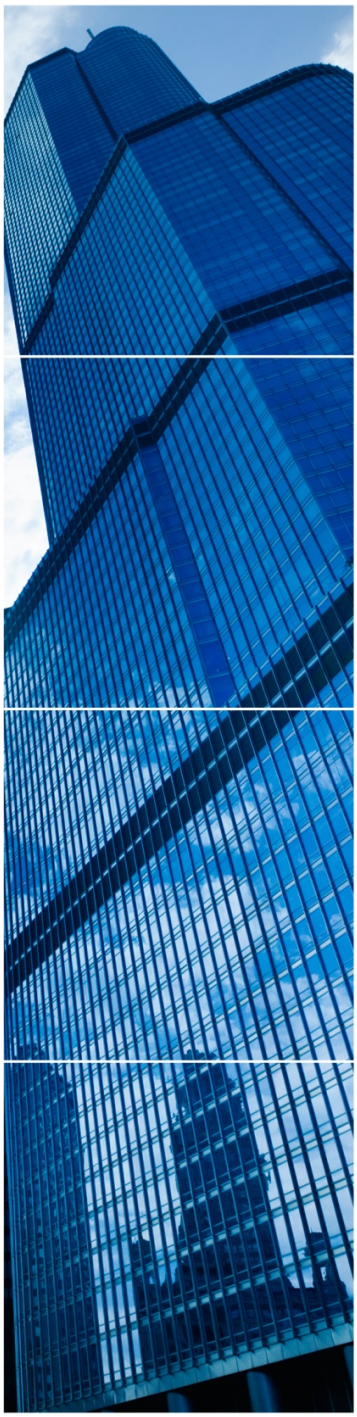
Law Firm Perspective

Phoenix | 2015



2015 Outlook for Law Firms in a growth economy and market

A snapshot of national trends

2015 revenues are up. So are CBD Class A rental rates.

With record AmLaw 100 revenue of $81.0 billion and growth rates at or above 4.5 percent in 2015, law firms still face a considerable challenge in finding attractive pricing for CBD Class A space. Fee compression and a weaker post-recession demand for legal services continue to force law firms to seek efficiencies on their second biggest expense—real estate.

Why CBD Trophy space is shrinking

Improving economic conditions have caused vacancy rates to fall to single-digits in many markets. At the same time, Trophy rents are rising 2.5 faster than the overall market average. New development is coming on line in response to demand, though new space commands a 20 to 25 percent premium.

Maintaining high profitability in the face of this landlord-favorable environment demands a sharp focus on effective strategies to counter the commercial real estate trends outlined below.

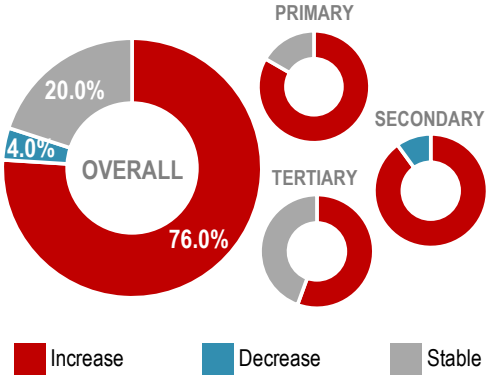
Just how tight is tight? Way tight.

1 TREND

Law firms occupy about 17.0 percent of Trophy and Class A urban office space nationwide. As of September 2015, direct vacancy in this segment averaged 11.1 percent, considerably less than the 14.2 percent overall office rate. Across the Trophy swath of the market, it's even tighter, with vacancy levels dipping below 10.0 percent. This dearth of space has led to higher rental rates.

The bottom line? Since 2010, rents have increased 22.7 percent to $47.19 per square foot. During that same period, Tropy rents have spiked by 28.3 percent to $57.97 per square foot, and we expect the full year 2015 annualized increase to top out at 18.1 percent at the end of the year.

Will rents rise, fall or remain stable over the next 12 months?



Greater efficiency through leasing strategies that allow for expansion and contraction

2 TREND

Law firms are one of the largest and most high-profile user groups within the national tenant base, yet they have played a smaller role during the current cycle than in past years. Example: With transactions larger than 20,000 square feet, law firms represented just 7.2 percent of all activity by volume in 2014. This is the fourth-largest contribution of any sector after finance, technology and government—but small compared to the 17.0 percent occupancy share nationwide that these other industries command.

This trend is attributable to the fact that space is at a premium and clients want more for less. Just as corporate America struggles to improve its bottom line, law firms are grappling with how to adapt their business and real estate strategies to new and ever-changing client demands. So they're focusing on more efficient use of space, rather than seeking bigger spaces.

Specifically, 38.7 percent of law firm activity was geared to rightsizing while only 22.4 percent was expansionary. That expansion occurred almost exclusively in industry-specific markets such as Silicon Valley, with its heavy payload of intellectual property firms. In comparison, the great preponderance of advertising/marketing and technology leasing, has been expansionary in recent quarters.

Development is up—and so are prices.

4 TREND

Looming supply shortages and improving macroeconomic conditions have spurred developers to ratchet up the pace of groundbreakings—offering law firms greater opportunity over the next 36 months. Currently, CBD Class A development activity totals 38.3 million square feet, the highest figure in seven years, and a whopping one-third higher than halfway through 2014. This total will increase even more in coming quarters, as groundbreaking rates rise. Rents for this space currently command far above-average premiums.

Example: in Q2 2015, CDB Class A space under construction had asking rents averaging $54.68 per square foot—15.9 percent above existing space rates.

Despite the rent hikes, demand for new space has been widespread nationwide. The result:

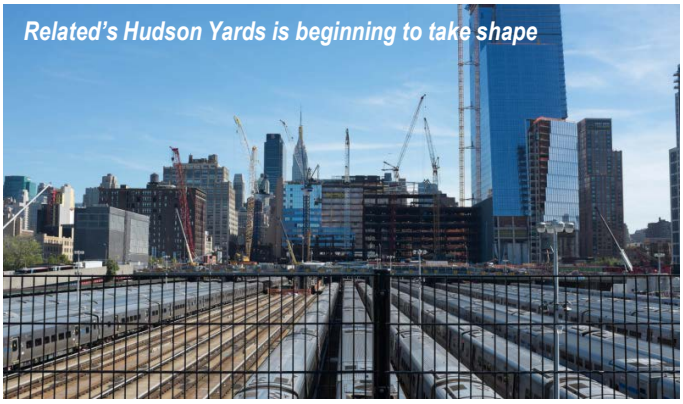
- a preleasing rate of 38.1 percent for CBD Class A space;
- drops in preleasing space due to speculative development have resulted in 15.0 million square feet of available space under construction.

Since space under construction is growing faster than preleasing, this bodes well both for law firms and other occupiers. As supply increases, we expect downward pressure on rates.

Core-fringe locations may be a viable alternative.

3 TREND

With leasing costs rising across core urban areas, some law firms are considering relocating to core-fringe CBD micromarkets, especially firms considering new construction. Core-fringe locations such as the Hudson Yards in New York, the Seaport District in Boston, and Mount Vernon Triangle in Washington, DC, are magnets for more mixed-use space and often are attractive to the younger talent needed to staff law firms in a strengthening economy. These less-office-focused parts of the urban core offer some of the most efficient workspace designs available.



Related's Hudson Yards is beginning to take shape

Focus on options within your control until conditions shift

?

Over the shorter-term, law firms in most markets face a very landlord favorable environment that will not abate until late 2016 at the earliest. Overall, the tenant environment is competitive across the board. However, firms in this unfriendly market can level the playing field somewhat by considering core-fringe locations, and designing and implementing modern work place strategies. Plus, more accelerated output across diversified industries will present opportunities for firms with strong practice groups in markets where those industries are located. As additional inventory comes on line via new development, law firms will see space opportunities increase and pricing will moderate.

Take a peak at your local city Law Firm Perspective

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Outlook

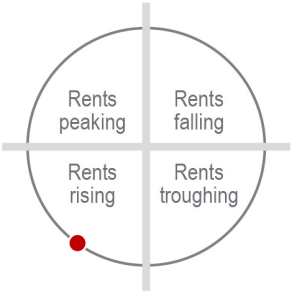
Real estate **challenges** *for law firms*

- Availability of Class A space in law firm-concentrated markets, which include the Camelback Corridor submarket and the Central Business District, is shrinking
- Rental rates in these law firm-concentrated markets are escalating, with several submarkets approaching pre-recessionary levels
- Limited availability of high-quality space with preferred premium views of Downtown Phoenix and Camelback Mountain

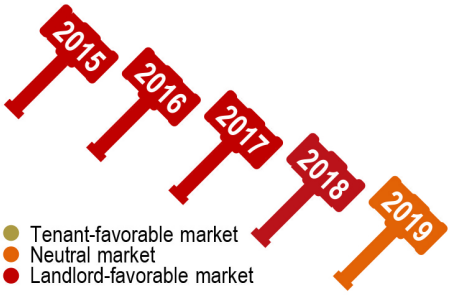
Real estate **opportunities** *for law firms*

- Active development pipelines in the Southeast and Northeast market areas will provide over 1.2 million square feet of new speculative Class A office space over the next 18 months
- Availabilities for small-sized law firms (fewer than 10,000 square feet) remain abundant throughout all classes

Law firm clock



Law firm leverage



Law firm environment prospects


Market

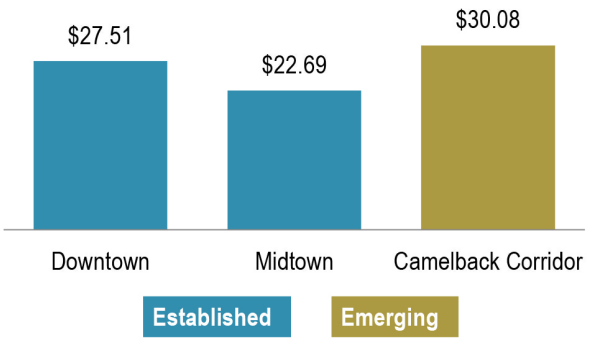

Business


Talent

Favorable
Unfavorable

Pricing

Class A Full Service rents in law firm-concentrated markets



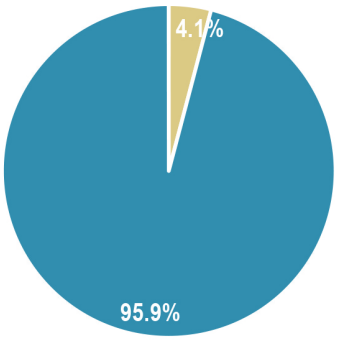
12-month rent change	*Free rent (months)	Premium for Trophy space
6%	6	9%

Forecasted 12-month rent change	*TI allowance ($ p.s.f.)	Discount for B space
5%	$20	20%

*based on a 6-year lease term in a move-in ready suite

Demand

Share of Professional and Business Services (PBS) employment



13,600
Legal services employment

+400 (+3.0%)
12-month growth

Recent law firm leases

Firm	Address	Deal type	s.f.
Jones, Skelton, & Hochuli, PLC	40 N Central Ave	New	60,000
Wilkes & McHugh	2355 E Camelback Rd	Renewal	6,557
Morrill & Aronson, PLC	1 E Camelback Rd	Renewal	6,400
Russell A. Brown	3838 N Central Ave	Renewal	5,034
Holden Willits, PLC	2 North Central Ave	New	3,680

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About JLL Law Firm Group

The JLL Law Firm Group provides strategic and innovative real estate solutions tailored to meet the unique operational and financial objectives of law firms. Our multi-disciplinary senior-level team has deep experience working both in and with law firms, and has a proven track record of consensus-building. Our global expertise coupled with local market knowledge enable us to work with firms of all sizes and ensure you are proactively dealing with the ever-changing real estate and economic markets.

About JLL Research

JLL's research team delivers intelligence, analysis and insight through market-leading reports and services that illuminate today's commercial real estate dynamics and identify tomorrow's challenges and opportunities. Our more than 400 global research professionals track and analyze economic and property trends and forecast future conditions in more than 70 countries, producing unrivalled local and global perspectives. Our research and expertise, fueled by real-time information and innovative thinking around the world, creates a competitive advantage for our clients and drives successful strategies and optimal real estate decisions.