U.S. Research Report

TOP OFFICE MARKETS SNAPSHOT

Q4 2018

Colliers INTERNATIONAL

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A Strong Close to 2018 as Major Office Markets Continue to See Significant Demand

Tech and Coworking Firms Still Growing Exponentially

Featured Highlights

- The major office markets in the U.S. remain on solid footing. Demand is principally being driven by tech and coworking firms, along with significant leasing volume by financial firms in select markets.
- Eight of our top 10 U.S. office markets posted positive absorption in Q4 2018.
- At the same time, vacancy rates declined in seven markets and held steady in two more. The national vacancy rate is at an all-time low.
- Average asking rates rose in six markets and held steady in the remaining four. New highs were set in several markets including Manhattan, Boston and Seattle.
- Leasing activity is almost exclusively weighted towards the best Class A space. In the race to attract and retain the best talent, firms are willing to pay a premium for the best work environment. Some tenants are offsetting these higher rents by downsizing to a more efficient footprint.
- Over one-third of flexible workspace across the top 19 U.S. office markets is in Manhattan, exceeding 10 million square feet.
- In the tightest markets, including Manhattan, the San Francisco Bay Area and Boston, pre-leasing is almost the only way of satisfying large requirements for top quality space.
- While there is no market-wide supply risk, there are localized pressure points in Atlanta, Los Angeles and Washington, D.C.

METRO CORE INVENTORY (SF)	CORE SUBMARKETS INCLUDED	ABSORPTION (SF)	AVG RENT ($)*	VACANCY RATE^
Manhattan 503,295,206	Manhattan Midtown, Midtown South, Downtown	3,839,176 ▲	$75.93 ▲	5.9% ▼
Washington, DC 187,540,174	CBD (DC), East End (DC), Capitol Hill (DC), NoMa (DC), Capitol Riverfront (DC), Carlyle (DC), R-B Corridor (NOVA), Tysons Corner (NOVA), Bethesda (SubMD)	825,919 ▲	$49.26 ▲	14.4% ▬
Chicago, IL 132,671,991	West Loop, Central Loop, River North, East Loop	-13,827 ▼	$40.67 ▬	13.3% ▼
Houston, TX 119,241,291	CBD, Katy Freeway, West Loop (Galleria), Westchase	1,335,452 ▲	$35.50 ▬	21.1% ▼
Los Angeles, CA 115,131,800	Dowtown Los Angeles, West Los Angeles, Tri-Cities	1,041,700 ▲	$47.38 ▬	14.6% ▼
Atlanta, GA 103,263,999	Midtown, Buckhead, Central Perimeter, Cumberland/Galleria	546,451 ▲	$30.37 ▲	13.4% ▼
San Francisco Bay Area, CA 100,748,513	Financial District (North Financial District & South Financial District), SOMA (West SOMA & East SOMA), Palo Alto, Mountain View, Sunnyvale	187,589 ▼	$84.86 ▲	4.5% ▬
Dallas, TX 77,690,374	Uptown, Preston Center, Far North Dallas	-62,463 ▼	$31.60 ▬	15.1% ▲
Boston, MA 70,141,985	Back Bay, Financial District, Charlestown, Crosstown, Fenway/ Kenmore, South Station, North Station, Seaport	347,566 ▲	$59.26 ▲	9.2% ▼
Seattle, WA 62,644,703	Seattle CBD, Lake Union, Pioneer Square, Belltown, Queen Anne, Ballard	423,291 ▼	$41.79 ▲	7.1% ▼

* A quarterly rent change of +/-1% or less, is judged to be flat.
^ A quarterly vacancy rate change of +/- 20 basis points or less is deemed to be flat

- Almost 42 million square feet of office space was leased in **Manhattan** in 2018, an all-time record. While financial tenants dominate leasing activity, space signed by coworking firms in 2018 totaled 4.5 million square feet—almost a three-fold increase from 2017.
- The **San Francisco Bay Area** remains the strongest major office market in the U.S. with the highest average asking rates in the U.S. Vacancy is now at an extremely tight 4.5%. Tech and internet giants continue to pre-lease large blocks of space and demand exists for several million square feet more.
- The key challenge facing the **Washington, D.C.** office market is the continued addition of new space. On a positive note, Amazon's announcement that it will be locating half of its HQ2 location in the D.C. area could have far-reaching implications with the promise of bringing 25,000 jobs to the area.
- Demand for office space in downtown **Chicago** is strong, driven by firms relocating from the suburbs and the coastal tech giants both establishing and increasing their presence.
- **Houston** continues to take small steps toward filling the glut of vacant space that was emptied during the energy downturn. While Houston's vacancy rate is still by far the highest of the top 10 markets, it is inching down.
- The **Los Angeles** office market is strengthening but supply concerns persist downtown. Entertainment and tech firms are driving demand both on the Westside and in Tri-Cities.
- Corporate headquarters continue to dominate major leasing activity in **Atlanta**. Vacancy may be tested by a series of speculative developments underway in Midtown.
- **Dallas** continues to expand further northward driven by the Dallas Cowboys new world headquarters in Frisco. New development is pushing vacancy upwards in Uptown/Turtle Creek.
- **Boston** continues to out-perform. With around six million square feet of known demand in the market, this trend looks set to continue. While tech and coworking firms secured some of 2018's largest leases, major banks are actively in the market as well.
- Tech and coworking firms continue to dominate the **Seattle** market, where vacancy remains low and is still tightening while rents have reached record levels. Speculative construction is leasing up and leading tech firms continue to pre-commit to satisfy large-scale requirements.

LOCAL INSIGHTS

Manhattan

- The **Manhattan** office market remained strong in 2018 setting new records for annual leasing volume and average asking rents. Almost 42 million square feet of office space was leased in Manhattan in 2018. Vacancy rates continue to contract with the Q4 2018 level at 5.9%, second only to the San Francisco Bay Area among the nation's 10 leading office markets.
- Demand continues to be led by FIRE (financial services, insurance and real estate) firms with a 42% share of leasing activity in 2018. Tech firms continue to increase their presence. Google leased a combined 459,000 square feet in Q4 2018 across two properties in Midtown South, taking 280,000 square feet at 315 Hudson Street and 179,000 square feet at 345 Hudson Street. Facebook increased its footprint at 770 Broadway by a further 319,000 square feet.
- Coworking firms continue to expand rapidly. Leases signed by coworking firms in Manhattan in 2018 totaled 4.5 million square feet—almost a three-fold increase from the 1.6 million square feet leased in 2017—and equivalent to 12% of total leasing volume in 2018.
- There is 8.5 million square feet of office construction underway in Manhattan that is due to deliver by the end of 2020. Reflecting strong demand for the best new space, more than 80% of this space is already pre-leased. An additional four million square feet could come online by the end of 2020, in proposed projects and from building renovations.
- Just over six million square feet of current construction is in three projects in Hudson Yards, of which just 400,000 square feet remains available. Hudson Yards/Manhattan West is garnering some of the highest rents in the market with average Class A asking rates of $120.30 per square foot compared to the Manhattan Class A average of $81.25 per square foot. While this is on par with the prior peak in 2007, in nominal terms, tenant concessions are much higher and increasing.

Washington, D.C.

- The key challenge facing the **Washington, D.C.** office market is the continued addition of new space. Almost 3.7 million square feet of new space was delivered in 2018 in the District alone, with an additional 4.3 million square feet still underway. Encouragingly, 67% of the 1.4 million square feet added in Q4 2018 was leased upon delivery.
- Net absorption in the District in 2018 totaled a mere 22,000 square feet. However, this is the first time that annual net absorption has been positive since 2015. Almost two million square feet of Class A absorption in 2018 was counter-balanced by negative 1.95 million square feet of net absorption in Class B and C space. This provides a second challenge. How to reposition the outmoded space that is being left behind as firms relocate.

- Average Class A asking rates showed little movement in Q4 2018 and stand at $49.25 per square foot. Where there is any uplift, it is driven by new product entering the market with higher asking rents rather than where deals are being struck. There is still a considerable delta between Class A rents in the District and those across the Potomac in Northern Virginia. Class A rents in the core D.C. submarkets of the central business district (CBD) and East End are close to $65 per square foot. Comparable properties in the Rosslyn/Ballston Corridor and Tyson's Corner are seeking $45 per square foot and $40 per square foot respectively.
- On a positive note, Amazon's announcement that it will be locating half of its HQ2 location in the D.C. area could have far-reaching implications. The sites chosen are in the National Landing submarket which is just outside the District, in close-in Northern Virginia. The initial lease signed is for 500,000 square feet, but the potential total is 4.1 million square feet. Site work is already in progress. Amazon has promised to bring 25,000 jobs to the D.C. area.

Chicago

- **Chicago's** office market had a quiet fourth quarter with marginally negative net absorption of 13,800 square feet while average asking rates held steady at $40.65 per square foot. Demand for 2018 as a whole was strong with net absorption totaling 1.4 million square feet.
- Two key trends are driving this demand. Suburban firms continue to relocate downtown, and coastal companies are establishing or increasing their central U.S. presence in Chicago. Five suburban companies, led by Walgreens, signed downtown leases totaling 394,000 square feet in 2018. In addition, Molendez is relocating 400 workers from Downers Grove with a requirement for 100,000 square feet.
- Major coastal technology firms looking to increase their presence in Chicago include Google, which is expanding its Chicago footprint by 132,000 square feet to 570,000 square feet, and Facebook which is moving into 263,000 square feet at 151 N. Franklin Street. Salesforce has a requirement for 500,000 square feet and is targeting a new property which should start construction in 2020.
- Construction activity is putting upward pressure on vacancy, which stands at 13.3% in contrast to 11.6% at the beginning of 2018. Seven projects delivered in Chicago's CBD in 2018, adding 2.1 million square feet, and a further 3.6 million square feet is expected to come online by the end of 2019.
- However, construction levels are skewed by the 2.5 million square feet Old Main Post Office project, which is only 30% pre-leased and due to come online in mid-2019. The project is in River North, which is a somewhat untested location and low-rise by Chicago standards with large floorplates and targeted at tech, coworking and creative firms.

Houston

- **Houston's** office market continues to take small steps toward filling the glut of vacant space that was emptied during the energy downturn. Net absorption totaled 1.3 million square feet in Q4 2018, up from 248,000 square feet in Q3 2018. While Houston's vacancy rate is still by far the highest of the top 10 markets, there was a 40 basis-point drop in Q4 2018 to 21.1%.
- The fourth quarter absorption total was boosted by ConocoPhillips' move to 597,600 square feet at Energy Center IV in the Katy Freeway submarket. The two largest leases signed in Q4 2018 were also in the Katy Freeway submarket. McDermott International took 524,300 square feet at Energy Center Five and Transocean signed for 300,900 square feet at Enclave Place.
- Average asking rates held firm in Q4 2018 at $35.50 per square foot. Houston's CBD has the highest average asking rates at $39.05 per square foot, compared with $35 per square foot in West Loop/Galleria and $31.25 per square feet in Katy Freeway.
- There are 12 former energy company sublease spaces of 125,000 square feet or greater across the Houston market, all but one of which are in the submarkets tracked by this report. The largest of these is Oxy's former space of 746,070 square feet at 5 Greenway Plaza, followed by 454,490 square feet of former BP space at Four WestLake Park in Katy Freeway. Five of the remaining spaces, totaling a combined 1.1 million square feet, are in the CBD.

Los Angeles

- The **Los Angeles** office market closed the year on a strong note with net absorption of just over one million square feet and an 80 basis-point drop in vacancy to 14.6%. However, vacancy rates are likely to move back upwards as new product delivers in 2019.
- West LA has been the principal beneficiary of the uptick in demand with 298,000 square feet of net absorption in Q4 2018, taking the annual total to 1.1 million square feet. Large-scale leasing activity in West LA is centered on Culver City whose lower rents and large block availability are attracting tech and entertainment tenants alike. Average asking rates in Culver City are $51.80 per square foot, compared to $67 per square foot in West LA's most prestigious locations of Beverly Hills and Santa Monica.
- Three leases totaling 670,000 square feet were signed in Culver City in Q4 2018. Amazon Studios took 250,000 square feet at 9336 Washington Boulevard, HBO leased 200,000 square feet at 8830 National Boulevard and Bytedance signed for 119,000 square feet at 5800 Bristol Parkway.
- Looking at the three core submarkets, average asking rates stand at $57 per square foot in West LA, $42 per square foot Downtown and $37.20 in Tri-Cities. Net absorption in Tri-Cities bounced back in Q4 2018 with Acco taking occupancy of 125,000 square feet at 888 E. Walnut Street in Pasadena and Twentieth Century Fox moving into 100,000 square feet of sublease space at Media Studios North in Burbank.

- Construction activity is centered on two locations: West LA and Downtown which have a combined 3.1 million square feet underway. While lease-up has been slower than anticipated, the new West LA properties are now filling up. Downtown presents a contrasting picture, best exemplified by the 1.1 million square feet renovation of Broadway Trade Center which includes 500,000 square feet of office space which remains fully vacant and is set to deliver in Q1 2019.

Atlanta

- The **Atlanta** office market closed out 2018 on an encouraging note. Net absorption and average asking rates both rose in Q4 2018, to 546,450 square feet and $30.40 per square foot respectively. The vacancy rate dropped by 30 basis points to 13.4% but remained flat over 2018 as a whole.
- Corporate headquarters continue to dominate leasing activity. NCR moved in to a combined 726,000 square feet at their new Midtown headquarters in 2018 with the final phase of 265,000 square feet taking place in Q4 2018. Midtown also saw by far the largest lease of the quarter, with Cousins Properties securing Norfolk Southern to an 856,000 square feet build-to-suit development at 680 W. Peachtree Street.
- Average asking rates in Midtown are slightly ahead of neighboring Buckhead at $36.60 per square foot and $35.15 per square foot respectively. Central Perimeter rents remain at a discount averaging $27.65 per square foot. Midtown also has the lowest vacancy rate at 9.4% compared with 13.2% in Buckhead and 14.8% in Central Perimeter.
- Just over two million square feet of office construction broke ground in 2018. The largest project to start was the 335,000-square-foot Twelve 24 development in Central Perimeter which is 61% pre-leased to Insight Global. Speculative construction starts are on the rise in Midtown with four projects now underway, totaling just over one million square feet. Only one of these, the Star Metals building at 1055 Howell Mill Road, has seen any pre-leasing, with Regus Spaces committing to 25% of the 262,000 square development.

San Francisco

- The **San Francisco Bay Area** remains the strongest major office market in the U.S. Average Class A asking rates continue to rise and stood at $84.90 per square foot at Q4 2018, almost $10 per square foot more than the second highest market in the top 10—Manhattan. Vacancy continues to contract and is now an extremely tight 4.5%, down from 5.8% at the beginning of 2018
- Net absorption totaled 4.2 million square feet in San Francisco in 2018, 3.4 million square feet of which was in the core North and South Financial District submarkets. Tenants are almost exclusively in the market for Class A space which accounted for 97% of space absorbed. With strong demand and rigorous planning policy, there is virtually no supply risk in San Francisco. Nearly 90% of space set to deliver by the end of 2019 is pre-leased. Tenants with major requirements are having to commit to space two to three years ahead due to the diminishing supply of development sites.
- Almost four million square feet out of 6.9 million square feet of known demand in San Francisco is from tech firms. Coworking firms follow with 1.6 million square feet of requirements representing a more than two-fold increase in the second half of 2018.
- San Francisco saw five tech firm leases more than 100,000 square feet signed in Q4 2018. These were led by Salesforce, securing all the office space (325,000 square feet) in the last tower that will connect to the Salesforce Transbay Terminal at 550 Howard Street and Google signing for 263,000 square feet at One Market Street.
- Silicon Valley presents a similar picture. Vacancy rates are less than 3% in locations such as Mountain View Central and Sunnyvale, while average asking rates are on a par with San Francisco. LinkedIn signed the largest lease in Q4 2018 taking a combined 410,675 square feet at 445-645 N. Mary Avenue in Sunnyvale. In the second largest lease of the quarter, Proofpoint pre-leased 242,000 square feet in Phase 3 of the Pathline development. LinkedIn also received approval to build their 1.1 million square feet headquarters at 700 Middlefield Road in Mountain View.

Dallas

- The **Dallas** office market stalled in Q4 2018 after a strong third quarter. Net absorption was slightly negative at 62,465 square feet, rents held firm and vacancy moved up to 15.1%. Dallas is one of the four markets in the top 10 where vacancy rose in 2018 and it witnessed the largest increase of the four, rising by 240 basis points from the Q4 2017 level of 12.7%.
- This increase is occurring in Uptown/Turtle Creek where Class A vacancy rose by 150 basis points in Q4 2018, while vacancy in Far North Dallas and Preston Center both fell. Just over one million square feet of new Class A space was delivered in Uptown/Turtle Creek in 2018, representing a 7.1% increase in total inventory.
- Average asking rates in Uptown/Turtle Creek are $40.25 per square foot, slightly ahead of neighboring Preston Center at $39.45 per square foot. Average asking rates in Far North Dallas are $28.80 per square foot. Rents for the best space in Uptown/Turtle Creek broke through the $50 per square foot barrier over a year ago. Developers of recent projects are looking to achieve top rents of around $60 per square foot.
- Demand is almost exclusively for Class A space with 1.7 million square feet absorbed in 2018, while Class B and Class C absorption were both negative. Two leases of more than 100,000 square feet were signed in Q4 2018. Reata Pharmaceuticals leased 121,000 square feet at 5320 Legacy Drive in Far North Dallas while Salesforce took 104,870 square feet at 2300 N. Field Street in Uptown/Turtle Creek.
- Far North Dallas continues to expand further northward driven by the Dallas Cowboys new world headquarters and 91-acre campus at The Star in Frisco which is attracting developers and corporate moves alike. Dr. Pepper is planning to relocate from its Plano headquarters to be closer to the Cowboys new complex.

Boston

- **Boston's** office market shows consistent improvement with the vacancy rate contracting from 10.6% to 9.2% between Q4 2017 and Q4 2018. Average Class A asking rates continue to rise and now stand at a record high of $59.25 per square foot—the third highest among the top 10 U.S. office markets, behind only San Francisco and Manhattan. After a quiet third quarter, net absorption was solid in Q4 2018 at 347,570 square feet.
- Demand remains strong with Boston's three core downtown submarkets (Back Bay, Financial District and Seaport), collectively posting more than 1.6 million square feet of net absorption in 2018. Back Bay is commanding the highest rents, with average asking rates at $64.50 per square foot compared with $58.60 per square foot in the Financial District and $60.55 per square foot in Seaport. Historically, the Financial District has the highest rents in Boston.
- Back Bay's vacancy rate is substantially lower at 6.2%. Reflecting this tight supply, the two largest leases signed in Q4 2018 were in the Financial District. Online catering firm ezCater took 100,000 square feet at 40 Water Street and investment group Pioneer leased 97,000 square feet at 60 State Street.
- With around six million square feet of known demand in the market, this trend looks set to continue. While tech and coworking firms, led by Wayfair and WeWork, secured some of 2018's largest leases, there are two major banks currently looking to lease 500,000 square feet each: Bank of America and State Street Bank.
- With limited large block availability, firms with large space requirements are forced into pre-leasing new construction to meet their needs. Recent rental growth has been slightly stronger for Class B space at 7.3% in 2018 compared with 6% for Class A space. However, the rental delta remains wide. High-rise Class A space can garner rents in excess of $90 per square foot, virtually double the rents for Class B space.

Seattle

- **Seattle's** office market continues to post healthy performance. Vacancy fell once more, this time by 60 basis points to 7.1% in Q4 2018, and average asking rates rose to $41.80 per square foot. Although down slightly from the preceding quarter, net absorption was solid at 423,290 square feet.
- Tech and coworking firms continue to dominate the market. Despite concerns that Amazon could scale back operations in Seattle following their HQ2 decision, the e-commerce giant continues to expand. On the coworking front, WeWork now has 1.2 million square feet in Seattle following its move in to 120,000 square feet at Met Park East in the CBD in Q4 2018. In the second largest lease signed in Q4 2018, another coworking provider, Regus Spaces, pre-leased 91,000 square feet at Skanska's 2+U project in the CBD. The largest lease of the quarter took place at the same property, with Indeed signing on for 200,000 square feet.
- Average Class A asking rates have broken through the $50 per square foot barrier for the first time in the CBD to stand at $50.40 per square foot, which is a year-over-year increase of 8.4%. Limited supply is also pushing up Class B rates in the CBD, which grew by 9.3% in 2018 to an average of $40.40 per square foot.
- Looking ahead, tech tenants are expected to continue to drive leasing activity, with more than three million square feet of known requirements in the market. In addition, Facebook, which already has more than 900,000 square feet in downtown Seattle, is taking another 400,000 square feet in Arbor Blocks East and West, which is due for completion in 2019 while Google will move in to more than 600,000 square feet in Lakefront Blocks the same year.

OFFICE SERVICES | contact

Cynthia Foster
President,
National Office Services
+1 212 716 3515
cynthia.foster@colliers.com

RESEARCH | contacts

Pete Culliney
Director of Research | USA
+1 212 716 3698
pete.culliney@colliers.com

Stephen Newbold
National Director of Office Research | USA
+1 202 534 3630
stephen.newbold@colliers.com

Colliers International
666 Fifth Avenue
New York, NY 10103
+1 212 716 3500
colliers.com