



LESSONS FROM COVID-19:

Potential Impacts on Portfolio and Occupancy Strategy

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COVID-19 PANDEMIC Q&A: A SAVILLS KLG ADVISORS PERSPECTIVE

Five months into the global COVID-19 pandemic, what lessons can business leaders draw from this mass experiment in remote working for the future of the office? The leader of Savills Workforce Strategy, Doane Kelly, cautions against making long-term decisions in the “fog of war.” Instead, the founder of the Savills KLG Advisors team advises using a data-driven approach to develop new occupancy strategies for the hybrid workplace that will emerge from this crisis. Kelly’s team specializes in four core practice areas: Workforce Planning, Location Strategy and Site Selection, Portfolio Optimization, and Acquisition of Business Incentives.

Q Will COVID-19 realities and future pandemic threats impact the trend of concentrating knowledge workers in densely populated urban centers?

Co-location of knowledge workers in order to foster collaboration and drive innovation has a proven track record of delivering results. The tech sector had already learned the lesson that a largely virtualized work environment can inhibit innovation. Prior to the COVID-19 outbreak, many companies in the tech sector that had virtualized large workforce segments reversed course and brought knowledge workers back to office centers. In those offices, these companies invested heavily in “agile” methodologies, space configurations, collaboration tools and amenities to encourage additional hours of face-to-face interaction.

Nevertheless, a greater awareness of pandemic risks will drive much scrutiny into identifying which functions/workers actually contribute to chains of innovation and to what degree. Methodologies like Organizational Network Analysis (ONA) will be employed to quantify common communication pathways within organizational structures or between business units and teams. ONA is an analytical approach to visualizing the socio-technical flows of information and expertise within an organization. This type of analysis will help highlight component organizational units that most benefit from urban co-location and identify where potentially higher risk thresholds (and likely higher expense) can be tolerated in order to accomplish mission-critical objectives.

For those jobs not immediately involved in an innovation chain, this will likely result in some level of continued virtualization and deployment of mobile jobs to distributed portfolio locations, often in less densely populated environments that are not extensively dependent upon public transportation. Bucking the national urbanization trend, this could portend a suburban office comeback in some markets.

Key takeaway

Make data-driven decisions. Once the crisis has subsided, careful analysis of the spread of COVID-19 across geographies will heavily influence the degree of workforce deployment and changes in space demand in core urban properties.

Q How will the COVID-19 threat affect demand for office space?

In the short-term, as long as COVID-19 remains a threat and until either the majority of the population is vaccinated or herd immunity is reached, offices will be operating at vastly decreased utilization levels. Many spaces with leases that expire soon will be downsized or vacated. Tenants with excess space will attempt to backfill reduced/vacated space in properties that have longer-term obligations. The exception to this trend will be in heavily invested leaseholds, such as laboratories, testing facilities and data/operations centers.

Imbalances between supply and demand will vary by region, and even within submarkets, based on specific sector composition and how adversely these sectors are affected by the inevitable COVID-19-induced recession. For example, highly concentrated tech markets (i.e., Cupertino) are likely to see less disruption than markets that are reliant on industries like transportation or leisure.

Demand for office space across virtually all submarkets will decrease and rents will drop from pre-COVID-19 levels. The magnitude of this drop will vary by market, and discounted pricing will persist until the economy reaches a period of sustained recovery of business activity, most likely linked to COVID-19 containment. The duration of discounted pricing will depend on GDP growth, rising income levels and falling unemployment.

With economic recovery, vastly improved pandemic preparedness, and new office standards and operating protocols, organizations will gradually return workers to offices in larger numbers. Demand may be somewhat lower than pre-COVID-19 levels due to expansion of work-from-home (“WFH”) programs. Regional demand is likely to vary based on workforce geography shifts. Large urban centers, especially those that heavily rely on public transportation (i.e., Manhattan), will be the hardest hit, especially in the short-term. Further, these markets may exhibit a slower path to recovery in the long term.

Noteworthy is a contrarian view (voiced by business advisor and former Google Chairman Eric Schmidt¹⁾) that office demand will increase, due to the combination of workers needing to co-locate in offices combined with the need for more space to support social distancing.

Key takeaway

Some reduction in office demand is inevitable in the near- to mid-term period, putting downward pressure on occupancy costs. The degree of reduction will vary greatly by market and industry sector, as well as by time remaining on leases or investment in facilities (such as laboratories and data centers).



1) <https://www.cbsnews.com/news/transcript-eric-schmidt-on-face-the-nation-may-10-2020/>

Q How do you view the pronouncements recently made by high-profile business leaders about no longer needing office space, or far less of it, in the future?

Respectfully, we believe these comments reflect the “fog of war” and are an understandable reaction to the current stay-at-home predicament. To some degree, these comments reflect the sense of relief that these leaders have experienced from seeing their businesses actually functioning in a highly virtualized state and unprecedented circumstances. However, in the fullness of time, it will likely be clear that their businesses are not functioning as productively as they did pre-COVID-19.

Virtualization fundamentally ignores the powerful role that culture plays in the effectiveness of an organization. Proximity is critical in building esprit de corps and sharing a sense of mission and purpose across a workforce.

By and large, the established virtualized workforce has a high degree of professional and institutional experience. The challenge ahead is how do we train, mentor and imbue the next generation of workers with a company’s mission, values and culture? Findings from COVID-19 WFH surveys indicate that the young and educated cohort (under 35, with a bachelor’s degree or higher) want to get back to the office — when it’s safe — because it is an important part of their social lives. Older and other at-risk employees will gravitate toward WFH.

It is no doubt appealing from a financial perspective to believe that a major expense item such as occupancy can be radically reduced by maintaining WFH levels. However, this is a highly leveraged bet, because, for example, a seat with a \$10,000 annual cost is occupied by a professional earning 10 times that amount. Relatively small decreases in productivity can rapidly degrade occupancy savings.

An important insight from this experience is that the old workplace model has gravely mismanaged our work week. “Heads down” work often is most easily accomplished at home (under the right circumstances) without the burden of commuting and endless office distractions. Collaborative work, ideation and innovation is a “team sport,” amplified by the random collisions that co-location facilitates. Before COVID-19, we tended to attempt to conduct both of these types of activities in the office, five days a week. A thoughtful reorganization of our place of work during the work week will follow for most progressive organizations. In short, our world is transitioning toward a hybrid model that incorporates multiple work behaviors.

Key takeaway

Don’t base long-term decisions on the initial “fog of war” thinking. While many companies have managed to sustain reasonable productivity during the initial phase of widespread working from home, it’s important to measure the long-term impact on collaborative work and culture-building efforts.





Q Within a property, how might space planning concepts change?

We believe that workforces will not remain highly virtualized after the current crisis wanes. We predict that a hybrid model will emerge, comprising core co-location, deployment of some jobs to geographically diversified properties and partial ongoing WFH. Further, we recommend organizations adopt comprehensive action plans and put into place the infrastructure and resources to revert to large-scale virtualization if needed again.

However, regardless of geography, physical distancing of workers within a space envelope will be carefully examined, posing a critical threat to large-scale benching – a practice that faced challenges prior to COVID-19. We will see a reversion to larger workstations and an emphasis on personal space in the workplace.

Changes to office environments, like distancing requirements, could be a result of corporate policy declarations or even regulatory intervention. Square footage per dedicated space will increase. Common practices such as hoteling or shared-seating arrangements may fall out of favor as corporations and employees look to control the occupancy of individual workspaces to better predict and mitigate intra-company spread and improve sanitization.

Office management technologies will almost certainly be leveraged further to safeguard workers. Geospatial data collected from badge readers, beacons, reservation systems and cell phones may be analyzed to pinpoint potential infectious spread within an office, allowing the rapid isolation and treatment of those exposed without disrupting and alarming non-impacted populations sharing a common space envelope. Obviously, these practices will need to be reconciled with privacy laws and health policies.



Key takeaway

A new hybrid working model will emerge, blending WFH, co-location and redeployment of some roles to geographically diverse properties. Widespread benching and desk-sharing arrangements will be re-examined, and personal space in the office will increase. Data collection from RFID badges and cell phones can help analyze space usage, and monitor health risks, once reconciled with privacy and health policies.

Q In what ways might COVID-19 influence the evaluation of properties?

Tenants will likely attribute greater value to wellness infrastructure as an important selection criterion, compelling a corporate responsibility charter that invests more heavily in the health and welfare of employees. Corporations' focus on health, safety and wellness will directly impact their talent recruitment efforts, as prospects will remain concerned about safety issues after COVID-19.

Investing in healthy buildings has been embraced by the residential and hospitality sectors, but less so in the commercial sphere. After COVID-19, we predict tenants will focus more on protecting health through building design, operations and policies. This wellness focus will decidedly favor newer, state-of-the-art properties or gut renovations/rehabilitations that have incorporated these technologies.

Additionally, very large occupiers may choose to operate their own dedicated infrastructure (as opposed to the traditional landlord-controlled HVAC systems). This option will work best for tenants who have requirements that can be accommodated in an entire building, although building-within-a-building options can be implemented in renovated/modernized properties.

Tenants currently spread across multiple properties within a city will migrate toward a single consolidated modern property, finding it economically and practically impossible to materially raise wellness standards over smaller envelopes in multiple properties that are managed by multiple landlords. All of this will significantly drive up current CapEx per square foot ratios.

Key takeaway

Wellness factors will rise to the forefront in space decisions, favoring newer construction, gut rehabilitations of older buildings and greater occupier control over HVAC, entrances and building-within-a-building options. CapEx per square foot ratios will rise, but in the larger picture, companies will view the expense as an investment in productive employees and talent recruitment.

The pandemic offers business leaders an opportunity to completely rethink their space strategies. At Savills KLG Advisors, we serve corporate clients by quantitatively answering the principal questions: "Where? And why?" Progressive leaders will meet this challenge head-on, with a thoughtful, analytical approach to reorganizing the work week within their organizations. Most will transition toward a hybrid model that can accommodate multiple work modes and that will attract the best talent.

The road to recovery will be uneven, with some occupancy shifting from urban core to suburban markets, and the selective virtualization of some types of work. However, for younger workers and work that relies on innovation and ideation, companies will need to consider the value of co-locating some talent groups in dense population centers to facilitate collaboration, mentoring and culture-building.

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