

REAL ESTATE

A Bold View on Office Space

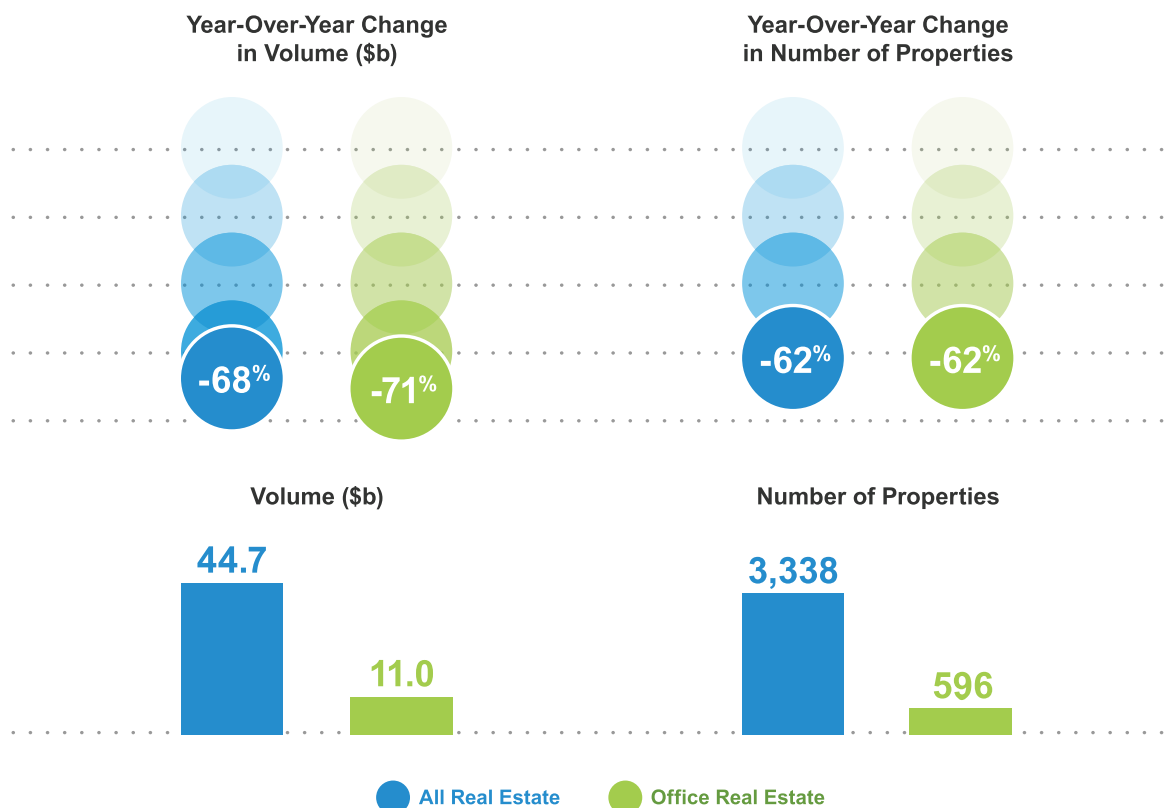
September 1, 2020

MetLife Investment Management (MIM) findings upend conventional wisdom about what might happen to office space demand post-COVID-19.

Early this year, an international consulting firm was on the verge of moving hundreds of employees into a new office tower in the heart of a fast-growing Florida city. The interior design was modeled on the latest thinking about how to foster collaboration and productivity: vast common areas for employees to mingle in, diverse amenities and, of course, open floor plans dense with desks without a partition in sight. Construction of the interior spaces had begun when the pandemic struck. Everyone would now work from home. Construction stopped, and plans were returned to the drawing board for a new post-COVID-19 office design.

By the middle of March, almost half the U.S. workforce—tens of millions of people—were suddenly working from home. Despite the enormous challenges, employees have persevered, companies have adapted and some business leaders have even announced plans to make remote work more permanent. Indeed, as the crisis has dragged on, this pivotal moment has called into question the idea that certain kinds of jobs require physical workplaces.

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Going office-less?

The effect on the office real estate market has been predictably severe. In New York City, hit so hard by the virus, hardly any deals have been struck since remote working kicked in this March, the longest stretch of near-zero activity in the city's commercial real estate since the Great Recession.¹ Potential buyers want a big discount; potential sellers don't want to give it. The illiquidity means that it's anyone's guess what office properties are actually worth. Meanwhile, darkening the long-term outlook is the possible permanent decline in tenant demand. Already there are clues this might be coming, says William Pattison, head of real estate research and strategy at MetLife Investment Management (MIM). "It's very common right now for tenants whose leases are maturing to renew them on a shorter-term basis while they figure out what to do."

In the office real estate business today, one major question looms: When the pandemic eventually abates, will tenants return? Not long after the first shelter-in-place orders were issued in the U.S., Pattison and his research team at MIM set out to find the answer.²

They began by studying a recent bit of corporate history. Over the past 15 years, a handful of large companies had attempted to institute broad work-from-home policies in a bid to save on office costs and increase productivity. Some firms even experimented with going completely

office-less, including a famous blue-chip computer maker, a giant global insurance firm and a first-generation internet company. In almost every case, MIM found, they failed. Each company eventually reversed course, bringing their employees back to the office.



The most sought-after buildings will accommodate different types of layouts.

Why did they fail? The companies all cited the same cause. Productivity had deteriorated, for a host of reasons. A remote workforce “becomes strangers to each other,” Pattison says, “and company culture can start to degrade.” The experience of these companies showed that creative collaboration is also harmed. Fundamentally, people in organizations seem to work best when they’re together in the same physical space. Mentoring younger staffers, motivating teams and demonstrating competence to one’s bosses are also all most effectively done in person. “Human beings are naturally social animals,” says Mark Wilsmann, MIM’s head of real estate equity strategies. “They like to gather.”

Productivity isn’t merely a function of whether an employee is sitting at a desk at home or in the office. The balance between the two has long been the subject of academic interest. Looking for answers, Pattison delved into peer-reviewed literature. What he found took him aback. “There was much more of a consensus than is typically the case in academic studies,” he says. “It made me question if I was sourcing and interpreting them correctly.” Over and over again, the studies isolated a similar principle. It amounted to a kind of working-from-home sweet spot. One or two days per week of remote work seems to increase an employee’s productivity, compared with full time at the office. But for every day more than that, productivity and job satisfaction declined. According to the research, although partial work-from-home policies appear to be a net benefit, offices remain nonetheless essential.

The future of office design

A trend in office design was starting to emerge even before the pandemic. “There was already a discussion about whether cramming a lot of people into a small space was optimal for productivity,” Wilsmann says. Over the past 20 years, companies have slowly shrunk their workspaces amid an overall desire for cost cutting. Since 1991, companies in the U.S.

have slowly removed more than 30 square feet of space from each employee on average. Meanwhile, cubicles went the way of the galley kitchen as open floors became the vogue. Now, that's all set to change. MIM, which manages an extensive commercial real estate portfolio, has heard from many corporate tenants on the matter—including the consulting firm that was rethinking the layout of their new Florida office space. Based on those conversations, Pattison expects a new set of standards to emerge that will establish social-distancing norms inside offices in order to “be more resistant to future pandemics.”

Pattison says that it's part of a broad movement to create healthier workplaces. The most sought-after buildings will be those that have the flexibility to accommodate different types of layouts as well as advanced air-filtration systems and other technologies that provide cleaner indoor environments.

These observations have become the cornerstone of MIM's forecast for office real estate. If companies want to give employees more square footage, they'll need more square footage overall. Increased social distancing could end up partially offsetting a diminishing demand for office space. “This really gets to the degree to which COVID-19 is going to make a permanent change to how people live and socialize and work,” Wilsmann says. “Our view is that it isn't going to change the basic benefit and need for people to be working together.”

Endnotes

- 1 Grant, Peter, “Coronavirus Triggers Steep Drop in New York City Commercial Property Sales,” The Wall Street Journal, July 6, 2020.
- 2 Pattison, Will, et alia, “Back to Work: Office Demand in a Pandemic World,” Metlife Investment Management, May 14, 2020.

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