CBRE

Richmond

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MARKETVIEW

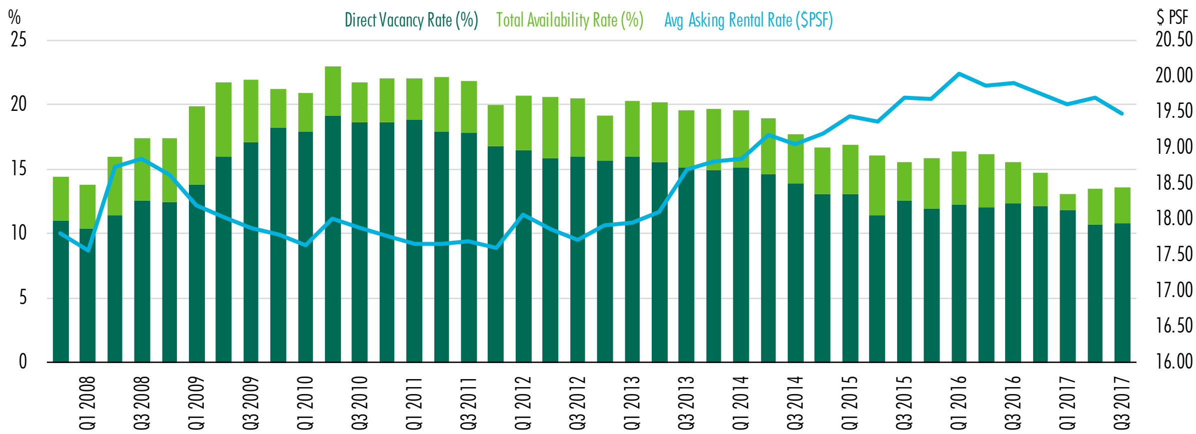
Richmond Office, Q3 2017

Tailwinds give way as user demand slips

Vacancy Rate	Asking Rate	Net Absorption	Construction	Deliveries
10.8%	$19.48 PSF FS	25,776 SF	337,218 SF	15,664 SF

*Arrows indicate change from prior quarter.

Figure 1: Historical Office Vacancy, Availability and Asking Rent Trends



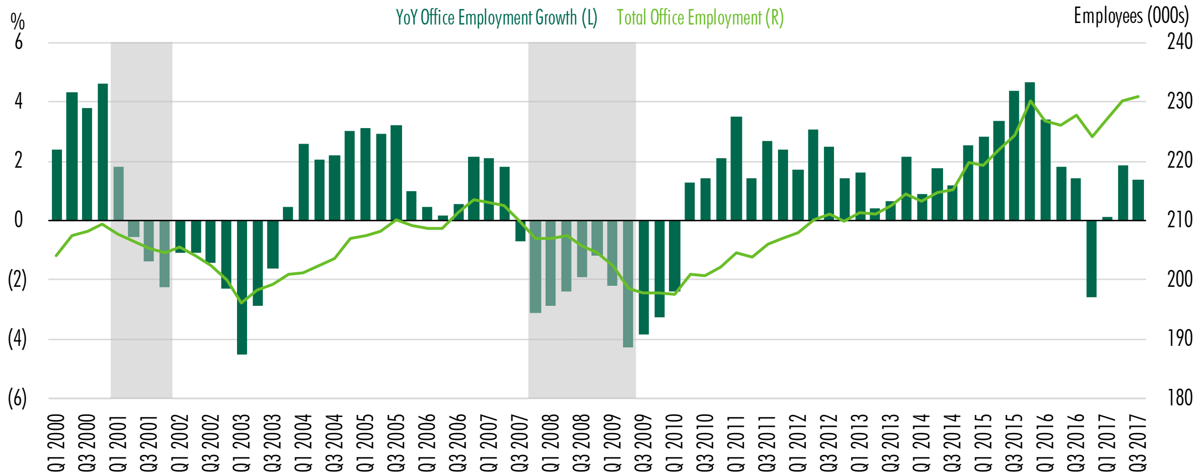
Source: CBRE Research, Q3 2017.

- After a decade-high 405,244 sq. ft. net absorption in Q2 2017, a quiet market in Q3 signaled that the tailwinds have subsided. The quarter closed at 25,776 sq. ft. net absorption.
- Richmond continued to see a modest rebound in office-using jobs at 1.4% growth over the year, and we expect to see an acceleration as the influx of firms new to the market begin hiring.
- Despite user demand falling 37.0% over the year to a 5-year low, a rebound in Office-using employment is expected to drive up future demand.
- Looming vacancies are expected to further offset recent economic development gains, as SunTrust downsizes in the CBD and Capital One relocates out of East Shore and back onto their campus.
- As re-urbanization accelerates, the CBD continued to benefit as the only Richmond market not to experience an increase in its vacancy rate over the quarter, remaining 13.2% vacant.
- Medical Office Buildings continued to be the market's primary development activity.

Following a modest decline in user demand, Richmond's Office market had a relatively quiet Q3 2017. Richmond's vacancy rate increased slightly in Q3 2017 to 10.8% following a lackluster 25,766 sq. ft. of quarterly net absorption. While this is a significant decline in net absorption from the record setting 405,244 sq. ft. that the market posted in Q2 2017, Richmond's 12-Month net absorption rose 21.0% over the quarter to 691,182 sq. ft. in Q3 2017. The lull in that the Office market experienced in Q3 2017 was anticipated following poor office-using job growth late in 2016. With the recovery in office employment this quarter, user demand will likely begin to expand in the coming quarters.

Reduced market activity saw Richmond's average asking rent fall 1.1% over the quarter to $19.48 per sq. ft. Notwithstanding the softening market conditions, Highwoods Properties (NYSE:HIW) proved to be the exception as they continued to push their rental rates higher.

Figure 2: Richmond Office Using Employment Total & Growth Year over Year



Source: St. Louis Federal Reserve Bank Q3 2017. Seasonally Adjusted Employment- Business Services, FIRE, Information, Federal & State Government

DEMAND DRIVERS

EMPLOYMENT TRENDS

Richmond's overall employment growth accelerated in Q3 2017, expanding by 2.2% (14,400 net jobs) over the year. Much of this growth can be attributed to the wave of new firms that entered the market over the past year picking up the pace of hiring. Over the quarter, Richmond added 5,300 net jobs, increasing total employment to 682,400 which held Richmond's unemployment rate steady at 3.8%, 60 basis points (bps) below the nation's unemployment rate.

Following the 2.6% contraction in Office-using employment at the end of 2016, Richmond's Office-using employment continued its rebound in Q3 2017, adding 400 net jobs over the quarter for a total of 230,800, an expansion 1.4% over the year.

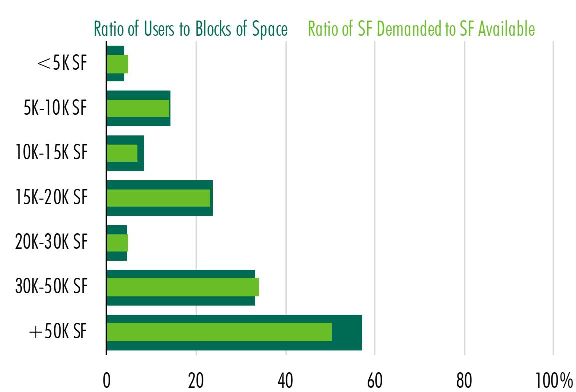
Richmond's Business Services sector outpaced the other Office-using industries, expanding by 2.0% (2,200 net jobs) over the year in Q3 2017. It was followed by the Financial Services sector, which added 800 net jobs (1.6%) since Q3 2016. As expected the Information sector shrunk over the year, shedding 5.3% of its workforce (400 net jobs), following the purchase of Media General by Nextstar Media Group and subsequent closure of its Richmond headquarters'.

TENANT DEMAND

Office tenant demand fell 37.0% over the year to a 5-year low of 732,000 sq. ft. The number of tenant requirements contracted by a similar rate of 35.7% over the year to 45 tenant requirements in the market at the end of Q3 2017.

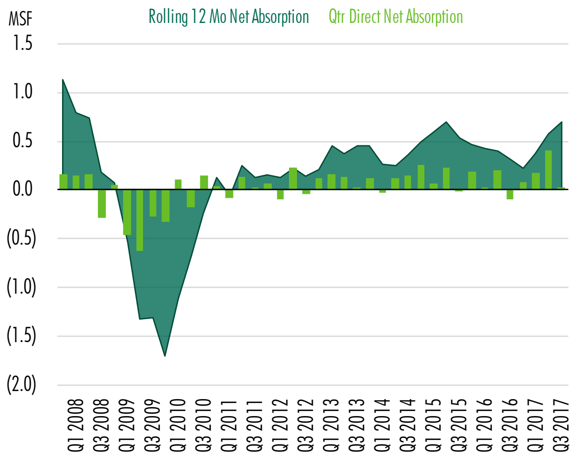
Richmond saw the largest dip in demand for requirements between 10,000-24,999 sq. ft., where demand declined 61.2%. Tenants have continued to migrate to Richmond's CBD, with Thompson Reuters as the latest example relocating from the Boulders to Riverfront Plaza. Despite the trend, however, CBD demand weakened slightly over the quarter due to several factors. The most significant being the fact that diminishing CBD supply is returning negotiating leverage to CBD landlords. Nonetheless, we expect to continue to see a modest gravitation towards Richmond's urban core as the re-urbanization trend permeates into the surrounding urban areas such as Scott's Addition.

Figure 3: Ratio of Demand to available Supply by Size Range



Source: CBRE Research, Q3 2017.

Figure 4: Quarterly & Rolling 12 Month Net Absorption



Source: CBRE Research, Q3 2017.

While Richmond's user demand slipped in Q3 2017, the modest growth in Office-using employment will likely result in an uptick in future demand.

NET ABSORPTION

After posting a decade-high of 405,244 sq. ft. of net absorption in Q2 2017, Richmond's office market closed Q3 2017 at a much milder 25,766 sq. ft. Innsbrook saw the suburban market's most significant decrease in net absorption in Q3 2017, closing the quarter with 46,129 sq. ft. of negative net absorption. This was primarily driven by the 61,778 sq. ft. of negative Class A net absorption for the otherwise prodigious submarket following a few large sizable within Highwoods' Innsbrook portfolio.

In a quarter of muted net absorption across Richmond's submarkets, Glenside topped the market with 59,018 sq. ft. of net absorption in Q3 2017. Glenside also saw the steepest decline in its availability rate, contracting 156 bps over the quarter to 9.4%, following strong leasing in Brookfield Commons in addition to the Paragon buildings.

Despite the slow quarter, Richmond's 12-month net absorption rose to 691,182 sq. ft. in Q3 2017. Richmond faces several large vacancies that will hit the market later this year such as SunTrust's plan to downsize within its CBD tower and Capital One's 65,000 sq. ft. relocation out of East Shore onto their campus. These expected vacancies are foreseen to offset some of the gains from the recent economic development wave.

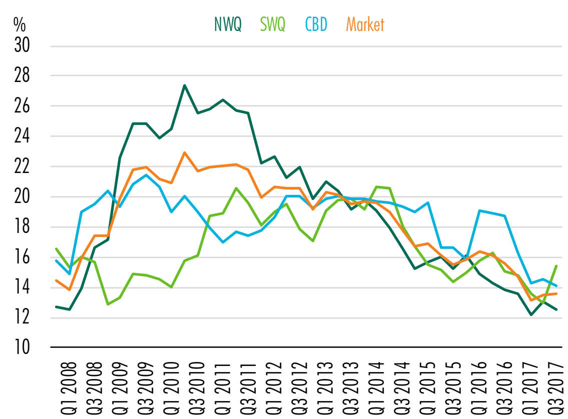
DIRECT VACANCY & TOTAL AVAILABILITY RATES

Reduced net absorption over Q3 2017 left both Richmond's vacancy and availability rates effectively unchanged over the quarter at 10.8% and 13.5%, respectively. It is important to note that while the market posted positive net absorption in Q3 2017, Altria's 250,000 sq. ft. headquarters building was dropped from the market set following their purchase of the building from the University of Richmond, as it is now owner-occupied. Resulting from minimal net absorption in addition to the removal of the Altria building from the market set, Richmond saw a slight uptick in vacancy (5 bps) and availability (4 bps) rates over the quarter.

The Northwest Quadrant saw a notable disconnect between positive net absorption and increasing vacancy rate, where 31,233 net sq. ft. was absorbed yet vacancy increased 5 bps to 9.5%. Despite the slight softening of its direct vacancy rate, the total availability rate tightened 52 bps over the quarter to 12.5%. The Southwest Quadrant trailed the market following a 17 bps rise in its vacancy rate in Q3 2017 to 9.8% and a 245 bps spike in its availability rate over the quarter to 15.4%. Overall, Richmond's suburban availability rate climbed 27 bps in Q3 2017 to 13.3%.

The CBD continued to benefit from the accelerating re-urbanization trend and was the only Richmond market not to experience an increase in

Figure 5: Total Availability Rate by Quadrant



Source: CBRE Research, Q3 2017.

Figure 6: Richmond Office Metrics

Submarket	Rentable Market Area (SF)	Direct Vacant (SF)	Vacancy Rate (%)	Availability Rate (%)	Average Asking Lease Rate[1] ($/SF/Yr)	QTR Net Absorption (SF)	YTD Net Absorption (SF)	Under Construction (SF)
Northwest Quadrant								
Ashland/ I-95	265,136	15,515	5.9	10.5	15.26	-	12,219	-
Glenside/ I-64	4,609,871	367,156	8.0	9.4	17.89	59,018	121,316	46,461
Innsbrook	6,176,309	587,844	9.5	13.3	20.73	(46,129)	151,521	90,000
Near West End	1,085,322	113,970	10.5	16.4	18.18	29,708	143,839	15,312
Parham Road Area	2,354,242	293,441	12.5	15.0	15.64	(11,364)	18,701	-
Northwest Quadrant	14,490,880	1,377,926	9.5	12.5	18.72	31,233	447,596	151,773
Class A	6,434,504	396,171	6.2	9.6	22.06	(69,000)	240,406	151,773
Class B	8,056,376	981,755	12.2	14.9	17.02	100,233	207,190	-
Southwest Quadrant								
Arboretum	982,083	129,134	13.1	21.5	16.26	(601)	(16,742)	87,000
Boulders	1,162,957	134,444	11.6	15.0	17.60	2,464	37,156	-
Moorefield/Koger	1,057,744	90,294	8.5	12.6	16.81	(4,420)	19,442	-
Route 288 Corridor	1,178,295	125,332	10.6	18.5	17.99	(15,481)	30,349	-
Stony Point	888,095	37,702	4.2	8.6	19.18	9,014	63,707	-
Southwest Quadrant	5,269,174	516,906	9.8	15.4	17.41	(9,024)	133,912	87,000
Class A	2,413,589	190,335	7.9	11.2	18.97	3,448	86,070	87,000
Class B	2,855,585	326,571	11.4	19.0	16.68	(12,472)	47,842	-
Suburban Total	19,760,054	1,894,832	9.6	13.3	18.37	22,209	581,508	238,773
Class A	8,848,093	586,506	6.6	10.0	21.26	(65,552)	326,476	238,773
Class B	10,911,961	1,308,326	12.0	15.9	16.93	87,761	255,032	-
Downtown								
Central Business District	9,396,823	1,241,710	13.2	14.1	21.50	3,557	109,674	98,445
Class A	4,952,575	673,465	13.6	15.3	24.46	19,578	94,443	-
Class B	4,444,248	568,245	12.8	12.8	17.76	(16,021)	15,231	98,445
Total Office Market	**29,156,877**	**3,136,542**	**10.8**	**13.5**	**19.48**	**25,766**	**691,182**	**337,218**
Class A	13,800,668	1,259,971	9.1	11.9	22.80	(45,974)	420,919	238,773
Class B	15,356,209	1,876,571	12.2	15.0	17.15	71,740	270,263	98,445

Source: CBRE Research, Q3 2017.

1 Average Asking Lease Rate: is the weighted average asking lease rate of total available inventory with a stated asking rental rate
Note: CBRE defines the 'market' as multi-tenant and single-tenant properties greater than or equal to 10,000 sq. ft. in which the owner does to occupy the entire property (ie non owner-occupied properties).

its vacancy rate over the quarter, remaining at 13.2% vacant. Despite the minimal change in its vacancy rate over the quarter, the CBD's availability rate tightened 44 bps in Q3 2017 to 14.1%.

AVERAGE ASKING RENTAL RATES

Richmond's average asking rental rate fell 1.1% over the quarter to $19.48 per sq. ft. in Q3 2017 as the percent of properties that decreased their average asking rents rose 112 bps over the quarter to 4.3%. Highwoods' portfolio was the exception, as its asking rents climbed an average of 5.2% in Q3 2017 across the portfolio. Innsbrook and Stony Point, the two submarkets with a prominent Highwoods presence, were the only submarkets in Richmond to experience a tangible increase in their average asking rent over the quarter.

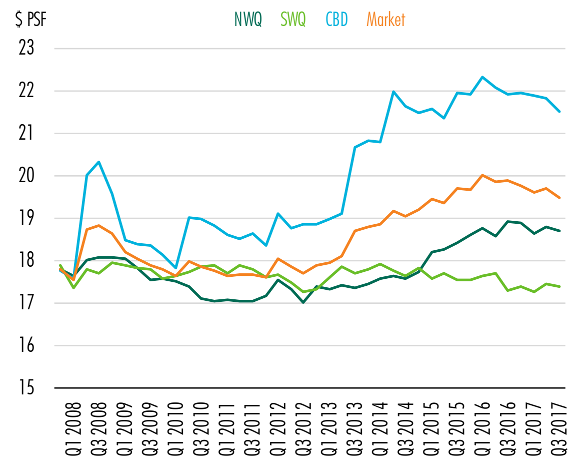
Innsbrook and Stony Point remained Richmond's most expensive suburban markets, as Innsbrook's average asking rent grew 1.3% over the quarter to $20.73 per sq. ft. and Stony Point's average rent climbed 1.9% to $19.18 per sq. ft. Innsbrook has maintained a steady 3.0% growth in its average rents on an annual basis, driving up its average Class A rent to $22.39 per sq. ft. and its average Class B rent to $18.41 per sq. ft. Arboretum was the only other submarket not to experience a drop in its average asking rent, gaining a slim 0.4% over the quarter to $16.26 per sq. ft.

After leading the market in Q2 2017, the Central Business District saw the market's most significant decrease in its average rent over the quarter, slipping 1.5% to $21.50 per sq. ft. This decline was primarily caused by continued leasing activity within Riverfront Plaza pulling premium-rent inventory from market rent numbers. Richmond's average suburban rent also fell, albeit at a more modest 0.5% over the quarter to $18.37 per sq. ft. in Q3 2017. The delta between Urban and Suburban rental rates subsequently narrowed 7.4% to $3.13 per sq. ft.

DEVELOPMENT TRENDS

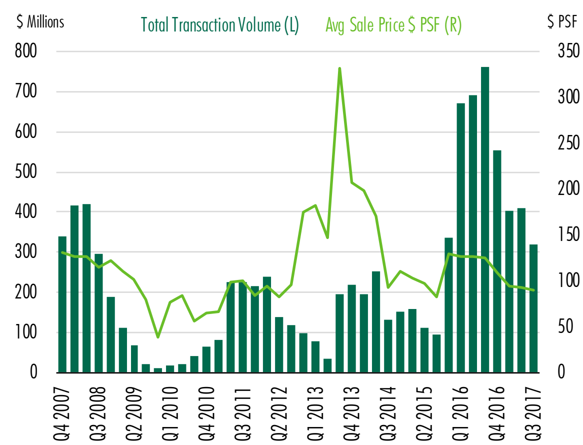
The development pipeline sprung to life in Q3 2017, climbing to 337,218 sq. ft. of construction. The new activity in the suburban market was comprised of Medical Office Buildings with the only traditional office buildings under construction inside Richmond's urban core.

Figure 7: Avg Rental Rate Comparison



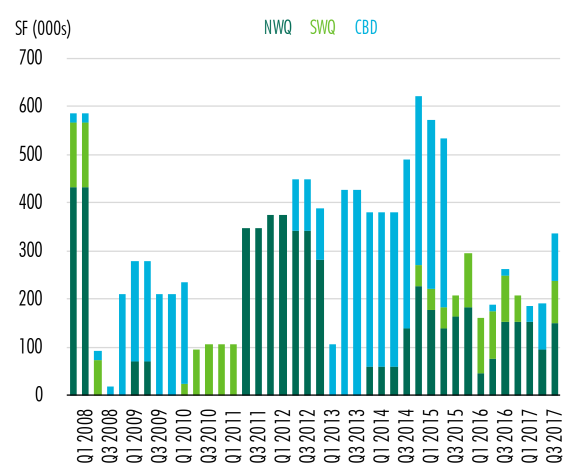
Source: CBRE Research, Q3 2017.

Figure 8: Rolling 12 Month Sales Volume and Average Price PSF

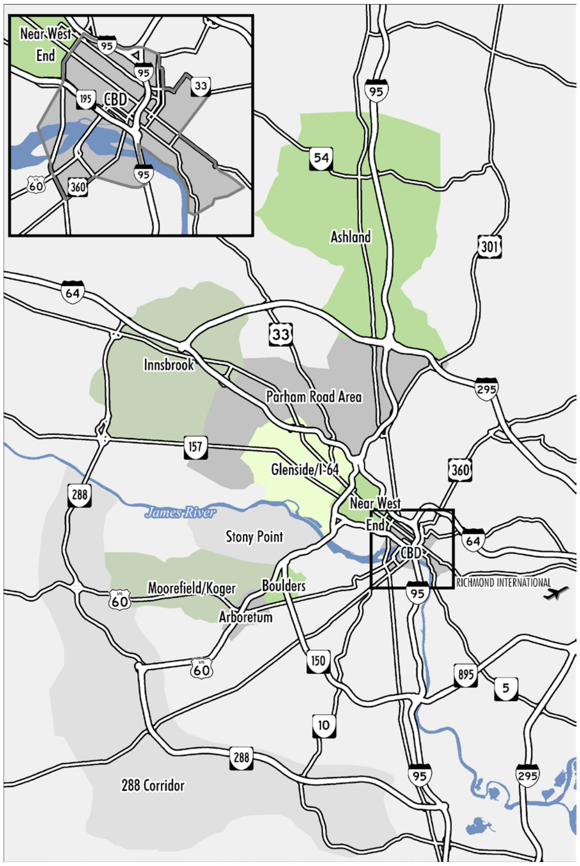


Source: CBRE Research, Q3 2017.

Figure 9: Richmond Office Development Pipeline (Under Construction)



Source: CBRE Research, Q3 2017.



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CBRE|RICHMOND RESEARCH

Andrew Cook
Director of Research
+1 804 237 8678
andrew.cook@cbre-richmond.com

Jordan Minnick
Research Analyst
+1 804 968 1979
jordan.minnick@cbre-richmond.com

Joe Marchetti, Jr
Managing Director
+1 804 320 5500
joe.marchetti@cbre-richmond.com

Todd Willett
Director of Asset Services
+1 804 320 5500
todd.willett@cbre-richmond.com

Trib Sutton
Director of Brokerage Services
+1 804 320 5500
trib.sutton@cbre-richmond.com

CBRE|MID-SOUTH VIRGINIA OFFICES

Richmond Office
6641 West Broad Street, Suite 101
Richmond, VA 23230

Hampton Roads Office
150 West Main Street, Suite 1100
Norfolk, VA 23510

Fredericksburg Office
523 Sophia Street
Fredericksburg, VA 22401

Charlottesville Office
314 East Water Street
Charlottesville, VA 22902