

Manhattan, New York
during stay-at-home
measures in April 2020

NEGOTIATING AN ANCIENT DISRUPTOR

ASSESSING THE LONG-TERM IMPACT OF COVID-19 ON REAL ESTATE

BY SAVILLS WORLD RESEARCH

When we decided on the theme ‘tipping points’ for our 2020 Impacts programme at the end of 2019, various topics were discussed: climate change, demographics, technology and many more. What we didn’t know is that we were about to be faced with a pandemic. Covid-19 changed the way we work and live almost overnight and is likely to have a long-term impact on real estate. A Black Swan event (or Grey Rhino for those who argue the warning signs were visible) tipping point.

The impact Covid-19 will have on the global economy is being fiercely debated. Most forecasters agree that there will be a global recession deeper than the global financial crisis (GFC) and many expect it to be the deepest since the Second World War. The debate is around the shape of the recovery. Will there be a V-shaped rebound? Or is a U, L or W shape more likely? We’re even hearing discussions about ‘a Nike swoosh-shaped’ recovery.

As countries come out of their strict lockdowns but social distancing is still encouraged, the long-term impact of Covid-19 is yet to be seen. Many believe the world will emerge as a different place. Here, we discuss the potential changes that may be seen across the different sectors.

1. OFFICES

Despite the success of home working, offices still provide a vital role in culture, community and connection
The Covid-19 pandemic has the potential to become one of the biggest tipping points for the future of offices, impacting corporate location strategies, office design and management as well as occupier practices.

Many corporates have allowed flexible working in some form for years. However, the large proportion of employees working away from the office in the wake of Covid-19 for an extended period may be the catalyst for accelerating flexible working patterns. According to the Savills Global Sentiment Survey of research heads in 31 countries around the world, 84% of respondents expected home working to somewhat

increase, the remaining 16% expect it to greatly increase. Over half expect the use of video conferencing to greatly increase after the pandemic.

But the office will still play a vital role. Katrina Kostic Samen, Head of Savills KKS Workplace Strategy & Design says: “Workplace change was inevitable. However, what we expected to evolve over time transformed almost overnight in response to the pandemic. These exceptional circumstances are akin to an elastic band being stretched to its limit; it will go back but not completely.

“It will be down to businesses to determine how this evolves but it must be with people at the heart. The role of the office long term is vital to provide what we crave – culture, community and connection, essential after the emotional and physical impact of the pandemic.”

We expect to see a shift towards diverse location strategies and the emergence of a hybrid model, a combination of home working, local office hubs and a head office. This is an opportunity to improve long-term employee wellbeing, organisational resilience, and sustainability. A reduction in the environmental footprint may arise from less travel, shorter supply chains and sustainable building design, to name a few examples.

If the home is to become more important as a workplace, consideration will need to be given to longer term work from home policies. Cyber security and confidentiality, health and good ergonomics for a home office will all need to be managed.

Communication and policies will be needed to develop ‘flexible people’ and not just focus on flexible workplaces. In some places, particularly the developing world, slow home internet connections or high-density households mean working from home is just not feasible.

An increase in home working isn’t the only trend that could change office space. Safety, hygiene and employee wellbeing are in the spotlight. Regular deep cleaning of the work premises has become a fundamental health and safety >

“WE CAN EXPECT THE GROWTH OF REGIONAL MANUFACTURING HUBS SUCH AS MOROCCO FOR WESTERN EUROPE, AND MEXICO FOR THE USA”

consideration for businesses and is one of the more visible ways in which a company can demonstrate its commitment to providing staff with a safe working environment. Occupiers may look again at building ratings schemes such as LEED and WELL that are focused on creating sustainable spaces and delivering occupant comfort, health and wellbeing.

Contactless design in buildings, for example in appliances, lifts and doors, is expected to increase according to 87% of Savills research heads across the globe.

Some 63% expect occupier density in offices to decrease. This could see occupiers taking the same amount, or potentially more, office space as before the pandemic, but using it differently.

Sarah Dreyer, Head of Research for Savills US says: “Going forward, health and safety will come first. How this plays out in office demand is yet to be seen and is not likely to be clear until more effective virus treatment and prevention measures are available. At one end, those organisations that have adapted well to having a remote workforce could re-evaluate future in-office functions and ultimately reduce office size requirements. The net impact on demand will be affected by changes to workplace design and a possible reversal of high occupancy densities and desk sharing



Companies may diversify their supply chains across global locations

to one of lower densities and more generous circulation and collaboration areas.”

Despite Savills researchers expecting a slight fall in occupier demand, they are less bearish on office investment activity.

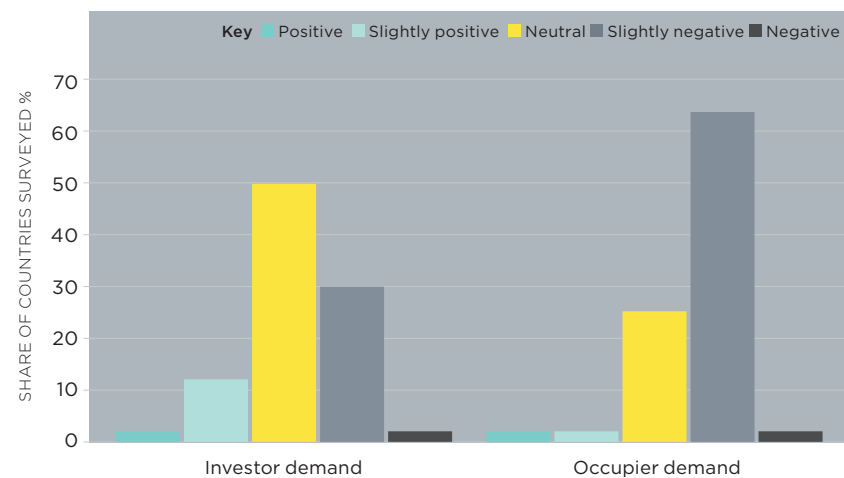
Half expect no change due to Covid-19, one-third forecast less activity and the remainder expect an increase. This reflects the ongoing demand for real estate from investors seeking long term secure income streams and the comparatively good returns the sector offers.

Flexible offices, in particular hot desks, could be impacted by the focus on hygiene in the short term. Many flexible offices are putting together plans for adjusting the use of their space while the pandemic is still ongoing, but we expect these design changes to be temporary.

Larger companies may find flexible space does not suit them in the shorter term as they prefer to retain control of the cleaning procedures and density. However, long term, companies of all sizes are expected to focus on flexibility in terms of overall costs and office space in particular, which will likely benefit flexible offices.

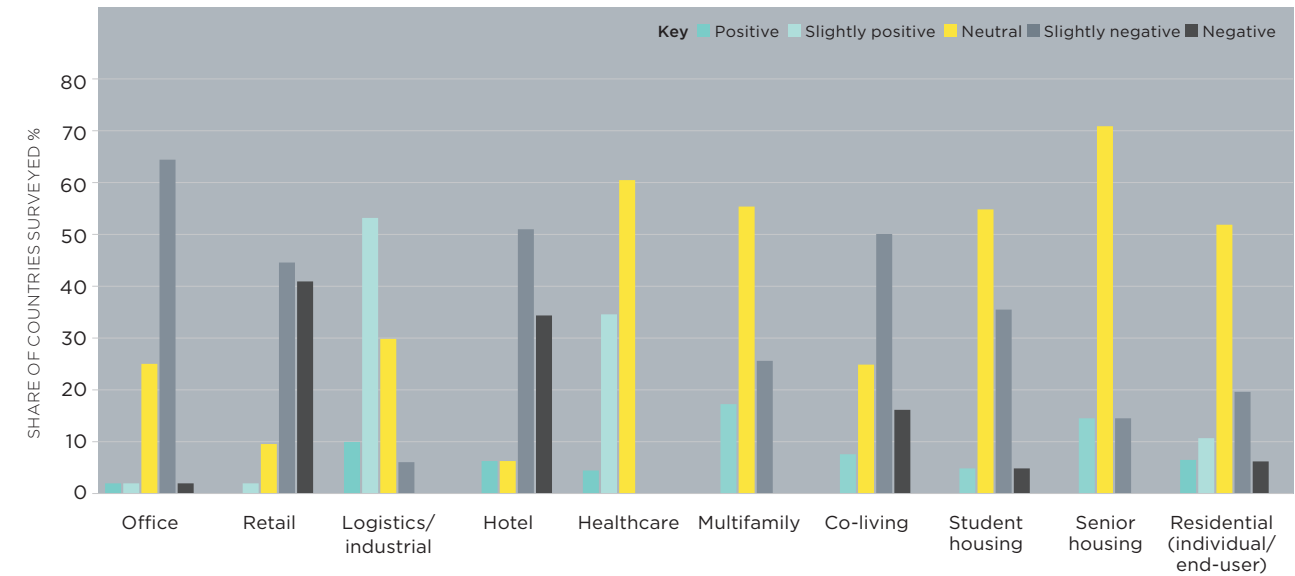
Jessica Alderson, Global Researcher, Workthere, adds: “Our data, collected from over 100 flexible offices, showed that 62% of flexible office providers are optimistic about the prospects for the sector over the next

IMPACT OF COVID-19 ON OFFICE DEMAND AFTER PANDEMIC HAS PASSED



Source Savills Research

IMPACT OF COVID-19 ON OCCUPIER DEMAND AFTER PANDEMIC HAS PASSED, BY SECTOR



Source Savills Research

12 months. In the short term, flexible offices will likely face challenges, with increased risk of contract cancellations as companies go into survival mode, albeit global contract occupancy levels are still above 70%.”

2. LOGISTICS

We expect to see supply chain diversification and the growth of regional manufacturing hubs

Thanks to the global growth in online retail, logistics was a sector already in vogue. The pandemic is expected to accelerate its ascension. Some online retailers, particularly supermarkets, struggled to keep pace with the surge in demand from consumers during lockdowns, pushing their supply networks to the limit.

With more people than ever before using online retail, the market is forecast to deepen longer term. Further investment in logistics space to service this demand and ensure resilience against future surges of demand will follow. Some 63% of country research heads expect to see some kind of positive impact on occupier demand in the logistics sector as a result of Covid-19.

Globally, one of the most widely felt impacts of the outbreak is in manufacturing and the supply chain. In 2003, at the time of SARS, China was less integrated into global supply chains and constituted approximately 4% of the world economy; it now stands at 16%, according to the IMF.

Domestic factory closures and the disruption of sending everything from car parts to clothing overseas effects companies from Boston to Berlin. Just-in-time inventories mean the cushion for even the slightest disruption is minimal, and this resulted in empty warehouses and shelves, and consumers unable to consume.

Companies may look to diversify their supply chains across several global locations to insulate against possible future incidents. This is a trend that had already started in Asia as manufacturers took advantage of lower-cost locations outside of China, leading to greater investment in Vietnam, Cambodia and India. The trend was further accelerated by the US-China trade war.

However, China dominates global manufacturing, and we expect to see

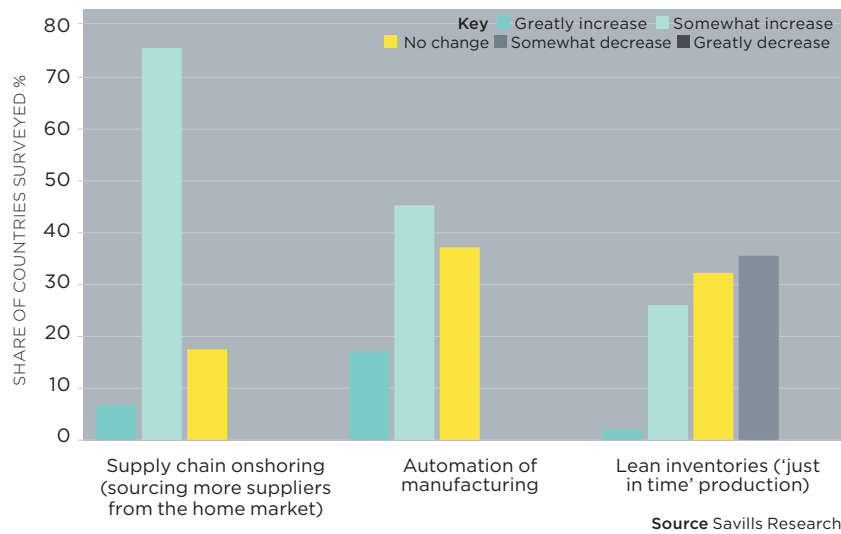
a gradual, not immediate, shift. Moving operations costs money. Increased automation may offset higher labour costs, but it requires huge capital investment.

Other factors must be taken into consideration. Kevin Mofid, Head of Savills UK Logistics and Industrial Research, says: “By bringing operations closer to their home markets, costs will likely increase. Will the post Covid-19 consumer be prepared to accept higher costs at a time when economic activity is set to be slower? Moreover, the perception that nearshoring increases the amount of inventory held in warehouses is not necessarily true. Shifting more manufacturing to the home market may in fact weaken demand for logistics as supply chains shorten.”

In reality, we’re likely to see future investment that would have gone solely to the lowest-cost destination be spread across many. In a trade-off between cost and distance, nearshoring is likely to outpace onshoring. We can expect to see the growth of regional manufacturing hubs such as Morocco for western Europe, and Mexico for the USA. >

“THE OUTLOOK FOR MULTIFAMILY REMAINS POSITIVE, WITH 55% OF COUNTRIES ANTICIPATING NO IMPACT ON INVESTOR DEMAND”

IMPACT OF COVID-19 ON SUPPLY CHAINS AND MANUFACTURING AFTER PANDEMIC HAS PASSED



This could change the dynamics of regional logistics networks. For example, Morocco, easily accessible to western Europe by ferry, could readily integrate into the existing logistics corridor that spans the ports of southern Spain, the Iberian Peninsula into France. This, in turn, may boost demand for logistics at strategic entry points, such as Algeciras, Valencia and Barcelona.

3. RETAIL

Online retail will accelerate, but the desire for physical retail will remain

Consumers were already looking for more from their retail experience prior to the pandemic. As Tom Whittington sets out on page 46, we can expect even greater consumer appetite for community and convenience-based retail, and a higher share of discretionary spending on leisure experiences rather than superfluous purchases. This will have a further knock-on effect to the way we shop and the amount of retail space we need. More repurposing and re-imagining of existing retail space will follow.

While the rise of online retail is expected to accelerate, shopping is a sensory experience and the desire for physical retail will remain. In emerging markets in particular, shopping is a recreational

activity and a hallmark of the burgeoning middle classes. Our researchers in India, Indonesia and Thailand all cited a more positive outlook for the sector once the pandemic has passed.

These countries have among the lowest e-commerce penetration rates in the world and for the majority of consumers physical retail is still the only retail.



4. HOTELS

Hit hard in the short term, but the longer-term fundamentals driving demand will stay unchanged

The hotel market was one of the hardest hit by the Covid-19 pandemic in terms of operational performance. International travel restrictions and national lockdowns saw many hotels close across the globe. Yet, the long-term demand fundamentals remain largely unchanged. Marie Hickey, Director, UK Commercial Research, Savills, says: “Once travel restrictions are lifted there will continue to be short-term challenges facing demand and operational recovery. However, the longer-term fundamentals driving demand remain, with many commentators forecasting that hotel performance will be back at pre-Covid-19 levels by 2022.”

For our research heads across the globe, the expectations of travel patterns once the pandemic has passed vary. Just over half believe personal domestic travel will increase, compared with 29% who think it will fall. However, 71% and 77% expect personal international travel and business travel to decrease respectively.

Business travel in many parts of the world was not back at pre-GFC levels when Covid-19 struck, some of which



was down to technology trends such as video conferencing. This trend is likely to be intensified post Covid-19.

International leisure travel may be impacted by some lingering nervousness to travel too far from home, at least in the short to medium term. Leisure destinations benefiting from good international rail and road connections are expected to see earlier demand recoveries than those more dependent on air connections. The pandemic may also see environmental concerns among travellers move higher up the agenda, shaping both mode of travel and hotel choices, to the initial benefit of locations with good rail connections.

5. INSTITUTIONAL RESIDENTIAL

The outlook for multifamily is positive, while the need for quality rental product remains

Institutional investment into residential asset classes has grown by almost 50% in the past five years. Once considered alternative, residential has entered the mainstream and the defensive benefits of investing in beds are set to continue, reflected in our survey. The outlook for multifamily, in particular, remains positive, with 55% of countries anticipating no impact on investor demand into the sector, and 27% expecting a positive impact.

Operation and design may see some long-lasting changes. Cleaning regimes will be upped. The nascent co-living sector, which is founded on the idea of smaller, denser individual units and larger communal areas, may see its model evolve with a rebalancing of private and communal space.

Some 67% of our researchers expect to see a slightly negative or negative impact on occupier demand for co-living as a result of the pandemic, although only 52% expect to see a negative impact on investor demand. This recognises that the underlying need for quality rental assets remains, particularly in major cities with high concentrations of young professional migrants.

Student housing is a sector that has grown rapidly as the number of international students has risen. After rapid development in the USA and the UK, the sector is building momentum in Australia, mainland Europe and in strategic regional hubs, such as the UAE.

The Covid-19 pandemic turned the higher education sector on its head overnight. Learning switched online, exams were postponed and student travel was halted. Students and on-campus instruction will return in time, likely with a greater emphasis on health and

safety, but many institutions face a loss of income and cost-cutting measures in the meantime.

The associated global economic downturn, affecting the ability of students to afford a higher education in more costly overseas markets will also have an effect. Marcus Roberts, Head of Europe, Operational Capital Markets, Savills, says: “Regional hubs, closer to the international student market may benefit, such as Malaysia and the UAE, together with some of the lower-cost European destinations. In Germany, for example, the cost of tuition is negligible, for international as well as domestic students.”

But the caché associated with studying at top-ranked institutions will not disappear. Students will be looking to maximise their investment and the most established university towns and cities in the USA, UK and Australia will continue to attract students from around the world, in turn supporting the market for student accommodation.

6. SENIOR HOUSING AND HEALTHCARE

The healthcare sector has specific real estate requirements. Housing with care is emerging as a major alternative sector. Health and wellbeing is now firmly at the top of government, corporate and personal agendas. This specialist asset class has particular real estate requirements.

As Steven Lang, Director, Savills UK Commercial Research, says on page 22, even before the pandemic, investment into vaccines was up 150% over five years, to give one example.

This kind of activity has fuelled the biotech sector and the core innovation markets in which it is concentrated; cities such as Boston in the USA and Cambridge in the UK where venture capital, universities and hospitals combine. According to our global researcher survey, 43% of countries expect to see a positive impact on investor appetite for the healthcare sector as a whole going forward.

One senior housing subsector in particular, the ‘housing with care’ sector (self-contained residential units with some shared amenities) proved resilient against the challenge of the pandemic. Relatively >

“IN THE SAME WAY THAT SECURITY CHECKS HAVE BECOME THE NORM, SO MIGHT BUILDING ENTRY HEALTH CHECKS”

well established in Australia, New Zealand and the USA, it is emerging as a major alternative sector for investors elsewhere.

Samantha Rowland, Savills Head of Senior Living, says: “The issue of social isolation among older people is a major challenge, brought into sharp relief during the pandemic. As life expectancy increases and people live healthier lives for longer, the question of where and how the elderly are going to live isn’t going to go away. Housing with care is one option, offering self-contained homes but with a resident community and care at hand when needed.”

Thanks to the demographic fundamentals, from an occupier and investor perspective, our survey shows future demand for senior housing to be unaffected by the pandemic – more than any other sector (see chart on page 9).

7. END-USER RESIDENTIAL

Properties with space to work and relax will be in greater demand, as will technology in the home-buying process

More home working has a direct impact on the residential market as households reassess their needs. The Savills sentiment

survey indicates that 90% of research heads expect demand for home offices to increase, while 86% expect an increase in demand for high-speed internet. The lockdowns have also highlighted the value of having access to a private outdoor space, and two-thirds of respondents expect demand for it to increase. These are factors that developers across the world will need to take into account when designing future homes.

Those without a private space will look for public outdoor green spaces, which may become a higher priority in deciding where to buy. Others may decide that as home working increases, they’d like to move to a more rural location. Nearly half of Savills research heads believe demand for rural/out of town locations will increase, while the rest expect it to stay unchanged. However, there were slightly more European research heads who expect this trend to occur than those in Asia-Pacific where city living is more common.

Lucian Cook, Head of UK Residential Research, Savills, gives us his take on the situation in the UK: “Our survey of potential buyers and sellers suggests that Covid-19 has substantially increased the

Residential demand for rural locations is likely to increase



attractiveness of prime properties in village and country locations. This is partly driven by a desire to have better access to outside space, allied to the prospect of working from home more regularly.

“It comes at a time when country property is looking good value, given the shift towards prime urban living in the five to 10 years preceding the coronavirus.”

Covid-19 has also increased the use of technology in the home-buying process. During lockdown, potential buyers were unable to physically view properties, which led to an increase in virtual viewings. Digital signing of documents and e-conveyancing have been enabled following legal changes.

As the lockdowns end and we look forward to a time after the pandemic, it’s unlikely that these changes will be reversed. Jelena Cvjetkovic, Director, Savills Global Residential agrees: “The use of new technology-enabled tools for the home-buying process will be further cemented in the near future as some degree of social distancing looks set to continue, and we believe they are here to stay. E-conveyancing and digital signing will streamline the purchase process, with a beneficial impact on all, but particularly cross-border transactions, and a number of countries are looking at changes in law to enable these.”

CONCLUSION

Covid-19 has made the world take stock of how, despite increasing technological and social advancements, the way we live and work can be altered by the most ancient of forces: a medical pandemic.

The world was already undergoing many upheavals before the emergence of Covid-19. Living and working practices were evolving as new demographic groups entered the workforce at scale, retail was undergoing structural change, and real estate was being re-imagined as a service.

Forced to adopt technology en masse, employees have seen the advantages of remote working. Health and wellbeing has shot up the agenda. In the same way that security checks have become the norm, so might building entry health checks. All sectors will feel the effect in the long term of enhanced sanitising regimes.

As outlined in the rest of this publication, there are many tipping points impacting the industry. The pandemic means that some of these structural shifts in real estate may now have extra impetus. ■

LEARNING FROM CHINA: ADDRESSING THE NEAR-TERM CHALLENGE

As countries around the world continue their lockdowns, all eyes have been on China as an example of how to slowly and steadily lift lockdown rules to enable a return to ‘normal’ day-to-day life.

Initial response

China adopted a strict response to the Covid-19 pandemic within its borders, swiftly implementing social distancing measures and closing businesses across the entire country. During this time, sectors beyond essential services were mandated to sharply reduce or completely stop operations. Malls reduced hours, restaurants were limited to takeaway or delivery, offices were closed, and workers shifted to working from home. There were also stringent travel restrictions; permits were required to leave residential complexes and all non-essential travel was prohibited.

Resumption

The measures began to be eased in mid-to-late February, except for the epicentre of Wuhan. As residents started to venture out more, temperature checks, registering visitors, and no-contact deliveries were still required. These measures, intended to further minimise the spread of Covid-19, have

also been seen in similar forms in other sectors.

Restaurants have had to limit capacity to adhere to physical distancing regulations. A gradual reopening beyond food service has incrementally extended to retail and other services, such as banking.

Offices opened with increased social distancing measures in place. Teams worked in the office on a rotating basis and working hours were staggered to minimise potential for disease spread. Firms also were required to register their workers to prove that the workers had been resident in their cities for at least two weeks. External client meetings were postponed, and employees who were able, opted to use private transport rather than public to further minimise risk of exposure.

The new normal?

As at April, temperature checks, travel history, and other details are still frequently checked before individuals are allowed access to many buildings and public spaces. Mask-wearing, social distancing, and contact tracing through apps and QR codes are widespread, and regular disinfecting is carried out, particularly as secondary outbreaks remain a concern. The Government is also acting

swiftly to clamp down on disinformation in order to maintain public trust.

Many aspects of public life are still shuttered. Cinemas and children’s shops remain closed. Schools in some provinces are also shuttered, while other provinces have reopened. Those still closed will have a staggered reopening. Exam age pupils will return first, then older students, and younger children will be last back in the classroom.

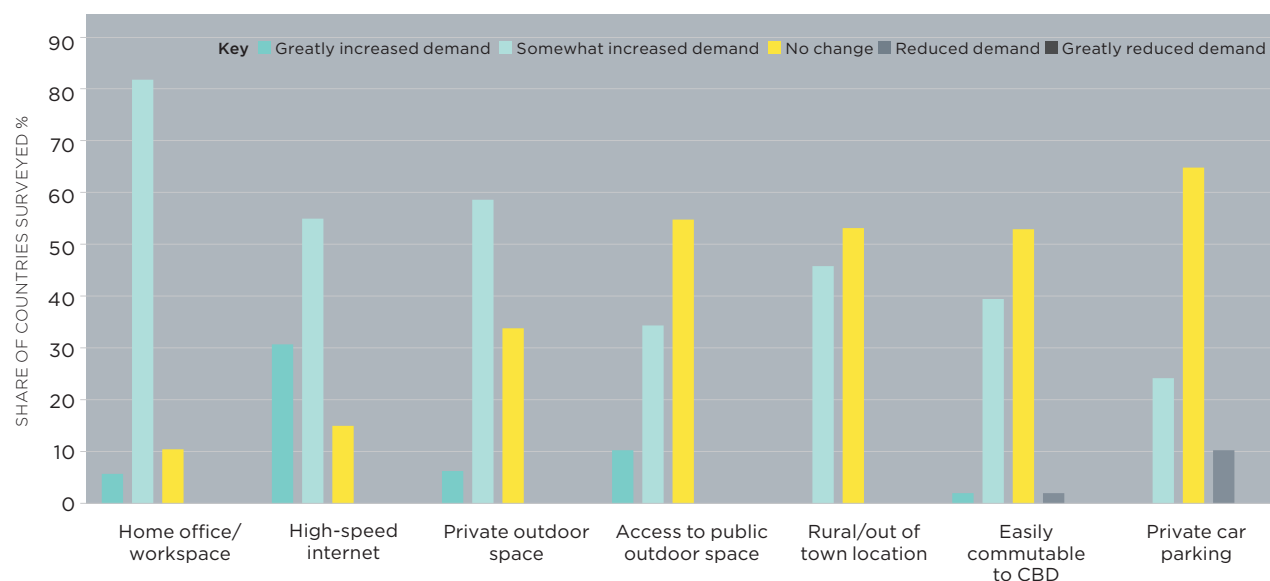
Discretionary spending patterns seem to have changed in the short run for sectors that have reopened. There are trends of a switch from international to domestic travel and a boost to domestic luxury consumption. The Government is trying to boost consumer spending by supporting sales promotions at retailers.

While no response to this unprecedented crisis is perfect, China offers an example to other states looking to ease lockdowns and encourage a return to normality. A slow lifting of restrictions, measured responses, and – most importantly – public compliance, are all critical to limiting the spread of Covid-19 while reopening economies and societies.

James Macdonald
Head of Research,
Savills China

IMPACT OF COVID-19 ON HOME FEATURES AFTER PANDEMIC HAS PASSED

Demand for home offices, high-speed internet and outdoor space is expected to increase



Source Savills Research