

Adaptive Spaces

Prime Office Buildings Benefit from New Working Patterns & Tenant Preferences

VIEWPOINT

The gulf between prime and non-prime office market performance is expected to widen amid a continued flight to quality and a slowdown in new prime construction.

CBRE RESEARCH
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Executive Summary

- CBRE Research and CBRE Econometric Advisors have compiled a dataset of highly desired prime office buildings,¹ representing 8% of total U.S. office space by square footage and 2% by building count.
- There is a growing divide in the U.S. office market between the performance of prime and non-prime buildings. The prime office vacancy rate was 14.8% in Q1 2024—4.5 percentage points lower than the non-prime vacancy rate. Prime buildings had positive net absorption of 49 million sq. ft. from Q1 2020 to Q1 2024, while non-prime buildings had negative net absorption of 170 million sq. ft.
- In most markets, the availability of prime space is below market averages. Based on the strong preleasing of the current prime construction pipeline and projected demand, prime vacancy is expected to return to its pre-pandemic rate of 8.2% by no later than 2027.
- As of Q1 2024, the average prime office asking rent was 84% above the average non-prime rent. Continued demand for prime space and a shrinking construction pipeline mean prime rents will continue rise and command a premium over non-prime space.
- The next tier of buildings after highly occupied prime space will likely benefit from overflow demand, especially in vibrant mixed-use districts.



2000 Avenue of the Stars, Los Angeles

¹ Prime office buildings are considered best in class in terms of design and offerings, with an emphasis on occupant productivity and well-being. They are typically newly constructed or extensively renovated and offer highly sought-after amenities, including ample parking, strong security measures, fitness centers, social lounges, outdoor spaces, coworking areas, diverse dining options, touchless technology and sustainability features. Prime buildings are strategically located in desirable neighborhoods and often near public transit or major thoroughfares, providing easy access to walkable amenities and supporting shorter commutes.



2121 N Pearl St, Dallas

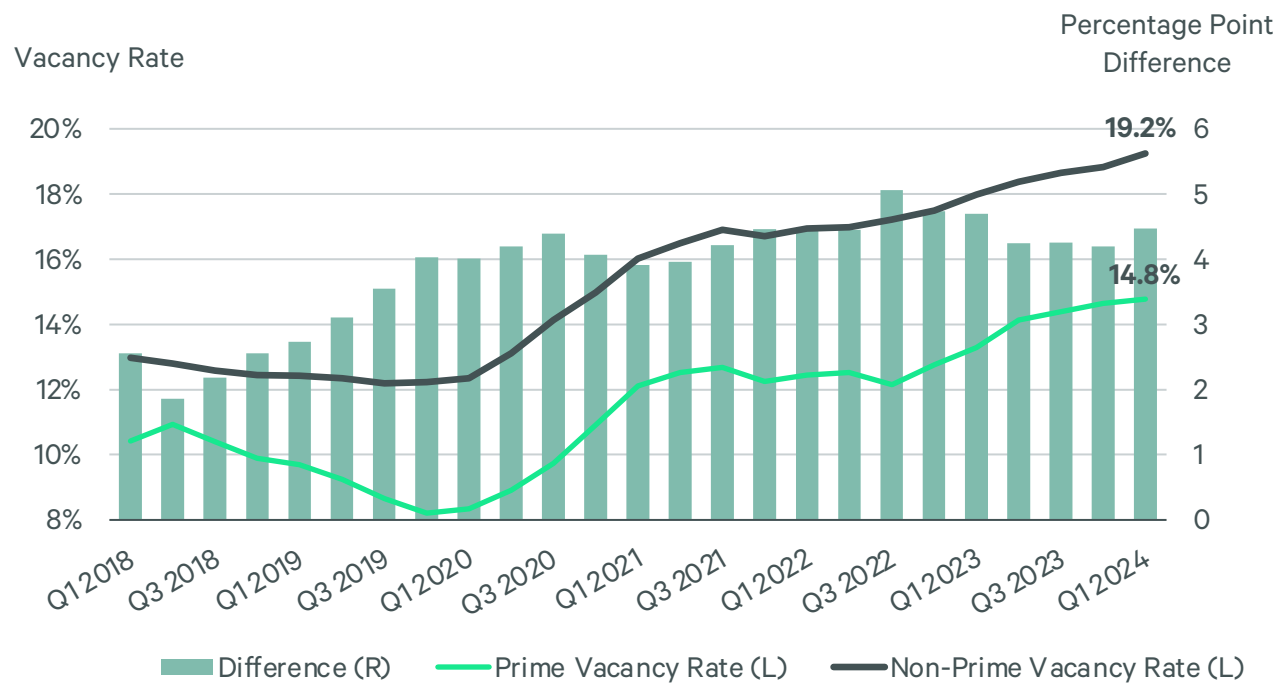
Prime vs. Non-Prime Office Market Performance

Despite office market turbulence, prime buildings remain attractive to occupiers willing to pay a premium for office accommodations that provide a better workplace experience and help in recruiting new talent.

CBRE Research and CBRE Econometric Advisors have created a dataset of 830 prime office buildings totaling 338 million sq. ft. across 57 U.S. markets. Prime buildings represent 8% of the total U.S. office space by square footage and 2% by building count. About 60% of these buildings were constructed in the past decade, while the rest have recently undergone extensive renovations. Prime buildings have quality design, wellness standards, a strong mix of amenities and are in walkable neighborhoods near retail and transit.

As they did before the COVID pandemic, prime buildings continue to have a much lower vacancy rate than non-prime buildings. The margin between the prime and non-prime vacancy rate increased from the recent low of 1.9 percentage points in Q2 2018 to 4.5 percentage points in Q1 2024. The margin between the two quality tiers is large despite a higher share of renewals since the pandemic (an average of 41% since Q1 2020 vs 31% between 2018 and 2019). As occupiers gain more clarity about the economic outlook and how hybrid work impacts their space needs, the share of renewals will decrease as more occupiers move to better quality space.

Figure 1: Prime vs. Non-Prime Office Vacancy Rate



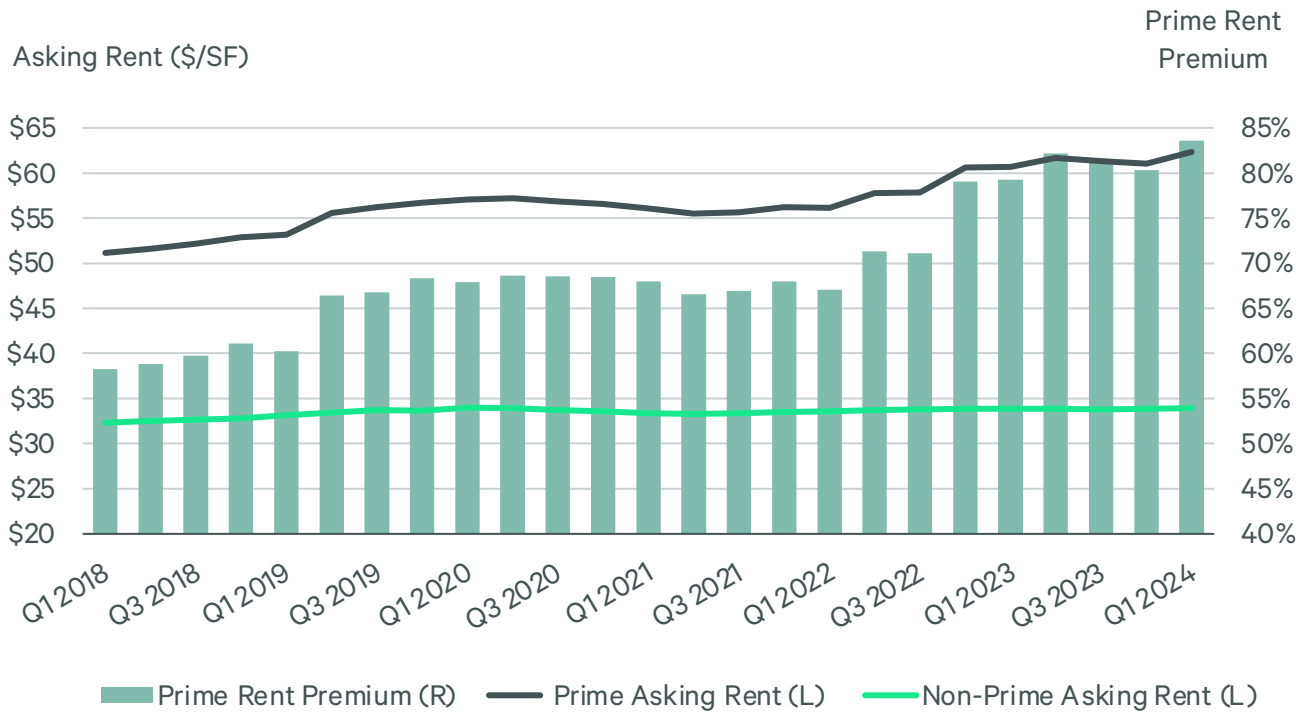
Source: CBRE Econometric Advisors, CBRE Research, Q1 2024.

The rent premium for prime office space also increased from 60% in Q2 2018 to 84% in Q1 2024. The outperformance highlights the divide between prime and commodity office space due to occupiers' flight to quality amid widespread adoption of hybrid office work.



1700 M Street NW, Washington, D.C.

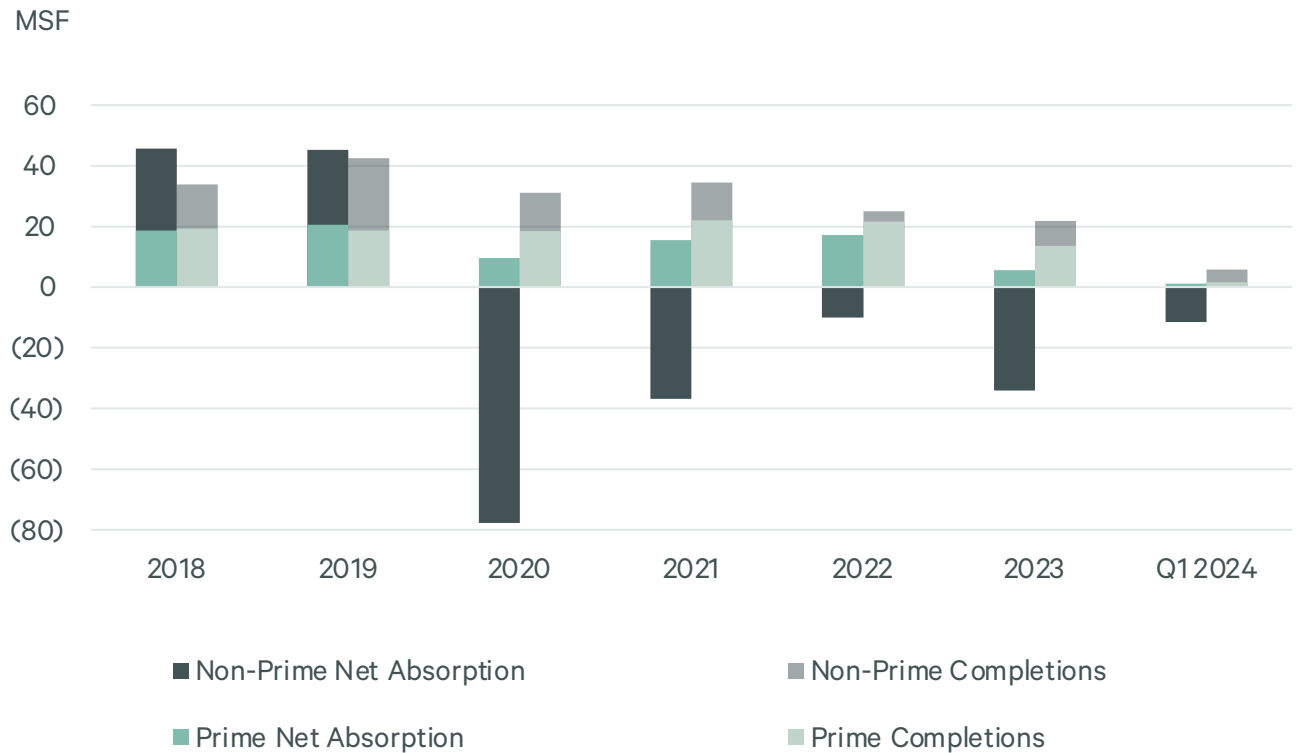
Figure 2: Prime vs. Non-Prime Office Asking Rent



Source: CBRE Econometric Advisors, CBRE Research, Q1 2024.

Nearly 60% of respondents to CBRE's latest Office Occupier Sentiment Survey are considering relocating to higher-quality space. The most sought-after feature is proximity to public transit stations for ease of commute. Prime buildings also are seen as more likely to help companies meet their sustainability goals. Twenty-one percent of survey respondents say they would pay a premium for space in green-certified buildings, while 18% would reject buildings without such a certification.

Occupiers are finding that workplace quality is more important than ever, as cited by two-thirds of respondents to [CBRE's Global Live-Work-Shop Survey](#). Prime buildings have recorded 48 million sq. ft. of positive net absorption from Q1 2020 to Q1 2024, while non-prime buildings recorded 170 million sq. ft. of negative net absorption. As tenants adjust their portfolio strategy to more flexible working patterns, we expect this preference for high-quality office space will endure.

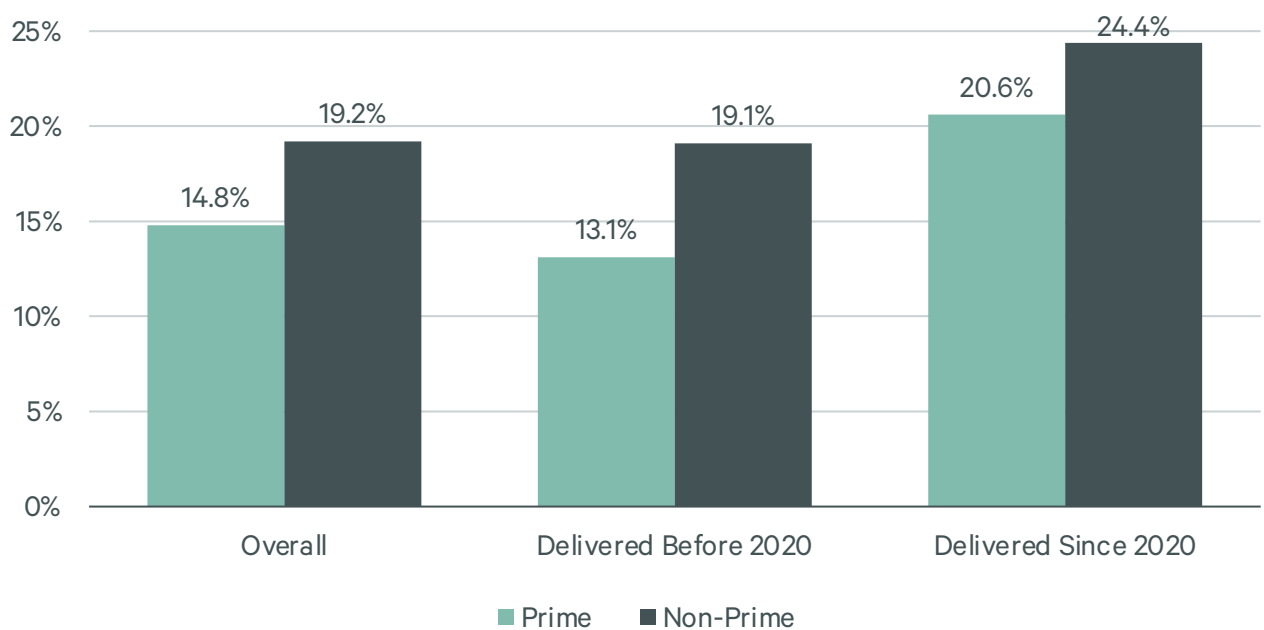
Figure 3: Prime vs. Non-Prime Supply & Demand

Source: CBRE Econometric Advisors, CBRE Research, Q1 2024.

Regardless of their quality, new office buildings have leased up more slowly than before the pandemic amid structural and cyclical challenges over the past four years that have reduced demand for office space. However, even among newly delivered prime buildings, the average vacancy rate (20.6%) was lower than that of non-prime buildings (24.4%). Markets with the biggest increases in new prime supply since the pandemic and tech-heavy markets like Austin, Nashville, San Jose are the biggest contributors to the overall prime office vacancy rate of 14.8%. However, we view this as a short-term issue reflecting cyclical weakness rather than a structural issue.



767 Fifth Avenue, Manhattan

Figure 4: Prime vs. Non-Prime Office Vacancy Rate by Age

Source: CBRE Econometric Advisors, CBRE Research, Q1 2024.

Prime Space Will Become More Scarce

Tenants searching for the best space will face limited options due to a sharp drop in new prime deliveries beginning in 2025.

Approximately 22 million sq. ft. of prime office space was under construction in Q1 2024, with completion dates extended through 2027. This under-construction total equals the total amount of prime office completions in 2021 alone. Half of the prime space currently under construction—most of which is scheduled for delivery this year—is already preleased. Deliveries will slow to just 4 million sq. ft. in 2025, less than a quarter of the pre-pandemic average annual total.

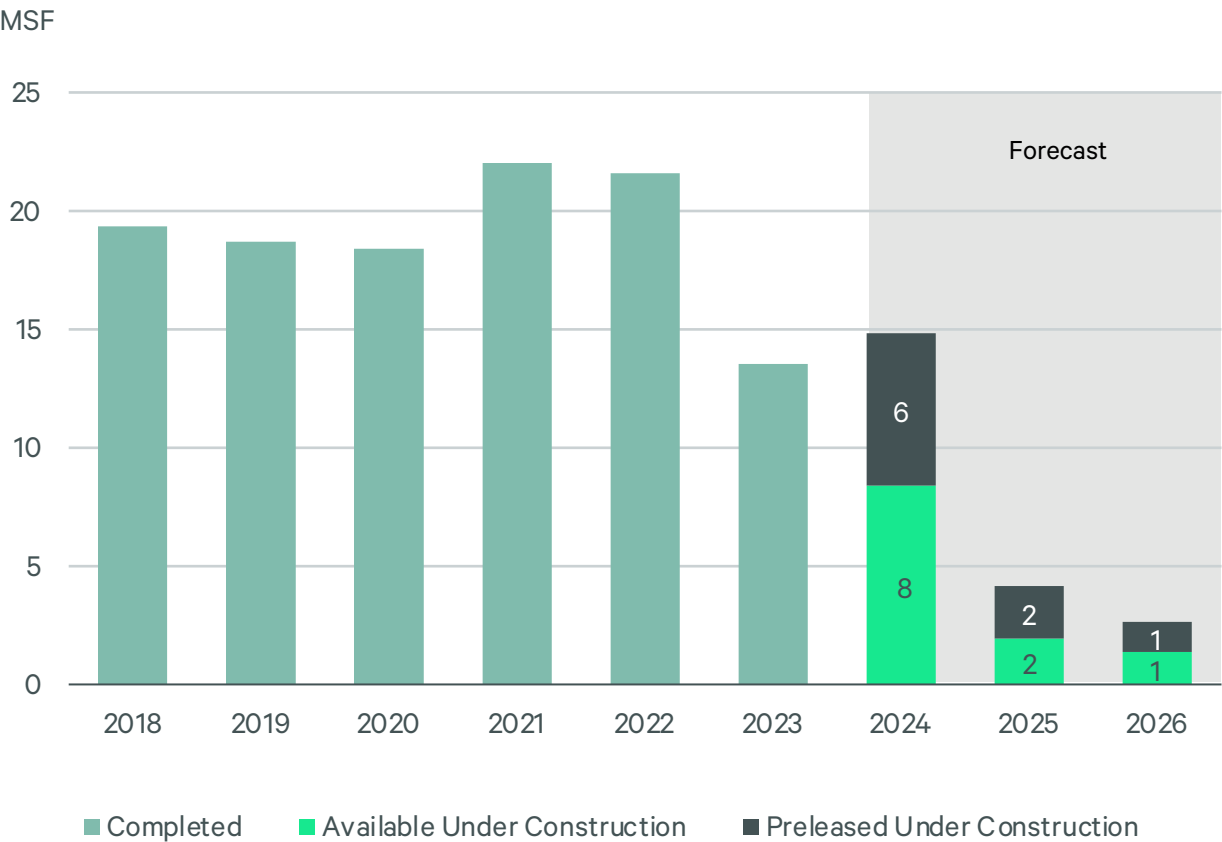
Assuming that average annual prime space absorption remains near 12 million sq. ft., based on average annual totals from 2020 to 2023, the prime vacancy rate would fall to its pre-pandemic average of 8.2% by 2027. We believe that this absorption estimate is conservative, and the prime vacancy rate could return to its pre-pandemic level sooner given continued job growth and a smaller share of renewals as the economy improves over the next year. While that is a nationwide estimate, some markets and micro-markets will reach that point earlier than others, in part based on their varying supply of prime space.

Prime vacancy is forecast to fall to its pre-pandemic rate by 2027.



3550 Peachtree Rd. NE, Atlanta

Figure 5: Prime Completions



Source: CBRE Econometric Advisors, CBRE Research, Q1 2024.

Of the 57 U.S. office markets tracked by CBRE, 20 had less than five prime buildings, while 15 markets had five to nine prime buildings and 22 markets had 10 or more prime buildings.

Among downtown markets, 65% of those tracked by CBRE had a lower prime office vacancy rate than their overall downtown rate. Downtown San Francisco, Washington, D.C. and Denver had more than a 10-percentage-point gap between their prime office vacancy rate and their overall downtown rate.

Figure 6: Downtown Prime vs. Overall Downtown Vacancy Rate by Select Market

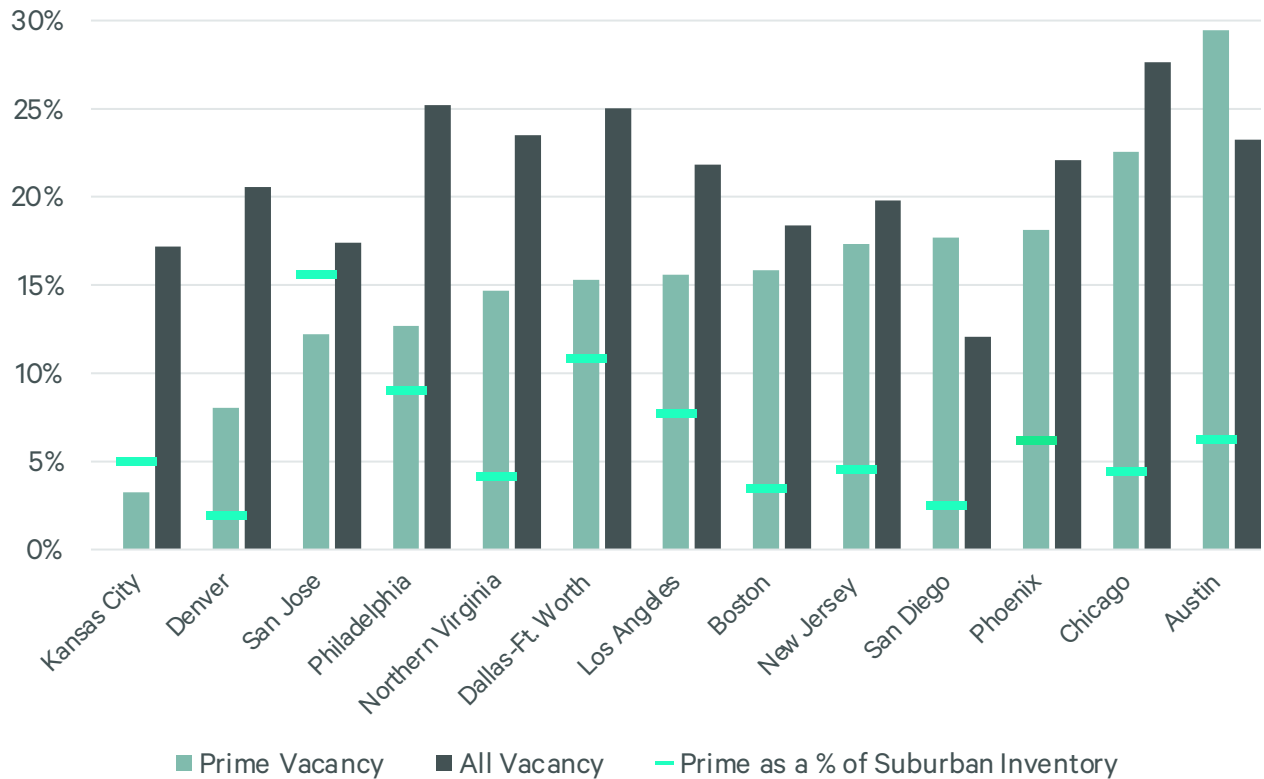


Note: markets with more than 10 downtown prime buildings.
Source: CBRE Research, Q1 2024.

Similarly, 73% of the suburban markets tracked by CBRE had a lower prime office vacancy rate than their overall suburban office rate. Suburban Philadelphia, Kansas City and Denver had more than a 10-percentage-point gap between their prime office vacancy rate and their overall suburban rate.



1001 Boylston Street, Boston

Figure 7: Suburban Prime vs. Overall Suburban Vacancy Rate by Select Market

Note: markets with more than 10 suburban prime buildings.

Source: CBRE Research, Q1 2024.

Markets in which prime office space has not outperformed were mainly affected by either the tech industry slowdown (Seattle, San Diego and Midtown-South Manhattan) or a sizable increase in new prime completions or renovations (Midtown-South Manhattan and Austin).

Available prime office space is dwindling in select markets. For example, Kansas City's prime office vacancy rate is only 3.3% compared with its overall rate of 17.9%. Midtown Manhattan's prime office vacancy rate stands at 11.4% vs. Manhattan's overall vacancy rate of 15.6%. And in Dallas, the prime office vacancy rate is 14.5% vs. an overall rate of 25.8%.

Opportunities for Landlords & Tenants

As prime space availability tightens, demand will likely overflow to the next quality tier of buildings. Those near prime buildings could benefit from this spillover if their owners invest in more in-demand amenities. CBRE's 2024 Occupier Sentiment Survey found that the most sought-after building amenities included top-rated indoor air-quality equipment, electric vehicle charging stations, ample parking and/or bicycle storage space, shared meeting space, tech-enabled building controls and sustainability features.

Tenants who are nearing lease expiration and plan to relocate to higher quality space should consider starting their search early due to shrinking prime space availability. An early search also could help tenants lock in more favorable lease terms and rates.

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