VTS

VTS Green Shoots Report

Quarterly Report:

Q1 2022

Office Market Overview

While the pandemic has made hybrid work viable and continues to impact long-term market dynamics of the office sector, data from VTS paints a more nuanced picture and points to many green shoots emerging across office markets. The waning of Omicron since early Feb ‘22 opened the door for tenants to begin their space searches. In Mar ‘22 alone New Requirement Velocity is up from the seasonal December slowdown by +42% for SF and +54% for the count of new tenants entering the major U.S. markets. Though the velocity of New Requirements remains below pre-covid levels, demand (sf) in Q1 ‘22 is up 27.2% on average over Q1 ‘21 across the major U.S. office markets. Key trends to consider:

FIRE is recovering the fastest.

FIRE’s share of overall demand has recovered to or surpassed pre-covid levels in 6 of 8 markets tracked by VTS (DC & SF are the exceptions). TAMI’s share of demand surpassed pre-covid levels in LA (driven by Creative demand), and TAMI demand in SF has been flat since Jan ‘21 vs. pre-covid (46%). *(See Appendix)*

Elevated concessions but rents hold.

Landlords have upped concessions vs. dropping starting rents, which have actually increased 3.3% across VTS markets for Class A properties when comparing active proposals to 2019 executed leases. Conversely, market average TI’s over the trailing six months (T6M) vs. pre-covid are up 15.4% to $10.18/sf/yr and months of free rent is up on average 27.3% to 0.91 mos/yr. *(See Appendix)*

Upsizing large requirements yet small tenants touring.

When looking at the trailing three month (T3M) count of New Requirements vs. Jan / Feb ‘20 baselines, smaller tenants (<10k sf) declined the least (-27%), followed by large (50k+ sf; -39%) and mid-size tenants (10-50k sf; -40%). However, the average New Requirement size has increased (+5%) for large tenants while both small (-7%) and mid-size (-6%) tenant requirements shrunk. Less demand from large tenants but they are looking for more space on average vs. pre-covid.

More touring in low remote markets

The average VODI in Q1 ‘22 is much closer to ‘18-’19 averages (-32%) in low remote work (NYC, HOU, LA, CHI)[1] markets than in high remote-work (DC, SF, SEA, BOS; -52%)[1]. *(See Appendix)*

Standout Statistics by Market

The below table summarizes recent trends around tenant demand and deal economics (volume, rent, concessions, term). Combined with the VODI (tracks unique requirements starting their space search), VTS proposal data is a reliable indicator of rates and leasing activity expected over the next ~2 quarters.

		VODI	Logged Lease Proposals (T3M - Mar '22)[2] [3]					
		Mar	% Change vs Prior T3M				Avg. $/sf/yr	
Market	Trending	'22 / '21	Count[4]	NER	TI's	Term	NER[5]	TI's
Boston	▼	55 / 35	-14.1%	-4.4%	+0.3%	-2.1%	$64	$10
	Despite a sluggish recovery, Boston has the most favorable ratio of Active Demand (AD)[6] to currently vacant space[7] and leases executed Q1 '22 had an increase in average term of lease reversing a four year consecutive decline.							
Chicago	▶	59 / 85	+36.4%	+7.8%	+1.3%	-5.4%	$39	$10
	36% jump with 101 new tenants touring in Mar '22. The River North + River West Market is an outperformer not just in Chicago but nationally as well. 36% of all AD[6] of sf in Chicago is touring this submarket and skews towards large tenants (40K avg sf/req) with tech and finance demand leading the way.							
Houston	▲	78 / 98	+54.2%	+2.0%	+1.5%	+5.9%	$31	$8
	NER's in Houston have slightly trended up (+2.9%; T3M ending Mar '22 over prior T3M) alongside energy stocks/price, but off of a low base ($31/sf; - 12% vs. '19)[5]. While encouraging, there is great uncertainty around the upswing's duration. *See: Reward for Risk?*							
Los Angeles	▲	85 / 80	+64.4%	+6.5%	+9.9%	-4.3%	$49	$11
	Lowest point drop in VODI vs. pre-pandemic levels (down 15 points), lifted by Creative Demand.							
New York City	▶	76 / 61	+2.7%	+0.5%	-2.0%	-0.6%	$68	$12
	Large tenant demand surged in Feb '22, up 180%; 1.6M sf total. Due to flight to quality, there is a rent premium of 81% for best-in-class office space (top 10% of rents) vs. other 90%, up from 67% pre-covid *(See Appendix)*. Tours in B assets were 25% of total tours in Q1 '22, up from 22% vs Q1 '21 and 20% Q3 '20 low - a positive for assets primed for value-add investmen							
San Francisco	▶	37 / 45	+12.7%	+7.3%	+12.7%	+5.6%	$84	$13
	New demand (sf) over the TTM through Q1 '22 is up +190% over the prior TTM, coming off a weak base after the steepest demand drop of any market (-95%) during the onset of the pandemic *(See Appendix)*. TAMI has been the primary industry driving the rebound with 43% of sf of requirements over TTM and count of TAMI requirements is up 33% in Q1 '22 vs Q1 '21.							
Seattle	▲	48 / 68	+47.8%	-2.4%	-0.4%	-2.5%	$47	$8
	Given tech's drag on office, Seattle is perhaps a surprising top momentum pick. *See: Markets on the Move*							
Washington, D.C.	▼	78 / 75	-1.1%	-5.0%	+5.2%	-0.9%	$52	$11
	Sluggish momentum over prior T3M, however, average starting gross rents in proposals have rebounded 5% from the 2021 low. Tour demand is up 37.4% in Q1 '22 over Q1 '21 (vs 27.2% market avg.).							
Average		65 / 69	▲25.4%	▲1.5%	▼3.6%	▼0.5%	$54	$10

SEATTLE

Markets on the Move

Seattle exhibits strong momentum and is poised for continued improvement in fundamentals:

- NER's from active proposals are up (+6%) when compared to 2021 Class A new leases (5k+ sf & 60mo+), buoyed by favorable declines in TI's/sf/yr (-17%) and Free Rent (-9%).

- No sign of a slowdown in current proposal volume (+47.8%) in Q1 '22 over 4Q '21. Proposals traded for larger Class A deals (10k+ sf) over the T6M, NER growth was +1.3% vs. the prior TTM, third to LA and NY and slightly above the market average (+1.1%). In addition, Seattle had the lowest TI/sf/yr. increase (+6.3%) over the T6M of the top 8 markets (+15.4% avg.) vs. the pre-covid TI average.

- Seattle had the largest percent increases in VODI for both T3M (+49%) and T6M (+87%) averages over prior periods as evidence of strong tenant demand to date. However, Mar '22 saw an unexpected drop of 20 points in the VODI (68–>48). The decline was from the Professional Services (-69%) (particularly Legal) and Other (-66%) sectors. TAMI & FIRE thus contributed 72% of total sf in Mar '22, well above pre-covid pro-rata contribution and a 44% average combined contribution by the two industries since Apr '20. The next few months will confirm if Mar '22 was an outlier.

- The non-core Seattle CBD submarket[8], driven by Lake Union, is one of only six VTS submarkets with double digit T3M demand growth (+10%) vs. Jan/Feb '20 as measured by count of tenants. Midtown South in New York (+79%) tops the submarkets (SEE Appendix). This upward new demand trend in non-core CBD is consistent with recent tech demand at the market level.

HOUSTON

Reward for Risk?

The Russia / Ukraine war and surging oil prices might be a major catalyst that ignites demand in the energy corridor and other energy centric areas of Houston. Green shoots are emerging that are consistent with this dynamic as the count of Class A proposals is up 54.2% Q1 ‘22 over Q4 ‘21 (25.4% market average) and the energy corridor’s share of total tours has increased from 22% to 29% during the same period. Despite a favorable VODI (78), and a second lowest drop (-26%) in new demand sf (Q1 '22) compared to pre-covid (Jan/ Feb ‘20), these levels haven’t made a dent in Houston’s high vacancy rate (28.1%)[7]. Houston has the lowest ratio of AD[6] to vacant sf[7] (17.3%) of the 8 markets (45.4% market average). Similarly, the total number of employees in the Oil & Gas Extraction sector in Mar ‘22 remains down 37.5%[9] compared to the Oct ‘14 peak.

Market Health & Momentum Comparison

The below table spotlights the dispersion of recovery across markets tracked by VTS by highlighting key data points for Seattle, a clear outperformer as demand continues to recover, Washington DC, which has only recently experienced some green shoots, and the market average for reference.

Metric or Percent Change	SEA (High)	DC (Low)	Mkt Avg	Analysis Time Frame
		Demand / Supply		
AD[3] sf to Avail sf[7]	+38.2% (6)	+34.3% (7)	+45.4%	Mar '22 / 4Q-21
% chg. New Demand sf	-13.6% (2)	-14.8% (4)	-17.4%	T6M (Mar '22) to Prior T6M
% chg. New Demand sf	+0.5% (2)	+1.6% (1)	-23.6%	T6M (Mar '22) to Prior T6M
		Rent Dynamics (Class A Trophy 60+ Mos)		
NER Proposal Growth	+1.3% (3)	-0.3% (6)	+1.1%	T6M (Mar '22) to Prior T12M
% change in TI's	+6.3% (1)	+20.7% (6)	+15.4%	T6M (Mar '22) to Pre-Covid
% chg. Starting Gross Rent	+4.9% (1)	+0.2% (6)	+3.6%	Active Proposals to Executed '19
% chg. Starting Gross Rent	+7.8% (1)	+4.5% (5)	+3.9%	Active Proposals to Executed '21
Top 10% NER Premium	+9.8% (4)	-3.4% (7)	+9.7%	Proposals to Executed '18 & '19
Average of Market Ranks	2.9 (1)	5.3 (7)		

Notes

[1] Market selection is based on a University of Chicago White paper titled “How Many Jobs Can be Done at Home?” published in June 2020.
[2] Limited to Trophy/Class A 5K+ sf (10K+ in CHI + NY).
[3] Unless noted the period is T3M ending Mar ‘22.
[4] Count is the number of proposals logged in VTS Lease.
[5] NER adds $15 to HOU and $18 to CHI of avg. expense reimb. for gross rent comparisons.
[6] Active Demand (AD) quantifies the total sf and count of reqs. touring/pursuing space in the market and is similar to Tenants In The Market
[7] Direct vacancy rate and Available sf obtained from JLL market reports for 4Q-2021.
[8] This submarket includes S. Seattle, Queen Anne, Ballard, University District, Denny Regrade, Lake Union, Central District, Pioneer Square, Waterfront.
[9] https://fred.stlouisfed.org/series/CES1021100001

Appendix available upon request for charts and tables supporting the green shoots and other emerging trends and themes referenced in this report.

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