



The COVID-19 pandemic amplified some of the disadvantages of living and working in densely populated cities and accelerated that migration. [An October 2020 survey](#) by freelancing platform Upwork found that as many as 23 million U.S. workers planned to move due to work from home flexibility, a near-term migration rate four times the usual level. Twenty percent of those planning to move were based in major U.S. cities. In San Francisco alone, 89,000 households have left the city, according to Public Comment in an [analysis for USPS](#), and new office lease activity fell 71% in 2020 compared to the prior year, from 7.7 million to 2.2 million sq ft, [according to Cushman & Wakefield](#). In New York City, January 2021 leasing volume was down 47% year-on-year, [according to Colliers](#). The pandemic also boosted adoption of e-commerce, putting additional pressure on bricks-and-mortar retailers. Recent surveys have found that several years of e-commerce adoption has been compressed into a matter of months as a result of the pandemic.

The impact of this exodus goes beyond just quieter streets and emptier buses. The ensuing loss of tax revenue couldn't come at a worse time for major cities already struggling with the enormous cost of combating COVID-19. [A December 2020 survey of 901 city governments by the National League of Cities](#) found that almost 70% had seen a negative financial impact from the pandemic, with respondents reporting a 21% drop in revenue and a 17% increase in expenditures, on average. And while many individuals and businesses can relocate, landlords and other commercial real estate organizations don't have that option—their fortunes are inextricably linked to the recovery wherever their properties are located. These commercial real estate stakeholders are facing unprecedented vacancy rates and an uncertain path to recovery as the pandemic retreats.

In this piece, we take a closer look at the nature and impact of this shift away from major metropolitan areas, outline some ways in which those metros can hasten their recovery, and discuss how landlords with big city footprints can not only survive in the short term, but thrive over the next few years and beyond.

### **Tips to get started on a property tax appeal**

For many businesses, property tax is the largest state and local tax obligation and one of the largest regular operating expenses incurred. Unlike other taxes, property tax assessments are based on the estimated value of the property, and thus, are subject to varying opinions. Businesses that fail to take a proactive approach in managing their property tax obligations in the current economic environment

may be missing an opportunity to reduce their tax liability. A proactive approach manifests itself in two ways:

1. **Do your research.** A proactive management plan includes researching your jurisdiction to understand the appeal process, monitoring changes in your property that could alter values and annually making your own assessments. If the jurisdiction's assessment notice differs from your expectation, you will be prepared with the data to support your appeal.
2. **Get ahead of the process.** A more preemptive strategy includes providing the jurisdiction with information prior to the tax assessment period, or in conjunction with filings, with a view toward influencing a reduction and avoiding the appeals process entirely. In the case of personal property, this would include taking positions, on personal property tax returns, that corroborate the additional information being provided in hopes it will be accepted and reflected on the personal property assessment notices. With real estate pursuits, it includes providing the jurisdiction with factors affecting the property, such as closures, vacancies and changes in revenue and expenses, before the notices are issued in the hope of securing a lower value.

### **The great alpha to gamma migration's effect on the biggest U.S. cities**

The Globalization and World Rankings Research Institute periodically releases a ranking of cities, categorized from more to less important to the global economy using the Greek letters alpha, beta and gamma. This ranking provides a useful lens through which to view the trend of people and businesses relocating away from the "biggest of the big" U.S. cities. In a recent survey by professional social network Blind and housing app ROOM8, 23% of respondents said they had relocated away from a major city as a result of having the option to work from home. Out of the respondents indicating that they'd already relocated, a combined 61% had left alpha-level urban agglomerations New York City and the San Francisco Bay Area. Fifteen percent of those respondents had moved to gamma-level city Austin. An analysis by relocation platform Updater found that moves out of Chicago increased 19% in the period from March to September 2020 over the same period in 2019, and New Jersey, New York and Illinois topped a recent United Van Lines survey of outbound relocations in 2020, with the majority of movers heading to Texas, Florida and Arizona.

This outflux has created huge holes in major-city budgets. Even before the pandemic, cities were struggling with ballooning health care and public employee pension costs. State laws dictate that municipalities must balance their budgets, and there are only three ways to do that: higher taxes, layoffs and cuts to government services and capital expenditures. For example, New York City is cutting spending and services to deal with a projected \$13 billion revenue shortfall over the next four

years. Seven hundred cities have announced plans to freeze infrastructure spending on things like mass transit and improvements to utility systems. State and local governments have laid off a total of 1.3 million workers, mostly in education. The revenue losses alone are expected to total hundreds of billions of dollars for local governments.

As business income and property values drop, the cities on the wrong side of this trend will take a hit in decreased property and sales tax revenue. [A December 2020 survey by the National League of Cities](#) found that revenues had declined more than 20%. In San Francisco, where about half the professionals reside outside city limits, the city's sales tax revenue has dropped by 43%, and city controller Ben Rosenfield warned in a recent Axios interview that "permanent [job] relocations out of the San Francisco area could have a larger impact on the city's tax base."

In some cases, workers don't even need to relocate for a city's tax base to take a hit. Traditionally, workers paid taxes to the jurisdiction in which they worked. There is now some question as to whether workers who used to commute across state lines for work still must continue to pay income tax in jurisdictions that they may not have set foot in for the duration of the pandemic. The fight has been escalated to the Supreme Court, with New Hampshire suing Massachusetts for demanding that Massachusetts telecommuters pay income taxes on work they did in New Hampshire. The case is being watched closely by New Jersey and Connecticut, each of which has hundreds of thousands of residents who commuted to New York City before the pandemic. Those residents would usually pay New York state income tax as well as a New York City commuter tax.

Many workers who have gotten used to not having to commute are understandably pushing to work from home full time. In a December 2020 [Pew Research survey](#) of adults who were able to work remotely, 20% of respondents said they worked from home prior to the pandemic, while 71% were working from home at the time of the survey. Fifty-four percent said they would like to continue to work from home after the COVID-19 outbreak ends. While not all of those people will get their wish, a September 2020 study by Cushman & Wakefield predicted that the percentage of people working from home in the United States will settle at more than 10% permanently after the pandemic, double the pre-pandemic share. Experts think most businesses will adopt a hybrid working arrangement, wherein employees are expected to be in the office a certain number of days each week. That's still not good news for major cities. Even in a scenario where an employee spends only two days at home, that would still represent a 40% drop in everything from mass transit ridership to spending at local businesses for that individual. If the Supreme Court finds that workers should pay state and local income tax based solely on where their work is performed, that would represent a substantial and long-term decrease in tax revenue for certain cities.

"There's going to be a shakeout of what economic activity looks like and where it's going to get done,

and that's going to require cities to rethink what their tax base looks like," said Kim Rueben of the Urban-Brookings Tax Policy Center.

## **How major cities and their real estate stakeholders can survive in the short term**

### **Federal and state government aid**

For their part, big cities have lobbied state and federal government officials hard for aid and relief throughout the pandemic. The Coronavirus Aid, Relief and Economic Security (CARES) Act, passed in March 2020, included \$27 billion in emergency funding for cities and counties with more than 500,000 residents. However, emergency funding for state and local governments was dropped from the Coronavirus Response and Relief Supplemental Appropriations (CRRSA) Act of 2021, passed in December 2020. Assistance also came from the Federal Reserve in the form of Municipal Liquidity Facility, which entailed direct purchases of short-term municipal debt. Established under the CARES Act, that program, which ended on Dec. 31, 2020, made up to \$500 billion available to the Fed to loan to state and city issuers. However, many cities haven't taken the Fed up on the offer because the interest rates involved were too high.

On March 11, 2021, President Biden signed the American Rescue Plan Act of 2021 into law, designating \$350 billion to states, cities and tribal governments. The Biden administration's pandemic relief bill includes \$350 billion in aid to state and local governments, of which \$130.2 billion is allocated specifically to metropolises. That funding is in addition to \$122 billion the bill allocates to helping public schools reopen.

In turn, landlords are looking for help at all levels of government to shore up cash flow and continue operations. Through 2021, vacancies are expected to hit all-time highs, sending rental rates plummeting. So, for the near term, the focus for landlords and other stakeholders will be on keeping their heads above water. While all sides (including governmental entities) agree that the situation is dire and that the real estate industry needs immediate relief, there seems to be little agreement on how much help is needed and how to apportion assistance at a time when so many other individuals and industries are asking for help.

The good news for landlords is that economic aid to individuals in the form of rental assistance will trickle down to property owners. On the other hand, non-financial relief to the general public, such as an eviction moratorium, increases pressure on landlords and leaves them with few—or no—options to replenish revenue streams. That's especially true for individual investors, who collectively own more than 40% of residential units. Landlords do not qualify for Paycheck Protection Program (PPP) loans, and the Main Street Loan program ended in early January 2021, so they will need to find other means of relief and sources of capital. For other commercial real estate stakeholders such as hotel

owner/operators, real estate developer and landlord Steve Witkoff noted in a recent Bisnow webinar that accessing PPP loans and getting help from the government “might hurt us a little in the future, but it’s the only way to get to the future.”

The CARES Act also generally excluded real estate developers and lessors from the PPP, to ensure that PPP funds didn’t flow through to real estate investors. However, the government did make PPP loans nontaxable to the extent the loan was forgiven while allowing businesses to still deduct costs used to compute the loan amount. Many commercial real estate landlords encouraged tenants to apply for PPP loans, as funds could be used to pay rent.

The CARES Act also expanded the Economic Injury Disaster Loan (EIDL) program, which allows the Small Business Administration to offer loans of up to \$2 million at an interest rate capped at 3.75% for terms of up to 30 years. Finally, Freddie Mac and Fannie Mae allowed landlords to temporarily delay making monthly mortgage payments, in exchange for suspending tenant evictions. The CRRSA Act provided \$25 billion in additional rental assistance under the Emergency Rental Assistance Program (ERAP). Those funds can be used to address back-due rent accruing from March 13, 2020. Although the funds are targeted to assist renters, landlords will be able to apply on their tenants’ behalf. The CRRSA Act also includes \$325 billion in assistance to small businesses, most of which is earmarked to replenish the PPP. The American Rescue Plan proposes \$30 billion of aid to renters and small landlords, while extending the eviction and foreclosure moratorium and forbearance for federally guaranteed mortgages through Sept. 30, 2021.

While commercial real estate stakeholders lobby and wait for government aid, their ability to access funding from lenders has also been hindered by the pandemic. Unprecedented vacancy rates and uncertainty around recovery timelines and magnitude due to hiccups in vaccine rollout and individual and business relocations have made it difficult to determine valuations in real estate. Organizations are even holding fire on debt modification initiatives—loan activity is not expected to rebound until there is some agreement on all sides about where prices are going to settle.

In addition to accessing government programs and support, other options include initiating a proactive property tax appeal in anticipation of future valuation decreases and repurposing existing space, for example, from office to affordable housing or healthcare facilities.

### **Long-term success will depend on bold new approaches now**

To thrive in the long-term, one pressing question for landlords is how to retain current tenants and attract new ones. A September 2020 study by Cushman & Wakefield estimated that commercial real estate vacancy levels should stabilize back to 2019 levels by 2025. COVID-19 has dramatically altered

the dynamics of how people live, work and play. Local governments and real estate stakeholders must keep these changes in mind as they move forward in trying to retain existing residents and attract new ones.

As vaccination rates climb, the outflow of residents and businesses from the country's biggest cities will ebb. But even then, these metropolitan areas won't be able to rest on their laurels. Not only will they be competing against other major metropolises, but against smaller cities like Tulsa, which through its Tulsa Remote program offers a \$10,000 incentive for remote workers to move to the city. It's critically important for economic development agencies (EDAs) and state and local officials to "pull out all the stops" to attract large corporations and site selection decision makers by offering incentives and tax credits that they might not have had to put on the negotiating table a decade ago. Leaders will need to walk a fine line, however, as lower revenues will mean less to bargain with, and existing residents and businesses may bristle at the idea of funds being allocated to economic development that could otherwise be spent on helping them recover.

One of the primary factors businesses list as a key component in their decision to relocate is the proximity to talent. Locations that have universities nearby are attractive for that reason. If no large universities are nearby, discuss a potential partnership with a university to create another campus. Other ways to enhance location include helping to connect businesses with needed venture capital and pitching to wealthy donors projects that benefit the entire community.

In addition, city leaders may need to accentuate amenities that have been traditionally associated with the suburbs, like green space and dedicated walking and biking trails. Cities may take this opportunity to accelerate the conversion of built space that is no longer needed into outdoor features like parks, ballfields and playgrounds. This is one area where a lack of action can be beneficial—so-called "rewilding" saves cities maintenance costs while adding to recreational space available for residents. Cities may also encourage the continuation of special dispensations that facilitate outdoor dining, such as allowing dining tables on sidewalks and in parking lots adjacent to restaurants. Doing so encourages socialization, an important draw for residents of urban areas, while injecting some humanity in otherwise stark and uninviting urban streetscapes. Along those same lines, many large cities are permanently closing off some streets to cars, creating pedestrian-friendly spaces free from blaring horns and exhaust fumes.

While highlighting the positives, city leaders should also work to address some of the aspects of urban life that motivated individuals and businesses to leave. For example, city residents may feel uneasy about crowding into a packed subway car post-COVID. A marketing and ad campaign touting the application of antimicrobial coatings to high-touch bus and subway surfaces could help ease that

anxiety. At the same time, cities could highlight the addition of bike lanes to give commuters an alternative to crowded mass transit.

### **Tools that EDAs and city governments will be looking at and commercial real estate stakeholders should encourage**

- Tax abatements
- Using tax increment financing (TIF) programs to stimulate economic development
- Issuing new municipal bonds to investors
- Hotel room and tourist tax abatements, to attract business travelers and tourists

States and cities can work together to gain a competitive edge through the reduction or elimination of business regulations, fees, permitting requirements and oversight. Cities may also see funding infusions from major nationwide initiatives, such as President Biden's infrastructure plan or the continued rollout of 5G cellphone infrastructure.

One pitfall that will be hard to address is the cost of living or doing business in major cities. City leaders will have to get creative to compete against places like Austin and Orlando, where there is no state income tax. One solution would be to focus on attracting new residents and businesses from overseas. Much of New York City's ability to weather previous downturns has been due to international migration. It is not unusual for the number of people leaving New York City for other parts of the country to exceed domestic migration into the city. However, immigration from outside the United States normally more than makes up for that loss, increasing the city's overall population.

Finally, there are some people for whom the elimination of their commute was not a welcome development. For those people, the commute represented a natural transition from work to home and vice versa, a chance to wind down from a stressful workday or prepare for an important meeting. A recent Axios report outlined the phenomenon of the "fake commute," whereby workers have established a ritual of leaving their house for a drive, walk or bike ride before and after work. Cities may be able to jump on this seemingly quirky bandwagon to help residents replicate the positive attributes of their commute and combat feelings of loneliness and isolation, like establishing library cafes to encourage people to work from a public library or providing "pop-up" public work pods with air conditioning, wi-fi and power outlets, positioned in scenic parts of the city (think overlooking Central Park's Bethesda Terrace or along the Esplanade in San Francisco.)

While cities and commercial real estate stakeholders are very different entities with differing pathways to recovery, there is one step both need to take: continuing to embrace digital transformation. Cities can help reassure prospective new residents and businesses by touting their

use of technology to provide transparency and services that will help residents face the next crisis. For landlords and property managers, whether you're undertaking enhancements to lease and debt agreements, working with tenants to offer them more flexibility in space uses or considering repurposing your property, technology can provide a fundamental understanding of how specific property sectors changed due to COVID-19. Innovative tech solutions can help facilitate new initiatives to retain and attract tenants and drive operational efficiency during normal times, while helping organizations react more quickly and effectively to unforeseen crises.

### **Landlords: Tools for Retaining Existing Tenants and Attracting New Ones**

The most obvious tool in any landlord's toolbox for boosting occupancy is to lower rents, and that's exactly what many have done in response to skyrocketing vacancy rates. Nationwide, the average residential rent fell 1.3% year-on-year, according to Apartment List. The drop has been much more dramatic in big cities, however, with the median rent for a one-bedroom apartment in San Francisco falling by almost one-quarter between October 2019 and October 2020. Rent in New York City and Boston fell by 17% and 16%, respectively, in the same period.

The market is very competitive among landlords competing for qualified tenants. Concessions—free weeks of rent, waived application and/or broker fees, reduced security deposits, free parking and gift cards—play a pivotal role in securing tenants. Altogether, incentives are saving renters about 17% on residential leases in major cities, [according to Zillow](#).

These price drops and concessions may be achieving short-term gain while setting the stage for long-term pain, however. To begin with, some concessions, such as free parking, can be hard to eliminate or discontinue. Reduced rent may attract less-than-optimal tenants, and it may be difficult to bring rents back up in line with the recovering economy. Landlords should watch the market closely before offering rent discounts, and even then, it's imperative that those discounts be applied only to leases of one year (or less). Make sure lease agreements clearly spell out the terms under which concessions or discounts are offered. Other approaches to attracting new tenants may not stem the bleeding immediately but will put landlords in a better competitive position as big cities recover and rents rebound.

### **Repurposing existing space**

Even before the pandemic, many companies were tinkering with the traditional need for office space, including expanding work-from-home options for employees, downsizing head offices and exploring the use of shared office space. According to the Energy Information Administration's [2018 Commercial Buildings Energy Consumption Survey](#), while the growth of total commercial building floor space continued in the preceding decade, that expansion occurred in service (40%), public assembly (39%),

lodging (35%) and warehouse and storage (26%), rather than in traditional office and retail sectors. The pandemic, of course, hastened these initiatives to an extent that the universality of the traditional worker-office dynamic may be gone for good.

That leaves landlords with the question of what to do with certain types of commercial space for which there may never be a resurgence in demand. One answer is the conversion of office space, hotels and even indoor shopping malls to residential use. Aside from absorbing unused space, this repurposing could provide a partial solution to another intractable problem that COVID-19 made worse, the lack of affordable housing in most big cities.

Other examples of retrofitting existing space include transforming offices and industrial spaces to life science facilities and creating e-commerce fulfillment centers from vacant storefronts. This kind of repurposing might even be incentivized, or at least strongly encouraged, by local, state and federal governments seeking to revitalize urban districts. Furthermore, a trend toward transitioning existing space to new uses rather than clearing more land for new construction could align with government efforts to address climate change.

### **Going green to save some green**

Even if landlords and building owners are unable to obtain subsidies for their repurposing projects, they can take advantage of existing energy efficiency programs and policies that reward upgrades to windows and installation of HVAC energy management and internal air quality (IAQ) systems. Retrofits and enhancements will need to focus on the intersection of public health and energy efficiency to compete for tenants, who will also likely prefer space reconfigurations that feature more natural light and better air flow.

### **A contract terms tug of war**

The coronavirus pandemic has been a stark reminder of how quickly circumstances can change, and that fresh lesson is likely to manifest itself in changes to business contracts of all kinds, including lease agreements, that will provide greater flexibility and protections. Landlords can take steps to protect themselves by inserting new clauses in lease agreements that would help to reduce their burden in the event of another pandemic or similarly disruptive crisis. They should also aim for greater flexibility in debt agreements.

Keep in mind, however, that new stipulations that are favorable to landlords will come at the expense of tenants, who will likewise be looking to address vulnerabilities. Whereas the fine print in lease agreements may have gone largely unread pre-pandemic, landlords should expect tenants to go through contracts with a fine-tooth comb going forward. For that reason, new clauses are likely to become an important point of differentiation between lessors. Landlords who can identify

stipulations their competitors have added and then advertise their more-favorable terms will have a competitive edge. For example, building managers may tout the availability of shorter-term leases or innovative lease structures such as offering a percentage of sales as part of the rent, as opposed to a flat base rent.

### **Knowledge is power**

Along those same lines, landlords will need to make a greater effort to understand what their tenants are up against and try to work with them accordingly. What are spaces being used for? How have their needs changed? For example, tenants are unlikely to enter into long-term leases unless rates are very favorable. A bricks-and-mortar retailer already under pressure from the shift to e-commerce may not agree to a 10-15-year lease. Also, it will behoove landlords to understand in which industries hybrid work situations are likely to become standard, and to take this into consideration as they work with tenants in those industries. Residential property owners should keep in mind that tenants will likely need more space to incorporate work set-ups. So, for example, a one-bedroom apartment may no longer be sufficient for a couple with no children. Property managers should also seek out information on unconventional uses for their space that may intersect with tenants' evolving needs. For example, landlords can brush up on what would be required to make some of their vacant space suitable for co-working, opening up a new revenue stream.

### **Don't neglect the suburbs**

While lots of workers would love to work from home full time, there are others who are more conflicted about what work will look like as the pandemic passes. While they're in no hurry to resume the two-hour daily commute, they miss the camaraderie of working shoulder to shoulder with colleagues. In fact, 70% of U.S. office workers would like to return to the office for three days a week or more, while the same percentage of office workers based outside the city center don't want to give up the lack of a commute and the money they save by working from home, according to CBRE. Some companies are hearing this faction loud and clear, adopting a "hub and spoke" model that involves maintaining a main office in a center city while establishing smaller satellite offices in the suburbs. That model is cost-effective for tenants—suburban office space is usually cheaper than downtown—and can help attract perimeter-based talent who are not keen on a long commute. Landlords who have suburban properties in addition to space downtown shouldn't neglect the former in favor of the latter. Property managers may want to ramp up marketing and advertising for both areas, and may even want to proactively market their suburban properties to downtown tenants in the event those tenants are considering moving to a hub-and-spoke model.

### **Roll out the red carpet for tech tenants**

Prior to the pandemic, the technology sector was the 500-pound gorilla in office-leasing activity. When lockdowns took hold, many tech-heavy real estate markets took a hit, with tech behemoths breaking

leases and subletting large swaths of their own headquarters. At the same time these companies were announcing sweeping and generous work-from-home policies, however, many were gobbling up massive amounts of office space, including 730,000 square feet snapped up by Facebook in Manhattan and leases totaling 900,000 square feet signed by Amazon in New York and Dallas, as well as Gamma cities Phoenix, Dallas, Detroit, San Diego and Denver. The industry remained resilient through 2020 and is expected to grow moving forward, so landlords may consider focusing their sales and marketing efforts on tech tenants.

## Conclusion

The actions of tech-industry behemoths reflect a fundamental truth: New York City and the Bay Area will recover as the effects of the pandemic wane and will continue to be dynamic engines of American culture, innovation and finance. Case in point: While New York City experienced a year-on-year decrease in overall real estate market activity over the course of 2020, it was also home to 20 of the biggest lease deals of 2020, totaling 6 million square feet.

“Neither devastating fires when cities were made of wood, nor the cholera of Dickens’s London, nor the urban bombardments of World War II, nor the postwar fears of nuclear holocaust, nor even the shock of 9/11 fundamentally altered the pull to urbanize,” said Alex Krieger, architect and urban designer. “Neither will COVID-19 over the long term.”

In the meantime, landlords are in dire straits and need to shore up their finances to ensure survival. Beyond that, landlords will need to have a fundamental understanding of how their property sector changed due to COVID-19 and offer more flexibility in space usage, lease agreement terms and other areas to attract and retain tenants. Technology can help facilitate the process and drive efficiency.

While there are some steps commercial real estate stakeholders can and should take to make it through the current crisis and be better prepared for the next one, the fortunes of landlords and big cities are inextricably linked. COVID-19 accelerated migratory trends and showed without a doubt that big cities can’t rest on their laurels. Not only are they in competition with other big cities like Dallas and Miami, but with secondary cities like Austin and Charlotte that are getting another look due to the pitfalls of living in a big urban city during a pandemic. All parties can benefit from getting involved in activities that benefit their shared interests, such as lobbying state and federal governments for aid and collaborating on improvements that will make their city more desirable.

Big cities are in the midst of a prolonged lull in demand from new residents and businesses, which will continue to have a deep and broad impact on everything from rents to government services. How long

that downturn lasts will depend on the actions government entities, economic development agencies and even business owners themselves take—or don't take—in the coming months and years.