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Economic policies and Pittsburgh office vacancies

Summary: Pittsburgh's central business district's (CBD) class A office space vacancy rate continues to climb. As a prior *Policy Brief* (*Vol. 20, No. 11*) reported, the vacancy rate already had reached a 10-year high of 15.9 percent in the fourth quarter of 2019. That mark preceded the onset of COVID-19 and was remarkable because six years earlier in 2013, Pittsburgh's CBD had the second-lowest class A office vacancy rate (5.2 percent) among 53 major U.S. cities. What's behind the latest number and what's ahead?

An April 2020 *Policy Brief* (*Vol. 20, No. 11*) reported that the vacancy rate for Pittsburgh's central business district's (CBD) class A office space reached a 10-year high of 15.9 percent in the fourth quarter of 2019. That mark preceded the onset of COVID-19 and was remarkable because six years earlier in 2013, Pittsburgh's CBD had the second-lowest class A office vacancy rate (5.2 percent) among 53 major U.S. cities.

First quarter 2021 vacancy data compiled by the research firm Jones Lang LaSalle (JLL) point to a further softening of demand for office space in Pittsburgh's CBD. The latest data show Pittsburgh's CBD class A office vacancy rate had climbed to 18.1 percent, a 13.8 percent increase from the fourth quarter of 2019.

Bear in mind that the vacancy rate is a measure of available space that is not under a rental agreement. So even though a large amount of Downtown space was not being used during the pandemic lockdown, most of the leased space was still under contract and thus not vacant for purposes of vacancy rate reporting. However, as some leases expired, no doubt the lockdown and economic conditions that produced financial hardship for some firms resulted in fewer square feet being leased. Hence, the rise in unleased space that is reflected in the 18.1 percent vacancy rate.

The U.S. economy was hard hit by the pandemic with some states faring worse than others depending on gubernatorial responses. Thus, the question; how does Pittsburgh's latest vacancy rate compare to cities across the country?

Vacancy rates for a group of 13 cities representing a geographical cross section were chosen for comparison. Within the group only four cities had a higher rate than Pittsburgh's first quarter CBD rate of 18.1 percent: Los Angeles (18.2 percent); Seattle (19.3 percent); Dallas (32.0 percent); and Denver (20.1 percent). Pittsburgh's first quarter vacancy rate was higher than Austin (16.2 percent); Boston (9.0 percent); Charlotte (10.3 percent); Cincinnati (14.4 percent);

Columbus (14.6 percent); New York City (12.3 percent); Nashville (16.1 percent); Raleigh-Durham (14.8 percent); and San Francisco (12.6 percent).

It is likely that some cities saw an increase in office vacancy due to the economic fallout from COVID-19. The extent of the pandemic effect will not be fully known until there is a full economic recovery.

The problem for Pittsburgh is that the vacancy rate had significantly increased prior to COVID-19 and the economic "lockdown" only further exacerbated it. The buildout of office space and slow employment gains lifted the vacancy rate over the previous 10 years.

But it is important to keep in mind that Pennsylvania's prolonged COVID-19 restrictions compelled many companies to implement work-from-home options and those restrictions continue to hurt the utilization of Downtown office space. The big question for many firms will be to what extent the work-from-home phenomenon continues and at what level after the all-clear is given from the COVID-19 pandemic. That phenomenon is also likely to be a factor in the other cities.

Within the Pittsburgh area's market, the Oakland/East End neighborhood displayed a significant jump in class A office space vacancy, more than doubling the vacancy from the fourth quarter 2019 (6.9 percent) to first quarter 2021 (16.4 percent). Demand may continue to diminish as companies continue to allow work-from-home options. This is especially true for sectors such as technology. In this case, most of the office space in the East End was leased to technology companies. So, while some companies will resume office leases once COVID-19 restrictions are lifted the demand will still be less than pre-COVID-19 due to the rising trend of work-from-home options.

The 2013 Pittsburgh's CBD class A office vacancy was 5.2 percent. But it has increased since. At the beginning of 2020 EQT reduced its lease in EQT Plaza from fifteen floors to five. Now the skyscraper bearing EQT's name only uses 15 percent of the space in a 32-story skyscraper. Currently, the building has 125,300 square feet available for lease out of about 600,000 square feet. EQT's lease ends in 2024 and there is a high probability that the company will move its headquarters closer to its operations in Washington and Greene counties, dealing another blow to Downtown's tenuous office market.

The problem is a failure to attract new companies and businesses already in the city not adding significantly to payrolls. The city and state's business regulatory environments deter growth. The advancement the city made in 2013 due to growth in energy and technology sectors has since tapered off. Many of the energy-related companies have moved away from Downtown as well. This decline has not been replaced with new business arrivals. The city has been unable to sustain its attraction of new businesses.

Many of Pittsburgh's new technology companies related to the robotics industry have chosen office space away from the CBD. The majority of companies are located in "robotics row" in the Strip District and lower Lawrenceville area. Downtown's skyscrapers have failed to entice.

Optimism for the Pittsburgh market of late has been focused on Gecko Robotics 69,000 square foot lease in Nova Place. However, Nova Place is on the North Side and does not contribute to CBD market's vacancy rates. Then too, 69,000 square feet of office space is minor compared to the total space (class A and B) in the CBD and greater Pittsburgh area—18,972,607 and 35,996,246 square feet, respectively.

Google has recently added three more floors to its lease at Bakery Square. Again, this cannot be hailed as a sign of significant growth when Google's total lease (including the new lease) is about 300,000 square feet. While both of these developments have been cited as demonstrating growth in the market, they have failed to prevent the rise in the CBD class A vacancy rate.

Moreover, the recent announcement that First National Bank of Pennsylvania (FNB Financial Group) has the go ahead to build a 26-story office tower, creating 500,000 square feet of office space on the site of the former Civic Arena, is almost certainly going to exacerbate the vacancy rate Downtown. It will increase office space to the already saturated Downtown market.

Worse still, the new skyscraper will be subsidized by taxpayers. Which begs the question; why are taxpayers subsidizing a private company's new construction, especially when there are already high vacancy rates for office space in the CBD?

In all likelihood, owners of commercial properties that have high vacancies and diminished lease revenue might well appeal their property tax assessment. To the extent these appeals succeed, tax revenue to the county, city and school district will be reduced. Yet another example of policymakers ignoring market forces with predictable consequences.

Pittsburgh's CBD class A office vacancies highlight and reflect the problems plaguing the City of Pittsburgh. An anti-free market regulatory environment that deters business growth, along with city-subsidized projects that have a strong likelihood of failure, combined with the strict COVID-19 economic restrictions, have contributed greatly to the prospect of further increases in office vacancies in Pittsburgh.

Unfortunately, if the past is prologue, there appears to be little hope of meaningful change with respect to the city's understanding of its role in promoting economic growth.

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