

## Office Usage Is Up, But What About Vacancy?

**Vacancy rates are still ticking up in New York and San Francisco despite a recovery in utilization rates.**

By Lynn Pollack

There's no denying that the WFH trend is leading to higher vacancy rates in the office sector, but according to a trio of analysts from Moody's, "there's more nuance than meets the eye."

Data from Kastle Systems shows that physical office usage hit 40.5% nationally last month, the highest since the onset of the COVID-19 pandemic in 2020. The physical utilization rate has been climbing since then, save a few dips related to the outbreak of new variants. And by the first quarter of this year, many large employers began implementing return-to-office plans.

"As these plans ramp up, we expect office physical utilization to climb at least in the short run," write Moody's Analytics researchers Xiaodi Li, Victor Calanog and Kevin Fagan. "However, a multitude of surveys and early indications from initial post-COVID-19 work arrangements, it is likely that some workers will average around two days less in the office, which may ultimately form somewhat of a fuzzy ceiling at around 60%, with continued wide variance by office market, firm industry, and individual job type."

Office vacancy hit 18.1% in the first quarter, 40 bps below its pandemic peak in Q2 2021, but Moody's notes that vacancy rates are still ticking up in so-called "superstar cities" like New York and San Francisco despite a recovery in utilization rates. The analysts note that office vacancy "reflects the aggregate need for space in a market relative to office stock," and maintain that can be "influenced by tenants' expectation of their workers' office utilization rates."

"In other words, tenants expecting substantially reduced office utilization (whether from less personnel needs in a typical downturn, or more remote working after the pandemic) will shrink their space," they write. "But tenants will likely renew leases if they expect their employees to return to the office soon, even if they haven't quite stormed back as of yet."

Leases for 243 million square feet of office space will expire in 2022, representing 11 percent of the overall office space in the US, according to JLL. That's the largest amount to hit the market since the firm began tracking expirations in 2015. The Wall Street Journal has previously reported that many office tenants whose long-term leases expired during the past two years negotiated one- or two-year extensions with landlords so they could wait out the pandemic without having to definitively decide on their office footprint.

Moody's suggests that tenants in expensive cities like New York and San Francisco may be more financially motivated to shed space, and analysts there say they'll be closely watching that trend. But they conclude that for "desirable cities rich with amenities and talent, this pay portend more of a repricing than an exodus."

Boston and San Francisco, for example, have similar WFH percentages at about 50%, but Boston's vacancy has remained flat while San Francisco's ticked up from 8.8% to 12.4% from Q4 2019 to Q4 2021. There are a few explanations for these differences: San Francisco has more tech employees using office space, for example, and tech companies have embraced remote work more than other industries. Boston is also a life sciences hub, and many of those firms are following suit with their WFH policies. Moody's also notes that the city has also historically been a resilient office market.

Hybrid work models also do not necessarily lead to higher vacancy, the analysts say: "If all workers decide to show up on the same day—which is highly likely if companies mandate three days a week in the office centered on specific days—office space needs will not automatically decline," they note.

"It's clear that there are many caveats to WFH impact on office vacancy rates. These caveats vary market-to-market, firm-to-firm, and job-to-job," according to Moody's. "The office market is on an evolutionary path, and we will continue to monitor it closely as new office vacancy models solidify into their eventual form."