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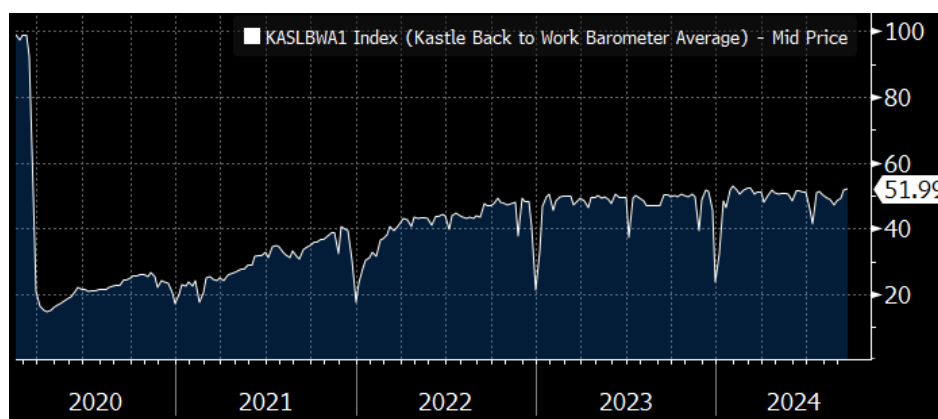
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PLRA Daily REIT Note September 24th, 2024 Return-to-Office Check-In

This will be my last thematic note of the quarter. I actually drafted it last week as a more direct response to Amazon’s five-day requirement, but that case study method has outlived its usefulness. We’ve all learned by now not to take these “policies” at face value, and the cycle of backlash and backtracking has gotten repetitive. So I’m starting over with a top-down framing, and then we’ll see how Amazon (and others) fit in.

If we look through the meme stock trading dynamics in REITs, I’d say there’s a rough RTO consensus among well-informed investors, or at least a shared baseline scenario. I’ll begin by sketching that out, so we can focus on what’s incremental.

To start with — attendance may grind a bit higher, but we’re likely approaching an asymptote:



For more on that card-swipe data, see [this May note](#) [p4-6]. But long story short, it’s still higher midweek, and hotdesking hasn’t been too bad so far. In other words, most tenants have resigned themselves to a significant step up in space per person-hour of usage, which is probably now a more useful way to think about it than “space per head.”

Many large tenants still have too much space for this new equilibrium, but they’re not trimming it all at once. Smaller tenants have had less of an attendance problem, and may be a bit underweighted by card swipes. Lender gridlock and other extend-and-pretend incentive structures are keeping a lot of space off the market, and that’s also playing out slowly. Even more so with resi/hotel conversions, given additional red tape.

Finally, there’s also still quite a bit of variance across tenant segments, markets and submarkets. Third-party data is noisier at this level, and it can be even harder to generalize across REIT and non-REIT exposure. But certainly NYC has been a positive outlier from our end, and tech-heavy West Coast markets have been a negative outlier.

Fair enough? So the devil's in the details, and these are three of the important details where I've been the most non-consensus:

1. At the tenant level, our best indicator of future attendance and space needs is (a) current senior-level attendance (b) in the same office as their direct reports. In other words, even if you can force junior employees back without their bosses, **it won't stick**.
2. Long-term attendance will be more driven by location/commute time than current leasing preferences would suggest, and less by amenities or new construction.
3. The cost of living is a much greater practical constraint vs. pre-Covid. This is the wonkiest of the three points to apply, but often the most important. If you can't afford to hire in the commute radius of your pre-Covid office footprint, you're not bringing everyone back there.

None of these arguments are inherently anti-RTO, and we could rephrase each of them in a more neutral way.¹ But if they sound adverse to REITs, or to other institutional owners with a similar "quality" bias... that's mostly because they add up to even more dysfunction at the *largest* corporate occupiers, which would put some of those portfolios a bit offside. As I put it last year:

If you set aside the lazy value judgments about clueless CEOs and entitled workers, **this is really a story about organizational dysfunction**. And when we point to higher RTO rates in other countries as a forward indicator for the US, that's just as lazy. We should be reversing the question — why is the US lagging? — [and] without an answer, **we should assume more creative destruction and new small tenants, not a large tenant comeback**.

This is an investable assumption across all kinds of office exposure, not just REIT stock-picking. If you think I'm wrong about it, there's probably some alpha there too. So let's tackle this large-tenant dysfunction head on, and see how it goes deeper than just remote work.

The first point about Amazon's five-day requirement is that it's offset by more layoffs, much like their three-day rule (and similar Big Tech patterns) in May 2023. From last week's announcement:

...we're asking each s-team organization to increase the ratio of individual contributors to managers by at least 15% by the end of Q1 2025. Having fewer managers will remove layers and flatten organizations...

If you needed a further reminder of that "white collar recession" overlay, they announced another pay *raise* for delivery drivers at almost the same time. But in terms of office headcount, that's very tortured phrasing above — even by the awkward standards of layoff announcements — and not at all the same as the "15% of managers" being reported.

Which is not to say it's better or worse. It may give you some idea of the distribution across their footprint (see [here](#) for the "S-team") and in general, Big Tech may be ready to cut deeper into HQ locations than in prior rounds. But Amazon in particular has always been cagey about layoffs; I'm not sure they've even really stopped since 2023. So I'd take that reporting with a grain of salt.

¹ For example, #1 just says not to reason from the broader job market, because "leverage" at the top matters more. So if a company is willing and able to force their senior employees back to pre-Covid attendance patterns, I'm saying that would trickle down to everyone, *even if* the entry- and mid-level job markets are tighter.

The RTO section is a little more clear:

If anything, the last 15 months we've been back in the office at least three days a week has strengthened our conviction about the benefits.

Before the pandemic, not everybody was in the office five days a week, every week. If you or your child were sick, if you had some sort of house emergency, if you were on the road seeing customers or partners, if you needed a day or two to finish coding in a more isolated environment, people worked remotely. This was understood, and will be moving forward as well. But, before the pandemic, it was not a given that folks could work remotely two days a week, and that will also be true moving forward—our expectation is that people will be in the office outside of extenuating circumstances (like the ones mentioned above) or if you already have a Remote Work Exception approved through your s-team leader.

Especially this part:

We are also going to bring back assigned desk arrangements in locations that were previously organized that way, including the US headquarters locations (Puget Sound and Arlington). For locations that had agile desk arrangements before the pandemic, including much of Europe, we will continue to operate that way...

And if you see it as partly a deliberate cull, the timing fits with that end-of-Q1 deadline for layoffs:

To help ensure a smooth transition, we're going to make this new expectation active on January 2, 2025...

But remember, the open-ended back door ("if you already have a remote work exception") is a critical element of every corporate RTO policy, whether it's spelled out or not. Everyone has key employees they won't force back — or in any event, not back to the same office.

It's part of the standard discourse to frame every high-profile RTO requirement as a stealth layoff, and debate the actual and intended selection effects. Are they filtering out the lazy remote workers, or the best ones? Are they really solving for comp, tenure, age, gender, parenthood, visa status...

There's never a simple answer, but just note that this discussion rarely extends to my three points above. Particularly not the first one, about the tension between bringing everyone "back" and bringing functional teams back together.

You can see how it's not in anyone's interest to dwell on these points, even from the employee side. But it's also easy to see how they'll compound over time, and work together to erode these mandates. Or let's put it this way: if you believe the value of in-person collaboration is high enough to overcome that reversion to remote work and tiny satellite offices, then you're also predicting a lot more transfers and turnover.

Anyway, it's worth reading this **whole thing**, because I can't fully capture how odd and tone-deaf it sounds. Again, all layoff announcements sound awkward... but this is like a podcast interview:

When I think about my time at Amazon, I never imagined I'd be at the company for 27 years. My plan (which my wife and I agreed to on a bar napkin in 1997) was to be here a few years and move back to NYC...

Or take Eric Schmidt's anti-remote work comments that were all over the news last month. Someone sent me this whole video when Stanford took it down, and it's also somewhat stranger

than the headlines or clips make it sound. If I had to guess why it was controversial, I would not have picked this banal RTO answer:

Q: [Google] has lost the initiative to OpenAI, [and] even Anthropic... I asked Sundar [Pichai] about this, he didn't give me a very sharp answer. Maybe you have a sharper objective explanation for what's going on there?

A: I'm no longer a Google employee, in the spirit of full disclosure. Google decided that work/life balance, and going home early, and working from home, was more important than winning. And **the reason startups work is that people work like hell.** I'm sorry to be so blunt. But the fact of the matter is, **if you all leave university and go found a company, you're not going to let people work from home, and only come in one day a week...**

It's a funny thing to say to a class of Stanford undergrads, half of whom are probably already involved in a remote-only startup. But it's also clear that being in the office is not the main thing Schmidt cares about:

Q: In the early days of Google, Microsoft was like that.

A: Exactly. There's a long history, in our industry, of companies winning in a genuinely creative way, and really dominating a space, and not making the next transition...

As with Amazon ("the world's largest startup") his main concern is large corporate dysfunction. Which is not exactly a new or contrarian view, especially in the tech sector:

The founders need to be in charge. The founders are difficult to work with. They push people hard. As much as we can dislike Elon's personal behavior, look at what he gets out of people. I had dinner with him [in] Montana, he was flying that night at 10 PM to have a meeting at midnight with xAI...

Often it's rooted in disdain for other large companies, or American companies in general:

I was in Taiwan; different country, different culture. And they said — this is TSMC, who I'm very impressed with — they have a rule that the starting PhDs [have to] work in the factory, on the basement floor. Now, can you imagine getting American physicists to do that? Highly unlikely. Different work ethic...

And **in most businesses, time doesn't matter that much...** the fight between Coke and Pepsi will continue to go on, it's all glacial. When I dealt with telcos, the typical telco deal would take 18 months to sign. There's no reason to take 18 months to do anything. Get it done.

So for any landlords who assume their interests are aligned with all this tough talk on remote work from large corporate CEOs, or ex-CEOs... well, to begin with, they're not all saying the same thing. But more to the point: would you rather have Musk's companies as tenants, or Coke and Pepsi and "sleepy" 2003 Microsoft?

Now we're getting to the heart of this tenant size question. There are times when growth, scale and credit go together, and Big Tech in the last cycle was a great example. Those are good times to be an elephant hunter in the office business. But in this cycle...

Look, suppose the government doesn't break up Amazon or Google, and their AI bets work out (whatever that even means) and they stay on top in economic terms. That would still have more to do with capital projects like data centers, or labor in other non-office settings. It would probably still involve more rearrangement and dispersion of their current office headcount, and maybe that's

a continued tailwind for lower-cost metros. But there's no realistic scenario where they return to their prior pace of hiring or M&A.

That doesn't map perfectly to every non-tech sector, and in others it may have more to do with the election and the regulatory environment. But it generalizes pretty well, and it's an even higher-level way to make my point about tenant size. Even if you don't expect any reversal of concentration in the US economy, it's reasonable to expect less concentration of office-using headcount, and (all else being equal) a long-term headwind for large tenant oriented assets and portfolios.

Of course, it's somewhat better for landlords if it happens via creative destruction at the firm level, and changes in market share — rather than even higher revenue per desk at today's giants, and lower-paid jobs elsewhere. But “occupancy cost” is not really our main concern in the office sector. It's more about this sorting process, and how desk workers will gradually shake out into groups with a *functional* reason to be in the office together, even for just 2-3 days per week. So far, it looks like the average size of those groups will be a lot smaller than Amazon or Google.

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