The Outlook for the Leading U.S. Office Markets is Improving

The downturn in office market fundamentals continued in Q2 2021, but the pace of decline slowed. Net absorption was negative in all but one of the top 10 markets and vacancy rates rose in seven. Rents remain under pressure and are falling in four markets.

Asking rates across the 10 markets fell by an average of 0.8% in Q2 2021, with the greatest falls occurring in the San Francisco Bay Area (-3.1%) and Boston (-1.9%). Effective rents continue to decline across all markets due to increased incentives on offer.

While net absorption across the 10 markets in the second quarter was a combined negative 9.1 million square feet, out of a U.S. total of negative 18.6 million square feet, the pace of occupancy losses has slowed. Combined net absorption across the 10 markets was negative 24.4 million square feet in Q1 2021.

Manhattan once again dominated these occupancy losses, with 4.9 million square feet of negative net absorption, compared to negative 11 million square feet in the first quarter. Conversely, in Atlanta, absorption turned positive to the tune of 383,630 square feet. While absorption remained negative in the remaining eight markets, levels were lower in every market except Los Angeles.

<table>
<thead>
<tr>
<th>Metro Core Inventory (SF)</th>
<th>Core Submarkets Included</th>
<th>Absorption (SF)</th>
<th>Avg Rent ($) *</th>
<th>Vacancy Rate^</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manhattan 519,975,292</td>
<td>Manhattan Midtown, Midtown South, Downtown</td>
<td>-4,924,076 ▼</td>
<td>$72.79 ▼</td>
<td>9.7% ▲</td>
</tr>
<tr>
<td>Washington, D.C. 191,052,729</td>
<td>CBD (DC), East End (DC), Capitol Hill (DC), NoMa (DC), Capitol Riverfront (DC), Carlyle (DC), R-B Corridor (NOVA), Tysons Corner (NOVA), Bethesda (SubMD)</td>
<td>-522,228 ▼</td>
<td>$49.88 ▼</td>
<td>17.7% ▼</td>
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<tr>
<td>Chicago, IL 137,976,287</td>
<td>West Loop, Central Loop, River North, East Loop</td>
<td>-1,095,505 ▼</td>
<td>$42.79 ▼</td>
<td>16.8% ▲</td>
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<tr>
<td>Los Angeles, CA 118950122</td>
<td>Downtown Los Angeles, West Los Angeles, Tri-Cities</td>
<td>-1,575,631 ▼</td>
<td>$51.14 ▼</td>
<td>18.9% ▲</td>
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<tr>
<td>Houston, TX 118346543</td>
<td>CBD, Katy Freeway, West Loop (Galleria), Westchase</td>
<td>-167,067 ▼</td>
<td>$34.67 ▼</td>
<td>23.6% ▼</td>
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<tr>
<td>San Francisco Bay Area, CA 109049501</td>
<td>Financial District (North Financial District &amp; South Financial District), SOMA (West SOMA &amp; East SOMA), Palo Alto, Mountain View, Sunnyvale</td>
<td>-463,433 ▼</td>
<td>$68.05 ▼</td>
<td>11.1% △</td>
</tr>
<tr>
<td>Atlanta, GA 109444147</td>
<td>Midtown, Buckhead, Central Perimeter, Cumberland/Galleria</td>
<td>383,631 ▲</td>
<td>$34.07 ▼</td>
<td>19.3% ▲</td>
</tr>
<tr>
<td>Dallas, TX 80677846</td>
<td>Uptown, Preston Center &amp; Far North Dallas</td>
<td>-49,749 ▼</td>
<td>$35.31 ▼</td>
<td>21.6% ▲</td>
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<tr>
<td>Seattle, WA 75274873</td>
<td>Seattle CBD, Lake Union, Pioneer Square, Belltown, Queen Anne, Ballard, Northgate</td>
<td>-538,251 ▼</td>
<td>$52.78 ▼</td>
<td>13.3% ▲</td>
</tr>
<tr>
<td>Boston, MA 65938087</td>
<td>Back Bay, Downtown, Allston/Brighton, Charlestown, Crosstown, Fenway/Kenmore, South Station, North Station, Seaport</td>
<td>-122,541 ▼</td>
<td>$63.25 ▼</td>
<td>15.8% ▼</td>
</tr>
</tbody>
</table>

* A quarterly rent change of ±1% or less is deemed to be flat
^ A quarterly vacancy rate change of ±20 basis points or less is deemed to be flat
Vacancy rates continued to rise, posting an average increase of 50 basis points across the top 10 markets, down from the 160 basis points rise in the first quarter. Only two markets posted three-digit increases in Q2 2021 – Los Angeles with a 140 basis points increase and Seattle, where vacancy rose by 110 basis points. Manhattan remains the only market in the top 10 with a sub-10% vacancy rate.

**Top 10 Office Markets: Vacancy Rates Q2 2020 vs. Q2 2021**

Total sublease space available across the top 10 metro markets has risen to 100.5 million square feet, representing an average sublease availability rate of 3.5%. San Francisco is by far the most exposed market with an 8.8% sublease availability rate. Seattle and Manhattan follow at 4.3% and 4%, respectively.

The average discount in asking rents between Class A direct and sublease space in the downtown areas of the top 10 office markets has been trending in the 25% to 30% range and currently stands at 26.7%. Given their vacancy rates of over 20%, it is not surprising that Houston and Dallas have the greatest sublease rental discounts at 49.2% and 37.5%, respectively. Downtown Chicago also ranks high with a 34.9% discount. Silicon Valley has by far the lowest discount at just 10.8%.

**Top 10 Office Markets: Sublease Availability Rates Q2 2021 (%)**

**Class A Sublease Space – Rental Discount Q2 2021 (%)**
Current office occupancy rates typically stand between 15% to 20% in the major CBDs and 40% to 45% in suburban markets and more car-dependent cities such as Atlanta, Dallas and Houston.

Growth projections for the U.S. economy have been reined in a little in recent weeks, but GDP is still forecast to post an increase of around 6.0% this year. As a result, forecasts for 2022 have been upgraded with the leading West Coast cities, especially those that are tech-driven, expected to outperform in terms of GDP and employment growth next year. We expect the office sector and its leading markets to remain challenged through 2021, with increased signs of stabilization as we move into 2022.

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Featured Highlights

- **Manhattan** retains the lowest vacancy rate of the major markets despite eight consecutive quarters of negative absorption.

- Average asking rents in **Washington, D.C.** have fallen below the $50 per square foot mark.

- Vacancy in **Chicago** is at a 15-year high due to a combination of new construction and large blocks entering the market.

- **Los Angeles** was the only market to post increased occupancy losses in Q2 2021, with negative 1.6 million square feet net absorption.

- Although vacancy held steady in Q2 2021, **Houston** still has the highest vacancy rate of the markets tracked in our report.

- **The Bay Area** continues to face significant challenges, particularly in downtown San Francisco where there is a glut of sublease space.

- **Atlanta** posted positive absorption in Q2 2021 – the only one of the top 10 markets to do so.

- The **Dallas** office market continues to slow and has the second-highest vacancy rate in our survey.

- **Seattle** continues to see some of the sharpest market corrections, coupled with supply-side risks

- The amount of sublease space on the market in **Boston** fell slightly in the second quarter.

Local Insights

**Manhattan**

The Manhattan office market saw further retrenchment in the second quarter with rising vacancy, a fall in asking rents and negative absorption. However, the pace of decline has slowed. The vacancy rate increased by 40 basis points to 9.7%, the highest quarterly vacancy level on record. Manhattan's pre-pandemic record-high vacancy rate was 9.1% in Q2 2003. The volume of available sublease space stands at 20.8 million square feet, equivalent to 4% of total market inventory.

Net absorption was negative for the eighth successive quarter. The Q2 2021 net absorption total of negative 4.9 million square feet was down from negative 11 million square feet in Q1 2021, which looks to have been the low point of the current cycle. At 4.6 million square feet, Q2 2021 leasing volume was 43% higher than recorded in Q2 2020 (3.2 million square feet). However, leasing activity during the second quarter was 43.3% below the 10-year average (8 million square feet).

Manhattan’s FIRE (financial services, insurance and real estate) sector led leasing by industry with a 32% share during Q2 2021. The largest lease signed in Q2 was by the U.S. Securities and Exchange Commission which extended its 302,525-square-foot lease at 200 Vesey Street.

At $72.79 per square foot, Manhattan’s average asking rent decreased – for the fifth consecutive quarter – by 0.6%, to the lowest quarterly average since 2017. Manhattan’s average asking rent has decreased by 8.2% year-over-year. The average Class A asking rate ($79.01 per square foot) fell by 1.7% in Q2 2021, while Class B rates ($63.01 per square foot) rose by 2.3% over the same period.
**Washington, D.C.**

The pace of decline in the Washington, D.C. office market slowed in Q2 2021. Net absorption totaled negative 522,528 square feet, compared to negative 2.2 million square feet in Q1 2021, and the vacancy rate held steady at 17.7%. Average asking rates fell by 1.1% to $49.88 per square foot.

Tenant activity picked up in the second quarter and seven of the 10 largest leases signed in central Washington, D.C. involved new leases or relocations rather than renewals. These were led by Boston Consulting Group taking 97,799 square feet at 655 15th St NW. The East End remains the most challenged submarket in The District, with vacancy at 19.5% and negative absorption of 726,824 square feet in the second quarter.

Second quarter occupancy losses in the suburban markets of Northern Virginia totaled 463,647 square feet, with the greatest loss occurring in the Rosslyn-Ballston Corridor at negative 508,384 square feet. On a positive note, one of the quarter’s largest leases took place in Rosslyn, with the Department of State signing for 108,296 square feet at 1200 Wilson Blvd.

The occupancy strategy adopted by the Federal Government will remain a critical issue for the health of the Washington, D.C. area office market. The Federal footprint has already been falling in response to cost-cutting measures. This will be further exacerbated as remote working practices, which were already in place before the pandemic, are solidified.

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**Chicago**

The Chicago office market posted a further 1.1 million square feet of negative absorption in the second quarter. This contributed to an 80 basis points rise in the vacancy rate to 16.8%. Average asking rates held steady at $42.79 per square foot. CBD vacancy is at its highest level in over 15 years and fast approaching the record peak of 16.9% in Q2 2005.

New construction continues to place pressure on the Chicago market. There are currently nine office buildings underway in the CBD that will add 3.7 million square feet to the market over the next three years. Approximately 63% (2.4 million square feet) of this new space remains available. In addition, 72% of the space delivered in the first half of this year remains vacant.

While tenant demand remains subdued, leasing volume increased for the second successive quarter in Q2 2021. The most notable transaction was Kimberly Clark’s relocation and expansion into 92,704 square feet at 1155 W. Fulton Street. However, the wider trend is for tenants to reduce their footprint when signing lease renewals as landlords seek to retain them in a challenging market.

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**Los Angeles**

The Los Angeles (L.A.) office market posted its fifth successive quarter of occupancy losses in the second quarter. Net absorption totaled negative 1.6 million square feet. The vacancy rate, which stood at 14.2% at the start of the downturn, rose by a further 140 basis points in Q2 2021 to 18.9%.

The Downtown submarket remains challenged. Vacancy stands at 21.9%, following an increase of 80 basis points in Q2 2021. Encouragingly, construction activity which had been driving up the Downtown vacancy rate, has slowed, with only 356,600 square feet remaining undeveloped.

In West L.A., vacancy continues to rise sharply with a 220 basis points increase in the second quarter to 18.7%. Negative absorption in the second quarter was again skewed heavily toward West L.A. at negative 1.3 million square feet. This comes when there are 2.7 million square feet under construction across the submarket, accounting for half of space underway across Greater L.A. However, key tenants remain committed to West L.A., with Hulu and Creative Artists Agency signing significant renewals in Q2 2021.

The vacancy rate in Tri-Cities has risen to 14.9%, representing an increase of 40 basis points in the second quarter. Burbank’s vacancy rate is only 8.7%, one of the lowest in L.A. County. In contrast, vacancy in Tri-Cities’ other key submarkets, Glendale and Pasadena, stands at 20.3% and 16%, respectively.
Houston

The Houston office market took a pause in the second quarter. Occupancy losses continued to slow and net absorption came in at negative 167,067 square feet. The vacancy rate held steady at 23.6% but remained the highest among the markets tracked in this report. Average asking rates, which fell by 3.5% in the first quarter, held steady at $34.67 per square foot.

Vacancy rates are elevated across all the key submarkets, ranging from a high of 25.7% in the CBD to a low of 21.2% in Katy Freeway. The CBD has the highest average asking rates by a fair margin at $40.27 per square foot.

There is 3.5 million square feet of office space currently under construction. Most of this new inventory is expected to deliver this year and is 60% pre-leased. The largest development underway is Hines Securities Inc.’s 1.1 million square foot Texas Tower in the CBD, scheduled for completion in Q4 2021. The project is 40% preleased.

San Francisco Bay Area

The Bay Area office market remains under pressure. Net absorption was negative for the sixth successive quarter and while the vacancy rate held steady, it has more than doubled during the current downturn. Meanwhile, average asking rates fell by 3.1% in Q2 2021 to $60.05 per square foot.

San Francisco continues to bear the brunt of the downturn. The city saw an additional 1.7 million square feet of negative absorption in the first quarter, 76% of which took place in the Financial District. Sublease space continues to ramp up, and now stands at 8.5 million square feet – equivalent to 8.8% of market inventory, which is more than double the next highest sublease availability rate across the leading markets.

While Silicon Valley is not immune from the downturn, it is being impacted less. Office vacancy stands at 10%, up by 60 basis points quarter-over-quarter, and rents are holding firm. Net office absorption in the Valley was positive in Q2 2021 at 179,308 square feet. New construction remains a lead story, with 7.6 million square feet currently underway, 75% of which is already pre-committed.

Atlanta

The Atlanta office market rebounded in the second quarter with 383,631 square feet of positive absorption in sharp contrast to almost negative two million square feet in the first quarter. In doing so, Atlanta was the only one of the 10 markets in our survey to post positive absorption this quarter.

Despite this improvement, the vacancy rate rose by 80 basis points in Q2 2021 to 19.3%. The key factor driving up vacancy was the completion of 1.7 million square feet of new space, the larger share of which was delivered vacant. This still leaves an additional 5.3 million square feet underway across the Atlanta metro, 2.9 million square feet of which is taking place in the Midtown submarket.

Second quarter occupancy gains were led by the Central Perimeter submarket with 264,518 square feet of positive absorption, largely due to State Farm moving into 215,000 square feet in the third phase of its new headquarters.

Average asking rates held steady in the second quarter at $34.07 per square foot. Midtown rates remain the highest in the market at $40.58 per square foot, followed by Buckhead at $36.87 per square foot.
Dallas

The contraction of the Dallas office market slowed in the second quarter. Net absorption was only marginally negative at 49,749 square feet, in contrast to negative 1.6 million square feet in Q1 2021. The vacancy rate increased by 90 basis points to 21.6%, while average asking rates held steady at $35.31 per square foot.

Significant differentials persist between the three core submarkets tracked in our survey. Preston Center retains the highest average asking rents at $44.49 per square foot and the lowest vacancy rate at 11.1%. Vacancy stands at 23.2% in Far North Dallas and 19.4% in Uptown/Turtle Creek.

While asking rents in the close-in submarkets are holding up the best, tenant concessions are on the rise as landlords try to attract occupiers in a low-velocity market. Rising levels of sublease space continue to put pressure on rents. There is 8.9 million square feet of sublease space available across the overall Dallas market.

Construction activity has slowed by Dallas standards, with 5.9 million square feet underway across the Metroplex. However, two-thirds of this activity is taking place in the three core submarkets, led by 2.4 million square feet in Far North Dallas and one million square feet in Uptown/Turtle Creek. As such, some supply-side concerns persist.

Seattle

Seattle has seen a marked downward shift in fundamentals since mid-2020, but the pace of this decline slowed in the second quarter. Net absorption in Q2 2021 was negative 538,251 square feet compared to negative 1.8 million square feet in Q1 2021. While vacancy rose by 110 basis points to 13.3%, this contrasts to a 250 basis points increase in the preceding quarter. Even so, this was the second largest Q2 2021 vacancy increase among the top 10 markets, behind only Los Angeles.

Average asking rates in the Seattle CBD held steady in the second quarter at $52.85 per square foot. As landlords compete for tenants, who have an outsized number of quality sublease options in addition to direct space, rents could still erode. While prime Class A assets in the CBD and Lake Union may still be posting asking rents in the $55-$60 per square foot range, effective rents are notably lower when increasing concession packages are factored in.

Sublease availability across the overall Seattle office market stands at 4.3%, the second highest rate among the top 10 markets and 80 basis points above the overall average. In addition, there is 2.2 million square feet of new space under construction, just over half of which is scheduled to deliver in the remainder of this year. Only one of the projects currently underway is pre-leased: Vulcan’s 372,000-square-foot Block 38 development, which is fully committed to Google.

Boston

Boston’s office market showed little change in the second quarter after witnessing one of the most severe contractions among the 10 leading markets over the prior five quarters. Net absorption remained negative but by only 122,541 square feet in contrast to an occupancy loss of 1.2 million square feet in Q1 2021. The vacancy rate held steady at 15.8% but is virtually double the level seen before the downturn.

The flow of sublease space onto the market has slowed, but there is still 3.5 million square feet available across central Boston. The greatest impact is felt in the Downtown submarket, where sublease availability stands at 1.8 million square feet. Second quarter net absorption in this submarket was negative 248,361 square feet, pushing the vacancy rate to 17.4%. Vacancy in Seaport stands at 16.7%. Back Bay is below the market average at 10%.

Back Bay retains the highest average asking rates at $67.53 per square foot compared to a market average of $63.25 per square foot—representing a fall of 1.9% in the second quarter. Rents have now declined for two successive quarters. Concessions are up, with tenants negotiating additional months of free rent or higher tenant improvement allowances. But overall, despite the recent declines, rents have yet to respond to market conditions anywhere near as dramatically as they have historically.
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