

Second quarter office vacancy rates remain high

Background

At the onset of the pandemic, Pennsylvania officials reacted by forcing nonessential businesses to close and recommended that people who could, work from home. This lockdown resulted in a new work-from-home culture which left many office buildings empty. As the lockdown subsided and the pandemic appeared to wane, many employees decided to remain home instead of going back to the office. This will likely affect the vacancy rate in Pittsburgh's central business district (CBD) going forward as some firms will allow employees to continue to work from home and look to reduce their footprint and rental costs.

As we wrote in April 2020 (*Policy Brief Vol. 20, No.11*), prior to the lockdown in the fourth quarter of 2019, the vacancy rate for class A office space in Pittsburgh's CBD stood at 15.9 percent, the highest since the recession year of 2010. In 2013 a low of 5.2 percent was recorded—one of the lowest in the country. All data come from real estate research firm Jones Lang LaSalle.

For the first quarter of 2021, *Policy Brief Vol. 21, No. 19*, commented that Pittsburgh's CBD vacancy rate reached 18.1 percent, reflecting a further softening of demand for office space.

With the pandemic slowing in the second quarter of 2021 and economic activity approaching normal, how has the CBD vacancy rate fared? In this *Brief*, we will compare Pittsburgh's CBD with those in Austin; Charlotte; Cincinnati; Dallas; Denver; Los Angeles; Nashville; Raleigh-Durham; San Francisco and Seattle.

Keep in mind that the vacancy rate is a measure of available space that is not under rental agreement. So even though a large amount of office space was not being used during the pandemic, most space was under lease and not vacant for the purpose of vacancy rate reporting.

Office vacancy rates

In 2021's second quarter, the class A office vacancy rate for Pittsburgh's CBD remained flat at 18.1 percent. Compared to the other 10 cities in the sample, it was better than Los Angeles (18.6 percent); Seattle (19.8 percent); Denver (21.8 percent); Austin (23.5 percent) and Dallas (33.3 percent). Of the cities with lower vacancy rates, Charlotte had the lowest (12.7 percent) followed by Cincinnati (14.7 percent), San Francisco (16 percent) with Raleigh-Durham and Denver tied with a 16.2 percent vacancy rate.

It is interesting to note that in the first quarter of 2021, Austin recorded a class A office vacancy rate in their CBD of just 16.2 percent but posted a 7.3 percentage point jump in the second quarter. Pittsburgh was the only city in this sample to hold steady as each had seen a vacancy rate rise from the first to the second quarter.

Looking at total vacancy rates (classes A and B) in the second quarter for the CBDs in the group reviewed, Pittsburgh once again finished in the middle at 20 percent—just slightly higher than the first quarter rate of 19.4 percent. Austin again had the largest percentage point increase going from 16 percent to 22.5 percent followed by Cincinnati with a 3.9 percentage point increase, going from 16.8 percent to 20.7 percent. Both cities went from having a lower rate than Pittsburgh to a higher rate between quarters.

Inventory of office space

The pandemic did slow down the development of class A office space in some cities' CBDs, while others in the sample continued to add to their inventory. Pittsburgh's inventory of class A office space in the CBD remained constant at 13.5 million square feet, which is the fifth-highest amount in this sample. Raleigh-Durham has the smallest inventory at 6.2 million while San Francisco has the most at 46 million square feet.

Four other cities in the sample—Cincinnati, Los Angeles, San Francisco and Seattle—also held constant with their inventory of class A office space. However, Austin, Charlotte, Denver, Nashville and Raleigh-Durham added class A square footage. Only Dallas experienced a reduction. But it was minimal—less than one-half of a percent of the first quarter inventory.

For all classes of space, the inventories didn't change too much in the CBDs. Pittsburgh's inventory of 18.97 million square feet remained the same between the quarters. Los Angeles, San Francisco and Seattle also held steady. Only Austin, Charlotte and Cincinnati added class B space to their inventory in the second quarter of 2021.

Absorption of office space

Perhaps the best indicator of the health of the office market is the absorption of unleased space to leased space. Negative absorption implies that leased space became unleased or vacant. In the first quarter of 2021 all but three cities in this sample had negative

absorption of class A office space in their CBD—Charlotte, Cincinnati and Nashville. Pittsburgh's CBD had a negative absorption of 22,800 square feet—the smallest in the sample. Seattle had the largest negative absorption of 857,820 square feet.

In 2021's second quarter, five cities had positive absorption of square footage, including Pittsburgh. Charlotte had 657,330 square feet go from unleased to leased followed by Raleigh-Durham (116,548), Nashville (34,482) and Austin (6,524). Pittsburgh's CBD had a positive absorption of just 447 square feet. That's essentially no change considering the city has 13.5 million square feet of class A space in the CBD.

Six cities continued to shed leased space. The city with the highest negative absorption of class A square footage in their CBD was San Francisco (1,557,895) followed by Dallas (243,103); Denver (134,804); Los Angeles (114,873); Seattle (101,238) and Cincinnati (21,995).

When looking at both classes of space the results are more severe. In the first quarter the same three cities—Charlotte, Cincinnati and Nashville—had positive absorption rates with the remainder having negative absorption rates. Pittsburgh's CBD had a negative absorption of 101,263 square feet, the second-lowest amount. San Francisco had the highest amount (1,055,492).

In the second quarter, only Charlotte and Nashville continued to have unleased space become leased space. Cincinnati encountered a reversal in the second quarter as 73,400 square feet become vacant. Raleigh-Durham also did a reversal as nearly 147,000 square feet in the CBD came under lease.

The other cities in the sample, including Pittsburgh, had more total office space become unleased in the second quarter. Pittsburgh's CBD had an additional 88,638 square feet become vacant. As noted above, Pittsburgh had 447 square feet of class A office space become leased; the 88,638 represents all class B office space. The range runs from a low of 22,647 square feet (Austin) to 1,881,550 square feet (San Francisco). However, San Francisco represents an outlier in this sample as the next highest city was Dallas with just 246,842 square feet of negatively absorbed space.

Conclusion

The vacancy rate data for the second quarter shows a slower recovery for office space than for the rest of the economy. The class A office vacancy rates in the central business district for most cities continues to rise from 2021's first quarter to the second.

While Pittsburgh's rate stayed constant for class A office space, the vacancy rate for both class A and B ticked up from 19.6 percent to 20 percent. While there currently isn't any office space being developed in the central business district, class A or B, according to the JLL data, there is almost 1.2 million square feet of office space being developed, 1.1 million class A, in the fringe and the Oakland/East End sections of the city. This will put

more pressure on the CBD as existing firms will have options to explore outside the Golden Triangle.

The tech companies that were either spun off from the universities, or were drawn here because of them, are more flexible with employees working from home and are likely to not require much office space. This could cause vacancy rates to climb even higher.

The much anticipated, and taxpayer-subsidized, office building at the former Civic Arena site will also put pressure on an already soft office market.

Furthermore, the business climate in the city is such that there is little to draw new firms to enter the city to assume any vacant office space. With City Council pushing mandates covering sick leave and wages, most businesses that are unable to pass along the higher costs from these mandates will look elsewhere to set up.

Given this climate, and the lingering, or ramping up, of the pandemic, the office buildings in the CBD will continue to have high vacancy rates. That could have consequences for property tax revenues, payroll tax revenues and the local service tax collections.

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