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Future office use: Cacancy vs. availability - by Daniel Calano

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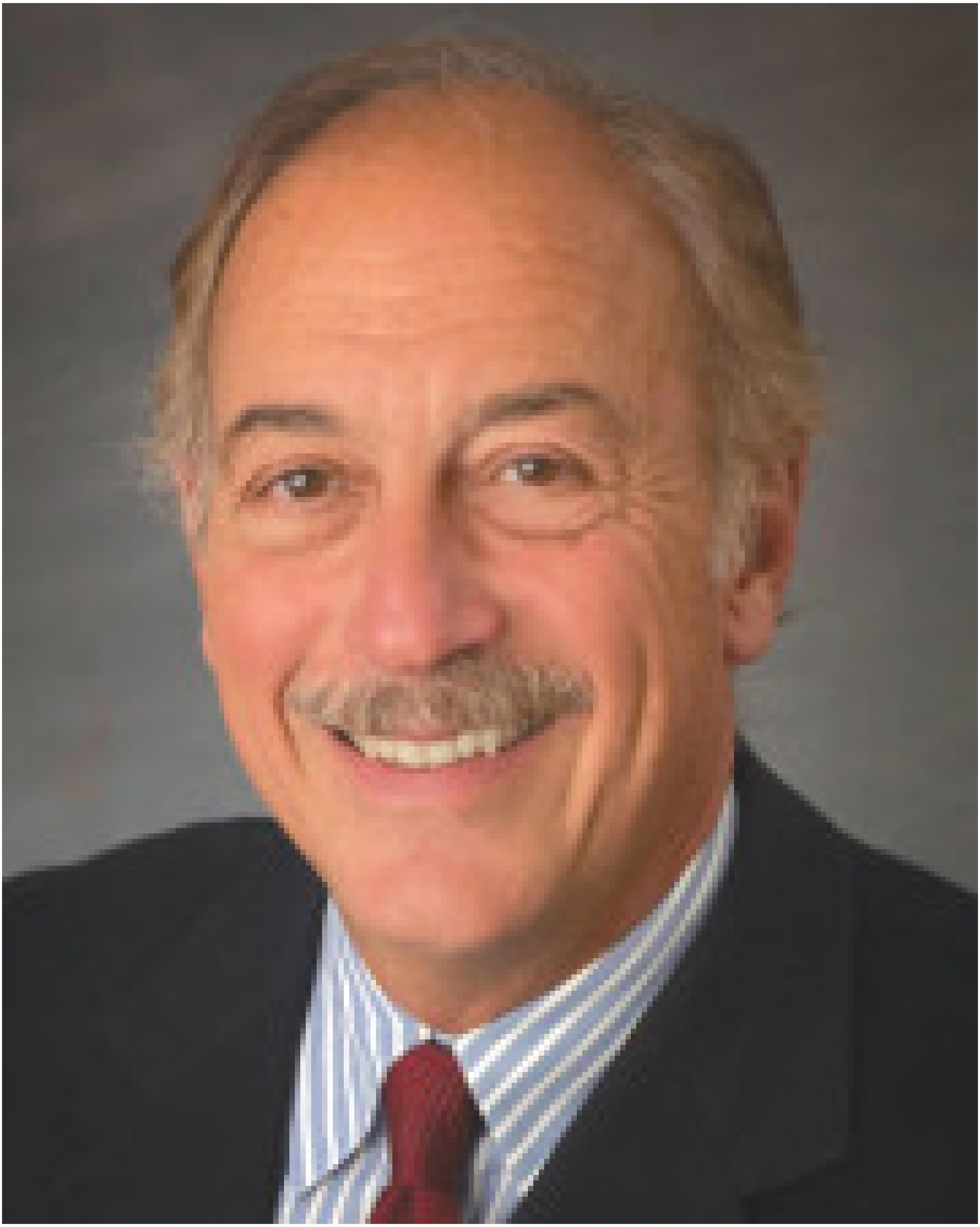

Daniel Calano

Just last summer, with COVID mostly under control, the big discussion from every venue was whether employees would return to the office, or not. The debate was intense, as some companies tried to insist upon having employees back in their office seats. Other companies were allowing work from home on Fridays and Mondays. Some, particularly tech companies, were happy with 100% remote. Expectations were that office space would ultimately be occupied at a 60 to 70% level.

Jump to the new year, and the future is slightly more clear, but not yet optimistic. Regardless of work from home or hybrid, office space availability has grown and is having a very large impact on office real estate. The press is very different now. Despite requirements posed by CEOs, the “threats” to return to office have not worked. Mostly anecdotal, reports are that workers, at best, have returned to the office at a 50% rate.

So why do office landlords, developers, and brokers worry? They have always dealt with vacancy rates in office, and have managed to “bake vacancy into” their pro forma’s. Depending upon where the buildings were located, normal vacancy could range from 30% all the way down to below 10%. But baked in vacancy is quite different from availability. In the past, availability meant temporary vacancy, usually ameliorated through subleases or growth by current tenants.

The difference now? There are many new forces that have come into play. First, the obvious one is that remote working has improved and clearly has a niche. Improvements in remote work, like Zoom, have made a big difference, and remote workers have adapted, if not flourished. As a result, office use has obviously had less space needs. Companies have reduced their space where possible, or are planning to do so when leases come up.

But the newest and most formidable impact has been the realization of inflation, and the Federal Reserve bank response: ie, increasing interest rates to tamp down growth. The Fed is hell-bent on reducing inflation, which is a strong part of its mandate. In fact, the mandate has two parts: low percentage inflation, and high percentage employment. At this unusual moment in time, these two objectives are often in conflict with one another. The Fed wants high employment, but lower wages, and thus larger supply of workers. But it also wants lower rental costs. It continues to raise interest rates which clearly has a higher cost for building and company debt. Get the conflict?

Good examples of companies like Meta, Amazon, and Google, have both increased workers and space over the years, but now have recently pivoted, laying off workers, thus making excess space available. Meta has already decided to shed 590,000 s/f that it recently occupied in Austin, Texas. Additionally, according to a recent New York Times article, this has been in simultaneous with more than 100,000 technology workers losing their job this year.

New York City is a good city example of how this is playing out This is a good example of the canary in the coal mine. New York is the biggest canary, but Boston, Atlanta, San Francisco, Los Angeles, Dallas and Chicago are all having similar impacts. NY has a total of 540 million s/f of office space, the largest office market the country. It is estimated that space in Manhattan is 20.2% or 100 million s/f available, according to Colliers. It is true that is mostly in older buildings, and many tenants have fled those in order to move to new towers, some not even built yet. Many will continue to pay rent under current leases, but have already made it clear that they will not renew. But the owners of these older buildings, who typically have an optimistic viewpoint and have weathered slowdowns, will do what they can to keep their office space viable and competitive, hoping that a strong economy will eventually balance labor force and refill their buildings.

Others are reviewing and analyzing their buildings for the possibility of changing office into residential. If workable, this would both reduce office availability and provide more affordable housing. It has become a popular concept, but all parties are well aware that regulations, rehab costs, feasibility etc. are all difficult barriers. However this is resolved, there will certainly be issues in the near future that will be burdensome. Much depends on the growth of the economy over the next few years, as well as resolution of the impacts of higher interest rates. There will be solutions, but not quite yet.

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