CITY
JOURNAL

EYE ON THE NEWS

(Virtually) Here to Stay

With remote work the new normal, cities must adapt to remain competitive.

Arpit Gupta
August 16, 2022

New York City may be coming back to life, but midtown remains relatively sleepy. Estimates from Kastle suggest that office occupancy in the New York metro area is at 40 percent of pre-pandemic levels. Only 8 percent of Manhattan office workers come in five days a week, while 28 percent work remotely full-time, and still more follow a hybrid remote schedule. Similar patterns hold nationwide: 30 percent of paid work days are done remotely, estimates remote-work expert Nick Bloom, a figure that includes in-person jobs for which no remote option exists. For jobs that *can* be done remotely, only about half of the hours happen in the office.

Remote work, then, is clearly here to stay. Firms and workers have invested heavily in the technology and living space that make it possible. Workers report very strong desire to work remotely in the future, and firms are increasingly accommodating these demands to attract and retain the best talent. Many other aspects of society have fully recovered from the pandemic, but remote work persists. That carries major implications for the functioning of commercial real estate and urban space—and calls for a drastic rethink of how cities operate.

Start with the commercial office buildings themselves. Formerly a basic requirement of white-collar work, these have been made optional, leading firms to cut back their leasing demand. In research I have done with Stijn Van Nieuwerburgh and Vrinda Mittal, we document these shifts in leasing revenue and try to project the impacts on office real-estate valuations. We estimate that valuations in New York have dropped by as much as 28 percent. If extrapolated to the rest of the country, that would translate to a total value loss of $500 billion—and a catastrophic fall in the value of the central business district, the core anchor holding together urban areas.

Also profound are the challenges for municipal governance. Consider the direct revenue loss that remote work inflicts. New York City derives more than half of its tax revenue from real estate, much of which can be attributed to office buildings—including a commercial rents tax that raises close to $1 billion. Declines in office values are already starting to show up in property assessments and city revenues. Indeed, cities across the country depend on a healthy business district to raise revenue, imposing sales taxes on retail and personal income taxes on workers. San Francisco derives substantial revenue from business and commercial real-estate taxes, some of which went into effect just before the pandemic.

Remote work also endangers transit systems. Commuters formed the backbone of New York's MTA, where ridership remains depressed by about 40 percent. At these levels, the system will face impending bankruptcy in a few years. Many other cities around the country have seen comparable declines in transit ridership, though federal relief may stave off disaster.

These shifts in commuting and office presence reinforce one another. Fewer people commuting to the office means a less visible human presence on streets and subways, encouraging crime and disorder. As more people leave a metro area, the shrinking tax base makes it hard to provide public goods and amenities for those who remain, encouraging more people to leave. Such urban "doom loops" unfolded throughout the 1970s and 1980s.

Revival came only to those locales that could attract successful businesses and their employees back into their city centers. But these superstar cities failed to construct enough housing for their new workers, resulting in large price increases. The population in many large cities had begun to decline even before the pandemic, suggesting that housing costs were already driving some workers out. The pandemic accelerated these pressures. Now that people have more options for where to live and work, cities will have to innovate to remain competitive. Three key policy changes can help.

Revamp central business districts. Our research finds evidence for a "flight to quality" effect: the highest-amenity office space appears to be in greater demand. In a remote-work world, firms must motivate workers to show up to the office. Encouraging further upgrades to office space, therefore, may help to sustain demand.

Lower-quality offices—class B and C space—are in much less demand and should be converted into residential units. Office-to-residential conversion is challenging but far from unprecedented. In New York City's financial district, old office buildings possess narrow plates, which make for easy conversion. Conversions are particularly appealing because they produce new housing at the center of the transit network, offering residents many appealing transit options.

Zoning changes and the relaxation of residential regulations can speed the process. Conversions are made more expensive by various housing regulations, including the requirement that each bedroom have a window. While natural light is indeed valuable, famed investor Charlie Munger has successfully designed buildings with bedrooms without natural light, which remain quite appealing nonetheless. Ultimately, it should be up to residents whether they want to live in units with natural lighting.

While office work is down, tourism is booming, especially in amenity-rich cities. However, effective bans on new hotel construction, as well as short-term Airbnb rentals, drive up hotel prices and limit the number of tourists who can visit. As cities shift away from being centers of production to being centers of consumption, they will need to accommodate visitors and tourists who bring revenue.

Fix transit. Different commuting patterns call for different transit patterns. Tourists are visiting city centers on the weekends, but the typical weekday office commuter volume remains low. Passengers are taking trains at all hours of the day, rather than mostly during the morning and evening peak-commuting rush.

Bringing down transit costs remains a priority. New York, especially, should consider drastic reforms, including reevaluating the requirement that each subway car have two-person crews and redirecting the (projected) proceeds from congestion pricing toward plugging the operational defficts. Fare amounts should also be reassessed, and potentially hiked, above all if the alternative is service cutbacks.

Transit infrastructure can be improved at the margins. In cities across the country, people increasingly ride bikes, e-bikes, scooters, and other "micro-mobility" vehicles. Lime and Bird scooters are a common sight in Washington, D.C., while in New York, bike traffic across the East River bridges is up 40 percent since the pandemic. Rather than spend money on expensive new projects, cities can invest more in these forms of transit. A new set of pedestrian and bike bridges across the Hudson and into Queens, for instance, would connect many more people at much less cost than traditional infrastructure.

Build more housing. Finally, the best thing that cities can do to address remote work is to permit and accommodate more housing. Conversions address one source of housing demand, but in general, cities need to allow far more housing than they currently do. The post-pandemic recovery has brought increases in residential rents, which now exceed pre-pandemic levels. But that increase doesn't necessarily mean that the exodus from large cities has reversed. Instead, it appears that the flows in population from other urban areas have simply reverted to the same pre-pandemic levels. Once again, people are leaving these expensive cities.

So what accounts for rent recovery without a population recovery? Remote workers, whether they are at home full- or part-time, tend to need more space. People are less likely to live with roommates than before the pandemic, and more likely to demand home offices or combine adjacent units. With a fixed housing supply, these workers will push out other city residents. The only way to prevent this from happening is housing abundance.

Remote work does not mean the end of cities. It should, however, represent a wake-up call for complacent ones. Remote work has given workers more options and choices, and many are choosing to live elsewhere in ways that have consequences for urban governance. These problems may be manageable—but managing them will require greater creativity and focus than urban leaders have shown in the past.

Arpit Gupta ***is an adjunct fellow at the Manhattan Institute.***