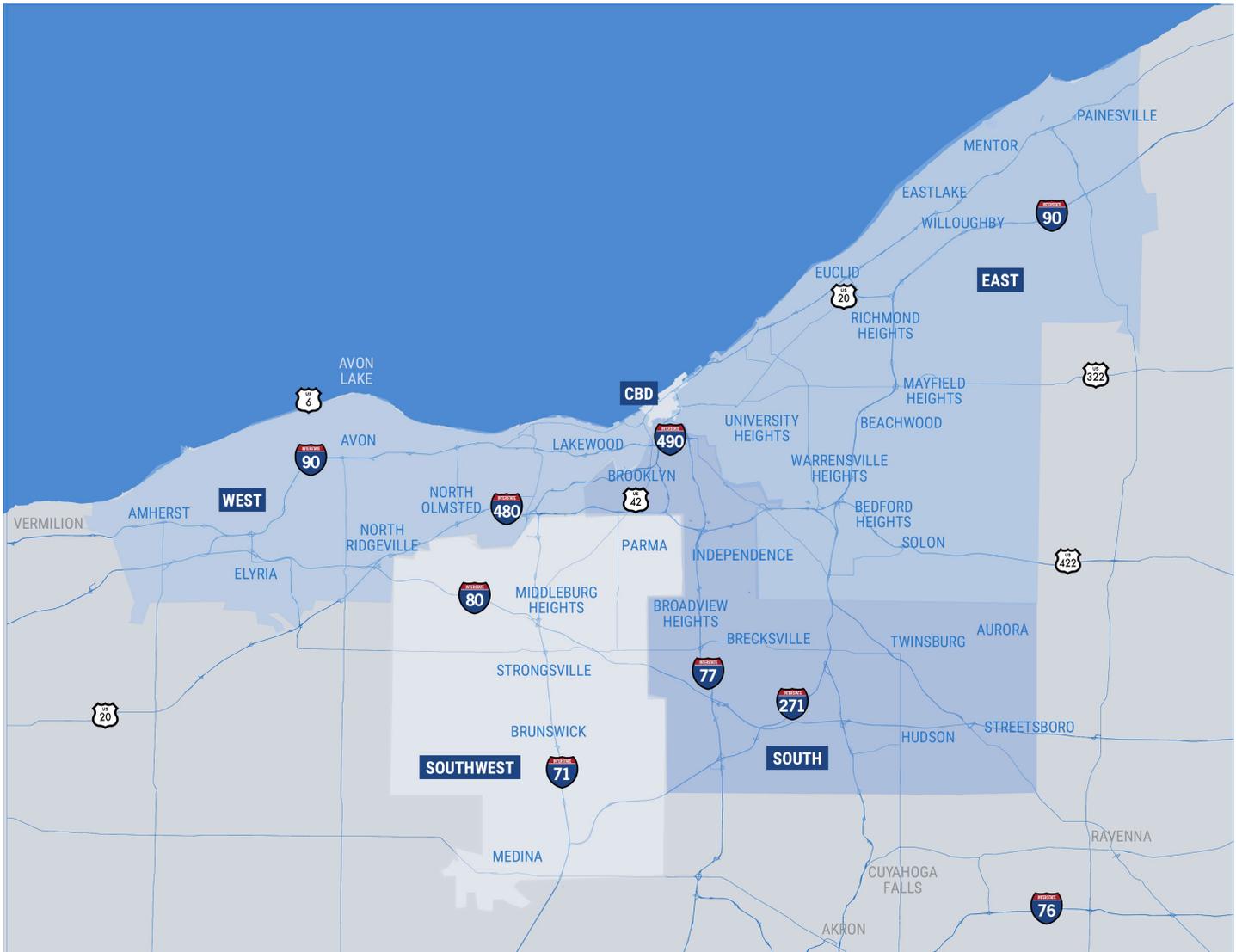
## EMPLOYMENT GROWTH BY INDUSTRY

### Cleveland-Elyria-Mentor, Oct. 2019\*, 12-Month % Change, Seasonally Adjusted



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

## CLEVELAND OFFICE SUBMARKETS



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