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BGO CANADA RESEARCH

# FUTURE OF CITIES



## GLOBAL CITIES WILL CONTINUE TO THRIVE.

In this first of a three-part series, we'll explore the future of cities and the impact of technology on knowledge work and mobility. In the second part, we will take a deeper look at how knowledge work is evolving, how firms are re-evaluating their office space requirements, and what the future holds for corporate headquarters. In the final piece, we'll look through a few different lenses at the forces that will shape the future of cities over the next decade, including demographics, technology, environment, social, and governance (ESG) factors and the potential economic impacts from the COVID-19 recession.

### GLOBAL CITIES ARE RESILIENT.

- The coronavirus has disproportionately impacted global cities. It's evident that larger cities have had higher case rates and fatalities than other parts of the world, and with many places now facing a second wave, the recovery efforts are likely to face a setback. **But we believe that this is not the end of cities, simply a bump in the road for urbanization.** Cities have historically endured much greater challenges and have emerged stronger and more vibrant on the other side. We expect global cities to remain leading centres of culture, innovation, and economic power.
- The future of work is becoming more decentralized and that means greater choice on where to live and work. However, **the office is not going to disappear, nor will it be the catalyst for the demise of urban centres.** People will still want to physically come together to connect and build relationships, exchange ideas and learn from one another, and to develop their careers. Greater flexibility in how people live, work, and play provides cities with an opportunity to become more flexible themselves. Adoption of more adaptive planning and design principles can help reshape cities into more livable, walkable, inclusive, and sustainable communities.

**This is not the end of cities, simply a bump in the road for urbanization**

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- The resiliency of cities is rooted in our belief that agglomeration economies will remain strong, reinforced by even greater “amenity value” that cities will need to create to attract and retain talent. The digital world enables relationships to develop across geography. Like-minded people can now connect from anywhere in the world but ultimately, they will want to come together in-person to exchange ideas, create new ventures, and enjoy some laughs over an evening on the town. After all, our desire to connect in-person with one another on the other side of this pandemic will likely be greater than ever.

### CITIES HAVE BEEN THE EPICENTRE OF OUTBREAKS.

- Density, or more appropriately “overcrowding,” particularly in low-income communities, has led to higher infection rates in cities across the globe. Low-wage workers often: 1) are employed in essential services; 2) don’t have the ability to work from home; and 3) don’t have adequate health care benefits. They often live in larger households and dense housing communities, where the virus can be transmitted more easily. Lower income workers often must travel great distances on crowded public transit to get to and from work, potentially further fuelling the spread of the virus.
- Teralytics, a Swiss technology firm, analyzed mobility data in European and U.S. cities and discovered that local infection rates were more accurately predicted when their models also included two measures of the propensity for travel: the number of journeys people take and “network centrality,” or how many other people they come in contact with. This suggests that better regionally and globally connected cities are more likely to be impacted by the virus than those with less network centrality. <sup>1</sup>





- Lower rates of infections and fatalities can be found within more affluent areas of some of the hardest hit cities, where there is better access to health care and residents are more likely able to isolate at home while continuing to work. For example, data from New York City shows that the least impacted areas were in the most prosperous neighbourhoods in Manhattan, while high rates of infection occurred in more deprived areas.
- These “hot spots” have led to an exodus of affluent, more mobile knowledge workers from cities such as London, New York, and San Francisco. Many of those who left during the height of the pandemic have since returned, but some may have relocated permanently.<sup>2</sup>
- While coronavirus was likely a contributing factor in relocation decisions, it’s unlikely the only factor. The virus merely accelerated an existing shift away from higher-cost cities that have become victims of their own success. As Brookings Institute demographer William Frey has documented, the growth of “superstar” cities, such as New York and San Francisco, had begun to reverse over the past five years as people began heading to smaller metros, suburbs, and rural areas in search of more affordability, lower commute times and a higher quality of life.<sup>3</sup> Similar research from Oxford Economics points to net outflows of young adult Londoners between 2016 and 2018, largely in search of more affordable housing.<sup>4</sup>
- In many instances, outflows from major cities have largely gone unnoticed because of a backfill from robust international migration. For example, Canada’s comparatively open immigration policy has attracted record levels of both permanent and nonpermanent residents, including temporary foreign workers and international students. The result has been a surge in population growth in gateway cities like Toronto and Vancouver, particularly among young adults. The near-term outlook for growth has dampened with COVID-19 shutting down borders. And while we don’t expect international mobility to be impaired over the long term, it remains a risk.

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- While many of the of virus-related challenges that cities currently face will hopefully prove transitory, this crisis and the resulting economic fallout have shone a bright light on the systemic issues that negatively impact the lure of cities, primarily a lack of affordable housing, income inequality, and racial and social injustices.

### IS THIS A TURNING POINT FOR THE WORLD'S GREAT CITIES?

- We don't believe this marks the demise of global cities – merely a bump in the road for urbanization. The pre-pandemic projection is that, over the next 10 years, nearly 1 billion people are expected to move to cities. Today 4.2 billion people (55%) live in cities around the world; by 2050, that number is expected to be 6.7 billion (68%).<sup>5</sup> This pandemic may warrant a reforecast of those figures, but the result is unlikely to materially dent the continued wave of urbanization.
- There are many examples throughout history of cities that have survived far worse pandemics, natural disasters, wars, and economic collapses. In his recent Bloomberg CityLab article, *This Is Not the End of Cities*, urbanist Richard Florida explains that “urbanization has always proven the greater force – stronger than the devastating Black Plagues that began in the 14th century, the deadly cholera outbreaks in 19th-century London, and the horrific tragedy of the Spanish Flu, which killed as many as 50 million people worldwide between 1918 and 1920.” He goes on to say that “each and every time, the economic power of cities – their ability to compound innovation and productivity by compounding the talent of ambitious and creative people – has been more than enough to offset the destructive power of infectious disease.”<sup>6</sup>
- In part three of this series, we'll discuss the forces that are re-shaping global cities and how many of those forces have been amplified by COVID-19 and will accelerate over the next decade. We'll look at how these factors might influence which cities people choose to live in and where they will reside

COVID-19 is merely a bump in the road for urbanization.

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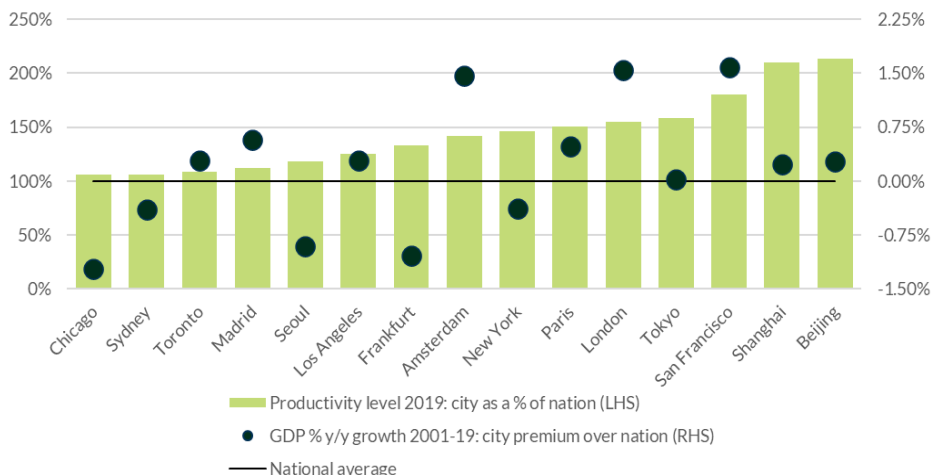
within them. One of those driving factors is the evolution of work in a knowledge-based economy.

**CITIES WILL CONTINUE TO BE CENTRES FOR TALENT AND INNOVATION.**

- The current pandemic and its economic fallout will not lead to the demise of cities or urban centres, but we do anticipate that they will be the catalysts that accelerate many underlying demographic and economic shifts already underway. These shifts will influence the spatial distribution of supply and demand, and could have a profound impact on how cities are organized.
- Our long-term view is that we expect urban environments – particularly in the world’s premier cities – to continue to be the centres for talent and innovation. Research from Oxford Economics suggests that the world’s great cities possess a productivity and GDP growth premium relative to their national averages. The researchers note that “although the economic superiority of major cities is not completely universal, it is certainly widespread.”<sup>7</sup>

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**Selected Major Cities' Productivity and Growth Relative to Their National Averages**



The world’s great cities possess a productivity and GDP growth premium relative to their national averages.

- The recovery and long-term success of cities will depend largely upon how city leaders and their citizens handle the current health crisis. People will want to go to the cities that provide them with the best opportunities to succeed – increasingly that will depend on those cities that place the health, safety and wellness of its citizens above all else. And it's no longer enough to simply provide the physical infrastructure that supports an economy. It is imperative that cities create reasons for people to live within them and visit regularly.



New York, U.S

**AGGLOMERATION ECONOMIES WILL ENDURE.**

- Underpinning our conviction in the vibrant future of cities is the belief that agglomeration economies will endure even in the information age.
- In fact, like investment returns compound over time, so too does knowledge. This “winner-take-all” environment is evident in Florida’s influential article published in *The Atlantic*, “*The World is Spiky*.” He suggests that “in terms of sheer economic horsepower and cutting-edge innovation, there are surprisingly few regions that truly matter in today’s global economy.” Moreover, the tallest peaks – the cities and regions that drive the world economy – are growing even higher in recent years.<sup>8</sup>
- “Amenity value” will be increasingly important in the decade ahead. Knowledge workers demand high amenity places to live – places with cultural attractions, exciting restaurants and nightlife, animated public spaces, and a rich assortment of retail establishments. Amenity value adds to the external benefits received so that, like firms, residents are willing to pay higher rents or receive lower wages in exchange for such benefits. This means that conventional sources of agglomeration do not have to be net beneficial for agglomeration economies to occur.
- Recent findings by researchers Giuliano, Kang and Yuan (2019) also suggest that agglomeration economies – at both regional and subregional levels – are likely to continue to be a significant factor in urban spatial structure.<sup>9</sup> In their work, they find evidence of the persistence of agglomeration economies over time in Los Angeles. They observe a high degree of employment concentration despite the perception of Los Angeles as the epitome of urban sprawl.

Agglomeration economies will endure, even the information age.

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Los Angeles, U.S



## WHAT ARE AGGLOMERATION ECONOMIES?

- Agglomeration economies are the external benefits that firms receive from locating close to one another. In theory, if external benefits are greater than the added costs of the higher wages and transport costs that agglomeration generates, there would be geographic clustering.
- The premise is that spatial clustering allows for a variety of external benefits, such as labour pooling, sharing of suppliers and specialization, which in turn contribute to increased productivity and economic growth.
- Agglomeration economies exist at both a regional and subregional level, exhibited in polycentric cities that possess a number of different employment centres.

## WILL REMOTE WORK PROVE TO BE THE GREAT MOBILITY ENABLER?

- The largest work from home (WFH) experiment ever undertaken has proven that many tasks, if not complete jobs and companies, can be moved online. Throughout this pandemic, many firms have reported that there has been little negative impact on productivity and job satisfaction. This view is far from unanimous, but it's clear that any prior stigma around remote work has been reduced if not lifted entirely.
- Looking at data from the U.S., remote work had been gaining momentum since 2005 and now represents more than 3.0% of the labour force.<sup>10</sup> The pandemic will accelerate the WFH trend beyond COVID-19, and WFH is likely to become more entrenched the longer the virus persists.

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The pandemic will accelerate the WFH trend beyond COVID-19.

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- A WFH study conducted by prominent architectural firm Gensler indicated that, although an overwhelming majority of people want to return to the office, 30% want greater flexibility, allowing them to work remotely at least three days a week.<sup>11</sup>
- Although that may not seem all that significant, using similar assumptions to the results in the Gensler survey, real estate advisory firm Green Street estimates a 10% to 15% decline in U.S. office space demand resulting from a reduction in the total number of employee days in the office.<sup>12</sup> They predict that this reduced demand could have a negative 30 basis point decline on long-term net operating income growth relative to pre-COVID levels.<sup>13</sup>
- Similarly, real estate firm CBRE projects a 15% decline in demand in its base case but suggests that greater attention on wellness will lead to dedensification, helping offset the decline in demand. Their current forecast calls for a net loss of only 2% in office demand relative to pre-COVID levels.<sup>14</sup> While remote work strategies can be implemented quickly, long-term leases suggest that the impacts on asset owners will take a while to unfold, very much like the office densification trend of the past decade.
- While long-term implications for office demand are still highly uncertain, decentralization of knowledge work now enables greater flexibility and choice of where to live. It's now possible to relocate farther from the office – to the suburbs, smaller cities or even rural areas.
- History has shown us that employers will take their cue from the “talent” – those high-demand professions hold the leverage even though, more broadly, the balance of power may currently reside in the hands of employers with elevated unemployment.

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- As the nature of knowledge work evolves, the office of the future is likely not a single location but, rather, a network of spaces and services that facilitate productivity and well-being. The purpose of the office will be to provide inspiring destinations that strengthen cultural connection, learning, bonding with customers and colleagues, and foster creativity and innovation.<sup>15</sup>
- We expect that hybrid work solutions will influence occupier leasing decisions. It's too soon to tell how office space will be reconfigured, especially given the short-term need for physical distancing and more flexibility to accommodate fluctuations in occupancy levels. Possible solutions will likely be some combination of a "hub and spoke" model, a "total workplace ecosystem,"<sup>16</sup> and the integration of flexible space from coworking operators. We'll explore the evolution of office space in more depth in the second part of this series and consider how it could impact both the office and residential real estate markets.

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<sup>1</sup> *The Economist*, “Phone data identify travel hubs at risk of a second wave of infections: Well-networked areas tend to have more infections than their average incomes and population densities suggest,” May 16, 2020.

<sup>2</sup> Oxford Economics, “Is 2020 a Turning Point for the World’s Great Cities?” August 2020.

<sup>3</sup> Brookings Institute, “Even Before Coronavirus, Census Shows U.S. Cities’ Growth Was Stagnating,” April 6, 2020.

<sup>4</sup> Oxford Economics, “Is 2020 a Turning Point for the World’s Great Cities?” August 2020.

<sup>5</sup> United Nations Department of Economic and Social Affairs, “World Urbanization Prospects: The 2018 Revision.”

<sup>6</sup> Richard Florida, Bloomberg CityLab, “This Is Not the End of Cities,” June 19, 2020.

<sup>7</sup> Oxford Economics, “Is 2020 a Turning Point for the World’s Great Cities?” August 2020.

<sup>8</sup> Richard Florida, *The Atlantic*, “The World is Spiky,” October 2005

<sup>9</sup> Giuliano, Kang, and Yuan, “Agglomeration economies and evolving urban form,” November 25, 2019.

<sup>10</sup> U.S. Census Bureau.

<sup>11</sup> Gensler, “U.S. Work from Home Survey,” May 26, 2020.

<sup>12</sup> Federal Reserve Bank of Atlanta, “Survey of Business Uncertainty,” May 2020.

<sup>13</sup> Green Street, “Office Insights: Whistle While You Work from Home,” June 30, 2020.

<sup>14</sup> CBRE, “The Future of Office,” September 2020.

<sup>15</sup> Cushman & Wakefield, “The Future of Workplace: How Will COVID-19 and Data Shape the New Workplace Ecosystem,” June 2020.

<sup>16</sup> *Ibid.* Cushman & Wakefield define the “total workplace ecosystem” as working across the balance of the office, home and third places. They suggest that 50% of the workforce will adopt this approach.