OFFICE INDEX

OFFICE SECTOR REBOUNDS IN THIRD QUARTER, LED BY SUBURBAN SURGE

Extended office closures and the shift to a remote work environment that was more productive than businesses expected left investors debating the future of the commercial office. While there is still uncertainty regarding how people will now use office space and the percentage of time they will work from home, office assets are recovering. After four straight quarters of declines, the sector saw valuations begin to rise in the second quarter, with the NCREIF Property Index reporting a 0.31% increase.

Digging deeper into the numbers we begin to see an interesting trend: the appreciation is coming exclusively from the suburban office market, which saw growth of 1.27%, up from 0.29% in the first quarter when this market began to recover. When we look at the Central Business District (CBD) properties, the values continue to trend downward with 0.39% depreciation.

Looking into the submarkets, the Northeast region showed the largest disconnect between central business district and suburban office appreciation. While CBD office values declined 0.12%, suburban offices in the Northeast saw the greatest increase of any region, rising 4.21%, as many investors are placing bets on the sprawl of office tenants in New York and Boston to suburban markets. Not all CBD assets experienced declining values. Offices in the East North Central, Southeast and Southwest CBD regions saw appreciation, as most COVID-19 residential migrations tended to gravitate toward these markets due to the lower cost of living, greater space and nicer weather.

While investors are placing bets on the comeback of the suburban office and migration to the Midwest and Southern United States, fallout from the pandemic and the resulting evolution of work preferences are still in the early stages. As corporations work through their office policies, with some mandating employees back to the office and others providing options for full or partially remote work, they are all re-evaluating their leases and required square footage per employee, which was shrinking prior to the pandemic. With needs for less square footage and guiding a workforce adjusted to flexible work arrangements, corporate occupiers will have more leverage in lease negotiations over the next three to five years than ever before, which will have long term implications on the office market.

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