OFFICE INDEX

Q1 2020 OFFICE MARKET ASSESSMENT DURING COVID-19

The NCREIF Property Index reported 1,524 office properties with a market value of over $241M over 42 years. The index posted a 1.28% total return in Q1 2020 as opposed to 1.7% in Q4 2019, although income increased from 1.06% in Q4 2019 to 1.09% Q1 2020, given that COVID-19 only took hold in the U.S. towards the end of the quarter.

It's clear that the office sector is facing unprecedented challenges due to COVID-19 and resulting mandates for people to shelter in place. Q1 2020 was subject to some of the disruption caused by the pandemic, but the real effects likely will not be known until we make it through the second and third quarters of the year. That said, some trends emerged in the first quarter and early portion of the second quarter that may give us clues as to tenant behavior in the coming months.

First, contracts with refundable earnest money in Q1 saw some potential buyers walk away from transactions. However, contracts under non-refundable contracts saw a spike in price negotiations. Recently closed deals had downward price adjustments ranging anywhere between 4% to 16%, showing that buyers are demanding lower prices due to the effects of COVID-19. The other takeaway is that if a seller does not have to transact, then they will remain on the sidelines.

As noted in JLL's Q1 office outlook, the trajectory of the market will be shaped not only by the ability of policy makers and the private sector to manage the crisis, but also by the potential structural changes in how space is used. Our "next normal" will likely consist of employees coming in on a staggered basis to enforce social distancing. Safety will continue to be a top priority, especially in urban areas where buildings can have dozens of floors and hundreds, if not thousands, of tenants. These buildings will need to be especially conscious of the capacity and cleanliness of communal areas such as lobbies, elevators and kitchens.

Another consideration is the attractiveness of suburban offices, where buildings usually have fewer floors and lower occupancy. With the option to drive to work and avoid public transportation, the demand for suburban vs. urban offices may find an equilibrium.

We expect the co-working providers to be under pressure in the near-term. This model was built on open-plan design with the intention of socialization that would spur on creativity and interaction. This is inconsistent with what we envision as strategic space utilization in the near future as social distancing limitations continue to impact communal and shared spaces.

Office occupant sentiment will continue to shift as organizations across the globe evaluate the density of their space going forward. Although office usage became scarce toward the end of Q1 due to stay-at-home orders, the conversation around strategic planning for the design, utilization and safety of physical space continues to be at the forefront of investor considerations and challenges – pointing to a desire to get back in the office. More clarity on the true impacts of the office sector will be explored as companies engage on their re-entry.

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OFFICE TOTAL RETURNS

	Total NPI	Total Office	East	Midwest	South	West
1st Q 2020	0.71	1.28	0.91	0.42	1.36	1.81
4th Q 2019	1.55	1.70	1.09	1.11	1.78	2.45
One Year	5.28	6.23	3.98	3.83	6.85	9.12
Three Years	6.41	6.50	4.58	4.90	7.41	8.75
Five Years	7.65	7.18	5.61	5.65	7.25	9.32
Ten Years	10.17	9.46	8.54	6.81	9.05	11.26
Twenty Years	8.64	7.93	8.24	5.56	7.17	8.71

OFFICE INCOME RETURNS

	Total NPI	Total Office	East	Midwest	South	West
1st Q 2020	1.10	1.09	1.01	1.03	1.23	1.15
4th Q 2019	1.10	1.06	1.00	1.16	1.19	1.08
One Year	4.51	4.43	4.13	4.62	5.06	4.54
Three Years	4.57	4.51	4.16	5.04	5.35	4.58
Five Years	4.68	4.55	4.20	5.24	5.47	4.56
Ten Years	5.26	5.14	4.84	5.90	5.85	5.13
Twenty Years	6.15	6.16	6.01	6.76	6.66	6.03

OFFICE APPRECIATION RETURNS

	Total NPI	Total Office	East	Midwest	South	West
1st Q 2020	-0.39	0.19	-0.10	-0.61	0.13	0.66
4th Q 2019	0.45	0.64	0.09	-0.05	0.59	1.37
One Year	0.74	1.74	-0.15	-0.77	1.73	4.42
Three Years	1.77	1.92	0.41	-0.14	1.98	4.03
Five Years	2.87	2.54	1.36	0.40	1.71	4.60
Ten Years	4.73	4.17	3.58	0.88	3.07	5.91
Twenty Years	2.38	1.69	2.14	-1.15	0.47	2.55

OFFICE INDEX—QUARTILE RANGE OF RETURNS