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MARKET BRIEF

Office Market Challenges Persist

Office fundamentals slip but growth markets remain resilient. The broad adoption of hybrid work is placing increasing pressures on office buildings, but some markets are absorbing the changes better than others. Click below to read the full report.

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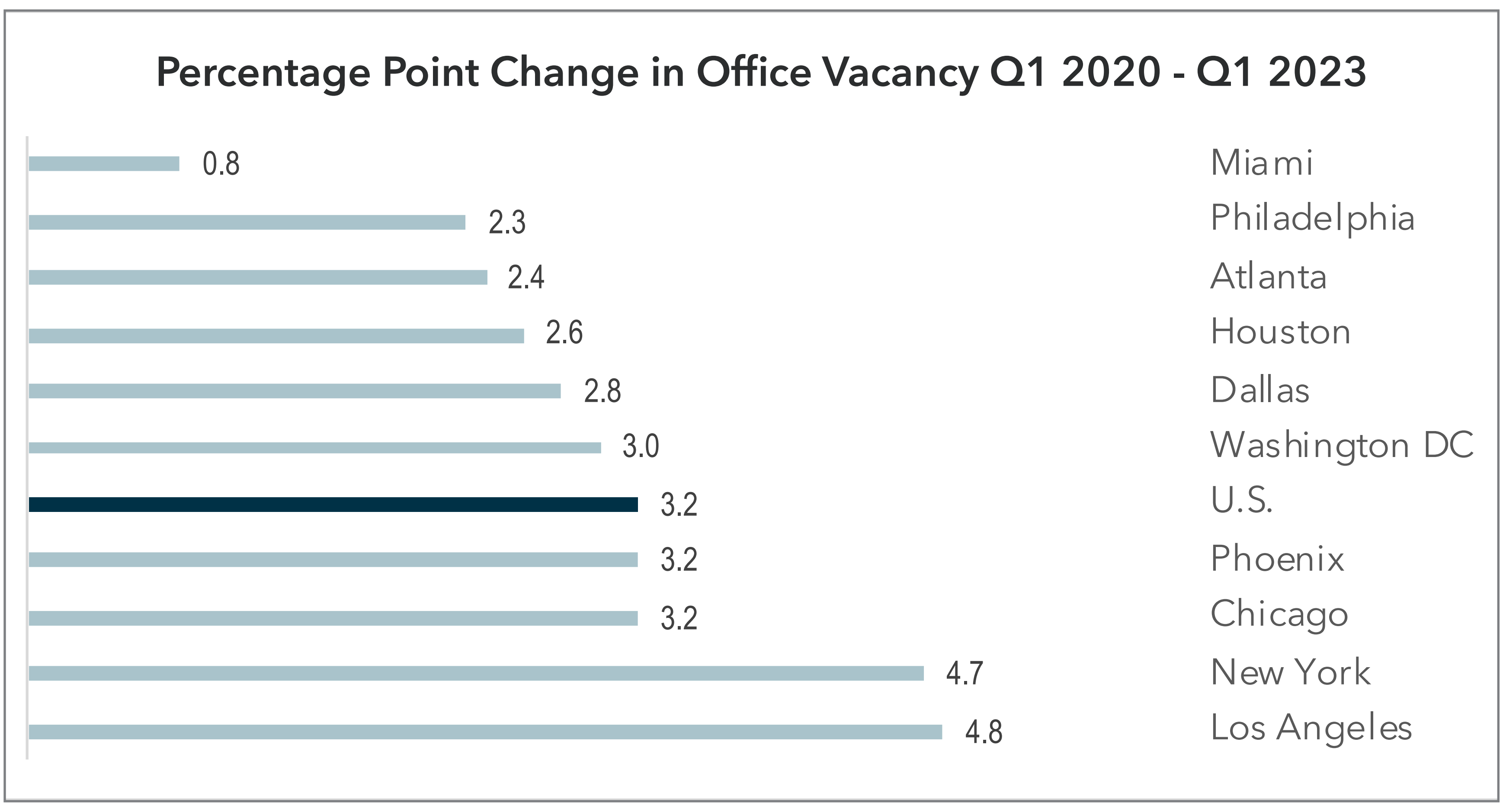

Our Perspective

Office market fundamentals have been heavily impacted by the broad adoption of hybrid work. At this point in the real estate cycle a few realities have set in:

1. Companies have been slow to bring employees back to the office en masse and space utilization is hovering around 50%.
2. Larger tenants are downsizing, and older buildings with location and amenity challenges are struggling to maintain occupancy levels.
3. Buildings with these challenges and with pending loan maturity are at greater risk of default.

According to CRED iQ, office properties account for 21% of total CMBS maturity defaults (nationally) through March, a rise of 14% from roughly one year ago. While concerning, the structural change in demand for office space won't have equal impact across markets, or individual assets. Though overall vacancy in the U.S. has grown from 9.6% to 12.8% over the last three years, Sunbelt markets have exhibited greater resistance to slowing fundamentals thanks to stronger underlying growth.

More specifically, job growth remains an important driver of office space demand. Markets exhibiting the least amount of vacancy inflation over the last three years such as Miami, Atlanta, Houston and Dallas led the post-recession jobs recovery (each surpassing their pre-recession employment peak within 25 months or less). These markets are also in states with greater overall mobility (as measured by the number of trips that include a stay of longer than 10 minutes away from one's home). After falling precipitously during the pandemic, the average number of daily trips in Georgia, Texas and Florida are 6% to 7% higher today than they were in 2019. In contrast, California's daily trips are down 16% relative to 2019 and New York's are up a modest 2.5%.

Markets with modern office product, sustained job growth and vibrant economies have shown recent resilience and stronger bounce-back from periods of anemic demand. While there are any number of micro factors which contribute to specific office asset performance, possessing the fundamental ingredients for growth places sunbelt markets in a position to once again recover relatively quickly.

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