A good fit

Global cities and real estate investors are best mates

by Richard Fleming

Real estate investors know what they like. They like global cities, the furnaces for growth. They like the kind of substantial commercial building that you often find in major city centres and they like those buildings to be tenanted with the kind of stable, long-term global employers that base themselves in those city centres to service their customers and maximise their chances of finding and keeping the kind of employees that they need to run their businesses smoothly and efficiently. Real estate investors also like the choice of properties and liquidity that is usually on offer in global cities as a means of implementing their particular strategy. Buy or sell, in or out, it's a win-win game.

Usually. Sometimes things get in the way and the hoped-for lengthy relationship falls victim to circumstance, whether investor/manager or landlord/tenant or employer/employee. A relationship failure is often a sign of a wider malaise; an economic downturn, a problematic market, sector difficulties or some indication that a city's position in the system is under threat. That doesn't happen often, but it does happen. Just look at the decline of Detroit.

Take your pick

Everyone knows what the top global cities are, and where they are. The list of the top cities is pretty constant, but there will be some movement within the list year on year or decade on decade, depending on the criteria chosen, and occasionally there will be movement in and out of the list. Just as the list of the top countries in the world, as measured by aggregate GDP, changes every year and decade as the developing countries continue their march up the list, so too does the list of the top world cities. I have included one here, from Oxford Economics' recent *Global Cities 2030* report — looking at both absolute and relative GDP and population parameters — but feel free to disagree. You do not have to follow a list or the data, and everyone has their favourites, their criteria and their reasons.

"Global cities," says Brian Klinksiek, senior vice president and director of European investment research at Heitman, "are not just about business activity, important as that is. They are also about governments, capital markets, stock exchanges, international transport connections, international conferences, universities, international students, local and international media, cultural experiences, sporting events and tourism."

Kim Politzer, director of European research at Invesco Real Estate, agrees that there is no fixed definition of "global city". "It's a combination of size and function," she says. "You need a critical mass of corporate headquarters and business services. A strong central or regional government helps in terms of developing and maintaining both regulatory regimes for business operations and planning regimes to support and develop the real estate and infrastructure that is needed."

One of the key attributes that make cities global, says Chris Blanchard, portfolio manager, global real estate securities, at Presima, is market transparency and liquidity. "One of the most important things for investors is that there is a liquid market," he says. "Many investors these days are looking for preservation of capital and want to make sure that they are investigating markets where there is a sound legal system and where they would actually be able to get their money out."

Snapshots from the Oxford Economics report reveal that in 2030 the world's top 750 cities are forecast to: produce 61 percent of global GDP; have 60 percent of the world's high-income families; be the base for 30 percent of the world's jobs; and house 35 percent of the world's population. That's a convincing ratio, almost 2:1, of GDP against population, and a not-so-convincing ratio, more than 2:1, of GDP against jobs. 61 percent of GDP but only 30 percent of jobs? It's almost like someone is saying "keep those mucky, industrial jobs away from me;" whereas, in fact, it's more likely to mean that the 30 percent of jobs are the best GDP-generating jobs going.

"Data on urban GDP across all of the world's largest cities in each continent can be difficult to source," says Graeme Harrison, associate director at Oxford Economics and author of the firm's *Global Cities 2030* report, "and is not even published for many cities in continents like Africa. So we selected the 750 cities based on published population data. Had we selected cities on the basis of published or estimated GDP alone, this would have meant covering fewer cities from developing but fast-growth markets and excluding mega-cities like Lagos in Nigeria."

The Oxford Economics report also shows that there will be a demonstrable shift in urban economic power eastward to Asia, particularly to China. Eight European cities will drop out of the global top 50 cities by GDP list by 2030, and nine new Chinese cities will join that list, taking the Chinese total to 16. Above all, the absolute change in the urban landscape around the world over that 17-year period will require large-scale new investment in commercial and residential real estate as well as associated infrastructure. And that is where real estate investors, developers, landlords and tenants come in.

"Our report," says Harrison, "will make people think about cities that they have probably never heard of! It will make people think about the up-and-coming cities." Which will invariably be in Asia and Africa.

"But Europe does offer stability and maturity," Politzer explains. "Volatility in Europe is very low, much lower than in the United States. If you buy in the wrong city there, it can go very wrong; whereas in Europe, if you buy in the wrong city, it's not going to be nearly as bad — European cities are much more heterogeneous, not tied into one very specific sector and therefore you're not exposed to one specific industry. In the medium to long term, Europe will not offer investors very big returns, but it will offer lower volatility and more stability. It really is more about the maturity and stability of the markets, the transparency of the markets and the legal frameworks that you're working in than it is about the rate of growth and how absolutely big cities are."

"We like South Africa," says Presima's Blanchard. "Durban, Cape Town, Johannesburg are all potential beneficiaries not so much from growth in South Africa but from growth on the African continent. They are positioning themselves well as gateways for that growth. You need good ports, and the infrastructure to ship goods to the final destination, and South Africa has that. It also has good real estate transparency and good liquidity."

As a provider of logistics and industrial space, Prologis is active on four continents but not yet in Africa. In terms of growth and real estate sector, says Chris Caton, vice president and head of research at Prologis, "logistics real estate is not on

The top 10 global cities

By total GDP, 2030*		By change in GDP, 2013–2030*	
1	Tokyo	1	New York City
2	New York City	2	Shanghai
3	Los Angeles	3	Tianjin
4	London	4	Beijing
5	Shanghai	5	Los Angeles
6	Paris	6	Guangzhou
7	Osaka	7	Shenzhen
8	Beijing	8	London
9	Chicago	9	Chongqing
10	Tianjin	10	Suzhou
By total population, 2030		**By change in total population, 2013–2030**	
1	Jakarta	1	Lagos
2	Tokyo	2	Dhaka
3	Chongqing	3	Karachi
4	Shanghai	4	Kinshasa
5	Beijing	5	Beijing
6	Lagos	6	Tianjin
7	Dhaka	7	Jakarta
8	Mumbai	8	Delhi
9	Delhi	9	Mumbai
10	Mexico City	10	Dar es Salaam

** 2012 prices and exchange rates*
Source: Oxford Economics Global Cities 2030

the leading edge of real estate development in emerging markets. This type of real estate serves consumer classes, which can take time to establish. Key growth catalysts include integration into the global economy and rising affluence as the economic model matures. As that happens, we find that logistics real estate rises hand-in-hand with the expansion of consumer classes."

"It's not clear," Heitman's Klinksiek suggests, "where new global cities are going to emerge from, with the exception of China. And how the cities in China sort out after Beijing and Shanghai remains to be seen.

"It's not just about size," says Klinksiek, "it's also about a city's role. Seattle, Portland and Austin in the United States are up and coming. In Europe, Berlin and Stockholm have lifestyle appeal, they are 'cool'. Berlin, especially, is less expensive to live in for young people and attracts the creative types."

Tishman Speyer recently acquired the 30,467-square-metre office building at 33 Holborn in London from Union Investment Real Estate GmbH for a reported $517 million (€378 million). The nine-storey property, designed by Sir Norman Foster, is the headquarters of Sainsbury's Supermarkets Ltd.

Resilient to a fault

A recent research report from Grosvenor Group on long-term real estate investment potential ranked 50 of the world's top cities according to their resilience — a measure that the firm describes as "a product of their environmental and social vulnerability and adaptive capacity, which covers community, infrastructure, resources, environmental and climatic factors." On that basis, the top three cities were Toronto, Vancouver and Calgary; obviously, Canada has something that other countries have not. Chicago came fourth; maybe it's all to do with proximity to the 51st parallel north. That may be a coincidence but it would bring in a lot more candidates. Have a look.

"We are not suggesting that you shouldn't invest in those cities that place lower down the rankings," says Mark Preston, group CEO of Grosvenor, "but the research highlights the risks that those cities face and enables more informed decision making."

Dr Richard Barkham, group research director at Grosvenor (and since appointed as global chief economist at CBRE Group), adds: "Investors with a long-term perspective, such as pension funds or sovereign wealth funds, can deploy capital in these cities and be confident that if they take a knock they will bounce back in a relatively short term. These cities are safe havens in a rapidly-changing global environment."

Barkham explains that earlier Grosvenor research had found that the key economic drivers of sustainable, long-term property cashflows were: GDP, which is positively correlated with rents in the residential, office and retail sectors; liveability, which also correlates very well with rental values; and the presence of service sector company headquarters.

"We then went beyond the normal investment metrics of risk, which are standard deviation, vacancy rate and rental growth, to a much more holistic measure of risk that would be much more suitable for a long-term investor. We are aware that sovereign wealth funds, life insurance companies and also high-net-worth individuals have goals not just to generate a return but to preserve capital in the very long term — maybe 30–40 years. Standard deviation and those kind of risk metrics don't say anything about that, really. That brought us to resilience."

Treading water

It will not go unnoticed that many of the global cities mentioned in this article feature a coastal location. The role as a gateway for shipping — passenger and freight — is often what helped them develop into global cities in the first place. (It's the original meaning of "gateway", not the entry point into a market for foreign capital that the word "gateway" is taken to mean today.)

In these days, however, of growing concerns about the impact and implications of climate change, rising sea levels and the increasing prevalence of 100-year flooding events, a coastal location for a global city is not necessarily the first item on an investor's wish list. But the coast often comes with the territory, as it were. It is back to Grosvenor's point about resilience or, in this case, how well a global city is able to deal with the threat of global warming. Going up the risk curve was not meant to be about higher temperatures and melting icepacks.

We will be considering this aspect of real estate investing further in a forthcoming issue, and it will not be a surprise to learn that investors are now being encouraged to think more broadly about the climate change issues that could affect a global city's place in the world. Frankly, if you do not, you could lose money; at best, you will tread water, perhaps literally. ❖

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