# U.S. OFFICE SECTOR
# FAQs: HAS THE TIDE TURNED YET?

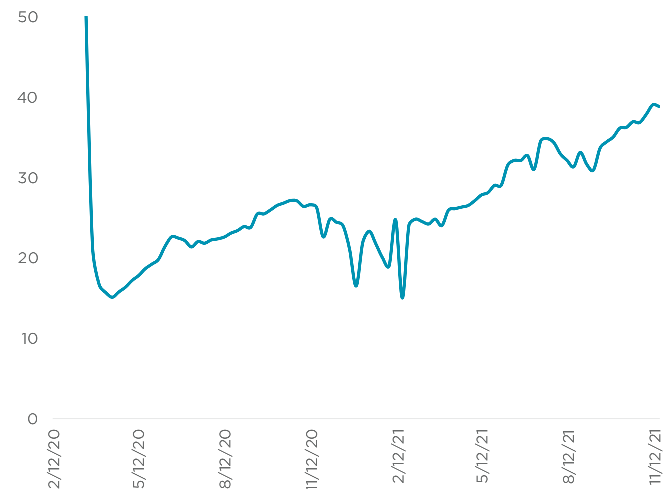
CUSHMAN & WAKEFIELD

December 2021

**Q: In December 2021, are we actually any closer to seeing employees return to the office on a regular basis?**

**A: Yes, the data is trending up, generally**. The Delta variant put a wrench in the plans of many U.S. companies to return to the office en masse right after Labor Day. After peaking at 35% of pre-pandemic usage in July 2021,[1] U.S. in-office attendance declined through August, due both to the Delta variant's impact as well as the increase in vacation time in parts of the country as the summer came to a close. Since Labor Day, however, in-office attendance has been increasing each week. Every week in October, and to date through November, has represented a new post-pandemic high for the proportion of workers frequenting the office. As vaccination numbers increase—and as vaccinated populations get booster shots—the U.S. and many countries around the globe are steadily moving towards herd resiliency, which health experts characterize as 70%+ of the population having immunity and/or being vaccinated. This milestone, mixed with the decline in case numbers and hospitalizations, is giving organizations more clarity around returning to the office over the next few quarters. February 2022 is expected to be an inflection point in the U.S.[2] The situation remains fluid as we enter the holiday travel season. That said, it is generally assumed that if there are future waves of the virus, they will be less disruptive than prior ones.

**In-Office Employee Attendance**




Source: Kastle Access Control System

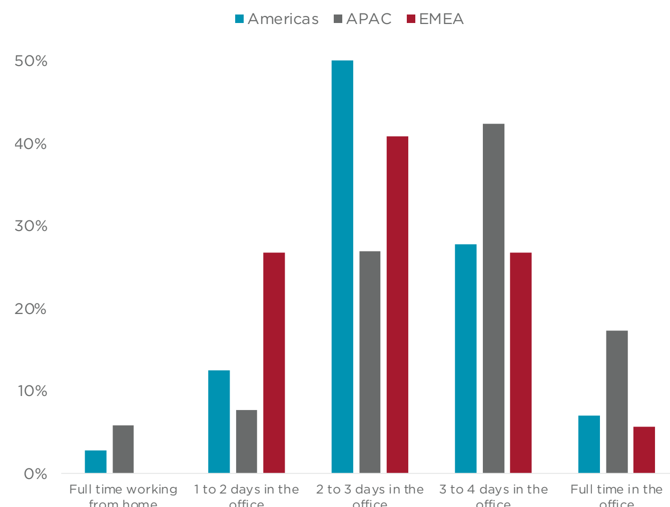
**Q: Will employees ever return to the office five days a week?**

**A: Some but clearly not all.** Prominent among the things we don't know is just how persistent current employee and employer perspectives on flexibility will prove to be. That said, workforce agility is on the rise, which suggests the following:

- The future office will look different for many employees
- Employees will work in the office on a different cadence
- The office will have different purposes than it did prior to the pandemic

In a recent survey partnership between Cushman & Wakefield and CoreNet Global, nearly three-fourths of large global occupiers indicated they expect employees to be in the office between two and four days in an average week.[3] This is likely the norm for a plurality of office workers, with smaller subsets of employees either working remotely most days or in the office full time. Cushman & Wakefield's Experience per Square Foot™ (XSF) data clearly illustrates that for most employees frequenting the office three-plus days a week optimizes employee experience, productivity and engagement. In all of this discussion, most organizations plan to give more employees some level of autonomy and choice to determine when and where they work.

**Expected In-Office Requirements for Optimal Work Efficiency**




Source: CoreNet Global; Cushman & Wakefield Research

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**Q: In the spring, Cushman & Wakefield reported that tour activity was on the rise—is that positive trend continuing?**

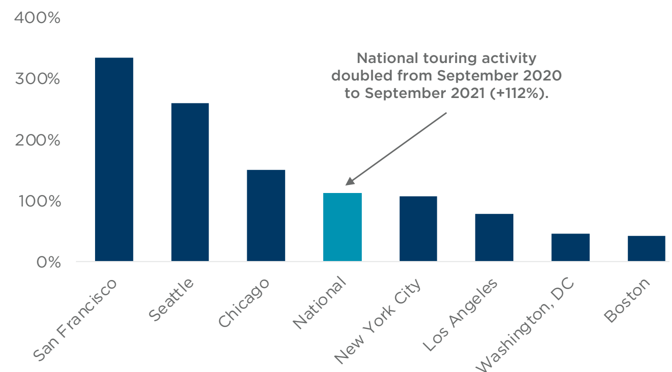
**A: Yes, though not as prominently.** After significantly reduced office touring volume in 2020, activity did surge in the spring of 2021, nearly tripling during the first quarter.[4] The activity trend continued upwards—although more mutedly—through August before dipping back in September. This late summer decline is in line with historical seasonal trends. For example, in 2018 and 2019, touring peaked in the spring and activity was below average in both August and September.

Even with the recent decline, four of the largest markets tracked by VTS[5] are within 20% of the two-year pre-pandemic average (2018-2019):

- Seattle (90)
- Chicago (85)
- Los Angeles (82)
- New York City (81)

National office touring remains on a road to recovery as activity in the fall of 2021 is more than twice as high as at the same time in 2020. Office tour activity is typically a leading indicator for accelerated leasing activity. In the wake of stronger 2021 tour activity, total leasing in Q2 and Q3 2021 have been 50% higher than during the last three quarters of 2020, improving from an average of 41 msf per quarter to 60 msf per quarter. All this activity bodes well for lease executions, and eventually net absorption, over the next several quarters.

**September Office Tour Activity, YoY Change**




Source: VTS Office Demand Index (VODI), October 2021 Report

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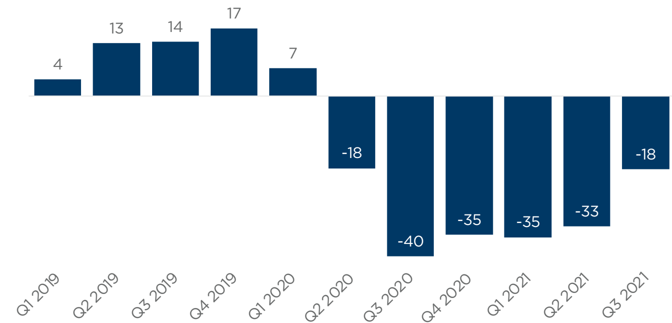
**Q. After a sixth straight quarter of negative absorption, is the office market showing any signs of life?**

**A: Yes, the market is improving.** While it's true that net absorption was negative again in Q3 2021, the -18.3 million square feet (msf) of absorption in Q3 was a nearly 50% improvement on the previous four quarters that averaged -35.7 msf of absorption per quarter. At the market level, there are ground swells of activity as 25 different markets had positive absorption in Q3 2021. These gains were led by the following markets: Atlanta, Puget Sound – Eastside (Seattle), Suburban Maryland and San Diego.

Additionally, net absorption improved quarter-over-quarter (QoQ) across 60 of the 90 markets tracked by Cushman & Wakefield, including significant improvements in gateway markets: San Francisco (+1.8 msf), Midtown Manhattan (+1.8 msf), Los Angeles (+1.3 msf) and Boston (+1.0 msf).

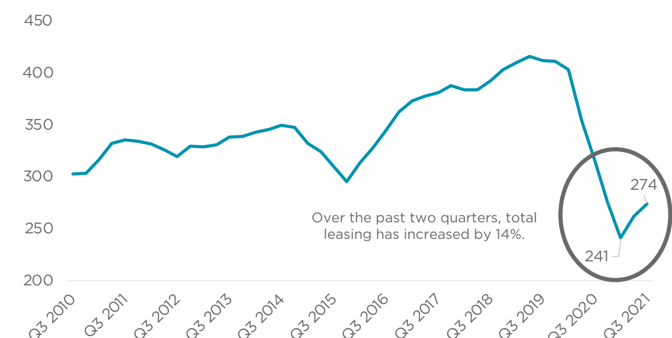
Leasing activity (or gross absorption) has also been improving the past two quarters. After hitting a nadir of 241 msf in Q1 2021, four-quarter rolling total U.S. leasing activity has increased by 14% over the past two quarters.

**Overall U.S. Net Absorption, MSF**




Source: Cushman & Wakefield Research

**Total U.S. , Rolling 4 Quarters, MSF**




Source: Cushman & Wakefield Research

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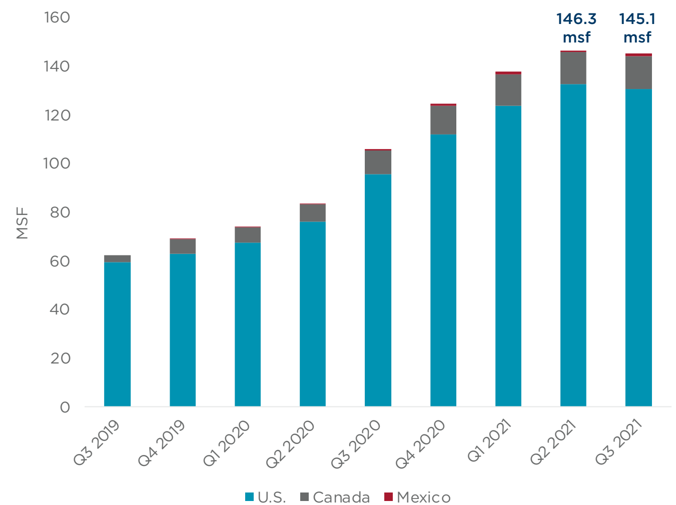
**Q: Is sublease space continuing to be a driving factor in negative absorption and higher levels of vacancy?**

**A: Sublease availabilities remain elevated, but the market appears to be reaching an inflection point.** As of Q3 2021, there was 130 msf of vacant sublease space, which equates to 13.4% of total vacant space in the U.S. For perspective, sublease space was just under 60 msf in mid-2019, representing 9% of total vacancy. The good news is that sublease space in the U.S. appears to have peaked. After seven quarters of increasing inventory, total sublease availabilities declined by 2.0 msf in Q3 2021, which represents a 1.5% decline from the Q2 peak level (132 msf). This timing would match a similar path to the previous two recessions when sublease space increased for approximately two years before hitting its highest point and then receding.

The improvement is widespread, with vacant sublease space falling QoQ in more than 50% of the 86 U.S. markets tracked. This includes 20 markets where sublease inventory dropped by more than 100,000 sf. Markets that experienced the largest QoQ decline include two gateway markets—Manhattan (1.3 msf) and San Francisco (1.0 msf)—followed by Oakland/East Bay (0.5 msf), Austin (0.5 msf), Charleston, SC (0.4 msf) and Boston (0.4 msf).

Most of the decline in sublease space in Q3 was the result of new occupiers taking sublease space. Acquiring sublease space is attractive for many occupiers given current pricing—across major markets, sublease space discounts off direct rents range anywhere from 10% to 50%. (Note: this does not account for increased direct lease concessions currently available.) Additionally, given the uncertainty around the future of the agile workplace and hybrid work models, many office occupiers are viewing the shorter lease terms often required with a sublease as a benefit when historically they may have considered the shorter terms as a downside.

**Sublease Space Falls for First Time Since Onset of Pandemic**




Source: Cushman & Wakefield Research

**Q: Last year, Cushman & Wakefield Research reported that an unusually high percentage of businesses were signing short-term renewals as a bridge to a better day. Is that continuing into 2021?**

**A: Lease lengths are returning to a normal range.** Historically, less than 10% of all U.S. leases signed are for less than one year. Last year, that topped 17% in Q3. However, the number has been ticking down each quarter, and only 8.6% of all leases signed in Q3 2021 were for less than one year. The average length of new leases and renewals signed in Q3 2021 are nearly in line with the pre-pandemic historical average. The average Q3 renewal length is only 2.2 months shorter than the historical average (4.0% shorter) and the average Q3 new lease is less than a month shorter (1.2% shorter). While companies hesitated to make long-term commitments during the first year of the pandemic, office lease terms have been increasing as occupiers become more confident about future space needs. In fact, 38% of all space leased in Q3 and 43% of Class A space was part of leases for 10 years or longer, outpacing the historical averages (32% and 37%, respectively).

**Lease Lengths Returning to Pre-Pandemic Norms**

Source: Cushman & Wakefield Research

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**Q: How is hybrid work changing how companies are utilizing office space?**

**A: It remains to be seen.** Companies have been busy with a significant amount of scenario planning. However, because uncertainty remains around how offices will be used in the future, businesses have been reluctant to invest in office redesigns and space restructures. This period has served as an opportunity for companies to reassess how closely aligned their business, labor, workplace and portfolio strategies are.

It appears the return to office is imminent. To prepare, a growing number of companies are piloting different hybrid work models. Over time, these workplace tests will identify best practices and lead to new workplace norms that can scale across portfolios. In some cases, organizations may require the same footprint, though with a focus on an enhanced employee experience. In other situations, companies will find ways to reduce their office footprint. In either case, experience is going to be critical and will be driven by more emphasis on shared spaces, amenities, services, wellness, sustainability and technology. All of which points to the importance of de-commodifying office space, which is already playing out in the market as newer office product that focuses on experience is outperforming during the pandemic.

**Q: Are businesses moving from large expensive cities to small cities due to COVID-19?**

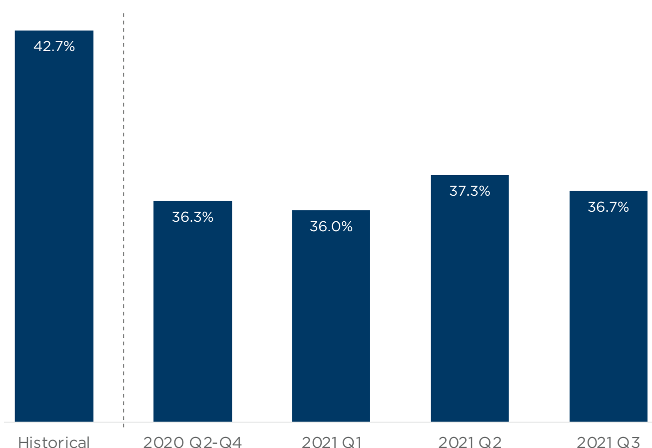
**A: Some, but not en masse.** Cushman & Wakefield Research tracks 90 office markets across the U.S., totaling 5.4 billion square feet of inventory. According to our data, 42.7% of nationwide lease square footage signed in the five years leading up to the pandemic (2015-2019) occurred in the six gateway cities: Boston, Chicago, Los Angeles, New York, San Francisco and Washington, DC. Since the onset of the pandemic, however, that proportion dropped to 36.5%. While that could suggest there has been some movement out of gateway markets, it is worth noting that those same cities were the ones hit hardest by the pandemic. So, perhaps the drop in leasing activity simply reflects the fact that it was more difficult to complete leases in areas where COVID-19 was the most severe. We also note that in Q3 2021, the share of square footage signed in Q2 and Q3 2021 has been stronger. And the recent rebound is even stronger among Class A product, where nearly 41% of square footage leased in the past two quarters has been in gateway markets.

Net absorption in the six U.S. gateway markets remained negative in Q3 but improved by 35% QoQ. Additionally, total gateway market leasing activity is up 41% in the first three quarters of 2021 when compared to the last three quarters of 2020. This improvement is twice as strong as the national leasing activity total, which over the same time period is up 19%.

However, that doesn't mean that some businesses aren't going to move. In analyzing housing data and population data, we do know that the pandemic caused people to move to lower cost markets at a rate that was larger than the pre-pandemic norm. (It is noteworthy that most movement involved households relocating to lower cost parts of the same city and not to another city.) Among businesses, there has been far less movement, which also makes sense. Leases are longer and relocating a business is a bigger decision, likely a trailing indicator.

Our view is that the migration trend is a bit overstated and that once the pandemic is over, there will be a strong return to the gateway cities for all the reasons businesses were there in the first place—clustering and innovation, deep labor pools, infrastructure, mass transit, amenities, airports, vibrant retail and restaurants, arts and entertainment options and so forth. This trend is already showing up in multifamily data, where occupancy is back to pre-pandemic levels in four of the six gateway markets.

**Percent of Total Leasing Occurring in Gateway Markets**




Source: Cushman & Wakefield Research

Gateway = Metro areas in and around Boston, Chicago, Los Angeles, New York, San Francisco and Washington, DC.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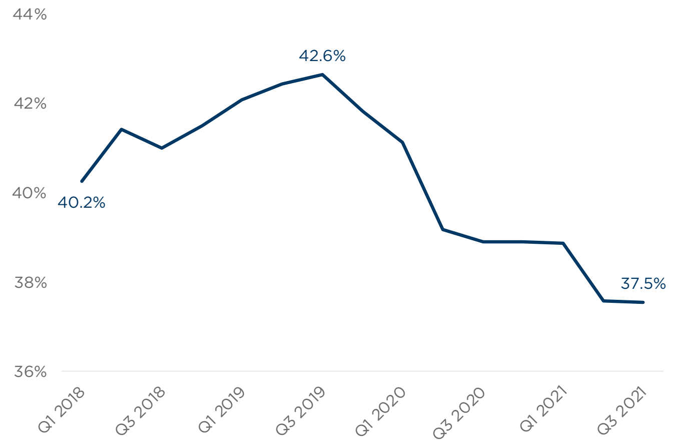
**Q: Are businesses leaving CBDs?**

**A: Perhaps some, but it does not appear to be significant.** According to our data, CBD submarkets accounted for 41.7% of Class A office leasing in the three years prior to the pandemic. Since Q2 2020, only 37.4% of Class A leasing activity has been in the CBD, so that does suggest that perhaps there has been some movement out of CBDs. However, similar to our notes on gateway markets, CBDs were more deeply impacted by the pandemic in general because of tighter government restrictions and reduced consumer and commuter activity. This might explain why leasing was lower proportionally in CBDs during the height of the pandemic. Moreover, the CBD share of leasing activity increased slightly in Q3 2021. Additionally, in Q3 the average size and median length of leases signed in CBD submarkets were larger and longer than at any time during the pandemic.

**Proportion of Class A Overall Leasing in CBD Submarkets (4-Qtr Rolling Avg)**




Source: Cushman & Wakefield Research

**Q: When will effective office rents rise again?**

**A: Second half of 2022 and into 2023.** In the third quarter of 2021, we estimate that effective rents—which factor in concessions—were down 13% in the U.S. versus their peak in Q2 2020 (for CBDs, the peak was in Q1 2020). The usual "pandemic disclaimers" apply—that is, smaller sample size of deals to draw from and some businesses are delaying decisions until they have fully returned to the office. It is very difficult to get a clean read on rental rates at the moment.

Starting rents (sometimes knowns as "contract rents") are generally holding well but concessions are rising sharply. Average tenant improvement allowances are up 15% nationwide, while some major markets have risen from just shy of $70 per square foot pre-pandemic to $85-$90 as of Q3 2021. For Class A space, it is not uncommon to see tenant improvement allowances in certain major markets well over $100 per square foot along with 6-12 months of free rent.

In general, rents will follow vacancy. As vacancy pivots from rising to falling, rents will follow, though at a lag. We model that effective rents will begin to stabilize in mid-2022 and begin rising again in the second half of the year, albeit modestly at first. Of course, real estate is tied to local dynamics, and not every city, every submarket, or every building will follow the same glide path.

**Q: How could density (i.e., square feet per worker) change post-COVID-19?**

**A: It is too soon to say and impossible to predict with any precision.** So much of this depends upon business space strategy. In most cases, occupiers will shift space allocation between workstations and communal areas. This in itself is unlikely to increase or decrease space needs. Instead, the net change in density hinges on whether and to what degree companies utilize policies such as designated in-office schedules, hoteling, people attending the office in shifts, etc. Each of these can affect peak physical office occupancy, which is the determining factor for space needs.

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**Q: Are any markets performing better than others?**

**A: Yes, but it is early**. The pandemic's impact on the office market was widespread, as usage and demand spent most of 2020 at unusually low levels. However, in the most recent quarter, absorption turned positive for 27 of the 103 North American markets we track, including 25 U.S. markets, one Canadian market and one market in Mexico. The strongest Q3 performers tended to be large secondary markets, such as Atlanta, Seattle's Puget Sound – Eastside, San Diego and Austin. Other mountain and sunbelt markets also performed well in Q3, including Boise, Nashville and San Antonio. Additionally, five Florida markets—including Miami and Tampa—had positive net absorption in Q3 2021. Net absorption remains negative in the gateway markets. However, as noted previously, leasing activity in 2021 has improved by twice the national average (41% vs. 19%).

Typically, office employment is a strong gauge of office demand—historically job growth and absorption have moved hand-in-hand. However, during the pandemic, the relationship between the labor market and demand remains a bit off-kilter.[6] For example, Seattle's office-using employment is back above pre-pandemic levels but its net absorption as a percent of inventory is down by more than any market other than San Francisco and New York. Austin's office-using employment is back above pre-pandemic levels as well, and despite faring relatively better from an absorption basis, its pipeline has led to an 1,100 bps increase in vacancy since Q4 2019—second to only San Francisco. It is fair to say that Sunbelt markets are seeing better than average real estate market performance so far. That said, in the large gateway markets like Manhattan and San Francisco, we are starting to observe some early signs that the worst might be over. Although vacancy in those two markets was still rising in Q3 2021, it was doing so at a slower rate, and sublease space vacancy declined QoQ.

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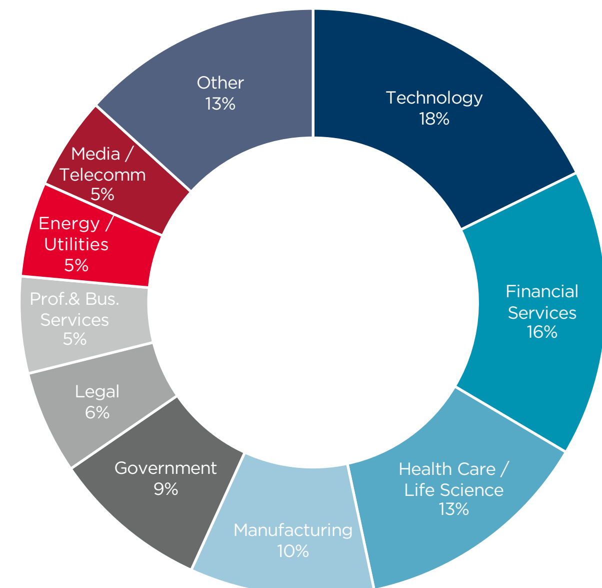
**Q: Is office demand expected to vary across different types of tenants (e.g., tech/finance or large corporate/small business)?**

**A: Yes, the sectors driving demand for the largest leases in 2020 and 2021 are similar to those before the pandemic**. Technology continues to be the top sector for leasing activity, although the share has dropped from 24% in 2018-2019 to 18% from 2020 through the first half of 2021. The financial services industry has remained consistent at number two, accounting for 16% of office square footage. Perhaps not surprisingly, healthcare and life sciences firms now make up a larger percentage of companies leasing office space. In the largest leases signed in 2018-2019, those firms made up 9% of the square footage, but during the pandemic, these sectors have accounted 13% of the square footage leased.

It is worth noting that office usage plans varies within sectors. The tech sector is one example, where there is a large spectrum of perspectives on office usage and space needs. Some technology firms have made public announcements that full remote work will continue indefinitely for employees who choose it, but other large technology firms have been clear that they see the office as a critical part of their business strategy. The continued tech leasing activity bears that out.

**Sectors with Most Leasing in 2020 & 2021***




*Analysis of leases signed in 2020 or H1 2021 for 40,000 sf or more across U.S. and Canada.

Source: Cushman & Wakefield Research

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**Q: How has flexible office, commonly referred to as coworking space, been impacted by the pandemic and is demand recovering?**

**A: In the U.S. / Canada, flexible office inventory declined by 7% between mid-2020 and mid-2021.** Coming into the pandemic, over-exposure in specific markets was an issue. Since the beginning of the pandemic, some operators are being creative about shoring up their businesses. These strategies include selling off assets, focusing on core business services and walking away from underperforming locations.

The largest declines in inventory were in San Francisco (-36%), Washington, DC (-17%) and Dallas (-14%).

Moving forward, flexible office providers are more bullish on demand prospects. According to a recent CoreNet Global-Cushman & Wakefield survey, 38% of occupiers are currently providing employees with access to flexible office and half (53%) are planning to increase employees' access to flexible office. However, most of the current demand for space is being structured as management agreements, as opposed to flexible providers signing leases.

**Q: Is the U.S. office sector ever going to fully recover from this event?**

**A: Yes. Our thesis on the office sector hasn't changed.** The office sector will return to pre-pandemic levels of performance—it's just going to take time. Regardless of how remote working shakes out, the economy is going to continue to produce knowledge-based workers, business formation will improve, employees will continue to need workspaces, and most do not want to sit at home all of the time. The data we collected in conjunction with CoreNet Global indicates that companies are not any more likely to consider a remote-first workplace portfolio strategy than they were pre-pandemic. Office buildings will repopulate. It's just a matter of time. That said, the pandemic is likely to accelerate the obsolescence of certain commodity office buildings, so not all buildings will fare the same.

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[1] Kastle Access Control System.
[2] Cushman & Wakefield *Predicting the Return to the Office* report.
[3] Cushman & Wakefield-CoreNet Global 2021 What Occupiers Want survey.
[4] VTS Office Demand Index (VODI).
[5] VTS is a provider of leasing, marketing and asset management software for CRE landlords. VTS produces a monthly office demand index (VODI) which tracks office tour activity.
[6] For more analysis of how the current labor market is intersecting with office, industrial and retail real estate, read Cushman & Wakefield's 5 Key U.S. Labor Market Trends Impacting CRE.

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