Houlihan Lokey

Real Estate Market Update—Office

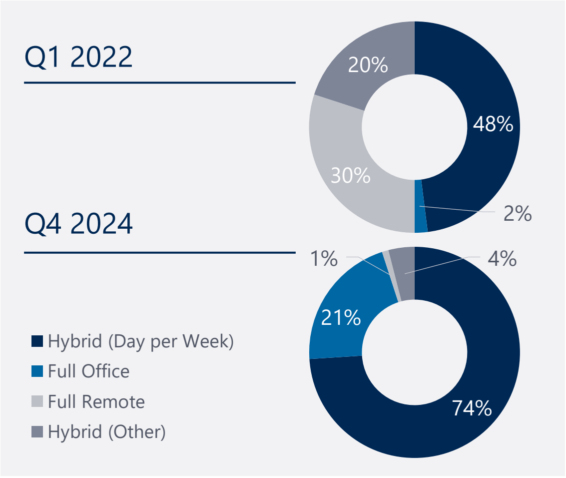
Winter 2025

01

Back to Office

As more companies bring employees back to the office (presumably to enhance productivity, encourage collaboration, and/or strengthen company culture), the demand for office space is on the rise. Net absorption turned positive in Q4 2024, marking the first positive momentum since 2021.

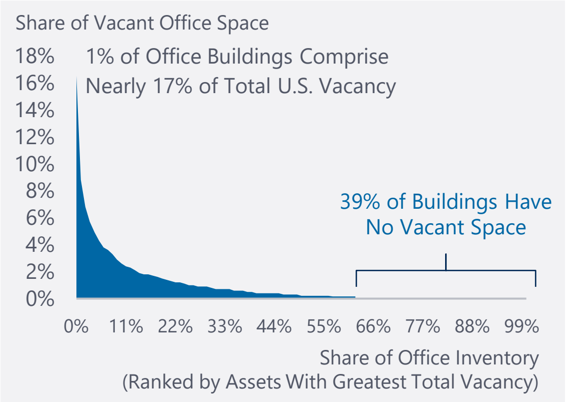
Leasing volume jumped 17.6% YoY, reaching the highest quarterly levels since the pandemic began and approaching 92% of pre-pandemic levels.



Fortune 100 Returning Back to the Office

Some of the largest shifts back to the office have occurred in the Fortune 100, with companies such as J.P. Morgan and Amazon recently mandating their employees return five days a week. Overall, only 1.0% of Fortune 100 employees are currently fully remote—a stark contrast from the 30.0% in Q1 2022.

In contrast, others (such as Citi Bank) are sticking to a hybrid work schedule, citing competitive workforce advantages. The new normal for most workers appears to be a hybrid attendance, with the average Fortune 100 employee required to be in the office for 3 to 4 days as of January 2025.



Flight to Quality Trend Intensifies

There has been a stark bifurcation in the office sector, with demand for trophy and Class A office space well exceeding other products. Office vacancy is concentrated in obsolete products built for a workforce of another era, with 60% of total office vacancies being concentrated in 10% of buildings. During the pandemic, many companies that downsized their leases opted for newer, more amenity-rich buildings (and smaller spaces), resulting in net-neutral spend when they returned to the office.

02

Inventory Trends

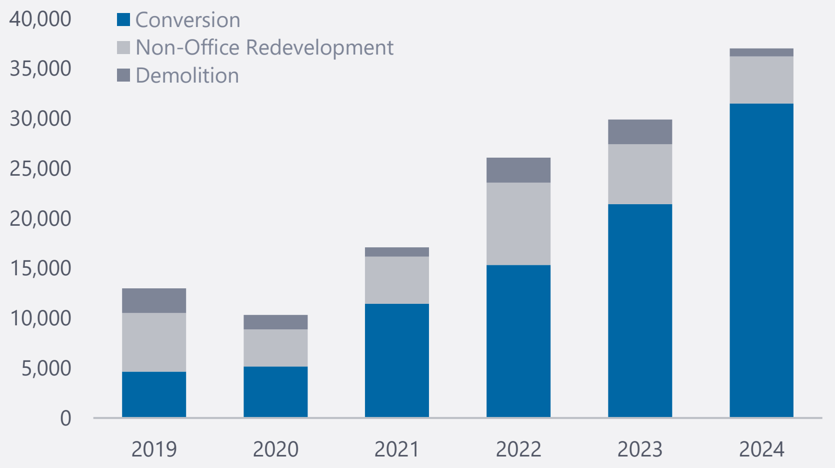
The office development pipeline continued to shrink in 2024, with new office deliveries expected to be a fraction of pre-pandemic levels. Currently, existing projects are predominantly smaller projects—planned before the pandemic—or those that are well-pre-leased or built-to-suit projects for credit tenants.

Unless there is a significant shift, new office deliveries are likely to remain muted beyond 2025. A lack of new construction, combined with an acceleration in conversions and demolitions of existing office space, bodes well for existing office owners.

Office Inventory Removals Continue to Accelerate

U.S. office-to-apartment conversions are set to soar from 23,100 units in 2022 to 70,700 units by early 2025, fueled by continued demand for adaptive reuse and growing government support. However, project completions are lagging; only 3,700 units were reportedly finished in 2024, carrying more than 50,000 units into 2025. Since 2020, 13 of 20 major U.S. MSAs have started incentive programs to support conversions. Even major dedicated office investors like SL Green and RXR in New York City are planning conversions, taking advantage of this trend and government incentives.

Inventory Removals (1,000s of SF)



29.3MSF
Of U.S. Office Space Currently Under Construction

This represents a **16.0%** quarter-over-quarter decline, representing the first time that U.S. office construction pipeline has been below 30.0 MSF since 2011.

0.7%
Percentage of Construction Pipeline to Total Office Inventory

The pipeline is below half of the **pre-pandemic average of 1.5%**. The ongoing construction slowdown will reduce supply pressures, helping preserve the value of existing high-quality assets in the coming years.

20.0%
The Annual Growth Rate of Office Conversions and Redevelopment Since 2020

In 2024, **more than 37 MSF** were taken offline or planned for removal.

1.2MSF
Average Groundbreakings Over the Past Six Quarters

Coupled with diminished demand, continued elevated financing and construction costs have dramatically impeded new office starts.

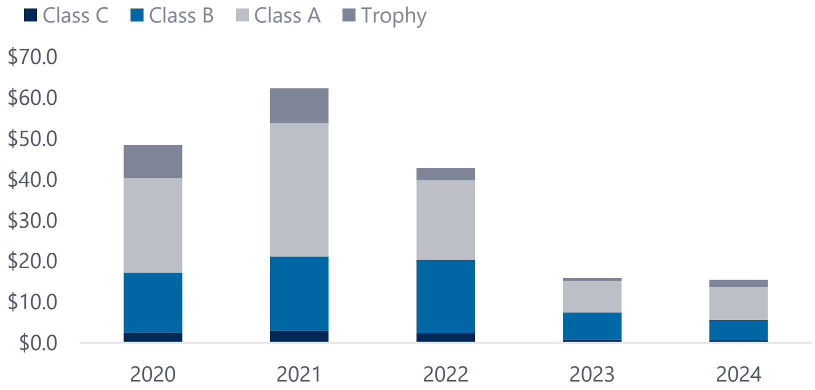
Sources: JLL Q4 2024 Market Report, JLL Q3 2024 Market Report, Cushman & Wakefield Q4 2024 Office Report, and CRE Daily.

03

Performance Across Classes

The U.S. office market is poised for a significant transition in 2025, as the “new normal” for office usage stabilizes and a new cycle begins. With office attendance reaching a more consistent level and the economy experiencing a soft landing, occupiers can approach portfolio planning with greater confidence.

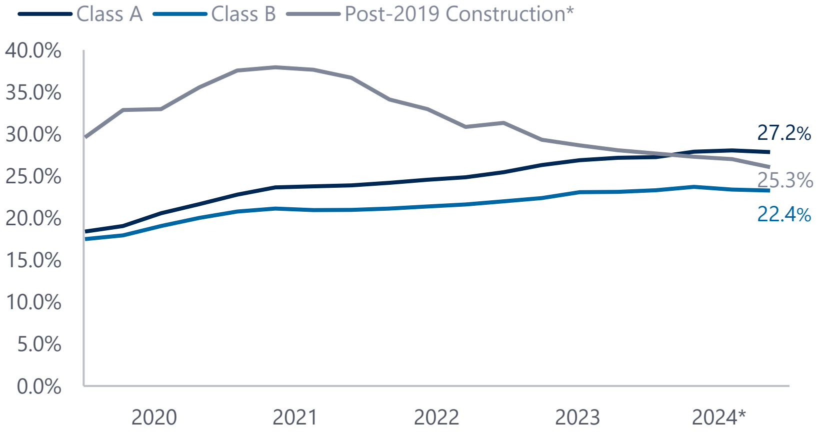
Office Investment Activity By Class ($ in Billions)



Note: Data for Chicago, Boston, Houston, Manhattan, San Francisco and Washington, D.C.

Year over year, traditional office sales remained sluggish; however, investor interest remained steady in alternative office sectors like life sciences, medical office, and the ever-increasingly important conversion plays for data centers, with sales in those areas reportedly up nearly 30%.

Office Market Availability Rate By Class



**Office buildings over 20,000 SF. 5-Star CoStar Rating. Excludes owner-occupied.*

While there is a clear demand for premium, high-quality, flexible space with top-notch amenities, a closer look reveals that Class B office properties are demonstrating resilience, especially when compared to commodity Class A buildings. As shown in the chart at left, Class B availability rates are consistently lower than both Class A buildings and post-2019 constructed (all classes) office buildings.

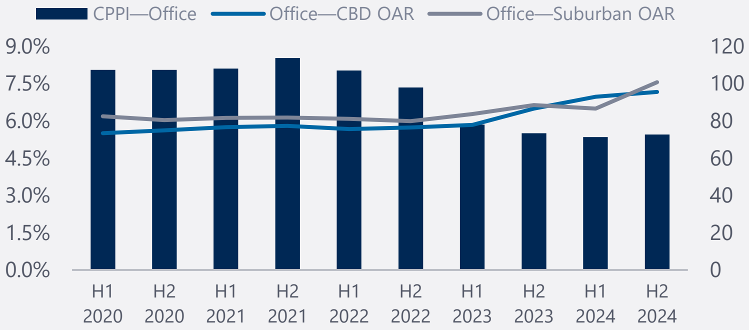
Certain industries seem to drive demand for Class B/C spaces, primarily to reduce occupancy costs, often in ex-urban areas.

04

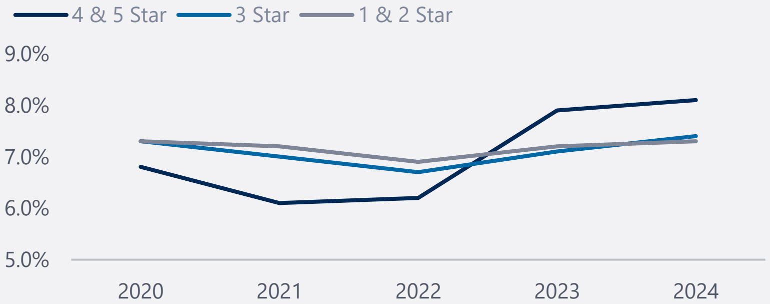
Valuation Dynamics and Capital Markets

Office values have faced a downward tailspin, with notable differences across markets and asset classes. Per MSCI’s December 2024 report, CBD office properties saw the sharpest annual decline, dropping 9.3% YoY in December, while suburban offices performed relatively better with a 2.2% decrease. Overall, lower-quality properties have been under more pressure, primarily due to sector challenges like the rise of remote work and limited financing options.

Property Price Index—Office and Surveyed Overall Cap Rates (OARs)



CoStar Transaction Cap Rates



Office returns have lagged behind other properties, pressured by rising operating expenses, longer downtimes between tenant vacancies, and generally sluggish NOI growth. Further, tenants are able to command elevated leasing concessions, thus further reducing net effective rents, diminishing property value, and disproportionately impacting under-occupied and lower-quality buildings. As a result, many investors remain cautious due to the high leasing and operational costs needed to attract quality tenants or sustain occupancy in the current market conditions.

While Class B availability rates remain stable (thus benefiting from alternative space utilization), cap rates have risen by more than 100 basis points since 2022, which puts significant downward pressure on property values.

+10%

Office CMBS Delinquency as of Dec-24; Represents a 250-Basis-Point Increase QoQ

Distress-driven transactions were more frequent in 2024 and appear to be slated to grow in 2025 and beyond.

$36B

Upcoming Office Maturities Slated for 2025

Delinquencies may inch closer to **13%–15%** in 2025, given upcoming maturities.

$7.9B

Total Office Originations in 2024 Across 172 Loans

In contrast, office originations totaled **$36.4 billion across 583** loans in 2021.

Sources: Avison Young: Q4 2024 U.S. Office Market Overview, Newmark: Q3 2024 United States Office Leasing House View, Costar, PwC Investor Surveys, JLL Research, MSCI Research, and CRE Daily.

05

Nationwide Metrics

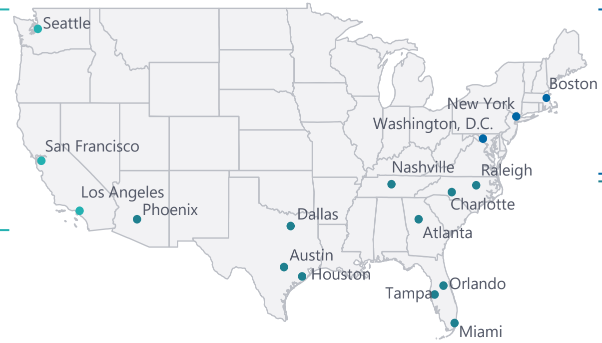
Gateway vs. Non-Gateway: Rent and Supply Growth

West Coast Gateway

Forecasted Rent Growth (25–29):
1.2%–1.7%
Supply Growth (25–29):
0.3%–0.6%

Other Non-Gateway

Forecasted Rent Growth (25–29):
0.0%–0.5%
Supply Growth (25–29):
0.2%–0.5%



East Coast Gateway

Forecasted Rent Growth (25–29):
1.3%–2.0%
Supply Growth (25–29):
0.2%–0.6%

Sun Belt

Forecasted Rent Growth (25–29):
0.5%–1.0%
Supply Growth (25–29):
0.3%–0.7%

Uneven Recovery Across Markets:

- ▲ East Coast gateway markets are set to outpace others, with New York anticipated to lead the pack.
- ▲ South Florida, Charlotte, and Nashville are among the top-performing markets, while certain Sun Belt locations may face challenges from new supply, resulting in general positivity in the region but mixed forecasts.
- = Outlooks are mixed on the West Coast, where Seattle and San Francisco may lag in 2025 but are poised for a stronger upswing beginning in 2026. Only time will tell.
- ▼ Los Angeles may fall behind due to limited demand from its key industries, particularly media and entertainment. However, rebuilding after the recent historic fires may spur growth over time.

Market	Asking Rent (PSF)	Market Vacancy	Total Inventory	T12 Investment Volume	Under Construction (SF)
Manhattan	$59.43	13.7%	978,128,748	$9.5B	8,824,273
Miami, FL	$54.01	8.6%	118,690,883	$1.7B	2,627,626
Dallas-FW, TX	$32.20	17.9%	433,769,427	$430M	5,203,880
Chicago, IL	$30.68	16.7%	512,276,037	$1.6B	1,329,099
San Francisco, CA	$50.73	23.2%	193,010,261	$1.2B	1,266,481
Seattle, WA	$36.87	15.9%	238,585,218	$1.5B	5,172,739

Sources: Costar, The Real Deal, Globest, Chron, Bisnow, and CRE Daily.

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Notable Activity

Sales Transactions

Target/Seller	Acquirer/Buyer	Date	Size ($M)	Property Name/Description
Ivanhoé Cambridge	RXR	Jan-25	NA	49% interest in 1211 Avenue of the Americas.
Nuveen	Norges Bank	Dec-24	$977	50.1% stake in eight office properties.
SL Green	Mori Building Company	Nov-24	$517	SL Green sold an 11% stake in One Vanderbilt valuing the 1,401-tt Midtown tower at $4.7 billion.
Nuveen	Morning Calm Management	Oct-24	$443	Originally acquired in 2002, Class A trophy office building totaling 685,279 SF.
Portfolio—13 Class A Bldgs.	Prime US REIT	Oct-24	$550	$400 million term loan and $150 million revolving facility.
Central Place Tower	CoStar Group	Feb-24	$339	31-story office building located in Arlington, Virginia, sold for $666.1 per SF.

Refinance

Target/Seller	Acquirer/Buyer	Date	Size ($M)	Property Name/Description
299 Park Avenue	Fisher Brothers	Jan-25	$500	$95 million cash-out refinance; 10-year fixed rate IO.
The Spiral	Tishman Speyer	Jan-25	$2,850	Five-year fixed rate.
Rockefeller Center Campus	Tishman Speyer	Oct-24	$3,500	Five-year SASB fixed rate at 6.23%.

Notable Valuation Indications

Building/Portfolio	Owner	Value Decline	Description
Water Garden (Los Angeles)	JP Morgan Asset Management	65%	Originally listed for $1.4 billion in 2022. Later relisted in 2023 at $700 million. Even then, the top bid was just $490 million, with no sale finalized yet.
PCT (Los Angeles)	Starwood Capital and Artisan Realty	75%	Originally bought for $611 million in 2017, later refinanced at a $960 million valuation. Recently valued at $240 million, based on a bid by Beacon Capital.
Greenway Plaza (Houston)	Silverpeak, Canada Pension Fund and Nuveen Real Estate	60%	Appraised at $1.03 billion in 2017. Now marketed as a redevelopment opportunity, with an expected sale price dropping to $416 million.
Piedmont Center (Atlanta)	Ardent Cos	70%	Valued at $657 million in 2021. Currently listed for sale, with expectations dropping from $230–$200 million.

07
Outlook

Stabilization

- The U.S. office market is expected to achieve a somewhat stabilized level in 2025, with office users settling on in-office policies and workers settling into their post-pandemic work lives. Occupiers are shifting from contraction to stabilization—and even selective expansion—supporting net positive office absorption.
- As tenants require employees to return to the office, coupled with the dearth of new supply, market demand is expected to increase, which should result in moderation of the significant tenant concession packages that are currently present in many markets. Accordingly, this below-the-line cash recovery should enhance returns for investors as the recovery unfolds.
- Full recovery is expected until at least 2026 or beyond, as the office will continue to be "under demolished" for some time while existing owners continue to figure out new ways to adapt the current office space to new needs or swallow the hard pill of selling for potentially significant losses.

Market Divide

- The divide between high-quality and lower-quality office buildings will continue to grow in 2025. Newer Class A assets are expected to significantly outperform other products.
- Certain sectors like government, education, and manufacturing/industrial could drive demand for available Class B and C spaces. Alternative users may start to pick up underutilized office space in ex-urban areas on the cheap for other uses (e.g., childcare centers).
- Office tenants may become more cautious in evaluating landlords' financial stability to ensure they can meet debt obligations and properly maintain their properties.

Capital Markets

- Significant capital will be focused on opportunistic, value-add situations.
- Despite lower Fed target rates, yields initially widened and spreads stayed consistent. Rates are expected to ease throughout 2025, but with new economic policies being implemented, only time will tell. Investors and lenders alike are hopeful that markets will continue to loosen.
- Many fixed-rate loans were originated during periods of low interest rates and more stable occupier demand. However, as these loans approach maturity in a higher-interest-rate environment and tenants reassess space needs amid evolving workplace trends, distress is expected to pick up. Borrowers will be forced to reset terms while simultaneously suffering from lower property NOI; certain borrowers will be hit hard, which may present opportunities for other investors.

Transformation
An Opportunity, Not a Problem

- In the post-pandemic era, cities must reinvent themselves to remain competitive. Those with strong economic fundamentals, vibrant mixed-use districts, and responsive governance will be best positioned for success.
- Using the shift in office demand to spur this reinvigoration will help municipalities tap into investors and developers alike via public-private partnerships, incentives programs, and more to revitalize and grow blighted districts and underutilized buildings more quickly.
- Office buildings in walkable, amenity-rich neighborhoods—such as Chicago's Fulton Market, Washington, D.C.'s Wharf, Boston's Seaport, Atlanta's Midtown, and Denver's Union Station—will likely achieve the highest occupancies and rents. Expanding and creating these districts will be key to attracting tenants. People will continue wanting to be in these areas, and investors will continue building in these areas. These areas will continue demanding the highest prices and most tenant and investor activity.
- Public and private stakeholders will play a growing role in revitalizing struggling downtowns through financial incentives and long-term place-making strategies. While transformation will take time, 2025 is expected to be a pivotal year, with early-stage investors positioning themselves for long-term gains.

Technology
Rapid Evolution

- While the long-term effects of AI on the office market remain uncertain, its influence could range from declining demand due to job displacement to increased office usage driven by economic growth and workforce reskilling.
- In the near term, AI is expected to enhance workforce productivity, leading some companies to prioritize well-located, highly amenitized office spaces despite higher rents. Additionally, increased uncertainty around future labor needs may drive demand for more flexible leasing arrangements.
- AI-driven automation in office operations could also improve operating margins—a trend already emerging in the industry. Given the potential for significant shifts in NOI, tracking AI's trajectory will be critical for office market participants.

Houlihan Lokey's **Real Estate Expertise**

Houlihan Lokey has a successful track record of assisting its clients—comprising real estate investors, owners, and other stakeholders—with various valuation, transaction, and special situation needs.

Valuation and Advisory Services

We have deep valuation expertise in investment, financial reporting, and tax matters.

We advise boards of directors and special committees as they navigate a range of strategic situations and challenges.

We value large portfolios of real estate equity and debt positions and offer bespoke valuation services (e.g., positive assurance) to help clients mitigate valuation risk.

Leveraging our accounting and real estate expertise, we help clients with transaction advisory services related to real estate equity and debt investments.

Our bench of experts includes dispute resolution counselors to advise on valuation matters involving disputes, mediation, arbitration, and litigation.

We provide fairness opinions, solvency opinions, and valuation opinions to clients across a variety of property- and entity-level transactions.

Investment Banking

We have a track record of structuring and executing value-optimizing transactions for our clients.

We run efficient, momentum-driven processes that drive results in M&A and capital raising for both healthy corporate finance and restructuring transactions.

We advise clients on strategic alternatives that enable them to accomplish next-level strategic goals—whether the aim is accelerated growth or divestiture—for PropCo and/or OpCo structures.

Our team of experienced financial professionals has an extensive and expansive reach of traditional and nontraditional real estate debt and equity investors around the world.

We are well versed in crafting tailored solutions to achieve client objectives, with deep experience across sectors, company types, and market cycles.

We are uniquely positioned to help address special situations, ranging from liquidity management to recapitalizations.

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