

Investment Banking and Women, Cycles in American Politics, Future of Office
What Happens Next – July 18, 2021
Lisa Picard QA

Larry Bernstein:

You said that 25% of work are new roles, and 50% is existing jobs that have to be upskilled. That's right.

Larry Bernstein:

So, what does that mean? Take any field, describe what that means in context? And how does the office environment fit into upskill?

Lisa Picard:

Let's just take a worker at Salesforce who maybe have been in marketing, and realize that the nature and the way in which you reach the customer from a marketing perspective is more the pull than the push. And this employee was sort of skilled in the push, which means, "I'm pushing out messages to you via digital channels," versus working with an influencer network, or working with collaborative companies who actually pull people into selling that product, right? And this worker decides, "You know what, I'm going to upskill and I'm going to figure out how to actually learn coding. And I'm going to learn how to essentially digitally code some of these aspects or algorithms that naturally find buyers through digital networks, as opposed to me writing copy."

I also think that people who do repetitious work, and they're cranking out a product, they may be producing financial models, and it's a very easy job that they can do at home because someone just gives them the assumptions, they plug it in. Or we might offshore that through Upwork, where we're paying somebody 50 cents an hour in India to do that work, right? Just because it's just input and entry.

And just as much as manufacturing jobs got off-shored because that skilled labor could be done cheaply and effectively in places like Asia, we're seeing the knowledge workers becoming a commodity, and particularly people that can provide knowledge work. If you're just planning to continually crank out your work, then I think that's problematic.

Larry Bernstein:

I had a friend of mine who is a commercial real estate broker in Chicago, and pre-COVID, I asked her what type of subleases are out there, what's available. And she told me that basically every law firm in Chicago recognized that they had way too much space. They had an office for everyone. And they're going to this model where an employee that came in could use any office. They could just kind of click and play. And Nicholas Bloom, who was on our show a few months ago, analyzed the future of work. He's a professor at Stanford. He imagined a world where the marketing team might come to the office on Monday and Wednesday, and the technology team might come to the office on Tuesday and Thursday, and Friday, maybe we all get together to talk about firm-wide decisions.

Lisa Picard:

And there's a notion of if your organization is siloed and you're still in a hierarchical or traditional machine-based structure, as opposed to an agile network structure, then it's perfectly logical that you would sort of set up the marketing team to show up one day and then each of the silos to show up a particular day. But if you're a networked or an agile organization, you're figuring out the teams, the collaborative teams, and those teams are developing charters for how they want to work and make decisions together. And you'll find that those companies are actually driving different solutions.

I was talking to a CEO one day who was really struggling with the talent that wants to work at home, and some of the talent, the younger talent, that wants to be in the office, because the younger talent all felt like last year, they lost the advancement in their careers. And in fact, a side note to that is that over the last few months we've been interviewing for analysts and senior associates. And when asked why are they leaving their current job, the number one reason why they are saying they're leaving their job is because their manager is not coming into the office. They feel that they're going to miss this opportunity for learning.

I was talking to a technology company in Seattle was going to go with that Hoteling model that you mentioned, that everybody would sort of be able to check out a desk when they arrived, and there was an insane revolt that happened within the organization, largely because there's this logical thing that happens when you give somebody space in an office, they feel a part of the organization.

Larry Bernstein:

I remember in 2008, when the crisis hit, I spoke to some buddies of mine who worked with a Canadian bank in New York City, and they always assumed they were going to grow. And so they had an extra floor just in case for growth. And when everyone said, oh my God, not only do we not need that extra floor, but we have an extra floor to go, it put an enormous pressure on office rents. This is a very vertical supply curve where price is going to collapse if an enormous percentage of the market becomes available. What do you think the needs for office space will be? Will it be down 10, down 20, down 30%, and will it have an incredibly dramatic, negative impact on real estate?

Jane Jacobs talked about what's the implications for B minus, C plus office, is that it needs to be transitioned into residential. Do you see, a tremendous excess of office space and that that office space will be transitioned towards residential in dense urban areas? How do you think about the whole picture?

Lisa Picard:

No, this is a phenomenal question, and it really comes down to supply constrained markets and supply constrained markets that have demand drivers and non-supply constrained markets that don't have demand drivers. And let me give an example of what's really going to happen here is that we have the bifurcation of two kinds of products, right? The human loves new products. And we have new construction, which is always desired and seems to be a panacea for talent attraction, and to get that, companies pay an enormous price to get new construction. And

what I mean by an enormous price, they sign 10, 12-year leases. And I don't know what technology company knows how big they're going to be in three years, but certainly over 10 years, they're going to be wrong.

And so typically, to your point, what happens is they plan 10% growth a year. They sign a 10-year lease. They're doubling the size of the space they need day one, then what they need currently. They'll get 2X the space, and this, as to your point, takes down a heck of a lot of space that may end up on the sublease market for a while. Or if they have a good cash position, they just want to control it just in case it is creating pressures.

Then you have everything else, if it's still your father's office building, and it's going to be your father's office building, it's going to be a race to the bottom because the market and the customer is only going to be able to differentiate by price. And if there's a ton of supply in these non-supply constrained markets, or in markets that don't have demand drivers, that don't have really big demand drivers, like DC or Chicago, I think we're seeing demand come back pretty strong in New York right now. But I think it's got a long road to go because there's a lot of products.

But in markets like LA and markets like the Bay Area and markets like Seattle and Boston, there are constraints to supply. Things are defined to a particular area, and they have very strong demand drivers. And so in those markets, I think you're going to find product will do just fine. In fact, it'll take a little bit of time to absorb some of the stuff, but I don't think you're going to have issues that you saw in Dallas, where some of the product is considered obsolete, and obsolete means that it's been vacant for more than three years.

Larry Bernstein:

I don't know Dallas, but I'm familiar with New York City a little bit. And you mentioned new product, and the newest of the new product pre-COVID was Hudson Yards was coming online. And there was a lot of excitement. People were planning to move out there. A number of my hedge fund buddies got some space in Hudson Yards and they were totally psyched. And then when COVID hit, not only did Hudson Yards get in trouble, but all the retail and a bunch of the residential properties also really didn't do well. How do you think about the new new, as you think about Hudson Yards and the problems that it has?

Lisa Picard:

What's interesting about new products and new markets is it creates an entirely new energy. Even if it doesn't make any sense from a geographic perspective, you talk to any real estate person who understands the traditional dynamics in New York and they're like, Hudson Yards, I just don't get it. And I got it just because it's new product, it's the shiny new object.

I think how they do over time really depends if there's infrastructure to support a population to get relatively easy access to that. Fulton Market in Chicago. It was outside the loop. People were like, that's crazy. There's no train that goes over there. Well, there's this thing called Uber, and there's really great food and beverage and amazing environments. And those buildings just keep getting built and built and built in a market that has pretty substantial vacancy. I think

you're going to see continued bifurcation of this market, between new products that have high amenities, great ground floors and energies, that really feel that you're a part of the community.

Larry Bernstein:

Fulton Market started as a food and beverage mecca. Where did this come from? Oh my God, this place is fantastic. And then office kind of went to the new food and beverage place.

Larry Bernstein:

Is that kind of a different way of thinking about it? This is not if you build it, they will come, but we built food and beverage, and then office said, oh my God, we've got to be next to that because that's where the fun is. Is that how-

Lisa Picard:

Well, yeah, and that's where talent wants to be. Talent wants to be near the cool stuff. And so if you can highlight to people on your HR tour, look at all these cool restaurants and places you can be, and you can hang out with your colleagues, people start to envision their lifestyle. Now, keep in mind, work is a lifestyle now. It's not a place that I clock in at 8:00 and clock out at 5:00. These are people that are part of my community, and so I want to know what's a part of my community. And so much so that this ground floor experience and environment is so much a part of how we curate office buildings now.

Larry Bernstein:

Brooklyn. When I was a young man, Citi put out that tower in the middle of Brooklyn, and it was sort of like, God, is anyone going to go out there? And now we have a whole host of young people living there with cool hotels, cool restaurants.

But I haven't seen a lot of office being built in Brooklyn. Would you think that Brooklyn is going to become a new office mecca or is it going to remain just primarily residential, retail?

Lisa Picard:

Here's the interesting thing about office and the way in which companies pursue office space. Jobs follow people, right? People don't necessarily follow jobs unless it's like I've always wanted to work for Tesla and I go follow them to Austin, Texas. But for the most part, jobs are going to that location so they can capture that talent.

If you think about Brooklyn and my access to talent, how do I get Brooklynites? I mean, downtown is sort of like the centroid for getting Brooklynites and also people in New Jersey and people further up Manhattan. Right? And I think that the challenge with putting office in Brooklyn is that it's not the centroid of talent. Right? You can access Brooklyn talent by being in downtown, but you can't access talent elsewhere when you're in Brooklyn.

Larry Bernstein:

Yeah. It's pretty limited to Brooklyn only because of the transportation problem.

Lisa Picard:

That's right.

Larry Bernstein:

Well, that was why it was interesting what you mentioned with Fulton Market, which is not very transportation-friendly. The Metra station's not bad, but the rest of it isn't really designed to go that area.

But you said, oh, but what about Uber? Uber can solve that. Uber can't solve a lot of things. What COVID did with traffic has been non-existent, but traffic's going to come back with a vengeance. And when it does, it's going to limit where we're working.

So how do you think about the transportation nexus as being the critical variable for where are you going to build your new office buildings?

Lisa Picard:

No, it's a phenomenal point. And going back to the Fulton Market example, I think the thing that really shifted in and was the vote of confidence is when McDonald's moved their headquarters in from the suburbs into the Fulton Market neighborhoods, right? Because they were deliberately going after... They couldn't hire young people. And as soon as they went into Fulton Market, they were able to hire a ton of young people who wanted to work in that market.

And they realized that McDonald's was a different company because it had totally shifted from the suburbs and moved into the city.

But I think your comment about transportation and access is really going to be key.

And when I look at a market, we'll say, like Austin, which was the only market that actually had job growth during 2020, office employment growth in 2020. Austin that has had unbelievable growth and has absolutely no infrastructure to support transit except the car. This is going to be a really interesting experiment.

Larry Bernstein:

I feel like there's a ton of uncertainty. And you opened with what's so incredible about the new building is they're able to lock people down for ten-year leases.

Do you think the long-term lease is a thing of the past or is that something you can still persuade? Or is it fear of the unknown sublease market and the unknown employment market for them? But unknown future for them is so high that they may not wish to enter term leases.

Lisa Picard:

Yeah, exactly my point of the bifurcation of the market. You're only going to enter the long-term lease to essentially engage in new construction. Because then the quantity of supply of new construction is so finite. And to get it, you're willing to commit huge resources and swallow a big pill.

And what's happening in the office industry is the lease has gotten shorter and shorter and the retention rates smaller and smaller. And in essence, the landlords have to do more to create a stickiness and a higher service level.

Larry Bernstein:

Pre-COVID, WeWorks was the phenomena. They took down a crazy amount of space. In every market, they were the number one guy. And they offered a product, to get rid of term, and in exchange, we're going to jam you in tighter than you ever thought was possible in an office environment. And not just with people you work with, but strangers. Now in a period of COVID, that seems insane.

Lisa Picard:

I think the concept that was there was actually allowing sort of a much more flexible lease strategy. A lot of the WeWork practices were in essence buying top line revenue to essentially obviously reach their revenue targets, and many of the things weren't sustainable. They structured a lot of things that had duration matching issues between long-term leases and buying really short-term deals. But I think the model in and of itself, a high service level model with a really good digital layer that gives companies a purview as to usage. There are operators in the space who've really figured out the model and they're in it for the long game.

Larry Bernstein:

You started the conversation by saying, "Look, it's about collaboration and getting pulled to work." If Nicholas Bloom is right, where we need to meet at the office to talk about and collaborate about certain things on a very flexible schedule, is that Regus space where they can offer conference rooms and digital technology in a very easy way, is that just going to just dominate and allow for multiple firms to work in shared spaces? Is that our future?

Lisa Picard:

Yes. Yeah, I think you're going to see the hotelification of the office market. They're going to see a variety of different products that suit different needs. A lot of people don't like the Regus model. They don't like the aesthetics. They don't like the vibe. So they'll go pursue a different hotel brand, one that they do like. Many owners are getting into the space and figuring out ways of which they can parse out the space and also provide a product for the market that the marketplace wants. But I do think what's interesting today is that the legacy way of building out space, the legacy way of procuring space, of hiring a broker, procuring your space a year from now and basically it takes six months to build it out with all the requirements that cities have and the construction processes, that most people when they're out in the market and they need space, they realize they need it today and they can't wait a year to get it.

Larry Bernstein:

I went to a shared space in London pre-COVID, and I went to visit a friend of mine. He was in some space, but it was weird. There was no window and it was packed. It was very dense office. It was, "Okay, we got to hang out. What are we going to do?" We went downstairs and they

were offering beer and it was like a party going on in the office, which was kind of complicated. I said, "This is ridiculous. I can't work here. Let's just go to a restaurant and order some food and talk."

Is that really what young people want?

Lisa Picard:

I like to think about how did you learn? When I was in college, I had a laptop that lasted like about maybe 35 minutes, and then I had to find a plug and plug in, and so that really drove me to learn how to work in a dorm room. Then, the next generation really had mobile devices that lasted much longer and they could work from a Starbucks and they could work on top of rooftops and they'd learn to work in cafes because it was sort of a unique space that they felt like they could see and be seen. What happened is the whole generation of next workplace to attract the millennials looked like Starbucks cafes because that's how that workforce learned how to do projects and collaborate on assignments.

I think if you want to look at the future of work, look at how kids are learning today. Will that learning truly be decentralized and distributed? Will it be fully online content? Will kids truly learn that way? And so I think the reason why you're seeing all of these bars and cafes and things of that nature that are brought into fancy new workplaces is because they're attracting people from college and say, "Hey, look, this is just like college for you. It's like you never left."

Larry Bernstein:

I usually end our show with a note of optimism. What are you optimistic about in the office market?

Lisa Picard:

I think what I'm optimistic about in the office market is that I think there's a whole new revolution of unique workspaces that truly allow humanity to thrive. What we're seeing is this integration of a lot of wellness aspects and a lot of concern of making sure humans can perform and perform at their best level. If that's bringing in natural light, if that's bringing in spaces that allow a little R&R, if it's bringing in medical services or dental services so that there's this aspect of convenience, I think the workplace is not going to be about seeing the human as a machine, but actually seeing the human as a living organism that that needs care, quite honestly. Then, I think all of us can do our best work.

Larry Bernstein:

Dean Adler, when I asked him about the future of office, he mentioned getting access to fresh air. He imagined that new construction would have balconies, would have the ability to engage with the outside. Is fresh air... goes back to that wellness point you're making? That, how do I-

Lisa Picard:

Yeah, it's a big deal. It's a big deal. If you think about it like humans as machines, we sort of put them in assembly line or cubicles, in the Dilbert style. If we look at humans as things that need

to have light and air to thrive, a lot of companies, the tech companies actually have requirements if you're building them a new building, they have to have a certain frequency of open windows or windows that can open. These are even in high rises. Decks and rooftops and access to the outdoors become key leasing features. We're looking at spaces across our portfolio that we can begin to open up, not at just the ground plane, but other levels of the building, because these become really treasured amenities and really create differentiation in your product.