Q4 2019
Office First Glance

Pre-Release Analysis of Fourth Quarter 2019 Moody's Analytics REIS Findings in the Office Sector

ANOTHER SLOW YEAR FOR OFFICE FUNDAMENTALS

Vacancies stayed flat in the fourth quarter of 2019 at 16.8%. This is, in a sense, reason to celebrate given that vacancies remained steady throughout 2019 at 16.8%. After bottoming in the low 16s in 2017, vacancies have in fact been on a slow, upward trend. There are many reasons for this previously discussed, from economic and demographic change, technological improvements that allow people to work remotely, and shifts in the usage intensity of office space. But the net result is that fundamentals have been lackluster for most of this economic recovery period.

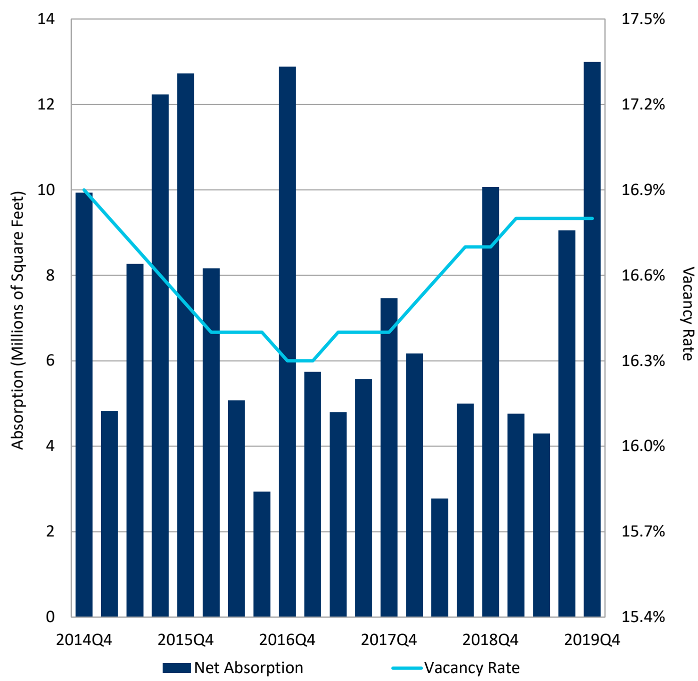
Net absorption came in at a robust 13.0 million SF in the fourth quarter: the strongest quarterly absorption figure seen since the third quarter of 2007. This comes over a base of new completions that added up to 13.7 million SF. Comparatively speaking, this is higher than last quarter's figure of 11.8 million SF, and the average quarterly figure in 2018 of 12.3 million SF. This quarter's figure still falls short of the 14.7 million SF of office space added in the fourth quarter of 2018, which marked the recent high watermark for construction and deliveries since 2009.

RENT GROWTH SIMILARLY SLOW

Asking and effective rent growth were muted, registering at 0.5% and 0.6% this quarter – similar to growth seen in previous quarters. For the year, asking and effective rents increased by 2.6% and 2.7%, respectively, also in line with 2018 calendar year figures, and well below the 3.4% and 3.6% growth rates that the sector posted in 2015, a year that marks this property type's cyclical peak in terms of rent growth.

The relatively slow performance of rents and vacancies in the office sector does not mean that development and space uptake has been slow everywhere. These numbers focus on single- and multi-tenant office space for rent at market rates. Tens of millions of square feet of this type of office

OFFICE NET ABSORPTION AND VACANCY



space have in fact been converted for use as other, newer types of 'office' – medical office, for example. Similarly, owner occupied office properties – typically occupied by firms like Google in industries like tech that continue to perform well and hire more people – always make the news in terms of space uptake in certain markets. Proponents of the view that 'demand for office is doing fine' mention that Google has been expanding its presence in New York City, now operating out of three spaces in Manhattan.* But their main headquarters, all 2.8 million SF of it, is owner-occupied, and therefore does not affect market rate rental statistics.

Absorption was positive in 61 out of REIS' top 82 markets,

* "Inside Google's Massive NYC Expansion," Michael Scotto for NY1, September 17, 2019. https://www.ny1.com/nyc/all-boroughs/news/2019/09/16/inside-google-s-massive-nyc-expansion

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with occupancy improving in 38—up from 37 last quarter. Effective rents rose in a majority of markets (73 out of 82), but as discussed—the absolute numbers for rent growths were far from spectacular, and summed up to only 0.6% for the aggregate national figure.

MARKET HIGHLIGHTS

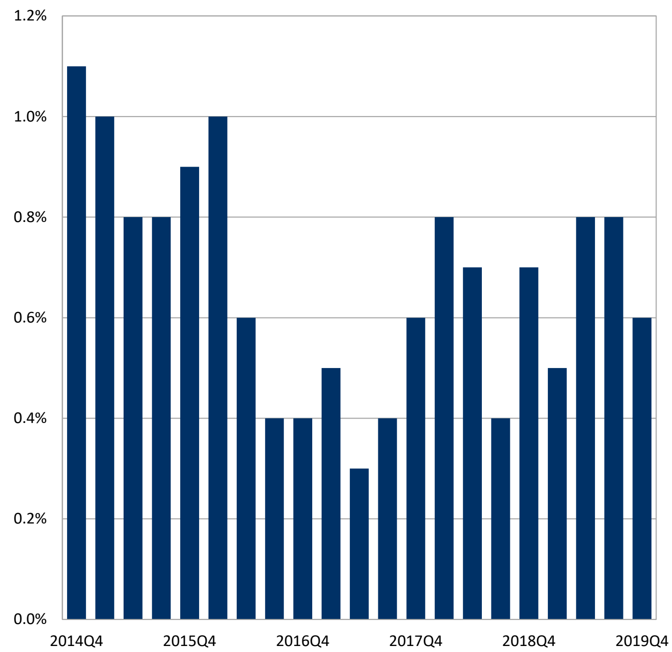
Only 23 of 79 metros saw a vacancy rate increase, down from 35 in the previous quarter. Those with the highest vacancy rate increase include Louisville, Oklahoma City, Greenville, Little Rock and San Antonio. Metros that saw the biggest decline in vacancy include New Haven, Suburban Maryland, Tampa-St. Petersburg, San Bernardino/Riverside and Columbus.

Rent growth was better than in previous quarters as 12 metros saw rent growth of 1.0% or more, led by Seattle, Austin, Denver, Phoenix and Raleigh-Durham – all of which had rent growth of 1.3% to 1.9% in the fourth quarter. At the same time, only six metros posted a small (0.1% - 0.2%) effective rent decline in the quarter including Tacoma, San Antonio, Rochester, Oklahoma City and Milwaukee.

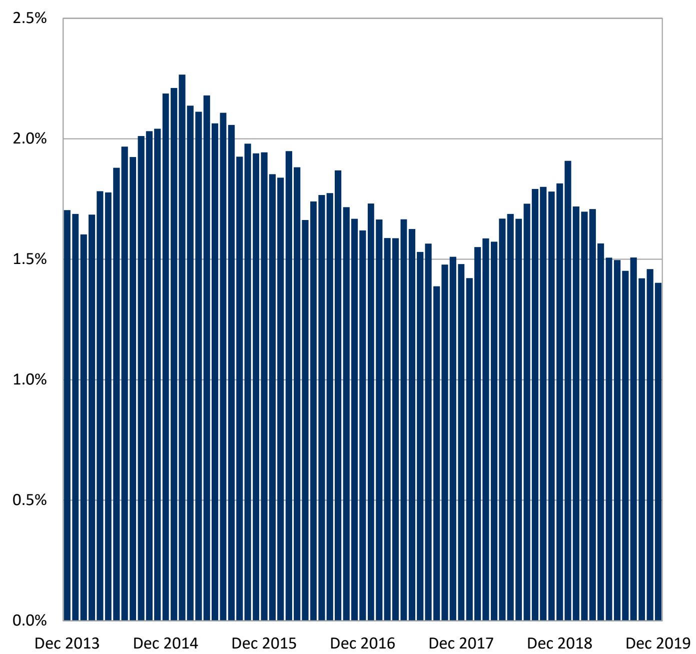
At 8.1%, New York City saw a slight (+0.1%) increase in vacancy; New York's average effective rent was flat in the fourth quarter at $62.44 per SF, up 2.8% over 2018. Still, two new buildings were completed in the quarter: newly renovated 1271 Avenue of the Americas was added back to the inventory (2.1 million SF) and Hudson Quarters at 441 Ninth Avenue was added as well (700,000 SF). Separately, Queens saw the addition of the Jacx building at 28-07 Jackson Avenue and Brooklyn added two buildings.

Chicago led completions in the fourth quarter and saw the addition of the Old Post Office building at 433 Van Buren Street (2.4 million SF) along with 333 N Green Street (583,400 SF). Chicago's vacancy declined 0.2% to 17.5% while its effective rent growth for the quarter was 0.4% and for the year was 2.5%. Metros that posted the highest effective rent growth for the year include Seattle, Austin, Denver, Charlotte and Raleigh-Durham – all of which saw growth rates of 4.2%

OFFICE EFFECTIVE RENT GROWTH



12-MONTH CHANGE IN EMPLOYMENT



Source: Bureau of Labor Statistics

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to 6.2%. Markets with the weakest growth include Milwaukee (-0.9%), Chattanooga (-0.2%), Hartford (+0.1%), Rochester (+0.2%) and Tacoma (+0.3%).

These numbers are only loosely consistent with office employment growth for the year as Orlando, San Francisco, Salt Lake City, Dallas and San Jose led job growth with rates of 3.9% to 5.3%. However, 20 metros registered a decline in office jobs for the year including Long Island, Columbia, Rochester, Dayton and Tulsa that had job declines of 1.4% to 3.7%.

OFFICE OUTLOOK

With the US economy expected to have grown at barely 2.0% this year – a slowdown relative to last year's 2.9% - it should not be a surprise that trends in office fundamentals have been flat. The good news is that the risk of a recession for 2020 appears to have receded, or at least that is what prognosticators often say at the start of the year, pushing recession forecasts 18 months out. With that said, we should not expect an acceleration or improvement in office rent growth and vacancies for the coming year.

Fourth Quarter 2019 Market Performance

Improving Fundamentals / Flat or Declining Fundamentals

	Absorption		Occupancy		Effective Rent	
Q4 2019	61 +	21	38 ↑	44	73 ↑	9
Q3 2019	54 +	28	37 ↑	45	77 ↑	5
Q2 2019	46 +	36	26 ↑	56	71 ↑	11
Q1 2019	50 +	32	38 ↑	44	65 ↑	17
Q4 2018	50 +	32	32 ↑	50	74 ↑	8

Figures are based on 82 metro markets

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