



CRE RESEARCH > OFFICE CRE STUDY

## Sentiment on Office Fundamentals Turns Sour

*Exclusive WMRE research shows that owners of office buildings do not see positive prospects for occupancy or rental growth.*

David Bodamer | Jan 24, 2023

The persistent popularity of work-from-home well after the height of the COVID pandemic has complicated the outlook for office buildings. While most office-using employees go into offices at least a few times a week, the days of companies having the majority of employees in offices five days a week seem at an end. There has been some notable pushback and outliers to this, but hybrid work seems here to stay.

That has created a muddy outlook for the office sector. This piece explores responses to WMRE's latest exclusive research on the state of office fundamentals. A previous story examined investor sentiment .

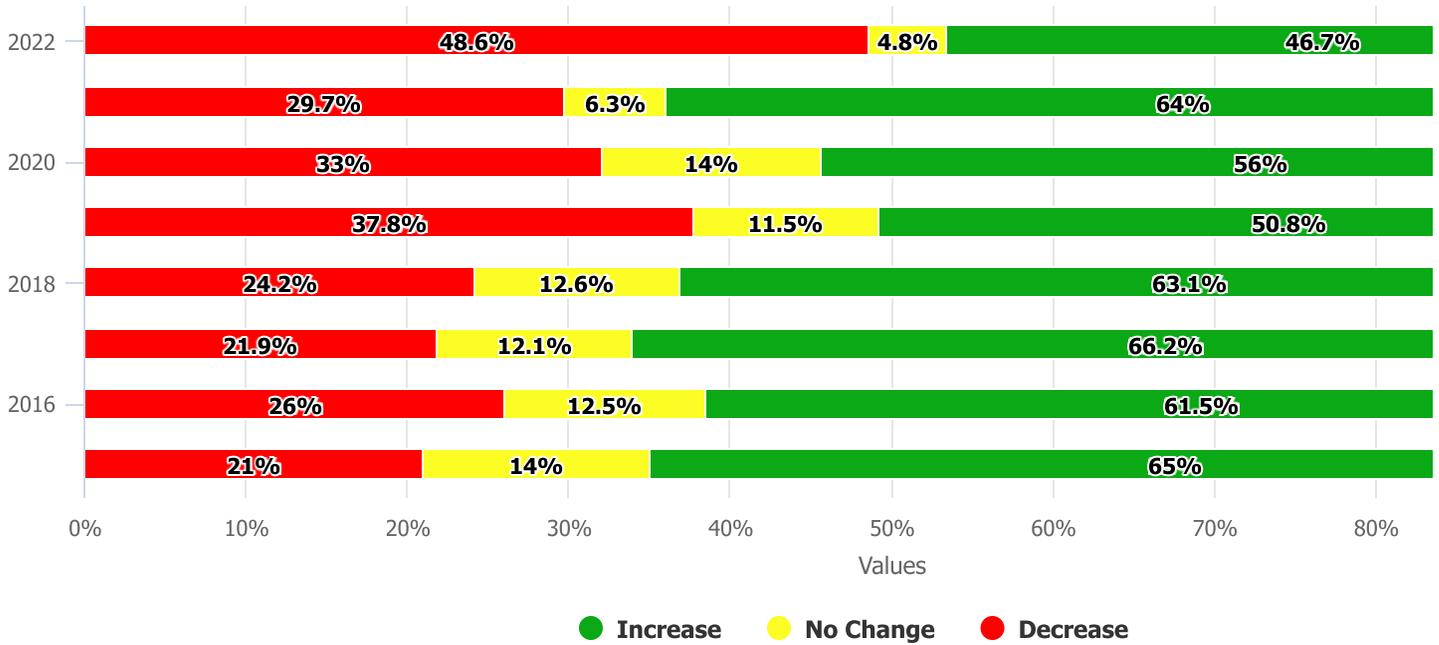
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For the first time in the eight years the survey has been conducted, a plurality of respondents (48.6 percent) said they expected occupancy rates for office buildings to drop in the next 12 months. While sentiment was far from bullish in 2020 and 2021, a majority of respondents in

those years still thought occupancies would rise (56 percent and 64 percent, respectively). This year the figure dropped to 46.7 percent.

## National Office Occupancy Rate Expectations

Respondents were asked what they expect to occur with occupancy rates in nationally in the next 12 months.



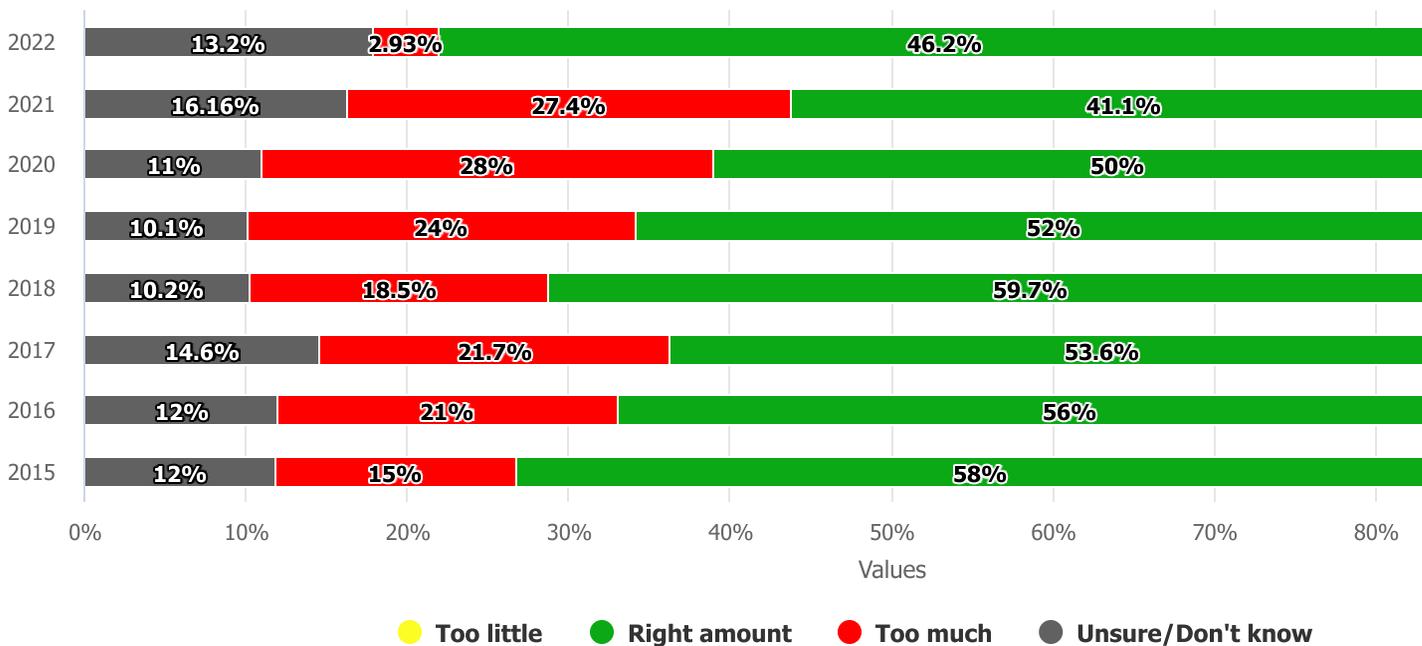
Rising sublease inventory is complicating matters for owners. Overall, about two-thirds of respondents said the amount of sublease space is increasing somewhat (49.1 percent) or dramatically (17.0 percent). Another 23.6 percent said the level of sublease inventory is unchanged, while 8.5 percent said it is decreasing somewhat.

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Just less than one third of respondents (29.3 percent) also believe there is too much development of office properties in their regions. About half of respondents (46.2 percent) think the right amount of development is occurring. The figures are roughly in line with previous years, although the number of respondents concerned about overdevelopment is at the highest level in the eight years the survey has been conducted. Reinforcing that sentiment, nearly 40 percent of respondents (37.5 percent) said their markets could absorb less than 5 percent of additional supply based on current market inventory.

## Office Development Trends

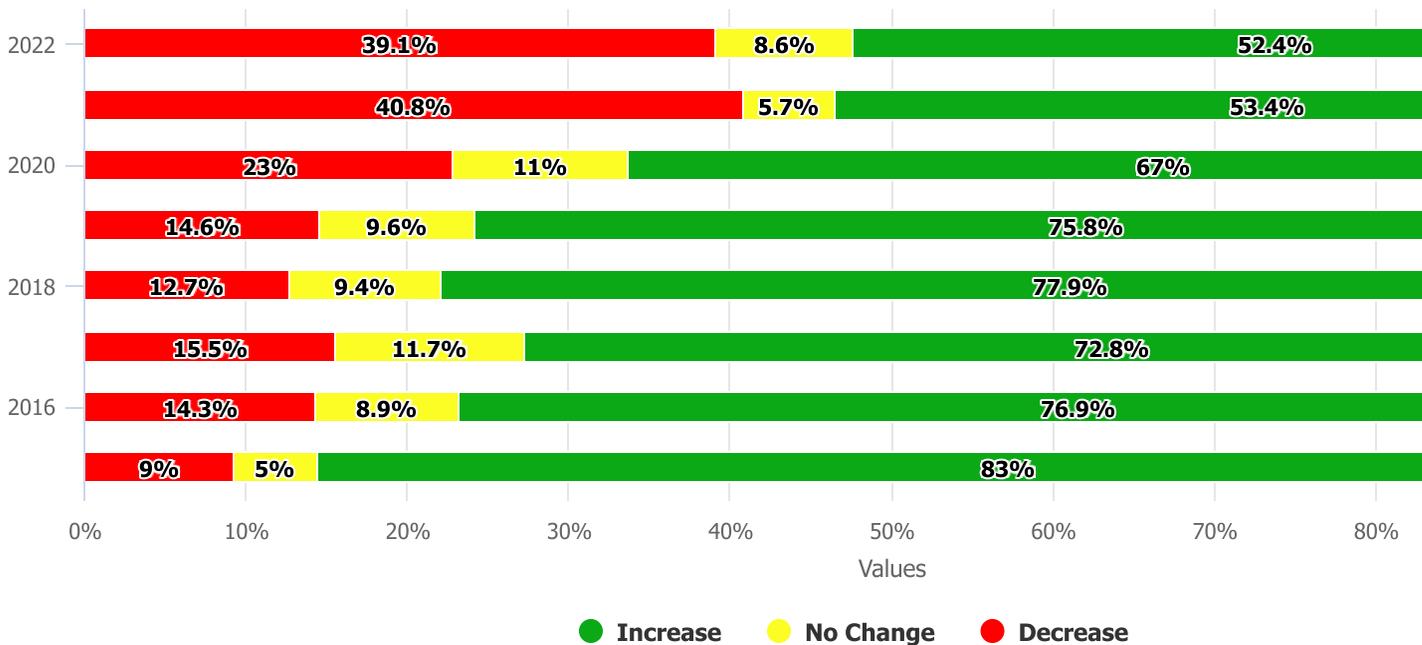
Respondents were asked to characterize the level of development in their region.



In addition, just more than half of respondents (52.4 percent) believe office rents will rise in the next year. That’s down from 53.4 percent in 2021 and 67 percent in 2020. In all surveys prior to the pandemic, typically more than 70 percent of respondents thought office rents would rise.

## Office Rent Expectations

Respondents were asked what they expect to occur with office rents in their markets in the next 12 months.



Another sign of the sector’s challenges is the lack of demand from industries that had been big occupiers of office space in past years. When asked to rate companies were the most active tenants on a scale of one to five, respondents gave no option more than a score of three. In past years, tech firms were ranked as the most active tenants. But this year’s survey reflects

what's been occurring in the broader market the past year with many tech firms conducting mass layoffs and reducing office footprints.

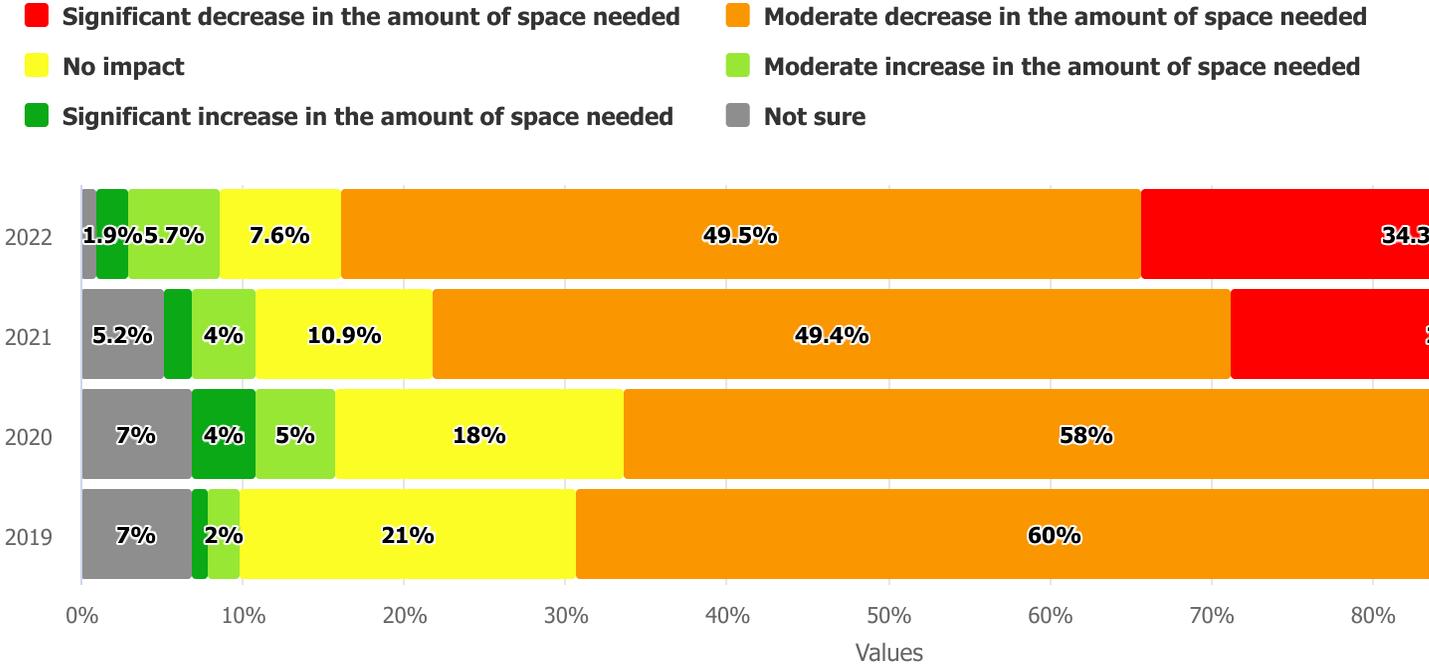
The survey has also attempted to gauge how the emergence of co-working spaces and the increase in telecommuting is affecting the sector.

A plurality of respondents (35.2 percent) said co-working has been a mild net negative, while 11.4 percent said it has been a significant net negative. An additional 25.7 percent said co-working has not been a factor and 21.0 percent said co-working has been a mild net positive. All of those results are in line with responses to that question in the prior three surveys it was asked.

The sentiment on telecommuting, however, has shifted dramatically. In the 2019 and 2020 surveys, fewer than 10 percent of respondents said telecommuting was leading to a significant decrease in the amount of space their tenants needed. But in 2021 that number jumped to 28.7 percent and hit 34.3 percent in the most recent survey.

When asked specifically about tenants in their buildings, 60.4 percent said employers are using a hybrid model, with only 22.8 percent bringing their staffs back five days a week. (Notably, that figure is up from 12.4 percent a year ago.) Overall, a plurality of respondents (37.8 percent) said their buildings are between 51 percent and 75 percent capacity on a daily basis.

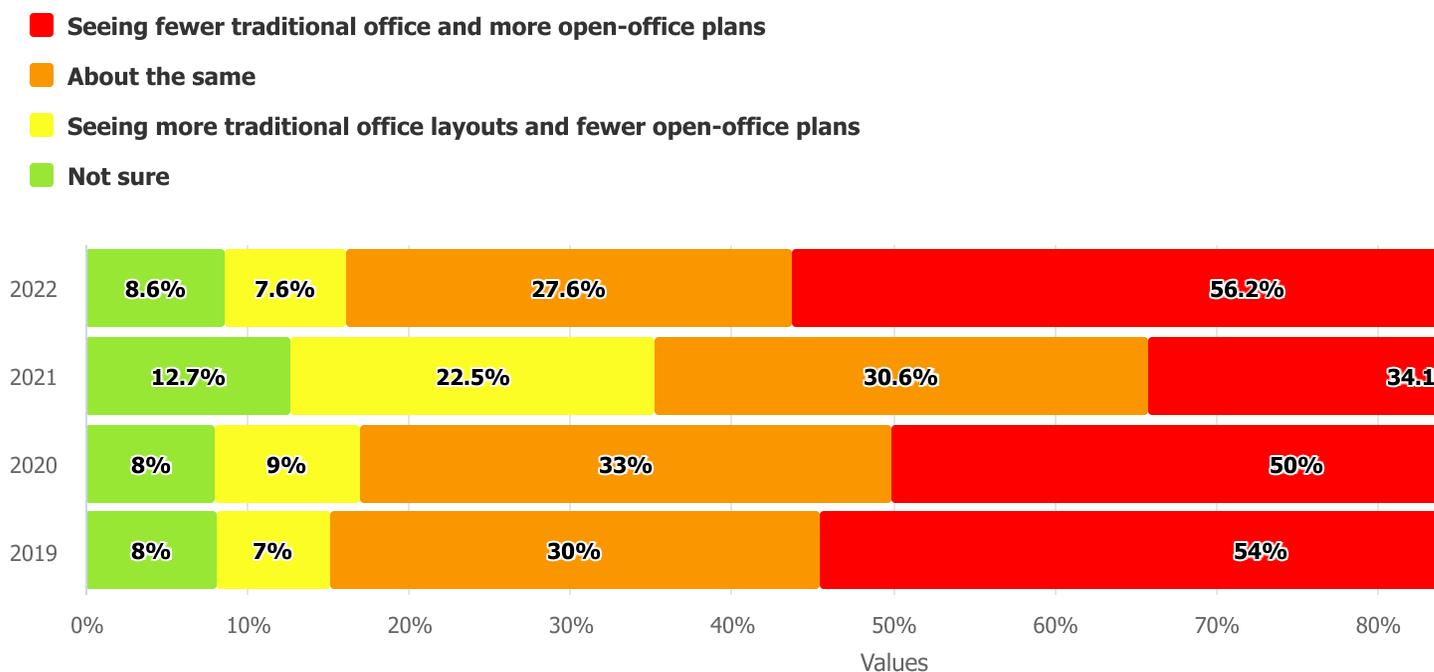
### How Much is the Ability to Telecommute Affecting Tenants' Needs for Space per Employee?



In terms of office layouts, there's also been a marked swing in sentiment. Prior to COVID, open-office plans predominated. In the 2019 and 2020 surveys, about half of respondents said they were seeing more open-office plans and fewer than 10 percent said they were seeing traditional layouts. About 30 percent said the split was even. During the pandemic there was

some speculation that tenants might move to different types of layouts. In fact, in the 2021 survey, more than one-fifth of respondents said tenants were opting for traditional plans and those saying they were seeing more open offices dropped to 34 percent. But in the most recent survey, there's been a hard swing back. Now, 56.2 percent say they are seeing more open-office plans and only 7.6 percent say they are seeing more traditional office layouts.

### How Would You Characterize Trends in Tenant Layouts?



The uncertainty in the sector is translating to lease lengths. More than half of respondents in this year's survey (50.5 percent) said average office leases are becoming shorter. That's up from 42 percent in 2021.

Office tenants are also downsizing. More than 70 percent of respondents said office tenants in general are asking for less space—a jump from 57.5 percent who said that in 2021 and 52 percent in 2020. Just 5.6 percent of respondents said tenants are asking for more space. In addition, when asked about existing tenants, 39.2 percent of respondents said their tenants are decreasing the amount of space they are leasing.

On balance, 78.6 percent of respondents said more than half of their tenants with expiring leases are renewing. In fact, 12.2 percent of respondents said all of their tenants are renewing. Both of those figures are up from 65.5 percent and 6.1 percent, respectively, in the 2021 survey.

Among non-renewing tenants, most respondents believe tenants are relocating either to smaller spaces (57.4 percent) or newer buildings (22.3 percent). Others are relocating from CBD to suburban offices (11.7 percent). Only 16.0 percent of respondents said non-renewing tenants are closing their offices entirely. Other responses included moving to larger spaces (8.5 percent), moving to a new office market entirely (6.4 percent) or moving from a suburban office to one in a CBD (4.3 percent).

During the pandemic, there was some thought that tenants might de-densify offices. But that has not come to fruition. In 2021, there was a roughly even split when among respondents saying tenants were increasing space per employee (32.1 percent) vs. decreasing space (24.4 percent). (An additional one third said there was no change.) In 2022, only 17.5 percent of respondents said tenants were increasing square footage per employee vs. 37.9 percent who said tenants were decreasing space (37.9 percent). An additional 35 percent said there has been no change in density.

One positive for landlords is that fewer tenants are asking for rent relief. This year, 39.6 percent of respondents said no tenants asked for relief—that's double the figure from 2021's survey. Another 42.5 percent said fewer than 25 percent of their tenants had requested relief. Further, owners say they have largely not been granting those relief requests. Just less than one-third of respondents (31.7 percent) said they have not granted any relief, while another 39.7 percent said they have granted fewer than 25 percent of the relief requests.

***Survey methodology:*** *The WMRE research report on the office real estate sector was completed via online surveys distributed in October and November of 2022. The survey yielded 107 responses. Half of respondents (50 percent) hold the titles of owner, partner, president, chairman, CEO or CFO. The results from the current research were compared against prior studies completed between 2015 and 2021.*

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