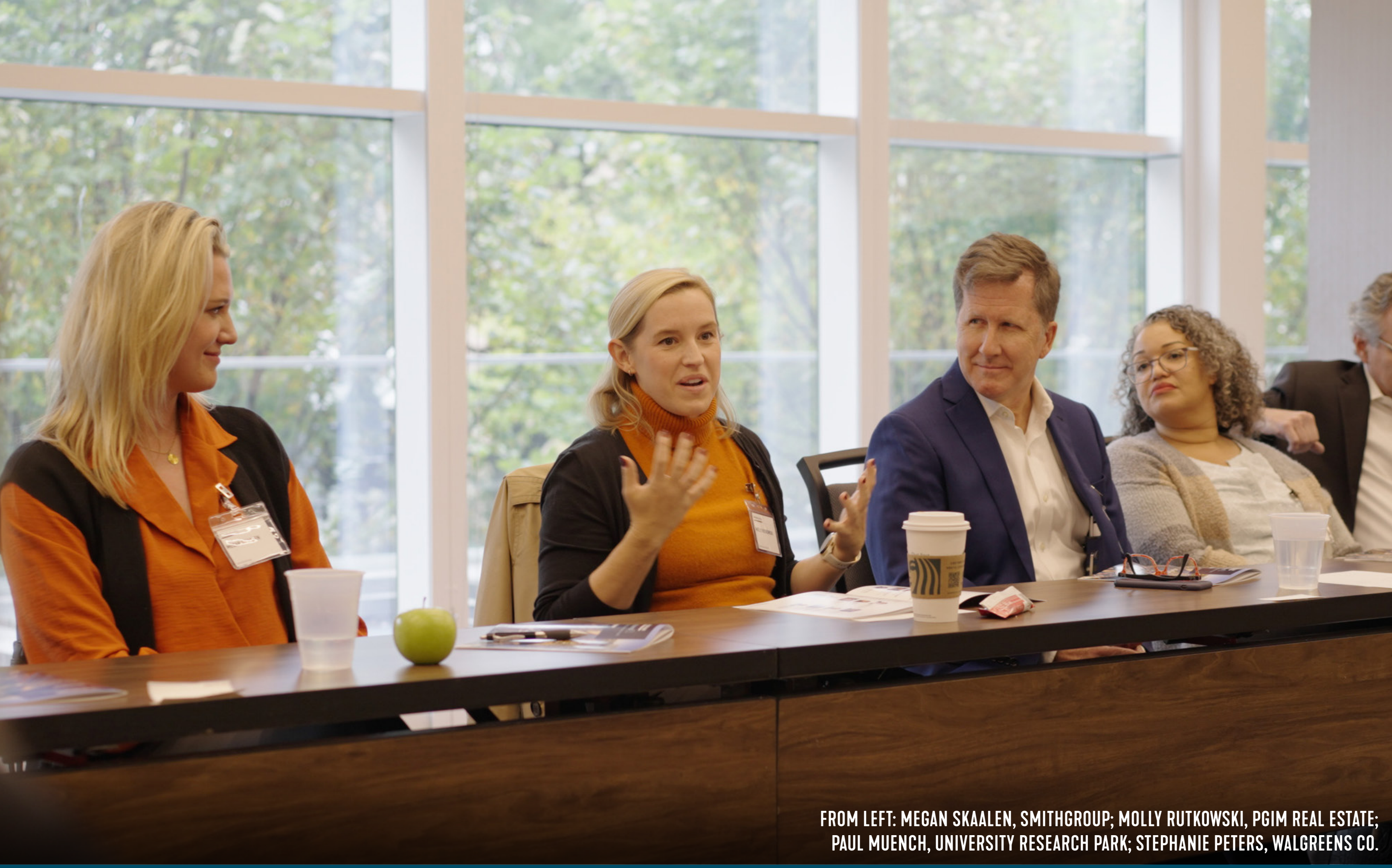
SMITHGROUP

TranscendRE

EVOLVING SPACES, EMPOWERING FUTURES



FROM LEFT: MEGAN SKAALEN, SMITHGROUP; MOLLY RUTKOWSKI, PGIM REAL ESTATE; PAUL MUENCH, UNIVERSITY RESEARCH PARK; STEPHANIE PETERS, WALGREENS CO.

CLIENT ADVISORY BOARD

At the end of 2023, SmithGroup's corporate and commercial market leaders, strategists, designers, and engineers gathered alongside real estate executives from across the country to explore new possibilities, embrace innovation, and leverage transformative opportunities to shape the future of their spaces and businesses.

The event kicked off with an open roundtable discussion surrounding two main questions:

- ***What are the biggest challenges you are facing during this unprecedented time?***
- ***What innovative measures is your organization implementing as this paradigm shift in the commercial real estate industry continues to unfold?***

The sampling of headlines below reflect the powerful changes sweeping the marketplace and impacting participants and their organizations:

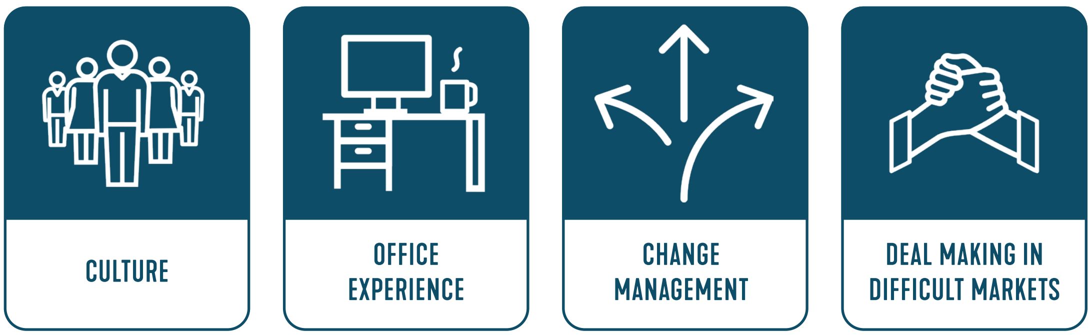
- "As low-interest loans mature at higher rates, all commercial real estate sectors face challenges"[1]
- "We're in the first inning of the commercial real estate correction," billionaire real estate investor Jeff Greene [2]
- "Analysts at Morgan Stanley have raised concerns about the industry, citing recent loan defaults by prominent office landlords and a decline in demand for office spaces as warning signs." [3]
- "Record-high amounts of available sublease space are placing further downward pressure on asking rents across the country, putting 2023 on pace for the largest amount of negative net absorption on record." [4]
- "WeWork, once valued at $47 billion, files for bankruptcy" [5]
- "A $1.5 Trillion Wall of Debt is Looming for U.S. Commercial Properties" [6]

TRANSCEND REAL ESTATE

Faced with these widespread changes, discussions regarding the future repeatedly came back to one word: uncertainty.

Uncertain of the market's trajectory—will it result in a "crash and burn" scenario or will it shift and become a "soft landing?" Uncertain how Fortune 500 companies will lead the way or fail in return to the office mandates. Uncertain how the country's impending monstrous debt will be restructured. Uncertain, uncertain, uncertain...

As one seasoned developer, Chris Anderson of Hines, pointed out, "With uncertainty, there is also a great opportunity to create change." With this more positive outlook in mind, the group dove into the biggest challenges and how the industry might transcend them.



CULTURE

On the top of everyone's mind was how current remote and hybrid work policies are impacting company culture. Organizations are grappling with difficulties in managing a distributed workforce. New software, tools and technology can solve many distributed workforce challenges. But where is the "easy button" for culture? We understand the critical nature of creating a company culture that fosters growth, development, and innovation. But to do so in 2024, we need to collectively reimagine firm culture and reconcile its past, present, and future states.

As strategic business and workplace advisor Kelly Colón stated, "We never really considered how or if humans were necessarily reacting positively or negatively in those environments. We were in burn and churn mode for far too long."

With the onset of COVID-19, we collectively opened the door to the nuances of choice, flexibility, and individual autonomy. The current labor market is making it extremely difficult to put that genie back in the bottle. "The workforce wants the continued ability to navigate the distribution of options made available to them," Colón put simply. "Now, we have an amazing opportunity to collectively create environments that are more conducive to human beings and the work at hand."

As we design for the next generation of workers, we need to understand that for them, COVID-19 had a counter impact than it had on Gen X or Millennials. Kelly concludes, "For them, the pandemic solidified the real critical importance of interpersonal connection, collaboration, and mentorship."

OFFICE EXPERIENCE

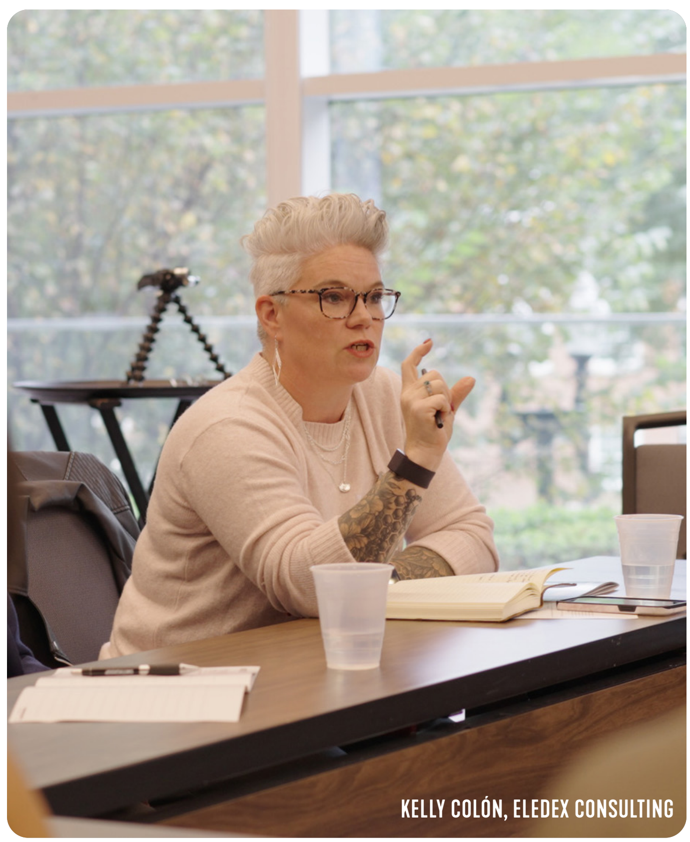
Since the beginning of 2020, the role of managing real estate and workplaces has become increasingly complex. For those professionals in attendance at the roundtable, predicting when and how employees will use office space going forward emerged as the number one challenge facing organizations today. From failed return-to-office mandates to vague guidelines suggesting how often employees should show up in person—the groups' outlook was nothing but uncertain.

Adding complexity to an already multifaceted job are new requirements to meet a range of new, nuanced needs and desires that employees are demanding. The days when a one size fits all solution checked the proverbial box are gone. If we are to create a new, illusive firm culture focused on togetherness, we must acknowledge and recognize the various types of users in our buildings and design spaces in which they can thrive—while also right-sizing and future-proofing real estate portfolios.

Olivia Millar, Section Chief for Space Management at the International Monetary Fund (IMF), asserts "We are starving for data to solidify any new approach to in-office work." Stephanie Peters, Director, Guest & Team Services at Walgreens, doubles down "Our badge data drove all our decisions when it came to determining what's next. I live and die by these dashboards."

But quantitative data can't get us there alone. We need qualitative data to understand the different needs that drive creative, collaborative, and focused work. We can't afford to go another decade without understanding that users are made up of neurotypical and neurodiverse individuals. If we lean into the fact that a distributed workforce allows for a greater capacity for employees to address their individual needs, the employee, team, and company will be better poised for success.

> "The workforce wants the continued ability to navigate the distribution of options made available to them. We have an amazing opportunity to collectively create environments that are more conducive to human beings and the work at hand."


KELLY COLÓN, ELEDEX CONSULTING

3 CHANGE MANAGEMENT

Sitting comfortably and collectively in our uncertainness, another challenge that rose to the top for this group of experts was change management. Several attendees expressed that they felt an innate pressure to capitalize on this paradigm shift to create better in-office environments and more effective spaces. That said, as leadership opinions and policies continue to shift, there is a natural fear of making expensive physical changes that won't last beyond the next leadership transition.

"The big challenge is we are getting this opportunity to rethink the way we work, question the status quo, and confront space standards that have been followed for decades," pondered Olivia Millar with IMF. "The issue is doing it fast enough but at the same time slow enough, so we don't invest in the wrong things."

Developing an effective change management strategy is crucial to successfully adopting any new business or space initiative, especially when dealing with seasoned professionals who are accustomed to old policies and ways of working. According to research by Prosci—the global leader in Change Management Solutions—organizations that deploy a structured change management process are seven times more likely to meet project objectives and realize their desired future state at a higher adoption rate and in less time.[7] That said, it's more about developing a framework for change management that includes a systematic approach and broader understanding of an organization beyond the change itself.

As John Orsak, Senior Vice President of Lincoln Property Company, states "There is unprecedented change and there is no road map. We are all doing it together, learning in real time." Organizations that create an ecosystem poised for continuous improvement to address new challenges and opportunities will come out ahead.

4 DEAL MAKING IN DIFFICULT MARKETS

The last major challenge addressed in our discussions was deal making in difficult markets. Inflation, high interest rates, debt management, shadow space and identifying lenders are all contributing to difficulties in deal making today.

Chris Anderson, Senior Managing Director at Hines, states, "Right now developers are playing good defense. We're protecting the assets we want to hold and are investing in those assets to create what people want. We are also working hard to take risks off the table and focusing heavily on the lending side."

When asked about their opinions of an impending recession, Anderson declared, "A recession is coming, it is absolutely coming. But we're in a different place demographically than we were during the 2008-2009 collapse. Collectively, the workforce is more skilled. A recession will hit, but it may be a full employment recession, which we're not used to."

Greg VanKirk, Partner at Plante Moran Realpoint, agreed stating, "A recession appears imminent, but the balloon isn't going to pop, per se, but rather be a slow leak. Companies are making money and waiting for their leases to burn off. In the foreseeable future, we anticipate continued negative absorption."

Today, the notion of 'flight to quality' remains with trophy and Class A office buildings leading in leasing. As shadow vacancy increases and badge data solidifies the Tuesday-Wednesday-Thursday in-office attendance bell curve—developers and brokers are interested in uncovering what motivates employees to show up to the office—just as much, if not more than the end-users themselves.

> "Organizations that deploy a structured change management process are seven times more likely to meet their project objectives and realize their desired future state."

SPOTLIGHT PERSPECTIVES

THE DEVELOPER

The commercial real estate industry is facing several challenges, including the cost of capital and capital availability, tenants downsizing and indecision, outdated parking regulations, and a lack of new construction. Chris Anderson, Senior Managing Director of Hines, shared some insights from the developer and investor perspective.

As one of the largest privately held real estate investors and managers in the world, Hines has a diversified portfolio in 395 cities, 30 foreign countries, and five continents. Since Hines has traditionally focused on high-amenity spaces in downtown areas due to better returns historically, Chris understands first-hand the nuances of commercial development going into 2024.

Developers are playing good defense by rethinking, refinancing, or shedding assets. When making these decisions, it is critical to truly understand the asset's pinch points. A building might be ripe for acquisition from a debt perspective, but understanding the level of transformation necessary for success and financial gain is critical.

The discussion centered on the importance of creating unique and personalized spaces, focusing on the future generations' wants and needs. "It's easy to get caught up in spreadsheets, numbers, and legal agreements, but at the end of the day the real focus needs to be on why people want to be there. It's still a product, it's a widget," said Chris Anderson.

As such, focusing on the ground floor and the first 20 feet of the building is a strategy Hines is having success with. "Each asset wants to have its own personality and authenticity. And that doesn't stop at the base building design. The retail tenants within any commercial property must be brand-authentic too."

This strategy has transformed several key properties in Hines' robust portfolio. Allowing the retail tenants to create their own branded storefront gives the ground floors in these commercial properties a more small-town, genuine feel where people want to converse, connect, and shop.

Thinking about 2024 and beyond, Chris shared that an essential mindset shift and a long-term view will be required when contemplating what success looks like. "Investors are purchasing highly distressed assets based on land value alone, and essentially getting buildings for free. Eventually real estate will get so degraded and cheap, that shrewd investors will take the bet, like the early 1980's and 1990's. Overtime, those investors will have the ability to think differently and try different things. It's just going to take time."

In the end, what development really takes is optimism. As Chris bluntly put it, "If you're a developer that's pessimistic, you're not a developer."


CHRIS ANDERSON, HINES


GREG VANKIRK, PLANTE MORAN REALPOINT

THE BROKER

Greg VanKirk, Partner at Plante Moran Realpoint, shared insights from the broker and program manager perspective. Plante Moran Realpoint covers various markets across the country, including office, industrial, government, infrastructure, healthcare, senior living, and higher education.

Despite Greg's strong belief that a recession is imminent, he also admitted that brokers love a swinging pendulum. Simply put, volatile markets are good for business. Greg likened the current market to a game of hot potato. "Excess space: the banks don't want it; the developers don't want it; and the tenants don't want it. Someone must take it, but no one wants to fail."

In the office market, Greg believes the 20% vacancy rate across the country right now is only going to get worse. "We're in limbo and covered in uncertainty. Shadow space is at an all-time high, trophy and Class A buildings are leading the way, but the level of uncertainty is causing decision paralysis." Several clients have leases coming due, but without an ardent desire to make a strong decision, they keep kicking the can down the road. That could mean anything from signing a three-to-five-year lease as a stop-gap solution, to pulling the plug on a planned $100 million new headquarters project or reducing a major office renovation to simply updating the paint and carpet.

But end-users can only kick the can for so long. Strategic organizations need to take the long view and develop the interim steps they can take now to get them closer to their future ideal state. He encourages clients to ask themselves, "How can I get ahead of the curve and take advantage of current opportunities in the market?" A little 'progress over perfection' mentality could go a long way in the current market.

Massive disruption can also usher in silver linings. As the residential market soars and home values rise, so do the taxable values. Institutional spending on things like libraries, city halls, police stations, museums, infrastructure, and education will continue to increase over the next several years. This shift will bring tremendous opportunities to markets that were largely ignored for far too long. Opportunities for collaboration in these areas will also increase with developers and government institutions coming together in public-private partnerships (P3).

THE END-USER

At the end of 2023, what does it feel like managing workplace real estate for a major organization? The end-user representatives shared a collective answer: daily uncertainty. Caught somewhere between c-suite leadership, human resources, and the employees their job requires them to serve—the role can sometimes feel like a long, arduous game of ping pong.

As most have settled into their second, third or fourth versions of return-to-work policies, show-up rates are still lagging as well as policy enforcement. This combination makes it extremely difficult for facility directors to plan for the future. Most organizations are currently experiencing the Tuesday-Wednesday-Thursday bell-curve of in-office work, but occupancy numbers are still low compared to pre-COVID figures. One of the major corporations in attendance cited only 20% occupancy on mid-week, high-user days, and 4-6% occupancy on Mondays and Fridays. That's a lot of real estate for only 5% of the employee base to use two days a week.

Attendees shared that they collect as much information as possible through badge data, Microsoft Outlook, occupancy sensors, and meeting and seat reservation systems, etc. But with less than stellar occupancy, it is still hard to understand the full picture. How can facility management understand what new spaces and experiences offer improvements to new ways of working if they can't observe it in real time? You can't have a successful pilot program without occupants. How can facility management understand future needs, if they aren't brought into c-suite level conversations about the organization's approach to hybrid work policies until they hit the inbox?

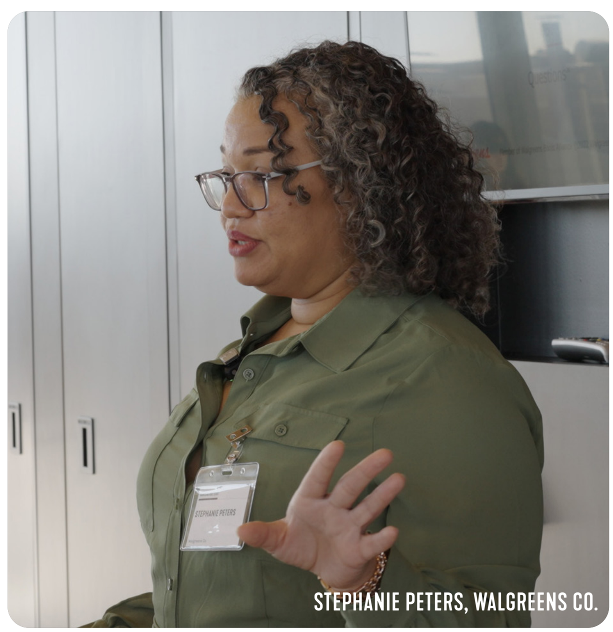
> Given the current state of the market, the organization is open to different solutions than previously.

Whether their organization is seeking to reduce capital and/or reduce operating expenses—the facility department representatives said they are doing everything they can to usher in more effective and efficient operations.

Stephanie Peters, Director of Guest & Team Services at Walgreens Co., said her team tried to centralize as much as they could, including office supplies. "We went from each department's admin buying and storing office supplies to creating a one stop shop for the whole campus. I didn't buy a single office supply in two years—not a notebook, not a pencil, nothing."

Attendees shared how they are also implementing co-working solutions, particularly for smaller field offices across the country. "Given the current state of the market, the organization is open to different solutions than previously. If I've got four, five, ten people in a field office and the lease is expiring, I'm not resigning a small office lease. I'll structure a deal with a co-working space for two or three days a week for the team members who need it."

Until c-suite leaders roll out an enforceable return to work policy with clear guidelines and expectations, facility management will continue to feel a bit influx in 2024 and potentially beyond.



STEPHANIE PETERS, WALGREENS CO.

PUTTING IT TOGETHER

The Client Advisory Board event concluded with an interactive workshop led by Bob Varga, Design Principal at SmithGroup. Before breaking into groups, Bob set the stage "Our challenges and opportunities, are becoming more and more multi-dimensional. How can we reduce uncertainty and increase opportunity?"

The attendees split into two groups—one focused on people, the other on place—each given its own challenge to create a framework for problem-solving. Each group reviewed the challenge and obstacles presented and identified critical data points necessary to create a solution-based framework for decision-making.

PEOPLE

CHALLENGE

Organization A is struggling to get staff back to the office. Engagement scores are down, turnover is increasing. Trailing data shows error-related costs are increasing. Productivity is high, but employees are too busy and stressed. The organization needs to hire more talent including data scientists, engineers, finance, and consumer care professionals. Overall, the company is profitable, yet forecasts are mixed at best.

OBSTACLES

- Unengaged employees
- Error-related costs are increasing
- Turnover
- Staffing shortage
- Breakdown of trust and communication
- Unclear path/anxiety about the future
- Lack of clear purpose/shared mission
- New roles are needed to support new and evolving work styles.

DATA GATHERING

VISION

ORGANIZATION	PEOPLE	PROCESS
DEMOGRAPHIC DISTRIBUTION	WHY ARE PEOPLE COMING TO THE OFFICE?	HISTORICAL DATA OF THE ERRORS
GROUP & DEPARTMENT ORGANIZATION	WHAT AMENITIES ARE MAGNETS?	GROWTH PROJECTIONS
DAILY OCCUPANCY	MENTORSHIP TRAINING	REASON FOR THE ERRORS?
WORK MODES & PATTERNS	EMPLOYEE EXPERIENCE SURVEY	WHERE FUTURE TALENT LIVES IN THE REGION
TRAVEL DISTANCES FROM STAFF ZIP CODES	RECENT VS. TENURED EMPLOYEES	OUTLOOK DATA
EMPLOYEE BADGE DATA	NEED FOR DEDICATED SPACE VS. SHARED SPACE	FUTURE & CURRENT TALENT NEEDS
SPACE OCCUPANCY/SENSOR DATA		
QUALITATIVE OBSERVATION		

The working group started by pinpointing three obstacles they felt were or greatest importance and the highest priorities to address:

- Breakdown of trust and communication
- Unclear path/anxiety about the future
- Lack of clear purpose/shared mission

When considering employees that present as disengaged, we immediately concern ourselves with stress levels, workload, and staffing issues. We fail to consider how breakdowns in organizational structure, direction, and a lack of understanding of the company's vision and mission impact employee trust and therefore, engagement. "When employees don't know the company direction and where and how he/she fits into it, you lose trust," stated Stephanie Peters of Walgreens. "Trust and engagement come from a shared purpose and mission."

In this scenario, what is lacking is an overall shared vision from leadership. "The vision can't be 'come to the office.' That's a tactic, not a vision. The challenge arises when leadership relies on tactics to solve much larger problems," stated Kelly Colón. When these tactics don't clearly align with a firm vision and broader organizational goals, it can impact turnover. A recent study conducted by Unispace in partnership with Opinium Research surveyed nearly 10,000 workers. Results showed that "42% of companies that mandated returns to in-person work have experienced higher than normal employee attrition, while 29% are struggling to recruit." [8]

Kelly Colón encouraged the working group to consider the military as an example of connecting a mission to policies. "You have droves of people signing on the dotted line for arguably one of the most arduous, difficult, and challenging types of work. They do so almost blindly because they believe in a shared mission and the connection between comradery and people. How can that construct of leadership, vision, and teamwork be applied to knowledge-based organizations?" pondered Kelly Colón.

John Orsak, Senior Vice President of Lincoln Property Company continued, "Return to office mandates aren't reflective of a company's vision, but it is guidance, it is a clear expectation. In the military, you know what the expectations are based on your role. Current RTO recommendations are doing a disservice to your employee base. Companies need to realize expectations are good and need to be met, if broader goals and a clear understanding of the company culture sets the tone." John resumes, "For example, if you have an apprentice-style culture, team members need to be in the office to engage in that culture. If not, employees need to understand that not meeting this expectation will impact his/her personal development and opportunity for advancement at their company. That's a clear expectation."

According to a recent Forbes article and Bankrate survey, "around 68% of full-time workers favor hybrid work schedules, yet 90% of companies are planning to implement return-to-work policies by the end of 2024."[9] As the disconnect between leadership and employees regarding returning to work wages on in 2024, the group agreed that the companies who connect their vision to office policies will come out ahead.

Outside of the three highest priorities identified by the working group, they wanted to capture and process data in three main categories: organization, people, and process. Organization centers around mostly quantitative data regarding organizational structure, demographics, space occupancy, etc. Not surprisingly, the people-focused category centers primarily around qualitative data, while process is a combination of the two. In this example, that includes understanding how and why errors are occurring, as well as how to address future and current talent needs, growth projections and more.

For Organization A to create a sound solution to its current real estate options, the group contends that the magic comes at the intersection of each category. One does not overpower the others.

> "The vision can't be 'come to the office.' That's a tactic, not a vision. The challenge arises when leadership relies on tactics to solve much larger problems."

PUTTING IT TOGETHER

PLACE

CHALLENGE

Organization B has 300,000 sf leased space ending. Pre-COVID, meeting spaces were overbooked, yet underutilized. Each employee maintains a dedicated workspace. The space feels empty and uninspired. Currently, 30% of the square footage is shadow space and no longer needed. Two lease options exist: a 10-year-old Class A office building in a tired section of town that had high hopes of becoming an amazing mixed-use development but that never came the fruition. The second option is a suburban office location.

OBSTACLES

- Lease terms (time)
- Asset owner
- Organizational structure
- Building limitations
- Space utilization data
- Commute time
- Employee & leadership perceptions
- Occupancy costs as percentage of full-time employee (FTE)

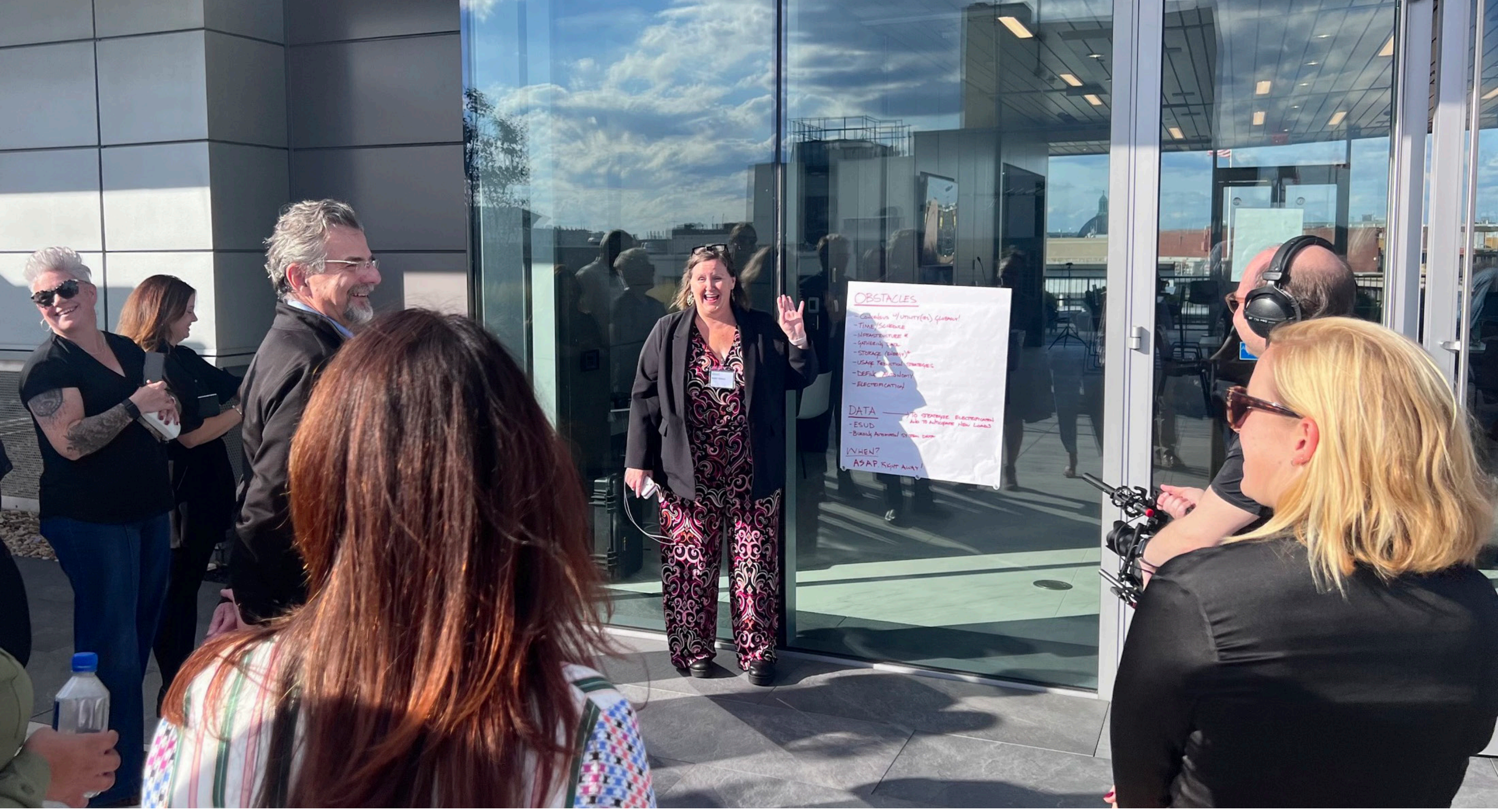
DATA GATHERING

- GROWTH PROJECTIONS
- MARKET OPTIONS
- LABORSHED
- WORKPLACE STRATEGY
- SPACE UTILIZATION
- FUTURE SPACE NEEDS
- EMPLOYEE SURVEY
- COMMUTE INFO

This working group started by reinforcing the notion that in all real estate decisions, time is the most critical factor. Too much or too little time can both be deterrents. Like this scenario, another obstacle the group frequently sees in client work relates to organizational structure. These days, it isn't uncommon for lease terms to extend beyond the lifespan of previously deployed organizational structures, visions, and leadership styles. When this occurs, the organization is in a recalibration mode without the opportunity to shift real estate needs in a timely manner.

Like the first group, the team agreed both qualitative and quantitative data is needed to create sound solutions. The group wants to understand current space utilization and future needs, commute times, current workplace strategy, engagement info, and more. After the data was discussed, the conversation went quickly to an often-referenced statistic regarding professional service companies: Suggesting that 66% of net revenue costs are related to people, and only about two percent is spent on real estate.

With that notion in mind, the group contends that organizations need to focus on what matters first. "If your company isn't performing well, don't try to cut a small percentage from an already small percentage—go for real impact on the other 66%. Make sure you know the obstacle ahead of you. What is truly not allowing your organization to thrive?" stated John Orsak from Lincoln Property Company.



Contrarily, Bob Varga, design principal and workshop leader, pointed out that although 2% is a small percentage, it does have an inordinate impact on a company's brand and how it is perceived by its people. John agreed, "It is absolutely a circular equation."

Varga then asked the group, "In the environment we're in today and in today's economy, is the impact the same? Has is lessened? Has it increased?" Attendees had different takes. Some believed it has lessened given that time spent in said real estate has diminished post-COVID. Others argued that it has increased, and the market responded with an unproportionate amount of trophy office building development.

Greg VanKirk responded, "It hasn't lessened. For less than $10/sf, organizations can make their staff—the driving force behind 66% of a firm's costs—so much happier. It's an inverse relationship. The same dollar amount invested in office space and culture, will have a bigger impact than spreading that same investment across minimal compensation increases for team members who are uninspired to come to work in sub-par space. The impact of space matters."

Kelly Colón replied, "As with anything, it's nuanced. If offered with the premise 'build it and they will come,' it won't work. If the solution is designed based on employee, team, and company needs and desires, then yes, the impact will be there. Are you solving a people problem or a real estate problem or both?"

Although the data lags, strategic leaders are now considering how return-to-office policies impact business beyond speculation. According to a study by Resume Builder, the respondents whose companies have already returned to the office have seen improvements in revenue, productivity, worker retention, employee relationships, and company culture.[10]

The group summarized the discussion contending that when making these real estate decisions, the organization needs to lead with a solidified company vision and prioritize which challenges they are trying to solve. Everything has a trade-off.

> For less than $10/sf, organizations can make their staff—the driving force behind 66% of a firm's costs—so much happier. The impact of space matters.

CONCLUSION

As we head into 2024, we are covered in uncertainty. Creating or maintaining culture, determining the future purpose of the office, managing change, and deal making in this volatile market are top of mind challenges. But there are a few things everyone can agree on.

Future spaces need to be more directly tied to human wellbeing and individuality—while simultaneously creating connectedness and organization-wide culture. If the pandemic taught us anything, it's that not every worker has the same needs, challenges, and desires.

True trust and engagement come from a shared purpose and mission. Organizations need to examine both quantitative and qualitative data related to the organization overall, its people, and processes. The answers lie in the intersection. Return to office policies rooted in the company's vision and broader organizational goals will be more successful than presenteeism-minded policies.

While a recession is imminent, investors and developers will continue to play defensive roles. Tenants remain in limbo. The $1.5 trillion commercial real estate debt coming due before the end of 2025 will force the multi-dimensional issues to come to a head. In the meantime, commercial real estate professionals need a long-term view to remain positive. In these uncertain times, understanding the real challenges that need to be solved and identifying your long-term ideal state is critical. Balance is the name of the game.

Special thanks to the esteemed participants for the insights that were shared, and solutions discussed. This event brought us closer to advancing our mission: to design a better future.

THANK YOU PARTICIPANTS!

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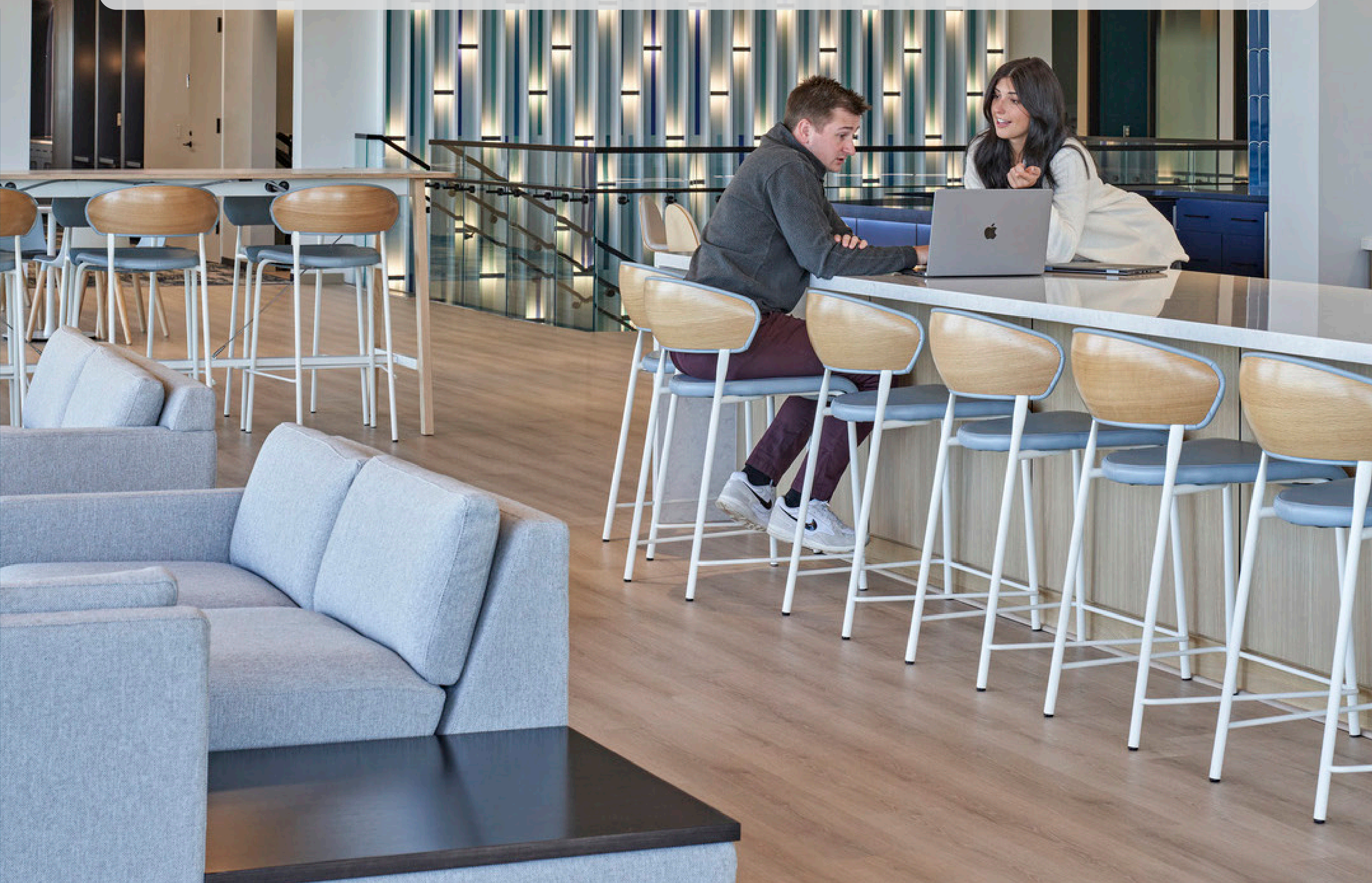

Design a Better Future

INTERESTED IN LEARNING MORE?

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