VTS

VTS Office Demand Index (VODI).

MONTHLY REPORT: JANUARY 2021

KEY TAKEAWAYS FROM THIS REPORT:

- After some upward momentum in the summer of 2020, the VTS Office Demand Index (VODI) fell every month in the fourth quarter. The national VODI finished off the year with just over a third of pre-COVID-19 demand.
- While looking strong at the end of summer, the Seattle and Washington, D.C. VODIs took a dramatic downward turn over the fourth quarter as new tenant activity slowed. Washington, D.C. benefited earlier in 2020 from a more mild initial fall in demand during early crisis days, while Seattle is now the furthest market from pre-crisis levels.
- Los Angeles continues to be a bright spot with office leasing activity currently only 35 percent down from pre-crisis demand levels. Boston is a distant second at 61 percent down.
- New York City office demand continues to experience a pronounced flight to quality with tours in premium office spaces taking up a significantly larger share of demand than pre-crisis.

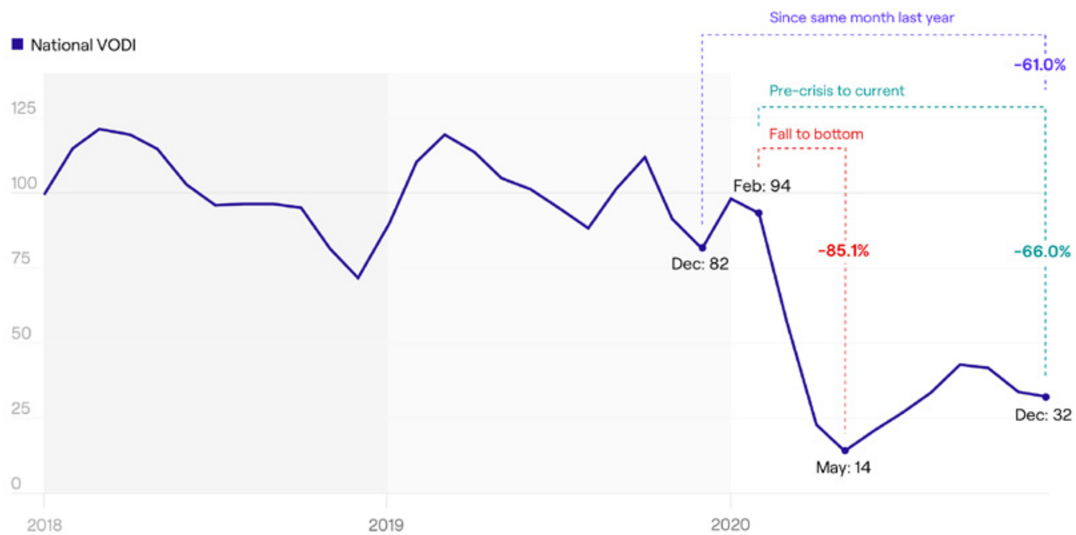
The VTS Office Demand Index (VODI)

VTS is the leading provider of leasing and asset management software for commercial real estate landlords, with market share in excess of 65% for office buildings in every major market. The VTS platform captures, aggregates, and anonymizes supply and demand data across all office asset classes and age segments. Due to VTS' market share and the multiple spaces considered by tenants in a given search, VTS sees 99% of all newly created tenant "requirements." With this unprecedented view, VTS has developed a new index, the VTS Office Demand Index, to be published monthly, to provide landlords, brokers, tenants, and the business community with visibility into a previously opaque segment of the market – real-time tenant demand in the United States office leasing market.

The VTS Office Demand Index, or VODI, captures demand for office space as it hits the market – when a tenant tours potential spaces, virtually or in-person – the earliest available indicator of signed leases to come in major U.S. markets. The VODI reflects the total square feet toured by tenants in a given month relative to the total property square feet tracked in VTS' expansive network to control for new construction and VTS' own market expansion. The VODI is indexed to evolve from its base year in January 2018.

Analyzing the VODI's progress is to understand the sentiment of office tenants through the most significant recession and public health crisis in U.S. history with the appetite for office space at the center of the analysis.

VTS Office Demand Index (VODI)

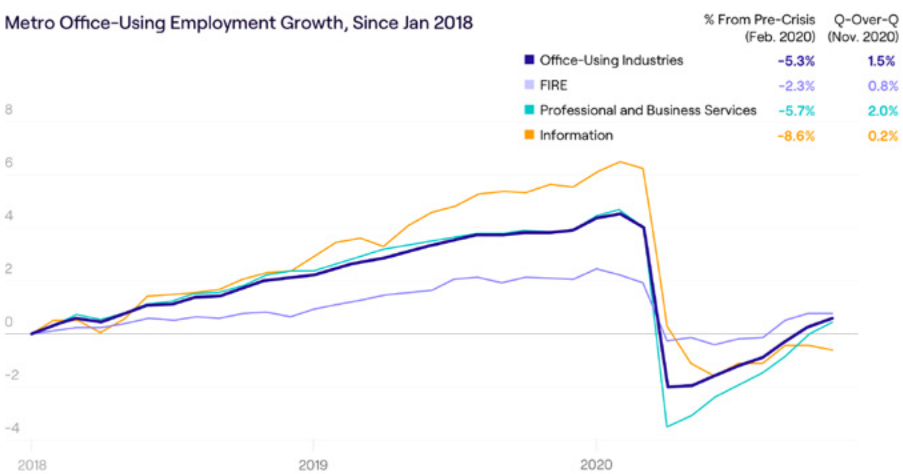


The National VODI Results

While 2020 is over, the coronavirus public health crisis is still with us and political uncertainty and tight economic conditions still reign over most markets. Commercial office space is not an exception. As the number of COVID-19 cases swelled dramatically into winter, rising 144 percent over the last quarter, seasonally adjusted employment growth in office-using industries slowed.[1] While much is made of remote work and its potential impact on future office space use, it's critical to remember that healthy office space demand is also dependent on healthy office-using industries. Until confidence grows in our ability to tackle the public health crisis, economic activity and employment levels will struggle to sustain growth and with it, office leasing demand.

Having plummeted 85 percent in the spring, the national VODI was at a six-month high in September, but fell every month in the fourth quarter finishing off the year with just over a third of pre-COVID-19 demand. While it is typical for office leasing demand to soften in the winter months, without the typical burst of activity in October, and given the absolutely devastating and atypical drop in early spring, it is difficult to characterize the end of this year – at a VODI of 32 index points – as anything but disappointing. Office leasing demand closed out 2020 50 index points lower than it started, or 61 percent from the end of December 2019, and 66 percent below pre-crisis, February levels (with a VODI of 94 points).

Metro Office-Using Employment Growth, Since Jan 2018



Source: U.S. Bureau of Labor Statistics, Employment Data, retrieved from FRED, Federal Reserve Bank of St. Louis

Local Market Office Demand

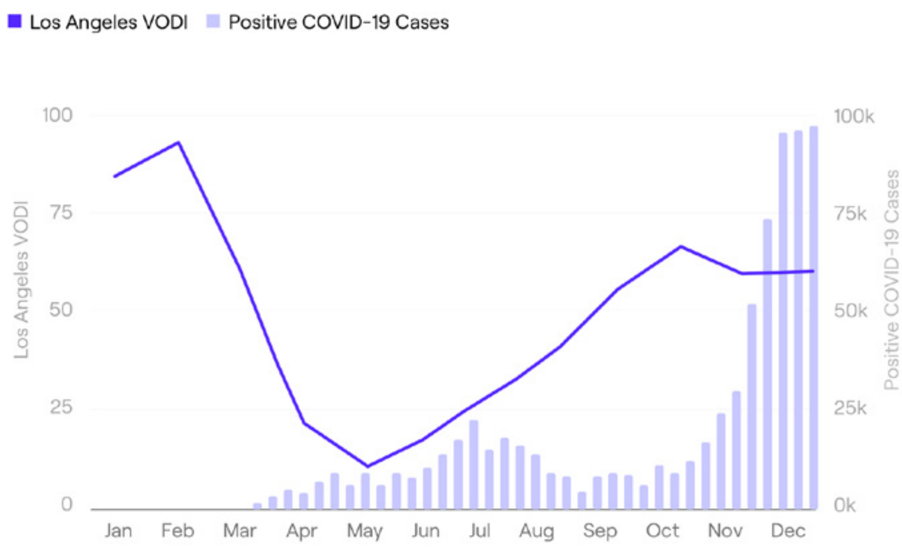
VTS Office Demand Index by Market

Demand since pre-crisis to current month.

Locally, the story is more nuanced. All of our covered markets experienced a terrifying swell in coronavirus cases this fall and winter. However, the size of the winter decline in the VODI over the last quarter doesn't appear to be more significant in metros harder hit by the virus nor metros with the slowest growth in office-using employment (our best performing market, Los Angeles, is a great example of this seemingly counterintuitive result). This reflects the shared and national nature of this crisis, but also suggests that what the VODI tracks – the amount of space toured by tenants with credible interest in new spaces – provides a unique view into the speculation and expectations of office-using industries for the coming years.

[1] Seasonally adjusted employment in office-using industries (FIRE, professional and business services, and information) across all markets covered in this VTS report grew almost 1.2 percent between July and September. From September to November the growth rate slowed to 0.8 percent. As of this writing, December jobs numbers at the metro level have not yet been reported.

VTS Office Demand Index vs. Positive COVID-19 Cases in L.A.



Source of COVID-19 Case Data: The New York Times

Once a market noted as a bright star in the pace of its early recovery, **Seattle** saw demand fall significantly over the last few months and by December had gained back only 9 percent of what was lost between February and May. Despite being closest to pre-COVID-19 office-using employment levels, Seattle office demand ended the year the furthest from recovery of all markets covered at 80 percent below the pre-crisis levels of February 2020. Given the reversal of Seattle's early recovery, this may suggest a significant embrace of more remote work in Seattle over the long-term. Second only to San Francisco in aggressive growth of office-using employment pre-crisis (especially in tech), Seattle tenants are demonstrating their ability and willingness to explore alternatives to returning to office space in a post-COVID-19 world.

Chicago and Washington, D.C. experienced a similarly dramatic reversal of progress over the fourth quarter. In Chicago, office leasing demand remains 73 percent below pre-crisis levels. It initially fell 84 percent between February and April, and while touring activity did grow through the summer, any progress made was mostly reversed by year-end with the market having regained only 13 percent of demand initially lost.

While Chicago's continued struggles are unsurprising given the metro's poor general economic performance over the past several years, the Q4 drop in Washington, D.C. – the largest decline across all metros covered at 22 index points down – was a bit more unexpected, though perhaps not with hindsight. Washington, D.C, which historically avoids dramatic volatility, saw demand drop sharply to close out the year. In fact, December demand in Washington, D.C. was more akin to the level of demand seen shortly after the bottom than it was just two months ago.

The current decline is likely fueled by withdrawing demand from the incumbent ecosystem – space requirements are often directly tied to government contracts – yet unreplaced by the incoming administration during a rocky transition. Despite the observed fall in demand this winter, however, we do expect office leasing demand to rise quickly once the new administration gets settled. When all three branches of government align, legislation can pass more easily, often stimulating new demand not just from those charged with implementing the new policy, but also the lobbyists of impacted industries who desire a physical presence near the action.

The two markets that sustained or improved their recoveries throughout the last quarter of the year were **Los Angeles and San Francisco**, although the overall health of the markets differs dramatically between the two. Los Angeles started out with a VODI of 95 index points in February and had lost 88 percent of demand by May. It has since gained back 61 percent of what was lost and ends the year only 35 percent below pre-crisis levels. This apparent and growing interest is a strong signal for Los Angeles' prospects especially given poor employment numbers – of all markets covered, office-using employment fell the most with an almost 12 percent drop and remains one of the furthest markets from hiring those jobs back. This resiliency in the face of a poorer employment situation could suggest a novel signal of future employment and office sector strength in the market. Many industry insiders have begun to speculate on a boom in content creation, as the pandemic keeps us in our homes and constantly seeking new diversions.

VTS Office Demand Index by Market

Share of demand recovered since trough.

While also up over the last quarter, San Francisco's rise should be considered relative to their low VODI pre-pandemic. In February 2020 the San Francisco VODI was at 56 and within three months, 95 percent of that demand was lost. San Francisco has since regained 32 percent of what was lost since February to end the year 64 percent below February levels which currently places it in front of Chicago, New York City, and Seattle in the race back to normalcy. But it might be hard to assign too much good news to the odd seasonality in San Francisco. Like Seattle, San Francisco benefitted from tech and other office-using employment growth pre-crisis driving vacancy down – a trend that completely unwound and may be less likely in a COVID-19 impacted future.

While also seasonally down, **Boston** office leasing demand fell only 2 index points over Q4 to end the year 61 percent lower than pre-crisis levels. A more steady and consistently improving market, Boston ranks as a distant second to Los Angeles in its climb back up to normal, only marginally beating out Washington, D.C.

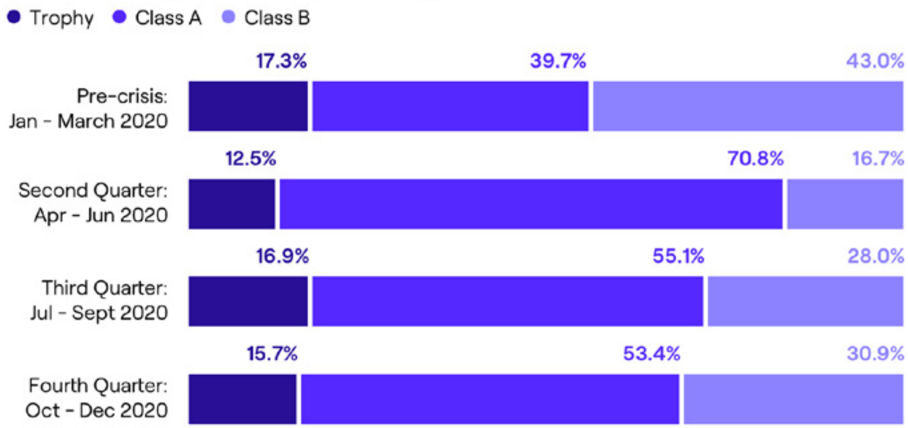
Like most other markets, **New York City** experienced a decline in demand after the summer but was unchanged from November to December. The stability of New York City demand in December, a month that saw declines of over 10 index points in both 2018 and 2019, is another indication that this year is anything but normal. Without the typical upswing in October, even the atypically stable December wasn't enough to keep from wiping out almost half of the summer gains seen in the market. There is still a long way to go towards a full recovery – New York City office demand remains 74 percent below pre-crisis levels with a mere 21 percent of lost demand regained since bottoming out in May 2020.

Demand by Building Class

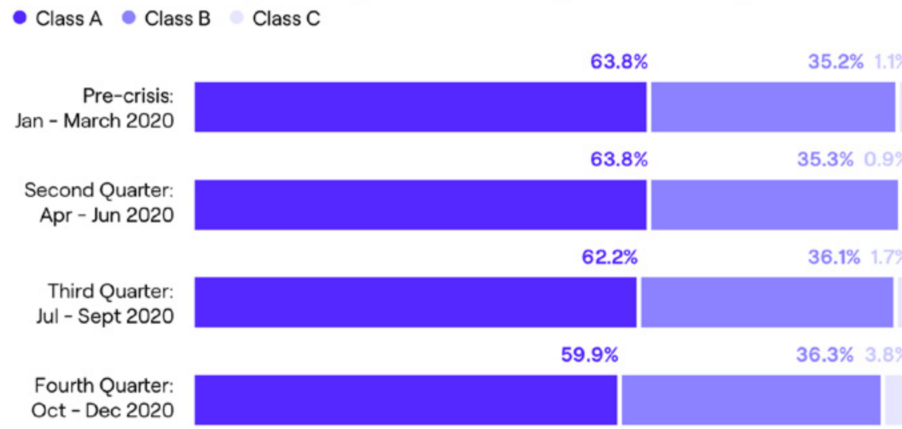
While New York City struggles alongside other markets to build and sustain confidence in the future, active demand is more often for premium office spaces, indicating a continued flight to quality. After jumping up to 83 percent during the second quarter, the share of tours in Class A or Trophy spaces in NYC has since begun to move back to the 57 percent share seen during the first quarter of 2020. That said, Class A and Trophy spaces are still taking up more than their typical share in the market at 69 percent in the last quarter of 2020, positioning New York City as the only market with a significant and measurable flight to quality.

Driving some of this dynamic is the increased supply due to new construction and rising vacancies in Trophy and Class A, providing a new opportunity for tenants. Additionally, a desire for newer, higher quality buildings that are more "COVID-19 friendly" as well as the relative financial strength of tenants still active in the market have also contributed to a shift in demand.

NYC Demand by Building Class



National Demand by Building Class (excluding New York City)



Looking Ahead

Without significant progress on the coronavirus pandemic, we will be unlikely to see sustained growth in office demand. Without knowing when they'll be able to move into a new space with their employees, most tenants will remain in a holding pattern. But it's not just the pandemic directly, the economic impact to smaller companies in particular has been devastating and it will take economic stability and potentially more stimulus to build momentum again.

Signs of a credible plan and progress are building. The vaccine rollout, although more logistically challenging than expected, means timelines for re-opening are becoming more tangible. We're not out of the woods, but the light is beginning to filter through. The coming late winter and early spring months typically bring with them a burst in office demand activity. The activity we see this spring will likely be bolstered by this growing confidence. The VODI is ready to capture it.

	NATIONAL	BOS	CHI	L.A.	N.Y.C.	SEA	S.F.	D.C.
December 2019 VODI	82	85	49	72	105	83	75	92
February 2020 VODI (pre-crisis)	94	103	55	95	128	86	56	110
October 2020 VODI	42	47	26	68	43	34	13	66
November 2020 VODI	34	44	17	61	33	22	15	48
December 2020 VODI (current)	32	40	15	62	33	17	20	42
VODI Change from February 2020 to Trough (%)	-85.1%	-74.8%	-83.6%	-88.4%	-94.5%	-88.4%	-94.6%	-72.7%
VODI Change from February 2020 to current (Dec.) (%)	-66%	-61.2%	-72.7%	-34.7%	-74.2%	-80.2%	-64.3%	-61.8%
Quarter-to-Quarter VODI Change	-11	-2	-17	5	-16	-20	5	-22
Quarter to Quarter VODI Change (%)	-25.6%	-4.8%	-53.1%	8.8%	-32.7%	-54.1%	33.3%	-34.4%
Year-to-Year VODI Change	-50	-45	-34	-10	-72	-66	-55	-50
Year-to-Year VODI Change (%)	-61%	-52.9%	-69.4%	-13.9%	-68.6%	-79.5%	-73.3%	-54.4%

Methodology

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The VODI reflects the total square feet toured by tenants in a given month relative to the total property square feet tracked in VTS' expansive network of leasing, marketing, and asset management software. to control for new construction and VTS' own market expansion.

The reported index is a smoothed but not seasonally adjusted view of this demand ratio. The smoothing procedure is a symmetric 3-month moving average where the concurrent month's value is weighed twice as heavily as either of the adjacent months to better surface overall trends without losing the month-to-month variability of interest to market analysts during this time. To compute the most recent month, VTS projects the relative demand ratio forward by one month using the seasonality inherent in the raw national series before smoothing.

To enhance comparability across regions, VODI is reported as an indexed value from the base month, January 2018.

To ensure viability of VTS data for market insight, VTS suppresses data points reflecting information from less than four customers and all data aggregated prior to January 2018.

About VTS

VTS is commercial real estate's leading leasing, marketing, and asset management platform where the industry comes to make deals happen and real-time data comes to life. The VTS platform captures the largest first-party data source in the industry, which delivers real-time insights that fuel faster, more informed decision making and connections throughout the deal and asset lifecycle. VTS Data, the industry's only forward-looking market dataset, and VTS Market and Marketplace, the industry's first integrated online marketing solution, give landlords, brokers, and tenants unparalleled visibility into real-time market information and the direct connectivity to execute deals with greater speed and intelligence at every point in the planning, marketing, leasing, and asset management cycle.

More than 60% of Class A commercial space in the U.S. and 12B square feet of commercial real estate globally is managed on the VTS platform. Our user base includes over 45,000 CRE professionals including respected industry leaders like Blackstone, Brookfield Properties, LaSalle Investment Management, Hines, Boston Properties, Oxford Properties, JLL, and CBRE. To learn more about VTS, and to see our open roles, visit **www.vts.com**.

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