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Demand-Side Risk in the Office Sector

April 23, 2015

SUMMER STREET ADVISORS OVERVIEW

Experience Expertise Excellence

- Summer Street Advisors (SSA) is a real estate advisory firm that provides a full range of highly rigorous, client focused services ranging from **underwriting**, **collateral valuation, credit** and **risk analysis**, to **operational** and **compliance support** and **asset management**.

- SSA has successfully played key strategic roles in providing services on assets in excess of **$10 billion**, in over **100 transactions** ranging from **$5,000** to **$1 billion** in value.

- SSA's clients include commercial and community banks, private equity funds, institutional investors, commercial real estate lending platforms, and law and accounting firms.

AGENDA

2014-2015: Good Times for the Office Sector

- Falling unemployment
- Falling vacancy rates
- Highest net absorption since 2007
- Rising rents
- Investment prices approaching pre-recession peak
- Spec development in many markets

Falling Unemployment

- 10% unemployment in October 2009
- 5.6% unemployment in December 2014
- 3% unemployment of workers with Bachelors or advanced degrees in December 2014
- 74.9% participation rate of workers with Bachelors or advanced degrees in December 2014

Conclusion: There's no shortage of office jobs

Comparing Job Growth in Two Economic Recoveries

- 8 Million Net Jobs 2003-2007

- 12 Million Net Jobs 2010-2014

Average Annual Job Growth/Loss		
Sector	2000-2010	2010-2020
All Sectors	-0.2%	+1.3%
Information	-2.9%	+0.5%
Financial	-1.0%	+1.0%
Prof./Business Services	0	+2.1%

--Source: Bureau of Labor Statistics

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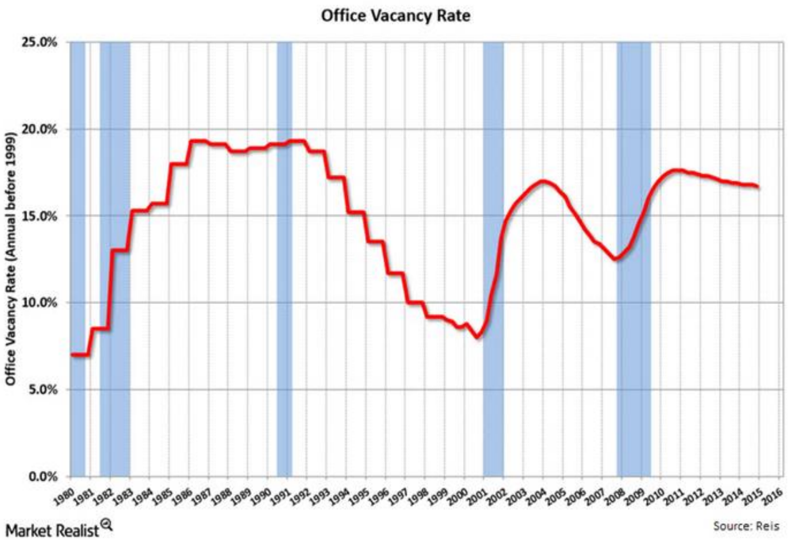
The Bad News for Office Investors

- Vacancies are still high in most markets
- Absorption has not kept pace with job growth
- Rents are still below pre-recession peaks
- Investment prices and development are driven in part by capital supply

Job Growth vs. Vacancies

Despite Strong Job Growth, Vacancies Remain High



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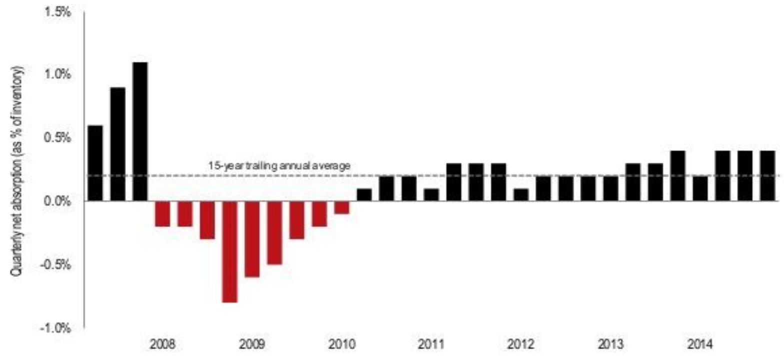
Net Absorption vs. Job Growth

Net Absorption Hasn't Kept Pace with Job Growth

After a recovery high in Q3, Q4 demonstrated even more gains in occupancy, with 16.8 million square feet of net absorption



Source: JLL Research

JLL

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Net Absorption vs. Job Growth
Influencers

- Densification
- Live-work-play neighborhoods
- Mobility

Densification

- CoreNet Global member survey: Average office space per employee is falling

  - 225 square feet in 2010
  - 176 square feet in 2012
  - 151 square feet by 2017

- Law firms renewing leases are taking about 1/3 less space due to more efficient layouts and less need for paper file storage

- CBRE’s new HQ reduced space per employee nearly 40 percent

Will this trend continue, or level off, or reverse itself in the next five years?

Live-Work-Play Neighborhoods

- Tech sector, the driving force behind office job growth, seeks Millennials
- Millennials choose to live and work in non-CBD neighborhoods with social and transit options

  Result: Companies are renovating warehouses to attract talent

Example: Chicago's Fulton District attracts Google, Uber and McDonald's for 357k sf, while CBD vacancies are 17.1%.

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Mobile Workers

- Wifi, smartphones enable productivity anywhere – less work is done in office
- At any given time, most office desks are not being used
- U.S. Census Bureau: 4.3% of employees work mainly from home
- Millennials, the largest labor cohort, are comfortable with mobile work styles

Most companies still assign space to each employee – a wider move to unassigned spaces could lessen demand

Conclusion

- Observed trends are here to stay
- Investors – Lenders need to be mindful when making investment and lending decisions
- What's next – always thinking down the road

Key Questions

- How has job growth translated into space demand in this economic cycle?
- How does this relationship compare with past economic cycles?
- If the relationship has changed, what factors are driving the change?
- How can these insights be used to improve office investment strategy?
- To what extent are these trends likely to affect Class A office leasing in the next 5-10 years?
- How might these trends affect NOI?
- How can investors mitigate risks and maximize opportunities relating to these trends?