

Dwindling Office Supply Pipeline Has a Different Look

Recent Construction Starts Are Concentrated in a Few Markets and Target Specialty Uses

By Phil Mobley

The rising cost of capital and uncertain future demand have resulted in a dramatic decline in office construction activity. Furthermore, the composition of the projects that remain in the pipeline appears to be quite different from a few short years ago.

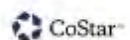
Only about 3.5 million square feet of new office construction is underway from April through June to date, making it increasingly likely that office construction starts nationally will set another record low for the third consecutive quarter. The slowdown has already begun to affect net deliveries, though the completion of buildings that are already underway will lead to a temporary surge over the next 12 months.

While the office construction pullback has been geographically broad, it has not been universal. Some markets were in the middle of a construction boom when the pandemic hit. From 2015 to 2021, developers in San Jose completed nearly 26 million square feet of office space in buildings of at least 50,000 square feet, increasing the market's total office inventory by about 19%. Austin saw

Supply Growth Is Historically Low and Falling



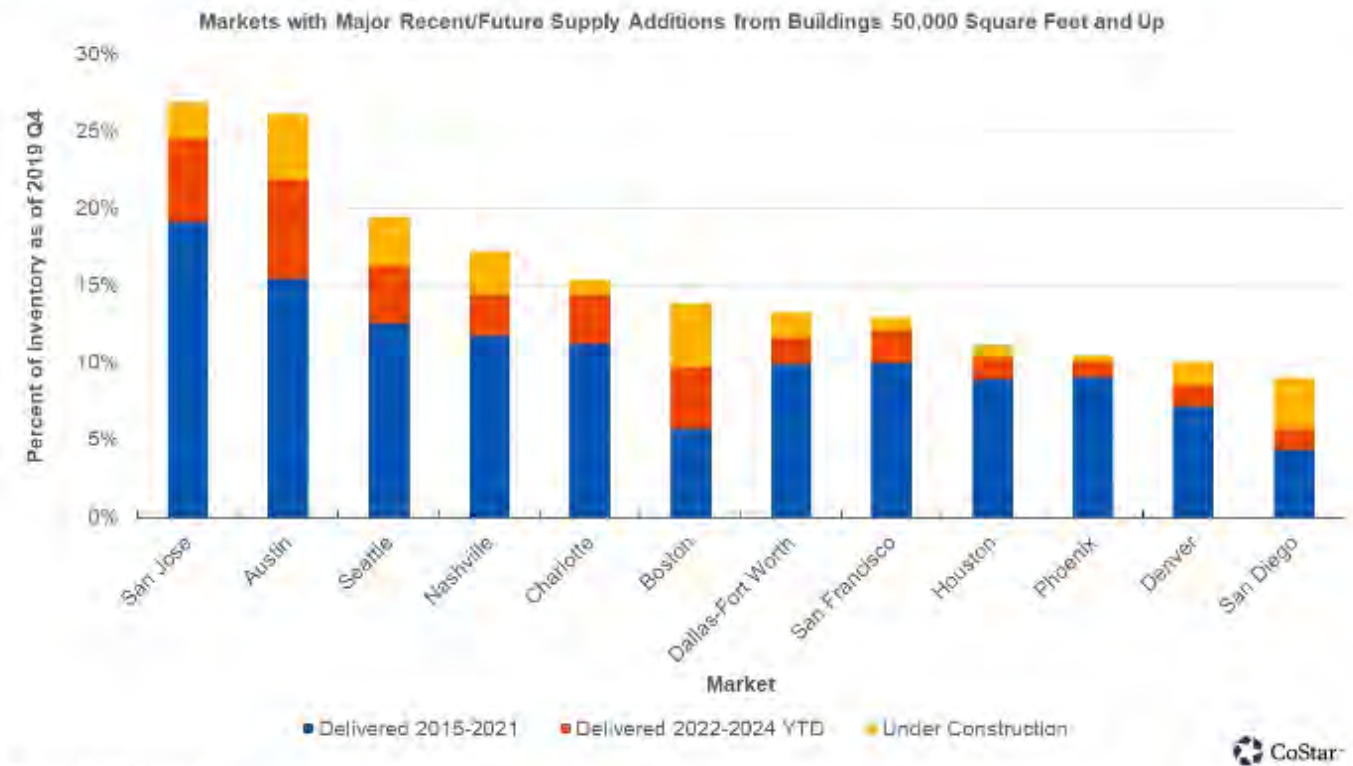
Source: CoStar, June 2024



a similar surge with the completion of large buildings of over 18 million square feet, or 15% of inventory.

Both markets saw a huge boom in demand from technology companies in the 2010s when these buildings were planned and started. Both have also seen robust construction activity continue in the early 2020s, contributing to massive vacancy increases despite relatively resilient demand.

Some Markets Still Face an Elevated Supply Pipeline



Office vacancy in San Jose has risen 350 basis points since the beginning of 2022, even as another 5.4% of inventory has come online with the completion of numerous large buildings. In Austin, large completions have added another 6.4% of inventory since the beginning of 2022, with the vacancy rate rising more than 450 basis points. The pressure will not let up for some time in Austin, which still has a nation-leading 4.3% of its office inventory under construction.

In most other markets, office completions have slowed dramatically since 2021. San Francisco has added about 2% of inventory in large buildings but has less than 1% still underway. Houston and Phoenix both expect an increase of only about 2% of their combined office inventory from recent completions and projects still underway. Even Dallas has seen relatively moderate construction recently, with a little over 3% of inventory in large post-2021 projects.

The differences in recent office construction are about more than geography. Since 2022, new office construction has been weighted toward specialty use by life sciences research and development organizations.

From 2015 to 2021, only about 3% of space in newly delivered large office buildings was oriented toward biotech occupiers. Since then, the percentage has risen above 11%. Among projects that are still underway, it is even higher, almost 18%.

The major biotech hubs account for the lion’s share of this new lab inventory. Boston has nearly 8 million square feet of large labs underway, accounting for 52% of its total pipeline.

The 3 million square feet of large labs under construction in San Diego comprise a whopping 82% of all the office space currently underway in that market. Seattle, too, has a significant amount of large lab-oriented space underway, representing 11% of its pipeline.

When these projects are completed, nearly 30 million square feet of large buildings targeting lab tenants will have been added to inventory since the beginning of 2022. These completions arrive even as vacancy in existing labs has increased from about 12% to nearly 16%, corresponding to slowing venture-backed startup activity in the sector.

The overall slowdown in office construction holds fascinating implications for an occupancy market in which new construction has been one of the few bastions of resilience. Meanwhile, developers in major lab hubs will be hoping for a fast recovery in biotech demand.

Labs Comprise an Increasing Share of New Construction



Source: CoStar, June 2024

