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## **Compass: Now What?**

*By Charlie Grantham and Jim Ware*

Okay, now what do we do?

For some time now we have been ranting about the overhang of commercial real estate space and related assets. Every time we say there is 30% more commercial real estate in the U.S. market than is needed (or being used), brokers run for the doors, facilities management professionals get visibly ill, and you would think we'd just insulted motherhood and apple pie.

In Our Humble Opinion (we haven't said that for a while), commercial real estate is one of the most poorly managed strategic assets in the vast majority of organizations. First, we know that most employees only "occupy" their assigned workspaces about 25-30 percent of the average work day (and of course when you consider a 24x7 week, that number is a whole lot lower). You, Mister or Madam CEO, are paying for all the rest of that time the space is empty. It's sort of like paying a full year's rent or a mortgage for a church that's only used about two hours a week. Does that make sense? Maybe if you are an AIG investment executive, but not in the rest of the real world (by the way, we know a number of churches that have made very creative use of their spaces during the rest of the week, getting a whole lot more than two hours of value out of that rent payment).

Now comes a report (from no other than the *Wall Street Journal*) that office vacancies are heading north of 33% in most markets, while the Dow Jones REIT index has dropped 60% in the past 12 months (see "Money and Investing," Page C1 print edition, March 18, 2009, "[GE to Shed Light in Its Properties](#)" – subscription required to access online version).

Let's look at some representative numbers. Remember Equity Office Properties? Sam Zell sold \$39 billion worth of assets to Blackstone Group in 2007. It's hard to sort out all the "toxic" and "not-so toxic" assets, but those properties are probably worth pennies on the dollar today.

If you think the residential real estate market took a major hit, just wait until the commercial market tries to re-set those loans this year. It's a perfect storm. Vacancies rising, rents falling, and large loans coming due. But hey, it's been coming for a long time, and the industry is due for a major re-think. The smart money will snap up those distressed assets at fire sale prices and very thoughtfully reinvent the inherent purpose of buildings in metropolitan areas. You don't need them (or at least as much of them) for people to work in everyday. So, what good are they?

We believe one high-potential approach is to develop public/private partnerships that can put the asset to use for the entire community—not just the business sector. We will be limited only by our collective imagination: affordable housing, libraries, learning

centers, neighborhood health care clinics, shelters for the homeless—in short, community resources for enhancing our quality of life (the common weal, or common good).

Let's also take a look at suburbs. We are convinced that suburban America may well be the next shoe to drop. When the banks and insurance firms are done playing double shuffle and "two-card Monty" with our grandkids' income streams we think there's going to be truck loads of vacant and largely useless ranch homes and strip malls. Commuting long distances may someday be thought of as "so 20th-century," environmentally crazy, and largely unnecessary.

We were intrigued by a recent article in a special issue of *Time Magazine* on how to re-design the suburbs (["Recycling the Suburbs,"](#) March 23, 2009, page 48 in the print edition).

Hmmm, re-cycling real estate. The same logic applies to suburban residential assets as it does to commercial properties. Catch this: [The Metropolitan Institute at Virginia Tech](#) predicts that by 2025 there will be a surplus of 22 million large-lot homes in the United States. Think about that one for a minute. As all those aging Baby Boomers start downsizing and moving into retirement homes, who's going to buy the homes they're trying to get out of?

Now we don't like to play "We told you so," but we humbly ask you to go back to an article that Charlie wrote way back in July 2008 (well before that Wall Street meltdown) called "[Ding Dong the Dream is Dead.](#)" It's almost scary to read it now since it highlights the future death of the suburbs. That future has certainly gotten a whole lot closer than we imagined just nine months ago

Another excellent source for more information on this important topic is [Retrofitting Suburbia](#) (link is to the book listing on Amazon.com; we have no financial interest) by Ellen Dunham-Jones.

We are convinced that the mix of uses for both commercial and residential real estate is not going to return to the patterns we've known for the last 50+ years. That mix grew up with suburbanization and the gradual industrialization of knowledge work. But it wasn't thought through carefully then, and it certainly makes no sense today with virtually instantaneous global communication and information access.

Let's say that again one more time with feeling: "*It's not going to go back to where it was.*" Someone has hit a great big re-set button on the way we live, work, learn, and play. But unfortunately it's not going to re-set overnight; remember that it took decades to get to where we are.

President Obama wrapped up his March 24 press conference by describing the entire economy as like an ocean liner; it takes a while to change direction. We certainly hope it will be less than 50 years, but don't count on things settling down in 2009.

The challenge for those of us concerned about commercial real estate is both financial and intellectual. What are the new purposes, and consequent uses, of these under-performing assets? We built them; we're going to have to repurpose them. As a profession we're only beginning to figure out that we *have* to do it, let alone *what* to do.

Why don't you send us some of your creative ideas for transformation? If that strip mall down the street weren't occupied with pizza parlors and uniform shops what could your community do with it? If you owned a downtown twenty-story office building with only two floors occupied, what could you do differently with the other 18 floors that would make money? That's our challenge to you.

[Please send your comments directly to us](#), or post a comment on the blog version of this article. We look forward to learning from you. This article is also available online [here](#),

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