

2Q23

Raleigh Office Market Overview

NEWMARK

Market Observations

Economy

- The market's unemployment rate ticked down by three basis points year over year to 3.0% but remained well below the five-year average of 4.1%.
- Although job growth pace has slowed compared with recent highs to 2.9% year over year, employment growth continues to significantly outpace pre-pandemic levels, with 2019 growth averaging only 2.4%.
- All sectors reported employment growth, with information leading job gains at 7.1% over the past 12 months.
- Office-using jobs in the market eases from historical high to 213,600 employees, reflecting 20.3% growth since 2019.

Major Transactions

- The largest lease of the quarter was signed by Baxter for 55,000 square feet in Palisades III in West Raleigh.
- Cloud-based collaboration firm ShareFile subleased 54,420 SF in Tower 2 at Bloc 83 in downtown Raleigh for the quarter's second largest deal.
- Northrop Grumman (41,800 SF) and Weatherby Healthcare (34,000 SF) signed renewals while Timmons Group (32,000 SF) renewed and expanded its space.

Leasing Market Fundamentals

- Annual full-service asking rental rates remain near all-time historical highs at \$29.80/SF, a 1.0% increase year over year.
- Occupancy declined, pushing overall vacancy rates to increase by 70 basis points year over year, and remains elevated at 14.7%.
- The under-construction pipeline remains muted with only 855,390 SF in progress at the end of the second quarter of 2023.
- Total leasing activity closed the quarter at 904,645 SF, averaging 7,415 SF per deal and reflecting an increase in deal size of 25.8% quarter over quarter.

Outlook

- The Raleigh office market will likely see continued suppressed growth this year. Office investment activity will remain low in the near term due to elevated inflation and a steeper cost of debt.
- The decreasing rent spread between Class A and Class B assets will likely push more tenants to shed unused space and lease smaller footprints in higher-quality assets.
- In the near term, vacancy rates are projected to increase as demand remains muted and an influx of sublease space reverts to direct space in the coming quarters.

1. Economy
2. Leasing Market Fundamentals

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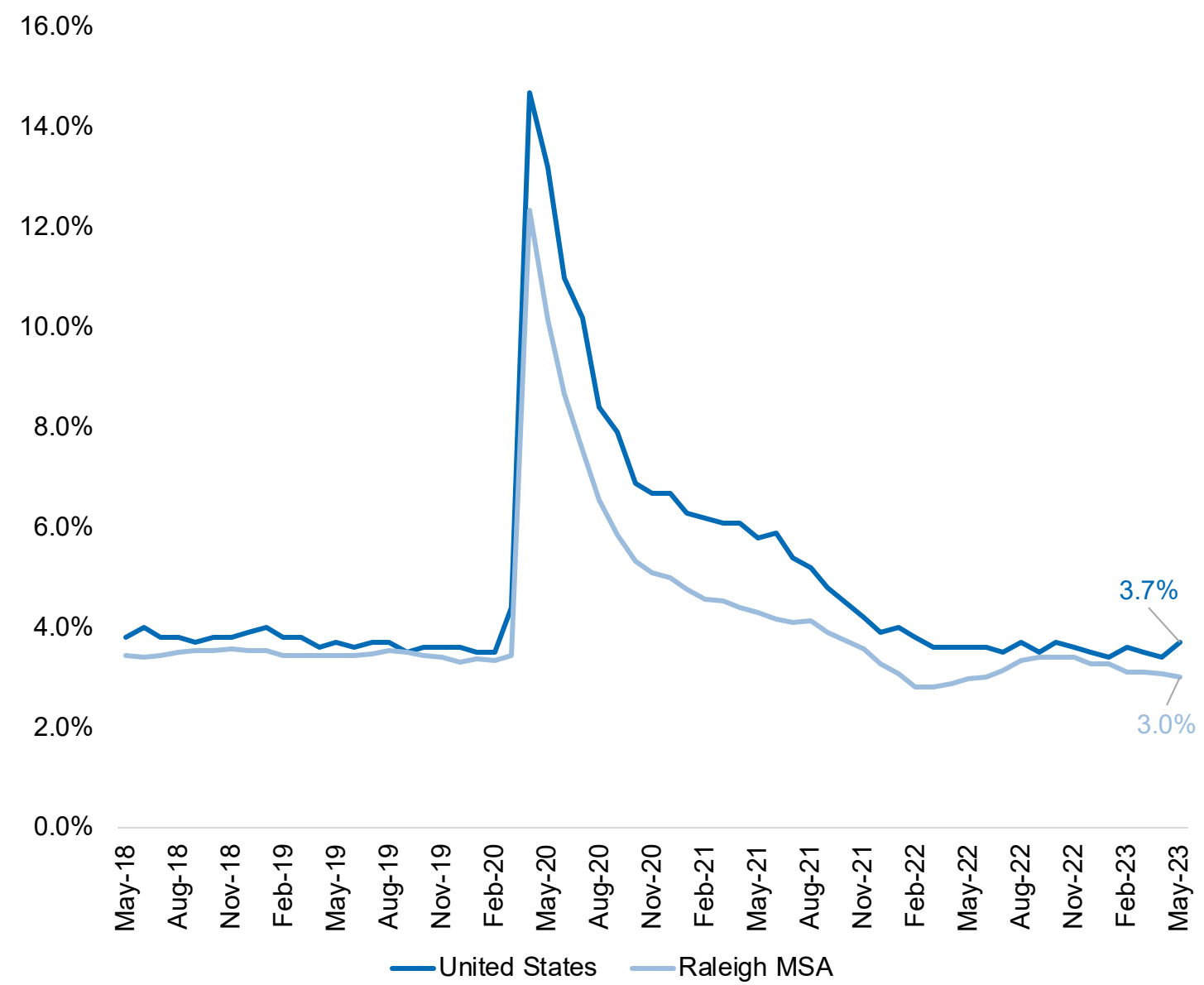
Economy



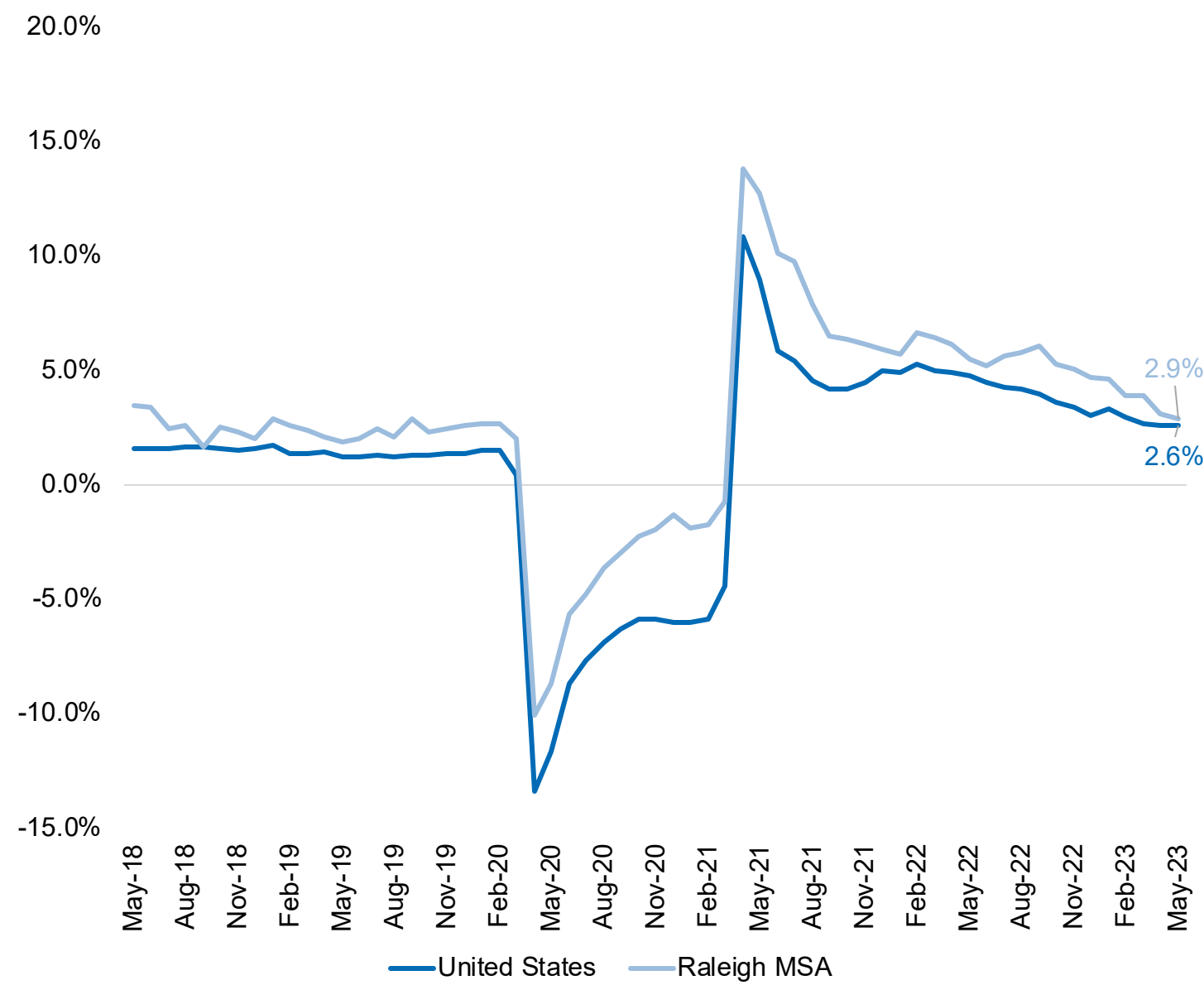
Metro Employment Trends Signal a Slowing Economy

The Raleigh market has generally reported lower unemployment rates compared with the national average, while being an outperformer in employment growth. Although the region's unemployment rate decreased by a mere three basis points year over year, national economic headwinds have pushed employment year-over-year growth rate to slow by roughly 260 basis points compared with the previous year.

Unemployment Rate, Seasonally Adjusted



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

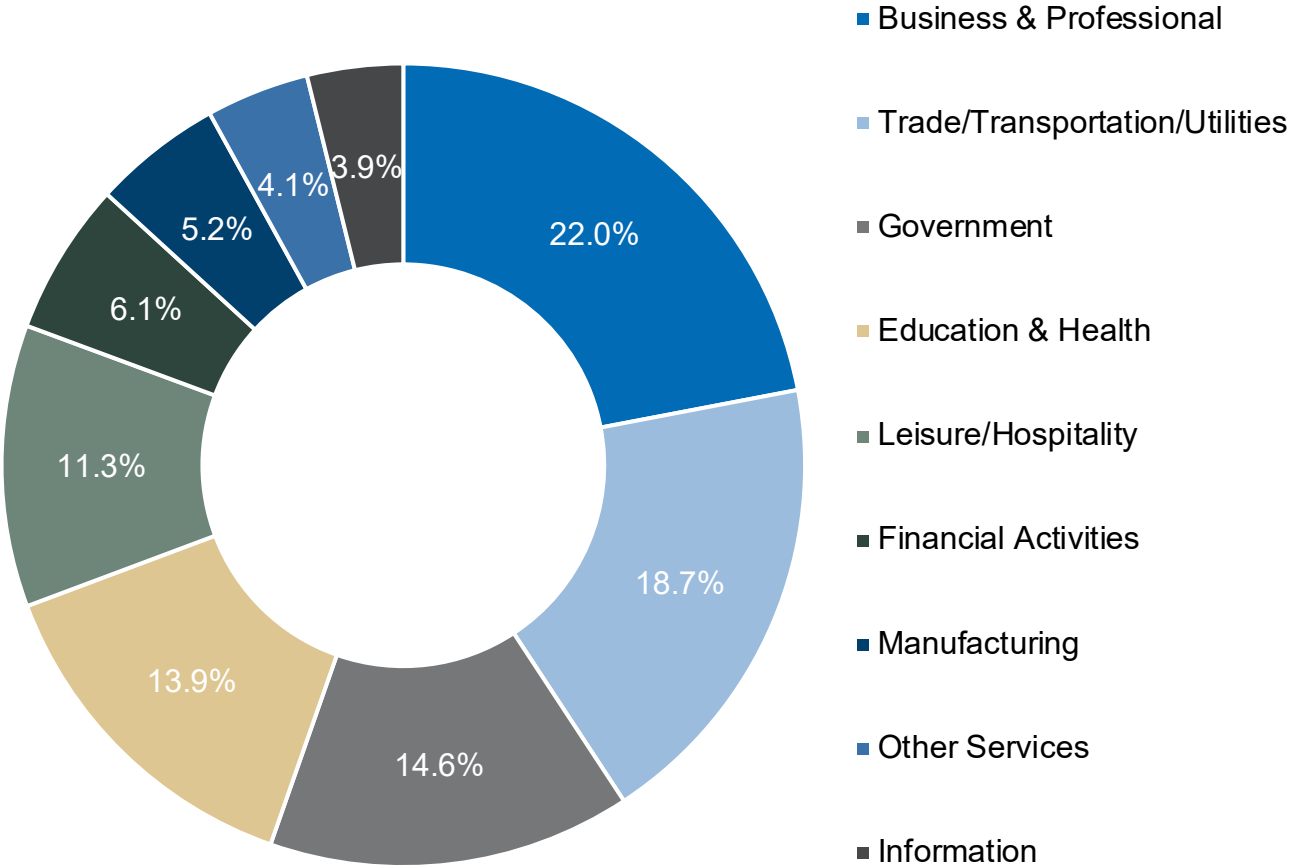


Source: U.S. Bureau of Labor Statistics, Orlando MSA

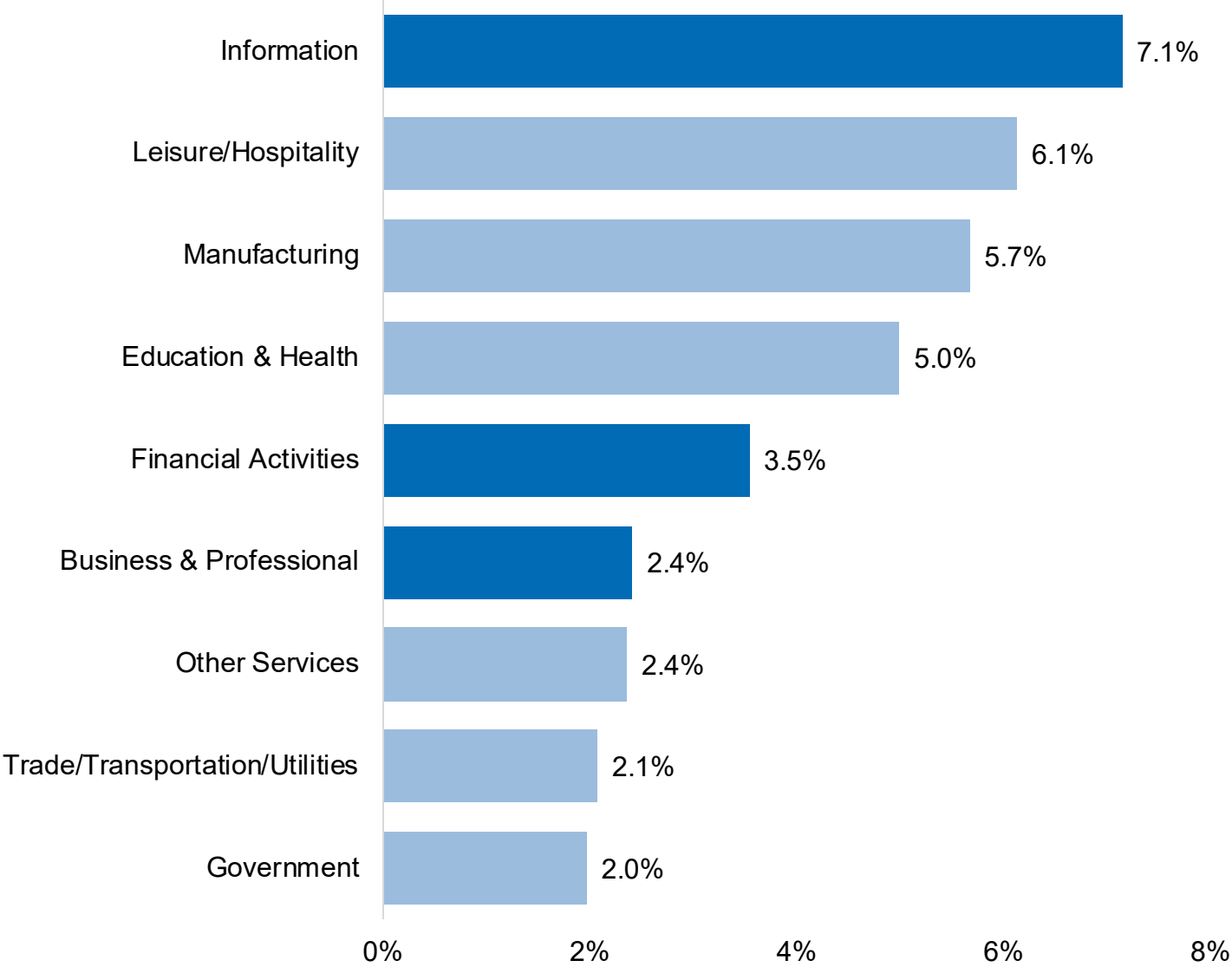
Employment Growth Continues across All Sectors

Known for its professional and scientific services sector, the Raleigh market’s top two employment industries account for 40.7% of the market share. The office-using employment’s business and professional sector is the largest industry sector in the metroplex, at 22.0%. All industries in the metroplex reported growth, with office-using industries reporting year-over-year growth, ranging widely from 2.4% to 7.1%.

Employment by Industry, May 2023



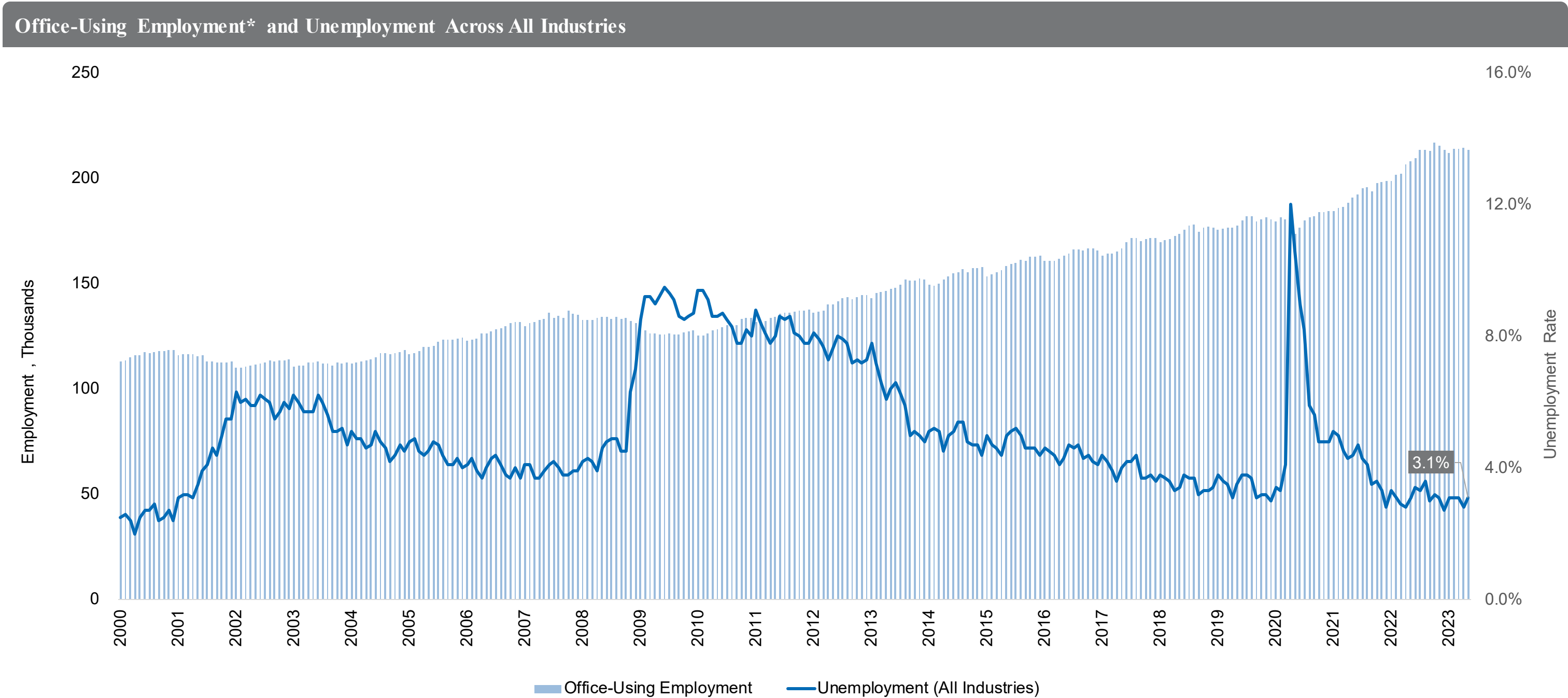
Employment Growth by Industry, 12-Month % Change, May 2023



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

Overall Office-Using Employment Eases from Historical Highs

Office-using employment in the Raleigh market continues to remain elevated at 213,600 employees as of the end of May 2023, easing from the historical high of 216,900 employees reported in October 2022. Currently, the non-seasonally adjusted unemployment rate is at 3.1%, below the 3.4% average levels reported in 2019, indicating that office-using industries are part of the contributing factor in lowering the unemployment rate in the market.



Source: U.S. Bureau of Labor Statistics, Orlando MSA
*Office-using employment includes employment in the following industry sectors: Professional & Business Services, Financial Activities and Information.

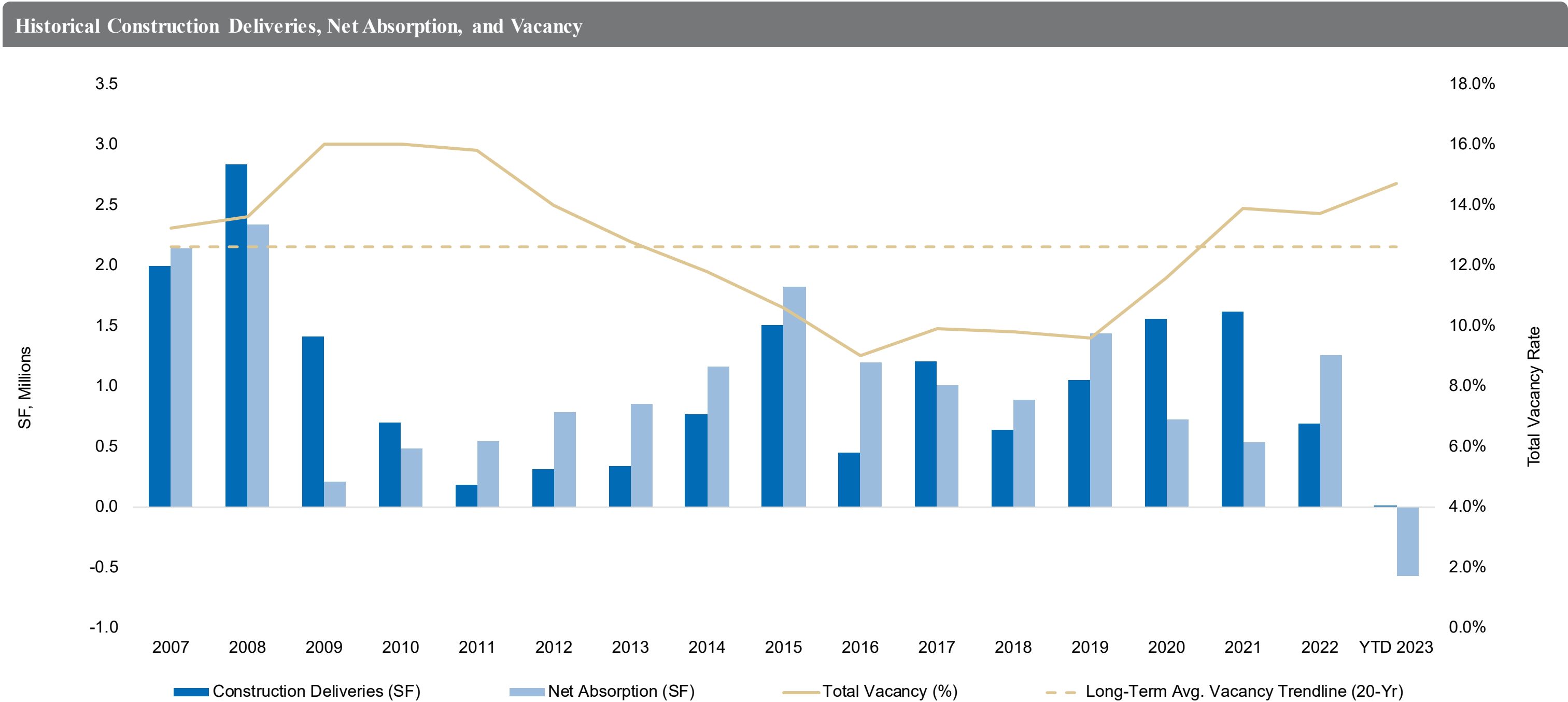
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Leasing Market Fundamentals



Vacancy Increases as Occupancies Remain Muted

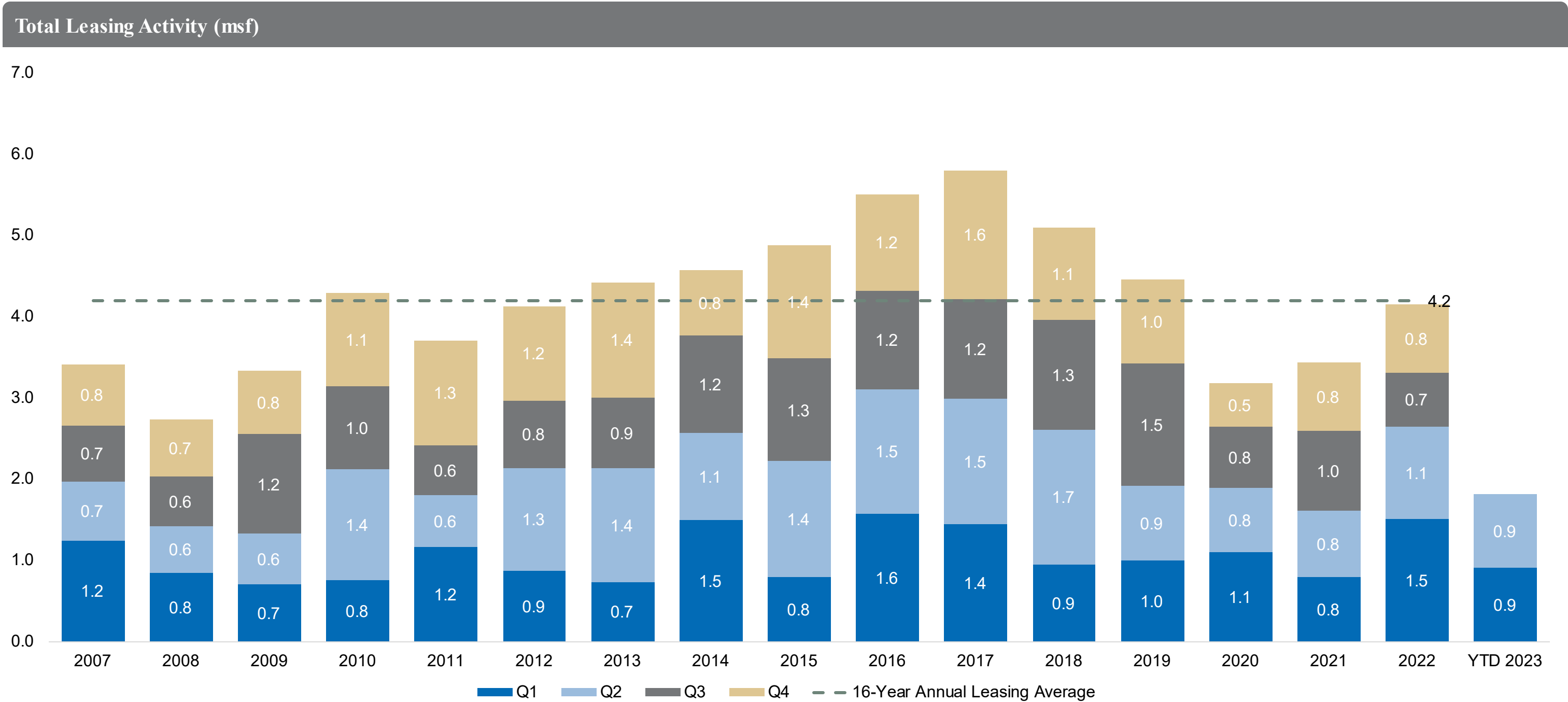
The Raleigh office vacancy rate increased by 70 basis points year over year, to 14.7% in the second quarter of 2023. Negative absorption in the second quarter of 2023 helped to keep vacancy elevated, despite a lack of new product delivering. Vacancy rates continued to increase following the pandemic as an influx of new product delivered and demand waned.



Source: Newmark Research, CoStar

Declining Deal Activity Results in Slowing Leasing Activity

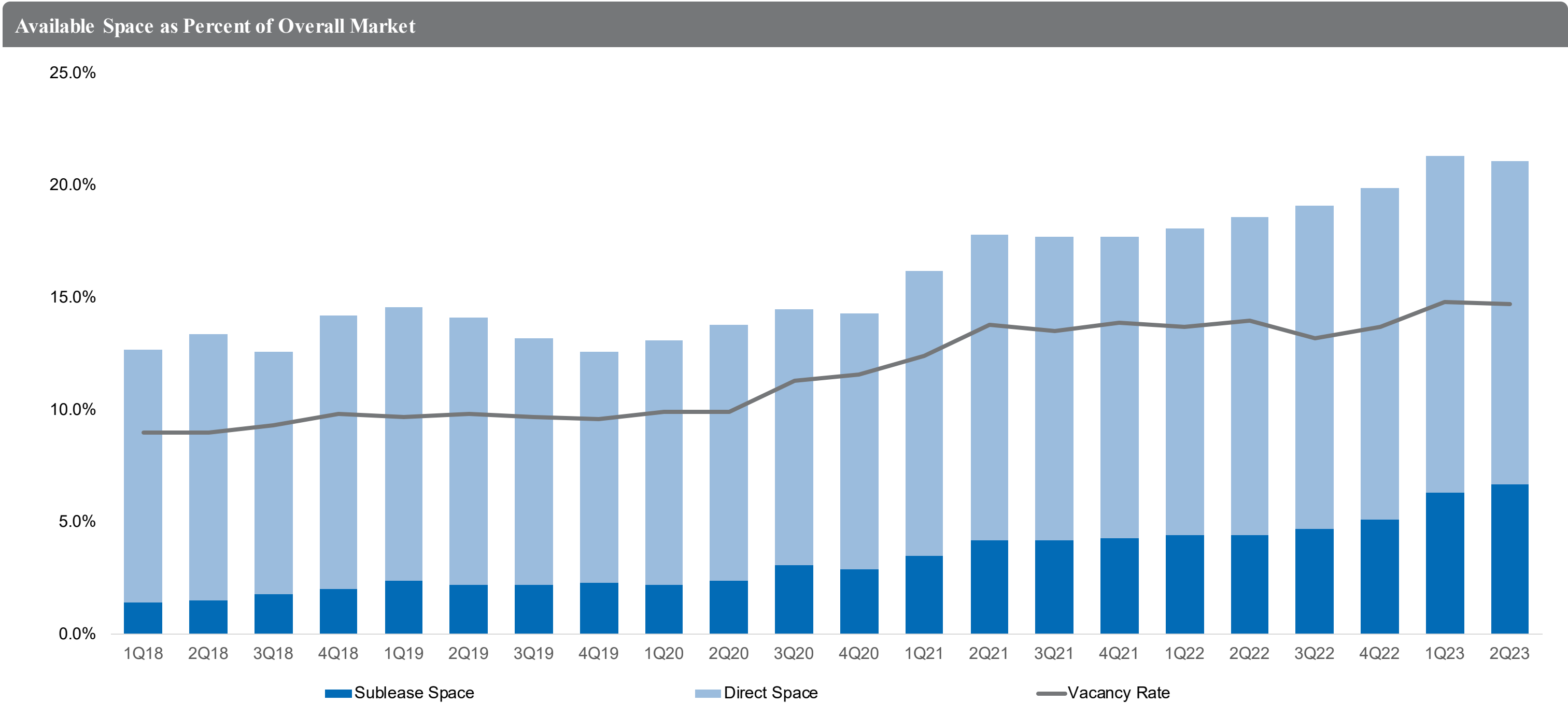
Leasing activity in the market slowed in the first half of 2023 to 1.8 MSF, falling from first-half yearly performance reported in 2022. Since 2007, second-quarter leasing activity averaged 1.1 MSF, with the second quarter of 2023 below historical averages at 904,645 SF. Deal size averaged 7,415 SF in the second quarter of 2023, an average of 34 SF less than a year ago and 1,519 SF more than the previous quarter. The slowing leasing activity pace is largely attributed to fewer deals being done, likely impacted by a more challenging debt liquidity environment preventing larger deals from occurring as easily.



Source: Newmark Research, CoStar

Availability Maintains Recent Highs

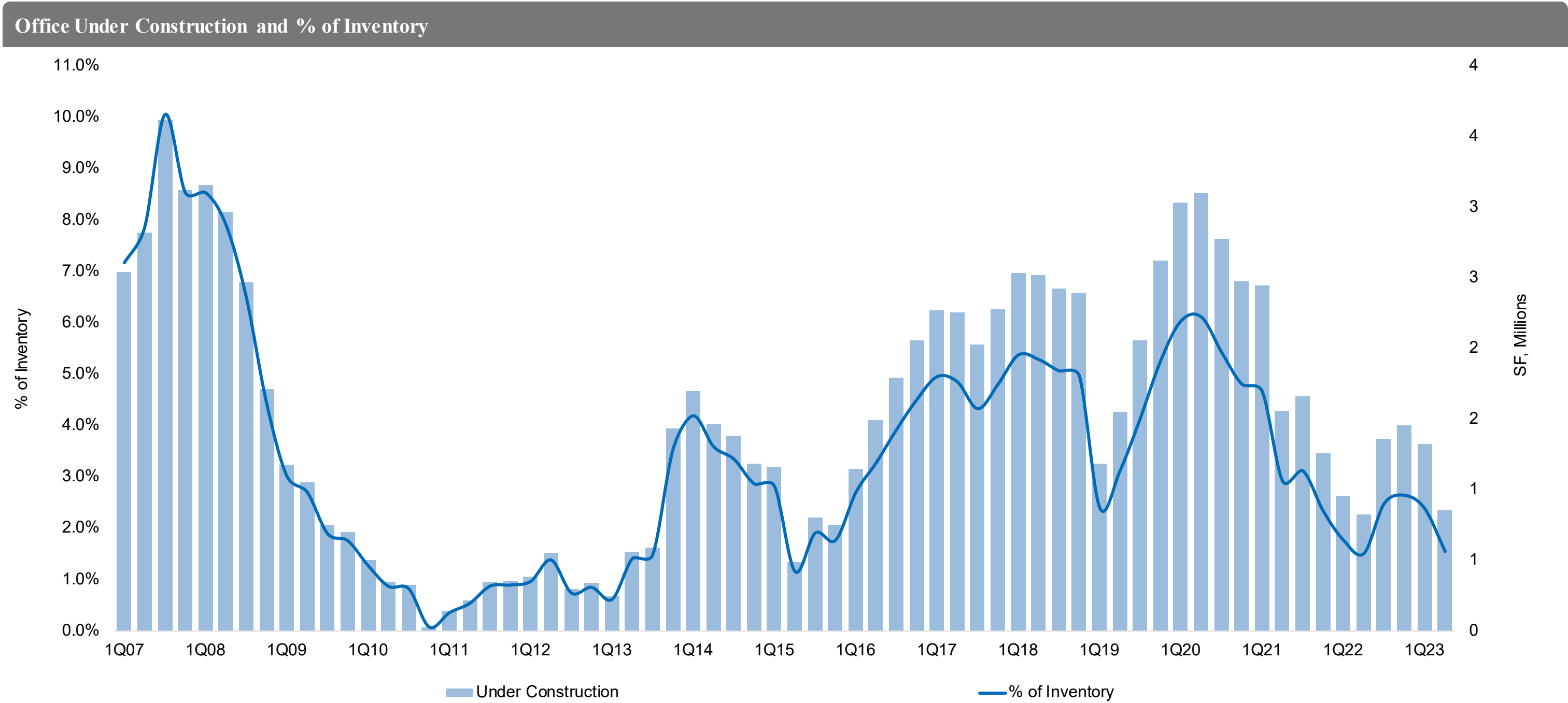
Sublease availability in the Raleigh market has continued to slowly inch upward since the pandemic. As of the end of the second quarter of 2023, sublease availability in the market was at 6.7%, increasing from the first quarter of 2023 high of 6.3%. Direct availability fell from its recent high of 15.0% but remained elevated at 14.4% in the second quarter of 2023.



Source: Newmark Research, CoStar

Construction Activity Declines

Construction activity has remained relatively muted in the market since the pandemic, when activity reached near-record highs. As of the second quarter of 2023, the market had 855,390 SF under construction, accounting for 1.5% of the market's inventory, indicating there is less risk of overbuilding.

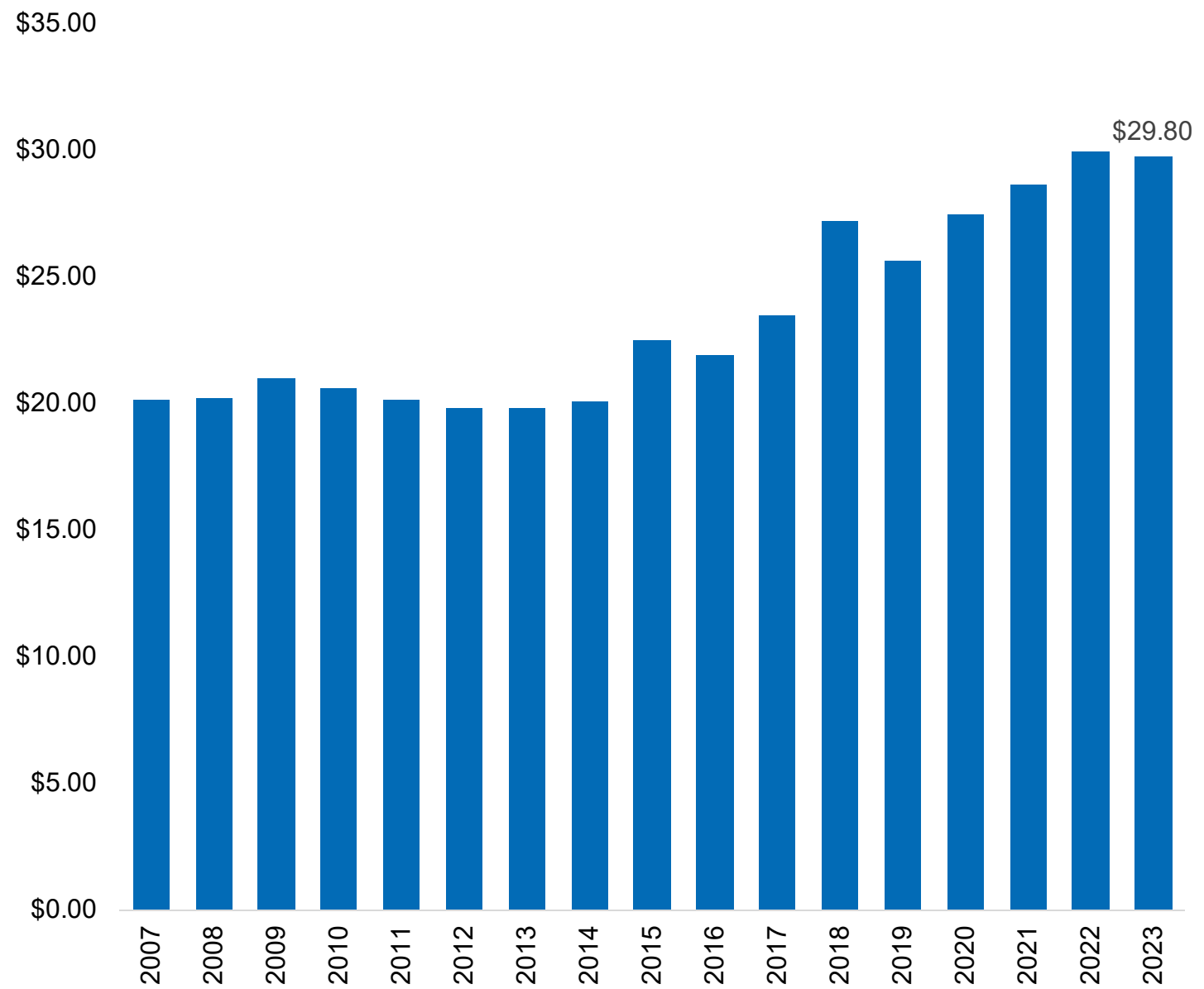


Source: Newmark Research, CoStar

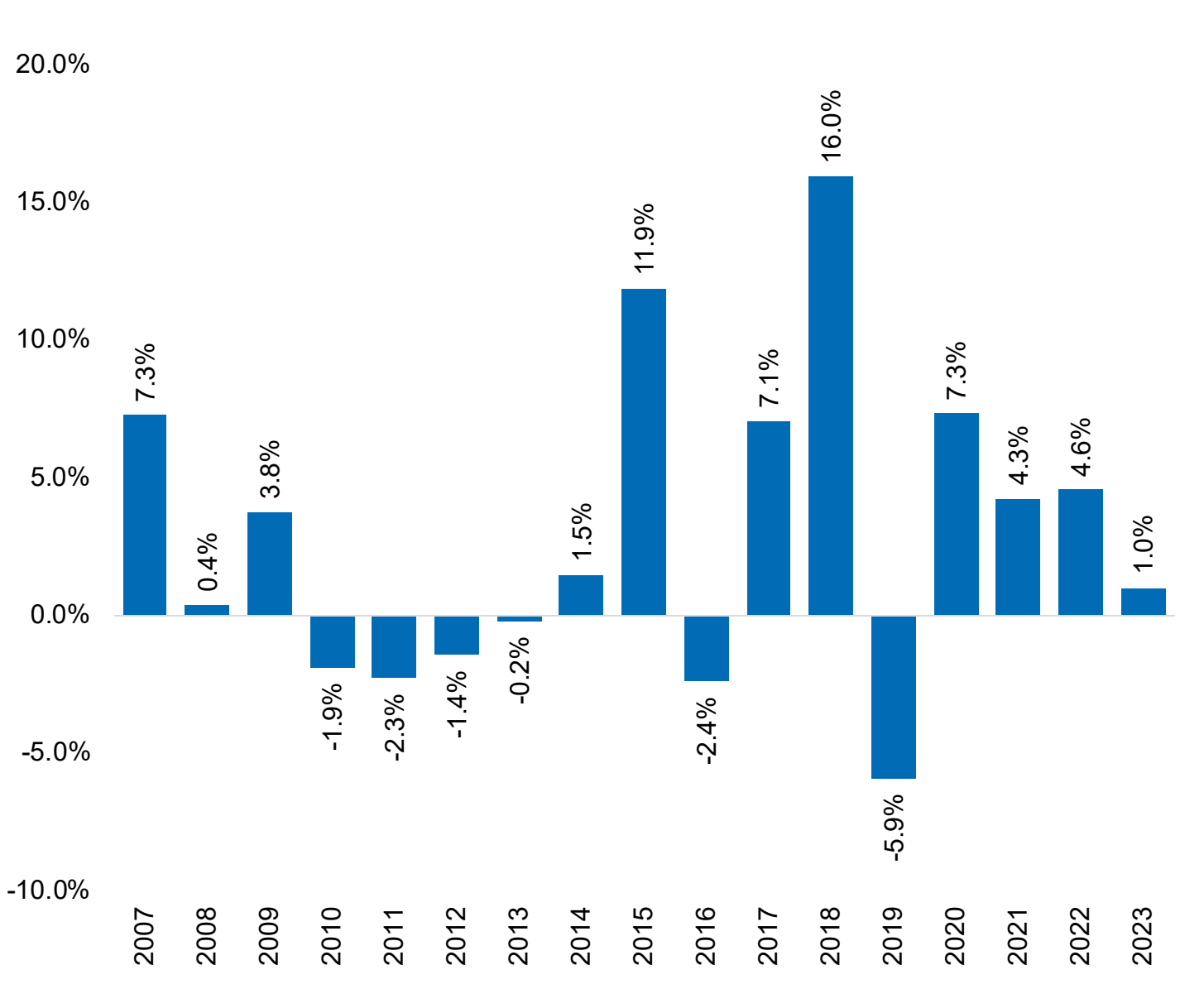
Rents Continue Record Highs

Rents remain elevated but fell slightly in the second quarter of 2023, to \$29.80/SF. Rent growth in the market is generally attributed to higher-quality space availability, bolstered by more delivery of new product in recent quarters. Asking rents are likely to remain elevated in a market impacted by inflation and increasing operating costs.

Office Average Asking Rent, \$/SF, FS



Year-over-Year Asking Rent Growth Rate

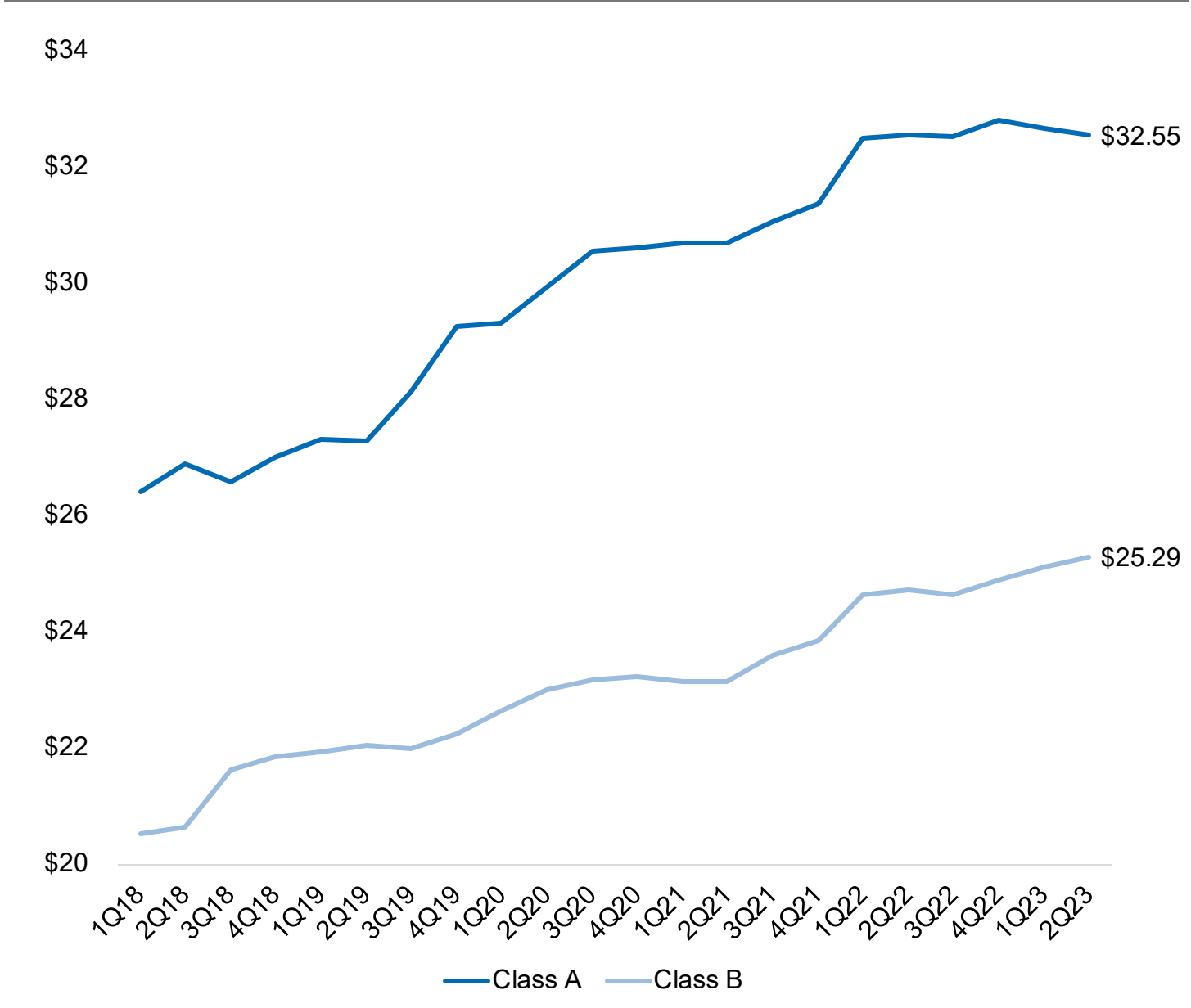


Source: Newmark Research, CoStar

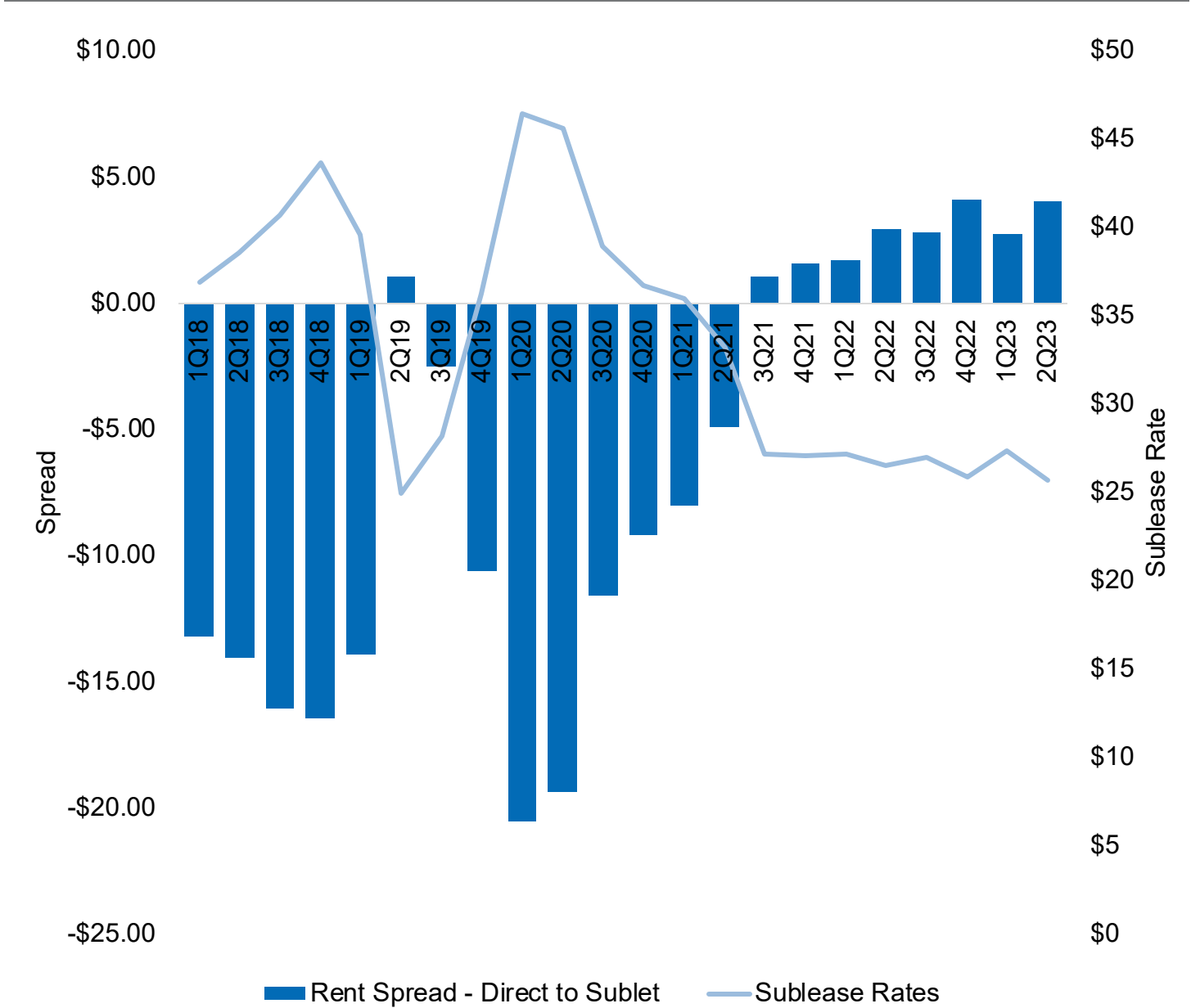
Decreasing Rent Spread on Class A Assets

As of the end of the second quarter of 2023, Class A rents ended at \$32.55/SF, while Class B reported \$25.29/SF. The rent difference between the two assets is at \$7.26/SF, a spread decrease of 7.4% year over year but a 38.8% spread increase since 2019. The closing rent spread between Class A and Class B assets will likely continue to push tenants to lease smaller footprints in higher-quality assets. Sublease rates have trended downward in recent quarters, with asking sublease rents decreasing by 6.0% quarter over quarter.

Class A and Class B Asking Rents



Sublease Rates



Source: Newmark Research, CoStar

Flight-to-Quality Leasing Activity Increases

Despite slowing leasing activity in the market, flight to quality increases as a trend in the market due to the closing spread in rental rates on Class A spaces. As of the end of the second quarter of 2023, Class A space accounted for 77.1% of the market’s leasing activity by SF and 59.0% of the market’s deal volume. Average leases signed in Class A space were 9,690 SF and continue to remain larger than the average market deal size at 7,415 SF.

Notable 2Q23 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
Baxter	1501 Nowell Road	West Raleigh	Direct New	55,000
Multinational healthcare company Baxter signed the largest lease of the quarter, taking 55,000 square feet at Palisades III.				
ShareFile	621 Hillsborough St	Downtown Raleigh	Sublease	54,420
ShareFile, a cloud-based content collaboration platform, signed the second largest lease of the quarter, taking the 7 th and 8 th floors of Tower 2 at Bloc 83.				
Northrop Grumman	3005 Carrington Mill Road	RTP/RDU	Direct Renewal	41,800
Global aerospace, defense, and security company Northrop Grumman signed a renewal for 41,800 square feet on the 2 nd floor of 3005 Carrington Mill Rd.				
Weatherby Healthcare	5003 S Miami Blvd	Research Triangle	Direct Renewal	34,000
Healthcare administrative services company Weatherby Healthcare renewed its lease for 34,000 square feet on the 2 nd and 4 th floors.				
Timmons Group	5410 Trinity Rd	West Raleigh	Direct Renewal	32,000
Engineering and technology firm Timmons Group renewed (21,940 SF) and expanded (10,000 SF) its lease at 5410 Trinity Road.				
HNTB	4000 Center North Hills St	Six Forks/Falls of Neuse	Direct New	30,000
Infrastructure design firm HNTB leased 30,000 square feet at 4000 Center North Hills Street.				
Butterball, LLC	1 Butterball Ln	Southeast Wake County	Direct Renewal	25,692
Food manufacturing company Butterball, LLC renewed 25,692 square feet at 1 Butterball Lane.				

Source: Newmark Research, CoStar

For more information:

Kirsten Kempf

Senior Research Analyst

Kirsten.Kempf@nmrk.com

Ching-Ting Wang

Head of Southeast Research

ChingTing.Wang@nmrk.com

Raleigh

4242 Six Forks Rd

Suite 930

Raleigh, NC

t 919-390-0281

New York Headquarters

125 Park Ave.

New York, NY 10017

t 212-372-2000

nmrk.com

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