Some Encouraging Signs in the Office Sector

Back-to-office directives and absorption and occupancy increases deserve at least consideration as a glass half full.

By Erik Sherman

Heavens and the tax authorities know that the office market has been tough. Just within the last few weeks, Goldman Sachs said that work-from-home will continue to push office vacancy rates upwards; on the whole, sales of office properties in metros are down year-over-year in the first half of 2023; and office skyscraper vacancy rates are on the rise.

But in all this, "there is a glimmer of hope in the news surrounding office properties," according to Trepp.

One of the news points is that companies like Google, Amazon, and Meta are pushing on a return to the office, "signaling a shift in their approach to remote work," as Trepp's Vivek Denkanikotte wrote. These major companies are moving to a three-day-a-week in-office requirement, and they will need to keep space for this. For data on Amazon and Google properties with outstanding loan balances, Trepp shows respective weighted average debt service coverage ratios to be 2.30 and 2.11, showing significant strength and the potential, though not the guarantee, that refinancing the loans — between the two, $2.70 billion in loans maturing by the end of 2024 — might have an easier time refinancing than what has been seen of late.

Similarly, although Trepp didn't mention this, some major financial services companies have also been pushing for employees to return to the office and could represent another important economic sector propping up many loans.

Then there is metro performance. "The San Francisco, Chicago, and Seattle metros are three of the nation's largest with respect to office exposure, harboring massive office properties for top companies like Google, Meta, and Amazon amongst others," wrote Denkanikotte. "For most of 2023, office performance in these regions was grim, as many of said companies chose to scale down their office presence. However, recent data has revealed the following positive indicators."

For example, in a July recap, Placer.ai said that "return-to-office mandates appear to be slowly but surely moving the needle." June and July 2023 saw stronger office visits than in any other month since the pandemic.

"Regionally, Washington, D.C. continued to lead in overall office recovery, with the smallest year-over-four-year (Yo4Y) visit gap of any analyzed city – just 22.4% in July 2023," Placer.ai wrote. "But San Francisco, where return-to-office has been particularly sluggish, saw the greatest year-over-year (YoY) jump in visits. While San Francisco office foot traffic dipped slightly in July 2023 compared to the month before, it remained higher than it's been at any other time since COVID. Other cities too – including New York, Denver, Boston, and Chicago – saw the most office visits in July 2023 that they've seen since before the pandemic."

"According to Trepp CMBS data," that firm wrote, "San Francisco has the third-largest allocated balance for office properties of $12.3 billion, trailing only Los Angeles and New York. Of this balance, more than 71% have a DSCR (NOI) greater than 2.00."

Chicago's central business district has seen positive office absorption. Vacancies were up in Seattle, but more workers are downtown.

"As we look ahead to 2024 and the maturing office loans, the data reveals a mix of occupancy rates, but the overall trajectory appears to be toward recovery," Denkanikotte wrote. "The presence of Class A buildings and the eagerness of Fortune 100 companies to return to offices further bolster this optimism. While the office sector has faced substantial challenges, these encouraging trends indicate that a brighter future may be on the horizon, offering hope and potential for the industry's revival."