Market Insights

The Changing Demand for Office Space

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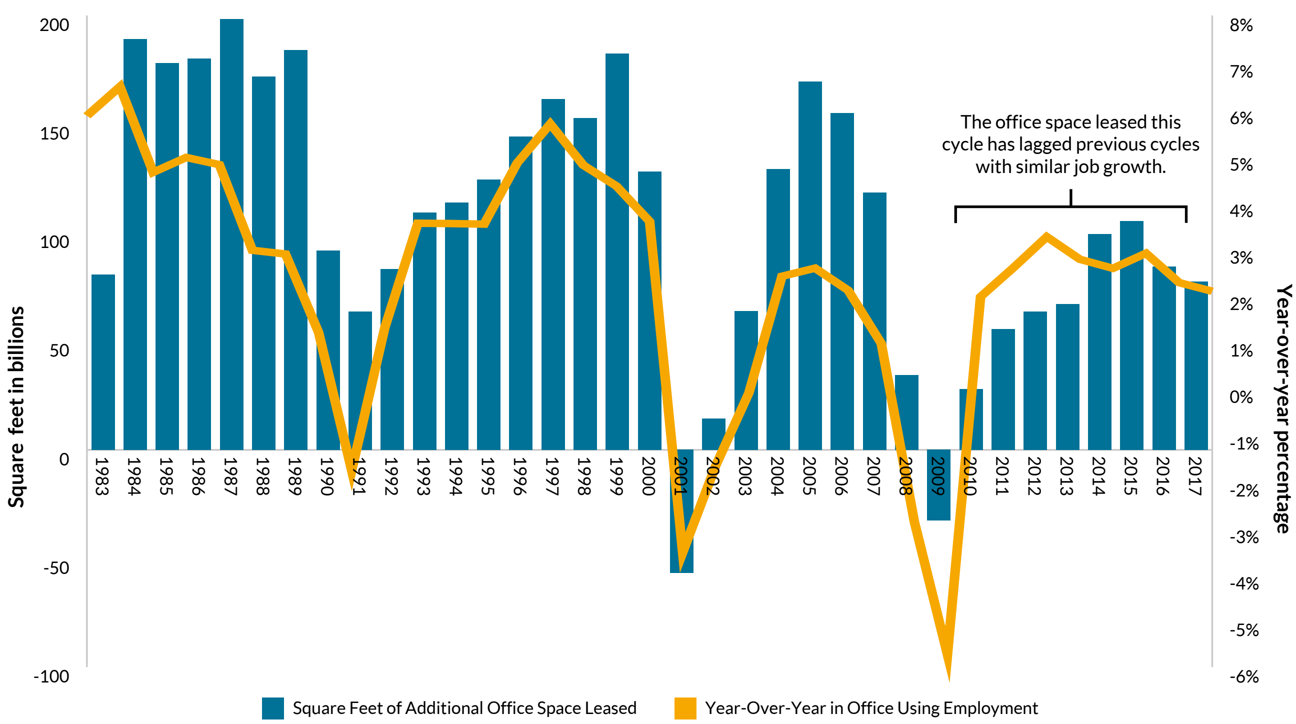
The office property sector is undergoing significant change — driven by changes in U.S. employment, the demands of employees for new and different types of amenities and workspaces, and corporate cost-cutting measures.

One way to measure demand for office properties is by assessing "office-using employment," which is essentially the population of office workers. U.S. employment has grown from 43% of population in 1980 to 48% in 2017. Office-using employment as a percentage of total employment has grown from 20% in 1980 to 26% in 2017.

While open creative office space is not a new concept, the trend has accelerated during this market cycle as employers seek ways to both lower occupancy cost per employee and utilize collaborative "cool" office space as a tool for recruiting human capital. The elements in this cycle that have fueled the trend include the proliferation of both cloud-based business systems and the dominance of the tech-savvy millennial generation in the workplace.

Since 2000, the average space allocated per employee in the U.S. has shrunk by 25% — from an average of 283 square feet per employee to 212 square feet — with some employers, especially in the tech sector, allocating only 100 to 150 square feet per employee. While the macro effect of densification has served as a headwind for overall office occupancy, it has created an opportunity for office investors who can address this demand to create tremendous value.

U.S. Office Space Leased and Change in Office Using Employment[1]

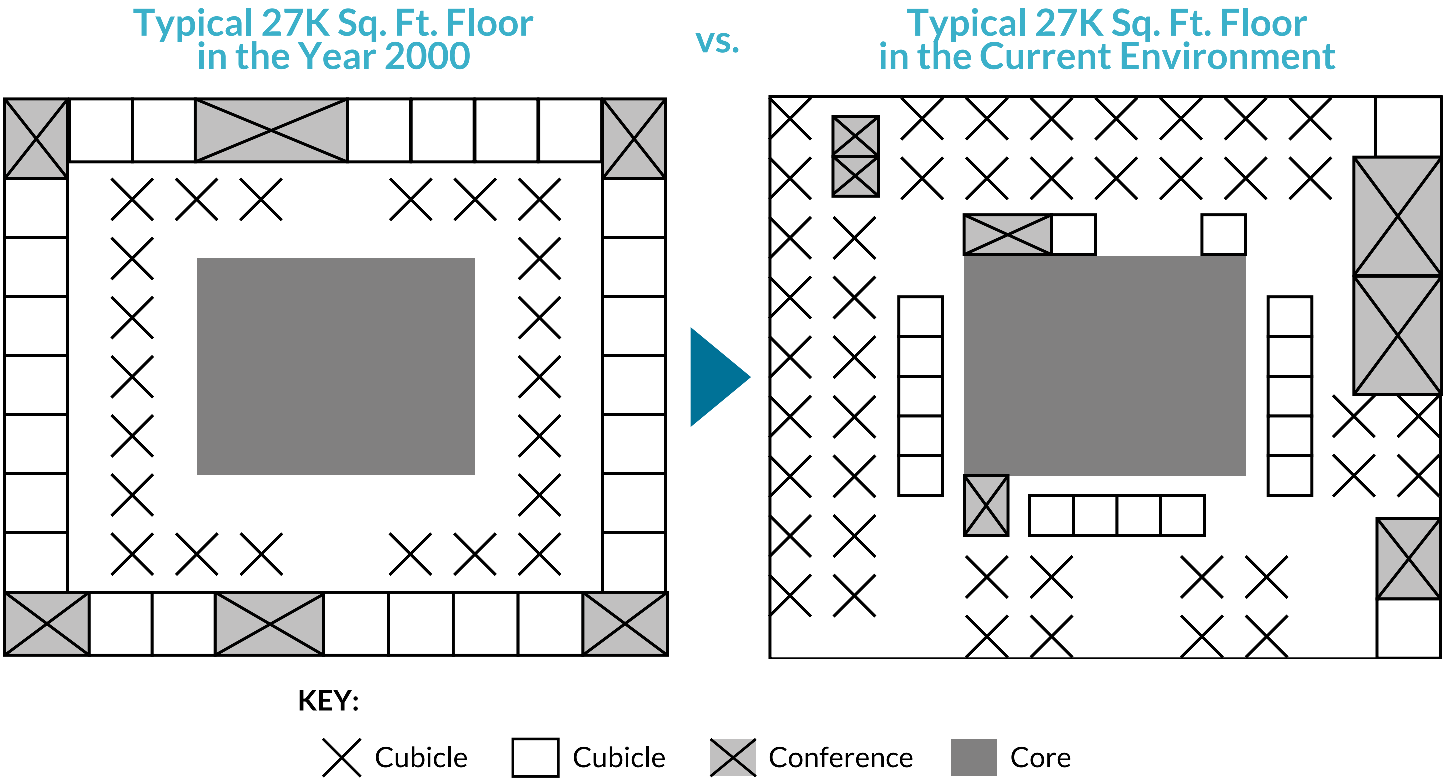


Office Building Considerations

Landlords capable of offering open creative office space with highly amenitized common building spaces have been able to command a per-square-foot rent premium over traditional office space while providing lower occupancy cost per employee. Moreover, due to the limited hard walls and reusable nature of the design, the long-term capital expenditures required in re-tenanting the space are reduced.

[1] Source: Net Absorption - CoStar 2Q17 Office Using Employment - BLS (Government, Financial Activities, Private Service-Providing and Information).

Higher density office space impacts already-limited parking resources, amplifying the importance of buildings located near mass transit or near a critical mass of ride sharing. The parking demand of a 200 square foot per employee office building requires a parking ratio of five spaces per 1,000 square feet, a ratio double what is typically offered in a downtown office property. Additionally, the importance of building amenities such as roof-top decks, tenant lounges, conference rooms, outdoor seating, bike storage and fitness facilities with showers become increasingly important as densification transitions space from leased to shared.



Source: Green Street Advisors.

Real Estate Implications

While the ultimate productivity impact of open workspaces remains a hotly debated topic among those working in these environments, the trend remains that employers are seeking maximum utilization of leased space. As employers continue to adapt their footprint to meet their business needs, it is important for office landlords to adapt as well. No longer is a grand lobby serving function other than an aesthetically pleasing transfer space, or the fitness facility crammed into otherwise un-leasable basement space desirable. To capture tenant demand, today's office investor needs to offer creative, functional and useful shared spaces that serve as an extension of a tenant's leased space. To address parking challenges, landlords may offer secure bike storage with showers, subsidized ride share or shuttle service. This trend has bifurcated the office market into investors who are able to adapt and capture tenant demand and those with empty buildings.

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