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Q4 2023 - Office

State of the U.S. Office Market

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The office market in 2023 was sluggish as **macroeconomic uncertainty** and **slowing office-using employment growth** caused a pullback in space demand nationally

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

Post-pandemic impacts have left the office market strained and availability high despite recent data showing higher Return to Office rates. Hybrid workplace is now a viable “new normal” for occupiers.

02 Leasing activity was lower in 2023 than 2022

Office space demand softened in 2023 and was lower than 2022, led by a slowdown in office-using employment growth and uncertainty in the macroeconomic environment.

03 Average asking rents have remained high

Advertised rents have not decreased as much as thought despite lower demand. However, landlord concessions are at peak levels in many markets as many owners have kept their face rents high.

04 Flight-to-capital as well-capitalized owners win deals

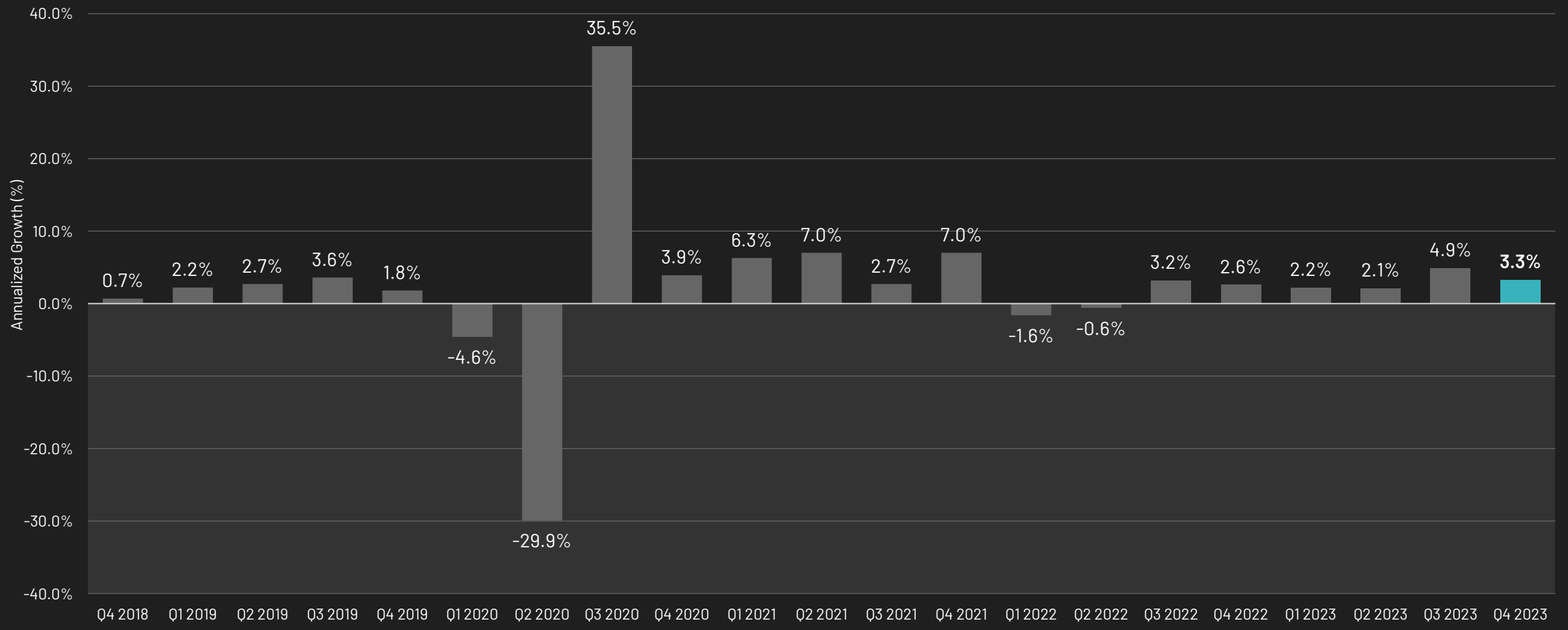
While occupier flight-to-quality continues, “flight-to-capital” has become more prevalent as office building owners in a stronger financial position have been better able to win deals.

05 Purpose of the office continues to evolve

Rather than merely warehousing employees, higher focus on office as a forum for collaboration, training, mentorship, and creating company culture. However, the long-term effects of the hybrid workplace model remain to be seen.

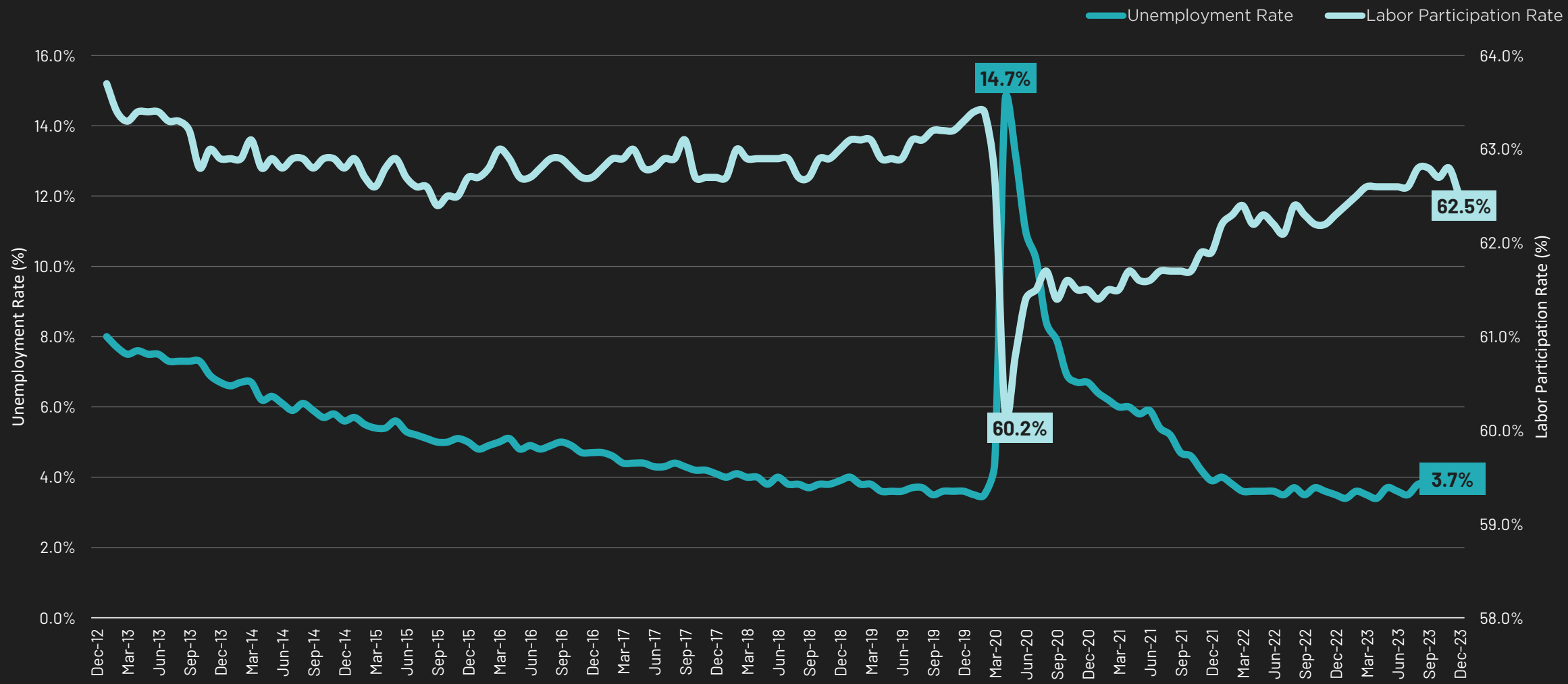
Despite Slowdown Concerns, Growth was Strong at Year-End 2023

U.S. Gross Domestic Product (Annualized Growth %)



Source: Bureau of Economic Analysis

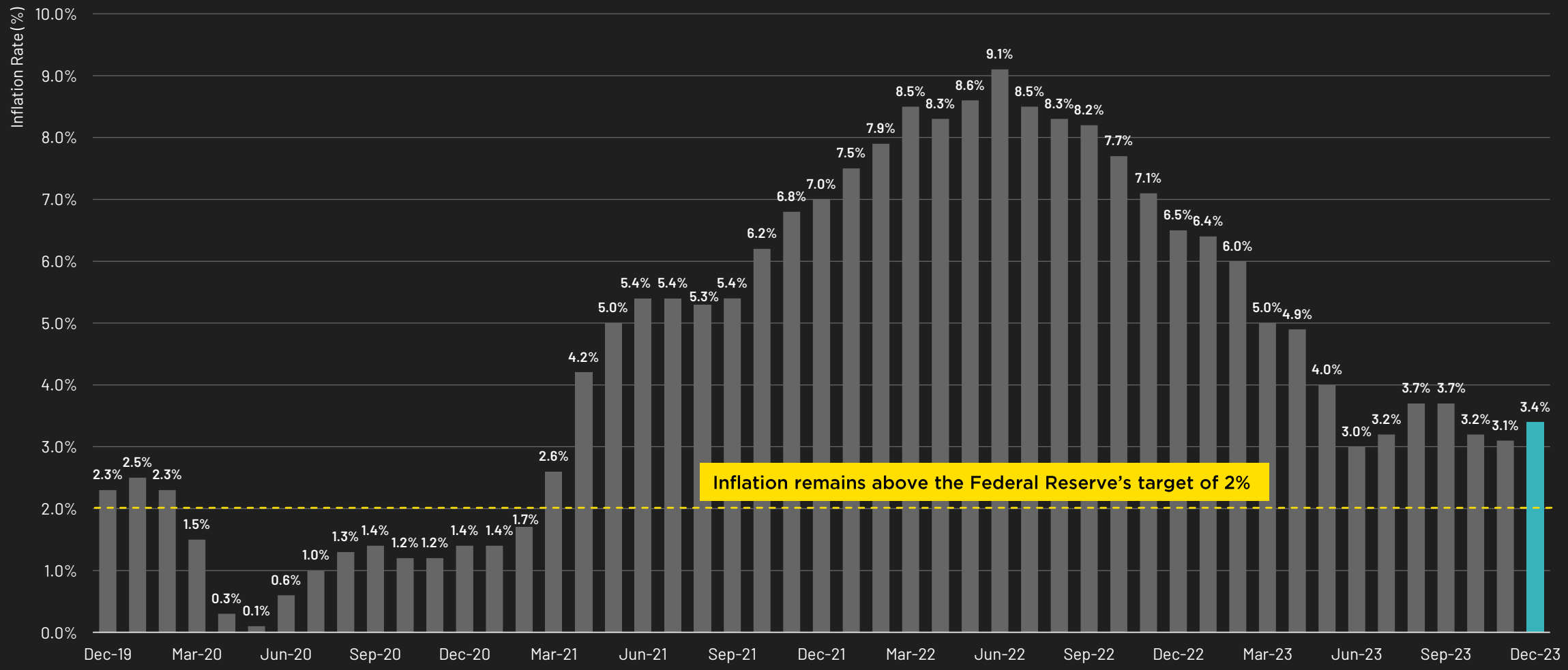
U.S. Unemployment Rate Seeing an Uptick in Recent Months



Source: Bureau of Labor Statistics

Slowing Inflation Has Caused More Optimism of a Soft Landing in 2024

U.S. Monthly Inflation Rate (Year over year %)



Source: Bureau of Labor Statistics

However, Growth in the Office-Using Employment Sectors Has Slowed

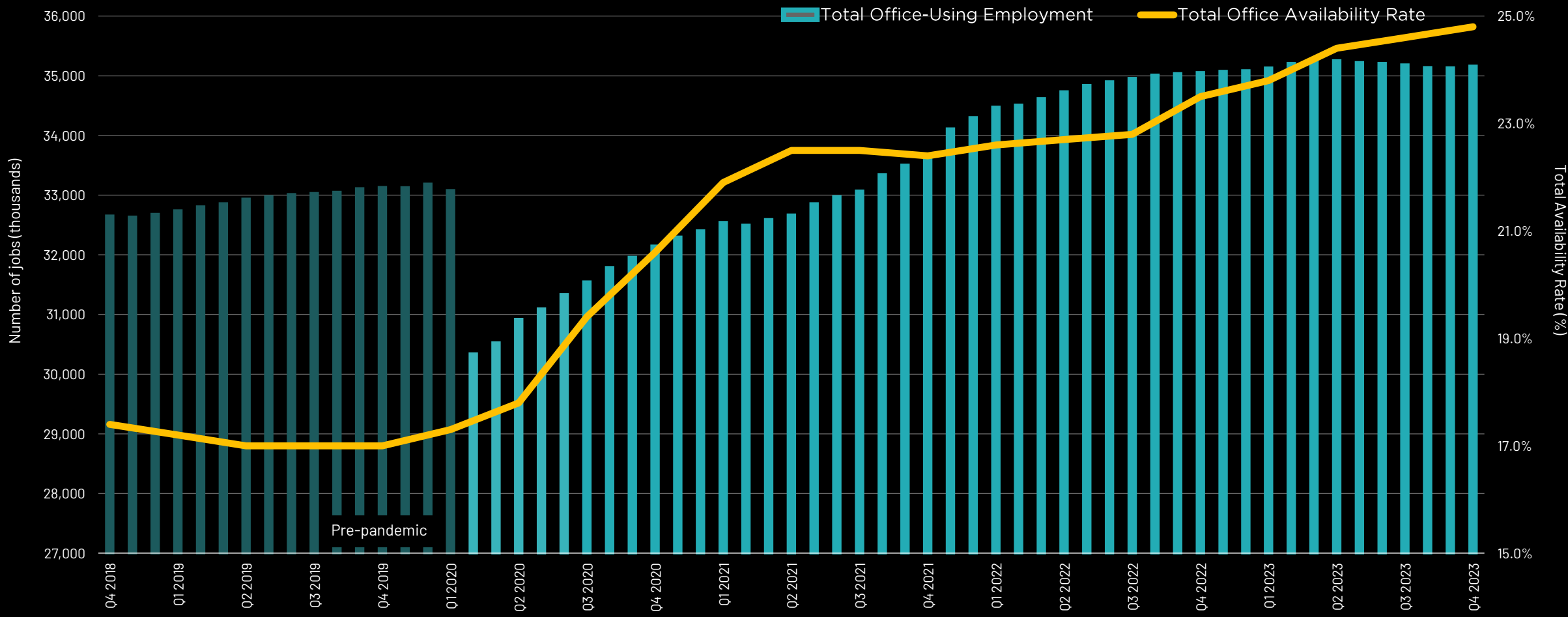
Year over year Employment Growth by Major Sector (%)



Source: Bureau of Labor Statistics

Higher Office-Using Employment but Availability Has Not Decreased

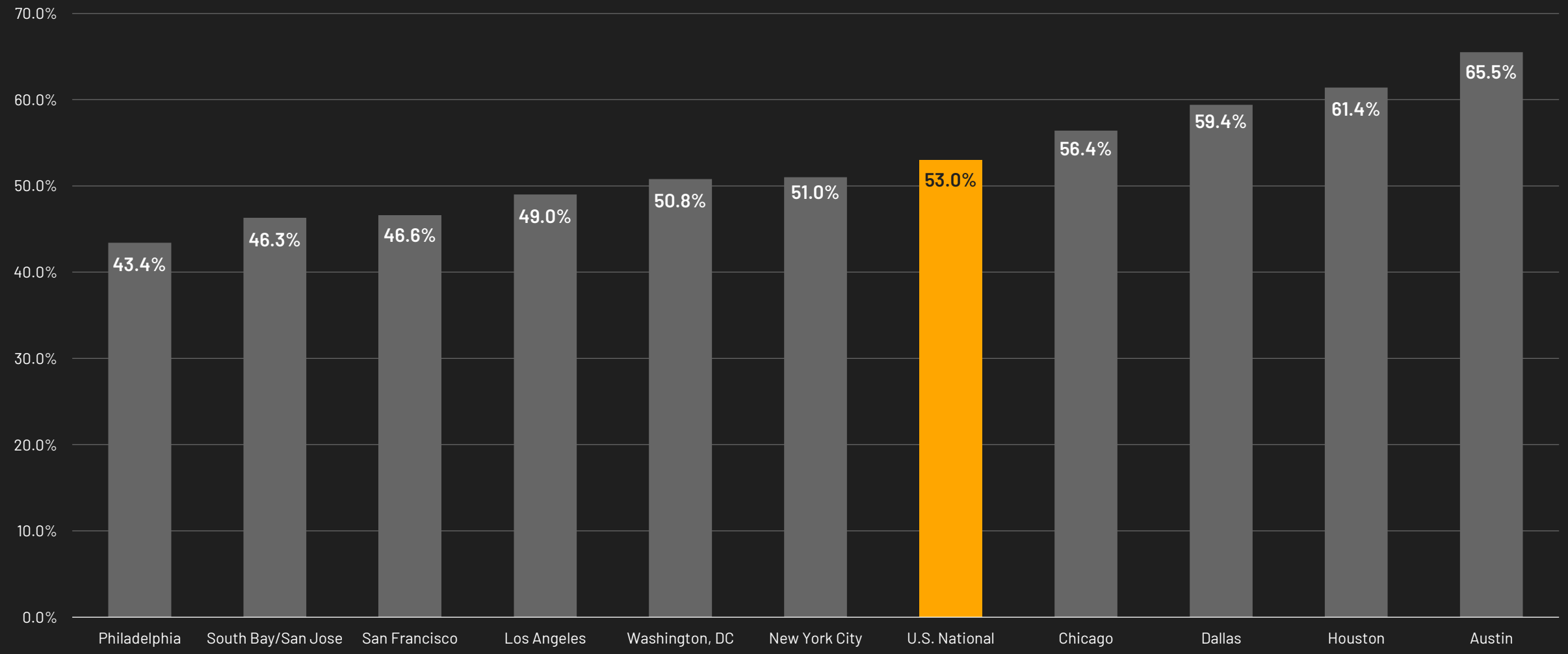
Total Office-Using Employment vs Total Office Availability Rate



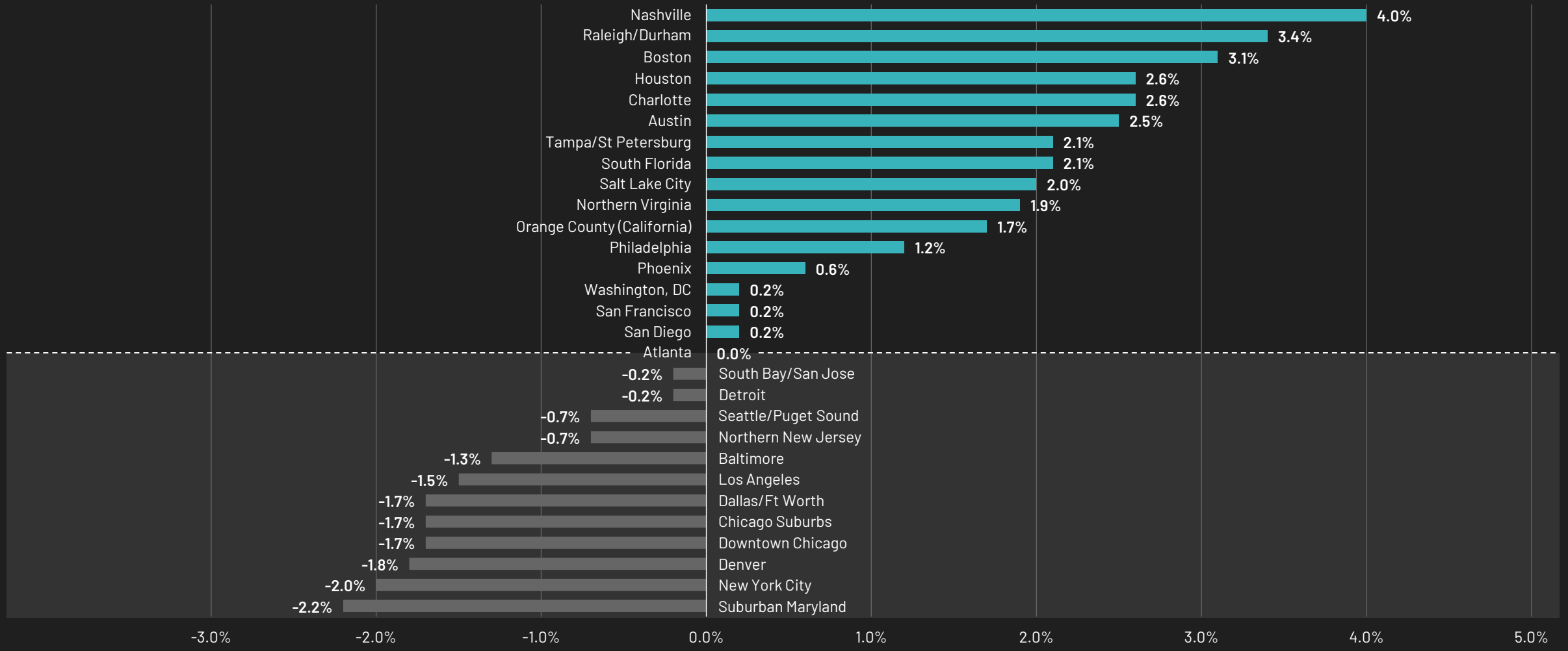
Sources: Savills Research, Bureau of Labor Statistics

Average Weekly Occupancy Now Over 50% as Sunbelt & Midwest Lead

Kastle Systems Back to Work Barometer (Average Weekly Occupancy %) – 1/31/2024



Office-Using Employment Growth Being Led Mostly By the Sunbelt



Source: Bureau of Labor Statistics

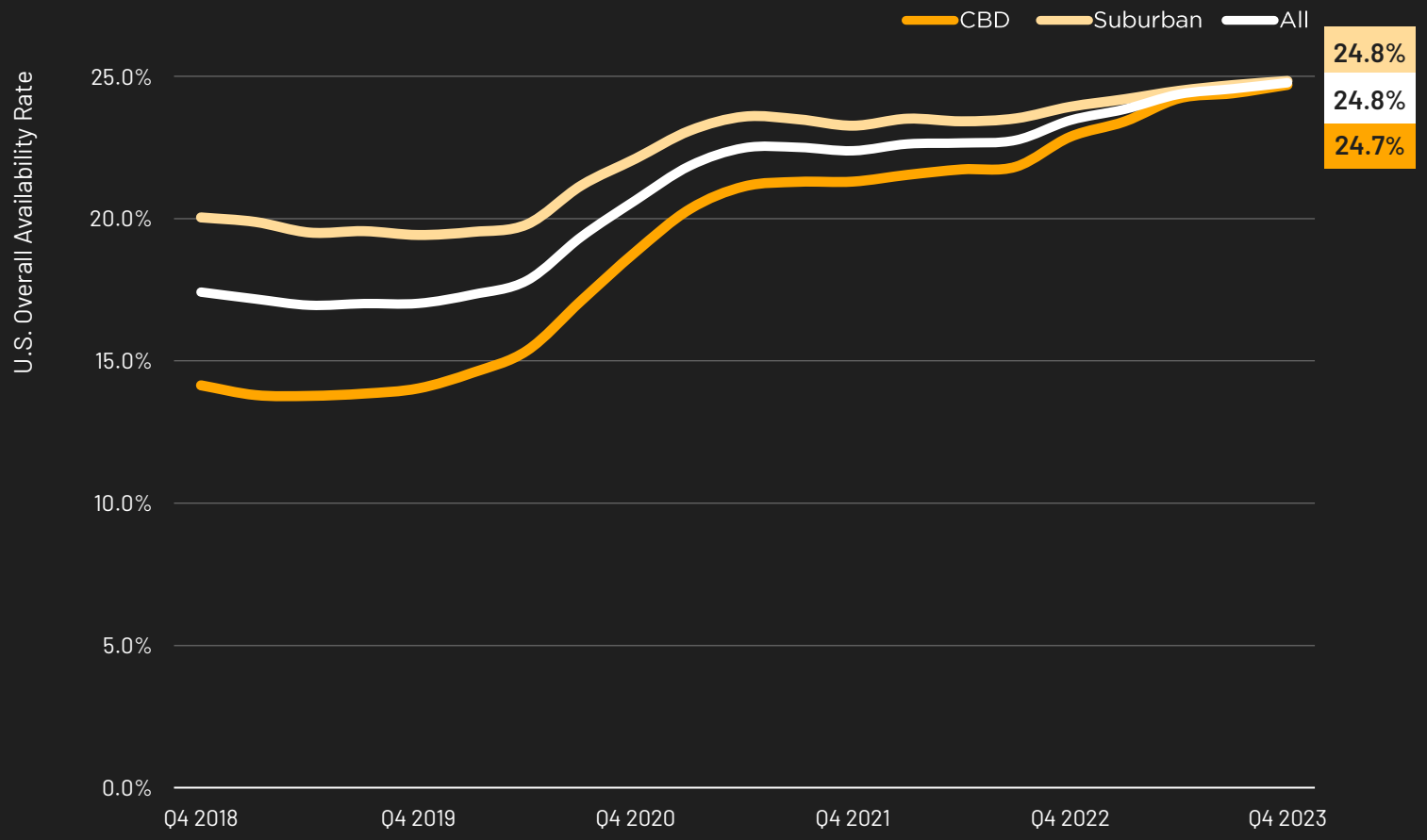
Availability Remains Stubbornly High Due to Space Givebacks

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

Central Business District (CBD) availability currently at 24.7%, up 1,070 basis points from pre-pandemic as **dense urban centers remain heavily impacted**

Suburban availability has increased at a slower pace, now at 24.8%, up 540 basis points from pre-pandemic levels

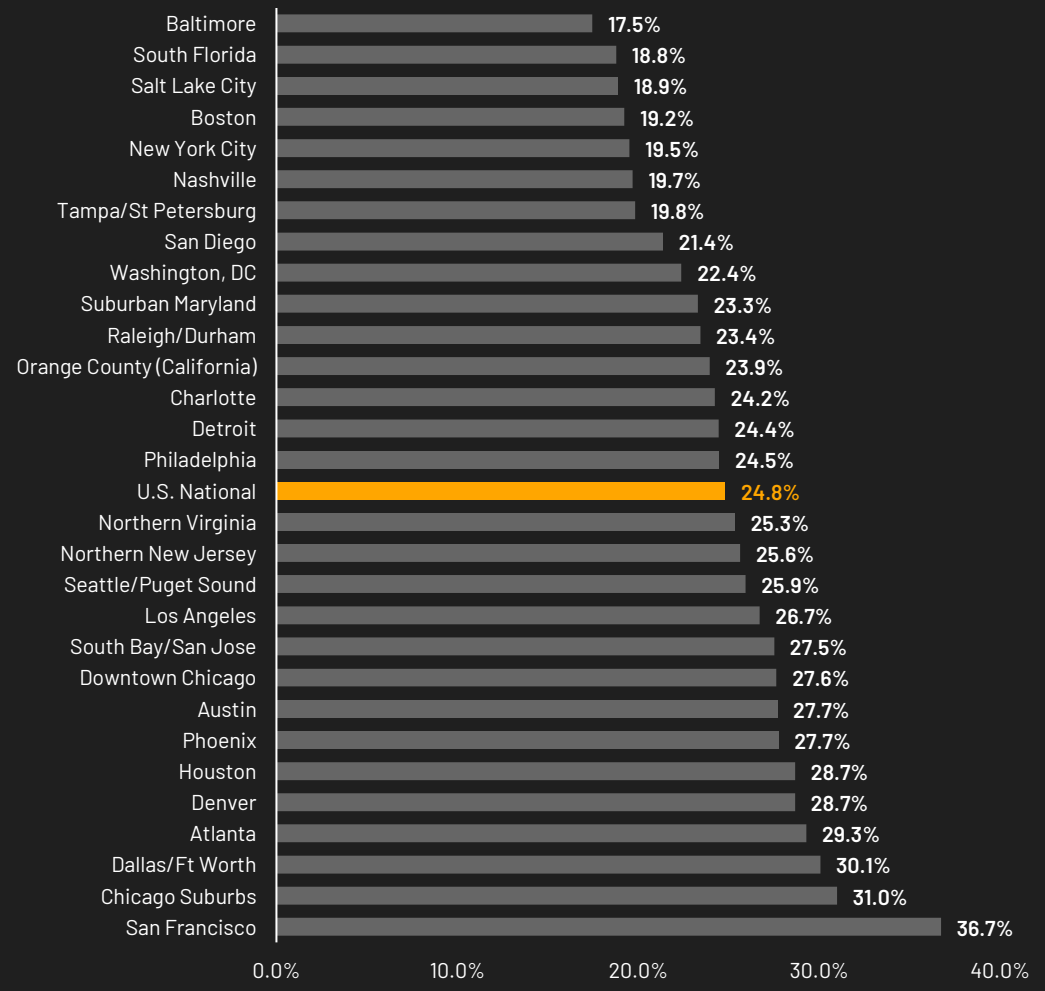
It will take time and sustained leasing activity to substantially offset the amount of space returned to the market since the onset of the pandemic



Tech-Centric Office Markets Observing Largest Increase in Availability

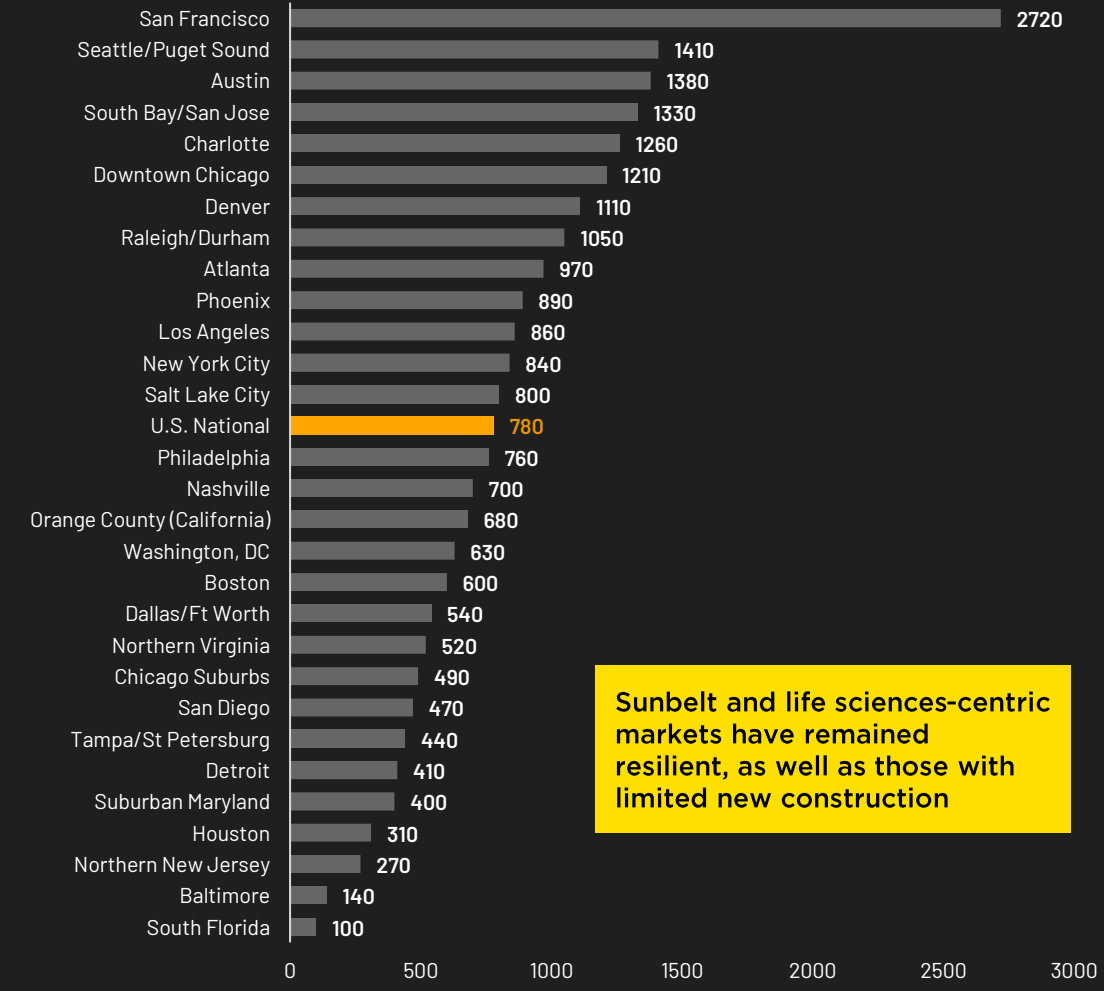
Total Availability Rate (%)

Q4 2023



Total Availability Rate (bps)

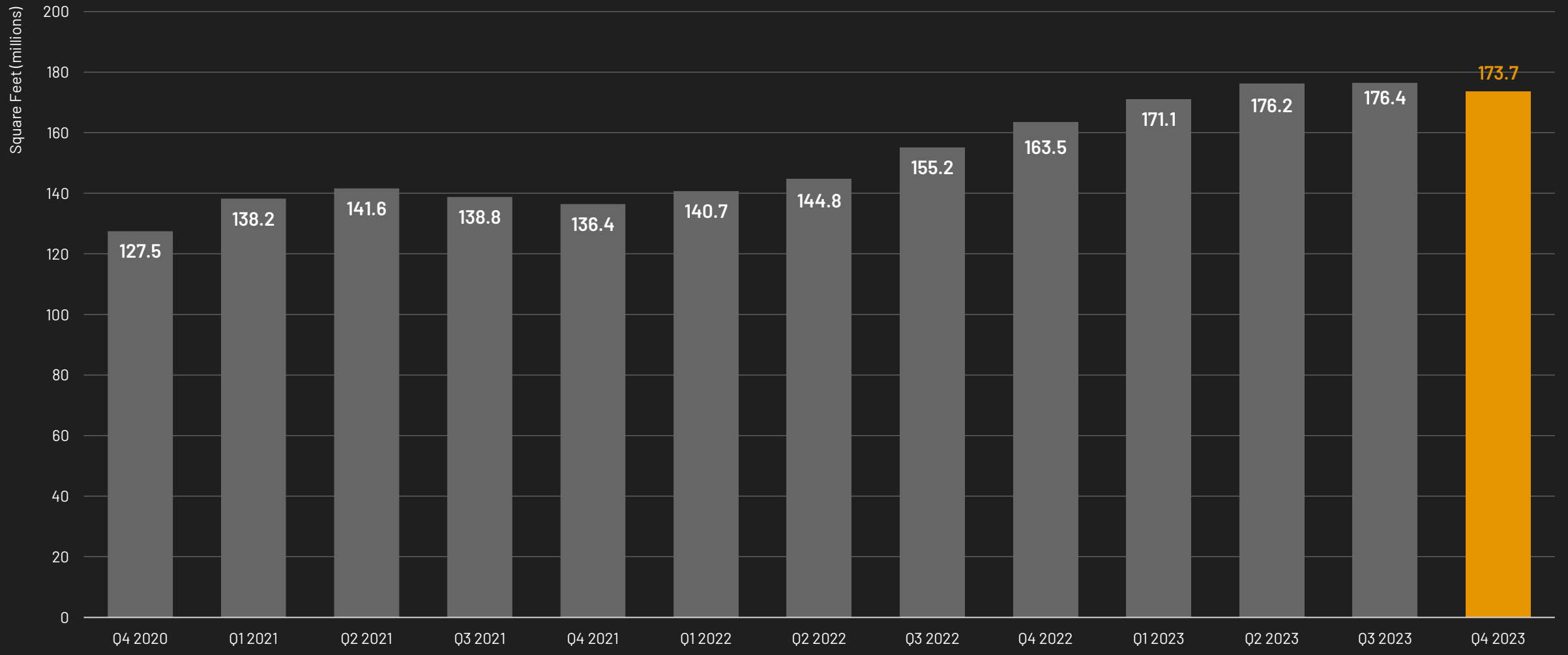
PANDEMIC CHANGE COMPARED TO Q4 2019



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

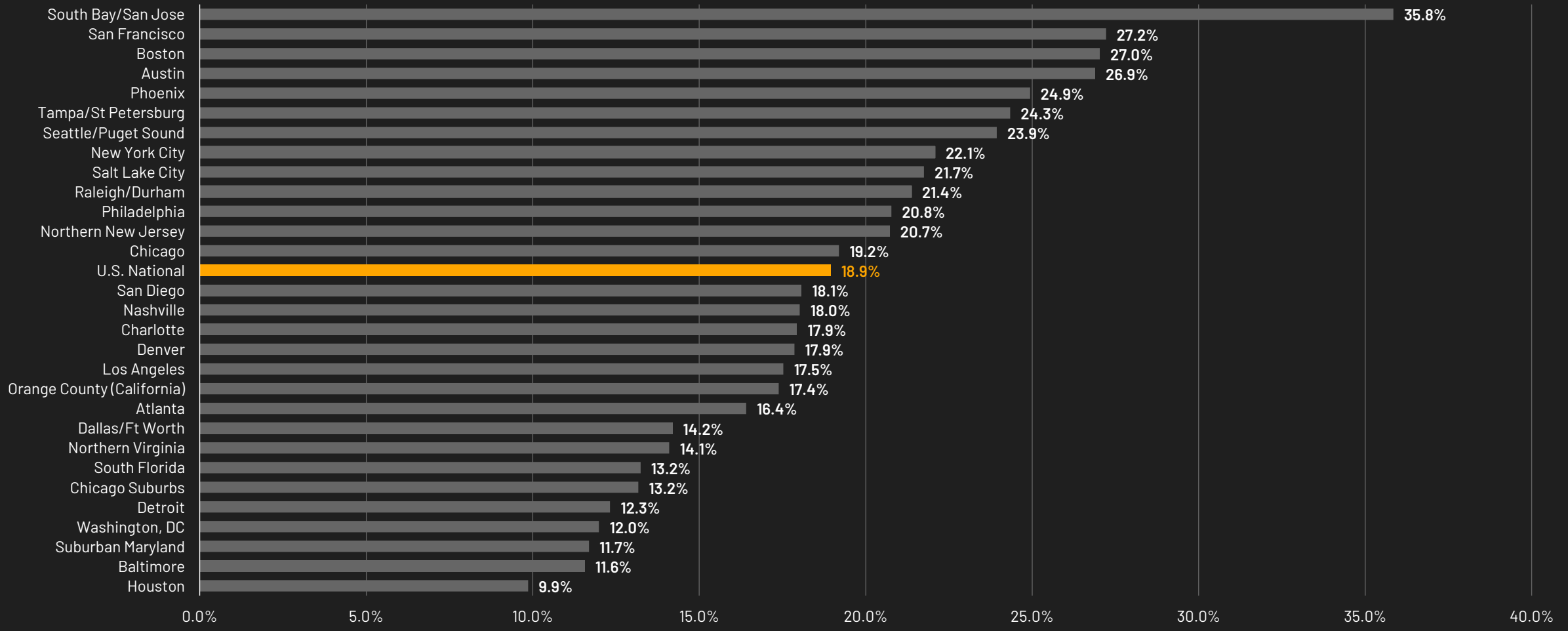
Sublease Space Down at Year-End But Remains Historically High

Total Available Sublease Space (msf)



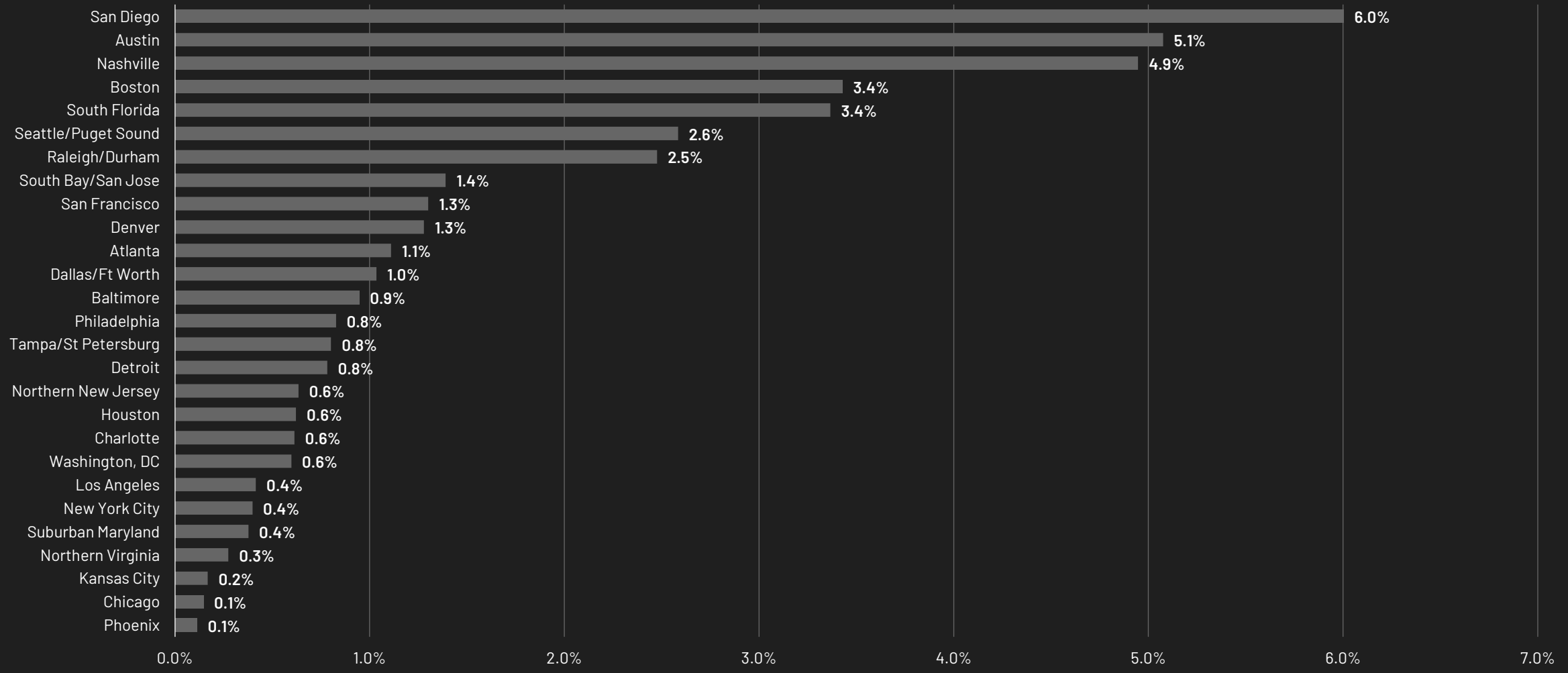
Sublease Space Glut is Most Pronounced in Tech-Centric Markets

Available Sublease Space as a % of Total Available Space by Market



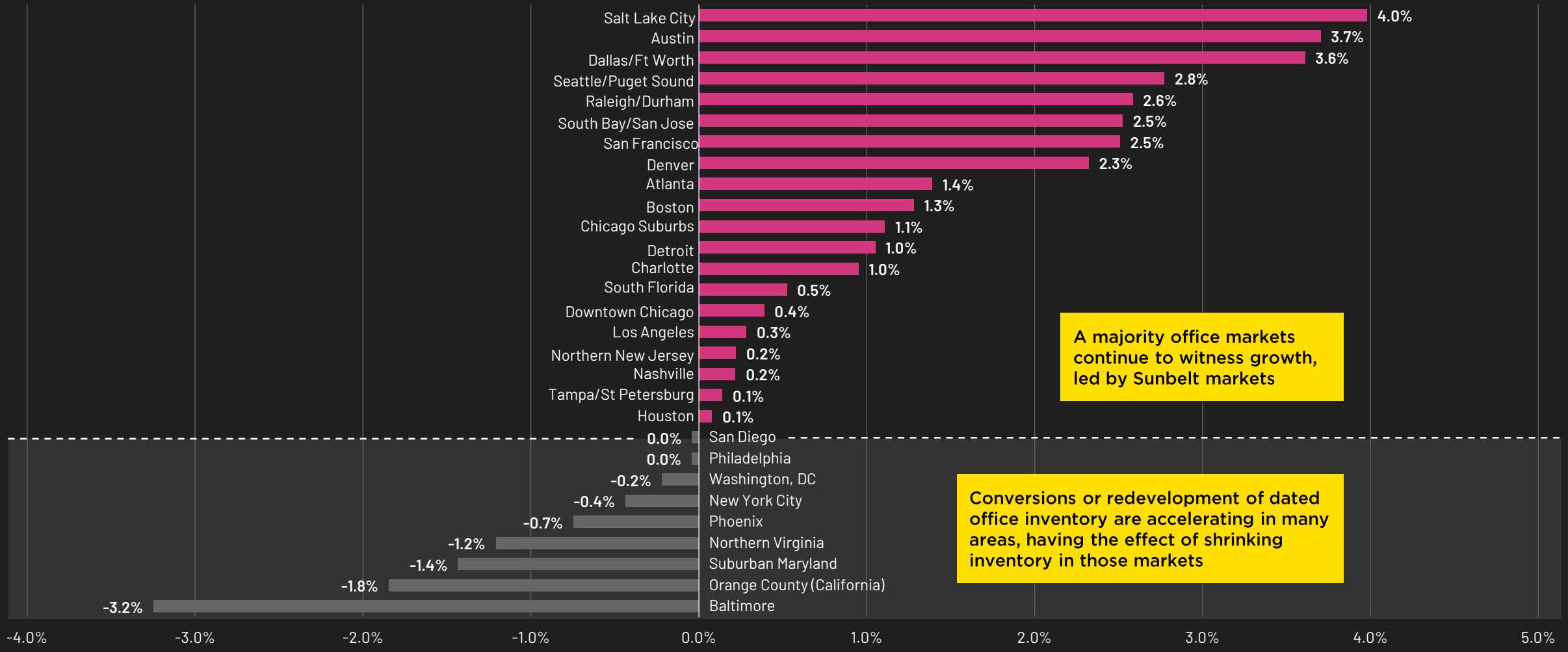
Oversupply Concerns Now Limited to Only a Few Markets

Office Square Footage Currently Under Construction as % of Inventory (100,000+ SF projects)



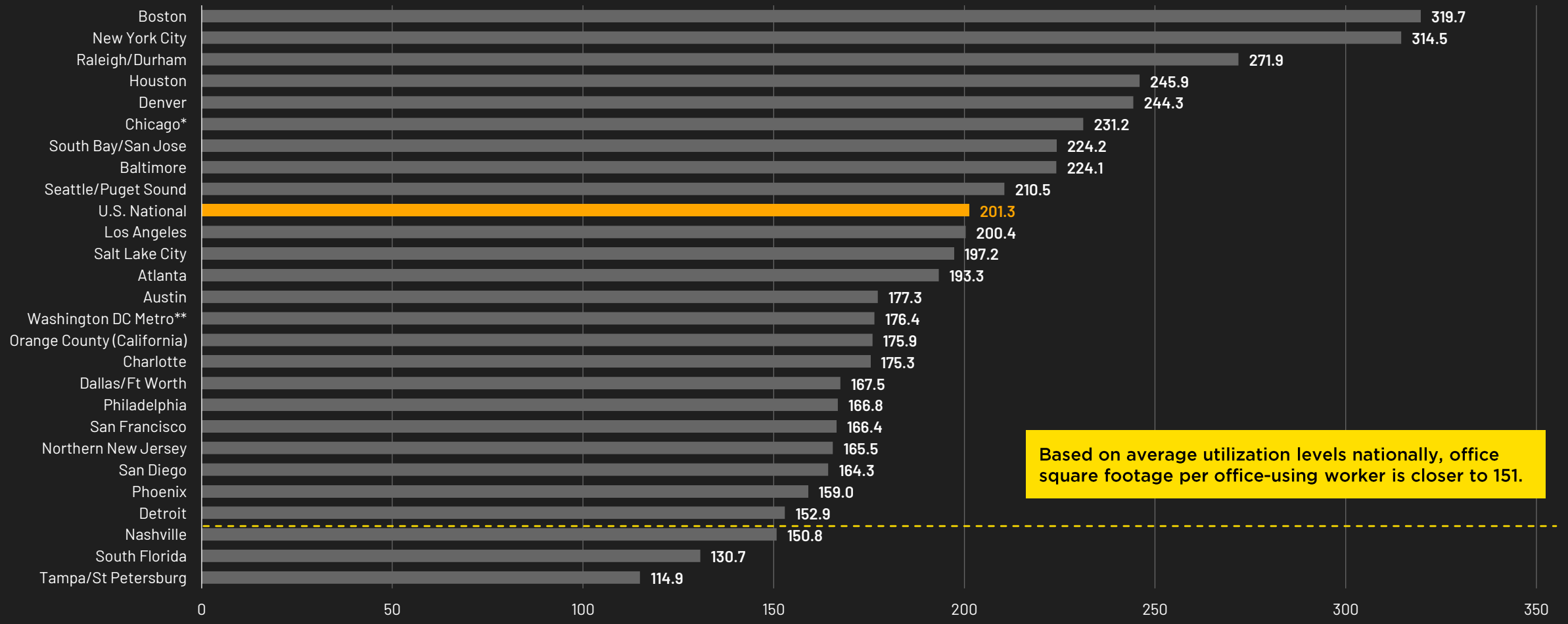
Office Inventory is Now Shrinking in Some Markets

% Inventory Change From Q4 2022 to Q4 2023



Office Markets are Now Mostly Oversupplied Compared to Demand

Office Square Footage Per Office-Using Worker by Market (sf)



*Downtown Chicago and Chicago Suburbs combined.

**Washington DC, Northern Virginia and Suburban Maryland Combined.

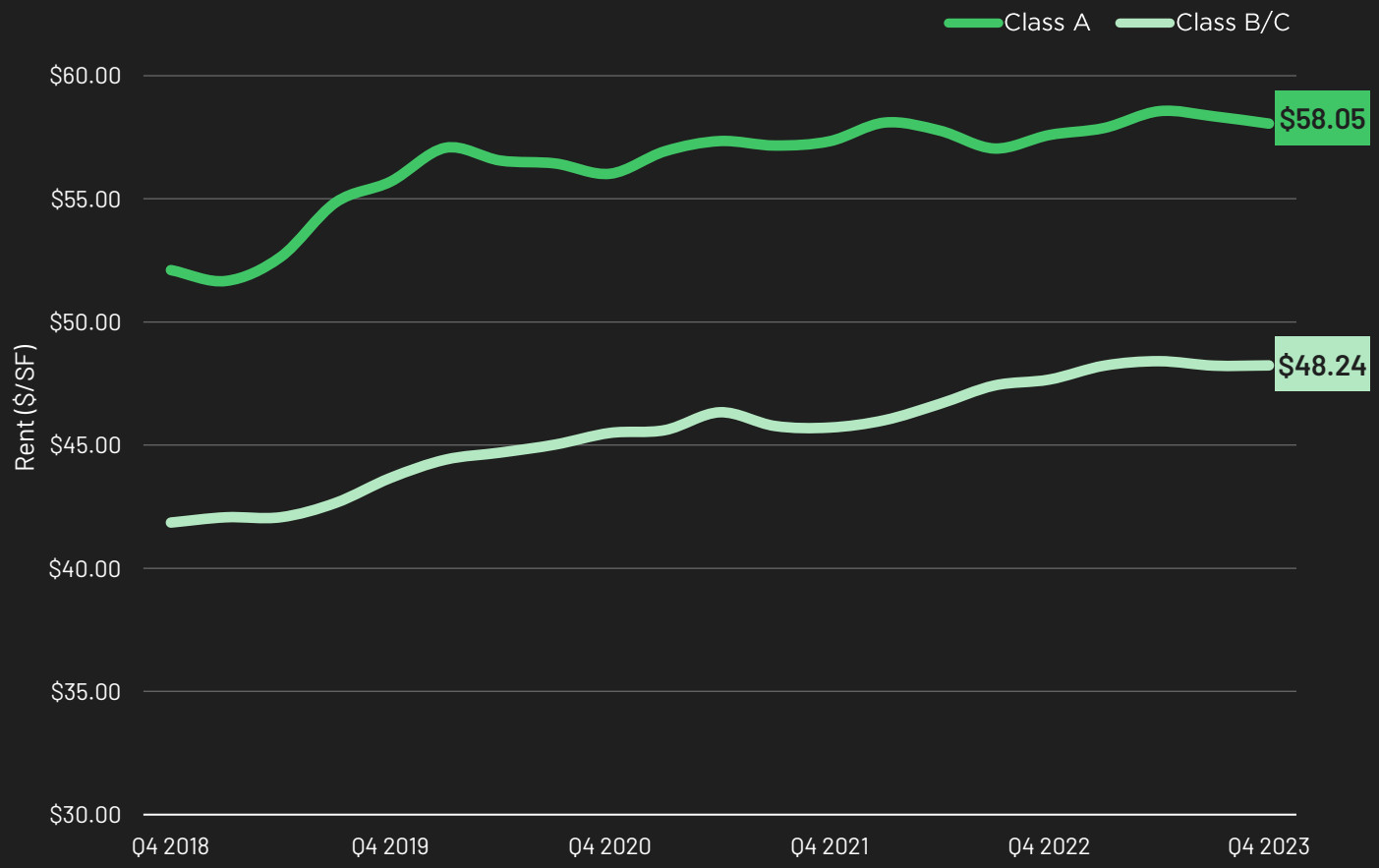
Little Change to Asking Rents as Owners Offer High Concessions

CBD Average Asking Rents – Class A vs Class B/C ($/sf)

Central Business Districts (CBDs) have not yet seen drastic repricing of asking rents with many owners **continuing to offer high concessions rather than dropping their face rents**

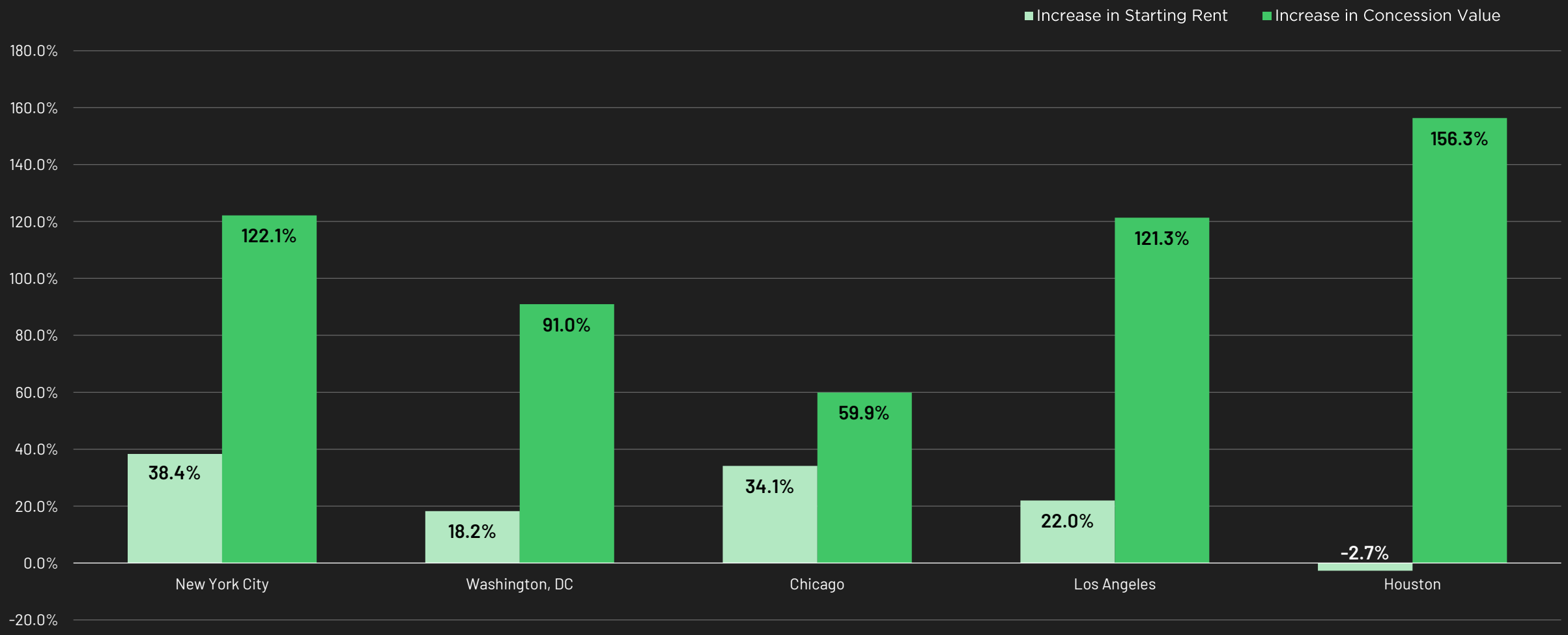
Flight-to-quality and active construction pipelines have contributed to stabilization of Class A rents – and **increasing at the very top of the market**

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**



Growth in Concession Values Have Outpaced Growth in Starting Rents

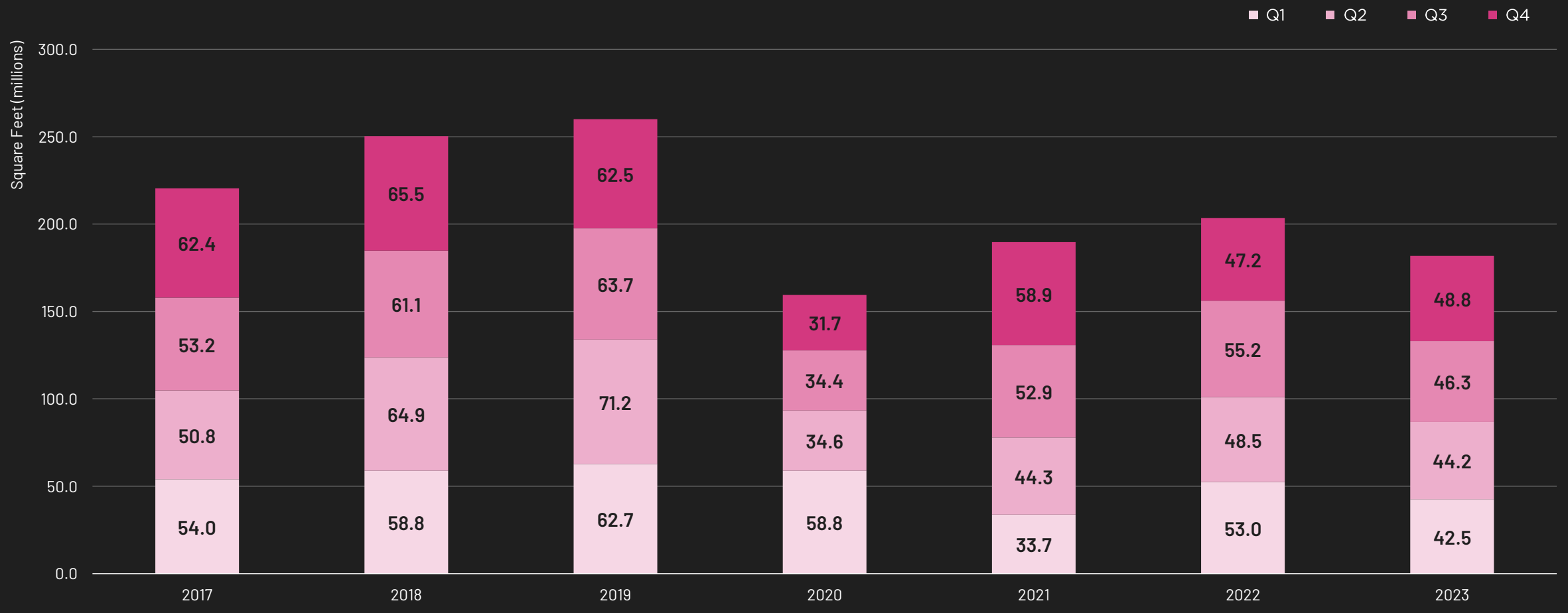
Class A New Long-Term Leases in Select Markets (2013-2023)



Source: Compstak Analytics

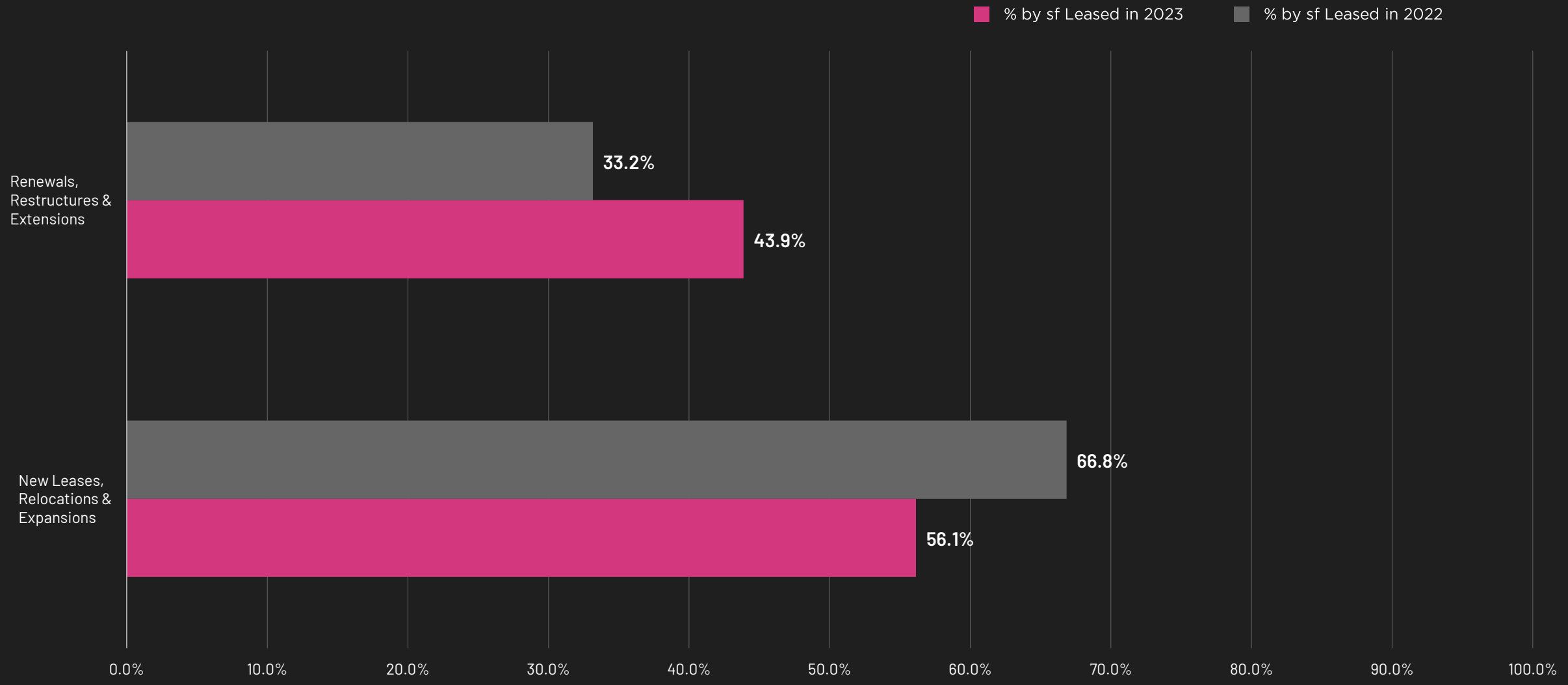
Leasing Activity Slowed in 2023 and was Lower than 2021 and 2022

Total Leasing Activity (msf)



Economic Uncertainty Has Cooled Demand for New Space in 2023

Lease Transactions 20,000+ sf



Largest Office Lease Transactions in 2023

TENANT	INDUSTRY	MARKET	BUILDING	SIZE (SF)	LEASE TYPE	QUARTER LEASED
IBM	TAMI	Raleigh	4205 S Miami Boulevard	774,000	Sale - Leaseback	Q4 2023
Paul Weiss	Legal Services	New York City	1345 Avenue of the Americas	765,931	Relocation	Q4 2023
Walmart	Retail	South Bay/San Jose	1275, 1345, 1375 & 1395 Crossman Avenue	718,651	Sublease	Q4 2023
Davis Polk	Legal Services	New York City	450 Lexington Avenue	710,000	Renewal and Expansion	Q3 2023
U.S. Securities and Exchange Commission	Government	Washington, DC	100 F Street NE	709,403	Extension	Q3 2023
ACS	Government	New York City	110 William Street	640,000	Relocation	Q2 2023
Bank of America	Financial Services	Northern New Jersey	525 Washington Boulevard	547,962	Renewal and Expansion	Q4 2023
DCAS NYC Administration for Children's Services	Government	New York City	150 William Street	530,000	Renewal	Q4 2023
OpenAI	TAMI	San Francisco	1455-1515 3rd Street	486,600	Sublease	Q4 2023
AMD	TAMI	Austin	7171 Southwest Parkway	443,987	Renewal	Q4 2023
New Jersey Transit	Government	Northern New Jersey	2 Gateway Center	407,173	Relocation	Q2 2023

Office Leasing Activity by Market

Total Leasing Activity 2022 vs 2023

Savills Leasing Momentum Meter
BY BUBBLE COLOR

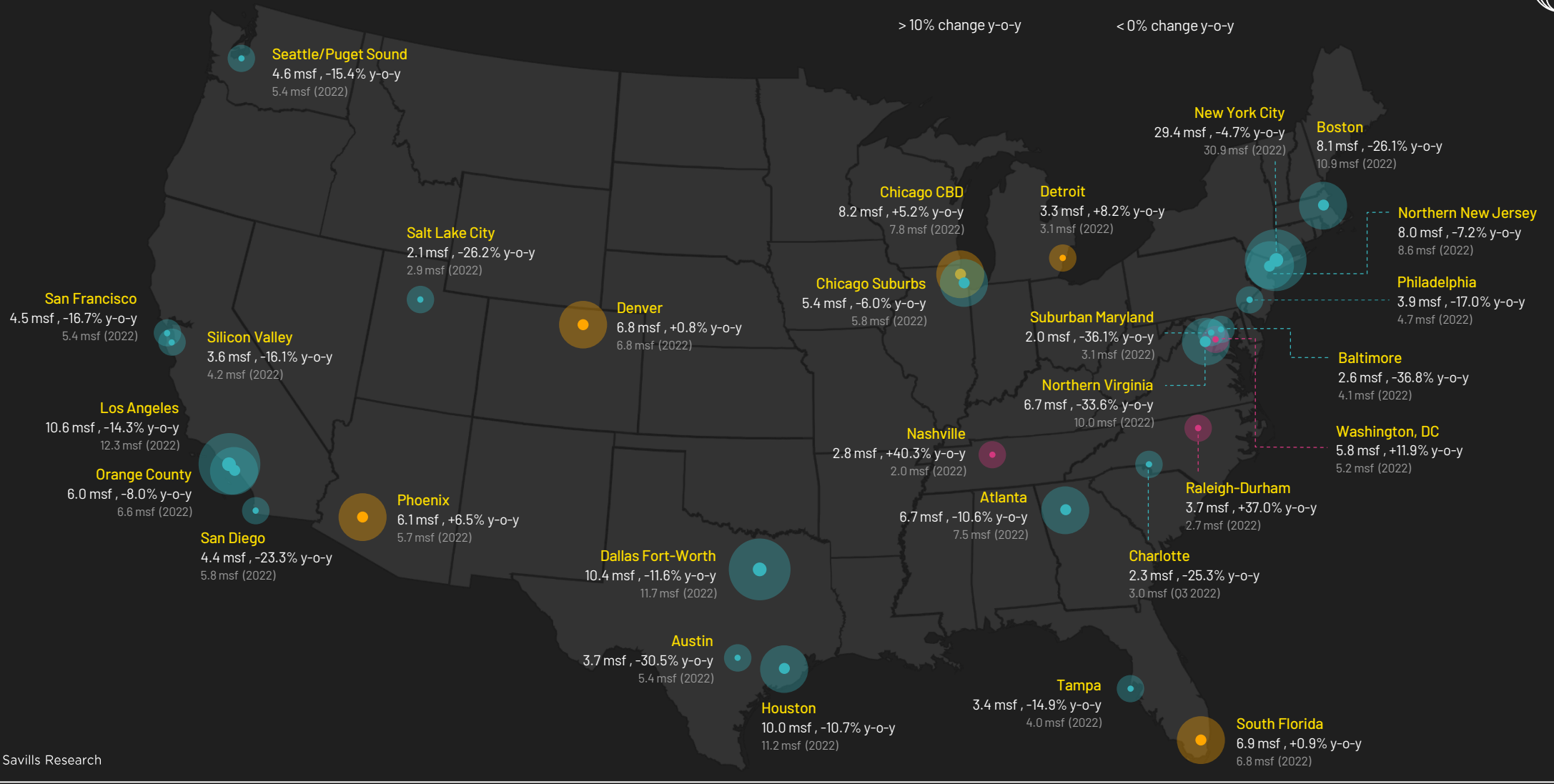
Rising | Stable | Falling

> 10% change y-o-y

< 0% change y-o-y

Trailing 4-Quarter Leasing
BY BUBBLE SIZE

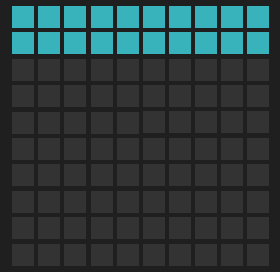
10+ msf
5-10 msf
0-5 msf



Source: Savills Research

TAMI Sector Leads Demand Despite Pullback From Large Tech Firms

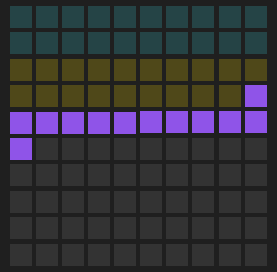
Total Leasing Activity 2023; 20,000+ sf



19.7% Technology, Advertising, Media & Information



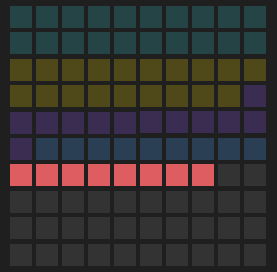
18.6% Financial Services and Insurance



11.8% Legal Services



9.3% Government



8.0% Professional & Business Services



5.4% Retail



4.2% Construction, Engineering and Architecture



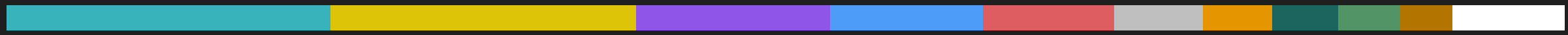
4.0% Energy



3.8% Healthcare



3.2% Manufacturing



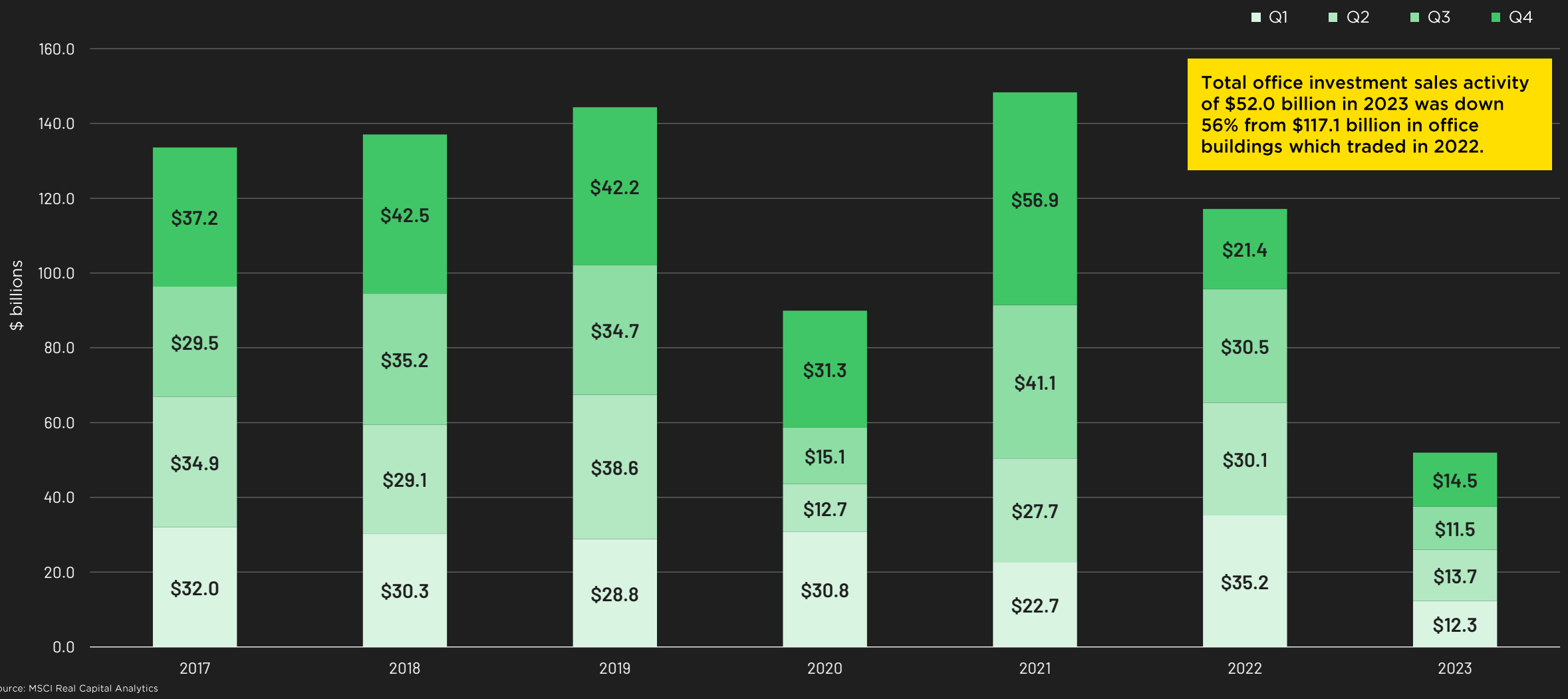
11.9% Other*

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

Office investment sales market has been largely frozen as cost of capital remains high and most investors wait on the sidelines for distressed opportunities

Investment Sales Activity Has Slowed Significantly in the Office Sector

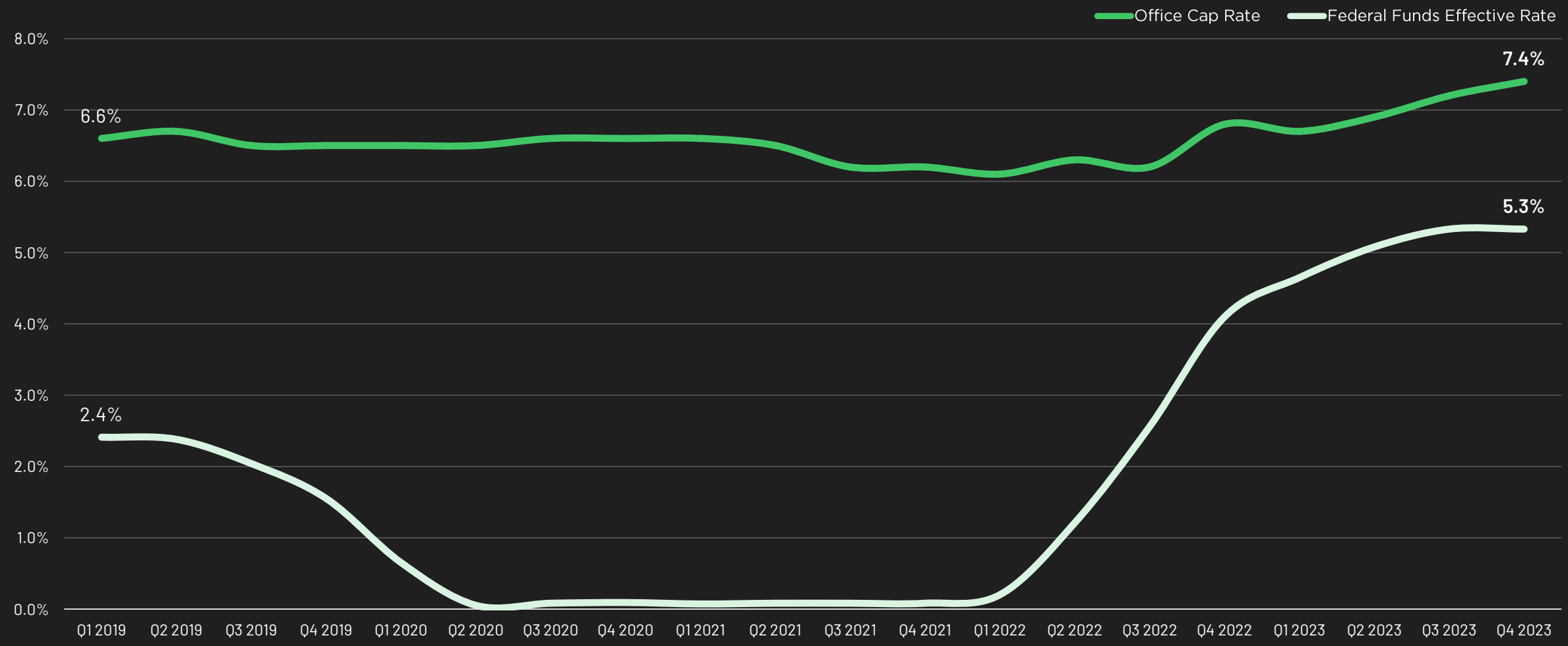
Total Office Property Sales Volume ($ billions)



Source: MSCI Real Capital Analytics

Office Cap Rates Have Increased as Interest Rates Have Increased

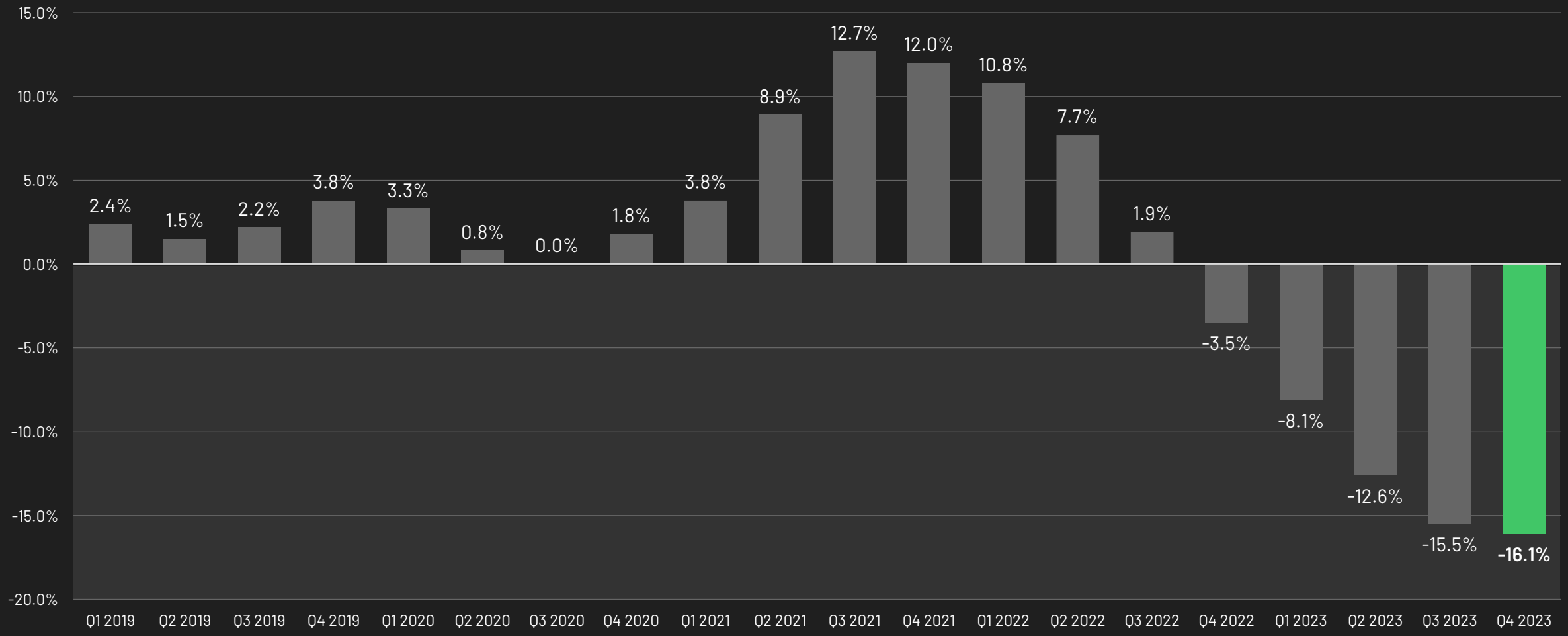
CBD and Suburban Office Average Cap Rate vs Federal Funds Effective Rate (%)



Source: MSCI Real Capital Analytics, Federal Reserve

Office Property Valuations Have Decreased and Continue to Drop

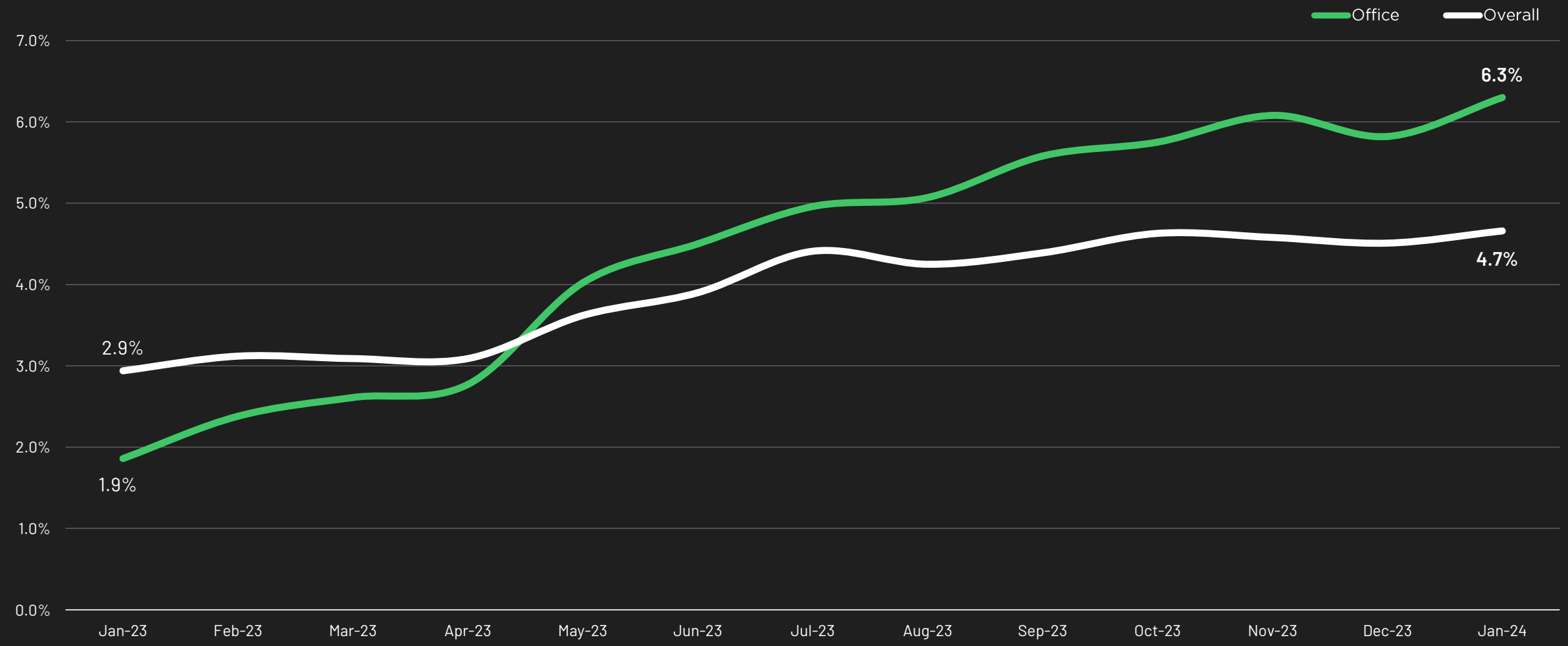
MSCI Real Capital Analytics Commercial Property Price Index (CPPI) – Year-over-Year Change (%) by Quarter



Source: MSCI Real Capital Analytics

CMBS Delinquency Rates Have Spiked in the New Year

Overall Delinquency vs Office Delinquency (%)

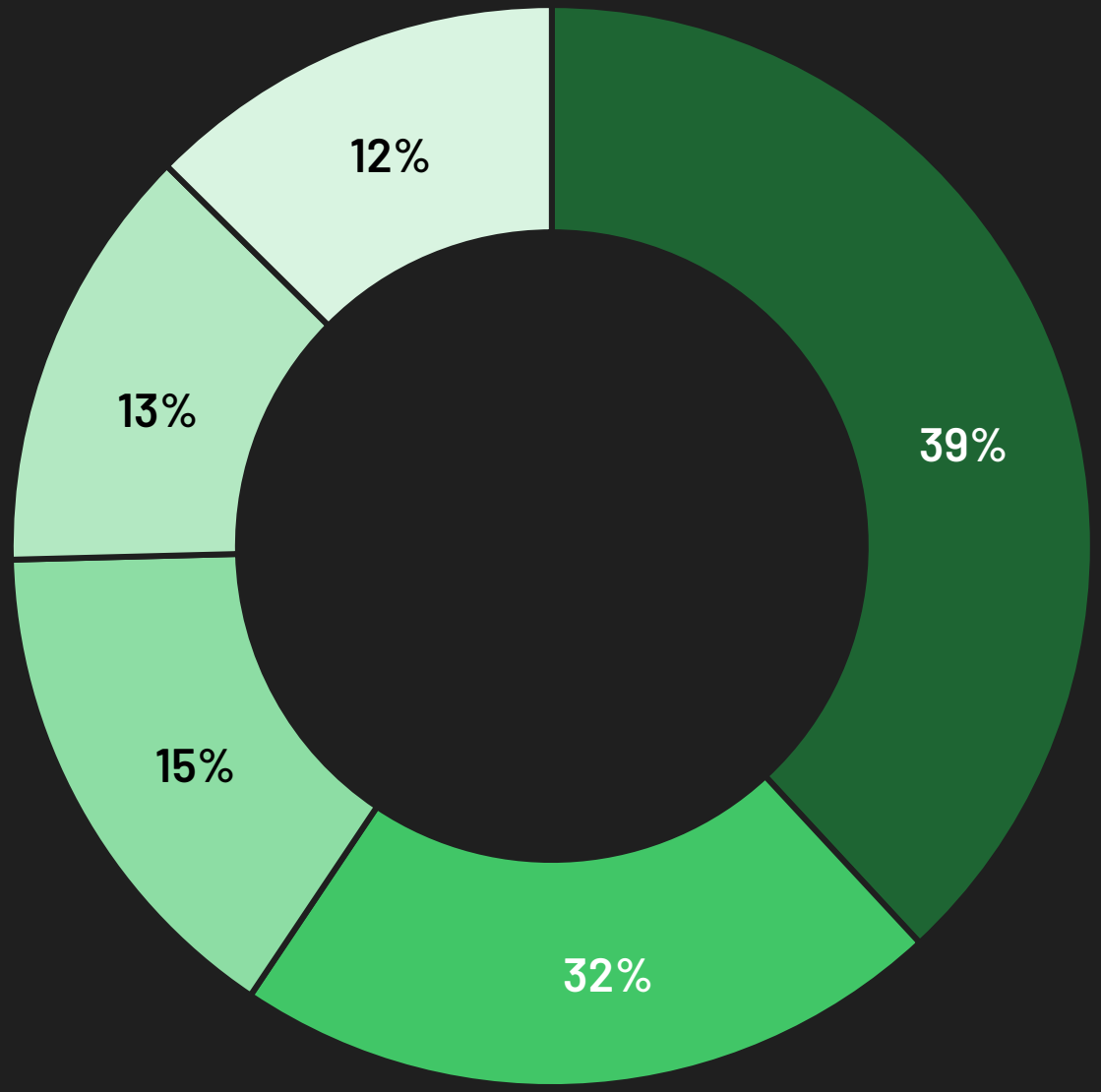


Source: Trepp

CMBS remains only 13% of Total Commercial/Multifamily Debt Outstanding

Est. $4.63 trillion

Commercial/Multifamily Debt Outstanding from Mortgage Bankers Association

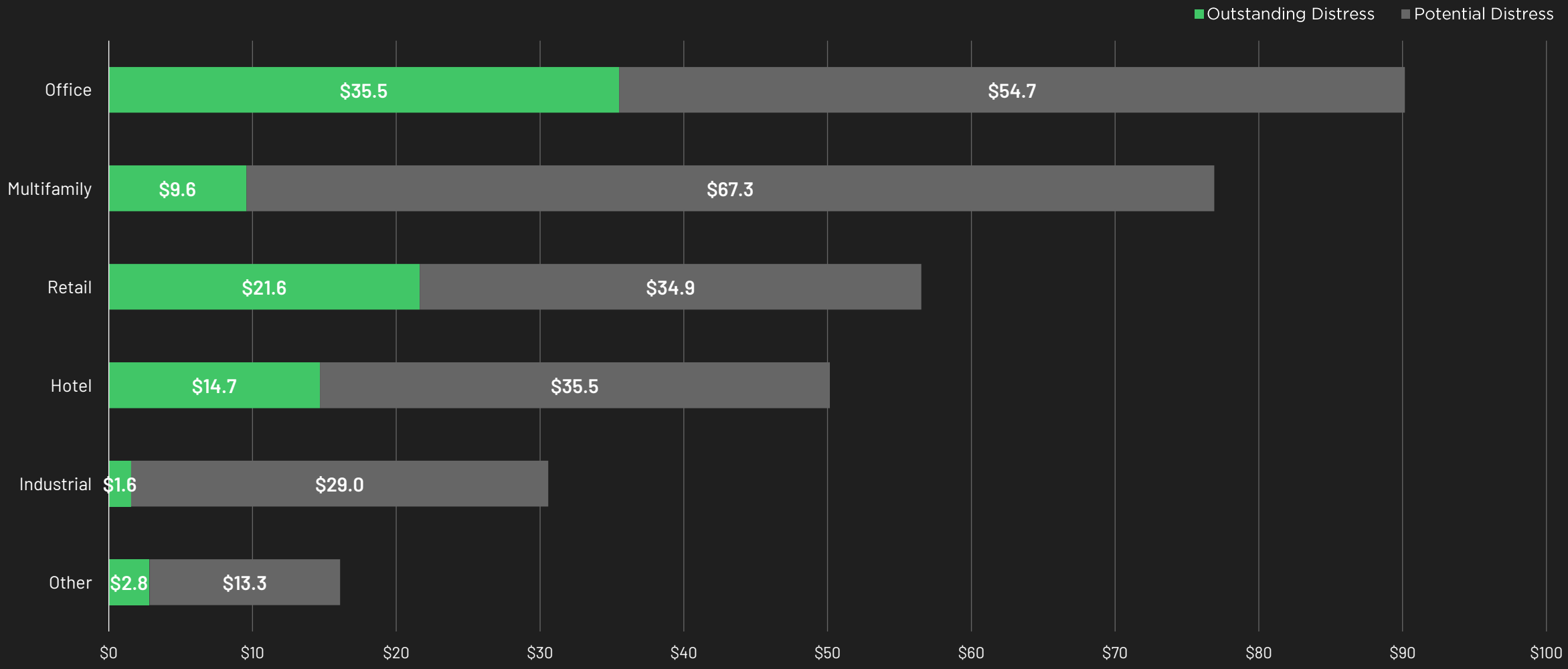


- Banks & Thrifts
- Agency and GSE Portfolios and MBS
- Life Insurance Companies
- CMBS, CDO and Other ABS Issues
- Others

Source: Mortgage Bankers Association

Commercial Property Loan Distress Led by Office and Multifamily Sectors

CMBS & Non-CMBS Cumulative Debt through Q4 2023 ($ billions)



Source: MSCI Real Capital Analytics

Commercial Real Estate Lending Environment Continues to Evolve as Occupiers with Superior Credit are in the Driver's Seat

High interest rates, falling valuations, soft market fundamentals

- Interest rates remain high as the Federal Reserve has signaled that rate cuts could be imminent in 2024
- Shift from historically low interest rate environment has led to increase in cap rates and decrease in property valuations
- Capital remains available but is expensive, especially as banks have pulled back on new lending
- Office property fundamentals remain soft despite higher Return to Office rates

Approximately $2.2 trillion in CRE loans will come due by 2027

- Through year-end 2023, $85.8 billion in commercial real estate loans are now distressed which is the highest level since 2013
- Office property loans comprise $35.5 billion or 41% of all commercial real estate loans which are currently distressed
- Another $54.7 billion in office loans have been identified as potentially distressed
- Expect more office building owners to give back their buildings to lenders in 2024

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
- Occupiers in a strong financial position with superior credit are in the driver's seat as landlords aggressively look to maintain and increase occupancy

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