



STAT HIGHLIGHTS

DOWNTOWN (CBD)

	Vacancy	Avg. Rents
Q2 2015	8.69%	\$26.36
Q4 2015	9.47%	\$27.01

MIDTOWN

	Vacancy	Avg. Rents
Q2 2015	5.54%	\$24.75
Q4 2015	7.29%	\$26.23

SOUTHPARK

	Vacancy	Avg. Rents
Q2 2015	12.62%	\$26.15
Q4 2015	13.55%	\$27.27

CBD FULL FLOOR AVAILABILITY

Full Floor Vacancies	Total Fls Available	Inventory/ Available SF	Total % CBD SF
2nd Floor & Up	30	740,221	4.1%
12th Floor & Up	13	43,362	2.2%
20th Floor & Up	9	166,349	.92%
35th Floor & Up	3	69,922	.39%

Out With 2015

2015 will mark the year when Charlotte’s office market grew faster in year over year rental growth than any year in the last decade. The spike in rental rate growth has been even more discernible than the pre-great recession run up in prices. We found an article from July, 2007, titled: “*Rents Continue Growth, Leading Office Market to Post Modest Comeback in Q2.*” The title was followed by the caption, “*The U.S. office market staged a modest comeback in the second quarter, with rents continuing to surge higher.*” Keep in mind, this so called comeback was occurring the exact month that the real estate world began to crumble. An analyst was quoted in the article as saying, “*As predicted, demand for office space picked up relative to the first quarter, but is still operating below anticipated levels. Of particular concern is the slowdown in office using employment. However, that aside, the story is generally the same-steady demand, significant increases in rents and a gradual increase in supply.*” Wow, does this sound eerily familiar?

Generally steady demand, **significant** increases in rents and a gradual increase in supply is exactly where we are today. Are we on the verge of another real estate meltdown? We hope not. But the numbers suggest a bubble is potentially forming. Partly because the rapid increase in rental rates is more to do with capital markets than the actual physical demand from end users. Case in point, Charlotte’s vacancy mid-year 2014 was 13.82%. At year-end 2015, vacancy was 13.78%. Average rents in mid-year 2014 were \$21.73. At year-end of 2015, they were \$23.43/SF. So, as a whole, we are roughly even on vacancy, but rents have climbed almost \$2.00/SF on average.

While the investor craze for real estate yields is largely to blame for the run-up in rental rates, let’s not completely rule

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out good ole’ fashion development and leasing. In Charlotte, Ballantyne Corporate Park stands alone in this category. The roughly 4m SF of existing Class A product is now less than 5% vacant. And while Ballantyne Corporate Park would make a great acquisition for the right investment bank, REIT or life company, it is not for sale. There is no other factor contributing to the increase in rental rates other than strong demand for great product. Rental rate growth in Ballantyne is not artificial, but factually based upon true demand for office space. Such is not the case for the entire market. For example, a certain building in uptown leased for \$22.00/SF 2 ½ years ago. The building gradually increased its asking rental rates to \$24.00/SF, then \$26.00 SF. The building was sold in 2015. Overnight, asking rates increased to \$29.00/SF, even with a vacancy rate of 30%. 2016 will determine if the tenant market is willing to play the game, or if it is willing to put the brakes on the runaway rental rate train.

NOTABLE INVESTMENT SALES TRANSACTIONS

Building	Submarket	Price	Price per SF
Carillon	CBD	147,000,000	\$308
121 W. Trade Street	CBD	71,600,000	\$216
300 S. Brevard	CBD	45,500,000	\$126
Water Ridge Office Park	Airport	115,000,000	\$136
Toringdon Office Park	Hwy 51/ Southeast	114,400,000	\$220

In With 2016

Picking back up on the 2007 article from page 1, if a bubble is potentially forming, what are we to do? As tenant advisors, do we recommend signing a 10 year lease at highly (and sometimes fictitiously) inflated rental rates? No we don’t. As we outlined in the Mid-Year 2015 market report, there are certain circumstances that merit a longer term lease. New construction is one example. Most Class A buildings in Charlotte are not coming out of the ground unless the building can fetch a lease rate in the low to mid \$30’s. If tenants desire new space, the buildout from shell will likely necessitate a longer term lease. Tenants in this position may be perfectly fine with a longer term commitment, as they are relocating into a brand new building with a brand new upfit. Also, tenants leasing 2nd generation spaces that require significant improvements to modernize the space, may be willing to bite off on more term in order to achieve the maximum tenant improvement allowance from the landlord. For some tenants, the space itself can actually produce an ROI from employment growth that outweighs any premium in real estate costs paid. But for many tenants in the market, and to take it a step further, for most tenants in the market, keeping real estate costs in check is the priority.

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GLOBAL TO LOCAL : WHAT TO LOOK FOR



Tenant Advice

For tenants with leases expiring in 2016 and 2017, do your homework before signing a lease term of 5 years and longer. Under the right scenario, it may even be a wise decision to pay a premium lease rate for a 2 year lease. As supply begins to hit the market in 2017, options for tenants should begin to multiply. The higher price paid for a 2 year lease could pay dividends if the tenant is then able to move in the 3rd year, locking into a favorable longer term deal. Charlotte, at least for now, is not San Francisco. Nearly all of the space slated for delivery in San Francisco over the next 12 months is pre-leased. In Charlotte, we have buildings coming out of the ground with zero pre-leasing completed. That said, tenants may feel pinched in submarkets like Midtown, SouthPark and Uptown over the coming quarters, until supply is delivered and 2nd generation spaces are vacated. The short term play suggested above should be seriously considered during this time period.

Foreign Capital:

The amount of foreign capital flowing into US real estate is at an all- time high and is expected to grow in 2016. Two major law changes have occurred over the last year that could potentially draw an additional \$20 billion to \$30 billion in foreign investment: (1) Foreigners can now hold a 10% stake (up from 5%) in a real estate investment trust (REIT) without triggering federal law requiring income taxes to be paid at the sale of the asset. (2) Foreign pension funds will now be generally exempt from paying taxes on investment gains, a law passed by the Obama administration to spur growth in commercial real estate and infrastructure.

Interest Rates:

The combined foreign and domestic investment is expected to continue as long as interest rates remain low and the economy has a pulse. This push will continue to put downward pressure on capitalization rates and upward pressure on rental rates, especially in the core and trophy asset classes, where competition from investors is at its highest and vacancy is generally at its lowest. Expect the Class A & B asset classes to also follow suit. To use the analogy, if the luxury cars are going 80-90mph on the highway and not getting pulled over, the value based vehicles are likely to step on the gas to keep up with the pack. With the Fed’s recent delay in its second 25bps increase, don’t expect any slowdown in building acquisitions in the near future.

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Charlotte Office Market Report Year End 2015

MARKET	Inventory/SF	Net Absorption YTD (SF)	Gross Absorption YTD (SF)	Direct Vacant SF	Direct Vacant %	Sublet Available SF	Total Available SF	Total Available %	Direct Gross Average Rent	Sublet Gross Average Rent	Gross Quoted Rents (Range)	SF Delivered YTD
CHARLOTTE	51,716,957	852,984	3,591,598	6,121,919	11.84%	676,930	6,798,849	13.15%	\$23.43	\$19.99	\$11.00-\$34.00	381,755

Submarkets

Southpark	4,268,163	139,638	536,151	578,191	13.55%	139,037	717,228	16.80%	\$27.27	\$20.18	\$15.00-\$34.00	236,250
Downtown	18,145,197	(189,479)	435,666	1,718,638	9.47%	250,257	1,968,895	10.85%	\$27.01	\$22.28	\$17.00-\$35.00	-
Midtown	2,693,003	44,957	236,576	196,374	7.29%	42,927	239,301	8.89%	\$26.23	\$22.21	\$17.00-\$33.50	79,119
Airport	8,726,597	168,494	666,062	1,367,377	15.67%	127,640	1,495,017	17.13%	\$18.97	\$13.26	\$12.00-\$25.00	-
Highway 51/ Southeast	6,086,085	290,560	814,327	686,290	11.28%	20,905	707,195	11.62%	\$24.93	\$22.36	\$16.75-\$30.00	-
North	3,078,297	85,512	236,410	444,429	14.44%	10,009	454,438	14.76%	\$20.06	\$16.45	\$14.00-\$27.50	66,386
University	4,770,710	237,957	385,328	549,512	13.52%	62,242	611,754	12.82%	\$19.09	\$15.00	\$15.00-\$22.50	-
Matthews/ Crownpoint	1,316,862	17,119	123,411	301,398	22.89%	-	301,398	22.89%	\$17.30	-	\$12.00-\$23.00	-
Cotswold	275,637	5,454	11,256	17,833	6.47%	3,279	21,112	7.66%	\$22.36	\$21.50	\$16.00-\$26.00	-
Park Road	854,966	38,161	97,281	85,226	9.97%	4,110	89,336	10.45%	\$18.49	\$17.25	\$12.00-\$31.00	-
East	1,501,440	14,611	49,130	176,651	11.77%	16,524	193,175	12.87%	\$13.02	\$8.25	\$11.00-\$23.50	-

SC TOTALS	1,587,045	65,468	108,879	183,372	12.08%	24,652	216,380	13.63%	\$19.50	\$26.50	\$13.50-\$26.50	18,473
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SC Border Submarkets

Lancaster County	654,023	6,113	26,508	70,759	9.90%	-	64,759	9.90%	\$18.89	-	\$17.50-\$24.00	18,473
York County	933,022	44,199	82,371	112,613	13.61%	24,652	151,621	16.25%	\$19.93	\$26.50	\$13.50-\$26.50	-