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REPORT

Commercial Real Estate in 2022:

# Outlook for an Industry in Recovery

Landlords and tenants square off on the trends impacting the commercial real estate market in a post-pandemic world.

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# Executive Summary

## The COVID-19 pandemic upended many sectors of the U.S. economy and as a result, fundamentally changed the commercial real estate landscape.

Government-ordered shutdowns and a resulting rent crisis led to a lot of finger-pointing between landlords and their tenants. Many companies struggled – and continue to struggle – to navigate unforeseen conditions, including new security considerations, limited access to equipment and materials, mandated sanitation practices and more.

To remain relevant and profitable, business owners are evolving how they prioritize and manage their commercial real estate leases. They require easy access to their lease agreements to effectively act on what needs to change in response to both internal and external events. In addition to helping organizations make better-informed decisions and get the most value out of their lease portfolios, having this level of visibility can also equip them with the data they need to properly report on their leases.

Today, tenants want to ensure that their leases still serve them amid any pivots to their business models. Similarly, landlords are re-evaluating how they manage their assets to accommodate companies' evolving needs while also ensuring their own needs are met in the process. On both ends of the spectrum, there is a significant amount of money and time at stake.

As we head into 2022, companies are preparing real estate assets for the next year and beyond, but the lingering uncertainty in the market is making them take caution in future-proofing lease agreements.

Some of the shifts we are seeing in tenant and landlord behavior may be temporary responses to unprecedented market conditions, while others may be indicative of long-term trends that we can expect to shape the future of the commercial real estate industry. Whether short-term or long-term, landlords and tenants must proactively track and manage the resulting changes to their leases to ensure they're effectively measuring the impact on their bottom line. With greater visibility into critical elements of their portfolio, companies can make better-informed decisions about their future.

To provide you with the information you need to maximize the value of your commercial real estate lease portfolio, we polled 200 senior accounting and finance professionals who manage their companies' leases, representing the perspective of tenants. We also surveyed 200 commercial real estate executives, including real estate investment trusts (REITs), developers, operators, managers, brokers and international property consultants that oversee rented properties, representing the perspective of landlords.

Our data serves as a guide for both parties on how to best plan for the year ahead.

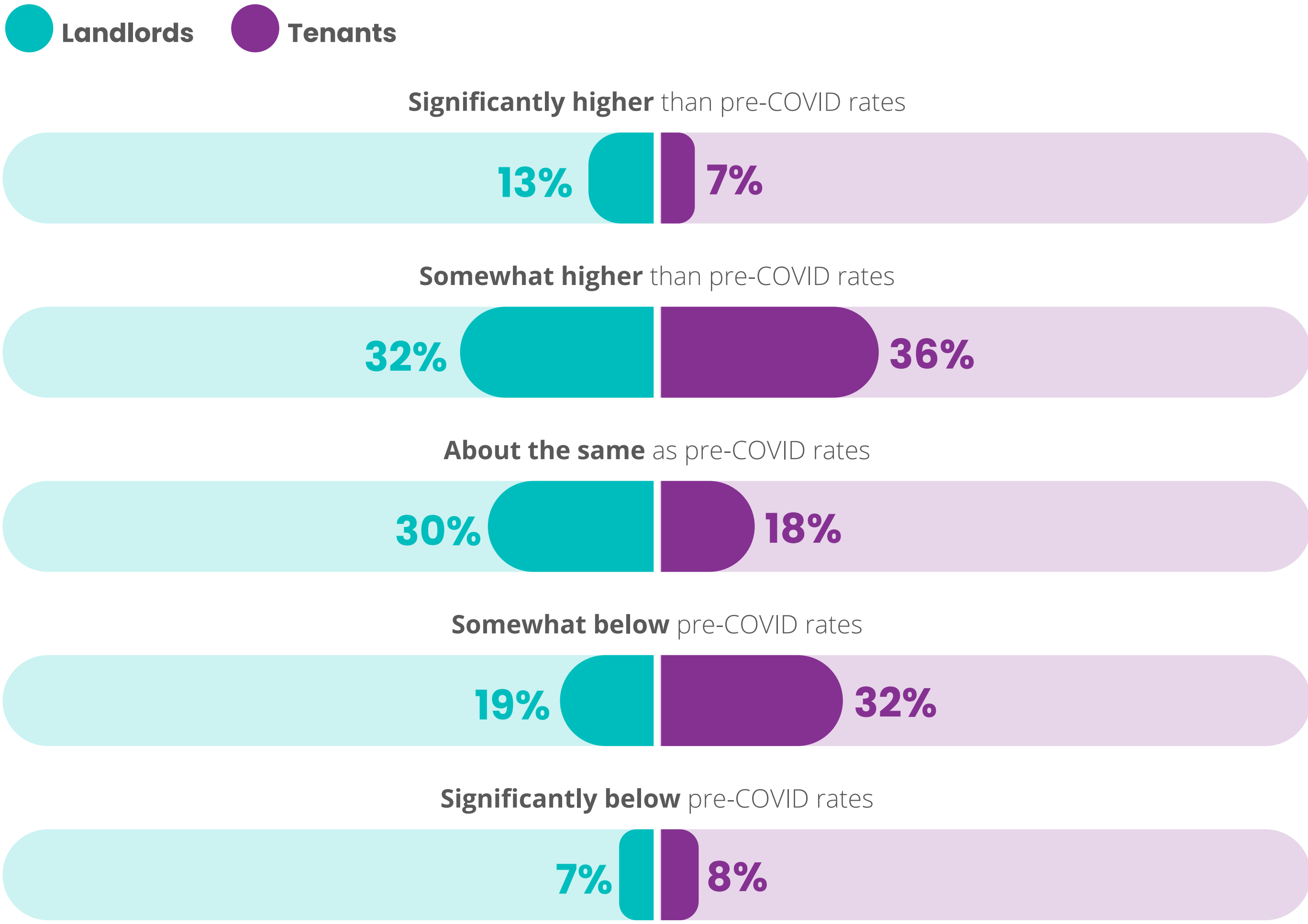
# Preparing for the Future

## Rent Rates Bounce Back

During the height of the pandemic, companies struggled to make rent, with more than three in five (61%) tenants sharing that their company fell behind on payments during the pandemic, and more than one third saying they are still behind.

As tenants and landlords explore new leasing opportunities, both agree that companies looking for short-term arrangements are at risk for an increase in rent prices in the upcoming months and years ahead. In fact, 75% of landlords expect 2022 commercial real estate prices to be about the same or higher than they were before the pandemic, which is in line with what three in five (61%) tenants expect.

*How do you believe commercial real estate rent in 2022 will compare to pre-COVID rent prices?*



## Ready to Commit to Longer Terms

In anticipation of the rising cost of commercial real estate, landlords and tenants are taking a closer look at their portfolios and are prepared to resume longer-term planning.

**65%** **of tenants** are looking at space needs **more than 1 year out**

**58%** **of tenants** are prioritizing leases of **5 years or more**

**18%** **of tenants** are prioritizing leases of **10 years or more**

While this indicates that plans are being made, the future continues to remain uncertain, and a resounding **93% of tenants** consider their 2022 corporate real estate strategies to be a short-term solution.

*"**Companies are eager to plan ahead, but it will take time for the commercial real estate industry to settle down.** The world is still grappling with the ripple effects of the pandemic and, as a result, is learning to navigate new waters. The best thing that landlords and tenants can do to fuel their ability to remain agile is to create and sustain visibility across their lease portfolios. With a firm grasp on their lease data, they will make better-informed decisions regarding their futures."*

–

**Marc Betesh,** Founder & CEO

**Visual Lease**

*"The last 18 months could just as well have been 18 years. **Trends that were already in flight were significantly accelerated during the pandemic.**"*

–

**Josh Herrenkohl,**

Senior Managing Director and Real Estate Business Transformation Leader

**FTI Consulting**

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## Real Estate Footprints Poised to Expand

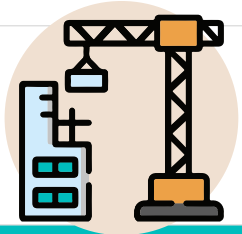
As companies re-evaluate their lease portfolios, many start by deciding whether they need to increase or decrease holdings to support their businesses.

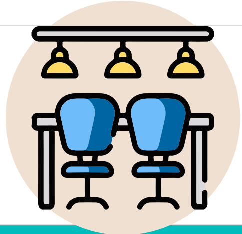
Seven out of 10 tenants claim they are looking to add space to their company's real estate footprint in 2022. Similarly, 65% of landlords also predict that their tenants will desire additional square footage and facilities.

With nearly two in five tenants preferring longer occupancy terms for future property leases, acquiring more space now may enable them to get ahead of possible rent increases and save a significant amount of money.

**Tenants' real estate strategies for 2022**

| | | |
|---|---|---|
| **48%** are **expanding** existing spaces | **43%** are **relocating** existing spaces | **40%** are **leveraging** co-working spaces |





**What landlords are expecting**

| | | |
|---|---|---|
| **41%** expect tenants to **expand** existing spaces | **36%** expect tenants to **relocate** existing spaces | **45%** expect tenants to **leverage** co-working spaces |

**Respondents were asked to select all options that apply.*

Despite the possible savings, long-term planning isn't the answer for everyone. **Thirty percent of tenants plan to downsize,** which further demonstrates that there's still a level of instability in the market.

*"As corporations continue to trim their legacy real estate footprint, they will also look to acquire newer spaces that inspire employee greatness, resulting in improved productivity. Real estate will be seen as a differentiator among peer organizations and will move to the front lines of the war for talent. And for corporate real estate leaders, building flexibility into their portfolio will be a critical priority."*

–

**Josh Herrenkohl,**
Senior Managing Director and Real Estate Business Transformation Leader
**FTI Consulting**

## To get a handle on your organization's unique circumstances and real estate needs, conduct an evaluation following these steps:

1. **Assemble the right team.**

   Decisions about real estate and the future use of assets aren't always made by CFOs alone. Ask your finance, FP&A and legal teams to provide their input so that you're considering all factors and working toward a singular vision for your future.

   **Pro tip:** Bring in an auditor for the initial discussion around re-evaluating your lease portfolio to understand and get ahead of the lease accounting implications.

2. **Determine your goals.**

   What are you looking to achieve in revisiting your commercial real estate footprint? Are you hoping that with these changes, your assets will better support operational needs? Are you looking to simplify overly complex and inefficient areas? Are you banking on freeing up capital? Is your success dependent on reducing administrative burdens?

   Isolate your main reason for revisiting your lease portfolio and ensure all team members (mentioned above) are aligned.

3. **Consider your organization's lease accounting needs.**

   Once you identify and review your organization's investments, agreements and obligations, you will be able to better visualize where and how you can maximize the value of your leases. As mentioned in step one, keep in mind that any changes to new or existing leases will be impacted by the new lease accounting standards (ASC 842, GASB 87 and IRFS 16).

   These new standards require private and public companies, as well as many government entities, to account for many (if not all) of their real estate and equipment leases on their balance sheet as assets and liabilities, and to provide expanded disclosures on their lease portfolio.

   Having a centralized system to automate much of this work will create efficiencies and mitigate the risk of human error. It will also allow you to better visualize your enhanced lease portfolio so you can measure the impact of the changes that you made.

## Effects on the CRE Market

Asset type and location both play a large part in how landlords expect the commercial real estate market to perform in 2022.

The majority of landlords expect retail space, multi-tenant offices, single-tenant offices and industrial space to garner the most interest from tenants.

And nearly four out of five landlords predict that in 2022, the greatest demand for leased office properties will be in cities, with Tier 1 cities like New York City and Los Angeles having the most appeal.

Increased interest in urban areas suggests many companies are considering how they will set up physical office spaces amid hybrid working conditions and whether they will be available to employees full-time or part-time.

While no universal blueprint for a return to the workplace exists, many companies that had a remote work option during the height of the pandemic continue to offer hybrid workplaces and still plan for some form of real estate presence.

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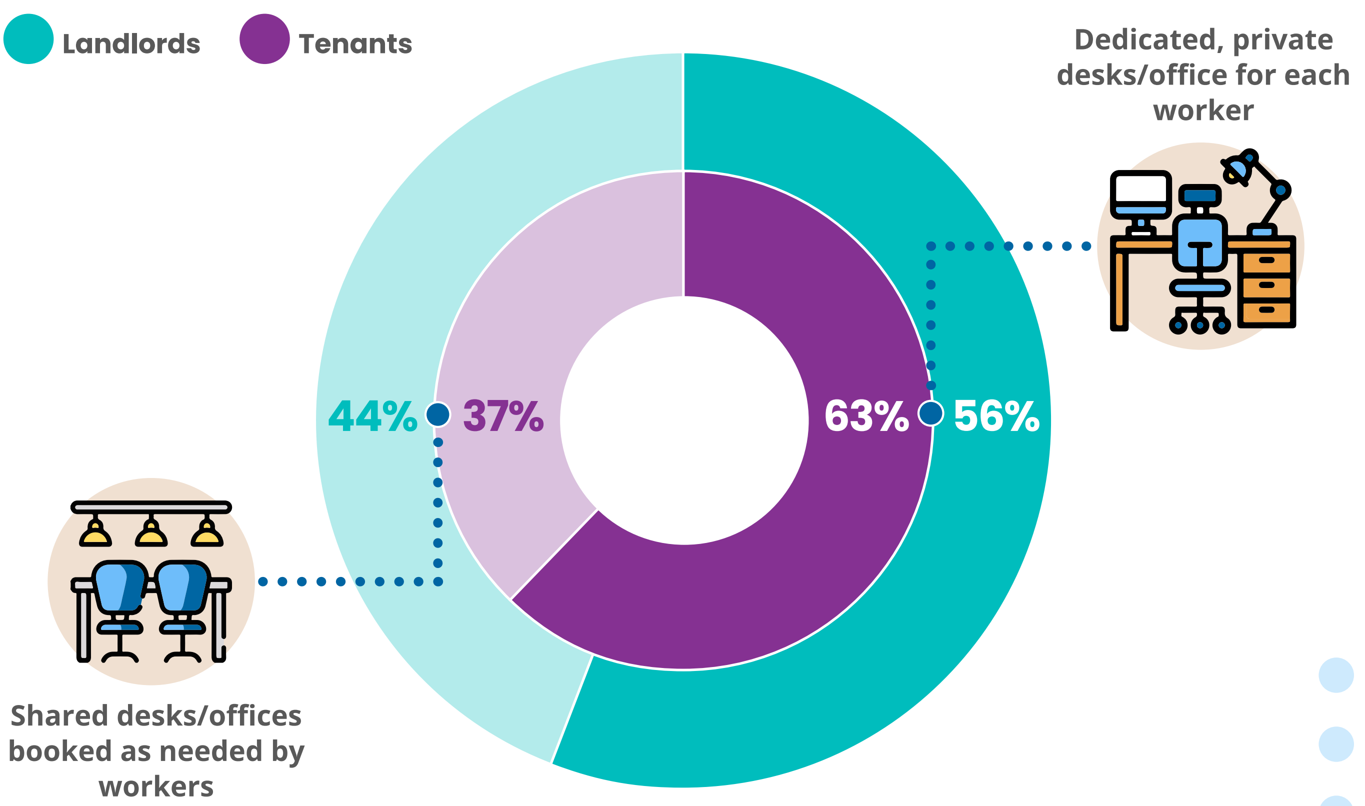
*Which office floor plan is most appealing?*




**100%** **of landlords** plan to reposition at least some of their existing real estate assets for alternate use (ghost kitchens, warehouses, labs, etc.)

*"Many companies have spent the past 12-18 months imagining what the office will look like when there is a more earnest return-to-office (now and into early next year).* ***There is a focus on spaces that provide collaboration, wellness and flexibility.*** *In terms of real estate demand, it is yet to be seen if this will result in net space growth or reduction, however, there will most certainly be a flight-to-quality as tenants seek out premium space in key talent areas, as well as an increase in the incorporation of flexible (co-working) options within tenants' portfolios as they provide choices for employees operating in a more distributed environment."*

–

**Kim Esposito**, Senior Managing Director, Lease Administration & Audit

**Savills U.S.**

*"Today, employees are looking for healthy standards, flexibility in the workplace and effective meetings.* ***The pandemic has confirmed that work can take place outside of the office, but should ideally include a mix of in-person interaction to support effective operation.*** *Technology is becoming more critical than ever to drive successful meetings and ensure workers have a safe and productive space when they come into the office. Once only relegated to the back office, today, real estate technology needs to establish a unified user experience for the employee, consolidating multiple functions into one simple and easy-to-use format. Employee engagement starts the moment they decide to go into the office up to the minute they leave; the virtual concierge needs to support their journey."*

–

**Paul B. Head**, Digital Leader, Construction and Real Estate Consulting

**Ernst & Young LLP**

## Changing Expectations

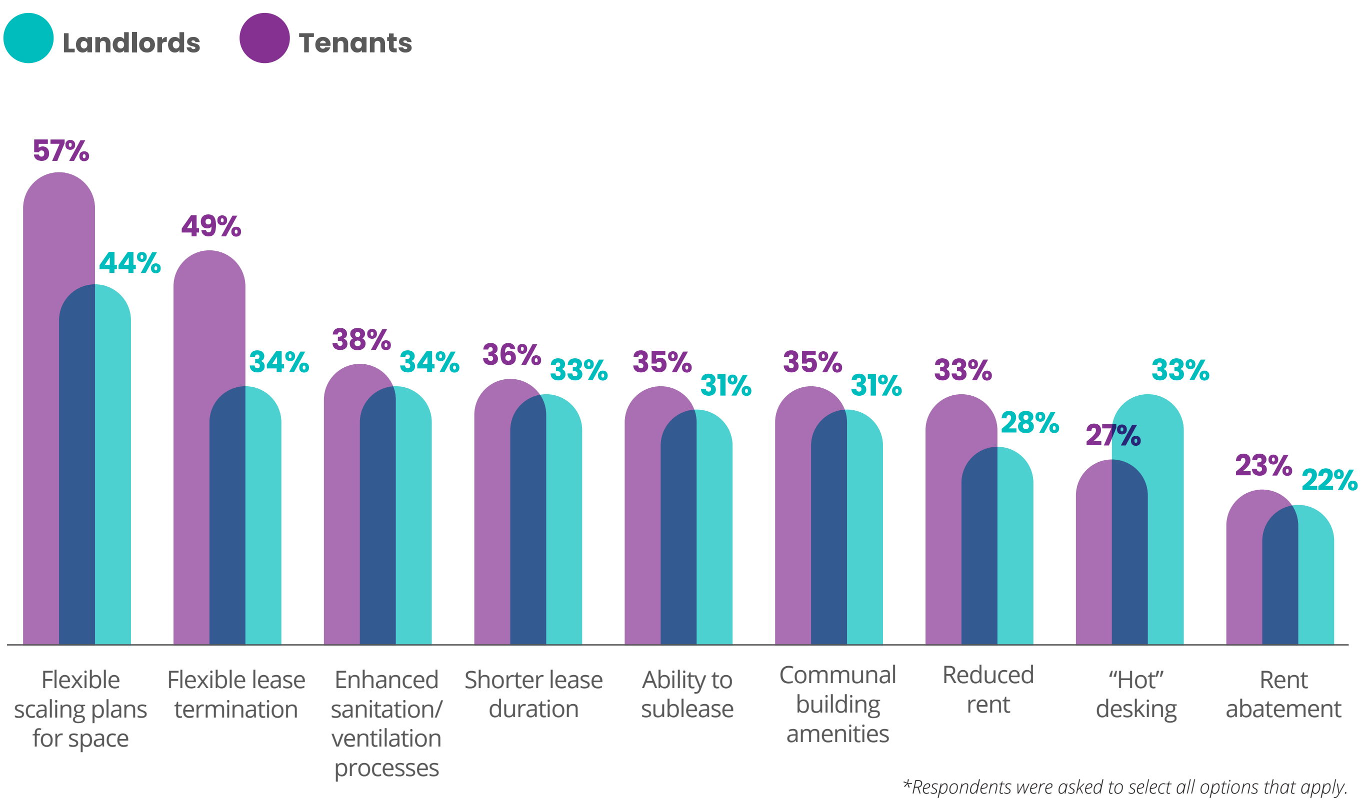
There's a new priority for tenants that once took a backseat in their leases: **flexibility.**

At the height of the pandemic, landlords and tenants were at odds over who was responsible for a variety of expenses, and tenants were often left without options due to inflexible lease terms.

As a result, 100% of landlords reported that their tenants requested modifications to their leases mid-term in response to COVID-19.

**Going forward, tenants will continue to prioritize flexibility to deal with the uncertainty that lies ahead.**

Most important negotiation points:

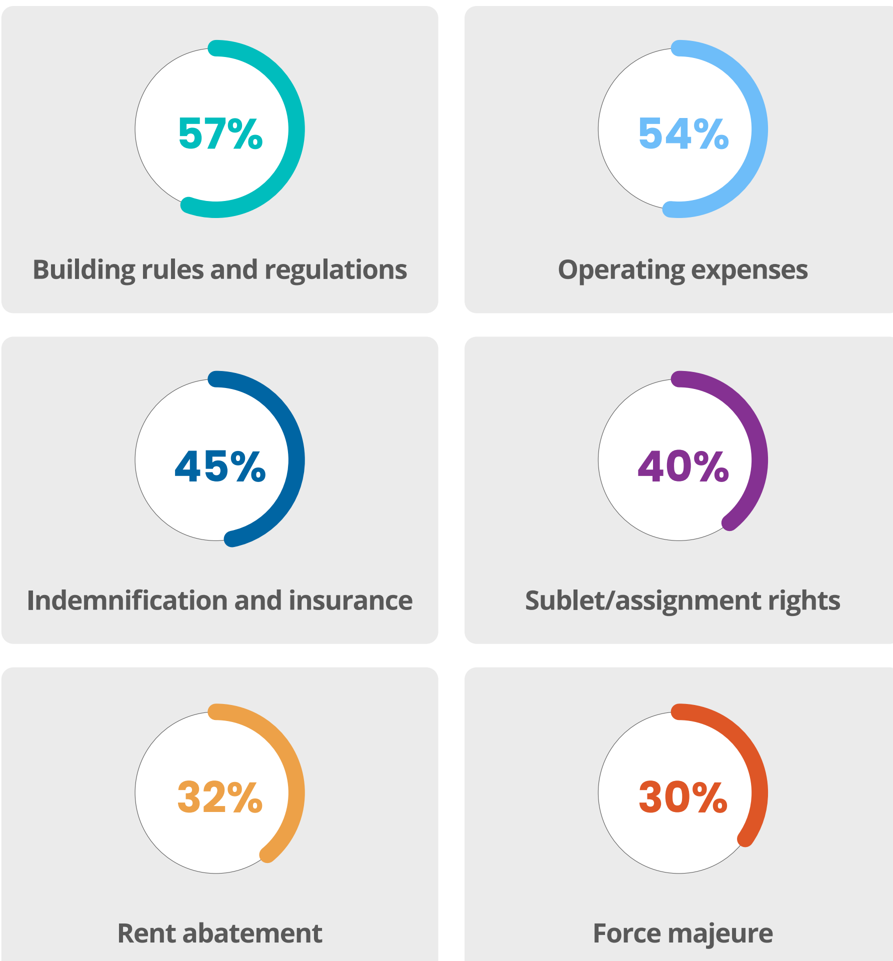



**Respondents were asked to select all options that apply.*

## Future-Proofing Leases to Accommodate Changing Demand

To adapt to today's climate, landlords are working diligently to re-evaluate their properties and adjust lease terms to meet new business demands. **As a result, nearly all – 99% – of landlords have revised their standard lease agreements to account for new requests from tenants.**

Landlords shared the following modifications were made to their lease agreements in response to tenants' requests during the pandemic:




**Respondents were asked to select all options that apply.*

While the pandemic unearthed a need for more flexible lease terms to retain existing tenants and attract new ones, landlords remain evenly split on whether they'll prioritize short-term tenants who can pay full rent or long-term tenants who will pay discounted rent.

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*"**During the height of the pandemic, we saw tenants exercising short-term extensions, renewals or subleases to delay making longer-term real estate commitments amidst uncertainty.** There is some evidence we will see a reversal of that moving into next year. Markets have seen significant softening and the tenant opportunity is prime to secure long-term lease commitments at potentially reduced rates with generous concessions offered. Recently, there has been an uptick in activity signaling that organizations are willing to re-commit to their office spaces long-term moving forward. A highly configurable lease administration tool, like Visual Lease, provides the flexibility our clients need in order to meet any challenges that arise in managing the demand side of real estate."*

–

**Kim Esposito,**
Senior Managing Director,
Lease Administration & Audit

**Savills U.S.**

# Proactive Lease Management

Getting your company's lease portfolio in a centralized system is the first step to take toward achieving your broader business goals for these investments. What many organizations fail to realize – and account for – is that they cannot "set and forget" their leases, as this behavior can open their companies up to a range of risks.

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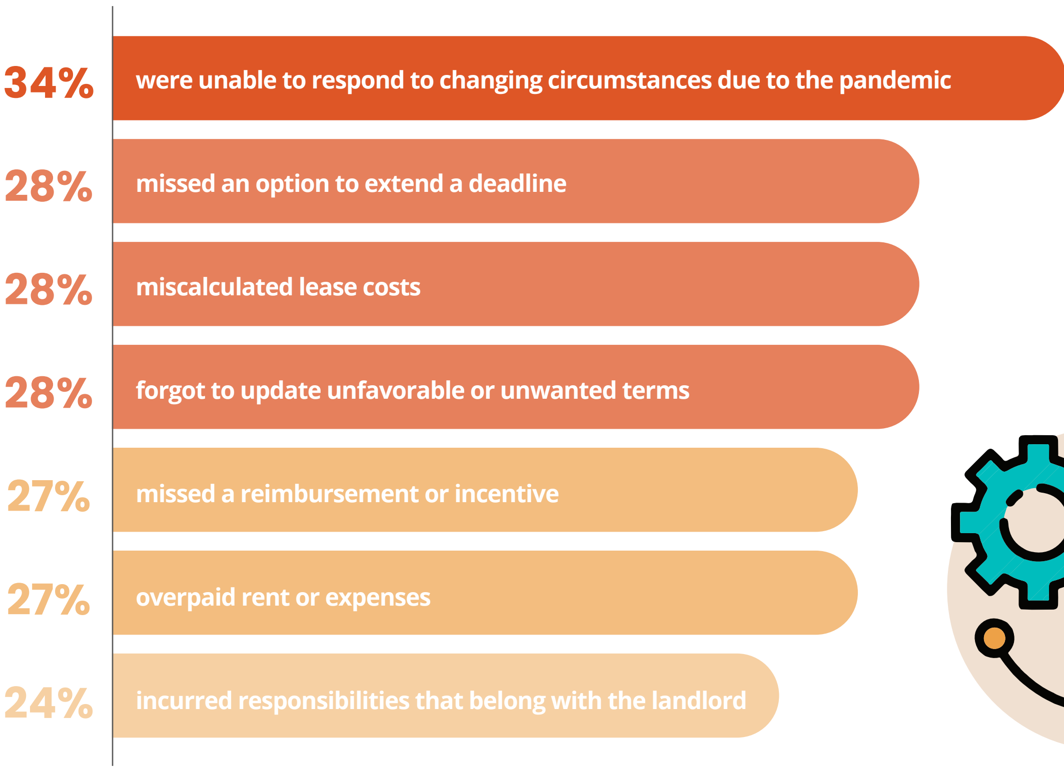
## Automating Processes to Avoid Costly Mistakes

**An overwhelming four out of five tenants experienced negative impacts to their businesses due to inadequate controls, including:**




**Respondents were asked to select all options that apply.*

Historically, companies relied on more manual processes, such as Excel spreadsheets, to track their leases.

But, for organizations with more than 10 leases, it's nearly impossible to manually track and manage all components of their lease portfolio without missing important information and fatiguing internal teammates. Thankfully, today, only 10% of senior accounting and finance professionals use Excel for lease accounting.

# Here's why organizations should prioritize implementing a dedicated tool or service for lease management:

## 1. To help them manage their lease portfolio.

*"Since I started using Visual Lease, I have all contracts in one place. It's very easy to use and very efficient to find all information for every single location we have in the market."*

**Fabian Zettel,**
Regional Facilities Planning Manager, Switzerland & Austria | **Starbucks**

## 2. To enable them to easily achieve and sustain lease accounting compliance.

**Liberty Global consolidates 15,000 leases into Visual Lease to stay globally compliant.**

*"Visual Lease helped us not only standardize the way we account and report on our lease contracts, but also, made sure that we implemented the standard correctly, accurately and on time."*

**Joel Mackley,**
Director, Finance Optimization Projects
**Liberty Global**

## 3. To empower them to leverage their leases as strategic business assets to expose gaps and opportunities for significant cost savings and competitive advantage.

**Newmark, a major commercial real estate advisory firm, built a digital core to bring in data from a wide range of systems, providing its customers with a complete and accurate picture of the impact of the pandemic on lease portfolios.**

*"Once Newmark's GCS Tech Team took that step forward with Visual Lease's Integrations Hub functionality to integrate data, it has taken Newmark's data visualization dashboard to the next level."*

**Carla Hinson,**
Executive Managing Director, Global Technology
**Newmark**

## Conclusion

### With added flexibility incorporated within lease terms, there's much more to track and maintain.

If your business isn't tracking its commercial real estate leases, you are likely missing opportunities to negotiate some of the market-competitive terms highlighted in this report.

As we head into 2022, both tenants and landlords can maximize the value of their leases by being more mindful of the other parties' needs and market demands.

Lease optimization software simplifies complex, lengthy lease documents and organizes the information in one centralized location, saving businesses time and money. With this technology, organizations have easy access to important information, like critical dates, contacts and key terms within seconds, instead of spending days manually collecting this information.

**To properly manage and track your lease portfolio, prioritize a solution that provides:**

- **Internal controls and audit trail:** Each action taken within the platform should be tracked with integrated approvals for a reliable, comprehensive audit trail.
- **Configurability:** Enable your company's unique processes and reporting requirements, regardless of asset type or industry.
- **Third-party integrations:** Seamlessly and securely integrate (via API or managed file transfers) with your existing ERP, including general ledger, accounts payable and accounts receivable modules.
- **System security:** Trust that your lease data and financials are held in a secure data center that scales with your business as you grow.
- **Lease accounting (ASC 842, IFRS 16 and GASB 87):** Generate the required journal entries, disclosures and footnotes automatically, and handle every calculation and remeasurement with confidence.

## About The Visual Lease Data Institute:

The Visual Lease Data Institute is a collection of market-leading data, trends and insights on lease accounting, management and optimization created and curated by Visual Lease, provider of the #1 lease optimization software. The Institute was founded on 25 years' experience managing lease data and financials, and was created to arm organizations with the knowledge required to achieve and maintain lease accounting compliance and leverage their leases as strategic business assets.

## Survey Methodology:

The Visual Lease – Tenant Survey for **Commercial Real Estate in 2022: Outlook for an Industry in Recovery** was conducted by Wakefield Research among 200 U.S. Senior Finance and Accounting Professionals, with seniority of Director+, at companies of 1,000+ employees, between October 8th and October 18th, 2021, using an email invitation and an online survey.

The Visual Lease – Landlord Survey for **Commercial Real Estate in 2022: Outlook for an Industry in Recovery** was conducted by Wakefield Research among 200 U.S. Commercial Real Estate Executives - REITs, CRE Developers, CRE Operators and Managers, and CRE Brokers/International Property Consultants - between October 8th and October 18th, 2021, using an email invitation and an online survey.

Results of any sample are subject to sampling variation. The magnitude of the variation is measurable and is affected by the number of interviews and the level of the percentages expressing the results. For the interviews conducted in this study, the chances are 95 in 100 that a survey result does not vary, plus or minus, by more than 6.9 percentage points from the result that would be obtained if interviews had been conducted with all persons in the universe represented by the sample.

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