Hybrid Work and the Future of Office: Adapting to a New Paradigm in Occupier Demand

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About NAIOP

NAIOP, the Commercial Real Estate Development Association, is the leading organization for developers, owners and related professionals in office, industrial, retail and mixed-use real estate. NAIOP comprises some 20,000 members in North America. NAIOP advances responsible commercial real estate development and advocates for effective public policy. For more information, visit naiop.org.

The NAIOP Research Foundation was established in 2000 as a 501(c)(3) organization to support the work of individuals and organizations engaged in real estate development, investment and operations. The Foundation's core purpose is to provide information about how real properties, especially office, industrial and mixed-use properties, impact and benefit communities throughout North America. The initial funding for the Research Foundation was underwritten by NAIOP and its Founding Governors with an endowment established to support future research. For more information, visit naiop.org/researchfoundation.

About CBRE

CBRE Group, Inc. (NYSE: CBRE), a Fortune 500 and S&P 500 company headquartered in Dallas, is the world's largest commercial real estate services and investment firm (based on 2022 revenue). The company has approximately 115,000 employees (excluding Turner & Townsend employees) serving clients in more than 100 countries. CBRE serves a diverse range of clients with an integrated suite of services, including facilities, transaction and project management; property management; investment management; appraisal and valuation; property leasing; strategic consulting; property sales; mortgage services; and development services. Please visit our website at www.cbre.com.

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Contents

Executive Summary

The widespread adoption of remote work during the COVID-19 pandemic is reshaping occupier plans for office space. Many observers initially expected the pandemic to be an acute short-term problem for the office sector that would end with demand looking much like it did in 2019 once the public health emergency was over. However, the emergency phase of the pandemic lasted much longer than most expected, allowing time for both workers and their employers to adapt to new work patterns. Hybrid work emerged as a common approach to safely transitioning employees back to in-person work, but it has since become the norm in many office-using industries.

The NAIOP Research Foundation commissioned this report to examine the current state of hybrid work and how it affects the office sector. The study draws from survey and market data provided by CBRE to explore how occupiers are approaching their use of office space, and the building locations, features and amenities they prioritize. These data also provide insight into the factors contributing to functional obsolescence in the buildings that have seen the largest increases in vacancy rates. The authors interviewed commercial real estate professionals to examine how developers, owners and operators are responding to current market conditions. Findings from this report include:

- Although the expansion of hybrid work schedules has accelerated a decline in the amount of occupied office space per worker, there is greater demand for shared meeting and coworking space that allows occupiers flexibility to accommodate more employees on busier days. Many are willing to pay for these spaces on a per-use basis or through a provision in their leases.
- Many occupiers are trading quantity for quality, preferring smaller office footprints in conveniently located modern buildings with amenities that will draw workers to the office and improve productivity.
- Occupiers are looking for buildings that make commuting easier, with ample parking, access to public transit and onsite amenities. They also increasingly prioritize sustainable design features and access to outdoor space.
- Office use is likely to grow, with 38 percent of occupiers indicating they expect utilization to increase and 60 percent indicating that utilization has stabilized.
- One tenth of U.S. office buildings account for 80 percent of the overall increase in vacancy since the first quarter of 2020. These commodity buildings tend to be in high-crime areas, lack access to amenities, and are concentrated in markets that have been slower to return to the office. Other commodity office buildings are performing better than the average vacancy rates would suggest.
- Only a small proportion of the most functionally obsolete office buildings are good candidates for extensive renovation or conversion to new uses. Current tight lending standards, higher interest rates and higher construction costs have made many rehabilitation and conversion projects cost-prohibitive, absent public subsidies.

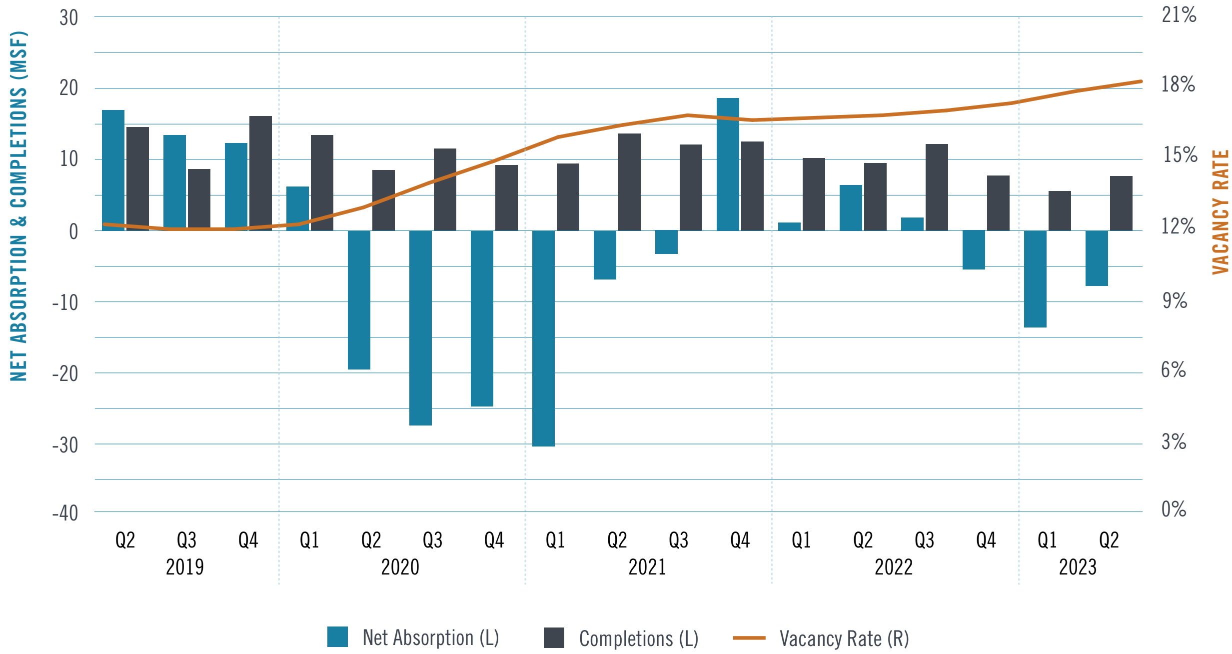
Methodology

This study is informed by market data provided by CBRE as well as surveys of occupiers and office workers conducted by CBRE in recent quarters. It also draws on the perspectives of real estate professionals to gain a sense of how office building owners, operators, developers and investors are responding to the hybrid work phenomenon to ensure their assets and investments are as competitive as possible. Interviewees include institutional and value-add investors, developers, owner-operators, advisors and third-party real estate service providers familiar with the office market. Institutional and value-add investors were associated with insurance companies, private equity funds and REITs. They were asked to discuss how hybrid work is affecting office-occupier preferences, what types of office buildings are likely to succeed and struggle in the current market environment, and what steps office owners and operators can take to position their assets for future success. Architects were also interviewed to offer insights into how to adapt office space to meet current occupier expectations and ensure it will remain attractive in the future.

The Impact of Hybrid Work on the Office Market

The effects of the pandemic are apparent in U.S. office market data. Net absorption of office space (the amount of space newly occupied minus space newly vacated) turned sharply negative in the second quarter of 2020, recovered in the fall of 2021 after workers began returning to the office on hybrid schedules, and has since dropped back into negative territory in the last three quarters, partially due to increased economic uncertainty. Negative net absorption, combined with continued completion of new space, has pushed up the average vacancy rate, which stood at 18.2 percent in the second quarter of 2023, the highest level since 1993 (Figure 1).

FIGURE 1: U.S. OFFICE MARKET NET ABSORPTION, COMPLETIONS AND VACANCY RATE



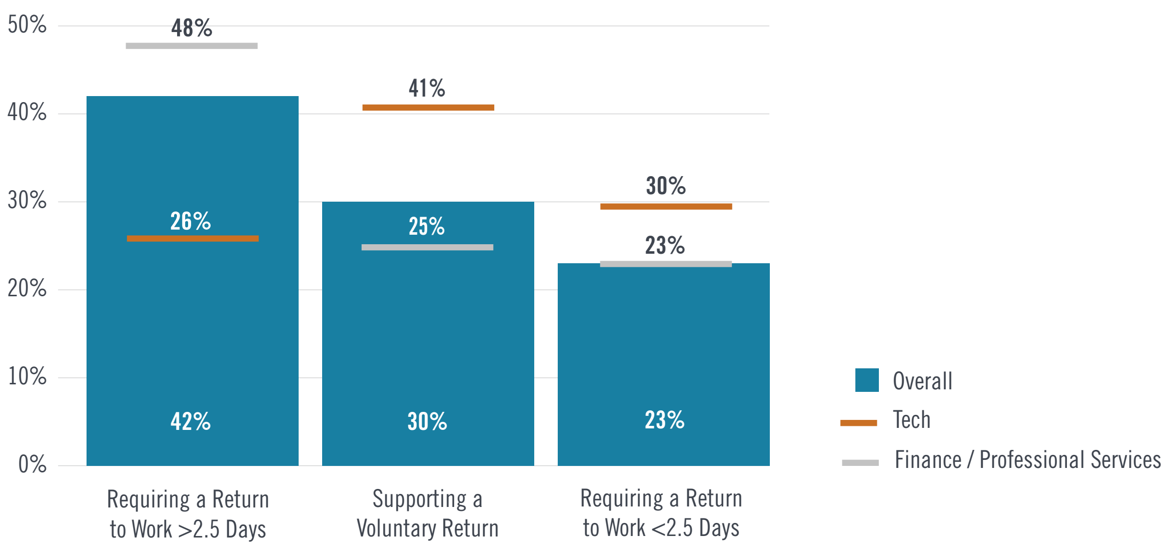
Source: CBRE Econometric Advisors, Q2 2023

Although office-using employment has increased steadily since the second quarter of 2020 and has risen 5.8 percent above pre-pandemic levels, occupied office space is 3.3 percent below pre-pandemic levels, and the average amount of office space per employee has fallen to a 22-year low of 146 square feet.[1] While recent concerns about an expected economic slowdown or recession have led occupiers to be more cautious about leasing additional space, remote and hybrid work policies remain the largest factor contributing to the divergence between employment and office space absorption.

According to CBRE's Spring 2023 U.S. Office Occupier Survey, only 42 percent of occupiers require employees in the office more than 2.5 days per week, with 53 percent either requiring fewer days in the office or encouraging employees to return voluntarily (see Figure 2). Most respondents to the survey report that office utilization remains below pre-pandemic norms, which is in line with other sources such as Kastle Systems.[2] The survey also reveals that occupiers that require attendance on specific days generally expect employees to be in the office mid-week, with few requiring workers to be in the office on Mondays or Fridays. Return-to-the-office policies vary by industry, with finance and professional service firms generally requiring more days in the office than technology firms.[3] Interview respondents confirm diverging approaches to office use in different industries, with technology firms being among those with the most flexible hybrid and remote work policies. On the other end of the spectrum, architecture firms and other design-oriented companies prefer in-person collaboration to accomplish creative work effectively.

Occupier survey results also reveal that smaller firms (those with fewer than 1,000 employees) report a higher share of their workers showing up to the office each week than larger firms. Sixty percent of respondents indicated that their office utilization had achieved a steady state, but 38 percent expect utilization to increase through 2023 and into 2024.[4] Should a widespread increase in space utilization materialize, it could stabilize demand for office space.

FIGURE 2: CURRENT GUIDANCE AROUND EMPLOYER EXPECTATIONS FOR OFFICE ATTENDANCE

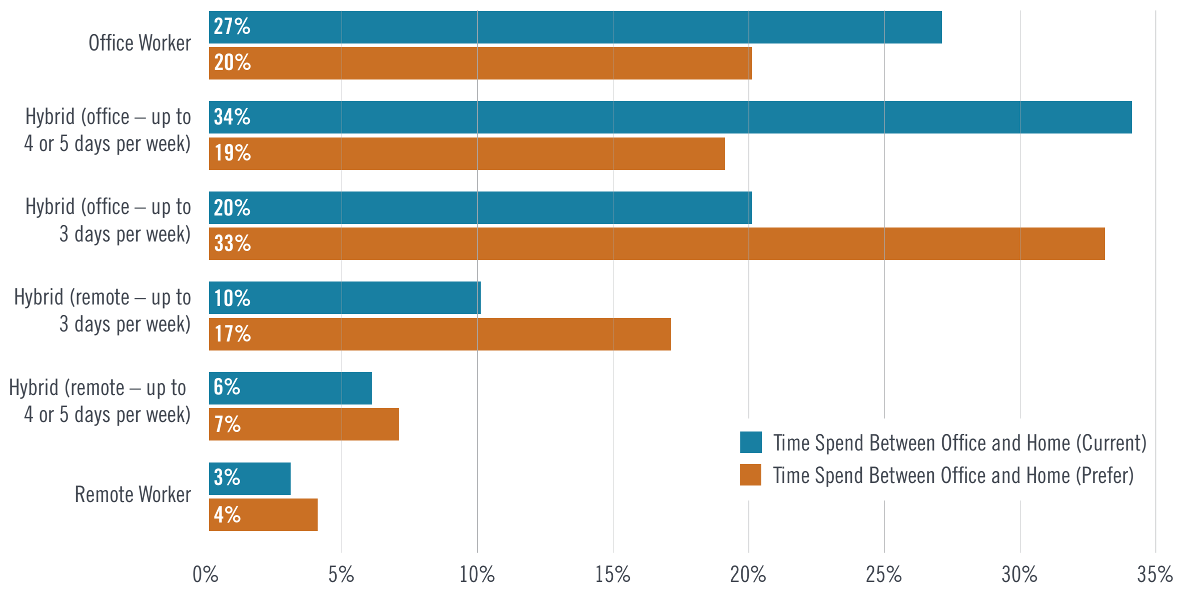


Source: CBRE Spring 2023 U.S. Office Occupier Sentiment Survey

Given the tight labor market, employee preferences regarding remote and hybrid work are playing an important role in how employers approach office work policies. Even as the labor market is expected to cool, employers interested in recruiting and retaining the best talent will need to consider worker preferences regarding remote and hybrid work. According to another CBRE survey from November 2022, U.S. workers in traditional office-using jobs would generally prefer to spend less time in the office than they currently do, though 89 percent of workers would like to spend at least some of their workweek in the office, with 33 percent preferring to work up to three days in the office and 39 percent preferring to be in the office more frequently (Figure 3).[5]

Engaging employees through focus groups and conversations is a common strategy organizations are pursuing to ensure that new workplace strategies are aligned with both corporate strategic objectives and individual employee objectives with the goal of attracting employees to the office more often. The collective outcome of these discussions will impact how much office space will be needed in the future.

FIGURE 3: TIME SPENT BETWEEN OFFICE AND HOME (CURRENT VS PREFERRED), U.S. WORKERS



Source: CBRE Global Live-Work-Shop Report

The Silver Lining: Prioritizing Office Use is a Focus for Many Organizations

According to the commercial real estate professionals interviewed for this report, a substantial number of organizations now want their employees to increase their office attendance as quickly as possible. Interview respondents attribute most managers' preference for on-site work to a belief on the part of organizations that virtual interactions are inferior to face-to-face ones when it comes to objectives such as training and mentoring new hires, building culture, encouraging innovation and promoting operational efficiency. Furthermore, managers perceive that productivity is generally higher and work quality is better when workers are at the office. Widespread agreement exists among interviewees that in-person meetings are superior to remote alternatives, whether one-on-one or in groups. Respondents noted that much of interpersonal communication is non-verbal, and there are more opportunities for organic and unplanned discussions when employees are in the office. However, employee preferences for hybrid work arrangements (see Figure 3) suggest they may not fully share these views.

The managing director of a privately owned office development firm maintained that: "[Organizations] have become increasingly aware of the shortcomings of remote work, and they are going to bring their people back to the office sooner rather than later. Maybe not five days a week or 40 hours a week, but for a much larger part of the week than they are coming in right now." Other interviewees agreed, indicating it is not a question of whether demand for office space will persist, but rather how much demand and in what form.

CBRE's occupier survey data suggest that allowing an equal mix of office and remote work is a strategy that is losing favor, with companies gravitating toward either being mostly or fully in the office or mostly/fully remote. Approximately 45 percent of respondents support a mostly or fully office culture (vs. 37 percent in 2022), while 22 percent support a mostly or fully remote culture (vs. 15 percent in 2022).[6]

How the Flight to Quality is Shaping Demand

One of the most notable effects of the COVID-19 pandemic on the office market is the flight to quality it triggered. "As an office building owner today, you have a vibrant, happening place where people want to be, or you have nothing," said a principal at a privately owned real estate development firm with a regional portfolio. "There has been an absolute flight to quality, and [office owners] have to provide unique, interesting and activated spaces to compete." Correspondingly, numerous interviewees spoke of a bifurcated market in which best-in-class office buildings are performing at enviable occupancy and rental rates, while lower-quality buildings are struggling to remain solvent as leases expire. Most newer buildings were constructed with solid preleasing to credit tenants assuming long-term leases. Further, newer buildings have the least amount of physical, functional and economic obsolescence.

"Class A assets are winning all the deals and taking all the absorption," said the executive managing director of valuation and advisory services at a third-party real estate services firm. "Eighty percent occupancy may be wishful thinking for lower-quality office buildings in many markets over the next several years." This interviewee went on to attribute the bifurcated market to three conditions: an overall reduction in office demand brought on by hybrid work, a perception among top tenants that there is an opportunity to upgrade their office space at a reasonable cost, and a desire on the part of top tenants to use high-quality office space to attract and retain employees asked to work onsite.

Although market data reveal that class A office space is not generally outperforming the rest of the market, newer high-quality class A space is. Net absorption for buildings built since 2010 has been consistently positive throughout the pandemic, and the vacancy rate is lowest among the newest stock, with buildings built since 2010 at a 14.4 percent vacancy rate in the second quarter of 2023 compared to the overall vacancy rate of 18.2 percent.[7]

A substantial slowdown in new office development and redevelopment activity should limit the outperformance of newer buildings in the future. With substantially less new space becoming available each quarter than in the years preceding the pandemic, and as more occupiers relocate to buildings constructed in the last decade, space in these buildings should become increasingly scarcer and more expensive relative to older buildings. A slowdown in completions should also reduce supply-side pressure on the office vacancy rate.

The flight to quality should not be interpreted as a willingness on the part of office occupiers to markedly increase their real estate spending. Rather, tenants are controlling their costs by trading quantity for quality.

More than half of occupiers in CBRE's survey plan to relocate to higher-quality space,[8] and the average lease size in the first half of 2023 was 28.5 percent smaller than the first-half average for 2018 and 2019.[9] "Tenant footprints are shrinking," said a director of real estate at an insurance company. "In some instances, prospects that used to look at two floors are looking at one. They may not know exactly how they are going to operate in the smaller footprint, but they think quality will get people back in the office. That is the priority."

Since 2009, the average square footage of office space per employee has declined steadily, but this decline accelerated during the pandemic with the shift to hybrid work.[10] The fact that tenants are simultaneously reducing space per employee and trying to entice employees back to the office suggests that they contemplate some form of hybrid work well into the future. Occupiers concerned about a potential recession may also seek to reduce the size of their office space portfolios further than they otherwise would, though doing so may make it harder for these organizations to recruit and retain workers in the future. As occupiers continue to right-size their real estate portfolios, office owners and occupiers must keep an eye on space-utilization trends and forgo reliance on antiquated square-footage-per-employee ratios that have little meaning in environments where employees are not expected to be onsite all day, every day.

Newer high-quality buildings are clearly outperforming commodity buildings, but not all older buildings are struggling to the same degree. A CBRE analysis of building-level performance data estimates that across the markets tracked by CBRE, an average of ten percent of buildings—representing 17 percent of total office space—accounted for approximately 80 percent of occupancy loss in U.S. office buildings between the first quarter of 2020 and the fourth quarter of 2022, as measured by square feet.[11] Average vacancy rates among these "hardest-hit buildings" (HHBs) stood at 38 percent at the end of 2022. HHBs are more overrepresented in downtown office markets (one in every seven buildings) than in suburban markets (one in every 12 buildings), tend to be between 100,000 and 300,000 square feet in size (84 percent of HHBs vs. 78 percent of all office buildings), and are more prevalent in the Northeast and Pacific regions than elsewhere. CBRE also found that HHBs have 11 percent higher crime in their immediate vicinity than the average for their local markets, and they tend to have fewer amenities, though this mattered more where amenities like restaurants were not adjacent, as was the case for many suburban HHBs.

Notably, age is not a distinguishing characteristic of these struggling buildings. Most HHBs were built between 1980 and 2009, but their age distribution generally matches that of buildings in each market. This suggests that many other older buildings that have attractive characteristics (good locations, low crime risk, desired amenities) are performing significantly better than market-wide vacancy rates would suggest. CBRE estimates that if all HHBs were removed from total office inventory, it would shave four percentage points off the total vacancy rate. However, the concentration of vacancies in a narrow set of functionally obsolete buildings also suggests that many of these buildings will eventually either need to be significantly repriced, repurposed or demolished.

In the near term, some functionally obsolete office buildings face the prospect of default if their cash flows are insufficient to support a new loan when existing loans mature. Higher interest rates, more stringent underwriting requirements and limited investor appetite for older office properties have increased default risks. Several large office properties have already entered default, and foreclosures have resulted in some notable write-downs to property valuations.[12] One interviewee observed that in some markets, banks do not want to foreclose on office properties because they have no prospective buyers and want to avoid property tax liability.

Developers Cautious in Face of Uncertainty

Developers have responded to uncertainty about the outlook for office space with caution. A senior office developer, owner and investor noted that very few developers are currently planning to initiate new speculative projects.[13] Even in situations where credit-worthy tenants are willing to sign a long-term (e.g., 15-year) lease, pay relatively high rents and occupy an entire building, developers face significant challenges due to current lending conditions. Interest rates in the six to seven percent range and debt-coverage ratios in the 1.25 to 1.45 range limit potential loans to 40 percent or 50 percent of cost. Lower leverage often makes potential returns to equity investors unattractive given perceived risks. This senior office developer, owner and investor expects that non-institutional investors will primarily focus on office properties they already own, especially those purchased with short-term, low-interest debt that may need to be refinanced in the next several years. He also anticipates that value-add investors who have sufficient equity to purchase distressed office properties may be deterred by uncertainty about the economy and demand for office space. Even if the market bottoms out in the next two years and office properties can be acquired at 80 percent discounts from prior valuations, these investors may not feel confident that occupancy rates and rents will recover fast enough to generate an adequate return on the investment needed to acquire and retrofit a building.

Adapting to New and Renewed Occupier Preferences

Further complicating the decisions office building owners and operators must make is the fact that many assumptions about office space utilization made during the COVID-19 pandemic have turned out to be inaccurate. Expected preferences for low-density, suburban environments with office suites and common areas designed for social distancing have not emerged. To the contrary, many interviewees noted that office-occupier preferences today look like they did before the pandemic. Irrespective of whether office buildings are high-rise or low-rise, or located in urban or suburban settings, tenants demand high-quality on- and off-site amenities, attractive common areas where they can engage with others, and programming that encourages social interactions. Interviewees note that tenants are unwilling to forgo these things for design features favored during the pandemic, such as operable windows or large staircases.

"Live/work/play environments are thriving again in the cities and the suburbs," said the managing director of office asset management at an insurance company. "Tenants are looking for everything—amenities, dining, executive housing, retail and public transit." If anything, the pandemic has increased occupier interest in buildings located near public transit, with 82 percent of occupier survey respondents indicating that proximity to transit has an impact on their real estate decisions.[14] One of the few assumptions about tenant preferences made early in the pandemic that seems to have come to fruition is heightened demand for access to outdoor space, be it from inside or outside a tenant's suite. Nearly one third (32 percent) of occupiers in CBRE's "Spring 2023 U.S. Office Occupier Survey" indicated that outdoor space is a highly sought-after building amenity.[15]

Commuting: Managing the Cost and Burden

CBRE survey data published in November 2022 indicate that workers prioritize commute time as a top factor when considering future job opportunities. Among U.S. workers, shorter commute times and availability of car parking were the two top factors that would make frequent visits to the office desirable, with each selected by 73 percent of respondents.[16] Strong tenant demand for office buildings with proximity to public transit and ample parking exists as a result, with 59 percent of occupiers favoring buildings near public transit and 54 percent ranking parking as a key amenity (see Figure 4).[17]

Multiple interviewees confirmed that the return to the office has made occupiers sensitive to the inefficiencies of driving long distances to work and searching for convenient and affordable parking once they get there. While it may be impossible for office owners to provide these amenities if they do not already exist, they may be able to "improve parking ingress and egress," "lighten and brighten parking decks," and "enhance security, service and customer satisfaction in existing parking facilities" to make commuting less burdensome. Another strategy to reduce the cost of commuting involves bringing housing closer to office space. "In some of our properties, we are considering the development of apartments on existing parking lots," said an officer at a public office REIT.

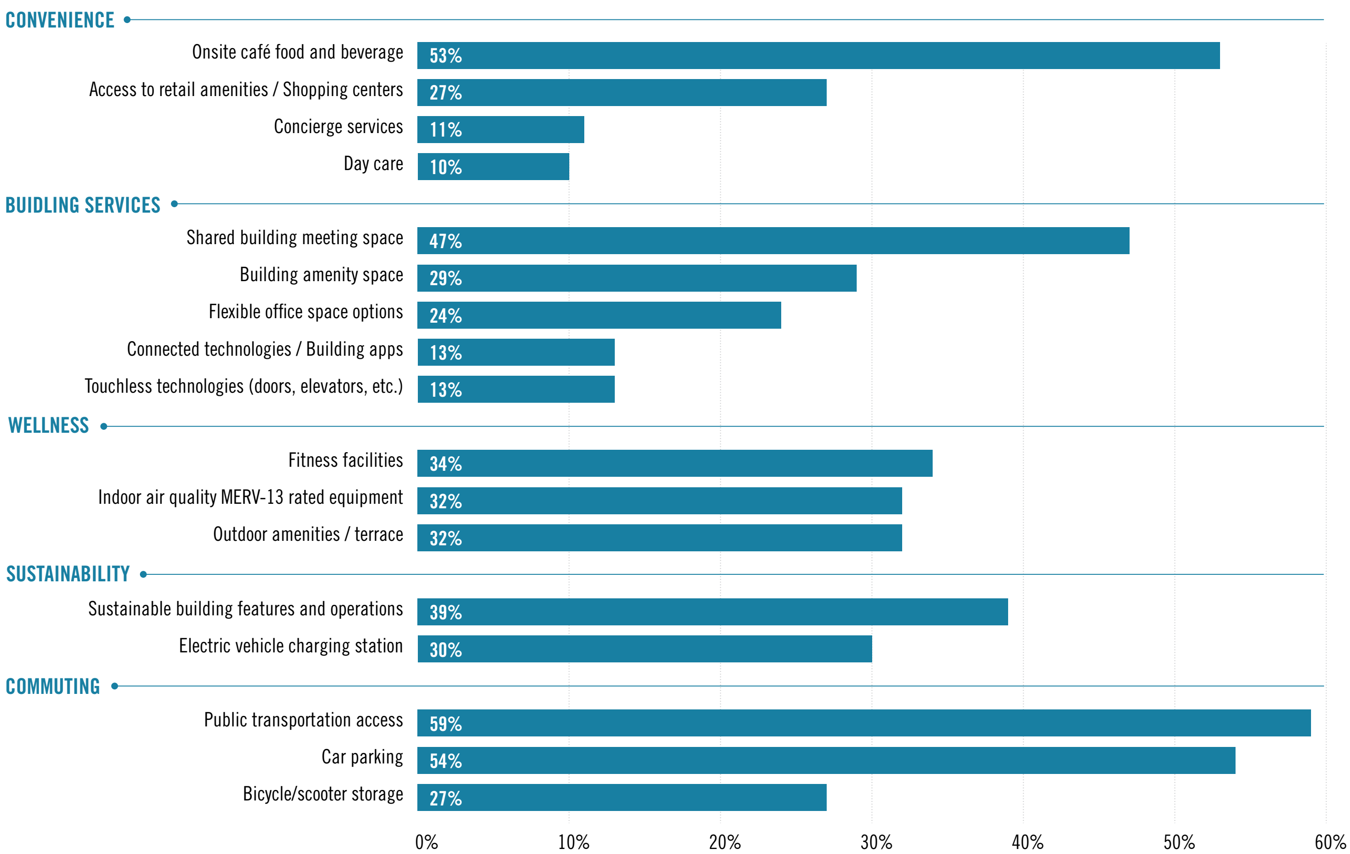
Amenities: More and Better

Office owners are investing heavily in amenities designed to improve the onsite experience to attract tenants that hope to use their office space as a recruiting and retention tool. Interviewees compared the trend to shifts in the apartment market a decade ago when resort-style amenities became mainstays in high-end rental communities. A nonexclusive list of amenities that have found their way into office buildings include complementary coffee bars, expansive fitness centers, food halls, golf simulators, luxury lounges, pickleball courts, putting greens and technology-enhanced conference rooms. Interestingly, it may prove necessary for office owners to invest in

these amenities regardless of whether they anticipate tenants will use them. "The amenities show great, generate leases and give companies positive news to communicate to their employees, but they aren't always heavily used," said the managing director of asset management at a private equity firm. "A building still needs them to check the boxes and make a prospect's short list." Other interviewees described amenity investments as primarily "defensive moves" designed more to retain existing tenants than attract new ones.

Data from CBRE's occupier survey provides insight into the relative importance that occupiers place on different building amenities (see Figure 4). An onsite café ranked as the top third amenity (after public transit and parking) that occupiers considered important when evaluating a property. The data also reveal that a large share of respondents prioritize environmental sustainability, with 39 percent indicating they look for sustainable building features and operations, and 30 percent indicating they seek buildings that offer electric vehicle charging stations. Large companies are particularly interested in sustainability, and many have public sustainability goals. Most (61 percent) of the largest firms in the survey indicated they prioritize sustainable building features and operations.

FIGURE 4: MOST DESIRABLE BUILDING AMENITIES FOR OCCUPIERS



Source: CBRE Spring 2023 U.S. Office Occupier Sentiment Survey.

Respondents from major design firms echoed the rising importance of sustainable design to occupiers and identified it as critical to preparing office buildings for the future. The pressure to reduce the environmental impacts of operating office buildings is expected to grow. Moving away from fossil-fuel use in building systems and reducing the amount of energy used for building operation and maintenance will be integral to office design in the future. Respondents identified Cisco's smart offices in New York City, Atlanta and elsewhere as examples of how to use technology to meet net-zero carbon goals.

Bringing Convenience and Flexibility to Office Interiors and Common Areas

Occupiers are looking for new approaches to interior design within the spaces they lease to make them more effective tools for talent recruitment and retention, and to increase worker productivity. According to the latest CBRE occupier survey, the most common actions to reallocate space in support of new work patterns focus on making space more efficient for the company and more effective for employees. Two-thirds of respondents indicated they were moving away from individual seat assignments toward a greater ratio of seat sharing. A majority (52 percent) are planning up to a two-to-one employee-to-seat ratio, while 15 percent are planning up to a three-to-one ratio. Only one-quarter of respondents plan to keep a one-to-one ratio or less. This trend is also contributing to greater demand for shared meeting and coworking space that

allows occupiers to flex into additional space when more employees are in the office. When it comes to identifying integral building amenities, just under half (47 percent) of survey respondents said shared meeting space, while 24 percent said flex space. Over half would engage with a landlord who was open to bundling shared building space and flex space into their lease agreement.[18]

In interviews, experts from design firms weighed in on important interior design considerations that are intended to improve the quality of the office space and maintain its utility in the future. Occupiers are looking for office interiors that offer both private space for concentration and collaborative space for mentoring, team building and learning. Michael Vander Ploeg, workplace leader and principal at DLR Group, proposed a framework for office interiors that considers the benefits, tasks and designs associated with six work modalities: hard focus, soft focus, collaborating, learning, socializing and rejuvenating. Hard focus requires private space without distractions, neither visual nor acoustic. Soft focus is most successful in open spaces with high ceilings and light background activity and noise. Collaboration is facilitated by open space with shared areas, surfaces and technology. Learning requires access to appropriate materials, equipment and technology in spaces that are comfortable. Socializing is supported by circular seating arrangements, exposure to nature, comfort, and access to food and beverages. Rejuvenating spaces look like socializing spaces, but with more noise and movement and access to the outdoors.

Building owner and operator respondents spoke more frequently about strategies to make office buildings more appealing to occupiers than they did about strategies to make them more conducive to hybrid work. However, there were a few noteworthy examples of the latter. Investments in "open and inviting common areas" with "comfortable seating," "natural light" and a "variety of places where people can work independently or in groups" were identified as a direct response to hybrid work, as were investments in shared conference rooms available upon reservation. These features were purported to provide individuals with "greater flexibility" when they come to the office and "more control over their surroundings" when working on-site. Furthermore, attractive common areas were said to serve as "spillover space" for tenants still trying to figure out their space needs. Coworking space available on a short-term basis for a fee was put forth as another way to achieve these ends, while spec suites built out for 3,000- to 5,000-square-foot users were identified as a more appealing option for tenants who want to control their space but are unwilling to sign long-term leases or invest heavily in improvements until their space needs are better understood. Indeed, 34 percent of occupier survey respondents indicated they would prefer fully built-out speculative suites or turnkey office space.[19]

Small Upgrades, Big Impact

Large investments in amenities often complement more modest investments that improve office occupants' lives on a day-to-day basis. "Freshening up lobbies and restrooms pays dividends," said a senior property manager at a third-party real estate services firm. "Bright, clean, updated spaces that people use every day makes the transition back to the office more manageable." The director of leasing for an owner-operator added: "Lobbies with new furniture that have a community feel like a hotel lobby are popular with our tenants. So are micro-markets in the common areas of our building that we stock daily or weekly with perishable and nonperishable food items and operate on the honors system." Neither interviewee suggested that such investments can transform functionally obsolete buildings, but both indicated that they have the potential to make already competitive buildings even more so. Interviewees also reported using customizable apps to make tenants aware of an expanding array of onsite programming, ranging from food truck rallies to live music to cooking classes to massage and manicure days. These experiences are intended to create a sense of community among those working in an office building or office park.

Revitalization and Conversion: A Difficult Road Ahead for Many Office Owners

Targeted capital improvements may be an appropriate response to the flight to quality taking place in the office market for some assets, but they are not a panacea. In fact, they may do little to bolster the competitive position of buildings with significant functional obsolescence. "I'm not hearing much chatter about revitalizing B- and C-quality office buildings among debt or equity providers at the moment," said a managing partner at a private equity firm. "It's difficult to justify the risk unless a building has an extremely compelling story or location." Those interviewed agreed that a large portion of the office stock simply cannot be improved to the standards of today's discerning tenants. The director of real estate market research at an insurance company summarized the situation as follows: "The office market isn't oversupplied, it's under-demolished. There are too many assets that no longer meet tenant demands, and there isn't a clear path to turn them around." The interviewee also stated that conversion isn't a solution for most of these troubled buildings because the cost of moving mechanical, electrical and plumbing systems is prohibitive even when buildings are well located and have floorplates that can be easily demised. This suggests a difficult road ahead for many owners and operators of office buildings. To date, only a small share of existing office buildings has been converted to new uses. According to CBRE, even if every planned office conversion is completed, together with the conversions completed since 2016, only 91.1 million square feet would be removed from the market, representing roughly two percent of total U.S. office inventory.[20]

New Uses for Office Buildings: Life Science, Medical and Multifamily Conversions, published by the NAIOP Research Foundation in 2022, evaluates the risks and opportunities associated with office conversions and examines the characteristics of properties that make the best candidates for conversion. Since the report's publication, life science conversions have become less frequent as higher interest rates have decreased the amount of funding available to new biotechnology firms, and the focus of potential conversions in most markets has shifted to multifamily. As the report explains, older downtown office buildings are likely to offer the best opportunities for adaptive reuse to multifamily for many reasons. Buildings more than 80 years old are more likely to be located near transit and amenities. They often have notable architecture, are less than 20 stories tall, and have smaller floorplates, operable windows and other features that make conversion easier. Attractive residential unit dimensions and greater light penetration are more feasible in these buildings. They also often qualify for historic tax credits.

Respondents for this report echoed those findings and added that the least attractive buildings for conversion are likely to be urban B-class and suburban C-class buildings with large floorplates, limited or narrow windows, and undistinguished architecture. These features increase conversion costs while limiting the appeal of a converted building. Several interviewees thought that suburban office parks with 40- to 60-year-old buildings surrounded by a sea of surface parking will be the least likely to remain in office use. If transactions occur, purchase prices are likely to be less than the cost of comparable vacant land to account for demolition costs.[21] However, there are examples of the successful redevelopment of suburban offices to industrial/warehouse and self-storage space, as examined in a 2022 article for *Development*.[22]

Despite the many challenges associated with converting obsolete office buildings, several interviewees noted that local governments are devoting serious attention to finding alternative uses for the growing inventory of excess office space. Simply demolishing vacant office buildings produces several negative externalities, including the environmental impacts of demolition and debris disposal, potentially adverse effects on surrounding properties, and reductions in local property tax collections. For these reasons, should municipalities become owners of tax-delinquent office properties, they will look for ways to repurpose them. Observers expect a range of potential new uses may be considered, depending on local needs and market conditions. Options may include inexpensive coworking space for small businesses, urban agriculture (growing fruits and vegetables indoors and on rooftops), homeless shelters, emergency shelters, senior housing and recovery housing. However, alternative uses that do not generate substantial revenue for a jurisdiction are likely to be adopted on only a limited basis and should not be considered a long-term solution for struggling business districts.

Conclusion

The experience of working through the COVID-19 pandemic has led organizations to reappraise the value of office space and in-person collaboration. The office has not become obsolete, but organizations are not returning to the way things used to be. Office utilization has slowly increased as more occupiers operating in a hybrid format gradually adopt formal requirements for a minimum number of days that workers come into the office, but recent survey data and occupier behavior suggest that a large segment of office-using industries will continue to employ hybrid work schedules to at least some degree for the foreseeable future. In most office-using industries, many work tasks can be effectively performed remotely, so to add value to workers' labor, offices need to offer more than simply a location for work that could be performed elsewhere. In the context of hybrid work, occupiers are interested in spaces that are conducive to collaboration and exchanges of ideas, that can contribute to the maintenance of a corporate culture, and that offer amenities that can compete with those available to workers at home. At the same time, they want to maximize the use of the space they lease, thereby increasing demand for access to shared amenities such as conference rooms, coworking spaces and cafeterias. And with occupiers looking to minimize barriers to coming into the office, short commutes, access to public transit and abundant parking spaces are as important as they have ever been.

In the short term, high interest rates and stringent underwriting criteria will make it difficult for owners of older office buildings to make significant renovations. However, there is reason to believe that older buildings in convenient, safe locations with access to adjacent amenities should be attractive to more cost-conscious occupiers. Nonetheless, the minority of office buildings that have suffered the largest increases in vacancy will pose a challenge for building owners, lenders and municipalities. The most functionally obsolete buildings are unlikely to be worth the expense to renovate, and only a small share of these will be attractive targets for conversion to new uses in the absence of public subsidies. Developers, building owners and municipalities will need to work together to find creative ways to transition these properties to new uses.

Endnotes

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[11] CBRE, "Office Buildings Hardest Hit by Pandemic Share Common Characteristics," April 4, 2023, https://www.cbre.com/insights/viewpoints/office-buildings-hardest-hit-by-pandemic-share-common-characteristics.

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[13] New starts may be limited to build-to-suit projects for companies that will own that office space upon project completion.

[14] CBRE, "Spring 2023 U.S. Office Occupier Survey."

[15] Ibid.

[16] CBRE, "Cross-Generational Attitudes."

[17] CBRE, "Spring 2023 U.S. Office Occupier."

[18] Ibid.

[19] Ibid.

[20] CBRE, "Office Conversions: A Second Chance for Underutilized Space," December 2, 2022, https://www.cbre.com/insights/viewpoints/office-conversions-a-second-chance-for-underutilized-space.

[21] On the other hand, any office building in an urban area with underground parking is likely to find a productive use given the value of that feature.

[22] Ron Derven, "Office-to-Industrial Conversions: A Market Worth Exploring," *Development*, Summer 2022, https://www.naiop.org/Research-and-Publications/Magazine/2022/Summer-2022/Business-Trends/Office-to-Industrial-Conversions-A-Niche-Market-Worth-Exploring.

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