SEA CHANGE IN THE OFFICE MARKET

By John Salustri

The last time we met, for the Q3 edition of Professional Report, we chatted about the progress being made in the industrial market, the "I" in SIOR, if you will, changes taking place at the hands of exponentially growing technology and the trend of manufacturers to reshore. No less dramatic changes are taking place in the "O," the office side of the equation, literally transforming the way these environments look and function.

First the statistics. According to the latest data from CBRE, the market is in full-bore national recovery. "By virtually all metrics," writes Americas president for agency and asset services Ed Schreyer, "the second quarter of 2014 was one of the most robust we have seen in years." More than 15 million square feet of Q2 net absorption was the highest since 2007, he reports. In addition, the US vacancy rate dropped by 30 bps, and "at 14.5 percent, office vacancies have hit the mid-point between their pre-recession low and recessionary peak." Happy days are here again.

But the numbers tell only a part of the story. There is a sociological shift taking place in the country's offices, one at the hands of a new generation of users.

This shift is "completely driven by the younger generation," says newly elected SIOR president Angela West, who states her belief that the office market is indeed in full recovery. This new generation “may not be the drivers within management, but they understand how important job satisfaction is. The mindset no longer exists where you start after college and spend your entire career at a company and retire with a gold watch."

That implied freedom and the mobility to work where they want or need to and enter the office when collaboration is key far outweigh the traditional touchstones of career advancement, the private office and the walnut plaques. It is this “autonomy to make those decisions on their own" that is, says West, pushing employers "to be far more innovative than they have in the past."

"There is a sense of entitlement with senior people who have earned their way up to that private office," adds Schreyer. On the other hand, "the up-and-coming generation is the first to say, 'I am willing to not have the traditional career trophies. I'd prefer an environment where I can find a spot and plug in."

Not all of the shifts taking place in the office today can be laid at the doorstep of the Millennials. The advancement of technology, just as it impacts the industrial sector, retail and all walks of our lives, is making its presence known in the office more than ever.

Hoteling, a concept that is as old it seems as the paperless office, is a fact of life today along with other "workplace strategies, such as free addressing" says Schreyer. It seems that "every firm, including law firms, are trying to figure out how to employ hoteling in order to achieve greater efficiencies, not just square footage. Workers no longer need to be bound to an office or cubicle in order to reach the best work environment." And while the worker is off hoteling, other employees can take advantage of the freed-up space and the amenities that go along with it.

Up until a year or two ago, the industry media were writing about the "doing-more-with-less" trend as companies looked to squeeze any savings they could out of their built environments. In addition to the massive recessionary layoffs, cubicle spaces shrunk in that time to as small as 100 square feet, according to architecture firm Gensler. But CBRE's Schreyer reports that corporations are awakening to the fact that they can only "cut so far without impacting productivity." At some point, they've got to grow to impact the P&L, and that means hiring.

But it doesn't mean we'll see an increase in cubicle size. "We're finding there's a delta between the exact space you need and the amount of square footage you need for creative, collaborative space," he says. "You're trading empty cubes for environments where people can be collaborative or just be more comfortable, spaces with more comfortable couches or a pool table or foozball, the things that bring people together."

Not your old man's office environment, is it? And that's exactly the point. The office that Schreyer describes, while benefiting all employees, is geared specifically to a younger audience.

All in, Schreyer estimates that there is still a reduction in the total amount of space companies are leasing, but the reduction is, well, reducing. "We're trading dead square footage for interactive square footage," he says. "The net of it may be 20 percent less space but not 40 or 50. It's a slight reduction, but the space you have is much more useful."

"Companies are much more focused on employee satisfaction with the environment," agrees West, who in addition to her SIOR duties is also vice president at the Tulsa CBRE office. "We see so much competition for hiring and recruitment, it's become much more important for companies to attract new employees based on physical space."

She calls it no less than a paradigm shift. "Coming out of the recession, it was all about creating more efficiency by driving down the dollar per square foot." In such a severely compressed environment, "how do we keep that satisfaction number? If employees are more comfortable, they're more productive and less likely to take sick days." Schreyer reports that in CBRE's new, much-publicized Los Angeles HQ, which he says employs many of the above-mentioned types of amenities, there has actually been an increase in the office headcount as employees seek that comfort and collaboration.

But is this truly a sea change? Are we closing the door on an office environment that has existed since the Kennedy Administration? "The American dream has shifted," reflects West. "What the average worker wanted in the '60s is very different than what the average worker wants today."

"This is not a fad that's going to run its course," adds Schreyer. "But there may always be a moderation, some kind of balance over time." But clearly, he says, the people, and especially the younger people, "have spoken." ■

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GETTING AHEAD OF THE COMPETITION:
USING ADVANCED MARKET ANALYTICS

Another observation about commercial real estate is that there seems to be a fascination on the past. Comparables from as far back as a year ago are used to predict what a good lease should be today, or even in the future. As brokers who have been in the business for a while can attest to, the market changes rapidly. A year old comparable is antiquated in many instances, so why is it such a prominent tool in the business? Why not use a more scientific method in predictions? Admittedly, forecasting is a scary endeavor. There are many factors that constitute market movement that nobody can fully predict, but having a mathematically based model that has had a proven track record for years helps ease some of the tension associated with the unknown future. If it is used in conjunction with modeling out a prospect or client's transaction and using the economics to project their future rental rates, it gives them a basis from which to make tough decisions. A statistical model can be as simple as using past and current job growth, annual absorption rates, or even square feet under construction. Or it can be an analysis on transactions completed in a single building showing the trend in what the landlord perceives to be the market in terms of rate and concessions. These types of analyses can be very powerful during negotiations in a tight market.

The bottom line is that you can still use traditional tools on a daily basis (comparable transactions, market reports, etc.), but be prepared to use other devices to help make more informed decisions for your current clients as well as prospective clients. Commercial real estate is both an art and a science. Ultimately, a fool with a tool is still a fool. You cannot simply imbed yourself into the analytics without having experience or a story to go with it. Accordingly, while using the analytics, they are simply another powerful tool that you possess in order to drive the best economics for your client. Just as the landscape on how to interact with potential clients is ever evolving, so are technological capabilities of the industry. It may be a slow change, but it is changing and is unstoppable. Be at the forefront of this movement, by embracing data analytics, to secure your advantage over your competition. ■