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Downtown office market keeps struggling

Introduction: The second quarter office statistics were released and there are few positives to be seen. The office market's recovery from the pandemic continues to be slow and arduous. Total vacancy for the Pittsburgh area, all classes of space, comes in at 21.7 percent and the forecasters at real estate research firm Jones Lang LaSalle (JLL) are forecasting that it will continue to rise.

Vacancy rates measure the amount of space that is not currently under lease. This does not include space that is leased but currently unused by a firm. All data comes from JLL.

Vacancy rates by class

As mentioned above, the total vacancy rate for the entire Pittsburgh area was 21.7 percent in 2024's second quarter. In the central business district (CBD), defined as Pittsburgh's Downtown area, the vacancy rate was a bit lower (19.6 percent) for all classes of office space. The urban area—which includes the North Shore, Strip District and South Side as well as the Oakland/East End neighborhoods—is a bit higher at 21.2 percent. The suburban rate is at 22.4 percent, bookended by a 35 percent rate in the eastern suburbs and 16.9 percent in the northern I-79/Cranberry suburbs.

Class A office buildings represent the top-tiered buildings. Post-pandemic, it is largely believed that firms were looking to relocate to buildings that offered the most amenities for their employees to lure them back into the office. Thus, the vacancy rate for these buildings tends to be lower as they have been more sought after. The data bears that out.

The class A vacancy rate for Pittsburgh's urban area is 19 percent led by 17.2 percent in the CBD and 19.9 percent in the fringe area, with each rate a few percentage points lower than their all-class total. However, the Oakland/East End area's class A office vacancy rate is higher than its all-class rate (29.5 percent vs. 25.8 percent).

It is worth noting that the average asking price for class A space, with all the amenities, is higher than those for lower-class space. In Pittsburgh's CBD, that price comes in at $32.25 per square foot, whereas lower-class space in the CBD is going for $22.82. In the Oakland/East End area that spread is more pronounced. Class A space has an average asking price of $41.97 per square foot with lower-class space at $22.55. The suburban spread is smaller at $24.42 per square foot for class A space and $20.57 for lower-class space.

Thus, if an area has higher vacancy rates for class A space than for lower-class space, it may be a matter of being price conscious for firms still struggling in the post-pandemic era rather than looking for amenities to lure employees from home.

Recent history of vacancy rates

Prior to the pandemic, vacancy rates were much lower. In 2019's fourth quarter the total vacancy rate for the entire Pittsburgh area, for all classes, was just 17.6 percent—four percentage points lower than 2024's second quarter. The urban area had just a 16.1 percent total vacancy rate while the suburban rate was 19.6 percent and the CBD was 16.9 percent. The shining star was the Oakland/East End with a total vacancy rate of just 4.2 percent—21.6 percentage points lower than the most recent rate.

The class A rates were also much lower. The urban area was 14.4 percent with the CBD coming in at 15.9 percent and Oakland/East End at 6.9 percent. The suburban rate was 19.4 percent with many areas under 20 percent.

Of course, 2020's first quarter changed everything with the outbreak of the pandemic in March as businesses were forced to close and send their employees home. Many of them never returned to the office as the work-from-home culture took root. While many firms are beginning to mandate the return to the office, many are allowing employees to return just a few days a week. Firms began downsizing space requirements to save money. Vacancy rates quickly spiked.

And, of course, that doesn't take into consideration any employees that may have lost their jobs in the economic struggles that many firms experienced from the pandemic and its aftermath.

In 2021's second quarter, the total vacancy rate, all classes, in the Pittsburgh region jumped to 21 percent. The urban rate reached 19.7 percent; the CBD increased to 20 percent with the Oakland/East End rate leaping to 17.7 percent. The suburban rate hit 22.7 percent.

The class A vacancy rates also rose. The area total was 20.6 percent, with the urban area at 17.6 percent and the suburban area at 24.7 percent. The CBD's rise was 2.2 percentage points to 18.1 percent and the Oakland/East End rate was 21.6 percent.

As demonstrated earlier, not much has changed since 2021. The rates have remained steady even with the CBD's class A rate which dipped by less than one percentage point.

The consequences

As we had written in a recent *brief* (*Vol. 24, No. 19*) the assessed value of a building is tied to market value, which is, in turn, tied to the vacancy rates. When vacancy rates are high, market values fall, building owners appeal their tax-assessed values, and have been winning lower values, and property tax revenues for taxing bodies will drop.

One news report from early this year estimated that Allegheny County property values have dropped by $1.4 billion with $570 million coming from Pittsburgh's suburbs. In some cases, building owners have won reductions for past tax years and have been awarded refunds. The pressure of these refunds, and the realization that future property tax revenues are going to fall, has forced the Pittsburgh Public Schools to sue Allegheny County to force a long-overdue property reassessment—which county officials are loathe to do.

In August 2024, it was reported that 11 Stanwix Street, the former Westinghouse headquarters, had its deed transferred in lieu of foreclosure due to being only 69 percent occupied. Past *Policy Briefs* have noted the struggles of buildings in the CBD because of high vacancies (*Vol. 22, No. 6 and Vol. 24., No 19*).

And the news keeps getting worse as BNY will be closing its Pittsburgh office and vacating its skyscraper—the second tallest in the city. Other tenants have also started to leave that building on the news. Furthermore, the proposed sale of U.S. Steel to Nippon Steel is being slammed by politicians and the steelworkers' union. If the acquisition falls through, U.S. Steel has threatened to vacate its headquarters space in the city's tallest building, putting even more upward pressure on CBD vacancy rates and, subsequently, property tax revenues for the relevant taxing bodies.

Conclusion

The work-from-home culture seems ingrained in the workforce and will cause firms to keep a smaller office space footprint. As a result, vacancy rates may stay elevated over the 2019 levels. One way to encourage more people to rethink coming into the CBD to work will be to clean up the crime and homelessness that became prevalent in the pandemic and caused some businesses to leave Downtown.

One solution to solving high vacancy rates—that is being bandied about by policymakers and developers—is the conversion of vacant office space into residential space. The thinking behind this is that if square footage being devoted to office space is removed from the inventory when it becomes residential, the vacancy rate is lowered—an idea being considered in cities nationwide. And it is mostly confined to older lower-class buildings which are being vacated at higher rates.

If a developer wants to take on such a project, it must be the sole risk-taker. Taxpayers have no responsibility to undertake any risk in such an endeavor: Older buildings will need to be replumbed and likely rewired for residential use. Then there will always be issues once construction begins that will be unanticipated (*Policy Brief, Vol. 23, No. 19*). Furthermore, high interest rates and the increased cost of construction materials since the pandemic make such conversions very costly.

A recent article made mention that Pittsburgh's housing market overall is cooling down. Homes are sitting on the market longer than they had previously been, going from a sellers' market to a neutral market. With the possibility of a greater supply of homes due to the conversion of office buildings to residential, the converted residences will likely also sit empty.

Given that the population of the city and area has dropped significantly over the last few decades, from where will new condo owners come? Without jobs to bring them in, building new condos will be nothing more than trading one problem for another.

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