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# Office vacancy rates continue to climb

**Summary:** As 2022 ended, the fourth quarter office vacancy rate for all building classes in 54 office markets across the nation stood at 19.6 percent. For the Pittsburgh area, that rate was 21.3 percent. All data are from the national real estate firm Jones Lang LaSalle (JLL, jll.com). Data from the first quarter of 2023 show the situation has not improved. The national vacancy rate has climbed to 20.2 percent while the Pittsburgh market has hit a high of 21.8 percent. It doesn't appear the upward trend is going to change anytime soon.

*The national office market*

In the 2023 first quarter summary, JLL noted that companies are still in a defensive posture and preparing for an economic slowdown. Office-using sectors such as finance, information technology and professional services are now experiencing a softening of the labor market as both job openings and hiring volumes over the last 12 months have fallen faster than in other sectors. These sectors are seeing layoff volumes increase twice as fast as other sectors. In particular, the technology sector comprised 60 percent of the public layoff announcements over the last six months. As a result, firms in these sectors are trimming their office space requirements, either by moving to smaller spaces as leases expire or through subleasing. The Pittsburgh market is no exception (*Policy Brief, Vol. 23, No. 10*).

The report also notes that leasing volume across the country fell for the third consecutive quarter and is down nearly 10 percent since the fourth quarter of 2020. This was most likely due to a record number of lease expirations. While JLL believes this should slow throughout the remainder of 2023, leasing volume decreases are expected to remain high for another few years as roughly one-third of leased space is expected to expire from 2023-2026.

This shows up in the national absorption rate. Absorption measures whether used office space becomes unleased (negative absorption) or unused space becomes leased (positive absorption). In the first quarter, the net absorption rate is -0.4 percent. Thus, an additional 0.4 percent of office space inventory in the 54 markets became vacant. This represents the fifth straight quarter of net negative absorption. Of the 54 markets in the study, only nine had net positive absorption rates with one market breaking even. The remaining markets (81.5 percent) all had net negative absorption rates, including Pittsburgh (-0.4 percent).

In addition, the report notes that the U.S. office market is also undergoing a rapid loss of inventory as the conversion of office to residential space grows in many markets. However, these conversions are not having much of an impact on office tenants as they typically occur in lower-class buildings—not class A trophy buildings—that have been vacant, or mostly vacant, for a few years. These buildings are not competing with class A trophy buildings and have been impacted by the flight-to-quality movement since the pandemic.

The obvious pitfall in this rush to conversion is the use of public money. Many local governments will be tempted to subsidize this movement. They should not. If a building is worth converting, and many older office buildings are not as they are not wired or plumbed for residential, then let a private developer undertake the risk and enjoy the reward if successful.

Developers may push a little harder for assistance as the economy remains stagnant. Inflation, while lower than it has been, is still hovering around 5 percent and the Federal Reserve is still likely to continue to raise interest rates to bring inflation down, which, of course, increases the cost of borrowing. Furthermore, most predictions are for growth to Real Gross Domestic Product to be flat, around 1 percent. That dampens the market for new construction as potential tenants remain in the defensive mode and are less likely to expand office space.

*The Pittsburgh office market*

As mentioned above the total market—all classes of buildings—vacancy rate in the Pittsburgh region hit a high of 21.8 percent. The market had a negative absorption rate for three straight quarters. As mentioned in an earlier *Brief* (*Vol. 23, No.10*), large corporate users are still downsizing to meet the needs of the hybrid workforce. JLL research suggests that this giving back of space will continue for the foreseeable future as leases come due and firms look to control costs in an uncertain economy. Thus, the vacancy rate is expected to continue to reach new highs through 2023.

The core of the Pittsburgh area is the central business district (CBD). For all classes of buildings, the total vacancy rate in 2023's first quarter was 20.2 percent, with a net absorption rate of -0.7 percent. For just class A office buildings the rate was a little lower at 17.5 percent. But the net absorption rate was worse at -1.0 percent. Two years prior, in the first quarter of 2021, vacancy rates were 18.1 percent for class A and 19.6 percent for all classes of buildings. Thus, the rate for class A has dropped while the other classes of buildings had risen. This lends credence to the flight-to-quality theory as firms are looking for better office space and amenities to draw employees back to the office.

For the entire Pittsburgh area, from Cranberry in the north to Southpointe in the south and west and east Allegheny County, the two regions with the highest vacancy rates were the Oakland/East End market with a 29.5 percent overall vacancy rate with a 39.9 percent vacancy rate for class A office space. The suburban East market followed with an overall vacancy rate of 27.5 percent and a 36.5 percent rate for class A space.

The best regions in the area for overall vacancy rates were found in the suburban South market (13.5 percent) and the suburban North market (17.9 percent). For class A office space, the suburban South market again led with just an 11.3 percent vacancy rate followed by Pittsburgh's CBD and then the urban fringe at 19.5 percent.

*Conclusion*

Clearly, the Pittsburgh office market vacancy and usage rates are not improving and are likely to get worse before there is any improvement. This will have significant consequences for rental rates, valuations of properties, lease prices and property tax assessments as appeals of valuations are filed.

Unfortunately, the rush to "do something" to reverse the upward vacancy rate trend is likely to cost taxpayers as developers are going to plead their case for government financial assistance. It's already happening in Pittsburgh as the Pittsburgh Urban Redevelopment Authority (URA) has waded into the subsidy pool by offering a $300,000 loan to convert the non-class A Triangle Building into residential. The expected cost is to be $13.2 million for a structure built in 1866.

And according to the news report, "the building's infrastructure was found to be in worse shape than anticipated." No doubt the first of many "worse than anticipated" discoveries. The URA loan is designed to cover the cost overrun for the building's infrastructure. The article also states that, as of now, the developer's share of financing is just 26.5 percent—a ridiculously low percentage.

As has been well-documented in previous *Briefs*, the pandemic has changed the office culture as many employees have opted to keep their work-at-home status. The push has been on from many firms to have employees come into the office at least a couple of days per week. Moreover, this will also result in a reduced need for space as office space can be shared alternatingly by other hybrid-attendance workers.

One likely and more powerful justification for employees not coming into the city—despite the benefits of collaboration and increased productivity of being in the office—as reported in the news, but doesn't make research like the JLL reports, is the prevalence of panhandlers, homelessness and crime in the Downtown area.

Many Downtown merchants and other businesses have expressed the need to have the area cleaned up. Some have threatened to leave. This is perhaps the most pressing matter before the city and county. Until workers feel safe walking to the office, even during the day, they will be reluctant to return and the vacancy rate problem will continue.

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