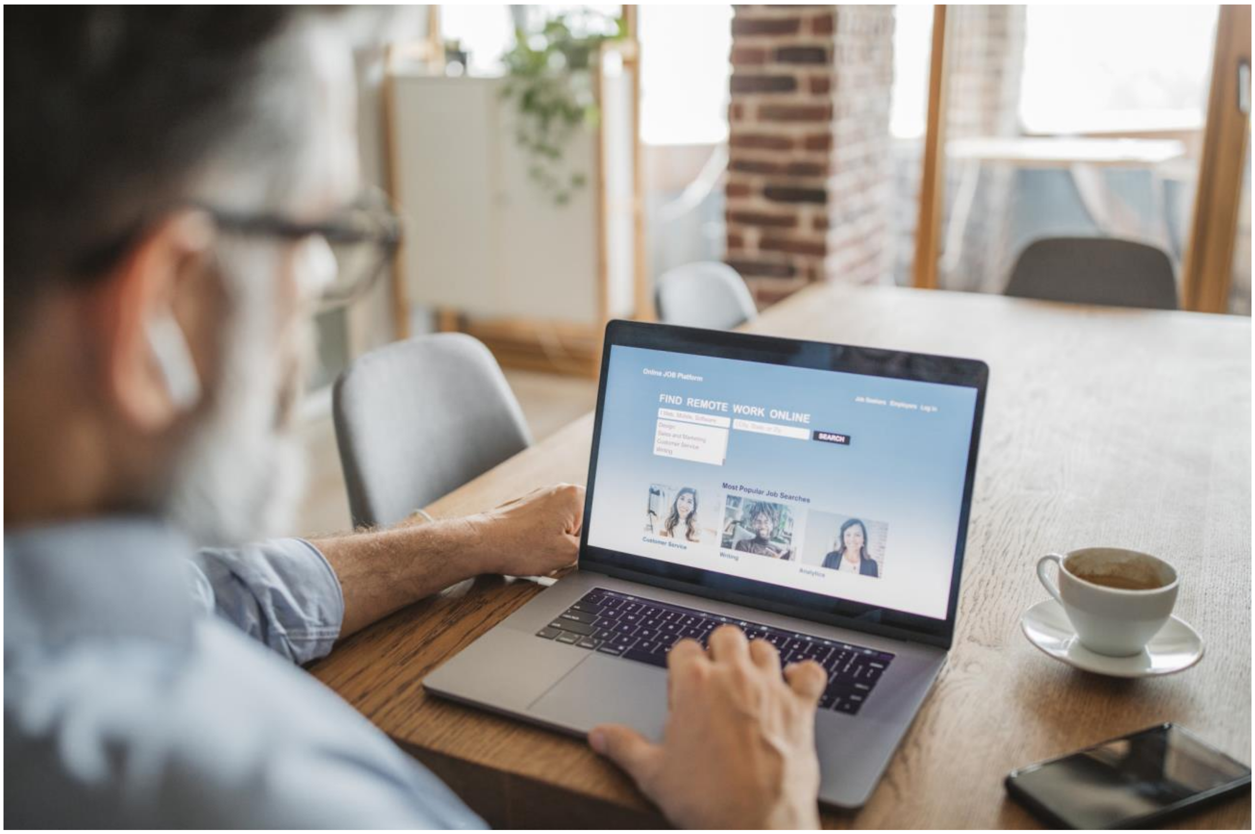
CoStar Insight

US Office Demand Plummets

Losses Surpass Those During the Great Recession As Tenants Shed Space at a Record Clip



Uncertainty over the pandemic's course, resulting economic stress and the success of working from home have many office occupiers in space-reduction mode. (Getty Images)

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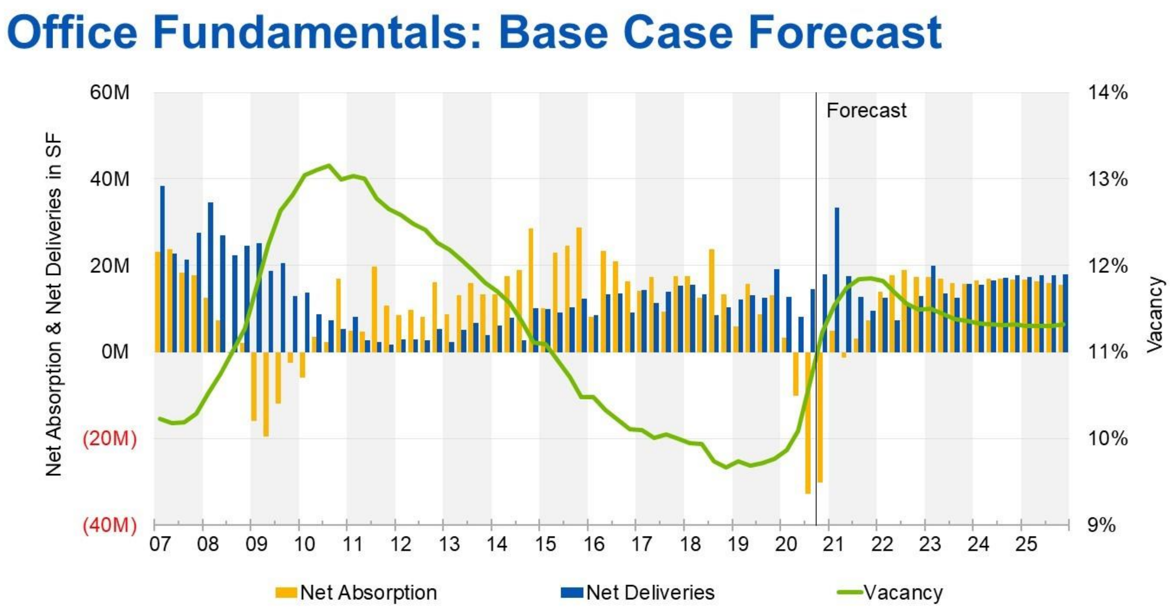
November 9, 2020 | 7:17 A.M.

Office demand in the U.S. has fallen to its lowest level in nearly 20 years as tenants shed space at a rate never seen before and the accumulated losses have now eclipsed the total from 2009 to 2010 as a result of the Great Recession.

While the long-term future of office space needs is still very much up for debate, the unknown course of the pandemic, the resulting economic stress and the success of working from home have many office occupiers in space-reduction mode.

The third quarter saw office tenant demand turn negative to the tune of more than 30 million square feet. That followed a mid-year total of negative 10 million square feet. That number doesn't include the entire 40 million square feet of sublet space that has been added to the market since the first quarter, as much of that space is available though not yet vacant.

Looking ahead, CoStar's baseline forecast calls for further office demand losses in the fourth quarter, again surpassing 30 million square feet. Though losses are anticipated to moderate in subsequent quarters, the total demand drop is on pace to surpass the previous record of 67 million square feet in the tech wreck of 2001.



Many of the decisions to reduce office space are based on cost savings. Aerospace and defense firm Raytheon Technologies Corp. had planned to reduce its 31-million-square-foot office footprint via consolidation as part of its merger with United Technologies Corp. even prior to the pandemic targeting an initial 10% reduction. However, the firm now envisions a greater embrace of remote working.

During its third quarter earnings call, the firm's CEO said he could see a 20% to 25% reduction in space, starting with its leased offices, over the next five years. The efficiency achieved by its staff working remotely and a major cost savings in lease expenses were cited as the reasons for the decision.

Raytheon Technologies Corp. could shrink its total office footprint by up to 25% within the next five years. Shown here is a building in the aerospace and defense firm's headquarters complex in Richardson, Texas. (CoStar)

Some tenants are opting to let leases expire and continue to work from home, if not permanently at least until the pandemic subsides. When Seattle tech firm SoundCommerce's lease expired at the end of July, the firm chose to not to renew and instead had the standing desks, large computer monitors and other supplies from the office delivered to its employees' homes instead.

The CEO said most of his employees preferred to continue working from home and he didn't want to make a long-term office space decision right now. The cost savings will allow the company to build cash reserves or hire additional talent as the company grows.

Conversely, larger tech firms have been responsible for some major leases that will help offset some of the demand loss as those leases commence. Despite public declarations of envisioning 50% of its workforce permanently working from home over the next several years, Facebook signed a lease for 730,000 square feet of office space this summer in New York's Moynihan Station project. This deal will bring Facebook's total office footprint in New York to about two million square feet. The firm followed up that deal by purchasing a 400,000-square-foot newly developed office campus near Seattle from outdoor outfitter REI.

Additionally, Microsoft leased nearly 1 million square feet of office space in Reston, Virginia and Atlanta during the second quarter, despite announcing that its workforce can freely work from home for less than 50% of the week once the pandemic is over. Notably, these leases occurred not in the Seattle or San Francisco Bay areas, but rather in more cost-friendly areas of the country.

While major tech firms such as these, as well as Amazon and Google, continue sign leases that will ultimately translate into office occupancy, one sector alone cannot buoy the entire U.S. office market. Office demand is expected to rebound. However, the moderate amount of new construction underway will probably keep pace with the muted demand, preventing the vacancy rate from returning to pre-pandemic, single-digit levels for the next few years.