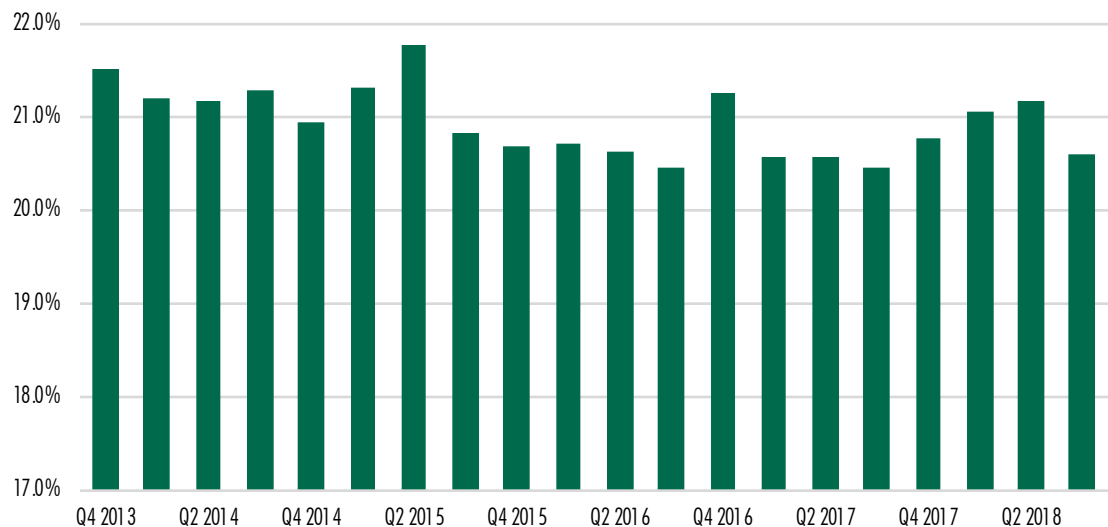


The Incredible Shrinking Deal

New Jersey transforms into a “small deal” market

New Jersey office fundamentals have remained largely stable over the past five years. Most notably, the availability rate has ranged in a narrow band between 20.5% and 21.8%. Rent growth, at 9.7%, has been less than half the 20.7% growth rate for the U.S. overall and well below the 14.6% rate exhibited by the Manhattan office market. These trends have persisted, despite statewide job growth, a declining unemployment rate and strengthened local and national economies.

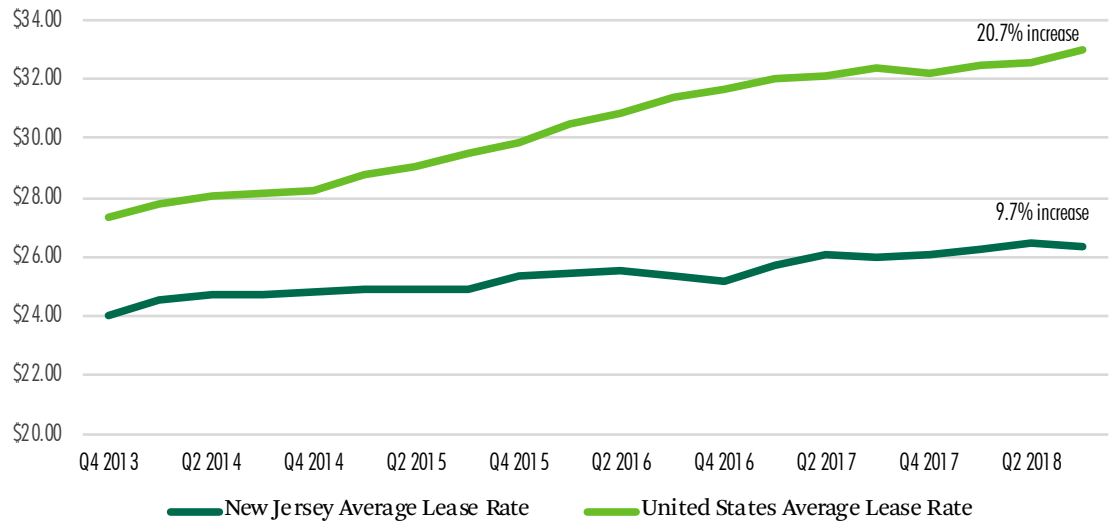
Figure 1: New Jersey Office Historical Availability Rate



Source: CBRE Research, Q3 2018.

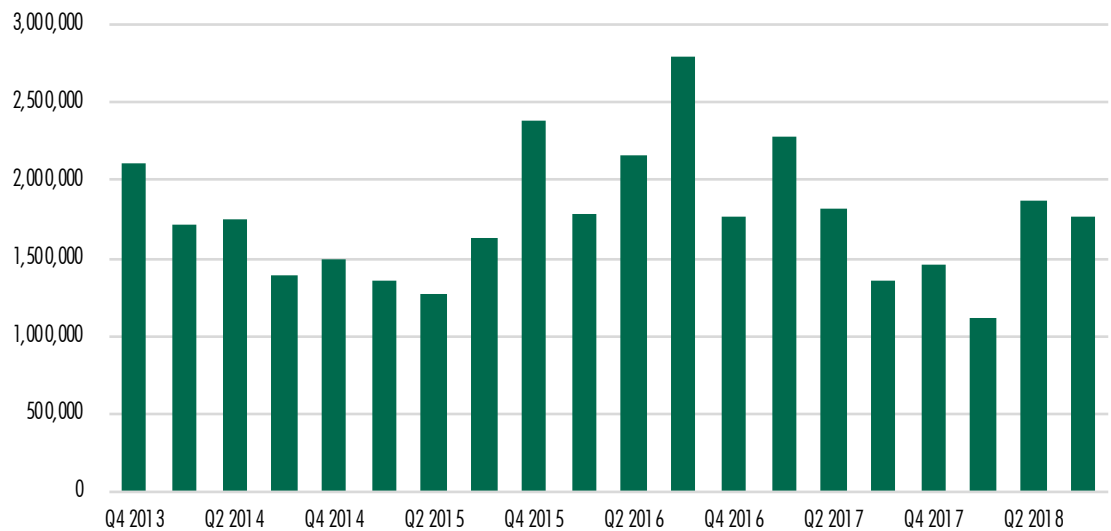
Has the NJ office market hit a wall? Certainly, there is a lot of activity among smaller tenants, resulting in a large and growing volume of transactions below 10,000 sq. ft. However, the persistent softness of the overall market is the result of a decline in large transactions, those of 50,000 sq. ft. and greater, which in turn has led to an overall decrease in total leasing activity¹ in recent years. Furthermore, there is an abundance of large blocks of available space, much of which is outdated and misaligned with the occupiers' current or future needs.

Figure 2: New Jersey vs. United States: Average Asking Lease Rate



Source: CBRE Research, Q3 2018.

Figure 3: New Jersey Office Historical Leasing Activity



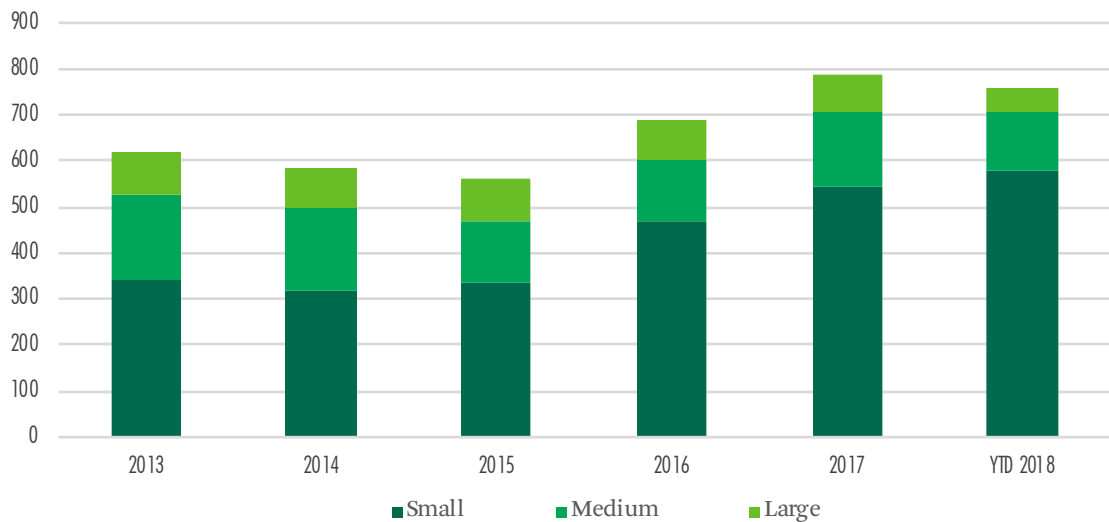
Source: CBRE Research, Q3 2018.

The combined impact of too many large blocks and not enough large block demand suggests that the market is likely to see the current availability and rent levels persist. Changing the trajectory of the market will require reducing the oversupply of space and realigning available inventory to better meet the demands of current and future tenants in the market.

A SHIFT FROM LARGE TO SMALL LEASED

Breaking down the annual number of office transactions, it is clear that the New Jersey market has changed in recent years. As Figure 4 indicates, the total number of leases increased year over year in both 2016 and 2017 and is on pace to do so again; however, 2017 marked a five-year low in the number of large-size transactions. Given leasing activity through the third quarter, it looks as though 2018 will see the total number of big leases decline even further.

Figure 4: Annual Lease Transactions by Size



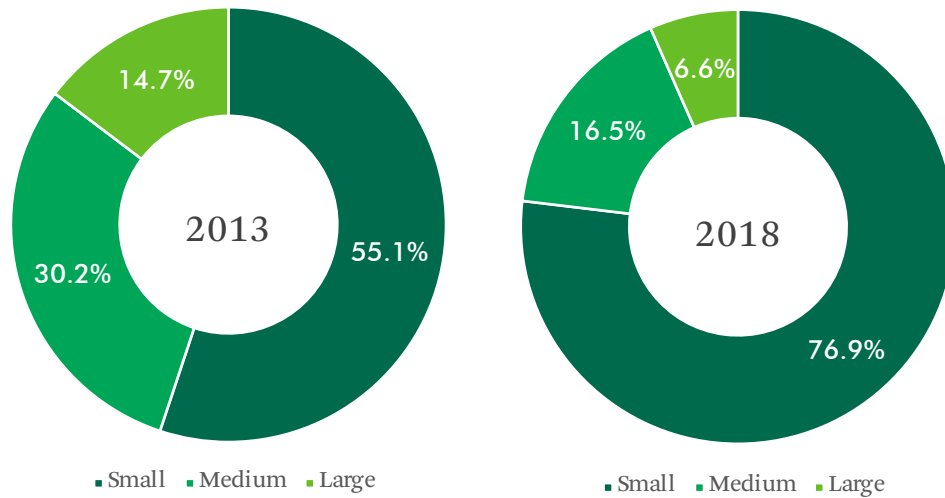
Source: CBRE Research, Q3 2018.

Meanwhile, the number of small transactions, defined as those less than 10,000 sq. ft., has been on a strong upswing since 2013 and shows no sign of abating. At the end of the third quarter, the total number of small leases in 2018 had already reached 581, surpassing the previous year-end total and setting a new high water mark.

As shown in Figure 5, market share by size group in 2013 versus today leads to the same conclusion: New Jersey has become a small deal market. Transactions below 10,000 sq. ft. are now responsible for more than three-quarters of all leases signed and the market share has been growing each year since 2015. At the same time, the number of leases signed in the large transaction category has declined from a 14.7 percent share in 2013 to 6.6 percent through the first three quarters of 2018.

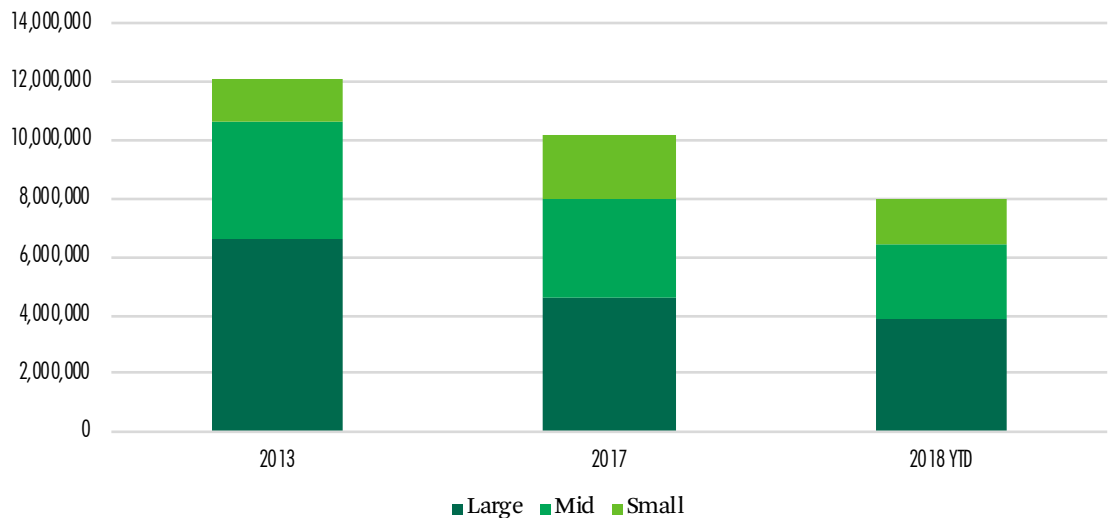
The decline in the number of large leases has led to an overall decrease in square feet leased between 2013 and 2018—a deficit that has not been overcome by the increasing number of small leases signed over the same period, as seen in Figure 6.

Figure 5: Market Share by Lease Size



Source: CBRE Research, Q3 2018.

Figure 6: Market Share by Lease Size

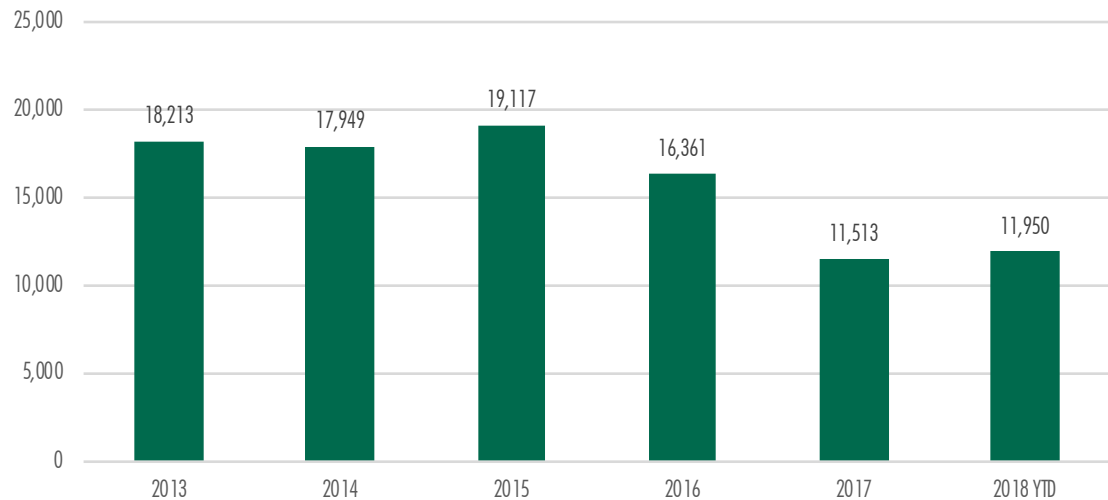


Source: CBRE Research, Q3 2018.

AVERAGE DEAL SIZE DECLINES

The growing prominence of small deals can also be seen in the declining average transaction size in the market. The average deal size in the first three-quarters of 2018 was 11,950 sq. ft., a 37.5% drop from the high-point mark set in 2015. While the 2018 year-to-date figure is a slight uptick over 2017, the growing volume of transactions below 10,000 sq. ft. suggests that the average transaction size will remain far below the peak level for the near term.

Figure 7: Average Transaction Size



Source: CBRE Research, Q3 2018.

SUPPLY VS DEMAND: A SHORTAGE OF SMALL SPACES?

There appears to be a mismatch between supply and demand when it comes to the size of spaces available in the market. On the one hand, there is an ample supply of spaces available in the larger size categories. Looking at the availability of blocks sized 50,000 sq.ft. and greater – at the current rate of leasing – it would take nearly 2.75 years to absorb the large block inventory currently on the market. Similarly, in the group from 10,000 sq. ft. to 49,999 sq. ft., based on our projected transactions for the fourth quarter, it would take just over two years for the available blocks to be absorbed.

On the other hand, looking at the smaller space availabilities, there is a potential shortage. Our forecast indicates 194 potential new transactions to take place in the fourth quarter of the year, but only 277 currently available blocks of 10,000 sq. ft. or below to accommodate that demand. Landlords are frequently reluctant to break up larger blocks of space for a variety of reasons and despite an obvious potential solution, small tenants may find themselves facing a dearth of desirable suites in the sizes that they need.

Figure 8: Available Blocks vs. Projected New Transactions

	Available Blocks (SF)	Direct	Sublet	Total Spaces	Projected Q4 2018 New Deals	Available Spaces: Projected Transactions
Small	0 - 9,999	202	75	277	194	1.4:1
Mid	10,000 - 49,999	288	62	350	42	8.4:1
Large	50,000+	169	17	186	17	11.2:1
Total		659	154	813	252	

Source: CBRE Research, Q3 2018.

WHAT DOES THIS MEAN FOR LANDLORDS?

- Pre-built spaces, flexible lease terms and other strategies should be considered, particularly as shared space alternatives (i.e., coworking), are poised to grow in the New Jersey market.
- At the same time, landlords with large blocks of space to fill must invest in adding highly desirable amenities, upgrading common areas both inside and outside and providing a broader array of traditional and non-traditional space options, as well as deploying other strategies that would allow them to compete successfully for the comparatively small pool of large users.
- Corporations are waging a war for talent, particularly millennial and Generation Z workers, and amenities and a sense of community are among the most critical elements in attracting and retaining employees. For landlords to successfully draw large users, they must adapt their properties to meet and exceed corporate expectations.
- The market would also benefit from conversion of outdated office space to other uses, such as residential or mixed-use projects with a strong residential component. Buildings with large blocks of space and long tenures on the market might be especially ripe for redevelopment.

DEFINITIONS

Availability — Space that is being actively marketed and is available for tenant build-out within 12 months. Includes space available for sublease as well as space in buildings under construction.

Asking Rent — Weighted average asking rent.

Leasing Activity — Total amount of sq. ft. leased within a specified period of time, including pre-leasing and purchases of space for occupancy, excluding renewals.

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