COSTAR INSIGHT

Suburban Office Real Estate Faces a Reckoning

As Demand Continues To Reset, This Property Type May Lose Its Edge

Suburban offices, such as 285 Sobrante Way in Sunnyvale, California, are beginning to feel the force of the same demand dislocation affecting their downtown counterparts. (CoStar)

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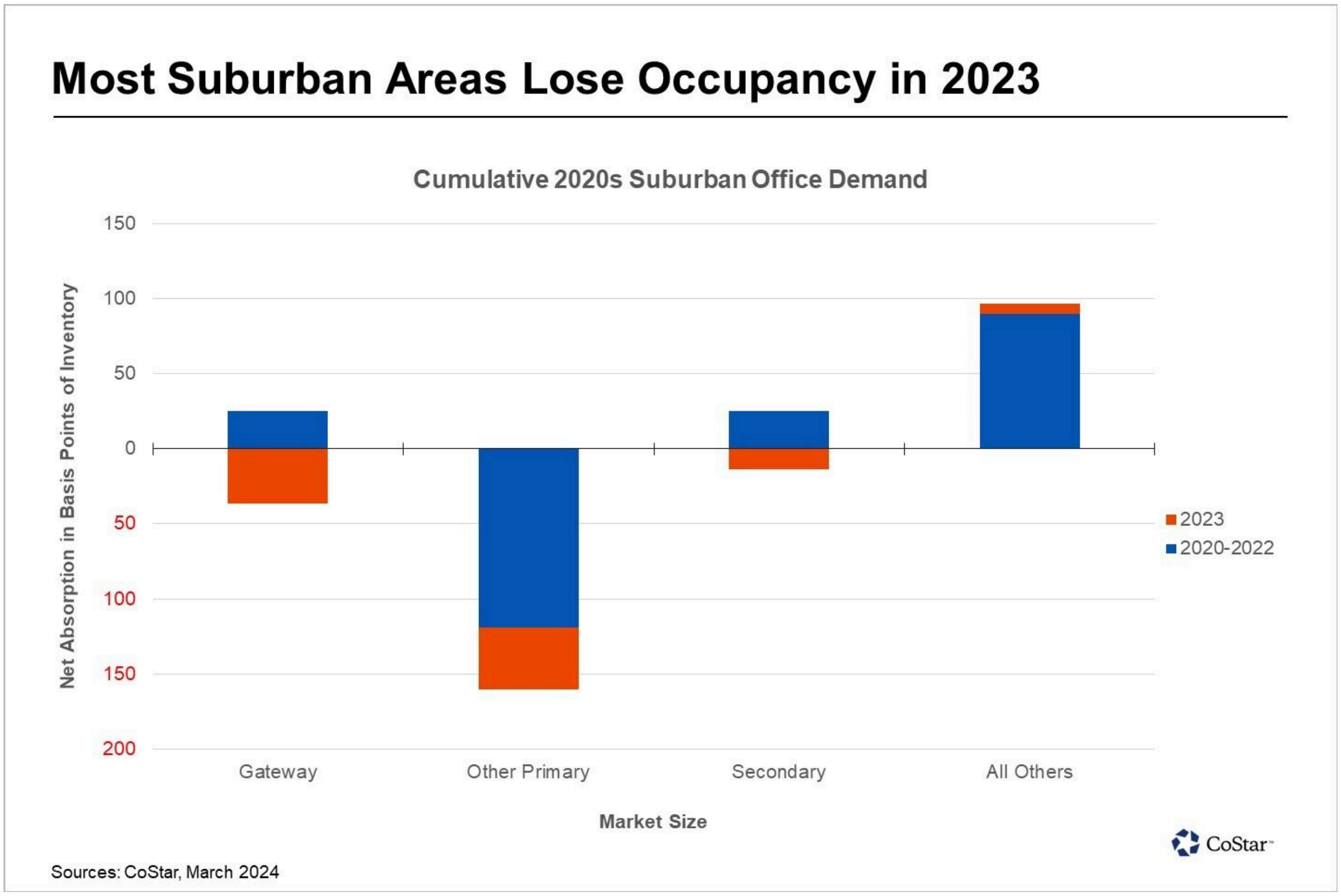
The impact of lower office attendance over the past four years has been especially profound in urban cores. While offices in suburban areas have proven more resilient so far, they are far from immune to the forces affecting their downtown neighbors.

Since April 2020, office occupiers have vacated more than 200 million square feet or nearly 2.5% of the total U.S. office inventory. Most of this, about 54%, has occurred in central business districts. Meanwhile, suburban offices, comprising almost half of all office space, have accounted for only 20% of the aggregate occupancy loss. Recently, however, net absorption, the change in move-ins versus move-outs, has turned sharply negative in the suburbs. Nearly 50% of all the suburban occupancy lost since 2020 occurred in just the past 12 months.

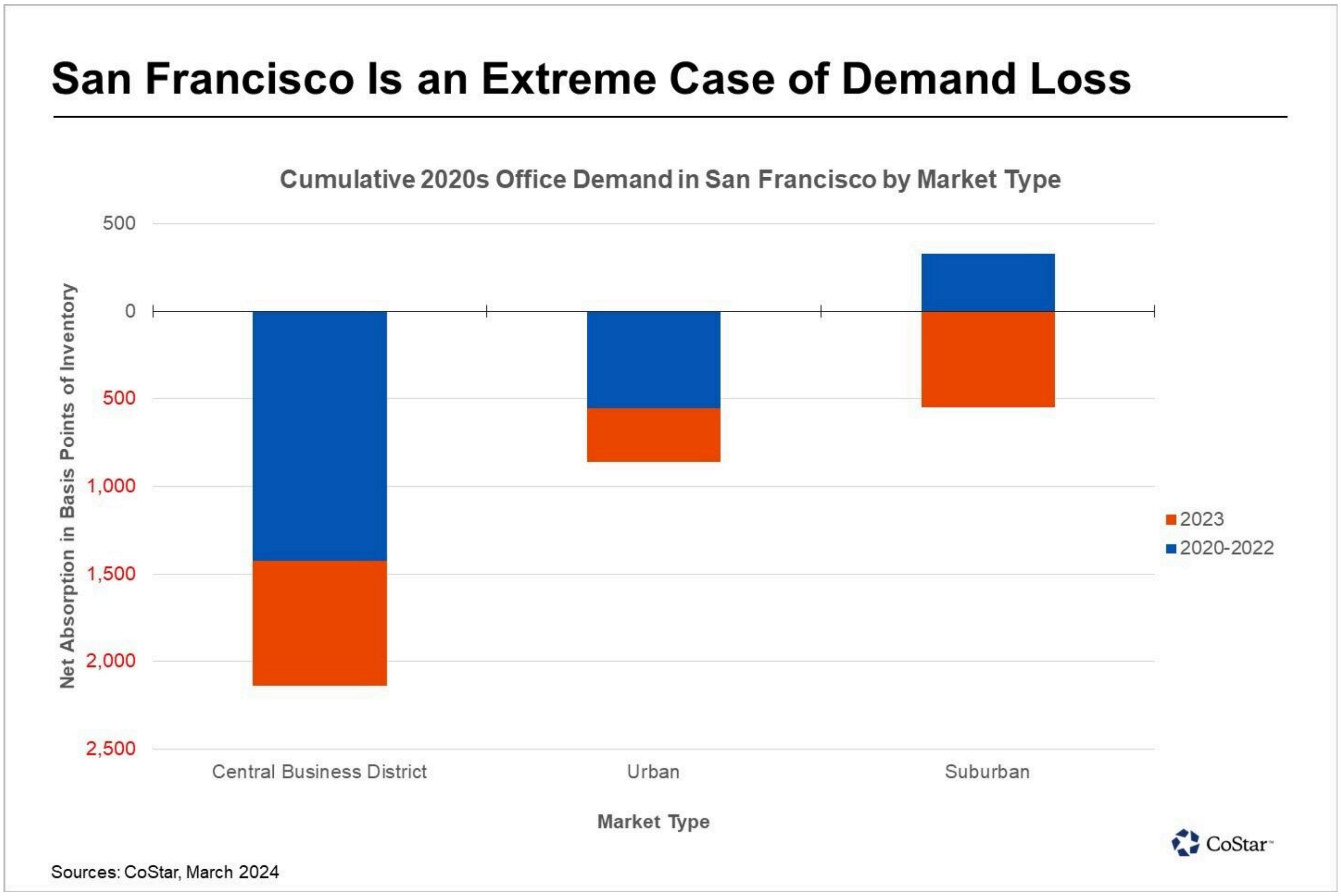
The idea, then, that suburban offices will be fine even as downtown offices struggle, is one that, at minimum, requires more nuance. In reality, market size may have as much or more to do with office performance than the degree of urbanization.



From 2020 to 2022, the suburbs in most U.S. markets saw positive demand for office space. Net absorption at suburban offices was positive everywhere except in the approximately 20 non-gateway, primary markets, defined as those with an estimated aggregate asset value of $200 to $550 billion. Things changed in 2023, with suburban offices losing occupancy in all but the nation's smallest markets, those with less than $50 billion in asset value.

Even in the gateway markets, the downtown-versus-suburban office dynamic is complex.

San Francisco offers the most extreme illustration of the trend in these large cities. In the first three years of the current demand cycle, San Francisco saw a striking amount of occupancy losses approaching 1,500 basis points, or 15%, of inventory in its central business district. Other urban areas in the city also experienced severe negative absorption, exceeding 500 basis points.



Suburban San Francisco, on the other hand, posted positive net absorption in the first few years of the decade, with tenants absorbing nearly 330 basis points of inventory from 2020-2022. The trend did not last, however, as all that space — and then some — was returned to the market in 2023.

San Francisco typifies the direction of the office-demand trend in gateway markets, but it is an outlier in terms of the magnitude of its occupancy loss throughout the greater San Fransisco area. The others generally follow the pattern of weak demand hitting the central business district and other urban areas harder first, followed by a broader and more general softening later in 2023.

Several intriguing exceptions exist, some of which can be attributed to the performance of a single section of the city, or even a single building. Office demand in suburban Houston and Dallas has remained consistently resilient since 2020, while Google's consolidation into owned locations in Mountain View, California, has bolstered occupancy outside San Jose.

Meanwhile, San Jose's central business district saw a spike in absorption in 2023, largely attributable to Adobe's new owner-occupied headquarters at 333 W San Fernando St. The nearby speculative development at 200 Park Ave. remains almost entirely available, though, suggesting that demand remains generally soft.

A similar situation exists in Boston's central business district, where tenants took up over 1.5 million square feet in two new office towers at 1 Congress St. and Winthrop Center at 115 Federal St. Much of this is not new demand for the market, however. For example, when Deloitte moves into its new 139,000-square-foot office at 115 Federal St. later this year, it will be vacating a similarly sized space in the Back Bay area.

The overall trend in 2023, though, was the acceleration of overall occupancy losses, including in the suburbs. Office absorption turned negative in suburban Atlanta last year, and the pace of negative absorption quickened in the suburbs of Boston, Chicago, Seattle and Washington. As occupiers continue adapting their footprints when their leases expire, the effect of lower overall office demand looks to be felt well beyond city centers.
