Design

Sleeping giants and aging assets are everywhere

"Sleeping giants" are not fairy tale creatures or historic architectural icons like the Empire State building in New York City or the Wells Fargo Building in Denver. Sleeping giants in corporate real estate are the vast stock of older, more prosaic buildings dominating our skylines. Sleeping giants are valuable building assets that struggle to compete as cities change around them and new buildings enter their markets, luring away prime tenants.

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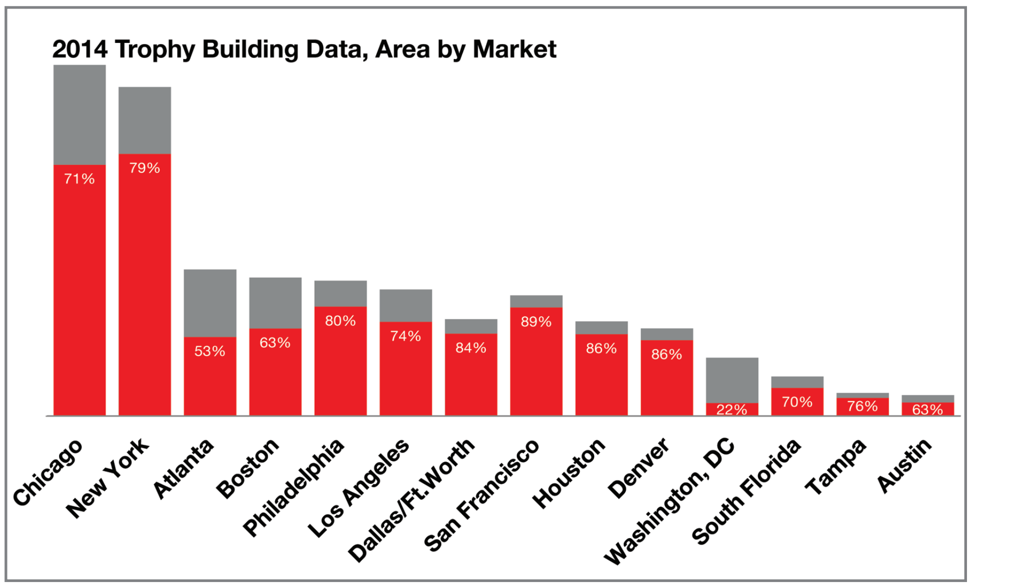
What these buildings have in common, given their age, is that they were built before a large number of form-giving developments in building technology were introduced. Before, for example: Ethernet was standardized in 1983; cellular telephones were introduced in 1984; the Internet backbone was created in 1992; the U.S. Green Building Council was established and underfloor air systems were incorporated into signature projects in 1993; and building automation systems emerged around 2000.

These buildings were planned and designed for a traditional idea of the corporate office environment, well before Richard Florida chronicled the rise of the creative class of workers in 2002 and pop culture lambasted the drudgery of high-walled cubicle environments in movies like "Office Space" and "The Incredibles," not to mention the ubiquitous Dilbert comic strip from the mid-1990s.

These buildings have very little of the amenity infrastructure to help them compete with the redefined workspace led by creative 21st century firms like Google, which went public in 2004. That same year, Google's free-spirited approach to workspace was widely published and won numerous design awards.

To illustrate the scale of aging asset inventory across the country, we analyzed building data across 14 key U.S. corporate real estate markets. We built our analysis from JLL's Spring 2014 US Skyline Review. The buildings represent the top-quality urbanized office micromarkets in each city. We graphed today's buildings by year completed since 1950 to show that the vast majority of our current multitenant office buildings were in place by 1990, which was 25 years ago. This building landscape is familiar to us, we can see it down many streets in Denver, and this is the opportunity to reposition assets facing our industry.



Seventy percent or more of the 2014 trophy-building stock in 10 of the 14 markets was in place by 1989.

While new office tower construction is exciting, the bigger and more enduring story lies in understanding how the buildings in the background must reposition themselves to remain relevant. The bottom line is that aging assets become candidates for repositioning when there is evidence that investment will result in higher occupancy, increased rental rates and a positive return on the investment.

Asset Considerations

Key considerations for asset owners contemplating repositioning their aged assets are the current and desired market position of the space, timing, potential revenue and approach.

Market position in corporate real estate is often described by class. In Denver, there is a large inventory of Class A buildings, with a small subset identified as Class AA. When an owner believes an asset has potential to perform like a Class A or AA property, but knows that the asset is widely considered a Class B building by the local market, improving that market perception of the building can be a primary driver of a repositioning investment.

Timing is a crucial factor. First, consider the duration the property will be held and resulting window for improved returns to materialize. Some repositioning investments will impact revenues more quickly than others. Second, when new buildings are coming on line that may compete for desirable tenants, strategic repositioning projects can take advantage of relatively short delivery cycles and beat a ground-up construction project to market. Finally, a major vacancy can trigger repositioning, offering both incentive to improve leaseability and simplified construction.

Revenue concerns often trigger repositioning. To justify the investment, asset owners must believe that material increases in rental rates can be achieved and the building will be leased more quickly. Alternatively, doing nothing may risk a reduction in rental rates over time, and increased difficulty leasing up vacant space. Yet revenue forecasting models are limited. Predicted return on any investment is based upon best-guess assumptions and may change as unanticipated factors impact market conditions.

Key to effective repositioning is to take a fresh look at the property. Asset insiders may find it difficult to imagine all the viable possibilities. A design competition can be a great tool to solicit ideas before finalizing the project scope and selecting a design team. Offering payment helps to ensure that design firms will dedicate their best resources, and setting up the competition brief with minimal guidance from the owner can free designers to generate unexpected visions for the project.

Releasing Value

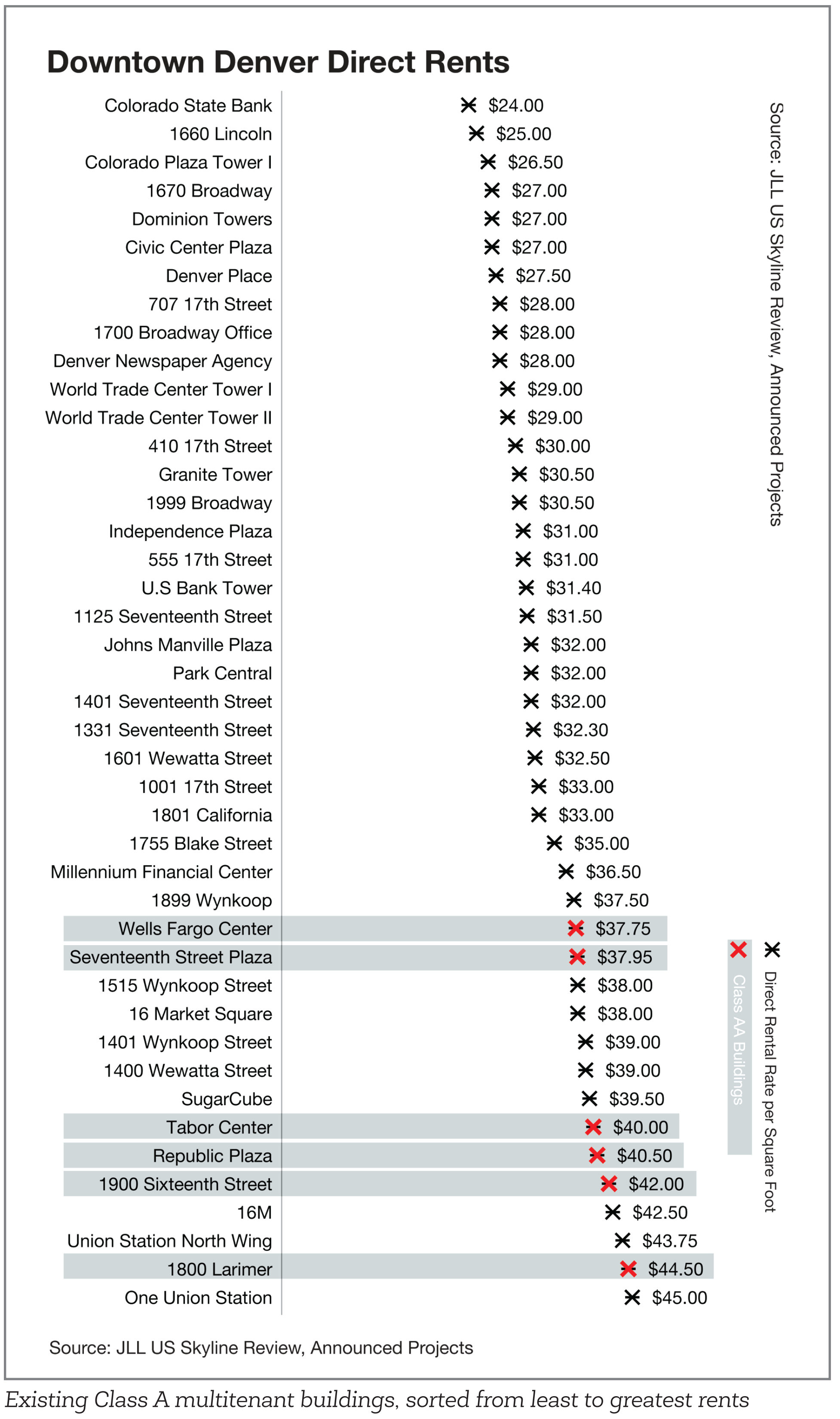
Through experience across numerous repositioning projects, we have identified 10 key approaches to pinpoint and unlock trapped asset value.

1. Ask local experts – People most familiar with the building are a great resource for ideas and possibilities. Beyond the owners, leasing agents, property managers and facilities team, we find it beneficial to reach out to people in the market such as brokers and tenants who interact with the property from the outside and offer a broader view of prospective tenant perception and market demand.

2. Quantify anecdotal trends – Follow up on informal conversations by quantifying relevant trends in your market. One approach is to compare development activity on a timeline to highlight relationships and illustrate dynamics unique to your market. Tracking the changes in downtown Denver over time highlights the role of residential development. Hotel room availability has grown dramatically over the last decade, but the number of residential units downtown has been growing steadily since the early 1990s. While almost half the inventory of multitenant office space in Denver was built by 1985, unlike many cities that are only now seeing growth from that base, the Denver market has steadily added office properties since 2005.

3. Investigate market dynamics – Competitive data is available from numerous sources and can be used to understand what the key competitive drivers are in a particular market and identify assets that may be poised for repositioning. Plotting the trophy buildings in downtown Denver on a graph sorted by direct rents shows a fairly large spread in Class A rents across the market (from about $24-$45 per sf). Surprisingly, the properties identified as Class AA do not command the highest rents in the market.

This observation invites a closer look at market competitiveness. A quick re-sort to separate the buildings by location within downtown adds clarity. Grouped first by location, then sorted by rent, the Class AA buildings rise to the top in the core commercial area group. While buildings are much larger and the scale of building inventory is far greater in the core commercial area, the average direct rent for the Lower Downtown/Central Platte Valley buildings (about $38) is greater than



Existing Class A multitenant buildings, sorted from least to greatest rents

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that commanded by 83 percent of the space in the core commercial area. This suggests that there is upside tolerance in the market if sleeping giants in the core commercial area can successfully reposition themselves.

4. Understand location and context – Aging assets sit in dynamic urban environments. Changes to the urban context over the life of an asset often provide new sources of value. Many cities have introduced or extended transit pathways through developed areas such as Denver did with the 16th Street Mall. Assets that are close to new transit may realize value from rethinking their connection to the street and pedestrian access.

Similarly, when major destination buildings have been inserted into existing urban fabric near an aged asset, owners can capitalize on the activated street environment with improved or incremental ground-level retail. Like Denver, many cities are actively improving their connection to natural features like rivers, lakes and even bayous. Older buildings with proximity to these features may realize value by opening up views or access to the new attraction.

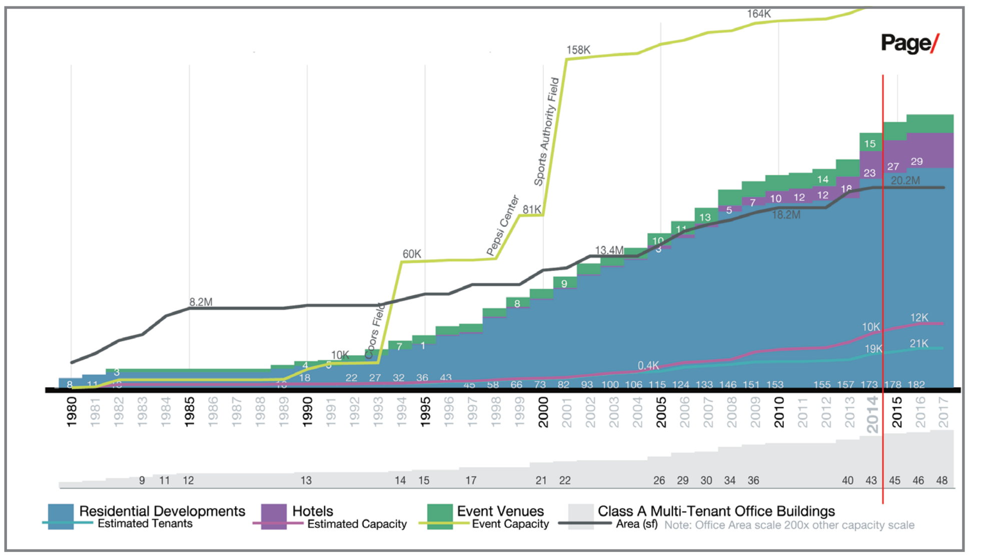
5. Deconstruct asset performance – Often some parts of an asset perform consistently better than others. Three-dimensional visualization tools can help to understand patterns in persistent vacancies. Identifying space that underperforms in its current configuration or program suggests opportunities to unlock value by repurposing the space. Incorporate market differentiating tenant amenities or reset as a multipurpose asset, introducing residential or large impact retail.

6. Engage immediate partners – Aging assets can increase the reach and impact of repositioning investment by proactively coordinating with surrounding initiatives. Local streetscape improvements can be leveraged to add value, and urban revitalization efforts that target public space can dramatically increase nontenant traffic around a building while simultaneously making the location more attractive for tenants.

7. Establish the foreground – Key to taking advantage of the urban context is attention to how the asset meets the street. By activating plaza space, an asset can achieve improved recognition and prominence as a place and destination within the city. Careful attention to the public realm has made major urban destinations out of the foreground of many corporate office buildings nationwide.

8. Optimize brand identity – While the physical foreground of an asset can shape experience of the place and increase relative value in a market, many buildings also establish a brand identity through name identification with a particular neighborhood or address. In the 14 markets studied, 55 percent of the trophy buildings are identified by their address on a specific street. Including place names, 70 percent of trophy buildings are branded by their notable urban location.

9. Choreograph tenant experience – Additional asset value can be unlocked by focusing on the details of tenant experience. While the street-facing grand lobby appearance matters, the tenant pathway from parking or transit, often through a secondary entry and up into lease space, impacts how it feels to work in the property. Also consider the potential views from tenant space. Accessible roof decks and balconies can offer dramatic perspectives onto the urban scene, and even inaccessible spaces can be fine tuned to improve the view tenants have onto them.



Downtown Denver development since 1980 and projected

10. Tailor design solution – Material and product selection is shaped by a specific point in time. Key to tailoring the design solution for an effective repositioning are to recognize the time or timelessness of materials, consider how enduring a specific trend or approach will prove, and determine how much intervention is required to achieve a substantive difference in asset perception.

Scale of Opportunity

Specific repositioning strategies vary by building and market, but we calculate that the opportunity is enormous. While Chicago and New York represent almost 40 percent of the national trophy building stock, 70 percent or more of the trophy buildings across 10 of the 14 markets we studied are at least 25 years old. The opportunity to unlock value through strategic repositioning is local and national. Put another way, 66 percent of buildings representing 73 percent of rentable area across major U.S. markets fall in this category.

If older assets are repositioned to their respective current market mean lease rates, an additional $330 million in annual rent could be garnered. In Denver, the 23 buildings in the commercial core designated as Class A have a weighted average direct rent in the $29-$30 per sf range. If each of those buildings repositioned to improve their lease rate just to the overall market average (about $33), the annual rental increase could be more than $40 million.

The newly constructed trophy buildings are wired with Wi-Fi and broadband, power dense, sustainable, efficient, VOC-free, daylight penetrated, flexible, amenity rich and work-life supporting. The question aging-asset owners have to ask themselves is: How will I unlock the trapped value in my asset and remain competitive?▲