

OFFICE INDEX

OFFICE: NEGATIVE APPRECIATION RETURNS DECELERATE WITH SELECT MARKETS POSITIONED WELL FOR A RECOVERY

The office sector delivered a total return of 0.48% in the fourth quarter, marking the second consecutive quarter of positive total returns and a continued deceleration in negative appreciation return as optimism around vaccine rollouts support a clearer path for a return to the office. Income return in the fourth quarter remained steady at 1.06% as tenants across NPI properties continued to pay rent¹. While broad demand uncertainty caused by working from home coupled with increased sublease availability poses the most immediate risk to the office sector going forward, fundamentals within certain growth-oriented, non-gateway cities provide more reason for optimism.

As a result of COVID-19, the amount of sublease space available in the U.S. in the fourth quarter of 2020 grew to 141.5 million square feet², an amount that exceeds the record set following the bursting of the dot-com bubble³. Office landlords face headwinds in leasing current vacancy and competing with the economics and current availability of sublease space throughout the country. Likewise, many tenants continue to “wait-and-see” as they prepare for their employees to get vaccinated and then make decisions around returning to the office. Only after this return to the workplace occurs will we better understand the degree to which longer term Work From Home policies are adopted in the office sector. In an encouraging sign for demand, according to PwC’s US Remote Work Survey, currently 70% of executives expect to maintain or increase their company’s physical office footprint within three years⁴.

In spite of near-term uncertainty in the office sector, there are several office markets demonstrating strong fundamentals through the effects of COVID-19. One predictive indicator for office space demand historically has been the change in office-using employment. Office-using employment across the United States ended 2020 down 3.85% from its peak in February, with the vast majority of markets across the country registering declines⁵. However, there are several select markets, such as Austin, TX, Denver, CO and Seattle, WA, that have actually experienced an increase in office-using jobs throughout much of the pandemic in 2020⁶. Austin, in particular, has been the top performing market for office-using job growth, increasing 5% since February 2020. This has been further reinforced by recent corporate relocations to the market, including Tesla and Oracle, in 2020 representing nearly 10,000 new jobs⁷.

While uncertainty around near term office supply-demand dynamics remain, those markets that exhibit positive office-using job growth appear to be well positioned to recover quickly once a majority of the population receives vaccinations. Several of these growth markets have benefited from population migration trends over the last several years from high cost of living and high tax states to low cost of living and low tax states, particularly those in warm or attractive climates and in proximity to higher education institutions. With anticipated widespread vaccine distribution in 2021, we believe the market will provide greater clarity on working from home and office demand, as well as the relative performance of gateway and growth markets this year.

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OFFICE TOTAL RETURNS

	Total NPI	Total Office	East	Midwest	South	West
4th Q 2020	1.15	0.48	0.54	0.48	0.30	0.46
3rd Q 2020	0.74	0.31	0.23	0.49	0.27	0.38
One Year	1.60	1.57	1.13	0.15	0.95	2.49
Three Years	4.89	4.97	3.43	3.34	5.48	6.89
Five Years	5.91	5.43	4.02	4.15	5.38	7.34
Ten Years	9.00	8.38	7.08	6.15	8.36	10.37
Twenty Years	8.19	7.38	7.59	5.22	6.83	8.00

OFFICE INCOME RETURNS

	Total NPI	Total Office	East	Midwest	South	West
4th Q 2020	1.01	1.06	1.01	1.05	1.21	1.07
3rd Q 2020	1.02	1.08	1.02	0.99	1.25	1.11
One Year	4.20	4.39	4.12	4.18	5.02	4.51
Three Years	4.43	4.44	4.13	4.55	5.16	4.53
Five Years	4.55	4.49	4.14	5.01	5.38	4.54
Ten Years	5.06	4.95	4.64	5.71	5.72	4.95
Twenty Years	5.98	6.00	5.83	6.57	6.53	5.89

OFFICE APPRECIATION RETURNS

	Total NPI	Total Office	East	Midwest	South	West
4th Q 2020	0.14	-0.58	-0.47	-0.58	-0.91	-0.61
3rd Q 2020	-0.28	-0.77	-0.79	-0.50	-0.98	-0.73
One Year	-2.52	-2.73	-2.90	-3.91	-3.91	-1.95
Three Years	0.44	0.52	-0.68	-1.17	0.31	2.29
Five Years	1.32	0.91	-0.11	-0.83	0.00	2.71
Ten Years	3.80	3.31	2.36	0.42	2.53	5.23
Twenty Years	2.11	1.32	1.69	-1.29	0.28	2.02

OFFICE INDEX—QUARTILE RANGE OF RETURNS

