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The Pendulum in the Office Market Reveals Inconsistency is the New Consistency





As organizations are forced to make office space decisions based on lease expirations or other factors, they are evaluating their spaces, workforce, and external data such as commutation trends to make thoughtful decisions for the best interest of their company and their employees. With so many individualized variables at play for tenants, is it possible for there to be any consistency in the decisions that are being made by organizations and across various industries? In the near term, the answer is 'Likely not,' and because of this, there is only one consistency with office market trends, data, and tenant decisions - inconsistency.

Based upon daily interactions with Savills' tenant clients and a November 2022 client survey, there is inconsistency and uncertainty across all, or even within, specific organizations and industries as to how office space and occupancy levels are being managed and how that may change in the future. Some organizations are driven by cost savings and/or how often their employees want to use office space, while other companies prioritize the importance of in-person employee collaboration, productivity, and training. All in all, organizations and even different departments within certain organizations' immediate desires around space use and their long-term objectives may differ significantly, which makes it difficult for the commercial office market to draw definitive conclusions as to how office occupancy will be impacted in the future.

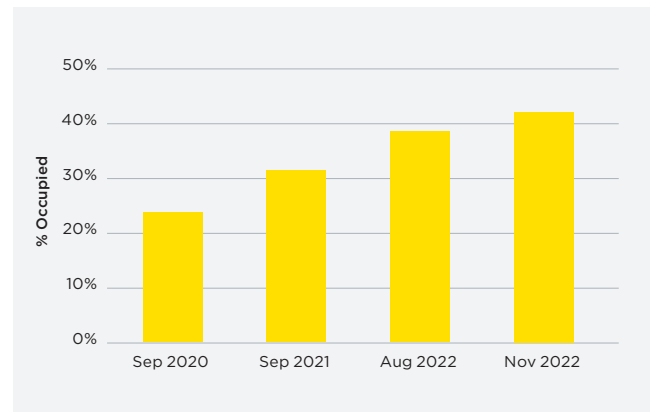
One area of consistency for most employers is the objective to provide employees with a better work-life balance and working experience. This may take the form of relocating to a higher-quality office building with attractive amenities or providing flexibility with hybrid work scheduling. Increased deference to employee needs is often seen as essential when recruiting and retaining talent, which can mitigate costs associated with turnover and training. It remains to be seen if recent layoffs in specific industries, such as tech, will cause the pendulum to swing back toward the employer.

But What Does the Data Say?

Since the beginning of the pandemic, Savills has been studying data surrounding occupancy levels and trends in the commercial real estate market across North America. Tenants rely on this data to devise an informed strategy for their commercial office needs. In Philadelphia, we explored data points, including pedestrian foot traffic, office occupancy in the Philadelphia Central Business District (CBD), public transportation statistics, recent client survey feedback, and Savills day-to-day interactions with its tenant clients.

- Data suggests that pedestrian foot traffic and occupancy in office buildings within the Philadelphia CBD increased steadily throughout 2022
- Center City District reported the average daily population among residents, non-resident workers, and visitors reached 68% of 2019's pre-pandemic levels in November 2022, with residents' return (125%) outpacing non-residents (57%) and visitors (70%)
- Pedestrian foot traffic has increased 82% since January 2022 in the heart of Center City, and the greatest foot traffic increase has been felt in the CBD during and after business hours
- Office occupancy in the Philadelphia CBD, has increased consistently since Labor Day 2020, up to 42.7% of pre-pandemic occupancy levels as of November 2022, with occupancy strongest Tuesday through Thursday and weakest Mondays and Fridays

Office Space in the Greater Philadelphia Area:
% Occupied Compared to Pre-Pandemic Levels



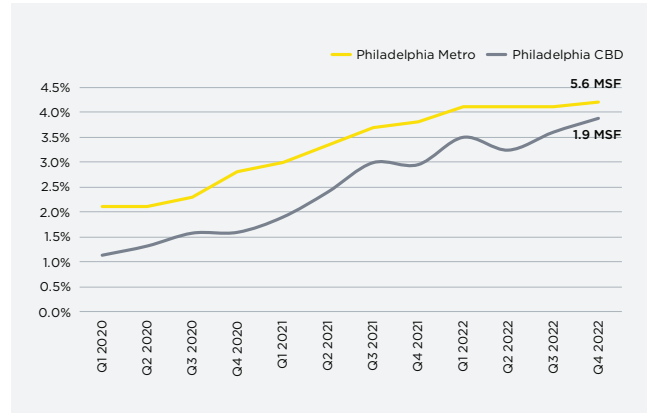


Philadelphia’s recent public transportation data is also showing an increase in ridership as occupancy within the office sector has improved over the past two-plus years. Weekly ridership on PATCO reached 47% of pre-pandemic levels in November 2022, and weekly ridership on SEPTA increased to 3.34 million in October 2022, roughly 60% of pre-pandemic levels. Per Parkway Corporation, the largest owner of parking spaces in Center City Philadelphia, daily parking has typically ranged from 80%-90% of pre-pandemic levels.

Notwithstanding what the data reflects from a variety of sources, organizations can interpret it with different lenses, even within the same industry, and often extrapolate this information in a manner that supports the overall goals and objectives of the respective organization. Tenants are making decisions based on a variety of factors which may include pressure from their employees, expiring leases, and/or their bottom lines.



Sublease Availability Rate



Flexible Cost Cutters

Some companies who are not prepared to address their space needs via a lease negotiation, have allowed employees the flexibility to determine if, when and how often they return to the office. Organizations with years remaining on their leases are often the most accommodating in allowing employees to dictate space usage.

We have also seen organizations being proactive in their efforts to reduce costs when they believe that flexibility and in-office collaboration are less critical to the financial and cultural success of the organization. One resulting effect of this strategy has been a dramatic uptick in the number of subleases on the market. Subleases in the Philadelphia CBD have nearly tripled from pre-pandemic levels as organizations look to reduce their footprint and costs.

However, since early January, we have seen more than one sublandlord pull their sublease space off-market as they began seeing an increase in occupancy that justified retaining their space as opposed to entering into a sublease with a credit subtenant.



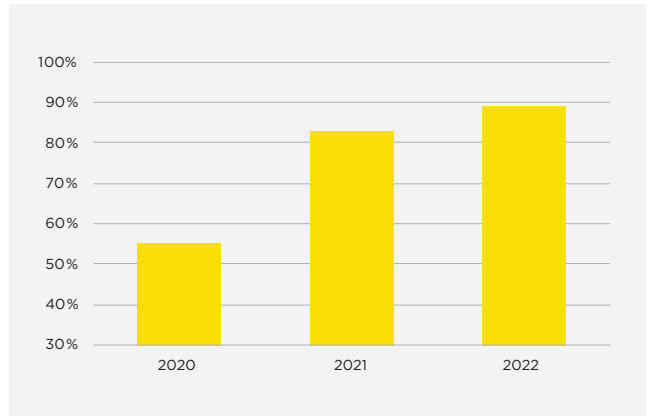
In Office Collaborators

In our recent client survey, productivity was the biggest measure of success for return-to-work policies. This has instigated some organizations to create firm policies around when and how often employees must work onsite. Another factor that often pushes an organization in one direction versus another is the company’s culture. If collaboration, training, recruitment, and retention are important to an organization, we are seeing those organizations direct their employees to return to the office, even if only for three days per work week.

Talent is the lifeblood of most organizations, and as such, when senior members work from home, there is significant concern over the absence of in-person training and professional development. The lack of mentorship opportunities and the daily ability to gain knowledge directly from experts is problematic for the younger generation across virtually all industries. It is essential that organizations that value these resources offer an environment that fosters collaboration, learning and incentivizes employees to leave home and spend time in the office.

Companies seeking to maintain and attract talent are often employing a “flight to quality” strategy. In the office market, this often means relocating to a higher-quality building that offers amenities such as fitness centers, shared conference rooms, meeting/training spaces, and food service. Since the pandemic began, transactions in Class A space have increased by more than 50%. The chart below shows a steady increase in lease activity in the Class A office market in Philadelphia. Organizations are willing to reduce their footprint but pay more in rent

Percentage of Class A Space in Overall Leasing Activity



to not only move into a higher quality office product (even at a cost-neutral or cost savings) but also to help recruit and retain talent.

What Does The Future Hold?

Overall, there is no one-size-fits-all solution to how organizations can, should, or will manage occupancy and face-to-face interaction. Companies often differ in their motivations for the actions they are taking, and we believe that inconsistency will continue to be reflected in the data and business decisions tied to commercial office space. Organizations are continuing to learn best practices and until they are forced to make a space or financial decisions, many will continue to evaluate the best approaches for their respective organizations to build/maintain a culture, retain existing talent, properly train and invest in their young talent and recruit for the future. The consistent inconsistency will be ever-present unless and until the pendulum swings and stays in one direction.



Greg Soffian
Vice Chairman
+1 267 256 7571
gsoffian@savills.us



Catherine Pullen
Senior Managing Director
+1 267 256 7590
cpullen@savills.us



Perry Kaplan
Corporate Managing Director
+1 267 256 7562
pkaplan@savills.us



Michael Styer
Assistant Director
+1 267 256 7577
mstyer@savills.us

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