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Workplace roundtable 2022

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Work in progress

Participants in PERE's Workplace roundtable seek to clear the fog of uncertainty surrounding post-pandemic working practices and the future of the office. Stuart Watson reports

While the threat posed by the pandemic may have receded, in most offices it is certainly not business as usual. And for the four real estate professionals gathered for *PERE*'s Workplace roundtable, that poses a considerable challenge, as they represent major institutional real estate owners with significant exposure to the office sector.

Each has been keeping a close watch on occupancy levels within their respective markets. Sondra Wenger, head of Americas commercial operator division at CBRE Investment Management, notes the contradictory signals emanating from the US market, where some firms have mandated a full-time return, while many tech companies have backed away from compelling attendance for fear of losing valuable talent.

However, she says that there now seems to be a trajectory of "steady growth," with overall US office occupancy reaching a pandemic-era high of 43 percent in early April, according to research by building security provider Kastle Systems. Meanwhile, regional variations have emerged: "We have seen the Sun Belt markets return quicker than coastal ones, which are more reliant on public transit."

Occupancy in continental European capitals is higher than 50 percent, says Donato Saponara, head of investment and strategic development for West Europe at Allianz Real Estate: "It is getting better. But for sure, we will not return to the levels of the past."

That tallies with the appraisals of 50 to 75 percent for continental Europe that Zachary Gauge, head of research and strategy EMEA ex DACH at UBS Asset Management has heard from office sector brokers. The UK is trailing, however, with occupancy rates hovering around 25 to 30 percent in July, according to research from European real estate consultancy Remit Consulting. "I suspect a lot of that difference is down to longer commuting times. People can lose two hours-plus a day coming into the office in London. In markets like Madrid, Amsterdam and Munich, it is easier to get in and out."

It is impossible to know how current levels compare with those of the

Zachary Gauge
Head of research and strategy, EMEA ex DACH, UBS Asset Management

Gauge's main role is to advise the investment teams at UBS-AM on prudent strategies using a combination of macroeconomic, real estate and liquid market data. He is a voting member of the European investment committee and sits on the Urban Land Institute's Technology and Real Estate Council. Prior to joining UBS in 2014, he held research positions at CBRE and Property Market Analysis.

Pierre Leocadio
Head of investments, Europe, Oxford Properties Group

Leocadio has responsibility for the origination and execution of new investment opportunities across asset classes and European markets that fit Oxford Properties' global investment strategy. Prior to joining Oxford Properties, Leocadio worked at investment and asset manager Renshaw Bay, and at UBS Investment Bank within its debt capital markets division.

Donato Saponara
Head of investment and strategic development, West Europe, Allianz Real Estate

Saponara is responsible for Allianz Real Estate's acquisitions strategy in West Europe, which includes France, Italy, Benelux and Iberia, and for overseeing the portfolio owned in Italy by Allianz investors. Saponara leads several Board and Advisory Committees for Allianz and sits in Senior Management Committees for the Western European region. Before joining Allianz in 2014, he spent 14 years at Morgan Stanley.

Sondra Wenger
Head of Americas Commercial Operator Division, CBRE Investment Management

Wenger is responsible for the overall leadership, strategic vision and growth of CBRE IM's office and retail assets in the Americas, including overseeing transactions management, asset management and development for these sectors. Prior to joining the firm in 2021, she served as a senior executive for institutions including CIM Group, General Electric and Equity Office Properties.

past, because occupancy data was not collected until after the pandemic, he observes. Estimates of "normal" pre-covid occupancy vary from 60 to 80 percent. A positive indication is that firms signing new leases are generally taking a similar amount of space as they did before the pandemic, he says. "While the number of physical desks may be reducing, in some cases the actual floor space is staying the same, or even increasing, to accommodate more interactive spaces."

It is still very difficult to draw firm conclusions as to what the new normal will be, says Pierre Leocadio, head of investments for Europe at Oxford Properties Group. "There are big discrepancies depending on the type of occupier and the location they are in. Companies don't yet have all the answers. They are testing out new ways of working and trying to get feedback from employees, while at the same time there is a war for talent going on. We should see a clearer picture emerge over the next 12 to 24 months."

Offering flexibility

In the meantime, office landlords are increasingly inclined to offer flexibility to their occupiers. "It is very difficult for tenants to have a full view of what they will need day-to-day, so every time we design an office space, we keep in mind that it needs to allow for internal changes of use," says Saponara. He adds that in large multi-tenanted buildings of more than 10,000 square meters (100,000 square feet) Allianz Real Estate typically reserves around 20 percent of the building for co-working or flexible office space, usually managed by a specialist provider, as a "service for the occupiers."

Oxford Properties has a similar approach in multi-tenanted buildings, says Leocadio. "That provides occupiers with some potential for growth, and co-working space also adds something to the atmosphere of the building, making it feel more like a business center.

"For occupiers, being able to show that they are adopting measures to reduce the carbon footprint of their headquarters is a key point for attracting talent"

DONATO SAPONARA
Allianz Real Estate

UK national average office occupancy since May 2021 (%)

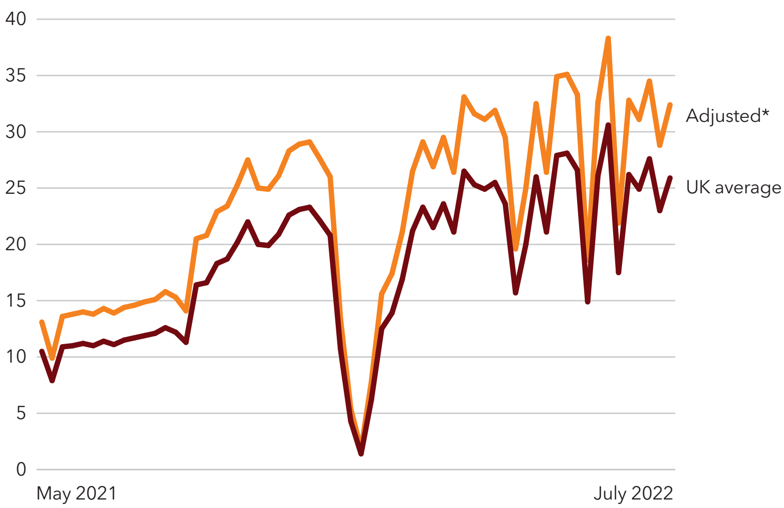

*Chart shows an adjusted figure to compare current figures with a possible pre-pandemic 80% average office occupancy
Source: Remit Consulting

Life sciences in practice

Opportunities to develop space for biomedical tech firms abound. But the participants caution that success depends on meeting the sector's stringent requirements

With uncertainty still hanging over the future of offices, real estate investors – including some of the roundtable participants – have sought to devise strategies to harness rapid growth in the life science sector. Wenger says that in the US, CBRE IM has focused on building new space near existing hubs for innovation. Adapting existing office space to life science use is difficult and expensive, she argues, because of its requirement for ceiling height, floor loading and environmental specification. She observes that there is an increasing tendency for companies in other sectors, such as food technology, wanting to co-locate on campuses designed for life science firms. "Scientific talent is attracted to those areas, and other technology companies want to start attracting that talent."

Attempts to rebrand excess office space in the UK for life science space have tended to prove fruitless, notes UBS-AM's Gauge. Developers have largely focused on providing purpose-built R&D space to the extent that there is now a "pretty sizeable" pipeline of supply. "We are focused on the manufacturing side, which needs to be located near to the places where new drug development is taking place. Land is too expensive to do that in London, Cambridge or Oxford, but in a location like Stevenage, which is close to the research clusters, it stacks up," he says.

"Another advantage of investing in that segment is that once companies have reached their trial phase, they are slightly more mature, and less likely than start-ups to be affected by the slight tail-off that we are now seeing in venture capital funding."

Leocadio argues that in locations such as London, where building land is expensive and scarce, office buildings that have been converted to life science use can attract tenants. "Sometimes a conversion is the only solution to provide new life sciences products in central locations. Obviously, you need to think about the technical specification because life science firms have very specific location and building infrastructure needs. But by doing a conversion you can also deliver new product more quickly than brand new developments."

He warns that office landlords cannot simply retool as life science space providers overnight, however. "Operating that real estate requires much heavier asset management than for offices. You need to have a properly-resourced team with specific expertise."

There is an ongoing debate around whether owners should manage and operate that space ourselves, but at the moment we prefer to work with the big co-working operators."

US office landlords are also allowing tenants more leeway, says Wenger. "Post-covid, we are finding that large leases of 100,000 square feet or greater may need to be accompanied by a short-term option – for example, the right to lease an additional 20,000 square feet month-to-month."

Before the pandemic CBRE IM's occupiers on average kept a buffer of 24 percent of their space unoccupied to accommodate potential growth. "That would usually be embedded in the lease. But we are finding that post-covid we have to offer them that option on a more flexible basis."

Understanding occupier needs

Technology is crucial to understanding and providing for occupiers' needs in the current rapidly-evolving environment, argues Saponara. Working with proptech companies, Allianz Real Estate has developed a suite of technologies that can be adopted by tenants to monitor factors such as energy consumption, connectivity and patterns of work. "Technology allows occupiers to use their space more efficiently and enhances the experience for the people using it. It also gives us much more information so that we can better understand tenant's needs."

A survey of CBRE IM's office tenants reveals that the most in-demand amenities have shifted since the pandemic. "Pre-covid tenants wanted fitness centers, onsite food, and public transportation. Now those have all fallen down the list," says Wenger. "Flexibility, collaboration areas, space for private calls and web meetings and having the latest in technology are all more crucial. So is wellness and sustainability. Users have become more sophisticated in what they want."

UBS-AM's Gauge has observed a cultural shift from companies wanting to have their own amenities in-house, toward being more comfortable with using shared facilities. "Apart from the very largest corporates, they do not

Showing the way

The participants pick exemplary developments from around the world

Zachary Gauge
British Land's redevelopment of 100 Liverpool Street, London
It was a comprehensive refurbishment using some existing elements of the building, which saved on carbon. The entrance feels different to any office I have ever been in, more like a luxury hotel. It ticks all the right boxes for connectivity, sustainability, amenities and outdoor space to keep it relevant for tenants going forward.

Pierre Leocadio
Redevelopment of the former Paris police HQ, now renamed La Félicité Paris, Sully-Morland
The project was carried out by French developer Emerige with Nuveen as the investor. It has a really interesting mix of uses with offices, a hotel, residential, retail, a hostel, art gallery and restaurants – all with a green roof. It is like a city within one building, which is something we are seeing more of today, but was fairly visionary when it was designed a few years ago.

Donato Saponara
Hines' refurbishment of the 1950s-built tower Torre Velasca in Milan
That is the kind of activity that real estate should focus on in the future. It is a really important historic landmark building in the center of Milan. If Hines can reposition it to create a modern workplace, reducing its carbon footprint and incorporating modern technology, it is sure to attract a lot of dynamic users.

Sondra Wenger
Hines and SL Green Realty's 59-story One Vanderbilt development in New York
That is the sort of building that will bring people back to the office. It is in a location close to Grand Central station, it is a beautiful building and it has saved some of its most interesting space for the public. It is very well done, exceeded expectations, and has achieved some of the highest rents in New York.

need their own auditorium or gym. That has been enabled by technology, which allows them to book amenities by using apps. Reducing cost is a factor, but so is sustainability. It gives landlords the opportunity to offer more, and also align that to exactly what people need day-to-day."

"It is absolutely crucial to be in a location that a lot of people can get to, from a lot of different places, relatively easily. And that means city centers"

ZACHARY GAUGE
UBS Asset Management

Carbon footprint

The participants agree that the highest ESG credentials are increasingly vital, both for occupiers to entice people back into the office, and for owners to attract tenants. "Just having a green certification is not good enough anymore," declares Leocadio. "Large occupiers have to report on their carbon footprint, and real estate is one of the key tools in reducing it, so when we are discussing new leases that is a main topic."

Moreover, carbon neutrality has become a vital weapon in corporates' war to attract the best young employees, says Saponara. "The new generation of talent has different sensibilities, and climate change is a priority for them. For occupiers, being able to show that they are adopting measures to reduce the carbon footprint of their headquarters is a key point for attracting talent."

ESG has begun to manifest as an important differentiator in other ways too, argues Wenger. "We have companies here in the US that are making ESG part of executive compensation. But also, ESG has evolved to become linked with productivity. The quality of the air that you breathe, the light, the aesthetic of your workspace can actually make you more productive. There is research that says a healthy building can create a 10 percent increase in revenue. ESG has become about lifestyle too, with more focus on wellness, healthy food delivery, exercise and meditation apps. All of those things have become more important post-covid."

Much real estate sits unoccupied most of the time, observes Gauge, with offices being among the worst offenders in this regard. Growing awareness of the need to maximize the usage of space and therefore lower carbon impact is beginning to give rise to a fascinating new trend, he says. "I see this mainly in the US, but I have not seen in it in the UK yet – though some offices are becoming more open to the public. They have ground floors which are open at the weekend, with wi-fi provided, or community projects being held. It will not happen overnight. But over the next decade or so, those kinds of changes could warrant reconsideration of what the office does, and its function within a location."

Despite some evidence that workers were reluctant to use public transit systems during the pandemic, the drive for sustainability means that the importance of locating offices close to transportation hubs will only increase, argues Saponara. "That is a key element of the offer to our tenants, especially in this environment where the carbon footprint is a crucial point not only for the company, but also for the people working there."

He believes that consideration will combine with occupiers' desire for access to a wider range of amenities to point firmly to city centers as the most desirable locations. "Tenants need to give young people what they want so that they have a good reason to come into the office."

Gauge concurs: "Maybe it is a difference between the European and the US markets, but connectivity to public transport is still absolutely the number one factor. With people working from home and more remotely, it is absolutely crucial to be in a location that a lot of people can get to, from a lot of different places, relatively easily. And that essentially means city centers."

In the US, the business districts that will be most attractive will not always be located in city centers, says Wenger. "It is about clusters that can be anywhere – in a city, outside of a city. They are basically a concentration of high-growth industries and activities. For example, last year we purchased a life science portfolio in Mission Bay, San Francisco. And while the [metropolitan statistical area] stats aren't as strong as some other markets, that specific cluster within the MSA has far exceeded expectations. You have to pick the right block-by-block area, and that doesn't have to be a [central business district]. We have distinct strategies, and then it is about investing in the clusters that meet that strategy."

> *"The market will definitely divide into haves and have-nots"*
>
> **SONDRA WENGER**
> **CBRE Investment Management**

Haves and have-nots

With so much uncertainty surrounding demand for offices, it might be assumed

Half empty, or half full?

Identifying the biggest challenges and opportunities for the future of the workplace

Zachary Gauge
Opportunities: Creating sustainable buildings by carrying out high end-refurbishments that utilize the existing infrastructure and minimize the embedded carbon.
Challenges: The impact on occupational demand of a global recession if inflation proves to be long-lasting.

Pierre Leocadio
Opportunities: The innovations that come out of the drive to better ESG and the implementation of technology in buildings so that you can better understand your customer.
Challenges: Accelerated obsolescence of buildings and continued uncertainty over how occupiers will use their office space.

Sondra Wenger
Opportunities: Strategies that focus on life sciences, medical office, responsive high-ESG offices and adaptive reuse projects.
Challenges: The risk of further pandemics, and the threat that virtual reality technologies are developed that successfully emulate the advantages of physical offices – such as collaboration and creating corporate culture.

Donato Saponara
Opportunities: Repositioning historic city-center offices in Europe to create low-emission buildings with a full technology package that enhances user experience and helps tenants to attract talent.
Challenges: The macro-economic environment and that obsolescence will create problems for some owners.

> *"We are still seeing rental growth in big cities for the right assets, because there is a lack of fully ESG-compliant buildings"*
>
> **PIERRE LEOCADIO**
> **Oxford Properties**

that tenants can pick and choose, with landlords striving to offer ever more attractive terms to secure them. That is by no means always the case, however, says Leocadio. "We are still seeing rental growth in big cities for the right assets, because there is a lack of fully ESG-compliant buildings. If you have the right building in the right location, it is more like a landlords' market because there is growing demand for that space."

To support Leocadio's case, Saponara cites the example of a large new net-zero office campus being developed by Allianz in Milan. "As soon as it became public, we were contacted by several of the biggest companies in the city to say they were interested in taking a building."

"The market will definitely divide into haves and have-nots," agrees Wenger. "For the right location, user, and user experience, some of our buildings are achieving record rents. They are the ones that allow occupiers to develop and promote their company culture in a way that they cannot do virtually."

Gauge sounds a note of caution: "There is no denying this is still a very challenged market, with high inflation, and construction cost inflation running even higher than that. We have interest rates, cost of capital, and exit yields all moving out, so I don't think you can say these assets are going to be in such high demand that the rental growth will cover it. And that's not even to mention that we are teetering on the edge of a potential recession that could impact demand."

There are still some attractive opportunities for creating new stock, particularly through refurbishing existing buildings to reduce the carbon impact of development, he says. "But ultimately, the entry price needs to be lower than it is today to make a lot of this stack up, and my view is that actually, the market hasn't moved enough yet."

Further bifurcation of the office market is inevitable, concludes Leocadio. "There will be markets where it makes sense to continue to invest capex because there will be occupier demand and you will be able to drive higher income. But investors are going to have to think very hard about what to do with buildings in secondary locations that are not fit to meet occupier demand, because the level of capex needed to transform them into high-quality, ESG-compliant offices doesn't make sense. It is a big unknown, because we do not yet know how much stock will be impacted. It all depends on what will be the demand from occupiers tomorrow, which, again, remains unknown." ■