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From the Philadelphia Business Journal:

<https://www.bizjournals.com/philadelphia/news/2023/02/06/office-rents-concessions-landlord-income.html>

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Concessions offered to lure office tenants are eating away at landlords' income

Feb 6, 2023, 9:30am EST



Getty Images (Sascha Kilmer)

In New York, average work values (or tenant-improvement allowances) are up more than 46% since the third quarter of 2019, according to CompStak Inc.

A growing spread between starting and effective rents illustrates how office landlords — even among coveted Class A buildings — are seeing their rental income eroded as the office market remains squarely in favor of tenants.

It represents another challenge facing the office market, which continues to see depressed leasing activity and rising vacancy, including from sublease space.

New York commercial real estate data and analytics company CompStak Inc. found, since the end of 2019, Class A effective rents in office space across markets it analyzes are up 1.4% while starting rents are up 4.5%. Starting rent is the rate at which a lease is signed

while effective rent represents the rate after concessions are factored in.

"What we're seeing is, even if starting rents look like they're back to pre-pandemic levels or even exceeding it, the amount of concessions landlords are offering are well above pre-pandemic, which is really affecting the income to the landlord," said Alie Baumann, director of real estate intelligence at CompStak.

Even with flight-to-quality being a demonstrated trend across the U.S., it's become increasingly necessary for landlords — including owners of the most desirable office space — to offer incentives to attract a smaller pool of companies in the market today.

CompStak found the average amount of free months awarded for Class A office space is up 42.9% from the end of 2019, to 6.2 months, while it's up 32.1% for Class B space, to 3.9 months. Among Class B office space tracked by CompStak, effective rents are down 4.4% since the end of 2019, and starting rents are down 1.8% during the same period.

Landlords are generally unwilling to budge much on rents advertised for a building, Baumann said, another reason why so many have upped concessions like free rent and additional tenant-improvement allowances since the pandemic.

The average work value — a term used by CompStak to describe tenant-incentive allowances — awarded for Class A office space is up 48.9% from the end of 2019 to \$58 per square foot, according to CompStak. In Class B space, the average work value is up 32.3% from late 2019, to \$31 per square foot.

In New York, average work values are up more than 46% since the third quarter of 2019, according to CompStak, and free months can comprise up to 8% of a total lease term.

Work values are elevated now not only because of a softer office market but also to offset higher construction costs for space buildouts.

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Ashley Fahey

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