

4Q23

# United States Office Leasing House View

NEWMARK



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# Market Observations

- **Demand Drivers:** The Federal Reserve's efforts to combat inflation have modestly slowed employment growth, but overall, labor markets remain in expansion. National GDP growth was robust at 3.3% in the fourth quarter of 2023, a decline from 4.9% in the third quarter of 2023. National office-using employment is now 6.4% above December 2019 levels, with the recovery being led by technology, advertising, media and information companies. Accordingly, technology companies drove much of the leasing activity over the last two years; however, in 2023, technology companies accounted for just 10.1% of leasing activity, down from 36.9% in 2022.
- **Labor Market:** National nonfarm employment recovered to pre-pandemic levels in June 2022 and is up 20.9% from the pandemic low in April 2020. Office-using employment was less impacted during the pandemic and has maintained a consistent pace of recovery, measuring 1.9 million jobs above pre-pandemic levels.
- **Leasing Fundamentals:** Net absorption continued to post losses in the fourth quarter of 2023, driven most strongly by the West and East. Leasing activity was again sluggish in most markets in the fourth quarter of 2023, decelerating nationally to an estimated 0.8% of inventory, compared to the quarterly average of 1.4% realized between 2011 and 2019.
- **Regional Fundamentals:** The South Region recorded minor occupancy growth in the fourth quarter of 2023, the first region to realize positive net absorption since the third quarter of 2022. Gains here were driven by strong performance in the Houston market, where net absorption totaled positive 1.5 million SF during the quarter. Despite this, occupancy declined overall in the South over the course of 2023. Minimal leasing activity as a percent of inventory was relatively ubiquitous across most regions, indicating a slowdown in the momentum that had been gained in the prior two years in some secondary and Sun Belt markets.
- **Market Size Comparison:** Gateway markets shed the majority of space in the fourth quarter of 2023; over the course of the year, losses in major gateway and secondary markets were comparable. Tertiary markets outperformed other categories, recording minor positive net absorption in the fourth quarter of 2023. Occupancy ultimately declined over the course of the year, aligning with trends seen in other markets.
- **Segmentation Analysis:** Quality office assets continue to command a disproportionate share of the market's limited activity, with leasing activity in the Class A sector accounting for 53.1% of all leasing in the fourth quarter of 2023. This has declined from a recent high of 54.6% in the fourth quarter of 2021. Class A vacancy increased 220 basis points year over year, in line with the overall market. There is growing segmentation in this top tier with commodity Class A (four-star) inventory recording vacancy that was 180 basis points higher than trophy (five-star) at the end of the fourth quarter of 2023. This difference has increased 110 basis points since the end of 2019.

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# Demand Drivers

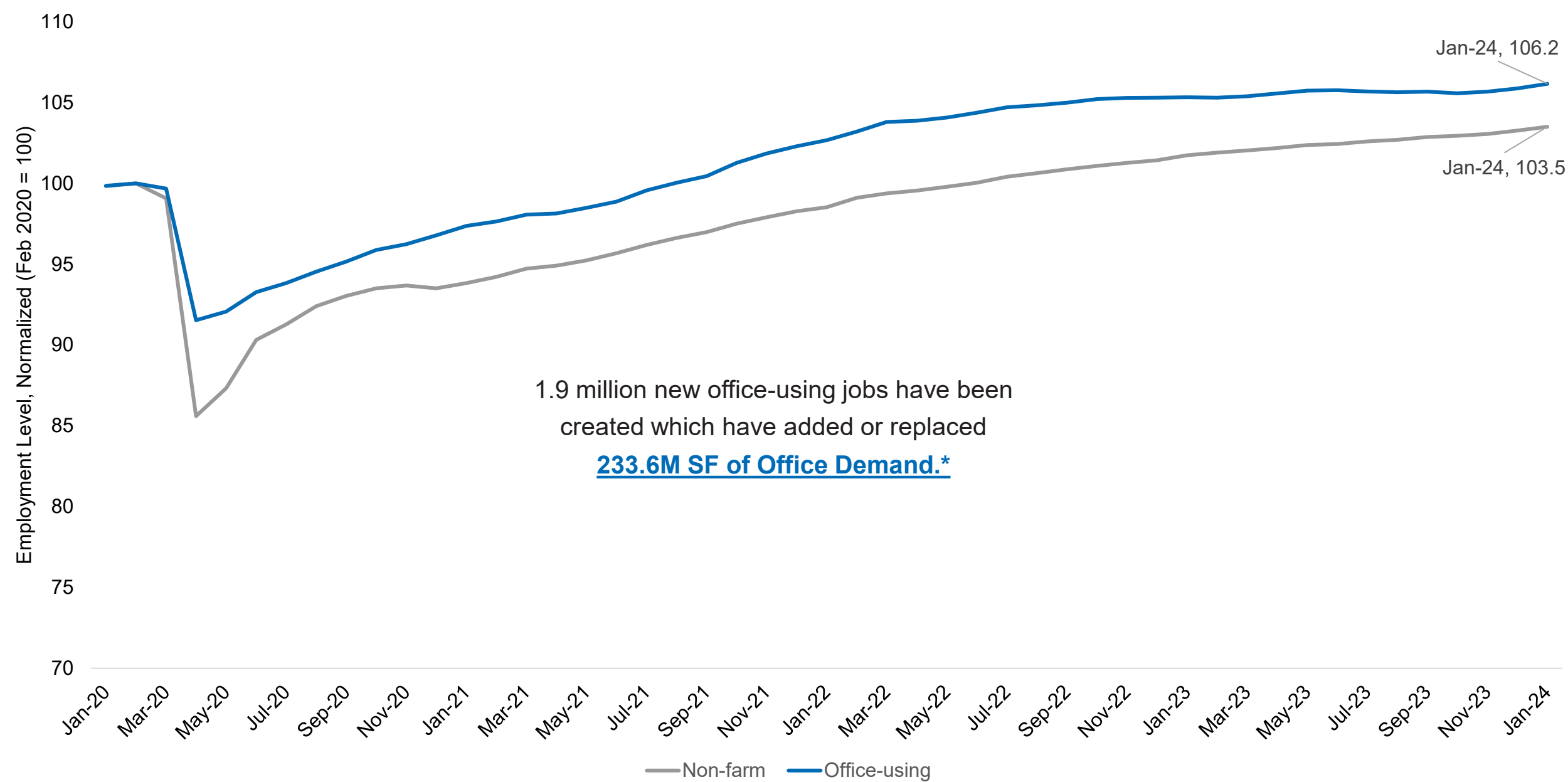




# Office-Using Employment Has Outpaced the Overall Labor Recovery

National nonfarm employment recovered to pre-pandemic levels in June 2022 and is up 20.9% from the pandemic low in April 2020. Office-using employment was less impacted during the pandemic and has maintained a consistent pace of recovery, measuring 1.9 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.

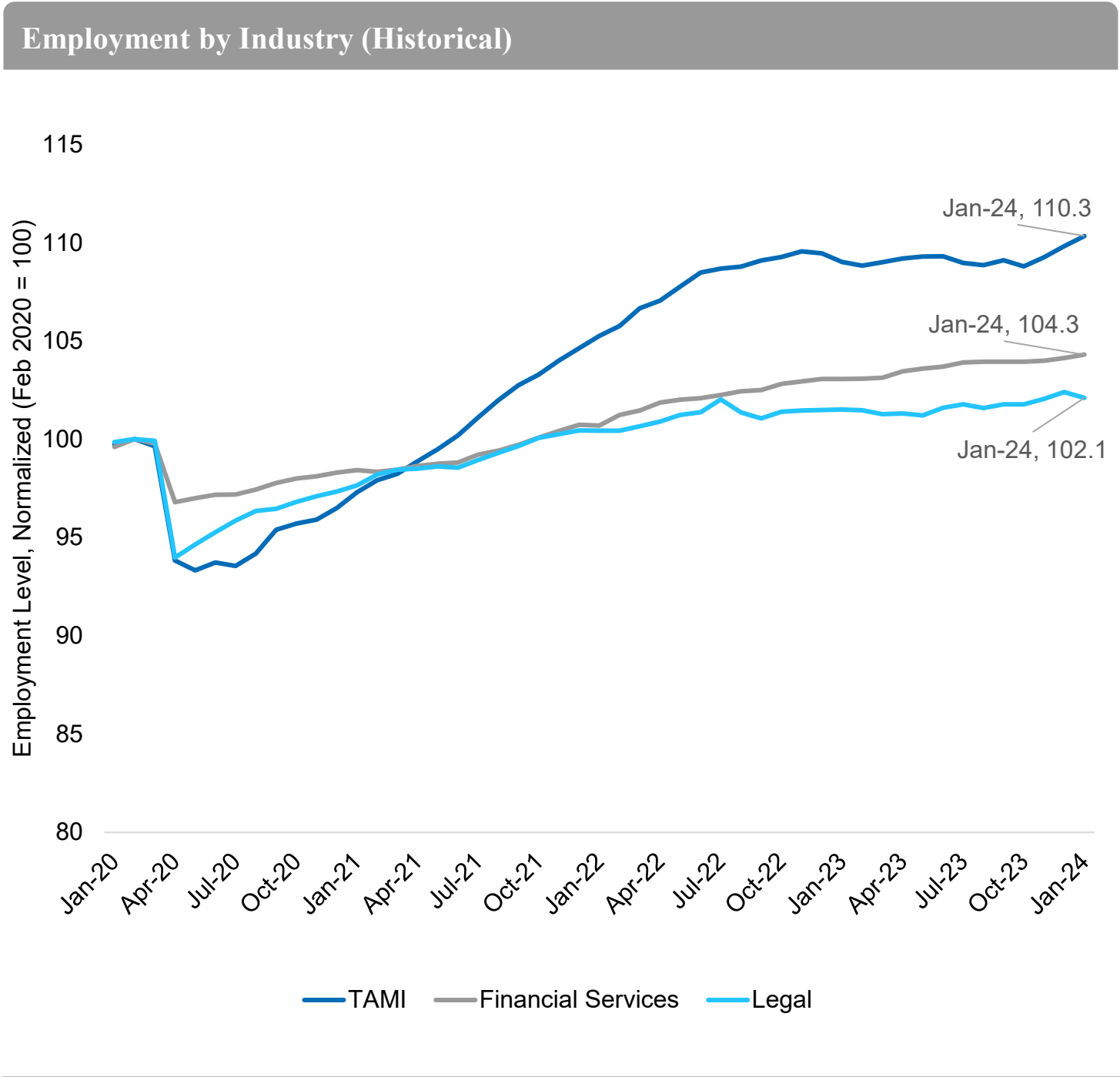
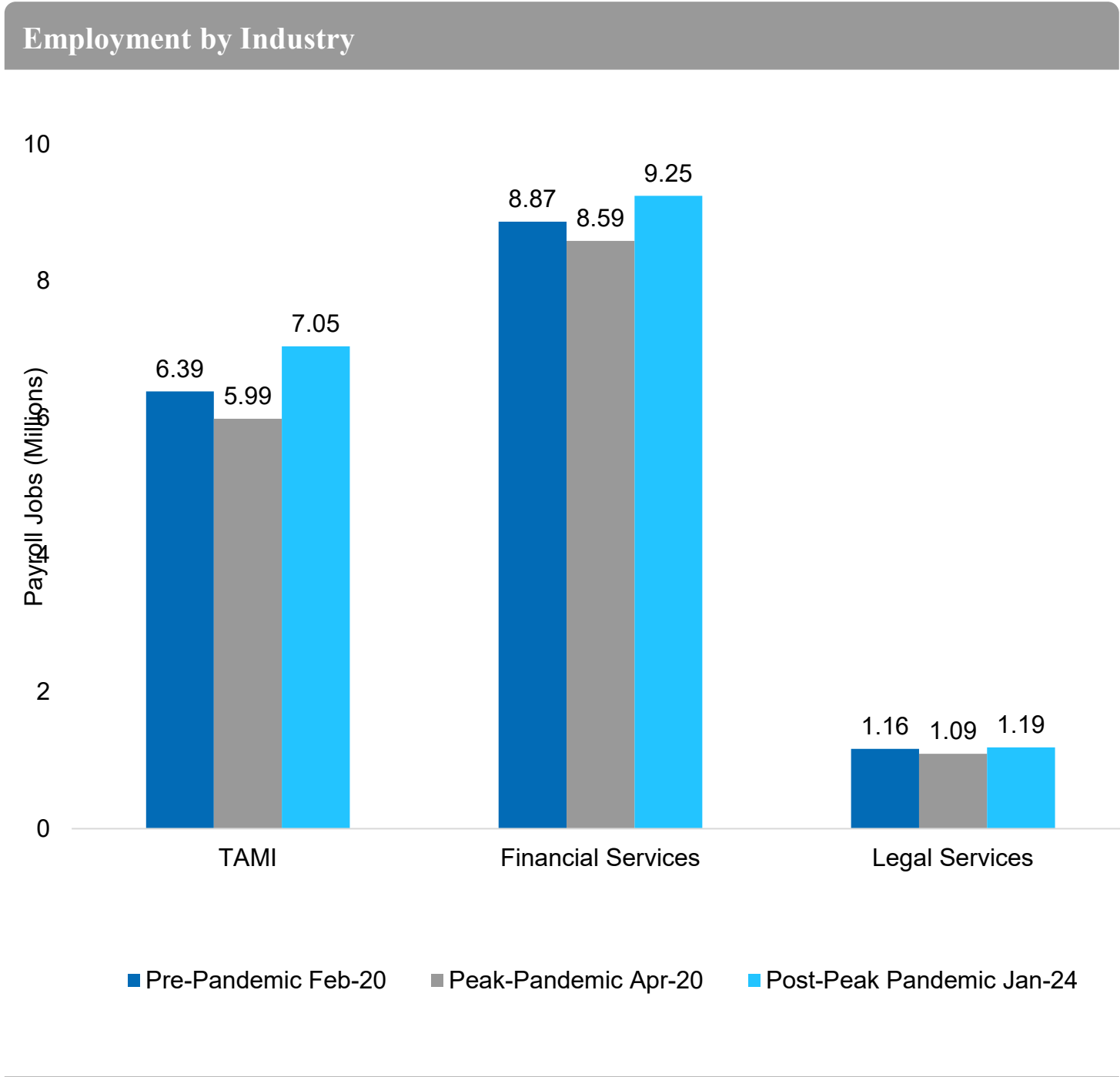
Employment Recovery Comparison – Normalized to February 2020



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

# Employment Growth Across Office-Using Industries

Employment now exceeds pre-pandemic levels across office-using industries. The recovery in TAMI has been particularly strong, despite significant layoffs in the information sector in 2023, with employment 10.3% above February 2020 levels. Impressive gains have been made across a range of professional and business services, which in the aggregate are up 7.0% from February 2020. Legal services have more than fully recovered as well, but less than these other categories.



Sources: United States Department of Labor, Newmark Research

# Office-Using Employment Growth Decelerating in Most Markets

Employment has been mostly tempered after a red-letter 2022. Several markets saw positive job growth decelerate from the prior year, while several key gateway markets in the East and West saw steeper negative growth in 2023 than the prior year. There were just three markets that saw elevated growth from the prior year: Las Vegas, Raleigh and Baltimore.

2023 Compounded Average Monthly Office-Using Employment Growth vs. 2022 – 2023 Acceleration

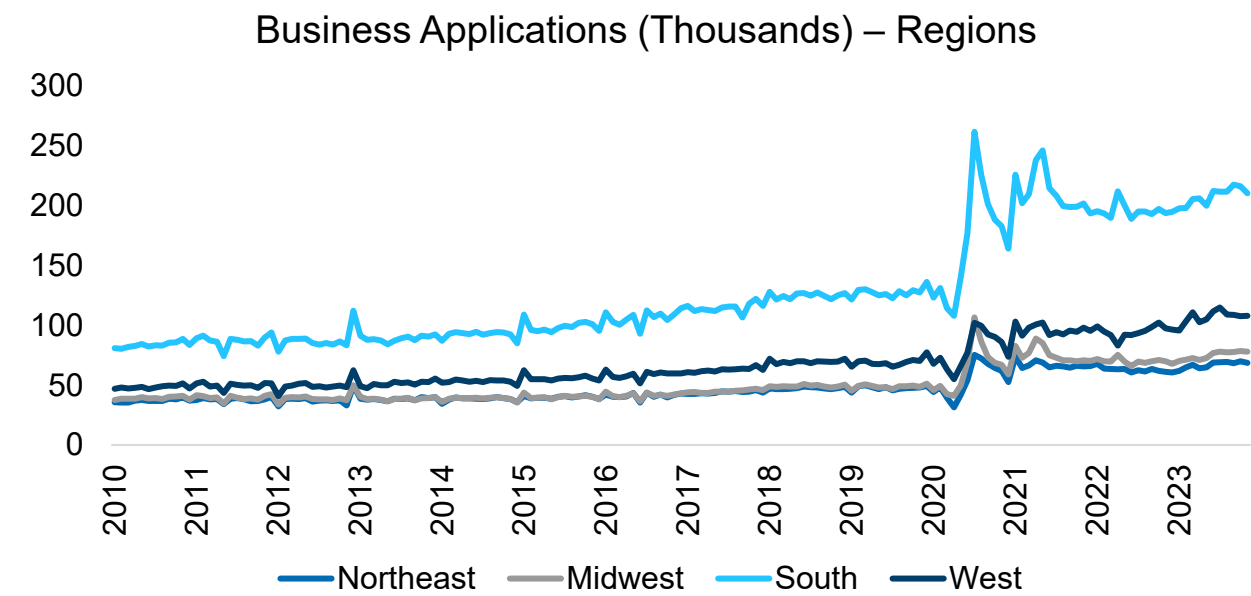
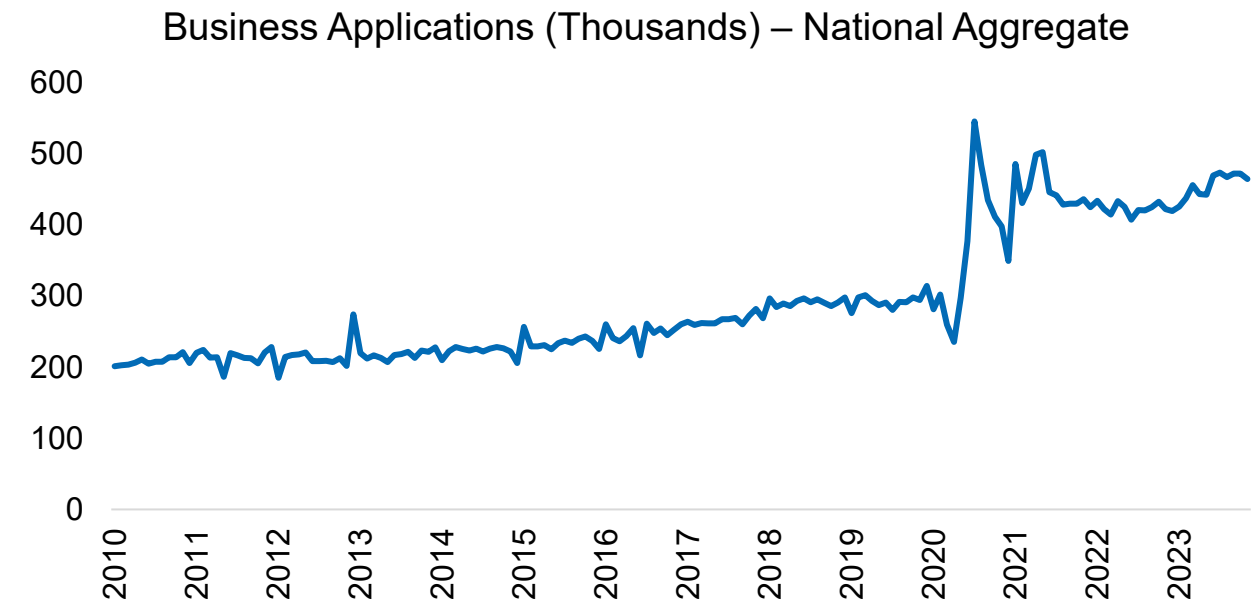
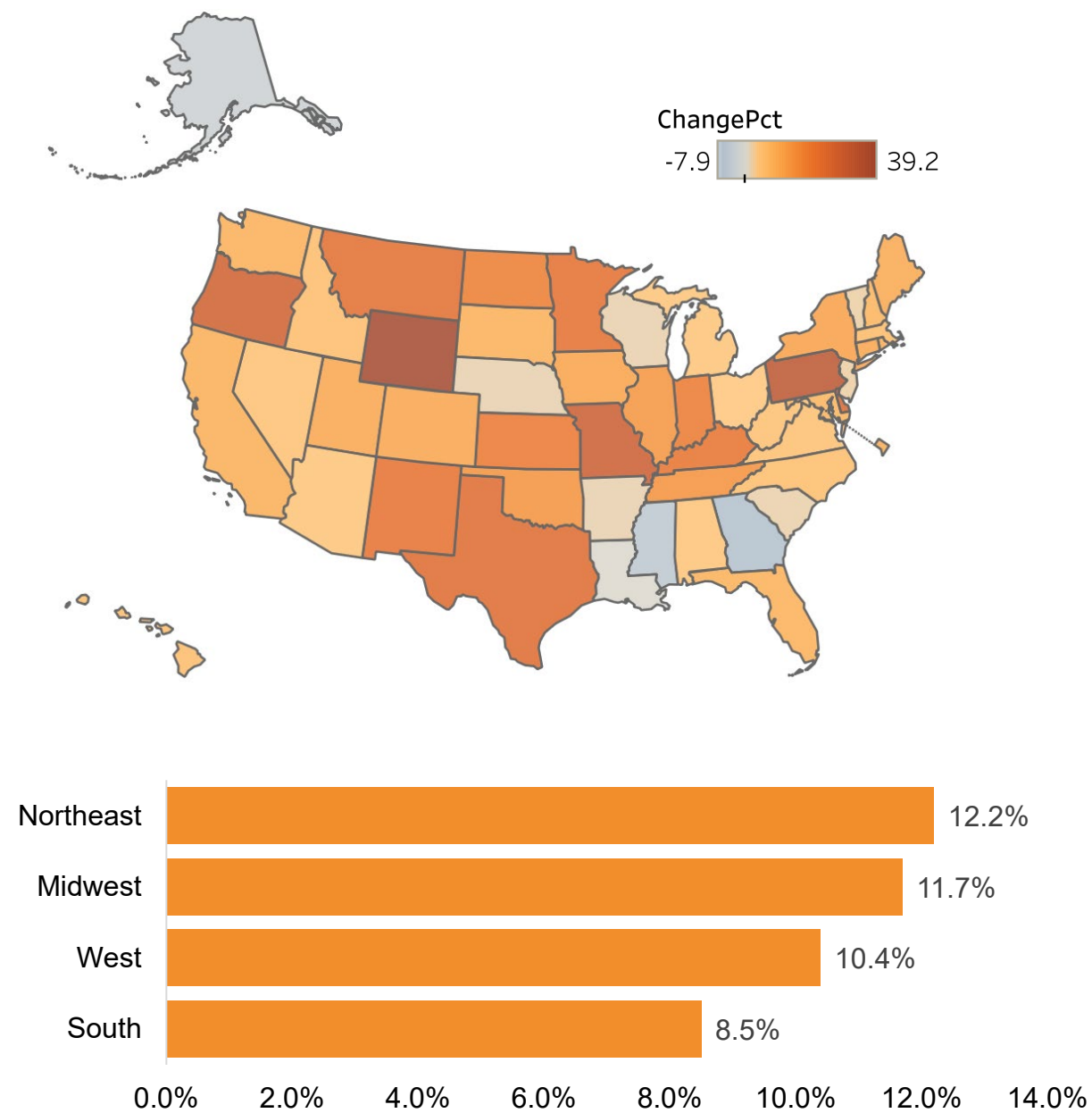


Source: Bureau of Labor Statistics, Newmark Research

# New Business Formation Maintains Momentum

Business formation accelerated healthily in November 2023; 464,838 new business applications were filed, which is up 10.0% from September 2022. This acceleration was realized in every US region, with the Northeast Region realizing a 12.2% increase from this time last year. Overall business creation remains notably higher than pre-pandemic levels in all geographic regions.

Business Applications: Change from November 2022 to November 2023 (Seasonally Adjusted)

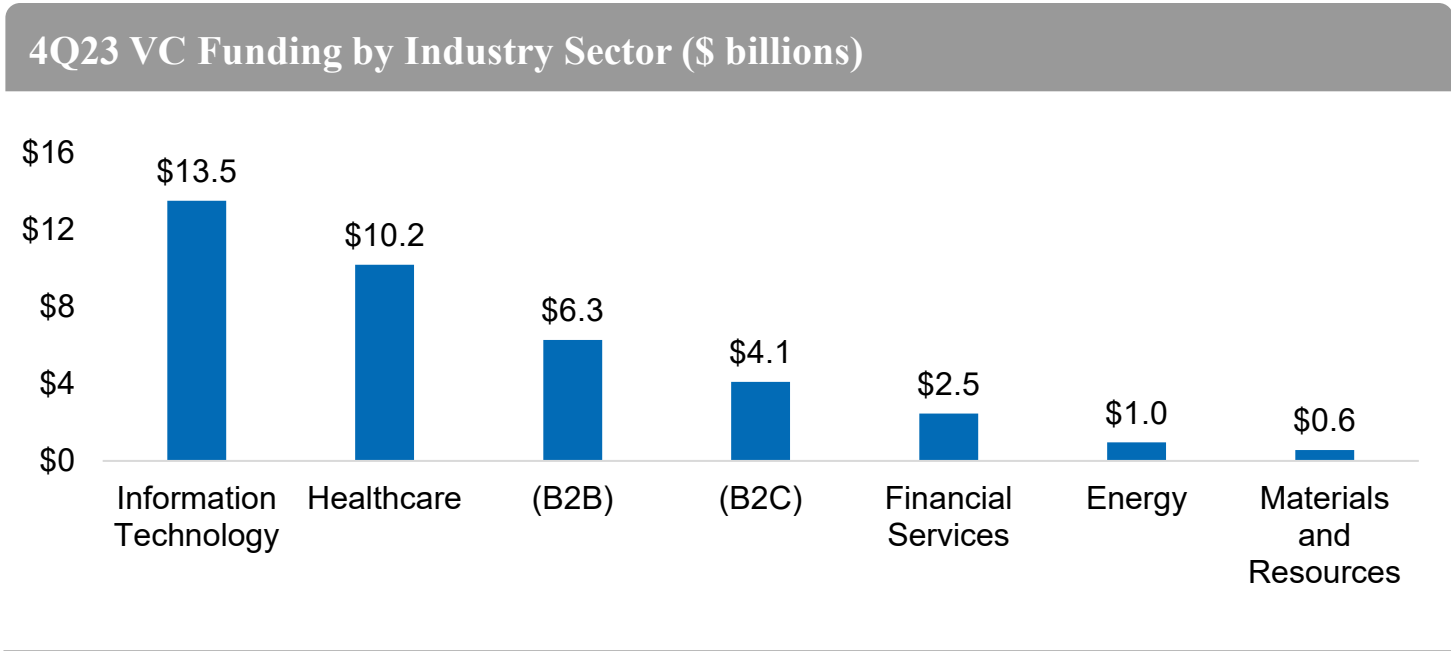
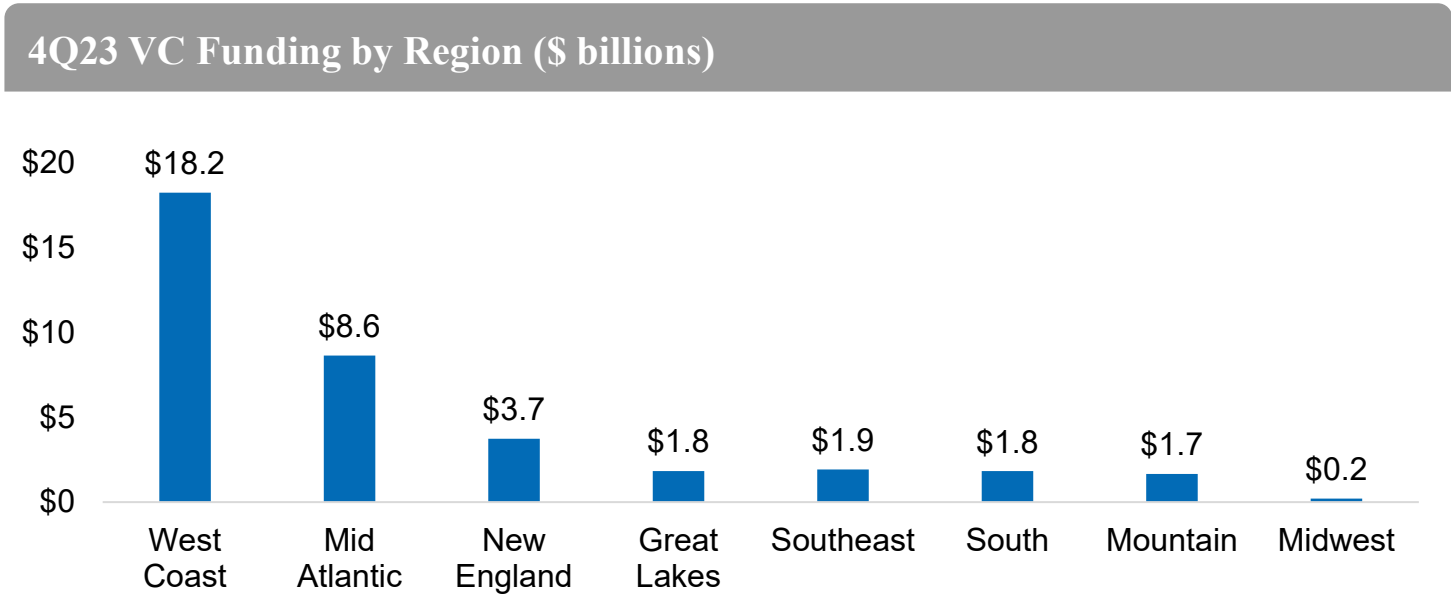
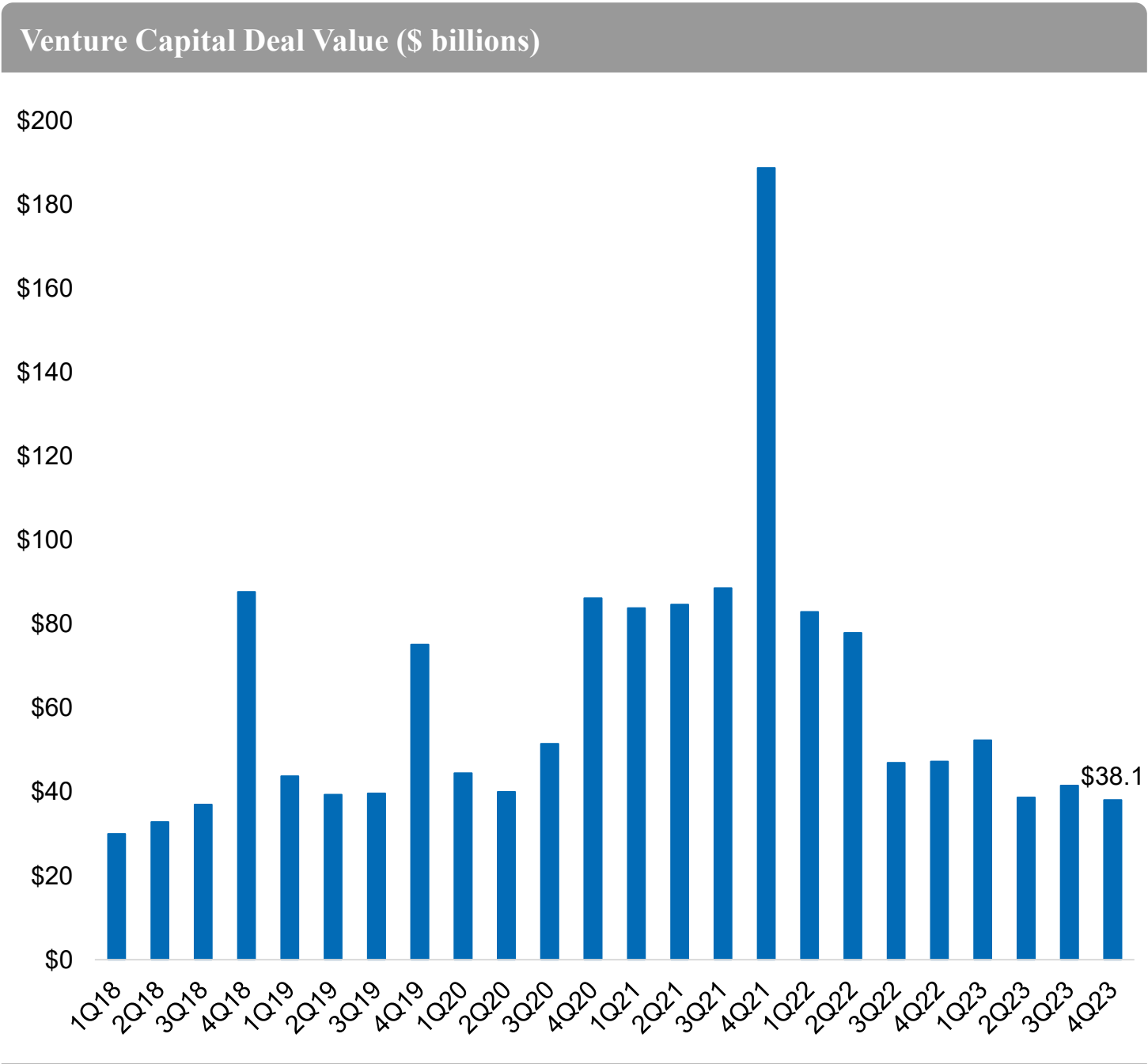


Source: United States Census Bureau, Newmark Research



# Venture Capital Investment Activity Has Returned to Pre-Pandemic Level

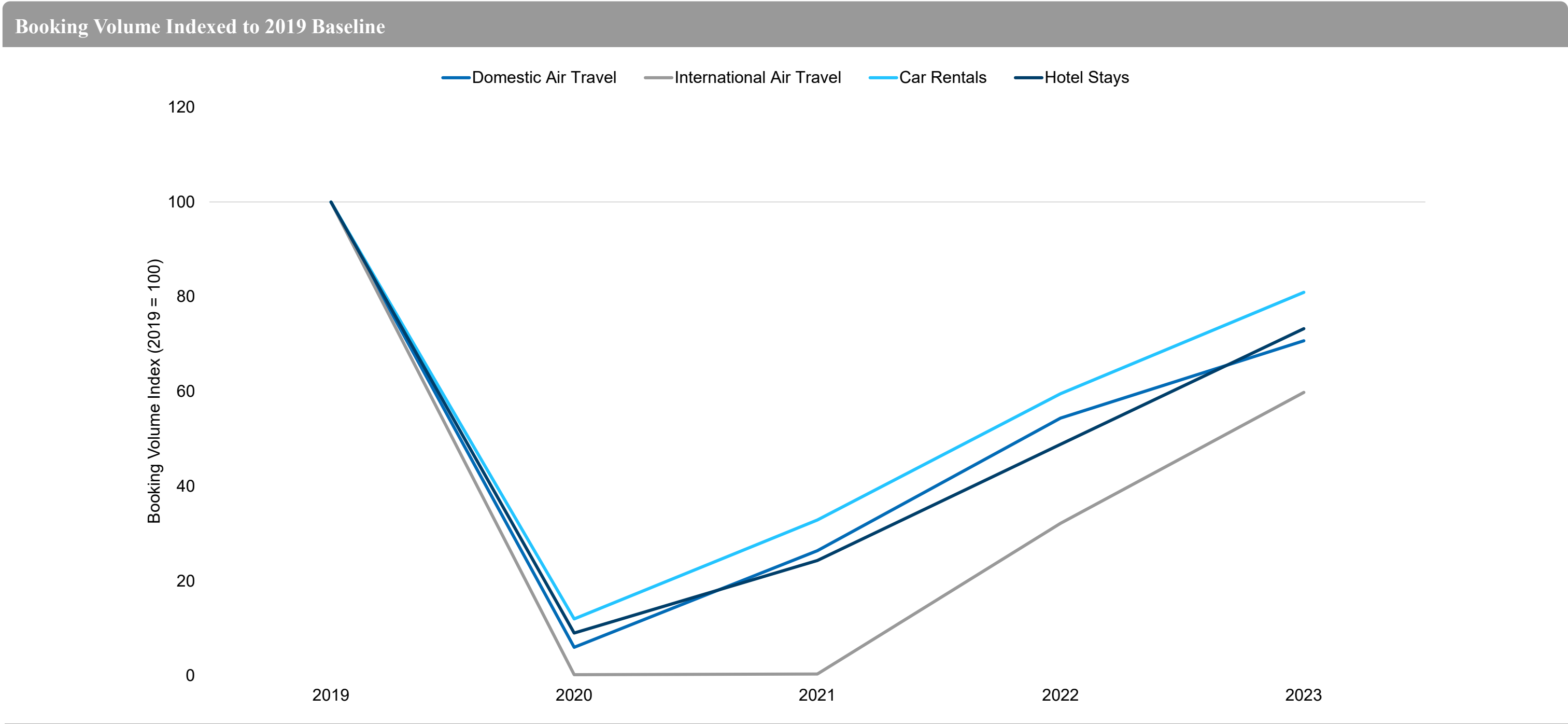
Overall venture capital contracted in the fourth quarter of 2023 as investors remain cautious. Although total investments are down significantly from the cycle’s recent peak in 2021, activity in the past year is elevated from a historical perspective. Investment activity trended up solely in the financial services sector, while all other categories realized annual declines, with the materials and resources sector declining 76.8%. 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.



Sources: PitchBook, Newmark Research

# Business Travel Recovering Well in 2023

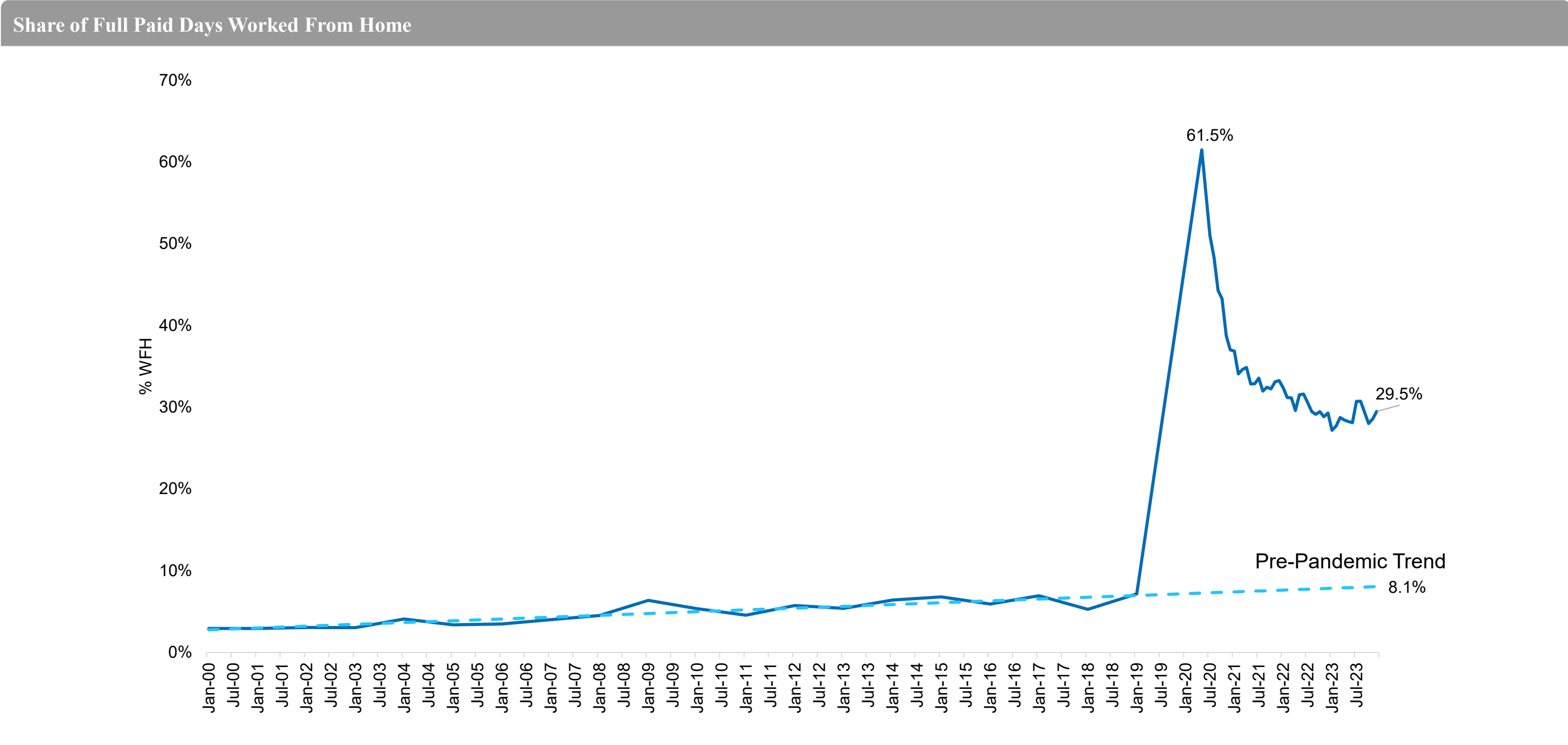
Business travel continued accelerating in the second quarter of 2023, with very few health restrictions left in place restricting the return of in-person business meetings, conventions and tradeshows both in the United States and abroad. The return of business gatherings is an encouraging indicator for the utility of office space in the period ahead. According to data from Emburse, a global leader in spend optimization for businesses, booking volume for car rental travel has increased dramatically and has nearly recovered to pre-pandemic levels.



Source: Emburse Travel Trends, Newmark Research

# The Pandemic Compacted Decades of WFH Transition into 3 Years

In the two decades prior to 2020, the full paid days worked from home by all employees averaged 5.2%. This metric grew significantly in the first quarter of 2020, reaching a maximum of 61.5% in May of 2020. Since then, this metric has declined at a decelerating pace and stands at 29.5% as of December 2023.



Source: Barrero, Jose Maria, Nicholas Bloom, and Steven J. Davis, 2021. "Why working from home will stick," National Bureau of Economic Research Working Paper 28731.





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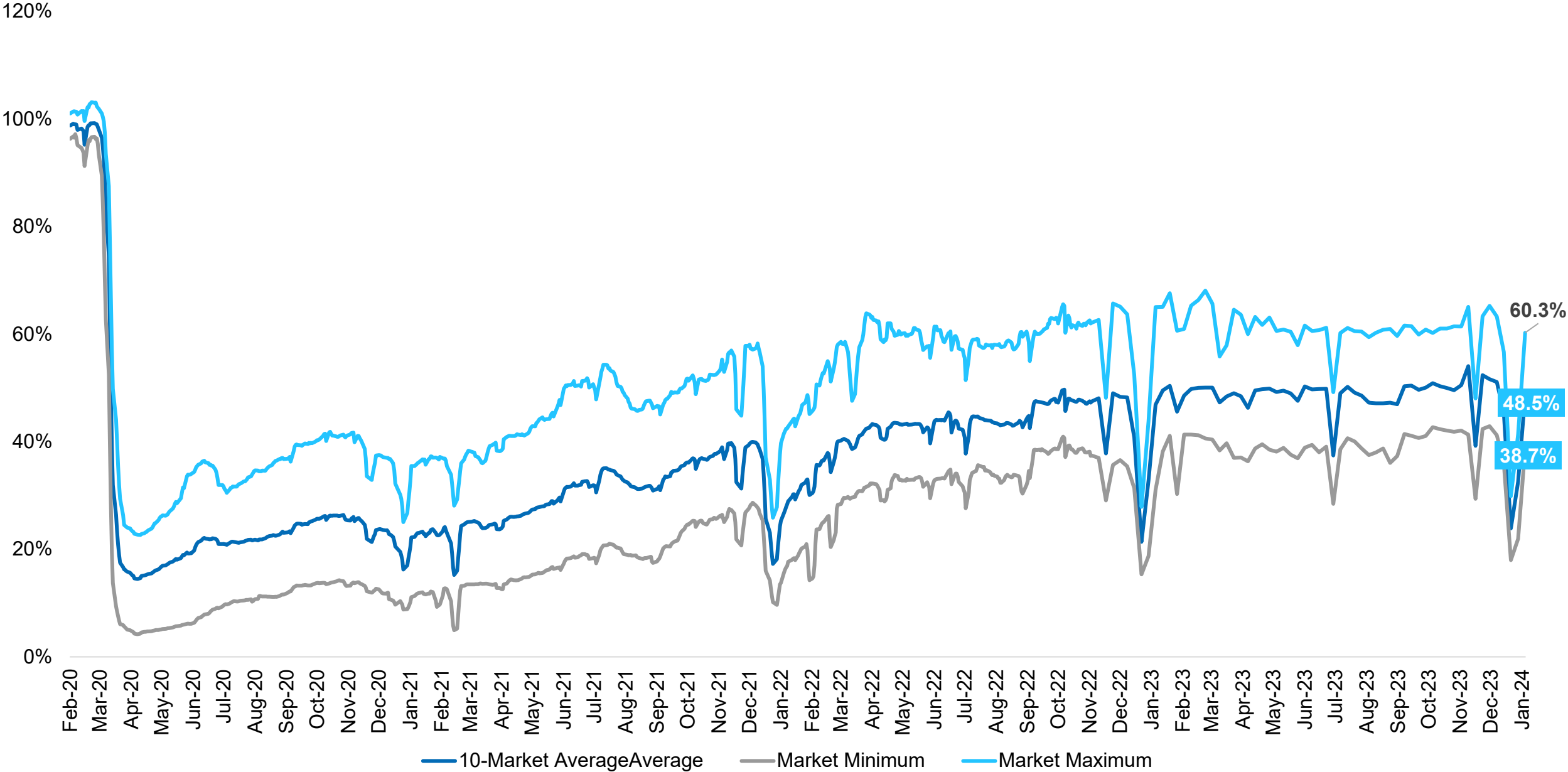
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# Return to Office Has Stabilized

Kastle Systems data shows' office utilization increased marginally over the course of 2023. The 10-market average reached 54.1% in mid-November, the highest occupancy levels seen since pre-pandemic, before sliding down again, as expected due to the holiday season. The 10-market average stood at 48.5% as of January 2024. There continues to be significant variation in daily office attendance during a given week, suggesting that peak office attendance may have been as high as 70% and pushing 80% in the markets with the most robust return to office.

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



Source: Kastle Systems, Newmark Research



A low-angle, upward-looking photograph of a modern building's interior or exterior structure. The image features a complex network of steel beams and girders forming a grid-like pattern. Large glass panels are visible, reflecting light and showing the sky. The perspective creates a sense of height and architectural scale. A solid blue horizontal band is overlaid across the middle of the image, containing white text.

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4Q23 US OFFICE MARKET OVERVIEW

# Leasing Market

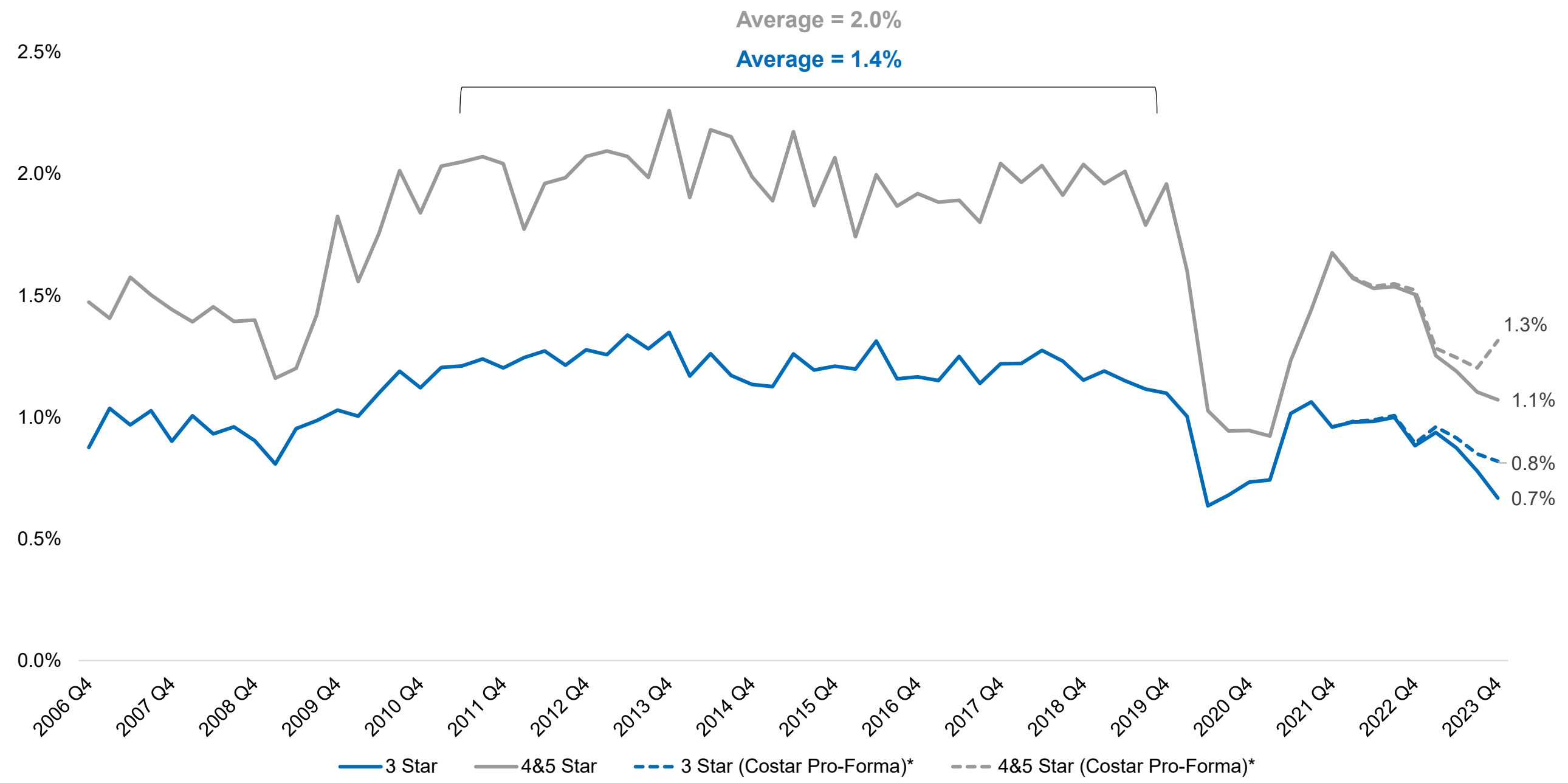




# Office Leasing Inches Down In 4Q23

Higher-quality buildings continued to outpace the overall market and drove a larger share of leasing activity in the fourth quarter of 2023. Although four- and five-star buildings only account for 38.7% of inventory, these assets captured 53.1% of leasing activity in the fourth quarter of 2023, a downward trend from the fourth quarter of 2022.

Leasing Activity as a Share of Inventory



Source: CoStar, Newmark Research as of 1/16/2024  
\*CoStar pro-forma based on proprietary internal calculation that estimates remaining leases not captured based on analysis of historical leasing trends.



A low-angle, upward-looking shot of a modern building's interior or exterior structure. The image features a complex network of steel beams and girders forming a grid-like pattern. Large glass panels are visible, reflecting the sky and other parts of the structure. The perspective creates a sense of height and architectural scale. A solid blue horizontal band is superimposed over the middle of the image, containing white text.

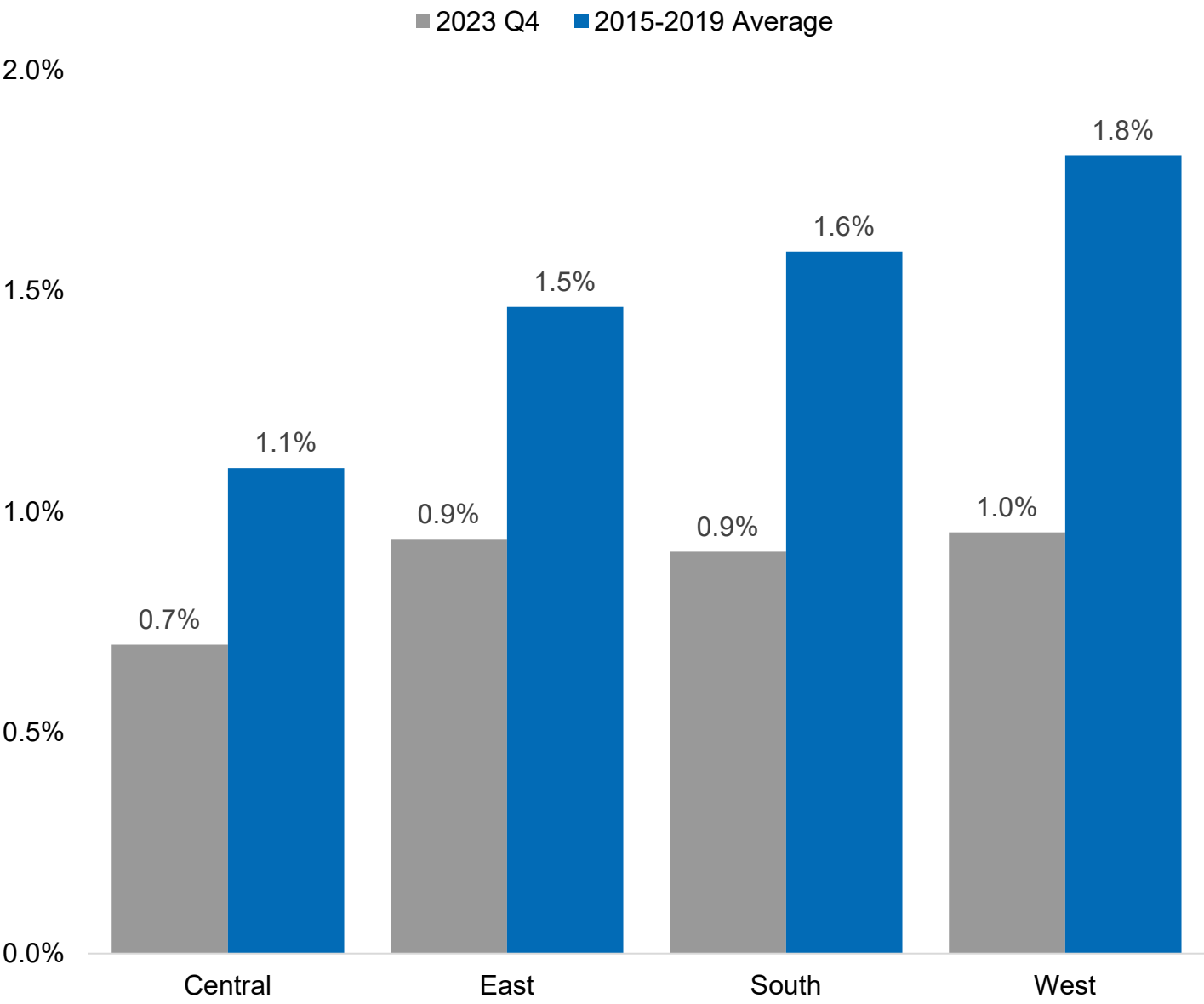
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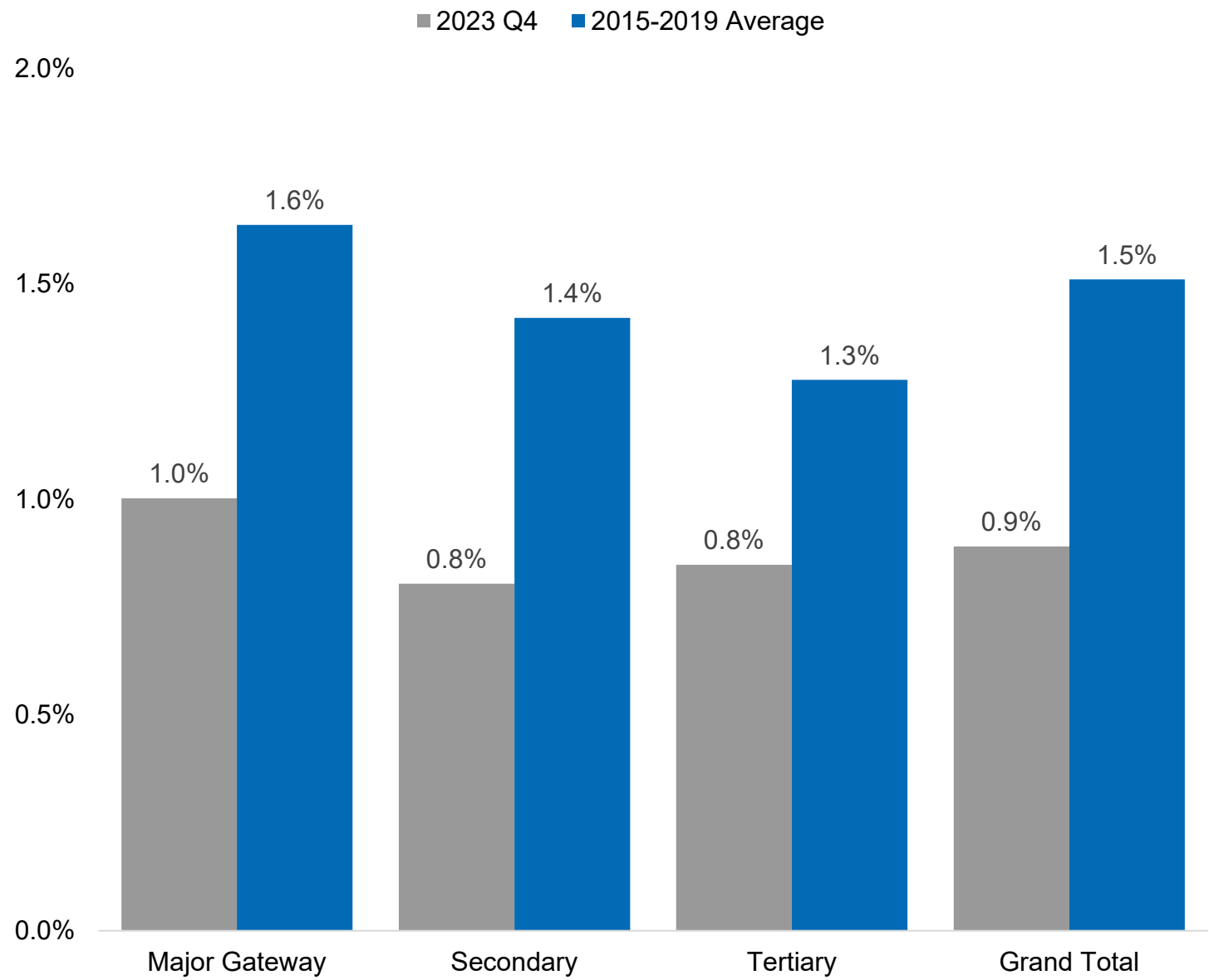
# Leasing Activity Lags Pre-Pandemic Baseline

Leasing activity was again sluggish in most markets in the fourth quarter of 2023. Leasing momentum had been more varied prior to the onset of the pandemic, with Western and major gateway markets commanding a large share of leasing relative to inventory. In the fourth quarter of 2023, leasing activity as a percent of inventory was relatively even across most regions and market sizes.

Regional Leasing Activity as a Percent of Inventory



Market Size Leasing Activity as a Percent of Inventory



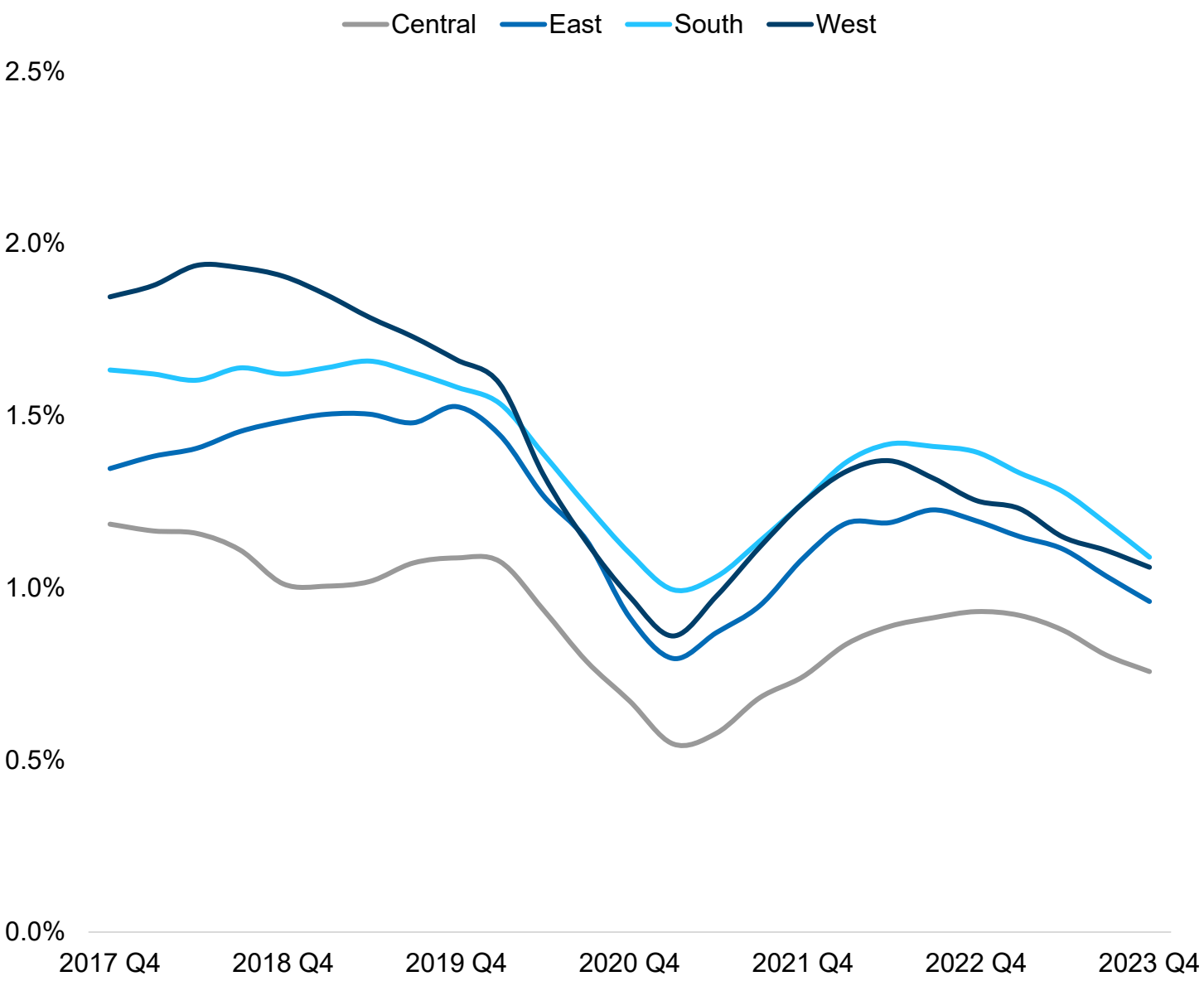
Source: CoStar, Newmark Research



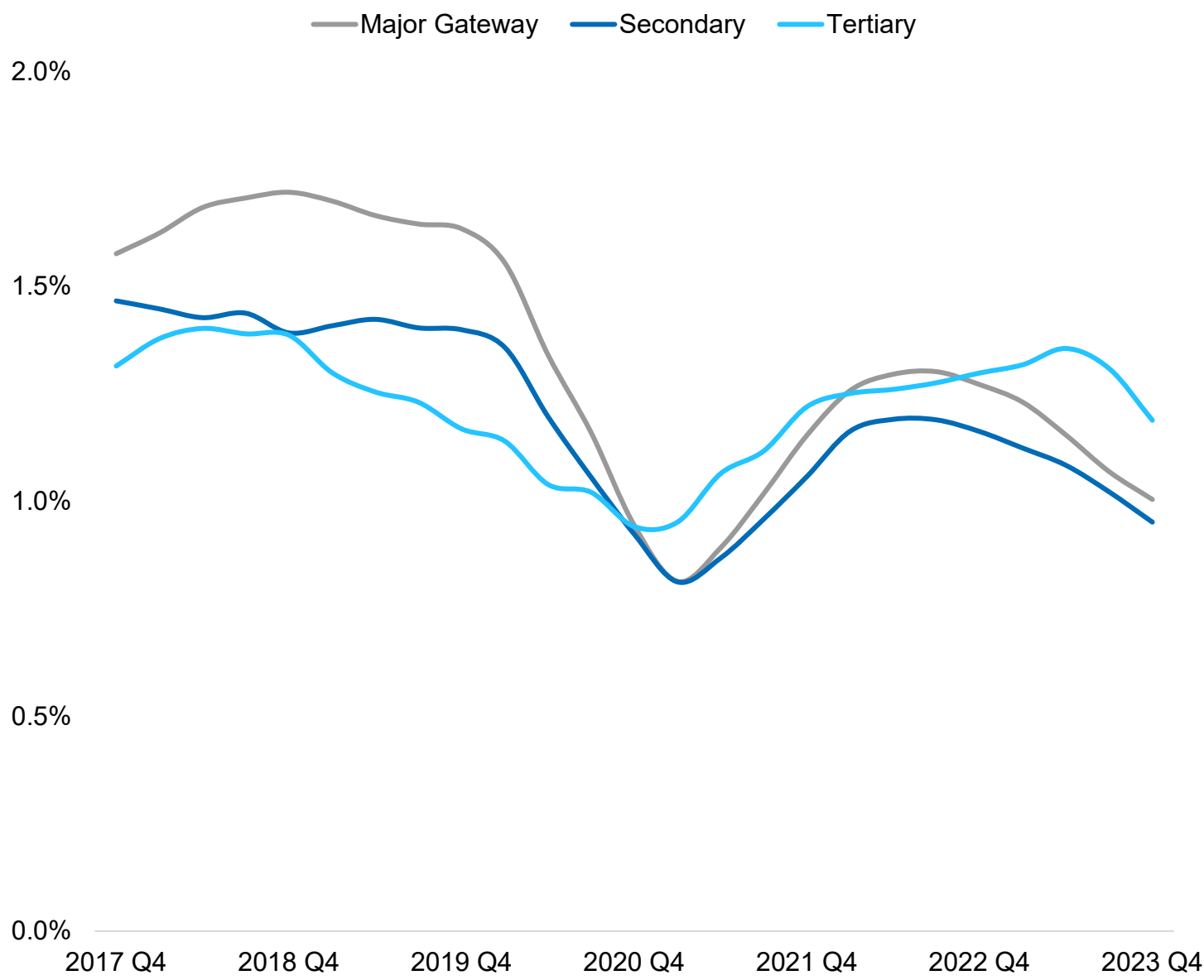
# Leasing Activity: Historical Perspective

Most regions and market sizes have seen a slowdown in leasing activity compared to gains in 2022, with tertiary markets being a notable exception.

Regional Leasing Activity as a Percent of Inventory (4-Quarter Trailing)



Market Size Leasing Activity as a Percent of Inventory (4-Quarter Trailing)



Source: CoStar, Newmark Research



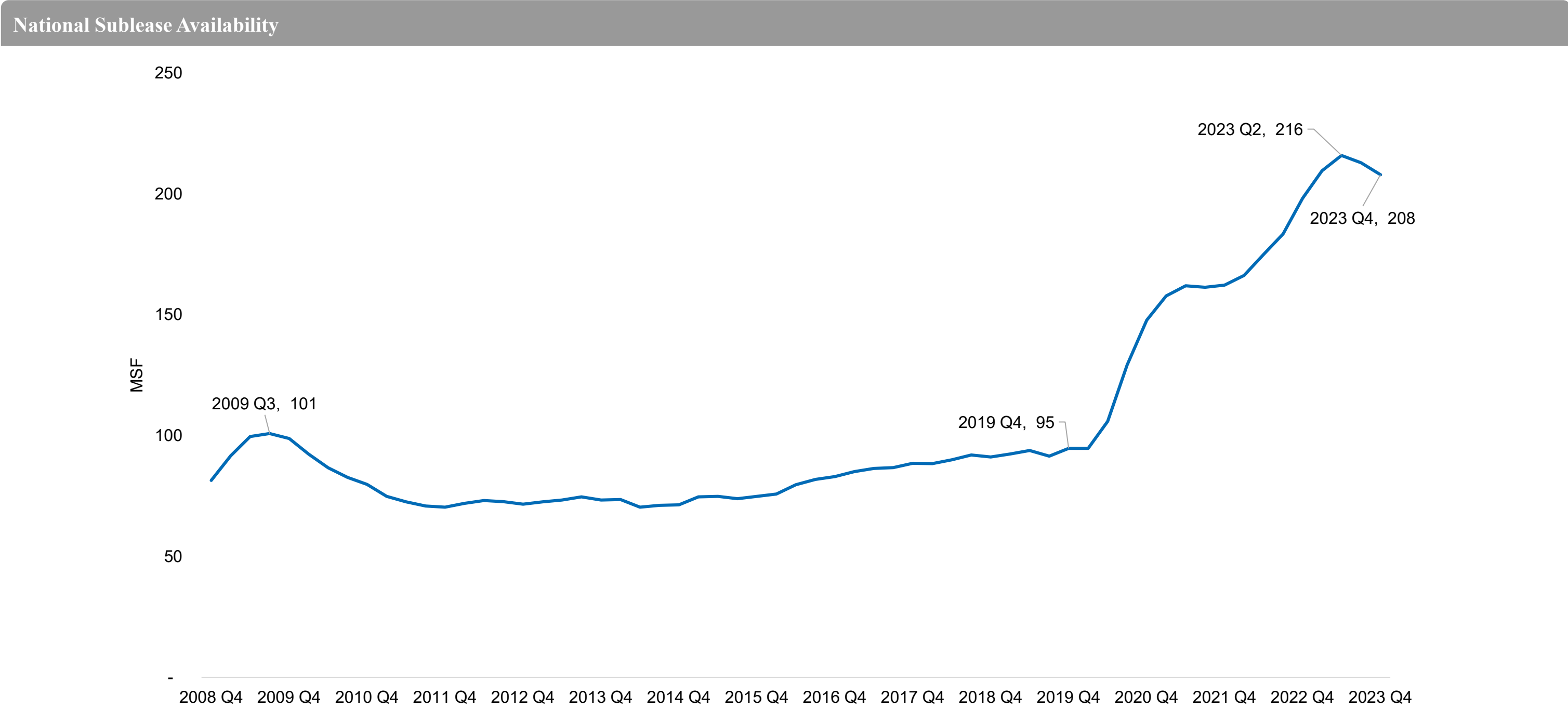


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# Sublease Availability High but Stable in 4Q23

Sublease availability dipped down in the fourth quarter of 2023, having declined 3.7% from the second quarter of 2023. National square footage available for sublet is currently near an all-time high, totaling 207.9 million SF.

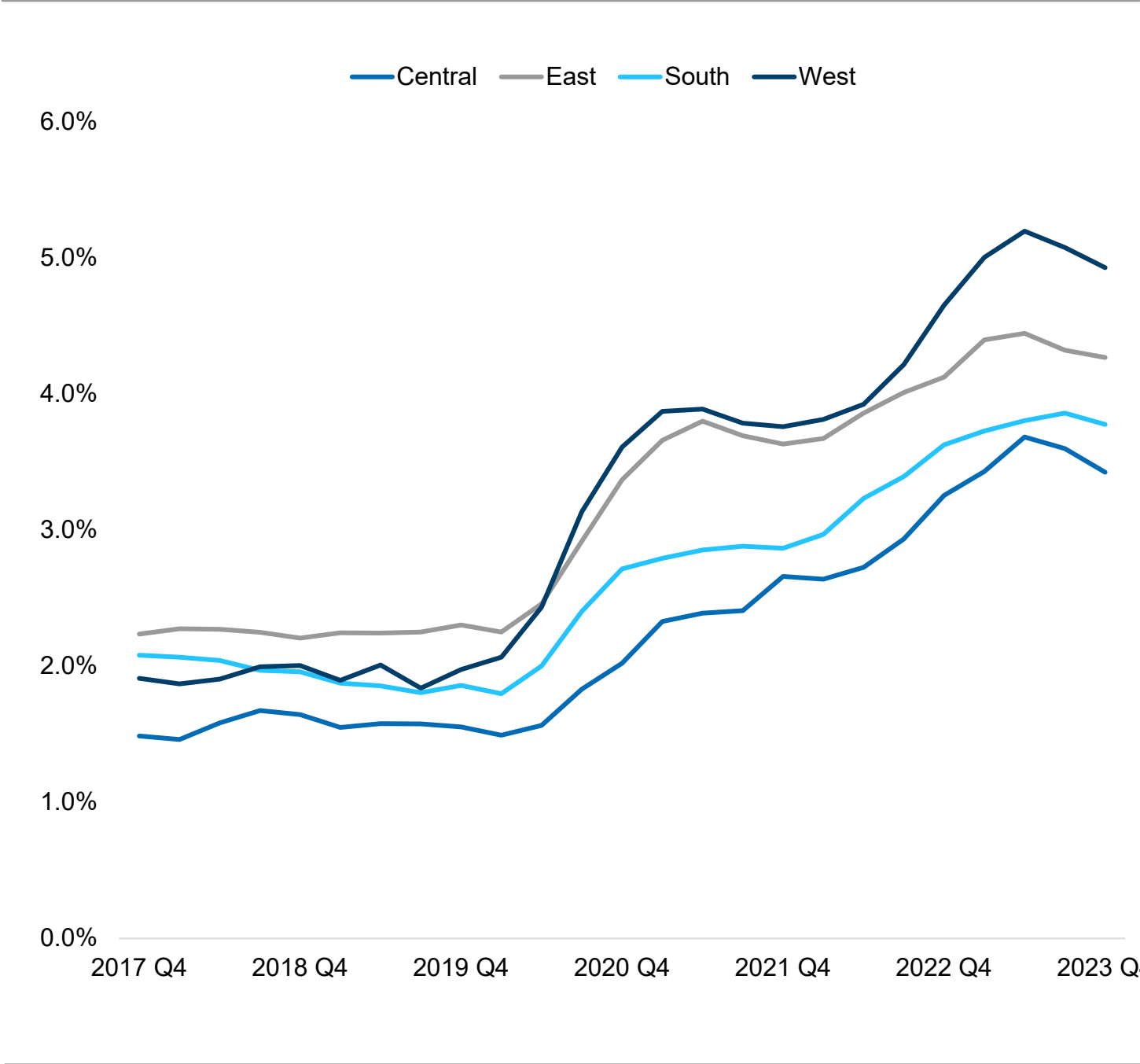


Source: CoStar, Newmark Research

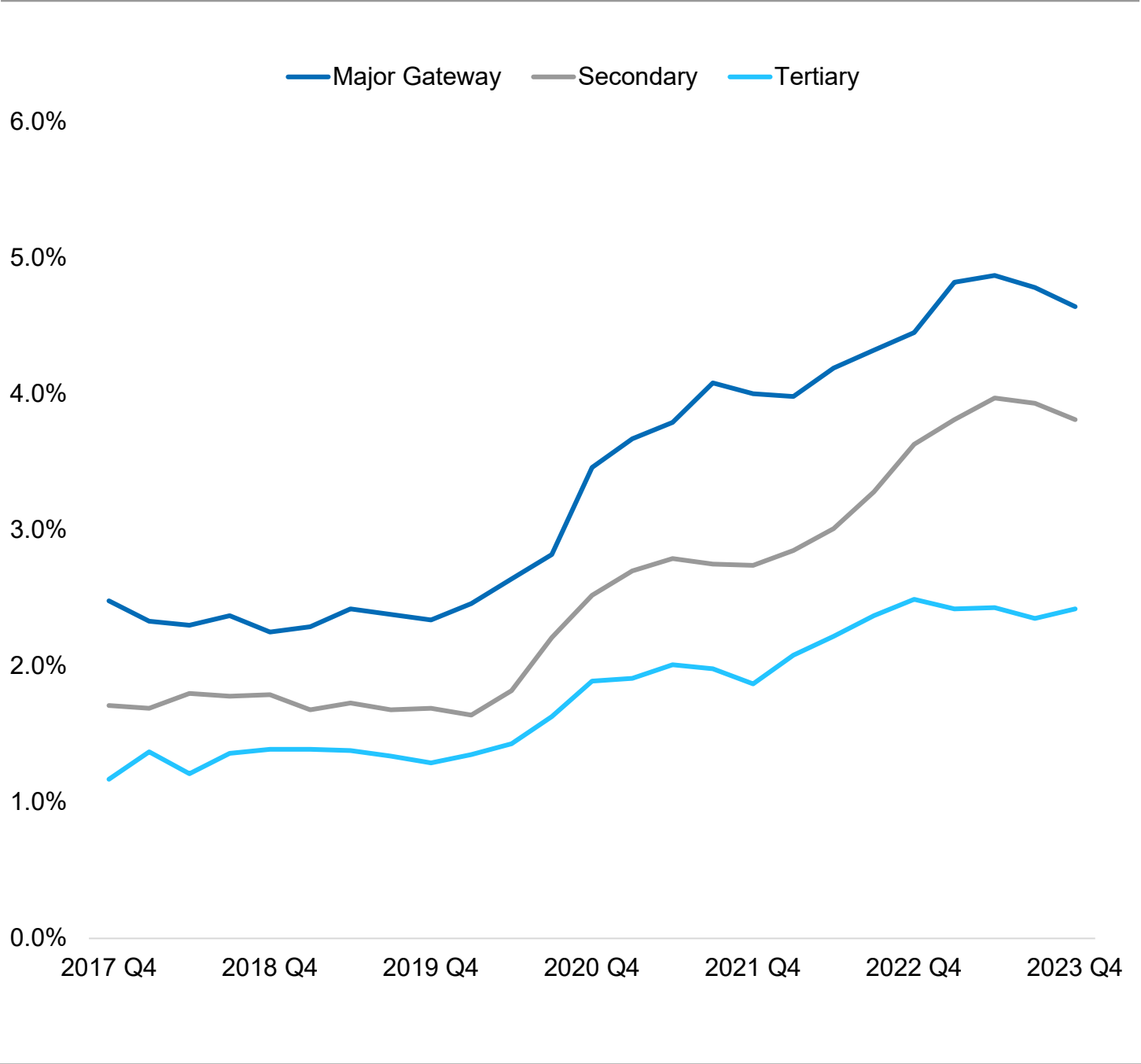
# Sublease Availability Significantly Elevated Above Pre-Pandemic Baseline

While sublease availability declined in the fourth quarter of 2023, it remains elevated from a historical perspective. Sublease availability is highest in Western Region markets, notably San Francisco, as well as major gateway markets more generally.

Regional Sublease Availability Rate



Market Size Sublease Availability Rate

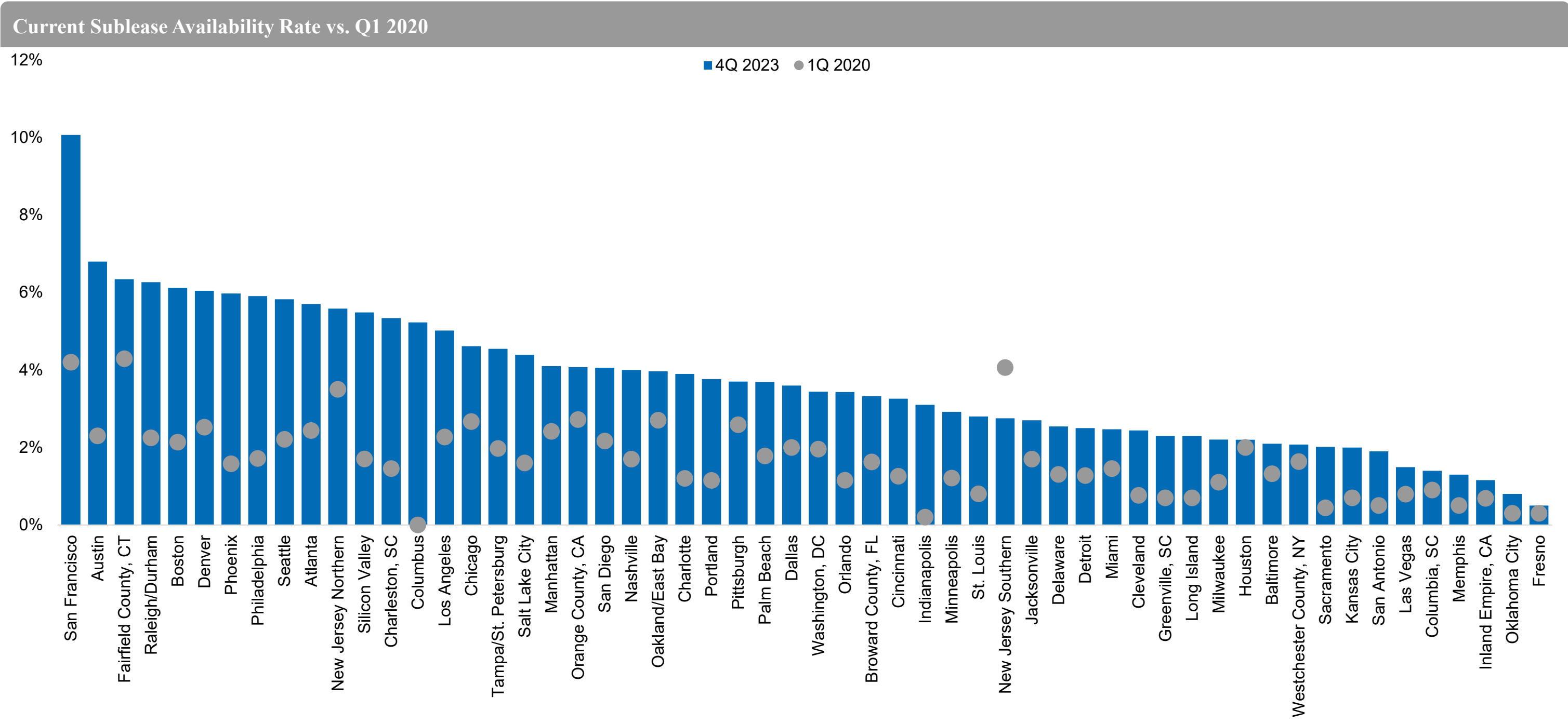


Source: CoStar, Newmark Research



# Sublease Availability by Market

Sublease availability remains elevated above pre-pandemic baseline levels in most U.S. markets. Larger markets exhibiting particularly challenging sublease environments include San Francisco, Austin, Fairfield County, Raleigh/Durham and Boston. Instability in the tech industry, evidenced by layoffs over the course of the year, indicates that these markets could experience greater increases in sublease availability, further softening fundamentals.

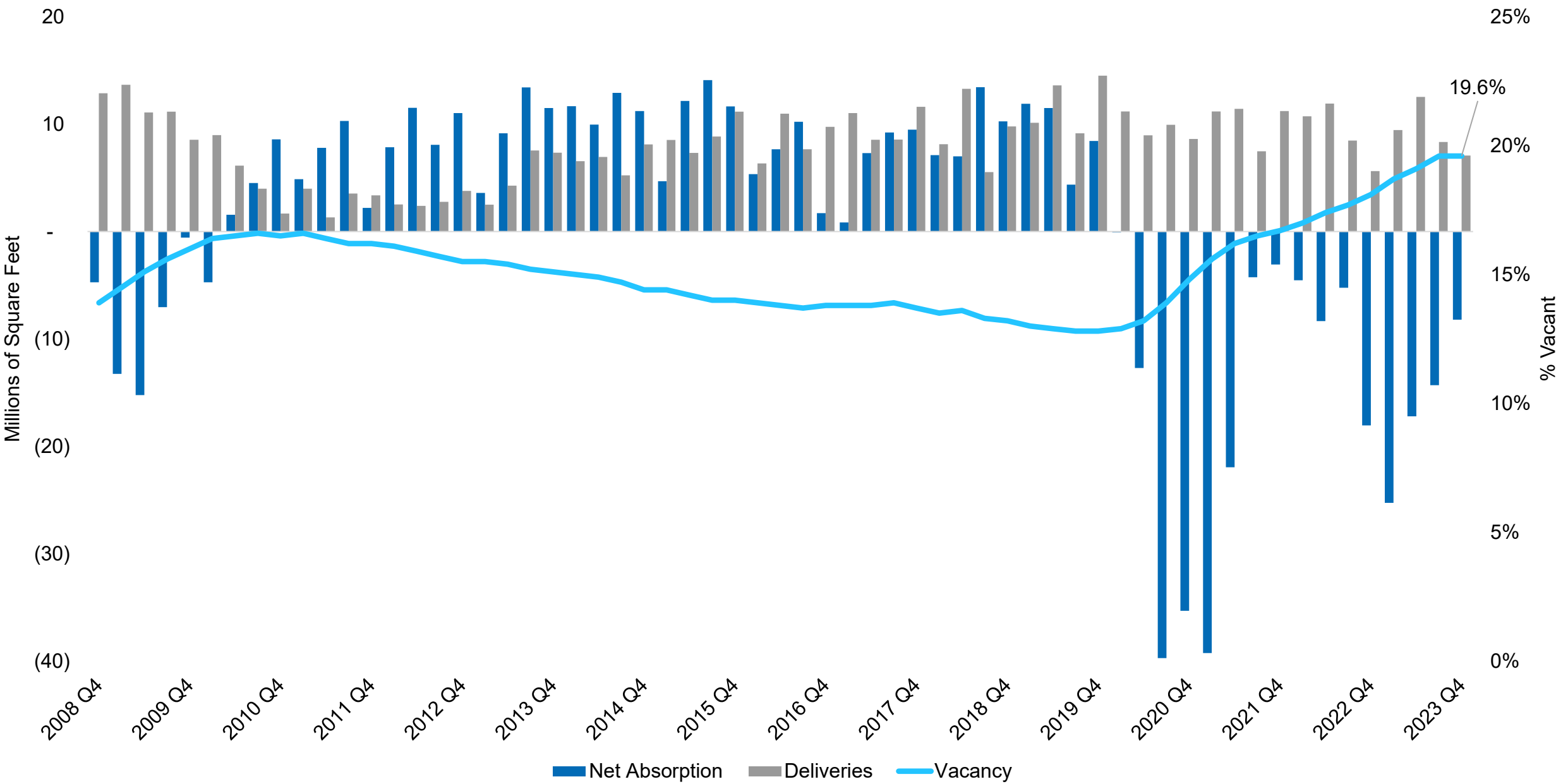


Source: CoStar, Newmark Research

# Net Absorption Remained Negative, but Losses have Declined for Three Quarters

Net absorption, though negative, improved on the margin in the fourth quarter of 2023, resulting in space givebacks totaling negative 8.2 million SF. Since the first quarter of 2020, net absorption has totaled over negative 257.4 million SF, significantly worse than either the Great Recession (negative 51.6 million SF) or dot-com (negative 75.7 million SF) market downturns. Despite consistent delivery of new product, the noteworthy reduction in demand has driven vacancy to its highest levels in the cycle, reaching 19.6%.

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



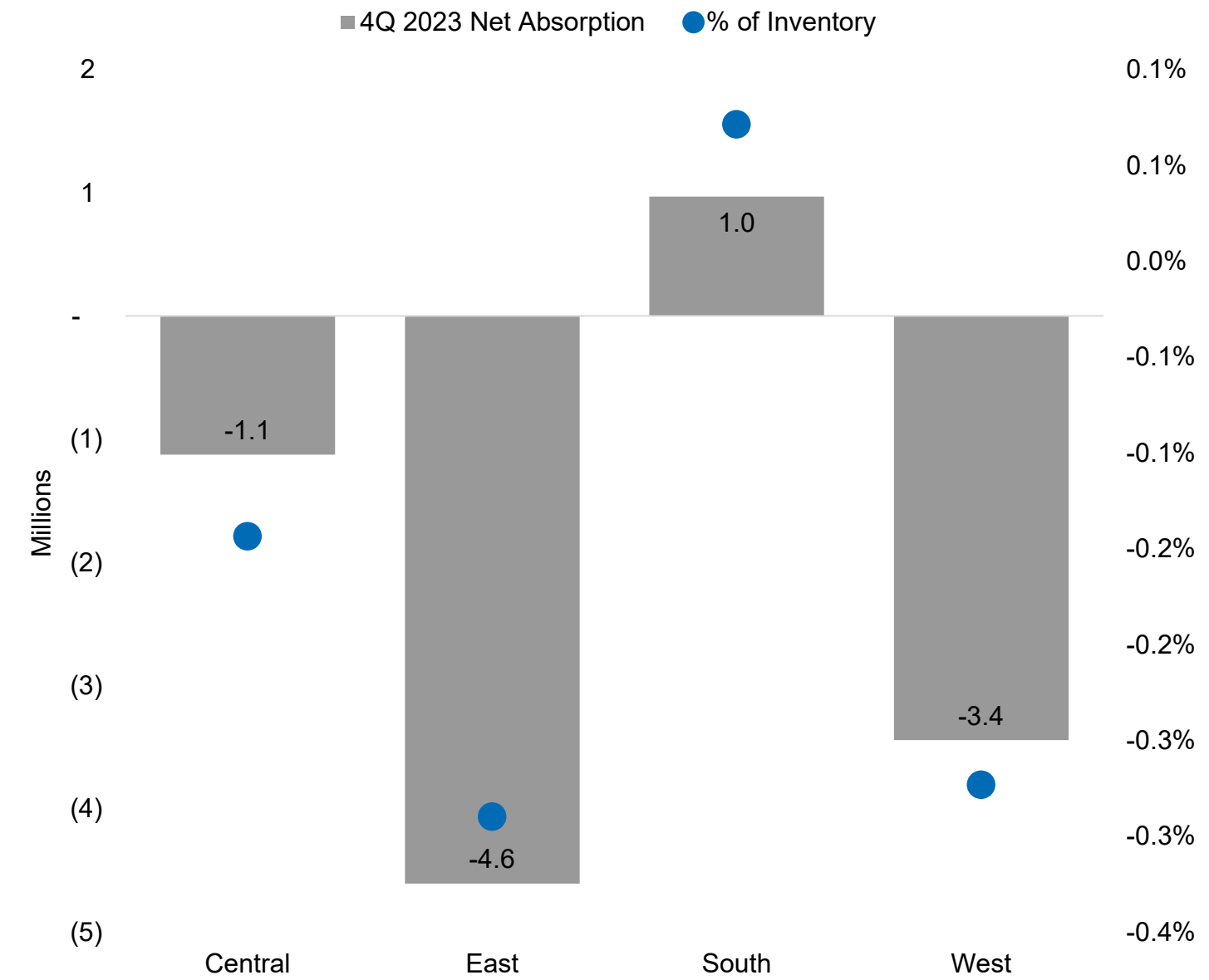
Source: CoStar, Newmark Research



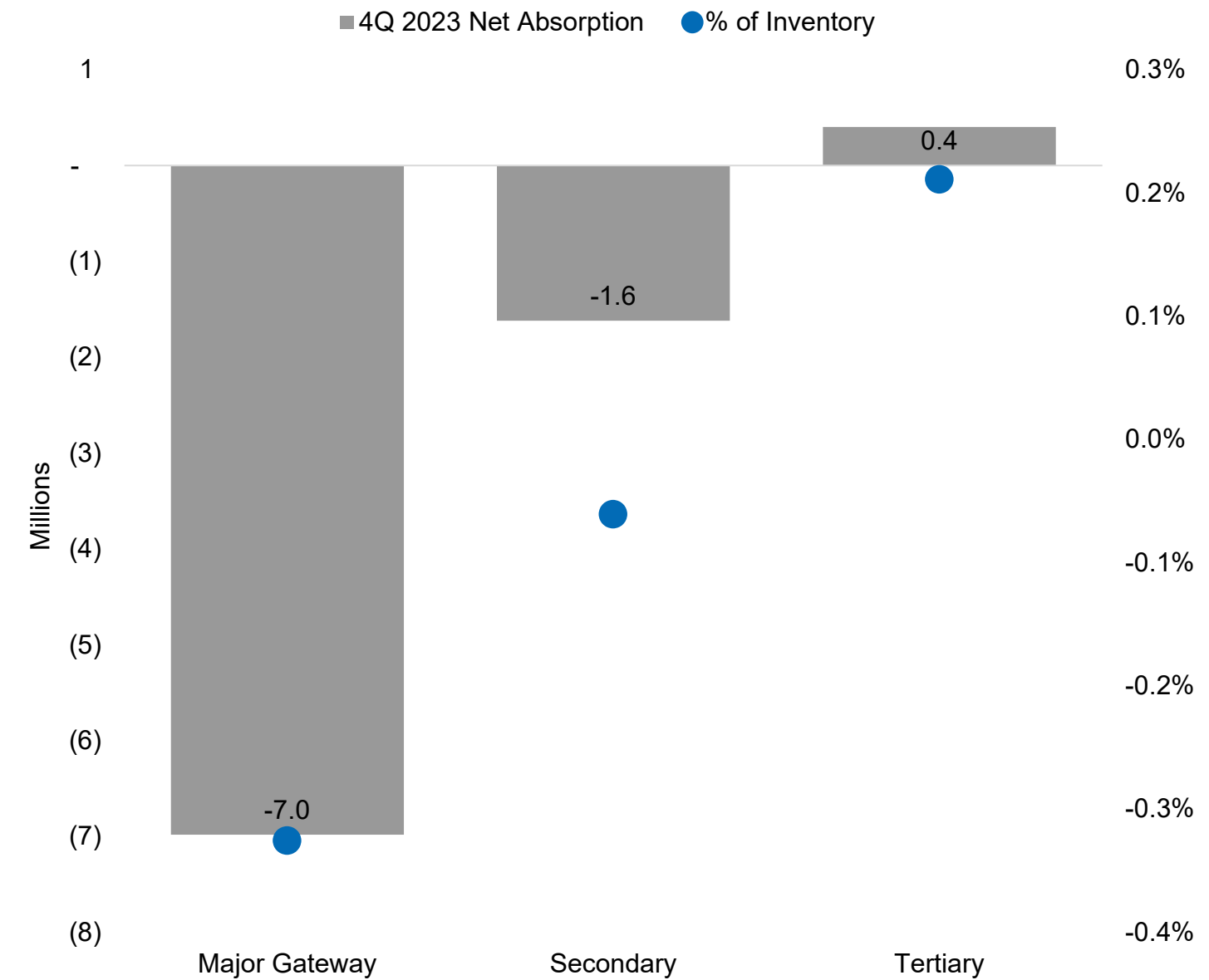
# Net Absorption Contracted in 4Q23 in Larger Regions and Market Tiers

Occupancy losses continued to mount in the fourth quarter of 2023, driven most strongly by the Eastern Region, where losses in the fourth quarter of 2023 amounted to negative 4.6 million SF. Losses in major gateway markets amounted to negative 7.0 million SF. Southern markets saw notably positive occupancy growth in the fourth quarter; this was driven by strong gains in the Houston market, where net absorption totaled positive 1.5 million SF.

Regional Net Absorption



Market Size Net Absorption

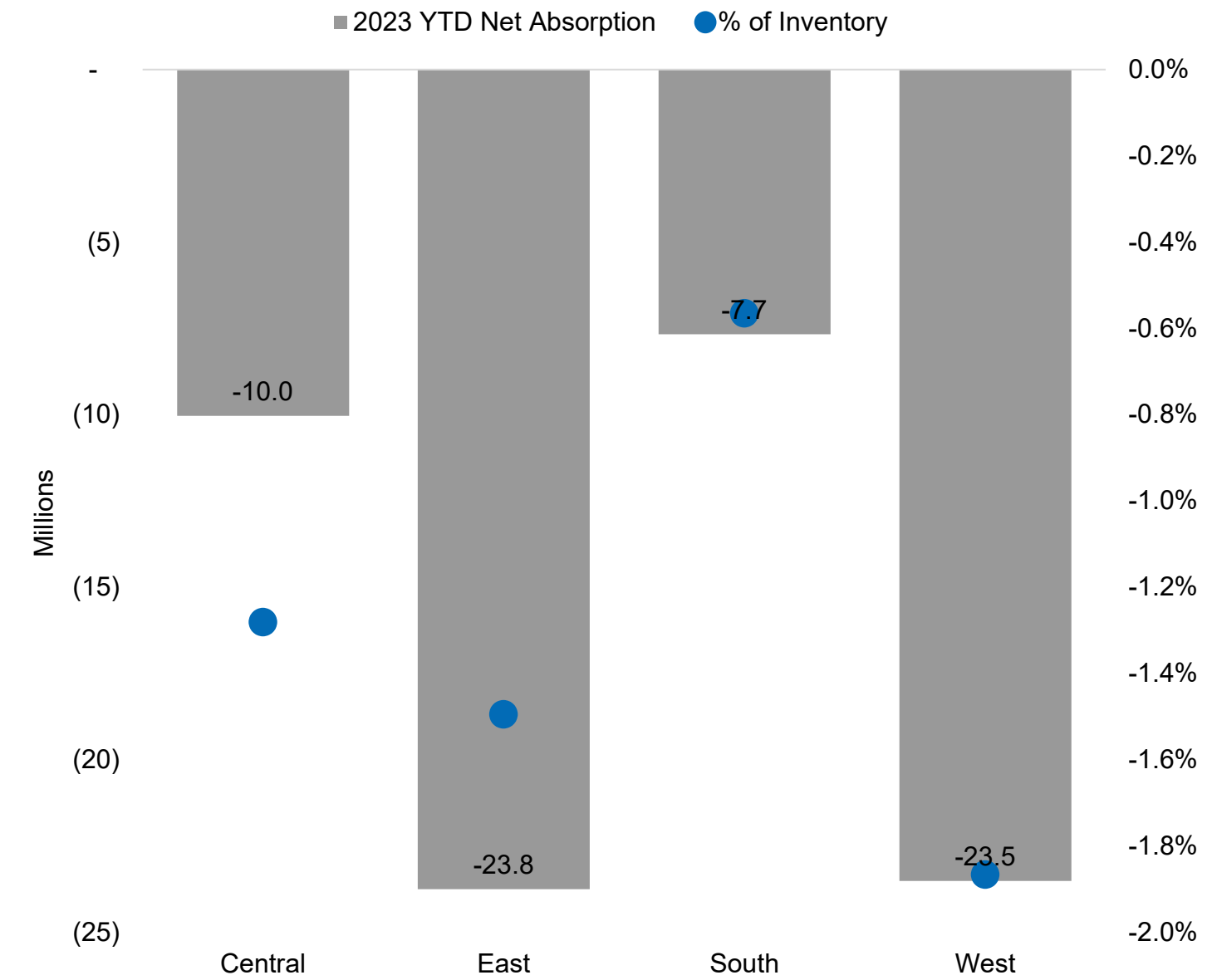


Source: CoStar, Newmark Research

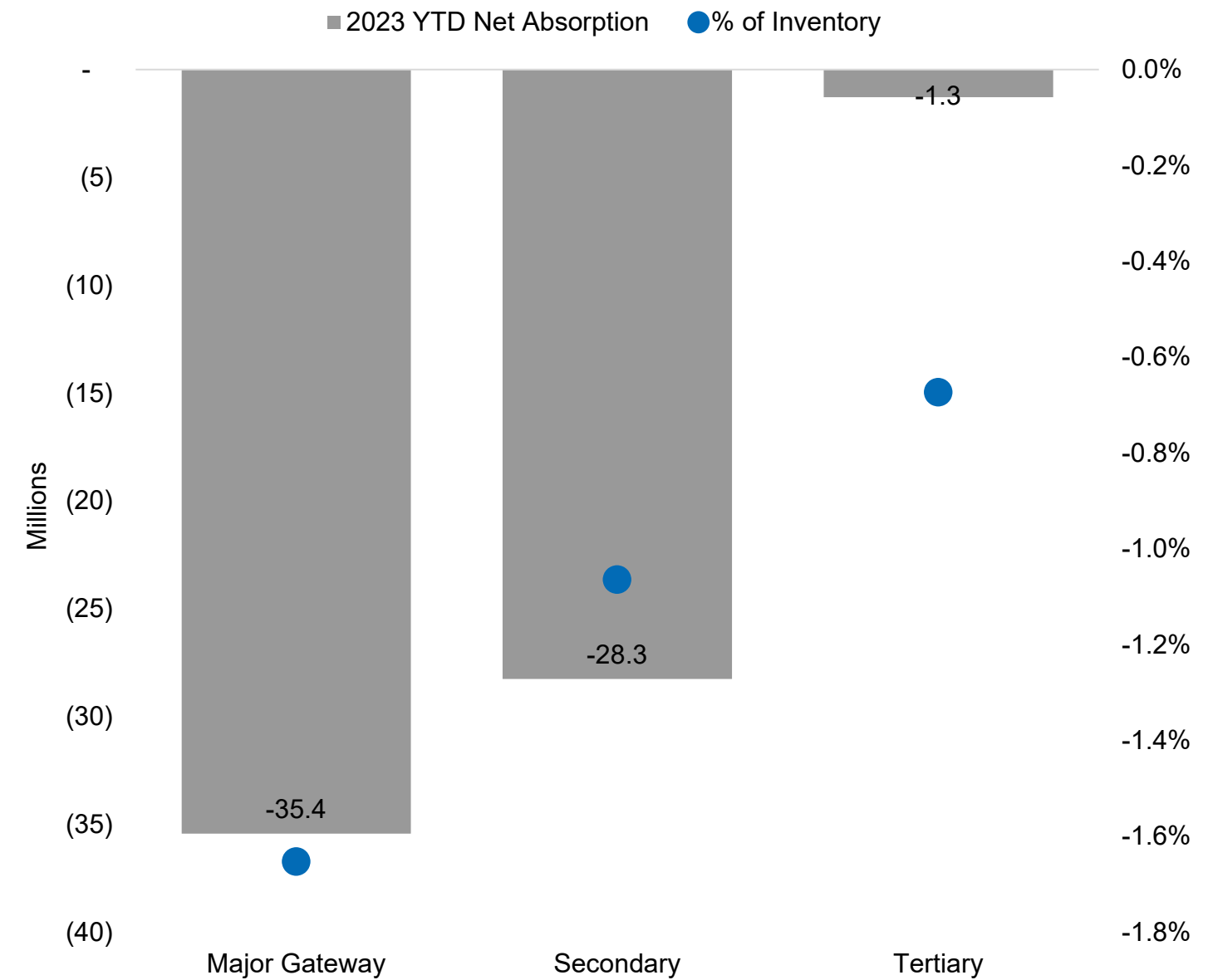
# Occupied Space Declined Across Regions and Market Tiers in 2023

Annual net absorption in 2023 was strongly negative across regions and market tiers, with Eastern and Western markets shedding comparable amounts of occupancy over the course of the year. Net absorption totaled nearly negative 65.0 million SF in 2023.

Regional Net Absorption



Market Size Net Absorption



Source: CoStar, Newmark Research





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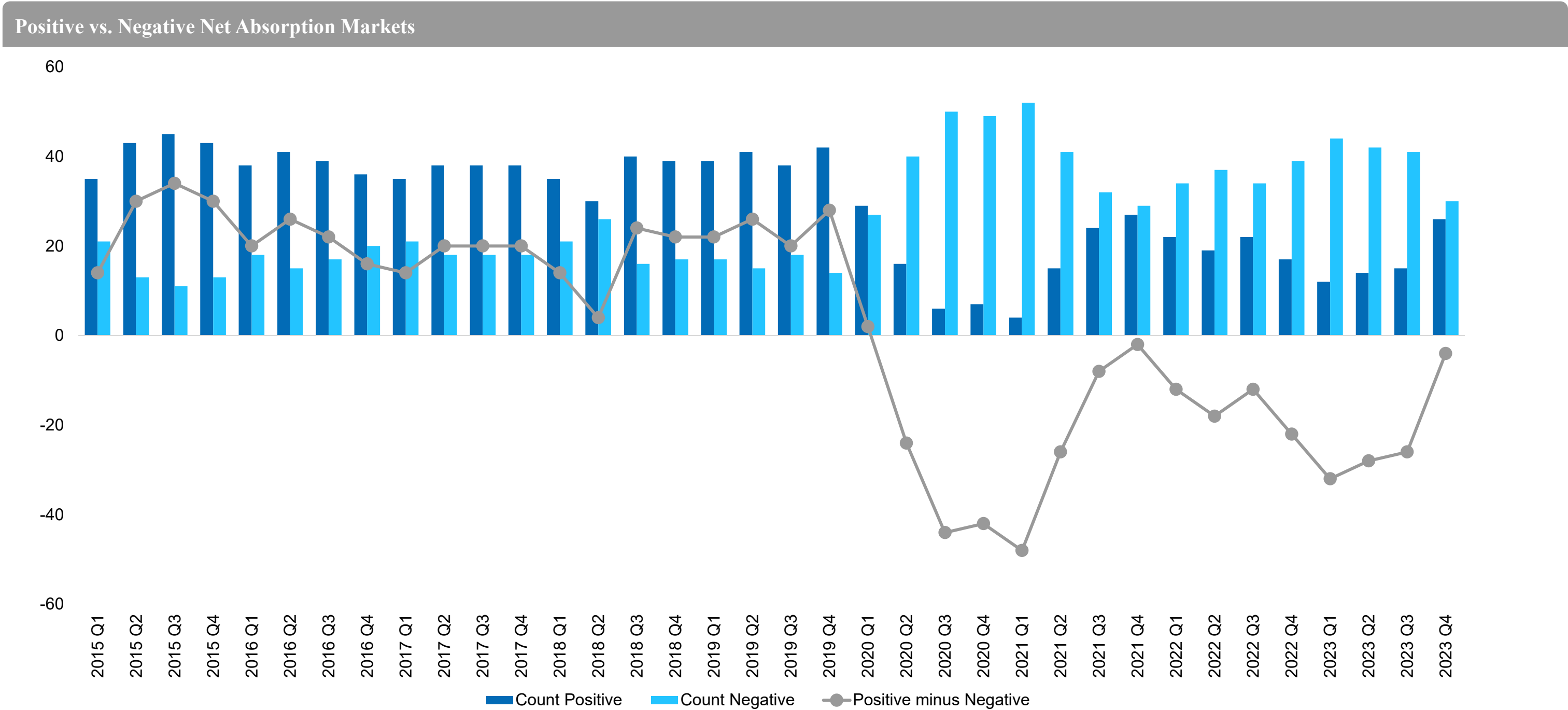


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# Net Absorption: 15 Consecutive Quarters of Negative Diffusion

26 markets recorded positive net absorption in the fourth quarter of 2023 while 30 recorded negative net absorption, giving a diffusion index of negative 4.0 for the fourth quarter of 2023. Since the second quarter of 2020, an average of 40 markets have recorded quarterly negative net absorption, with an average diffusion index of negative 23.2.



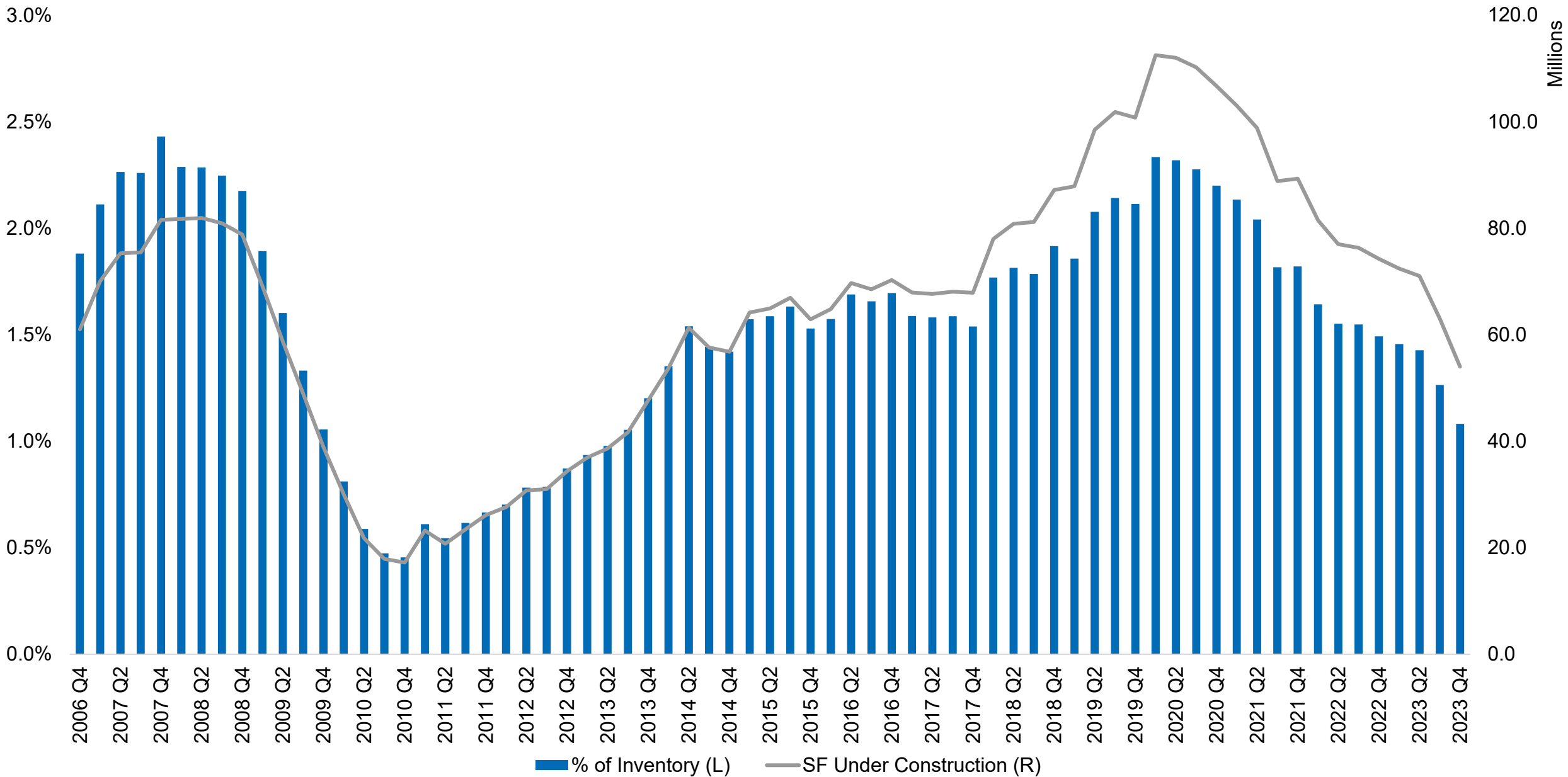
Sources: CoStar, Newmark Research



# Office Construction Pipeline Contracts at Measured Pace

Office space under construction peaked in early 2020 at nearly 112 million SF but has slowed as the pandemic influenced office demand in the years since. Construction activity inched down in the fourth quarter of 2023 as pessimism among some discouraged new groundbreaking activity. The pipeline is expected to at best remain stable in the near term due to decreased overall demand for office space and increased economic uncertainty.

Under Construction: Percent of Inventory and Total Square Footage

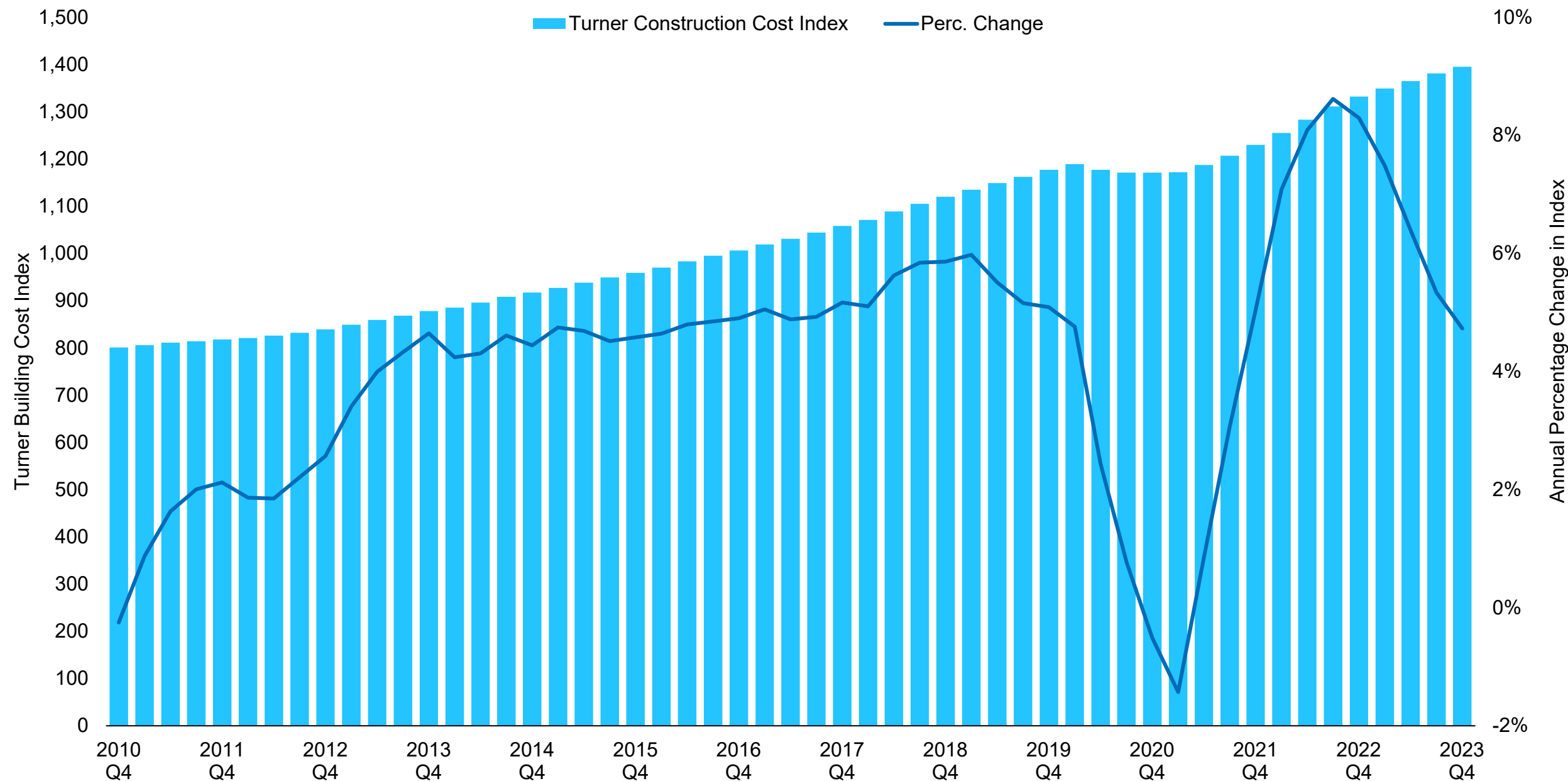


Sources: CoStar, Newmark Research

# Office Construction Cost Growth Decelerated in 2023

Inflationary pressures continued softening in 2023, and construction pricing appeared to respond in the fourth quarter of 2023. Construction pricing generally increased from 4.0% to 5.0% through much of the mid-2010s. While the annual growth rate of the Turner Building Cost Index slid down in the fourth quarter of 2023, it remains high at nearly 4.7%.

Turner Building Cost Index



Source: Turner Construction, Newmark Research





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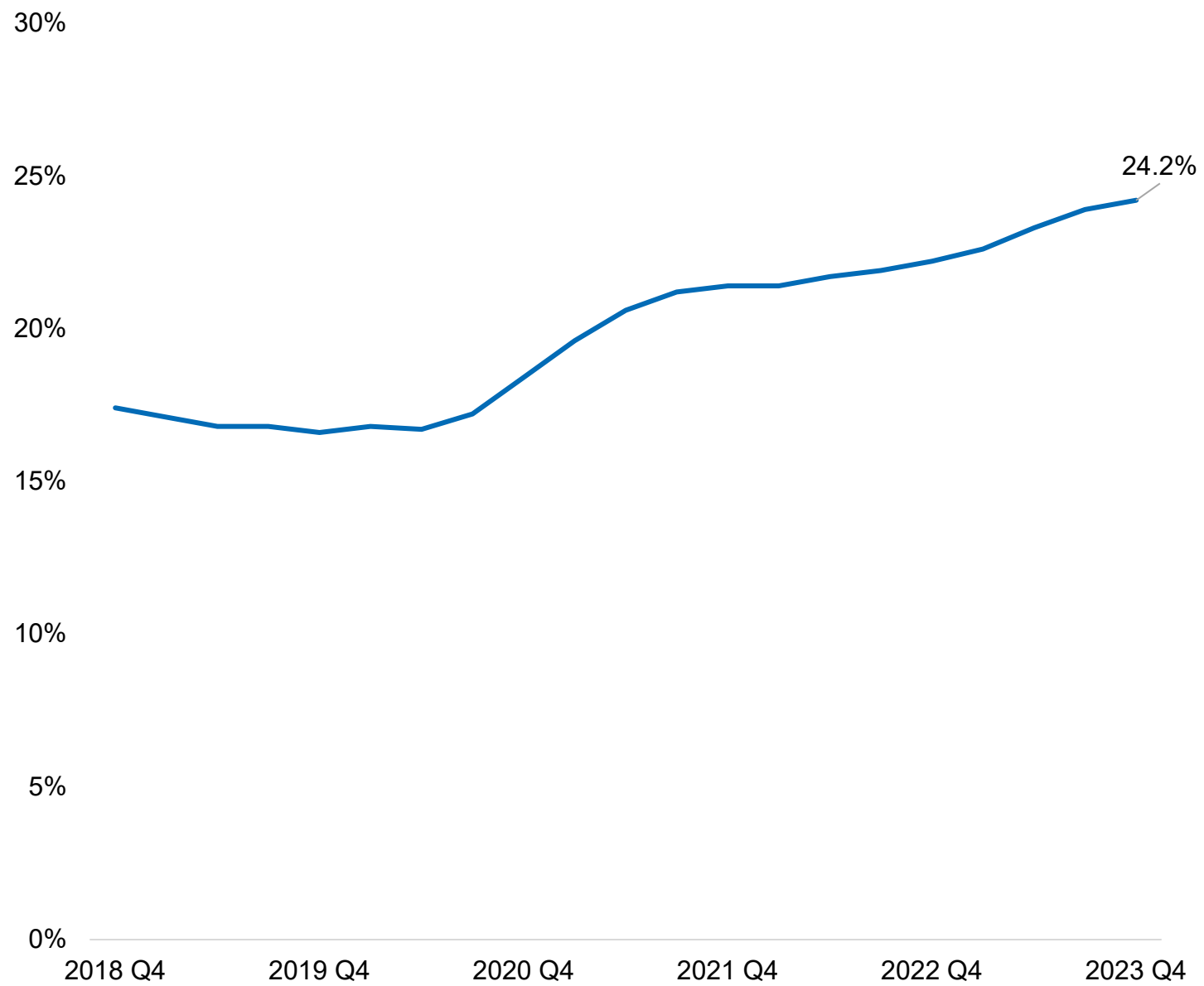
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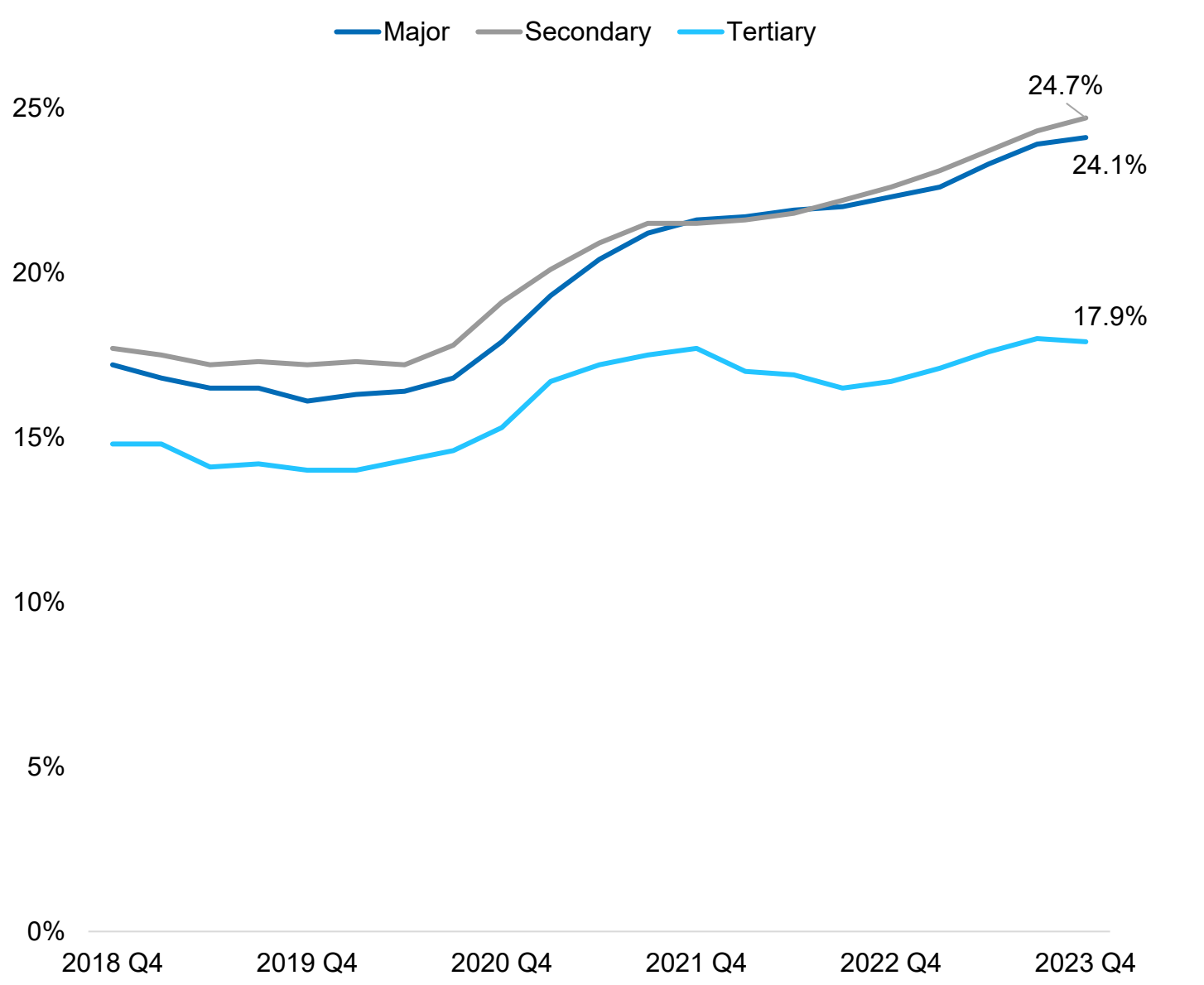
# Availability Rates Have Not Yet Peaked

With the vacancy rise, overall availability rose as well in the fourth quarter of 2023 and is notably elevated in major and secondary markets. Prior to the fourth quarter of 2022, tertiary markets had recorded stabilizing availability levels, but renewed uncertainty has driven up availability rates alongside other fundamentals, including sublease space and vacancy.

National Office Market Availability Rate



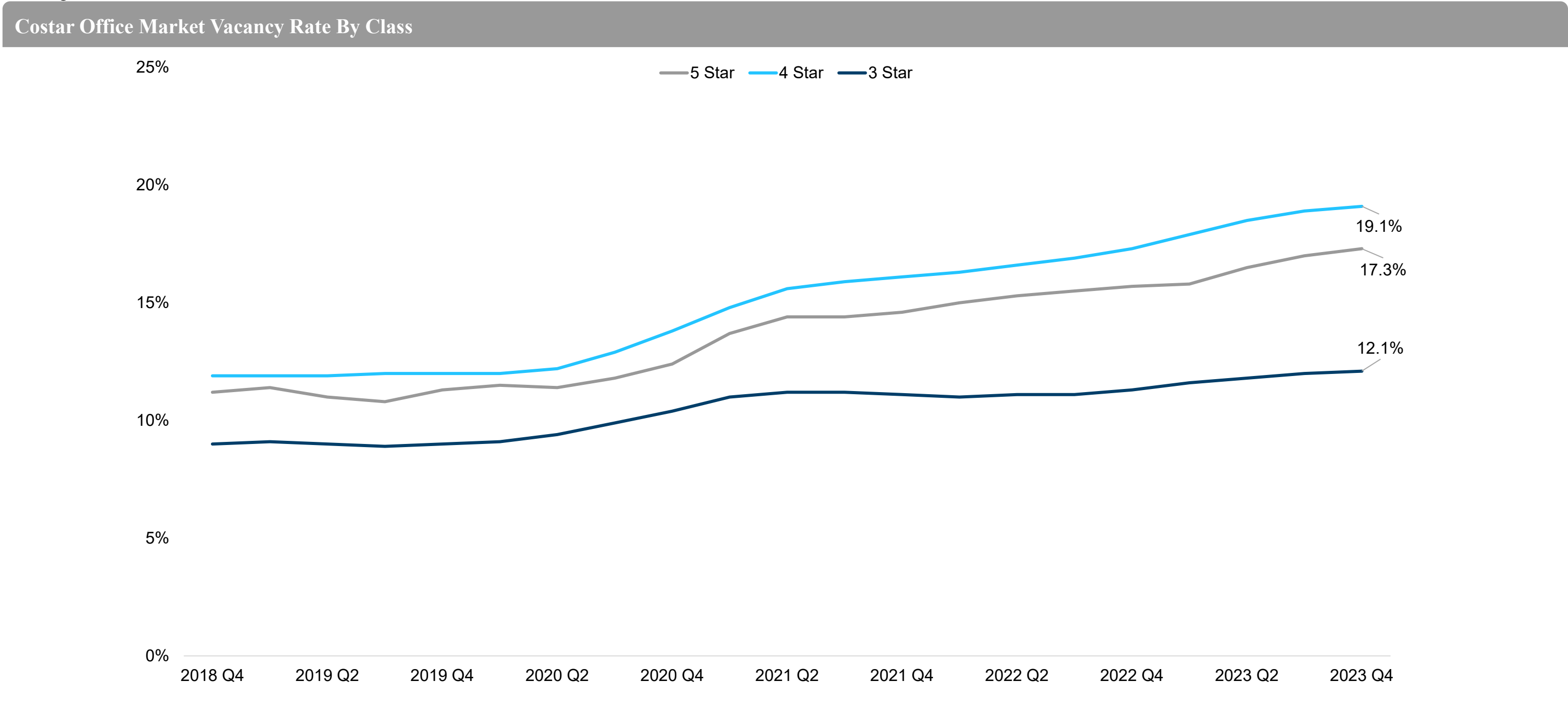
Availability Rate Comparison By Market Size



Sources: CoStar, Newmark Research

# Vacancy Rates Continue to Rise Across Building Grades

There is a disconnect between the well-attested preference for high-quality office space by investors and large tenants and data. CoStar is just one example that shows middle-tier outperforming upper-tier product on an occupancy basis. Partly, this seems to be due to a large performance gap between trophy office – the top 5% to 10% of a market – and commodity Class A, proxied here by 4- and 5-star properties. Class A owners arguably have yet to capitulate on rents to a sufficient degree to siphon demand from lower-quality buildings.



Source: CoStar, Newmark Research



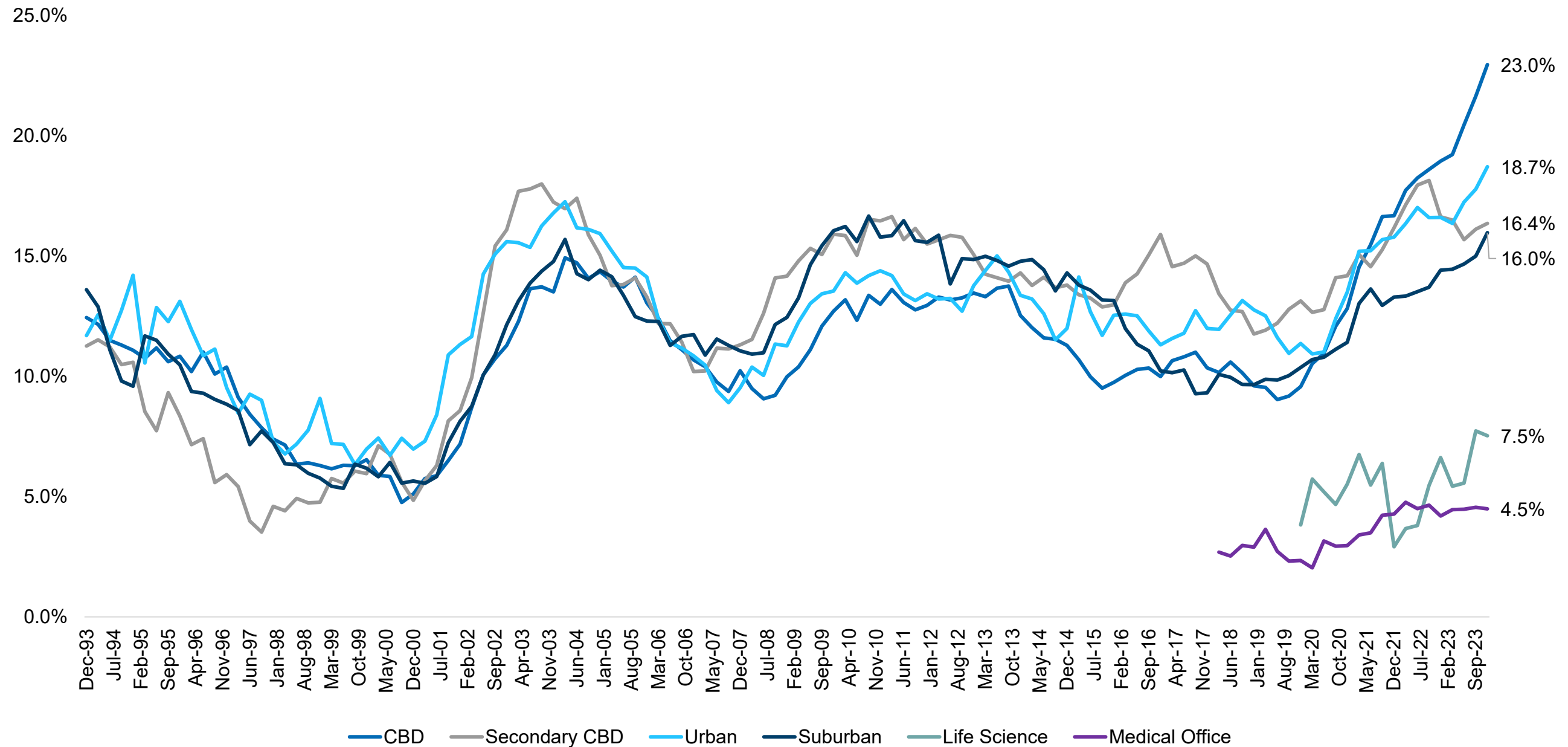


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CBD office buildings in NCREIF member portfolios have the highest availability rates. This contrasts with historical experience, where CBD offices experienced shallower downturns and quicker recoveries. Suburban office holdings have been impacted as well, but to a lesser extent. While availability continues to increase, suburban office rates are still below the Great Recession highs. NCREIF member holdings of life science and medical office are comparatively small, but they are well-occupied.

**NCREIF National Property Index Office Availability Rate**



Sources: NCREIF, Newmark Research as of 2/12/2024

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





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A low-angle, upward-looking photograph of a modern building's interior or exterior structure. The image features a complex network of steel beams and girders forming a grid-like pattern. Large glass panels are visible, reflecting the sky and other parts of the structure. The perspective creates a sense of height and architectural scale. A solid blue horizontal band is overlaid across the middle of the image, containing white text.

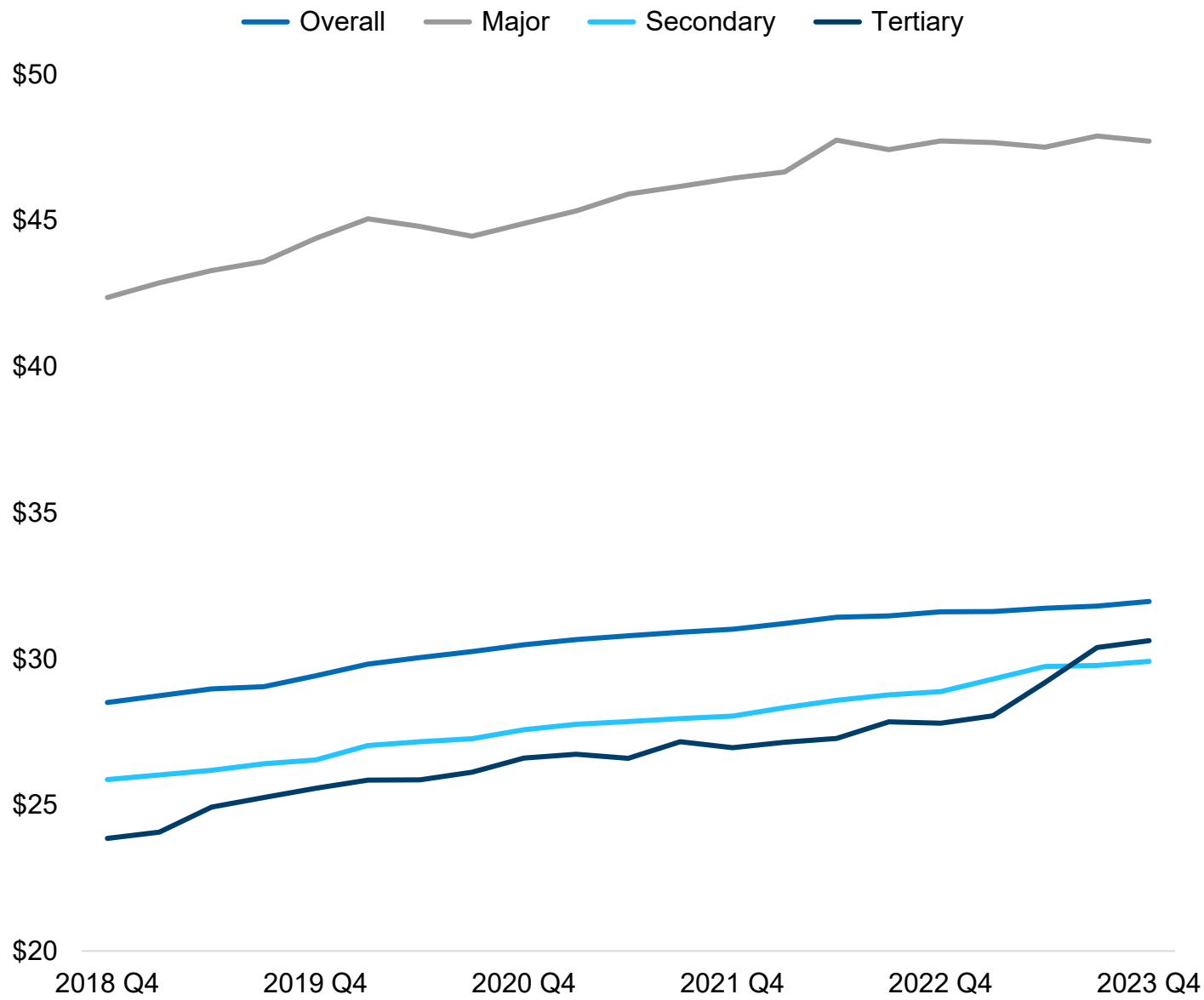
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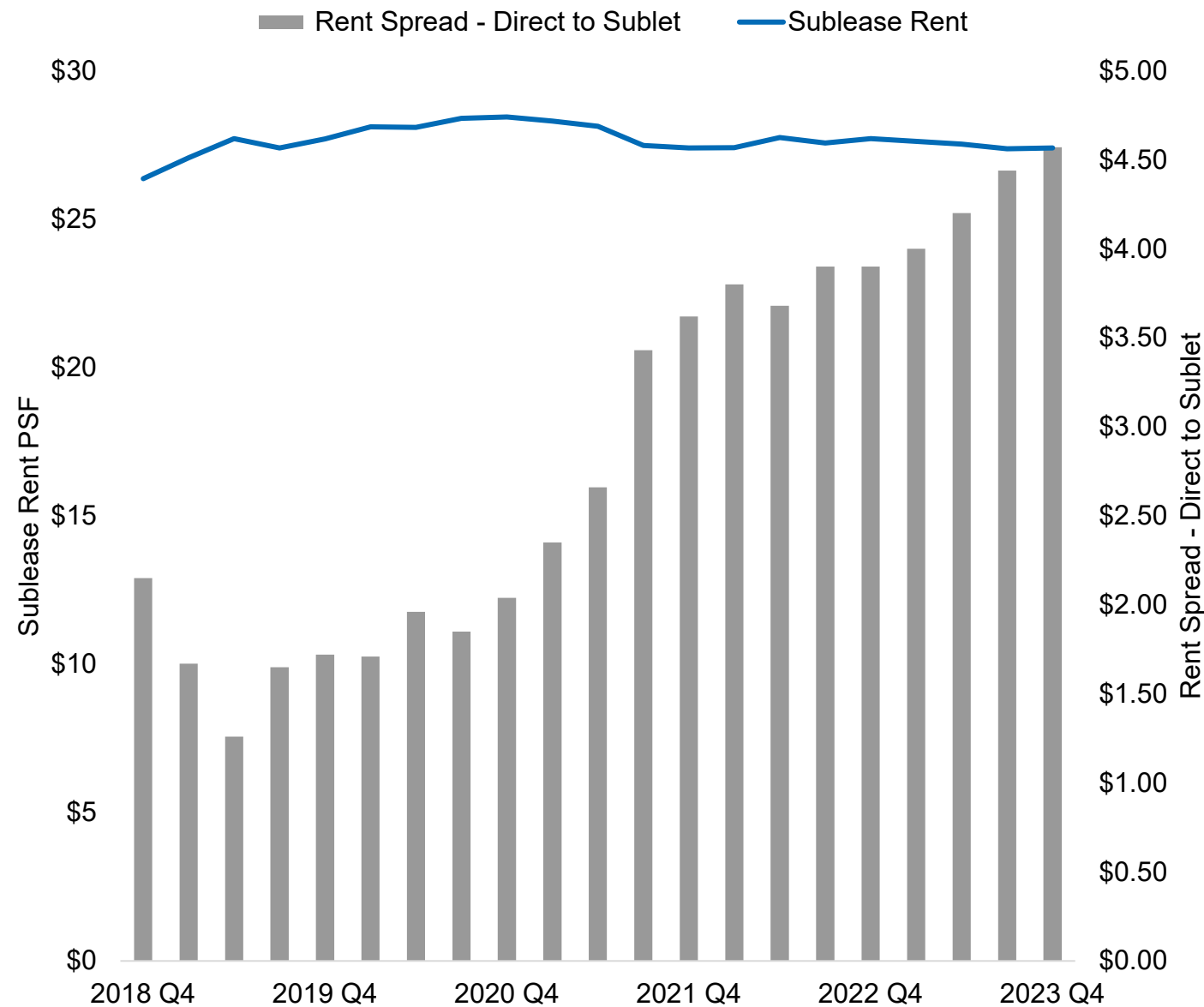
# Asking Rents March On

In past cycles, asking rents have adjusted downward to account for depressed demand; however, asking rents have largely held value since the onset of the pandemic. Some rent compression is being experienced among major markets, but secondary and tertiary markets continue to appreciate. 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 widened to near all-time highs.

Overall Asking Rents Up 1.1% YoY in Q4



Sublet Rents Stabilized; Rent Spread Relative to Direct Rates Near All-Time High



Source: CoStar, Newmark Research





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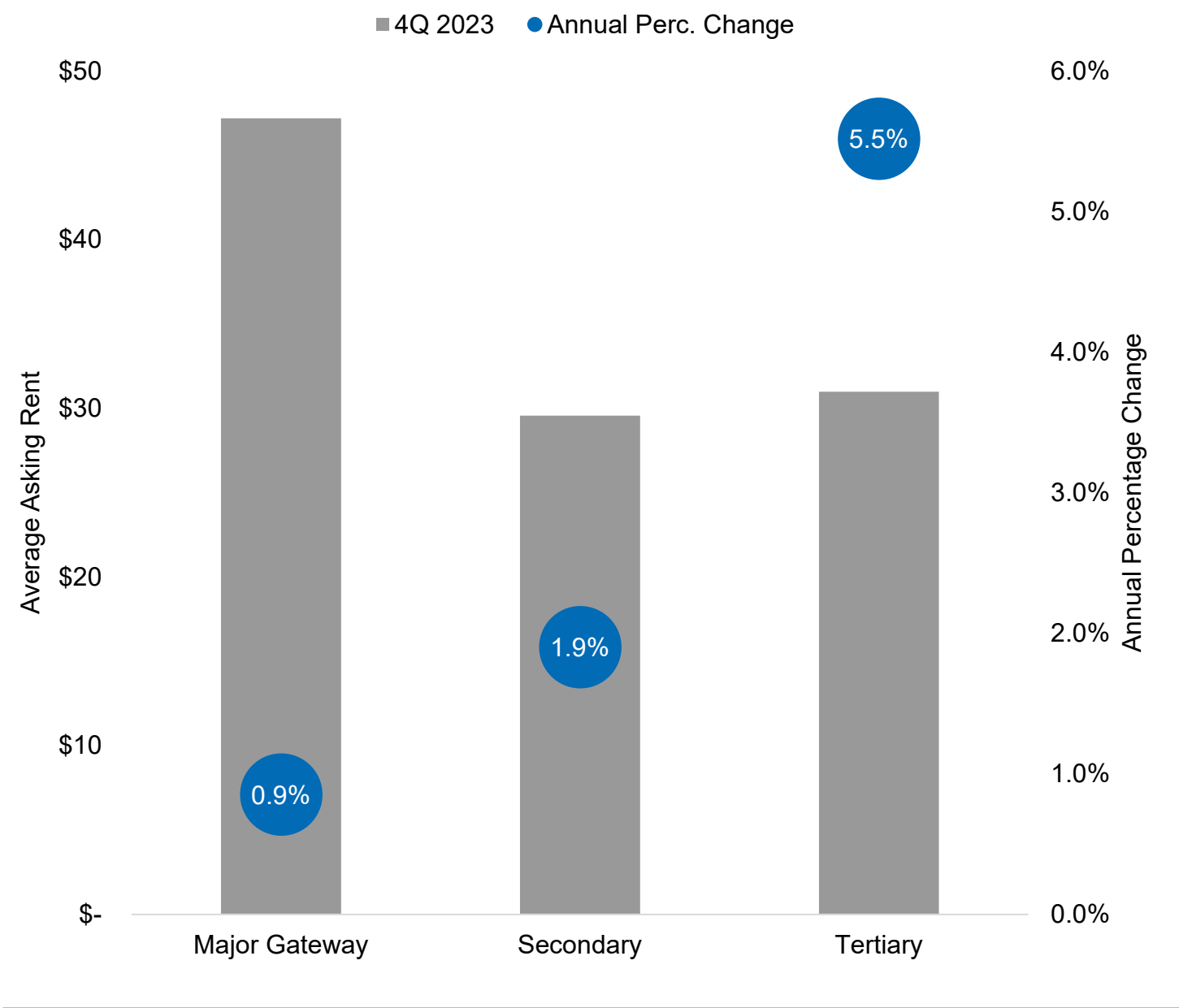
# Southern and Western Regions and Non-Major Markets Leading in Rent Growth

Overall asking rents are most elevated in major coastal Eastern and Western markets, including San Francisco, Manhattan and Silicon Valley. The South and West Coast continue to experience aggressive rent appreciation, driven partly by inventory expansion and the success of secondary markets in attracting office demand in an otherwise challenging time. Effective rents are under downward pressure and modest rent compression is being felt in some markets.

Asking Rents Growing Fastest in the Central and West Regions



Non-Major Markets Experiencing the Most Rent Growth



Source: CoStar, Newmark Research





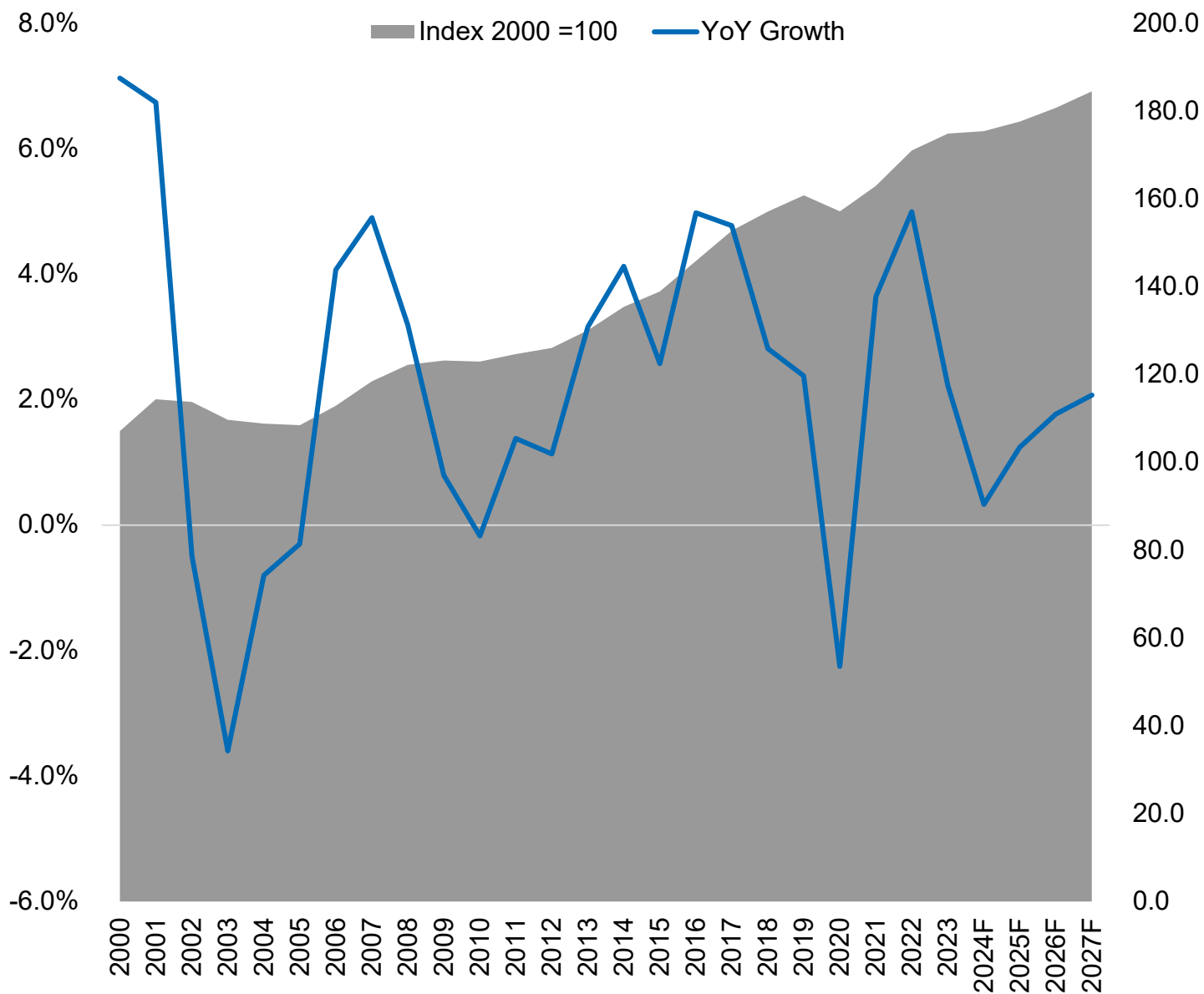
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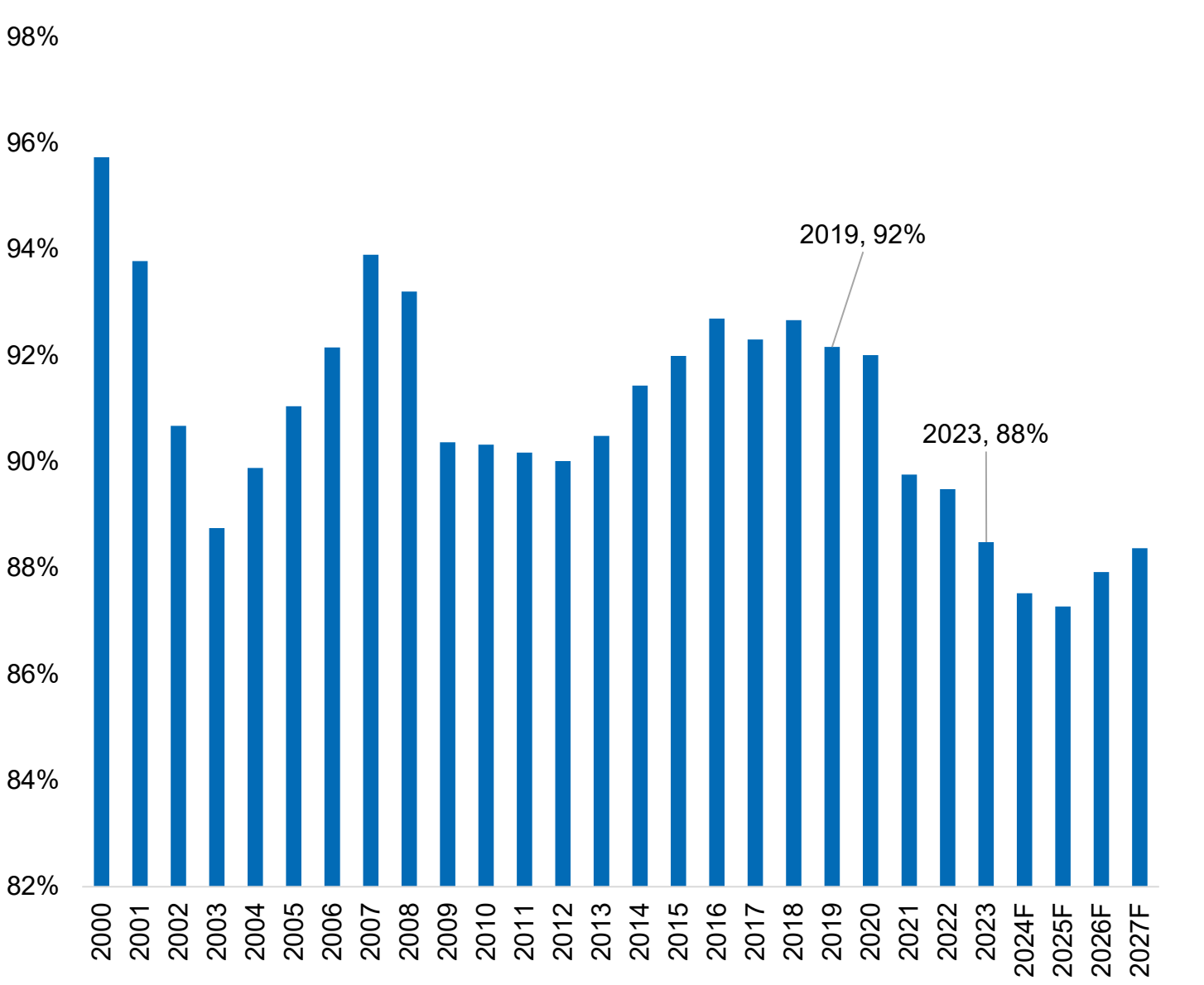
# Office REITs Also Show Better than Expected Cashflow Trends

Despite the significant deterioration in overall leasing market conditions, office REITs have continued to grow their same-store NOI. Partly, this reflects disposition of underperforming assets, but this still means that the pruned portfolios are performing. Occupancies are at their lowest levels since at least 2000, but projections suggest they could bottom soon.

REIT Same-Store NOI



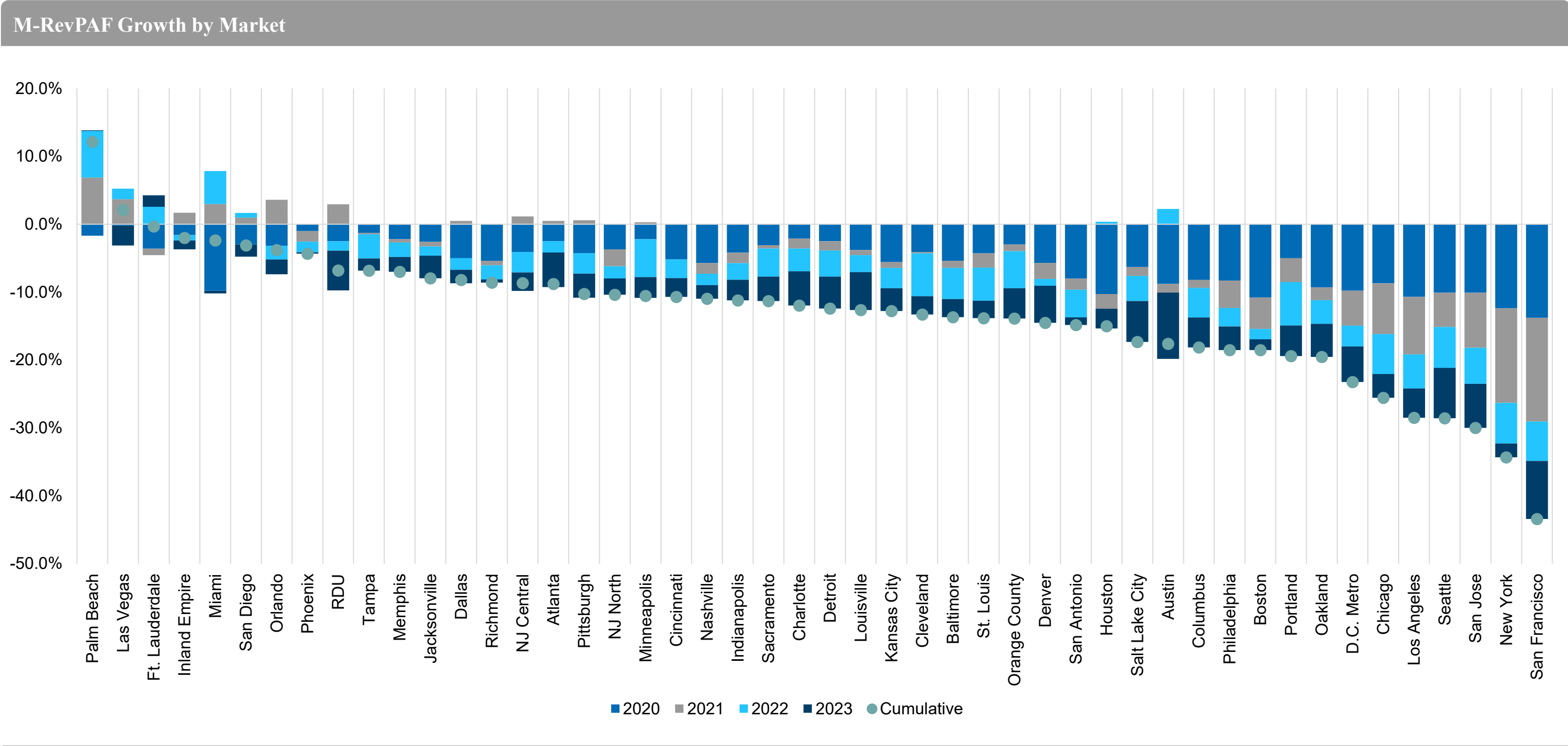
REIT Same-Store Occupancy Stabilizing



Source: Green Street data as of 2/12/2024, Newmark Research

# RevPAF\* Contracts across Markets in 2023

The larger picture, however, shows that Sun Belt markets have outperformed since 2020, notably Florida markets, as well as San Diego and the Inland Empire. By far, the worst-performing market has been San Francisco, but other gateway markets have also been hard hit, including New York, San Jose, Seattle, Los Angeles, Chicago and DC.



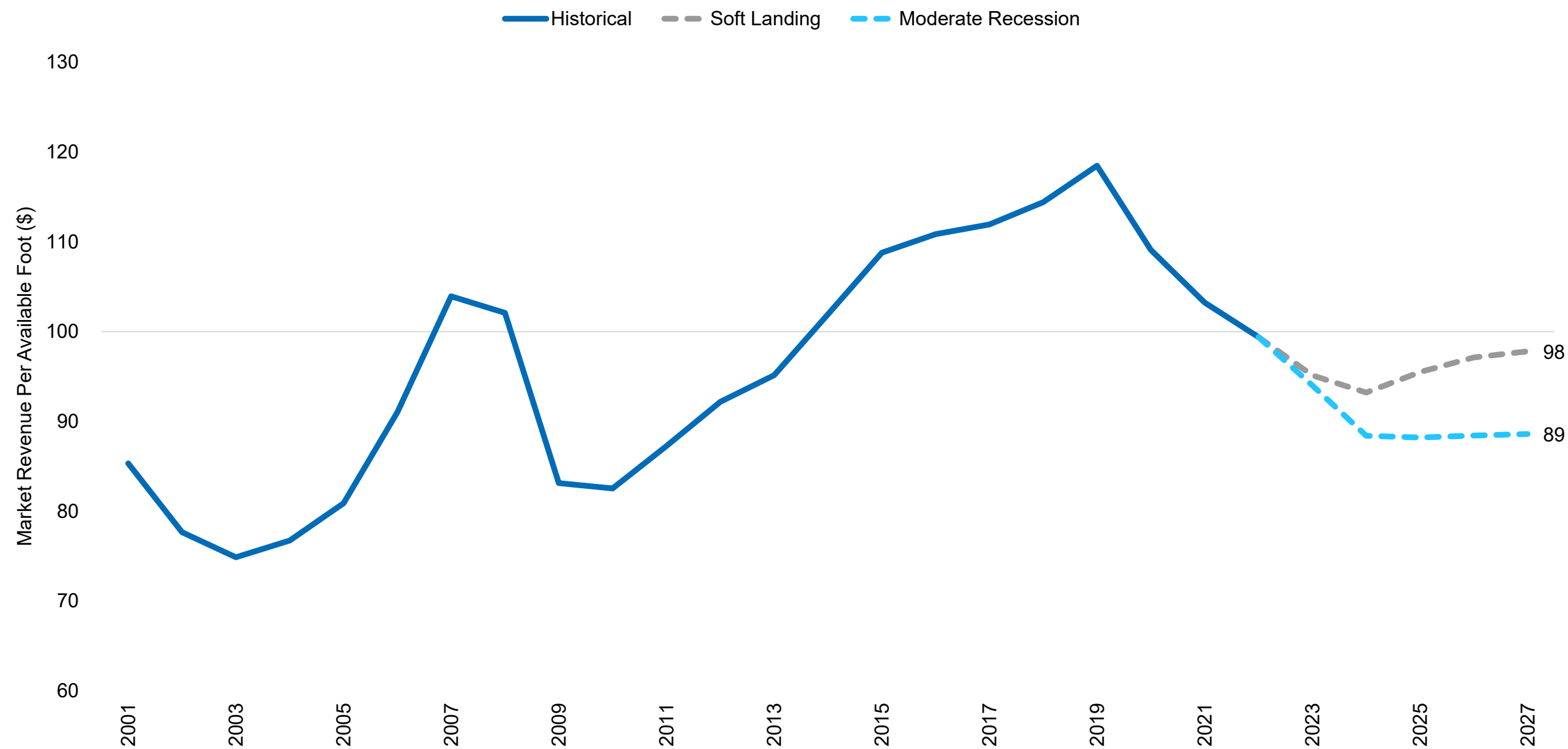
Source: Green Street data as of 1/25/2024, Newmark Research  
\*Market revenue per available foot combines the impact of changes in effective rents and occupancy to produce a measure of overall leasing market performance.



# Broad Market Fundamentals Face a Slow Recovery

Market revenue per available foot has been trending downward since 2019, and it is not expected to hit bottom until the end of 2024 at the earliest. A recession would result in a deeper trough and a slower rebound. Even in the event of a soft landing, the office market fundamentals will improve slowly and only return to the previous peak through a process of eliminating large quantities of obsolescent stock. Newer, well-located properties have had a very different experience and will continue to do so.

Green Street M-RevPAF (December 2000 = 100)



Sources: Green Street, Newmark Research as of 2/12/2024



4Q23 US OFFICE MARKET OVERVIEW

# Office Market Statistics







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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 [nmrk.com/insights](https://nmrk.com/insights).

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