THIS MONTH

REPORT

Seizing Strategic Opportunities in a Transforming U.S. Office Market

10000 Energy Drive

EXECUTIVE SUMMARY

01

Hybrid Work Transformation
The U.S. office market is adapting to hybrid work trends, with a notable shift toward flexible, hybrid-oriented workspaces. This evolution requires significant investment but offers strategic opportunities for investors focused on properties adaptable to modern work needs.

02

Quality-Focused Demand in Prime Office Spaces
A ‘flight to quality’ is emerging, as prime office spaces demonstrate resilience and stability in a shifting market. Prime properties command significant rent premiums, creating a valuable niche for investors targeting high-quality assets in key U.S. cities.

03

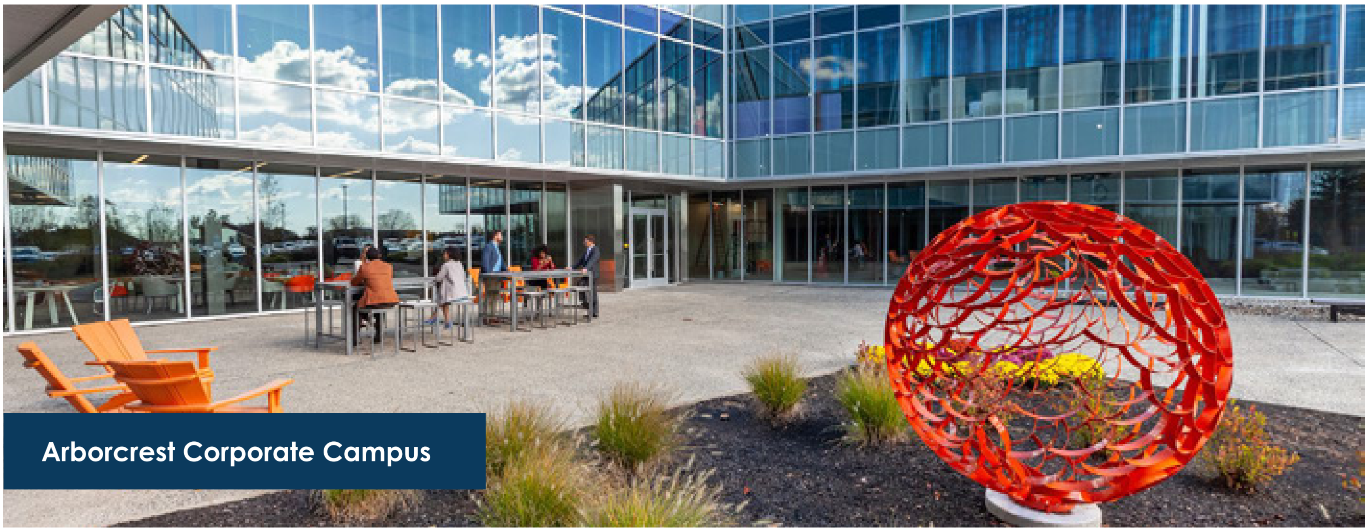
Regional Growth and Market Segmentation
The South and select secondary markets show strong net absorption rates, offering lucrative entry points. Prime regions and specific locations with high demand fundamentals are likely to support steady rent growth and long-term value.

04

Capital Markets and Funding Strategies
With $2.81 trillion in commercial real estate (CRE) loans set to mature between 2024 and 2028, office loans account for a substantial portion. Investors with available capital can capitalize on private credit and alternative financing to acquire assets in distressed segments, particularly where recapitalization is needed.

05

Adaptive Reuse as a Value-Add Strategy
High vacancy rates create opportunities for adaptive reuse, particularly in high-growth sectors like healthcare and technology. By repositioning underperforming office assets, investors can diversify their portfolios and meet demand in these emerging asset classes.



Arborcrest Corporate Campus

STEADY ECONOMY AND FED RATE CUTS PROVIDE STRATEGIC PIVOT

For investors following politics in the United States, it might seem like the country is perpetually on the brink of an economic crisis. However, this perspective doesn't capture the full picture.

As President Donald Trump prepares to take office, he is set to inherit an economy that appears strong. The stock market is hitting record highs, unemployment is historically low, and the gross domestic product (GDP) has been growing at a steady rate of around 2.5% this year. At the same time, it is also true that despite the economy's resilience, many Americans are not experiencing this prosperity. Even with positive indicators like easing inflation, robust hiring and consistent growth, optimism remains elusive due to the lingering effects of prolonged inflation. Notably, lower inflation has not led to lower prices.

U.S. GDP Growth - 2024

Quarter	Real GDP Growth (Annualised)
Q1	1.6%
Q2	3%
Q3 (Prelim)	2.8%

Table 1: US GDP At a Glance

*US Bureau of Economic Analysis
In our last report on the U.S. Commercial Real Estate outlook, we projected a much brighter horizon for 2024 going into 2025. This optimism hinged on a forecast that the Federal Reserve would implement three rate cuts this year. With two of those cuts already in place, we anticipate a gradual uplift in public sentiment as the effects continue to filter through the economy.

Federal Funds Target Rate

July 2000 - November 2024

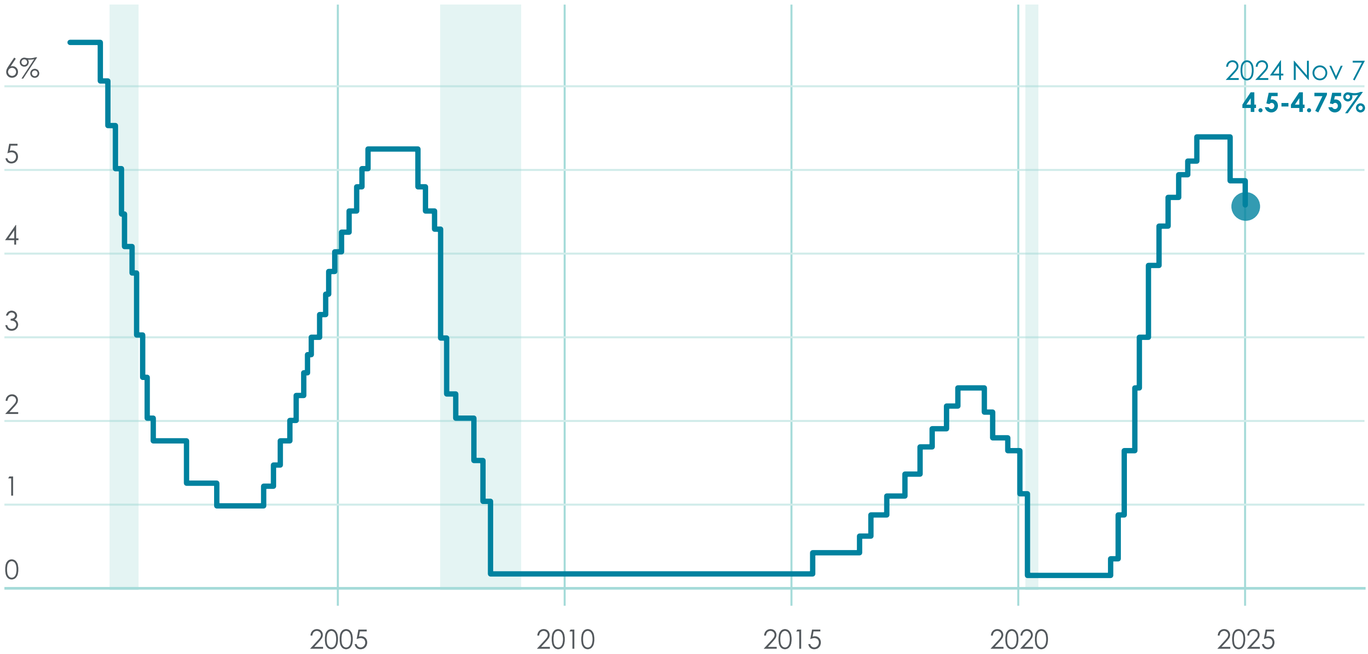


Figure 1: Federal Funds Target Rate

However, it is important to keep in mind that while Federal Reserve policy rates are expected to reach around 3.0% by mid-2025, even that level would represent the highest benchmark interest rates since 2008. This means that the upcoming cycle will likely be the first in many decades that has higher benchmark rates, on average, than the previous cycle.

In this report, we will examine how this backdrop is shaping consumer behavior and its impact on the commercial office sector in the U.S.

EVOLVING WORK LANDSCAPE: HYBRID-DRIVEN TRANSFORMATION

The U.S. office market is undergoing a serious transformation, with hybrid work emerging as the preferred model among American employees. Despite corporate management's push for a full return to the office, employees are steadfast in their desire for flexibility. This shift has pressured office landlords to invest heavily in transforming traditional workspaces into flexible, hybrid-oriented environments. While essential for retaining corporate tenants, these adjustments represent a significant expenditure.

For high-net-worth and institutional investors, this evolution offers an opportunity to pivot strategically in an evolving market.

According to JLL's 'US Office Market Dynamics' report, the office market hit a key milestone in Q3 2024, with leasing activity increasing and new supply slowing significantly. This trend is beginning to drive the first sustained reduction in office availability since 2019. The demand for more adaptable office spaces is gradually stabilizing, as tenants recalibrate their long-term space requirements in a hybrid era.

While these shifts pose challenges, they also present unprecedented opportunities. Prime office spaces outperform non-prime ones, with tenants gravitating toward high-quality assets equipped with modern amenities that align with flexible work models. This 'flight to quality' reinforces the case for targeting premium office properties in key U.S. cities where rental rates continue to command significant premiums.

PRIME VS. NON-PRIME: QUALITY IS THE NEW CURRENCY

In a market increasingly segmented by quality, prime buildings have emerged as safe-haven assets. Prime vacancy rates were 14.8% as of Q1 2024, compared to 19.3% in non-prime properties, with the difference attributable to tenants' preference for premium spaces. From Q1 2020 to Q1 2024, prime spaces achieved positive net absorption of 49 million square feet, whereas non-prime buildings lost 170 million square feet, underscoring the relative stability and value retention of high-quality properties.

This quality-focused demand is driving prime rents sharply higher. Prime office rents in Q1 command an 84% premium over non-prime rents, up from a 60% premium in 2018. This trend shows no sign of abating, and with a shrinking pipeline of new construction, prime office assets should continue to attract tenant interest and command elevated rents. For high-net-worth investors, the lesson is clear: prioritize quality assets in top-tier locations where the demand for premium office space remains robust and resilient.

Oakmont Point

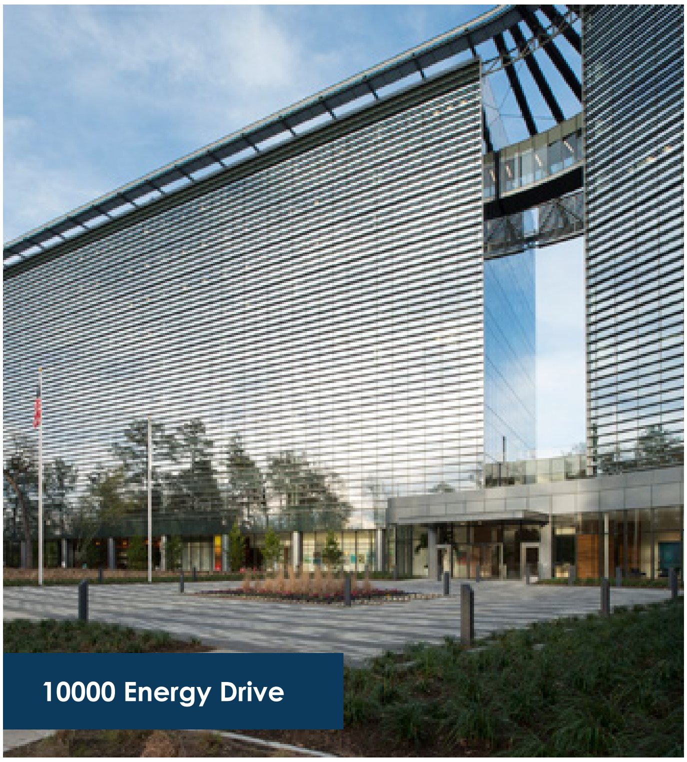
LABOR MARKET AND LEASING TRENDS: CATALYSTS FOR DEMAND

While new office-using jobs have contributed an estimated 243.2 million square feet of office demand since early 2020, office-using job growth has slowed compared to broader employment gains. However, for investors with a selective eye, this slowdown could provide opportunities to capitalize on quality assets in high-growth markets. As hybrid work gains traction, the average lease size has shrunk by 13.5% since the pandemic, signaling a continued preference for smaller, adaptable office spaces that suit flexible work models.

Investment banks and high-net-worth investors can focus on markets with sustained demand from office-using employment. In cities with resilient job markets and vibrant mixed-use districts, prime properties can provide stable cash flow and potential for capital appreciation, even as hybrid work reshapes the broader office demand landscape.

REGIONAL AND RENT TRENDS: STRATEGIC ENTRY POINTS

Geographically, the South has emerged as a regional outperformer, with net absorption gains recorded in Q3 2024, driven by markets like Dallas, which has seen high volumes of pre-leased construction. Secondary and tertiary markets have also posted positive absorption, with standouts such as Northern New Jersey and Columbia, SC. Such areas offer strategic entry points for investors seeking long-term returns in regions where the demand for quality office space is rising alongside job growth.



10000 Energy Drive

A good example is Sidra Capital's 10000 Energy Drive, located in North Houston, Texas, where the North Tower serves as the headquarters for the esteemed Southwestern Energy Company. These two Class A, amenity-rich, LEED Gold-certified office towers that stand as a testament to modernity and sustainability, offering a total of 558,055 square feet of net leasable area.

On the rent front, national asking rents rose 0.8% year-on-year "YoY" in Q3 2024, with major markets seeing gains of 1.6% YoY. While high tenant concessions remain a feature of the market, effective rents in prime locations are stabilizing, and in some cases, rising. These trends underscore the relative value of prime markets where effective rent growth is likely to outpace concessions. Investors focused on long-term value should therefore target geographies with a healthy supply-demand balance and strong office fundamentals.

TACKLING LOAN MATURITIES AND FUNDING GAPS

Despite the challenges of lower transaction volumes and higher interest rates, several of the main types of CRE lenders continued to grow. With traditional bank lending constrained by regulatory scrutiny, alternative financing – such as private credit – has emerged as a viable solution to recapitalize existing debt and support new acquisitions. Across all lender types, $2.81 trillion in loans will come due between 2024 and 2028, inclusive. This creates both risks and opportunities for capital-rich investors.

For investors less reliant on debt capital, this period could present an acquisition window as distressed or highly leveraged owners seek liquidity solutions. This temporary dislocation creates potential for value-driven acquisitions, especially in markets with limited new construction and growing demand for adaptive reuse.

INVESTMENT INSIGHTS FOR HIGH-NET-WORTH INVESTORS

With the national vacancy rate hovering around 20.4%, adaptive reuse has become a compelling option for underperforming office properties. Demand for alternative uses, such as multifamily, healthcare, and science & technology facilities, provides new pathways to maximize real estate investments. With expertise across multiple asset classes, we offer clients deep analysis of similar potential opportunities, assessing scope, risks and returns to identify the optimal fit for each investor.

For investors seeking long-term growth in U.S. commercial real estate, our guidance is to look beyond conventional strategies and embrace adaptable approaches. Prime office assets in established markets are likely to remain resilient, while hybrid work and shifting tenant preferences underscore the importance of flexibility. Strategic priorities for high-net-worth and institutional investors should include:

01 **Focus on Premium Assets:** Prioritize high-quality properties in core markets with solid demand fundamentals and stable, long-term rent growth prospects.

02 **Capitalize on Adaptive Reuse:** Consider alternative uses for traditional office properties in prime locations, diversifying portfolios with assets in high-growth sectors like multifamily, healthcare, and science & technology.

03 **Leverage Alternative Capital:** Explore private credit and other financing structures to capitalize on opportunities arising from the current capital markets landscape, while extending reach into prime locations and high-demand asset classes.

04 **Focus on Premium Assets:** Invest in value-add strategies to enhance asset value, whether through adaptive reuse, repositioning, or targeted renovations that improve tenant experience and rental income potential.

CONCLUSION

As we navigate the evolving landscape of the U.S. office market, it is critical to be armed with strategic insights that are needed to capitalize on the unique opportunities presented by this period of transformation. For high-net-worth investors and institutions, a disciplined, quality-focused investment approach, paired with adaptability to market shifts, will be the key to seizing value in the dynamic U.S. office sector.

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