Dallas/Fort Worth

Office Market Research Report 4Q 2018

Market Overview

The Dallas-Fort Worth metro continues its healthy evolution into the next stage of the economic cycle. Among the 12 largest metropolitan areas in the country, Dallas ranked second in the number of jobs added over the year and ranked third in the annual rate of job growth. Unemployment dropped from 3.5% to 3.2% year over year, still below the national average which which recently dropped to an impressive 3.5%. Net office absorption rose for the quarter with nearly 1 msf absorbed across the metroplex, bringing the yearly total to 4.2 msf, including single-tenant build-to-suits, and 2.3 msf for multi-tenant only.

Overall, the market remains healthy and much more durable than it has been in previous cycles. Sustained job growth, reasonable construction, and single-tenant build-to-suit projects for large corporate users have kept vacancies at stable levels, still below the last cycle's low. Dallas is traditionally known for being over-built, but discretion has helped this period of growth set itself up to avoid many of the past cycle's pitfalls. Even as supply levels begin to crest, with a number of major spec projects delivering or set to deliver in the coming quarters, occupancies have barely taken a hit.

Looking ahead, Dallas's cost of doing business and strong talent pool will position it to remain one of the most in-demand office markets in the country.

Market Facts

94,700
Jobs added in the last year, a 2.6% increase in employment.

3.2%
Unemployment in Dallas.

2.4%
12 Mo. Rent Growth

$25.47
Average Gross Direct Rental rate

Dallas/Fort Worth 2018 Summary

322,407,131
Square Feet

15.9%
VACANCY

4,230,021 SF
12 MONTH TOTAL ABSORPTION
(Single Tenant Owner Occupied Space Included)

2,297,391 SF
12 MONTH MULTI-TENANT ABSORPTION
(Single Tenant Owner Occupied Space Excluded)

Average Gross Asking Rents

$29.42
CLASS A

$21.50
CLASS B

7.4 MSF
UNDER CONSTRUCTION

5.9 MSF
12 MONTH DELIVERIES

Parameters: Office | 20,000 sf+ Buildings | Existing | Owner Occupied Included

The Market: **Core Submarket Highlights**

Allen/McKinney

6,422,623 Square Feet

$31.22 CLASS A | **$23.68** CLASS B

293,999 SF 12 Mo. Net Absorption

10.8% Vacancy

CBD

33,307,029 Square Feet

$27.31 CLASS A | **$20.80** CLASS B

563,877 SF 12 Mo. Net Absorption

21.5% Vacancy

Central Expy

13,737,069 Square Feet

$31.89 CLASS A | **$26.99** CLASS B

-323,469 SF 12 Mo. Net Absorption

12.8% Vacancy

Frisco/The Colony

6,409,417 Square Feet

$34.20 CLASS A | **$29.06** CLASS B

630,191 SF 12 Mo. Net Absorption

15.0% Vacancy

Las Colinas

40,283,184 Square Feet

$30.77 CLASS A | **$22.01** CLASS B

-5,895 SF 12 Mo. Net Absorption

16.0% Vacancy

LBJ Fwy

22,624,157 Square Feet

$26.38 CLASS A | **$19.56** CLASS B

-205,360 SF 12 Mo. Net Absorption

21.7% Vacancy

Rent rates are presented as Gross Direct rates.

The Market: **Core Submarket Highlights**

Preston Center

5,524,064 Square Feet

$39.86 CLASS A	**$28.56** CLASS B

222,810 SF 12 Mo. Net Absorption

7.9% Vacancy

Quorum/Bent Tree

22,548,654 Square Feet

$30.15 CLASS A	**$20.46** CLASS B

-704,990 SF 12 Mo. Net Absorption

21.3% Vacancy

Richardson/Plano

29,047,181 Square Feet

$27.46 CLASS A	**$20.44** CLASS B

696,217 SF 12 Mo. Net Absorption

17.4% Vacancy

Stemmons Fwy

14,837,935 Square Feet

$18.97 CLASS A	**$16.25** CLASS B

379,667 SF 12 Mo. Net Absorption

22.1% Vacancy

Upper Tollway

31,498,357 Square Feet

$34.08 CLASS A	**$25.77** CLASS B

2,540,070 SF 12 Mo. Net Absorption

12.3% Vacancy

Uptown

14,443,170 Square Feet

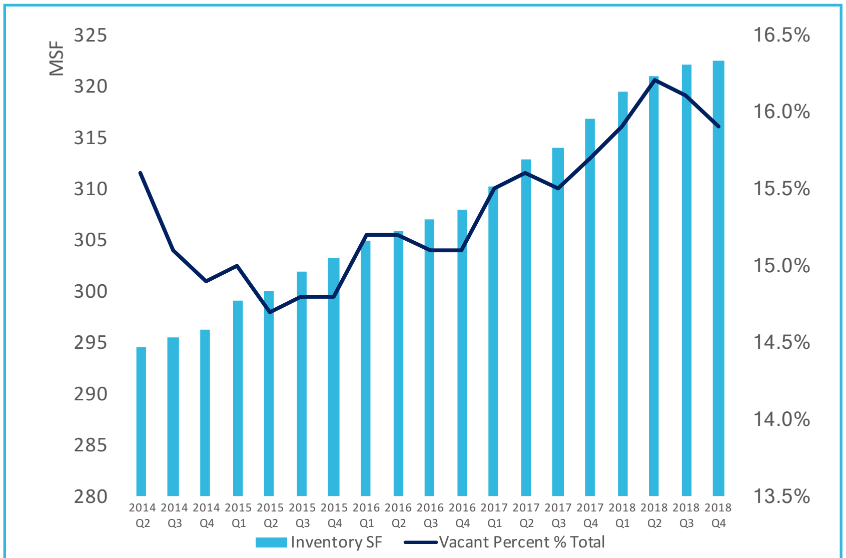
$41.92 CLASS A	**$34.18** CLASS B

670,035 SF 12 Mo. Net Absorption

14.4% Vacancy

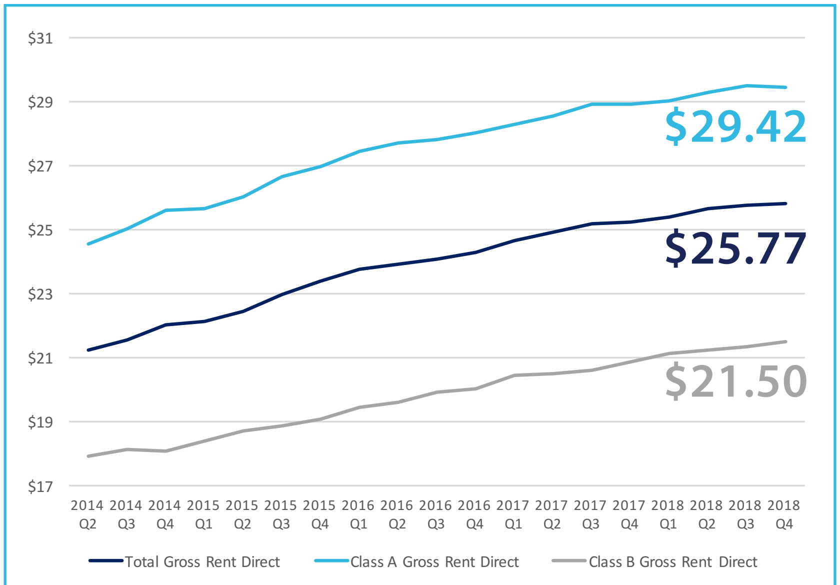
Rent rates are presented as Gross Direct rates.

Total Inventory vs. Vacancy Rate



Source: Costar

Gross Asking Rent Per SF



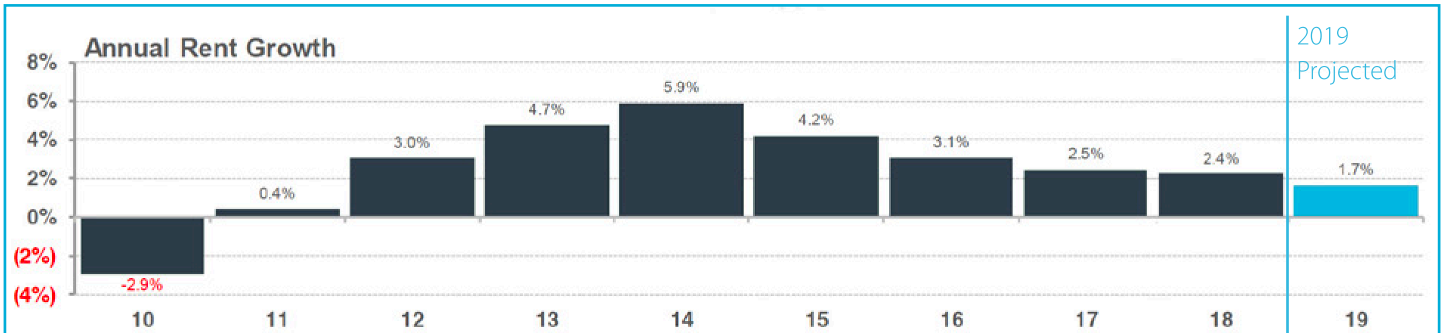
Vacancy

The Dallas-Fort Worth Office market ended the year with a vacancy rate of 15.9%. In all, there was 51 msf vacant. The vacancy rate was down from the year's previous quarters, with year-to-date net absorption totaling positive 6.2 msf when single-tenant build-to-suits (BTS) are included. Excluding BTS from inventory and absorption, vacancy rates rise but remain consistent, finishing the quarter at 20.3%. This is essentially the same rate it has been since Q2 2017. Then 10-year trending average is 20.7%.

Sublease vacancy rates are up to 1.3% from the 10-year average of 0.8%. The majority of this is space vacated by large users moving to newer and/or owned spaces, but it is still worth noting as this is the largest amount of available sublease space in 15 years.

Rental Rates

Annualized rent growth for Q4 was 2.4%, compared to the national average of 2.1%. Class A rates grew 2.8%, and Class B rates grew 1.8%. Rent growth is slowing, even declining in some submarkets, but rents remain about 15% higher than 2008 pre-recession peaks. Premier submarkets such as Uptown/Turtle Creek, Frisco/The Colony, and Upper Tollway/West Plano saw the strongest growth, with rents now 20% greater than pre-recession peaks.



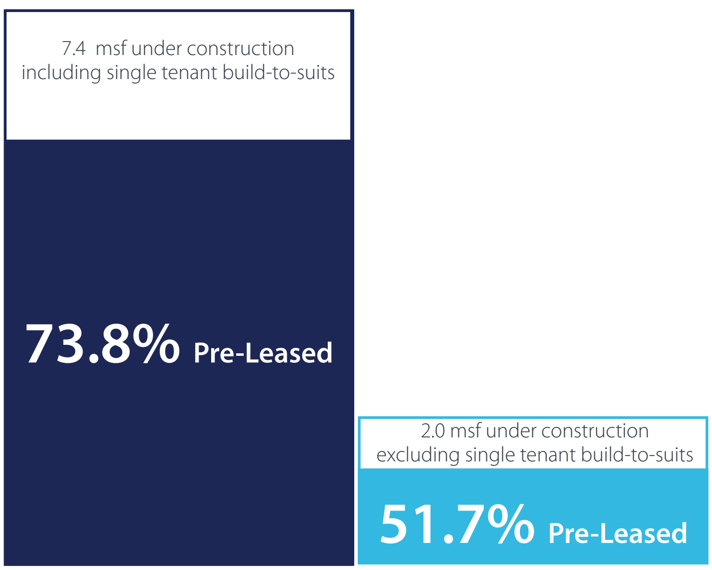
Source: CoStar Market Analytics

Absorption & Supply

Net absorption finished the year at 4.2 msf, which put 2018 as outperforming comparably to 2017 and 2016, but lower than the cycle highs of 2015 and 2014. Q4 itself saw almost 1 msf absorbed when single tenant owner-occupied space is included. When owner occupied space is excluded, absorption was still very strong at over 700,000 sf. As with 2017, the majority of absorption is continuing its flight-to-quality trend towards upgraded Class B and newer Class A product. When Class A and B product is separated, the numbers show Class B absorption is actually negative on the whole for the year so far.

Class A 12 Month Absorption (Owner Occup. Excluded)	Class B 12 Month Absorption (Owner Occup. Excluded)
4,953,835	-401,544

Newly built product is performing very well. Of the 22 msf of non owner-occupied inventory built since 2013, 82.0% has been leased. Of the 7.8 msf currently under construction, including single tenant build-to-suits, the availability rate stands at 27.3%. When those owner-occupied build-to-suits are removed, this number rises to 51.7% availability for the roughly 2.2 msf underway.

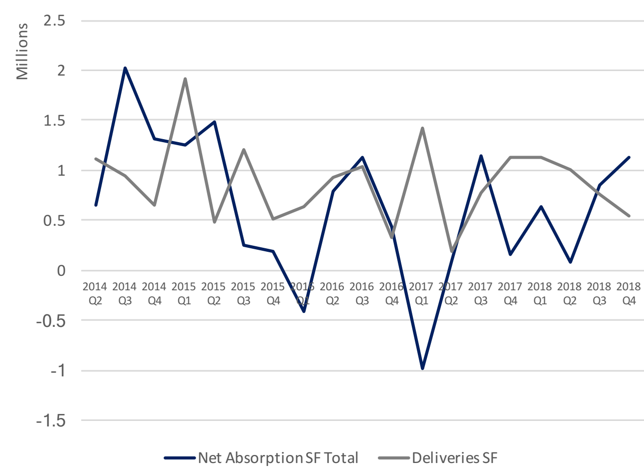


2018 did see some submarket absorption narratives shift. CBD was able to end the year with positive absorption for the first time in 3 years. Quorum/ Bent Tree suffered under the 750,000 sf vacancies at International Plaza I & II, and Stemmons saw positive gains thanks to Southwest Airlines' 414,000 sf build-to-suit.

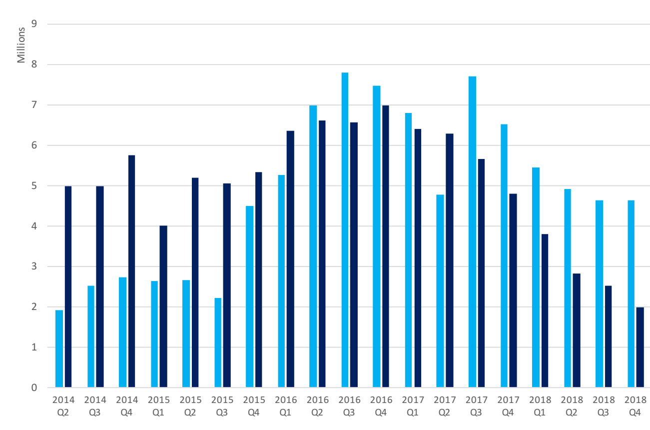
Absorption & Deliveries

Build to suits have helped keep absorption steady and vacancies in line with historical averages. To offset the 32.4 msf delivered in the last 5 years, 28.1 msf of that has been absorbed by the market.

In looking at only multi-tenant buildings, there has been 18.2 msf delivered in the last 5 years and 13.8 msf of absorption.

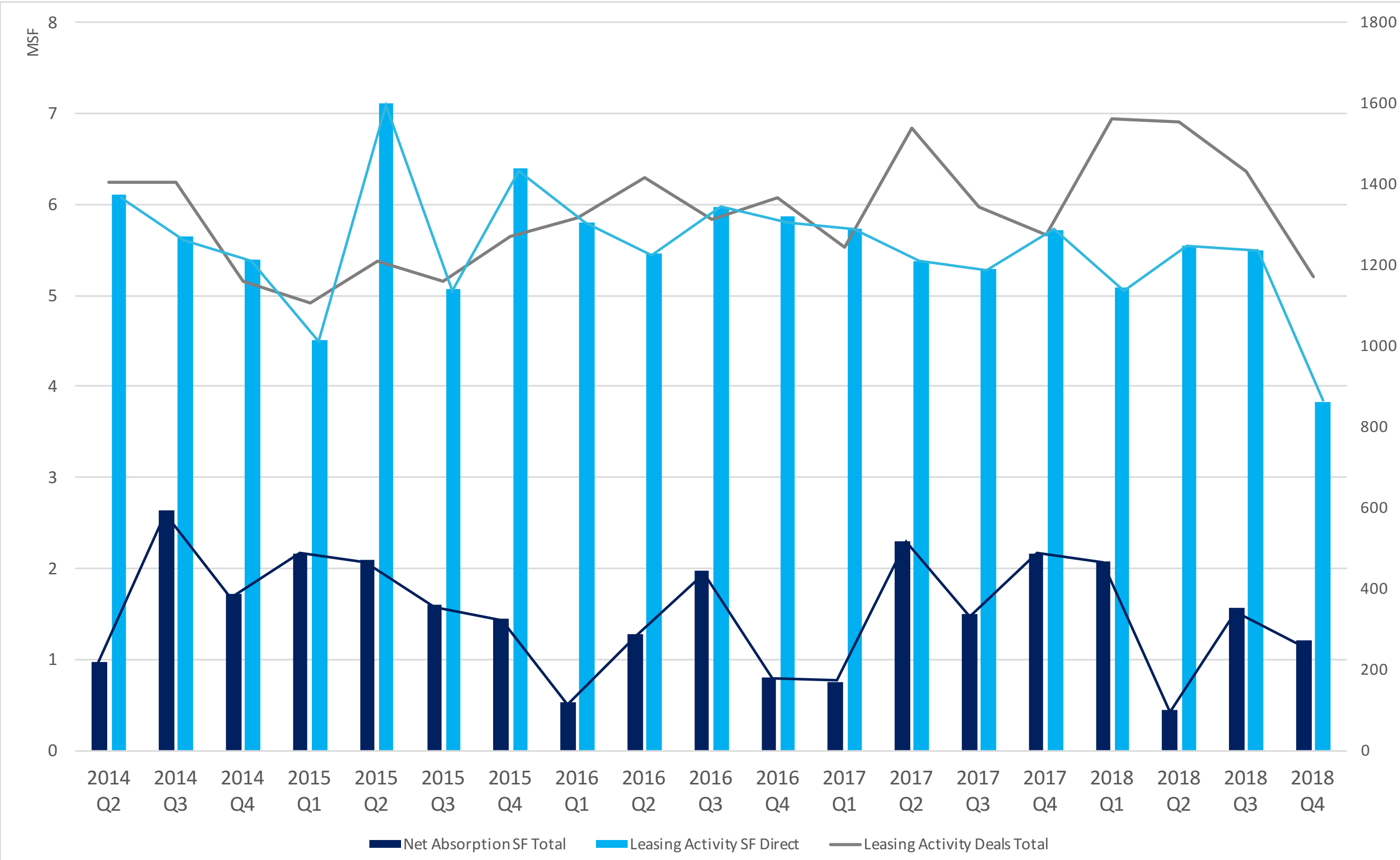


Under Construction



Leasing Activity

Whilte Leasing activity and total net absorption have been trending downward overall, leasing activity deals have trended upwards over the last five years. This implies that deals are taking less square footage, which could be related to trends such as more companies try to reduce their footprints to save on costs, and flexible co-working deals being signed for small spaces.



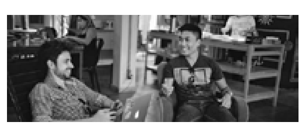
Top Leases for Q4 '18

Address/Complex	Tenant	Size (sf)	Deal Type
Lakeside Centre II	MetroPCS Communications, Inc.	115,583 sf	Renewal
Campbell Creek Pavilion		77,181 sf	New
The Point at Las Colinas		65,400 sf	New
Las Colinas 3	Figueroa Brothers, Inc.	64,176 sf	Renewal
Gateway Commerce I		62,921 sf	New

Trends to Watch:

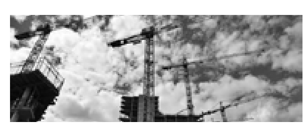
Workplace Strategies

Smaller, more thoughtful spaces will reduce space requirements and deal sizes.



Coworking

Flexible alternatives such as coworking continue to grow in demand.



Supply Drop

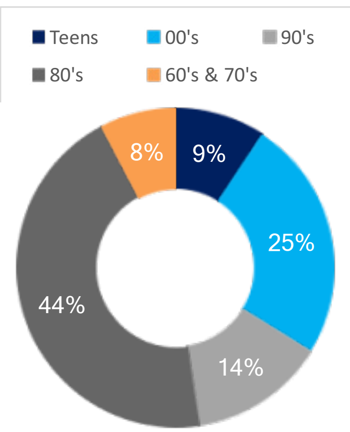
Tariffs, rising borrowing costs, and concerns of a looming slowdown may cause the cycle's pipeline to pump breaks.

Investment Sales

2018 saw over $4 Billion in office transactions. The sales covered the entire market, showing investors are taking interest in product across the board. Real Capital Analytics tracked the average price per sf for 2018 to be $257/sf, which is a 23.2% YOY increase.

In terms of recent major suburban sales, Fannie Mae's new 324,100-SF campus at Granite Park sold in September 2018 for $163 million. That pricing, $503/SF, is a record for suburban deals in D-FW.

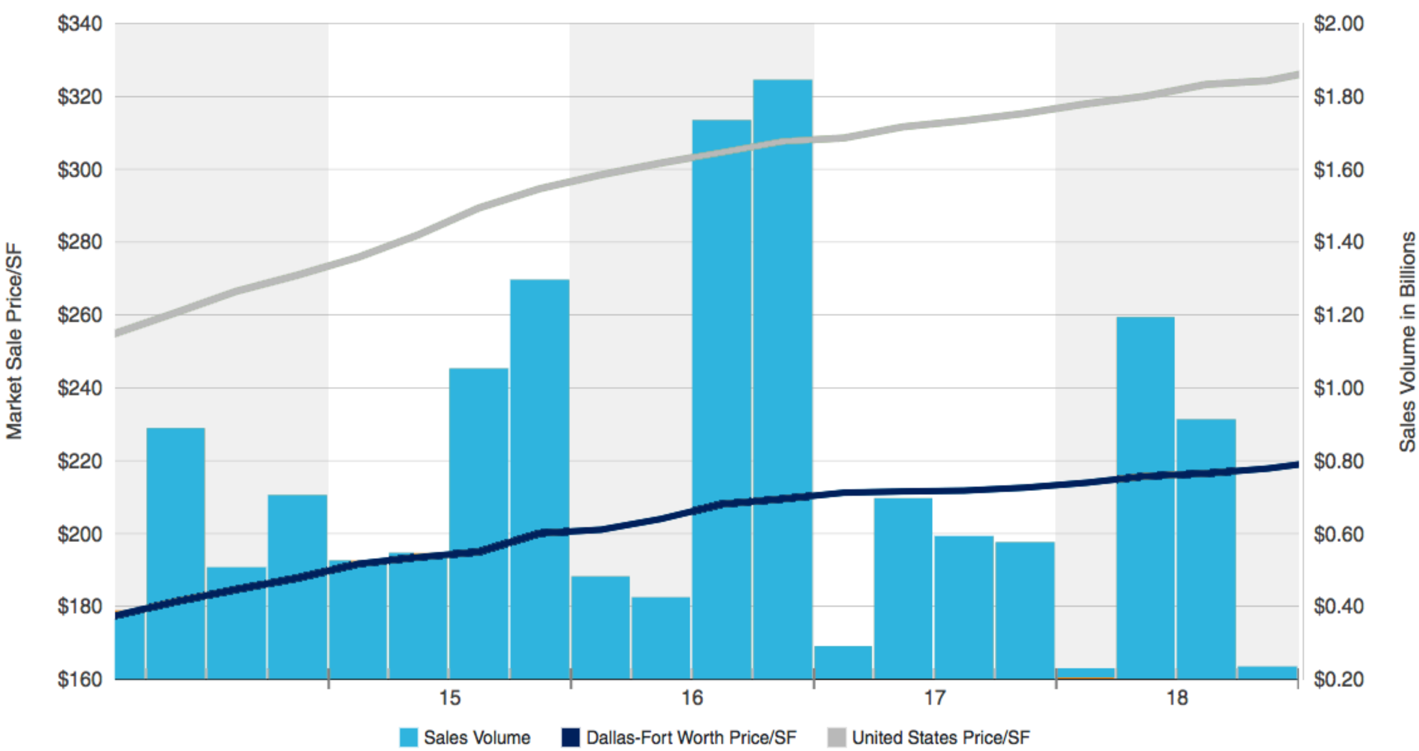
Infomart's sale in April is the major driver of 2Q, selling for $800,000,000 at 1,600,000 sf for an average price per sf of $500/sf.



6.9%

Market Cap Rate

Period	Office Sales Volume	Price/SF
2014 Q1	$387,729,580	$177.40
2014 Q2	$887,731,052	$181.15
2014 Q3	$505,117,398	$184.51
2014 Q4	$703,528,564	$187.63
2015 Q1	$524,167,994	$191.56
2015 Q2	$544,963,267	$193.34
2015 Q3	$1,050,895,979	$194.80
2015 Q4	$1,294,545,072	$199.93
2016 Q1	$480,392,432	$200.89
2016 Q2	$422,895,085	$203.82
2016 Q3	$1,732,904,043	$207.90
2016 Q4	$1,843,238,658	$209.35
2017 Q1	$289,186,684	$211.05
2017 Q2	$695,254,974	$211.39
2017 Q3	$590,576,948	$211.62
2017 Q4	$574,289,297	$212.44
2018 Q1	$322,425,988	$213.77
2018 Q2	$1,602,418,833	$215.58
2018 Q3	$1,311,291,122	$216.35
2018 Q4	$1,232,670,124	$217.67



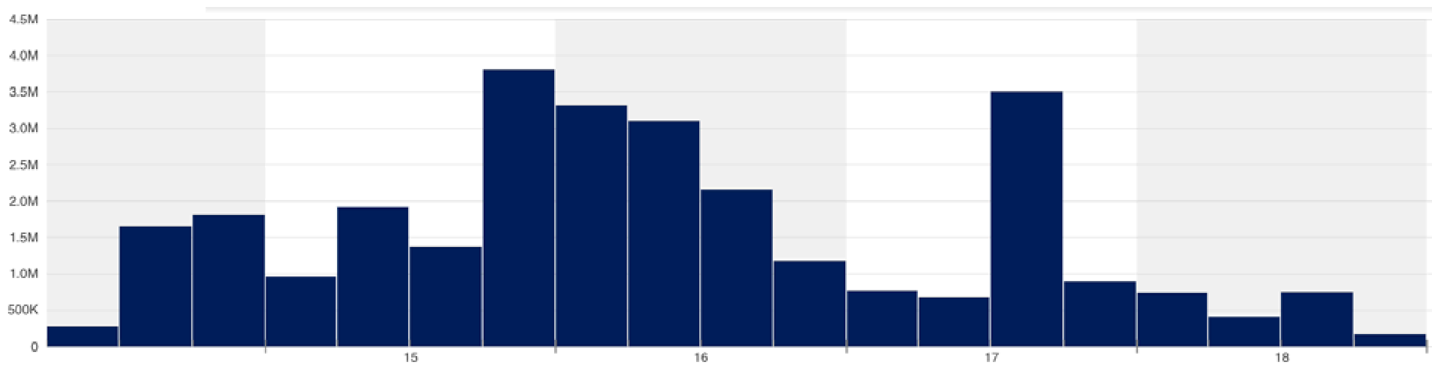
Construction Pipeline

Construction activity is tapering down from its cycle highs. 2018 saw a substantial drop in construction starts. The 5-year average of 12 month ranges for starts has been 5.7 msf, and the current 12 month range is only at 1.2 msf. This decline is mostly due to the drop in corporate campus construction, such as Toyota and Liberty Mutual, which each equated millions of sf.

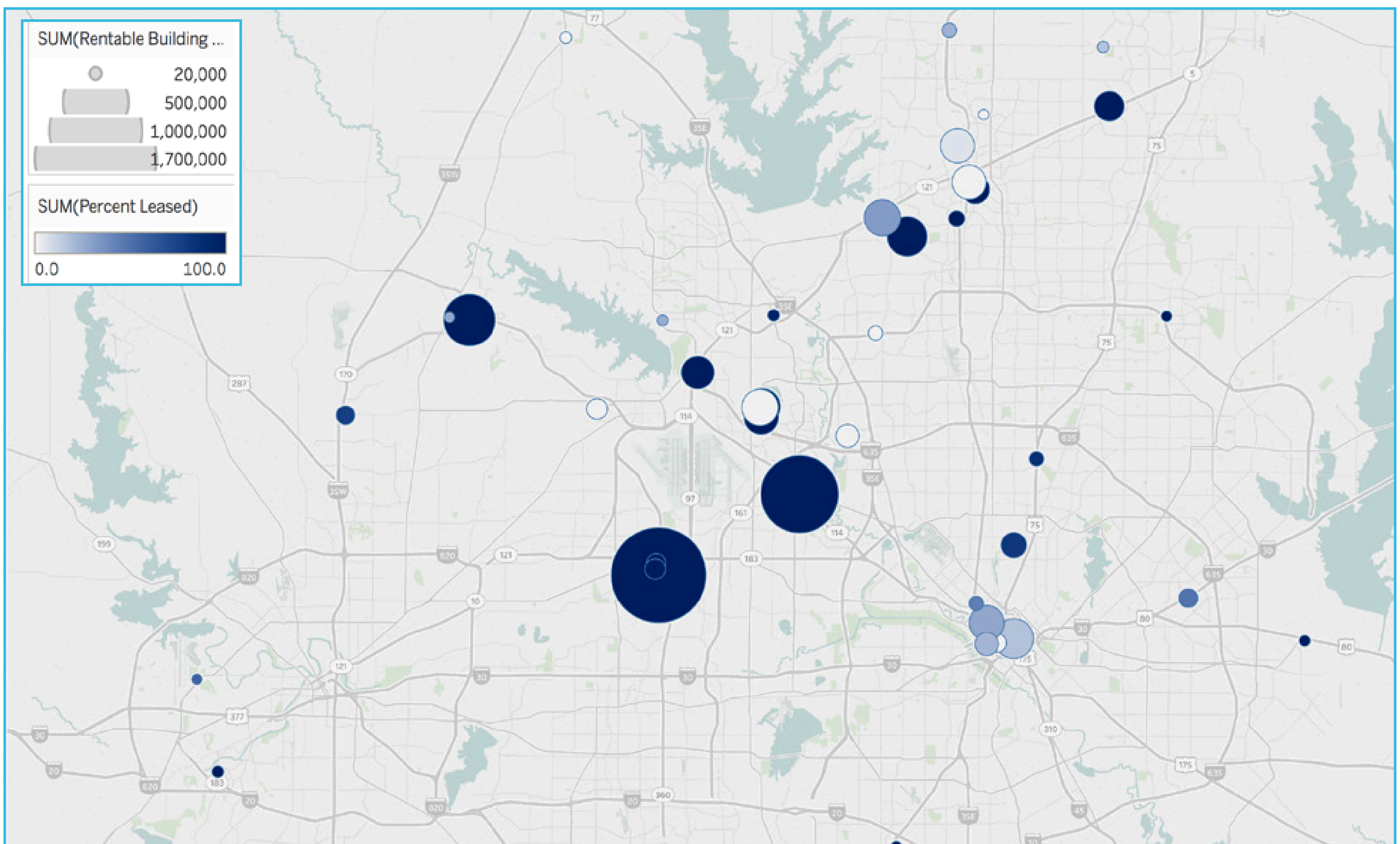
Rolling projects that started before 2018 have also dropped in volume or delivered. Total "under construction" volume is back in line with its 2013-2014 range, no longer at the intensity of its late 2015, 2016 and 2017 pace.

The largest projects currently underway are American Airlines Corporate HQ (1.7 msf), Pioneer Natural Resources HQ (1.1 msf) and Charles Schwabb Corporate HQ (500,000 sf), all of which are fully leased build-to-suits.

Construction Starts



Currently Under Construction



Under Construction: Single & Multi Tenant Office | Size and Percent Leased

Noteworthy Projects

American Airlines Corporate Campus
1,700,000 SF
Single Tenant
Delivers Dec. 2019

Hidden Ridge: Pioneer Natural Resources
1,125,000 SF
Single Tenant
Delivers July 2019

Charles Schwabb Corporate Campus
500,000 SF
Single Tenant
Delivers May 2019

AmerisourceBergen Specialty Group
300,000 SF
Single Tenant
Delivers March 2019

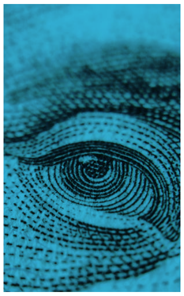
The Epic Deep Ellum
294,820 SF
Multi Tenant
Delivers March 2019
% Leased: 15.9%

3201 Olympus Blvd
250,000 SF
Single Tenant
Delivers March 2019

3200 Olympus Blvd
250,000 SF
Multi Tenant
Delivers Oct. 2019
% Leased: 0.0%

The Realm at Castle Hills
248,387 SF
Multi Tenant
Delivers Aug. 2019
% Leased: 30.7%

Harwood No.10
231,098 SF
Multi Tenant
Delivers Dec. 2018%
Leased: 26.1%



Economic Outlook

PwC and Urban Land Institute recently named DFW as their top real estate market for 2019 for both residential and commercial. The report echoes sentiments seen across the board. Industry insiders are touting DFW's long-term growth prospects as a safe haven for future activity.

The area will continue to be a business friendly haven with general affordability, strong universities and community colleges, diverse economic strength, great public schools, ample developable land, myriad amenities, a well-educated young population that continues to grow, and momentum that seems to be rolling along.

Even if 2019 is not as strong as 2018, just maintaining the average annual employment growth rate for 2010 to present would put growth at 2.9%, or roughly 90,000-100,000 new jobs next year. If absorption, leasing activity, and construction trends continue, 2019 will most likely see a slight drop from recent highs and will reach a more stable, "steady as she goes" pace.

Threats are uncertainty in the political climate, the continued trade war, rising interest rates and borrowing costs, inflation, a tightening of business spending, near-full employment, declining immigration growth, an overheating of the market, rising unaffordability for homeownership and renters, and competition for other metros.

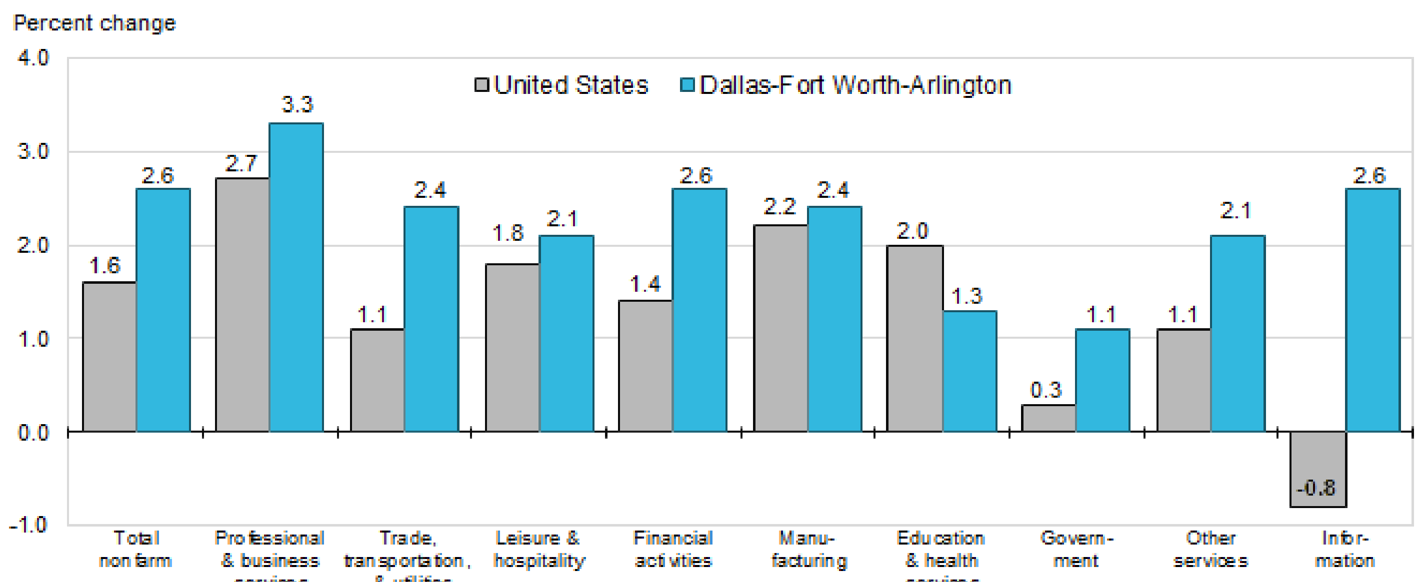
DFW has **40 Fortune 1,000 companies** located in the metro.

All economic sectors reported growth in the last 12 months, with **Professional & Business Services (19,900)**, and **Trade, Transportation, and Utilities (18,900)** leading the way.

In the latest population estimates provided by the U.S. Census Bureau, the DFW area was ranked as the **second fastest-growing** metropolitan area in the U.S.

Total nonfarm employment in the Dallas-Fort Worth-Arlington Metropolitan Statistical Area stood at **3,765,700** in Dec. 2018, up **94,700** over the year.

Employment Growth by Sector



Source: Bureau of Labor Statistics

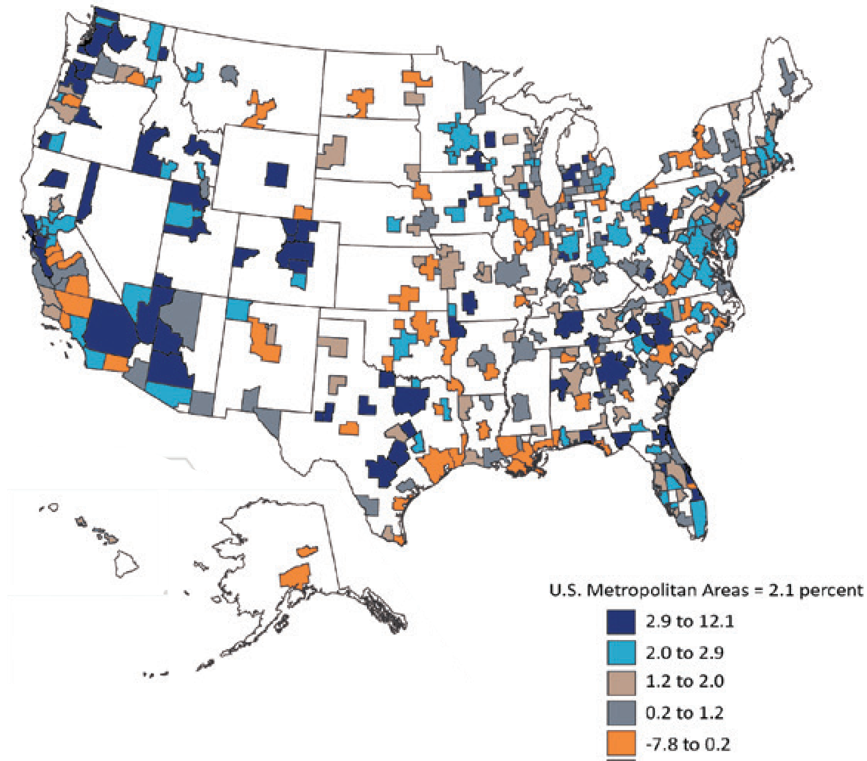
Economic Overview

While still awaiting official numbers, DFW currently has the 4th largest metro GDP in the country, according to the Bureau of Economic Analysis. Within Texas, the Dallas business cycle index had fastest YOY growth among major Texas metros.

10-year GDP growth for DFW was an impressive 22%, and 1-year GDP growth was 3.9%, the highest rate among major metros. This is compoundingly impressive when it it is considered that DFW is already the 4th largest metro in population and GDP, so to maintain this amount of growth shows that DFW is postioned to continue a healthy rate of expansion.

This GDP and job growth bodes well for office usage, as office-using sectors such as Financial activities & Professional/Business Services are performing well. Much of this is from corporate relocations, but their growth should help keep absorption high and vacancies even, especially if they are moving to BTS space.

Gross Domestic Product by Metropolitan Area, as of 2018



Source: Bureau of Economic Analysis

Metro	2016 GDP (Billions of Dollars)	2017 GDP (Billions of Dollars)	% Change
New York-Newark-Jersey City, NY-NJ-PA	1,662,671	1,717,712	1.3%
Los Angeles-Long Beach-Anaheim, CA	996,432	1,043,735	2.8%
Chicago-Naperville-Elgin, IL-IN-WI	657,589	679,699	1.5%
Dallas-Fort Worth-Arlington, TX	**503,667**	**535,499**	**3.9%**
Washington-Arlington-Alexandria, DC-VA-MD-WV	509,599	529,990	2.1%
San Francisco-Oakland-Hayward, CA	475,417	500,710	3.4%
Houston-The Woodlands-Sugar Land, TX	472,331	490,074	3.0%
Philadelphia-Camden-Wilmington, PA-NJ-DE-MD	431,384	444,975	1.4%
Boston-Cambridge-Newton, MA-NH	419,783	438,684	2.8%

Contributions to Percent Change in Real Gross Domestic Product (GDP) for DFW (2017)

Percent change in real GDP by metropolitan area	Percentage points												
	Natural resources and mining	Construction	Durable-goods manufacturing	Nondurable-goods manufacturing	Trade	Transportation and utilities	Information	Finance, insurance, real estate, rental, and leasing	Professional and business services	Educational services, health care, and social assistance	Arts, entertainment, recreation, accommodation, and food services	Other services, except government	Government
3.9	0.81	0.18	0.45	-0.12	0.16	0.30	0.13	1.06	0.52	0.26	0.08	0.03	0.04

Texas Metro Comparisons

Unemployment & 12-Month Job Growth* (Based off most recent BLS data)

2.7%	3.2%	3.5%	3.1%
Austin	Dallas	Houston	San Antonio
+35,200	+94,700	+114,400	+9,200

Texas

3.8% Unemployment | **+ 365,400 12-Month Job Growth**

Nonfarm Employment and 12-Month Change by Industry Supersector (Numbers in thousands)										
Metro	Total nonfarm	Mining, logging, and construction	Manufacturing	Trade, transportation, and utilities	Information	Financial activities	Professional and business services	Education and health services	Leisure and hospitality	Other services	Government
Dallas	94.7	18.3	6.5	18.9	2.2	7.8	19.9	5.9	7.9	2.6	4.7
Houston	114.4	28.1	14.0	13.5	-0.4	4.6	31.7	12.4	1.9	6.6	2.0
Austin	35.2	6.1	0.2	11.6	0.5	0.6	4.5	3.4	4.2	2.1	2.0
San Antonio	14.3	2.4	1.4	3.6	0.1	-0.8	-1.4	5.2	0.9	0.6	2.3

Dallas-Fort Worth area employment (numbers in thousands)	Nov. 2018	Change from Nov. 2017 to Nov. 2018	
		Number	Percent
Total nonfarm	3,765.7	94.7	2.6
Mining, logging, and construction	233.9	18.3	8.5
Manufacturing	281.5	6.5	2.4
Trade, transportation, and utilities	811.1	18.9	2.4
Information	85.4	2.2	2.6
Financial activities	304.2	7.8	2.6
Professional and business services	624.5	19.9	3.3
Education and health services	458.5	5.9	1.3
Leisure and hospitality	390.5	7.9	2.1
Other services	126.4	2.6	2.1
Government	449.7	4.7	1.1

Austin area employment (numbers in thousands)	Nov. 2018	Change from Nov. 2017 to Nov. 2018	
		Number	Percent
Total nonfarm	1,088.0	35.2	3.3
Mining, logging, and construction	67.2	6.1	10.0
Manufacturing	58.0	0.2	0.3
Trade, transportation, and utilities	194.1	11.6	6.4
Information	31.2	0.5	1.6
Financial activities	61.6	0.6	1.0
Professional and business services	188.6	4.5	2.4
Education and health services	124.8	3.4	2.8
Leisure and hospitality	133.6	4.2	3.2
Other services	47.4	2.1	4.6
Government	181.5	2.0	1.1

Houston area employment (numbers in thousands)	Nov. 2018	Change from Nov. 2017 to Nov. 2018	
		Number	Percent
Total nonfarm	3,177.8	114.4	3.7
Mining and logging	81.6	4.1	5.3
Construction	245.6	24.0	10.8
Manufacturing	234.1	14.0	6.4
Trade, transportation, and utilities	647.2	13.5	2.1
Information	31.0	-0.4	-1.3
Financial activities	164.9	4.6	2.9
Professional and business services	523.6	31.7	6.4
Education and health services	396.5	12.4	3.2
Leisure and hospitality	321.4	1.9	0.6
Other services	114.6	6.6	6.1
Government	417.3	2.0	0.5

San Antonio area employment (numbers in thousands)	Nov. 2018	Change from Nov. 2017 to Nov. 2018	
		Number	Percent
Total nonfarm	1,066.2	14.3	1.4
Mining and logging	9.1	1.0	12.3
Construction	55.0	1.4	2.6
Manufacturing	49.9	1.4	2.9
Trade, transportation, and utilities	189.8	3.6	1.9
Information	20.3	0.1	0.5
Financial activities	90.1	-0.8	-0.9
Professional and business services	134.7	-1.4	-1.0
Education and health services	167.5	5.2	3.2
Leisure and hospitality	134.4	0.9	0.7
Other services	39.0	0.6	1.6
Government	176.4	2.3	1.3

2019 Predictions

Avison Young is tracking over 15 msf of leases expiring in the next 2 years. This, coupled with build-to-suits, co-working, and corporate relocations seeking greener pastures, means 2019 should maintain a healthy, though slightly softened market. Of those set to sign new leases, many will be facing the new "sticker shock", as average gross rents in the metro have gone up over $5/sf in the last 7 years. This could lead to a slight reshuffling of tenant structures per submarket, as some tenants are forced to leave current locations for more practical and affordable options.

15,584,241 SF Due to Expire

2019	2020
51.1%	**48.9%**

Looking ahead, rising intereste rates, fears and uncertainty surrounding the economy, political turmoil, tariffs and trade, employee shortages, and potential economic downturns will likely slow the momentum that carried the last five years, but Dallas is still poised to weather any incoming strains or slowdowns.

Trends to Watch: (In no specific order)

Experience-Driven Spaces
Amenities Arms Race
Co-coworking Cohabitation- Rise of the shared-work ecosystems: sharing space, resources, and talent
Workspace Strategies will continue to scale down lease footprints
NNN or bust as more landlords embrace the lease structure over + E
More green space and green certifications
Uncertainty
Opportunity Zones
Rental Rate growth softening- Rents probably won't rise $1/yr, but closer to $0.40
At least 2 Fed interest rate hikes
Peak employment will see businesses offering more incentives to attract and retain talent
Investor demand for safer U.S. assets will keep transaction volume strong
More "Proptech" integration as it becomes an industry buzz word (Property technology for real estate markets)
Downtown Dallas will continue its urban revival as more people move to the city core
Investors will focus more on Industrial and Mult-family, and less on Office
Secondary and tertiary markets will gain more momentum as investors seek out better yield
The yield curve recession curse- The yield spread on the 10 yr-2 yr Treasuries could invert in early 2019
Flexible leasing will become more popular as companies embrace the lack of long term lease obligations
Construction industry will continue grappling with labor shortages and high costs
Companies will try to use HQ2's influence to gain as much financial support from cities as possible
Dallas will see the flight to quality continue as older and class B product continue to lose tenants
Records will be set on price per/sf for office building sales

All this and more! For more information, please reach out to Avison Young's research team and keep an eye out for the 2019 Forecast, coming soon.

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