Hybrid Working

PART 3 CITY IMPACTS AND ADAPTATION STRATEGIES

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INTRODUCTION

Globally and in Australia, office markets are reeling as CBD vacancy hits record highs. Meta stumping up AU$238m to exit their London lease (see here) is just the latest high profile office casualty of hybrid working. Whether we are in the office end times or experiencing a passing working from home (WFH) fad divides opinion, which is usually determined by the age, living arrangements and vested interests in the office market of either side.

To date most office prophecies have been based on personal perspectives, experiences and hopes rather than facts. In order to provide a more balanced understanding of what is happening in reality and what the future for offices is likely to be using objective facts and evidence, we have crunched an array of non-real estate data sourced globally and within Australia on the factors which influence the home versus office working balance. Our findings offer genuine insight to the murky and opinionated public discourse.

IN THREE PARTS, WE EXPLORE:

Part 1: Global hybrid working trends and drivers – exploring how regional and country level working preferences vary and primary reasons why. This has been published (see here).

Part 2: Australian hybrid working trends and drivers – illuminating the influencing factors of hybrid working down under which reveals a unique local twist on the global pattern. Based on these findings we unveil our WFH vulnerability index tool to assess office market resilience and risk at a city and sub-market level. This has been published (see here).

Part 3: City impacts and adaption strategies – here we offer advice for city governments, owners and other stakeholders on proactively responding to the transformational changes of hybrid working based on the insight contained within Parts 1 and 2.

If you think the hybrid working trend is nearly done, buckle up. Its implications are only just starting to manifest and they will be seismic. Our series will educate you on the factors which determine hybrid working impacts in any city or location, its implications and suitable ways for local government, city planners, asset owners, operators and occupiers to lean into the structural change to capture the best outcomes.

CITY IMPACTS AND ADAPTION STRATEGIES

Our detailed analysis on hybrid working trends and drivers set out in Parts 1 and 2 of this series establish that:

- **Office re-entry rates differ markedly at a global level and between countries.** Asia has the highest re-entry rates followed by Europe and the USA.
- **The drivers of office re-entry and WFH rates vary significantly.**
  - In Asia, it seems that cultural norms play an outsized role in encouraging greater office attendance despite long commutes, although dwelling size, high provision of modern office stock and better pandemic-management are important factors for office attendance.
  - In Europe, public transport availability and the vibrancy of office sub-markets which are typically mixed use appears to support the appeal of office presenteeism.
  - The USA has a high reliance on commuting by car, a high volume of dated office stock, a high proportion of single-use office locations which evolved around car-based access, and large dwelling sizes which all encourage higher WFH.
- **Within Australia, state approaches towards pandemic management seem to have had a major impact on WFH preferences, as does public sector-based employment.** The importance of office stock and micro-locational quality may be greater at encouraging office re-entry in Australia than in other global markets. Commute mode and length and average dwelling sizes appear to be comparatively less important. We speculate that the quality of local residential neighbourhoods in Australian cities is a key factor in determining WFH preference relative to other global cities, given the wider variety of Australian suburbs, many of which offer significant lifestyle appeal.
- **Whilst the differences in many drivers at a city-level do not vary much between Australian CBDs, they are likely to vary significantly by sub-markets within each city.** This suggests a granular approach towards considering these drivers in the context of office micro-location and sub-market is a useful tool to assess WFH vulnerability as a means to better manage existing and proposed office buildings and precincts.
- **Over time the relative balance of WFH drivers in any city or country will change, but it is unlikely to do so at the same dramatic pace that was triggered by the pandemic.** This allows more time for stakeholders with an interest in offices and the sub-markets, cities and countries which rely on them to adapt if they monitor the relevant trends.

SOCIETAL IMPACTS: LIVE/ WORK/ PLAY HABITS

Office workers in Australia are empowered by generous hybrid working policies and have significant freedom to choose where to work and when. This is distinct from other countries which may have established cultural norms predicated on office attendance which makes it harder to WFH, which have strong social bonds, or which do not yet have WFH rights enshrined in government policies like Australia's public sector does.

The desire to live/ work/ play is rising across communities globally, and is being incentivised by governments as a means to support more sustainable city development and travel patterns. An outcome from the extensive analysis in this report highlights the likely importance of offices within mixed-use precincts and the desirability of residential neighbourhoods as a critical driver of the WFH versus office balance. The data suggests that cities with greater volumes of single-use office locations without diversified uses struggle to attract office workers, even if those cities provide large volumes of prime space such as parts of Melbourne and Sydney.

The strong localised lifestyle appeal of certain residential neighbourhoods is likely to provide a more compelling reason to WFH than is the case in most non-Australian office markets globally. The ability to use your lunchbreak to surf at Bondi Beach (Sydney) for example, or stroll around one of the parks in Northcote (Melbourne) provides a compelling alternative to the office location which successful CBDs will need to counter. As a result of stricter lockdowns during the pandemic, it may be that more residents relocated to more desirable suburbs or are planning to do so for lifestyle reasons on the basis that hybrid working allows more WFH days. This further erodes the appeal of the office.

Over time, the structure of our cities should realign accordingly. Single-use office markets will need to either diversify their offer significantly to stay relevant or transition to other uses. It may not be possible for some non-CBD markets which are entirely car-based to remain viable even if they diversify, as the home office or a CBD location with rich amenity and mixed-uses is always likely to be more appealing to workers free to split their time as they like. Furthermore the aggregate demand for office space will fall as occupiers consolidate onto smaller portfolios, meaning that Australia's office market may shrink in the short to medium-term.

Residential neighbourhoods may need to diversify their offer over time to better serve a rising WFH population through local amenities like cafes, exercise facilities and flexible office space of the type historically concentrated in CBD and office-dominated sub-markets. The lines between traditional office and residential precincts will become even more blurred. Office stock will be unevenly distributed, with a small provision scattered liberally around cities. The successful sub-markets and CBDs which can combine a mixture of uses and with public transport accessibility will provide the strongest draw to workers and concentrate a greater amount of the office space that remains viable within them. This will lead to fewer office sub-markets.

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CITY GOVERNANCE

Our findings suggest that city governments may be limited in their ability to influence WFH patterns at a macro level, given they are unable to alter the State-level approaches adopted during lockdown or significantly alter their employment profile in anything other than an ultra-long timescale. However, what they can do is assess the vulnerability of individual office sub-markets to WFH within a city using the metrics identified here as well as considering the associated impacts on residential neighbourhoods.

The vulnerability of office sub-markets varies drastically. Understanding which sub-markets are well placed to survive and thrive in the hybrid working world and which are unlikely to be viable will allow city authorities to better target their policies.

Support can be provided to strengthen the viability of those least vulnerable to WFH through, for example, widening the mix of uses provided, supporting new high quality office space, improving transport connectivity and the overall quality of the micro-location. Those sub-markets which are unlikely to be viable in the long-term can be assisted to transition to alternative uses in a managed decline of the office component in order to provide alternative uses which the city needs. This represents a position of proactivity in the face of transformational structural change which will play out regardless of the city governance response.

TOWN PLANNING

Town planning will need to become more flexible to adapt to the WFH drivers identified here and manage their impacts. It will be challenging for city-wide blanket planning policies to be effective in managing change optimally given the uniqueness of these drivers at a local level. The blurring of lines between different uses within a micro-location and even within individual buildings also requires a flexible planning approach which can be adapted to the unique circumstances of each building and location.

Office uses in highly vulnerable sub-markets should not be protected on the grounds of preserving employment. If such sub-markets are not viable, occupiers will not locate there if they cannot attract their staff to the office even if existing office space is retained. Rather, employment is best maintained by prioritising support for the healthiest office markets and seeking to aid the adaptive reuse of offices in sub-markets expected to experience long-term decline. Ultimately, this will deliver better city-wide outcomes in terms of employment, housing affordability and choice and sustainability by making better use of previously developed land and buildings.

COULD TRENDS CHANGE AGAIN?

The pandemic rapidly enabled the mass adoption of hybrid working. Companies and the real estate industry were caught unawares and are still struggling to adapt. It is worth considering if things could change again, and why. Several trends are worth highlighting in this regard. Whilst these are unlikely to prompt such a rapid reset of working practices as the pandemic, over time they may change the balance between in-office and WFH days and they should be monitored.

1. IMPROVED OFFICE PERCEPTION

With hybrid working having been established for several years post-pandemic, credible data is becoming available on how offices need to adapt to better serve workers in the new paradigm. It is clear, for example, that a modern, amenitised and sustainable office with a mixture of working environments together with leisure, café and outdoor space either within the office itself or in the immediate locality is most appealing to workers. So too is an office that is easy to get to by public transport and in a vibrant micro-location.

Lease events provide businesses with the opportunity to recalibrate their office portfolios accordingly. Whilst the supply of hybrid-enabled space is tight, over time more space will be built and adapted to align to occupier expectations and older failing stock will be improved or repositioned for alternative uses. As the market adapts, the appeal of offices should grow. As it does, more workers could be tempted back to the office more often if they are provided with stronger reasons to visit.

2. POWER REBALANCING TO EMPLOYERS

Employers have valid reasons to want workers back in the office more frequently than workers prefer. Multiple studies over several years from both before and after the pandemic have conclusively proved that output is greater in the office relative to home by approximately 20% (The Economist, 2023b). Higher output is credited by higher worker engagement, easier communication with colleagues and more creativity sparked by spontaneous interactions or 'water cooler moments'.

That is not to say that a full five days in the office each week is optimal. Some tasks may be better suited to the home environment as explored previously. Certain groups like parents with childcare responsibilities or those caring for sick or older relatives may benefit greatly from the flexibility provided by WFH and may otherwise be excluded from working. WFH enhances employee satisfaction. Companies may be happy to accept lower output if they can offset that through greater input cost savings by relinquishing their office space and saving rental outgoings or by lowering worker salaries. But for most companies, greater office attendance will be preferred due to associated productivity benefits.

In the current paradigm, employees have the power. Australian unemployment was 3.6% in September 2023 and the participation rate was 67% (ABS, 2023b). Employment has been cyclically high for several years now and unemployment has remained below 4.0% since March 2022. Tight labour markets make employment competitive and forces employers to compete on WFH flexibility amongst other measures. However, if labour conditions were to soften and the power balance shifts back to employers, WFH rules may tighten. Employees who have fewer alternative job prospects and highly motivated to keep their job will be less inclined to push back on more in-office days and adhere to employer expectations.

Recent survey evidence from KPMG indicates that business leaders do expect higher office-based working days in the medium term. Two-thirds of Australian CEOs in their latest survey expected traditional white collar roles to be fully office-based in three years' time with only a minority believing hybrid or fully-remote patterns would dominate (KPMG, 2023). Three-quarters stated that workers who spend more time in the office would get access to better rewards such as pay rises, promotions and superior projects. This assertive shift is likely to reflect anticipated weaker labour market conditions with 22% of Australian CEO's predicting staff cuts of up to 5% within three years.

However, unemployment is still unlikely to rise significantly any time soon. Whilst Oxford Economics projects unemployment increasing to 4.3% in 2024 and 2025, it will be down to 4.0% again by 2026 and will remain there for the medium-term (Oxford Economics, 2023). With Australian unemployment remaining so low, marginally greater labour market availability is unlikely to substantially transfer power from employees back to employers. These survey responses may reflect CEO aspirations which they have limited ability to control, rather than reality. However a significant deterioration in economic conditions triggered by a black swan event could rapidly change the dynamic and stimulate a stronger return to the office.

3. EMPLOYER CARROT AND STICK

Immediately after the pandemic, employers were reluctant to force workers back into the office. There was uncertainty as to what the post-pandemic normal would be and labour markets were tight as the so-called ‘great resignation’ played out. Now, occupiers are being more forceful in issuing demands and enforcing a minimum number of office-based days each week using both carrots (incentives) and sticks (punishments).

Using carrots, employers are seeking to increase the appeal of the office by adding additional perks for staff who use it. Examples include free food, subsidised travel and social events like yoga or concerts (BBC, 2023). For sticks, companies as diverse as Google, JP Morgan and Davis Polk (a US law firm) have indicated that office attendance will be factored into performance reviews and bonus allocations (ibid). Amazon, Citigroup and Zoom are monitoring employee attendance and notifying those who do not achieve minimum expectations (Financial Times, 2023).

Over time, more evidence will emerge on which carrots and sticks are most effective. This is likely to widen their adoption by companies which will build momentum for more days in the office over time. The impact of better rewards for workers who spend more time in the office as expected in KPMG’s CEO survey has the potential to substantially alter working patterns if implemented effectively.

The ability for them to discriminate based on working location may be subject to legal or ethical challenges though. Given that not all roles and tasks benefit from being office-based, it may also be difficult to impose discriminatory rewards of this nature on employees who WFH more frequently but are also highly productive. In summary then, it remains to be seen if employers will ever again regain their pre-pandemic power to dictate work location.

4. A SHORTER WORKING WEEK

A potential counterbalance to greater office attendance may come in the form of a shorter working week. There is increasing public debate about the impact that rising use of artificial intelligence (AI) will have on office-based work by increasing employee productivity and reducing the amount of time necessary to undertake tasks. One response to this could be to mandate a shorter working week.

60 companies in the UK recently completed the largest study globally on a four-day working week. It found significant success in increasing productivity and employee happiness without a significant loss in output (World Economic Forum, 2023). Sick days fell by 65%, burnout was down by 71% and 90% of the companies involved in the trial elected to continue with a four-day week afterwards (ibid).

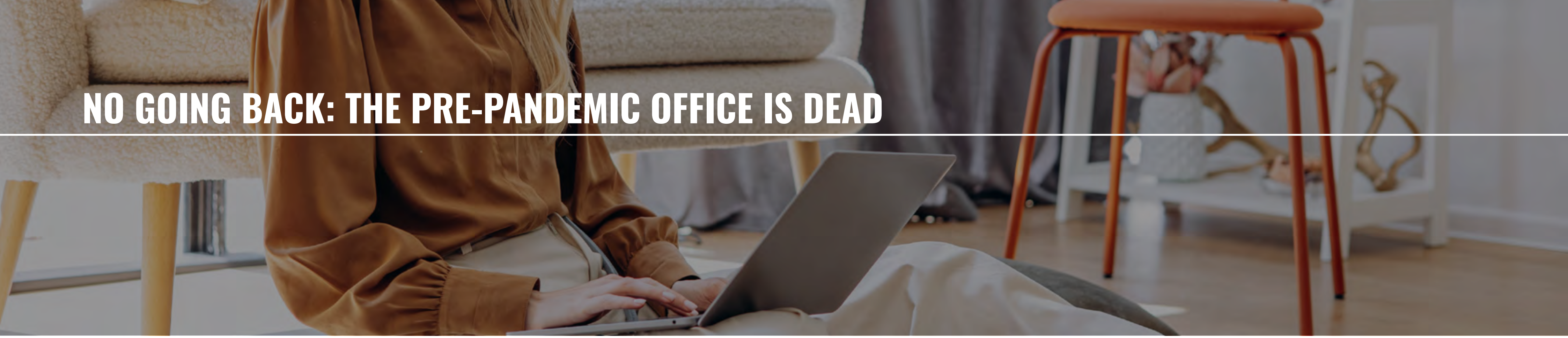
Australian companies are experimenting in this area too, with 10 companies participating in a recent trial of which only one did not adopt a shorter working week afterwards (The Sydney Morning Herald, 2023a). The Senate is investigating the topic and firms including Bunnings, Oxfam and Unilever are testing it.

It is far too early to predict how this trend will play out. If it is adopted en masse, it has the potential to reduce aggregate office demand by as much as 20%. However, it may remain a niche policy for a minority of companies. It may be the case that companies still need to maintain office portfolios capable of accommodating all their staff on any given day which would mitigate the reduction in office demand. Companies may also still need to provide their staff with the ability to work four days over a five-day week thereby offering a shorter working day. There is high uncertainty over how this will evolve, but it is an important trend to monitor.

CONCLUSION: THE WFH/ OFFICE BALANCE MAY CHANGE AGAIN...BUT GRADUALLY

Trends will continue to encourage and discourage WFH in the future. As with all occupier trends, demand will be in a constant state of flux and will mutate and evolve over time. These trends should be monitored as a predictor of future office demand. However, these will manifest slowly over years and are highly unlikely to have the same transformational impact in such a short space of time as the pandemic. This will provide space for stakeholders to adapt in real time alongside these trends, rather than be overwhelmed by them.

NO GOING BACK: THE PRE-PANDEMIC OFFICE IS DEAD



This series has explored WFH habits and drivers globally and within Australia using data and evidence. It has also highlighted ways in which home versus the office balance could shift again in the future. Whilst the balance may change to a degree, what is quite clear is that the hybrid working genie is out of the bottle and regardless of what CEOs may want, it cannot be put back. Employees have experienced the many benefits of hybrid working. Some have made substantial life-changes as a result like moving to far-away suburbs or countries. These decisions cannot easily be undone. Employees working expectations have fundamentally altered and the inefficiency and expense of the commute exposed. These lessons will never be forgotten.

Given that business performance has been maintained or even improved despite hybrid working, it is difficult for employers to mount a strong case that office presentism is essential for success. In any case, employers appreciate the cost savings available by occupying a lesser amount of better quality office space even if they pay more for it, as well as their ability to tap a wider pool of talent by offering hybrid working. Employees will continue to be highly sought which blunts the power of employers to impose working location mandates. Increasingly too, the right for employees to work from home at least some of the time is being enshrined into law. Unless an unforeseen event substantially changes the situation, a full return to the office is unlikely.

Whilst WFH drivers and trends may change to some extent, any change will be minor in the context of the paradigm shift triggered by COVID-19 which established hybrid working as the default position. The office flight to quality will not reverse as occupiers and their staff will never again accept poor quality stock for purely experiential reasons. That is distinct from the sizeable sustainability challenges of older stock which provide insurmountable impediments to their long-term office use. The bulk of secondary office stock will never again be viable.

As lease events occur, occupiers will increasingly consolidate onto a lesser amount of centrally located, high quality and sustainable office space at the expense of their legacy portfolios. Office uses will be selectively located within vibrant micro-locations which combine a broad mix of uses, an attractive environment and public transport connectivity. Most Australian office stock does not conform to these requirements by virtue of its location, its physical quality or both.

What do to with such large volumes of redundant office stock is perhaps the most immediate urban challenge we face. Entire sub-markets and their infrastructure are predominantly built around an office use which no longer works. However, simply demolishing old offices and starting again is impossible due to our pressing need to limit greenhouse gas emissions, towards which real estate construction is a major contributor, in order to achieve Australia's net zero goal.

The only solution is to adaptively reuse obsolete offices for entirely new uses. This is not easy – adaptive reuse can be more expensive than demolition. It is always more complex given that the needs of new users must be accommodated with largely pre-set hard parameters. Nevertheless, city governments, planners, investors, owners and occupiers will need to learn how to effectively deliver adaptive reuse if we are to successfully navigate our urban areas to a thriving, dynamic and climate-friendly future.

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