

3Q22

United States Office Market Overview

NEWMARK



Key Takeaways

What We Know

- The Federal Reserve’s efforts to combat inflation have modestly slowed employment growth, but overall labor markets remain in expansion. National office-using employment is now 3.9% above pre-pandemic levels, led by technology, advertising, media and information (TAMI) companies. Accordingly, technology companies accounted for 40.5% of all leasing activity through the third quarter of 2022; however, technology firms have been somewhat reactive to the worsening economic outlook and have undertaken strategic layoffs and hiring freezes.
- Net absorption continued to contract in the third quarter of 2022, equitably driven by both major gateway and secondary markets. Occupancy losses have been a reflection of the low leasing activity in recent quarters. Leasing activity further contracted in the third quarter of 2022 as the weight of economic uncertainty further suppressed real estate decision-making.
- Tenants are continuing to support flight to quality, as evidenced by the above-average performance of higher-quality office assets. Class A leasing activity as a percentage of inventory exceeded the national average by 40 basis points in the third quarter of 2022. Despite this flight to quality, Downtown markets continue to struggle. NCREIF suburban office vacancy was 11.0% compared with 18.0% for Central Business District (CBD) office and 21.9% for the office market as a whole.
- Office investment activity decelerated once again in the third quarter of 2022, down roughly 6% quarter-over-quarter. While year-to-date sales volumes are on par with 2021, activity in the fourth quarter of 2022 is likely to be weak and certainly weaker than the record volumes achieved in the fourth quarter of 2021. Office loan originations are down about 23% year-to-date compared to 2021. Sun Belt office assets continue to exhibit the greatest liquidity relative to the pre-pandemic trend.
- Overall transaction cap rates have been stable, but there have been some relatively notable shifts within the office market. The spread between CBD and suburban cap rates had closed in 2022. Higher-quality, Class A assets in suburban markets have performed better than CBD office markets thus far in 2022. Similarly, secondary office market yields have closed relative to major metros, highlighting the strength of non-gateway markets, including Dallas, Austin, Atlanta, et cetera.
- In contrast, REIT-implied cap rates have increased sharply, driving a sell-off in office REIT values, down about 35% year-to-date. As noted, appraisal- and transaction-based measures of value have been much less reactive thus far; however, this is beginning to change. According to NCREIF, office total returns have decelerated sharply, with CBD office turning negative in the third quarter of 2022.

Key Takeaways

What we expect

- Challenging macroeconomic conditions are expected to remain a headwind for market stability. The Federal Reserve’s systematic interest rate increases are cooling parts of the economy, but labor markets are tighter than anticipated and inflation remains stubbornly elevated. Further interest rate increases are anticipated, even if modest cooling occurs before year-end.
- Return-to-office momentum is expected to hold steady or potentially exhibit modest improvement in the remainder of 2022. There is debate as to whether a weakening labor market could incentivize greater employee return-to-office momentum, but the seasonality of the fourth-quarter holiday season and hybrid schedules could mitigate the power of that accelerant. Overall, Newmark Research expects hybrid work adaptations to continue to exert downward pressure on office demand.
- Flight to quality will drive tenancy for the foreseeable future, though high-quality assets in dynamic suburban markets may hold an advantage over traditionally stable Downtown assets. Relatively high availability, downward pressure on rents and greater demand for a vibrant worker experience will benefit the upper tier of the office market. For investors with greater risk appetite, capitalizing on low pricing for Class B+/Class A- buildings with plans to modernize could be attractive, along with build-to-core in markets structurally lacking in top-tier office space.
- Overall investment activity is likely to slow further, given the uncertain and unsteady nature of current financial markets. The cost of debt is expected remain elevated. Fixed finance costs are up 2.4% year-over-year, and office cap rates are likely to adjust upwards in the private market, in keeping with a sustained higher cost of debt. The combination of the highest debt costs in years, office write-downs and a large quantity of debt maturing in 2023 and 2024 makes an increase in distress likely, albeit from low levels today.

3Q22 US OFFICE MARKET OVERVIEW

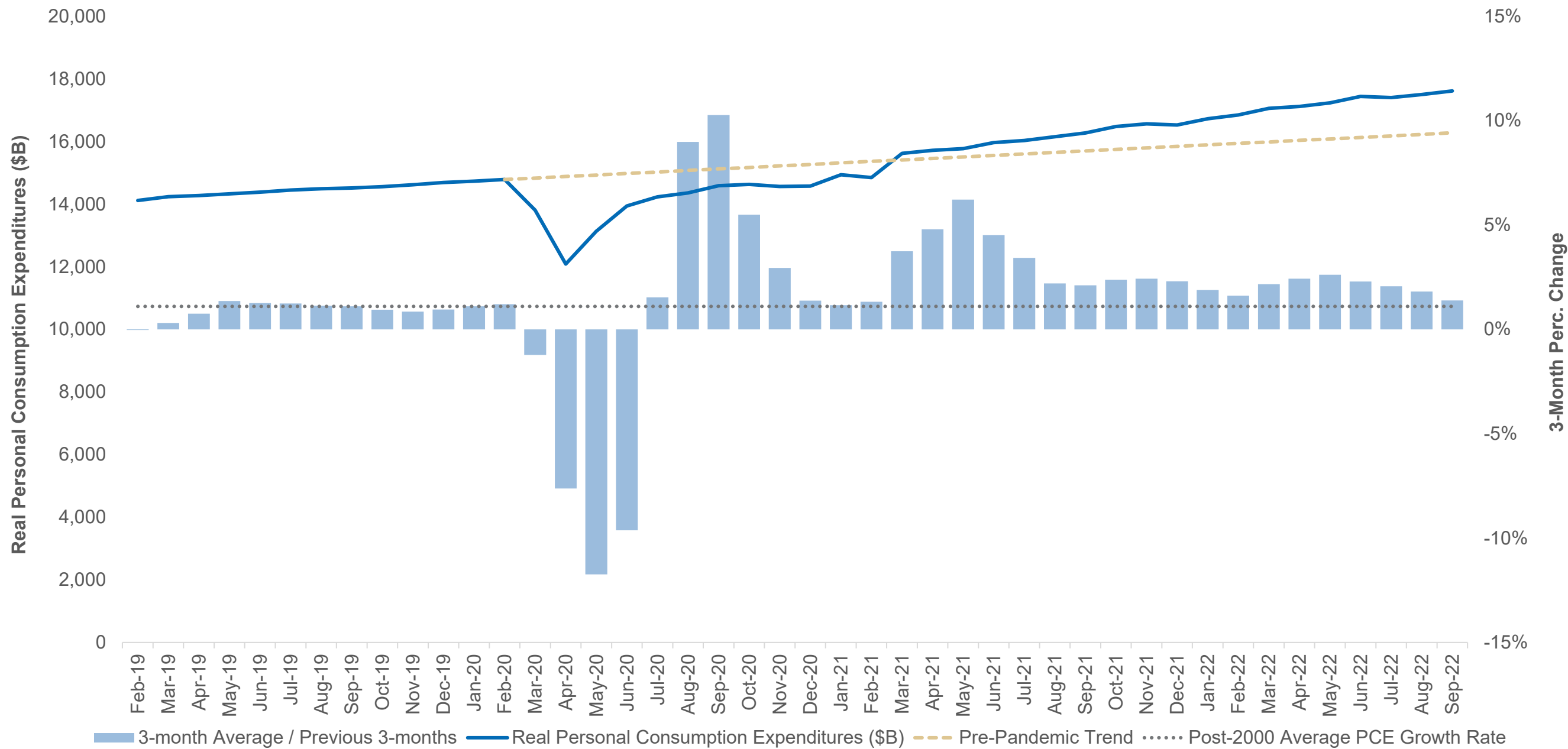
Economy



The Economy Is Not in a Recession (Yet)

Consumer spending is still above the pre-pandemic trend, though the rate of growth is rapidly decelerating.

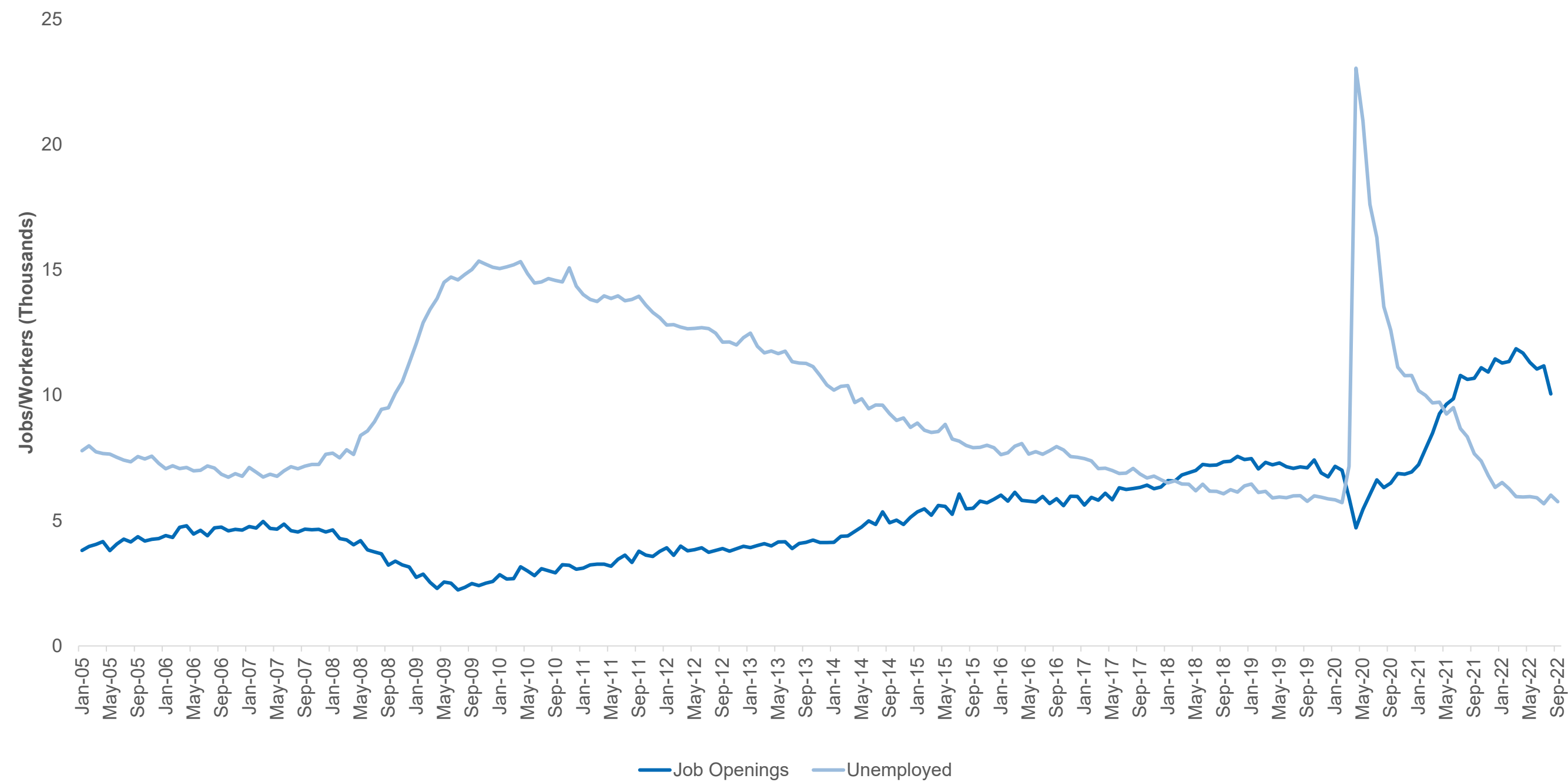
Real Personal Consumption Expenditures



The Economy Is Not in a Recession (Yet)

Jobs aren't scarce but labor is, with around 1.7 open positions for every unemployed worker. Recessionary concerns are causing some companies to reduce headcount or freeze hiring initiatives; a trend which could accelerate in the fourth quarter of 2022.

U.S. Labor Market Dynamics

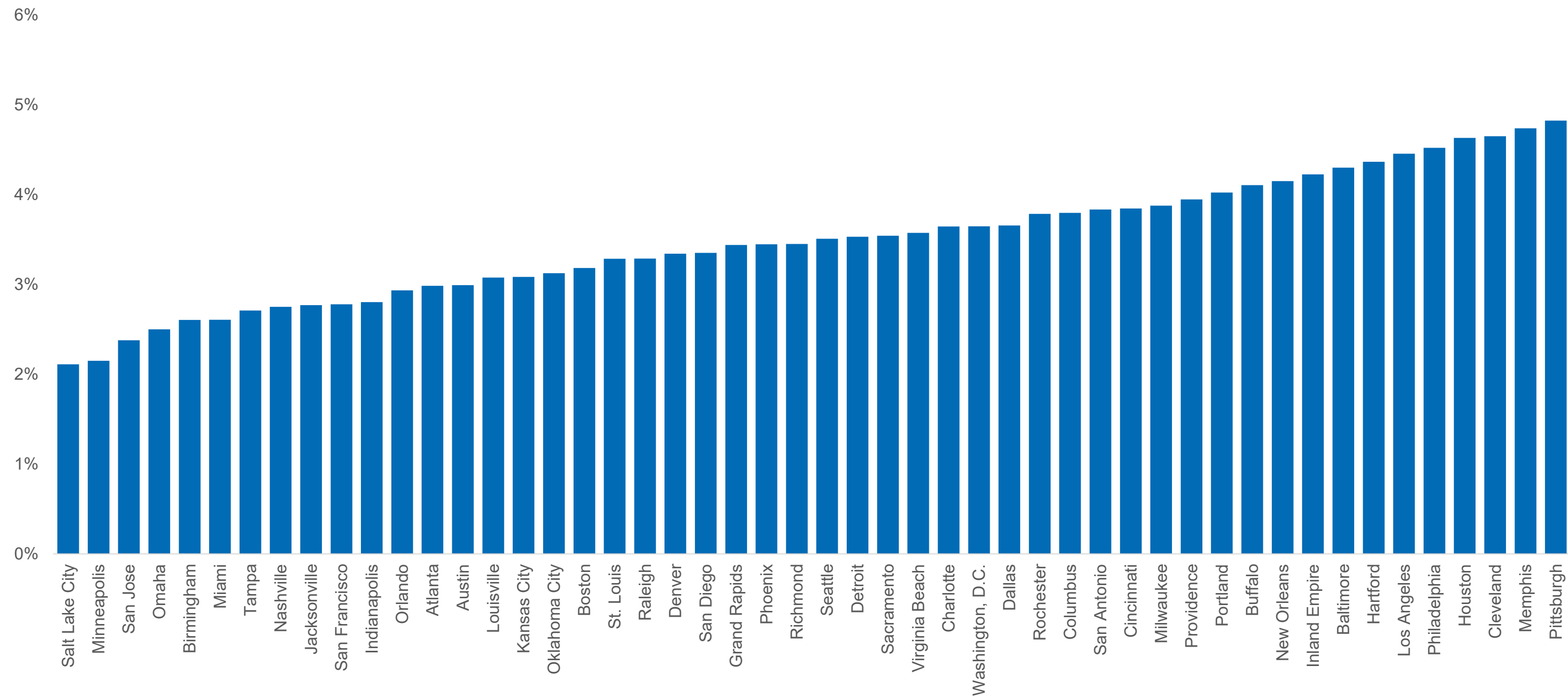


Source: Bureau of Labor Statistics, Newmark Research

Labor Tight Across Markets

Small and midsized markets exhibit some of the lowest unemployment rates nationally.

Metro Area Unemployment Rate: August 2022

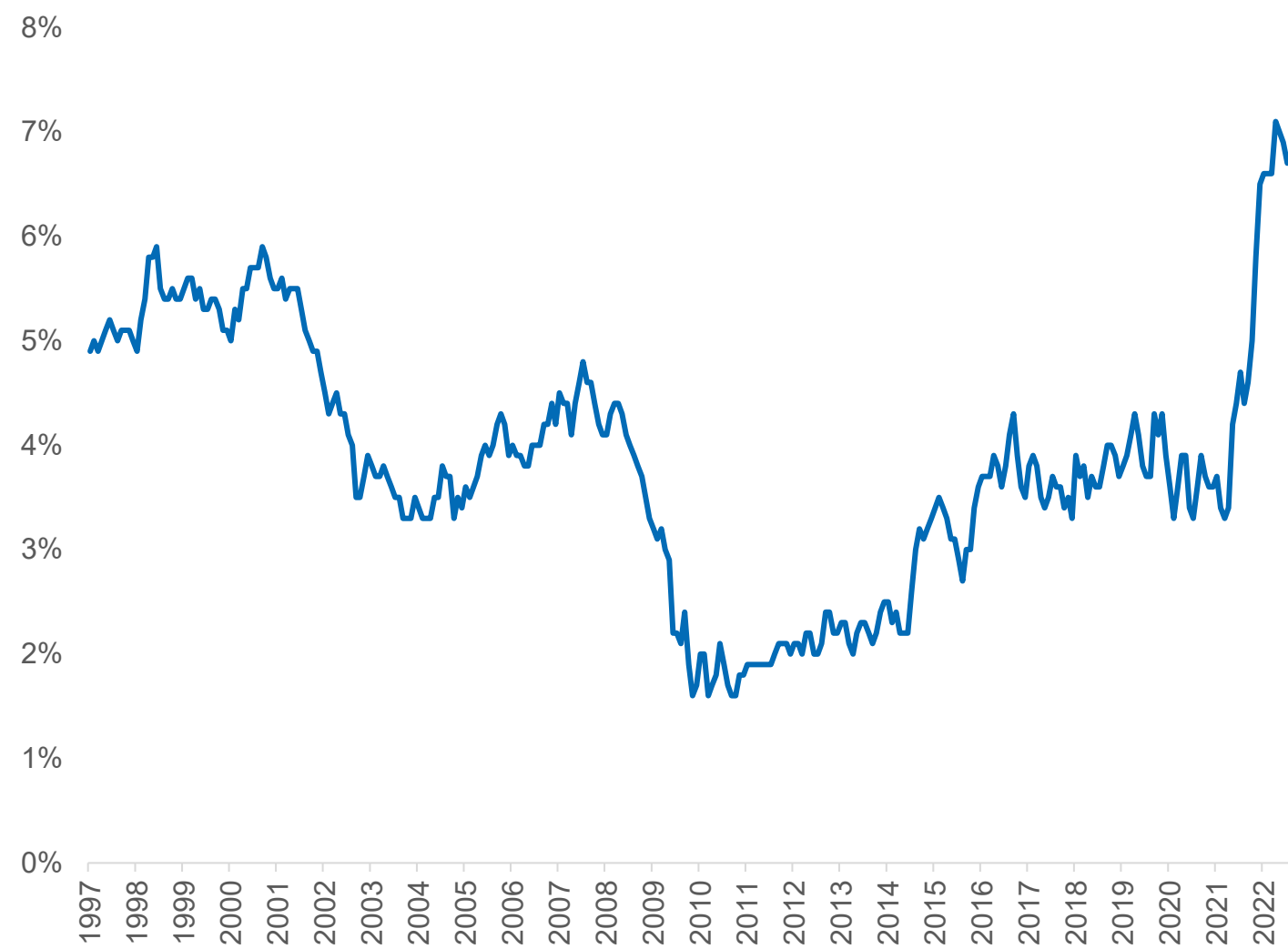


Source: Bureau of Labor Statistics, Newmark Research
Metros over 500,000 civilian labor force

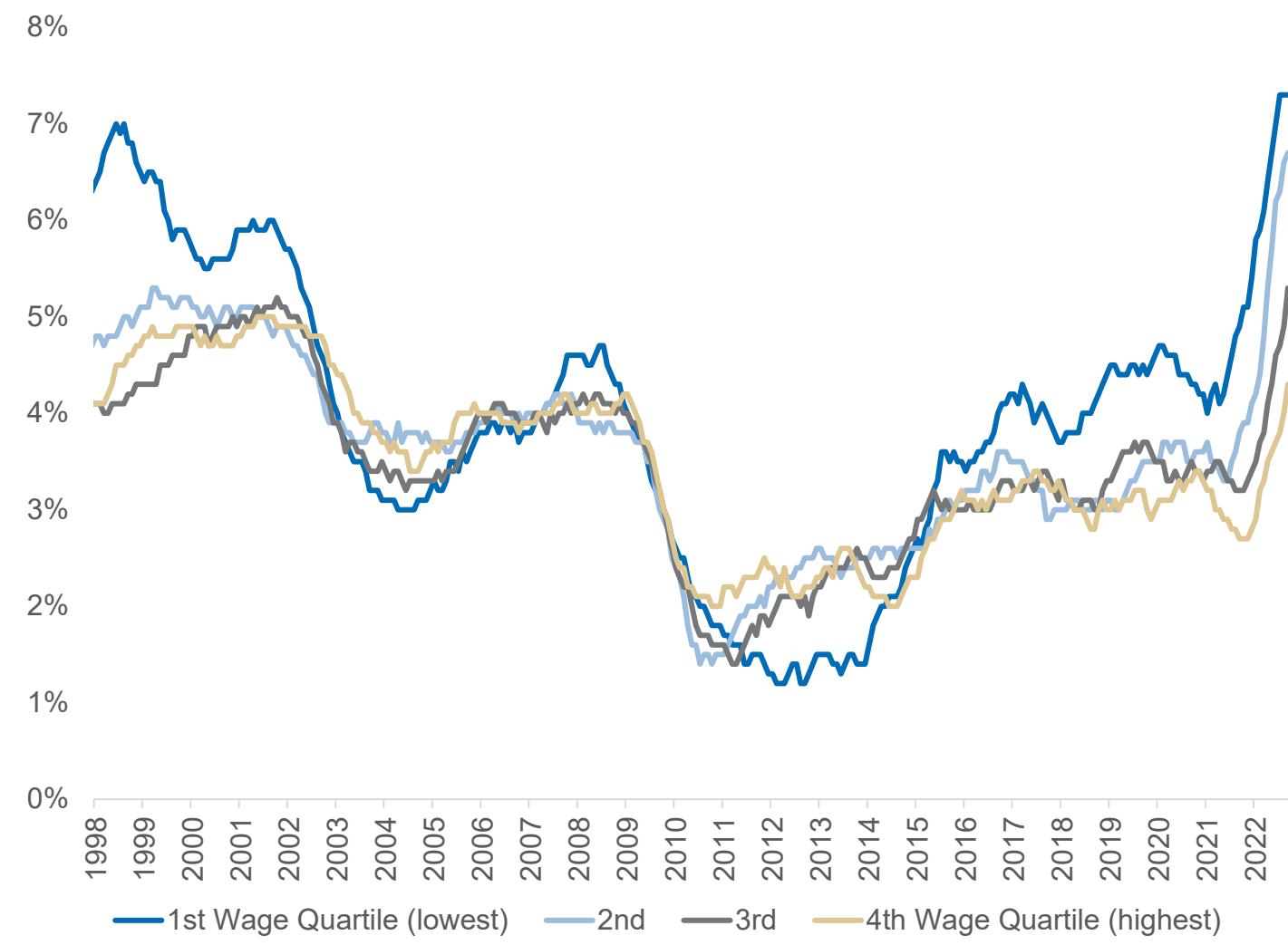
Fastest Wage Growth in Decades

Wage growth is broad-based, but lower income workers, service workers and those without a college degree are seeing the greatest wage growth. Even so, prices are rising faster, resulting in negative real wage growth.

Median Wage Growth Highest on Record



Wage Growth Highest For Lower End of Income Spectrum

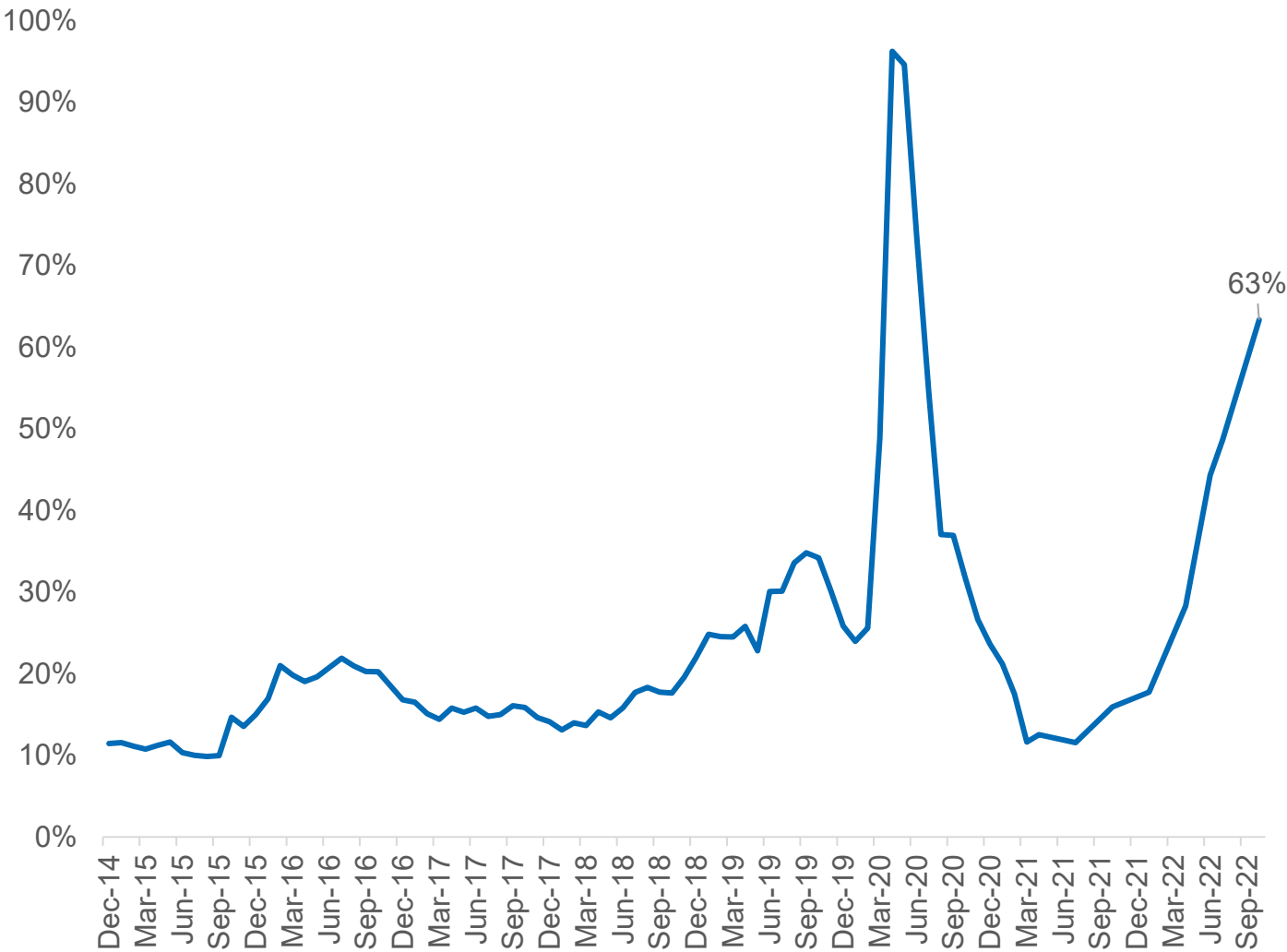


Source: Atlanta Fed Wage Tracker, Newmark Research

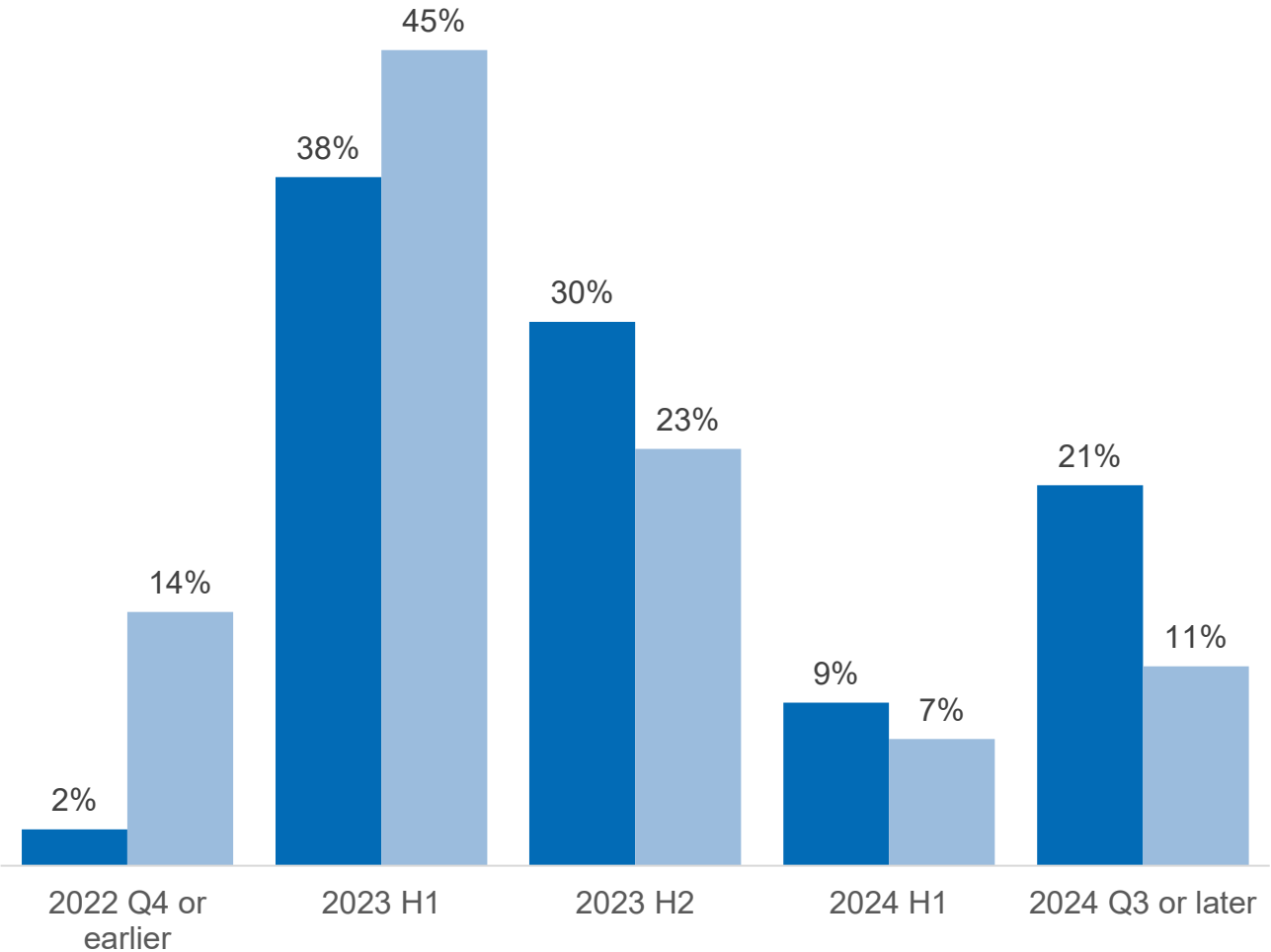
But a Recession Is Widely Anticipated

Conference Board estimates a roughly 96% chance of recession in the next 12 months. Moreover, a wide range of yield curve measures are inverted, including the three-month/10-year spread, which has predicted every recession within a year going back to the '60s, *with no false positives*.

Probability of Recession in Next Twelve Months Over 60%



With Most Expecting Recession in Early 2023

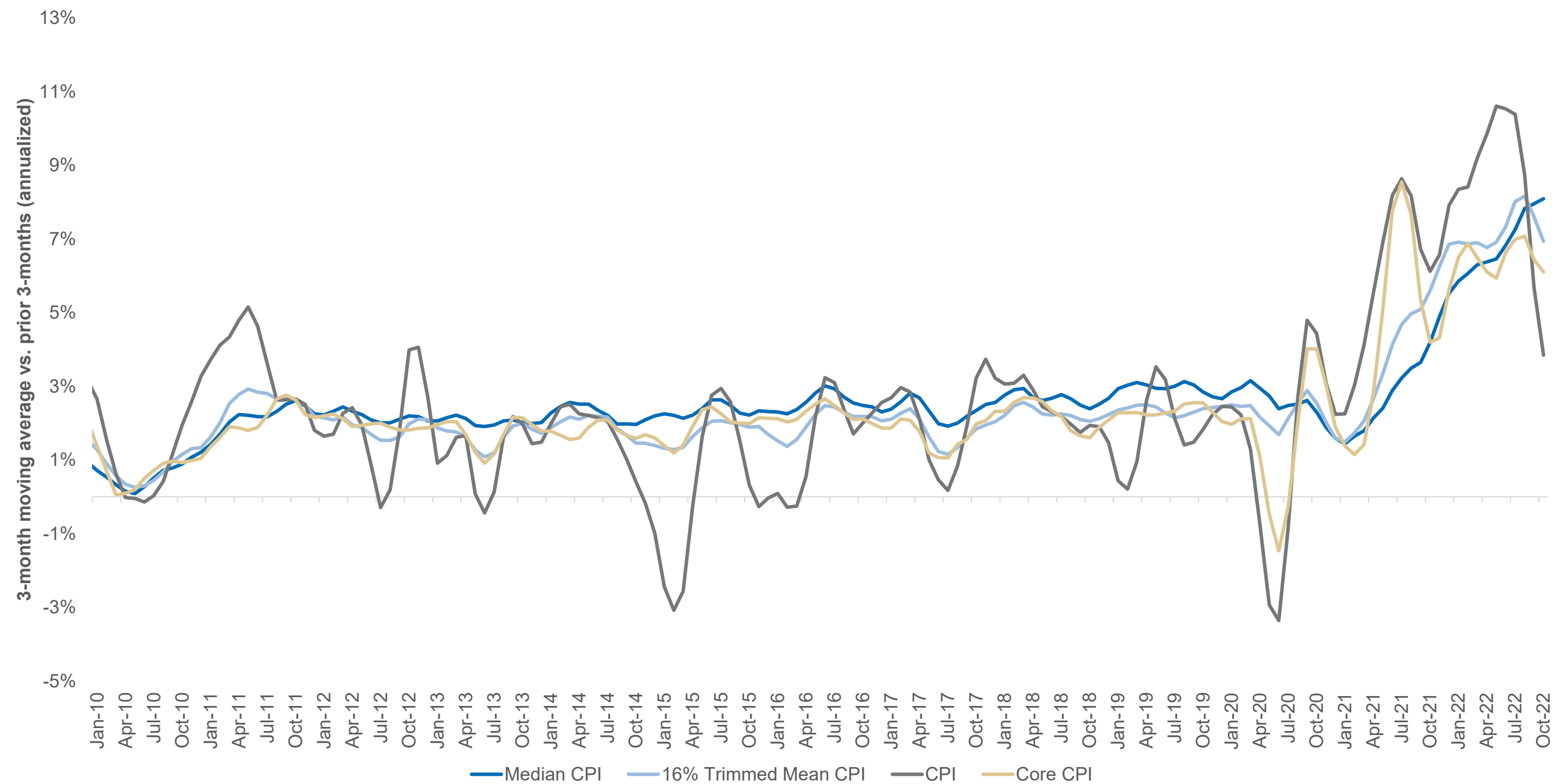


Source: WSJ Economic Forecasting Survey, Financial Times – Chicago Booth Initiative on Global Markets June 2022 Survey, Newmark Research

Inflation Is Far from Where the Fed Wants It

The October inflation print was a large positive surprise, with headline and core CPI dropping sharply. Median and trimmed means CPI strips out effects of strong outliers and are therefore better indicators of underlying inflation pressure. In a more optimistic trend, these too appear to have inflected downwards in October but they remain a long way from target.

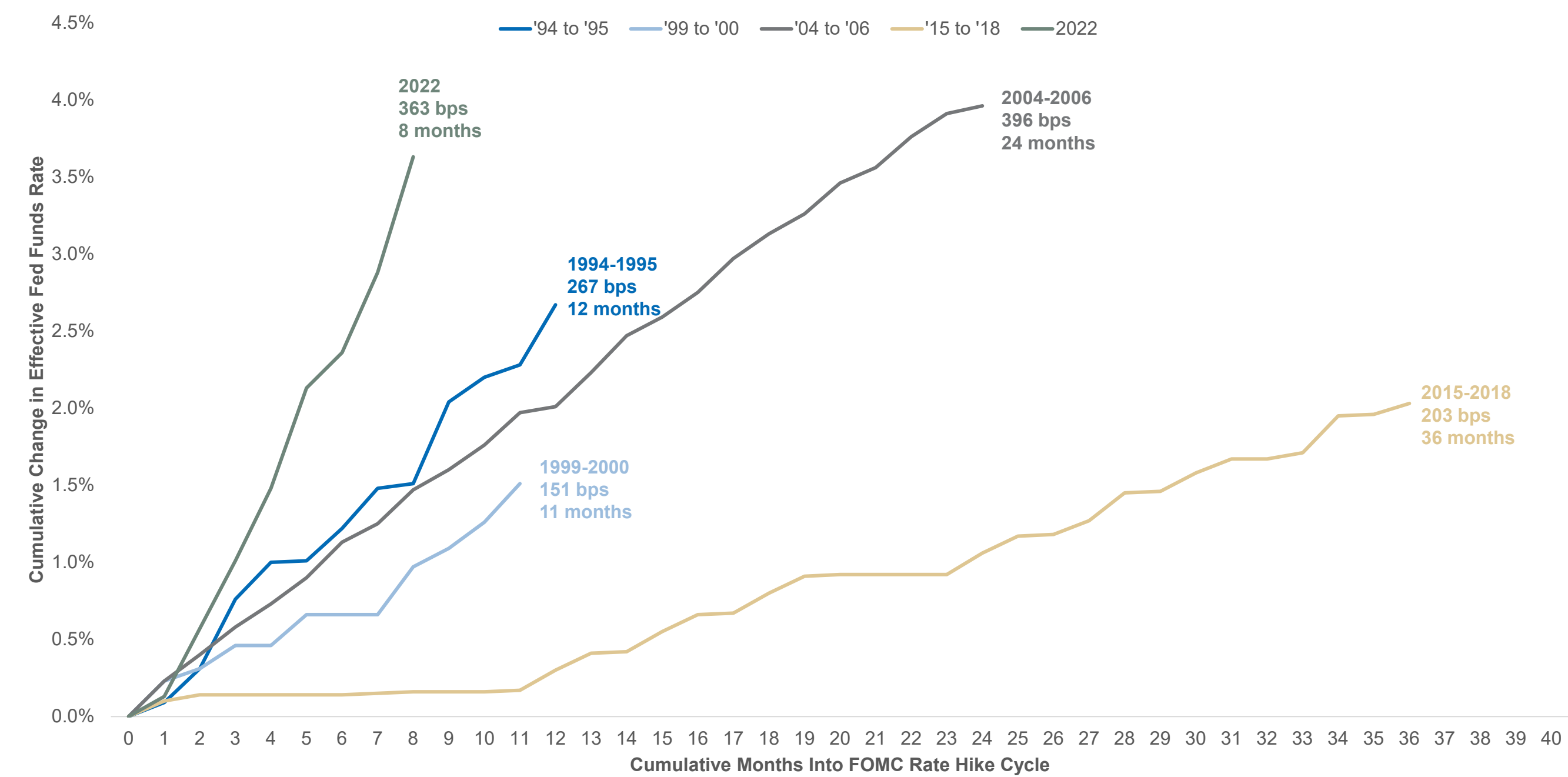
Consumer Price Inflation



FOMC Hiking Rates Faster than Any Time In Modern History

The Federal Open Market Committee (FOMC) being caught flat-footed by inflation earlier in the year now means “all gas, no brakes.”

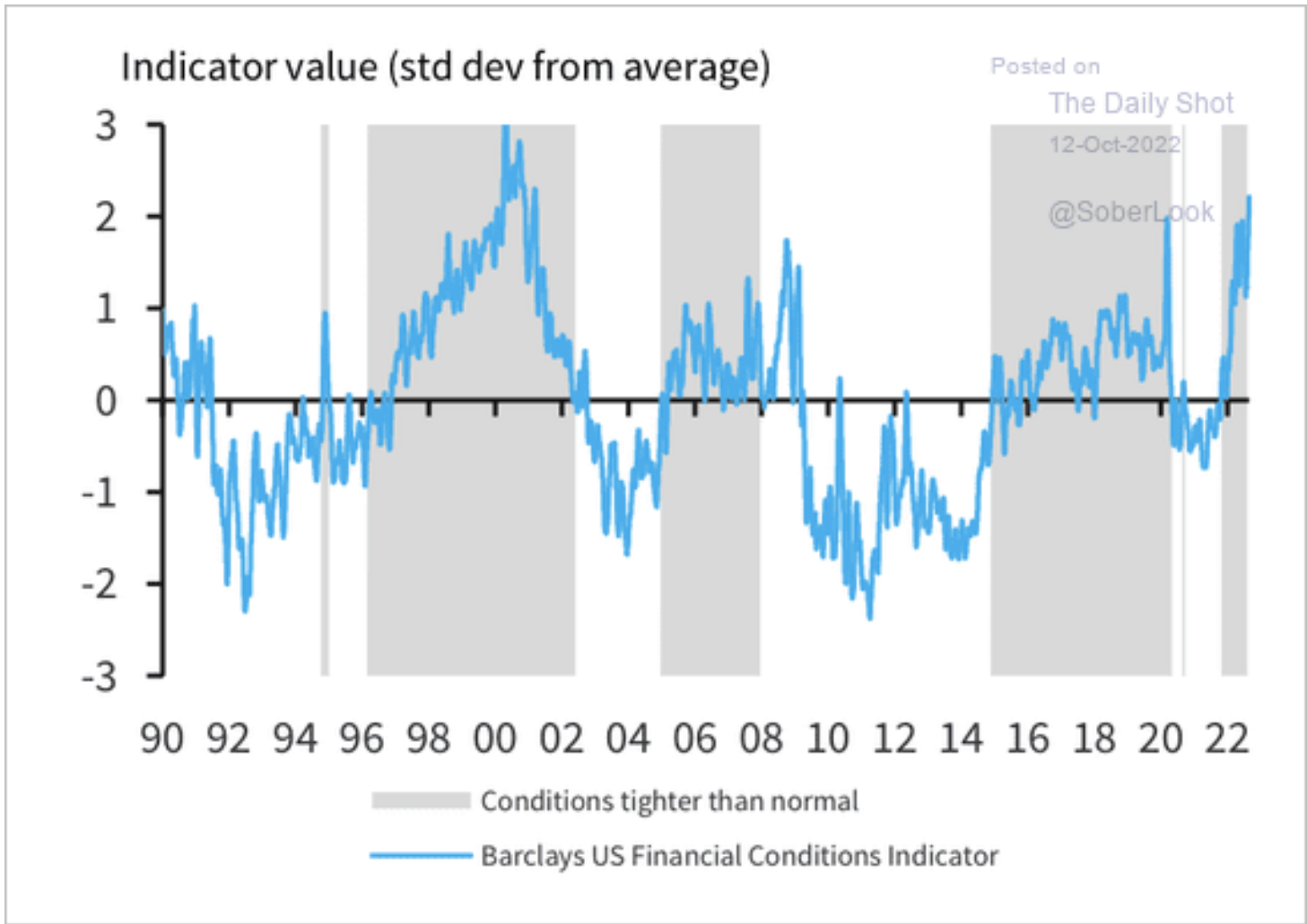
Effective Federal Funds Rate



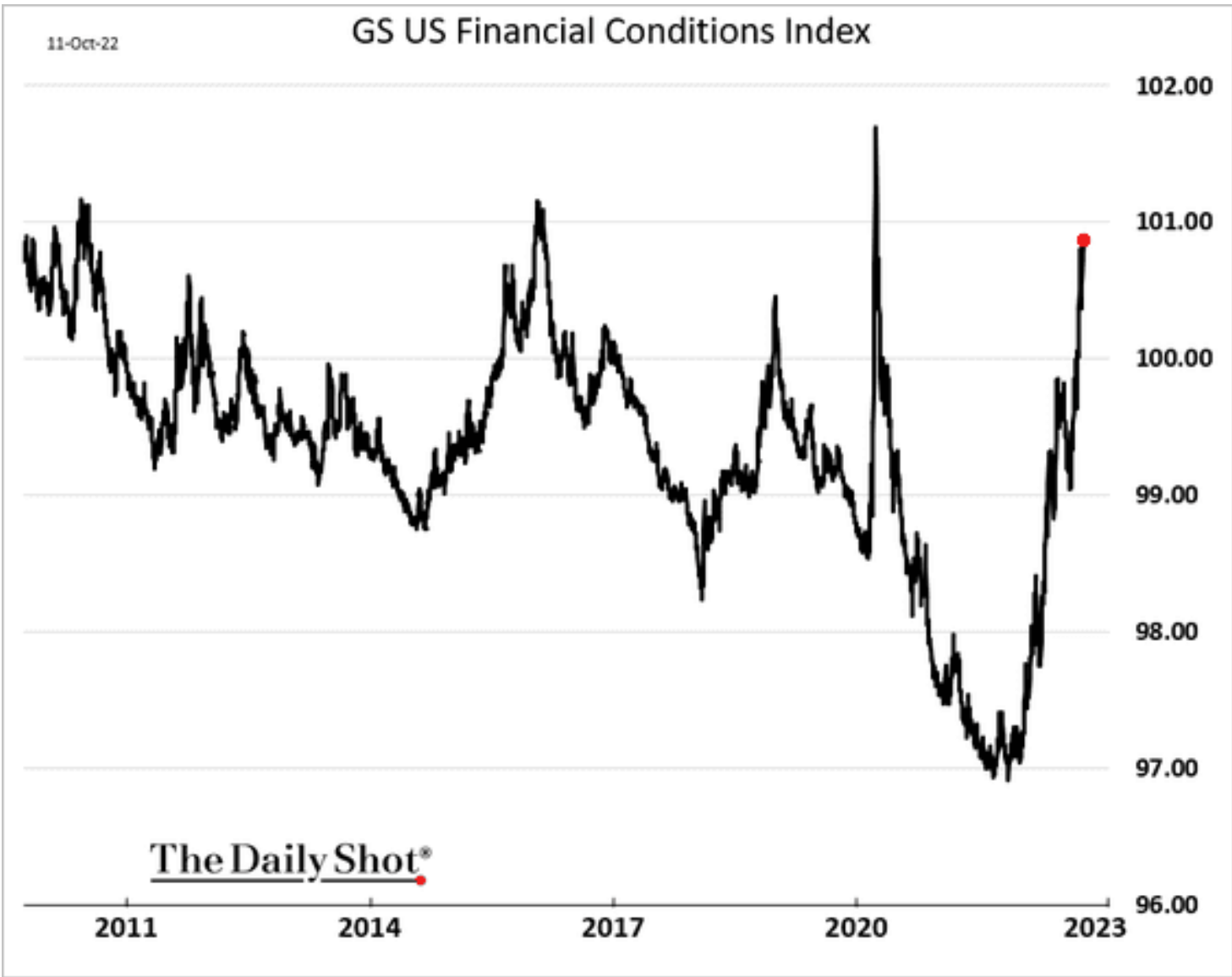
Tightening Financial Conditions

Meanwhile, 10-year real yields, while the highest they have been in more than a decade, would have been considered normal in the mid-2000s. Similarly, the term premium on a 10-year bond, a measure of compensation for rate uncertainty, has increased sharply since bottoming at negative 0.9% in 2020 but now sits at only 0.2%, well below the pre-financial crisis average. Financial conditions, while tight, could reasonably become tighter.

Barclays Says Tighter Than During the Financial Crisis



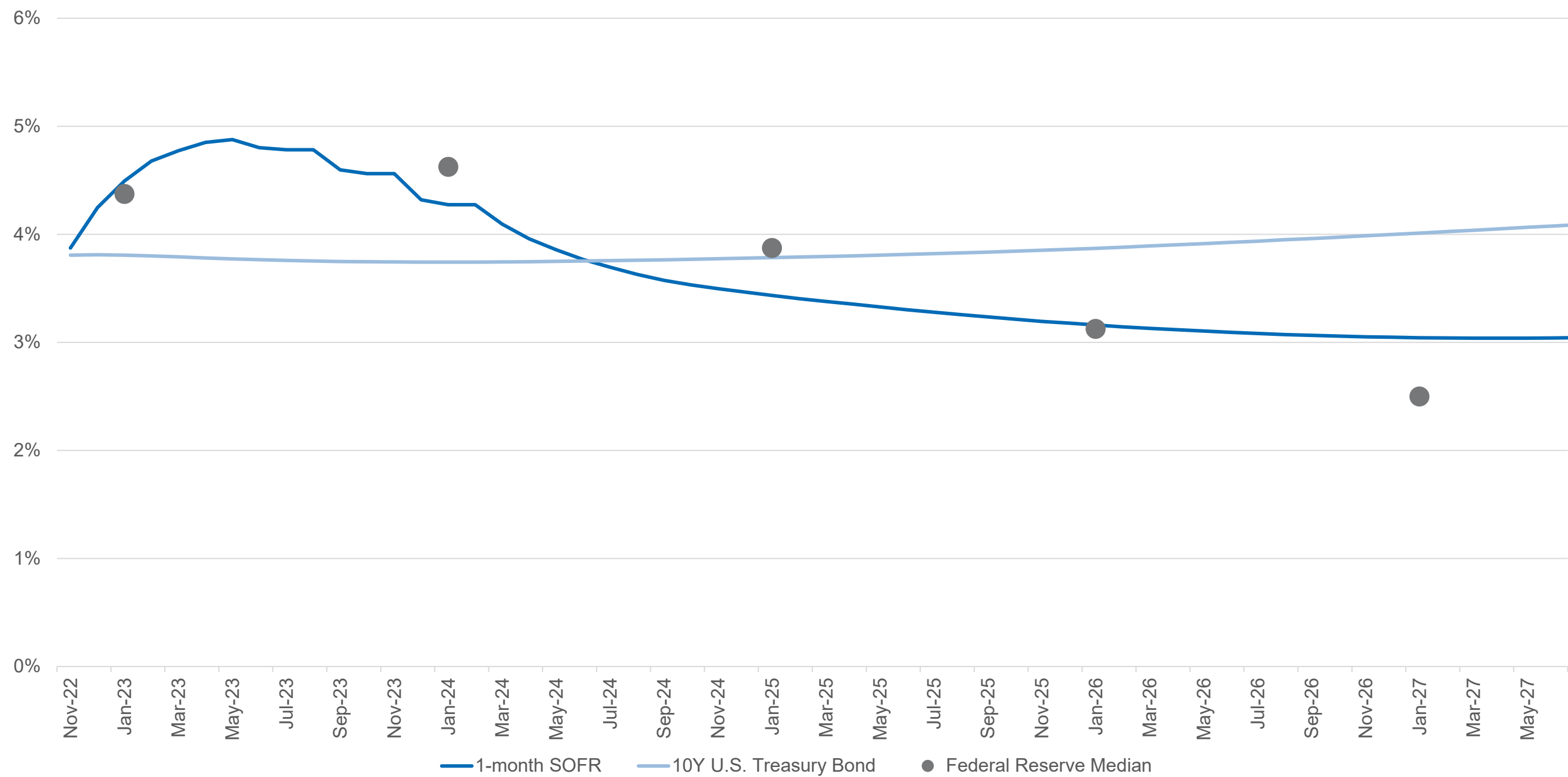
Goldman Says Since Tightest Since HY Debt Implosion of 2015



Rates Expected to Peak Next Year but Remain Over 3% For Years to Come

Rate expectations remain highly data-dependent. The October inflation print surprised to the upside, leading to a sharp reduction in yields across the curve. Even so, markets expect short-term rates to peak near 5% and remain above 3% until the end of the decade. The 10-year forward curve was pricing 4%+ yields prior to the inflation data point, but now has pulled back to just under 4%. As with short rates, the core message remains higher for longer.

U.S. Rates Forward Curve

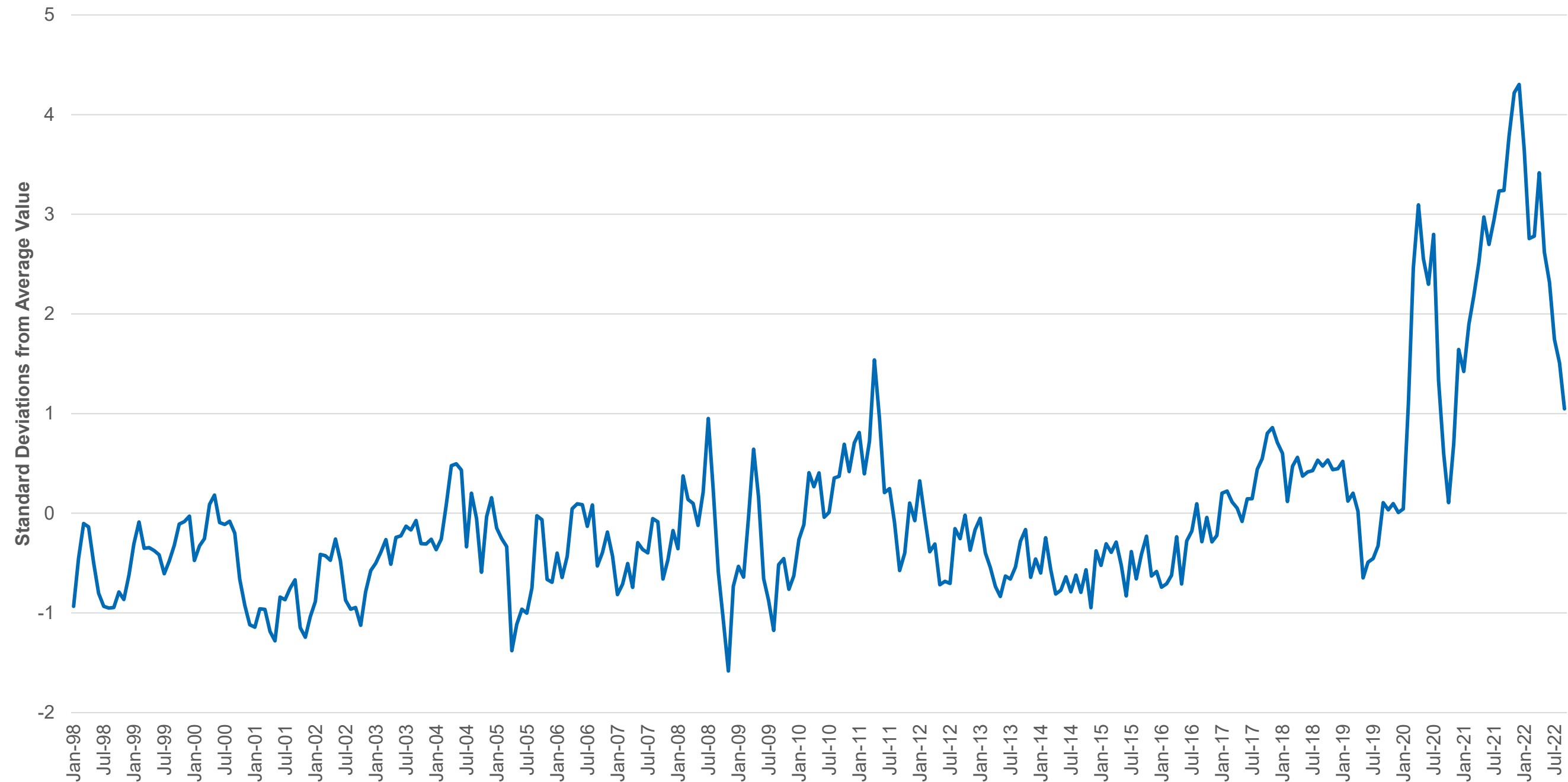


Source: Chatham Financial, Newmark Research

Not All Bad News; Indications That Supply Side Pressures Are Easing

Stress is still a standard deviation above normal, but the pace of easing has been rapid.

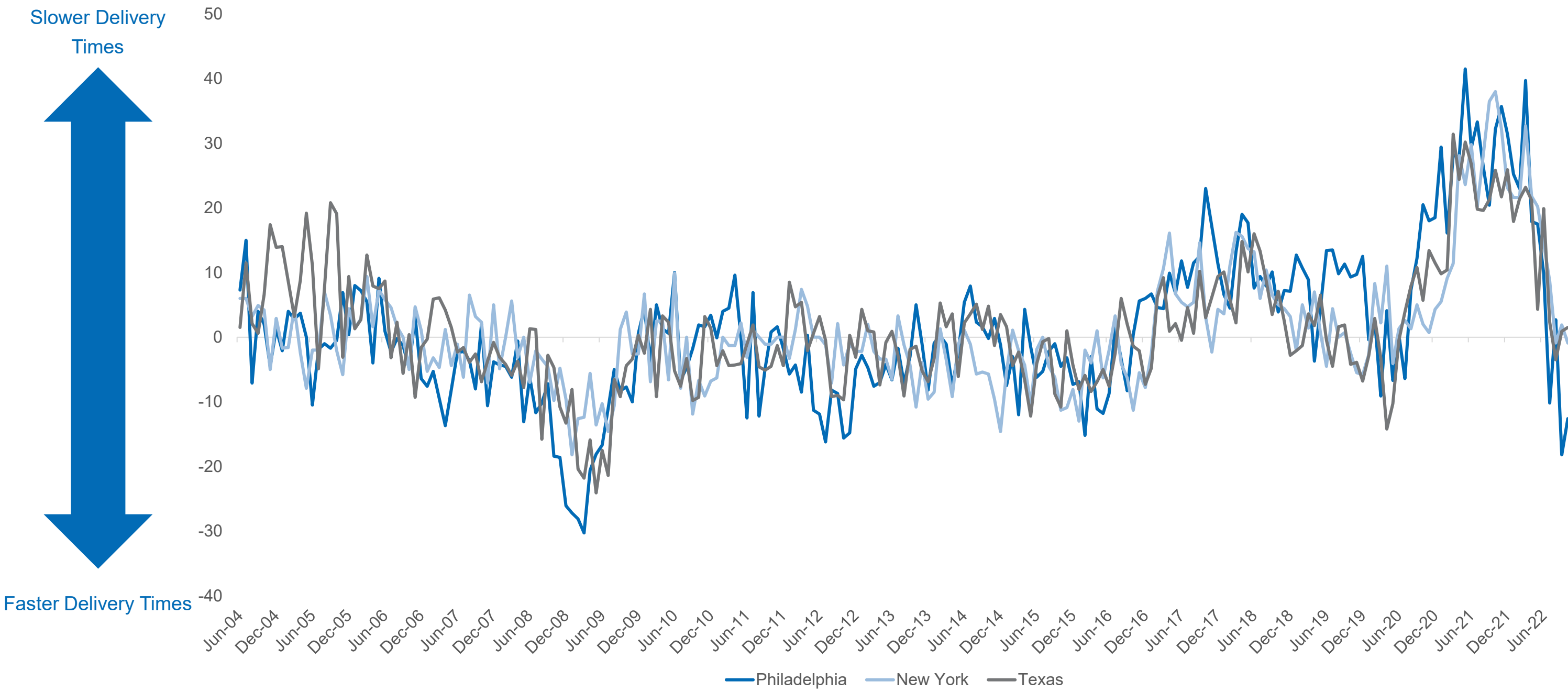
Federal Reserve Global Supply Chain Stress Index



Delivery Times Faster, Declining Order Backlogs

Purchasing managers' indices and small business sector surveys show the same trends.

Federal Reserve District Current Delivery Times Diffusion Index

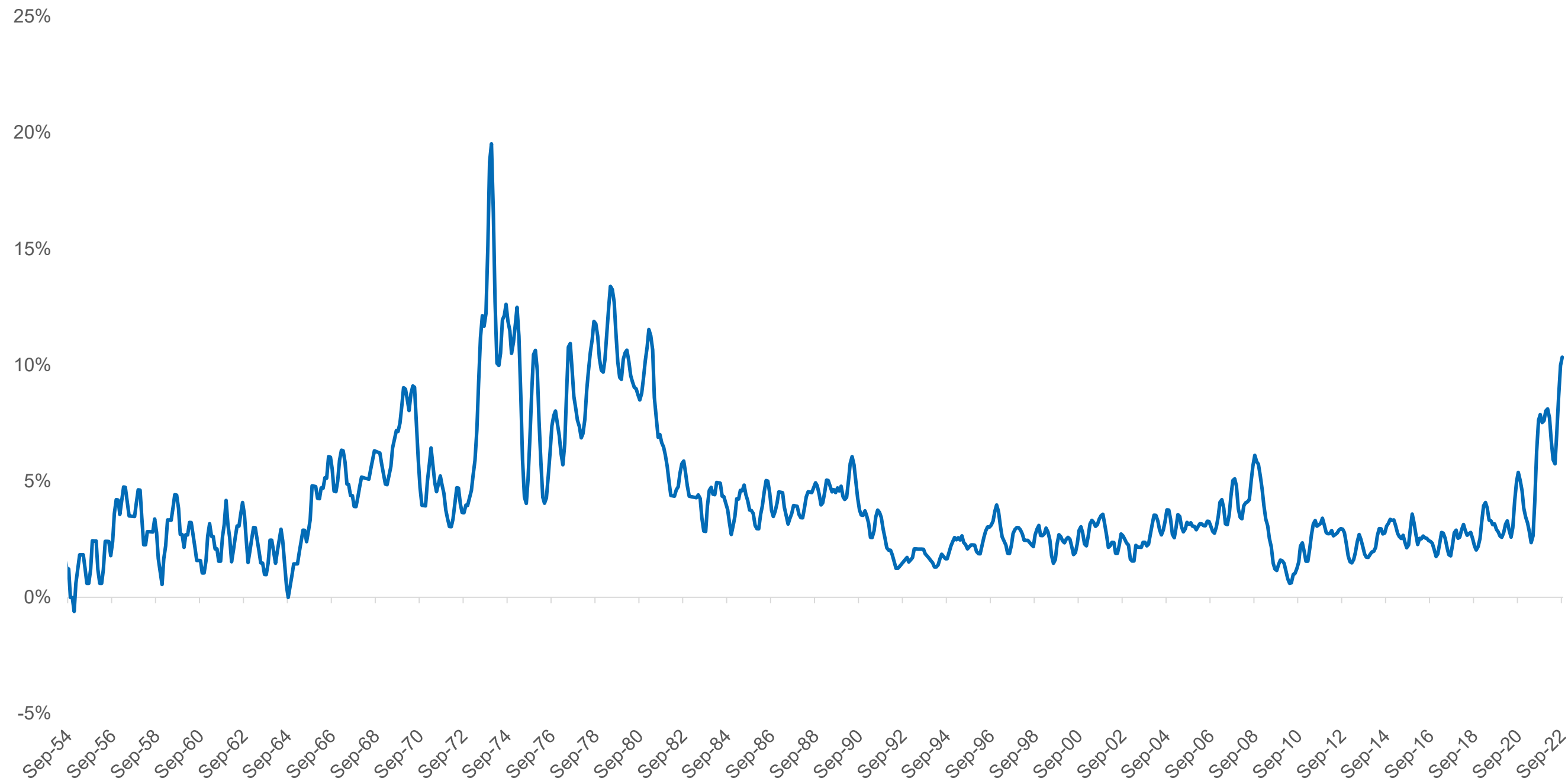


Source: FRB Philadelphia, FRB New York, FRB Texas

But Wage/Labor Scarcity Driven Inflation Continues to Accelerate

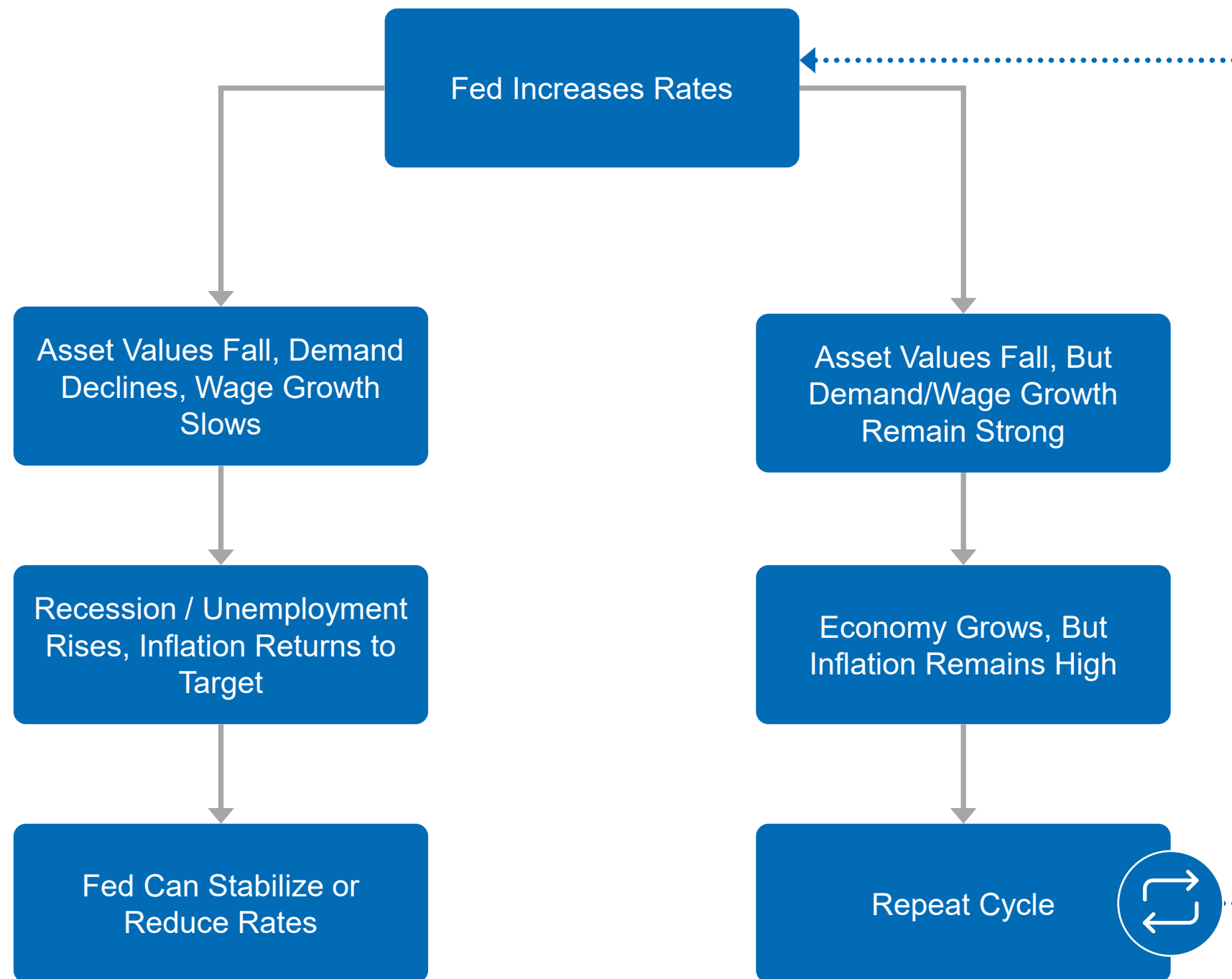
Food away from home is a strong predictor of wage/labor market-driven inflation in the broader economy. Unfortunately, even as supply-side drivers of inflation have waned, the wage-driven or endogenous, drivers of inflation have, if anything, accelerated. Inflation will not be controlled until the labor market weakens and endogenous inflation slows.

Food Away From Home Inflation: 3-month / 3-month (annualized)



Source: U.S. Bureau of Labor Statistics, Newmark Research

The More Resilient the Economy, the Harder the Fed Will Push Rates



3Q22 US OFFICE MARKET OVERVIEW

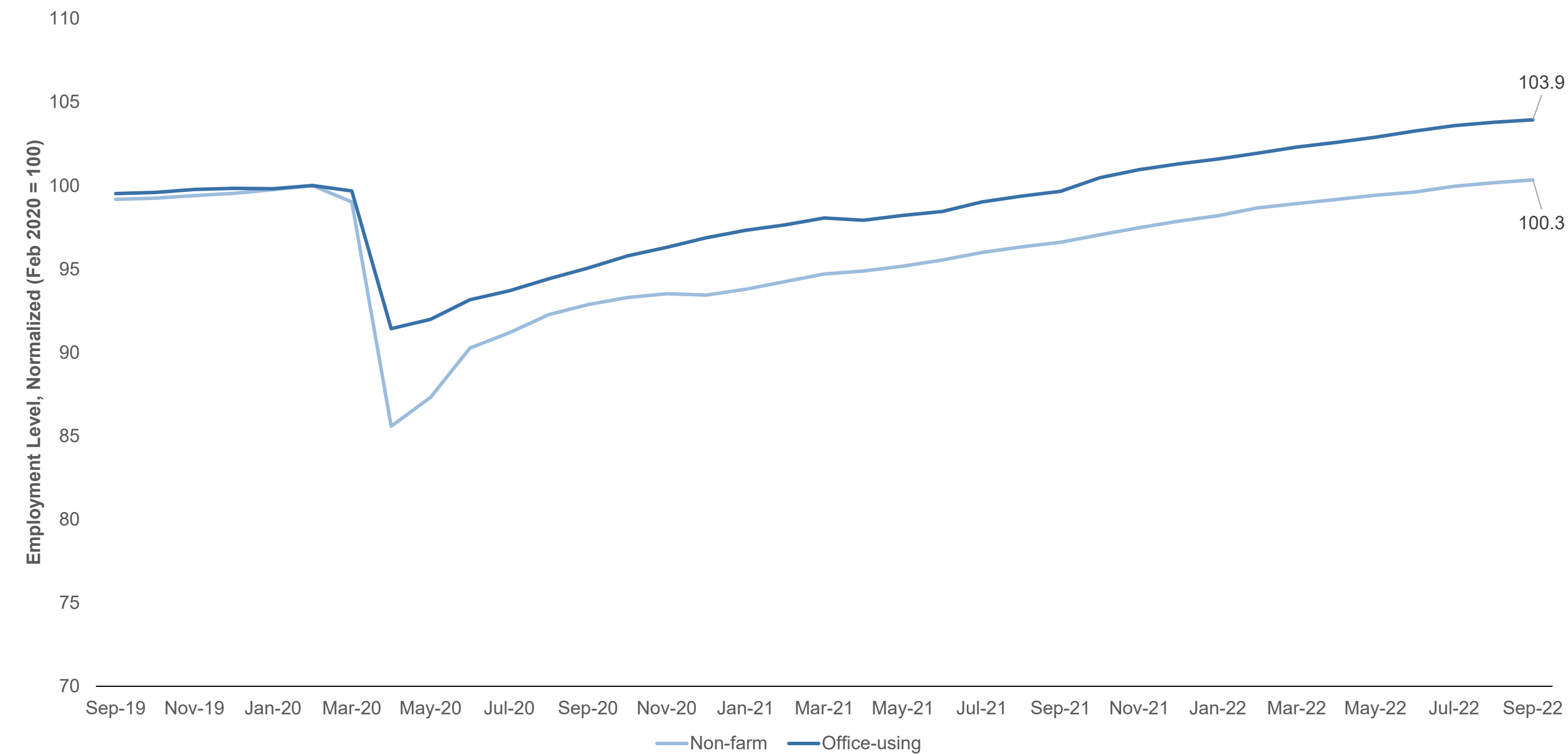
Office Drivers



Office-Using Employment Has Outpaced the Overall Labor Recovery

National nonfarm employment recovered to pre-pandemic levels in July 2022 and is up 17.2% from the pandemic low in April 2020. Office-using employment was less impacted during the pandemic and has maintained a consistent pace of recovery over the last year, measuring 1.3 million jobs above pre-pandemic levels. This is significant because net-new jobs can provide a counterweight to the negative demand effects from remote work. Conservatively assuming 120 feet of office space for each of these workers suggests that the new jobs have added or replaced 156.8 million square feet of office demand.

Employment Recovery Comparison – Normalized to February 2020



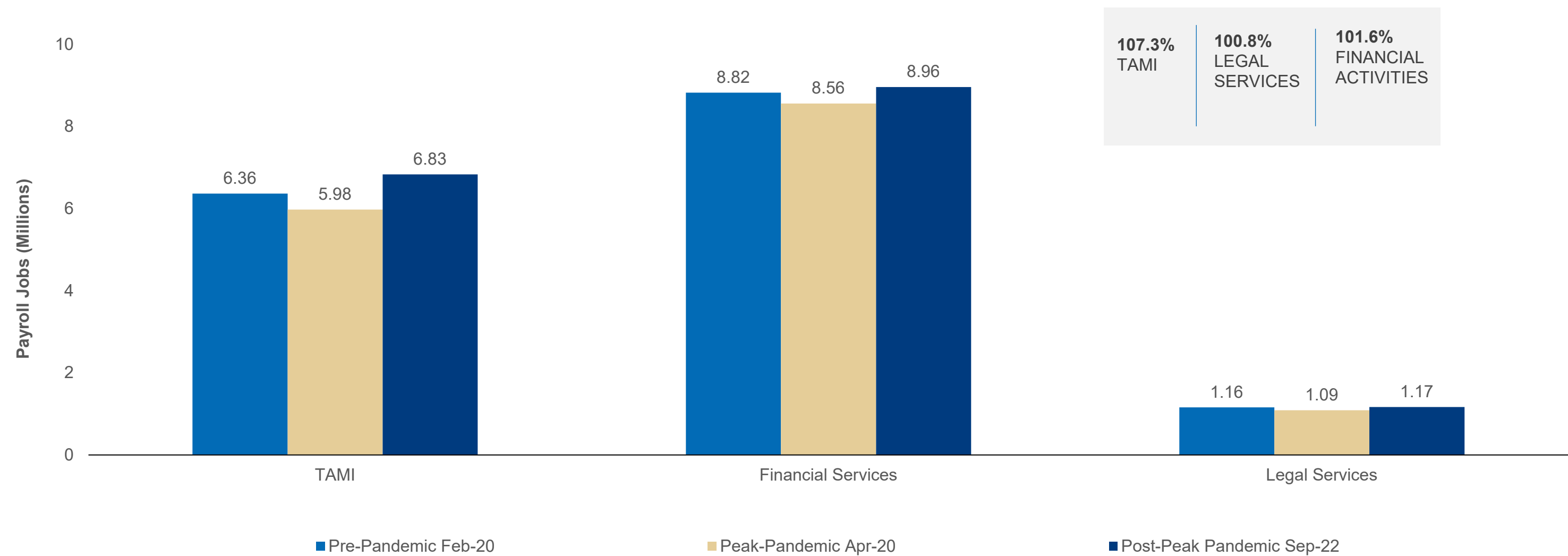
Seasonally Adjusted
Sources: U.S. Bureau of Labor Statistics, Newmark Research

Employment Growth Across Office-Using Industries

Employment now exceed pre-pandemic levels across office-using industries. The recovery in technology, advertising, media and information (TAMI) has been particularly strong, with employment 7.3% above December 2019 levels. Impressive gains have been made across a range of professional and business services, which in the aggregate are up 4.6% from Feb 2020. Financial services have more than fully recovered as well, but less than these other categories.

Employment by Industry

Current Share of December 2019 employment

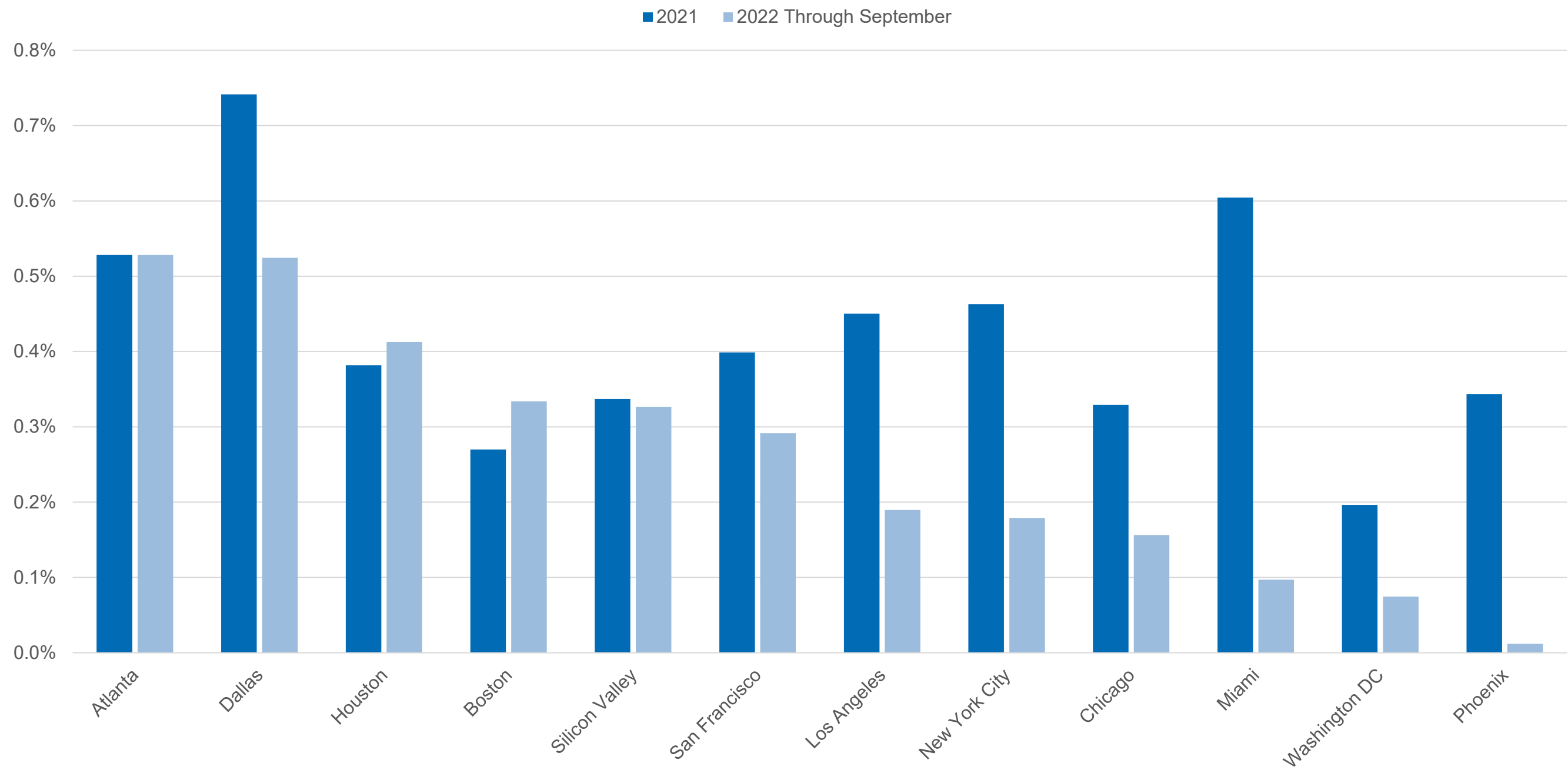


Sources: United States Department of Labor, Newmark Research

Office-Using Employment Expanding but Its Pace Has Slowed in 2022

Office-using employment continues to expand nationally, though the growth rate has slowed in most large U.S. markets. Relative to the healthy office-using job gains experienced in 2021, year-to-date monthly employment growth in 2022 has fallen notably in the largest gateway markets, including New York, Chicago, Los Angeles and Washington.

Compounded Average Monthly Office-Using Employment Growth, Select Large U.S. Metro Markets

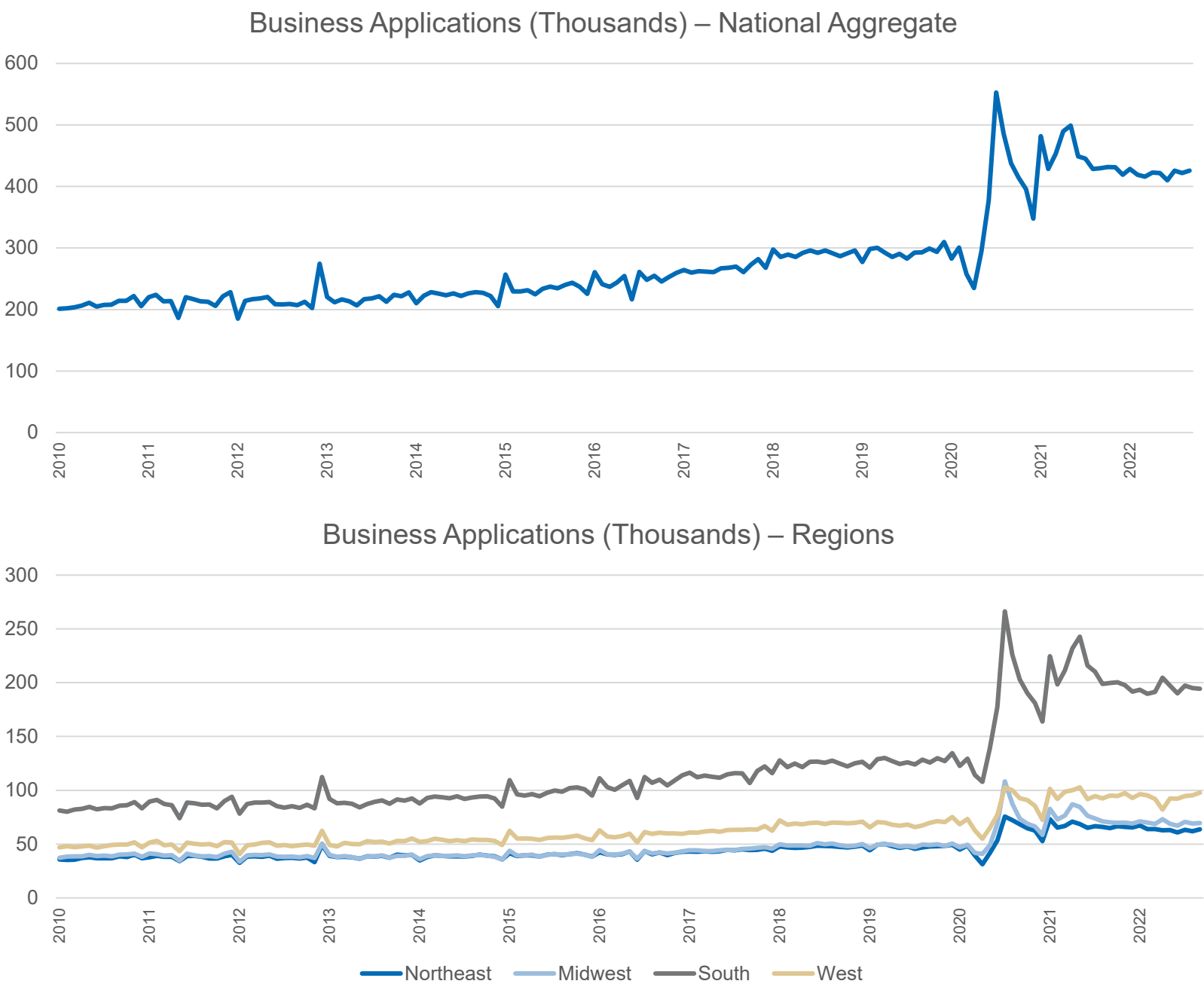
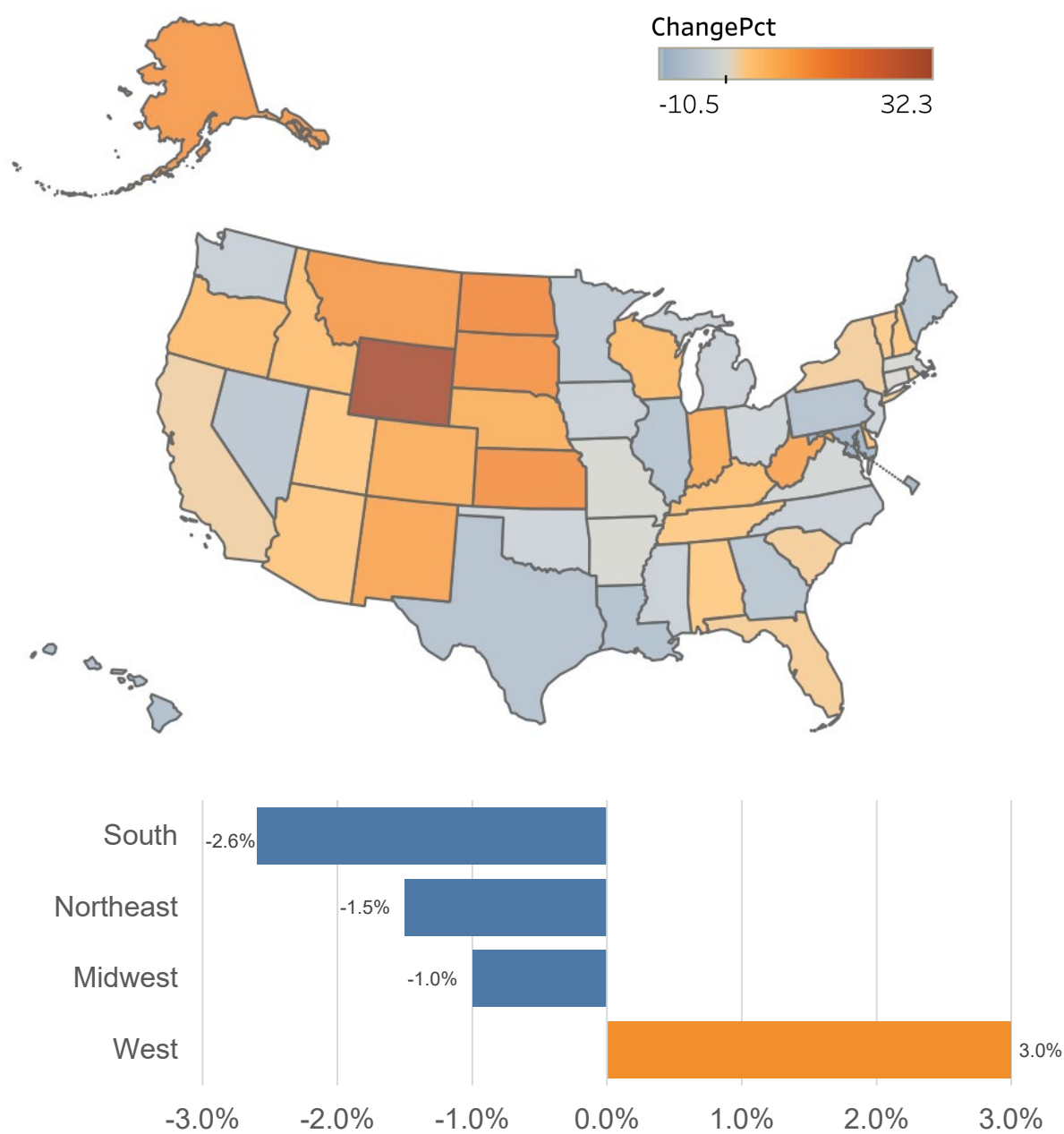


Source: Bureau of Labor Statistics, Newmark Research

New Business Formation Maintains Momentum

Business formation continues to remain strong nationwide. In September 2022, 425,741 new business applications were filed, which is down 0.9% from September 2021. This modest deceleration was attributable to the South, Northeast and Midwest regions, although the West recorded annualized growth of 3.0%. Overall business creation remains notably higher than pre-pandemic levels in all geographic regions.

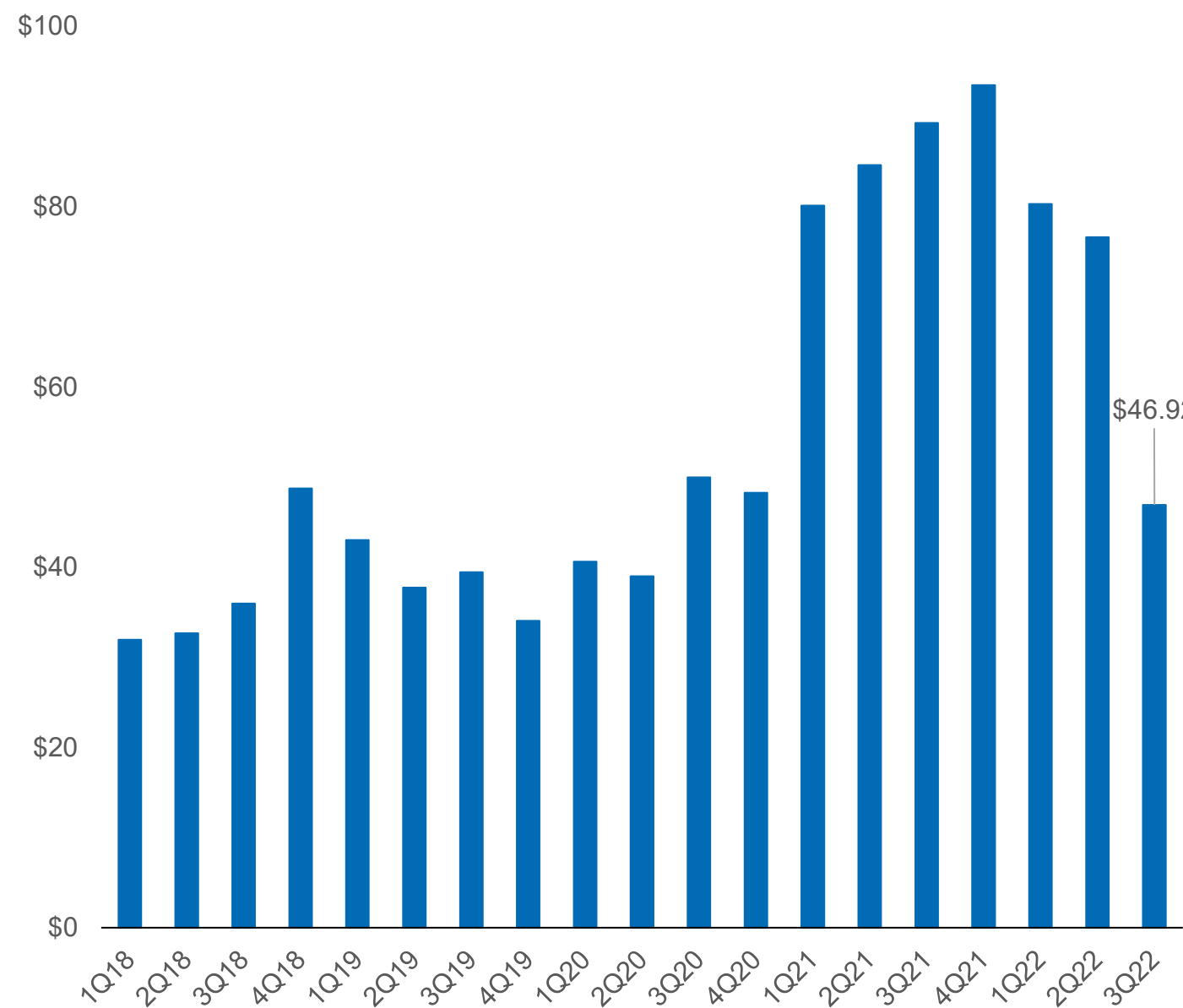
Business Applications: Change from September 2021 to September 2022 (Seasonally Adjusted)



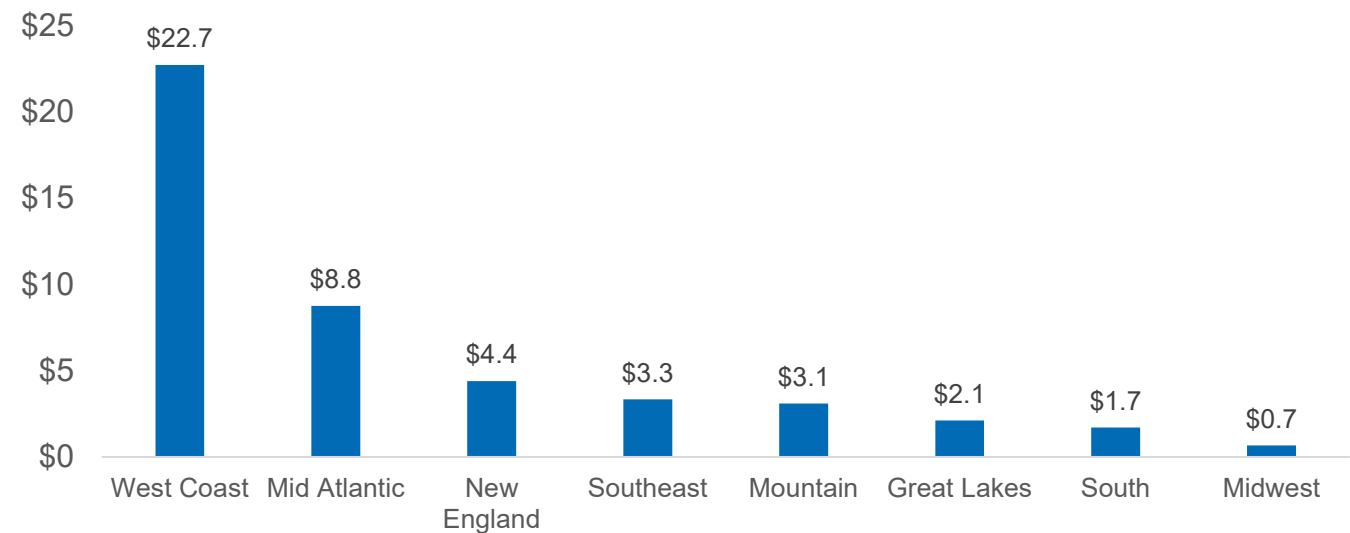
Venture Capital Investment Activity

Overall venture capital investment activity slowed in the third quarter of 2022 as greater caution was exhibited by investors. Although total investments are down from the cycle’s recent peak in 2021, activity through the third quarter of 2022 is elevated from a historic perspective. While overall investment has trended down in 2022, the energy sector saw increased activity, securing \$4.0 billion in funding in the third quarter of 2022, marking a nearly 200% increase from the previous quarter. The market’s largest funds are likely to experience the greatest contraction in activity, but high levels of dry powder should continue to support investment activity among smaller funds.

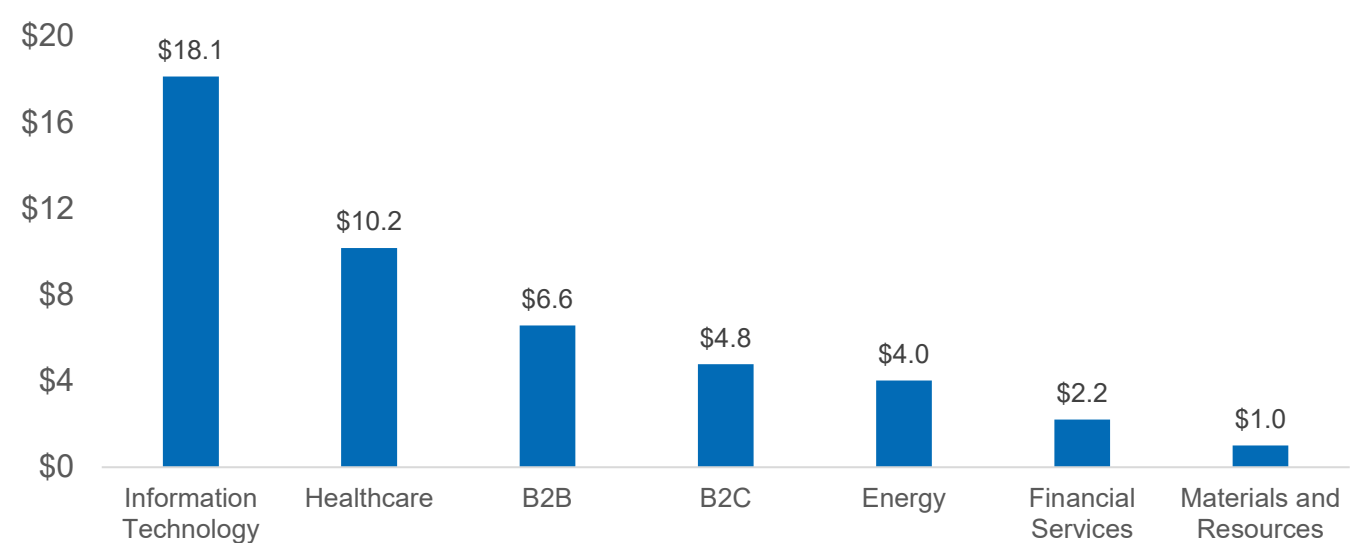
Venture Capital Deal Value (\$ billions)



3Q22 VC Funding by Region (\$ billions)



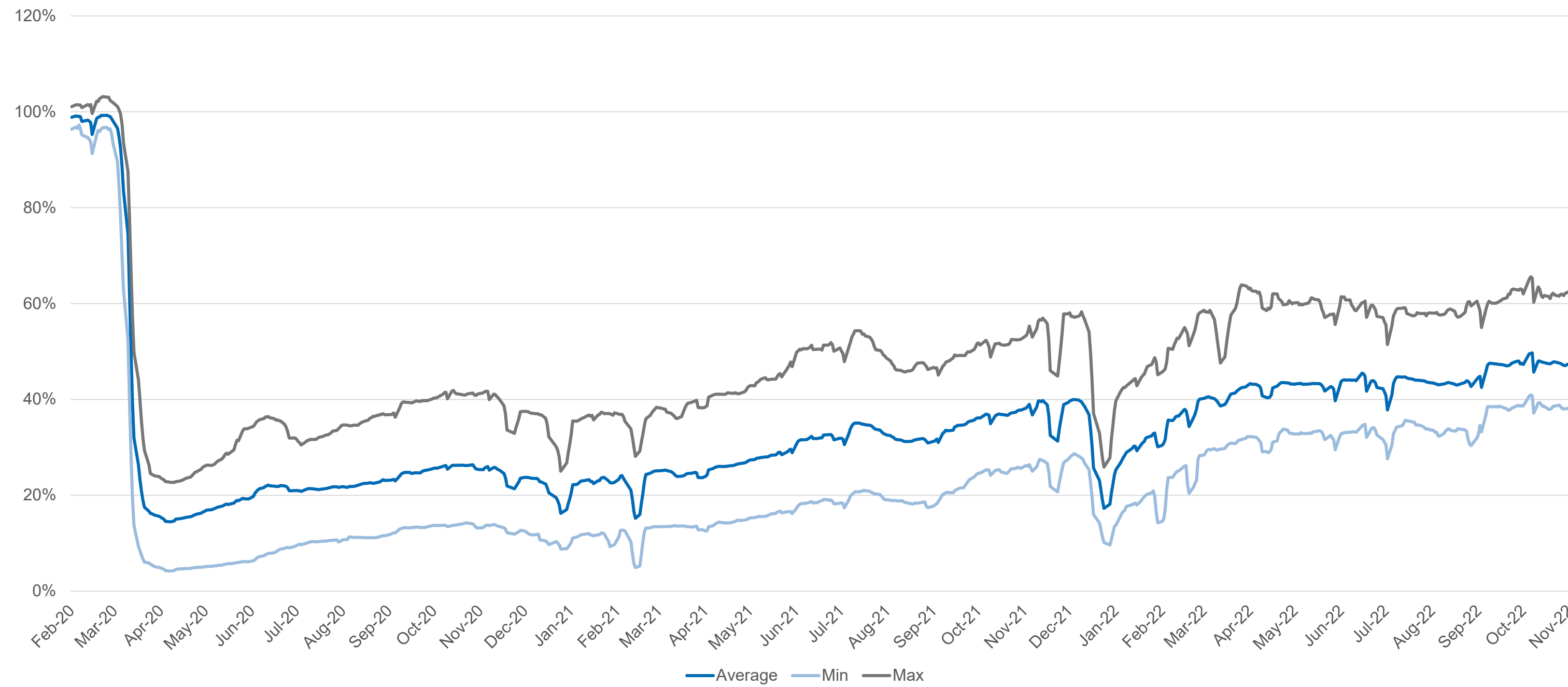
3Q22 VC Funding by Industry Sector (\$ billions)



A Robust Return to Offices Could Change Expectations

Kastle Systems's office occupancy index points to a modest uptick in office utilization in September 2022, following the Labor Day holiday. In-office occupancy has been relatively static for much of the second and third quarters of 2022, despite relatively improved public health conditions.

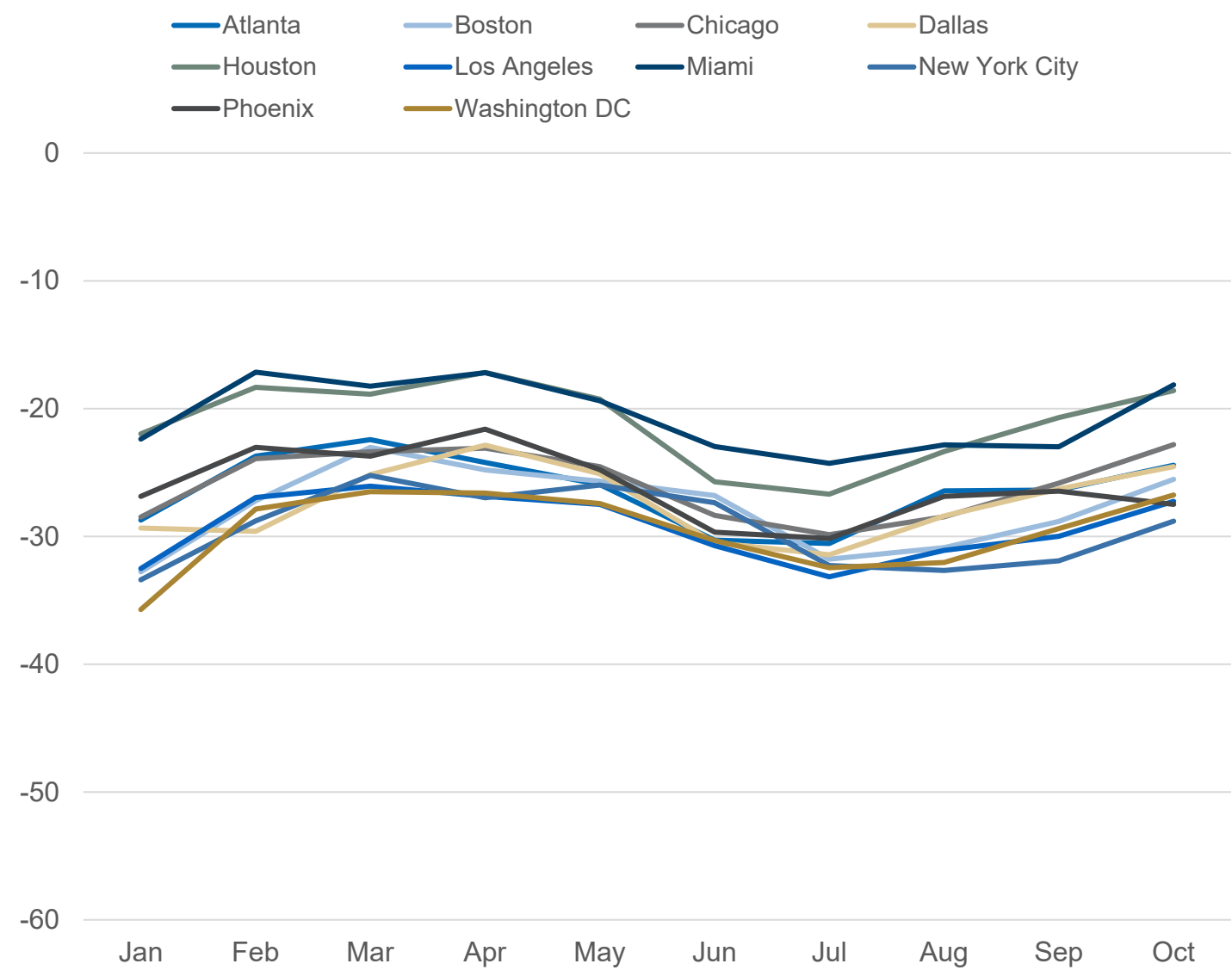
Kastle Systems Daily Office Physical Occupancy Index – 5-Day Trailing Average (Baseline = February 2020)



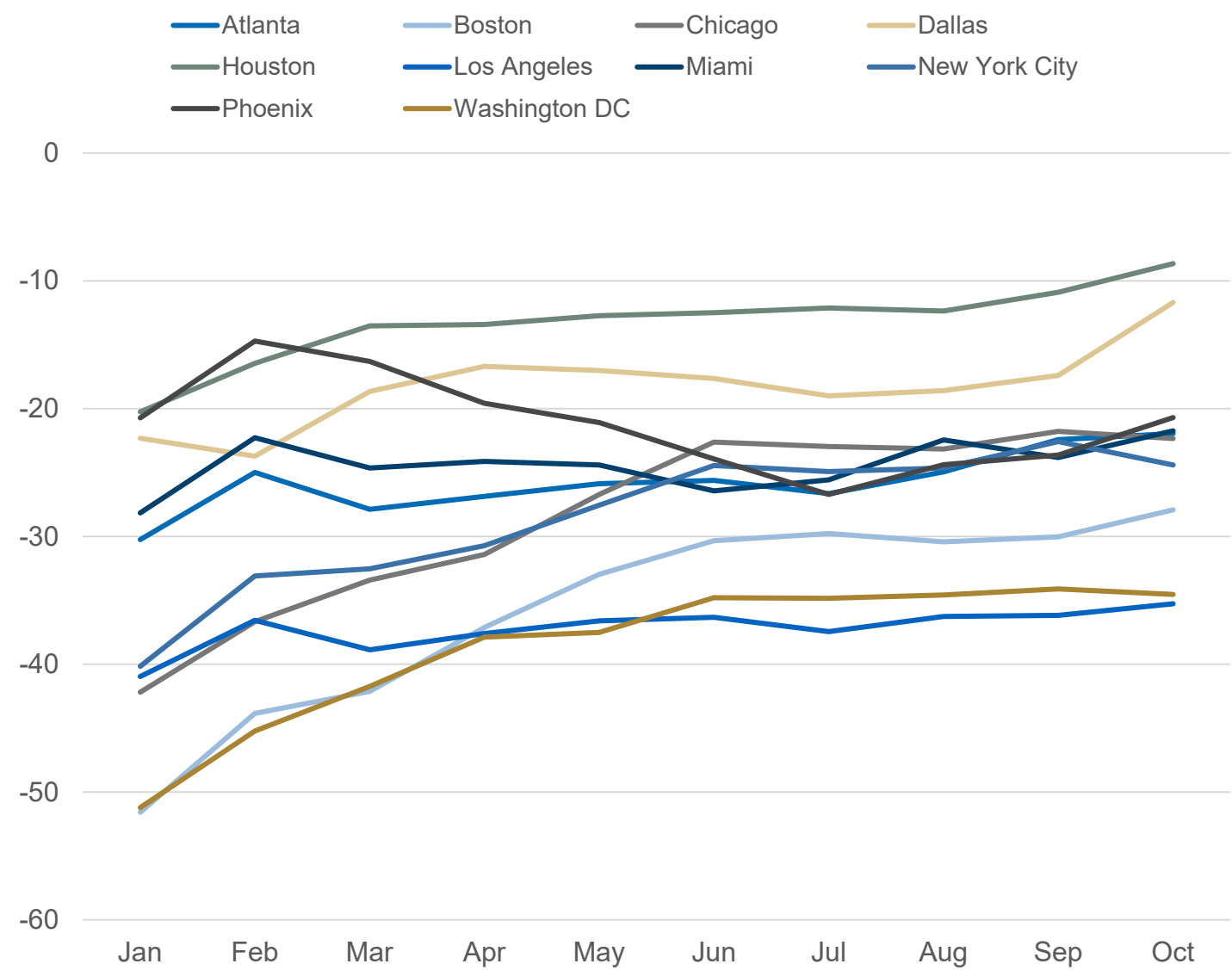
Travel to Workplaces and Mass Transportation Hubs is Rising

Mobility data collected by Google indicates slowly rising activity to and from workplaces and, to a slightly lesser degree, public transit stations. This trend is an encouraging confirmation that return-to-office momentum is building in the nation’s largest metro markets; however, mobility to workplaces does remain notably below the pre-pandemic baseline.

Google Mobility Index to Workplaces in 2022
Indexed to Pre-Pandemic Baseline



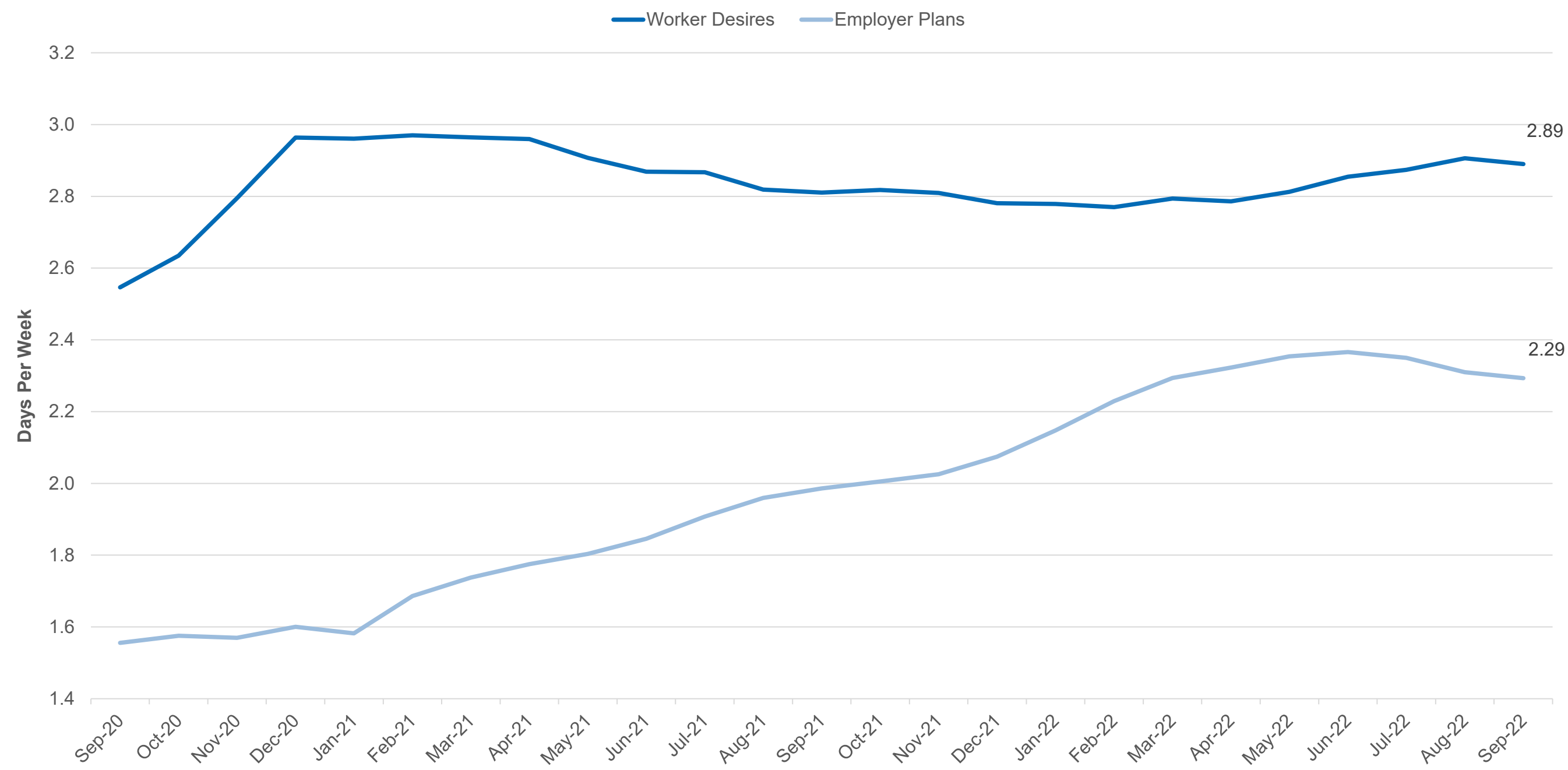
Google Mobility Index to Transit Stations in 2022
Indexed to Pre-Pandemic Baseline



Worker and Manager Expectations Differ; Recession Could Close the Gap

Many employers are considering long-term adoption of hybrid and semi-remote work schedules, given the experiences learned in the pandemic. Still, worker expectations for remote privileges exceeds that of employers' plans. As recessionary headwinds strengthen, employers have begun tightening their expectations of in-office work. Combined with a potentially softer labor market, leadership may begin to hold more leverage to recall employees back to offices on a more frequent basis.

Average Days per Week Working From Home After the Pandemic Ends: Workers Able to Work From Home



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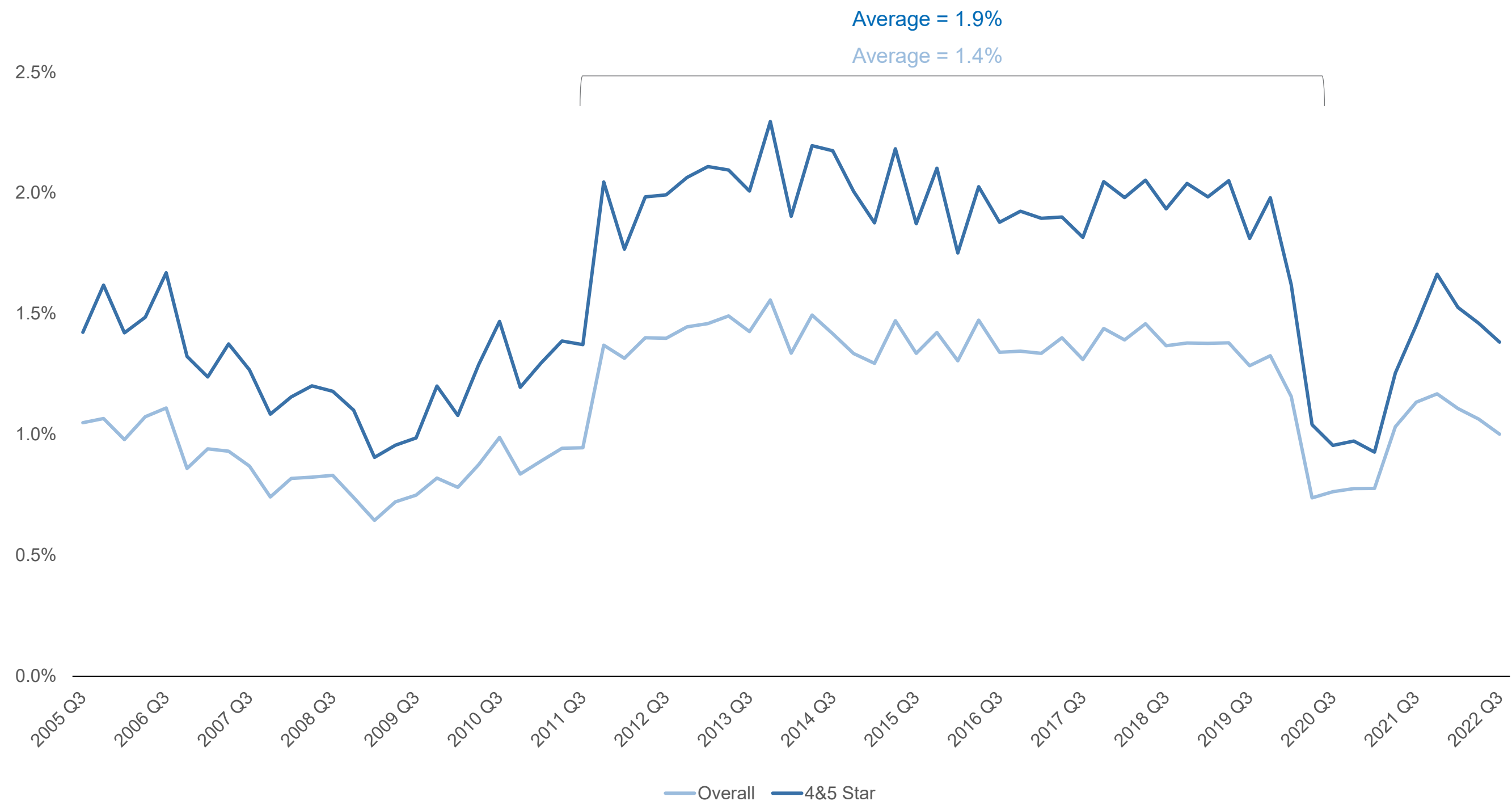
Leasing Market Fundamentals



Office Leasing Activity Continued to Slow in 3Q22

Higher-quality buildings continue to outperform the overall market, attracting 52.7% of demand while comprising only 38.2% of inventory. Leasing activity has cooled in 2022 across all assets and remains well below rates measured in the decade predating the pandemic.

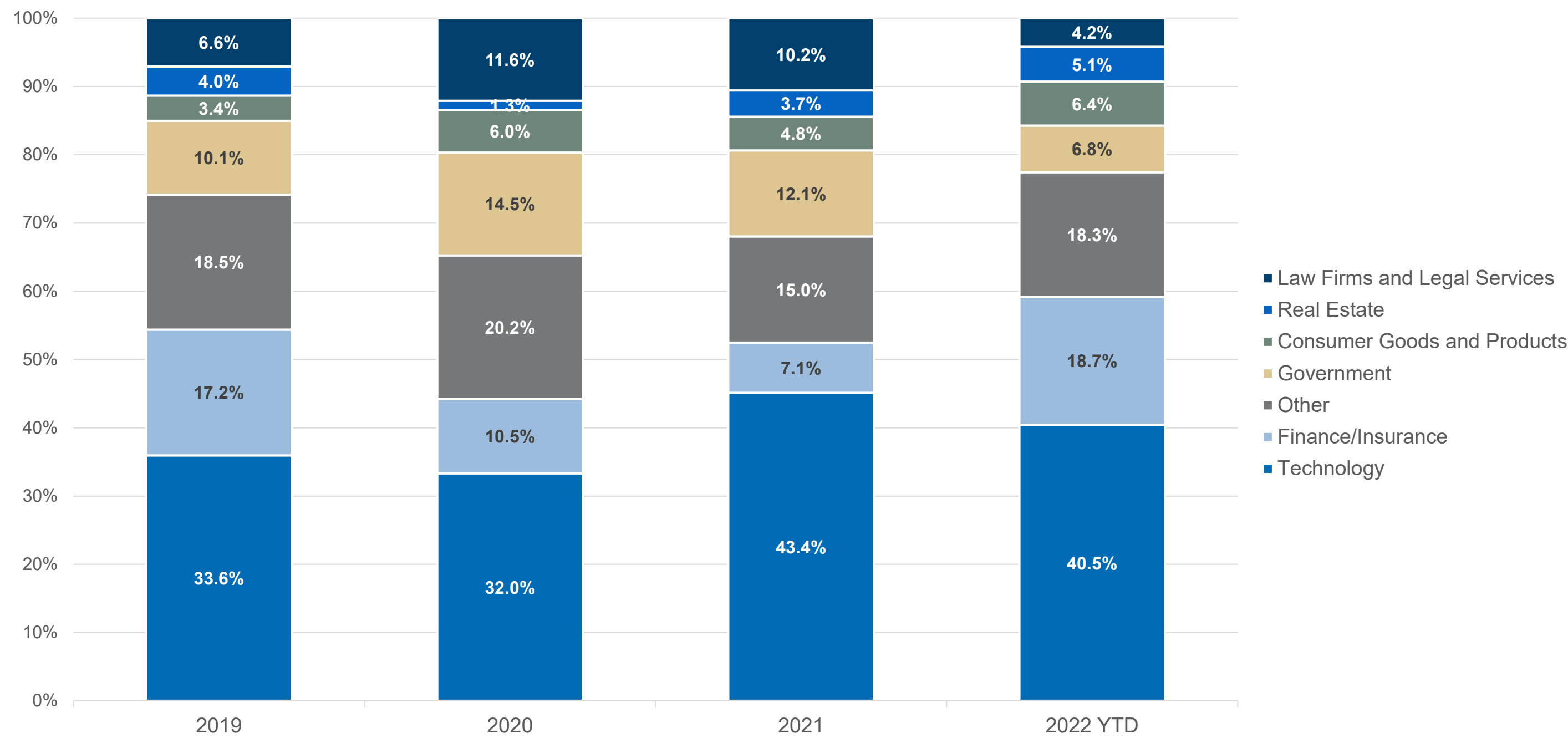
Leasing Activity as a Share of Inventory



Leasing Activity by Year

Leasing activity slowed in 2022, but activity remains concentrated in the technology and life sciences industries. Occupiers in these industries have accounted for over 40% of the total square footage leased among large-footprint tenants since 2021. However, recessionary pressures have slowed hiring among several notable technology firms, which could foreshadow a cooling of new real estate requirements.

Percentage of Total SF Leases Among Leases Greater than 100,000 SF

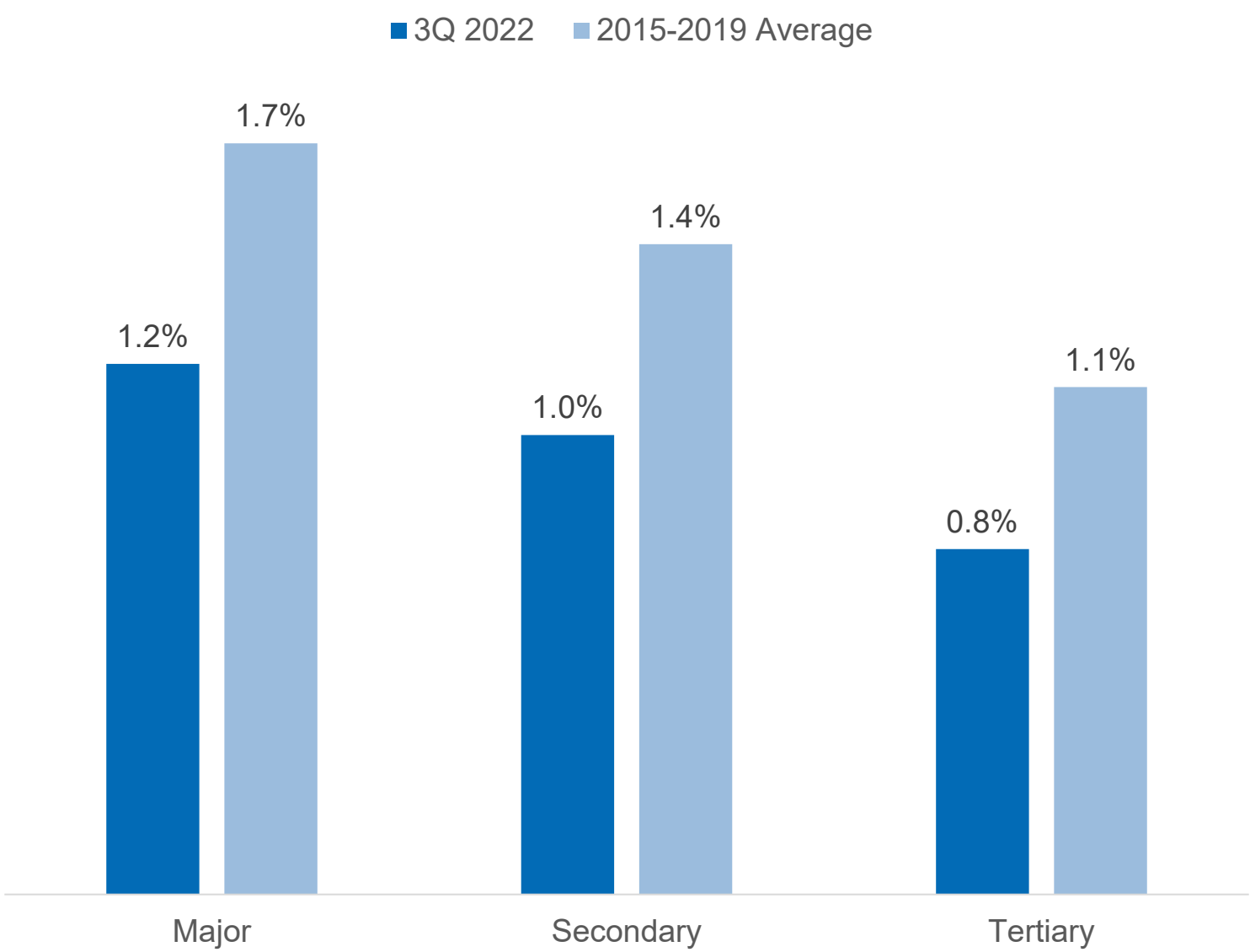
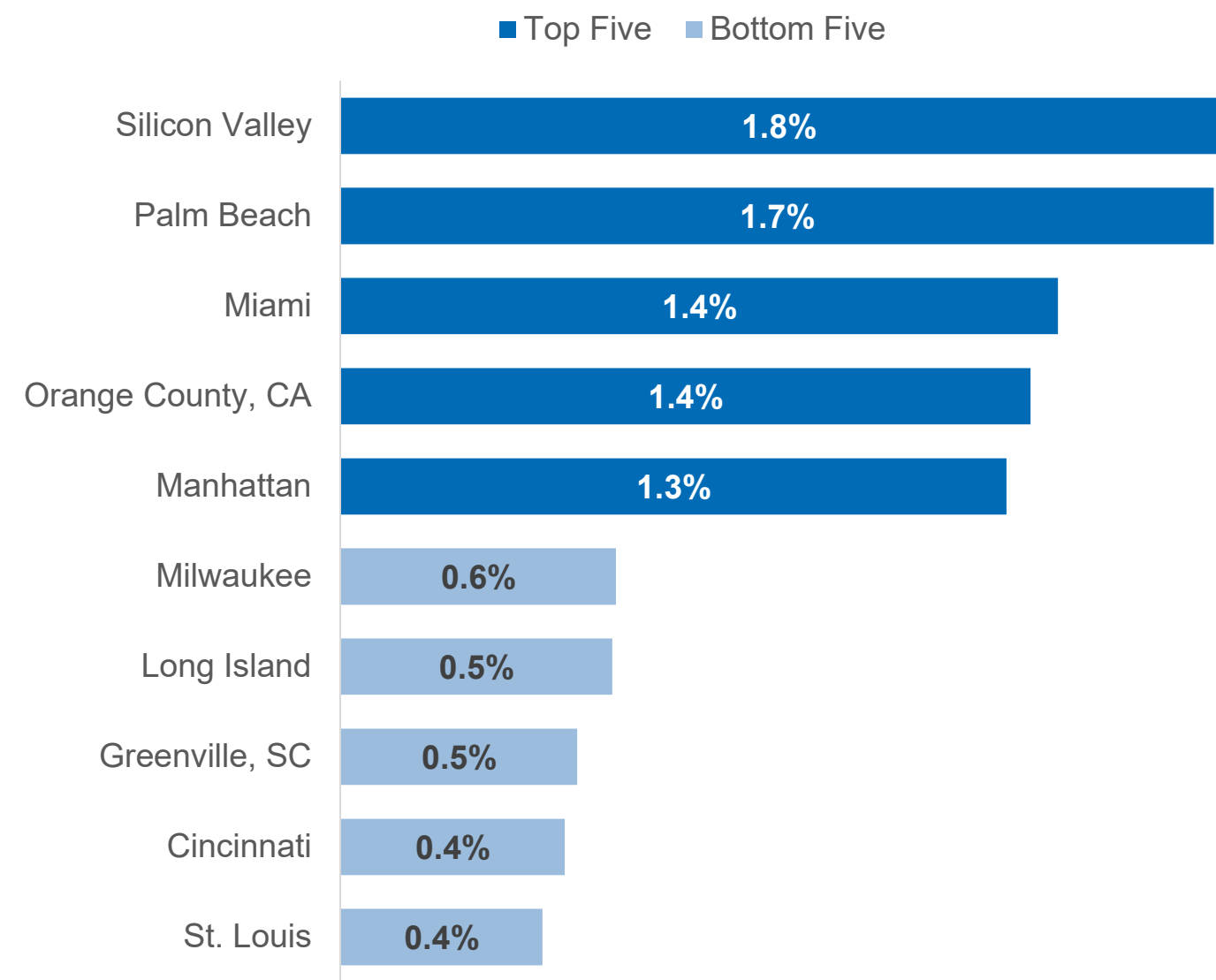


Sources: Newmark Research

Leasing Activity by Market

Sluggish leasing activity remains a staple of most US markets in the third quarter of 2022. For most markets, quarterly leasing activity lags that of pre-pandemic levels and is most evident in formerly fast-growing technology markets like San Francisco and Austin. Although most office markets are below historical expectations, relatively healthy leasing activity was experienced in coastal markets led by Silicon Valley, Palm Beach, Miami, and Orange County, California.

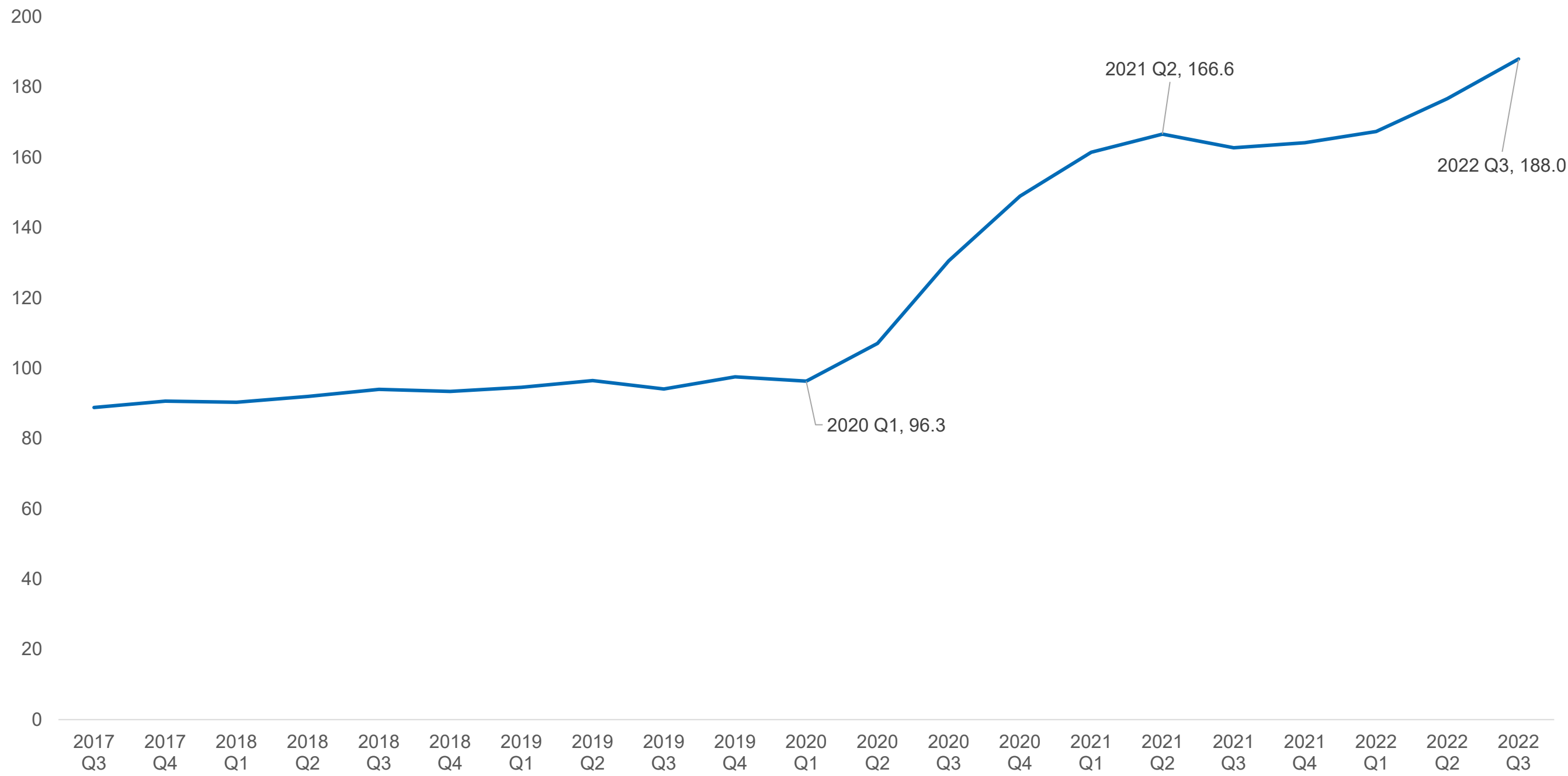
Leasing Activity as a Percent of Inventory



Sublease Availability Growth Accelerates Once More

Sublease availability has expanded steadily in 2022 and has increased by 6.4% between the second and third quarters of 2022. This marks the strongest quarter-over-quarter rise since early 2021.

National Sublease Availability (msf)

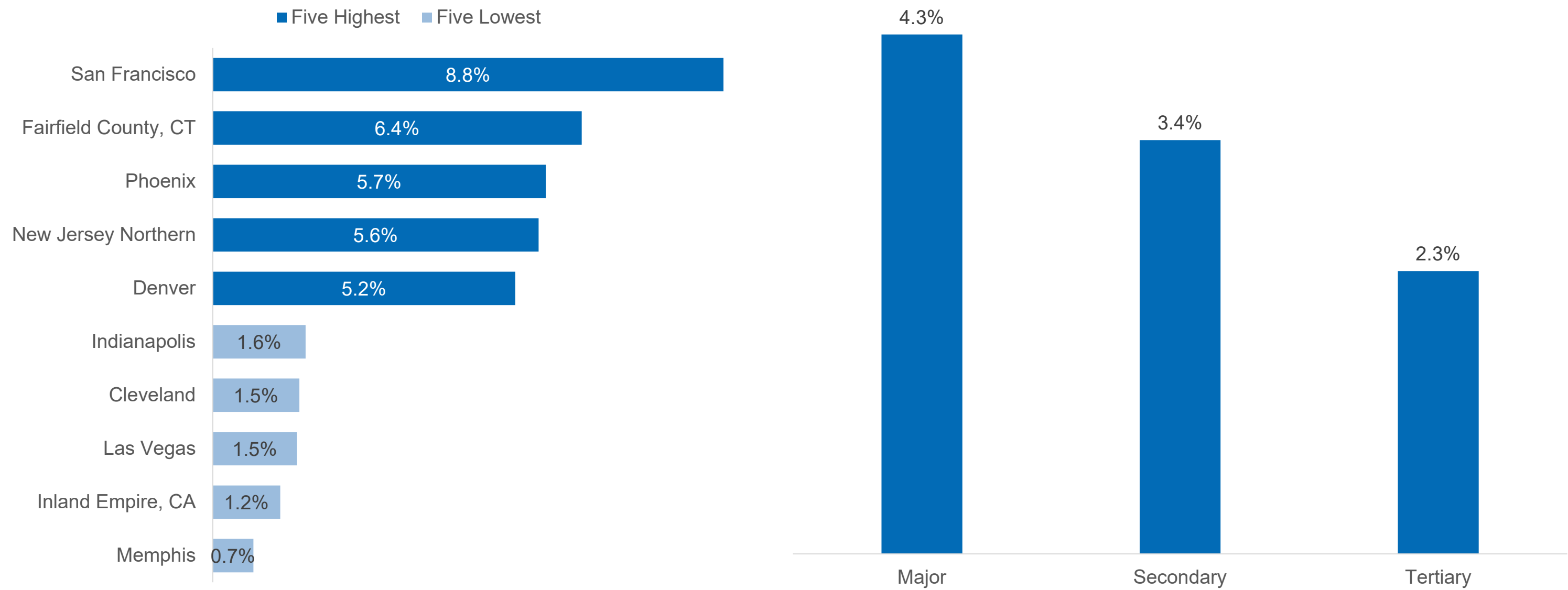


Source: CoStar, Newmark Research

Sublease Availability by Market

Sublease availability is most elevated in major gateway markets, which are challenged by inventory oversupply and suppressed demand. San Francisco leads the nation in sublet availability; however, much of this rise can be attributed to space sublet by technology occupiers. Many tech firms held large blocks of space under lease as future growth options, but much of this product has re-entered the market as sublet availability as growth plans and remote working have lessened the necessity of the excess space.

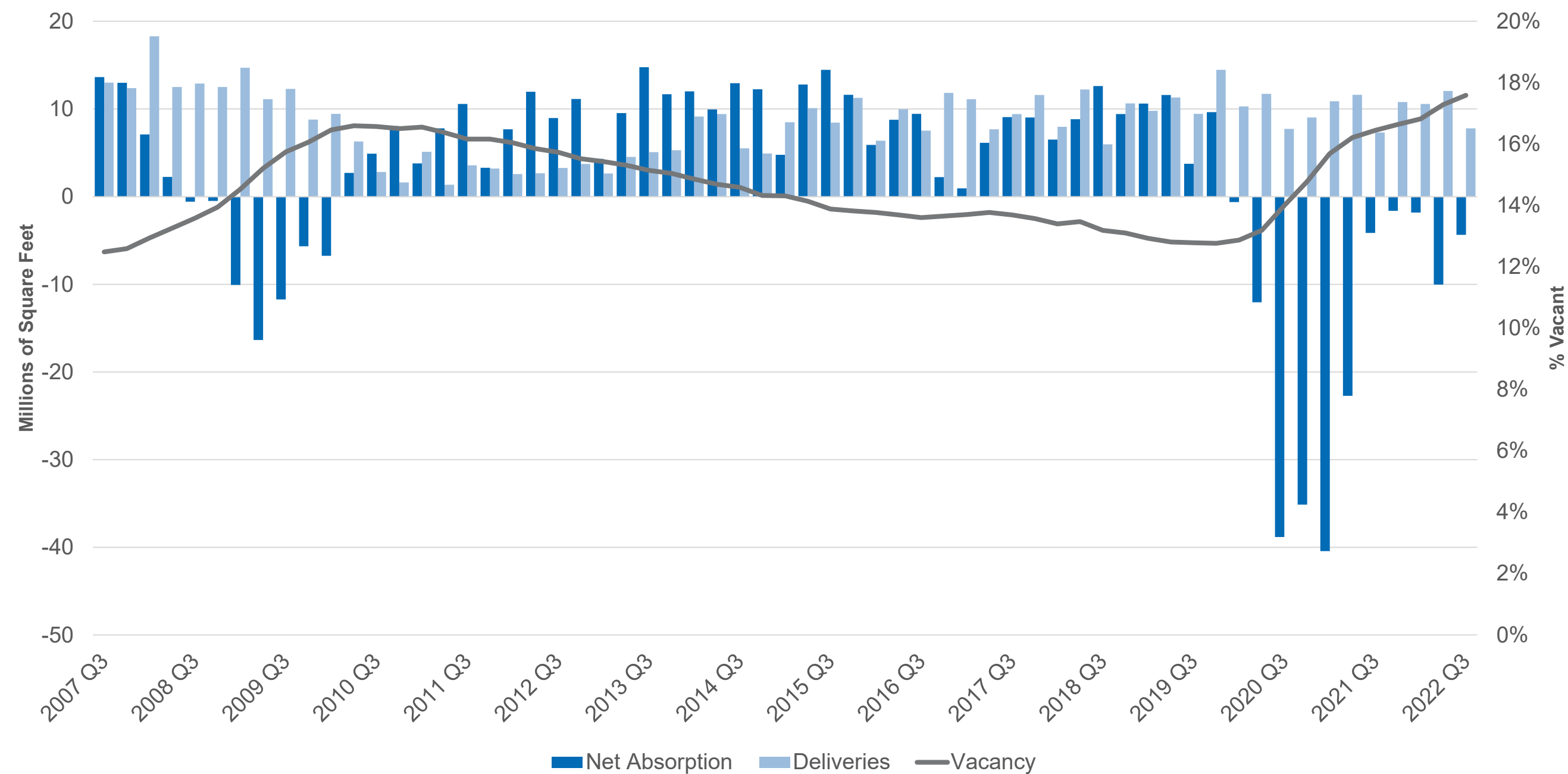
Sublease Availability Rate as a Percentage of Total Inventory



The Market Continued to Shed Space in 3Q22

Since the first quarter of 2020, net absorption has totaled negative 171.7 million square feet, significantly worse than either the Great Recession (negative 51.6 million square feet) or dot-com (negative 75.7 million square feet) market downturns. Concurrently, the national construction pipeline has steadily delivered net-new inventory. These supply and demand forces have worked in concert to drive vacancy to its highest levels in the cycle, reaching 17.6% in the third quarter of 2022.

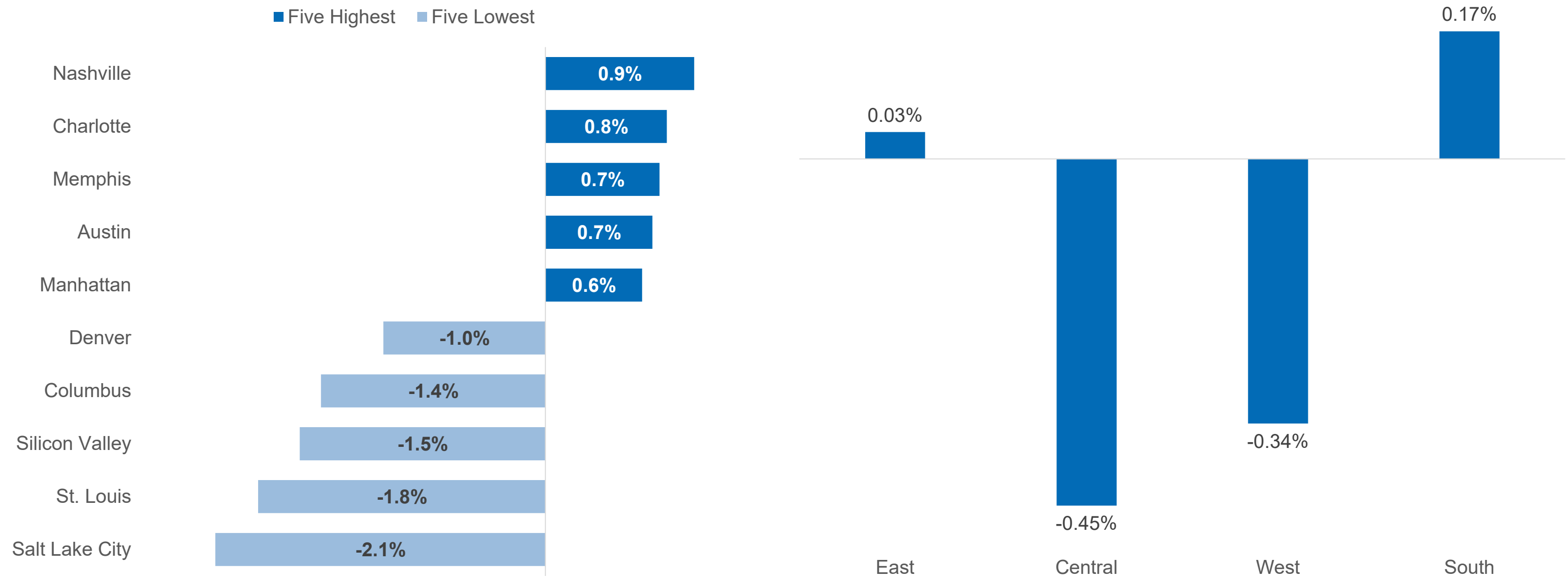
Supply and Demand: Net Absorption, New Construction Deliveries, and Vacancy



Net Absorption by Market

Major gateway markets recorded modestly net-positive occupancy growth in the third quarter of 2022, an improvement from the steady declines measured for much of the last two years. Still, overall net demand is low as recovery in office occupancy continues to lag in most markets. In aggregate, the South continues to outperform other regions, exhibiting the highest net absorption as a percentage of occupied space, supported by markets like Nashville, Charlotte, Memphis and Austin.

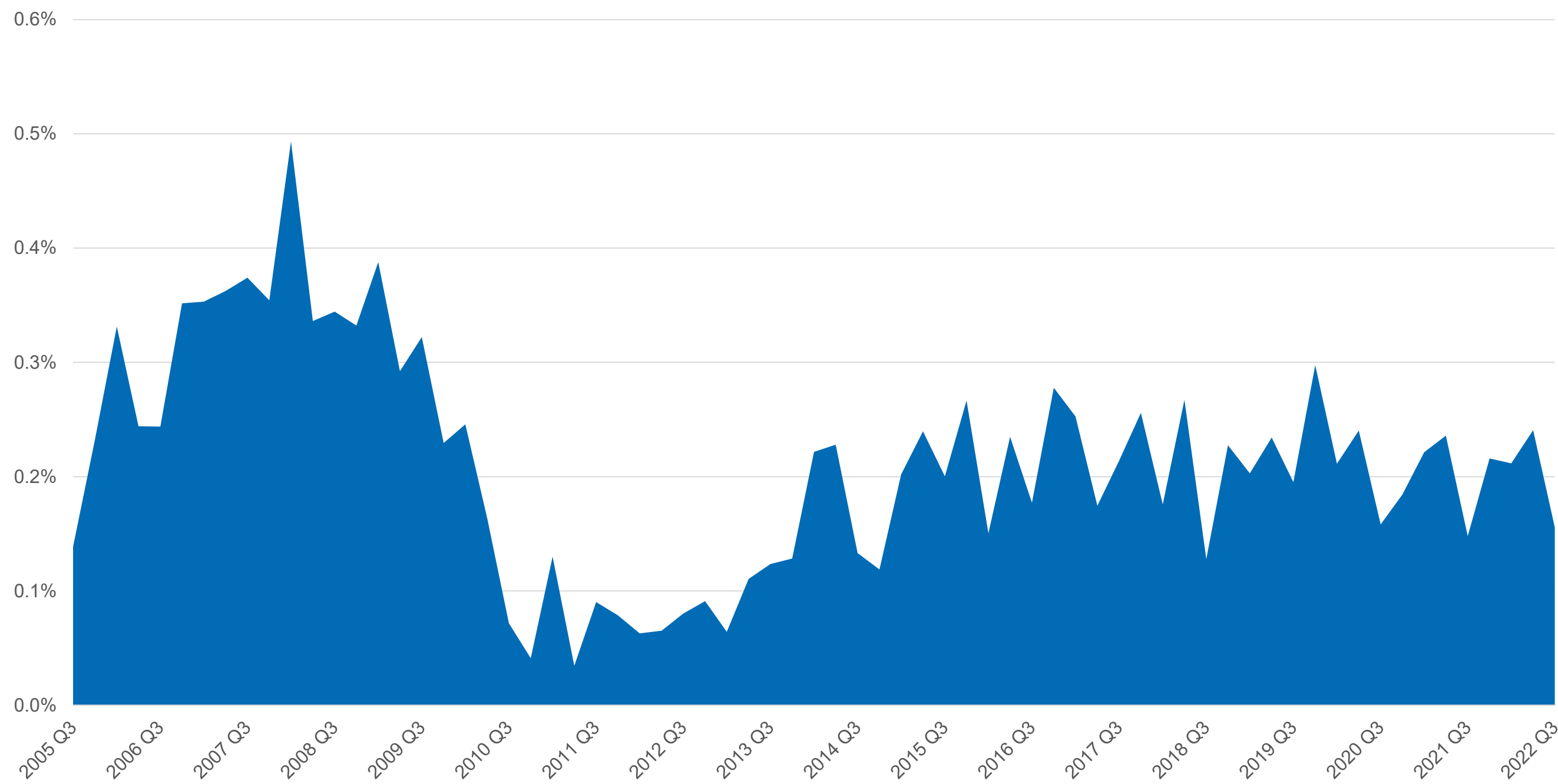
Third Quarter 2022 Net Absorption as a Percentage of Occupied Space



Market Fundamentals: Supply Dynamics - Deliveries

The pace of deliveries decreased modestly in the third quarter of 2022 but remains roughly consistent with pre-pandemic levels. The pace of future deliveries is likely to slow, as evidenced by the contraction in the construction pipeline. While the data suggests demolitions are within a normal range, market commentary indicates that this could increase in the coming years due to accelerated obsolescence of commodity office stock.

Office Deliveries as Percent of Inventory

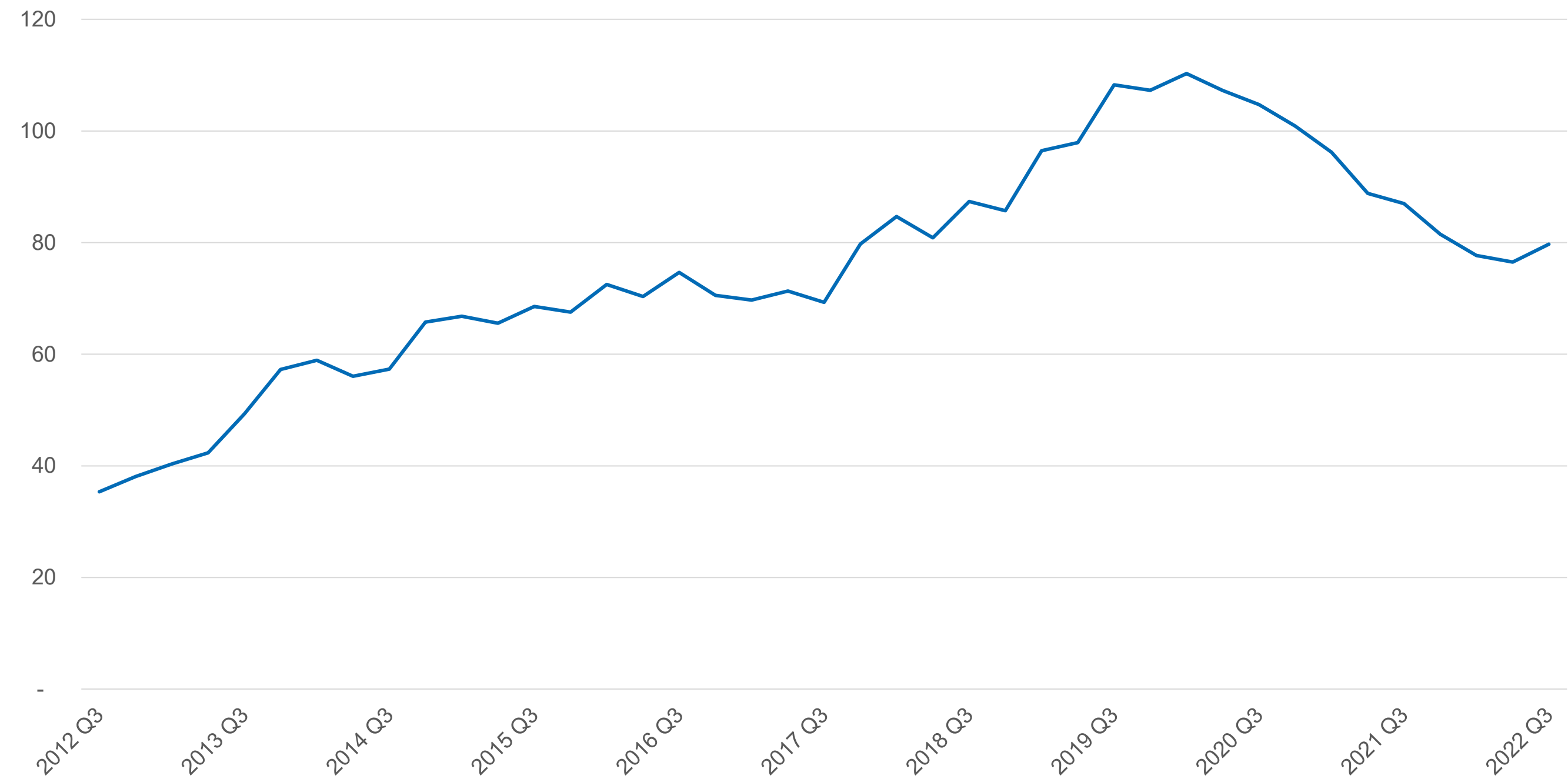


Sources: CoStar, Newmark Research

Market Fundamentals: Supply Dynamics - Pipeline

Office space under construction peaked in mid-2019 at over 110 million square feet, but the pipeline has since slowed to about 80 million square feet, similar to 2017 levels before the recent construction boom. Though the pipeline modestly increased in the third quarter of 2022, it is expected to trend downward in the coming years, which will help office markets adjust to the impact of hybrid work on demand. Much of the pipeline is concentrated in fast-growing tech and Sun Belt markets, notably Austin, Seattle, San Diego and Miami.

Total Square Footage Under Construction In Millions

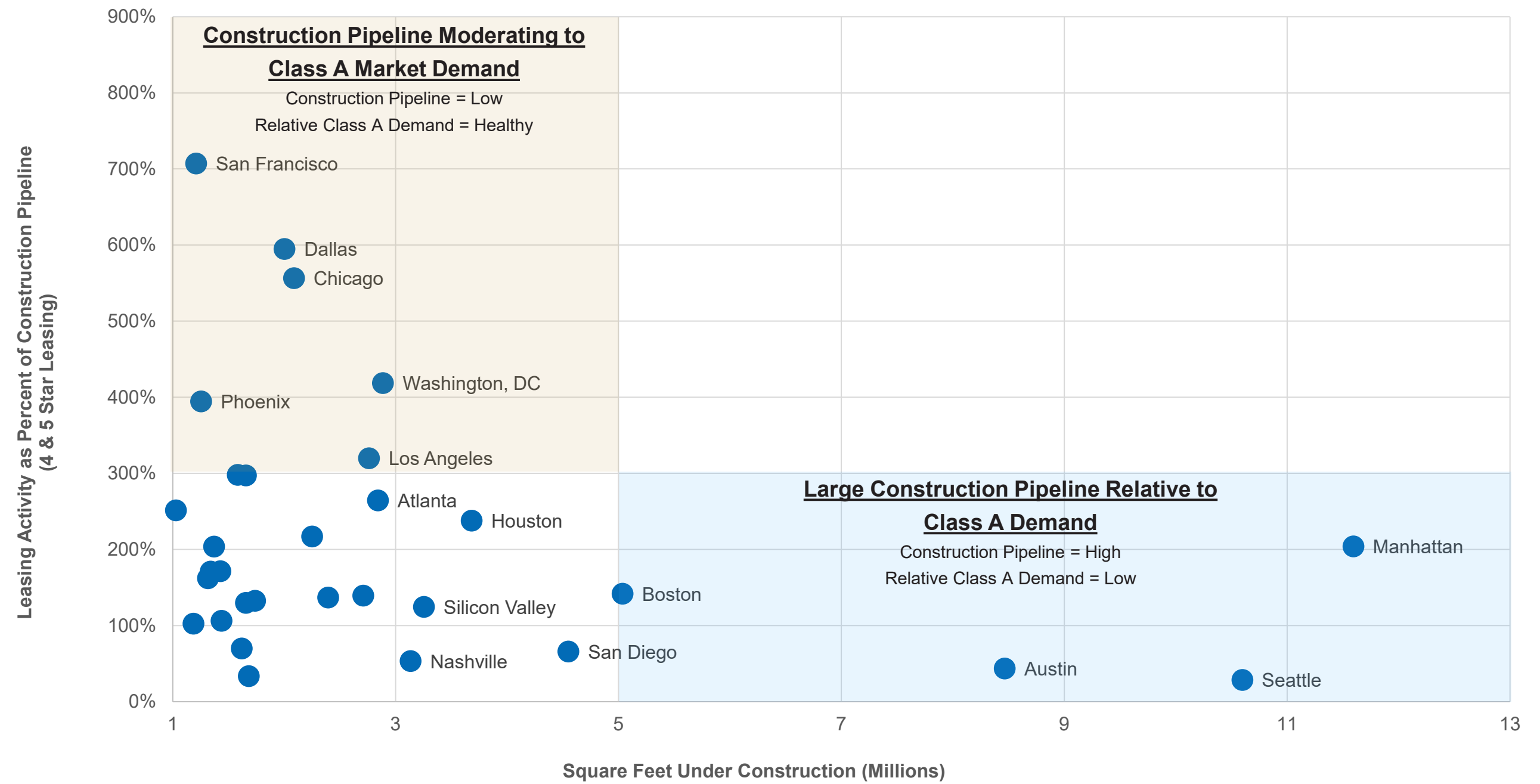


Sources: CoStar, Newmark Research

Markets Seek Balanced Supply and Demand

The national construction cycle is trending down, which will help to manage inventory expansion, but high construction and low demand in some markets will sustain imbalanced office conditions. Among markets with the largest total construction pipelines, including Manhattan, Seattle and Austin, relative Class A leasing activity is low, suggesting these markets are poorly positioned to reduce vacancy and availability. Conversely, large markets with modest construction pipelines, like San Francisco, Dallas and Chicago, may be in a better position to achieve more balanced supply and demand.

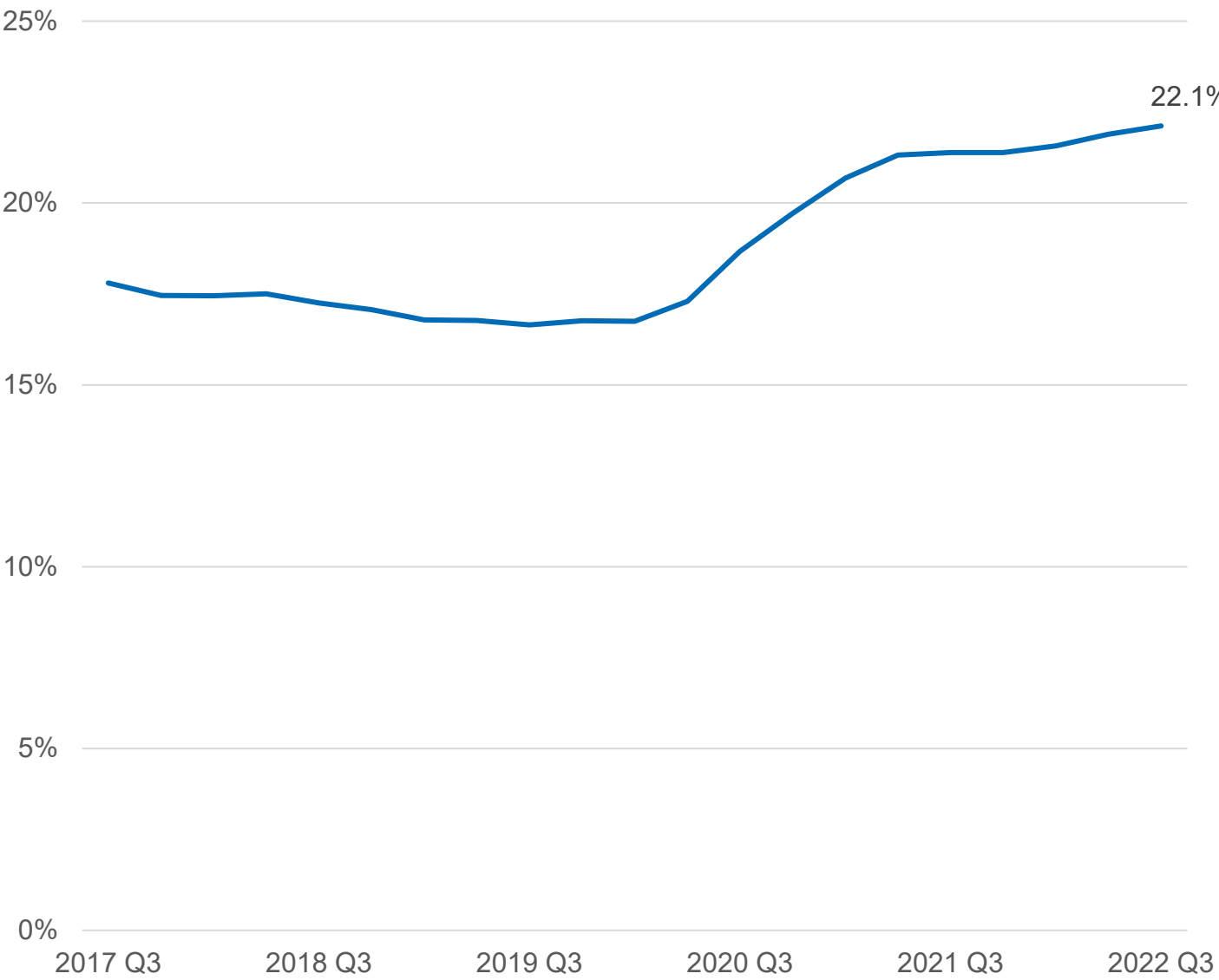
2022 Leasing Activity as a Percentage of Construction Pipeline (Markets with >1 million square feet under construction)



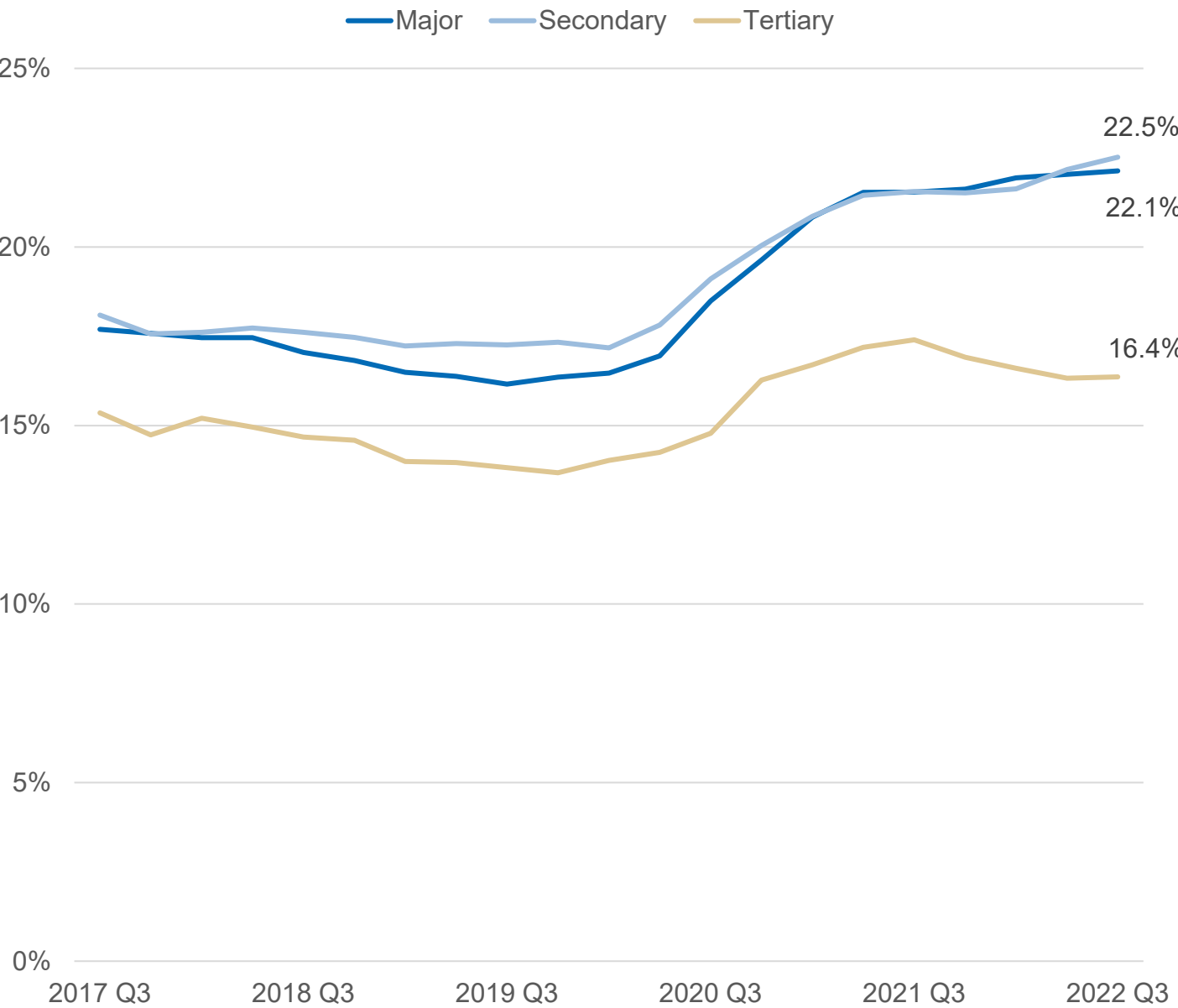
Availability Rates Have Not Yet Peaked

Availability rates increased in the third quarter of 2022, which was chiefly supported by secondary markets. Over the last year, major and tertiary markets have recorded stabilizing availability levels, despite more noticeable softening of other fundamentals. A slowing construction pipeline is aiding this stabilization of availability in many markets.

National Office Market Availability Rate



Availability Rate Comparison By Market Size

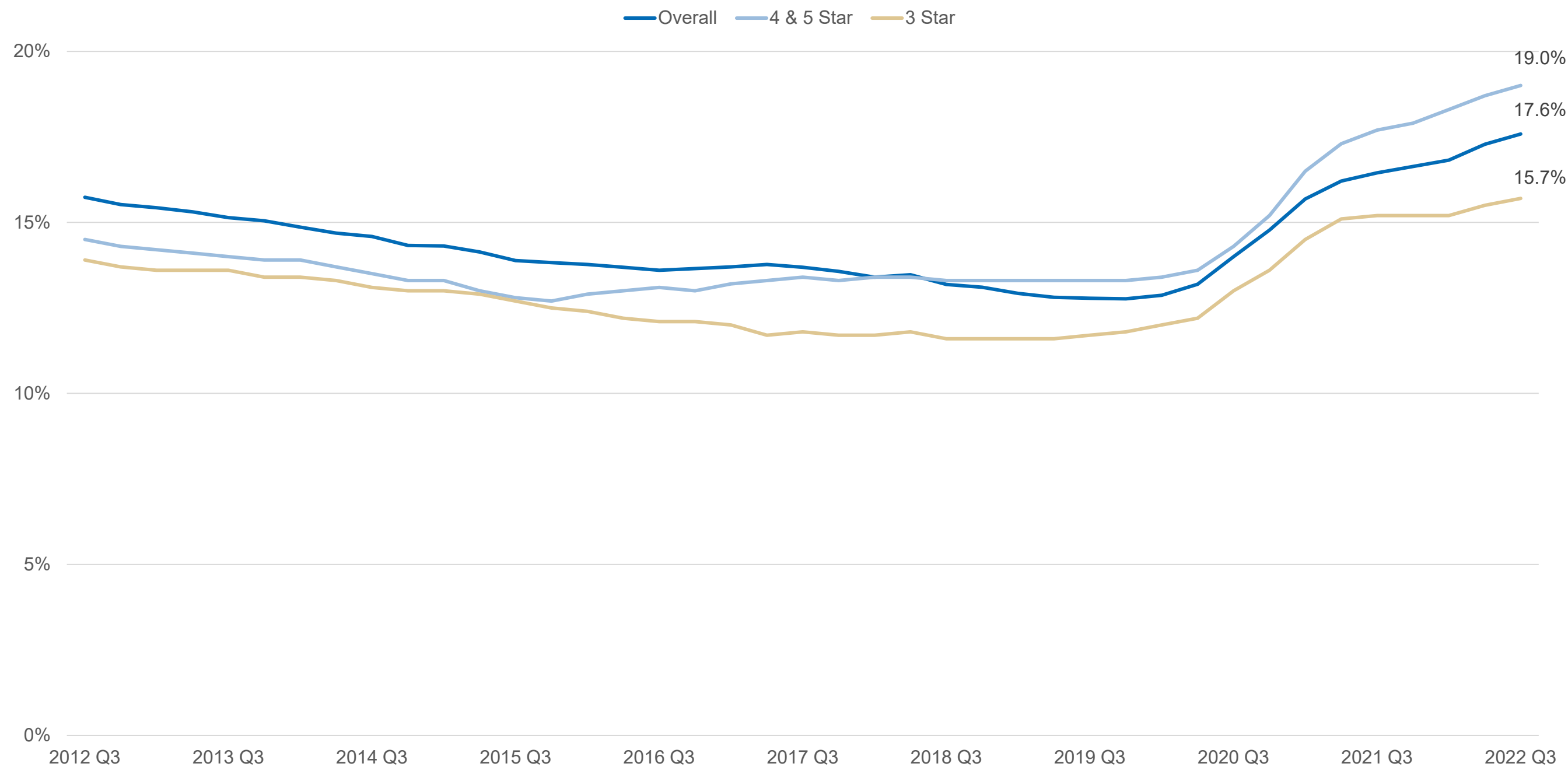


Sources: CoStar, Newmark Research

Inventory Expansion and Occupancy Losses Steadily Drive Vacancy

Vacancy rates have been steadily rising throughout the pandemic across buildings of all quality levels.

National Office Market Vacancy Rate By Class

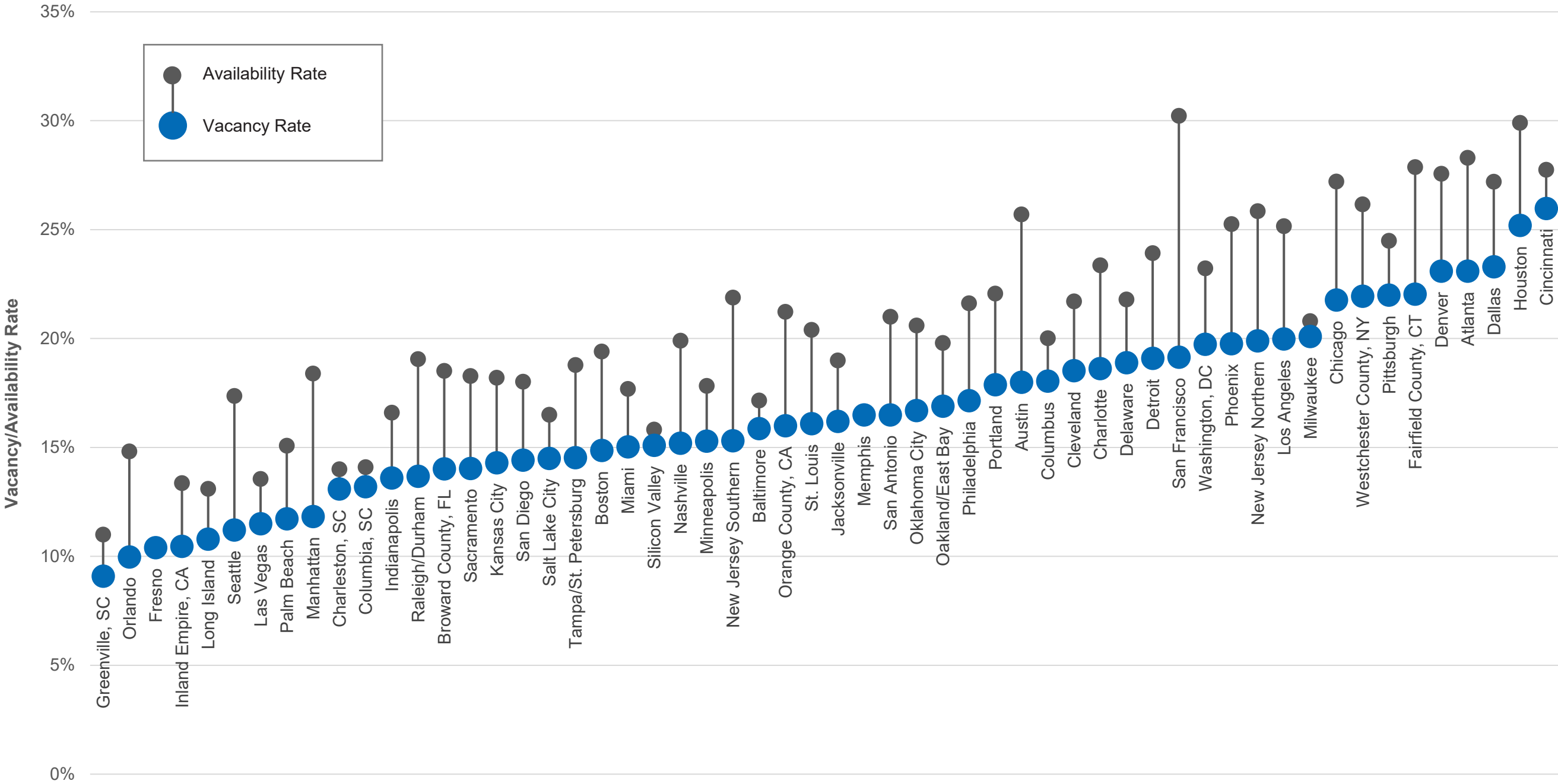


Source: CoStar, Newmark Research

Vacancy and Availability by Market

Both vacancy and availability have largely been trending up over the last two years, but the degree to which markets have experienced these increases has varied. Generally, the healthiest and most stable markets are those exhibiting low vacancy and a narrow spread with availability. Primary gateway markets have been most challenged by rising vacancy and availability, due to downsizing and increasing sublease inventory, and tend to exhibit less-stabilized vacancy and availability rates.

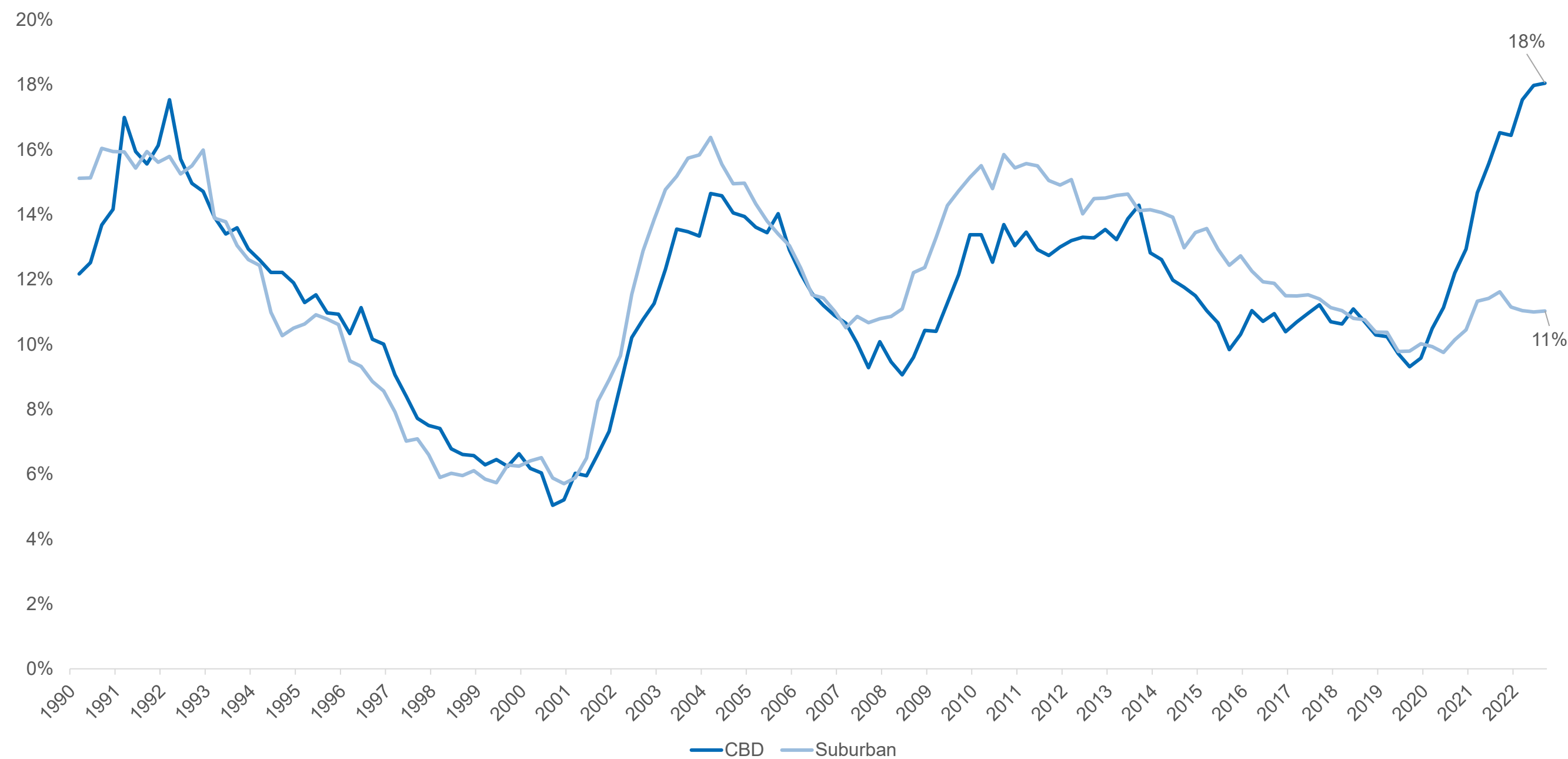
Vacancy and Availability Rate by Market



Institutional Properties More Resilient, Especially in the Suburbs

Overall institutional office vacancy increased by 3 bps quarter-over-quarter/13 bps year-over-year, to 13.0% in the third quarter of 2022. This marks a cumulative 3.1% increase from December 2019. In the past two office market downturns, institutional vacancy rose 5.1% (2008 to 2009) and 10.4% (2000 to 2001). Employment has recovered more quickly than in either of those episodes while the supply overhang is less severe compared to 2000 to 2001. On the other hand, the secular challenge of hybrid work is at play today and will continue to drive the adjustment. Even so, we can observe first that the institutional segment has been less impacted thus far compared to the overall market; and second that vacancies have risen acutely for CBD assets (+8.5%) as compared with institutional suburban assets (+1.0%).

NCREIF National Property Index Office Vacancy Rate



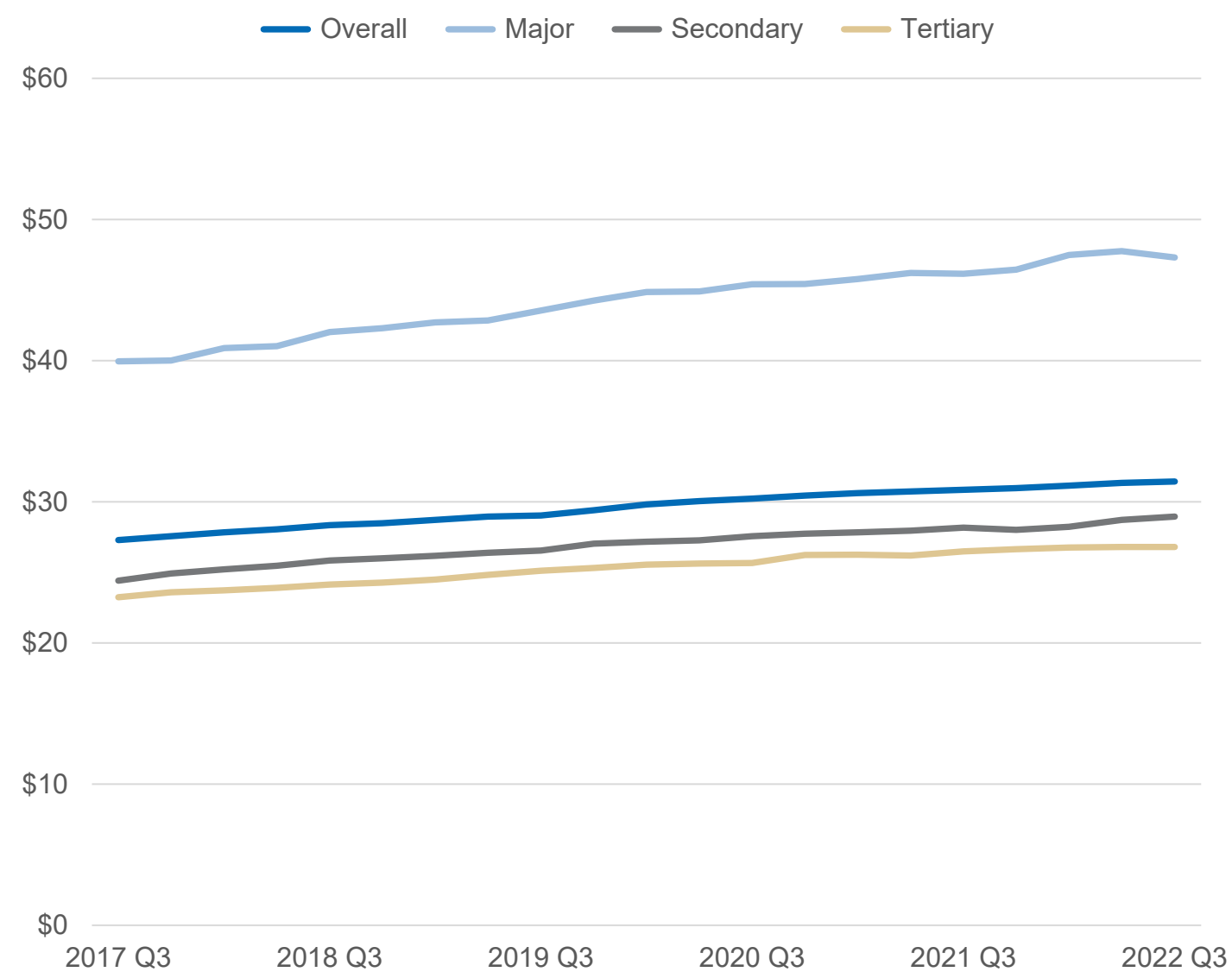
Sources: NCREIF, Newmark Research

*We use the NCREIF National Property Index as a proxy for the national institutional grade office market.

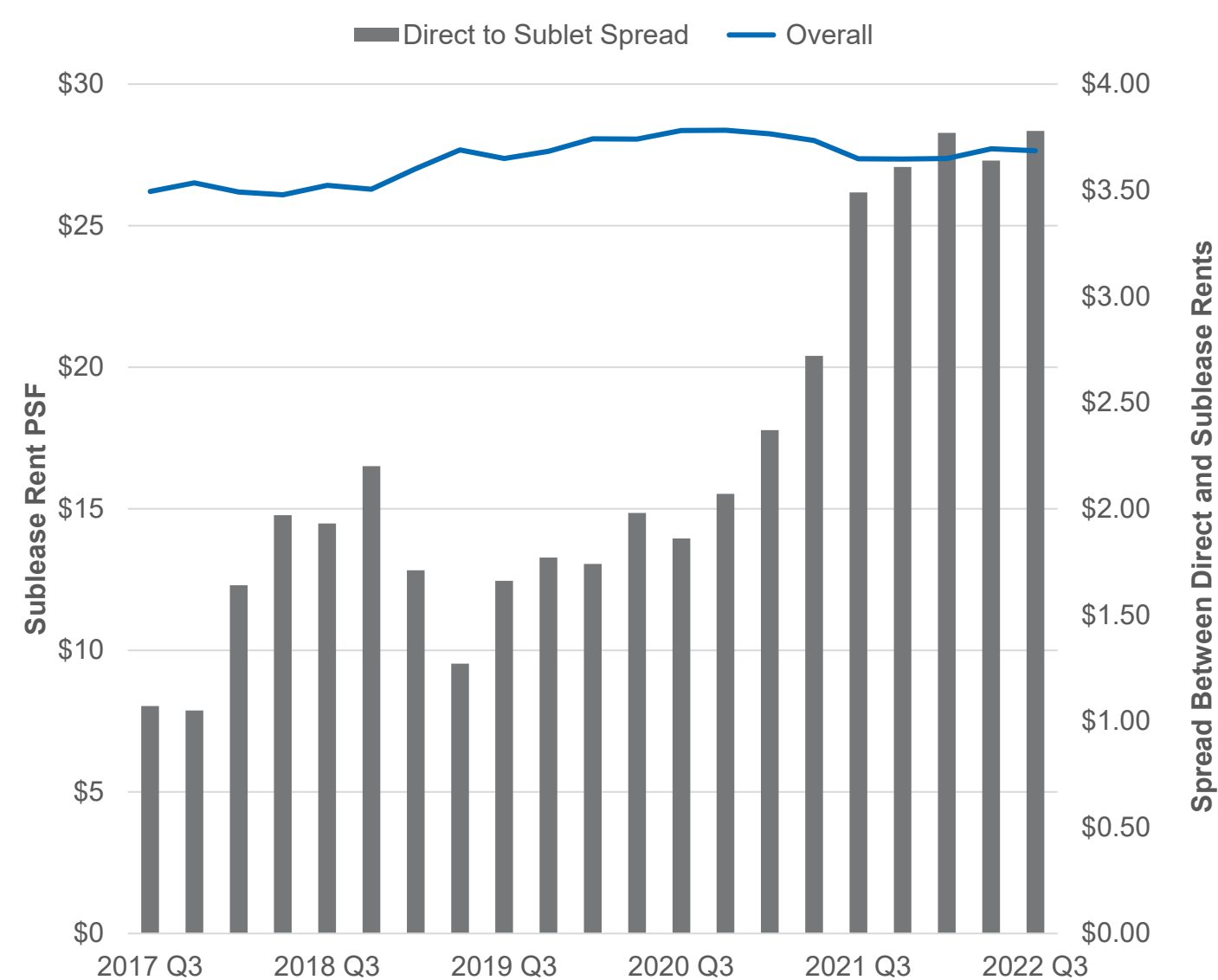
Asking Rents March On, Despite All

In past cycles, asking rents have adjusted downward to account for depressed demand; however, rents have largely held value since the onset of the pandemic. Some rent compression is being experienced among major markets, but secondary markets continue to drive appreciation. Sublease rents have been holding relatively flat for much of the last three years, which more visibly exhibits the impact of low demand. As a result, the spread between sublease space and direct space has only widened.

Overall Asking Rents Up 1.9% YoY in Q3, Led Secondaries



Sublet Rents Have Stabilized and Modestly Appreciated in Third Quarter

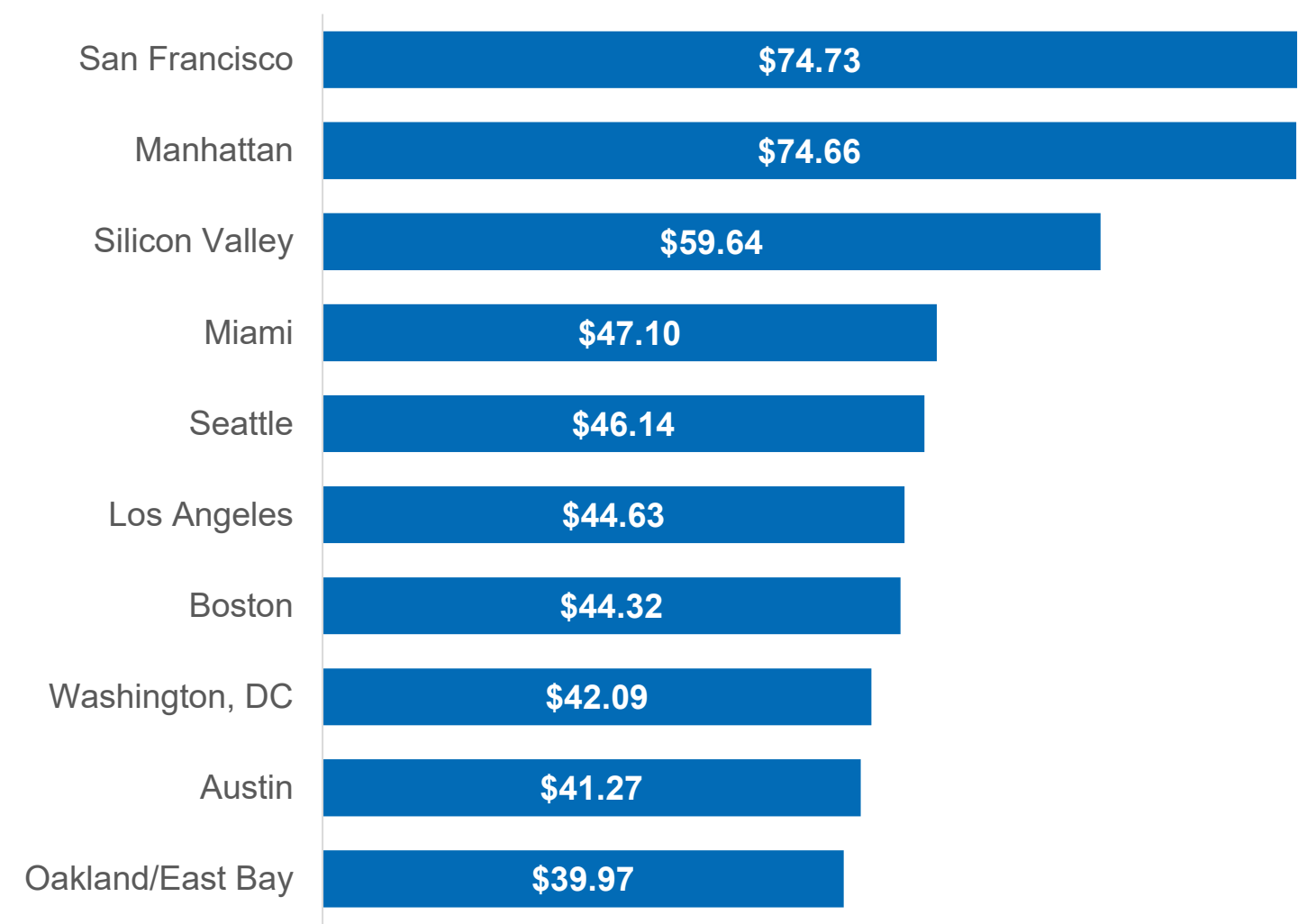


Rent Growth Varies by Market

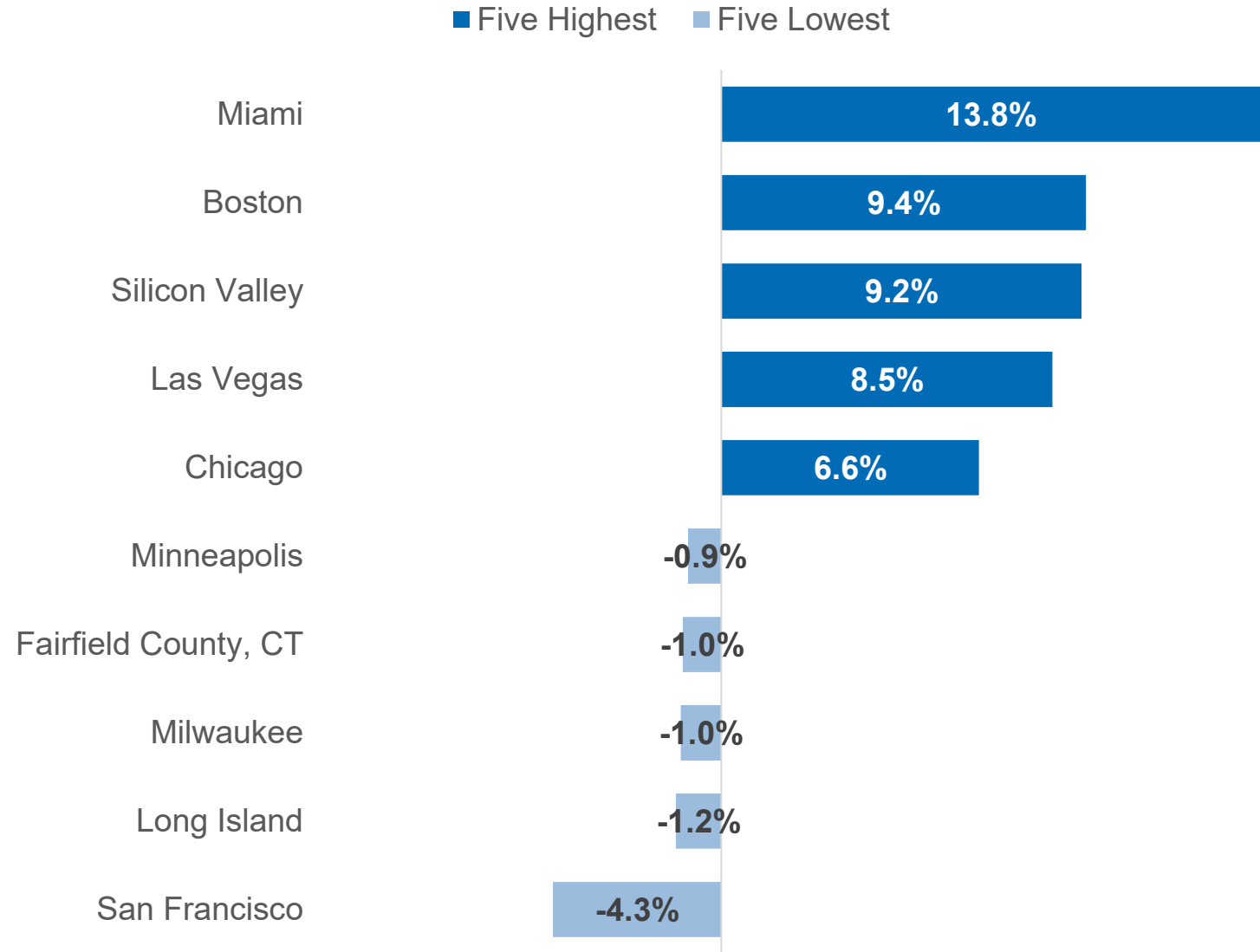
Overall asking rents are most elevated in major coastal markets, including San Francisco, Manhattan and Silicon Valley. Secondary markets that experienced significant inventory growth in recent years have recorded noteworthy rises in average asking rents. Despite the economic headwinds present in the third quarter of 2022, face rates in most markets indicate stability; however, effective rents are under downward pressure and modest rent compression is being felt in some markets.

Third Quarter 2022 Overall Rent Comparison

Top 10 Overall Asking Rents



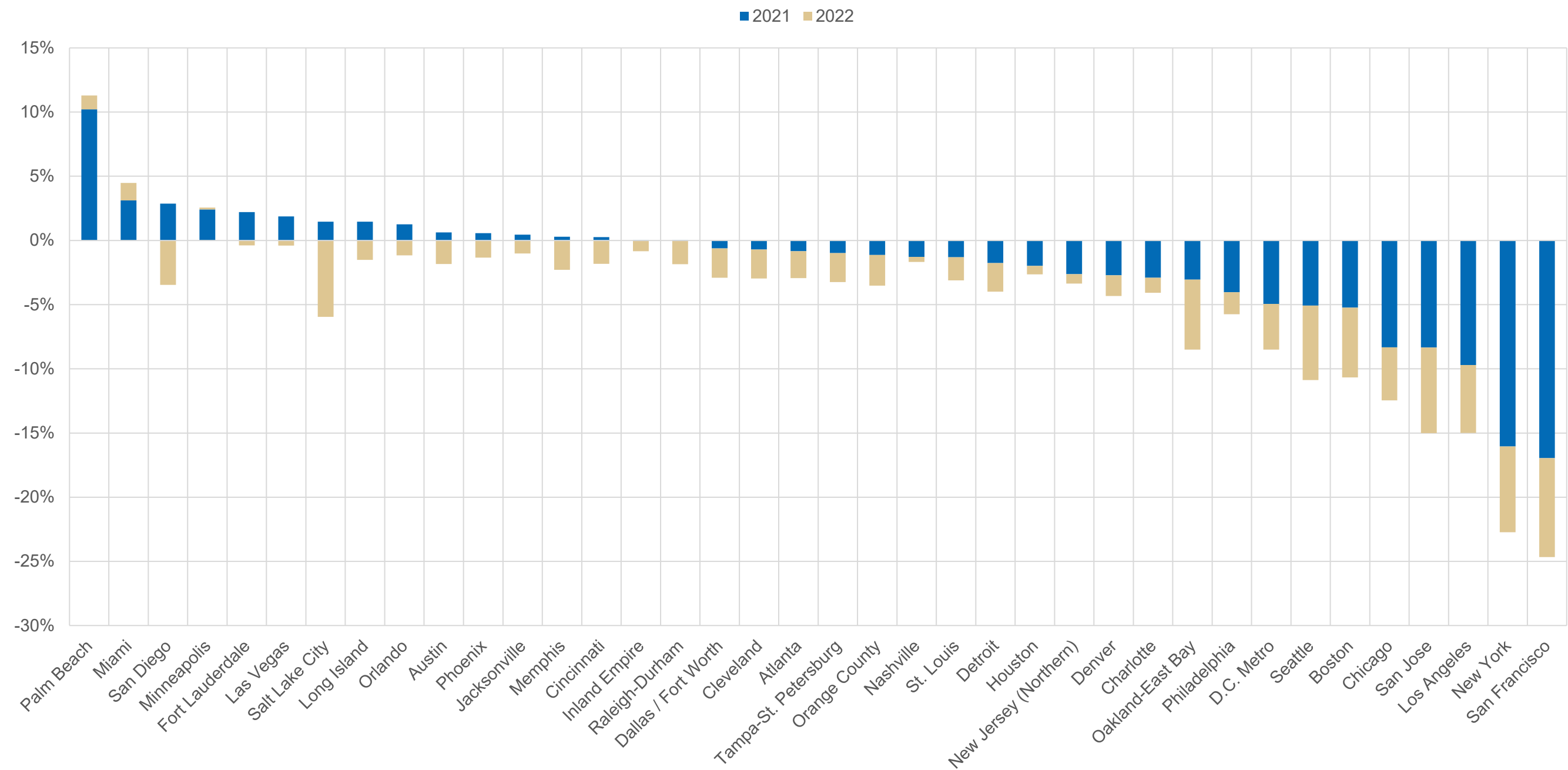
Annual Overall Asking Rent – Five Top and Bottom Growth Markets



Secondary Sun Belt Markets Outperforming

Market revenue per available foot combines the impact of changes in effective rents and occupancy to produce a measure of overall leasing market performance. Declines have been widespread across the top 50 U.S. office markets with highly urban gateway markets experiencing the worst impacts. Several Sun Belt markets recorded RevPAF growth in 2021, but conditions have recoiled RevPAR optimism in 2022. Exceptions notably include Palm Beach and Miami.

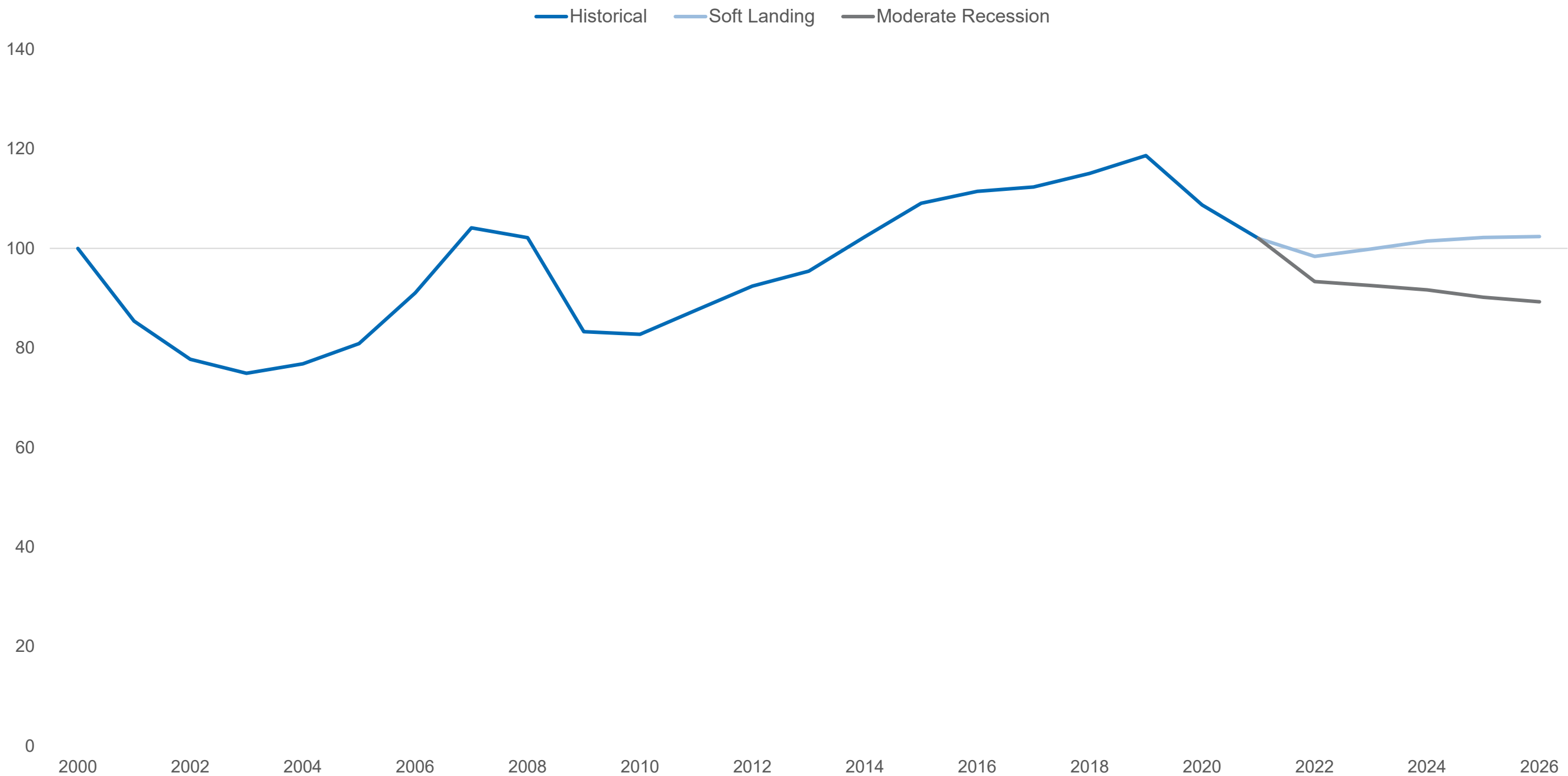
M-RevPAF Growth (2021 – Q3 2022)



Office Fundamentals Likely to Remain Under Pressure Across Economic Scenarios

Market revenue per available foot has been trending downward in 2022, and its recovery will be impacted by the depth of the recessionary pressures in the period ahead. Under a soft-landing economic scenario, M-RevPAF is expected to oscillate around the baseline growth set in 2000; however, a moderate recession could result in continued contraction in M-RevPAF into 2026.

Green Street M-RevPAF (December 2000 = 100)



Sources: Green Street, Newmark Research

3Q22 US OFFICE MARKET OVERVIEW

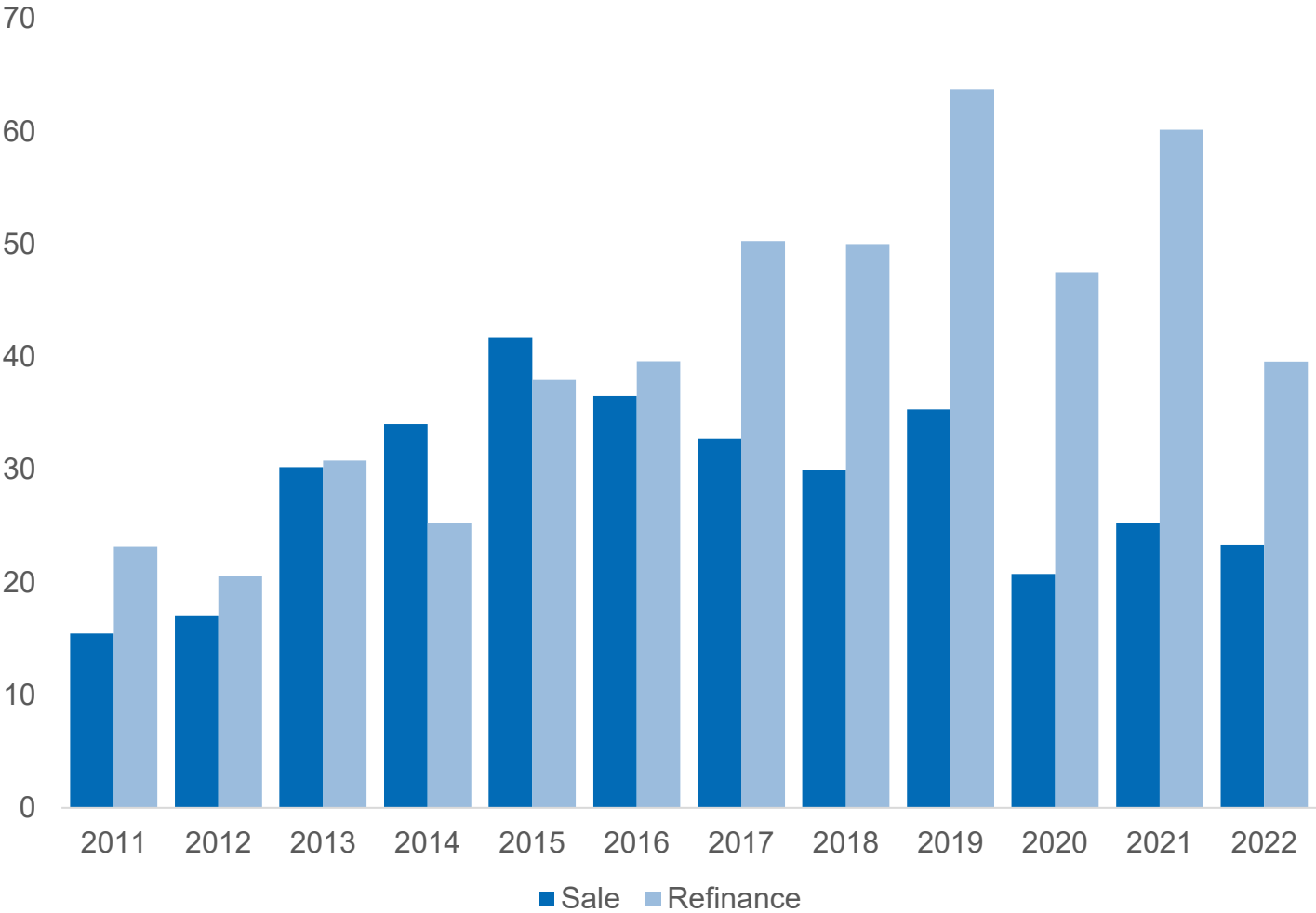
Office Capital Markets



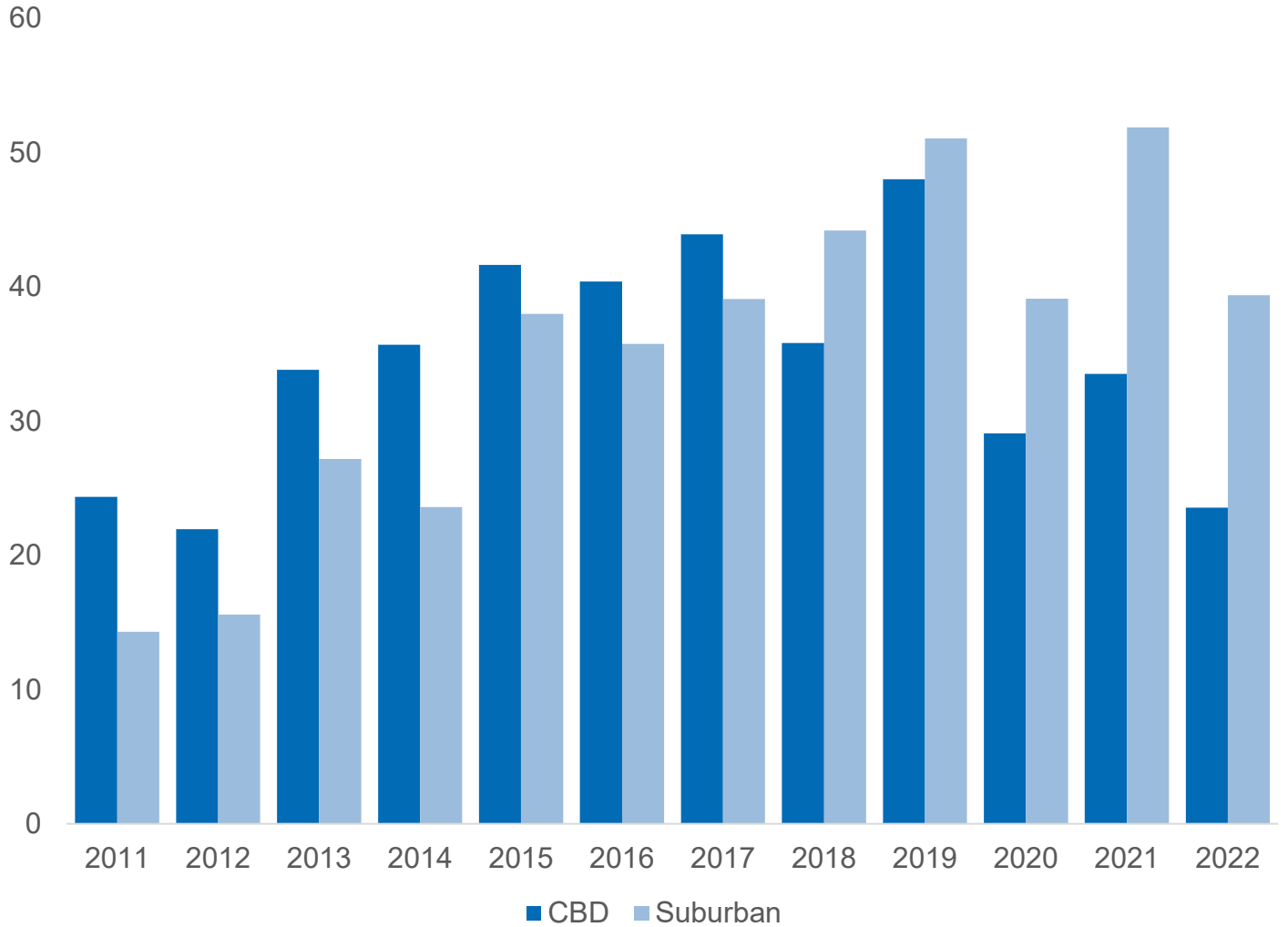
Office Loan Originations Down About 23% Year-to-Date Compared to 2021

Office Loan Origination Volumes: Year-to-September

Refinancing Volume Down 34% YoY Amid Rising Rates, Thinner Lender Pool



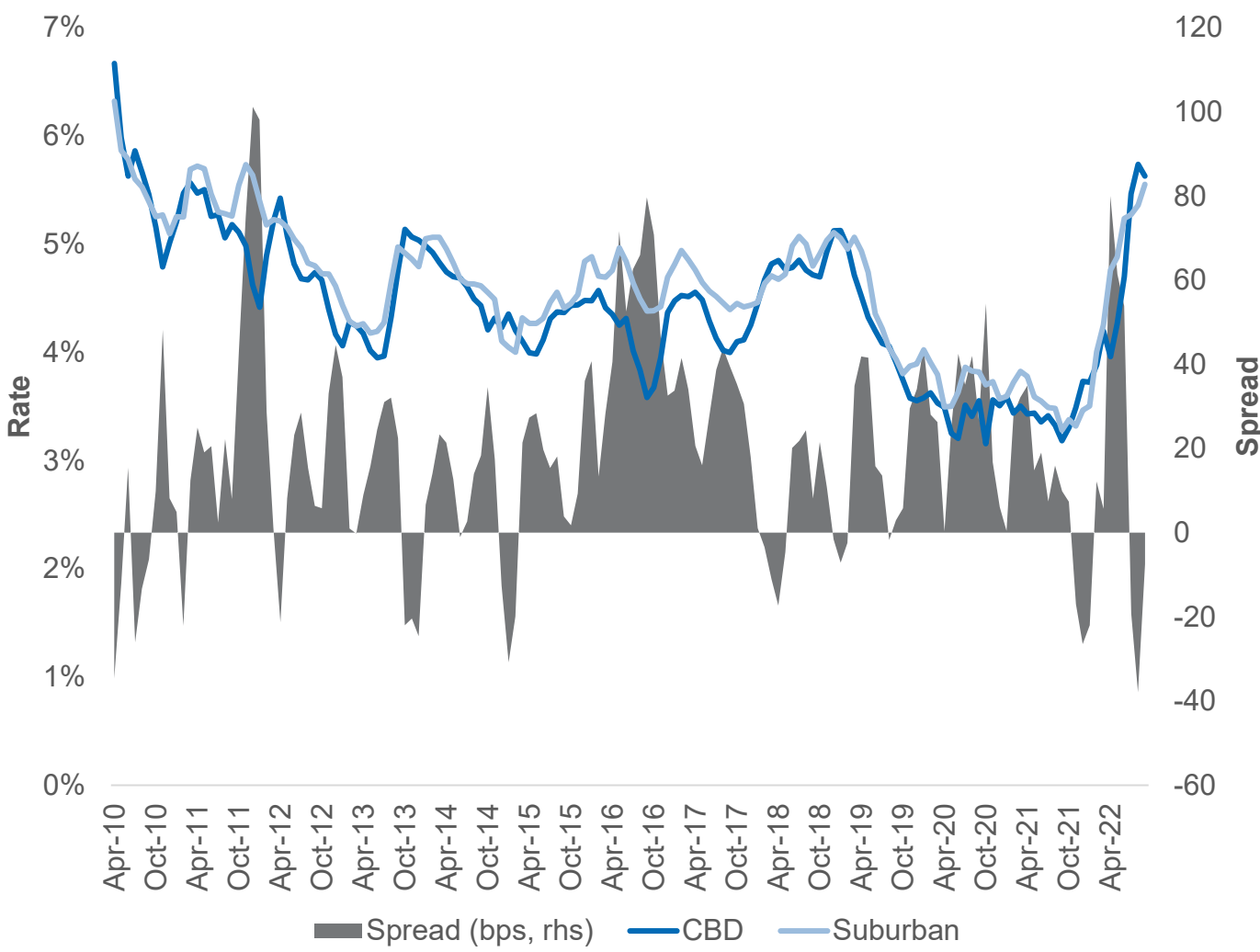
Both CBD and Suburban Originations Down Sharply



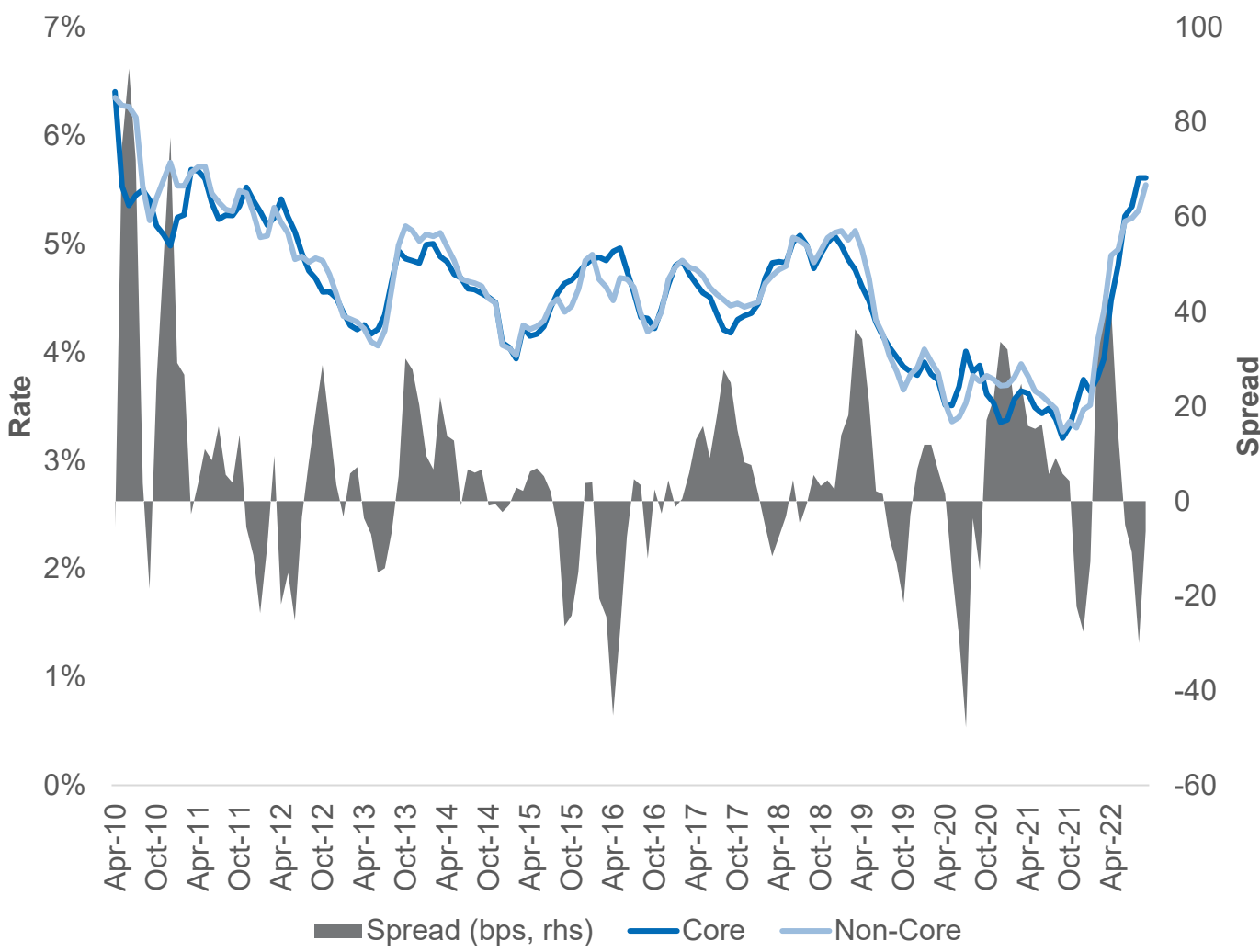
Debt Costs Have Risen Sharply and Are Likely to Rise Further

Median Transaction Fixed Finance Rate; Rolling Three-Month

Fixed Finance Costs Up 2.4% YoY, Suburban Debt Costs Below CBD



Little Differentiation Between Core and Non-Core Office Properties, Though Subject to Selection Bias Particularly for Non-Core Properties

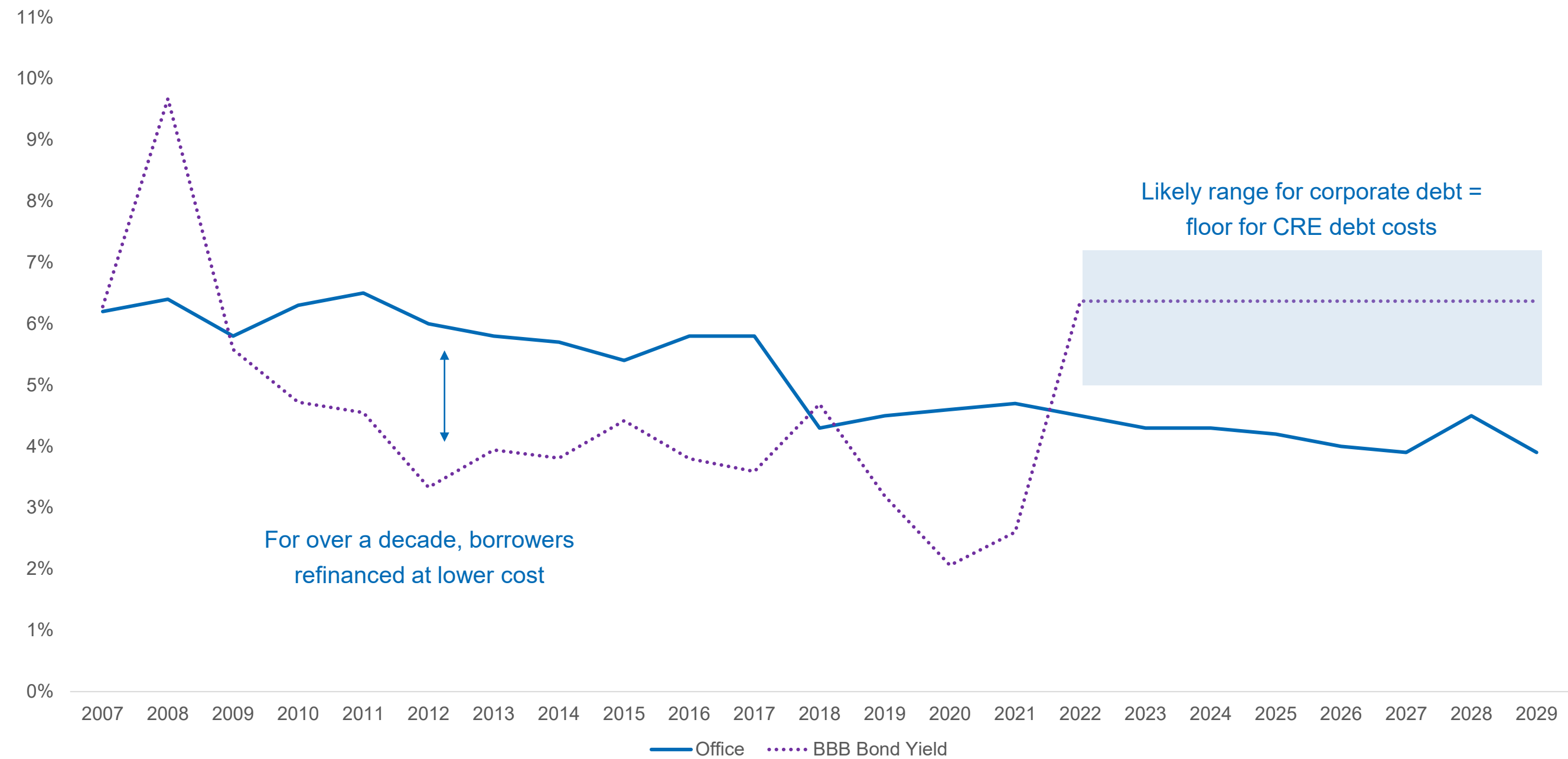


Source: RCA, Newmark Research
Note: Excludes construction financing

Borrowers Will Face Starkly Higher Costs as Loans Mature

Higher debt costs on refinancing will lower return for all and will give rise to a range of reactions within the market. Some borrowers will choose to pay down their debt, especially if the asset has appreciated meaningfully. Others will refinance the principal or partially pay down, whereas in a lower cost of capital environment, they would have re-levered. Still others will be unable to make the math work and will need to pursue a loan modification, return the keys and/or source rescue equity at an appropriate price point.

Weighted Average Interest Rate on Maturing Debt vs. Prevailing Bond Yields

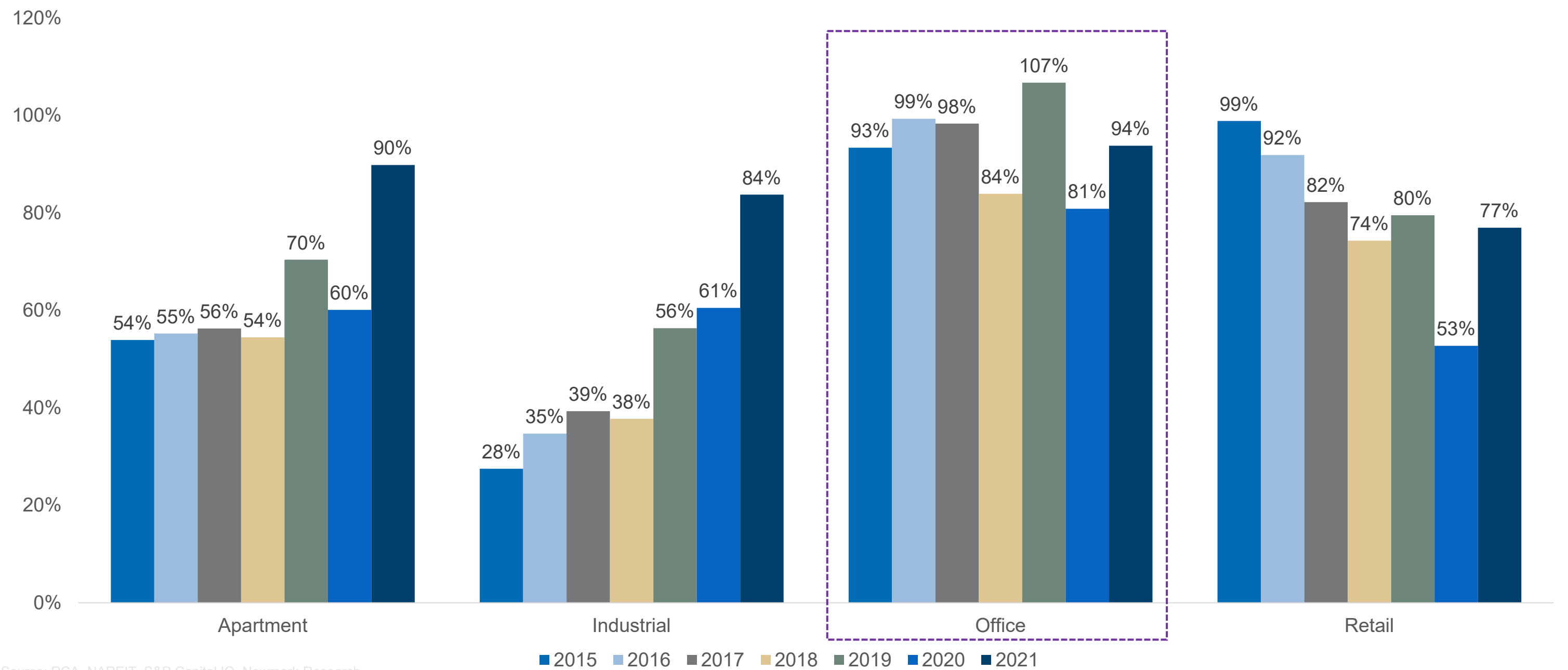


Source: RCA, ICE Data Indices, Newmark Research

But Falling Asset Values Means That Some Loans Are Underwater

Mark-to-market leverage levels are extremely elevated for recent vintages of office loan originations. Even if financing costs were better contained, this would imply a significant increase in distress, but combined with the doubling in debt costs, a wide range of property loans are likely to require some manner of restructuring or rescue capital.

Mark-to-Market* Loan-to-Value Ratio by Year Debt Originated



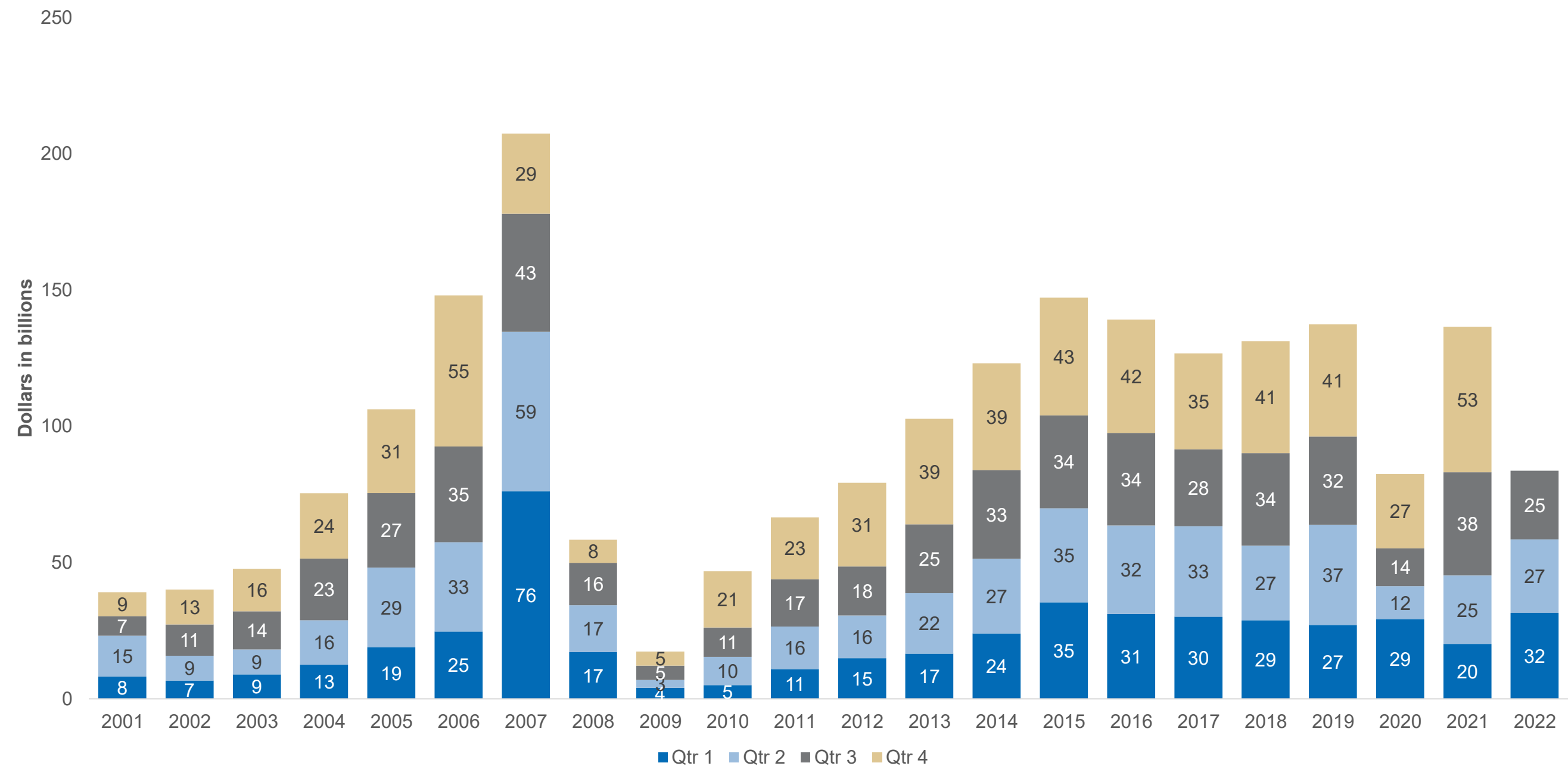
Source: RCA, NAREIT, S&P Capital IQ, Newmark Research

*We take the average LTV in a given year and then increase the value of the denominator by the cumulative price return of the corresponding NAREIT property sector index since the year the loan was originated. For example, apartment loans made in 2005 had an average LTV of 68%. We would then increase the denominator by the cumulative REIT price return from 2006-2022 YTD.

Office Investment Sales Volumes Down 33% Year-over-Year in 3Q22

Office volumes were the highest since 2015 in the first quarter of the year, partly due to some deals in the fourth quarter of 2021 having delayed closings. The market was not able to sustain this pace of activity in the second quarter of 2022 with sales falling about 15% quarter-over-quarter to \$27.0 billion. Deal velocity continued to decelerate in the third quarter of 2022, down about 6% quarter-over-quarter. Year-to-date sales volumes are on-par with 2021, but activity in the fourth quarter of 2022 is likely to be weak and certainly weaker than record volumes achieved in late 2021.

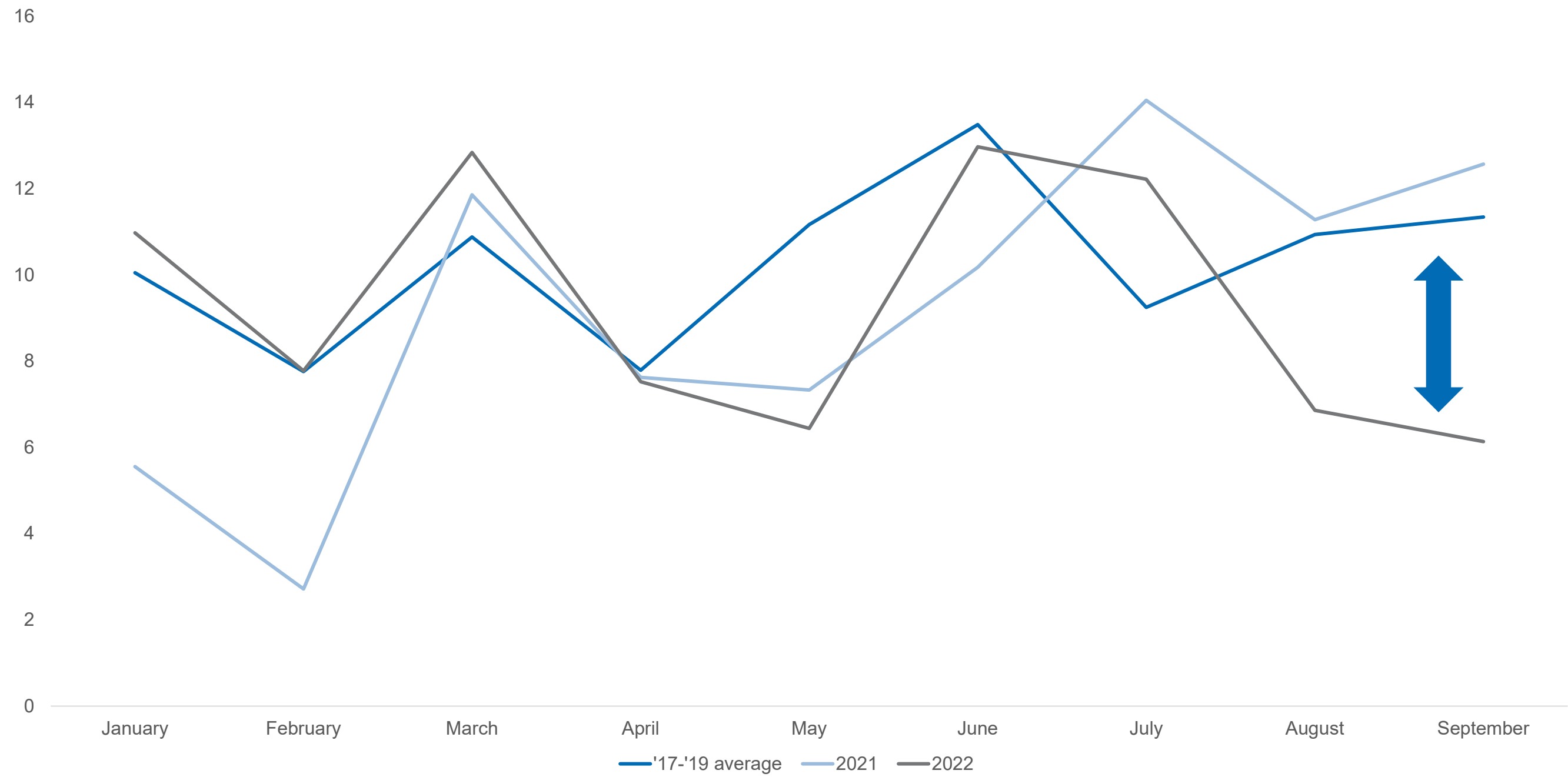
Office Investment Sales Volume



Transaction Velocity Has Declined Sharply in Recent Months

September Sales Volume Down About 52% Year-over-Year

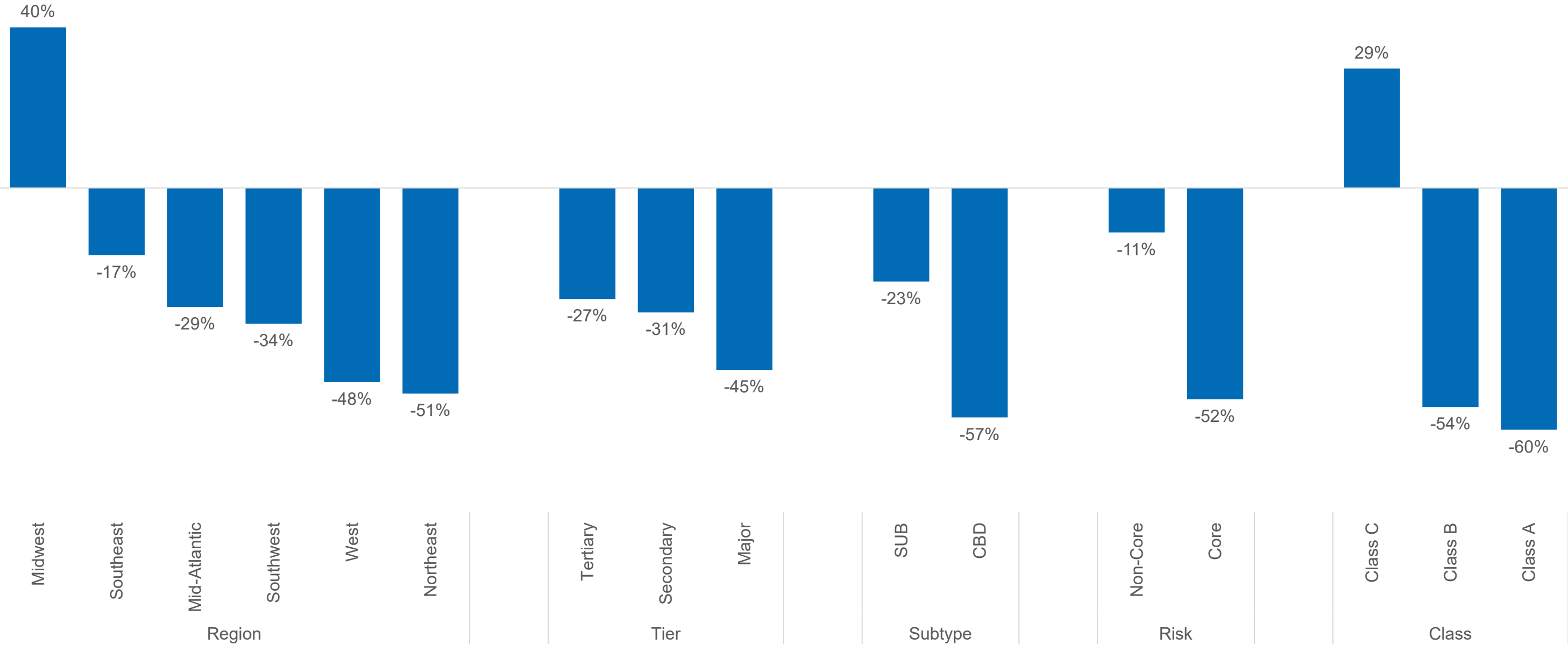
National Office Investment Sales Volume (\$B)



Broad-Based Decline in Volumes in 3Q22

The Midwest region and Class C office were the only market segments to register a year-over-year increase in volumes in the third quarter of 2022. On the other hand, the West and Northeast regions, major gateway markets, CBD office and core investments decelerated most sharply.

Q3 2022 Investment Sales Volume YoY Percent Change



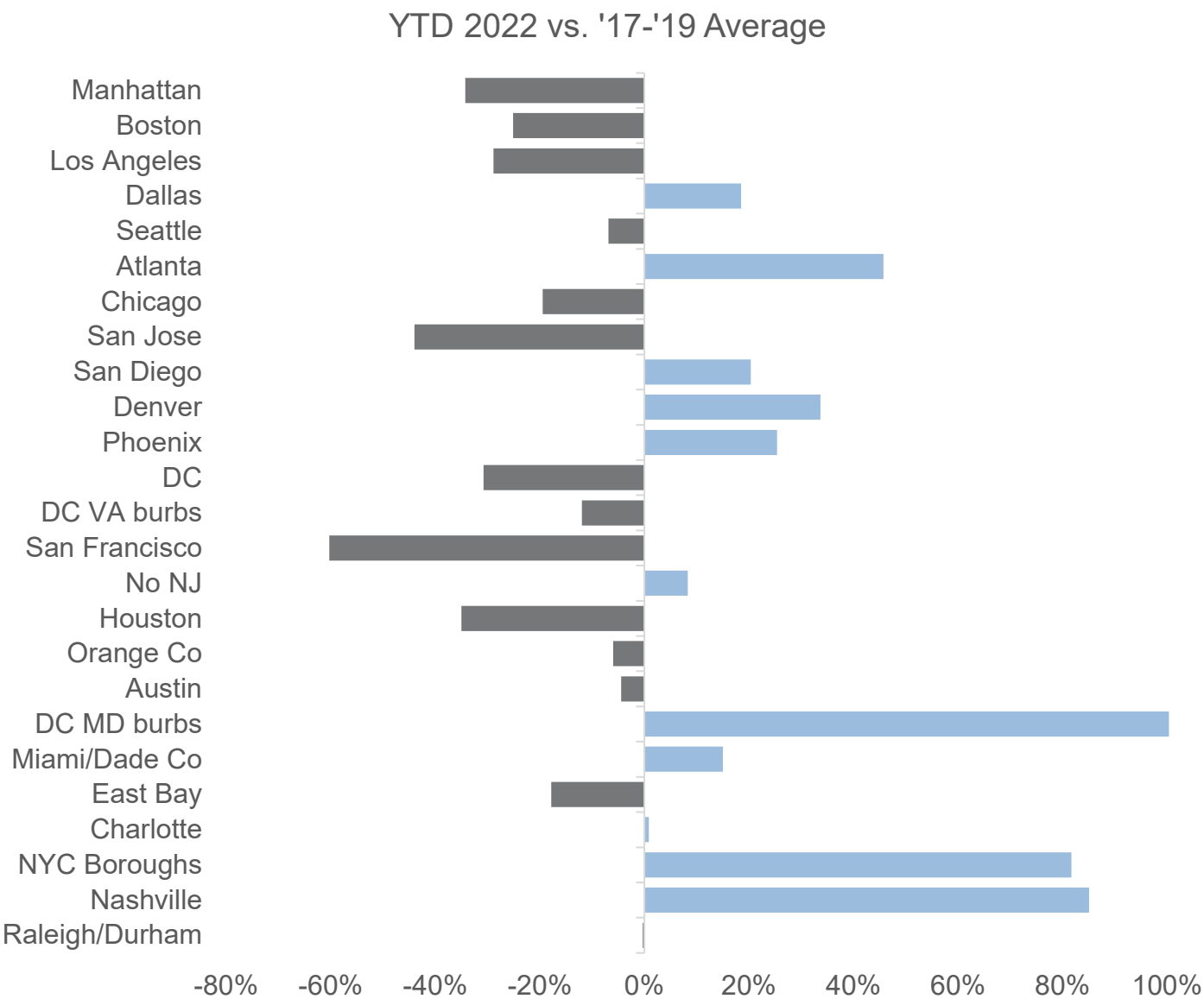
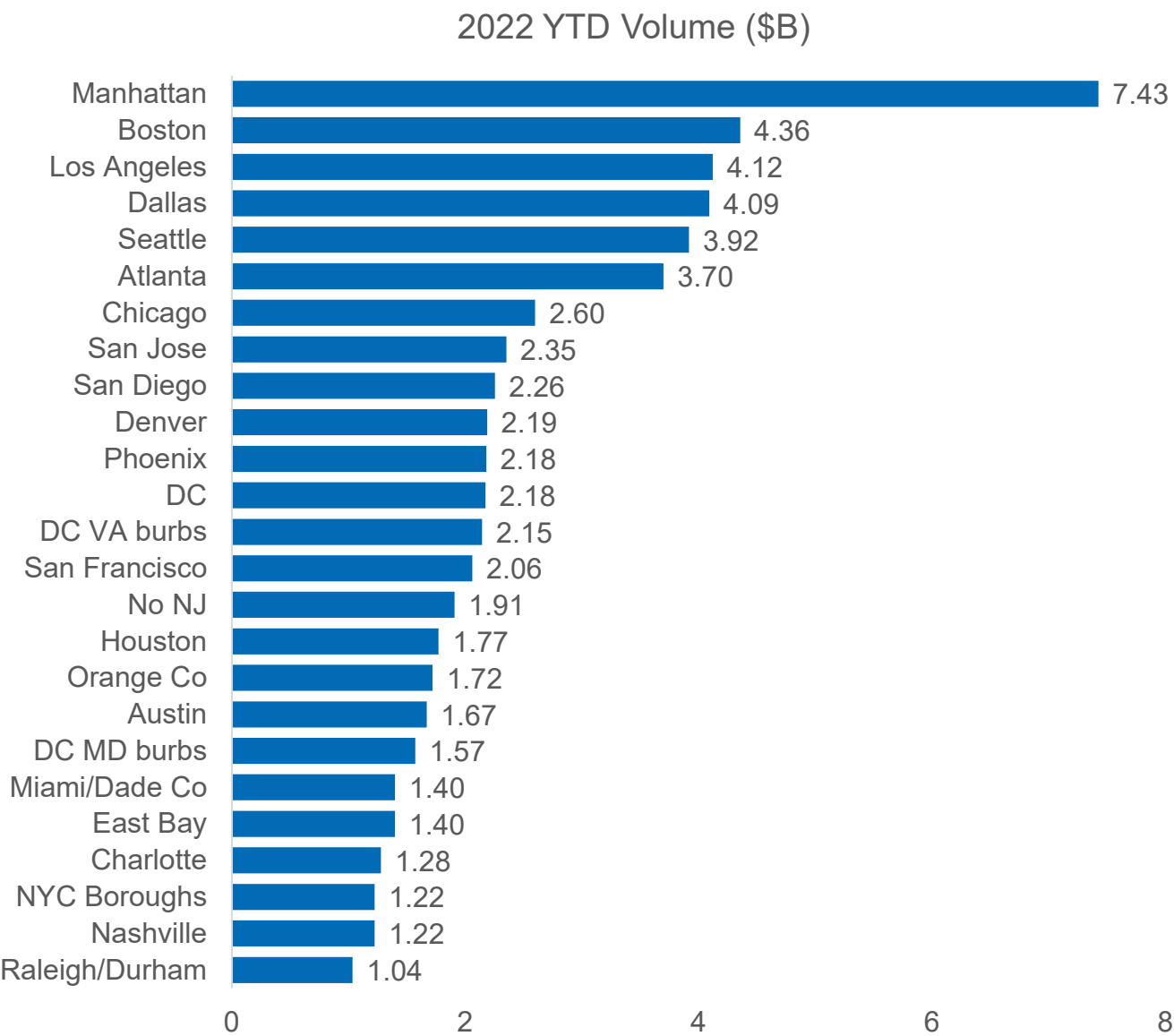
Source: Newmark Research, Real Capital Analytics

However, Volumes Up versus Pre-Pandemic in 11 out of 25 Top Markets

Top 25 Office Markets by Year-to-Date Investment Sales Volume

Manhattan Remains Most Liquid Market; Dallas, Seattle and Atlanta Now Consistently in the Top Ranks

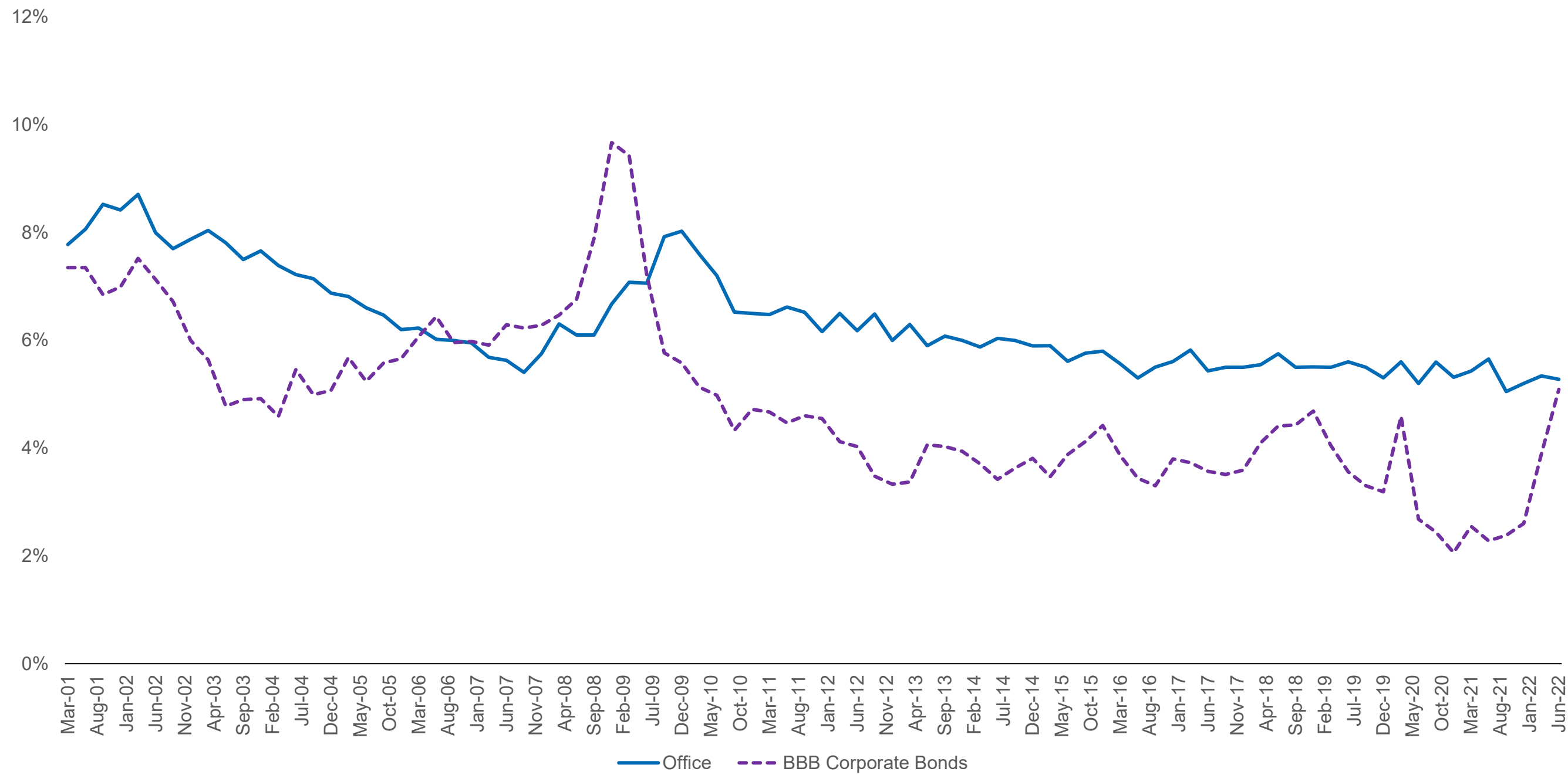
Gateway Markets Down; Sun Belt and Suburbs of Gateways Have Gained



Increasing Cost of Debt Placing Pressure on Cap Rates

Transaction cap rates have been surprisingly stable amid the twin pressures of increasing interest rates and below-average office leasing market activity stemming from hybrid work. The public markets have been more sensitive by comparison. In 2020, this represented a buying opportunity as REIT implied cap rates overreacted in the short term; however, in the current episode, the shoe is likely on the other foot with private market pricing needing to adjust. Commentary from the markets supports this conclusion with reports of thinning bidder pools and rising yields.

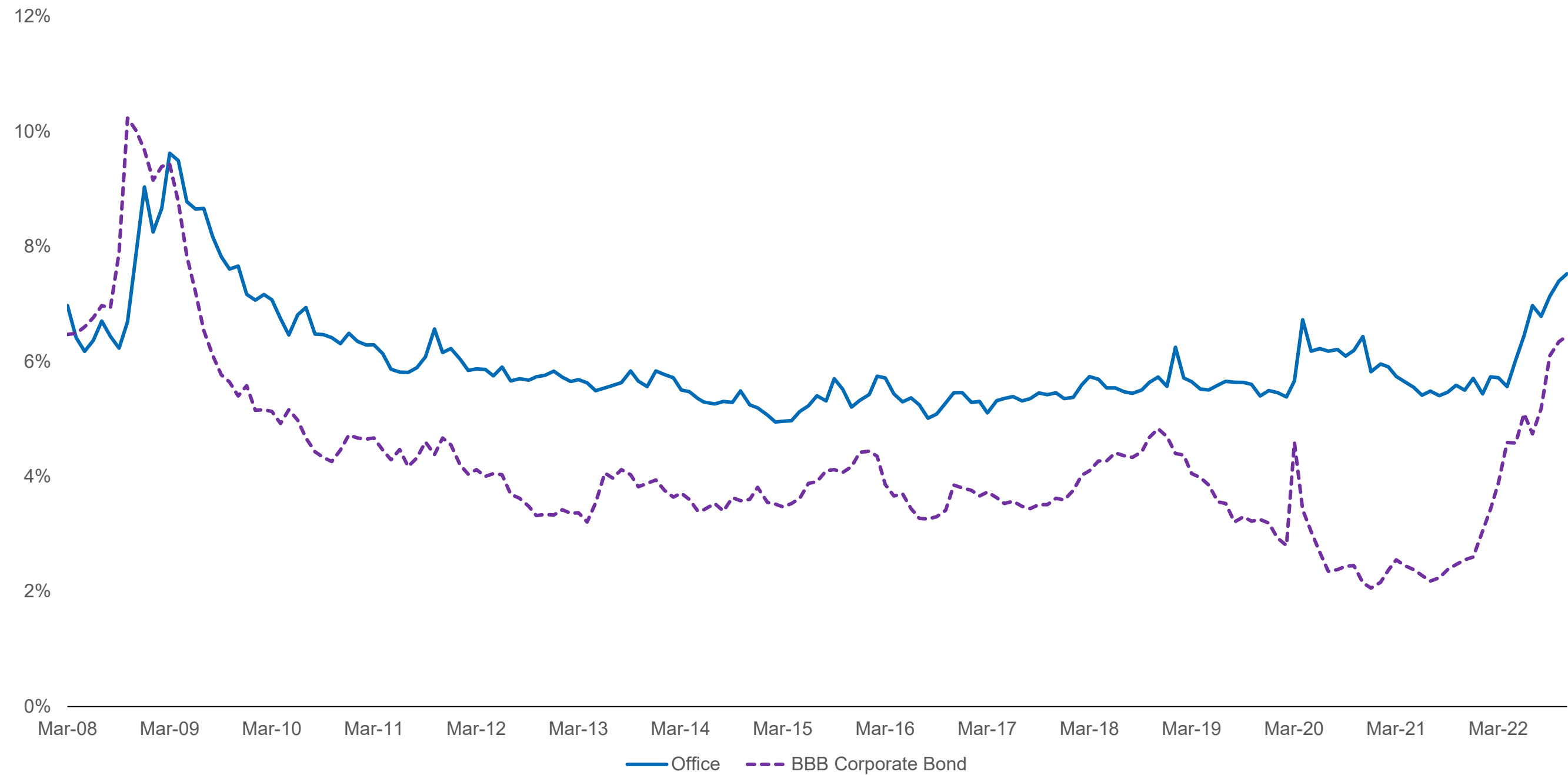
Top Quartile Transaction Cap Rate



Public Markets Presage Adjustment in Private Markets

Public markets have moved more quickly to reflect changing valuations. The change in corporate bond yields led the movement, suggesting that value adjustments thus far have mostly been due to general financial conditions, rather than any specific deterioration in property fundamentals. The same is true for the broader equity markets, where earnings growth forecasts remain robust, seemingly at odds with rising recessionary sentiment. As such, even if debt costs remain rangebound, changes in the economic, and ultimately, leasing market outlook could be a catalyst for further movement in cap rates and price performance.

REIT Implied Nominal Cap Rate

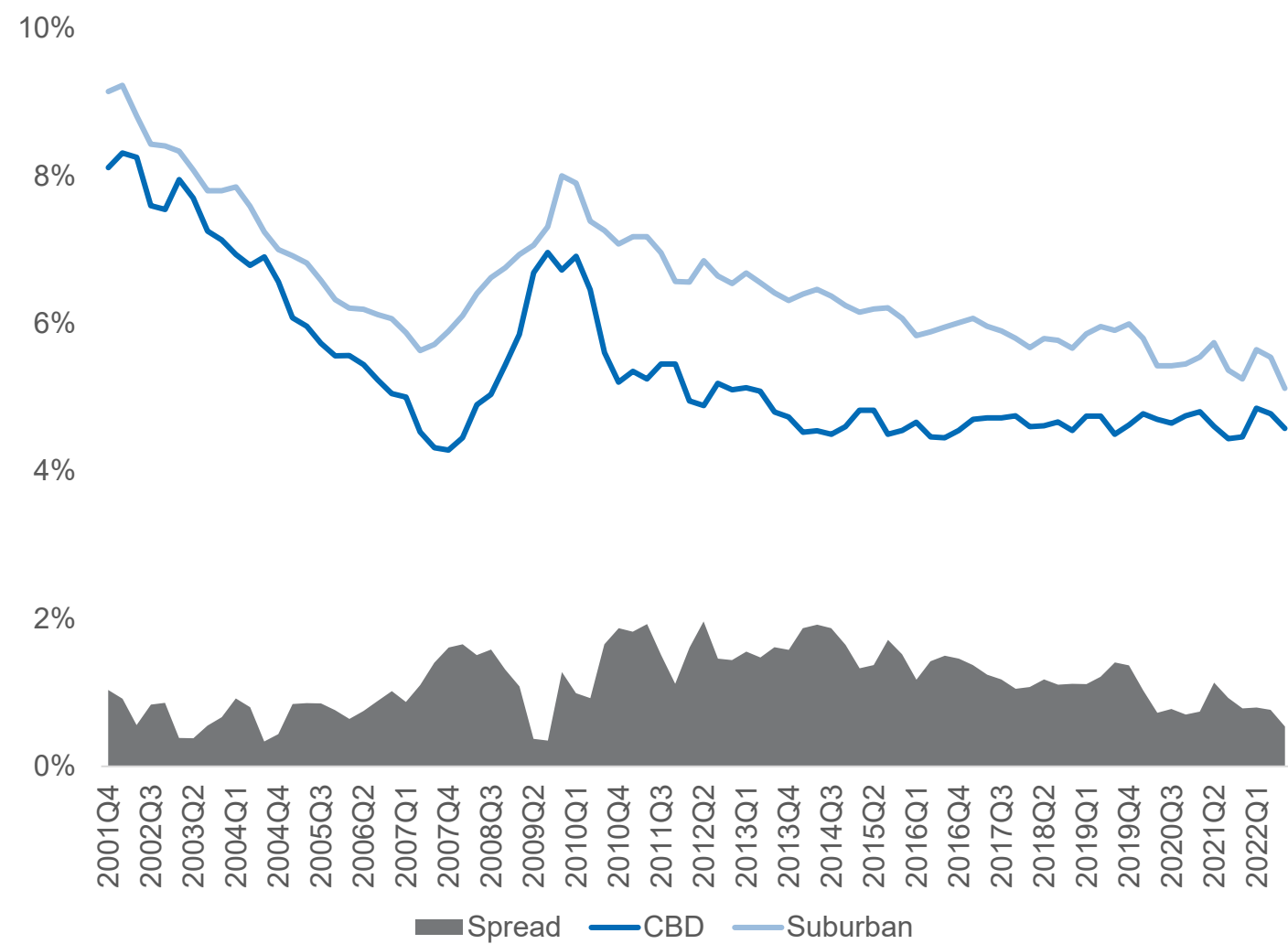


Source: Green Street, FRED, Moody's, Newmark Research

Transaction Cap Rates Compressing Across CBD, Suburbs, Market Tiers

While overall transaction cap rates have been stable, there have been some notable relative shifts within the office market. The spread between CBD and suburban cap rates continued to close in the third quarter of 2022. CBD office markets have generally been more impacted by the office downturn, while transaction activity in the suburbs has increasingly shifted towards higher quality product and submarkets. This is the result. Similarly, secondary office market yields have closed with the six major metros as, again, the major markets have been relatively more impacted, compared with secondary markets, such as Dallas, Austin, Atlanta et cetera.

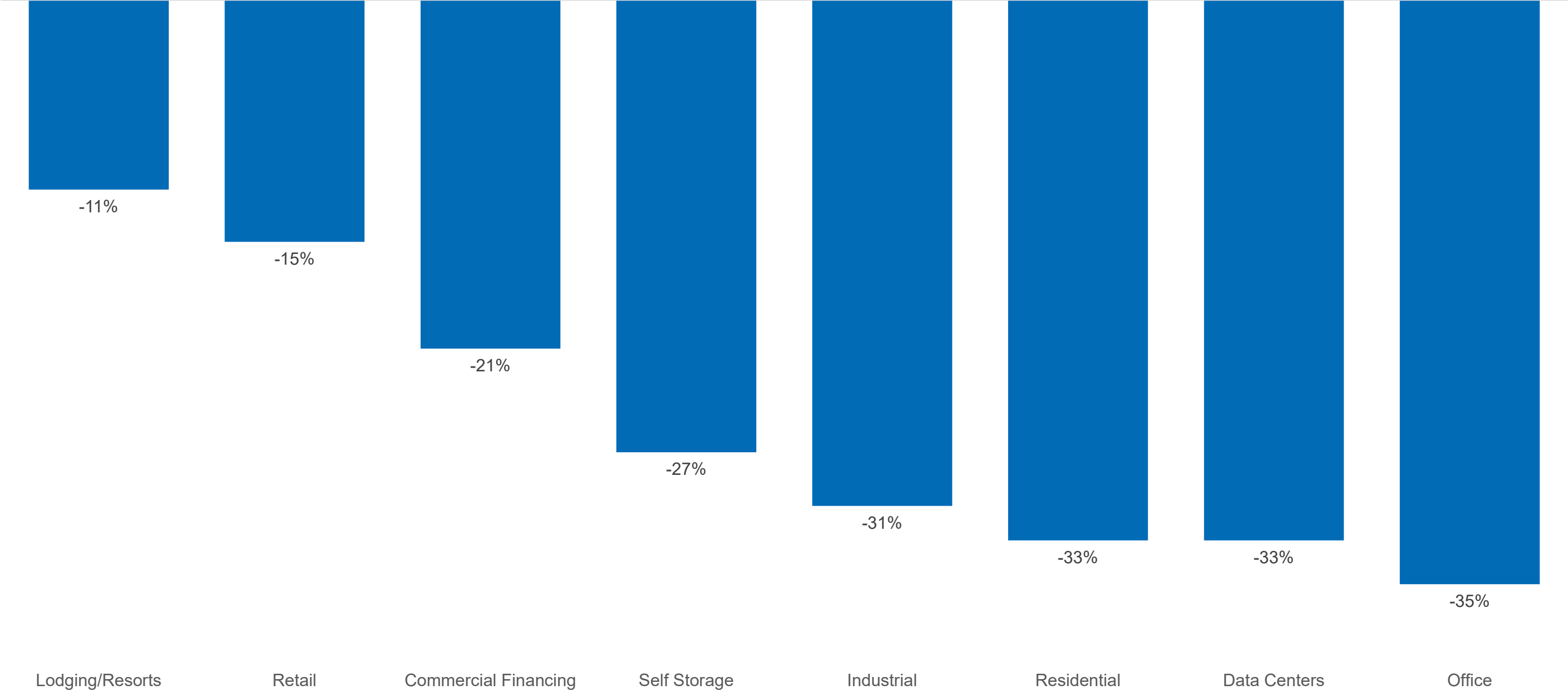
Rolling 2Q Volume-Weighted Office Cap Rates



Office REITs Have Sold Off Dramatically Year-to-Date

Combination of Market-Wide Impact from Increasing Cost of Capital and Weakening Fundamental Outlook

YTD Total Return by NAREIT Sector

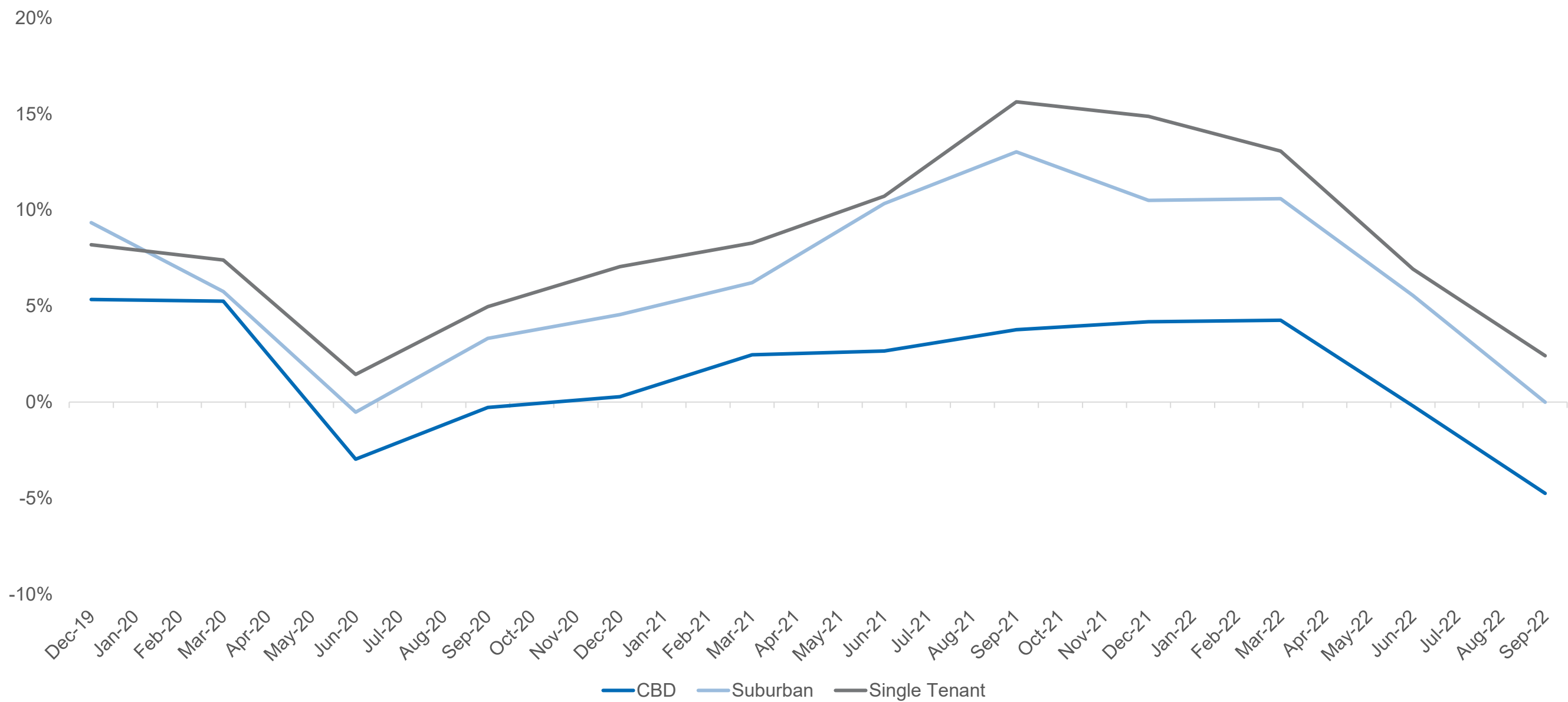


Sources: Newmark Research, Green Street

Core Office Rapidly Decelerating

The impact of the pandemic on office returns was muted, particularly when compared with the Great Recession. This was a result of: 1) extraordinary action by the federal reserve to drive discount rates lower; 2) lease terms mitigating near-term cash flow loss; and 3) lower leverage in the office sector enabling investors to avoid fire sales and “catching the falling knife.” CBD office was more impacted in the downturn, both because of its higher beta and construction pipeline and the particularities of the pandemic. The recovery, however, has departed from past experience, with suburban properties rebounding more strongly. Since mid-2021, returns have been slowing once more. Newmark Research expects more disruption as downward rent adjustments impact NOI, combined with rising cap rates. CBD assets are likely to remain more vulnerable compared with core suburban.

NCREIF Quarterly Office Total Return (Annualized)



3Q22 US OFFICE MARKET OVERVIEW

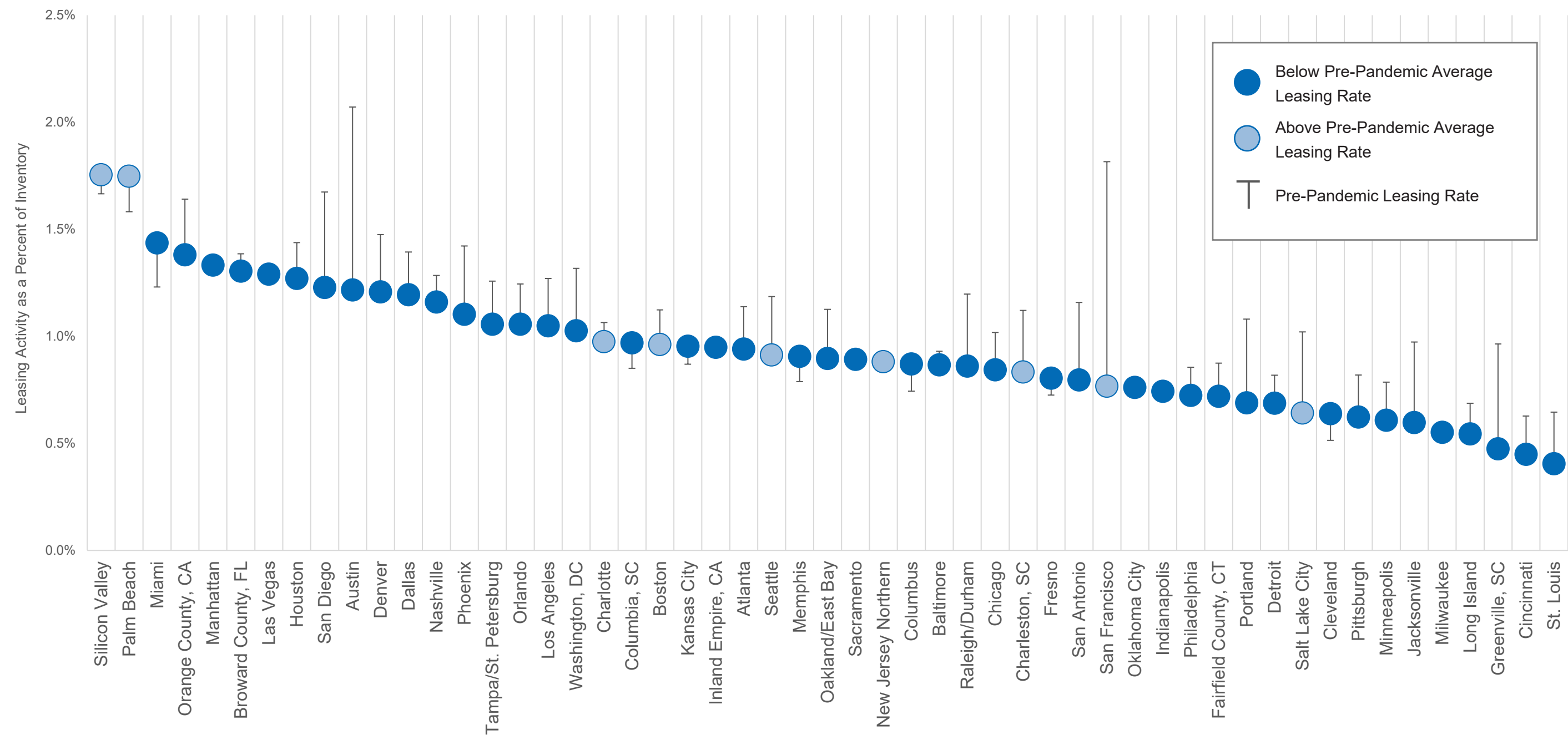
Appendix



Leasing Activity by Market

Sluggish leasing activity remains a staple of most US markets in the third quarter of 2022. For most office markets, quarterly leasing activity lags that of pre-pandemic levels and is most evident in formerly fast-growing technology markets, like San Francisco and Austin. Although most markets are below historical expectations, relatively strong leasing activity was experienced in coastal regions led by Silicon Valley, Palm Beach, Miami and Orange County, California.

Leasing Activity as a Percent of Inventory And Pre-Pandemic Average (2015-2019)



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Newmark has implemented a proprietary database and our tracking methodology has been revised. With this expansion and refinement in our data, there may be adjustments in historical statistics including availability, asking rents, absorption and effective rents. Newmark Research Reports are available at ngkf.com/research.

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