Yardi® Kube

Remaking the Office for a New Era

A revolution is taking place in America's office spaces. What does it mean for owners, brokers and their clients?

KEY ISSUES ADDRESSED IN THIS YARDI WHITE PAPER

- A market in transition
- Driving factors: complexity, uncertainty or both?
- Shared space reimagined
- Office brokerage 2.0
- Technology and the decision-making process

YARDI

Despite the upheaval experienced in the office market during the past several years, some things haven't changed. Unless an office occupier has completely divested its commercial real estate holdings (and a few apparently have) in favor of remote work, it is still the second-most costly line item on a corporate balance sheet.

It may be a while, however, before the full impact of those costs are realized, given the sector's current performance. The same goes for the benefits, such as collaboration, camaraderie and—probably most important to the bottom line—strategic productivity. Despite some reports of occupancies creeping back up, **CommercialSearch reported** that office vacancy jumped 260 basis points year-over-year in August, bringing the national rate to 17.5 percent.

Not all of the bad news can be attributed to pandemic-related disruptions, although the acceleration of hybrid work options has given employees—and their employers—reason to rethink the traditional role of the office setting.

The economic uncertainty of the past few years and a long string of interest rate hikes melded with a sharp decline in attendance to create 8.5 million square feet of negative net absorption in the second quarter of 2023 alone.

Another entrant into the workspace dynamic has also added to the disruption. Much like hybrid work protocols, shared office space was established decades before the pandemic, and it has now become even more prevalent. The compound annual growth rate (CAGR) for shared space was

MEAGHAN ELWELL
JLL

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19.7% in 2022 and is projected to grow 17.8% through 2026.

Such dynamics challenging the viability of traditional approaches to office space make the long-term outlook for the market cloudy. Theoretically, clarity should come as the pandemic's impact begins to fade and office occupiers regain certainty about their needs. When that will be is very much open to question.

Transition is another key issue, and those dynamics tell the story of a market undergoing a sea change.

"Companies are recognizing the importance of flexibility for their employees," says Meaghan Elwell, president of the industrial unit in JLL's Work Dynamics division. "To attract and retain the best talent and enable the most productive workforce, there's a need to create that flexibility through such strategies as shared spaces and hybrid protocols."

And both fit the need to manage space holdings more actively and optimize portfolios, notes David Smith, head of Americas occupier research for Cushman & Wakefield. Some occupiers around the globe "oversubscribed their footprints," he says, and as a result, the average lease today is about 20 percent smaller than it was pre-pandemic.

That downsizing trend should moderate over time. But a return to less flexible attendance patterns is probably a thing of the past for most organizations. To be sure, some corporations—such as Amazon, Chipotle, Disney and JP Morgan—are going old school in their attendance mandates. But this flies in the face of the recognition that, as Smith says, "not every employee can be in the office every single day."

> *We'll see a steadier rhythm in the determination of how much square footage occupiers need per employee.*

DAVID SMITH
Cushman & Wakefield

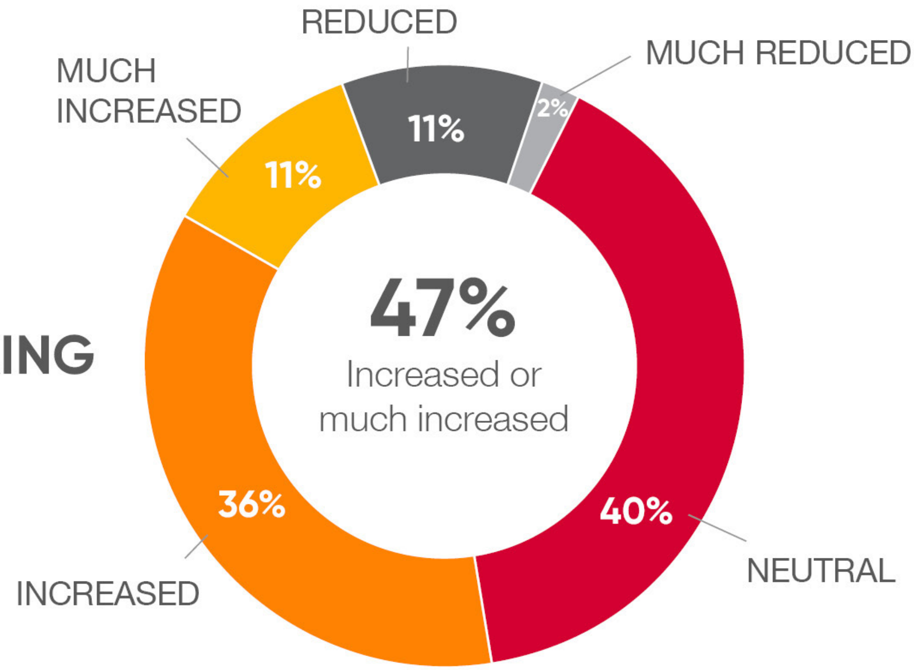
COMPLEXITY OR UNCERTAINTY?

Clearly, the office is refitting for a new age of demand. But the path to what might be called a "new normalization" will not be easy.

Over time, Smith predicts, "we'll see a steadier rhythm in the determination of how much square footage occupiers need per employee." That would be the natural progression as we pull away from economic upheavals and pandemics.

Even without those outside threats, that progression, natural though it might be, will come with challenges. A recent Knight Frank Cresa office occupier survey bears this out. Nearly half of the 640 corporate real estate professionals who participated, 47.5 percent, said that the complexity of real estate decision-making has increased.

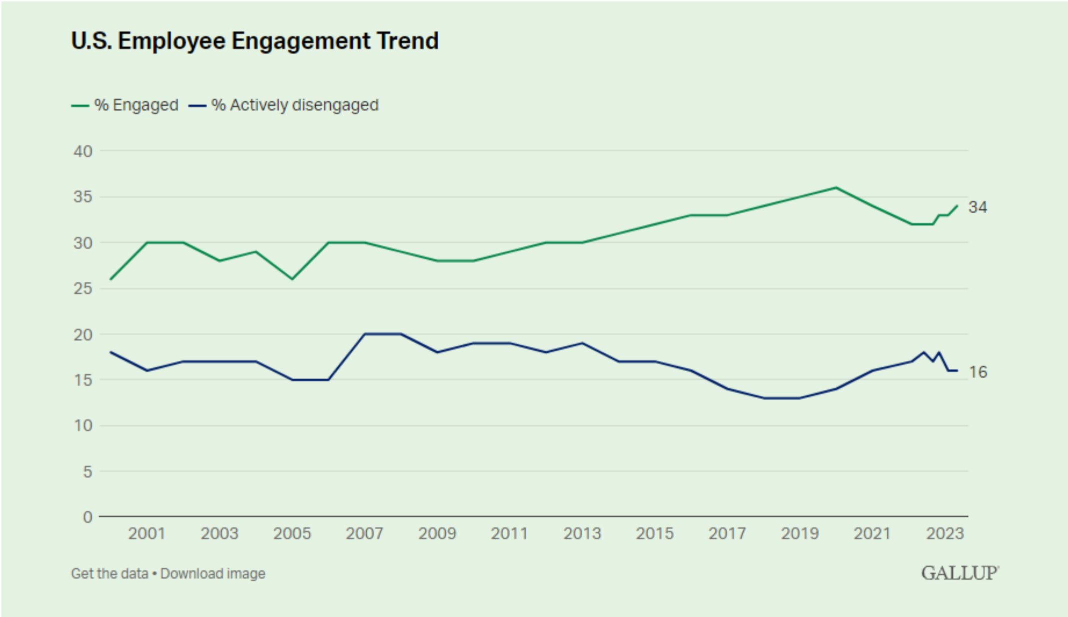
PERCEIVED COMPLEXITY IN REAL ESTATE DECISION-MAKING CAPABILITY

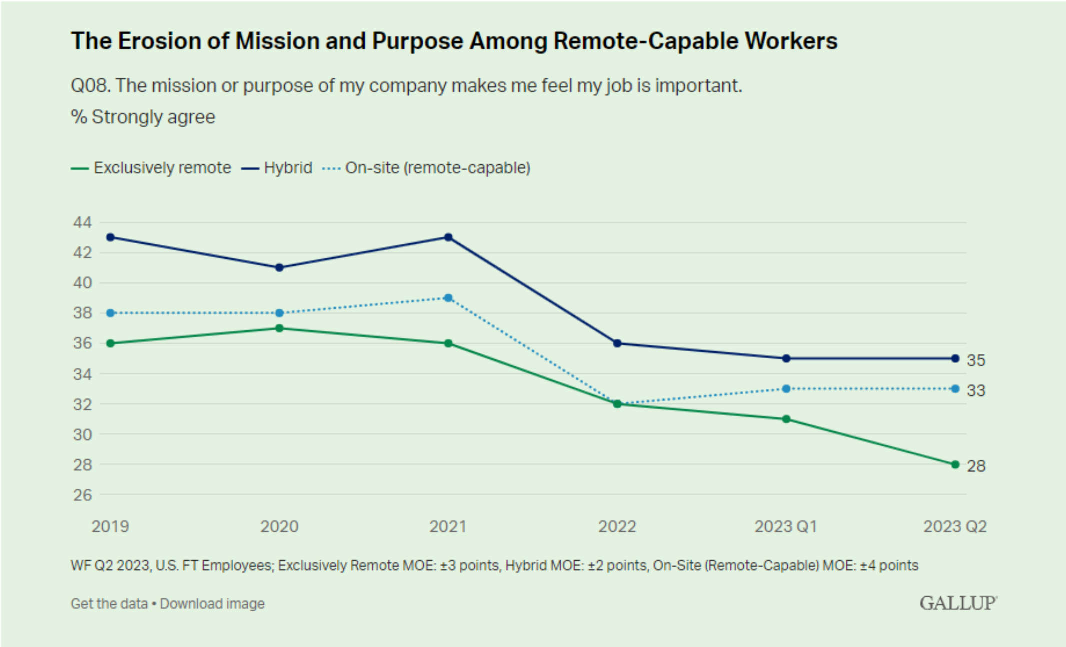


This mounting complexity also touches on such issues as environmental, social and governance (ESG) concerns (considered influential by 72 percent of respondents). But in terms of potential relocation alone, changes in workstyle and the effect on workspace quality were the second-most important factors, named by 38 percent, followed by quantity of space (37 percent). Only the cost of space (47 percent) was named by more respondents as the biggest expected driver of relocation over the next three years.

The complexity becomes even greater when you fold in the loyalty factor. At midyear, the percentage of U.S. employees who could be considered engaged was 34 percent, up 2 percent from 2022, reports Gallup.

But what **Gallup describes** as the most worrying trend is that employees who can do their work remotely have "an eroding connection to the mission or purpose of the organization." Only 28 percent of exclusively remote workers report feeling "connected to their organization's mission and purpose," a record low.





“One hundred percent agree that the process will become more complex,” says Peter Kolaczynski, director of CommercialEdge. “Historically, it’s been simple,” with predetermined square footage per person, varying by title as a determining factor of need. “Now people’s expectations are also changing.”

WARREN HERSOWITZ
Yardi Kube

> ”
> *The seeds of working remotely—from home or from another offsite facility—have already been planted.*

So, will office decisions become more complex or just more uncertain? That’s the question posed by Warren Hersowitz, sales lead for Yardi Kube. He cites the current economic uncertainty as casting a shadow over space decisions—and their cost. Moreover, the Pandora's box of employee flexibility is unlikely to close. As Hersowitz puts it, “the seeds of working remotely—from home or from another offsite facility—have already been planted.” He is not alone in reviewing the pressure release valve of shared space as the solution.

SHARED SPACE, REIMAGINED

A MIRO suite at BGO's 685 Third Avenue.

The push to provide office workers with what they want is influencing the democratization of office space. "Many decision-makers are now re-evaluating space needs because of employees' reluctance to revert back to the historical norm," Kolaczynski says. Office occupants have multiple reasons to leverage their spaces: to enhance collaboration and innovation and to connect people with one another and with the organization, as well as to support productivity.

ROBERT NASO
BGO

> *Our ongoing dialogue with brokers across the country is more important now than ever.*

"Private offices may be de-emphasized as space becomes more activity based," adds Smith, "and there's a greater emphasis on providing more flexibility, different types of workspaces and more access to natural light and window views." It all comes down to how the office can best support team performance and drive business goals.

Then there is the modular take on the theme and a sign that landlords are adapting to the evolving needs of tenants with innovative solutions. A week after BentallGreenOak rebranded itself as BGO this past summer, the firm launched MIRO (the name is shorthand for Move-in-Ready Offices). Robert Naso, managing partner and head of U.S. asset management for BGO, described the product as a "fully built-out, ready-to-go alternative, especially for small and medium-size tenants that might need only a few desks for ultimate flexibility." He sees MIRO as an alternative to both long-term agreements and more typical shared spaces.

But he emphasizes that MIRO is not coworking in the conventional sense. While it may function as a flexible office solution, there is a significant difference: BGO's offering is driven by lease agreements rather than by memberships. Naso describes it as a tenant-specific lease alternative and an offering exclusive to BGO assets.

And this underscores the more democratic nature of space needs today. "We're seeing companies change their protocols, their guidelines, their strategies," says Elwell, adding, "We can expect the traditional guardrails to diminish" as the need for greater flexibility grows. "The most sophisticated companies are using technology to optimize that flexibility and to promote effective collaboration."

That technology is also exercising increased influence over the office market. Through such connected programs as Yardi Kube, corporate users have greater control over the management of flex-space operations and even the financials driving the decision, "without third-party integrations," as its website proclaims. Users even have at their disposal all the necessary market data and space availability to make informed decisions. And that, in turn, raises questions about the role of the office broker.

PETER KOLACZYNSKI
CommercialEdge

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THE BROKER OF THE FUTURE

Will the growing ubiquity of tech resources do away with brokers? Most likely not. Will it change how they serve clients? Without a doubt.

Not surprisingly, talk of the "disintermediation" of brokers long predates COVID. As far back as 2018, the National Association of Realtors commented: "Brokers are finally enjoying the benefits of workflow efficiency that other industries saw many years ago. Technology isn't replacing brokers but empowering them to be more productive and enabling them to focus on the human side of the commercial real estate business."

The discussion around complexity plays into this, as well. Smith cites the broad, diverse scope of guidance a third-party adviser can provide. It travels far beyond deal execution and touches such bases as "the total workplace consulting strategy, what my employees really want and what type of space we need." It also includes advising on construction cost and schedule. Holistic and long-term space decisions "are big factors that require a lot of help, support and leadership."

Opinions vary as to whether most brokers will hold out for their traditional bread-and-butter deals—massive, long-term leases with institutional clients—or go where the trends take them, which often points to securing smaller, shared spaces.

"We send 25,000 or 30,000 leads to brokers from our platform," reports Kolaczynski. "But if an individual occupier is looking for short-term space, to some brokers, the juice isn't worth that squeeze."

That said, he adds that many opportunistic brokers will expand their scope to include smaller deals, and the eventual automation of short-term leases will by no means cut the adviser out of the process. "The broker will not become obsolete. Not anytime soon." Brokerage, like all other facets of commercial real estate, is a relationship business.

Smith agrees: "Occupiers are looking for partners who are going to do anything and everything they need, regardless of the size, recognizing that these are long-term relationships." Holistic service is the key here. Given that markets are changing dramatically for end users of all sizes, continuing the dialogue with brokers is as important as ever. "Brokers want to support their clients and provide practical solutions for their office space needs," Naso says. "Increasingly, move-in-ready spaces are an important piece of those solutions, especially for organizations that need access to private, well-located, highly amenitized space." The human touch and the power of relationships will clearly factor into the decision-making of occupants in the future, but it will not stop the upward trajectory of technology.

HOW TECHNOLOGY INFORMS DECISION-MAKING

And that technology can enhance the roles of the real estate broker as much as the corporate user. "It's all very exciting," JLL's Elwell observes of the trends in artificial intelligence and tech-optimized workplaces. By delegating what she calls the "more tactical work" to software, all involved players open their focus to more strategic pursuits. She sees that optimization occurring within the next five years or so.

In the meantime, it might be easy to go online and book a conference room for an hour, says Hersowitz, but "what's not very easy right now is to sign up for an office that can be completely self-service. How do I sign up for a private office including all the needed amenities without an operator-initiated process?"

That issue still needs to be addressed, and providers such as Yardi are on the case. The first order of business, Hersowitz says, is to "look at our clients' needs and the demands of the market to ensure we can provide those capabilities and expand the self-service aspects of the platform."

Ditto the integration of AI and "the ability to understand what's happening in the market based on the data" that is typically collected by services such as Yardi Kube.

"Those types of tools, like the internet before them, will be useful in making real estate more efficient over time and allow us to better understand data at a deeper level," says Smith. "That's a critical part of this. The quality of the data will determine how effective you can be and how successful in creating bespoke insights for individual decisions as well as broader portfolio strategies."

The office market may take years to emerge from its current state of flux and achieve a new paradigm. Technology, shifting work patterns and new approaches to configuring space are among the key signs of a work in progress. Brokers will need to adapt to their changing roles, even as many owners will have to address tough choices and financial challenges. But it also seems clear that the reports of the office's demise are premature. To ensure success owners, developers and brokers must create a paradigm that meets the needs of the 21st-century occupant.

Contact us to discuss the Yardi Kube solution that's right for you.

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