3Q24

Raleigh-Durham Office Market Overview

Market Observations

Economy

- The market's unemployment rate increased by 20 basis points year over year to 3.4%, remaining below the five-year average of 4.0%.
- Employment growth decelerated by 28 basis points to 2.5% year over year, remaining ahead of the national average of 1.6%.
- Most sectors reported employment growth, with education and healthcare leading the way, up 6.8% over the past year.
- Office-using jobs in the market dipped by 45 basis points to 214,310 jobs from the all-time high of 215,276 office-using jobs recorded at the end of May 2024.

Leasing Market Fundamentals

- Annual full-service rental rates recorded a historic high of $30.84/SF, reflecting a 3.1% increase year over year. However, rental growth has begun to level off as vacancies continue to rise and leasing activity remains muted.
- Occupancy declined quarter over quarter, with both sublease and direct availabilities increasing, pushing overall vacancy rates up by 70 basis points to a historic high of 20.4%.
- The under-construction pipeline ticked up to 154,666 SF under construction, marking the first increase since the third quarter of 2023, as higher building costs and steeper capital costs slowed new starts.
- Total leasing activity closed the quarter 11.0% below the 16-year third-quarter average of 1.1 MSF at 959,724 SF.

Major Transactions

- Parexel signed the largest lease of the third quarter of 2024 when it relocated its offices to North Hills Tower V.
- Flight-to-quality by tenants has continued into the third quarter of 2024, with older buildings continuing to shed space and newer, better-amenitized assets becoming the most attractive to tenants. While most tenants are upgrading their offices, leasing is not concentrated exclusively in trophy assets. As reflected by an increase in leasing activity, only the market's oldest assets are being avoided by new tenants and sitting idle.
- Companies have built flexibility into their space utilization strategies to be able to pivot as return to office policies evolve.
- It is expected that the recent moderation in construction costs will spur new office projects.

Outlook

- The office market began to show signs of recovery but is projected to experience slower growth in the near term. Office investment activity will be subdued in the near term due to elevated inflation, steeper cost of debt, and muted demand and will pick up as lower construction costs spurs new projects.
- As leases signed pre-pandemic expire, more tenants are likely to reduce their underutilized space, opting for smaller footprints in higher-quality buildings. This coupled with the market's recent historically elevated deliveries will push vacancy rates to new highs, until the market is able to absorb the new inventory that has recently delivered.
- The office market is expected to remain tenant-friendly, with stagnant demand keeping overall asking rates flat or modestly declining.
- Vacancy is expected to remain elevated as the market works through the substantial second quarter of 2024 deliveries. Minimal growth in newly delivered spaces is anticipated through year-end, with most of the under-construction pipeline already completed.

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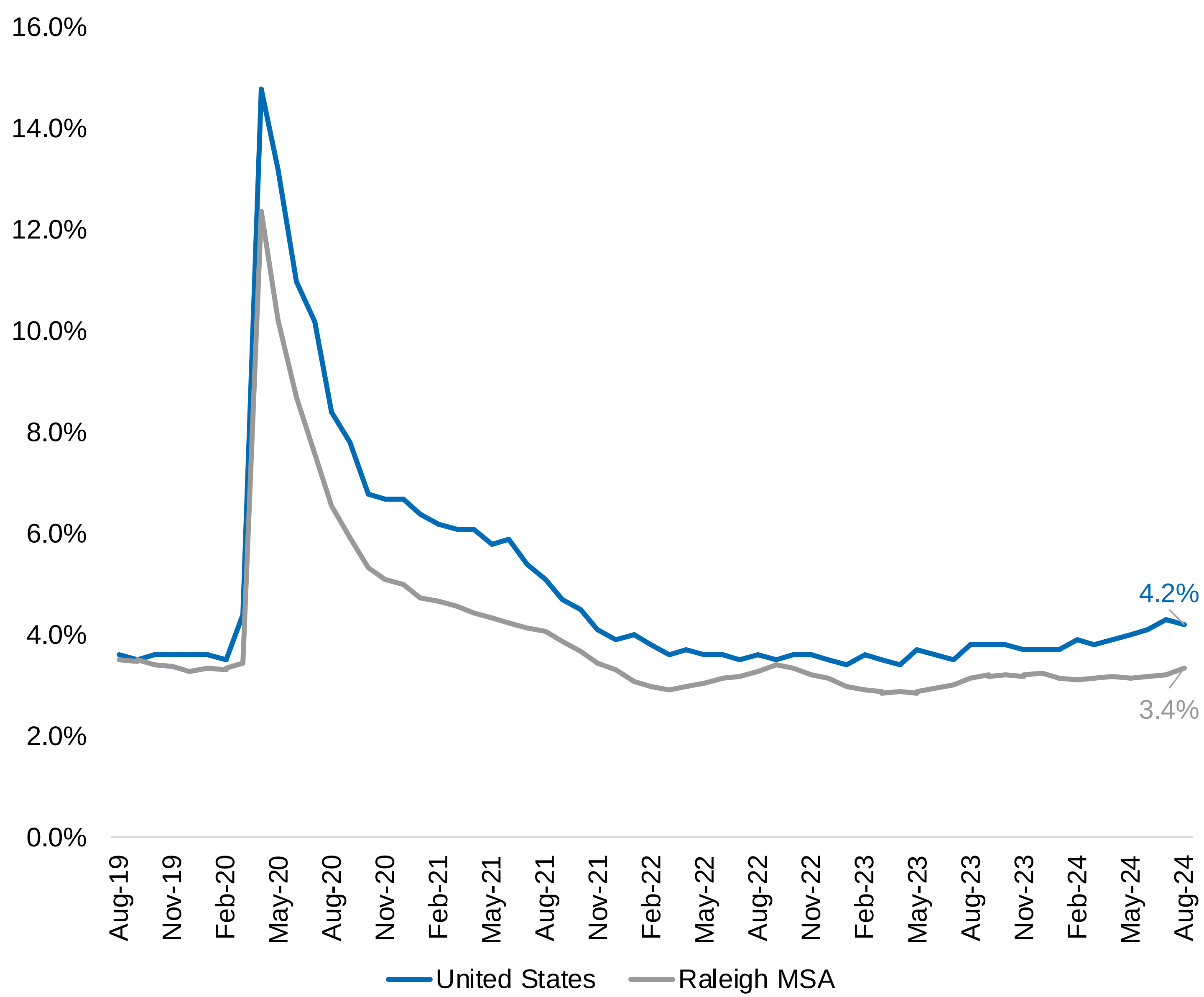
Economy

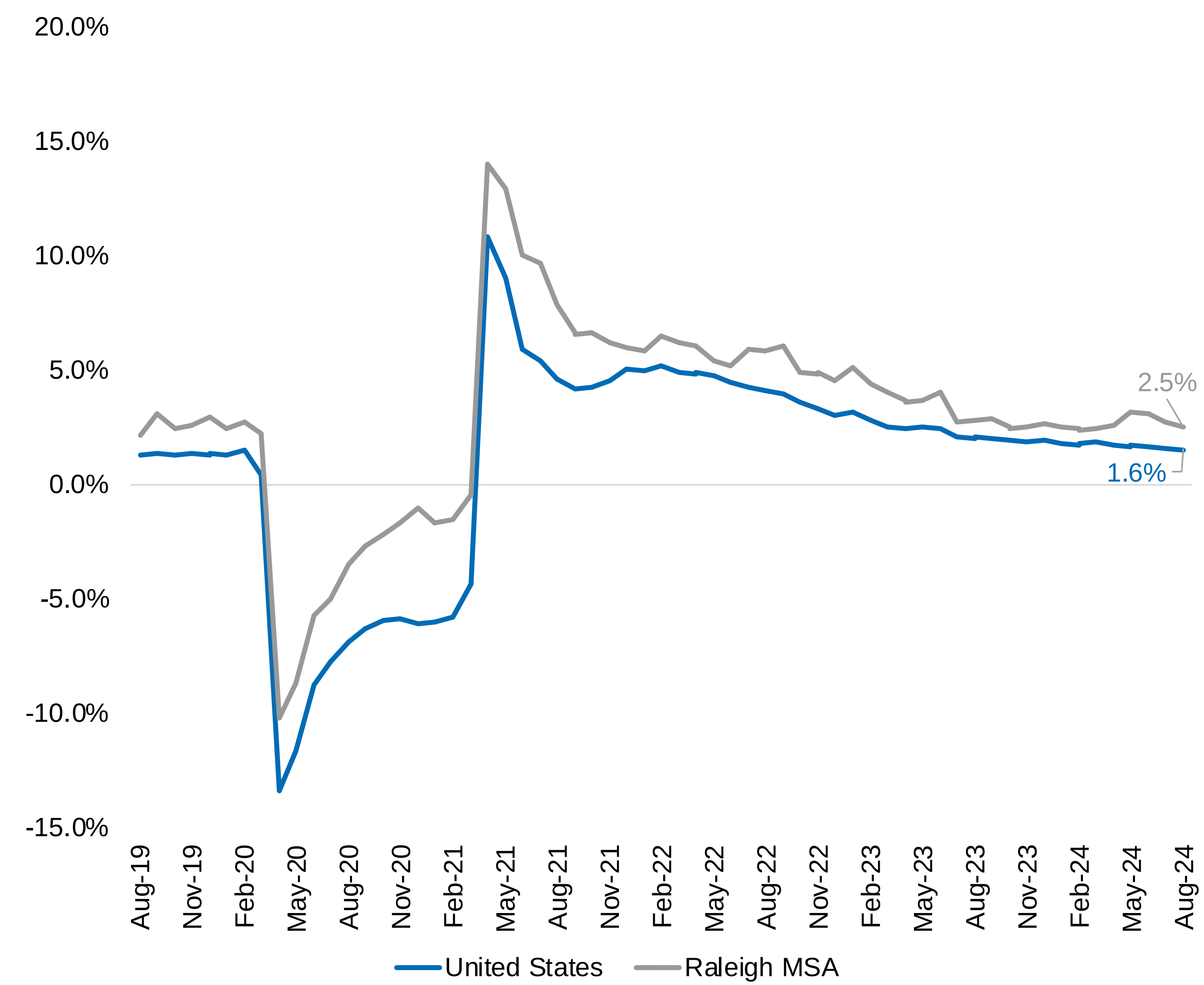
Raleigh Continues To Lead In Job Growth Despite Economic Slowdown

Raleigh has consistently reported lower unemployment rates compared to the national average, while being an outperformer in employment growth. This trend carried into the third quarter of 2024, with the market's unemployment rate inching up by 20 basis points year-over-year to 3.4%, still well below the U.S. average of 4.2%. The region's seasonally adjusted nonfarm payrolls also outperformed the national average, with a year-over-year decline of 28 basis points, resulting in a 2.5% growth rate. Despite outperforming the broader U.S. market, Raleigh's employment softened slightly from recent peaks, driven by job losses in the information and trade/transportation/utilities sectors.

Unemployment Rate, Seasonally Adjusted



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

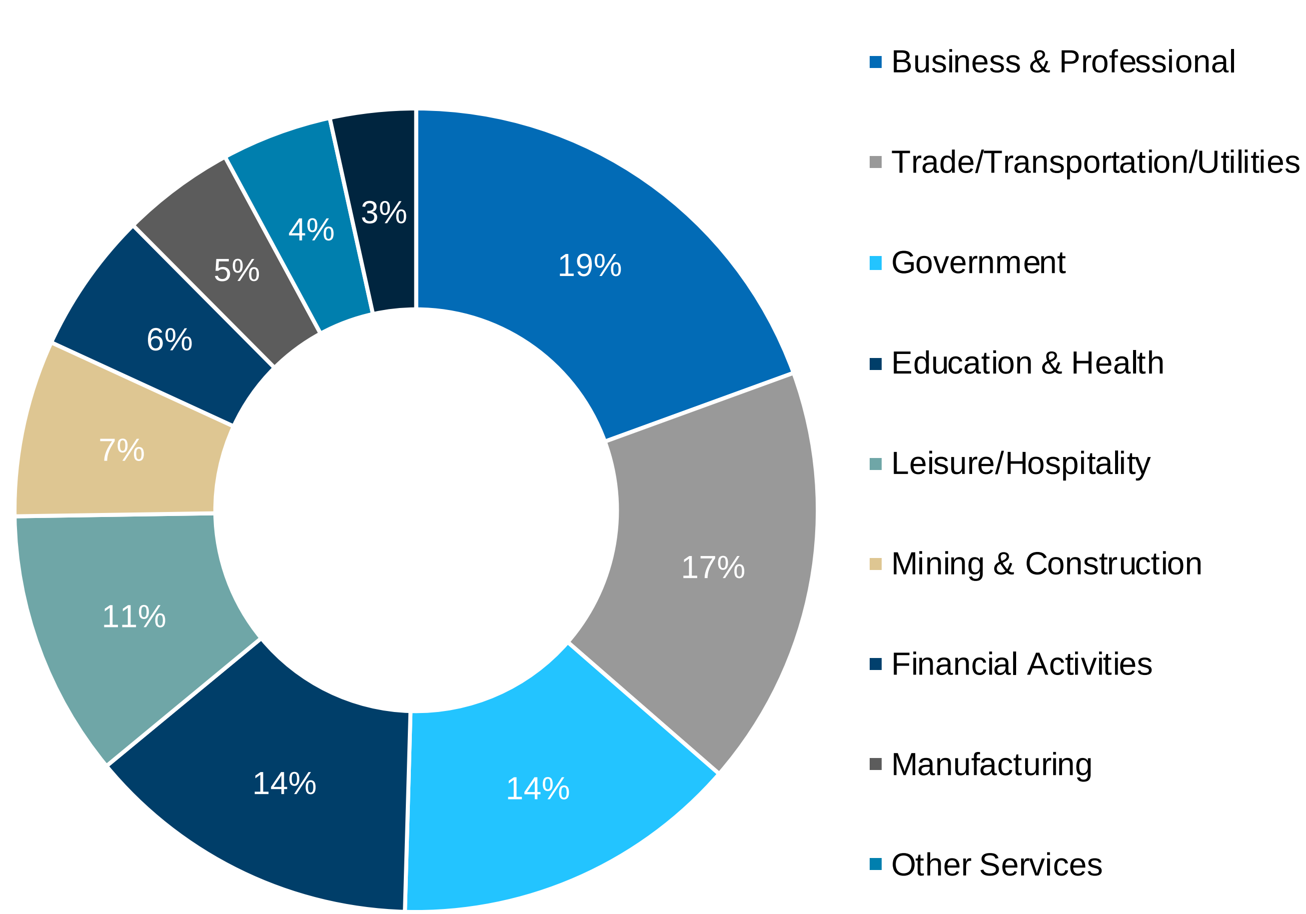


Source: U.S. Bureau of Labor Statistics, Raleigh MSA

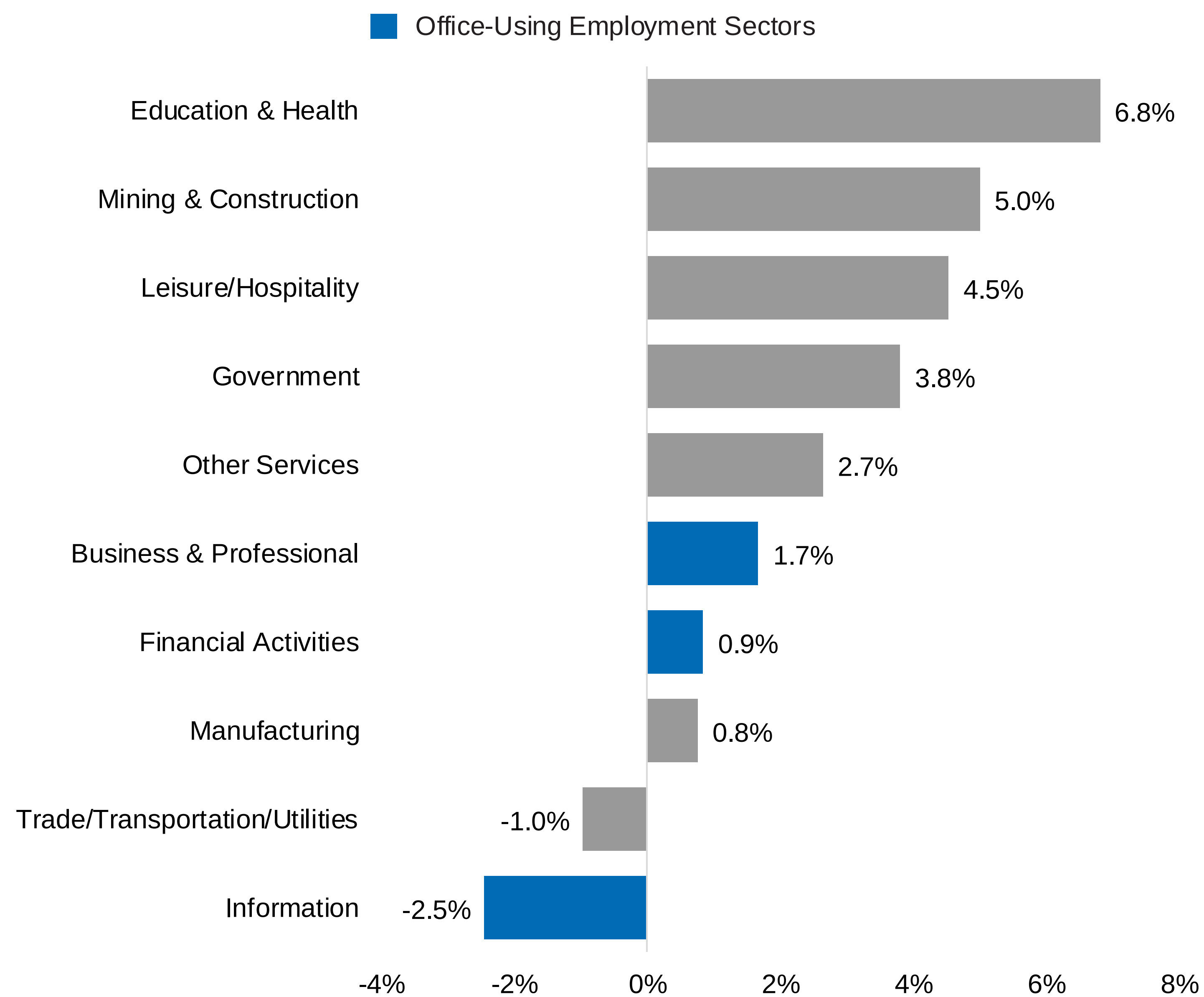
Yearly Employment Growth Continues across Most Sectors

Raleigh's tech-forward market is driven by its top two employment industries: business and professional services and trade/transportation/utilities, which account for 36.4% of total local jobs. The business and professional sector, Raleigh's largest office industry, makes up 19.4% of the market. Most sectors, aside from information and trade/transportation/utilities, experienced year-over-year job growth. Office-using industries such as business and professional services and financial activities saw yearly growth of 1.7% and 0/9%, respectively. Meanwhile, the information sector posted the biggest decline, down 2.5% year-over-year.

Employment by Industry, August 2024



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

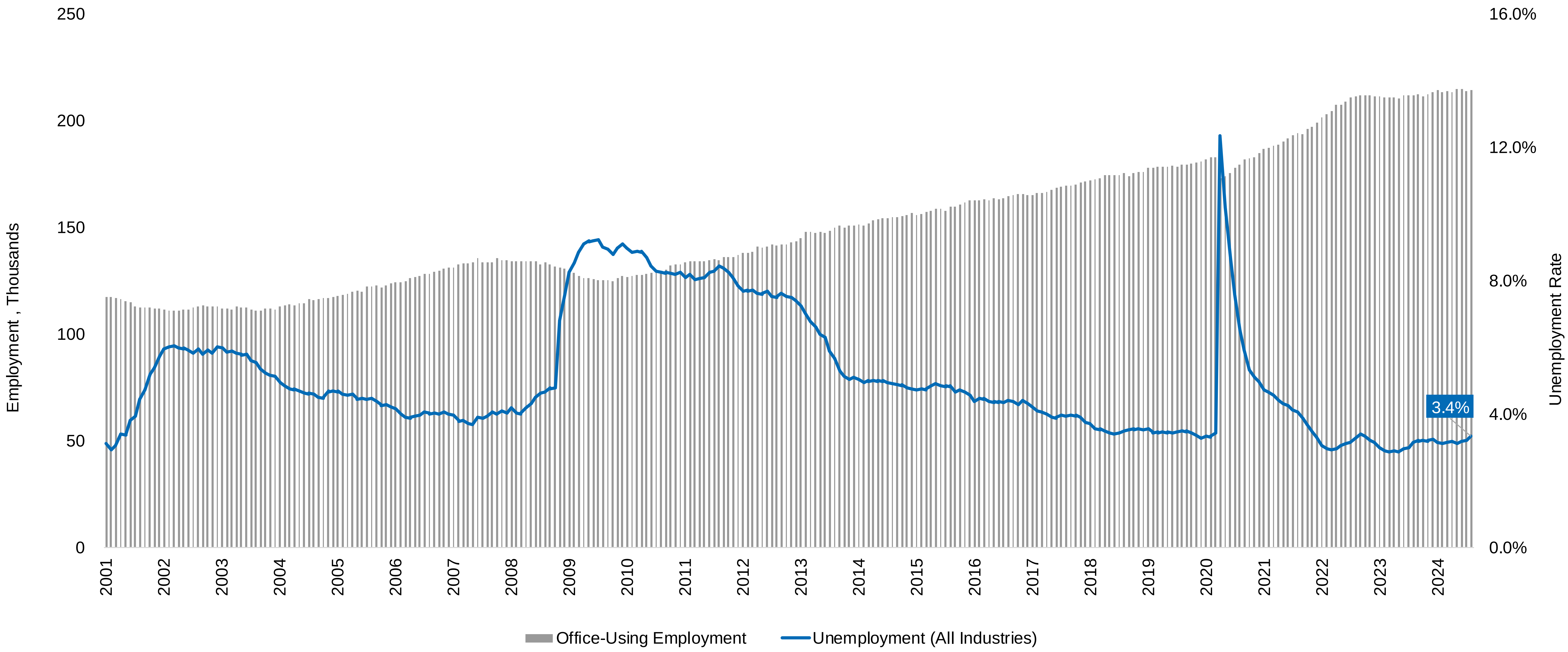


Source: U.S. Bureau of Labor Statistics, Raleigh MSA

Overall Office-Using Employment Slightly Declines From Historic High

Raleigh's Office-using employment recorded a near historical high of 214,310 office-using employees at the end of August 2024, just 962 jobs below the record high set in May 2024. Currently, the seasonally adjusted unemployment rate stands at 3.4%, less than the 3.5% average levels reported in 2019. While unemployment in the market has recently trended upward, overall office-using employment remains stronger than pre-pandemic levels.

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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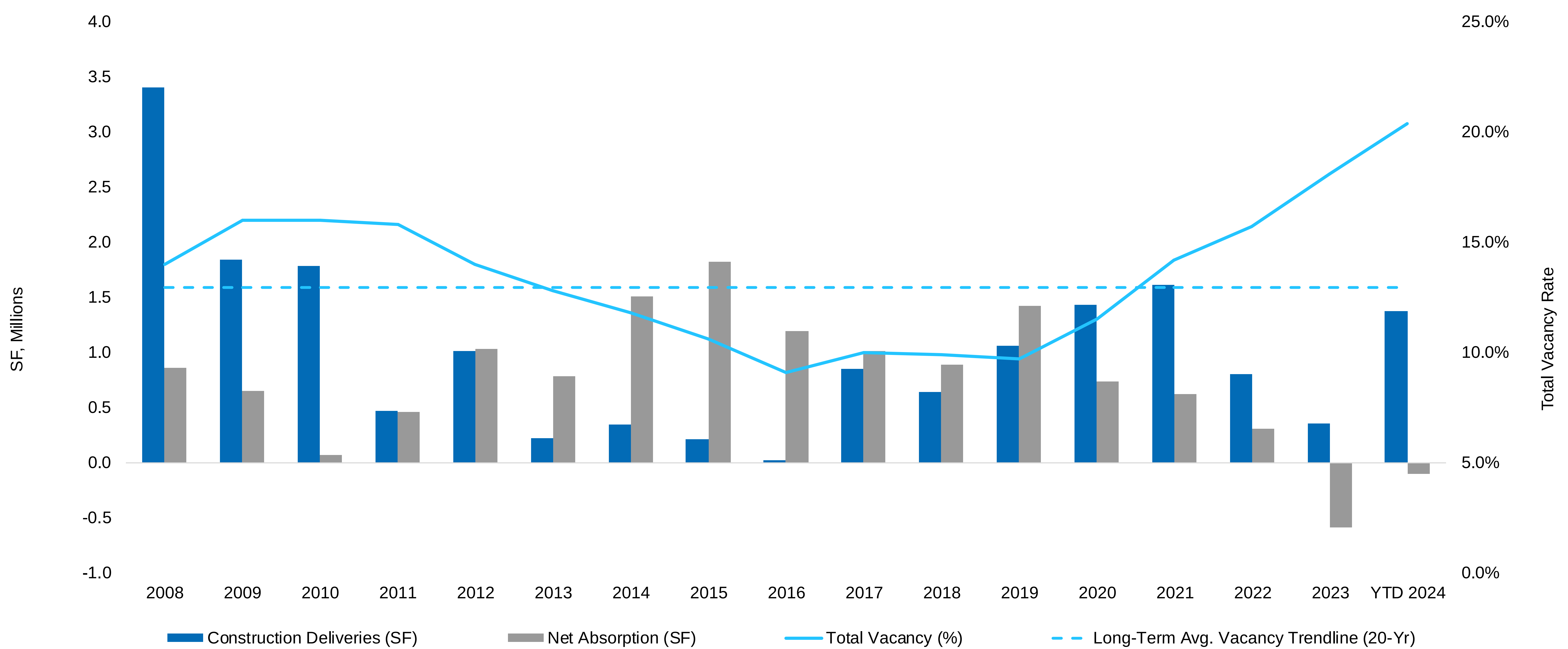
Leasing Market Fundamentals

Elevated Deliveries and Negative Net Absorption Push Vacancy to Historic High

The Raleigh office vacancy rate climbed 340 basis points year-over-year to 20.4% in the third quarter of 2024, well above the 20-year average of 12.9%. Since the fourth quarter of 2019, vacancy rates have generally increased in the market, with the trend continuing in the third quarter of 2024 as vacancy rates increased by 70 basis points quarter over quarter. This can be attributed to several factors, including continued historically high levels of direct and sublet availability, a surge in recent deliveries of vacant office buildings and recent periods of low or negative yearly absorption. Vacancy is expected to remain elevated as the market absorbs the new deliveries and corporations continue to shed space to “right size” their office footprints.

Historical Construction Deliveries, Net Absorption, and Vacancy

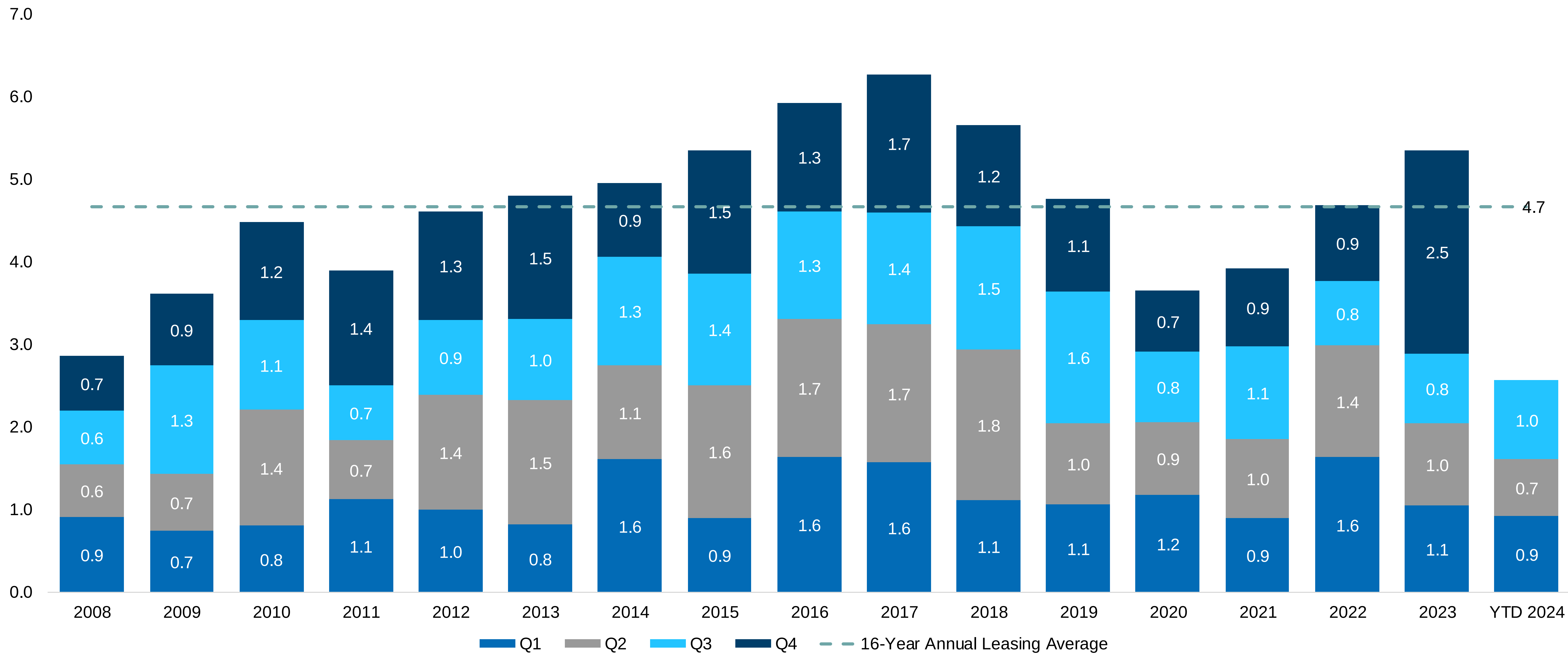


Source: Newmark Research, CoStar

Economic Uncertainty Keeps Leasing Activity Levels Below Historic Average

Leasing activity in the third quarter of 2024 in the market increased by 277,890 SF when compared with the second quarter of 2024 and 111,532 SF when compared with the third quarter of 2023. However, the quarter's leasing activity of 959,724 SF remains below the 16-year third-quarter leasing average of 1.1 MSF. This decline in leasing activity is likely driven by companies reevaluating corporate office space needs amid corporate downsizings and hesistancy to lease space in an uncertain economic environment.

Total Leasing Activity (msf)

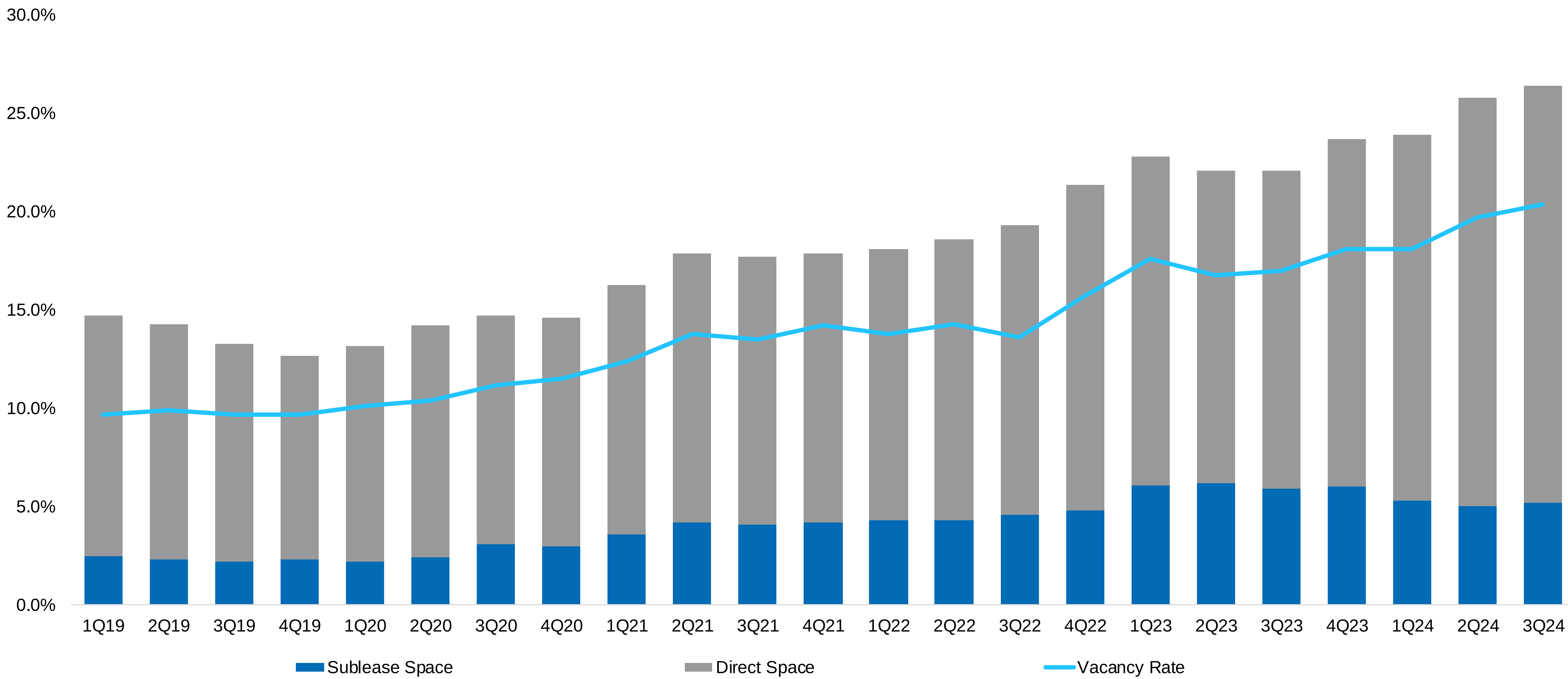


Source: Newmark Research, CoStar

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

Sublease availabilities in Raleigh, which recorded 5.2% in the third quarter of 2024, ticked upwards toward their historic high of 6.2%. This marks a 20-basis-point quarter-over-quarter increase and 70-basis-point year-over-year decrease. Direct availability increased 40 basis points quarter over quarter and surged 500 basis points year over year to a record high of 21.2%. The quarterly increases in sublease and direct space availabilities drove overall vacancy up by 70 basis points quarter over quarter to a historic high of 20.4%.

Available Space as Percent of Overall Market

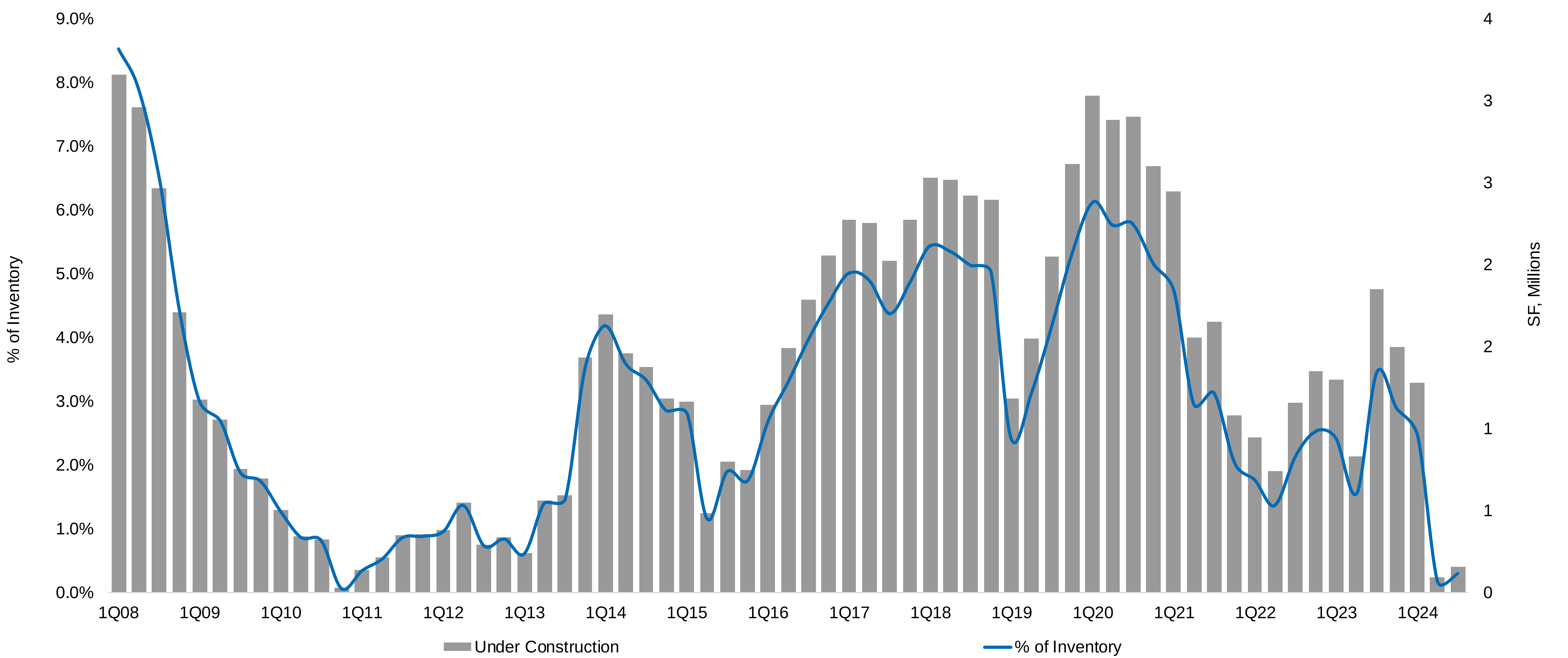


Source: Newmark Research, CoStar

Construction Activity Inches Up

Recent construction activity surged and peaked in the third quarter of 2023, driven by strong demand by the technology and biotechnology sectors. However, the under-construction pipeline has steadily declined in each quarter since, impacted by the effects of elevated inflation and a higher cost of debt reverberating throughout the economy. The trend reversed this quarter, with the under-construction pipeline expanding to 154,666 SF from 90,000 SF in the second quarter of 2024. As of the third quarter of 2024, Raleigh's under-construction inventory only accounted for 0.3% of the market's total inventory.

Office Under Construction and % of Inventory

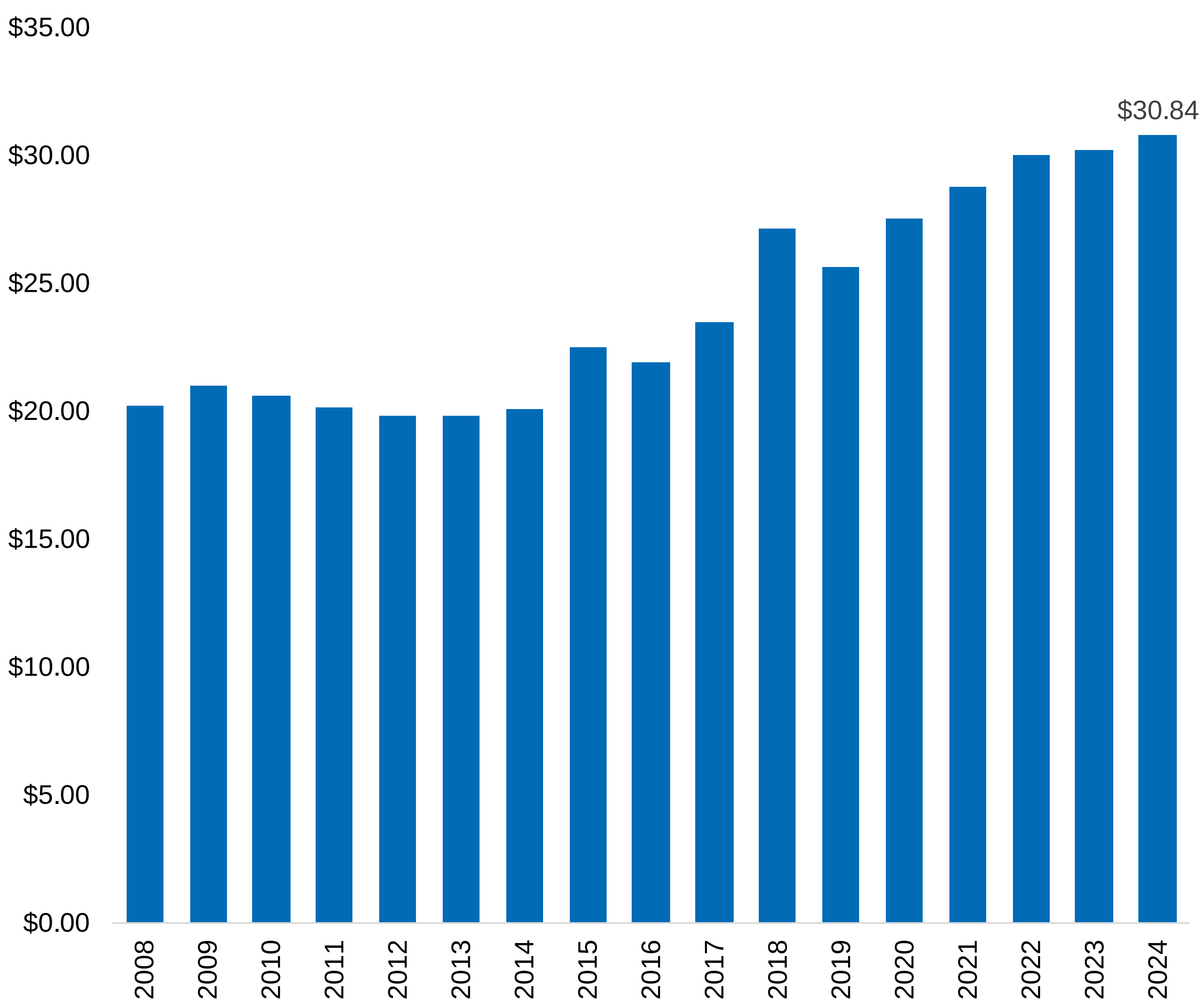


Source: Newmark Research, CoStar

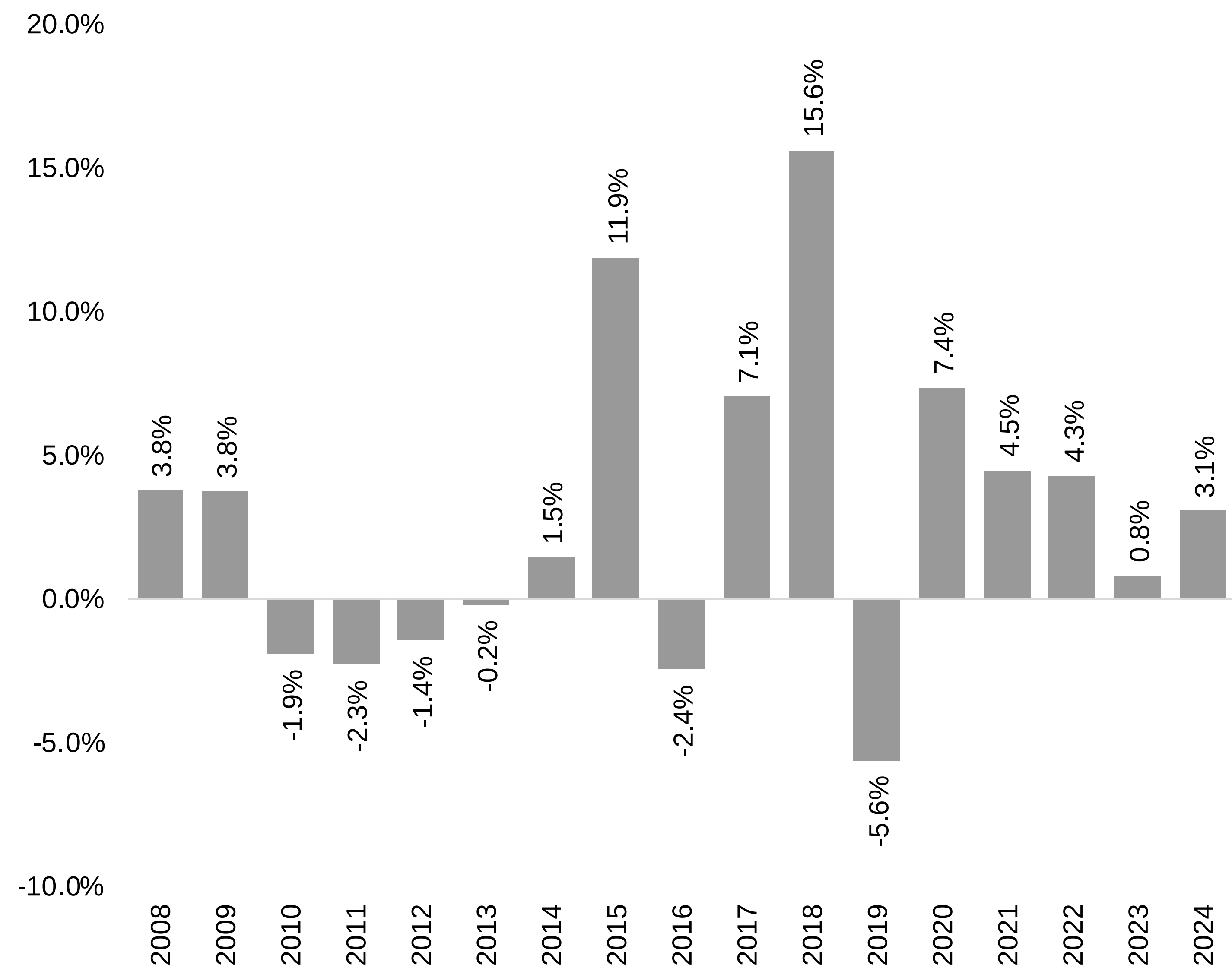
Rents Inch Higher to New Historic High, Though Growth Flattens

Asking rents rose by 0.4% quarter over quarter and by 3.1% year over year to record high of $30.84/SF. This flattening of ren t growth is driven by several factors, including generally rising vacancy in recent years, historically low leasing activity, and several recent quarters of subdued demand for space due to economic h eadwinds and uncertainty. While new high-quality space deliveries and higher inflation-driven costs have pushed rents higher, historically high vacancy levels, stemming from low leasing activity and net absorption, have tempered overall growth.

Office Average Asking Rent, $/SF, FS



Year-over-Year Asking Rent Growth Rate

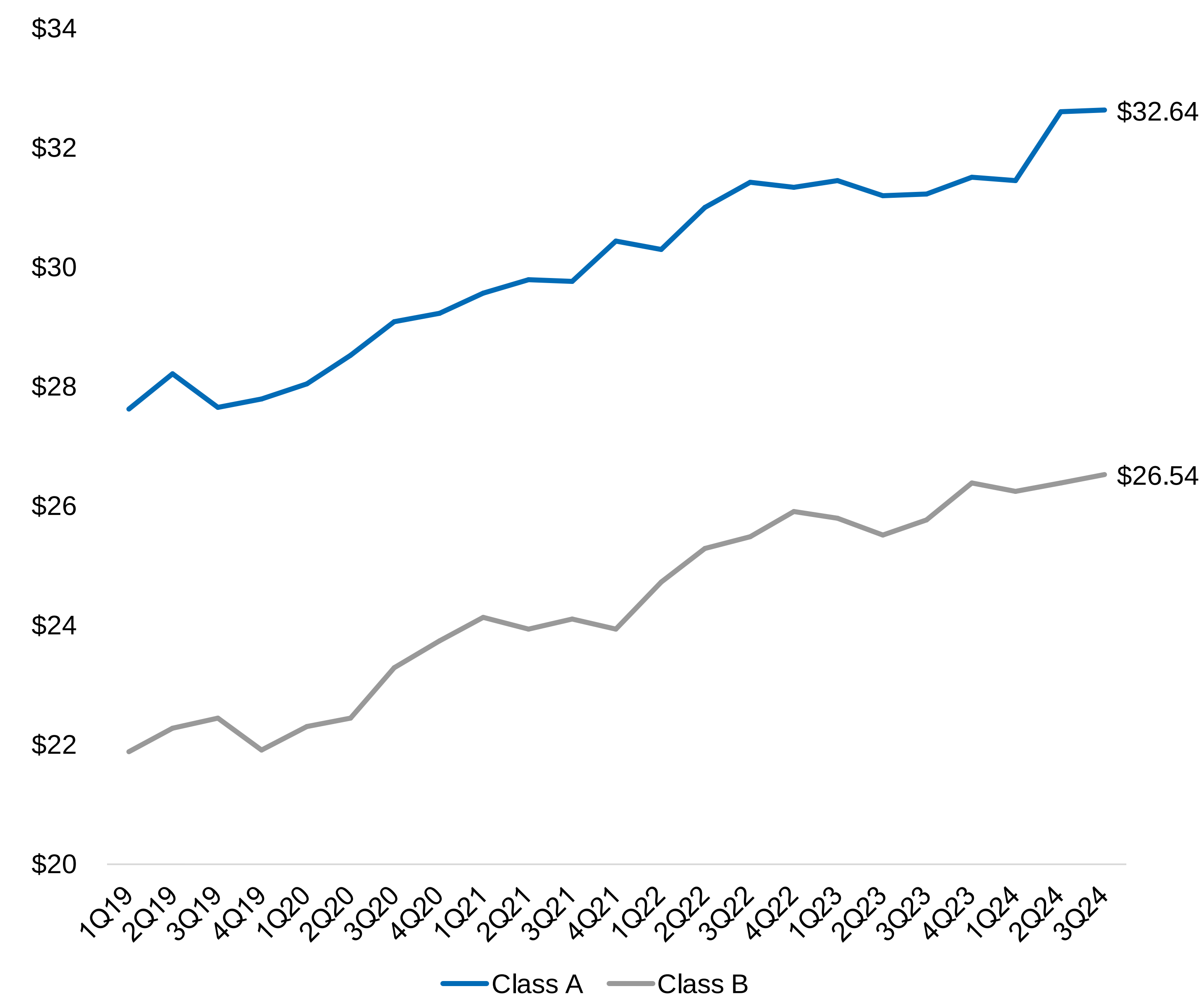


Source: Newmark Research, CoStar

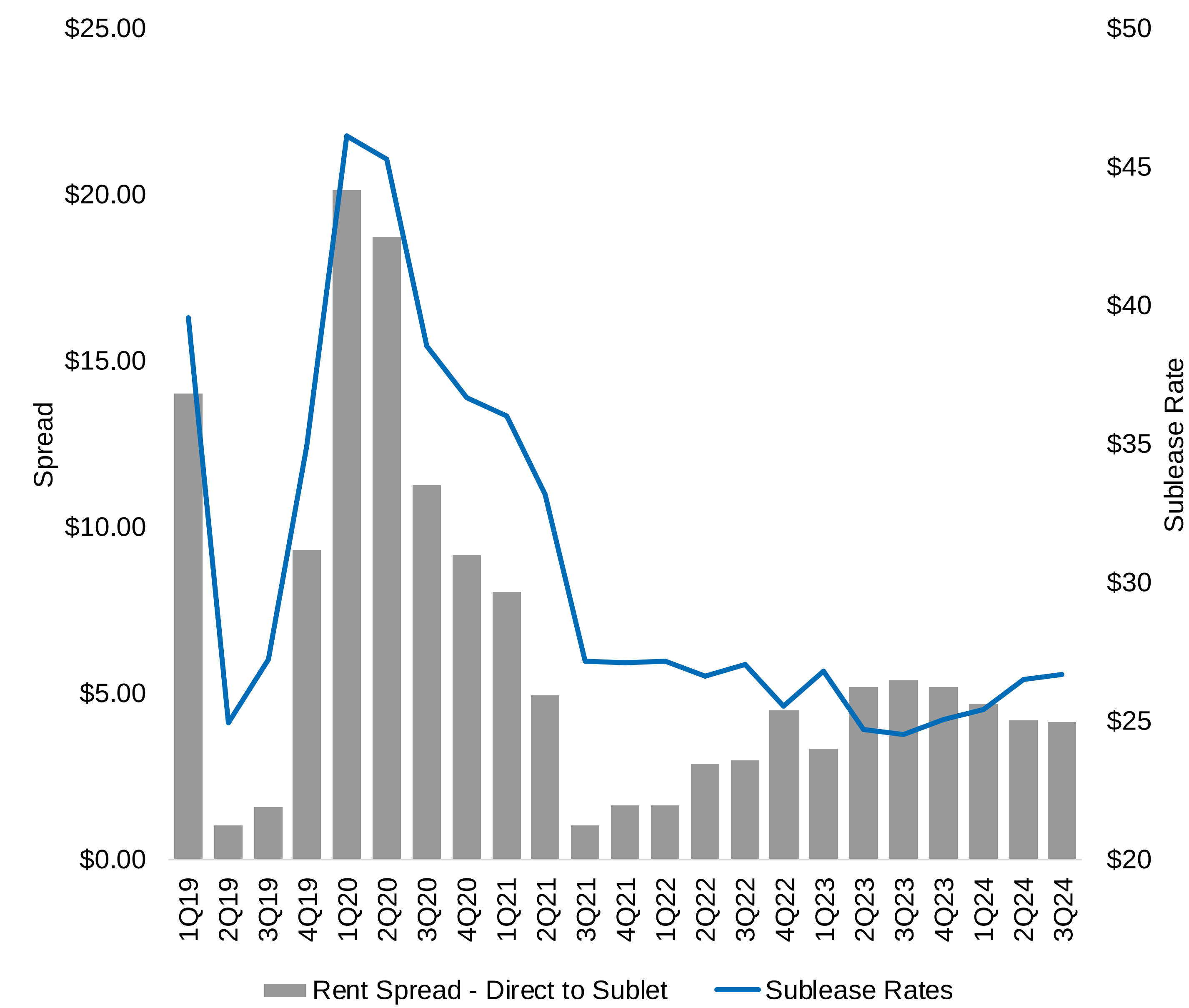
Class A and Class B Asking Rents Increase to Historic Highs

As of the end of the third quarter of 2024, Class A rents reached $32.64/SF, while Class B reported $26.54/SF, a $6.10/SF difference. The difference in rents between the two assets reflects a 3.9% spread increase since the fourth quarter of 2019, though the rent spread decreased by 2.1% quarter over quarter. The widening divergence between Class A and Class B assets is expected to push tenants to downsize in lower-quality buildings and opt for smaller spaces in higher-quality, amenity-rich properties and is likely to increase as Class B office owners look to lower asking rates to entice tenants to lease space. Third-quarter asking sublease rates increased by 0.7% quarter-over-quarter and 8.8% year-over-year.

Class A and Class B Asking Rents



Sublease Rates



Source: Newmark Research, CoStar

Healthcare and Professional Services Companies Drive Leasing Activity

Flight-to-quality by tenants has continued into the third quarter of 2024, with older buildings continuing to shed space and newer, better-amenitized assets becoming the most attractive to tenants. The majority of the quarter's largest leases were direct new leases whereby companies elected to re-locate their offices, mainly to the Six Forks/Falls of Neuse submarket. While most tenants are upgrading their offices, leasing is not concentrated exclusively in trophy assets. Only the market's oldest assets are being avoided by new tenants and sitting idle. This is being reflected in the increase in leasing activity seen throughout the market. Meanwhile, companies have built flexibility into their space utilization strategies to be able to pivot as return to office policies evolve. It is expected that the recent moderation in construction costs will spur new office projects.

Notable 3Q24 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
Parexel	North Hills Tower V	Six Forks/Falls of Neuse	Direct New/Relocation	61,000
Clinical Research Organization Parexel signed the largest lease of the quarter when it took the ninth and tenth floors of Tower 5 at 541 Church at North Hills Street in Raleigh. The building is expected to deliver in November 2024.				
HDR	Charter Square	Raleigh CBD	Renewal	50,000
Architecture, engineering and environmental services firm HDR renewed its lease on the ninth floor of 555 Fayetteville Street in Raleigh.				
Weatherby Healthcare	One North Hills Tower	Six Forks/Falls of Neuse	Direct New/Relocation	46,300
Healthcare staffing company Weatherby Healthcare relocated its offices to the seventh and eighth floors of 4000 Center at North Hills Street in Raleigh.				
HCL	Perimeter Park Two	RTP/RDU	Direct New/Relocation	46,000
Technology company HCL relocated its office to the third floor of 3020 Carrington Mill Boulevard in Morrisville.				
General Dynamics	5444 Wade Park	West Raleigh	Direct New	34,500
Aerospace and defense company General Dynamics has leased 34,500 SF at 5444 Wade Park Boulevard in Raleigh.				
Jewelers Mutual	One North Hills Tower	Six Forks/Falls of Neuse	Direct New	31,550
Jewelry insurer Jewelers Mutual will open its innovation hub on the ninth floor of 4000 Center At North Hills Street in Raleigh. It is expected to bring over 200 tech jobs to the region.				

Source: Newmark Research, CoStar

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