MARKET REPORT

Office

Detroit Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

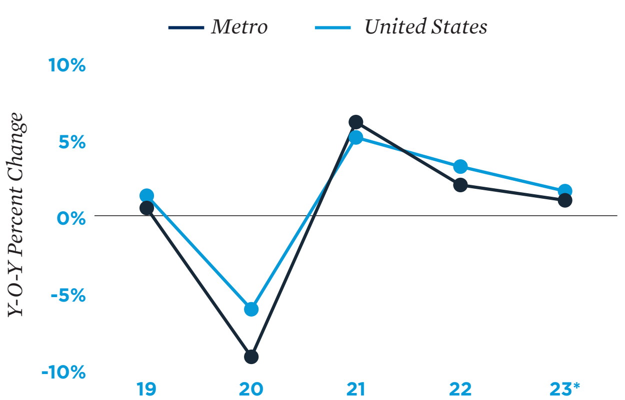
4Q/23

Metrowide Office Sector Recalibration Persists, but Soft Performance Trends not One-Size-Fits-All

Four lower-cost submarkets have shown resilience. Detroit entered the second half of 2023 with office vacancy sitting at a 35-quarter high; however, headwinds are not equal across the market. In fact, four submarkets — North Oakland, Macomb, Northern Outlying and Downriver — registered year-over-year vacancy declines in June. The latter two of these areas also maintained sub-10 percent rates entering the third quarter of 2023, significantly undercutting the marketwide measure. While headline leases in these submarkets have been rare, they are proving to be top choices for firms seeking 10,000- to 20,000-square-foot floor plans. Cost advantages are likely a consideration, as all four areas have an average asking rent below $17 per square foot, and excluding North Oakland, offer the lowest rates in the market. These four submarkets combine for less inventory than just the urban core; therefore, their strength has had a limited influence on metro fundamentals.

Pair of office-heavy areas among the most challenged. Two submarkets that unite for almost 40 percent of the metro's total inventory — Detroit-The Pointes and Southfield — had respective year-over-year vacancy hikes of 250 and 620 basis points. As a result, these areas combined for 13.7 million square feet of vacant office stock in June. Detroit-The Pointes could face additional pressure as two projects totaling 184,000 square feet marked available for lease in September are scheduled to finalize here in the second half.

Employment Trends



** Forecast*

Sources: BLS; CoStar Group, Inc.

Office 2023 Outlook

20,000 JOBS
will be created

EMPLOYMENT:

Detroit's traditional office-using employers lost 3,300 positions during the first eight months of 2023. Gains in leisure and hospitality, as well as government, underscore a 1.0 percent overall expansion this year, however.

525,000 SQ. FT.
will be completed

CONSTRUCTION:

Supply additions in 2023 fall to less than half of last year's total as metro stock expands by just 0.3 percent. The greatest chunk of new space marked available for lease as of September is slated for Detroit-The Pointes.

160 BASIS POINT
increase in vacancy

VACANCY:

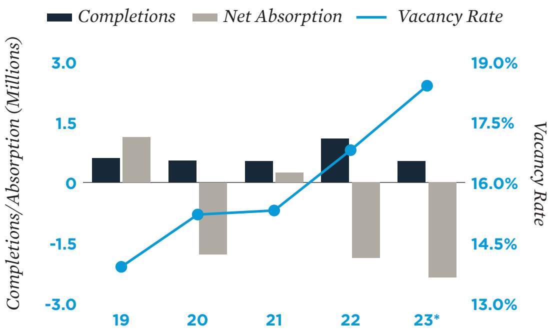
Similar to last year's 150-basis-point vacancy increase, the rate continues to elevate as expiring pre-pandemic leases put space on the market. Metrowide vacancy will rise to 18.4 percent, marking an 11-year high.

0.4% DECREASE
in asking rent

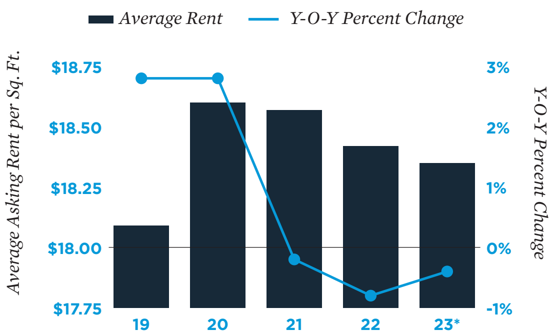
RENT:

For a third straight year, Detroit's average asking rent will tick down by a sub-1 percent margin, bringing the figure to $18.35 per square foot. The Class B/C segment has been exhibiting greater rent stability.

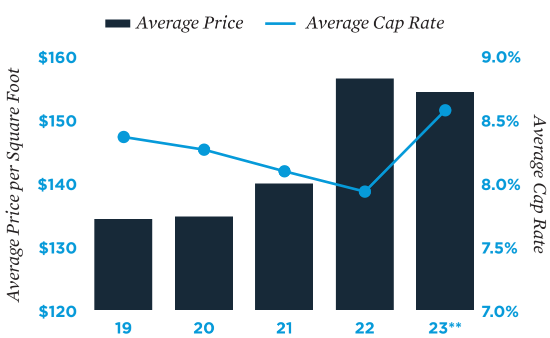
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 2Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

2Q 2023 - 12-Month Period

CONSTRUCTION

858,000 sq. ft. completed

- More than two-thirds of the space added over the past year ending in June was finalized in the third quarter of 2022. After that stretch, new supply has been very moderate, holding annual inventory growth to 0.5 percent.
- Medical offices account for about 150,000 square feet of the 2023 pipeline, headlined by the Rochester Hills Surgery Center that finalized in April.

VACANCY

160 basis point increase in vacancy Y-O-Y

- Metrowide vacancy rose to 17.6 percent in June. Nevertheless, the 10-basis-point rise between the first and second quarters was the smallest elevation going back to the opening frame of 2022, a potential sign of stability.
- The Class A vacancy rate jumped 300 basis points to exceed 20 percent at midyear, the first time it has eclipsed that threshold since 2012.

RENT

0.4% decrease in the average asking rent Y-O-Y

- Rising vacancy at higher-end offices subdued rents in that segment. The average Class A asking rate dipped 1.5 percent, offsetting stable Class B/C rents and pulling the overall figure down to $18.46 per square foot in June.
- Only three of 11 submarkets had rent declines; however, the drops were notable. Rates fell beyond 3 percent in Northern Outlying and Southfield.

Investment Highlights

- Softer performance trends, elevated debt costs and conservative lending are all working in concert to subdue office asset trading. Excluding 2020, deal flow from April through June 2023 measured as the lowest quarter since 2012. The potential for greater capital markets stability going forward could help revive the investment market, although buyers are likely to remain selective. At the same time, widespread discounts have not transpired. The average sale price of trades completed during the 12 months ending in June increased 4 percent to $154 per square foot. A 60-basis-point rise in the mean cap rate to 8.6 percent, meanwhile, indicates buyers and sellers are finding common ground.
- Based on preliminary data, the number of trades from June through August 2023 outpaced the prior three months, potentially foretelling an emerging uptick in deal flow. During the summer months of 2023, sub-30,000-square-foot mid- and lower-tier assets drove the bulk of activity.
- Medical offices continue to transact in the metro, particularly in North Oakland and Macomb. Entry costs range widely depending on location and property specifics, but have averaged near $135 per square foot as of late.

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