The Weekly Take

What’s Going On: What’s Next for the Global Economy and Commercial Real Estate

08.09.2022

Spencer Levy
It's been a year of economic shockwaves felt across the world: Supply chain disruptions, Russia's invasion of Ukraine, surging energy prices and inflation and more. But make no mistake, the headlines only tell part of the economic story. On this episode, we take stock of the developing saga that is 2022.

Julie Whelan
On behalf of the CBRE Global Research Team we welcome all of you to the 2022 Global Mid-Year Real Estate Market Outlook.

Spencer Levy
You may recognize the familiar voice of Julie Whalen, CBRE’s Global Head of Occupier Thought Leadership. Julie will help us dig in with a roundtable of CBRE sector leaders to hear what they see in the headlines and on the horizon. Meanwhile, another top CBRE leader joins me for a one-on-one to provide deeper analysis and perspective, namely head of Americas Leasing, Mike Watts.

Mike Watts
Hi, Spencer. Great to be here and I look forward to digging in.

Spencer Levy
Coming up: CBRE’s Global Mid-Year Real Estate Market Outlook for 2022. I'm Spencer Levy and this is The Weekly Take. Welcome to The Weekly Take and our annual mid-year outlook. Mike, hope you are having a good year so far.

Mike Watts
I am, Spencer. Thanks. The economy, on the other hand, is taking its share of lumps, but that's what we're here to talk about today.

Spencer Levy
Well, Mike, I don't think it's all doom and gloom. But before we offer our take, let's turn to the Mi-Year Outlook. So our listeners know here's how it's going to work. We'll share excerpts of CBRE’s full Outlook presentation. And then, Mike, you and I will unpack what our panelists have to say – and we'll give it a fresh Weekly Take take, so to speak.

Mike Watts
Sounds like a plan.

Spencer Levy

We begin with an overall look at the economy with Julie Whalen and CBRE Global Chief Economist, Richard Barkham.

Julie Whelan
Richard, there are mixed messages about the direction of the global economy. Consumer confidence is low. Business confidence is falling and inflation continues to surprise on the upside. But on the other hand, consumers are still spending and U.S. job growth continues to outpace the supply of workers. But clearly, the concerns around the risks are growing and they're real. Can you help us frame out what the story is today?

Richard Barkham
Yes, I can. And I think we're heading to recession or at least a very serious slowdown. It's important to note, despite all the volatility that you've mentioned, we are not there yet. But I think the pressure on the consumer and on business from rising energy prices, high food prices and most importantly, rising interest rates is going to see demand ebbing away by Q4 of this year and into the first half of 2023. We've had some slowdown in the United States, but there is more to come over the next 12 months or so. So I think we're headed for recession.

Julie Whelan
So you talk about recession. And I know from my perspective, the global financial crisis was the last recession that really resonates with me in part because of how severe it was. How severe can we expect this recession to be?

Richard Barkham
Okay. Well, I don't want to sugarcoat the message, but I think there are factors in play, quite a few of them, that might lead us to a conclusion that we're going to face a moderate recession. On the one hand, corporate balance sheets are reasonably strong. And despite the fact that demand will ebb away, I think because of the war for talent, companies will want to hold onto their labor. So we may not see widespread spiking unemployment. I would say also that consumers even now have still quite a lot of savings and cash accumulated from the pandemic period. And they can use that. They can draw that down in tough times. So consumer spending might not dip quite as hard as it might otherwise have done. And I think with regard to inflation, we're not going to see some multi-year wage price spiral that we saw in the 1970s. This is a very nasty inflation spike. But I think we've reached the peak of inflation. I think it's going to ease over the next six, 12, 18 months and by the middle of 2023, that will allow the Fed and the other central banks around the world to start cutting interest rates so demand can revive. So I do think there is a route out there to a moderate recession. Having said all of that, there are some big downside risks out there as well. And I think the war in Ukraine is the biggest downside risk that could escalate and that would have a serious impact on Europe. And I'm particularly worried about emerging markets right now. Emerging markets are struggling with oil prices, with food costs, and they themselves hold around $4 trillion denominated debt. So they may struggle to pay the interest on that debt. We might see some defaults and that could feed through the financial system. But on balance, we're looking at a moderate recession. I think that will last through the first half of 2023 and then we will see things pick up again.

Julie Whelan
So the world is a big place. And you mentioned a little bit about Asia, but how do you see the scenario playing out between the different regions?

Richard Barkham
Well, I think Europe looks to be the most vulnerable. You've got the rising energy prices. It's important to realize that gas feeds northern European manufacturing business. And so the impact there on the northern European export machine is pretty acute. I think the United States seems to have the most acute inflation problem right now, not just through rising prices, but also because labor demand is well ahead of labor supply. But equally, I think at the moment in the United States, we're seeing supply chains easing up, we're seeing inventories building up. And I think we're about to see inflation easing there as retailers begin to cut prices in order to shift the backlog of inventories that they have. Asia is actually quite mixed. China is in recession already, but it's stimulating. But a lot of the big economies in Asia, they export to China. So they've had a hit from the slowdown in China and they're about to take a hit, I think, from the slowdown in demand in Europe. On the other hand, China is picking up. And I think one bright spot for Asia is just auto demand. Even though we might be going into a slowdown in the United States, there is a backlog of demand, pent up demand for US autos and in Europe, maybe 4 million autos in the United States. And of course, what that means is that that keeps up demand for semiconductors. And APAC is a really big semiconductor producing region. So China stimulating, semiconductor cycle still pretty strong in APAC might offset some of the current and future downside from the export hit.

Julie Whelan
For your final question from your bird's eye view, how is this outlook going to impact our real estate markets?

Richard Barkham
Well, all recessions lead to rising unemployment, and rising unemployment will feed through into rising vacancy. Some sectors will be worse hit than others, but rental growth will also ease back quite considerably because vacancy is on the increase. Life sciences, data centers and industrial, the sectors that are powered by the digital economy – they're likely to fare better than some of the more traditional sectors.

Spencer Levy
Okay, Mike, so from Richard's point of view, it looks like we're in for a modest recession. But Mike, you're in the office leasing business and you speak to clients every day that have to make decisions based upon the macro outlook. What are you hearing from the clients?

Mike Watts
Well, like yourself, Spencer, I am a road warrior, so I am across the country pretty much every week. And I would say the number one question I get from owners of office real estate, especially those institutional owners with large portfolios, is what should I do with my asset right now? And I remind them that real estate is a unique product type and its unique asset in particular office buildings. So it matters what you own, where you own it, and what kind of improvements you've done to it, which is really how it should be. So we're advising our clients to step back and take a look at their asset objectively, look at where they think it's strong, where they think it's weak, and from there, devise a plan to compete better in a somewhat new environment. Owners understand recessions. But work from home, flexible hours, COVID, that's a bit of a curveball that everybody is getting adjusted to. One other point I want to mention that Richard brought up: unemployment and vacancy. Historically, you could say when unemployment rises, it has a negative impact and vacancy rises. I might take a bit of a contrarian view in the U.S. on office space and say a little bit of an increase in the unemployment rate might not be a bad thing because

as corporate America figures out how to get people back to the office, full employment doesn't help that. But a little bit of unemployment increase could potentially shift a little bit of the power balance back to corporate America, maybe dictating a little bit more than they're doing right now.

Spencer Levy
So, Mike, that's a terrific segue to go back to the Outlook as we're now going to discuss the office sector specifically. Here again is Julie Whalen was CBRE Director of Office Research for the Americas, Jessica Morin and Ada Choi, who leads Occupier Research in APAC.

Julie Whelan
The global office market has been in the hot seat, as we all know so well for the past two plus years, and its very existence has been called into question. So from your perspective, what is the state of the market today in major markets around the world?

Jessica Morin
In the U.S., the worst really seems to be behind us. Over the past three quarters, we have seen that move-ins have actually exceeded move-outs. Vacancies are starting to stabilize, although they reached that nearly 30 year high and asking rents are starting to moderately rise. In EMEA, same thing across major markets we've seen they can see either stabilizing or decreasing with a few exceptions, like in Berlin and Barcelona. Now on the return to office side in both regions, the U.S. and Europe, it has been slow, but we do expect occupancy levels to really start to pick up in the fall once employers really make it more clear what their expectations are for their employees. But with that said, the majority of employers, both in the U.S. and in Europe do support hybrid work. So we do expect employees to be in the office less and that will have an overall net negative impact on demand.

Ada Choi
I think, Jessica, if you compare Asia-Pacific, we are coming out from this crisis earlier. I look at the net absorption in 2021. In fact it has increased 40% last year in APAC. It’s a very strong rebound. However, for this year we are expecting this demand momentum to be normalizing. Of course, APAC is quite a big region, so the supply and vacancy fundamentals vary significantly. If we look at mainland China, particularly Shanghai, it was largely affected by the restrictions and city lockdowns in Q2. So the numbers do not look well. But for the other markets that have limited supply, rents are escalating. This includes Singapore, Seoul and Sydney and we know that occupiers have to plan ahead just to secure the space. Meanwhile, some of the occupiers can enjoy more optionality and rental discounts. The rental cycle will last longer in mainland China, Hong Kong, Tokyo and some of the Southeast Asian markets. 12:48

Julie Whelan
Great. Thank you for those insights. It's always important to look market to market because real estate is still a very local discussion. So here in the U.S., we have seen enhanced trends and we hear a lot of anecdotes around the flight to quality. So, Jessica, I'm interested to hear if you have data that supports those anecdotes and then Ada, I would be really interested to understand if you're seeing the same trends in Asia Pacific.

Jessica Morin
Yeah, so we do have the data to support flight to quality. In the second quarter in the US, we looked at 2700 leased transactions across 12 of the largest U.S. markets from 2019 to

the first half of this year. And we classified the buildings where the leases took place as either top tier, which is that A, A-plus space or a lower tier. And so what we saw is that base rents across all quality tiers increased this year. However, for a lower tier space, we saw that concessions in the forms of tenant improvement allowances and free rent increased quite a bit and that lower tier base. And so that had a net overall effect that brought effective rents down by 3.4% last year and by 1.1% this year. Alternatively, on the top tier space, landlords have actually been able to roll back concessions because of strong demand for very high quality of space. So we actually saw effective rents increase by 3.8% last year and by 6.7% so far this year. So this flight to quality is very real. We're seeing it in this growing preference for sustainable features and buildings.

Ada Choi
Asia-Pacific is not that different. And also in this region, in many cases when it comes to relocation this flight to quality is associated with the workplace transformation initiatives. So the occupiers can use the new space for more flexible, hybrid working style as well. I think another reason for this flight of quality is the ESG desire. So some of the relocation is to the greener buildings, and we know so many of them are new buildings as well. Well, I think there is a lot of discussion whether those relocations involve downsizing. And we know this is true, but most of these moves are basically cost or space neutral. It’s a trend we are seeing in Tokyo, in Taipei and several Australian markets. However, I think going forward there may be some resistance to this relocation because of the shock escalation of fit-out costs. So this could potentially lower occupiers’ intention to relocate. It's difficult to get the budget. We know that some of the landlords are increasing incentives on tenant improvement, or the fit-out period or even provide turnkey solutions. So it will be easier for them to attract the tenants.

Julie Whelan
Very interesting. So it's clear that tenants want better space. They're willing to pay for it, and the rest of the market is really going to get converted into highest and best use, which makes sense. There's a reshuffle going on. So as if the pandemic weren't enough to challenge office, we have what Richard talked about, which is a global economic slowdown and a looming recession. So how does that outlook change your outlook for office in the near term?

Jessica Morin
A recession will weaken demand for office space and it's going to further delay the U.S. office recovery. Companies are going to look for where they can cut expenses. So I'd expect continued rightsizing and possibly an increase in short term renewals. With that said, we have started seeing this play out. There's been a few tech companies that have pressed pause on planned office expansions and even their current underway build-out and cities like New York, San Francisco and Washington, D.C. But aside from those few examples of companies, I do think we'll still continue to see leasing activity over the next several quarters. But occupiers are just going to move even more cautiously.

Ada Choi
I think for Asia-Pacific, there is pent up demand for several markets who are relatively late when it comes to coming back to the office. India, for example, we have seen a very strong rebound in terms of the demand. Philippines is another example, I think, Richard has also mentioned that we are optimistic about a recovery in China. So it's quite of a countercyclical kind of movement. China, Hong Kong, we are going to see the recovery in year 2023 and that's why we are expecting out of demand to improve, in fact, in 2023 in that region. And it is expected that the Chinese government is going to prioritize the

supports of economic growth. And this will also help us as an office market just see the improvement in demand for the later half or next year.

Spencer Levy
So Mike, we just heard from our colleagues in the U.S. and in Asia about how we are looking at a recovery period of a couple of years. What's your point of view of when we get back to normal? I love your point of view on that, Mike.

Mike Watts
Sure. And not to be flippant, but I think we've got to figure out what the definition of normal is going forward. A couple of things, I would say. One, job growth does matter. And you see in markets where there's been good job growth over the last 3 to 5 years, typically they have outperformed from an office standpoint. But I want to touch on flight to quality. When you hear the term flight to quality, most people think flight to quality is synonymous with flight to new construction. And that's not the case. Flight to experience is more appropriate. That includes new construction, but it also includes older buildings that have been completely redeveloped and create a great experience for an employer and their employees. As I like to say, there's a number of five star hotels across the world that are in 100 year-old buildings. Right. It's the experience. It's not the building, but the building supports the experience and helps enhance the experience. We are pretty consistently seeing that across the U.S. in most major markets, we're seeing a disproportionate amount of deal activity go into new construction and buildings that have been redeveloped over the last five years. So that for existing owners of older buildings becomes a bit of a dilemma. They need to create a new experience that they're building that can help them capture this lease velocity. But one point that's really been overlooked and this is a huge deal. Never have office tenants been more insensitive to rental rate than right now. If you create the environment I want for my employees, I will pay you what you want. And a great example, I was talking to the CEO of a company yesterday who just signed a new lease in downtown Chicago to relocate. And he said the first proposal he got from the building that they ultimately signed a lease at, they accepted the rental rate. They did not negotiate that. Negotiated all the other turns hard, but they provided an upgrade to them in building quality. They provided brand new prebuilt space that was furnished and they also had wired the space. So that transaction experience was easy. The building experience was easy. And his employees are fired up to make the move. So the good news for office owners, even in markets like we see across the country that are recovering and the demand is off, is that if you create the right experience, you can get the rent you want. And that's the most direct impact on building value.

Spencer Levy
So Mike, I am hearing that people are price insensitive to rent, so I'm agreeing with you on that. But what I'm also hearing is that some of these other factors, the T.I. packages, the free rent periods, those are also getting larger in some of these. And second tier buildings or having to pay up to get that face run. Is that a fair statement, Mike?

Mike Watts
Yeah, I think that's a fair statement. Some of that is driven by market factors. Some is simply driven by the cost of construction. So there was no way tenant improvement packages were going to remain stable or go down as cost of interior build-outs typically always exceed the allowances that are given.

Spencer Levy

I want to pick up on another point, Mike, that you and I have debated before, which is the amenity package versus the amenities in the neighborhoods surrounding the building. And we could put a whole host of amenities into the building, outdoor space, food courts, whatever it might be. But how does that compete with the neighborhood around it that may not have those things? And so how do you describe that to some of your tenants? Like.

Mike Watts
What do we advise the owners on is – and you're right – it's in a perfect world you have both you have a robust amenity package within the building. And when they walk out, they have various food options for lunch and health clubs and other things. One thing we are telling owners, especially of larger assets, you can't always rely on amenities outside the building to be perceived by the tenants as equivalent to an amenity inside the building. A typical example would be I'm sitting, I've got an office building and right next door is a very nice four star health club that will not satisfy most tenants. They would rather have a less than four star health club within their building that's reasonably priced or passed through an operating expense than have to walk outside, go next door. So you need to have the amenity package in the building right now. There's really no way around it because developers doing new construction have a blank slate. They can gauge the interest of the tenants that are in the market at the time or their target tenants and pretty much paint, you know, the water color of perfection. So as an existing building, you need to be able to compete with that and you can't rely solely on your neighborhood. The neighborhood can support you, but the neighborhood cannot replace you having a robust amenity package within the building.

Spencer Levy
So let's push the argument just a little bit further now. Some buildings are older and may not make sense to put some of these amenities or the CapEx required to make it green, particularly when you're seeing changes in law like we're seeing Local Law 97 in New York and equivalent versions of that around the country, which essentially will regulate the amount of electrical use you have and carbon footprint your building has. Are we going to see a wave of conversion of some of these older office buildings to multifamily or other uses? What do you think, Mike?

Mike Watts
I'm not sure if you're going to see a wave of it. I would say you're probably going to see a higher amount of it in most markets than historical. Markets, especially some of the larger urban cities, where multifamily is going pretty well right now – older buildings often have awkward floor plates, courtyards, lots of columns. Those things are a little bit easier to design around in multifamily, depending on the size of the units you're doing and the diversity of the units within the complex itself. If a office tenant is evaluating the inefficiency of an older building versus the efficiency of a newer building – doesn't have to be new construction, just a newer building which will typically be rectangular core, rectangular floor plate, floor to ceiling glass, continuous window line. Right. That's kind of the benchmark – it would make a lot of sense as an owner to consider a conversion now more than ever, because that efficiency, that inability to not lease the tenant more space, because the building has some issues, ultimately comes down to, you know, their ability to pay rent. And even though I'm saying they're rent insensitive, they're not efficiency insensitive. So I think you'll see more, but I don't think it's going to be wholesale in many markets.
[00:25:20]

Spencer Levy

Well, Mike, as we're talking about conversion from office to multifamily, it conveniently is a good segue into our discussion of multifamily on the outlook call. And before we get into what our experts on the Outlook call said, I will say that historically we saw a situation where the office sector led the multifamily sector where for every six office-using jobs approximately, you saw demand for one more multifamily unit as an example. That may have reversed now because we're seeing more demand for multi, and maybe that drives office. But let's hear what the experts have to say and then we'll come back and we'll have more of a discussion on this, Mike.

Mike Watts
Sure.

Spencer Levy
But now here's Julie again with our multifamily research leads Jen Siebrits in the U.K. and Matt Vance in the Americas.

Julie Whelan
Matt, Multifamily has been a resilient asset class since the pandemic. On one hand, inflation and wage growth suggest that could continue. But as Richard mentioned, consumer confidence is low, which might suggest something else. So what's your perspective?

Matt Vance
Well, Julie, apartment rents are generally determined around occupancy and housing demand in the US remains exceptionally high. It has brought occupancy rates to historic levels and so it's not surprising that we're seeing exceptional rent growth as well. The average renter pays right around 27% of their income toward rent. It's below that 30% typical threshold considered to be cost-burdened. So there is room for additional rent growth, and as you point out especially with additional wage growth. I should probably acknowledge quickly that for lower income households there, especially in high cost cities, they face much more significant affordability issues. But it is great that we're seeing more and more emphasis from the FHA, Fannie and Freddie and investment funds and strategies being established to tackle this problem. Now, on the other hand, vacancy rates did begin to increase last quarter, and it was really the result of both supply and demand. Developers have responded to these incredibly strong fundamentals. They've added a lot of new supply to the pipeline. And at the same time, we saw unseasonably weak demand. And some of that slowdown in demand is the delayed effect of what we saw last year, which was a truly record year for housing demand in the U.S. But also I have to believe that some of that slowdown in demand is being driven by falling consumer confidence The US multifamily sector will continue performing above trend for a while longer, but that vacancy rates will continue their drift back up toward more normal levels this year and next, and that we can expect rent growth to decelerate as a result.

Julie Whelan
Jen, we hear global investors are targeting Europe now for multifamily properties. What is behind that trend and do you think it's going to be lasting?

Jen Siebrits
Yeah. So, Julie, compared to North America multifamily housing is an investment grade asset class is a relatively new concept. Living in private rental homes isn't a new concept in Europe. But instead of being provided by the state or individual landlords, more is being provided by large-scale, private and institutional investors. And of course many of these

investors cut their teeth in the US and are bringing their expertise to Europe. In many places as a first mover advantage to be had with the ability to gain significant market share, particularly in the higher end space which is still achieving premium rents. It's not just that the size of the rental market is growing. This is being driven by longer run social and demographic factors which are delaying entry into homeownership. Also factored in is height and rising house prices. This has led to affordability barriers to home ownership, and this demand has led to robust rental growth and low vacancies. In the U.K., we currently have the highest levels of occupancy since we started collecting the data.

Julie Whelan
So this last question for this section goes to both of you. And we know the world is a connected place. And Jessica and Ada talked about the rise of hybrid. So how does the rise of hybrid and in turn more remote or home-working, what does that mean for downtown and conversely, suburban multi-family market health?

Matt Vance
Well, I would say in the U.S. early in the pandemic, we saw a much bigger, much more negative impacts in downtowns and expensive coastal cities. But now renters have stormed back into their urban, live-work-play, downtown apartments. Developers in the U.S. have recognized the need that their residents have for more space to accommodate remote working. They are increasing the average size of the apartments being developed. The other way that they're approaching this is by incorporating workspaces directly into the shared common areas of these properties and really giving their tenants the ability to leave their apartments and feel almost like they're going to work, even if it's just down the hall or up or down a few floors.

Jen Siebrits
Yeah, I mean, similar to you in the U.S., Matt, large cities like London were really hard hit by remote working practices, but we found housing demand has returned very swiftly. Interestingly, we've seen a pickup in demand for centrally located small apartments, pied-à-terre, where families have left London rural locations and now need somewhere to stay for the few days a week that they work in the office. I also agree with you, Matt, and probably demand workspaces within apartments all within the overall scheme. This has become an essential requirement and of course another issue that's high up on the agenda is sustainability. Developers in Europe are starting to consider how upcoming regulations might have an impact on the overall design of their schemes.

Spencer Levy
So Mike, there's a close relationship between multifamily demand and office demand. And as I said before, we heard the clip, the case used to be that for every six or so office using jobs, there was a multiplier effect in terms of multifamily unit demand. It was also a multiplier effect for retail demand, hotel and otherwise. But now it seems like it might have reversed where multifamily demand might be driving office demand, particularly in big cities where people have smaller units. If I were to quote one of our great friends and colleagues, Mary Ann Tye, she said, nobody moves into an apartment in New York City to work in that apartment. And I think that's a great statement. But what do you think, Mike?

Mike Watts
Well, first, I agree with that statement. In a lot of major markets and secondary markets, you could make an argument over the last ten years they didn't have enough multifamily. And so the development you see going on now is really catching up, especially in these secondary markets. As that happens, then you find the commute becomes virtually a non-

issue. If you are renting a new apartment in downtown Minneapolis, working in downtown Minneapolis becomes quite easy. You know, aside from the snow on occasion. So I do agree that the multifamily impact may have taken the lead and will help drive the office demand. I have seen some very large projects where they have put more common space in the multifamily rental buildings so that people, in theory, in a hybrid scenario when they are working from home, can leave their apartment but not leave the building and kind of drop down to this common space level. And that becomes sort of getting out of the house, so to speak. But there are impacts for this. One: that we're seeing pretty much across the board is the return of the conference center wholeheartedly and office buildings. And why is that? Why that is, is many employers who are offering a hybrid work scenario are dictating the specific days when everybody has to be in the office. On those days, most of their offices were never designed to have 100% of the population in the office at the same time. And they're using that time to disseminate key information initiatives because they don't have everybody in the office on a normal basis where it would happen organically over time. So now they need the building to provide larger conferencing space than historical, to put all of their people in one place for a couple of hours so that they can disseminate information, talk about initiatives, and also rally the troops. So we are seeing that impact of hybrid force a little bit of a change in the amenity package that an office building or certain tenants who are larger are reconfiguring their space so they can build out large conferencing facilities within their space to accommodate all hands on deck certain days of the week.

Spencer Levy
Let's talk now about multifamily retail office all in the same place. Does that mixed-use environment, live-work-play environment – or what I often call the better business district environment – drive some of the advice you're giving to your clients, Mike?

Mike Watts
Yeah, I mean, those kinds of developments, which are large developments, usually done in the largest cities – I was just speaking with a client who's about to embark on one of those that'll have retail parking office in a bit of residential in it also. That particular project now – it's a Main and Main location in a really strong city – they will not be quoting a rental rate on the office space because their fear is they quote something and it's too low. So think about that. There will be well in excess of $100 a foot, but they're not going to quote. They're not going to let their agent quote. They're going to sort of have the people quote to them what they're willing to pay. So that's a pretty interesting factor. But the environment that they're putting together within a broader city that's desirable to many people in terms of location and weather and some other things is part of what you're talking about. So I think those mixed-use projects are here to stay. Most cities have a neighborhood that's trendy, that's hot. That's where the top chefs will open the restaurants. That's where you have the cool restaurants and bars and some boutique hotels in those areas as office buildings come up or get converted. They really are integrated into that neighborhood like you're talking about. So they directly benefit from the neighborhood and they directly contribute to the neighborhood.

Spencer Levy
Mike, as you mentioned earlier in the show, we're both road warriors. And, you know, like Johnny Cash said, I've been everywhere, man, and I have been everywhere. And this week I was in Salt Lake City. And when I was in Salt Lake City, I was in a neighborhood called Silicon Slopes, which is about 20 miles outside of downtown. It had a tremendous amount of new multifamily. It had a tremendous amount of office retail. It also had the local

soccer stadium. And it reminded me of Frisco in Dallas and reminded me of Tempe in Arizona, reminds me of the Fulton Market in Chicago. Are those markets the future of office? And what do you say about the future of CBD?

Mike Watts
Well, those markets, they're not the future of office, but I think you're going to see most major cities – that area that's kind of been designated five, six, ten years ago as a little bit edgy – start to turn over and turn into a cooler area. South End in Charlotte, perfect example. Relative to CBDs I think a few things. Buildings have the opportunity to reinvent themselves. And maybe some owners have been a little reluctant over the years to do it because they've been able to maintain occupancy without putting more capital into the building. That really probably is not going to work right now. So they're going to have to start investing in these buildings. It’s not all doom and gloom for them. It's figuring out what the proper package is and calibrating it and the proper capital requirement to make their building competitive from an experience standpoint. The other thing that COVID has done – there was a backlog of buildings, as you know, that had pretty much executed, their lease up plan and we're going to come to market in 2020 and they couldn't come to market. And so a couple of years later, what's happened is the lease term that they had, the WALT, now has been eaten into and eroded a bit and they're facing living through a little bit of a re-let scenario that they weren't planning on. So it's also the perfect time for them to contemplate what improvements do I need to make so I’m competitive because I actually now I'm going to probably have a little vacancy or some rollover that I want to deal with and I need to make sure that I can compete.

Spencer Levy
So Mike, I want to hear your final thoughts because, look, we both know we are in a period of flux coming out of COVID. We're in a period of flux in this uncertain economic environment. And yet we move forward. We advise our clients on the landlord and the tenant side what to do. So what are your final thoughts of how they should be riding the storm, so to speak, for the next year or two?

Mike Watts
Here's what I would say and here's what I am saying. You know, this is a moment in time, right? It's been a couple of years, but in the grand scheme of things, a couple of years is not that long a period in time. So making wholesale statements or judgments on how it's going to be from here on out when we're in a moment in time, a moment of disruption, probably isn't the smartest thing. There's a moment in time in the year 2000, when the markets were all flooded with tenants that ended in dot com. And had you gone with the wave, that dot com tendency was the wave of the future and pretty much was going to end up controlling 80% of the tenancy in any major market. You would have given the keys back if you did a lot of leases with dot com tenants. The exact opposite happened. Again, that was a moment in time. You know, utilization of space is not linear, right? It depends on a lot of things. So I think this is a moment in time COVID has dragged on longer than people thought it would. But tenants looking at office space are evaluating experience as much as anything else. Owners need to know that and they need to adjust accordingly.

Spencer Levy
Great, Mike. Well, I think I'm going to use one of your lines: the use of office space is not linear. And a lot of the things that you think are obvious about we're all shrinking. That trend could very easily reverse once you see the office space for what it is not just a place

to do work, a place to get together and to do things better. So, Mike, thank you very much. Terrific commentary on our office and our overall macroeconomic outlook. Great job.

Mike Watts
Thanks. That was fun.

Spencer Levy
Thanks again to Mike and a special thanks to CBRE, head of Global Occupier Thought Leadership. Not to mention a great friend of the show, Julie Whalen, and a shout out to the entire team behind the 2022 Global Mid-Year Real Estate Market Outlook. Well done. And thank you for tuning in. There is also more on our website. CBRE.com/TheWeeklyTake. And don't forget to share the show, as well as subscribe, rate and review us wherever you listen. We'll be back next week. I'm Spencer Levy. Be smart. Be safe. Be well.