3Q24

Charlotte Office Market Overview

Market Observations

Economy

- The market's unemployment rate increased by 46 basis points year-over-year to 3.7%, still below the five-year average of 4.4%.
- Employment growth decelerated by 109 basis points year over year in August 2024 to 1.5%.
- Most sectors experienced yearly employment growth, with government leading job gains at 4.5% over the past 12 months.
- Office-using jobs in the market reached a record high of 380,930 as of the end of August 2024, reflecting a 10.4% increase since 2019.

Leasing Market Fundamentals

- Annual full-service class rental rates remain elevated but have decreased slightly from the record high reported last quarter to $34.00/SF, a 0.9% decrease quarter-over-quarter.
- Occupancy declined, leading to a year-over-year increase in overall vacancy rates by 330 basis points to a record high of 26.8%.
- The under-construction pipeline continued its six-quarter decline from the recent peak of 2.1 MSF recorded in the first quarter of 2023 and ended the third quarter of 2024 with 252,643 SF currently in progress.
- Total leasing activity closed the quarter at 1.1 MSF, slightly above the 16-year third-quarter average of 1.0 MSF.

Major Transactions

- WeWork signed the largest lease of the third quarter, taking the eighth and ninth floors of 615 Regions. This marks a notable shift from Charlotte's reputation as a financial hub, where the fifth-largest notable lease was signed by a financial institution – United Bank at Four Morrocroft.
- A key leasing trend seen throughout the quarter was companies capitalizing on market weakness to lease entire buildings. The Imagine Group leased the entirety of Innovation Park and United Bank secured all of Four Morrocroft.
- All notable transactions were direct new leases, highlighting healthy demand for space as office users took advantage of favorable market conditions to relocate into smaller, better amenitized spaces.

Outlook

- The Charlotte office market is expected to experience slower growth this year. Office investment activity will remain subdued in the near term due to elevated inflation and higher debt costs.
- The increasing rent spread between Class A and Class B assets will likely continue to widen as Class B office landlords look to make their properties more competitive with higher-quality offices by lowering asking rents.
- With demand continuing to lag, the market is expected to remain tenant-friendly, and overall asking rates may see little to no growth.
- Vacancy is expected to remain elevated and stagnant in the near term as the market absorbs the historically elevated deliveries that occurred during the current quarter and tenants continue to shed excess space.

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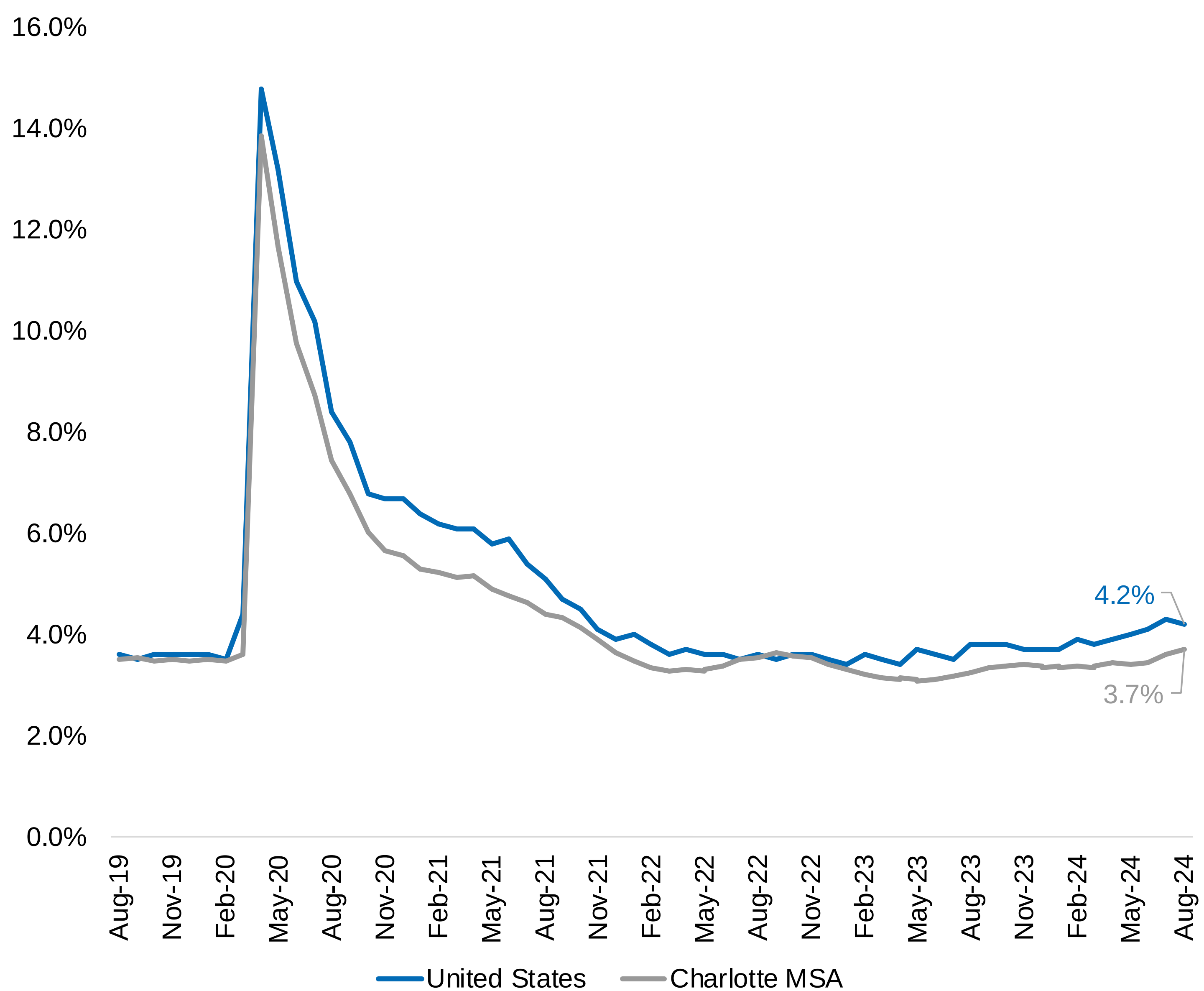
Economy

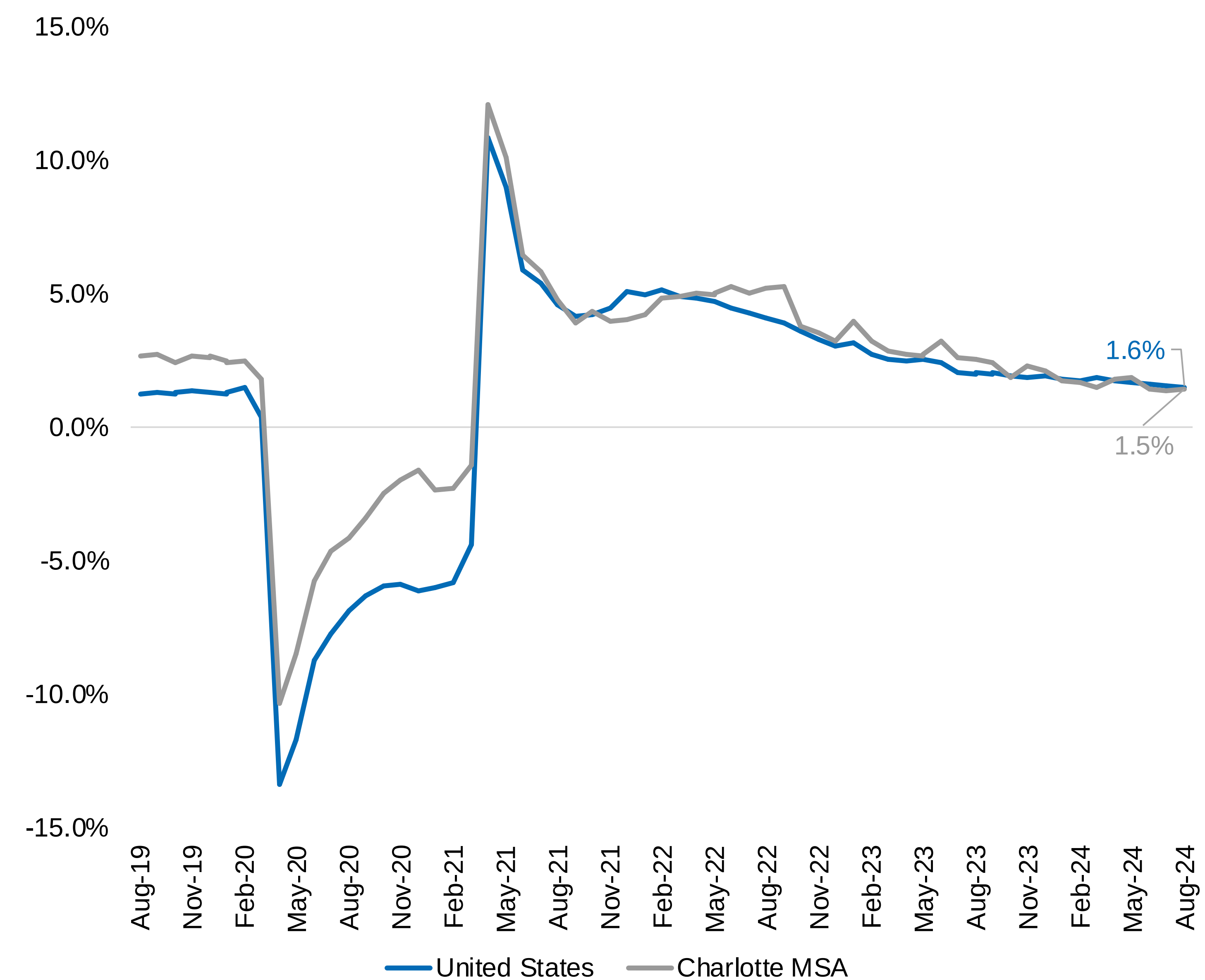
Yearly Unemployment Increases, Declining Payroll Growth Signal a Cooling Economy

Charlotte, traditionally an outperformer in both employment growth and low employment compared to the national average, saw a shift in the third quarter of 2024. The market's nonfarm payroll growth marginally underperformed the national average by 10 basis points. Unemployment in the market rose by 46 basis points year-over-year to 3.7%, still below the national rate of 4.2%. Seasonally adjusted nonfarm payrolls declined by 109 basis points, posting a year-over-year growth rate of 1.5%.

Unemployment Rate, Seasonally Adjusted



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

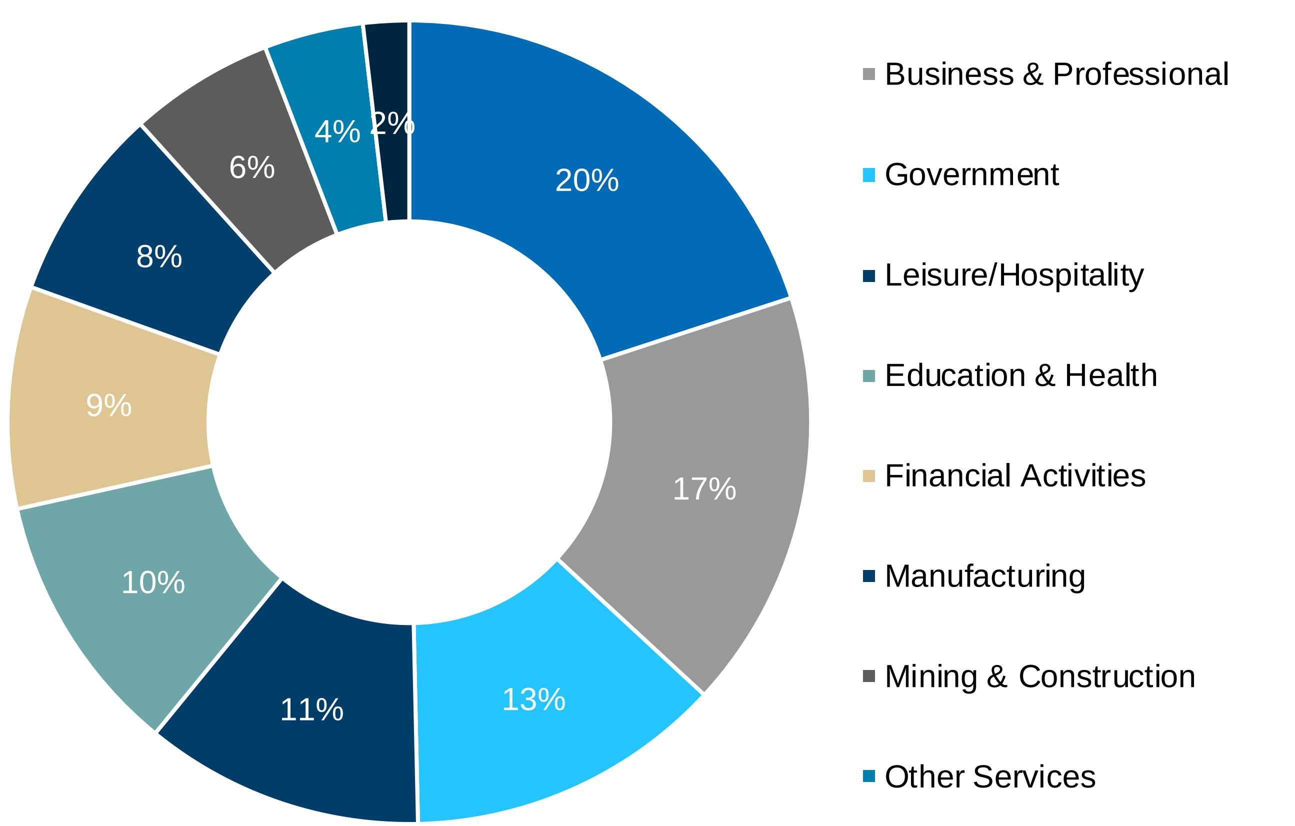


Source: U.S. Bureau of Labor Statistics, Charlotte MSA

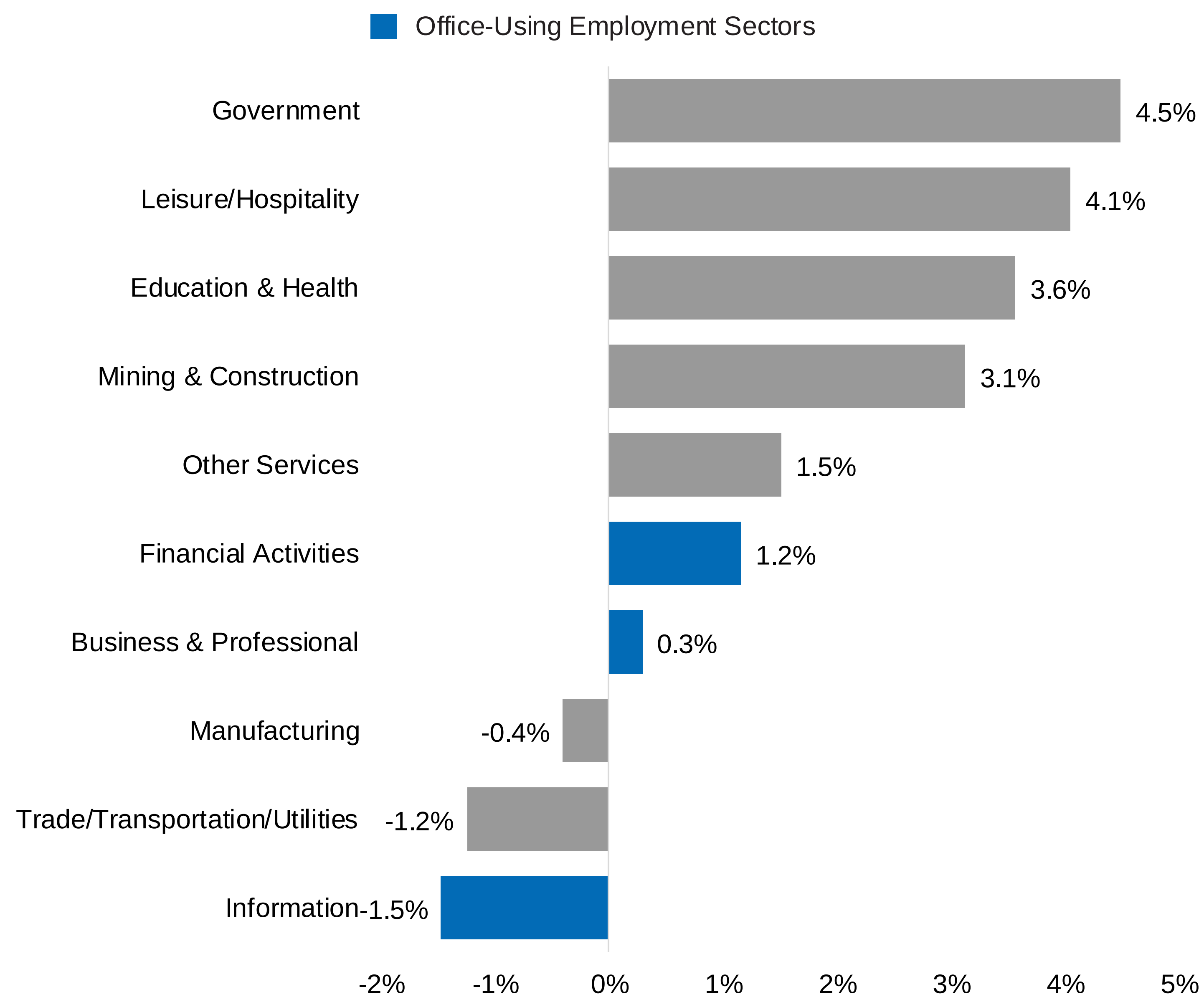
Office-Using Employment Continues to Grow, Led By Business And Financial Sectors

Charlotte, known for its strength in the financial sector, has its top two employment industries—trade/transportation/utilities and business/professional services—making up 36.9% of total jobs. The business and professional services sector is the largest office-using employment sector, representing 16.9% of total employment. Most industries saw year-over-year job growth, with the exception of manufacturing, trade/transportation/utilities, and information. The office-using business and professional services and financial activities sectors reported growth of 0.3% and 1.2%, respectively. The information sector saw the largest annual decline, dropping by 1.5%.

Employment by Industry, August 2024



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

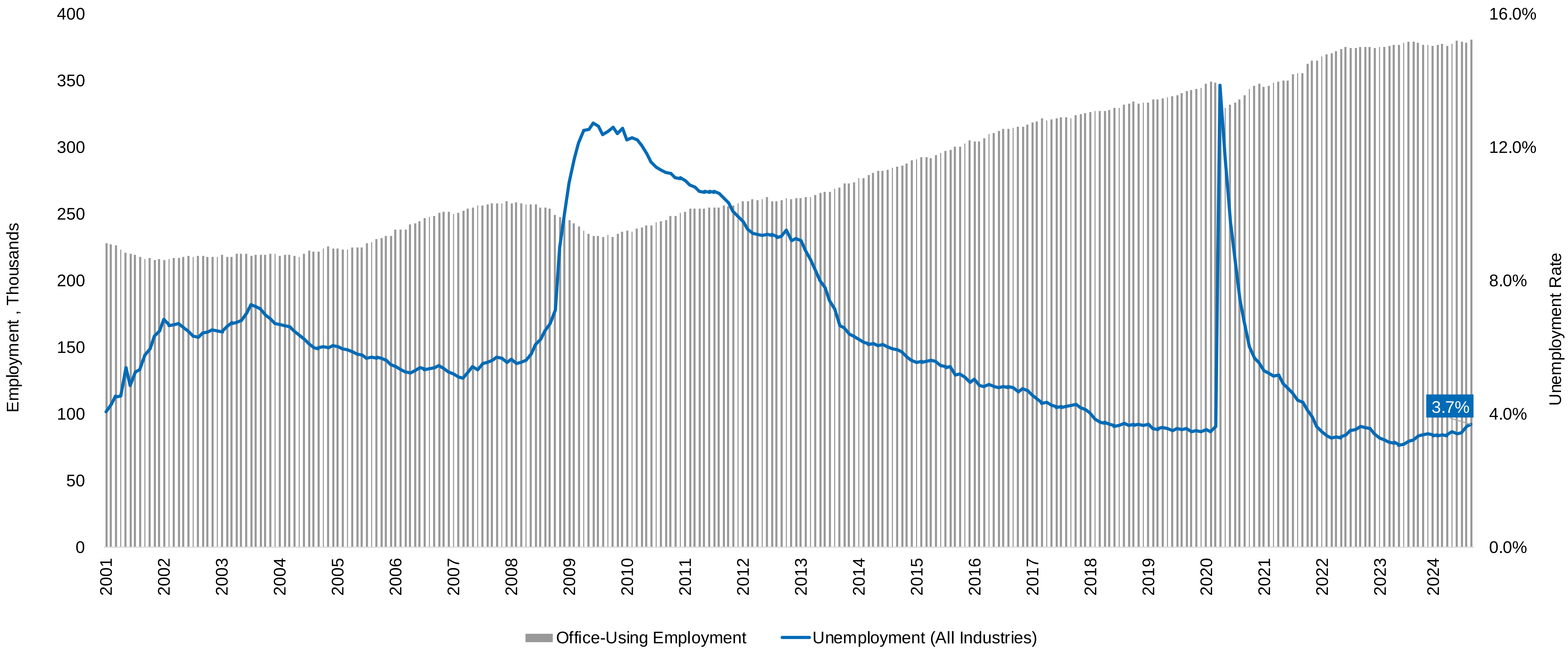


Source: U.S. Bureau of Labor Statistics, Charlotte MSA

Office-Using Employment Reaches Historic High

Office-using employment in the Charlotte market reached a record high of 380,930 jobs in August 2024. While the information sector saw year-over-year job losses, gains in the financial activities and business/professional services sectors more than offset these declines. The seasonally adjusted unemployment rate stands at 3.7%, slightly above the 3.6% average reported in 2019. This increase reflects weakness in non-office-using sectors such as manufacturing and trade/transportation/utilities, which continue to drive the regional unemployment rate higher.

Office-Using Employment* and Unemployment Across All Industries



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

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

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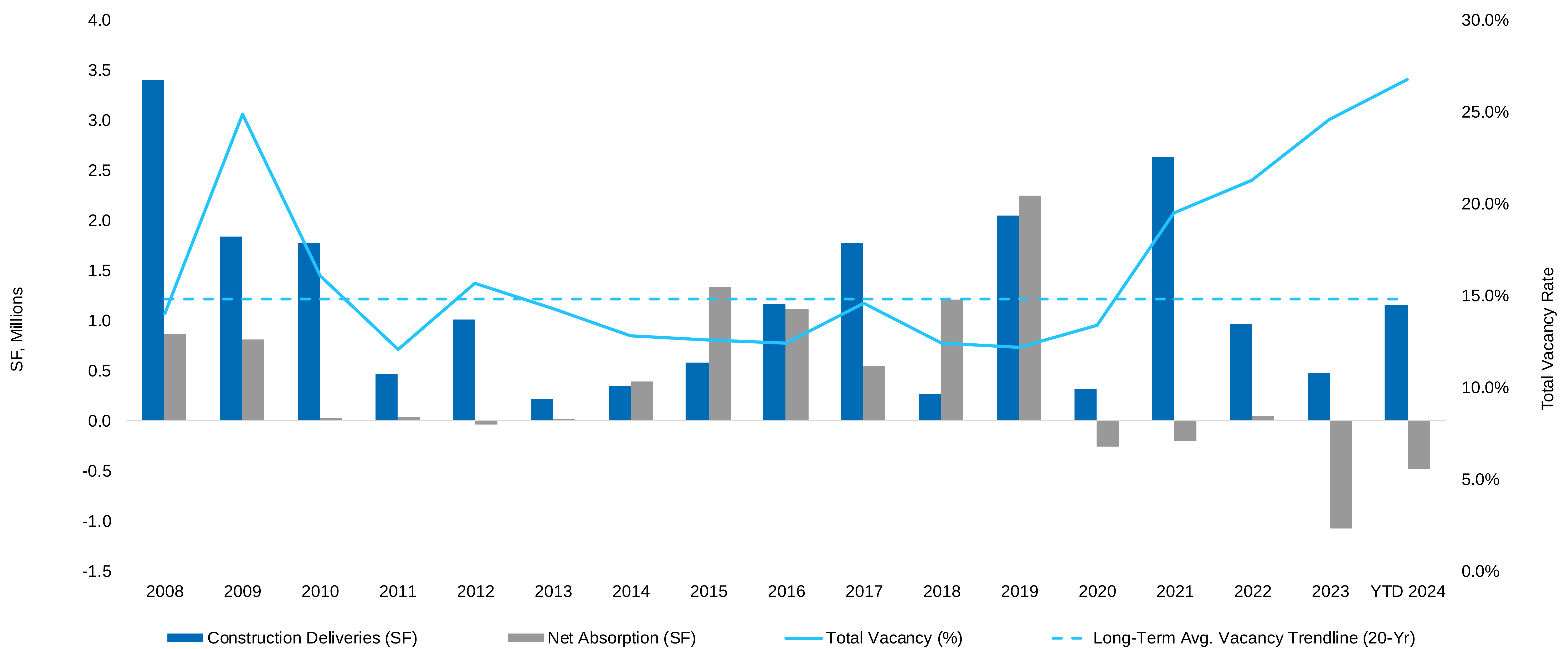
Leasing Market Fundamentals

Elevated Deliveries and Continued Negative Absorption Drive Vacancy to Record High

The Charlotte office vacancy rate rose by 330 basis points year-over-year to 26.8% in the third quarter of 2024, significantly above the 20-year average of 14.8%. Since the first quarter of 2020, vacancy rates have trended upward, with a 110-basis-point increase quarter-over-quarter. This rise can be attributed to several factors, including continued historically high levels of direct and sublet availability, elevated deliveries of new office space, and ongoing recent negative yearly absorption. The pandemic era shift to hybrid and remote work, coupled with corporate reticence to lease more space than necessary, due to the impacts of restrictive fiscal policy and political and economic uncertainty, has only exacerbated this trend.

Historical Construction Deliveries, Net Absorption, and Vacancy

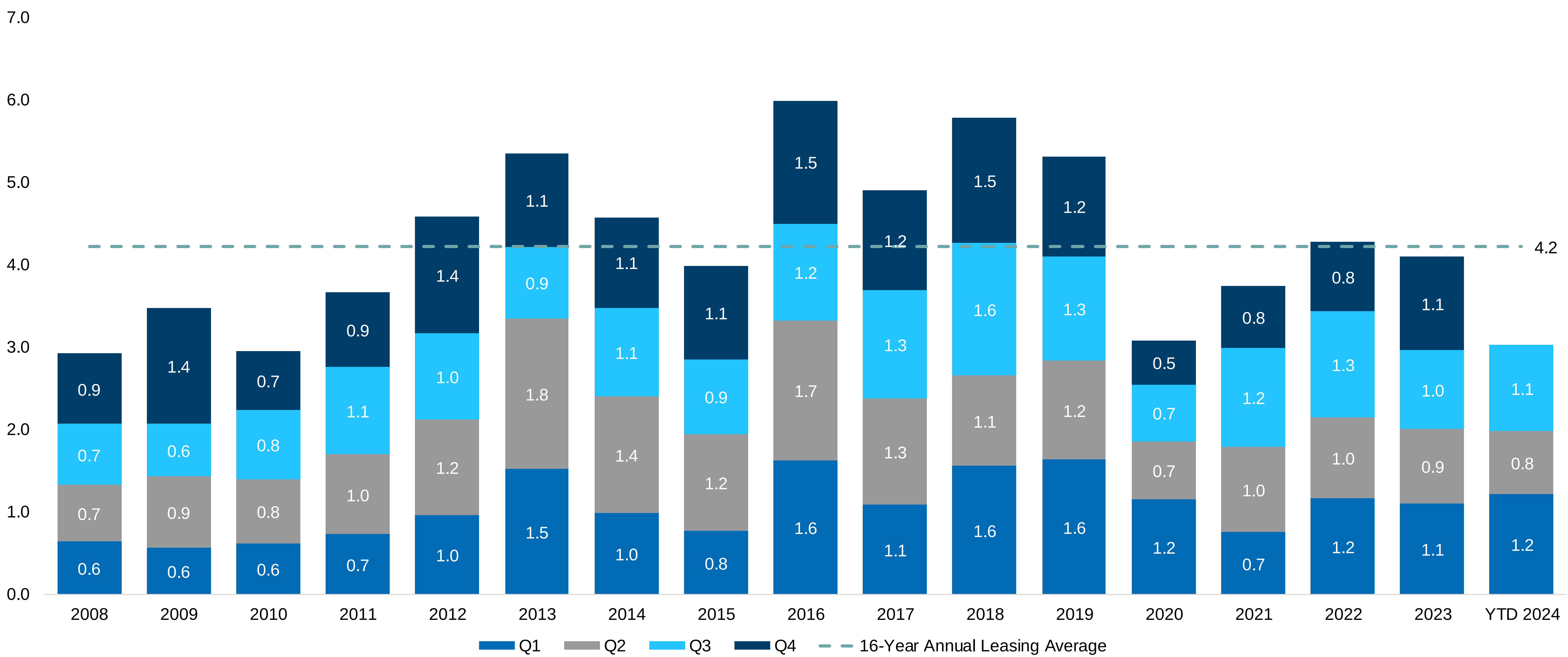


Source: Newmark Research, CoStar

Leasing Activity Slightly Above Long-Term Quarterly Average

Leasing activity in the Charlotte market saw an increase both quarterly and annually, with the third quarter of 2024's total leasing activity reaching 1.1 MSF, slightly surpassing the 16-year quarterly average of 1.0 MSF. This represents a 295,430 SF increase from the previous quarter and a 101,587 SF year-over-year rise. The uptick in leasing activity can likely be attributed to more companies, likely in the financial services sector, taking on additional space as they phase out work-from-home policies and require employees to return to the office. However, businesses are taking a measured approach to their space utilization amid ongoing economic and political uncertainty.

Total Leasing Activity (msf)

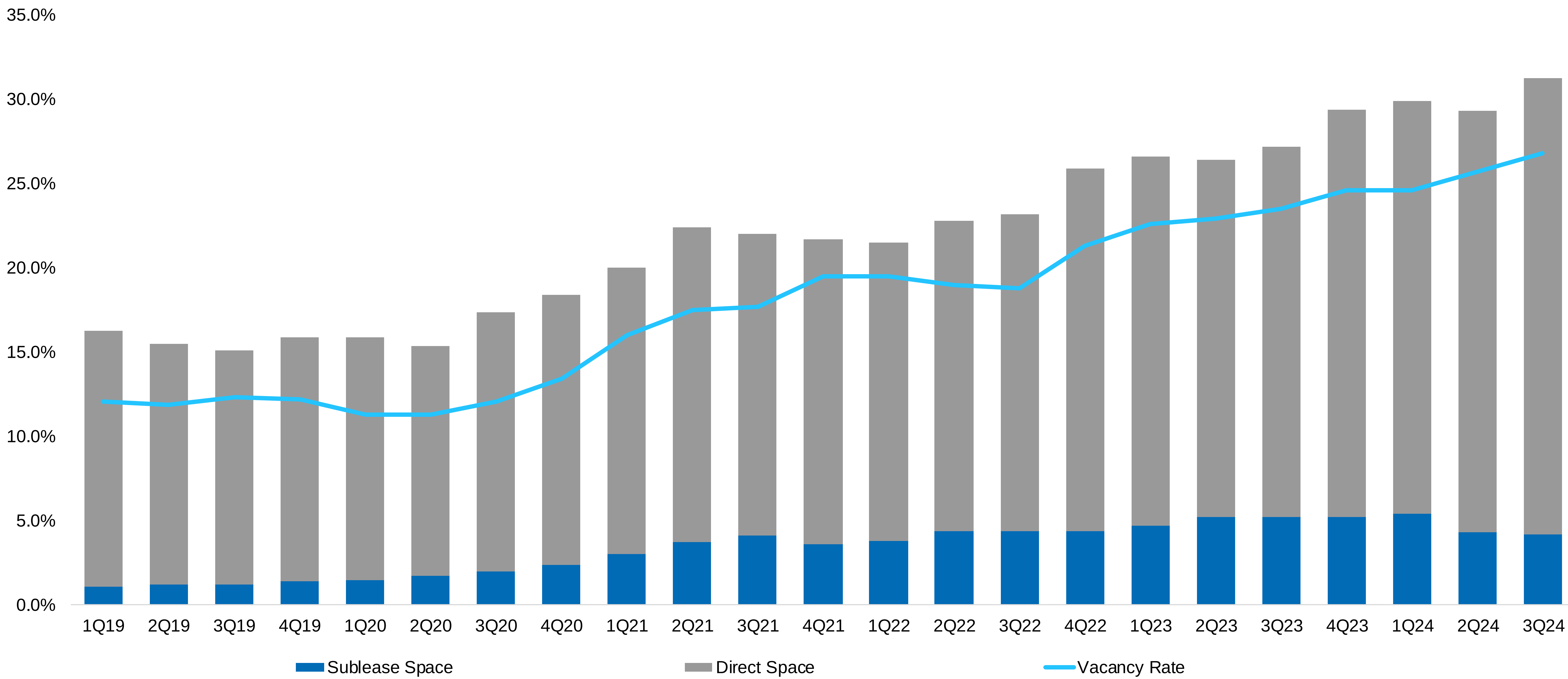


Source: Newmark Research, CoStar

Rising Direct Drives Push Overall Vacancy to Record High

Sublease availability in the Charlotte market decreased by 10 basis points quarter-over-quarter and 100 basis points year-over-year to 4.2% in the third quarter of 2024. In contrast, direct availability rose by 210 basis points quarter-over-quarter and 510 basis points year-over-year to 27.1%. This surge pushed the overall vacancy rate to a historic high of 26.8%. The reduction in sublease availability likely stems from the expiration of pre-pandemic leases, leading to excess space transitioning to direct availability. Meanwhile, the rise in direct availability can be attributed to the delivery of new office product and corporate downsizing.

Available Space as Percent of Overall Market

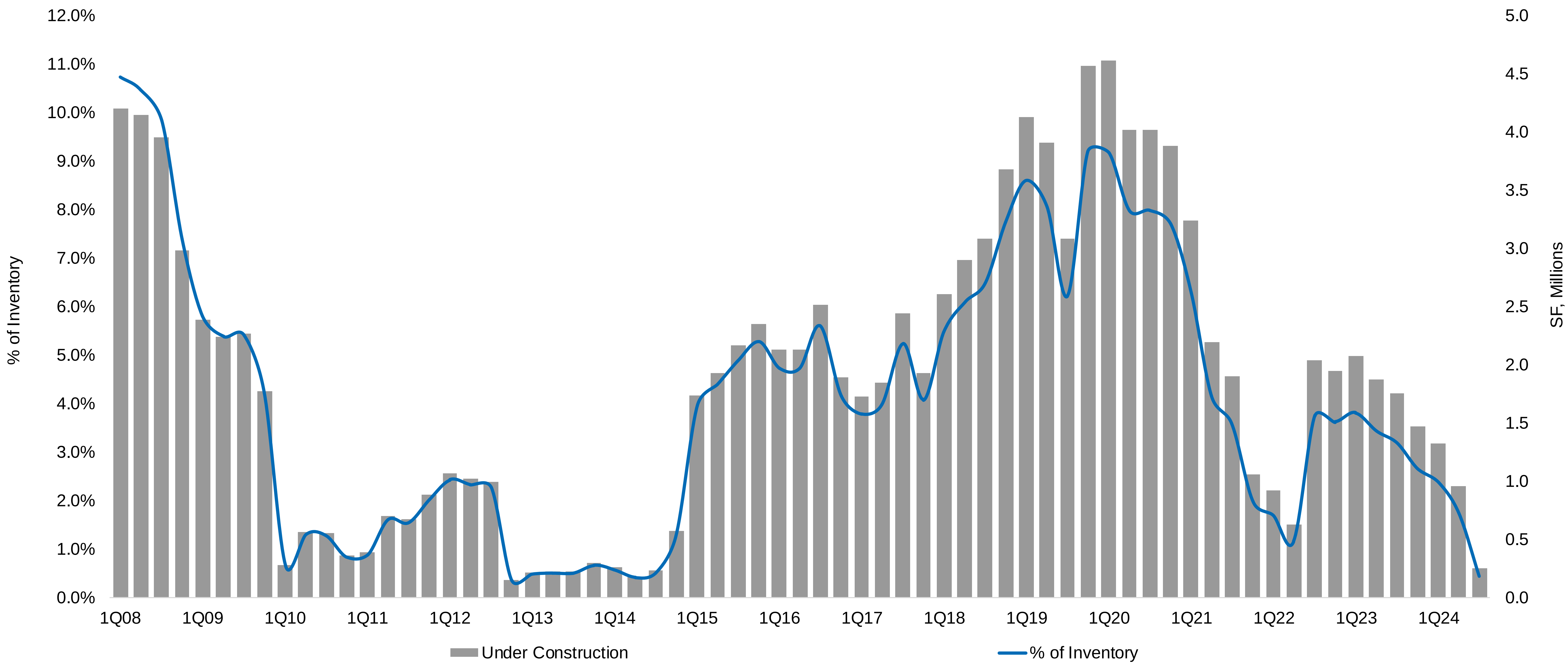


Source: Newmark Research, CoStar

Construction Activity Continues to Dwindle

Construction activity more than tripled to 2.0 MSF in the third quarter of 2022, driven largely by demand from the financial sector, but has steadily declined in almost every quarter since. This slowdown can be attributed to rising capital costs and elevated construction expenses, both influenced by ongoing inflationary pressures. As of the third quarter of 2024, the market had 252,643 SF under construction, representing 0.4% of the market's inventory – the lowest percentage of inventory under construction since the third quarter of 2014.

Office Under Construction and % of Inventory

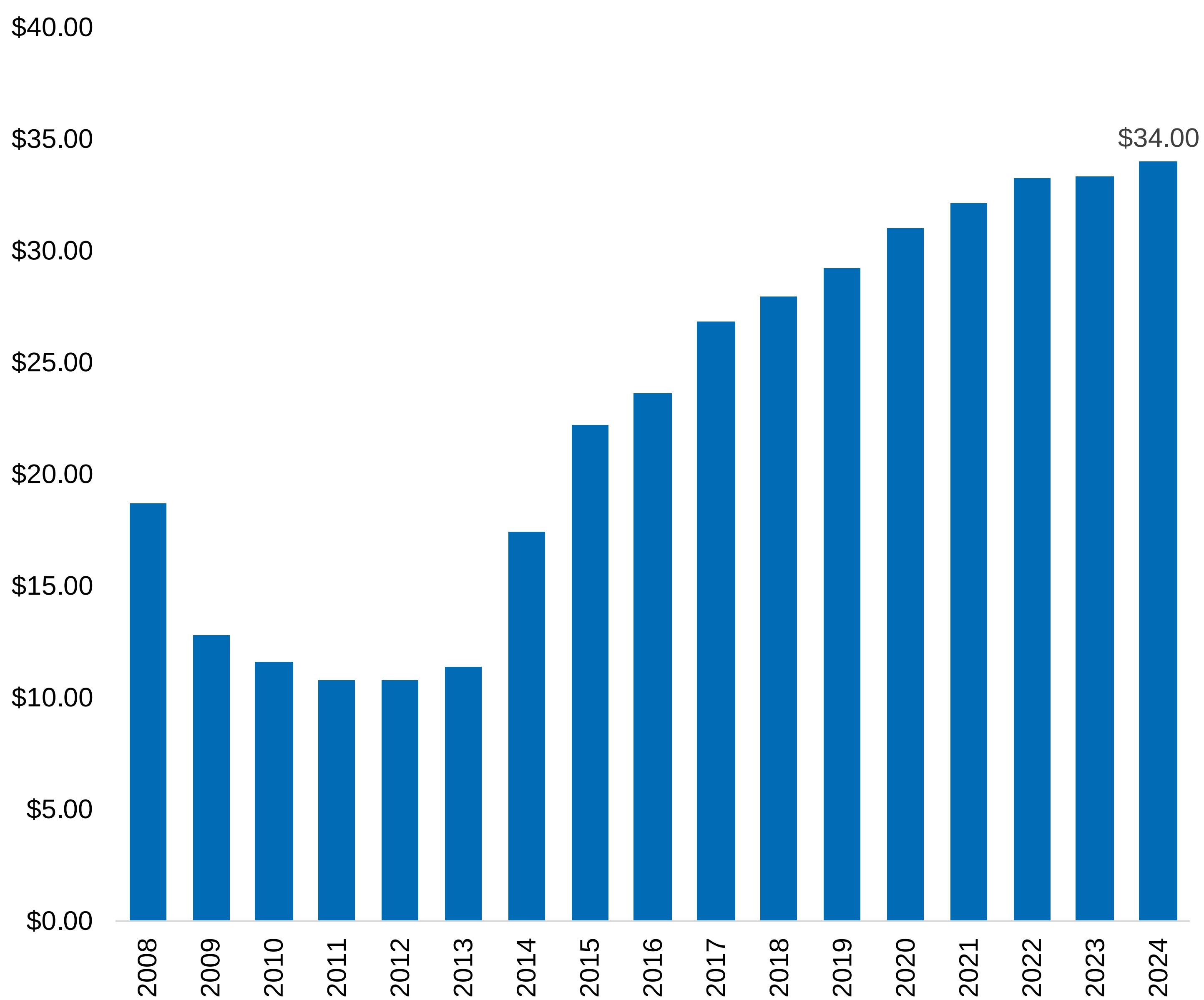


Source: Newmark Research, CoStar

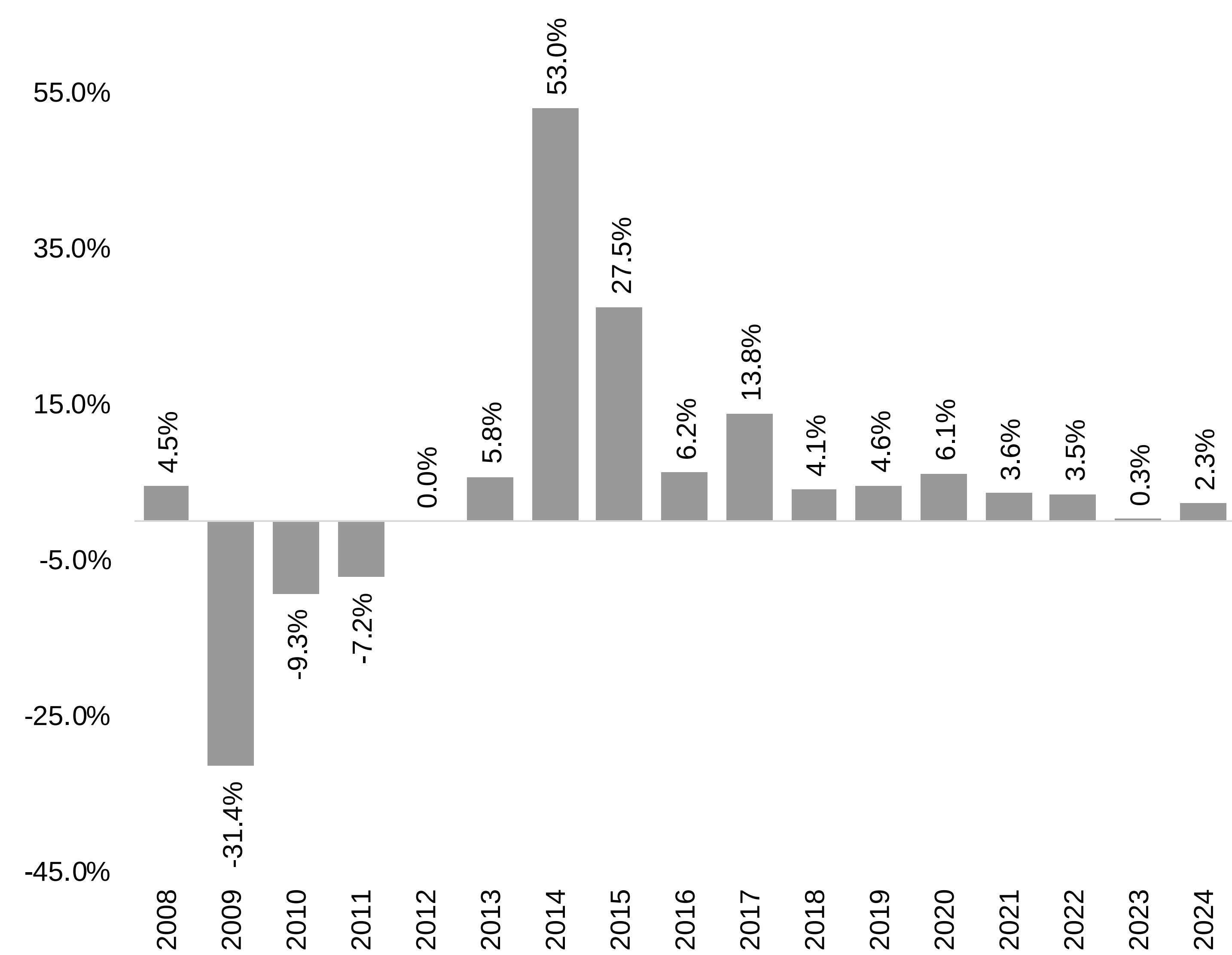
Rents Remain Elevated But Decline From Prior Quarter's Record High

The market has seen positive annual rent growth every year since 2013. However, the third quarter of 2024 posted one of the lowest annual growth rates at 2.3%, just above the rate recorded in 2023. Rents remain elevated but have decreased by 0.9% quarter-over-quarter from their record high to $34.00/SF. The flattening in asking rent growth can be attributed to several factors, including rising vacancy rates and slower leasing activity.

Office Average Asking Rent, $/SF, FS



Year-over-Year Asking Rent Growth Rate

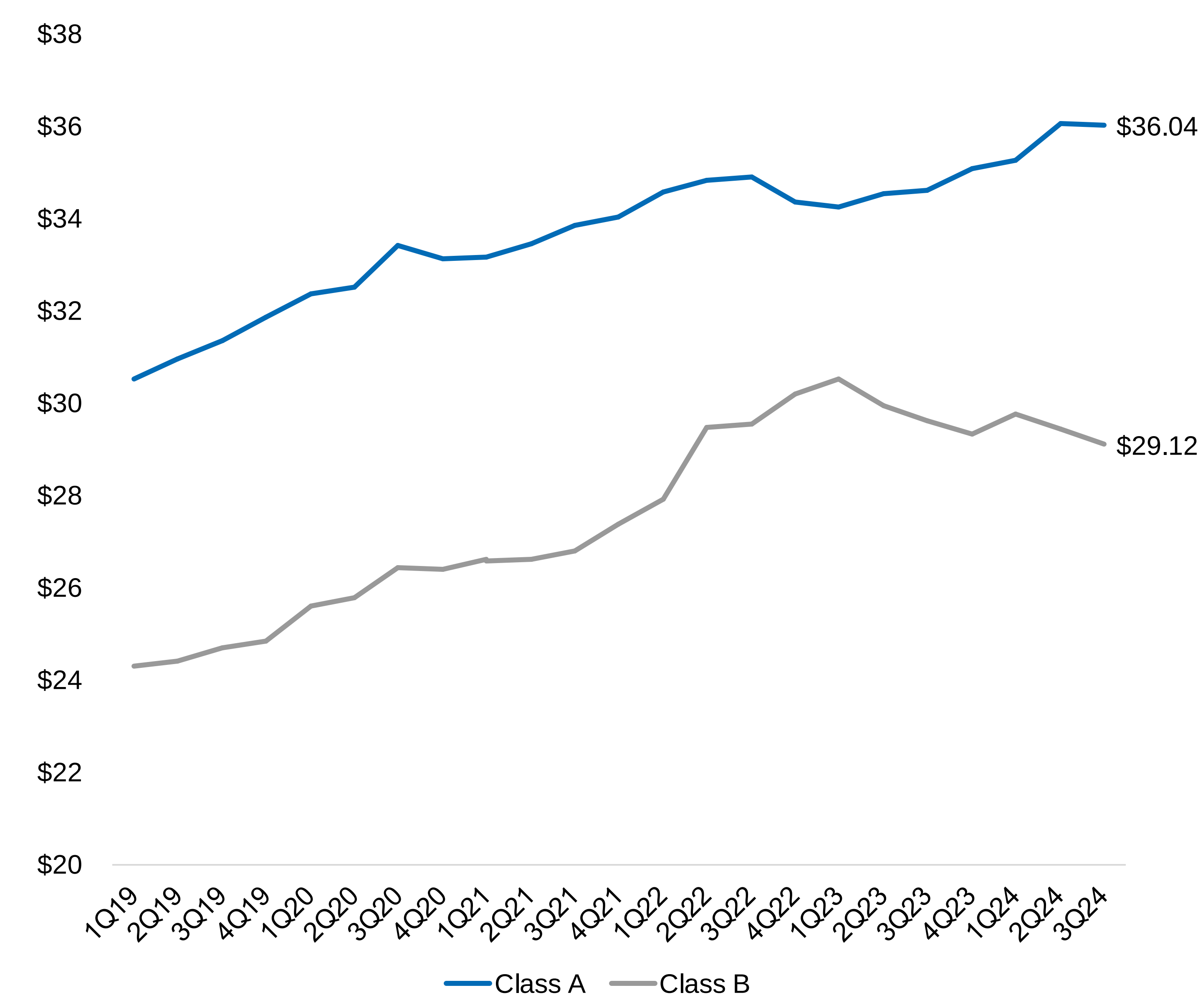


Source: Newmark Research, CoStar

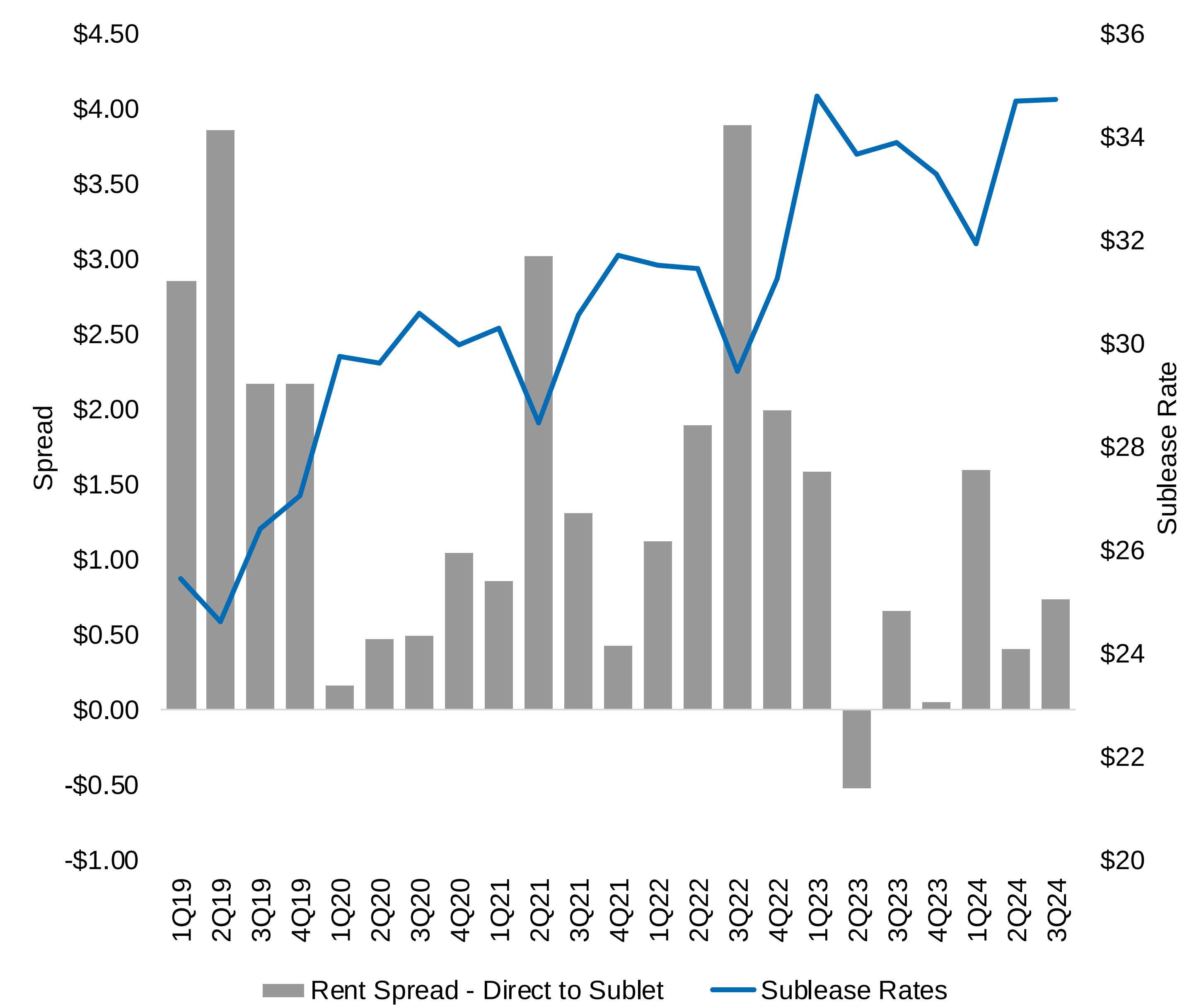
Decline in Class B Rates Pushes Rent Spread Up to Near Historic High

As of the end of the third quarter of 2024, Class A rents stood at $36.04/SF, while Class B were $29.12/SF, reflecting a $6.92/SF difference. This represents a 1.6% decrease in the spread since the fourth quarter of 2019, although the spread increased by 5.3% quarter-over-quarter. The widening gap between Class A and Class B rents is likely driven by declining Class B rates, as landlords reduce asking rents to make their assets more competitive with Class A properties. Despite historically elevated sublease availability, rent spreads have not enticed occupiers to take on subleases. Third-quarter asking sublease rates have increased by 0.1% quarter over quarter and 2.5% year over year.

Class A and Class B Asking Rents



Sublease Rates



Source: Newmark Research, CoStar

Third Quarter Brings More Diverse Leasing Activity

WeWork signed the largest notable lease of the third quarter when it leased space on the eighth and ninth floors of Regions 615. In contrast to Charlotte's reputation as a financial hub, there was generally more diversity in the third quarter of 2024's major leases, with only one of the third quarter of 2024's largest leases was signed by a financial institution – United Bank at Four Morrocroft. Another marked shift observed during the quarter was two of the largest leases, The Imagine Group at Innovation Park and United Bank at Four Morrocroft, were signed for the entire building. All of third quarter's notable leases were direct new leases.

Notable 3Q24 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
WeWork	Regions 615	CBD	Direct New	51,547
Coworking space provider WeWork leased the eighth and ninth floors of 615 South College Street.				
The Imagine Group	Innovation Park	University	Direct New	44,662
Printing solutions provider The Imagine Group has leased the entire building at 8405 IBM Drive through January 2035.				
Spectrum Companies	One Independence Center	CBD	Direct New	39,480
Charlotte-based full-service commercial real estate firm The Spectrum Companies has leased the second floor of 101 North Tryon Street.				
Pulte Homes	Toringdon 2	South/485	Direct New	25,722
Home-builder Pulte Homes has leased space on the second floor of 3430 Toringdon Way.				
United Bank	Four Morrocroft	SouthPark	Direct New	18,000
West Virginia-based regional bank United Bank has leased the entire building at 6821 Carnegie Boulevard.				

Source: Newmark Research, CoStar

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