

iMPACTS

THE FUTURE OF GLOBAL REAL ESTATE

Property with
purpose



Climate resilience

Which cities are best prepared to weather climate change? **p18**

People

Accommodating the needs of a blooming Generation Z **p06**

Investment

The business case for investing in clean energy infrastructure **p26**

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WORDS BY MARK RIDLEY GROUP AND GLOBAL CEO

IN 2023 PROPERTY NEEDS PURPOSE



The world is changing quickly and real estate with it. Mark Ridley looks at the challenges and opportunities that come with the quest for community

Welcome to the 2023 edition of Impacts. It comes at what feels like a defining moment in history. Global instability is affecting all world markets and calls for action on the climate crisis are becoming more urgent. Meanwhile, the world has not returned fully to pre-pandemic norms and arguably is struggling to reach a consensus on how today's society should live and work.

So our theme this year is “purpose”, because now, more than ever, not just the environmental but the social impact of how we use real estate is very relevant. Property has always had purpose, of course. It's where we make our homes, earn our livings and spend our time. It brings comfort, protection and inspiration. Good property is essential to a life well lived.

But the world is changing in fundamental ways and what we need from property is changing with it. Real estate plays a central role in shaping our lives. It's a major challenge – and opportunity – for our industry.

Adapting for climate change

The world is getting warmer. The contradictions of climate change mean that it's getting wetter in some places and dryer in others. We're experiencing more floods and more droughts.

Real estate has to adapt. We need it to be resilient in the face of extreme weather events and mitigate their impact.

Sustainable cities hugely reduce global carbon emissions. Resilient neighbourhoods keep us cooler or dryer, or help us to use less water. Property investment has a huge part to play in building these environments.

Demographic upheaval

Generation Z has become the largest generation on Earth. That has profound implications for real estate. Young people demand sustainability. They want to live in cities that pulse with life and also offer flexibility.

But while many cities are getting younger, that's by no means true of them all, or of every neighbourhood. In many urban areas property demand is being driven by older, more affluent people who are today moving towards city centres rather than away from them.

This 50-plus demographic is diverse, but it has both accumulated wealth and a sense of purpose. It wants green space, healthcare and culture, and many of its members still want an easy commute. Most of all, it craves community.

Here, the similarities between Generation Z and the baby boomer generation are more pronounced than their differences. Together, they are driving the 15-minute city concept, demanding amenities close at hand. They make property choices that feel purposeful, in terms of community and sustainability.

A safe haven

The confluence of these trends has important consequences. To take one example, physical retail is seeing a revival. Vacancies are falling in prime retail hotspots.

Mixed-use developments that blend retail with other uses – commercial, residential, hospitality and healthcare – satisfy the requirements for amenity and community. Retail is regaining its purpose. It is also generating returns.

The regenerative nature of real estate will ensure it remains an attractive asset class as city environments evolve and opportunities to repurpose or reposition buildings come forward.

Of course, higher prevailing interest rates, as well as the pricing recalibration that many markets are undergoing, has naturally made investors cautious in the short term.

It is difficult to predict with total accuracy how long this recalibration will take or when there will be a clear horizon on the direction of interest rates, but as this focus returns, it will provide the backdrop to improved investor sentiment with volumes normalising. The recovery will be sector specific, but with a reduced development supply and selective rental growth, this will again provide investors with steady returns, compensating for the higher cost of leverage.

In a post-pandemic, ESG-focused world, real estate will drive change. This issue of Impacts shows that property with purpose creates sustainable neighbourhoods alongside sustainable returns. I hope you enjoy the edition.

**NOW, MORE
THAN EVER,
NOT JUST THE
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IMPACT OF HOW
WE USE REAL
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RELEVANT**



ILLUSTRATION: KARI MODEN

WORDS PAUL TOSTEVIN

GLOBAL DEMOGRAPHIC SHIFTS: WHAT ARE THE IMPLICATIONS FOR REAL ESTATE?

As Generation Z comes of age and a growing global population embraces new ways of living and working, demand for real estate is changing and the mix of uses is becoming more fluid

In November 2022, the global population reached eight billion. This milestone was described by UN Secretary-General António Guterres as “an occasion to celebrate diversity and advancements while considering humanity’s shared responsibility for the planet”. In the same year, India, with 1.4 billion people, overtook China as the world’s most populous country.

Over the next 10 years, India’s population is set to be the fastest growing in the world, adding 100 million people. Meanwhile, China’s population is expected to tip into long-term decline, having fallen last year for the first time in 60 years.

India’s growing population will spur domestic and outbound demand in all sectors of its already burgeoning real estate market. “It is important to understand India from the viewpoint of rising urbanisation, as well as its changing age-group mix,” says Arvind Nandan, Managing Director of Research and Consultancy, at Savills India. “India’s urban population is growing rapidly, and is expected to pass 600

million people by 2030 – putting pressure on existing infrastructure and housing. The task ahead is not merely to improve infrastructure but also to add more towns and cities to the existing 4,400. In this respect, two key government initiatives, ‘Make in India’ and ‘Smart Cities Mission’, for manufacturing and urban development respectively, now gain unique significance.”

An ageing world

This epoch-defining shift is emblematic of wider demographic changes around the globe. The developed world is ageing, as are China and many countries in South America and the Middle East. This means the balance of population growth is shifting to Asia and Africa.

At the same time, Generation Z – those born between 1997 and 2012 – is coming of age and has become the largest generation on Earth.

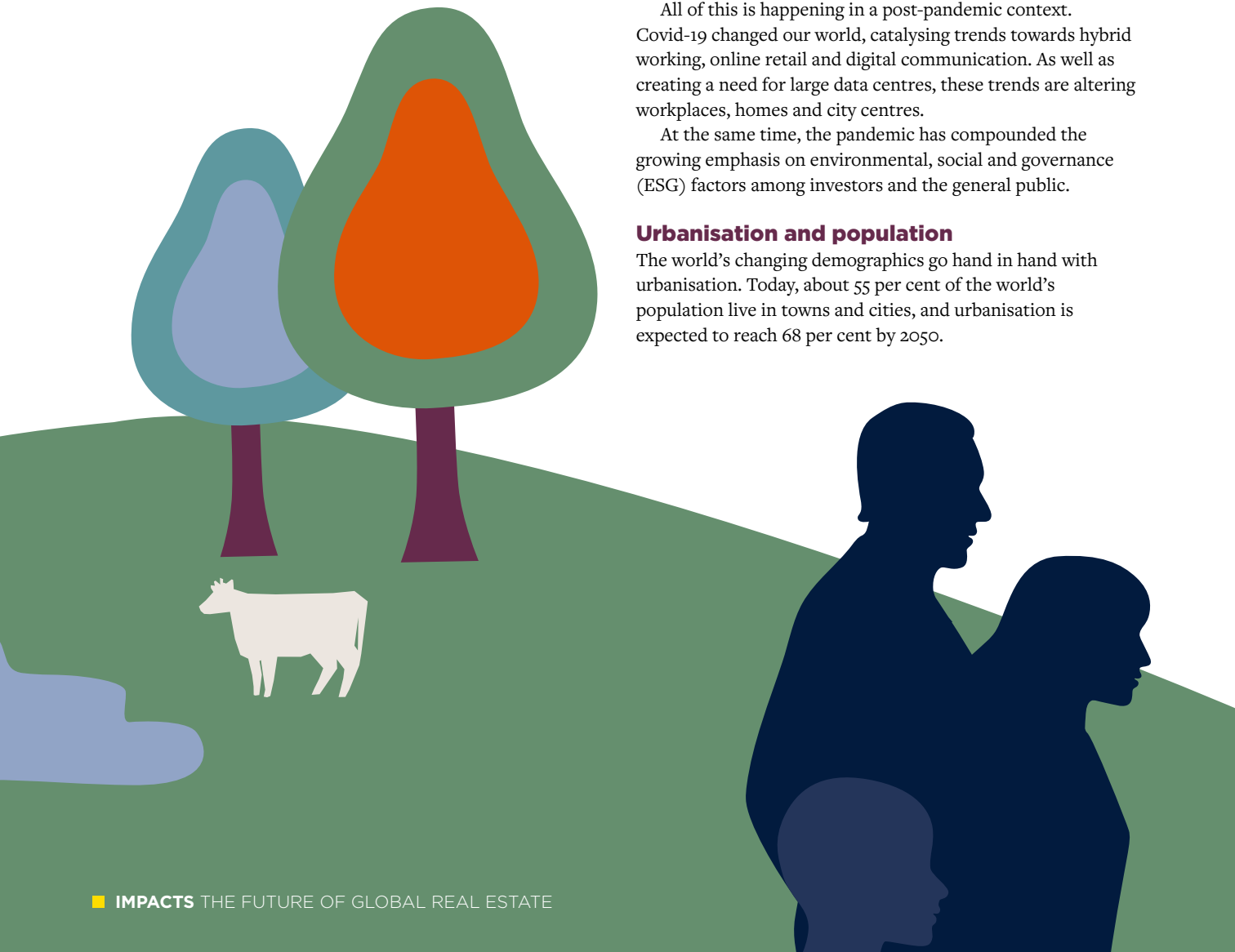
This has profound implications for real estate and cities. The most in-demand hubs are changing, as the mix of uses for real estate evolves and becomes more fluid.

All of this is happening in a post-pandemic context. Covid-19 changed our world, catalysing trends towards hybrid working, online retail and digital communication. As well as creating a need for large data centres, these trends are altering workplaces, homes and city centres.

At the same time, the pandemic has compounded the growing emphasis on environmental, social and governance (ESG) factors among investors and the general public.

Urbanisation and population

The world’s changing demographics go hand in hand with urbanisation. Today, about 55 per cent of the world’s population live in towns and cities, and urbanisation is expected to reach 68 per cent by 2050.



COVID-19 CHANGED OUR WORLD, CATALYSING TRENDS TOWARDS HYBRID WORKING, ONLINE RETAIL AND DIGITAL COMMUNICATION

This is a profound change – until 2009, more people lived in rural areas than urban ones – and one that must be carefully managed if we are to protect our imperilled planet. While occupying less than two per cent of the world's total land area, cities produce 80 per cent of gross domestic product but also 70 per cent of carbon emissions.

Much new and future urbanisation is occurring in developing markets. Nine countries will be responsible for half of population growth in the period to 2050 and only one of these, the US, is in the developed world. India, Nigeria, Pakistan, the Democratic Republic of Congo, Ethiopia, Tanzania, Indonesia and Egypt will lead the population growth that will drive urbanisation.

At the city level, however, demographics depend on much more than national population growth. One of the youngest cities in our analysis, Dubai – 54 per cent of whose population will be aged 15 to 39 by 2033 – is in the ageing Middle East.

Although China's population is in decline, the country has a number of youthful cities, notably the tech centres of Shenzhen (53 per cent aged 15-39) and Guangzhou (41 per cent).

The US will have both some of the oldest cities in the world in North Port and Fort Myers, and younger mid-sized cities, such as Austin and Denver. Like Bristol in the UK, which also ▶

PAVLOS GENNIMATAS
MANAGING DIRECTOR,
EUROPEAN LIVING,
HINES EUROPE



Demographic changes are transforming the housing sector across Europe. In the last two decades, the European population has grown by 34 million. At the same time, Europeans are having fewer children and starting families later in life, resulting in a lower birth rate and a 30% growth in single-person households. This has led to increased demand for smaller apartments. In response to this, our schemes combine more green spaces, high-end work-from-home amenities, integrated technology and a focus on ESG.

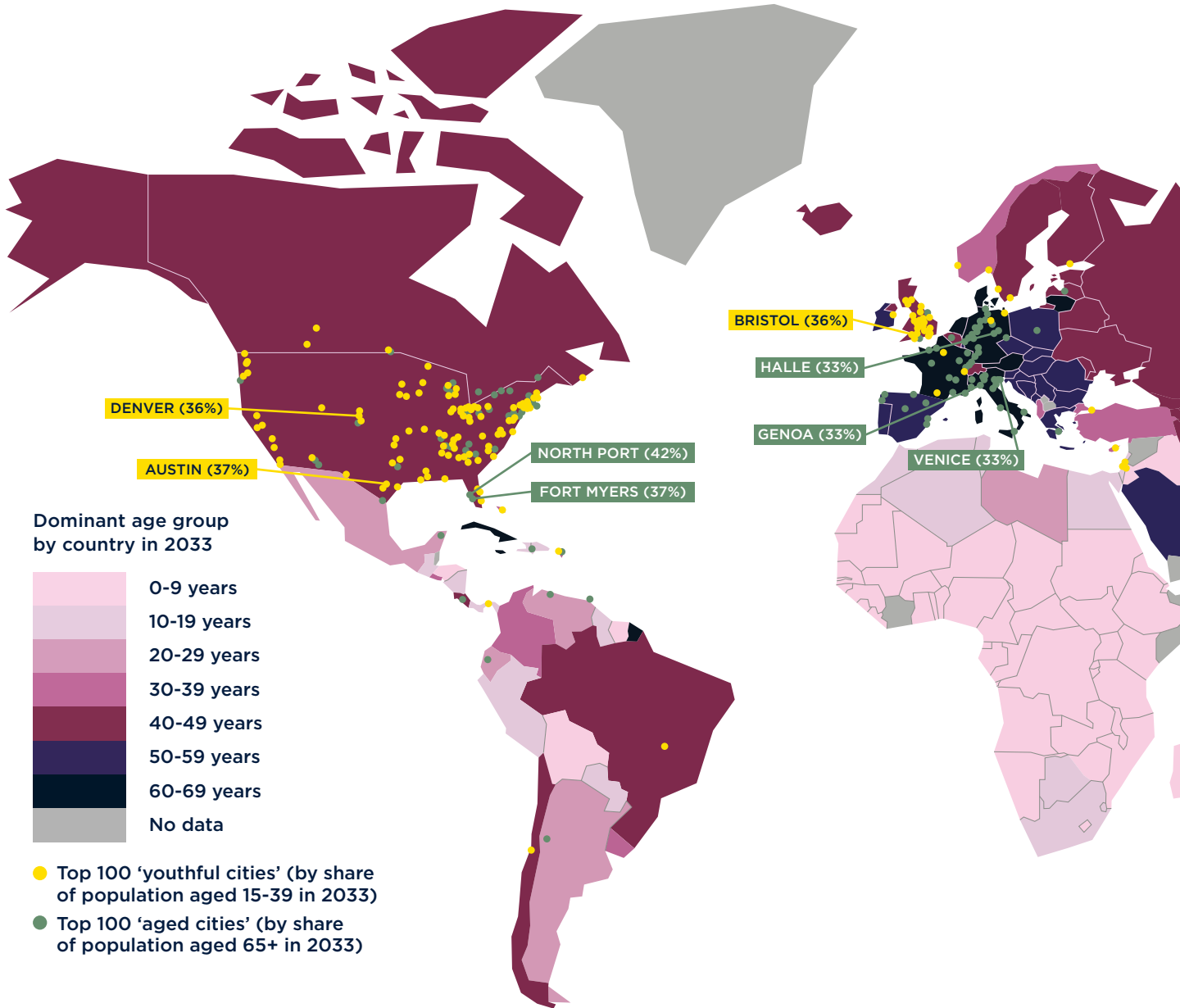
From a macroeconomic standpoint, while unemployment rates in Europe have reached a record low since 2008, the cost of buying a home has increased by 45% since 2013. In combination with the rising cost of living, it has meant the average age for a first-time buyer has shifted from 31 in 2013 to 34 today, further increasing the demand for rental products. As such, we are incorporating a substantial component of attainable housing, such as Il Trotto, a mixed-use scheme in a consolidated residential area in Milan.

Furthermore, Generation Z tends to prioritise travel, convenience and city living, with 1.2 million digital nomads in Europe today. Students, particularly internationals, are following suit, as academic enrolment is countercyclical and tends to increase during economic uncertainty. At the other end of the age spectrum, rental demand is also being driven by the senior population. Life expectancy has significantly increased, with people over 65 expected to account for 30% of the population in the next 25 years.

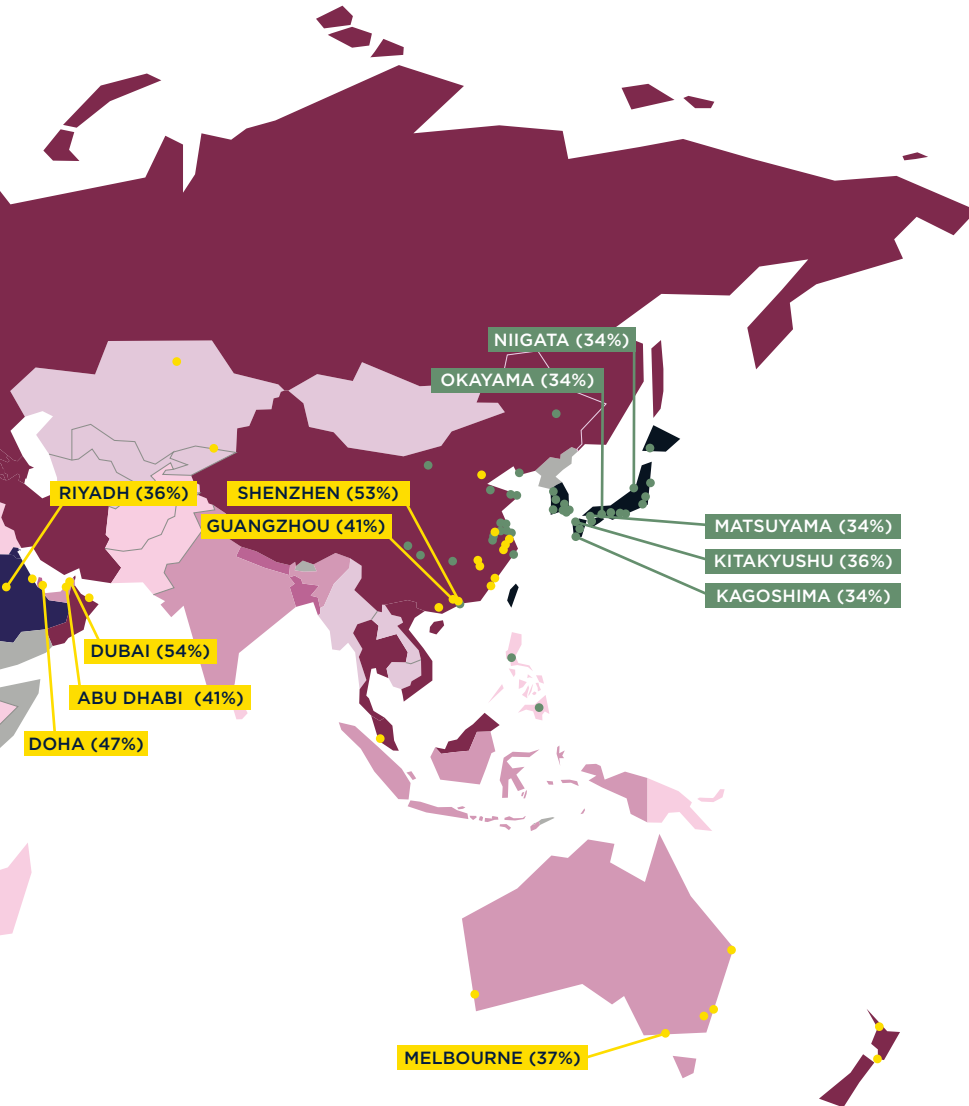
To continue to meet modern-day and future rental needs, we are proactively focused on investing, developing and managing intergenerational schemes across Europe, including student housing and hybrid forms of short- to medium-term stays.

GLOBAL DEMOGRAPHICS IN 2033

DOMINANT AGE GROUP AND TOP 'YOUTHFUL' AND 'AGED' CITIES BY SHARE OF POPULATION



GENERATION Z IS COMING OF AGE AND HAS BECOME THE LARGEST GENERATION ON EARTH



Source: Savills Research using Oxford Economics
Note: top 100 cities based on those forecast to have GDP per capita greater than \$25,000 in 2033. Selected top 100 cities labelled.

has a comparatively youthful profile, these smaller, vibrant cities attract younger populations through their strong knowledge economies and high quality of life ratings.

At the other end of the spectrum, some big, dynamic cities are sucking population away from smaller ones. In Japan, for example, the population of Tokyo continues to rise while those of smaller cities such as Kitakyushu and Kagoshima fall and age. As a result, the Japanese government is now offering parents Yen 1 million (\$7,500) per child to move out of Tokyo.

The digital generation

Generation Z, half of whom are now aged over 18 and beginning to enter the workplace, are driving many of these trends. This generation comprises the majority of the population in Africa. With their digital savviness, they are able to leapfrog the legacy infrastructure found in continents with older populations.

Generation Z are also more mobile than previous generations and less likely to be rooted in one national identity. In the European Union, nearly 13.9 per cent of those aged 14 and younger in 2019 were born in another member state, while 6.6 per cent were born outside the EU.

Many of these connected, global citizens want to study abroad, fuelling demand for student housing in the most popular education markets of the US, the UK and Australia, as well as rising international student hubs in mainland Europe and elsewhere.

Between 2000 and 2020, the number of international students in the world more than tripled from two million to 6.3 million. Post-pandemic, with the majority of Generation Z residing in developing markets, the numbers are likely to increase further, creating huge potential in this sector.

Drawn to cities and less inclined to drive a car out of concerns for the

GENERATION Z PRIZES THE SENSE OF COMMUNITY THAT COMES FROM BEING IN THE WORKPLACE

environment, Generation Z may provide the tipping point for 15-minute cities. To appeal to this cohort, property managers need to be environmentally aware and offer seamless app-based or online services that are personalised.

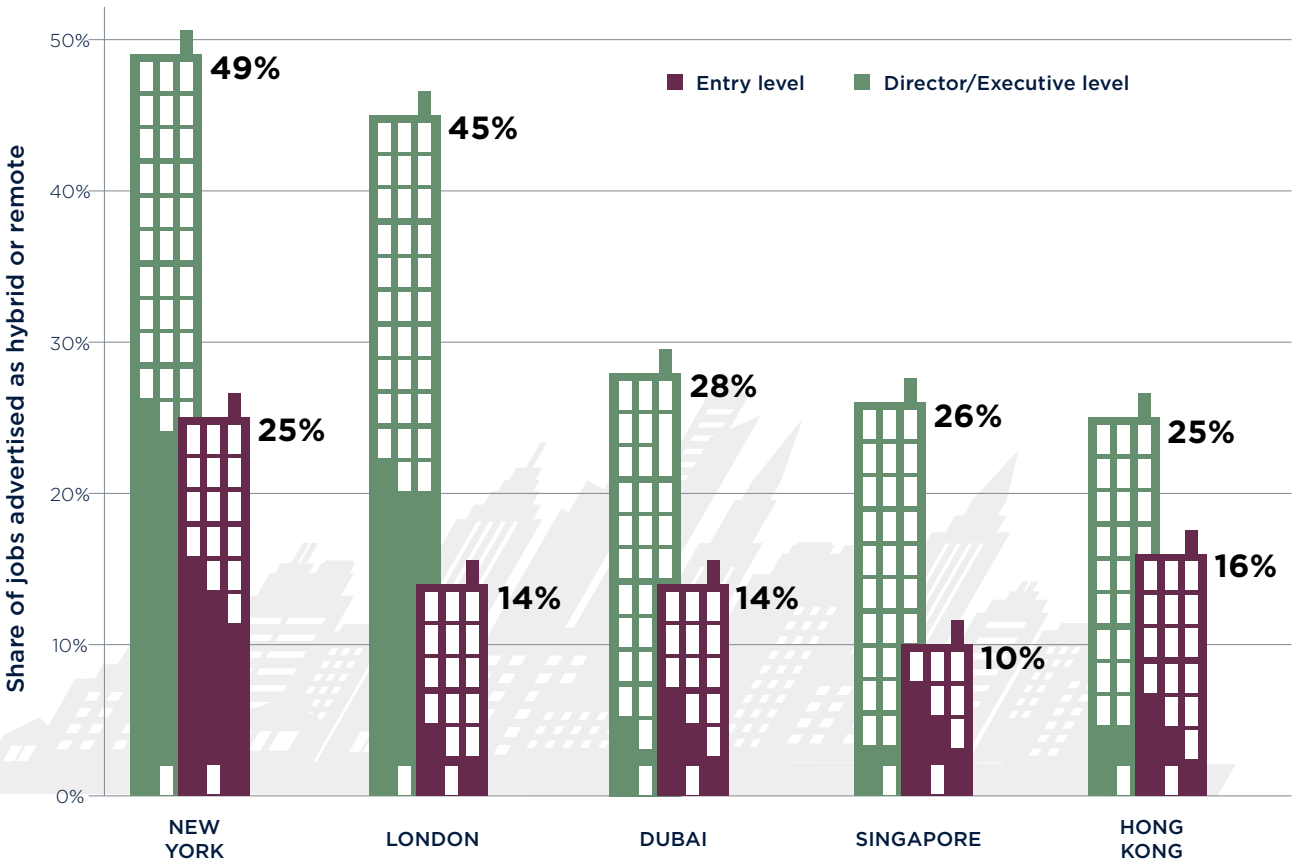
New working hybrid

Conflicting forces are at play in the workplace as well. Generation Z seeks a good work-life balance and employment with purpose, but that is not always within reach.

A 2023 Oliver Wyman survey of this generation in the UK and US found that 85 per cent prefer hybrid or remote working. However, Savills research shows such working arrangements are more typically offered for higher-level roles than entry-level jobs.

At the same time, Generation Z prizes the sense of community that comes from being in the workplace. That feeling has intensified since the pandemic, with almost 80 per cent of this age group appreciating the workplace community in 2022 compared with under 70 per cent in 2013, according to Leesman.

PROPORTION OF HYBRID OR REMOTE ROLES ADVERTISED BY SENIORITY



Source: Savills Research using LinkedIn

Starting their careers, Generation Z also benefits from learning and mentoring in the workplace – though, ironically, community is less important to the older generations who might provide that knowledge.

“It is the younger employees and those with fewer years in service where the workplace really contributes to their sense of belonging – through socialising and interacting with others and physically being in a space that provides them with a sense of identity,” says Kirsty Toye, Associate Director, Senior Workplace Strategist and Change Manager at KKS Savills. “Trainees and junior staff need to absorb knowledge by osmosis and have easy access to others for guidance, but the more experienced, older generations will often favour working in their study at home without the distractions of the office.”

Generation Z may think they want hybrid working, but older generations really do want it. This is not the only overlap between younger and older generations. Larger, older populations mean more single-person households. This creates a need for smaller homes – a trend compounded by younger households getting married and having children later.

Sometimes, however, there is a clash between the needs of different generations. “Sweden is facing a demographic change where the number of older residents in relation to younger ones is increasing rapidly,” says Maryrose David, Head of Research at Savills Sweden. “Furthermore, Sweden’s housing market has been stalled by the expense of moving and a lack of suitable housing for the elderly.”

Flexible rental models and new types of housing such as unassisted senior living can free up real estate for younger generations, while mitigating loneliness among the elderly. In 2007, Sweden introduced an investment subsidy for reconstruction and new construction of housing for the elderly, which has stimulated this sector.

Global demographic shifts mean it is important to involve all age groups in the workplace. Recent research from the IMF showed that labour force participation is rising fastest in countries with higher rates of working from home. This is especially important in ageing societies with shrinking workforces – flexible working can help keep older people in the workforce when they may have caring responsibilities for parents or grandchildren, or declining health.

Future trends

According to the WHO, healthy life expectancy, which rose from 58.3 in 2000 to 63.7 in 2019, is not keeping pace with total life expectancy, which rose from 66.8 to 73.4 over the same period.

The health and wellness sector is experiencing considerable growth and this will inform the real estate

market. Healthcare clinics are likely to become fixtures in the high street, and both public and private spaces will need to adapt to the needs of ageing populations. Technology can play a vital role in helping people to stay in their homes for longer if they wish, even if they are less fit, and in improving healthcare, senior care and senior living.

Extensive childcare may also boost labour market participation. Sweden established a childcare programme in the early 1970s to help parents combine parenthood and employment. Parents are entitled to 480 days of paid parental leave and children are entitled to childcare from their first birthday.

According to Statistics Sweden, there were 9,450 preschool units in Sweden in 2021. Around 86 per cent of children in Sweden between the ages of one and five were enrolled in preschool in 2021.

The world’s next billion people are going to be slower to arrive than the last. The global population took 12 years to grow from seven to eight billion, but it will take 14 years to reach nine billion. It’s a sign that the population growth rate is slowing, which is good for the planet, but poses a number of challenges that will be reflected in the real estate market.

The watchword will be flexibility. As the millennial and Z generations move further into positions of power, green cities and mobility will become standard.

At the same time, spending will shift to older age groups. In Japan, half of consumer spending already comes from those aged 60 and over.

Tomorrow’s older consumer will be digitally savvy and this will drive societal shifts. Online and hybrid retail will thrive, while digital and real-world experiences will become entwined and offices and homes less firmly demarcated.

As ever, it is the purpose of property to respond to these changing – and sometimes contradictory – trends in a way that satisfies our basic human needs for shelter, comfort and functionality. ■



EYEING RETURNS

WORDS OLIVER SALMON

Interest rate rises may be nearing their peak, but where they settle will have long-term implications for real estate investors across the world

Most major economies, with the exception of China and Japan, have seen interest rates rise sharply over the past 18 months after more than a decade of being at rock bottom. This has had a knock-on effect on the pricing of many financial assets, including commercial real estate.

This current cycle of monetary tightening and interest rate rises appears to be coming to an end. However, the question now for property investors isn't how high interest rates may go in the short term, but where rates will settle in the longer term.

Risk-free returns and the cap rate

The pricing of many financial assets is underpinned by the notional "risk-free" rate of return that investors would get if they held long-term government bonds. These are deemed risk-free because most governments won't default on this debt, so investors can be confident of getting the promised return. There

is clearly more risk investing in other assets, such as commercial property, which means investors will want a higher return to compensate them for the risk they are taking. As interest rates increase and government bond yields rise with them, riskier assets can begin to look less attractive to investors.

Commercial property prices are typically expressed in terms of a capitalisation rate, or cap rate – the net income divided by the market value of the asset. The historical correlation between interest rates and this cap rate has focused real estate investors' minds. They are keeping a keen eye on the potential future direction of interest rates as an indication of expected yields on property holdings.

Where next for interest rates?

In the past four decades, interest rates across advanced economies have been trending lower, as the graph overleaf shows.

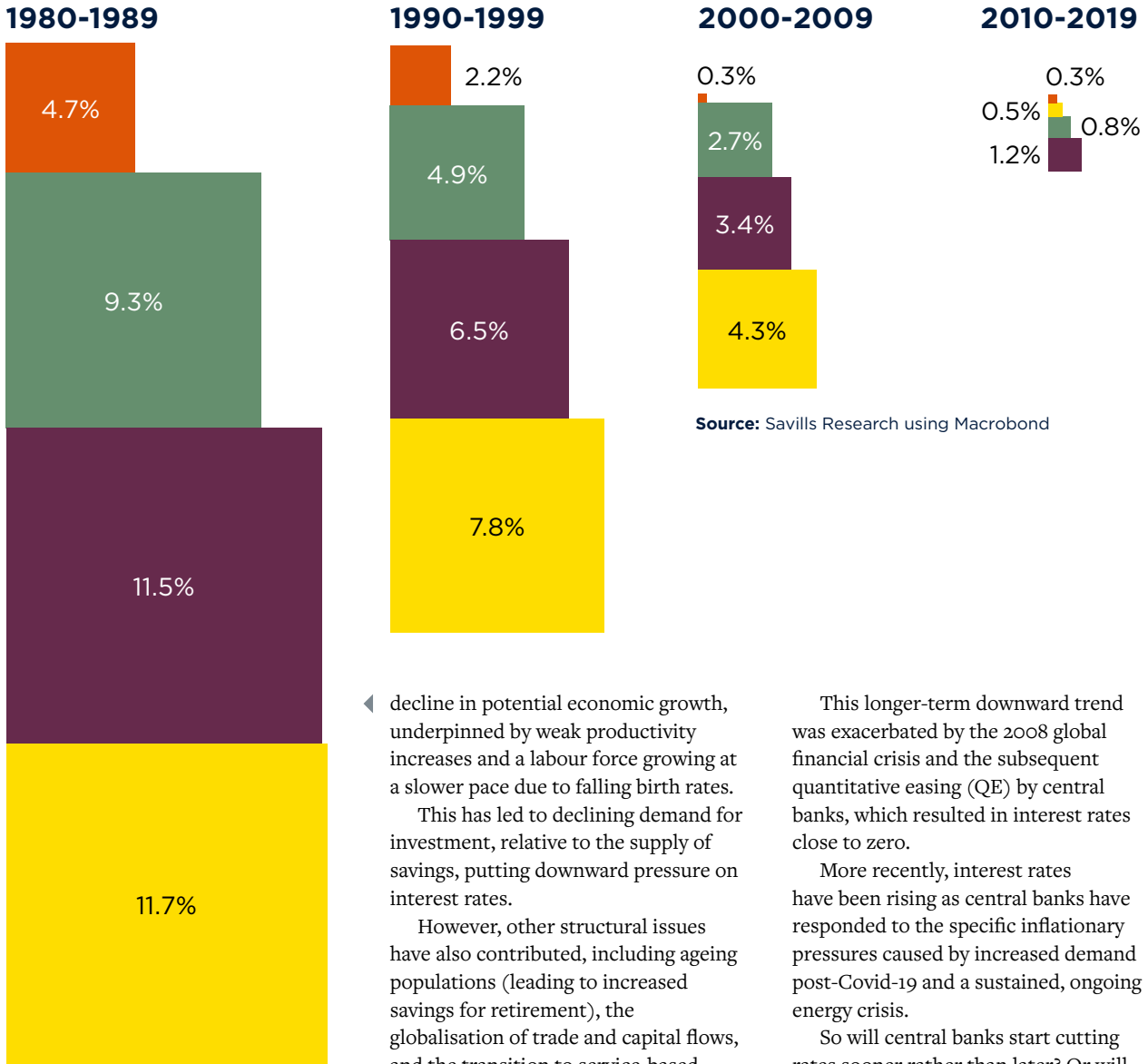
These reductions have been driven by a ▶



**...IN AN
UNCERTAIN
INTEREST RATE
ENVIRONMENT**

CENTRAL BANK AVERAGE POLICY RATES

■ US ■ UK ■ Canada ■ Japan



Source: Savills Research using Macrobond

◀ decline in potential economic growth, underpinned by weak productivity increases and a labour force growing at a slower pace due to falling birth rates.

This has led to declining demand for investment, relative to the supply of savings, putting downward pressure on interest rates.

However, other structural issues have also contributed, including ageing populations (leading to increased savings for retirement), the globalisation of trade and capital flows, and the transition to service-based economies that are less capital-intensive than goods-based economies.

This longer-term downward trend was exacerbated by the 2008 global financial crisis and the subsequent quantitative easing (QE) by central banks, which resulted in interest rates close to zero.

More recently, interest rates have been rising as central banks have responded to the specific inflationary pressures caused by increased demand post-Covid-19 and a sustained, ongoing energy crisis.

So will central banks start cutting rates sooner rather than later? Or will rates need to stay higher? Here is a summary of the main arguments.

IN THE PAST FOUR DECADES, INTEREST RATES ACROSS ADVANCED ECONOMIES HAVE BEEN TRENDING LOWER

Arguments for lower interest rates

- A continued shrinking in the labour force, coupled with weak productivity growth.
- No significant change to supply issues around savings, given an ageing global population, rising household incomes (particularly in emerging markets) and diminishing risk appetite.

Arguments for higher rates

- Stronger productivity growth emerging from greater use of technology. This could lead to increased demand for investment.
- The transition to net zero. Addressing climate change will require significant new investment.
- Higher public debt. This implies an increase in demand for capital from governments that want to spend more.
- QE is now unwinding, and many households and private businesses are in a much healthier financial position now than they were back in 2008, which could support future demand.

Secular stagnation

Looking at these arguments, we believe that demographic change is likely to be the most dominant factor, suggesting a lower “neutral” interest rate and return to a period of “secular stagnation”. However, some arguments for higher rates hold water. The end of QE and the transition towards net zero are likely to act as counterweights, for example, meaning the neutral rate is not as low as it has been for much of the past decade.

However, this return to the “normal” is unlikely to happen quickly. While there are some positive signs that inflation has peaked, central banks continue to err on the side of caution with concerns about a return to the “Great Inflation” of the 1970s.

Normally, it can take up to two years for the full effects of a change in monetary policy rates to feed through to economic growth. But there is an argument that the economy is less interest rate sensitive than it was in the past, with far more borrowed on fixed-rate mortgages and loans, for example. As a result, we expect a very gradual transition.

What does this mean for property investors?

Cap rates have to a degree mirrored the rise in interest rates over the past 18 months.

But this move has been relatively small in comparison and has made most commercial property a less attractive asset class for investors, relative to risk-free assets like government bonds.

In the short term, the longer interest rates remain above the neutral rate, the more likely it is that property yields will continue to rise. But if rates come down relatively quickly, prices may stabilise.

In the longer term, a permanently higher interest rate will force many investors to deleverage. There has been a lot of talk about refinancing risk in commercial property following the sharp rise in interest rates over the past 18 months. In practice, the level of distress that some anticipated hasn’t yet materialised.

Instead, many investors can temporarily withstand high interest rates, either because they were already on a fixed deal or because lenders anticipating a return of the low-rate environment have found creative solutions to avoid short-term defaults.

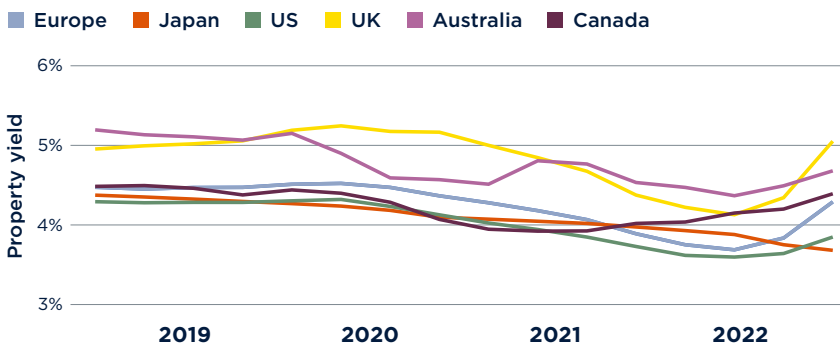
But if rates now settle at a much higher level than we’ve seen for the past decade, debt servicing costs will remain permanently high. This will mean higher refinancing costs, or selling unprofitable buildings, potentially at discounts.

A return to a low interest rate environment, even if it is not as low as before the Covid-19 pandemic, will alleviate some of these concerns. But investors may need to revise their expectations on the returns available through commercial real estate nevertheless, as there is an expectation that risk premiums are likely to be lower in the future than over the past decade.

Real estate has become a more “vanilla” asset class: institutions are allocating more money to it and there is more liquidity/transparency in trading. Therefore, investors will need to generate income growth to counter low-entry yields and tight risk premiums.

In turn, strong income growth is going to be more difficult in a low-growth secular stagnation scenario. ■

PROPERTY YIELDS IN DIFFERENT COUNTRIES AND REGIONS




Source: Savills Research using MSCI



ILLUSTRATION: KARI MODÉN

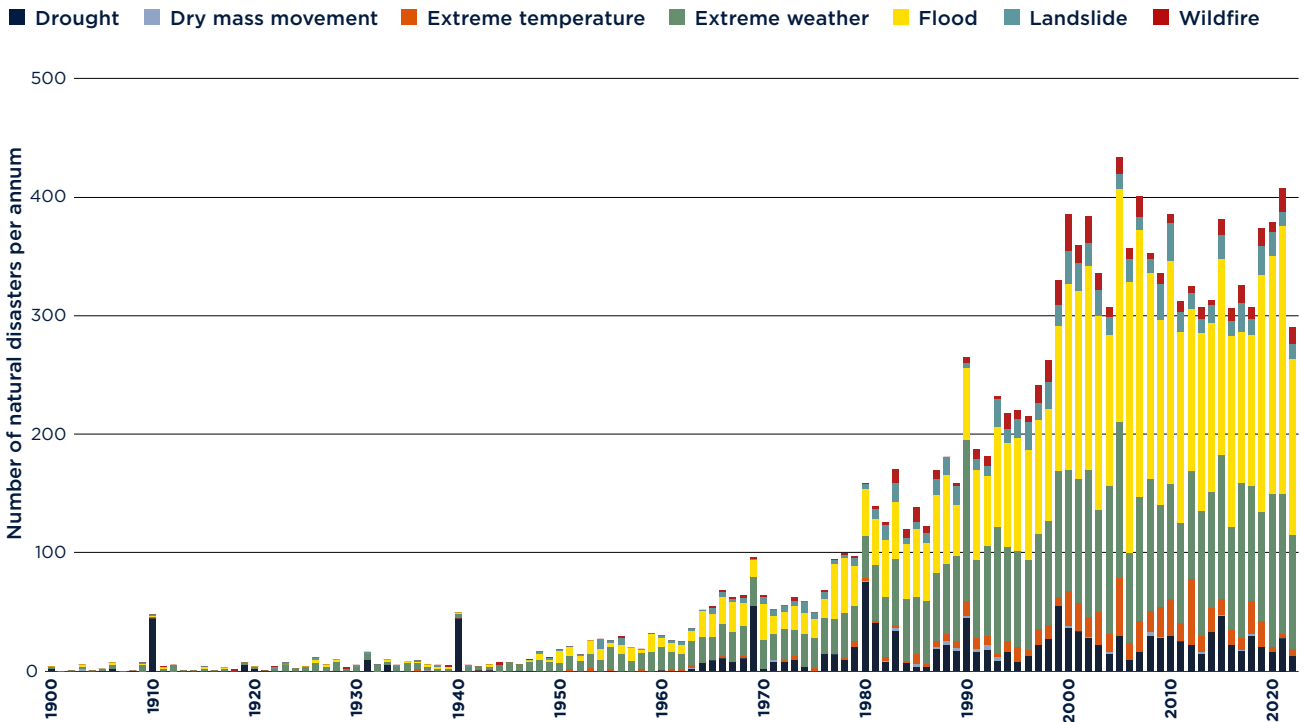
WORDS PAUL TOSTEVIN AND LUCY PALK

A stylized illustration of a city landscape. At the top, a large dark blue water drop is positioned over a light blue area. Below it, a large yellow sun is partially obscured by a red semi-circle. To the left, a grey house with a blue roof and windows sits on a grey hill. Two dark blue trees are next to it. In the foreground, three yellow silhouettes of people stand on a grey path. To the right, a stylized orange and yellow flame rises from a dark blue base. The background is a mix of purple, teal, and grey.

CLIMATE RESILIENCE IN CITIES

**OUR NEW INDEX
OF CLIMATE
RESILIENCE
SHOWS HOW
CITIES ARE
PREPARING FOR
THE COMING
STORMS**

NUMBER OF CLIMATE-RELATED DISASTERS GLOBALLY SINCE 1900



Source: Savills Research using Our World in Data

**SINCE 2000,
EXTREME
CLIMATE
RELATED
EVENTS
HAVE BEEN
HAPPENING
WITH
ALARMING
REGULARITY**

City policymakers increasingly understand that, in the face of a changing climate, doing nothing isn't an option. That's the overarching message from our Climate Resilient Cities Index, which looks at the preparedness of major urban centres around the world for the climate-related challenges they face today and those they're likely to face in future.

The background is well known. Since 2000, extreme climate-related events have been happening with alarming regularity. We've seen wildfires in California and floods in Dubai. Extreme climate events have become five times more common since the 1970s.

Our Index focuses on how 23 of the world's largest, wealthiest and most populous cities are fortifying themselves against climate-related events.

These cities attract huge sums in real estate investment; their ability to do so in future may depend on their resilience to climate-related risks.

Climate change adaptation requires awareness

So what did we find? The good news is that nearly every city in our survey is aware of the risks they face, and nearly all have plans in place to mitigate these challenges.

This is important. Climate-related risks are not going away.

A high percentage of current building stock was not designed with such threats in mind. In the near future, a city's appeal as a destination for investment will depend to some degree on the extent and effectiveness of its climate-mitigation strategy.

The bad news is the breadth of the threats our cities face. When we talk about water, for instance, we could be talking about river flooding, rising sea levels or access to drinking water. Climate change is a multi-headed monster. It drives extreme rainfall and severe drought – sometimes in the same location.

Wildfires, landslides and hurricanes have always been a threat to some cities, but climate change is making them more frequent and more severe. Some cities are built to withstand extreme heat, but others are having to adapt to it, as scorching summers become the norm.

Climate risks in real estate to 2050

Our index looks at all these climate-related events and projects into the future, to reveal the threats cities will be exposed to by 2050.

We also look specifically at real estate resilience, including the share of building stock that is resilient, the proportion vulnerable to climate-related hazards and the degree of likely damage escalation up to 2050.

The future view is important because we know that cities can be especially good at dealing with threats they are used to. Tokyo's world-leading building codes have been refined by a history of earthquakes and tsunamis. Cape Town's "Day Zero" water conservation scheme followed years of declining rainfall.

Cities are often good at dealing with the now, but less good at preempting what might be around the corner. In a rapidly changing world, they have to do both.

To that end, the index is, to some extent, an educational tool – a disseminator of best practice for the real estate industry. If a city is getting hotter, wetter or stormier over the next 20 years, here's how others have introduced policies and modified their built environments to mitigate that threat.

All to play for

When the index takes all factors into account, Berlin comes out on top, followed by Toronto, Paris and Madrid. All face serious climate threats, but a mix of geographical good fortune (they are all inland with no risk from coastal flooding) and planning mean they are at the lowest risk overall.

But there are no winners and losers here, and the index shouldn't be used as a league table. If anything, we hope it's a call to action. All cities face real challenges and most policymakers have acknowledged the threat and begun to address it.

Real estate resilience and carbon

There is an elephant in the room. While cities should prepare for the consequences of climate change, they can't ignore their

**ROBERT
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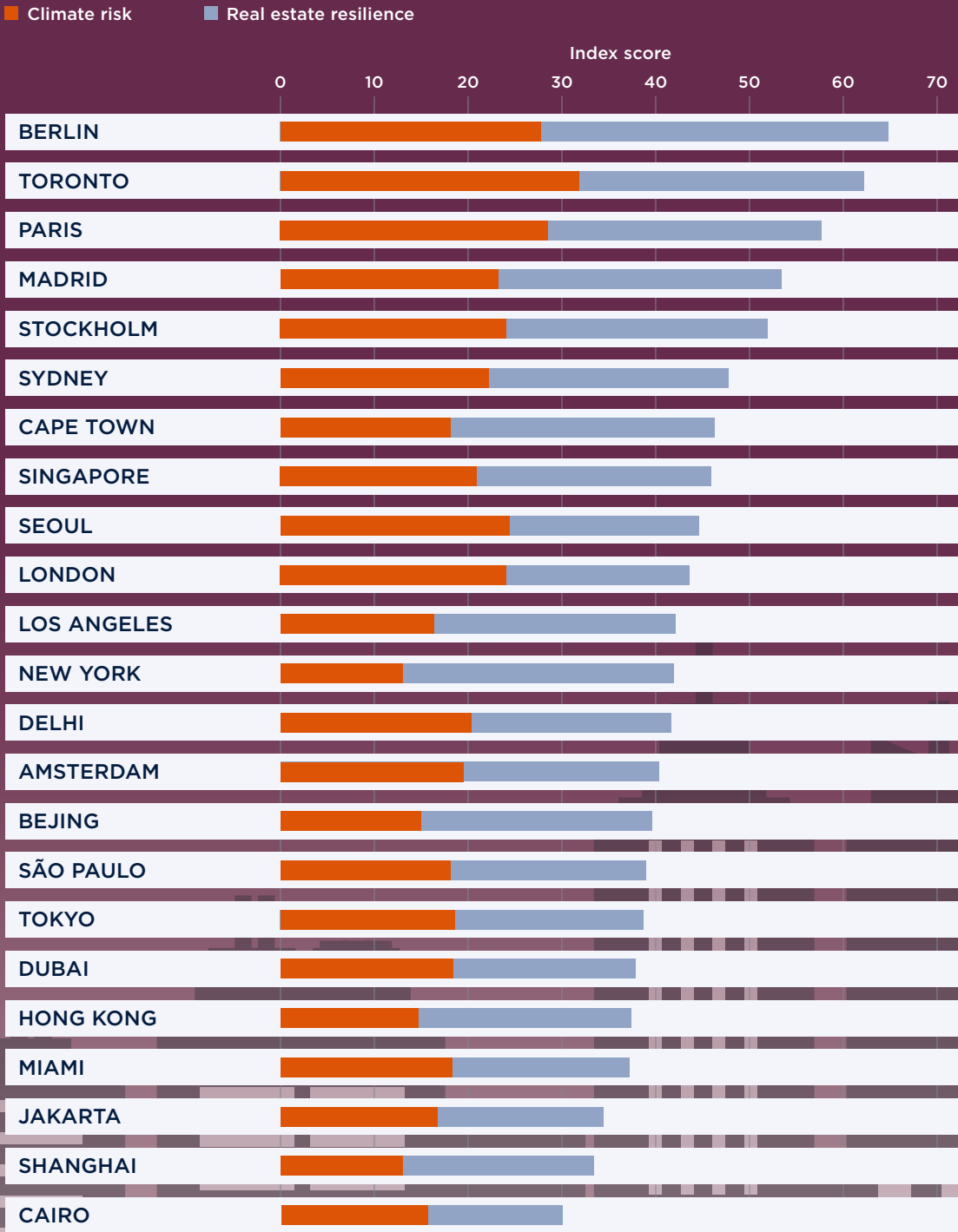
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The increasing occurrences of wildfires, floods and other climate-related events demonstrate the dire consequences of inaction. These escalating threats emphasise the need for investment not only in the decarbonisation and resilience of the built environment but also in the natural capital that sustains life. As we strive to create cities capable of withstanding climate change, we must remember that the health and robustness of thriving human communities are reliant on ecosystem services. These services, such as the provision of clean air, water purification and climate regulation, are fundamental to the vitality of our urban environments. Climate change, biodiversity loss and the resilience of cities are intrinsically interconnected; we cannot address one without considering the others. Our approach to addressing these challenges must therefore be holistic, integrating both.

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CLIMATE RESILIENT CITIES INDEX



Source: Savills Research using climate data, UNESCO, UCCRN, ThinkHazard, CDP, 2023 XDI Gross Domestic Climate Risk

Methodology: Climate Resilient Cities Index

Our index compares 23 of the world's largest, wealthiest and most populous cities that are particularly important for global real estate investment. It measures each city's climate risk and the resilience of its real estate to those risks. There are two pillars:

Climate risk considers a city's current and future climate risk. Current risk measures changes in rainfall and temperature over the past decade, average elevation above sea level and availability of groundwater. Current risk is also assessed by physical disasters that are exacerbated by climate change; future risks are predicted exposure to extreme heat, sea level rise, coastal flooding and freshwater availability by 2050.

Real estate resilience looks at whether the city, and the country it's in, has assessed its climate risk, whether it has a plan in place to combat it, and the extent to which the city's real estate is vulnerable to climate risk. It also measures the city's share of green certified building stock.

part in causing it. Cities account for 70 per cent of global carbon emissions.

Put another way, the best way for cities to protect people from a warming world is to play a leading role in stopping it from warming too much.

A huge challenge – but there are solutions

That's much easier said than done, of course: restricting global warming while maintaining familiar comforts is a difficult circle to square. Governments can lead by example. They could retrofit their buildings to reduce carbon emissions and establish carbon-zero rules for new developments.

Sustainable building and planning

While these measures are a start, they're clearly not enough. So what more should cities be doing to reduce carbon emissions? It depends first on where they're starting from.

Industrial cities are more polluting than those with service-based economies. Older cities tend to host more carbon-intensive infrastructure. More populous cities simply produce more carbon. These factors may help prioritise initiatives, but there are things that all cities can do to lower their carbon footprints.

For example, many of the cities in our index have plans to reduce operational carbon. New York's Local Law 97 aims to reduce the emissions from large properties (over 25,000 sq ft) to 40 per cent below 2005 levels by 2030.

Significant inroads into carbon emissions can also be made with more sustainable city planning. That includes prioritising renewable energy sources for heating and lighting, and encouraging a shift towards public transport. Many cities are expanding rail and light rail services and discouraging car use through emissions penalties.

The era of carbon pricing

One interesting development in the real estate world is carbon pricing, which offers financial incentives for building users to reduce their carbon emissions.

Singapore is a leader in this, introducing Southeast Asia's first carbon pricing scheme in 2019. South Africa also introduced a carbon tax in 2019, while the EU is establishing a "polluter pays" principle.

In Singapore, carbon taxes apply to commercial establishments that emit at least 25,000/t CO₂ annually. To avoid shocking the economy, the rates will progressively increase over time. The objective is to reach a range of S\$50 to S\$80/t CO₂ by 2030.

"The additional cost to a premium office space, though significant, is not too burdensome," says Alan Cheong, Executive Director of Research and Consultancy at Savills Singapore.

"The positive impact will outweigh the additional cost because green-compliant tenants will increasingly find

‘LONGER PERIODS OF DROUGHT, AS WELL AS MORE FREQUENT AND MORE SEVERE STORMS AND HEAVY RAIN EVENTS, ALREADY POSE CHALLENGES FOR THE CITY’

◀ themselves with fewer options when relocating, creating a demand that could offset the drag caused by the tax.”

Carbon pricing could significantly impact both residential and commercial real estate markets. The pandemic accelerated a flight to quality, with grade-A buildings commanding premium rents and lower-tier properties seeing lower demand.

Rewards for sustainability (or penalties for its absence) may accelerate this trend and nudge landlords and occupiers towards greener properties.

Collaboration in the fight against carbon

In all of these areas, education will be key. City governments need to take businesses and residents along with them, and convince them of the need for change.

To that end, many are prioritising collaboration. In Madrid, the “Green Office” is a tool to promote sustainability in residential building stock and point citizens towards sources of public funding for refurbishment projects. New York’s Retrofit Accelerator provides free and bespoke advice to building owners looking for energy-efficient solutions.

Together this represents a carrot and stick approach to real estate sustainability. When it comes to carbon reduction, city authorities can only do so much on their own. A mix of penalties, rewards and resources – encouraged by infrastructure improvements – is persuading private individuals and businesses to make a difference in their own homes and offices. ■



CITIES AT THE SHARP END

If cities can learn from each other, they can become future-proof, or at least future-prepared. So what examples should they follow right now? Which cities are leading the way in the fight to protect people and property from climate impacts?

Many cities are already taking positive, practical steps towards climate mitigation. In many cases, they are doing so in the face of a clear and present threat.

“Real estate investor awareness of climate issues has risen significantly in the last five years, and major institutional investors already factor in climate risk in their decision making,” explains David Jackson, Head of Savills Earth. “This has implications for certain locations, but also for the assets themselves – how well will they perform in extreme temperatures? Are they built to withstand future natural hazards?”

The key to future resilience will be to build upon these efforts to combat threats that are not yet so obvious.

In that, forewarned is to be forearmed. Due to quirks of geography, some cities are facing climate emergencies earlier than others. Everyone can learn from what they do.

TOKYO: AN EXAMPLE OF RESILIENCE



Tokyo faces a number of threats, most notably typhoons and earthquakes. But it is facing them head on. Its world-leading construction codes mean that 87% of the city’s buildings meet the most stringent anti-seismic criteria.

As a huge and densely populated coastal city, Tokyo is especially vulnerable to flooding. “Tokyo is forward-thinking in utilising underground reservoirs to drain excess water in the case of floods and typhoons,” says Tetsuya Kaneko, Head of Research and Consultancy at Savills Japan.

Tokyo boasts the world’s largest underground storm drain, the Metropolitan Area Outer Underground Discharge Channel. Just over 20 years ago, it cost \$2.1 billion to build, but is projected to save the city at least three times that amount in mitigated flood damage over a 50-year period.



NEW YORK GETS SERIOUS

While Tokyo has a long history of natural disasters, New York’s wake-up call came from a single event. The devastation Hurricane Sandy brought in 2012, through flooding, extended power outages and loss of life and livelihoods, was a defining moment for

resilience planning for the city. The concentration of a vast amount of capital, infrastructure and people means it has the rare combination of urgency, motivation and resources to act.

The Brooklyn Bridge-Montgomery Coastal Resilience project, which will protect Lower Manhattan from both sea-level rises and storm surges, is due to start construction this year. The construction of a further \$52 billion of flood protections will begin in 2030 if the funding is approved.

Tokyo and New York are acting retrospectively. They are reacting to threats that are already apparent. This is necessary, but is it enough? Part of the purpose of the Climate Resilient Cities Index is to help real estate investors, developers and occupiers of cities understand and prepare for climate impacts to come.



Postdamer Platz in Berlin

GETTY IMAGES

BERLIN PLANS AHEAD



As an inland city without a history of extreme climate-related events, Berlin is luckier than many.

At the moment, the city faces challenges rather than specific emergencies. Nevertheless, there is significant support for climate-mitigation action among its population.

“Longer periods of drought, as well as more frequent and more severe storms and heavy rain events, already pose challenges for the city,” explains Matti Schenk, Associate Director of Research at Savills Germany. “Berlin’s state government is trying to address these issues through urban planning instruments and guidelines, such as more green roofs.”

It is also investigating “sponge city” concepts. “The Urban Tech Republic at the former Tegel Airport is being designed as a sponge city,” says Schenk. “This will provide impetus for further projects.”

Schenk says that some climate-adaptation schemes have been delayed, but Berlin is at least being proactive. The city is at the top of our Climate Resilient Cities index, partly because of its acceptance of the need to act early. A global transition from reactive to proactive climate mitigation will be crucial as impacts increase. ■



WORDS ERI MITSOSTERGIU

POWERFUL INVESTMENT

OPPORTUNITIES IN RENEWABLE ENERGY INFRASTRUCTURE

More private funds are investing in clean energy projects, but this needs to grow significantly to meet global net-zero targets

There has been a significant increase in investment in clean energy infrastructure in recent years, with countries around the world looking to reduce their dependence on fossil fuels. The bulk of this money has been used to further renewables projects – those that use no finite resources – although nuclear power projects, which have no carbon emissions and are therefore classified as ‘clean’, have also attracted a small chunk of investment.

While many of these projects are funded by government and public money, private investment is being sought for others.

The shift away from fossil fuels is being driven by environmental factors and the urgent need to reduce carbon emissions to meet the net-zero targets set out in the 2016 Paris Agreement on climate change.

All this is deeply connected to property and cities. Get it right and urban areas and the built environment will become more resilient and flourish. Get it wrong and decline is likely, with

the attendant loss in values. Renewables are therefore at the heart of real estate’s purpose.

The longer-term push to renewables has been accelerated by more recent geopolitical and economic factors. The war in Ukraine and subsequent international sanctions against Russia have caused wholesale gas and oil prices to spike, creating demand for alternative energy supplies that are more cost-effective.

At the same time, political uncertainty has underlined the importance of the security of energy supply. In a bid to achieve domestic energy “sovereignty”, more countries are looking to increase onshore production and storage of renewables to limit their reliance on imports from less stable parts of the world.

These three factors – carbon reduction, security of supply and rising energy costs – have led to a significant increase in the development of renewable infrastructure globally, creating new opportunities for institutional investors.

Clean energy: a growing market that will grow further

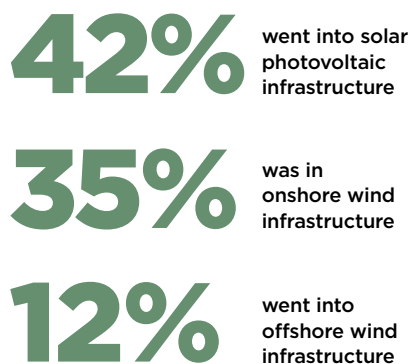
Global energy consumption continues to grow and an increasing slice of this is coming from carbon-free renewable sources. Figures from BloombergNEF point to the energy sector being at a tipping point, with investment in low-carbon technologies now reaching parity with the capital being deployed into traditional fossil-fuel extraction and supply.

The majority of new investment in the energy industry is now going towards these greener technologies. International Energy Agency (IEA) data shows that investment in clean or renewable energy now accounts for almost three-quarters of the growth in overall energy investment.

In total, the IEA estimates that more than \$1.4 trillion was invested in clean energy projects last year – a record high – with the biggest swathe in China and the Asia Pacific region, followed by the EU and then North America, as shown in the graph overleaf.

Much of this new investment is going into more “established” renewable sources, such as wind and solar energy projects. This is partly because these are now the cheapest option for new power generation in many countries.

Figures show that of this new investment:



This money isn't just funding renewable infrastructure, such as wind turbines or large-scale solar farms. Significant investment is also going into the tertiary market – building and upgrading the infrastructure needed to store and distribute power.

Clean energy also encompasses other infrastructure initiatives, such as retro-fitting existing buildings to make them more energy efficient, as well as smart technologies and building infrastructure to support more widespread adoption of electric vehicles.

But is this level of investment enough? According to the International Renewable Energy Agency (IRENA), investment levels are languishing at less than 40 per cent of that required each year between 2021 and 2030 to meet net-zero targets. The IEA estimates that investment in clean energy needs to triple by 2030 – to \$4 trillion – to achieve a global net-zero target by 2050.

Solving the investment challenge

Despite the clear magnitude of the problem and the sector's fantastic growth prospects, investors can be reluctant to commit.

One reason is that some renewable energy generation from sources such as solar or wind is by its nature intermittent and more variable than from fossil fuels, which makes it difficult to match demand with supply consistently.

This means the infrastructure behind it needs to be more flexible, in relation to weather for example. Energy storage therefore becomes a critical supporting technology to solar and wind, as do smart technologies that allow for load shifting.

Financial hurdles

On top of the technological and engineering challenges relating to renewable energy infrastructure, there are specific financial hurdles that can impact potential returns on investment.

THE IEA ESTIMATES THAT MORE THAN \$1.4 TRILLION WAS INVESTED IN CLEAN ENERGY PROJECTS LAST YEAR

The major issue for many investors is the long lead time involved in such projects. Getting planning permission for large infrastructure projects can take years, particularly in more developed economies. Figures show the average design and build time for wind farms in the UK is between seven and 11 years.

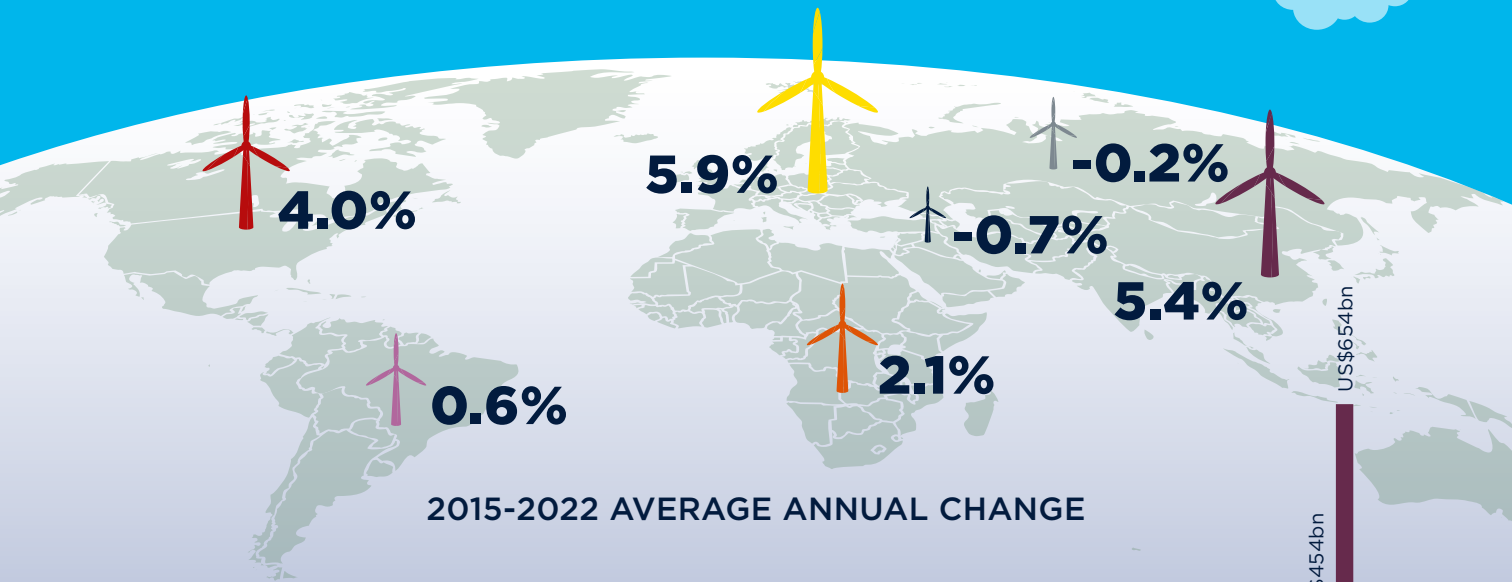
Such protracted delays are more likely on the larger projects needed to provide renewable energy at scale, as these will also require a build-out of transmission lines, connections and upgrades to national or international grids, flexible systems and storage solutions.

The complexity of planning requirements for such projects can cause supply-chain bottlenecks and skills gaps. This can be a major issue for investors, who are asked to tie up capital for many years before seeing a return.

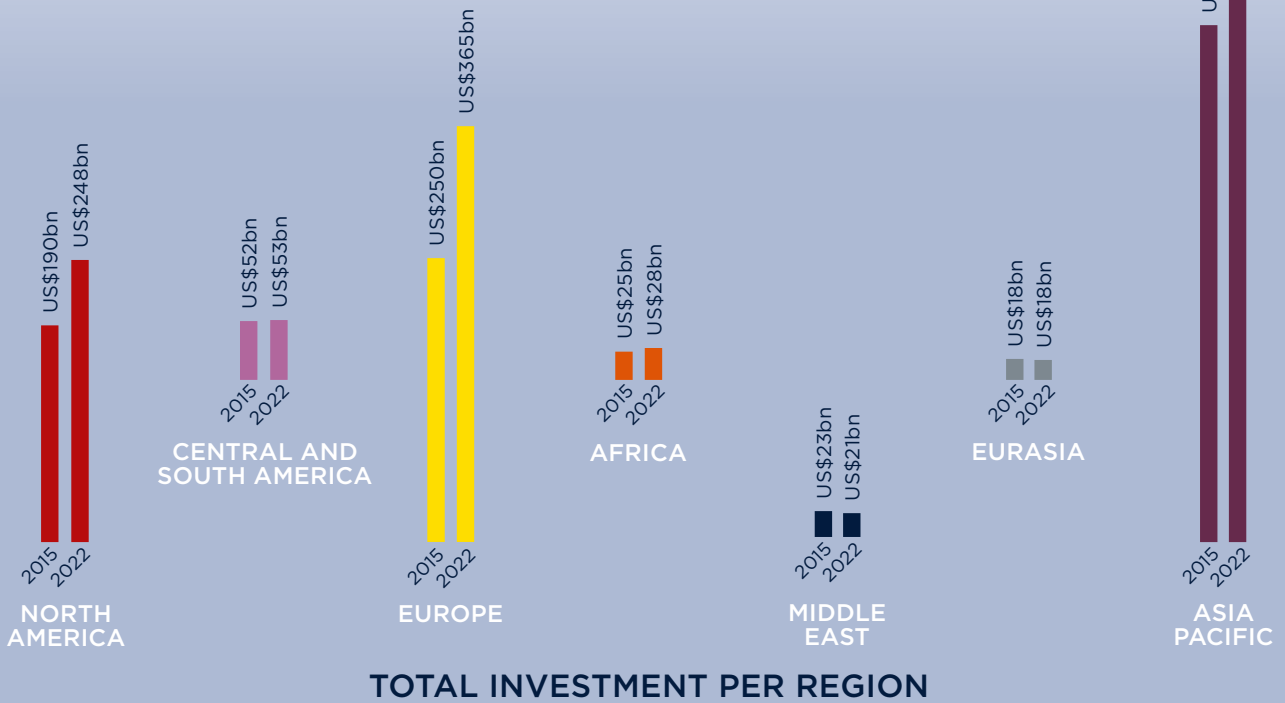
Smart technologies and solutions such as heat pumps, battery storage, smart meters, vehicle-to-grid technology and solar panels don't have this planning risk. As a result, they offer an alternative investment option that is more akin to the technology sector rather than the infrastructure sector.

Building costs are another growing challenge for investors. In recent years, prices of aluminium, copper and steel – essential for cables, turbines and photovoltaic (PV) panels – have

CLEAN ENERGY INVESTMENT



2015-2022 AVERAGE ANNUAL CHANGE



Source: Savills Research using International Energy Agency (IEA)

increased significantly, driving up overheads for projects in both developed and developing economies. Rising labour costs only add to the expense, potentially weighing on overall returns for investors.

Government subsidies and the way in which different energy sources are taxed can help or hinder matters. Although China and India have been investing heavily in renewables, most developing countries tax fossil fuels at a noticeably lower rate, making investment into renewables less attractive.

Financing for projects in developing markets is often expensive, due to its scarcity and there being less regulatory protection. This is one reason why the Just Energy Transition called for more innovative funding models at COP26, with developed countries helping to support infrastructure in less developed economies.

Opportunities for private investors

These factors mean that there have to date been limited opportunities for private – and, in particular, institutional – investors in this sector. Figures from IRENA show that total funds from institutional investors accounted for only 1 per cent of private investment in renewables – at \$2.5 billion.

Most of this private money has been to fund more established technologies, such as solar PV and onshore wind, which accounted for 84 per cent of these funds in 2020. In addition, there has been more of a weighting towards renewable projects in North America and Europe, accounting for 31 per cent and 29 per cent of these investments respectively. In contrast, just 14 per cent of this institutional investment money went into renewable projects in the East Asia Pacific region.

Thomas McMillan, Director and Head of Energy and Consultancy at Savills, says that despite these challenges there remain exciting opportunities for investors in this sector, particularly with

INVESTORS SHOULD NOT OVERLOOK HOW ENERGY UNDERPINS OUR DAY-TO-DAY LIVES

regard to technologies that support renewables deployment, such as energy storage and smart technologies.

“The transition to renewable energy sources is gaining momentum globally, but the rate of growth is insufficient to meet international climate goals. However, the growth we have seen recently may very much be the tip of the iceberg. With developments in the pipeline, we expect to see far more renewable infrastructure projects and smart technologies coming through in the next few years,” he says.

“Real estate companies should look at these as an opportunity to diversify risk. But they should also look at their existing portfolios, and how energy efficiency, renewables and smart technologies can be integrated into assets. This will help determine if there are assets that should be disposed of or repurposed over the coming decade.

“There are infrastructure investment opportunities across different global regions and it is clear that countries that can modernise their grid infrastructure, shorten planning issues and offer opportunities to invest in tertiary infrastructure present more attractive options for investors.

“This can be further supported by government policies, particularly those that create a long-term framework to encourage institutional investment into these important strategic areas.

“Investment in smart technologies is likely to be driven more by customer needs than government regulations,

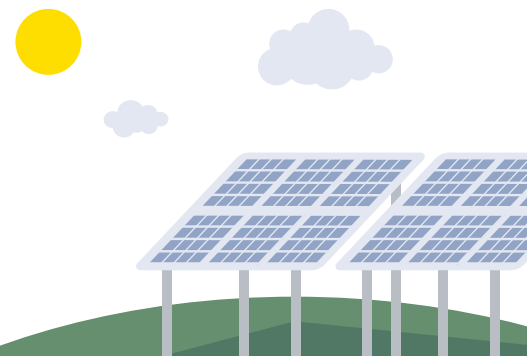
where customers seek to reduce running costs or address security of supply concerns,” adds McMillan.

A collective effort, from governments, the private sector and local communities, is essential if we are to successfully transition towards a greener, cleaner energy future.

Looking ahead

Renewable energy infrastructure is a sector that looks set to be increasingly important for many private and institutional investors. But barriers to investment, such as the inherent complexity and long timelines of such projects, remain, which may make investment into supporting technologies more attractive to some investors.

When entering the renewables market, investors should not overlook how energy underpins our day-to-day lives. Technology cannot be powered without it. Transport stops without it. Commercial and residential real estate cannot flourish without it. ■



WORDS ERI MITSOSTERGIU,
RICHARD VALENTINE-SELSEY
AND CLARE BAILEY



URBAN AFFORDABILITY CHALLENGES AND SOLUTIONS

How can cities foster innovation and attract talent when costs and inflation are pushing young businesses to the margins? And how are cities addressing residential affordability and quality of life to draw such talent?

Rising costs are impacting all aspects of life in 2023 and the real estate sector is no exception. It's a troubling scenario for both commercial and residential occupants.

High inflation rates have clear knock-on implications for businesses – smaller firms and startups especially. As their operating costs rise, they are likely to find it harder to afford the commercial spaces they seek in the locations they want, which may limit their ability to grow.

These businesses' most important asset is their workforce, which faces an acute shortage of affordable accommodation local to their workplace. This could pose challenges for recruiting and retaining talent.

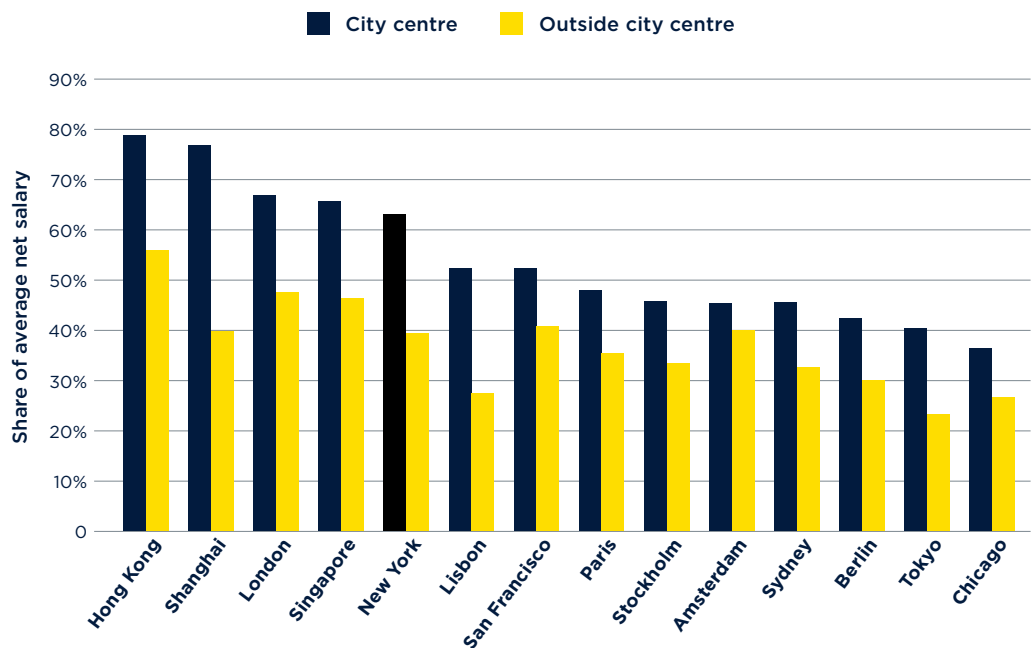
At the same time, competition has been rising for high-quality office space over recent years, pushing up rents. Demand continues to increase as businesses of all sizes seek energy-efficient,

flexible, imaginatively designed units in well-connected locations that will attract top talent. Covid-19 lockdowns generally reduced completions, setting back construction schedules and causing supply-side material shortages.

Savills Research shows that between 2019 and 2022, prime office rents increased across most major global city centres, despite the disruption caused by the pandemic. Dubai tops the ranking, with rents up 25 per cent, followed by Berlin (23 per cent), downtown New York (17 per cent) and the West End of London (13 per cent).

Small and medium-sized enterprises (SMEs) are again being hit hardest by this upward trend. In many cities, rising rents have rippled outwards from the historical central business districts, pushing up prices in the more affordable fringe areas. SMEs are being forced farther out into more remote districts and less attractive buildings.

ONE-BED RENT AS SHARE OF AVERAGE SALARY



Source: Savills Research using Numbeo

◀ The issue here is partly one of how to protect and nurture small businesses. According to the World Bank, SMEs account for about 90 per cent of businesses and more than 50 per cent of employment worldwide.

Off-the-shelf solutions

Potential solutions are emerging. One is the rise of commercial co-working spaces, which offer all-in packages without restrictive long leases. Given the costs of setting up and maintaining an office, these deals can work out simpler and cheaper over time.

To compare the cost of a co-working arrangement relative to the net effective cost of a conventional prime office, Savills Research assumed a 10-person business, operating across 16 key global markets.

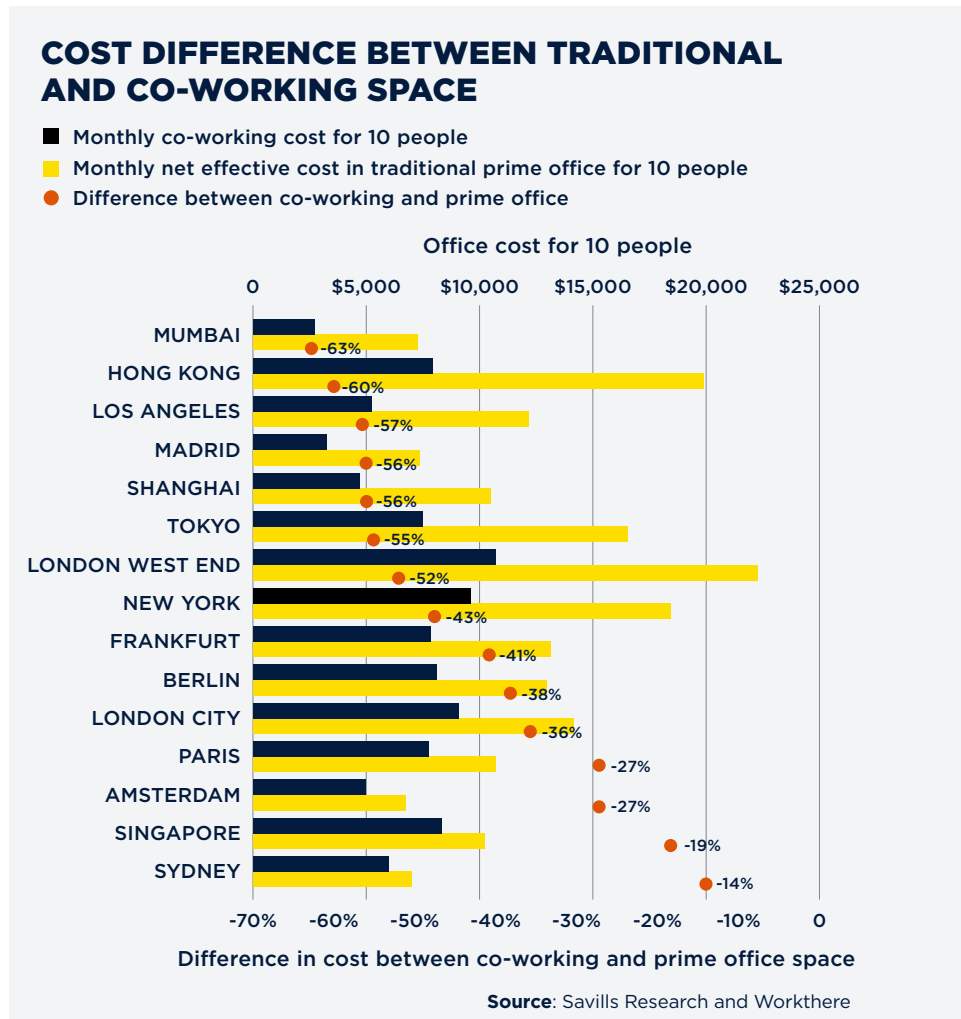
The study found that a co-working space is 40 per cent cheaper on average, although there is considerable variation between locations. While co-working costs 63 per cent less than renting a prime office in Mumbai, the differential is just 14 per cent in Sydney. The cheapest cities for co-working include Mumbai, Madrid, Shanghai, Amsterdam and Los Angeles. New York and London are the most expensive.

Cal Lee, Global Head of Workthere and Savills Flex Co-Head in the UK, notes that for companies starting out, any savings made on premises and channelled into the business could prove the difference between success and failure.

“For any mature office market hoping to have a strong base of start-up and scale-up businesses, it is imperative there is a diverse range of space available from a price perspective. Co-working can be a very affordable route for a young business and it is vital for any start-up ecosystem within a city,” Lee says.

Nurturing the start-up ecosystem

Nonetheless, even co-working arrangements may be too expensive for



the smallest start-ups. In these cases, public-sector funds are being used alongside private investment in the creation of start-up hubs. These offer cheap rents and share resources among similarly small-scale enterprises in convenient locations.

Beyond affordable rent, co-working arrangements also bring people together to foster collaboration across communities, locally and within their industry sectors.

The Factory Berlin project is a great example of how public and private-sector funding can make such communities viable. Members can choose from a variety of membership plans, ranging from part-time desks to full-time private offices. It means that

they only pay for the space they need and can afford, and are not burdened by lengthy leases or high upfront costs.

Incubators and accelerators

Similarly, university incubators support enterprises and start-ups driven by the university community, helping to retain academic talent.

Corporate accelerators provide mentorship, resources and funding to early-stage businesses. For the corporates supporting these initiatives, it's a valuable chance to engage with innovative start-ups and the talent they attract.

The 4,400 sq m JLABS @ Shanghai is the first Johnson & Johnson innovation hub to be established in Asia. It can

accommodate more than 50 life-science and healthcare start-ups and larger companies, and provides lab facilities, equipment and mentor support.

Pushed up and priced out

On the residential real estate front, too, affordability pressures are acute. Many city dwellers, especially younger people, students, and essential workers and their families, are affected.

Ageing populations and a rise in single households mean intensifying competition for a limited supply of affordable city housing. Both capital and rental values have been pushed up, with demand for rental accommodation exacerbated by recent hikes in mortgage rates that have thwarted prospective buyers in many big cities.

Historically, an affordable rent would cost less than 40 per cent of net income. These days, tenants in most city centre locations can expect to pay more.

Yet existing social housing stock is failing to keep up with the growing demand for affordable accommodation. New York's City Housing Authority has just 178,000 such units; London has almost 800,000, but supply has shrunk over the past five years; in Hong Kong, you can expect to wait five years for a public rental home.

Frustrated and outpriced, renters are having to look further afield, live at home for longer, move to cheaper cities or "hutch up" by taking a room in a shared flat.

That pressure has refocused attention on the need to deliver genuinely affordable social housing, usually through some form of public-sector support.

As Helen Collins, Head of Affordable Housing Consultancy at Savills, observes: "To increase supply, nations and regions need to put in place clear strategies, targets and delivery models underpinned by state funding, land supply and policy support. Continuity, consistency and certainty provide developers, investors and providers with the confidence to invest."

Such models can take many forms. For instance, in Spain and other EU countries, Covid-19 recovery funds are being used to subsidise affordable housing. The UK provides housing associations with direct grant funding, while in the US investors are incentivised by tax credits to fund affordable accommodation.

Singapore and Hong Kong, meanwhile, run extensive and heavily subsidised public housing schemes for local residents, although they are among the most expensive places in the world for expatriates to buy or rent privately.

Repurposing old commercial stock

Other potential opportunities to boost the availability of affordable stock in city centres include the repurposing of old commercial stock into new housing and the regeneration of deprived neighbourhoods through a mix of affordable and market housing alongside commercial properties.

One example of repurposing in action is Les Grand Voisins – located in Paris's former Saint Vincent de Paul Hospital – which was developed as a temporary but very successful 'meanwhile' mixed-use space for the local community to connect with society and work. For entrepreneurs, rentable workspaces are available.

A relatively recent financial development has been the expansion in the UK and Europe of closed-ended ESG-focused social housing funds from the likes of Man Group and Civitas, among others. These bring private capital to support publicly-funded social housing schemes, with investors accepting a lower financial return than those of full-blown commercially focused funds.

Clearly, there's a pressing need to reimagine city-centre living and working in many big cities, and to make it more affordable in a 21st-century context. The most successful schemes are likely to be those that focus on delivering wider social and environmental benefits, too. ■



GETTY IMAGES

Barcelona: space to innovate

Barcelona policymakers are on a mission to attract talent and make the city a European hub for start-ups.

Barcelona Activa, the local development agency, offers incubation spaces and added services to new start-ups.

Three of Barcelona Activa's incubators are located in 22@, the city's innovation district.

Small spaces at its four incubators are 30 per cent cheaper than the market rate, while its Technology Park, which is specifically aimed at companies scaling up, offers up to 200 sq m at between 15 per cent and 25 per cent less than in the rest of the area.

"Bringing economic activity in an urban, dense area generates interactions that foster innovation and boost the entrepreneurship ecosystem, says Mario Rubert, Director of City Promotion at Barcelona City Council. "At the same time it produces a transformation toward a better balance between working and living."

WORDS KELCIE SELLERS

OUT OF OFFICE

ADAPTING TO NEW WAYS OF WORKING

Covid-19 changed office-based working almost overnight. Technology stepped up to keep us connected while working from home. How are offices now evolving to meet the generational and geographical demands of the workforce?

The working habits formed over the past three years may prove longer-lasting than many initially anticipated. In the US, 56 per cent of full-time employees – that’s 70 million people – say their jobs can be done remotely. In Germany, 51 per cent of people work remotely at least one day a week. In the UK, it’s 42 per cent.¹

As a result, many firms are downsizing or “right-sizing” their office spaces; others are still taking the equivalent amount of floorspace but upgrading in terms of quality or layout to give workers a better experience.

The picture, however, is far from uniform worldwide, as the Savills Future Office Availability Index reveals. It

certainly doesn’t spell the end of the office either.

We have created an index of the top-tier office markets globally to understand how current office environments – in terms of cost and availability, pipelines and hybrid working trends, as well as future office needs – could all come together to result in an increase in office availability in some markets.

Time for a rethink

Our analysis suggests we need to rethink the number and nature of the

offices we are building – and reposition existing offices to suit new ways of working. By identifying the factors leading to rising availability levels in different cities, we can pinpoint the key drivers for office market resilience in each location.



Factors include existing vacancy rates, quality of stock, ESG considerations, and the prevalence of hybrid working. Booming finance and business services sectors in certain cities – notably Mumbai, Delhi and Ho Chi Minh City – are also driving demand. Each of these cities is forecast to see the Gross Value Add from their finance and business services sectors increase by 50 per cent or more in the next five years, and employment in the sector is also forecast to increase by more than 10 per cent over the same period.

Demographics are also crucial in this conversation; growing populations, especially increasing numbers of younger people in some locations, are likely to help support office usage in the near to mid-term. Over the next five years, the populations of Mumbai, Shenzhen, and Ho Chi Minh City are forecast to increase by 8 per cent or more.

Office allure

Office life may help the younger demographic feel more involved in company culture. It also provides an alternative to working from their homes, which are likely smaller and without dedicated office space compared to older colleagues.

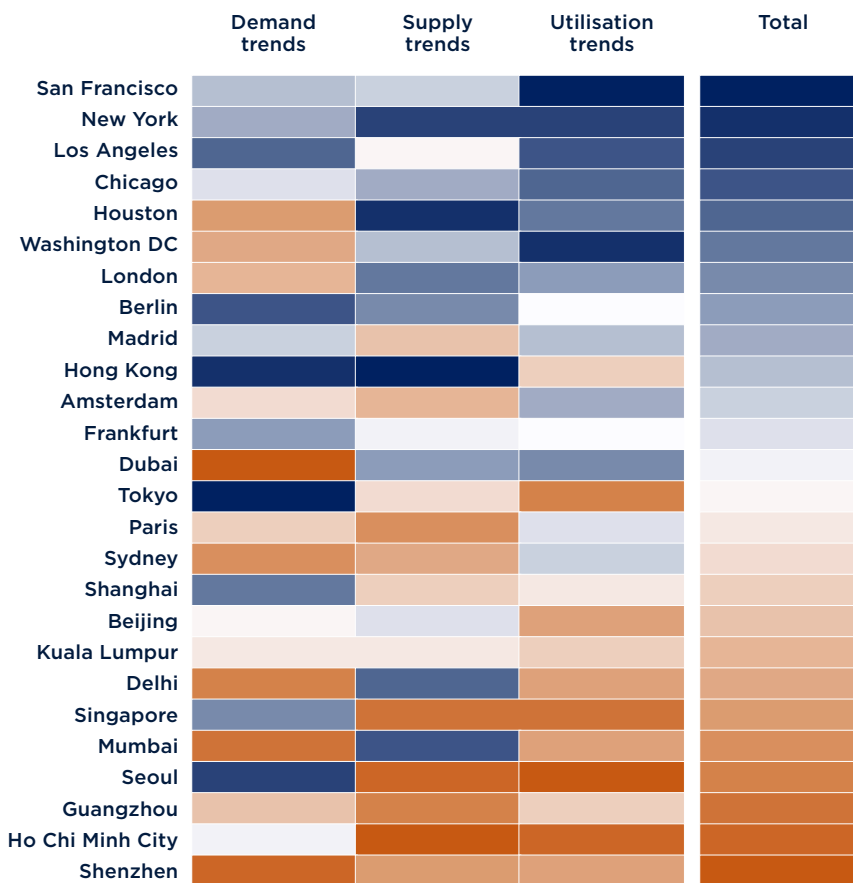
This is not only driving demand for offices; it's also shifting the nature of those offices to more flexible and collaborative environments than in pre-Covid times.

Cultural factors can also drive our attitudes to office life and hybrid working. Businesses in Tokyo and Paris tend to encourage cultures of mentorship in the office. They prize the informal training opportunities that face-to-face interaction with experienced colleagues brings and this is reflected in their higher utilisation rates – 80 per cent in Tokyo and 66 per cent in Paris as of March 2023.

Paris's central business district (CBD) has one of the lowest vacancy rates in Europe, at 2.3 per cent. Tokyo has one of the lowest vacancy rates in Asia Pacific, with approximately 4 per

FUTURE OFFICE AVAILABILITY INDEX

Note: Index is colour ranked from markets most likely to see an increase in office availability (dark blue), to those least likely (burnt orange). Each category is individually colour-scaled. Utilisation trends is given a half weighting. Demand trends and supply trends are equally weighted.



Source: Savills Research using Oxford Economics, Kastle Systems, and local sources

cent of stock available for rent; only Seoul and Ho Chi Minh City have lower vacancies at 3 per cent.

Commutability is another key part of the office/hybrid working equation. American cities with significant urban sprawl are more likely to have greater numbers of workers commuting by car, which carries time, cost and environmental implications. Their more compact European equivalents are better placed to embrace the “15-minute city” concept of mixed-use neighbourhoods designed for living, working and playing.

Future of offices: newbuilds and refurbis

Also topping priority lists is the green factor: the need to build or retrofit office space that fulfils companies' ESG responsibilities, in turn providing the calibre of sustainable stock that occupiers seek.

We are seeing a growing chasm between the best and the rest, with best-in-class, sustainable, people-focused office space in highest demand and achieving the highest prices. In Europe, for example, the average rent for prime office stock is 142 per cent higher than

ILLUSTRATION: JAKE READ

¹ Practices and representations associated with teleworking in Europe – Fondation Jean-Jaurès (jean-jaures.org)

◀ the average rental price for secondary stock. Even if the pandemic hadn't disrupted work practices, much of the older stock was overdue for modernisation.

In most cities studied for the Savills Future Office Availability Index, the majority of stock (an average of 69 per cent) was built before 2010 – meaning there was already an oversupply of non-green office stock. This stock does not meet the growing demand and preference for sustainable office spaces, as large numbers of occupiers seek out spaces that support their ESG commitments.

East meets West

By piecing it all together, we have drawn a new map of the office environment based on hybrid working. Broadly it shows an East-West divide – between countries that have largely returned to pre-Covid-19 office practices and those in which hybrid working is much more normalised. This is reflected in office utilisation rates – the share of workers going to the office on a daily basis. Across Asia Pacific markets, the average office utilisation stands at 86 per cent, as at March 2023. This stands in contrast to the averages across EMEA and Americas markets, which average 61 per cent and 48 per cent respectively.

US markets – particularly key cities such as San Francisco, New York and Los Angeles – have higher potential to see increased office availability in the future. Of examples, San Francisco is among the strongest. Pre-Covid-19, it had one of the lowest office availability rates in the US, at 9.5 per cent. In the current climate, 30 per cent of its office space is vacant or due to return to the market in the next year, representing a 30-year high in availability rate.

San Francisco's status as a tech hub cannot be overlooked in this either; post-pandemic, many tech companies and workers alike have reassessed their needs for in-person working. In the current economic climate, too, we are seeing some tech firms examine their

THERE APPEARS TO BE A GROWING EAST-WEST DIVIDE – BETWEEN COUNTRIES THAT HAVE LARGELY RETURNED TO PRE-COVID-19 OFFICE PRACTICES AND THOSE IN WHICH HYBRID WORKING IS MUCH MORE NORMALISED

space and staffing needs, with reports of tech redundancies also characterising this shift.

Asia-Pacific markets – including Chinese cities, Singapore, Seoul and Mumbai – are likely to have a lower surplus of space over the next decade. Their expanding economies are drivers for office demand and hybrid working trends have not taken root in the same way as in the West. Europe sits somewhere in the middle. The average vacancy rate is 13.7 per cent, which while lower than the availability rates in the US markets (which accounts for vacancy as well as space listed as available for lease in the next 12 months), has increased in recent months with the rise in hybrid working and the changing office environment. Berlin, London and Madrid are in the middle of the table where demand for high-quality offices is expected to persist, meaning that availability will likely be concentrated in older office stock.

Adapt and evolve

The question now is how to retrofit and repurpose excess and vacant office stock to suit today's needs.

Where there is the potential for higher availability levels, there are opportunities for repurposing. In central locations, there is often both the demand and potential for converting offices into residential property. The boom in on-demand delivery culture in some locations is driving the need for last-mile logistics, which may lead to some spaces in suburbs and more fringe urban locations being turned into delivery depots, fulfilment centres or retail outlets.

Regardless of the end-use of the repurposed office, cities becoming more mixed-use will provide opportunities for new uses and revitalisation. New locations for residential, education, health, retail, and culture will increase the social and environmental sustainability of cities, supporting the livability, walkability, and diversity of the social fabric across these areas.

Given the sheer amount of embodied carbon in buildings, interest in finding new uses for existing properties is only increasing, and we expect to see this trend towards thoughtful repurposing continue. ■

San Francisco

MICHAEL McCANDLESS

CORPORATE MANAGING DIRECTOR,
SAVILLS SAN FRANCISCO

Markets across North America could see increased availability over the coming years, with San Francisco leading in terms of both rising availability and opportunities. Even before the pandemic, the market was beginning to embrace remote work. As a result, the city is still trending below 45% office utilisation, according to Kastle Systems, giving the city the lowest utilisation rate of all the Tier One markets in the US.

The situation is less than optimal for landlords. Availability rates are nearing 30%, which is an all-time high for San Francisco, above even the highs that followed the 2001 dotcom crash and the 2008 financial crisis. Couple the high availability and low daily utilisation rates and most office buildings are running at sub 30% capacity.

On top of this, most San Francisco renewals have reductions in floorspace of anywhere from 20 per cent to 50 per cent. We are also seeing very little growth or even stability in new square footage leased from existing companies that did not put space on the sublease market. Occupiers, notably tech tenants, have begun implementing “return to office” mandates in 2023, so a greater share of employees returning to the office would likely help office demand increase over time and begin to chip away at the oversupply of space.

Looking ahead, there are opportunities to be found for tenants in San Francisco and beyond. Increased interest rates, reduced building valuations, and growing vacancy have resulted in a strong tenant’s market.

Prospective tenants will have a lot of options, and aggressive landlords are offering big concession packages to lure tenants into relocating or

staying in their buildings. San Francisco also remains a hub for innovation, with a highly educated workforce. This will help it recover from current market volatility over time.

Paris

SERGE VAYER, HEAD OF OCCUPIER SERVICES, SAVILLS FRANCE

The French capital is Europe’s outlier when it comes to office vacancy levels. The vacancy rate – currently 2.3 per cent in the CBD – has fallen drastically over the past decade. The supply pipeline is limited and swamped by demand for Grade A spaces.

Demand is partly driven by a culture of working in the office and in-person interaction. Some managers still believe work can only be done in the office. It is both cultural and generational, and that is changing slowly with younger generations and the tech industry. But most managers still like to have their team around them in the office.

Most companies prioritise having a central Paris address over a more modern office, such as in La Défense business district on the outskirts, where vacancy is at 16 per cent.

A city-centre location is a way to attract new talent, attract people back to the office and offer a good office experience compared to working from home.

Although companies are keen to occupy Grade A, ESG-certified office

space in the centre, most of the CBD stock is Grade B and there is little land available for new-build, as the Town Hall favours residential over offices.

China

JAMES MACDONALD

SENIOR DIRECTOR AND HEAD OF RESEARCH, SAVILLS CHINA

The majority of Chinese workers are now back in the office, after nationwide lockdowns, marking a return to company culture which prizes in-person working.

While employees had to work remotely during these lockdowns, generally speaking, remote work has not really caught on that much. When travel giant Trip.com implemented its policy of two days working from home a week in February 2022, it was the first large tech company in China to give employees a hybrid working option.

Chinese cities’ efficient and inexpensive public transport is one incentive for workers to go into the office along with the desire to escape typically cramped, multi-generational home environments.

However, the threat of oversupply is constant. There is a concept of constructing an office building to attract a company and grow your economy and tax base. But even leading cities such as Shanghai are seeing multi-year high vacancy rates.

It’s the result of overbuilding and weak demand – because of slower economic growth, especially in 2022 – and business uncertainties, especially surrounding zero-Covid-19 policies. ■





WORDS LUCY PALK

WELCOME TO

THE AGE OF AGEING

**AND THE
UPSCALE HOMES
TO GO WITH IT**

People of 50 and older – many with accumulated wealth – will drive prime residential markets around the world over the next decade

The percentage of people aged 50 and above is forecast to reach 28.4 per cent globally by 2033. For some countries, it will be more. In 47 of 165 countries we analysed for our Savills Prime of Life Residential Index, the figure will be at least 40 per cent.

The global trend is towards lower birth rates and increasing life expectancy. Health and educational improvements are driving demographic change. As nations advance, older people tend to accumulate wealth. There's a correlation between better health, fewer children and rising incomes. Populations that are getting older also tend to be getting wealthier.

In other words, many countries are seeing significant growth in the number of affluent, mature people, many of whom are seeking more from their homes.

What do affluent, mature homebuyers want?

This is not a homogenous group. The 50-plus category includes everyone from busy working parents to carefree retirees.



GETTY IMAGES

When it comes to property, their top priorities are quality and space – for example enough space to comfortably work from home.

They may also be looking for ease of ownership. The US branded residence trend, now gaining popularity in Europe and Asia, provides a hassle-free turnkey experience that appeals to many in this age group – especially those who own multiple properties around the world. Those seeking the city lifestyle but larger living spaces increasingly opt for smaller cities, which offer the advantages of urban centres but often at lower costs.

The country picture

Using Oxford Economics data, Savills quantified the trends by country over time.

First, we focused on countries whose 50-plus populations are forecast to grow by more than 10 per cent in the next 10 years. They also had to be

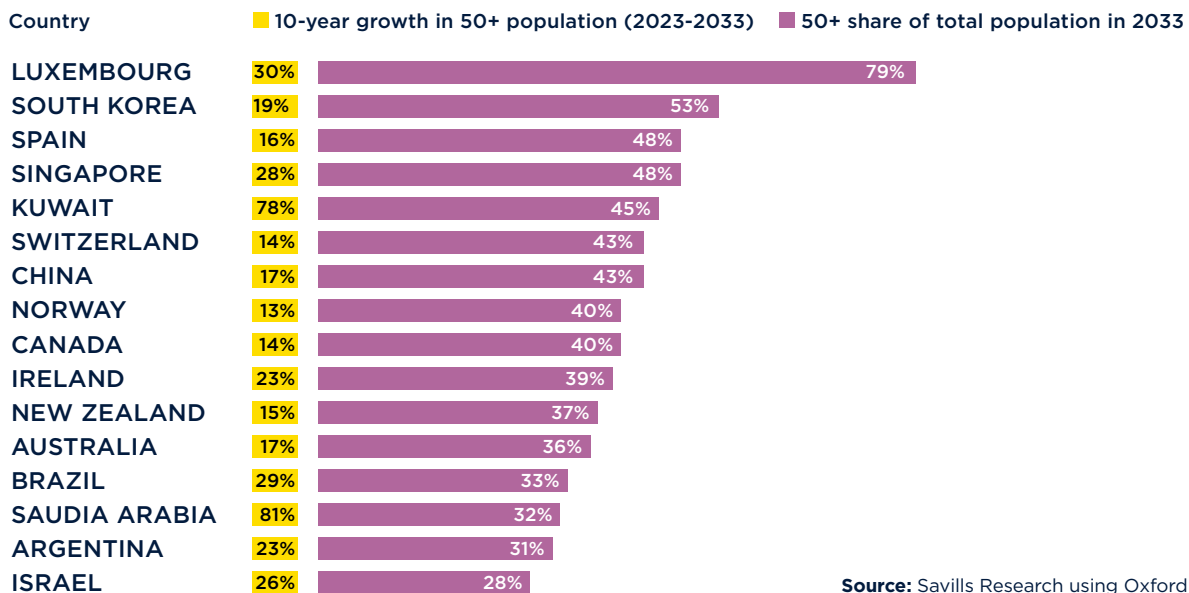
home to at least 10,000 households with incomes of \$250,000 or more.

Our top 16 is striking in its geographic diversity. Luxembourg will have the largest share of over-50-year-olds in 2033 (79 per cent), with South Korea (53 per cent) in second place. But the fastest growth in this age group over the next decade will be in Saudi Arabia and Kuwait. European nations already have high proportions of people over 50. A large number of Asian and Middle Eastern countries will see their mature populations explode, as more people become richer. And while some cities will attract more newcomers, many will rely on domestic trends to drive growth.

The result for real estate is the same. Prime residential hotspots around the world should prepare for influxes of affluent over-50s, with different sets of expectations around what a home should be.

[TURN TO SEE THE SAVILLS PRIME OF LIFE INDEX](#) ▶

COUNTRIES WITH THE LARGEST AND FASTEST-GROWING SHARES OF WEALTHY OVER-50s, 2033

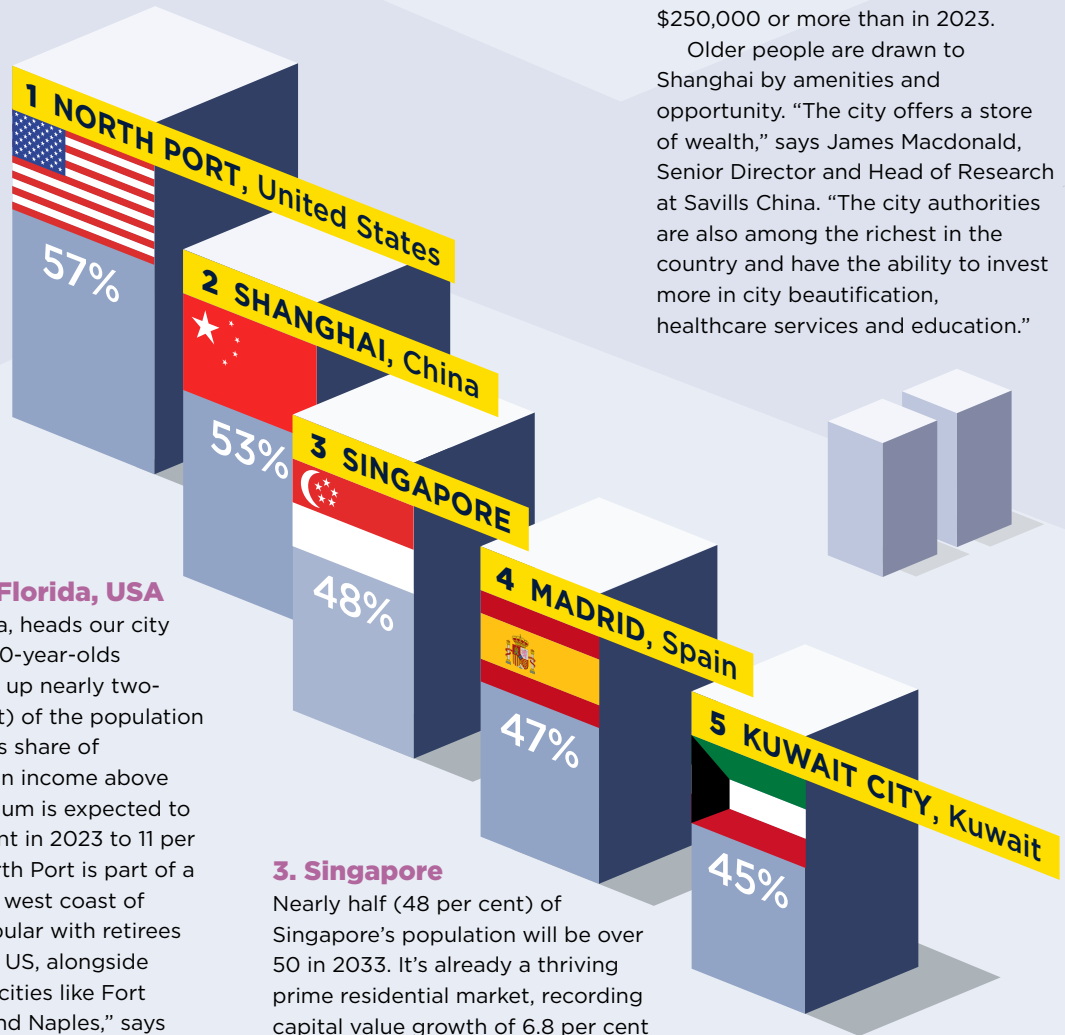


Source: Savills Research using Oxford Economics

Note: Analysis focuses on countries with a population greater than half a million people, more than 10,000 households with an income of \$250,000 per annum or higher, and forecast to see more than 10% growth in their over-50s populations between 2023 and 2033.

THE SAVILLS PRIME OF LIFE INDEX

Percentage of population over 50



1. North Port, Florida, USA

North Port, Florida, heads our city index, with over-50-year-olds expected to make up nearly two-thirds (57 per cent) of the population by 2033. The city's share of households with an income above \$250,000 per annum is expected to rise from 9 per cent in 2023 to 11 per cent in 2033. "North Port is part of a larger area on the west coast of Florida that is popular with retirees from the northern US, alongside more well-known cities like Fort Myers, Sarasota and Naples," says Ryan Schleis, Senior Vice President of Research at Corcoran.

3. Singapore

Nearly half (48 per cent) of Singapore's population will be over 50 in 2033. It's already a thriving prime residential market, recording capital value growth of 6.8 per cent last year.

A maturing and affluent population presents challenges alongside opportunities. A growing number of fifty-somethings in the city are single. Future development will have to include a large number of apartments and smaller homes that meet their needs, forcing residential developers to be creative with space.

2. Shanghai, China

By 2033, slightly more than half (53 per cent) of Shanghai's population will be over 50, up from 47 per cent today. Strikingly, by 2033, four times as many households will be earning \$250,000 or more than in 2023.

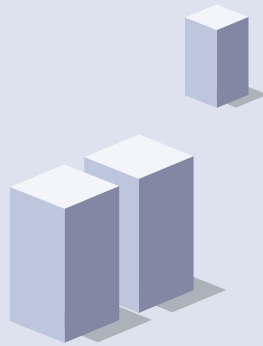
Older people are drawn to Shanghai by amenities and opportunity. "The city offers a store of wealth," says James Macdonald, Senior Director and Head of Research at Savills China. "The city authorities are also among the richest in the country and have the ability to invest more in city beautification, healthcare services and education."

4. Madrid, Spain

Madrid's attractions are no secret. "It has an incredible offer when it comes to entertainment, gastronomy and luxury shopping," says Pelayo Barroso, Research Director at Savills Spain. "Madrid has become one of the most sought-after European capital cities over the past few years."

Around 47 per cent of the population will be 50 or over in 2033, with affluent households (incomes of \$250,000 or more) set to double in that time.

That will be a challenge for the prime residential market in particular, given that demand already outstrips supply in central areas. "In the centre, buyers are looking for renovated apartments in classical buildings with historic façades, but these are often protected and don't have parking," says Barroso. "The farther you move out of the centre, the more opportunities there are for projects."



5. Kuwait City, Kuwait

Kuwait is a microcosm of the modern Middle East, with a rapidly expanding middle class. At the same time, the city has become a thriving location for second homes. The share of its population aged 50 and above will rise dramatically over the next 10 years, from 27 per cent to 45 per cent, alongside a 39 per cent growth in households with annual incomes of \$250,000 and more.

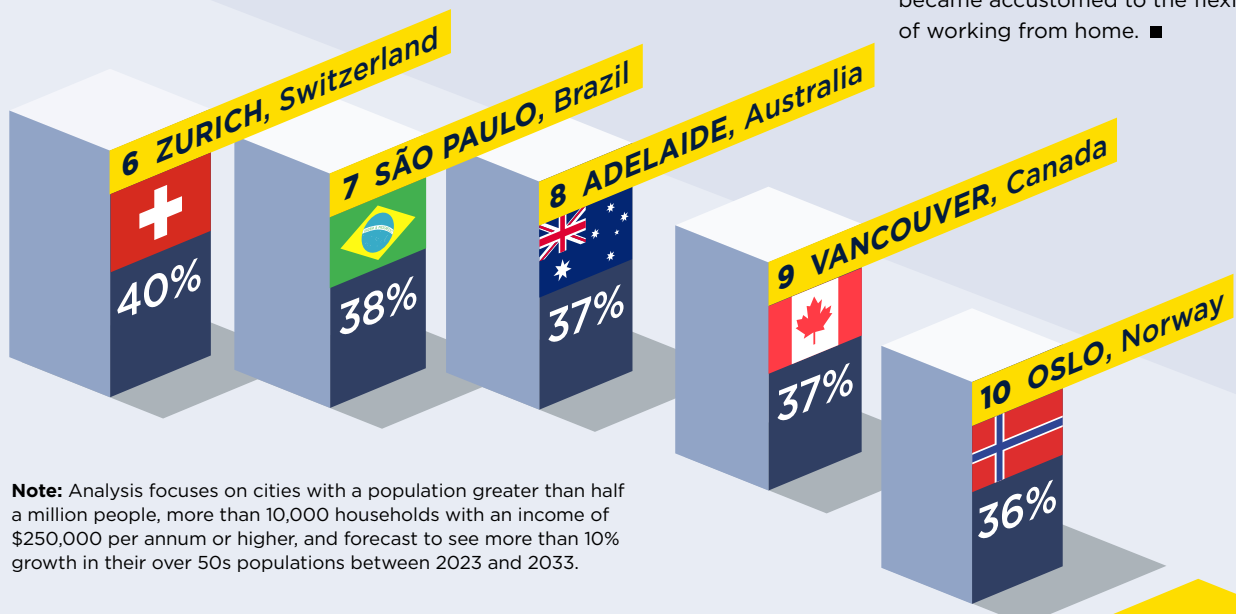
Many of these affluent and mature homebuyers - nearly one-third (32 per cent) of the population as a whole - will still be of working age. Their demands for space, entertainment and lifestyle factors will shape the prime residential market in Kuwait over the next decade.



6. Zurich, Switzerland

The Swiss city already boasts one of the highest figures for GDP per capita in the world and its wealth is only likely to increase over the next decade. That's especially true if the Swiss retirement age is raised to counter perceived labour shortages. A national debate is currently underway.

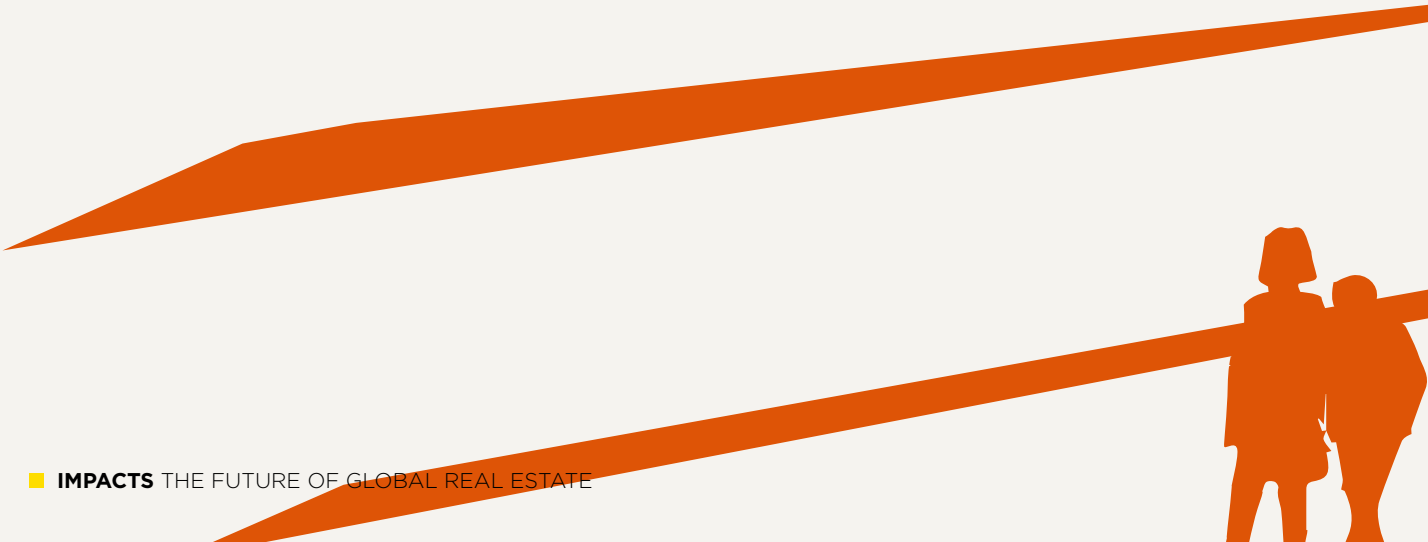
Increasing wealth, driven by longer careers, will shape the city's prime residential market. Zurich's economy is largely service-based and, during the Covid-19 pandemic, many service-sector employees became accustomed to the flexibility of working from home. ■



Note: Analysis focuses on cities with a population greater than half a million people, more than 10,000 households with an income of \$250,000 per annum or higher, and forecast to see more than 10% growth in their over 50s populations between 2023 and 2033.

Source: Savills Research using Oxford Economics

ILLUSTRATION: JAKE READ



WORDS ERI MITSOSTERGIU,
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PHYSICAL RETAIL IS REGAINING ITS PURPOSE

Optimism is back on the agenda for bricks-and-mortar retailers, but the places where retail happens are changing

Funan in Singapore is a city centre neighbourhood under LED lighting. This former technology mall is now a bustling mixed-use development with six floors of office space, serviced residences and retail. Visitors can enjoy a cycle path on the ground floor, or make their way to the top floor to take a stroll in the urban garden and sample some of its produce at the attached restaurant.

Nuveen's redevelopment of Edinburgh's St James Quarter takes a different tack. It's about repositioning, not replacing, the city's retail offer – making the shopping environment more relevant and engaging. The mixed-use space, which incorporates hotel, residential, leisure and offices, also boasts a large number of sustainability/ESG initiatives.

While Funan and St James Quarter may seem different, they send similar messages about the future of city centre retail spaces. They're ▶

◀ breathing new life into areas and structures once largely abandoned, repositioning them as vibrant centres of their communities. In both places, retail and leisure, while still being front and centre, are part of a much broader offer.

Physical retail is changing with the times

Funan and St James Quarter demonstrate that bricks-and-mortar retail can evolve beyond its traditional limits. The pandemic-fuelled rise of e-commerce threw down a clear challenge to bricks-and-mortar retail – and it is responding.

In fact, there are signs that physical retail is regaining its purpose. It isn't happening everywhere, but in many markets, brands are moving back into core retail locations and vacancy rates are falling. At the luxury end, some are even pushing their physical retail presences into new and novel areas.

Sam Foyle, Director and Co-Head of Prime Global Retail at Savills, says many brands are expanding their physical retail presence. “Globally, brands never left their prime locations and some have used recent rent reductions as opportunities to expand into other high-end or tourist-rich areas, or move from great shopping streets to iconic ones. Others have expanded into affluent suburbs.”

It is impossible to overstate the catalysing effect of the pandemic on all of this. During lockdowns, people who already shopped online did more of it. People who had never shopped online started doing it. E-commerce penetration soared, raising fears that bricks-and-mortar shopping would never truly recover. But recently, that acceleration has eased. Worldwide e-commerce penetration increased by 29% in 2020 but by just 5% in 2022.

Electronic marketplaces are farther ahead than they might have been without the pandemic, but they are far from all-conquering. People are returning to shops.

Pure-play e-commerce operations, facing an array of operational cost increases on top of expensive returns policies, are seeing their already squeezed margins hit. Genuine omnichannel retailers – with both online and in-store presences – are faring significantly better.

After Covid-19 lockdowns, consumers are looking for connection and community, feeling the lure of communal

spaces. At the same time, the ease of e-commerce has given customers expectations of convenience and an “on demand” mindset. Retail locations that meet all of these disparate requirements are likely to prove most resilient in the long run.

Going local

It's been widely reported that the local suburban high street was given a much-needed shot in the arm by the pandemic's forced mass experiment in home working. This was partly down to convenience and amenity – people working from home were unable or unlikely to travel into the city centre for a quick errand.

At the same time, the pandemic amplified the celebration of local and independent retailers that had been emerging for some time. Covid-19 highlighted the importance of a great local coffee shop and bookstore. Local pride became a driving force behind suburban renewal. People re-examined where they lived and what their area offered, and found places to meet, socialise and shop.

This attitude hasn't gone away. Many office workers have now added one or two work-from-home days to their pre-pandemic schedules. The money they spent in city centres hasn't been lost. It's most likely been deflected to local shops and cafés.

The caveat is that this hasn't happened everywhere. The trend is much more evident in affluent areas that house better-paid office-based professionals and boast independent retail presences. Nevertheless, it has happened, and it is helping to shape the urban landscape.

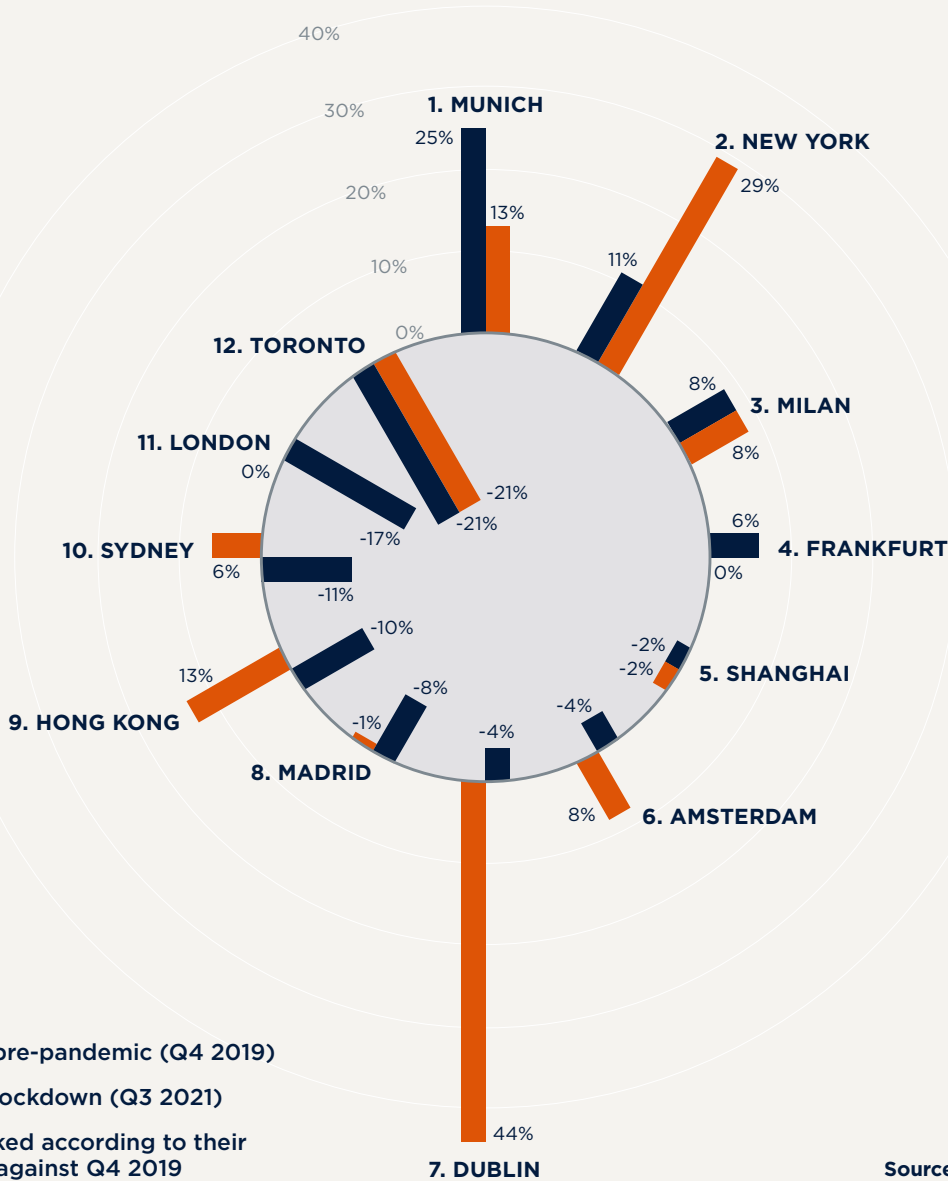
The case for cities

So what of those city centres? It's true that many central business districts have become quieter at certain times of the week and hybrid working regimes have had impacts on the stores that once serviced busy commuters and lunch-break browsers.

If 25 per cent of pre-pandemic spending in city centres came from workers who now spend one or two weekdays at home, it's likely that between 5 and 10 per cent of that expenditure has been redirected to local high streets.

THE PANDEMIC-FUELLED RISE OF E-COMMERCE THREW DOWN A CLEAR CHALLENGE TO BRICKS-AND-MORTAR RETAIL – AND IT IS RESPONDING

PRIME LUXURY RETAIL RENTS: CURRENT V PRE- AND MID-PANDEMIC



The picture is complex and the green shoots of retail recovery are apparent in city centres, too. Vacancies in core retail streets are falling. Brands have taken advantage of rent corrections during the pandemic to move back into high-footfall locations. Affordability is allowing retailers to move up the footfall ladder, from secondary into primary pitches and from tertiary into secondary. There is a flight to prime.

Prime luxury retail rents are still below pre-pandemic levels in a number of premier high streets across the world – down at least 10% or more on 2019 levels in Toronto, London, Sydney

and Hong Kong. In the past two years, however, prime luxury retail rents have grown by an average of 7% (Q1 2023 data).

Cost is certainly a factor, but it isn't the only one. These retailers obviously still see huge value in city centre locations, even with reduced weekday footfall and, in many cases, their own thriving e-commerce offers. Why might that be?

Changing city centres

There are a number of drivers. Consumers want novelty and amenity in one place. By being home to independent operators ▶

RETAIL SPACE AS PART OF MIXED-USE ENVIRONMENTS IS INCREASINGLY POPULAR, WHETHER PLACES ARE REPURPOSED OR BUILT FROM SCRATCH. CITIES ARE GRADUALLY FIGURING OUT WHAT WORKS BEST FOR THEM

◀ and big name brands, city centres provide exactly that. Consumers can visit a global fashion retailer and an independent local restaurant in the same trip.

At the same time, some are willing to travel much further afield for unique experiences. Tourist spend is a key driver of prime physical retail and may drive expansion as the world continues to open up after Covid-19. “One of the key features of regional retail markets like Hong Kong is tourism, especially visitors from the Chinese mainland,” says Simon Smith, Regional Head of Research at Savills Asia Pacific. “In some markets tourists can account for a significant share of physical retail spend – almost 80 per cent in the case of pre-pandemic Hong Kong.”

Perhaps somewhat counter-intuitively, online retailers are increasingly taking up prime retail pitches in major cities. This is the lure of community in action. E-commerce brands have been using social media to build online communities for years. Now, they’re bringing brand engagement and a sense of togetherness to the real world by opening stores.

Amazon, the king of electronic shopping, now operates nearly 100 retail locations and has plans to expand. Alibaba, its Chinese equivalent, also runs hundreds of physical stores.

German online fashion and beauty brand Zalando sells discounted and overstocked items through a network of bricks-and-mortar retail outlets. In 2021, it opened a flagship location in Berlin, which offers a personalised shopping experience with in-store stylists and digital features.

In some cases, these spaces may be showrooms and community hubs, complete with cafés and event halls, as much as profit centres. They’re places for people to meet, mingle – and engage with the brand – as much as to shop. It’s all about extending brand visibility.

This is especially true of “athleisure” brands like Fabletics, Under Armour and LuluLemon Athletica. LuluLemon’s experiential store in Chicago features fitness studios and a

“fuel bar”. High-end retailers are using physical locations to reinforce their appeal to a community that may actually buy the merchandise online.

Finding new purpose

These are examples of retail reinventing itself to suit changing consumer trends. While many of us are spending less time in city centres, we may be spending more money when we do travel in.

Trips into the city centre are becoming diverse and multifaceted experiences. Consumers might go to shop, eat and catch a film. They might go for a doctor’s appointment followed by an hour at the gym, or combine click-and-collect shopping with an art gallery visit.

All of this demands the repositioning or repurposing of retail. Away from the most prime locations, there is often an oversupply of space. Some retailers are rationalising their store networks, focusing on locations with higher footfall and visibility that can boost both online and offline sales. Secondary shopping malls and traditional department stores are suffering as a result.

At the same time, consumers value convenience and mixed-use spaces, which give them multiple reasons to make a single trip into town. The mixed-use concept offers an obvious future for physical retail. It’s why Funan has been retrofitted as a mall that responds to a range of requirements. It’s why the St James Quarter has been designed as a place to stay, dine and play as well as shop.

A captive audience

Mixed-use is an increasingly popular template, whether places are repurposed or built from scratch. California, where malls proliferated in car-centric suburbs, is ahead of the curve. Huntington Beach, an ageing 1960s-vintage indoor mall, has been reenvisioned as Bella Terra, an open-air town centre with

Tuscan-inspired architecture and tenants such as upscale grocer Whole Foods. A 300-unit residential complex is part of the plan.

Elsewhere, retail has been combined with hotels, university campuses and hospitals. In fact, healthcare is a major driver of the mixed-use trend. Clinics, holistic wellness centres and gyms attract visitors to nearby health food stores and athleisure brands.

This is happening in old out-of-town malls and in city centres, where – away from the prime shopping streets (where retail is actually outbidding other uses) – traditional shopping, leisure and cultural zones are merging into mixed-use neighbourhoods, offering convenience, community and experience in a post-Covid-19 world.

Challenges remain

While many of the larger schemes have been master-planned with great care, there are also smaller piecemeal developments. There's no grand design at work here – just cities gradually figuring out what works best for them.

Of course, daunting challenges remain. In many markets – the US is a prime example and Europe is following suit – there is too much retail space for current demand. Some of it isn't suitable for mixed-use repurposing. Turning a windowless old concrete-and-asphalt mall into a diverse and pleasant neighbourhood centre isn't easy – and it certainly isn't cheap.

Yet “retail with purpose” chimes with the sentiment of the times. Post-Covid-19, we value community and connection and have come to expect convenience. After lockdowns, we want experiences to savour. That's a massive boost for local retailers and repurposed out-of-town malls, but it works for city centres too.

Many of us are attracted to elements of the “15-minute city”, where services and amenities lie within a short walk from where we live or work, whether we recognise the term or not. If they can offer multiple reasons to visit within easy reach of one another, mixed-use city centre neighbourhoods are clear ways forward for physical retail.

Cities can help themselves in this regard by offering rent reductions to small independent retailers, improving infrastructure, pedestrianising streets and promoting events and festivals.

Retail is rediscovering its purpose. The places where retail happens may be changing, but stores continue to find their places in a rapidly evolving consumer landscape. ■

VINCENZO CARRIERI

ASIA PACIFIC
REGIONAL
DIRECTOR AT
CANALI, THE
LUXURY ITALIAN
MENSWEAR BRAND



Physical and digital retail are like complementary instruments in an

orchestra that must play together: both are essential, otherwise the customer will only hear half a song, but they must be in synergy, so the song is harmonious.

While an online presence showcases products and conveys our principles and values, even the best digital experience is very transactional and price-led. The store, meanwhile, delivers intangible value, particularly at the luxury end of the market, fully displaying our craftsmanship and maximising the personal experience to build one-to-one relationships between clients and the Canali brand. For an independent name, the boutique is essential in raising our profile and placing us quite literally alongside bigger luxury brands in the minds of consumers. Competition for prime retail space in the traditional premier shopping malls and streets remains extremely fierce, as they continue to be destinations for discerning customers. We focus on the store providing a bespoke experience in an oasis of private space, beyond the busy outside world.



EDUC

DRIVES
DEMAND
FOR
REAL
ESTATE

GETTY IMAGES

WORDS PAUL TOSTEVIN

Businesses want to be where brains congregate. With clear links between cities' university rankings and demand for commercial real estate, we take a view of the global markets

ATTENTION

The world's best universities are the sources of the most highly skilled workers of the future. Running in tandem, and at some speed, with the increasing demand for higher education is the explosion in specialist 'clever' tech sectors – the likes of AI, ClimateTech, Deep Tech and CleanTech – whose sharpest minds are tackling the biggest environmental, scientific, engineering and humanitarian issues the world faces.

Businesses want to be where mighty brains congregate. Whether that is through direct links to universities or by recruiting the most skilled graduates, we are seeing a fast-evolving synergy between education and the knowledge economy.

There is inherent and considerable

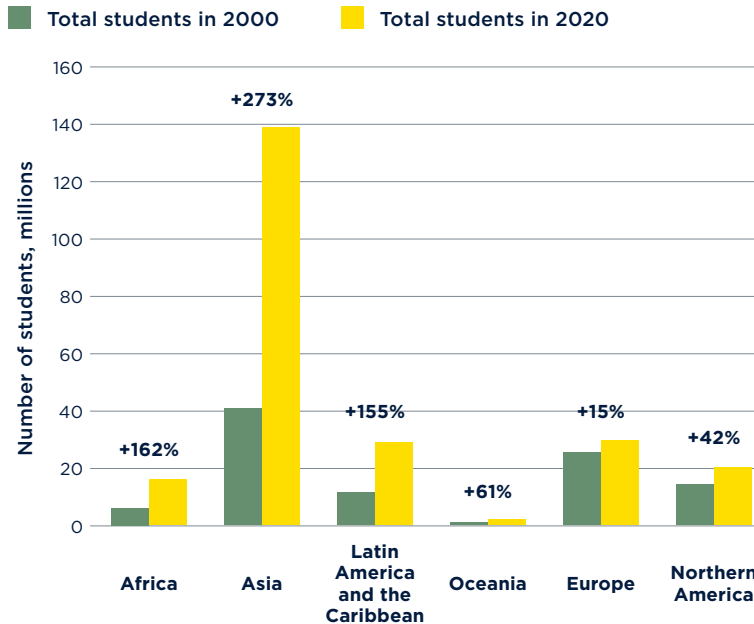
value for businesses to be part of it, resulting in high demand for best-in-class offices and laboratory space near top-ranking universities.

There is a clear link between any given city's university rankings and the demand for, and value of, its commercial real estate.

Analysis of office capital values in top global cities shows that those that have a QS Top 200 university have higher capital values (\$672 per sq ft on average) than those that do not (\$425 per sq ft). The distribution of cities with higher capital values is strongly skewed to those that are also home to top ranked institutions. ▶

There are now around 236 million students in higher education globally, which is 136 per cent more than at the start of the millennium. Asia – which has seven times more students than North America – has seen a 237 per cent rise in numbers in that time. And growth in the sector is set to continue, with UNESCO forecasting the world's tertiary student population will hit 594 million by 2040.

GLOBAL GROWTH IN HIGHER EDUCATION NUMBER OF STUDENTS



Source: Savills Research using UNESCO

Businesses in search of top talent have a balancing act to perform. The cost of hiring and retaining the best graduates takes on a different hue if you are seeking to base yourself in San Francisco, Silicon Valley or Boston – where the average salary of a scientist comfortably exceeds \$100,000 – rather than Bengaluru, where it’s less than \$10,000. Naturally, the most in-demand individuals will gravitate to cities with high-performing businesses and prestigious tech clusters that, in turn, push up office rents and capital values. Good news for investors, but a challenge for small and growing companies that need to minimise their costs.

Tech hubs also have a proven track record of beginning in relatively fringe locations – think Shoreditch in London, Kreuzberg in Berlin and Brooklyn in New York – before, arguably, becoming victims of their own success, as prices rise and long-established local enterprises move out to more affordable areas.

Another factor to consider with embryonic tech hubs is how meshed they are into the fabric of the local community. These innovation ecosystems rarely thrive if they exist in isolation – and those that are mindful of their environment, in both eco and community senses, are likely to provide the best return on investment.

Build it and they will come – but only if it is in the right place. Investors, and employers in search of the next generation of top talent: take note.

United States

The US is a higher education powerhouse and, as Savills Tech Cities explores, the leader in global tech. With more top-tier higher education institutions than any other country, the nation is particularly adept at attracting and retaining the best and brightest individuals.

In Boston, the top-ranked city for Life Sciences, Harvard- and MIT-incubated spinouts drive demand for

lab space. The proliferation of RNA-based discovery platforms, following the success of BioNTech and Moderna, as well as the growth in firms focusing on the intersection of AI and drug discovery and delivery, is key to this.

“Although lab demand is down on the peak of 12-18 months ago, it’s holding steadiest in the biotech hubs of Kendall and Seaport, as well as Watertown, Waltham, and Lexington,” says Chris Gorczyca, Managing Director at Savills Boston.

He adds that in the Kendall Square area, where the ready availability of Harvard and MIT talent has historically kept lab space at a premium, vacancy rates have risen. In the broader Cambridge, Massachusetts area, “vacancies are running at about 5-6%,” says Gorczyca. “This is actually a much healthier level for the overall market and for emerging companies to find the space they need to grow.”

China

China has invested heavily in its universities.

When it comes to the pulling power of universities for industry, quality is not the only measure; quantity also counts. London beats all other world cities for the number of QS top 100 universities, but Beijing isn’t far behind, in fourth place, after Hong Kong and Boston.

China is investing heavily in its higher-education sector, in both infrastructure and resources, leading to 824 per cent growth in university and college enrolment since 1997.

“Most universities are designed with a particular economic, business or political objective in mind,” says James Macdonald, Senior Director and Head of Research at Savills China. “Although this is slowly changing, with more time being spent on primary research, universities are not necessarily built purely for the pursuit of knowledge.”

The US may still be the world leader for science research output, but China’s output has more than doubled in the

past five years (see chart). And it is simultaneously building up a tech ecosystem that is changing the face of many Chinese cities.

“The geography of the Chinese tech sector reflects the country’s large and diverse economy,” says Macdonald. “Innovation and entrepreneurship is spread across a variety of regions and industries.”

He notes that Beijing is home to many of China’s top universities, research institutions, and government agencies: “That makes it a centre for research and development in areas such as artificial intelligence, robotics and biotechnology.” The capital is also the headquarters of tech giants such as Baidu, Tencent, ByteDance and JD.com.

Shanghai has a thriving e-commerce industry, plus one of the largest stock exchanges in the world, and Shenzhen is a mecca for electronics manufacturing. “It’s also home to a vibrant start-up scene,” says Macdonald. “Favourable government policies encourage entrepreneurship in Shenzhen.”

With globalisation comes mobilisation and while China’s domestic student population has

rocketed, so has the number of Chinese students attending overseas universities, which increased by 509 per cent from 2006 to 2021.

India

India’s tech cities also illustrate the strong interplay between university excellence and tech success. An educated and fluent English-speaking labour force is key to the decades-old ‘tech town’ reputation of Bengaluru in southern India, which has 150 universities, a strong IT/business process management sector and a good stock of Grade A office space.

“Human capital indeed is one of the most important criteria for tech occupiers critically analysing locations to set up offices or expand their operations,” says Suryaneel Das at Savills India. “Tier I cities (Delhi-NCR, Bengaluru, Mumbai, Hyderabad, Chennai and Pune) with excellent higher educational facilities act as talent magnets for the whole country. Tech talent tends to have a strong preference for cities with ample educational and technical opportunities.”

At the same time, far smaller

COLLEEN O’CONNOR
SENIOR VICE PRESIDENT,
LEASING, EAST COAST AND UK MARKETS,
BIOMED REALTY

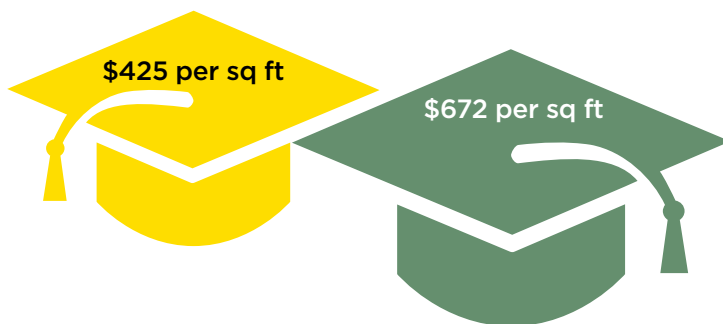


“ Proximity to world-leading research institutions is the key ingredient to creating innovation ecosystems. For life science companies, access to skilled talent with the right qualifications and experience is a critical factor when deciding on a location. Ground-breaking research and development relies on a three-way partnership between academia, the government and private enterprise, but also relies on having access to mission-critical life science infrastructure.

Access to talent remains one of the major barriers to scaling up life sciences companies, meaning location is often considered just as important as building specification. Our developments are anchored by some of the world’s leading institutions – whether that’s the Massachusetts Institute of Technology in Cambridge, MA or the University of Cambridge in the UK. With recent data revealing that Britain has had significant growth in life science patent applications across all of the main European markets in the past decade, we can expect the growth of life sciences to continue on its positive trajectory – meaning a highly skilled workforce is more important than ever for commercialisation ambitions.

OFFICE CAPITAL VALUES IN CITIES WITH AND WITHOUT TOP 200 UNIVERSITIES

- Cities without a university in QS Top 200 global ranking
- Cities with universities in QS Top 200 global ranking



Visit the Impacts website to see where individual cities sit

Source: Savills Research using QS and MSCI Global Intel Digest: Property Index

MATT FLOOD
OFFICE LEAD
- BRENT
CROSS TOWN,
RELATED
ARGENT



Education drives demand for real estate



At Related Argent we see a huge amount of value in educational uses and their role in

creating innovation and knowledge clusters. Businesses see advantages of co-locating and partnering with these institutions. At Brent Cross Town, we're in conversation with Sheffield Hallam University on what courses they will offer at their new campus, to bring relevant talent and content that align with the values of the wider knowledge community we are creating.

By doing this we hope to attract talent, provide a district that nurtures university spin-out businesses and encourage a research capability which aligns with our target commercial occupiers - all of which breathe life into a new town district.

As we learnt from UAL at King's Cross, educational uses are a catalyst for creating vibrant mixed-use places, attracting office occupiers, bringing footfall that boosts the daytime economy, driving residential demand and drawing students that come to learn and choose to stay to live. We want to provide for all stages in life that brings a genuine authenticity to community living.



THE COST OF TALENT TO BUSINESSES

SCIENTIST SALARIES COMPARED TO THE SAVILLS TECH CITIES RANK

City	Scientist salary USD	Savills Tech Cities Rank	Premium or discount to all-city average
SAN FRANCISCO	\$121,000	1	69%
SILICON VALLEY	\$113,400	3	59%
BOSTON	\$107,700	8	51%
SEATTLE	\$103,800	15	45%
LOS ANGELES	\$102,000	6	43%
WASHINGTON, DC	\$99,000	18	39%
SAN DIEGO	\$97,600	20	37%
HOUSTON	\$91,900	29	29%
NEW YORK	\$90,000	2	26%
CHICAGO	\$86,300	28	21%
DENVER	\$85,900	23	20%
DALLAS	\$83,700	24	17%
RALEIGH-DURHAM	\$82,700	21	16%
AUSTIN	\$77,300	11	8%
ATLANTA	\$72,800	27	2%
BERLIN	\$65,500	19	-8%
TORONTO	\$62,500	25	-12%
TOKYO	\$60,400	10	-15%
CHENGDU	\$57,000	30	-20%
SYDNEY	\$56,200	26	-21%
PARIS	\$55,500	9	-22%
SINGAPORE	\$48,800	12	-32%
LONDON	\$46,200	5	-35%
SEOUL	\$43,000	16	-40%
SHANGHAI	\$35,100	7	-51%
BEIJING	\$28,900	4	-60%
GUANGZHOU	\$15,000	22	-79%
BENGALURU	\$9,800	17	-86%

Source: Savills Research, Glassdoor

◀ Bhubaneswar, in the east of the country, is a challenger city with 35 technical colleges, excellent quality of life and far lower office rents than the region's leading city of Kolkata. These smaller cities have increasingly attracted flex space providers. "The co-working segment in recent years has become a significant demand generator," Das notes. "Flex space operators have been making a conscious effort to expand in tier II & III cities of the country. We expect 15-25 million square feet of office space

take-up by the IT-BPM sector in 'Challenger' and 'Emerging' tech cities over the next five years. Almost 50% of this anticipated demand is likely to be met by flex space operators."

UK

Where education meets business meets funding, it leads to local regeneration and economic growth. "This isn't a new trend," says Sadie Janes, Director of Development at Savills Birmingham and Co-Lead of the UK Education sector group. "London's King's Cross

redevelopment was anchored by an education tenant. But more recently the desire for universities to have a more open collaborative setting for key sectoral focus (and to assist student recruitment) is playing a major part in growing clusters.”

Steamhouse in Birmingham, an old factory-turned-incubator for big thinkers in a variety of spheres, provides workspaces, social areas and learning opportunities for the community. In

London, King’s Cross – whose Knowledge Quarter, a major life-sciences and tech hub, is home to Google, Meta and AstraZeneca – and White City, an emerging new tech cluster anchored by Imperial College, education has catalysed the transformation of the surrounding area.

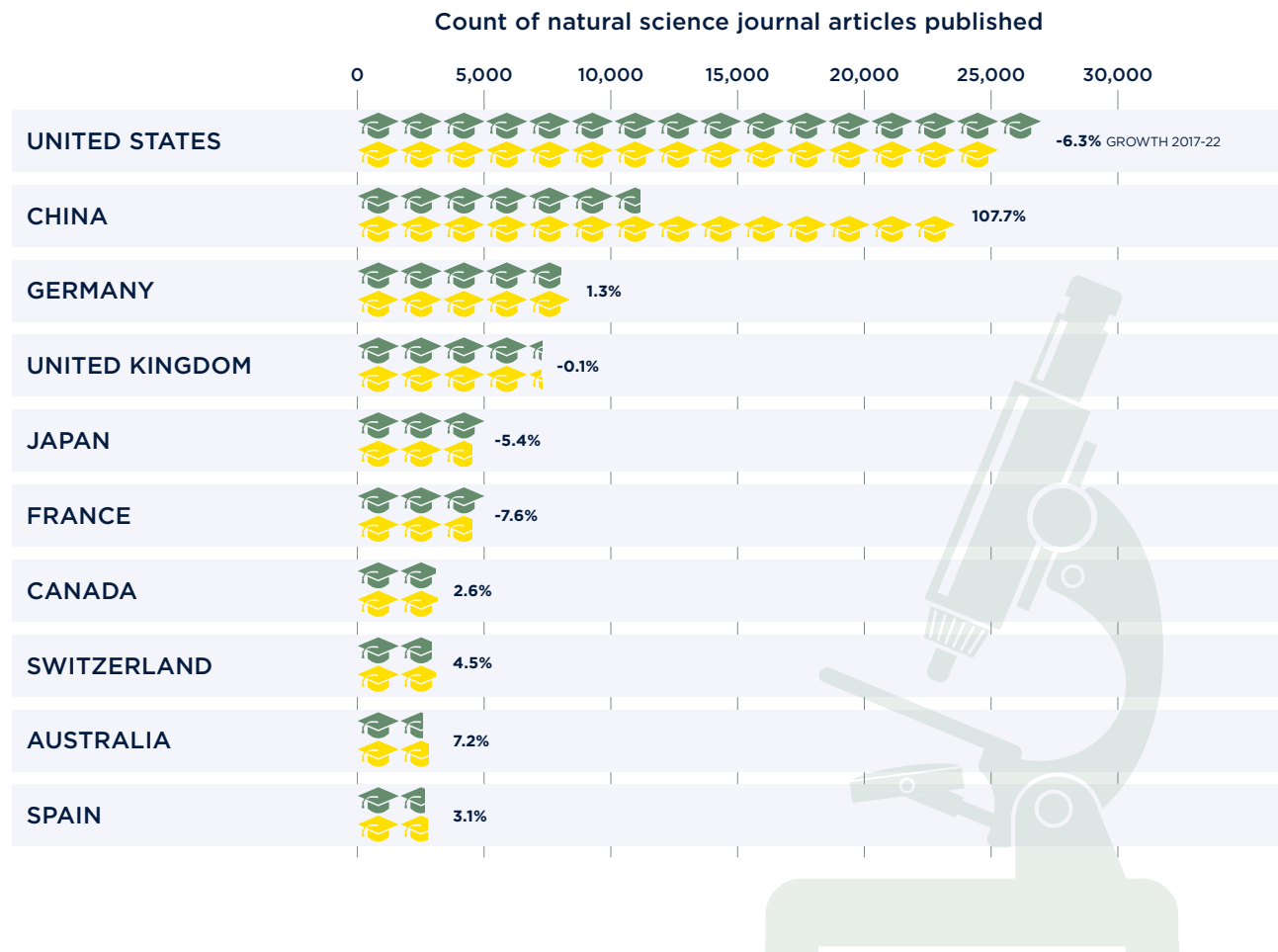
Oxford and Cambridge illustrate how scientific excellence honed in their universities gives rise to significant tech clusters. The University of Cambridge

alone contributes £30 billion a year to the UK economy and supports 86,000 jobs through its research and commercial activities.

They are illustrative too, though, of the huge need for fully-fitted, ready-to-use laboratories, which are time-consuming and complex to build and fit out to the appropriate standards. Such is the lack in Cambridge that there are plans to repurpose part of a shopping centre as lab space. ■

COUNT OF NATURAL SCIENCE JOURNAL ARTICLES PUBLISHED

■ 2017 ■ 2022



Source: Savills Research using Nature

WORDS ERI MITSOSTERGIU, LYDIA BRISSY
AND CHARLOTTE RUSHTON

SECURING AN ALTERNATIVE FUTURE

Investors are turning to alternative property sectors for resilient returns and growth opportunities

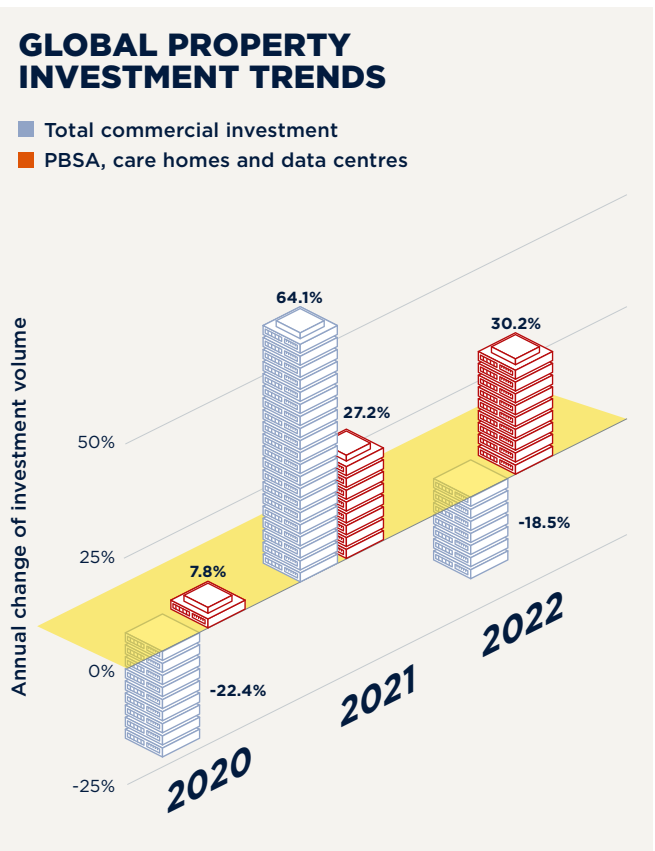
Alternatives covers a plethora of property sectors. We have focused on three with strong potential: data centres, purpose-built student accommodation (PBSA) and care homes.

These sectors offer purpose-focused investors a few key benefits: strong demand supports returns, and the living sectors in particular have the potential to make a positive ESG contribution.

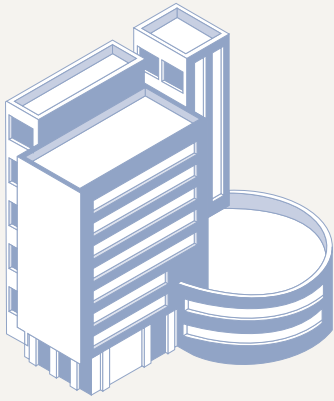
Driven by structural factors largely unaffected by business cycles, alternatives can be a good way to diversify. Phenomena such as the digitalisation of our business and personal lives, the population ageing and growth in higher education continue whether the economy is up or down.

While total commercial property investment has seen some volatility over the past few years due to the pandemic and changing interest rates, investment into PBSA, care homes and data centres has steadily increased – highlighting their strong fundamentals. Over the past 10 years the average annual growth of total commercial real estate investment was around 7%; the average annual growth of investment into PBSA, care homes and data centres was 17%.

Our projection across 13 global markets for these three sectors over the next decade shows a significant opportunity, amounting to 17 million care home beds, 18 million PBSA beds and 110,000MW of data centre capacity. This translates to an additional space of more than 12 billion square feet – a sizeable opportunity for investors and developers.



Source: Savills Research using RCA



12.4

BILLION SQ FT

ADDITIONAL SPACE NEEDED BY 2033 GLOBALLY TO REACH IDEAL PROVISION

More than 12 billion sq ft of additional space is required to satisfy the growing need for alternative uses in the next decade, creating an immense development and investment opportunity for real estate players.

	Number of beds, millions/MW	Additional space needed by 2033 (Sq ft, million)
Care homes	17	3,600
PBSA	18	6,600
Data centres	110,000 MW	2,200

Note: This is based on 13 markets

Source: Savills Research using CoStar, HESA, German Federal Statistical Office, Korean Council for University Education (KCUE), UNESCO, OECD, Oxford Economics, TeleGeography

Digitalisation

“Data centres are on the verge of significant growth, driven by increasing demand for cloud computing, big data and the Internet of Things,” says Scott Newcombe, EMEA Head of Data Centres at Savills. “The emergence of new technologies, such as 5G and AI, has further accelerated this trend. As businesses continue to move towards digital transformation, demand is expected to rise, creating investment opportunities.”

Digital use around the world still varies enormously. At the top end of the scale, 55 countries enjoy internet adoption rates exceeding 90%. At the lowest end, 730 million people across India were still not using the internet at the start of 2023. Meanwhile – despite showing an internet adoption

rate over 70% – China has the world’s second-largest “unconnected” population, with almost 375 million people not yet online.¹

Multiple new technological innovations – including artificial intelligence (AI), machine learning (ML), the internet of things (IoT) and quantum computing – are expected to have game-changing effects on how data is being generated and used by individuals and businesses. This will have a notable effect on data centres.

Access to data centre assets has been somewhat limited for real estate investors. Much of the world’s space is owner-occupied, predominantly by a few specialised public REITs such as Equinix and Digital Realty. However, as data centres are expensive to build and manage, they need significant

ROY GIBBENS
CHIEF
REVENUE
OFFICER,
FORM8TION



“Over recent years, the data centre sector has taken giant leaps forward in improving power efficiency and reducing reliance on potable water. We have also seen some interesting use of waste heat in providing community heating projects and even the heating of swimming pools. I see the next big target of our sector as continuing the development of heat reuse strategies.

Heat reuse in data centres is a strategy to reduce energy consumption and greenhouse gas emissions. Data centres generate a large amount of heat, which can be captured and reused for various purposes. Heat reuse will improve the efficiency and reliability of data centres by reducing the cooling load and mitigating overheating challenges. However, there are many barriers to implementing heat reuse in data centres, including technical, economic, regulatory and social factors.

Generating power from heat is rapidly becoming a viable technology. Most facilities currently eject most of their waste heat. But with the advances in thermoelectric generation, we could soon see systems capable of reusing this waste heat at around 40% efficiency. If this approach can be developed, we will also see significant savings in operational costs and, more importantly, our sector’s impact on the planet will reduce.”

¹Source: Datareportal

THERE IS A NEED FOR SENIOR HOUSING ACROSS A SPECTRUM WHICH RUNS FROM INDEPENDENT LIVING TO SPECIALIST NURSING HOMES FOR END-OF-LIFE CARE

◀ investment to meet ESG credentials, and require scale to achieve profitability, their owners are increasingly looking for external capital. This is where property investors can step in.

Data centres are power hungry and generate significant emissions, so meeting ESG criteria can be challenging. However, many resourceful operators are improving energy efficiency. There are many means to green the industry; the most straightforward way is to avoid fossil fuels. Data centres are increasingly using renewable energy or generating their own – off- and on-site.

Higher education

The number of university students rose 30% in the decade preceding 2020. During this period there was a 68% increase in the number of international students. Most of this growth was in developing nations with youthful populations and it is set to continue. This will drive demand in growing nations such as India and in countries popular with international students, such as the UK and Australia.

UNESCO forecasts that over the next decade the number of students is going to double in Japan, South Korea, Australia, China and India. Across the 13 global markets analysed in this article, the number of university students is predicted to rise from about 130 million in 2020 to over 227 million in 2033.

A lack of alternative housing

options, due to a limited supply of affordable accommodation and a higher number of smaller households, has accentuated the increased propensity to stay in purpose-built student accommodation post-pandemic.

Even developed markets lack high-quality student housing. Provision rates are below 10% in most markets, with the highest rate (in the UK) at 25%.

The need for accommodation that provides space for students' social needs and offers additional wellbeing services is growing.

Students seek housing options that offer community living, amenities, safety and access to transportation and entertainment. This drives demand for high quality PBSA in major university cities in the world.

Paul Savitz, Director of Operational Capital Markets at Savills Australia and New Zealand, says new development projects in the sector are experiencing some challenges: “The structural undersupply of the student housing market in Australia looks set to continue for the medium term, given the relatively restricted pipeline of new projects underway.

“Increases in build costs and high debt finance costs are contributing to decreasing development feasibility, and land acquisition for development remains competitive as developers of multifamily, hotel or residential for sale pursue the same opportunities.”

Ageing populations

Populations are ageing worldwide, although approaches to later-life living setups vary across regions. Oxford Economics says the proportion of people aged 60 and above is currently 14 per cent and is expected to be 18 per cent by 2033 globally. The number of people aged over 80 will nearly double across the 13 markets analysed, from 94 million in 2023 to close to 160 million in 2033. In cultures where older relatives living with younger generations or extended family is not the norm, substantial numbers of these people will need specialist accommodation.

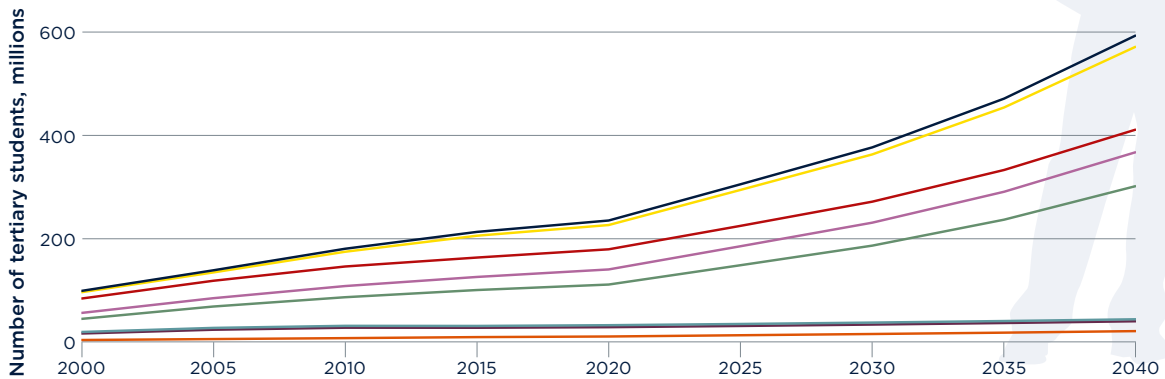
“Property investors who meet this demand will be fulfilling a real social need,” says Richard Valentine-Selsey, Head of European Living Research at Savills. “There is a need for senior housing across a spectrum which runs from independent living to specialist nursing homes for end-of-life care. In New Zealand and the US, for example, they have retirement communities that don't look like old people's homes.”

Other markets, such as the US, are developing intergenerational multifamily housing and schemes that mix accommodation for students and seniors. Being close to the facilities of a university suits retirees, especially those engaged in “lifetime learning”. The market is also moving towards rental accommodation. This suits retirees who wish to hang on to their capital and investors looking for resilient income streams.

As lifestyles and priorities change, driven by technological advancements and demographic and social change, new real estate asset classes are emerging and proliferating.

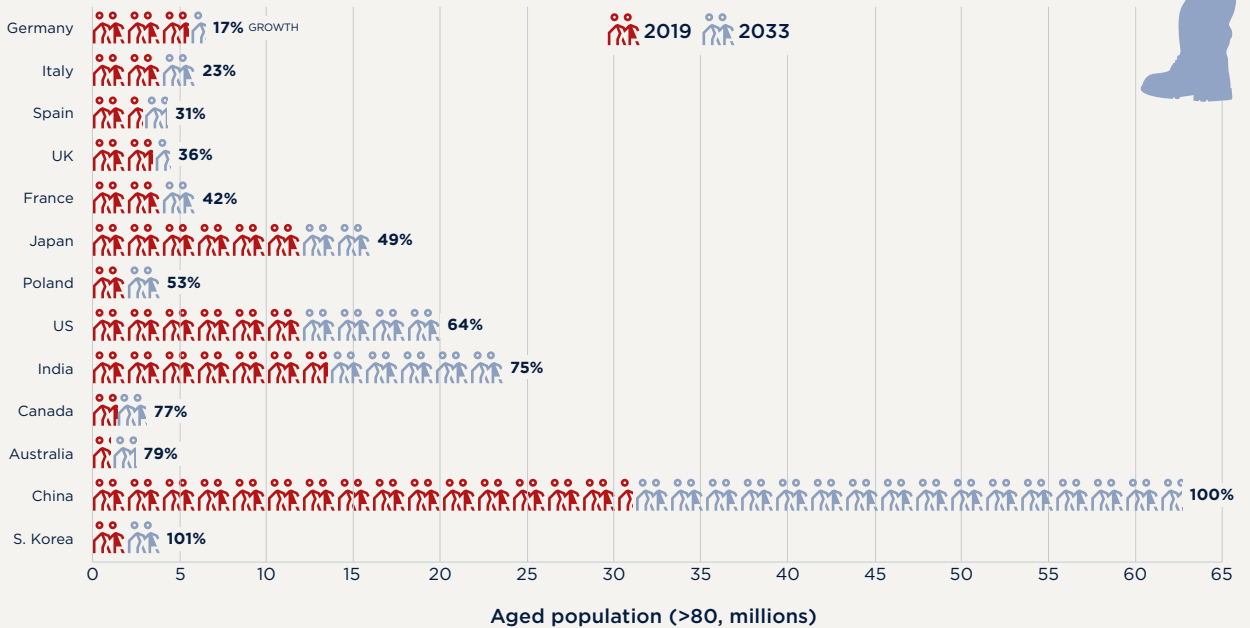
For property investors, this presents an opportunity to look beyond the traditional triptych of office, retail and industrial assets – to an asset class that is growing rapidly, resistant to economic uncertainties and benefits future generations. It's a compelling case for investment. ■

GLOBAL STUDENT NUMBER GROWTH



Source: Savills Research using UNESCO

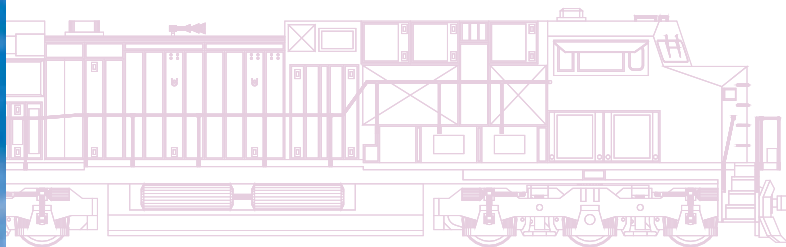
AGED POPULATION GROWTH



Source: Savills Research using Oxford Economics



RESILIENCE AND SECURITY ARE THE KEY LINKS IN SUPPLY CHAINS



WORDS OLIVER SALMON

Disruption is easing post-Covid – but geopolitical tensions and more insular government policies are redefining how businesses manage their supply chains

supply chains and placed a new emphasis on resilience. Meanwhile, cost continues to be key in a tough economic climate.

Fragmented politics and new strategic alliances

The changing approaches to supply chains aren't being driven solely by businesses; in response to geopolitical tensions and a new economic paradigm, they're underpinned by strategic government policy in many parts of the world.

The single defining feature of the past 20-plus years has been unconstrained globalisation, with ever-increasing efficiencies driving global business growth.

This has now been tempered by a new focus on security and renewed protectionism in many parts of the world. Governments are looking to drive domestic productivity while safeguarding strategically important sectors – be that energy, food and pharmaceuticals, or the minerals and technologies needed to support high-growth future businesses, such as semiconductors or electric vehicles.

The IMF refers to this situation as “geo-economic fragmentation”, with the Russian invasion of Ukraine expediting a decoupling of US-China relations, potentially creating two major global spheres of political and economic

influence – a situation not seen since the collapse of the Soviet Union.

Against this backdrop, “friendshoring” could be a key driver of supply chains, as industrial policy is deployed to help deliver domestic and foreign policy initiatives relating to energy security, new technology and the transition to net zero.

What does this mean for property markets?

These geopolitical shifts could have an impact on international capital flows into real estate markets. This has already started to happen in some parts of the world. Chinese investment into the US – including into commercial real estate – has fallen sharply since 2016, which according to the Rhodium Group, was largely attributable to a combination of Beijing's regulatory crackdown on capital outflows and growing investment hurdles in the US for Chinese firms.

These global headwinds will also impact demand for specific types of commercial property, particularly logistics and manufacturing, across the US, Europe and Asia Pacific.

North America

Resilience has become a buzzword for supply chain managers in North America, but cost remains the single biggest factor in location decisions. ▶



GETTY IMAGES

After three years of disruption, international supply chains appear to be returning to normal. The cost of shipping freight by sea or air has largely returned to pre-Covid-19 levels; container ships aren't queuing outside major ports and businesses no longer cite “supplier delays” as one of their most pressing problems.

This does not, however, mean it is business as usual for logistics, manufacturing and other industrial sectors. The pandemic and geopolitical tensions have exposed the fragility of



▶ Although job announcements linked to nearshoring have risen in recent years – with these primarily relocating from Northeast Asia – many firms are still utilising overseas manufacturing and benefiting from cheaper labour.

JC Renshaw, a Senior Supply Chain Consultant at Savills UK, says: “The reality on the ground is that it is difficult for firms to wean themselves away from strategies that for decades have focused purely on maximising profits. There may also be a first-mover disadvantage, impacting pricing and profits, which could slow this transition.”

Government policy could be shifting this balance, though. For sectors deemed strategically important by US legislators, pull factors (such as subsidies for relocating companies) and push factors (such as EV subsidies) are being introduced. In the words of President Joe Biden, the US is “in competition with China and other countries to win the 21st century”.

Renshaw cites the recent US Inflation Reduction Act (IRA) 2022, which provides huge incentives via tax credits to firms investing in clean energy infrastructure, manufacturing and transportation, including EVs.

This act focuses on building domestic scale, with incentives linked to US production and components sourced from countries with free trade agreements with the US. Similar

incentives are provided through the CHIPS and Science Act 2022, designed to reduce US reliance on imports of semiconductors from Taiwan and South Korea.

Legislation such as the IRA is driving change in commercial real estate markets. Export restrictions, with the aim of curtailing China’s access to advanced semiconductors and related technologies, will have a similar effect. Firms, including TSMC, Intel, Samsung and Texas Instruments, have announced plans to build semiconductor plants in the US. More than 20 electric vehicle projects with new battery plants and investments in existing facilities are slated for completion by 2026.

Renshaw says that over the longer term this could influence where logistics facilities are located. If fewer Chinese goods are imported, this could hit demand for warehousing and logistics in California.

Meanwhile, Mexico could also benefit because it is geographically close and, with Canada, part of the North American Free Trade Agreement. This could drive additional demand for logistics and transport facilities in states close to the Mexico border.

Europe

There has been huge demand for industrial warehousing in Europe in recent years, with the take-up from manufacturing-related companies at its highest ever in 2022. This demand can be seen in many European countries including the UK, which also saw record levels of demand last year.

Kevin Mofid, Head of EMEA Industrial and Logistics Research at Savills UK, says that while there has been much discussion around supply chain resilience post-Covid-19, increased warehouse demand has largely been driven by the growth in online retailing.

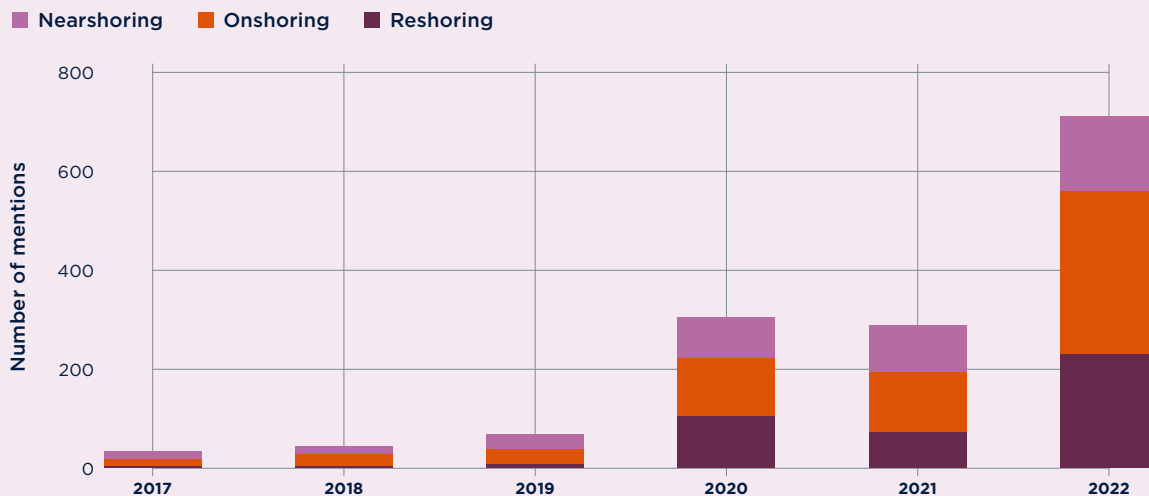
Over the medium term, the security of supply chains amid global defragmentation may have greater impact. “Covid-19 might have put supply chains at the top of the corporate agenda but other factors are keeping it there. The Ukraine war highlights problems with energy security, while there is also a recognised need to invest in green technology and manufacturing,” says Mofid.

Europe may not deploy the same “America First” protectionism introduced by the Trump administration and continued in President Joe Biden’s



GETTY IMAGES

MENTIONS OF KEY TERMS IN CORPORATE PRESENTATIONS



Source: Savills Research using IMF

policies. But it is in the same game of “strategic competition” with the European Green Deal and European Chips Act – which aim to double the EU’s market share of semiconductors.

Nearshoring may also create opportunities for real estate investment in Eastern European countries, particularly those strategically aligned to EU objectives and values but with cheaper labour pools.

Mofid adds: “This focus on supply chains will create a slow-burn ripple effect in demand for warehousing and manufacturing in commercial real estate markets. This is in contrast to the rapid surge in demand seen in recent years from the explosion in online retailing.”

Asia Pacific

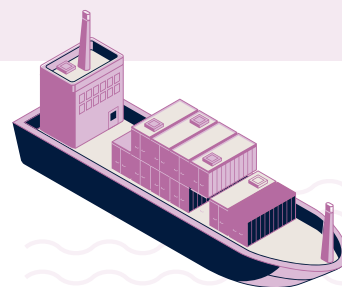
China remains the “world’s factory”, accounting for around 30 per cent of global manufacturing. Despite the decoupling of the US and China, and unease in the West about its relations with Russia, China still holds significant

competitive advantage with its relatively mature infrastructure, high-quality workforce and deep integration into global supply chains.

Jack Harkness, Director of Regional Industrial and Logistics Services at Savills Asia Pacific, says cost remains a powerful lever of location decisions. But rising labour costs in China mean it is not as cost-effective as it once was, particularly when domestic incentives to reshore and ongoing security concerns are factored in.

He says: “Companies already embedded in China are not necessarily withdrawing. But there may be a slowdown in new facilities being established there.”

Harkness points out that many companies with facilities in China are looking to complement rather than replace existing plants. Apple, for example, has announced plans to diversify away from China, while Siemens has said it is looking at other locations in Southeast Asia.



Countries such as Vietnam and Indonesia could be beneficiaries if firms start to look for other low-cost production centres in Asia, particularly when it comes to labour-intensive and low-margin industries. India also offers strong growth potential for commercial real estate investors in the future.

Harkness adds: “This process is being accelerated across sectors deemed strategically important to US and European industrial policy.

“Furthermore, there has been scepticism around state influence of some Chinese tech firms, which suggests the Western expansion of Chinese firms will be more constrained in the future.” ■

‘THERE MAY BE A SLOWDOWN IN NEW FACILITIES BEING ESTABLISHED IN CHINA’

WORDS OLIVER SALMON

REPURPOSE AND REVITALISE THE FUTURE OF COMMERCIAL REAL ESTATE RENTS

The global real estate market has changed, but the green transition and growing urban populations present new opportunities for investors

Beijing Central Business District

In the decade before the Covid-19 pandemic, it sometimes felt like ultra-loose monetary policy would never end. Now it has. Interest rates have surged over the past 18 months, stemming the flow of cheap money that buoyed the global real estate market in the aftermath of the global financial crisis. Inflation and a weaker global economy mean the halcyon days of real estate are over, and rental income is harder to find.

At the same time, disruptive structural shifts are having complex impacts on real estate use. In the new normal, investors must adjust their expectations and burnish their sector-picking skills to succeed.

GDP growth: the short- and long-term effects on real estate

Few asset classes are more closely correlated to GDP growth than real estate. The strength of the economy underpins commercial and residential rents. Demographics help determine long-term economic growth, and the world's ageing population means the long-term outlook is one of low growth and low interest rates.

Rising affluence in many quarters is stemming growth too, since lower-income groups feed more money into the economy than wealthy savers. This will affect rental income across sectors, shifting investors' focus from following the market to beating it.

It isn't all grey skies though. In the short term, sluggish economic growth may be offset by supply issues, as higher borrowing costs and tighter credit conditions dampen speculative developments.

"This is likely to exacerbate supply shortages of certain

types of real estate, especially in the prime and green spaces, leading to stronger rental growth from 2024, which should go some way to improve returns," says Mat Oakley, Director and Head of UK and EMEA Commercial Research at Savills UK.

Longer-term, however, GDP also drives supply. Developers follow returns, which tends to limit a sector's spell in the limelight. The US logistics sector, for example, saw a development boom in recent years because of strong rental growth, with nearly 900 million square feet under construction at the end of 2022 – more than double the long-term average. So while long-term trends continue to support the sector, there are some markets at risk of oversupply in the short term.

At the same time, disruptive forces are breaking traditional links between GDP growth and real estate sector growth. Hybrid working, for example, has upset the correlation between employment figures and office rents. In the US, which embraced hybrid working more readily than other regions, office-based employment is well above pre-pandemic levels, but vacancy rates are rising and leasing activity is down in some markets.

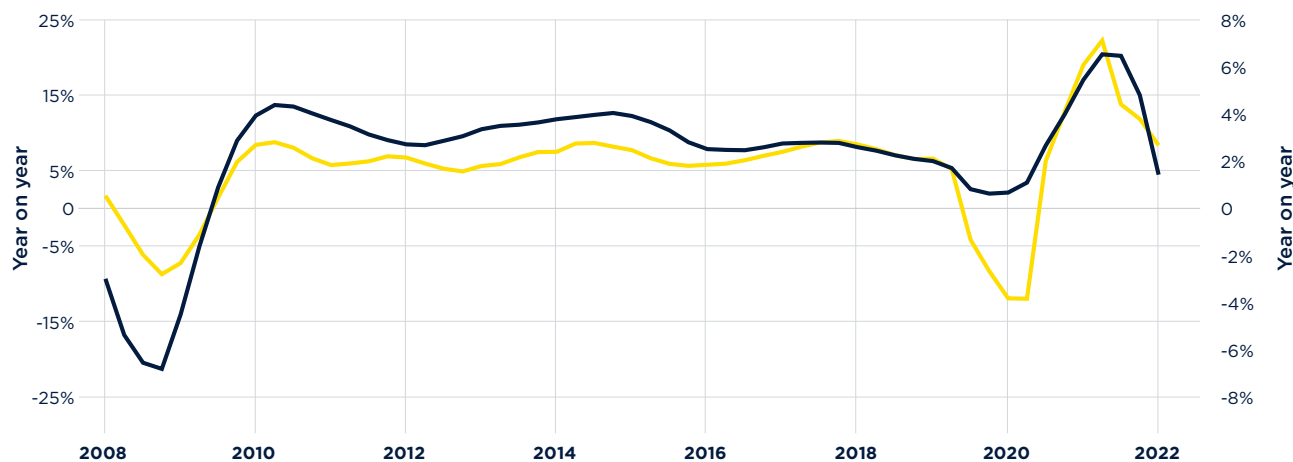
Climate change increasingly drives trends

Understanding these trends and how they interact is critical for investors. The retail "apocalypse" of the last decade provides a salutary example of what can happen if investors end up on the wrong side of disruptive forces.

As retail moved online – a trend that the pandemic strengthened – changing shopping habits in the US, UK and to a lesser extent mainland Europe exacerbated rising vacancies and lower rents in the retail sector, although retail sales

GLOBAL GDP AND PROPERTY RETURNS

■ All property total returns ■ GDP growth, 4QMA (RHS)



Source: Savills Research using MSCI and Oxford Economics

continued to rise. Now, to confuse matters, shoppers are again embracing bricks and mortar retail when many expected the relentless rise in e-commerce to continue.

It's getting harder to deconstruct trends and predict sector growth. Analysis by MSCI shows that the growth of trends such as e-commerce and hybrid working are driving increased sector dispersion in the real estate market. As well as causing sectors to diverge, this is creating new growth niches and doldrums.

In the office sector, for example, demand for best-in-class sustainable buildings is dividing the market, with tenants prepared to pay higher rents for green spaces. Some older, less sustainable buildings are facing obsolescence or repurposing, while green buildings, which are in short supply and attract much-needed employees, are at a premium.

This highlights the huge challenge that climate change poses for the global economy and real estate. Investors who do not adapt risk being left with stranded assets.

Deglobalisation: who will benefit?

Dispersion of geographic returns, by contrast, is decreasing, according to MSCI, as real estate assets become more globalised. However, this could be set to shift. Again, climate change is a big part of the reason. European, US and Asian governments are addressing the challenge at different speeds, and it is consuming large amounts of capital.

At the same time, increasing geopolitical tensions, exposed due to the war in Ukraine, are potentially pushing the world into two spheres of political influence, prompting retrenchment and putting the brakes on globalisation.

Current demographic trends and patterns of economic

growth favour developing countries with accessible real estate markets. Countries with positive demographics or significant catch-up potential, or both, include: China, India and Malaysia in Asia Pacific; Mexico in the Americas; and South Africa, the Czech Republic and Poland in EMEA. However, in a fast-changing and increasingly volatile world, there are no simple geographic solutions to finding rental income.

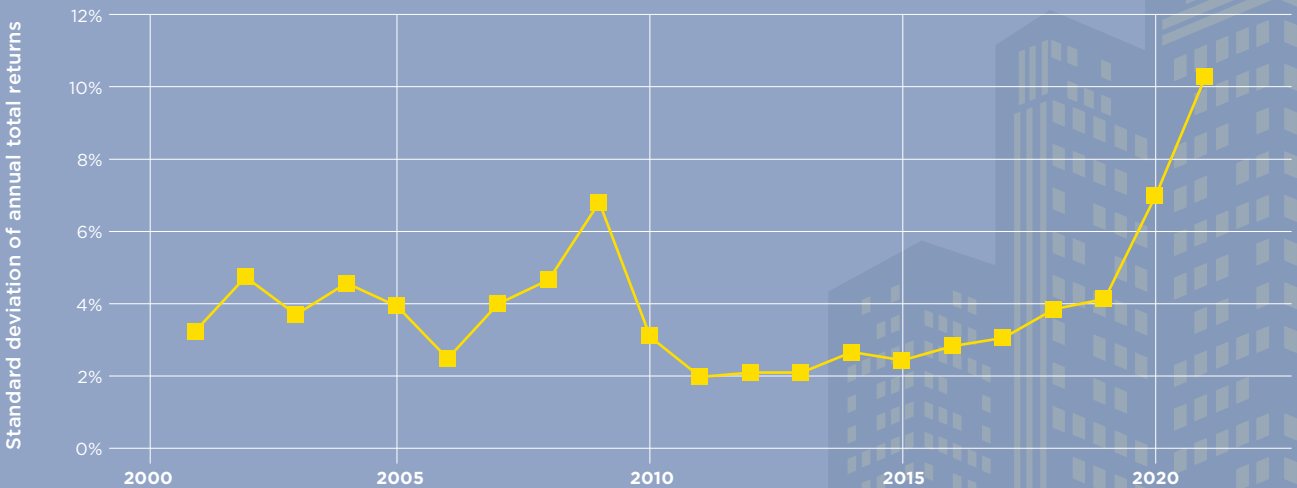
Deglobalisation could drive global capital flows in new directions and the beneficiaries could be outside these fast-growth markets. The US government is providing massive subsidies to encourage production in strategic sectors such as semiconductors back to the US, even if a complete decoupling would necessitate finding a new source for key raw materials. Nearshoring has implications for global supply chains and demand for logistics space that could benefit the US market, where e-commerce and AI are already boosting demand for warehousing and data centres.

“Despite recent economic challenges, the fundamentals support sustained growth in US industrial rents over the long term,” says Mark Russo, Senior Director and Head of Industrial Research at Savills US. “These include structural changes in global supply chains bringing production home or close to home as well as consumer preferences continuing to move toward more online purchases with expectations for faster delivery.”

Potential for growth in cities and across Asia

With China's population declining for the first time in six decades in 2022, even the demographic picture is no longer as clear as it once was. The US population remains relatively

DISPERSION OF SECTORAL REAL ESTATE TOTAL RETURNS



Source: Savills Research using MSCI Global Quarterly

young, and there is great demographic variation among the world's cities in both developed and developing countries, meaning it often makes more sense for real estate investors to take a city rather than a country approach.

Urbanisation is a disruptive global megatrend that is playing out in many different ways. The urban population is expected to double in size by 2050, with 70 per cent of the world's population living in cities by then. In developing countries, this creates huge housing and infrastructure challenges – but it also brings opportunities for rental growth.

In the so-called developed world, large cities such as London and Sydney continue to draw younger people and have positive demographics, but in the US, there is a counter trend of people moving out of big cities into mid-tier ones.

They're drawn by more affordable housing and sometimes by centres of technological excellence based around universities. Due to hybrid working and changing retail patterns, city dwellers are also moving out of city centres into suburban areas, changing rental dynamics.

Although these powerful disruptive forces are shaping the future of the global real estate market, it still makes sense to pan out and consider economic fundamentals.

“With so much happening today, it is easy to lose sight of longer-term trends and what used to be referred to as the Asian growth story,” says Simon Smith, Regional Head of Research and Consultancy at Savills Asia Pacific. “Asia Pacific's enviable growth rates, youthful demographics and rising incomes continue to drive occupier markets across all asset classes, from traditional offices and shopping malls to data centres and healthcare facilities.”

The global real estate market is entering a new phase that will be characterised by greater volatility and increased fragmentation, but long-term shifts such as Asian growth remain in play. Meanwhile, disruptive forces create dangers and opportunities. Although an ageing population means slower global growth, for example, it also necessitates greater investment in healthcare and senior care. Similarly, as more local data centres are set up, rather than relying on overseas outsourcing, vacant office space can be repurposed and revitalised. To secure rental income, investors must stay abreast of these trends and remain nimble. ■

PAUL CLARK
HEAD OF EUROPEAN
PROPERTY,
AUSTRALIANSUPER



“ We aim to achieve stable long-term income and capital appreciation by finding attractively priced investments benefiting from the structural changes driving demographics, digitisation, the net zero carbon agenda and placemaking, underpinned by limited land supply, restrictive planning and deep pools of talent.

Our approach looks through the medium-term volatility created by events like the pandemic or, more recently, localised crises such as the LDI crash. But the one issue we cannot ignore in the real estate sector is climate, which is why we have a strong focus on asset decarbonisation, with ESG at the heart of the Fund's investment assessment and asset management processes.

Whilst volatility and change may encourage near-term caution, they also create pricing dislocations. For example, although the challenges around repayments, refinancing and re-pricing across the sector are presenting significant challenges, there will undoubtedly be attractive opportunities for well-capitalised investors such as ourselves.

Drawing all this together, we believe the best opportunities are to be found in major mixed-use city-centre development and investment; pan-European logistics and industrial; and the living sector. Not every city in the world can offer the kind of large-scale investment opportunities we're seeking. We have invested in London and are examining cities like Berlin, but the exacting nature of our criteria means we focus only on the locations where we believe the best opportunities lie.

DISRUPTIVE STRUCTURAL SHIFTS ARE COMPLICATING THE FUNDAMENTALS OF REAL ESTATE

WORDS BY WESLEY ANKRAH DIRECTOR OF SOCIAL VALUE

LAST WORD

PROPERTY'S SOCIAL PURPOSE



“ Value in real estate has traditionally focused on easily quantifiable metrics: price per square foot, return on investment, value-add. But while less tangible, social value has become a fundamental part of the equation.

The constituent pillars of ESG were conceived to support building a better, healthier and most sustainable world. And now that they are widely understood by individuals and businesses, there is growing awareness that the inherent value of real estate is about more than the sum of physical bricks and mortar. Whether it's residential, hotels, offices, or entirely new mixed-use neighbourhoods, real estate has to have purpose.

Property needs to take into account the lives of the people who live in, or next to, these sites, and how they are involved with and impacted by them. This goes beyond environmental impact, for which the LEED (Leadership in Energy and Environmental Design) sustainability certificate offers a framework.

Purpose, in the context of social value, does not have an equivalent. You can't easily measure a community's health or happiness in the way you can carbon emissions or energy output. But the more the E and S in ESG work in tandem, the greater the value of each.

When designing green spaces for the local community, for example, encouraging people to be involved in their planning and empowering them to understand the standards around biodiversity and net zero, enables a broader range of stakeholders to benefit.

Social value and consideration of an asset's purpose should be embedded in real estate from the very start, from the initial analysis of what value can be derived from the site, through the planning, delivery and operational phases.

Ultimately, social value should be seen not as a cost, but as an investment.



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We're a dedicated team with an unrivalled reputation for producing well-informed and accurate analysis, research and commentary across all sectors of the UK property market.

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THE FUTURE OF GLOBAL REAL ESTATE



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