Trepp®
CMBS Research

August 2017

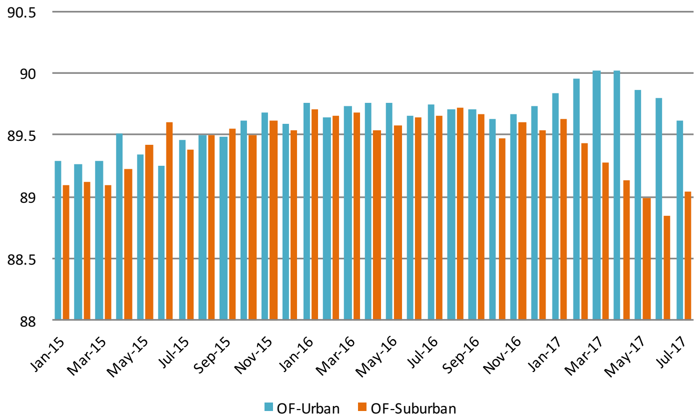
Have Millennials Forced Corporations to Leave Suburban Offices?

Trepidation towards the suburban office market has risen in recent years, as a number of the country's largest corporations have fled their suburban headquarters for urban office space. Such companies include McDonald's, Kraft Heinz, and ConAgra Foods, which have each relocated from the Chicago suburbs to downtown urban offices since 2015. Manufacturing giant Caterpillar followed suit in February and announced that it was moving its headquarters from Peoria, Illinois to Chicago. General Electric, UBS, and health insurer Aetna have each taken similar strides away from their suburban headquarters in Connecticut for Boston and Manhattan. Millennials are thought to be the driving force of this urban exodus, as companies continue to find top talent in larger, urban environments. *Business Insider* also notes that millennials — who outnumber every other generation in the US — prefer public transportation, accessible fast-casual restaurants, and apartment-based amenities, which are all typically offered in an urban setting. Businesses want to either hire or sell to millennials, which is why more firms are beginning to relocate from secluded, traditional suburban office parks to more modern office space in cities where millennials prefer to live.

On the other hand, many in the industry argue that the suburban office market is actually showing signs of strength and growth potential. For one, rents for class-A suburban office space are typically half of the amount than that of class-A office space in central business districts. *National Real Estate Investor* observes that some large companies — especially tech giants like Google, Facebook, and Apple — continue to lure young talent to the suburbs with creative office campuses that provide a number of amenities, along with greater housing affordability.

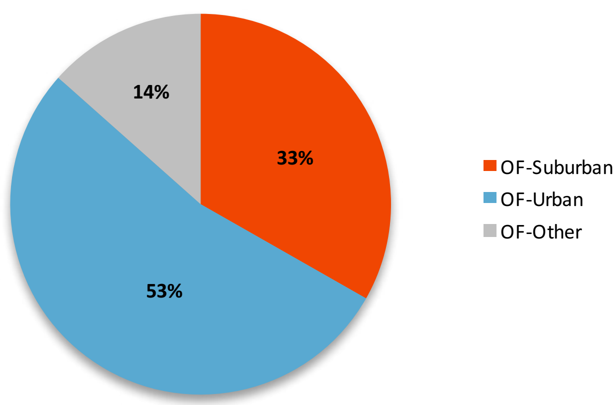
The data indicates that suburban and urban office properties behind CMBS loans have comparable occupancy levels, though the gap has widened in 2017. Average occupancy has been hovering just below the 90% mark for both subsectors over the last three years. On average, urban office loans are 89.6% occupied, and suburban offices lagged that number by half of a percentage point in July. However, the suburban office subsector has a substantially higher percentage of loans in distress, which may reinforce the idea that tenant migration towards urban offices is becoming a nationwide trend.

GRAPH 1: SUBURBAN OFFICE CMBS - HISTORICAL AVERAGE OCCUPANCY



Source: Trepp

GRAPH 2: OFFICE CMBS - TOTAL BALANCE



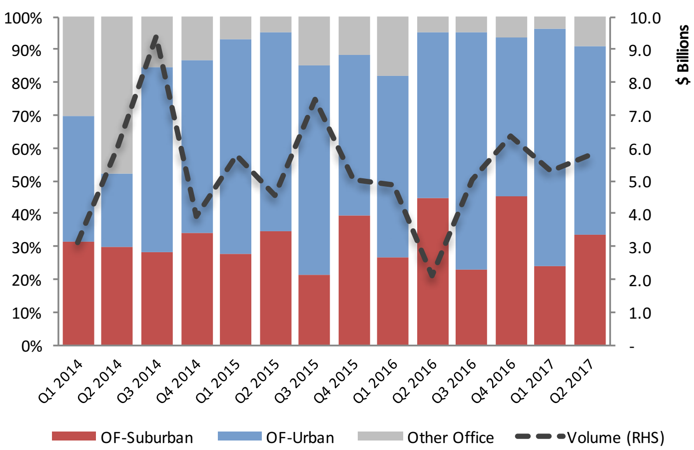
Source: Trepp

Suburban Office Issuance Shows No Signs of Slowing

Private-label office loans amount to $125.1 billion in outstanding CMBS debt, the majority of which is allocated to urban office properties. Suburban office loans account for 33% of the total outstanding office loan volume.

In 2016, suburban office securitizations comprised 34.1% of the year's office issuance total. Suburban office allocation has represented just 26.4% of the sector's issuance in 2017 year-to-date. New issuance for suburban offices reached $3.2 billion in the first half of the year, which is up 43% year-over-year for the segment.

GRAPH 3: OFFICE CMBS - QUARTERLY ISSUANCE

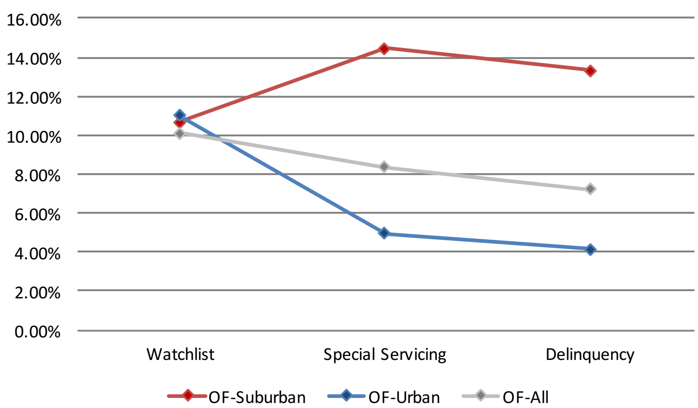


Source: Trepp

High Percentage of Suburban Office Loans in Distress

According to Trepp data, office CMBS debt carries one of the highest distressed volumes among all major property types seen in recent years. Within the office sector, urban office loans are outperforming, while suburban offices carry the highest percentage of distressed debt. About 8.4% of outstanding CMBS office debt is currently in special servicing. The rate of urban office debt in special servicing comes in at a relatively low figure 4.9%. The rate jumps to 14.5% for suburban offices.

GRAPH 4: OFFICE CMBS - DISTRESS RATES

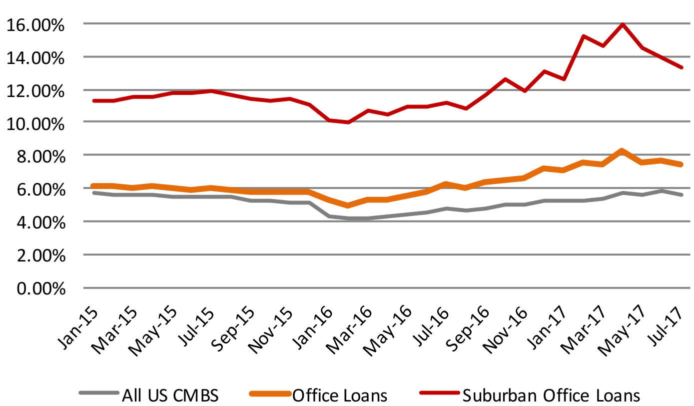


Source: Trepp

Already Elevated Suburban Office Delinquency Rate Jumps Higher

The suburban office subsector carries a notably high delinquency rate of 13.3%, while the reading for the broader office sector is currently 7.24%. In comparison, the delinquency rate for all US CMBS loans was 5.49% in July. The difference between the suburban office delinquency rate and that of the the broader office sector has been nearly 5% or higher since the start of the wall of maturities in 2015. The suburban office delinquency rate peaked in April, as it hit 15.9%.

GRAPH 5: OFFICE CMBS - DELINQUENCY RATES



Source: Trepp

CHART 1: SUBURBAN OFFICE CMBS – FIVE LARGEST LOANS TURNED NEWLY DELINQUENT IN JULY 2017

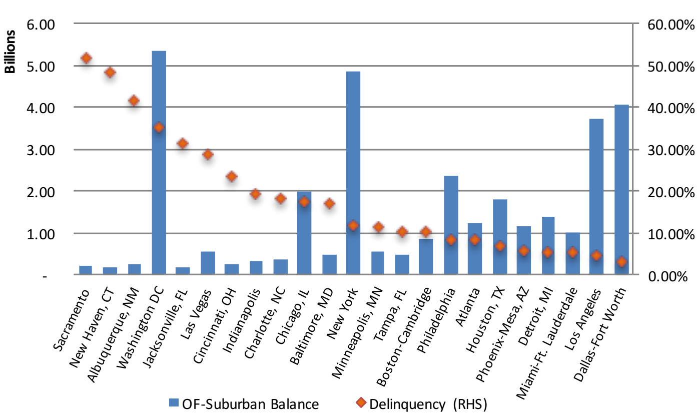
BLOOMBERG NAME	PROPERTY NAME	BALANCE	CITY	STATE	DELINQUENCY STATUS
GSMS 2012-GCJ7	545 Long Wharf Drive	$28.6M	New Haven	CT	30 Days
GSMS 2007-GG10	CitiFinancial	$27.7M	Fort Mill	SC	Non-Performing Beyond Maturity
BACM 2007-4	Belward North	$12.4M	Rockville	MD	Non-Performing Beyond Maturity
BACM 2007-4	Belward South	$10.1M	Rockville	MD	Non-Performing Beyond Maturity
CGCMT 2007-C6	Alverson Taylor Mortensen & Sanders Law Office	$8.7M	Las Vegas	NV	Foreclosure

Source: Trepp

The largest suburban office loan to become newly delinquent in July was the $28.6 million 545 Long Wharf Drive note, which makes up 2.34% of the remaining balance behind CMBX 6 deal GSMS 2012-GCJ7. The underlying collateral is a 249,962 square-foot office located in the New Haven-Milford, Connecticut MSA. The note was transferred to special servicing in May due to imminent monetary default, as the largest tenant — AT&T with 71.2% of the general leasable area — did not renew its lease which expired shortly after the first quarter.

Unsurprisingly, suburban offices in top-tier markets feature the highest delinquent volumes, as these submarkets face the highest risk of companies migrating to nearby central business districts. Delinquency rates are particularly high in Jacksonville, New Haven, Sacramento, Washington D.C., Cincinnati, Chicago, and Las Vegas.

GRAPH 6: SUBURBAN OFFICE CMBS - DELINQUENCY RATES BY MSA

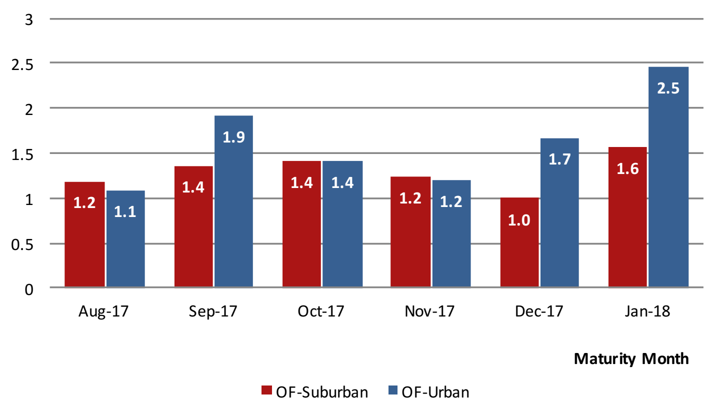


Source: Trepp

Outlook

Suburban office loans are underperforming the broader office CMBS market, with delinquencies at peak levels and a high volume of debt being specially serviced. However, issuance levels for suburban office loans have increased on the year, signifying that demand is still relatively steady. When comparing the current weighted-average DSCR levels of urban and suburban office loans due to mature over the next six months, urban office loans are generally outperforming. Urban office loans maturing between August and January 2018 carry a weighted-average DSCR of 1.57x, while the levels for suburban office loans maturing within the same timeframe average 1.30x.

GRAPH 7: OFFICE CMBS - WEIGHTED-AVERAGE DSCR BY MATURITY MONTH



Source: Trepp

Even as some of the largest American companies reposition from suburban office park headquarters to urban digs, many in the industry have contrasting views on what this implies, and to the extent that it will continue. While some fear of a mass exodus from suburban offices to urban home bases, others believe suburban markets will be able to adapt and remain desirable for other large companies. Connecticut is a major suburban office hub that has taken considerable hits in recent years, with major relocations from General Electric, Aetna, and Travelers Cos. Although these departures make for negative headlines, *Hartford Business* shares that the nationwide migration towards urban office space is often a management trend, in which companies "are increasingly separating their corporate executives from the rest of their workforce." General Electric, Travelers Cos., and Aetna still maintain the bulk of their employees at their suburban offices. Rather than an exodus, companies may simply be reallocating more resources and top talent to urban offices, while still maintaining demand for suburban quarters.

Although the suburban office market overall is underperforming the broader office segment in terms of loan performance, the subsector is still showing signs of strength in positive absorption over the last several years. To boot, vacancy rates have been hovering near pre-recession lows. However, *Bisnow* makes an important observation: "A lot of [suburban] markets that registered strong absorption have an urban feel," such as West Los Angeles, and Scottsdale, Arizona. Millennials prefer "offerings such as access to public transportation, walkability, housing options, access to jobs and available amenities," which thriving suburban office markets have been able to provide. Therefore, a suburb's fundamental strength would seemingly rely on its ability to implement urban-like features and amenities. Looking ahead, suburban office loan performance might coincide directly with the versatility of the corresponding area.

For inquiries about the data analysis conducted in this research, contact press@trepp.com or 212-754-1010.

For more information about Trepp's commercial real estate data, contact info@trepp.com

About Trepp

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