

CLEVELAND OFFICE MARKET

OFFICE MARKET STUTTERS; SHORT- AND LONG-TERM FUTURE CLOUDY

The Greater Cleveland office market was uninspiring during the third quarter of 2020, precipitated by a modest 36,952 square feet of negative net absorption. Total absorption remained in positive territory for the year, however, with an overall net gain of 510,937 square feet from the first three quarters of 2020.

The negative absorption increased the market's vacancy rate by 10 basis points this past quarter to 16.6% for all office properties. One reason that space came back to market was that leases that were signed in the current and prior few quarters dropped, precipitating less occupation in the third quarter. This was coupled with new spaces coming online that outweighed occupation. Overall, the market stayed flatter than expected, considering the volatility and uncertainty that has been caused by the pandemic.

However, the average asking rental rate increased by \$0.15/SF to \$18.18/SF for all classes, a result of new spaces coming to market and some landlords increasing rental rates. In fact, four out of the six office submarkets saw an average asking rental rate increase.

A silver lining for landlords was that the overall average asking rental rate stayed above \$18.00/SF for the last seven quarters. In fact, the overall Class B average asking rental rate climbed by \$0.17/SF to \$16.83/SF, while the Class A average asking rental rate of \$22.38/SF, up by \$0.02/SF from last quarter, remained above \$22.00/SF for six of the last seven quarters.

The Cleveland office market has showed signs of decline since the start of 2019, and the pandemic has accelerated this tumble, despite a fairly strong start early in the year. Fortunately, office leases are most often multi-year commitments, so despite more employees working from home, the immediate impact was softened, though will likely be a "slow drip" for many quarters to come, as a result. Despite employees slowly returning to the office this past quarter, the long-term infusion of remote work into daily business and its lasting impact remains a wild card. No commercial property type has been immune to the pandemic, though office space's employee make-up and function makes it more vulnerable from an impact perspective than others, such as industrial or self-storage.

The East submarket's vacancy rate increased by 10 basis points to 11.6% this past quarter. It was the tightest submarket in the area for the third quarter, despite giving back 6,759 square feet. Rental rates increased substantially in the East; the submarket's third-quarter average asking rental rate was \$18.65/SF, up \$0.79/SF from the previous quarter. Both Class A and Class B asking rental rates increased significantly in the East, as Class A rates stood at \$22.97/SF, up \$0.31/SF from the prior quarter, and Class B rates were at \$16.26/SF, up \$0.25/SF from the second quarter. Year-to-date, the East has accumulated 30,589 square feet.

CURRENT CONDITIONS

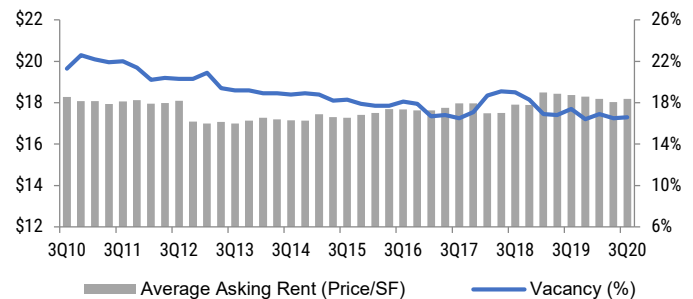
Overall vacancy increased as leases that were signed in the current and prior few quarters dropped, precipitating less occupation in the third quarter. This was coupled with new spaces coming online that outweighed occupation.

Lease signings continued to be sparse as a result of the pandemic – and there has been an increase in sublease space coming to the market.

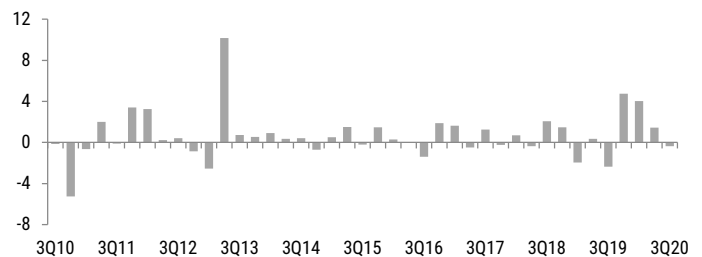
The outlook for the rest of the year remains uncertain. The increase in average asking rental rates indicates that landlords are trying to recoup losses from the pandemic-induced leasing lethargy by nudging rents up.

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	38.9 MSF	37.5 MSF	↑
Vacancy Rate	16.6%	16.5%	17.4%	↑
Quarterly Net Absorption	(36,952)	145,803	(234,318)	→
Average Asking Rent	\$18.18	\$18.03	\$18.37	→
Under Construction	100,000	100,000	60,000	↑
Deliveries	0	0	0	↑

In a quarter devoid of marquee leases and sales, the East was home to a couple notable transfers. Two modest-sized Beachwood properties were purchased by Realife Real Estate Group: the 34,710-square-foot 24400 Chagrin Boulevard, for \$3.2 million, or \$92/SF; and the 43,725-square-foot 25700 Science Park Drive, for \$3.8 million, or \$88/SF.

The suburban office submarkets saw a vacancy jump of 20 basis points from last quarter to 15.1%. The last two quarters have seen increased interest in suburban office hubs, such as Rockside Road in the South submarket, as companies are investigating relocation from Downtown or just the suburbs in general, presumably due to less density and lower rental rates. That interest has not converted to positive absorption just yet.

All suburban submarkets except the Southwest and West had vacancy increases of various degrees. The overall average asking rental rate for the suburban submarkets increased by \$0.42/SF to \$17.22/SF. Paced by a large increase this past quarter, the suburban submarket with the highest overall asking rent was the East. The South's overall asking rent was up \$0.23/SF to \$17.09/SF from the prior quarter, while the West's rent increased \$0.24/SF to \$16.29/SF. The lowest rental rate in the market once again came in the Southwest, which had a rental rate decrease of \$0.03/SF to \$13.94/SF.

The West submarket netted 14,159 square feet of positive absorption, the most of all submarkets this past quarter. This led to a 40-basis-point decrease in vacancy to 17.0%. Of note in the West was the Class B average asking rental rate decreasing by \$0.46/SF to \$14.48/SF, a drop that led all submarkets.

The South gave back the most space of any suburban submarket in the third quarter with 50,773 square feet of negative absorption, which prompted a 70-basis-point increase in vacancy to 17.4%. Through the first three quarters of 2020, the South has accrued the most space of all the suburban submarkets, with a year-to-date total of 318,425 square feet of positive absorption. One statistical silver lining for the South this past quarter was increases in the average asking rental rates of both Class A and B office assets in that submarket.

The Southwest submarket's average asking rental rate decrease came, despite 3,457 square feet of positive net absorption. The vacancy rate in the Southwest decreased 30 basis points to 20.9%, and the submarket continued to post the highest vacancy rate and the lowest average asking rental rate of the suburban office submarkets. It is also the only submarket that has negative net absorption year-to-date.

CBD SUBMARKET STUNTED BY THE PANDEMIC

The Central Business District accrued a modest 2,963 square feet of net absorption for the third quarter, bringing the total space gained so far this year to 205,956 square feet for the submarket. This caused the CBD's vacancy rate to stay flat at 18.4%, the second highest in the market. Despite the small amount of positive absorption, the overall asking rent in the CBD decreased by \$0.05/SF to \$19.13/SF, the highest rate for all submarkets. Though not included in this report, this overall decrease was caused by a sharp drop in the Class C average asking

rent, by 0.34/SF from the second quarter to \$14.31/SF. Conversely, Class A (\$25.18/SF) and Class B (\$18.18/SF) asking rents in the CBD shot up, by \$0.26/SF and \$0.10/SF, respectively.

The Cleveland CBD is still considered a desirable location for prominent local, regional and national companies, though it is estimated that Downtown Cleveland has seen an 80.0% reduction of office workers during the pandemic. Office trends, such as unassigned seating, coworking and large "bullpens" of worker cubes, have companies rethinking safe reoccupation strategies, and leasing activity in the CBD from April through September was as sluggish as it has ever been. This past quarter's statistics already bear out that it might become more expensive to lease space in the future, especially at the Class A and B levels. As office employees will want to work from home more often, companies might consider lease more space per person to keep germs from spreading. The outlook for the rest of 2020 is uncertain.

One significant development to come out of the CBD in the third quarter was the pending sale of the Rockefeller Building, located at 614 West Superior Avenue. Despite the transfer not appearing in the Cuyahoga County auditor records by the end of the quarter, several reports indicated a \$13.35-million deal for the 256,000-square-foot office building, or \$52/SF, to a partnership of Realty Dynamics Equity Partners, LLC and Wolfe Investments, LLC. The new owners plan to convert a majority of the office building to apartments, while retaining some office space and retail on the lower floors.

Also in the CBD, Sherwin-Williams crept back into the headlines in the third quarter, as the company formally announced that it still plans to build a roughly 1-million-square-foot headquarters complex that straddles the Public Square and Historic Warehouse Districts, though the anticipated opening has been delayed until 2024. The announcement came concurrently as the company identified the key external partners it has selected to build both its new global headquarters in Downtown Cleveland and its new R&D center in the Cleveland suburb of Brecksville, located in the South submarket.

The 740,000-square-foot Tower at Erieview in the CBD also made news, as the skyscraper located at 1301 East 9th Street was awarded a \$5.0-million state tax credit in August. The tax credit will be used toward an approximate \$80.0-million mixed-use redevelopment initiative for the 40-story building. Plans call for converting 20 floors of the largely empty property into 200-plus apartments and 200-plus hotel rooms, with 320,000 square feet of office space remaining. The Tower at Erieview is a key office building in the city's Erieview District, which the Ohio Historic Site Preservation Advisory Board recommended be added to the National Register of Historic Places this past quarter. If that designation comes to fruition, all properties within the 65-acre district could be eligible for federal and state historic preservation tax credits to supplement major conversions, renovations or redevelopment projects.

Finally in the CBD, new information came out about the long-awaited redevelopment of 925 Euclid Avenue, now known as the Centennial. Owner Millennia Companies scrapped plans to remake the property into a hotel, luxury apartments and office space in lieu of workforce housing.

SUBLEASE LISTINGS TREND UPWARD

COVID-19 has continued to force both building owners and occupiers to examine space needs. After a tumultuous first and second quarter this year, sublease space in Cleveland has followed a growth trend in the office market. As the end of the third quarter approached, Cleveland's sublease market grew month by month. In fact, 60,799 and 52,825 square feet of sublease space came online in July and August, respectively. Although the second quarter also saw a marked uptick in sublease space, the third quarter's tallies exceeded it even before all of September's numbers could be factored in. Overall sublease availability stood at 360,582 square feet as the third quarter ended.

Some of the most notable Cleveland subleases that have been marketed since March 2020 include Downtown buildings such as 1300 East 9th

Street, 1111 Superior and 800 Superior, all of which have spaces greater than 20,000 square feet available. Suburban locations such as Solon's 6675 Parkland in the East submarket also had big blocks of sublease space available. Coming to market in mid-September was the largest available sublease, the 57,419-square-foot Aleris/Novelis headquarters at Beachwood's 25825 Science Park Drive, also in the East. This came as a result of the company announcing it is closing this location, though a date wasn't reported.

Only a total of 19,444 square feet of office sublease space that was already on the market has been absorbed this year. A deeper look into the status of the pre-existing market is warranted, but the initial takeaway is clear: this emerging sublease market is not being countered by the existing one diminishing. This growth is substantial and significant, and the conversions have been slow.

SELECT LEASE/USER TRANSACTIONS

Tenant	Building	Submarket	Type	Square Feet
Insight Behavioral	842 Corporate Way	West	New	5,327
CityView Baptist Church	1701 E. 13th St.	CBD	New	5,000
Citymark Capital, LLC	1375 E. 9th St.	CBD	Extension	3,570
Step by Step	2012 W. 25th St.	CBD	Sublease	2,500
Benter's Insurance	6325 York Rd.	Southwest	New	2,300

SELECT SALE TRANSACTIONS

Building	Submarket	Sale Price	Price/SF	Square Feet
29055 Clemens Rd.	West	\$1,700,000	\$113.83	14,934
24400 Chagrin Blvd.	East	\$3,208,997	\$92.45	34,710
25700 Science Park Dr.	East	\$3,834,003	\$87.68	43,725
40 Tarbell Ave.	East	\$337,500	\$59.73	5,650
7350 Palisades Pkwy.	East	\$725,000	\$27.88	26,000

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	18,071,632	0	18.4%	2,963	205,956	\$25.18	\$18.18	\$19.13
East	8,769,134	0	11.6%	(6,758)	30,589	\$22.97	\$16.26	\$18.65
South	7,416,807	0	17.4%	(50,773)	318,425	\$20.20	\$14.84	\$17.09
Southwest	1,339,605	0	20.9%	3,457	(63,698)	\$14.43	\$14.19	\$13.94
West	3,402,059	100,000	17.0%	14,159	19,665	\$19.55	\$14.48	\$16.29
Suburban Total	20,927,605	100,000	15.1%	(39,915)	304,981	\$20.80	\$15.23	\$17.22
Market Total	38,999,237	100,000	16.6%	(36,952)	510,937	\$22.38	\$16.83	\$18.18

ECONOMIC CONDITIONS

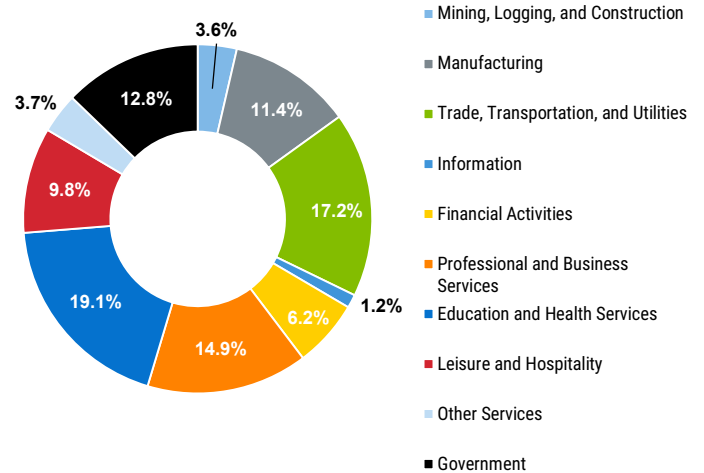
The Greater Cleveland economy lost more jobs in August 2020, as preliminary total nonfarm payroll employment contracted by 11.0% year-over-year. By contrast, the United States contracted by 7.0% year-over-year. The August numbers were an improvement from July, which saw Greater Cleveland payroll employment dip by 11.6% year-over-year and the United States as a whole fall by 7.7% year-over-year. The nation's unemployment rate stood at 8.4% in August, down from 10.2% in July.

Only one industry sector saw employment growth from August 2019 to August 2020: mining, logging and construction, at positive 1.0%.

All other sectors saw a drop in the past year due to the implications of COVID-19. The leisure and hospitality industry contracted the most, by negative 28.8%, followed by professional and business services at negative 15.0%, government at negative 11.7%, education and health services at negative 10%, the information sector at negative 9.7%, trade/transportation/utilities at negative 6.9%, financial activities at negative 6.5%, manufacturing at negative 5.7% and other services at negative 3.0%.

EMPLOYMENT BY INDUSTRY

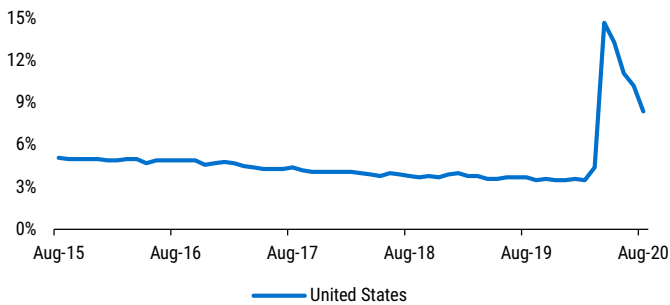
Cleveland-Elyria-Mentor



Source: U.S. Bureau of Labor Statistics

UNEMPLOYMENT RATE

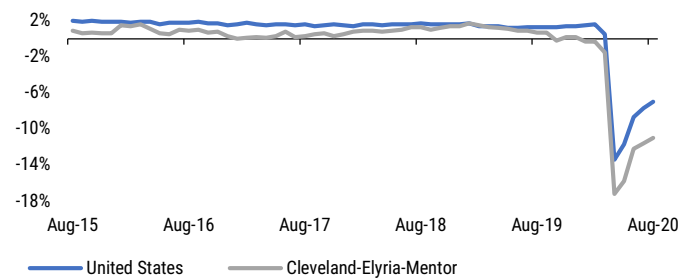
Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

PAYROLL EMPLOYMENT

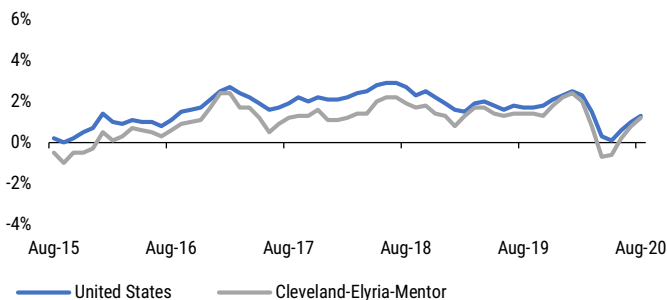
Total Nonfarm, Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics

CONSUMER PRICE INDEX (CPI)

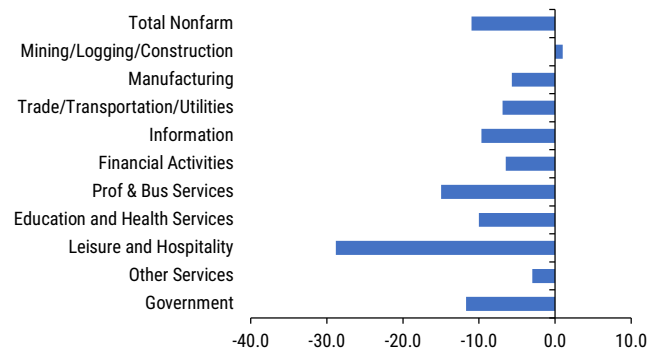
All Items, 12-Month % Change, Not Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

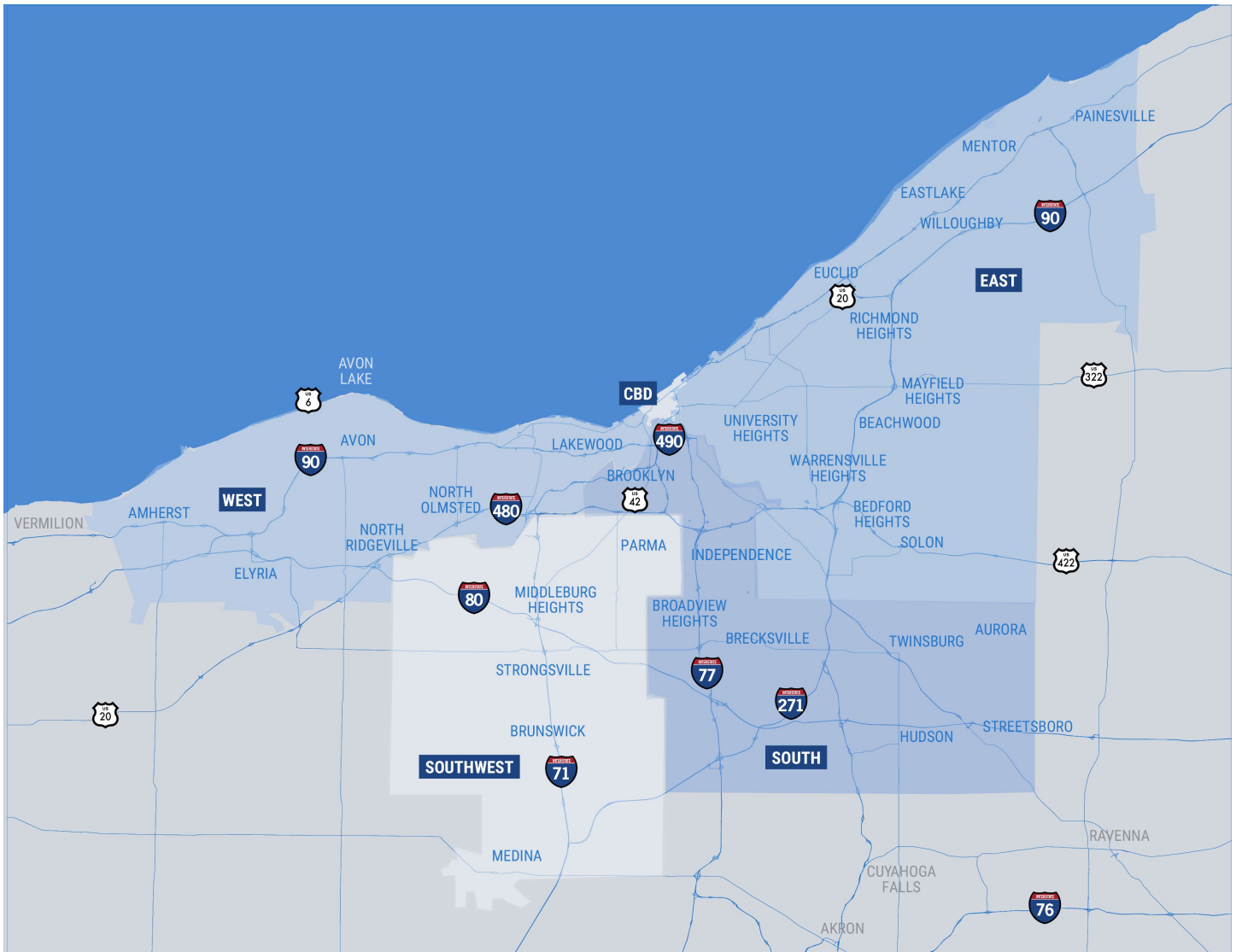
EMPLOYMENT GROWTH BY INDUSTRY

Cleveland-Elyria-Mentor, August 2020*, 12-Month % Change, Seasonally Adjusted



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

CLEVELAND OFFICE SUBMARKETS



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