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NAVIGATING A NEW NORMAL

Impact of COVID-19 on Lease Characteristics
in the Greater Chicago Office Market



Introduction

In mid-2024,

the office market is well into its fourth year of rapid changes in work and office space use, yet many companies are still figuring out the future. The market has faced significant negative impacts, with daily unflattering headlines. While one might expect dramatically depressed effective rents, the gross effective rent for commercial office buildings has decreased post-COVID-19, but the situation is more nuanced than it appears. The pandemic-induced shift to remote work significantly reduced the demand for office space as many companies adopted hybrid or fully remote work models. This decrease in demand has led to higher vacancy rates and increased tenant incentives, such as rent-free periods and fit-out contributions, which have impacted gross effective rents. Furthermore, economic uncertainty and cost-cutting measures have made businesses hesitant to commit to long-term leases, putting additional downward pressure on rental prices. Landlords, in response, have had to become more flexible and competitive to attract and retain tenants, further contributing to the decline in gross effective rent.

While this latest period of shifts in the office market may be the most impactful, it also occurs within a longstanding debate about the optimal workplace locations that balance attracting talent and efficiently spending corporate resources. The past two decades have seen many companies moving to city centers as the fight for talent led organizations to locate closer downtown.

Many notable moves in Chicago during the 2000s and 2010s have shown this trend with companies such as McDonalds, Motorola, and Walgreens all abandoning large suburban campuses in search of greater concentration of talent downtown. With remote work forcing companies to rethink their footprints, it might be surprising that the suburban office market has fared better from a vacancy perspective than in the city center. Downtown office vacancy has increased more than 400 basis points over its suburban counterparts from 2017 to today. This may be driven by a suburban occupier community that was already “right-sized” as a result of a more balanced user base, compounded by downtown occupiers that overleased space during a robust economic growth period.

To verify the impact of gross effective rents post-COVID and compare urban and suburban markets, we have analyzed two Chicago submarkets: the West Loop in the Central Business District (CBD) and O’Hare in the suburbs. The data was further separated into Class A and Class B asset types, as there has been a noticeable trend in occupiers moving to higher-quality assets in the hopes of luring employees to the office. In this joint report from Cresa and CompStak, leasing data was analyzed from 2017 through the first half of 2024. The pre-COVID period is considered to be from 2017 through 2019, while the post-COVID period is from 2020 through 2022. The ‘new normal’ refers to 2023 through the first half of 2024. With this analysis, we uncovered the following major findings:

Vacancy & Absorption

Increased Direct Vacancy has been the subject of many reports in Chicagoland: Class A space has largely been spared dramatic increases, for Class B space, it all depends on your market.

Trends show that for downtown space, older stock is being left behind for newer, more amenity-rich space. Class B space in the West Loop has seen vacancy figures over triple from their pre-COVID numbers (9.6% to 31.1%). Class A space has a much more muted increase, 10.8% to 15.0%.

In O'Hare, we found a similar trend in Class A space, with direct vacancy only increasing a few hundred basis points from 11.7% to 16.2%. Class B space tells a story of its own, with vacancy decreasing slightly (18.5% to 17.9%), likely benefitting from lower total inventory, fewer large users, and less impact from downsizing.

There are stark differences between the downtown and suburban sublease vacancy trends, with downtown users shedding space at a much faster pace than their suburban counterparts. This is most

pronounced in Class A West Loop, where sublease vacancy has nearly tripled from 2017 to today (1.0% to 2.9%). Total sublease square footage (996,000 SF) equates to nearly double the three other subject submarkets combined (506,000 SF). All studied submarkets are now seeing a decline in sublease space as users take advantage of below-market rates and natural lease expirations return space to landlords.

Interestingly, West Loop Class A space is the only subset to see total availability decline from 2017 to today, down 230 basis points from 2017 to 24.3%. O'Hare Class B space again benefits from a smaller inventory with only a 3.0% increase. Both Class A O'Hare space and Class B West Loop space suffered a 15%+ increase with 16.2% and 22.1% respectively.

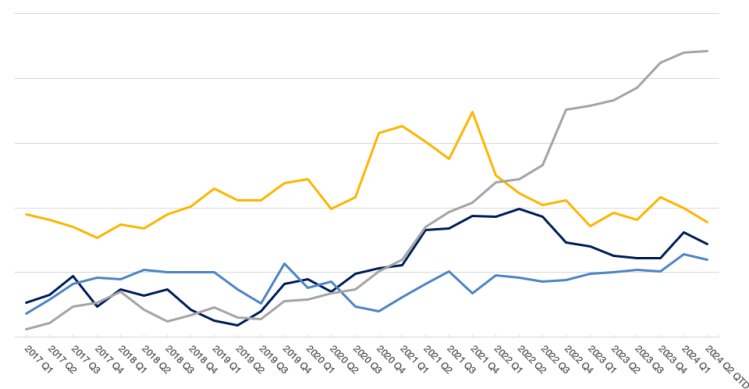


Net Absorption is dominated by the West Loop both pre and post-pandemic with O'Hare only seeing a fraction of the movement that its downtown counterpart experienced.

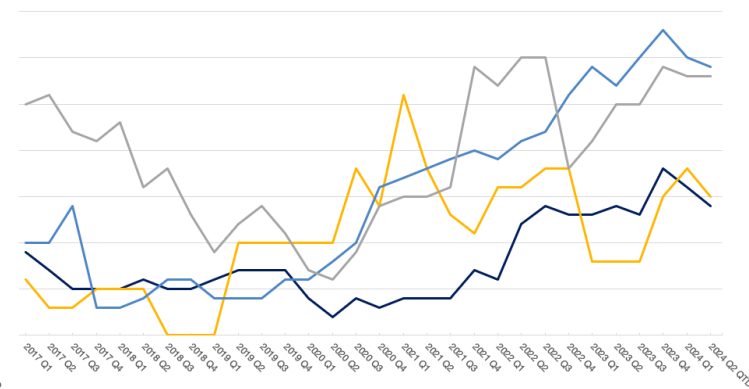
Pre-pandemic net absorption is dominated by West Loop Class A figures, with 1.9 million square feet of move-ins before work-from-home mandates, the only subject subset to record positive absorption during this period. As expected, all asset classes suffered during the post-pandemic period, none more than West

Loop Class B space, with 2.4 million square feet of move-outs. From 2023 to today, suburban markets have the least impacted figures, with Class A O'Hare space barely negative and Class B space positive. Both West Loop figures are heavily negative (644,478 for Class A and 854,733 for Class B).

DIRECT VACANCY



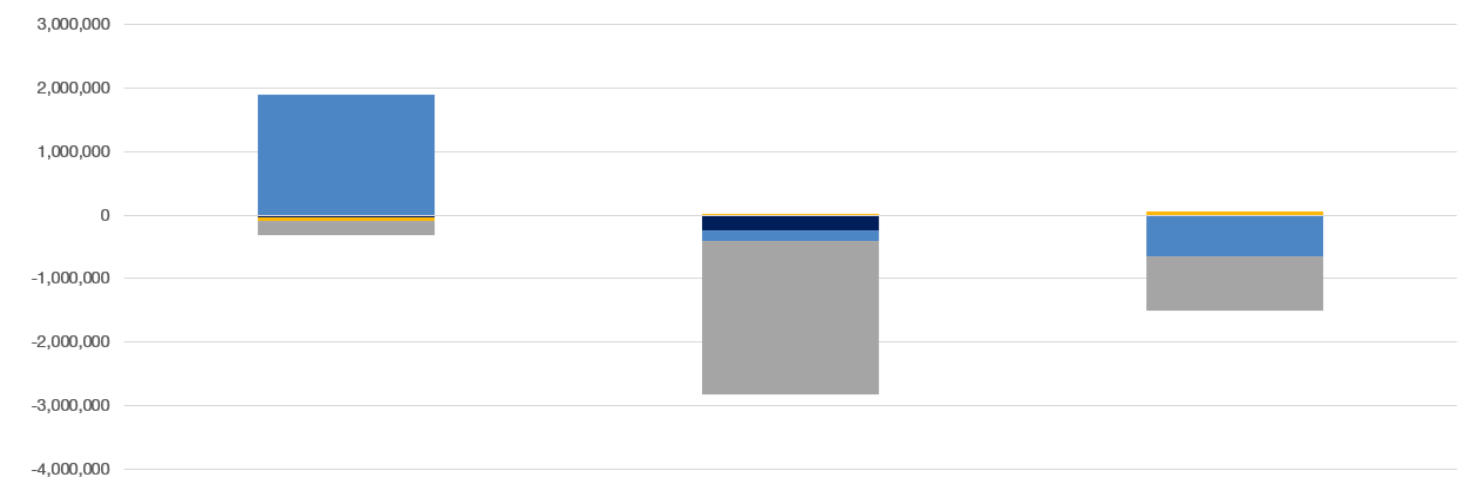
SUBLEASE VACANCY



Total availability varies wildly with no submarket seeming to be on the same trendline.

Downtown users have put space on the market for sublease at a much higher rate than users in the suburbs, undercutting the market for space.

- O'Hare Class A Vacancy
- O'Hare Class B Vacancy
- West Loop Class A Vacancy
- West Loop Class B Vacancy



2017-2019

2020-2022

2023-2024

- O'Hare Class A Net Absorption
- O'Hare Class B Net Absorption
- West Loop Class A Net Absorption
- West Loop Class B Net Absorption



Gross Effective Rents

West Loop Class A effective rents dipped most from pre-COVID during the 2020-2022 period but have most recently rebounded, surpassing pre-COVID levels.

Average effective rents for Class A in the West Loop have increased steadily from 2021 to 2024, driven by higher-priced deals in trophy buildings and new construction. Recent deals that drove up the recent average include Prudential Financial's lease at 150 North Riverside Plaza and deals from Molson Coors and Antares Capital inked at 320 South Canal Street.

Meanwhile, average effective rents in Class A O'Hare are most recently on par with pre-COVID levels, while Class B O'Hare effective rents are up from pre-COVID and 2022-2022 levels. Deals driving up the Class B O'Hare effective rent average include leases from Lee & Associates at 9450 West Bryn Mawr Avenue and UniteHere Local 1's lease at 5440 North Cumberland Avenue.

Transaction Size & Lease Term

Both West Loop and O'Hare Class A buildings have average transaction sizes below pre-COVID levels, with West Loop experiencing a greater decline.

If we break out average transaction size by building class for O'Hare vs. West Loop, it is evident that the greatest increase from Pre-COVID levels to the average for 2023-2024 year to date has taken place for Class B O'Hare transactions (+36.1%). However, transaction size remains substantially small in that submarket (6,762 square feet) and has experienced more limited activity.

Meanwhile, the average transaction size in Class A West Loop transactions has decreased the most from pre-COVID levels to the 2023-2024 average (-42.5%), resulting in an average of just over 18,000 square feet.

Despite the substantial decrease in the average transaction size from pre-COVID levels, there were several notable deals in the 2023-2024 period for Class A West Loop buildings. Some of the highest-ranking transactions included: Teachers Insurance and Annuity Association of America (165,689 square feet at 333 West Upper Wacker Drive), and PNC Bank (95,114 square feet at 1 North Franklin Street). The largest Class A O'Hare transactions from 2023-2024 year to date were Federal Aviation Administration (108,094 square feet at 9600 West Bryn Mawr Avenue) and Fifth Third Bancorp (54,658 square feet at 6111 North River Road).

The average lease length for Class A and B West Loop transactions remains below pre-COVID levels, as tenants pursue greater flexibility.

While both Class A and B transactions in the West Loop saw improvements in lease term lengths in 2023- 2024 year-to-date from the post-COVID period, they remain below pre-COVID levels by -4.2% and -3.1% respectively. Leases that recently boosted the West Loop Class A average to just over seven years included Molson Coors, CCRM Fertility of Chicago, and Citibank, each signing a new lease of fifteen years or longer. Meanwhile, the average term length for Class A transactions in the O'Hare submarket is on par with pre-COVID levels.



Concessions

Free rent periods have risen for Class A and B buildings across submarkets, with West Loop Class A receiving the most generous terms.

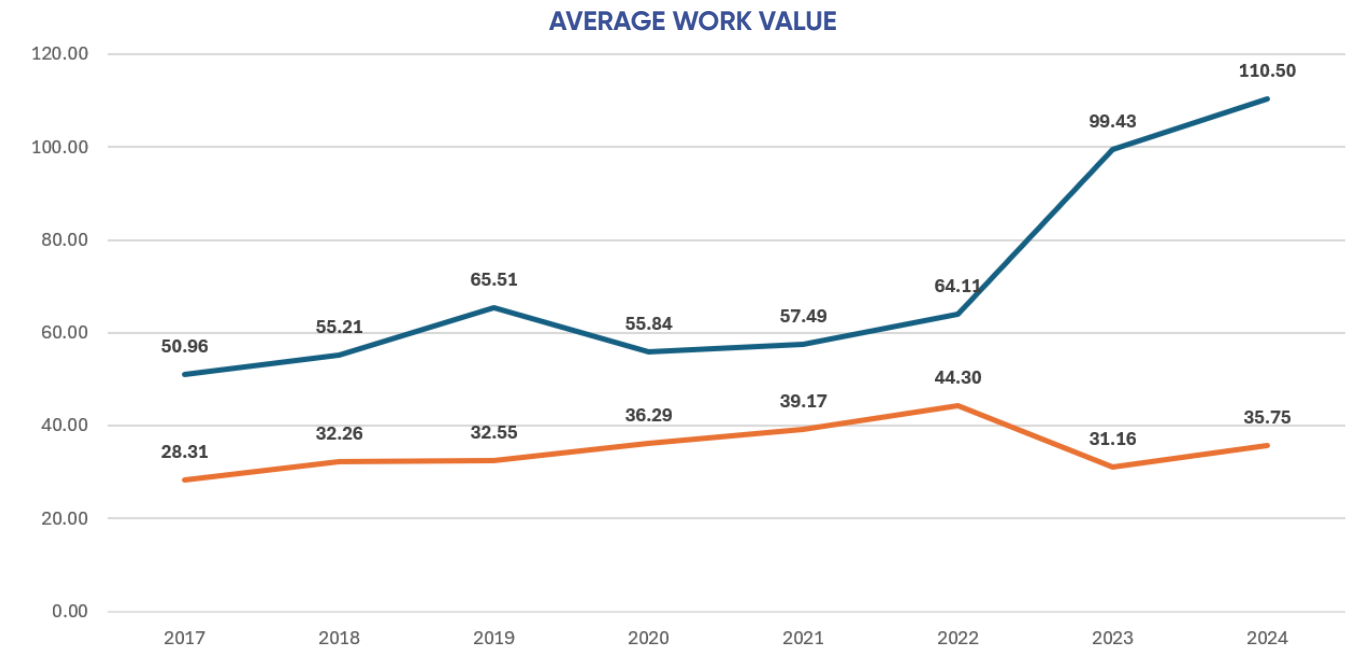
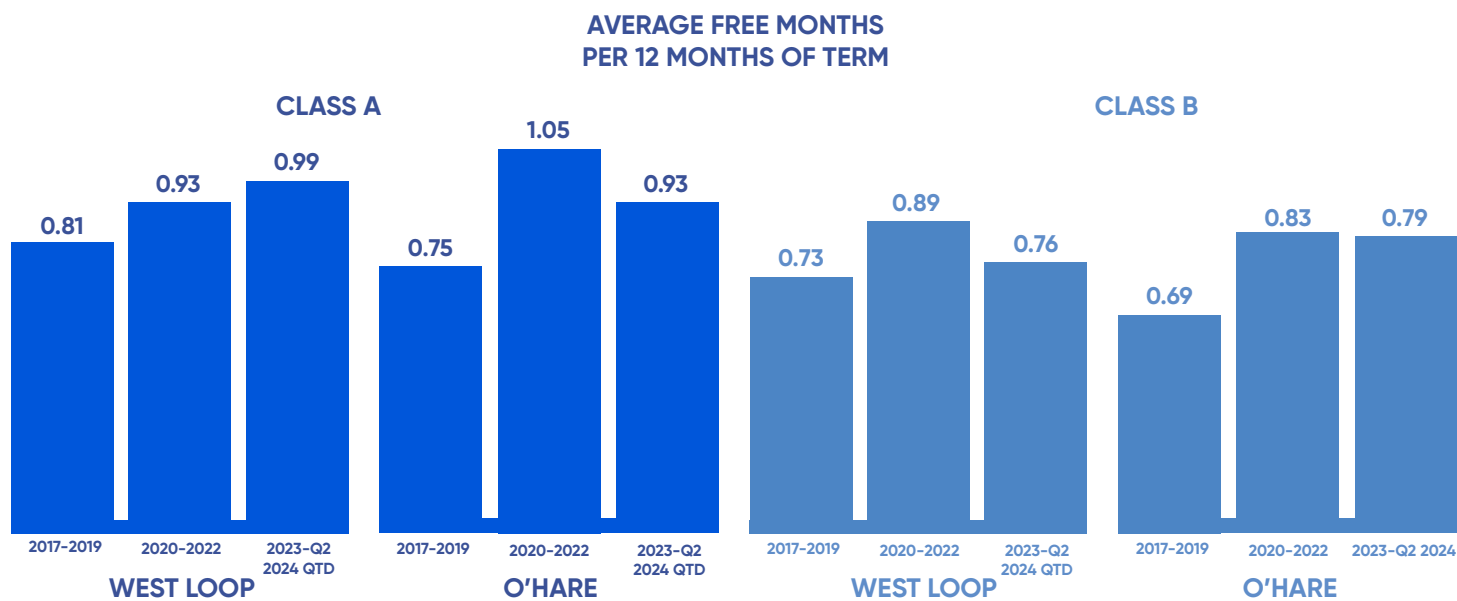
The average number of free months per 12 months of lease term length has shown a clear trend of exceeding pre-COVID levels for both submarkets. Among these categories, Class A transactions in the West Loop are receiving the most months of free rent per 12 months of lease term, averaging about one month (8%) of term,

up a considerable 22.2% from pre-COVID levels. Meanwhile, Class B buildings in both submarkets average fewer free months per 12 months of lease term as compared to their Class A counterparts. In the West Loop, Class B buildings have recently averaged .8 months per 12-month term, up 4.1% from pre-COVID.

Tenant improvement allowances have surged to triple digits in the West Loop but held steady in O'Hare.

The average work value marched upwards from 2021 to 2024 year to date for the West Loop submarket, while it remained relatively stable from pre-pandemic for the O'Hare submarket, increasing just slightly from 2019 to 2022 before declining in 2023 and 2024 to

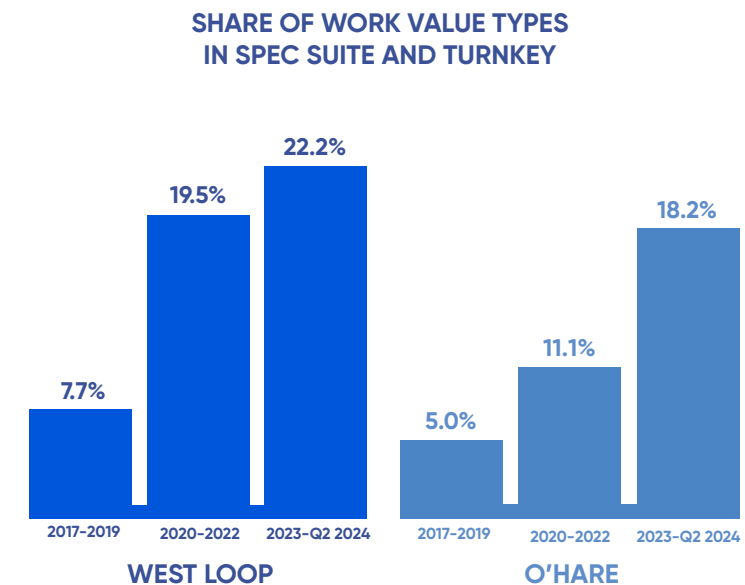
date. From 2019- 2024 year to date, the average work value is up 93.1% to a triple-digit average of more than \$110 per square foot in the West Loop office market.



Turnkey deals are on the rise in a competitive market as tenants seek quality and ready-to-go space.

Across each submarket, the share of work value allowances received by tenants via spec suite or turnkey options has increased significantly since the pre-COVID average. In the West Loop, nearly 20% of deals from 2020 through 2022 with TI were in turnkey and spec suite transactions. The average for 2023-2024 year to date was even higher, reaching 22.2%. For the O'Hare submarket, the

average of deals receiving TI in turnkey or spec suite increased in each of the past two periods; in 2022-2022, the average reached 11.1%, more than double that of the pre-COVID average, and increased again to 18.2% during the most recent period (2023-2024 year to date).



Findings

The O'Hare and West Loop were impacted significantly by work-from-home mandates. However, when separated by building class, there are noticeable differences. From a market metric perspective (Direct Vacancy, Sublease Vacancy, Total Availability, and Net Absorption), Class A space in the West Loop outperformed all the subject markets in all areas except sublease space, which was driven primarily by larger users having more space than needed at the highest rates in the city. Class B space in the same market suffered the most in all market categories except sublease space. In the O'Hare market, the reverse occurred. Somewhat counterintuitively, Class B space in O'Hare performed better than its Class A counterparts across the board except for sublease space. This is likely the result of a lower inventory that produces less disruption in the market.

Examining the transaction details reveals a clear trend from the pre-pandemic period to the present day: an increase in concessions combined with shorter lease terms to attract occupiers.

Gross effective rates have increased or changed marginally, across the board as Landlords hold their face asking rates in exchange for more free rent and tenant improvement allowances.

West Loop Class A gross effective rents experienced the most significant decline immediately after the onset of COVID-19 but have recently rebounded as users seek quality space in the heart of the city. All other studied subsets saw marginal movement from the pandemic to today.

West Loop Class A properties experienced the largest dip in transaction size over the analysis period as users significantly reevaluated their footprints, while all other markets showed minimal movement.

Concessions (including free rent and tenant improvement allowances) have increased across the board for all studied submarkets and classes. As occupiers become more averse to capital expenditures and seek to avoid lengthy construction timelines, the rise of turnkey solutions has been evident in the statistics. Both markets have seen a tripling in the share of transactions attributed to this type.

Why it Matters

Regardless of market or building class, many occupiers enter today's market expecting wildly below-market transaction terms from landlords as vacancy rises and sublease space undercuts the market. However, gross effective rates haven't declined substantially from pre-COVID averages. Despite shrinking transaction sizes and increased concessions, many landlords simply cannot drop face asking rental rates as part of their debt covenants. Occupiers are also increasingly looking at quality space, which is found in higher rent, well-leased assets that can command top-tier gross figures. In addition, landlords are conceding to shorter-term leases as occupiers' desire for flexibility has taken center stage. Termination options have become more commonplace for all users, not just the larger, more creditworthy companies that traditionally secured them in deal negotiations.

Conclusions

By and large, the O'Hare and West Loop submarkets are recognized as the bellwethers of the suburban and downtown markets. After analyzing the data and trends from this study, it is evident that the market has adjusted and is progressing beyond the immediate impacts of the pandemic. However, there are substantial and distinct changes in lease characteristics compared to the pre-COVID period. Occupiers are resetting their space needs and rethinking the workplace for a modern workforce while still building in flexibility into their leases. In response, landlords have utilized their resources to create transactions that, while offering more concessions, continue to generate returns for their stakeholders.





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