U.S. Law Firm Real Estate Trends: Their Recent Evolution and What to Expect Post-COVID

FEBRUARY 2021

NEWMARK

TABLE OF CONTENTS

NEWMARK

Key Findings

01 Through the 12 months ending November 2020, legal services employment in the U.S. declined 2.8%, a figure significantly lower than the 5.2% legal services job losses resulting from the prior economic downturn. Legal Services' relatively superior employment protection relates to a variety of factors, most notably a significant reduction in client-entertainment, conference, and travel-related expenses.

02 Some law firms are taking a wait-and-see approach to their real estate decisions, as both the length of the economic downturn and post-pandemic office use trends remain uncertain. Across most major U.S. office markets, law firm leasing activity was reduced in 2020 from previous years. In a sample of gateway markets, total gross leasing activity by law firms declined 41% between 2019 and 2020. While it is prudent to make informed real estate decisions, waiting to make a move or renewal could result in a missed opportunity to take advantage of the current tenant-favored market.

03 In many U.S. markets, major firms that were already in the process of increasing space efficiency executed long-term leases to capture immediate cost savings, in many cases securing better terms through the negotiation process as asset owners increasingly felt the negative impacts of the pandemic. Other firms have taken advantage of the tenant-favored environment to renegotiate their existing leases and return unused space to the asset owner. In short, many of the transactions that occurred after the pandemic started were driven by opportunism rather than a change in space usage or configuration resulting from a need for social distancing.

04 Some firms are considering implementing a more flexible office configuration beyond the single-size offices that had already become a prominent trend. Firms are now considering a continuum of future options ranging from a fully virtual firm to the traditional in-office model that was prevalent pre-pandemic. Most firms, regardless of size or location, are now willing to ask questions and consider new ways of working that would not have been considered prior to the pandemic.

05 Another trend that has emerged from opportunism surrounding the pandemic is a significant uptick in law firms placing excess office space on the market for sublease. Many firms had already begun or were planning to downsize their office space footprints pre-pandemic but now have put more sublease space on the market than perhaps they would have had the pandemic not occurred.

06 As of early 2021, it is still too soon to have a comprehensive understanding of how the pandemic will impact the future use of space. While some firms are experimenting with more flexible office layouts and some portion of non-dedicated offices, many firms, especially those that are already committed to new space, are awaiting more data before making any major decisions in this regard. Most law firm office market experts consulted for this study predict that if there is an impact on workplace strategy resulting from the pandemic, it is more likely to be a move toward smaller offices and potentially some shared offices; a strong shift toward universal hoteling is unlikely, particularly among AmLaw 100 firms.

I.

How Law Firm Real Estate Trends Have Evolved Over the Past Decade

Over the past 10-15 years, space efficiency became a primary real estate strategy for most major law firms. Accordingly, the amount of square feet leased per attorney generally decreased across major U.S. markets. At the end of 2019, the median leased square feet per attorney at Am Law 100 firms in 10 major U.S. cities ranged from 619 SF in Miami to 935 SF in Chicago with the figures ranging significantly across most cities.

However, factors such as fluctuating attorney counts, subleasing of unused space, and variances in space design versus space utilization make it difficult to draw direct conclusions from the amount of leased space per attorney. In short, the intent behind how law firms lease and use office space does not always match the reality of how much space they occupy. Nonetheless, these figures generally trended downward as many firms adopted single-size offices, improved space efficiency, right-sized conference centers, and carried less vacancy for desired future growth.

A Newmark Research white paper published in November 2019 found that across the 10 largest U.S. cities for legal services employment, law firms collectively had fewer square feet under lease than in the prior 10-15 years. This reduction was due to both the densification trends noted previously and the fact that the law firm sector saw slow employment growth after the Great Recession. Between 2010 and 2019, U.S. legal services employment growth averaged only 0.2% annually. Advancement in technology allowed attorneys to become more efficient and reduced the need for legal secretaries and support staff. These changes also brought the digitization of law libraries and high-density physical filing systems, further reducing the need for office space.

Rental rates for law firm leases rose significantly following the Great Recession. The 10 largest law firm markets experienced a 21% average increase in law firm rental rates during the 2015-2019 period compared with the 2010-2014 timeframe. This significant increase was mostly attributed to a flight-to-quality trend among law firms, as the increase in efficiency allowed many firms to upgrade their space while maintaining or reducing overall occupancy costs.

Am Law 100 firms' status as a desirable tenant type with significant space requirements allowed them to garner attractive concessions from asset owners during the expansion cycle, with average concession packages for recent deals as of the end of 2019 spanning from $65 in Philadelphia to $173 in Washington, DC. For a detailed overview of pre-pandemic law firm real estate data for major U.S. markets, please see our white paper: **The Evolving Law Firm Office Market: Key Trends in 10 Major U.S. Cities.**

II.

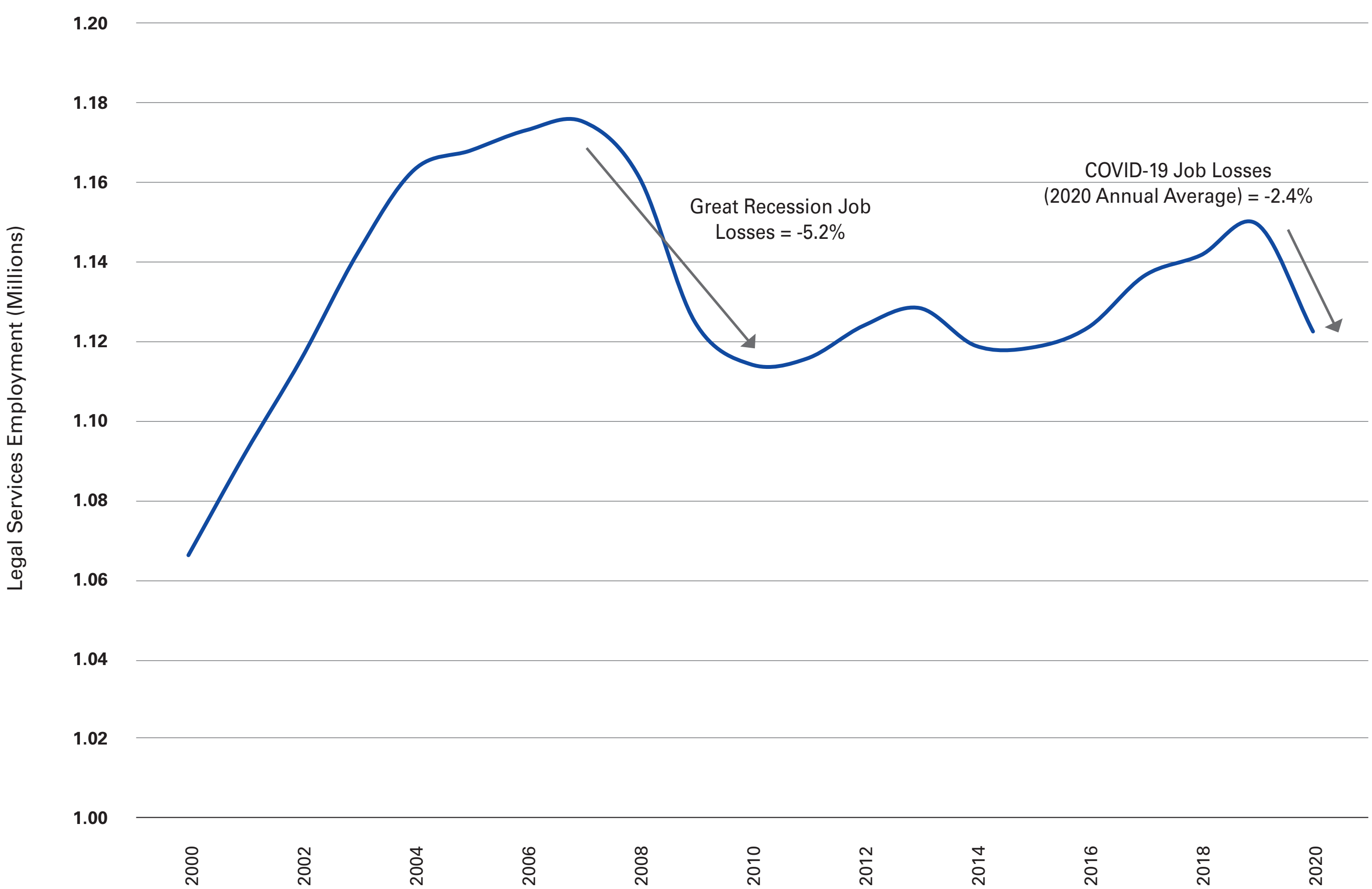
Firms' Reaction to the COVID-19 Pandemic Varies by Market, Firm Size, and Culture

As with a majority of global industries, the legal services sector was hurt by the onset of the coronavirus pandemic. However, the industry was impacted less significantly than many others. Through the 12 months ending November 2020, legal services employment in the U.S. declined 2.8%, a figure significantly lower than the 5.2% legal services job losses resulting from the prior economic downturn, as shown in the adjacent chart. While the time periods are not equivalent and the current economic downturn is not yet over, news of several vaccines and additional federal financial relief means it is unlikely the industry will see job losses as significant as those during the Great Recession.

During 2020, legal services employment in the U.S. declined 2.4% on an annual average basis, a figure significantly lower than the 5.2% legal services job losses resulting from the prior economic downturn.

Legal Services Job Losses Less Severe than During Great Recession

U.S. Employment Change: Legal Services | 2000–2020 Annual Averages



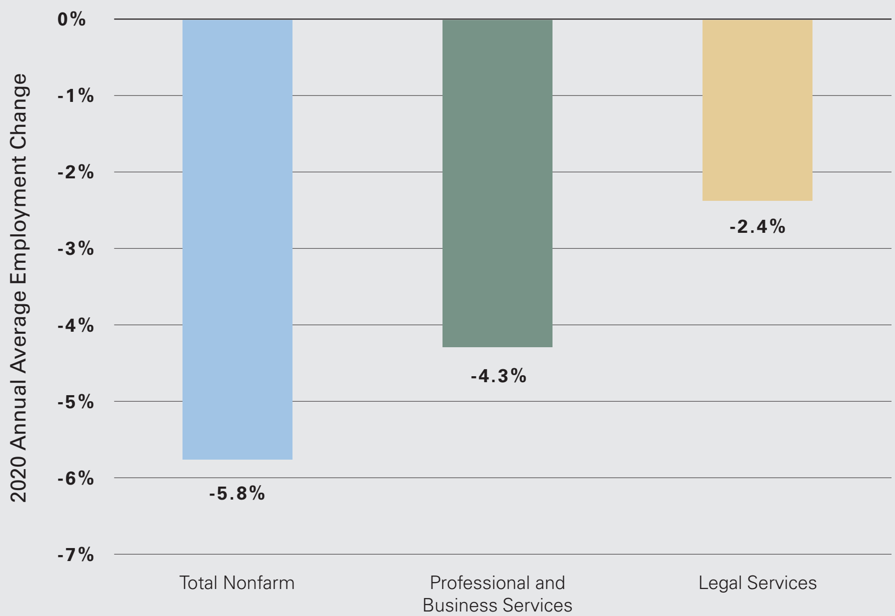
Source: U.S. Bureau of Labor Statistics, Newmark Research; February 2021

Over the past 12 months, the legal services industry also endured fewer job losses than both the broader Professional and Business Services sector and the U.S. economy as a whole, as illustrated in the adjacent chart.

Legal Services' relatively superior employment protection relates to a variety of factors, including some firms benefitting from an uptick in business as other businesses seek legal help in a troubled economy. A significant reduction in client-entertainment, conference, and travel-related expenses also allowed firms to offset some loss of business and avoid significant attorney and staffing cuts. In fact, while *The American Lawyer's* gross revenue numbers for law firms in 2020 will not be released until later this year, many firms have reported soaring production levels, making 2020 their strongest year on record.

Legal Services Employment Endured Fewer Pandemic-Related Job Losses

U.S. Employment Change: Selected Categories | 2020 Annual Average



Source: U.S. Bureau of Labor Statistics, Newmark Research, February 2021

Some Law Firms Take a Wait-and-See Approach

Some law firms are taking a wait-and-see approach to their real estate decisions, as both the length of the economic downturn and post-pandemic office use trends remain uncertain. According to real estate industry experts who represent these firms, some decision makers feel there is too much uncertainty to commit a significant amount of capital to a new lease at this time. Across most major U.S. office markets, law firm leasing activity was reduced in 2020 from previous years. In a sample of gateway markets, total gross leasing activity by law firms declined 41% between 2019 and 2020. In addition, some large requirements were put on hold. For example, an AmLaw 100 firm with offices in New York and Washington, DC put its 200,000-250,000 square foot New York office requirement on hold due to the pandemic. While it is prudent to make informed real estate decisions, waiting to make a move or renewal could result in a missed opportunity to take advantage of the current tenant-favored market.

In a sample of gateway markets, total gross leasing activity by law firms declined 41% between 2019 and 2020.

Some Law Firms Take an Opportunistic Approach

Most of the major law firm transactions that were completed during the latter three quarters of 2020 were for non-headquarters leases. Since plans for a headquarters relocation tend to be made years in advance of a lease expiration, many of those deals are either so far along that a significant change in plans would not make financial sense, or are still in the early planning stages where any necessary changes can be incorporated as post-pandemic trends become clearer. Many of these non-headquarters transactions took advantage of immediate cost-savings and increased flexibility in both the short- and long-term. Several firms restructured their leases in a blend/extend to take advantage of attractive concession packages in the current tenant-favored environment. Many of the transactions completed in 2020 were shorter-term in nature as firms seek flexibility and cost savings. For example, in New York City, the five largest law firm transactions signed after the start of the pandemic were for terms of five years or less. In other U.S. markets, major firms that were already in the process of increasing space efficiency executed longer-term leases to capture immediate cost savings, in many cases securing better terms through the negotiation process as asset owners increasingly felt the negative impacts of the pandemic. Many firms have taken advantage of the tenant-favored environment to renegotiate their existing leases and return excess space to the asset owner. In short, many of the transactions that occurred after the pandemic started were driven by opportunism rather than a change in space usage or configuration resulting from a need for social distancing. In New York City, there is a clear delineation between the largest firms, which are primarily taking a wait-and-see approach, and the smaller to mid-size firms, which are taking an opportunistic approach.

In New York City, the five largest law firm transactions signed after the start of the pandemic were for terms of five years or less.

Significant Uptick in Law Firms Marketing Space for Sublease

Another trend that has emerged from opportunism surrounding the pandemic is a significant uptick in law firms placing excess office space on the market for sublease. There are several drivers of this trend, most notably the long-term cost savings in offloading unused space. Firms are realizing that near-term growth is unlikely in the current economic environment, and they are in a position to offset expenses by offering space for

sublease that they may have reserved for future growth. Should the economy have a swift rebound allowing firms to resume growth, the current tenant-favored environment in most U.S. office markets means firms will likely have numerous options. In short, offering unused space for sublease is a low-risk strategy for freeing up capital in a tight economic environment.

Of course, with so many firms offering space for sublease in a tenant-favored market, it may be difficult to find subtenants. However, firms are able to offer the space at competitive rental rates since they do not have the same overhead costs as the asset owner. In addition, it is relatively inexpensive to market space for sublease, and thus not a significant risk if the strategy is ultimately not successful. A beneficial strategy for new leases is designing a portion of the space that can easily be demised for a sublessor should the firm's space needs change in the future. Key features to enhance the flexibility and marketability of future sublease space include good egress to common area corridors, space for a reception area, an internal conference center with two to three rooms together on the perimeter, and the right to provide separate signage for the subtenant.

While an uptick in available sublease space is a trend across U.S. office markets, it is especially prevalent in higher-cost markets with a high concentration of law firms. In Los Angeles, at least three law firms are offering blocks of sublease space 25,000 square feet or larger in the Downtown and Century City submarkets. In New York, at least three Midtown firms have listed significant blocks of sublease availability that are pandemic-related. In Chicago, there are currently 37 law firm subleases available downtown with an average size of 8,585 square feet. In the District of Columbia, 20 major firms have cumulatively placed over 500,000 square feet on the sublease market, representing an average of 34% of their total space under lease.

The pandemic has accelerated trends that were already underway for some law firms. Many firms had already begun or were planning to downsize space among their offices pre-pandemic but now have put more sublease space on the market than perhaps they would have had the pandemic not occurred. Offloading space via sublease allows firms to right-size for the short-term but provides the flexibility to expand in a few years if necessary. A major AmLaw 100 firm plans to offer upwards of one-third of its office space in the District

In **LA**

at least three law firms are offering blocks of sublease space 25,000 square feet or larger in the Downtown and Century City submarkets.

In **Chicago**

there are currently 37 law firm subleases available downtown with an average size of 8,585 square feet.

In **NY**

at least three Midtown firms have listed significant blocks of sublease availability that are pandemic-related.

In **DC**

19 major firms have cumulatively placed over 500,000 square feet on the sublease market, representing an average of 34% of their total space under lease.

of Columbia for sublease. In a *Washington Business Journal* article disclosing the sublease plans, a spokesperson for the firm cited interest and growth in agile work arrangements in addition to high performance under remote working conditions as the firm's motivation for offering excess space via sublease.

The uptick in marketed sublease space may pose a challenge for asset owners, especially in those cities seeing the largest increase in sublease availability. Asset owners might consider entering negotiations with tenants to take back excess space in lieu of that tenant offering the space for sublease. The loss of revenue from the reabsorbed space may ultimately be less costly than the prospect of competing against one's own tenants to fill vacancy.

Pandemic Begins to Spark Change in a Change-Averse Industry

Some firms are considering implementing a more flexible office configuration beyond the single-size offices that had already become a prominent trend. Firms are now considering a continuum of future options ranging from a fully virtual firm to the traditional in-office model that was prevalent pre-pandemic. Non-dedicated workspaces, or hoteling, is a concept that has gained ground as firms come to the realization that even prior to the pandemic, many attorneys and staff were only in the office 2–3 days per week due to travel, meetings and remote work. Options now being considered include hoteling for some portion of attorneys and staff, relocating non-legal staff to less expensive real estate markets, and giving staff and attorneys increased flexibility to work from home. Law firm culture is notoriously resistant to change; forced remote work due to the pandemic brought the realization that many offices were infrequently used even prior to the pandemic. Most firms, regardless of size or location, are now willing to ask questions and consider new ways of working that would not have been considered prior to the pandemic.

Though hoteling is often thought of as a cost-saving measure, for many firms, cost-savings were not the impetus for experimenting with a non-dedicated workspace model. Rather, it was the realization that their office space was not being used efficiently, with many workspaces going unused for a significant portion of the workweek. According to law firm tenant representation professionals, on average, firms who are implementing hoteling are doing it for only 10–30% of their workforce. As a start, some firms have begun surveying employees to see how they are using office space both pre- and post-pandemic, with a goal to determine how frequently each employee plans to be in the office and how that translates to space requirements.

One major concern with the hoteling concept is firms' ability to continue attracting and retaining top talent without offering private office space to that talent. Associates may weigh job offers based on their workspace, and some may prefer a private office to a non-dedicated workspace. However, the flexibility provided with hoteling may also be attractive to some employees. In the near-term, there is also the significant concern about the spread of disease in shared spaces, and any company considering this model must have plans and procedures in place to ensure the safety and security of its employees—which may entail additional cost. Firms that are implementing hoteling are wary of making sure those who are assigned to non-dedicated workspaces do

One major concern with the hoteling concept is firms' ability to continue attracting and retaining top talent without offering private office space to that talent.

not feel like second-class colleagues. Some strategies to ensure these employees feel safe and valued include implementing standards and protocols on cleaning and sanitation procedures, and the utilization of technology such as an app where employees can reserve an office or desk in advance. Some firms will have a concierge to welcome employees, assign them to a desk, and confirm their workspace has been cleaned and sanitized after the last user. These firms may also offer higher-end amenities to draw people into the office.

While hoteling has begun to catch on with some firms, it is not yet a widely accepted trend. Many firms do not believe in an expanded work-from-home model and want to have interaction among the different levels of attorneys for mentoring and growth, most notably having associates learn from partners. This long-standing tradition is mutually beneficial: the partners want to ensure their firm has a capable next generation of leadership and the younger attorneys want to learn from experienced colleagues and get on a partnership track. At many AmLaw 100 firms, decision makers want to wait to see how colleagues respond to the impact the pandemic has had on their work/life balance, and factor in workspace changes—if any—in future expansions.

While hoteling has begun to catch on with some firms, it is not yet a widely accepted trend. Many firms do not believe in an expanded work-from-home model and want to have interaction among the different levels of attorneys for mentoring and growth.

III.

How Will Changes Wrought by the Pandemic Impact the Law Firm Leasing Market in the Years to Come?

As of this writing, we are likely still several months away from most Americans having been vaccinated against the coronavirus, effectively ending the pandemic in the U.S. We likely will not know the true impact of the pandemic on office trends until several years into the future. Whether or not the hoteling trend will catch on more broadly remains to be seen. However, we see a range of outcomes for the law firm office leasing market, with two primary scenarios shaping the future; the actual outcome will vary by firm and market.

We see a range of outcomes for the law firm office leasing market, with two primary scenarios shaping the future; the actual outcome will vary by firm and market.

Scenario 1:

A Shift Toward Hoteling/Non-Dedicated Workspaces Resulting in a Further Space Reduction for Law Firms

The generational perception of remote work may have been flipped by the pandemic. It is commonly assumed that millennials and Generation Z—being digital natives—embrace remote work, while the baby boomer generation prefers the face time provided in a more traditional office setting, and with Generation X falling somewhere in the middle of these two preferences. However, the forced remote work resulting from the pandemic may have temporarily shifted these preferences. Most firms' top-earning attorneys and decision makers tend to be older and more established. Many of them found it easy to adapt to new technology such as video conferencing. They have the space and financial resources to function from home successfully and their children are grown so childcare and household noise and disruption are not issues they face. Conversely, many millennials struggled with lack of space or resources for successful remote work, in addition to the productivity challenges stemming from lack of childcare. If the top-producing partners who are the firm's decision makers were previously resistant to more flexible working arrangements, the pandemic may have changed those perceptions. They may now be more open to considering alternative arrangements such as hoteling for attorneys and/or non-legal staff, especially at firms where productivity remained high.

Overall, employees generally value flexibility and may be willing to adapt a smaller physical footprint while in the office in exchange for the option to work remotely some of the time. If this scenario were to come to fruition, the 20-30% space reduction some firms are achieving via subleasing or negotiating with asset owners to return excess space may become a permanent reduction. This would have a major impact on net demand for space in office markets where law firms make up a significant portion of the tenant base, such as Chicago, Los Angeles, New York and Washington, DC.

Scenario 2:
Law Firms Revert to Pre-COVID Office-Use Trends

The key question for law firms going forward is how to balance cost savings and culture. While real estate is law firms' second-largest expense after salaries, it is primarily the people and culture that make a firm successful. When considering alternative workspace strategies, many decision makers believe that junior associates and the senior lawyers who mentor them need in-person interaction. Firms will want to maintain their office culture, which can be challenging when a significant portion of the staff is working outside the office. While many millennials may have previously embraced remote work, the pandemic may have reinforced the value of being in the office for the productivity and space constraint reasons discussed previously. Longer-term, millennials may continue to favor being in the office for the opportunity to network, be mentored, and advance their careers.

Prior to the pandemic—and especially in the higher rent markets—there was a generally accepted trend toward smaller, single-size, glass-enclosed private offices that provide excellent space efficiency, natural light, and visibility to others in the office. Law firms that recently executed long-term leases for brand new attractive and efficient attorney space, with dedicated offices, are unlikely to completely reverse course. They may consider offering excess space for sublease but only if it can be demised in a way that does not impact their branding or workplace culture. Many firms are reluctant to commit to further significant changes in workplace strategy at this stage, especially if they have recently invested significant capital in brand new efficient office space with a smaller footprint.

IV.

Summary and Action Steps

The pandemic likely has accelerated the trend toward smaller law firm footprints but also enhanced the importance of workplace strategy and implementing a strong culture. Certainly, some of the trends that were accelerating prior to the pandemic, such as more space being dedicated to teaming and gathering areas, could be reconsidered in a post-pandemic environment. Still, warnings of a mass exodus from the office market are likely overblown. As of early 2021, it is still too soon to have a comprehensive understanding of how the pandemic will impact the future use of space. While some firms are experimenting with more flexible office layouts and some portion of non-dedicated offices, many firms, especially those that are already committed to new space, are awaiting more data before making any major decisions in this regard. Most law firm office market experts consulted for this study predict that if there is an impact on workplace strategy resulting from the pandemic, it is more likely to be a move toward smaller offices and potentially some shared offices; a strong shift toward universal hoteling is unlikely, particularly among AmLaw 100 firms.

Action Steps for Law Firm Tenants

- Firms who found the remote work experiment to be successful might consider relocating some portion of their non-legal staff to lower-cost markets to achieve real estate cost savings.

- While law firm tenants can achieve significant cost savings by improving efficiency in their space layouts, a denser configuration means less square footage over which to spread the construction costs. Tenants might consider committing to longer-term leases in exchange for a higher tenant improvement allowance to help offset these costs. Implementing creative design components or the use of modular furniture may help provide increased flexibility in office layout.

- Firms that implement hoteling for some portion of their attorneys might consider offering upgraded amenities and services such as enhanced file-management systems for baby boomers who like to work with paper, lower support ratios to provide enhanced administrative services, and dry cleaning or other personal services to support workers efficiency and draw them into the office.

Action Steps for Asset Owners Who Lease Space to Law Firms

- Offering increased concessions to law firm prospects—and in-place law firms that require a space upgrade—will make owners more competitive and could help to mitigate some pandemic-related loss of occupancy. Spending more on concession packages up front may be less costly than future vacancy. Additionally, offering future flexibility in the form of give-back rights could entice law firms with expiring leases to recommit in an uncertain environment.

- Owners might consider extending property management services to tenant spaces for an additional revenue source in a tenant-favored market. Owners that can provide tenant services such as management of hoteling space programs within their assets may find a competitive advantage.

- Upgrading branding opportunities and building amenities that can extend a law firm's presence in a building can be an efficient way to retain occupancy. Outdoor amenities such as rooftop decks or balconies may be especially attractive post-pandemic.

Sources and Acknowledgments

The American Lawyer

Newmark Research

U.S. Bureau of Labor Statistics

The Washington Business Journal

Report Author

Bethany Schneider
Director, Research

Report Editor

Alexander (Sandy) Paul, CRE, LAI
Senior Managing Director of National Research

Report Designer

Sam Willger
Senior Graphic Designer

Our thanks to the numerous Newmark Research, Workplace Strategy, and Brokerage professionals and their clients who provided data and insights for this study.

New York Headquarters
125 Park Ave.
New York, NY 10017
t 212-372-2000

nmrk.com

National Research Contacts:

Alexander (Sandy) Paul, CRE, LAI
Senior Managing Director, National Research
apaul@ngkf.com

Jonathan Mazur
Senior Managing Director, National Research
jmazur@ngkf.com

NORTH AMERICA
Canada
United States

LATIN AMERICA
Argentina
Brazil
Chile
Colombia
Costa Rica
Mexico
Peru
Puerto Rico

EUROPE
Austria
Belgium
Czech Republic
France
Germany
Ireland
Italy
Netherlands
Poland
Portugal
Romania
Russia
Spain
Switzerland
United Kingdom

ASIA PACIFIC
Australia
Cambodia
China
India
Indonesia
Japan
Malaysia
New Zealand
Philippines
Singapore
South Korea
Taiwan
Thailand

AFRICA
Botswana
Kenya
Malawi
Nigeria
South Africa
Tanzania
Uganda
Zambia
Zimbabwe

MIDDLE EAST
Saudi Arabia
United Arab Emirates

NEWMARK