

VIEWPOINT CINCINNATI

# GREATER CINCINNATI OFFICE INVESTMENT LANDSCAPE

CBRE



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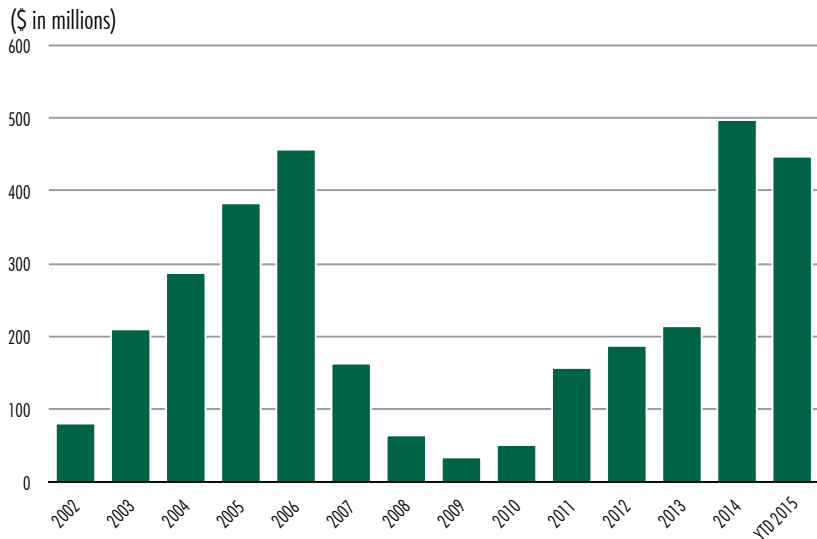
**CHANGING PERCEPTIONS**

Cincinnati has changed dramatically over the past 10 years. Office investment is increasingly happening in secondary markets including Cincinnati; investors are searching for attractive yield after being priced out of Gateway markets. That storyline is happening all over the U.S., but Cincinnati is experiencing investment in unique fashion as investors’ perceptions of Cincinnati have changed over the past 10 years. Downtown Cincinnati of a decade earlier is a far cry from its current environment. In 2005, the Banks project was a dustbowl between Great American Ballpark and Paul Brown Stadium. Over-the-Rhine (OTR) is unrecognizable, no longer treated as an undesirable neighborhood. Downtown is no longer an office park that is only inhabited from nine-to-five. It resembles the live, work, play mantra with 15,000 residents and growing compared to 7,500 residents in 2005.

The Banks is a reality with 300 existing apartment units, nearly 100,000 sq. ft. of retail and 291 additional apartment units under construction. A 340,000 sq. ft. office building is being constructed for General Electric’s Global Operations Center which will create approximately 2,000 new jobs. OTR has risen and continues to be a hotbed for investment. OTR is home to start-ups, restaurants, bars and the leading industry of its past; breweries.

Greater Cincinnati is a diversified market home to nine Fortune 500 companies and many regional headquarters. Drivers of the economy include finance, marketing, branding, healthcare, manufacturing and logistics.

**Figure 1: Cincinnati Investment Sales Volume**



Source: Real Capital Analytics, Q3 2015.

**WHY CINCINNATI?**

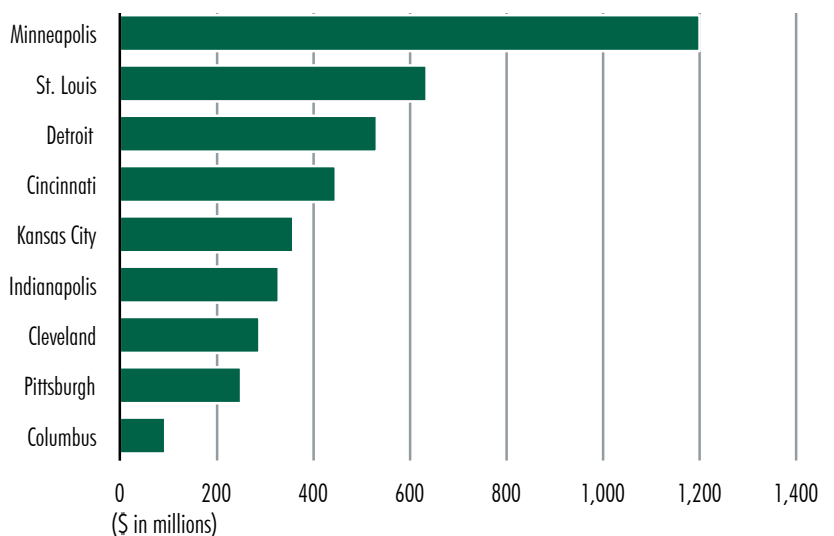
Traditionally, the majority of buyers in the market have been private equity groups including local companies and individual investors. They are willing to accept more risk but demand a higher return. Consequently, they gravitate toward value-add properties in hopes of maximizing their return. As market fundamentals strengthen, the value-add options in desirable submarkets are running dry. As a result, stabilized product has been trading and the capital is coming from outside of Cincinnati. Local private equity capital is not happy with stabilized product as the yields are lower and lacking upside. As seen in figure 2, Cincinnati is competing very well with its peer cities in the Midwest (excluding Chicago whose sales volume totaled \$6.1 billion). Cincinnati ranks fourth behind Minneapolis, St. Louis and Detroit in terms of sales volume.

*Cincinnati is no longer viewed as just a place in the Midwest but rather as a place where investors want to be.*

On the national level, investors are buying for cash flow which is highly competed for in Gateway markets and yields are being squeezed. National investors including REITs, life insurance companies, pension funds and high net worth family offices are buying in Cincinnati for a variety of reasons. First, there is activity in Cincinnati. Second, we have large stable companies headquartered in the region including P&G, Kroger and Macy’s. Third, those Fortune 500 companies bring associated companies to Cincinnati. This creates a stable job market and a need for office space. According to CBRE Econometric Advisors, the Cincinnati market has added over 10,000 office-using jobs since Q3 2014.

According to Real Capital Analytics, out of town investors have purchased 39 office properties totaling over \$1.1 billion in sales volume over the past 24 months. Cincinnati provides a safe haven for investors with stable cash flow and room for unexpected volatility such as interest rate risk.

**Figure 2: Midwestern Peer City’s Sales Volume 2015 YTD**



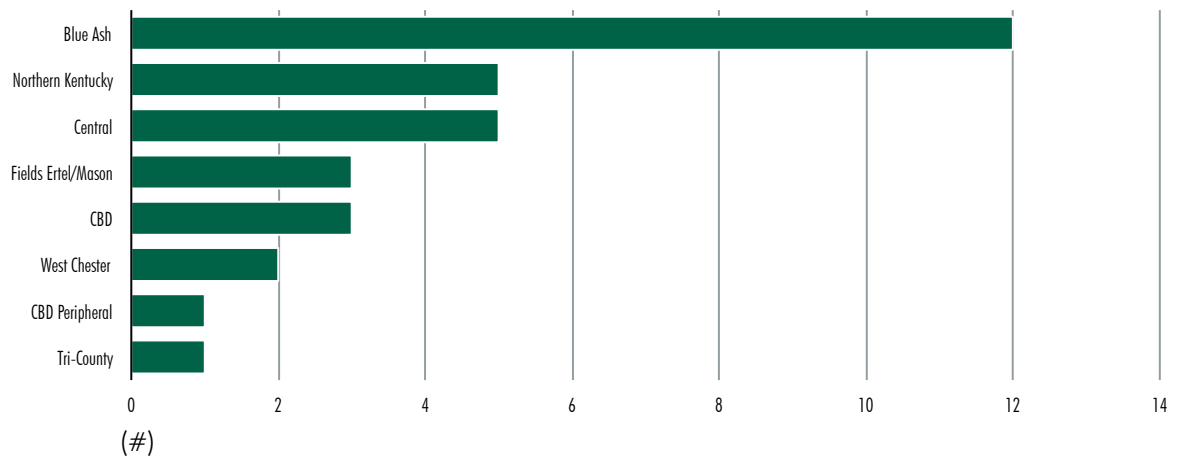
Source: Real Capital Analytics, Q3 2015.

**WHERE IS THE INVESTMENT OCCURRING?**

Office investment is occurring in the Central Business District (CBD), Blue Ash, Fields Ertel/Mason and West Chester submarkets. In the CBD, overall investment in infrastructure and real estate construction projects total approximately \$1.0 billion including the streetcar project and the I-71 Martin Luther King Interchange project. The lure of downtown includes a strong employment base, strengthening fundamentals and increasing residential population comprised of young professionals and empty nesters. Furthermore, Class A office has limited large-block space and decreasing vacancy in those buildings which are driving rents upward.

The desirable suburban submarkets are experiencing similar prosperity and surrounding submarkets are enjoying the spillover. Blue Ash, Kenwood and West Chester all have limited availability as many Class A buildings are stabilized. With the limited availability in the aforementioned submarkets, Fields Ertel/Mason, Tri-County and the Central submarkets are experiencing positive spillover in the form of increased leasing activity and reduction in struggling ownership. For example, in mid 2015, Macy's leased 110,000 sq. ft. of office space in an industrial building in the Tri-County submarket. With limited land sites in the more desirable submarkets, tenants are forced to look elsewhere for space and capital will follow. Less risk-adverse investors could find an opportunity in secondary submarkets such as Tri-County and/or Fields Ertel/Mason.

**Figure 3: 2015 YTD Transaction Totals By Submarket**



Source: Real Capital Analytics, Q3 2015.

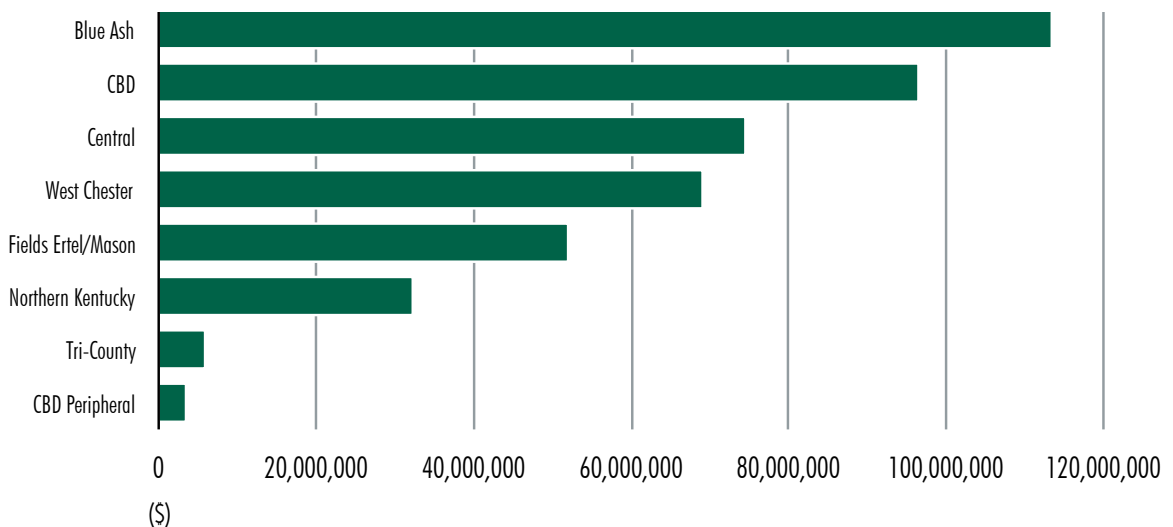
**DEBT MARKETS**

The debt markets are active but there are differences between 2007 and today. Capital is available but not irrational capital. That being said, attractive debt is available at historically low interest rates in the Midwest from CMBS, life insurance companies and commercial banks. Additionally, debt is available for Class B properties in Class B locations if equity is willing to follow. And equity is following the debt as it moves from primary to secondary to tertiary locations.

**OUTLOOK / SUSTAINABILITY**

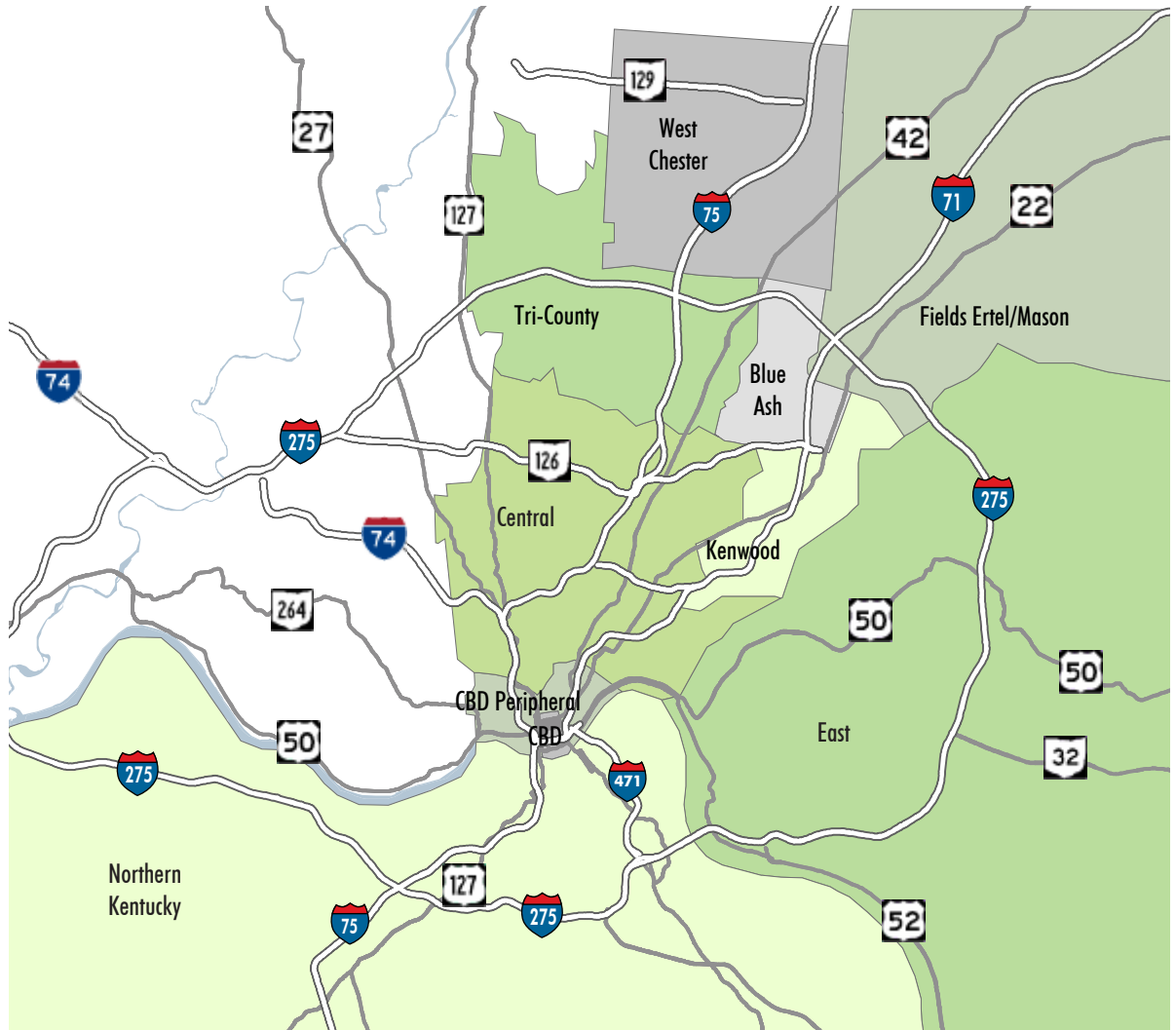
Office is at the tail end of recovery and still has room for compression as local fundamentals continue to strengthen. In the previous cycle, underwriting was so lax that risk was priced out of deals. We are not there yet as investors are exercising more discipline in their underwriting and pricing risk into the deal. Investors are anticipating interest rate risk. Consequently, it is more sustainable and we see a positive market in 2016 and possibly into 2017. One reason we have a positive outlook into 2017 is we are starting to witness cross-border investment in Cincinnati. Cross-border capital has the ability to increase due to geopolitical risk aboard as they mitigate risk. We view this cycle as sustainable into the immediate future especially since investors/lenders are underwriting risk and using caution unlike the previous cycle.

**Figure 4: 2015 YTD Transaction Sales Volume By Submarket**



Source: Real Capital Analytics, Q3 2015.

**Figure 5: YTD 2015 Transactions by Submarket**



<b>WEST CHESTER</b> 2 Total Transactions \$69,075,000 Sales Volume	<b>FIELDS ERTEL/MASON</b> 3 Total Transactions \$352,000,000 Sales Volume	<b>TRI-COUNTY</b> 1 Total Transaction \$5,889,532 Sales Volume	<b>BLUE ASH</b> 12 Total Transactions \$113,434,701 Sales Volume
<b>CENTRAL</b> 5 Total Transaction \$74,518,692 Sales Volume	<b>CBD PERIPHERAL</b> 1 Total Transaction 3,465,000 Sales Volume	<b>CBD</b> 3 Total Transactions \$96,500,000 Sales Volume	<b>NORTHERN KENTUCKY</b> 5 Total Transactions \$32,267,436 Sales Volume

Source: CBRE Research & Real Capital Analytics, Q3 2015.

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