

Top 10 Western Region Commercial Real Estate Trends in Q4 2021

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The annual [Allen Matkins View From the Top](#) brings together the top real estate economists, owners, investors, developers, and brokers in Western Region commercial real estate. Now in its 14th year, View From the Top remains a key source for up-to-the-minute market information and predictions.

Here are the top takeaways from this year's CRE brain trust:

- 1. Yields Driving CRE Investments Over the Next Year.** Michael Van Konynenburg, President of Eastdil Secured, kicked off this year's event with an excellent summary of the unprecedented bullish economic climate. The U.S. economy is heating up at a fast rate, and due to a doubling of the Federal Reserve balance sheet over the last 18 months and an injection of stimulus capital into the economy equal to 25% of the annual GDP, there is a massive amount of capital in play. Banks and investors are having trouble finding places to invest this capital. At the same time, low interest rates are pushing investors to search for yield and are pushing down cap rates—the longer we have low rates the lower cap rates will go. This bullishness bodes well for commercial real estate, as this “need for yield” should drive investments over the next year.
- 2. A Strong Economic Recovery from COVID-19 Points to a Big Recovery for CRE Markets (At Different Rates).** The U.S. and world economies are coming out of the COVID-19 pandemic with strength. As Owen D. Thomas, CEO of Boston Properties, points out, “strong economic growth coupled with low interest rates creates a great environment for real estate investment evaluation.” As a result, most CRE sectors are trading competitively above pre-pandemic levels, with office being the one exception (except for highly leased first-class office projects in urban areas) for the sole reason that most employees have not yet returned to the office, which should change in the next year. According to Gregg Walker, Senior Managing Director and Head of Business Development at DivcoWest, “many office tenants are still trying to figure out what their office footprint will look like. For the next 24 months, there will be a lot of tenants trying to figure out what that balance will look like for them.”
- 3. Demand for Office Space that Incorporates Collaborative Outdoor Areas Will Skyrocket.** With businesses in a post-COVID-19 world eager to bring back employees to the

office, there is a massive new demand for office layouts to emphasize outdoor space—decks, rooftops, terraces, and plazas will be incorporated into workspaces like never before. Kilroy Realty Corporation's CEO John Kilroy sees workplace environments as moving towards a greater engagement with the outdoors: "with COVID and other things that will come up in the future, more and more meetings will take place outside, whether they're small group collaborations or several hundred-person events." Kilroy has invested heavily in incorporating collaborative outdoor areas into the company's recent office developments and believes strongly that "if I can have my office outside in nature, I can be much more productive. I think that's the model we're all headed towards."

4. **Employees Will Return to the Office in Greater Numbers Than We Think.** Despite the current hesitancy of workers to return to the office, panelists all agreed that a return to office life is inevitable, and a year from now offices will be filling up faster than we anticipate. It will look different, with offices filled to 65- 80% of pre-pandemic levels on any given day. There will be more separation between employees and more collaborative workspaces, but the bottom line is that companies have come to realize the importance and value of having employees collaborate together in an office, and employees themselves will follow suit due to a fear of missing out. Though a hybrid work-from-home model will likely be the future for many companies, research conducted by CBRE indicates that "most companies want their employees to come into the office at least 2.5 days a week, if not more. The smaller the company, the higher the expectation they have that people will come to the office all the time," according to Julie Whelan, Global Head of Occupier Thought Leadership at CBRE.
5. **State-of-the-Art, Reimagined Office Space is Needed to Bring Employees Back to the Office, Causing a "Flight to Quality."** In a post-COVID-19 world, it's clear from panelists' insights that companies will need to re-think their office space in fundamental ways to attract talent and bring their employees back to the office. Aside from an increased emphasis on outdoor space, "a common theme for office tenants today is a flight to quality, safer new spaces, and buildings as their top choice," according to Walker. Whether it's larger lobbies and conference areas, blurring the lines between outdoor and indoor space, or offering a variety of different spaces within the office where employees can work, will help the employer compete for and attract talent, which is vital right now. "What we're moving into is a world where employers will have to make their workspace so much more appealing and productive than being at home that there's no doubt for employees that they will get more done at the office," says A. Robert Paratte, Executive Vice President of Leasing and Business Development at Kilroy Realty Corporation. Van Konyneburg believes that "the product that can't do that will have to be re-imagined to make it special enough to bring workers back to the office and give them a reason for being back at work."
6. **Leasing Transactions are Mixed, Depending on Location and Industry.** The consensus among all the Western region leasing markets panelists was an optimistic outlook across most sectors and regions, though it may take a year or two to get office leasing (other than first-class office space in urban areas) back to pre-pandemic levels. In Seattle, life science construction is currently hitting all-time highs, while big tech companies continue to move forward with large office projects, according to David Abbott, Executive Vice President at Colliers. In the Los Angeles region, technology-driven entertainment companies, dubbed the "techtainment" industry, are extremely hot and driving the leasing market, especially in Culver City, Burbank, and Hollywood, per Jeffrey Welch, Executive Vice President at CBRE. It is taking longer for leasing activity in San Francisco to pick up than in other regions, however, as the city has seen very stringent lockdown rules. Companies and workers are taking longer

to get back to a normal work routine. According to Jonathan Lange, Senior Vice President, Los Angeles Region at Boston Properties, “if you look at the fundamentals of West L.A., Bellevue, Seattle, parts of the Bay Area, and San Diego, there is tremendous leasing coming from a few specific areas of our economy while other areas have slowed down.”

7. **Sublease Space is Still Prevalent, but it is Decreasing.** Vacant subleased space skyrocketed during the pandemic as large tech companies found their massive offices empty and questioned how much they would be using their space moving forward. This uncertainty has led to more clarity for companies who have determined that office culture will still be a vital part of their work environment moving forward, though the time frame is still unclear. As a result, this sublease space is beginning to be taken off the market due to increased demand. Abbott predicts that in the Seattle market “sublease space will decrease in Q4 by way of transactions and landlords taking their space off the market in anticipation of a return to the office.” Lange points out that “when you look at some of these rental rates, pricing and asset values are up—even in some multi-tenant assets—in an environment where everyone is still questioning how much we’ll be using the office moving forward.” It’s safe to say that this trend will continue as the office picture becomes clearer in the coming months.
8. **The Trend of Office-to-Life Science Conversions Will Slow.** Currently, the lack of demand for office space in many regions has spurred a trend of converting office space to life science space, which is red hot right now. When asked about where he sees the market going in the next year, Elliott Trencher, Senior Vice President and Chief Investment Officer at Kilroy Realty Corporation, pointed out that as employees begin to return to the office and office space becomes more in-demand, this life science conversion trend will slow and we will see people gravitate towards traditional office buildings: “As we begin to get closer to a pre-pandemic world with a return to the office, people that are going to life science as a safe haven will begin to reassess the need to make this conversion.”
9. **COVID-19’s Effects on Construction Site Protocol, Material Costs, and Availability Have Impacted Developers, but Not Stopped Them.** Developers reported that it was a large learning curve to adjust to construction site COVID-19 protocols which led to some inefficiencies, but residential projects continued to be built and delivered, albeit a bit behind schedule and over budget (commercial projects were deemed non-essential and were not able to move forward for a period). Supply chain disruption during the pandemic caused delays and price spikes for construction materials, which has increased overhead costs considerably for many projects. Lumber costs saw a huge spike at one point and have since come down to 2018 prices, while overseas delivery of steel has seen a huge delay. Aaron Fenton, Vice President of Development at Boston Properties believes that “we’re still in a transitory inflation period that’s affecting commodity prices and there’s a backlog of orders that are still getting filled due to factories being shut down last year. It will probably take six to nine months for that backlog to get churned through before prices start to settle.”
10. **There is Still Much Uncertainty as to how COVID-19 Applies to Force Majeure Clauses in Construction Contracts.** Owners and contractors will be reconsidering the specific force majeure language, and allocation of force majeure risks, in construction contracts going forward. According to Matt Field, President at TMG Partners, “the contract language we’re going to get now is going to contemplate these things and there will be a new negotiation around delays that come from these kinds of events.” These negotiations could cause issues with lenders, who may have issues with the increased costs that could result from these negotiations.

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