

# CLEVELAND OFFICE MARKET

## CLEVELAND OFFICE MARKET KICKS OFF 2020 ON SOLID FOOTING

Conditions in the Greater Cleveland office market held steady during the first quarter of 2020, following a boost from the positive return in the fourth quarter of 2019. That quarter was preceded by three straight quarters of negative absorption. Overall positive absorption totaled 411,996 square feet in the first quarter of 2020, a great sign for the market despite a slight increase in its vacancy rate, which jumped 50 basis points from the prior quarter to 16.9% for all office properties. Interestingly, the first quarter's 16.9% vacancy rate matched the rate of one year ago. However, vacancy has decreased by 1.9% over the last five years and by 4.5% over the last 10 years. Looking ahead, market progress that began to show this past quarter will most likely slow down significantly due to the explosion of the COVID-19 pandemic that came to a head in March.

The disconnect between absorption and vacancy was due to an increase in the market's inventory, as more than 1.3 million square feet was added at the beginning of 2020. Inventory recalibration is performed at the beginning of each year and accounts for such factors as buildings that are no longer owner-occupied, building size changes and conversions from other asset classes to office. The market brought a lot of vacant office space onto the market through this process.

The average asking rental rate dipped across the Greater Cleveland office market, finishing the first quarter at \$18.18/SF for all classes, down \$0.11/SF from the fourth quarter of 2019. Although the average asking rental rate for Class A assets increased by \$0.29/SF to \$22.28/SF, this was not enough to overcome a \$0.41/SF drop in the Class B average rental rate to \$16.70/SF.

Beyond the beginning-of-the-year inventory recalibration, changes to vacancy in just a few properties had implications for the overall market. For example, absorption in the South submarket and, consequently, the market as a whole, was paced by the 344,355-square-foot occupation of Medical Mutual in its new office space, located at the former American Greetings Headquarters at 1 American Road in Brooklyn. The company consolidated its suburban locations, from spaces in the East submarket's 23700 Commerce Park, the Southwest submarket's 15885 West Sprague Road and a site in Copley, near Akron.

This one lease absorption at 1 American Road did not cause the South's vacancy rate to decrease because nearly 900,000 square feet of inventory was added to this submarket. As a result of all of these factors, and despite a total of 388,741 square feet in positive absorption, the South's office vacancy increased by 210 basis points to 16.5% from the previous quarter.

### CURRENT CONDITIONS

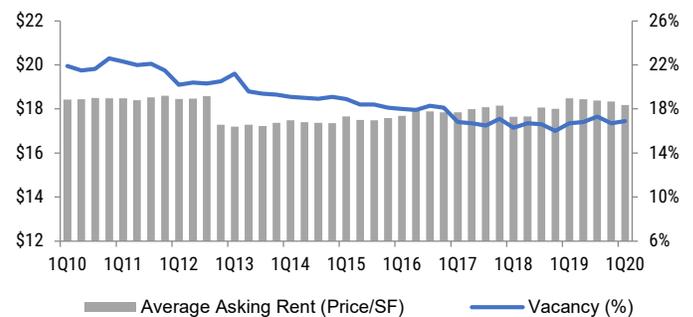
Overall vacancy increased slightly due primarily to an increase in inventory, despite a strong positive absorption showing.

Will they stay in Cleveland? YES! The Sherwin-Williams corporate headquarters decision and follow-up stories dominated the headlines.

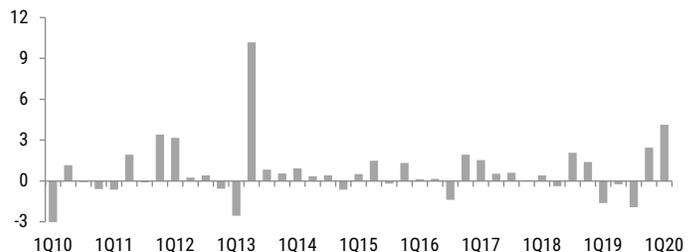
The CBD began the year strong with positive absorption, a drop in vacancy and an increase in its average asking rental rate.

### 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	38.9 MSF	37.6 MSF	37.5 MSF	↑
Vacancy Rate	16.9%	16.4%	16.9%	→
Quarterly Net Absorption	411,996	473,999	(194,447)	→
Average Asking Rent	\$18.18	\$18.29	\$18.49	→
Under Construction	100,000	160,000	114,209	↑
Deliveries	60,000	0	0	↑

## SHERWIN-WILLIAMS STAYING IN CLEVELAND AS CBD BEGAN THE YEAR STRONG

The Central Business District's overall asking rental rate increased by \$0.33/SF to \$19.37/SF during the first quarter, and its vacancy rate decreased by 80 basis points to 18.9% as a result of 111,977 square feet of positive absorption. Of note was a \$0.94/SF increase in the CBD's Class A average asking rent to \$24.84/SF. The Class B average asking rent increased by \$0.09/SF to \$18.14/SF.

The main headline grabber in the CBD once again involved Sherwin-Williams. The company confirmed via a February 6 news release that it will build its new global headquarters in Downtown Cleveland, just west of Public Square between St. Clair and Superior avenues, and a new R&D center in the Valor Acres development in the suburb of Brecksville, located in the South submarket. Preliminary plans call for the company to invest a minimum of \$600 million to construct both facilities. The headquarters facility will measure approximately 1 million square feet, and the R&D facility approximately 500,000 square feet. The two facilities will together house more than 3,500 employees, with room for future growth. In late March, the company paid \$49.4 million for 6.9 acres of downtown property (parking lots that essentially bridge Public Square and the Historic Warehouse District) where the headquarters facility will be constructed. That amounts to more than \$7.0 million per acre.

The next step is the allocation of incentive packages to the company by various entities. The city of Cleveland has approved a nearly \$100 million package that includes 30 years of non-school tax increment financing (expected to provide Sherwin-Williams \$2.0 to \$2.5 million per year; an economic development construction grant of up to \$13.5 million; and up to \$11.5 million over 15 years in a job creation grant (based on 50.0% of the income taxes that would be collected on newly created jobs in Cleveland). Additionally, the Cuyahoga County Council has a proposed \$14.0 million construction grant that is awaiting approval, pending the full details of the city's final package and of a potential package from the state of Ohio. The county is also considering working in good faith with Sherwin-Williams to redevelop the company's current headquarters, the Landmark Office Towers at 101 West Prospect Avenue.

A noteworthy CBD building transfer that took place in the first quarter was the 53,000-square-foot Baker Building, located at 1900-1940 East 6th Street. This strategically located yet largely empty asset transferred for \$1.825 million, or \$34/SF, to 1900 East 6th Street LLC, an affiliate of Walton Enterprises (of Walmart and Sam's Club fame). The company also paid nearly \$1.7 million for factors beyond the real estate, bringing the total to approximately \$3.5 million. The new owner is reportedly seeking \$3.0 million in tax credits for a proposed \$30.0 million project that has yet to be revealed, although it is believed the building will be redeveloped into a boutique hotel.

Despite their relatively poor performance this past quarter, the suburban submarkets have a combined vacancy rate that remains lower than the CBD's rate; at 15.2%, the suburbs enjoyed a vacancy rate that was 3.7% lower than the CBD's. The average asking rental rate for the suburbs decreased by \$0.49/SF to \$16.97/SF, still below the aforementioned CBD's \$19.37/SF.

The South's overall asking rent decreased the most of any submarket in the first quarter, by \$1.10/SF to \$16.94/SF from the prior quarter, while the Southwest's rental rate decreased by \$0.25/SF to \$13.77/SF. The Southwest's rental rate stayed the lowest in the market. The West was the only suburban submarket to experience an increase in average asking rent, by \$0.69/SF to \$15.86/SF. The largest negative shift in the Class A average asking rental rate took place in the East, where it dropped by \$1.03/SF to \$22.50/SF. The suburban submarkets' Class A average asking rental rate stayed flat at \$20.54/SF.

The East submarket's overall asking rent was once again the highest of the suburban submarkets, despite a decrease of \$0.75/SF from fourth-quarter 2019 to \$18.08/SF. Although the East's vacancy rate increased by 120 basis points to 12.5%, it was the tightest submarket in the area. The solid-performing 40,888-square-foot Class B asset located at 24200 Chagrin Boulevard in Beachwood transferred to Realife Real Estate Group for \$5.25 million, or \$128/SF. This was one of the most notable sales of the first quarter on a price-per-square-foot basis.

Also in the East, AML RightSource occupied its 43,000-square-foot lease at 23000 Millcreek Boulevard, and the Cleveland City Council approved a plan to build the city's new police headquarters in the Kinsman neighborhood along the Opportunity Corridor. This project is expected to cost nearly \$60 million and will replace the department's location in the CBD with a campus-style complex in an area that has been earmarked for major improvements and developments by way of connectivity, infrastructure and construction.

The West submarket netted 30,101 square feet of positive absorption, though the addition of inventory to the submarket prompted a 60-basis-point increase in vacancy to 16.7%. Of note in the West was the delivery of the 60,000-square foot Convergent East building. This first phase, located at 30005 Clemens, came online with a 26,000-square-foot tenant, IMCD, occupying in the first quarter.

The South submarket's Class A and Class B average rental rates both decreased, by \$0.11/SF and \$0.75/SF, respectively. The city of Brecksville unanimously passed a tax incentives and development package for the Sherwin-Williams R&D facility. The package includes provisions for tax-increment financing, a job creation grant and infrastructure assistance that could amount to more than \$100 million over 30 years.

The Southwest submarket's vacancy rate increased from the previous quarter to 22.1%, as a result of 80,185 square feet in negative net absorption and an increase in the surveyed inventory in what is the smallest submarket.

## TMUD PROJECTS A GAME-CHANGER?

Tax laws and regulations can benefit commercial real estate when they enable large, community-changing, impactful projects to come to fruition. For example, Ohio's Substitute Senate Bill 39, which has yet to become law, could kickstart several proposed megaprojects in the state. This bill would authorize an insurance premiums tax credit for capital improvements to transformational mixed-use development (TMUD) projects. Developments would need to cost at least \$50.0 million, measure at least 350,000 square feet and be at least 15 stories tall to qualify. Moreover, developers would need to prove that the tax revenues generated from the project would be worth more than the tax credit, and that the tax credit is a necessity for the project to be built. Major developments in Ohio's central business districts can cost as much as or more than in larger cities such as San Francisco or Chicago due to building costs and other factors, yet they are unable to

command the rents that projects in gateway cities can. If passed, this bill could bridge those gaps. The key word is "transformational."

By design, this law would assist the completion of mixed-use projects within 10 miles of a major city, such as Cleveland's proposed \$350.0 million nuCLEus development, which could transform the Gateway District, and the city's CBD. nuCLEus, through adding high-end residential, office (potentially 400,000 square feet of Class A space) and retail users, and thereby attracting other nearby developments that could add to the economic activity, could be one of two TMUD game-changers to commence in Cleveland as early as this summer. The other proposed project that may benefit from this legislation is the redevelopment of 925 Euclid Avenue, known as The Centennial. This project could include a high-end hotel, high-end restaurant, high-end condos, affordable apartments, a luxury auto showcase and an unknown amount of office space.

## SELECT LEASE/USER TRANSACTIONS

Tenant	Building	Submarket	Type	Square Feet
Adcom	1468 W. 9th St.	CBD	New	38,000
Eagle Family Foods	1975 E. 61st St.	CBD	New	30,000
Spaces	1468 W. 9th St.	CBD	New	27,000
HX5, LLC	3000 Aerospace Pkwy.	Southwest	New	26,892
HX5, LLC	2001 Aerospace Pkwy.	Southwest	New	20,790

## SELECT SALE TRANSACTIONS

Building	Submarket	Sale Price	Price/SF	Square Feet
24200 Chagrin Blvd.	East	\$5,253,000	\$128.47	40,888
6110 Parkland Blvd.	East	\$1,875,000	\$71.28	26,306
7200 Center St.	East	\$1,000,000	\$65.36	15,300
* 1900-1940 E. 6th St.	CBD	\$1,825,000	\$34.43	53,000
6886 Pearl Rd.	Southwest	\$510,000	\$29.88	17,068

\* Doesn't include \$1.7 million more for factors beyond the real estate

## 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>18,071,632</b>	<b>0</b>	<b>18.9%</b>	<b>111,977</b>	<b>111,977</b>	<b>\$24.84</b>	<b>\$18.14</b>	<b>\$19.37</b>
East	8,769,134	0	12.5%	(38,638)	(38,638)	\$22.50	\$16.24	\$18.08
South	7,416,807	0	16.5%	388,741	388,741	\$20.13	\$14.17	\$16.94
Southwest	1,339,605	0	22.1%	(80,185)	(80,185)	\$14.42	\$13.94	\$13.77
West	3,402,059	100,000	16.7%	30,101	30,101	\$19.31	\$14.80	\$15.86
<b>Suburban Total</b>	<b>20,927,605</b>	<b>100,000</b>	<b>15.2%</b>	<b>300,019</b>	<b>300,019</b>	<b>\$20.54</b>	<b>\$15.08</b>	<b>\$16.97</b>
<b>Market Total</b>	<b>38,999,237</b>	<b>100,000</b>	<b>16.9%</b>	<b>411,996</b>	<b>411,996</b>	<b>\$22.28</b>	<b>\$16.70</b>	<b>\$18.18</b>

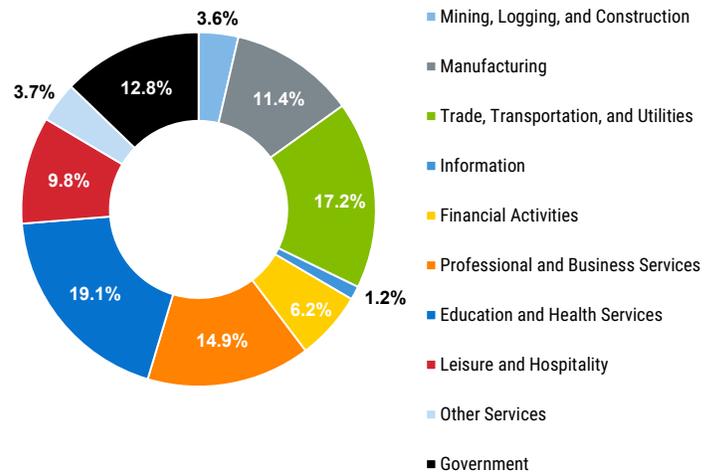
## ECONOMIC CONDITIONS

The Greater Cleveland economy added a small number of jobs early in the first quarter of 2020, as total payroll employment grew in January by 0.2% year over year. This was significantly behind the national total payroll employment growth of 1.5% for January 2020.

Strong gains were posted by the mining, logging and construction sector, which grew 8.0% from 2019, followed by the other services sector, which grew 4.1%. The leisure and hospitality and trade, transportation, and utilities sectors were up 4.0% and 1.1%, respectively, from 2019. By contrast, job growth contracted from 2019 in the information, professional and business services (negative 3.0%), manufacturing (negative 2.1%), financial activities (negative 1.9), government and education (0.9%) and health sectors (negative 0.2%).

## EMPLOYMENT BY INDUSTRY

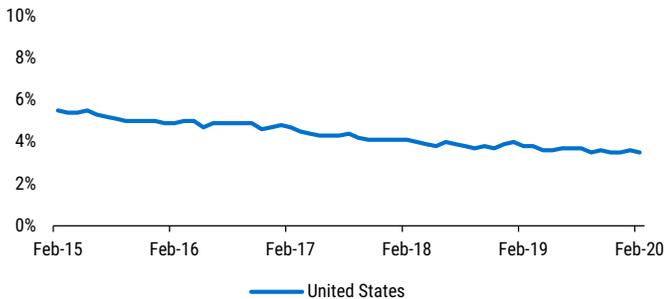
### Cleveland-Elyria-Mentor



Source: U.S. Bureau of Labor Statistics

## UNEMPLOYMENT RATE

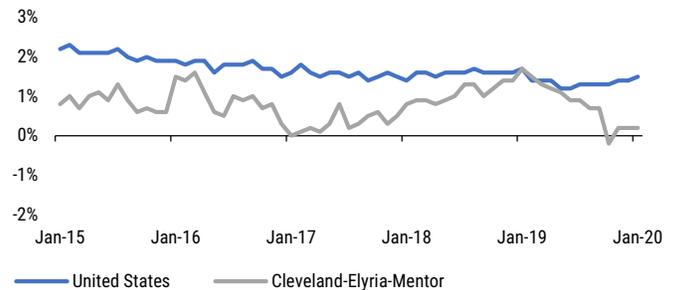
### Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

## PAYROLL EMPLOYMENT

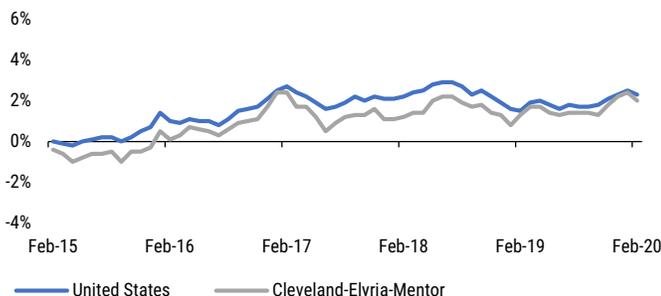
### Total Nonfarm, Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics

## CONSUMER PRICE INDEX (CPI)

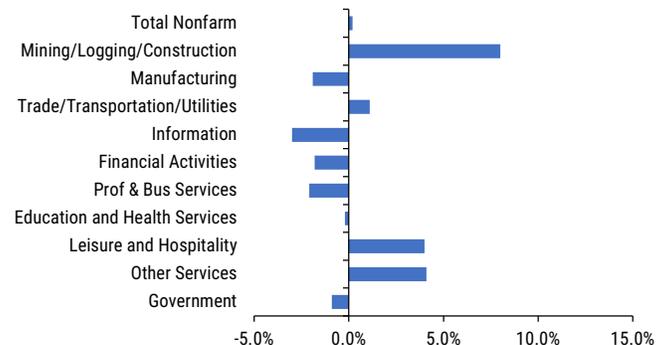
### All Items, 12-Month % Change, Not Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

## EMPLOYMENT GROWTH BY INDUSTRY

### Cleveland-Elyria-Mentor, Jan. 2020\*, 12-Month % Change, Seasonally Adjusted



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

