Office Demand Shows Remarkable Sign of Life

VODI Index shows a 31% rise in demand from February to March.

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By: Richard Berger

Office demand emerged from the slower winter months with an exceptionally strong start to the busier spring season, rising 31.3% from February to March, according to the latest VTS Office Demand Index (VODI).

That's a 31.3 percent spike for a sector that has been getting talked down, left and right lately.
The VODI tracks unique new tenant tour requirements, both in-person and virtual, of office properties in core U.S. markets, and can be seen as an early indicator of upcoming office leasing activity.

The March VODI, however, was still down 4.5 percent from its level a year ago.
Nick Romito, CEO of VTS, said in a prepared statement, "The Fed's streak of interest rate hikes and a spectrum of severe weather lashing all areas of the country in recent months undoubtedly sidelined office touring activity and leasing decisions for many employers.

"The sluggish start to the year left us in limbo as to whether we'd see normal levels of spring activity return. Thankfully, the office leasing market had its spring awakening – and then some."

Locally, all cities tracked by the VODI saw office demand increase in March, with five of the seven cities reporting office demand jumps of more than 30 percent month-over-month. San Francisco saw the largest jump, rising 69 percent from February to March to a VODI level of 49.
Office demand in both Boston and Los Angeles jumped 42 percent in March, followed by New York City and Washington, D.C., whose VODI levels rose 35.7 percent and 32.7 percent month-over-month, respectively. Of note, San Francisco and New York City are now at their highest levels since September of 2021.

Ryan Masiello, Chief Strategy Officer of VTS, said in a prepared statement, "Some of what we're seeing play out in the East Coast vs. West Coast office leasing markets are partially a reflection of the city's job market performance.

"Layoffs and declines in job postings have hit the tech sector particularly hard, and consequently held office demand back in tech-heavy metro areas like San Francisco and Seattle.

New York City's combination of smaller living spaces and comprehensive public transportation is making a return-to-office much more appealing for employees and employers alike, according to Masiello.

"We're still operating in cloudy economic conditions though, so it will be interesting to see if this coastal gap persists as we continue into the busier spring and summer months."

Looking ahead to 2024 Lease Expirations

Howard Schmidt, vice president – tenant representation & occupier solutions, Avison Young, Denver, tells GlobeSt.com that in Denver, companies are looking at 2024 and 2025 lease expiration dates and are getting started early to meet their goals and are recognizing that landlords are offering incentives not seen in a long time as they work to elevate their occupancy levels.

Sectors such as AI, tech, and engineering are growing in Denver. For example, one international engineering firm that recently relocated to Denver has expanded its current office size by four times.

Denver is still dealing with pent-up demand/tenant plans coming out of the pandemic, Schmidt said.

"Many tenants did short-term extensions and are now rolling out their post-COVID space needs going forward," he said. "Overall, there has been a continued flight to quality and CBD Denver tenants flocking to other locations such as Cherry Creek, West Denver, and the Tech Center."

Accepting Remote is Not Going Away

Ian Weiner, President and CEO of PEBB Enterprises, tells GlobeSt.com, "Office demand is stronger than projections in core U.S. markets because there has been widespread acceptance of the fact that remote work is not going away, but it will not entirely replace the traditional office setting.

"Much of the demand is for Class A office space offering access to amenities within or surrounding buildings. Some of the largest corporations have either returned their workforce to the office or announced intentions to do so, and those 'first movers' influence the rest of the corporate world.

"Employment remains very strong despite inflation and interest rate challenges so that further bolsters confidence in the office sector. If there is a dramatic increase in the national unemployment rate, that could potentially blunt some of the sector's momentum."

Miami, Houston Head-and-Shoulders Above

Phil Mobley, national director of office analytics at CoStar Group, tells GlobeSt.com that the current reality in the office market is that the pre-pandemic years are still the best frame of reference for leasing trends.

In that context, only two major U.S. markets have seen consistently strong leasing performance in the past 12 months.

Mobley said new leasing volume in Miami was 48% above its 5-year pre-pandemic average in 2023 Q1 and has exceeded that benchmark by an average of 44% since the beginning of 2022. Similarly, Houston's new leasing volume has averaged 13% above its pre-pandemic benchmark since the beginning of 2022, including exceeding it by 17% in 2023 Q1.

At the other end of the spectrum, leasing volume has remained consistently poor in San Francisco, where it was 55% below the pre-pandemic average in each of the past two quarters.

Seattle, Philadelphia, and Washington, D.C. have also seen new leasing volume stay persistently 30% to 40% below historical norms over the past year, though each of these markets did experience a less pronounced underperformance in 2023 Q1.

"San Diego is an interesting case because its leasing volume appeared to have recovered in 2021 and early 2022, but more recently has seen volumes lag far behind, placing it among the worst performers among major markets," Mobley said.

Under 3,500 Square Feet a Sweet Spot

Chris Okada, CEO of Okada & Co., tells GlobeSt.com that Q1 concluded with 38 lease transactions representing 68,211 SF mostly in New York's Chelsea & The Fashion District areas – a 216% increase in the number of transactions completed compared to Q1 2022 (12 leases), and a 230% increase in the total square feet leased in Q1 2022 (20,643SF).

"Although we have a volume increase, trends we are noticing are that spaces under 3,500 SF move almost 2.5 times faster than spaces over 6,000 SF, and larger spaces have been sitting on the market with little activity compared to pre-pandemic levels," Okada said.

He said that location-wise, commercial tenants West of 7th Avenue are migrating East to 6th or 5th Avenue where rents are equivalent, and proximity to transportation, high-end restaurants, and parks like Madison Square Park and Bryant Park, are closer.

"Most tenants seeking space over 3,500 SF require landlord construction or modification of some sort," Okada said. "Office rents in Class B or Class C properties have declined 25.6% compared to pre-pandemic levels, and true occupancy rates hover around 80%.

"In a nutshell, although rents and occupancy are down, we are experiencing a strong level of leasing and remain hopeful that there is more runway in the return to the office."

Strength Outside Just Florida and Texas

Mukang Cho, CEO and managing principal at Morning Calm Management, tells GlobeSt.com that in the past few months, his portfolio has seen a healthy level of activity across all markets and not just in the markets that have the greatest demographic tailwinds, such as Florida and Texas.

"Even with the recent volatility in the banking sector, activity on the ground – be it tours, signed new leases, or signed renewals – has been fairly robust," Cho said.

"We recently launched a venture to finance office assets through originations and secondary purchases. While we are not taking the view that the office sector as a whole will rebound, we are comfortable making select investments in which we have convictions in the sponsor's business plan and the standing of the underlying collateral in its competitive set."

Here are Florida's Hot Markets

Kevin Will, a senior associate with Foundry Commercial, speaking about a submarket just north of downtown Orlando called Winter Park, tells GlobeSt.com its office vacancy is sitting at 2.6% – near all-time lows amidst a challenging office environment nationwide.

"Winter Park has continued to be successful due to proximity to executive housing and lack of new development," Will said. "Most importantly, Winter Park stands out due to its small-town charm and chain of lakes while being just over a 10-minute drive to Orlando's downtown."

Adrian Rahimi, CIO at Tricera Capital, tells GlobeSt.com that he has seen strong Q1 leasing velocity across his South Florida office properties, namely in the West Palm Beach and Boca Raton markets.

"Given that some of the dust is settling after three consecutive quarters of market volatility, both landlords and tenants are more comfortable moving forward with signing long-term leases," Rahimi said.

According to Blanca Commercial Real Estate's Q1 Miami Office Report, the Miami-Dade office market has achieved record levels of net absorption, leasing activity, new-to-market activity, and rental rate growth.

"As Miami continues to become one of the most sought-after real estate investment destinations in the country, the demand for office space has become more competitive with increased leasing activity and decreased vacancy rates seen across its submarkets." Tere Blanca, Founder, Chairman and CEO of Blanca Commercial Real Estate, tells GlobeSt.com.

Daniel Chaberman, developer and leasing broker at Grupo Eco, which is developing the four-phase culinary and office destination, Atlantic Village, in Hallandale Beach, said their Class A office product was created in response to growing demand in the market.

“Some suburban office markets continue to outperform bigger markets locally and nationally,” Chaberman tells GlobeSt.com. “This performance is being driven by the influx of wealthy individuals from the US, Latin America, Russia, and elsewhere, who want office space outside traditional downtowns.

“Instead, they want the convenience of a wave of new premium office buildings available in burgeoning neighborhoods like Hallandale Beach that are close to home, their kids’ schools, and new five-star restaurants and entertainment. No one wants to drive.”

SPP just announced that the office portfolio at Water Street Tampa, the massive mixed-use development reshaping Tampa’s downtown, is now over 80% leased. This includes the neighborhood’s Sparkman Wharf office property — a collection of waterfront, loft-style offices — reaching 100% leased and Thousand & One — Tampa’s first WELL Core and Shell Gold-certified office tower and first new Downtown trophy office tower in 30 years — signing a new tenant to reach over 80% leased.

SPP’s EVP of Corporate Leasing, Dave Bevirt tells GlobeSt.com that he continues to see this “flight to quality” on both a national and local level.

“More than ever, companies are investing in cities like Tampa that provide a wide array of talent,” he said.

Northern Virginia Outperforming DC Market

Tim Steffan, Chief Operating Officer for Comstock, tells GlobeSt.com that he has experienced an increase in both trophy and defense contractor office activity in its Northern Virginia portfolio, while the DC market remains far less active.

“Both user types have a much higher requirement for a return to office than commodity space users,” Steffan said. “Larger space (25,000 sf plus) tours have picked up as well because of the limited availability of meaningful new supply coming to market over the next 12 to 18 months.

“Economic discussions are far more in-depth and while concession requests are high, trophy rates and terms have increased to offset these requests and the costs of new construction as well.”

In Chicago, Amenities Bring Office Workers Back

Luke Hamagiwa, Vice President, Acquisitions and Asset Management at KBS Realty Advisors, tells GlobeSt.com that Chicago, which has always been tremendously competitive in terms of office amenities, is performing well.

“Now, as companies are eager to bring their employees back to the workplace, landlords are concentrating on building out appealing amenity space and activating it in an engaging and enticing way,” Hamagiwa said.

For example, at Accenture Tower, an iconic 40-story building in Chicago’s West Loop that sits over Ogilvie Transportation Station, saw its occupancy rise from 80% to more than 95% after recently implementing $22 million in upgrades.

These improvements include a new hospitality-inspired lobby, a state-of-the-art conference center with a pre-function area, and a contemporary tenant lounge with an outdoor terrace containing two fire pits in a garden-like setting.

“As people continue to search for communities and spaces that promise a higher quality of life and a wealth of innovation following the pandemic, demand for office properties that provide an elevated tenant experience will grow,” he said.

‘Being Together’ More Effective

William Mandara Jr., CEO and Co-Owner of Mancini Duffy, a national design firm headquartered in New York City, tells GlobeSt.com that creative businesses and companies that require collaboration are having more success bringing people back to the office than those that require heads-down individual work.

“While virtual meetings have their place, the appointment culture that has been spawned over the last years is not nearly as effective as being together,” Mandara Jr. said.

Workplace as a ‘Destination’

Kurt von Koch, CEO of FM:Systems, tells GlobeSt.com that corporate real estate facilities that are close to other conveniences like gyms, date-night-restaurants, and other extracurricular activities are doing well right now and the old office parks without those nearby amenities are suffering.

“We are seeing clients investing to create the ‘workplace as a destination’ with amenities like cafés, childcare, and even pickleball, with mixed results in actual utilization. But clients that make those same investments while also being in a location that is also surrounded by the activities and businesses coworkers want to go to after work are seeing much better success in bringing coworkers back to the office.

The highest utilization of office space is very much focused on Tuesdays, Wednesdays, and Thursdays. The US’s return to the office is slow and halfhearted with a meager 9% utilization (25% of pre-COVID utilization). While we are seeing stronger returns from the UK and Western Europe at about 25% utilization or (70% of pre-COVID utilization). In Asia, on the other hand, we are actually seeing utilization rates that are higher than what they were pre-COVID.”

https://www.globest.com/2023/04/28/%E2%80%8Boffice-demand-shows-signs-of-life/