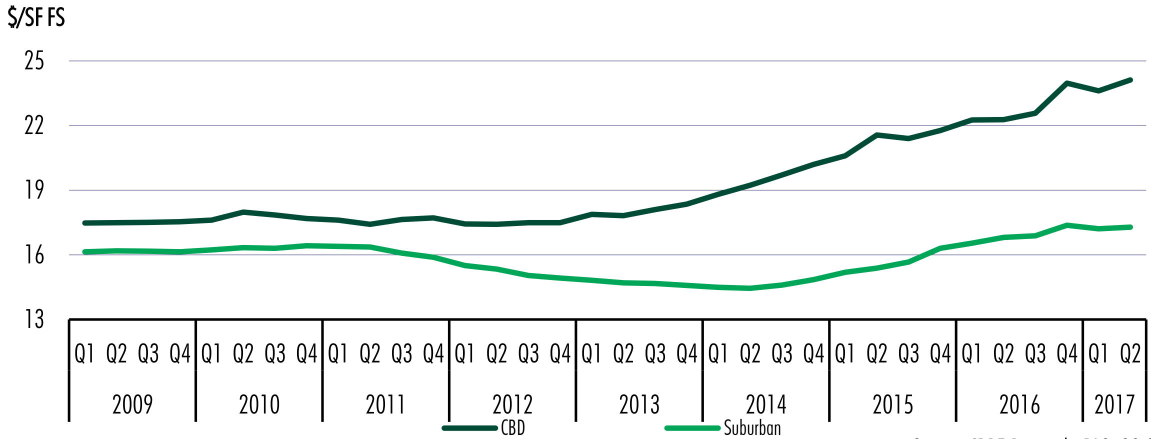
Greenville-Spartanburg Office, Q2 2017

Market growth slips off record-setting pace but pressure on rates remains

Vacancy Rate	Availability Rate	Net Absorption	Asking Rate	Under Construction
12.7%	17.5%	(25,439 SF)	$ 19.80 PSF FS	0 SF

Figure 1. Asking Rates By Submarket



Source: CBRE Research, BLS, Q2 2017

After finishing 2016 as the fastest growing office market in the country, Greenville-Spartanburg office market growth is slowing. For the first time in the last ten quarters the market experienced negative absorption, largely fueled by a few large tenant migrations. However, looking at the shortage of Class A office space in the market and only one major office development in the pipeline, vacancy is likely to decline further in the next several quarters, driving asking rents on their continued upward path.

It is worth noting that the movement a single large tenant can greatly affect market data in a small market. The rise in vacancy this quarter was largely driven by Erwin-Penland vacating over 14,000 sq. ft. in the CBD and Ricoh Americas Corp leaving more than 13,000 sq. ft. in the Greenville Suburban submarket. Not all movement was negative, with NVR, Benchmark Mortgage, and AMEC E&C Services accounting for nearly 31,000 square feet of leased suburban office space.

Additional Class A space this quarter has given way to further increases in asking rates, which are now $19.80 per sq. ft. on a full service basis for the entire market. Other tenant activity trends have presented in the form of tenants downsizing. Traditionally, the term *downsizing* is associated with economic contraction, but more often is being associated with tenants migrating to more modern space that provides for a smaller and more efficient footprint, the net effect of which is to reduce the total amount of space occupied. In some cases, the need for flexibility has prompted growth in co-work space, where tenants have

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	12.6	18.7	26.14	-	131,691	21,618
Greenville CBD Class B	1,143,164	15.5	17.7	20.27	-	(21,424)	(15,152)
Downtown	3,757,190	13.4	18.1	24.11	-	114,863	6,466
Greenville Suburban Class A	2,756,998	8.5	15.0	22.06	-	(39,507)	(28,233)
Greenville Suburban Class B	3,174,952	12.8	18.0	16.68	-	231,959	(7,123)
Spartanburg Class A	448,737	0.8	3.1	23.61	-	9,627	-
Spartanburg Class B	960,695	26.2	26.2	13.54	-	2,400	3,687
Suburban	7,510,202	12.4	17.1	17.28	-	101,227	(31,905)
MARKET TOTAL	**11,267,392**	**12.7**	**17.5**	**19.80**	**-**	**216,090**	**(25,439)**
Class A	5,728,556	9.7	15.7	24.43	-	105,277	(6,615)
Class B	5,278,811	15.9	19.4	16.60	-	106,453	(18,588)
MARKET TOTAL	**11,267,392**	**12.7**	**17.5**	**19.80**	**-**	**216,090**	**(25,439)**

Source: CBRE Research, Q2 2017

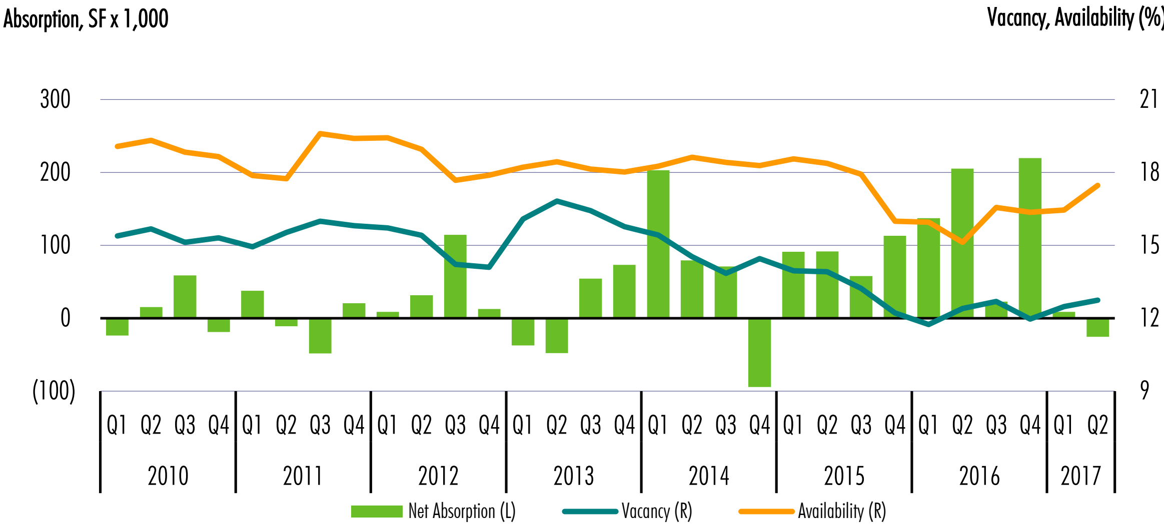
access to open collaborative space with extremely flexible terms.

Despite the increasing need for new office space in Greenville-Spartanburg, there remains little new office construction in the pipeline. One major development is the mixed-use Camperdown project on the old Greenville News site. The building will deliver more than 120,000 sq. ft. of Class A office space along with space for retail, apartments, and hospitality. With delivery not expected until the beginning of 2019 at the earliest, current market conditions -- which are prompting rising asking rates--are expected to remain. While discussions are just preliminary, it appears likely that additional office space will likely be developed during the redevelopment of the County Square, but the timeline extends. beyond 2020.

The lack of active office space under development is misleading, as downtown is dotted with construction cranes as developers respond to demand in the multifamily and hospitality sectors. The U.S. Census recently listed the City of Greenville as one of the five fastest growing cities in the country from 2010 to 2016. Much of the growth can be attributed to the recent success of multifamily development.

To a certain extent, the ability to deliver new office product is being hampered by an active multifamily sector. Apartment communities typically provide more favorable returns to investors than office product, complicating the development of new Class A office space. High

Figure 3. Vacancy, Availability and Absorption



Source: CBRE Research, Q2 2017

levels of development also have created a shortage of labor, driving up construction costs.

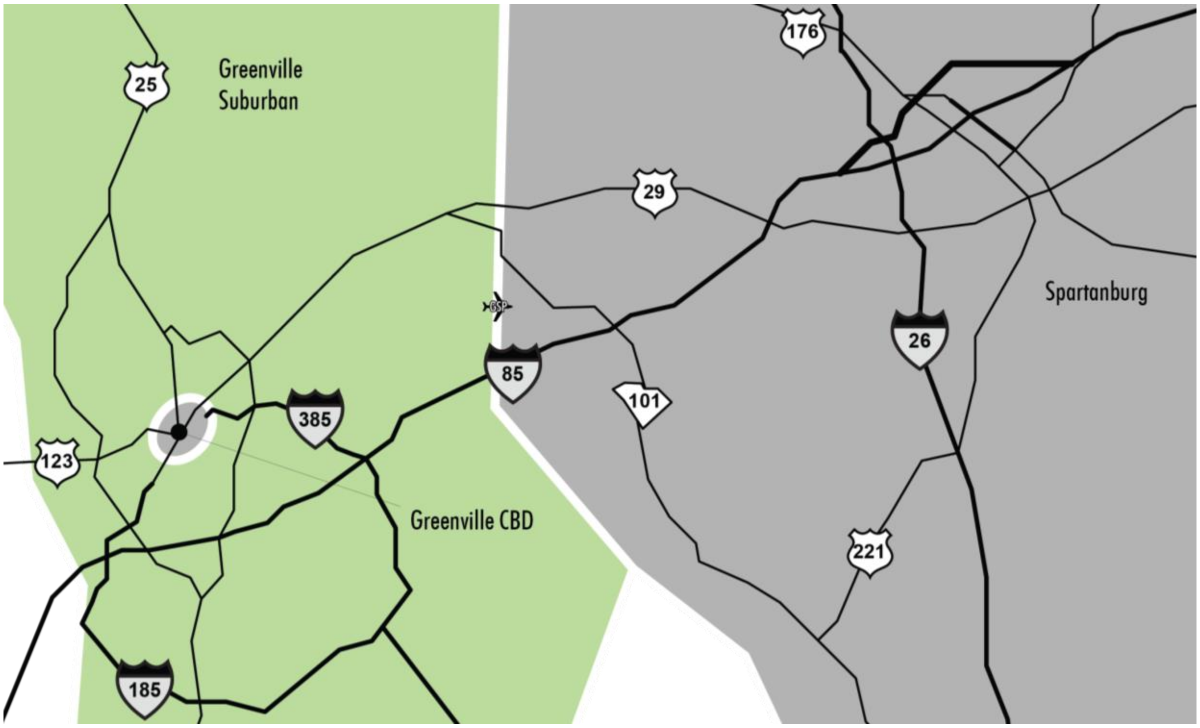
Given the crossover of multifamily and office construction contractors, construction costs are expected to remain high until the multifamily pipeline slows. With more than 3,000 units currently under construction, this is unlikely to happen until 2018.

Indicative of a market with tightening vacancy, tenants confident in their needs for large amounts of space are often forced to shift from leased to owned office space. Q2 saw two major tenants moving to owned facilities. United Community Bank purchased a 30,000 sq. ft. building in the CBD for occupancy. While this number does not directly affect absorption figures, the reality is that there are few options for Class A tenants larger than 25,000 sq. ft. Other movement included BB&T migrating to newly constructed office space that they will own in the Greenville Suburban submarket. Their previously occupied space in the CBD is outdated and is unlikely to re-enter the market as office space.

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 population percentage 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 moving away from the market by more than 6,000 residents annually.

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, nearly 2.4 million sq. ft. of the competitive inventory traded hands. New investment groups are based in markets as varied as New York, Atlanta and Richmond.

A frequent question from investors new to the market involves how much longer rent rate growth can continue. While rent growth is not a given, until the relationship between construction costs and the amount of rent tenants are willing to pay for new space changes, it is not expected to end soon.



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