MARKET REPORT

Office

New Haven-Fairfield County Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

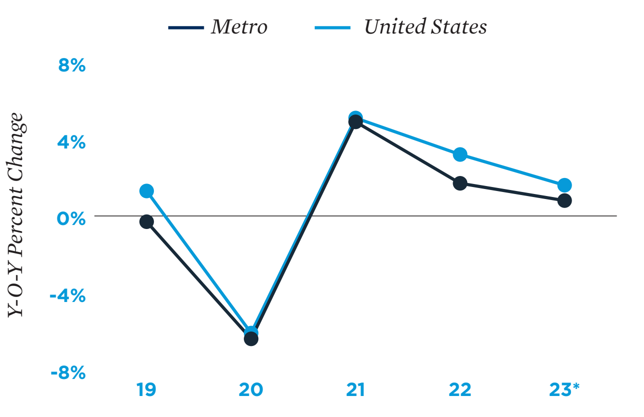
4Q/23

Class B and C Demand Remains Steadfast; Top-Tier Inventory Landscape Shifting

Smaller office-using employers drive tenant demand. Vacancy remains roughly in line with pre-pandemic norms, driven by a low metric in the Class B and C segments. The vacancy rate in these tiers held at 10.2 percent during the first half of 2023, well under the long-term average of 13.3 percent. While the metro has seen a number of larger tenants vacate the market over the past decade, southwestern Connecticut retains a solid base of smaller accounting and law firms to support demand for mid- and lower-tier office space. A notable amount of upper-tier stock available remains a caveat, however.

Narrow development pipeline and demolitions aid existing stock. Challenges remain in the amenity-rich segment, with over a quarter of supply consistently vacant since early 2022. The local economy could impede a recovery in the Class A tier moving forward; a high cost-of-living throughout the region can frustrate recruitment efforts, in turn hindering some larger firms' ability to expand. This would impact attempts to backfill spaces vacated in the aftermath of the health crisis. However, current demand challenges are mitigated by development trends. Nearly half a million square feet was removed from the market by demolition this year, eclipsing the amount of office space added to the market since the end of 2020 by nearly 60 percent. Developers could increasingly target vintage single-tenant office campuses for conversion like in nearby markets, as the region is replete with such assets.

Employment Trends



* Forecast

Sources: BLS; CoStar Group, Inc.

Office 2023 Outlook

6,500 JOBS *will be created*

EMPLOYMENT:

Although the broader employment base noted robust expansion over the first eight months of the year, traditional office-using fields are shrinking, losing roughly 2,400 positions since the start of 2023.

40,000 SQ. FT. *will be completed*

CONSTRUCTION:

This year's additions will be the second lowest on record, only exceeding 2021, when deliveries were nominal. Roughly 750,000 square feet is scheduled for next year, however.

40 BASIS POINT *decrease in vacancy*

VACANCY:

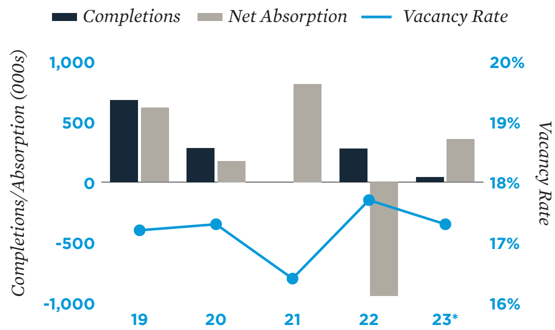
Vacancy will retreat on an annual basis this year after a 130-basis-point leap in 2022, bringing the metric down to 17.3 percent. This rate is just 10 basis points above the year-end 2019 measure.

1.1% DECREASE *in asking rent*

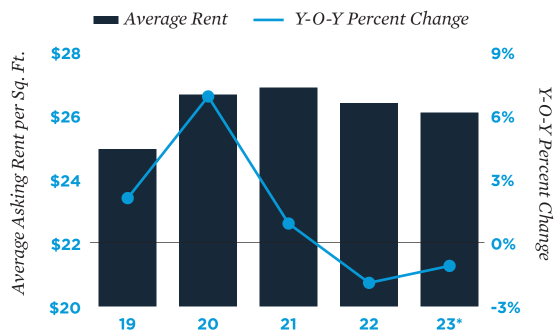
RENT:

Southwestern Connecticut will note falling rents for the second consecutive year, the first such span since 2018. The mean marketed rate will decline to $26.10 per square foot by the end of the year.

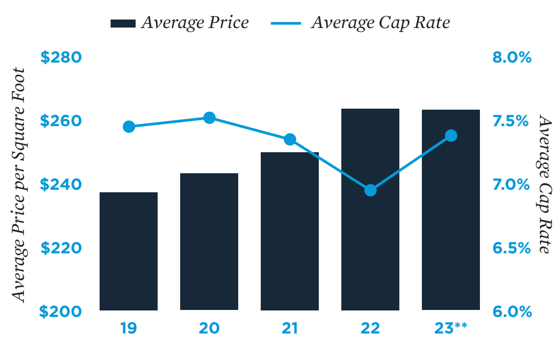
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 2Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

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Price: $250

2Q 2023 - 12-Month Period

CONSTRUCTION

30,000 sq. ft. completed

- The first quarter of 2023 accounted for all the completions of note during the 12-month period ended in June.
- The long-term pipeline is comprised of a handful of projects set to deliver in 2024, the majority of which are accounted for. High Class A availability suggests that a further large-scale stock expansion is unlikely.

VACANCY

50 basis point decrease in vacancy Y-O-Y

- Vacancy hovered in the mid-17 percent range throughout the 12-month period ended in June, ending the span at 17.4 percent.
- The market retains a large availability gap between Class A complexes and other office tiers. Amenity-rich stock was 26.7 percent vacant entering July, 1,650 basis points ahead of the Class B and C segments.

RENT

0.8% decrease in the average asking rent Y-O-Y

- Asking rents have noted annual declines since late 2022, closing the 12-month period ended in June at an average of $26.10 per square foot.
- All office tiers noted declining marketed rates during this span, led by Class A complexes with a 0.8 percent decline to $33.88 per square foot. The mean Class B/C segment fell 0.7 percent to $20.31 per square foot.

Investment Highlights

- Transaction velocity declined notably during the first half of 2023, with deal flow during this period proceeding at the pace comparable to six-month spans seen following the financial crisis. However, trades in the $15 million-plus category increased during the second quarter, indicating that institutions are still identifying opportunities in the region.
- Pricing momentum remained positive over the 12-month period ended in June, bumping up to a mean of $262.88 per square foot, more than 2 percent above the preceding span. This stems from investors targeting high-occupancy assets in the region's multiple downtown cores. Low vacancy, even among vintage assets, has prompted many users to target the market's ample selection of pre-millennial stock.
- The region features a number of larger, single-tenant Class A campuses that could become attractive targets for re-development. Many office tenants favor downtown-adjacent properties over suburban complexes farther from urban amenities, with municipalities in similar nearby markets offering generous tax incentives to rehabilitate vacant facilities.