# MUST Insights: From recovery to growth in the U.S. office market

March 2022

# U.S. office market trends

## Green shoots in demand

- Four consecutive quarters of increased office leasing velocity, driven principally by the tech sector
- Sublease space plateauing
- Positive net absorption for the first time since the onset of the pandemic in Q4 2021

## Migration of talent

- Employers are struggling with retention and wage inflation given acute labor shortages
- Housing affordability and quality of life driving workforce migration to the Sun Belt and Mountain West
- HQ relocations and hub-and-spoke expansions becoming increasingly popular

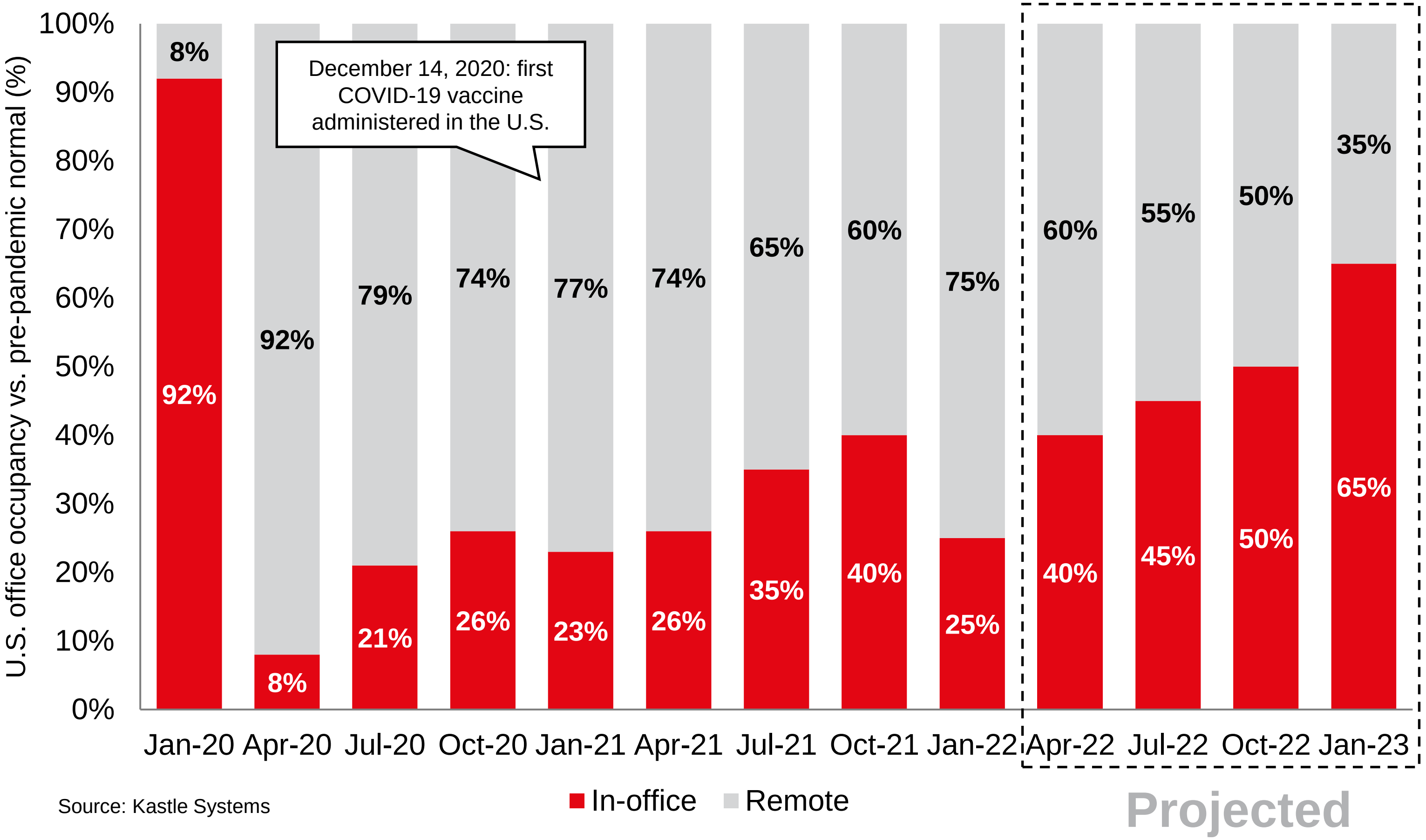
## Hybrid work

- Office re-entry is gradually rising – currently 36% of pre-pandemic levels
- Employers are finalizing hybrid work policies – with many allowing 2 days per week of locational flexibility
- Efficacy of hybrid work remains uncertain, with a discovery process now underway

## Flight to quality

- Tenants are gravitating to best-in-class space
- Newly delivered assets registered 52 million s.f. of occupancy gains since onset of the pandemic vs. 148 million s.f. of losses among commodity assets
- Rents for top-quality space up 15% vs. 10% decline for the commodity segment

# Office re-entry patterns and forecast



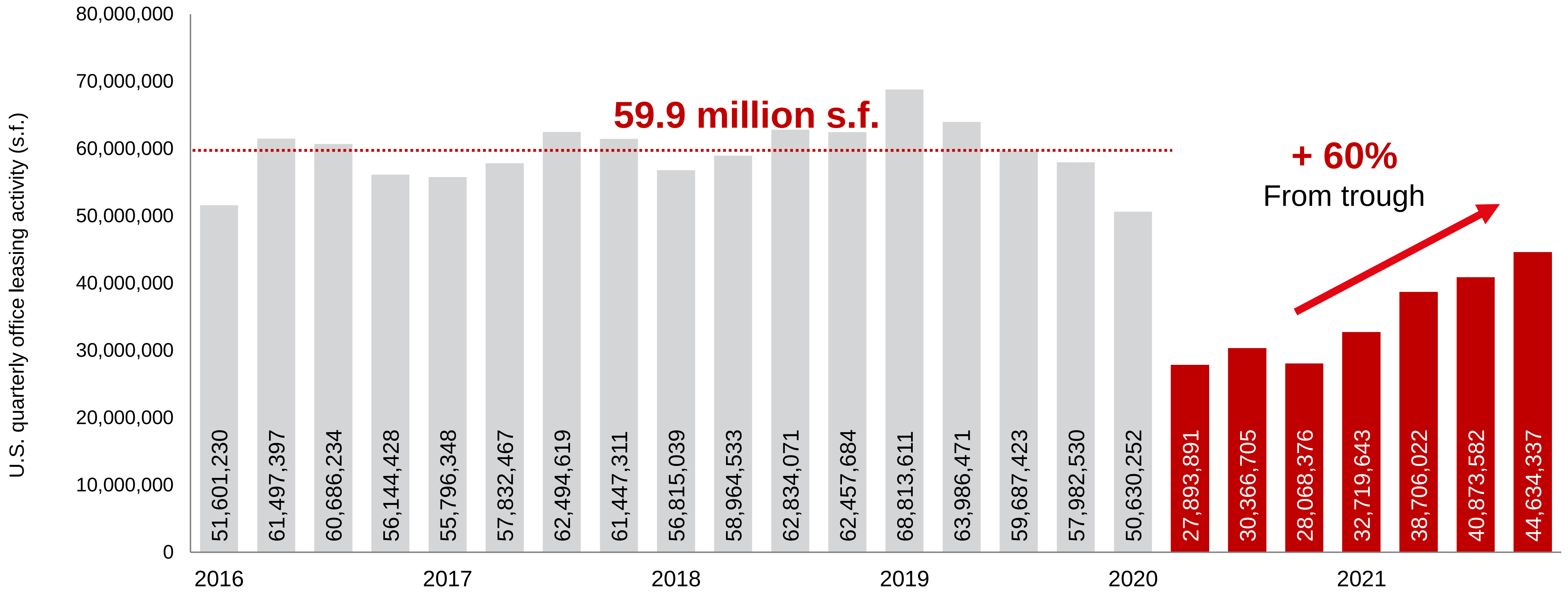

Source: Kastle Systems

### Office occupancy comparison

| Market | Feb 2022 est. |
|---|---|
| Austin | 52% |
| Dallas | 47% |
| Houston | 50% |
| New York | 31% |
| Chicago | 32% |
| San Francisco | 25% |
| Los Angeles | 33% |
| Washington, DC | 32% |
| Silicon Valley | 27% |

Office attendance is currently 36% of pre-pandemic levels, with Sun Belt markets leading dense urban gateways.

# Overall office leasing activity continues to rebound

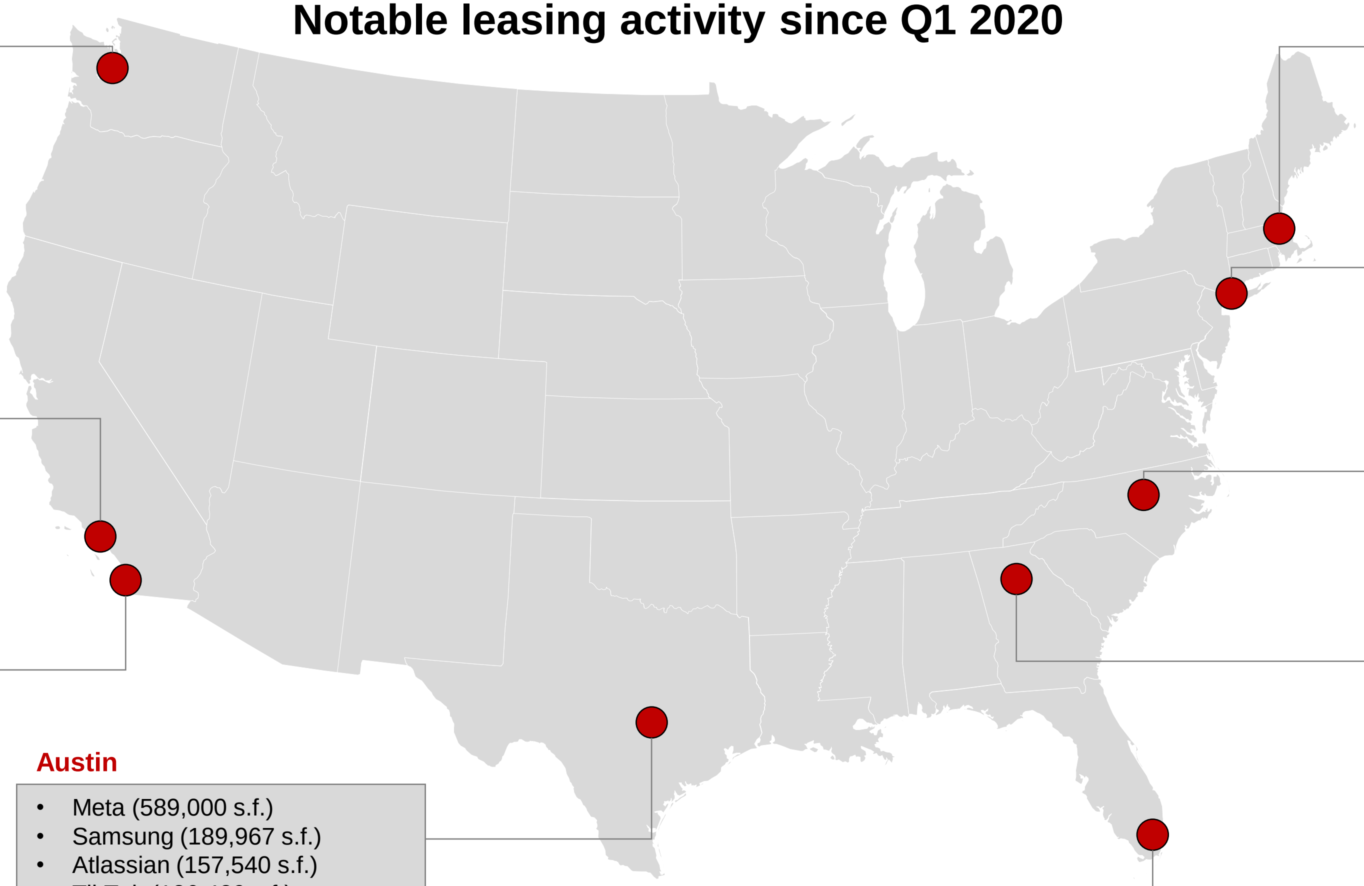



Leasing activity rose 9% last quarter, marking the fourth consecutive quarterly increase – while overall volume is up 60% from the trough, levels remain almost 30% below pre-pandemic norms

# Tech sector fueling U.S. office demand

JLL

## Notable leasing activity since Q1 2020



**Seattle/Bellevue**
- Amazon (1.8 m.s.f.)
- Meta (558,000 s.f.)
- Microsoft (246,638 s.f.)
- Blue Origin (92,834 s.f.)

**Los Angeles**
- Netflix (538,145 s.f.)
- Amazon (373,156 s.f.)
- Hulu (351,000 s.f.)
- Riot Games (199,882 s.f.)

**San Diego**
- Apple (591,511 s.f.)
- BD (318,000 s.f.)
- Google (115,285 s.f.)
- Resilience (49,130 s.f.)

**Austin**
- Meta (589,000 s.f.)
- Samsung (189,967 s.f.)
- Atlassian (157,540 s.f.)
- TikTok (126,429 s.f.)

**Boston**
- Amazon (630,000 s.f.)
- Whoop (121,682 s.f.)
- Insulet (119,060 s.f.)
- Hubspot (116,007 s.f.)

**New York**
- Meta (730,000 s.f.)
- Roku (237,333 s.f.)
- TikTok (232,188 s.f.)
- Apple (220,000 s.f.)

**Raleigh**
- Biogen (102,972 s.f.)
- Merz (79,162 s.f.)
- Bioventus (52,101 s.f.)
- Carsgen (36,590 s.f.)

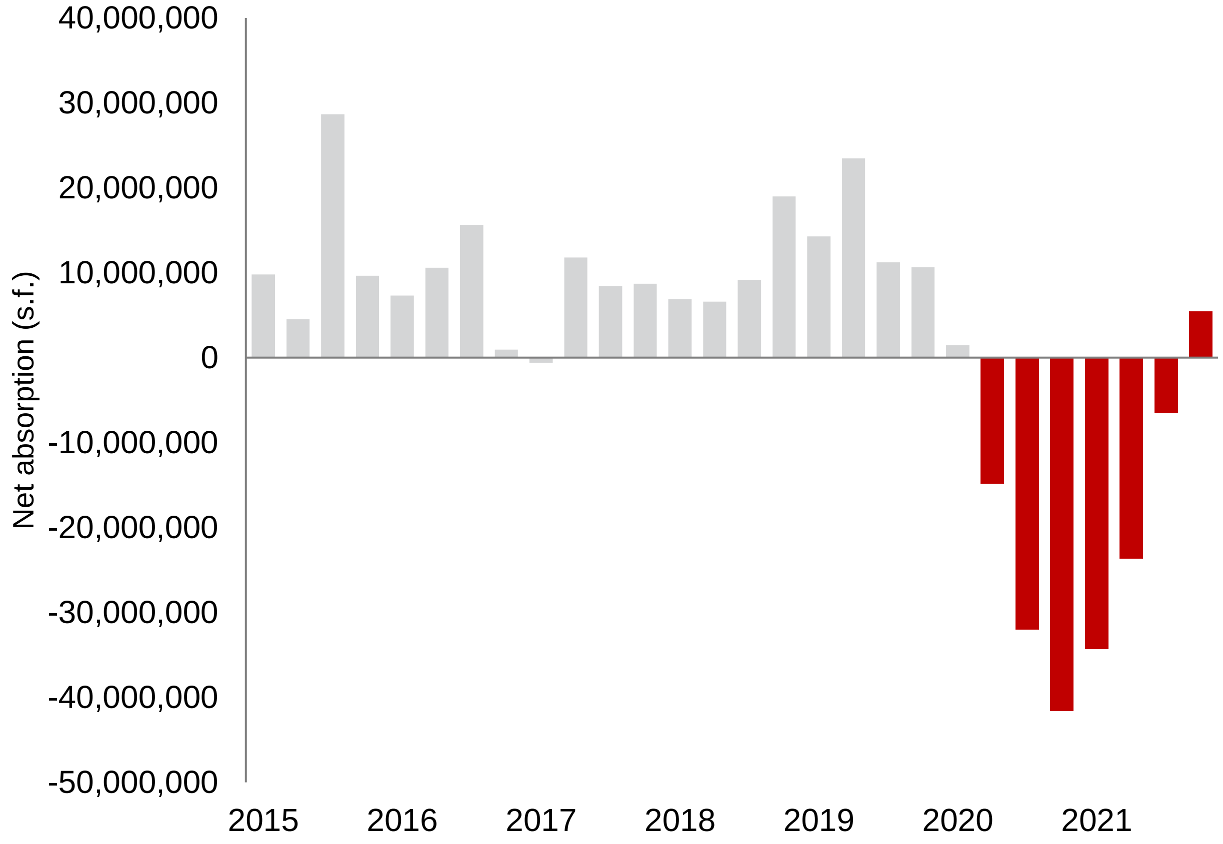
**Atlanta**
- Microsoft (523,511 s.f.)
- MailChimp (300,000 s.f.)
- CGHI (116,993 s.f.)
- Cisco (93,389 s.f.)

**Miami**
- Wix (48,148 s.f.)
- Microsoft (43,885 s.f.)

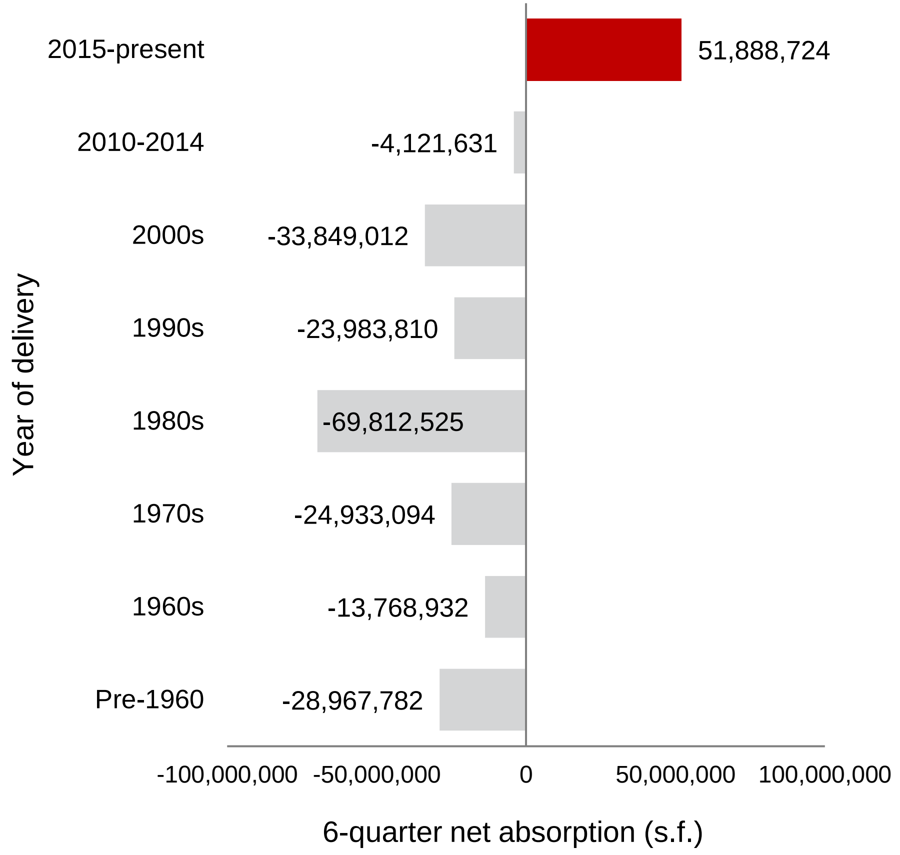
Tech companies are expanding beyond the Bay Area to satellite markets

# Overall office demand turning positive

### Quarterly net absorption

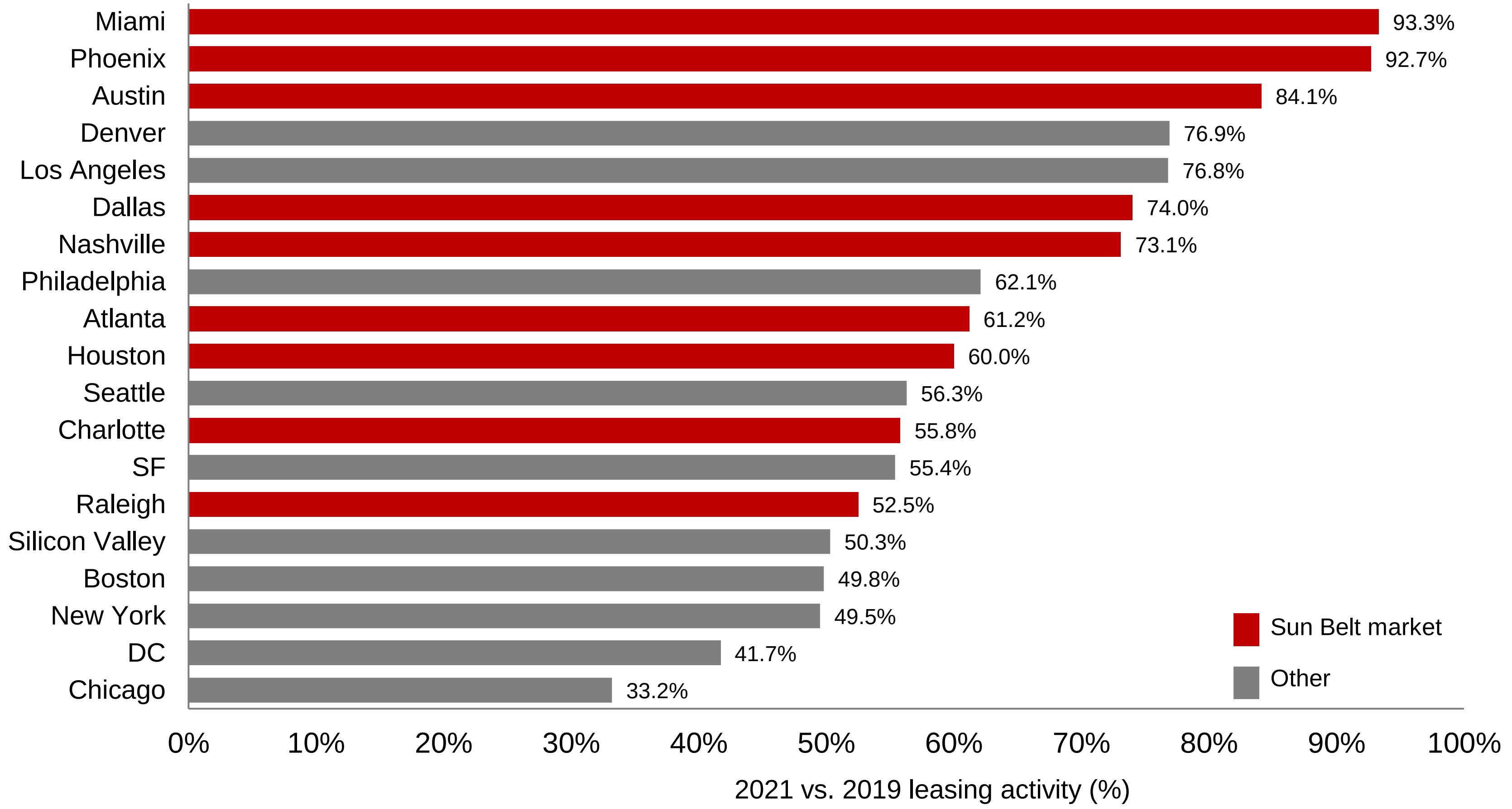



### Absorption by asset vintage

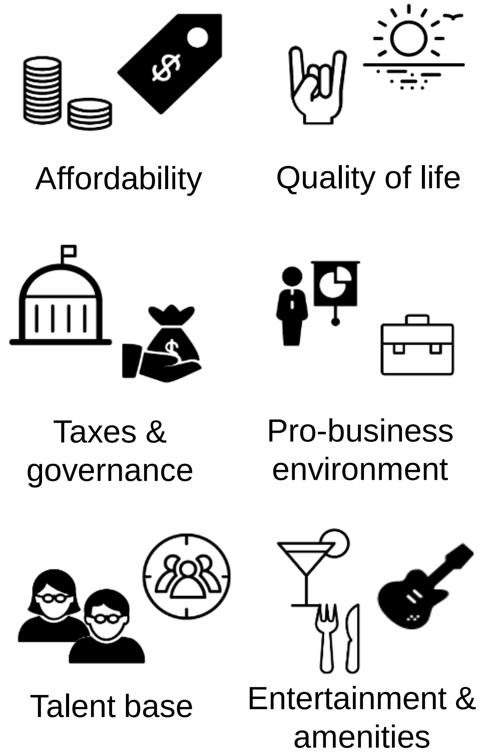



Net absorption returned to positive territory in Q4, with 5.4 million s.f. of total occupancy growth, disproportionately concentrated in new assets

# Sun Belt markets recovering faster than urban gateways




## Sun Belt demand drivers

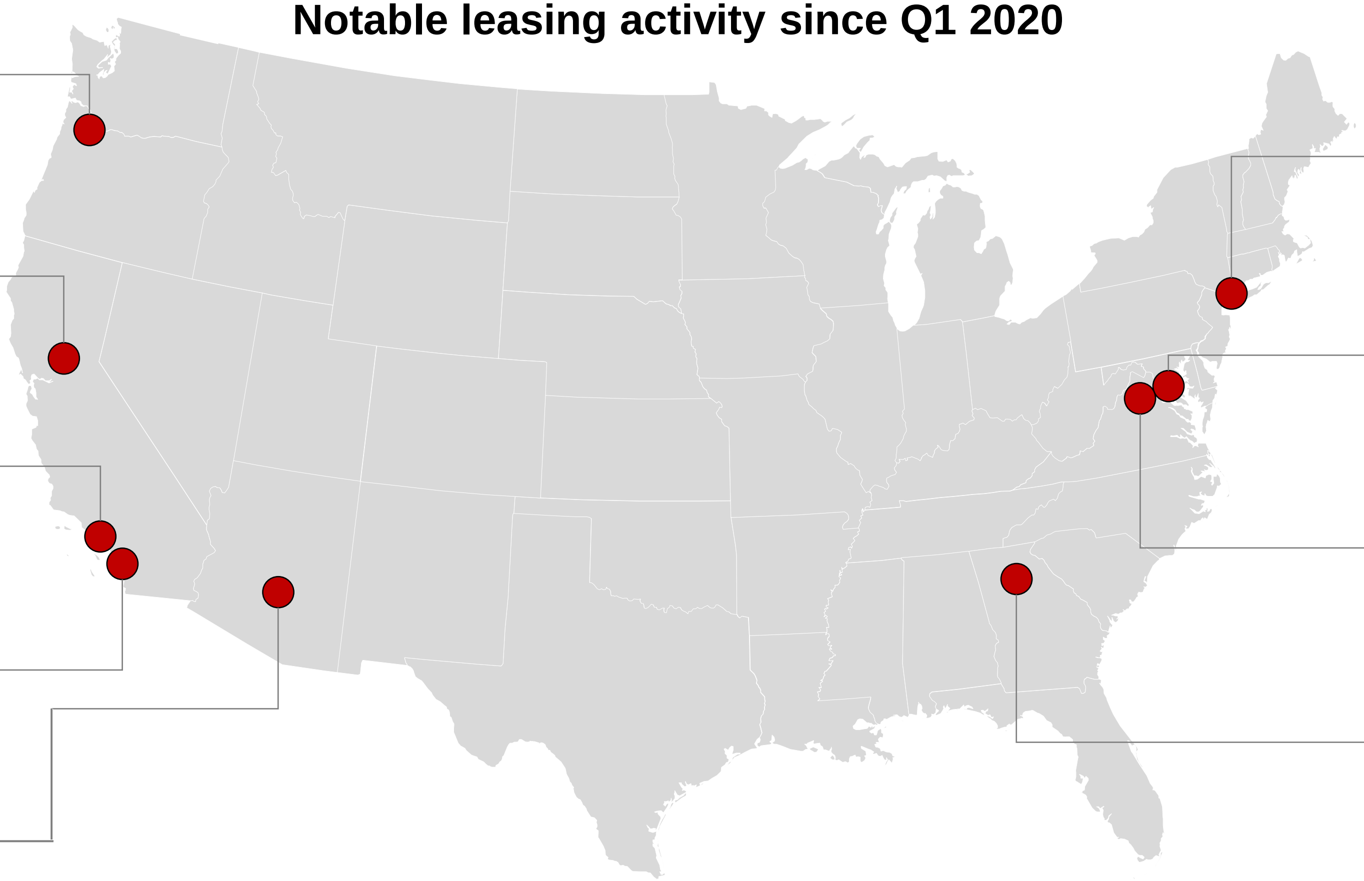



The Sun Belt has benefitted from domestic migration and loose pandemic-related restrictions, making their office markets more resilient than gateway cities

# MUST's portfolio combines stability with growth potential

JLL

## Notable leasing activity since Q1 2020



**Portland**

- Offers an attractive value proposition relative to the Bay Area for companies, investors and employees alike.

**Sacramento**

- Capital of the State of California, buffered by government presence and cost-of-living advantages.

**Los Angeles**

- Epicenter of media and entertainment industry, which has thrived throughout COVID.

**Orange County**

- Diverse economy with a high quality of life and ample work-near-home opportunities

**Phoenix**

- Experiencing explosive population growth and rapid expansion in tenant demand.

**Northern New Jersey**

- Attractive market for spillover demand form New York due to employees' growing aversion to long commutes.

**Washington, DC**

- Historically the most durable and recession-proof office market in the country.

**Northern Virginia**

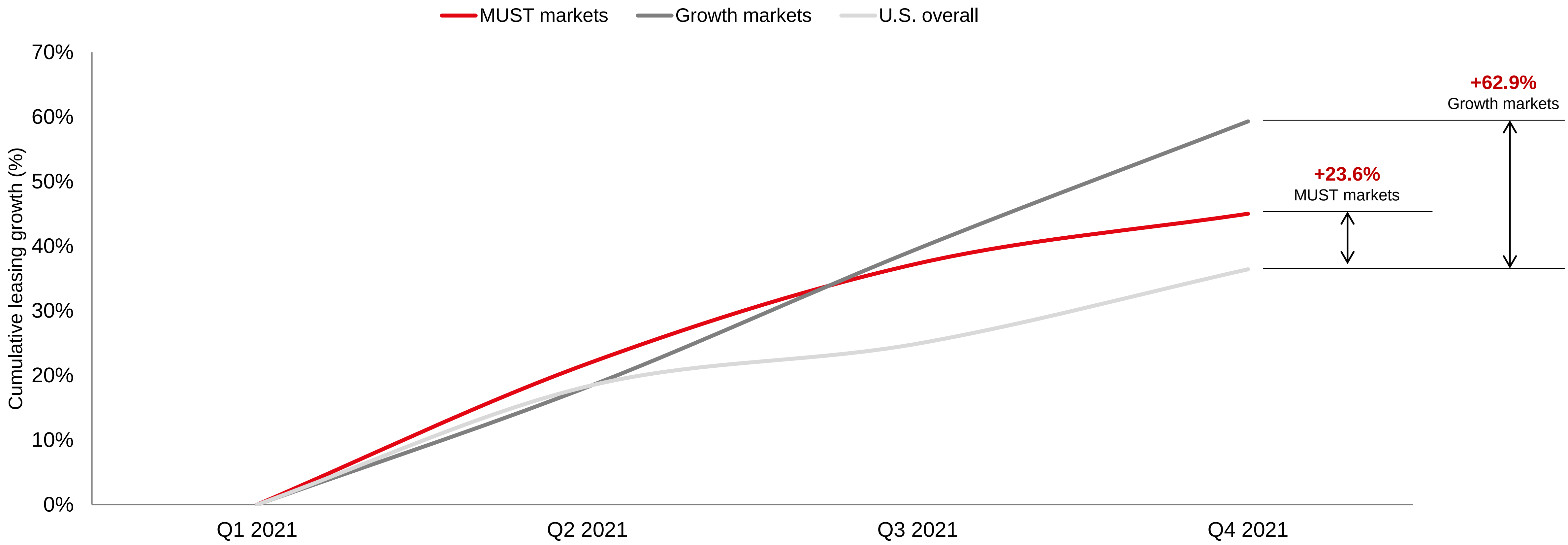
- Diversifying tenant base given growth of tech sector, including Amazon's HQ2, Microsoft and Google expansions.

**Atlanta**

- Fast-growing market attractive to tech companies given proximity to Georgia Tech and diverse workforce.

MUST owns a solid foundation of assets in durable, low-volatility markets, combined with attractive growth prospects in hot emerging markets.

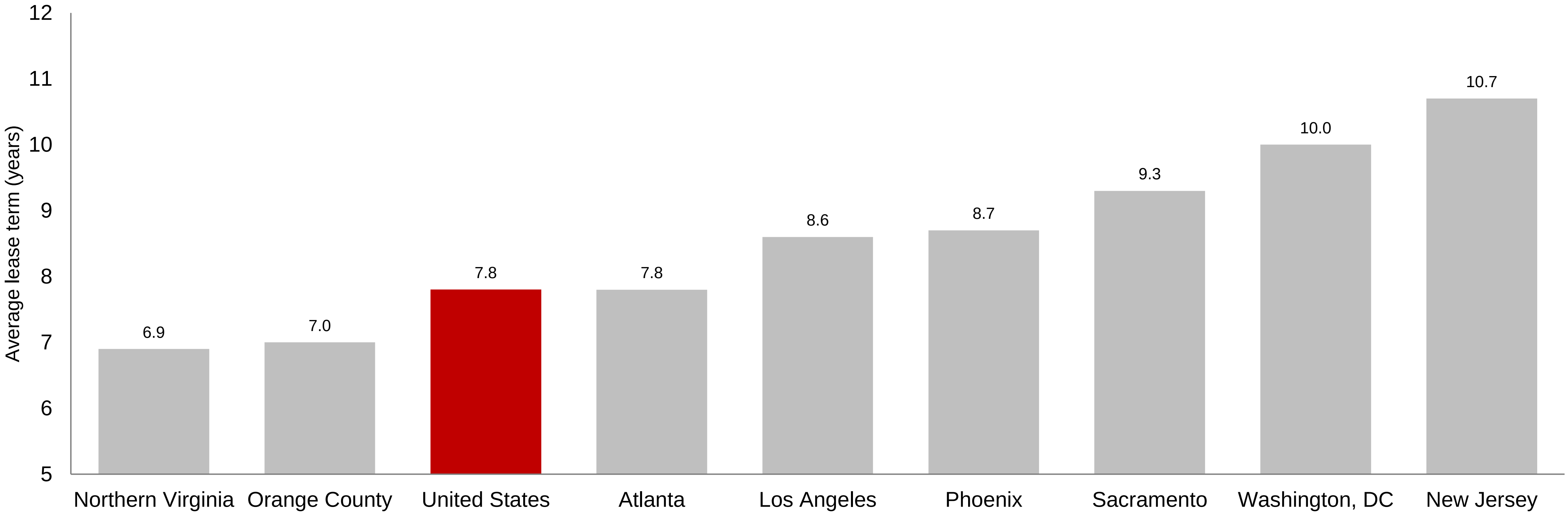
# Leasing has rebounded significantly faster in MUST's markets than broader U.S. averages




MUST markets saw leasing grow 23.6% faster than the U.S. overall over the course of 2021 compared to 62.9% for growth geographies.

Source: JLL Research – *growth markets defined as Austin, Charlotte, Denver, Nashville, Phoenix, Raleigh, San Diego and Seattle*

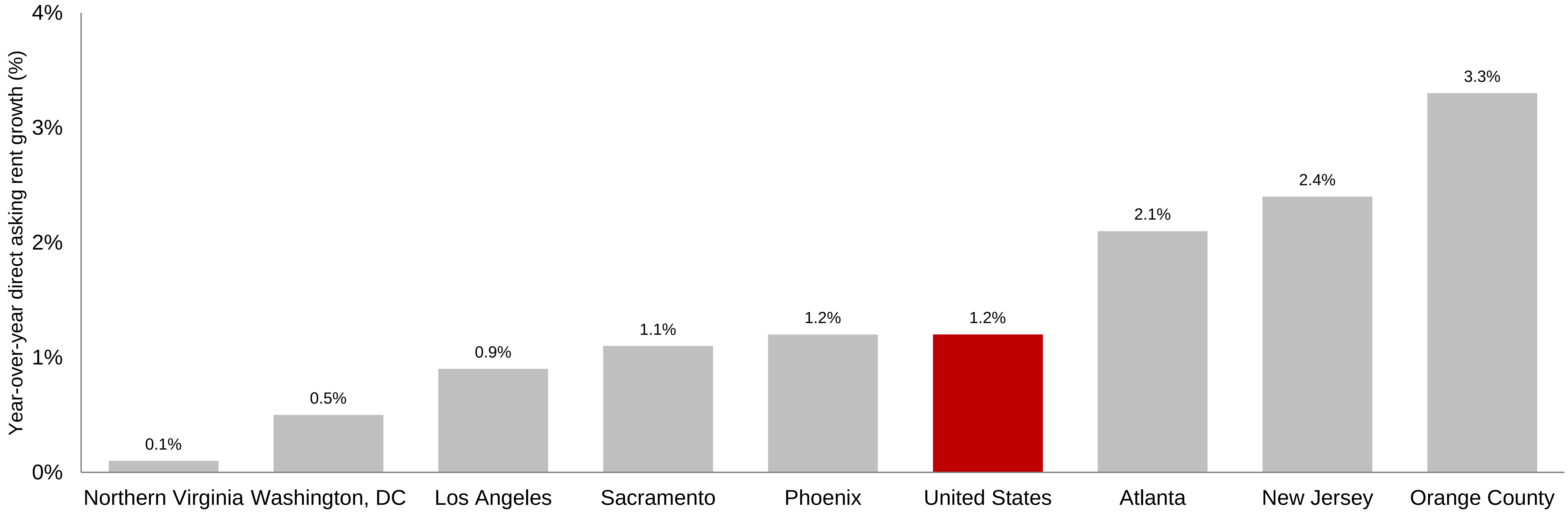
# Lease terms are extending as tenants return to the office and resume decision-making




Average lease terms are longer in MUST's markets than the U.S. as a whole, underlining tenants' confidence in those regions and lower risk profile with less exposure to shorter-term tech tenants.

Source: JLL Research – *data as of Q4 2021*

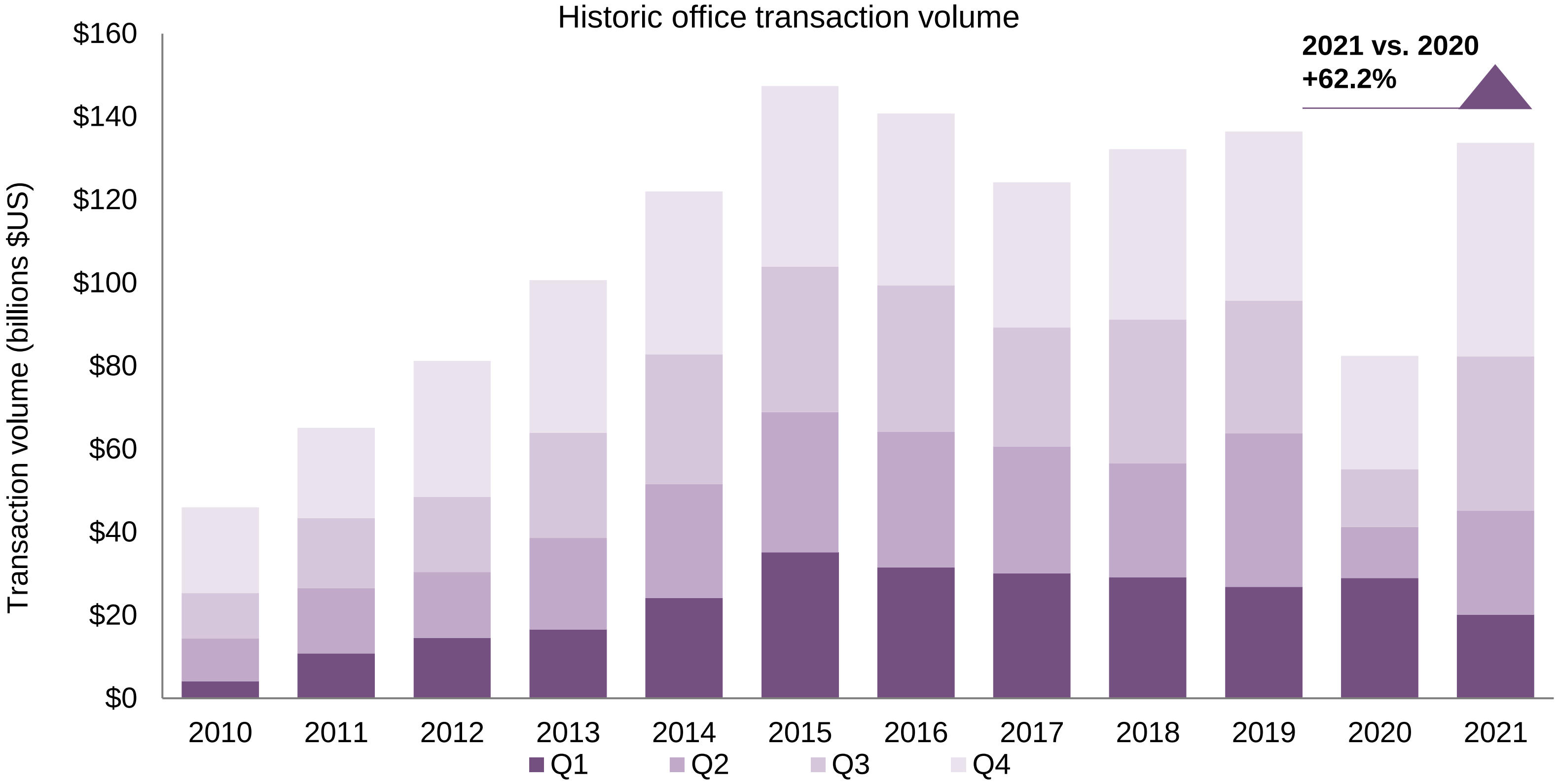
# Direct rent growth is modest as new blocks of higher-quality space hit the market




MUST rent growth averages out similarly to the U.S. overall. Lower volatility and a smaller development pipeline will help keep pricing in MUST markets stable as fundamentals are more balanced.

Source: JLL Research – *Q4 2021 vs. Q4 2020 asking rent growth*

# Office investment grows notably amid strong large deal activity in gateway markets during second half




**Volume in portfolio markets ($B)**

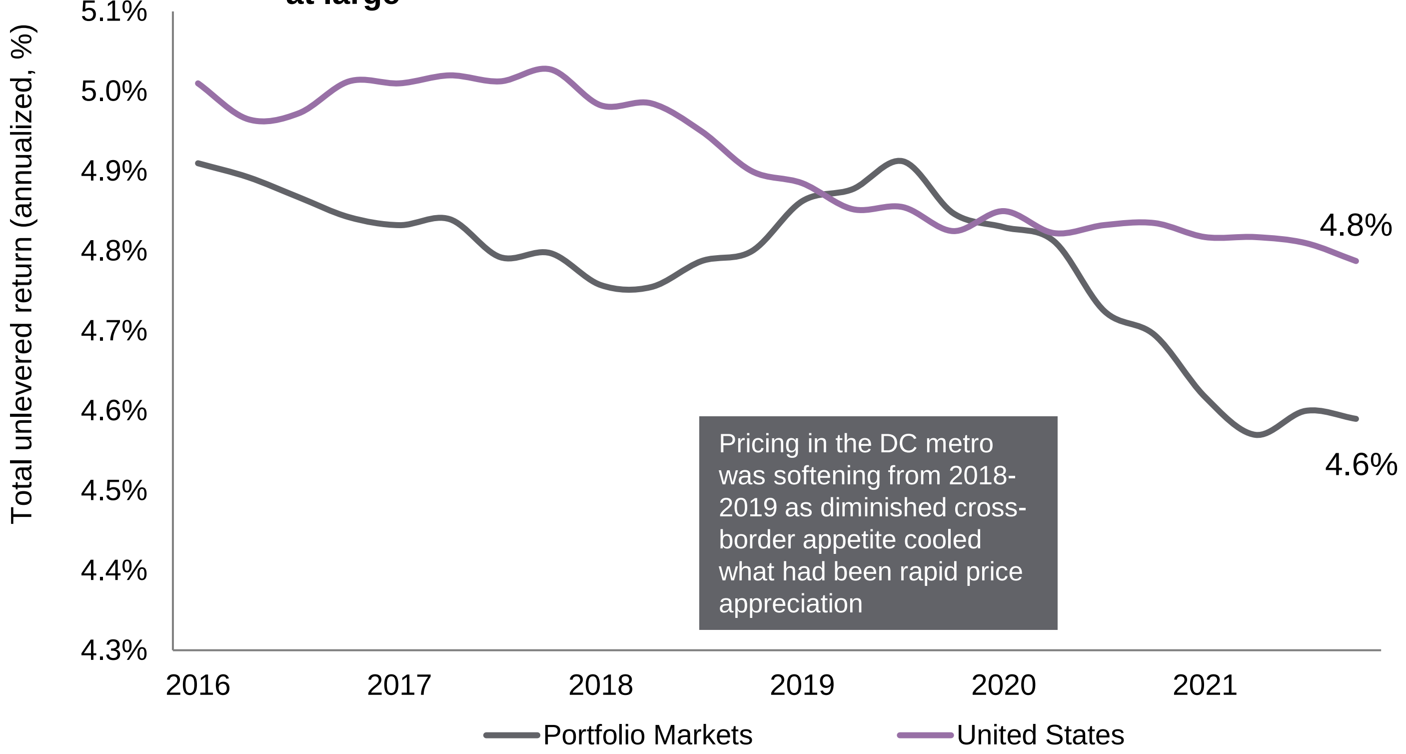
| Market | 2019 | 2020 | 2021 | Y-o-Y change |
|---|---|---|---|---|
| Atlanta | $2.1 | $0.9 | $2.9 | +218% |
| Los Angeles | $5.6 | $3.5 | $4.0 | +15% |
| New Jersey | $1.9 | $1.9 | $1.6 | -16% |
| Northern VA | $0.6 | $0.1 | $0.8 | +441% |
| Orange County | $1.8 | $1.2 | $1.8 | +59% |
| Phoenix | $2.1 | $1.0 | $2.2 | +131% |
| Sacramento | $1.0 | $0.7 | $0.4 | -42% |
| Washington, DC | $7.0 | $4.0 | $4.6 | +15% |
| **MUST portfolio** | **$22.1** | **$13.3** | **$18.3** | **+38%** |
| **U.S. overall** | **$136.5** | **$82.4** | **$133.7** | **+62%** |

MUST portfolio markets registered a healthy 37.5% increase in investment sales in 2021 despite lower exposure to primary geographies, with further runway for improvement in 2022.

Source: JLL Research

# Cap rates trending downwards; portfolio markets slightly outpacing U.S. average

**Cap rates for core product in portfolio markets are outperforming the U.S. at large**




**Overall cap rate impact by market**

| Market | 2020 Q1 avg. | 2021 Q4 avg. | Change (bps) |
|---|---|---|---|
| Atlanta | 6.39% | 6.10% | -29 |
| Los Angeles | 5.68% | 5.45% | -23 |
| New Jersey | 7.10% | 6.54% | -56 |
| Northern VA | 6.47% | 5.82% | -65 |
| Orange County | 5.81% | 6.13% | +32 |
| Phoenix | 7.89% | 6.77% | -112 |
| Sacramento | 6.87% | 7.11% | +24 |
| Washington, DC | 6.86% | 6.29% | -57 |
| Portfolio markets | 6.61% | 6.18% | -43 |
| **U.S. overall** | **6.53%** | **6.16%** | **-37** |

Faster declines in cap rates in MUST portfolio markets than the national average underscore investors' desire for stability and longer-term holds.

Source: JLL Research, Real Capital Analytics – *transactions > $5 million*

# Looking ahead

## Tenant demand

Net demand should remain slow but steady as tenants continue to struggle with uncertainty over return-to-office timelines, hybrid work programs and an increasingly geographically dispersed workforce.

## New construction

Completions will continue to outpace starts, bringing the overall pipeline down.

## Vacancy rates

Occupancy will be bifurcated by vintage, location and quality, with commodity assets struggling with structural vacancy.

## Cap rates

Limited investment alternatives and inflation hedging will support asset values despite gradual interest rate hikes and choppy leasing fundamentals in many segments.

## Sales volume

Abundant dry powder and a global search for yield should signal greater transaction volume in 2022. Office is viewed increasingly opportunistically given overheating in other asset classes.

## Economic growth

Easing supply chain disruption will help to propel additional growth into 2022, although GDP will increase more slowly after a blockbuster 2021. Labor shortages will remain.

# Thank You

**Scott Homa**
Senior Director, Research
Property Sectors
Scott.Homa@am.jll.com

**Phil Ryan**
Director, Research
U.S. Office
Phil.Ryan@am.jll.com