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Raleigh-Durham Office Insight Report

Q3 2021

AVANT by AVISON YOUNG

Key takeaways

Economic conditions

- The Triangle's unemployment rate has dropped from a high of 12.0 percent in May of 2020 to **4.0 percent** in July 2021. Over the course of the pandemic's recovery, employment has grown 17.1 percent since April 2020.
- Office-using job losses have totaled **2.4 percent** compared with 1.6 percent for other industries' job losses. Raleigh-Durham's professional and business services sector gains have surpassed pre-pandemic levels, rebounding by 14.6%.

Recovery

- The Triangle's access to talent, employment and education continue to provide key fundamentals for market recovery.
- Adding to the impressive list of expansions and job wins the Triangle has been awarded since the pandemic, **Fidelity** will add another **1,538 jobs** in Research Triangle Park. This will mark the financial services giant's third expansion this year.
- Raleigh-Durham ranks **#1** in the U.S. for real estate prospects in 2021 by the Urban Land Institute.

Office demand

- Demand is beginning to rebound as YTD 2021 leasing activity reached **2.2 msf** in the Triangle.
- The "flight to quality" trend continues, with the Class A segment accounting for **75.8 percent** share of post-COVID leasing activity.
- In the largest deal of the quarter, Cree LED will lease **89,167** of Class A office space at Park Point. Park Point is a 100-acre adaptive re-use office and life science campus that is currently under construction in Research Triangle Park.

Key takeaways

Office supply

- Total office vacancy continues to increase, reaching **15.1 percent**, up 350 bps year-over-year.
- The sublease market continues to strain aggregate fundamentals as the total amount of vacant sublease space rose to **2.0 msf** in the third quarter.
- Alexandria Center for Advanced Technologies at 8 Davis Drive delivered in Q3 2021. The **117,855-sf** building is **52% preleased** and is part of the highly amenitized 1msf life science campus currently underway in Research Triangle Park. The campus offers turnkey lab, office space, and collaboration spaces.

Pricing trends

- Overall asking rents in the Triangle continue to increase, rising **2.8 percent** year-over-year to end the third quarter at **$29.26 psf**.
- New construction and recent delivery of Class A product continues to support rents in the segment. Class A asking rents ended the quarter at **$31.08 psf**, up **2.1 percent** from the previous year.

Capital markets

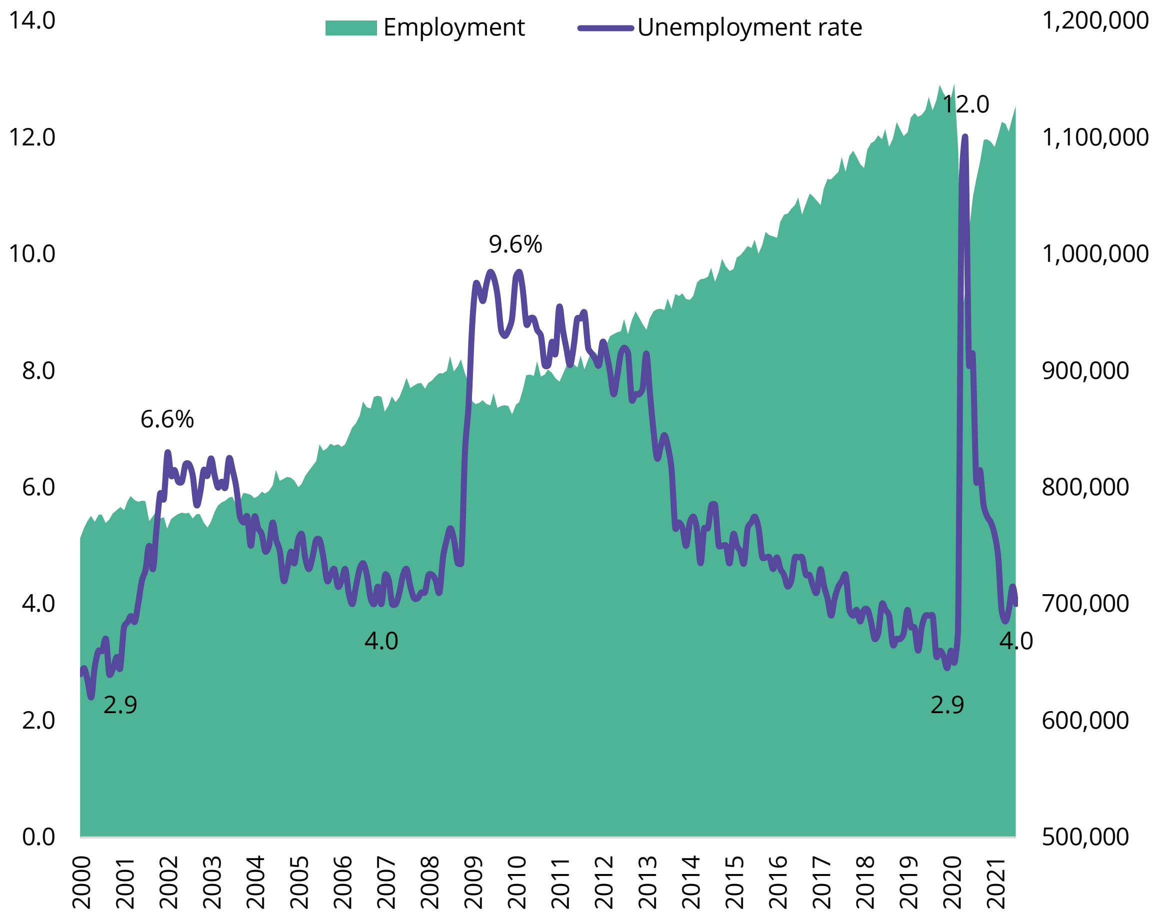
- Trailing-12-month sales volume totaled **$1.0B**, an annualized decrease of **32 percent** compared with the five-year average.
- Asset pricing in the office sector has softened by **11.7 percent** since 2019, resulting in an average of **$225 psf** in the Triangle.
- Cap rates were reported at **6.2 percent** at the close of the quarter, down **20 bps** since 2Q21. Private investors continue to dominate, representing **63.5%** of total buyer composition.

Employment and unemployment rate

4.0%

Raleigh-Durham unemployment rate as of July 2021

The Triangle's economy has rebounded significantly since unemployment reached a pandemic high of 12% in May of 2020. Employment rolls have grown by over 177,000 since April 2020, recovering nearly 90% of job losses incurred during the pandemic.



Note: Not seasonally adjusted data.
Source: Bureau of Labor Statistics, Combined Statistical Area

Office-using job gains and losses

-2.4%

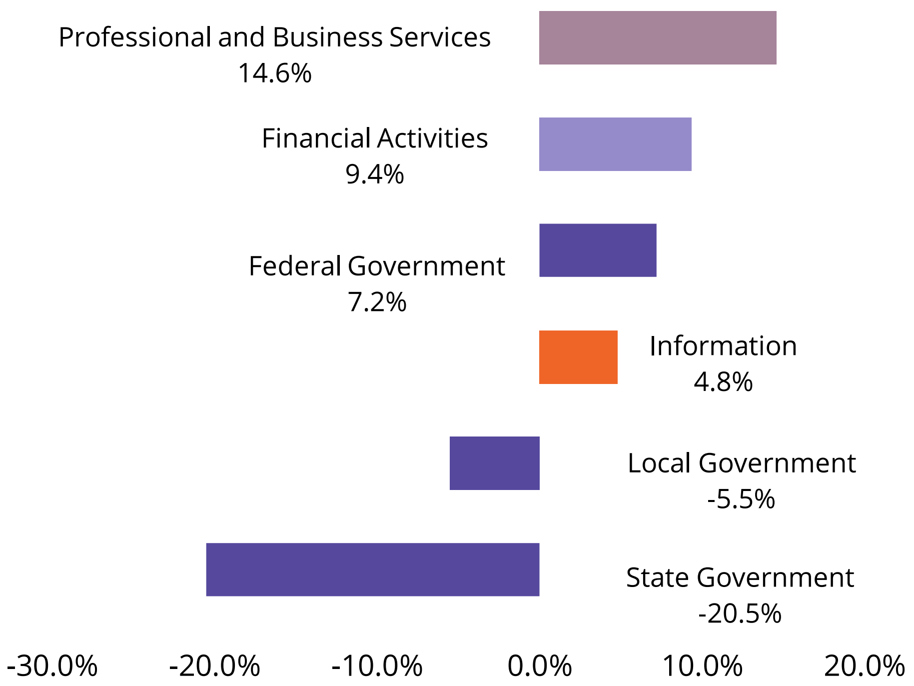
Change in office-using employment from February 2020 to July 2021

Raleigh-Durham's overall employment base has declined by 1.6% since February of 2020, while office-using jobs contracted by 2.4%. The most notable gain in office-using jobs was in the professional and business services industry which rebounded by 14.6%.

VIEW DASHBOARD

Total change in Raleigh-Durham MSA* job gains/(losses)

February 2020 to July 2021



Note: Not seasonally adjusted data. Combined Metropolitan statistical area.
Source: Bureau of Labor Statistics

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U.S. return-to-work rates since start of COVID

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-72.3%

Average office visitor volumes across U.S. gateway cities, March 2, 2020 vs. September 20, 2021

Return-to-work efforts across cities have been influenced by governmental regulations (informed by infection and vaccination rates), office-using industry composition and employees’ reliance on mass transit.

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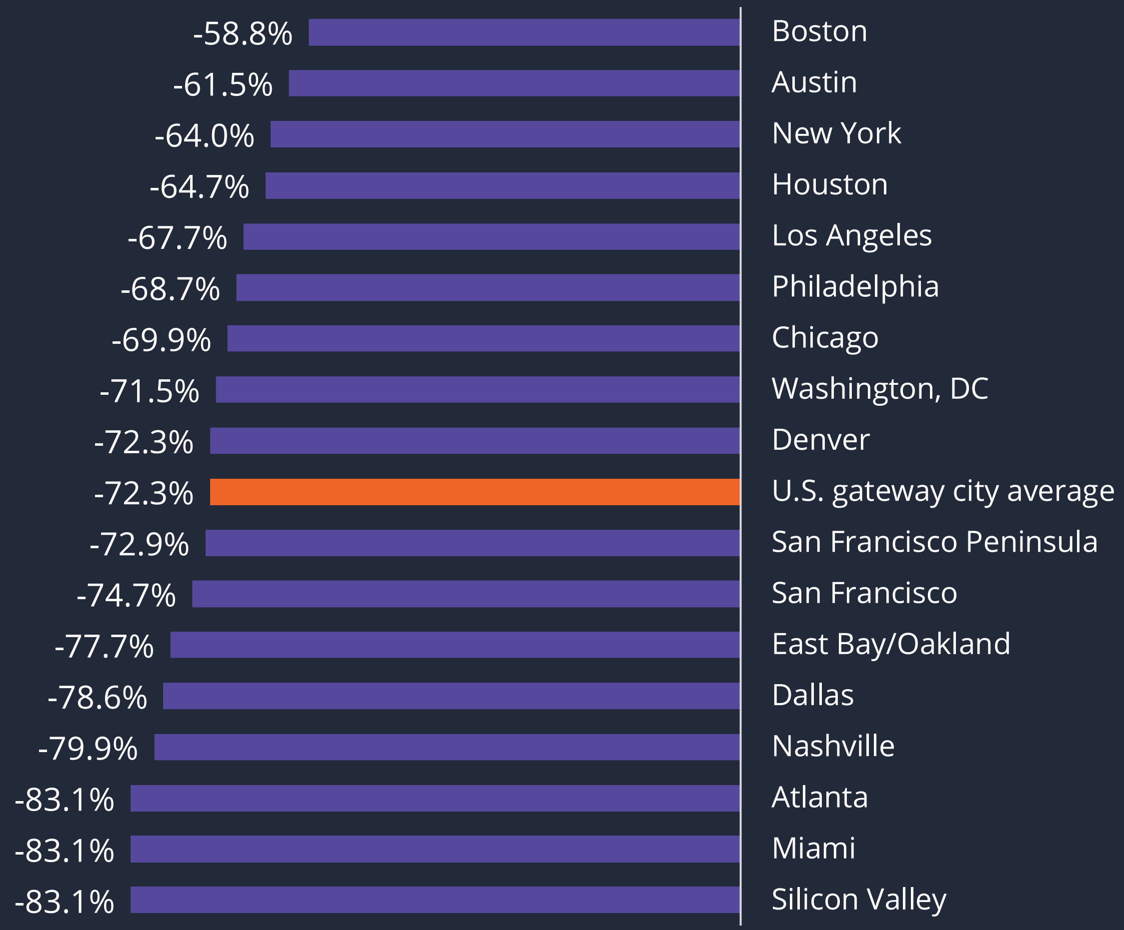

Note: Representative full-building office occupiers only. Weekdays only. Data as of September 20, 2021.
Source: Orbital Insight, AVANT by Avison Young

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U.S. return-to-work rates since start of COVID

-76.9%

Average tech office visitor volumes across U.S. gateway cities, March 2, 2020 vs. September 20, 2021

Tech companies have adopted remote work strategies more than most major office-occupying industries, while life sciences and real estate companies have embraced flexible in-office and remote working arrangements.

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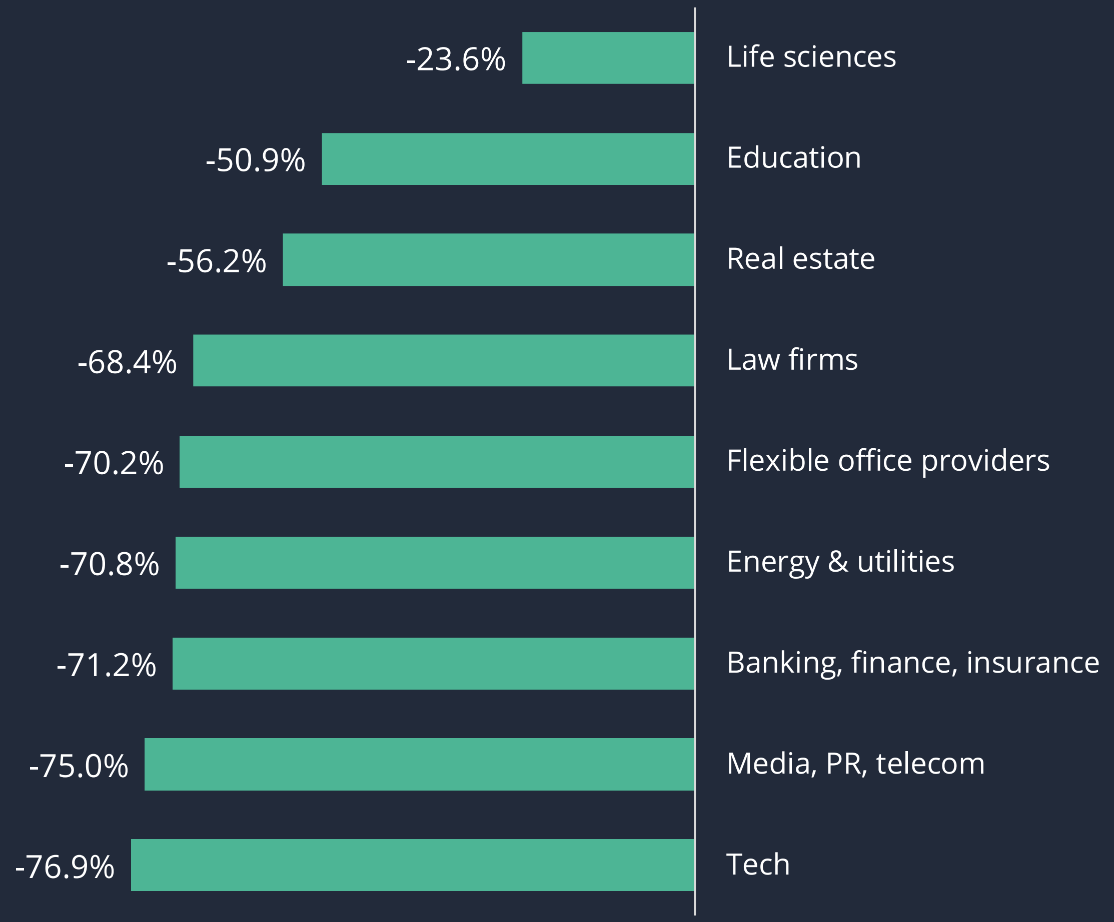

Note: Representative full-building office occupiers only. Weekdays only. Data as of September 20, 2021.
Source: Orbital Insight, AVANT by Avison Young

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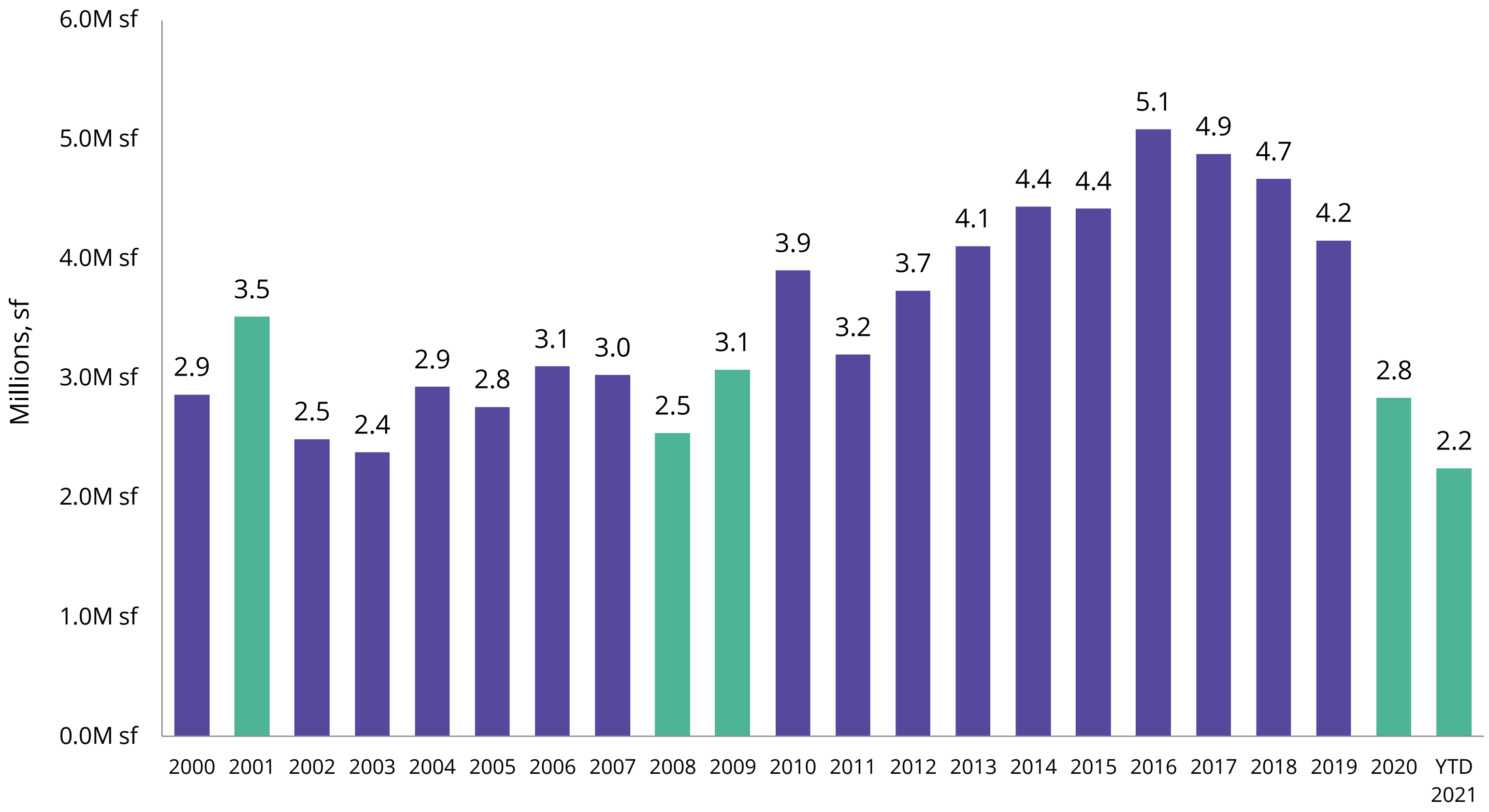
Office leasing activity

2.2 msf

YTD 2021 leasing activity



Leasing activity is beginning to show signs of life after declining in the first half of 2021. YTD 2021 leasing activity reached 2.2 msf, yet the annualized pace of closed deals remains feeble.

Source: AVANT by Avison Young

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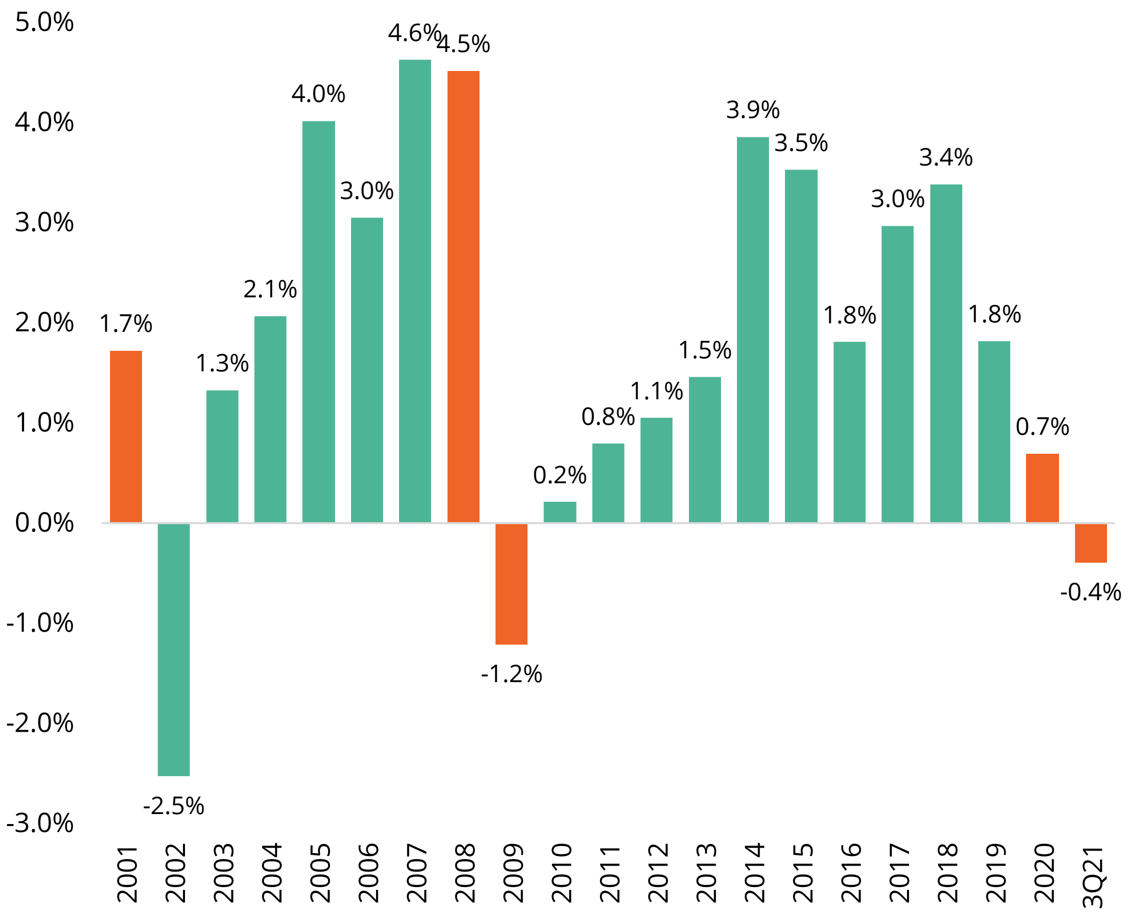
Absorption

0.3%

Net absorption as a percentage of inventory, 2020 through Q3 2021

Net absorption from 2020 to Q3 2021 has totaled just over 139,000 sf, resulting in 0.3% of the existing inventory. Net absorption is expected to inch upward by the end of 2021 with the delivery of new supply and increased demand over the summer months.



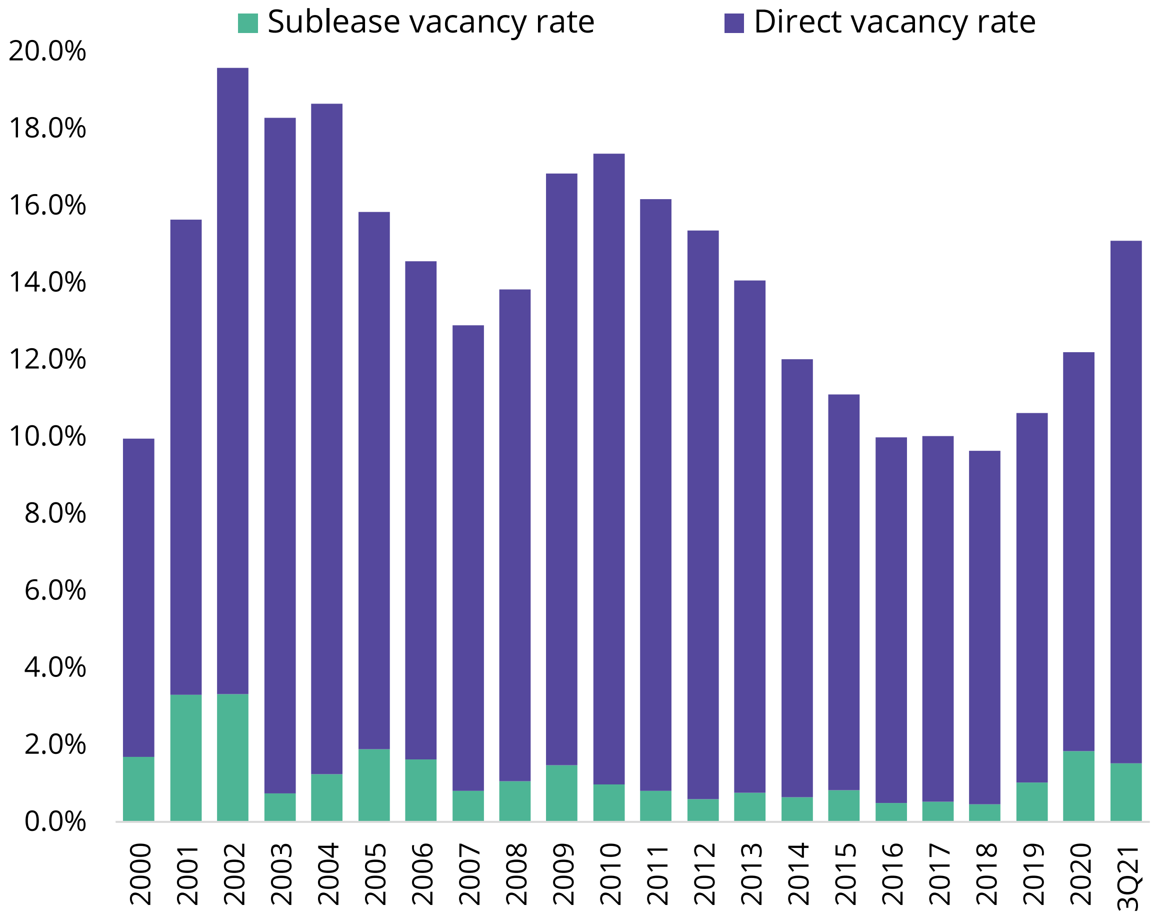
Source: AVANT by Avison Young

Vacancy rate

15.1%

Total vacancy as of Q3 2021

Raleigh-Durham's total vacancy rate reached 15.1% in 3Q 2021, while the sublease vacancy rate increased by 40 bps year-over-year. The rise in direct and sublease vacancy is not only attributed to tenant retractions, but also a significant amount of new product that has delivered year-to-date (1.6 msf).



Source: AVANT by Avison Young

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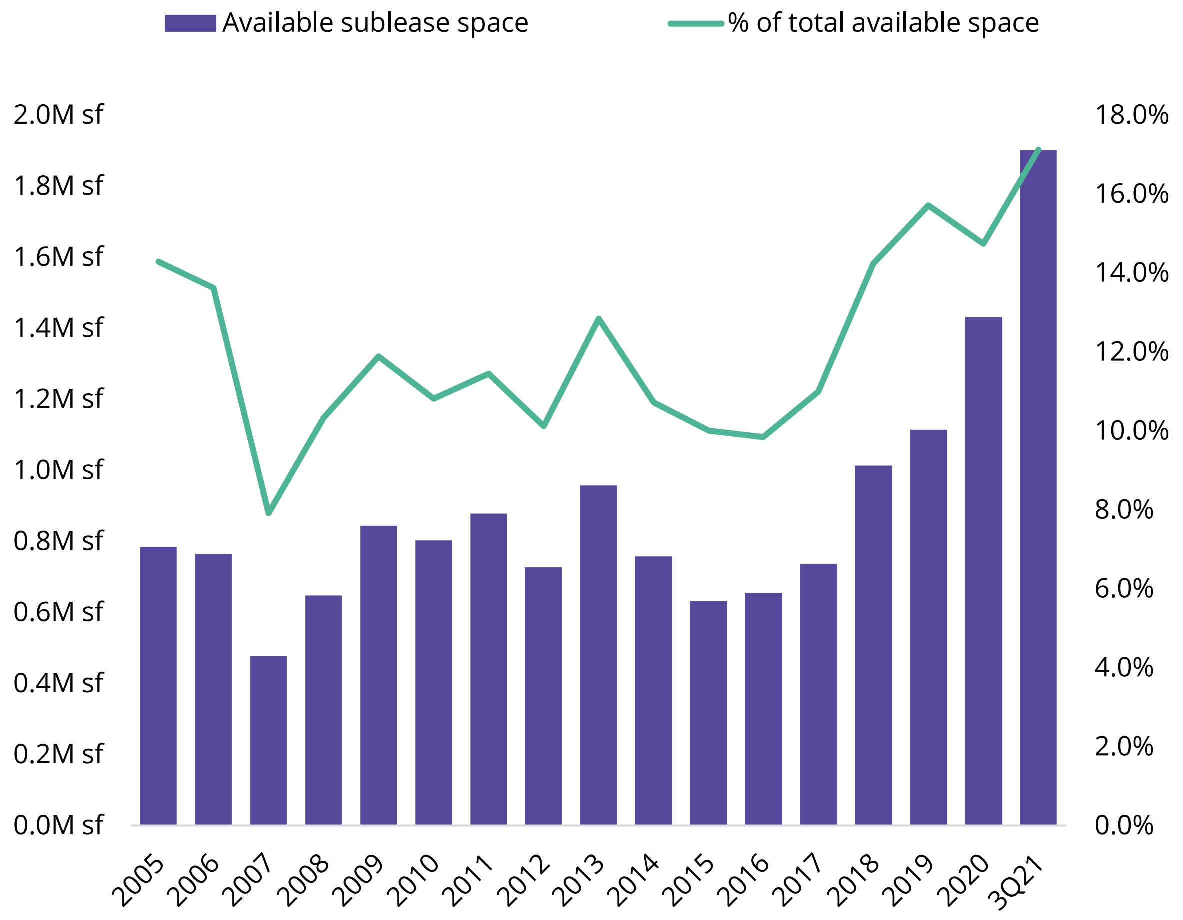
Available sublease space

1.9 msf

Available sublease space

Available sublease space spiked to 1.9 msf in Q3 2021, pushing the share of sublease-to-total vacant space to 17.1%. Return-to-work strategies during the first half of the year slowed during the third quarter as more employers are embracing a hybrid work environment.



Source: AVANT by Avison Young

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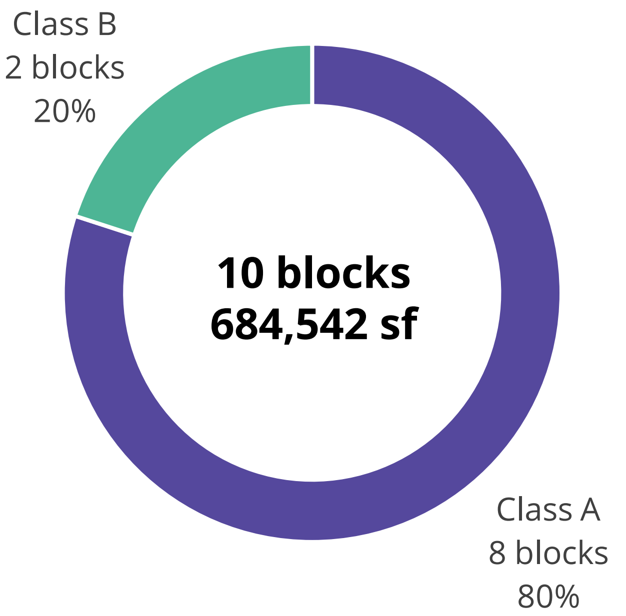
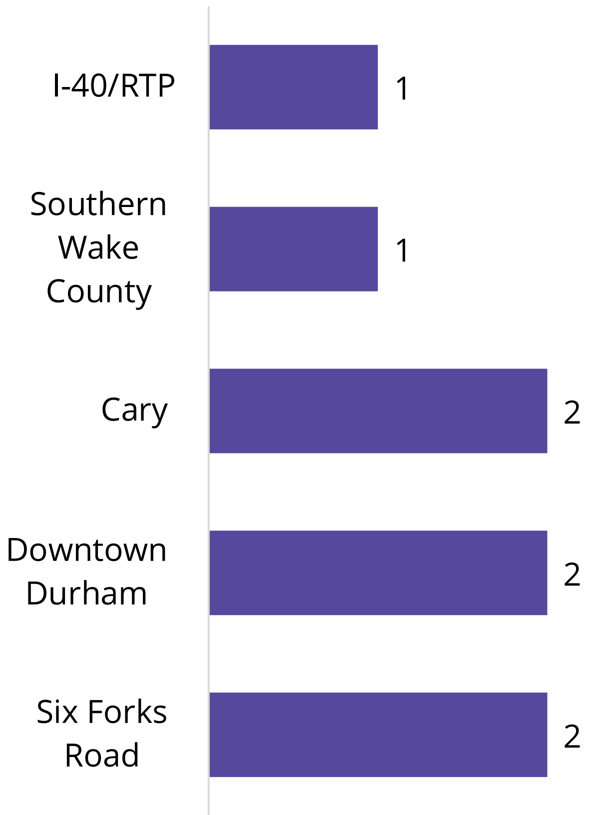
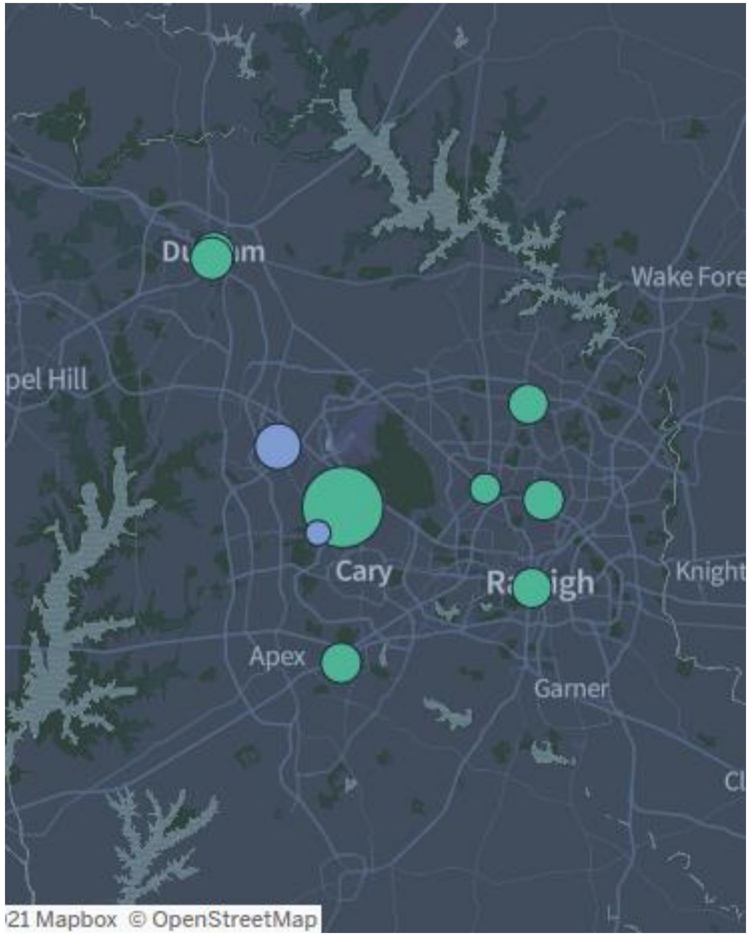
Sublease supply pipeline

Building classification



Submarket availability by total size (sf)





Source: AVANT by Avison Young

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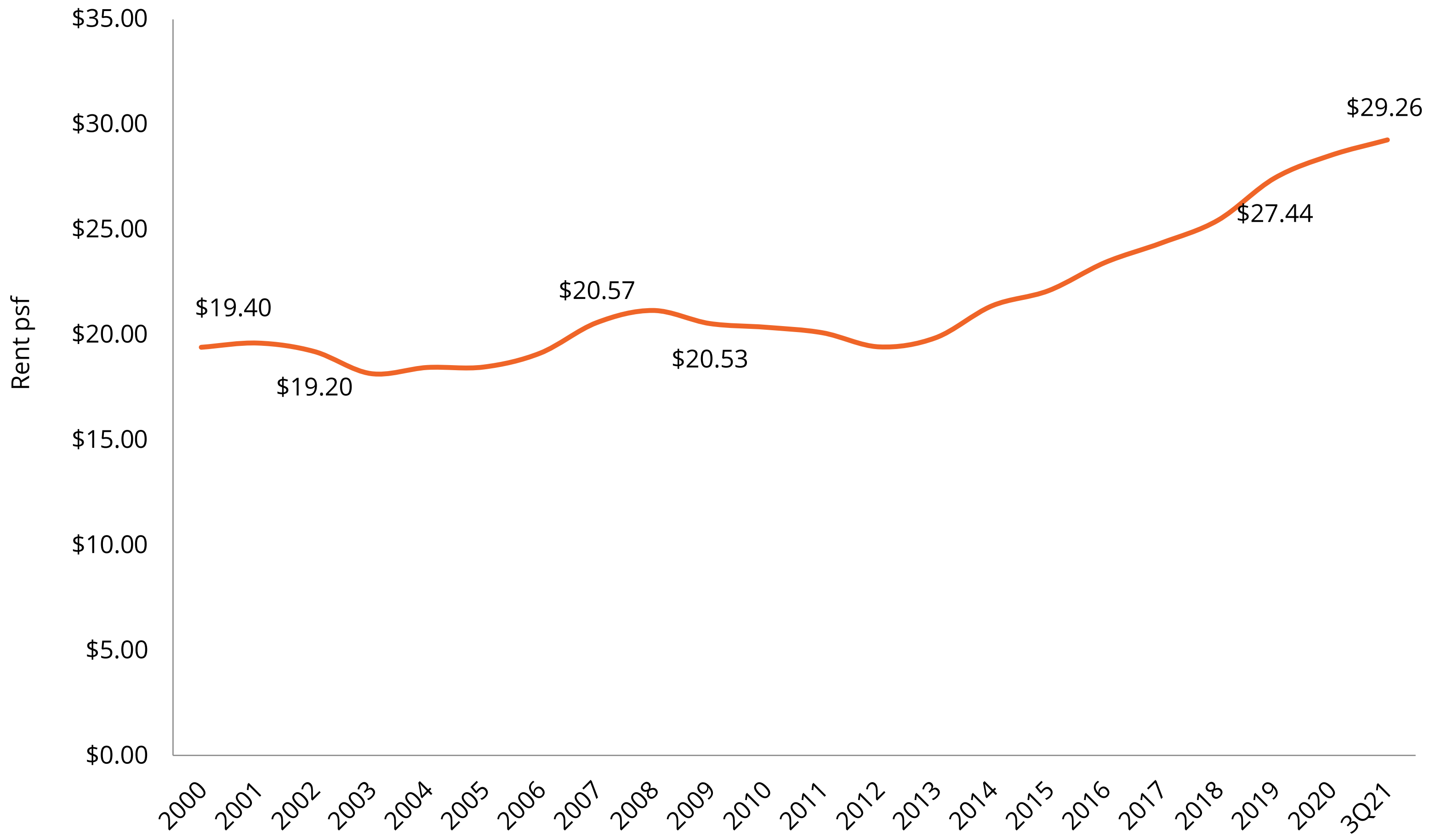
Base rents

2.8%

Average rent growth year-over-year

Triangle-wide rent growth slowed in the last 12 months but remains positive at 2.8%. Overall base rents reached $29.26 psf at the close of Q3 2021, up 1.4% from the second quarter.



Source: AVANT by Avison Young

Construction Pipeline

18 properties

under construction

2.1 msf

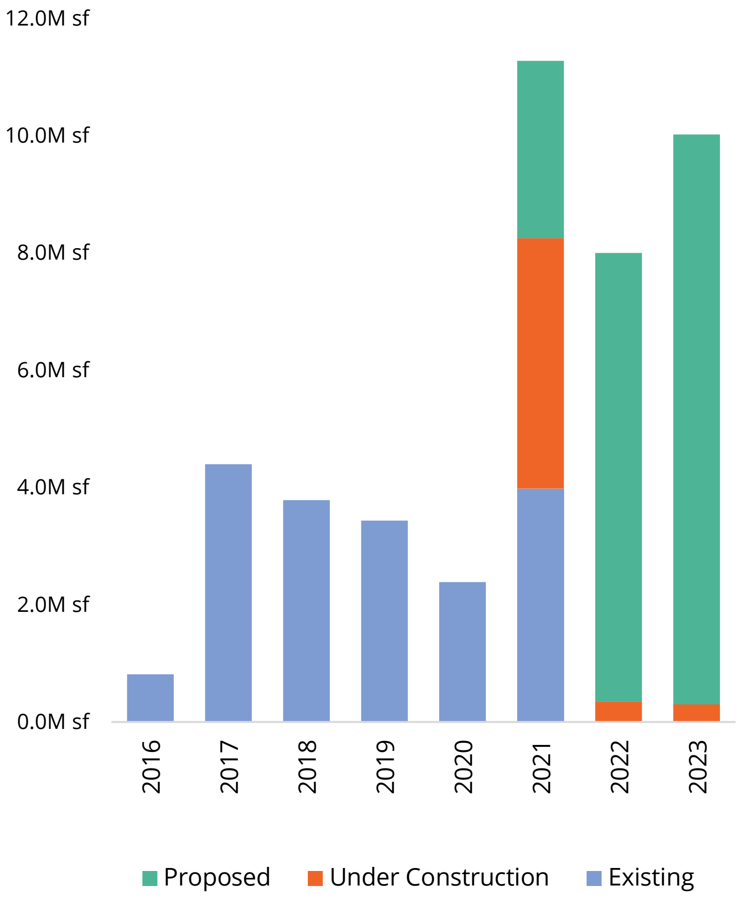
under construction

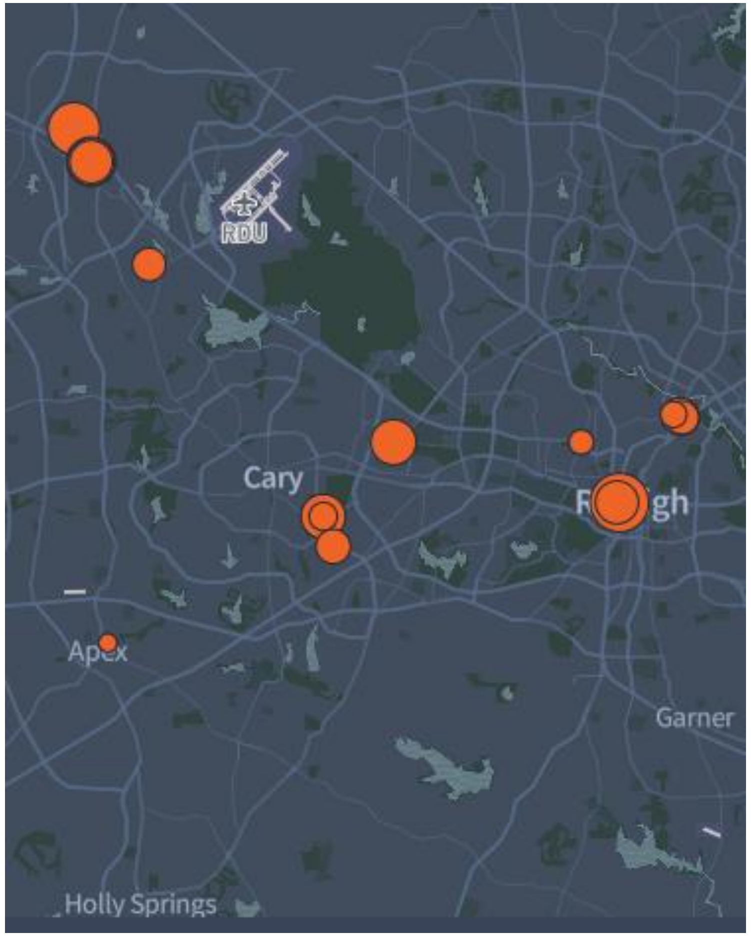
3.3%

share of office inventory

17%

preleased





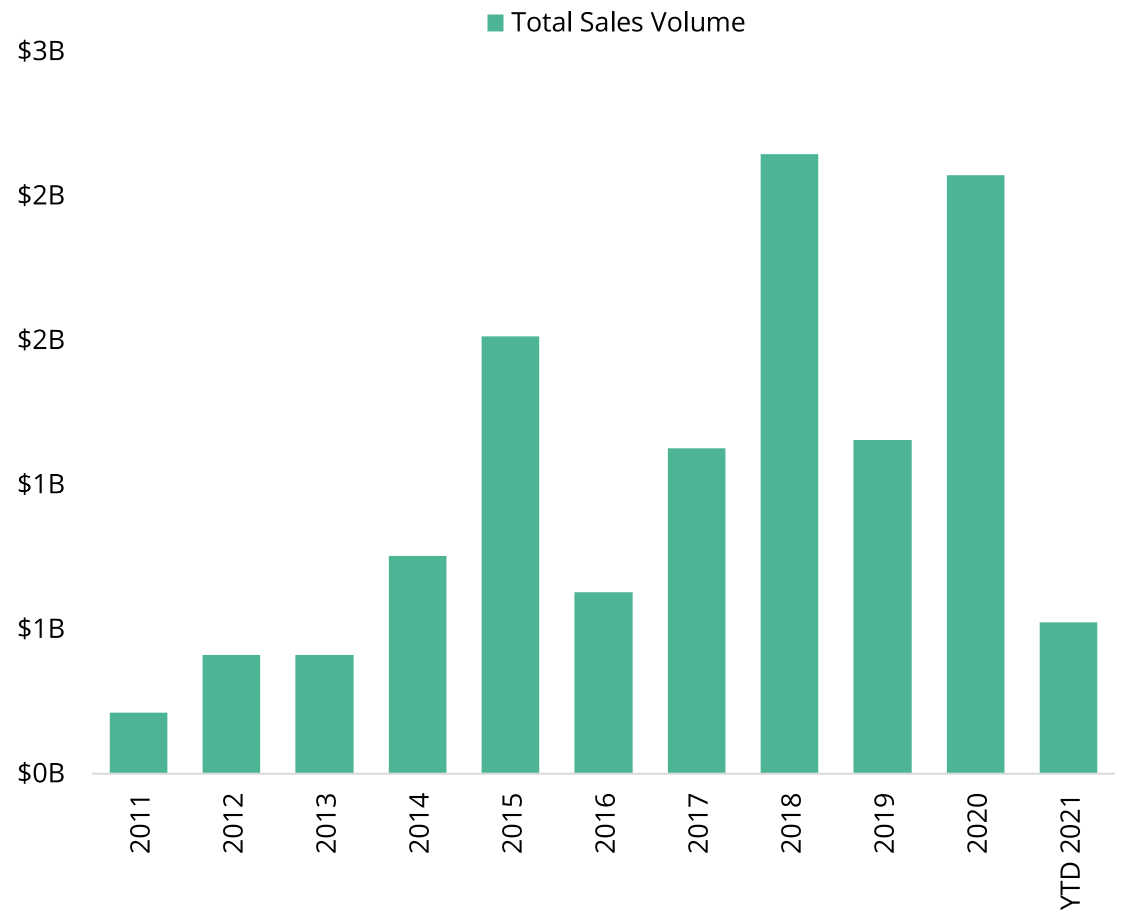
Source: AVANT by Avison Young

Office investment dollar volume

$2.6B

Office dollar volume 2020 to present

Trailing-12-month office sales totaled $1.0B, down 46% since the same time period in 2020. Ferncroft Capital's purchase of the 450,000-sf Wells Fargo building was the largest sale of the quarter at $63 million ($140 psf). Ferncroft Capital, out of Charlotte, NC, is a private investor with interests across 16 assets with an estimated value of $479M.



Source: AVANT by Avison Young, RCA

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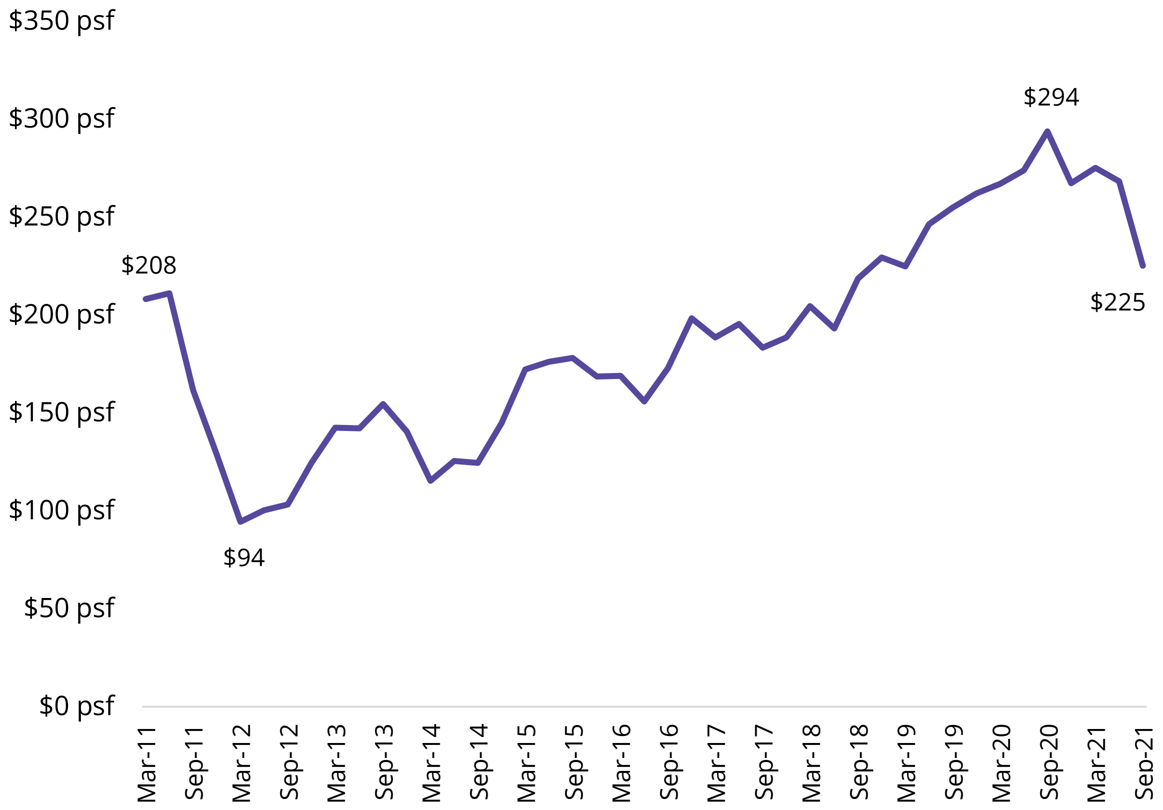
Office asset pricing

-11.7%

Office pricing from Q3 2019 to present

Pricing softened during the pandemic as investors have adopted more conservative underwriting approaches. As a result, asset pricing continued to trend downward at the close of 3Q21, decreasing 11.7% since Q3 2019.



Source: AVANT by Avison Young, RCA

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Looking forward

Here's what we can expect

- The Delta variant continues to test the anticipated arrival of office demand post Labor Day. **Tenant activity and interest have increased** but have yet to return to pre-pandemic levels. Companies will look to achieve a balance of retaining and attracting talent while maintaining cost savings in the near term.
- **Tenants can expect to hold leverage** in most lease negotiations, excluding top-of-market properties that have benefitted from flight-to-quality and ease-of-accessibility trends.
- Cap rates and asset pricing are expected to remain steady based on increased economic momentum and investors' renewed focus on core transaction profiles.

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Let's talk

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