Hybrid Work and the "Great Decentralization": A Correction Towards Resiliency?

Volume 46, Number 5 - August 8, 2022 • Written by: Ms. Cassandra Francis, CRE

Photo: WD Stock Photos/Shutterstock.com

Ms. Cassandra Francis, CRE

FAICP, FRICS, FCIArb, Principal, KARIATID, is a corporate board director & global advisory services provider supporting strategic management, governance and growth in the industries of urban planning, real estate and construction.

Hybrid work was listed as the #3 issue in the 2022-23 Top Ten Issues Affecting Real Estate® by The Counselors of Real Estate®.

> ***"Current decentralization pressures and the potential for property devaluation are sure to keep the entire financial sector on guard during the evolution of the next few years."***

In the aftermath of the pandemic, one thing everyone can agree on is remote work is here to stay, sending a clear message to employers as they struggle to retain workers and rethink their business models. Most also agree that COVID accelerated trends that were already emerging, including remote work, online retail, and migration to warmer climates and tertiary urban markets. However, an unexpected shift, the "Great Decentralization",[1] took many by surprise in the wake of this latest global disruption. Reversing decades-long flow of people and resources to large dense urban areas, this new trend towards geographic and organizational decentralization has changed most regions, with bracing effect on specific real estate markets and sectors. In the aftermath, government, businesses, and individuals now find they must adapt and evolve in light of this de-concentration, while addressing the increasingly underutilized built environment concentrated in urban areas. This will be particularly challenging given the array of concurrent social, economic, and existential shifts that include inflation, rising interest rates, wage growth, climate change, crime, geopolitical crisis, and wealth divergence. But will these new decentralized development patterns and socioeconomic structures provide the legacy of resiliency that better weather future disruptions and the next pandemic?

Despite pleas from politicians and employers that employees return to the "workplace" to restore normal operations and reinvigorate downtowns, only 40% of workers in larger American metropolitan areas have returned to the office.[2] Remote and hybrid work is favored by almost 80% of U.S. employees who want to work from home at least one day per week.[3] With the onset of the pandemic, the closure of offices and the quick adoption of digital mechanisms to support work from home modality provided employees with new freedom to work away from large urban employment centers, allowing them to move to suburbs, exurbs, second homes and destination locations. Workers sought more living space at lower housing costs, moved closer to family or to more natural and socially distanced environments, all which contributed to an increase in quality of life and work/life balance. This movement of people and resources has caused many of these further-flung areas to flourish, drawing energy and economic activity from downtowns.

Workers are now accustomed to these benefits and a return to the office would mean potentially much longer or impossible commutes, less time with family, less flexibility and privacy, and increased costs and complexity, particularly with inflation and rising gas prices. Despite reports of isolation, loneliness and burnout associated with remote work and blurred boundaries between work and private life, on balance workers appreciate the autonomy remote work provides. Now as workers confront the resurgence of COVID moving into the summer of 2022,[4] they appear to be even more reticent to return to work given what they believe are viable remote work alternatives.

In today's competitive labor market, companies must retain existing—or attract new—employees by accommodating remote and hybrid work, at least in the near term. The Great Resignation hit hard, and worker mobility is on the rise. Apple employees and more recently Google Map subcontractors sent a petition to company leadership to urge a continuation of their ability to work remotely after being ordered into the office. Most surveys indicate that the majority of workers favor approximately 2.5 days per week in the office with a strong preference for Mondays and Fridays at home. Employers are eager to have a return to the office to get the most out of their employees and to cost-effectively utilize their office footprints. Many offices have been reduced in size, mothballed, or are in some state of transition, having expanded technology, improved ventilation, implemented more stringent cleaning protocols, and added attractive new amenities, all which have likely increased CapEx. As long as workers have leverage in this tight labor market, companies with a “office-first” mentality, requiring a majority or full return to the office, may need to lighten up, pay more or suffer the consequences of employee departures.

As a movement to the suburbs, exurbs, smaller municipalities, and destination locations continues, other externalities have compounded workers’ desires to work on a hybrid basis. Current inflation, rising interest rates, rapidly increasing housing prices and rents, and uncertainties around schooling and childcare reinforce demand for hybrid working scenarios. Further, the decimation of employment center restaurants and retail, increased crime, increasing taxes, and visible homelessness in once-bustling downtowns heightens concerns about working and living in urban centers when less dense, more livable options exist.

As companies consider a reduction in their footprints in response to emboldened employees’ desires, the key will be to adapt offices for mid-week peak occupancy rates while trying to incentivize employees to spread the peak so reduced space can be better utilized. Employers will need to triage different work functions to specific locations, scheduling office meetings during the middle of the week while pushing phone and computer-based activities towards the shoulders of the week when workers prefer to stay home. Companies may look to invest in less expensive satellite units or shared and co-working spaces as they try to predict their future office needs once work lifestyles normalize and their leverage increases as the labor market stabilizes.

Some employers have found they can add amenities while reducing overall space and travel costs, resulting in overall savings. Curating an appealing, experiential office culture with a focus on interpersonal socializing will become even more important to draw workers to the office, as will prime office locations. Balanced collaboration between asset owners and managers and employers with a focus on the long term will be crucial to provide flexibility in the game of musical chairs that is underway across real estate sectors. A company’s ability to expand, contract, sublet and terminate early, while rapidly providing more attractive flexible/shared workspaces, may ultimately correlate with its ability to survive, especially as energy, fuel, tax, and labor costs rise.

Proptech and smart building companies can expand their data-collection focus supporting optimal conditioning, cleaning, and maintenance operations to include more precise occupancy, space type utilization and movements of users' data through the use of sensors to help companies reevaluate their changing real estate needs. Architects and designers will also be center stage in physically and culturally adapting spaces in unexpected ways.

A recent study from Columbia University and NYU5 estimates a tremendous devaluation of U.S. office buildings resulting from the rise in hybrid work. The study estimated a 32% decline in the value of U.S. office buildings in 2020 and an anticipated 28% decline in the long term in response to structural changes surrounding a shift to more remote working practices. These estimates were extrapolated from the detailed study of the New York City office market where they estimated a $49B value declination by 2029. Higher-quality and newer office buildings would fare the best relative to the rest of the office inventory, and there is significant concern about the viability of adapting older office buildings with larger and deeper floorplates to residential uses and whether there will be enough future demand to backfill these altered spaces. This level of possible property devaluation, combined with rising inflation and interest rates, and a potential recession, is sure to keep private lenders, public finance and policymakers, and the entire financial sector on guard during the evolution of the next few years.

There are other real estate sectors which may face similar pressures in response to hybrid work including education, health care, hospitality, and entertainment industries as demand is reduced in employment centers. Like the anticipated reduction of office space that may occur if remote work continues longer term, it is anticipated that colleges and universities may reduce their real property as more online delivery and remote work makes large campuses obsolete; some institutions may fail altogether. Other sectors will likely invest in labor-reducing technologies in this expensive labor market including automation, robotics, and lesser but very effective mechanisms including QR code restaurant menus, telemedicine, contactless hotel check-in, and greater use of chatbots to fulfill customer service needs, all of which may increase efficiencies and reduce repetitive and lower-wage work functions.

Beyond the decline of downtowns, the decentralization of people and resources outward from employment centers poses other problems. It places great pressure on suburbs, exurbs, and in geographic regions that may not be able to properly serve the influx of demand for infrastructure and services. It also potentially complicates achievement of equity goals. Remote work potentially widens the digital and economic divide, causing a need for re- and up-skilling of lower tech workers. Women and minorities lead in prioritizing remote working, which may cause these groups to miss out on face time that may better support promotions that would fulfill corporate diversity goals. Mixed-presence collaboration may also lead to "presence disparity" which could also limit career advancement for remote workers.

Economists estimate that, as a legacy of the pandemic and decentralization, 50% of the workforce will work remotely or in a hybrid manner in the future.6 This de-concentration of workers will cause government and businesses to pursue resource deployment models that support a more dispersed economy while repositioning and backfilling the existing built environment designed around now-less-relevant constructs of centralization. However, despite the urban exodus, downtown employment centers are expected to continue to draw residents seeking abundant urban amenities even as these centers become less pronounced as employment hubs. This is demonstrated by record high residential sales and opportunistic office space users who are betting on a return to these amenity-rich environments. Urban and regional planners will need to follow the arc of the pendulum between regional centralization and decentralization as the homeostasis is increasingly impacted by future disruptions. Planners, government staff, and elected officials will face renewed pressure for new and upgraded Infrastructure and increased need for services in more decentralized locations which are often the most expensive and difficult areas to service.

At least in the short-term, it is possible that continued decentralization of our employment and economic systems may help support enhanced resilience against additional future disruptions. Decentralization is credited for building redundancies and spreading out system footprints while building talent diversification amongst system participants, all which could be advantages when faced with future pandemics, severe weather, and other system stressors. The COVID disruption and the resulting shift to remote work may well be the bellwether for future resilience, forcing a move toward a more decentralized, diversified, and adaptable built environment and geographic land use pattern across all regions. Accompanying benefits of less traffic, cleaner air, improved access and mobility, more flexible and full employment, higher quality of life, better work/life balance, higher productivity, and potentially cost savings will further support the continuation of this new hybrid work trend at least in the short term. Employers who move from "business as usual" to "business as evolutional" will benefit as disruption and change inevitably accelerate.

Endnotes

[1] https://www.livemint.com/opinion/columns/the-great-decentralization-that-coronavirus-has-heralded-11590685800975.html

[2] https://www.kastle.com/safety-wellness/getting-america-back-to-work/

[3] Harvard Business Review, https://hbr.org/2021/08/dont-force-people-to-come-back-to-the-office-full-time

[4] https://covid19.healthdata.org/united-states-of-america?view=social-distancing&tab=trend

[5] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4124698

[6] https://www.inc.com/bill-murphy-jr/a-stanford-economist-who-studiesremote-work-says-half-of-allworkers-will-make-thisbig-change-in2022.html