IPA Institutional Property Advisors

A Division of Marcus & Millichap

Institutional Property Advisors 2016 Office & Industrial Market Outlook

Solid Growth Prospects on the Horizon For U.S. Office Sector in Year Ahead

Office properties were late to reap the benefits of the economic recovery, but last year's steady improvement in performance provides momentum into 2016. Growing payrolls pushed more tenants into bigger spaces in 2015 and helped lower the U.S. vacancy rate. Tightening availability balanced negotiating power last year, blunting the edge previously wielded by tenants in lease discussions and supporting more vigorous rent growth. Last year's modest drop in the vacancy rate, however, likely reflects the continuing reduction of the workspace per employee ratio. Since the pre-recession peak, a 5 percent rise in office-using jobs has translated into only a 4.3 percent bump in occupied space. New office construction has lagged throughout the recovery and may not be sufficient to alleviate tenant demand for modern amenities. Many office users took advantage of lower rents early in the recovery to relocate to buildings with the features and amenities they desire, but they now face constricting availability in suitable properties.

- **Vacancy Tightens, Rents to Grow:** Additions to office-using payrolls will push more tenants to the limits of their existing layouts, sparking additional needs for larger spaces. During the year, tenant expansions and new business formation will drive net absorption of nearly 90 million square feet and trim the national vacancy rate 30 basis points to 14.6 percent. Projected rent growth of 3.9 percent is on par with last year.
- **New Space Deliveries at a Faster Trickle:** Developers have lined up 79 million square feet for completion in 2016, marking an increase from last year. This year's total is concentrated in 10 markets, led by 8 million square feet in Houston and 6.4 million square feet in San Jose. Traditional debt financing for construction remains challenging, helping to maintain construction well below the years preceding the recession.
- **Tug of War Between Urban, Suburban Locations:** The concentration of apartment development in urban cores provides office employers with a large source of potential workers. The growing appeal of live-work-play will influence site selection and relocation decisions, potentially elevating the performance of urban office assets. Suburban locations are strengthening and could gain momentum as maturing millennials move to the suburbs to buy homes and start families.

Sector's Upswing Lifts Investor Sentiment, Driving Sales Activity

The industrial property sector continues to record vigorous growth as the U.S. economy expands. Nationwide, intensifying space demand drove vacancy to its lowest level in 15 years during 2015, supporting an outsized 6 percent increase in the average rent. Completions increased and primarily consisted of properties that were significantly pre-leased, minimizing the impact on the vacancy rate. The sector's lengthy upswing throughout the current economic cycle will likely spur additional speculative construction in the near-term. Demand for warehouse space will continue to grow as the retail industry evolves. Growing Internet sales have encouraged many retailers to adapt an omni-channel approach, combining existing physical locations and an online capability that will require higher locally warehoused inventories and order fulfillment centers near major population centers. Multi-line retailers with a predominantly digital presence, including Amazon, also continue to expand and will remain a leading source of new demand for warehouse space.

- **Strong Dollar Lifts Industrial Demand:** The strong U.S. dollar continues to lower the price of imported products, raising the amount of good entering U.S. ports, though it has also eased exports. Imported goods generally stoke greater space demand than exports as shipments are unloaded at an entry point and subsequently redistributed to locations throughout the country.
- **Industrial Demand Emerging From New Channels:** Secondary sources of space demand are also helping drive the performance of industrial properties. Medical testing labs continue to expand into flex buildings as more consumers gain employer-sponsored healthcare coverage. In addition, resurgent homebuilding continues to lift the outlook for multi-bay properties as building contractors and expand.
- **Market Liquidity Spreads Beyond the Core:** Transactions continue to escalate as additional capital channels to the industrial sector. Equity and debt flows are supporting elevated transaction volume and also pushed the average price last year to a multi-year high and compressed the average cap rate to the mid-7 percent range. The search for yield is also narrowing the cap rate spread between primary, secondary and tertiary markets.

2016* U.S. Outlook

OFFICE		INDUSTRIAL
79 Million Sq. Ft. will be completed	Construction:	150 Million Sq. Ft. will be completed
30 basis point decrease in vacancy	Vacancy:	50 basis point decrease in vacancy
3.9% increase in effective rents	Rents:	6.2% increase in effective rents

* Forecast

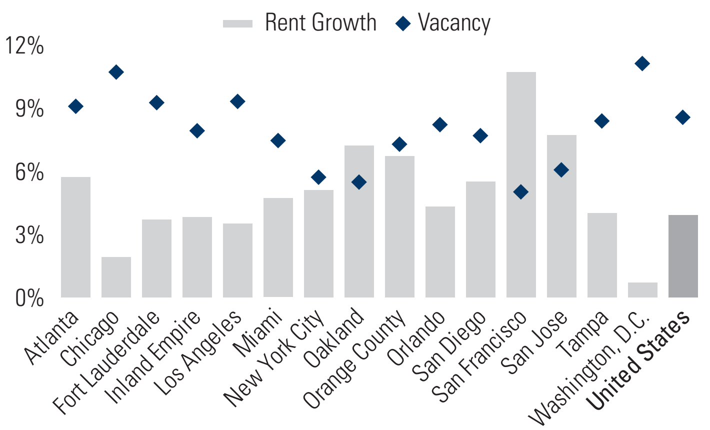
Office Market Summary

	2016 Inventory*	2016 Completions*	2016 Completions % of Inventory*	2016 Vacancy*	2016 Absorption*	2016 Asking Rent*	Y-O-Y Rent Growth*
Atlanta	259,147,345	1,455,000	0.6%	15.6%	3,704,986	$22.67	5.7%
Chicago	431,977,972	2,000,000	0.5%	18.4%	2,077,839	$24.01	1.9%
Fort Lauderdale	60,107,454	500,000	0.8%	16.2%	868,131	$25.57	3.7%
Inland Empire	55,873,223	180,000	0.3%	13.6%	707,929	$21.20	3.8%
Los Angeles	347,609,652	2,500,000	0.7%	15.6%	1,946,674	$34.39	3.5%
Miami	95,919,578	600,000	0.6%	12.8%	1,213,419	$31.75	4.7%
New York City	631,436,647	3,600,000	0.6%	9.8%	4,081,397	$62.16	5.1%
Oakland	95,511,813	225,000	0.2%	9.9%	1,608,650	$30.63	7.2%
Orange County	139,409,528	425,000	0.3%	12.5%	2,020,226	$29.11	6.7%
Orlando	71,790,107	270,000	0.4%	14.1%	918,013	$20.89	4.3%
San Diego	101,838,323	175,000	0.2%	13.2%	1,462,566	$30.41	5.5%
San Francisco	167,889,329	2,900,000	1.8%	8.6%	4,182,323	$60.53	10.7%
San Jose	107,547,037	6,400,000	6.3%	8.1%	6,611,568	$43.18	7.7%
Tampa	105,578,157	300,000	0.3%	14.2%	1,092,594	$21.27	4.0%
Washington, D.C.	456,929,056	3,500,000	0.8%	19.8%	923,244	$36.24	0.7%
United States	**7,506,149,030**	**79,000,000**	**1.1%**	**14.8%**	**86,598,238**	**$29.48**	**3.9%**

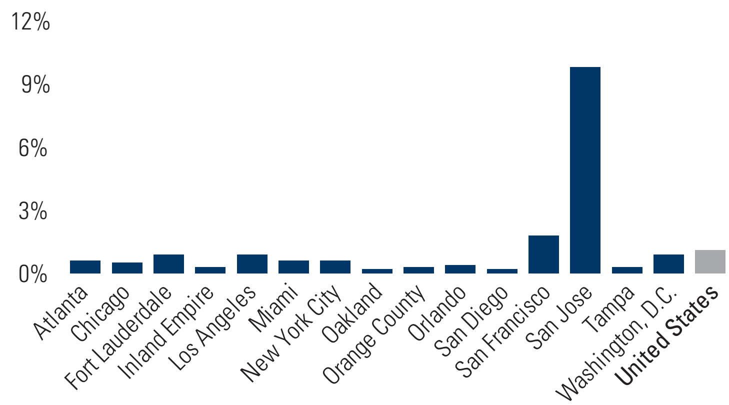
Industrial Market Summary

	2016 Inventory*	2016 Completions*	2016 Completions % of Inventory*	2016 Vacancy*	2016 Absorption*	2016 Asking Rent*	Y-O-Y Rent Growth*
Atlanta	604,897,283	14,500,000	2.5%	7.0%	16,364,819	$3.98	5.9%
Chicago	959,747,604	9,500,000	1.0%	6.7%	15,785,953	$5.62	7.3%
Fort Lauderdale	95,583,567	800,000	0.8%	6.4%	1,128,537	$7.94	6.6%
Inland Empire	510,093,868	17,200,000	3.5%	5.3%	15,611,139	$5.70	6.3%
Los Angeles	772,927,689	3,700,000	0.5%	1.9%	5,565,538	$9.30	7.0%
Miami	186,750,780	550,000	0.3%	4.6%	1,113,450	$9.27	7.4%
Oakland	233,771,682	2,400,000	1.0%	4.8%	3,455,919	$11.25	9.4%
Orange County	244,379,262	570,000	0.2%	2.4%	1,310,910	$9.00	4.3%
Orlando	119,933,498	650,000	0.5%	6.8%	1,486,540	$5.65	10.8%
San Diego	155,351,571	1,600,000	1.1%	5.1%	2,047,659	$12.05	4.9%
San Francisco	58,599,917	408,000	0.7%	3.7%	379,360	$18.00	15.8%
San Jose	157,779,405	800,000	0.5%	7.0%	1,207,244	$24.25	14.0%
Tampa	160,692,449	1,800,000	1.1%	6.4%	2,439,039	$5.23	4.6%
Washington, D.C.	169,755,822	3,500,000	2.1%	7.9%	4,086,570	$7.73	0.9%
United States	**12,989,306,180**	**150,000,000**	**1.2%**	**6.0%**	**202,818,301**	**$6.35**	**6.2%**

2016* Office Vacancy Rate/Rent Growth



2016* Office Change in Inventory

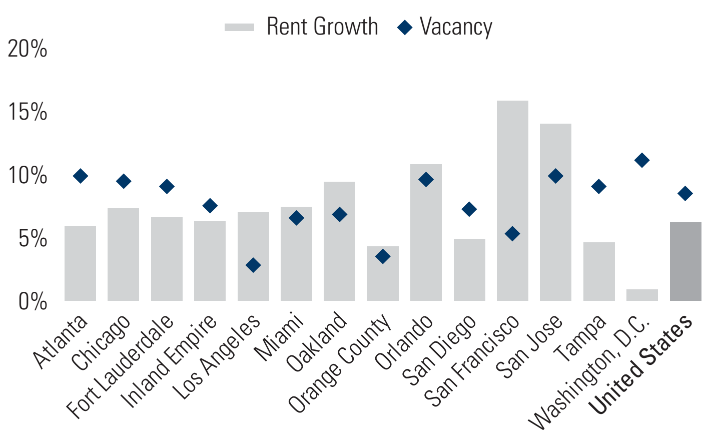


* Forecast ** Includes sales $1 million and greater through 2015 estimate for average prices and cap rates; trailing 12 months total through 3Q 2015 for transactions and dollar volume

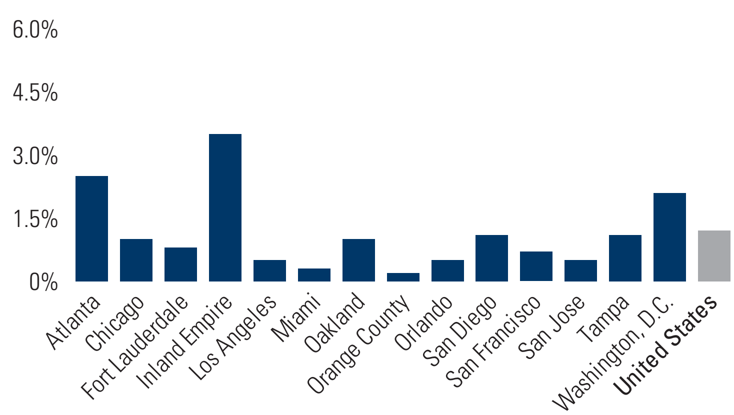
Average Price/ Sq. Ft.**	Change From Prior Peak	Average Cap Rate**	Transaction Activity**	Dollar Volume**	2016 Employment Growth (Abs.)*	2016 Employment Growth (%)*	
$157	-22.0%	7.2%	197	$4,280,951,960	84,000	3.2%	Atlanta
$148	-14.5%	7.1%	277	$8,830,482,471	54,000	1.2%	Chicago
$165	-27.8%	7.1%	116	$1,115,315,385	21,000	2.6%	Fort Lauderdale
$190	-26.0%	7.7%	101	$548,856,106	52,000	3.8%	Inland Empire
$357	4.2%	6.3%	442	$6,179,419,486	65,000	1.5%	Los Angeles
$275	-6.1%	8.0%	148	$1,745,504,272	23,700	2.1%	Miami
$592	10.6%	4.8%	278	$26,922,914,268	90,000	2.1%	New York City
$233	-15.1%	6.7%	112	$1,395,097,216	27,600	2.5%	Oakland
$259	-14.2%	5.9%	202	$2,596,104,028	45,200	2.9%	Orange County
$162	-27.8%	7.2%	79	$733,474,104	36,000	3.1%	Orlando
$281	-11.6%	6.2%	203	$3,054,133,941	39,000	2.8%	San Diego
$476	9.6%	5.6%	152	$7,212,401,327	42,000	3.9%	San Francisco
$432	24.3%	5.3%	179	$6,545,023,811	48,000	4.5%	San Jose
$180	-26.8%	7.6%	123	$1,610,121,127	42,000	3.3%	Tampa
$334	-6.8%	6.0%	215	$8,239,241,738	65,000	2.0%	Washington, D.C.
$223	**-4.7%**	**7.3%**	**8,985**	**$143,266,869,918**	**2,500,000**	**1.7%**	**United States**

Average Price/ Sq. Ft.**	Change From Prior Peak	Average Cap Rate**	Transaction Activity**	Dollar Volume**	2016 Employment Growth (Abs.)*	2016 Employment Growth (%)*	
$54	-27.0%	7.7%	260	$1,333,177,680	84,000	3.2%	Atlanta
$72	-10.5%	7.8%	523	$2,589,973,458	54,000	1.2%	Chicago
$107	-17.1%	7.0%	119	$562,618,902	21,000	2.6%	Fort Lauderdale
$111	-15.2%	5.7%	252	$1,812,257,084	52,000	3.8%	Inland Empire
$177	-1.2%	5.4%	811	$4,825,204,260	65,000	1.5%	Los Angeles
$129	0.2%	7.0%	225	$1,120,755,887	23,700	2.1%	Miami
$152	-4.0%	5.8%	217	$1,557,480,395	27,600	2.5%	Oakland
$190	-8.6%	5.2%	296	$1,731,636,924	45,200	2.9%	Orange County
$76	-25.1%	6.7%	64	$290,600,665	36,000	3.1%	Orlando
$154	-22.8%	6.5%	195	$1,410,059,645	39,000	2.8%	San Diego
$316	38.0%	4.4%	144	$1,300,433,884	42,000	3.9%	San Francisco
$247	36.6%	5.8%	289	$3,158,308,644	48,000	4.5%	San Jose
$66	-36.2%	8.2%	93	$500,849,909	42,000	3.3%	Tampa
$135	-17.1%	6.9%	105	$1,078,831,729	65,000	2.0%	Washington, D.C.
$73	**4.3%**	**7.4%**	**11,658**	**$65,494,394,095**	**2,500,000**	**1.7%**	**United States**

2016* Industrial Vacancy Rate/Rent Growth



2016* Industrial Change in Inventory

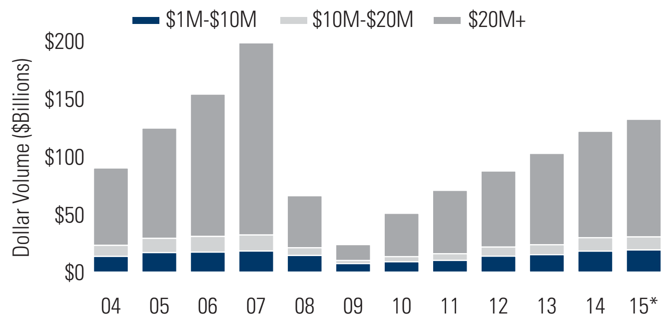


Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; Real Capital Analytics; BLS

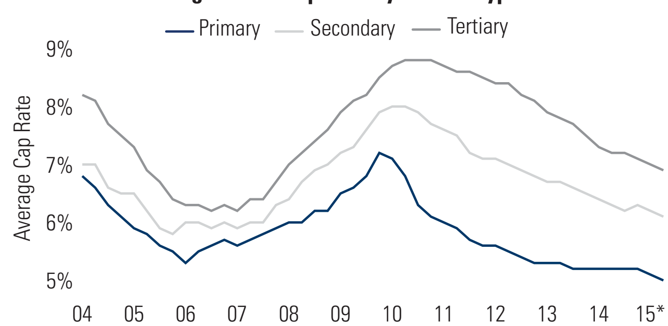
2016 Office Investment Index

MSA Name	Rank 2016	Rank 2015	15-16 Change
San Francisco	1	1	0
San Jose	2	2	0
New York City	3	4	1
Seattle-Tacoma	4	3	-1
Miami-Dade	5	7	2
Austin	6	11	5
Orange County	7	5	-2
Nashville	8	9	1
Denver	9	6	-3
Portland	10	10	0
San Diego	11	8	-3
Boston	12	12	0
Oakland	13	17	4
Salt Lake City	14	13	-1
Charlotte	15	18	3
Minneapolis-St. Paul	16	16	0
Dallas/Fort Worth	17	20	3
Los Angeles	18	14	-4
Atlanta	19	19	0
Tampa-St. Petersburg	20	24	4
Chicago	21	22	1
Washington, D.C.	22	26	4
Houston	23	15	-8
San Antonio	24	23	-1
Phoenix	25	21	-4
Philadelphia	26	25	-1
Riverside-S.B.	27	31	4
Orlando	28	34	6
West Palm Beach	29	28	-1
Columbus	30	27	-3
Indianapolis	31	30	-1
Pittsburgh	32	33	1
Kansas City	33	29	-4
Fort Lauderdale	34	35	1
Louisville	35	32	-3
Baltimore	36	37	1
Las Vegas	37	39	2
Sacramento	38	42	4
Jacksonville	39	38	-1
St. Louis	40	36	-4
Cleveland	41	40	-1
Cincinnati	42	43	1
New Haven-Fairfield County	43	45	2
Detroit	44	46	2
Milwaukee	45	44	-1
Northern New Jersey	46	41	-5

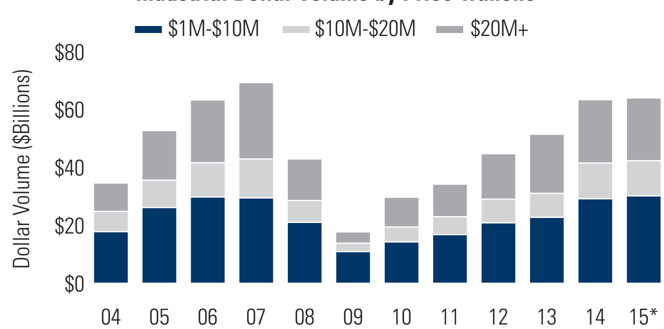
Office Dollar Volume by Price Tranche



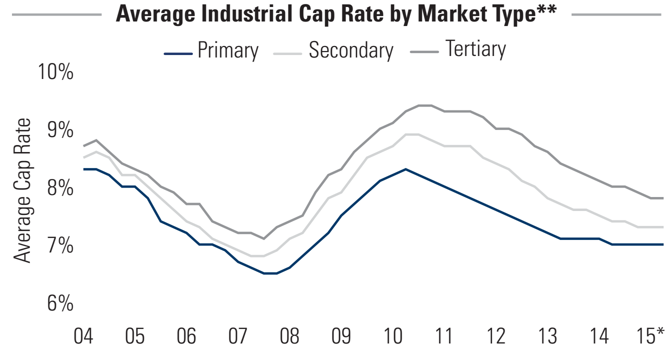
Average Office Cap Rate by Market Type**



Industrial Dollar Volume by Price Tranche



Average Industrial Cap Rate by Market Type**



* Preliminary estimate ** Properties $1M+
Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; Real Capital Analytics