VIEWPOINT
U.S.OFFICE

The Changing Expectations for U.S. Office Recovery

Alex Krasikov
Economist

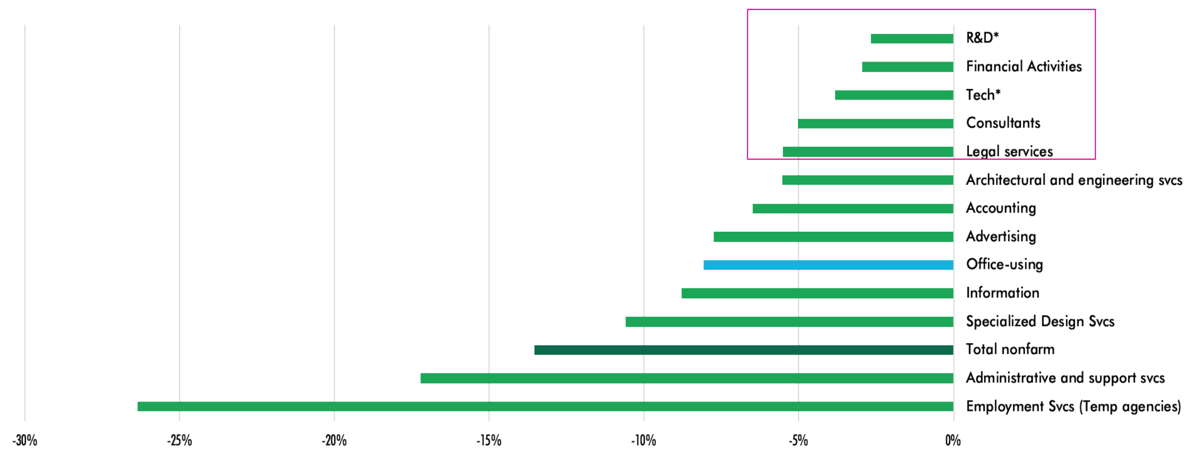
EXECUTIVE SUMMARY:

- Despite the staggering rise of unemployment and negative GDP figures, 9 of 10 respondents to a Bureau of Labor Statistics survey considered themselves on a temporary layoff.
- The office sector benefited from a fast adoption of work-from-home policies.
- Looking forward, the U.S. office sector most likely will not be able to go through the current crisis unscarred. CBRE Econometric Advisors (EA) are evaluating different projections for new office densities and the magnitude and duration of work-from-home regimes.

American workers filed more than 40 million claims for jobless benefits over a span of 10 weeks, with one in four workers in the U.S. filing for unemployment. The debilitating toll of the current pandemic on the U.S. economy led to the national unemployment rate jumping from 3.5% in February to 13.3% in May - the worst rate since the Depression Era, according to the Bureau of Labor Statistics (BLS). Based on updated estimates from the Bureau of Economic Analysis, in the first quarter of 2020 U.S. GDP shrunk by an annualized rate of 5%.

Despite the staggering rise of unemployment and negative GDP figures, 9 of 10 respondents to a BLS survey considered themselves on a temporary layoff. Moreover, most of the layoffs happened in the leisure and hospitality and retail sectors. Tech and financial sectors recorded comparatively smaller declines. And while first quarter negative GDP growth was large, given extraordinary quarantine measures, it was in line with EA's expectations.

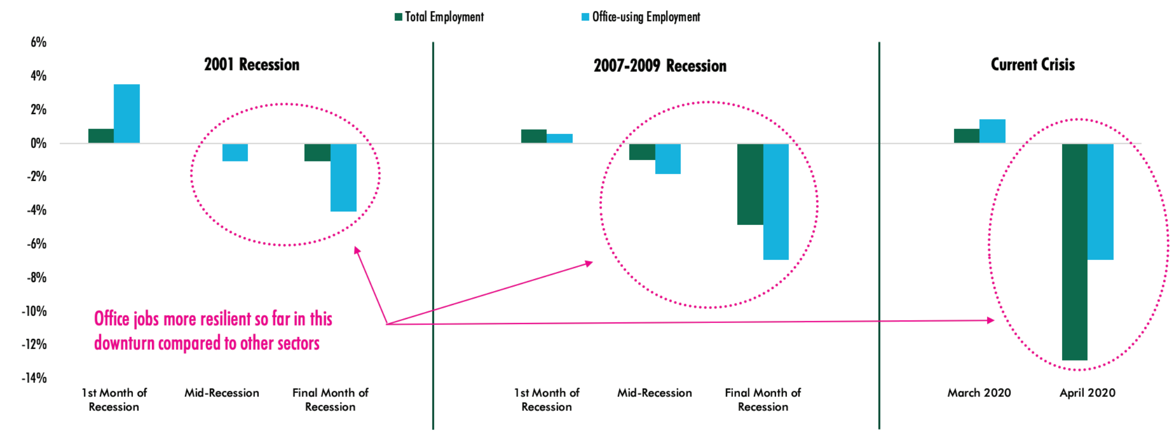
Figure 1: One-year Change in U.S. Office-Using Employment Subsectors Through April 2020



Source: CBRE Research, US BLS, Q2 2020. Note: "R&D" consists of Scientific Research and Development Services. "Tech" is comprised by "Computer Systems Design and Related Services" and "Data Processing, Hosting and Related Services."

Because many office jobs are well-suited to be performed at home, layoffs were less severe than in sectors that require face-to-face contact, such as hospitality and health care. The office sector benefited from a fast adoption of work-from-home policies, which preserved production capacity and operational efficiency of many companies. So far, the U.S. firms have been able to soften the blow on office employment.

Figure 2: One-year Changes in U.S. Total and Office-using Employment

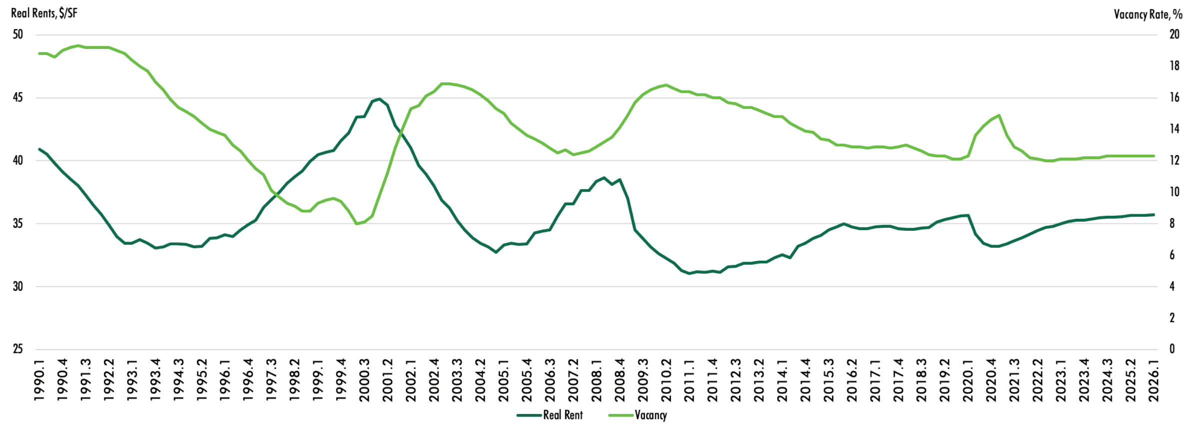


Soure: CBRE EA, Q1 2020.

Before the pandemic, the office sector had been on a well-balanced growth path over the past 10 years. Demand either matched or outpaced supply for 9 out of the past 10 years. Vacancy reached its lowest point, and inflation-adjustment rents reached their cyclical peak, in Q4 2019. Both rents and vacancy were within sensible ranges at the national level, far from levels that could lead to the market overheating.

Looking forward, the U.S. office sector most likely will not be able to go through the current crisis unscarred. In our Baseline scenario we expect U.S. office vacancy to rise from its current 12% to almost 15% within a year. Rents are expected to decline by more than 9%. But with a V-shaped recovery, in our Baseline scenario, we expect to see a sharp rebound of economic activity in the second half of 2020 and during 2021, with most national-level office variables returning to near precrisis levels by 2022.

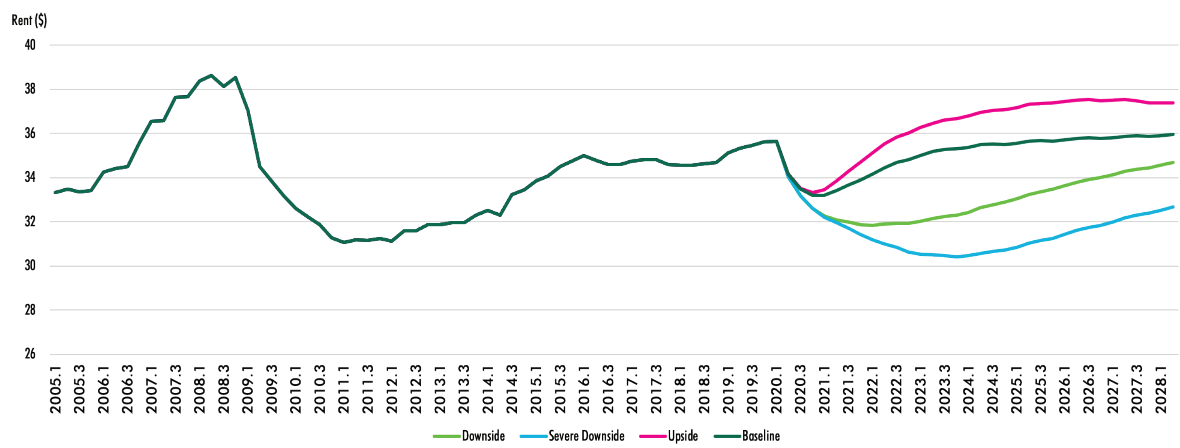
Figure 3: Real Rent and Vacancy Baseline Forecast



Source: CBRE EA, Q1 2020.

Compared to previous recessions, in our Baseline scenario we expect a severe but quick economic crisis. While the expected decline in office employment is much more rapid compared to the Dot Com bust or Great Financial Crisis, the duration of the current crisis is much shorter. Thus, recovery in office rents and vacancy is driven by the ability for the economy to bounce back and start to recover quickly.

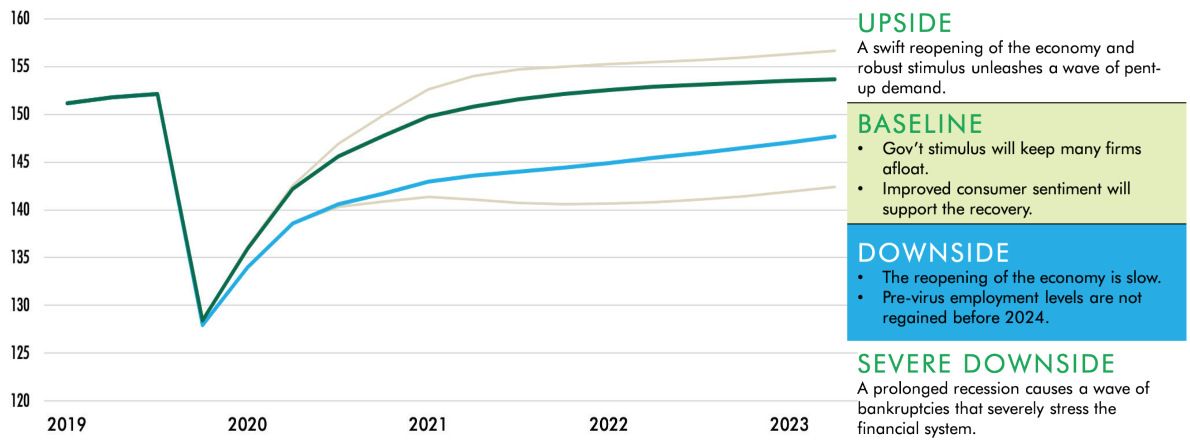
Figure 4: U.S. Office Real Rents by Scenario



Source: CBRE EA, Q1 2020.

Given current uncertainty, besides the Baseline scenario, we highlight other economic scenarios, produced by EA. While our Upside scenario predicts even faster economic recovery, Downside and especially Severe Downside, project a prolonged period before the economy can regain strength and return to the current level of output and employment. Our scenarios not only account for severity and length of the pandemic, but also likelihoods of various direct and indirect effects on the economy, such as actions by the Federal Reserve and Congress to stimulate the economy, adjustments of monetary policy, additional quantitative easing and new inflationary targets, further changes in labor market conditions and risks in corporate borrowing, to name a few.

Figure 5: CBRE's Current Forecast Scenarios On U.S. Employment



Source: CBRE EA, Q1 2020.

Downside and Severe Downside scenarios translate into much longer periods of recovery in inflation-adjusted office rents. While the likelihood of the Downside scenario is fairly high, we still think that such a prolonged recovery is too pessimistic.

Our traditional office demand assumptions are based on the historical relationship between office employment and office space demand, but the current pandemic established two new and influential trends. The first is social distancing, which should lead to at least a temporary decrease in office density and increased space requirements per office worker. The second is the institution of public quarantine measures and adaptation in the form of work-from-home policies implemented by nearly all of the U.S. professional service companies. While many office workers are currently working from home, it is too early to tell whether this quarantine-induced trend will persist after the pandemic subsides. Media and industry experts list plenty of valid organizational, financial, operational and even psychological reasons why working from home might or might not work after the crisis ends.

CBRE Research and EA are evaluating different changes for new office densities and the magnitude and duration of work-from-home regimes. Based on preliminary findings, neither of those two trends should lead to drastic chnages in space demand. Increase in space demand is bound by current stock and low vacancy rate and decrease in demand is unlikely in the short term, due to long average lease terms. Tenants are uncertain if their short-term mass-scale experiment of working from home can be successfully maintained without affecting the long-run performance of their workers and businesses.

FOR MORE INFORMATION, PLEASE CONTACT:

Alex Krasikov
Economist
CBRE Econometric Advisors
+ 617 912 5249
Alex.Krasikov@cbre.com

Matt Mowell
Senior Economist
CBRE Econometric Advisors
+1 336 688 6637
Matt.Mowell@cbre.com

Ian Anderson
Senior Director of Research
CBRE Americas Research
+ 215 561 8997
Ian.Anderson2@cbre.com

Jamie Lane
Senior Research Director
Economics & Forecasting
+ 404 812 5254
Jamie.Lane@cbre.com
Follow Jamie on twitter: *@Jamie_Lane*

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