RE-THINKING THE RETURN: SIGNS OF NEW SENTIMENTS IN THE OFFICE REAL ESTATE OUTLOOK

Zain Jaffer - May 5, 2021, 3:41 pm

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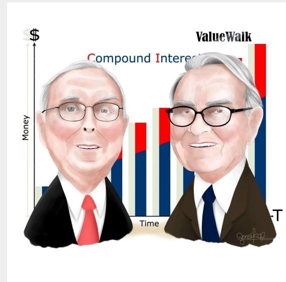
Of the many ways the pandemic will be understood as we move forward, the past four quarters will be branded in the corporate world as ‘The Year We Went Remote.’ A global experiment, virtually every team across all industries spent more time working from home than ever before. And in the ongoing two-camp debate—those who swore off office working and those who maintained that remote work would be temporary—there are signs of an early winner. Though, as we’ve learned throughout the crisis, no one can really be sure.



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Going Back To The Office

But as the rate of vaccinations steadily picks up, the megaphone voices that were singing remote work's praises have reneged on their commitment within the last few months. In March of 2020, the CEO of Morgan Stanley was bullish on reducing the company footprint, remarking that the team had proved effective operation was possible without any office real estate. This March, though, a spokesperson for the company said: "We plan a full return to the Midtown office when it is safe to do so." He went on to explain that they expect to maintain flexibility for employees to work from home during some of the week, and that the return could vary widely based on the professional's role.

Morgan Stanley certainly isn't alone. Ernst & Young expected their employees back this April, Goldman Sachs expects a full return by the end of the year, and Apple's Tim Cook has gone on record emphasizing the need for proximity for optimal team innovation.

Motivations for a return seem to go above and beyond innovation. There's a general sentiment across many teams that from home, the boundaries between work life and personal life have been harder to uphold. Many employees, especially newer team members, feel that with their work life occupying their living room, they feel an increased pressure to monitor their email, answer calls, and work earlier or later than they might have in a structured office environment. With more time at home, employers could quickly see signs of declining productivity and diminished employee satisfaction; both of which come at far too great a cost as we tackle the task of an economic recovery.

Mapping Sentiments Onto Office Real Estate Market Outcomes

For all the aforementioned reasons, it’s clear that the office will endure as an important part of our corporate culture as we move forward. A return to office space in some capacity seems inevitable, but understanding the forces in the office real estate market is less straight forward.

Certainly, some changes are here to stay. Employers who are considering a hybrid approach could easily reduce their real estate footprint to accommodate only part of their team at a time. Similarly, it's safe to say that demand in the market has been completely redistributed. Secondary and tertiary markets, with more favorable living conditions and lower prices, saw an early uptick in demand. Recently, office real estate in sunbelt markets, and in specialty-oriented offices including life sciences and government-oriented companies, have seen a faster rate of recovery. High-density areas with higher costs of living and shoulder-to-shoulder commutes might continue to struggle even after the full distribution of the vaccine. Some sectors that depend less on office operations (sales teams, consultants) might also maintain a lower office footprint for longer.

But an interesting metric to consider after many months is the relationship between physical occupancy and lease occupancy—are employers abandoning their leases, or just keeping their teams at home? According to an April report by UBS, the national office vacancy rate for offices in all classes was 16% in Q1 of this year. Their experts add that a partial factor in that 16% is the number of new capacity additions and construction projects that have recently been completed. Still, there aren’t many market segments that are significantly more vacant than that national average. In partnership with UBS, Kastle Systems produced a Back To Work Barometer, using keycard and fob information for 3,600 buildings across 47 states. Areas in which COVID-restrictions were lighter, such Dallas, Austin, and Houston metro, have been hovering around 35%-40% of professionals making some use of the office since December (with the exception of a stark dip in February due to the extreme weather). San Francisco, New York, and San Jose were among the slowest on the back to work barometer, staying steady at about 10%-15%.

Impact On Post-Pandemic Leasing

And while the market is showing the expected negative trend in unit absorption, the new need for more space will impact post-pandemic leasing. The average space allotted per employee in the office has been steadily declining across the last decade. Pre-pandemic, it reached a low of 175 square feet per employee. The new emphasis on health and safety will create a major trend toward de-densification across all offices. Even with diminished team volume, employers will need more space.

New construction projects and updated buildings that take those new needs into account will be well-positioned to win the next wave of market demand. Throughout the pandemic, startups and vendors have developed tools to help employers and building owners optimize their use of space as they navigate their return. ~~Basking~~ is a solution that connects to a building's WiFI infrastructure to offer real-time office occupancy monitoring, accumulating valuable data and reporting on real estate opportunities. ~~Watson Works~~ is a set of tools released by IBM with embedded AI to help employers manage space allocation, employee compliance, and facilities management as they return. Building owners and ~~investors~~ who leverage the powers of smart technologies to help employers better understand their use of space, and to better protect their team, will see an incredibly quick return on their investment.

In short, the new corporate normal will be comprised of what's worked in both versions of our working lives. Some of the conveniences of home will surely survive, with so many teams having proved efficiency and productivity in a remote working environment. But the locale of the office has proved equally important; many employers are showing an eagerness to return when it's safe in a full or almost full capacity. Without a doubt, the post-pandemic office real estate market has more twists and turns ahead, and it won't all be smooth sailing. Still, this is a different post-pandemic landscape than what we might have predicted last March. After four long quarters, there's reason for hope and signs of strength in office real estate.

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