

CLEVELAND OFFICE MARKET

CLEVELAND OFFICE MARKET WEATHERS COVID-19 STORM... FOR NOW

Conditions in the Greater Cleveland office market held steady during the second quarter of 2020, despite the full weight of the COVID-19 pandemic upon the United States. The market managed 145,803 square feet of positive net absorption last quarter. Leasing activity throughout the Cleveland market did drop dramatically in the second quarter due to the pandemic, though leases signed in the prior two quarters yielded occupation, and thus a fair amount of positive absorption in the past quarter. Total absorption for the first half of the year showed a positive 547,889 square feet.

The overall positive absorption decreased the market's vacancy rate by 40 basis points from the prior quarter to 16.5% for all office properties. A more immediate implication of the onset of COVID-19 was the average asking rental rate dipping by \$0.15/SF across the Greater Cleveland office market, finishing the second quarter at \$18.03/SF for all classes.

The office market has remained reasonably steady for the last two years, as vacancy rates have stayed below 17.0% for five of the last six quarters and the average asking rental rate has stayed over \$18.00/SF for the last six quarters. The market hit its most recent high mark of \$18.49/SF in first-quarter 2019.

The outlook for the rest of the year is very uncertain. The steady numbers of the second quarter should likely not provide false hope for the coming months, as absorption numbers will certainly be affected by the lackluster lease signings in the second quarter and the pandemic. Building owners, leasing brokers and tenants have injected some creativity to help all sides navigate COVID-19. Some owners have worked with tenants to defer lease escalations into renewal terms, while one client borrowed their own security deposits to later be paid back, a creative workaround wherein the tenant was granted some relief without impacting landlord cash flow.

Another interesting development in the second quarter was the announcement by Ohio Secretary of State Frank LaRose that 12,892 new businesses filed with the state in May, the most filings in May of any year on record, up 13.0% from the previous month of April and 16.0% higher than in May 2019. The overall effect of this news on the need for space is undetermined as these filings declare the formation of a business entity, including for-profit, non-profit and professional corporations, limited liability companies, partnerships, limited partnerships and limited liability partnerships. The Ohio Secretary of State's office pointed out that filing as a business in Ohio does not guarantee the company will begin operations, be profitable or create jobs. Nonetheless, this is something to watch as the year progresses.

CURRENT CONDITIONS

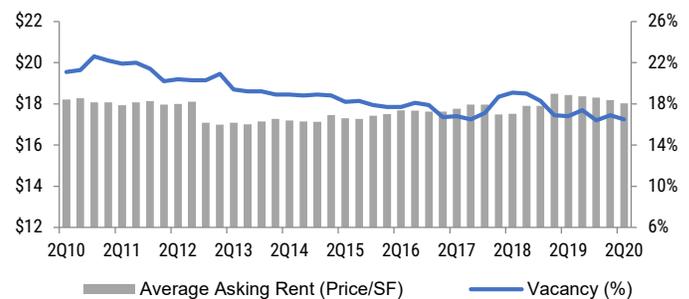
Overall vacancy decreased due to the occupation of leases that were signed in the prior few quarters.

The market accumulated strong absorption numbers in the first half of the year, though lease signings were sparse in the second quarter as a result of the COVID-19 pandemic.

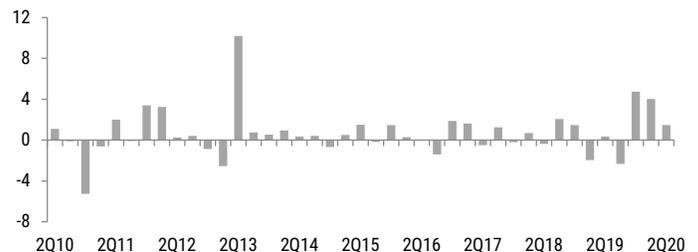
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MARKET ANALYSIS

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	37.5 MSF	↑
Vacancy Rate	16.5%	16.9%	16.8%	↑
Quarterly Net Absorption	145,803	402,086	34,538	→
Average Asking Rent	\$18.03	\$18.18	\$18.43	→
Under Construction	100,000	100,000	174,209	↑
Deliveries	0	60,000	0	↑

EAST SUBMARKET TIGHTEST ONCE AGAIN

The East's vacancy rate decreased by 100 basis points to 11.5%, to remain the tightest submarket in the area. 85,895 square feet of positive net absorption was behind the vacancy decrease and helped push the East's year-to-date absorption into the positive with 37,347 square feet.

Rental rates in the East decreased as the second-quarter average asking rental rate notched \$17.86/SF, down \$0.22/SF from the previous quarter. The Class B asking rental rate in the East paced this decrease, as it fell by \$0.23/SF to \$16.01/SF. Rates for Class A properties in the East increased by \$0.16/SF to \$22.66/SF. East Class A properties remained below the Central Business District's Class A rate of \$24.92/SF, which increased by \$0.08/SF from the previous quarter and led all classes and submarkets. Class A office assets in the East commanded the second highest average rental rate in the market and were above the Class A overall market average of \$22.36/SF, which was up \$0.08/SF from the first quarter.

Sales and leases in the second quarter were lackluster, though the East submarket saw the majority of the top sales. The 34,380-square-foot 29225 Chagrin Boulevard sold for \$4.8 million, or \$140/SF, as a fully leased investment sale to Waterstone Brainworks Company. Also in the East, 24075 Commerce Park transferred to Retina Associates of Cleveland Inc. for \$1.5 million, or \$77/SF, in an owner/user sale. The 19,440-square-foot building will become the headquarters of the eye surgery company. Just 0.3 miles away, 23700 Commerce Park sold for \$3.65 million, or \$72/SF. Saber Healthcare Group, LLC was the owner/user purchaser of the 51,000-square-foot building.

One other notable sale in the East in the second quarter was the 36,000-square-foot 20820 Chagrin Boulevard. Cellular Technology Limited bought the building for \$1.25 million, or \$35/SF. The global biotech company intends to remain in its nearby headquarters at 20521 Chagrin Boulevard, with the intention of expanding into the newly purchased property to accommodate additional offices and production space.

The quarter's largest lease transaction took place in the East, as TMW Systems, Inc. renewed 55,508 square feet at 6085 Parkland Boulevard.

The CBD led the way in terms of absorption during the second quarter, as this submarket gained 91,016 square feet. The occupancy gain caused the CBD's vacancy rate to decrease by 50 basis points to 18.4%, no longer the highest in the market. In turning around a recent down streak and despite the COVID-19 emergence, the continuing popularity and relevance in the market endured for the CBD, as it ended the first half of 2020 with the most absorption of any submarket, netting a positive 202,993 square feet, a 180-degree reversal from negative 245,012 square feet after the first half of last year.

Class B asking rents in the CBD did not follow their Class A counterparts. Class B rents decreased by \$0.06/SF from the previous quarter, coming in at \$18.08/SF. The overall asking rent in the CBD also decreased in the second quarter. The CBD's \$0.19/SF drop to \$19.18/SF still made it the highest in the market

A number of significant CBD developments took place in second-quarter 2020, though one of the most talked-about leases took place just as the first quarter ended and the second quarter began. Law firm Weston Hurd signed a full-floor, 29,766-square-foot lease at AECOM Centre, located at 1300 East 9th Street. This building has generated a lot of buzz in the last year as it has made an amazing comeback with \$11.0 million in owner-initiated renovations that are nearly complete. Some renovations include: a state-of-the-art fitness center that features Peloton bikes, a golf simulator and a half basketball court; modern conference facilities; newly updated common areas; elevator upgrades to destination dispatch; a parking garage overhaul; and much more.

Sherwin-Williams news continued to add intrigue to the office landscape, despite the start of its headquarters construction being slowed down by the pandemic. In mid-June, Cleveland City Council approved a tax increment financing package that was signed by Mayor Frank Jackson as the second quarter ended. The TIF package will allow Sherwin-Williams to postpone the payment of new property taxes so that the money can be used to help finance the construction. It will provide an estimated \$2.0 million to \$2.5 million per year over its 30-year lifespan. This comes after JobsOhio approved \$37.5 million in grants in April for the company's new HQ and R&D facility. Additional incentives from the City of Cleveland, as well as Cuyahoga County, were previously announced in the first quarter.

Sherwin-Williams will build its new global headquarters in Downtown Cleveland, just west of Public Square between St. Clair Avenue and Superior Avenue. Preliminary plans call for the company to invest a minimum of \$600.0 million to construct both facilities. The facility will measure approximately 1 million square feet. In late March, the company paid \$49.4 million for 6.9 acres of Downtown property (parking lots that bridge Public Square and the Historic Warehouse District) where the facility will be constructed. That amounts to more than \$7.0 million per acre.

The suburban office submarket saw a vacancy decrease of 30 basis points from last quarter to 14.9%. While the success of the East played into this, the submarket with the second biggest vacancy decrease was the Southwest, which dropped 90 basis points to 21.2%. The Southwest still had the highest vacancy rate of all the submarkets, but also helped contribute to the overall suburban drop. The overall average asking rental rate for the suburban submarkets decreased \$0.17/SF to \$16.80/SF, despite vacancy dipping. The likely main contributor to this atypical outcome is the advent of COVID-19. As stated previously, the suburban submarket with the highest overall asking rent was the East, which led the suburbs. The South's overall asking rent was down \$0.08/SF to \$16.86/SF from the prior quarter, while the West's rent increased \$0.19/SF to \$16.05/SF. The lowest rental rate in the market came in the Southwest, which had a rental rate increase of \$0.20/SF to \$13.97/SF.

The West netted 24,595 square feet of negative absorption, which helped propel this submarket with the second lowest amount of inventory in the market to a 70-basis-point jump in vacancy to 17.4%. A sale of note in the West was an affiliate of REBEL Development Company's purchase of the 95.0%-occupied 2035 Crocker Road in Westlake. The sale price for the 30,000-square-foot building, which transferred from Cleveland area developer Stark Enterprises, was undisclosed.

The Class A average asking rental rate in the West led all submarkets with a \$0.20/SF increase to \$19.51/SF. Class B assets also had an increase in asking average rental rate, by \$0.14/SF to \$14.94/SF.

The South was the only other suburban submarket in the second quarter to post negative absorption, giving back 19,543 square feet of space and prompting a 20-basis-point increase in vacancy to 16.7%. Yet, this still represented the second-tightest vacancy in the market behind the East. Despite the negative absorption this past quarter, the South's year-to-date absorption stood at positive 369,198 square feet after a mammoth first quarter that helped carry the entire market.

The Southwest submarket's vacancy rate decrease came as a result of 13,030 square feet of positive net absorption. This submarket has the smallest amount of inventory in the overall Cleveland office market.

SELECT LEASE/USER TRANSACTIONS

Tenant	Building	Submarket	Type	Square Feet
TMW Systems, Inc.	6085 Parkland Blvd.	East	Renewal	55,508
* Weston Hurd	1300 E. 9th St.	CBD	New	29,766
Focus Groups of Cleveland, Inc.	2 Summit Park Dr.	South	Renewal	4,158
Infinity Title Solutions	4511 Rockside Rd.	South	New	2,403
Blue Cranium, LLC	20525 Center Ridge Rd.	West	New	1,290

* Lease was signed at the very end of First Quarter 2020

SELECT SALE TRANSACTIONS

Building	Submarket	Sale Price	Price/SF	Square Feet
29225 Chagrin Blvd.	East	\$4,800,000	\$139.62	34,380
24075 Commerce Park	East	\$1,500,000	\$77.16	19,440
23700 Commerce Park	East	\$3,650,000	\$71.57	51,000
20820 Chagrin Blvd.	East	\$1,250,000	\$34.72	36,000
2035 Crocker Rd.	West	Undisclosed	Undisclosed	30,000

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	18.4%	91,016	202,993	\$24.92	\$18.08	\$19.18
East	8,769,134	0	11.5%	85,895	37,347	\$22.66	\$16.01	\$17.86
South	7,416,807	0	16.7%	(19,543)	369,198	\$20.07	\$14.56	\$16.86
Southwest	1,339,605	0	21.2%	13,030	(67,155)	\$14.43	\$14.13	\$13.97
West	3,402,059	100,000	17.4%	(24,595)	5,506	\$19.51	\$14.94	\$16.05
Suburban Total	20,927,605	100,000	14.9%	54,787	344,896	\$20.51	\$15.07	\$16.80
Market Total	38,999,237	100,000	16.5%	145,803	547,889	\$22.36	\$16.66	\$18.03

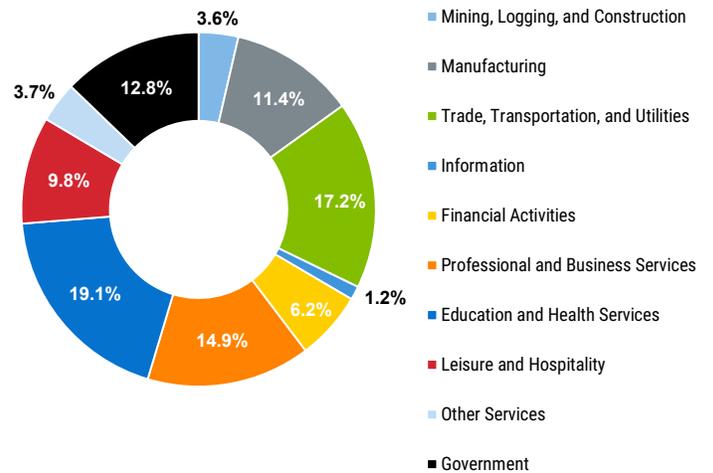
ECONOMIC CONDITIONS

The Greater Cleveland economy lost an unprecedented amount of jobs throughout the first half of 2020, especially as the pandemic took over the entirety of the second quarter. Total nonfarm payroll employment plummeted in May by 15.9% year-over-year after dropping 17.2% in April year over year. Overall payroll employment for the United States also fell in May, by 11.8% year over year.

All but one Greater Cleveland industry sector saw significant declines from May 2019 to May 2020. The mining, logging and construction industry grew by 0.3%. Conversely, the leisure and hospitality industry contracted the most, by negative 49.3%. The other industries to report a negative change year over year were the other services industry (negative 19.3%); professional and business services (negative 18.2%); government (negative 14.2%); education and health services (negative 13.3%); trade, transportation and utilities (negative 10.6%); information (negative 9.6%); manufacturing (negative 9.7%); and financial activities (negative 3.9%).

EMPLOYMENT BY INDUSTRY

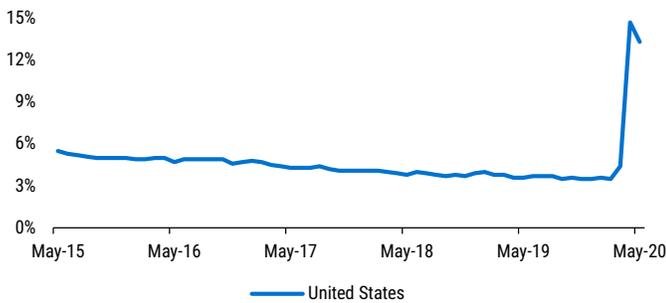
Cleveland-Elyria-Mentor



Source: U.S. Bureau of Labor Statistics

UNEMPLOYMENT RATE

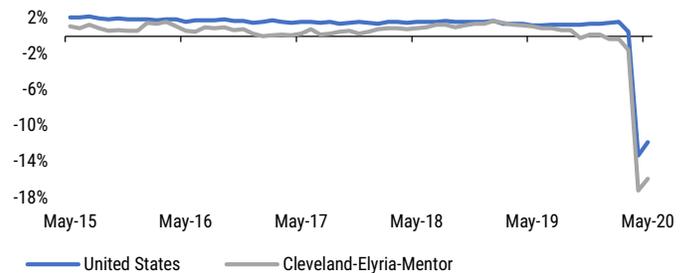
Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

PAYROLL EMPLOYMENT

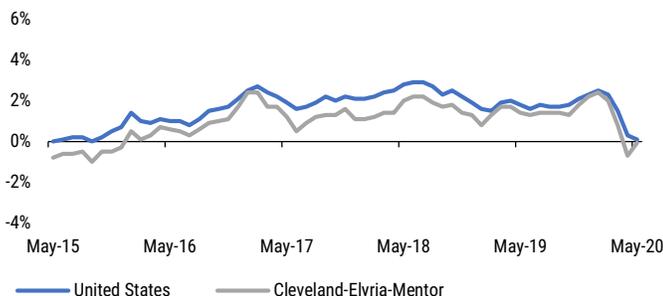
Total Nonfarm, Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics

CONSUMER PRICE INDEX (CPI)

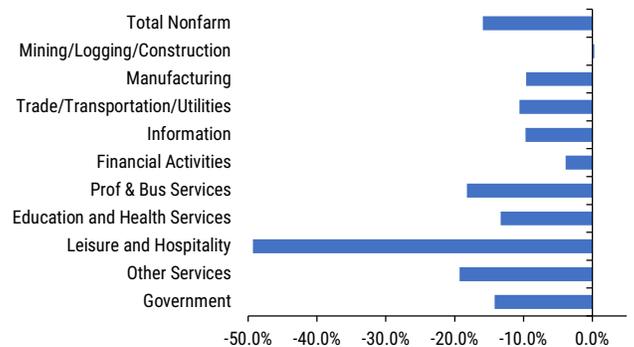
All Items, 12-Month % Change, Not Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

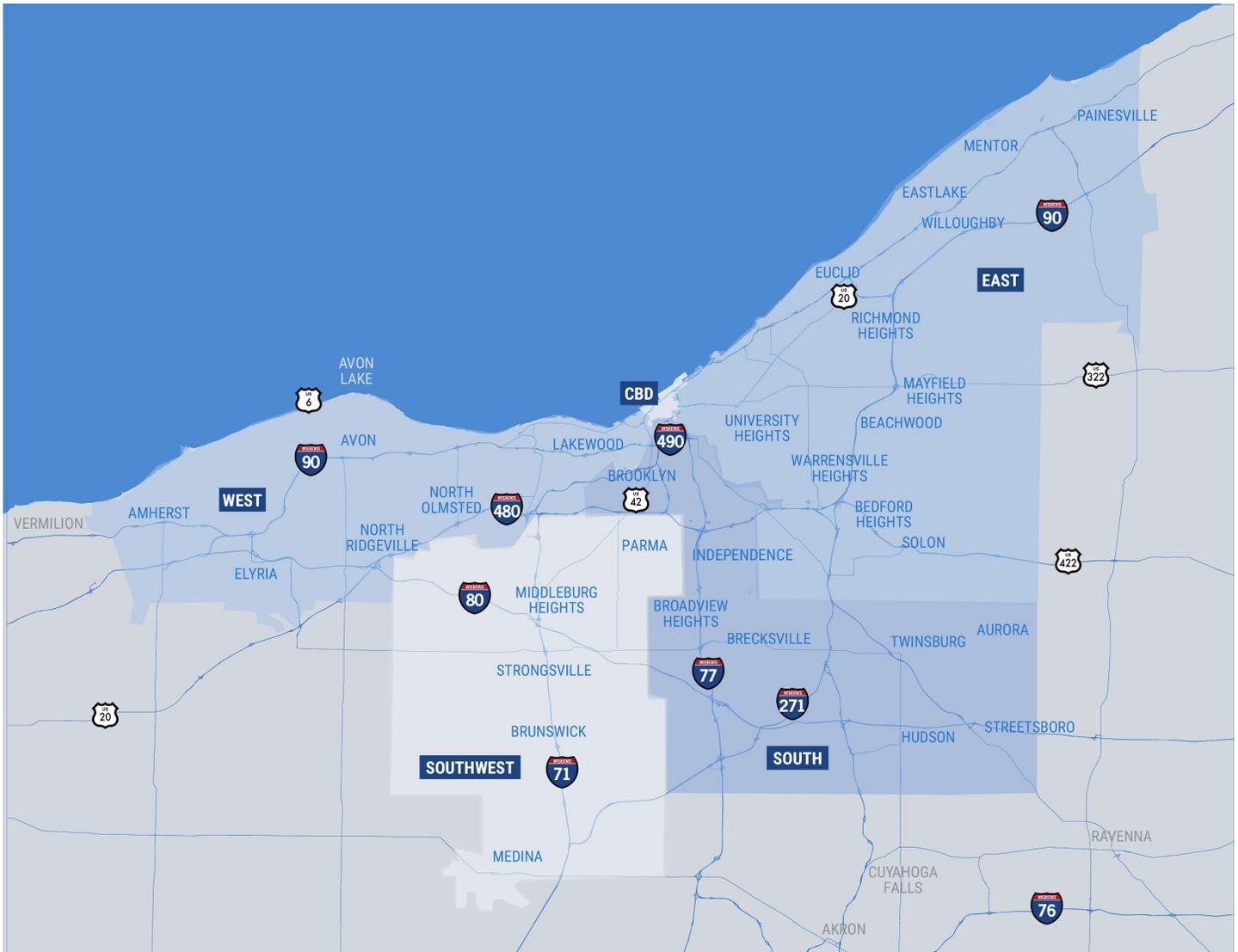
EMPLOYMENT GROWTH BY INDUSTRY

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



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

CLEVELAND OFFICE SUBMARKETS



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Newmark Knight Frank has implemented a proprietary database and our tracking methodology has been revised. With this expansion and refinement in our data, there may be adjustments in historical statistics including availability, asking rents, absorption and effective rents. Newmark Knight Frank Research Reports are available at www.ngkf.com/research

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