



The So What from BCG Podcast

Zombie Buildings and the Future of Cities

Santiago Ferrer

GEORGIE FROST: Reports of the death of the workplace may be exaggerated, but demand for office space is decreasing. Fewer workers are coming into cities, favoring hybrid working over traditional Monday to Friday commutes. This shift is having big implications for building owners, cities, transportation, and the economy that office workers generate. So what will the cities of the future look like and how should businesses be preparing? I'm Georgie Frost and this is The So What from BCG.

SANTIAGO FERRER: So the way that we use our downtowns will become more agile. You'll see some days where it's very busy, some days where it's not. It will be driven not only by work but also by events. In the US we're now dealing with the economic implications of Taylor Swift's concerts that drive a whole bunch of people into places.

GEORGIE FROST: Today I'm talking to Santiago Ferrer, BCG's North America lead for Cities, Real Estate, and Infrastructure Development.

SANTIAGO FERRER: The workplace is not dead. It is however, changing, and the way that we all use offices is obviously evolving. As we sit here, I am in an office and it seems like you might not be in an office or if it is an office, it's a very well-designed office. So really, I think the way that we've all passed through what I would say the work experiment that the COVID pandemic resulted in, means that now we're working in a completely different way and that obviously has impacts in the physical space that we use. And in particular, the office space.

GEORGIE FROST: I can assure you I don't have candles and pictures of my grandma in my office. No, I don't. This is from home. But I, like many people, I'm a hybrid worker, so I will be going to the office sometimes and I'll be at home the other time. Obviously there are industries where that's impossible, but what are you actually seeing, apart from the obvious being that there are less people

around in the office? What is the knock-on effect of that?

SANTIAGO FERRER: So I think there's two ways to think about the impact. Number one is there's a challenge as I think about what is the right base load of office space to have. Because whilst before everyone used to use the space the same Monday to Friday, now you start having this variability by days.

And then second, obviously, there is the impact that that has not only on office space and how much office space is required that a lot of individuals have talked about, but also the whole economy that is there to support office workers. As we go into the offices, we use transportation. When we're in the office space, we use retail and restaurants around it.

And now we see that the impacts of people not coming into downtowns at the same rate is having this second order impacts on other parts of the economy.

GEORGIE FROST: Santiago, I need to ask you because I'm based here around London, you in LA. We have listeners all around the world that may be thinking, I don't recognize this. Is this just a US/European issue?

Santiago Ferrer: It's a great question. I think the issue of the way that people have changed really impacts the whole world. I would say the extent of that impact is different. And within the US also, there's actually quite different stories, depending where you are. But I would say US large coastal cities have been impacted more.

As we move to Asia, it's probably on the other side of the spectrum. There was recently some work done that a lot of money is actually—investments—are going into Japan because the office sector is so strong there. So I think Japan is probably on the other side of the scale. And then I would say Europe is in the middle. There's some places where there is a higher propensity from



work from home and remote work and there's others where the culture is such where individuals are expected to come back to the office.

A lot of it also has to do with the way that people live. In places where they have the ability to have a home office that is separate to the spaces where they live and eat and sleep, I think you start finding obviously the ability for people to be able to work remotely.

Where that is not available or the internet connection or broadband connection is not as strong, then obviously you see a stronger return to the office.

GEORGIE FROST: How are businesses responding? Are we seeing them dragging, trying to drag workers back or actually cheering about the fact that they don't have to pay so much rent anymore?

SANTIAGO FERRER: Well, at the moment they're still paying rent. A lot of corporates and a lot of organizations had short-term extensions on their leases. And those are starting to come up. And if you think about the number, I think about 60% of corporate rents, at least in the US and I would assume similar in Europe, are coming up for renewal in the next two to three years.

So right now, there's this fine balance of trying to understand how many people are going to come back to the office and then hence, how do I then align my real estate strategies, so how much space I need, to that number. We've seen in recent months an increased comfort of corporate clients asking their employees to be back to the office. But even then, most people are asking people to come back at least three days a week. It's not like the majority of employees are coming back five days a week, at least in the US and I would assume similar in Europe or London. You can tell me better.

And then obviously there is that issue about, well, if I only have certain number of people and not all my people coming back, they're only coming three days a week, then how much office space do I need? They now have the ability to act on it on the next two to three years. And you'll see a lot of what I would call right-sizing of real estate where you'll see less space being used than before, but that space will be used differently.

GEORGIE FROST: What do you need to be thinking about or preparing as a business for this continued change?

SANTIAGO FERRER: What I would say is we need to have a clear alignment with what is the business strategy that the corporation or the business unit that is trying to drive. Because everything that we do around our people and then our real estate should align to that.

So what we've seen a lot is a lot of businesses thinking independently about these three legs, but to me, we need to have full alignment. What is our business strategy? How do we drive competitive differentiation? What does that mean for my people? How do I make sure that I have the best people at the right place, working in the most effective way for them to be productive?

And then obviously having the real estate to support that. And not having alignment through that is often what leads to a lot of conflict even within an organization, because we're asking people to do things that are not necessarily in the best interest of the overall outcome, and then they don't have the real estate or a physical space that allows them to deliver on what that business needs to do.

GEORGIE FROST: You've done research into zombie buildings. Tell me about zombie buildings.

SANTIAGO FERRER: It's a great name. Zombie buildings, as we've described, as half-empty office buildings. So what we've tried to do is look at the implications of everything we were just talking about. What does it mean?

And if we look at it now, we call it a zombie building, a half-empty office building. Roughly now, if you look at it, occupancy's about 35 to 45% at the start of this year. We think that when things stabilize over the next 6 to 12 months, we'll get to about 55 to 60% occupancy of office buildings across North America, hence making them half-dead, half-alive. And obviously there's actions that can be taken to tip them one way or tip them the other.

GEORGIE FROST: You said you wanted to look at what it means. What does it mean? What's wrong with having a building that's 55% full? Which way would you want to push it?



SANTIAGO FERRER: Exactly, which way we push it? [laughs]

GEORGIE FROST: We don't want to push a building over.

SANTIAGO FERRER: Exactly. No, no, we're not pushing the building over. But it all comes down to the economics. Historically, an office building has occupancy around 80 to 85% and a vacancy of 17%. There's always going to be some vacancy in buildings. All businesses tend to buy more space than they need as they grow. And there's also just the normal churn.

However, what we're seeing is that we're going from that, call it 85 to 15%, so 85 occupancy, 15% vacancy, to around 35 to 40% vacancy and 60 to 65% occupancy. And that has big implications around the number of office space that will be needed. And then obviously it has implications around the rent revenue that comes in and the value of the buildings themselves that is a representation of that rent that comes in.

GEORGIE FROST: So indulge me, let's fast-forward into the future. How do you see us building the cities of the future? What will they look like if the trends continue?

SANTIAGO FERRER: I feel like there is always this tension. And if you indulge me for a little bit of just sort of sharing my thinking, is humans are very fluid. We change all the time. We are great at reacting to pandemics and there's a lot of things that we can take as human beings.

Our built environment is very physical. It is designed not to change. And I think there's constantly this tension between human beings and the built environment that we built. Having said all that and going on a rant, to me, it is like we are going to change, but we change more than the built environment itself. So the way that we use our downtowns will become more agile. You'll see some days where it's very busy, some days where it's not. It will be driven not only by work but also by events.

In the US, we're now dealing with the economic implications of Taylor Swift's concerts that drive a whole bunch of people into places. But I think that shows the fact that the way that people want to use cities is changing. And I think that's a positive thing, because obviously we should always make

sure that people have access to use our infrastructure in the way they need to use it.

But that has big implications around the operations of it. If you talk to me about what the future means, I feel we need to be a lot more operationally focused in our infrastructure, make sure that we are able to provide capacity at different levels. That means moving away from very rigid schedules of the way that we used to plan for transportation and infrastructure. It also means about integrating more with more on demand type of transit.

So think about ride-share, but as we look 10, 20 years down the road, we'll have more of electric and autonomous vehicles. There's been a lot of conversation about when those will come, but eventually they will come and we'll need integration around all these different modes of transport.

While that happens, which I would say is sort of what you can actually change quickly in the operating environment, is how do you use what you have better? As we plan for infrastructure investments going forward, we need to think about that change of how people use it and think about how do we actually connect people in a way that doesn't necessarily funnel everyone in the same place at the same time.

So we'll be going from cities which are very focused on one center to poly-center cities that come in and that allow also people to access jobs, health, education, closer to where they live and also using different modes of transportation to do that.

GEORGIE FROST: What are you most excited about? Where are the opportunities?

SANTIAGO FERRER: I think the opportunities are around connecting individuals. Well, maybe this is a pun. I think the opportunities are about connecting better individuals with opportunities, but to me that's all what infrastructure, transportation, and cities is about.

We have such untapped potential in human beings that are bounded by where they were born, where they live. And having a way to connect people with better things, better opportunities that they had themselves from where they won the lottery of where they got put, is to me sort of the exciting part.



And that is obviously the advent of remote everything and virtual everything is part of it. But I still think that the human connection is really important. To me, what I'm excited about is we've been able to sort of democratize access to a lot of different jobs, healthcare, education through everything that is virtual, the virtual world and Zoom and so on and so forth.

How do we actually bring some of that also to the physical side. How do we actually think about our transportation and infrastructure networks in a way that... we know that everything cannot be virtual, but how do we make sure that we build that last 20% of connection that most people will need to be able to do things in a way that is not looking at the past, but looking at the future and the way people want to work. Work and live.

GEORGIE FROST: And the big risks I suppose, that you see coming? Technology or sustainability or anything?

SANTIAGO FERRER: Definitely. All of this needs to be done with technology hand to hand, and obviously with a huge sustainability impact. We also saw a decrease in carbon emissions when we were all hanging out at home. Obviously we need to balance both.

But to me actually, I think the biggest challenge is this is what I would call an issue around orchestration. Nobody owns this. Everyone touches it and nobody owns it. And I think that's what's most difficult about solving a problem like this because it requires leadership from business. It requires leadership from owners of buildings.

It requires leadership from the public sector and the civic sector, and it requires everyone to move in concert. We've seen some places where that's starting to happen, but not having that strong sort of civic community is something that obviously makes it hard for then cities to act together or in unison.

GEORGIE FROST: Are there any examples that you can give me where you are seeing this working?

SANTIAGO FERRER: So, the work that Chicago has been doing around the revitalization of buildings within the Loop. I think it's called the LaSalle Corridor. It is a beautiful street in Chicago, which is filled with buildings from the earliest 20th

century. And I think it's also appeared in Batman movies and everything. It's a very iconic scene.

However, those floor plates and those buildings are obviously not where offices want to have teams nowadays because of ceiling heights, because of the way the space is and the number of columns. Everyone's been talking about office to apartment conversions. The complexity here is when you have a whole street where you have zombie buildings that are not being used, if you just are going to turn one into apartments, the future residents still live in a world of zombies.

However, if you're able to coordinate a number of developers to change, to really create a whole neighborhood, to do placemaking, then it's not that you're moving into a sea of zombies. You're moving into a place where 2,000, 3,000 other people will be moving in, in two to three years.

So it suddenly goes from being a risky proposition to change one building to being no, we're creating a new neighborhood, we're creating a new place. And that really takes leadership not only from developers, it also takes leadership from the city, and it takes leadership from civic organizations to make sure that all the pieces are there because one organization would not be able to do it by themselves.

GEORGIE FROST: I know this is not your area of expertise, you are more a cities man. But what about the regions? What about going a little bit further afield? How do you expect, I guess... I mean it would be different depending on the size of the country. I know England is a lot smaller than the North America, but how do you expect that to change?

SANTIAGO FERRER: I think the regions will...not to say that I'm a cities guy versus a regions guy...but I think the balance between the cities and the regions will probably tilt even more to the regions. The advent of not having to come into the office every day means that people can live further away from these big city centers.

And that allows for the development of... I guess it goes back to the point I was making before about having cities or may be cities and regions that have multiple centers around them. The ability to be located a little bit further out, but still have great transportation to bring people in to connect them with jobs and services when they need it will just go up. And also because, frankly, whilst a lot of our



cities have room to grow, there is still a lot of NIMBYism. I think we use that term in the US. I think you might use it over there as well.

GEORGIE FROST: Oh, yeah.

SANTIAGO FERRER: Yeah, people still do not like big apartment buildings everywhere. So whilst our cities continue to be filled up, the regions are going to be a very important part of the equation of how do we make sure we have housing for everyone and how do we make sure we have housing that fits their needs and also is at the right price point, because the city won't be able to do it all.

GEORGIE FROST: And of course, Santiago, we've been talking about hybrid working and people wanting to be at home in the regions, and that's why offices will be more bare. But also, offices, I imagine will be more bare as AI takes over some of those traditional office roles.

SANTIAGO FERRER: Yes, I've heard of this AI thing.

GEORGIE FROST: Yeah.

SANTIAGO FERRER: Just a couple of times. So definitely. I mean, obviously, if we think about how jobs are going to change, AI is going to lead to a lot of rethink of where human capital should be focused on. If you look at every time we've introduced sort of new technology, we always find new jobs and new ways for human beings to contribute in different ways.

But it will be a transition, and a lot of the jobs that are going to be impacted are also the jobs that are focused more on individual tasks than obviously of people working together. So I think that will also impact the way that people use it. Interestingly enough, I think it might lead to people using offices the way that people want to use offices, for everything that is collaboration, will stay, and I think people will be much more productive in the individual work that they do because of AI.

But it will take, like every other transition... Again, I said human beings are good at changing fast...we're good at changing fast compared to the built environment, but we're still pretty bad at changing because it takes us time to learn new things and do it. And in that way, I think the transition as these new tools come in will require us to use the office differently. And you might see

changes in the amount of people doing different tasks as a result.

And I think that will play out over the next decade. I don't think it's something that we'll turn on a switch and suddenly AI will do all our jobs, but it will change the way that we work across everything we do.

GEORGIE FROST: Santiago, thank you so much, and to you for listening. We'd love to know your thoughts. To get in contact, leave us a message at thesowhat@bcg.com. And if you like this podcast, why not hit subscribe and leave a rating wherever you found us? It helps other people find us too.