BLOG

The Other Side: COVID and the Evolution of Real Estate Occupancies

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Having sat on the Board of Directors for the Downtown Boston Business Improvement District, I am intimately aware of the social, financial and employee impact the COVID-19 pandemic has had on Boston's Commercial Real Estate District. Footfall traffic has dropped to unprecedented lows and tenant office space utilization is in the single digits. The ripple effect on local business cannot be overstated and this is not unique to Boston. The national impact has been no less dramatic.

Since March of 2020, commercial, retail and hospitality real estate nationally has seen a utilization drop of over 30%. In certain sectors the drop in utilization has been much greater. Google, along with many large employers in the service sector, are pushing back their return to office dates from October 2021 to January 2022.

Hotels are suffering a huge economic downturn. Retail has seen stalwarts including Brooks Brothers, Neiman Marcus, Lord & Taylor, J.C. Penny and innumerable small operators close their doors. Global office occupancies will inevitably drop due to the new remote and hybrid work paradigm, driven not least by businesses eyeing cost savings and access to remote talent in their overall space and occupancy plans.

Questions commercial real estate owners will have to face in this upheaval include:

- How will remote / hybrid occupancy affect tenant space needs and lease renewals?
- What new systems will be required to make the office occupancy as healthy as possible?
- What new air purifying or other post COVID measures will be required for safe occupancy?
- Properties that remain vacant will face increased exposure to liabilities such as fire, water damage, vandalism, or deterioration.

The challenges created for cities with this dramatic downturn in office occupancy are not, however, much different than those faced by the regional manufacturing hubs in past decades. Those centers of manufacturing became obsolete as industries moved and globalized. Huge mill buildings and complexes sat fallow for decades until housing, office space, and other uses revitalized those properties. Downtown office and retail space may face the same fate. But, what uses will come next?

Options abound. Cities aggregate not just labor, but creativity and innovation. Housing and life sciences conversions are just two areas where much discussion is already taking place.

Retrofitting buildings into lab and research space is being actively pursued by many owners and developers who see these activities as largely requiring in-person workforces. Steve Lynch, principal with King Street Properties a life sciences developer, was quoted recently in the Boston Business Journal saying, “demand for life-science real estate is really built upon the growth in medical innovation. And we’re lucky. We live in the golden era of medical innovation. New therapies are being created in real time for diseases that have puzzled scientists for a long time. One new therapy can launch a very good-sized company. That really is the engine room, if you will, for the demand we see for the buildings that are being built.”

Life sciences workforces will need places to live and nobody likes a long commute. Hotels are being considered for use as apartments as well as assisted living facilities. For remote-oriented companies needing temporary accommodations, office space may be adapted into common flexible “hoteling” concepts. Whatever the use, needed adaptations will take time and the engineering required to upgrade structural and electrical systems will be expensive.

City and state government agencies that oversee this expansion and re-use trend are facing new political hurdles. Noise, height, air emissions and other factors are causing some to question whether these new occupancies are appropriate for their neighborhoods. Lab conversions require higher quantities of electrical supply, sophisticated HVAC and mechanical systems, increased plumbing services, and higher floor to ceiling heights, which can make the conversion difficult. Hotel conversions into residential or long term care facilities pose similar challenges.

Risk managers will also need to consider insurance exposure changes. Exposure to vacant building insurance, higher replacement cost values, pollution exposures that are not historically part of an office occupancy are among the many considerations that must be carefully evaluated. Again, this is not so different from the hurdles developers and owners faced re-purposing abandoned mill buildings and manufacturing sites.

The pandemic’s sudden onset has been jarring for cities, with many observers suggesting it might mark their end as drivers of economic and social activity. History suggests, however, a more resilient future. Getting to that vibrant future with minimal risk will require a prudent approach to addressing the myriad issues presented by converting office, retail and hospitality spaces to accommodate new uses in a post-COVID world.

Looking to map the risk and liability issues on your road ahead?

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