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Uptick in Office Demand Snaps Three-Month Losing Streak

VODI shows office demand holding steady in September.

Despite the slight increase in demand in September, the VTS Office Demand Index (VODI) analysis has generally been trending downward in recent months amid rising interest rates and a cooling labor market.

Its reported uptick ended three consecutive months of losses and the report showed specific interest in smaller spaces.

Nationally, demand for office space increased 4 percent month-over-month in September despite slight seasonal headwinds, according to the report.

“Prior to the pandemic, demand for office space tended to decline in September, falling 3.1 percent in September 2018 and 1.1 percent in September of 2019,” Nick Romito, CEO of VTS, said in prepared remarks, “The verdict is still out on the anticipated depth of any upcoming recession. Combine this economic uncertainty with signs of a cooling labor market, and it’s no surprise employers are pumping the brakes on plans for office leasing.

“Demand for smaller office spaces in particular has remained steady. This could reflect a dynamic where smaller tenants delay leasing plans while larger tenants shrink their requirement size, making up for lost demand in the small-space category.”

A Second, Seismic Shift

It is little secret why the office sector is struggling with overall demand: it is undergoing a seismic shift for the second time in just over a decade, Petra Durnin, Head of Market Analytics at Raise Commercial Real Estate, tells GlobeSt.com.

“The hybrid workplace model has become a disruptor for how office space is used, nullifying the decades-old headcount and occupancy metrics.

“Companies are looking to create intentional workplaces and embracing the hybrid workplace model, which is buoying demand, but also recalibrating market fundamentals.”

Available NYC Space Dwindling

Still, as the VTS report shows, there is reason for cautious optimism. Michael T. Cohen, President, Colliers Tri-State, tells GlobeSt.com that there's "no question" the statistics show positive absorption and reversal of the pandemic trend.

"Available NYC office space is no longer accumulating, it's dwindling," Cohen said. "But we're still looking at historically high availability rates.

"This raises the question of what happens next. History has shown that at this kind of an inflection point, the market skims along the bottom for a period of years. During the 2001 dotcom recession, the market stayed along the bottom for three years, and after the 2008 financial crisis, it took six years to recover. This current recovery will probably be different from the prior two.

"While the financial and tech industries are expanding overall, other industries are creating new efficiencies and reducing their footprints. We're not going to rent our way down to single digit availability rates. Instead, we're going to see conversions to residential, tear down and replacements, and a variety of other approaches to actually reduce some of the excess inventory. There are already millions of square feet in the pipeline for conversion or demolition."

Bradley Tisdahl, CEO, Tenant Risk Assessment, tells GlobeSt.com that there have been a few major leases that likely drove up square footage leased in NYC, which could move the needle among A buildings in Midtown and Hudson Yards.

"Also, we are coming off historic lows in leasing in NYC in general from the pandemic, so improvements are likely to look significant because on a percentage basis, growth appears magnified. But my suspicion is that it's largely magnified in class A assets," Tisdahl said.

Workers Understand Value of Being in the Office

There are also small signs that more workers are realizing the value of being in the office. Michael J. Romer, Managing Partner of NYC law firm Romer Debbas tells GlobeSt.com, "Given the current state of the job market and the economy, leverage is starting to shift back to the employers and the workforce is starting to understand that their job security likely increases if they report to the office.

"In person interaction is the glue that holds employers and employees together. There is absolutely an element of fear at play here as employees are worried about job security. This fear is driving the workforce back to the office and, in turn, is helping the office market improve."

'Flight to Quality' Emerges

Doug Ressler, manager, business intelligence, Yardi Matrix, tells GlobeSt.com that office owners nationally are still struggling with high vacancy rates and uncertainty around future tenant demand, but one growing segment has begun to emerge this year.

"Driven by hybrid work arrangements, a flight-to-quality among occupiers and a desire to avoid long-term leases, demand for flexible office space is rapidly increasing and aiding in the stabilization of office market demand.

"The shift to hybrid work is also leading owners to consider coworking spaces to restore occupancy and cash flow.

“The opinion of flex and coworking has changed drastically. Today asset owners realize that this is part of not only an occupier strategy, but it needs to be part of asset owners’ strategy.”

Employees’ Office Demands Have Changed

Bob Wislow, developer of Fulton East, a 12-story, office and retail building in Chicago’s Fulton Market District, tells GlobeSt.com, “Despite talk of economic headwinds, certain segments of the office market are still very active. While most companies want employees to return to the office, they understand that what their employees want in an office environment has changed, and that they need to adapt their space to fit a new set of needs.

The post-pandemic workforce craves the collaboration and engagement with coworkers, but want flexibility, convenience and amenities that fit their lifestyle. This has created opportunity in the marketplace for buildings housed in vibrant urban districts that offer live/work/play conveniences and are also home to a cluster of innovative companies that create an energy, vitality, and intellectual interchange that is impossible to duplicate, and unachievable working from home.”

Anthony Lanier, President and CEO of EastBanc, tells GlobeSt.com that Washington, D.C., is seeing an increasing demand for office space as employers and their employees continue to recognize the value of spaces that are designed to best support productivity, wellness, and collaboration.

“We’ve approached the office market with heightened flexibility for several years, and now as employers are faced with big decisions around leasing office space, we’ve found that providing flexible lease terms allowing the tenant to easily reverse or modify their decision is the key to success both for landlords and employers looking to make the transition into an office new space as smooth as possible.”

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