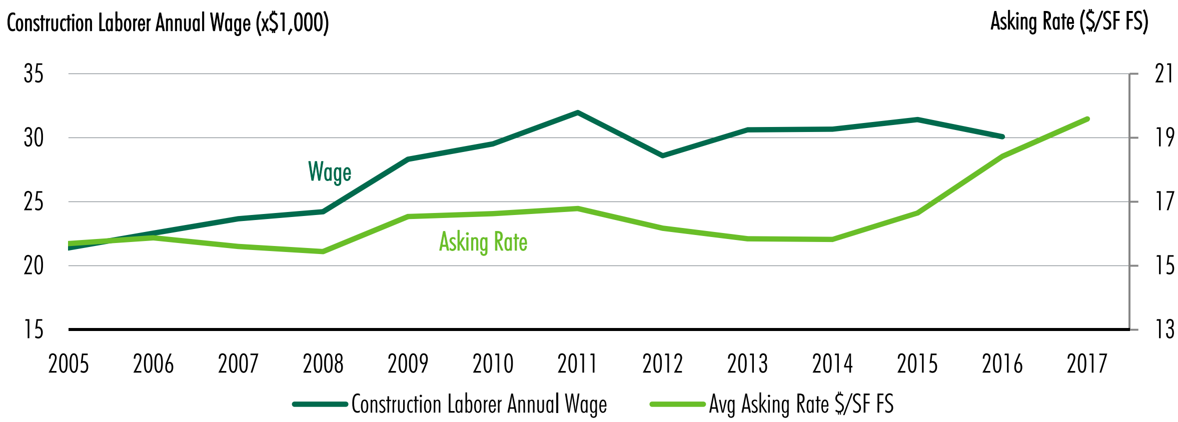
Greenville-Spartanburg Office, Q1 2017

Construction costs, market fundamentals pushing asking rates higher

Vacancy Rate	Availability Rate	Net Absorption	Asking Rate	Under Construction
12.5%	16.5%	8,834 SF	$19.59 PSF FS	0 SF

Figure 1. Construction Wages and Asking Rates



Source: CBRE Research, BLS, Q1 2017

Over the last three years, the Greenville-Spartanburg office market has established a brand of rent growth. Class A CBD asking rates climbed to a new record high of $26.11 per sq. ft. on a full service basis, a rise of 42% in the last seven years. While tenants have demonstrated a willingness to pay rising rates, developers are finding difficulty in responding to demand due to rising construction costs, primarily driven by growth in wages. In addition to rapid rent growth, vacancy is on the verge of a record low, despite a modest uptick in Q1.

The rise in vacancy is largely attributed to a modest level of absorption coupled with the delivery of a building in the CBD for The Greenville News which included some speculative space. While the property only accounts for 28,000 sq. ft. of space, the movement of the media organization will provide for the demolition of their existing facility, which sits on four acres of land in the heart of the CBD. In its stead will rise the development of Camperdown, a high-profile mixed-use project expected to bring with it an additional 110,000 sq. ft. of Class A office space as well as multifamily, retail and hospitality space.

The impact of the delivery of a small building with ancillary speculative space drives home the reality that small markets like Greenville-Spartanburg are prone to significant swings in market statistics based on the movement of single tenants. While the volatility of small market data has historically warded off risk-averse investors, things have are changing. Unperturbed, investors are being lured by the duel attraction of rent growth and rapid

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)
Greenville CBD Class A	2,522,821	13.5	16.9	26.11	-	118,563	(26,750)
Greenville CBD Class B	1,143,164	14.2	18.7	19.62	-	63,465	755
Downtown	3,757,190	13.6	17.2	23.61	-	188,024	(25,995)
Greenville Suburban Class A	2,756,998	7.5	13.9	22.02	-	93,827	7,771
Greenville Suburban Class B	3,213,386	12.4	16.3	16.77	-	257,216	27,058
Spartanburg Class A	448,737	0.8	3.1	23.61	-	9,627	13,093
Spartanburg Class B	960,695	26.6	26.6	13.57	-	(83,823)	-
Suburban	7,548,636	11.9	16.1	17.21	-	258,713	34,829
MARKET TOTAL	11,305,826	12.5	16.5	19.59	-	446,737	8,834
Class A	5,728,556	9.6	14.4	24.35	-	222,017	(18,979)
Class B	5,317,245	15.4	18.7	16.53	-	218,724	27,813
MARKET TOTAL	11,305,826	12.5	16.5	19.59	-	446,737	8,834

Source: CBRE Research, Q1 2017

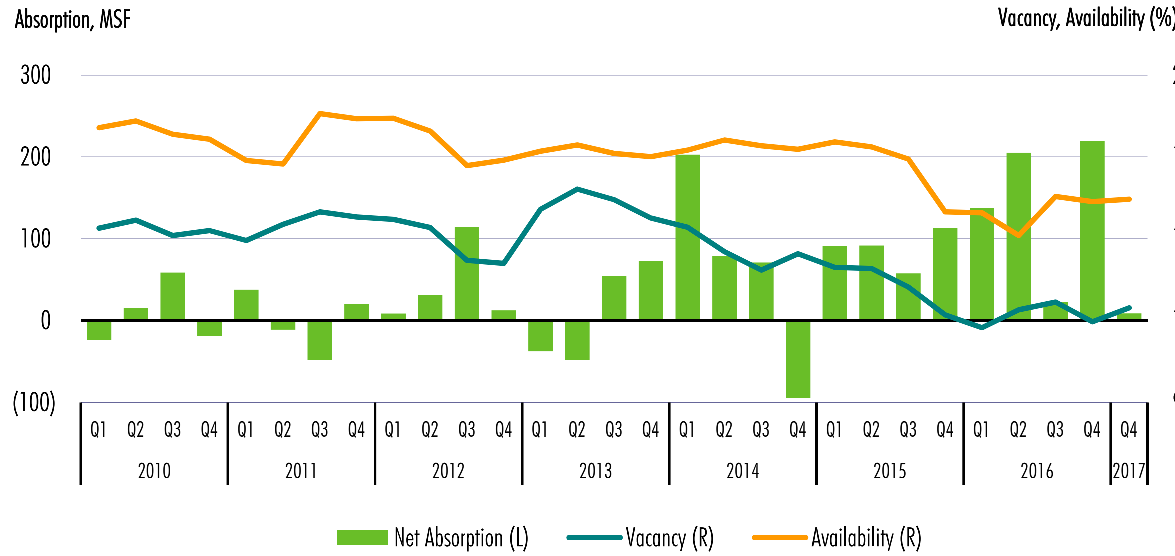
absorption. Based on the ratio of absorption to existing product, Greenville-Spartanburg was the fastest growing office market in the country in 2016.

Historically, small office markets like Greenville-Spartanburg have largely been off the radar of firms looking for stable investment-grade product. With cap rates compressing in major markets, investors are broadening their scope in search of opportunity. In 2016, over 2.1 million sq. ft. of the competitive inventory traded hands. New investment groups are based in markets as varied as New York, Atlanta and Richmond.

The successful trade of an asset from one out-of-market investor to another helps build the credibility of the Greenville-Spartanburg office market for additional investment. Based on the success of these new investors, expect to see increased capital availability for additional investment, including that which would provide for the development of new product in the market. Vacancy is expected to hit a record low later this year, which should be a strong indicator for potential developers.

A frequent question from investors new to the market involves how much longer rent rate growth can continue. While the last three years the Greenville-Spartanburg office market has exhibited significant rent growth, it was immediately preceded by a period of decades in which rent growth was non-existent. While rent growth is not a given, until the relationship between construction costs and the amount of

Figure 3. Vacancy, Availability and Absorption



Source: CBRE Research, Q1 2017

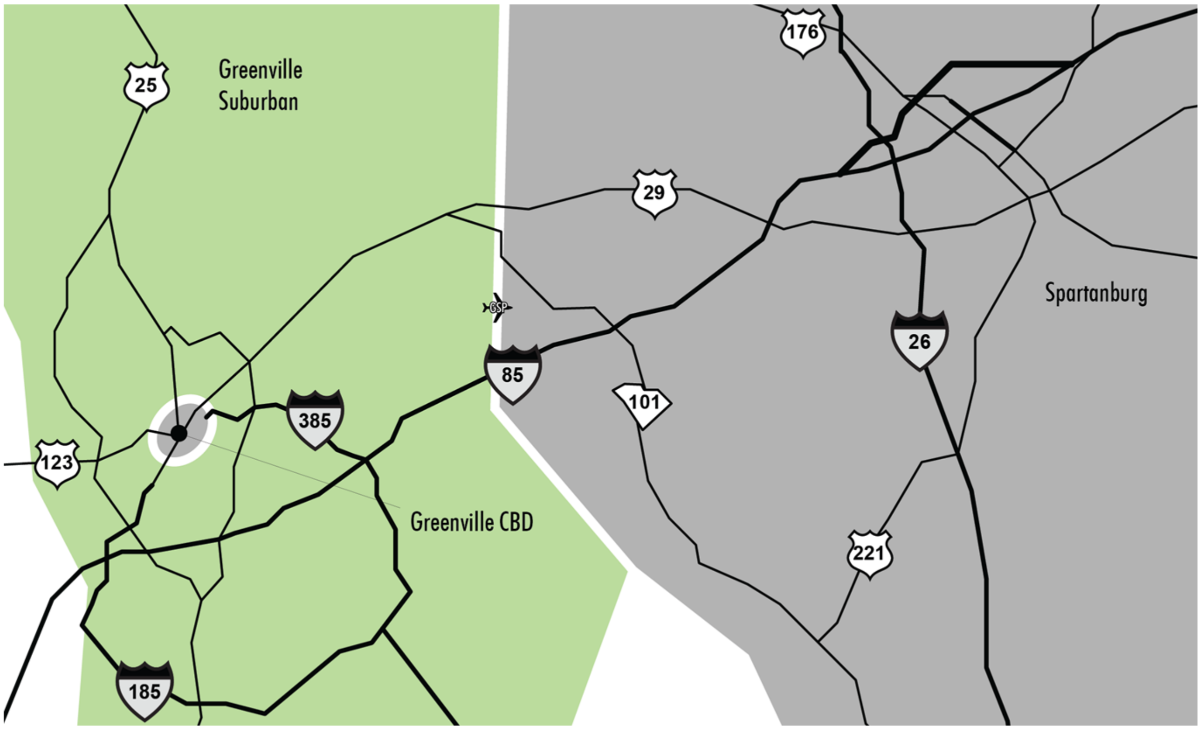
rent tenants are willing to pay for new space changes, it is not expected to end soon.

Although tenants have demonstrated a willingness to pay increasingly higher rents to lease better quality space in an effort to attract and retain talent, the labor cost of construction has kept pace, complicating the ability for prospective developers to deliver new product. Locally, there are more than 3,000 multifamily units under construction. Given that many local multifamily contractors are also involved in office development, it is reasonable to expect construction costs to remain elevated until the multifamily development pipeline slows.

In the face of vacancy approaching a record low and a lack of new construction, developers and tenants have often creatively partnered to bring new office space to the market over the last few years. The most successful example is the 40,000 sq. ft. Claussen Bakery, but several others are in the planning stages including Judson Mill and Markley Station. Combined the two could bring as much as 230,000 sq. ft. of office, retail and flex space to the market. While not all of the space will be accounted for as part of the for-lease office inventory, they will be attractive to tenants interested in unique office space.

The highlights of tenant activity during Q1 include leases to NVR, Meritage, and Southern Tide, as well as an expansion by Jedsen Engineering. Combined, these tenants accounted for more than 40,000 sq. ft. of absorption. The largest vacancies left by tenants were from United Community Bank and accounting firm Cherry Bekaert, which combined to vacate more than 25,000 sq. ft. as they secured space in the ONE Building and EP360 during Q4. It is worth noting that the tenants are bucking the trend of space consolidation, as both expanded their footprints in the market with the move, confident in their long-term space needs.

While a lack of new product presents an economic challenge in the short-term, on the horizon lies a larger challenge that is facing many markets: labor availability. According to data from ESRI, Greenville-Spartanburg has the smallest percentage of population between the ages of 20 and 34 years old of all markets in the state. While this is largely driven by a small number of college students in the market, it suggests tenants may face fierce competition when hiring employees during the first decade of their professional career. Fortunately, the number of people moving to the market exceed the number of people moving away from the market by more than 6,000 residents annually.



CONTACTS

Brian Reed, AICP
Research Manager
+1 864 527 6073
brian.reed@cbre.com
@BrianReedCRE

Steve B. Smith, SIOR
Managing Director
+1 864 527 6030
steve.b.smith@cbre.com

CBRE
101 North Main Street
Suite 1400
Greenville, SC 29601
@CBRE_SC

OFFICE SERVICES

Charles Gouch, CCIM, SIOR
Senior Vice President
+1 864 527 6073
charles.gouch@cbre.com

Ryan Clark
Senior Associate
+1 864 527 6036
ryan.clark@cbre.com
@RSClark

Blaine Hart, SIOR
Vice President
+1 864 527 6054
blaine.hart@cbre.com
@BlaineHart86

Shelby Dodson, LEED AP
Vice President
+1 864 527 6022
shelby.dodson@cbre.com

Doug Webster
Senior Associate
+1 864 527 6033
doug.webster@cbre.com
@DougWebster21

Joe Cummings
Associate
+1 864 527 6023
joe.cummings@cbre.com
@jcummings19