

Experts don't expect massive changes for commercial real estate industry as offices reopen

Surge in short-term leasing likely

By KEVIN OKLOBZIJA

As the coronavirus pandemic forced businesses to shut down and offices to shift into work-from-home mode, the future of commercial real estate's office sector came into question.

If productivity remained high from employees working remotely, then why couldn't this be the new norm? Why would a company continue to lease 12,000 square feet for its downtown office when 6,000 would easily accommodate the staff not able to work at home?

Many executives have asked themselves those very questions.

"The work-from-home edicts have shown productivity doesn't suffer," said Tom Hanna, president of All-American Home Care. "In some ways we've become more efficient. So do I cut my space in half and try to sublet the space we don't need? The demand is going to be shrinking. There's going to be a lot of excess."

Others, however, say it's too early to know. What may seem like a great idea now may have drawbacks next year. Truth be told, no one is quite sure how the commercial real estate



Hanna

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industry will be impacted, from traditional office space to co-work facilities.

Can workers continue to work from home? Even if they do, will my office still require the same space in order to meet social-distancing requirements? What happens to "hoteling" space; will workers really want to share the same workstation?

"We've heard everything from downsizing, to creating a mix of in-person workers and remote workers, to staying the same but allocating more space for each employee, to re-allocating space where the office

is for collaboration and team-based work," said Kelly Jahn, interior architecture and design discipline lead with Bergmann's office design specialty team.



Jahn

Simply put, the ideas span the spectrum.

Jahn said the initial thought a month or so into the pandemic was that large numbers of firms would make work-from-home a more permanent scenario and would look to shrink the office by leasing less space. But as the weeks have passed, C-suite personal are backing off from that sentiment.

"We have some clients starting to look at the long-term, but for the most part it seems like most companies are holding off on downsizing," Jahn said. "There's definitely synergy from being in the shared workplace. Some companies are now saying, 'We're a collaborative-based company; we want our employees in the office.'"

"I think it will take time to play out. What's good for one company won't work for another."

Rick Pollack, principal at RCLCO Real Estate Advisors, says the theory that businesses will pull back on leased space is a myth. RCLCO

is based in Los Angeles and has four offices nationwide. The firm provides strategic and tactical advice on property investment and development through analytics and studies.

"We're seeing employees do want to come back to the office space when it's safe to do so," Pollack said during a recent webinar. "Working from home comes with significant distractions. Interestingly, and perhaps counterintuitively, millennials and younger people are reporting having a harder time working from home than Baby Boomers and older generations."

While leasing less space would save a company money, there is intrinsic value to an office setting, he says.

"From an employer's standpoint, there's certainly a social aspect, both in on-boarding new employees, which is more difficult to do virtually than in person, and with the cultural benefit of having people in the office in terms of camaraderie of the team," Pollack said. "And certainly there are bottom-line benefits that come with in-person collaboration and informal collaboration."

Joe Rowley Jr., senior advisor and managing broker at Rochester-based SVN Realty Performance Advisors, draws on history for an example of a similar trend.

"This happened maybe 15 years ago where work-from-home became popular and it lasted about five years," Rowley said. "People missed the camaraderie of being in the office."

They missed team-building as well.

"Personal interaction is important, especially for *esprit de corp* within the company," Hanna said.

Except, as Rowley points out, quality video conference technology didn't exist the last time working remotely was trendy.

"This is a different world; this is a Zoom world now," Rowley said. "There is going to be a drop in demand for office space. With the added video feature that you can access from your phone, iPad, Surface Pro or home desktop, we're making a much more portable work force."

"For the next 12 months and even over the next four or five years as leases turn, tenants will have the opportunity to leave without a penalty and may do so or they may reconfigure their space. I think you will see entirely different floor plans. Some may even go back to private offices."

The Rochester Downtown Development Corp. is in the midst of conducting its summer survey of landlords and tenants.

"We're in unknown territory," said Heidi Zimmer-Meyer, president of the RDDC. "The home office may

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be here to stay. It depends on the kind of business, but maybe everybody comes in for a staff meeting once a week and then works from home.”

Zimmer-Meyer doesn't foresee instant massive change, though.



Zimmer-Meyer

“It doesn't happen overnight; some businesses may have just signed a five-year lease,” she said. “The leasing environment isn't likely to be impacted immediately unless a company goes out of business.”

I. Gordon Corp. owns about a half-million square feet of office space in three downtown buildings, First Federal Plaza, 200 East Main St. and the Reynolds Arcade. Tenants are largely in legal and professional services.

“In our office portfolio, I haven't gotten a sense or feedback from tenants that are saying, ‘We're done,’ ” said Chris Hill, a partner in I. Gordon. “Culture is important, along with oversight and productivity. For a lot of people, there are distractions at home; children, a spouse, whatever. The people I talk to, they want the normal office again.”

Because of fears about transmission of COVID-19, co-work space was thought to be an endangered species about six weeks into Gov. Andrew Cuomo's New York on Pause

edict. Who would want to work near strangers or in an environment where there's a continual turnover of users?

Rowley said he was one of those who was pretty sure commercial space designed for co-working would need to be transformed.

But a funny thing may be happening. The demand won't go away.

“I talked to a developer in Virginia who has co-working and is looking at Rochester,” Rowley said. “He said it has flourished there because people who have been working at home want to get out of their houses. They're tired of being at home.”

Pollack of RCLCO said co-work won't really change much.

“It's really branded short-term leasing,” Pollack said. “Once you introduce more flexibility and shorter-term leases, the market is going to continue to demand that. So whether it's traditional landlords responding to that demand by offering shorter leases — sort of their own unbranded sweeps — or sort of a resurgence of branded co-working, that demand is here to stay just because of the attractiveness of the flexibility.”

The developers of the Aqueduct Building that sits along the west bank of the Genesee River between Broad Street and East Main Street share that belief. When Peter Landers, Rob Sands and Jim Costanza bought the building from Thomson Reuters in March, co-work space was part of their plans. The pandemic hasn't prompted changes to their blueprints, Landers said.

Current layouts for existing offic-



Rennert

es may need to change, however, and landlords may need to be flexible when it comes to design of space.

“Everybody thought office would plummet

because people are able to work from home, but I've been working with two companies that typically travel to meet with clients and buyers and now they're not going to be flying to New York City or to L.A.,” said Dara Rennert, salesperson with Keller Williams Commercial. “Instead, they'll have a dedicated technology room that looks professional and they'll teleconference. If the ports close again, if the borders close again, they'll still be able to operate.”

“There are benefits to certain types of buildings and leases. Tenants now want a clause regarding pandemic language. There has been a lot of compromise and flexibility on the part of owners. There are some wonderful landlords that are understanding and sympathetic to tenants' needs.”

And if firms do decide they need less space, building owners will shift accordingly.

“Real estate is adaptable,” Hill said. “Look at downtown; the Metropolitan, Tower280, those buildings have adapted.”

“A few years ago with First Federal, we were contemplating converting some space to residential. Now, we could always flip back to that plan. Office is easier (to manage) but you

sure can get a lot more price per square foot for residential (around \$16 for office compared to \$25 for residential). It costs a little more to build out residential, but the trend is there.”

There is, of course, some fear that a stalled economy, the inability of tenants to pay rent during the pandemic and the possibility of office downsizing will lead to financial hardship for some building owners.

“It's going to take at least six months to a year for any stress to show up,” Rowley said. “There's the PPP (Paycheck Protection Program) and other things keeping some (owners) artificially floating right now, but eventually it's going to create a burden.”

Smaller property owners could be hardest hit.

“The larger landlords will be fine but for the smaller landlords who own strip plazas where businesses haven't been open and haven't been able to pay rent, they may have to sell because they can't carry the mortgage, the taxes, the upkeep,” Rennert said.

That doesn't necessarily mean there will be big bargains on distressed property, however.

“There are a lot of people who are looking for commercial property and there's not much available,” Rennert said. “People always think when it's a distressed sale that it's going to sell cheap, but that's not really the case.”

Hill says he doesn't sense fear in the industry.

“I'm very bullish on downtown,” he said.

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