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RETAIL & COMMERCIAL DEVELOPMENT GROUP
2021 FORECAST

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OFFICE LEASING IN 2021: SOME LIGHT AT THE END OF THE TUNNEL

by Andrew Ouvrier

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2020 will be remembered as a year of great tragedy and upheaval for many reasons, but first and foremost for the ravages wrought by the COVID-19 pandemic. The pandemic affected everyone and changed everyday lives and habits. People avoided close contact with family and friends, faced shortages of basic necessities, and were forced to learn and interact in a virtual environment. The pandemic even turned some of our most routine tasks, such as going to the grocery store, into new and potentially risky adventures.

The COVID-19 pandemic also profoundly affected the economy and the U.S. real estate markets. While the COVID-19 pandemic has been particularly devastating on the retail sector, principally due to mandatory closures of a variety of retail operations such as restaurants, health clubs and the like, the office leasing market was not spared from the impacts of the pandemic. With many smaller tenants unable to pay rent, some landlords worked to provide rent abatement or other forms of rent relief to help keep these tenants in business. In many areas where office tenants were unable to make rental payments, vacancy rates have gone up while rental rates have gone down. Fortunately, unlike most retail industries where employees need to be on-site to perform their tasks, the nature of office work makes it far easier for employees to be able to work remotely from home, and in 2020 many office employees shifted to working from home for the first time in their working careers. As a direct result, the actual utilization of leased office space dropped significantly in 2020, resulting in a precipitous drop in the volume of office leasing activity, especially in denser office environments such as central business districts.

With the recent surge in COVID-19 cases across the country, it is clear that the pandemic's effect on all aspects of our economy, including office leasing, will continue to be with us far longer than most people had hoped. However, while no one can predict what 2021 will look like, we do think the outlook is far brighter than in 2020 because the COVID-19 pandemic will eventually subside. Some experts predict that, even with the (hopefully soon) wide-spread availability of vaccines, "normal" life will not return to the United States before the third quarter of 2021, with the real estate industry lagging somewhat behind. We think it is safe to say that only when life returns to some semblance of normalcy will we see an increase in office space use and a corresponding increase in office leasing activity.

So, while there is some uncertainly as to when the "return to the office" will occur, there are some factors that will have large scale effects on office leasing activities in 2021.

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The first factor is that the return of employees to the office environment will not happen all at once, but will instead occur gradually as employers and employees alike assess their office environments and the effectiveness of improvements and policies intended to support social distancing. Companies may also seek additional protections from their office building landlords in the form of touchless technologies before allowing their employees to return in person. This gradual return will limit office leasing activities in the immediate future as companies wait to enact long term leasing plans while they evaluate their space requirements and weigh their leasing options.

The next factor is the effectiveness of remote working. As cities went into lockdown, many companies were left with no choice other than to switch to working remotely. One study suggests that up to 88% of office-based companies encouraged or mandated working from home in response to the pandemic. Even though many companies allowed employees to work remotely before the COVID-19 pandemic, working from home has now become the new standard for many office employees. Working from home has been, in broad terms, far more effective than most had expected due to the many new video and teleconferencing tools available on the market. Remote working also saved workers a considerable amount of time by eliminating commutes. One study indicated that workers saved an average of 227 hours per year (or the equivalent of 28 eight-hour work days) that can be used for either work or play. Remote working also saves many companies money that would have been spent on other costs, such as parking, meals and travel expenses. For these reasons, companies may need to continue offering employees the ability to work from home even after there is a return to the office. Companies may find it necessary to offer remote working as an amenity in the ongoing effort to attract new talent and retain existing employees who have grown accustomed to the freedoms and flexibility that working from home offers, even after the abatement of office density control measures imposed in response to social distancing requirements. It is important to note, however, that remote working may not be for everyone. For example, remote working is less likely to be an effective alternative to the office in situations where employees lack adequate space and/or privacy to work from home, or where high-speed internet is unavailable or unaffordable.

We anticipate that the trend of remote working will continue in the foreseeable future. Remote working doesn't always mean working from home, and can just as easily be done in smaller satellite offices. This trend favors those companies with less centralized offices, as opposed to centralized offices often found in higher density central business districts, and with more satellite offices in suburban areas closers to employees' homes.

While we expect increased leasing activity in all office leasing sectors, we anticipate seeing the greatest rebound in leasing activity in Class A and medical office properties, and with technology users.

The last factor is the need to increase the amount of office space available per employee in order to meet social distancing requirements. Once the pandemic struck, many office building landlords implemented operational and physical upgrades at their buildings in order to comply with governmental requirements and public health and safety recommendations. When employees begin returning to the office environment in significant numbers, we will see this extend to the interior of office spaces, resulting in tenants likely requiring more space on a per-employee basis than before COVID-19.

The trend toward remote working, with less employees in an office on any given day, will likely translate into a push towards smaller office size and a corresponding decrease in office rental rates. The need for additional space per worker, however, will have the opposite effect and will likely translate into a push towards larger office spaces and a corresponding increase in office rental rates. While the full effect of both of these trends is impossible to predict, we anticipate that these two trends will, at least in the short term through 2021, tend to offset one another.

While we expect increased leasing activity in all office leasing sectors, given the factors mentioned above, we anticipate seeing the greatest rebound in leasing activity in Class A and medical office properties, and with technology users.

Studies have shown that Class A properties typically experience a greater rebound in leasing activity and rental rates after a recession than Class B properties, and we expect that trend to continue as part of the post COVID-19 office leasing recovery. It wasn't that long ago that touchless technologies in office buildings, such as app-based or facial recognition at building entrances and elevators, would have been considered an amenity, but tenants who are now returning to the work place will expect touchless technologies or other high-level social distancing/ safety measures to have been implemented by their landlords. The availability of such technologies will also be a differentiator for tenants in evaluating new spaces for leasing. Since Class A properties are in the best position to provide these often-costly technologies, we anticipate they will see the greatest rebound in office leasing activity. Additionally, many companies who reduced the amount of space they leased during the COVID-19 pandemic may need to lease Class A flex space and other short-term spaces in order to solve short term space needs as their employees return to the office, or to serve as satellite offices in suburban areas close to employees' homes. Additionally, as we move forward in a post COVID-19 world, we will likely see new Class A office product designed with touchless technologies and other social distancing requirements in mind.

The COVID-19 pandemic has made the need for readily available medical care all the more evident. In addition to COVID-19, a confluence of factors, such as the aging U.S. population and increasing lifespans, rising medical costs, new medical technologies/outpatient procedures, and insurance companies' push for outpatient care in an effort to reduce costs, has caused an increase in demand for medical services at medical offices, rather than at more traditional hospital or surgery center settings. As a result, we expect to see steady growth in medical office demand in 2021.

The COVID-19 pandemic also has posed unique office development challenges for the tech industry. Before the pandemic, many "tech" companies invested heavily in promoting a robust corporate culture. For these companies, the office environment is not only a work environment, but also a social environment, and tech companies worked to offer their employees a live/work/play type of balance in their office spaces. Larger tech companies have provided amenities such as cafeterias, fitness centers, access to health professionals, private work spaces for focused work and open environments for communal work and engagement. Tech companies have been willing to provide these amenities in an effort to make an office environment more of a community and to attract and retain "talent". Remote working is at odds with this type of culture, and while tech companies currently offer the ability to work from home, they will push to have their employees back in their offices as soon as it is safe to do so. The tech sector was the largest single source of demand for office space in the U.S. in both 2019 and 2020, and we expect that this trend will continue in 2021 as tech companies continue to seek office space to physically accommodate their employees. We also expect that developers and landlords with office space positioned to provide the types of amenities stated above will have advantages in their leasing activities.

Only when there has been a substantial containment of the COVID-19 pandemic, and a significant number of employees return to the office environment, will the full impact on office leasing activity be known.

In summary, so long as the COVID-19 pandemic continues to rage through the United States, office leasing activity will continue to be slow. Only when there has been a substantial containment of the COVID-19 pandemic, and a significant number of employees return to the office environment, will the full impact on office leasing activity be known. Several factors, including working from home, which will tend to push down occupancy and rental rates, will be offset by the need to lease additional space so that employees can maintain social distance standards, which will tend to increase occupancy and rental rates. It is expected that some office leasing sectors, such as Class A properties, medical office properties, and technology users, will lead the rebound in office leasing activity in 2021.