

2Q24

Raleigh-Durham Office Market Overview



NEWMARK

Market Observations

Economy

- The market’s unemployment rate declined by four basis points year over year to 3.1%, remaining below the five-year average of 4.0%.
- Employment growth decelerated by 63 basis points to 3.1% year over year, remaining above the national average of 1.8%.
- Most sectors reported employment growth, with education and healthcare leading job gains at 6.5% over the past 12 months.
- Office-using jobs in the market recorded an all-time high of 214,592 jobs as of the end of May 2024, reflecting 20.2% growth since May 2019 and 39.4% growth since May 2014.

Major Transactions

- IXL Learning signed the largest lease of the second quarter of 2024 when it renewed and expanded its office at 1600 Perimeter Park.
- Tenant demand is strongest in trophy assets located in North Hills, Fenton, Raleigh Ironworks and Raleigh Central Business District.
- International corporate relocations were a major theme in the second quarter of 2024’s lease transactions as Audemars Piguet and JTI relocated their North American offices to Raleigh.
- Vacancy is expected to increase as leases and subleases expire and tenants relocate to the highest quality trophy assets, which will continue to see the lowest vacancy rates.
- With reduced leasing activity, there is not enough demand to offset the large quantities of vacant space entering the market, which will serve to push vacancy higher.
- Tenants still have a healthy appetite for spaces 15,000 SF and below.

Leasing Market Fundamentals

- Annual full-service class rental rates recorded a historic high of \$30.69/SF, reflecting a 3.2% increase year over year, but rental growth has begun to flatten as vacancy has continued to climb and leasing activity has continued to be muted.
- Occupancy declined quarter over quarter as several new projects delivered vacant during the quarter, leading overall vacancy rates to increase 320 basis points to a historic high of 19.9%.
- The under-construction pipeline significantly declined to 102,500 SF currently in progress as several under-construction projects, such as One North Hills Tower and 1000 Social @ The Exchange, delivered throughout the quarter and fewer projects have broken ground due to higher building costs, steeper cost of debt and significant vacancy to be absorbed.
- Total leasing activity closed the quarter at 581,485 SF with one of the lowest levels of leasing activity on record, 45% below the 16-year second-quarter average of 1.0 MSF.

Outlook

- The office market began to show signs of recovery but will report slower growth in the near term. Office investment activity will be subdued due to elevated inflation, steeper cost of debt, and muted demand near- and mid-term.
- The expiration of leases signed pre-pandemic will likely push more tenants to shed unused space and lease smaller footprints in higher-quality assets and push vacancy rates upward.
- The office market is expected to remain tenant friendly, with ongoing stagnant demand. As a result, overall asking rents are projected to stay flat or modestly decline.
- Vacancy is expected to remain elevated as the market works through the substantial deliveries that occurred during the second quarter of 2024. The Raleigh office market will likely see continued growth in higher-quality spaces this year as the market’s new projects continue to deliver.

1. Economy
2. Leasing Market Fundamentals

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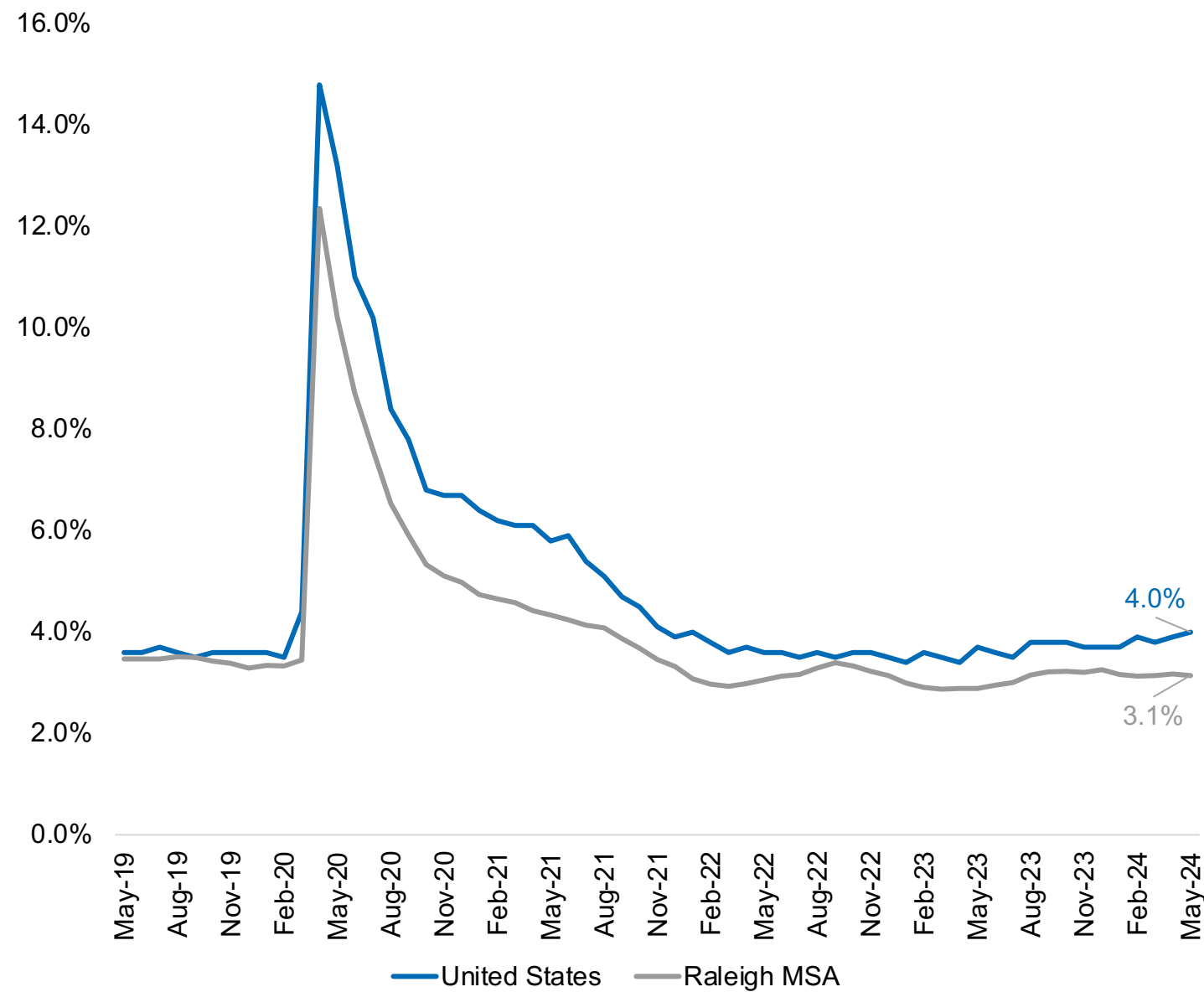
Economy



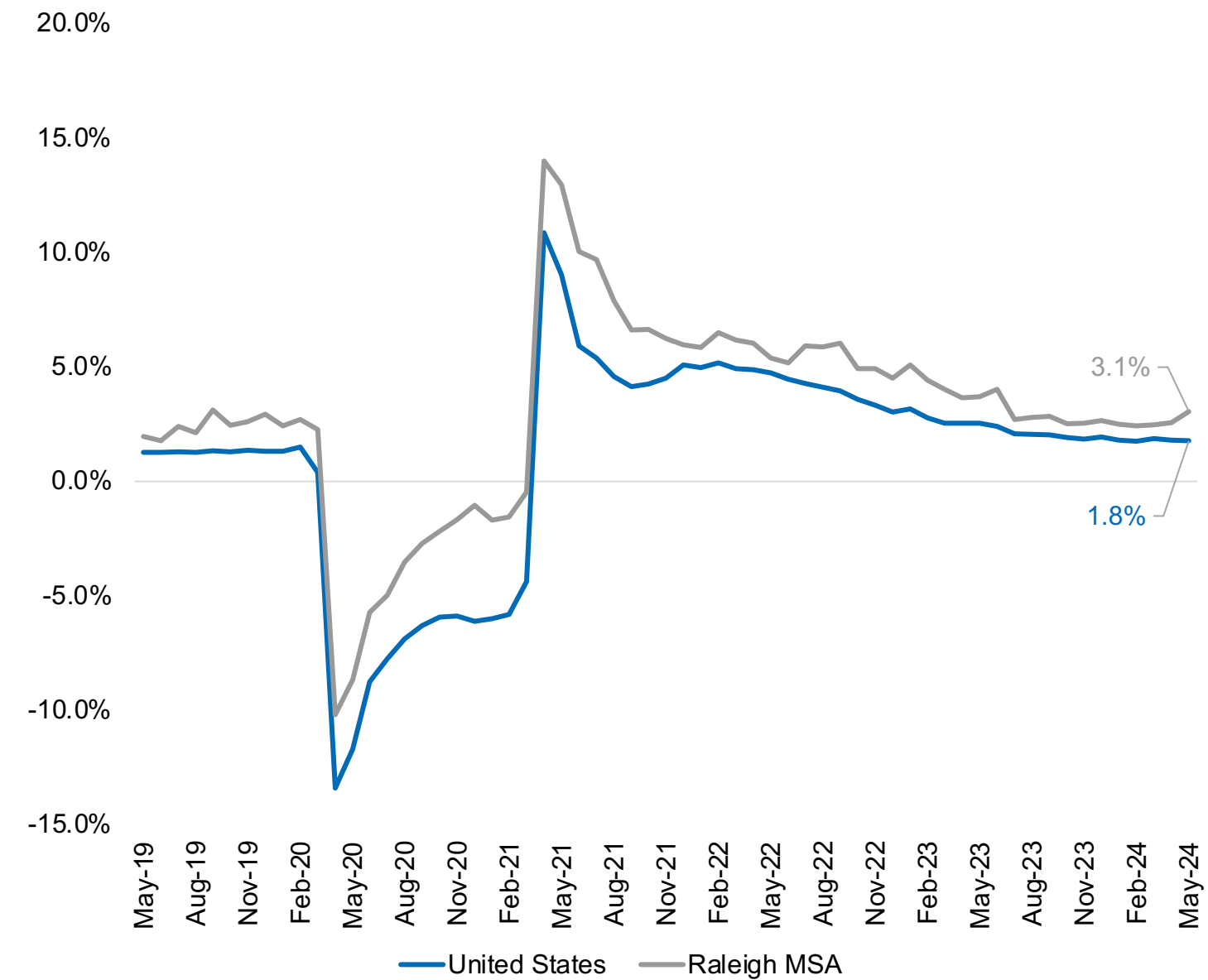
Year over Year Increase in Unemployment Rate Signals a Slowing Economy

Raleigh has generally reported lower unemployment rates compared with the national average, while being an outperformer in employment growth. This trend has continued into the second quarter of 2024, with the market's unemployment rate marginally increasing by 26 basis points year over year to 3.1%, well below the U.S.'s unemployment rate of 4.0%. Seasonally adjusted nonfarm payrolls also outperformed the U.S. and reported a 63-basis-point year-over-year decline, to 3.1%. Although Raleigh outperformed the United States, employment declined due to job losses in the information and trade/transportation/utilities sectors.

Unemployment Rate, Seasonally Adjusted



Nonfarm Payroll Employment, Seasonally Adjusted, 12-Month % Change

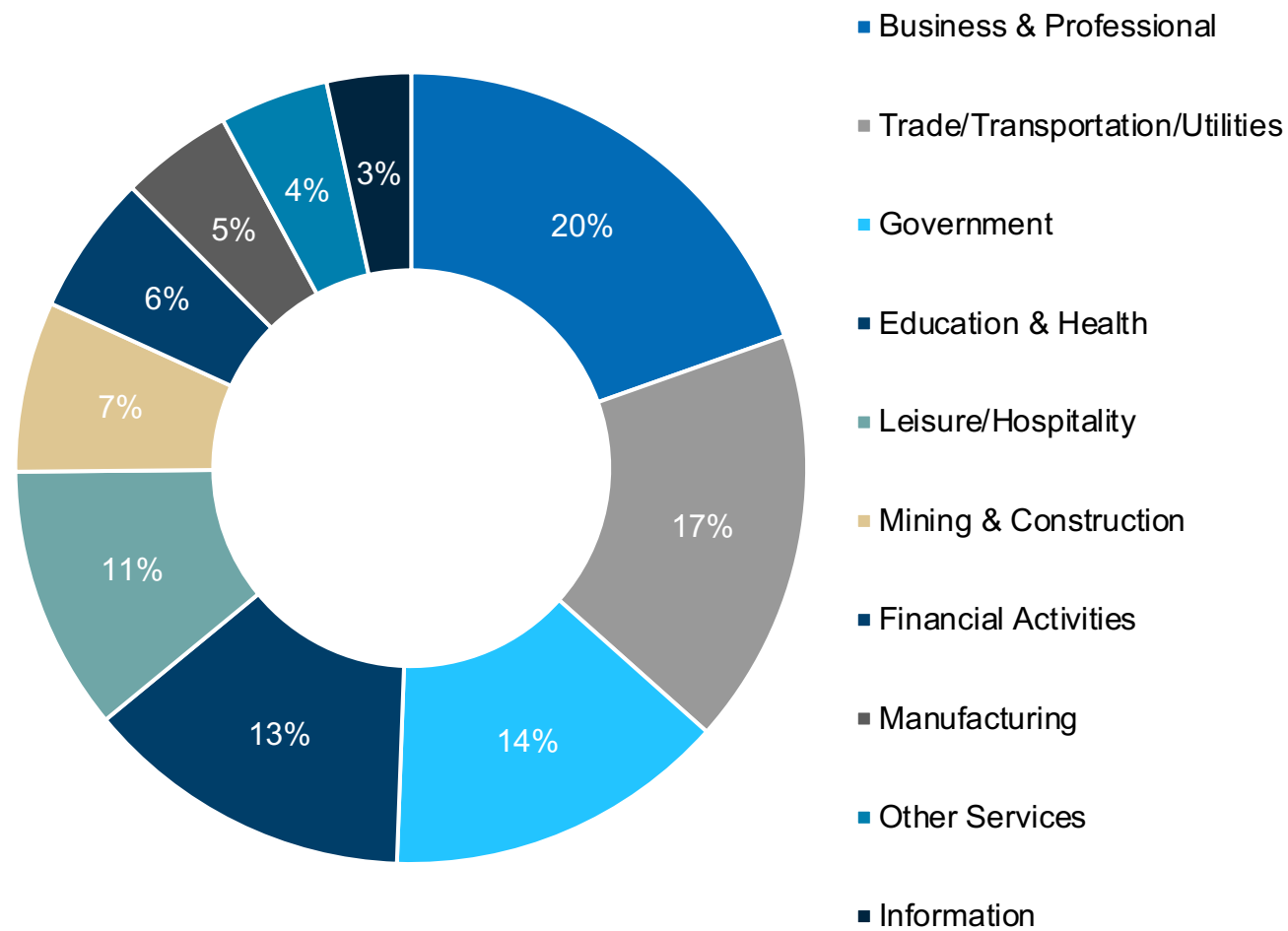


Source: U.S. Bureau of Labor Statistics, Raleigh MSA

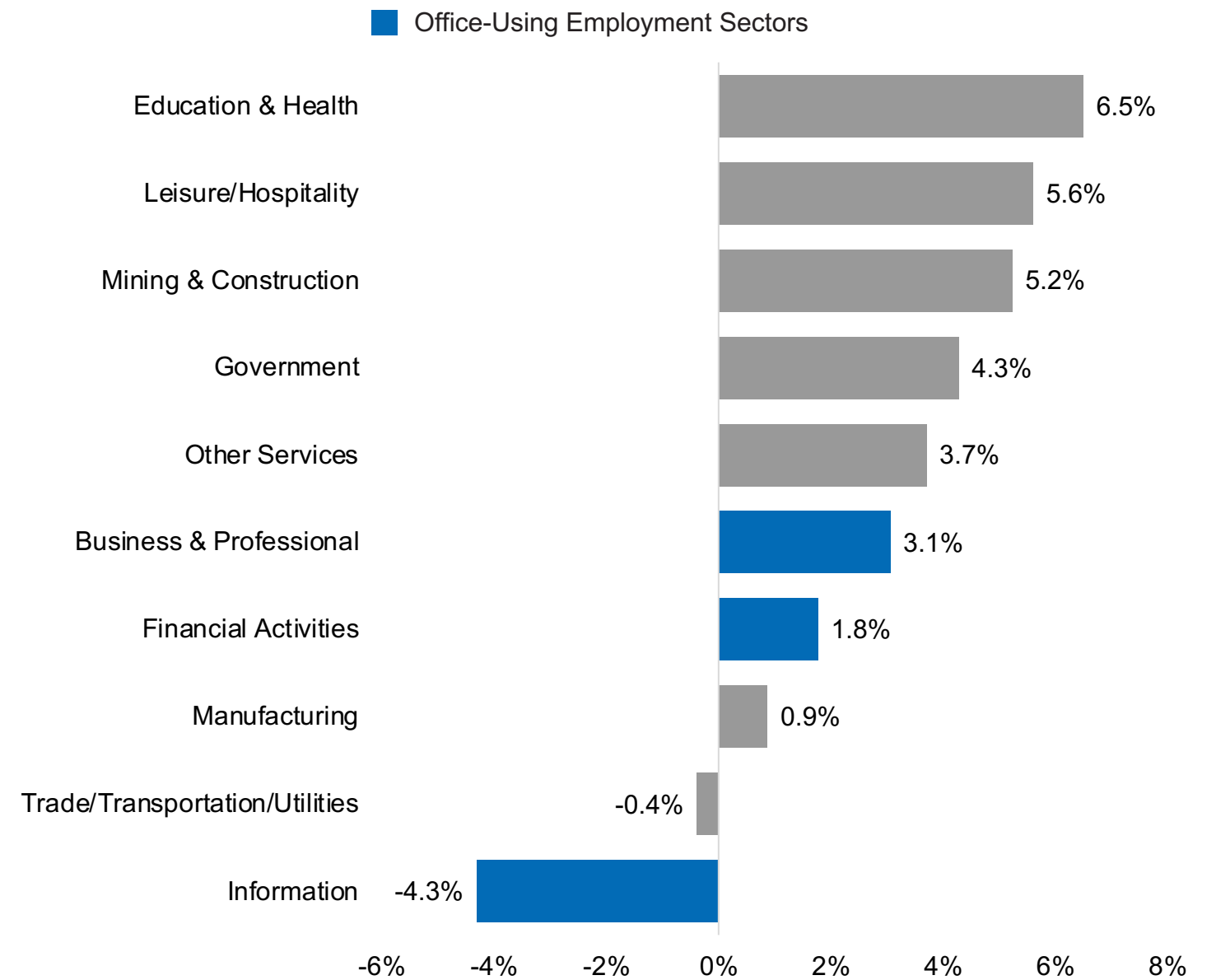
Employment Growth Continues across Most Sectors

Known for its technology sector, the Raleigh market's top two employment industries, business and professional and trade/transportation/utilities, account for 36.6% of jobs. The office-using employment's business and professional sector is the largest industry sector, at 19.6%. Most industries, except trade/transportation/utilities and information, reported year-over-year job growth. Office-using industries, like business and professional and financial activities sectors, reported 3.1% and 1.8% year-over-year growth, respectively. Meanwhile, the information sector reported a decline of 4.3% growth year over year.

Employment by Industry, May 2024



Employment Growth by Industry, 12-Month % Change, May 2024

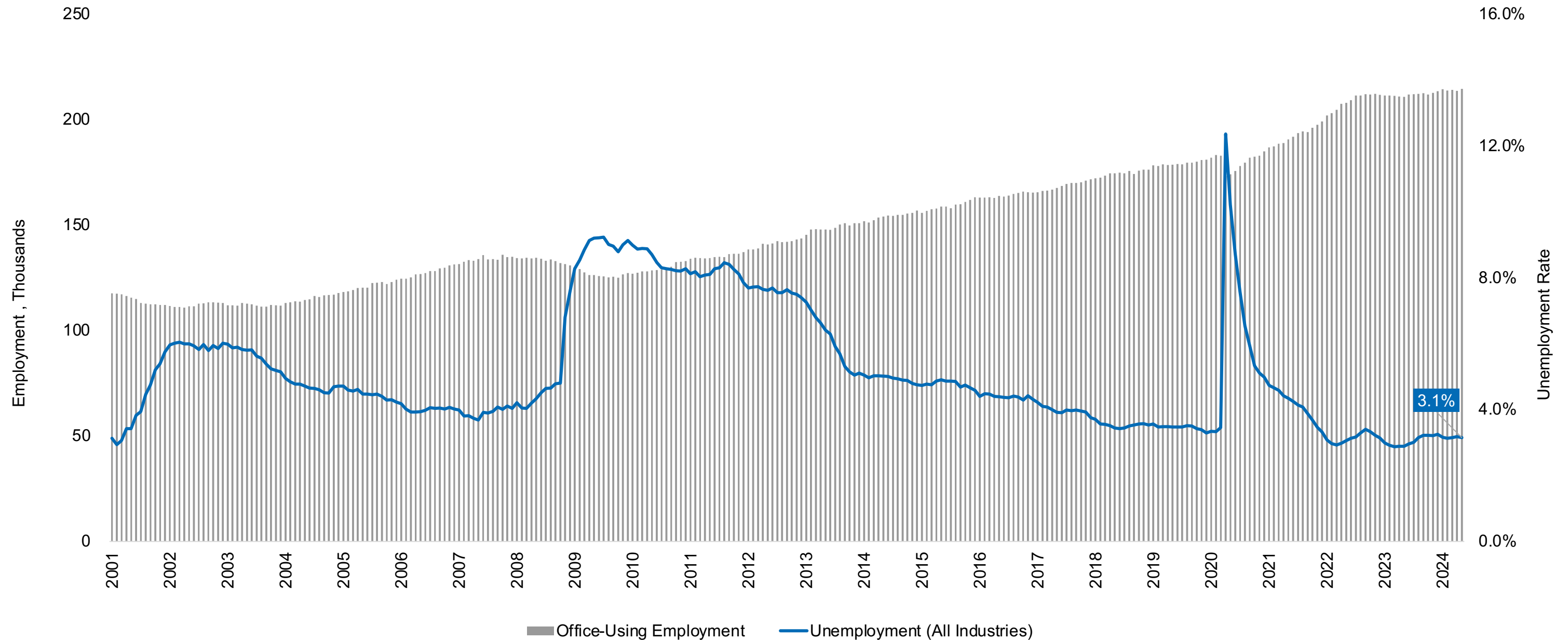


Source: U.S. Bureau of Labor Statistics, Raleigh MSA

Overall Office-Using Employment Records Historic High

Office-using employment in the Raleigh market recorded a historical high of 214,592 office-using employees in May of 2024, 165 more jobs than the previous record set in January 2024. Currently, the seasonally adjusted unemployment rate is 3.1%, less than the 3.5% average levels reported in 2019, indicating that industries outside office-using jobs are likely contributing to most of Raleigh's unemployment rate.

Office-Using Employment* and Unemployment Across All Industries



Source: U.S. Bureau of Labor Statistics, Raleigh MSA

*Office-using employment includes employment in the following industry sectors: Professional & Business Services, Financial Activities and Information.

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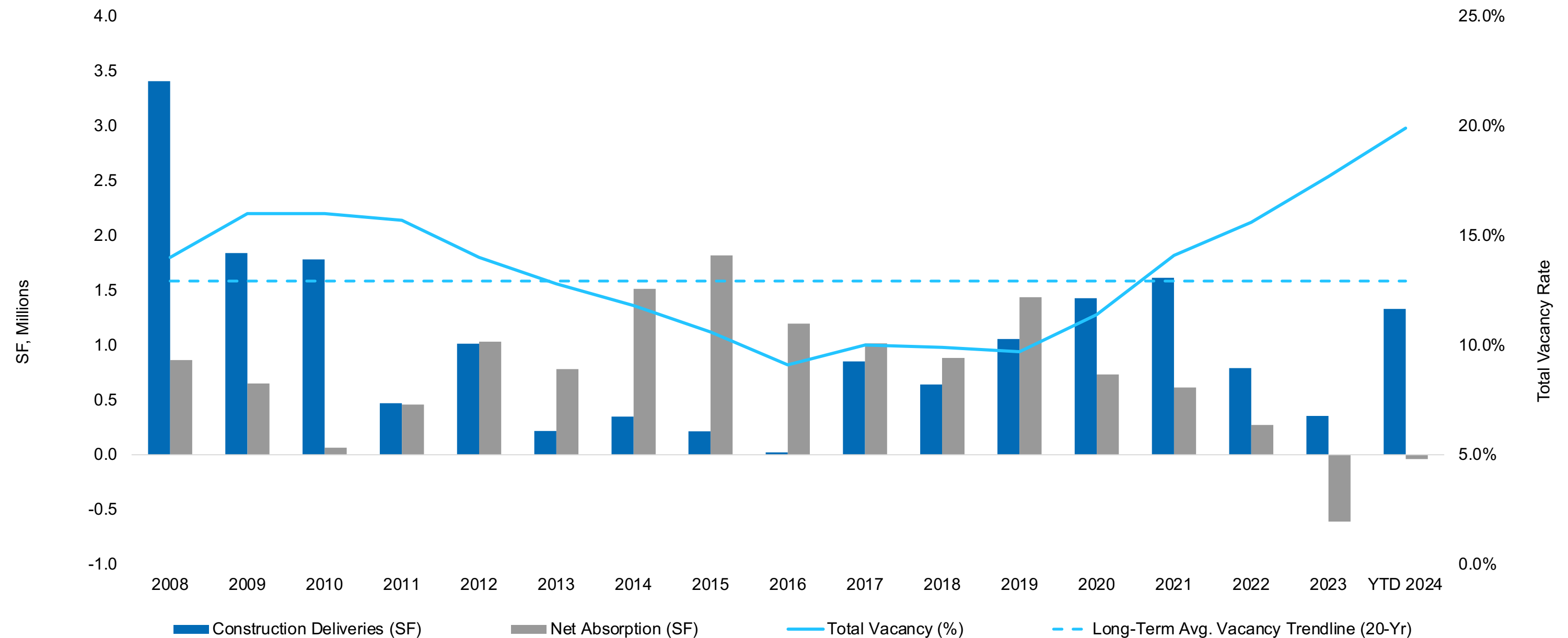
Leasing Market Fundamentals



Elevated Deliveries and Negative Net Absorption Push Vacancy to Historic High

The Raleigh office vacancy rate increased by 320 basis points year over year to 19.9% in the second quarter of 2024, above the 20-year vacancy average of 12.9%. Since the fourth quarter of 2019, vacancy rates have generally increased in the market, with the trend continuing in the second quarter of 2024 as vacancy rates increased by 200 basis points quarter over quarter. This can be attributed to several factors, including continued historically high levels of direct and sublet availability, historically elevated deliveries of vacant office buildings and recent years of low or negative yearly absorption. Going back to 2007, this quarter's building deliveries were second only to the fourth quarter of 2008 and first quarter of 2010. Vacancy will remain elevated as Raleigh works through the new deliveries.

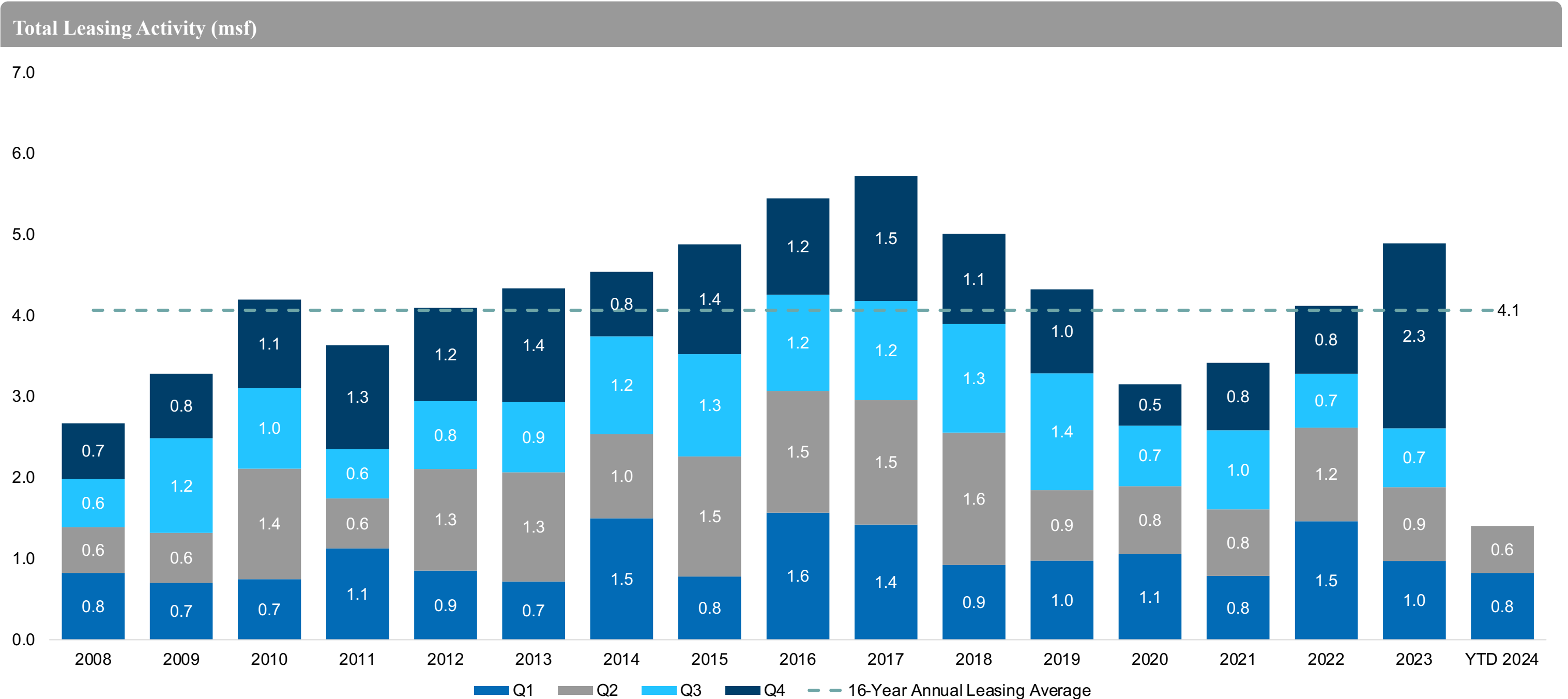
Historical Construction Deliveries, Net Absorption, and Vacancy



Source: Newmark Research, CoStar

Leasing Activity below Historic Quarterly Average

Leasing activity in the second quarter of 2024 in the market slowed compared with the second quarter of 2024. Overall, leasing activity was at one of the lowest levels on record going back to 2008, only second lowest to the second quarter of 2008. The quarter's leasing activity of 581,485 SF was well below the 16-year second-quarter leasing average of 1.1 MSF. The decrease in leasing activity is likely being driven by companies reevaluating corporate office space needs and a reluctance to lease space in an uncertain economic environment.

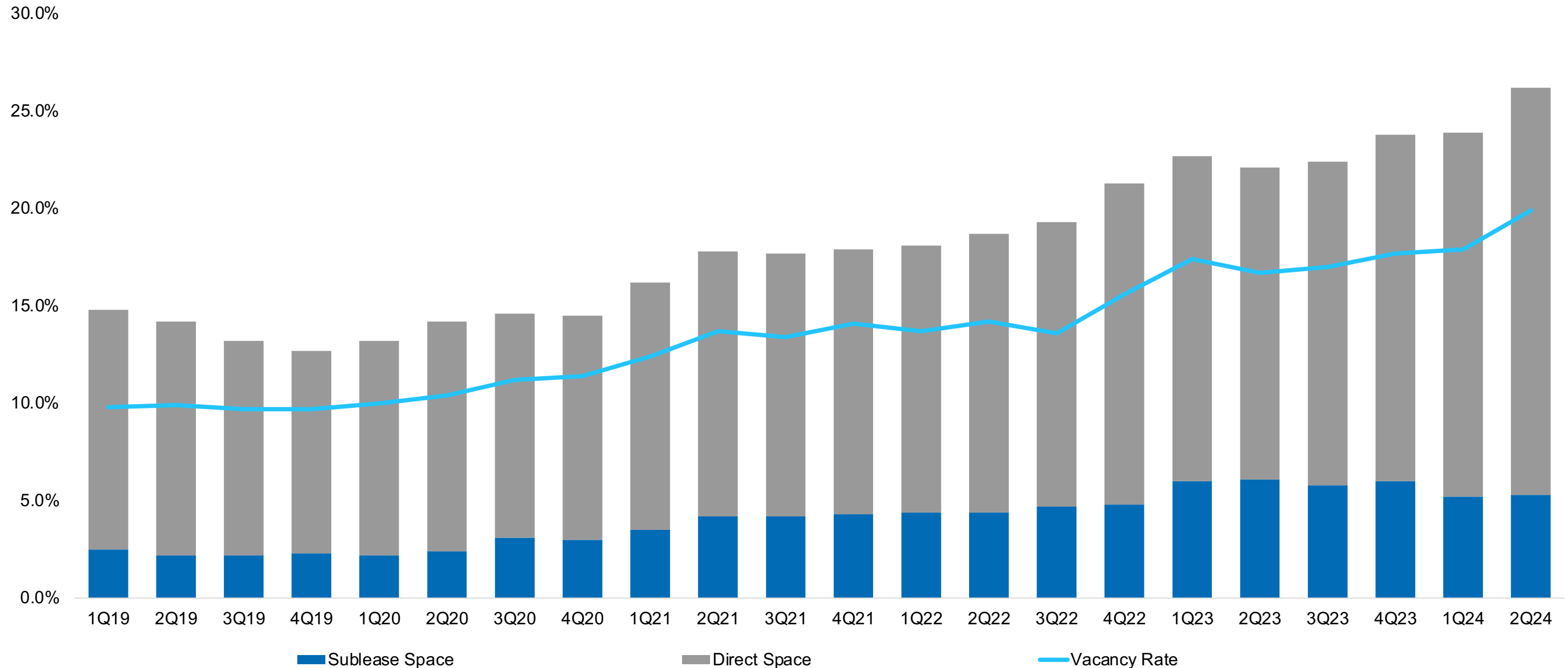


Source: Newmark Research, CoStar

Elevated Sublet Availability, Record Direct Vacancy Push Vacancy to New High

Sublease availabilities in the Raleigh market, which recorded 5.3% in the second quarter of 2024, have begun to tick up towards their historic high of 6.1%. This reflects a 10-basis-point quarter-over-quarter increase and 80-basis-point year-over-year decrease. Direct availability increased 220 basis points quarter over quarter and increased 490 basis points year over year to 20.9%, a record high. Overall, the quarterly increases in sublease and direct space availability resulted in overall vacancy for the second quarter of 2024, increasing 200 basis points to a historic high of 19.9%.

Available Space as Percent of Overall Market

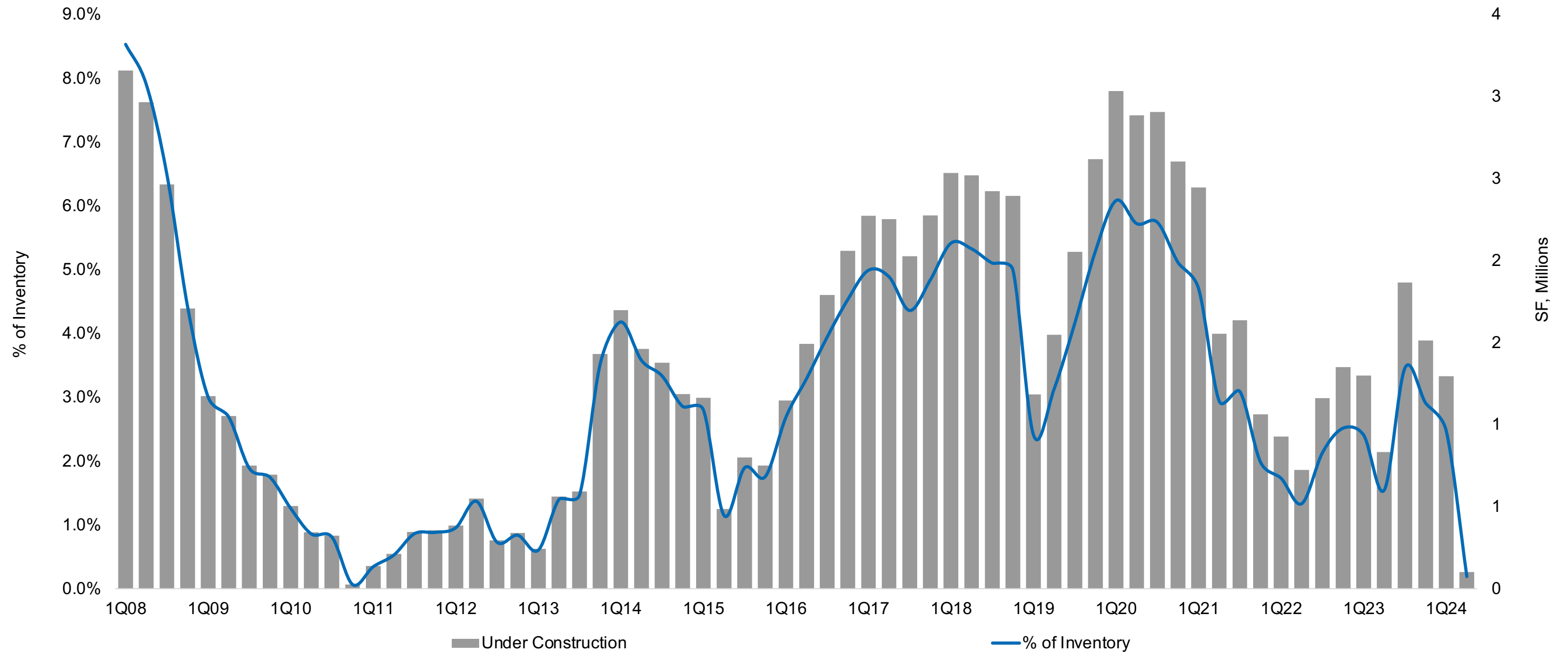


Source: Newmark Research, CoStar

Construction Pipeline Empties Out

Recent construction activity rapidly increased and peaked in the third quarter of 2023, driven by the technology and biotechnology sectors' office usage. The under-construction pipeline has declined in every quarter since. The construction pipeline emptied out to 102,500 SF quarter over quarter as buildings delivered and as new office starts were impacted by elevated inflation and a higher cost of debt. As of the second quarter of 2024, Raleigh's under-construction inventory only accounted for 0.2% of the market's total inventory.

Office Under Construction and % of Inventory

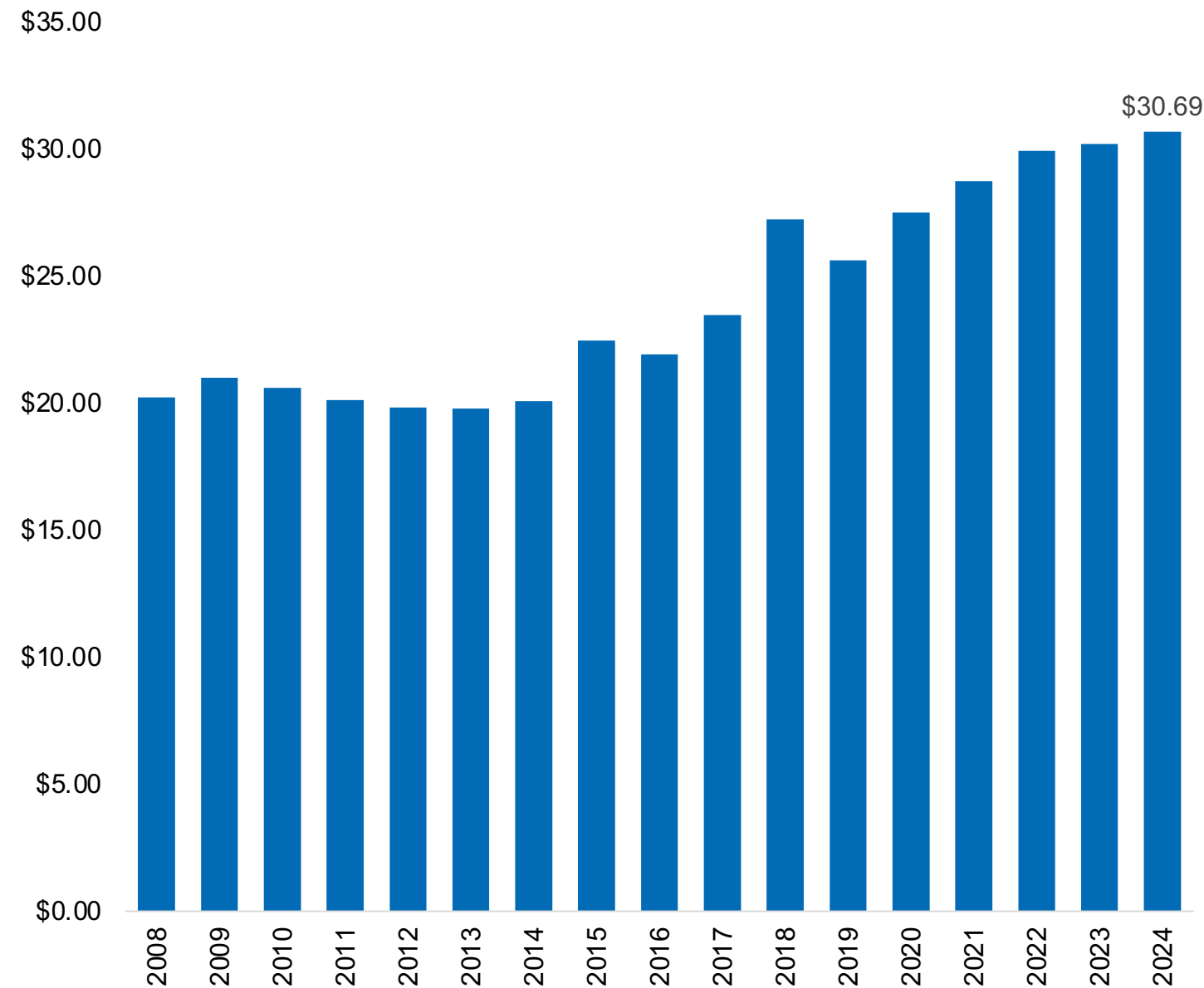


Source: Newmark Research, CoStar

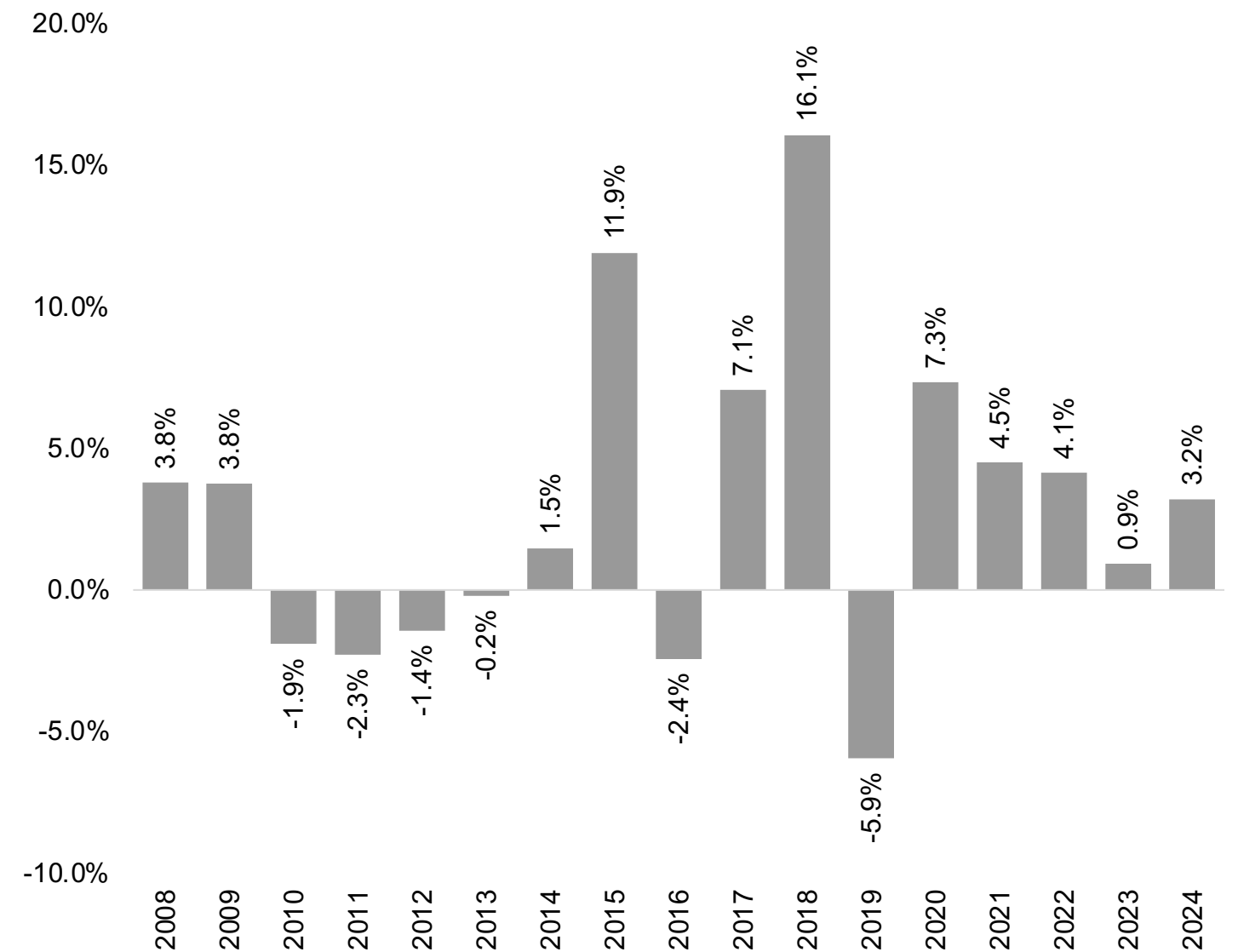
Rents Inch Higher to New Historic High; Rent Growth Flattens

Asking rents increased by 1.9% quarter over quarter and by 3.2% year over year to \$30.69/SF, a record high. The rent growth flattening can be attributed to several factors, including generally rising vacancy over the past several years as vacant buildings have delivered into the market, historically low leasing activity and several recent quarters of negative or slightly positive absorption. New space deliveries have pushed rents up; however, historically high vacancy resulting from low leasing activity and net absorption have muted growth.

Office Average Asking Rent, \$/SF, FS



Year-over-Year Asking Rent Growth Rate

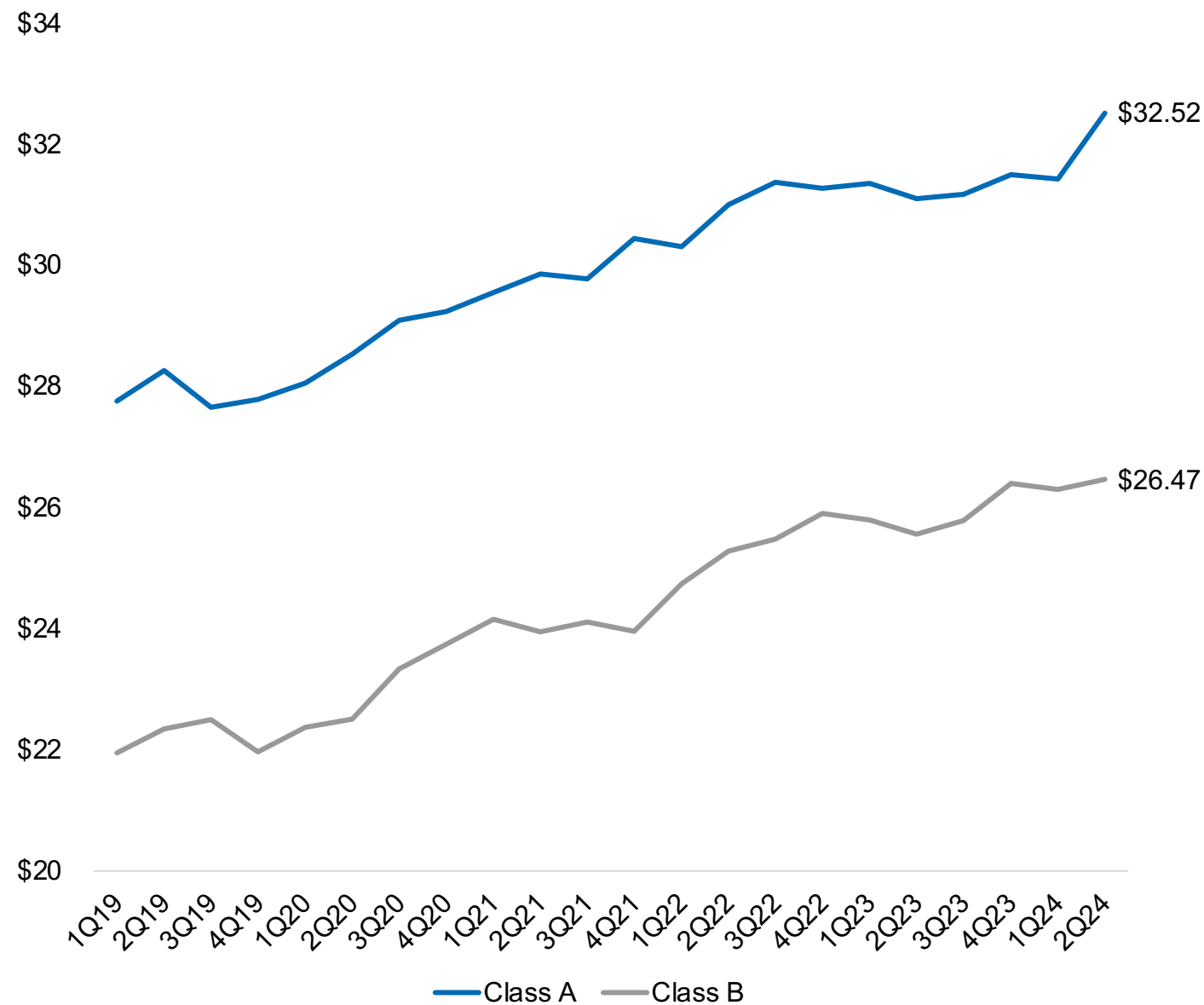


Source: Newmark Research, CoStar

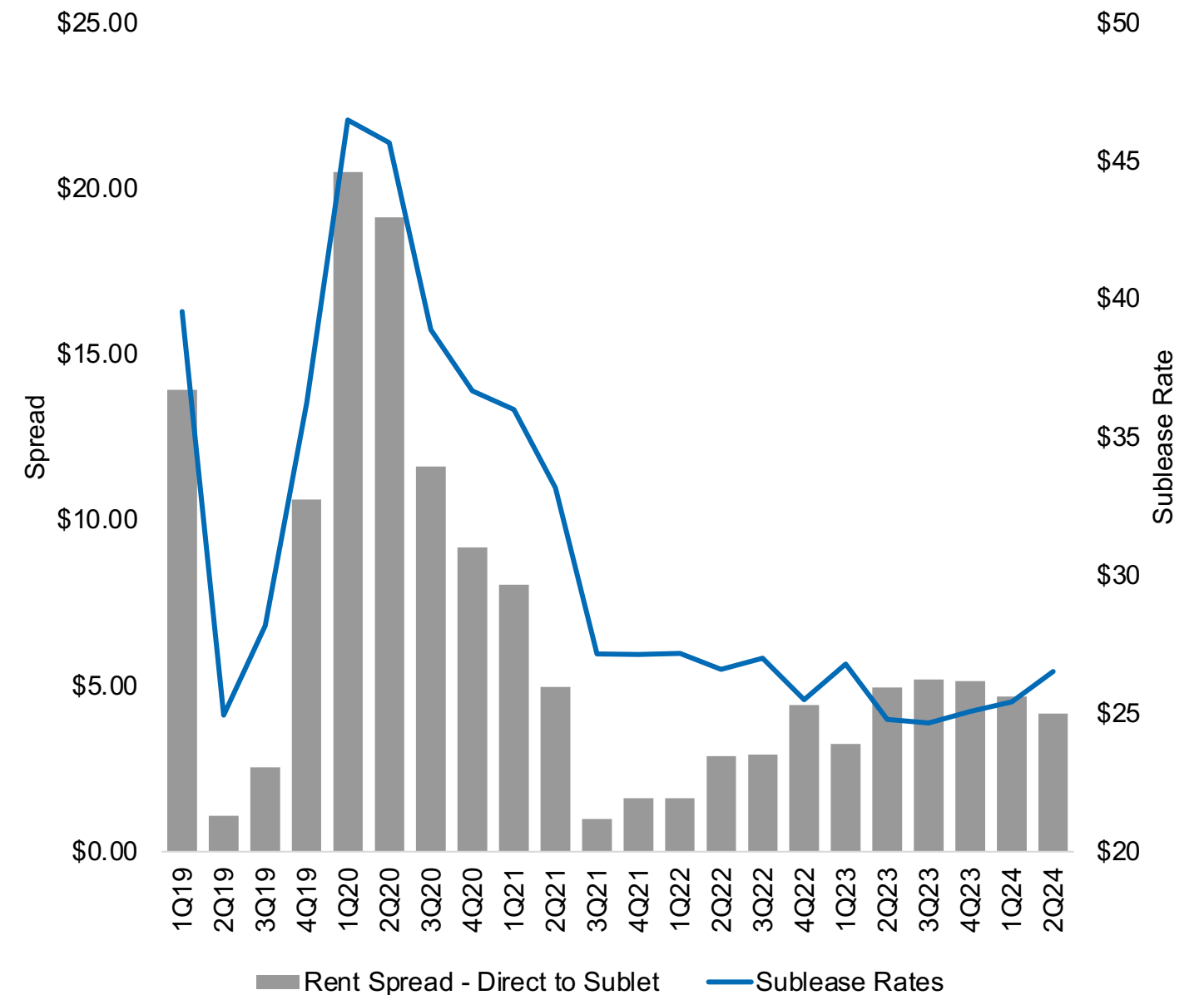
Class A and Class B Asking Rents Increase to Historic Highs

As of the end of the second quarter of 2024, Class A rents ended at \$32.52/SF, while Class B reported \$26.47/SF. The rent difference between the two assets is \$6.05/SF, a 4.0% spread increase since the fourth quarter of 2019. Quarter over quarter, the rent spread increased by 17.9%. The divergence between Class A and Class B assets will likely drive more tenants to shed unused space in less desirable assets and lease smaller footprints in higher quality, better amenitized assets. As sublease space has entered the market, asking rents for sublease space have decreased. Second-quarter asking sublease rates have increased by 4.3% quarter over quarter and 7.0% year over year.

Class A and Class B Asking Rents



Sublease Rates



Source: Newmark Research, CoStar

International Corporate Relocations Driving Office Demand in Trophy Assets

The flight-to-quality pattern is still present in the second quarter of 2024, with older buildings continuing to shed space and newer assets with amenities becoming the most attractive to tenants. Demand is strongest in North Hills, Fenton, Raleigh Ironworks and Raleigh Central Business District micromarkets, as demonstrated by the Audemars Piguet, PwC and JTI deals. Trophy asset rents are expected to increase and create an even larger rent spread between trophy assets and the rest of the market. As leasing activity slows and subleases convert to direct vacancy upon expiration, overall vacancy will likely increase in the near term. Two of the quarter's largest leases signed were international corporations moving their offices to Raleigh, namely Audemars Piguet and JTI. There is consistent tenant demand for spaces that are 15,000 SF and below for all building classes.

Notable 2Q24 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
Applied Research Associates	Forum 5	Six Forks/Falls of Neuse	Renewal	110,000
<i>Scientific research and engineering company Applied Research Associates signed the largest lease of the second quarter of 2024 when it renewed its space at 8537 Six Forks Road.</i>				
IXL Learning	1600 Perimeter Park	RTP/RDU	Renewal/Expansion	90,000
<i>Educational technology company IXL Learning renewed and expanded its presence at 1600 Perimeter Park.</i>				
Audemars Piguet	Raleigh Iron Works	Six Forks/Falls of Neuse	Direct New	64,000
<i>Luxury watch-maker Audemars Piaget signed the quarter's largest lease when it agreed to relocate its North American service center to the second and third floors of Raleigh Iron Works from Tampa, Florida.</i>				
SoftPro	4800 North Park	Six Forks/Falls of Neuse	Renewal	29,000
<i>Raleigh-based real estate closing, title and escrow software provider SoftPro renewed its lease at 4800 Falls of Neuse Road.</i>				
PricewaterhouseCoopers LLP	Creative Office @ North Hills	Six Forks/Falls of Neuse	Direct New	22,500
<i>Multinational accounting and consulting firm PricewaterhouseCoopers relocated its office to their newly-delivered offices located at 4114 Center at North Hills Street.</i>				
JTI	One North Hills Tower	Six Forks/Falls of Neuse	Direct New	17,000
<i>Japanese tobacco company JTI joins several Japanese companies that have established a presence in Raleigh when it relocated its North American headquarters from New Jersey to Raleigh.</i>				

Source: Newmark Research, CoStar



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