# Top 10 Real INSIGHTS

Global Property Market Conference 2022

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# TOP 10 | REAL INSIGHTS | Global Property Market 2022 | ISSUE 86

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### 1. GLOBAL PROPERTY MARKETS ACTIVITY IS FACING THE HEADWINDS OF RISING INTEREST RATES, GEOPOLITICAL ISSUES AND FOREIGN EXCHANGE MOVEMENTS

To what extent will economic and geopolitical fundamentals affect investment decision-making?

As central banks around the world aggressively raise interest rates to combat inflation with, so far, little effect, the global property market has entered a phase of uncertainty. JLL reported in its August 2022 "Global Real Estate Perspective – Highlights" that "[d]ecision-making processes are lengthening as occupiers take a 'wait and see' approach. ... For investors, the increasing cost of debt and inflation are impacting pricing and bidding dynamics around the world."

While global three-month real estate returns for Q1 2022 were 4.4 percent, this was a decline from Q4 2021's record 5 percent, which represented positive momentum as markets began to recover from the pandemic. "[I]n the context of broader weakness in economic and market sentiment, slowing three-month returns at the global aggregate level and across many individual markets could indicate that the recent run of stellar global real estate performance is starting to fizzle out." (MSCI, "Globe Real Estate Returns at a Turning Point?")

Higher interest rates, inflation that is proving stubborn, the impact of the Russian invasion of Ukraine on global energy supply and pricing, renewed lockdowns, and slowing growth in China that has led to its government lowering interest rates "will cause full-year investment volume to fall below 2021 levels but remain relatively healthy on a historical basis." (CBRE, "Global Real Estate Remains an Attractive Investment Despite Economic Headwinds")

In regions where interest rates are rising, assets are hitting the market more quickly as sellers cash out as part of a reassessment of asset values. Meanwhile, investors are becoming "more selective about their preferred property types, locations, and expected yields." Institutional investors are looking to realize gains before prices fall and also hoping to avoid having to refinance at significantly higher interest rates. In markets where interest rates have remained stable, particularly Asia Pacific (with the exception of New Zealand, Australia, and Korea), investors are not taking profits to the same extent as in other parts of the world, but are rather becoming more selective about "the type, quality and location of potential acquisitions. Tenant quality is becoming an increasingly important consideration in the due-diligence process." (CBRE)

While investment volumes were relatively stable between Q1 and Q2 2022, those levels are being challenged by rising rates and price discovery. Markets are slowing after seeing considerable post-pandemic rebound. According to JLL, global direct investment totaled US$281 billion in Q2 2022, a 2 percent increase year-over-year. H2 2022 volumes were US$566 billion, a 19 percent increase year to date. "The Americas outperformed with volumes up 23% year-over-year in the second quarter. Performance was mixed across Europe and Asia Pacific during the quarter," with additional lockdowns in China leading to a slowdown. (JLL)

Investors are assessing their portfolio performance and their strategies. During Q2 2022, investment in logistics and office sectors declined, by 13 percent and 10 percent respectively year-over-year. The strongest activity was recorded in the living sector, which rose 20 percent during the same time period.

While premium office space is still considered resilient, in Q2 2022 the global office vacancy rate increased to 14.4 percent as a result of less demand in both the U.S. and Europe. Adoption of hybrid work arrangements means most employees are not returning to the office five days a week, but are instead continuing to work remotely two to four days. Vacancy rates remained stable only in Asia Pacific.

Increasingly, purchasers are looking for brown discounts and ESG is becoming more of a factor in APAC transactions.

### 2. USA: RISKS, OPPORTUNITIES, CHALLENGES AND DIFFERENCES FROM COAST TO COAST

Looking across the United States, not all markets are created equal – from investment volume, risk profile and growth.

The US Federal Reserve has been increasing interest rates in lockstep with Canada, and by November 2022 had even exceeded the Bank of Canada's increases. As of November 3, 2022, the Federal Reserve increased the primary credit rate 75 bps to 4 percent, while the Bank of Canada appeared to be pulling back on at the least size of its increases, and announced only a 50 bps increase on October 26, 2022, leaving the Canadian rate at 3.75 percent.

The US saw a very strong pandemic recovery in 2021, with foreign investors buying $57.7 billion of US commercial real estate that year. This represents a 49 percent increase over 2020, (NAR, "2022 Commercial Real Estate International Business Trends") The large capital market (transactions worth $2.5 million or more) had a total of $638.2 billion total transactions (domestic and cross-border), returning to pre-pandemic levels ($52.6 billion in 2019; $52.9 billion in the four quarters ending Q3 2021). Cross-border transactions represented 8 percent of the totals in 2021, with foreign institutional investors responsible for 70 percent or $37 billion of the $52.9 billion total.

In the small commercial market though, foreign investor acquisitions increased from $2.0 billion in 2020 to $4.8 billion in 2021, and accounted for 3.1 percent of a total of $155.9 billion in NAR-member commercial real estate transactions. The small commercial market is dominated by individual investors (97 percent).

While Chinese buyers were the top foreign purchasers of US commercial real estate in 2020 (14.3 percent), in 2021 there were no Chinese buyers due to pandemic travel restrictions. Mexicans were the top foreign buyers of US assets last year ((23.6 percent), followed by Canadians (12.6 percent), and Columbians (10 percent).

"Seattle, Atlanta, and Dallas dislodged Manhattan as the top destinations among foreign investors of U.S. commercial real estate. Investors purchased $3.2 billion in Seattle's commercial real estate market during the four quarters ending 2021 Q3, an increase of 25% from the level in 2020. Seattle (#2 in 2020) placed ahead of the other tech-heavy metros of San Francisco, San Jose, and San Diego. Atlanta jumped to second place (#5 in 2020), as investors poured in $2.8 billion, up 85%. Dallas was the third largest destination (#4 in 2020), with foreign investor acquisitions of $2.3 billion, up 43% from the level in 2020. Manhattan, the #1 destination for years, fell to #8, as foreign investor acquisitions fell 52% to $1.9 billion."

New York is no longer the top target for foreign investors in US commercial real estate. Florida has displaced New York and was the most popular area, attracting 22 percent of foreign US CRE purchases in 2021. Texas had 14 percent of foreign investment, while California had 9 percent and Georgia, New Jersey, and North Carolina each had 5 percent.

Foreign investor focus has shifted from major to secondary markets, with Seattle, Atlanta, Dallas, San Francisco, Boston, Chicago, and Phoenix all ahead of Manhattan's 2021 $1.9 billion in foreign investment. The $3.2 billion of Seattle CRE bought by foreign investors in 2021 was an increase of 25 percent over 2020 investment levels. Atlanta saw $2.8 billion in foreign investment, a whopping increase of 85 percent, while the Dallas increase was 43 percent for a total of $2.3 billion.

NAR reports that foreign investors were looking for – and acquiring – multifamily assets and land in 2021 (25 percent and 21 percent respectively). Its outlook for 2022 was an increase in foreign buyer investment in all CRE property classes except office and hotel, with the biggest increases projected for multifamily (3 percent) and land (2 percent).

## 3. INVESTMENT ACTIVITY IN ASIA-PACIFIC

Asia-Pacific represents a very mixed bag for investors these days. Global energy demand is down, due primarily to a huge drop in demand from China, whose economic growth is forecast to be only 2.8 percent in 2022, a 25-year low. While US markets are seeing average office vacancy rates of 15 percent in central business districts, in Asia-Pacific these rates are averaging only 8.6 percent. (Colliers Global Capital Markets, Global Real Estate Insights, "The global pricing reset: key trends/October 2022")

In Hong Kong, investment volume fell 48 percent quarter over quarter in Q1 2022. Industrial purchases accounted for 55 percent of investment capital that quarter, while "[t]he severe impact of tighter social-distancing measures on the retail sector dissuaded many investors from increasing their exposure to this asset class, with just US$416 million worth of assets changing hands" in Q1 2022. (CBRE, "Asia Pacific Investment Trends Q1 2022")

In Mainland China, Q1 2022 investment volume dropped 28 percent quarter over quarter, and was the lowest first quarter total in five years. Most investment activity was in Shanghai, despite a Q1 2022 Omicron outbreak. Institutional investors, property funds and companies and end-users, as well as domestic high-end manufacturing and tech companies were the buyers, and demand for both offices and R&D facilities remained strong. The turnover in logistics and industrial real estate was the most significant, doubling year over year. CBRE's six-month outlook for the mainland indicate geopolitical and economic uncertainty would cause investors to take a "wait-and-see" approach to investing, while domestic developers would be looking to offload assets at a discount to improve their cash flow.

Taiwan saw its second highest quarterly investment volume in Q1 2021, although this was driven by local end-users, developers, and insurance companies. "Foreign capital remained inactive due to low yields and limited stock." Office represented the bulk of investment income, although demand for industrial assets was stable, generated by manufacturer and logistics operator end-users. CBRE forecast Taiwan would enter into a period of prolonged negotiations in 2022 "due to the sizable price gap between buyers and sellers." Investors continue to look for industrial land for development, while business parks and warehouses in Tai Nan were expected to increase as transaction activity moves from the island's north to south.

Despite strong demand, limited availability in Japan led to a 37 percent year-over-year drop in CRE investment in that country. There were fewer large transactions by both overseas and domestic investors other than J-REITs. As in the US, investors, especially those seeking office and logistics assets, are looking to secondary markets in regional cities due to tight yields and competition for assets in Osaka and Tokyo. CBRE forecast investment volume in 2022 would be higher than in 2021 due to Japan's loose monetary policy and low interest rates (the Bank of Japan rate remains at -0.1 percent, despite inflation estimated to increase 0.6 percent between July and October, from 2.3 percent to 2.9 percent).

In Korea, the bulk of investment volume was in the office sector, which grew 35 percent year over year (Q1 2021 to Q1 2022), while interest in logistics remained solid. Hotel and retail sectors aren't expected to rebound until inbound tourism starts to increase. Korea has seen a tourist decline from a high of 17,502,756 visitors in 2019 to less than a million in 2021. Rising interest rates means financing costs are a concern for investors, while supply chain disruptions have pushed up costs for logistics development projects, which may lead to delays in completion of new supply. CBRE's forecast for the remainder of 2022: "Domestic buyers are expected to dominate the market. Facing tighter liquidity and higher prices due to interest rate hikes, foreign investors are advised to aggressively reduce LTV portions and raise equity portions in acquisitions."

The Singapore office sector was the most active in Q1 2022. Supply remained tight and demand was strong, particularly from tech and financial (non-bank) companies. While there was also strong interest in retail, primarily suburban shopping malls, "vendors are displaying more aggressive pricing expectations." Major buyers were institutional funds, while sellers were primarily REITs divesting themselves of non-core assets and looking to invest their capital in higher-yield assets, including industrial/logistics. While the easing of pandemic restrictions is making the hotel sector attractive once again, "the higher cost of borrowing due to interest rate hikes is beginning to worry investors, prompting some buyers to become more prudent in underwriting and more careful in asset selection." (CBRE)

In India, too, the office sector remained very strong, with institutional and wealth fund investors from the Middle East and Canada looking for equity and brownfield investments, while domestic developers focused on greenfield developments. Overall, investment volume rose 36 percent in Q1 2022 quarter over quarter. Retail and data centre assets were also viewed as desirable, although new supply continues to increase in price, with construction costs being passed on to end users. "Major risks will include the limited stock of complete assets for sale and tight restrictions on land acquisition and ownership."

Australia also saw the bulk of its investment volume coming from the office sector. Sydney and Melbourne office properties were particularly sought after by buyers from Singapore and Korea. "Well-located office assets saw aggressive bidding by offshore institutional funds and were traded at a tight yield." CBRE forecast that Australia would remain "an attractive destination for foreign capital amid elevated global uncertainty," due to its stability and resilience during the pandemic, although financing costs are rising due to interest rate hikes.

## 4. GROWTH IS SLOWING IN THE EUROZONE

How is the political landscape in the UK and key European countries impacting investment decisions? How has the Ukraine-Russia conflict affected capital flows?

"Key commodity prices have finally started to drop from their peak rates of Q2 2022. The war on Ukraine that began in February, and the subsequent supply-side shocks that followed, resulted in huge hikes to the price of basic commodities, including fertilisers, food, oil, and gas." (Colliers, "Global Real Estate Insights," October 2022)

While Eurozone growth was 0.7 percent year over year in Q2 2022, due mainly to easing of COVID-19 restrictions that led to a rebound in tourism in Spain and Italy primarily, "[d]isruptions caused by the ongoing war in Ukraine, surging energy prices, persistently high inflation, and the looming risk of Russia cutting off gas supplies in the winter months have put the Eurozone economy under an unprecedented level of stress." (Deloitte Insights, "Eurozone economic outlook, August 2022")

That was evident particularly in the UK, where The Guardian's Economics Editor, Larry Elliott, summed things up as follows:

'The economy is going backwards. National output is lower than it was at the start of the pandemic. Property prices have started to fall. Households have started to increase the amount they save in anticipation of hard times ahead. Living standards are falling because wages are not keeping up with prices. Despite the government's price cap, average energy bills are double what they were a year ago. Officials are "war-gaming" the possibility of week-long energy blackouts this winter. NHS England has more than 7 million people on its waiting lists. Food bank usage is soaring.' In a column at the beginning of November 2022, Elliott condemned the Bank of England's monetary policy of continuing to raise interest rates (as they have done eight meetings in a row), and suggests that its policy of knowingly taking action that will cause additional pain to consumers now on the assumption it will save long-term pain is misguided.

ING economists see the Eurozone economy shrinking (-0.6 percent GDP) in 2023 after only 2.6 percent growth in 2022, "mainly on the back of a strong carry-over effect" from pandemic savings. The "breadth of the negative energy shock Europe is experiencing" with natural gas prices more than tripling between June and September 2022, a summer drought that has affected not only agriculture but also manufacturing and the ability to generate nuclear power, has led to a huge hit in household purchasing power, real wages, and consumer confidence. ING rates the chances that households will continue to "delve into their savings to uphold their consumption expenditures" as "slim." With companies hit equally hard by energy prices, "financial conditions are tightening and we see business investment falling back in the coming quarters."

The Eurozone saw record logistics space demand during the pandemic, leading to low vacancy rates and growing rental values. Big box logistics yields were close to 40 bps higher than office yields by the end of 2021. BNP Paribas anticipates this gap will begin to narrow:  demand for Class A office with amenities to accommodate a hybrid workforce will continue to increase as pandemic restrictions are lifted. The performance gap between prime and secondary office will continue to widen, and investors might want to look at prime assets in secondary markets for greater returns. Retail is considered to have reached the bottom of its down cycle, with shopping centres having struggled the most, while high street retail in prime locations and retail parks/strip/outlet malls have fared better during the pandemic. While multi-residential has performed well between 2017 and 2022, increasingly regulation, especially rent regulations in Barcelona, Berlin, Dublin, and Paris, limited supply in prime markets, and ESG considerations all pose challenges in this sector.

### 5. EMERGING AND DEVELOPING MARKETS: UPDATE ON LATIN AMERICA AND OTHER ALTERNATIVES

As the world, if not its economies, rebounds from the COVID-19 pandemic, emerging markets in Latin America are providing opportunities for real estate investment. While these opportunities vary from country, some general trends are perceptible.

With its 650 million population, double that of the US, Latin America currently has the fastest rate of urbanization in the world and is rich in both commodities and natural resources. Well-established industries such as financial services, life sciences, and manufacturing are now joined by data centres, retailers, and healthcare. "A multi-lingual and increasingly educated workforce, relatively low labor costs and time-zone/location considerations are also driving more interest among multinationals in establishing Latin America-based call centers and distribution/logistics centers." (Newmark, "CRE in Latin America: Emerging Opportunities in an Immense, Dynamic and Diverse Region")

In its early fall investment team update, Franklin Templeton noted that "Latin American equities rebounded in October. The IMF expressed confidence in the growth trajectory of Latin America for 2022, raising its economic growth forecast and estimating inflation for Latin America to dip in 2023." Peru, Mexico, and Brazil's equity markets all performed well. (Franklin Templeton, "Emerging markets in November – Latin America continues to shine"

Mordor Intelligence identifies Brazil, Mexico, Peru, and Chile as providing the best investment and development opportunities in Central and South America, from infrastructure investments in sanitation, communications, logistics, energy, and housing over the period 2022 to 2027. (Mordor Intelligence, "Commercial Real Estate Market in Latin America/2022-27")

In smaller Latin American cities with populations under 2 million such as Monterrey (Mexico) and Montevideo (Uruguay), premium office space has reached sale prices of US$280 psf, while lease rents hit US$1.68 psf. Lack of inventory and need for new supply is driving these price increases.

A second World Trade Center tower was recently added to new supply in Montevideo, focusing on service-exporting businesses, co-working, and start-up spaces. And in Goiania, Brazil, the country's 11th largest city, WTC Goiania, a mixed use two-tower project incorporating hotel, office, residential living and retail office spaces is under construction to service the region's agribusiness base. (Mordor)

With the defeat of incumbent Brazilian president Jair Bolsonaro in 2022 and the re-election of former president Lula da Silva, Brazil is poised to capitalize on raw material prices that remain elevated and a small (1 percent) fiscal surplus. Brazil's central bank has not raised interest rates since August 2022, and inflation has subsided considerably since the spring of 2022, although this may change when fuel subsidies with sunset clauses expire. Other challenges to the Brazilian economy include a potential slowdown in commodity-based exports as demand from China, its largest trading partner, decreases.

However, "Stable or falling interest rates, the lowest unemployment rate since 2015, rising real wages and improved confidence mean that Brazilian consumers are arguably in ... good shape, especially compared to many markets in the developed world." (Franklin Templeton, 'Lula returns to helm of world's 12th largest economy: "Brazil is back"') Double-digit returns from the energy sector and the checks and balances that will result from recent legislative reforms to minimize interference in government-controlled companies are all positive indicators for investment in Brazil.

Brazil is also the main data centre market in Latin America, with more than 40 locations throughout the country. Main players in this market are Ascenty, Equinix, Scala, and Odata. (Cushman & Wakefield, "Data Center Market: Investment Opportunities in Brazil") The government is actively seeking more investment in data centres, and despite their huge energy consumption, Brazil is well suited to this type of industry, since most of its energy is renewable.

On the multi-family front, triple-digit growth may be possible in the medium term with investors like Brookfield partnering with Luggo. Brookfield retains ownership of the buildings, while Luggo handles marketing, commercialization, building administration, and contract management. There are currently 5,000 units in development or under construction, with completion expected within three years. This is in addition to the 648 units Brookfield owns in Contagem, Lauro de Freitas, and Sao Paulo. Brookfield is following a national strategy that includes developments in all areas of the country, while Paladin Realty Partners focuses on Sao Paolo development projects, and RBR Asset Management is targeting finished or nearly finished multi-residential assets for acquisition. RBR's target market is "people aged between 25 and 45 years and small families, couples with up to one child or single and divorced people, who have a high average income," according to RBR Asset Partner Bruno Nardo dos Santos. (GRI Club, "Investors reveal strategies for the multifamily product in Brazil," October 19, 2022)

Peru, despite both rising interest rates and inflation (7 percent and 8.53 percent respectively in September 2022), also provides opportunities for multi-family investors, with "a track record of positive returns and ... the demographic bases [that] justify the present and future demand for the asset" (GRI Club, "Multifamily, logistics and mixed uses: why are they attractive in Peru?" October 21, 2022)

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Chile, with its renewable energy resources and the world's largest lithium reserves, "has been one of the most attractive institutional investment markets over the last 20 years in terms of Latin America," according to Tim Gifford, Managing Director, CBRE Capital Advisors, Latin America. The combination of Chilean political stability and changing demographics we have already seen in other parts of the world – people marrying and deferring child bearing till later in life, as well, of course, as increased urbanization – make multi-family residential an attractive prospect for investors. With 180,000 new households being formed annually and a housing deficit of around 700,000 units, there are "great tailwinds for rental housing," according to Tom Livelli, Greystar managing director, who also points out that while there are 280,000 renter households in Sao Paulo, which is three times the size of Santiago, there are 250,000 renter households in Santiago. Affordable housing is increasingly becoming an issue in Chile. According to Gifford, 20 years ago 18 percent of Santiago's population rented; that number has climbed to 30 percent, with the price of an average Santiago home 14 to 15 times annual income, compared with the eight to 10 times average annual income in some of the most expensive US real estate markets like New York and San Francisco.

Chile is also seeing investment in office and industrial sectors (including data centres) from German, Swiss, American, and Canadian funds. Nicolas Cox, president of CBRE Chile, pointed out that while Santiago's Class A office vacancy rate is 11 percent, that's considerably lower than Sao Paolo's 24 percent, Rio de Janeiro's 31 percent, and Mexico City's 25+ percent office vacancy rates. Chile's parallel currency (the UF) allows investors to mitigate inflation risks by allowing them to borrow in that currency, while locally there is a considerable amount of local liquidity, and "[c]ommercial banks and lenders are willing to lend to international investors on these core type transactions." (Gifford) (CBRE, The Weekly Take, "Look at me: Why Chile Attracts Global Capital")

## 6. AN INCREASE IN INVESTOR ACTIVITY IN THE ALTERNATIVE PROPERTY MARKETPLACE

As traditional asset classes become fully valued and yields shrink across the country, investors are looking to alternative asset classes for superior returns.

Cushman & Wakefield's "Global Guide to CRE Investing in 2022: Recovery to hit the fast lane" noted that "less traditional sectors merit stronger investment were fueled by robust demand drivers and operations gains." Shortage of supply for life sciences, self storage, healthcare, and technology infrastructure were key drivers and can provide positive contributions to portfolio performance. Single-family rentals, senior and student housing are other options for investors looking for higher returns.

Economic uncertainty means looking for liquid safe-haven markets, but also for opportunities to supply more or different space in various sectors. For industrial investors, large bay large industrial supply is still in demand for logistics and e-commerce, the appetite for data centres continues to grow globally.

CBRE's "Global Midyear Real Estate Market Outlook 2021" saw investor demand for data centres, cold storage warehouses, life sciences facilities and single-family residential properties increasing in the US over the course of 2021, while demand for sectors considered still recovering such as seniors housing and health care remained stable. With their lower inventory and turnover in combination with higher yields, alternative investment averaged approximately US $93 billion between 2016 and 2021. That's almost double the record high of US$52.1 billion in 2016 (JLL). Alternative investment did fall 20 percent for the year ending Q1 2021, but that was considerably less than the 33 percent drop in total commercial real estate investment during that period, the first year of the pandemic. In H1 2021, alternatives were 11 percent of global commercial estate investment, with "strong transaction activity of data centers worldwide and life sciences facilities in the U.S. and Asia-Pacific." (CBRE) The student housing and leisure sectors were still in recovery mode at that time, waiting for lockdowns to be lifted and vaccination rates to increase significantly.

### Data Centres

Big data, 5G, autonomous vehicles, AI, AR and remote working are the tailwinds behind demand for and growth of data centres. So far Northern Virginia, Silicon Valley, Frankfurt, London, Singapore, and Hong Kong have established themselves as primary markets, but Brazil is seeking to position itself as a data centre leader.

### Cold Storage

Direct-to-consumer grocery shopping accelerated greatly during the pandemic, and e-commerce grocery sales are on the rise in the US, catching up to adoption rates in more densely populated Asian and European markets. Global investment volume in cold storage facilities increased 56.4 percent year-over-year in H1 2021, while the annual average increase over the last decade was 28.9 percent.

### Single Family Rental

With housing affordability out of reach for many, especially millennial first-time buyers who didn't have sufficient funds for down payments at market peak and are now hampered by a combination of higher interest rates and not-yet-subdued inflation, single family rental (SFR) has become an established alternative product. Hybrid and continued work from home trends mean there is increased demand for space to accommodate both living and working. While the majority of investment in the SFR sector is private "mom and pop" investors, larger firms like Invitation Homes, American Homes 4 Rent, Pretium, and Tricon Residential are all expanding in this sector. Blackstone Group acquired Home Partners of America and its 17,000 SFR US assets in 2021 for $6 billion. Peak housing prices delayed acquisitions in this sector in 2021, but as house prices fall, CBRE estimates this sector will see at least $12 billion in equity capital invested.

## 7. RISK AND RETURN: CORE VS. VALUE ADD VS. OPPORTUNISTIC

Class A office and high-end retail looks good, and hospitality has begun to rebound.

Just as urban cores are becoming innovative, collaborative, inclusive spaces for both social and business interactions, central business districts with Class A office space that offers amenities sought not so much by employers as by employees, and high end high street (think flagship luxury brands) retail in those same districts are perennially good investments. However, as noted in Section 8, small and medium urban areas with the infrastructure and demographic potential to become innovation hubs may provide highly attractive development opportunities investors with lots of dry powder might want to undertake.

What makes less sense these days is hanging on to Class B and C office, retail, and multi-residential that may be impossible to electrify and would require huge investments in both structural and engineering renovations to get them anywhere close to net zero by 2030, unless they're in prime locations. With buildings generating between 60 and 70 percent of greenhouse gas emissions in urban areas, cities are beginning to "double down" on sustainability and zero carbon initiatives. There will continue to be "further disparity" between good and average assets. (JLL, "Regeneration, 2021")

For 2023, JLL forecasts pandemic recovery will continue, with climate change replacing COVID as the number one business risk factor. "For investors, the slow increase in interest rates may suggest that investment strategies need adjustment."

With the lifting of COVID restrictions, the hospitality and retail sectors have begun to rebound. Retail repricing may offer opportunities for investors looking to create mixed-use retail/office/multi-residential, particularly in transit-oriented developments (TODs).

## 8. ANALYSIS OF 100 CITIES: WORLD'S LEADING INNOVATION GEOGRAPHIES

As the global economy recovers from the pandemic, innovation-oriented industries and talent will be key to the next cycle of urban renewal and creating new growth drivers. Cities which outperform on these measures are best positioned to record the strongest economic recoveries in the coming years. There is also a powerful link between innovation and talent ecosystems and real estate performance.

The combination of anchor universities, a broad mix of industries, good amenities and a critical mass of people have kept San Francisco, Tokyo, and London in the top 10 of global innovation centres, according to JLL's "Innovation Geographies: Resilience and Recovery". Seoul, Beijing, Singapore, Paris and Seattle are also in the top 10. Smaller cities around are making names for themselves as talent and innovation hubs, many with highly specialized focuses. These include Austin and Raleigh-Durham in the US, Tel Aviv, Berlin, and Helsinki.

The pandemic has accelerated a metamorphosis in work and lifestyle preferences, increased digitalization in almost every industry, and the increased need for more sustainable and resilient communities.

Seoul, in sixth place for innovation, is second only to Tokyo when it comes to international patent applications. It ranks 10th globally in terms of number of start-ups as a result of government support for entrepreneurs. With five top-ranked universities and 12.9 % of its workforce focused on innovation, its major challenge is its aging population and an anticipated decrease in its working age population.

Denver, which ranks only 52nd on innovation and 22nd on talent, is building on its healthcare, wellness, and energy industries and is becoming a life sciences hub in the US. It would undoubtedly rank higher if it could attract more R&D spending. With 45 percent of its population with at least one degree and a population of 3 million, Denver is "one of the quickest growing markets in the U.S. for workers in the innovation economy."

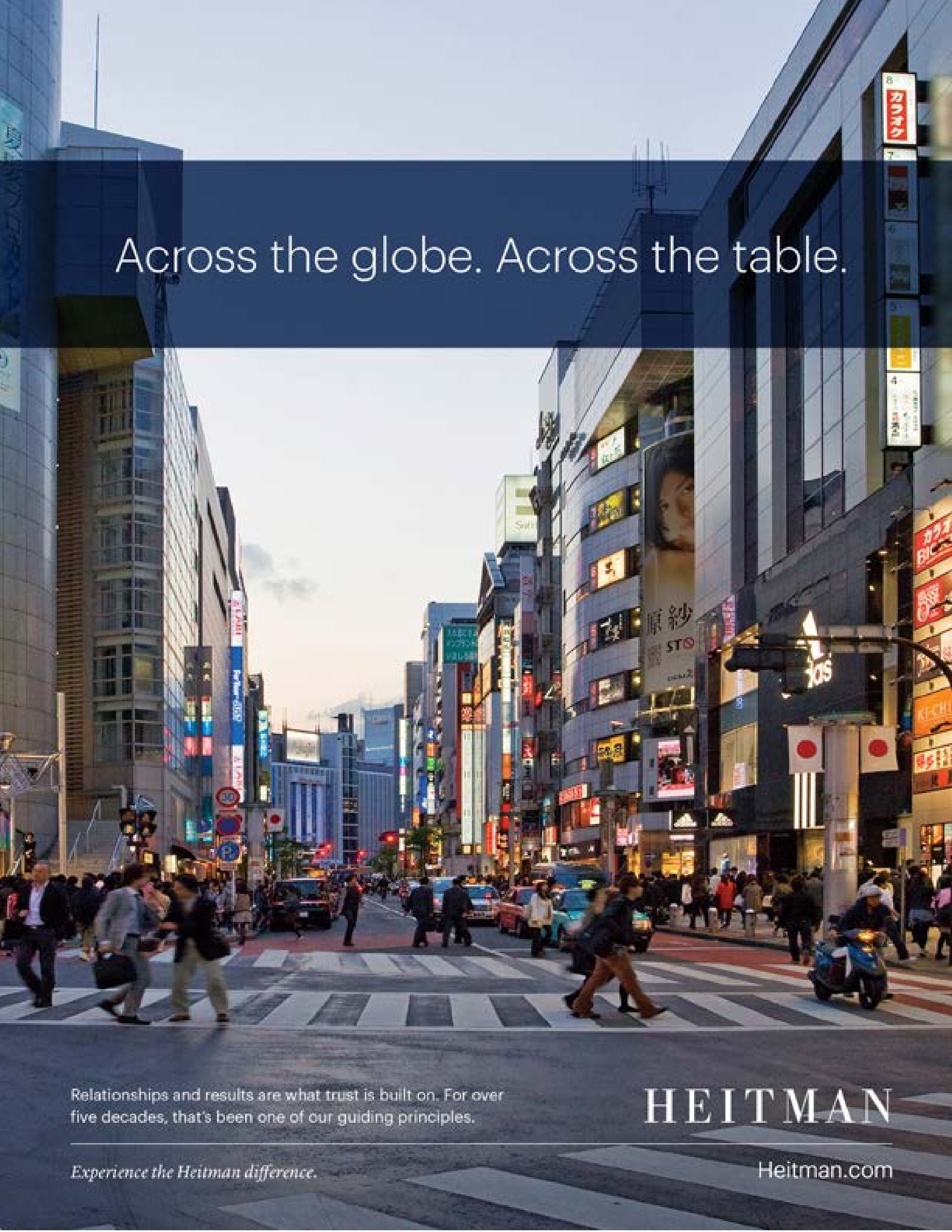
Barcelona's urban regeneration project, the 22@ district, has led to it becoming both an innovation hub and a global technology centre. It significantly outranks both the EMEA and global averages for number of start-ups between 2018 and 2020 (close to 400, vs the EMEA's average 200-250 and the global average of around 300). The challenges of an aging population can probably be met by attracting and retaining more young people with its three world-class universities.

A KPMG survey on tech innovation hubs conducted in 2021 indicated that 61% of technology leaders have revised their views of which cities will become future hubs since the pandemic began, with many believing Silicon Valley's days are numbered. The innovation focus will instead shift to Singapore, New York, Tel Aviv, Beijing, London, Shanghai, Tokyo, Bengaluru (Bangalore), Hong Kong, Austin, and Seattle.

The top five factors in creating a successful innovation hub, according to KPMG, are:

- an urban location that is attractive to young professionals
- a skilled talent pipeline
- high-speed bandwidth and modern infrastructure
- at least one university that is research intensive, and
- positive demographic growth trends.

This is one of the reasons investors "are increasingly drawing on innovation and talent metrics when making strategic decisions on which cities to invest in. ... not only does capital target cities with stronger innovation and talent credentials, but those same cities also outperform over the longer term." (JLL))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## 9. GLOBAL TALENT SHORTAGE AFFECTS THE REAL ESTATE INDUSTRY

One of the many side effects of the pandemic was the acceleration of the digitalization trend, when working from home became both a necessity and the norm during lockdowns. Add an increasingly regulated environment with stringent reporting requirements as onerous as tax filings and a talent shortage fueled in part by growing adoption of ESG, and, as Enertiv Director of Marketing Comly Wilson told bisnow.com, "Whether it's ESG consultants or building engineers, it's a serious issue, all at a time when portfolios are being forced to do more, when they have less people to do it. It's an issue everyone faces." ("Commercial Real Estate's ESG Push Has Industry Fighting Over Talent," September 27, 2022)

Ironically, the biggest skills gaps could be solved if CRE embraced technology more passionately and focused less on traditional skills like finance and accounting, sales and marketing, customer service and property management when hiring. Prioritizing data analytics, AI, software development, and cloud computing skills would help CRE firms "digitalize business processes and refresh their talent strategy so as to not lag further behind. Of note, 41% of survey respondents are accelerating their efforts to use technology to redefine business processes, job roles, and skill requirements." Nearly half (47 percent) of European firms told a Deloitte global outlook survey ("Gaming the commercial real estate talent conundrum") they are likely to speed up their digitalization adoption, while only 44 percent of APAC respondents and 32 percent of North Americans thought they would do so. Just over a third of survey respondents indicated their talent and recruitment strategies were shifting to meet future technology and skills needs.

Recommended for CRE companies after analyzing the results of the survey, Deloitte suggests CREs:

- redefine skills and roles
- refine the corporate recruiting approach
- create alternate talent marketplaces, and
- strengthen talent analytics.

Among the most coveted skills are big data and/or real estate analytics as evidenced by a bachelor's degree or certification. Soft skills in great demand include critical thinking, problem solving, communication, presentation, and relationship building.

Modernizing the recruiting process is a matter of creating digital content and relying more heavily on social media for recruitment of both open positions and to create potential future talent pools. Intuit is using VR to give candidates a real-time glimpse of its day-to-day activities.

Shorter job descriptions and a mobile-friendly application process as well as automated interview-scheduling for the shortlist are other examples of easy – and necessary – tech solutions CREs need to adopt.

Consciously setting out to create an alternate workforce of contractors, freelancers, and gig workers is one way companies can quickly plug their talent gaps. Talent sharing through knowledge-sharing and mentorship programs can facilitate skills transfers between older and younger employees, with experienced professionals imparting leadership and relationship-building skills and newer young recruits teaching digital tools and helping to "absorb the impact of digitalization" on older employees.

Data analytics can help firms in two ways: by eliminating selection bias and increasing the likelihood that selected candidates will succeed. Machine learning can enable better talent decisions through predictive analytics.

The news is not all bad on the talent front, however. While Canada is experiencing a tight labour market along with most of the rest of the world, August data from Statistics Canada saw a "dramatic shift among workers toward certain sectors, such as public administration and real estate, and away from others, such as food services." Workers are, according to McGill labour economist Fabian Lange, climbing the job ladder and seeking industries with better compensation and benefits. This is happening in the US as well, Lange says. (CBC, "In a tight labour market, this is where Canadian workers are going, August 23, 2022)

In the three and a half years between January 2019 and June 2022, the number of employees of finance, insurance, rental, and leasing firms increased 14.4 percent. This was the third largest increase, eclipsed only by professional, scientific, and technical services' employee growth (19.5 percent) and public administration (17.1 percent).

Over the same time period, industry wages have increased 16 percent. (Statistics Canada)

## 10. ESG, DIVERSITY, CLIMATE CHANGE AND THE SHIFT TOWARDS A NET ZERO ECONOMY

The demand and importance from governments, investors, tenants and other stakeholders for asset owners, public entities and corporations to address environmental, social and governance (ESG) issues grows stronger every year.

Cushman & Wakefield's annual Signal Report ("Global Guide to CRE Investing in 2022: Recovery to hit the fast lane") stated that ESG has "moved rapidly up the investor agenda in the last two years as the pandemic pushed public health and environmental concerns to the fore." Both occupiers and investors are increasingly demanding green buildings, and dramatic price increases in energy costs due to the Russian invasion of Ukraine is a factor in higher European focus on sustainability )(the Americas and APAC tend to zero in on waste and material resilience).

While green may sometimes come at a premium, increasingly it's becoming standard in new supply. What we're seeing instead is a rising brown discount, as assets that cannot be converted to green are becoming obsolete. "Investors," say Cushman & Wakefield, "must act now, starting with knowing their assets and understanding how they can be improved – whether in financial or non-financial returns – and that needs monitoring, data analysis and a strategy to improve over time."

The most important sustainability factors in new construction are cutting waste, material resilience, operational carbon, and embodied carbon, while climate change, water consumption, and biodiversity are other factors.

LEED office buildings have higher cash flows, higher sale prices psf, and higher cap rates. PwC Canada noted that while 2021's mergers and acquisitions activity rose 117 percent over 2020, investors are increasingly emphasizing ESG factors when evaluating potential target companies. (PwC, "Embracing ESG and defining purpose to create value and attract investors") Investors are now looking at how companies are addressing – and reporting – on various dimensions of ESG, including regulatory, compliance, strategy, impact, and operations. They're interested in learning about both material risks and growth opportunities before purchasing. ESG value factors include value erosion, value preservation, and value creation. Higher input costs, supply chain disruptions, climate change and regulatory non-compliance risks all lead to value erosion. Value preservation can be generated when owners meet planned greenhouse gas emission targets, reduce waste, become more energy efficient, and have defined customer and employee strategies that support meeting ESG targets. Value creation results from ESG actions over time that lead to new markets, products, and services while increasing customer loyalty and employee retention and incurring lower debt costs.

PwC outlines three key ESG tactics to increase value for potential sellers. These include:

- developing and reporting on baseline ESG activities, including comparisons to key competitors using accepted ESG standard frameworks: SASB, TCFD, or SDG UN Sustainability Development Goals;

- allocating capital and making specific investments to ensure desired ESG outcomes are met. These can include investing in enabling tracking and reporting technologies and funding R&D initiatives, as well as ensuring ESG funding initiatives become a standard item in operating budgets; and

- identifying growth opportunities using ESG activities so ESG becomes fundamental in approaching end-to-end operations.