THE FUTURE OF OFFICE

How Landlords Will Achieve **Outsized Success** in the Era of **Remote Work**

Although the pandemic accelerated the trend toward remote work, recent data indicate that – over the long term – the effect on office demand will be negligible. In fact, as capable property owners reposition their properties and reimagine office assets, and as organizations and sectors that were once expected to fully embrace remote work return to the office, we anticipate a rapid rebound to pre-pandemic activity levels, with growth to follow.

Remote Work is Here to Stay, but to What Extent?

"Remote work is here to stay" is a message that has been consistently repeated by researchers, forecasters and the news media since the early phases of the COVID-19 pandemic. Far less consistent, in terms of their conclusions and supporting data, are the analyses of how widespread the Work-from-Home (WFH) trend will be, and to what extent it will impact U.S. office real estate.

In this white paper, we will argue that increased adoption of WFH- and hybrid-work arrangements will, indeed, outlast the current pandemic. For a variety of reasons, however, the shift will be less "seismic" than anticipated. We will also argue that, in the medium and long term, this trend will not generate a major shift among commercial tenants in the perceived utility of physical property.

On the contrary, as capable property owners reposition their assets and reimagine the paradigm of office property, we believe that the market will quickly rebound and then continue growing, especially among "best-in-class" assets.

Although evidence indicates that the pandemic did, indeed, accelerate the pre-existing trend toward WFH and hybrid work, as well as adoption of the technologies to support the shift, recent data suggest that the ubiquity of the trend, and its impact on the office sector, has been greatly overestimated.

The Case for Optimism

It's difficult to pinpoint the percentage of U.S. workers who worked from home most or all of the time prior to the pandemic, though a reasonable estimate is 15% to 20%, a share that rose to 44% at the height of the pandemic. According to recent data from the U.S. Bureau of Labor Statistics, however, only 5.5% of businesses have reduced their office space since the beginning of the pandemic, with most companies choosing to redesign their spaces instead.

Although the pandemic significantly impacted the market, we believe that property owners who proactively adapt to changing economic realities and tenant preferences will benefit from an imminent rebound in demand. This projection is supported, in part, by the following data:

- A recent analysis by CBRE Economic Advisors forecasts that the office space recovery will begin in mid-2022. It further predicts that average rents will reach pre-pandemic levels by Q2 of 2022 at the earliest or Q1 2026 at the latest.
- Big tech companies, once viewed as the vanguard of the remote trend, are fueling a nationwide recovery in commercial office real estate. In the last three quarters of 2021, the tech industry leased 76% more office space than it did the previous year.
- Though the average U.S. employee will spend 24% less time in the office, reducing the amount of space per employee by 9%, CBRE estimates that companies moving from traditional to modern, activity-based spaces will require 15% more square footage on average.

- Already, even some of the more optimistic forecasts made in 2021 have proven conservative. For example, while CBRE predicted that net absorption rates would remain negative through 2021, the fourth quarter of 2021 actually produced a positive absorption rate for the first time since the start of the pandemic, with 5.4 million square feet of net occupancy growth. Leasing activity also rose (by 9.2%) in Q4 2021. Across sectors, leases larger than 100,000 square feet grew significantly faster than the market as a whole, and we also saw an increase in lease terms longer than 10 years, underlining "growing momentum from major tenants." And all of this occurred despite the arrival of the Omicron variant, which put the return-to-office policies of many companies on hold.

The Remote Work Paradox

There are good reasons to believe that over the next 5-10 years, employees will spend more hours working in offices than many experts predicted at the start of the pandemic.

On the one hand, survey after survey has shown that remote work and flexible scheduling are popular among most employees. A 2021 survey by EY found that 9 in 10 employees worldwide want flexibility in where and when they work, and 54% would consider leaving their jobs after the pandemic if they weren't "afforded some form of flexibility in where and when they work." A 2020 survey by McKinsey & Company uncovered similar numbers: 52% of employees wanted their organizations to develop more "flexible hybrid virtual-working models – an increase of 22% since the start of the pandemic."

On the other hand, recent research has revealed significant downsides to WFH arrangements. To start, there's an upper limit to the number of people who can work from home (three to five days a week) without incurring a significant loss of productivity. According to a 2020 analysis of 800 jobs in nine countries by McKinsey & Company, only 20% of the workforce can work from home as effectively as they can in the office.

Even in sectors that seem suited to remote work – e.g., banking, finance and IT – the percentage of employees who can work effectively from home for three or more days per week may be limited to those whose jobs largely consist of digital-based tasks or project management versus those whose jobs are team-based or require high levels of collaboration.

This last assumption has been reinforced by a large-scale study conducted by Microsoft of its own U.S. workforce to evaluate the effects of remote work. The conclusion: "Firm-wide remote work caused the collaboration network of workers to become more static and siloed, with fewer bridges between disparate parts. Furthermore, there was a decrease in synchronous communication and an increase in asynchronous communication. Together, these effects may make it harder for employees to acquire and share new information across the network." In sum, remote work often cuts the "weak ties" between groups of employees. This phenomenon, researchers suggest, can have a negative effect on an organization's ability to innovate.

Moreover, though many employees report that remote work has allowed them to achieve greater work-life balance – and save money on meals and transportation – a significant number have experienced pronounced mental health issues as a result. A study conducted in 2021 by the American Psychiatric Association found that "nearly two-thirds of those working from home feel isolated or lonely at least sometimes and 17% do all the time. More than two-thirds of employees who work from home at least part of the time report they have trouble getting away from work at the end of the day always (22%) or sometimes (45%). Younger adults (73% of 18- to 29-year-olds and 73% of 30- to 44-year-olds) were more likely to report feeling isolated or lonely working at home compared to older adults (48% of 45- to 64-year-olds)."

Other studies have uncovered similar results, commonly finding that remote workers are more likely to suffer from loneliness, increased anxiety, burnout, and an inability to separate their workdays from their personal lives. As one business reporter summarized: "It is not possible to simply erase our evolutionary bandwagon and replace millions of years of in-person interaction with technologically mediated or virtual communications."

Studies such as these highlight another problem: the obstacles to learning and career advancement that new and younger employees will face when joining a largely virtual workplace. New and younger employees rely on experienced colleagues for information about their jobs, the company and its culture – and on experienced superiors for informal mentoring. Historically, this information and mentoring has been transmitted through informal (and sometimes random) face-to-face interactions. When these interactions disappear, new employees will find it far more challenging to adapt to new organizations, new cultures and new roles.

In addition, it is hard to overstate the importance that physical buildings and office space can have on a company's culture and brand. A well-designed, amenity-packed building in a desirable location makes a positive brand impression on employees, potential employees and consumers. These favorable impressions are unlikely to occur when a company's offices are second rate, or if the firm's "ambassadors" typically interact from home offices (or kitchen tables) via Zoom.

Finally, it should be noted that, in addition to landlords and their employees, there are many other "supporting players" in urban centers with an embedded stake in a rapid return to the office. From retailers and restaurateurs to hoteliers and taxi drivers, there are natural layers of political and commercial support bent on ensuring that thriving cities do not become a relic of the past. Because these stakeholders depend on a healthy office real estate market for (in many cases) their very survival, we expect them to exert considerable pressure on companies to quickly return employees to their offices in the coming months.

Collectively, the research above suggests that over the long term, the amount of time that American workers spend working from home will be substantially lower than McKinsey's upper limit of 20%. We would also argue that in certain industries, including the tech sector, the need to collaborate and innovate across teams and business units will require employees to visit the office for an average of at least three days a week. And because most/all employees will be in-office during these "peak" collaboration days, relatively few organizations will be able to significantly reduce their space requirements.

The Conventional Consensus

Over the past two years, a conventional consensus has emerged around the future of office and how property owners should adjust. Some oft-cited insights include:

- Markets in major urban centers (New York, San Francisco, etc.) will continue to suffer as companies and employees flee to secondary and tertiary markets in suburbs and smaller cities.
- Landlords should consider converting office assets for alternative uses – e.g., warehouse and distribution centers.
- Landlords should focus on enhanced health and safety infrastructure (e.g., improved ventilation), more physical offices (goodbye open floor plans) and amenities.
- Owners should position their properties as "destinations" and offer unique experiences – experiences that employees won't find in a home office.

Sason's Office Strategy

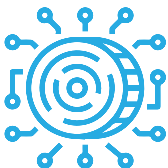
Our strategy at Sason, developed well before the pandemic, incorporates some of these insights while rejecting others. For example: We expect to see robust growth in secondary and tertiary markets due to population migration that was occurring prior to the pandemic (and was then accelerated by it), but we also anticipate a rebound in major urban markets. We believe the impact of remote work will be far less severe than some experts have predicted and, therefore, that converting spaces for alternative uses should (normally) be limited to Class C buildings that cannot be effectively repositioned as modern office assets.

While we agree that office assets must be repositioned to acknowledge emerging tenant preferences regarding health, collaboration and amenities, such repositioning work will require substantial creativity and capital. Quick-fix solutions will not suffice. Currently, Sason is executing a strategy that comprises five “pillars” – a strategy that resembles, in some respects, that of a hospitality company.

Pillar 1:

A focus on desirable amenities that are integrated, to the extent possible, into the building’s central gathering area, typically the lobby. The goal? Create a fully activated lobby (with music and pleasant scents similar to those seen in a fine hotel) that includes attractive, usable amenities (e.g., quality restaurants or “grab and go” options, world-class fitness centers, indoor-outdoor tenant lounges, activated rooftop spaces) – all conveniently and centrally located, not tucked into remote corners. This approach to amenities goes well beyond “checking the box.”

Pillar 2:



A focus on developing “best-in-class” assets. We seek assets with discernible competitive advantages in preeminent locations, as well as buildings with “great bones” that might be older and/or mismanaged. After acquiring these properties, we focus on completely refreshing and reinvigorating the assets, taking advantage of the location and “bones” to turn them into “best-in-class” properties – be they class A or B.

Pillar 3:

Actualizing seamless indoor-outdoor work spaces. We’re doing this in a variety of ways. Example: in Baltimore’s Fells Point, we have a public park in the middle of two portfolio assets, which we’re activating in partnership with the city. We’re enabling it with Wi-Fi and working to upgrade the furniture and maintenance regimen in conjunction with the Fells Point Association and Waterfront Partnership to create a unique experience for tenants – one where employees can take phone calls, work on a laptop, etc. outside. In some warmer markets, we’re creating roll-up doors, so tenants can seamlessly move from inside to outside to work within their suites or in the building’s common areas.

Pillar 4:

Hospitality-style branding and services. We're now approaching the business of owning offices in the way a hospitality company would run a hotel. For example: in addition to integrating music and scents in common areas, we're examining the possibility of integrating branded water bottles, bathroom napkins, etc. to convey a luxurious and hospitable feel that reflects the asset's brand. We're also evaluating the concept of a tenant concierge who could provide tenants with services ranging from travel reservations to dry cleaning pick-up and delivery. We're preparing to go the extra mile to deliver unique experiences.

Pillar 5:

Enhanced focus on tenant wellbeing. In addition to offering better ventilation and air filtration, green walls, environmentally-friendly heating and cooling, etc. in our buildings, we're thinking seriously about providing wellness-oriented programming – from yoga and meditation programs offered in the fitness centers to visiting therapists or other mental health services.

Already, this approach is generating positive results: From the start of 2020 through the end of January 2022, Sason's portfolio of repositioned assets enjoyed a 257% increase in occupancy rates. In another example, Sason bought a portfolio of assets in Tampa in late-2020 at ~12% occupancy. As of this writing, we have achieved 95% occupancy.

Conclusion

History is replete with the kinds of upheavals that we've endured over the past two years. In most analogous cases, however, the eventual "new normal" resembled the "old normal" as balance was eventually restored. For example: if, as many commentators have observed, the closest parallel to the COVID-19 pandemic is the Influenza Pandemic of 1918, it's heartening to note that the economic impact of that earlier pandemic "caused a sharp economic contraction followed by a sharp recovery." For this reason, and those highlighted elsewhere in this paper, we expect that the office market will continue to trend as it's been trending for the last 150 years. The human species is not one that has historically undergone vast behavioral change globally at the drop of a dime. Rather, it tends to evolve slowly, over time. Further, because humans are genetically wired to crave (and thrive on) face-to-face interaction, we continue to believe that people and companies will generate the best results, and that people will live more fulfilling lives, in the office.

While we don't claim to understand what the future of tenant spaces may look like, as, historically, they have constantly changed in terms of design and orientation, we're convinced that even in an increasingly virtual world, "the physical office is more relevant than ever as the space which brings people together, whether they're employees or clients. While people may spend less time there, the experience [will be] more sophisticated, [and more] carefully designed to support a vibrant community and nurture sustainable, long-term performance."

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