

REPORTING ON COVID-19 | JUNE 2020

Office Recovery: Productivity, Working from Home and Space Demand

Prepared by Colliers
Real Estate Management Services

COVID-19 has disrupted the global economy and businesses across different markets. At Colliers, we are continually analyzing and following market trends to provide our tenants, clients and the broader industry with timely and accurate insights.

For our June report, we surveyed our tenant base to study the effect COVID-19 is having on businesses and the commercial real estate industry. This report is the **second of three reports** in a series focused on office, retail, and industrial assets and tenants.

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Methodology

To analyze our portfolio, we surveyed a stratified and representative sample size from across Canada to gauge how our tenants are responding and adapting to the pandemic. The sample size totaled 445 tenants, 163 of which were office tenants, 148 were retail tenants, and 134 were industrial tenants. Our sample size includes businesses of different sizes, risk classes and geographies. The confidence level for our analysis is above 95%.

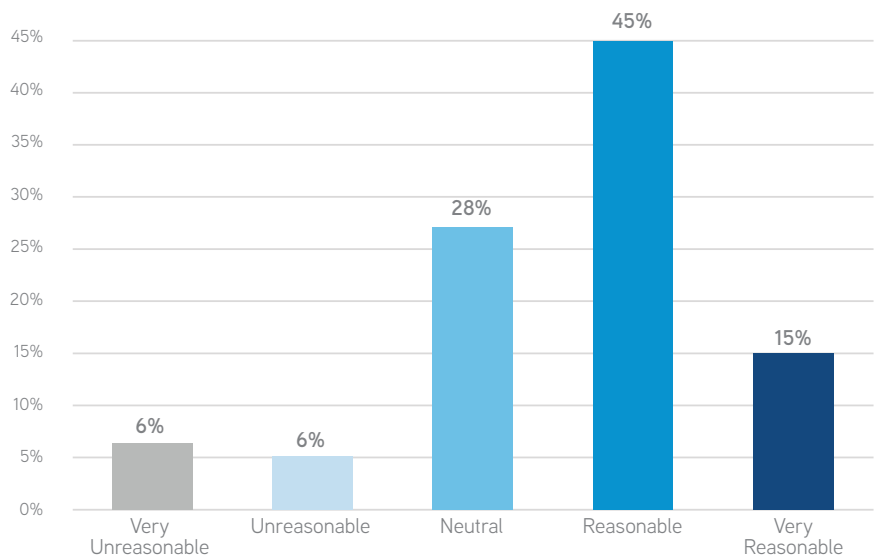
Findings

1. Government Regulations and Associated Costs

As provinces across the country reopen, businesses are encountering new restrictions and government regulations that they must meet in order to control the spread of COVID-19 and avoid the possibility of a second wave. On average, tenants believe the government restrictions are acceptable considering the current circumstances. 60% of respondents think restrictions are reasonable or very reasonable, 28% are neutral, and 11% think they are unreasonable or very unreasonable (Figure 1).

[Figure 1] Do you feel that government regulations around reopening are reasonable for your business?

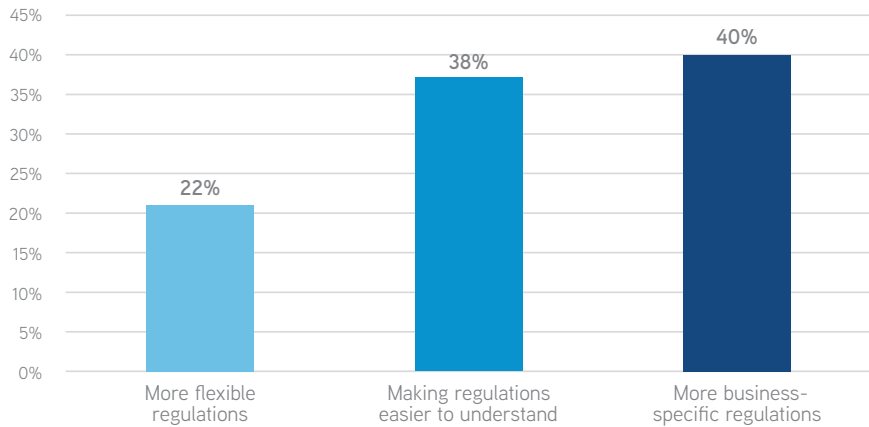
Data by Percentage



“60% of office tenants believe the government restrictions are reasonable or very reasonable.”

Respondents largely agree that regulations need to be tailored to their business needs. 40% of respondents want more business-specific regulations while 38% feel regulations should be easier to understand and 21% believe regulations need to be more flexible.

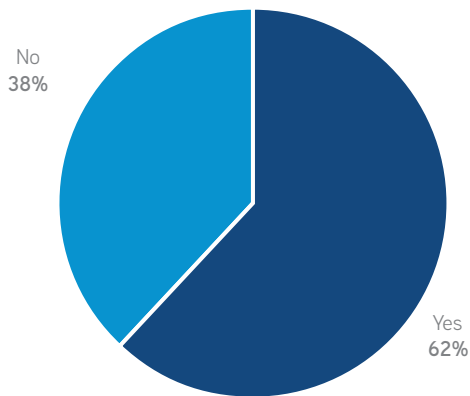
[Figure 2] What would help you reopen your business?
Data by Percentage



The mandatory regulations have added various steps and procedures to regular business operations. 62% of businesses believe adhering to these regulations will increase operating costs. Of all commercial tenant types, office tenants are less likely to believe they will face additional costs.

“62% of businesses believe adhering to government regulations will increase operating costs.”

[Figure 3] Is adhering to government regulations going to increase your business operating costs?
Data by Percentage

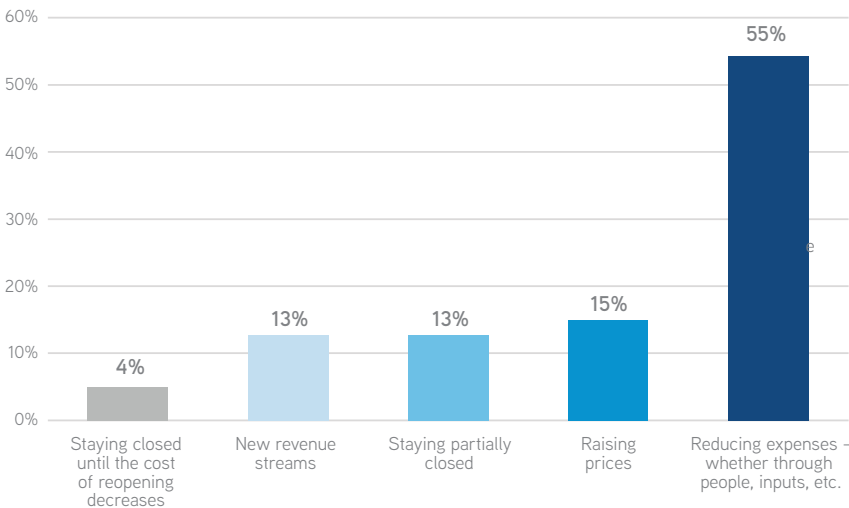


The median office business indicated their overhead costs will increase by around 15%. This median is higher for retail than office and industrial. Retail tenants believe their overhead costs will increase by 25%, while industrial tenants believe they will increase by 19%, and office tenants believe they will increase by 15%.

Overall, most tenants are uncertain about how to offset cost increases, with some indicating they will have to absorb the costs. Of the tenants who know how to offset the cost increases, 52% indicated they would reduce expenses and 19% indicated they would increase prices. We can see the impact of these cost cutting measures when we look at Canada’s unemployment rate; in April, [Canada lost more than 2 million jobs](#).

“Most tenants are uncertain about how to offset cost increases, with some indicating they will have to absorb the costs.”

[Figure 4] How are you planning to offset your cost increase?
Data by Percentage

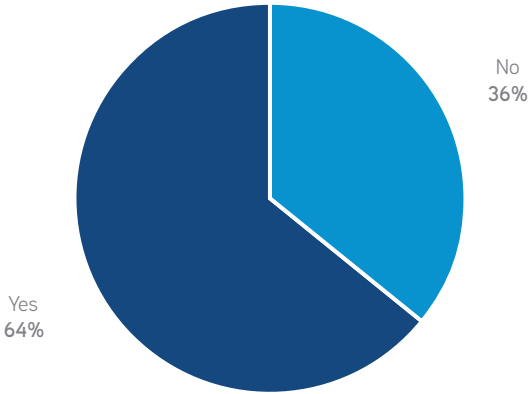


2. Business Adaptation

Similar to any other global crises, we believe COVID-19 is imposing new ways of doing business that will inevitably change the market and office assets.

Our office tenants have been widely adaptive, with 64% modifying their business in some form. Compared to other asset classes, office tenants are more likely to offer new services or products.

[Figure 5] Are you adapting your business?
Data by Percentage

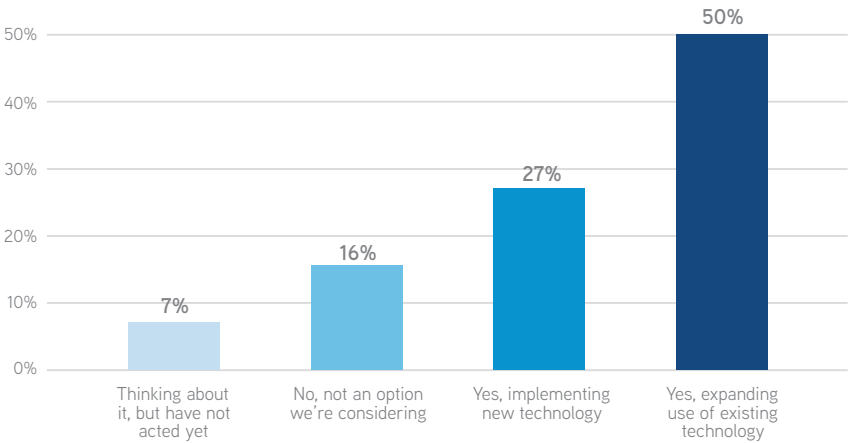


3. Use of Technology

As the pandemic forced businesses to close their physical locations, office tenants relied on technology and remote work to continue business operations. Office tenants were 1.2 times more likely to expand their use of technology compared to other asset classes. 41% of respondents are investing more in existing technology and 20% indicated they are implementing new technology.

“Office tenants were 1.2 times more likely to expand their use of technology compared to other asset classes.”

[Figure 6] Are you changing how you approach the use of technology for your business?
Data by Percentage

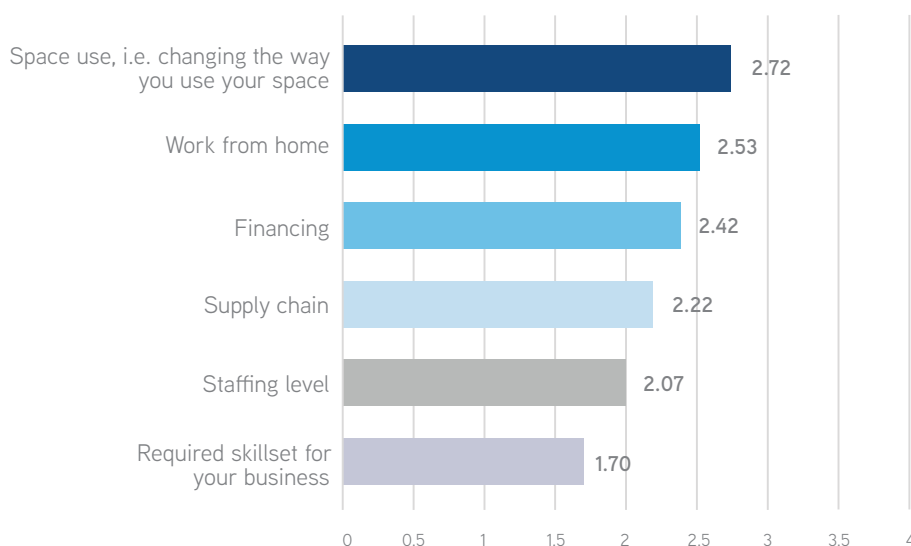


4. Change in Operating Plans

To gauge how business operations are changing as a result of the pandemic, we asked respondents to rank how their businesses will be impacted over the summer on a scale of 0 to 4 with zero representing no impact at all, and four representing significant impact. The weighted average results indicate that office tenants are changing their approach to working from home and the way they use space.

[Figure 7] How will your operating plans change in these categories for the foreseeable future (June/July/August) as a result of COVID-19?

Data by Percentage



5. Work from Home

In [April, we reported](#) that office tenants requested the least relief between the three asset classes. This was primarily because office tenants are capable of maintaining operations by working from home or by remaining partially open.

COVID-19 has forced most office tenants to work remotely to ensure uninterrupted operations during provincial lockdowns. The effect of COVID-19 on office spaces is a multi-variate problem and cannot be explained by simply looking at employee productivity. We have analyzed a few variables that could influence the change in office: employee productivity, permanent closures, working from home, industry type and economic activity.

“The effect of COVID-19 on office spaces is a multi-variate problem and cannot be explained by simply looking at employee productivity.”

We asked our tenants to rate employee productivity while working from home during the pandemic and our analysis indicates that, on average, businesses believe employees' productivity decreased by 22.6%. [Similarly, The Globe and Mail recently reported a 21% decline in productivity.](#)

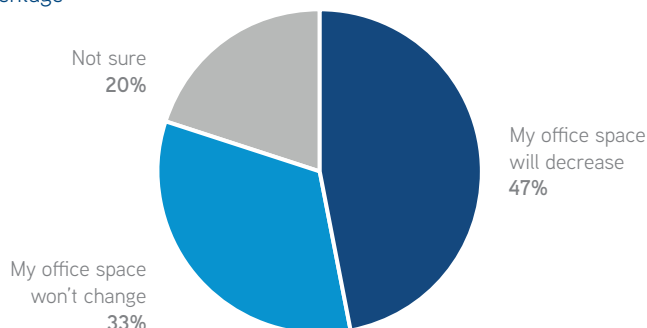
This perception supports evidence from across different industries that have experimented with working from home. Evidence on employee productivity is mixed, and remote work can have a detrimental effect on workplace culture and employee productivity, [as IBM found a few years ago.](#)

33% of our office tenants believe their office space needs will not change in the future, while 47% believe their office space needs will decrease, and 20% are uncertain of their office space needs going forward (**Figure 8**).

Of the businesses that indicated they would like to reduce their office space, 56% indicated they are doing so because of a reduction in employee numbers, while 44% have maintained the same number

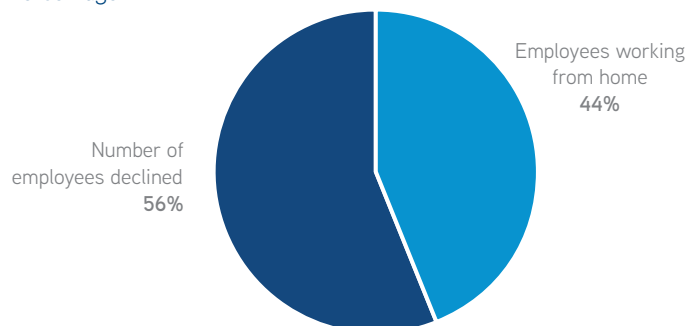
[Figure 8] How do you think your office space needs would be affected by COVID-19?

Data by Percentage



[Figure 9] Why are you reducing your office space?

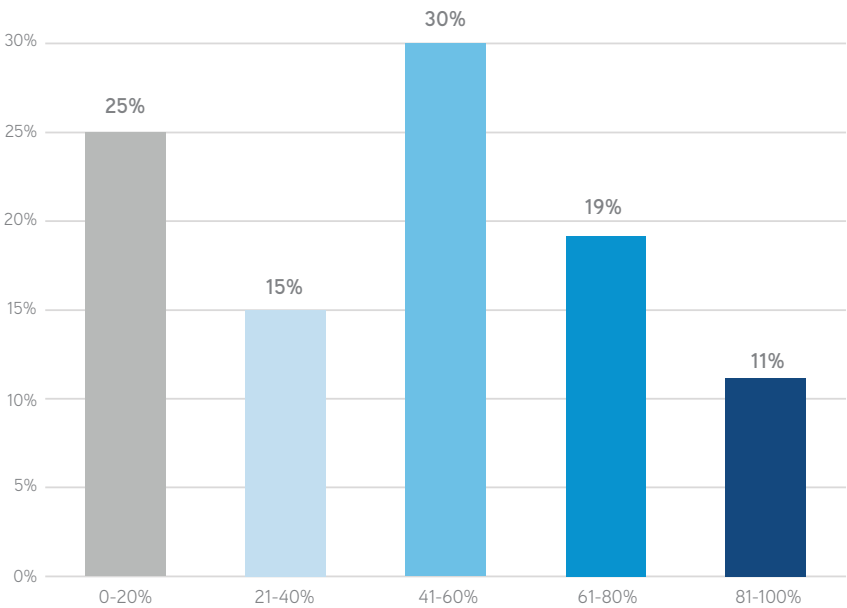
Data by Percentage



“Tenants felt employees’ productivity decreased by 22.6%”

Of the 47% who want to decrease their office space, the average reduction rate by square footage is 41%, with 25% of respondents indicating they would like to reduce space by 0-20%, 15% indicating a 21-40% reduction, 30% specifying a 41-60% reduction, 19% showing a 61-80% reduction, and 11% of respondents choosing to reduce their office space by 80-100%. This wide range of responses could indicate a level of uncertainty among office tenants in terms of how things will look beyond the next few months.

[Figure 10] Percentage reduction of office space versus % of respondents
Data by Percentage

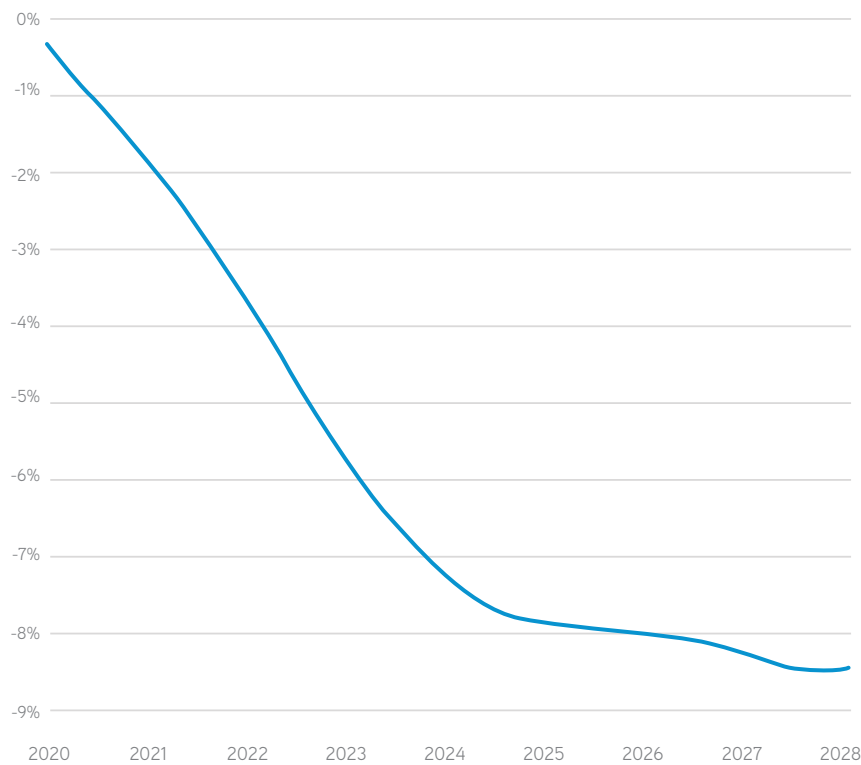


“Of the respondents reducing their office space, the average reduction rate by square footage is 41%”

Assuming the economy recovers to pre-COVID-19 levels, our analysis indicates that the factor of an ongoing work from home approach alone could result in a potential reduction of tenant office space needs by an average of 8.5%.

In **Figure 11**, we’ve assumed that space reductions would occur at lease expiry, after the negotiation of a new lease. Based on this, the 8.5% decline in space would not be seen in the market for approximately eight years, with 82% of that decline happening within the next four years. This does not take into account other factors such as organic growth of demand over time or employment growth.

[Figure 11] Decline of office space demand due to working from home over time
Data by Percentage



“The anticipated decline in space occupied is 8.5% across Canada, with most of the change happening in 2022 and 2023.”

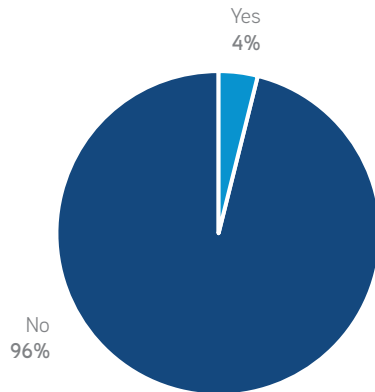
This analysis shows that, according to business owners and managers, while working from home could decrease demand for office space, it is too early to proclaim the “death” of office. The anticipated decline is 8.5% nationally across Canada, with most of the change happening in 2022 and 2023.

6. Permanent Closures

Our most recent survey indicates that 4% of office tenants are working on plans to permanently close their businesses (**Figure 12**). If all of these tenants followed through with these closures, it would lead to a 3% decrease in rent collections and a 2% increase in the vacancy rate. The impacts of permanent closures are much more pronounced in the retail asset class.

[Figure 12] Are you working on a plan to permanently close your business?

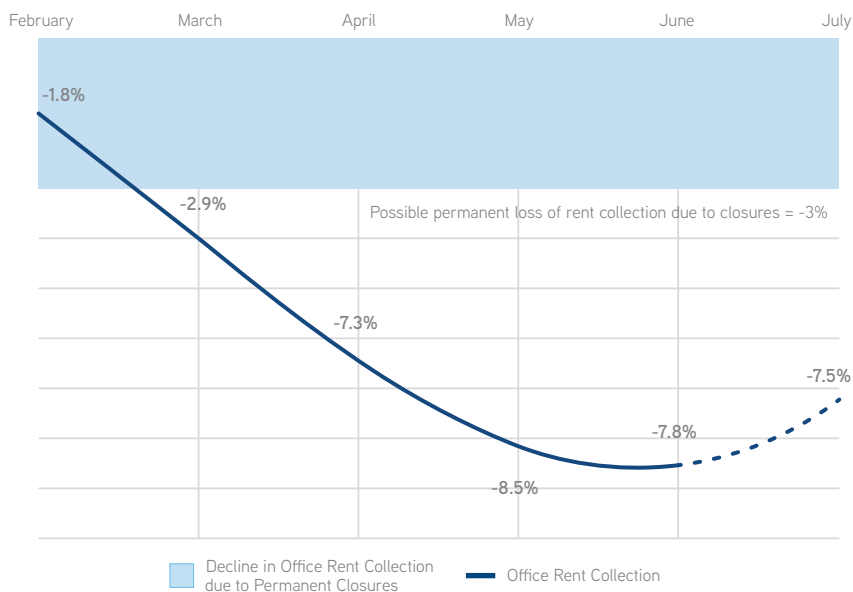
Data by Percentage



“4% of office tenants are working on plans to permanently close their businesses.”

[Figure 13] Office rent collection percentage and permanent closures

Data by Percentage



7. What does this mean for owners?

1. Occupant experience in the early days of re-entry will influence longer-term tenant occupancy: As employees start returning to their offices, there will be a need for a complete overhaul of operating plans. Owners will need to consider how to manage things like elevator wait times and occupancy issues, a possible extension of operating hours to accommodate shift work, and tenants will need to adjust their office space use to meet physical distancing guidelines.

2. Extensive communications with tenants: Understanding what tenants are thinking about their space needs could become a major differentiator in how a building performs. If tenants ask to decrease their space, owners can look for other leasing opportunities, or consider a more flexible leasing approach with shorter lease terms, or they can repurpose the space.

3. Position office assets for the future: It is early, but as owners and property managers actively work together to bring tenants back to commercial buildings safely, there is an opportunity for compliant buildings to explore safety commitment platforms, such as [POST Promise](#). These certifications show that a business is taking the necessary steps to help stop the spread of COVID-19. Owners can support office building “COVID-19 readiness” by:

- **Upgrades for wellness, design & systems:** Buildings with upgraded systems (e.g. HVAC system, new interior design layouts, etc.) will have higher occupancy rates, as they will be considered safer in comparison to other buildings without similar upgrades. The design of office buildings will change with the use of new technologies and innovation to mitigate the spread of COVID-19 and to help avoid future pandemics.
- **Technology:** Being open to implementing new technologies that could support people working safely, such as touchless interactions, antibacterial coatings on high touch surfaces and building systems innovations.
- **Accessibility:** Cycling may become an attractive way of commuting to downtown offices for individuals who want to avoid public transit. Owners could consider adding bicycle racks to accommodate the new traffic coming into their buildings.

“Occupant experience in the early days of re-entry will influence longer-term tenant occupancy.”

4. Urban vs suburban: Subjectively, people may attempt to avoid public transportation in the near future, which could affect downtown offices negatively and suburban offices positively in the short term. Objectively, there is no statistically significant difference in data between urban and suburban yet, although we will continue to monitor this.



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