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Q2 2023 - Office

State of the U.S. Office Market

Powered by Savills Research & Data Services

Office market recovery at mid-year 2023 remains sluggish as economic uncertainty and slow return to office persists

01

The “New Normal” has emerged in the U.S. office market

COVID-related impacts have left markets strained and availability high, though uneven across cities and regions.

02

Leasing activity has slowed this year

While 2022 leasing levels outpaced those seen in 2020 and 2021, office space demand has softened in 2023 as occupiers remain wary of economic headwinds and are highly conscious of controlling costs.

03

Average asking rents have seen little change

Advertised rents are holding high but don't tell the full story. Landlord concessions are at peak levels in many markets. Mortgage distress may exacerbate owner push to keep face rents high.

04

Flight-to-quality creates bifurcation in many markets

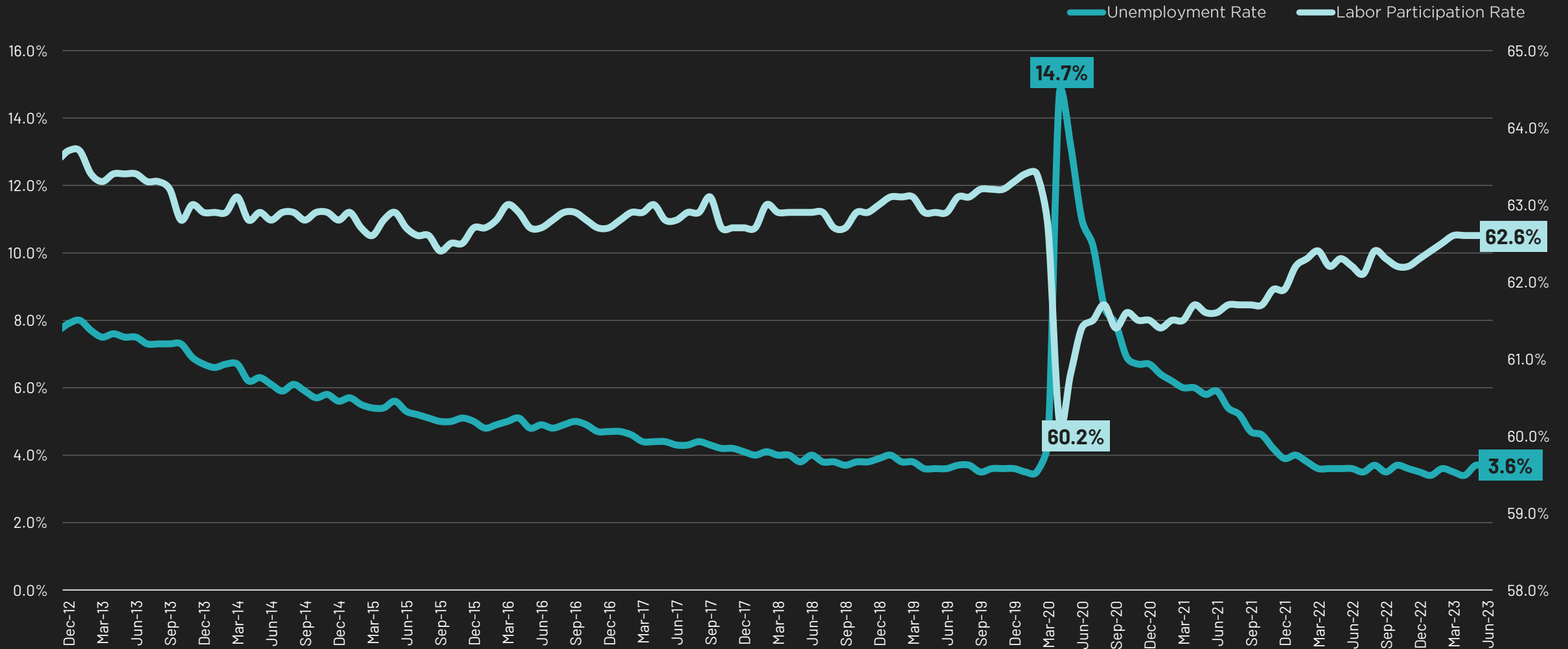
Occupiers who can, have been seeking out higher quality space and amenities to “earn back the commute” although right-sizing has been common as occupiers have become more efficient in how they use space.

05

Purpose of the office is evolving

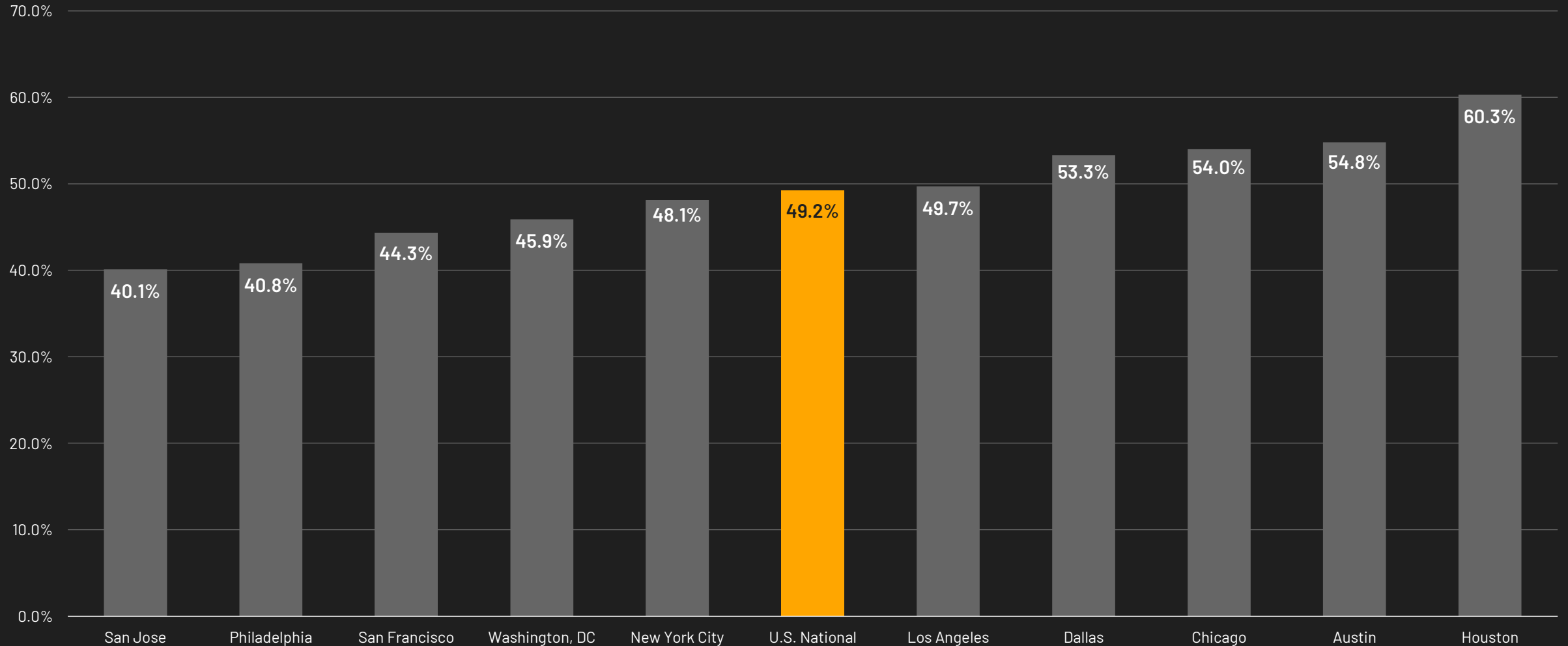
High focus on location, efficiency and sustainability. Major emphasis on space as a forum for collaboration and mentorship but also productivity compared to Work From Home. Long-term effects of hybrid workplace models remain to be seen.

U.S. Unemployment Drops to Pre-Pandemic Level



Weekly Occupancy Stalls Around 50% as Sunbelt & Midwest Lead

Kastle Systems Back to Work Barometer (Average Weekly Occupancy %) - 7/26/2023



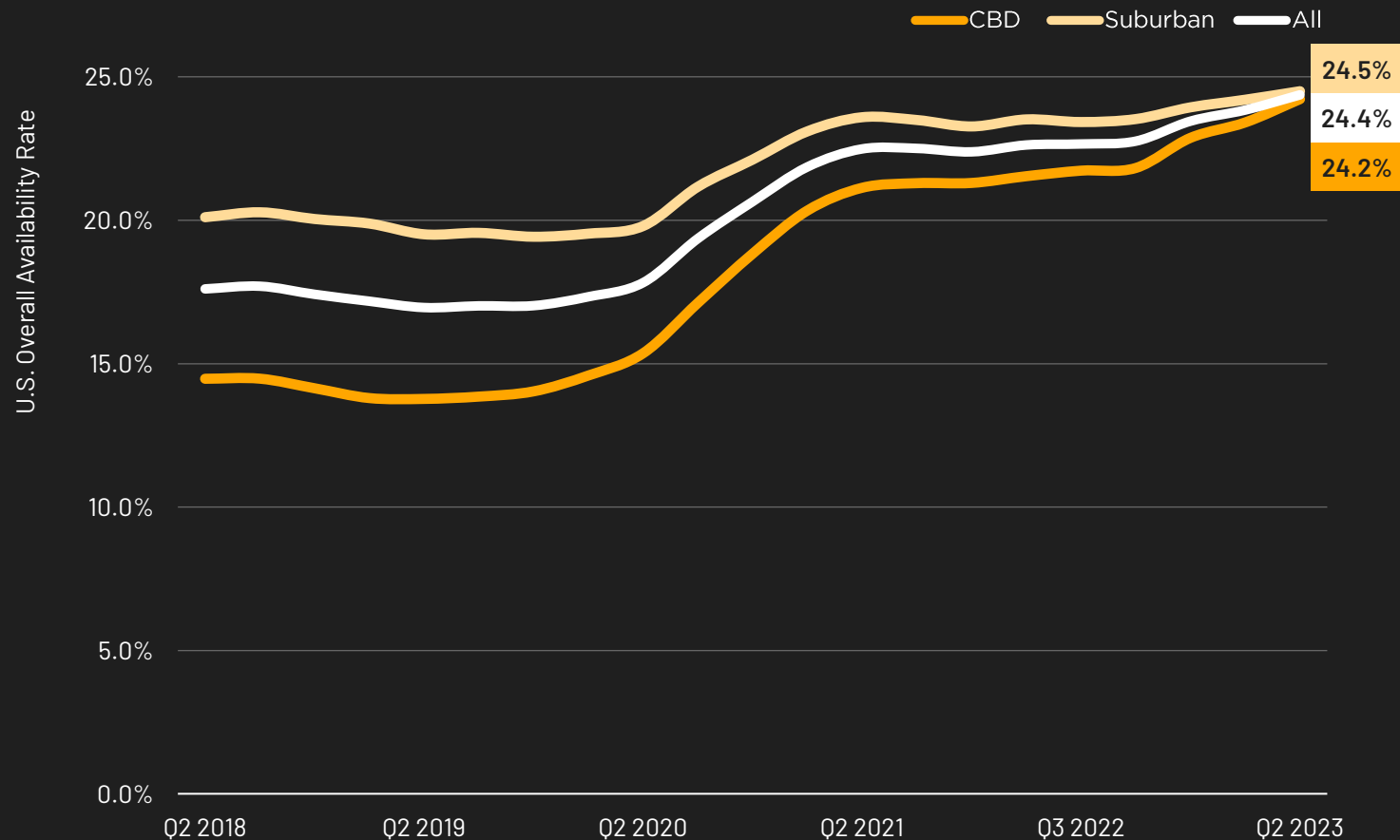
Availability Remains Stubbornly High

Availability remains elevated across U.S. markets as sublease space swells

Central Business District availability currently at 24.2%, up over 1000 basis points from pre-pandemic as **dense urban centers remain heavily impacted**

Suburban availability has increased at a **slower pace**, now up to 24.5%, a 540-basis point increase from pre-pandemic levels

It will take time and sustained leasing activity to substantially offset the amount of space returned to the market since the onset of the pandemic

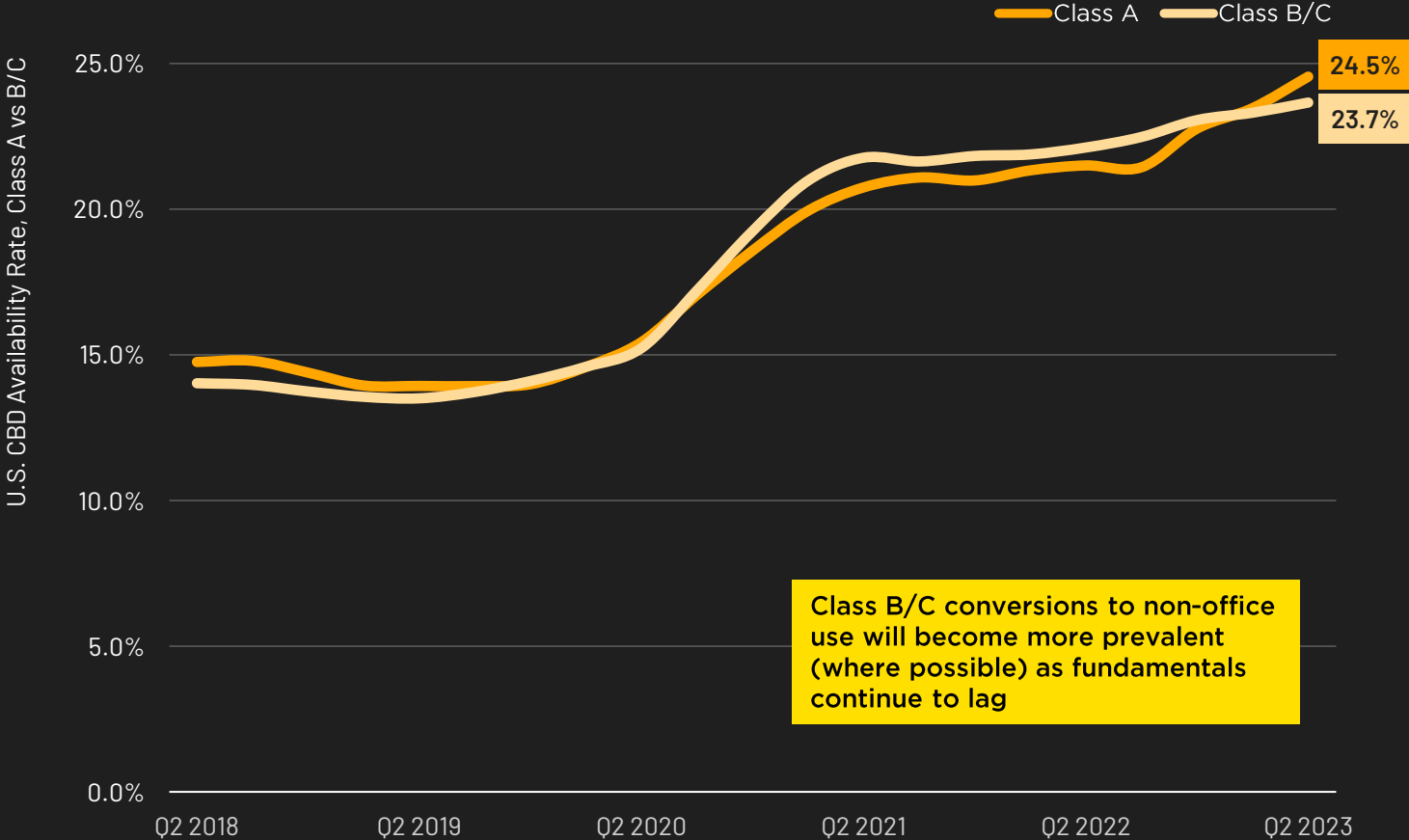


Flight-to-Quality Spurs Bifurcation in Market in Central Business Districts

Due to a continued active development pipeline **Class A availability is now higher than Class B/C availability**

Flight-to-quality driving demand with **occupiers seeking best-in-class locations and amenities**

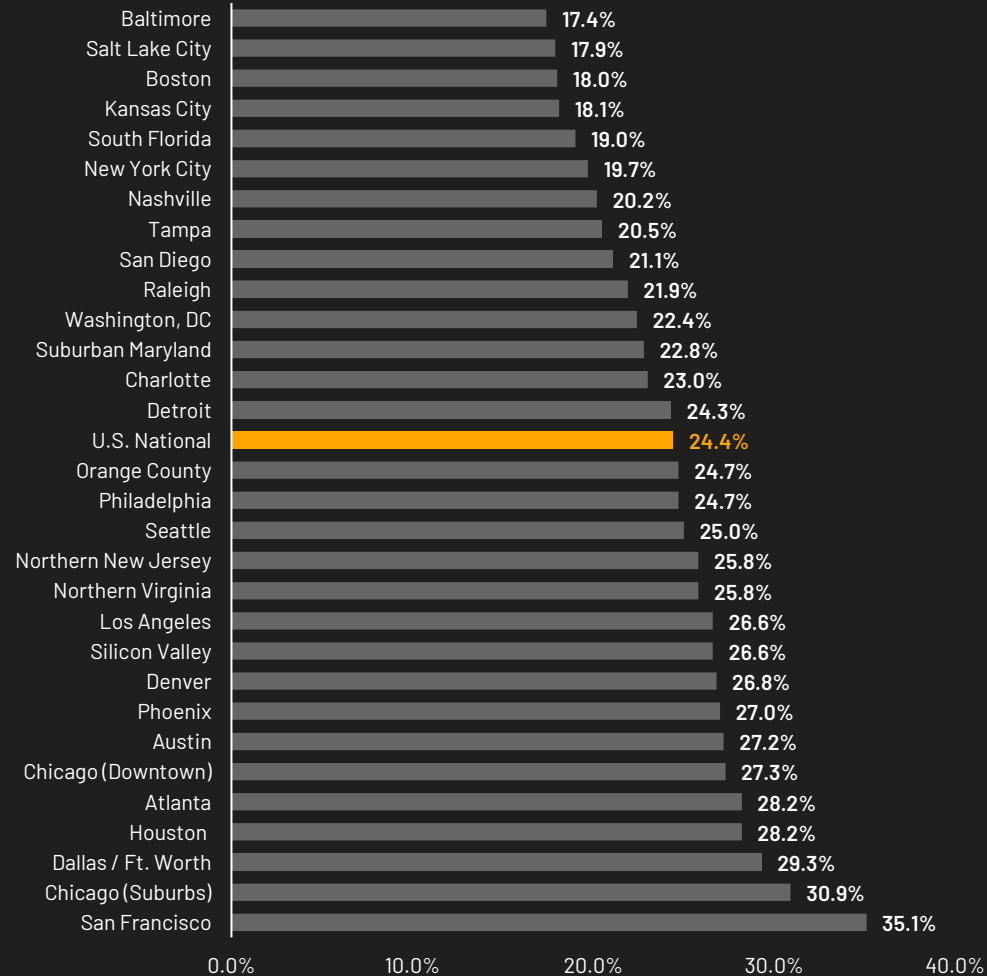
Bifurcation extends to pricing with **Class A properties asking 25% more on average**



Tech-Centric Office Markets Seeing Highest Rise in Availability

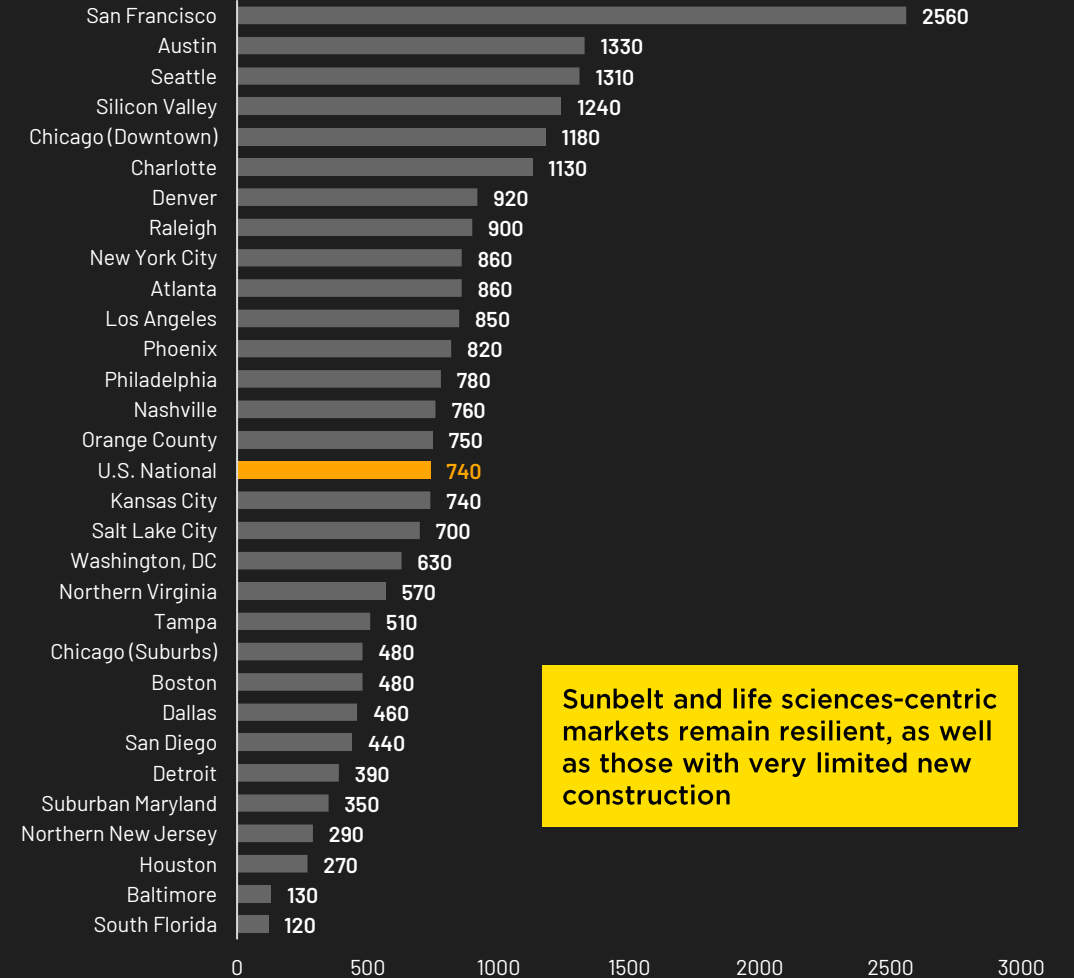
Total Availability Rate (%)

Q2 2023



Total Availability Rate (bps)

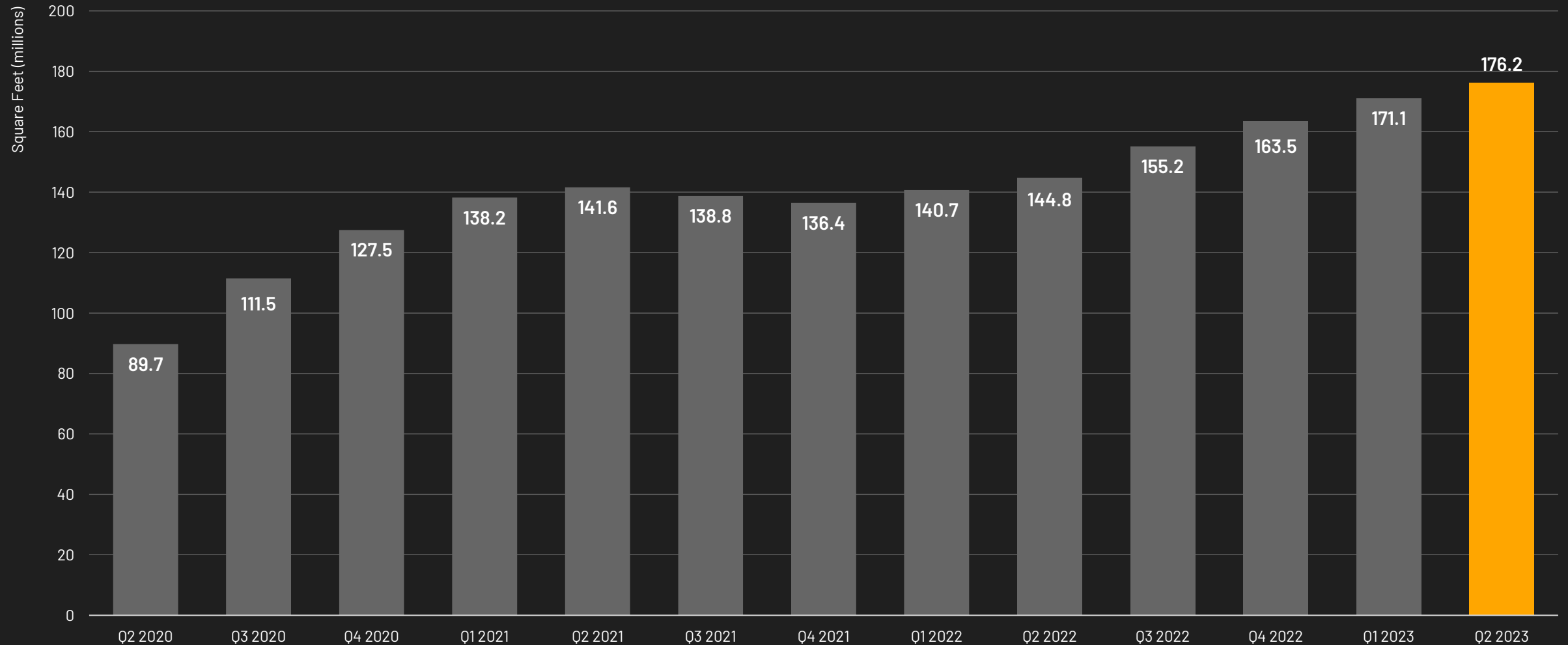
PANDEMIC CHANGE COMPARED TO Q4 2019



Sunbelt and life sciences-centric markets remain resilient, as well as those with very limited new construction

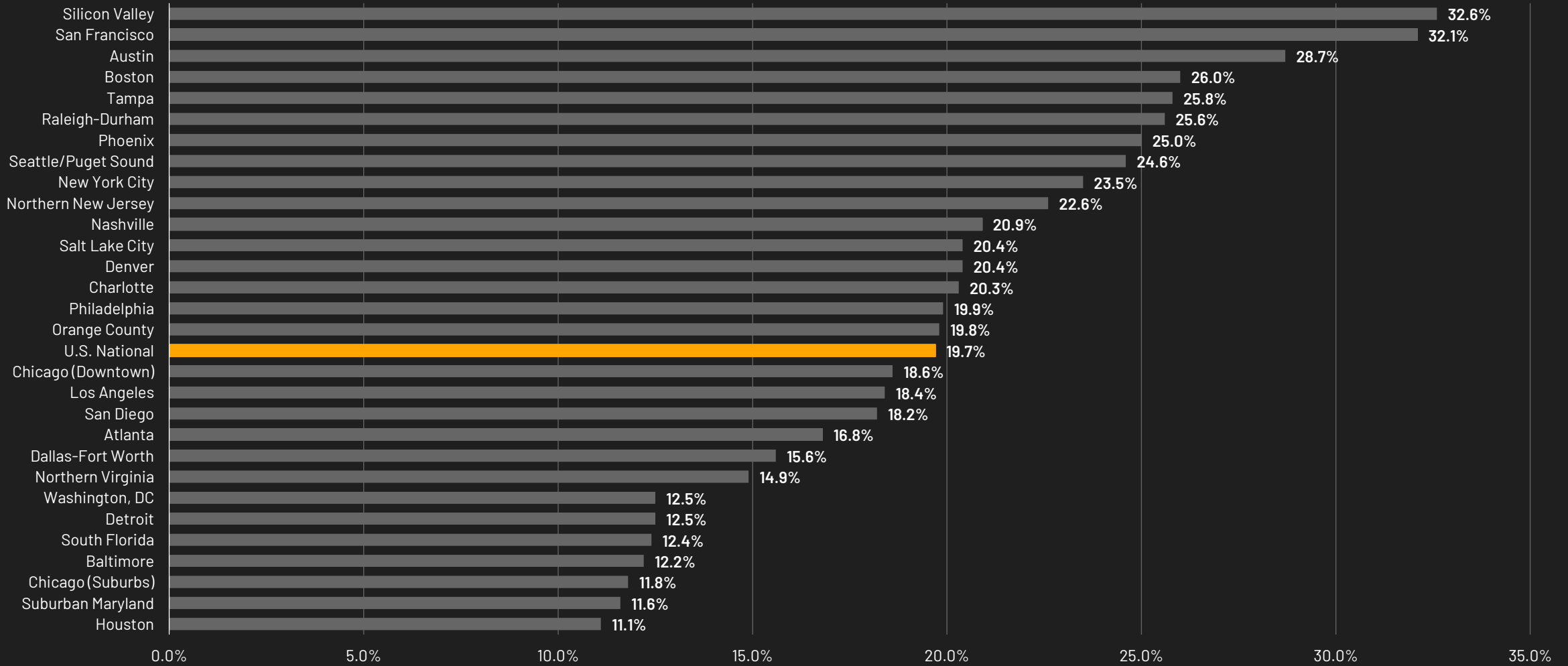
Available Sublease Space at Historic Highs

Total Available Sublease Space (msf)



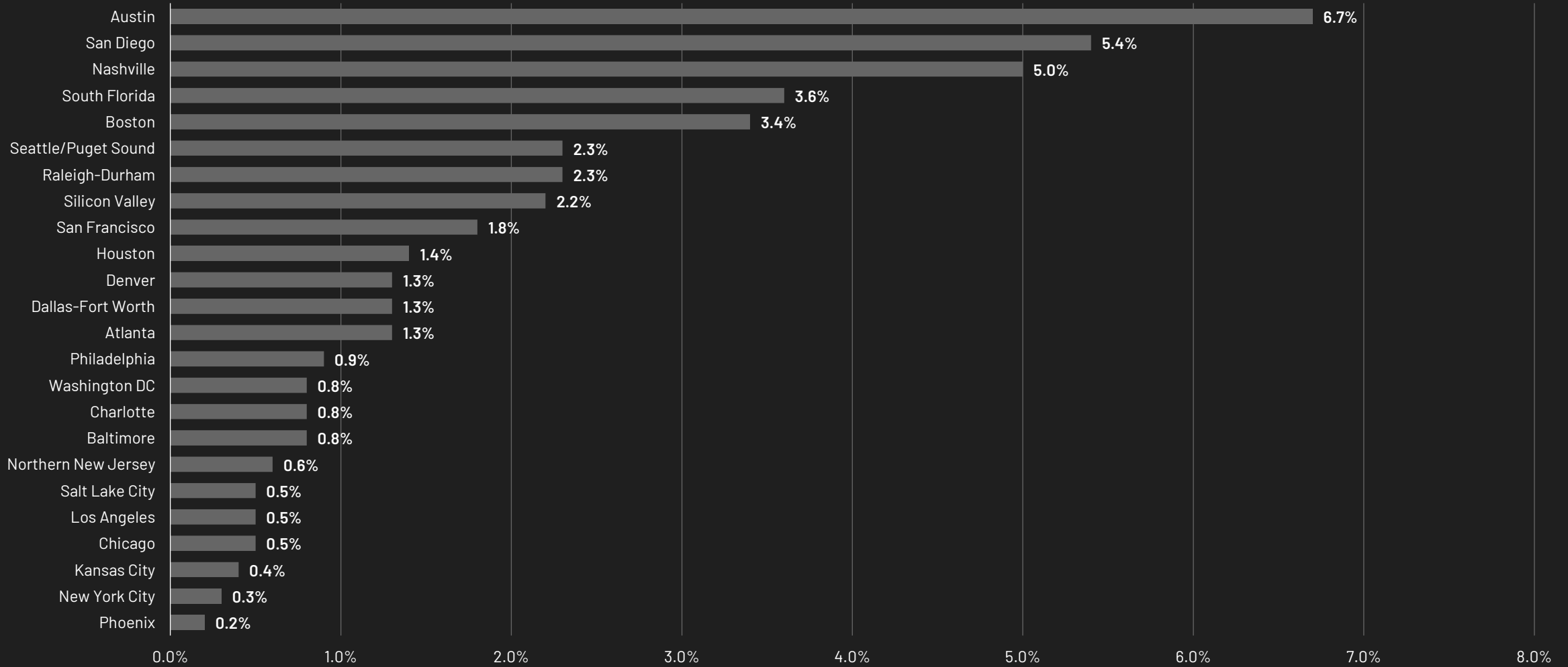
Sublease Availability Rate by Market

Available Sublease Space as a % of Total Available Space



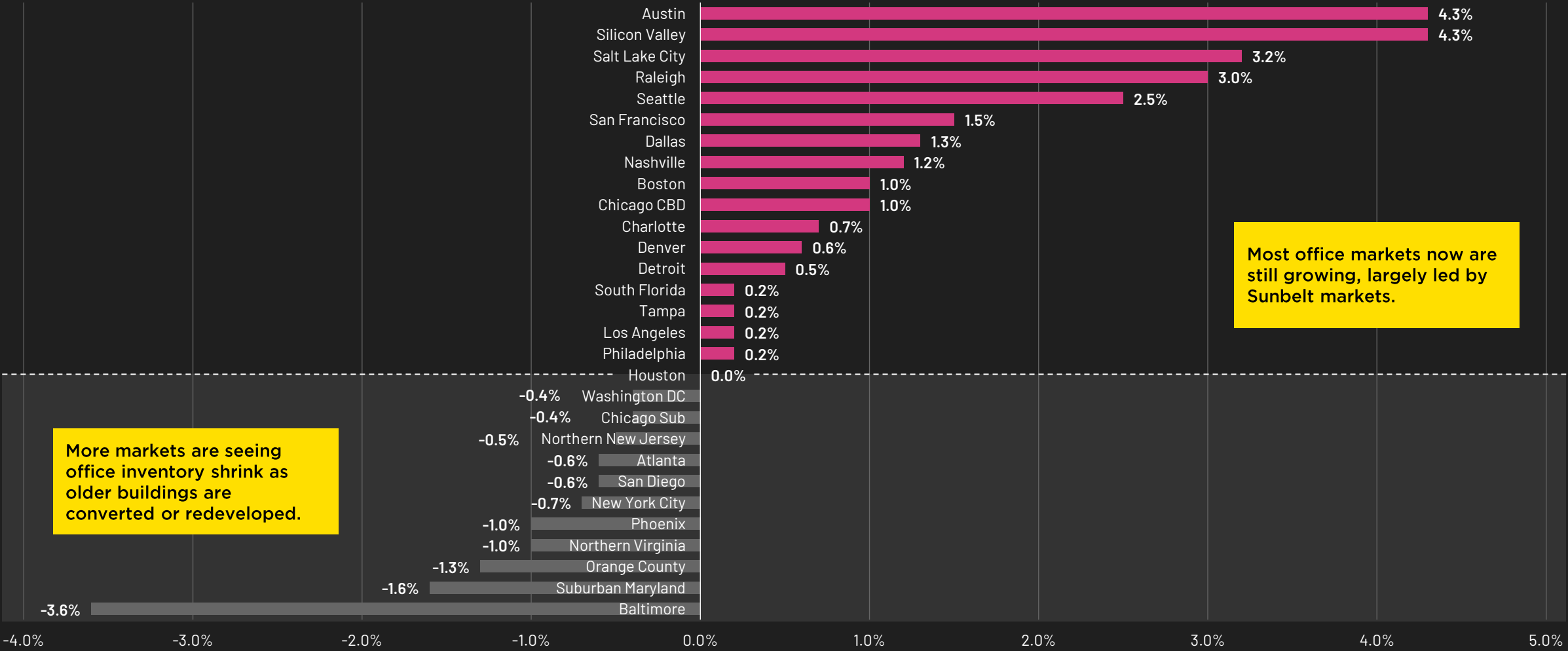
Top Inventory Growth Markets

Office square footage under construction as a % of inventory



Office Inventory is Now Shrinking in Some Markets

% inventory change from Q2 2022 to Q2 2023

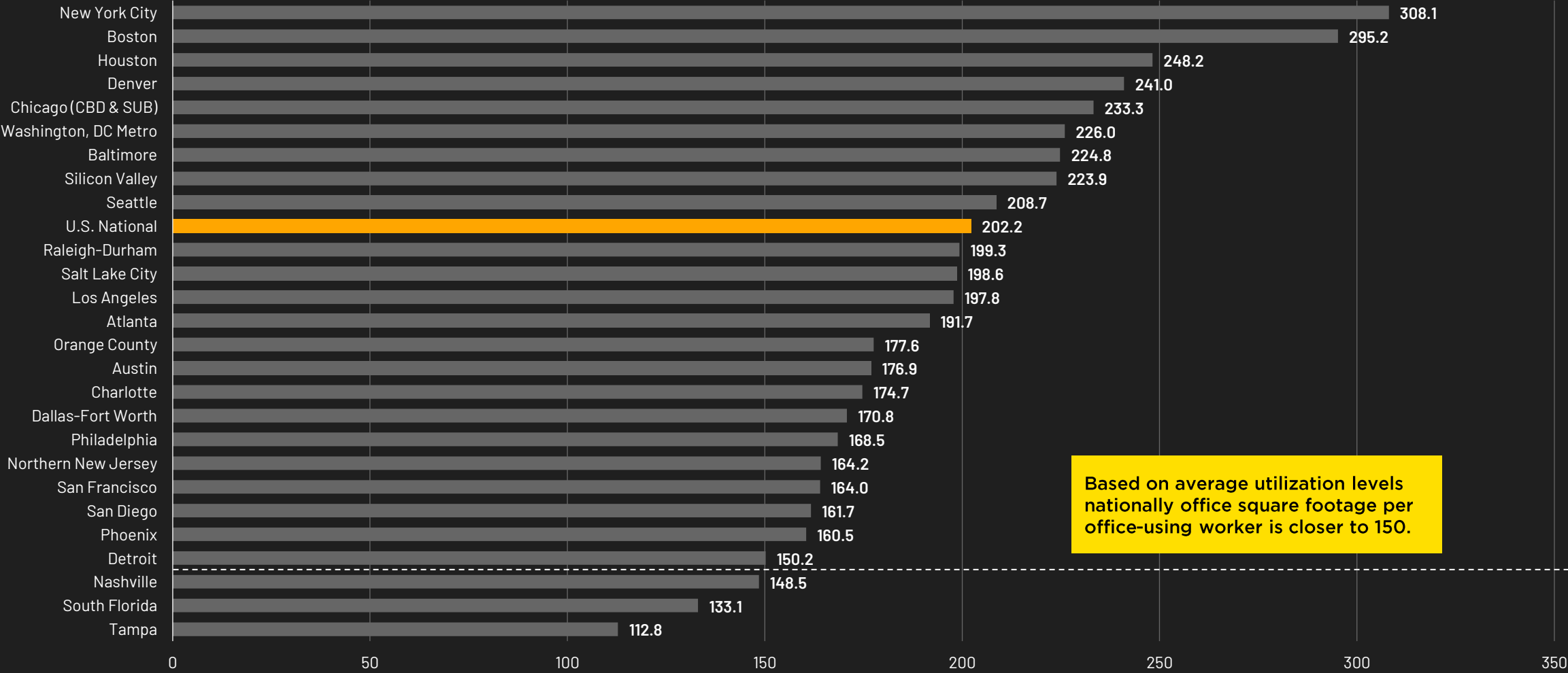


Most office markets now are still growing, largely led by Sunbelt markets.

More markets are seeing office inventory shrink as older buildings are converted or redeveloped.

Office Markets are Now Mostly Oversupplied Compared to Demand

Office square footage per office-using worker by market (sf)



Based on average utilization levels nationally office square footage per office-using worker is closer to 150.

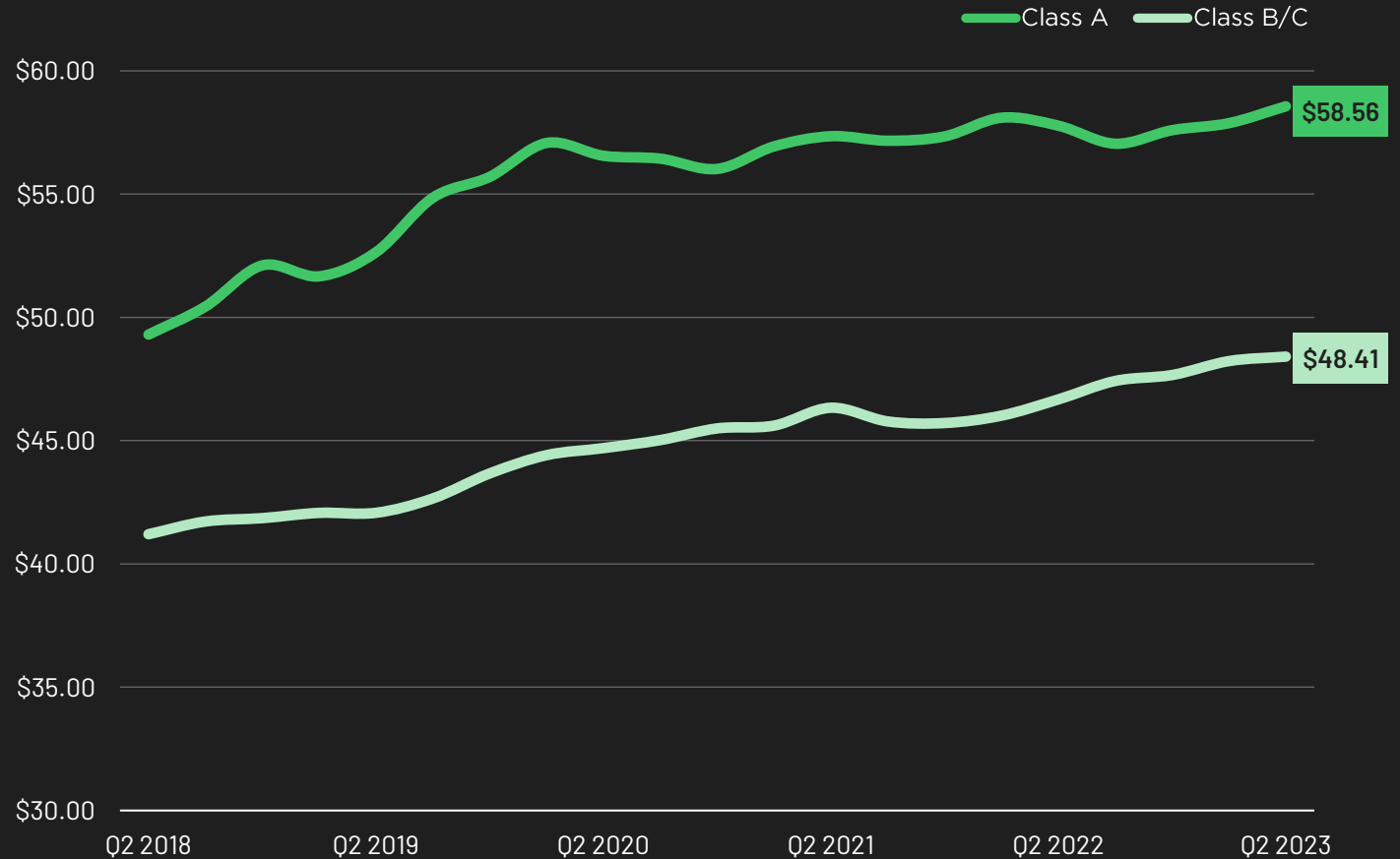
Little Change to Asking Rents as Owners “Wait and See”

CBD Average Asking Rents

Core markets (CBDs) have not yet seen drastic repricing of asking rents with many owners taking **“wait and see” approach amidst uncertainty**

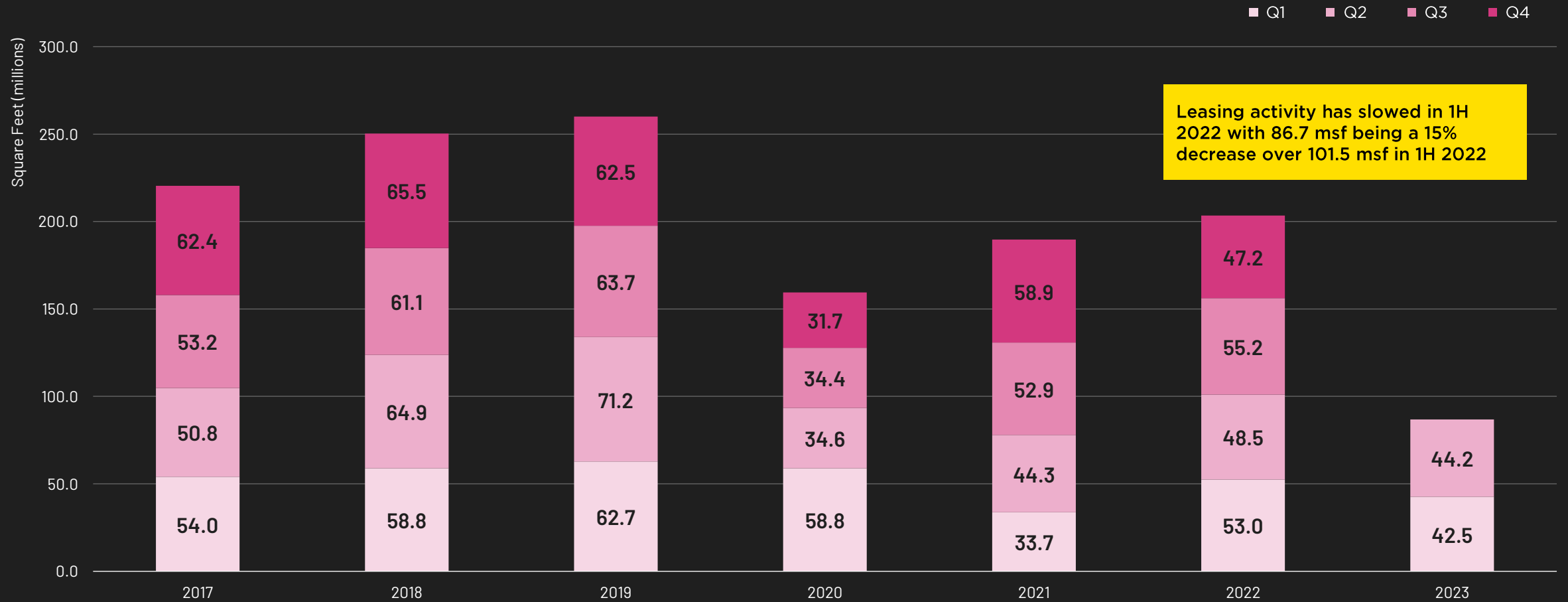
Flight-to-quality and active construction pipelines have contributed to keeping Class A rents stable – and **increasing at the very top of the market**

Growing bifurcation in many markets where pricing is high (and space limited) for top-tier buildings, while older, **more dated space is sitting on the market longer**



Leasing Activity Has Slowed Over the Past Three Quarters

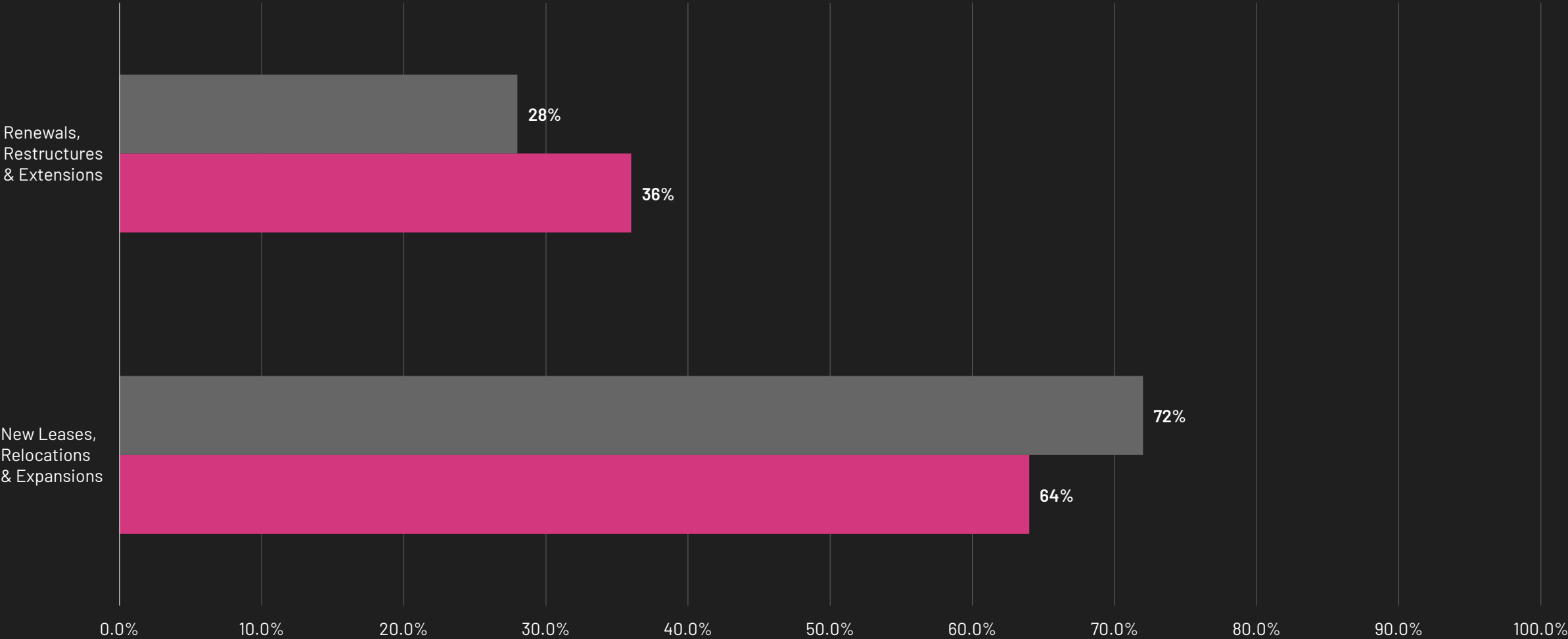
Total Leasing Activity (msf)



Economic Uncertainty Cools Demand for New Space in 1H 2023

Lease transactions 20,000+ sf

■ % by sf Leased in 1H 2022 ■ % by sf Leased in 1H 2023



Largest Office Leases in 1H 2023

TENANT	INDUSTRY	MARKET	BUILDING	SIZE (SF)	LEASE TYPE	QUARTER LEASED
Fox Corporation	Entertainment/Media	New York City	1211 Avenue of the Americas	666,000	Renewal	Q1 2023
Department of Citywide Administrative Services	Government	New York City	110 William Street	640,000	Relocation	Q2 2023
News Corporation	Entertainment/Media	New York City	1211 Avenue of the Americas	486,400	Renewal	Q1 2023
New Jersey Transit	Government	Northern New Jersey	2 Gateway Center	407,173	Relocation	Q2 2023
San Diego Gas & Electric	Energy & Utilities	San Diego	8306-8335 Century Park Court	406,462	Renewal	Q1 2023
Merck	Pharmaceuticals	Northern New Jersey	2000 Galloping Hill Road	393,000	Sale-Leaseback	Q1 2023
Northrop Grumman	Professional Services	Northern Virginia	45101, 45201 & 45301 Warp Drive	337,226	Renewal	Q1 2023
LyondellBasell Industries	Manufacturing	Houston	2800 Post Oak Boulevard	318,504	Relocation	Q2 2023
Fluor Corporation	Engineering Services	Houston	737 N Eldridge Parkway	308,186	New Location	Q2 2023
Aon	Financial Services	Chicago	200 E Randolph Street	300,000	Extension	Q2 2023
Paul Hastings	Legal Services	New York City	200 Park Avenue	277,227	Renewal and Expansion	Q2 2023

Annual Leasing Change by Market

Q2 2023 - Trailing 4-Quarter Total Leasing Activity

Savills Leasing Momentum Meter

BY BUBBLE COLOR

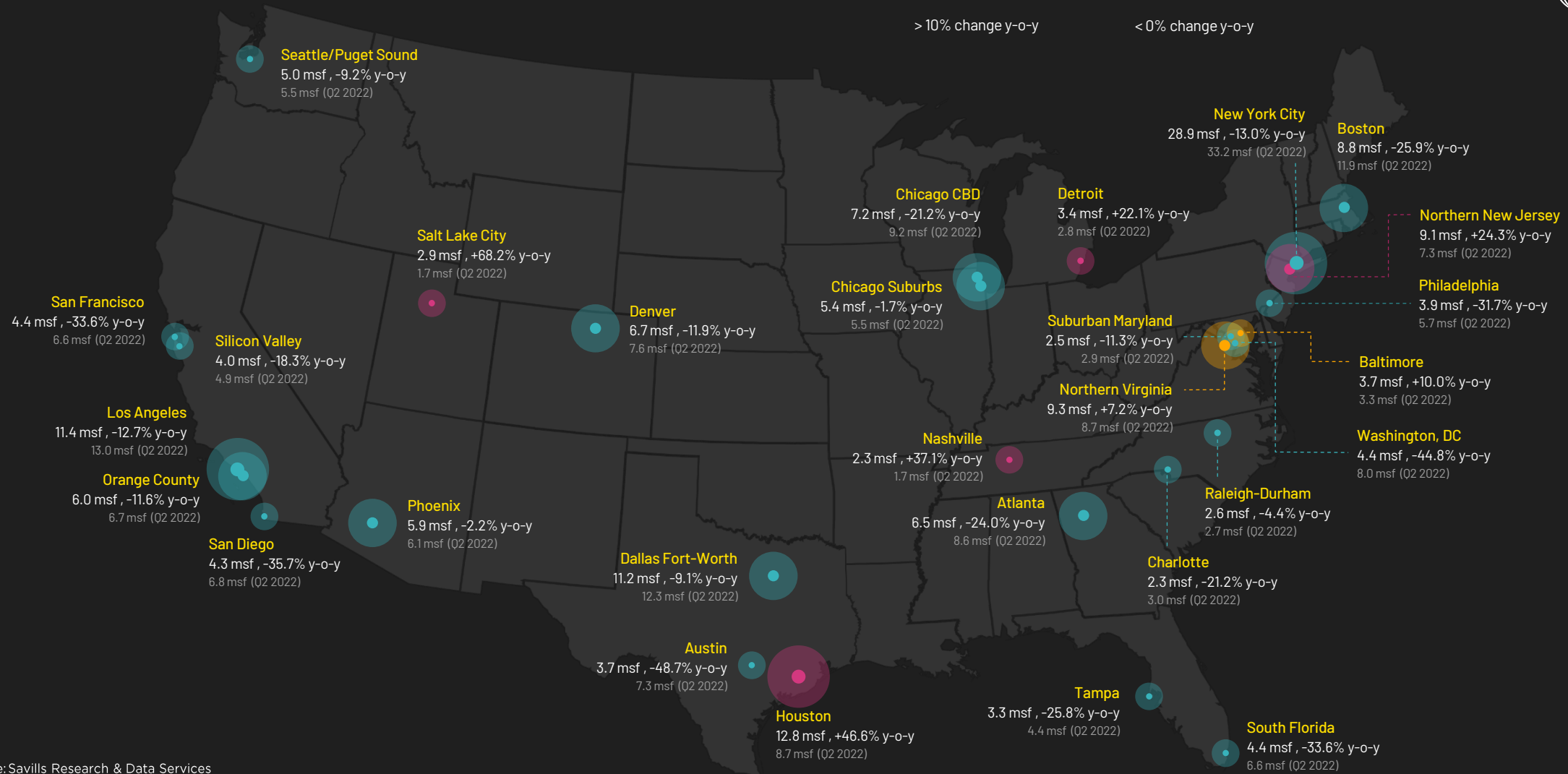
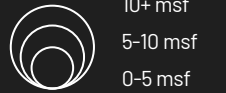


> 10% change y-o-y

< 0% change y-o-y

Trailing 4-Quarter Leasing

BY BUBBLE SIZE



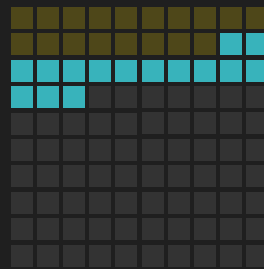
Source: Savills Research & Data Services

FIRE & TAMI Sectors Lead Demand Again, Government Sector Grows

Total Leasing Activity 1H 2023; 20,000+ sf



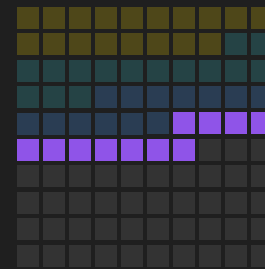
18.1% Financial Services, Insurance & Real Estate



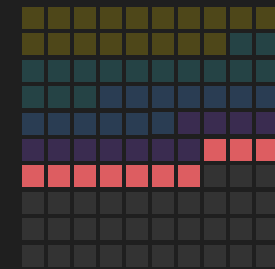
14.8% Technology, Advertising, Media & Information



13.0% Government



10.9% Legal Services



9.7% Professional & Business Services



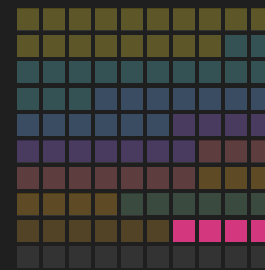
7.1% Architecture, Engineering & Construction



6.4% Healthcare/Bio/Pharma



5.5% Manufacturing

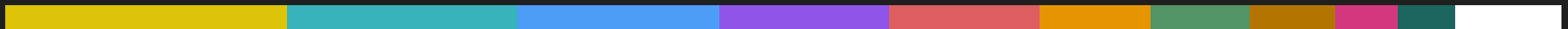


4.0% Associations & Non-profits



3.7% Energy & Utilities

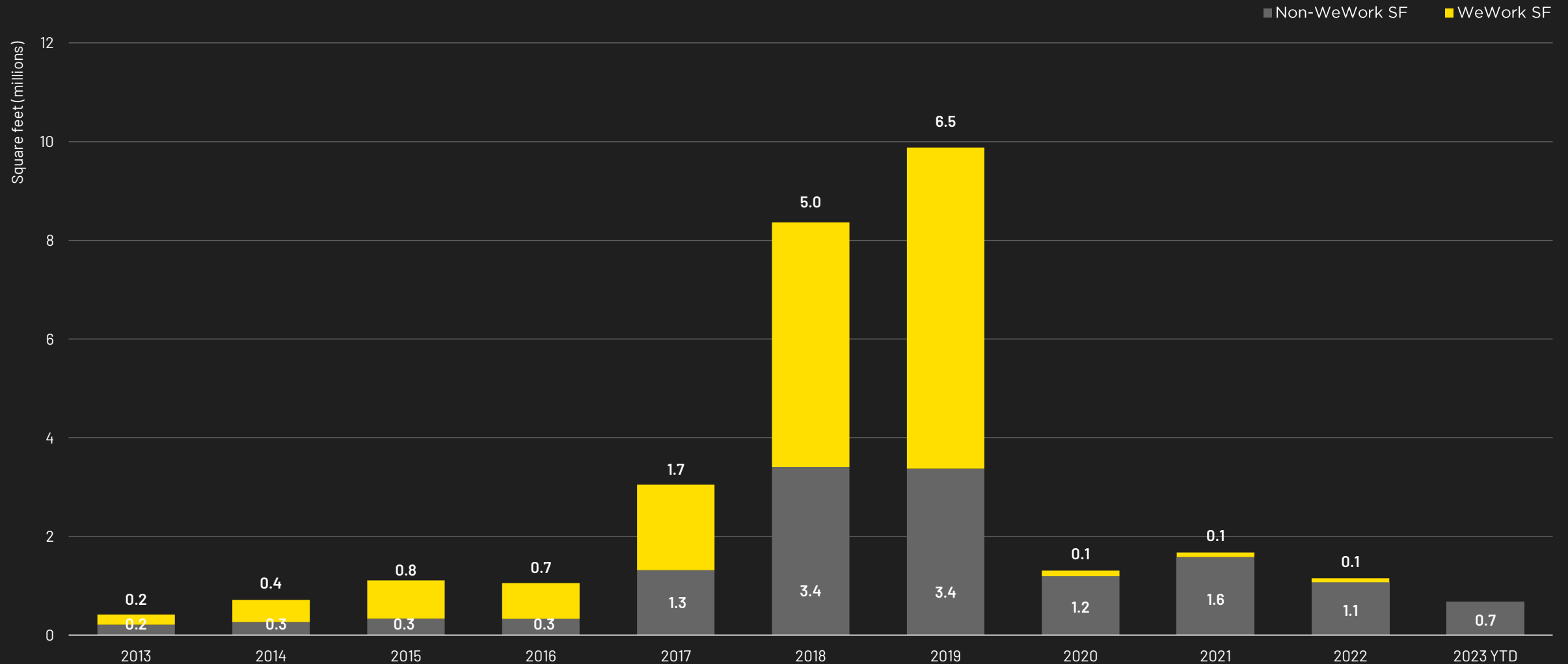
6.8% Other



*Other includes all remaining industries tracked by Savills Research and not represented in the top 10.

Coworking Sector Leasing Activity Has Decreased Significantly

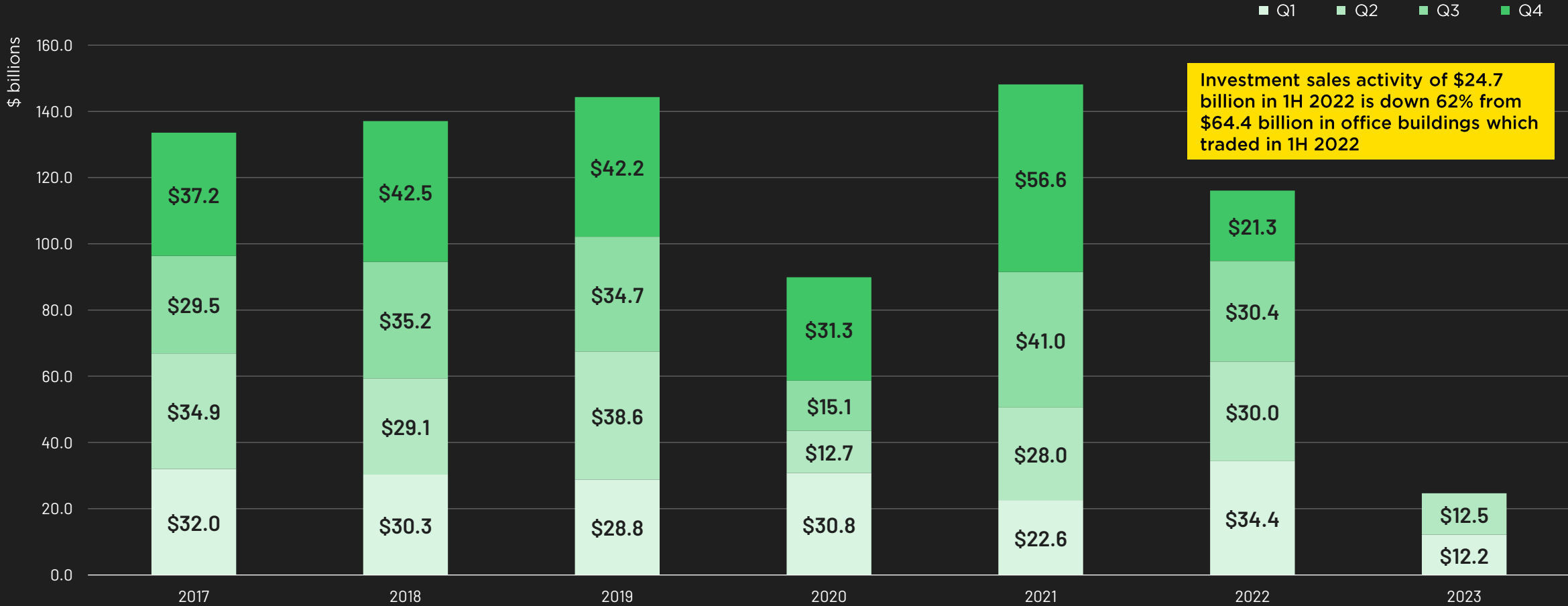
U.S. Coworking Leasing Activity - WeWork vs Non-WeWork Leasing Activity (sf)



**Office investment sales market
remains mostly frozen as
investors wait for more
distressed properties.**

Investment Sales Activity Has Slowed Significantly

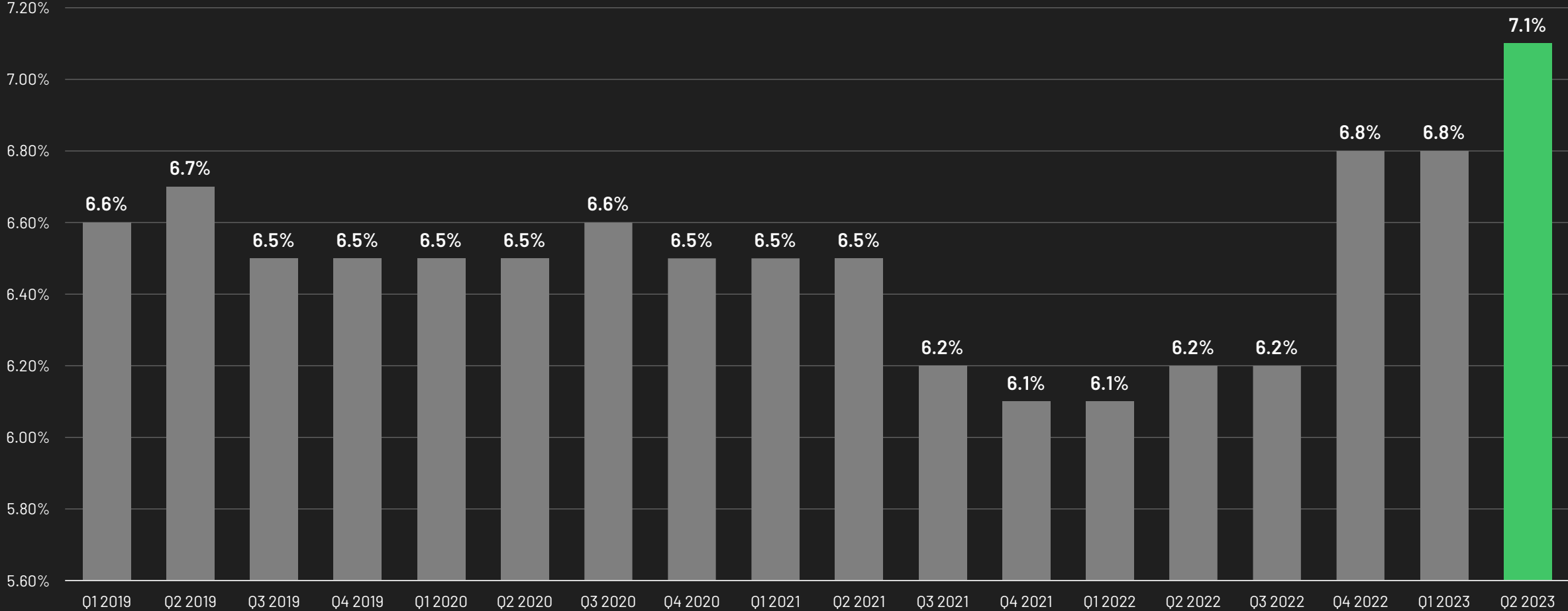
Total Office Sales Volume (\$ billions)



Source: MSCI Real Capital Analytics

Office Cap Rates Have Increased as Interest Rates Have Increased

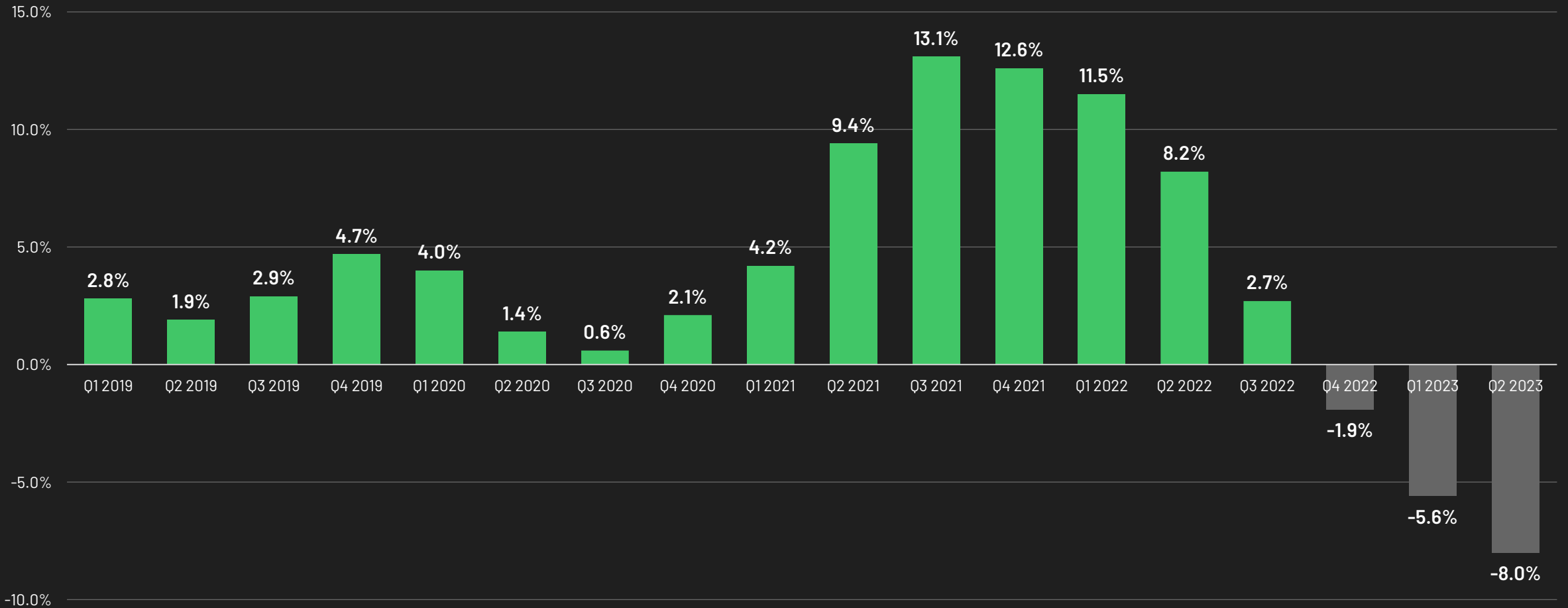
CBD and Suburban Office Average



Source: MSCI Real Capital Analytics

Office Property Valuations Have Decreased

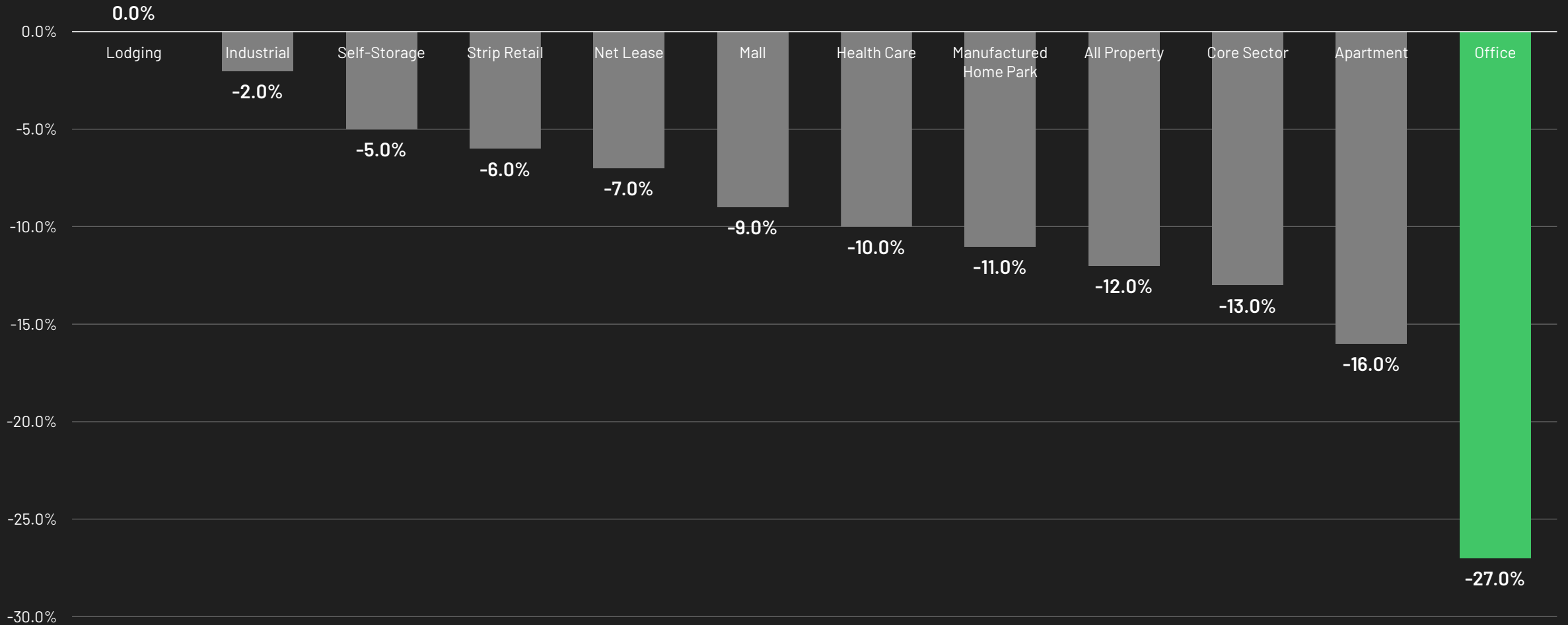
MSCI Real Capital Analytics Commercial Property Price Index (CPPI) – Year-over-Year Change (%) by Quarter



Source: MSCI Real Capital Analytics

Other Firms Are Showing a Sharper Decrease in Office Valuations

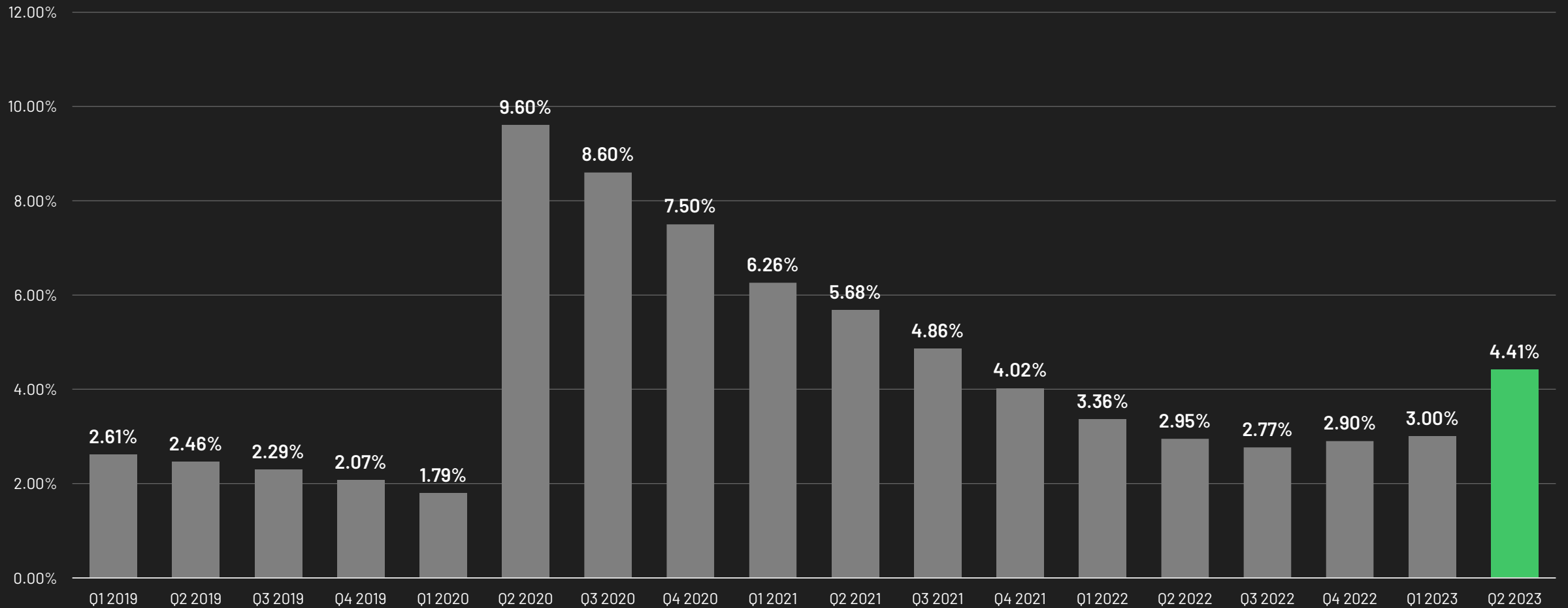
Green Street Advisors Commercial Property Price Index (CPPI) - Year-over-Year Change (%) by Property Sector



Source: Green Street Advisors

CMBS Delinquency Rates Remain Low but the Market is Spooked

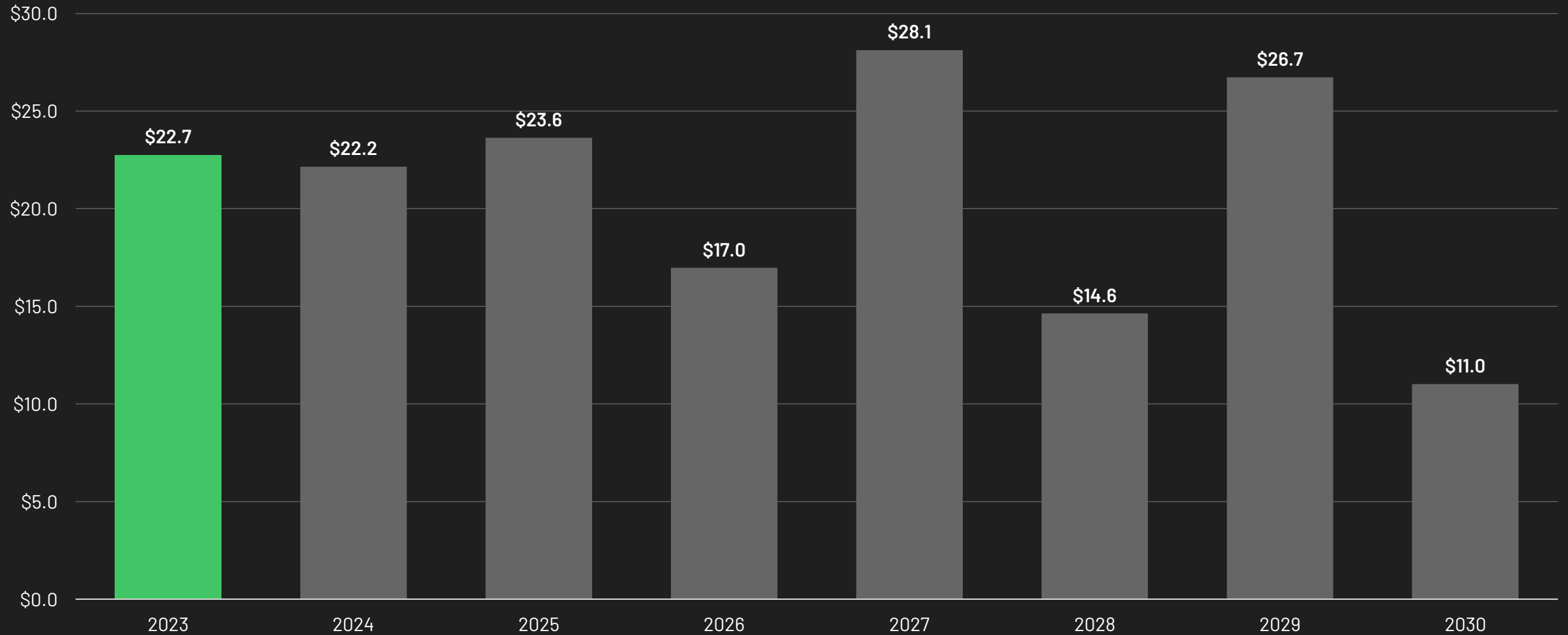
30+ Days Delinquent and REO - All property types



Source: Trepp

CMBS Office Loan Maturities Elevated Over the Short-Term

Loan maturities by year (\$ billions)



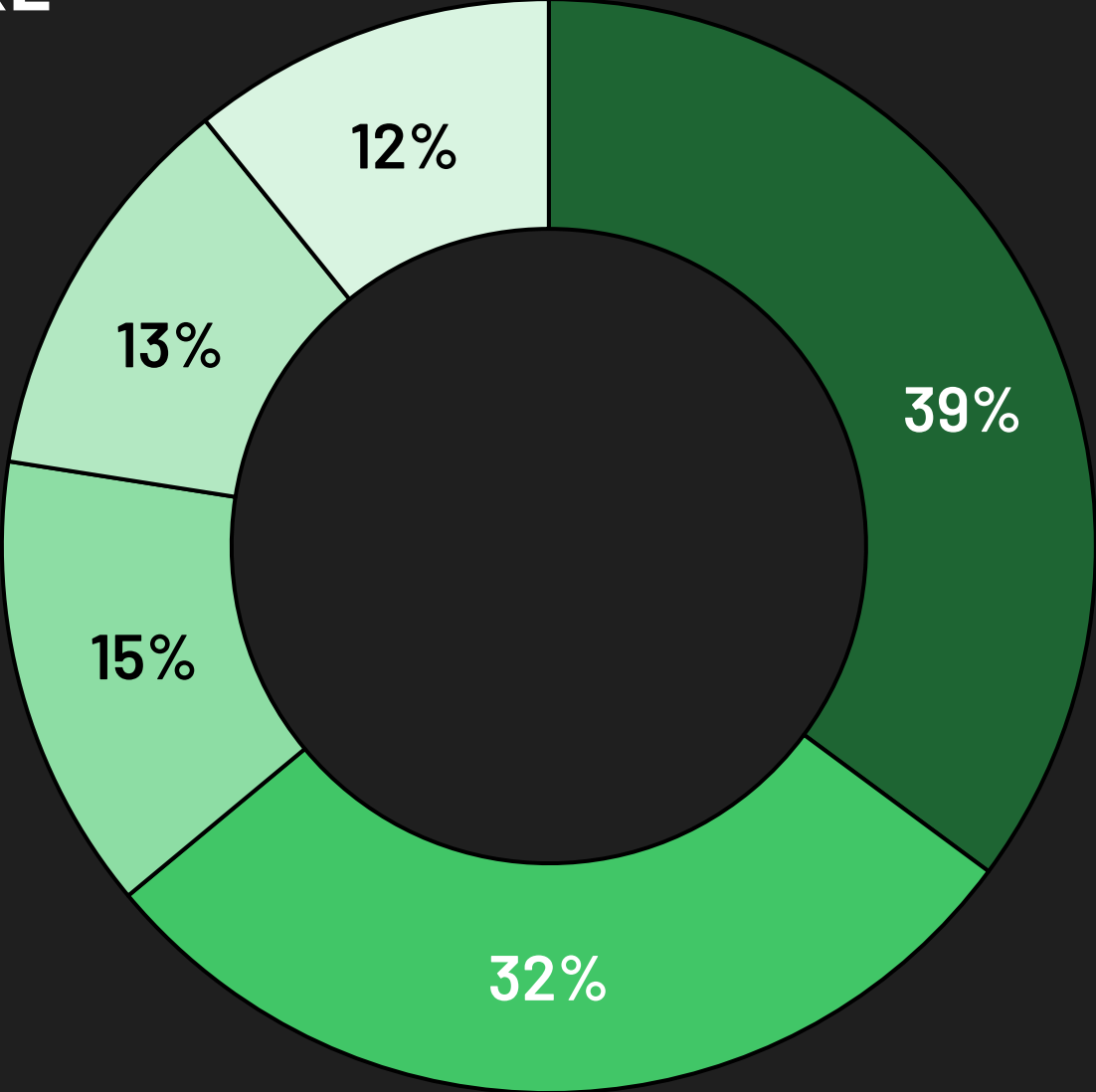
Source: Trepp

But CMBS is only 13% of Total CRE Debt Outstanding

Est. \$4.5 trillion

Commercial/Multifamily Debt Outstanding from Mortgage Bankers Association¹

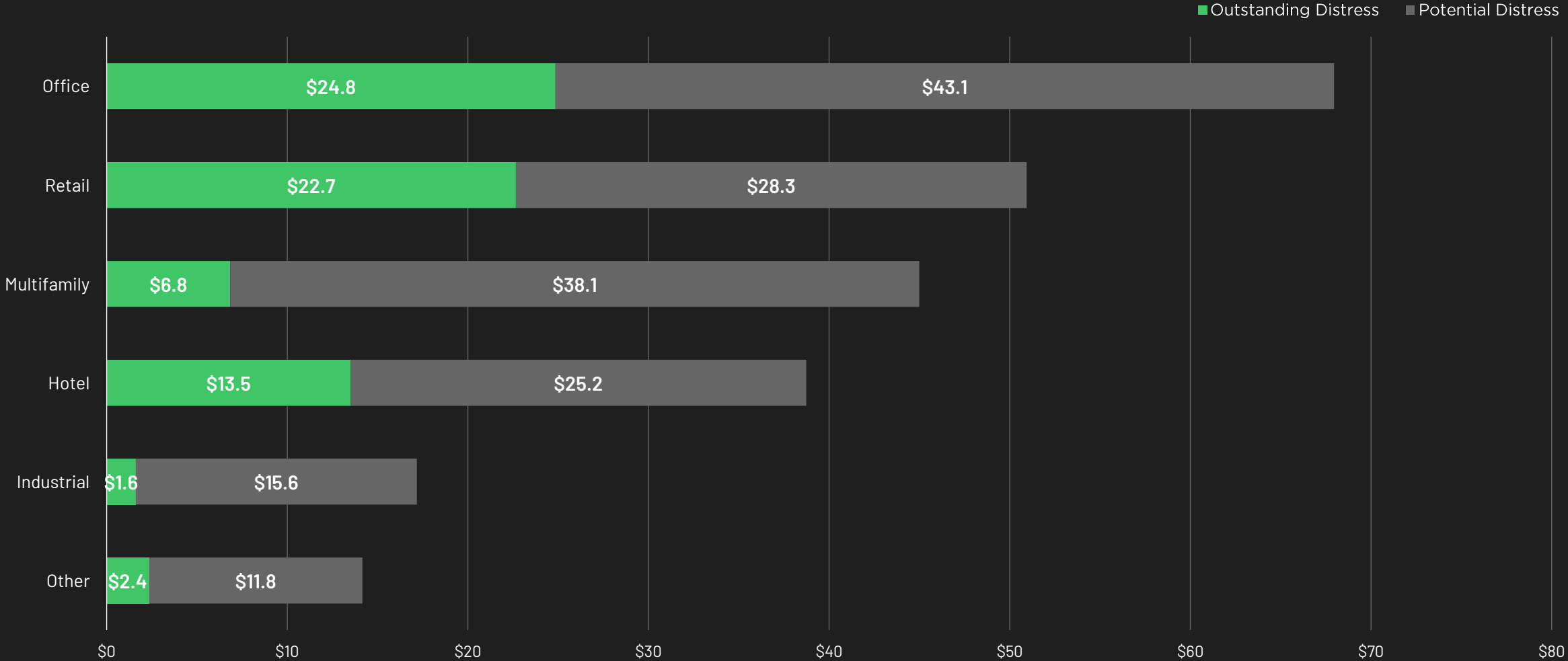
- Bank & Thrifts
- Agency and GSE Portfolios and MBS
- Life Insurance Companies
- CMBS, CDO and Other ABS Issues
- Others



Source: Mortgage Bankers Association

Commercial Property Loan Distress by Property Type

CMBS & Non-CMBS Cumulative Debt through Q2 2023 (\$ billions)



Source: MSCI Real Capital Analytics

Conversation Surrounding Commercial Real Estate Lending Environment is Evolving But Conditions Remain Challenged

Rising interest rates, falling valuations, soft fundamentals

- Interest rates continue to rise as the Federal Reserve seeks to tamp down inflation
- Shift from historically low interest rate environment leads to increase in cap rates and decline in property valuations
- Cost of capital has at least doubled over the past year
- Office property fundamentals remain soft as occupiers rethink how they use the office

\$189 billion in office loans maturing in 2023, \$117 billion maturing in 2024

- At-mid-year 2023, \$72.0 billion in commercial real estate loans are now distressed
- Office property loans comprise \$24.8 billion or 34% of all commercial real estate loans which are currently distressed
- Another \$43.1 billion in office loans are potentially distressed according to MSCI Real Capital Analytics
- Expect more owners to give back their buildings to lenders as they are now underwater

What does this mean for office occupiers over the short-term?

- Critical to understand underlying debt situation of ownership, as well as the property's financial situation / capital stack
- Distress does not necessarily mean rents will decline or there will be a substantial increase in concessions as owners might be constrained by their lenders
- Expect continued flight-to-capital by occupiers as owners in a stronger financial position are better able to win deals



Thank you.

For more information, please contact us:

Michael Soto

Senior Director,
Head of Office Research

+1 213 553 3833
msoto@savills.us

Joao Vieira

Research Associate,
Boston

+1 617 925 6298
jvieira@savills.us

Sid Jaitly

Data & Technology Manager

+1 206 773 2276
sjaitly@savills.us

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