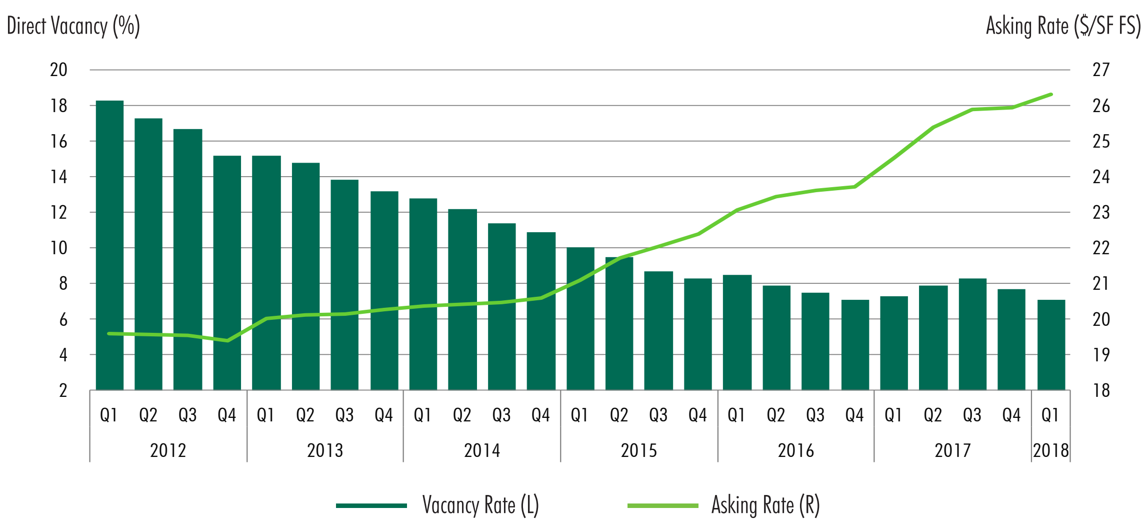
Charlotte Office, Q1 2018

Office market builds on momentum, continued improvement

Direct Vacancy 7.1%	**Lease Rate** $26.31 PSF	**Net Absorption** 285,584 SF	**Construction** 1,357,073 SF	**Completions** 0 SF

*Arrow indicates change from previous quarter.

Figure 1: Direct Vacancy Rate vs. Asking Rate



Source: CBRE Research, Q1 2018.

Following a robust 2017, the Charlotte office market continued its positive performance in the first quarter. Leasing activity was steady as vacancy rates continued to decline, average lease rates increased and construction activity remained strong. Positive absorption exceeded 280,000 sq. ft. for the quarter, marking the eighth consecutive quarter of positive net absorption. Ten out of eleven submarkets recorded positive absorption during this quarter. Top performing submarkets included some of the usual suspects: SouthPark with more than 92,000 sq. ft., the CBD with more than 89,000 sq. ft. and I-485/South with more than 43,000 sq. ft. These three submarkets accounted for approximately 79% of total net absorption for the quarter.

Nine of Charlotte's eleven office submarkets currently report single-digit vacancy rates. Market-wide direct vacancy was recorded at 7.1%, a decrease of 60 bps from last quarter. Total vacancy (vacancy including sublease space) was 7.3%, indicating that there is very little sublease space available. Compared to 8.0% vacancy in the

Figure 2: Market Statistics

Submarket	Building (sq. ft.)	Direct Vacancy Rate (%)	Total Vacancy Rate (%)	Last 4 Qtrs Net Absorption (sq. ft.)	Q1 2018 Net Absorption (sq. ft.)	Weighted Avg Rent ($/SF/YR)	Under Construction (sq. ft.)
CBD	17,017,143	7.4	7.6	773,697	89,009	31.65	853,073
Midtown/Southend	1,982,707	2.1	2.1	162,033	3,711	31.89	349,194
Cotswold	177,412	0.0	0.0	2,602	0	24.50	0
SouthPark	4,472,998	6.9	7.0	172,232	92,933	31.12	0
Park Road	625,184	4.2	4.2	3,588	2,197	18.35	0
I-77 Corridor/Airport	6,593,695	9.3	9.4	83,513	28,286	20.38	120,000
East	1,044,688	10.2	10.2	4,354	994	15.29	0
I-485/South	5,133,932	4.4	4.5	175,943	43,319	26.90	0
Crownpoint	649,761	20.7	20.7	14,988	1,885	15.71	0
NE/University	3,399,951	5.4	5.5	57,474	16,598	21.33	0
North	1,254,185	5.8	5.8	47,905	6,652	23.74	0
Market Total	**42,340,280**	**7.1**	**7.3**	**1,498,329**	**285,584**	**26.31**	**1,357,073**

Source: CBRE Research, Q1 2018.

CBD by Class

Class A	13,853,862	7.7	8.0	764,676	86,486	32.38	853,073
Class B	2,921,604	9.2	9.4	9,021	2,523	30.11	0
Class C	241,677	2.9	2.9	0	0	19.50	0

Source: CBRE Research, Q1 2018.

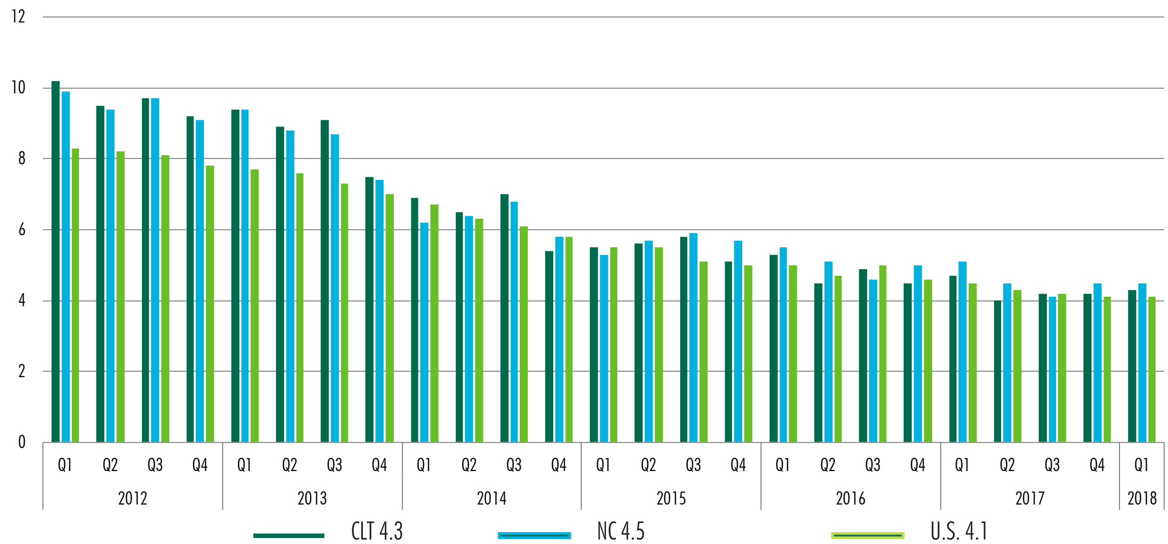
in the same time-period one year ago, this indicates gradual but steady improvement. Direct vacancy in the CBD, Charlotte's largest submarket, was 7.4%.

Weighted average asking rental rates increased for the twenty-second consecutive quarter, increasing to $26.31 per rentable sq. ft. on a full-service basis, a record high for the Charlotte office market. Year-over-year, overall rates have increased by 7.1%. Rental rates in the CBD experienced similar growth, increasing 10.8% year-over-year. More importantly, actual lease comparables are showing a similar increase as expiring and expanding tenants and new entries to the market are accepting higher rates.

The cost of construction and tenant improvements has risen dramatically the last development cycle. Assuming economic conditions remain stable, low vacancy and high construction costs will cause rental rates to maintain their upward trend. Since weighted average asking rates are calculated based on available space and speculative construction often arrives with a substantial amount of vacancy, average asking rates reflect these conditions and should continue to rise.

Construction remained active during the quarter. Five multi-tenant buildings are under construction in the Charlotte market, one in the CBD and four in the suburbs. Cumulatively, these buildings are approximately 60% pre-leased. Bank of America has inked a deal to take approximately 550,000 SF in Legacy Union Tower, under construction in the CBD, elevating their already notable presence. They have yet to make public any plans for right-sizing the amount of space they currently occupy.

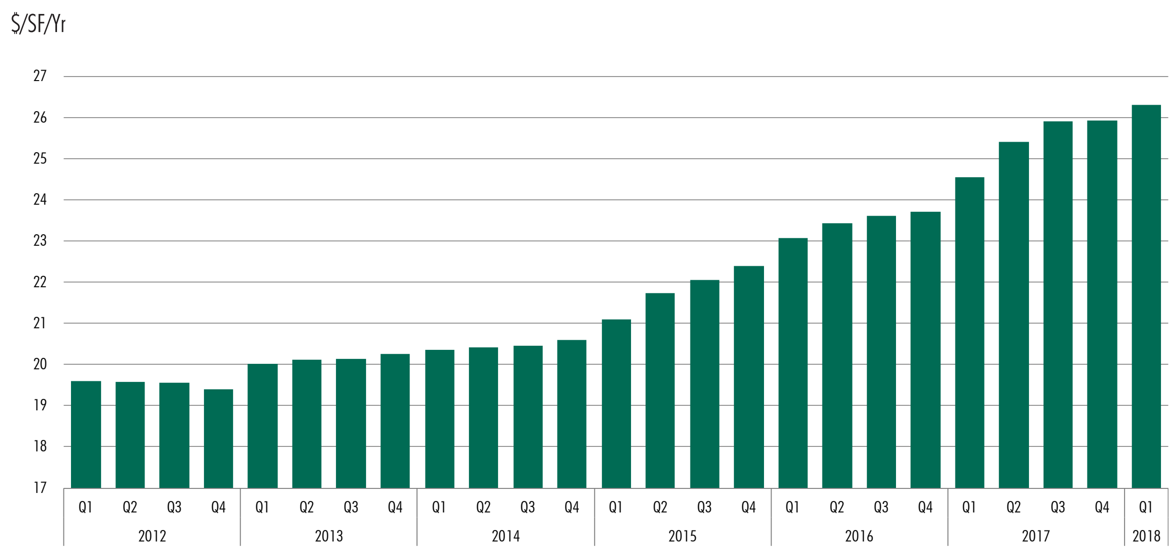
Figure 3: Unemployment Rate (%)



Source: CBRE Research, Q1 2018, Bureau of Labor Statistics.

The Charlotte unemployment rate increased slightly by 10 bps and was recorded in February 2018 at 4.3%. North Carolina's overall unemployment rate increased slightly by 20 bps to 4.5%. North Carolina and Charlotte came in just behind the overall national unemployment rate, which stayed flat and was recorded at 4.1%. A challenge that many other markets face is the availability of a quality work force, a higher unemployment rate in Charlotte suggests that this is less of an issue.

Figure 4: Direct Asking Lease Rate ($/SF)



Source: CBRE Research, Q1 2018.

For the twenty-second consecutive quarter, overall full service asking rates (weighted average) in Charlotte have increased. Rates increased to $26.31 per rentable sq. ft., the highest market rent ever recorded. Average rental rates in the CBD climbed to $31.65, up from $31.29. Full service rental rates in the suburbs closed the quarter at $23.47. The market will likely continue to see gradual rate increases throughout 2018 as new speculative product is delivered.

As availability in a market dwindles, the potential for absorption diminishes. New construction provides the market with an opportunity to post high absorption numbers.

A question that has been generating a lot of speculation in the market is when and where a tenant will secure office space at a rate higher than $40 per sq. ft. on a full service basis. Executed leases are now exceeding $35 per sq. ft. with more regularity and with the confidence in the market and the new product coming on line, strike rates are likely to reach or exceed $40/SF in the coming quarters. The most likely location is in the CBD submarket, although rental rates in SouthPark, Midtown/SouthEnd and Ballantyne in the I-485/South submarket are also pushing the envelope. With Charlotte's low operating expenses, the uptick in rental rates is especially beneficial to building owners. However, the impact has been felt by small to medium-sized tenants and their brokers, who are feeling a little sticker shock. Helping to offest this hurdle, many users are attracted to creative office space with its open floorplans and collaborative space that can allow for a more efficient footprint. Many owners of Class B and older Class A buildings are renovating to entice these tenants to relocate from their traditional Class A homes.

A looming concern on the horizon is the 2019 tax revaluation. According to Dena Diorio, County Manager, "We always calculate a revenue-neutral tax rate, so theoretically if the values go up we need a lower tax rate to generate the revenue that you need to provide services. So just because your value is going up, that doesn't necessarily mean that your taxes are going to go up. Historically this (revenue neutral tax rate) has been true more often than not."

Economic developers at the Charlotte Chamber report that they are busier than ever. They have been working with several large users looking to relocate to Charlotte and confirm observations regarding the attractiveness of creative office and the resurgence of the Class B market. Traditionally, light rail has been a key driver of commercial real estate development. This has certainly proven true along the Southern Corridor and the same impact is already beginning to be felt along the recently completed extension of the Blue Line - which runs Northwesterly and ultimately connects the CBD to the University of North Carolina at Charlotte. While the areas along the new Blue Line extension are beginning to attract more interest from investors and developers, the already established SouthEnd remains the most sought-after locale.

Market conditions in Charlotte are ripe for a continuation of the steady, positive growth we experienced during 2017. Our forecast for 2018 remains optimistic.

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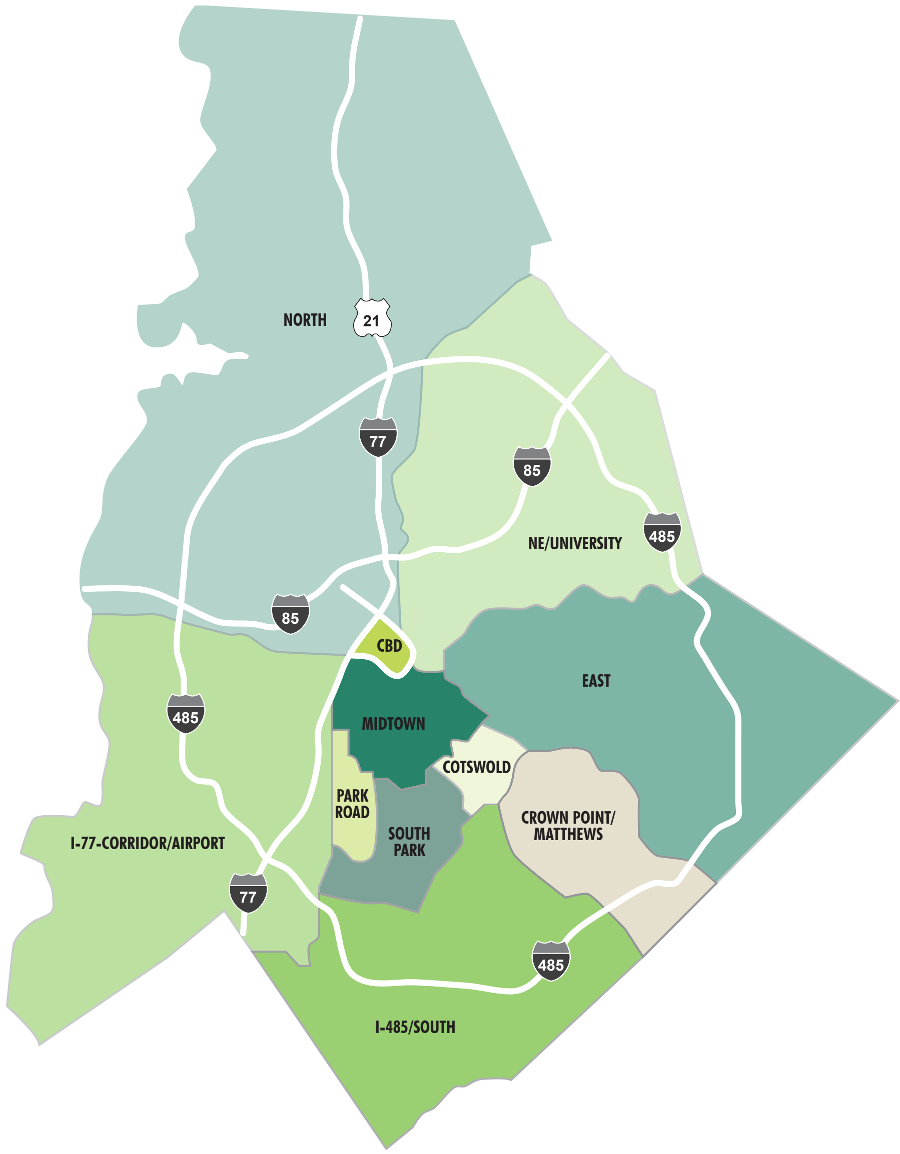

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