Office First Glance

Pre-Release Analysis of First Quarter 2019 Reis Findings in the Office Sector

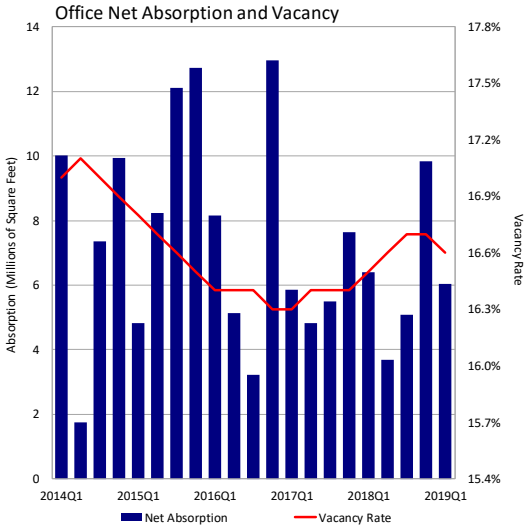
2019 Quarter 1

Victor Calanog PhD
Chief Economist &
Senior Vice President

New York — April 15, 2019

Some Improvement, But Mostly A Lot of Flatness

Vacancies fell by 10 basis points in the first quarter of 2019, ending the period at 16.6%. This provides no evidence of an inflection point (vacancies have been creeping upwards since mid-2017), and nor do we expect an accelerated, or even sustained drop in vacancies over the next couple of years. The various forces that have dampened demand for office space since the recession officially ended in mid-2009 are still in play, and may gain greater ground given slower GDP growth this year.



Consistent with the general theme of flat fundamentals, net absorption came in at just slightly over 6 million SF in the first quarter: right in line with quarterly patterns over the previous two years, over a modest base of new completions that clocked in at just 3.77 million SF. "Modest" is a bit of an understatement: this is the lowest figure for new deliveries of single– and multi-tenant market rate office space in six years, underscoring the overall lack of developer enthusiasm for this property type.

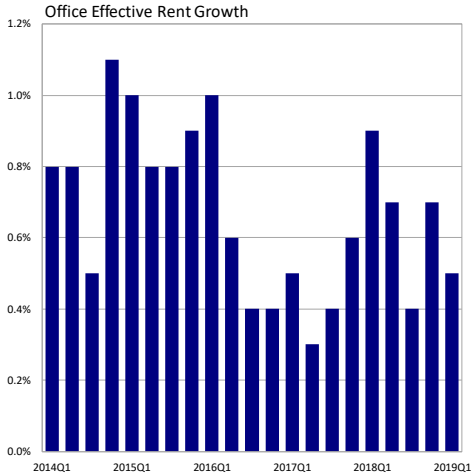
Developers Are Rational

With vacancies hovering at just 100 basis points below its cyclical peak of 17.6% in late 2010, there isn't much to excite builders. Asking and effective rent growth have been similarly muted, registering at only 0.4% and 0.5%, respectively.

On a year over year basis, asking and effective rents increased by 2.2% and 2.3%, respectively, which is right 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 may well mark this property type's cyclical peak in terms of rent growth.

With vacancies mostly flat and rent growth in the low to mid-2s, it is no wonder that there hasn't been much of a building boom for office properties over the last nine years.

To be fair, the office sector has been struggling to cope with longer term trends that appear to be prompting employers to rethink their need for office space (and what type). The rise of industries driven by technology and social media suggest that traditional office space formats, which tended to require more space, need to be reevaluated: perhaps less space for actual office equipment, and more space for amenities that younger employees find desirable. The development of technology that allows workers to do their jobs remotely also bolsters the argument that perhaps employers don't need to lease as much office space. Companies like WeWork position themselves at the forefront of "the new office space," catering to "the gig economy" as it evolves—some statistics show that WeWork is now the biggest office tenant in cities like New York, London, and Shanghai. But time will tell which format and offering will prevail. In the meantime, the rate at which office space was built from 2003 to 2008 was about half that from 1997 to 2002, and it has slowed further in the current period of economic expansion.



First Quarter 2019 Market Performance Improving Fundamentals / Flat or Declining Fundamentals						
	Absorption		Occupancy		Effective Rent	
Q1 2019	51 +	31	43↑	39	65↑	17
Q4 2018	50 +	32	31↑	51	74↑	8
Q3 2018	47 +	35	23↑	59	70↑	12
Q2 2018	41 +	41	24↑	58	77↑	5
Q1 2018	42 +	40	28↑	54	76↑	6

Figures are based on 82 metro markets.

Absorption was positive in 51 out of Reis's top 82 markets, with occupancy improving in 43. Effective rents rose in a majority of markets (65 out of 82), but as discussed—the absolute numbers for rent growths were far from spectacular, and summed up to only 0.5% for the aggregate national figure.

Market Highlights

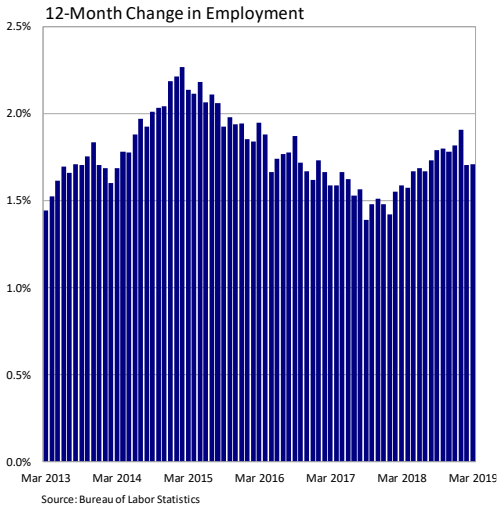
The gap between healthier metros and weaker ones has widened over the last few years. Metros with the highest vacancy rate increase include Tacoma, Ventura County, Charleston, Tulsa and Columbus. Oddly enough, some of these metros have seen healthy office employment growth including Charleston and Tacoma. Metros that saw the biggest decline in vacancy include Wichita, Fort Lauderdale, Knoxville, Albuquerque and Louisville.

Rent growth was also weak in the quarter as only four metros saw an increase in effective rent of 1.0% or more: Tampa-St. Petersburg, Charlotte, Colorado Springs and Sacramento. Thirteen metros posted an effective rent decline in the quarter including Milwaukee, Chattanooga, Syracuse, Columbus and Tucson.

After adding 4.8 million SF of new inventory in 2018, New York City (Manhattan) saw no added inventory in the first quarter, but net absorption was 768,000 SF. New York still boasts the lowest office vacancy rate of 8.1% and highest effective rent of $61.10 per square foot that grew 2.1% over Q1 2018. Separately, Brooklyn saw 30,000 SF of new inventory – all of which was pre-leased. The vacancy rate fell 1% to 11%, it had climbed to 12% in 2018 with the addition of just over 1 million SF of new inventory. The vacancy rate in Queens increased 0.2% to 9.2%. The average rent fell 0.2% in Queens but was flat in Brooklyn.

Office Outlook

The US economy grew at a relatively healthy 2.9% in 2018, posting the highest GDP growth rate since 2014, and fueled mostly by tax cuts that spurred business investment. While that resulted in a slight uptick in job creation, it did not manifest in much stronger office fundamentals.



It is widely expected that GDP growth will slow in 2019 to 2.1% to 2.2%, as benefits from fiscal stimuli fade. Reis expects to see a moderation in economic fundamentals—not an economic contraction—but that still means that we will likely see a whole lot of flatness, and a relative lack of building activity and rent growth, in this somewhat beleaguered property type.