At Your Service: How Accelerating Demand Patterns are Giving Rise to Real Estate as a Service (REaaS)

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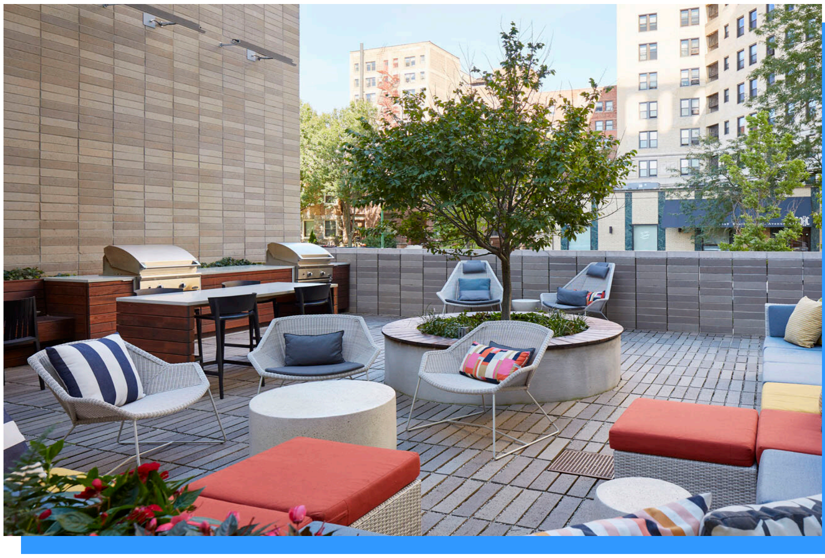
Executive Summary

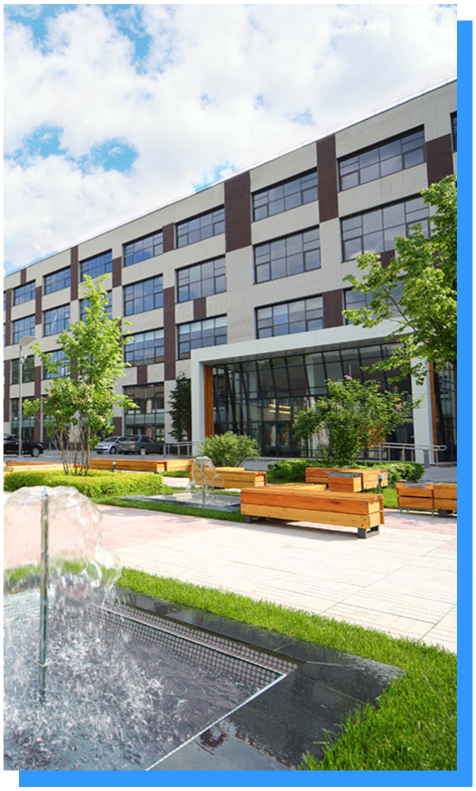
Demand patterns that existed pre-COVID, including evolving housing preferences, growing ecommerce activity and the acceptance of remote work environments, have been accelerated by the pandemic. These shifts are rapidly changing our "sense of place" and altering the value proposition for the real estate that hosts our daily activities. Properties are no longer just buildings to be leased at favorable prices; landlords must now deliver ancillary features, services and amenities that the modern tenant requires. In this paper, we discuss these changing demand patterns, the rise of Real Estate as a Service (REaaS), and how investors in value-added properties can best leverage this unique opportunity across sectors.

Introduction

Over the last decade, the rise of Real Estate as a Service (REaaS) has impacted all property sectors as tenants have come to expect more amenities alongside the physical spaces that they lease. While this shift is not new, it was accelerated by the COVID-19 pandemic as the way we utilized space changed quickly and meaningfully. The critical importance of "home," the need for the efficient and timely procurement of purchases, and the evolving remote work experiment will have short- and long-term implications for the real estate value proposition. Now, as the world begins to embark upon a new normal, populations are determining which behaviors they wish to retain – and which to abandon. While the ultimate outcomes remain uncertain, it is clear many changes related to how we use real estate will be permanent.

In response, landlords are now in the position to do more than serve as space providers and rent collectors; they must also be solution providers, delivering value in a different manner. This enhanced functionality will be offered in a variety of ways, including the application of REaaS business models and technology-based or PropTech offerings. Similar to the software industry dynamic whereby providers began offering subscription-based services alongside the product, real estate owners are now seeking ways to create value for the end user by increasing the functionality and flexibility of the physical space. As the tenant acquisition and retention process becomes increasingly competitive, it will require responsive and dynamic asset management to provide benefits that satisfy the needs of emerging and evolving consumer demand. A review of three specific property sectors sheds light on what will be required to keep pace with this budding transformation.





Residential: Creating a Home Field Advantage

Within the residential sector, changing demographics are driving new demand patterns in a significant way. A U.S. Census Bureau estimate indicates that over the coming decade, the balance of the adult population will dramatically shift from those aged 20-29 to those in their 30s and 40s. As this millennial generation ages and their families continue to grow, they will require more space to live, and increasingly to work, educate, exercise and play. Yet, the cost of home ownership continues to be a barrier with skyrocketing housing prices, particularly in coastal cities.

In response, populations are not only migrating from dense, costly urban areas to the less expensive suburbs and the Sunbelt, but they are also choosing to rent versus buy in these markets. The COVID-19 pandemic accelerated this migration for many, creating significant demand for properties that are specifically designed to win over this growing pool of tenants.

As real estate investors are taking note of the growing checklist of features these millennial families are seeking, several common themes are emerging. First, there is a quest for community among residents, particularly as they spend an increasing share of their time at home thanks to hybrid work models. Tenants are pursuing safe and healthy spaces to gather with others, both indoors and outdoors. These areas run the gamut in terms of purpose from promoting fitness and activity for themselves, their children and their pets to social opportunities to co-working options outside of individual units. The most desirable properties will meet these needs with gyms and fitness classes, outdoor eating options and shared grills, dog runs, conference rooms and workspaces, as well as clubhouses for both property-sponsored and private gatherings.

Alongside community, residents increasingly value privacy and security. Amenities that offer both are among the most popular with renters today, and many would pay a premium for these features. Security systems and doorbell cameras provide peace of mind around individual units while property-wide cameras and emergency systems create a sense of safety more broadly for residents and their guests. Smart locks allow tenants to control who can access their residence, an important consideration for residents who wish to allow maintenance or cleaning services to enter their unit when they are not home. Many properties are also providing the convenience of package lockers and app-based technology to receive and send shipments safely and reliably.

The millennial generation is also more focused on environmental issues and is seeking properties that support long term sustainability. These features include recycling programs, composting opportunities, and electric car charging stations, which help reduce the tenant carbon footprint. Opportunities to save energy and water in units are also very well received and benefit both the tenant and the landlords who can decrease costs longer term while making a positive environmental impact.

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Perhaps most important, next generation tenants are extremely tech-savvy and are demanding features that allow them to access the latest amenities online. Here the application of PropTech is critical for landlords to enable the efficient delivery of services. Shared spaces are scheduled, concierge services are procured, utilities are controlled, rent is collected, property tours are provided, and maintenance is arranged -- all digitally. This application of technology has become the norm and is considered fundamental for newer properties. Landlords without these features are finding themselves at a disadvantage to those who can offer them.

For real estate investors who understand these demand drivers, the options to remain competitive are fairly straightforward but vary in terms of risk. Some are electing to renovate and apply technology to existing multifamily properties through traditional value-added business plans and rental increases over time. Tenants are willing to absorb these rent hikes to a certain point, but investors must ensure they don't price themselves out of the market. Additionally, the number of existing properties that are optimally located and possess the core physical features that appeal to a broad base of tenants are limited. Investors seeking to acquire and renovate these coveted assets could be met with increased competition from others doing the same for the foreseeable future.

In response to lower supply and heightened demand, many investors – both public and private -- have begun developing brand new communities from the ground up to include the most important services and features from day one. This new development is particularly prevalent in the Sunbelt region of the U.S. and primarily in the suburban neighborhoods that millennials are coveting. Properties can take the form of contiguous townhomes, horizontal apartments or even detached single family homes, but are typically community-centric with centralized leasing and property management. These assets are designed and built with community, security, sustainability and technology top of mind. Private investors have the option to participate at various stages of development, based on risk preferences. Increasingly, more investors are choosing to come in earlier, at the development or certificate of occupancy stage. While this poses more risk and has a longer runway to stabilization, it allows for entry at a more attractive basis.

Regardless of the approach, the more successful residential properties of the future will have amenities, services and perhaps even brand recognition that more closely resemble what is offered by the hospitality industry. While these features require upfront investment, they are also poised to improve retention, provide pricing power and deliver cost savings to real estate owners who can reduce onsite headcount and enjoy efficiencies and economies of scale by utilizing them. It is a win-win for both conscientious landlords and their modern residents who expect more from where they live.

Industrial: Expanding Priorities and Stakeholders

While ecommerce has grown steadily due to a host of externalities over the last decade, the pandemic quickened this shift, as it pushed the population to consider online shopping as the primary means to acquire an expanded array of goods in a safe manner. Consumers driven by health concerns soon appreciated the convenience of the ecommerce channel and many have permanently adopted new buying behaviors. As brands have begun to embark on their expanded ecommerce strategies, they are being met with a supply chain struggling to catch up with a challenging list of consumer demands, including the expectation for timely and seamless delivery of their purchases. According to a Q1 2021 survey by Convey, a delivery management company, nearly half of respondents would be unlikely to use an online retailer again if they had a bad experience in shipping or delivery. This new reality increases the pressure on companies to ensure their logistics operations can handle the requirements of the modern ecommerce model.

One of the most critical components of a successful omnichannel supply chain strategy is the effective use of industrial real estate. Today, these warehouse properties must not only be storage spaces, but they must now contribute to the efficient execution of a business model that must integrate a sophisticated logistics operation into the traditional hub and spoke system. Tenants of industrial spaces – online behemoths like Amazon, national third-party logistics companies, and increasingly fresh food grocers – must be strategically located near the customers they serve and be positioned to optimize the entire transportation operation to keep up with growing expectations for guaranteed delivery. In order to do so, their properties must also meet a new list of requirements.

Time is money for these companies. Transportation represents the largest component of supply chain costs, accounting for 45-55% (Prologis 2019). It is here that real estate owners must consider new value-added ways in which they can empower tenants to be as efficient as possible, and in turn, be able to serve their stakeholders who include not only customers but also employees and communities in which their warehouses reside. A property that can optimize transportation costs and do well by its workers while contributing to the sustainability of the environment is the ultimate objective for more and more brands.

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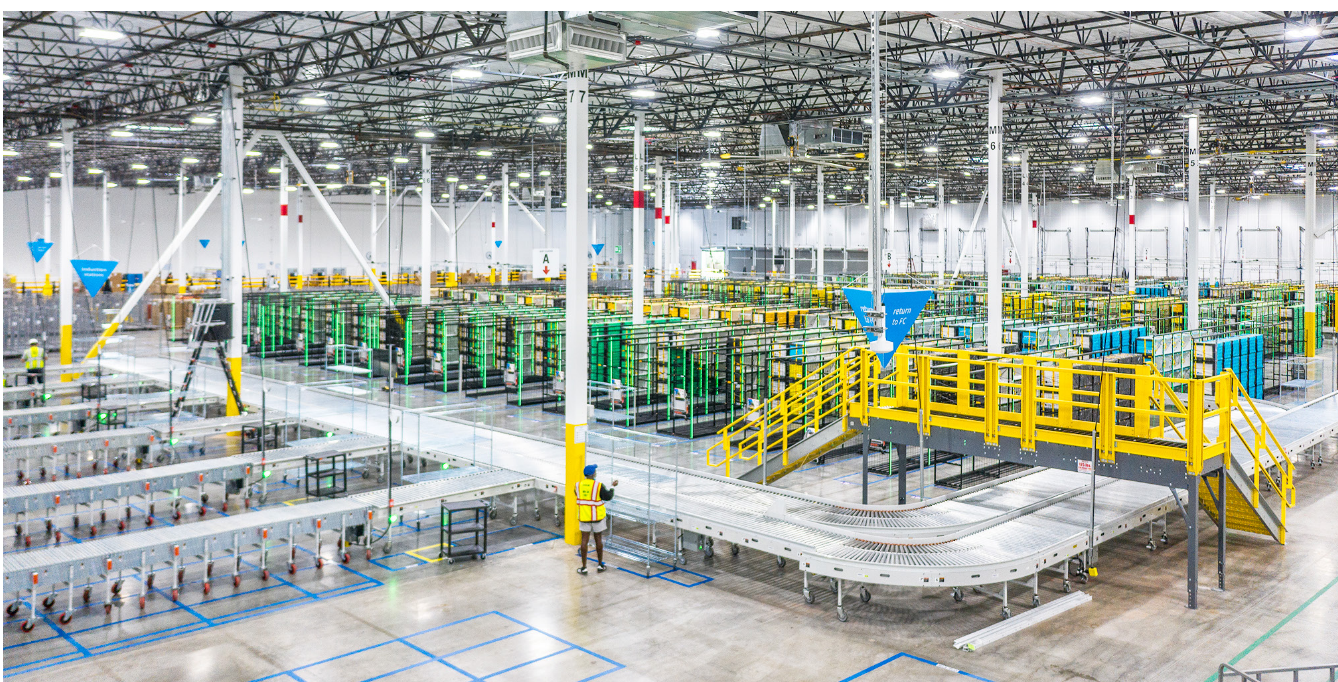
Efficiency has always been the name of the game for industrial properties and this necessity is only becoming more critical as the omnichannel supply chain grows and broadens. Property configurations which allow trucks to freely move in and out of loading docks have always been a prerequisite of any industrial space. Now new types of tenants – such as companies that transport perishable items -- have even greater operational and technological needs. Temperature controlled warehouses require specific features that can address various requirements - from cold docks for loading to multi-functional cooling systems - all while being more cost efficient and environmentally friendly.

During the pandemic, the country relied on logistics workers to ensure their deliveries arrived on time. With this reliance came a long overdue reckoning that these essential workers are deserving of amenities that their white-collar brethren have enjoyed for some time. In order to attract and retain employees, industrial properties are assigning investment dollars to affect better working conditions. This investment includes healthier spaces with optimal air filtration and more natural light. It also considers square footage dedicated to employees in the form of onsite fitness, eating areas, and outdoor break spaces. Facilities also need ample and convenient employee parking, often that is located away from the main warehouse to avoid any interference from personal vehicles in daily operations. For infill locations, shuttle services to and from public transportation better enable employees to commute to work more efficiently. With the demand for logistics workers projected to increase significantly over the next decade, properties that can increase the quality of work life will be a competitive advantage for tenants seeking to attract and retain these important employees.

Tenants of industrial properties – like all tenants -- are also thinking hard about the environment and moving towards a carbon neutral supply chain. For investors, this reality translates into increased use of renewable energy sources, especially solar, and the application of energy efficient features including lighting and water saving technologies. It also impacts location decisions as transportation is one of the largest contributors to carbon emissions. Properties that are positioned within “the last mile” near the end customer not only save time and money, but also contribute to a more environmentally friendly approach. The opportunity to add value, therefore, comes by repositioning existing assets into new modern warehouses -- or developing those properties from the ground up -- in infill areas. The corresponding challenge is that many existing warehouses within well-populated urban areas are outdated and cannot handle the volume required by the rise in ecommerce, especially after the spike caused by the pandemic. However, by investing capital to modernize these properties to meet new demand, value-added real estate investors can create the best possible combination of efficiency and location and be rewarded with an attractive return on investment.



Modern Office: Flexing for Employers

When assessing the impact of the pandemic, the disruption of the modern office has created the most uncertainty in terms of the lasting effects on the sector. In 2020, the office as we knew it shut down, and the great remote work experiment began. The experience demonstrated that most employees are productive in environments outside the traditional office. Additionally, many workers enjoyed the flexibility that work-from-anywhere offers, leaving employers with a dilemma of how best to attract a new generation of remote and in-person talent, while managing their office footprint.

We believe the answer for many companies will lie in embracing a model that promotes flexibility for the employee and employer alike. A mandated fulltime return to the office could hurt a company's ability to attract talent while a full shift to remote work could do damage to company culture, collaboration, innovation and forsake important training opportunities that come naturally with a face-to-face environment. To address these competing realities, the hybrid work model is likely to be adopted by many organizations. While the rise of the Delta variant has prolonged uncertainty, we expect that any reduction in square footage requirements for certain organizations in the short term will be offset by continued economic growth and the formation of new companies in the long run. We are confident that tenants will return to the office in some form and, in doing so, will demand a higher level of quality from the space that is leased. If employers are going to ask their teams to return to a central location – even part time – it will be important that their workspace is safe, appealing and productive.

Here, REaaS will play a key role in a successful future for employers and landlords alike. When considering how to meet these emerging needs, real estate investors can look to implement value-added improvements which have long been offered by co-working facilities as well as new features that have become more important over the last year of the pandemic. These services include onsite cafeterias and contracts with food trucks to provide workers with appealing options while reducing the need to travel for food breaks, a feature particularly important in suburban office locations that may lack a variety of walkable amenities. Aesthetically pleasing communal areas with large screen TVs and outdoor recreational options give workers a place to enjoy down time without leaving campus as well. Concierge services that reduce the need to run errands will also be well received, offering employees time-saving personal services that make an office day more productive all around. Lastly, with health and wellness being more critical, buildings with dedicated spaces to exercise, meditate, and rest will differentiate offices of choice.

Value-added real estate owners will need to consider upgrading office infrastructure as well when developing business plans. It should go without saying that buildings will need an advanced technological framework to allow for robust high-speed video conferencing and connectivity between onsite and remote workers. Energy efficiency upgrades like

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motion-sensor lighting alongside smartly designed spaces that let in plenty of natural light not only benefit the environment but also lower operating costs for the tenant. Water conservation and drought-tolerant landscaping make a location more sustainable, a feature that more and more workers are seeking. Lastly, spaces will need to be healthy, requiring state-of-the-art air filtration, contactless entry and regular deep cleaning. Delivering such amenities that cater to an increasingly discerning workforce will support an organization’s quest for the best talent, regardless of the size of the space or the number of people who inhabit it.

Not every office building will be able to be upgraded to meet this new demand. We are seeing a clear bifurcation of properties as it relates to identifying opportunities for value-added investment. Newer buildings are emerging as winners as structures that have been built in the last 10-15 years are far more easily retrofitted. Older office buildings which are unable to be updated or modified will continue to lose relative value as they cannot offer the key features required by modern tenants. As many investors paint the office sector with a broad brush, we believe there is value in acquiring and upgrading newer structures that have yet to be recognized for their underlying attractiveness, while avoiding commodity buildings that can only attract tenants with a low-cost offering.

Conclusion

The value proposition for commercial real estate has begun a significant transformation, expanding beyond the physical structure to include services and amenities that have become more meaningful and important to tenants. This change didn’t occur overnight; however, the COVID-19 crisis accelerated many demand patterns already underway as populations responded quickly to externalities out of their control. Now, as uncertainty subsides and behaviors adopted during the pandemic are becoming permanent, consumers of real estate will be looking for better experiences, greater efficiencies, and improved sustainability alongside the structures that they lease. As these populations evolve, so too must real estate investors. By embracing the REaaS business model, landlords across property types will be positioned to provide a broader set of benefits that deliver on the promise of a new -- and better -- normal for all.

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