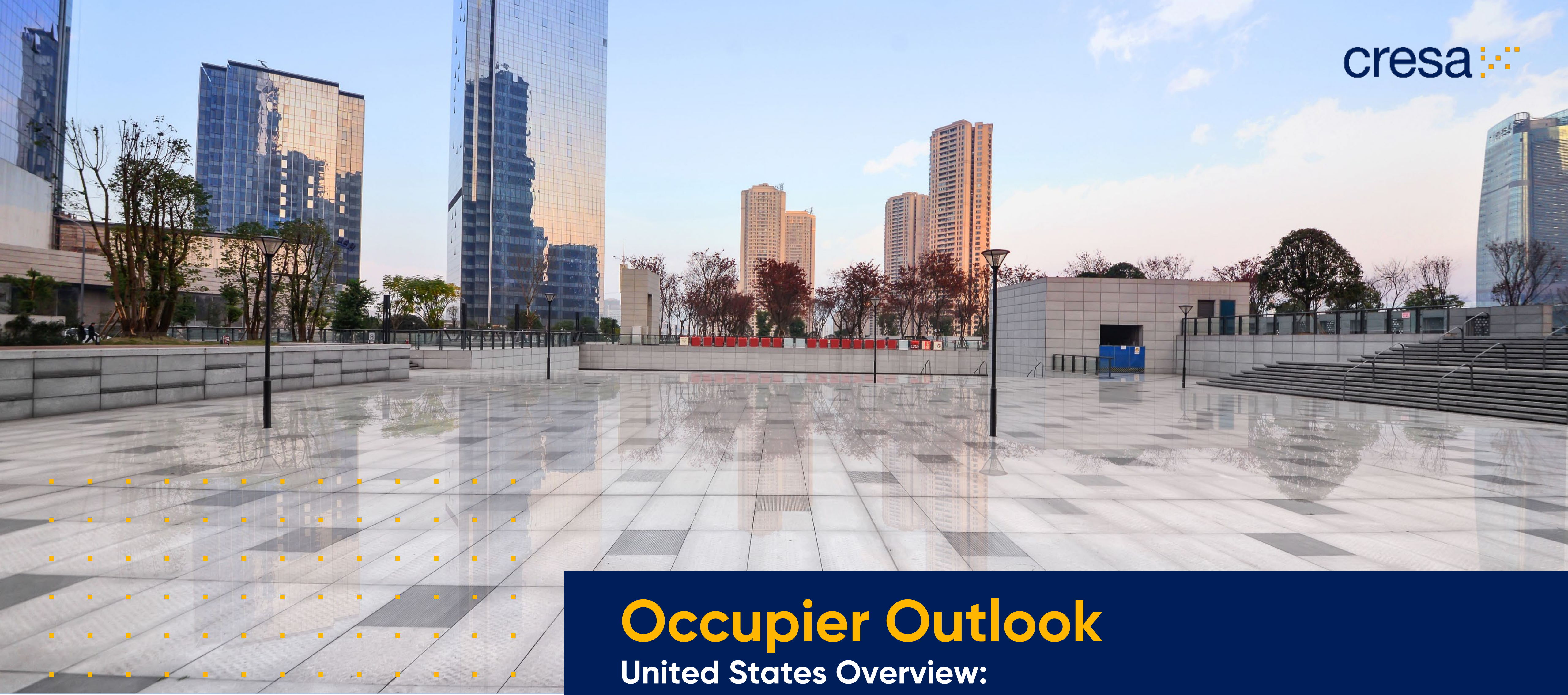
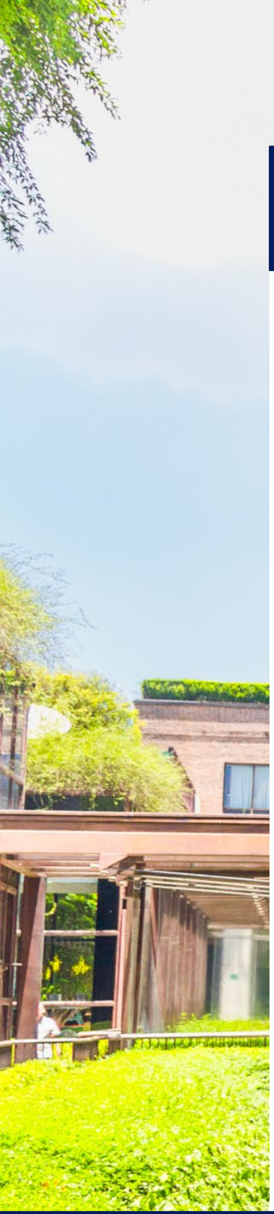


Occupier Outlook

United States Overview:
The Economy and its Impact on Commercial Real Estate

Cresa Research

Q4, 2023



Executive Summary

Macro Economic View

- Labor market defies expectations, keeping unemployment rates near record lows, BUT there are caveats
- Preliminary GDP records the biggest expansion in Q4 seen in seven quarters
- Inflation falls, but remains higher than pre-pandemic levels
- Fed likely to conservatively raise rates in 2024, as 10-year treasury notes remain above past 20-year historical average
- Consumer spending surpasses expectations in Q4, sentiment is low
- Housing starts slow, sale prices creep higher

Office Market Fog Begins to Clear

- Remote work trends appear to be holding steady
- Negative net office absorption continues, but sublease space retreats
- Office deals are getting done, but pace slows and deal size shrinks
- Trophy and other top-end office properties remain competitive, following a flight-to quality

Industrial Cools and Retreats to Mean

- Rates push higher, but annual increases slow to under four percent
- Construction starts fall by nearly 50 percent in 2023, with new deliveries, vacancy, availabilities, and sublease space increases

Resilient Economy Pushes Forward,
While Commercial Real Estate Faces Challenges

Economy Exceeds Expectations and Eyes a Soft Landing

Mixed Signals Indicate Caution Ahead

The predicted 2023 recession never materialized as consumers and businesses continued to spend despite increased borrowing costs. Economic expansion blew past expectations, growing by 4.9 percent in the third quarter with households spending down their excess savings on pent-up demand for recreation and entertainment activities.

Still, there has been a slowdown in some areas, with manufacturers reporting that new orders for products have fallen, leading to a contraction in factory activity.

The housing market has seen a decrease in sales velocity as rate increases have stalled new listings due to the benefit of remaining in a low fixed-mortgage rate. Further, home prices have dipped as the momentum of steep increases over the past few years have stalled.

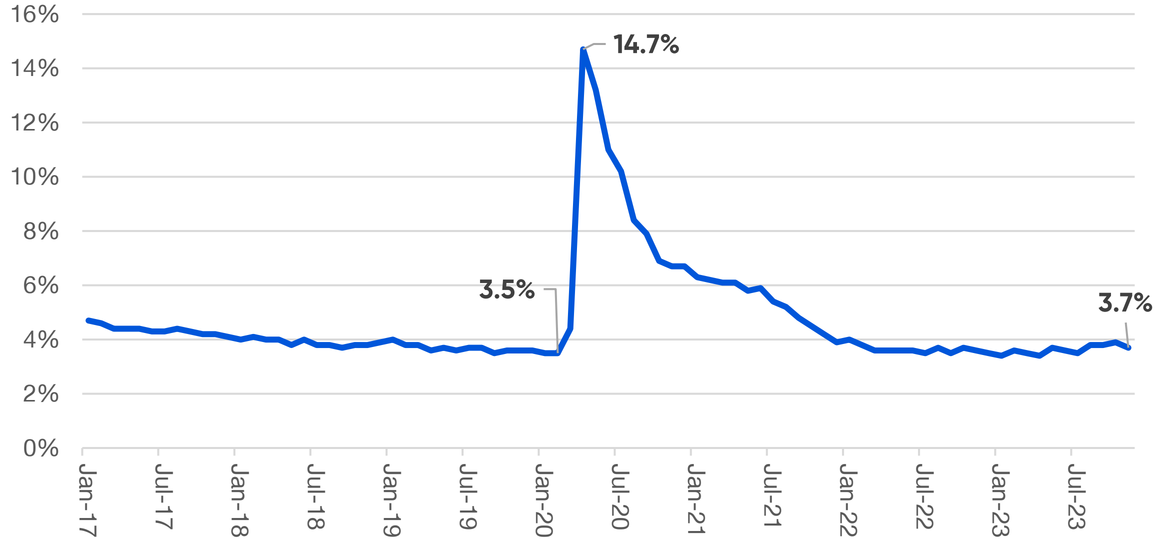
Despite tightening financial conditions and higher business costs, the labor market has remained resilient. However, scratching the surface deeper shows job openings retreating and increasing layoff announcements indicate a slowdown. Further, a large percentage of jobs being created are in the service and healthcare sectors, while traditional higher-paying office-occupying jobs have slowed or decreased.

Unemployment

Unemployment Remains Low

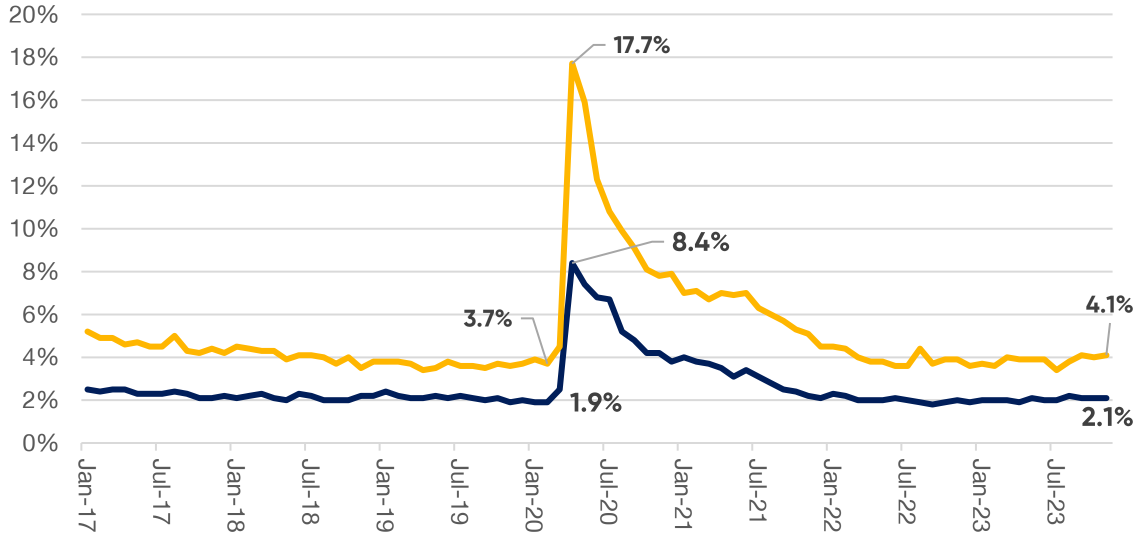
Unemployment remains near historic lows. Fed rate increases are expected to slow as inflation has fallen. College educated employees remain near full-employment despite recently announced layoffs in the tech industry. Additionally, lower-skilled service-oriented jobs are the main driver of job growth.

Total Unemployment: (United States)



Source: U.S. Bureau of Labor Statistics, https://bls.gov

High School Only vs. Bachelor's Degree or Higher



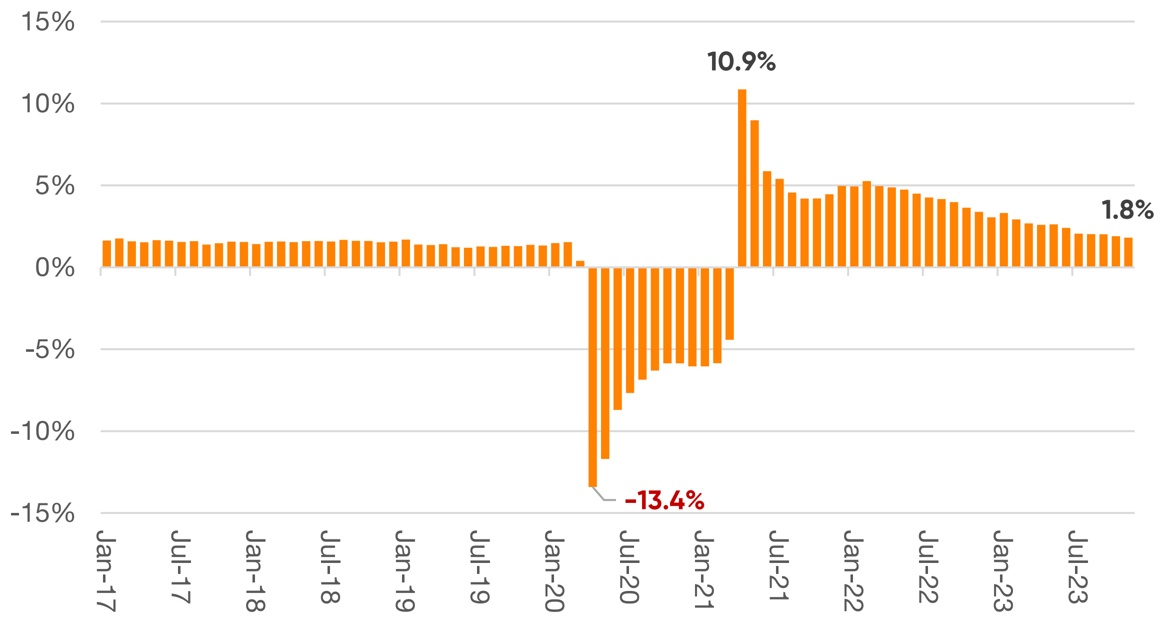
Source: U.S. Bureau of Labor Statistics, https://bls.gov

Employment

Job Creation Defies Expectations With Continued Strong Gains

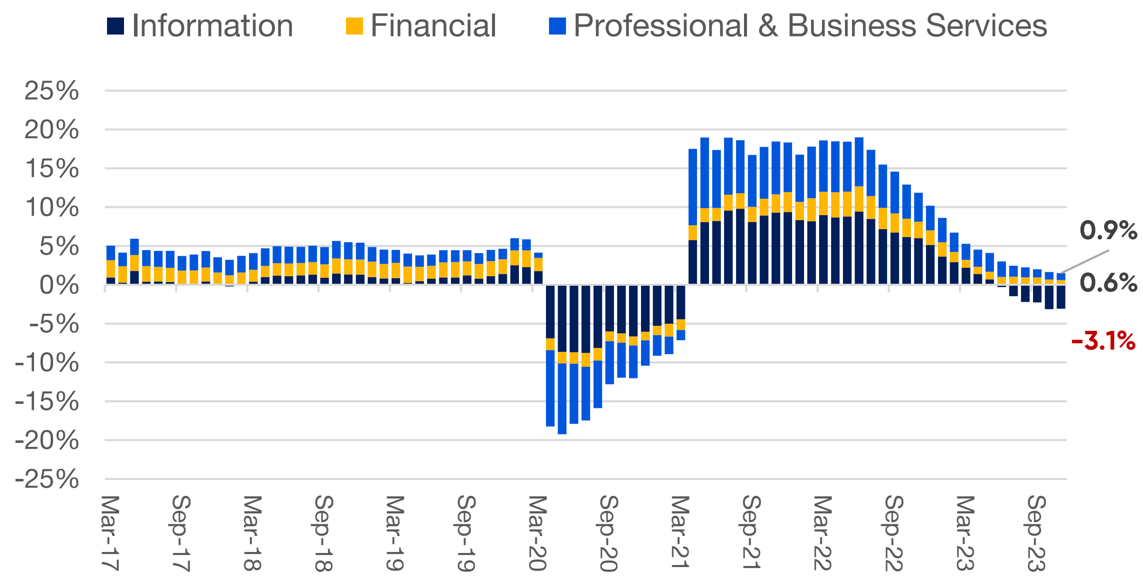
Total nonfarm payroll employment rose by 216,000 in December, surpassing expectations. Job gains occurred in government and healthcare jobs underpinned the growth. Office-occupying job creation is slowing, with information sector jobs down 3.1 percent from a year earlier.

All Job Sectors (12-Month Change)



Source: U.S. Bureau of Labor Statistics, https://bls.gov

Office-Occupying Jobs (12-Month Change)



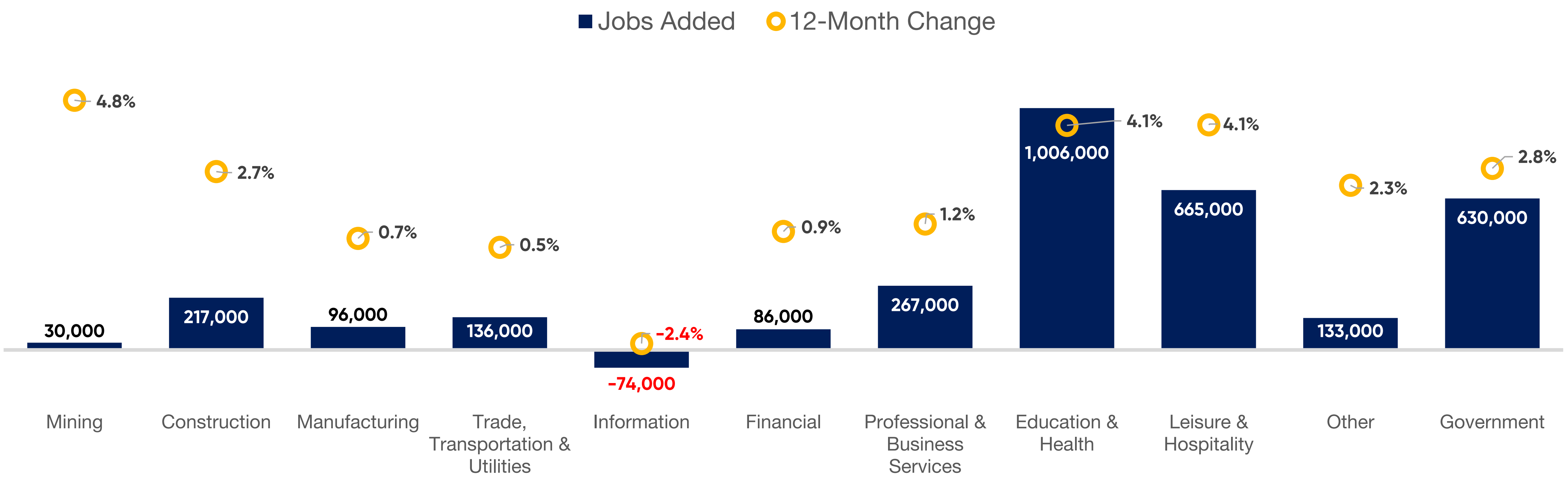
Source: U.S. Bureau of Labor Statistics, https://bls.gov

Employment

Education/Health and Leisure/Hospitality Lead the Way

Pent-up demand leads to increases in leisure and health services sector jobs. The jobs being added are not concentrated in office-occupying sectors, meanwhile nearly 450,000 jobs were created in the industrial sector last year, highlighted by the construction sector.

Job Creation by Sector (12-Month Change)



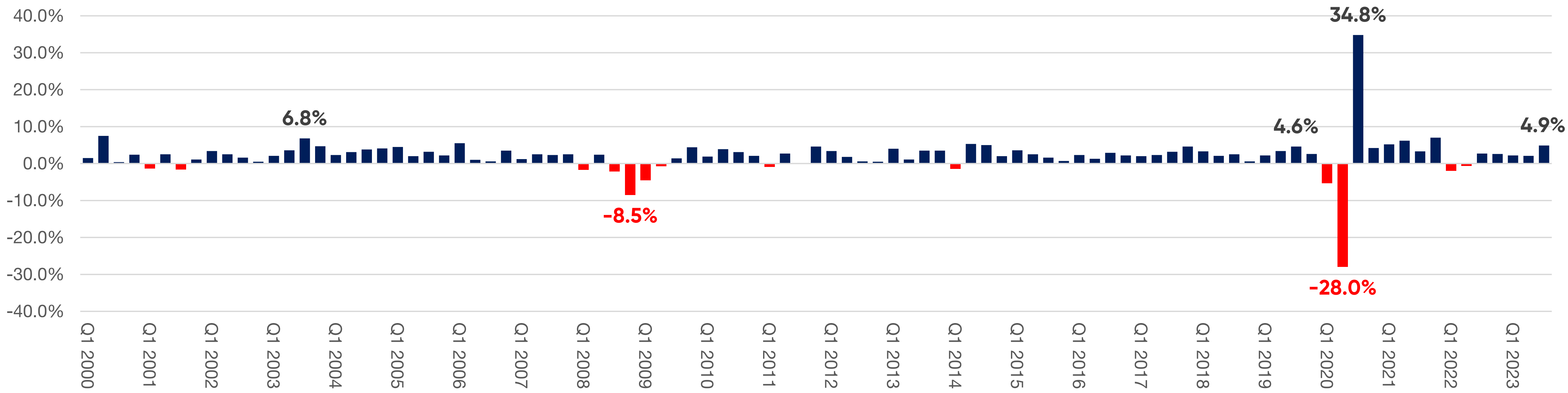
Source: U.S. Bureau of Labor Statistics, https://bls.gov

GDP

Gross Domestic Product Posts Fourth Consecutive Quarter of Growth

The GDP has expanded for the past five quarters. According the *Bureau of Economic Analysis*, the increase in the third quarter primarily reflected increases in consumer spending and inventory investment. Profits increased 3.4 percent in the third quarter after increasing 0.2 percent in the second quarter.

Real GDP Percent Change from Preceding Quarter



Source [Real Gross Domestic Product (A191RL1Q225SBEA) | FRED | St. Louis Fed (stlouisfed.org)]

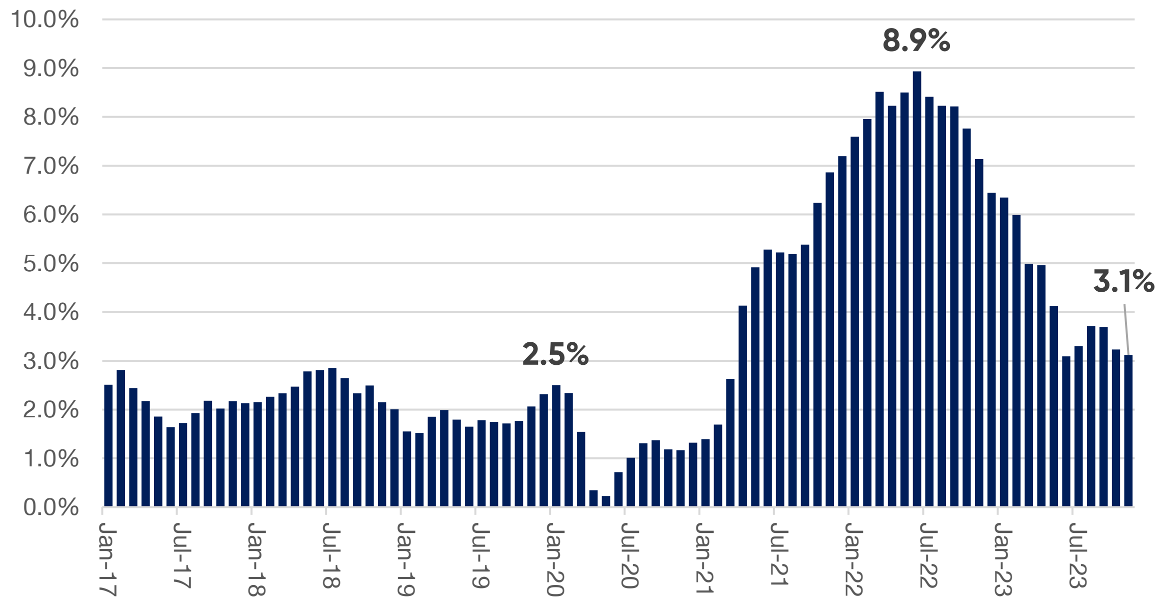
Note: Seasonally adjusted at annual rates, Bureau of Economic Analysis date published December 21, 2023 (third estimate).

Inflation

Inflation Ticks Lower for the Past Two Months After Brief Spike

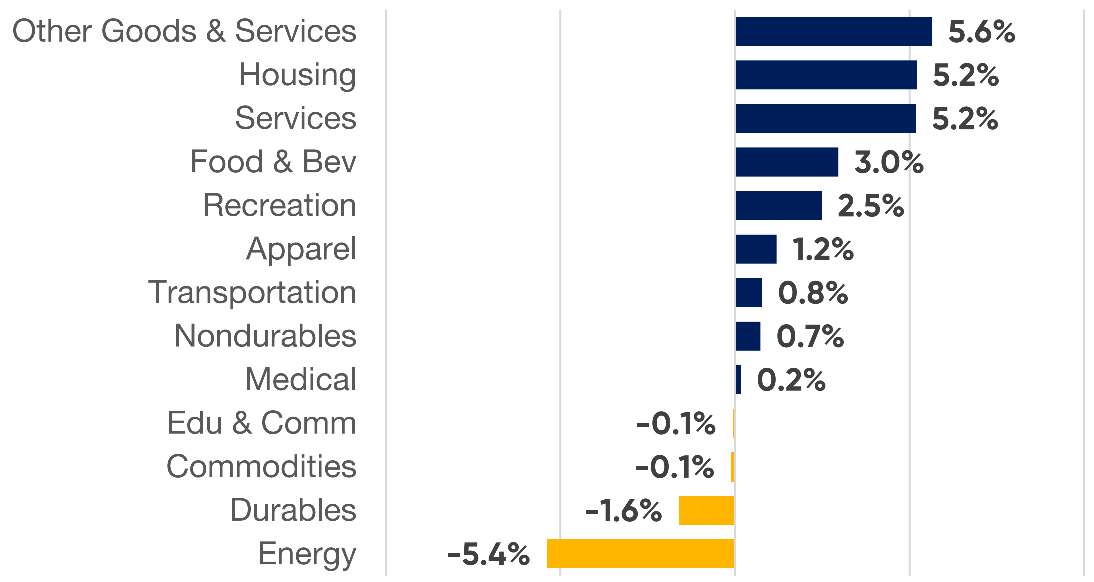
Driven by consumer demand, supply chain disruptions and a tight labor market, inflation pushed prices higher, peaking in June 2022. Inflation growth had slowed for 12 consecutive months, before ticking higher in mid-2023. Overall, inflation has slowed the past two months, lead by energy and durable goods. The drop in durable goods means demand for big-ticket items like vehicles, household goods and electronics are slowing.

Consumer Price Index (12-Month Change)



Source: U.S. Bureau of Labor Statistics, https://bls.gov
Note: Seasonally adjusted, Data pulled January 2024.

Consumer Price Index by Sector (12-Month Change)



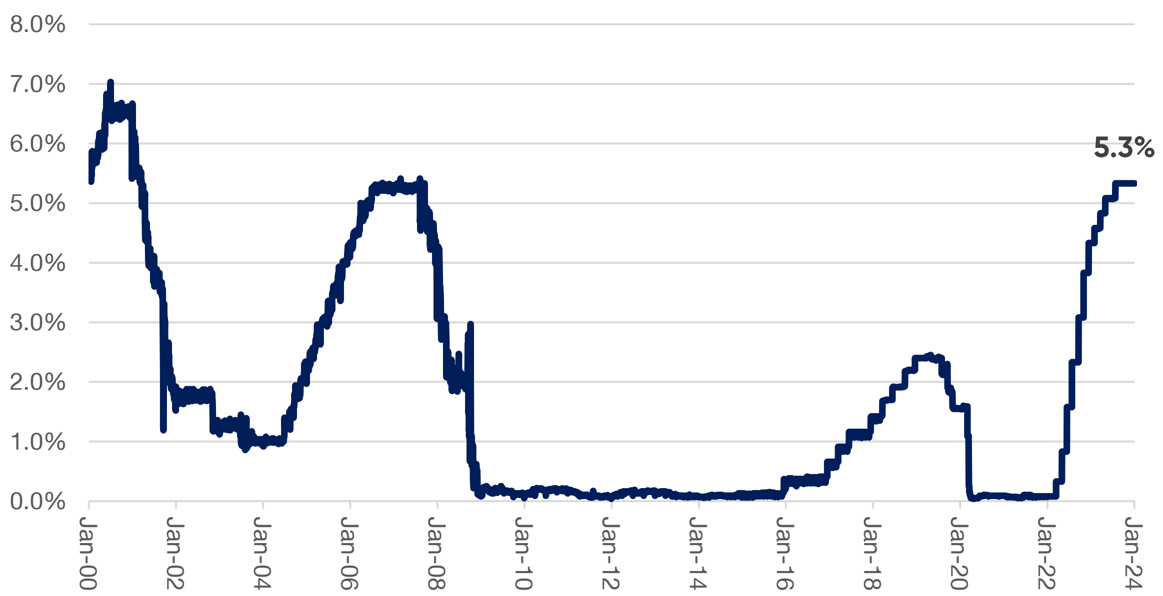
Source: U.S. Bureau of Labor Statistics, https://bls.gov

Monetary Policy

Rate Increases Pause as Fed Attempts to Control Inflation

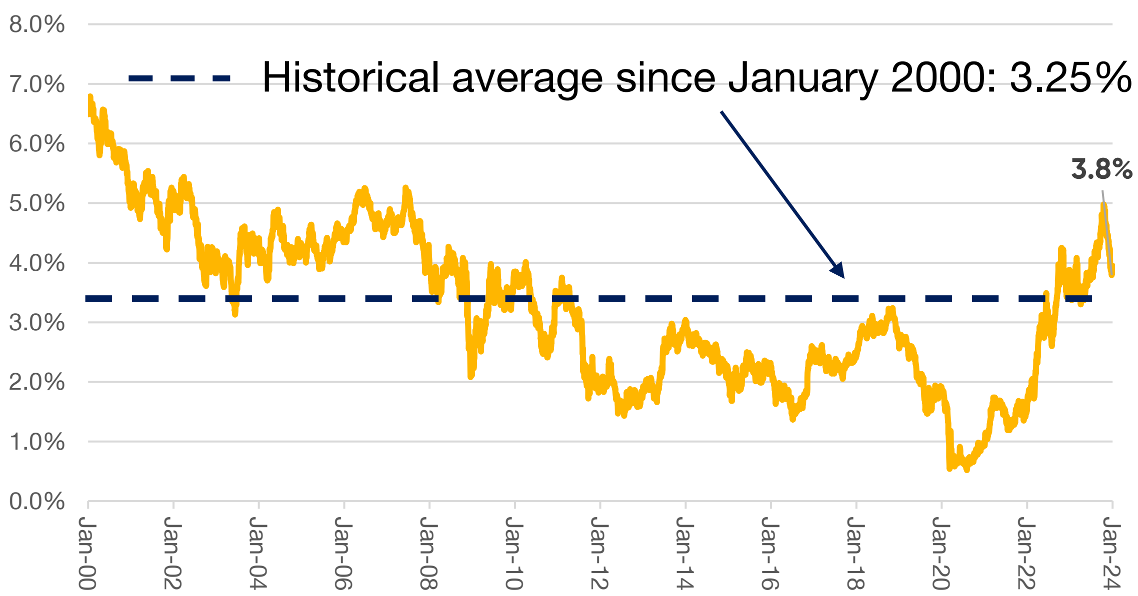
A series of increases in the Fed rate, including three 75bps increases in 2022, has bumped the range to 5.25% to 5.50%, the highest level in more than 20 years. The Fed has held rates steady after a 25-basis point increase in July. Rates are expected to increase only modestly heading into 2024. Meanwhile, the 10-year US treasury note, an indicator for broader investment confidence, has slowed, falling to 3.8 percent in late December.

US Effective Fed Fund Rate



Source: Federal Reserve Economic Data, https://fred.stlouisfed.org
Data is through December 2023

10-Year US Treasury Note



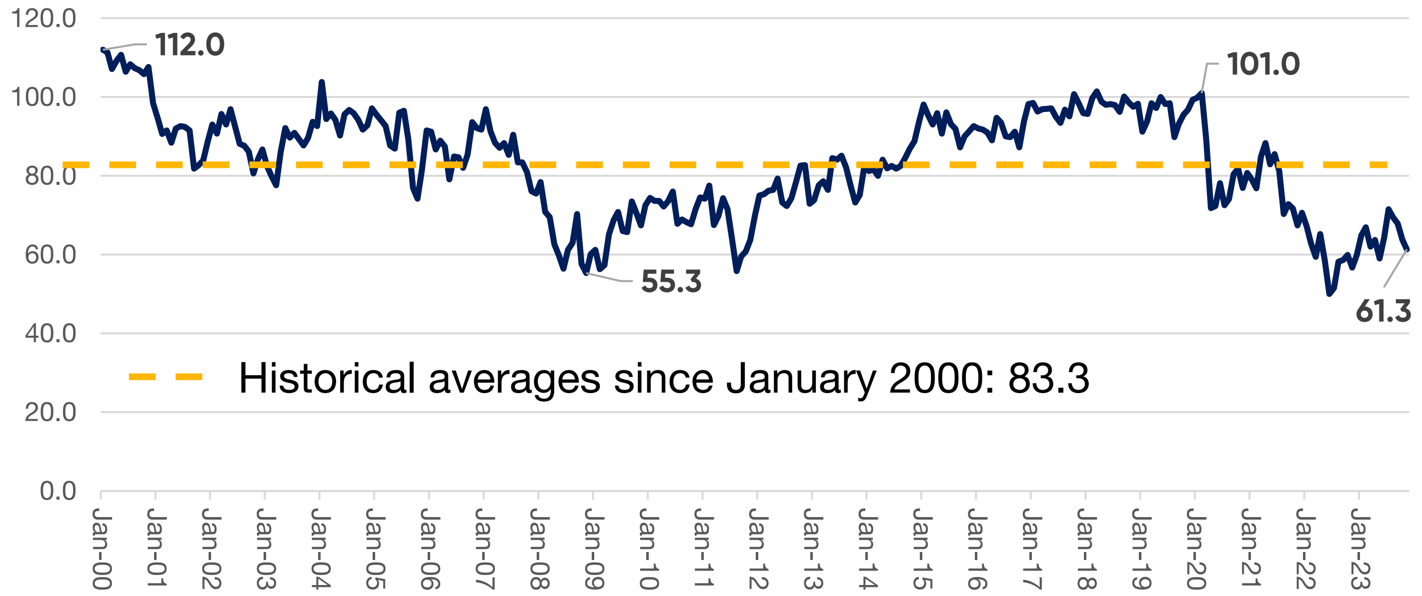
Source: Wall Street Journal
Data is through December,2023l

Consumers

Consumer Sentiment Remains Near Decade Low

Despite strong consumer spending related to pent-up demand, the consumer sentiment index has dropped precipitously since the beginning of the pandemic. The index is now (61.3) near levels following the end of the Great Recession in 2011 before going on a near decade long trend of increases leading up to the start of the Covid-19 pandemic. Moving into 2024, consumer sentiment is still well-below historical averages.

Consumer Sentiment Index: (United States Total)



Source: Federal Reserve Economic Data, https://fred.stlouisfed.org;
Note: Data thru August 2023

Consumer Sentiment Index

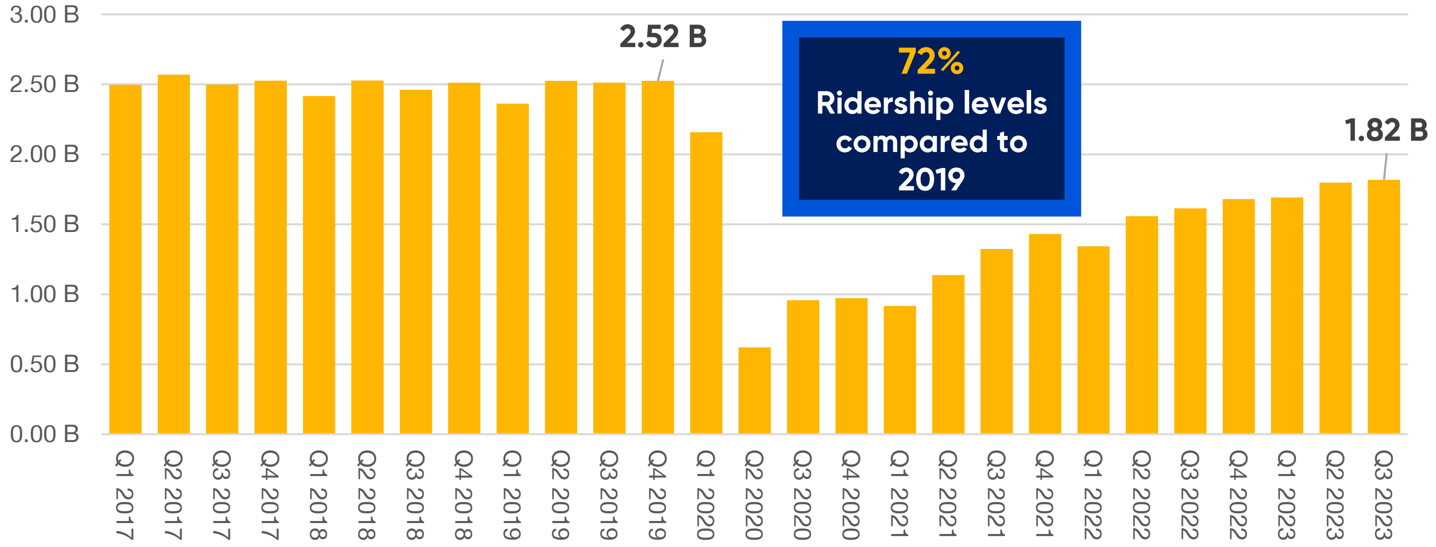
Consumer sentiment is a statistical measurement of the overall health of the economy as determined by consumer opinion. It considers people's feelings toward their current financial health, the health of the economy in the short-term, and the prospects for longer-term economic growth.

Public Transit

Public Transit Slowly Gains Momentum as Return-to-Work Ticks Higher

A good indicator of the health of an urban core, and by extension the downtown office market, is the use of public transportation. Public transit ridership increased for the past six quarters, experiencing a 35.8 percent increase since the start of 2022. As more workers return to the office, these increases are expected to continue. However, as return-to-work continues to stabilize, ridership levels will likely see only moderate gains.

Public Transit Ridership: (United States)



Source: American Public Transportation Association Quarterly Ridership Report. Ridership Report - American Public Transportation Association (apta.com)

Ticket to Ride

Public transportation has been reliably consistent since the turn of the century. Sky-rocketing gas prices temporarily encouraged public ridership in 2008, but quickly dropped back to historic levels. During the first year of the declared pandemic, ridership was cut in half (52.8% decrease). The economy opened wider in 2021, but ridership still only increased 3.1 percent from the previous year. The beginning of 2022 marked the beginning of the economy opening back to near pre-pandemic levels, yet ridership on public transportation ended the third quarter of 2023 at 72 percent of the average ridership of 2019, the last full-year before the start of the pandemic.

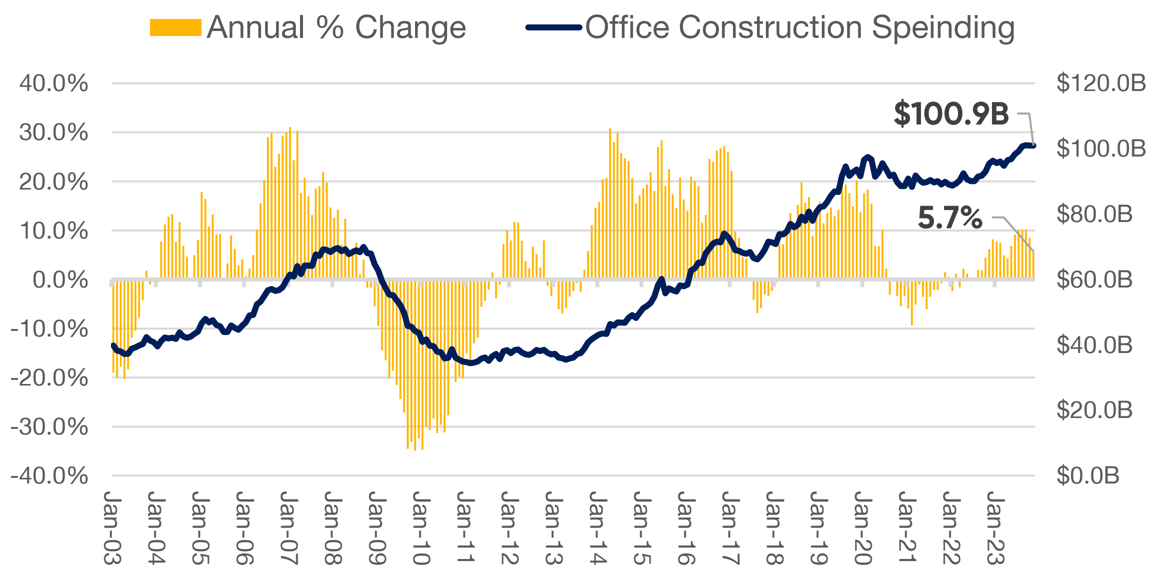
Construction

Office Construction Spending Slows, While Industrial Spending Peaks

Perhaps surprisingly, the amount spent on office construction has not fallen below pre-pandemic levels. New, well-located office construction with plentiful amenities are drawing interest from occupiers as they look to entice people to the office.

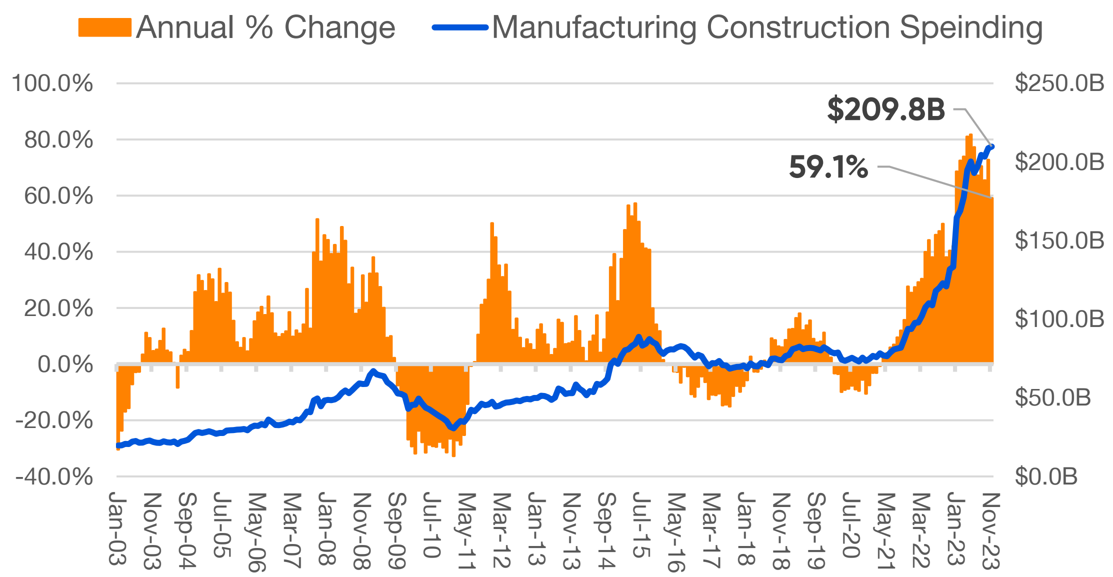
After sky-rocketing for the past three plus years, spending in the industrial sector has begun slowing from prior years. While still near record highs, spending will likely decelerate as investors/ developers wait to test demand as new products deliver.

Construction Spending: Office ($ Millions)



Source: U.S. Census Bureau, https://census.gov/construction
Note: Data thru November 2023

Construction Spending: Manufacturing



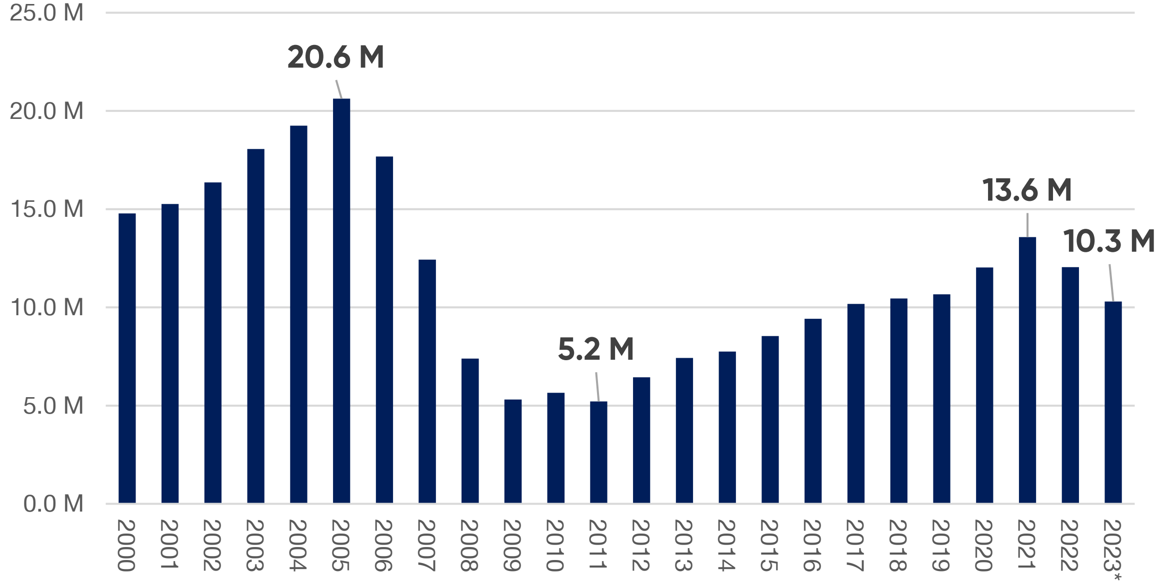
Source: U.S. Census Bureau, https://census.gov/construction
Note: Data thru November 2023

Housing

Housing Starts Contract, as Rising Interest Rates Slow the Market

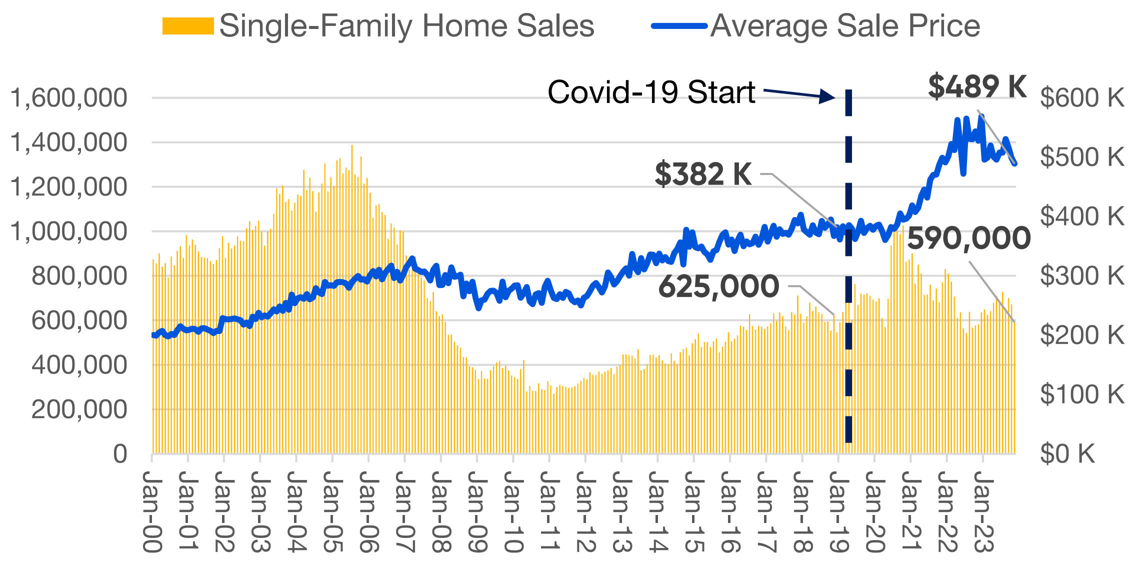
The number of residential housing starts soared at the start of the pandemic, while sale prices reached record highs in both 2020 and 2021. This growth is being tempered as mortgage rates increase, labor costs rise, and supplies remain scarce. The second half of 2023 is on track to match home starts closer to pre-pandemic levels. Meanwhile, prices have begun to fall as demand softens. After passing an average sale price of over $569,000 to end 2022, prices have fallen 14.1 percent through November.

Residential Housing Starts



Source: U.S. Census Bureau, https://census.gov/construction
*Note: Data thru November 2023

Single-Family Homes: No. of Sales (Thousands) vs. Price



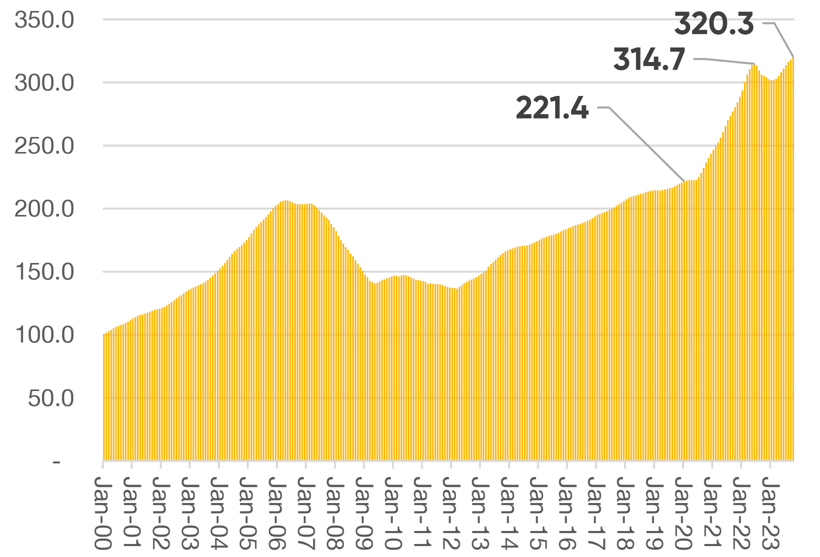
Source: U.S. Census Bureau, https://census.gov/construction
Note: Data thru November 2023

Home Price Index

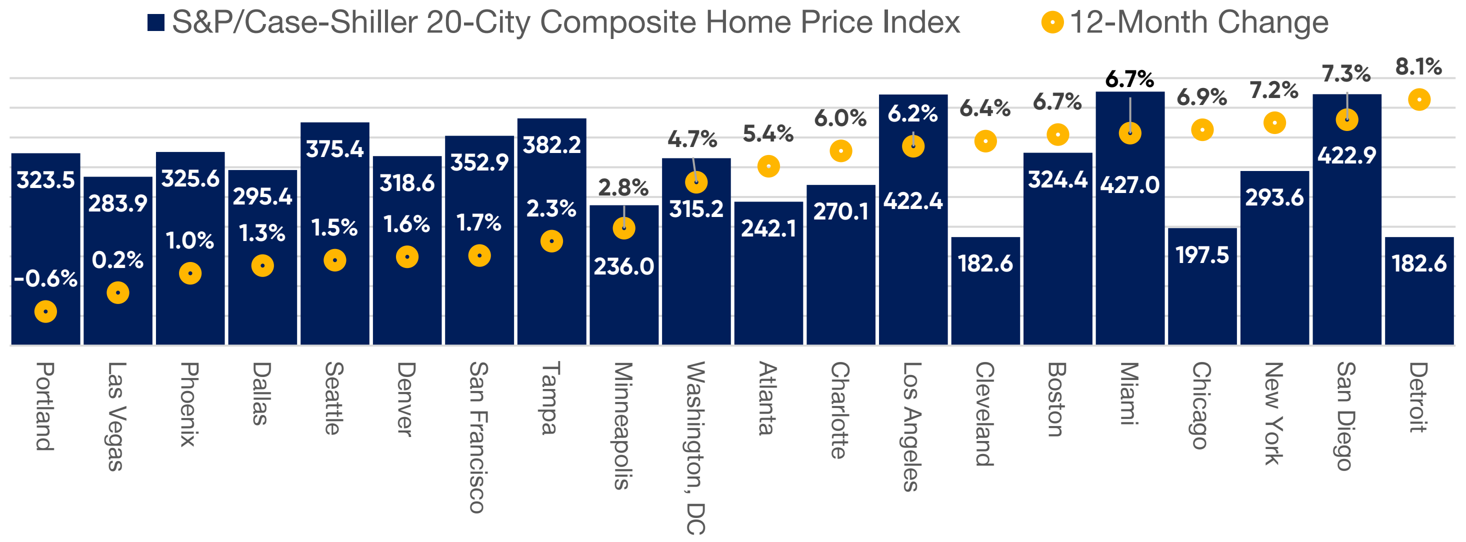
Case-Schiller Home Price Index Reclaims Recent Drops to Reach Record High

The Case-Schiller Index is an economic indicator that measures the monthly change in the value of the U.S. single-family home market. The 20-City Home Price Index peaked in June 2022 and dropped for 8-straight months, before ticking higher for the past five months closing October at a record high. Miami holds the highest Home Price Index, followed closely by Los Angeles and San Diego. Portland and Las Vegas have dropped the most in the past 12-months, while Detroit jumped the highest.

Home Price Index: 20-City Average



S&P/Case-Schiller Home Price Index: November 2023



Source: S&P Dow Jones Indices LLC, S&P/Case-Shiller U.S. National Home Price Index [CSUSHPINSA], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/CSUSHPINSA, November 2023.

Occupiers Search for Stability

Q4, 2023

Office Trends

Occupiers refocused on the efficient use of office space resulting in an additional reduction in footprints and higher vacancy in 2023. Additionally, this reduction in footprints occurred as employers continued to add jobs. With more than two years since the expected return-to-office mandates, occupancy levels have hardly budged. As new hiring slows, many organizations are focusing on maximizing utilization of space with a hybrid work force, using lease expirations as a trigger to reset space needs, manifesting in smaller lease sizes and concentrating on highly amenitized premium spaces. There are some bright spots, as negative absorption continues to grow, the amount of sublease space on the market contracted during the fourth quarter. The lack of new construction and office conversions will likely help curb over-supply issues in the long-term.

Office Tenant View

- The bad news for landlords/owners has provided a generational opportunity for occupiers as they seek to renegotiate and push for more flexible terms.
- Tenants are provided more options in sublease space that may have been out of reach as they seek to provide the space and location to entice workers back to the office.
- The time to secure a lease is being extended as negotiations now may involve not just the owner, but also debt holders.

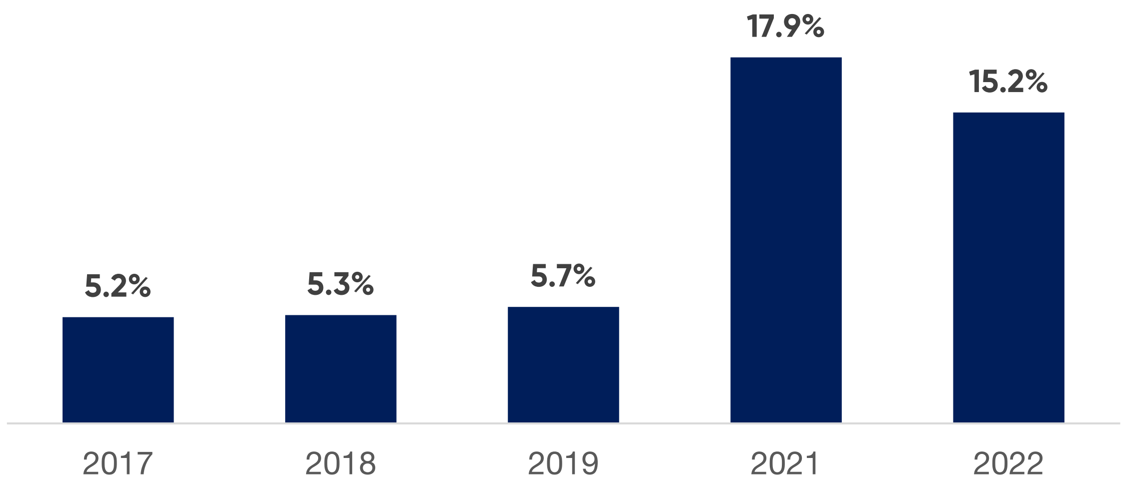
Remote Work

Percentage of People Working at Home Declined Between 2021 and 2022

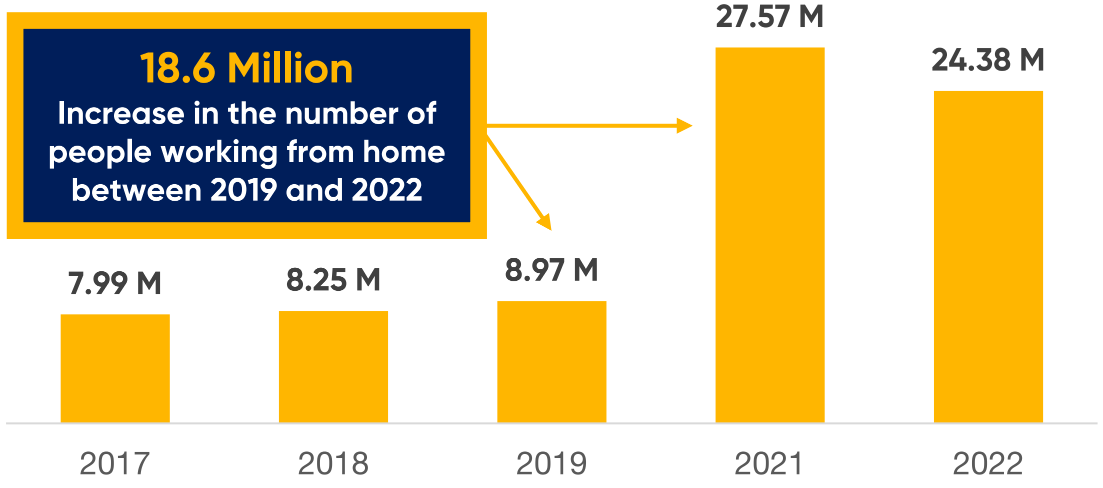
The percentage of people working at home before the pandemic remained steady at under six percent of the working population over the age of 16. The number jumped to 17.9 percent in 2021, an increase of over 200 percent.

The number of people in the workforce over age 16 working-at-home more than tripled between 2019 and 2021. The number fell moderately in 2022 from the previous year but is still well-above pre-pandemic levels.

Percentage of People Working-at-Home: US



Estimated Number of People Working-at-Home: US



Source: U.S. Census Bureau. (2022). *2022 American Community Survey 1-year* Retrieved from*:* https://data.census.gov/table/ACSDP1Y2022.DP03 (October 2023): Note data from 2020 was not released. The percentage of people working from is calculated by dividing the estimated people working-at-home by the number of workers over the age of 16.

Note: The number of people working at home increased from pre-pandemic levels despite 3.29 million office-occupying jobs added between the end of 2020 through the end of 2022.

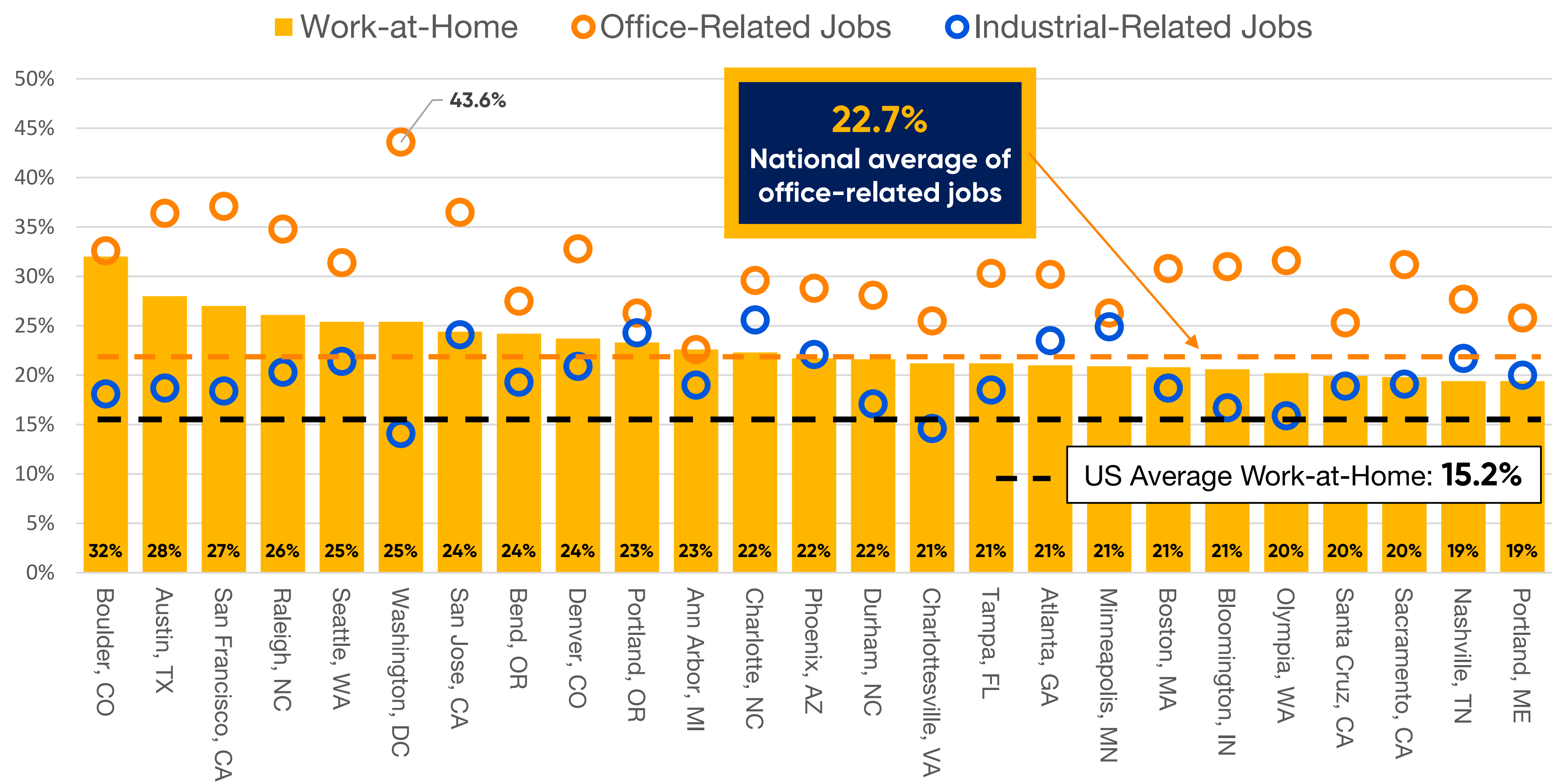
Remote Work

Markets with High Percentage of Office-Related Jobs Lead Remote Work

Markets with a high percentage of office-related jobs also have the highest percentage of workers that work at home. The national average of office related jobs is 22.7 percent, while the top 20 metros average 30.6 percent.

Note: Office related jobs are identified by the *US Census Bureau* as: Information, Finance, Professional & Business Services, and Government sectors

Top 20 US Metros with Highest Percentage of People Working-At-Home



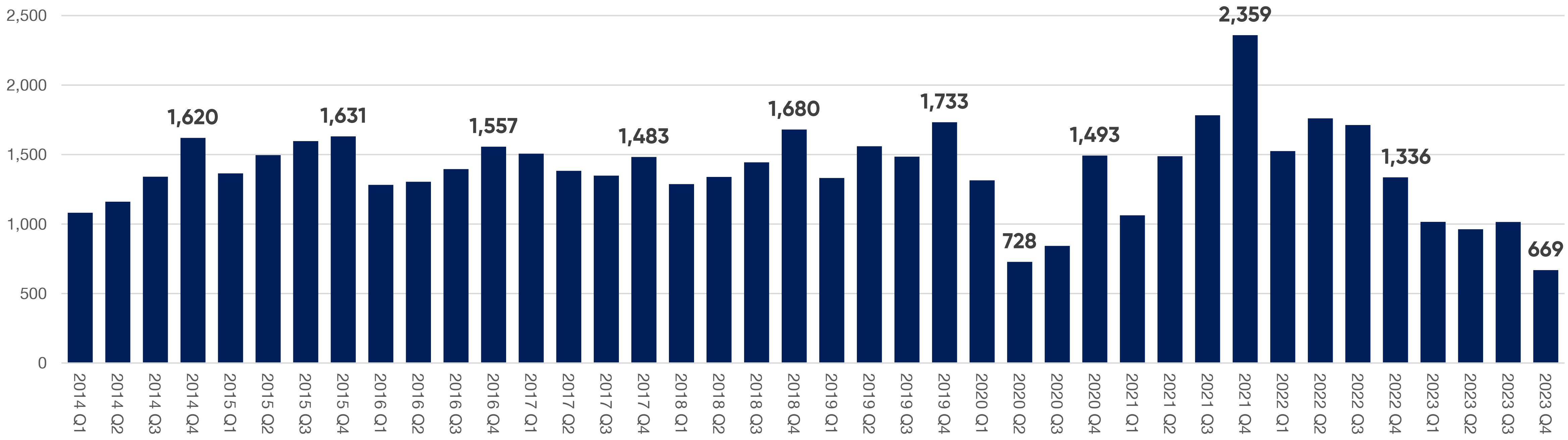
Source: U.S. Census Bureau. (2022). *2022 American Community Survey 1-year*
Retrieved from: https://data.census.gov/table/ACSDP1Y2022.DP03 (October 2023): Note data from 2020 was not released. The percentage of people working from is calculated by dividing the estimated people working-at-home by the number of workers over the age of 16.

Capital Markets

Sales Velocity Falls to Near Lows of Great Recession Era

While sales velocity has rapidly dropped in the past several years, it is still on track to match levels from 2008 to 2011. The sales velocity (or number of sales per quarter) has dropped for six of the last seven quarters.

Office Sales Velocity: (United States)

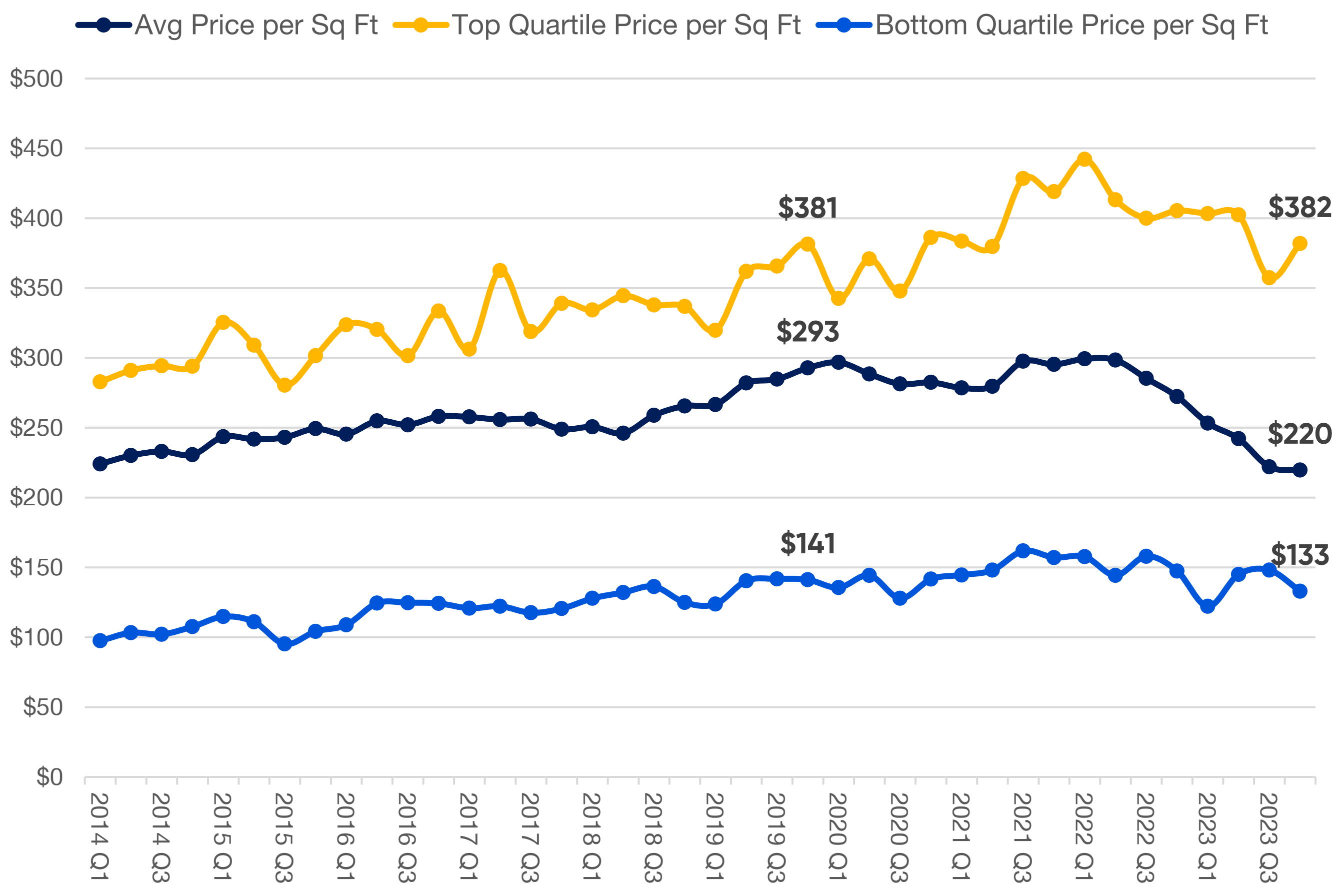


Source: Real Capital Analytics and Cresa; thru Q4 2023

Capital Markets

Sale Prices Per Square Foot Drop Sharply Through the End of the Year

Average Office Sale Price/SF (United States)



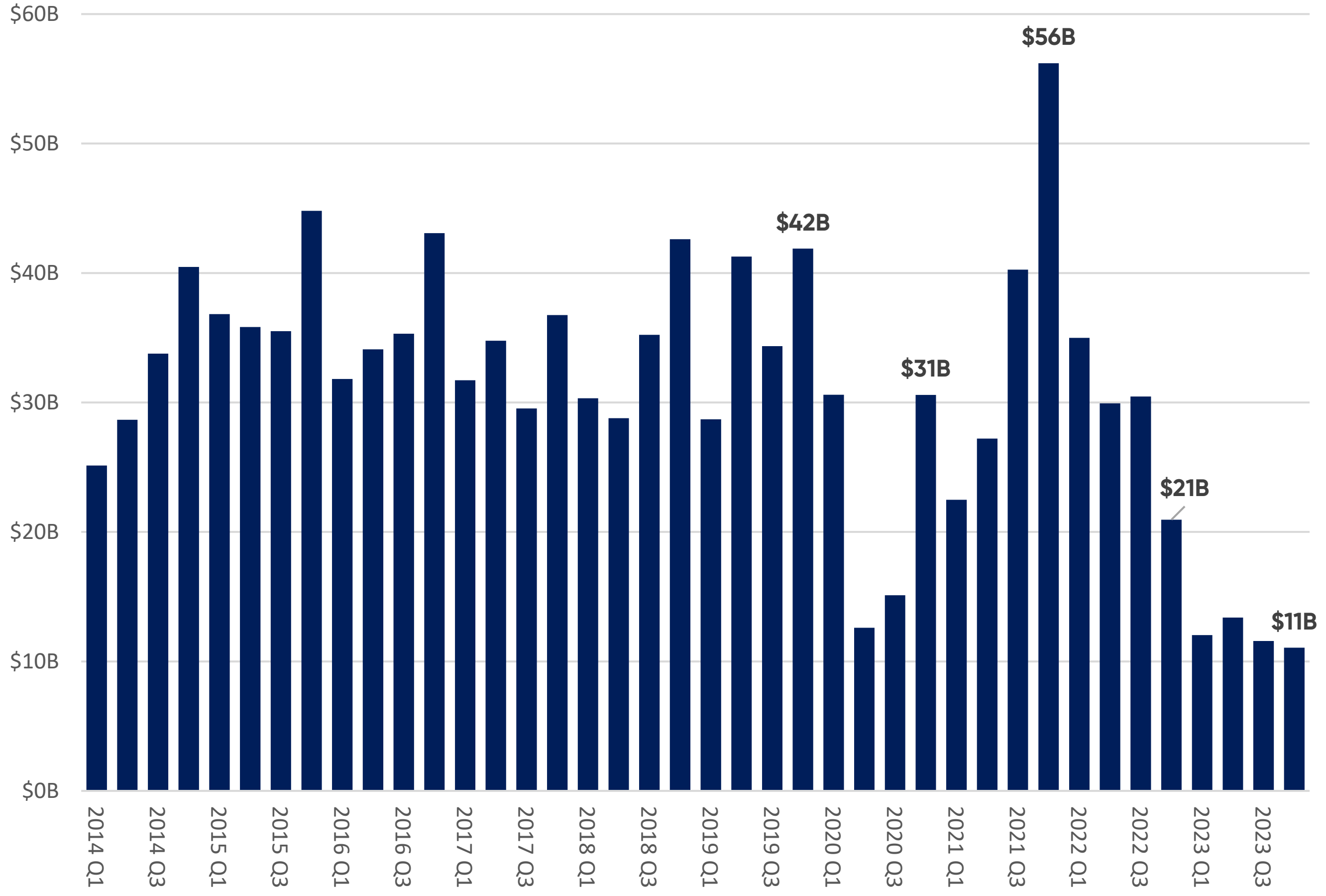
Source: Real Capital Analytics and Cresa; thru Q4 2023

Sales of office properties in the top quartile have remained flat since the end of the pandemic and the close of 2023. Meanwhile, the overall average sale price per square foot of office properties has dropped nearly 25 percent during the same period. The takeaway is that **high-end properties with amenities, high-quality finishes, and good locations have generally held their value**.

Capital Markets

Low Demand and High Interest Rates Stall Office Sales

Office Sales Volume: (United States)



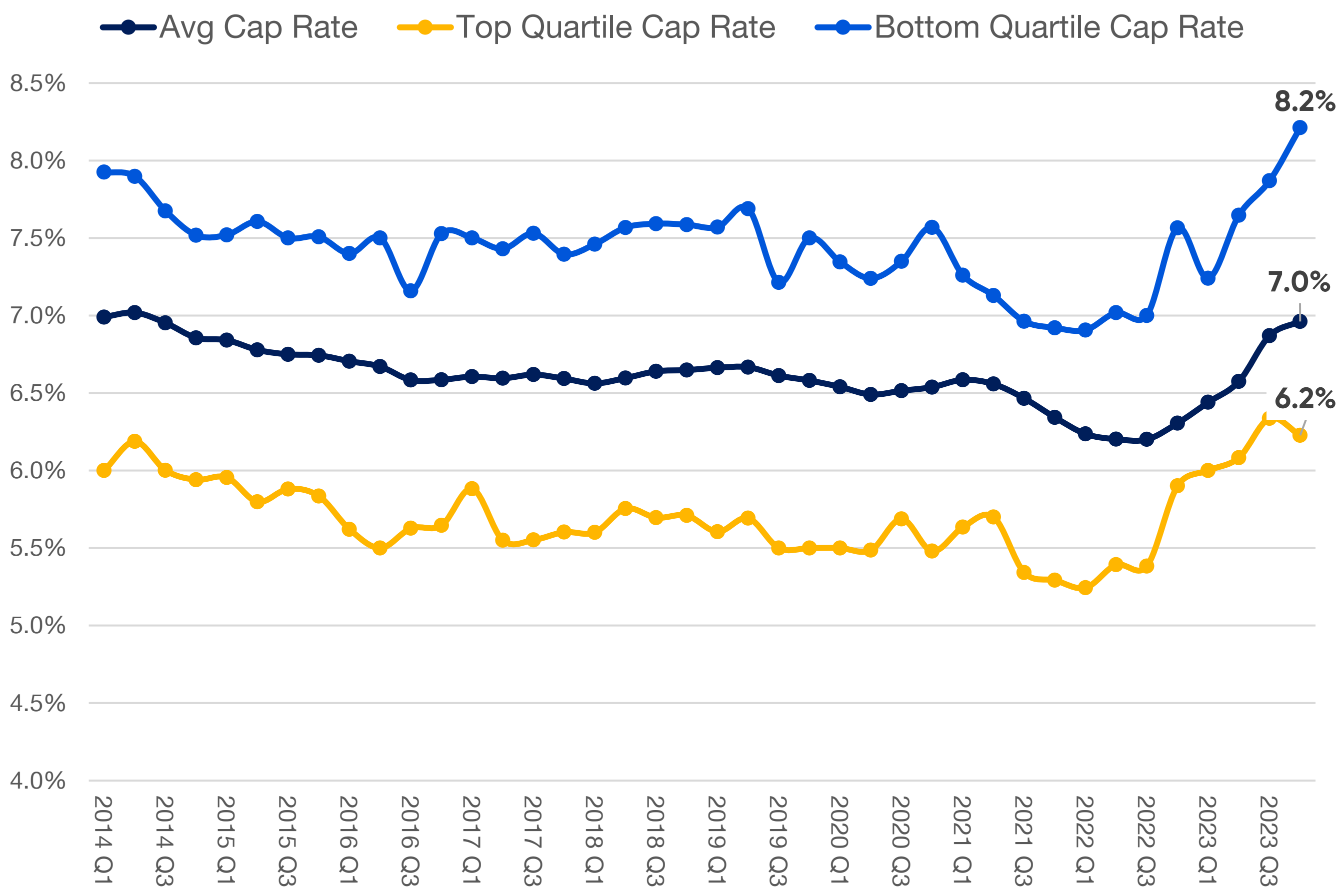
Source: Real Capital Analytics and Cresa; thru Q4 2023

Office sales volume closed 2023 at approximately $48 billion dollars, similar to the $49 billion volume that occurred in 2010. Sales volume has dropped for the past three years. While there is plenty of money in the form of dry powder on the sidelines, investors are waiting for valuations to stabilize and to better understand interest rate trends before getting back into the market. Sales volume during the fourth quarter of 2023 was similar to the volume during the second quarter of 2020, during the depths of the start of the pandemic.

Capital Markets

Cap Rates Drift Higher as Risk Increases and Demand Wanes

Class A Office Sale Price/SF & Average Cap Rates (United States)



Source: Real Capital Analytics and Cresa; thru Q4 2023

As sales volume has dropped, cap rates have reacted accordingly, increasing for six straight quarters. The seven percent average cap rate for office properties is on level with rates from 10 years earlier. Although prices paid per square foot for top quartile office assets have held steady, cap rates are hovering above six percent, pricing in the additional risk of the office sector.

Leasing Trends

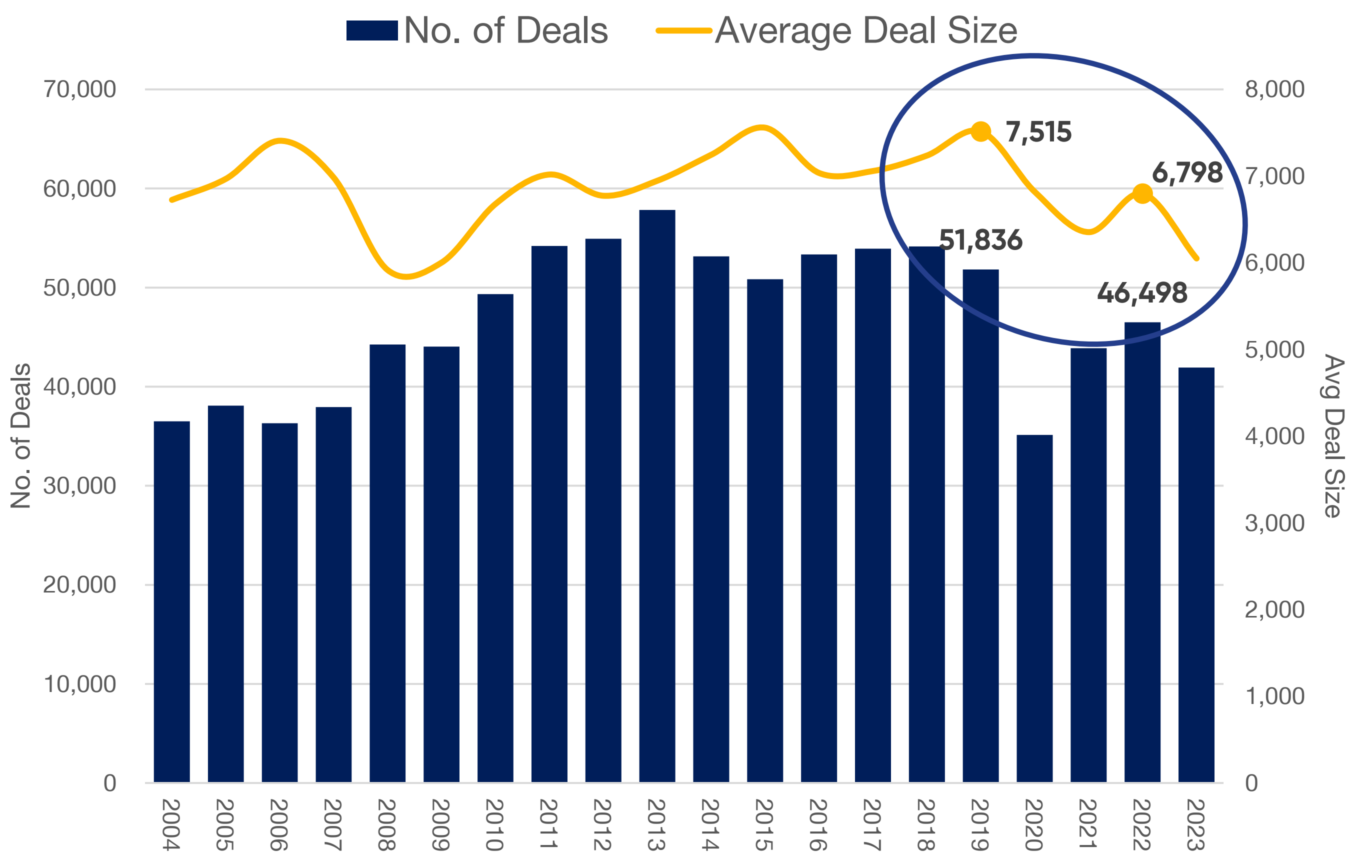
Transaction Size is Smaller Than 2019

Lease deal sizes in 2022 were **9.5 percent** smaller compared to 2019.

While lease deals in the 2023 are smaller compared to 2022, lease deals have historically taken time to be recorded in CoStar.

The number of deals between 2022 and 2019 have decreased by **10.3 percent.**

Historic Office Activity – Average Deal Size



Source: CoStar, Cresa

Market Rent

Office Rents Flat as Landlords Offset Demand With Concession Packages

Class A/B Office Asking Lease Rate ($/SF): (United States)

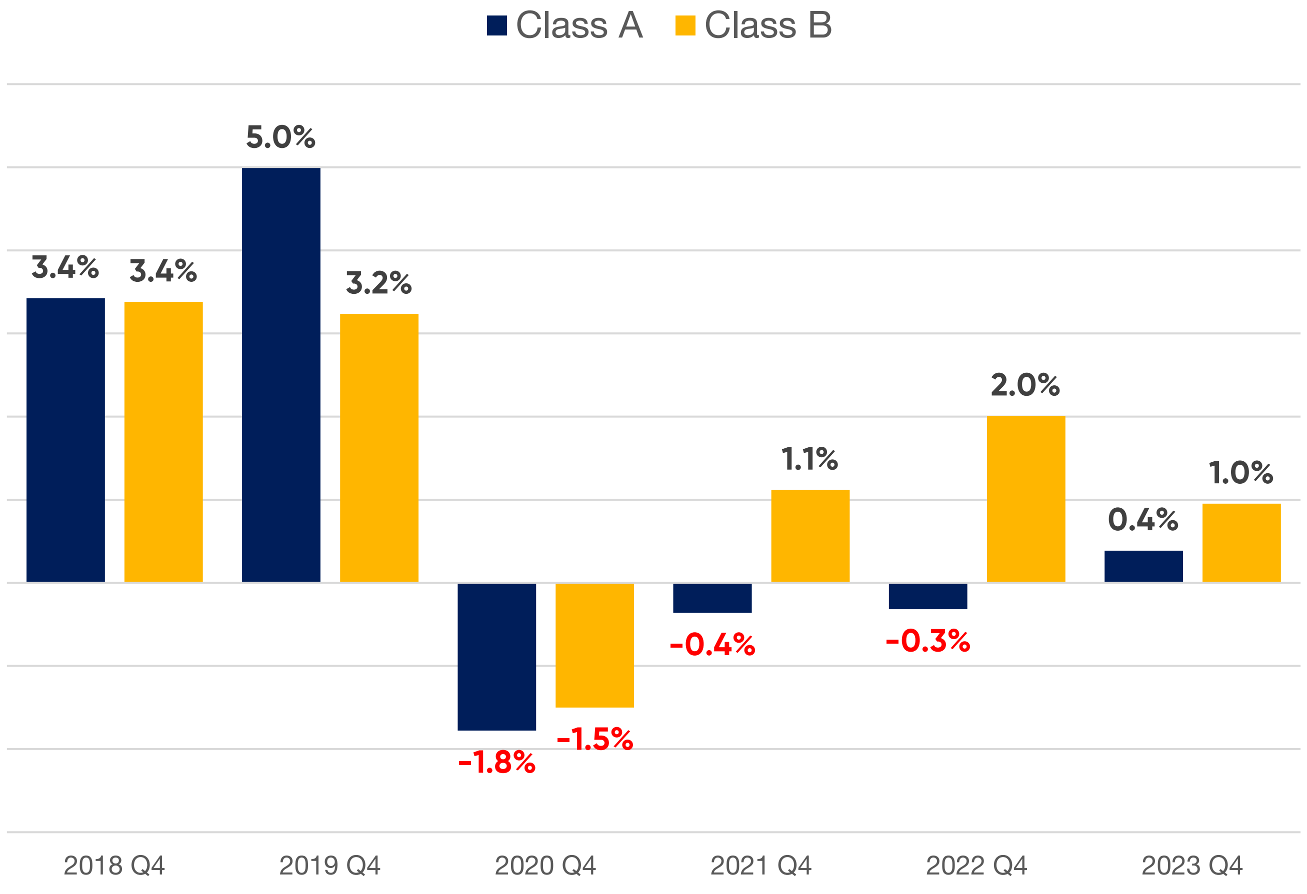
Source: CoStar and Cresa; thru Q4 2023;

Lease rates have remained static for the past three years within both class A and class B spaces. As demand has weakened, landlords have held steady with asking rates, although this notion is reportedly softening. Increasing concessions, free rent, and TI's are being used to attract occupants, lowering the nominal rent. However, increasing operating costs due to rising inflation and interest rates are eroding some of these gains for tenants. Nevertheless, the office market is tenant-favorable, providing generational leverage for occupiers.

Market Rent

Class A Direct Asking Rent Growth Flat Since the End of 2019

Class A/B Office Asking Rent Annual Increase: (United States)



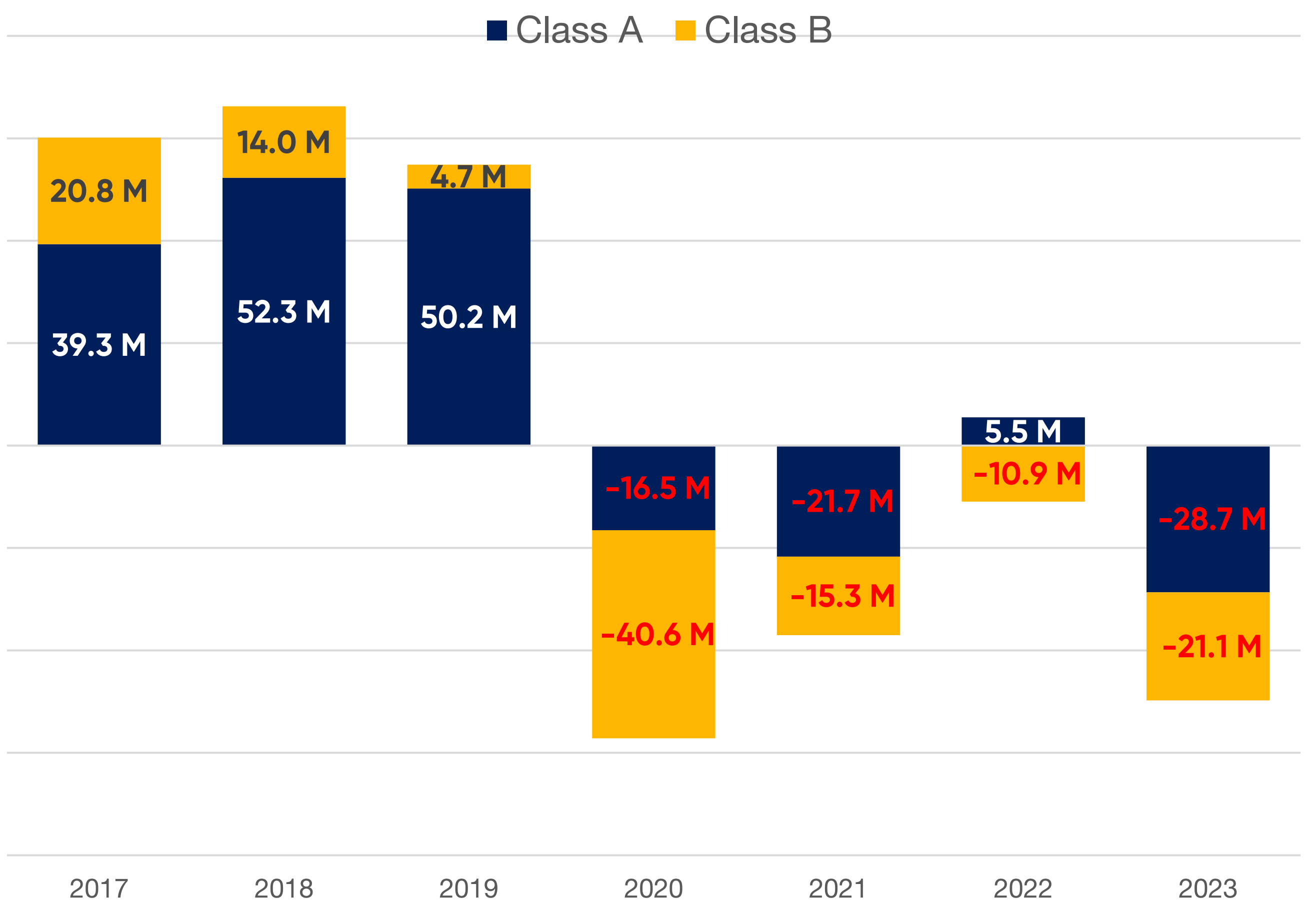
Source: CoStar and Cresa; thru Q3 2023

During pre-pandemic years, office rates historically increased 2.5 to four percent annually. After an initial drop in 2020, class A rents have increased moderately as landlords look to hold rates as long as possible, providing incentives and TI's to attract tenants. As demand continues to drag, rates will correct until market stability is reached. Meanwhile, class B rates have not seen a meaningful increase in average asking rates since 2019.

Absorption

Office Absorption Records Another Quarter in the Red

Office Net Absorption (SF): (United States)



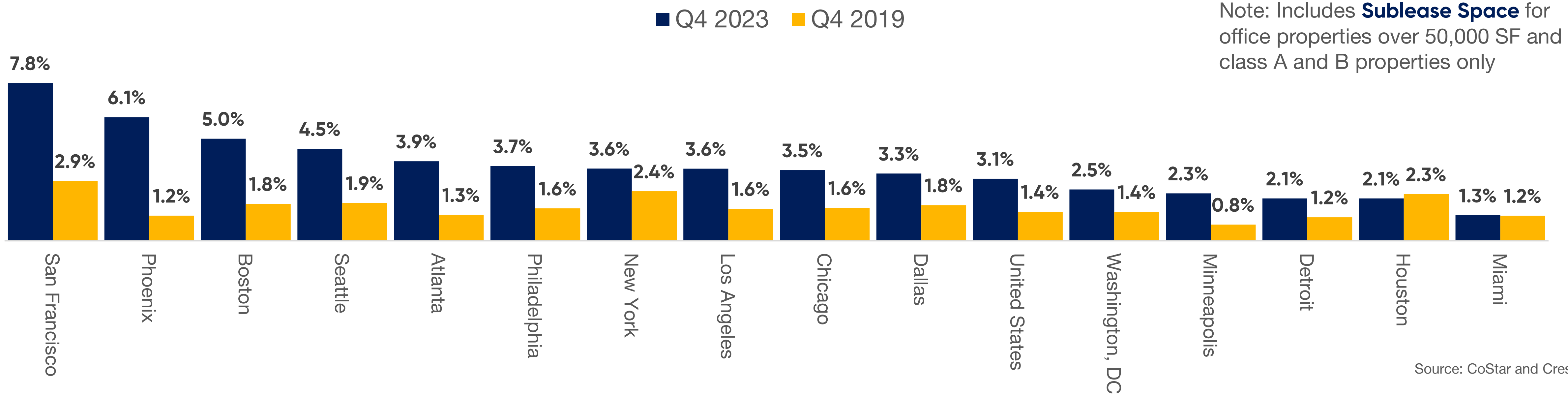
Source: CoStar and Cresa; thru Q4 2023;

Work-from-home policies have caused many companies to reevaluate their existing office footprint. As organizations right-size, office absorption has been overwhelmingly negative. Class B space has been particularly hard hit since the start of the pandemic. **There has been -150 million square feet of negative absorption recorded since the start of 2020**.

Sublease Space

Largest US Metros: Before & After announcement of Covid 19

Office: Sublease Space as a Percentage of Total Inventory



Note: Includes **Sublease Space** for office properties over 50,000 SF and class A and B properties only

Source: CoStar and Cresa

106%

Increase in sublease square feet on market in largest Metros

134.8 M

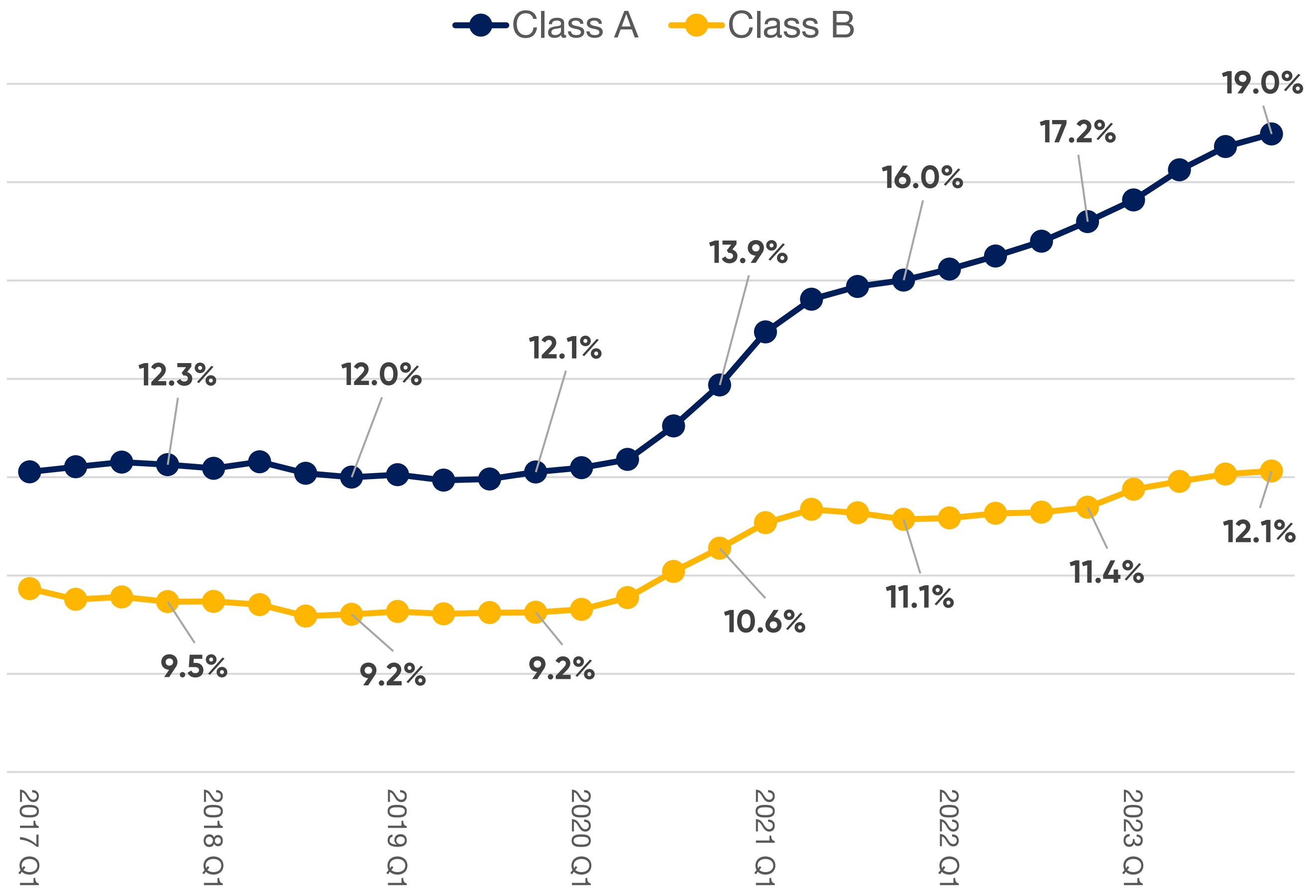
Square feet of sublease space available in largest Metros in December 2023, compared to 65.5 M in 2019

Sublease space has increased dramatically since the Covid-19 pandemic was announced during the first quarter of 2020. Cities that rely heavily on tech have been hit especially hard, such as San Francisco and Seattle, due to their ability to work remotely and job layoffs. Cities with more industry diversification have generally fared better, but **nine out of 15 of the largest Metros have seen the total amount of sublease space on the market more than double since the start of 2020**.

Direct Vacancy

Office Vacancy Spikes as Companies Right-Size

Office Direct Vacancy Rate: (United States)



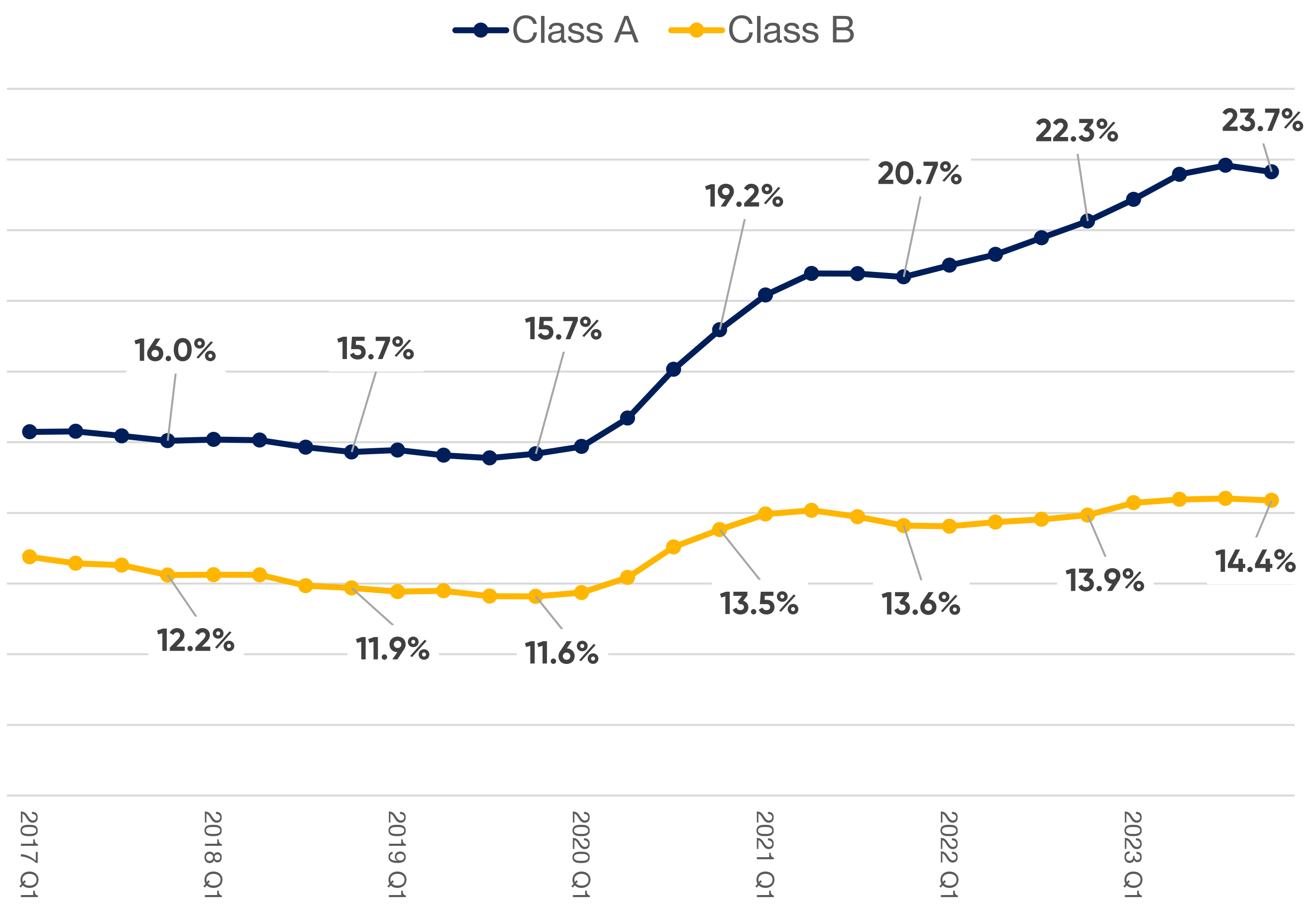
Source: CoStar and Cresa; thru Q4 2023

Class A direct vacancy has increased at a faster pace compared to class B space. Direct vacancy is expected to continue to rise as pre-pandemic signed leases begin to roll, adding to the 18 straight quarters vacancy has increased. Additionally, newly signed leases on average are shrinking which may buoy vacancy even as space is being removed from the market. Class B vacancy may be positively impacted long-term by office conversions to other uses.

Availability

Availability Climbs in Class A Office Space

Office Availability Rate: (United States)



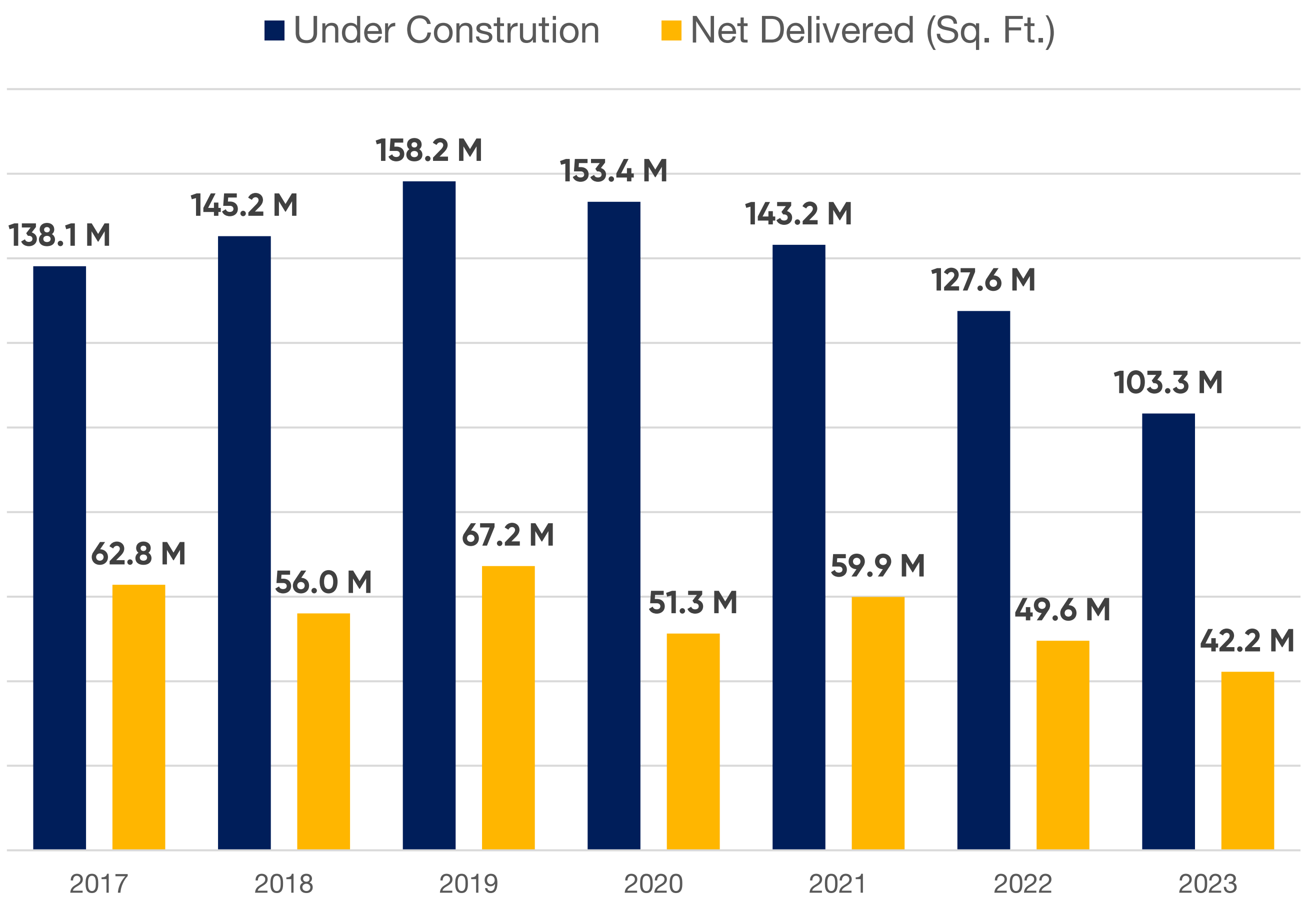
The availability rate includes the amount of space that is being marketed as available for lease, regardless of whether the space is vacant, occupied, available for sublease or available at a future date. Therefore, the **availability rate may be a more accurate depiction of the market during this volatile period than the direct vacancy rate**. Class A availability ticked lower to 23.7 percent to the end the fourth quarter, indicating that demand remains soft as the office market resets, but the bottom may be near.

Source: CoStar and Cresa; thru Q4 2023

Construction

Office Construction Tapers as Demand Wanes

Office Space Under Construction (SF): (United States)



Source: CoStar and Cresa; thru Q4 2023

As pre-pandemic office projects deliver, the amount of under-construction space is dropping. Weak demand, increasing construction costs and higher interest rates will likely stall many office projects. However, there is still 103 million square feet under construction. While this is not an insignificant number, it still represents less than two percent of the total office inventory, which is near or below historical averages. **During the fourth quarter, only 25 new office starts got underway, the lowest number in the past quarter century.**

The problem with the real estate market is the market itself.

The market Sees you as a **target.**

The market chases the **deal.**

The market is short term and **reactive.**

The system favors **landlords** not occupiers.

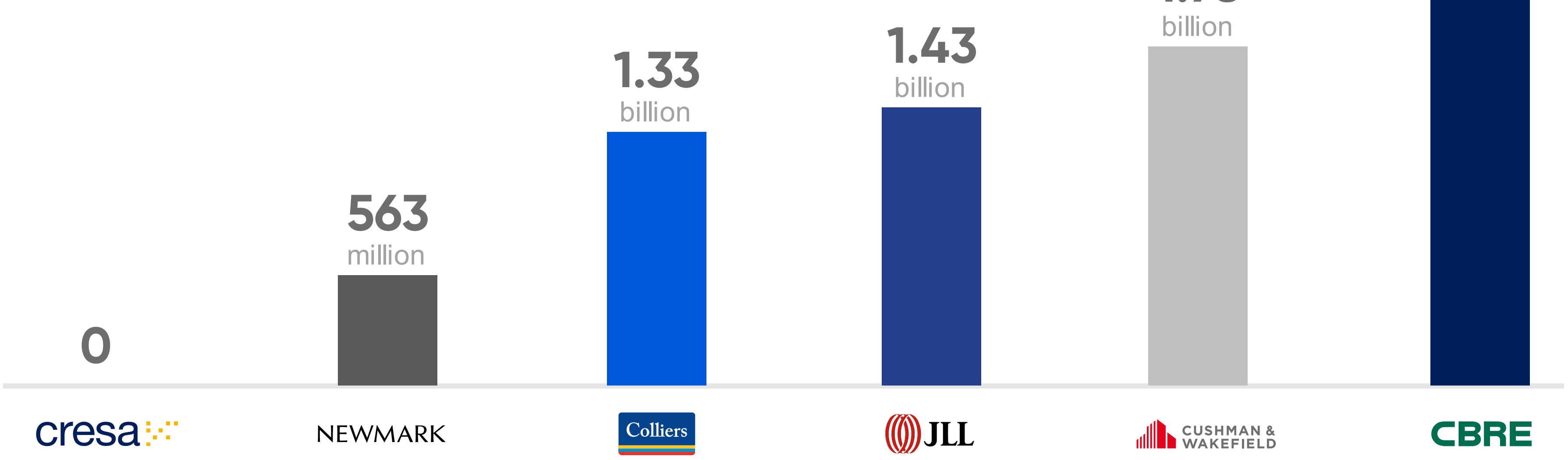
The stakes are high for occupiers. Real estate is expensive and inflexible. With the pandemic, labor dynamics, and economic instability, all bets are off.

It's time to go beyond the market and uncover how your commercial real estate can drive your goals, not impede them.

How We're Different

As the world's largest corporate real estate provider committed exclusively to serving occupiers, we're in a league of our own. We offer creative solutions, unbiased advisory services and executive leadership on every account. We believe this combination of transparency and executive involvement generates the superior service our clients have come to expect from Cresa.

Billions of square feet are represented on the landlord's behalf nationally. Cresa never does business on behalf of landlords.



An Unbiased Advocate

We're unbiased, uninfluenced by landlords. Everything we do is from an occupier perspective – and to their advantage.

Our Structure

As a privately-owned firm, we can adjust quickly, easily scaling project teams or service offerings to suit client needs.

Our Integrated Platform

Our services, each led by specialists in their field, are interconnected to enrich our clients' businesses and ensure seamless delivery.

Our People

Led by seasoned principals with years of experience, we hire selectively and empower our employees to think innovatively.

Transparency

Transparency is what allows us to foster lasting, meaningful relationships with each other and with our clients.

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Visit cresa.com for more information.

Cresa is the world's only global commercial real estate advisory firm that exclusively represents occupiers and specializes in the delivery of fully integrated real estate solutions. Our purpose is to think beyond space, strengthening those we serve and enhancing the quality of life for our clients. Delivered across every industry, Cresa's services include Transaction Management, Workplace Solutions, Project Management, Consulting, Lease Administration, Technology, Investment Banking & Capital Markets and Portfolio Solutions. In partnership with London-based Knight Frank, Cresa provides service through 16,000 people, across 380 offices in 51 territories.

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