U.S. Research Report

TOP OFFICE MARKETS SNAPSHOT

Q2 2019

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The Major U.S. Office Markets Remain on Solid Ground

Featured Highlights

- Following a subdued start to the year, the second quarter was mostly encouraging for the leading office markets in the U.S. Demand levels remain healthy though rental growth has slowed in several markets.
- Eight of our top 10 office markets posted positive absorption in Q2 2019, with levels rising from the prior quarter in five. Barring some localized exceptions, demand remains centered on two sectors: tech and coworking.
- Vacancy rates fell in three markets and held firm in four more. The increases in the remaining three markets were not of a sufficient scale to cause concern and reflect an increase in new supply or space being returned to the market following tenant relocations.
- Rents increased in four markets and held firm in the remaining six. Once more, new record highs were established in Boston, Manhattan and San Francisco.
- The torrid pace of leasing by coworking and flexible workspace operators shows no sign of abating. New submarkets are being explored as firms seek to diversify and grow their brand. WeWork signed some of the largest deals in several of our top markets.
- **Manhattan** performed well in the first quarter with rising demand and rents setting another record high. Demand is keeping pace with robust levels of new construction.
- Federal agencies dominated second-quarter leasing activity in **Washington, D.C.** Developers continue to move ahead with new projects in the District despite elevated vacancy.
- **Chicago** had a steady second quarter, but the delivery of 2.5 million square feet in the Old Main Post Office project in the third quarter looks set to negatively impact vacancy in the Central Business District (CBD).

METRO CORE INVENTORY (SF)	CORE SUBMARKETS INCLUDED	ABSORPTION (SF)	AVG RENT ($)*	VACANCY RATE^
Manhattan 510,751,725	Manhattan Midtown, Midtown South, Downtown	1,315,420 ▲	$77.80 ▲	5.6% ▼
Washington, DC 187,943,885	CBD (DC), East End (DC), Capitol Hill (DC), NoMa (DC), Capitol Riverfront (DC), Carlyle (DC), R-B Corridor (NOVA), Tysons Corner (NOVA), Bethesda (SubMD)	486,935 ▲	$49.90 ▬	14.5% ▬
Chicago, IL 132,424,655	West Loop, Central Loop, River North, East Loop	441,070 ▲	$41.75 ▬	12.7% ▬
Houston, TX 117,848,335	CBD, Katy Freeway, West Loop (Galleria), Westchase	-18,395 ▼	$36.15 ▬	21.6% ▲
Los Angeles, CA 114,800,600	Dowtown Los Angeles, West Los Angeles, Tri-Cities	370,900 ▼	$48.30 ▬	14.2% ▬
Atlanta, GA 104,297,620	Midtown, Buckhead, Central Perimeter, Cumberland/Galleria	179,808 ▼	$32.10 ▲	14.2% ▲
San Francisco Bay Area, CA 101,713,245	Financial District (North Financial District & South Financial District), SOMA (West SOMA & East SOMA), Palo Alto, Mountain View, Sunnyvale	126,015 ▲	$92.40 ▲	5.5% ▬
Dallas, TX 78,617,140	Uptown, Preston Center, Far North Dallas	-224,680 ▼	$31.90 ▬	16.2% ▲
Boston, MA 71,085,195	Back Bay, Financial District, Charlestown, Crosstown, Fenway/ Kenmore, South Station, North Station, Seaport	498,705 ▼	$60.85 ▲	8.3% ▼
Seattle, WA 63,884,655	Seattle CBD, Lake Union, Pioneer Square, Belltown, Queen Anne, Ballard	1,644,225 ▲	$42.15 ▬	6.6% ▼

* A quarterly rent change of +/- 1% or less is deemed to be flat
^ A quarterly vacancy rate change of +/- 20 basis points or less is deemed to be flat

- After some small steps forward, the **Houston** office market saw its vacancy rate, already by far the highest of the top 10 markets, move back up in Q2.
- In **Los Angeles**, the westside continues to out-perform. There has been an influx of coworking operators in Tri-Cities. Despite some leasing traction, new supply is still a concern Downtown.
- In **Atlanta**, the Midtown submarket is in the midst of a development boom. Following the successful lease-up of several projects, some developers are pressing ahead on a fully speculative basis.
- Average asking rents in the **San Francisco Bay Area** (the Bay Area) have broken through the $90 per square foot mark and are the highest in the nation by a wide and growing margin.
- The **Dallas** office market tred water in the second quarter. Although construction activity is low by historic standards, demand for this space has been modest to date.
- **Boston** continues to go from strength to strength. Although the heady pace of leasing activity may start to cool, fundamentals remain strong and vacancy continues to fall.
- **Seattle** was the star performer in Q2 2019, with the greatest drop in vacancy and the largest amount of absorption, driven by some major tech leases. Large blocks are at a premium.

LOCAL INSIGHTS

Manhattan

- The Manhattan office market enjoyed a strong second quarter, led by 1.3 million square feet of net absorption. Average asking rates reached a new record high of $77.80 per square foot, while the vacancy rate fell by 30 basis points to 5.6%, which is the second lowest among the top 10 markets.
- Gross leasing activity rose to 11 million square feet in Q2 2019 and was spread across a diverse range of industry sectors. WarnerMedia signed the largest lease during the quarter after closing on a 1.3 million-square-foot sale-leaseback at 30 Hudson Yards. Coworking firms have leased a further two million square feet across Manhattan in the first half of 2019. Market leader WeWork signed another major lease in the second quarter, for 212,935 square feet at 620 Avenue of the Americas in Midtown South.
- Midtown retains the highest average asking rates in New York at $84.50 per square foot, followed by Midtown South at $79.20 per square foot and $63.20 per square foot Downtown. However, the situation is reversed for Class A space. Average Class A asking rates in Midtown South are $98.70 per square foot, more than $10 per square foot higher than in Midtown. Within Midtown South, the combination of tight supply, strong demand and desirable space has pushed rents up to an average of approximately $140 per square foot and $110 per square foot in Hudson Yards/Manhattan West and Greenwich Village, respectively.
- Construction activity in Manhattan remains robust, but demand is keeping pace so far. The first half of 2019 saw 5.2 million square feet come online in the form of new construction and major renovations, a mere 6% of which remains available. A further 3.5 million square feet is set to deliver in the second half of this year, three-quarters of which is already pre-leased.

Washington, D.C.

- Net absorption in the Washington, D.C. office market turned positive in Q2 2019 at a solid 486,935 square feet, while average asking rates stand at $49.90 per square foot. However, vacancy remains at an elevated 14.5%, driven by continued construction activity.
- Federal agencies dominated second-quarter leasing activity in the District. Four of the five largest leases signed were Federal renewals for a combined 1.7 million square feet. WeWork signed the largest new lease, taking 111,275 square feet at Capitol Crossing, 600 Massachusetts Avenue, NW.
- Significant disparities persist between the District and Northern Virginia, as illustrated by vacancy rates of 13.1% and 17.6%, respectively. Although just across the Potomac, vacancy rates in Arlington County are in excess of 23% in both Ballston and Rosslyn. Average asking rates in the District, at $57.90 per square foot, are almost $20 per square foot higher than the Northern Virginia average of $38.55 per square foot.
- The fear factor in the District is one of further upward pressure on vacancy levels in the face of sustained new construction. There is still more than four million square feet underway in the District, with 2.5 million square feet set to deliver in the remainder of 2019, half of which is still seeking tenants.

Chicago

- The Chicago office market enjoyed a steady second quarter. Net absorption stayed positive and moved up slightly to 441,070 square feet, while average asking rates inched up to $41.75 per square foot and vacancy held firm at 12.7%. Class A vacancy is tighter at 10.9%, reflecting tenants' strong preference for high-quality space.
- Vacancy in the CBD's premier submarket, the West Loop, is slightly below the market average at 12.3%. The Central Loop and East Loop have higher vacancy rates of 14.2% and 14.4% respectively. Average asking rates in the West Loop are the highest in Chicago at $44.90 per square foot, with average Class A rents at $48.70 per square foot. The top floors of the most prestigious towers here can achieve rents in the region of $60 per square foot.
- Demand was healthy in Q2 2019 with 16 leases signed of 50,000 square feet or larger for a total of 1.7 million square feet, led by The City of Chicago leasing 222,825 square feet at 2 N. LaSalle Street. WeWork signed one of the largest leases,

taking 140,000 square feet at 167 N. Green and also leasing 53,000 square feet at 1 S. Dearborn Avenue. The coworking giant now has 11 locations in downtown Chicago.

- The delivery of the 2.5-million-square-foot Old Main Post Office project in the third quarter looks set to negatively impact vacancy in downtown Chicago. The development is located in the River North submarket and, while it is now seeing some leasing traction, remains almost 70% vacant.

Houston

- The Houston office market remains challenged. Net absorption was modestly negative for the second successive quarter, though average asking rates held steady at $36.15 per square foot. However, the vacancy rate, which had been inching downward, rose by 60 basis points to 21.6%. This is by far the highest rate among the markets tracked in this report.
- Houston's CBD was the only submarket to post positive absorption in Q2 2019 at 230,640 square feet, and has the highest average asking rate at $41.75 per square feet, which is $5.00 per square foot higher than West Loop/Galleria, which follows next at $36.70 per square foot. West Loop/Galleria, at 17.7%, is the only submarket with a sub-20% vacancy rate.
- Large blocks of sublease space continue to act as a drag on the Houston office market. All but one of the 10 largest such spaces across the metro are to be found in the four submarkets tracked in this report. These nine spaces total a combined 2.3 million square feet, the largest of which is BP's former space at Four Westlake Park in Katy Freeway totaling 454,500 square feet.
- There were five leases of more than 50,000 square feet signed in the second quarter, two of which were renewals. Honeywell signed the largest new lease for 114,200 square feet at City West Place I in the Westchase submarket. Although Houston has not been at the front of the coworking boom, operators are making inroads with WeWork taking 56,350 square feet in the CBD at 609 Main at Texas.

Los Angeles

- The Los Angeles office market posted a solid second quarter. Net absorption, while down from Q1 2019, was 370,900 square feet. Average asking rates and vacancy held steady at $48.30 per square foot and 14.2%, respectively. Entertainment and tech companies continue to drive demand.
- Net absorption in Q2 2019 was led by West L.A. at 315,900 square feet. The submarket posted 1.4 million square feet of gross leasing activity, compared with 845,700 square feet Downtown. Coworking companies remain active in both submarkets and are also setting their sights on Tri-Cities. WeWork leased 72,000 square feet at 611 N. Brand Boulevard in Glendale, while companies Industrious and Spaces both moved into new space in Glendale and Pasadena, respectively.
- There is a wide differential between average asking rents in West L.A., which stand at $59 per square foot, and the rest of the Los Angeles market. Average rates Downtown are $42.95 per square foot while those in Tri-Cities are $38.40 per square foot.
- Downtown and West L.A. continue to dominate construction activity with a combined 3.7 million square feet underway, representing 55% of the total for L.A. County overall. On the west side there is one million square feet underway in Culver City alone, which includes major new facilities for Amazon Studios, Apple and HBO. Although new projects are seeing some leasing activity, supply-side concerns still persist Downtown.

Atlanta

- The Atlanta office market held relatively steady in Q2 2019, with a marginal drop in absorption, no change in asking rents and a slight uptick in vacancy. The lead story in Atlanta is the continued rise in new construction in the Midtown submarket. Atlanta is at its highest level of office construction since 2001.
- Midtown has the highest average asking rents at $37.90 per square foot and, driven by new construction entering the submarket, the rent differential is widening over Buckhead, where rates stand at $35.90 per square foot. Average asking rates in Central Perimeter remain at a discount to the two premier submarkets at $27.90 per square foot. Rents that are higher than $50 per square foot are being achieved on new construction in Midtown.
- Driven by move-ins by WeWork and Sirius XM, Midtown posted 158,355 square feet of positive absorption in the second quarter. Conversely, absorption was marginally positive in Buckhead, while Central Perimeter saw 254,155 square feet of negative absorption.
- There is 3.6 million square feet of construction underway in Midtown, which represents more than half of the metro total of 6.7 million square feet. Three major preleases totaling almost 700,000 square feet were signed in Midtown in the quarter, led by Invesco taking 300,000 square feet at the Midtown Union project. This is prompting some developers to proceed on a fully speculative basis. Hines has three such projects underway totaling 760,000 square feet.

San Francisco

- The Bay Area remains the tightest and most expensive market in the nation. Vacancy held steady in Q2 2019 at 5.5%, while average asking rents moved up to $92.40 per square foot. The delta between Bay Area office rents and the next highest in Manhattan has widened to almost $15 per square foot.
- For once the largest lease signed in downtown San Francisco did not involve a tech tenant, with First Republic Bank expanding to 265,000 square feet at One Front Street. There were three additional leases of more than 100,000 square feet involving Sony Playstation, Glassdoor and Autodesk. The blockbuster leases of the second quarter occurred in Silicon Valley, with Google taking 728,335 square feet at 60 E. Broklaw Road in San Jose, followed by Uber leasing 290,925 square feet at 200 S. Mathilda Avenue in Sunnyvale.
- Availability remains tight across the Bay Area and several submarkets have sub-3% vacancy rates including SOMA West and SOMA East in San Francisco and Mountain View Central, Palo Alto Central and Sunnyvale in Silicon Valley.
- Construction activity remains elevated with 3.6 million square feet underway in San Francisco. Apart from Oceanwide's 957,000-square-foot 1st and Mission project, which does not come online until 2023, the majority of this space is pre-committed. There is almost 10 million square feet underway in Silicon Valley, boosted by Adobe breaking ground on its 1.3-million-square-foot expansion in downtown San Jose, ending an office construction drought in the submarket that has lasted almost 10 years.

Boston

- Boston's office market continues to go from strength to strength. Demand remains strong with half-a-million square feet of net absorption in the second quarter. At the same time, the vacancy rate fell by 60 basis points to 8.3% and average asking rates rose to $60.85 per square foot — the third-highest among the 10 markets surveyed in this report.
- Second quarter demand centered on the Financial District, which recorded 558,000 square feet of net absorption, driven by two major leases: Bank of America leased 545,000 square feet at its new headquarters at 100 Federal Street, while WeWork took 120,000 square feet at 100 Summer Street. With negotiations in place on several other large blocks, WeWork is expected to become Boston's largest office tenant by the end of the year.
- Net absorption in the Back Bay in Q2 2019 was stymied by limited supply. The submarket's vacancy rate of 5.6% is significantly below the market average and those found in the Financial District (9.2%) and Seaport (11.4%). Back Bay's average asking rate of $65.55 per square foot is the highest in the market and there have been multiple leases signed at $100 per square foot.
- Is this performance sustainable? Demand is strong but active tenant requirements have likely peaked. Foundation Medicine is the largest tenant in the market and is expected to sign for 600,000 square feet shortly. Two million square feet of new space broke ground in Q2 2019 but, for now at least, the bulk of space underway is pre-committed.

Dallas

- The Dallas office market had a subdued second quarter. Net absorption turned negative at -224,680 square feet, but this is trivial in a 78.6-million-square-foot market. Average asking rents held steady at $31.90 per square foot while the vacancy rate increased by 30 basis points to 16.2%.
- There were no large leases of note signed in Q2 2019 in the submarkets covered by this report and Uptown/Turtle Creek was the only one to post positive absorption at 117,980 square feet. The submarket also has the highest average asking rates at $40.60 per square foot, followed by Preston Center at $38.60 square feet and Far North Dallas at $29.70 square feet. Preston Center has by far the lowest vacancy rate at 8.8%.
- There is two million square feet of construction underway across the three submarkets out of 7.9 million square feet in the Dallas metro. Disquietingly, the majority of this space (1.7 million square feet) remains available, which includes 963,400 square feet being built in Far North Dallas, 90% of which is available.
- The two largest projects underway are both in Uptown/Turtle Creek. Victory Commons at 2601 Victory Avenue totals 364,730 square feet, with a further 292,800 square feet at The Link on Olive Avenue. Barring a small pre-lease at the latter, all this space is available, but the two projects are not scheduled to come online until 2021.

Seattle

- The Seattle office market rebounded strongly in the second quarter. Net absorption totaled an impressive 1.6 million square feet, helping drive the vacancy rate down by 100 basis points to 6.6%. The Q2 2019 absorption total was the highest of all the markets in this report and equivalent to 2.6% of market inventory.
- Tech firms drove both absorption and leasing activity in the second quarter. F5 Networks moved into 515,520 square feet in the F5 Tower in the CBD. On the leasing front, Apple claimed the entire 620,000 square feet at the 333 Dexter development in Lake Union where it will house 2,000 new jobs. In addition, Dropbox took 120,885 square feet at the 2+U development in the CBD.
- Average asking rates held steady at $42.15 per square foot, with the highest rents being in the CBD at $47.30 per square foot and Lake Union at $46.40 per square foot. With low vacancy and limited large block availability, new Class A space can command rents in the mid-$50s per square foot. Class A vacancy in Lake Union is a mere 2.6%.
- There is 3.4 million square feet of new construction set to deliver in the second half of this year, but most of this space is pre-committed, led by the 1.1 million square foot Amazon Tower II. The 722,000-square-foot Rainier Tower II was pre-leased by Amazon but is available to sublease. Oracle, Facebook and WeWork have all been linked with the space, which looks unlikely to linger on the market.

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