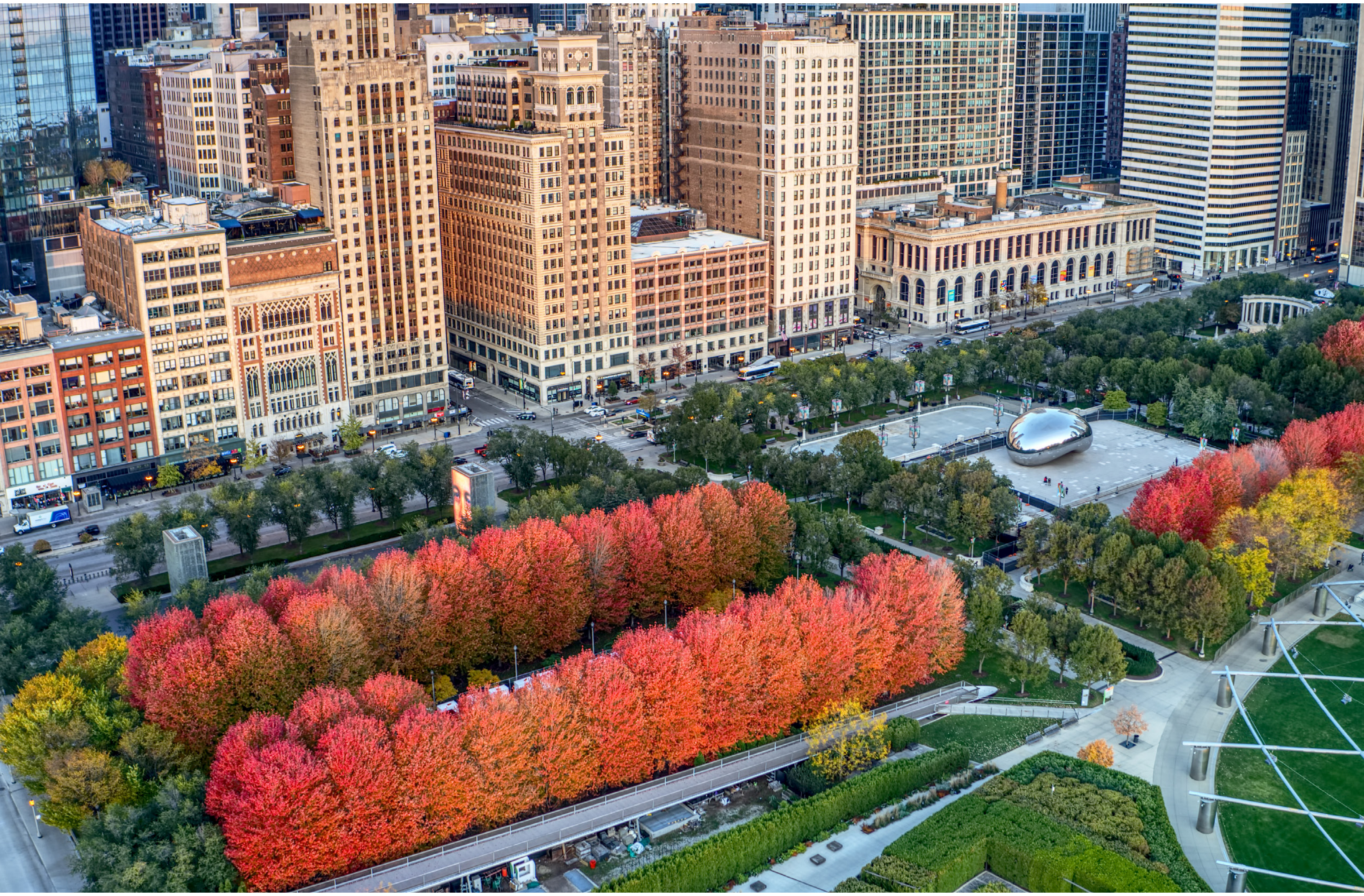
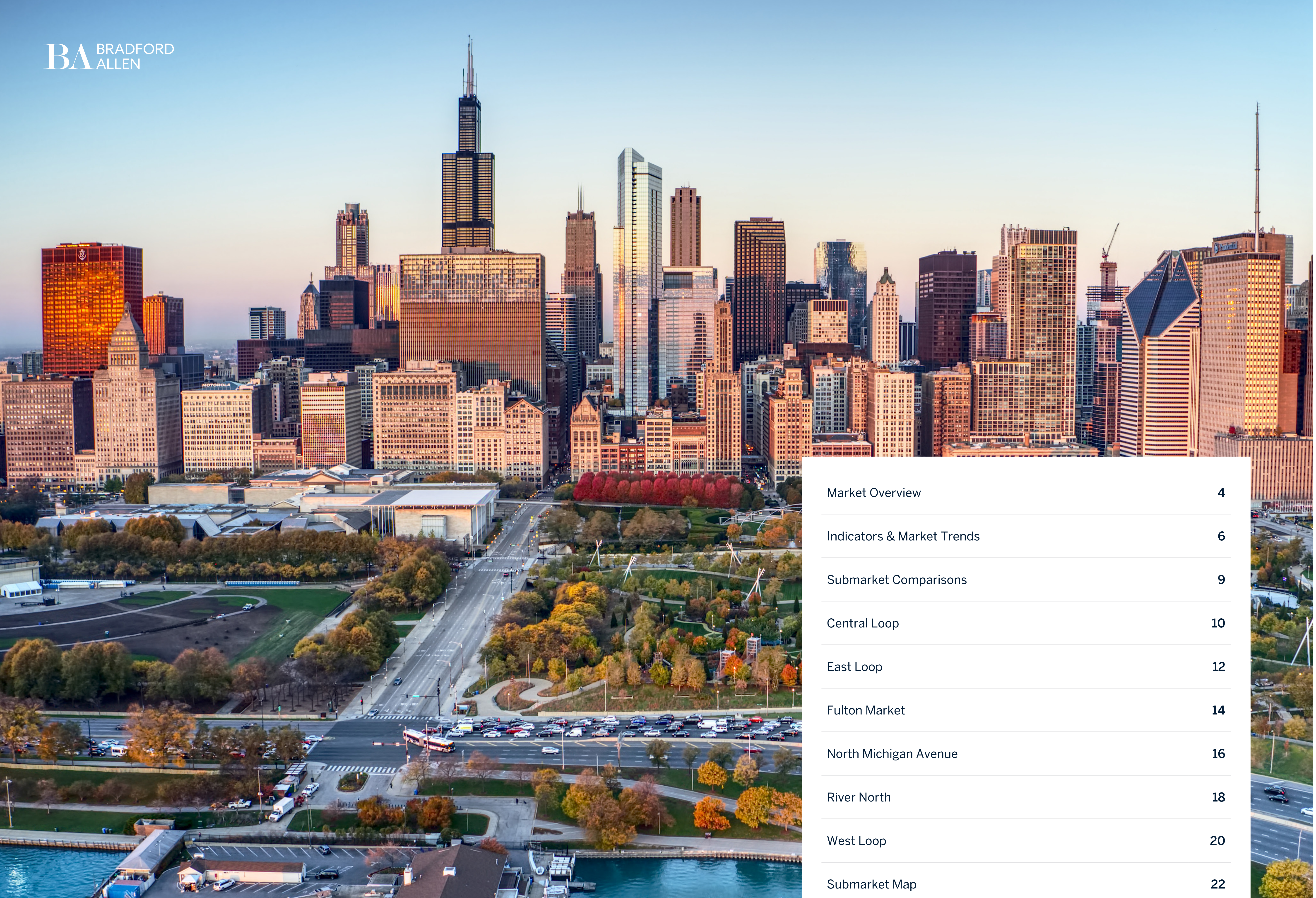
BRADFORD ALLEN

Q3/22
OFFICE MARKET REPORT
DOWNTOWN CHICAGO



TCN WORLDWIDE REAL ESTATE SERVICES



CONTENTS

POCKETS OF STRENGTH, SIGNS OF STRESS, AND THE RETURN-TO-OFFICE

Chicago's CBD showed signs of strength through Q3/22. Absorption levels turned positive for the first time this year as vacancy rates stabilized at roughly 18%. Even though vacancy levels steadily rose through the pandemic, owners did not lower rental rates in response. Not wanting to lock in contractually lower rents, landlords instead gave short-term financial incentives in the form of generous TI allowances and robust concessions as tenants began extending lease terms (**Figure 01**). Owners unable or unwilling to provide tenants with these financial incentives struggled to keep their assets well occupied, leading to a growing number of distressed office buildings in the CBD.

As we discussed in our most recent *Office Pulse*, new office development has slowed as oversupply issues weigh on Chicago's office market. An uncertain economic climate coupled with unfavorable financing conditions have limited ground-up construction of new office assets (**Figure 02**). Although development screeched to a halt, tenants continued their flight-to-quality by leaving Class B and C offices and moving to recently built, highly amenitized Class A buildings.

Responding to evolving employee preferences—driven in part by concerns over quality-of-life issues—many firms have shifted to hybrid schedules, providing workers with the flexibility to spend some days at home and some in the office. How these trends ultimately affect demand for office space long-term is something the market will have to keep evaluating and repricing until it finds a new equilibrium. These changes come at a time when asset managers are faced with rapidly rising interest rates and the CBD prepares for a wave of loan maturities. Using MSCI's Real Capital Analytics database, we calculate that approximately 40% of the debt outstanding secured by Chicago CBD office properties will come due by the end of 2024. Over the next several years, the leasing market is going to have pockets of strength and pockets of weakness, across submarkets and building classes, as it adjusts to ongoing cyclical and structural change.

LEASING ACTIVITY

Roughly 1.6 million square feet was leased in Q3/22, resulting in a total 5.3 million leased year-to-date. This figure is in line with the 5.3 million square feet leased through the first three quarters of 2021. Still, leasing activity remains significantly below pre-pandemic levels as the average leased in the first three quarters from 2010–2019 was approximately 9 million square feet.

As companies continue to re-evaluate their existing space needs in the evolving return-to-office environment, tenants nearing their lease expirations have waited longer to negotiate new lease terms. With deadlines imminent for many tenants, this uncertainty drove demand for fully furnished, move-in available office space. Like Q2/22, the rising demand for full spec suites has been met by increasing the supply of available sublease space. Sublease inventory has grown rapidly since the onset of the pandemic, evidenced by the 89% increase in total sublet square feet available from Q1/20 to Q3/22 (**Figure 03**). Additionally, unoccupied sublease space accounted for 0.9% of total inventory in Q1/20, whereas that figure reached 2.3% in Q3/22.

Although sublease inventory surged following the pandemic and oversupply issues remain, tenants are still willing to pay record-high rental rates to provide their employees with quality office space, evidenced by Headlands Technologies' new lease signed in August. The trading firm originally leased 16,000 square feet at 444 W. Lake, later deciding to nearly triple their footprint by occupying two floors at 110 N. Wacker for a net rental rate of more than $50 p.s.f.—one of the most expensive in Chicago's history. More than 170 companies have affirmed their long-term commitment to the city by moving to or expanding their office space downtown, including major brands like McDonald's, which decided to relocate some suburban employees to their new office space in Fulton Market—Chicago's most active neighborhood for new tenants.

Property data were compiled from CoStar with these parameters: existing and under-renovation office property type; within Central, East and West Loops, N. Michigan Avenue, River North, and Fulton Market. Excluded properties include those with under 20,000 s.f. of office space; non-conforming and owner-occupied properties, including those owned by coworking firms. Absorption numbers are calculated using currently reported square footage in CoStar, standardized over the last four quarters.

Fulton Market continues to attract more tenants than any other submarket in Chicago's CBD, consistently posting positive absorption every quarter since 2016. On the other hand, other submarkets have been struggling to bring in new tenants, especially the Central Loop, which posted positive absorption levels for the first time since Q3/20. In particular, the LaSalle Street Corridor has struggled to retain and attract tenants. As the flight-to-quality trend continues, owners of dated Class B and C assets must adjust their leasing strategies to remain competitive.

INVESTMENT SALES

Sale volume remained below pre-pandemic levels with only $250 million trading hands in Q3/22. More than a third of this figure was attributed to Google's decision to purchase, redevelop, and occupy the James R. Thompson Center in the Central Loop. Of course, a lot can change over the five-year timeline of this redevelopment, but if executed to plan, this deal could potentially be a significant benefit to Chicago's office market, particularly the LaSalle Street Corridor. But to what extent? The developer leading the Google-Thompson Center deal—Mike Reschke—noted at Crain's Fall Real Estate Forum that for every job Google brings into a market, they indirectly create an additional 4.5 jobs. The tech giant plans to bring 5,000 employees to the Thompson Center, which by this formula could lead to more than 20,000 additional jobs.

The Central Loop struggled more than any other submarket due to the high concentration of older product. What's more, the flight-to-quality trend has created additional pressures for owners of these Class B and C assets as tenants relocated to newly built or recently renovated Class A buildings, resulting in a rise of distressed assets. However, if Google's decision has even a small percentage of the effect on the Central Loop as it did on Fulton Market in 2015, then there could be opportunity for new investors looking to enter the market.

ADAPTIVE REUSE: OFFICE TO RESIDENTIAL

Vacant and distressed office buildings, especially in the Central Loop, are poised to become targets for office-to-residential redevelopments—like 29 S. LaSalle, the once-vacant office tower turned luxury apartment building. One Illinois Center, located at 111 E. Wacker, will be losing its largest tenant, leaving behind nearly 140,000 square feet of vacant space. Even though AmTrust, the owner of the property, is actively marketing the vacant space to new potential tenants, they also reference their plan to "reimagine" that entire building—something they're already in the process of doing with their distressed 135 S. LaSalle high-rise. The City of Chicago is actively encouraging investors to take on this adaptive reuse strategy, even unlocking TIF dollars to provide financial incentives in hopes of bringing new life to the Central Loop.

DOWNTOWN CHICAGO

Q3/22 SNAPSHOT

21.3%	18.3%	$43.94
DIRECT AVAILABILITY RATE	DIRECT VACANCY RATE	DIRECT GROSS ASKING RATE

FIGURE 01

CONCESSIONS & LEASE TERM

Source: *CompStak*

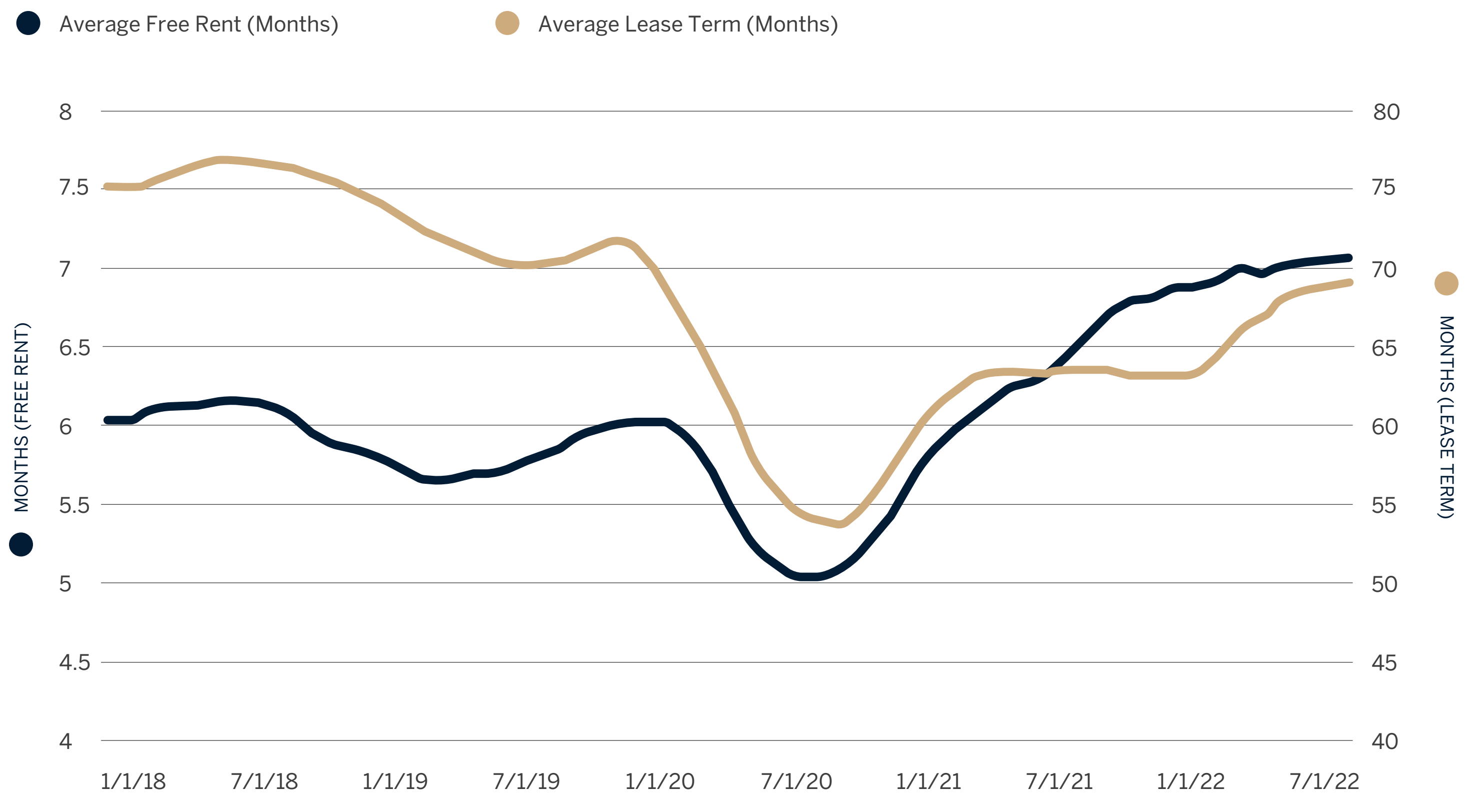


FIGURE 02

TOTAL SF UNDER CONSTRUCTION

Source: *CoStar*

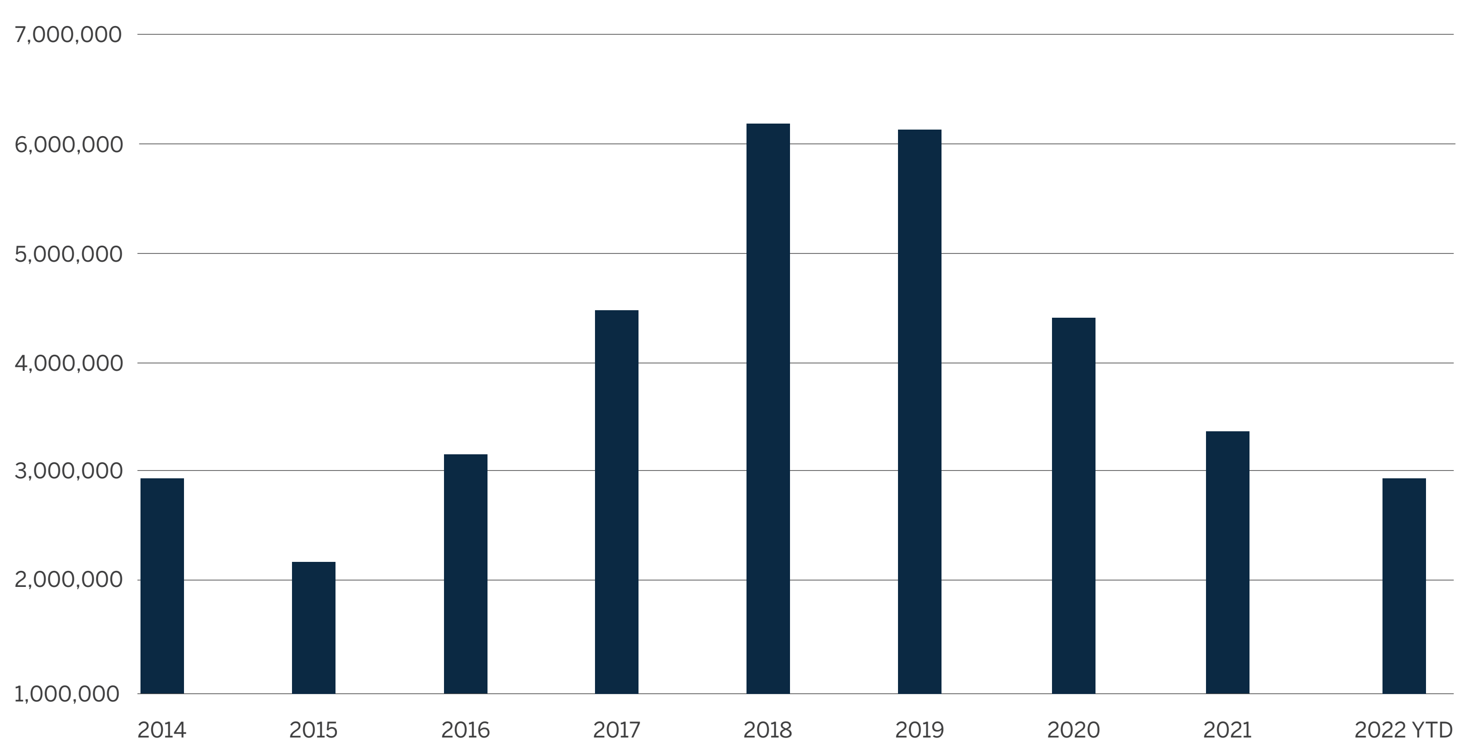


FIGURE 03

SUBLEASE TRENDS

Source: *CoStar*

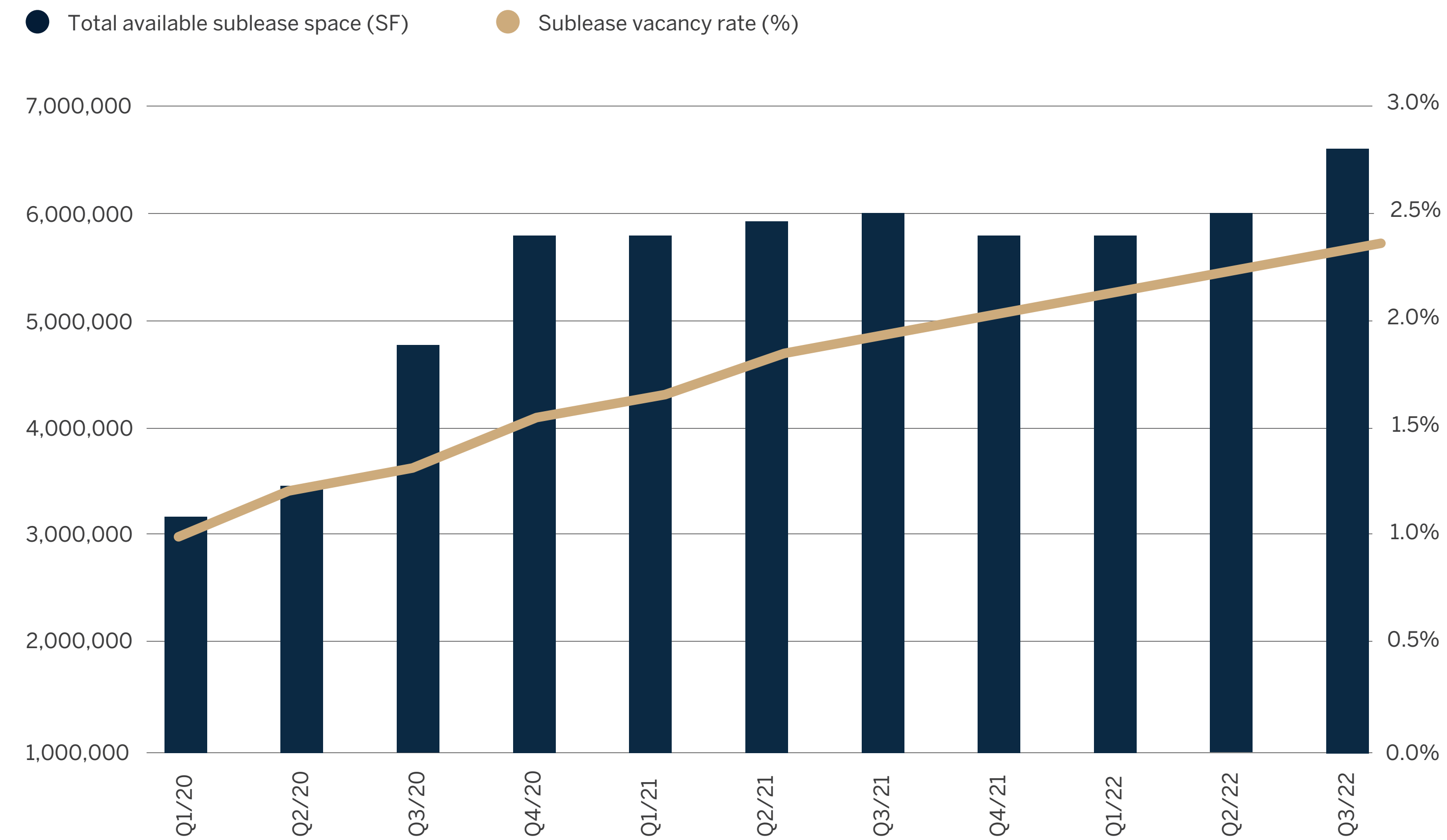


FIGURE 04

Q3/22 INVESTMENT SALES

Source: *CoStar*

PROPERTY ADDRESS	BUILDING SF	CLASS	SUBMARKET NAME	SALE PRICE	PSF	SALE DATE	BUYER	SELLER
100 W. RANDOLPH STREET	945,120	B	Central Loop	$105,000,000	$111	7/27/22	The Prime Group, Inc.	State of Illinois
115 S. LASALLE STREET	591,845	A	Central Loop	$75,000,000	$127	7/29/22	State of Illinois	Samsung SRA
111 W. MONROE STREET	610,760	B	Central Loop	$43,109,000	$71	7/28/22	The Prime Group, Inc.	Samsung SRA
217 N. JEFFERSON STREET	58,800	B	West Loop	$20,950,000	$356	7/18/22	Tri Star Equities	Metonic Real Estate Solutions

FIGURE 05

SUBMARKET COMPARISONS, ECONOMIC INDICATORS, & TRENDS

Source: *CoStar*

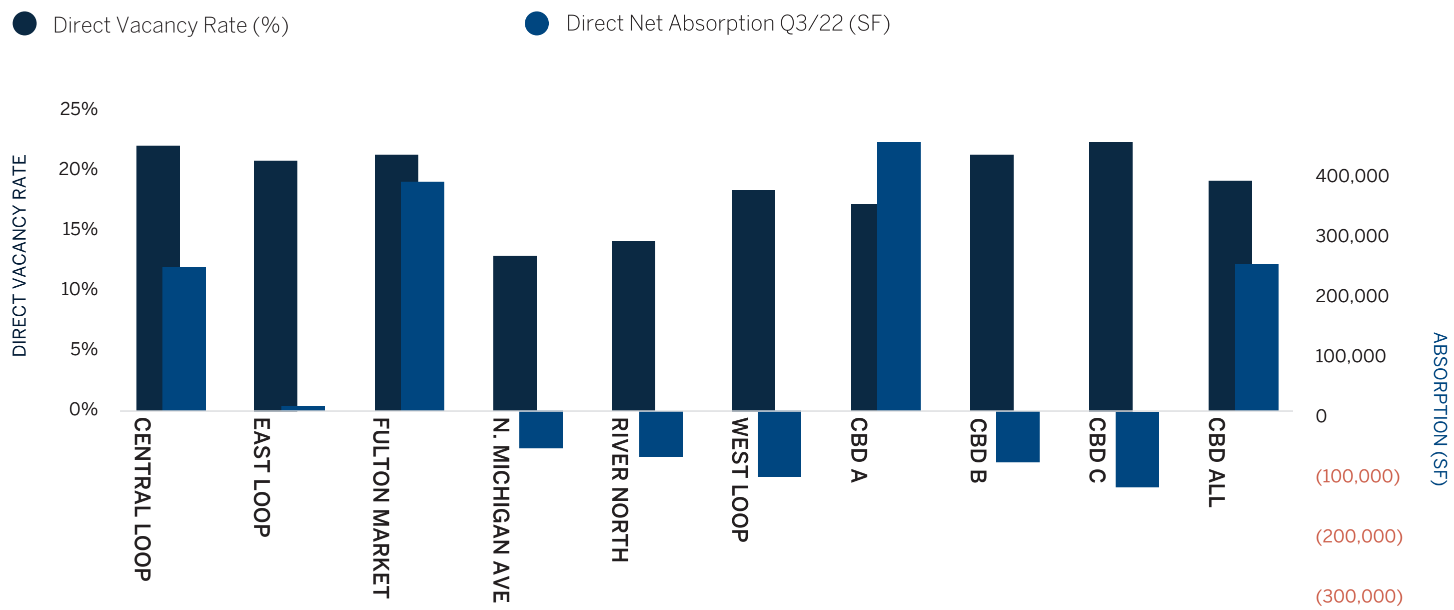


FIGURE 06

PRODUCT IN THE PIPELINE

Source: *CoStar*

(+50,000 SF)

SUBMARKET	PROPERTY ADDRESS	RBA (SF)	BUILDING STATUS	DELIVERY YEAR
RIVER NORTH	311 W. Huron Street	217,000	Under Construction	2023
FULTON MARKET/NEAR WEST SIDE	345 N. Morgan Street	200,000	Under Construction	2022
FULTON MARKET/NEAR WEST SIDE	360 N. Green Street	493,680	Under Construction	2023
WEST LOOP	732 W. Randolph Street	48,000	Under Construction	2023
FULTON MARKET/NEAR WEST SIDE	1020 W. Randolph Street	40,000	Under Construction	2023
RIVER NORTH	333 W. Wolf Point Plaza	1,200,202	Under Construction	2023
FULTON MARKET/NEAR WEST SIDE	1200 W. Carroll Avenue	494,775	Proposed	2023
FULTON MARKET/NEAR WEST SIDE	900 W. Fulton Market Street	62,723	Proposed	2023
FULTON MARKET/NEAR WEST SIDE	919 W. Fulton Market Street	400,000	Proposed	2023
FULTON MARKET/NEAR WEST SIDE	310 S. Green Street	190,810	Proposed	2023
FULTON MARKET/NEAR WEST SIDE	350 N. Morgan Street	527,912	Proposed	2023

FIGURE 07

CHICAGO CBD SUBMARKET COMPARISON SUMMARY

Source: *CoStar*

SUBMARKET/ ASSET CLASS	INVENTORY (SF)	AVERAGE BUILDING SIZE (SF)	DIRECT AVAILABILITY RATE (%)	SUBLET AVAILABILITY RATE (%)	DIRECT VACANCY RATE (%)	SUBLET VACANCY RATE (%)	GROSS ASKING RATE (DIRECT)	DIRECT NET ABSORPTION Q3 (SF)	DIRECT NET ABSORPTION Q2 (SF)
CBD	153,743,713	379,614	21.3%	4.3%	18.3%	2.2%	$43.94	221,780	(302,573)
CLASS A	106,782,603	796,885	19.2%	5.0%	16.7%	2.5%	$47.27	417,861	(67,126)
CLASS B	40,751,912	207,918	26.4%	2.7%	21.9%	1.9%	$39.58	(74,657)	(193,480)
CLASS C	6,209,198	82,789	23.6%	1.8%	22.0%	0.8%	$29.50	(121,424)	(41,967)
CENTRAL LOOP	35,855,944	560,249	25.6%	3.4%	21.7%	1.6%	$43.56	187,563	(344,178)
CLASS A	20,308,939	812,358	25.7%	3.8%	20.6%	1.6%	$45.55	(88,884)	(79,254)
CLASS B	15,021,706	455,203	25.5%	2.9%	23.0%	1.7%	$41.54	277,681	(270,614)
CLASS C	525,299	87,550	28.0%	0.0%	28.1%	0.0%	$25.44	(1,234)	5,690
EAST LOOP	25,603,921	512,078	23.1%	4.2%	20.0%	2.1%	$40.15	2,283	(77,714)
CLASS A	17,318,823	1,082,426	19.7%	5.2%	16.2%	2.2%	$43.73	186,018	1,462
CLASS B	5,852,063	344,239	33.4%	2.8%	30.8%	2.2%	$37.26	(150,756)	(26,251)
CLASS C	2,433,035	143,120	22.2%	1.0%	21.0%	0.4%	$28.02	(32,979)	(52,925)
FULTON MARKET	8,544,186	123,829	19.1%	1.9%	20.9%	0.8%	$39.60	285,100	140,066
CLASS A	5,409,131	270,457	18.5%	2.4%	22.9%	1.1%	$42.54	229,749	92,227
CLASS B	2,211,108	65,033	21.2%	1.1%	17.9%	0.0%	$36.44	58,315	38,083
CLASS C	923,947	61,596	17.8%	1.2%	16.0%	1.2%	$30.71	(2,964)	9,756
N. MICHIGAN AVENUE	12,475,295	378,039	14.7%	3.6%	13.3%	1.8%	$44.68	(62,651)	55,810
CLASS A	8,269,386	551,292	15.0%	5.0%	13.6%	2.6%	$47.80	(26,144)	39,276
CLASS B	4,205,909	233,662	14.1%	0.9%	12.7%	0.2%	$38.18	(36,507)	16,534
RIVER NORTH	16,951,395	180,334	17.8%	5.9%	14.2%	3.8%	$44.82	(73,612)	(232,011)
CLASS A	11,472,597	956,050	16.6%	7.9%	12.4%	5.2%	$50.98	(20,468)	(213,234)
CLASS B	4,196,144	71,121	18.3%	1.6%	16.0%	1.0%	$34.82	2,933	(11,522)
CLASS C	1,282,654	55,768	26.3%	2.0%	24.0%	0.7%	$32.67	(56,077)	(7,255)
WEST LOOP	54,312,972	571,715	20.5%	4.9%	17.2%	2.6%	$46.56	(116,903)	155,454
CLASS A	44,003,727	956,603	17.5%	5.1%	15.9%	2.4%	$49.61	137,590	92,397
CLASS B	9,264,982	264,714	33.9%	4.3%	22.4%	3.8%	$40.55	(226,323)	60,290
CLASS C	1,044,263	74,590	26.5%	5.0%	24.0%	1.6%	$29.97	(28,170)	2,767

CENTRAL LOOP

- In Q3/22, the direct vacancy rate remained steady at 21.7%. Sublease availability has increased from 2.9% to 3.4%.
- Absorption figures have turned positive for the first time since Q3/20, posting nearly 190,000 s.f. of net absorption.
- The Central Loop has seen more sale and lease activity than any other submarket this quarter, with the most notable being Google's decision to purchase and occupy the Thompson Center.
- Both Cook County and the State of Illinois have affirmed their commitment to the recently struggling submarket by signing two leases totaling more than 140,000 s.f.

MARKET MOVEMENT

BUILDING DISTRESS
10 BUILDINGS
(2,500,000 SF)
of available space

SALE
THE PRIME GROUP, INC.
(945,120 SF)
100 W. Randolph

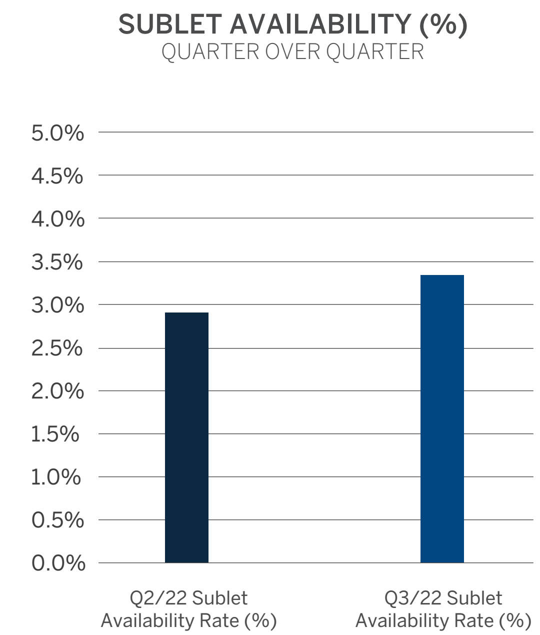
SALE
STATE OF ILLINOIS
(591,845 SF)
115 S. LaSalle

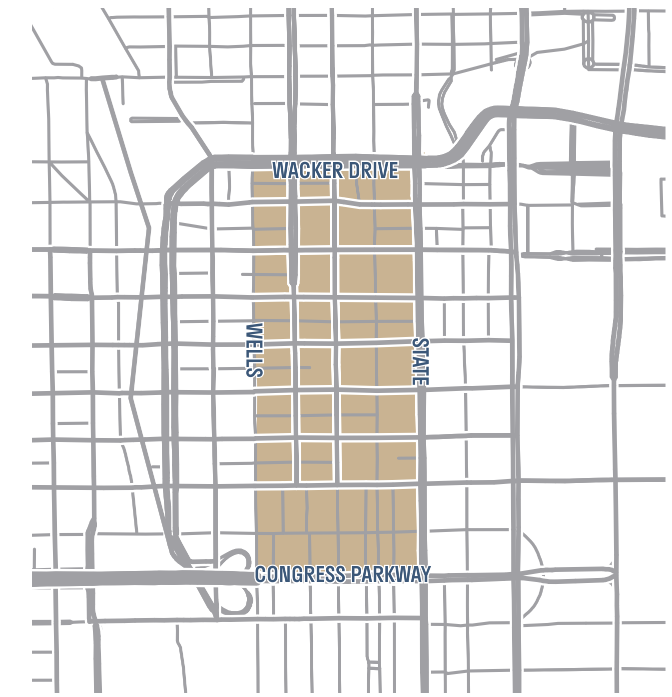
SALE
THE PRIME GROUP, INC.
(610,760 SF)
111 W. Monroe

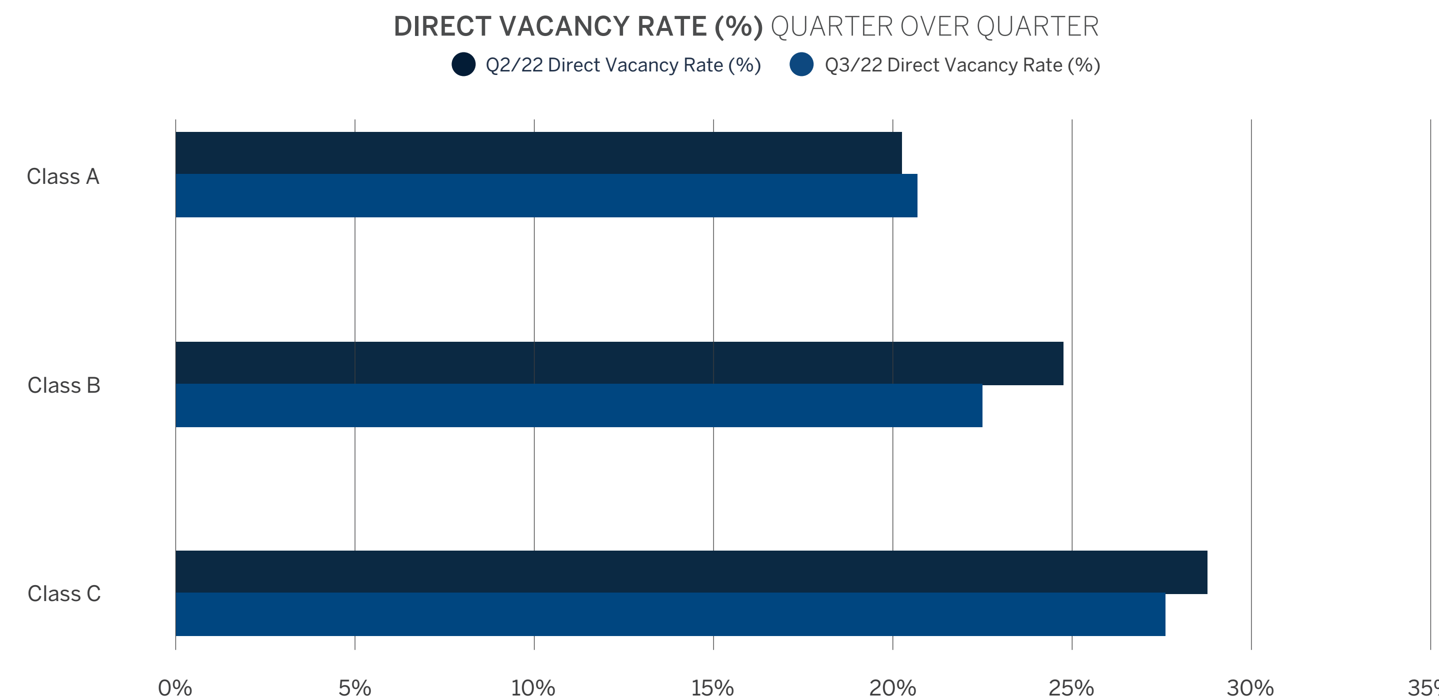
NEW LEASE
STATE OF ILLINOIS
(34,472 SF)
115 S. LaSalle

SUBLEASE
COOK COUNTY
(106,472 SF)
161 N. Clark

RENEWAL
PAPER SOURCE
(28,520 SF)
125 S. Clark







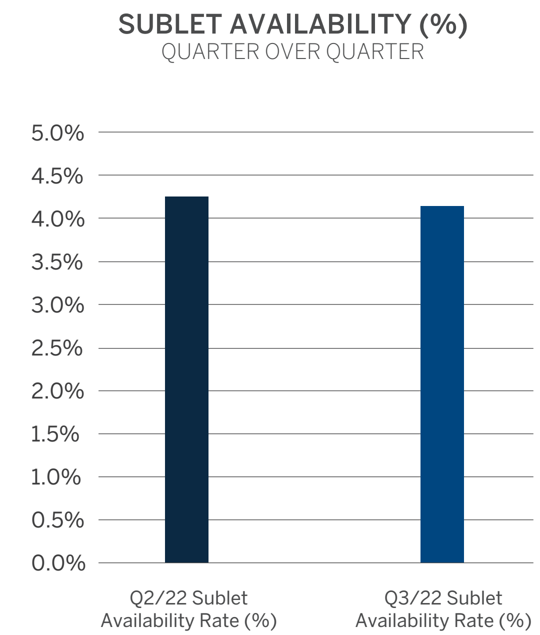
ASSET CLASS	INVENTORY (SF)	AVERAGE BUILDING SIZE (SF)	DIRECT AVAILABILITY RATE (%)	SUBLET AVAILABILITY RATE (%)	DIRECT VACANCY RATE (%)	SUBLET VACANCY RATE (%)	GROSS ASKING RATE (DIRECT)	DIRECT NET ABSORPTION Q3 (SF)	DIRECT NET ABSORPTION Q2 (SF)
CLASS A	20,308,939	812,358	25.7%	3.8%	20.6%	1.6%	$45.55	(88,884)	(79,254)
CLASS B	15,021,706	455,203	25.5%	2.9%	23.0%	1.7%	$41.54	277,681	(270,614)
CLASS C	525,299	87,550	28.0%	0.0%	28.1%	0.0%	$25.44	(1,234)	5,690
TOTAL	35,855,944	560,249	25.6%	3.4%	21.7%	1.6%	$43.56	187,563	(344,178)

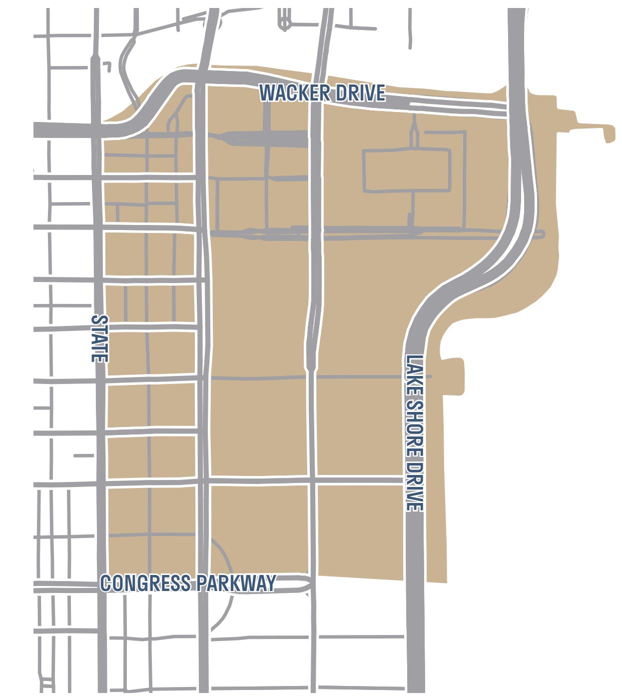
EAST LOOP

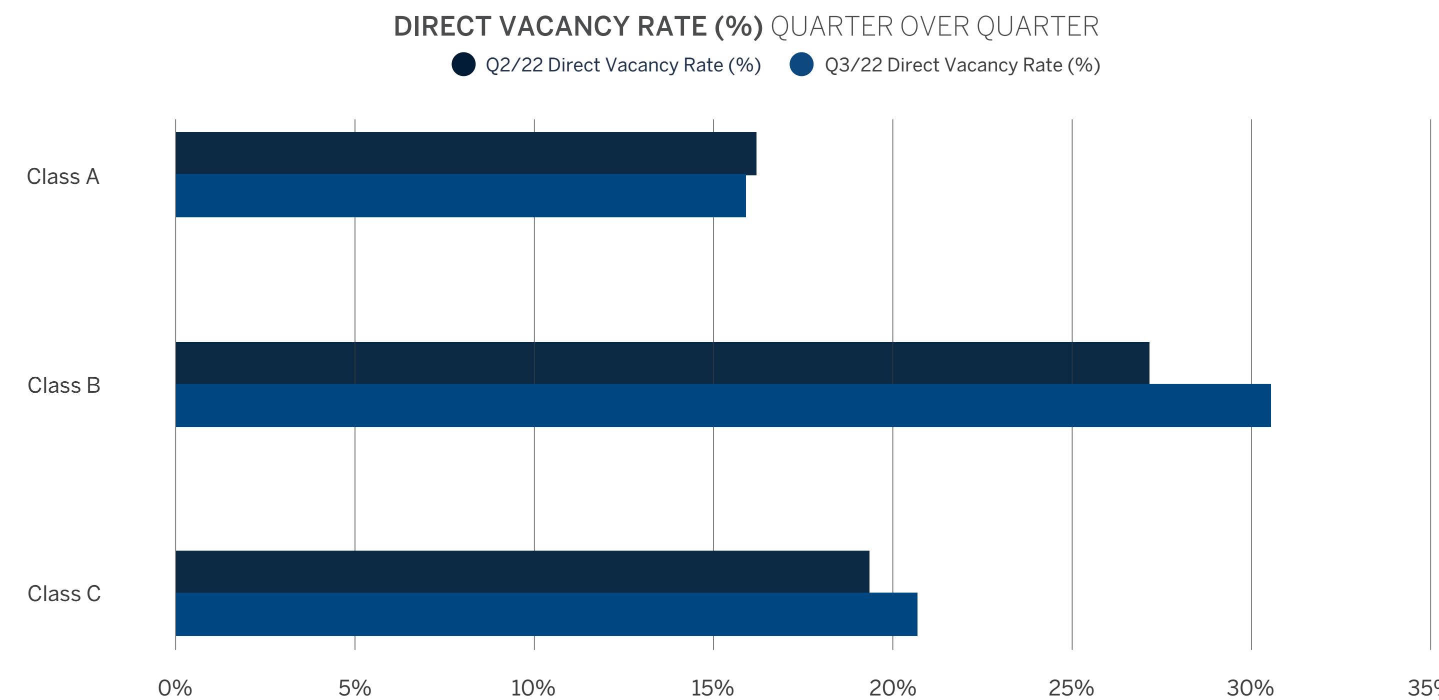
- In Q3/22, the direct vacancy rate remained steady, sitting just below 20%. Sublease availability has also remained relatively unchanged at 4.3%.
- Absorption levels are relatively flat this quarter, which is an improvement from the consecutive quarters of negative absorption through this year.
- Notable lease deals include a 44,357-s.f. lease signed by Ferrero at 24 E. Washington.

MARKET MOVEMENT

BUILDING DISTRESS	NEW LEASE	NEW LEASE
3 BUILDINGS (1,200,000 SF) of available space	FERRERO (44,357 SF) 24 E. Washington	ELEVATE K-12 (19,614 SF) 24 E. Washington







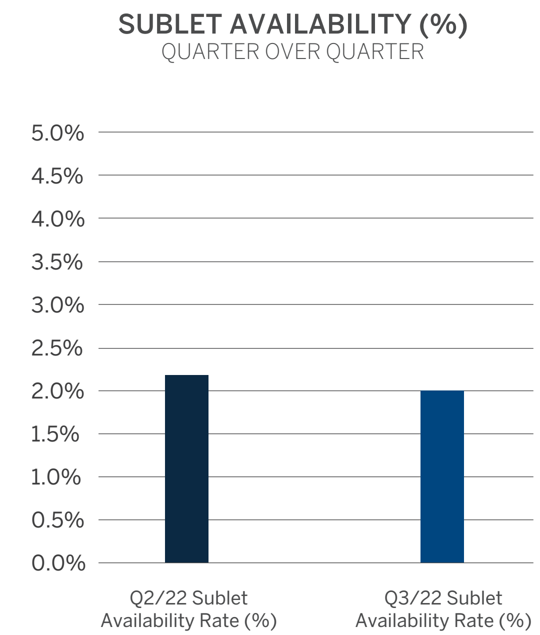
ASSET CLASS	INVENTORY (SF)	AVERAGE BUILDING SIZE (SF)	DIRECT AVAILABILITY RATE (%)	SUBLET AVAILABILITY RATE (%)	DIRECT VACANCY RATE (%)	SUBLET VACANCY RATE (%)	GROSS ASKING RATE (DIRECT)	DIRECT NET ABSORPTION Q3 (SF)	DIRECT NET ABSORPTION Q2 (SF)
CLASS A	17,318,823	1,082,426	19.7%	5.2%	16.2%	2.2%	$43.73	186,018	1,462
CLASS B	5,852,063	344,239	33.4%	2.8%	30.8%	2.2%	$37.26	(150,756)	(26,251)
CLASS C	2,433,035	143,120	22.2%	1.0%	21.0%	0.4%	$28.02	(32,979)	(52,925)
TOTAL	25,603,921	512,078	23.1%	4.2%	20.0%	2.1%	$40.15	2,283	(77,714)

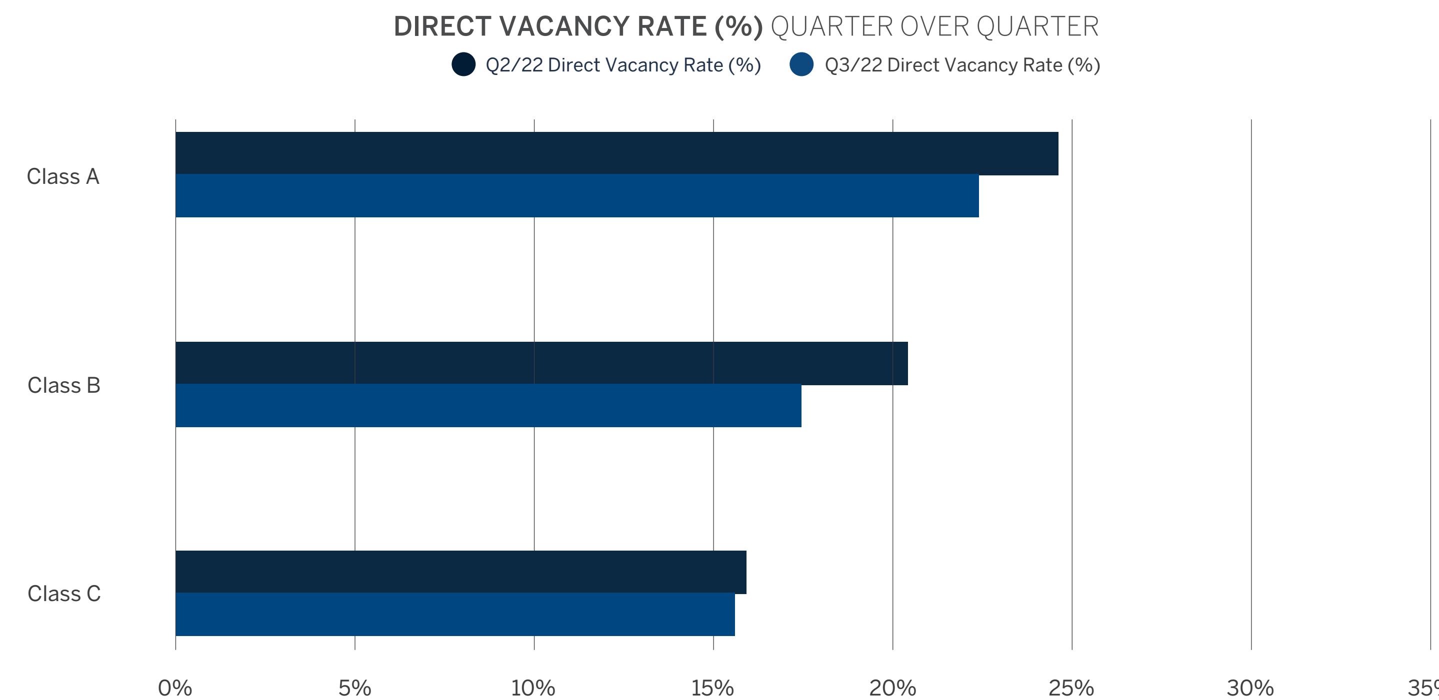
FULTON MARKET

- In Q3/22, the direct vacancy rate decreased from 22.6% in Q2/22 to 20.9%. Sublease availability followed suit, decreasing from 2.2% to 1.9%.
- Absorption figures remain positive as Fulton Market keeps attracting new tenants. The submarket continues to push against the theme of a “struggling office market” through declining vacancy rates, rising rental rates, and positive absorption levels.
- Notable lease deals include a 24,018-s.f. lease signed by Wellington Management Co. LLP at 345 N. Morgan.

MARKET MOVEMENT

BUILDING DISTRESS	NEW LEASE	NEW LEASE	NEW LEASE
1 BUILDING (10,292 SF) of available space	WELLINGTON MANAGEMENT (24,018 SF) 345 N. Morgan	NORTON ROSE FULLBRIGHT (18,073 SF) 1045 W. Fulton	SCHAFER CONDON CARTER (15,259 SF) 1201 W. Lake





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CLASS A	5,409,131	270,457	18.5%	2.4%	22.9%	1.1%	$42.54	229,749	92,227
CLASS B	2,211,108	65,033	21.2%	1.1%	17.9%	0.0%	$36.44	58,315	38,083
CLASS C	923,947	61,596	17.8%	1.2%	16.0%	1.2%	$30.71	(2,964)	9,756
TOTAL	8,544,186	123,829	19.1%	1.9%	20.9%	0.8%	$39.60	285,100	140,066

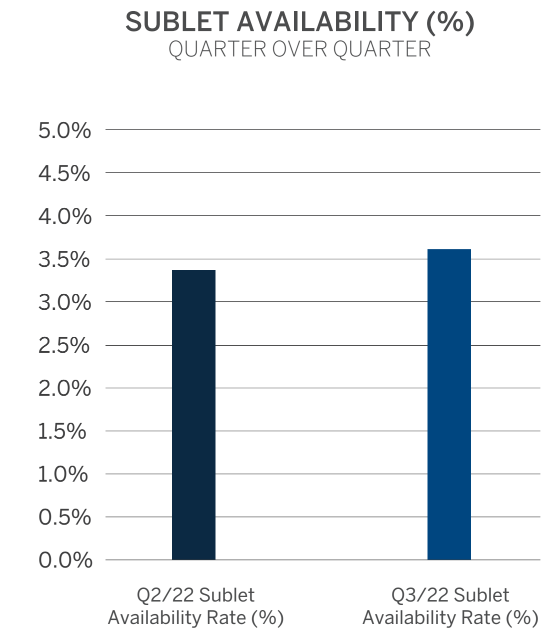
NORTH MICHIGAN AVENUE

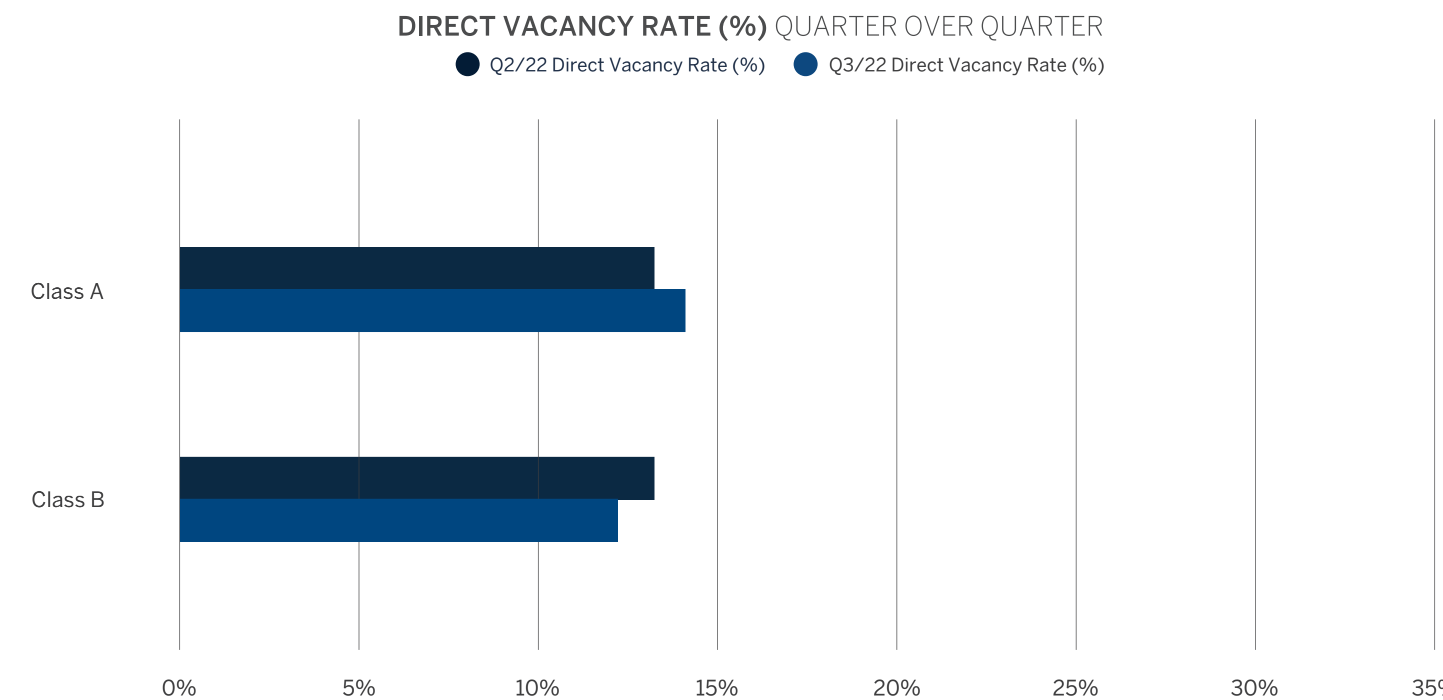
- In Q3/22, the direct vacancy rate remained relatively unchanged at 13.3%. Sublease availability increased to 3.6%.
- Absorption levels were negative through the quarter, a reversal from the positive 55,810 s.f. net absorption posted in Q2/22.
- Notable lease deals include a 22,389-s.f. lease signed by Acrisure at 401 N. Michigan.
- Mavrek Development secured a $102 million construction loan to build a new mixed-use building at 535 N. St. Clair, which is set to be the first delivery of Class A office space in several years to this submarket.

MARKET MOVEMENT

NEW LEASE

ACRISURE
(22,389 SF)
401 N. Michigan





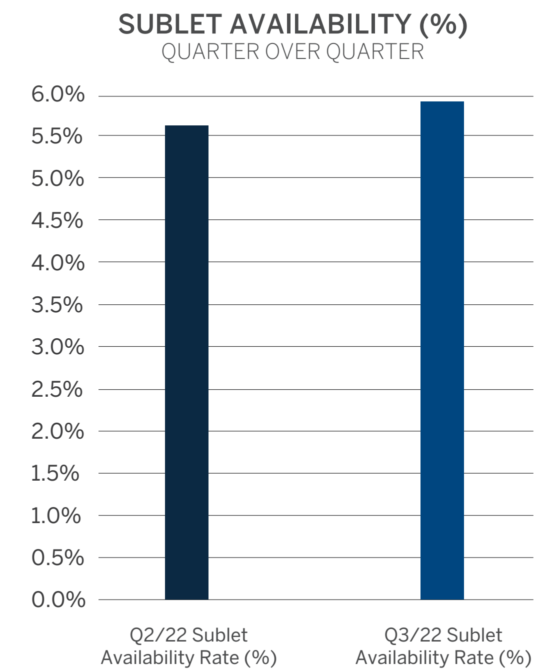
ASSET CLASS	INVENTORY (SF)	AVERAGE BUILDING SIZE (SF)	DIRECT AVAILABILITY RATE (%)	SUBLET AVAILABILITY RATE (%)	DIRECT VACANCY RATE (%)	SUBLET VACANCY RATE (%)	GROSS ASKING RATE (DIRECT)	DIRECT NET ABSORPTION Q3 (SF)	DIRECT NET ABSORPTION Q2 (SF)
CLASS A	8,269,386	551,292	15.0%	5.0%	13.6%	2.6%	$47.80	(26,144)	39,276
CLASS B	4,205,909	233,662	14.1%	0.9%	12.7%	0.2%	$38.18	(36,507)	16,534
TOTAL	12,475,295	378,039	14.7%	3.6%	13.3%	1.8%	$44.68	(62,651)	55,810

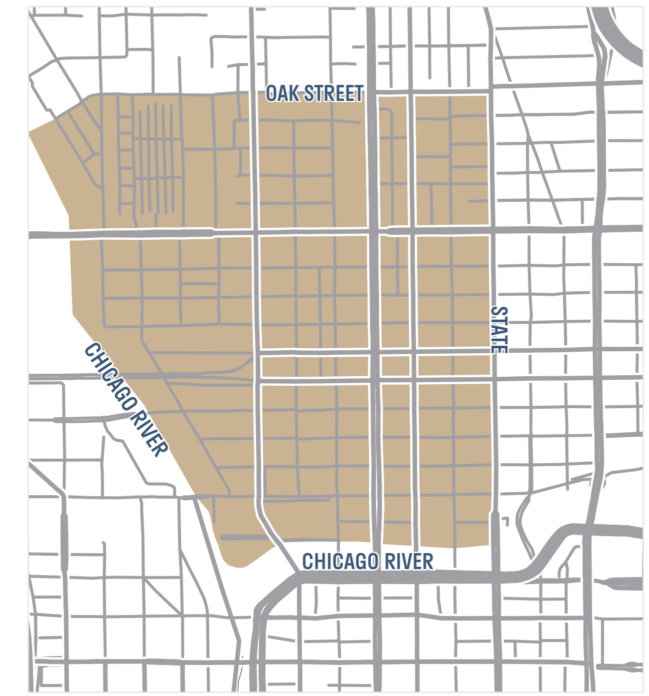
RIVER NORTH

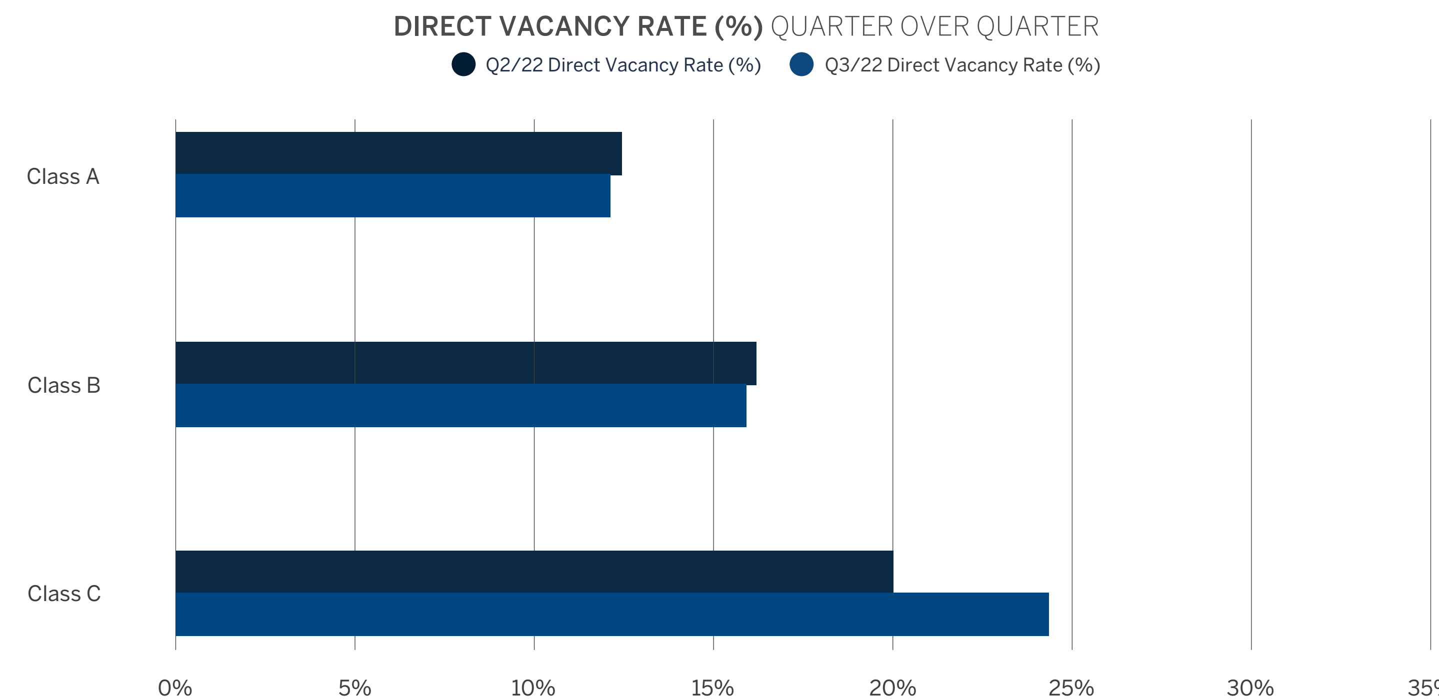
- In Q3/22, the direct vacancy rate remained relatively unchanged, sitting at just over 14%. Sublease availability also remained at similar levels to Q2/22 at 5.9%. River North vacancy levels have been consistently lower than the overall vacancy rate for Chicago's CBD.
- Absorption levels remained negative through Q3/22.
- Notable lease deals include a 13,505-s.f. lease signed by Dump Crypto at 600 W. Chicago.

MARKET MOVEMENT

BUILDING DISTRESS	NEW LEASE	NEW LEASE	NEW LEASE
4 BUILDINGS (96,847 SF) of available space	DUMP CRYPTO (13,505 SF) 600 W. Chicago	SCHULER SHOOK (10,504 SF) 363 W. Erie	CAMEO (10,000 SF) 620 N. LaSalle







ASSET CLASS	INVENTORY (SF)	AVERAGE BUILDING SIZE (SF)	DIRECT AVAILABILITY RATE (%)	SUBLET AVAILABILITY RATE (%)	DIRECT VACANCY RATE (%)	SUBLET VACANCY RATE (%)	GROSS ASKING RATE (DIRECT)	DIRECT NET ABSORPTION Q3 (SF)	DIRECT NET ABSORPTION Q2 (SF)
CLASS A	11,472,597	956,050	16.6%	7.9%	12.4%	5.2%	$50.98	(20,468)	(213,234)
CLASS B	4,196,144	71,121	18.3%	1.6%	16.0%	1.0%	$34.82	2,933	(11,522)
CLASS C	1,282,654	55,768	26.3%	2.0%	24.0%	0.7%	$32.67	(56,077)	(7,255)
TOTAL	16,951,395	180,334	17.8%	5.9%	14.2%	3.8%	$44.82	(73,612)	(232,011)

WEST LOOP

- In Q3/22, the direct vacancy rate remained at roughly 17%. Sublease availability slightly increased to 4.9%.
- Absorption levels turned negative for the first time this year, but the West Loop is still able to command the highest rental rate on average in Chicago's CBD.
- Even though absorption was negative, leasing activity remained strong—most notably with Headlands Technologies' decision to triple their original footprint by signing a new lease at 110 N. Wacker for a net rental rate of more than $50 p.s.f.
- Tri Star Equities purchased a 58,800-s.f. office building at 217 N. Jefferson.

MARKET MOVEMENT

BUILDING DISTRESS
4 BUILDINGS
(668,777 SF)
of available space

NEW LEASE
HEADLANDS TECHNOLOGIES
(46,981 SF)
110 N. Wacker

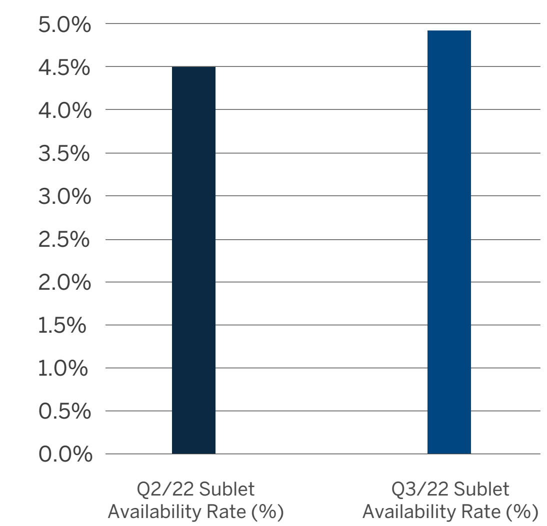
NEW LEASE
PRETZEL & STOUFFER
(32,676 SF)
1 N. Wacker

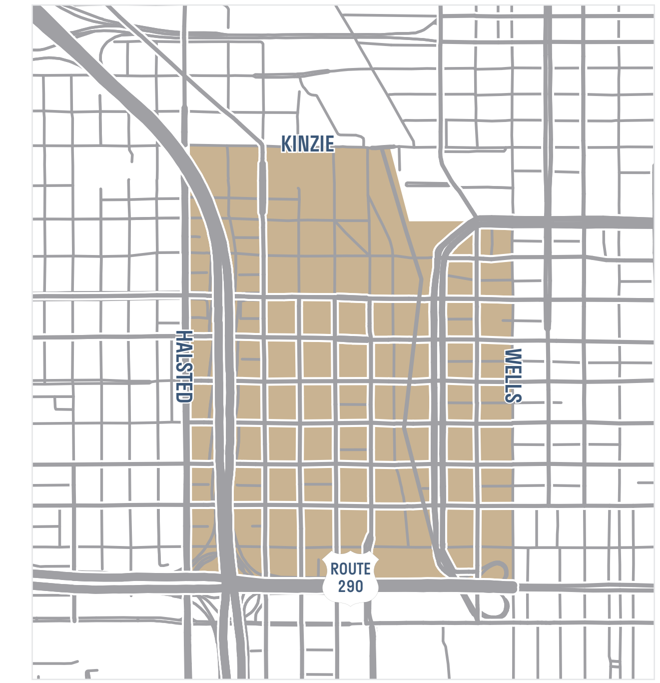
NEW LEASE
NATIONAL FUTURES ASSOCIATION
(55,364 SF)
320 S. Canal

NEW LEASE
SKADDEN ARPS
(89,100 SF)
320 S. Canal

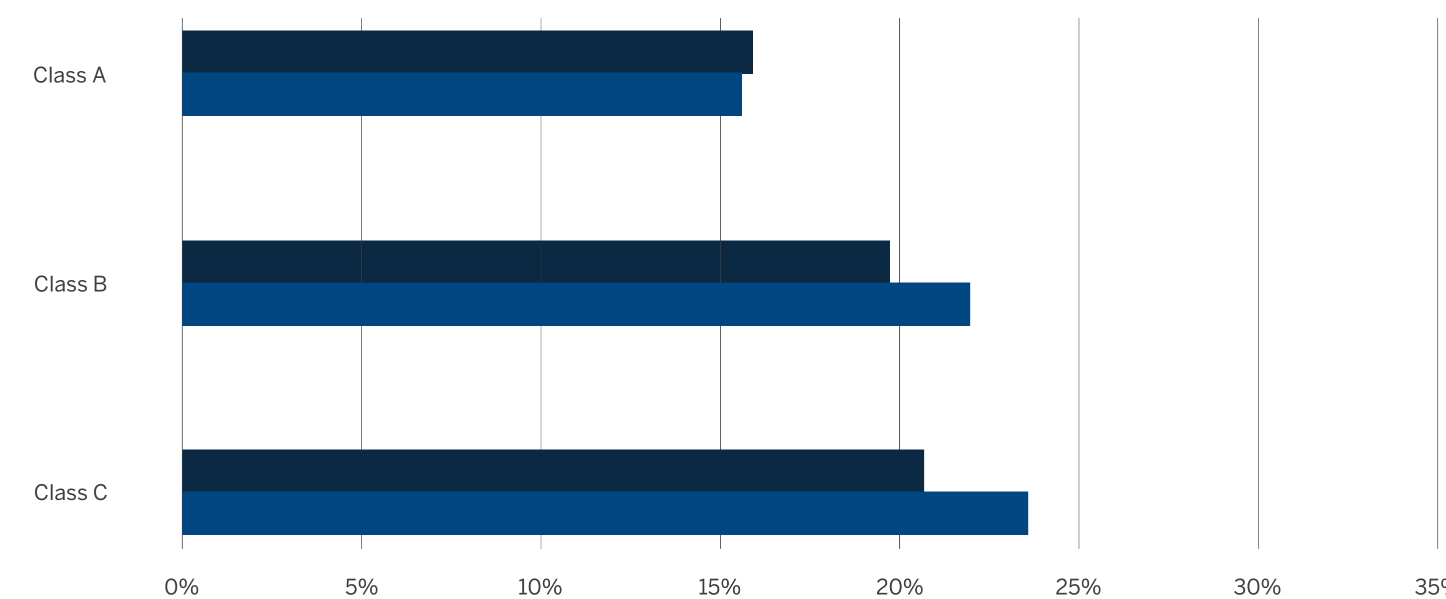
SALE
TRI STAR EQUITIES
(58,800 SF)
217 N. Jefferson

SUBLET AVAILABILITY (%)
QUARTER OVER QUARTER





DIRECT VACANCY RATE (%) QUARTER OVER QUARTER



ASSET CLASS	INVENTORY (SF)	AVERAGE BUILDING SIZE (SF)	DIRECT AVAILABILITY RATE (%)	SUBLET AVAILABILITY RATE (%)	DIRECT VACANCY RATE (%)	SUBLET VACANCY RATE (%)	GROSS ASKING RATE (DIRECT)	DIRECT NET ABSORPTION Q3 (SF)	DIRECT NET ABSORPTION Q2 (SF)
CLASS A	44,003,727	956,603	17.5%	5.1%	15.9%	2.4%	$49.61	137,590	92,397
CLASS B	9,264,982	264,714	33.9%	4.3%	22.4%	3.8%	$40.55	(226,323)	60,290
CLASS C	1,044,263	74,590	26.5%	5.0%	24.0%	1.6%	$29.97	(28,170)	2,767
TOTAL	54,312,972	571,715	20.5%	4.9%	17.2%	2.6%	$46.56	(116,903)	155,454

SUBMARKET LOCATION MAP