RESEARCH **2Q 2020**

Newmark Knight Frank

# NATIONAL OFFICE MARKET

## PANDEMIC WEAKENS DEMAND DURING SECOND QUARTER

The U.S. office market slowed materially during the second quarter of 2020 as the economic downturn precipitated by the COVID-19 pandemic softened demand for space. Absorption was negative for the second consecutive quarter after 39 straight quarters of positive net demand; the nation saw occupancy decline by 11.1 million square feet during the second quarter of 2020. Asking rents are 3.5% higher than at the second quarter of 2019, driven in part by deliveries of top-quality product, but asking rent growth is now plateauing and concessions are placing downward pressure on effective rents. Vacancy increased 40 basis points over the past 12 months, and approximately 6.9 million square feet of new product delivered during the second quarter of 2020. The amount of space under construction reached a new cyclical high and presents a challenge for asset owners in the year ahead. However, the duration of the pandemic and the speed of an economic recovery, rather than the construction pipeline, will be the greatest influences on market conditions during the balance of 2020 and into 2021.

## ABSORPTION DECLINES MATERIALLY

Absorption was negative 11.1 million square feet during the second quarter of 2020, down from 10.2 million square feet of positive absorption during the second quarter of 2019. During the second quarter of 2020, absorption was negative in 36 of the 56 markets tracked by Newmark Knight Frank. The largest losses in the nation were seen in some of the largest markets, including San Francisco, where tenants moved out of more than 3.0 million square feet. The New York metro area registered notable negative absorption as well, as tenants moved out of almost 1.6 million square feet in New Jersey Northern and 1.4 million square feet in Manhattan. Houston, Boston and Dallas each registered negative absorption of greater than 800,000 square feet as well. Minneapolis, Raleigh/Durham, and Chicago were among the markets where absorption remained positive, as each registered more than 400,000 square feet of occupancy gains.

San Francisco saw the second-highest amount of square feet delivered in the nation, eclipsing 1.0 million square feet. This, combined with the nation's largest negative absorption of more than 3.0 million square feet, led to vacancy increasing by more than 440 basis points over the past year, to 7.6%. Some large tech tenants have announced expanded remote work options for employees, which may materially impact office footprints downtown in the months and years ahead. Conversely, nearby Silicon Valley's office vacancy rate remains 60 basis points lower than it was a year ago.

## ASKING RENTS ARE PLATEAUING

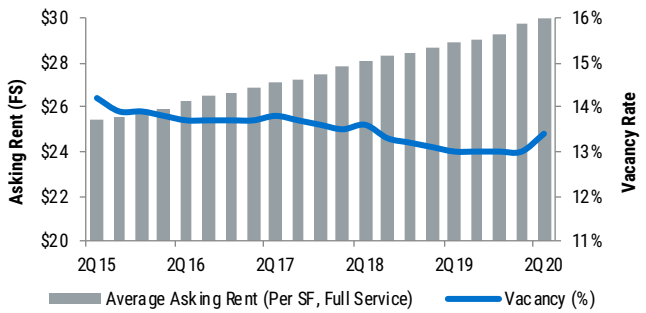
Quarterly rental rate growth has slowed since reaching a cyclical peak of 3.8% during the fourth quarter of 2015. The average asking rent across the U.S. ended the second quarter of 2020 at $29.94/SF gross full service, an increase of 3.5% over the past year. However, asking rent growth was only 0.7% over the past three months, driven by deliveries of top-quality space but restrained by weakening demand. Many asset owners are choosing to maintain face rates and instead use concessions as the main vehicle for meeting tenant requirements on overall occupancy costs.

## CURRENT CONDITIONS

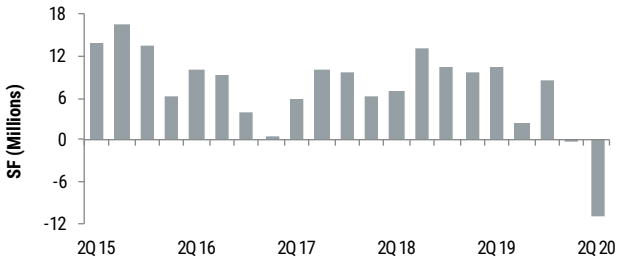
- Office absorption was down significantly in the second quarter of 2020 compared with the same period in 2019.
- The vacancy rate of 13.4% increased 40 basis points from one year ago.
- The average asking rent rose by 3.5% over the past year but is plateauing in response to weakened demand.
- The construction pipeline reached a new cyclical peak during the second quarter of 2020, at 102.8 million square feet.

## MARKET ANALYSIS

### Asking Rent and Vacancy Rate




### Net Absorption




## MARKET SUMMARY

| | Current Quarter | Prior Quarter | Year Ago Period | 12-Month Forecast |
|---|---|---|---|---|
| Total Inventory (SF) | 4.9 B | 4.9 B | 4.9 B | ↑ |
| Vacancy Rate | 13.4% | 13.0% | 13.0% | ↑ |
| Quarterly Net Absorption (SF) | -11.1 M | -0.4 M | 10.2 M | ↓ |
| Average Asking Rent | $29.94 | $29.72 | $28.93 | ↓ |
| Under Construction (SF) | 102.8 M | 96.8 M | 95.0 M | ↓ |
| Deliveries (SF) | 6.9 M | 9.5 M | 12.8 M | ↑ |

## VACANCY RISES DURING SECOND QUARTER

The vacancy rate increased 40 basis points over the past year to 13.4%. Manhattan (6.0%), Orlando (6.5%) and Seattle (6.9%) have maintained some of the lowest vacancy rates in the nation, notwithstanding new challenges to demand brought about by the pandemic. Two southwestern markets recorded the highest vacancy rates in the nation, with Oklahoma City at 27.1% and Houston at 22.4%. These markets traditionally maintain higher-than-average vacancy rates because of the availability of land.

Markets experiencing an annual decline in vacancy include New Jersey Southern, which saw vacancy decline 201 basis points to 15.7%, and New Jersey Northern, which saw a decline of 124 basis points to 16.7%. Additionally, Las Vegas saw a decline of 120 basis points to 12.6%. San Francisco saw the largest annual increase in vacancy, as the market's rate rose 443 basis points to 7.6%, followed by Austin, where vacancy increased 300 basis points to 12.3%.

## CONSTRUCTION PIPELINE AT CYCLICAL PEAK

The office construction pipeline totals a robust 102.8 million square feet. In the pre-COVID economy, tenants demonstrated strong interest in new, efficient trophy projects, but backfilling older, obsolete space was a challenge across the country. In the period ahead, the robust pipeline may result in oversupply due to a temporary pause in demand. More determinative of long-term positioning for new inventory will be how well the floor plans can accommodate new tenant preferences regarding privacy and less dense environments. Employers will need to consider new ways to protect their workers from the spread of disease once those employees return to an office setting.

Overall, U.S. office construction has remained under control and equals 2.1% of standing inventory, which should support the market's rebound once the pandemic is contained. However, some markets exceed this threshold and warrant monitoring, including Charlotte, Seattle, Salt Lake City, and Raleigh/Durham. In all of these markets, the construction pipeline exceeds 6.0% as a share of total standing inventory. Groundbreakings without substantial preleasing are likely to decline materially over the next year as developers reassess tenants' need for space and consider which designs will be most appealing in this new environment. Outdoor amenities are particularly likely to draw attention from tenants in need of space.

The national development pipeline has a number of significant projects underway including One Vanderbilt, located at 1 Vanderbilt Avenue in the Grand Central submarket of Manhattan. It will be a 73-story, 1.67 million-square-foot building that will deliver in the second half of 2020 and will include tenants such as The Carlyle Group and Greenberg Traurig LLP. In Chicago, Salesforce Tower Chicago, a 59-story office project located at 333 West Wolf Point Plaza in the River North submarket, will deliver 1.2 million square feet as the third phase in the Wolf Point development in early 2023. Additionally, Winthrop Center, at 115 Federal Street in the Financial District submarket in Boston, is expected to deliver 812,000 square feet in first-quarter 2022. The project will also include residential condominiums and will be among the world's most environmentally sustainable buildings.

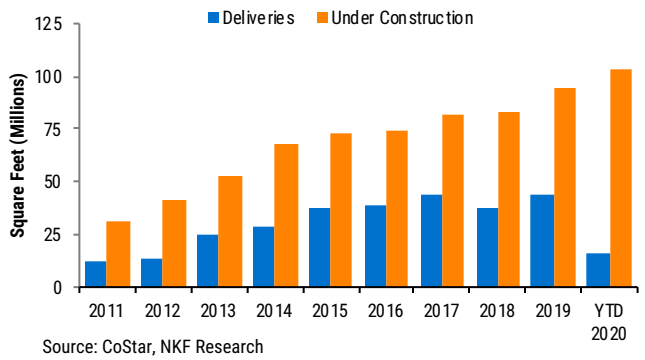
The ongoing coronavirus pandemic and resulting economic downturn are sure to have an impact on construction nationwide. Projects that are already underway will likely still deliver, though possibly later than planned depending on whether a resurgence of the virus affects on-site safety and slows progress. Additional projects in the pipeline that have not yet broken ground may be stalled in the short term until the full impact of the coronavirus comes into focus. Thus far, most construction projects have been allowed to continue but with differing physical distancing guidelines depending on the jurisdiction, as construction was deemed essential by state and local governments. The cost of construction is likely to ease as the supply of qualified labor rises in the near term.

## SUBLEASE AVAILABILITY RATE INCREASES

The second quarter ended with 111.0 million square feet of sublease space available, equal to 2.3% of the total office inventory and an increase of 30 basis points from one year ago. This is up from the cyclical low of 1.7% of inventory in 2014. Gateway markets such as San Francisco, Boston, Los Angeles, New York and Chicago have seen notable increases in sublease availability as a result of the coronavirus pandemic, although some tenants are taking a wait-and-see approach while they determine their future office footprint needs. The sublease market reflects an ongoing tension between the possibility of more remote work (meaning a reduced need for space) and the need for more space per employee for those in the office due to physical distancing. Concerns about the isolation of remote work and the need for a strong corporate culture also shape this dynamic and encourage a return to the office as soon as conditions are safe.

## CONSTRUCTION AND DELIVERIES

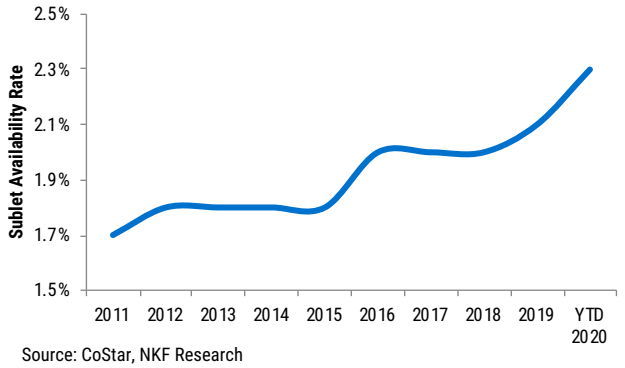
**United States Office Market**




Source: CoStar, NKF Research

## SUBLET AVAILABILITY RATE

**United States Office Market**




Source: CoStar, NKF Research

## MARKET HIGHLIGHT: MANHATTAN

The Manhattan market, home to large financial, technology and legal tenants, has seen uneven office metrics over the past few years. Absorption has been negative in 16 of the past 21 quarters, yet vacancy has remained low relative to other large markets, as tech and coworking demand bolstered the overall environment. Asking rents have increased in part due to the nearly 14.0 million square feet of new space delivering to the market during that same period. Inventory in the Manhattan market has increased by nearly 16.0 million square feet since second-quarter 2015, to 460.3 million square feet; it stands as the largest office market in the United States, 90.6 million square feet larger than the next largest market, Washington, DC.

Manhattan's vacancy rate is 6.0%, 10 basis points higher than it was at the close of 2019, a function of sublet space being returned to the market. The market's office pipeline has been robust for several years and includes a number of high-profile deliveries expected over the next few years including One Vanderbilt and The Spiral in Hudson Yards. Over the past five years the market has seen approximately 13.2 million square feet deliver, much of it at top-of-the-market rents, which has led the average asking rent to increase by 15.4%, to $80.98/SF.

Office fundamentals in the Manhattan market are likely to soften in the months ahead as the impacts from COVID-19 are fully realized. Tenants such as Google and Facebook have been busy in the market recently, however some tech companies are offering expanded remote work options for employees, which could lead to more large blocks of space being returned to the market. Additionally, the coworking sector is likely to quiet in the near term, as open and shared office space designs become less appealing to tenants until the coronavirus is contained. WeWork is the largest private office tenant in the market and has announced plans to restructure or terminate some leases nationally, although only a few of those changes have already occurred. Manhattan's market is significantly bolstered in the long term by the creative and tech sectors, which rely on the city's appeal to young, highly educated professionals.

## U.S. OFFICE MARKET OUTLOOK

The methodical growth of the national office market from 2010 through early 2020 has halted, as the United States remains the epicenter of the COVID-19 outbreak. The Federal Reserve and the federal government have taken steps to try to bolster the economy, and lawmakers continue to introduce legislation to provide financial assistance to companies and individuals. The CARES Act, signed into law in March, has assisted businesses as they attempt to weather the storm, but the rollout of some of its programs has been haphazard. Unemployment assistance is currently set to expire during the third quarter, which could create additional challenges for recipients and slow the economic recovery and thus the office market's rebound. However, ongoing volatility in the American and global economies will continue to underscore the value of hard assets like commercial real estate.

On the supply side, construction totals are an indicator to watch, with 102.8 million square feet currently under construction. This figure represents 2.1% of total inventory, a bit concerning while the U.S. economy remains soft, although changes to delivery timelines may lessen concern about near-term oversupply. Sublease availability is another indicator to watch, as rates have begun to rise, especially in some gateway markets.

Employment has declined significantly as the pandemic has caused large scale furloughs and layoffs, although professional services firms have been better insulated than some others, bolstering the office market. States are currently in various phases of attempted reopening, but the depth and duration of the economic decline will be determined by how quickly states that have seen a resurgence of the virus are able to contain its spread. Consistent with this, and in preparation for the next expansion cycle, an updated workplace strategy would benefit many tenants, and also may help to reverse the market's push for densification that persisted over the past several years. Opportunities exist for asset owners, including the potential to capitalize on what is likely to be a challenging environment for coworking firms; owners can work directly with occupiers and perhaps gain market share, especially those with outdoor amenities to offer.

## NOTABLE 2Q 2020 LEASE TRANSACTIONS

| Tenant | Market | Building | Type | Square Feet |
|---|---|---|---|---|
| Baxter Healthcare Corporation | Memphis | 629 Mount Carmel Road | Direct New | 851,622 |
| Microsoft Corporation | Northern Virginia | 11955 Freedom Drive | Direct New | 396,740 |
| SEC | Manhattan | 100 Pearl Street | Direct New | 241,339 |
| TikTok | Manhattan | 151 West 42nd Street | Direct New | 232,138 |
| City of Alexandria | Northern Virginia | 4850 Mark Center Drive | Direct New | 215,806 |

## NOTABLE 2Q 2020 SALES TRANSACTIONS

| Building | Market | Sale Price | Price/SF | Square Feet |
|---|---|---|---|---|
| 245 Summer Street | Boston | $728,500,000 | $847 | 860,249 |
| 1100 Merrill Lynch Drive | New Jersey Southern | $95,000,000 | $250 | 380,000 |
| 130 Shoreline Drive | Silicon Valley | $81,000,000 | $993 | 81,569 |
| 300 Baker Avenue | Boston | $74,200,000 | $179 | 413,415 |
| 100 Campus Drive | Boston | $66,000,000 | $451 | 146,361 |

## MARKET STATISTICS (CONTINUED ON NEXT PAGE)

| | Total Inventory (SF) | SF Under Construction | SF Absorbed This Quarter | SF Absorbed Year-to-Date | Vacancy Rate | Average Asking Rent (Price/SF) |
|---|---|---|---|---|---|---|
| **National** | **4,903,790,348** | **102,815,765** | **-11,086,372** | **-11,475,586** | **13.4%** | **$29.94** |
| Atlanta | 152,399,345 | 4,896,927 | 142,681 | 2,066,647 | 17.4% | $28.76 |
| Austin | 66,893,405 | 870,887 | -252,458 | -322,639 | 12.3% | $36.68 |
| Baltimore | 82,551,664 | 285,000 | 39,014 | 99,105 | 13.5% | $24.04 |
| Boston | 181,074,713 | 6,130,607 | -923,749 | -976,883 | 12.2% | $38.54 |
| Broward County, FL | 33,379,318 | 959,560 | -86,046 | -135,209 | 10.4% | $29.90 |
| Charleston, SC | 14,494,644 | 0 | 70,963 | -52,381 | 11.0% | $27.41 |
| Charlotte | 50,185,407 | 4,563,299 | -262,861 | 241,839 | 11.3% | $30.01 |
| Chicago | 241,007,709 | 6,023,984 | 444,631 | 945,433 | 16.8% | $30.17 |
| Cincinnati | 36,615,913 | 0 | -39,538 | 12,774 | 17.5% | $19.21 |
| Cleveland | 38,999,237 | 100,000 | 145,803 | 547,889 | 16.5% | $18.03 |
| Columbia, SC | 16,009,208 | 0 | -30,392 | 85,787 | 8.1% | $18.13 |
| Columbus | 58,525,740 | 145,160 | -178,038 | -397,477 | 10.6% | $19.34 |
| Dallas | 266,938,920 | 1,908,517 | -803,367 | -1,420,422 | 20.3% | $26.65 |
| Delaware | 17,715,844 | 0 | 37,740 | 444,619 | 16.6% | $25.67 |
| Denver | 99,513,437 | 2,207,674 | -568,944 | -257,895 | 14.7% | $28.53 |
| Detroit | 78,136,723 | 390,000 | -2,293 | 55,245 | 15.0% | $19.93 |
| Fairfield County, CT | 39,722,492 | 0 | -263,213 | -338,874 | 18.5% | $36.09 |
| Fresno | 19,981,376 | 129,426 | -39,280 | -3,795 | 10.1% | $31.15 |
| Greenville, SC | 21,242,828 | 0 | -27,410 | -12,526 | 6.5% | $22.63 |
| Houston | 238,488,242 | 4,167,422 | -1,141,276 | -1,534,813 | 22.4% | $29.45 |
| Indianapolis | 61,695,569 | 0 | -386,342 | -563,902 | 11.6% | $19.79 |
| Inland Empire, CA | 27,872,232 | 291,821 | -116,016 | -47,383 | 9.5% | $22.28 |
| Jacksonville | 32,118,276 | 149,000 | -47,349 | 111,610 | 13.6% | $20.63 |
| Kansas City | 74,420,521 | 225,028 | -758,392 | -1,052,675 | 10.9% | $20.79 |
| Las Vegas | 39,174,834 | 612,216 | 121,599 | 180,113 | 12.6% | $21.68 |
| Long Island | 56,359,259 | 0 | -507,902 | -703,048 | 9.6% | $25.35 |
| Los Angeles | 202,772,702 | 4,696,628 | -254,354 | 334,865 | 13.9% | $41.75 |
| Manhattan | 460,256,630 | 16,130,808 | -1,393,759 | -2,159,968 | 6.0% | $80.98 |

Note: Absorption is the net change in occupied space over a period of time. Data may not match totals in some NKF metro reports due to different local methodologies. Asking rents are quoted on a full service basis.

## MARKET STATISTICS (CONTINUED FROM PREVIOUS PAGE)

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| **National** | **4,903,790,348** | **102,815,765** | **-11,086,372** | **-11,475,586** | **13.4%** | **$29.94** |
| Memphis | 33,500,703 | 0 | 253,216 | 224,387 | 13.8% | $19.15 |
| Miami | 47,979,559 | 1,933,300 | 88,855 | 36,297 | 11.6% | $37.53 |
| Milwaukee | 36,349,787 | 551,047 | -198,517 | -151,015 | 18.3% | $20.09 |
| Minneapolis | 119,359,876 | 1,738,700 | 771,072 | 841,289 | 10.8% | $24.22 |
| Nashville | 53,828,679 | 2,290,000 | -256,307 | -724,754 | 9.0% | $28.79 |
| New Jersey Northern | 166,310,731 | 415,000 | -1,580,218 | -2,018,277 | 16.7% | $29.97 |
| New Jersey Southern | 16,799,544 | 0 | 8,928 | 80,787 | 15.7% | $20.90 |
| Oakland/East Bay | 75,826,127 | 375,300 | -384,516 | -450,404 | 11.2% | $39.51 |
| Oklahoma City | 15,029,565 | 153,000 | -54,619 | -283,798 | 27.1% | $19.91 |
| Orange County, CA | 95,920,058 | 1,053,725 | -131,090 | -188,283 | 12.4% | $33.72 |
| Orlando | 64,900,203 | 141,267 | -90,483 | 133,309 | 6.5% | $23.73 |
| Palm Beach | 25,015,213 | 761,971 | 13,597 | -38,836 | 11.5% | $34.47 |
| Philadelphia | 109,158,806 | 1,428,000 | -22,408 | -289,727 | 13.9% | $29.91 |
| Phoenix | 93,699,567 | 2,309,681 | 192,800 | 258,748 | 14.6% | $27.10 |
| Pittsburgh | 55,770,866 | 1,079,661 | -274,115 | -226,136 | 17.9% | $24.07 |
| Portland | 61,144,888 | 1,632,493 | -140,680 | -88,552 | 10.9% | $29.92 |
| Raleigh/Durham | 50,258,466 | 3,014,839 | 472,852 | 674,026 | 9.8% | $26.36 |
| Sacramento | 59,789,683 | 551,800 | -39,811 | 158,794 | 11.7% | $23.94 |
| Salt Lake City | 68,518,624 | 4,337,687 | 35,811 | 57,110 | 8.9% | $22.68 |
| San Antonio | 44,713,027 | 826,948 | -50,514 | -268,446 | 13.6% | $23.24 |
| San Diego | 72,468,004 | 1,667,352 | -289,682 | -561,605 | 12.5% | $38.21 |
| San Francisco | 85,465,654 | 1,996,968 | -3,069,454 | -3,764,643 | 7.6% | $84.39 |
| Seattle | 127,064,198 | 9,167,906 | 124,034 | 512,353 | 6.9% | $42.34 |
| Silicon Valley | 86,116,880 | 1,956,761 | 263,740 | 583,910 | 11.5% | $52.05 |
| St. Louis | 72,368,797 | 457,000 | 99,468 | -14,586 | 11.0% | $21.20 |
| Tampa/St. Petersburg | 61,110,333 | 1,199,993 | 118,686 | 129,467 | 9.1% | $25.41 |
| Washington, DC | 369,630,688 | 6,891,402 | 255,223 | -635,134 | 16.5% | $40.66 |
| Westchester County, NY | 27,145,634 | 0 | -121,692 | -607,903 | 17.6% | $27.66 |

Note: Absorption is the net change in occupied space over a period of time. Data may not match totals in some NKF metro reports due to different local methodologies. Asking rents are quoted on a full service basis.

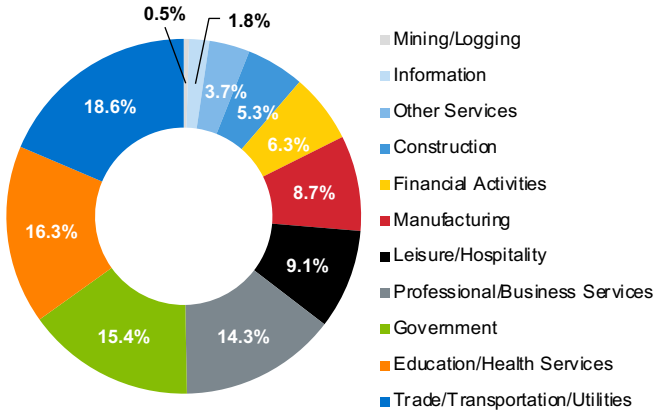
## ECONOMIC CONDITIONS

The U.S. economy contracted at an annual rate of 5.0% during the first quarter of 2020, according to the Bureau of Economic Analysis' third estimate, which was released in June 2020. The inflation rate was 0.1% (seasonally adjusted) for the 12 months ending in May 2020. The unemployment rate increased 740 basis points from one year ago, reaching 11.1% in June 2020, though this is down from a peak of 14.7% in April. The economy lost more than 22.0 million jobs between March and April of 2020 combined, but has added 7.5 million jobs over the past two months as states begin to reopen their economies—a trend that may be challenged by a reacceleration of the coronavirus's spread in July. Information, Financial Activities and Construction have lost the fewest jobs on a percentage basis during the past 12 months.

Uncertainty over the duration of the COVID-19 crisis will be a notable challenge to economic normalization—the virus must be contained before the economy can materially accelerate. Interest rates have remained stable over the past few months and are currently in the 0.00–0.25% range, as the Fed continues to shore up the economy. Metro areas that have a high level of tech, healthcare and professional and business services jobs likely will lead the office market rebound, as those sectors have functioned fairly well during the downturn.

## EMPLOYMENT BY INDUSTRY

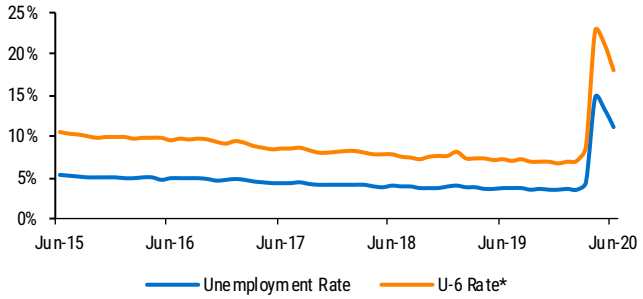
**United States, 2020 Annual Average**




Source: U.S. Bureau of Labor Statistics, NKF Research; July 2020

## UNEMPLOYMENT RATE

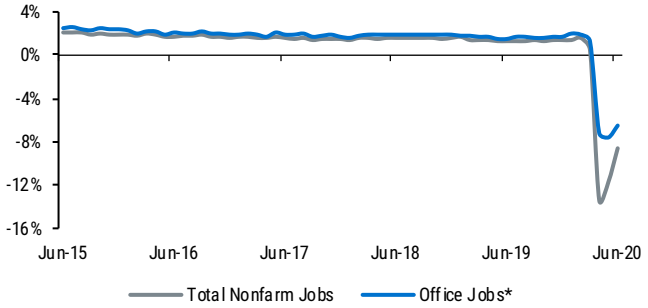
**United States, Seasonally Adjusted**




* Includes total unemployed, marginally attached workers, and those working part time for economic reasons
Source: U.S. Bureau of Labor Statistics, NKF Research; July 2020

## PAYROLL EMPLOYMENT

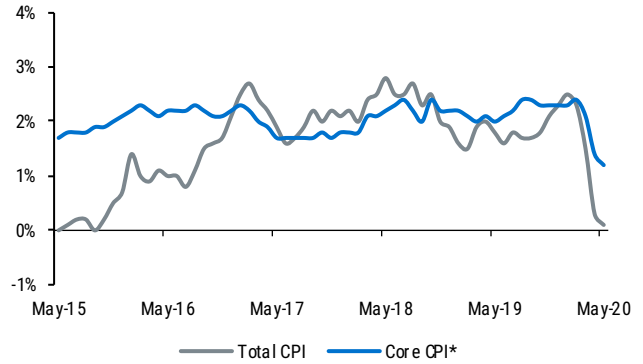
**United States, 12-Month % Change , Not Seasonally Adjusted**




* Includes Professional and Business Services, Information, Financial Activities, Other Services and Government
Source: U.S. Bureau of Labor Statistics, NKF Research; July 2020

## CONSUMER PRICE INDEX (CPI)

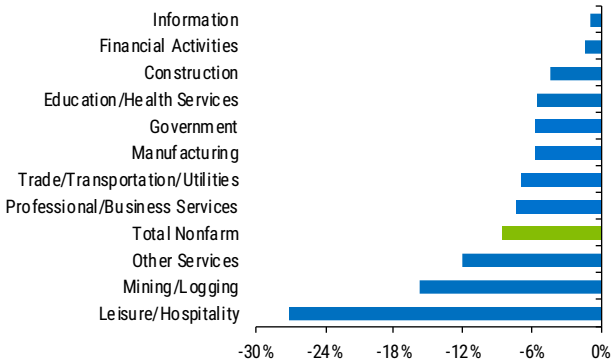
**United States, 12-Month % Change, Seasonally Adjusted**




*Excludes food and energy, which can be volatile; 1982–84=100
Source: U.S. Bureau of Labor Statistics, NKF Research; July 2020

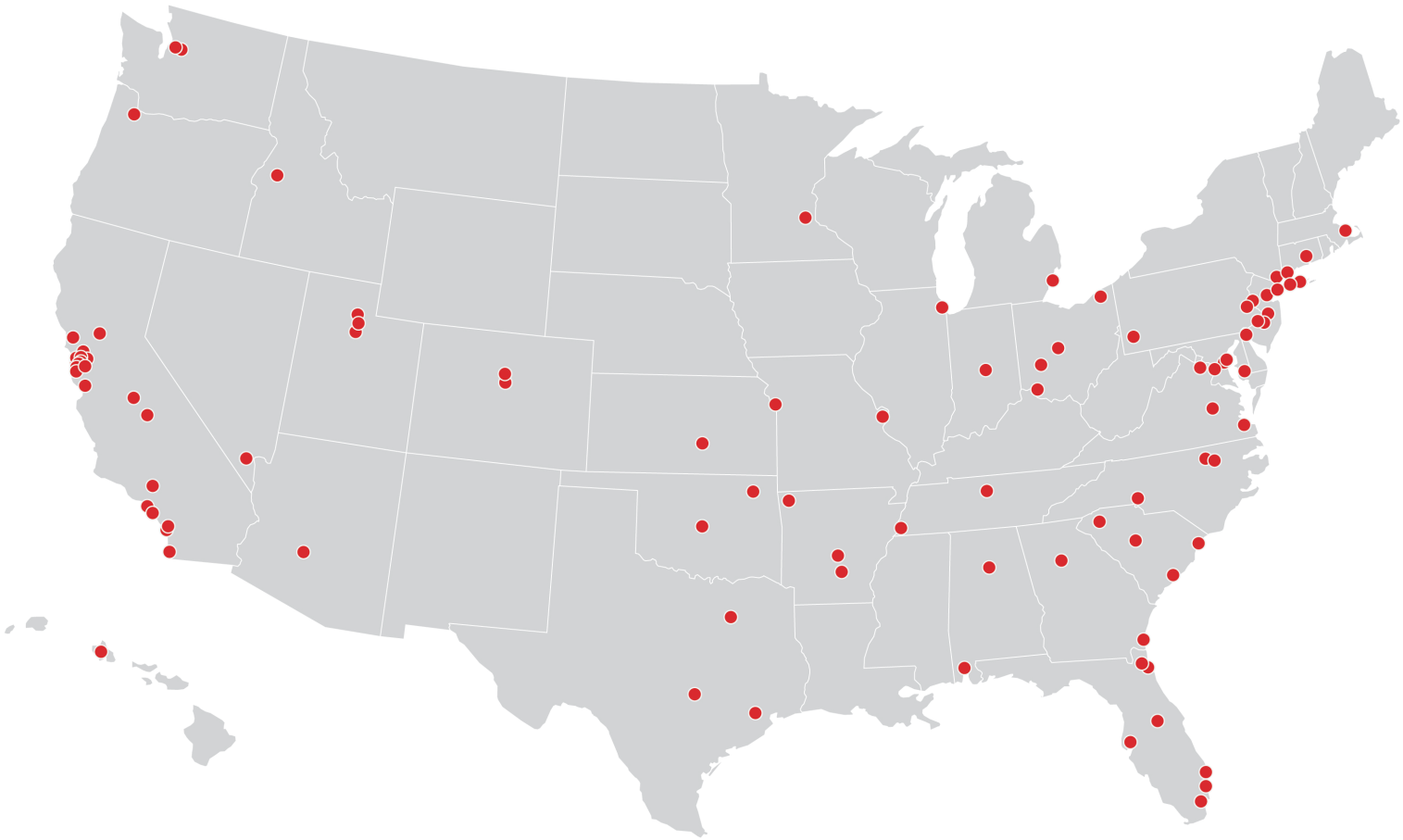
## EMPLOYMENT GROWTH BY INDUSTRY

**U.S., June 2020, 12-Month % Change, Not Seas. Adj.**




Source: U.S. Bureau of Labor Statistics, NKF Research; July 2020

## NEWMARK KNIGHT FRANK UNITED STATES OFFICE LOCATIONS



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