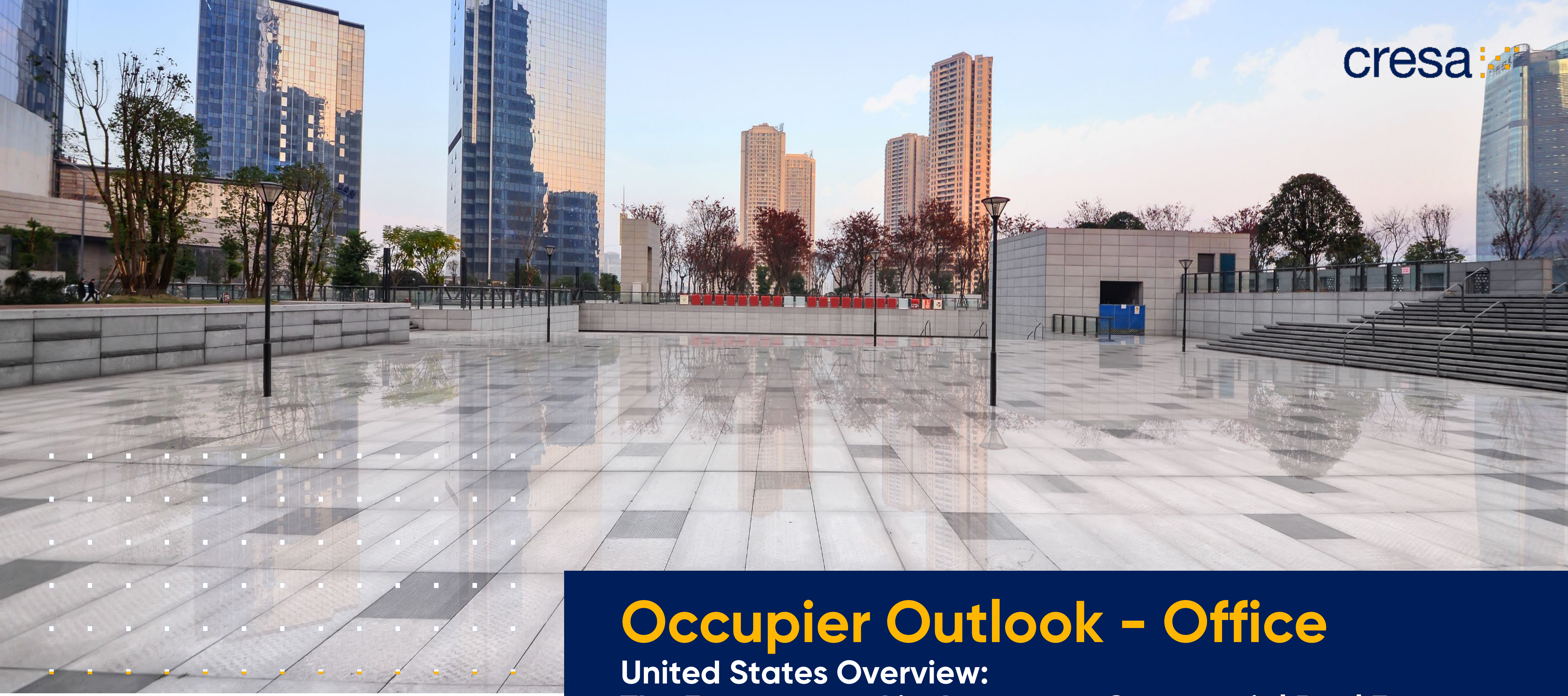
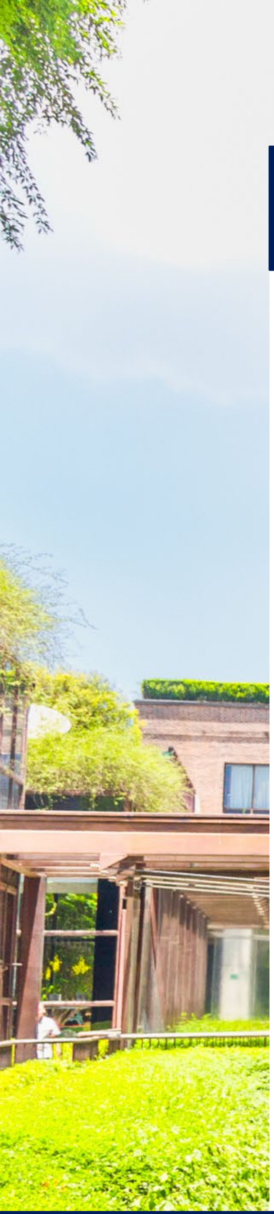


Occupier Outlook - Office

United States Overview:
The Economy and its Impact on Commercial Real Estate

Cresa Research

Q2, 2024



Executive Summary

Macro Economic View

- The US economy continues to grow, albeit at a moderate pace compared to previous quarters. GDP growth remains positive, supported by consumer spending, business investment, and government expenditure.
- The labor market has shown resilience with unemployment rates hovering at low levels. Job creation remains steady, although there are ongoing challenges related to labor shortages in certain sectors.
- Inflation remains stubbornly elevated, although it has moderately dropped for three straight months.
- Housing starts are consistent, but sales drag as interest rates discourage both buyers and sellers.

Office Market Slows Free Fall

- Return-to-office levels are now firmly stable as employee attendance levels have shown little movement for more than 18-months.
- Lack of new office construction is limiting top-tier space availability as flight-to-quality remains.
- Leasing velocity still lags pre-pandemic levels, along with shrinking deal sizes as companies right-size.

Industrial Sector Cautious, But Still Expanding

- Distribution/warehouse space asking rates slow their outsized growth, as availabilities tick higher.
- Supply is outpacing demand as new industrial products deliver, but a dramatic decrease in new starts will bring stability in the mid-term

Economy Stabilizes, as Commercial Real Estate Sector Continues to Search for Buoyancy

The US Economy Hits Pause Moving Into the Second Half of 2024

Economic Overview

Through the first half of 2024, the economy has continued to expand. However, there are signals that a broader slowdown may be in store. While inflation continues to remain above historic levels, it has been trending lower over the past few months. Meanwhile, unemployment levels are pushing higher from historic lows and job openings are approaching pre-pandemic levels as annual wage growth is slowing.

Despite these signals, consumer spending, the primary driver of economic growth, has been strong as households spend excess savings. According to the latest data, inflation-adjusted spending rose by 2.4 percent over the prior year in May.

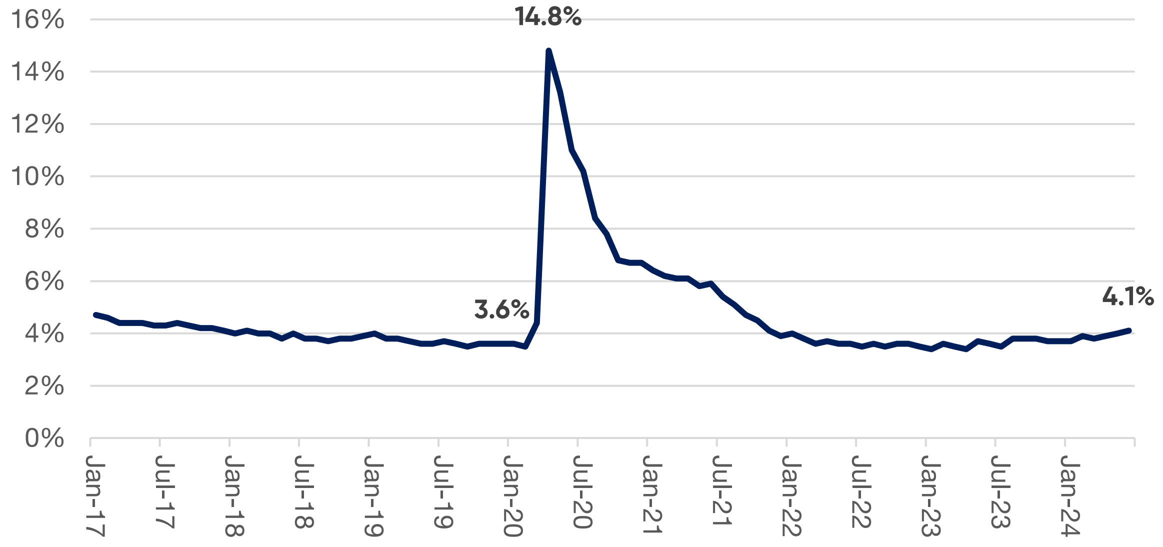
The outlook is for economic activity and job growth to continue to slow through 2024 as the full impact of higher interest rates flows through the economy. Factory activity has contracted for 19 of the last 20 months as investment and production cooled due to higher financing costs. The housing market, one of the most interest-rate-sensitive sectors of the economy, has stagnated as higher mortgage rates and still-elevated prices erode affordability and impact demand. At the same time, inventories of homes for sale remain lean.

Unemployment

Unemployment Drifting Higher

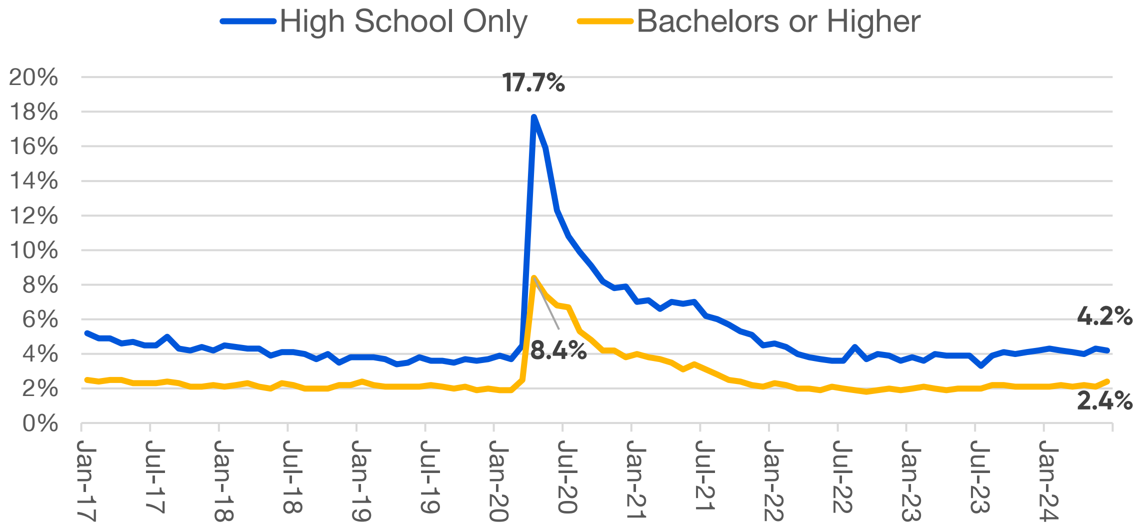
Unemployment, while low from an historic-standpoint, has been ticking higher. The market is closely watching Fed rate changes as inflation remains elevated. College-educated employees remain near full-employment despite recently announced layoffs in the tech industry. Additionally, lower-skilled service-oriented jobs are the main driver of job growth.

Total Unemployment: (United States)



Source: U.S. Bureau of Labor Statistics, https://bls.gov

High School Only vs. Bachelor's Degree or Higher



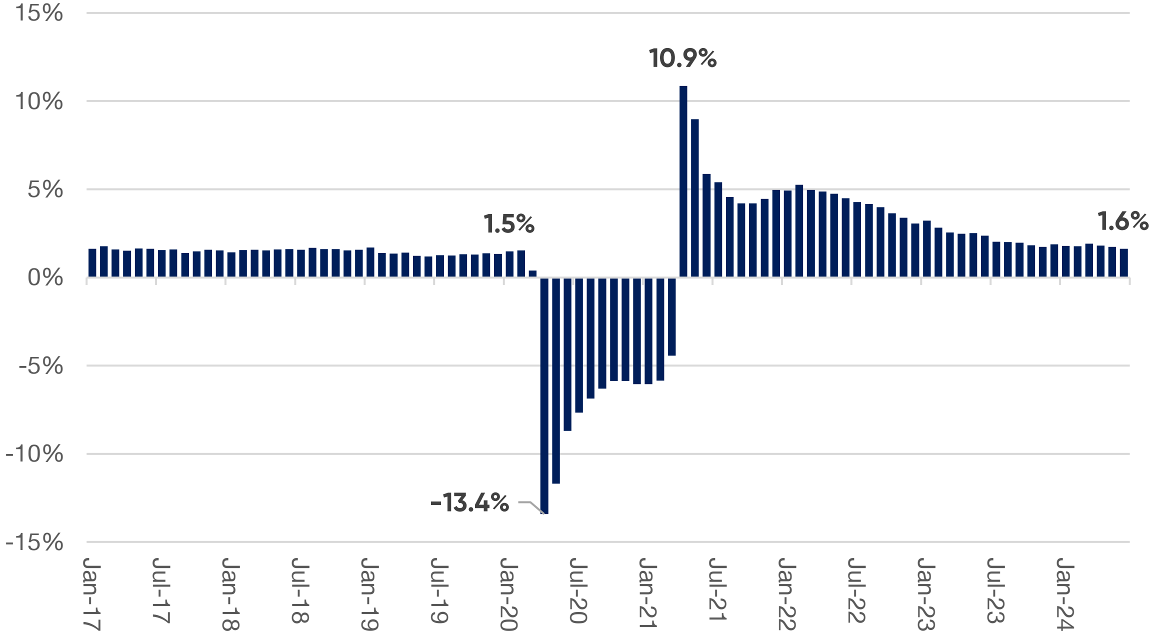
Source: U.S. Bureau of Labor Statistics, https://bls.gov

Employment

Job Creation Slows to Pre-Pandemic Levels

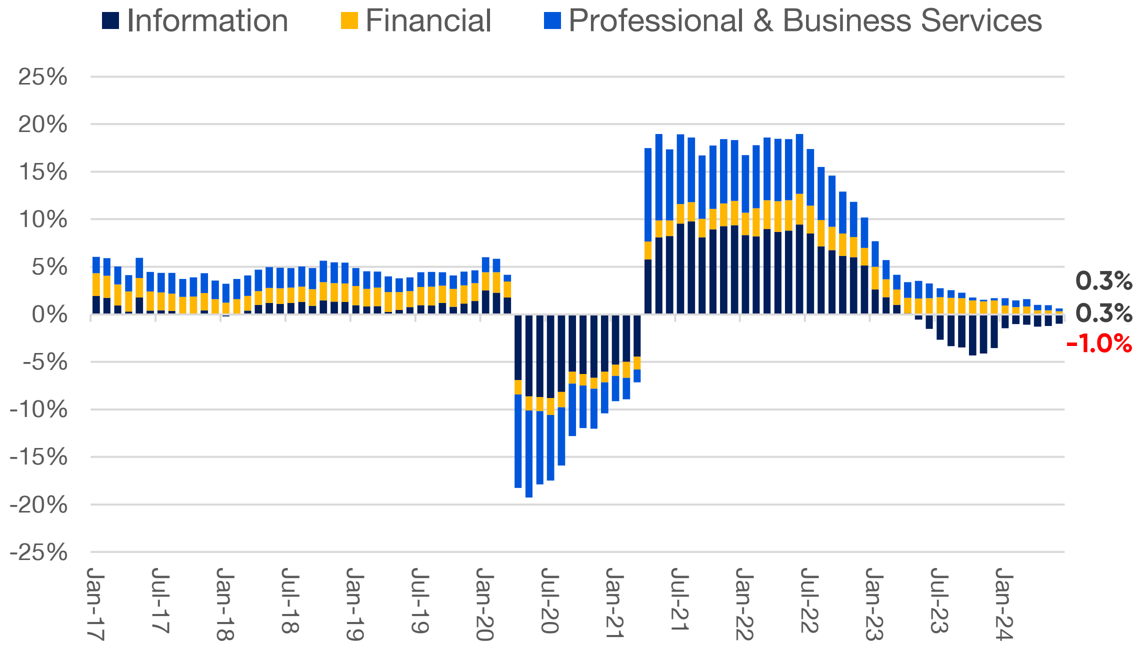
Total nonfarm employment rose by 206,000 in June, in line with average job creation over the past year. Job gains occurred in government and healthcare jobs underpinned the growth. Office-occupying job creation is slowing to a trickle, with information sector jobs down 0.3 percent from a year earlier, recovering from sharper drops in late 2023.

All Job Sectors (12-Month Change)



Source: U.S. Bureau of Labor Statistics, https://bls.gov

Office-Occupying Jobs (12-Month Change)



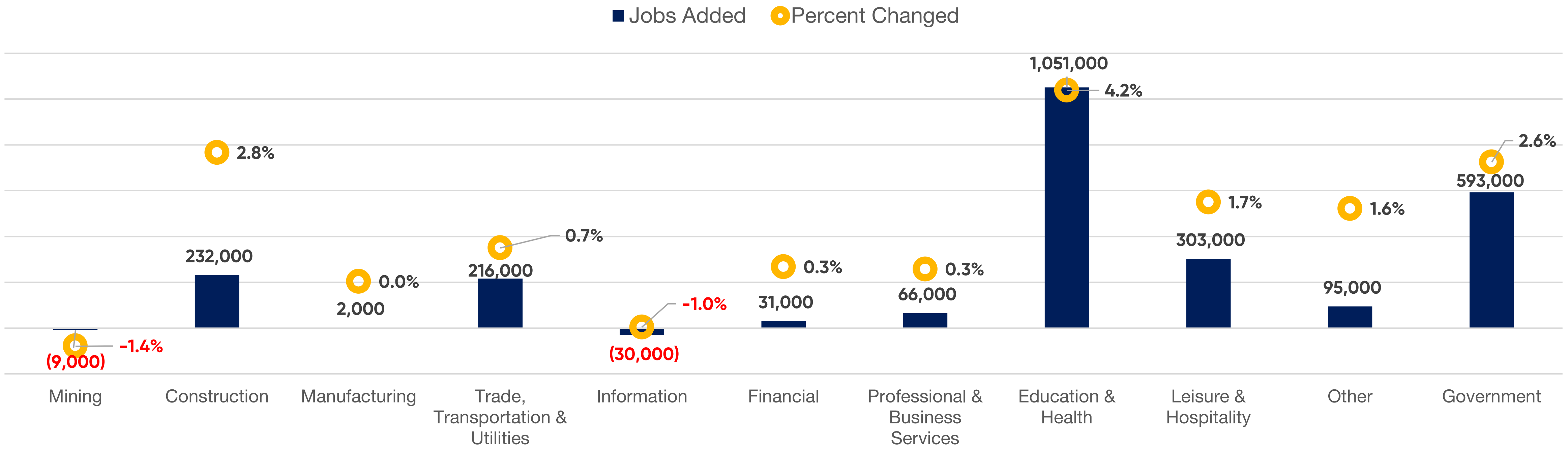
Source: U.S. Bureau of Labor Statistics, https://bls.gov

Employment

Education/Healthcare Sector Leads the Way

Pent-up demand leads to increases in health services sector jobs, with more than 1.0 million jobs added in the past year. The jobs being added are not concentrated in office-occupying sectors, meanwhile nearly 450,000 jobs were created in the industrial sector last year, highlighted by the construction and trade, transportation, and utilities sectors.

Job Creation by Sector (12-Month Change)



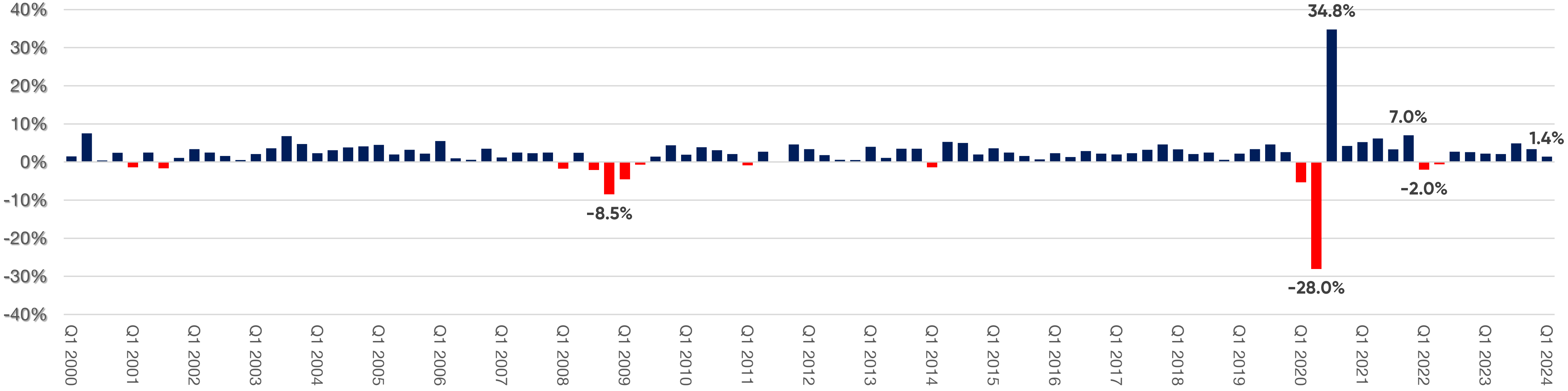
Source: U.S. Bureau of Labor Statistics, https://bls.gov

GDP

Gross Domestic Product Posts Seventh Consecutive Quarter of Growth

The GDP has expanded for the past seven quarters. According the *Bureau of Economic Analysis*, growth in the first quarter primarily reflected increases in consumer spending, residential fixed investment, nonresidential fixed investment, and state and local government spending that were partly offset by a decrease in private inventory investment. **Profits increased 1.4 percent in the fourth quarter after increasing 3.4 percent in the fourth quarter.**

Real GDP Percent Change from Preceding Quarter



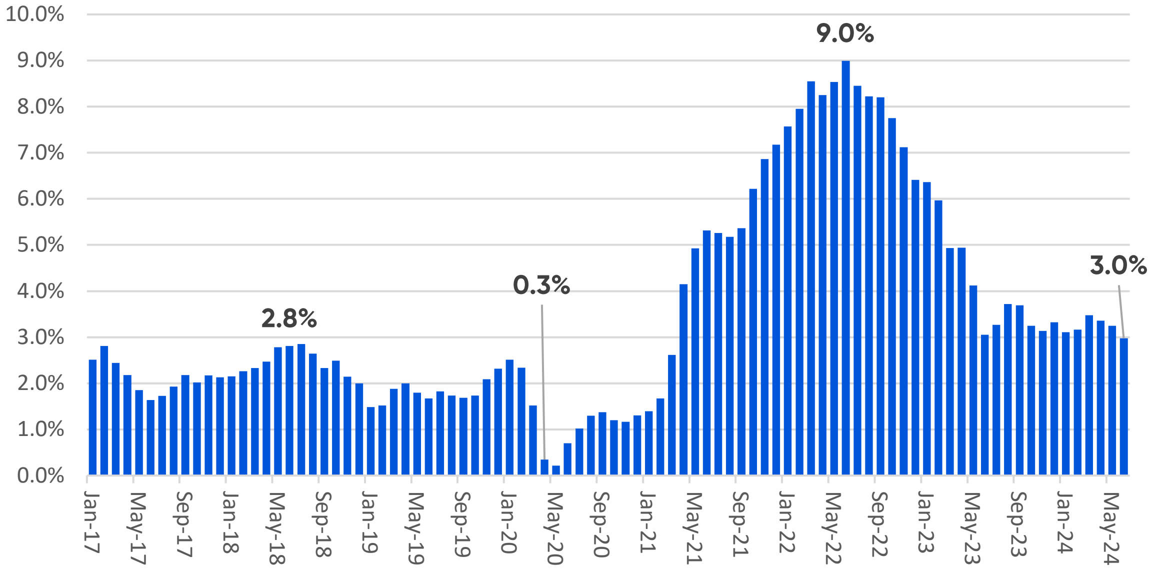
Source [Real Gross Domestic Product (A191RL1Q225SBEA) | FRED | St. Louis Fed (stlouisfed.org)]
Note: Seasonally adjusted at annual rates, Bureau of Economic Analysis date published May 30, 2024 (second estimate)

Inflation

Inflation Remains Elevated

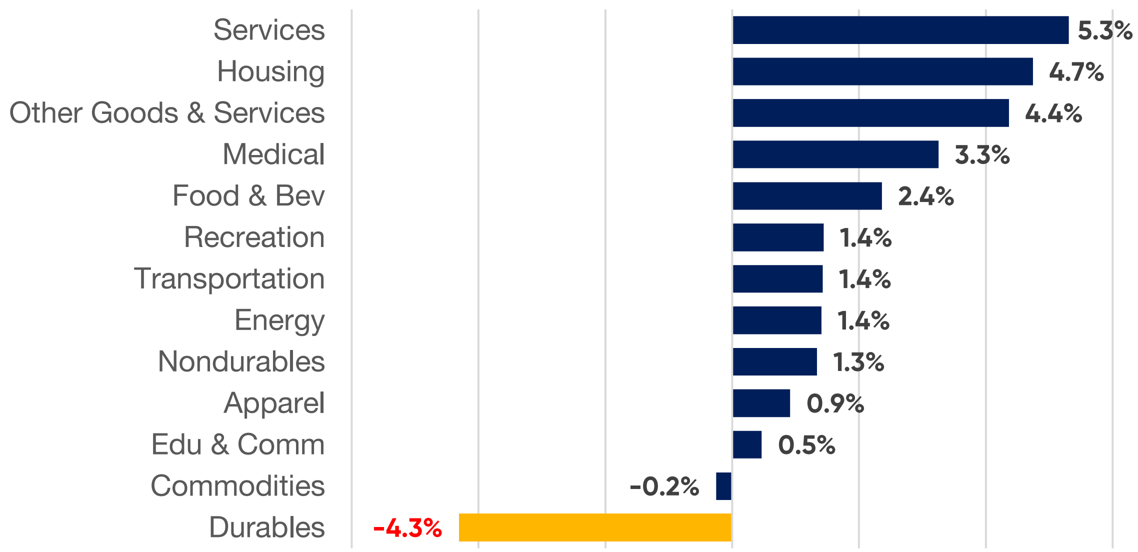
Driven by consumer demand, supply chain disruptions and a tight labor market, inflation pushed prices higher, peaking in June 2022. Inflation growth had slowed for 12 consecutive months, before ticking higher in mid-2023. Overall, inflation has dropped the past three months, lead by services and houses. The drop in durable goods means demand for big-ticket items like vehicles, household goods, and electronics are slowing.

Consumer Price Index (12-Month Change)



Source: U.S. Bureau of Labor Statistics, https://bls.gov
Note: Seasonally adjusted, Data pulled July 2024.

Consumer Price Index by Sector (12-Month Change)



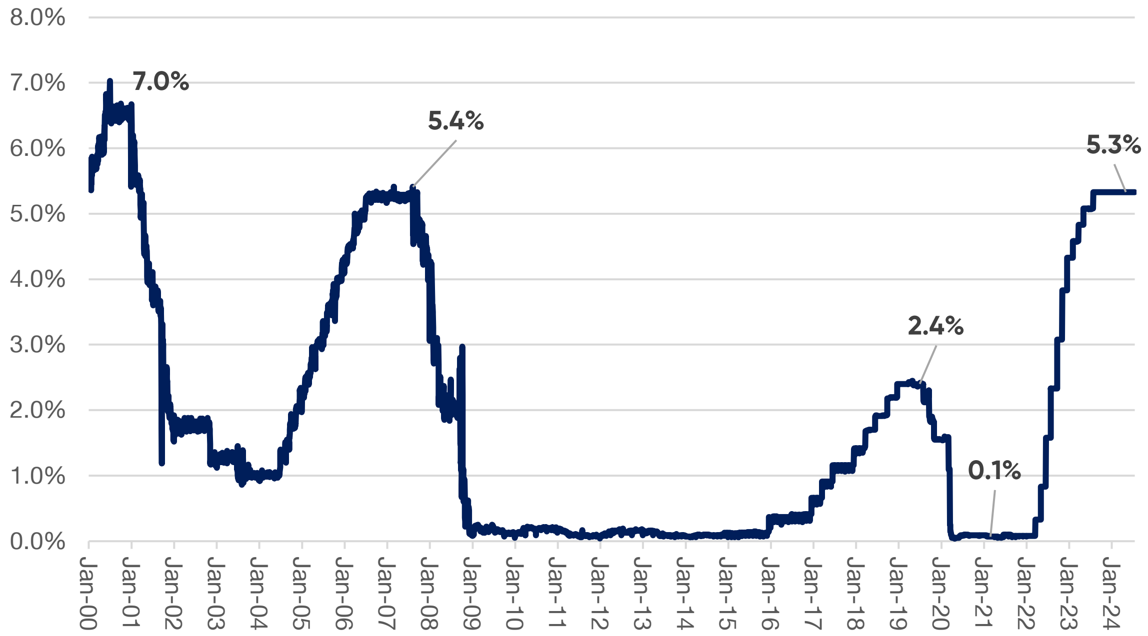
Source: U.S. Bureau of Labor Statistics, https://bls.gov
Note: Seasonally adjusted, Data pulled July 2024

Monetary Policy

Rate Increases Pause as Fed Attempts to Control Inflation

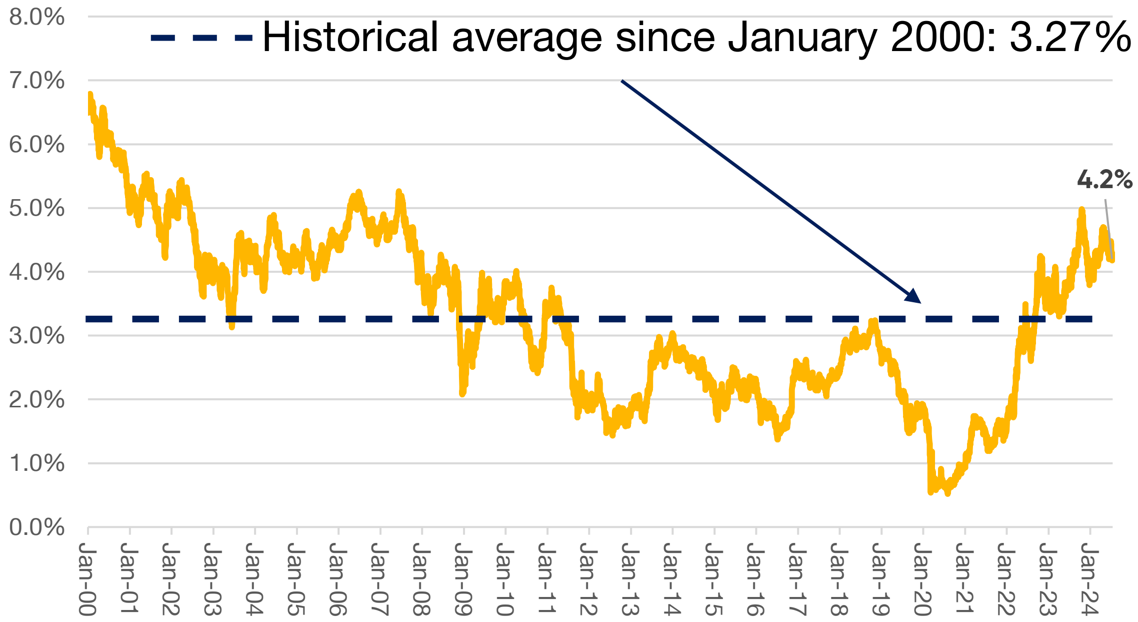
A series of increases in the Fed rate, including three 75bps increases in 2022, has bumped the range to 5.25% to 5.50%, the highest level in more than 20 years. The Fed has held rates steady after a 25-basis point increase in July 2023. Rate movement is being closely monitored as stubborn inflation remains above 3 percent annual growth. Meanwhile, the 10-year US treasury note, an indicator for broader investment confidence, has slowed, falling to 4.2 percent in early July.

US Effective Fed Fund Rate



Source: Federal Reserve Economic Data, https://fred.stlouisfed.org
Data is through July 15, 2024

10-Year US Treasury Note



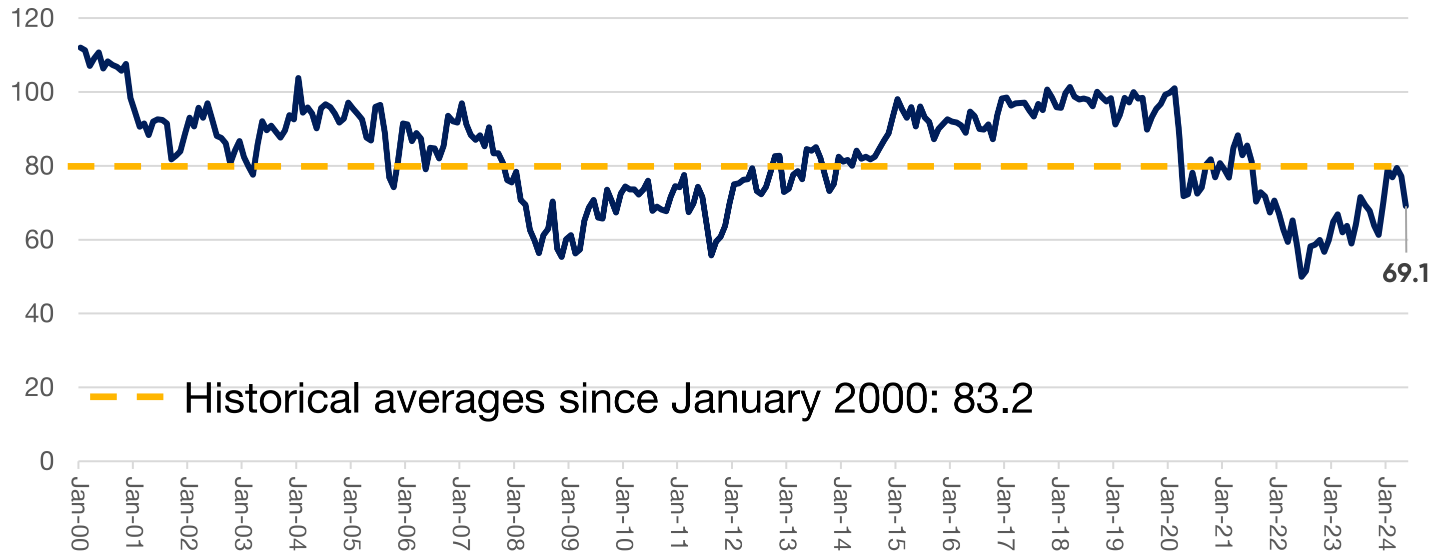
Source: Wall Street Journal
Data is through July 15, 2024

Consumers

Consumer Sentiment Trending Higher

Despite strong consumer spending related to pent-up demand, the consumer sentiment index remains well-below pre-pandemic levels. The index is now (69.1) near levels following the end of the Great Recession in 2011 before going on a near decade long trend of increases leading up to the start of the Covid-19 pandemic. Moving into the second half of 2024, consumer sentiment is moving lower.

Consumer Sentiment Index: (United States Total)



Source: Federal Reserve Economic Data, https://fred.stlouisfed.org;
Note: Data thru May 2024

Consumer Sentiment Index

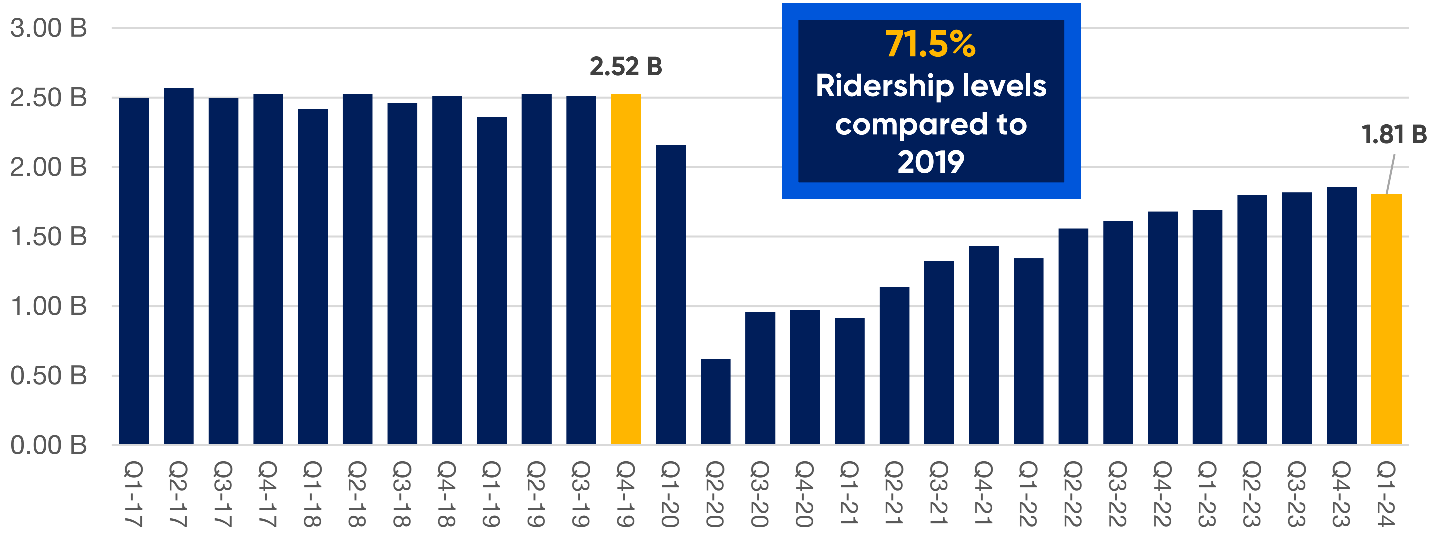
Consumer sentiment is a statistical measurement of the overall health of the economy as determined by consumer opinion. It considers people's feelings toward their current financial health, the health of the economy in the short-term, and the prospects for longer-term economic growth.

Public Transit

Public Transit Levels Off

A good indicator of the health of an urban core, and by extension the downtown office market, is the use of public transportation. Public transit ridership decreased in the first quarter after rising for seven straight quarters, experiencing a 35.1 percent increase since the start of 2022. Based on several other indicators, return-to-office momentum has appeared to stabilize.

Public Transit Ridership: (United States)



Source: American Public Transportation Association Quarterly Ridership Report. [Ridership Report - American Public Transportation Association (apta.com)]

Ticket to Ride

Public transportation has been reliably consistent since the turn of the century. Sky-rocketing gas prices temporarily encouraged public ridership in 2008, but quickly dropped back to historic levels. During the first year of the declared pandemic, ridership was cut in half (52.8% decrease). The economy opened wider in 2021, but ridership still only increased 3.1 percent from the previous year. The beginning of 2022 marked the beginning of the economy opening back to near pre-pandemic levels, yet ridership on public transportation ended the first quarter of 2024 at 71.5 percent of the average ridership of 2019, the last full-year before the start of the pandemic.

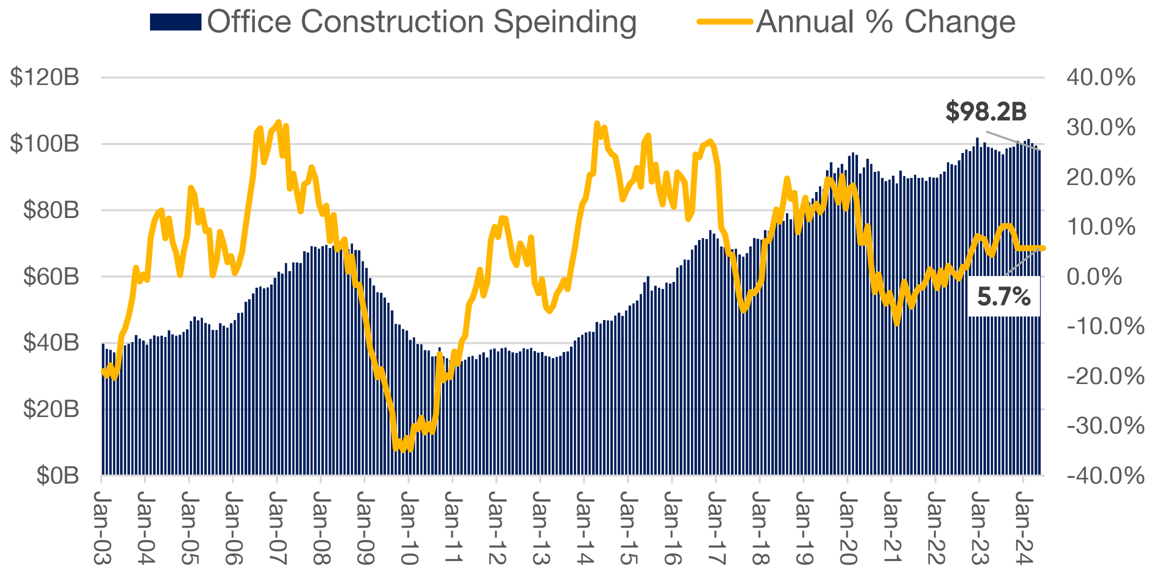
Construction

Office Construction Spending Falls, While Industrial Spending Peaks

Perhaps surprisingly, the amount spent on office construction has not fallen below pre-pandemic levels, according to the *US Census Bureau*. New, well-located office construction with plentiful amenities are drawing interest from occupiers as they look to entice people to the office.

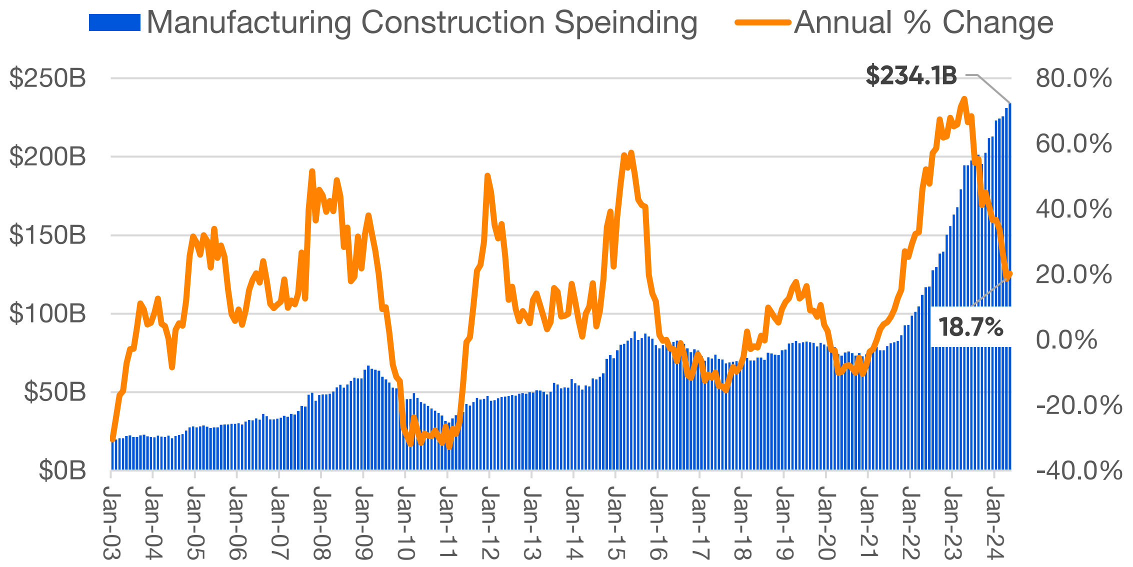
After sky-rocketing for the past three-plus years, spending in the industrial sector has begun slowing from prior years. While still near record highs, spending will likely decelerate as investors/ developers wait to test demand as new products deliver.

Construction Spending: Office



Source: U.S. Census Bureau, https://census.gov/construction
Note: Data thru May 2024

Construction Spending: Manufacturing



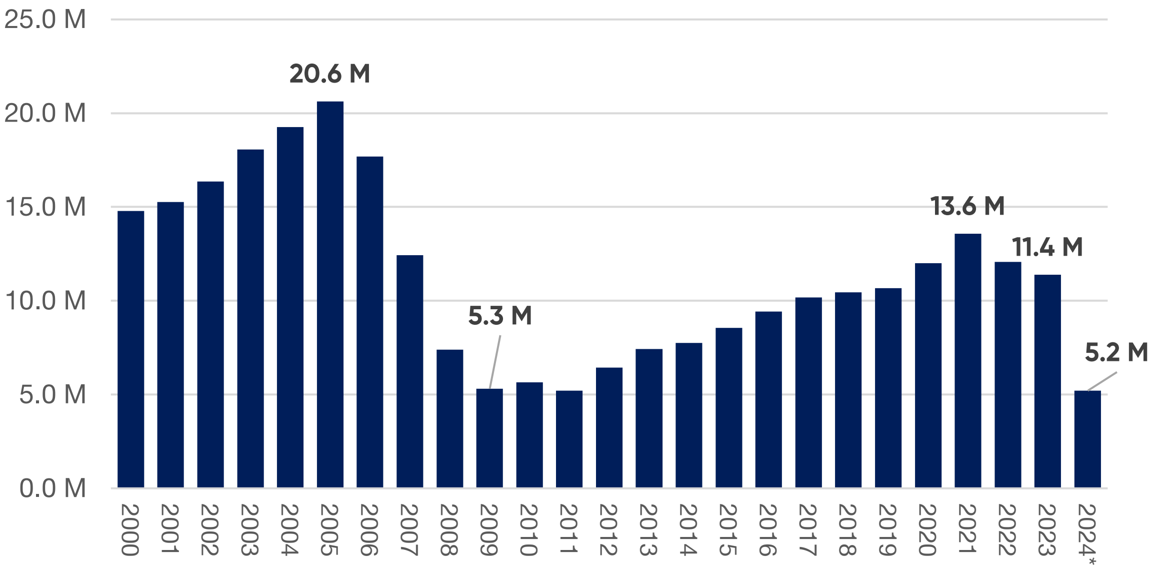
Source: U.S. Census Bureau, https://census.gov/construction
Note: Data thru May 2024

Housing

Housing Starts Pick Up, as Interest Rates Slow the Market

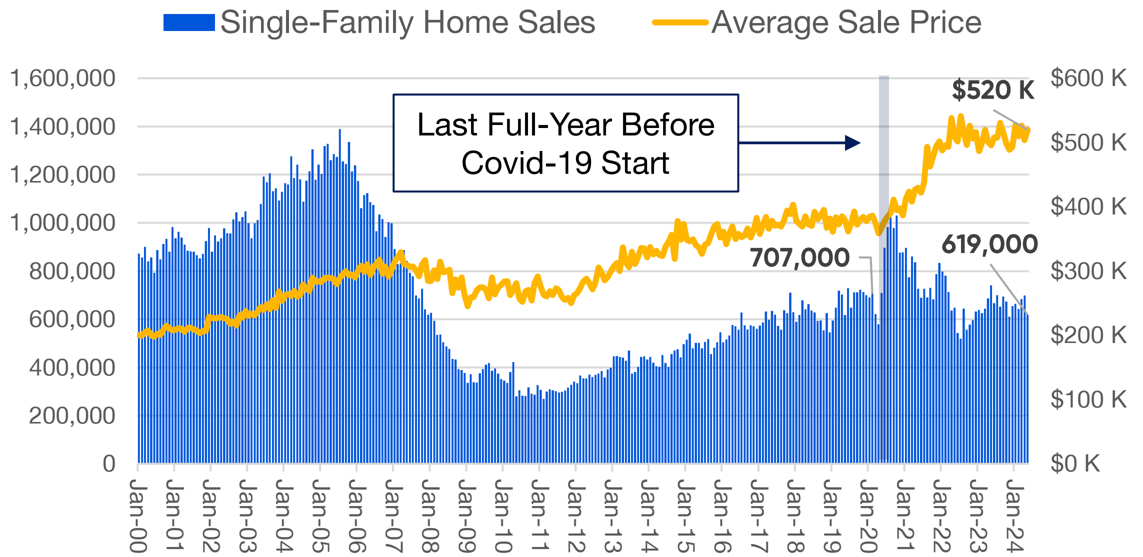
The number of residential housing starts soared at the start of the pandemic, while sale prices reached record highs in 2022. This growth is being tempered as mortgage rates increase, labor costs rise, and supplies remain scarce. During 2023, home starts declined from the previous two years but remain near pre-pandemic levels. Meanwhile, prices have begun to fall as demand softens. After passing an average sale price of over $569,000 to end 2022, prices have fallen 8.6 percent through May.

Residential Housing Starts



Source: U.S. Census Bureau, https://census.gov/construction
*Note: Data thru May 2024

Single-Family Homes: No. of Sales (Thousands) vs. Price



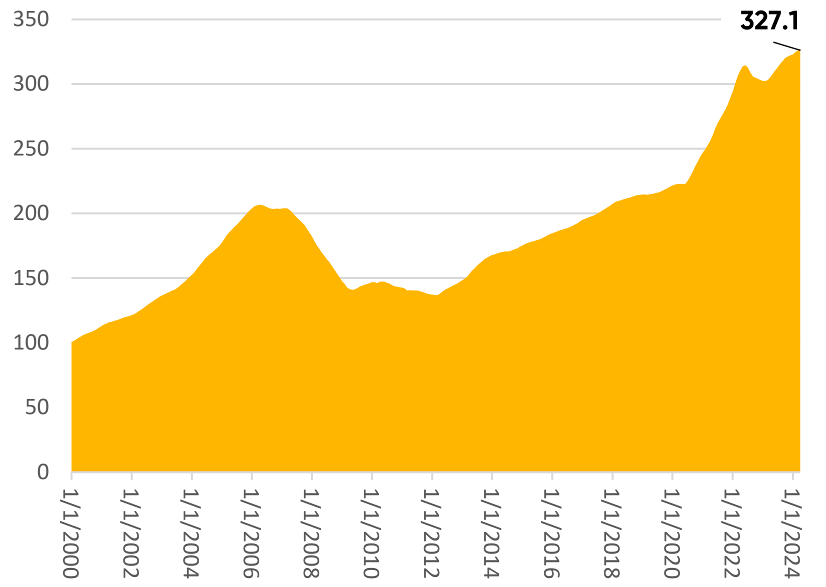
Source: U.S. Census Bureau, https://census.gov/construction
Note: Data thru May 2024

Home Price Index

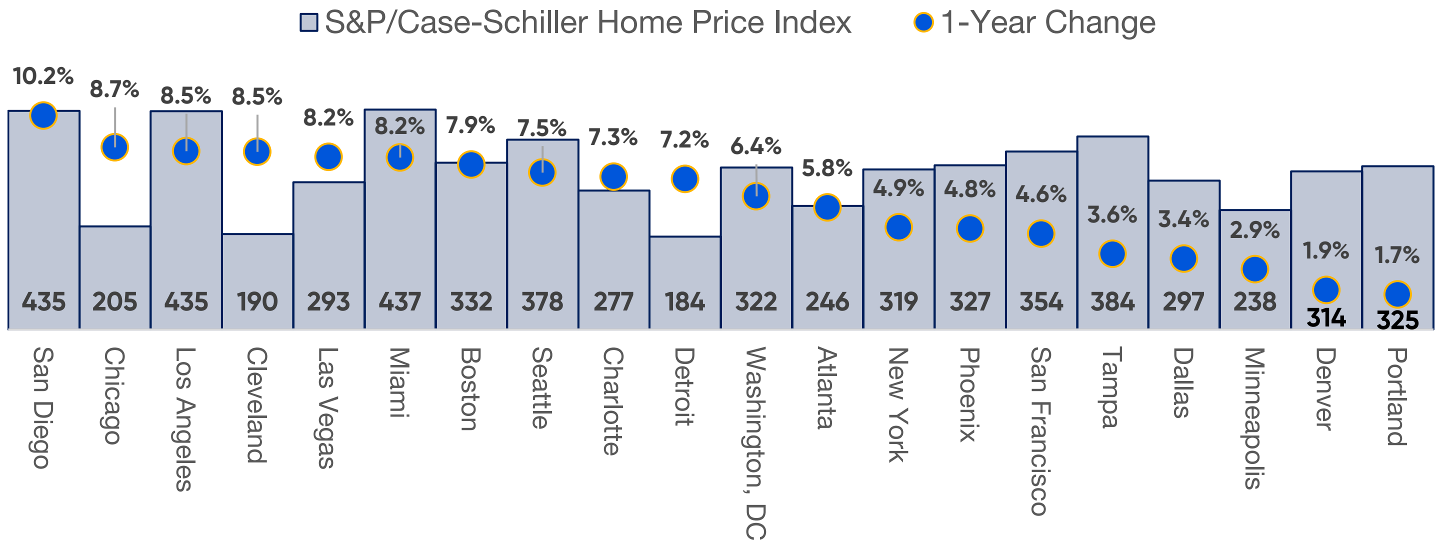
Case-Schiller Home Price Index Reclaims Recent Drops to Reach Record High

The Case-Schiller Index is an economic indicator that measures the monthly change in the value of the U.S. single-family home market. The 20-City Home Price Index peaked in June 2022 and dropped for eight straight months, before ticking higher for the past 11 months closing April at a record high. Miami holds the highest Home Price Index, followed closely by Los Angeles and San Diego. Portland and Denver increased the least in the past 12-months, while San Diego jumped the highest, closing April 10.2 percent higher than a year earlier.

Home Price Index: 20-City Average



S&P/Case-Schiller Home Price Index: April 2024



Source: S&P Dow Jones Indices LLC, S&P/Case-Shiller U.S. National Home Price Index [CSUSHPINSA], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/CSUSHPINSA, April 2024.

The Office Market Near Bottom

Q2, 2024

Office Trends

Occupiers continue to respond to slow employment growth and stable employee attendance by right-sizing their footprint to represent their current and projected needs. As a result, space continues to being given back and vacancy and sublease inventories push higher. Landlords continue to hold rents through aggressive TIs and concession packages, but there are signs that asking rents will drop in the next 12 to 18 months as the reality of true office demand pushes landlords to compete with growing sublease availabilities. More liquidity and further cap rate expansion are expected to exacerbate the situation. For investment-grade buildings, values are down around 40 percent since the end of 2021, exceeding what occurred during the Great Recession. An additional value correction over the next 12-18 months is expected as a steady stream of low-rate loans maturing into a high-rate environment.

Office Tenant View

- Competition for highly-amenitized space remains as occupiers look to re-invest savings on larger spaces for smaller, well-located office locales.
- New supply is tapering, with the lowest amount of new office construction starts (around 20 million square feet) the lowest on record.
- Cooling inflation means that the "soft landing" scenario is in play, bringing with it the prospect of lower interest rates that could ease distress for some owners and lenders. In this context, tactical office plays could prove shrewd.

Remote Work Index

Q2 2024

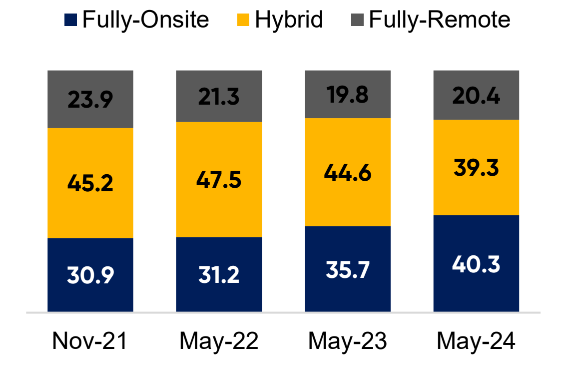
Remote Work Trend:
Increasing ↑; Decreasing ↓; Unchanged ↔

Trends

Since the last iteration of the *Remote Work Index* in the Winter of 2023, there has been a nominal amount of movement in remote work characteristics. Despite continuing pushes from leadership at many companies for workers to spend a larger amount of their time onsite, workers have stood firm on their preferences for flexibility.

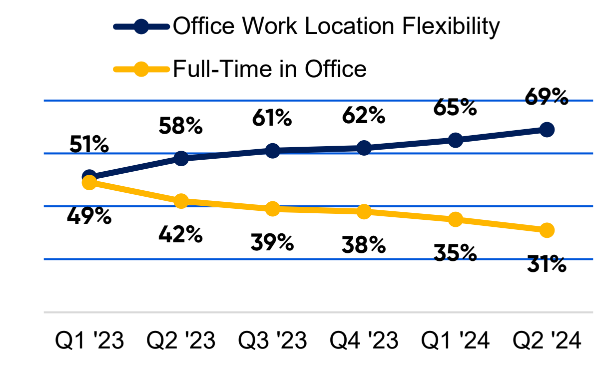
The change that has taken place is within the margins. For example, the *SWAA* data shows fully-remote work levels have remained consistent for the past three years, but more people are shifting from hybrid to fully-onsite. Meanwhile, the Flex Index indicates that companies are offering more flexibility on work options. Transit ridership, a proxy for people commuting to work, has stalled the last four quarters after rebounding from covid-era lows. The *USA Today Blueprint* survey shows there are not substantial differences for remote work based on education-level, job-title, or experience. Overall, it appears a general baseline for the "new normal" has arrived given the amount of time since covid concerns alleviated.

SWAA Data: Tele-workable Jobs ↓
(% of Workers Able to WFH):May 2024



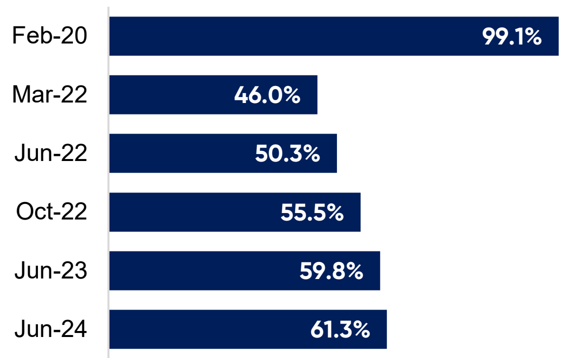
Source: Note 1

Flex Index ↑
(% of Companies Offering Flexibility) June:2024



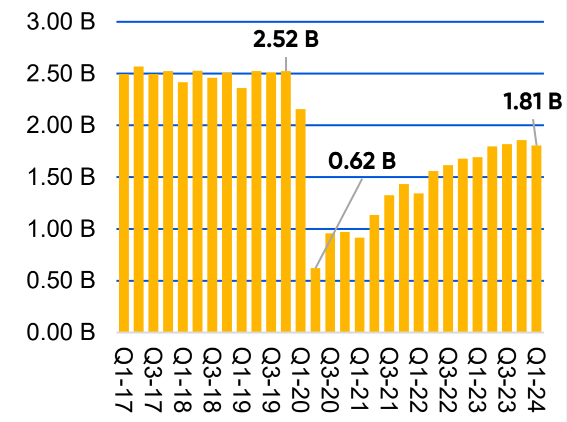
Source: Note 2

Kastle Systems ↔
(Weekly Peak Occupancy %): June 2024



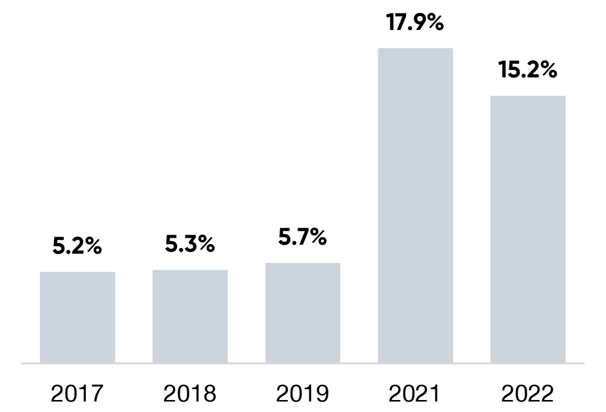
Source: Note 3

Transit Ridership ↔
(APTA Public Ridership Report): 1st Qtr. 2024



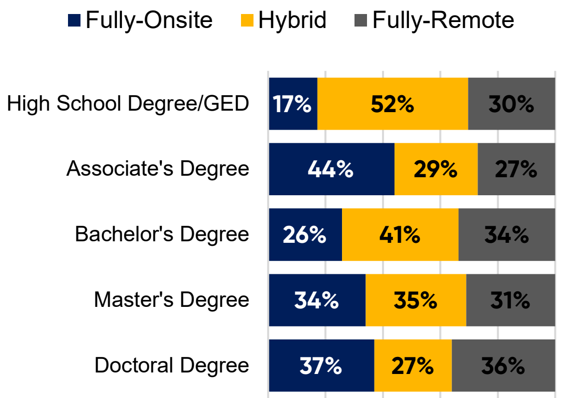
Source: Note 4

American Community Survey ↓
All Jobs: % of People WFH: September 2023



Source: Note 5

USA Today Blueprint Survey
Work Location By Education Level: April 2024



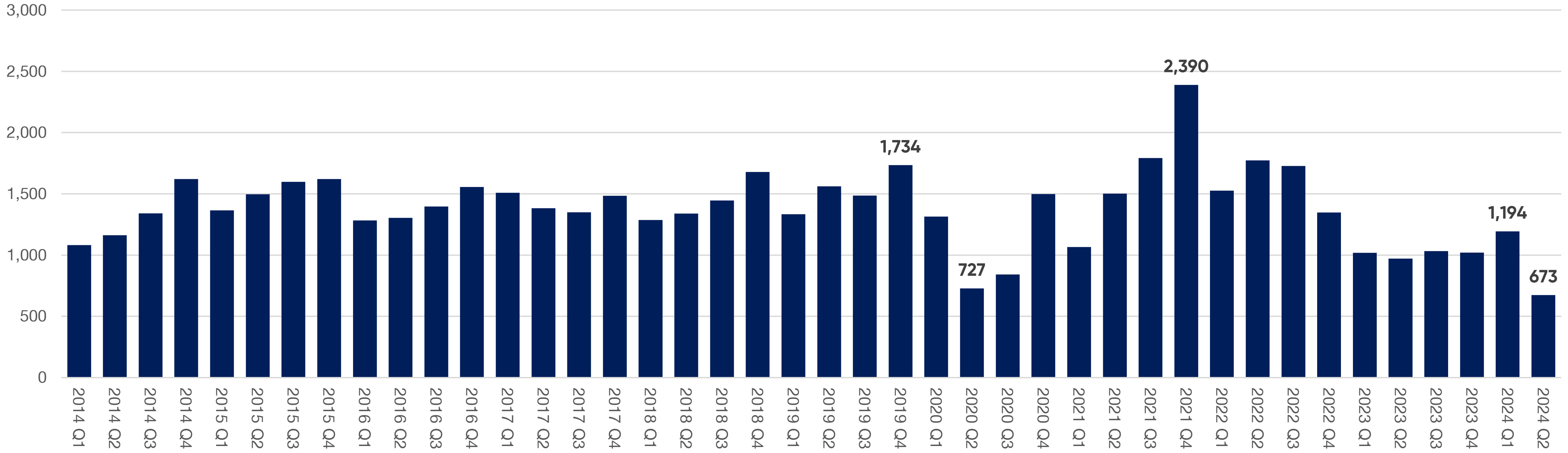
Source: Note 6

Capital Markets

Sales Velocity Falls to Near Lows of Great Recession Era

While sales velocity has rapidly dropped in the past several years, it is still on track to match levels from 2008 to 2011. The sales velocity (or number of sales per quarter) has dropped for seven of the last ten quarters. The number of office sales in the first quarter of 2024 jumped higher before falling in the second quarter.

Office Sales Velocity: (United States)

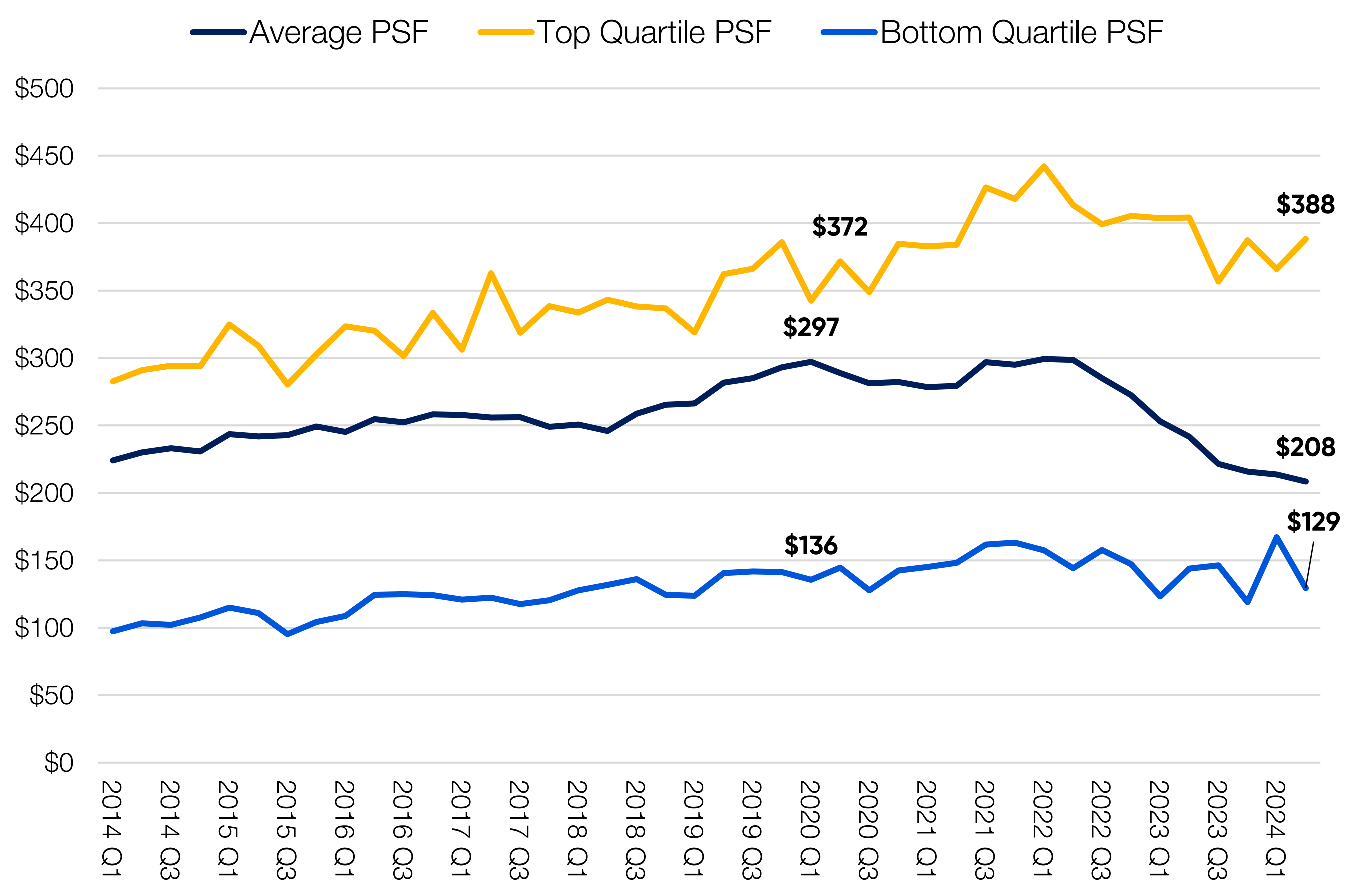


Source: Real Capital Analytics and Cresa; thru Q2 2024

Capital Markets

Average Sale Prices Per Square Foot Stabilize

Average Office Sale Price/SF (United States)



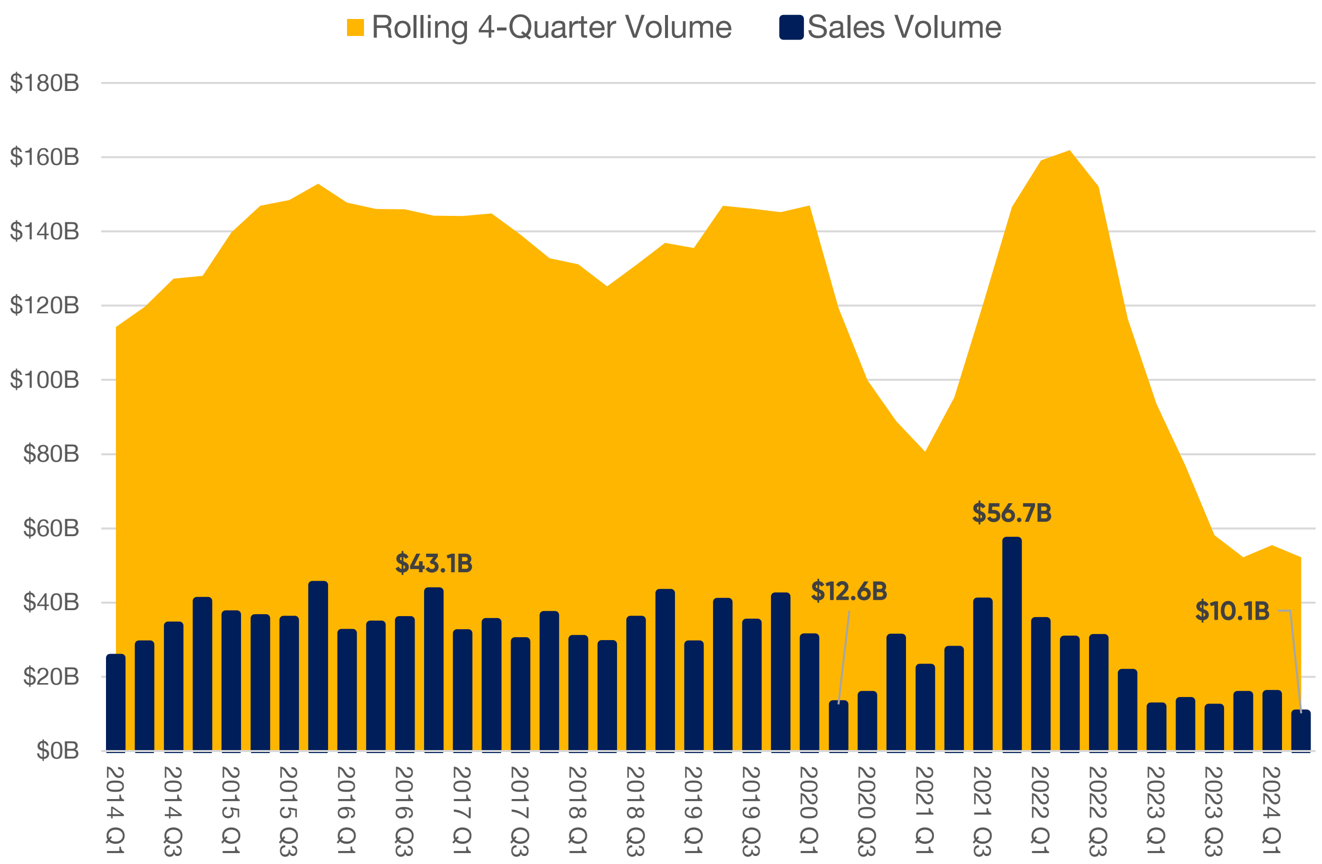
Sales of office properties in the top quartile have slowly grown since the end of the pandemic (and the close of 2023). Meanwhile, the overall average sale price per square foot of office properties has dropped nearly 25 percent during the same period. The takeaway is that **high-end properties with amenities, high-quality finishes, and good locations have generally held their value.**

Source: Real Capital Analytics and Cresa; thru Q2 2024

Capital Markets

Low Demand and High Interest Rates Stall Office Sales

Office Sales Volume: (United States)



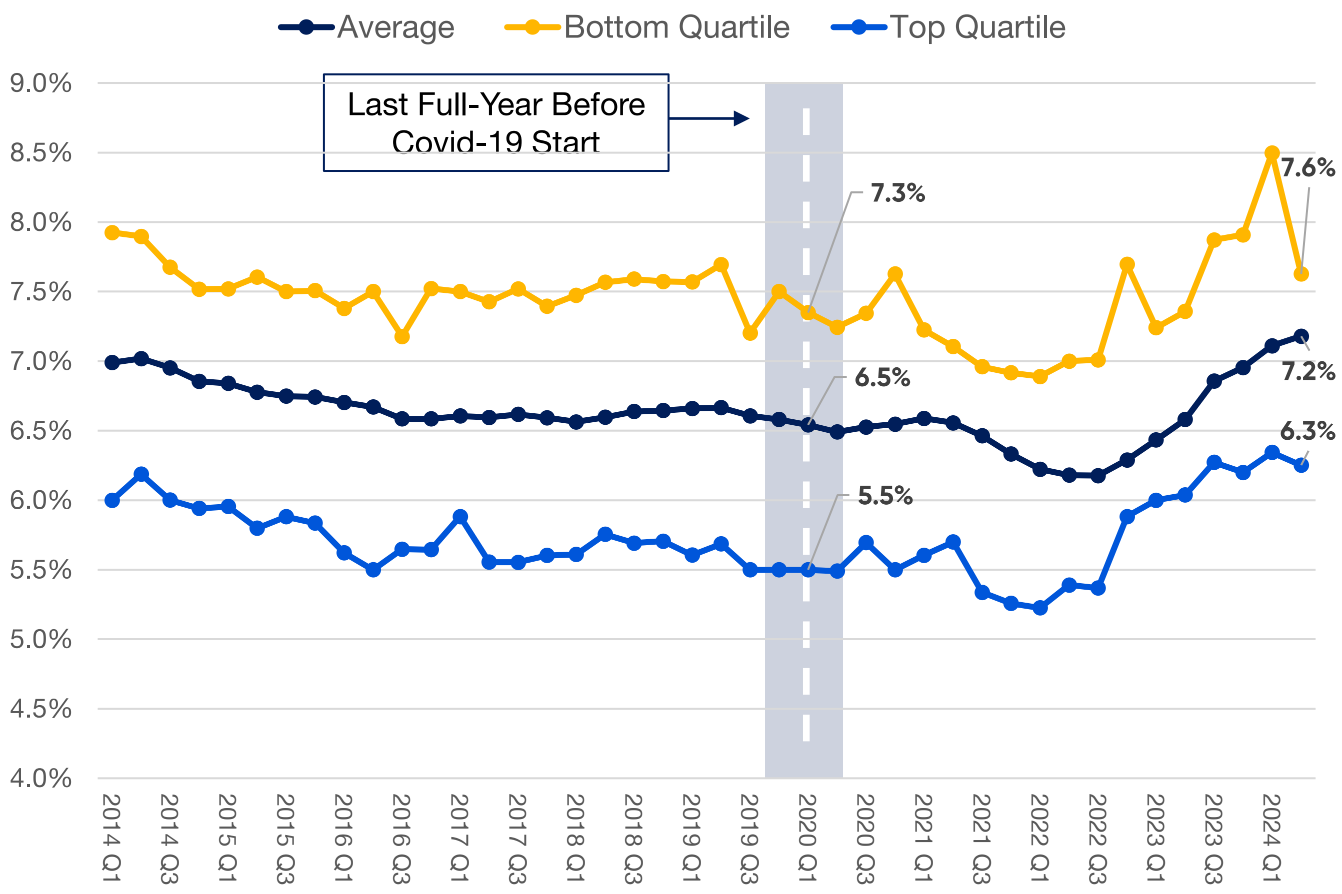
Source: Real Capital Analytics and Cresa; thru Q1 2024

Office sales volume closed the first quarter of 2024 at approximately $15.4 billion dollars, similar to the $15.1 billion volume that occurred in the third quarter of 2020. Sales volume is at the lowest levels in more than a decade. While there is plenty of money in the form of dry powder on the sidelines, investors are waiting for valuations to stabilize and to better understand interest rate trends before getting back into the market. The diminishing number of sales and fluctuating sale prices per square foot indicate that investors are still practicing caution. Sales volume during the second quarter of 2024 was comparable to the volume during the first year of the Great Recession, during the depths of the start of the last financial crisis.

Capital Markets

Cap Rates Drift Higher as Risk Increases

Office Cap Rates (United States)



Source: Real Capital Analytics and Cresa; thru Q2 2024

As sales volume has dropped, cap rates have reacted accordingly, increasing for six straight quarters. The 7.2 percent average cap rate for office properties is on level with rates from 10 years earlier. Although prices paid per square foot for top quartile office assets have held steady, cap rates are hovering above 6 percent, pricing in the additional risk of the office sector, markedly higher than the 5.5 percent cap rate before the announcement of the pandemic.

Leasing Trends

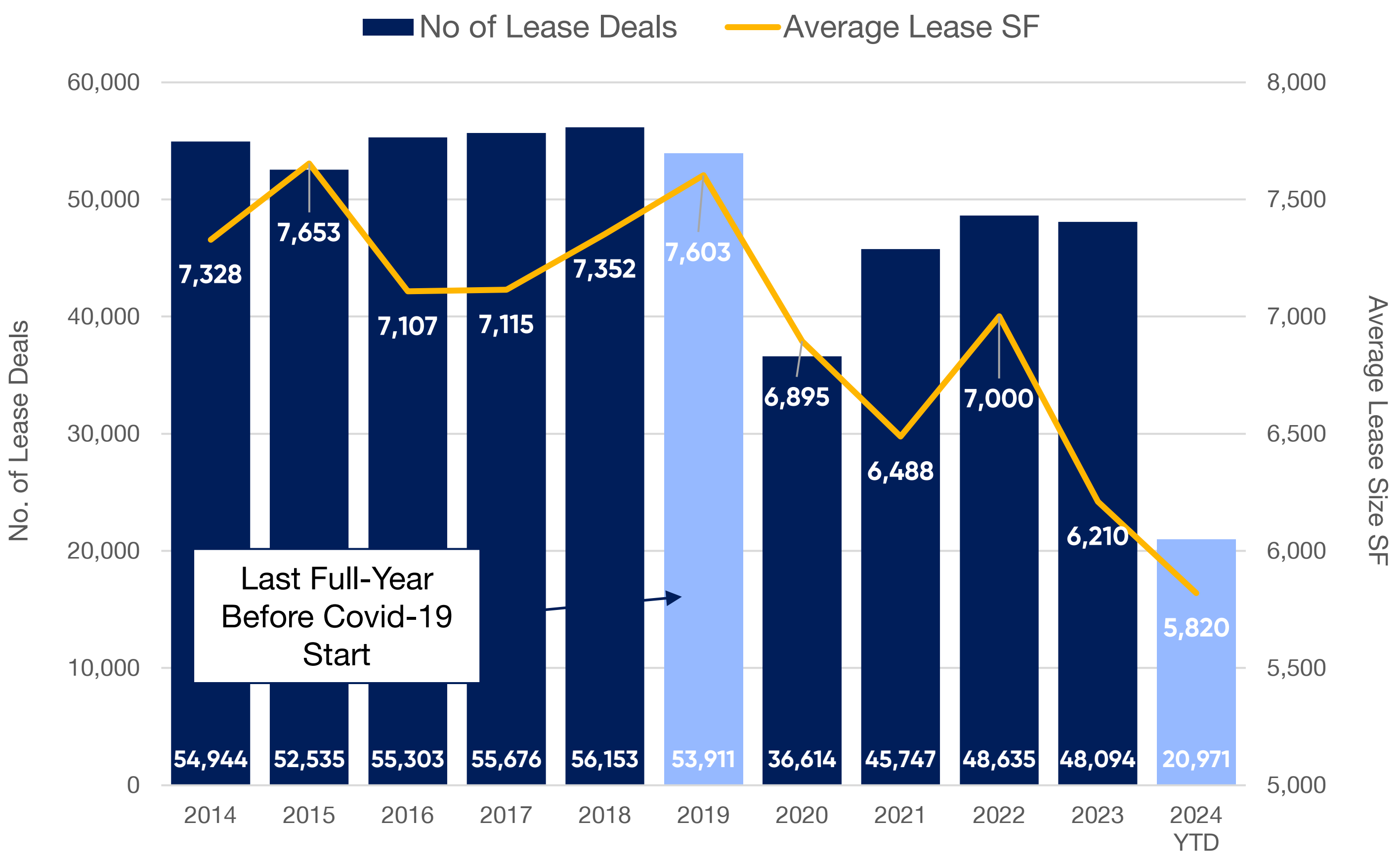
Deals Getting Done But the Number of Deals and Deal Size Shrink

Lease deal sizes through the first half of 2024 are **23.5 percent** smaller compared to 2019.

The number of deals completed in 2023 decreased by **10.7 percent compared to 2019.**

While lease deals in the 2024 are smaller compared to 2023, lease deals have historically taken time to be recorded so a final understanding of deal size may take some time to fully understand.

Historic Office Activity – Average Deal Size



Source: CoStar, Cresa

Market Rent

Office Rents Flat as Landlords Offset Demand with Concession Packages

Class A/B Office Asking Lease Rate ($/SF): (United States)

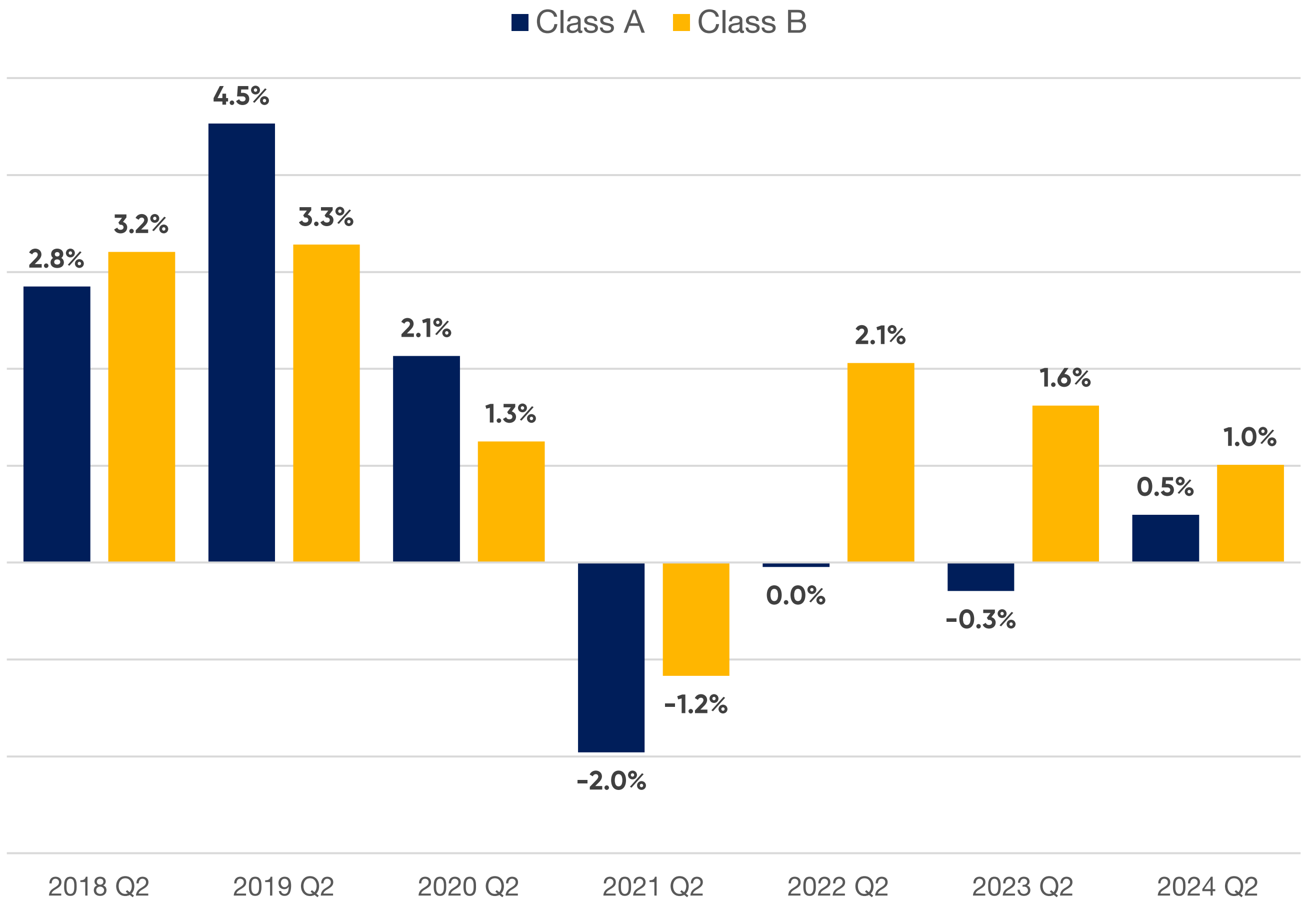
Source: CoStar and Cresa; thru Q2 2024

Lease rates have remained static for the past three years within both class A and class B spaces. As demand has weakened, landlords have held steady with asking rates, although this notion is reportedly softening. Increasing concessions, free rent, and TIs are being used to attract occupants, lowering the nominal rent. However, increasing operating costs due to rising inflation and interest rates are eroding some of these gains for tenants. Nevertheless, the office market is tenant-favorable, providing generational leverage for occupiers. The result has allowed tenants to receive more favorable terms such as contraction clauses, early termination options, and shorter terms.

Market Rent

Class A Direct Asking Rent Growth Flat Since the End of 2019

Class A/B Office Asking Rent Annual Increase: (United States)



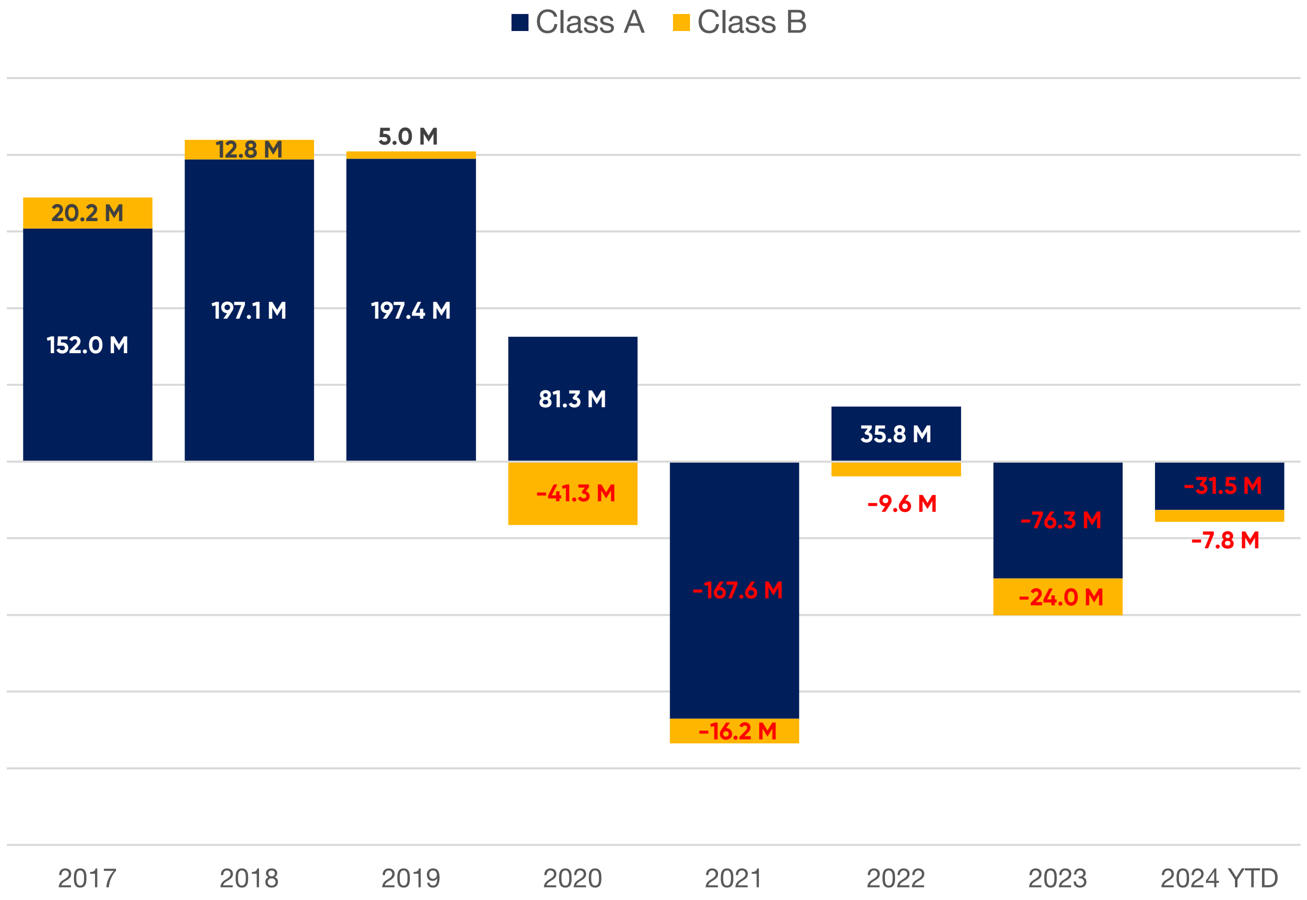
Source: CoStar and Cresa; thru Q2 2024

During pre-pandemic years, office rates historically increased 2.5 to 4.0 percent annually. After an initial drop in 2020, class A rents have decreased or increased moderately as landlords look to hold rates as long as possible, providing incentives and TIs to attract tenants. As demand continues to drag, rates will correct until market stability is reached. Meanwhile, class B rates have not seen a meaningful increase in average asking rates since 2019. Further, class B rents may not reflect what is happening on the building level as demand is weak and asking rates may not be publicly available.

Absorption

Office Absorption Records Another Quarter in the Red, But is Slowing

Office Net Absorption (SF): (United States)



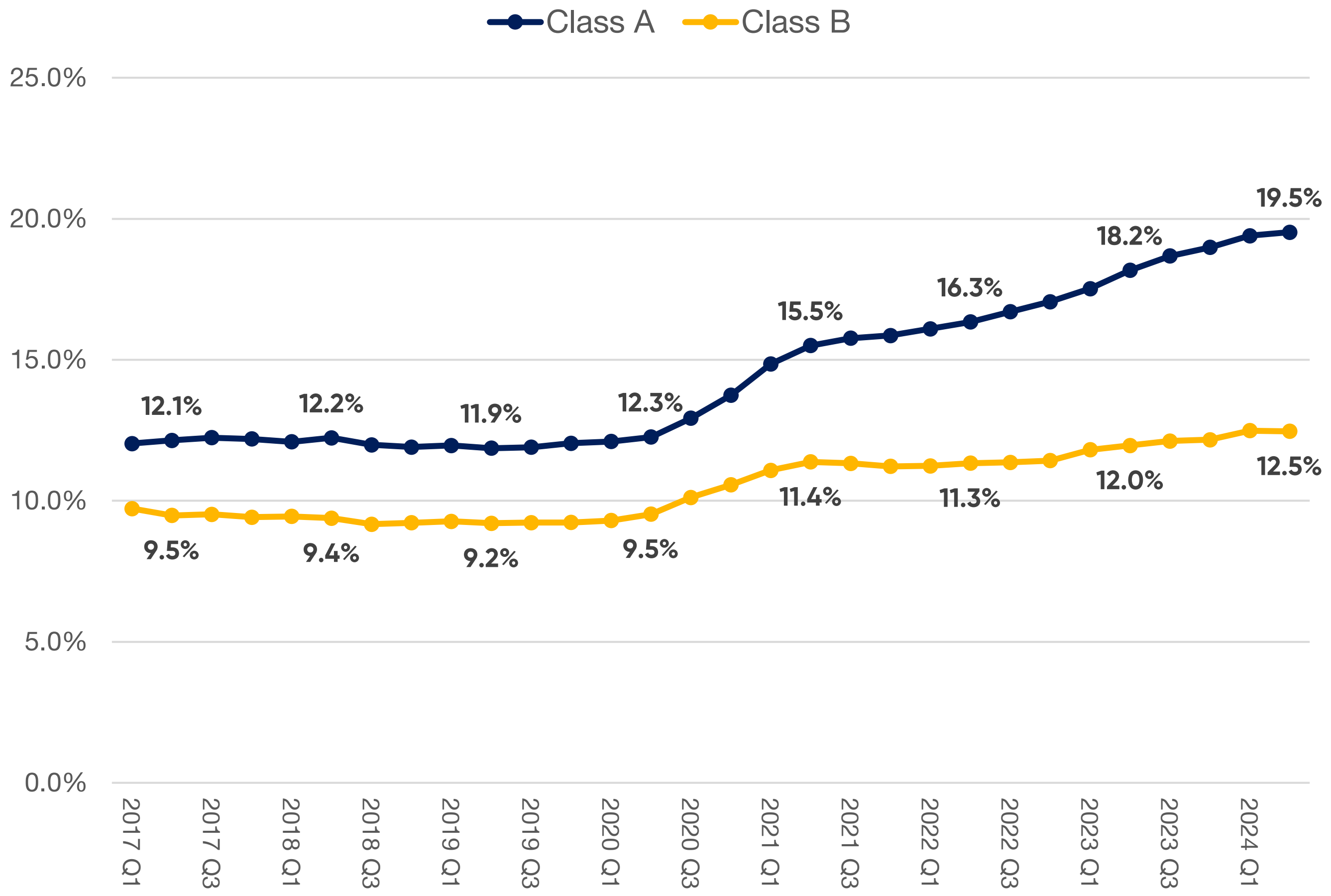
Work-from-home policies have caused many companies to reevaluate their existing office footprint. As organizations right-size and eliminate under-utilized space, office absorption has been overwhelmingly negative. Class B space has been particularly hard hit since the start of the pandemic. **There has been -173 million square feet of negative absorption recorded since the start of 2020.** As pre-covid leases continue to roll, absorption will likely continue to drop. However, as stability returns overall net absorption is expected to moderate. It will take several years before net absorption recovers the losses since the start of 2020.

Source: CoStar and Cresa; thru Q2 2024;

Direct Vacancy

Office Vacancy Spikes as Companies Right-Size

Office Direct Vacancy Rate: (United States)



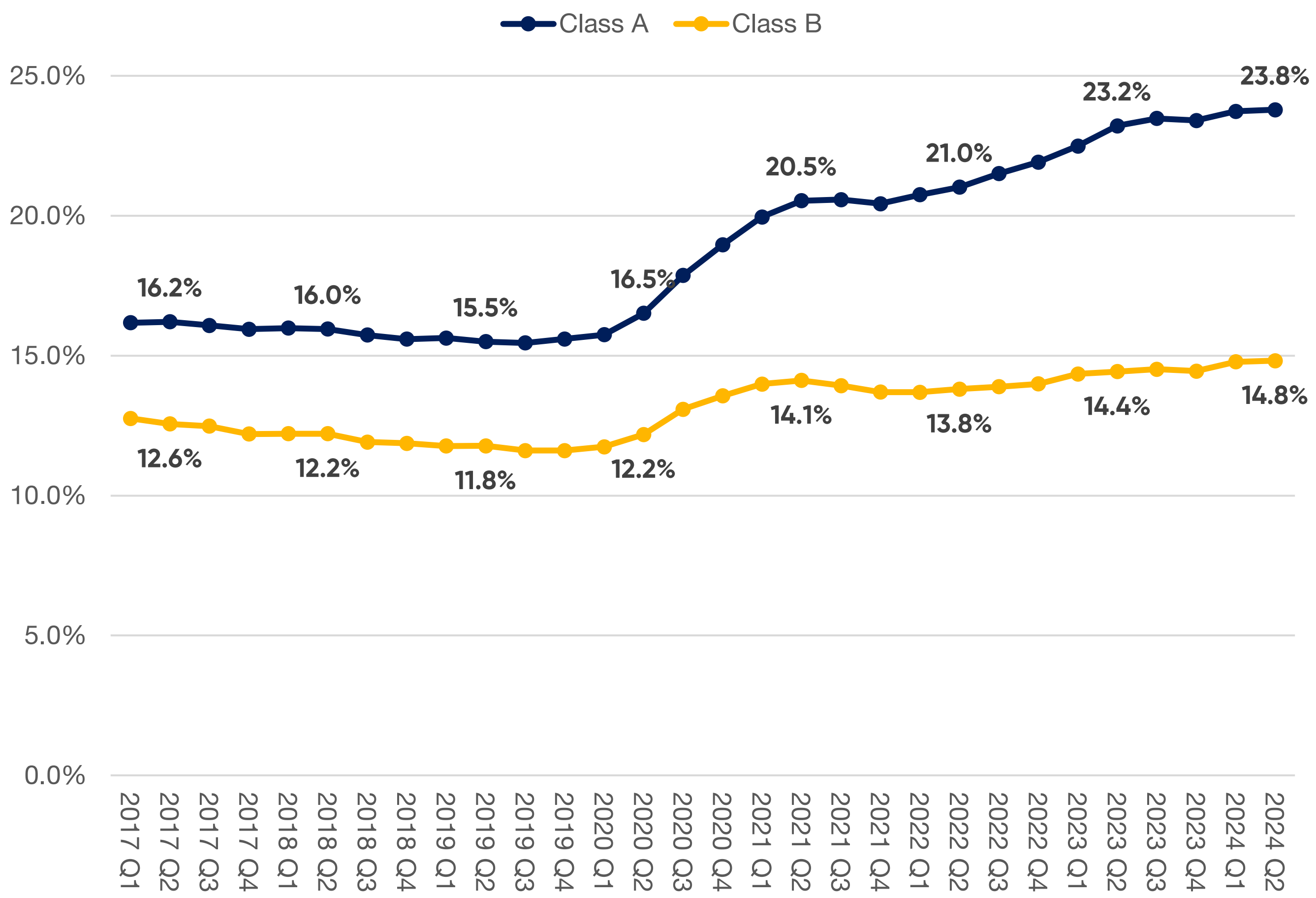
Source: CoStar and Cresa; thru Q2 2024

Class A direct vacancy has increased at a faster pace compared to class B space. Direct vacancy is expected to continue to rise as pre-pandemic signed leases begin to roll, adding to the **19 straight quarters vacancy has increased**. Additionally, newly signed leases on average are shrinking which may buoy vacancy even as space is being removed from the market. Class B vacancy may be positively impacted long-term by office conversions to other uses.

Availability

Availability Climbs in Class A Office Space

Office Availability Rate: (United States)



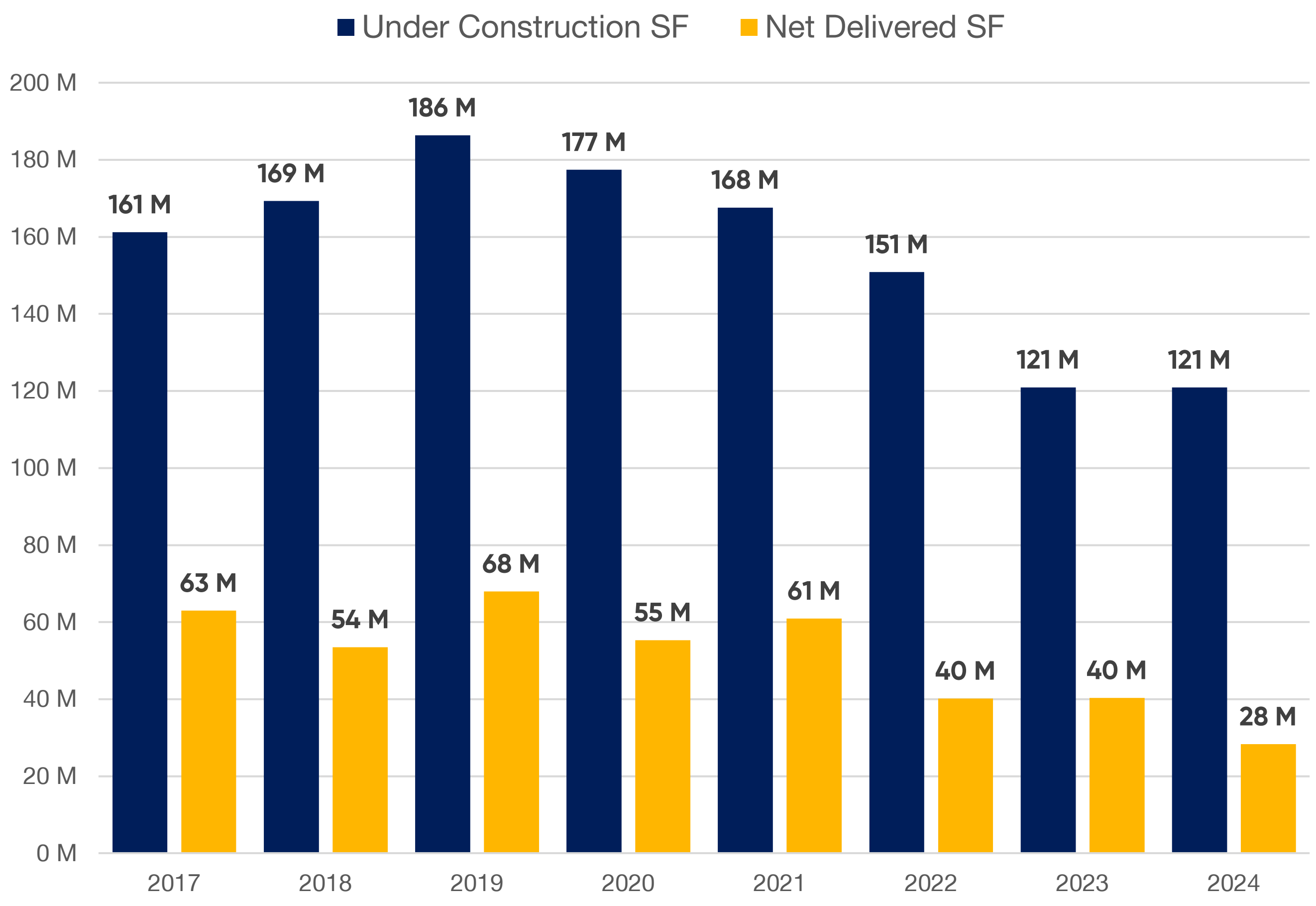
Source: CoStar and Cresa; thru Q2 2024

The availability rate includes the amount of space that is being marketed as available for lease, regardless of whether the space is vacant, occupied, available for sublease or available at a future date. Therefore, the **availability rate may be a more accurate depiction of the market during this volatile period than the direct vacancy rate**. Class A availability ticked higher to 23.8 percent to the end the second quarter of 2024, indicating that demand remains soft as the office market resets, but the bottom may be near.

Construction

Office Construction Slows to a Near Halt

Office Space Under Construction (SF): (United States)



Source: CoStar and Cresa; thru Q2 2024

As pre-pandemic office projects deliver, the amount of under-construction space is dropping. Weak demand, increasing construction costs and higher interest rates will likely stall many office projects. However, there is still 121 million square feet under construction. While this is not an insignificant number, it still represents less than two percent of the total office inventory, which is near or below historical averages. **During the second quarter, only 26 new office starts got underway, the lowest number in the past quarter century.**

The problem with the real estate market is the market itself.

The market Sees you as a target.

The market chases the deal.

The market is short term and reactive.

The system favors landlords not occupiers.

The stakes are high for occupiers. Real estate is expensive and inflexible. With the pandemic, labor dynamics, and economic instability, all bets are off.

It's time to go beyond the market and uncover how your commercial real estate can drive your goals, not impede them.

How We're Different

As the world's leading corporate real estate provider committed exclusively to serving occupiers, we're in a league of our own. We offer creative solutions, unbiased advisory services and executive leadership on every account. We believe this combination of transparency and executive involvement generates the superior service our clients have come to expect from Cresa.

Billions of square feet are represented on the landlord's behalf nationally. Cresa never does business on behalf of landlords.

An Unbiased Advocate

We're unbiased, uninfluenced by landlords. Everything we do is from an occupier perspective – and to their advantage.

Our Structure

As a privately-owned firm, we can adjust quickly, easily scaling project teams or service offerings to suit client needs.

Our Integrated Platform

Our services, each led by specialists in their field, are interconnected to enrich our clients' businesses and ensure seamless delivery.

Our People

Led by seasoned principals with years of experience, we hire selectively and empower our employees to think innovatively.

Transparency

Transparency is what allows us to foster lasting, meaningful relationships with each other and with our clients.

About the Author

Craig Van Pelt

Head of Research, Director

cvanpelt@cresa.com

cresa

Visit cresa.com for more information.

Cresa is the world's leading global commercial real estate advisory firm that exclusively represents occupiers and specializes in the delivery of fully integrated real estate solutions. Our purpose is to think beyond space, strengthening those we serve and enhancing the quality of life for our clients. Delivered across every industry, Cresa's services include Transaction Management, Workplace Solutions, Project Management, Consulting, Lease Administration, Technology, Investment Banking & Capital Markets and Portfolio Solutions. In partnership with London-based Knight Frank, Cresa provides service through 16,000 people, across 380 offices in 51 territories