

CLEVELAND OFFICE MARKET

PANDEMIC-INDUCED DOWNWARD SPIRAL HAS OFFICE MARKET REELING AT YEAR END

The Greater Cleveland office market closed 2020 in a downward spiral and generated 406,142 square feet of negative absorption in the fourth quarter, after netting three straight quarters of positive absorption, each of which got smaller as the year progressed.

Looking back, the overall Cleveland office market did poorly in 2019 until the fourth quarter of that year, when it began to rebound and then carried over into the beginning of 2020. The market started to feel the effects of COVID-19 in the latter half of the second quarter of 2020 and has continued its downward trajectory to the present timeframe. This market negativity can be seen in every submarket and office class throughout Northeast Ohio. In fact, all five office submarkets posted negative absorption this past quarter, which helped increase the overall vacancy rate to 17.6%, a jump of 110 basis points from the third quarter, giving the market its highest vacancy since the fourth quarter of 2018. One bright spot is that the market did manage to absorb a total of 149,545 square feet over the course of 2020, mostly due to good statistics in the first and second quarters.

Despite the vacancy rise and negative absorption over the fourth quarter, the overall average asking rent dropped just slightly, by \$0.07/SF, to \$18.11/SF. This was paced by the Central Business District, as all of the suburban submarkets had increases from quarter to quarter.

The East submarket was largely responsible for bringing down the office market in 2020 by generating 158,936 square feet of negative absorption for the year, by far the worst of any office submarket. By contrast, the South submarket netted 261,387 square feet in positive absorption for 2020 and helped keep the market from plummeting even further. The CBD was the only other submarket to end the year in positive territory, with 135,850 square feet of absorption for 2020. As mentioned earlier, every single submarket gave back space in the fourth quarter.

The CBD generated 70,106 square feet in negative net absorption during the fourth quarter. The occupancy loss helped push the CBD's vacancy rate up 40 basis points to 18.8%. Class B asking rents in the CBD decreased by \$0.34/SF from the previous quarter, coming in at \$17.84/SF. This was in addition to a Class A decrease of \$0.27/SF to \$24.91/SF. As a result, the overall asking rent in the CBD dropped \$0.19/SF to \$18.94/SF.

The CBD saw various office-related news items make headlines in the fourth quarter. The most impactful news came for all metropolitan areas in Ohio, as the Substitute Senate Bill 39 passed the Ohio House and Senate in early December. Governor Mike DeWine signed the bill just prior to the new year. It could kickstart several proposed real estate megaprojects in the state.

CURRENT CONDITIONS

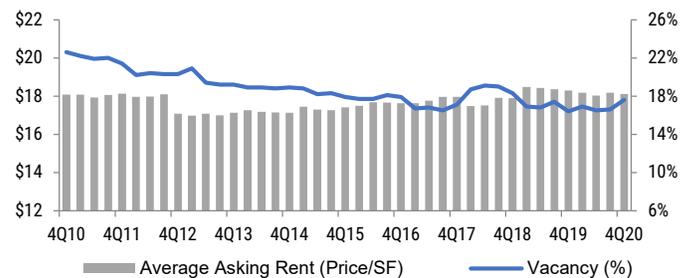
Sublease vacant square footage almost doubled to 306,155 SF from the second quarter to the fourth quarter; sublease available square footage shot up to the highest it has been in the last nine quarters.

Every submarket showed negative absorption in the fourth quarter, as no area or asset class was immune to the pandemic's impact.

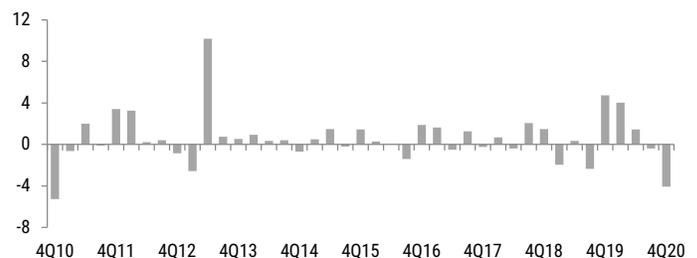
The outlook for next year continues to remain uncertain. The pandemic-induced leasing lethargy from the last three quarters caught up to the market statistic-wise, and the lackluster leasing continued as the year ended.

MARKET ANALYSIS

Asking Rent and Vacancy



Net Absorption (SF, Hundred Thousands)



MARKET SUMMARY

	Current Quarter	Prior Quarter	Year Ago Period	12 Month Forecast
Total Inventory	38.9 MSF	38.9 MSF	37.6 MSF	↑
Vacancy Rate	17.6 %	16.5%	16.4%	↑
Quarterly Net Absorption	(406,142)	7,798	473,999	→
Average Asking Rent	\$18.11	\$18.18	\$18.30	→
Under Construction	100,000	100,000	160,000	↑
Deliveries	0	0	0	↑

This bill authorizes an insurance premiums tax credit for capital improvements to transformational mixed-use development (TMUD) projects. If a development costs \$50 million or more, with at least 300,000 square feet of space and a minimum of 15 stories, it could qualify. The key word in all of this is “transformational.” By design, this law would assist the completion of a mixed-use project, such as Cleveland’s \$350-million NuCLEus that could transform a neighborhood or city through adding high end residential, office and retail users (and their tax revenues), and thereby attracting other nearby developments that could add to the economic activity.

State historic tax credits were also announced in December, and the future Cross Country Mortgage headquarters project in the CBD at the corner of Superior Avenue and East 22nd Street was awarded nearly \$4.5 million in support of the project’s historic rehabilitation.

The AECOM Building, located at 1300 East 9th Street, saw some CBD success once again, as Orion Business Center signed an 8,792-square-foot lease. The company plans to occupy in stages in the first and second quarters of 2021. The previously announced Weston Hurd and Perspectus Architecture leases at this building were due to begin occupancy in the fourth quarter, and BDO is expected to move in at the start of first-quarter 2021. These companies will operate out of over 57,000-square-feet combined between the three of them. 1300 East 9th Street has been one of the bright spots in an otherwise dismal Cleveland office market.

Perhaps a sign of how poorly the office market performed in the fourth quarter, the most notable lease signed was a renewal at One Cleveland Center, located at 1375 East 9th Street. Here, the Internal Revenue Service renewed its 18,996-square-foot lease.

Suburbs Fare Poorly in the Fourth Quarter

The overall suburban vacancy rate increased by 160 basis points in the fourth quarter to 16.5%, lower than the CBD’s rate and the market as a whole. In total, the suburbs gave back 336,036 square feet in negative absorption in the fourth quarter, while just eclipsing a positive mark of 13,695 square feet for the entire year.

In a quarter with very few significant office building sales, the East submarket saw the largest office building transfer of the quarter as 734 Alpha Drive in Highland Heights sold for \$2.0 million, or approximately \$52/SF. This 38,350-square-foot property was purchased by Metropolitan Veterinary Hospital, which is undertaking a multimillion-dollar renovation of the property. After the veterinary hospital occupies, up to 7,500 square feet of office space is being made available for additional tenants to lease.

Staying in the East, in Cleveland’s MidTown district on the western edge of this submarket, just outside the CBD, the Cleveland Foundation’s design for its new headquarters was approved in November by the Cleveland City Planning Commission. This, and the Ohio Supreme Court declining to hear the case of Dunham Tavern Museum trustees who were seeking to block the closing of the land the foundation purchased

for this development, paved the way for the Foundation’s project to move forward on the 1.2 acres located on East 66th Street between Euclid and Chester Avenues. The Foundation, currently located in Playhouse Square’s Hanna Building, 1422 Euclid Avenue, intends to build a \$21.8-million, three-story, 50,000-square-foot new headquarters that the organization will occupy in mid-2022. This project aims to be the anchor of a larger, planned “innovation district” in conjunction with MidTown leaders and other nonprofits.

Despite performing well in 2019, the East submarket struggled in 2020. The East remains a very important submarket, as it has the most inventory of any suburban submarket and is second in the market overall, behind the CBD. The overall rate in this submarket did jump slightly as the fourth-quarter average asking rental rate increased \$0.03/SF from the previous quarter to \$18.68/SF. This was the highest rate for any suburban submarket and remained second overall in the market, behind the CBD. The Class A asking rental rate ended the quarter at \$22.88/SF, and the Class B asking rental rate closed the year at \$15.97/SF. The East experienced 230,764 square feet in negative absorption during the fourth quarter, which pushed the vacancy rate up by a quarter-leading 260 basis points to 13.7%. The East had the poorest performance of any submarket in the fourth quarter by far.

The South submarket, which has the second-most inventory of the suburban submarkets, performed worse than it did earlier in the year, as its net absorption for the fourth quarter totaled negative 60,599 square feet. As mentioned earlier, the submarket’s annual net absorption stayed above water through 2020 at positive 261,387 square feet, which was the best showing of any submarket. The South’s vacancy rate remained in the middle of the pack and increased by 80 basis points to 18.2%. Its average overall asking rental rate increased by \$0.09/SF to \$17.18/SF for all classes. The Class A asking rental rate ended the quarter at \$20.28/SF, up \$0.08/SF from the third quarter, and the Class B asking rental rate closed the year at \$15.01/SF, up \$0.17/SF from the previous quarter.

The West submarket kept with the trend of the overall market as vacancy increased in the fourth quarter to 17.9%, a 90-basis-point jump that was paced by 31,855 square feet of negative absorption. This brought the 2020 absorption total for the West underwater, which ended the year with negative 12,190 square feet of space given back. The West’s overall asking rent increased more than any other submarket from the third quarter, by \$0.34/SF to \$16.63/SF. This was paced by an increase of \$0.33/SF in the Class B asking rental rate to \$14.81/SF.

The Southwest submarket, which has the highest suburban vacancy despite the least amount of inventory, also kept with the overall market trend as vacancy increased in the fourth quarter to 21.9%, a 100-basis-point increase precipitated by 12,818 square feet of negative absorption. With only 1.34 million square feet of total inventory, this seemingly trivial amount of negative absorption had an impact on vacancy. This submarket’s overall asking rent increased from the third quarter by \$0.02/SF to \$13.96/SF, the lowest in the market.

SUBLEASE SPACE CONTINUES TO GROW

COVID-19 has continued to force sublease space in Cleveland to follow a growth trend in the office market. As the end of the fourth quarter approached, Cleveland's sublease market grew from quarter to quarter. In fact, the second quarter had 129,395 square feet of vacant sublease space, which grew to 173,351 square feet by the end of the third quarter. By the end of the fourth quarter, sublet vacancy nearly doubled from the onset of the pandemic in the second quarter to 306,155 square feet, which resulted in a 0.8% vacancy rate, the largest rate the Cleveland office market has seen since the first quarter of 2013.

Overall sublease availability stood at 412,236 square feet as the fourth quarter ended, the highest it has been in the last nine quarters. This prompted a 1.1% availability rate. The average asking rental rate for sublease space for the last two quarters was \$19.31/SF, the highest it has been since this statistic started being kept in first-quarter 2015.

SELECT LEASE/USER TRANSACTIONS

Tenant	Building	Submarket	Type	Square Feet
United States of America (IRS)	1375 E. 9th St.	CBD	Renewal	18,996
Orion Business Center	1300 E. 9th St.	CBD	New	8,792
Rapid Medical Research	3401 Enterprise Pkwy.	East	New	8,434
Martin, Jolic and Bratton LLC	6050 Oak Tree Blvd.	South	New	4,155
Yuspeh Rappaport Law	25201 Chagrin Blvd.	East	New	3,643

SELECT SALE TRANSACTIONS

Building	Submarket	Sale Price	Price/SF	Square Feet
8747 Brecksville Rd.	South	\$1,725,000	\$156.59	11,016
24400 Chagrin Blvd.	Southwest	\$840,000	\$65.63	12,800
734 Alpha Dr.	East	\$2,000,000	\$52.15	38,350

SUBMARKET STATISTICS

	Total Inventory (SF)	Under Construction (SF)	Total Vacancy Rate	Qtr Absorption (SF)	YTD Absorption (SF)	Class A Asking Rent (Price/SF)	Class B Asking Rent (Price/SF)	Total Average Asking Rent (Price/SF)
CBD Total	18,071,632	0	18.8 %	(70,106)	135,850	\$24.91	\$17.84	\$18.94
East	8,769,134	0	13.7 %	(230,764)	(158,986)	\$22.88	\$15.97	\$18.68
South	7,416,807	0	18.2 %	(60,599)	261,387	\$20.28	\$15.01	\$17.18
Southwest	1,339,605	0	21.9 %	(12,818)	(76,516)	\$14.43	\$14.26	\$13.96
West	3,402,059	100,000	17.9 %	(31,855)	(12,190)	\$19.43	\$14.81	\$16.63
Suburban Total	20,927,605	100,000	16.5 %	(336,036)	13,695	\$20.81	\$15.23	\$17.33
Market Total	38,999,237	100,000	17.6 %	(406,142)	149,545	\$22.23	\$16.62	\$18.11

ECONOMIC CONDITIONS

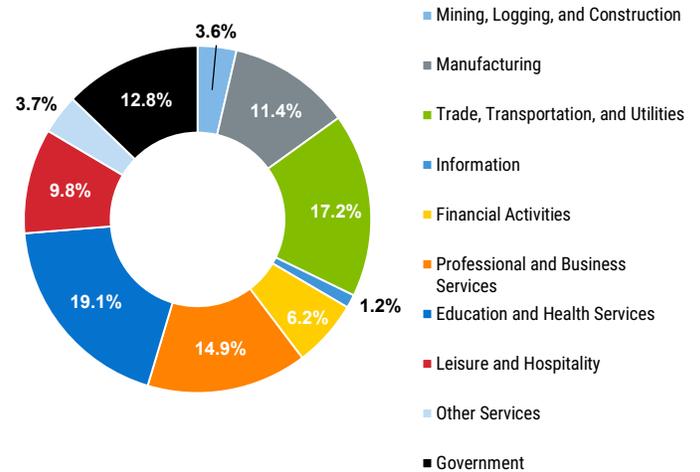
The Greater Cleveland economy lost more jobs in November 2020, as preliminary total nonfarm payroll employment contracted by 8.3% year-over-year. By contrast, the United States contracted by 6.0% year-over-year. The November numbers were an improvement from August, which saw Greater Cleveland payroll employment dip by 11.0% year-over-year and the United States as a whole fall by 6.9% year-over-year. The nation's unemployment rate stood at 6.7% in November, down from 8.4% in August.

Only one industry sector saw employment growth from November 2019 to November 2020: mining, logging and construction, at positive 6.5%.

All other sectors saw a drop in the past year due to the continued implications of COVID-19. The leisure and hospitality industry contracted the most, by negative 24.9%, followed by professional and business services at negative 11.1%, government at negative 7.2%, education and health services at negative 7.1%, other services at negative 6.5%, trade/transportation/utilities at negative 6.4%, the information sector at negative 6.1%, manufacturing at negative 4.6% and financial activities at negative 4.0%.

EMPLOYMENT BY INDUSTRY

Cleveland-Elyria-Mentor



Source: U.S. Bureau of Labor Statistics

UNEMPLOYMENT RATE

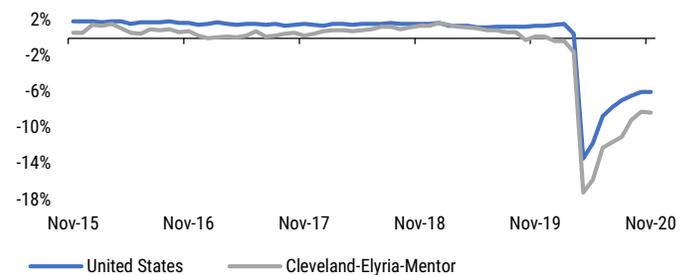
Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

PAYROLL EMPLOYMENT

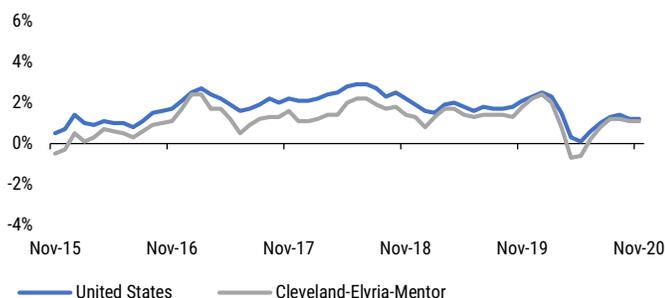
Total Nonfarm, Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics

CONSUMER PRICE INDEX (CPI)

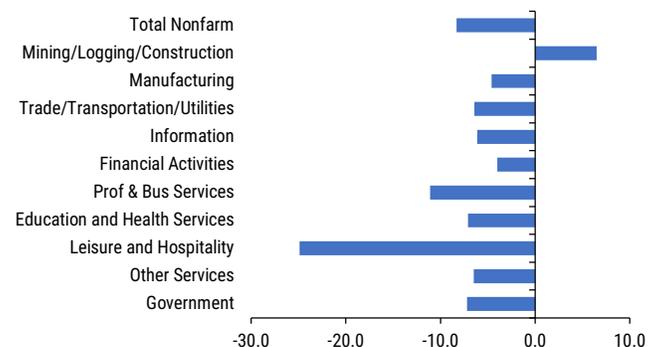
All Items, 12-Month % Change, Not Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

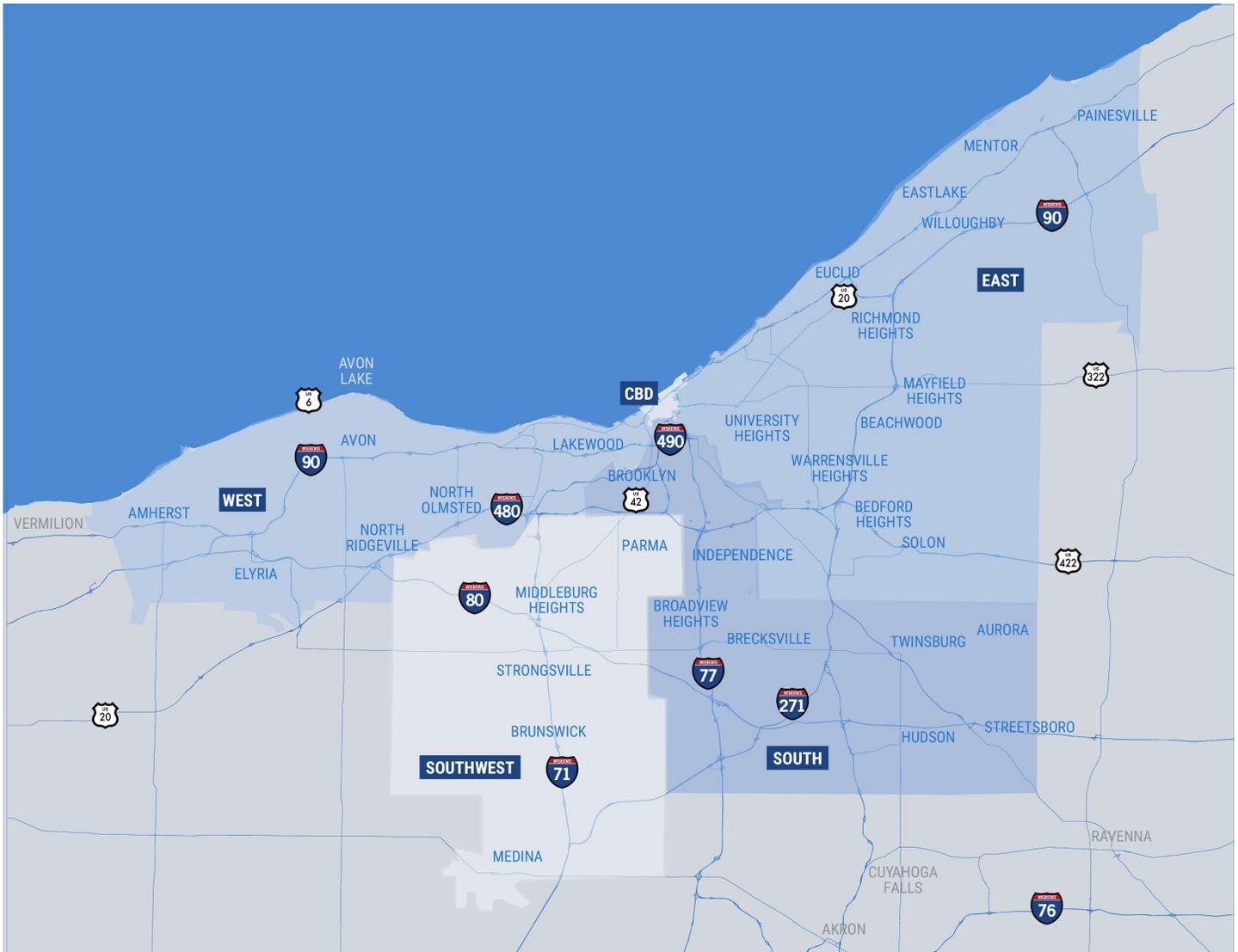
EMPLOYMENT GROWTH BY INDUSTRY

Cleveland-Elyria-Mentor, November 2020*, 12-Month % Change, Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics (*preliminary)

CLEVELAND OFFICE SUBMARKETS



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