SVN®
RESEARCH

State of the Market Report

OFFICE | 2023

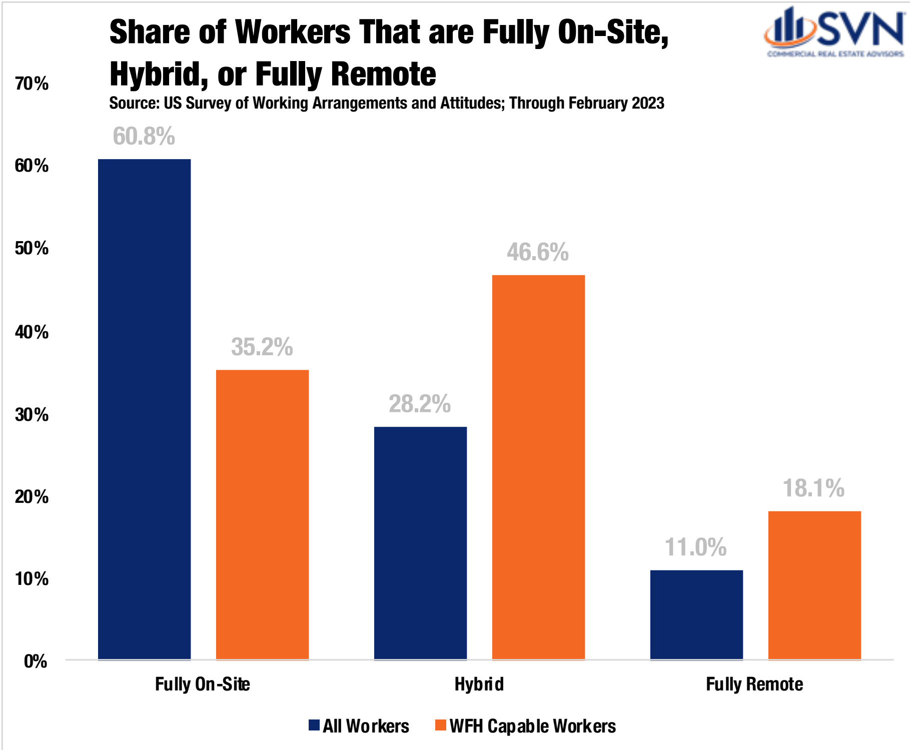
Office

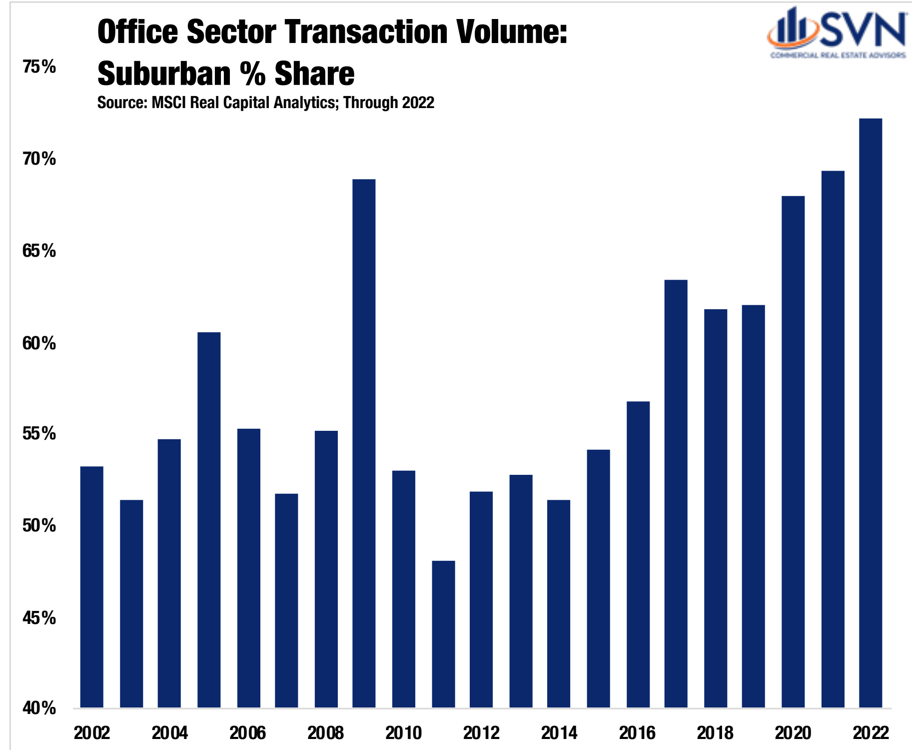
NATIONAL OVERVIEW

Ask a real estate economist what the office sector will look like five years from now, and you might get a similar response as if you asked your hybrid coworker if they will be in the office next Tuesday: “Unsure. We’ll see.” When it comes to the office market, especially in central business districts, the sector has a full list of open questions to contend with.

The role of remote work looks like it will be a long-lasting legacy of the 2020 shutdown. While fully on-site remains the dominant model across all workers, for workers that can work from home (WFH), hybrid setups have emerged as the dominant model.

The office sector held the lowest investment and development prospects of any sector in the 2023 ULI/PwC Emerging Trends in Real Estate Survey — a sign that the sector’s functional uncertainties are impacting investment demand.





Of course, **the sector's hotspots of difficulty are generally in the dense central business districts of major cities** — the kind of office markets that can have a workforce commuting an hour or more each way.

According to MSCI Real Capital Analytics, the price of CBD office space declined by 8.1% year-over-year in 2022. Meanwhile, suburban offices, which cater to a much more local workforce than their CBD alternatives, fared much better in 2022, with asset prices only dropping 3.6% from a year earlier. Moreover, **suburban properties continue to make up a bigger slice of the office investment pie**. In 2011, when CBD office assets were viewed as the safest of all CRE investments, suburban office assets accounted for just 48.0% of all US office transaction volume. Fast forward to 2022, this volume share has catapulted up to **72.2%** — its highest annual share on record.

Financials

TRANSACTION VOLUME

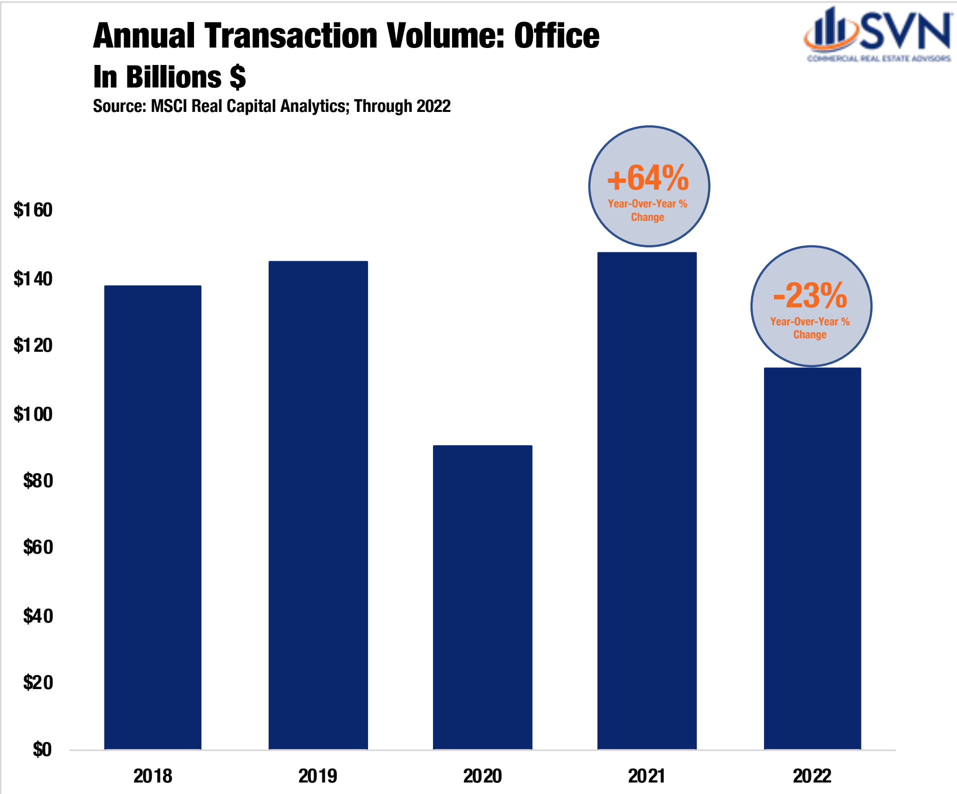
According to MSCI Real Capital analytics, office transaction volume totaled **$112.8 billion** in 2022 — a 23.3% drop-off from the previous year. A pullback in transaction activity was not uncommon for most commercial property types in 2022, as 2021 saw record volumes due to pent-up demand and a sense of urgency to get deals done before interest rates would rise.

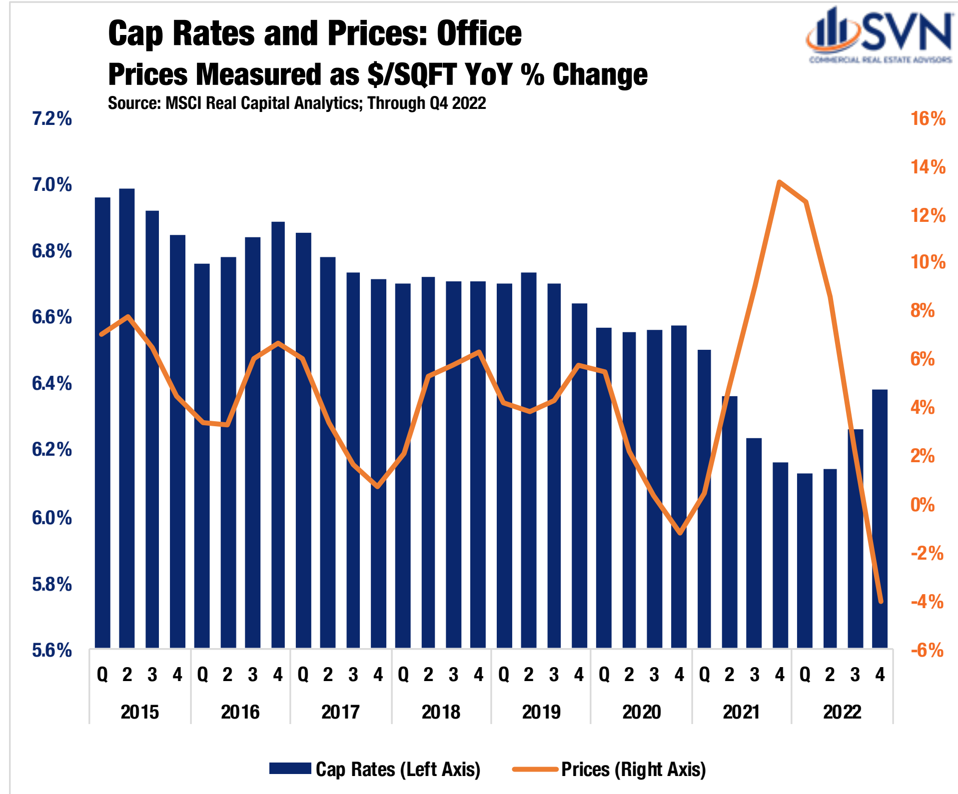
However, the office sector was unique in that its 2022 transaction volume total was low even compared to previous years other than just 2021. While 2022's volume was 26.0% higher than 2020's pandemic-depressed total, it is still the next smallest tally in recent memory. Compared to 2019's pre-pandemic benchmark of $144.2 billion, last year's total sank a discouraging 21.8% lower. Moreover, 2022 saw the least amount of property value trade hands since 2013 — a testament to the souring opinions surrounding large office buildings in gateway markets.

CAP RATES AND PRICES

Early on in 2022, cap rates in the office sector followed the declining trend that defined all commercial real estate property types. Even as open questions about the property type's long-term functionality swirled, the anticipation of rising interest rates sent buyers scurrying to secure assets like a game of musical chairs where the record player just stopped.

However, by Q2, the market inflection was already underway. Cap rates ticked up marginally in Q2,





followed by more substantial movements of 12 basis points in Q3 and Q4, respectively. The last time that office sector cap rates increased by 20 or more basis points in a six-month period was in 2009. By the end of 2022, office cap rates had jumped to 6.4%, reaching their highest levels since Q1 2021.

With office cap rates on the rise and new tenant demand remaining tepid, valuations took a hit in 2022. After reaching an all-time high of $268/sqft in Q1 2022, prices declined for the three remaining quarters of the year, falling to $255/sqft by Q4. Asset prices are down 4.1% year-over-year through Q4 2022. Moreover, compared to the record high set earlier in the year, Q4 prices were down by a slightly more substantial 4.7%.

Regional Performance

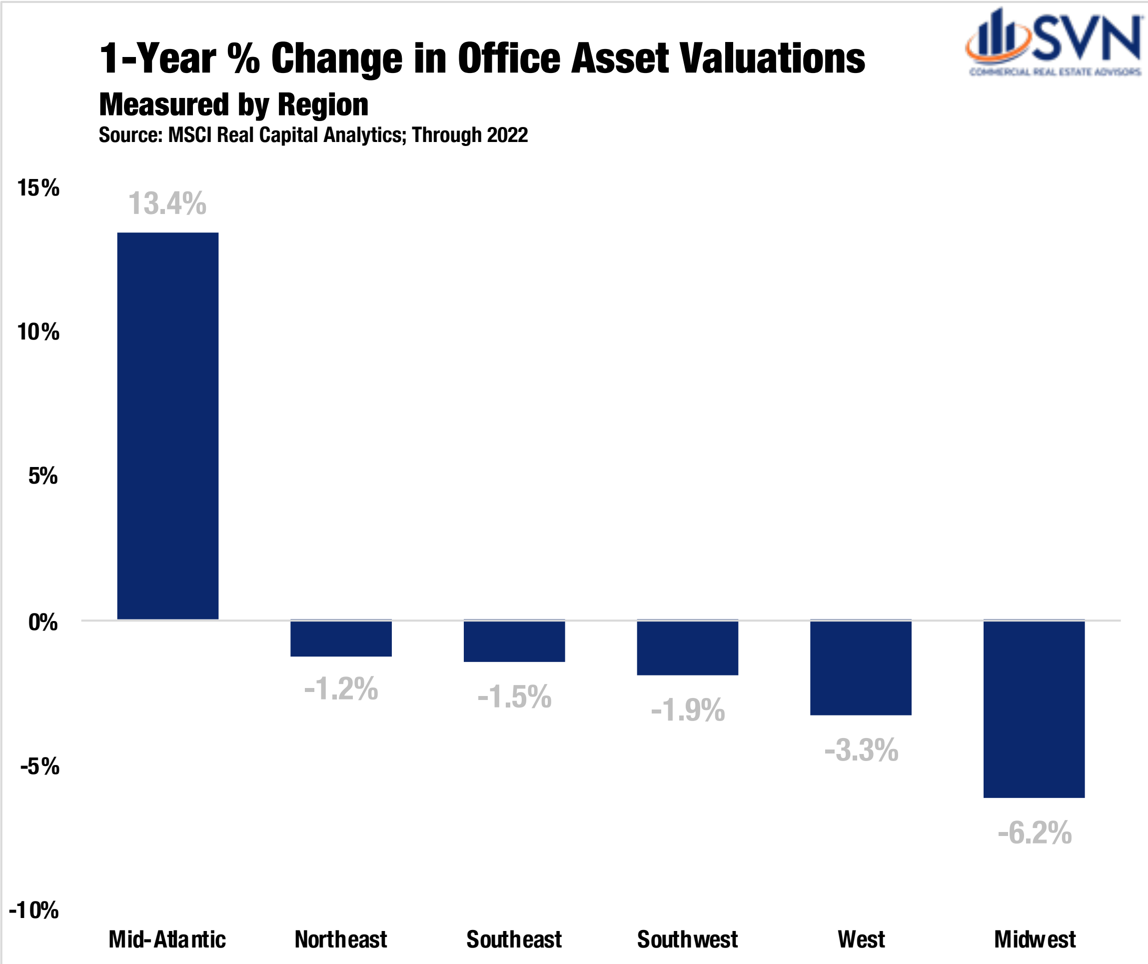
In developing the regional office rankings, the SVN Research Team utilized a scoring matrix. The matrix offers a comprehensive view of how regional markets are performing within the context of growth from a year earlier, as well as compared to before the pandemic. The **eight following criteria** were included in the matrix:

1. Transaction Volume: 1-Year % Change
2. Transaction Volume: % Change Over Pre-Pandemic (2019)
3. Share of US Transaction Activity: 1-Year Change
4. Share of US Transaction Activity: Change Since Pre-Pandemic
5. Cap Rates: 1-Year Change
6. Cap Rates: Change Since Pre-Pandemic
7. Pricing: 1-Year % Change
8. Pricing: % Change Over Pre-Pandemic

2023 Regional Market Rankings: Office

Source: SVN Research, MSCI Real Capital Analytics; Through 2022

Rank	Region
1	Mid-Atlantic
2	Southeast
3	Midwest
4	Southwest
5	Northeast
6	West



TOP PERFORMERS: MID-ATLANTIC

The Mid-Atlantic, which is anchored by the likes of Washington DC, Baltimore, Philadelphia, and Pittsburgh, came out as the top-ranking region for 2023, driven primarily by a recent burst of price growth. No region saw more office sector asset appreciation in 2022 than the Mid-Atlantic, where **prices gained 13.4% last year**.

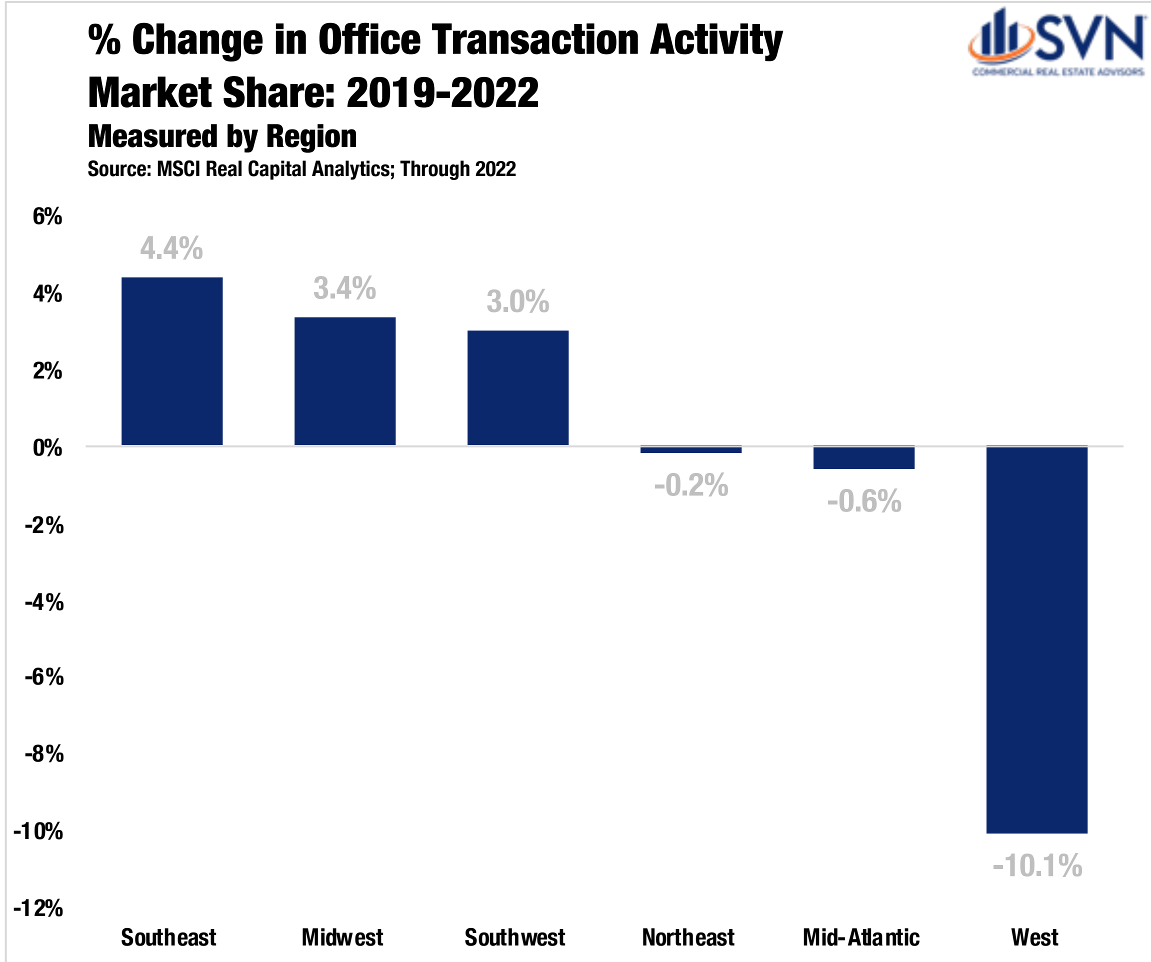
Moreover, the Mid-Atlantic was the only region to see any price growth at all, as valuations sank year-over-year in all other parts of the country. Recent cap rate trends also have the Mid-Atlantic standing apart from the pack.

The Mid-Atlantic saw more cap rate compression than any other area in 2022 and was one of only two regions to see compressing average cap rates last year. Further, compared to three years ago, office cap rates in the Mid-Atlantic have come down by a national-best 80 basis points.

TOP PERFORMERS: SOUTHEAST

The Southeast pops up as a top-performing region again, which is hardly a surprise. The region continues to attract firms and workers that are ready to ditch costly office markets in favor of lower prices per square foot, lower tax bills, and an average temperature bump.

Over the past three years, no region has seen a bigger uptick in transaction activity market share. Between 2019 and 2022, the Southeast went from 12.7% of transaction activity by dollar volume to 17.2% — a 4.5 percentage point step-up.



Office prices are also up the most in the Southeast compared to any other region over the past three years. Compared to 2019, office valuations in the Southeast are up by 17.0% — narrowly beating the Mid-Atlantic and Southwest for the title.

About SVN®

SVN International Corp. (SVNIC), a full-service commercial real estate franchisor of the SVN® brand, is one of the industry's most recognized names based on the annual Lipsey Top Brand Survey. With over 200 locations serving 500 markets, SVN provides sales, leasing, corporate services and property management services to clients across the globe. SVN Advisors also represent clients in auction services, corporate real estate, distressed properties, golf & resort, hospitality, industrial, investment services, land, medical, multifamily, office, retail, self-storage and single tenant investments. All SVN offices are independently owned and operated.

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