NEWMARK

Office Buildings and Commercial Property Valuation Issues

NATIONAL CONFERENCE
STATE TAX COURT JUDGES

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REAL ESTATE ECONOMICS – PRINCIPLE OF CHANGE

The Covid-19 pandemic and similar events re-enforce the notion that to understand property markets, you need to understand change.

As pointed out by Dr. Hugh Kelly, there are five forms of change fundamental to real estate economics that interact with one another (see "Change? It's Complicated!", *Real Estate Issues*, Volume 49, Number 13, The Counselors of Real Estate (July 23, 2025).

- Cycles
- Trends (e.g., vacancy as leading indicator)
- Change of state
- Maturation
- Disruption

REAL ESTATE ECONOMICS – PRINCIPLE OF CHANGE

Each state of change rarely exists alone. They interact dynamically with one another.

In terms of degree, "disruption" tends to be the most sudden form of change. It is often caused by a "black swan" event that causes temporary chaos in financial and property markets and in society in general. Some examples of more recent black swan events include:

Note that Covid-19 and 9/11 did not have economic causes.

- 2020 - Covid-19 Pandemic
- 2008 – Subprime Mortgage and Global Financial Markets Crisis
- 2001 – Collapse of Dot-Com Bubble
- 2001 – 9/11
- 1990 – Savings and Loan Crisis

VARYING EFFECTS OF COVID-19

Covid-19 did not affect property types in the same way.

Office:	Still recovering; more to come
Industrial:	Booming during Covid-19; strong but not as robust, data centers
Retail:	Sluggish prior to Covid-19 due to changes in buying habits, retail industry consolidation, efforts to reimagine properties
Residential:	Except for select areas, demand was significantly reduced; urban centers suffered most; flight from cities; Florida, which benefitted from in-migration during the pandemic, had the highest foreclosure rate of single-family homes in 3Q 2025
Hospitality:	Fewer travelers; diminished demand; strong rebound
Restaurants:	Not all survived; resourceful relance on take outs

PRIMER - BASIC TERMS

Some basic terms used in the real estate industry include

- Gateway Cities
- Rent per available foot (“RPAF”)
- Vacancy rate/availability rate
- Concessions (free rent, tenant improvement allowance, others)
- Face rent/effective rent
- Net absorption/negative absorption
- Trailing 12 months
- Occupier
- Supply (inventory *plus* under construction)

OFFICE BUILDING CLASSIFICATIONS

Office buildings have traditionally been characterized as

- Class A
- Class B
- Class C

Highest quality properties are also identified as “investment grade” or “institutional grade” properties. These investments are typically characterized by

- Magnitude of the investment required
- Location
- Age, size, and quality of construction, amenities provided
- Physical appeal and reputation
- Financial stability and economic security (creditworthiness of the tenants, potential for resale)

OFFICE BUILDING CLASSIFIACTIONS

Situs, a highly respected real estate industry data provider, recognizes that property markets have become more stratified and more nuanced. Situs divides properties into more nuanced, more discrete layers or “tiers”

- Both Tier 1 and Tier 2 properties are in the same cohort as Class A office buildings
- Teir 2 properties are older Tier 1 properties but continue to share many of the physical and reputational attributes, quality tenants, and location characteristics of Tier 1 assets.

Whether considered by class or tier, such metrics provide context, insights, and guidance to capital market participants to assist in evaluating risk and better understand capitalization rates, vacancies, discount rates, leasing assumptions, and other important markers.

Office building classification is critical to the real property valuation process because it drives rent, vacancy, and capitalization rate decisions, among others.

STATE OF THE OFFICE MARKET

Market	Vacancy Rate	Avg. Asking Rent
National	20.50%	$38.14
Atlanta	26.50%	$32.62
Charlotte	27.80%	$34.16
Dallas	24.70%	$31.14
Denver	30.20%	$35.06
DC	19.70%	$55.35
Houston	25.50%	$28.69
Jacksonville	17.20%	$22.90
Los Angeles	24.90%	$47.40

Market	Vacancy Rate	Avg. Asking Rent
Manhattan	12.90%	$75.49
Miami	15.00%	$59.63
Milwaukee	21.60%	$20.54
Minneapolis	19.70%	$28.65
Nashville	18.50%	$32.69
North Jersey	18.00%	$31.76
Philadelphia	22.00%	$31.53
Phoenix	25.30%	$30.15
San Francisco	30.60%	$66.25

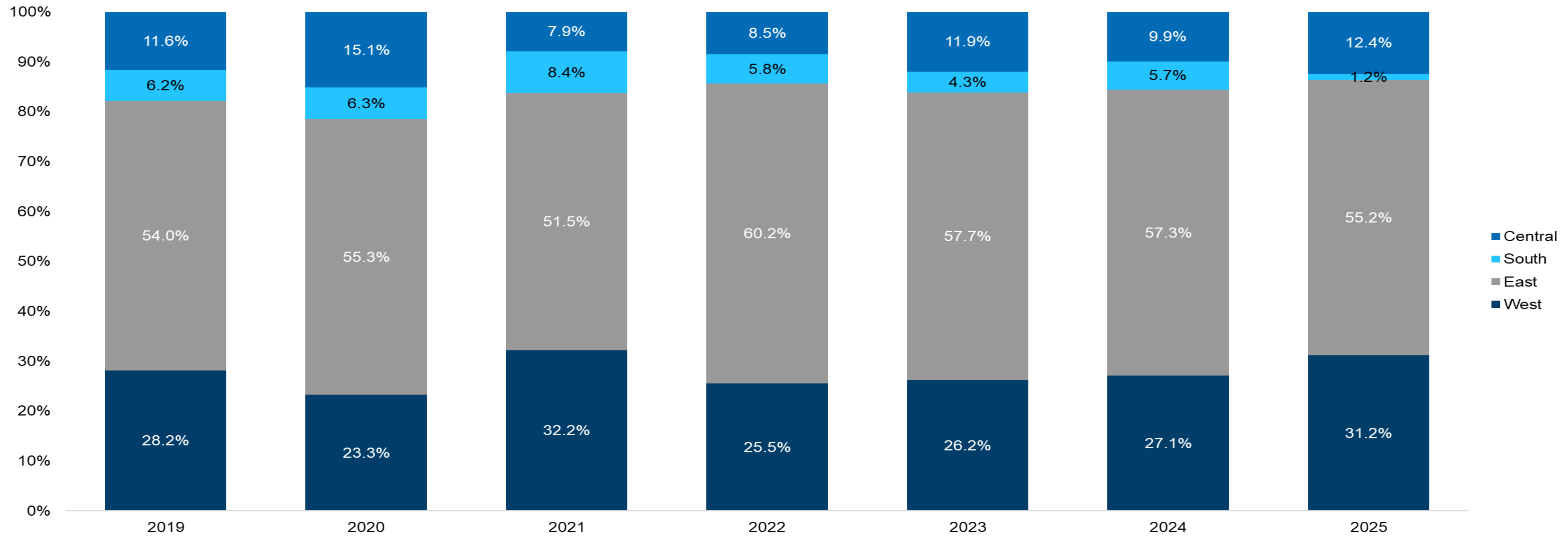
PRE-PANDEMIC LEASES YET TO EXPIRE

This analysis relates to leases greater than10,000 square feet.

Market	% of Pre-Pandemic Leases Yet to Roll
National	**49%**
New York	57%
Boston	50%
Los Angeles	47%
Miami	44%
San Francisco	43%
Atlanta	31%
Dallas	29%

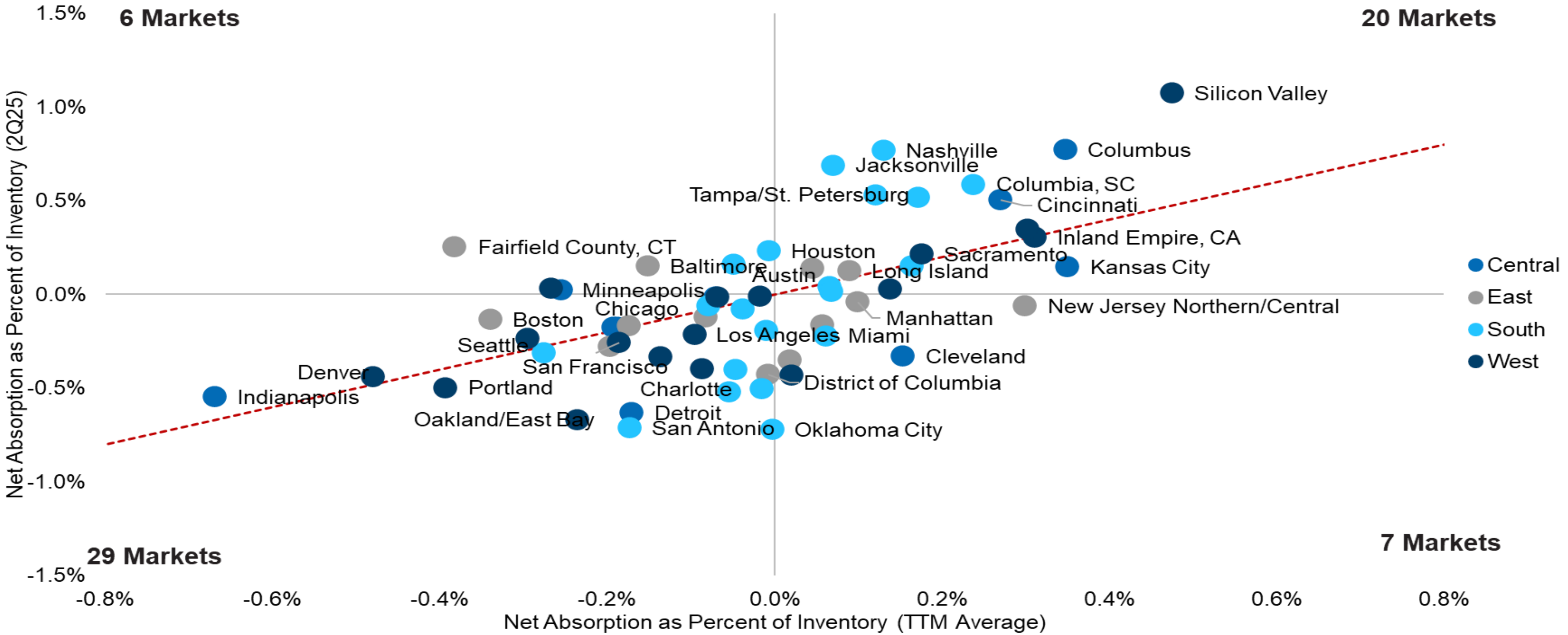
LARGE BLOCK LEASING

The East Region has historically dominated large block leasing activity (i.e., leases ≥ 50,000 square feet). This trend continued in 2Q 2025. New York City accounted for 40.5% of large block leasing in the East. The West has shown meaningful growth. Signs of San Francisco revival. Year-over-year growth is highest since 2021.



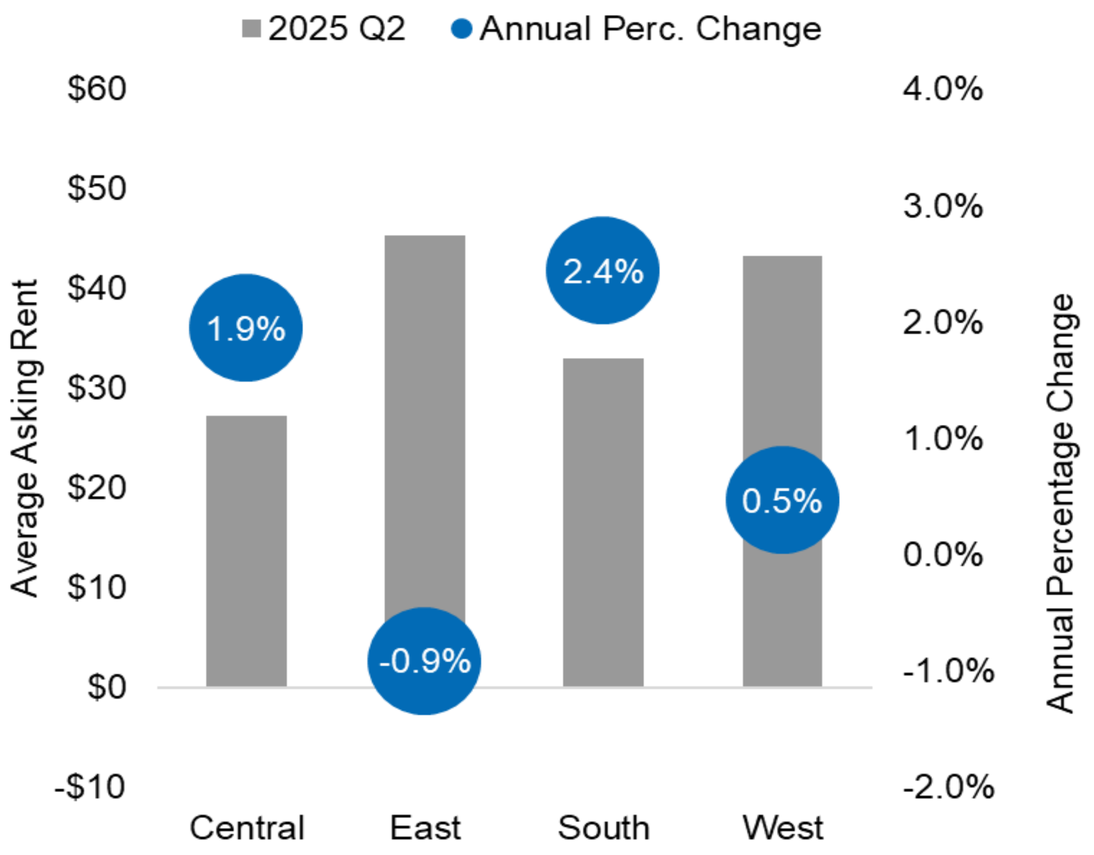
NET ABSORPTION

Net absorption accelerated in 31 of 62 markets in 2Q 2025 compared to trailing 12-month average.



ASKING RENT GROWTH

The South and Central regions lead in growth of asking rent.



CHARACTERISTICS OF POST-PANDEMIC MARKET

Some of the more significant characteristics of the post-pandemic office market include

- Flight to quality – newest buildings, vastly expanded amenities, location, location, location
- Law firms have led the rebound
- Increase in short sales and foreclosures – *duress, distressed transactions, valid sales and cap rates???*
- Decline in market liquidity
- Systemic lag in the ability of property assessments to adjust to prevailing market conditions in real time which increases stress in property economics and financial performance, particularly properties with thin or negative cash flows
- Property owners more willing to give back the properties to lenders
- Reduced deal volume – leases and sales

INCREASED BACK TO OFFICE MANDATES

In September 2025, Co-Star reported that 55% of Fortune 500 companies requiring 5-day workweeks soared to 55% compared to 5% two years ago. Although hybrid arrangements are still popular, particularly in smaller companies, mandatory in-person attendance is a growing trend.

- Amazon - one of first to mandate 5-day workweek
- JP Morgan and Goldman Sachs both require 5-day workweeks
- Paramount Skydance – 5-day workweek beginning 2026 in NY and LA
- Norvo Nordik – 5-day workweek
- NBC Universal – 4-day workweek beginning 2026
- Microsoft – 3-day workweek in 2026
- Starbucks – 3-day workweek
- Target – 3 days

JP MORGAN BACK TO OFFICE

One of the most publicized back to office examples is JP Morgan which has made a $3 billion bet on bringing people full time to the office.

- In 2025, completed a new 60-story, 2.5 million-square-foot headquarters at 270 Park Avenue, New York
- According to Co-Star, JP Morman is hiring private chefs, event coordinators, and waitstaff for several eating venues that include an Irish pub, coffee bar, and a food hall- sign of the times?
- *Compare Hugh McColl Bank of America headquarters, Charlotte*
- Unrivaled amenities including some arguably over-the-top features
- A signature scent has been developed for the building
- Interior lighting will change – brighter and dimmer with changing colors throughout the day
- Characteristic of Manhattan excess or indicator of continued trend on importance of building amenities?

DATA CENTERS

Data centers are secure buildings with specialized needs for power, cooling, and fire suppression systems. They house servers (computers that run applications and store data) and networking equipment such as routers, switches, and storage devices.

Although data centers have existed for some time, they have become the latest rage in property development due to changing technology.

There are three general types of data centers

- Enterprises centers – owned and operated by a single company for its own use
- Colocation centers – property owner rents space and power to multiple users
- Cloud data centers – operated by companies like Amazon, Microsoft or Google Cloud to deliver online services.

TYPES OF DATA CENTERS

Data centers require enormous amounts of power. Because the antiquated electrical grid system in the U.S. is finding it difficult to accommodate needs of data centers, developers and owners of such properties are considering joint construction of mini power plants on their own to serve the needs of multiple data centers in the same area.

Data centers provide interesting valuation challenges including the need to distinguish between

- real property
- personal property (equipment)
- intangibles (intellectual property, etc.)

DATA CENTER CONCENTRATIONS

Power and growing community opposition are making it increasingly difficult to develop data centers

Established markets include

- Northern Virginia
- Dallas
- Chicago
- Phoenix
- Northern California
- 23 smaller emerging markets

EMERGING INDUSTRIAL PROPERTY ISSUES

Since 2020 businesses have increasingly shifted manufacturing operations away from China to other countries, (including back to U.S.) motivated by

- Rising Chinese labor costs
- Evolving (arguably changing and confusing) U.S. trade policy
- Global supply chain vulnerabilities exposed by the Covid-19 pandemic
- Other geopolitical, labor related, and environmental disruptions

PROPERTY RIGHTS AND DARK STORE THEORY

One of the controversies in real property valuation, particularly in tax appeal cases, has been caused by the Appraisal Institute's change in the definition of fee simple.

***Real Estate Appraisal Terminology*, Revised Edition (1981)**

"fee simple. An absolute fee; a fee without limitations to any particular class of heirs or restrictions, but subject to the limitations of eminent domain, escheat, police power, and taxation. An inheritable estate".

***The Dictionary of Real Estate Appraisal*, First Edition (1984)**

"fee simple estate. Absolute ownership *unencumbered by any other interest or estate*; subject only to the limitations of eminent domain, escheat, police power, and taxation."

In truth, almost all appraisals assume forms of encumbrances such as power and utility easements.

PROPERTY RIGHTS AND DARK STORE THEORY

***The Appraisal of Real Estate*, Ninth Edition (1987)**

"A fee simple estate implies absolute ownership *unencumbered by any other interest or estate*."

The notion of *unencumbered* is used by some appraisers to justify a valuation methodology in property tax matters that treats the property as if vacant and available for lease on the date of valuation, requiring consideration of the time and lost income, among other things, to lease the property.

This raises many issues, including the difference in the methodology appraising property in eminent domain matters which customarily values the real estate based on market rent at market wide vacancy (i.e., effectively as occupied) on the date of valuation.

PROPERTY RIGHTS AND DARK STORE THEORY

Confusion has ensued.

“Nomenclature Matter! Unfortunately the term ‘fee simple’ has become short-hand in the appraisal industry for the phrase ‘unencumbered real estate’. Appraisal organizations, appraisers, legal treatises, lawyers and courts have been sloppy in categorizing ‘fee simple’ in an appraisal context.” From the paper “*After Fee Simple*” authored by William Shepard, J.D.

A paper published in 2015 in *Real Estate Issues* by Dr. Tom Hamiton attempted to clarify the issues by pointing out that the fee simple estate is always the fee simple estate.

- Fee simple estate subject to existing leases
- Fee simple estate subject to and existing mortgage
- Fee simple estate as if vacant

PROPERTY RIGHTS AND DARK STORE THEORY

Dr. Hamilton also contended, among other things, that in estimating market rent a hypothetical potential tenant could also be the existing tenant.

The Appraisal Institute has unintentionally been complicit in causing the confusion by imprecisely and incorrectly defining terms outside appraisal expertise.

As a result of the growing controversy, the Appraisal Institute held an invitation only “Property Rights Symposium” in 2017 that issued a working paper that adopted many of Dr. Hamilton’s ideas.

Confusion increased and sides have become increasingly polarized.

- The Appraisal Institute did not adopt the working paper resulting from the symposium
- In 2019, IAAO issued its own guidance on the subject in the publication of “Setting the Record Straight on Fee simple”

Both sides continue to wage a war of ideas in everyday practice and in the classroom and in the court room.

END

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