Implications of Office-Space Downsizing

Shift May Be Less Economy-Induced Response, More Ongoing Transition

LAUREN M. BURNS*

Abstract: This article examines the trend toward downsizing the average office-space allocation per worker, based on an interview with Dr. Norman G. Miller, his publications and a report from his students on the topic. It looks at office-space demand and the keys to the downsizing movement; defines the measurement tool of capacity utilization; speculates on where downsizing is most likely to occur; names the most active downsizers to date; and concludes by discussing the drivers influencing this trend.

On the heels of the 2007-2009 recession and subsequent economic malaise, a number of analysts perceived an oversupply of retail space. Putting this in a larger economic perspective, however, enables one to distinguish between short-term forces and long-term trends with more significant potential for lasting change. The office sector is another part of the real-estate industry experiencing similar changes. Dr. Norman G. Miller, Professor of Real Estate at the University of San Diego with the Burnham-Moores Center for Real Estate and former Vice President of Analytics for the CoStar Group, has been studying the office-market trend of downsizing average space per worker. He believes this phenomenon projects to millions of square feet (sf) in oversupply because of reduced office occupancy.

Is office-market demand disappearing? In September 2013, a CoStar data report found that new office leases, where the tenant moved in within the last 90 days, averaged only 180 sf per person. The same calculation for all leases exceeded 300 sf per person. Although this can be seen as a response to an economy still not in high gear, other key factors suggest that downsizing will become less temporary and more permanent. The following factors contribute to this downsizing movement:

1) work at home or third places;
2) standardized space;
3) non-dedicated space models with file storage in “the cloud”;
4) conference rooms and short-term space vendors as part of overflow plans;
5) productivity-based management.

Long-term changes to the workplace and arrangements between employer and employee offer evidence of permanent office-space reduction.

Why might this change be taking effect besides the assumable financial reasons? Start with capacity utilization, the amount of space a company occupies at any point in time. Capacity utilization is measured in two ways: 1) the hourly percentage of time a seat is occupied for a normal day or week; or 2) the number of days someone is in a particular office over a period of time. Dr. Miller observes that the typical occupancy has been found to range from 38% to 40% when using the first method and from 40% to 50% when employing the second.²

Space managers and asset managers looking for ways to save money, cut expenses, increase efficiency, add value or differentiate one investment property from another are using this measurement tool to make decisions and to push the performance of their properties to a higher rate. As capacity utilization is cited with increased frequency to tenants and purchasers, landlords will be tasked with selling the productivity per sf of a property or space versus sf alone.

In the United States, research today generally suggests that office space per worker has not declined in the larger cities but in the smaller markets. New York, San Francisco and Boston, for instance, use more space per worker while Columbus, Ohio and Tampa, Fla. use less.³ Reasons for this have been that larger cities tend to employ higher-paid professionals who utilize larger office space while smaller, less expensive cities employ back-office professionals found mostly in shared spaces. No inverse

* Candidate, master of science degree in real estate, University of San Diego (2015)


2 Norman G. Miller, interview with the author.

correlation has been found between the average space per worker and rental rates, however. Another plausible reason is that office buildings in more expensive and larger cities are often multiuse, coupled with ground-floor retail or restaurant space. CoStar data classify any building primarily used for office space as office-only space, so this may make average space per worker in more expensive cities appear larger than the true figures would confirm.

More information and study is needed to determine where most downsizing will occur, but focusing on which tenants are looking to downsize and why provides some insight. Washington, D.C. is already a prime location for downsizing, as the General Services Administration (GSA) has received Congressional mandates to reduce occupancy and shrink overhead. A Government Accountability Office (GAO) report issued in the spring of 2013 placed the annual cost of maintenance and operations of unused federal courthouse space at $51 million, and in the following September, the Judicial Conference of the U.S. ordered a 3% reduction in space inventory by the end of Fiscal Year 2018. According to Dr. Miller, the GSA is striving for much lower than 150 sf per worker and even encouraging telecommuting where possible. With the help and advice of the GSA, the Department of Homeland Security is reducing sf per employee to less than 150 from an average 200.

While the U.S. federal government may be the primary downsizing tenant, average footprints of leased space have shrunk by 24% between 2003 and 2013 across all industry sectors. Additionally, a 2011 survey conducted by Dr. Miller with the help of CoreNet Global and CBRE Group discovered that larger companies who were tenants of buildings 50,000 sf or more were more likely to be interested in increasing capacity utilization and reducing footprints than the typical smaller groups of tenants whose largest concern was simply staying in business or growing. One notable reason that larger, expanding tenants may pursue capacity utilization more often

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3 Norman G. Miller, "Downsizing," p. 29.
5 Norman G. Miller, "Downsizing," p. 28.
through downsizing than smaller tenants is because of their better positioning for negotiating lease terms.

The trend toward downsizing has been fueled by a number of factors, including:

- **Cost Containment.** Everyone is having to do more with less these days, and even industries that are performing well want to improve their efficiency, productivity and performance in order to maintain sustainable operations. Whether a company is looking to grow, sustain or survive, high-capacity utilization offers many benefits: trimming excess expenses (including lowering rent and occupancy costs), increasing productivity, promoting collaboration, sharing resources, and the like.

- **Technology.** Advancements in cloud technology (where such services as servers and applications are delivered to computers and devices through the Internet) have decreased the need for physical space, even while assuring more continuity of operations during disasters or power outages. Whereas documents and other work materials were previously only accessible from the physical office, mobile access and cloud storage have made the average worker’s office available from any place where an Internet connection can be used. This technology has decreased the need for dedicated work space and increased unassigned, temporary, and third-party work spaces, as well as open spaces. With less space needed for storing physical files and documents, offices can be reconfigured to more productive activities. Advanced technology has reduced the operational requirements for companies across many different sectors. Most tasks can now be handled efficiently in aggregate by a simple, modestly-sized computer.

- **"Big data."** Traditionally, spreadsheets containing manually-entered data tracked how many employees used a particular building. It was assumed that all of these employees used the building at the exact same time, so it was posited that certain space was necessary in order to conduct operations. Now, technology and applications offered by companies such as France-based Schneider Electric track and display how many people use a particular building, which spaces they use and when or how often. When this information became available, managers began to see that office space was not being used according to the display on the meeting-reservation chart or the total number of employees with access to the building. The office space was being used at different productivity levels and often did not require as much space as once believed. Many employees were out in the field or in different offices, leaving space vacant for enough periods of time that square footage per employee could viably be reduced while maintaining productivity. A student of Dr. Miller’s, Aaron Cook, reflects on how his company has downsized over the last few years: "I work for an international engineering firm with 26,000 employees and over 150 offices throughout the world. Over the last five years, we have begun reducing the size of our average work-space cubicles, creating more hotel spaces for telecommuters, and creating more collaborative work spaces. In the offices that have made the switch, nearly all private offices have been eliminated and converted to cubicle space.” Technology has increased clarity in building operations, thus empowering managers to make better-informed decisions about efficiency and office-space improvements.

- **Labor productivity.** Productivity in the workplace is still difficult to quantify. However, though the telecommuting ban by Yahoo Chief Executive Officer Marissa Mayer attracted considerable attention, the benefits of a productivity-based management policy that judges employees on their accomplishments, not their hours per day in the office, are adding up, including:

1) greater worker productivity as a result of less time spent commuting, more sleep and less stress;
2) absenteeism savings (for example, when a child is sick) and better employee health;
3) less turnover resulting from home-based responsibilities that compete with work (e.g., eldercare);
4) less need to subsidize transit and parking costs.  

In addition to the direct savings calculated of at least $9,671 per person per year, there were many indirect social benefits such as less carbon gas output and better air quality, and fewer insurance claims for injuries or accidents in transit.

According to a series of surveys conducted over several years by the University of San Diego and CBRE, the space attributes most consistently desired by tenants, aside from locational access and parking, include:

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7 Aaron Cook, conversation with author.
- Good natural lighting;
- Good temperature controls;
- Good air quality;
- Reasonable noise levels; and
- Collaborative spaces for meeting and amenities, such as a kitchen.

These desired space attributes relate ultimately to green/sustainability building standards. According to Dr. Miller, more productive space commands higher rents, which may be the result of quantitative energy savings as well as the qualitative higher demand for these more desirable spaces.

It should be mentioned that some current trends work against the shift toward downsizing office square footage: namely, American cultural standards of increased personal space, office size as a signifier of rank and importance within a company, and the general resistance of employees 55 years and older to coexist within unassigned spaces of the office. If today’s successful technology companies filled with recent entrants into the labor force are any indicator of workplace shift, these counter drivers will lose significance as older workers retire.

Students of Dr. Miller noted, in a fall 2013 San Diego metro market analysis report, the shift of office tenants toward shared, collaborative work spaces with open floor plates and more amenities. This trend will not only result in less workspace needed per employee, but will offset future demand generated from rising employment rates. Long-term leases held by most office tenants, as well as the capital-intensive nature of office-space renovation, mean that this change might not be so noticeable immediately, but will heavily affect the office market in the long term.9

Just how pronounced would this impact be? Dr. Miller spells out one possibility, for tenants occupying 50,000 sf or more, a group representing 36% of total office space. If these firms “all decided to use some of the space-sharing strategies described above, and reduce their primary leased office footprint by 50 percent, moving from 250 to 125 square feet, this would be the equivalent of 540 million square feet out of some 12 billion office square feet as of 2009. Historically this is equivalent to 3.6 years of average U.S. deliveries of net new space to the market, which has averaged close to 150 million square feet per year since 1983.”10 This freed-up space would become obsolete as the movement toward greener, more productive space becomes the norm, placing great pressure on owners to retrofit.

Forces for downsizing are not only observable within the office sector. E-commerce technology and the demand for greener, open spaces are also decreasing the demand for larger, outdated retail spaces. Merchandise is moving into industrial facilities to accommodate more online purchases, advanced technology is improving efficiency per worker and retail spaces are serving more as exhibition and try-before-you-buy centers.11 With the same factors impacting the office market assured to cause shifts in the retail sector, forward-thinking landlords and asset managers could begin the retrofit process now with goals of sustainability and government-compliant buildings in anticipation of future demanded space.

Lauren M. Burns is a 2015 candidate for a master of science degree in real estate from the University of San Diego (USD), a recipient of USD’s Women of Impact award in 2013, and a licensed realtor for Blue Chip Realty Group. Her most recent works have appeared on MIPIM, the world’s largest real-estate market blog, and she continues to look for writing opportunities to augment her graduate studies. Follow: @Laurenderella. For further information related to this article, she can be reached at: lmburns@sandiego.edu.

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9 Lori Motooka, Sean Murphy, Nikolas Parrish, Jared Rodio, "Outlook for the San Diego Metro Office Market" (University of San Diego, Burnham Moores Center for Real Estate, December 2013) ,p. 5.
10 Norman G. Miller, "Downsizing," p. 32.