RESEARCH **3Q 2020**

Newmark Knight Frank

NATIONAL OFFICE MARKET

MARKET SOFTENS DURING THIRD QUARTER AS VIRUS SLOWS ACTIVITY

The U.S. office market weakened during the third quarter of 2020 as the COVID-19 pandemic continued to impact the nation. Absorption was negative for the third quarter in a row; occupancy declined 35.4 million square feet during the third quarter of 2020. Asking rents rose 3.9% compared with the third quarter of 2019, driven in part by deliveries of top-quality product; rents tend to be a lagging indicator during market shifts. Vacancy increased 110 basis points over the past 12 months. Approximately 8.6 million square feet of new product delivered during the third quarter of 2020. The amount of space under construction reached a new cyclical high and presents a challenge for asset owners in the year ahead. However, the potential for a new wave of coronavirus infections during the fall and winter, and the pace of the ongoing economic recovery, will be the greatest influences on market conditions during the remainder of the year and in early 2021.

OCCUPANCY DOWN; TENANTS PAUSE DECISIONS

Absorption was negative 35.4 million square feet during the third quarter of 2020, down from 3.1 million square feet of positive absorption during the third quarter of 2019. During the third quarter of 2020, absorption was negative in 49 of the 56 markets tracked by Newmark Knight Frank. The largest losses in the nation were endured by some of the largest markets, including Manhattan, where tenants moved out of nearly 11.0 million square feet. California's Bay Area registered material negative absorption as well, as tenants moved out of almost 2.2 million square feet in San Francisco and 1.1 million square feet in Oakland/East Bay. Eight markets overall saw negative absorption of at least 1.0 million square feet, including Dallas, Houston, Boston, Chicago and Los Angeles. The seven markets which saw positive absorption during the quarter are geographically varied but primarily lower-cost markets, including Salt Lake City, Oklahoma City and Jacksonville; each registered more than 100,000 square feet of positive absorption.

Manhattan, the nation's largest office market, saw the most space delivered during the third quarter of 2020, nearly 1.8 million square feet. This, combined with the nation's most negative absorption at nearly 11.0 million square feet, led to vacancy increasing by more than 160 basis points over the past year, to 7.5%. Some tenants in tech, coworking and finance have expanded remote work options for employees or are rethinking their footprints, which may materially impact office fundamentals in the months and years ahead. However, some of the city's largest banks are encouraging their employees to return to the office, and major tech firms continue to take more space.

ASKING RENTS RISE BUT CONCESSIONS ARE HIGH

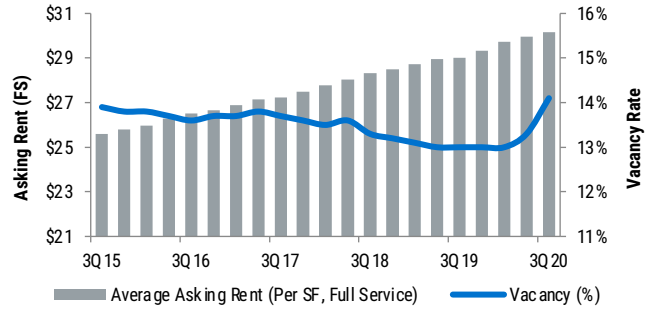
Rent growth has slowed since reaching a cyclical peak of 3.8% during the fourth quarter of 2015. Still, asking rents rose during the third quarter of 2020, supported by new deliveries. Rents tend to be a lagging indicator as the market shifts. The average asking rent is $30.15/SF gross full service, an increase of 3.9% over the past year. The pandemic will likely impact rent growth in the months ahead, although many asset owners are choosing to use concessions as the main vehicle for meeting tenant demands on overall occupancy costs, rather than reducing asking rents.

CURRENT CONDITIONS

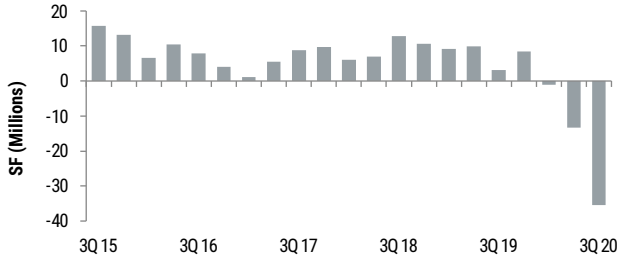
- Office absorption was down significantly in the third quarter of 2020 compared with the same period in 2019.
- The vacancy rate of 14.1% is 110 basis points higher than one year ago.
- The average asking rent rose by 3.9% over the past year. Many owners are holding asking rents but offering robust concessions.
- The construction pipeline reached a new cyclical peak during the third quarter of 2020, at 107.7 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 (SF)	4.9 B	4.9 B	4.9 B	↑
Vacancy Rate	14.1%	13.3%	13.0%	↑
Quarterly Net Absorption (SF)	-35.4 M	-13.3 M	3.1 M	↑
Average Asking Rent	$30.15	$29.96	$29.02	↓
Under Construction (SF)	107.7 M	99.0 M	97.9 M	↓
Deliveries (SF)	8.6 M	8.1 M	8.6 M	↑

VACANCY RISES DURING THIRD QUARTER

The vacancy rate increased 110 basis points over the past year to 14.1%. Year-to-date net absorption has been negative for three quarters in a row, totaling negative 49.7 million square feet, after 39 straight quarters of positive national absorption. Orlando (7.0%), Manhattan (7.5%) and Seattle (7.6%) recorded the lowest vacancy rates in the nation, though each saw vacancy rise quarter-over-quarter. There are three markets where the vacancy rate eclipses 20.0%, each of which is in the southwest: Oklahoma City at 25.9%, Houston at 23.1% and Dallas at 21.3%. These markets traditionally maintain higher-than-average vacancy rates because of the availability of land.

Markets experiencing an annual decline in vacancy include New Jersey Southern, which saw vacancy decline 90 basis points to 14.7%, and Cleveland, which saw a decline of 80 basis points to 16.6%. San Francisco saw the largest annual increase in vacancy, as the market's rate rose 660 basis points to 10.3%. Some tech firms have been placing sublease space on the market in downtown San Francisco as they reconsider the share of their workforce that can work remotely.

CONSTRUCTION PIPELINE REACHES NEW CYCLICAL PEAK

The office construction pipeline totals a robust 107.7 million square feet. Although tenants demonstrated a strong preference for new, efficient trophy projects before the pandemic, the large pipeline and slowing demand may result in temporary oversupply, particularly in some of the country's largest downtown markets. Backfilling older, obsolete space will become a greater challenge in the months ahead. Changes in tenant preferences as well as a push by some tenants toward more flexible scheduling will result in a reduction of demand. However, physical distancing requirements and a strong desire by many tenants to return to collaborative office environments will bolster demand in the long term. In the short term, many employers are implementing new protocols to allow their staff to safely return to the office.

Overall, construction has remained under control and stands at 2.2% of existing inventory, which should support the market's rebound once the pandemic is contained. However, some markets exceed this threshold and warrant monitoring, including Silicon Valley, where construction equates to 10.9% of inventory, and Charlotte, at 8.9% of inventory.

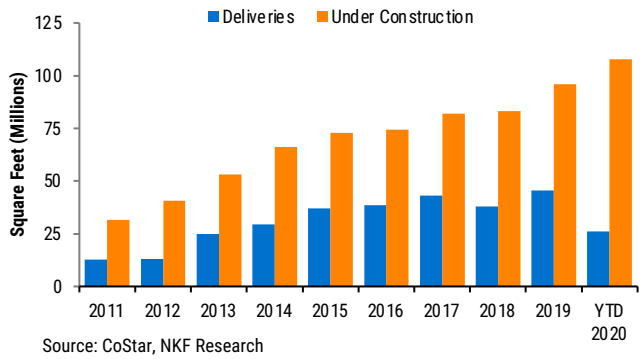
The national development pipeline has a number of significant projects underway, including Three Hudson Boulevard, located in the Far Wet Side submarket of Manhattan. It will be a 56-story, 2.0 million-square-foot building that will deliver in the fourth quarter of 2023. In Chicago, the BMO Tower, a 50-story office project located at 320 South Canal Street in the West Loop submarket, will deliver 1.46 million square feet in early 2022. It will be anchored by BMO Financial Group and will count Faegre Drinker and Chapman & Cutler LLP among its tenants. Additionally, One Congress, part of the Bulfinch Crossing development at 1 Congress Street in Boston's Beacon Hill submarket, is expected to deliver 1.0 million square feet in first-quarter 2023. The project will be anchored by State Street. Although the pandemic has impacted the office market in many ways, construction has largely remained on pace. Projects faced a few delays at the outset of the pandemic in some markets, but few timeline-altering restrictions remain. Projects that are underway are unlikely to see many changes, though the pace of the recovery may alter some proposed projects, as developers seek to determine their best timing or whether a different property type might result in a better return.

SUBLEASE AVAILABILITY RATE JUMPS

The third quarter of 2020 ended with 134.6 million square feet of sublease space available, equal to 2.7% of the total office inventory, an increase of 70 basis points from one year ago. This is up from the cyclical low of 1.7% of inventory in 2014. The sublease availability rate remained low throughout the just-ended cycle but now compares with the 2.6% peak during the financial crisis. The rise in the sublease availability rate was gradual in the early months of the pandemic but is now starting to accelerate. While the rate in Washington remains fairly low, other gateway markets including San Francisco, Boston, Los Angeles, New York and Chicago have seen substantial increases in sublease availability during the past few months. The sublease availability rate in San Francisco has eclipsed 8.0% percent as many tech firms shift toward more remote functions. Sublease availability rates in Boston, Chicago and New York are approaching or have already eclipsed their peaks from the Great Recession. Although many tenants are taking a wait-and-see approach while they determine their future office footprint needs, and taking physical distancing guidelines into account as they redesign their offices, it is likely that substantially more sublease space will reach the market during the fourth quarter of 2020 and in early 2021.

CONSTRUCTION AND DELIVERIES

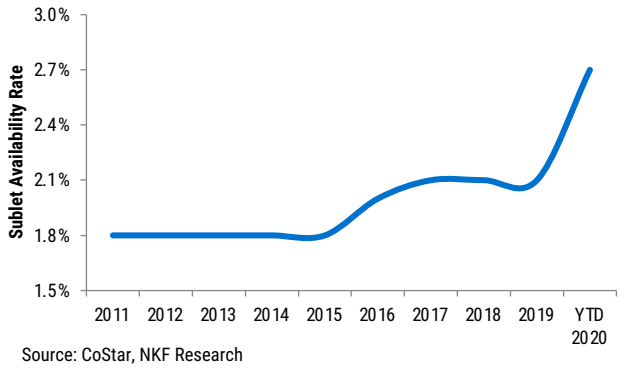
United States Office Market



Source: CoStar, NKF Research

SUBLEASE AVAILABILITY RATE

United States Office Market



Source: CoStar, NKF Research

OFFICE-USING SECTORS SEE FEWER JOB LOSSES

Nationally, office-using employment sectors—which include the Information, Financial Activities, Professional and Business Services, Other Services and Government sectors—have generally experienced fewer job losses than other sectors. In fact, markets with a higher proportion of office-using jobs have typically seen their unemployment rates remain lower than national averages. For example, the Washington, DC market, which counts approximately 60% of its total jobs as office-using, saw its unemployment rate peak at 9.8% in April. By contrast, in the New York metro area, where office-using jobs comprise approximately 48% of total employment, unemployment peaked in June at 18.3%. In Chicago, office-using sectors constitute 42% of all jobs, while 29.4% of jobs are in the Trade/Transportation/Utilities and Manufacturing sectors. Unemployment in that market reached 17.3% in April. The trend continues in the Los Angeles market, where office-using sectors make up an even smaller share of total jobs, at 41.0%. Unemployment there peaked in May at 19.3%. In each of New York, Los Angeles and Chicago, unemployment rates remain above 10.0%, while the rate in the Washington, DC metro area currently sits at 6.9%. Supporting Washington's office-intensive workforce is federal government spending, which is disproportionately captured in that market.

Nationally, the 12-month job change at September 2020 among office-using sectors was negative 4.7%, compared to negative 6.4% for total nonfarm jobs. In April, the figure for office-using job sectors was negative 7.2%, compared with negative 13.4% for total nonfarm jobs. The nature of office-using jobs makes them more likely to be retained during the current crisis, especially as network access has improved, allowing for more remote work opportunities. This is a Catch-22 for the office market today—remote work capabilities have protected office-using jobs from furloughs and layoffs, bolstering demand for space, but also jeopardized the usual level of occupancy. Most likely, many tenants will return to their offices once a safe and effective coronavirus vaccine is widely available, but likely with more flexible schedules for their employees. Importantly, many executives have discovered during this forced experiment that there is a difference between the ability to work remotely and the desire to do so.

U.S. OFFICE MARKET OUTLOOK

The national office market has seen three straight quarters of weakening market fundamentals. Construction remains at record levels, providing a boost to average asking rental rates; however, absorption has fallen off significantly and vacancy is on the rise. Although some workers have returned to their offices, the recovery slowed over the summer months. The Federal Reserve and the federal government have taken steps to try to bolster the economy, but the lack of additional stimulus as of mid-October has inhibited progress. The CARES Act was signed into law in March and provided some stop-gap measures, but some of those assistance programs have expired, and a second bipartisan plan has not yet been agreed upon. The U.S. unemployment rate has fallen each month since peaking at 14.7% in April, and more than half of the 22.0 million jobs that were lost in March and April have been restored. However, further delays on additional federal intervention could create significant problems for the economic recovery, with carryover effects for the office market.

Now entering its eighth month since disrupting American life, the pandemic will likely lead to structural changes both in the office market and the economy. Although the economic impacts of the virus were mitigated during the summer months, the fall and winter could see an uptick in coronavirus cases, which could cause additional modified shutdowns to occur. Office-using jobs have been spared some of the worst impacts, though productivity is a metric that companies will watch closely, especially as a school year based around distance learning progresses and the holiday season approaches. Schools reopening for in-person learning, renewed comfort with public transit, and the timing of a coronavirus vaccine all will shape the national office market's recovery.

On balance, the market currently is tenant-favored in most cities. Sublease space availability is likely to rise further in the months ahead, and effective rents are under downward pressure, with concessions elevated. However, concerns about corporate culture, talent attraction and retention, and collaboration will bring many tenants back to the office once it is safe to return.

NOTABLE 3Q 2020 LEASE TRANSACTIONS

Tenant	Market	Building	Type	Square Feet
Facebook	Manhattan	390 Ninth Avenue	Direct New	730,000
Foxconn Corporation	Houston	8303 Fallbrook Drive	Direct Expansion	400,250
PetSmart Inc.	Houston	19601 North 27th Avenue	Lease Renewal	365,672
Bristol Myers Squibb	Boston	250 Water Street	Direct New	360,000
NBC Universal	Manhattan	1221 Avenue of the Americas	Direct Expansion	339,833

NOTABLE 3Q 2020 SALES TRANSACTIONS

Building	Market	Sale Price	Price/SF	Square Feet
40 Sylvan Road	Boston	$210,000,000	$673	312,000
4353-4453 North First Street	Silicon Valley	$173,540,000	$466	372,011
123 Townsend Street	San Francisco	$140,000,000	$992	141,155
36 Whittemore Avenue	Boston	$125,000,000	$435	287,442
50 Sylvan Road	Boston	$120,000,000	$600	200,000

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)
National	**4,923,792,565**	**107,730,348**	**-35,392,960**	**-49,714,847**	**14.1%**	**$30.15**
Atlanta	152,351,040	5,186,403	-390,797	1,509,718	18.0%	$28.93
Austin	67,541,305	1,167,693	-832,342	-1,163,612	13.7%	$36.44
Baltimore	82,335,016	185,000	-124,504	-281,523	13.4%	$24.12
Boston	181,072,703	7,356,291	-1,712,638	-2,953,808	13.6%	$38.91
Broward County, FL	33,480,028	789,560	-486,820	-603,311	11.7%	$30.24
Charleston, SC	50,670,097	4,512,709	-327,702	75,686	12.0%	$31.06
Charlotte	14,596,078	0	-242,351	-295,047	12.5%	$26.64
Chicago	241,010,965	6,164,232	-1,683,206	-833,973	17.6%	$30.02
Cincinnati	36,615,913	0	-426,620	-413,846	18.6%	$19.37
Cleveland	38,999,237	100,000	-36,952	510,937	16.6%	$18.18
Columbia, SC	15,956,237	0	-129,182	-158,245	9.7%	$18.28
Columbus	58,779,888	145,160	-168,811	-626,717	10.8%	$19.46
Dallas	266,256,763	1,908,516	-2,806,386	-4,393,359	21.3%	$26.66
Delaware	17,172,662	0	-2,563	441,546	16.7%	$25.33
Denver	100,137,274	1,551,082	-387,004	-715,985	15.7%	$28.33
Detroit	78,243,370	390,000	-31,708	-24,806	15.2%	$20.18
Fairfield County, CT	39,722,492	649,063	-148,110	-463,903	19.1%	$37.36
Fresno	20,032,870	111,452	15,810	-33,478	10.3%	$21.60
Greenville, SC	21,915,841	0	-244,400	-337,667	9.0%	$22.37
Houston	242,527,609	4,322,712	-1,828,441	-3,613,636	23.1%	$29.43
Indianapolis	61,863,536	31,710	-363,812	-754,755	12.2%	$20.20
Inland Empire, CA	28,377,683	204,102	-91,726	-183,347	10.3%	$22.60
Jacksonville	32,103,188	149,000	149,388	224,834	13.6%	$20.53
Kansas City	74,429,658	108,000	-348,315	-1,516,843	11.4%	$20.95
Las Vegas	39,252,666	534,384	-62,104	17,706	13.1%	$21.71
Long Island	56,248,143	0	-424,234	-1,099,874	10.0%	$27.06
Los Angeles	202,695,586	4,722,389	-1,848,049	-2,052,823	15.1%	$42.98
Manhattan	461,034,126	14,365,327	-10,973,238	-13,133,206	7.5%	$78.75

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)

	Total Inventory (SF)	SF Under Construction	SF Absorbed This Quarter	SF Absorbed Year-to-Date	Vacancy Rate	Average Asking Rent (Price/SF)
National	**4,923,792,565**	**107,730,348**	**-35,392,960**	**-49,714,847**	**14.1%**	**$30.15**
Memphis	33,489,851	0	-232,639	-144,140	14.1%	$19.22
Miami	48,278,122	1,991,891	-424,332	-391,034	13.1%	$38.53
Milwaukee	36,468,593	600,737	78,502	20,267	17.9%	$21.56
Minneapolis	119,384,601	1,192,300	-279,922	-983	11.2%	$26.45
Nashville	54,310,299	3,016,793	-191,775	-962,701	9.7%	$28.94
New Jersey Northern	166,921,630	415,000	-593,970	533,433	17.2%	$30.07
New Jersey Southern	16,799,544	0	81,431	166,418	14.7%	$20.94
Oakland/East Bay	75,777,111	572,110	-1,076,219	-1,551,949	12.6%	$40.08
Oklahoma City	15,087,781	153,000	281,758	-59,708	25.9%	$19.55
Orange County, CA	96,040,026	1,261,555	-467,166	-806,362	13.0%	$33.16
Orlando	64,656,231	21,000	-218,411	-110,510	7.0%	$23.74
Palm Beach	25,127,184	650,000	-181,317	-229,462	12.5%	$35.01
Philadelphia	109,272,253	2,190,000	-247,655	-520,851	14.3%	$30.20
Phoenix	94,383,609	2,151,287	-80,423	-191,149	16.2%	$26.77
Pittsburgh	55,865,966	1,401,853	-268,003	-494,139	18.5%	$24.10
Portland	56,707,370	0	-308,098	-491,318	11.3%	$30.40
Raleigh/Durham	50,614,515	2,830,072	-272,654	376,453	11.0%	$27.31
Sacramento	70,118,170	551,800	-158,881	247,383	10.1%	$24.60
Salt Lake City	70,252,654	3,035,827	289,797	-33,910	11.9%	$22.96
San Antonio	44,907,768	768,650	-217,246	-475,169	14.2%	$23.54
San Diego	72,009,141	1,904,584	-291,878	-841,547	13.4%	$38.29
San Francisco	85,487,679	1,996,968	-2,182,531	-6,069,075	10.3%	$80.98
Seattle	127,733,635	8,253,359	-537,949	-39,772	7.6%	$41.86
Silicon Valley	88,033,374	9,599,287	-858,981	-2,246,567	11.1%	$55.20
St. Louis	72,813,374	526,000	15,989	111,464	10.8%	$21.30
Tampa/St. Petersburg	61,110,333	1,172,993	-32,716	-102,054	9.4%	$25.79
Washington, DC	369,574,143	6,818,497	-780,728	-1,652,533	16.6%	$40.75
Westchester County, NY	27,145,634	0	-280,126	-881,995	18.7%	$27.98

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.

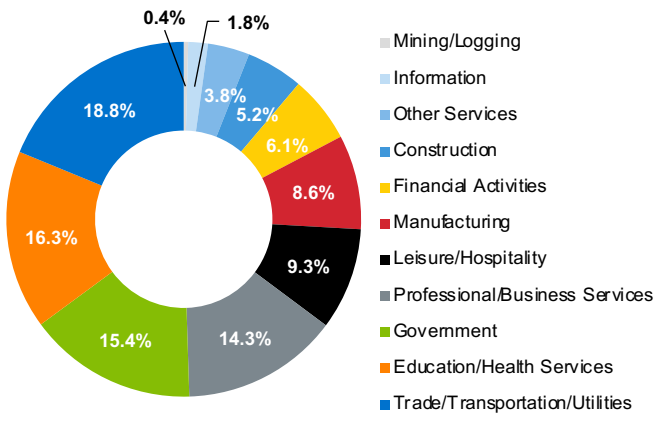
ECONOMIC CONDITIONS

The U.S. economy contracted at an annual rate of 31.4% during the second quarter of 2020, according to the Bureau of Economic Analysis' third estimate, which was released in September 2020. The inflation rate was 1.3% (seasonally adjusted) for the 12 months ending in August 2020. The unemployment rate has increased 440 basis points from one year ago and stood at 7.9% in September 2020, though this is down from a cyclical peak of 14.7% in April. The economy lost more than 22.0 million jobs between March and April of 2020 but has added 11.4 million jobs between May and September as states have begun to reopen their economies. Financial Activities and Government were among the notable office-using sectors that have been able to better withstand the downturn nationally.

Uncertainty over the duration of the COVID-19 crisis will be one notable economic challenge as the world tries to return to normal, but containment of the virus in the U.S. remains difficult. The Federal Funds Rate has remained stable over the past few months and is currently in the 0.00–0.25% range; the Fed has pledged to keep rates near zero through at least 2023 as a means to get the economy back to full speed. Metro areas that have high levels of technology, healthcare, and professional and business services jobs likely will lead the office market rebound, although the tech sector's shift to more remote work is an obstacle.

EMPLOYMENT BY INDUSTRY

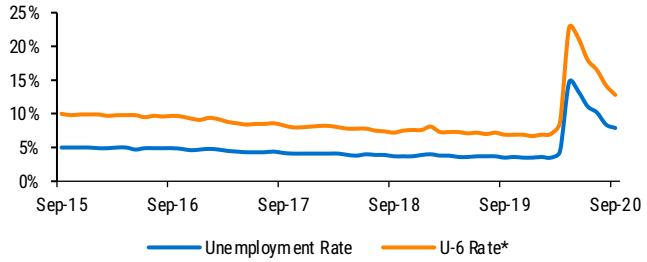
United States, 2020 Annual Average



Source: U.S. Bureau of Labor Statistics, NKF Research; October 2020

UNEMPLOYMENT RATE

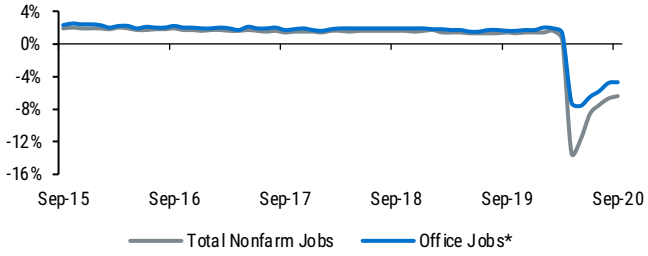
United States, Seasonally Adjusted



* Includes total unemployed, marginally attached workers, and those working part time for economic reasons
Source: U.S. Bureau of Labor Statistics, NKF Research; October 2020

PAYROLL EMPLOYMENT

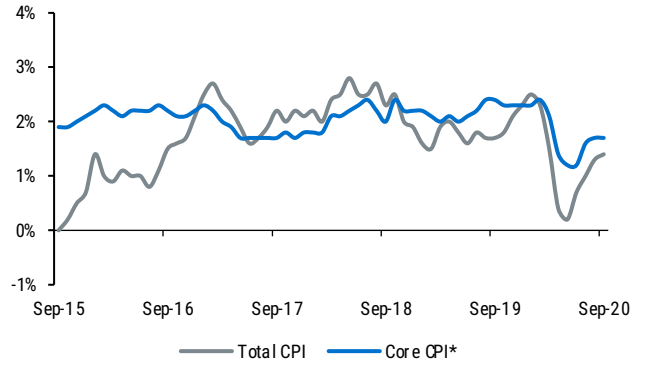
United States, 12-Month % Change , Not Seasonally Adjusted



* Includes Professional and Business Services, Information, Financial Activities, Other Services and Government
Source: U.S. Bureau of Labor Statistics, NKF Research; October 2020

CONSUMER PRICE INDEX (CPI)

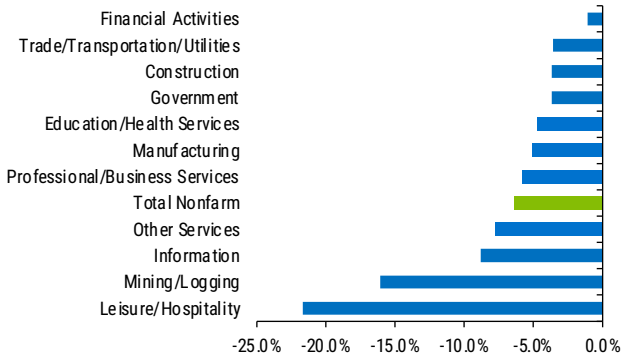
United States, 12-Month % Change, Seasonally Adjusted



*Excludes food and energy, which can be volatile; 1982–84=100
Source: U.S. Bureau of Labor Statistics, NKF Research; October 2020

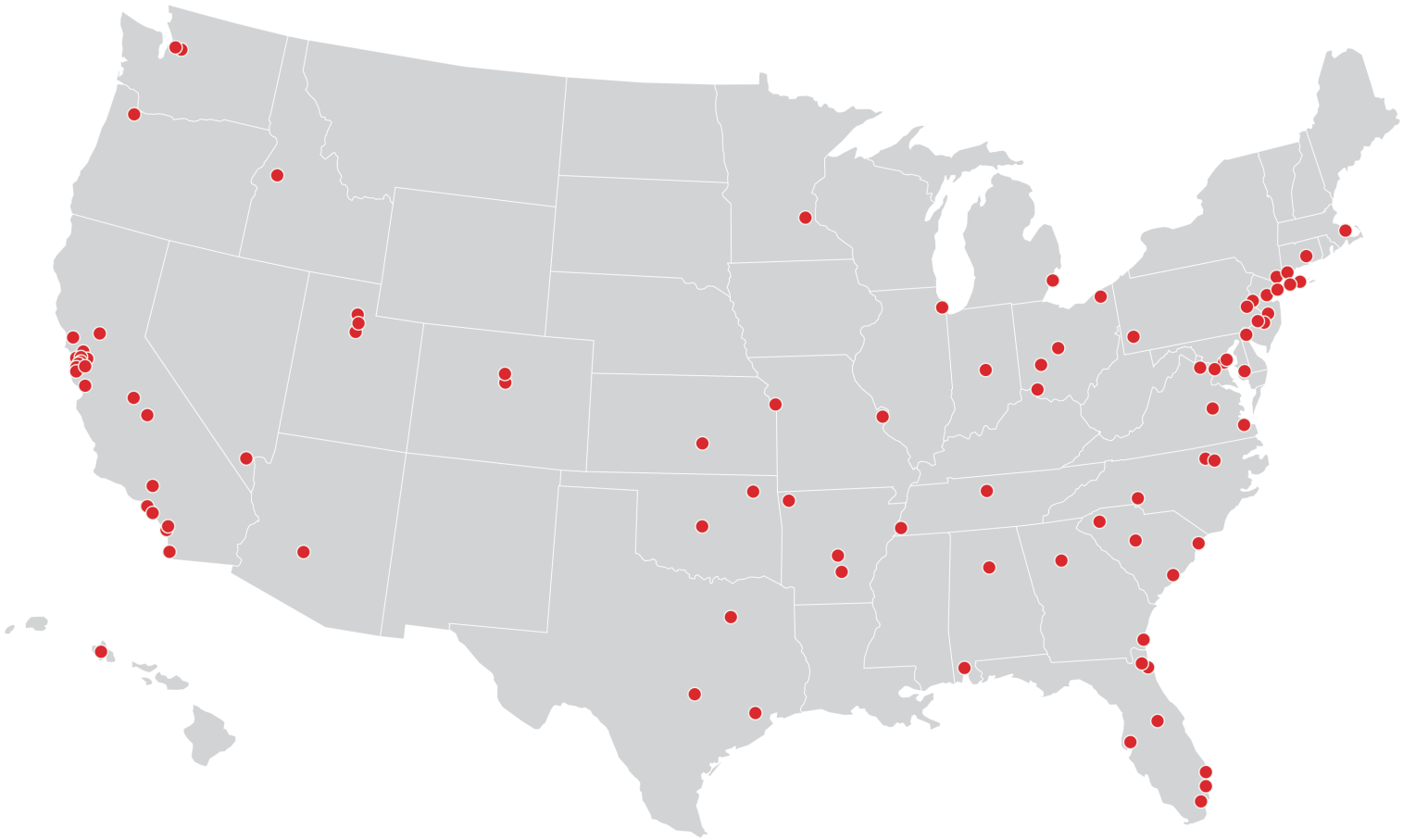
EMPLOYMENT GROWTH BY INDUSTRY

U.S., September 2020, 12-Month % Change, Not Seas. Adj.



Source: U.S. Bureau of Labor Statistics, NKF Research; October 2020

NEWMARK KNIGHT FRANK UNITED STATES OFFICE LOCATIONS



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