Intelligent Real Estate Investments

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Work From Home: What the Dutch Have to Teach Us

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The Challenge for Office

The COVID-19 pandemic has thrown the prospects for relative property sector performance into stark relief. Structural shifts in demand for retail and logistics – negative for retail and positive for logistics – are underway and accelerating; the fear for the Office sector is that Working from Home (WFH) raises the spectre of a significant drop in space demand. Multiple analyses that try to estimate the potential loss, including one from Hines Research, do suggest that the challenges to the office sector should be taken seriously. However, for now, all these studies are really just educated conjecture. There are just too many potential outcomes, all dependent on how a handful of contributing factors settle over the coming years.

And if thinking forward, even on the fastest timeline, it will take several years for this all to play out. During that time, employment growth will spur additional office space demand to offset any WFH losses. And what of supply? Vacancy is the fulcrum of supply-demand balance (or imbalance), and is a decisive factor in any given market’s ability to grow rents. In the case that office demand suffers WFH losses over the coming years, what if supply growth responds, declining to a point that essentially reinstitutes equilibrium?

What the Dutch Can Teach Us

When in doubt, find a case study.

It turns out that this has happened before, in the Netherlands, and studying that episode might give us some insights into how bad (or less bad) it could actually be. The Netherlands has promoted WFH practices for much of the previous cycle. In fact, following years of growth in the numbers of employees working from home, the government made it official in 2016 with the Flexible Working Act. While this legislation formalized the right of workers to choose flexibility and limited the ability for the employer to deny the request, the policy was preceded by a cultural shift that paved the way for flexible work arrangements. And Dutch workers have indeed taken advantage of the opportunity; in 2019 about 14% of workers in the Netherlands reported that they usually worked from home.¹ If considering those that sometimes work from home, the percentage that spend between 1-5 days a week at a home office could be even higher. Hines Research estimates 20-25% of the Netherlands work force is working from home.

And what did that mean for Dutch office markets?

A case study on Amsterdam suggests that the final answer for office may not be as bad as we think, and also confirms that how the demand-supply balance plays out in any given market will be a deciding factor for rental growth, if not the deciding factor.

¹ Eurostat: How usual is it to work from home? April 24, 2020.
Figure 1 tells an interesting story. We looked at office-using employment (OUE) growth, demand growth, supply growth and rent growth for Amsterdam’s office market over two periods, pre-2009 and post-2010, thus excluding 2009/2010 – years of fundamental correction – from both periods. The purpose was to see if performance differed significantly between Amsterdam’s pre-WFH and post-WFH years. However, rather than a direct comparison of the raw figures, we decided to rank Amsterdam against a full sample of 34 European office markets covered by Hines Research. In this case a lower rank equates to a positive result; e.g. higher demand growth or lower supply. We used ranks – cross-market relative performance – to avoid coming to a faulty conclusion that, for example, Amsterdam’s office demand growth had weakened due to WFH post-2010, only to find out that it had weakened in-line with a similar decline for all of Europe that may have occurred for different reasons.

Amsterdam really saw no difference in its relative performance in terms of the ultimate driver of office demand – office-using employment – over the two periods. Its ranks were slightly above average for both periods, and almost exactly the same. However, Amsterdam’s ranking for demand growth got much worse, moving from almost top tertile to a place at the top of the bottom third. However, at the same time, supply adjusted dramatically, going from 24th out of 34 markets to the top rank. Over the post-2010 period, Amsterdam’s office stock actually shrunk with withdrawals and conversions reducing the city’s office inventory consecutively over the six years between 2012 and 2018. The Amsterdam government was actively discouraging office development by instituting pre-leasing requirements for new development. This is obviously a contributing factor. However, the lesson from this analysis still stands; that a disciplined supply response can do much to offset WFH-induced losses of office demand and any negative impact on rent growth. Following Europe’s double-dip recession, Amsterdam’s office vacancy fell sharply spurring rent growth that, ultimately, proved stronger on a relative basis post-2010 than pre-2009.
Can it Really Play out like That?
Maybe Amsterdam is just an exception ... or maybe not. There is a reason to believe that the WFH evolution could play out (in aggregate) in a similar manner across Europe, and perhaps even in the US. In the last cycle, office demand growth had already been weakening relative to history for both the US and Europe (Figure 2). However, supply growth also reacted to the lower demand growth in order to maintain a generally healthy equilibrium. It is the consistency with which supply growth undershot demand growth over almost the entire cycle in both the US and Europe that is most noteworthy here. If WFH puts further pressure on demand, it seems fair to assume that supply, once again, will adjust, setting a new equilibrium either neutral to or supportive of occupancy and rent growth.

Figure 2

Sources: PMA, CBRE, Costar, NCREIF, Oxford Economics, Hines Research. As of 2020Q3. The averages are simple averages of the results for 41 office markets or submarkets covered by Hines Research in Europe and 54 in the US.

A final insight is that the low level of supply over the previous cycle means that European and US office inventory is now getting long in the tooth. We estimate that only about 15% of Europe’s office space is younger than 10 years of age, the lowest it’s been since 1993, the period for which we have data consistently across markets. Ironically, even with lower headline office demand, markets might see a wave of raze and rebuild or redevelopment. This would be fueled by two factors: (1) the age of current inventory, and (2) accelerated obsolescence consequent from a similarly accelerating (r)evolution in “state-of-the-art” design as developers respond to post-COVID tenant demands. All worthy of consideration, we think.
Hines Research

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