1Q24

Raleigh-Durham Office Market Overview

Market Observations

Economy

- The market's unemployment rate declined by four basis points year over year to 3.1%, remaining below the five-year average of 4.0%.
- When compared to February 2023, employment growth decelerated by 178 basis points.
- Most sectors reported employment growth, with education and healthcare leading job gains at 6.0% over the past 12 months.
- Office-using jobs in the market recorded an all-time high of 215,350 jobs as of the end of February 2024, reflecting 19.0% growth since 2019 and 42.0% growth since 2014.

Leasing Market Fundamentals

- Annual full-service class rental rates remain elevated at $30.00/SF, a 0.2% increase year over year.
- Occupancy increased quarter over quarter, leading overall vacancy rates to decrease 20 basis points to 17.2%.
- The under-construction pipeline slightly declined to 1.8 MSF currently in progress as fewer projects have broken ground due to higher building costs, steeper cost of debt and significant vacancy to be absorbed.
- Total leasing activity closed the quarter at 757,971 SF with one of the lowest levels of leasing activity on record, 31% below the 16-year first-quarter average of 1.1 MSF.

Major Transactions

- The first quarter of 2024 saw a slight uptick in lease signings greater than 20,000 SF.
- Mercalis renewed their lease in Morrisville's Perimeter Park, which has seen a recent wave of leasing.
- Cranfill Summer, KCI and RailInc all signed leases to relocate into largely similar sized footprints.
- HNTB expanded its lease at North Hills prior to commencing the original lease's buildout.
- It is too early to tell if a pattern is in motion, but of the leases signed, the majority either kept a similar footprint or expanded.
- Multiple large tenants are currently in the market, so the coming quarters will indicate if new trends are setting up.

Outlook

- The office market began to show signs of recovery but will report slower growth in the near term. Office investment activity will be subdued due to elevated inflation, steeper cost of debt, and muted demand near- and mid-term.
- The expiration of leases signed pre-pandemic will likely push more tenants to shed unused space and lease smaller footprints in higher-quality assets.
- The office market is expected to remain tenant friendly, with ongoing stagnant demand. As a result, overall asking rents are projected to stay flat or modestly decline.
- Vacancy is expected to increase as the construction pipeline, which currently accounts for 3.5% of inventory, continues to deliver. The Raleigh office market will likely see continued growth in higher-quality spaces this year as new projects continue to deliver.

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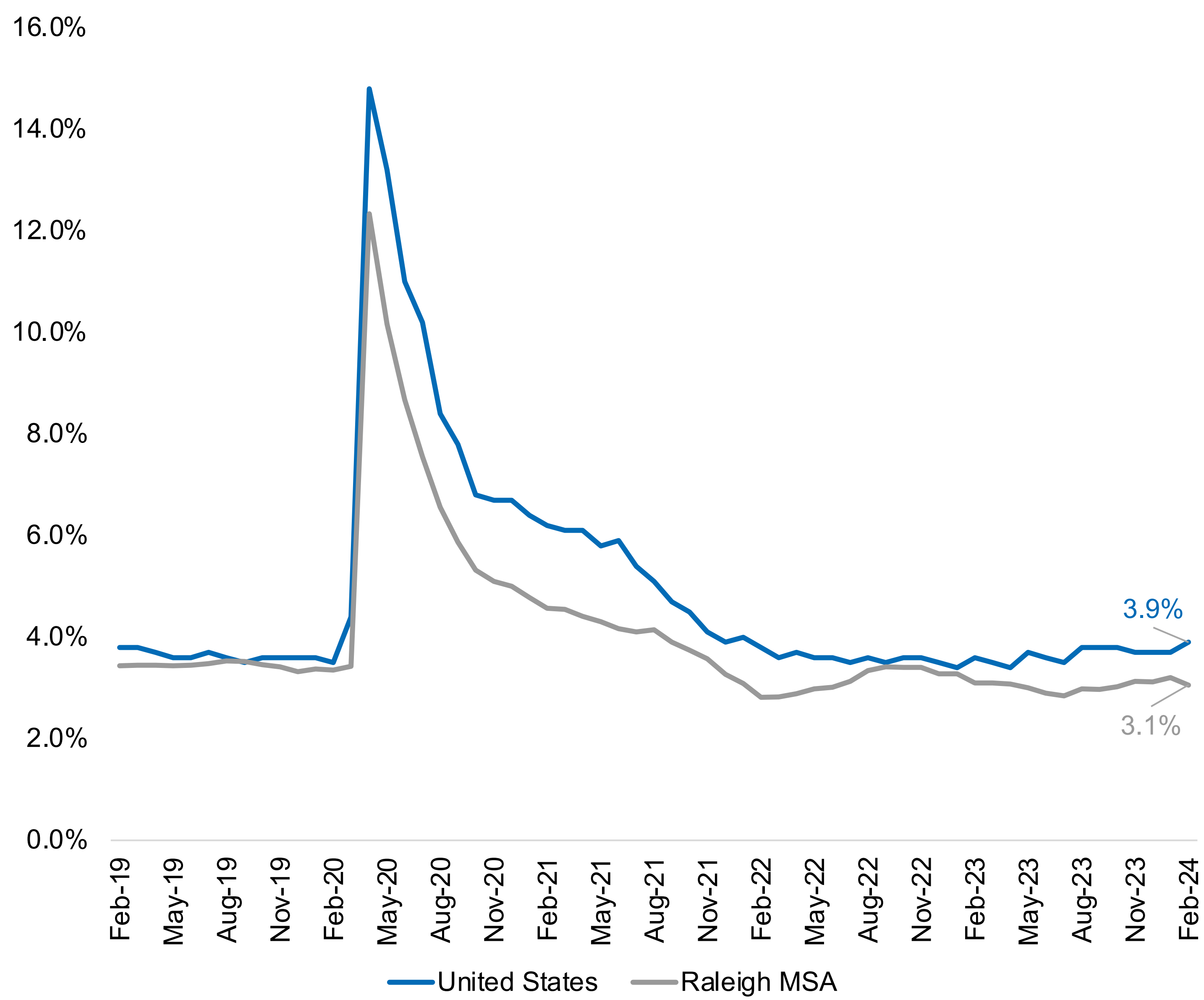
Economy

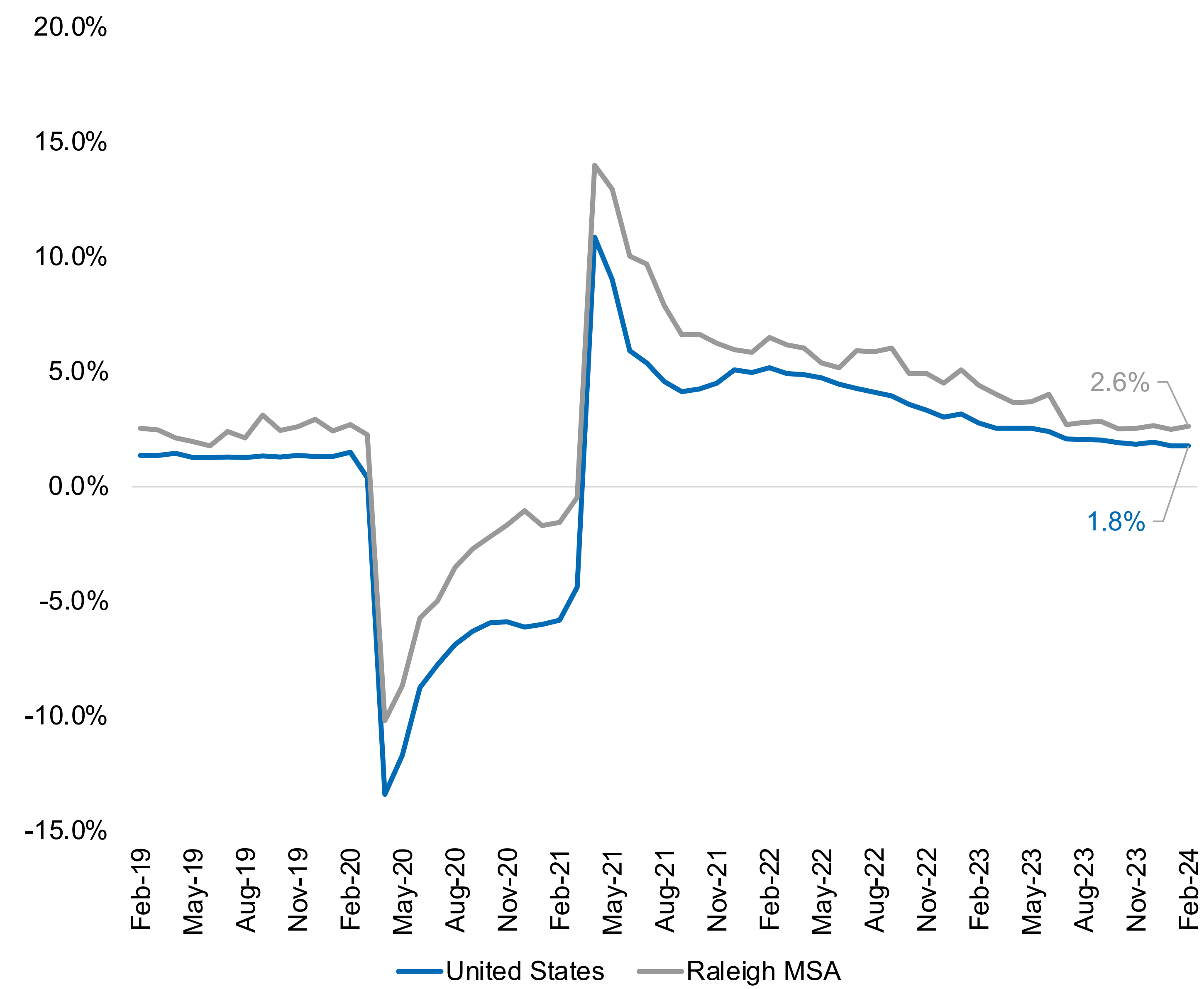
Employment Trends Signal a Slowing Economy

Raleigh has generally reported lower unemployment rates compared with the national average, while being an outperformer in employment growth. This trend has continued into the first quarter of 2024, with the market's unemployment rate marginally dropping by four basis points year over year to 3.2%, well below the U.S.'s unemployment rate of 3.7%. Seasonally adjusted nonfarm payrolls also outperformed the U.S. and reported a 178-basis-point year-over-year decline, to 2.6%.

Unemployment Rate, Seasonally Adjusted



Nonfarm Payroll Employment, Seasonally Adjusted, 12-Month % Change

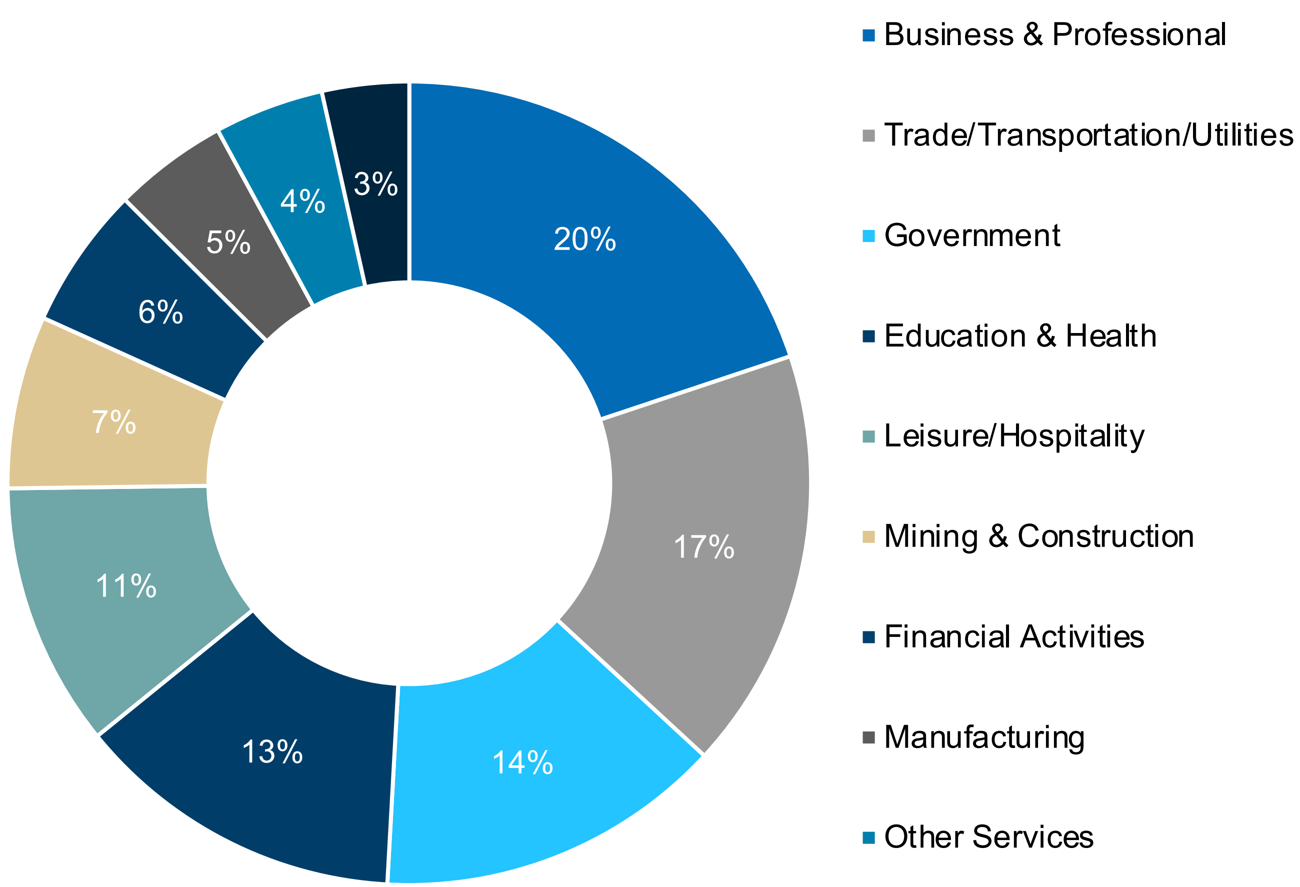


Source: U.S. Bureau of Labor Statistics, Raleigh MSA

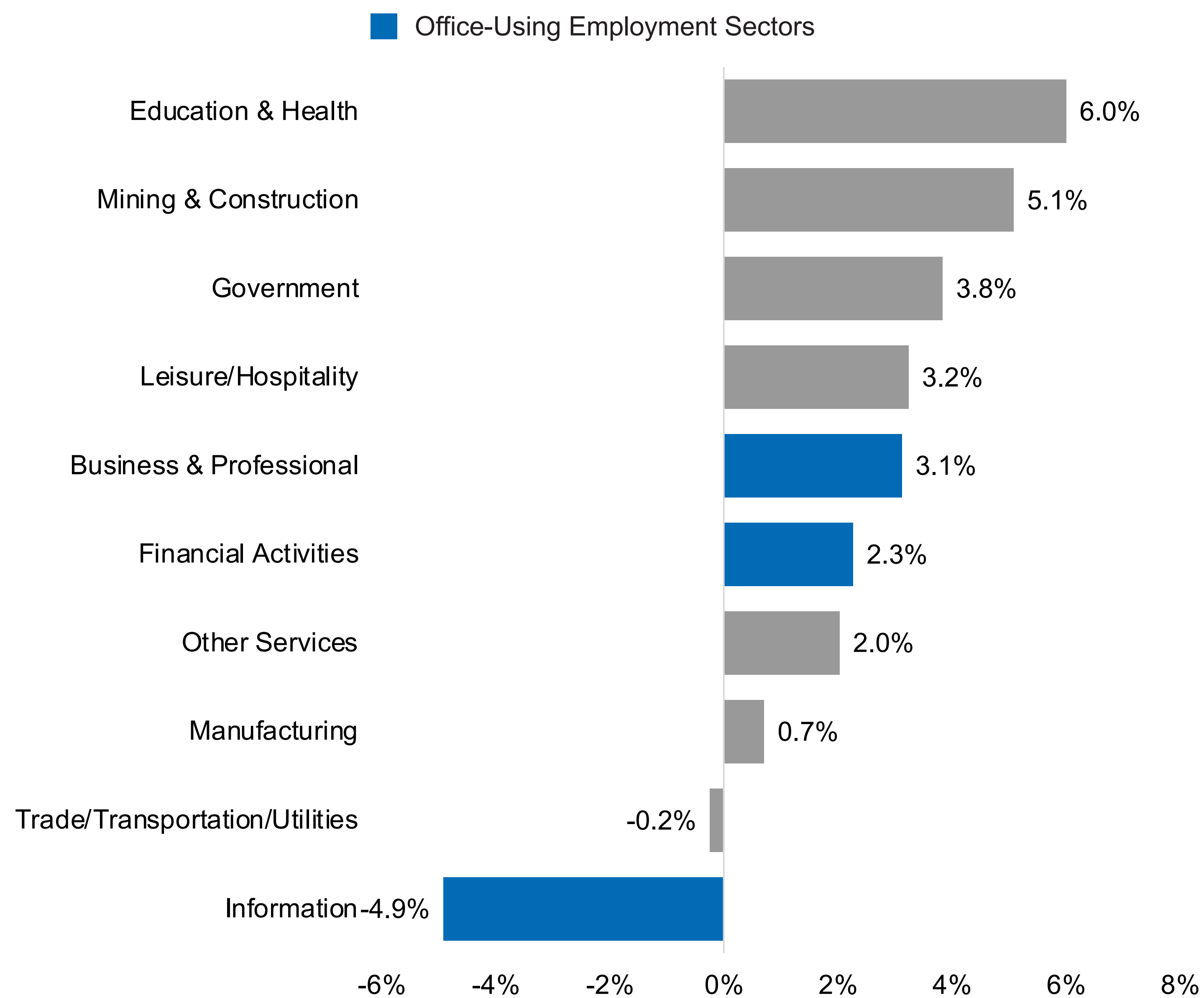
Employment Growth Continues across Most Sectors

Known for its technology sector, the Raleigh market's top two employment industries, business and professional and trade/transportation/utilities, account for 36.9% of jobs. The office-using employment's business and professional sector is the largest industry sector, at 19.9%. Most industries, except trade/transportation/utilities and information, reported year-over-year job growth. Office-using industries, like business and professional and financial activities sectors, reported 3.1% and 2.3% year-over-year growth, respectively. Meanwhile, the information sector reported a decline of 4.9% growth year over year.

Employment by Industry, February 2024



Employment Growth by Industry, 12-Month % Change, February 2024

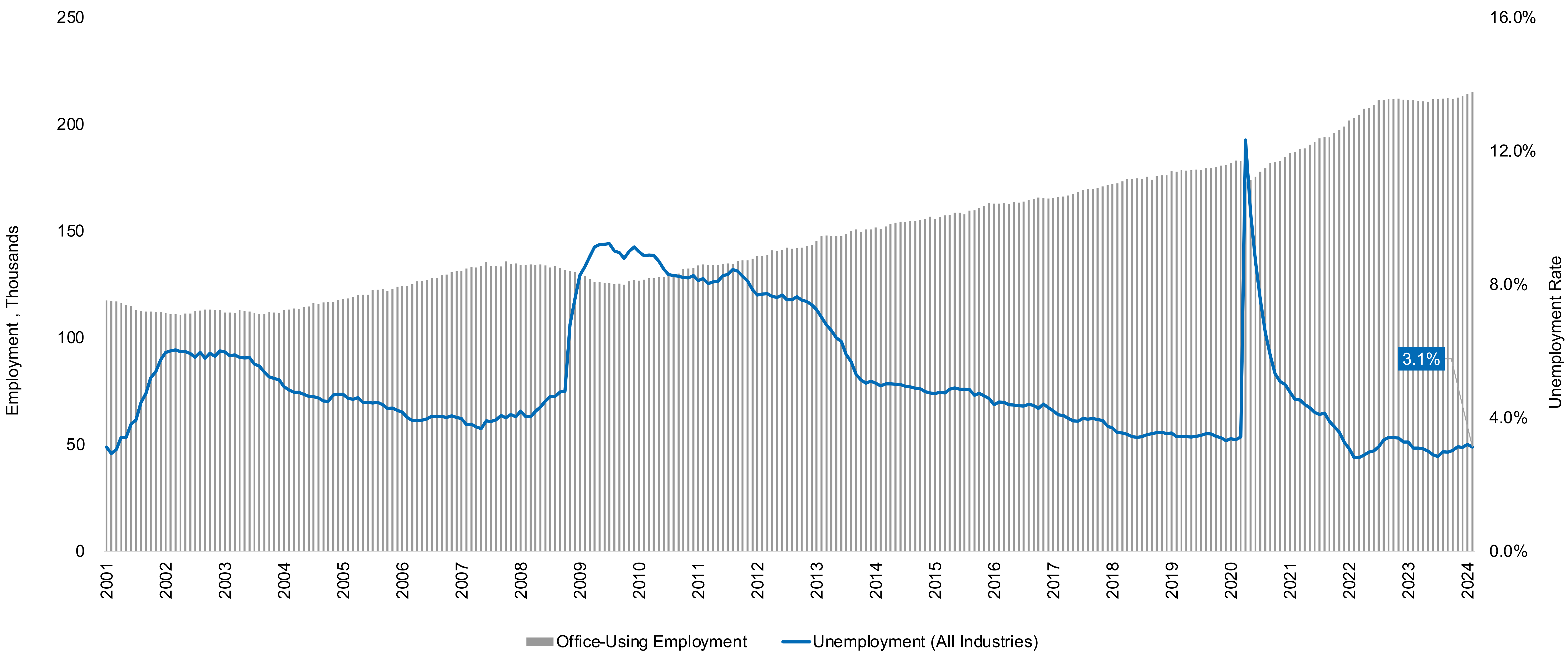


Source: U.S. Bureau of Labor Statistics, Raleigh MSA

Overall Office-Using Employment Increases to Record High

Office-using employment in the Raleigh market recorded an all-time historical high of 215,350 office-using employees in February of 2024. Currently, the seasonally adjusted unemployment rate is 3.1%, less than the 3.5% average levels reported in 2019, indicating that industries besides office-using jobs are likely contributing to most of the unemployment rate.

Office-Using Employment* and Unemployment Across All Industries



Source: U.S. Bureau of Labor Statistics, Raleigh MSA

*Office-using employment includes employment in the following industry sectors: Professional & Business Services, Financial Activities and Information.

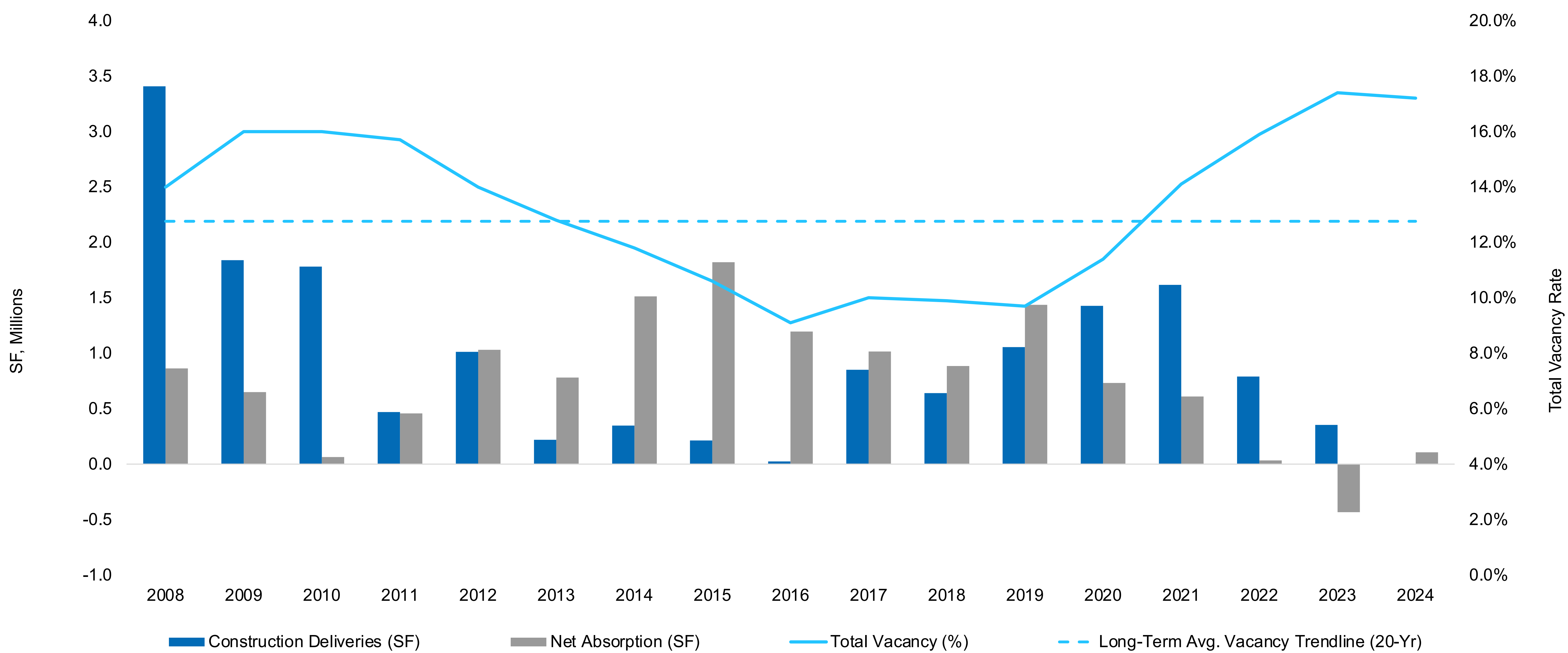
1Q24

Leasing Market Fundamentals

Vacancy Inches Lower from Historic High

The Raleigh office vacancy rate increased by 60 basis points year over year to 17.2% in the first quarter of 2024, above the 20-year vacancy average of 12.8%. Since the fourth quarter of 2019, vacancy rates have generally increased in the market, with the trend breaking this quarter when vacancy rates dipped by 20 basis points quarter over quarter. This can be attributed to a few factors, including continued historically high levels of direct and sublet availability, continued delivery of new office buildings and recent years of low or negative yearly absorption. The pandemic era change to hybrid and remote work exacerbated this trend.

Historical Construction Deliveries, Net Absorption, and Vacancy

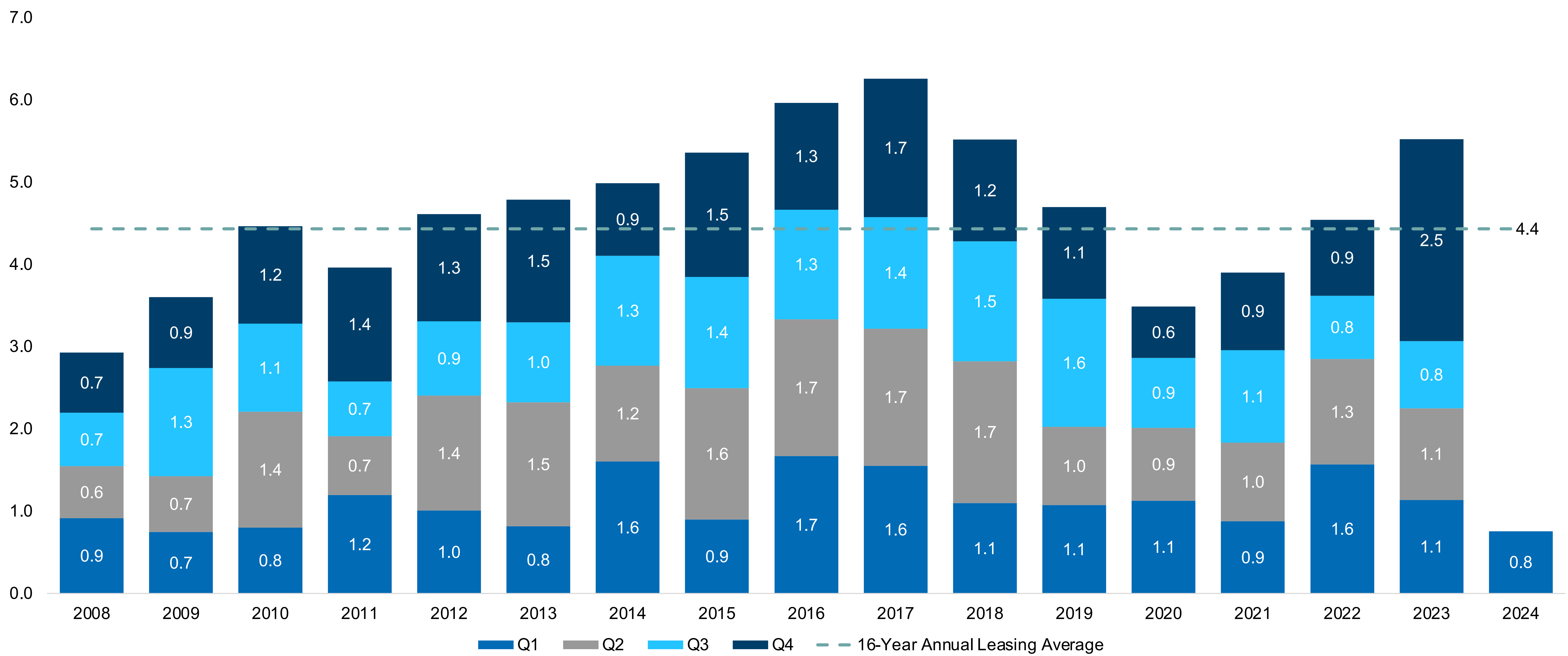


Source: Newmark Research, CoStar

Leasing Activity below Historic Quarterly Average

Leasing activity in the market greatly slowed in the first quarter of 2024 when compared to the record-breaking pace of the fourth quarter of 2024. Overall, the first quarter of 2024 had one of the lowest leasing activities on record. The quarter's leasing activity of 757,971 SF was well below the 16-year first-quarter leasing average of 1.1 MSF. The decrease in leasing activity is likely being driven by companies reevaluating corporate office space needs and a reluctance to lease space in an uncertain economic environment.

Total Leasing Activity (msf)

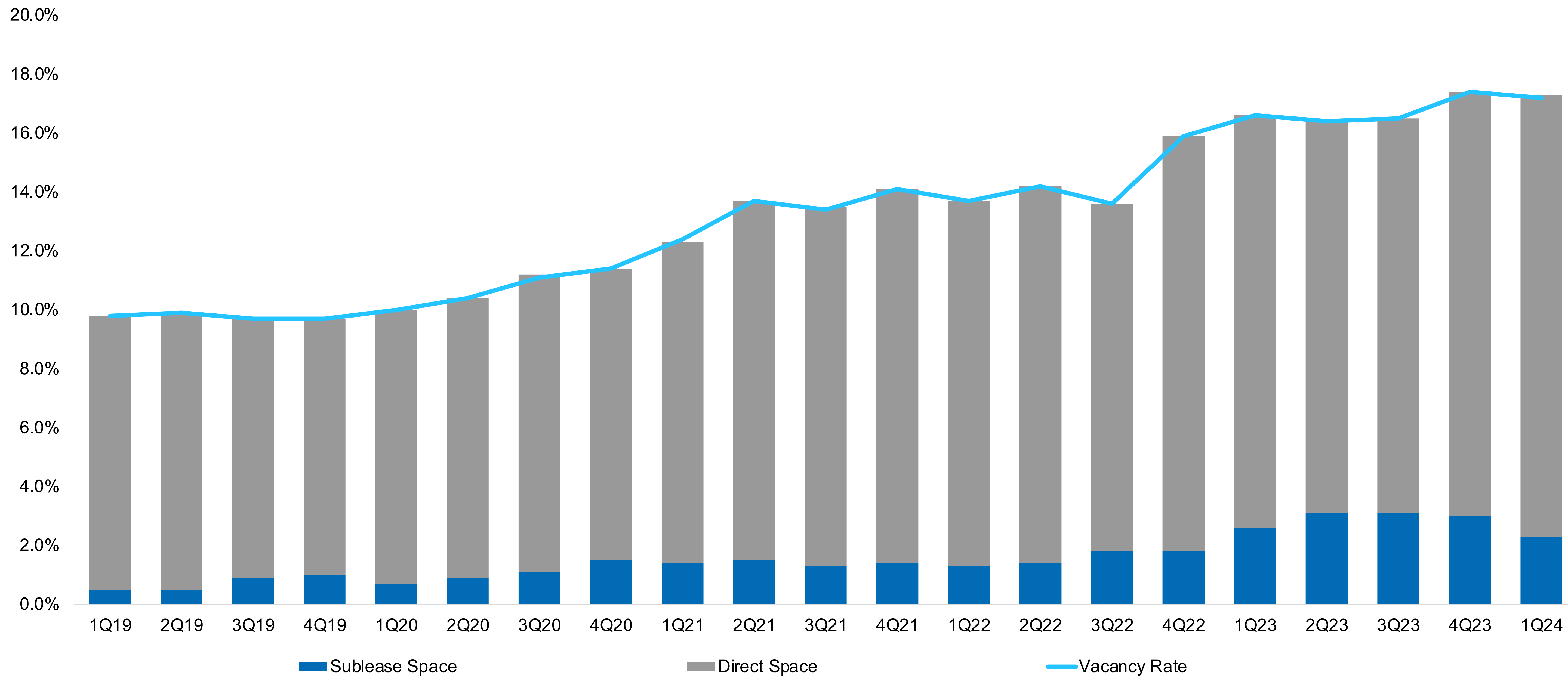


Source: Newmark Research, CoStar

Vacancy Negligibly Drops from Historic High

Sublease availabilities in the Raleigh market recorded have continually declined from their high of 3.1% recorded in the second and third quarters of 2023. As of the first quarter of 2024, sublease availabilities were 2.3%. This reflects a 70-basis-point quarter-over-quarter decrease and a 30-basis-point year-over-year decrease. Direct availability increased 60 basis points quarter over quarter and increased 100 basis points year over year to 15.0%. Overall, the decrease in sublease and increase in direct space resulted in overall vacancy dropping 20 basis points from the historic high recorded in the fourth quarter of 2023 to 17.2%. Sublease availabilities declining, coupled with direct availabilities increasing, is likely attributed to sublease spaces that were originally added on pre-pandemic converting to direct space upon expiration.

Available Space as Percent of Overall Market

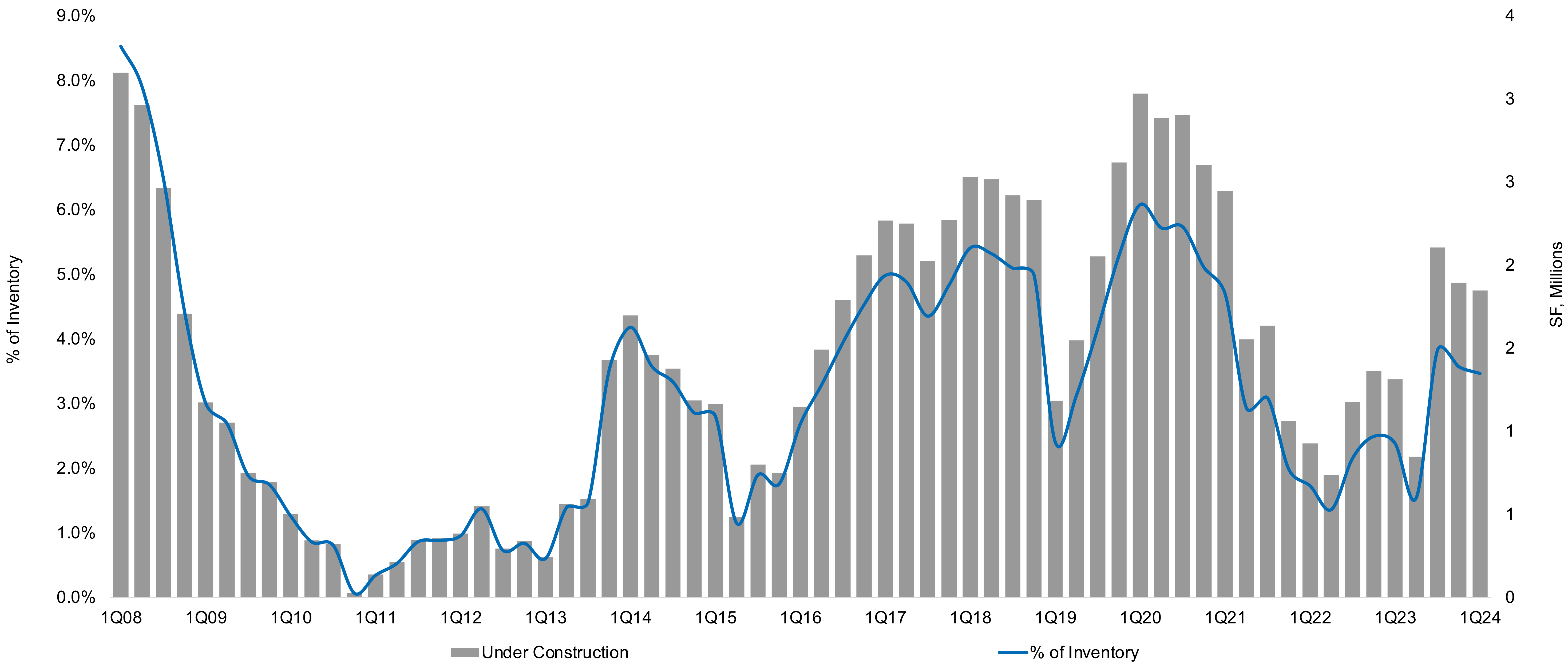


Source: Newmark Research, CoStar

Construction Activity Continues to Slightly Decline

Construction activity rapidly increased in the third quarter of 2023, driven by the technology and biotechnology sectors' office usage. The construction pipeline declined quarter over quarter as buildings delivered and as new office starts were impacted by elevated inflation and a higher cost of debt. As of the first quarter of 2024, the market had 1.8 MSF under construction, accounting for 3.5% of the market's inventory.

Office Under Construction and % of Inventory

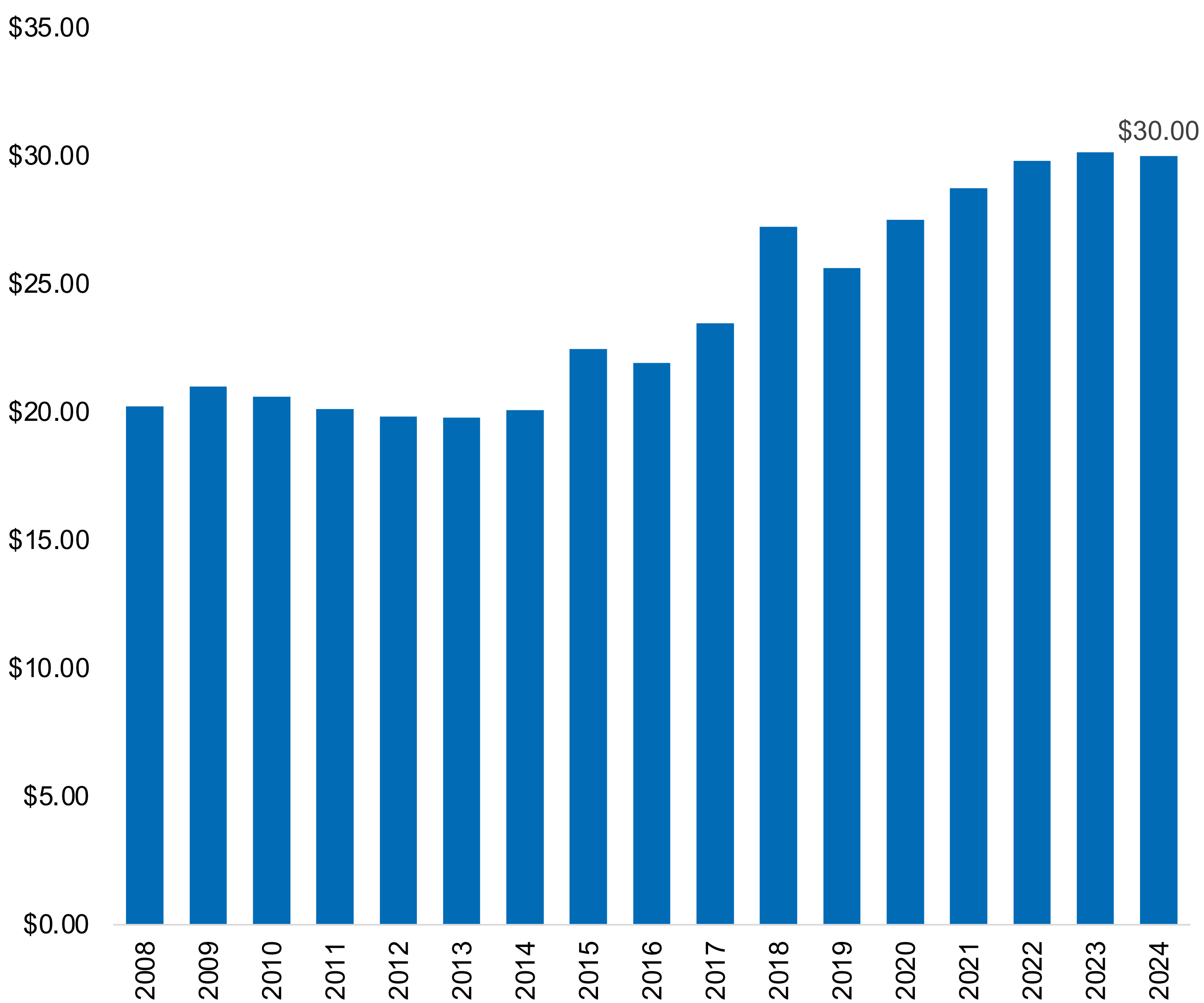


Source: Newmark Research, CoStar

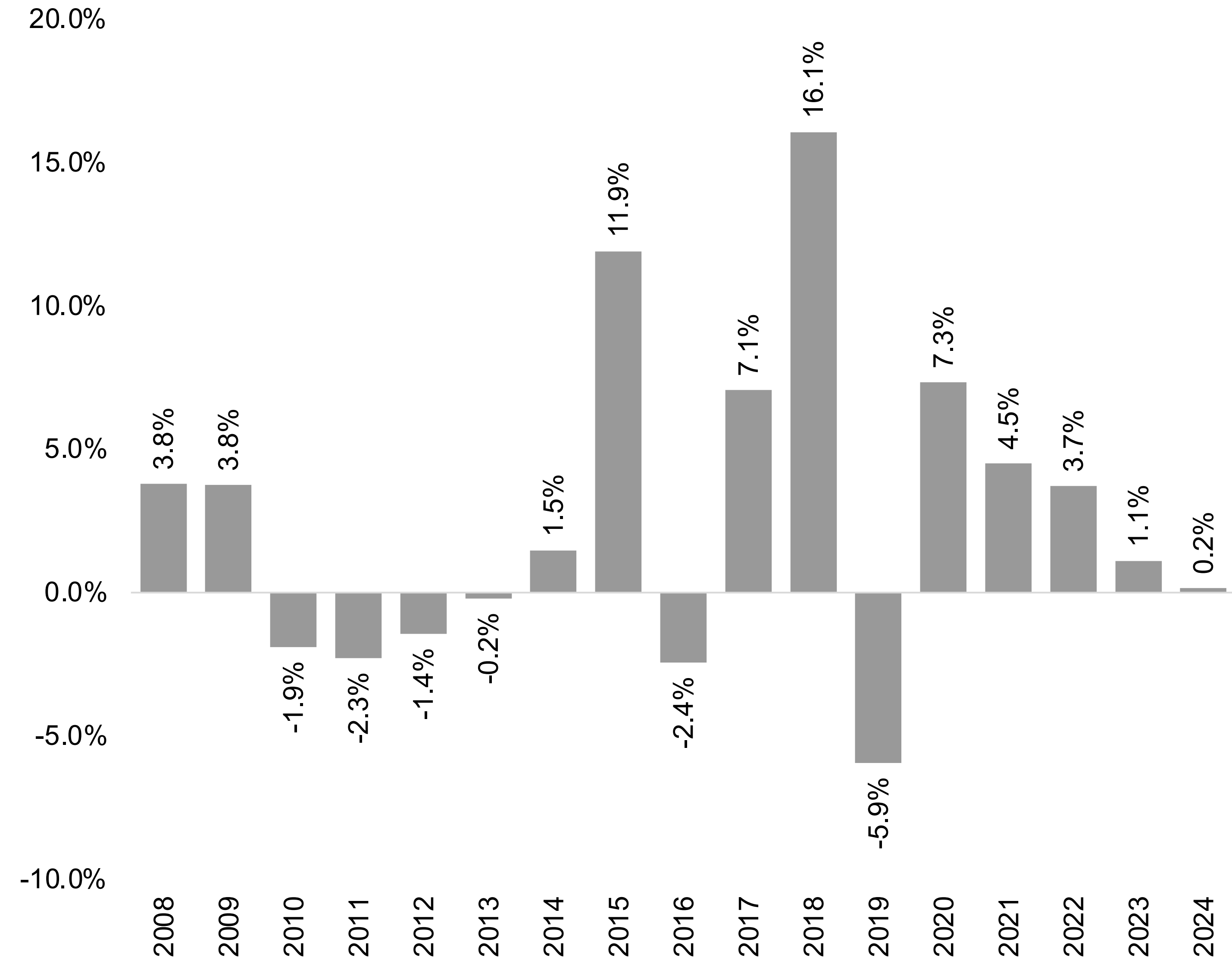
Rents Inch Lower from Historic High

Rents decreased by 0.5% quarter over quarter and increased by 0.2% year over year to $30.00/SF. The flattening of asking rent growth can be attributed to several factors, including generally rising vacancy over the past several years, a recent decline in leasing activity and slightly positive absorption after several quarters of negative absorption in recent years.

Office Average Asking Rent, $/SF, FS



Year-over-Year Asking Rent Growth Rate

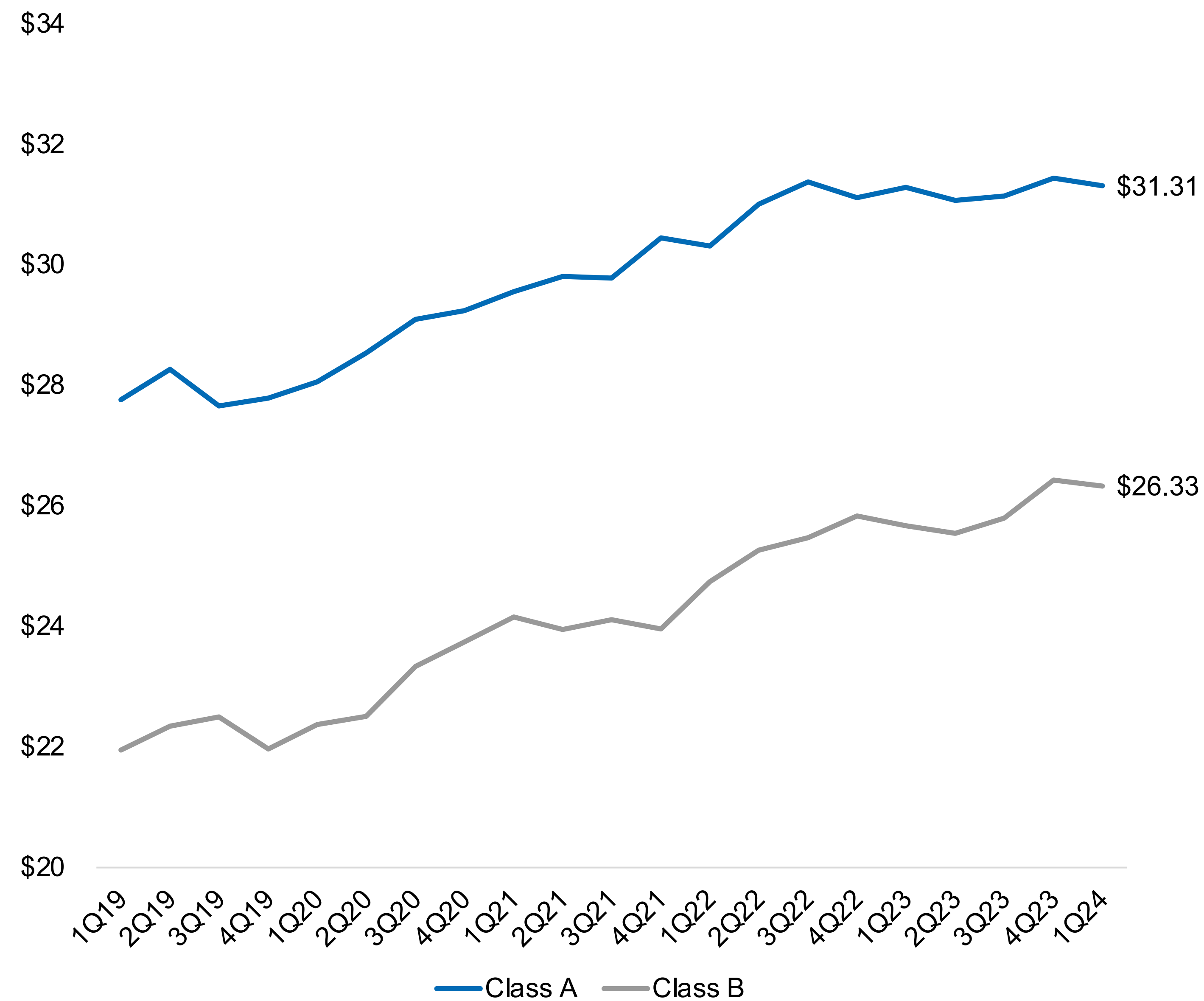


Source: Newmark Research, CoStar

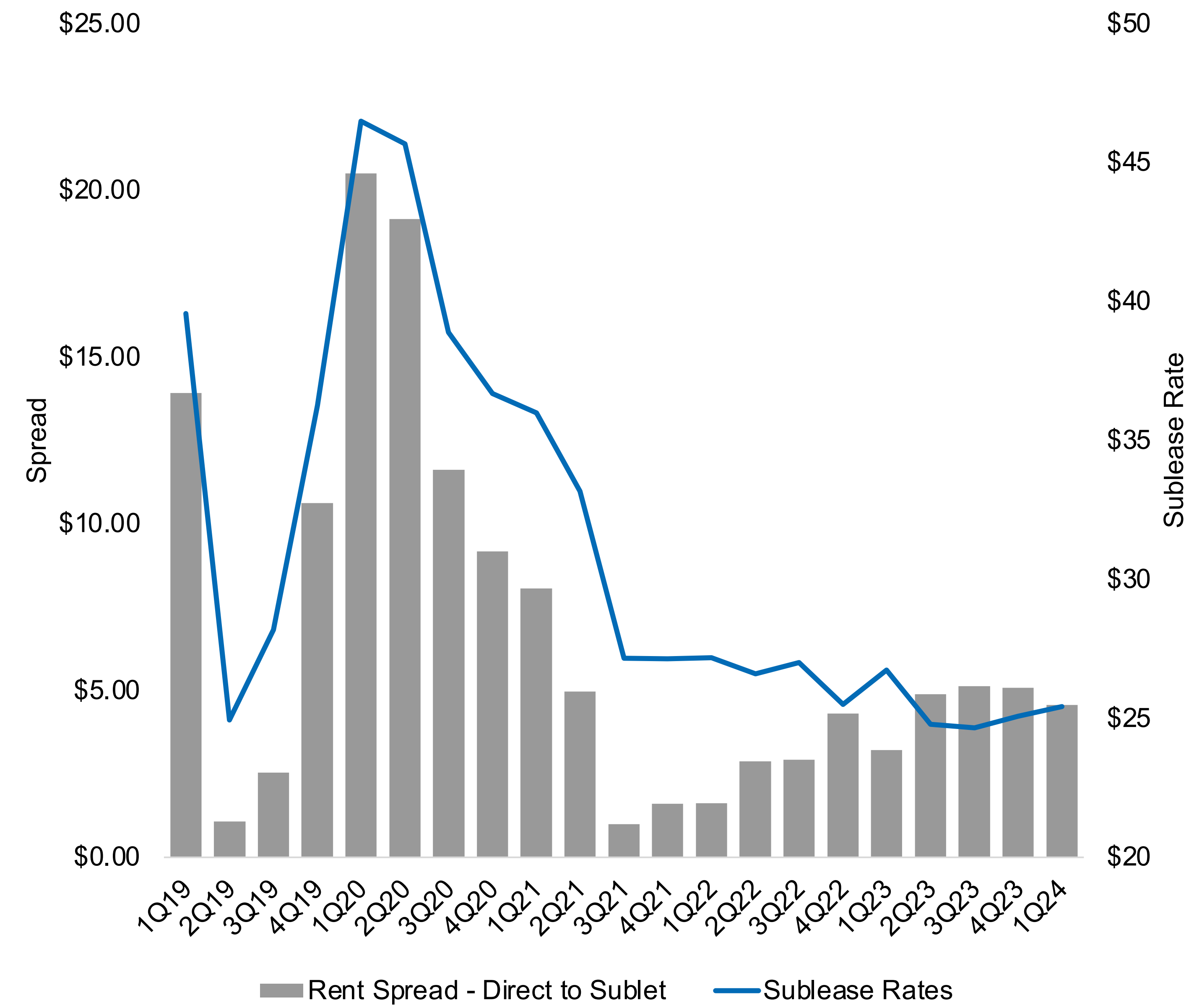
Class A and Class B Asking Rents Edge off from Historic Highs

As of the end of the first quarter of 2024, Class A rents ended at $31.31/SF, while Class B reported $26.33/SF. The rent difference between the two assets is $4.98/SF, a 14.4% spread decrease since the fourth quarter of 2019. Quarter over quarter, the rent spread decreased by 0.6%. The divergence between Class A and Class B assets will likely drive more tenants to shed unused space in less desirable assets and lease smaller footprints in higher-quality assets. As sublease space has continued to exit the market, asking rents for sublease space have increased. First-quarter asking sublease rates have increased by 1.4% quarter over quarter and decreased 4.9% year over year.

Class A and Class B Asking Rents



Sublease Rates



Source: Newmark Research, CoStar

Return of Larger Lease Signings?

Despite slowing overall leasing activity in the market, this quarter has seen an uptick in lease executions greater than 20,000 SF with multiple more active tenants in the market today. 2023 saw a dearth of large lease signings, with most activity in the 15,000 SF or less size range. Bucking a recent trend of downsizing, all the leases referenced below made either lateral footprint moves, or in one case, expanded prior to starting their initial lease buildout. As the return-to-office programs continue to vary, the coming quarters will be telling on whether the footprint reduction trend might slow as more workers are present at the office. The flight-to-quality pattern is still present, with older buildings continuing to shed space and newer assets with amenities becoming the most attractive to tenants.

Notable 1Q24 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
Mercalis / Trial Card	2250 Perimeter Park Drive	RTP/RDU	Direct	78,588
Mercalis elected to renew their lease in Perimeter Park after exploring the market for relocation options. Perimeter Park has seen an uptick in activity over the recent quarters.				
RailInc	11000 Weston Parkway	Cary	Direct	56,571
RailInc will relocate within the Highwoods portfolio to a nearby property. 11000 Weston, though similar age has undergone recent upgrades and boasts Crabtree lake views, café, and fitness.				
HNTB	One North Hills Tower	Six Forks/Falls of Neuse	Direct	30,521
HNTB expanded their footprint at One North Hills Tower and will occupy all of the 5th floor. HNTD signed the original lease in 2024 on a smaller footprint but required expansion.				
KCI Technologies	4800 North Park	Six Forks/Falls of Neuse	Direct	28,633
Consulting and construction firm KCI Technologies has signed a 28,633-SF lease for the second floor of 4800 Falls of Neuse Road in Raleigh.				
Cranfill Summer	Offices at Wade – Wade I	West Raleigh	Direct	27,354
Law firm Cranfill Summer signed a lease for 27,354 SF of space on the third floor of 5420 Wade Park Boulevard in Raleigh.				

Source: Newmark Research, CoStar

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