



Chicago Metro Office Market

Office Market Recovery Continues at Unhurried Pace

Metro Overview

Conditions failed to improve in the Chicago Metro office market during the fourth quarter of 2022. Sublease inventory rose to a record high of roughly 11 million square feet as recessionary headwinds continued to incentivize companies to cut costs and offload unutilized space into the secondary market. Overall leasing activity was relatively steady in the fourth quarter of 2022, with about 46 deals made over 10,000 square feet. Leasing transactions in the fourth quarter remained concentrated on amenity-rich Class A assets, and tenants are taking advantage of favorable concessions from landlords amidst an oversaturated market. Total vacancy increased 40 basis points quarter-over-quarter to 22.2%, and net absorption was negative for the 10th consecutive quarter. Investment activity was more prominent in the suburbs relative to its Central Business District counterpart, with 14 out of the 16 total deals made this quarter. As 2023 approaches, it is expected that contractions will continue to dominate the Metro office leasing market, leaving both tenants and landlords to develop creative solutions to accommodate a workforce that has embraced hybrid-work arrangements.

Current Conditions

- Metro vacancy rose once again, this time 40 basis points to 22.2% driven by a significant amount of negative absorption.
- There were trends this quarter of large tenants signing new deals in the suburbs, and CBD tenants contracting into smaller and higher quality space.
- Rental rates continued to increase in the metro largely thanks to supply continuing to outpace tenant demand.

Market Summary

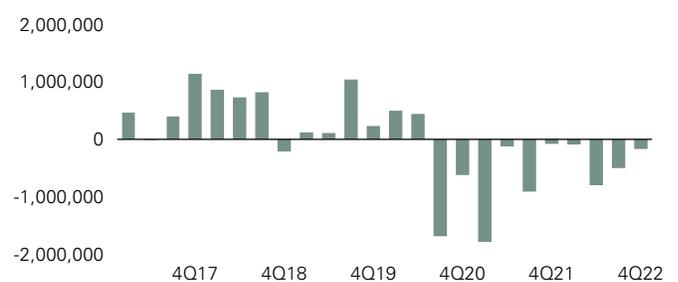
	Current Quarter	Prior Quarter	Year Ago Period	12-Month Forecast
Total Inventory (SF)	249.9M	249.8M	244.1M	↑
Vacancy Rate	22.2%	21.8%	20.6%	↑
Quarterly Net Absorption (SF)	(165,929)	(494,559)	(895,000)	↓
Average Asking Rent/SF	\$32.44	\$32.92	\$30.86	↑
Under Construction (SF)	1.8M	1.6M	3.5M	→
Deliveries (SF)	100,000	-	-	↓

Market Analysis

ASKING RENT AND VACANCY RATE



NET ABSORPTION



RESEARCH Q3 2022

CBD Overview

Available sublease space in the Chicago CBD office market has increased 82.0% between the first quarter of 2020 and the fourth quarter of 2022, to a historic high of 7.1 million square feet. Total vacancy increased 50 basis points quarter-over-quarter to 20.1%, and quarterly net absorption in the CBD was negative for the fourth consecutive quarter at negative 169,587 square feet. Average asking rents decreased slightly in the fourth quarter to \$32.44/SF.

Suburban Overview

Vacancy rates in the Suburban office market increased 30 basis points quarter-over-quarter to 25.5%, and occupancy losses have surpassed 2.2 million square feet since the advent of the pandemic in the first quarter of 2020. Sublease inventory rose to a record high of 4.1 million square feet, with recessionary headwinds incentivizing companies to cut costs and contract office space. Average asking rates across all submarkets were practically unchanged from the third quarter of 2022, with a weighted average rate of \$23.74/SF.

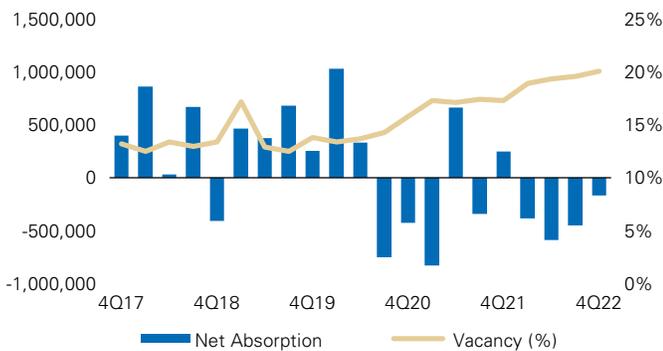
Leasing Activity

Both the CBD and Suburban office markets have reflected the national trend of leasing activity being concentrated on Class A space that is rich in amenities. Leasing activity in the CBD remained stable over the quarter, at approximately 1.1 million square feet. The key trend in the fourth quarter of 2022 was companies turning to the secondary market to alter their office footprints, taking advantage of readily available sublet space. With more employees working remotely, office occupancy rates have decreased, prompting companies to reevaluate the amount of square footage required for their workplaces. Many companies have seized the opportunity to upgrade to higher-quality offices

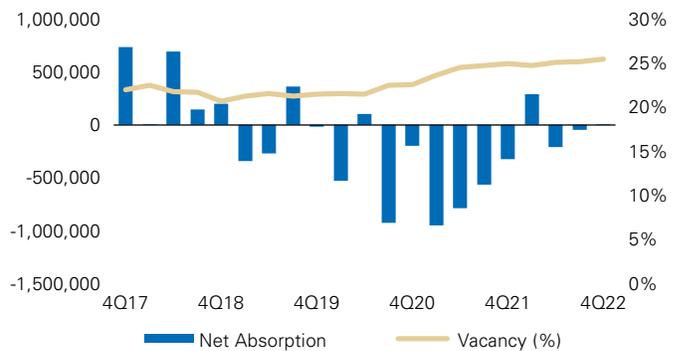
with lower square footage, more favorable lease terms, and reduced rental rates, as they contemplate the future of their in-office policies. Public relations services firm Cision exemplifies this trend; this quarter, it downsized its 52,000 square-foot headquarters in the suburbs and committed to subleasing 24,000 square feet at 300 S. Riverside Plaza. However, not all companies were looking to downsize in this quarter, as some tenants have taken advantage of the current market conditions to expand their space at low costs. One example of this is Twin Brook Capital subleasing 29,000 square feet at 111 South Wacker, thereby doubling the amount of space it already has in the building.

Overall leasing activity in the Suburban market was around 1.3 million square feet this quarter, bringing the year's total to 5.9 million square feet. The North and Northwest submarkets made up nearly 61% of total leasing transactions in the fourth quarter, with 324,000 square feet and 410,000 square feet, respectively. Among all new suburban office leases signed in 2022, 73.0% were in Class A properties. Landlords are offering generous perks to high-credit tenants in hopes of locking down long-term lease contracts, including extended rent abatement and generous tenant improvement concessions.

CBD Net Absorption and Vacancy



Suburban Net Absorption and Vacancy



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Sublease Space

Office sublease availability has been at record highs throughout 2022 in the Chicago CBD market, with the fourth quarter reaching over 7.1 million square feet. The West Loop submarket has been a significant contributor to this trend, accounting for almost half of all sublease inventory in the CBD with an additional 3.1 million square feet added during this quarter. Approaching three years since the onset of the pandemic, the market is feeling the aftershock effects of a workforce that has embraced the conveniences of working from home. Larger companies are considering the cost savings and work from home effectiveness as their primary motivation to shrink their office footprints as they look to make decisions on their long-term strategies. One such example of this movement occurred this quarter, when software firm Sprout Social listed 64,000 square feet of its Loop headquarters, focusing its office presence on the floor it leases below at 131 South Dearborn. On the other hand, the increase in sublease offerings has also given tenants in the market rare negotiating leverage, allowing them to expand office space at favorable costs. In 2023, nearly 700,000 square feet of sublease space is set to expire, which will convert to direct vacancy in the CBD if not leased up.

Capital Markets

The investment sales market in the Chicago metropolitan region reached \$402.2 million in the fourth quarter. The total investment sales volume for 2022 was \$2.76 billion, which is the highest it has been since the onset of the pandemic. This year, private capital accounted for the majority of buyers at 53.9%, followed by institutional capital at 35.0%. In terms of sales, institutional capital made up 56.7% of transactions and private capital accounted for 28.1%. Sales in the Central Business District were relatively subdued this quarter, making up only two of the 16 total transactions in the Chicago metropolitan area. Investors are currently reticent to make any commitments to downtown office space until interest rates begin to decrease, and the costs of debt become more stable.

Perhaps the most significant transaction in the Chicago Metro area this quarter was the acquisition of Allstate's former HQ campus by Nevada-based developer Dermody Properties for a reported \$232.0 million. The company plans on converting the 232-acre property into a 10-building logistics park, with 3.2 million square feet of available build-to-suit space. Other notable sales this quarter include Pointe O'Hare for \$38.7 million, DuPage Corporate Center for \$14.0 million, and Rosemont Corporate Center for \$13.0 million. As interest rate hikes are expected to continue and expand capitalization rates in the coming year, it is likely that buyers and sellers will remain at odds over asset valuations. Furthermore, both lenders and investors will be closely monitoring the work-from-home trends, and whether office occupancy rates will begin to return to pre-pandemic levels in 2023, before making any significant purchase or sale decisions.

Outlook

2023 will be a year of challenges and innovative solutions for the recovering office market. Employers will have to determine how to best utilize their space while balancing the need for office attendance with the increasing popularity of remote work. The market will continue to favor tenants, as the supply of available space will exceed the demand and more companies will seek to offload their space in the secondary market. With nearly 8 million square feet of sublease space available in the downtown area, this will have a significant impact on future vacancy if not leased. Over the next five years, just under 2.9 million square feet of sublease space will convert to direct vacancy, with 1.8 million of that happening within the next three years. Starting in 2023, over 500,000 square feet will be removed from the sublease market annually until 2029 if not leased. Additionally, tenants will likely continue to seek out amenity-rich Class A buildings to attract and retain talent and promote collaboration, while Class B properties may struggle to fill their vacant space in the coming months.

Chicago Life Science Inventory

Address	Location	Total Size	Rental Rates	Tenants
Innovation Park	Libertyville	350,000 SF of Lab	\$15 - \$18 PSF Gross	Valent Bio Sciences, Avexis
Illinois Science and Technology Park	Skokie	556,650 SF	\$35 - \$47 PSF Net	NorthShore, Vetter, LanzaTech
2430 N Halsted Street	Chicago (Lincoln Park)	120,000 SF	\$35 - \$45 PSF Net	Evozyne, Excicure, Solvd Health
West End on Fulton	Chicago (Fulton Market)	301,260 SF	\$45 - \$55 PSF Net	Talis Biomedical, Xeris Pharmaceuticals Portal Innovations

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Submarket Statistics

	Total Inventory (SF)	Under Construction (SF)	Total Vacancy Rate	Qtr Absorption (SF)	YTD Absorption (SF)	Class A Asking Rent (Price/SF)	Class B Asking Rent (Price/SF)	Total Asking Rent (Price/SF)
CBD Total	152,435,401	1,877,874	20.1 %	(169,597)	(1,555,788)	\$43.17	\$36.75	\$39.58
Central Loop	37,003,615	-	23.5 %	(300,818)	(1,464,280)	\$41.77	\$39.01	\$39.53
East Loop	25,510,592	-	22.3 %	(136,354)	(325,061)	\$38.89	\$35.14	\$36.43
Fulton Market	8,088,700	531,187	21.5 %	150,853	916,570	\$62.15	\$32.71	\$44.51
North Michigan Avenue	10,496,574	-	14.0 %	(100,697)	(153,366)	\$40.00	\$36.73	\$37.41
River North	16,343,502	1,346,687	17.9%	(51,139)	(545,652)	\$38.48	\$29.57	\$35.26
West Loop	54,992,418	-	18.4%	268,558	16,001	\$45.52	\$36.08	\$42.78
Suburban Total	97.4M	-	25.5 %	3,668	(47,085)	\$25.19	\$22.05	\$23.74
I-88 East	22,205,140	-	22.6%	(96,580)	(70,878)	\$25.93	\$23.21	\$24.75
I-88 West	13,470,532	-	22.2 %	33,143	110,512	\$22.92	\$20.76	\$22.08
North	25,341,257	-	23.2 %	111,840	(67,902)	\$24.63	\$21.12	\$23.28
Northwest	23,892,170	-	35.4 %	(64,469)	(62,837)	\$24.93	\$21.45	\$23.30
O'Hare	12,561,659	-	20.0 %	19,734	44,020	\$28.95	\$25.80	\$25.91
Chicago Metro	249,906,159	1,877,874	22.2 %	(165,929)	(1,602,873)	\$34.18	\$29.40	\$32.44

CBD Lease Transactions

Tenant	Market	Building	Type	Square Feet
Xeris Pharmaceuticals	Fulton Market	1375 W Fulton	Direct	87,000
Zoro Tools	West Loop	500 W Madison	Direct	42,000
Alvarez & Marshall, Inc.	West Loop	540 W Madison	Renewal	42,000
Loop Capital	Central Loop	425 S Financial	Direct	37,000

Suburban Lease Transactions

Tenant	Market	Building	Type	Square Feet
M/I Homes	I-88 West	2135 City Gate Ln	Direct	27,000
CliftonLarsonAllen	I-88 East	2021 Spring Rd	Direct	25,000
JMG Financial Group	I-88 East	2001 Butterfield Rd	Extension	23,000
Byline Bank	Northwest	10 N Martingale Rd	Direct	21,000

Metro Sale Transactions

Buyer	Market	Building	Price Per SF	Square Feet
Galaxy IL WI LP	I-88 East	Ginger Creek Office Park	\$372/SF	105,000 SF
Tri Star Equities	West Loop	217 N Jefferson	\$361/SF	58,000 SF
The Prime Group	Central Loop	115 S LaSalle	\$100/SF	1.2M SF

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Economic Conditions

As 2022 concludes, the global economy continues to face instability amidst converging factors, including residual COVID-19 impacts, European energy sanctions, China's housing market crisis, the war in Ukraine and widespread inflation. Perhaps the biggest focus for Americans is the increasing likelihood of a recession in the first half of 2023. The Fed's announcement of a 50 basis-point hike in mid-December has brought interest rates to a 15-year high at a target range of 4.25% to 4.5%, with no indication of rate cuts anytime soon.

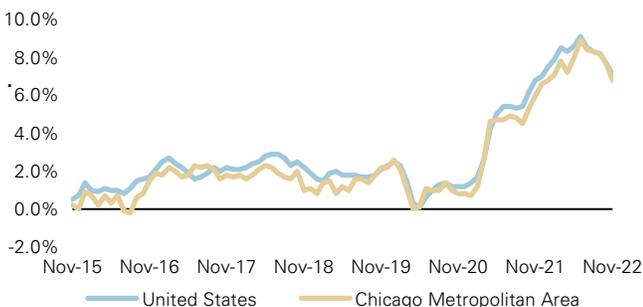
While the most recent US CPI measure of 7.1% is high relative to pre-pandemic levels, November's report is down significantly from June's peak of 9.0% and is an optimistic sign that the FOMC's monetary tightening efforts have been effective in decelerating price increases. Inflation rates in Chicago have mirrored this national decrease, with the latest CPI measured at 6.8%, a 210 basis-point reduction from June's peak.

Despite the economic slow down engineered by the Fed, the labor market has remained resilient in 2022, with the latest data from the BLS showing a national unemployment rate of 3.7%. Demand for workers is also outpacing supply in the Windy City with unemployment at 4.5%, perhaps fueled by strong job growth in the hospitality, manufacturing and tech industries. Illinois mass layoff claims are down more than 50% year-over-year, and workers who are being laid off are finding new jobs quicker than at the height of the pandemic. This workers market will not prevail in the long-term, however, as the Fed's future rate hikes will bring the labor market back into equilibrium, decreasing wage growth, and ultimately, prices.

The outlook for 2023 is one of slow GDP growth, a likely recessionary period, falling consumer sentiment and a softening in business investment. While the coming months may present some challenges, the US has historically been able to rebound from onerous periods of stagnant economic activity. The extent to which we'll begin to see a reversion to "normalcy" will largely be dependent on the efficacy of the Central Bank's monetary policy in conjunction with solutions to geopolitical frictions across the globe.

Consumer Price Index (CPI)

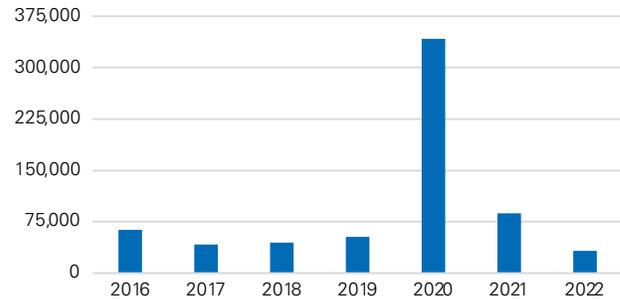
ALL ITEMS, 12-MONTH % CHANGE, NOT SEASONALLY ADJ.



Source: U.S. Bureau of Labor Statistics

Layoff Statistics

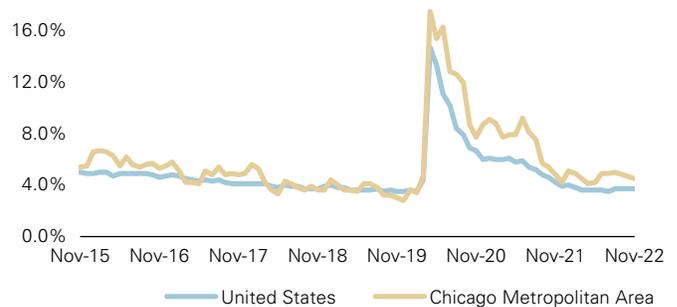
IL MASS LAYOFFS (INITIAL CLAIMS), NOVEMBER 2022



Source: Illinois Department of Employment Security, Economic Information and Analysis

Unemployment Rate

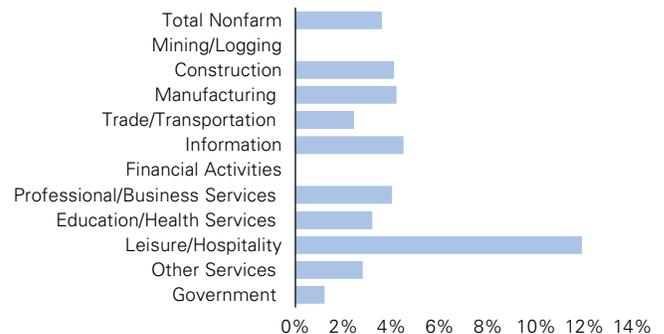
SEASONALLY ADJUSTED, NOVEMBER 2022



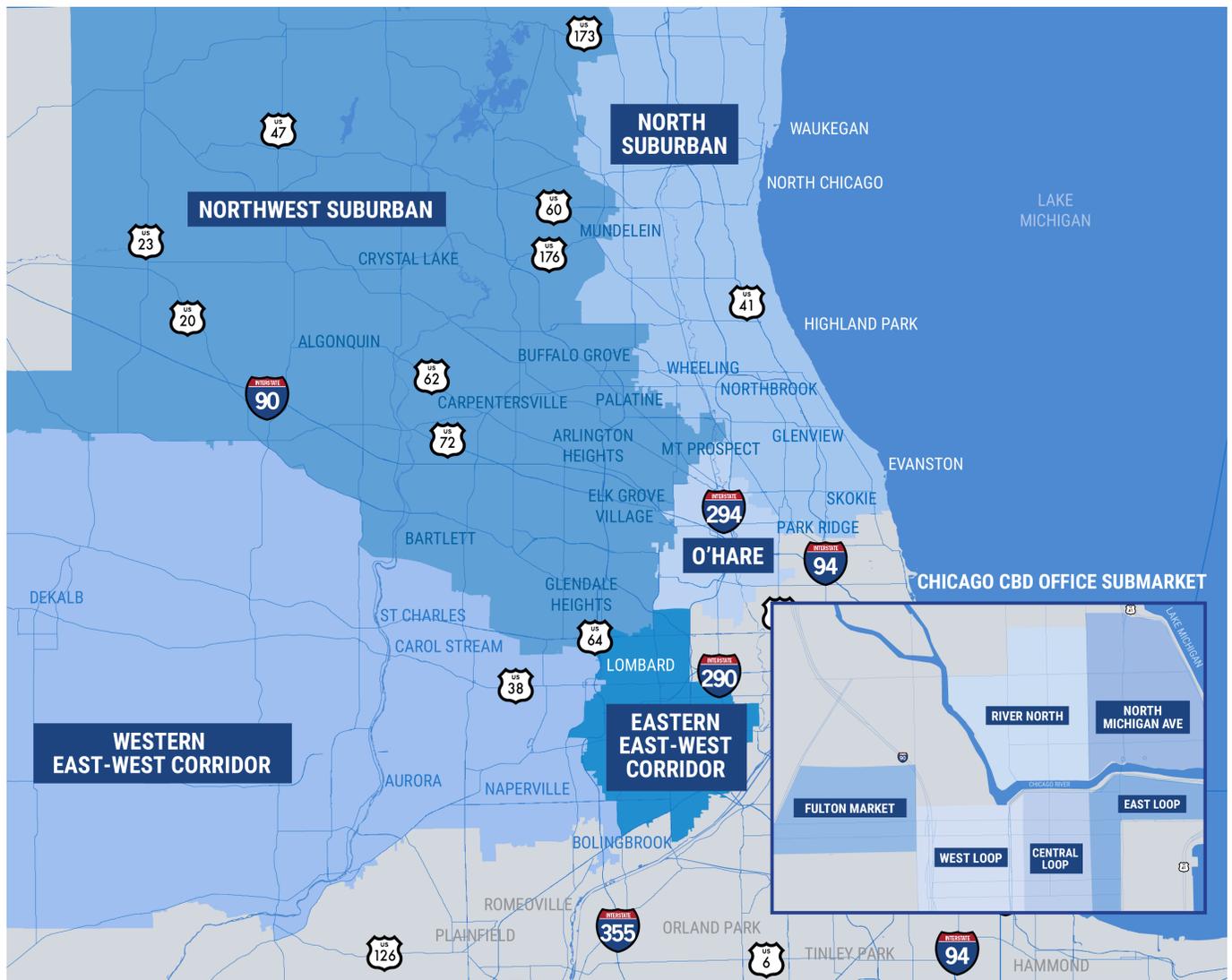
Source: U.S. Bureau of Labor Statistics

Employment Growth By Industry

CHICAGO, NOVEMBER 2022, 12-MONTH % CHANGE, SEASONALLY ADJ.



Source: U.S. Bureau of Labor Statistics



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