

# NATIONAL OFFICE MARKET

## FIRST QUARTER FUNDAMENTALS MIXED

U.S. office market indicators were mixed during the first quarter of 2019. Absorption was positive but decelerated compared with the nation's performance over recent quarters. Asking rents rose 3.2% compared with the first quarter of 2018, while vacancy declined 30 basis points over the past 12 months. Approximately 6.8 million square feet of new product delivered during the first quarter. The construction pipeline has reached its highest level of the cycle and is an indicator to watch in 2019. However, overall market conditions suggest the cyclical expansion will continue at least through the end of this year.

### ABSORPTION MODERATES

Tenants absorbed 6.2 million square feet during the first quarter of 2019, down from 10.8 million square feet during the first quarter of 2018. During the first quarter of 2019, absorption was positive in 37 of the 56 markets tracked by Newmark Knight Frank, led by Phoenix, where absorption approached 1.9 million square feet. The only other market to register at least 1.0 million square feet of occupancy gains was Washington, D.C. Other markets with a strong first-quarter performance include Boston, with more than 900,000 square feet of positive absorption, plus Salt Lake City and Los Angeles, which both registered absorption greater than 500,000 square feet.

Manhattan and San Francisco, two of the nation's principal gateway markets, saw the largest negative absorption in the first quarter, both registering totals greater than 1.0 million square feet. Of note, Dallas, Minneapolis and Charlotte continued to perform well. Dallas has registered positive absorption of at least 100,000 square feet in seven of the last eight quarters, while the Minneapolis market continues to tighten. The Charlotte market has seen positive occupancy change in 34 of the last 35 quarters. On the other hand, Manhattan has experienced negative absorption in seven of the last 11 quarters, and has more than 10.0 million square feet currently under construction.

### ASKING RENTS RISE IN FIRST QUARTER 2019

Rental rate growth has slowed since reaching a cyclical peak of 3.8% during the fourth quarter of 2015. Still, rents continue to increase, albeit at a more moderate pace, supported by new demand. The average asking rent across the U.S. ended the first quarter of 2019 at \$28.69/SF gross full service, an increase of 3.2% year-over-year.

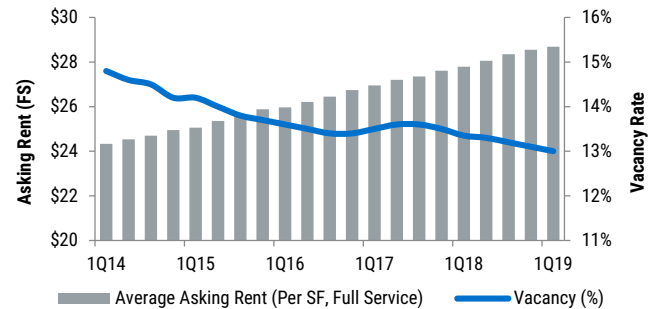
Notably, Denver (at 9.8%), Boston (at 8.9%) and Seattle (at 7.7%) experienced significant year-over-year rent growth. By contrast, Fairfield County, CT (negative 3.7%) and Long Island (negative 2.4%) stand out for their year-over-year declines in average rent. Ten markets tracked by Newmark Knight Frank saw year-over-year rent growth of 5.0% or greater, while four markets saw declines in year-over-year rental rates.

## CURRENT CONDITIONS

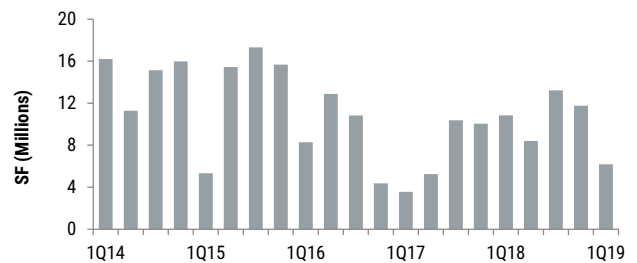
- Office absorption was down in the first quarter of 2019 compared with the same period in 2018, and was the lowest since the second quarter of 2017.
- The vacancy rate of 13.0% declined 30 basis points from one year ago.
- Asking rents rose by 3.2% year-over-year.
- The construction pipeline remains robust at 88.1 million square feet.

## MARKET ANALYSIS

### Asking Rent and Vacancy Rate



### Net Absorption



## MARKET SUMMARY

	Current Quarter	Prior Quarter	Year Ago Period	12-Month Forecast
Total Inventory	5.0 BSF	5.0 BSF	4.9 BSF	↑
Vacancy Rate	13.0%	13.1%	13.3%	↑
Quarterly Net Absorption	6.2 MSF	11.7 MSF	10.8 MSF	↔
Average Asking Rent	\$28.69	\$28.55	\$27.79	↑
Under Construction	88.1 MSF	79.2 MSF	74.2 MSF	↓
Deliveries	6.8 MSF	8.6 MSF	10.4 MSF	↑

## VACANCY DECLINES MODESTLY IN FIRST QUARTER

The vacancy rate edged down 30 basis points compared with one year ago, even as 6.8 million square feet of new product delivered during the quarter—following 39.5 million square feet of deliveries during 2018. First-quarter 2019 absorption decelerated, as the market saw a decline of approximately 4.7 million square feet of absorption compared with first-quarter 2018, and the change over last quarter is larger, at 5.6 million square feet. Despite having the nation’s largest construction pipeline, Manhattan recorded one of the lowest vacancy rates at 7.0%, while two major Texas markets recorded the highest vacancy rates in the nation, with Houston at 21.1% and Dallas at 19.7%. These markets traditionally maintain higher-than-average vacancy rates due to the availability of land.

San Francisco had its largest negative net absorption since the financial crisis, registering its first loss of more than one million square feet since the second quarter of 2009, leading to an increase in vacancy of 160 basis points—the largest in the nation quarter-over-quarter. This change can be attributed in part to almost 1.0 million square feet delivered during the quarter. Jacksonville saw the largest year-over-year increase in vacancy, as the market’s rate rose 160 basis points, to 12.1%. Silicon Valley saw the largest decline in vacancy, as the market’s rate is down 350 basis points since first-quarter 2018.

## CONSTRUCTION PIPELINE ESCALATES

The office construction pipeline saw an uptick in the first quarter of 2019 and now totals 88.1 million square feet. Tenants continue to show strong interest in new, efficient trophy projects, but backfilling older, obsolete space is a challenge across the country. Deliveries outpaced absorption during the quarter, which will lead to some concerns about overbuilding late in the expansion cycle.

Overall, U.S. office construction remains under control, at 1.8% of standing inventory. A ratio under 2.0% is considered manageable. However, some markets exceed this threshold and warrant monitoring, including Seattle, Silicon Valley, and Salt Lake City—markets whose construction pipeline relative to total inventory tops 4.0%.

The development pipeline has a number of notable projects underway, including One Manhattan West, a 995-foot-tall office project located at 400 West 33<sup>rd</sup> Street in Manhattan, that will deliver 2.1 million square feet in late 2019. It will be the tallest structure in the 7-million-square-foot Manhattan West development between Hudson Yards and Penn Station. In Nashville, 1001 Church Street will include 40 stories and 1.0 million square feet of office space in the Nashville Yards development. It is expected to deliver in early 2021 and will be located across the street from the to-be-constructed office towers that Amazon will occupy as part of its new operation in the city. In Charlotte, 620 South Tryon Street, the first phase of the Legacy Union development, will deliver approximately 850,000 square feet this year.

## SUBLEASE INVENTORY LITTLE CHANGED

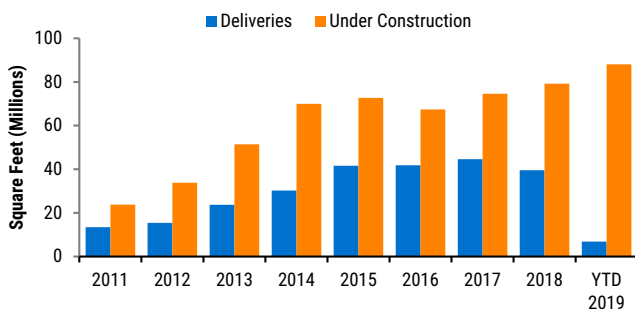
The first quarter ended with 101.2 million square feet of sublease space available, equal to 2.0% of the total office inventory, a decline of 10 basis points from one year ago. This is up from the cyclical low of 1.7% of inventory in 2011. However, the sublet availability rate remains low relative to the 2.9% peak during the financial crisis and the 5.4% peak after the dot-com bust. Rather than putting sublease space on the market, many tenants are retaining that space and using it to accommodate new hires in an expanding economy. Still, there are some markets that require monitoring. New Jersey Southern, for example, is faced with a significant amount of sublease space on the market, at 4.5% of inventory. Similarly, Fairfield County counts 4.2% of inventory as sublease space.

## REPURPOSING OBSOLETE OFFICE PROPERTIES

Adaptive reuse of old, obsolete office properties is not a new idea, but in many markets it has become an effective, and sometimes necessary, undertaking for asset owners. In many markets, large suburban office parks and even well-located Class B and Class C office properties are struggling to attract tenants. Office asset owners are trying to keep up with a changing demand and tenant mix by finding new ways to make their assets profitable and marketable. These changes impact office market fundamentals as well as the fabric of individual submarkets.

### CONSTRUCTION AND DELIVERIES

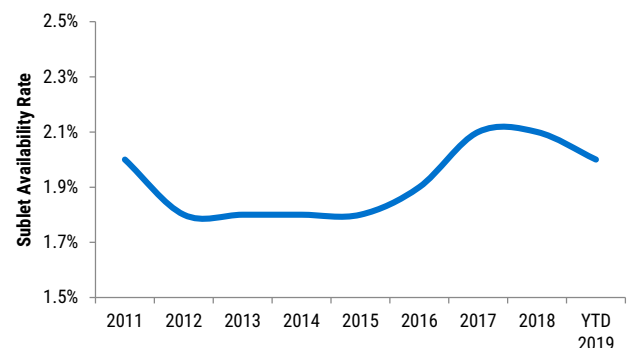
#### United States Office Market



Source: CoStar, NKF Research

### SUBLET AVAILABILITY RATE

#### United States Office Market



Source: CoStar, NKF Research

Shifts from office to multifamily, biotech, distribution facilities or retail have been taking place all over the country as companies densify and office buildings age. Some obsolete office space has been converted to self-storage, or even schools. A large national construction pipeline, and tenant movement back into cities, are adding pressure on some asset owners, who are taking steps to adjust. Conversions are especially prevalent in certain suburbs where vacancy rates have been rising due to corporate relocations.

Notable planned conversions include the Marriott International Headquarters campus in North Bethesda, MD. Erickson Living purchased the 34-acre site in January for \$105.0 million and plans to turn it into a retirement community when Marriott vacates for its new headquarters, which is currently under construction, in 2022. Similar plans are in store for the former McDonald's headquarters campus in Oak Brook, Illinois and the Toys "R" Us campus in Wayne, New Jersey.

### AMAZON'S HQ2 PLANS EVOLVE

The first quarter of the year saw some major modifications to Amazon's HQ2 plans. The company decided to pull out of its agreement with New York to create 25,000 or more jobs in Long Island City over public backlash. A combination of lack of organization by elected leaders and poor communication with local residents by Amazon officials led to a misunderstanding of proposed incentives. On the other hand, plans in Northern Virginia will continue as scheduled after state and local governments approved incentive packages with broad community support—overcoming some opposition. Leases totaling 537,000 square feet and land sale agreements for future development were signed, allowing the project to move forward, with the first 400 Amazon employees expected by the end of the year. It remains to be seen if Amazon's planned job creation in New York will be shifted to Northern Virginia or elsewhere.

### U.S. OFFICE MARKET OUTLOOK

The national office market continues to experience methodical growth, which reflects the continuing economic expansion cycle. Notably, consensus points to a gradual slowing of the economy over the next two years, and the Federal Reserve has lowered near-term expectations. This comes at a time when the economy has been experiencing some stress caused by political disagreement and trade disputes. Although interest rate increases have been tabled in the short term, a recent history of stock market volatility suggests that real estate will continue to offer relatively good value for investors.

On the supply side, construction totals are an indicator to watch, with 88.1 million square feet currently under construction. Still, this figure equals only 1.8% of total inventory, a controlled figure for this late point in the cycle.

Employment growth remains sturdy, with the first quarter of the year averaging 180,000 new jobs, although this figure is down from last year's first-quarter average of 228,000 new jobs. If the labor market can sustain this level of hiring, it will support healthy leasing activity and absorption through 2019. Projected unemployment rates for year-end 2019 and 2020 are 3.7% and 3.8%, respectively – very low by historical standards. However, the densification of office space – placing more workers into less space – persists, exerting downward pressure on absorption. It is likely to slow soon because of pushback from employees who are seeking more privacy and fewer distractions in a competitive labor market.

Continued job creation in office-using sectors, particularly professional and business services, will ultimately continue to impact demand more than any other factor. Overall, the U.S. office market is likely to maintain its current path of methodical growth through 2019.

### NOTABLE 1Q 2019 LEASE TRANSACTIONS

Tenant	Market	Building	Type	Square Feet
United Airlines	Chicago, IL	233 South Wacker Drive	Direct Extension	526,552
World Wrestling Fed. Entertainment	Stamford, CT	677 Washington Boulevard	Direct New	500,000
Christiana Care Health Services	Wilmington, DE	1800 Concord Pike	Direct New	500,000
USG	Chicago, IL	550 West Adams Street	Direct Renewal	468,000
Snowflake Computing	San Mateo, CA	450 Concar Drive	Direct New	350,000

### NOTABLE 1Q 2019 SALES TRANSACTIONS

Building	Market	Sale Price	Price/SF	Square Feet
7800 Beverly Boulevard	Los Angeles	\$750,000,000	\$1,456	515,000
300 Boren Avenue North	Seattle	\$739,885,000	\$906	817,000
885 Second Avenue	Manhattan	\$656,754,370	\$805	815,000
1000 Bridge Parkway	San Francisco	\$650,000,000	\$652	997,680
800 Fifth Avenue	Seattle	\$539,583,055	\$590	914,733

## MARKET STATISTICS (CONTINUED ON NEXT PAGE)

	Total Inventory (SF)	SF Under Construction	SF Absorbed This Quarter	SF Absorbed Year-to-Date	Vacancy Rate	Average Asking Rent (Price/SF)
<b>National</b>	<b>4,952,068,204</b>	<b>88,067,845</b>	<b>6,175,468</b>	<b>6,175,468</b>	<b>13.0%</b>	<b>\$28.69</b>
Atlanta	147,911,944	4,926,517	-693,219	-693,219	17.7%	\$27.04
Austin	65,683,524	1,023,023	263,822	263,822	10.0%	\$35.17
Baltimore	82,091,911	753,737	46,320	46,320	12.9%	\$23.56
Boston	182,270,248	4,322,682	956,728	956,728	11.7%	\$36.53
Broward County, FL	33,954,947	452,532	125,874	125,874	10.4%	\$28.86
Charleston, SC	14,205,486	206,998	152,347	152,347	7.0%	\$25.07
Charlotte	70,201,866	2,112,829	288,360	288,360	9.8%	\$27.45
Chicago	235,825,113	5,182,128	121,630	121,630	16.5%	\$29.69
Cincinnati	36,879,329	0	261,292	261,292	16.5%	\$19.34
Cleveland	37,304,984	114,209	-162,455	-162,455	16.7%	\$18.48
Columbia, SC	16,316,742	0	-108,639	-108,639	9.1%	\$17.97
Columbus	58,573,946	21,600	364,499	364,499	9.6%	\$18.23
Dallas	262,630,052	1,385,945	476,284	476,284	19.7%	\$25.76
Delaware	18,135,031	32,000	224,937	224,937	15.6%	\$25.22
Denver	99,381,439	1,812,207	508,852	508,852	15.0%	\$29.43
Detroit	76,389,959	624,000	254,533	254,533	15.2%	\$19.59
Fairfield County, CT	39,722,393	0	-189,165	-189,165	17.6%	\$35.60
Fresno	19,776,484	236,370	64,762	64,762	10.4%	\$30.71
Greenville, SC	21,695,352	0	-2,875	-2,875	8.7%	\$20.35
Houston	233,293,213	3,047,005	165,718	165,718	21.1%	\$29.27
Indianapolis	61,032,167	25,000	21,366	21,366	10.0%	\$19.32
Inland Empire, CA	30,998,766	112,817	41,675	41,675	8.5%	\$21.59
Jacksonville	32,494,755	0	-205,177	-205,177	12.1%	\$19.72
Kansas City	73,985,061	285,028	242,106	242,106	8.4%	\$20.69
Las Vegas	38,503,468	389,164	366,183	366,183	14.0%	\$21.81
Long Island	54,867,560	0	-84,634	-84,634	9.0%	\$25.52
Los Angeles	205,400,891	2,617,016	586,507	586,507	14.5%	\$40.07
Manhattan	450,633,901	10,483,068	-1,284,457	-1,284,457	7.0%	\$76.13

Note: Absorption is the net change in occupied space over a period of time. Data may not match totals in some NKF metro reports due to different local methodologies. Asking rents are quoted on a full service basis.

**MARKET STATISTICS (CONTINUED FROM PREVIOUS PAGE)**

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Memphis	33,568,209	0	-220,840	-220,840	14.0%	\$18.41
Miami	48,300,498	1,055,506	51,097	51,097	11.8%	\$36.15
Milwaukee	47,241,549	204,000	-178,998	-178,998	11.4%	\$17.35
Minneapolis	119,174,756	917,700	456,473	456,473	11.2%	\$19.83
Nashville	54,241,561	1,946,700	-126,736	-126,736	7.9%	\$26.98
New Jersey Northern	167,342,577	832,929	578,933	578,933	18.4%	\$29.28
New Jersey Southern	16,373,128	375,000	-33,593	-33,593	15.6%	\$20.86
Oakland/East Bay	73,190,615	948,167	107,471	107,471	10.4%	\$39.89
Oklahoma City*	19,418,672	0	105,754	105,754	11.1%	\$17.09
Orange County, CA	94,662,131	1,662,291	183,624	183,624	12.4%	\$32.16
Orlando	68,705,397	522,000	105,087	105,087	6.1%	\$22.55
Palm Beach	25,459,459	196,272	-58,626	-58,626	11.7%	\$33.29
Philadelphia	109,125,623	778,000	4,266	4,266	13.8%	\$29.33
Phoenix	89,320,701	2,422,095	1,884,093	1,884,093	15.2%	\$25.84
Pittsburgh	54,609,524	986,700	220,351	220,351	16.3%	\$23.90
Portland	60,798,393	782,142	144,038	144,038	10.7%	\$29.44
Raleigh/Durham	63,595,432	1,293,657	-137,518	-137,518	9.2%	\$25.37
Sacramento	69,151,256	670,350	43,171	43,171	11.5%	\$23.88
Salt Lake City	64,712,805	2,787,658	609,314	609,314	7.0%	\$22.06
San Antonio	44,680,638	662,179	-271,456	-271,456	13.5%	\$22.59
San Diego	71,201,234	1,015,691	201,092	201,092	12.3%	\$34.42
San Francisco*	124,164,877	4,019,088	-1,038,597	-1,038,597	8.5%	\$62.95
Seattle	122,358,626	8,334,457	277,625	277,625	8.0%	\$37.14
Silicon Valley	78,274,999	5,300,000	-61,096	-61,096	10.6%	\$51.12
St. Louis	74,925,581	60,000	-460,943	-460,943	10.6%	\$20.31
Tampa/St. Petersburg	64,159,095	550,000	-157,603	-157,603	9.4%	\$24.28
Washington, DC	366,004,702	9,579,388	1,115,886	1,115,886	16.1%	\$38.58
Westchester County, NY	27,145,634	0	30,025	30,025	16.6%	\$26.86

\*Note: Data source has changed.

Note: Absorption is the net change in occupied space over a period of time. Data may not match totals in some NKF metro reports due to different local methodologies. Asking rents are quoted on a full service basis.

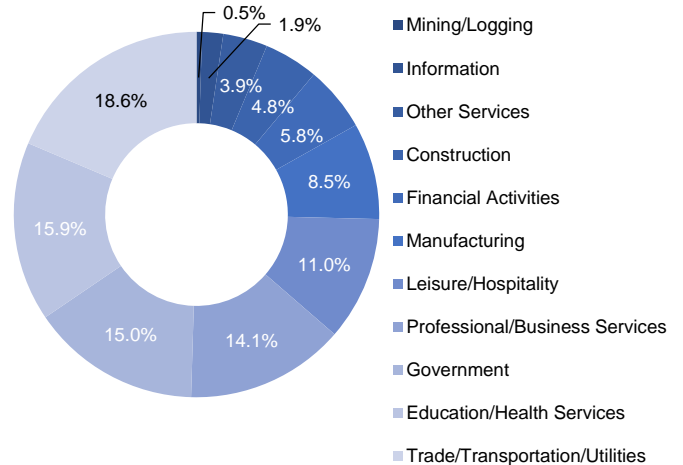


## ECONOMIC CONDITIONS

The U.S. economy grew at an annual rate of 2.2% during the fourth quarter of 2018, according to the Bureau of Economic Analysis' revised estimate, which was released in March 2019. The inflation rate was 1.5% (not seasonally adjusted) for the 12 months ending in February 2019. The unemployment rate declined 20 basis points from one year ago, reaching 3.8% in March 2019, reflecting an economy near full employment, though one in which job openings and the skills of available labor are not well aligned. Employers added 196,000 new jobs in March 2019, an increase from the 182,000 added in March 2018, with Mining and Logging, Construction, and Leisure and Hospitality among the notable growth sectors. Economic confidence continued to ebb and flow in the first quarter, as numbers released by the White House and the Fed differed. Concerns over trade tensions with China and issues at the Mexican border remain volatile, leading the Fed to lower its growth forecast to 2.1% in 2019 and 1.9% in 2020, while indicating there would be no interest rate hikes in 2019 rather than the two that were initially planned, and one in 2020. Still, other factors, including a steadily low unemployment rate and modest wage growth, continue to point to a stable economy despite these headwinds.

## EMPLOYMENT BY INDUSTRY

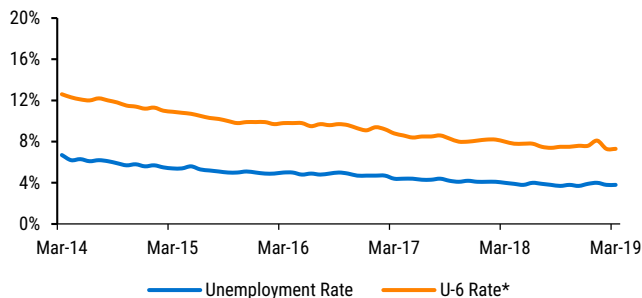
### United States, 2018 Annual Average



Source: U.S. Bureau of Labor Statistics, NKF Research; April 2019

## UNEMPLOYMENT RATE

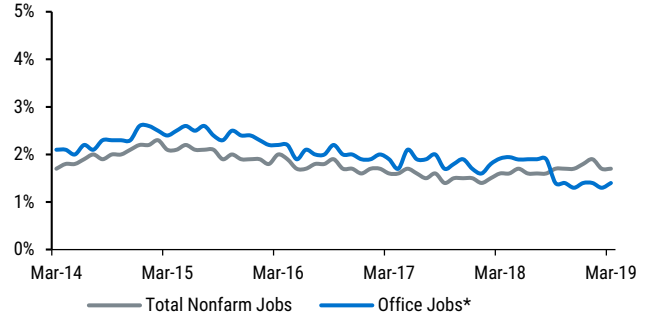
### United States, Seasonally Adjusted



\* Includes total unemployed, marginally attached workers, and those working part time for economic reasons  
Source: U.S. Bureau of Labor Statistics, NKF Research; April 2019

## PAYROLL EMPLOYMENT

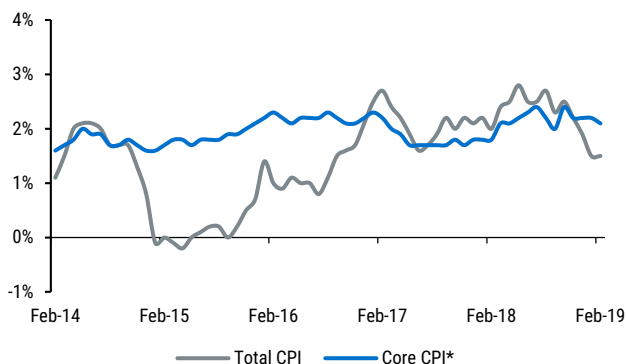
### United States, 12-Month % Change, Not Seasonally Adjusted



\* Includes Professional and Business Services, Information, Financial Activities, Other Services and Government  
Source: U.S. Bureau of Labor Statistics, NKF Research; April 2019

## CONSUMER PRICE INDEX (CPI)

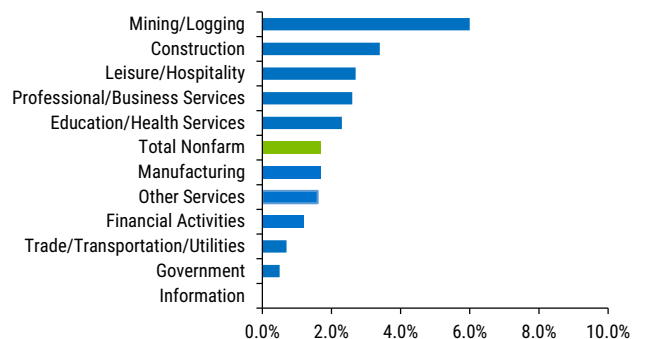
### United States, 12-Month % Change, Seasonally Adjusted



\*Excludes food and energy, which can be volatile; 1982-84=100  
Source: U.S. Bureau of Labor Statistics, NKF Research; April 2019

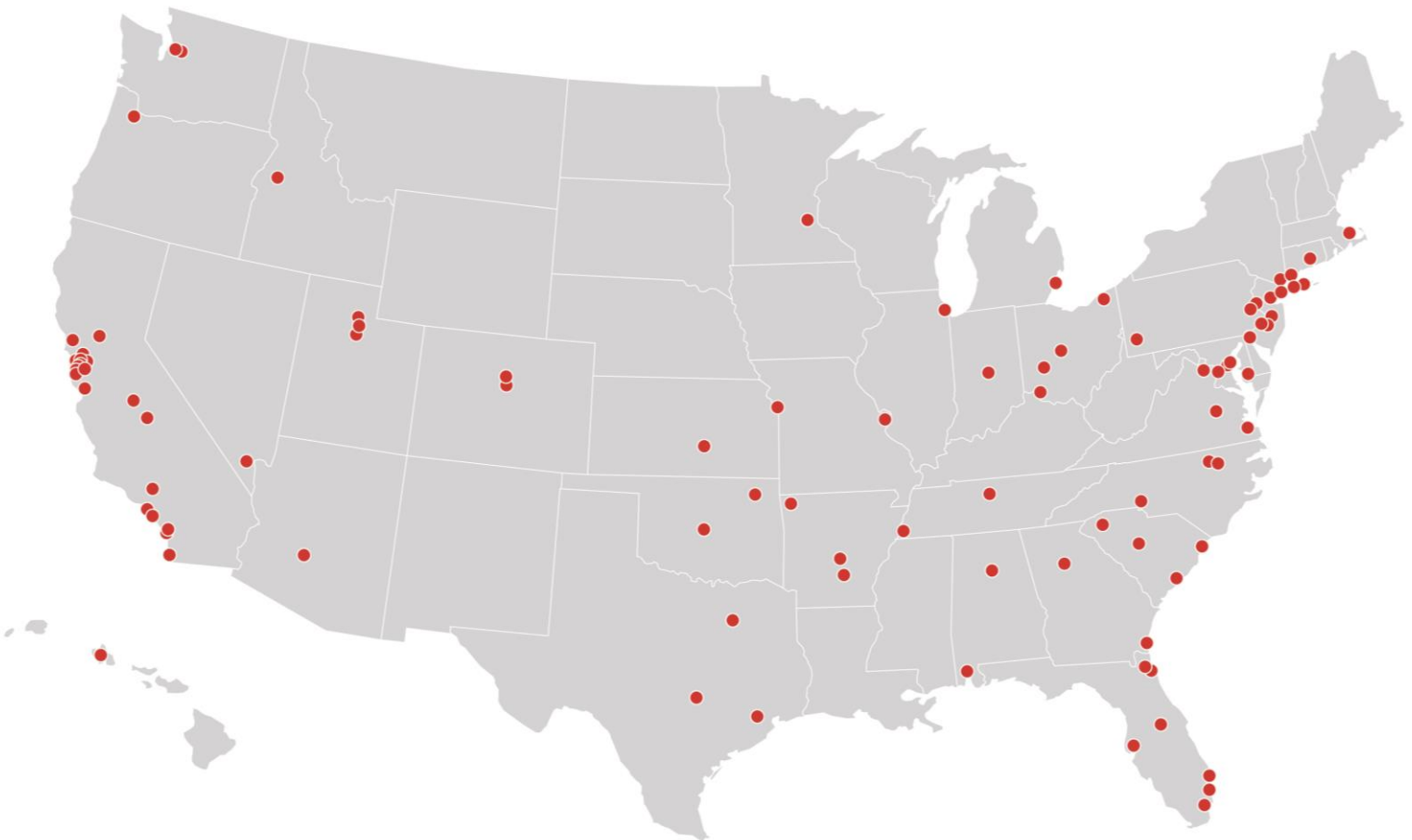
## EMPLOYMENT GROWTH BY INDUSTRY

### U.S., March 2019, 12-Month % Change, Not Seas. Adj.



Source: U.S. Bureau of Labor Statistics, NKF Research; April 2019

## NEWMARK KNIGHT FRANK UNITED STATES OFFICE LOCATIONS



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