

# The State of Office Real Estate

Few people know as much about office real estate on a global basis as **John Cushman**. Reached at his Idaho ranch, he shared his opinions on the current situation of different office markets and products—and his prognosis for the future. We began by asking him what he finds most surprising about office real estate today.

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**John Cushman:** We're seeing smaller companies out there buying office buildings—something they could never have done before. Capital is so accessible, and interest rates are so attractive that many more entrepreneurs, family companies, and startups can go look at buildings they would normally have leased, and actually buy them. When you do the net present value analysis of ownership versus leasing, it's more favorable for them to own because they can borrow so much of the purchase price at low interest rates.

It's the opposite with big companies. It's very unusual for them to be out there as an owner. Public ones in particular don't want real estate on their balance sheets. Chevron's purchase of the Enron building in Houston is an exception. Where else could they find a million square-feet in the right location, with the right quality and systems? The cost was low and the building, which was never occupied, was immediately available. So they bought it—but that was an anomaly. Most large companies want to lease, but not for more than 20 years. Longer than that and it's a capital lease—back on the balance sheet.

## **Do you see growth in new office building development in the U.S.?**

**JC:** Not until you see real, sustainable job growth here. It's not robust. The corporate sector's productivity gains and the mobility of their workforce have also reduced the demand for Class A office space. The people who run companies today want the ability to expand or terminate the lease, and to add or drop floors and parking spaces. They're concerned with getting the right floor size and shape, the right core-to-glass dimensions, the right systems and security. They're looking for office

buildings that are cost-effective in terms of operating expenses, not trophy buildings.

**Is mixed-use development a trend in urban markets, or a special case?**

**JC:** It's really a special case, because you need such a large site for this type of project, and they're difficult to find or assemble in most cities without public intervention. No one can argue with the success of mixed-use projects. I'd rather go to one, and live in one, but they're not easy to do well. You've got to have terrific skill sets to make all their different elements work together and at that scale. Very, very few people are great at that.

**An argument for mixed-use is to attract the “creative class.” What do you think of Richard Florida’s theory that creative people can help spur a city’s economic growth?**

**JC:** Florida's theory that the “creative class” can energize urban development has some merit, but in many of the cities he mentions, that energy has built up over many years. They already have a large base of creative people. Cities that are trying to emulate their success by making their downtowns more attractive to that population need to realize that it takes time. Not every city at the top of his list has a vibrant downtown, either. It may be better to focus on improving the quality of life for everyone, not just the creative class.

**Do you see any push for green buildings from the tenant side?**

**JC:** I just had my first meeting ever where a tenant asked if the building should be green. Generally speaking, CEOs and CFOs aren't driven by sustainability, and green buildings aren't on most tenants' radar screens yet, either—but they will be. Right now, it plays a zero factor, not because tenants are irresponsible, but because existing buildings, 15 or 20 years old, make up most of the product we're looking at in U.S. cities. New buildings will be green. Cities like Shanghai have an advantage here. It's like the way they were able to go right to wireless communications because they weren't so invested in the older technology.

**What about security? How will it impact office buildings?**

**JC:** Advanced security is going to be a way of life in gateway cities. It will be part of the base building program, integrated with the design of the lobby and elevator banks, for example, so it's more efficient. New office buildings will have stiffer structural systems, with more concrete than steel cores. Smoke exhaust systems will remove the smoke at faster rates. Fire ratings for construction will increase from two-hour to three-

or four-hour. Life safety systems will have more redundancy. Emergency generators will be located outside the building footprint. Lower levels will have bombproof windows and lobbies, loading docks, and building perimeters will have sophisticated security systems. This isn't just for single-tenant buildings—we're seeing it in multi-tenant situations, too.

**You mentioned Shanghai. Do you see it becoming over-built?**

**JC:** It could be. One of the problems you get in a market like Shanghai is that it's a free-for-all. They're developing some new office buildings that aren't really functional, that won't appeal to multi-national tenants. It's amazing, but you can go there and see a one million square-foot building with no freight elevators. At the same time, Shanghai is really emerging as the capital of East Asia. Vacancy levels of three percent have led prime rents to shoot up to \$35 per square-foot, with every prospect of rising even further. Moscow is very similar. They closed the book in December of 2004 with 38 million square-feet of office space. When they hit 2008, it's expected to be 83 million square-feet.

**John Cushman** is the chairman of Cushman & Wakefield, a trustee of the Urban Land Institute, a director of The Real Estate Roundtable in Washington, DC, and a member of California's Commission on Jobs and Economic Growth.