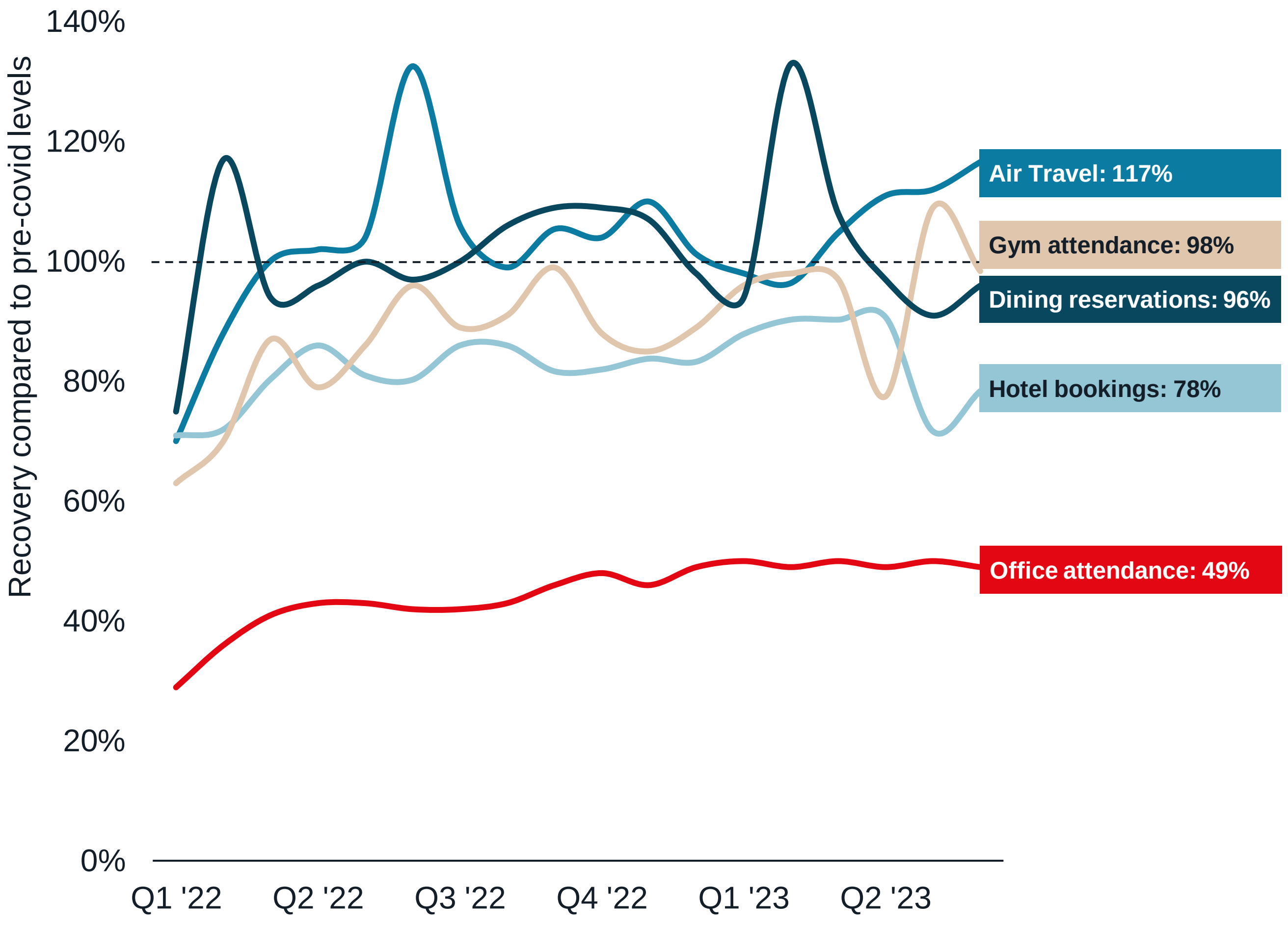
MUST Insights

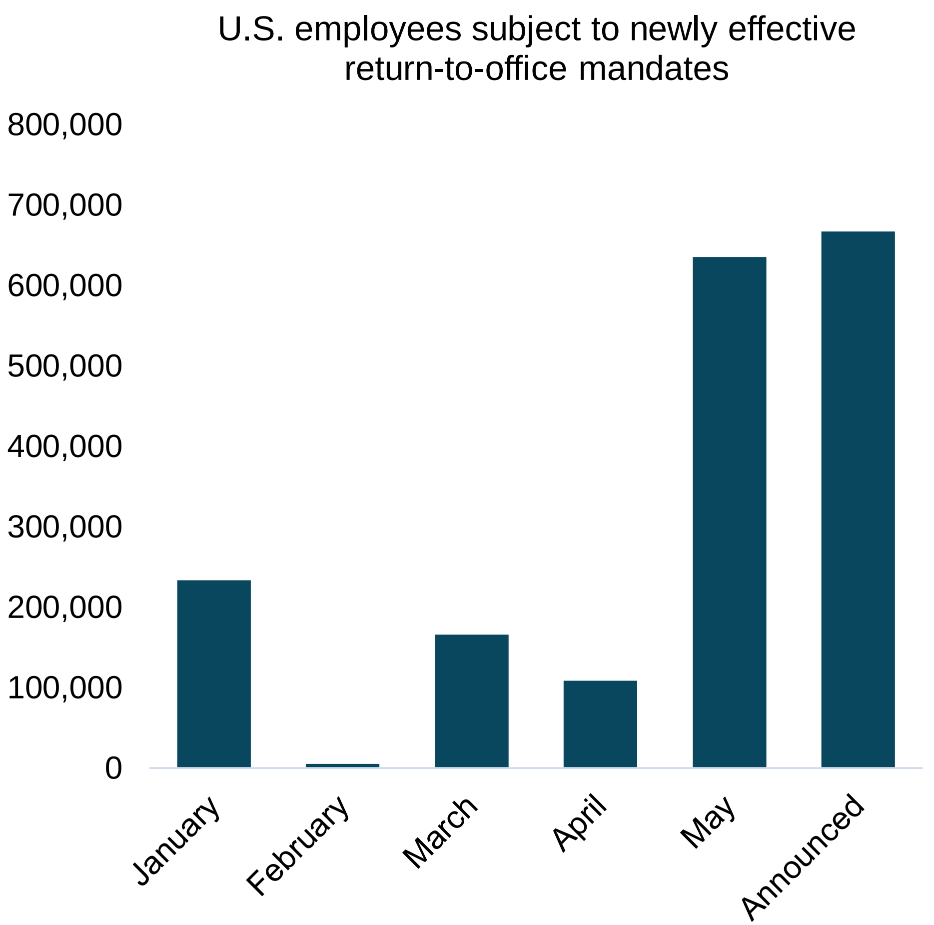
What lies on the horizon for U.S. office?

12 July 2023

SEE A BRIGHTER WAY

Office attendance remains stubbornly low, but new RTO mandates will cumulatively impact 1.8 million employees





Source: JLL Research, Placer.AI, Kastle Systems, OpenTable, TSA, data as of 6-6-23

Widespread RTO push actively underway

Meta Platforms
Beginning September 5, Meta employees will be expected to work from the office three days per week.

JP Morgan
5 day per week in-office requirement for senior employees beginning Spring 2023 and stricter enforcement of 3x for all staff.

Blackrock
Beginning September 11, employees will be expected to be in the office four days per week with one flex day.

Lyft
Beginning in fall, workers will be expected to RTO Mon, Wed, and Thu, with Tue strongly encouraged.

Apple
Instituting stricter monitoring and enforcement of hybrid employees' attendance

Capital One
Shifting from work-from-anywhere to three days per week attendance policy

Discover Financial Services
Shifting from work-from-anywhere to three days per week attendance policy

PricewaterhouseCoopers
Shifting to 100% in-office policy beginning Spring 2023

Skadden, Arps, Slate and Meagher
Instituting four day per week in-office mandate

Robinhood
Reversed flexible policy to require employees to attend offices 4+ days per week.

AT&T
In July, managers in Dallas and Atlanta must be in the office 3 days per week. All other managers starting September.

United States Dept. of Veteran Affairs
Beginning in September, employees will have to visit offices five times per two weeks.

Amazon
Shifting to three day per week attendance policy on May 1, rejected employee petition to prolong remote work

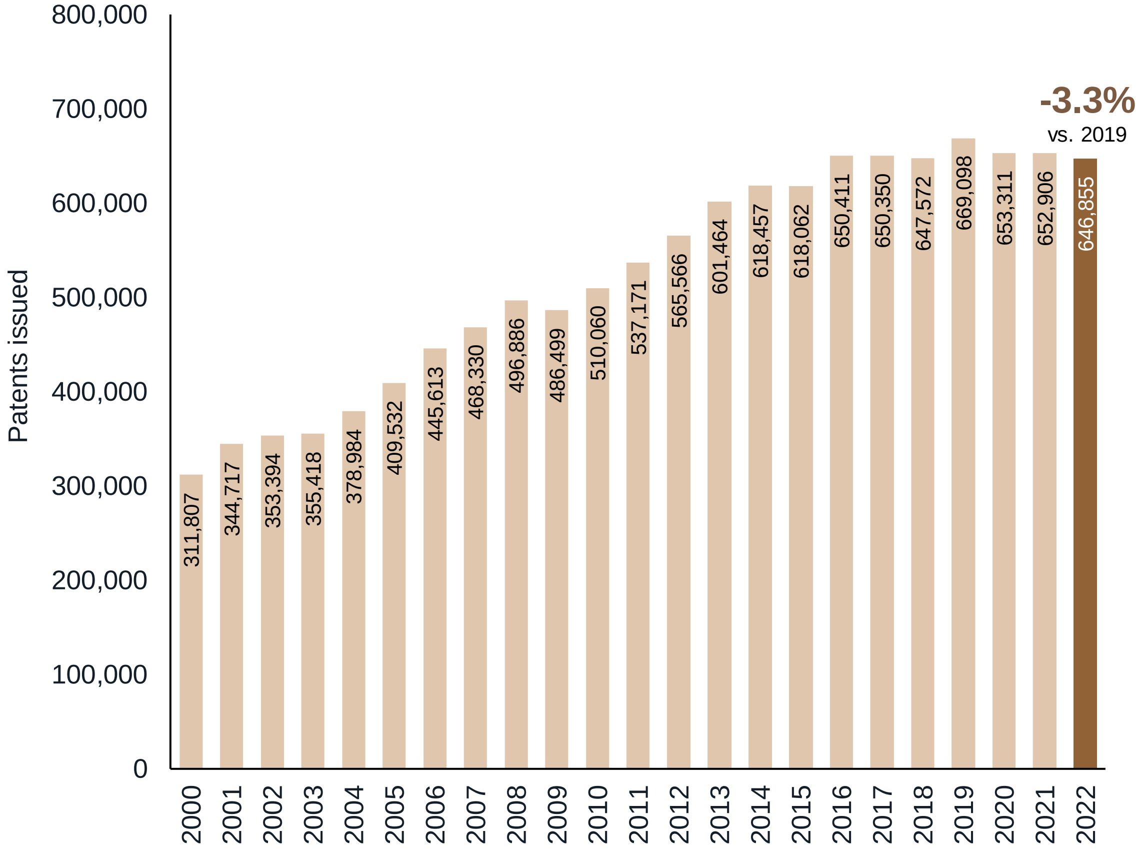
Deloitte
Increasing hybrid attendance policy from two days per week to three days per week

Geico
Shifting from work-from-anywhere to two days per week attendance policy

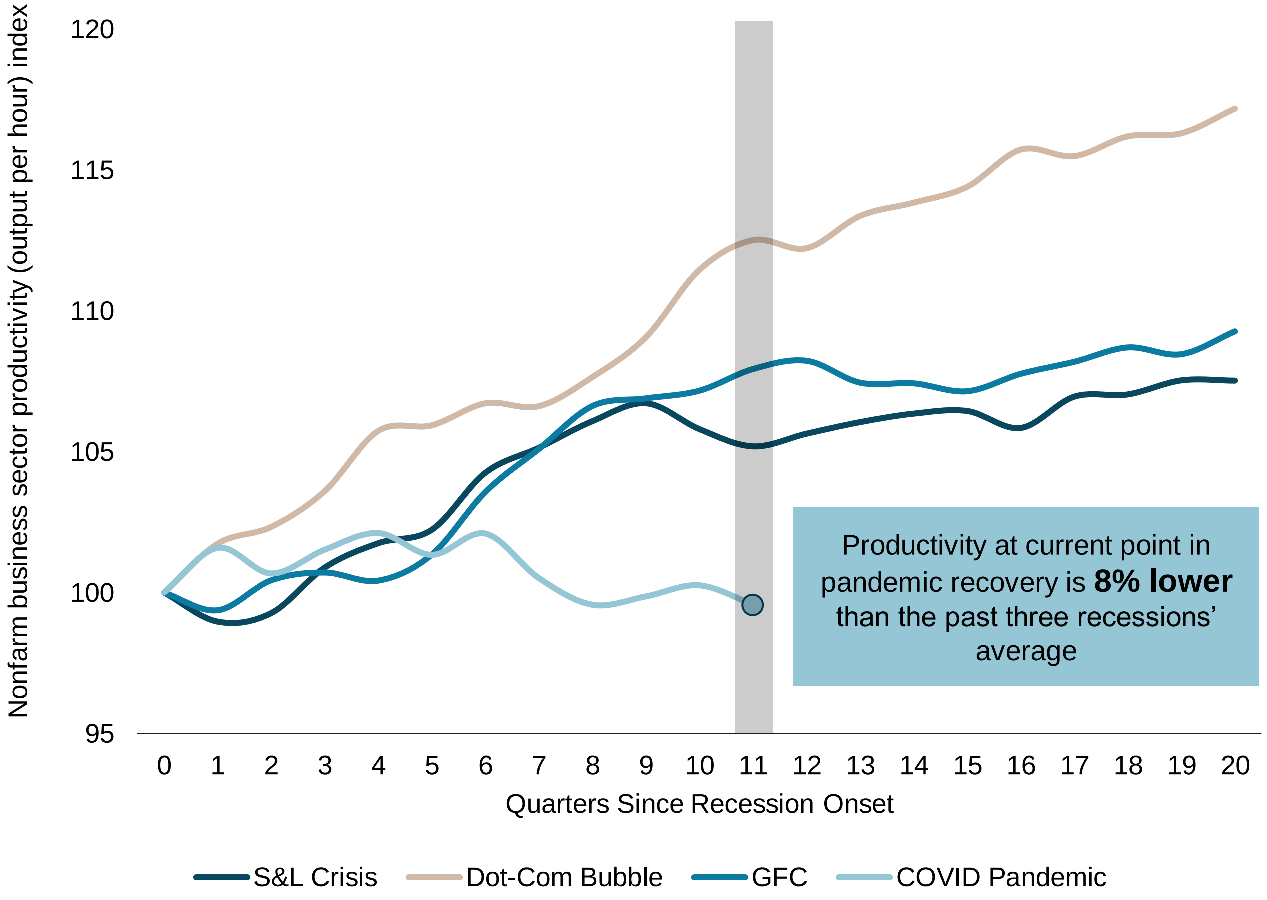
USAA
Select roles shifting back to full-time onsite

Innovation and productivity have underperformed in recent quarters

Patent application volume experiencing a prolonged reduction

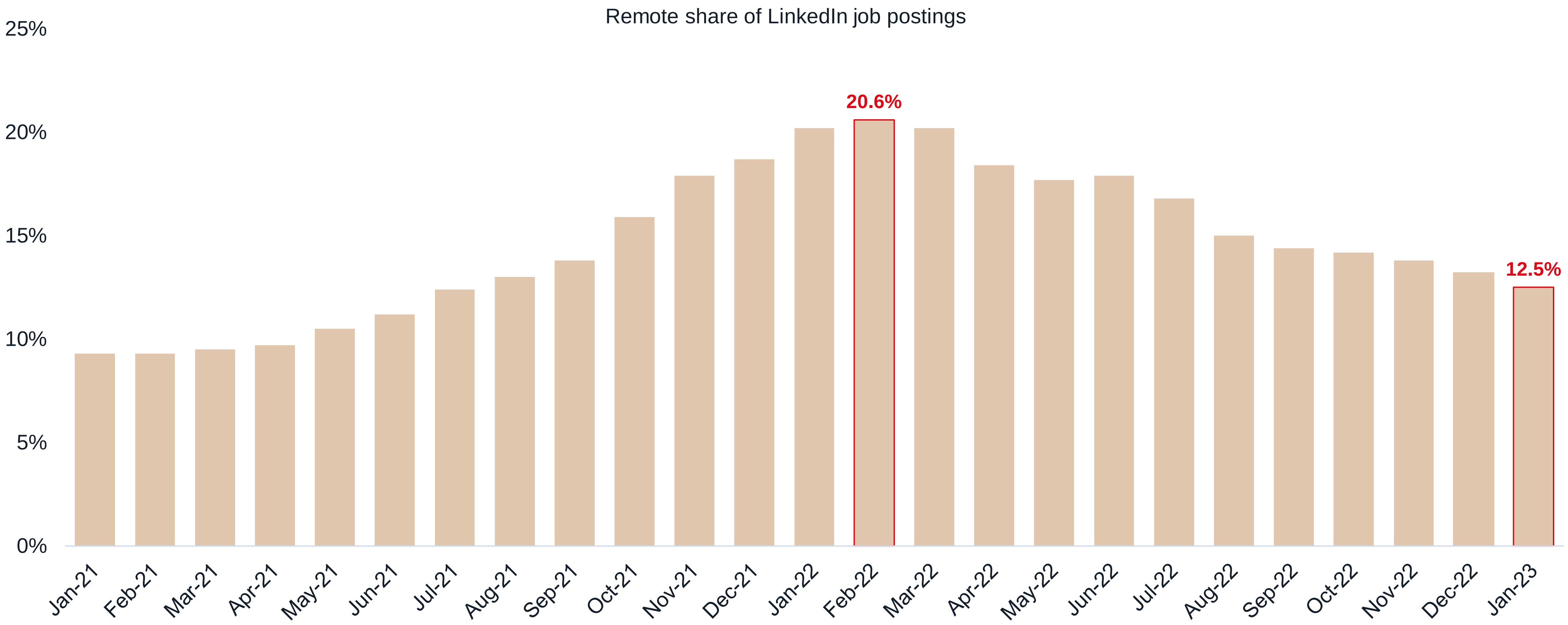


Business sector productivity has experienced its sharpest decline on record



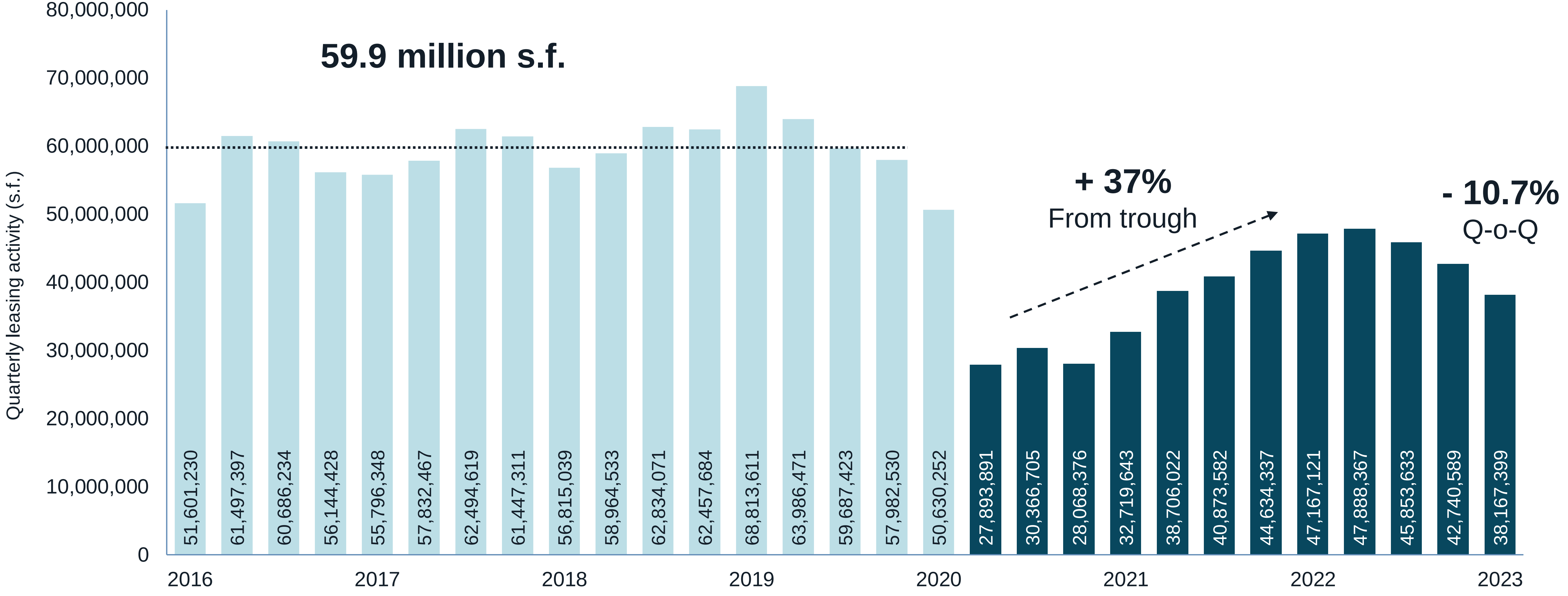
Source: JLL Research, USPTO, BLS

Share of remote job positions falling



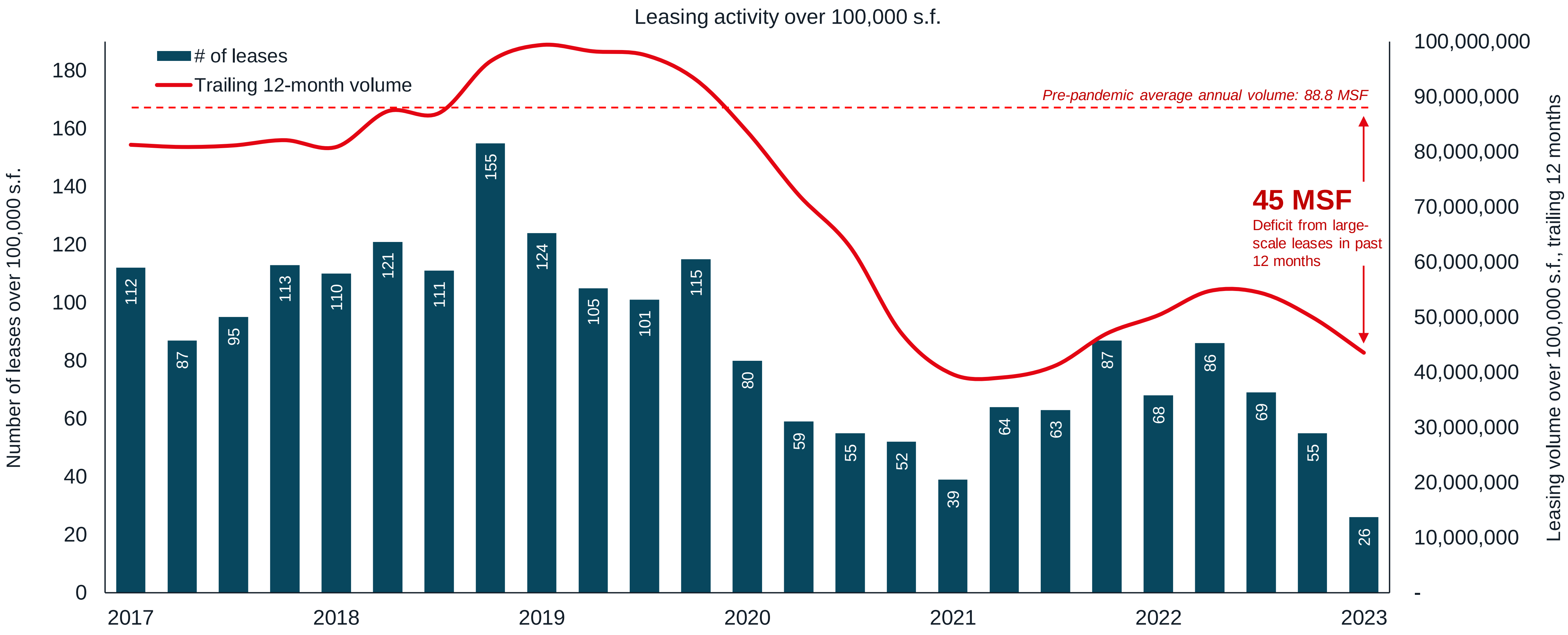
Source: JLL Research, LinkedIn Economic Graph

Leasing activity declines in Q1 2023, marking third consecutive quarter of deceleration



Source: JLL Research

Pause in large-scale deal velocity as companies assess economic risks



Source: JLL Research

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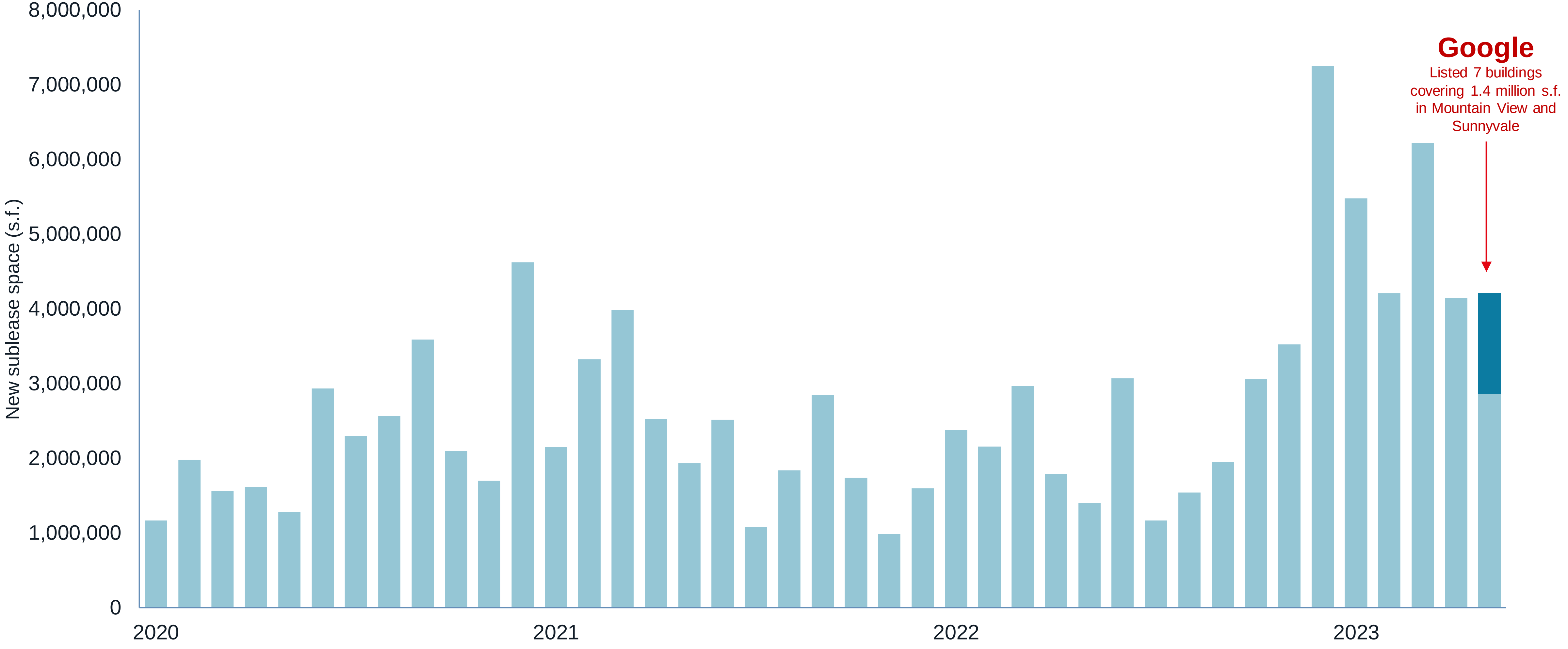
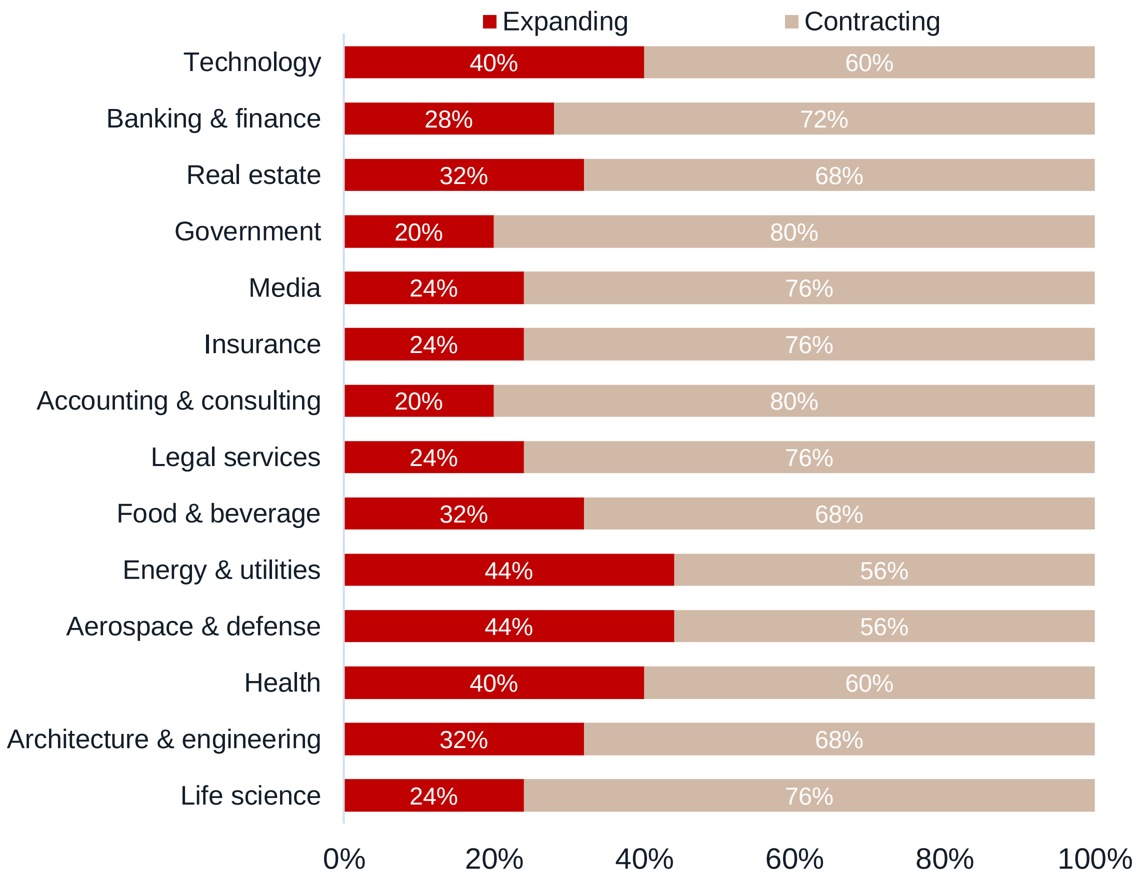
Sublease dispositions remain above pandemic levels in 2023, with Google contributing 1.4 million s.f. to sublease supply in May

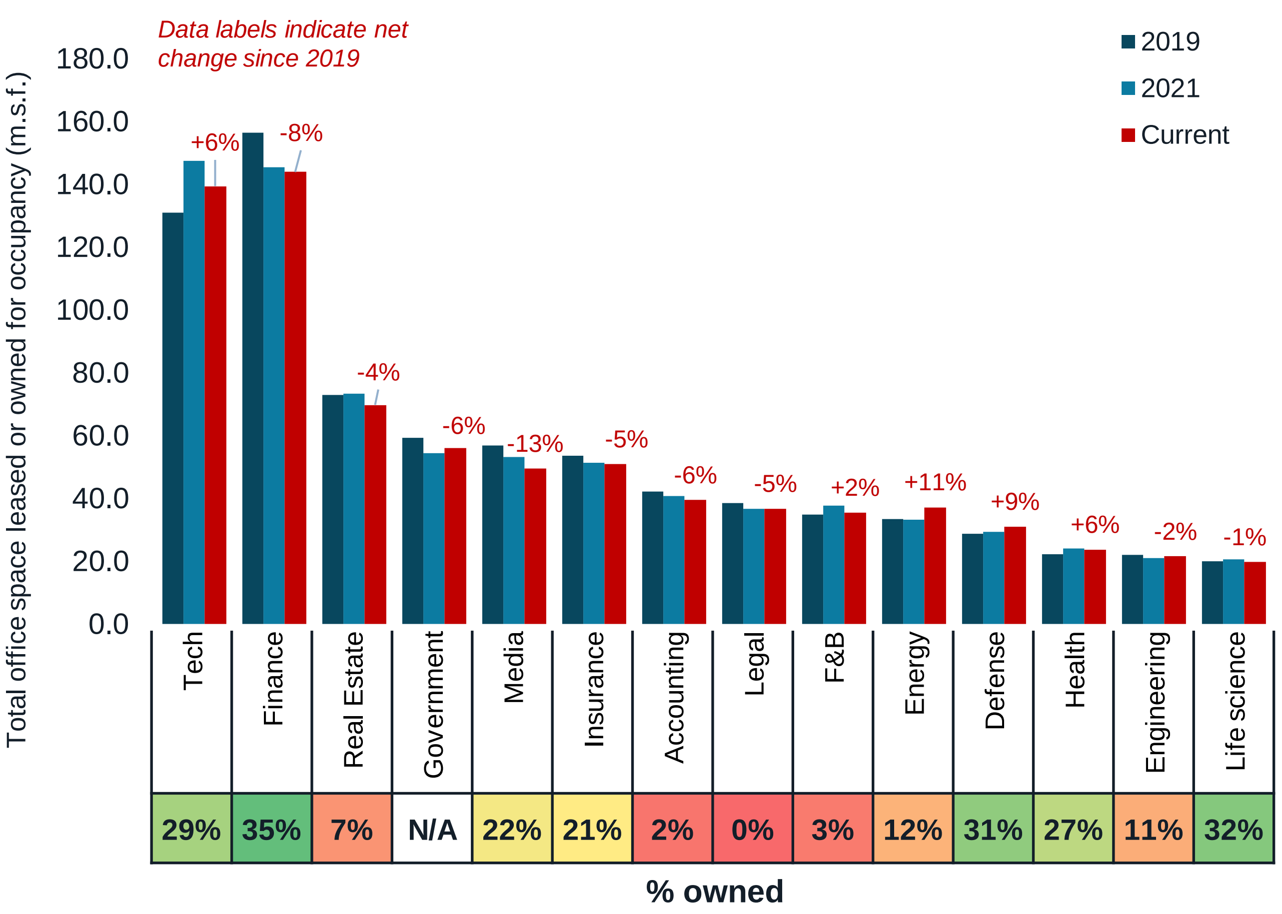


Most of the largest office tenants have contracted office footprints since the pandemic onset

25 Largest Tenants’ Change in Office Portfolio since 2019



Net change in footprint by industry, top 25 occupiers



Source: JLL Research
Note: Footprint changes are inclusive of owner-occupied office assets.

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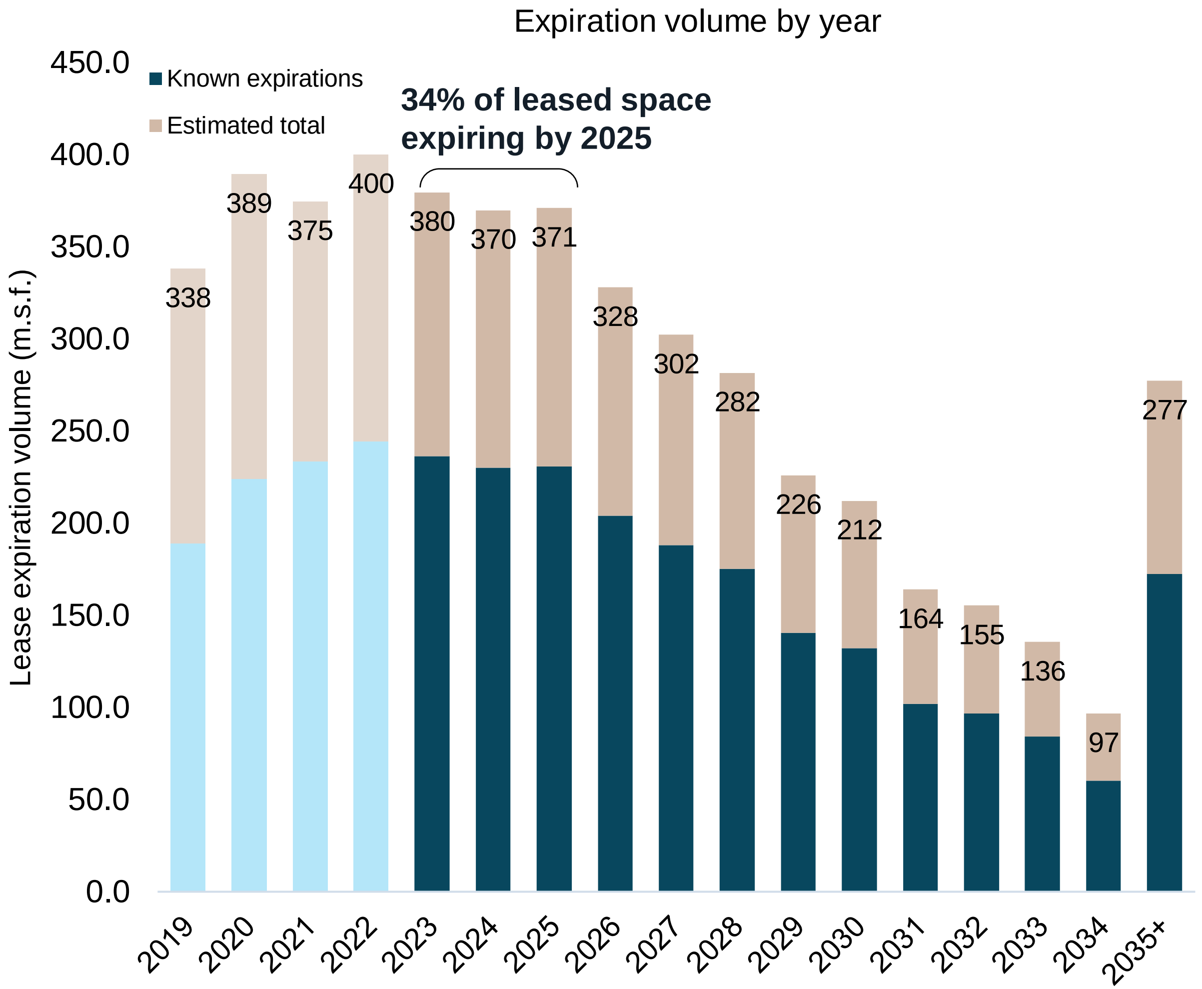
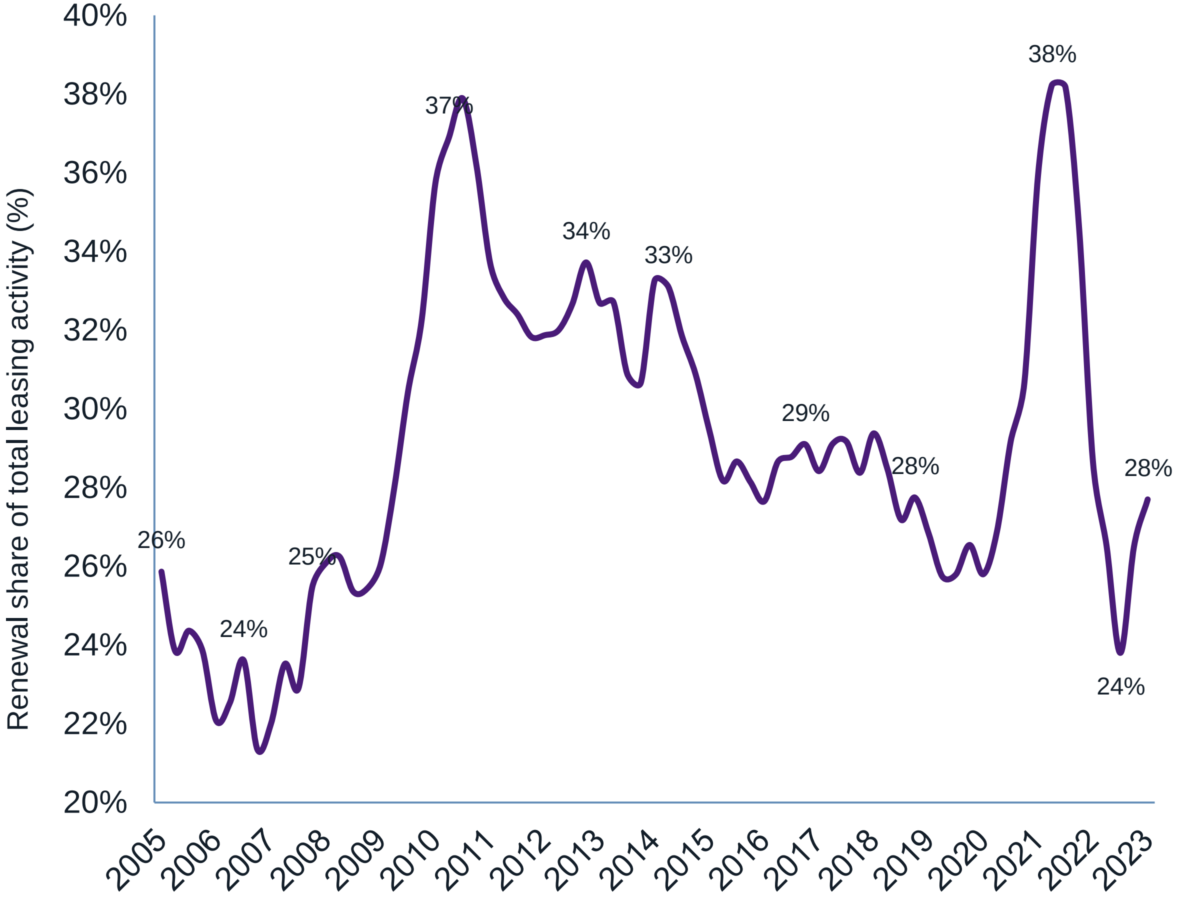
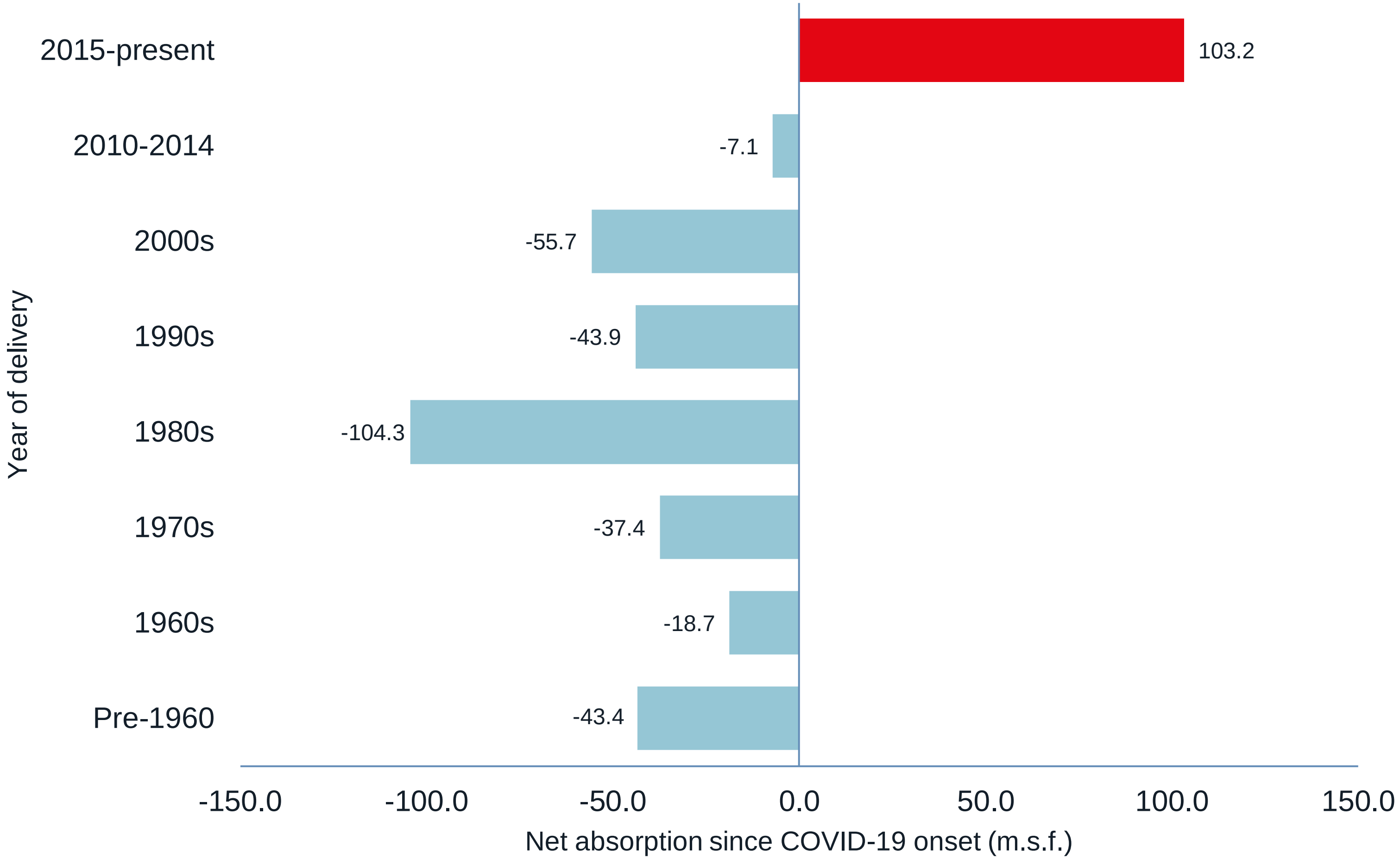
Lease expirations remain high while renewal rates remain low





Source: JLL Research

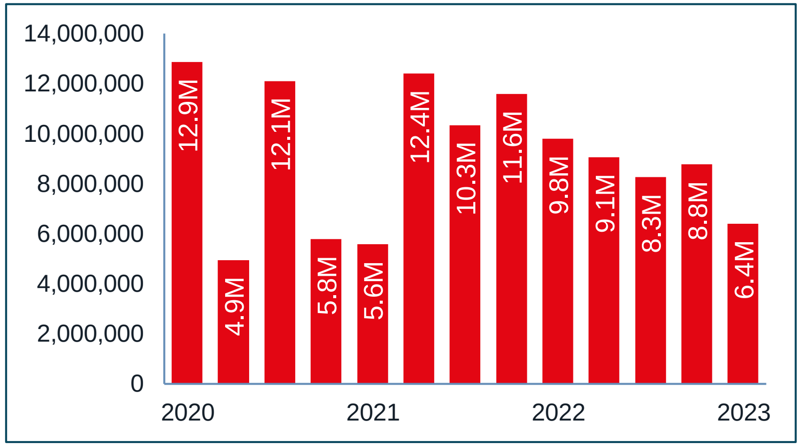
Flight to quality produces over 100 m.s.f. of positive net absorption in new-vintage buildings



The Alexandria Center
Seattle
Bristol-Myers Squibb
242,000 s.f.

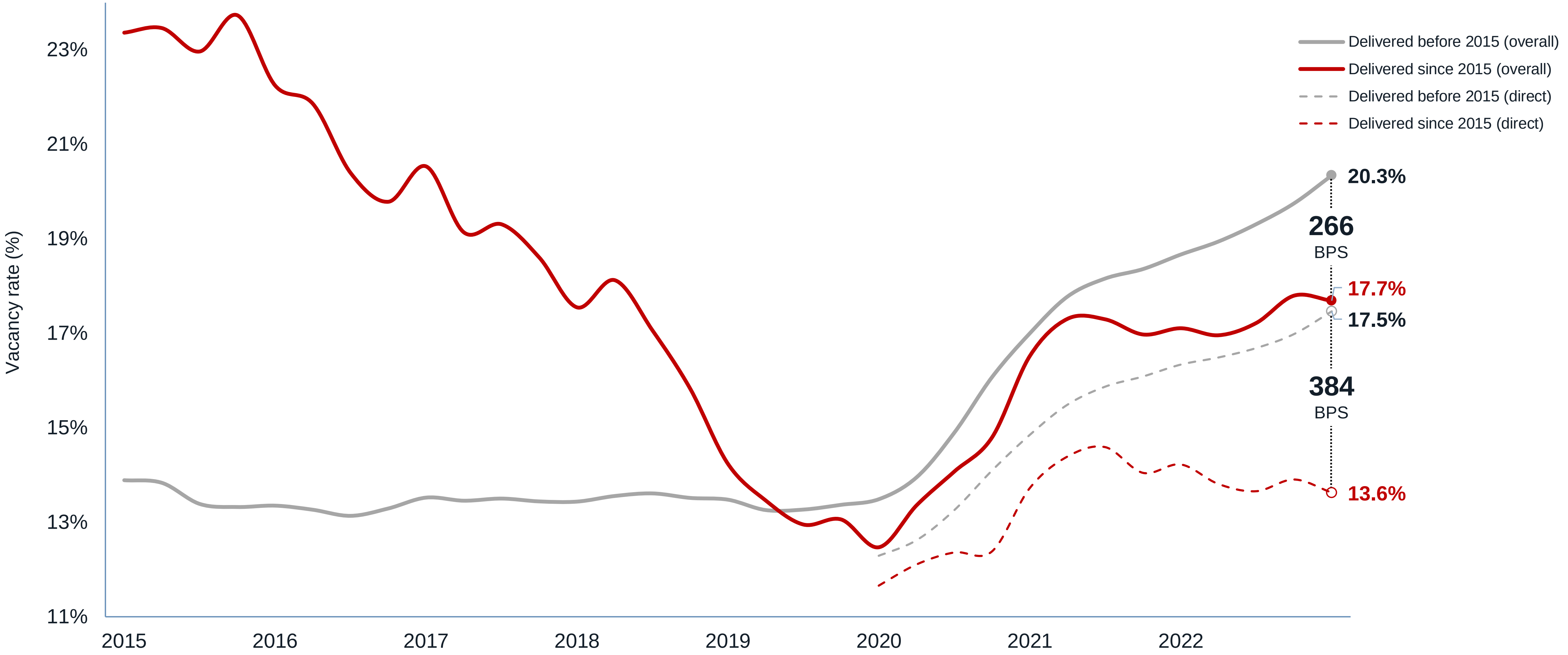
Station 2
Mid-Peninsula
Roblox
180,000 s.f.

Quarterly net absorption in offices built since 2015



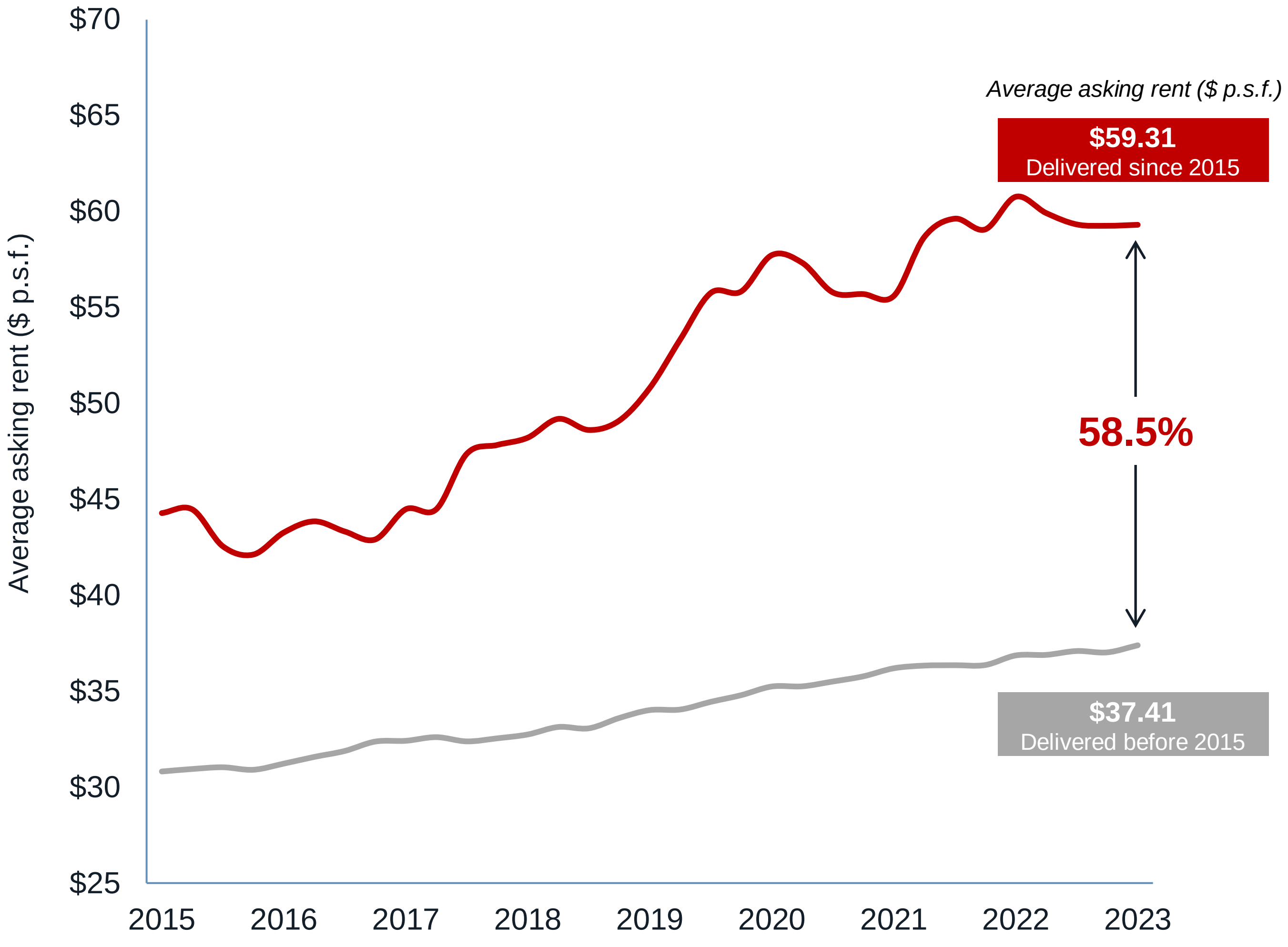
Source: JLL Research

New construction vacancy gap widens as deliveries slow

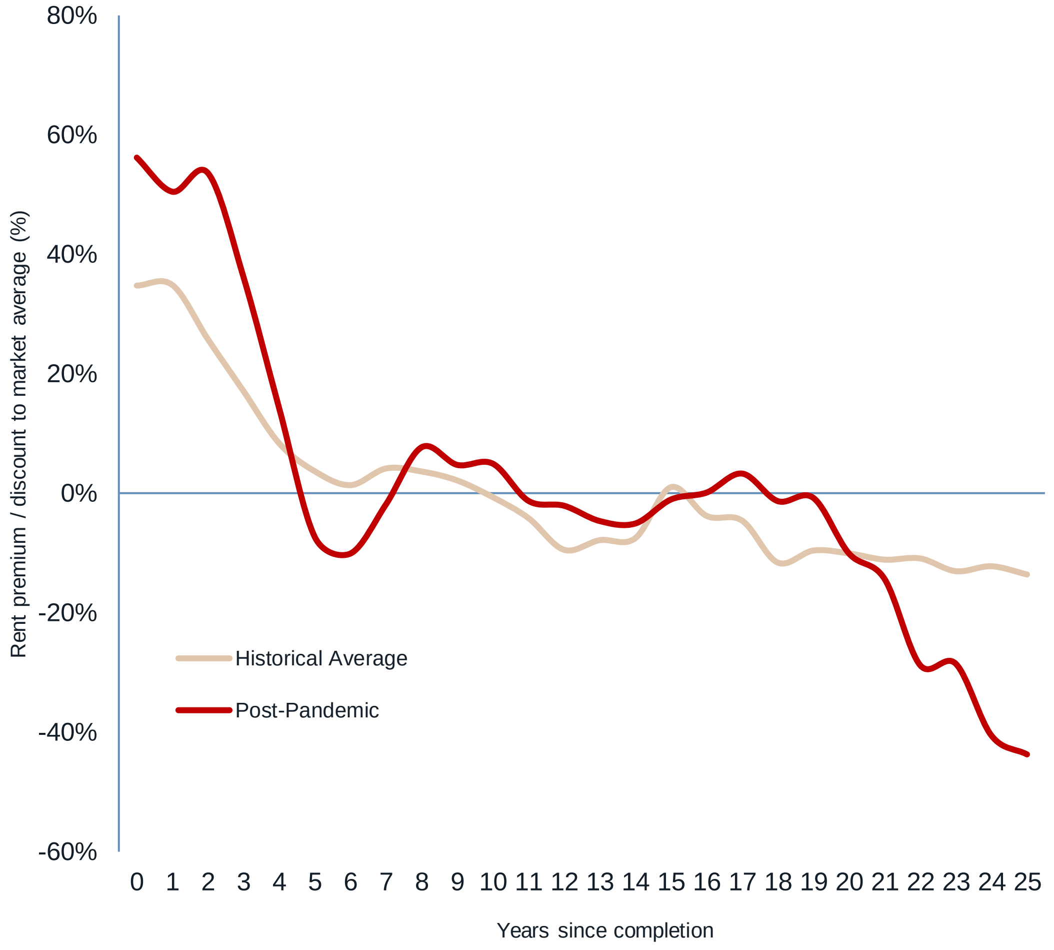


Source: JLL Research

Rent premiums for new construction remain elevated

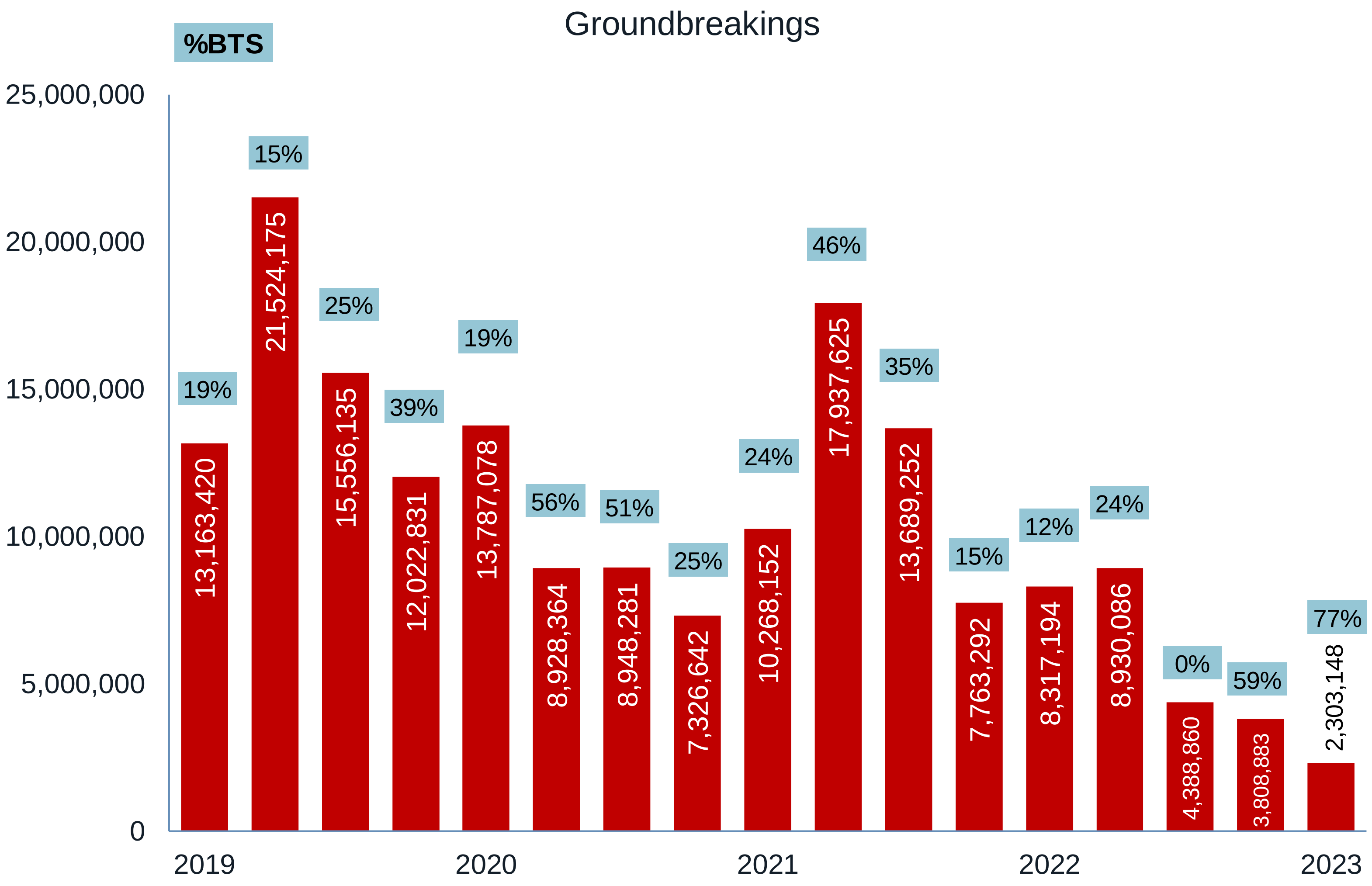


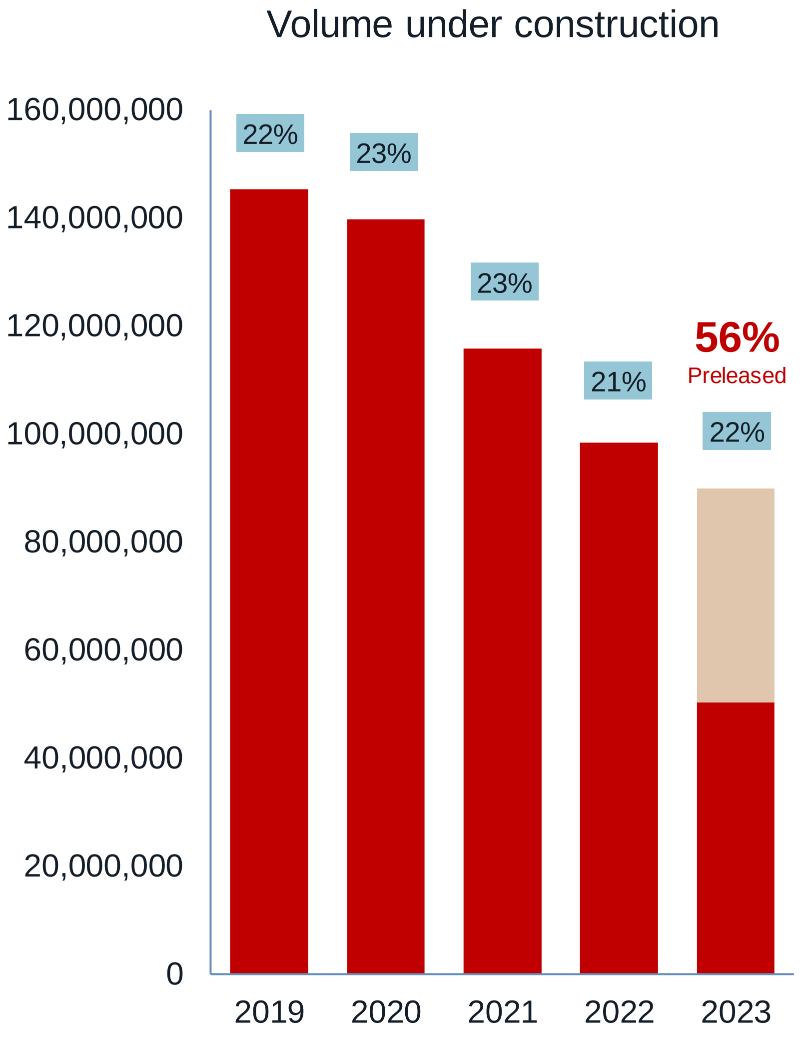
Rent premiums for new construction are widening, as are rent discounts for older vintage



Source: JLL Research

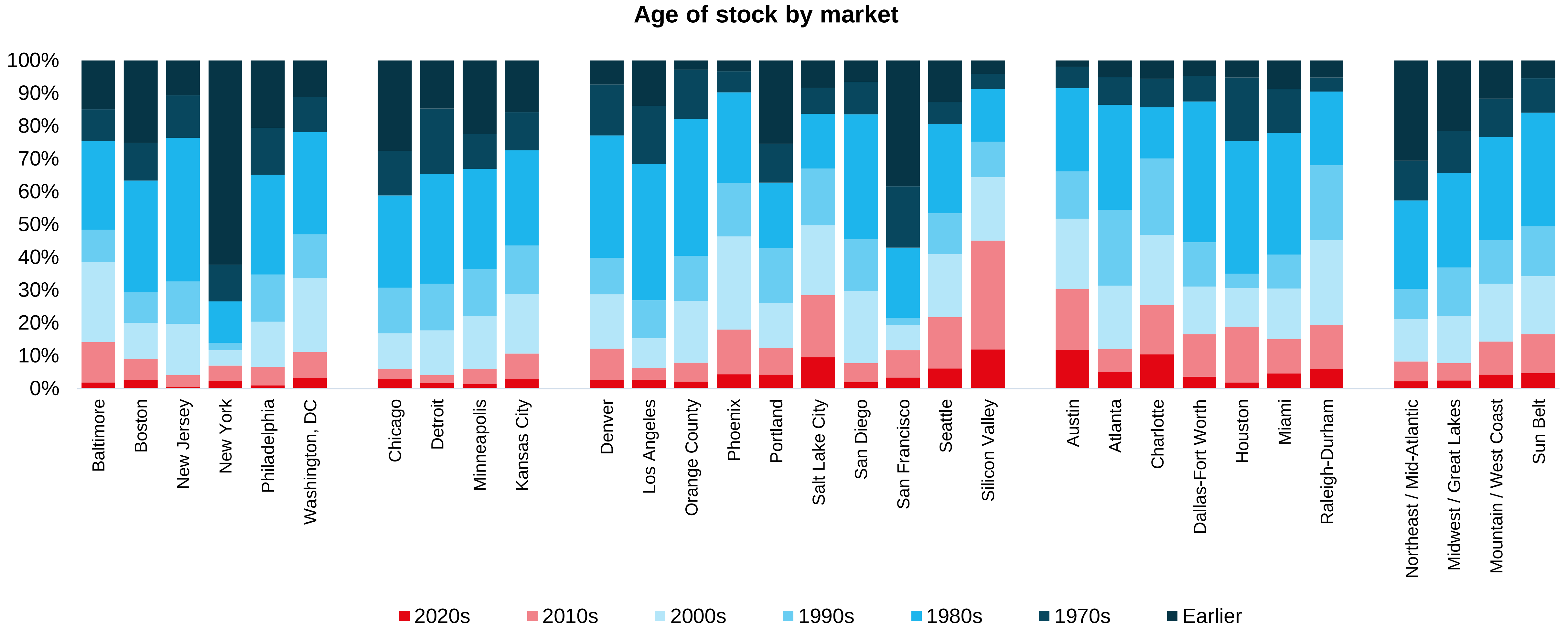
Limited groundbreakings driving down new direct supply





Source: JLL Research

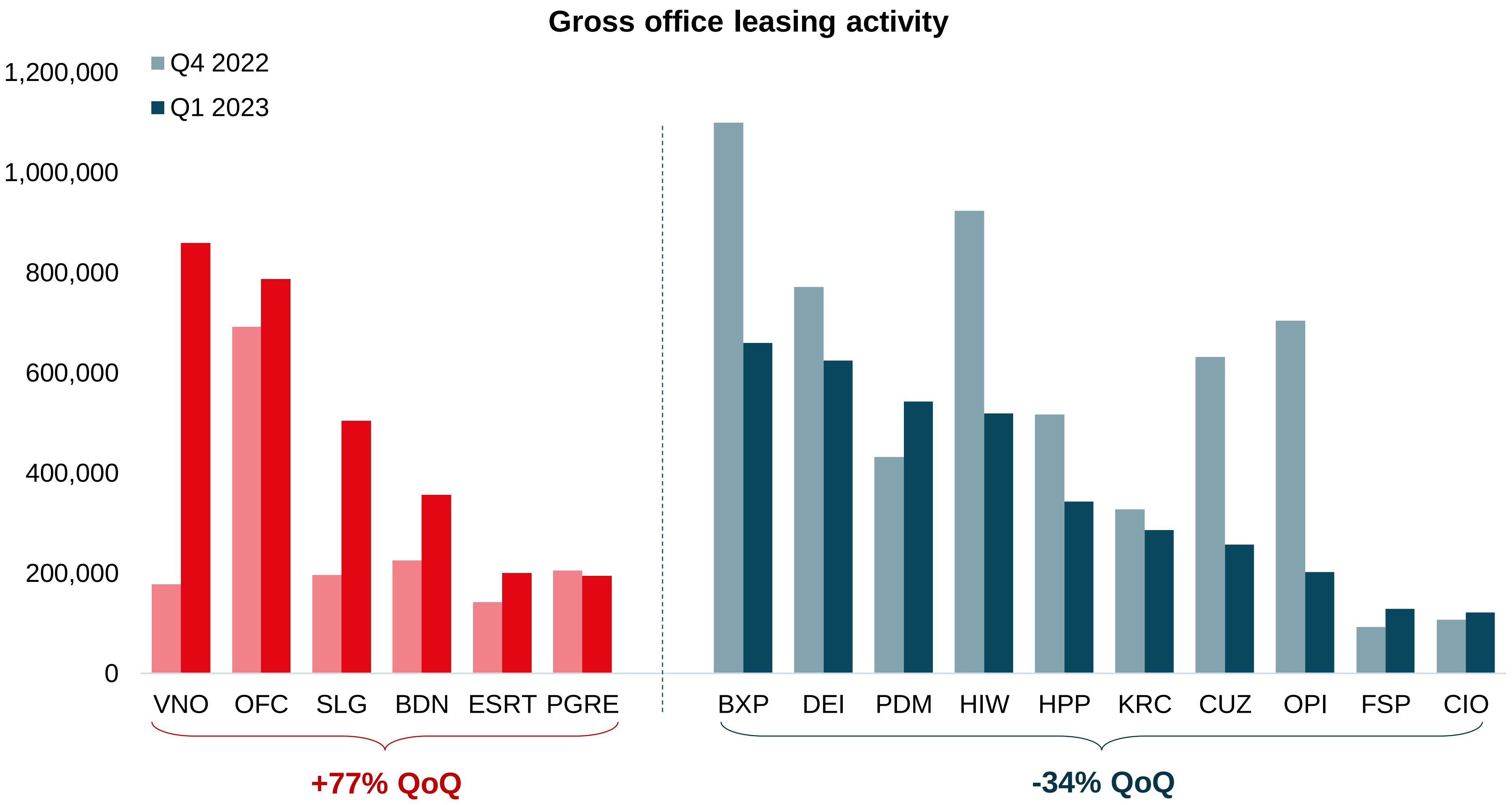
Sun Belt and West Coast gateways see highest concentration of new construction



Source: JLL Research

U.S. Office REITs: Diversified gateways vs tech-heavy gateways

- Divergence in QoQ leasing trends
- REITs with majority of investments in East Coast gateway markets seeing leasing volume grow, while REITs more exposed to growth markets and tech-dominant gateways have seen leasing velocity slow notably.
- Of the groups with majority of holdings in East Coast gateway: SL Green, Vornado, COPT, Brandywine, Empire State, Paramount saw 77% QoQ growth in leasing volume, with only PGRE (with the greatest Bay Area exposure in this set) seeing leasing volume slow moderately QoQ
- Remaining REITs with greater focus on West Coast gateway / Sun Belt growth markets are seeing a sharper short-term demand slowdown; leasing down 34% QoQ.
- Outperformers within the lagging group typically have similar geographical trends:
  - Piedmont has large Sun Belt exposure + ~30% of holdings in East Coast gateway
  - Franklin Street has significant exposure to non-Sun Belt secondary markets e.g. Denver and Minneapolis.



Source: JLL Research

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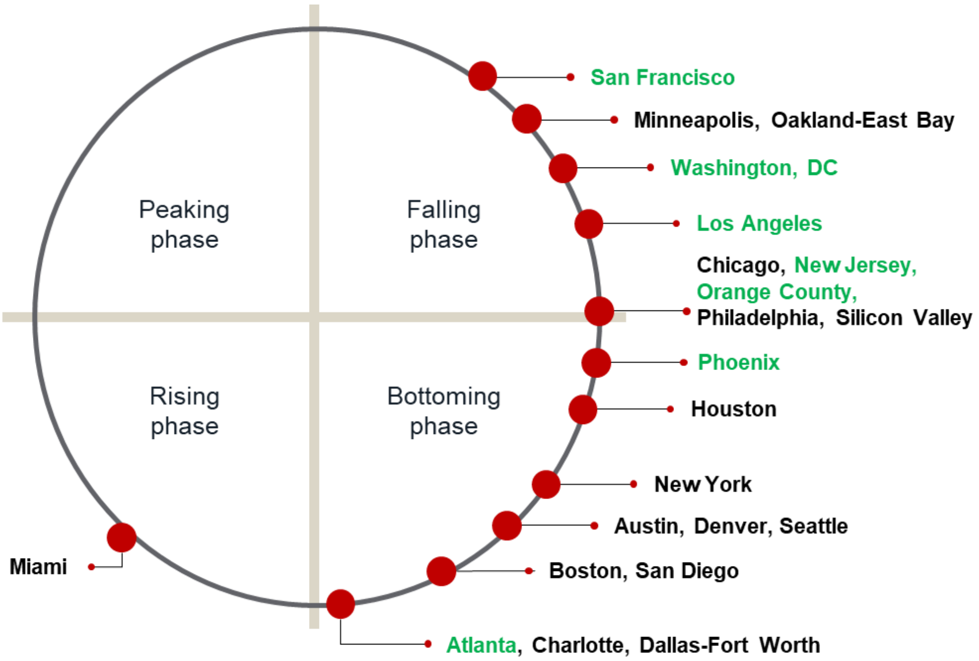
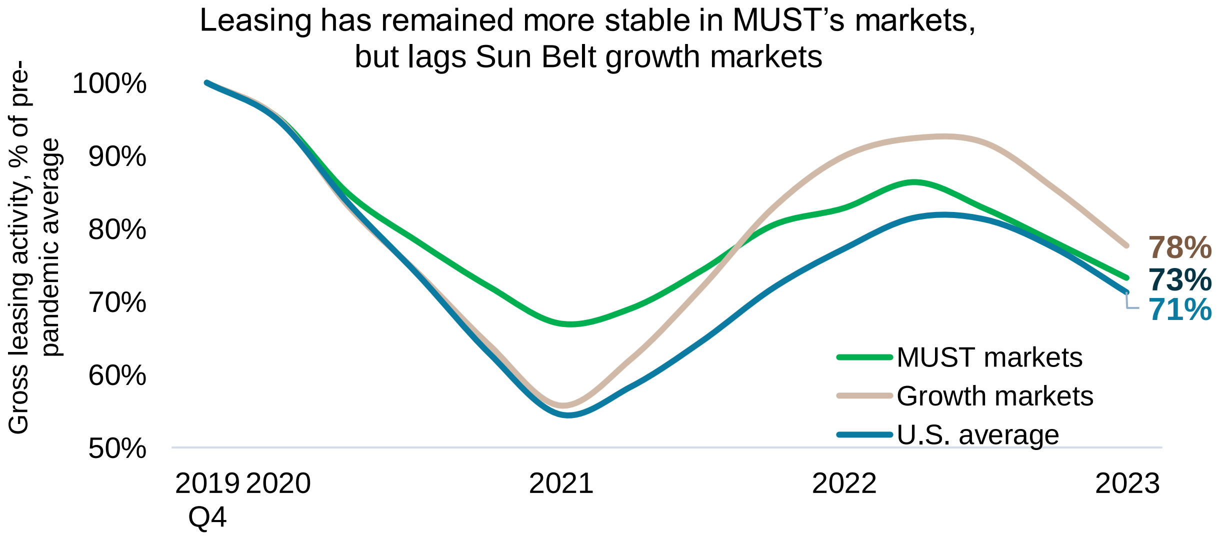
Regional market conditions

Market	2022 Net Absorption	Q1 2023 Net Absorption	Total Vacancy	Direct Rent (p.s.f.)	U/C Pipeline (% inventory)
Atlanta	1,150,344	-462,096	21.4%	$33.18	3.2%
Austin	612,768	-562,123	18.1%	$53.64	18.3%
Boston	-2,751,117	-1,659,179	18.1%	$46.87	6.3%
Charlotte	574,435	-831,018	20.6%	$35.00	5.5%
Chicago	99,330	-550,422	22.4%	$37.37	0.7%
Dallas	-1,854,455	-587,299	23.2%	$32.67	4.5%
Denver	-1,598,653	-476,353	21.6%	$34.03	4.5%
Houston	-252,346	-221,183	25.7%	$31.47	0.9%
Los Angeles	-2,437,530	-1,571,566	22.5%	$46.25	0.0%
Miami	644,438	54,590	16.4%	$50.44	8.1%
Minneapolis	-2,982,522	-502,823	19.7%	$31.29	0.8%
New Jersey	-161,218	-1,808,690	25.8%	$30.45	0.1%
New York	-2,290,301	-1,415,248	15.9%	$81.64	3.5%
Oakland-East Bay	-897,682	478,478	22.0%	$45.15	0.0%
Orange County	-1,025,468	-1,132,877	17.6%	$34.33	0.3%
Philadelphia	-1,850,957	-679,796	18.8%	$28.90	0.7%
Phoenix	-1,896,655	-797,677	23.9%	$29.52	0.0%
San Diego	381,336	-227,057	12.1%	$41.27	10.1%
San Francisco	-2,802,975	-1,140,896	25.1%	$78.12	0.1%
Seattle	-1,258,209	-725,504	16.7%	$49.38	4.4%
Silicon Valley	-518,140	833,381	17.3%	$71.02	13.7%
Washington, DC	-1,601,587	563,193	20.8%	$42.52	0.6%
United States	-1,032,598	-610,098	20.3%	$44.52	3.9%

Source: JLL Research





Recovery/growth drivers in MUST’s markets

Sacramento

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

Los Angeles

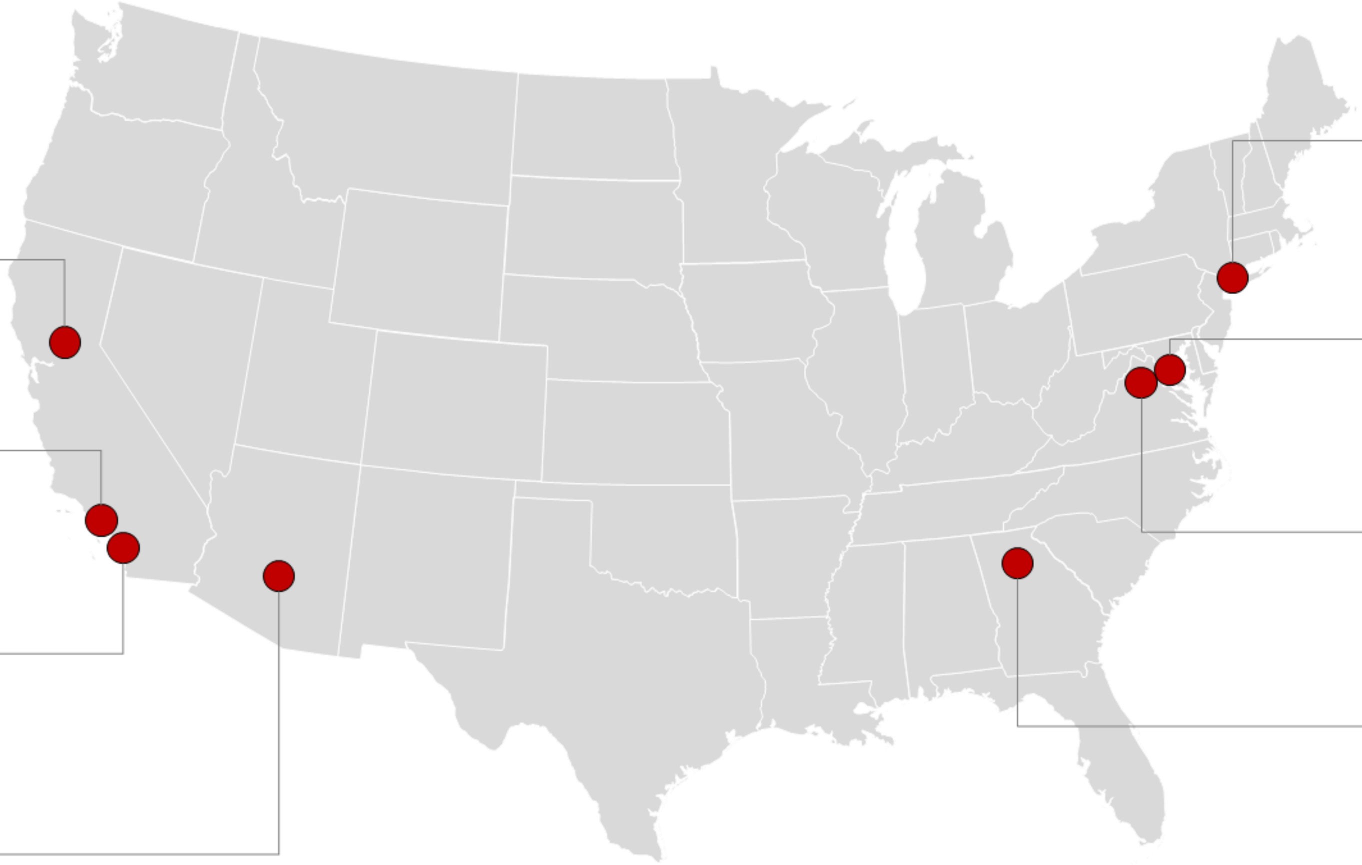
- Epicenter of media and entertainment industry, which has thrived throughout COVID.

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.

Source: JLL Research

Workplace strategy trends

Hybrid work

Employers are finalizing hybrid work policies, with most allowing 2 days per week of locational flexibility

Flexible space design

Spaces are being designed to accommodate flexibility – with fewer dedicated workstations and more collaborative spaces

Experiential spaces

Tenants are upgrading their offices with premium amenities and hospitality services to help lure remote workers back to the office

Hub-and-spoke

Companies are adapting to a more distributed workforce by targeting “work-near-home” options, which include non-gateway markets where employees enjoy greater affordability

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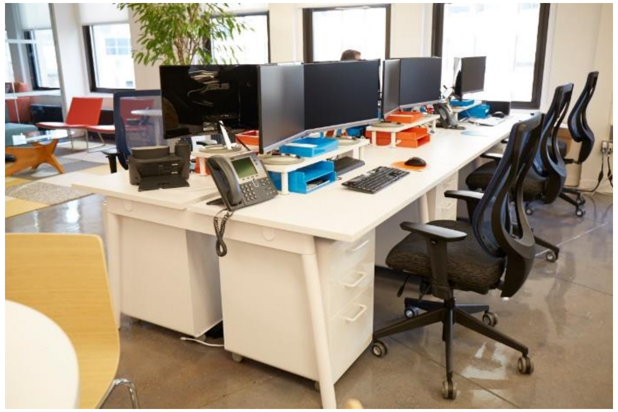
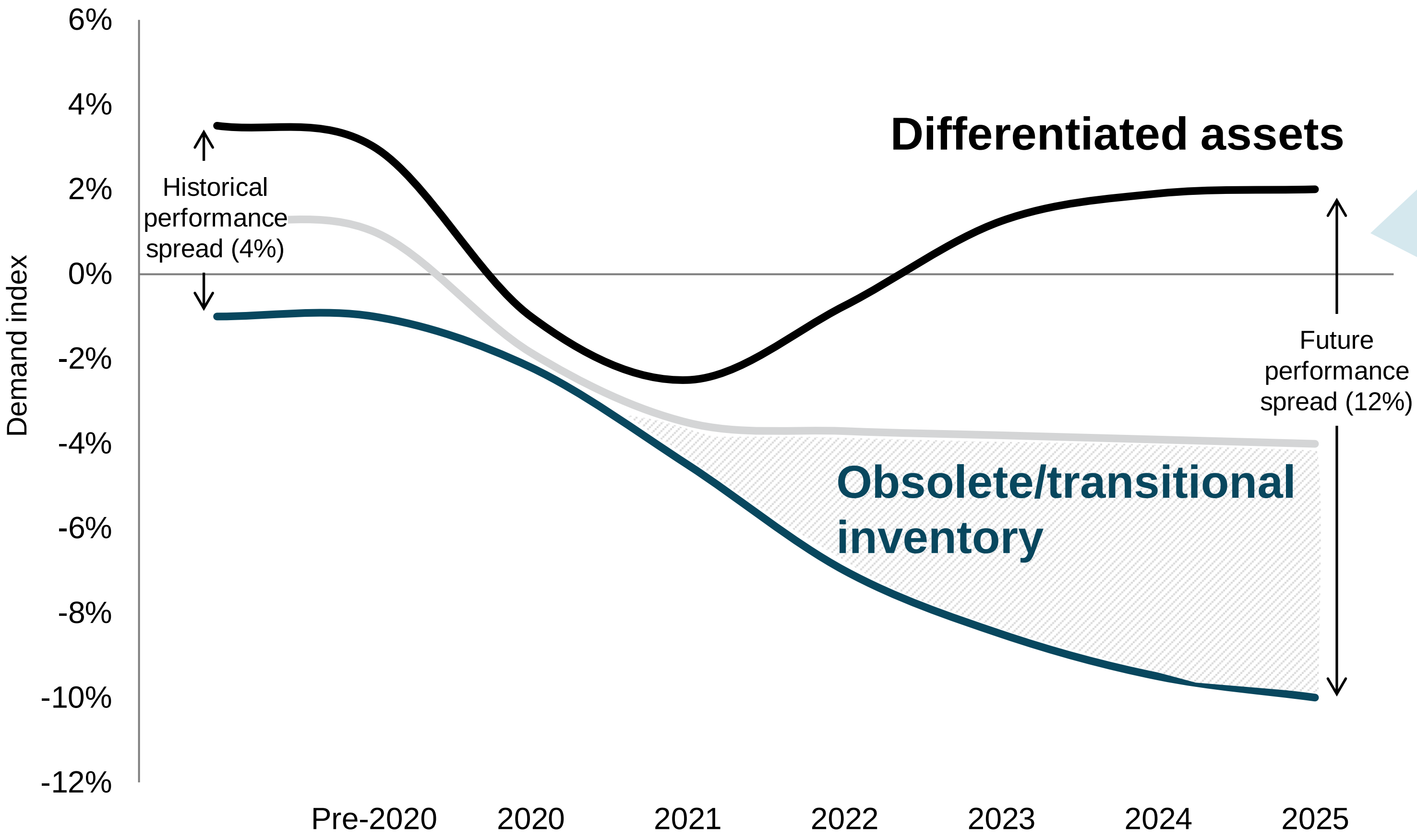
Tactical workplace shifts



1. Ratio of **unassigned seating** to dedicated desks is increasing as some employees trade assigned spaces for locational flexibility.
2. Improved **A/V technology** is being incorporated into meeting rooms to facilitate video conferencing.
3. Communal amenities and **informal gathering spaces** are being introduced to spur collaboration.
4. Greater **variety in meeting room sizes**, including more compact rooms.
5. Enclosed offices are getting **smaller** and shifting to **interior** locations.
6. Many (but not all) tenants are shifting to **smaller floorplates**, seeking greater **light penetration** and integration of **natural building materials**.

Despite today's low utilization rates, tenants are taking measures
to consume space more efficiently and effectively.

Flight to quality and the “amenities arms race”



What’s differentiating?

Vibrant mixed-use developments

Innovative design/architecture

Fun gathering spaces

Luxurious common areas

“What we’ve got today is good old-fashioned oversupply. We have an enormous amount of obsolete office space.”
– Sam Zell

Vacancy is becoming concentrated in inferior quality assets as tenants upgrade to new and differentiated space, which will require landlords to invest heavily in capital improvements to remain competitive

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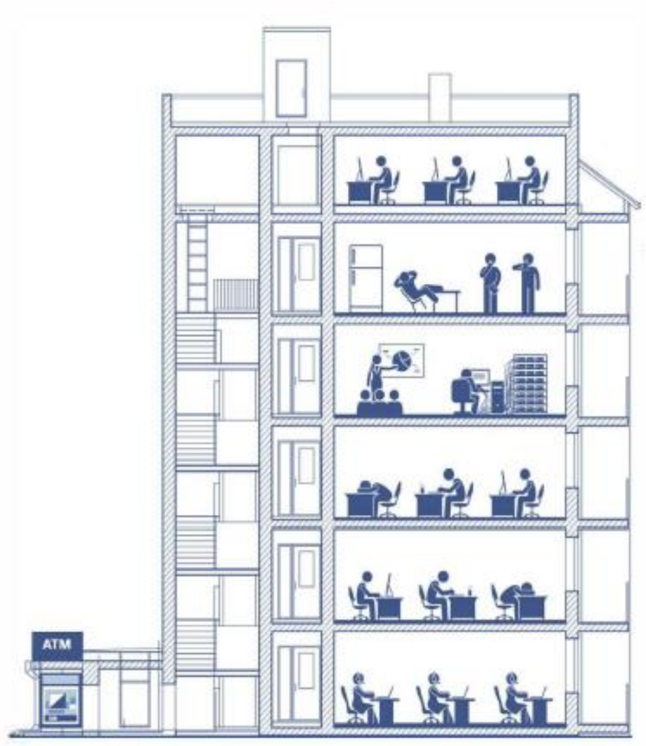
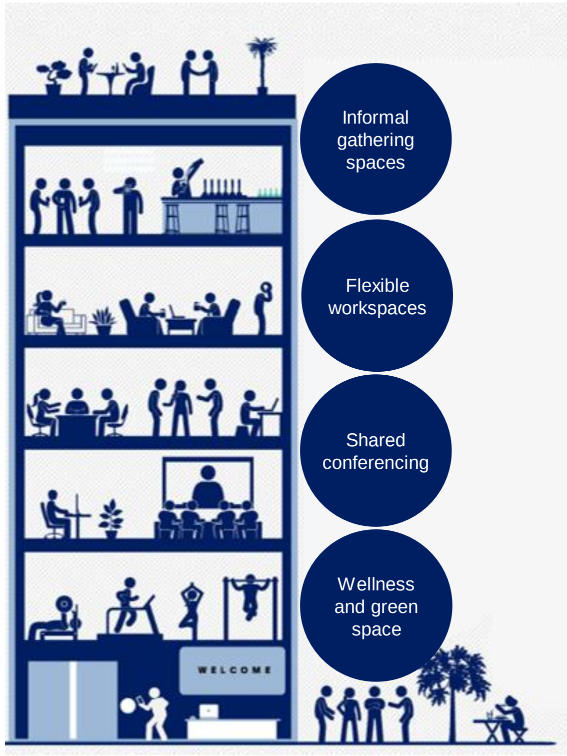
Future of office forecast

Yesterday



Today



Sector outlook

- Traditionally leased office footprints generally contract ~10% to 25% upon lease expiration
- Tenants use more "on-demand" space options during periods of peak occupancy to navigate midweek crowding (communal areas, conferencing facilities, coworking space)
- Core factors expand ~2x, allowing landlords to pass-through more expenses to tenants
- Investments into both base-building and in-suite amenities to help attract tenants & workers
- Commodity office buildings struggle to backfill, prompting more conversion activity

A stark divergence in market performance and dramatic changes in the cost and availability of capital will force an evolution in the office sector and require thoughtful reinvestment strategies

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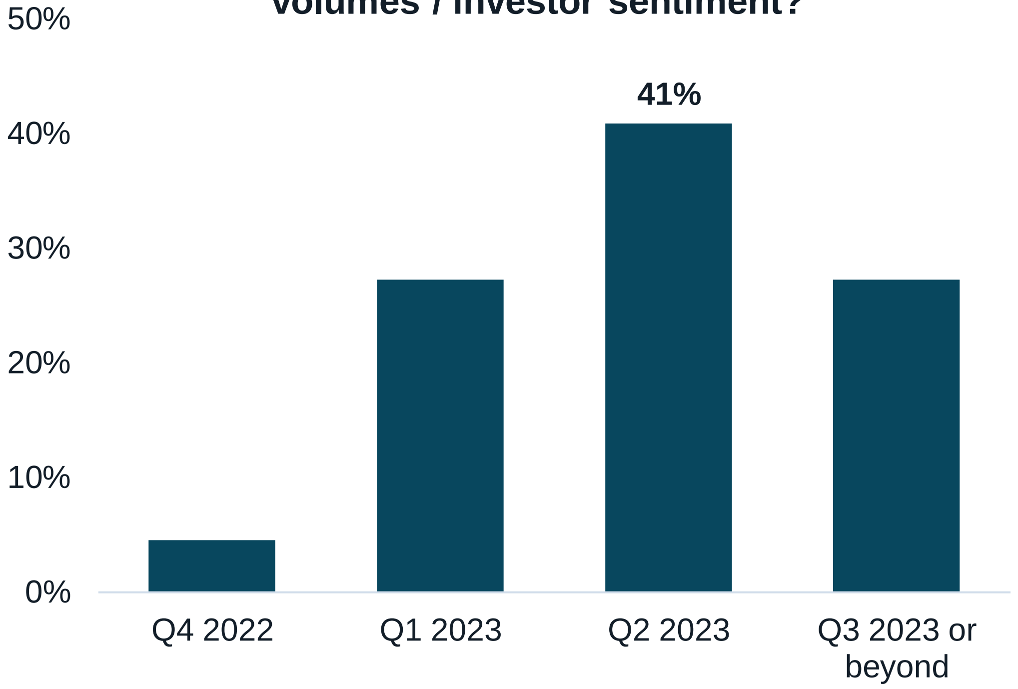
What is needed for a meaningful CRE capital markets recovery to set in?

- Fed signals an end to interest rate hikes
- Loan spreads stabilize
- Clarity on hybrid work's impact on office demand
- Investors' risk premium around recession risk must not worsen
- Large money center banks return to the market
- Core funds' valuations reflect reality

Which quarter will represent the market bottom in terms of closed transaction volumes / investor sentiment?



Source: JLL survey of 25 top LPs and institutional investors – February 2023

Thank you