

CAPITAL MARKETS UPDATE

Suburban Office: Is this the Next Play?

October 2016

Background

- Suburban office product has lagged the property recovery cycle. Most of the lag is the result of urbanization trends driven by the Millennial demographic.
- Millennials are attracted to CBDs not so much because they are Millennials, but because they are in their 20s and find the urban lifestyle more appealing.
- As these Millennials age (the average age of marriage is now 30 years old), many couples with young children will gravitate towards areas that are more affordable, have better schools, and offer more space.
- Given that Millennials are nearing their prime marriage years and prime home buying years, we expect a “**resuburbanization trend**” (already beginning) to gradually occur over the next several years.
- Suburban office is already showing signs of revitalization. Office vacancy in the suburbs has tightened by 150 basis points since 2015, and gross leasing is accelerating.
- Just as millennials hit their prime home buying years, autonomous vehicles enter the scene. Most studies show that suburbs and low density areas will benefit the most from the driverless car effect.

Opportunity

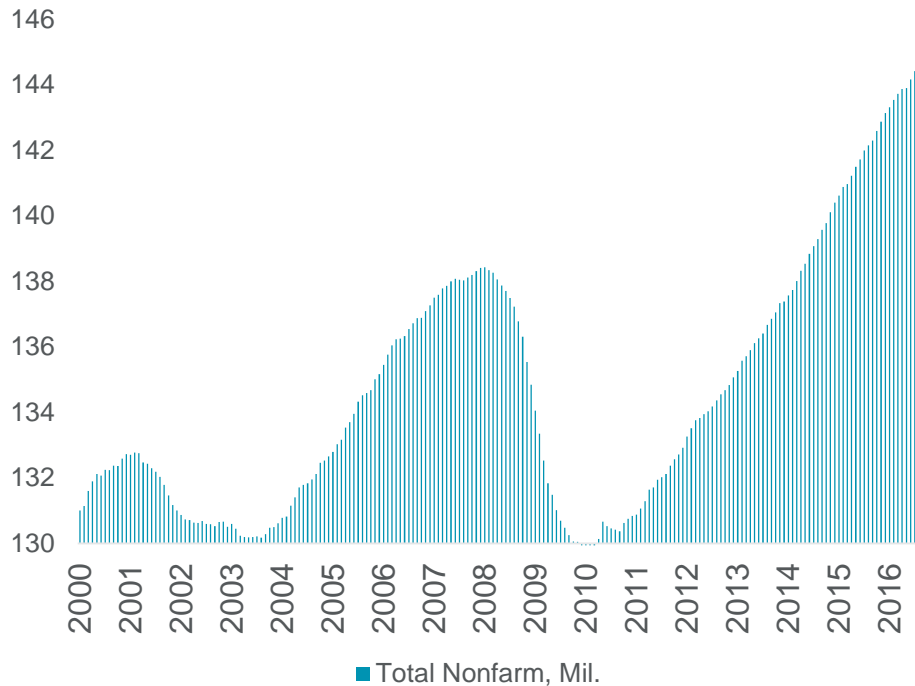
- Medium to long-term investors can take advantage of current pricing dislocations (suburban office is trading at all-time high spreads to CBD assets)
- Key suburban attributes should include: proximity to mass transit (until driverless cars fully emerge), high walkability score, high quality amenities, social/dining aspects
- Important to distinguish between 18-hour suburban markets on mass transit (lower risk) with more remote suburbs with car only access (higher risk)

Given This...

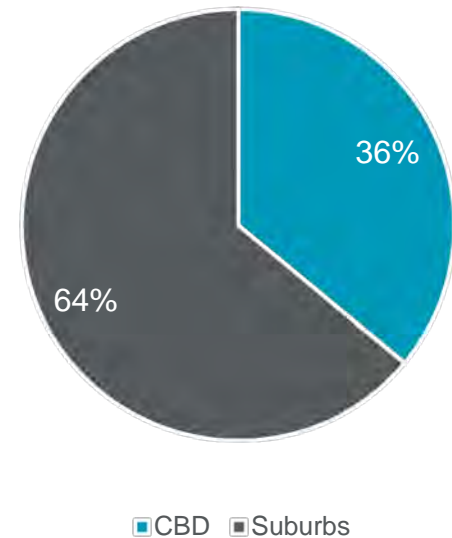
U.S. Employment



SINCE 2009, 15 MILLION JOBS
CREATED IN THE U.S.

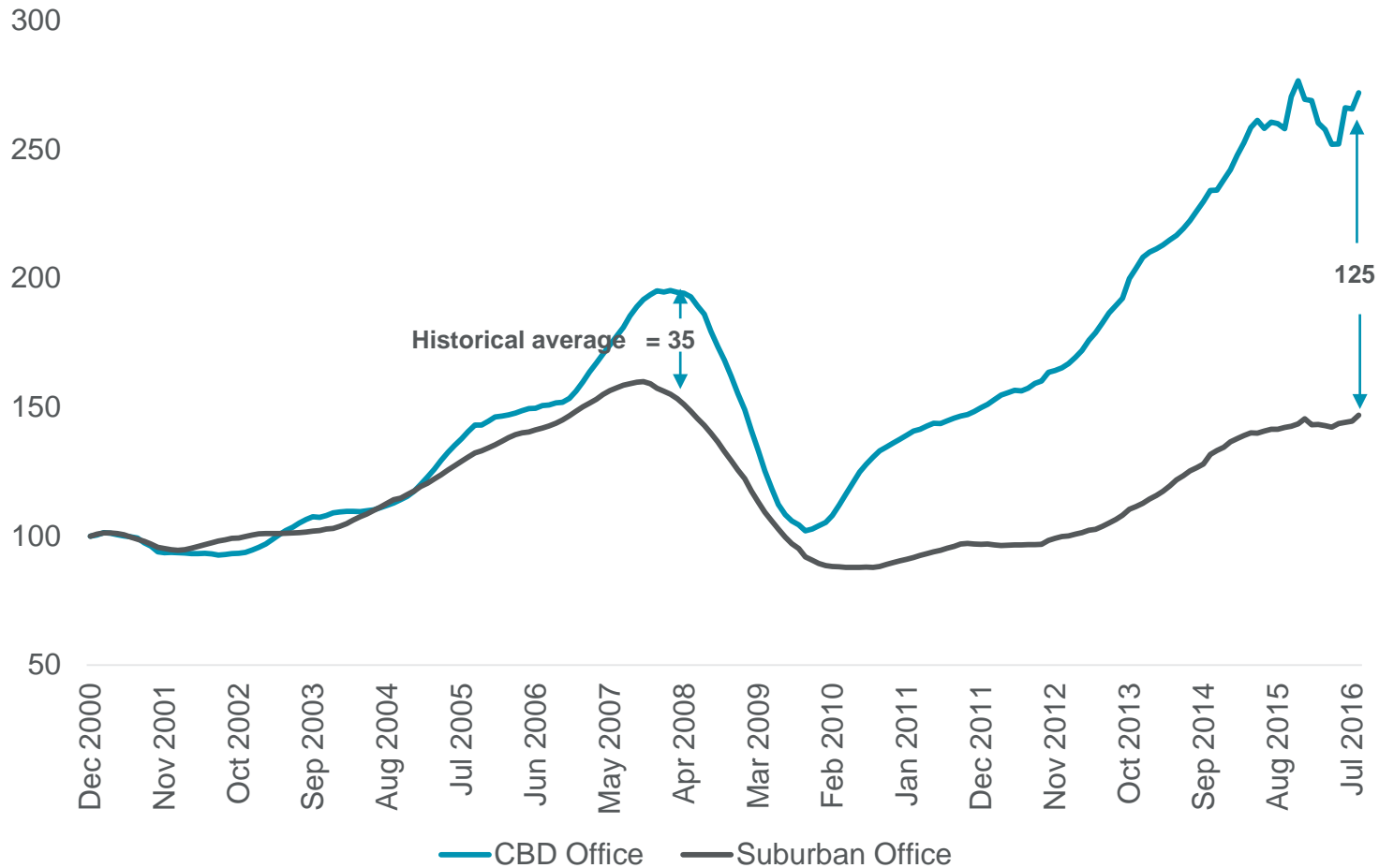


64% OF CURRENT WORKFORCE
SITS IN THE SUBURBS



Does This Spread Make Sense?

Moody's/RCA Price Index

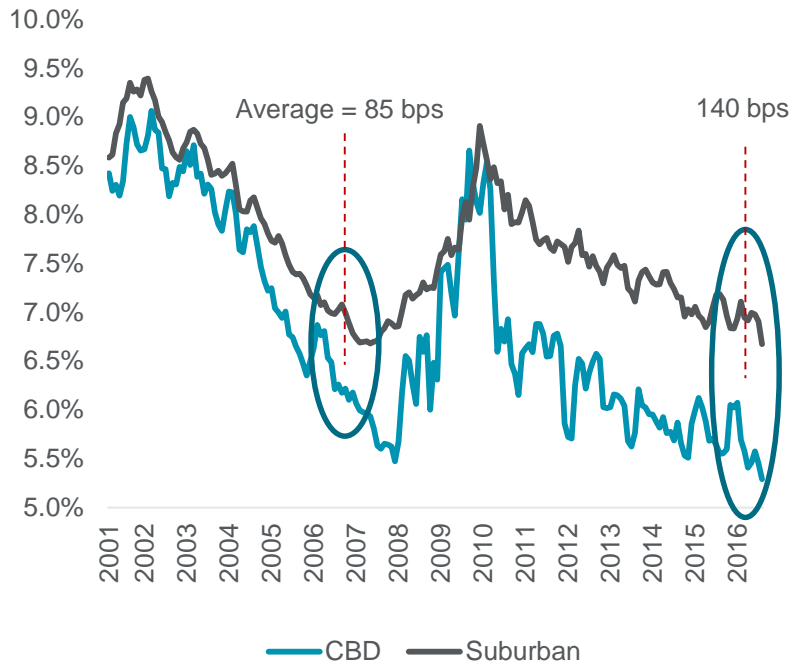


How About These?

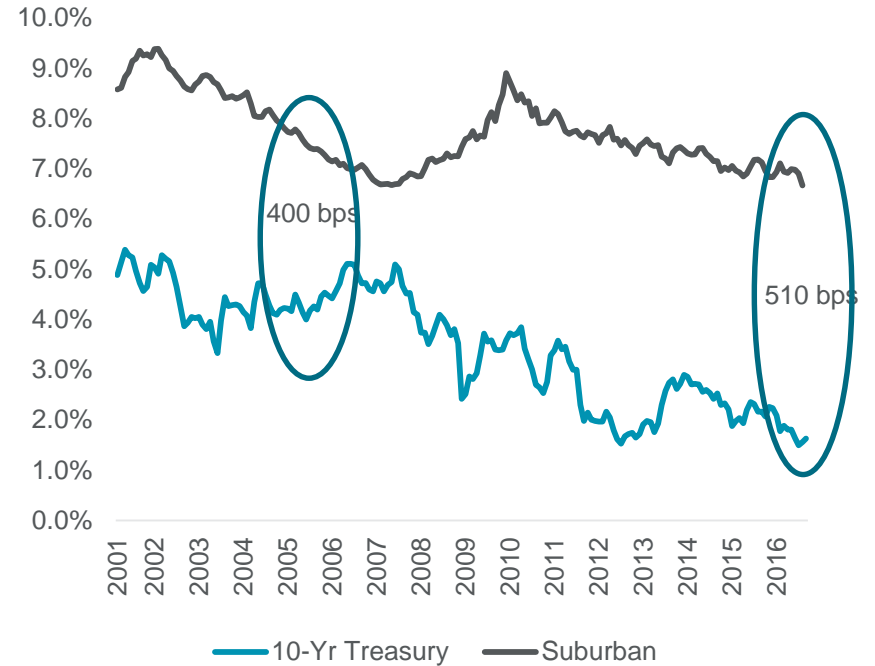
Office Cap Rates



SUBURBS VS. CBD



SUBURBS VS. 10-YEAR TREASURY

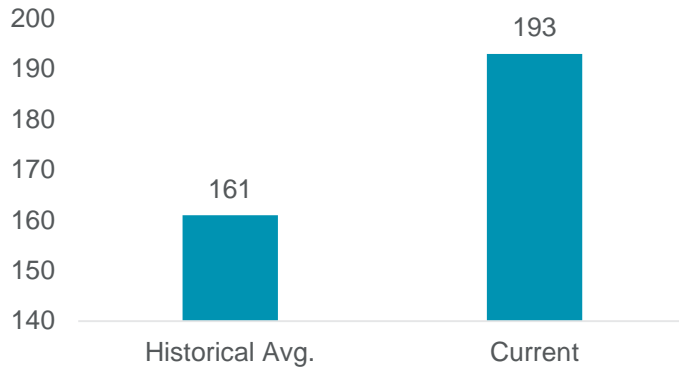


Or These?

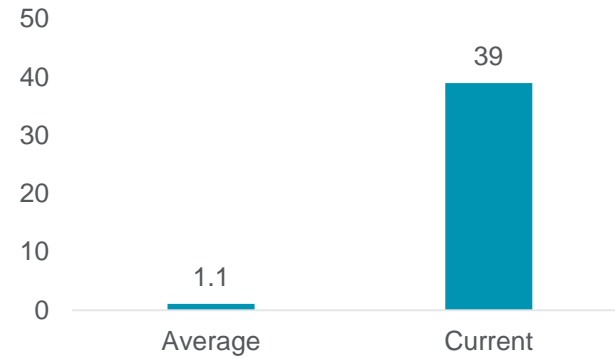
Cap Rate Spread: Suburban vs. Other Product Types



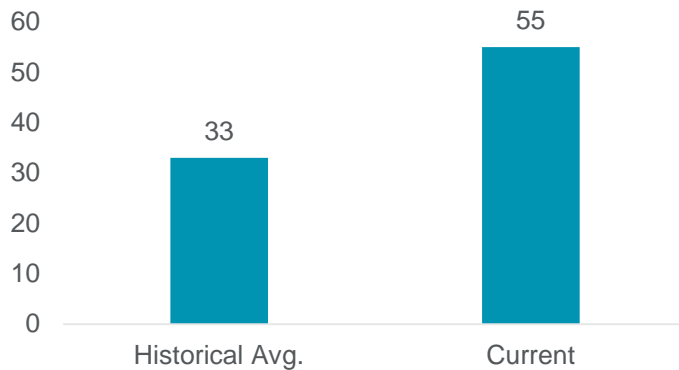
VS. MID/HIGH RISE APARTMENTS



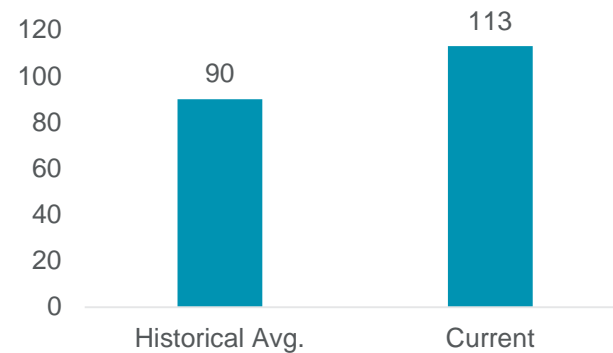
VS. WAREHOUSE



VS. RETAIL



VS. GARDEN STYLE

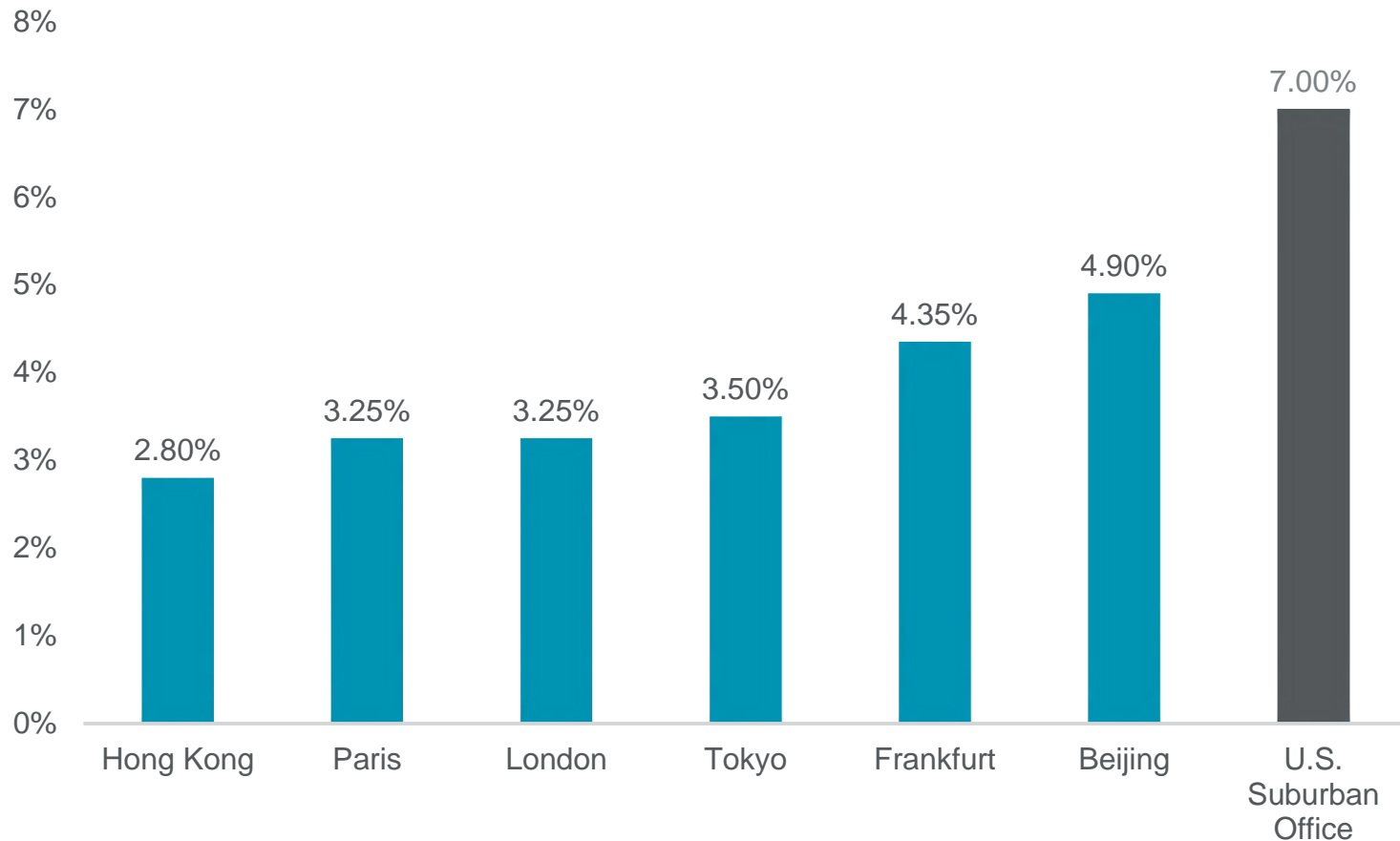


And Let's Not Forget About These

Global Cap Rate Comparison



SINCE THE RECESSION, THE U.S. SUBURBS HAVE CREATED 5.7 MILLION MORE JOBS THAN ALL OF THESE CITIES COMBINED



What About the Leasing Fundamentals?

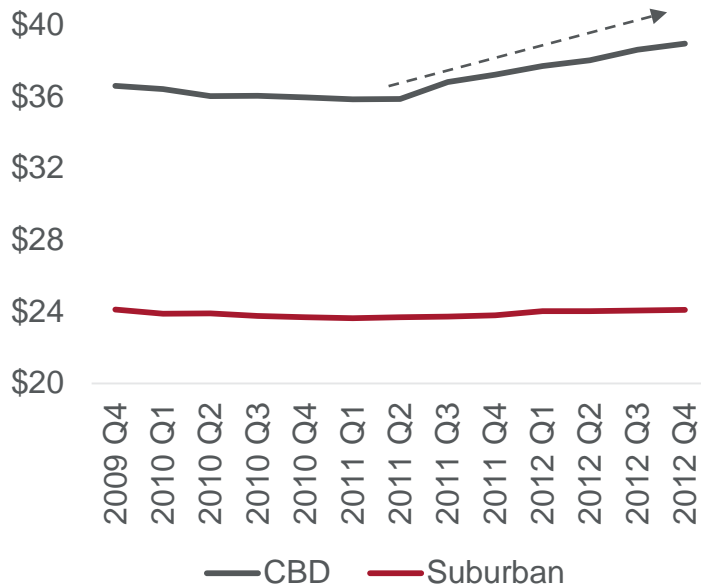


Suburbs Were Late to the “Recovery Party”

Trends Immediately Following the Great Recession

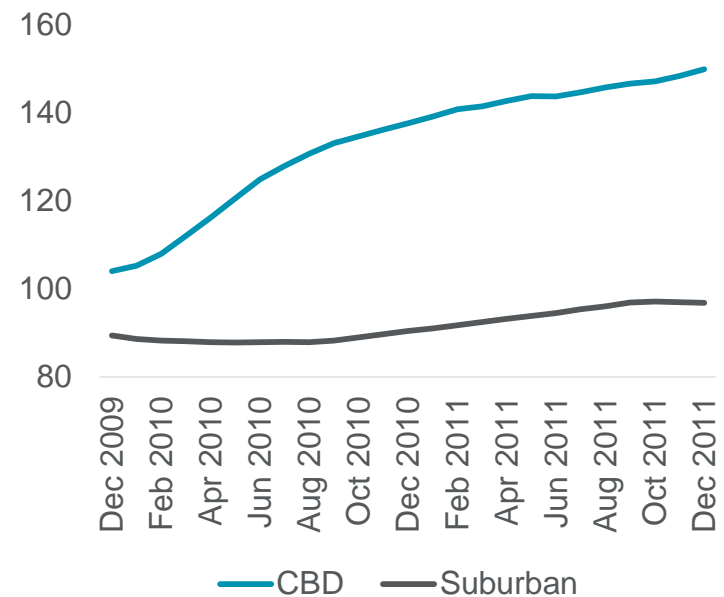


OFFICE RENTS



CBD rents began to recover in 2011, Suburban rents experienced little to no upward movement

MOODY'S/RCA Price Index



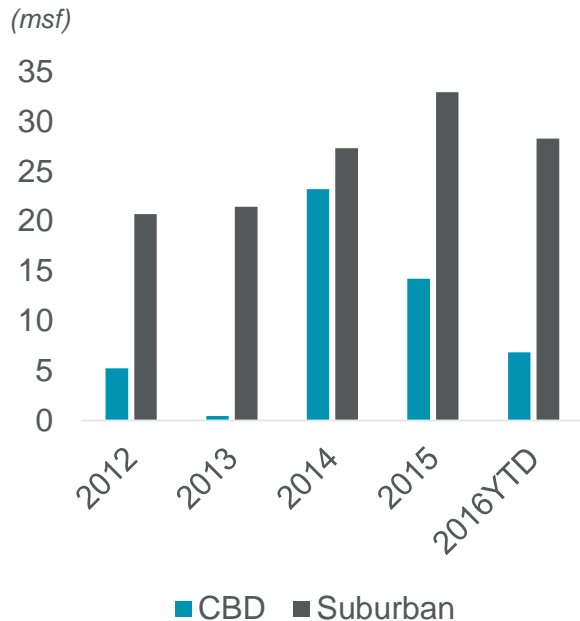
CBD pricing surged by 44% in two years following the recession while suburban saw minimal gains

But the Suburbs Are Turning It on Now

U.S. Absorption & Vacancy Trends

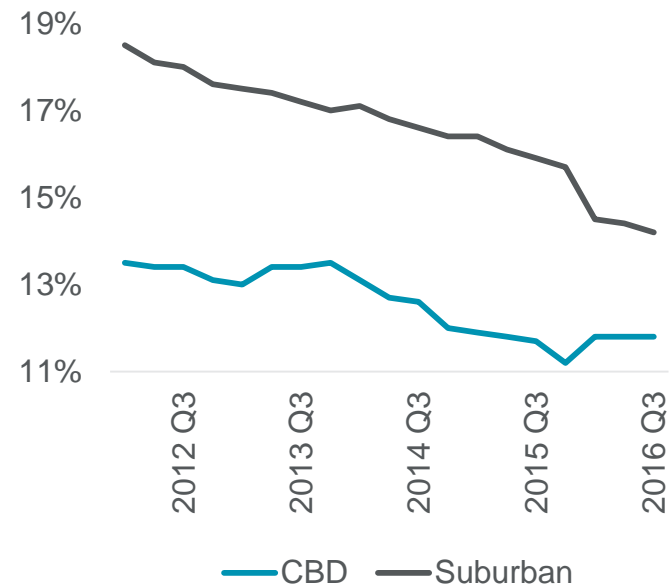


OFFICE NET ABSORPTION



Suburbs have accounted for 72% of all office space absorption since 2012

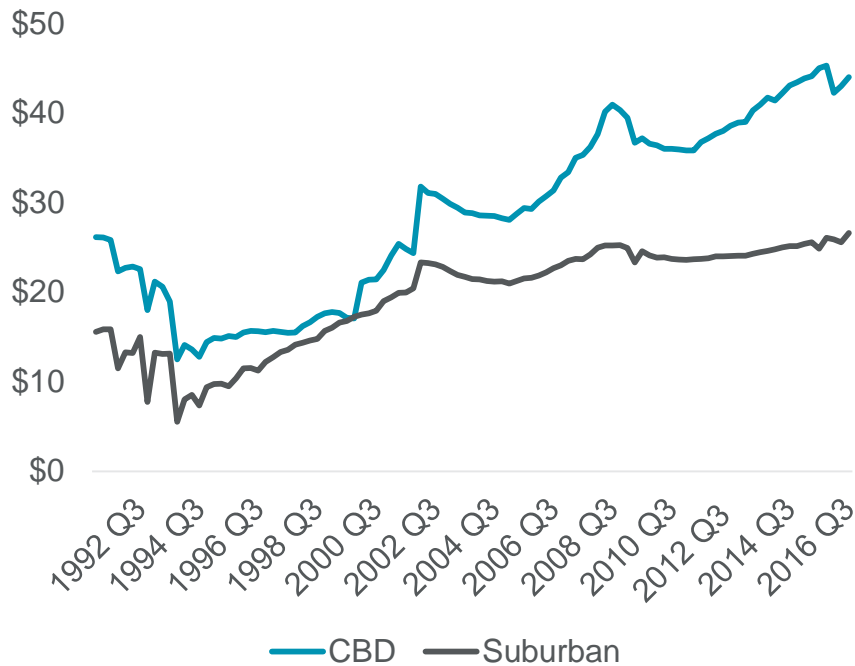
VACANCY



Vacancy in the suburbs has tightened by 150 bps since 2015; 430 bps since 2012

Today's Rent Spread Is Massive

Asking Rents: Suburban vs. CBD



| | CBD | Suburbs | Difference |
|---------|---------|---------|------------|
| 1990's | \$17.70 | \$12.58 | \$5.12 |
| 2000's | \$30.76 | \$22.14 | \$8.63 |
| Current | \$44.03 | \$26.62 | \$17.41 |

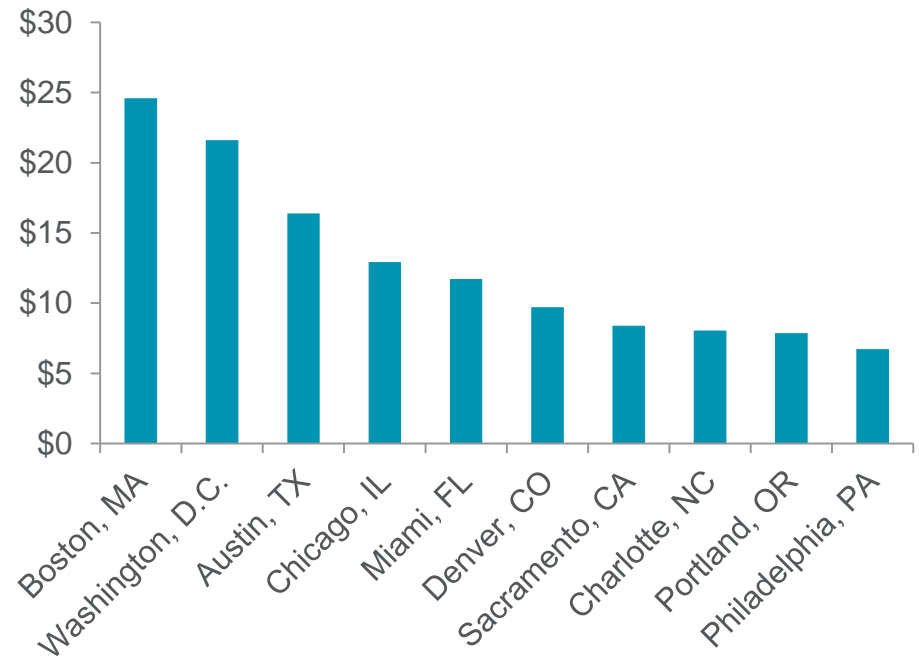
Rent Spread by Market

CBD vs. Suburbs



| Market | 16Q3 ASKING RENTS | | SPREAD | |
|-----------------------|-------------------|----------------|----------------|-----------------|
| | CBD | Suburbs | Current | 10-Year Average |
| Atlanta, GA | \$27.51 | \$21.24 | \$6.27 | \$4.89 |
| Austin, TX | \$48.18 | \$31.80 | \$16.38 | \$10.75 |
| Baltimore, MD | \$22.09 | \$27.42 | -\$5.33 | -\$3.09 |
| Boston, MA | \$50.31 | \$25.70 | \$24.61 | \$19.38 |
| Charlotte, NC | \$28.92 | \$20.88 | \$8.04 | \$5.92 |
| Chicago, IL | \$35.95 | \$23.02 | \$12.93 | \$9.81 |
| Cincinnati, OH | \$18.78 | \$17.00 | \$1.78 | \$1.64 |
| Dallas/Fort Worth, TX | \$28.13 | \$25.11 | \$3.02 | \$1.14 |
| Denver, CO | \$32.01 | \$22.30 | \$9.71 | \$8.08 |
| Houston, TX | \$30.84 | \$37.83 | -\$6.99 | \$4.29 |
| Indianapolis, IN | \$19.03 | \$17.29 | \$1.74 | \$1.52 |
| Los Angeles CBD | \$40.23 | \$34.56 | \$5.67 | \$4.74 |
| Miami, FL | \$42.64 | \$30.93 | \$11.71 | \$7.86 |
| Nashville, TN | \$25.39 | \$23.29 | \$2.10 | \$0.24 |
| New Haven, CT | \$20.24 | \$21.08 | -\$0.84 | \$2.26 |
| Orlando, FL | \$24.83 | \$19.67 | \$5.16 | \$4.48 |
| Philadelphia, PA | \$29.79 | \$23.07 | \$6.73 | \$2.51 |
| Phoenix, AZ | \$23.28 | \$24.14 | -\$0.86 | -\$0.28 |
| Portland, OR | \$29.91 | \$22.04 | \$7.87 | \$2.28 |
| Sacramento, CA | \$28.54 | \$20.16 | \$8.38 | \$7.35 |
| San Diego, CA | \$31.32 | \$34.92 | -\$3.60 | -\$0.47 |
| San Francisco, CA | \$70.23 | \$66.52 | \$3.71 | \$7.75 |
| San Jose, CA | \$39.12 | \$40.20 | -\$1.08 | -\$2.70 |
| St. Louis, MO | \$16.90 | \$20.42 | -\$3.52 | -\$3.73 |
| Tampa, FL | \$25.20 | \$22.85 | \$2.35 | -\$0.52 |
| Washington, D.C. | \$53.73 | \$32.12 | \$21.61 | \$13.19 |
| U.S. Average | \$44.03 | \$26.62 | \$17.41 | \$6.10 |

WHERE THE RENT SPREAD IS LARGEST

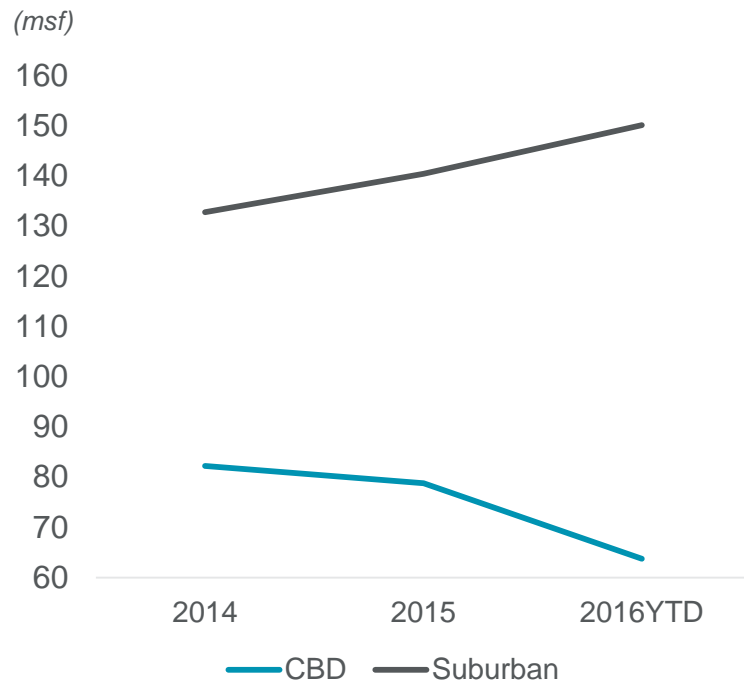


Tenants Have Taken Notice

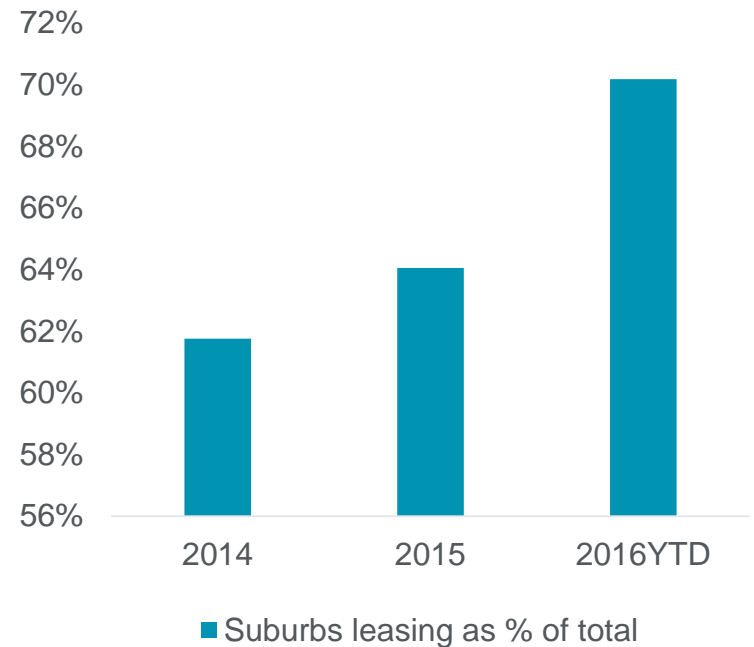
Gross Leasing Trends: Suburban vs. CBD



GROSS LEASING ACTIVITY



PERCENT OF TOTAL



But Millennials Will Never Work in the Suburbs, Right?

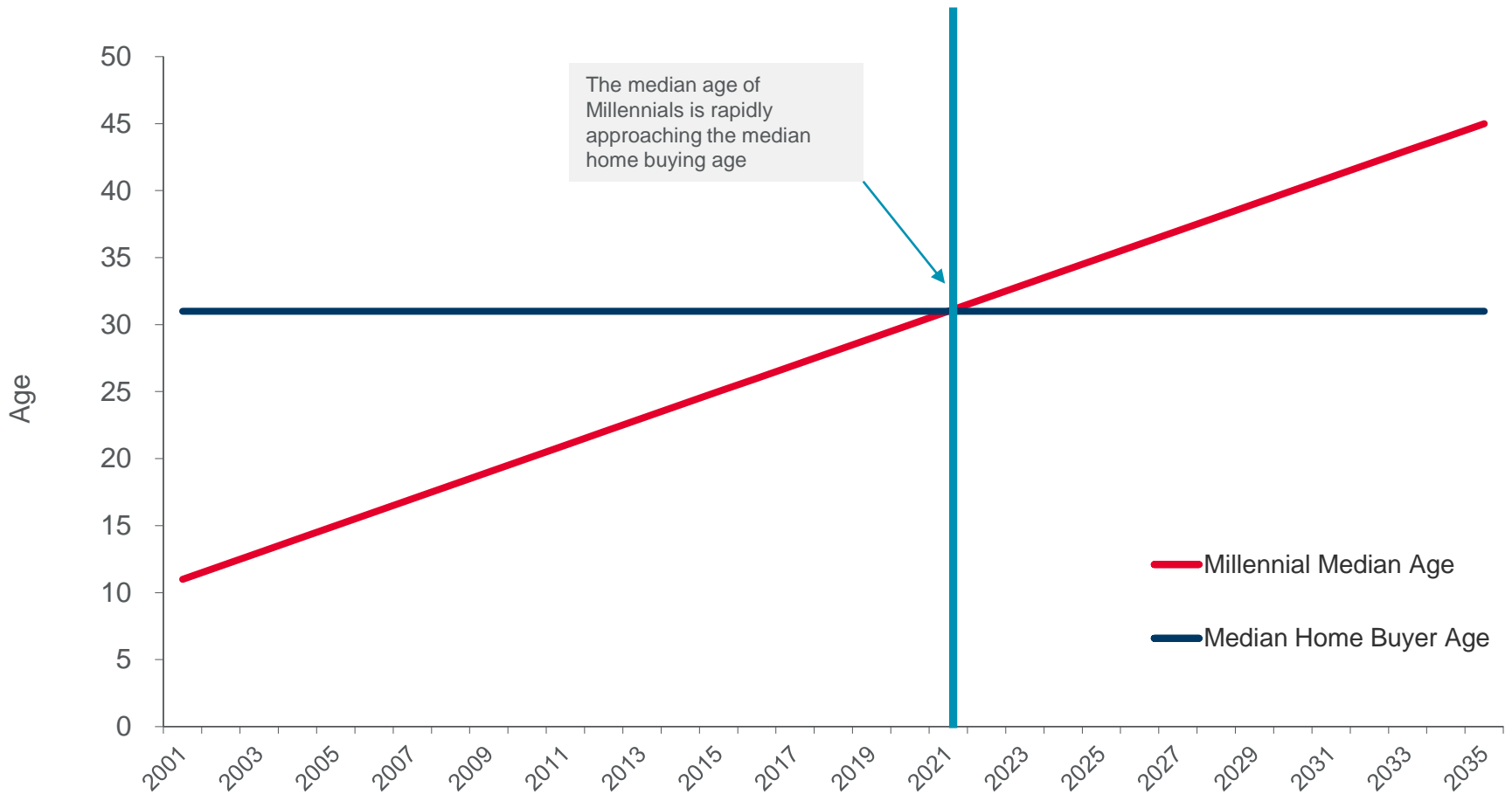
MILLENNIALS: FACT VS. FICTION

- *Millennials Prefer Cities?*
- *Millennials Prefer to Live in Smaller Spaces?*
- *Millennials Prefer Renting Over Owning?*
- *Millennials Are More Culturally Diverse?*
- *Millennials Aren't Getting Married?*
- *Millennials Aren't Having Kids?*
- *Millennials Are More Likely to Live in Parents Basements... FOREVER*



Wrong! Millennials Are Getting Older

Demographic Trends

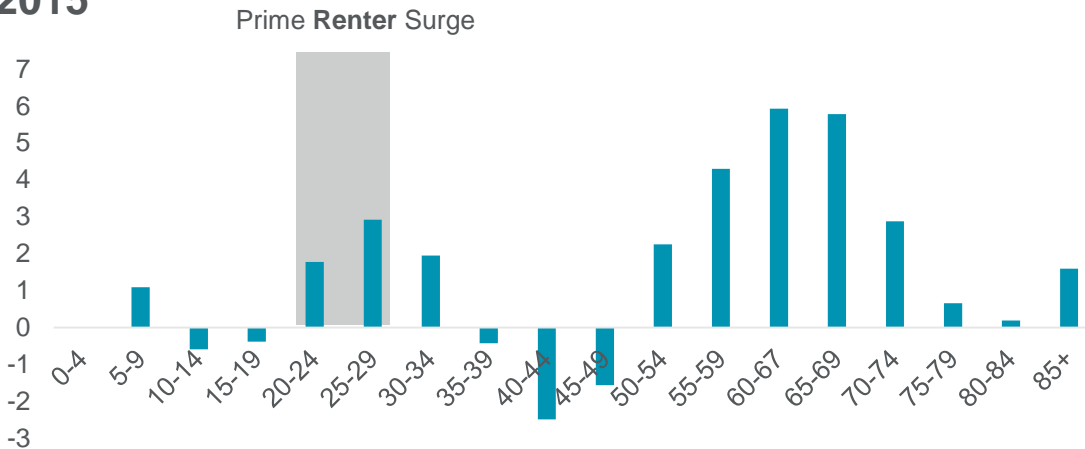


Millennials Nearing Prime Home Buying Years

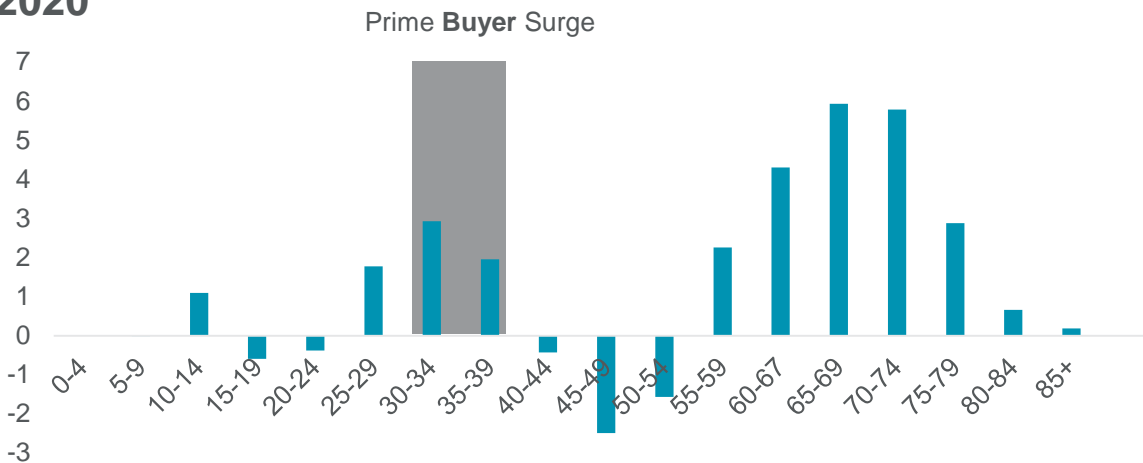


Change in Population, millions

2015



2020

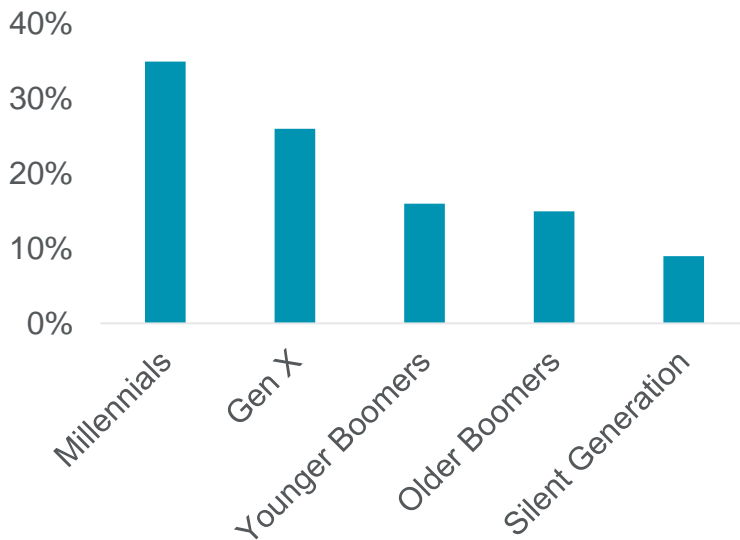


BY 2020, AN
ADDITIONAL 3.3 MILLION PEOPLE
 WILL ENTER
 PRIME HOME
 BUYING AGES

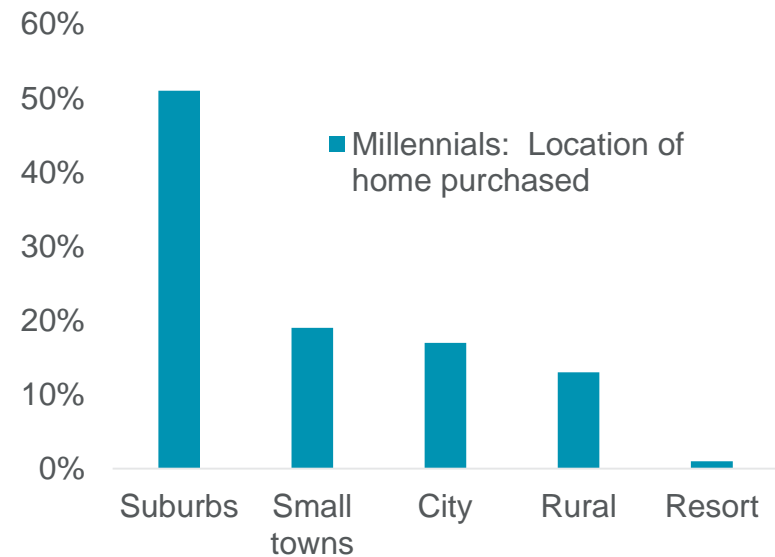
Millennials Have Already Started Buying and Moving to the Suburbs



PERCENTAGE BREAKDOWN OF HOMEBUYERS IN 2015



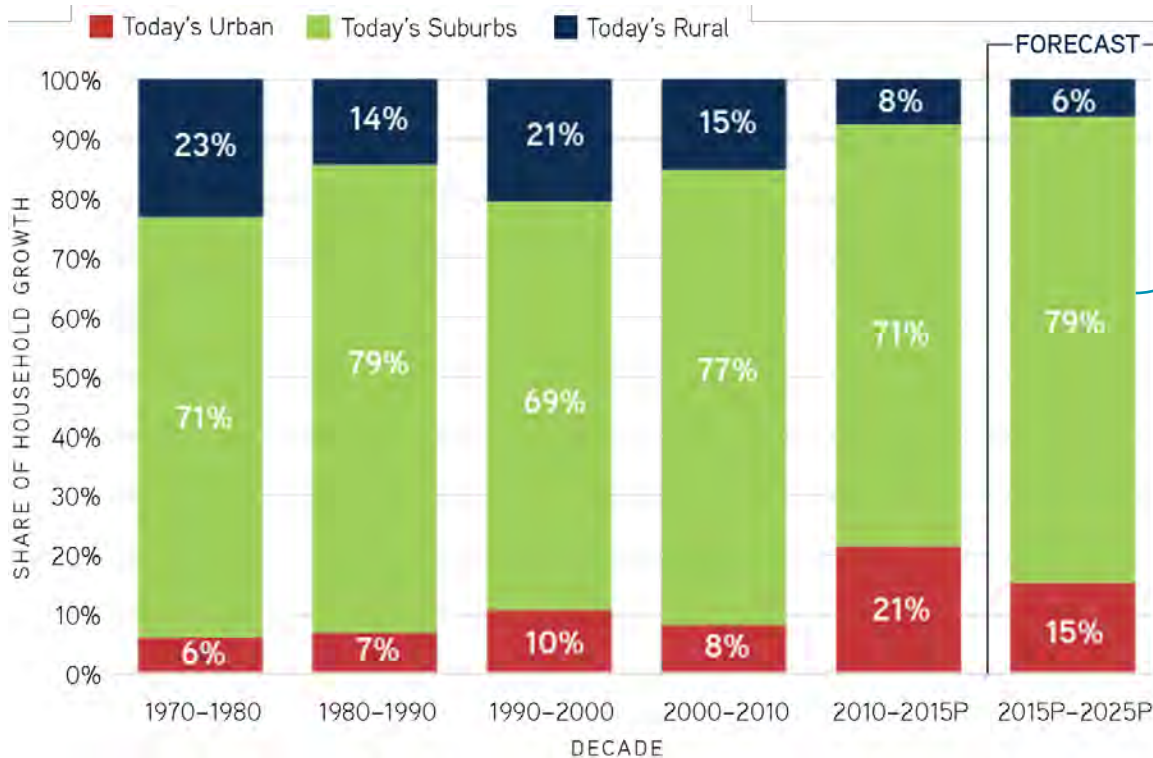
BUYING MOSTLY IN THE SUBURBS



Suburbs Expected to Gain Share Next 10 Years



Share of Household Growth By Decade



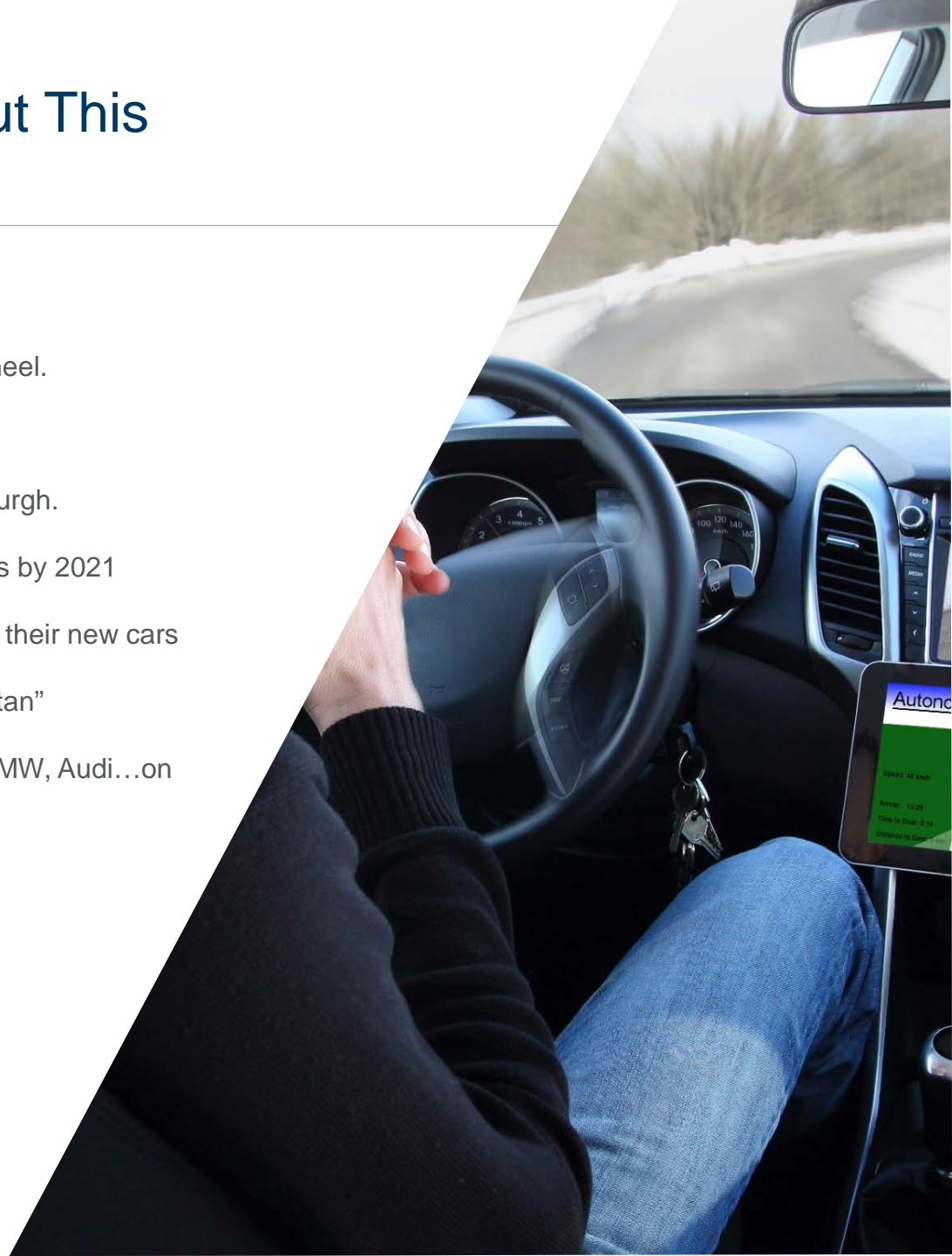
Suburbs will grow by **11.2 million households** by 2025

And Let's Not Forget About This

Driverless Cars

It is real

- Ford: 2021, mass-producing without steering wheel.
- Nissan: 2020
- Uber: Self-driving taxis operating today in Pittsburgh.
- Lyft says majority of rides will be self-driving cars by 2021
- Tesla: 2018 will see full autonomy capabilities in their new cars
- Apple has been piloting its top-secret project "Titan"
- Toyota is working on its own technology, as is BMW, Audi...on and on and on



Suburbs & Low Density Areas Will Likely Benefit the Most



It will have an impact

- 100% of commuting time becomes free time.
- Faster arrival (no parking). Autonomous cars will drop you off at the front entrance of your office.
- Premiums for being extremely close to public transportation will likely decrease because of the ease of door-to-door driverless chauffeur.
- Improved safety: Driverless cars don't have blind spots or get distracted by cell phones.

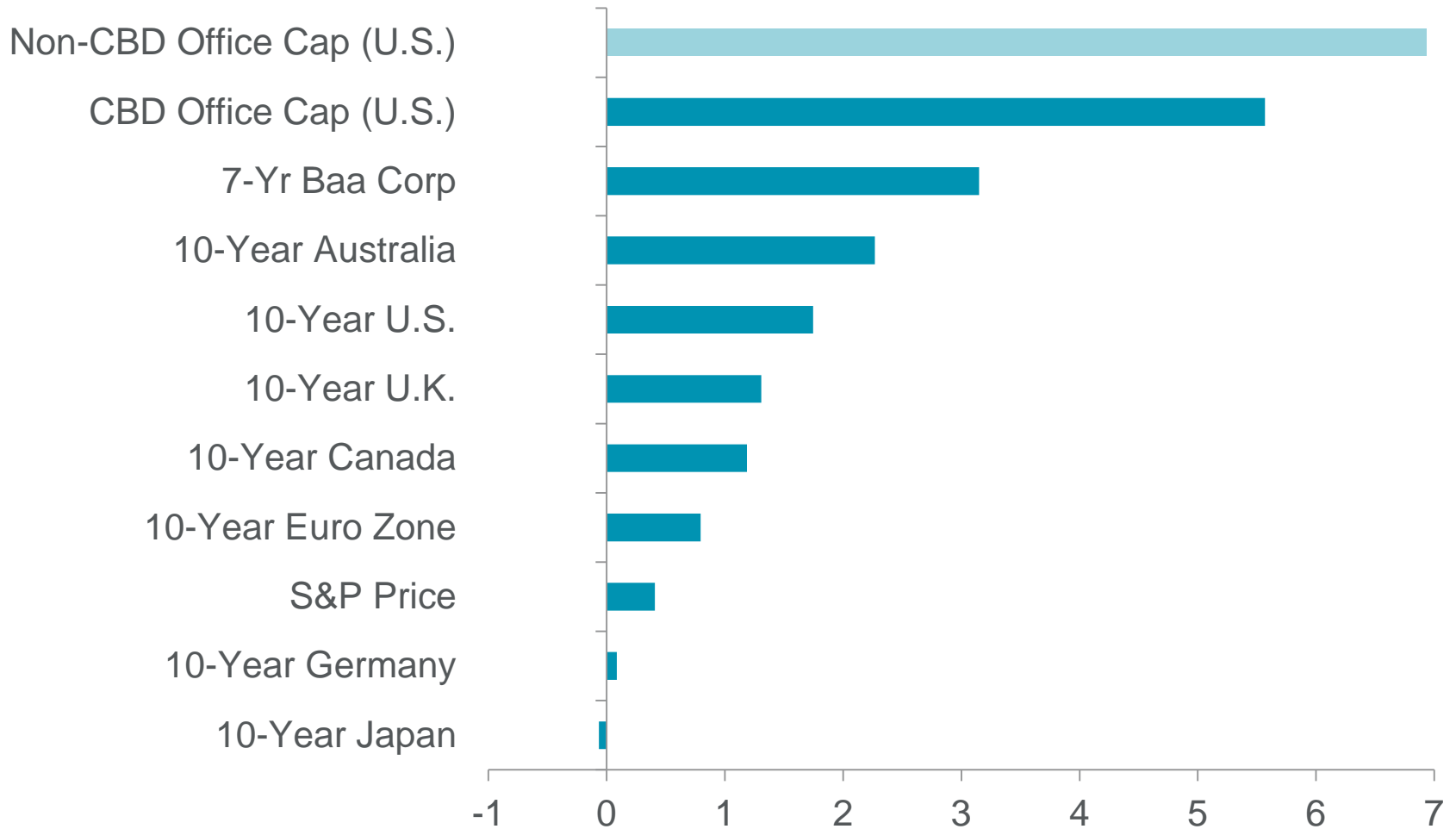
- **Most studies project increased demand for suburbs and exurbs.**

Where Are the Opportunities?



Returns Comparison

2016 YTD (%)



Office Cap Rates



| | CBD | | | | | | | | | | SUBURBS | | | | | | | | | | | | | | |
|-------------------------|---------------|---------------|------|-----------|---------|-----------------|----------------|---------------|------|-----------|---------|-----------------|---------------|---------------|------|-----------|---------|-----------------|----------------|---------------|------|-----------|---------|-----------------|---|
| | Class A | BIDDER TYPES | | | | | Class B | BIDDER TYPES | | | | | Class A | BIDDER TYPES | | | | | Class B | BIDDER TYPES | | | | | |
| | | INSTITUTIONAL | REIT | DEVELOPER | FOREIGN | PRIVATE CAPITAL | | INSTITUTIONAL | REIT | DEVELOPER | FOREIGN | PRIVATE CAPITAL | | INSTITUTIONAL | REIT | DEVELOPER | FOREIGN | PRIVATE CAPITAL | | INSTITUTIONAL | REIT | DEVELOPER | FOREIGN | PRIVATE CAPITAL | |
| Atlanta GA | 6.00% - 6.50% | • | • | | • | | 7.25% - 7.75% | | | | | • | 7.50% - 8.00% | • | | | | • | 9.00% - 9.50% | | | | | • | |
| Baltimore MD | 6.75% - 7.50% | • | • | | | • | 7.50% - 8.25% | | | | | | • | 7.25% - 8.00% | • | | | | 8.00% - 8.75% | | • | | | • | |
| Boston MA | 3.75% - 4.25% | • | | | | • | 4.25% - 5.00% | • | | | • | • | 6.25% - 7.00% | | • | | | | 7.75% - 8.50% | | | | | • | |
| Charlotte NC | 5.50% - 6.00% | • | • | | | • | 6.00% - 6.75% | • | | | • | • | 6.00% - 6.50% | • | | | | | 6.75% - 7.25% | | | • | | • | |
| Chicago IL | 5.25% - 5.75% | • | | | | • | 6.50% - 7.00% | • | | | • | • | 7.50% - 8.25% | • | • | | | | 8.50% - 9.25% | | | | | • | |
| Cincinnati OH | 6.50% - 8.00% | • | • | | | | 8.50% - 10.00% | | | | • | • | 7.50% - 8.50% | • | • | | | | 9.00% - 10.00% | | | • | | • | |
| Dallas TX | 5.75% - 6.75% | • | • | • | • | • | 7.50% - 8.50% | | • | • | • | • | 7.00% - 8.00% | • | • | • | • | | 8.00% - 9.00% | | • | | | • | |
| Denver CO | 5.00% - 6.00% | • | • | | | • | 6.00% - 6.75% | • | • | | | • | 6.25% - 7.00% | • | • | | | | 7.25% - 8.00% | | • | | | • | |
| Houston TX | 5.50% - 6.75% | | | | | • | 6.50% - 7.75% | | | | | • | 6.25% - 7.50% | | | | | | 7.75% - 9.00% | | | | | • | |
| Indianapolis, IN | 7.50% - 8.50% | • | • | | | • | 8.50% - 9.50% | | | | | • | 7.75% - 8.50% | | | | | | 8.50% - 9.50% | | | | | • | |
| Los Angeles CA | 3.75% - 4.50% | • | • | • | • | • | 5.25% - 6.00% | • | • | • | • | • | 6.00% - 6.75% | • | • | • | • | | 7.00% - 8.00% | | | | | • | |
| Miami FL | 6.00% - 6.75% | • | • | | | • | 7.00% - 7.75% | • | • | | • | • | 7.00% - 7.50% | • | • | | | | 8.00% - 8.75% | | | | | • | |
| Minneapolis MN | 6.00% - 6.75% | • | • | | | • | 7.50% - 8.00% | • | | | • | • | 7.00% - 7.50% | • | • | | | | 8.00% - 8.75% | | | | | • | |
| New Haven/ Stamford CT | 6.00% - 6.75% | • | | | | • | 7.25% - 8.00% | | | | | • | 6.25% - 7.25% | | | | | | 8.00% - 9.00% | | | | | • | |
| Manhattan NY | 3.50% - 4.25% | • | • | | | • | 4.00% - 4.50% | • | • | | • | • | | | | | | | | | | | | | • |
| Northern New Jersey | 5.50% - 6.25% | | | | | • | 6.50% - 7.25% | • | | | • | • | 7.00% - 7.75% | | | | • | • | 8.00% - 8.75% | | | | | | • |
| NYC Suburbs/Westchester | 5.75% - 6.50% | | | • | | • | 7.00% - 7.75% | | | | | • | 7.00% - 7.75% | | | | | | 8.25% - 9.00% | | | | | | • |
| Orlando FL | 6.00% - 6.50% | • | • | | | • | 7.00% - 7.50% | • | • | | • | • | 6.75% - 7.25% | • | • | | • | | 7.50% - 8.25% | | | • | | • | |
| Philadelphia PA | 5.50% - 6.50% | • | • | | | • | 6.75% - 8.00% | | • | | • | • | 5.00% - 6.50% | • | • | | | | 7.50% - 8.50% | | • | | | • | |
| Phoenix AZ | 6.50% - 7.25% | | | | | • | 6.50% - 7.25% | | | | • | • | 7.25% - 8.00% | | | | | | 7.50% - 8.25% | | | | | • | |
| Portland OR | 4.25% - 5.25% | • | | • | | • | 6.00% - 6.75% | • | | | • | • | 6.50% - 7.00% | • | | • | | | 7.00% - 7.75% | | • | • | | • | |
| Sacramento CA | 6.50% - 7.25% | • | • | • | | • | 7.00% - 7.75% | | | | • | • | 6.50% - 7.00% | • | • | • | | | | | | | | | • |
| San Diego CA | 5.00% - 5.75% | • | | | | | 4.50% - 5.25% | | | | • | • | 5.25% - 6.00% | • | | | | | 5.50% - 6.25% | | | • | | | • |
| San Francisco CA | 4.25% - 5.00% | • | | | | • | 4.75% - 5.50% | • | | | | • | 5.50% - 6.25% | • | | | | | 6.25% - 7.00% | | | | | | • |
| San Jose CA | 5.50% - 6.25% | • | | | | • | 6.25% - 7.00% | • | | | • | • | 5.50% - 6.25% | • | • | | • | | 6.50% - 7.25% | | | | | | • |
| Seattle WA | 4.00% - 5.75% | • | • | • | • | • | 5.25% - 6.50% | • | • | • | • | • | 5.25% - 6.50% | • | • | • | • | | 6.00% - 6.75% | | | | | | • |
| St. Louis MO | 8.00% - 9.00% | | | | | • | 9.00% - 10.00% | | | | | • | 7.25% - 7.75% | • | | | | | 8.50% - 9.50% | | | | | | • |
| Tampa FL | 5.75% - 6.25% | • | • | | | • | 6.50% - 7.00% | • | • | | • | • | 6.75% - 7.25% | • | • | | • | | 7.50% - 8.25% | | | • | | • | |
| Washington DC | 4.75% - 5.25% | • | • | • | • | • | 5.25% - 6.00% | | | | • | • | 5.00% - 8.00% | • | • | • | • | | 5.75% - 8.75% | | • | | | • | |

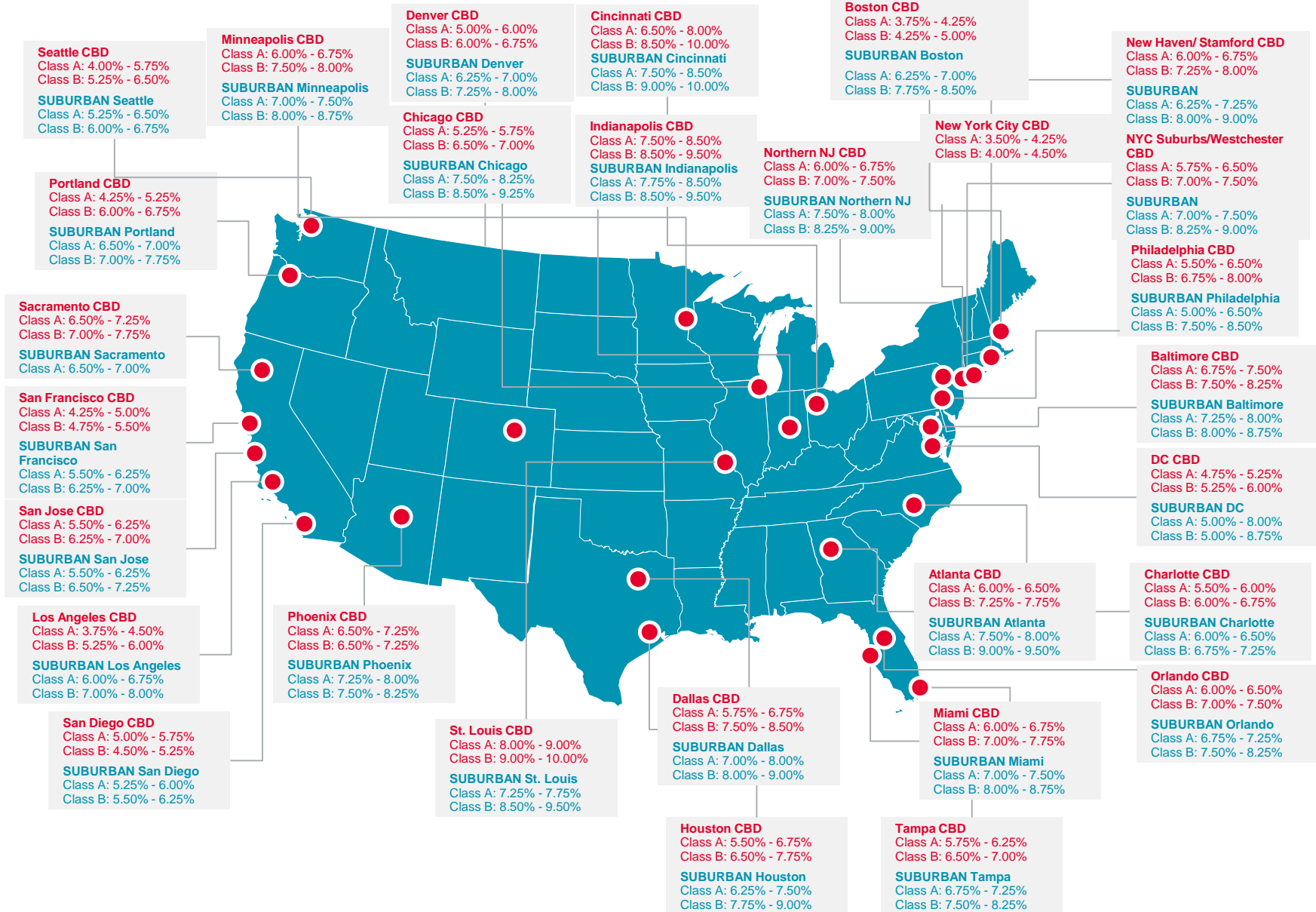
CLASS A
5.44% - 6.25%

CLASS B
6.40% - 7.19%

CLASS A
6.38% - 7.21%

CLASS B
7.51% - 8.40%

Office Cap Rates



CAPITAL MARKETS UPDATE

Suburban Office: Is This the Next Play?

October 2016