

# MARKET BEAT

## DEVELOPING TRENDS IN THE CHICAGO OFFICE MARKET

4<sup>TH</sup> QUARTER 2016

MB Real Estate

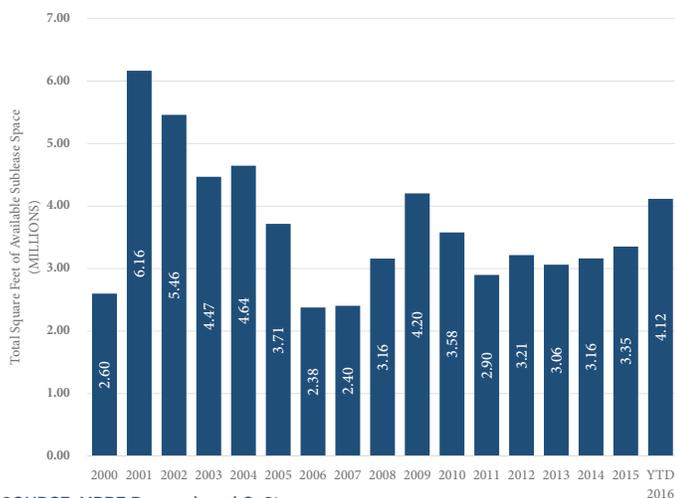
### Growing Sublease Market No Cause For Alarm

In the third quarter of 2016, the sublease market in Chicago's Central Business District (CBD) increased by 295,991 square feet, bringing the total amount of available sublease space up to 4.12 million square feet. This is the first time there has been more than four million square feet of sublease space on the market since 2009, during the Great Recession.

Though the CBD's vacancy rate is at a historic low of 11.1 percent, there is some concern that the large sublease inventory could be a sign that the office market is weaker than it appears. However, a closer look at the data indicates that the current supply is not alarmingly high in comparison to past market cycles. Additionally, the recent increase of available sublease space directly coincides with an increased demand for it.

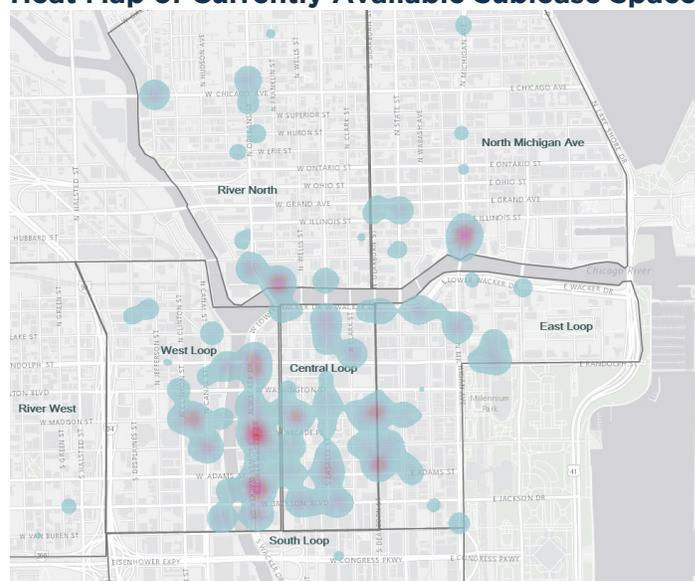
The third quarter's inventory of available sublease space is somewhat misleading. Four of the large blocks of space that were available for sublease in the third quarter had lease terms set to expire in 2017. These four blocks, all located at 131 S. Dearborn, contributed a total of 296,176 square feet to

#### Available Sublease Space (2001 to 2016)



SOURCE: MBRE Research and CoStar

#### Heat Map of Currently Available Sublease Space



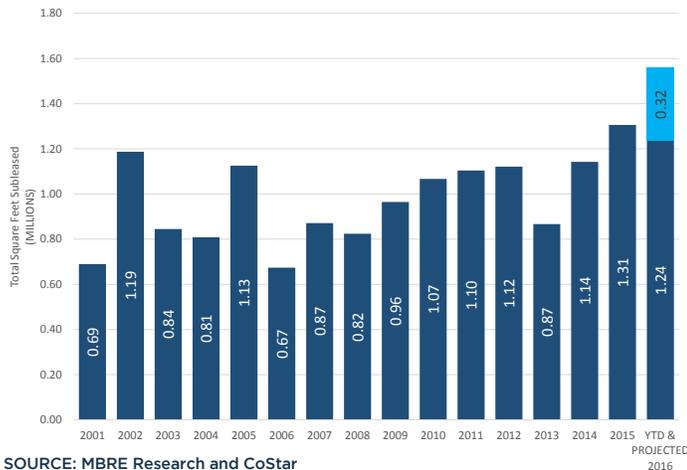
42% of the available sublease space is located in the West Loop submarket, 32% is located in the Central Loop, 10% is located in River North, 10% is located in the East Loop, 5% is located in North Michigan Ave, and 1% is in River West. SOURCE: CoStar

the sublease market even though it was highly unlikely that a sublease tenant could be found that would be interested in taking over a lease for a term of less than one year. Two of these blocks have since been removed from the sublease market and the remaining two will likely be removed soon.

As the chart on the left illustrates, the sublease inventory has steadily increased in recent years, but nonetheless remains significantly less than what was available fifteen years ago. In 2001, the amount of sublease space spiked to 6.16 million square feet after the dot-com collapse and 9/11. The inventory contained more than four million square feet for the next three years.

Prior to the events of 2001, many companies had been overly optimistic about their growth. Subsequently, many put space on

## Available Sublease Space 2001 - 2016



the sublease market. The amount of space subleased increased by 500,000 square feet the following year. However, there was not enough demand to meet the supply and the sublease inventory remained high until 2006.

In contrast, the current increasing supply of sublease space has, fortunately, coincided with an increased demand for sublease space. As the chart above illustrates, the total amount of sublease space leased last year reached an all-time high of 1.31 million square feet and is projected to reach 1.56 million square feet this year.

The current inventory of available sublease space is approximately 73% more than it was at its lowest level in 2006, but the current level of demand for space is 131.3% higher than it was in that same time period. Therefore, the sublease market itself has grown as a percentage of the CBD's rentable building area, not just the amount of available space.

The reasons for this overall increase in the sublease market are related to the growing market for co-working space, which is

also a form of subleasing. The faster pace of today's business climate has created higher demand for space that is available immediately and with less commitment.

Today's innovation economy requires the ability to rapidly seize opportunities, and taking time to plan new office space and wait for an extensive build-out when launching a new platform or product can thwart momentum. A culture of innovation requires also the ability to "embrace failure", creating the need to minimize risk where possible. Long lease terms with premium

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rental rates are an unnecessary risk for a company testing a new market.

Office build-outs generally take approximately six months to complete. Lease terms for direct new leases in 2016 have been an average of eight years, whereas lease terms for subleases in 2016 have been an average of four years. Gross rental rates for subleases executed in 2016 have been an average of approximately \$10 less per square foot than for direct new deals in the CBD.

The majority of tenants that have signed large subleases in Chicago in the past few years have been either rapidly expanding tech companies or established companies opening an office in the City for the first time, either to relocate or branch out. Subleases enable these companies to take chances that are important to Chicago's economic growth.

### SELECTED LARGE SUBLEASE DEALS EXECUTED IN 2016

Tenant	Building	Square Feet	Reason for Space
Beam Suntory	222 W. Merchandise Mart	112,803	Relocated HQ from Deerfield, IL
SC Johnson	550 W. Washington	48,928	Opened urban satellite office - HQ in Racine, WI
Horton Group	500 W. Monroe	26,751	New Chicago office
Riley Safer Holmes & Cancila	70 W. Madison	23,909	New Chicago office
Market Track	233 S. Wacker	33,271	Tech company expansion
Ahead	401 N. Michigan	29,512	Tech company expansion
Shiftgig	550 W. Jackson	16,534	Tech company expansion
Cappex	311 S Wacker	15,617	Tech company expansion