

How Will Working From Home Impact Office Real Estate?

Stijn Van Nieuwerburgh, the Earle W. Kazis and Benjamin Schore Professor of Real Estate at Columbia Business School, discusses his n

Topics

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Stijn Van Nieuwerburgh, the Earle W. Kazis and Benjamin Schore Professor of Real Estate at Columbia Business School, recently joined us to discuss the findings in his new research paper “[Work From Home and the Office Real Estate Apocalypse](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4124698),” which examines the impact of remote work on the New York City commercial real estate sector.

Q: How has the pandemic changed the corporate real estate landscape?

Stijn Van Nieuwerburgh: So we all know that the pandemic has brought about major changes in office use in many large cities in the world. So to give you some recent numbers, the turnstile data firm Kastle calculates that whereas office occupancy was 100 percent in January 2020, before the pandemic, that fell all the way down to 10 percent in the pandemic in spring of 2020, and has only very gradually and very partially recovered to office occupancy of around 40 percent.

Q: What does your research show about the outlook for commercial real estate?

Stijn Van Nieuwerburgh: So what we do in our recent research piece “[Work From Home and the Office Real Estate Apocalypse](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4124698),” is to ask what is this reduction in use of office ultimately mean for the value of office buildings? And what we end up finding is that the pandemic and the practice of remote work has reduced office values by about 33 percent, which over the first year of the pandemic and longer run results in a value loss of about 28 percent. So if you apply that 28 percent reduction to the value of the entire U.S. office stock, you end up with a \$500 billion reduction in value. Now that reduction in value is larger for lower-quality offices, maybe as large as 44 percent, according to our estimates. And then the last main finding is that there's some uncertainty around that number. We like to think of this as working from home risk. Depending on how the economy plays out, and in particular depending on how persistent this remote work activity will turn out to be over the next 10 years, that number could be as low as a 45 percent overall decline and as modest as a 10 to 15 percent decline.

Q: What data do you rely on as the basis for your findings?

Stijn Van Nieuwerburgh: So commercial real estate data is traditionally very opaque compared to other financial markets like the equity market or the bond market. But increasingly, there's been new data made available. And our paper leverages one source of data, namely commercial real estate leasing data. So a lot of office tenants sign long-term leases, and we have excellent data on the terms of those leases. How long is the lease for? What is the rent that is being paid, and so forth. And so we use that data to basically explore and track the state of the real estate market as the economy goes through this COVID transition.

Q: How are the major constituents of commercial real estate impacted?

Stijn Van Nieuwerburgh: Commercial real estate assets are a very large and important asset class. And they affect a range of constituents. One of them is city leaders, local governments. Another one is investors. And a third category is lenders. And I think these large-scale value reductions that we're talking about have major implications for all three of these food groups. So let's begin with thinking about investors. A lot of institutional investors, pension funds, have major asset allocations towards commercial real estate, and offices is often the largest component of that. So if you imagine that typical office that is being invested in is funded by about one-third equity and two-thirds debt, then a value reduction of a third basically means that equity investors are losing nearly their entire investment, at least on average. And so this is obviously a big deal if you're a large investor in office spaces, such as a pension fund.

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If you're a lender, again, a lot of buildings get bought with debt with substantial leverage, two thirds on average. Depending on how large that loss is, you may be facing a loss as a lender as well.

So a lot of building use will need to be readapted to the new mix of people that's in the city and the new uses and functions that we use our real estate for. You know, a lot of the natural conversion is toward residential, given the scarcity of housing that we have and the affordability problem we have in a lot of our large urban centers. One issue is that a lot of office product is not easily convertible into residential real estate. So for sure there will be conversion. It's going to take time. Sometimes the only conversion will happen through demolition, which means that somebody needs to take a large loss on an office building before that conversion can take place.
