

Outbreak Raises Questions About Future Office Demand; Coworking Space Faces Significant Overhaul

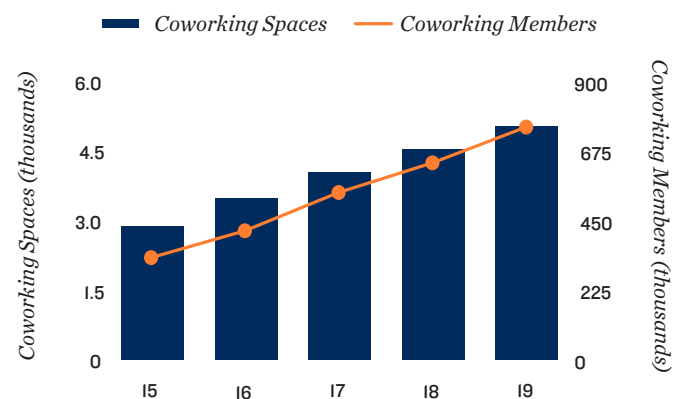
Tenants to reevaluate space needs and practices. The implementation of stay-at-home orders across the country forced many companies to adopt remote working solutions, a behavior that could have long-lasting repercussions for office investors. Prior to the health crisis, approximately 3.5 percent of the nation's labor force worked from home and over the past five years the number of U.S. remote workers increased 43 percent. Now, temporary closures due to COVID-19 safety regulations are forcing nearly all firms to reevaluate space needs as employees become more proficient in digital technology while working remotely. However, a structural shift into dispersed working practices following the lift of government guidance on social distancing is unlikely. Productivity levels will be reestablished by bringing employees back together following weeks of disconnect. Working from an office can ensure employees have the right technology setup to do their jobs efficiently, while they may not have access to the same tools remotely.

Slowing development pipeline to bolster outlook. Over the last decade, demand has gradually outpaced new supply, drawing the vacancy rate steadily lower. The rate has contracted approximately 300 basis points to 13 percent during this period, the lowest it has been since 2007. The economic downturn, however, will lift the rate in 2020 for the first time in a decade as business closures and state eviction moratoriums hinder leasing. Originally, 98 million square feet of office space was slated for delivery in 2020, about 72 percent of the volume completed in 2008. The pace of construction will likely pare back this year as social distancing guidelines and stay-at-home orders slow builders and some projects that have yet to break ground are canceled or delayed as developers await additional insights on future demand. Though leasing has slowed due to the pandemic and will likely remain below normal following an end to the shutdown, underlying fundamentals coming into the health crisis laid a sound foundation as a starting point.

Coworking model faces potential reset. A combination of short leases and increased social distancing will weigh on the outlook for coworking spaces. At WeWork, the nation's largest coworking company, the square footage per worker is 75 square feet, nearly one-third of the office market average of nearly 220 square feet. Close quarters once encouraged collaboration and social engagement, but the pandemic has transformed an asset into a liability. Although WeWork has announced new strategies to keep tenants safe, a path forward remains in doubt after SoftBank withdrew a \$3 billion tender offer. Despite the radical change in outlook, the tenant-improvement intensive spaces occupied by coworking firms may have many leasing options once the health crisis is resolved.

Traditional office space outcomes wide ranging. Amid longer leases, traditional office users will have more time to consider alternatives to their future space needs, along with fewer options. For example, a V-shaped recovery could muffle the impact of the global shutdown, while a slower recovery could push the sector into a prolonged period of space realignment. Outlying submarkets could be desirable to traditional office employers, though, as some may seek out a whole building or office floor in the suburbs to take control of the safety of their work environment. This transition to a larger space may not be cost effective in dense urban tech markets where prices are typically higher. Millennials may also prefer this arrangement as they move to the suburbs to have more living space and highly rated schools for their growing families.

— Coworking Rise in the U.S. | Prior to Outbreak —

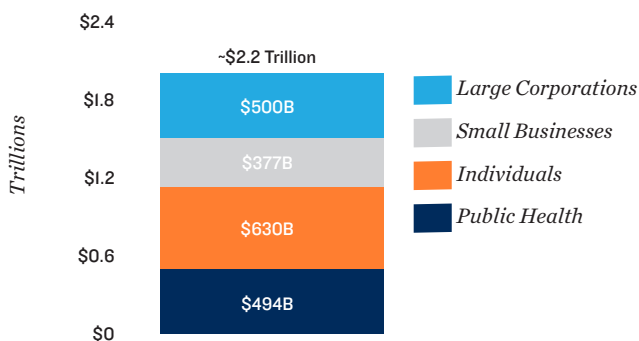


CARES Act Stimulus Offers Some Support For Office Tenants and Operators

Companies rapidly drain first round of stimulus. The \$349 billion Payroll Protection Program (PPP) focused on keeping workers on payrolls for the next two months through forgivable loans, but the entire budget was allocated within two weeks of becoming available. A second infusion of \$331 billion is expected to be available soon. When a second round is released, qualifying small businesses who missed the first round should apply as fast as possible. Larger firms with between 500 and 10,000 workers are eligible for low-interest loans, though these funds do not have an instrument for forgiveness or offer the same level of flexibility as the SBA program.

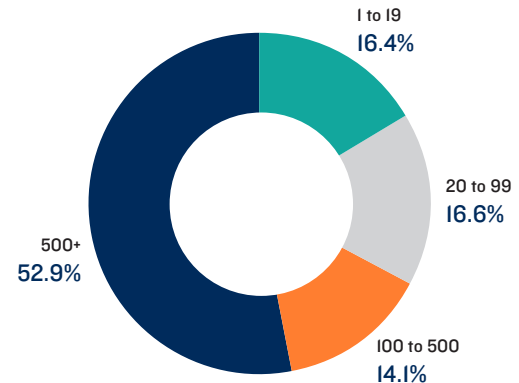
Transaction market seeks clarity; innovative solutions emerging. Although many investors have moved to the sidelines to await additional clarity on the impact of the health crisis, a variety of transactions continue to find a path forward. Logistics hurdles such as viewing properties, conducting appraisals, transaction closing, and recording mechanics have slowed the transaction process. In addition, questions about monthly rent collections have weighed on pricing dialogues, placing a greater emphasis on tenant rosters, property condition and location. Ultimately, buyers and sellers focused on closing transactions are making it to the finish line. Some investors are waiting on the sidelines for distressed sales, but the size and scope of the stimulus, together with sound underwriting this cycle and lower debt ratios, will reduce the probability of broad-based price discounting. Once the economy begins to reopen, much of the pressure will be alleviated and the investment market will move back toward normalization.

Congress Approves Largest Stimulus In U.S. History



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Employment by Company Size*



* Total employment as of February 2020; share of employment by establishment size as of 2017.

Establishment size determined by number of employees.

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