OFFICE DEMAND IN A POST PANDEMIC MARKET

CUSHMAN & WAKEFIELD

INTRODUCTION

This paper considers how office tenant demand in Australia might be impacted in the post COVID-19 economic recovery due to the trend towards increased remote working, as well as the predicted 'war-for-talent'.

Occupancy levels are expected to fall as tenants incorporate working from home policies into their workplace strategies. Relatively strong employment growth arising from the economic reopening should help to offset this decline as well as an expected decrease in workspace density and a shift from individual workspace to collaboration and amenity space.

Research by Cushman & Wakefield indicates that Australian office employment is likely to grow solidly in the next cycle, yet reduced occupancy levels due to working from home could result in a net decline of 5 to 15% in tenant demand for office space over the next three to five years. Our analysis indicates that, by 2026, employment growth and a lease renewal cycle should mean the long-term impacts of increased work from home are likely to be absorbed.

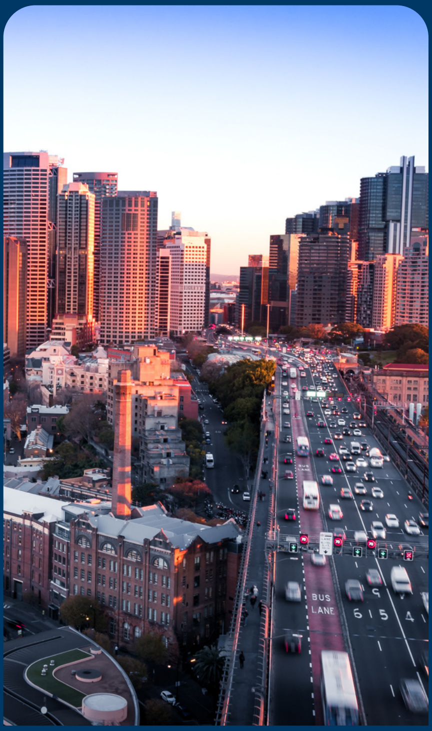
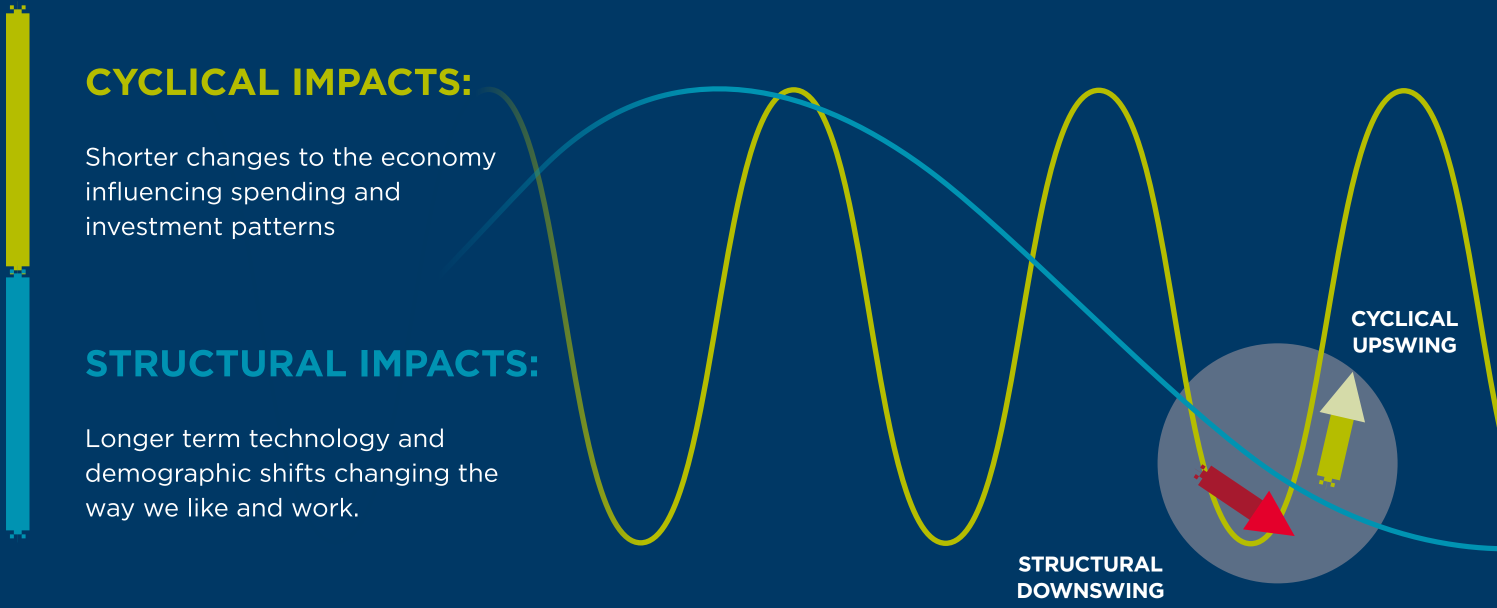


Figure 1 Cyclical and structural impacts



Looking at cyclical and structural impacts, overall occupancy may decline, but employment growth and a war for talent should drive demand for better quality office space with improved amenity.

CUSHMAN & WAKEFIELD

FOUR FACTORS ARE LIKELY TO DRIVE OFFICE TENANT DEMAND:

Over the next few years, four key factors are likely to drive office tenant demand in Australia.

1

Employment growth as the economy reopens following COVID-19 induced social distancing, lockdowns and border restrictions. The reopening is expected to generate solid employment growth and increase demand for office space.

2

A war for talent as unemployment is expected to fall to 40 year lows. To attract and retain the best talent, employers are likely to adopt more flexible work practices and improve workspace quality and design.

3

The rise of flexible work practices or working from home (WFH). With a higher percentage of employees WFH at any one time, tenants will require less space, with fewer dedicated seats.

4

At the same time, improvements in workplace quality and amenity will require more space dedicated to collaboration and social interaction, redistributing and offsetting the loss of individual desk space.

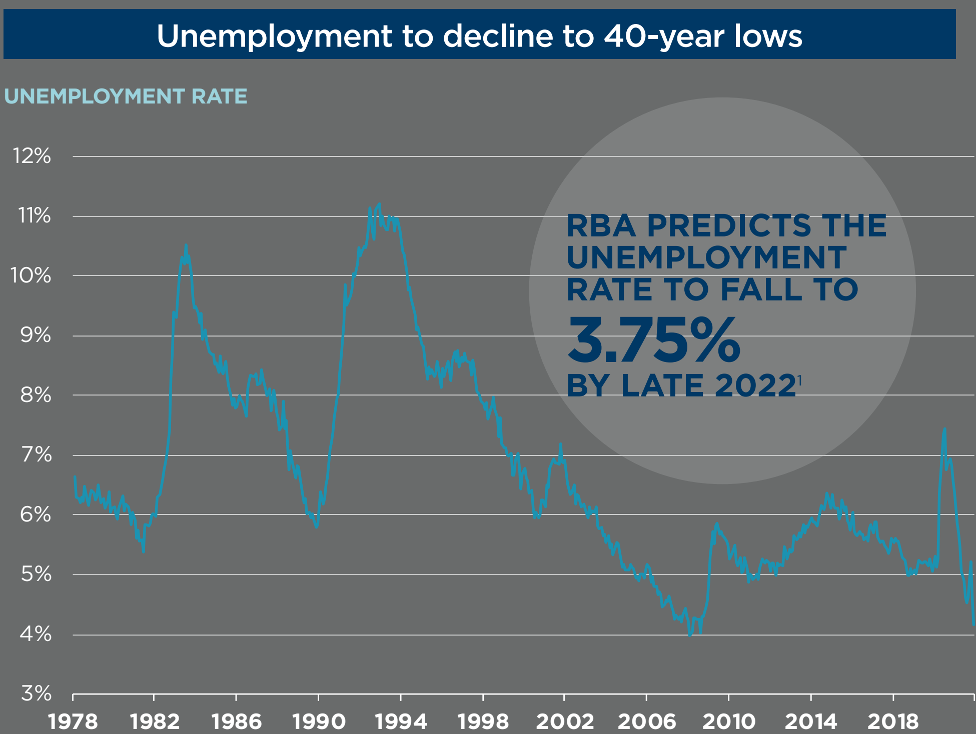
EMPLOYMENT OUTLOOK

Strong economic growth is forecast as the Australian economy reopens and recovers from pandemic induced lockdowns and border restrictions.

The Reserve Bank of Australia (RBA) recently noting that GDP growth of 4.0% was expected in 2022.[1]

The strong economic growth outlook should support employment growth. The RBA forecasts the unemployment rate to fall to 3.75 per cent by December 2022. If achieved, it will be the lowest rate of the past 40 years.

Figure 2 Unemployment outlook



Source: RBA; ABS; Cushman & Wakefield

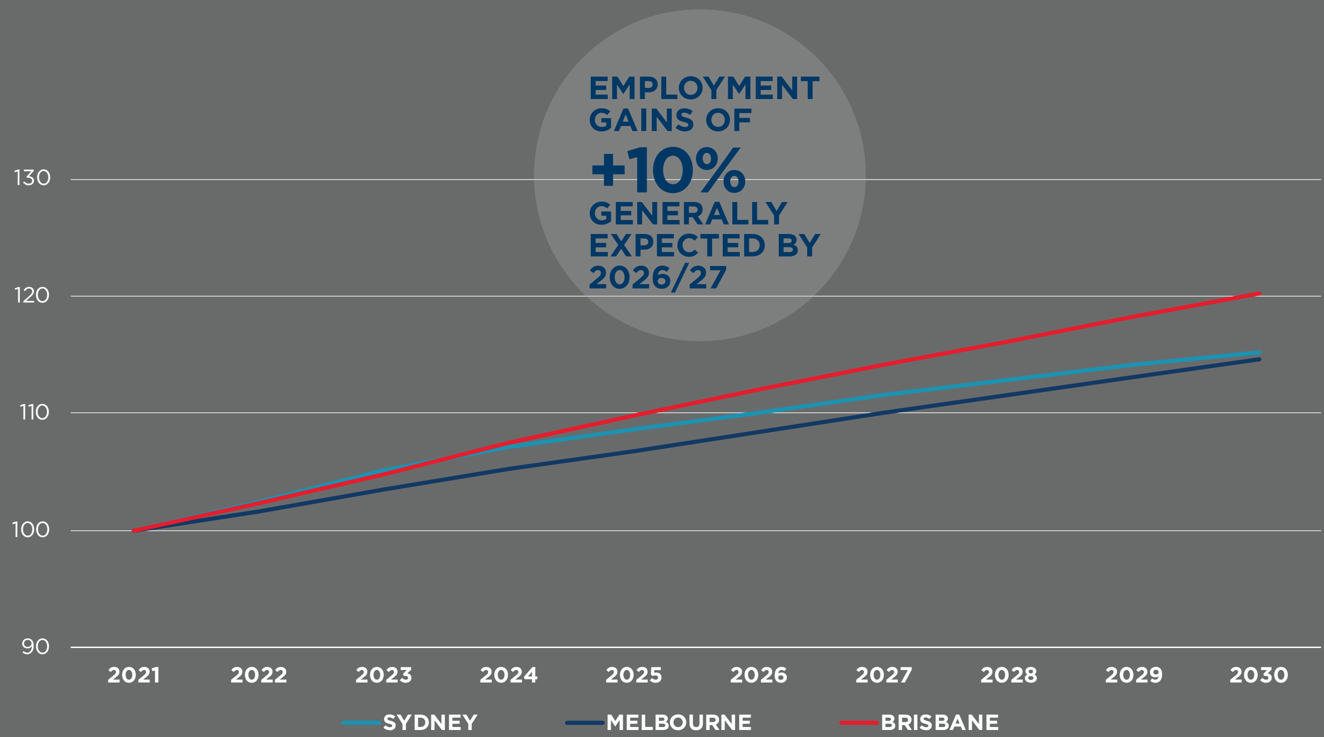
[1] *Reserve Bank of Australia, February 2022, Statement of Monetary Policy*

CBD OFFICE EMPLOYMENT OUTLOOK

Deloitte Access Economics is also forecasting solid employment growth in major city centres. Their September 2021 update predicts over 12,500 additional office workers for the Sydney CBD in 2022, nearly 7,500 in Melbourne's CBD and about 2,500 for Brisbane. This is approximately four times the annual average for the Sydney CBD and nearly twice the average for Melbourne and Brisbane.

This growth cycle is expected to continue with gains of around 15-20% in CBD jobs by 2030.

Figure 3 CBD Office employment growth, index to 2021 = 100



Source: Deloitte Access Economics; Cushman & Wakefield; Index Dec 2020=100

THE WAR FOR TALENT

Economic forecasts suggest strong demand for office staff will drive the unemployment rate to historic lows, so a high priority for employers will be not only attracting but also retaining talent.

Many factors determine where we choose to work, with salary, opportunity and convenience probably being key factors. In future, the flexibility to work from home (WFH) as well as the actual quality of office environment, or workspace, are likely to be significant factors.

A range of surveys suggest most workers would like a mix of working in the office and from home.

A study by PwC[2] found only 9% of those who can work remotely want to go back to a traditional commute and work environment full time. Nearly 75% wanted a mix of face to face and remote work and the remainder wanted a completely virtual workplace.

Data from Cushman & Wakefield's bespoke workplace strategy tool, Experience per Square FootTM (XSF)[3], shows less than 15% of Australian respondents want to be in the office every day or nearly every day. Yet half of all employees want to attend the office for between 1 and 4 days a week.

This data indicates that WFH is likely to become more widely adopted, meaning that most tenants will likely have less staff in the office, and lower occupancy rates than prior to the pandemic

LESS THAN
15%
AUSTRALIAN RESPONDENTS WANT TO BE IN THE OFFICE EVERY DAY OR NEARLY EVERY DAY

[2] *PwC Global, "Hopes and fears 2021", Feb 2021, https://www.pwc.com/gx/en/issues/upskilling/hopes-and-fears.html*

[3] *Cushman & Wakefield XSF@home survey 60,000 respondents 2020-21, https://www.cushmanwakefield.com/en/insights/experience-per-square-foot-xsf-tool*

WORKING FROM HOME IS LIKELY TO LEAD TO REDUCED OCCUPANCY RATES

Before the pandemic, most workplaces provided an allocated desk for all their staff and hot desking or Activity-Based Working (ABW) was an emerging trend. In an ABW office, staff store their personal belongings in a locker and book a free "clean" desk each time they enter the office. If each staff member does not need an allocated desk, there is an opportunity to reduce the number of desks.

Now that "working from home" is here to stay, our research indicates that a majority of tenants are considering ABW as a permanent solution to manage lower occupancy rates.

The number of desks provided is generally based on the average number of employees in the office each day. For example, with allocated desks, a daily occupancy rate of 100% was normally assumed. For 100 staff, 100 desks would be provided. However, at 80% occupancy, only 80 desks are required.

The proportion of staff-to-desks is referred to as the occupancy rate (OR). This is a key metric for the management of an "agile" or Activity Based Workplace (ABW).

OCCUPANCY RATIOS POTENTIAL IMPACT ON SPACE DEMAND

As more employees work from home the average occupancy rate will fall. For example, if a tenant allows staff to work from home two days a week, all other factors being equal, an occupancy rate of 60% might be appropriate.

To analyse the potential impact of WHF on space demand Cushman & Wakefield Research has considered four occupancy scenarios at different rates:

100% — NO WFH, THERE IS A DESK FOR EACH STAFF MEMBER.

80% — DESKS FOR 80% OF STAFF, BASED ON ONE DAY PER WEEK WFH.

70% — ASSUMES STAFF WFH THREE DAYS OVER TWO WEEKS.

60% — ASSUMES STAFF WFH TWO DAYS PER WEEK.

The following table shows a theoretical example of the original amount of space required for 100 employees at a density of 10 square metres (sqm) per person for the four scenarios.

Figure 4 Occupancy ratios and employment growth scenarios

AT AN
80% OCR
AND NO CHANGE TO WORKSPACES, THE WORKFORCE WOULD NEED TO GROW BY
24%
TO OFFSET THE REDUCED SPACE REQUIREMENTS

WSR=10	SQUARE METRES REQUIRED			
No. of staff	**OCR 100%**	**OCR 80%**	**OCR 70%**	**OCR 60%**
100	1000	800	700	600
110	1100	880	770	660
120	1200	960	840	720
130	1300	1040	910	780
140	1400	1120	980	840
150	1500	1200	1050	900
160	1600	1280	1120	960
170	1700	1360	1190	1020

We looked at how many more staff would be required to offset the reduced space requirements under each of the four scenarios.

Row 1 is the baseline. It shows the space required for 100 staff at a density of 10 sqm per person. At an OR of 100%, that's 1,000 sqm, an OR of 80% requires 800sqm and so on.

The next rows show the amount of space required for increasing numbers of employees at the ORs ranging downwards from 100% to 60%, or the equivalent of 0-2 days per week WFH.

The yellow highlighted cells show the approximate number of employees required to exceed the capacity of the original 1,000 sqm space requirement at each OR.

In this example, for an average OR of 80%, in theory, staff numbers would need to increase by more than 24% for the space requirement to exceed that required at a 100% OR.

CHANGES IN SPACE DISTRIBUTION

Another factor with an impact on occupancy rates and space demand is a redistribution of space from individual workspace to shared amenities and collaborative space. This change is expected to offset some of the long-term reduction in space caused by working from home.

The key drivers of this shift in space distribution are workplace experience and staff engagement. This trend has been emerging for several years as a feature of ABW offices and has been accelerated by the pandemic.

Reduced time in the office has a negative impact on staff engagement that can be mitigated by a more interactive and inclusive workplace experience. A better quality workplace and more flexibility about where and when to work gives employers a competitive advantage to attract and retain staff.

To estimate the impact of changes in space distribution on demand we analysed four scenarios with reduced occupancy rates and alternate space mixes between individual and shared work settings.

INDIVIDUAL WORKSPACE	COLLABORATIVE SPACE	AMENITY SUPPORT AND WELLBEING
		
70% → 40%	20% → 40%	10% → 20%

Depending on the space distribution mix, overall space requirements can increase, despite reduced ORs. For example, a 10% shift from individual to collaborative/amenity space, means the space decline from -20% (from WFH alone), is reduced to -6.7% once an expansion of collaborative and amenity space is allowed for. Over the range of scenarios tested the average decline in space was just 10%.

Figure 5 Occupancy ratios and individual/collaborative space mixes

AN INCREASE IN COLLABORATIVE SPACE CAN SIGNIFICANTLY REDUCE THE IMPACT OF THE DECLINING OCRs ON OFFICE SPACE REQUIREMENTS.

AVERAGE CHANGE

-10.2%

Staff no. 100	SQM/desk = 8.4	Collaborative	Amenity	SQM Reqd	Change
Static	**70%**	**20%**	**10%**	**Total**	
100%	840	240	120	1,200	
80%	672	192	96	960	-20.0%
70%	588	168	84	840	-30.0%
60%	504	144	72	720	-40.0%
Static Hybrid	**60%**	**25%**	**15%**	**Total**	
100%	840	350	210	1,400	16.7%
80%	672	280	168	1,120	-6.7%
70%	588	245	147	980	-18.3%
60%	504	210	126	840	-30.0%
Agile Hybrid	**50%**	**30%**	**20%**	**Total**	
100%	840	504	336	1,680	40,0%
80%	672	403	269	1,344	12.0%
70%	588	353	235	1,176	-2.0%
60%	504	302	202	1,008	-16.0%
Agile	**40%**	**40%**	**20%**	**Total**	
100%	840	840	420	2,100	75.0%
80%	672	672	336	1,680	40.0%
70%	588	588	294	1,470	22.5%
60%	504	504	252	1,260	5.0%

THE MORE EXTREME SCENARIOS ARE PROBABLY LESS LIKELY

Our analysis of changing space distribution scenarios indicates that significant reductions in space demand are likely to be less than expected, and for several reasons. These include:

- **People/desk management: To strictly maintain lower OR's, a booking system for allocation of desks and interactive settings will be required to enable choice and manage demand, i.e. to ensure not all WFH is on a Monday and Friday. A buffer to allow for increased occupation on some days suggests lower ORs are less likely to be implemented;**
- **Social distancing: health and safety risk management suggests a rapid return to high density workspace is unlikely over the short to medium-term;**
- **Industry type and workforce mix: while some sectors and job types lend themselves to remote working, some industries may require workers on site, e.g. for legal reasons. Other teams, such as sales or development, may prefer a more collaborative office environment;**
- **Economies of scale: bigger tenancies allow more opportunity for workplace change. Smaller tenancies (<1000sqm) are less efficient and elastic with static distribution of space.**

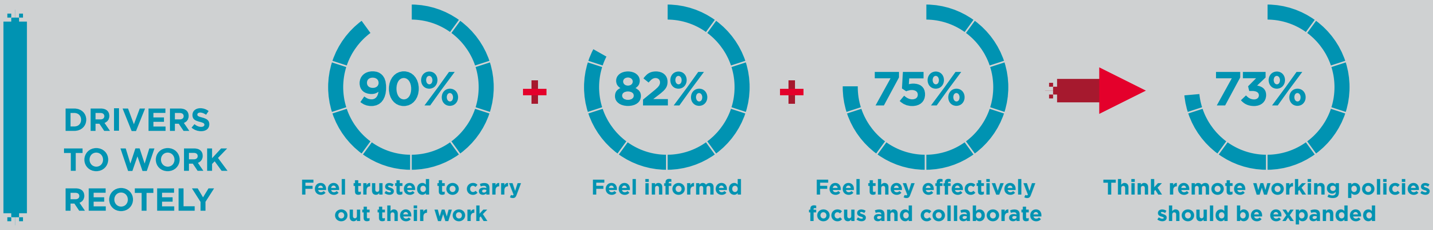
EVOLUTION OF THE "HYBRID" WORKPLACE

A study by Corenet and Cushman & Wakefield[4] measured the impact of working from home on employee experience during the pandemic.

The findings show that many more respondents have embraced the concept of a hybrid office than before the pandemic.

- **Before the pandemic 59% put office first as their preference, compared to 10% post Covid.**
- **Before the pandemic 22% put office hybrid as their preference, versus 58% post Covid.**
- **Before the pandemic 7% preferred remote hybrid, compared to 22% post Covid.**
- **The preference for remote first was unchanged at 10-12%**

Our XSF research study also identified several key drivers that motivate employees to work remotely for part of each week.



Yet, over time, there is evidence that working from home indefinitely is not sustainable. Some employers reported productivity gains early in the pandemic, yet our research shows that for many staff these were gradually eroded by isolation and loss of engagement, leading to a decline in health and wellbeing ,and for newer employees, a lack of mentoring and networking opportunities.

Some of the key drivers for returning to the office identified in the survey are shown below;

[4] *Cushman & Wakefield, Workplace Ecosystems: The Office's Changing Place in an Agile World, April 2021. https://www.cushmanwakefield.com/en/insights/workplace-ecosystems-the-office-is-changing-place-in-an-agile-world*

The reasons selected for working remotely and returning to the office do not outweigh each other.

Instead they point to the evolution of a blended or "hybrid" workplace model in future that enables employees to "do their best work" where and when they choose yet continue to connect, engage and interact with their colleagues in person at a central office location designed to facilitate learning and collaboration. An example of a potential scenario is below.

In fact our research indicates that the most likely scenario is a blended solution in which employees can decide what percentage of time they spend in the office, interacting with present or virtual colleagues or working independently in response to all of the drivers identified above.

HOW MUCH WILL SPACE DEMAND DECLINE AND HOW LONG WILL THE TREND LAST?

Due to other factors noted above we believe that WFH will not lead to large falls in occupancy across office markets in the medium-term, with an overall reduction in space demand from more agile working in the order of 5% to 15%.

Given the average CBD weighted average lease expiry (WALE) is about five years, many tenancies could move through a first iteration of more agile working by 2026. The cost of refitting space and the risks to productivity of increased density will limit moves or consolidation before lease expiry.

Separately, Deloitte Access Economics predict office employment should increase by about 10% in Sydney, Melbourne and Brisbane between 2021 and 2026/27, which is enough to offset the decline.

If more tenants take the opportunity at their next lease expiry to move to a more agile workplace, and employment grows as predicted, the main impact on office space demand could be washed through by 2026. This will allow markets to 'reset' with economic activity and employment growth as the primary drivers of office tenant demand, rather than the structural step change in demand anticipated by the rise of WFH.

WHAT DOES IT MEAN FOR:

LANDLORDS:

- **Attractive space with good amenity will be high priorities for tenants to retain staff.**
- **landlords seeking to reduce leasing risk should ensure their properties have excellent amenity with the flexibility to adapt to changing tenant needs.**

WHAT DOES IT MEAN FOR:

TENANTS:

- **An agile hybrid workplace with appropriate WFH systems and policies can give employers an advantage to attract and retain the best talent.**
- **Expert analysis by a workplace strategy and change team can help in building an appropriate workplace solution.**
- **Employers need to consider the risk and potential impact on staff retention and productivity vs any short term savings from downsizing their space**

CONCLUSION

Overall, the universal adoption of remote working during the pandemic and the impending war for talent will mean Working from Home is here to stay with a consequent reduction in demand for office space.

However, the incentive to retain talent and drive productivity by improving workspaces with more space allocated to amenity and collaboration should offset this to some degree. Tenants that shed or consolidate space in haste will risk disruption to staff engagement, retention and productivity.

Employment growth also likely to speed the transition with an overall decline in demand of 5% to 15% likely that should be ‘washed though’ in the next leasing cycle by 2026.

The reduction in tenant demand is likely to have the biggest impact on lower grade space as tenants seek better quality space to help attract and retain talent.

The war for talent and flight to quality will motivate occupiers to develop strategies to make the office experience an integral part of talent engagement, whilst landlords should ensure their properties have excellent amenity with the flexibility to adapt to changing tenant needs.

Cushman and Wakefield can help both occupiers and landlords to match future space needs and compatible buildings using our market knowledge, workplace expertise and consulting tools to develop a sustainable s trategies for your enterprise to thrive in a post pandemic future.

AUTHORS:

JOHN SEARS

Head of Research, Australia & New Zealand

Mobile: +61 466 387 016
John.sears@cushwake.com

CHRIS MARRABLE

Director, Strategic Consulting
Australia and New Zealand

Mobile: +(61) 412 360 969
chris.marrable@ap.cushwake.com

DR. DOMINIC BROWN

Global Head of Demographic Insights, APAC-lead

Mobile: +61 431 947 161
dominic.brown@cushwake.com

CUSHMAN & WAKEFIELD

ABOUT CUSHMAN & WAKEFIELD

Cushman & Wakefield (NYSE: CWK) is a leading global real estate services firm that delivers exceptional value for real estate occupiers and owners. Cushman & Wakefield is among the largest real estate services firms with approximately 50,000 employees in over 400 offices and 60 countries. In 2020, the firm had revenue of $7.8 billion across core services of property, facilities and project management, leasing, capital markets, valuation and other services. To learn more, visit www.cushmanwakefield.com or follow @CushWake on Twitter.