

OFFICE INDEX

THE SEAT BELT SIGN IS ON AS RETURNS FALL FROM CRUISING ALTITUDE

After three months of the most turbulent fiscal climate since the GFC, office investors find themselves in a tenuous position as the fate of global economic growth hangs in the balance. Buoyed by steady income, total return notched 3.2% annually in Q3. Though the story here is more attributable to the long-term commitment of leases propping up headline return, income returned 4.3% annually and appreciation return fell to -1.1%. In fact, each return metric fell to 10-year lows on a quarterly basis, with total return falling to -0.7%, income return to 1.0%, and appreciation to -1.7%.

One of the prevalent themes brought on by the pandemic has been the fundamental shift in the way we work, or perhaps more accurately, a shift in where we work. The acceptance of the permanency of the remote working trend has broken the traditional relationship between job growth and demand, which is having the biggest impact on CBD offices, especially in dense urban markets. At the subtype level, suburban properties recorded total return of 6.3% year over year, while CBD managed to return just 0.8%.

Returns in the South and West regions comparatively outperformed the East and Midwest regions during Q3. However, this is nothing new as population growth has fueled demand over the past decade and has been decidedly more concentrated in Sunbelt markets and away from Eastern coastal and Midwestern heartland markets.

Tenants and owners continue to apply an ESG lens toward occupancy and investment decisions, driving interest to high quality and healthy buildings. Analyzing the breakdown of prices on sold assets over the past 18 months, the data shows transaction volume has clearly become more heavily weighted toward higher price per square foot deals. This trend is most apparent for gateway CBD properties but is also prevalent in suburban markets and both subsectors of nonmajor markets. The bid/ask spread between buyers and sellers is the widest it's been in the past 18 months and is signaling that market risk is more elevated for lower-priced properties.

Earlier in the year, market watchers hypothesized a widespread return to office coinciding with the end of summer. While there was a notable return, with about two million fewer people working from home in September compared to August, there was an undeniably larger influx between February and April, when about four million employees per month returned. At this point, the tailwind to demand from the return-to-office trend may already be moderating as leasing activity has declined for the past three consecutive quarters and vacancy continues to rise.

That said, the challenges on the macro level will not affect all markets evenly and the increased economic uncertainty is sending out mixed signals depending on what you're watching. On one hand, certain industries are calling to shrink footprints to focus on profitability and flexibility, and on the other, if tight labor markets start to ease then the power dynamic could shift from employees to employers, which may result in people working more days in the office.

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OFFICE TOTAL RETURNS

	Total NPI	Total Office	East	Midwest	South	West
3rd Q 2022	0.57	-0.66	-0.75	-1.33	0.23	-0.77
2nd Q 2022	3.23	0.58	0.40	-0.91	0.27	1.11
One Year	16.08	3.21	2.30	-0.96	4.58	4.47
Three Years	9.91	3.62	2.60	1.45	4.15	4.95
Five Years	8.62	4.84	3.42	2.86	5.65	6.55
Ten Years	9.48	7.05	5.62	5.32	7.68	8.82
Twenty Years	8.91	7.32	7.18	5.02	7.00	8.23

OFFICE INCOME RETURNS

	Total NPI	Total Office	East	Midwest	South	West
3rd Q 2022	0.93	1.04	0.97	1.11	1.21	1.04
2nd Q 2022	0.97	1.08	1.03	1.16	1.18	1.10
One Year	3.98	4.30	4.07	4.47	4.88	4.34
Three Years	4.17	4.40	4.13	4.41	4.99	4.50
Five Years	4.33	4.45	4.14	4.65	5.16	4.54
Ten Years	4.73	4.69	4.39	5.31	5.50	4.69
Twenty Years	5.59	5.61	5.41	6.15	6.18	5.55

OFFICE APPRECIATION RETURNS

	Total NPI	Total Office	East	Midwest	South	West
3rd Q 2022	-0.37	-1.70	-1.72	-2.43	-0.98	-1.81
2nd Q 2022	2.26	-0.50	-0.63	-2.07	-0.91	0.01
One Year	11.76	-1.05	-1.72	-5.26	-0.29	0.13
Three Years	5.58	-0.75	-1.48	-2.86	-0.81	0.44
Five Years	4.15	0.38	-0.70	-1.74	0.47	1.95
Ten Years	4.59	2.27	1.20	0.01	2.10	3.99
Twenty Years	3.19	1.64	1.71	-1.08	0.78	2.57

OFFICE INDEX—QUARTILE RANGE OF RETURNS

