MARKET REPORT

Office

Dallas-Fort Worth Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

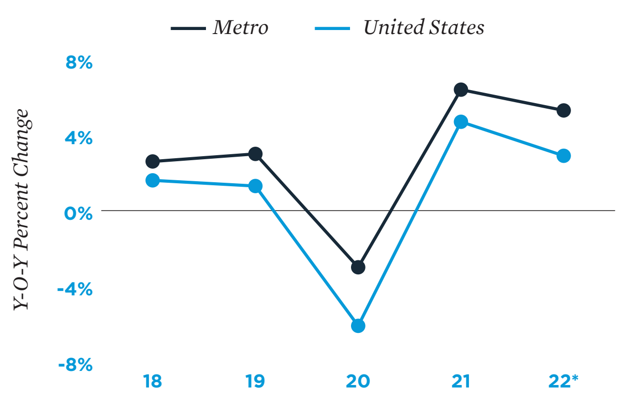
4Q/22

Office Utilization Rising in the Second Half of 2022 as the Market Shows Some Signs of Stabilizing

Workers are gradually returning to Metroplex workplaces. Kastle System's back-to-work barometer, which tracks weekday building access activity, is showing improved office utilization in Dallas. Using pre-pandemic admittance as a 100 percent baseline, the utilization rate in the metro approached 55 percent shortly after the Labor Day 2022 holiday, the highest point since the arrival of the health crisis. Leasing in the second and third quarters augment this utilization trend, showing substantial tenant interest persists for Dallas-Fort Worth offices in the age of remote and hybrid work. Net absorption eclipsed 550,000 square feet from April through June, marking the fourth time in five quarters with a positive reading. Major commitments since the culmination of that period include a 41,000-square-foot sublease by Omni Logistics in Coppell, and a 75,000-square-foot signing by cybersecurity firm Trellix in Plano.

Expiring leases will induce more stress. While upward trending utilization is a positive sign, it also indicates that a sizable portion of offices are not being used more than 30 months into the pandemic. As such, additional tenants may downsize their footprints as leases expire. This will weigh on net absorption, as the vacated offices will be competing with sublease stock and new construction to fill space. Development is mild in 2022, however, sublease space in the market climbed above 10 million square feet. Peloton recently joined Thryv and Uber on the list of firms that have subleased at least 100,000 square feet across the Metroplex since the onset of the pandemic.

Employment Trends



** Forecast*

Sources: BLS; CoStar Group, Inc.

Office 2022 Outlook

210,000
JOBS
will be created

EMPLOYMENT:

Of the nation-leading 173,000 jobs added during the first eight months of 2022, about one-third were in traditional office-using sectors. Gains in these fields are easing, however, with a mid-3 percent unemployment rate.

4,200,000
SQ. FT.
will be completed

CONSTRUCTION:

Less office space finalizes in 2022 than in any period since 2014. The forward-looking pipeline is also thin, as under 5 million square feet had broken ground as of August, with delivery dates in either 2023 or 2024.

50
BASIS POINT
increase in vacancy

VACANCY:

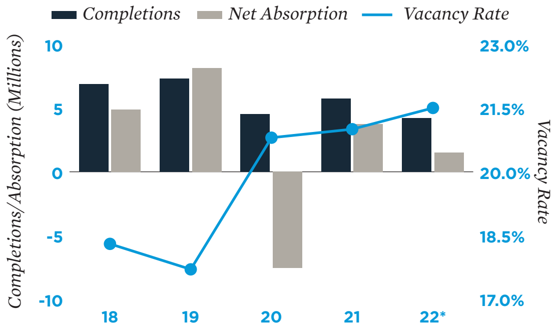
Vacancy climbs by more than last year's 20-basis-point lift, as leases expire and firms evaluate their space needs. At year-end, the projected rate of 21.5 percent exceeds 2019 availability by 380 basis points.

2.6%
INCREASE
in asking rent

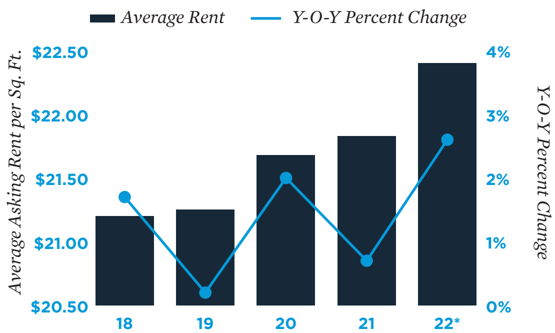
RENT:

The average asking rent has yet to retreat since the onset of the pandemic, preserved by a rise to $22.40 per square foot this year. About 60 percent of vacant stock is Class A space, aiding this elevation.

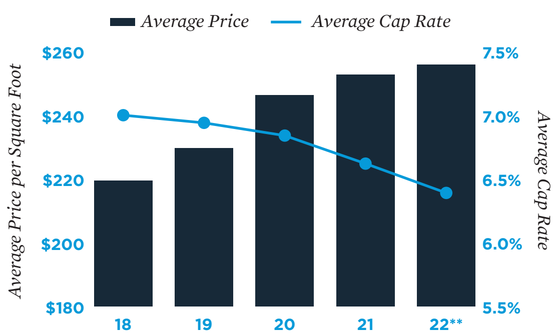
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 2Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

2Q 2022 - 12-Month Period

CONSTRUCTION

4,972,000 sq. ft. completed

- The 1.7 million square feet that finalized from January through June 2022 marked the smallest first half delivery volume since 2013.
- Six projects combining for 1.1 million square feet highlight the list of anticipated second half additions. More than half of that space was without a tenant as of August, potentially lifting vacancy, especially in Collin County.

VACANCY

10 basis point decrease in vacancy Y-O-Y

- While vacancy did inch down over the past four quarters ended in June, the starting point of that period featured the highest rate on record at 21.5 percent. A distinct downward vacancy trend has yet to be established.
- Fort Worth's CBD registered a 360-basis-point decline in vacancy to 15.4 percent, a rate that halves the Dallas CBD's market-peak 31.1 percent level.

RENT

2.0% increase in the average asking rent Y-O-Y

- Locations where vacancy fell and the average asking rent grew by at least 3 percent include South Fort Worth and Grand Prairie-South Irving, as well as the adjacent submarkets of Central Expressway and Preston Center.
- The Class B/C sector's vacancy rate contracted by 30 basis points, helping lift the segment's average asking rent 1 percent to $18.71 per square foot.

Investment Highlights

- Trading of office assets in the Dallas-Fort Worth metro area from July 2021 through June 2022 increased by more than 40 percent relative to the previous year. Preliminary figures indicate that higher borrowing costs and inflation have had marginal impacts on deal flow so far, with the number of third quarter transactions closely mirroring the April through June period. In the most recent six months, investors have been particularly active in the Mid-Cities and Richardson-Plano areas. Class B and C offices account for the bulk of trades here, with average pricing near $150 per square foot.
- The average cap rate for reported sales in Dallas-Fort Worth during the past 12 months ended in June fell 30 basis points from the prior period to 6.4 percent. This coincided with a 3 percent improvement in the average sale price of recorded trades to $256 per square foot, a function of Class A and B transactions almost doubling, while Class C deal flow held stable.
- Medical office transaction velocity surged by more than 60 percent annually during the four-quarter span ended at midyear. The most popular locales for these types of trades include the Mid-Cities, Far North Dallas and Richardson-Plano. Here, cap rates range from a minimum in the 5 percent zone, up to 8 percent for select multi-tenant buildings built pre-1990.

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