MARKET REPORT

OFFICE

Detroit Metro Area

IPA | INSTITUTIONAL PROPERTY ADVISORS

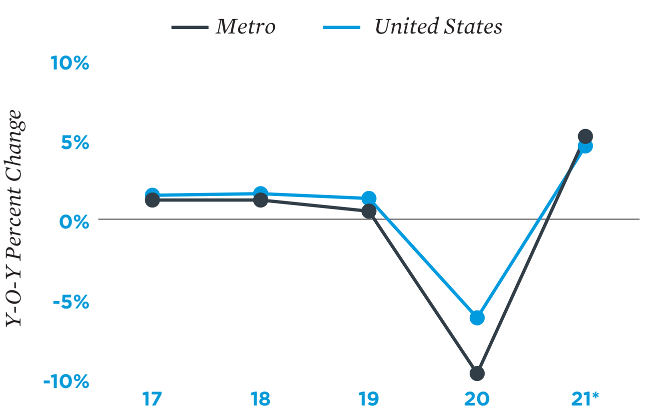
4Q/21

Construction Activity and Subdued Leasing Potentially Extend Motor City's Recovery

Pandemic continues to restrain office leasing. Detroit's office market remains encumbered by low office utilization as state-mandated capacity restrictions continue to keep many office-using employees working remote. Vacancy climbed 260 basis points to 17.0 percent over the past five quarters as available space increased by more than 4.4 million square feet. Asking rents managed to stay in positive territory last year but have since declined through the first half of 2021. Rising levels of vacancy will continue to place downward pressure on rents throughout the second half, as competition for tenants will incentivize operators to enhance concessions to attract occupants.

Corporate uncertainty clouds near-term office outlook. An optimistic sign for Detroit's long-term recovery is the strength of its labor market. The unemployment rate has steadily fallen to 4.1 percent as of August after reaching 24.7 percent in April 2020. Nevertheless, future office demand remains unclear as businesses continue to assess their working arrangements. Major employers like Ford Motor Company have delayed their return to office plans until 2022, while other companies like Rocket Mortgage and United Wholesale Mortgage have already initiated their return to the office. The ongoing uncertainty may result in diminished leasing in the near term. Suppressed market activity coupled with the largest construction pipeline in 14 years will likely place upward pressure on availability into 2022.

Employment Trends



** Forecast*

Sources: BLS; CoStar Group, Inc.

Office 2021 Outlook

96,000 JOBS
will be created

EMPLOYMENT:

Detroit will recover nearly half of the 199,800 positions lost in 2020. As a result, total employment will expand by 5.2 percent this year. The metro's traditional office-using sector will grow 3.4 percent with the addition of 17,500 jobs in 2021.

1,400,000 SQ. FT.
will be completed

CONSTRUCTION:

Deliveries this year will jump well above the trailing-five-year average of 639,000 square feet. Inventory will expand by 0.8 percent in 2021, the highest annual rate since 2007. The Central Business District will receive the bulk of new supply.

120 BASIS POINT
increase in vacancy

VACANCY:

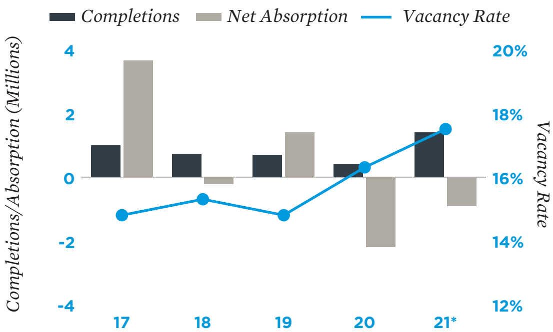
An increase in supply additions coupled with employer move-outs and space consolidations will further increase vacancy this year. However, the rise in availability will slow from last year's 150-basis-point increase as Detroit's vacancy reaches 17.5 percent.

0.9% DECREASE
in asking rent

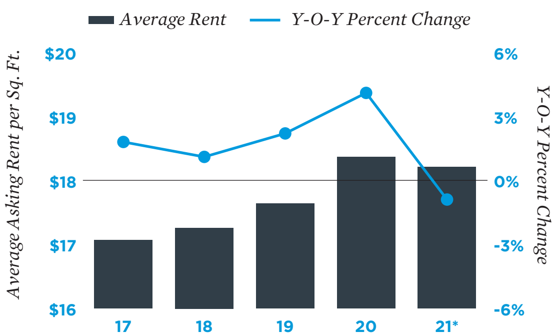
RENT:

Rising vacancy will weigh on the average asking rent in Detroit, resulting in the first annual reduction since 2012. The average rent will decrease to $18.21 per square foot by the end of this year.

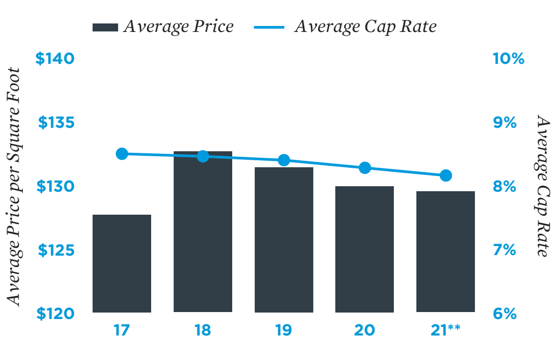
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 2Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

2Q21 - 12-Month Period

CONSTRUCTION

1,041,000 sq. ft. completed

- Developers expanded the metro's inventory by 0.6 percent over the past four quarters. Builders added nearly 700,000 square feet over the previous 12-month period.
- Approximately 65 percent of the 2.5 million square feet currently under construction is pre-leased.

VACANCY

220 basis point increase in vacancy Y-O-Y

- A 3.7 million square foot increase in vacant stock over the past year pushed the metro's vacancy rate to 17.0 percent in June, the highest rate in Detroit since early 2016.
- Class A vacancy rose 160 basis points to 17.9 percent while the Class B/C rate jumped 230 basis points to 16.6 percent.

RENT

1.6% increase in the average asking rent Y-O-Y

- The arrival of high-quality Class A office space over the 12-month period ended in June strengthened market rates, allowing the average asking rent to increase to $18.33 per square foot.
- The West Wayne submarket posted the largest rent gain over the past four quarters, rising 8.9 percent to $17.07 per square foot.

Investment Highlights

- Declining office fundamentals kept many investors on the sidelines in recent months, resulting in the lowest amount of transactions in an annual period since 2011. Deal flow over the past four quarters was down about 20 percent relative to the previous 12-month span.
- Decreased demand for office assets in the metro negatively affected pricing over the past four quarters. The average sale price contracted 1 percent to $129 per square foot while the mean cap rate remained in the low-8 percent range.
- Transaction velocity in medical office assets has remained steady over the past year, relative to the previous 12-month period. Properties in this sector traded at an average of $160 per square foot, with first year returns averaging in the high 7 percent range.
- Both local and out-of-state investors were most active in Macomb East, Southfield and the Southern I-275 Corridor submarkets. Lower entry-costs and the potential for higher yields piqued buyer interest.

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