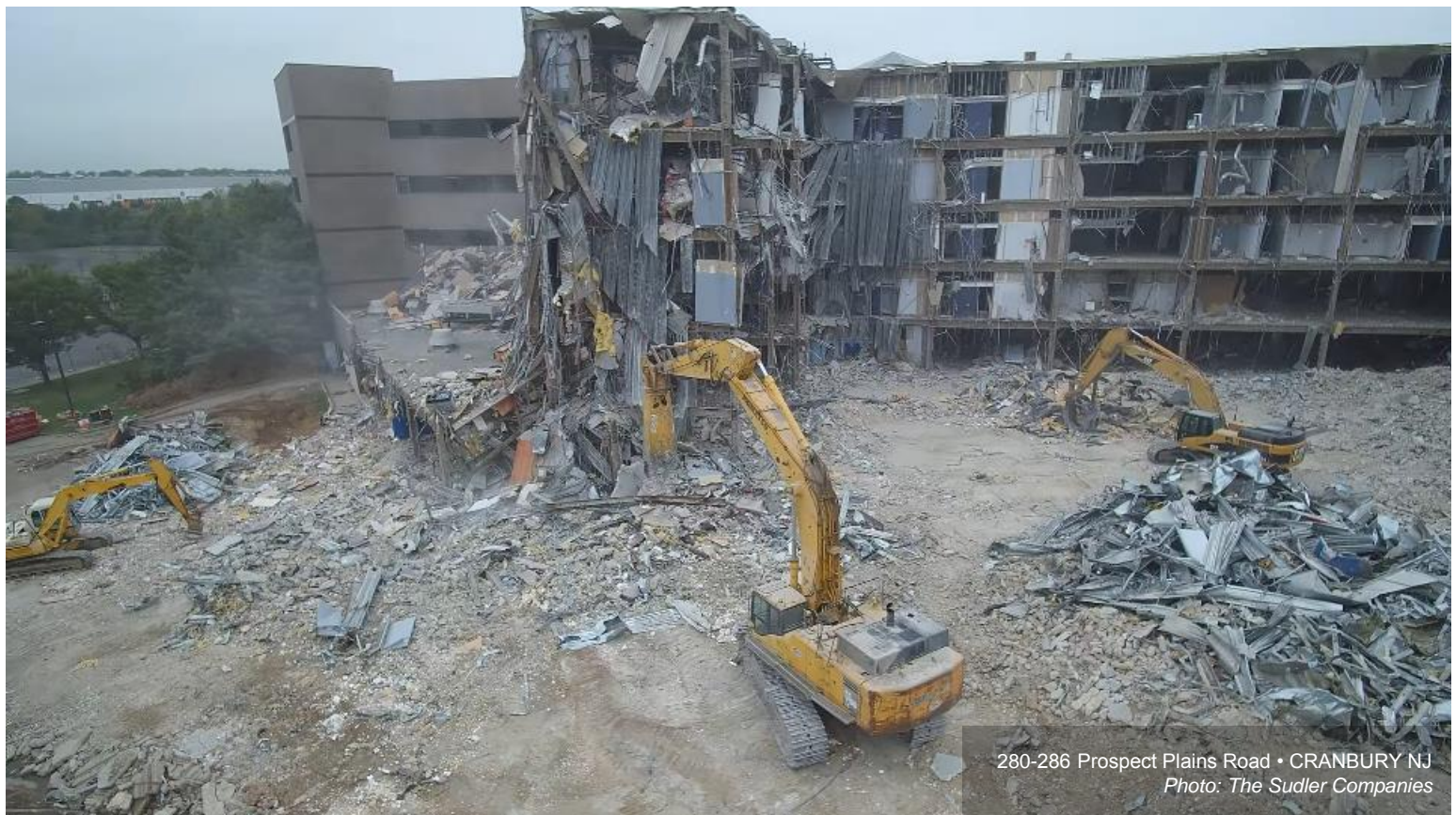


PRUNING THE OFFICE MARKET

Demolition Projects Help Lower Availability in Northern New Jersey

KEY FINDINGS

- ♦ More than half of the Northern New Jersey office market was built prior to 1990, while over 75% of the inventory is located in suburban submarkets.
- ♦ Demand trends are favoring urban and high-amenity buildings.
- ♦ The abundance of obsolete suburban buildings contributes to Northern New Jersey having one of the highest office availability rates in the US.
- ♦ There is more than 3.9 million square feet of recent and planned office building demolition and adaptive reuse projects, which is helping to lower the market's stubbornly high availability rate.



MARCH 2017 NJ OFFICE TRENDS

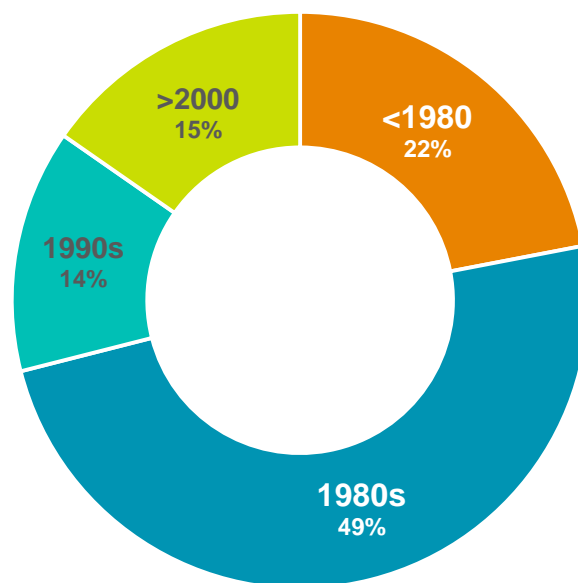
The Aging Office Market

Office buildings in New Jersey are showing their age. In fact, 71.0% of the inventory in Northern New Jersey was constructed prior to 1990. Tenants in the market are seeking upgraded amenities and working environments that are not typically provided by older facilities. Current demand drivers for office space include high ceilings, open floor plates, maximum window line exposure, ample parking and modern building amenities such as food service, fitness centers and conference areas. Availability for buildings built during the 1980s averaged 24.6% over the past five years, which is significantly higher than the trailing five-year availability rate of 20.1% for properties built since 2000.

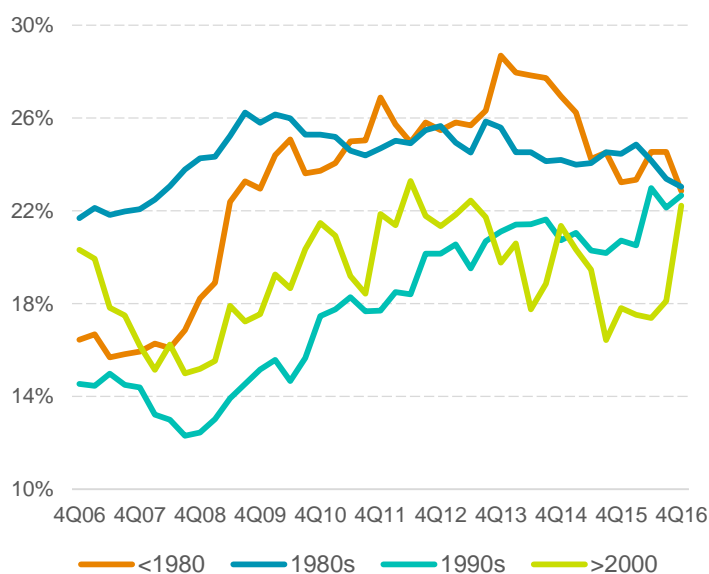
The trend of companies squeezing more employees per square foot has created parking challenges for older properties. A typical 1980s office building was built with three to four parking spaces per 1,000 square feet. Modern efficient floorplates require upwards of five spots per 1,000 square feet. Landlords are responding by adding parking decks, but this can cost \$20,000 to \$35,000 per space. Marcus Partners built a new 222-car parking deck at 500 Plaza Drive in Secaucus—a 466,718-square-foot building originally completed in 1985. This helped attract Quest Diagnostics, which leased 130,200 square feet in June 2016. The building is now 98% occupied. A new parking deck is also being added at 5 Giralda Farms to accommodate Allergan, which leased the 431,495-square-foot property in August 2016.

Tenants with strict requirements are leaving obsolete buildings behind for build-to-suit opportunities. Bristol-Myers Squibb's 555,000-square-foot build-to-suit facility in Lawrenceville is slated to deliver in early 2017. The company currently occupies over 2.0 million square feet in the Princeton area, a portion of which it will be vacating once the new building is complete.

Inventory By Year Built: Northern NJ



Availability By Year Built: Northern NJ



Inventory Deletions & Availability Impact

For every two million square feet of office space that is torn down, availability declines by approximately one percent.

-30 bps

636,000 SF
170-182 Tabor Road
Morris Plains
Office → Retail/Residential
2013

-23 bps

500,000 SF
280 Prospect Plains Road
Cranbury
Office → Industrial
2016

-22 bps

474,801 SF
1 Lake Street
Upper Saddle River
Office → Residential
2016

MARCH 2017 NJ OFFICE TRENDS

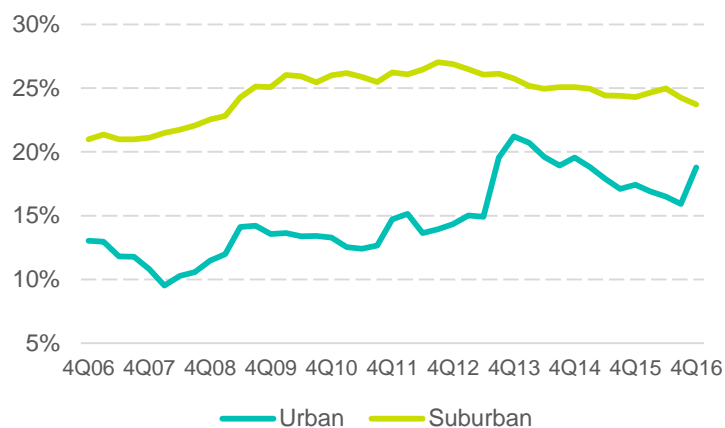
Lost in Suburbia

The Northern New Jersey office market is primarily suburban, which is another factor contributing to its relatively high availability rate. National trends have favored CBD office markets in recent years, as a growing number of companies want to be in live/play/work environments with transit access. The national CBD vacancy rate is 11.9% compared with the national suburban vacancy rate of 14.1%. Northern New Jersey's two major urban submarkets (Newark and the Hudson Waterfront) represent less than one-quarter of the market. Availability in New Jersey's urban submarkets has averaged 9.7% lower than the suburban submarkets over the past 10 years, while the average asking rent is nearly \$10.00/SF higher. Over the past few years, companies such as Pearson Education, Nice Systems and New York Life have relocated/consolidated into offices along the Hudson Waterfront, leaving behind suburban facilities. Newark has also attracted new corporate tenants from the suburbs, including Panasonic and Genova Burns.

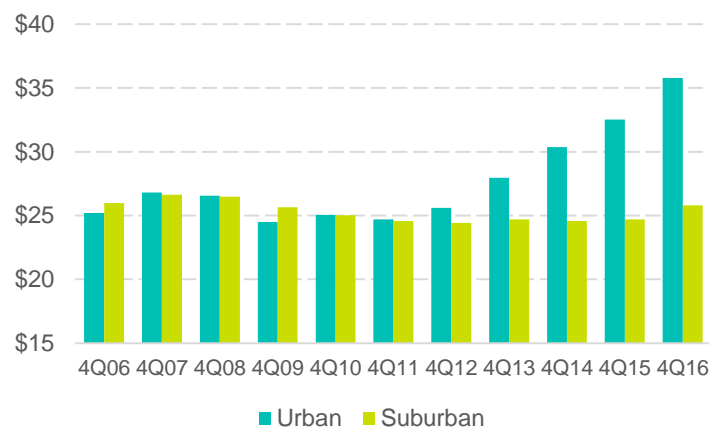
Some suburban properties have stayed competitive with extensive renovation programs and the addition of modern amenities. Mountain Development's 56 Livingston Avenue in Roseland was a vacant, isolated suburban asset when it was acquired in 2011. Following a \$50.0 million upgrade that included the addition of a full-service cafeteria, fitness center and conference area, the property is 82.3% leased by tenants such as Connell Foley, Lowenstein Sandler and Brown & Brown.

"Bell Works" is the rebranded and redeveloped 2.0 million-square-foot former Bell Labs building in Holmdel. The property has seen 514,445 square feet of leasing activity since its renovation, including major leases with iCIMS, WorkWave and Jersey Central Power & Light. In addition to gutting the building, Somerset

Availability: Urban vs. Suburban (Northern NJ)



Asking Rents: Urban vs. Suburban (Northern NJ)



Development is adding 75,000 square feet of retail space and a 250-key hotel to help create a mixed-use urban environment in the suburbs.

Other landlords, especially those with buildings in secondary locations, may find that redevelopment with alternative land uses such as apartments or industrial is a more lucrative option.

Inventory Deletions & Availability Impact



352,000 SF
307 Middletown-Lincroft Road
Middletown
Office → Residential
2016



288,742 SF
1515 Route 10
Parsippany
Office → Retail/Residential
Proposed



287,806 SF
480 Red Hill Road
Middletown
Office → Medical Office
2014



261,000 SF
1 & 3 Mercedes Drive
Montvale
Office → Mixed-Use
Proposed

MARCH 2017 NJ OFFICE TRENDS

Pruning the Office Inventory

The remedy to the stubbornly high availability rate of Northern New Jersey's office market may be redevelopment and repurposing of its many obsolete suburban assets.

Adaptive reuse projects are recycling and repositioning land sites and effectively "pruning" the office inventory, as obsolete buildings are replaced by new office buildings or other land uses such as apartments. This pruning is making the market on average newer and less suburban, which in turn is helping to lower availability and lift rents. For every 2 million square feet of empty office space in the Northern New Jersey market that is torn down and/or converted to an alternative use, availability declines by approximately one percentage point. The impact is even more pronounced at the submarket level.

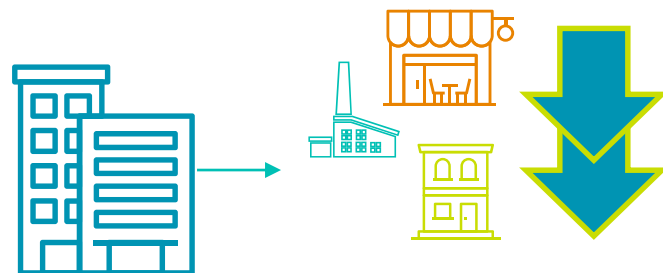
NKF has been tracking 2.7 million square feet of office space that was redeveloped or converted to non-office uses since the beginning of 2013. In addition, there are more than 1.2 million square feet of planned/proposed projects of this nature. During the fourth quarter of 2016, three vacant office buildings left the inventory because of demolitions and conversions. Pearson Education's former office at 1 Lake Street in Upper Saddle River was taken down to make way for 208 luxury townhomes. 280-286 Prospect Plains Road was an empty 500,000-square-foot office building in Cranbury, which is a secondary office location but a prime industrial market near Exit 8A of the NJ Turnpike. It is being redeveloped as 757,500 square feet of warehouse space.

The strong apartment and industrial markets are aiding this process. Availability in the industrial market is 8.7% as of the end of 2016, which is the lowest level in more than 10 years, while rents have shot up 13.8% year-over-year. This has prompted developers to start building; 11.3 million square feet of industrial space is under construction. The apartment market is also very strong nationally and in New Jersey. According to REIS, the

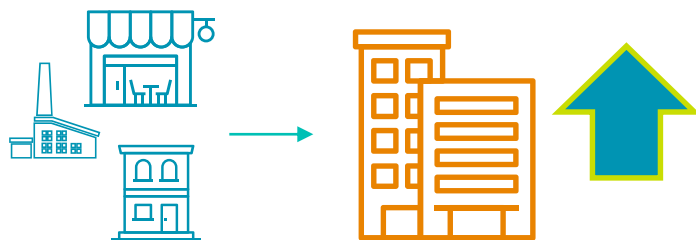
Evolving Inventory



Office to Office Vacant obsolete office property is redeveloped or extensively renovated into competitive product.



Office to Alternative Use Vacant obsolete office property is demolished and redeveloped with alternative use such as residential, retail, industrial, hotel, etc.



Other Use to Office Non-office uses such as old warehouses are converted into office, adding supply to inventory and putting upward pressure on availability.

Inventory Deletions & Availability Impact

-11 bps
240,000 SF
1 Executive Drive
Fort Lee
Office → Residential
2013

-10 bps
220,877 SF
1 Sony Drive
Park Ridge
Office → Residential
Proposed

-9 bps
202,019 SF
50 Meadowlands Parkway
Secaucus
Office → Industrial
2014

-7 bps
156,686 SF
2 Campus Drive
Parsippany
Office → Mixed-Use
Proposed

MARCH 2017 NJ OFFICE TRENDS

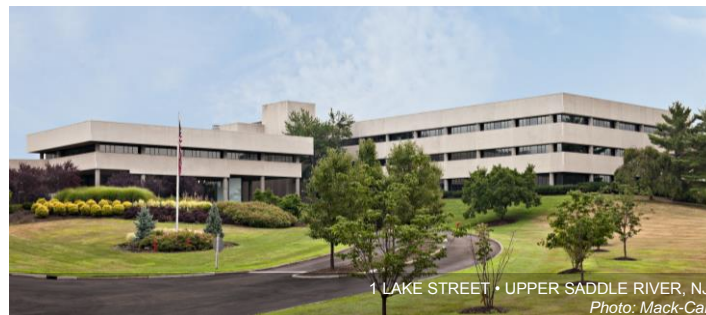
Northern New Jersey apartment market has a vacancy rate of 3.8% as of fourth-quarter 2016. Moreover, CoStar reports there are 23,571 units currently under construction in the Northern New Jersey market, more than at any time since 2000.

Recent affordable housing rulings by the New Jersey Supreme Court may also encourage apartment development. In January, the court reaffirmed its commitment to the series of Mount Laurel cases dating back to 1975. The high court ruled that towns must factor in “gap years” from 1999 through 2015 when calculating their affordable housing obligations. This is expected to lead to rezoning to allow for more residential development in undersupplied suburban towns. For example, Paramus revised its zoning and land use laws in December 2015 to help improve its tax base. It now allows apartment buildings of up to five stories across large swaths of the town, including a number of sites with high-vacancy office properties.

Outlook:

Redevelopment Activity Subject to Economic Conditions

The Northern New Jersey office market is beginning to clean house, as obsolete buildings in secondary suburban locations are taken out of the inventory due to redevelopment. Strong demand for apartments and industrial space is aiding this process, which is helping to lower availability in the office market. This office market pruning is expected to continue as long as the current economic expansion cycle continues. It will be counterbalanced by greenfield development and conversions from industrial to office in urban settings, such as 110 Edison Place in Newark. Over the long term, this trend should improve the overall quality of the inventory in New Jersey and result in lower availability and greater potential for rent growth.



Inventory Deletions & Availability Impact



145,874 SF
535 Mountain Avenue
New Providence
Office → Healthcare
2015



120,000 SF
377 Route 17 North
Hasbrouck Heights
Office → Hotel
2016



75,000 SF
250 Johnson Road
Morris Plains
Office → Residential
2015

For every two million
square feet of office space
that is torn down,
availability declines by
approximately one percent.





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Recent and Proposed Inventory Deletions



Newmark Knight Frank has implemented a proprietary database and our tracking methodology has been revised. With this expansion and refinement in our data, there may be adjustments in historical statistics including availability, asking rents, absorption and effective rents.

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