# 5 WAYS THE OUTPOST ECONOMY IS CHANGING AMERICA'S LANDSCAPE TODAY

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# 2021: Year of the Great Resignation

The year 2021 may very well be known as the year of the Great Resignation. We've heard that term everywhere. And for good reason. In September 2021 alone, 4.4 million people—or 3% of the workforce—quit their job. And that's not even an anomaly; tens of millions of Americans left their job in 2021 in pursuit of greener pastures.

While many news stories and conversations are focused on the "resignation," we tend to see it as more of a "renegotiation"—and this Great Renegotiation is not new. The winds of how people work and where they work have been shifting for years. COVID-19 simply accelerated some trends that were already occurring. Enhanced video technology, better project management software, and high-speed internet connections around the nation allow people to work anywhere. And 2021 labor shortages, spurned in part by changing demographics like aging and retired workers, are putting more flexibility and power into the hands of workers.

Labor shortages, a pandemic, and an overall reimagination of where people must be physically located to perform their job functions has led to a Great Renegotiation between employer and employee. Worker flexibility is not only a consequence of COVID; it's a result of a years-long evolution in how the U.S. economy is structured.

Howard Marks of Oaktree Capital Management writes about this in a recent memo to clients →

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> Increasingly, U.S. business is virtual, digital, and information-oriented, no longer devoted to agriculture or to manufacturing physical products. Even those companies that do produce physical goods or services increasingly employ information products and other aspects of technology. These elements will have a profound impact on which legacy businesses will survive, which moats will hold up, and which newcomers will supplant the incumbents, as well as what our world will look like ten or twenty years from now.

**Howard Marks**
Oaktree Capital

# Emerging Trends

A virtual, digital, and information-oriented economy comes with consequences: People can work wherever they want and the work they do takes less time (because they have the technology aiding every step of the way). This shift allows employers who otherwise would be hesitant to let people work remotely to do so—in some cases, they have no alternative. But, in others, they acknowledge that the time otherwise needed to spend together in an office setting every day is no longer needed. That, coupled with the markedly high cost of living in some primary markets like San Francisco, is bringing more people to secondary markets. If they can work where they want, when they want, many people are choosing a market with a lower cost of living and high quality of life.

Employer flexibility—and a pandemic-ridden world where people are asking deeper existential questions about what they are looking for in life—is leading to an exodus from jobs. And, in some cases, primary markets. The secular shift in how we work, live, and think about our life is opening opportunities in outpost economies around the U.S.

As we discussed in our January 2021 report on the "Rise of the Outpost Economy," outposts are defined as smaller cities with a quality of life that draw workers who have become untethered from their current living situation or location. The pandemic allowed employees to venture out into new markets. This outpost economy is a more dispersed economy consisting of a network of smaller regional hubs of employees and freelancers rather than centralized locations where most employees must come in for the workday every day.

These regions are more affordable compared to primary markets and they draw professionals to them. And with the shift in the overall economy and how we work, movement to secondary market outposts is easier than ever before for many people.

Now that we're here, how is the outpost economy shaping America's landscape today?

Five trends are already happening and will continue for the next three to five years because of the outpost economy. It is creating a secular shift in the lives of Americans, which impacts housing, the economy, and investors everywhere.

# 1

# The outpost economy is shifting and will continue to permanently shift how we work

We're witnessing the biggest shift in how we work since Henry Ford created the five-day workweek one hundred years ago. This paradigm shift will be just as permanent. Google's 3/2 flex model for hybrid work is the modern take on this shift and is one that many other tech companies and information-oriented businesses in the U.S. may follow.

In the words of Sundar Pichai, the CEO of Google's parent company Alphabet Inc, "Three days in the office is important for collaboration and community. Two days remotely gives employees time off from the commute." This sentiment is reflected throughout the tech industry, and we predict that a majority of tech-focused companies will implement a hybrid work approach like Google's model. We anticipate 20-30% of white collar professions to shift long-term to a hybrid model alternating days in and out of an office for most employees. Not only is hybrid work gaining ground. More people are working remotely. Google's CEO Pichai anticipates that 20% of the company's workforce will likely stay remote indefinitely. We anticipate that as many as one in five workers will be fully remote in the long run even after the pandemic wanes.

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**Sundar Pichai**
CEO @ Google

# 16% of workers are remote up from 3.2% in 2018

Currently, 16% of workers are fully remote, while in 2018 remote workers made up 3.2% of the American workforce, according to Global Workplace Analytics. This pattern gives employers the power to explore more flexible environments with a focus on productivity. Effectiveness will continue to be the number one driver; therefore, if employees are closest to their peak productivity in applying the 3/2 work model, then employers will benefit from allowing employees to conduct their job duties from the comfort of their respective homes or coworking spaces.

In terms of future office space demand, hybrid work has little impact. Hybrid only really impacts the interior layout of offices. Physical offices for workers to congregate will be necessary even if they are only present a portion of the time. However, the increase in remote workers has a significant impact on commercial real estate. Remote work creates a permanent reduction is office space needed in major cities and primary markets. Outpost economies generally benefit from a move toward remote work as it untethers the employee from primary markets. Many will decide to live in an area with a lower cost of living if they are given the green light to work from anywhere. As the pandemic wears off, some of those employees called back to the office will instead decide to instead launch out on their own as a gig economy worker (as noted further below). Remote worker and gig economy workers create new demand for office space in these outpost economies since not all remote work is work-from-home. Additionally, companies who find that a concentration of their employees have relocated to particular outpost economies will expand their office presence in these markets to reach and retain these employees and talent pools.

Technology allows us to do more in a more efficient manner and, in some circumstances, less time. This also fuels the growth of the outpost economy. Rather than work long hours in a crowded high-rise office in Manhattan and dealing with long commute times to have a house and yard, workers can spread out and work where they want—and in some cases, when they want. I write this while sitting in a coffee shop 40 miles from my office. The outpost economy is shifting how we work and it's accelerating a broader decentralization trend nationwide.

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# The outpost economy is and will continue to accelerate decentralization

As people spread to outpost economies with a high quality of life and lower cost of living and jobs remain unfilled—particularly in larger primary markets—employers will continue to find ways to utilize employees and independent contractors where they are. But this does not mean that major cities like New York City and San Francisco will become less robust. There is ongoing energy of economic and innovative activity in primary markets. Over the past two years, we witnessed a pandemic sweep through the country and impact the entire country. That impacted the economy and housing as primary markets felt a temporary wave of people leaving while secondary markets witnessed surging prices as demand increased in attractive outposts. This has decentralized, to a certain extent, the power and control of tech jobs in San Francisco and the financial services industry in New York. Professionals with industry expertise are now spread across the United States to secondary markets with high quality of life, outpost economies.

In addition, we are now experiencing an unprecedented shortage of employees as the baby boomer generation retires early and some families choose to become single-income families. This puts additional pressure on employers to more actively embrace alternative working arrangements.

The decentralization taking place means that people can work remotely from anywhere, leading to more workers across a more diverse network of people. This decentralization is a three-fold phenomenon:

## Hybrid Work

The radius from which employees can commute into the office just expanded. It is primarily a story for secondary markets that are within a two-hour drive of primary markets as most companies will still want their employees to come in a few days a week. Living one to two hours away may be bearable if one only needs to physically be in an office two days per week. This expands the distance professionals can live from a primary market – thus the explosion in places like New Jersey and California's Inland Empire and Central Valley.

## Remote/Gig Work

This allows people to work anywhere – as a full time employee or on a contract "gig" basis. It has the biggest impact on residential real estate across the nation. It may also increase demand for co-working spaces in secondary markets as remote workers too far away to commute to their company's main office decide to work in a shared office setting.

## Satellite/Offices

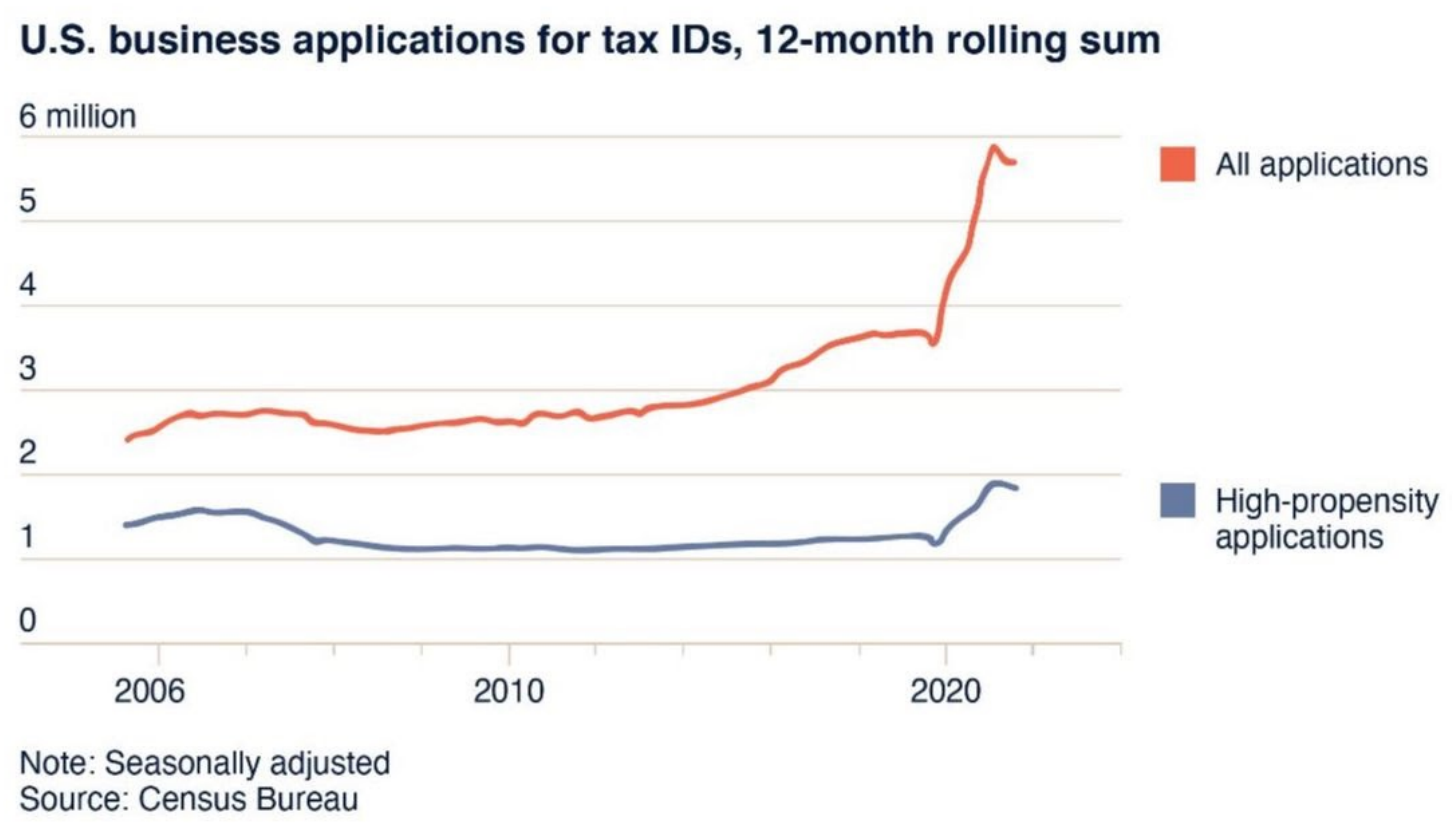
This occurs as people spread out and create worker communities where they can work together in outpost economies. This is the hub-and-spoke model that we discussed in our Rise of the Outpost Economy report. There's a movement of people and companies from core headquarters, which creates opportunities for commercial real estate (more specifically, office space) in these outposts

On a macro level, the acceleration of decentralization has a long-term impact on our economy as economic activity and knowledge workers are more dispersed across the United States. On the micro level, decentralization benefits secondary markets with a higher quality of life as more opportunity and intellectual capital flows to these markets. We will also see a flow of institutional investing dollars into these markets as we witness a sustained shift toward a decentralized economy over the next 3-5 years.

# 3 The outpost economy is and will continue to amplify the permanent trend of the gig economy

The gig economy is a labor market wherein workers are earning a living as an independent contractor through freelancing, short-term opportunities and contract work, or running a consulting business, either as a solopreneur or owner of a small firm with a few employees. The gig economy is a permanent and expanding part of the economy that has grown to employ an estimated 34% of the US workforce, and the pandemic accelerated this trend. Some people decided to take up part-time occupations less dependent upon others in addition to their main job. Many decided to quit their jobs all together to start their entrepreneur journey. New businesses have been started at a rate essentially never seen, many of those sole proprietors venturing out on their own for the first time.

Since the onset of the pandemic, more business applications were filed than ever before on record. It is double the historical average and the highest level since the Census Bureau started tracking in 2004. The chart shown below depicts the rate of business applications over time. Most interestingly, while “all applications” is up significantly, “high-propensity” applications are barely up from the historical average. “High-propensity” applications are those business types that are likely to result in additional employment (e.g. restaurant, manufacturing, etc.). So the vast majority of the historic increase is due to businesses with a “low propensity” to have additional employment – i.e. the gig economy. The pandemic has created a historic rise in new entrants to the gig economy, a trend unlikely to diminish as knowledge workers disperse to outpost economies.




# 56% Increase in Business Applications

As the Wall Street Journal recently reported:

> *Entrepreneurs applied for federal tax-identification numbers to register 4.54 million new businesses from January through October [2021], up 56% from the same period of 2019, Census Bureau data show. That was the largest number on records that date back to 2004. Two-thirds were for businesses that aren't expected to hire employees.*

We have a historic lack of labor supply and a historic rise in Tax IDs. That leads us to make a clear inference: People "left" the labor market, but a large segment made a shift in how they work and declared "I'm working independently now."

On a broader level, the acceleration of the gig economy follows the existential questions stemming from a pandemic environment. Millions of people asked questions like:

- What am I doing?
- Where am I going?
- What is important to me?
- Am I creating the family or personal life that I want?
- Do I want to work for someone else?
- How much control do I want over my time and my own destiny?
- Where would I move if I could live anywhere?

The shift to working from home accelerated the gig economy trend. Workers realized they may not be able to keep working in a remote setting forever, but some had no intention of moving back into an office after having improved their quality of life situated in a place like, say, Lake Tahoe, for months. More than one in ten Americans moved during the pandemic already and some of those moved during a period in which they were working remotely. After the move, they realized they could keep their skills as a freelancer or consultant and find a different job with a local business or land another position with a different company headquartered in a primary market with more flexibility—or, as the data shows happened quite often, start their own business.

The outpost economy makes it easier and more attractive for professionals living in them to start their own business because a.) they have a lower cost of living and b.) they feel that they can move back and forth between jobs more fluidly now. If it doesn't work out, they can always become a contract worker remotely for a company akin to the one they are leaving.

Government benefits like stimulus checks and unemployment from the pandemic potentially accelerated an incentive towards a "gigatized" economy for those that may have otherwise been resistant. We'll continue to see the gig economy grow. As many as 55 million workers of the roughly 160 million in the US are currently considered contributors to the gig economy, and we forecast that that will increase significantly over the next five years with as many as half of the workers in the U.S. contributing in some capacity or fully immersed in the broadening gig economy. That creates the need for potential office space for these workers should they want a small place to work outside of their homes. It also creates opportunities for home developers to build homes in markets that provide a little more space for, say, an in-home office. That desire for space leads us to our next point.

# 4

# The outpost economy is and will continue to expand the market for single-family build-to-rent homes

Single-family homeownership has traditionally been an iconic part of the American dream. The dream consisted of “a white picket fence around a private yard, 2.4 children in the home and a nice car or two,” as author Vikram Mansharamani aptly put in a column several years ago. But that American Dream has sailed for many. And not just because they can’t afford it. Some want the freedom and flexibility to live where they want and not feel tied down to a property for years.

Even after an increase over the last few years, still just 47.9% of millennials own their home. They have the lowest homeownership rates of any other generation: Gen-X’s homeownership rate is 69%, while 77.8% of baby boomers and 78.8% of the silent generation own their home. Homeownership has declined through each generation.

For those who rent single-family homes, traditionally their landlord has been a private owner with one or a few rental units. . But after the Global Financial Crisis (GFC), a shift took place and institutional players moved into the single-family home market. As we’ve witnessed in other real estate sectors, there is an institutional shift happening in single-family, making the rental market more centralized particularly in secondary markets. Global investment firms like Blackstone and Brookfield are purchasing single-family homes to rent. On a larger scale, they are developing entire subdivisions intended as long-term rentals

When more talent with a propensity to accept higher housing expenses comes into a secondary market, rent prices—as well as home prices—go up. According to CoreLogic data, rents rose nationally by 9.3 percent year-over-year in August 2021, with greater increases occurring in outpost economies. Primary markets have not experienced these increases to the extent of growing secondary markets.

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> The dream consisted of a white picket fence around a private yard, 2.4 children in the home and a nice car or two.

**Vikram Mansharamani**
Author


We're witnessing this phenomenon in our home market of Modesto. Housing demand and prices are up significantly, with nearly a 20 percent increase in home appreciation in 2021. Prices have almost tripled in the last decade in this city, two and a half times above the national average. Part of the reason for this is its proximity to Silicon Valley, making Modesto part of the outpost economy. Costs are so expensive in cities like San Francisco and San Jose that workers with the ability to work remotely at least part-time are choosing to live in places like Modesto, Sacramento, and other growing cities a few hours from the Bay Area. Institutional investors see opportunity for build-to-rent homes in markets where home appreciation is increasing and rent prices are going up.

The market is shifting toward single family homes, but not necessarily single family home ownership. Simultaneously, the large single family rental market is becoming increasingly institutionalized. There is a consolidation taking place in who owns these properties. In 2017, Invitation Homes and Starwood Waypoint united in what was an $11 billion merger. Fast forward to 2021: Brookfield recently acquired a controlling stake in single-family landlord Conrex, which operates more than 10,000 rental homes across the Midwest and Southeastern U.S. Brookfield also raised $300 million to launch Brookfield Single Family Rental, which will acquire and renovate homes.

Many young professionals are moving toward family formation and wanting more space. But that isn't translating neatly into homeownership for a swath of young professionals. They want a home to rent instead of an apartment yet are not clambering for the commitment of owning a home. The institutionalizing of this investment class is a byproduct of the GFC, and it is accelerating with post-pandemic shifts toward the outpost economy. It's a spin on the American Dream if you will.

Single-family build-to-rent homes in secondary markets will become more readily available for those seeking it.

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# The outpost economy is and will continue to make primary markets younger

As some older millennials move to outpost economies, they open a space for a younger generation ready to make a start in primary markets. College graduates tend to gravitate to cities since there are more job openings, career opportunities, and housing possibilities. And big cities have more to do: a vibrant restaurant scene, cultural activities, nightlife, and plenty of peers to socialize with on the weekends.

Millennials, on the other hand, are finding intrigue in fast-growing secondary markets rather than primary markets. For example, Seattle, Denver, and Austin (three cities in the top five of places where millennials moved in 2021) each have a millennial population that represents roughly a third of their overall population, whereas it's closer to a quarter in New York City.

A recent study from SmartAsset shows millennials are indeed flowing out most from the largest cities in the country. New York City lost a net of almost 40,000 from this generational group in 2019. The second-largest outflow came from Chicago, with a net decrease of more than 11,000 millennials. Other big cities with net migration losses include Los Angeles, San Diego, Boston, and Miami.

Hyojung Lee of Harvard University has studied the long-term flow of young people in and out of major urban areas. From his research, it appears that older millennials have been leaving cities and this is not a new phenomenon – the pandemic simply accelerated the trend. He writes: "Are millennials leaving cities? Yes, they are. In fact, even before the COVID-19 pandemic, millennials moving into their prime homebuying years were increasingly choosing homes in suburban locations."

However, when looking at "young adults," he notes that they are in fact not leaving urban areas. He writes: "Are young adults leaving downtown? No, they are not. The

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Are millennials leaving cities? Yes, they are. In fact, even before the COVID-19 pandemic, millennials moving into their prime homebuying years were increasingly choosing homes in suburban locations.

**Hyojung Lee**
Harvard University

# We predict the average age in primary markets will go down.

number and share of young adults in urban neighborhoods have gradually increased in recent years."

The author does anticipate a continuation of older millennials moving away from large urban centers but notes that this phenomenon will not impact the allure of urban life for many others.

"The demand for urban living will not disappear; there will still be a sufficient number of millennials, especially well-educated singles, who will choose to remain in their 30s and 40s, and post-millennials, who will prefer to spend their 20s in urban centers. Policymakers and community leaders should continue their efforts to capitalize on these demographic changes to build sustainable and healthy communities and meet diversifying demands."

While the outpost economy has concentrated some of the real estate boom and growth into secondary markets in the short term, we see an inroad for primary markets. As millennials settle down and consider secondary markets, younger and entry-level employees that want to be in offices and enjoy the energy of major cities will fuel a resurgence in primary markets.

We predict that over the next five years, we will see the average age in primary markets go down as older millennials move out while younger adults (Gen Z) and younger millennials continue to choose the urban lifestyle and populate primary markets.

Conclusion

# A Lasting Outpost Economy

It can be easy to read headlines on labor shortages, inflation, supply chain challenges and get discouraged. But there is a secondary story happening alongside all these headlines: Secondary markets are shifting the American landscape and bringing a decentralized approach to how we work and live. This is a secular shift that will continue to have momentum for years to come thanks to hybrid work, remote work, the gig economy, and consequent business expansions to secondary markets.

The outpost economy is new, but, in a way, it is a story that has been told before. While we stare at the challenges in front of us, perhaps some of the impacts of the shifting landscape can bring about an era of greater equality and opportunity. The outpost economy is a story of America and the potential within in the pursuit of a better, fairer future. Look at it through the lens of iconic poet Walt Whitman in his powerful poem "America"

An untethered workforce with the power of the Great Renegotiation and the power to live and work where they want more often: Perhaps this is what America needs right now.

> *Centre of equal daughters, equal sons,*
> *All, all alike endear'd, grown, ungrown, young or old,*
> *Strong, ample, fair, enduring, capable, rich,*
> *Perennial with the Earth, with Freedom, Law and Love,*
> *A grand, sane, towering, seated Mother,*
> *Chair'd in the adamant of Time.*
>
> Walt Whitman

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