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Key differences in which office markets are seeing growth in sublease inventory

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Nationally, the amount of sublease space increased by almost 24% between Q1 2022 and Q1 2023 among 50 metro areas examined by Moody's Analytics Inc.

Office sublease space is growing across the United States, but there are key trends that dictate which cities are seeing the greatest increase in space coming to market.

Perhaps unsurprisingly, the Northeast saw the biggest increase in the amount of sublease space listed on the market between the first quarter of 2022 and the first quarter of 2023, an analysis by New York-based Moody's Analytics Inc. recently found. Among major Northeastern cities, Boston saw the biggest increase in that time period, with its sublease inventory growing 83.2% in that one-year period.

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A few markets elsewhere actually saw their sublease inventory decrease in the past year, including smaller Midwestern cities like Wichita, Kansas, which saw its sublease space drop 21.7% between Q1 2022 and Q1 2023.

Ricardo Rosas, data analyst at Moody's, said the Northeast as a whole saw its sublease space grow about 32% between Q1 2022 and Q1 2023, while the South Atlantic region's sublease market grew about 10% in that same one-year period.

Moody's analysis found a few geographic outliers, including Tulsa, Oklahoma, where sublease space grew the most among the metros that were analyzed — 98.5%. Minneapolis followed at No. 2, with a 92.3% increase; Boston was third; Seattle ranked No. 4, with 77.2% growth in sublease space; and Orange County, California, saw its sublease inventory grow by 76.9%.

The markets that saw the biggest decrease in sublease space between Q1 2022 and Q1 2023 were Memphis, Tennessee (31.7%); Little Rock, Arkansas (22.3%); Wichita; suburban Virginia (18.1%); and Cleveland (18.1%).

Nationally, the amount of sublease space increased by 23.9% between Q1 2022 and Q1 2023, among the 50 metro areas examined by Moody's.

Rosas said commuting times and patterns impact return-to-office activity geographically, with a previous Moody's analysis having examined the change in office vacancy rates in the context of how long it takes a person to travel from home to work.

"In bigger cities, like New York and Boston, the commute can take considerably longer, and we saw those markets with longer commutes tend to have higher vacancy rates," Rosas said. "The ones that are seeing sublease space decreasing, those tend to have shorter commutes.

He cited as an example Greenville, South Carolina, where close to 50% of the population commutes less than 15 minutes between their homes and their offices, making those workers potentially more inclined to work in the office, Rosas said.

Nick Villa, associate director at Moody's, said another factor likely weighing on how much sublease space a market is seeing today is the percentage of Class A versus B and C office buildings in a particular city. Northeastern markets like New York and Boston tend to have an older supply of office space, with the average age of office buildings in New York being 50 years old. Southern cities like Charlotte, North Carolina, tend to have newer office buildings.

Exposure to the technology industry — a source of a significant amount of office sublease space — is another factor impacting whether a metro area is seeing growth or decline in sublease space.

"... (B)efore there was any economic impact, (technology) positions were easier to work from home, and utilization of office space wasn’t as high to begin with," Rosas said. "When you add the economic problems they may be facing, they’re in more immediate need to get cash flow and they try to do that by subleasing their office spaces. That’s why it’s primarily affecting the tech market."

Rosas said sublease activity is starting to expand to other industries, but that hasn't been observed in magnitude yet.

Eventually, higher amounts of sublease space will convert to direct vacancy if those spaces aren't leased by another tenant before a property's term has expired. That's expected to push up the national vacancy rate and, to varying degrees, vacancy rates in cities across the country. It also likely would add pressure to the estimated $8.9 billion in fixed-rate commercial mortgage-backed securities loans set to mature this year.

"Different tenants are starting to reevaluate how much space they need," Villa said. "There's been a lot of consolidation across the sector; it’s been under a lot of stress overall. A confluence of factors will keep the office vacancy rate high."

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