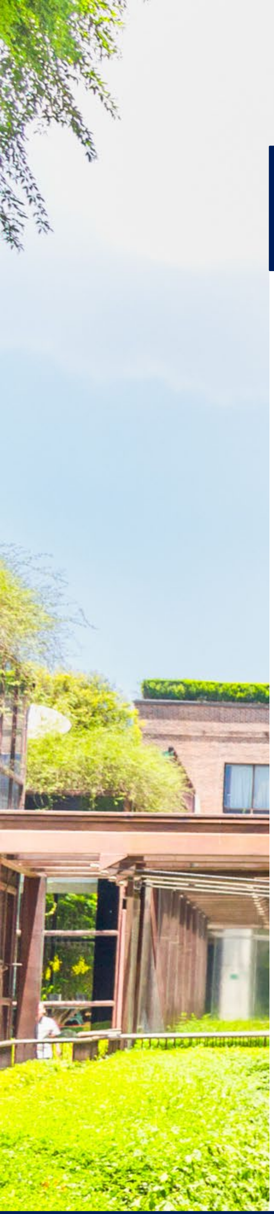
Occupier Outlook

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

Cresa Research

Q1, 2024



Executive Summary

Macro Economic View

- Office-occupying/knowledge worker jobs retreat as the health and service sector employment jumps higher
- The US economy continues expansion as GDP growth exceeds expectations
- Inflation remains stubbornly elevated, but consumers continue to spend down recession-era savings
- All eyes will be on the Fed to see if they hold rates steady or cut rates heading into the middle of 2024
- Housing starts tick higher, but sales drag as interest rates discourage both buyers and sellers

Office Market Searches for the Bottom

- Employee occupancy levels have now remained stable for the past 18-months
- Lack of new office construction is limiting top-tier space availability as flight-to-quality remains
- Landlords are holding firm on asking rents, but net effective rent drops due to attractive concessions and more favorable lease terms

Industrial Sector Comes Up for Air

- The US industrial market continues to downshift from historic highs in 2021 and 2022
- Supply is outpacing demand as new industrial products deliver, but a dramatic decrease in new starts will bring stability in the mid-term

The economy stabilizes, as the commercial real estate sector continues to search for buoyancy.

The US Economy Pushes Higher as Inflation Lingers

The Economy Defies Expectations With Strong Start to 2024

The economy kicked off 2024 with positive momentum from outsized GDP growth spurred by consumer spending and a tight employment market. Many economists predicted a shallow recession in 2023 that never materialized, and few expect a contraction this year. Despite the Fed raising 525 basis points in the past 24-months, the labor market has been resilient, with more than 300,000 jobs added in March. This marks the fourth straight month of job gains.

The result of the Fed boosting interest rates dropped inflation from the peak in June 2022. However, inflation has remained stubbornly above three percent annual growth. Persistent elevated inflation has caused concern that the Fed may prolong long-awaited rate cuts or even cause additional hikes.

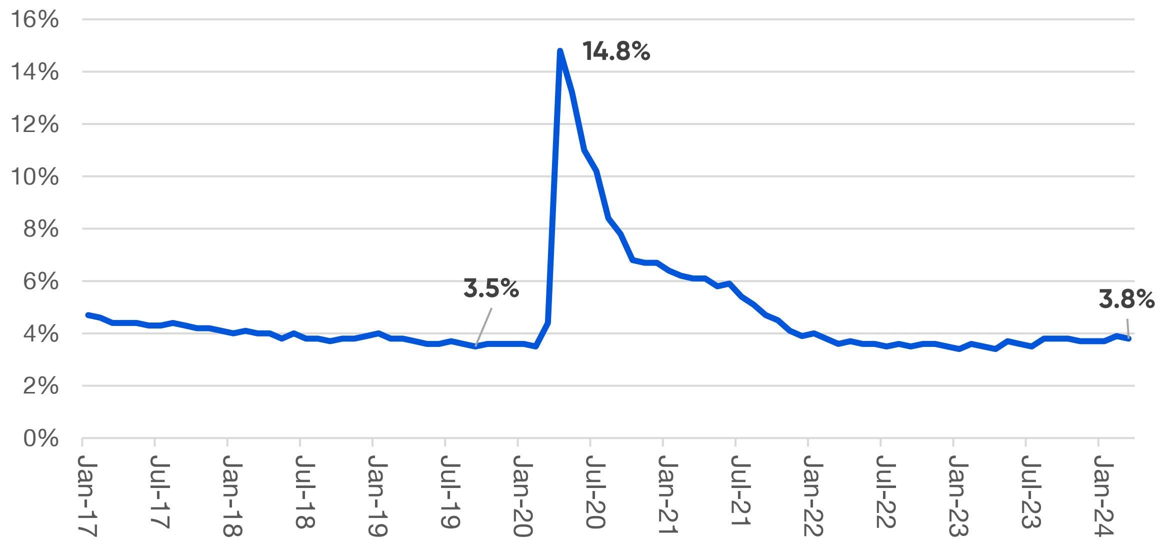
Still, there has been a general slowdown in some activity, including manufacturers experiencing a slowdown in product orders in 2023. The housing market has seen sales activity slow due to increasing rates. Nevertheless, elevated prices have eroded affordability. The services sector has defied some market indicators with demand for services such as travel, entertainment, and dining expanding throughout the past year.

Unemployment

Unemployment Remains Steady

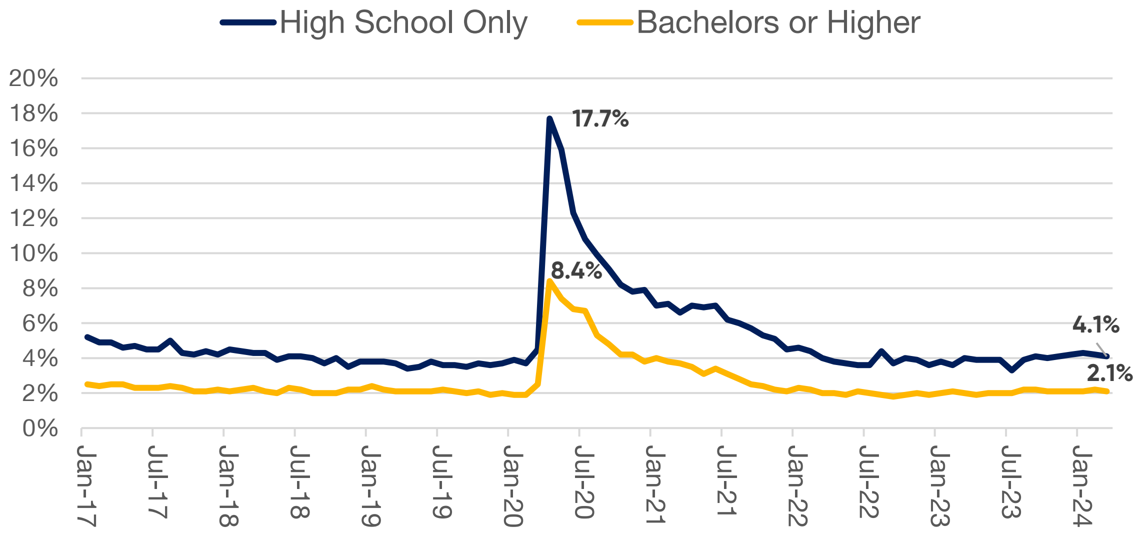
Unemployment remains near historic lows. The market is closely watching Fed rate changes as inflation remains elevated. College-educated employees remain near full-employment despite recently announced layoffs in the tech industry. Additionally, lower-skilled service-oriented jobs are the main driver 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



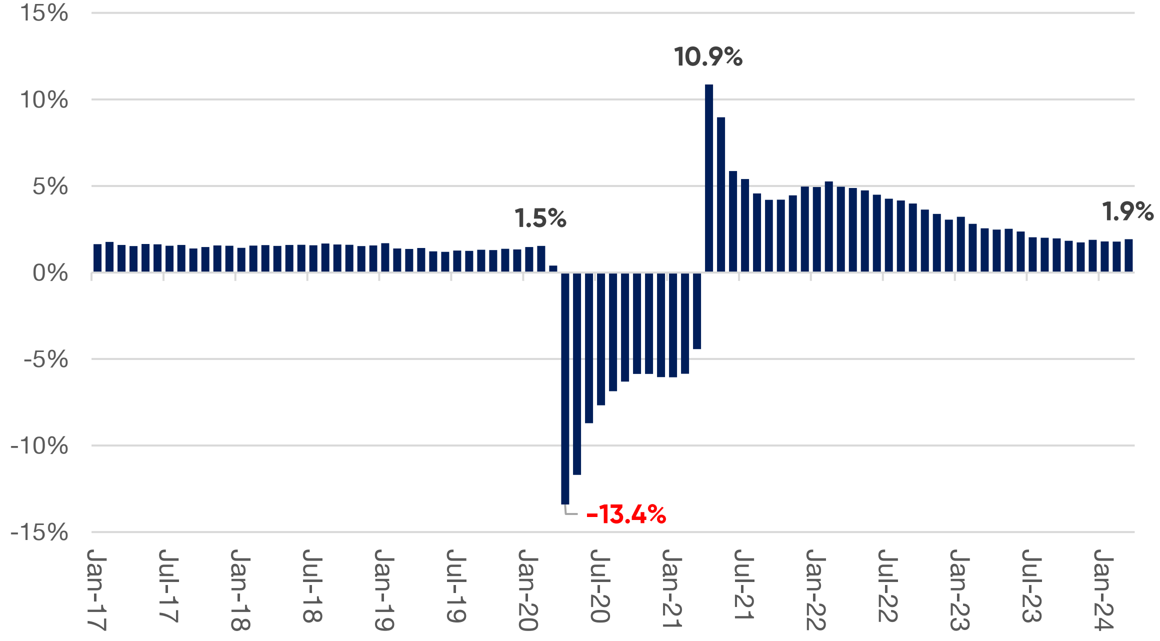
Source: U.S. Bureau of Labor Statistics, https://bls.gov

Employment

Job Creation Slows, but Maintains Momentum

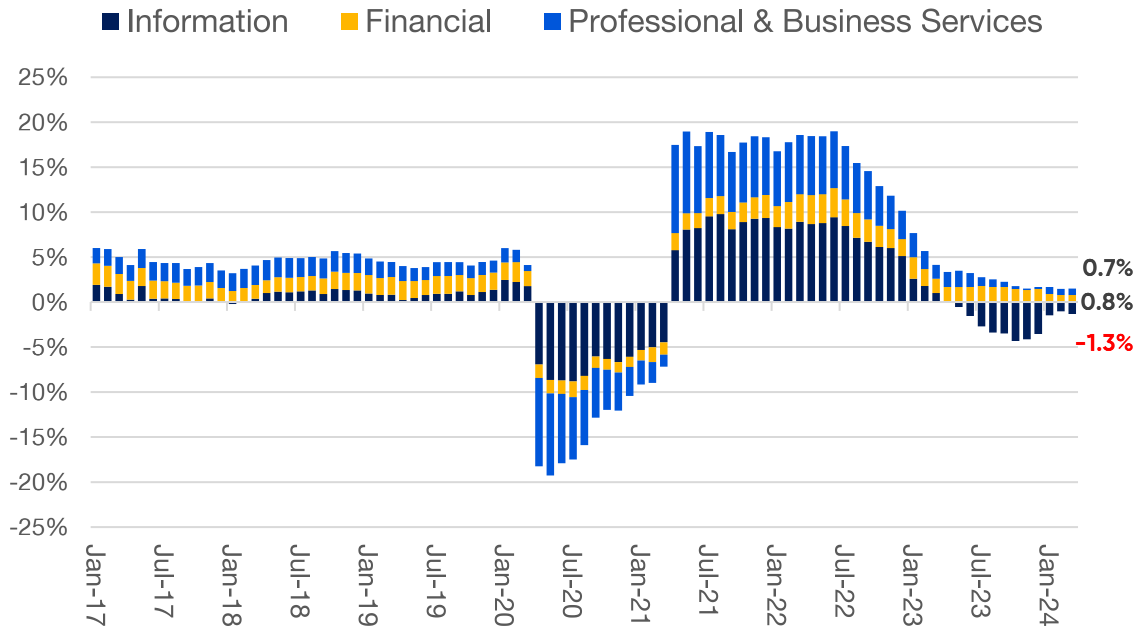
Total nonfarm payroll employment rose by 659,000 jobs in March, surpassing expectations. Job gains occurred in government and healthcare jobs underpinned the growth. Office-occupying job creation is slowing to a trickle, with information sector jobs down 1.3 percent from a year earlier.

All Job Sectors (12-Month Change)



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

Office-Occupying Jobs (12-Month Change)



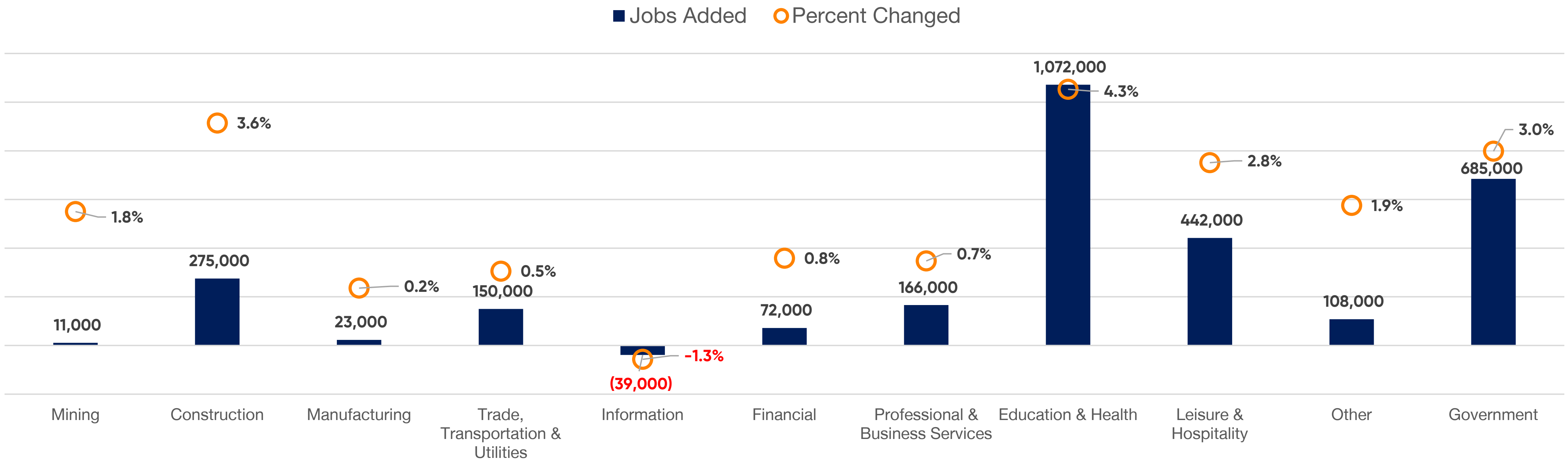
Source: U.S. Bureau of Labor Statistics, https://bls.gov

Employment

Education/Health and Leisure/Hospitality Lead the Way

Pent-up demand leads to increases in leisure and health services sector jobs, with more than 1.5 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 sector.

Job Creation by Sector (12-Month Change)



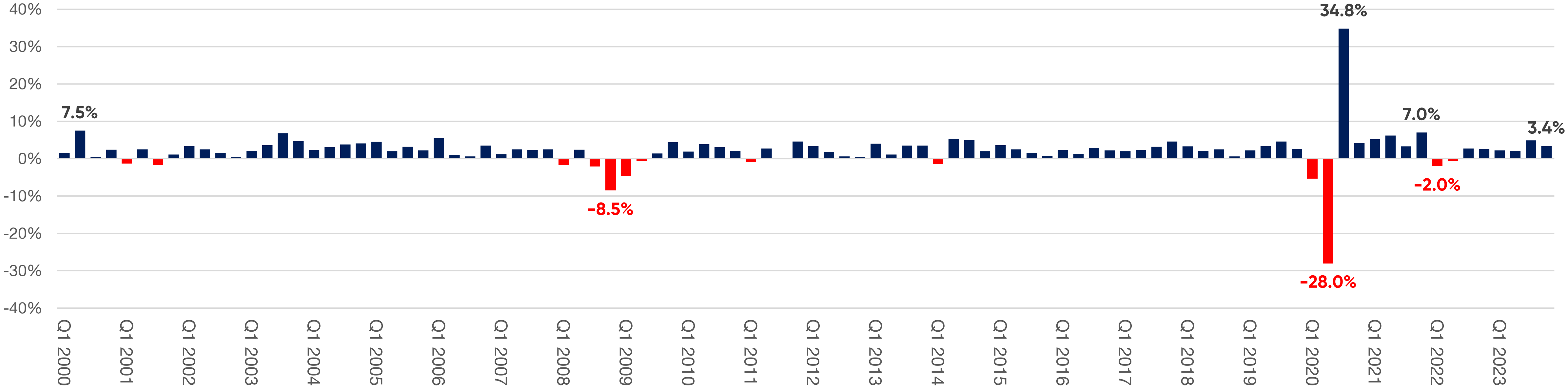
Source: U.S. Bureau of Labor Statistics, https://bls.gov

GDP

Gross Domestic Product Posts Sixth Consecutive Quarter of Growth

The GDP has expanded for the past six quarters. According the *Bureau of Economic Analysis*, the increase in the first quarter primarily reflected increases in consumer spending and nonresidential fixed investment that were partly offset by a downward revision to private inventory investment. Profits increased 3.4 percent in the fourth quarter after increasing 4.9 percent in the third quarter.

Real GDP Percent Change from Preceding Quarter



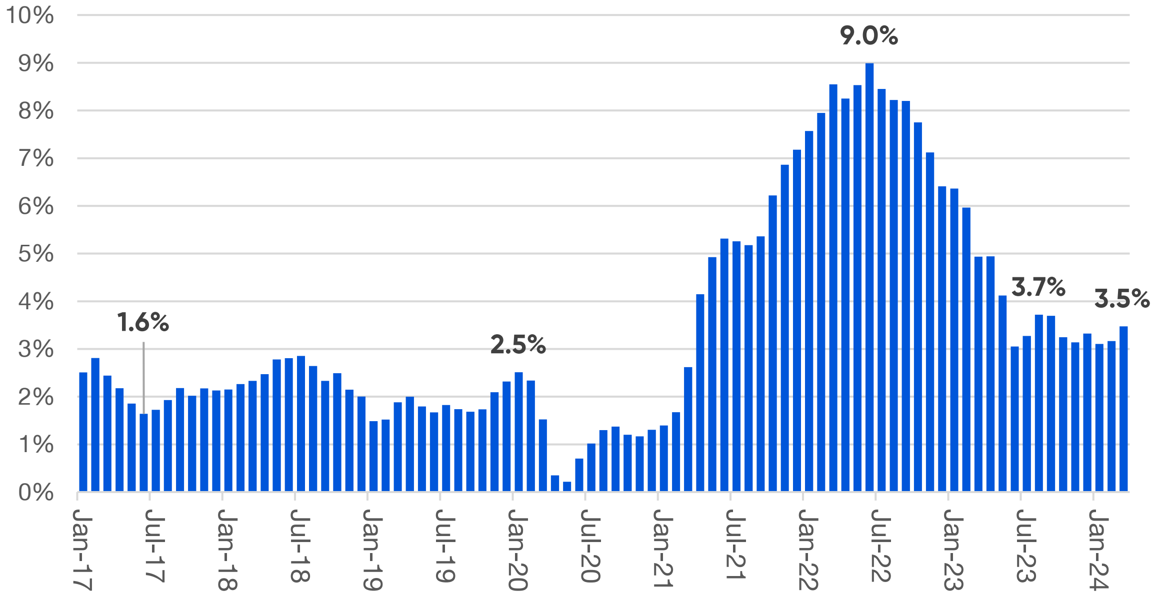
Source [Real Gross Domestic Product (A191RL1Q225SBEA) | FRED | St. Louis Fed (stlouisfed.org)]
Note: Seasonally adjusted at annual rates, Bureau of Economic Analysis date published March 28, 2024 (third estimate)

Inflation

Inflation Remains Elevated

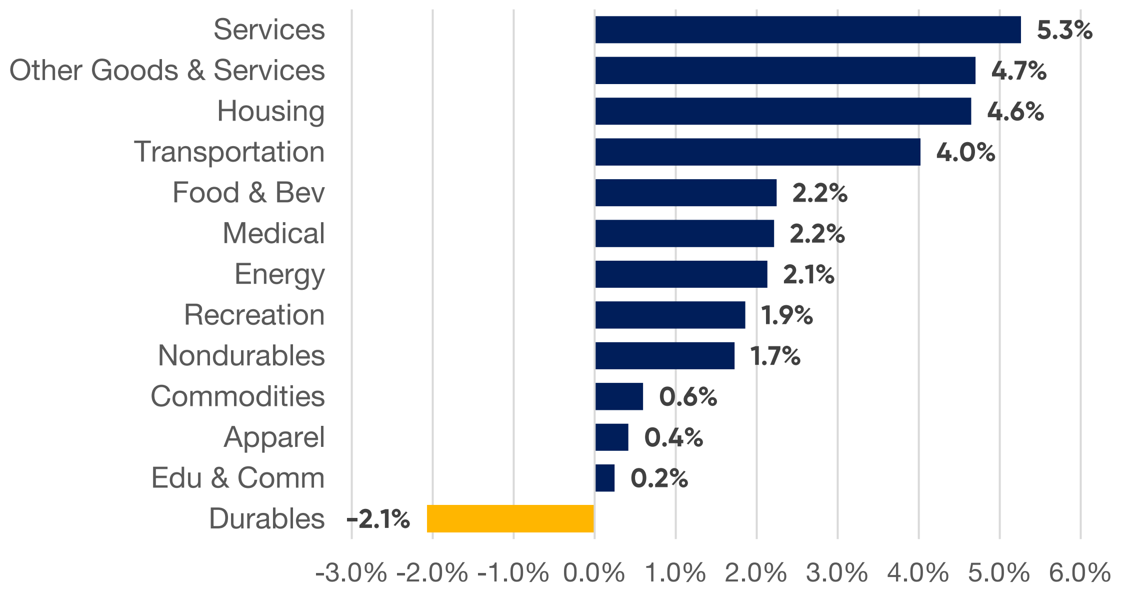
Driven by consumer demand, supply chain disruptions and a tight labor market, inflation pushed prices higher, peaking in June 2022. Inflation growth had slowed for 12 consecutive months, before ticking higher in mid-2023. Overall, inflation has ticked higher the past two months, lead by services and 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 April 2024.

Consumer Price Index by Sector (12-Month Change)



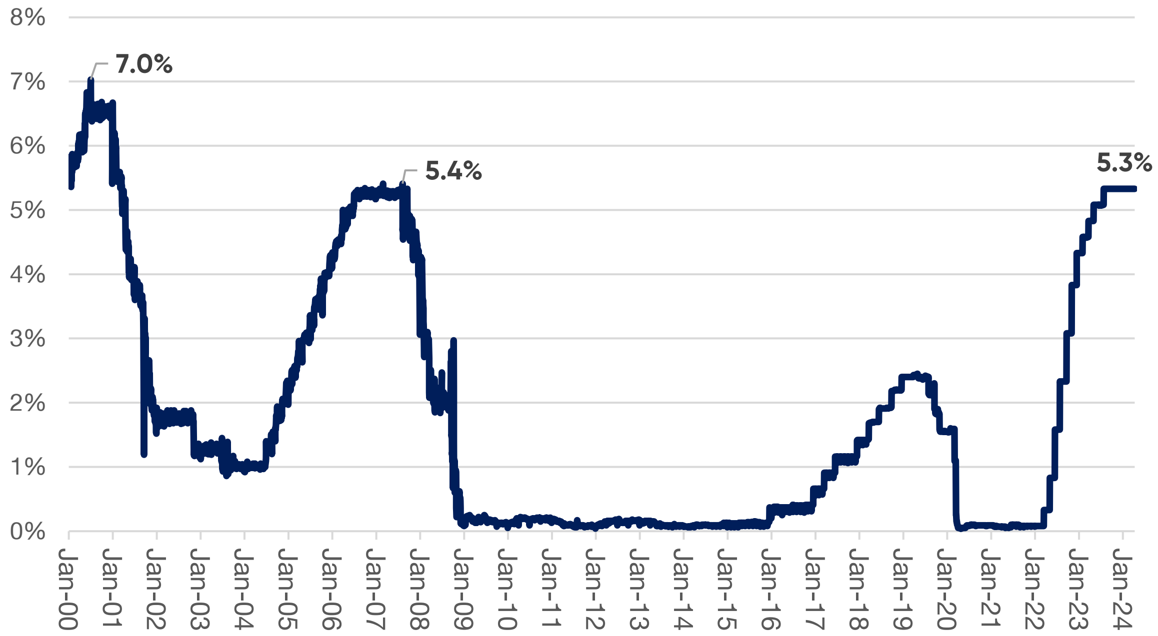
Source: U.S. Bureau of Labor Statistics, https://bls.gov
Note: Seasonally adjusted, Data pulled April 2024

Monetary Policy

Rate Increases Pause as Fed Attempts to Control Inflation

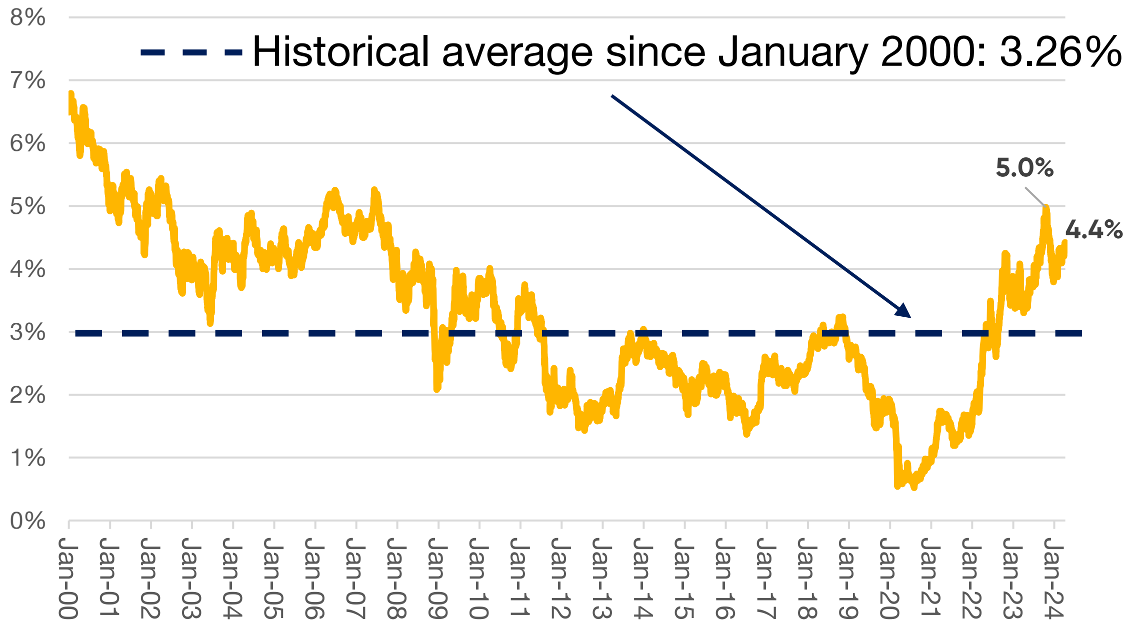
A series of increases in the Fed rate, including three 75bps increases in 2022, has bumped the range from 5.25% to 5.50%, the highest level in more than 20 years. The Fed has held rates steady after a 25-basis point increase in July 2023. Rate movement is being closely monitored as stubborn inflation remains above three percent annual growth. Meanwhile, the 10-year US treasury note, an indicator for broader investment confidence, has slowed, rising to 4.4 percent in early April.

US Effective Fed Fund Rate



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

10-Year US Treasury Note



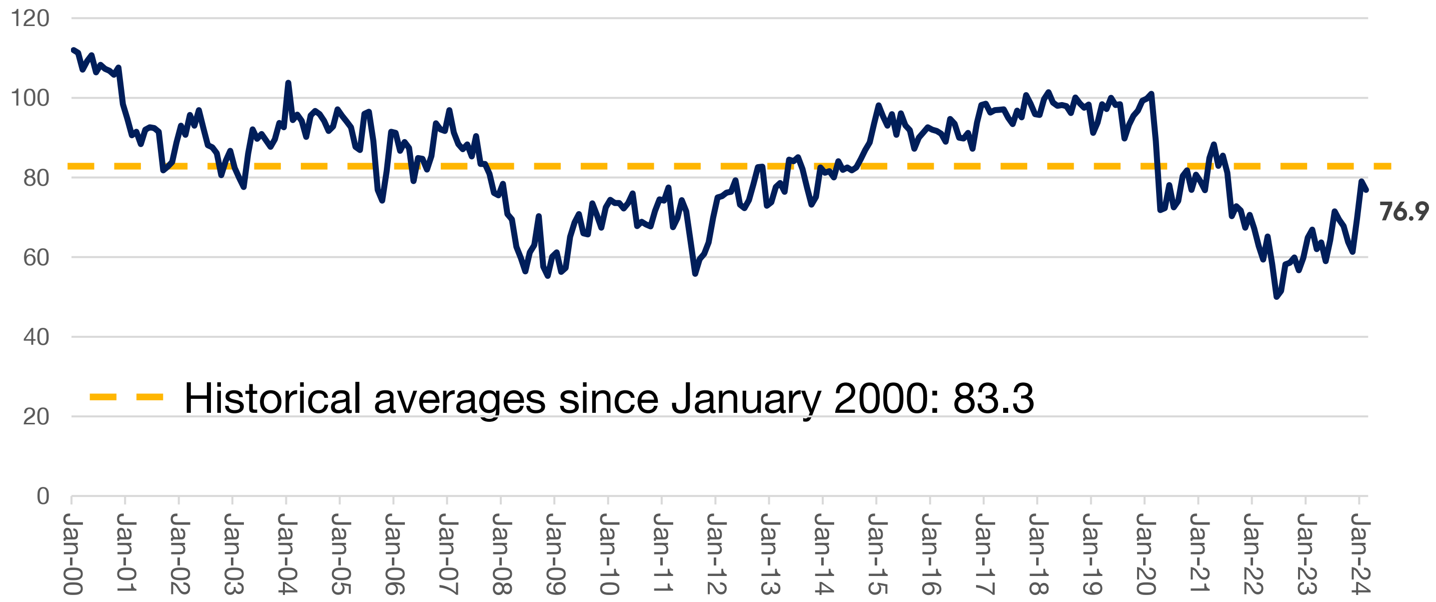
Source: Wall Street Journal
Data is through April,2024

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 (76.9) 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 2024, consumer sentiment is approaching historical averages.

Consumer Sentiment Index: (United States Total)



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

Consumer Sentiment Index

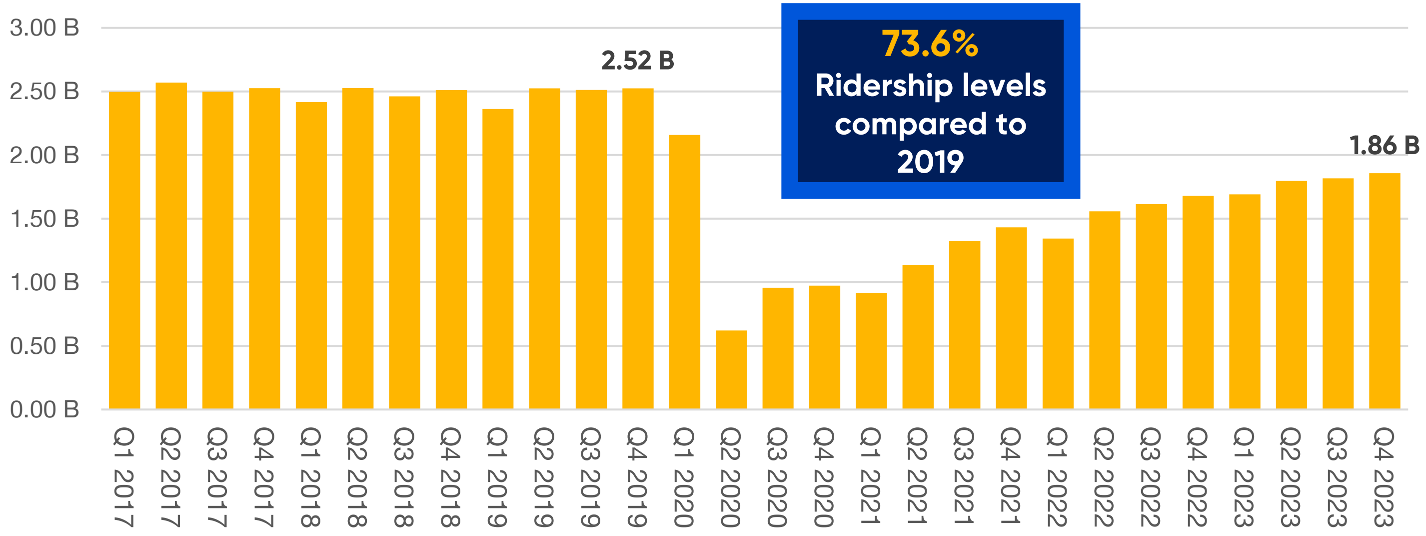
Consumer sentiment is a statistical measurement of the overall health of the economy as determined by consumer opinion. It considers people's feelings toward their current financial health, the health of the economy in the short-term, and the prospects for longer-term economic growth.

Public Transit

Public Transit Slowly Gains Momentum

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 has increased for the past seven quarters, experiencing a 38.3 percent increase since the start of 2022. As more workers return to the office, these increases are expected to continue. However, as return-to-work continues to stabilize, ridership levels will likely see only moderate gains.

Public Transit Ridership: (United States)



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

Ticket to Ride

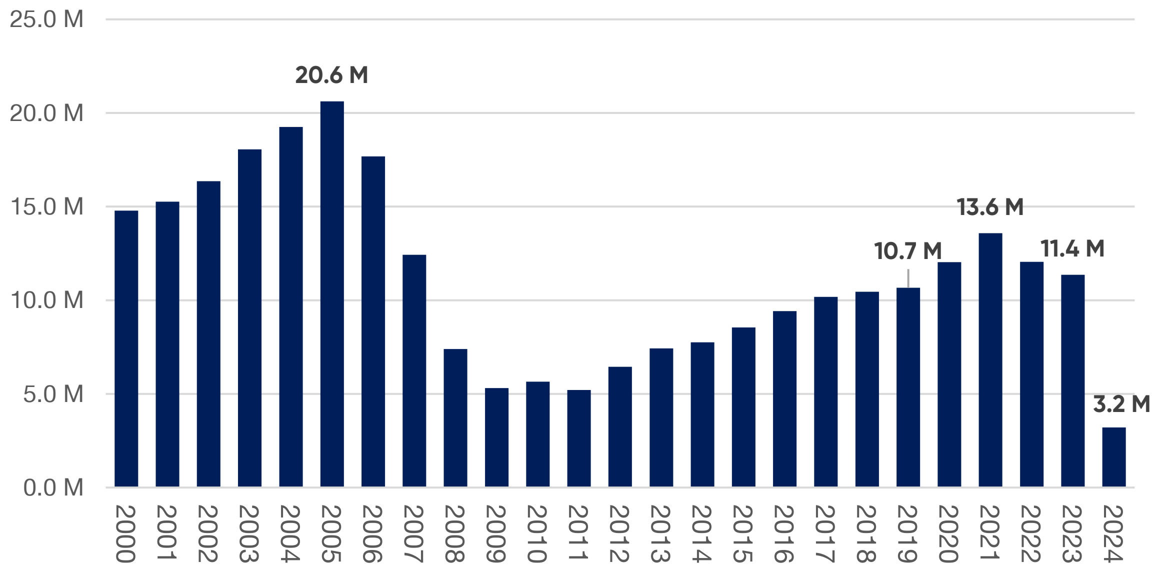
Public transportation has been reliably consistent since the turn of the century. Sky-rocketing gas prices temporarily encouraged public ridership in 2008, but quickly dropped back to historic levels. During the first year of the declared pandemic, ridership was cut in half (52.8% decrease). The economy 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 2023 at 74 percent of the average ridership of 2019, the last full-year before the start of the pandemic.

Housing

Housing Starts Pick Up, as Interest Rates Slow the Market

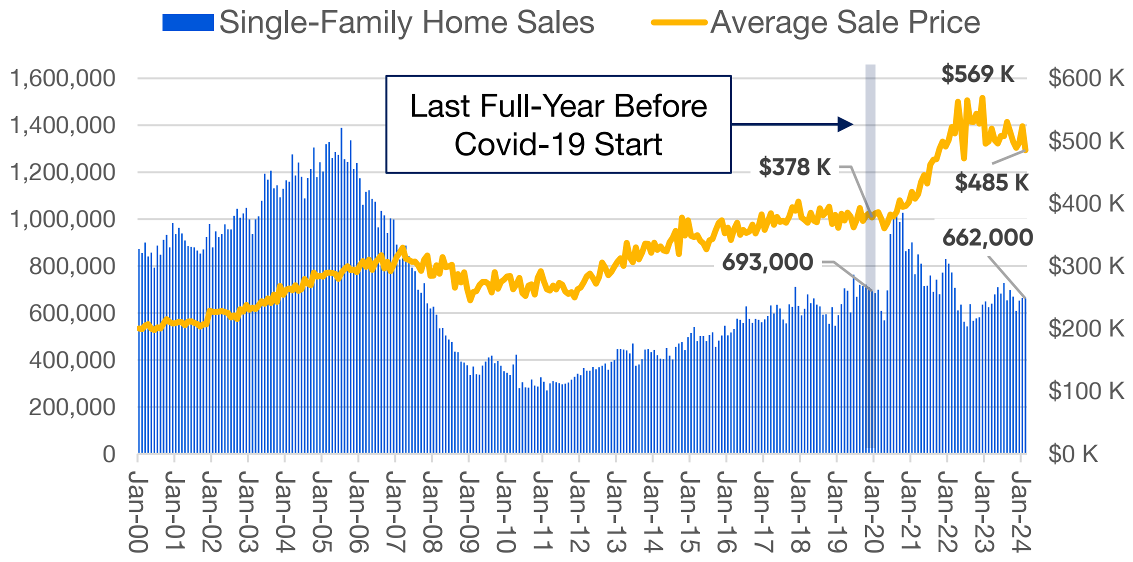
The number of residential housing starts soared at the start of the pandemic, while sale prices reached record highs in 2022. This growth is being tempered as mortgage rates increase, labor costs rise, and supplies remain scarce. During 2023, home starts declined from the previous two years but remain 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 14.7 percent through February.

Residential Housing Starts



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

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



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

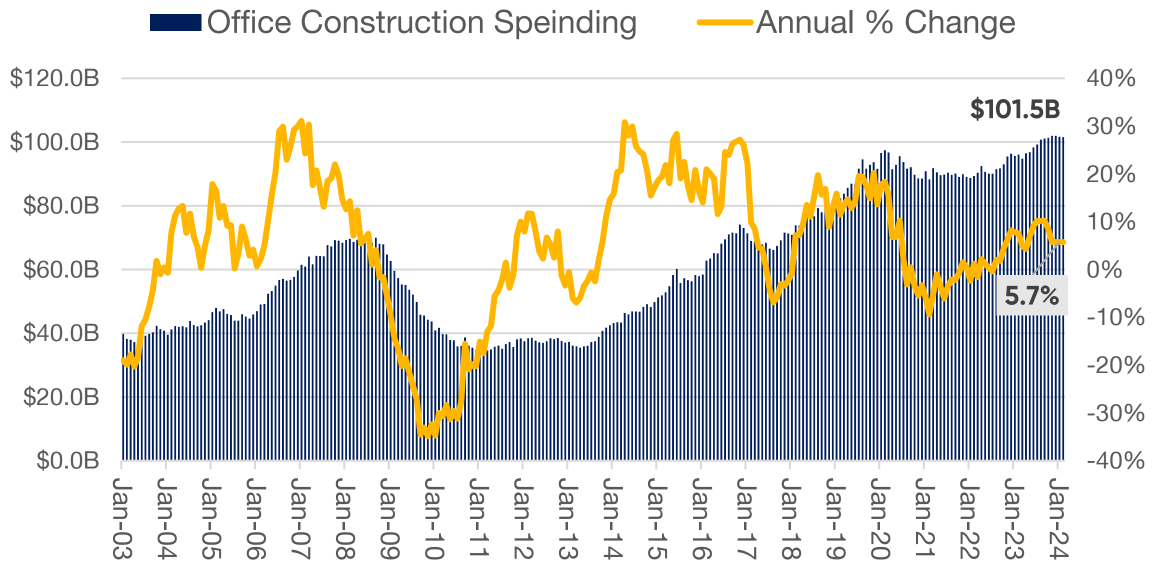
Construction

Office Construction Spending Falls, While Industrial Spending Peaks

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

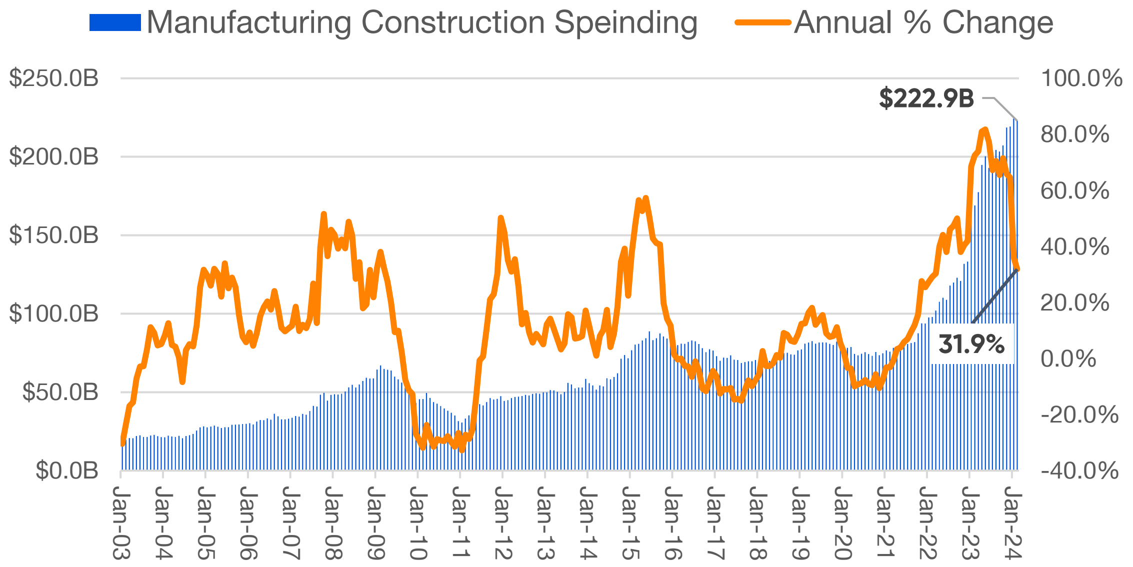
After sky-rocketing for the past three-plus years, spending in the industrial sector has begun slowing from prior years. While still near record highs, spending will likely decelerate as investors/ developers wait to test demand as new products deliver.

Construction Spending: Office



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

Construction Spending: Manufacturing



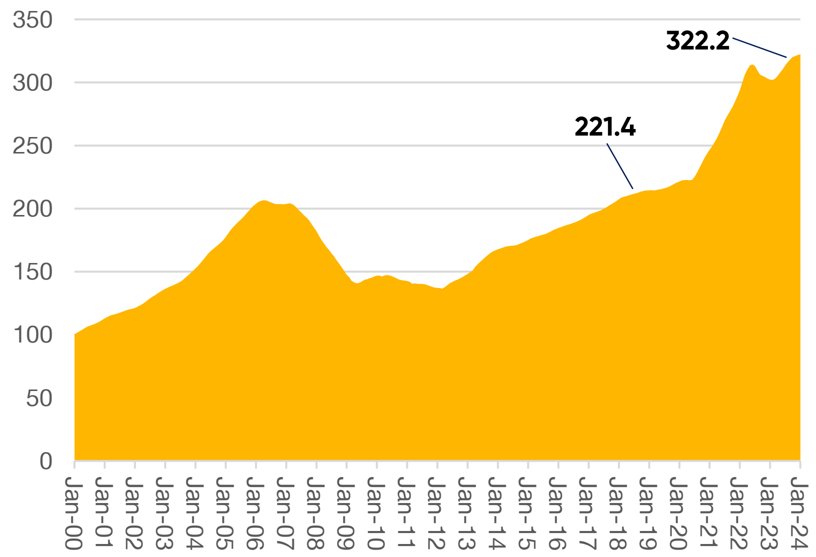
Source: U.S. Census Bureau, https://census.gov/construction
Note: Data thru February 2024

Home Price Index

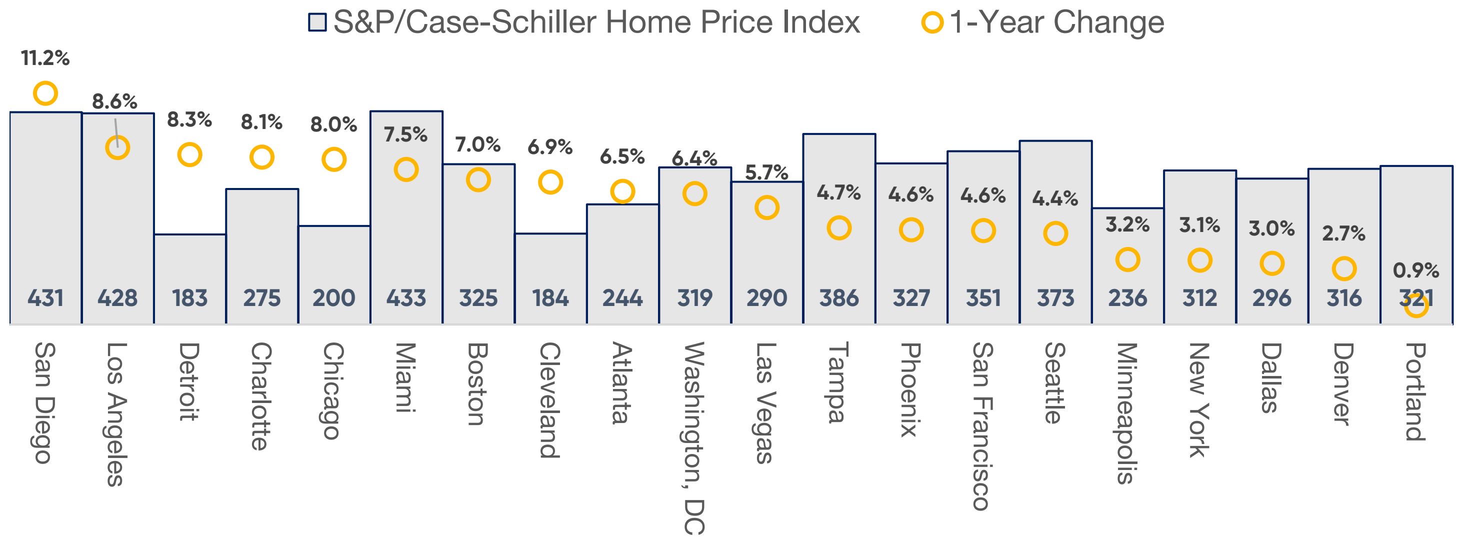
Case-Schiller Home Price Index Reclaims Recent Drops to Reach Record High

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 8-straight months, before ticking higher for the past 8 months closing January 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 2023 11.2 percent higher than a year earlier.

Home Price Index: 20-City Average



S&P/Case-Schiller Home Price Index: January 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 New Normal Has Arrived

Q1, 2024

Office Trends

Hopes for a mass return-to-work have not materialized and with nearly two years of stabilized trends, it appears that current attendance levels are now the norm. Additionally, slowing office employment growth has resulted in further occupancy drops and higher vacancy. While recession fears appear to have receded, the outlook for the office market is still downbeat. With stability and slow hiring, occupiers are focusing on the efficient use of space and general right-sizing their portfolio. With deal sizes down about 17 percent and the number of deals down approximately 10 percent compared to pre-pandemic levels, owners/landlords are eager to offer attractive concession packages. However, with instability in capital markets in the office sector and higher interest rates, closing lease transactions are taking longer to complete.

Office Tenant View

- The lack of new construction is limiting some options for top-tier space as occupiers look for highly-amenitized offerings.
- Tenants are provided more options in sublease space that may have been out of reach as they seek to provide the space and location to entice workers back to the office.
- Many occupiers are taking advantage of favorable market conditions and concentrating on first-generation space.

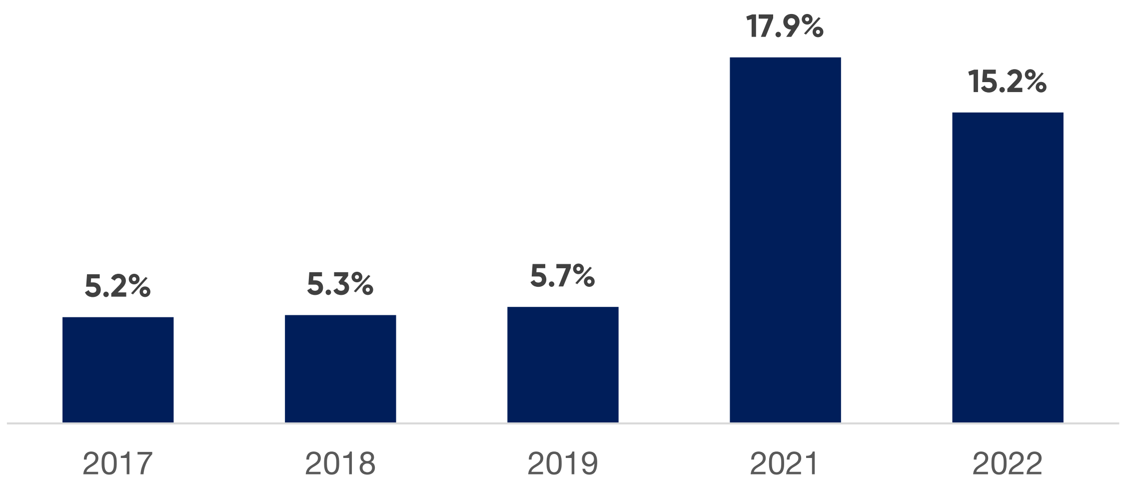
Remote Work

Percentage of People Working at Home Declined Between 2021 and 2022

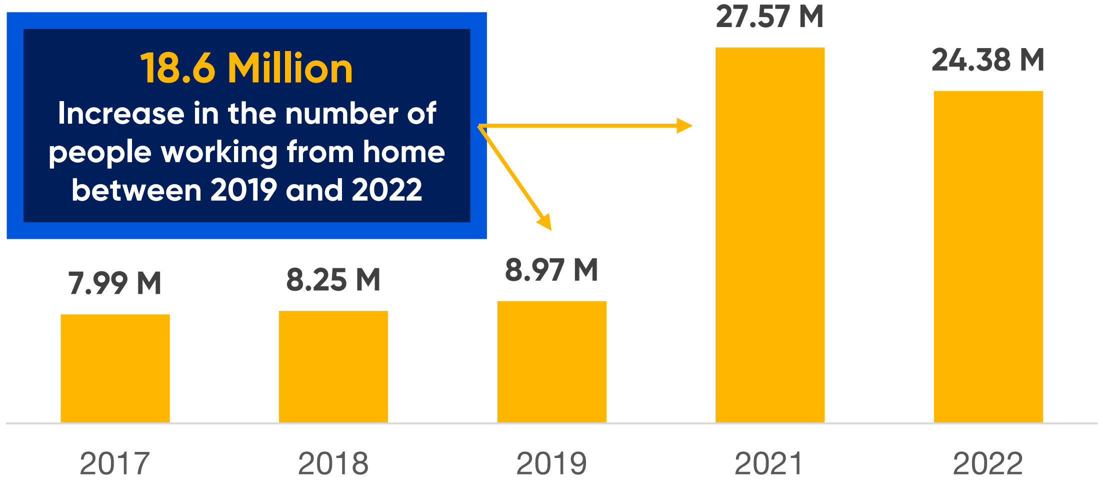
The percentage of people working at home before the pandemic remained steady at under six percent of the working population over the age of 16. The number jumped to 17.9 percent in 2021, an increase of over 200 percent.

The number of people in the workforce over age 16 working-at-home more than tripled between 2019 and 2021. The number fell moderately in 2022 from the previous year but is still well-above pre-pandemic levels.

Percentage of People Working-at-Home: US



Estimated Number of People Working-at-Home: US



Source: U.S. Census Bureau. (2022). *2022 American Community Survey 1-year* Retrieved from: https://data.census.gov/table/ACSDP1Y2022.DP03 (October 2023): Note data from 2020 was not released. The percentage of people working from is calculated by dividing the estimated people working-at-home by the number of workers over the age of 16.

Note: The number of people working at home increased from pre-pandemic levels despite 3.29 million office-occupying jobs added between the end of 2020 through the end of 2022.

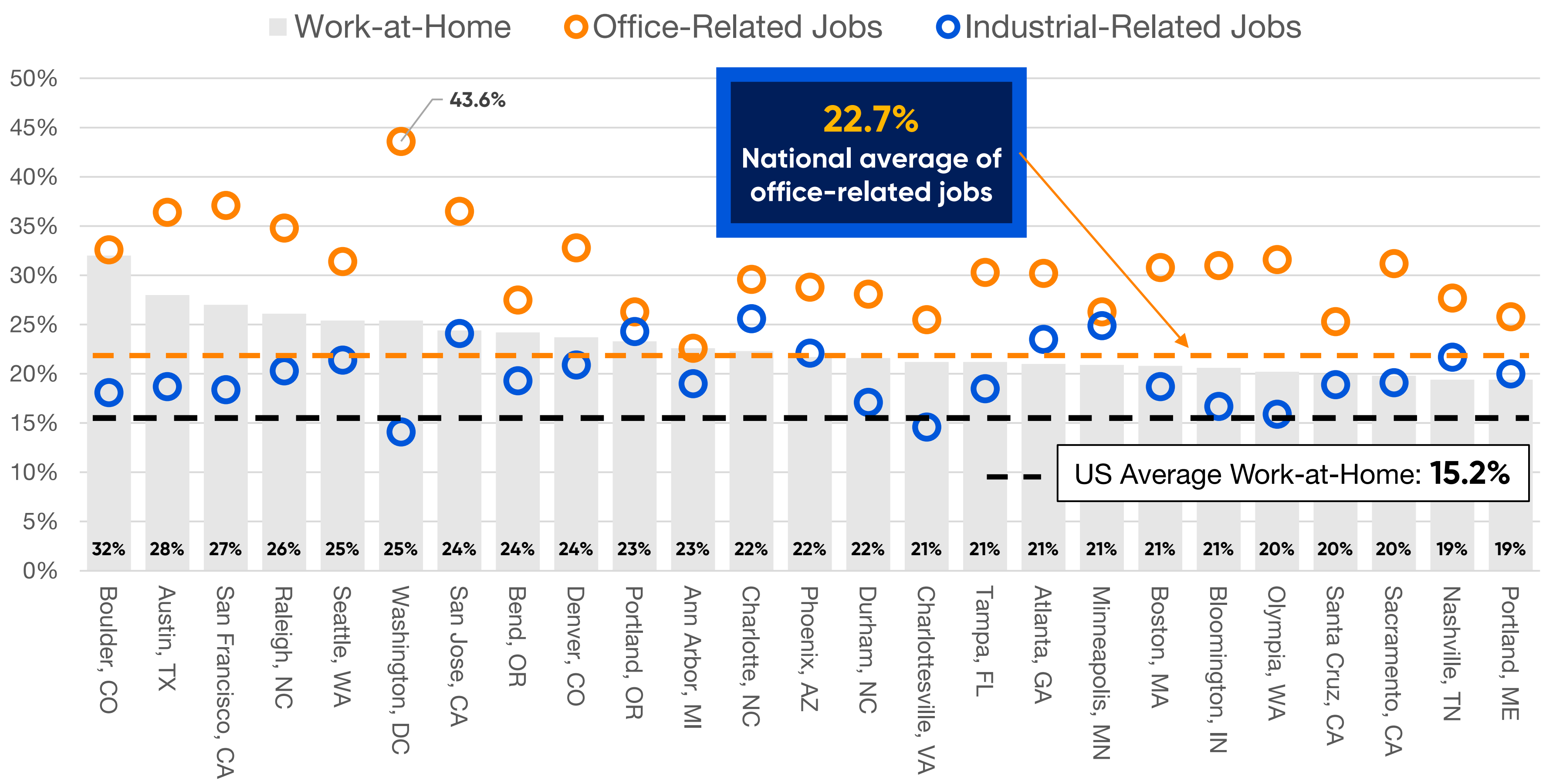
Remote Work

Markets With High Percentage of Office-Related Jobs Lead Remote Work

Markets with a high percentage of office-related jobs also have the highest percentage of workers that work at home. The national average of office related jobs is 22.7 percent, while the top 20 metros average 30.6 percent.

Note: Office related jobs are identified by the *US Census Bureau* as: Information, Finance, Professional & Business Services, and Government sectors

Top 20 US Metros with Highest Percentage of People Working-At-Home



Source: U.S. Census Bureau. (2022). *2022 American Community Survey 1-year*
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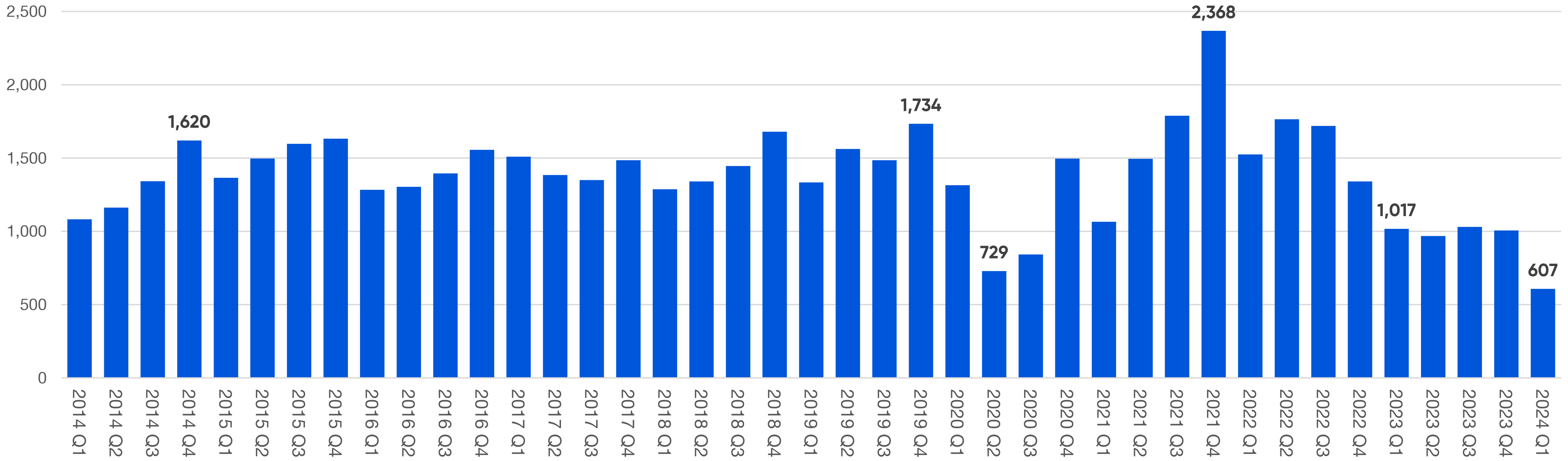
Capital Markets

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 eight of the last nine quarters. The number of office sales in the first quarter of 2024 is lowest level in the past decade.

Office Sales Velocity: (United States)

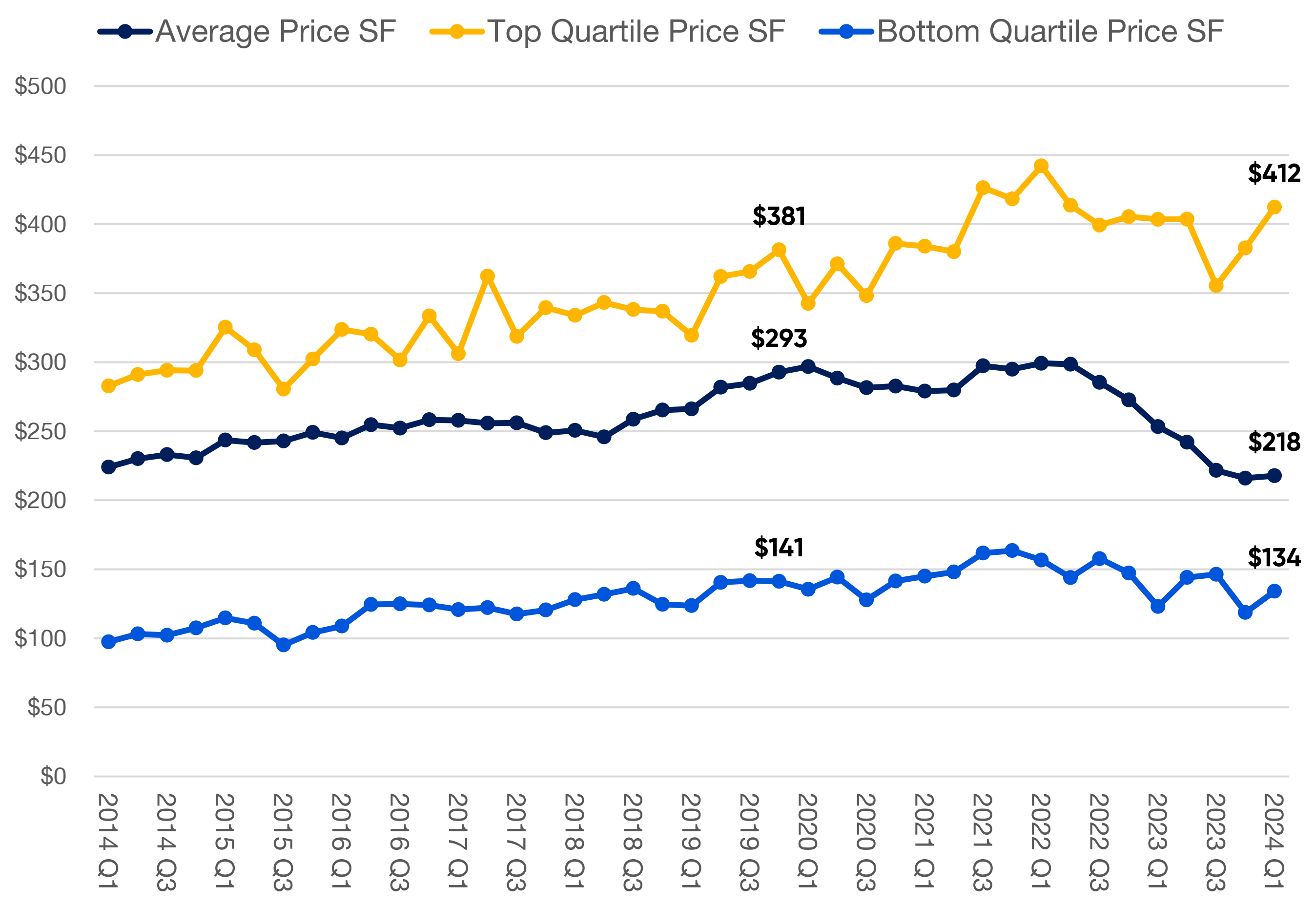


Source: Real Capital Analytics and Cresa; thru Q1 2024

Capital Markets

Average Sale Prices Per Square Foot Stabilize

Average Office Sale Price/SF (United States)



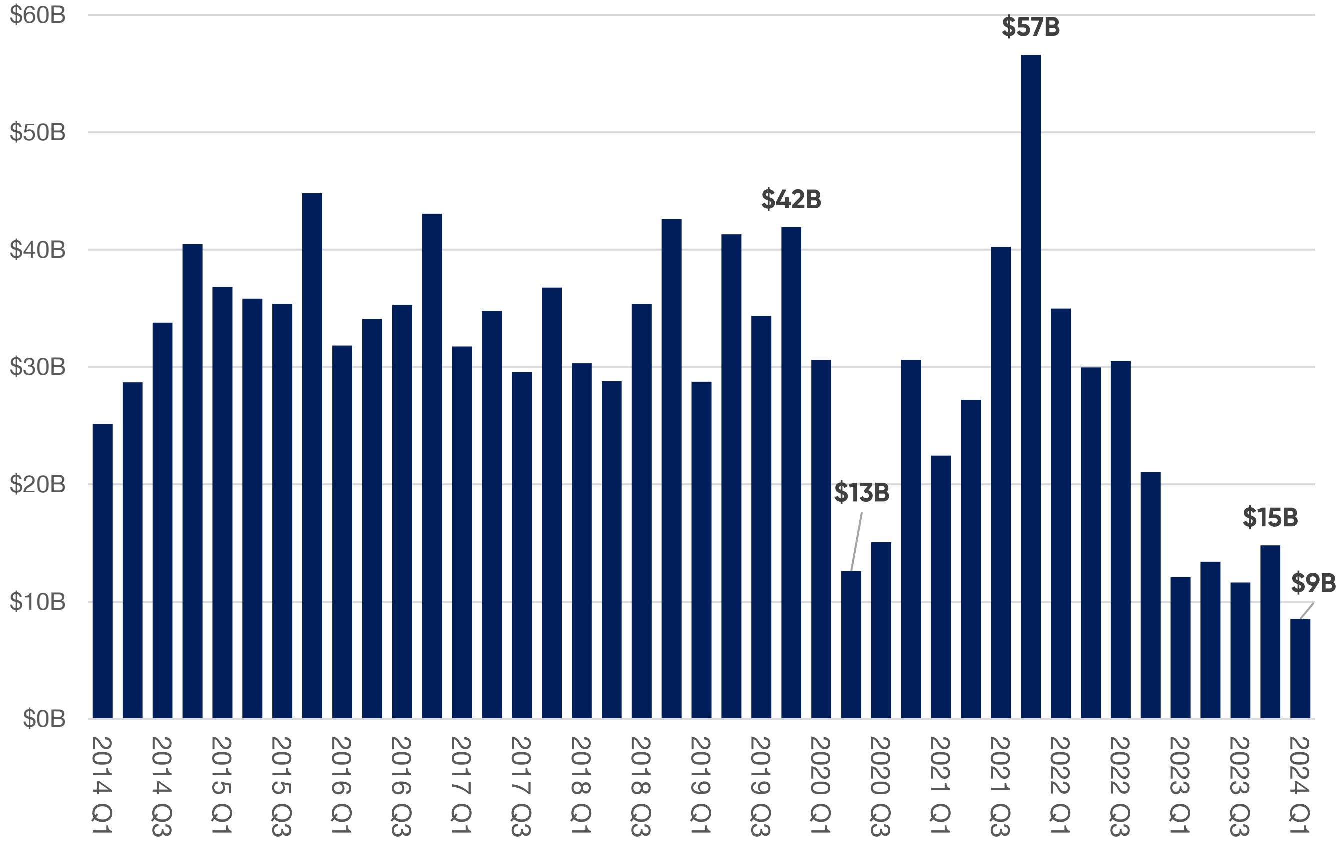
Source: Real Capital Analytics and Cresa; thru Q1 2024

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.**

Capital Markets

Low Demand and High Interest Rates Stall Office Sales

Office Sales Volume: (United States)



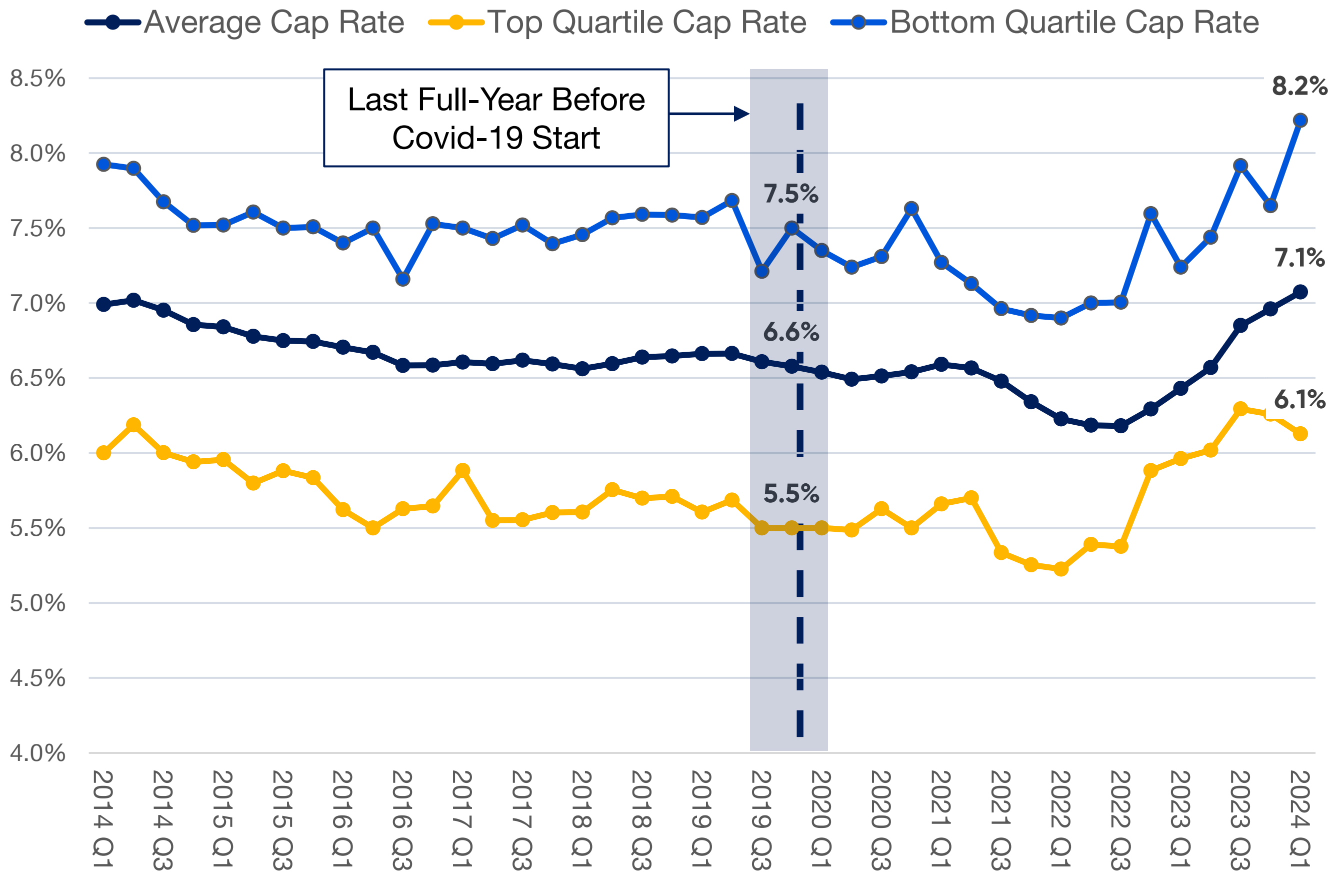
Source: Real Capital Analytics and Cresa; thru Q1 2024

Office sales volume closed 2023 at approximately $52 billion dollars, similar to the $49 billion volume that occurred in 2010. Sales volume has dropped for the past three years. 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 first 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 Q1 2024

As sales volume has dropped, cap rates have reacted accordingly, increasing for six straight quarters. The 7.1 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 six 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

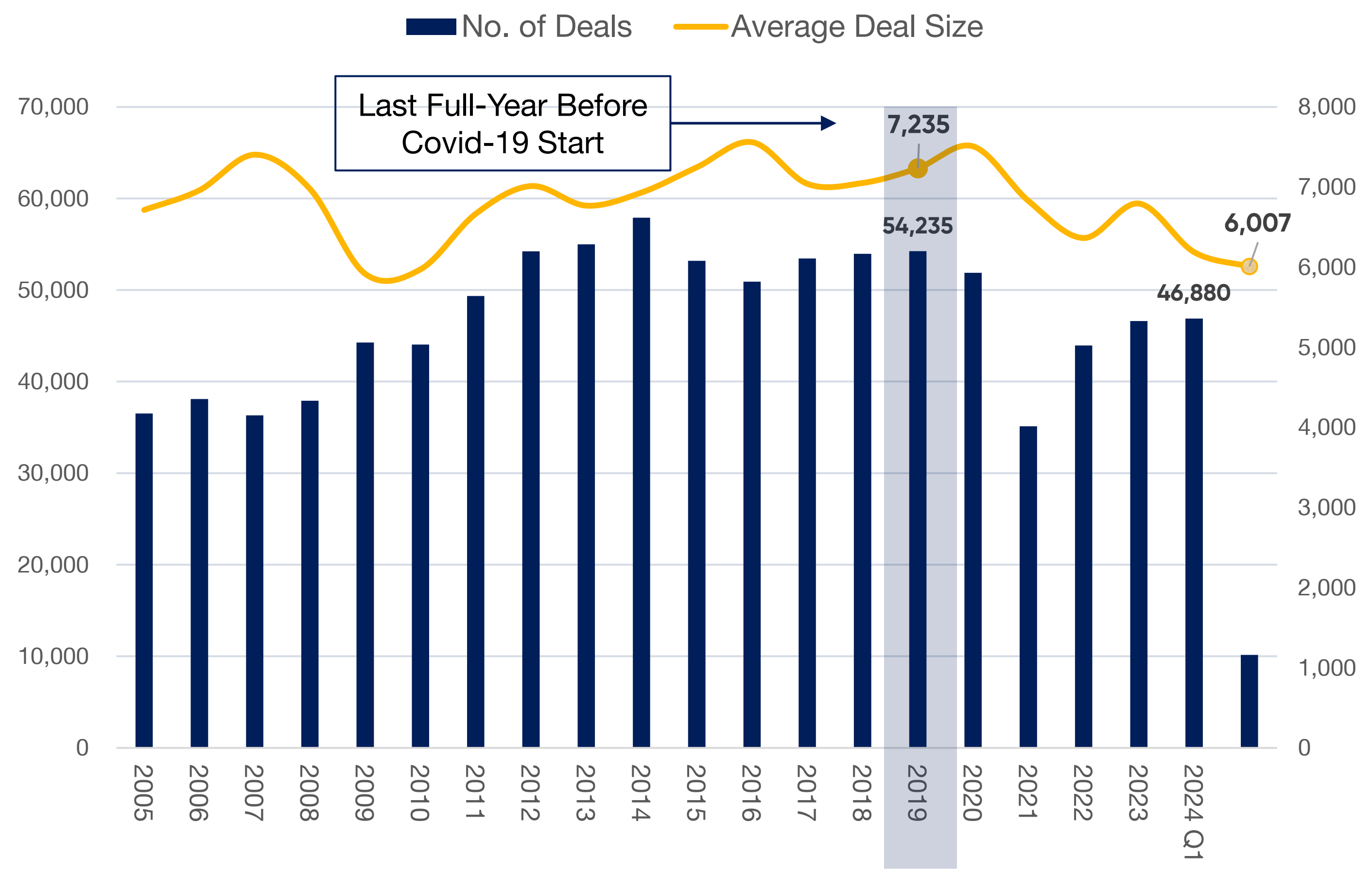
Deals Getting Done, But the Number of Deals and Deal Size Shrink

Lease deal sizes in 2023 were **17.6 percent** smaller compared to 2019.

The number of deals completed in 2023 decreased by **9.66 percent compared to 2019.**

While lease deals in the 2023 are smaller compared to 2022, 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

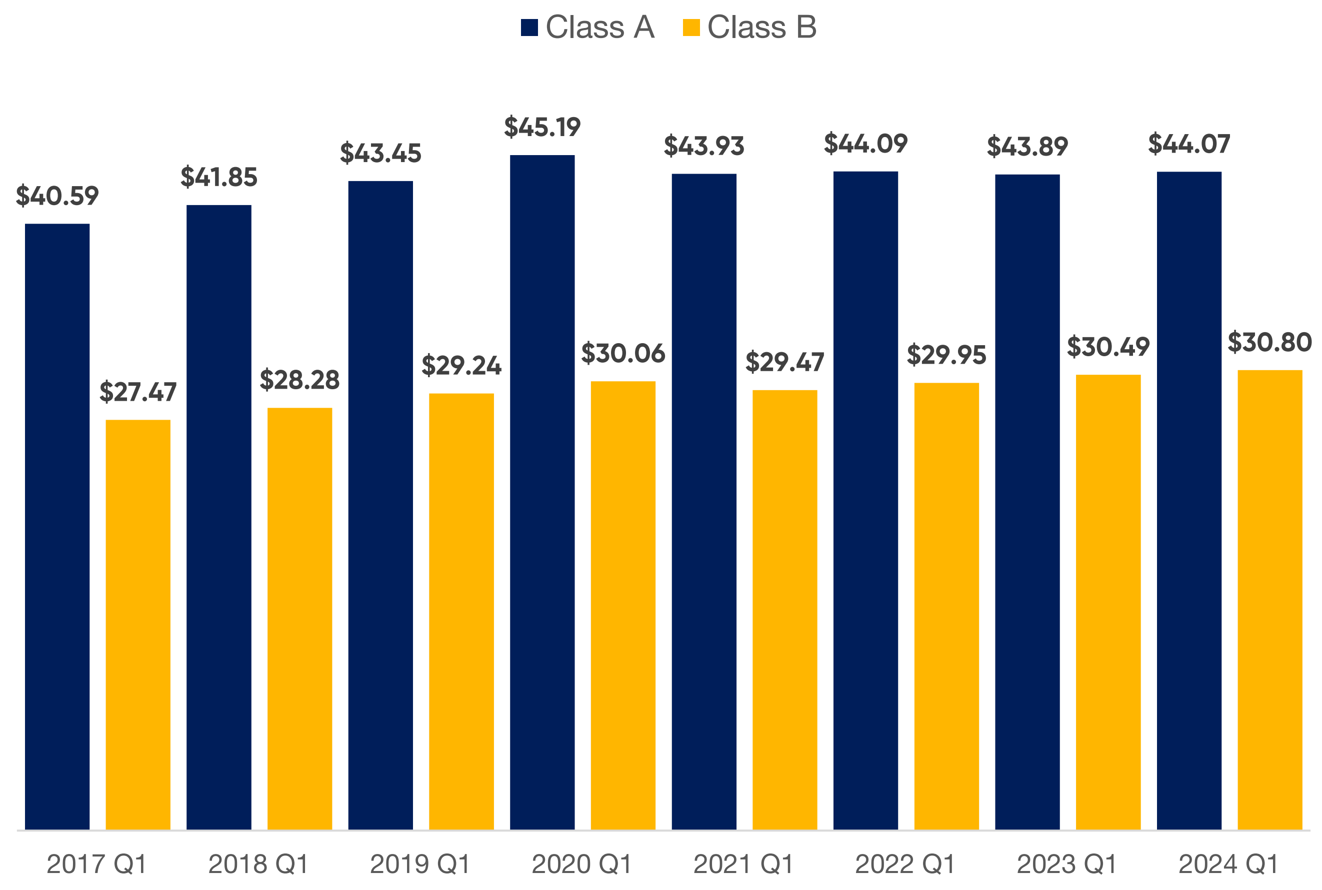


Source: CoStar, Cresa

Market Rent

Office Rents Flat as Landlords Offset Demand With Concession Packages

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



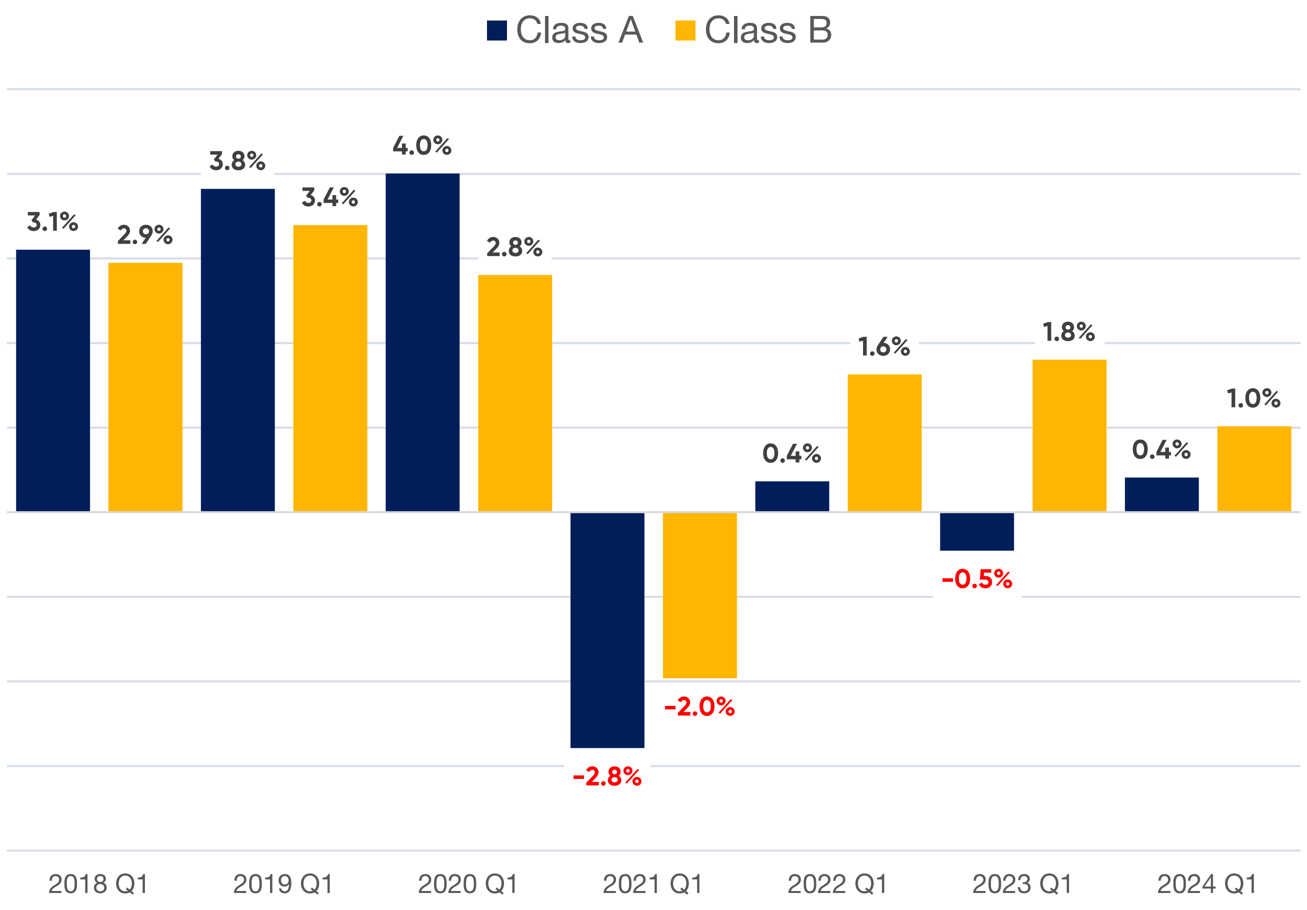
Source: CoStar and Cresa; thru Q1 2024

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)



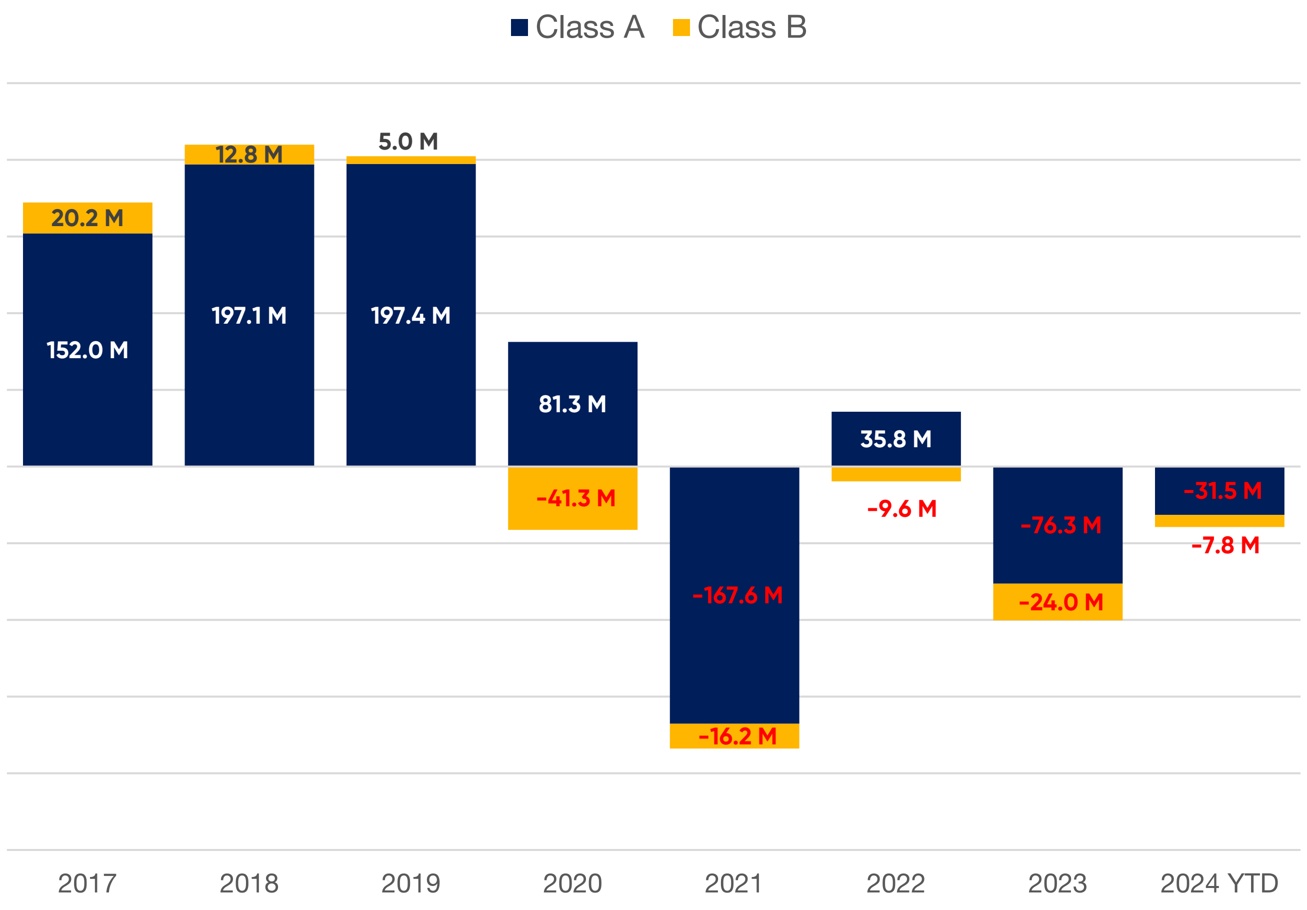
Source: CoStar and Cresa; thru Q1 2024

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 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 With No End in Sight

Office Net Absorption (SF): (United States)



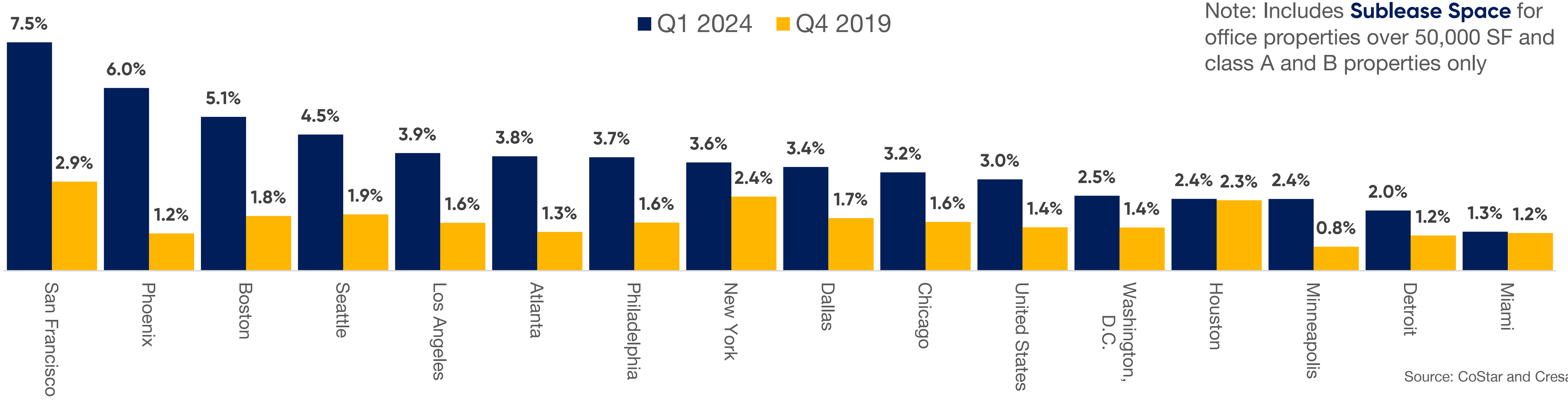
Source: CoStar and Cresa; thru Q1 2024;

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 -257 million square feet of negative absorption recorded since the start of 2020.**

Sublease Space

Largest US Metros: Before & After Covid-19 Announcement

Office: Sublease Space as a Percentage of Total Inventory



Note: Includes **Sublease Space** for office properties over 50,000 SF and class A and B properties only

Source: CoStar and Cresa

107%

Increase in sublease square feet on market in largest metros

135.3 M

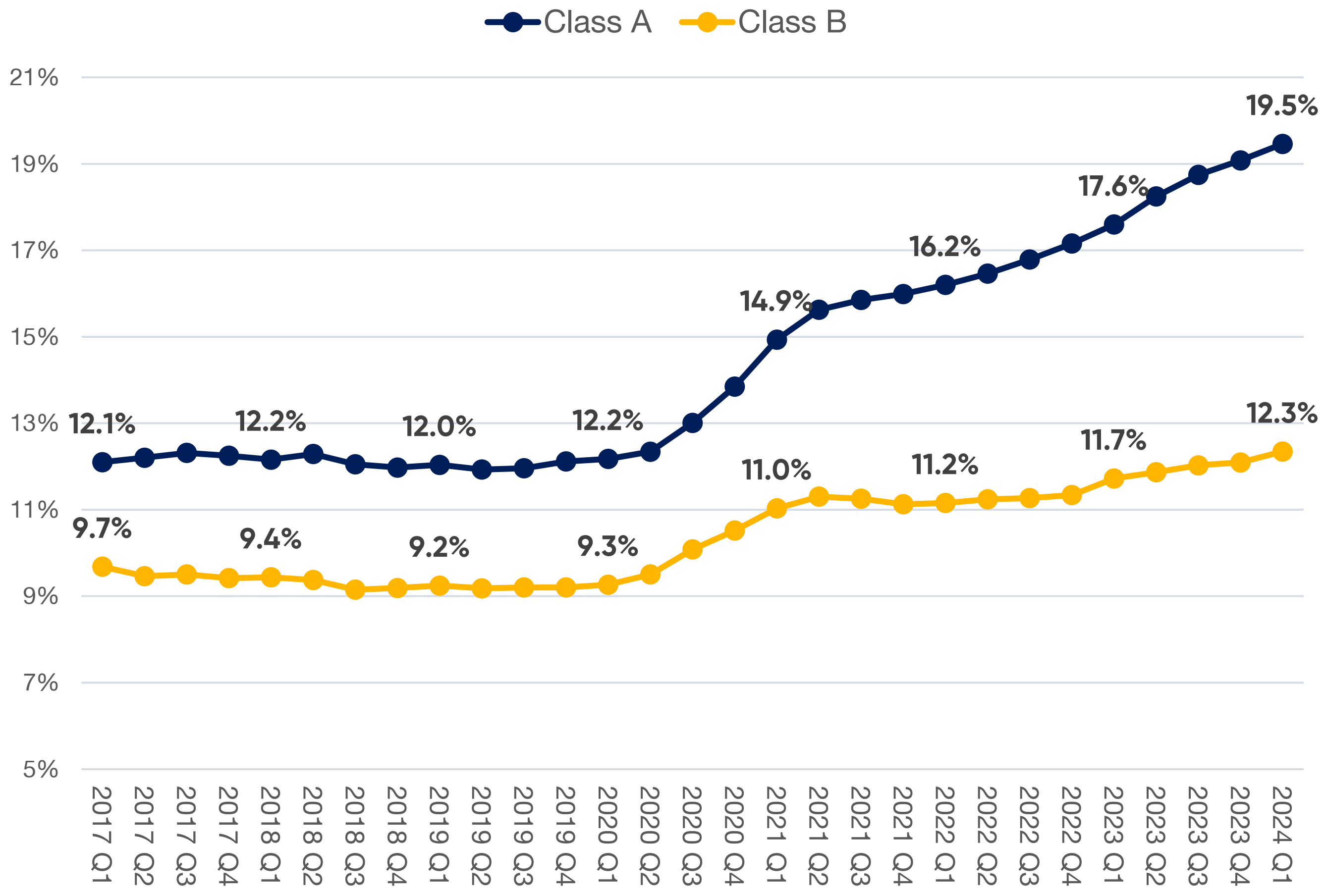
Square feet of sublease space available in largest metros in March 2024, compared to 65.4 M in 2019

Sublease space has increased dramatically since the Covid-19 pandemic was announced during the first quarter of 2020. Cities that rely heavily on tech have been hit especially hard, such as San Francisco and Seattle, due to their ability to work remotely and job layoffs. Cities with more industry diversification have generally fared better, but **10 out of 15 of the largest metros have seen the total amount of sublease space on the market more than double since the start of 2020**.

Direct Vacancy

Office Vacancy Spikes as Companies Right-Size

Office Direct Vacancy Rate: (United States)



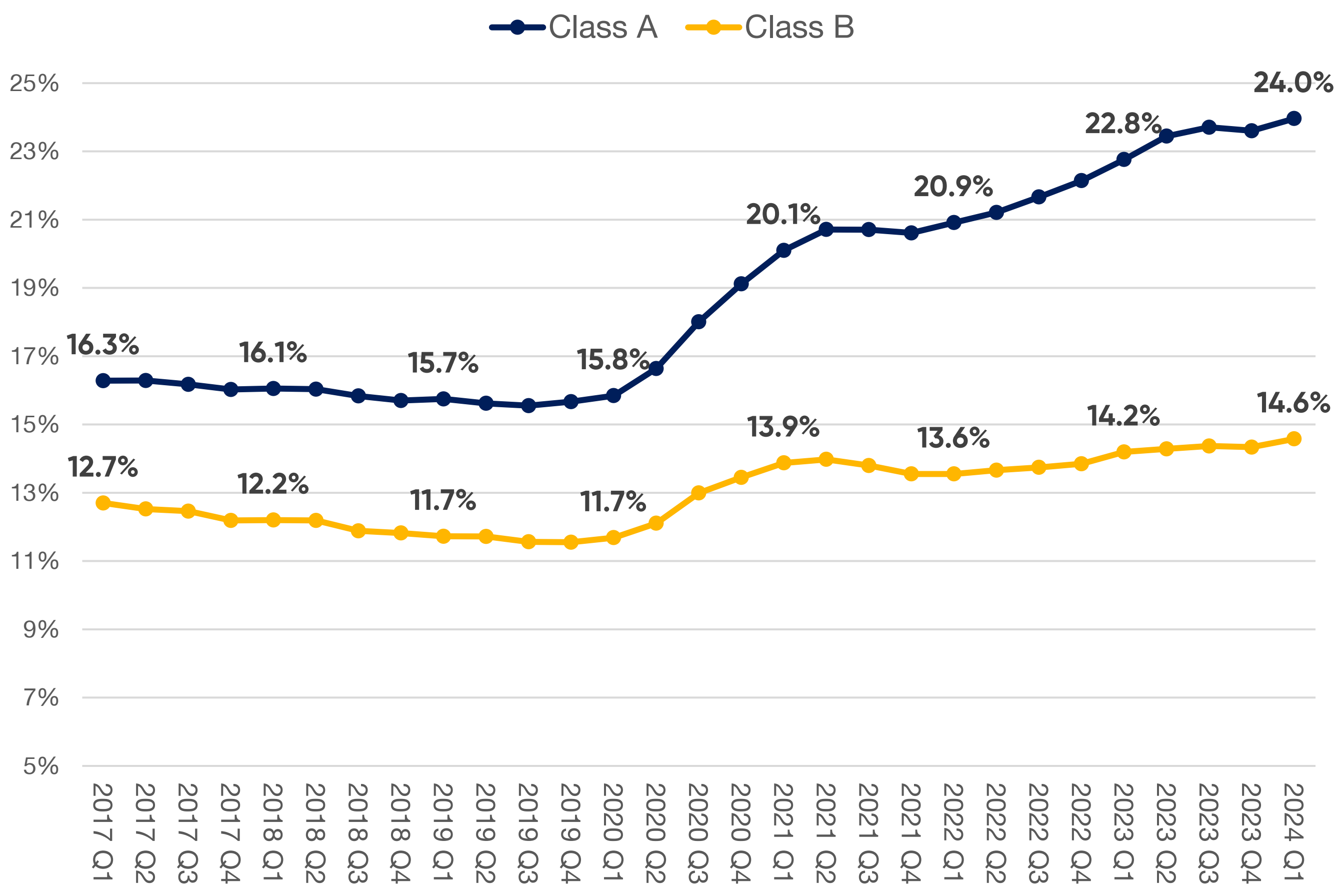
Source: CoStar and Cresa; thru Q1 2024

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 that 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)



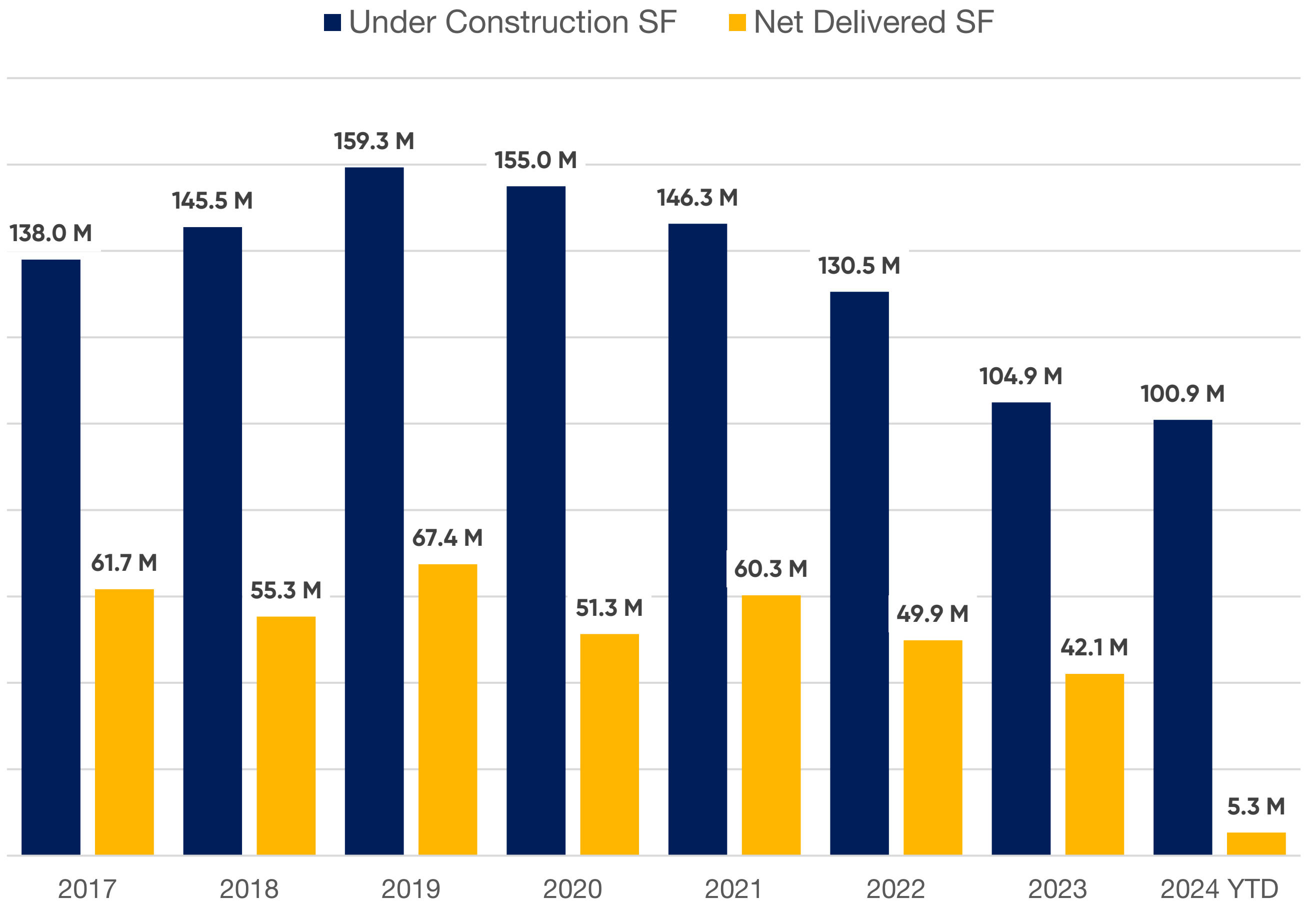
Source: CoStar and Cresa; thru Q1 2024

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 24 percent to the end the first 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 Q1 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 101 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 first quarter, only nine 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.

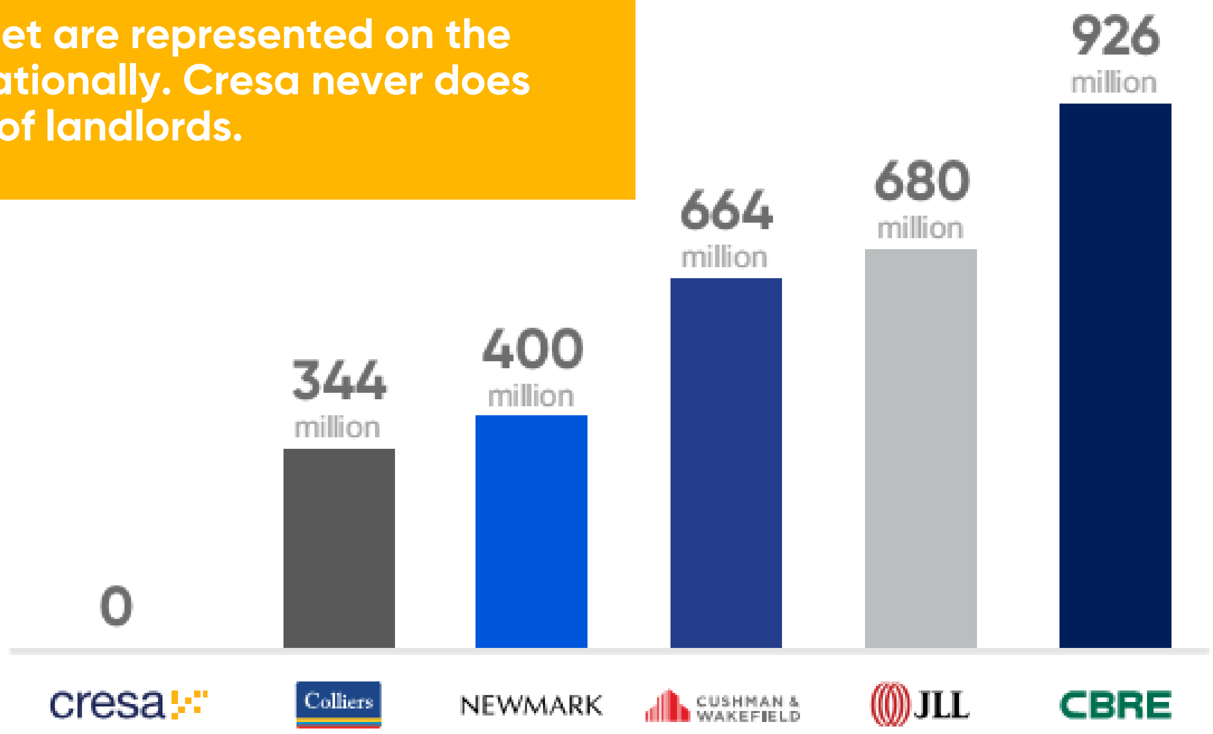
The stakes are high for occupiers. Real estate is expensive and inflexible. With the pandemic, labor dynamics, and economic instability, all bets are off.

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.

Visit cresa.com for more information.

Cresa is the world's only 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.

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