

ILLUminate Blog Transcript: Loren Keim on the Future of Office Space

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- ANNOUNCER: 00:02 [music] This podcast is brought to you by ILLUminate, the Lehigh Business blog. To learn more, please visit us at business.lehigh.edu/news.
- JACK CROFT: 00:13 Welcome. I'm Jack Croft, host of the ILLUminate podcast for Lehigh University's College of Business. Today is September 5th, 2022. Heading into fall, as the COVID 19 pandemic persists in its third year, companies across the nation are grappling with the question of whether workers should be required to return to the office. So we're talking with Loren Keim about what the future of offices may look like in the U.S. Loren is a professor of practice in the Perella Department of Finance's Goodman Center for Real Estate. He teaches Case Studies in Real Estate as well as the two-semester Real Estate Practicum. He is also an author of real estate how-to books, an international speaker and the owner of CENTURY 21 Keim Realtors, with more than 90 brokers and associates in eastern Pennsylvania and New Jersey.
- CROFT: 01:05 Loren, thanks for being with us again today.
- LOREN KEIM: 01:08 Thank you for having me, always a pleasure.
- CROFT: 01:11 Now, as I said in the intro, at the start of the COVID 19 pandemic, in fact, in March 2020, millions of American employees were abruptly forced to transition to working from home. Lately, there has been considerable speculation and prognostication about how many of those employees will return to commuting to an office full-time in the near future. Based on what you've been seeing and hearing in the real estate industry, what do you think is the most likely scenario for how things go?
- KEIM: 01:43 Yeah. It's an interesting question. One of the things that we have in a lot of podcasts where we have panels discussions over the past two years now have been those brokers that are tracking what percentage of office workers are coming back into the office. And we've heard numbers within the last year as low as 6% in some very large buildings up to maybe 60%. And that's about the highest number we've heard. But it's going to be hard to say what's going to happen exactly in the future because, frankly, many of these leases are 10-year leases. And many of these large companies are not going to walk away from them. As they finally end, we'll see whether or not they reduce space. But just like everything in life, there are two competing viewpoints. And there's research going on all over the place on whether or not remote work or hybrid work has been effective depending on the source of the study. And I've had conversations over the past few weeks with experts that claim that employees working remotely has dramatically increased production as they tend to work longer hours and don't have the commute time. However, I've heard just as many complaints from management of firms that workers are far less productive, and in fact team activities slow dramatically. It's hard to get them together and get them working. There are exceptional cases on both sides, of course. But while some people can work effectively remotely, there are others that get sidetracked by kids and the television, the refrigerator, and everything else that's part of the home.
- KEIM: 03:13 I do believe there's always going to be a component, or at least for the next decade, of remote work. But I also think we'll be seeing some substantial return to the office

environment probably in a hybrid model over the next few years for a few reasons. A couple of things that stick out that we've noticed that have become problems with the hybrid model. Young people tend to move to gateway cities like New York or Chicago or Miami for many reasons. They like the excitement, of course. But they also like the flexibility of being able to change from one firm to another if they are unhappy or if they get a bump in their salary. And it's easier to do that in an area where there are several competitors existing. That doesn't happen, unfortunately, in smaller suburban markets. In fact, firms like Google, Microsoft, Facebook or Meta, I guess it's called now, locate large facilities in New York in order to tap into that talent pool rather than requiring the best and the brightest young minds to move to the West Coast. And that benefit goes away if there's no one coming into the office.

KEIM: 04:14

The other issue I've heard from students who have graduated is that they're having difficulty learning in corporations where everything's remote. And it's harder to bounce questions or ideas off people that are in the firm. That's part of the learning process when you first get into a firm. So that's been a bit of a challenge as well. But I do know that every survey I've seen has most employees preferring a hybrid model or at least a component of working at home as part of their job. So I think, going forward, particularly in this environment when we're in a worker-driven environment because we've got such a shortage of employees, that they're going to dictate the ability to have some sort of hybrid model in place.

CROFT: 04:57

To that point. I'd just seen the latest Gallup poll which was released August 31st, and I think probably sheds some light on what you were just talking about. And that's Gallup found that slightly more than half of full-time workers in the U.S., more than 70 million employees, say their job-- they can do their job working remotely from home. And of those, currently, 5 in 10 are working part of the week at home and part in the office in that hybrid arrangement. 3 in 10 are exclusively working remotely. And only 2 in 10 are working entirely on site. Moving forward, 60% of those who can do their jobs remotely say they want a long-term hybrid work arrangement. And 6 in 10 say that they would be extremely upset if they couldn't get that and would look for a job elsewhere if their employer did not offer it. So if companies do wind up adopting some form of hybrid work solution, at least in the short-term coming up, what does that do to the demand for office space for companies? What are some of the problems that would create for them?

KEIM: 06:07

Well, obviously it creates more open space that's not being used. And we're seeing this heavily in the major cities like New York, where there is space that is leased, but it's not necessarily occupied. And the absorption rate for office space in Manhattan, as an example, I think the last quarter, if I can glance at it on my screen really quickly, New York City had a net absorption year to date as of the end of July of negative 4.7 million square feet. Over 2 million negative absorption just downtown. And that's with leases expiring and not being renewed. That's a real problem going forward to have all that extra space. But if the solution is a hybrid model, it still means there's a need for office space, just not as much. And the question is whether or not people will be sharing the same space if they come in two or three days a week. In some firms, the space may be redefined similar to a WeWork or shared office model with different levels of employees able to use whatever open space, open private office, or open cubicles available on that particular day. That would certainly decrease the need for office space. In shared space, we're seeing a lot of this happening in suburban markets.

KEIM: 07:20

Subscriptions are sold for shared desks. And the owners are able to actually oversell them because the tenants are only in a fraction of the time. It's rare they hit capacity. The nice thing is, for the employees, they can come in when they want to. For the landlord of the building, they're able to actually collect a higher form of rent. If you're renting 10,000 square feet to a firm, you might get a certain dollar per square foot. If you're taking that same 10,000 square feet and renting it to 80 different firms that are sharing that space, you actually get a higher price per square foot. Again, you can actually oversell it a little bit. The downside to that is, of course, you're putting a lot, what used to be in a larger square foot footprint, into smaller space in these shared offices, meaning you're leaving a lot of space open. And that's where the problem is going to come in for the real estate market and office in the long run.

CROFT: 08:11

Now, you touched on some of the differences between the cities and suburban areas. So let's talk about that a little. What are some of the main differences, then, in the way you think this will probably shake out between suburban markets, the differences with the cities?

KEIM: 08:31

The major cities-- now, I'm not talking about-- this gets kind of into the weeds. But the gateway cities where young people, young talent likes to go, New York, Miami, Chicago, tend to do very well. They're central business districts. The secondary cities sometimes struggle if they don't have a great lifestyle component, or they don't have a lot of firms in the same field. They tend to struggle a little bit more. But central business districts do a little bit better. It's funny. Probably four or five years ago, we had a meeting. I took a group of students, about 50 of them, into the city for a workshop where-- and I'm not going to say who. But the top speaker was talking about the fact that they felt New York office space prices were going to fall, which they did not at that point in time up until the pandemic. But they believed that the rate was going to decrease. And they felt that they were maxed at the amount of businesses that were going to be in that area. And this was probably slightly before Google and Facebook both signed their large leases. They were worried about the rate. And one of our students actually asked, "Well, what about New Jersey? If you go to Jersey City or to Hoboken the price to rent office space is significantly lower than Manhattan. Do you think firms will leave the city?" And the speaker got a little offended and said, "New Jersey? Who would go to New Jersey? That space is free." Obviously, it's not. Actually, those spaces for office are more expensive than the Lehigh Valley market. But it's interesting the way they look at it.

KEIM: 10:01

When you're looking at a firm like Google or any large law firm or accounting firm or finance agency, they locate in a city like New York because they want to be in New York. And it doesn't matter how much cheaper the space might be in Hoboken or Allentown. They're never going to move out of the city because the city is where they attract that top talent that they need. So when we look at markets, we have to look at them separately. The central business district in some cities will do well just because they have firms that have to be there and want to be there. In the suburban markets, you're seeing a lot of change. We're seeing office space in Lehigh Valley, as an example, converted into other uses.

Guardian Life Insurance, the main building for Guardian Life, a few years ago, JG Petrucci [Company] purchased and tore it down and actually put up three large warehouses because we'd become a distribution hub in this particular marketplace. But you have to look at each individual suburban market separately than the central

business districts because they are two completely different animals even though you're renting to similar uses.

CROFT: 11:08

We had earlier done a podcast on the disappearing shopping malls and what was happening to them. And I'm wondering what-- you just mentioned the warehouses, again, which makes sense for the Lehigh Valley. But what are some of the other uses you have either seen or anticipate seeing for the former office buildings and complexes that don't survive post-pandemic?

KEIM: 11:34

In suburban markets, there's a lot of different changes that can be made in central business districts. Even in Philadelphia, there's more limitations because you've got taller buildings that make it a little bit harder to redefine the space. In the Lehigh Valley, as an example, the suburban markets have turned into medical space. That's happened with both retail and office. You can see the former LSI building, the Lucent building along Route 22, has been turned into medical space. The challenge with making that change from general office to medical, though, is medical requires water in almost every room, in labs and in exam rooms. That makes it a little bit more challenging to convert it, but it is doable. The former Bell Labs building on Union Boulevard, which was a very large building, has become a large school. So there are lots of ways to repurpose them. I don't know if you recall, but a few years ago-- a few years ago, it's probably over a decade now, there was a building on 7th and Hamilton [in Allentown] that lost most of its office tenants. They actually rented different floors to bands to practice.

KEIM: 12:35

The Allentown Brew Works in Allentown at 812 West Hamilton, they turned the third and fifth floors, which would have been office space, into wedding venues for ceremonies and receptions-- anything that can be done to repurpose those spaces. There's a former office building on Union Boulevard. It's maybe four or five stories that became self-storage space. And I've even seen some offices opened up and turned into gyms. Where possible, some of these taller buildings are being converted into residential apartments because there's a real need for that additional multi-family space. If the ceilings are high enough, they do lend themselves to converting into that residential use if possible.

CROFT: 13:17

We've talked about New York City and other gateway cities. And recently, New York Governor Kathy Hochul has committed to moving forward with construction of 10 new towers of mostly offices around Penn Station in Manhattan. I mean, does that seem like a good bet that workers in New York City will return en masse to offices at a time when the city is experiencing, as you talked about, I think, with the first question, the near record highs in office vacancies?

KEIM: 13:50

I doubt it. I mean, there's a bit broader issue there as well. There have to be jobs in the city to sustain the city. One of the things that I use very often, or one of the ideas I use very often with growth of a city or decline of a city is population. And if you look at New York City as an example, from 1950 to 2020, the population in New York only grew 3.6%. And during the same period, that 70-year period up to 2020, Baltimore lost a third of its population. I think New Orleans did as well. Philadelphia and Boston both lost about a quarter of their population. If there aren't jobs, there isn't the need for the office space. And that happens in every recession as well. If people stop having a job, they don't need to be able to go to work. So there's less need for office space. They also stop buying stuff, which means less need for manufacturers to manufacture and less need for warehouse space. But when you look at a city, which generally has a

lot of large, tall buildings, you have a problem with that space when a lot of it vacates out. And if the businesses aren't there, you're going to end up having more and more vacant space.

KEIM: 15:00

I don't see many large businesses leaving New York because I think, in that particular city, they need to be there in order to acquire the talent. At the same time, though, I don't know that they're going to need as much space as many of these firms have currently, particularly with so many of them working remotely. So I think building a lot more space at this point in time, it's that old, "If you build it, will they come?" It doesn't actually work.

And it's been tried in so many different areas. You have to have the demand for the space in order to build it. You can't build that much space on spec. Even look at the amount of space that's empty in Hudson Yards right now. I don't see the need for it at this point in time.

CROFT: 15:44

So one of the other things that you'd mentioned in that most recent answer was these cities whose skylines are dominated by office towers. And what are some of the ways that, provided those offices do need to be converted, what are some of the most likely uses that, if cities got creative and imaginative, they perhaps could do to change a little bit of the-- let's say, reimagine what the cities themselves are?

KEIM: 16:20

I don't know if that's going to be possible with the amount of space. But I think part of it is going to go into a residential use. And I think part of it will go into entertainment and maybe part of it into hotel or resort type space. I don't think there's going to be another use that you can make happen with some of these tall buildings other than residential if you can't use it for office. You're not going to have tall, thin retail. I don't see a lot of self-storage in these tall buildings. So I really think your most likely use is going to be residential, at this point anyway. I mean, there are a lot of different firms trying to come up with ways to reimagine space. And there are a lot of cities trying to redefine themselves. And some of them work, and some of them don't. When you have areas along a river, you're looking at trying to build entertainment into the uses around that river. And there are some areas which have done great jobs redefining themselves. But actually taking those office spaces and converting them into something else, there aren't a whole lot of uses you can create with it. And I think residential is going to be the most likely for at least the Class B older space. When you look at New York as an example, most of the space that's being absorbed right now is the Class A space, the newer space. So that is, unfortunately, leaving a lot of the buildings that are even 15-years-old having huge holes in them because everybody's moving into that newer, cleaner space.

CROFT: 17:53

Inga Saffron, who is the Pulitzer Prize-winning architecture columnist for the Philadelphia Inquirer, did a big piece about a month ago putting out a vision for Philadelphia that-- and she firmly believes the offices will not be coming back, to a large extent, and floated the idea of this concept of a bedroom city based on the bedroom communities that sprung up after World War II, where people had pleasant places to live and shop and go out for entertainment as they commuted to a nearby city. And what she was talking about was that these neighborhoods in cities like Philadelphia becoming more-- if people are working from home, they're looking for places where they can live and have some of those amenities you've mentioned several times about the entertainment, good restaurants and all of that. What you've

seen, is that a feasible way of thinking that if the office space doesn't come back, maybe cities could look into?

KEIM: 19:09

In some areas, I think that'd work well. If you're in San Antonio or a city which is walkable, but has a lot of entertainment venues, I think that will work well. Without picking on Philadelphia, I think Philly is going to have some challenges with that because of the crime. If you want to be in a nice environment to raise your family or live singly - it doesn't really matter - and be able to stop down at the local coffee shop and be able to go to a play or a movie, there's so many great entertainment venues in Philadelphia. But there's also a pretty large component of crime. And when you're seeing, well, daily drive-by shootings, I think that'll drive people out of wanting to live in the city and then commute someplace else. I think they have to get the crime factor under control before they can look at trying to create that environment for people to live there and work elsewhere.

KEIM: 20:11

I do think you're going to see some businesses-- I'm talking a small and moderate businesses, I'm not talking Google, but will locate where they can get the best deal for their business. So you may see suburban markets. Philadelphia is a very expensive market in terms of taxes, in terms of employee cost. So if you have something just outside, you might have a better shot at a business being more successful or having less cost. So I do see that as a possibility. But for people who want to live somewhere - and there are many people who want to live in a downtown area. We're seeing that in Allentown right now. The number of apartments going up, and they're being filled almost instantly, which is really interesting. And it doesn't have nearly the entertainment-type venues that a place like Philadelphia would have. There's some. And of course, the new Da Vinci Center is going in Allentown. The Waterfront river project that Jai Indl [Enterprises] is working on is going to have a very similar feel to it. And you're going to have people living there and being able to come down to the river area and the entertainment venues there as well. Those areas have been working very well. So there is that desire to be in an urban environment for many people. They like the excitement of it. They like the ability to walk to anything they want to get to. That's a real desire among a lot of people. But I think, with certain cities, crime is a real problem for making that happen at the moment.

CROFT: 21:37

Getting back to the hybrid work arrangement, it was interesting. You started off talking about you've talked to people who have made the argument both ways that their company's employees are more productive than ever. Others saying, "Oh, no. That's not the case."

And I wonder is there any kind of trend or pattern you've seen in terms of the kind of work? Because we use this very broad term of remote work, but that covers a whole lot of different kinds of things. And it strikes me that maybe there would seem to be some jobs that would be easier to monitor depending on what it is that you're producing when you're productive, that you're either producing it or you're not, and that's easier to keep track of.

KEIM: 22:31

True. And anything I can tell you is more anecdotal than anything because, it's funny, I was talking about two or three weeks ago to a chemical engineer who is working remotely. And I cannot for the life of me figure out how a chemical engineer can work out of his house. But [laughter] if he does, great for him. Some of the people I've spoken with that are having challenges-- the people who are on a commission-based income, as an example, seem to do fairly well working from home. Many of them do,

anyway, real estate agents, insurance brokers where they don't necessarily need to be in the office. They're making their own time. At the same time, I spent quite a bit of time talking to some executives with a particular bank. And they were complaining about their foreclosure department administration team that was not nearly as effective at getting stuff done out of their homes. So I think it really does depend on the type of work that they're doing and the position that they hold. But I don't know that I have enough data to really give you an exact idea of what works well and what doesn't work well. I think that will shake out over time.

CROFT: 23:42

I guess that the point is that these are some of the questions that probably need to be answered instead of just the one-size-fits-all solution of, "Yes, we're going to go hybrid," or, "No. We're not," to understand more about what makes it work and when it doesn't work, so.

KEIM: 23:59

True. We had a situation with our firm in real estate where we allowed some of the admins to work in more of a hybrid model a year and a half ago. And part of the challenge became as we needed files. Even though most everything is done by PDF these days, anything that was dropped off at an office, someone else would have to scan and send to the people that are working on it, which became more labor-intensive to get everything moved back and forth. It also was easier, once we had everybody back in the buildings, to be able to pass information back and forth. Someone might be on the phone talking about something, and the person behind them would say, "Oh, wait a second. I handled that. This is what happened," rather than repeating work. So that's worked much better having them back in the office. But then again, the salespeople, some of them, we haven't seen in two years.

CROFT: 24:50

All right. And I usually like to close by asking if there's anything we haven't talked about that you think our listeners should know about the future of offices, even if it's just questions they might want to be pondering in looking at that.

KEIM: 25:05

I think the only other thing that comes to mind is that office space workers are looking for healthy space if humanly possible. It's a major trend right now. We're seeing more companies putting air exchange systems in to bring that constant flow of fresh air in to, hopefully, prevent future infections. Which, by the way, is not great for heating and cooling, but it keeps constant air flow anyway. We're seeing computer-controlled bathrooms to let maintenance know when to clean. We're even seeing companies that have apps on their phones that let you know if someone in your department was sick so that you can get yourself tested. So I think that sort of thing, even though it's not exactly office space related, is something we are going to see more and more of in the future.

CROFT: 25:44

Certainly, for the foreseeable future, that is very much office space related--

KEIM: 25:50

True.

CROFT: 25:52

--until we get a better handle on the pandemic as well, so.

KEIM: 25:58

Absolutely.

CROFT: 25:59

Once again, thanks, Loren. I appreciate you being with us today.

KEIM: 26:02

Thank you very much, Jack. I appreciate it.

CROFT: 26:05

I'd like to once again thank my guest, Loren Keim. He received both his undergraduate degree in management and his MBA from Lehigh University. Among the books he has authored are *The Fundamentals of Listing and Selling Commercial Real Estate*, *How to Sell Your Home in ANY Market*, *Compelling Buyers to Call*, and *Real Estate Prospecting*. This podcast is brought to you by ILLUminate, the Lehigh Business blog. To hear more podcasts featuring Lehigh Business thought leaders, please visit us at business.lehigh.edu/news. And don't forget to follow us on Twitter, @LehighBusiness. This is Jack Croft, host of the ILLUminate Podcast. Thanks for listening.