Comment

The global cities: Continuous reinvention and implications for CRE

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Abstract

The supplanting of finance with technology, media and telecoms (TMT) firms as the driving force behind the global city economy has been the defining characteristic of the last decade. As a result, 2007 seems a long time ago in the world of corporate real estate, and so much is changing in office occupation as more firms work tech-style. Nevertheless, for the real estate professional, there are some continuous trends to inform decision making. First, there is the growing centrality of people within a services-led economy. Secondly, we have the merging of a range of influences within a CBD setting (business, culture, academia and social life), with companies under pressure from workers and business needs to be inside that melting pot. Thirdly, there is the growing acknowledgment that an office is a place from which one operates, not a self-contained working location.

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The global cities have seen huge change in the last decade, much of which would have been difficult to imagine back in 2007. What are the lessons for corporate real estate?

Compared to 2007, the global cities have changed dramatically in the dynamics of their economies, the way people live, and how organisations occupy and use real estate. There has been a seismic shift away from financial industries as a driving force behind growth and change, with new technology and media industries now assuming this role. Despite the significant change, however, we can identify consistent long-term trends to inform the thinking of corporate real estate professionals. These relate to the centrality of people in the global cities, a merging of a range of business and non-business influences that are shaping our real estate needs, and shifting perceptions on how we use offices.

Corporate real estate is in large part an exercise in planning for the future, then balancing trade-offs between the benefits that investment in a new workplace can offer an organisation versus controlling costs.

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How big will our organisation be in five or ten years' time? In which cities will we be operating by 2022 or 2027? Are we planning to project an image of prosperity or frugality to clients visiting our office? Which fit-out gets the most out of workers? Where are the people who we need located, whether it be staff, clients, suppliers or stakeholders? Where are our markets, and how close do we need to be to them given the current state of communications technology (or what it may be capable of in the future)? These are all questions typically asked when making a property decision. In our fast-changing world, however, they are becoming harder to answer with much certainty. Little wonder that flexibility (in a myriad of different forms) is rising up the real estate agenda. To illustrate this point, it is worth considering just how rapidly the global business world has changed in a relatively short space of time.

THE WORLD A DECADE AGO

In 2007, financial firms were very much the driving force behind city economies in the developed world. Finance was not necessarily the largest source of office demand, even in big hubs like Manhattan and London, but other industries (law, accounting, advertising, even travel agents) typically prospered via trickle-down income from banks and brokerages. Technology, media and telecoms (TMT) firms, particularly the start-ups, were viewed with suspicion by some landlords, who considered them to be high-risk covenants and only ever likely to pay cheap rents.

A decade ago, cities in developing Asia, particularly in China, were heavily industrial, often with just a token tower cluster in the Central Business District (CBD) to house a small services industry. Those towers sometimes had high vacancy rates, as they were not necessarily developed in response to a surge in office demand. Sometimes a perception held by local politicians that glass-clad towers would put the city 'on the map' had been the true driving force behind developing a city's skyscrapers.

Meanwhile, in the advanced cities in Asia, such as Singapore and Hong Kong, there was a surge in enthusiasm for 'decentralisation'. This consisted of developing suburban office parks to move support jobs out of more expensive CBDs.

COMPLETE CONTRAST TODAY

The contrast with the global cities of today is stark. In several major financial centres, such as New York City and London, TMT has overtaken finance as the driving force behind economic growth. In 2007, some 287,000 New Yorkers worked in banking and securities broking, compared to 264,000 employed by TMT firms, according to New York State's Department of Labor. In 2017, over 335,000 people work in TMT in the city, which is nearly 23 per cent more than the number of banking and securities workers. Knight Frank figures show that in Central London, TMT overtook finance as the largest source of office demand in 2011, and has held the top slot every year since. It is not a brave forecast to predict the same will be true in 2017 and 2018.

Nor is this just a London or New York phenomenon. Shanghai's TMT sector has gone from a negligible number of employees in 2007 to well in excess of 300,000 today, according to the Shanghai Statistics Bureau.

Other industries, which once rode the coat-tails of finance, now look to the TMT sector for revenue. Increasingly these industries are occupying offices 'the tech way', with break-out areas, cafés, quiet rooms and buffets. This is in contrast to 2007, when many had mimicked the 'rows of desks' fit-out of the banks.

This is not to say that finance is disappearing from the CBDs of the global cities, but they are certainly re-sizing. Several banks in London have moved support roles to lower-cost cities in recent years, sometimes within the UK — Birmingham has been particularly popular — but also much further afield, to Poland or Portugal.

The last decade has seen the financial sector, particularly the banks, move from being trailblazers within corporate real estate — often setting expectations on location and best practice — to an industry that feels happier to move with the crowd. Indeed it is not uncommon to find trading floors where the brokers are in casual dress, not suits, and break-out areas pepper the floor. Even most banks now occupy space tech-style.

As a result of Brexit, further change could be ahead for financial firms in London, with speculation that jobs may have to relocate to other cities in order to maintain access to the European Single Market. This could accelerate the recent trend of slimming down the London office, and perhaps raise awareness of the cost savings available from moving jobs to lower-cost locations elsewhere in the EU. Yet conversely, it could highlight the difficulties in recruiting very specialist staff in much smaller financial centres, thus emphasising the strengths of keeping a presence in a large labour pool like London.

After Brexit, we will discover if the ultimate winners will be landlords in Dublin and Frankfurt, or the airlines flying business travellers between London and the continent.

UP-START TECH COMPETITORS

The desire to go for a tech working environment on the part of previously suited-and-booted corporations in part reflects the fact that the old guard face competition from upstart digital firms. Financial institutions are under pressure from FinTech firms, which produce software that allows computers to trade by themselves or empowers consumers to shop for financial products without speaking to intermediaries. Media giants have seen their iron grip on news distribution undermined by the rise of social media. Retailers now face competitors who have no shops and trade purely online.

Going tech-style in the office is seen as a means of changing corporate attitudes, to get everyone thinking about the shifting business landscape around them. It is also seen as being necessary to court the next generation of workers, or indeed to poach staff from tech competitors, as the established firms set up their own digital operations. GE recently went so far as to move its corporate headquarters from suburban Connecticut to downtown Boston, in order to be closer to an innovation culture it felt was essential to the future success of the business.

Landlords have quickly changed with the times and, far from proving reluctant to engage with young tech firms, are actively courting them on many levels.

THE RISE OF CO-WORKING

A good example has been the boom in collaborative or co-working centres, of which the most famous and widespread example is WeWork. This is effectively a communal serviced office, where a flexible fit-out office floor is multi-occupied by many entrepreneurs and their staff. Unlike a typical serviced office, there are no dividing walls between the various companies occupying the centre. Individuals mingle, and desks are occupied on a first-come-first-served basis. Some tenants do not even want to sit at a desk, preferring to work from a sofa with the laptop actually on their laps.

WeWork in particular has grown rapidly. Having founded their first centre in New York City in 2010, they now operate nearly 190 centres in 12 countries, with over 30,000 'members' (ie tenants) signed up. The company has even branched into offering a collaborative living version of serviced apartments, called WeLive. Despite WeWork's relatively short existence and rapid expansion, landlords are typically reassured on covenant issues by the strength of venture capital backing behind the company. This is often true of other fast-growing start-up firms.

To their tenants — or members — the co-working office allows a small entrepreneur to work in a setting they are comfortable with. Visitors to a branch of Starbucks in recent years are used to the sight of students and recent graduates working on laptops at tables as if they were in an office, and the co-working centres take this college work pattern into the business world. They also form an acknowledgment that humans are social creatures. Many of us like having other people around, even if we are not frequently conversing with them, and feel less isolated than working at home.

Co-working centres offer entrepreneurs a workstation in an accepted CBD location, which is a less acknowledged role of any office — a place one returns to between client meetings to type up notes, fill in forms and write reports.

Co-working offices are also building up an awareness of something that most corporate real estate professionals have known for years, but the rest of the business world has been slower (or very reluctant) to acknowledge: few workers occupy their desks all day, and depending upon the role, a desk can stay unoccupied for very long periods of time. In Starbucks we fully accept that when we leave the table we were sitting at, someone else will take it. By bringing the Starbucks environment into the workplace, co-working offices are eroding the concept of ‘my desk’.

NEW TECH LOCATIONS

The rising importance of TMT is inevitably creating a new series of locations that are growing in importance. In some cases it is gentrifying areas of existing global cities, as shown with the rise of London’s Shoreditch, Manhattan’s Midtown South and the Venice district of Los Angeles. There are also cities that have quickly risen as tech centres, with Berlin as the example that surprised many in the German real estate industry — just a few years ago it was thought of as an unemployment black spot. Also, Austin and Pittsburgh are coming to prominence, neither of which sprang to mind a few years ago when thinking of US cities with large digital industries.

Being on the right side of the tech phenomenon has also resulted in high rent inflation. Prime office rents in Berlin are over 46 per cent higher today than a decade ago, compared to just 10 per cent growth for the finance-oriented Frankfurt. Similarly, London’s Shoreditch has seen a 40 per cent rise in prime rents over the last ten years, compared to an increase of nearly 22 per cent over the same timescale in the neighbouring City Core — the largest financial district in London.

Another great contrast between the world of 2007 and that of today is the corporate real estate environment in Asia. The factory-led economy is increasingly less the case; now services account for the majority of GDP in China, for instance, while chronic labour shortages in countries such as Thailand have led to greater automation in manufacturing. Improved education, rising wealth and the migration of people towards problem-solving roles is creating more desk-based employment, and thus more demand for offices. Consequently, developing Asian cities will need more modern office blocks in their CBDs in the future.

In fact, the rise of factory automation, the move towards product customisation and shorter supply chains are starting to move manufacturing back to Western nations. Developing Asian cities may find themselves with the task of having to regenerate their former industrial districts sooner rather than later. Fortunately for developing Asia, the advanced economy global cities have provided a series of successful blueprints for moving former industrial sites to services use — for example, Paris's La Défense, London's Canary Wharf and Sydney's Barangaroo.

Interestingly, for cities in the advanced Asian economies, such as Hong Kong and Singapore, decentralisation has not disappeared, but it is less common today. Cheaper rents in financial districts have reduced pressure to move jobs, while the social changes seen in Western cities — with more workers choosing to live near the city centre — are starting to take hold. The focus is shifting to regenerating former industrial sites adjacent to the CBD, as shown by the redevelopment in Kowloon East in Hong Kong.

WORK AND HOME MOVE CLOSER

Generally, regeneration of former industrial sites in the global cities has brought work and home closer together, with mixed-use development and transport interchange invariably central to the master plan. In contrast to the flight to the suburbs and commuter towns of the 1960s and 1970s, inner city living is popular today, particularly with the young, as well as creative types and professional workers. Few people want a long commute these days, and many prefer to cycle or even jog to work. Consequently, today's office must accommodate the needs of cyclists and joggers, with showers, changing rooms, lockers and bike racks.

For many office workers, their social life kicks off straight after work, and employers must now consider the proximity of the office to the gym, restaurants, theatres and other recreation, in order to attract and retain the best staff. While this was an emerging phenomenon back in 2007, it is fair to say that it is now central to corporate real estate thinking in the global cities.

LONG-TERM TRENDS

The message from the last decade is clear: many of the trends that were prevalent ten years ago have given little real guide as to what has happened in the intervening years. Given the continuous reinvention that is ubiquitous across the global cities, what long-term trends can we identify to allow corporate real estate professionals to do their jobs and plan for their organisations' future needs?

One trend that has remained central throughout the last decade has been the importance of people. For most service organisations, real estate costs are typically only around a fifth of the wages bill, while research by Aon Hewitt showed that the total cost of losing professional workers can be as high as 150 per cent of their salary. Consequently, in comparison to high staff turnover, a few extra dollars per square foot in rent is not a big consideration if it delivers a well-located, bright and vibrant office environment, where staff like to work.

All this was true back in 2007. What has changed is how corporations use real estate to approach this challenge. In the finance-led economy of a decade ago, the centrality of the desk was taken as a given, underpinned by the technology of the time, with greater use of desktop PCs and lots of cables back then. With a move towards a creative-led economy, with TMT firms trailblazing, real estate is able to provide a dynamic environment for building team spirit and staff interaction, with new technology such as wifi, smartphones and very thin laptops facilitating the changes.

There is now a rising tide beneath active-based working, which involves offering staff a range of work areas to match the task at hand — for instance, break-out areas for an informal team meeting, or quiet rooms to focus on writing a report. Lessons from the media world have brought attention to the value of a café or buffet area in raising morale and getting colleagues to mingle and share ideas. This points to a trend whereby the aforementioned co-working office approach is now filtering into mainstream corporate real estate practice.

Moreover, if you want the best people you must recruit in the right cities. Particularly in North America and Europe, we have the phenomenon of rust belt cities declining both in population and economic significance, while the global cities, plus smaller cities with very good universities, go from strength to strength. London's share of UK GDP has increased in the last decade, despite predictions that the opposite would occur back in 2007, when the global financial crisis was just beginning.

BUSINESS, CULTURE AND ACADEMIA CONVERGE

Sheer size (usually a population in the millions), the presence of multiple offices of Fortune 500 companies and the leading professional firms, and global transport links are what marks out the global cities — the likes of San Francisco, Shanghai, Amsterdam and Tokyo. Setting aside this weight of economic muscle, however, the global cities have surprisingly much in common with the smaller university-centric cities, such as Austin, Bristol and Cambridge. In these cities, a strong academic community is matched by a vibrant cultural scene, and this thoughtful environment draws and retains people who are highly suited to creative or professional roles.

So strong is this phenomenon that there are cities actively trying to encourage creative and academic communities. New York City, despite already being a world centre in both creativity and academic thought, is nevertheless working with Cornell University, based in upstate New York, to convert part of Roosevelt Island in the East River into a new urban campus, Cornell Tech. Also, Dubai has encouraged international artists to stage exhibitions there — a move that echoes Miami's embrace of high culture with Art Basel.

Again, this underlying trend was in evidence back in 2007, and changes in the nature of the global city economy have brought it to greater prominence. For corporate real estate professionals this trend has implications when selecting a future office location, as the wider cultural environment of the city will have already shaped the type of person who lives there, and thus the labour pool available to a firm seeking new staff.

WORKERS AND CITY LIFE

One other continuous trend through the last decade has been the coming together of different types of property in a mixed-use setting. Few workers want to be in an office CBD with just a few sandwich shops nearby, and the expectations of the sort of amenities that should be close at hand are growing every year. The benchmark level is no longer just set at generic shops, bars or gyms. There is a growing desire for the office to be in a district with buzz, local character, and which incorporates the more unconventional elements of city life, from market stalls selling wok fried noodles to street art on the sides of buildings. This is occurring at a time of greater willingness to live near work and not just in a gentrifying area adjacent to the city centre. One of the more remarkable aspects of Toronto's impressive downtown tower cluster is just how many of the buildings are apartment blocks.

A firm that ignores these expectations simply risks losing staff. Offices are inevitably in demand in districts that are already blessed with a range of activities on the doorstep and a bohemian culture — New York's Midtown South is a good example. In other cases, the lifestyle, cultural and workplace trends described above are built into the master plan of large-scale new developments. London's King's Cross is a good example, where the University of the Arts is a short walk from Google's offices and close to where diners enjoy supper in former railway sheds.

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First, there is the growing centrality of people within a services-led economy. Secondly, we have the merging of a range of influences within a CBD setting (business, culture, academia and social life), with companies under pressure from workers and business needs to be inside that melting pot. Thirdly, there is the growing acknowledgment that an office is a place from which one operates, not a self-contained working location. In this context, owning a desk is an anachronism, and the surrounding neighbourhood is as important as the interior fit-out of an office.