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Vaccines are rolling out. How will it affect your office real estate?

BY ANDY GRAISER | MARCH 2021

The possible end of COVID-19 at some point in 2021 is good news for corporate real estate (CRE) executives. But unfortunately, CRE decision-makers are still likely to face a substantial level of uncertainty as they make decisions about their owned and leased real estate in the year ahead.

If the vaccination program goes swimmingly, workers could start returning to offices in droves within a few months. However, many states are already seeing logistical bottlenecks in their vaccination campaigns. What if the national push for COVID immunity takes a lot longer than expected?

Exactly what office life will look like moving forward is also highly uncertain.

Let's say the virus is nearly vanquished in a few months, but millions of Americans still need to get their shots before we reach herd immunity. When will your employees return to the office? Will you make them prove they have received two COVID shots before they can do so? Will mask-wearing and social-distancing (including having desks placed 6 feet apart) be mandatory until the pandemic is over?

Your answers could determine how many of your employees feel comfortable returning to the workplace – and therefore, how much space you will need.

Given such uncertainties, securing more options in your leases should be a top priority for CRE decision-makers in 2021. Below are some potential ways to accomplish this in your negotiations with landlords.

Pandemic ‘what if’ clauses

As you negotiate or renegotiate office leases, it might be a good idea to consider how future crises could affect your real estate holdings. Some landlords are now willing to consider giving office lessees specific protections against business interruptions caused by pandemics as part of the company’s lease-renewal program or in the course of negotiating a new lease. Naturally, these can be tough negotiations.

We’re all hoping to see a dramatic decline of the virus followed by its total disappearance at some point in 2021. Another possibility, though, is that we’ll endure additional surges of COVID – more peaks and valleys – before all is said and done. Protecting yourself in the lease could be worth the effort.

Shorter lease terms

Signing shorter lease terms for office space can provide strategic flexibility when the ultimate shape of things is up in the air. Today, many landlords are more open to signing shorter leases, so long as the lessee does not require a sizable tenant-improvement investment. In today’s office sector, speculation is rampant about the degree to which American workplaces will return to the pre-pandemic norm. If, ultimately, your need for space proves to be less or more than anticipated, you will be better able to adjust to that reality if you have signed a shorter lease.

Giving up certain lease clauses, such as the right to expand into another part of the building as needed, is one possible way to negotiate a shorter deal. Some owners are seeking more control over their properties because it allows them to pursue their own adaptive strategies involving new types of users and amenities.

Sublease options

In today’s marketplace, subleasing excess space tends to be a go-to option for office lessees that are looking to contain their occupancy costs. According to JLL, in fact, the U.S. sublease market has mushroomed to be even larger than it was in the late 1990s, with up to 150 million square feet (13.93 million sq. m.) of space for sublease on the market. All of that said, some office lease agreements still contain significant restrictions on subleasing. At the negotiating table, you might want to consider seeking maximum flexibility in the agreement with respect to subleasing. This gives you more options as you solidify your strategy.

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Additional considerations

Some CRE decision-makers are huddling (mostly on Zoom) to game-plan what the new normal could look like after COVID-19. Others are already making bets and pulling the trigger. In the Houston market, for example, one office client of ours is dramatically reducing its office space under the assumption that, moving forward, employees will divide more of their time between their homes and the office.

This particular executive team is convinced that, post-pandemic, Americans will be even more fed up with lengthy commutes, simply because so many of them have lived for many months without any commute at all. In other words, another major decision for office lessees moving forward is whether to relocate offices closer to the suburbs in response to these dynamics.

All of that said, it’s possible to make precisely the opposite argument and focus on cities. Some observers believe the Roaring 20s were due, in part, to the release of pent-up demand among Americans who sheltered in place for two years because of the Spanish flu.

When the COVID-19 pandemic ends, will American cities enjoy a renaissance as shoppers, diners, and entertainment-seekers flock to urban neighborhoods, museums, sports venues, and the like? If so, then now could be the perfect time to secure prime space in the city at rental rates that would have been unheard of prior to the current crisis. In New York, for example, many beautiful, brand-new office towers sit half empty. Landlords are showing more flexibility to address these serious issues. Those that own multiple offices might even be willing to pay you to relocate to one of their newer, higher-profile buildings.

The role of liquidity

Clearly, companies with substantial owned and leased portfolios need to engage in robust discussions about how today's uncertainties could play out for them – how much space employees will need, where offices should be located, and more. Experts from human resources, operations, and the CRE and executive teams should all be part of those discussions.

In addition to pursuing optionality in leases, all companies should take a look at reducing their real estate occupancy costs. In your dealings with landlords, avoid the common mistake of "dialing for dollars" – merely pleading for rent reductions in a generalized way.

In our experience, the right approach is to bring robust, transparent financial data to the landlord proactively. Make sure the landlord understands the dynamics, not just at your company, but also in your larger industry (again, backed up by solid data). This will enable the landlord to make a confident decision and, perhaps more important, educate its lenders and investors about what's happening.

You also need to understand your real estate down to fine-grained financial details as well as how other tenants are doing in that building. Third-party real estate experts can help on this score. Real estate expertise translates directly into more productive conversations with landlords. Bringing credibility and facts to these negotiations, no matter how dire the circumstance, will always provide a better outcome.

Having successfully renegotiated leases, reduced footprints and/or relocated offices as needed, you will gain a precious resource for executing on your go-forward strategy – liquidity and optionality.

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