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Office vacancy rates in Pittsburgh reach 10-year high

Summary: It was recently reported that the vacancy rate for class A office space in Pittsburgh's central business district (CBD) hit a 10-year high. But just a few years ago that rate was one of the lowest among major U.S. cities. The CBD mirrors the surrounding area which is also struggling with vacancy rates. With slow economic growth, a lack of expansion from existing firms and few new ones coming into the area, it's likely this situation will continue.

A recent news report revealed that the vacancy rate for class A office space for the fourth quarter in 2019 in Pittsburgh's central business district (CBD) stood at 15.9 percent, the highest rate since the recession year of 2010. It further went on to note that some of the more prominent buildings downtown suffer from high vacancy rates: U.S. Steel Tower (11.8 percent); One Oxford Centre (29.7 percent); 525 William Penn Place (59.5 percent); 20 Stanwix Street (33.8 percent) and the former Westinghouse building (29.5 percent). Some defend the high rates as the natural ebb of the marketplace. But it's a troubling statistic for the city and may underscore an economy that is not growing despite efforts to command it.

In 2013, it was quite different as the vacancy rate for class A space in Pittsburgh's CBD that year was just 5.2 percent which was the second-lowest rate of 53 major U.S. cities behind only Bellevue, Wash. (3.9 percent). All data in this *Brief* comes from real estate research firm Jones Lang LaSalle (JLL) for the fourth quarter of 2019.

Pittsburgh's CBD class A vacancy rate in 2013 was better than those in Austin (14.5 percent); Boston (11.1 percent); Charlotte (8 percent); Cincinnati (23.5 percent); Columbus (16.1 percent); Dallas (23.9 percent); Denver (12.7 percent); Los Angeles (19.2 percent) and Seattle (12.9 percent).

But what a difference six years makes. At the close of 2019, of the cities mentioned above, Pittsburgh's CBD class A vacancy rate of 15.9 is only better than Dallas (26.4 percent). In addition to Pittsburgh, only three of these cities had CBD vacancy rates rise from 2013 to 2019: Bellevue (8.1 percent), Charlotte (8.9 percent) and Dallas. But Pittsburgh's slide was by far the largest in this sample at 11.7 percentage points.

The other cities—Austin (5.2 percent); Boston (6.2 percent); Cincinnati (14.5 percent); Columbus (7 percent); Denver (12 percent); Los Angeles (16.8 percent) and Seattle (9.5 percent) —had seen their CBD class A vacancy rates drop.

The good news in 2013 also spilled across the Pittsburgh-area market which had an overall vacancy rate (both class A and B) of 10 percent and was the third lowest in the sample behind San Francisco (8.5 percent) and Manhattan (8.6 percent).

At the end of 2019 the total Pittsburgh-area vacancy rate climbed to 17.6 percent. The lowest rate can be found in the Oakland/East End area (4.2 percent) with the highest found in the East suburban area (26.2 percent).

Two major factors that contribute to low vacancy rates are current companies expanding their operations or new businesses coming into the market. In the article mentioning the 2013 vacancy rates, a real estate professional claimed, at that time, the low vacancy rate in Pittsburgh's area was attributed to growth in the energy and high technology sectors.

But since then growth to the energy sector has cooled off and nothing else has taken its place. The tech sector may be growing but those firms are typically clustered around the universities which may account for the low rate in the Oakland/East End area.

When compared to the cities mentioned above, Pittsburgh area's total vacancy rate of 17.6 percent is only better than the areas of Cincinnati (19.2 percent) and Dallas (20.1 percent). The remaining cities/areas were tightly grouped with Austin having the lowest total vacancy rate (9.2 percent) and Columbus with the highest at 14.9 percent.

The JLL report looked at 53 metros across the nation and finds that the total vacancy rate, all classes for the CBD's and suburban areas, was 14.3 percent. The Pittsburgh area had the 42nd highest vacancy rate.

The report notes that the Pittsburgh area has 53.4 million square feet of inventory which places it 27th of the 53 metros. It is estimated that the Pittsburgh area has another 1.65 million square feet under construction, ranking it 22nd in that category—and that doesn't include the subsidized soon-to-be-developed acreage at the former site of the Civic Arena or along Second Avenue in the city's Hazelwood neighborhood.

Of that total, only 400,000 is under construction in the suburban areas while the remaining 1.25 million are being built within the city itself in the fringe areas and the Oakland/East End area. It is likely that, as the construction is completed, the vacancy rate will only get worse as the lack of new companies moving into the area remains sparse in the area's sluggish economy.

Three years ago, the total inventory of both classes in the Pittsburgh area stood at 50.4 million square feet—a 3 million square foot increase. However, the total inventory of office space found in the CBD has not changed much since 2016 (18.93 vs. 18.97 million square feet). The total (class A and B) CBD vacancy rate in 2016 was 14 percent while it climbed to 16.9 percent in 2019. Despite virtually no addition in the square footage, over 556,000 square feet became available. Of the total square footage under construction in the area in 2016 (397,000) only 105,000 was being constructed in the city (all class A in the fringe). The remainder, mostly class A, was being built in the suburbs.

In 2016 the JLL report said that for class A office space "rents are not achieving the rate necessary for additional new construction to be viable." No new class A square footage was under construction in Pittsburgh's CBD in 2016 as well as in 2019.

The JLL report also looked at the employment situation of the 53 metros in their study (using its own research and U.S. Bureau of Labor Statistics data). They found that only four metros had a 12-month decline to the total nonfarm jobs in the area—Detroit (-6,600); Minneapolis (-6,100); Pittsburgh (-4,600) and Grand Rapids, Mich. (-1,300). The study also looked at the 12-month change to office jobs (professional and business services, financial activities and information) and found that the Pittsburgh area's increase of 1,100 places it 39th of 53 in the study.

Coming out of the recession of 2010, the Pittsburgh area economy did well largely on the back of the Marcellus Shale natural gas industry. But that has slowed considerably as the price of natural gas has fallen. Other industries, not bound here by geography, are not moving into this area in large numbers. The local economic growth is not keeping up with the national pace and it's showing up in the market for office space. As we have said before, the economy is held back by the fealty to unions, high tax rates and stifling regulations. Until these issues are addressed, the economy will not realize its full potential.

It is also worth noting that the data presented above came from 2019 and before the coronavirus hit the U.S. The subsequent stay-at-home orders that followed for each state and city, including Pittsburgh, may have long-lasting impacts on the office market in the CBD and area going forward. With many workers being required to work from home, how many businesses will find that a cost-saving option going forward? They may choose to allow employees to remain at home thus reducing the need for office space. Likewise, how many businesses will be forced to downsize or close as a result of a prolonged shutdown? This too will affect the demand for office space going forward. The virus could be another impediment to a turnaround in the office market.

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