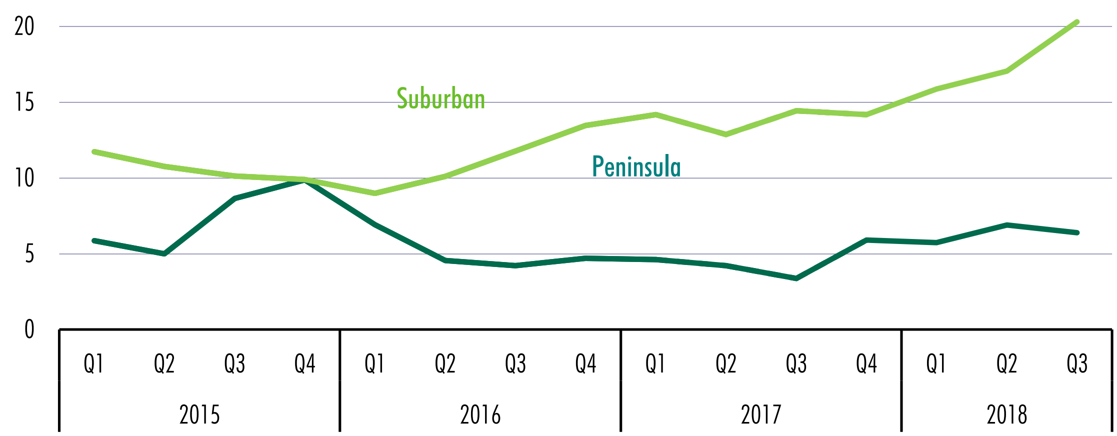
Charleston Office, Q3 2018

Peninsula and Suburban vacancy gap widens with new construction likely to continue the trend

Vacancy Rate	Availability Rate	Net Absorption	Asking Rate	Under Construction
16.7%	19.2%	(128,171) SF	$24.80 PSF SF	534,477 SF

Figure 1. Vacancy by Submarket



Source: CBRE Research, Q3 2018

The Charleston office market experienced its first negative absorption in the last six quarters with overall vacancy rising approximately 250 basis points in the last quarter to 16.7%. The change is largely the result of Verizon Wireless' departure from their 150,000 sq. ft. facility in the North Charleston submarket. The sudden rise in overall vacancy further accentuates the primary dynamic that defines the Charleston office market: the divergent levels of availability between the Suburban and Peninsula submarkets. Suburban vacancy is now three times as high as on the Peninsula submarket.

Market conditions in the Peninsula submarket continue to be tight due to the challenges in delivering new product as well as a preference for the convenience and comforts of Charleston's downtown over the newer facilities and amenities offered in suburban submarkets. Development restrictions and market dynamics prevent large-scale construction, but things appear to be changing. A new development, 22 WestEdge, is under construction and slated to bring more than 150,000 sq. ft. of office space to the crowded submarket. However, for tenants currently struggling to find space, the project is not expected to be completed until the second half of 2019.

Figure 2. Market Statistics

Market	Market Rentable Area (SF)	Vacancy Rate (%)	Total Availability (%)	Avg Asking Dr Rate ($ PSF/YR)	Under Construction (SF)	Net Absorption Last 4 Qtrs (SF)	Net Absorption Current Qtr (SF)
Peninsula Class A	1,644,771	7.3	9.0	35.31	154,998	(25,492)	19,774
Peninsula Class B	417,958	3.3	16.3	30.51	-	(16,231)	(2,000)
Downtown	2,171,149	6.4	10.3	34.46	154,998	(16,879)	21,209
Daniel Island	1,269,810	24.1	24.1	26.25	32,119	184,264	(4,798)
East Cooper	1,102,240	5.4	7.4	26.18	223,360	(19,613)	1,400
North Charleston	3,745,329	21.4	23.8	22.87	124,000	(86,776)	(151,827)
West Ashley	595,159	32.2	34.3	23.29	-	(16,268)	5,845
Suburban	6,712,538	20.3	22.1	23.55	379,479	61,607	(149,380)
MARKET TOTAL	8,883,687	16.9	19.2	24.80	534,477	44,728	(128,171)
Class							
Class A	5,207,256	16.4	18.0	27.19	416,117	225,036	35,817
Class B	3,307,138	17.9	21.6	21.16	118,860	(180,234)	(134,930)
MARKET TOTAL	8,883,687	16.9	19.2	24.80	534,477	44,728	(128,171)

Source: CBRE Research, Q3 2018

Outside of the Peninsula, additional projects currently underway in the East Cooper submarket include Gateway Mount Pleasant and Portside at Ferry Wharf together combined to bring a total of nearly 185,000 sq. ft. of Class A space to the marketplace. Additionally Belle Hall Office Park, in the East Cooper submarket, will bring roughly 40,000 sq. ft. of Class B office space to the market following its completion later this year.

The introduction of new office product to the marketplace has led to increased asking rents and sparked a rise in tenant improvement costs. Historically, landlords have utilized tenant improvements as a means to offset construction costs. In the last six years, construction costs have risen nationally an average of roughly 60% in the office property sector according to a recent report published by RSMeans, which is similar to the increase experienced in Charleston. Increases in construction costs complicating the development and tenant upfit process. In an attempt to attract talent tenants are in turn expecting more expensive upfits and amenities.

An additional wrinkle to consider is the impact of recent trade tariffs on imported steel and aluminum to the U.S. The effect of the change has already been felt as deal negotiations often include a “steel tariff contingency,” meaning that contractors are protected in the instance of rising costs, which adds an element of uncertainty to new development.

In response to these challenges, office users have begun to pursue alternatives to new construction by repurposing existing industrial warehouse and retail space into office space. The latest being

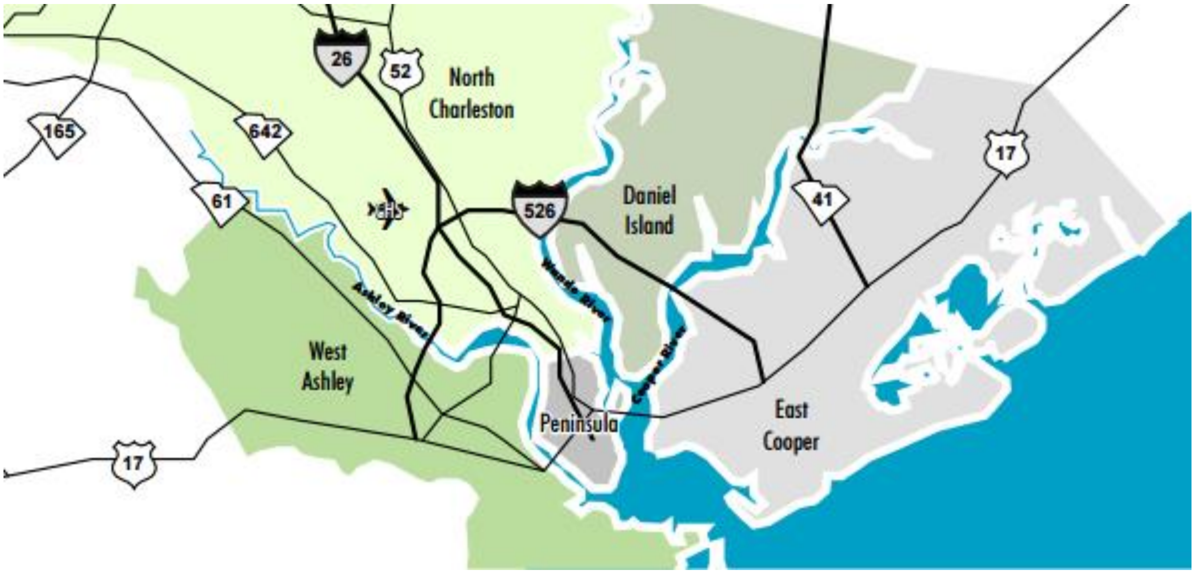
Figure 3. Vacancy, Availability and Absorption

Source: CBRE Research, Q3 2018

North Charleston's upcoming Garco Mill development. Formerly the site of an industrial textile mill, once complete the site will provide 60,000 sq. ft. of office space to the North Charleston submarket and will also contain a 20,000 sq. ft. food hall. The project is scheduled to be completed in the first half of 2019.

Tenant demand for available office space has not slowed however, and coworking continues to be an increasingly attractive option for tenants, allowing for a tremendous amount of flexibility in a collaborative work environment. This trend has become especially prevalent in the Peninsula submarket where viable space is difficult to locate. Coworking tenants in the market include Local Works, Office Evolution, The Skinny Dip, The Harbor Entrepreneur Center and Holy City Collective.

As tenants in the market continue to expand the Charleston market will continue to grow in the coming quarters. Peninsula owners look to hold onto office properties as occupancy remains very high and rental rates continue to rise. Strong investment fundamentals encourage investors to hold onto assets for the long-term as they look to capitalize on the expanding marketplace.



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