

# NATIONAL OFFICE MARKET

## MARKET TIGHTENS DURING SECOND QUARTER

The U.S. office market tightened during the second quarter of 2019. Absorption accelerated slightly compared with the nation's performance last quarter and was up moderately over second quarter 2018. Asking rents rose 3.2% compared with the second quarter of 2018, while vacancy declined 50 basis points over the past 12 months. Approximately 11.9 million square feet of new product delivered during the second quarter of 2019. The construction pipeline has reached its highest level of the cycle and is an indicator to watch during the balance of the year. However, overall market conditions suggest the cyclical expansion will continue at least through the end of 2019.

### ABSORPTION ACCELERATES SLIGHTLY

Tenants absorbed 10.2 million square feet during the second quarter of 2019, up from 9.3 million square feet during the second quarter of 2018. During the second quarter of 2019, absorption was positive in 42 of the 56 markets tracked by Newmark Knight Frank, led by Seattle, where absorption surpassed 1.8 million square feet, driven by tech and coworking tenants. Manhattan and San Francisco also registered at least 1.0 million square feet of occupancy gains. Other markets with a strong second-quarter performance include Phoenix, with more than 900,000 square feet of positive absorption, plus Charlotte and Washington, DC, which both registered absorption greater than 500,000 square feet.

In Texas, Houston and Dallas, two of the nation's largest office markets, both saw negative absorption in the second quarter. Austin, on the other hand, has seen positive absorption in 31 of the last 33 quarters, of which 29 have surpassed 100,000 square feet. Of note, Boston and Denver continued to perform well. Thanks to the technology and life science fields, the Boston market has tightened over the past year. The Denver market has seen steady occupancy growth, accumulating almost 4.2 million square feet of net absorption over the past three years. During the second quarter of 2019, Manhattan offset negative absorption from the first quarter of the year, but its performance has been uneven over the past three years. With almost 17.0 million square feet currently under construction, it remains a market to watch.

### ASKING RENTS RISE IN SECOND 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 second quarter of 2019 at \$28.98/SF gross full service, an increase of 3.2% over the past year.

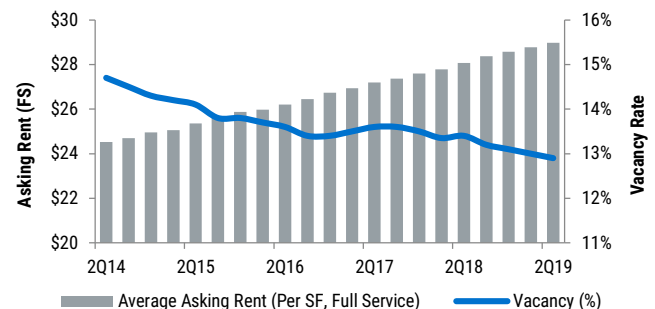
Notably, Raleigh/Durham (at 8.4%) and Boston (at 8.3%) experienced significant rent growth during the past 12 months. By contrast, Fairfield County, CT (negative 3.7%) and New Jersey Southern (negative 2.7%) stand out for their annual declines in average rent.

## CURRENT CONDITIONS

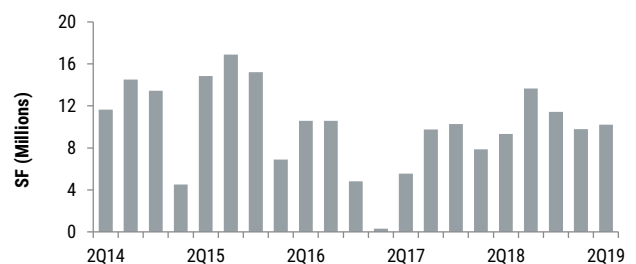
- Office absorption was up slightly in the second quarter of 2019 compared with the same period in 2018
- The vacancy rate of 12.9% declined 50 basis points from one year ago.
- The average asking rent rose by 3.2% over the past year.
- The construction pipeline remains robust at 97.2 million square feet.

## MARKET ANALYSIS

### Asking Rent and Vacancy Rate



### Net Absorption



## MARKET SUMMARY

	Current Quarter	Prior Quarter	Year Ago Period	12-Month Forecast
Total Inventory	4.9 BSF	5.0 BSF	4.9 BSF	↑
Vacancy Rate	12.9%	13.0%	13.4%	↑
Quarterly Net Absorption	10.2 MSF	9.8 MSF	9.3 MSF	↔
Average Asking Rent	\$28.98	\$28.77	\$28.07	↑
Under Construction	97.2 MSF	91.5 MSF	69.1 MSF	↓
Deliveries	11.9 MSF	8.6 MSF	12.4 MSF	↑

## VACANCY DOWN MODESTLY IN SECOND QUARTER

The vacancy rate edged down 50 basis points over the past year to 12.9%, even as 11.9 million square feet of new product delivered during the quarter—following 36.8 million square feet of deliveries during the previous four quarters. Second-quarter 2019 absorption accelerated slightly, as the office market saw an increase of approximately 900,000 square feet of absorption compared with second-quarter 2018. Despite having the nation’s largest construction pipeline, Manhattan recorded one of the lowest vacancy rates at 6.3%, while two major southwestern markets recorded the highest vacancy rates in the nation, with Oklahoma City at 24.7% and Houston at 21.2%. These markets traditionally maintain higher-than-average vacancy rates due to the availability of land.

Seattle, spurred by tech tenants, had the largest net absorption in the nation, registering a gain of more than 1.8 million square feet during the second quarter of 2019, leading to a decrease in vacancy of 230 basis points—one of the largest in the nation during the past year. Charleston, South Carolina saw the largest annual increase in vacancy, as the market’s rate rose 190 basis points, to 8.4%. Phoenix saw the largest decline in vacancy, as the market’s rate is down 320 basis points since second-quarter 2018.

## CONSTRUCTION PIPELINE GROWS

The office construction pipeline saw an uptick in the second quarter of 2019 and now totals 97.2 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 2.0% of standing inventory, though this ratio has been rising. 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 5.0%.

The national development pipeline has a number of notable projects underway, including the Old Post Office redevelopment located at 433 West Van Buren Street in Chicago, a 2.5 million-square-foot building that will deliver in late 2019. The property is more than 40% preleased and will count Walgreens among its tenants. Additionally, a 1,050-foot-tall office project located at 3 Hudson Boulevard in Manhattan will deliver 1.8 million square feet in late 2022. It is located in the Hudson Yards development. In Seattle, the Rainier Square redevelopment, located at 1301-1333 5<sup>th</sup> Avenue, will include 58 stories and approximately 725,000 square feet of office space in the central business district. It is expected to deliver in 2020 and also will include a hotel, residences and retail space.

## SUBLEASE AVAILABILITY RATE STATIC

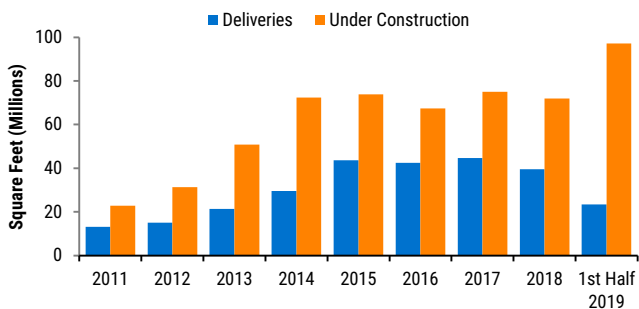
The second quarter ended with 102.4 million square feet of sublease space available, equal to 2.1% of the total office inventory, an increase of 10 basis points from one year ago. This is up from the cyclical low of 1.7% of inventory in 2014. However, the sublet availability rate remains low relative 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 4.5% of inventory as sublease space.

## MARKET HIGHLIGHT: CHARLOTTE

The Charlotte office market has expanded significantly over the past five years. Current inventory in the market sits at 70.8 million square feet. Since the second quarter of 2014, more than 5.1 million square feet has been delivered to the market. Absorption over the same period has exceeded 6.7 million square feet, which has led to a decrease in vacancy of 320 basis points to its current 9.3%. Moreover, absorption in the market has been positive in 35 of the past 36 quarters, surpassing 100,000 square feet of positive net absorption in all but two of those quarters.

## CONSTRUCTION AND DELIVERIES

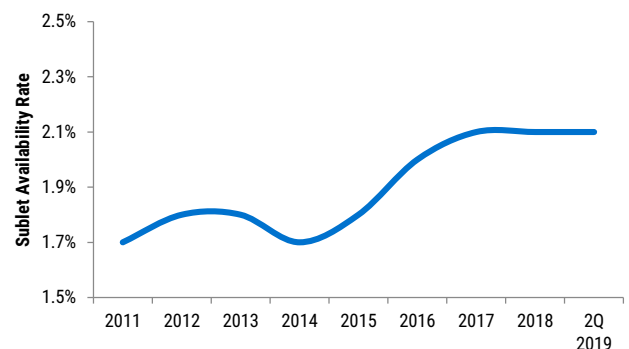
### United States Office Market



Source: CoStar, NKF Research

## SUBLET AVAILABILITY RATE

### United States Office Market



Source: CoStar, NKF Research

As a result of tightening market fundamentals, asking rents have risen dramatically since the second quarter of 2014 as well, spiking 34% in that period to \$27.66/SF at second-quarter 2019.

Long known as a major banking center, Charlotte continues to see the financial activities sector lead the way. Bank of America Tower is rising at the Legacy Union development on the south side of Uptown, while Ally Charlotte Center will deliver in 2021. The newly merged SunTrust and BB&T banks will be headquartered at Hearst Tower in the Tryon Street corridor. All three properties will be anchored by a financial services tenant. Charlotte also has been able to attract large companies such as Dole, Honeywell and Lowe's, which will bring thousands of employees into the city over the next few years. Tech and coworking tenants have expanded in the city as well. With approximately 1.6 million square feet currently under construction, market fundamentals may loosen modestly, but recent history suggests Charlotte can absorb additional inventory.

## CONSTRUCTION COSTS IMPACTING PIPELINE

Construction costs have been on the rise, with an average increase of 5.7% nationally in 2018, according to Rider Levett Bucknall. Costs across markets were uneven, with Chicago, Portland and San Francisco leading the way, while markets such as New York, Boston, Los Angeles and Denver had increases below the national average. Due to a construction boom, with 97.2 million square feet currently under construction nationally, costs have risen substantially since the financial crisis. In some markets, higher costs are leading developers to hold off on new projects until they become easier to pencil. Markets with an out-of-balance supply/demand forecast, such as Washington, DC, likely will benefit from a slowdown in construction starts as developers wait for prices to moderate before breaking ground on new projects.

## U.S. OFFICE MARKET OUTLOOK

The national office market continues to experience methodical growth, which reflects the continuing, and now record-length, 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. There is renewed potential for interest rate cuts over the remainder of the year, a reversal from previous plans. A recent history of stock market volatility suggests that real estate will continue to offer relatively good value for investors on a risk-adjusted basis.

On the supply side, construction totals are an indicator to watch, with 97.2 million square feet currently under construction. This figure represents 2.0% of total inventory, still a controlled figure for this late point in the cycle, but entering riskier territory.

Employment growth remains sturdy, with the second quarter of the year averaging 171,000 new jobs, although this figure is down from last year's second-quarter average of 243,000 new jobs. If the labor market can sustain this level of hiring, it will support healthy leasing activity and absorption through the balance of 2019. Projected unemployment rates for year-end 2019 and 2020 are 3.6% and 3.7%, respectively, according to the Federal Reserve Bank of St. Louis—very low by historical standards. However, the densification of office space—placing more workers into less space—persists, exerting downward pressure on absorption. Densification may 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, ultimately will 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 the rest of 2019.

## NOTABLE 2Q 2019 LEASE TRANSACTIONS

Tenant	Market	Building	Type	Square Feet
Time Warner	New York, NY	500 W 33 <sup>rd</sup> Street	Direct New	1,500,000
Bank of America	Boston, MA	100 Federal Street	Direct Expansion	499,158
Emblem Health	New York, NY	55 Water Street	Direct Renewal	493,114
International Business Machines Corporation (IBM)	Boston, MA	550 King Street	Direct Expansion	490,119
New York State Office of General Services	New York, NY	60 Broad Street	Direct Expansion	480,708

## NOTABLE 2Q 2019 SALES TRANSACTIONS

Building	Market	Sale Price	Price/SF	Square Feet
610 Main Street North*	Cambridge, MA	\$1,120,000,000	\$1,654	677,000
5800 Bristol Parkway	Culver City, CA	\$260,000,000	\$836	310,985
50 San Fernando Street	San Jose, CA	\$235,000,000	\$663	354,486
5800 Bristol Parkway	Culver City, CA	\$229,031,600	\$818	280,000
450 Concar Drive	San Mateo, CA	\$219,570,175	\$1,045	914,733

\*Three building portfolio transaction includes lab space

**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>4,910,146,198</b>	<b>97,152,031</b>	<b>10,223,237</b>	<b>20,075,457</b>	<b>12.9%</b>	<b>\$28.98</b>
Atlanta	149,260,111	6,322,294	376,036	723,583	17.6%	\$27.43
Austin	65,919,809	1,097,101	321,105	375,796	9.9%	\$35.32
Baltimore	81,809,113	753,737	23,110	122,541	12.6%	\$23.93
Boston	181,875,369	5,698,978	475,370	1,465,553	11.4%	\$36.48
Broward County, FL	33,954,947	617,532	121,927	247,930	10.0%	\$29.48
Charleston, SC	14,413,160	186,998	-238,425	-76,458	8.4%	\$24.26
Charlotte	70,814,346	1,586,829	694,362	1,049,417	9.3%	\$27.66
Chicago	235,815,066	5,182,128	174,258	295,888	16.4%	\$29.25
Cincinnati	36,535,904	0	33,072	67,862	16.9%	\$19.51
Cleveland	37,329,793	174,209	-25,415	-187,870	16.8%	\$18.44
Columbia, SC	16,064,162	0	7,446	-23,576	8.6%	\$17.85
Columbus	58,862,047	0	-432,313	-123,447	10.3%	\$18.54
Dallas	264,255,927	717,421	-134,768	892,067	19.6%	\$25.90
Delaware	18,041,486	32,000	-460,826	-244,524	16.6%	\$25.90
Denver	99,381,439	2,091,503	414,002	922,033	14.8%	\$29.04
Detroit	76,444,853	624,000	216,948	389,897	15.0%	\$19.72
Fairfield County, CT	39,722,393	0	110,391	-78,774	17.1%	\$35.70
Fresno	19,838,742	225,612	29,515	94,277	10.2%	\$30.78
Greenville, SC	21,848,711	0	-109,229	-99,714	8.0%	\$20.19
Houston	235,281,597	2,502,837	-513,137	-281,892	21.2%	\$29.43
Indianapolis	61,275,761	25,000	-376,916	-397,238	10.7%	\$19.30
Inland Empire, CA	30,974,735	88,817	-154,021	-164,692	9.3%	\$21.85
Jacksonville	32,337,219	218,700	-115,014	-347,270	12.5%	\$19.92
Kansas City	73,607,467	285,028	264,270	456,456	8.1%	\$20.71
Las Vegas	38,754,362	239,164	234,323	677,267	13.7%	\$22.74
Long Island	54,835,501	0	232,522	92,930	8.1%	\$26.03
Los Angeles	203,433,469	3,119,940	382,296	922,413	14.2%	\$40.22
Manhattan	453,328,851	16,874,886	1,365,188	486,660	6.3%	\$76.95

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.

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Memphis	33,649,421	0	67,441	-208,254	14.3%	\$18.27
Miami	48,399,984	750,020	87,999	132,585	11.7%	\$36.46
Milwaukee	36,189,707	902,282	50,232	368,388	16.6%	\$20.58
Minneapolis	119,324,665	1,413,791	72,200	650,909	11.2%	\$19.83
Nashville	54,294,922	1,806,000	291,964	177,681	7.7%	\$27.40
New Jersey Northern	168,269,945	550,200	303,431	903,780	18.5%	\$29.52
New Jersey Southern	16,767,292	0	46,220	23,018	17.3%	\$20.63
Oakland/East Bay	74,257,101	948,167	-54,333	-225,483	10.7%	\$40.98
Oklahoma City*	15,054,208	207,000	-79,521	-217,409	24.7%	\$19.94
Orange County, CA	95,233,603	799,607	148,358	431,546	12.6%	\$32.30
Orlando	68,961,397	242,000	64,211	191,056	6.2%	\$22.57
Palm Beach	25,508,649	111,972	-24,127	-53,526	11.7%	\$33.66
Philadelphia	109,125,623	778,000	5,358	33,449	13.8%	\$29.43
Phoenix	89,822,815	2,546,622	995,531	2,879,624	14.5%	\$26.04
Pittsburgh	54,770,024	1,083,200	4,963	225,314	16.5%	\$23.96
Portland	60,837,959	782,142	21,758	153,791	10.6%	\$30.14
Raleigh/Durham	50,856,323	1,369,971	165,639	377,982	10.1%	\$26.37
Sacramento	69,518,432	643,000	380,466	423,637	11.2%	\$24.00
Salt Lake City	65,292,052	3,801,669	424,170	840,359	6.7%	\$22.21
San Antonio	45,442,876	520,054	-21,509	-243,798	13.9%	\$22.95
San Diego	71,139,124	1,095,979	130,957	425,654	11.9%	\$34.67
San Francisco*	124,694,332	3,718,158	1,140,064	1,399,034	7.3%	\$63.81
Seattle	123,213,379	7,826,168	1,818,234	2,089,770	7.1%	\$38.68
Silicon Valley	86,822,249	6,765,802	461,828	584,172	8.9%	\$50.52
St. Louis	75,399,276	30,841	47,916	-142,725	10.5%	\$20.32
Tampa/St. Petersburg	64,159,095	550,000	139,990	51,269	9.2%	\$24.54
Washington, DC	366,169,478	9,244,672	592,216	1,490,990	16.2%	\$39.00
Westchester County, NY	27,145,634	0	25,504	55,529	16.5%	\$26.82

\*Note: Data source has changed.

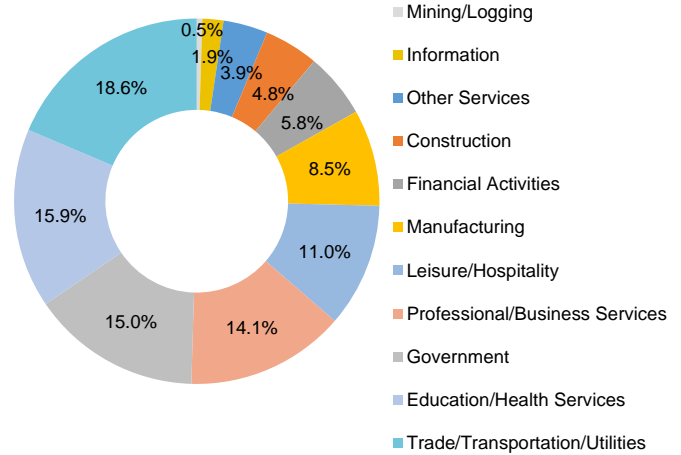
Note: Absorption is the net change in occupied space over a period of time. Data may not match totals in some NKF metro reports due to different local methodologies. Asking rents are quoted on a full service basis.

## ECONOMIC CONDITIONS

The U.S. economy grew at an annual rate of 3.1% during the first quarter of 2019, according to the Bureau of Economic Analysis' revised estimate, which was released in June 2019. The inflation rate was 2.0% (not seasonally adjusted) for the 12 months ending in May 2019. The unemployment rate declined 30 basis points from one year ago, reaching 3.7% in June 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 224,000 new jobs in June 2019, a deceleration from the 262,000 added in June 2018, with Mining and Logging, Construction, and Education and Health among the notable growth sectors. As of the second quarter of 2019, the current U.S. economic expansion has become the longest growth cycle of the post-World War II era. Concerns over trade tensions with China and issues at the Mexican border remain volatile; however, pending interest rate cuts may provide developers with the confidence to pursue projects late in the economic cycle. While the chance of an economic downturn in the next 12-24 months rose during the first half of 2019, a steadily low unemployment rate and modest wage growth suggest further economic expansion.

## EMPLOYMENT BY INDUSTRY

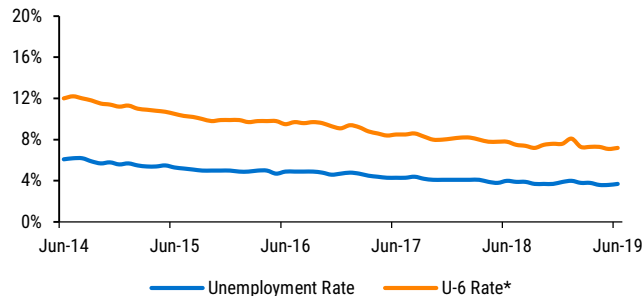
United States, 2018 Annual Average



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

## UNEMPLOYMENT RATE

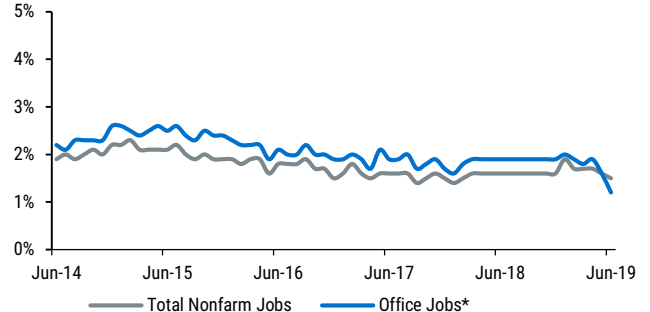
United States, Seasonally Adjusted



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

## PAYROLL EMPLOYMENT

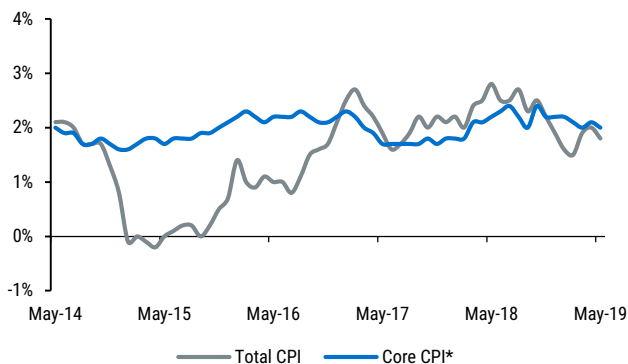
United States, 12-Month % Change, Not Seasonally Adjusted



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

## CONSUMER PRICE INDEX (CPI)

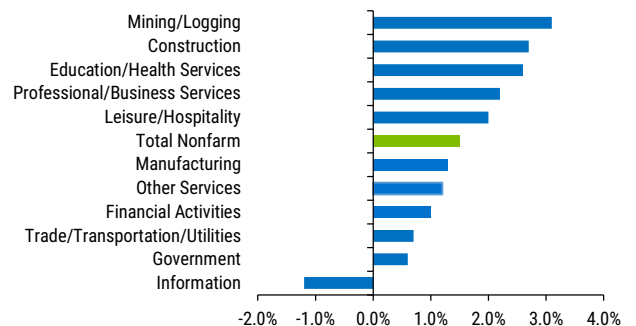
United States, 12-Month % Change, Seasonally Adjusted



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

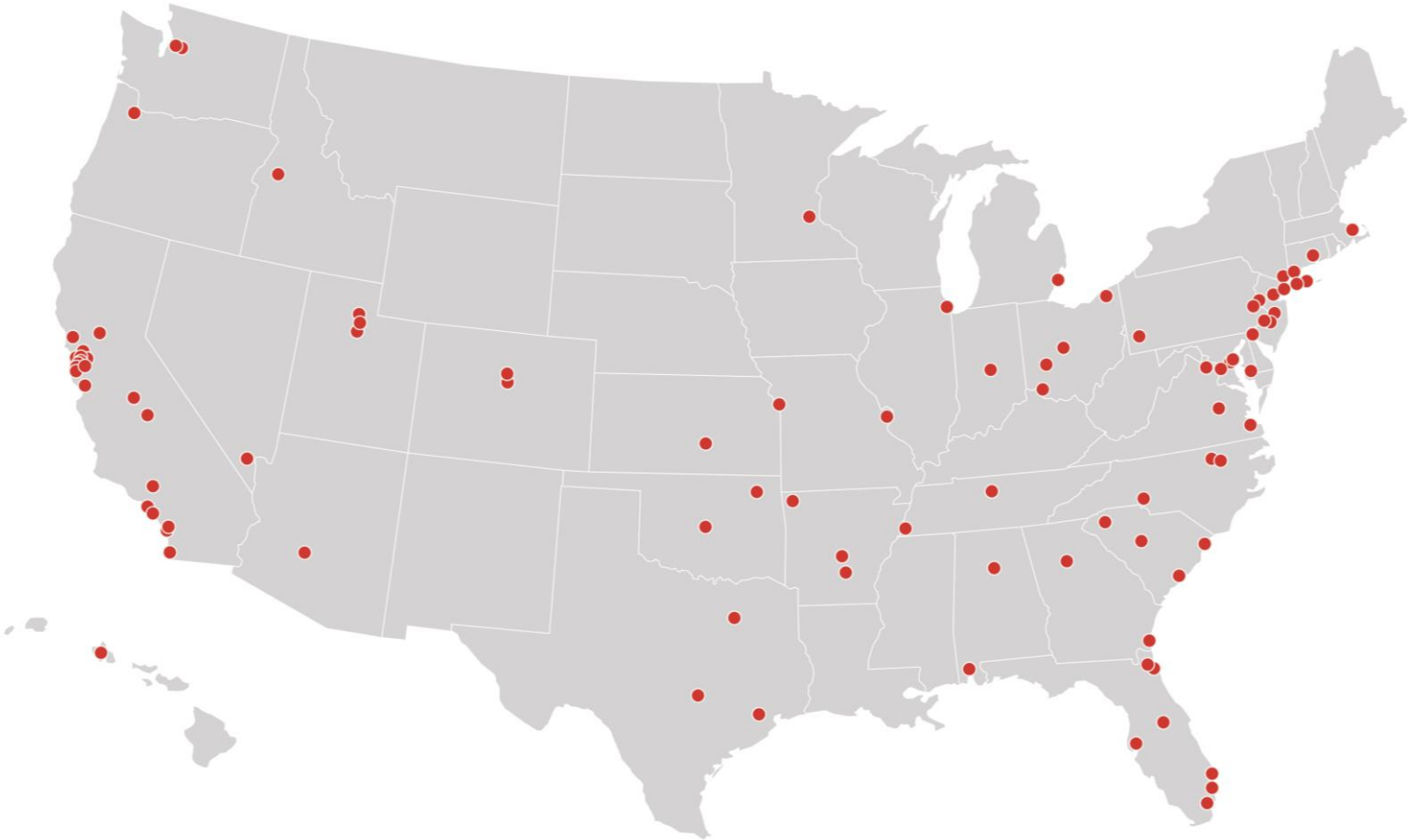
## EMPLOYMENT GROWTH BY INDUSTRY

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



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

## NEWMARK KNIGHT FRANK UNITED STATES OFFICE LOCATIONS



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