RESEARCH BRIEF
OFFICE MARKET

JULY 2022

Leasing Edge Emerging for Assets with Recent Health-Related Renovations

Bifurcated fundamentals surface within the office market. Despite the strong performance of freshly renovated offices in urban cores, vacancy in the nation's CBDs is climbing at a quicker rate than suburban office vacancy, based on preliminary second quarter data. This is in part due to the increased emphasis on facilities with health-conscious attributes, like air quality and moisture, water quality, and access to natural lighting. Tenants are choosing between paying premiums for spaces with health-promoting qualities, or reducing expenses by moving into more cost-effective locales. The result is stabilizing performance for space with post-pandemic upgrades, while older assets without modern features have struggled, especially in urban cores.

Shifting demands emerge in post-pandemic office landscape. Entering 2020, office tenants were placing escalating emphasis on the environmentally-friendly aspects of buildings when inking commitments. While the health crisis accelerated this trend, it also created a new and specific need for office space that promotes employee health and safety. A recent report found that as of spring 2022, only 30 percent of office stock meets recent elevated benchmarks for both environmental and health and safety criteria. The premium these spaces command is growing, and could rise to 20 percent if outmoded stock is left in the current state or is taken off the market. This rent boost for quality assets will be most pronounced in cities with the highest proportion of older stock.

Office owners ramp up renovation efforts. As amenities become more important to office tenants, some of the nation's most well-known towers are undergoing upgrades in order to stay competitive with new builds. In 2021, the number of alteration permits rose sharply, and many of these projects are finalizing in 2022. A prominent example of this is Willis Tower in Chicago, which recently completed a $500 million improvement. This sparked an agreement with Abbott Laboratories to occupy space in the building. The Thomson Reuters Building in Manhattan was also able to secure a long-term agreement from Roku after announcing upgrades last year. Despite stronger performances for suburban offices, modernized central builds have been successful in adding and retaining tenants into summer 2022.

Conversions to Tighten Office Market

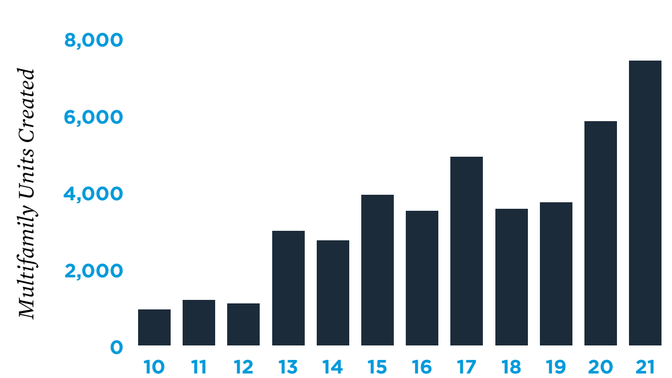
Major firm launches first office redevelopment play. This summer, Hines announced its intentions to convert Salt Lake City's 24-story South Temple Tower from offices into 255 luxury apartment units, the real estate firm's first ever office-to-multifamily conversion project. This adds to a growing list of high-profile office-to-apartment conversions, joining One Wall Street and 55 Broad Street in Manhattan, the Petroleum Building in Denver, the Phoenix Financial Center and others across the country. Additionally, Pittsburgh recently announced a fund aimed to assist office-to-multifamily conversions in the city.

Office-to-multifamily conversions heat up. A total of 32,000 apartment units have been added through the redevelopment of non-multifamily space since the start of the new decade, with a sizable 41 percent of these units being former office space — a number that has accelerated since the onset of the pandemic. Elevated office vacancy is encouraging some conversions, but urban apartment demand is also a strong force driving redevelopment decisions. Removal of this space will aid the leasing prospects and performance of remaining stock.

17.8% *Estimated Second Quarter CBD Office Vacancy*

15.6% *Estimated Second Quarter Suburban Office Vacancy*

Office-to-Apartment Conversions



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Sources: IPA Research Services; Zisler Capital Associates; CoStar Group, Inc.; RentCafe; Yardi Matrix