



Yardi® Matrix

National Office Report

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Pandemic Prompts a Flight to Quality

- The pandemic appears to be waning after two years. Governments have let most mandates expire, and bars, restaurants, concert halls and stadiums are filling back up. Yet office buildings remain relatively empty. Some corporate and political leaders are calling for a return to the office. Morgan Stanley CEO James Gorman and New York City Mayor Eric Adams have been vocal supporters. During his State of the Union, President Biden announced federal workers would soon be returning to the office and encouraged Americans to “get back to work and fill our great downtowns again with people.”
- Despite this push, office utilization levels from February 2020 are unlikely to return. Workers are hesitant to spend 40 hours a week in the office after two years of flexibility, and many may look for other jobs that provide remote options if forced to return. Most firms don't want to compel their employees to do so. CBRE's Occupier Sentiment Survey from last year found 87% of large companies surveyed would utilize a hybrid model. With such a model, many firms will look to entice workers into the office as much as possible, leading to increased demand for high-quality space.
- This so-called “flight to quality” is already playing out in some major markets. Despite out-migration of people and businesses from Manhattan, One Vanderbilt—a 1.8 million-square-foot Class A+ tower—is 90% leased after delivering in 2020. Boro Tower in Northern Virginia sits inside a 15-acre mixed-use development that offers an array of amenities and is 80% leased. Investors have taken notice, leading to a growing spread in average sale price between asset classes over the last two years. Class A buildings, on average, cost \$50 more per square foot (15%) in the fourth quarter of 2021 than 2019, while Class B buildings have only increased \$6 per foot (6%) over that time. An example can be found in Atlanta, where last year 725 Ponce sold for \$300.2 million, or an average of \$807 per foot, the highest average price per foot Yardi Matrix has ever logged in the market.
- For Class B and C buildings, the flight to quality will present challenges, but also opportunities. Some lower-quality assets will become prime targets for conversions, especially in markets where land is at a premium. In Orange County, Duke Realty paid \$34 million for an office fully leased to Raytheon, but it plans to demolish the building and develop an industrial property once the lease expires in the summer. Most offices are not suited for industrial conversions, so demolishing office buildings may become a common tactic in markets where developers feel they can leverage a good location.

