REAL ESTATE

Demographics key to the future of Real Estate

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For today's investor

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Introduction

Property investors have been hard-wired over the years to think solely in terms of location. However, the quality of the asset is dependent on demand dynamics and one of the key drivers of that is demographics, i.e. what is happening to an area, the kinds of people moving in and out of it and the resulting commercial and residential trends that naturally flow from these trends.

Developers and landlords are continually re-imagining traditional spaces to compel people to spend more time in them. However, seismic demographic shifts ultimately dictate long-term demand in the majority of real estate sectors and markets.

Rising life expectancy and record population levels have coincided with the greatest movement of humans in recorded history. People now travel further and more frequently than ever before.

As a result, the traditional sciences of geography and economics can no longer be relied upon solely by global real estate investors. A deep understanding of demographics, humanities and social sciences are also now required to ensure properties are fit for the future.

This paper looks at why local property investors need to think more globally about demographics and investigates how real estate is impacted by the most important factor of all: People.

Ageing world

According to the United Nations (UN), virtually every country in the world is experiencing growth in the number and proportion of older persons in their population. The UN adds that population ageing is set to become one of the most significant social trends of the twenty-first century, "with implications for nearly all sectors of society, including labour and financial markets, demand for goods and services, such as housing, transportation and social protection, as well as family structures and intergenerational ties".

The number of older people – those aged 60 and over – has increased substantially in the past decade in most countries and regions according to the UN, and is set to accelerate in the coming decades.

Between 2015 and 2030, the UN has projected that the number of people aged 60 and over will grow by 56 per cent from 901 million to 1.4 billion, and that by 2050 they will more than double in size, reaching nearly 2.1 billion.[1]

Yet research shows there are widely divergent perceptions among nations as to the severity of the issue and how it should be addressed. According to a study by Pew Research, people in Japan are very concerned with the ageing population, with over 90 per cent of respondents citing it as a concern, compared to a mere 26 per cent of people troubled by the issue in the US.[2]

The difference in attitude is easily explained. Japan's society is ageing fast and the population is now smaller than it was in 2000. By comparison, there are 16 per cent more people in the US than at the beginning of the century.

Moreover, the UN expects Japan's population to decline from a peak of over 128 million in 2010 to 127.5 million in 2017 and to just 100 million by 20653. By contrast, the population in what the UN calls the "more developed economies" will increase by around 4.5 per cent over the same period. However, other advanced economies face similar demographic pressures to Japan. For example, the UN forecasts that Portugal's population will fall by nearly 40 per cent by the end of the century, while Italy's will decline by around 17 per cent and Germany's by 13 per cent over the same time frame.[3]

Not that the problem is confined to advanced economies. The UN anticipates China's population will peak at 1.441 billion in 2030 before declining by nearly 16 per cent to 1.248 billion in 2065 and that it will have fallen by around 20 per cent to just over a billion by the end of this century.[2]

Pew Research also surveyed the public in 21 countries on who should bear responsibility for looking after the elderly: the elderly themselves, government or families. In just a few countries did a sizeable share of the public feel that the elderly bears the greatest responsibility for their own economic well-being. South Korea is the only country in which more than half (53 per cent) assigned principal responsibility to the elderly. In most countries, only about one-in-ten people responded that the primary responsibility rests with the elderly. People are more likely to say that care of the elderly is a family responsibility.[2]

However, in most countries, the public is inclined to believe that government should be responsible for the well-being of the elderly. The figure varies from 16 per cent of the population in Pakistan to 63 per cent in Russia. Perhaps, unsurprisingly, given its culture of self-reliance, just 24 per cent of Americans believe government should bear the greatest responsibility for the elderly.[2]

1. 'World Population Ageing 2015', United Nations 2015
2. 'Attitudes about Ageing; a global perspective', Pew Research, January 2014
3. 'UN World Population Prospects 2017', United Nations 2017

Healthy demand

In keeping with the “do-it-yourself” attitude towards those in retirement, the roughly 10,000 US citizens[4] entering retirement every day will result in significant demand for senior care and assisted living properties. As a result, healthcare REITs have grown in prominence in the US, constituting 11 per cent of the overall listed market by market capitalisation in 2017 compared to three per cent in 2000.[5] While supply has responded in a meaningful way over the last couple of years, the long-term demand drivers remain intact and should support industry growth for the considerable future.

Only a third of Britons believe government should be responsible for looking after the elderly and foreign investors are certainly being lured by the potential size of the market in the UK. The UK care home market has proven particularly attractive for US REITS investing in the UK, coupled with 25-30 year leases in the sector compared to the six-year average for traditional core commercial sectors. Those US REITS that are investing in the UK are focusing on formats similar to those popular in their home market, such as high-spec properties and retirement villages[6]. Investment into UK healthcare reached a record 1.917 billion in 2017, according to CBRE, and the strong growth is continuing in 2018.[7]

Japan is another country where the vast majority of people believe looking after the elderly should not simply be left to the authorities and here too the prospects for private investment appear strong. The government has implemented a number of measures to encourage the development of healthcare REITS specialising in the care of the elderly. The demand certainly appears to be there. Japanese choose to put ageing parents into specialist residential and medical facilities. Registrations for serviced housing for the elderly have leapt since 2012. Capacity had increased from only 31,000 rooms to more than 202,000 by May 2016.[8]

Figure 1. **Population aged 60 or over and aged 80 years or over for the world by development groups, regions and income groups, 2000, 2015, 2030 and 2050.**

	Persons aged 60 years or over (millions)				Percentage change		Persons aged 60 years or over (millions)			
	2000	2015	2030	2050	2015-2030	2015-2030	2000	2015	2030	2050
World	607.1	900.9	1402.4	2092.0	48.4	55.7	100.0	100.0	100.0	100.0
Development groups										
More developed regions	231.3	298.8	375.2	421.4	29.2	25.6	38.1	33.2	26.8	20.1
Less developed regions	375.7	602.1	1027.2	1670.5	60.3	70.6	61.9	66.8	73.2	79.9
Other less developed countries	341.9	550.1	938.7	1484.9	60.9	70.6	56.3	61.1	66.9	71.0
Least developed countries	33.9	52.1	88.5	185.6	53.8	70.0	5.6	5.8	6.3	8.9
Regions										
Africa	42.4	64.4	105.4	220.3	51.9	63.5	7.0	7.2	7.5	10.5
Asia	319.5	508.0	844.5	1293.7	59.0	66.3	52.6	56.4	60.2	61.8
Europe	147.3	176.5	217.2	242.0	19.8	23.1	24.3	19.6	15.5	11.6
Latin America and the Caribbean	42.7	70.9	121.0	200.0	66.1	70.6	7.0	7.9	8.6	9.6
Oceania	4.1	6.5	9.6	13.2	56.2	47.4	0.7	0.7	0.7	0.6
Northern America	51.0	74.6	104.8	122.7	46.4	40.5	8.4	8.3	7.5	5.9
Income groups										
High-income countries	230.8	309.7	408.9	483.1	34.2	32.0	38.0	34.4	29.2	23.1
Upper-middle-income countries	195.2	320.2	544.9	800.6	64.0	70.2	32.1	35.5	38.9	38.3
Lower-middle-income countries	159.7	237.5	393.9	692.5	48.8	65.9	26.3	26.4	28.1	33.1
Low-income countries	21.2	33.2	54.0	114.8	56.2	63.0	3.5	3.7	3.9	5.5

Source: UN World Population Ageing 2015

4. ‘10,000 boomers retiring every day’, CNBC, October 2017
5. ‘REITWatch’, National Association of Real Estate Investment Trusts, October 2017
6. ‘UK care homes lure US Reits’ Financial Times, June 2014
7. ‘Healthcare strong investment growth’, Property Week, June 2018
8. ‘Strong demand in Japan’, IPE Real Assets, February 2017

Housing: migration forces driving rental growth

The fact people are on the move is nothing new. It is the scale and velocity that has intensified. Between 1990 and 2017, the number of international migrants worldwide rose by over 105 million, or by 69 per cent. Most of this increase occurred from 2005 to 2017, when some 5.6 million migrants were added annually, compared to an average of 2.5 million from 1990 to 2005, according to the UN.

The UN adds that there are currently 258 million international migrants worldwide, and between the period 2000 and 2015 net migration accounted for 42 per cent of North American population growth. Were it not for net migration in Europe, population growth would have been negative rather than the two per cent growth recorded over the period.[9]

According to Eurostat, 4.32 million people migrated to European member states during 2016 and only three million were reported to have left. Germany reported the largest amount of net immigration at roughly 500,000 people with the United Kingdom a distant second with roughly half that number of immigrants. There are currently 22 million non-EU citizens living in the EU.[10]

The UN forecasts that between 2015 and 2050, the top net receivers of international migrants (more than 100,000 annually) will be the US, Germany, Canada, the United Kingdom, Australia and the Russian Federation. The countries projected to be net senders of more than 100,000 migrants annually include India, Bangladesh, China, Pakistan, and Indonesia.[9]

As migrants arrive at their new destination they have a significantly higher propensity to rent accommodation than to buy property from the outset, fuelling rental growth. Moreover, low levels of residential construction are fuelling rental growth just as demand, partly driven by migration, is increasing. In Europe, for example, there has been a major reduction in construction activity in a number of countries since 2000, with the global financial crisis playing a particularly significant curbing role in countries that had previously experienced a prolonged boom, according to the European Federation of Public, Cooperative & Social Housing. Residential construction as a share of GDP is currently just over half than its 2006 level, and construction is recovering much more slowly than house price growth.[11]

9. 'International Migration Report 2017', UN 2017
10 'EU migration explained' Eurostat, March 2018
11 'Housing in the EU' Housing Europe, October 2017

Various European countries are experiencing a shortfall in new housing supply compared to demand as a result of increasing household formation and demographic change. Moreover, across European countries there are significant housing shortages in attractive urban areas due to rural-urban migration.

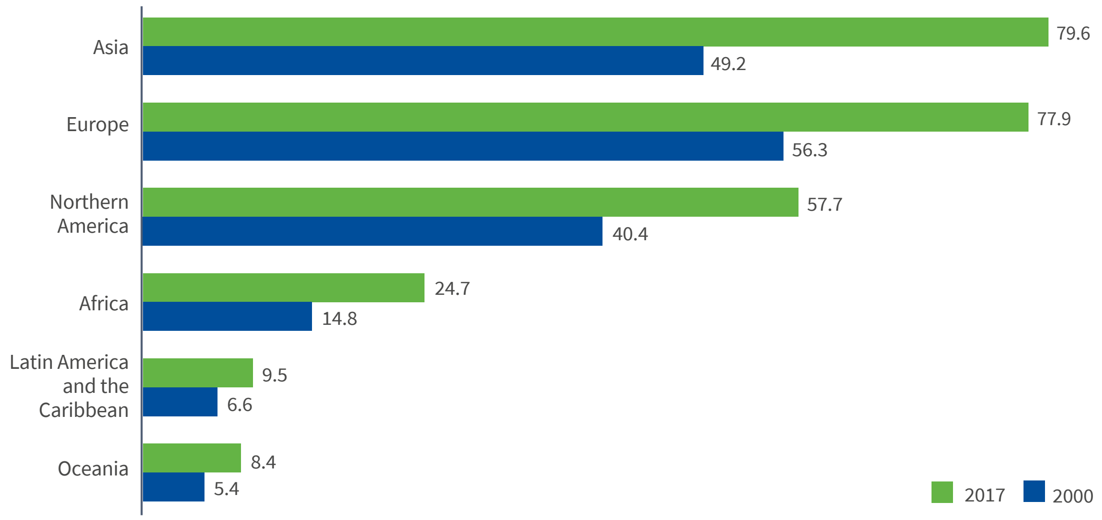
In Germany, for example, there is a growing housing shortage in major urban areas and a number of towns because housing construction has failed to keep pace with population growth in metropolitan areas and in university cities over the past decade, according to the European Federation of Public, Cooperative & Social Housing. In 2016 around 290,000 new dwellings were built, an increase of 130,000 units compared to 2010. But new construction still falls short compared to the estimated need for 400,000 new dwellings per year and the shortage of social/ affordable housing is particularly acute.[11]

Most people in Europe are owner-occupiers with 69.4 per cent of the population living in owner-occupied housing against 30.6 per cent who are tenants although there are significant variations across the continent. Only in Switzerland and Germany is renting more common than owning. However, a number of countries have seen rates of home ownership fall since the beginning of the century. The global financial crisis is partly responsible but increasing house prices and worsening affordability prior to the global financial crisis have also played a role.[11]

Growing demand, coupled with a significant supply shortage, means rental growth prospects continue to be robust in both the UK and Germany and many other European countries.

Furthermore, millennials in the US have demonstrated a preference to rent over owning their properties, reflecting their modus operandi in the "gig-economy", and have fuelled robust growth in multi-family property demand over the last decade. As household formation takes shape and families start to grow, single-family home rentals are likely to be the next beneficiary with the wave of millennials entering the next stage in their life-cycle.

Figure 2. **Number of international migrants (millions) by region of destination, 2000 and 2017**



Source: UN International Migration Report 2017

Hotels: Japan's tourism boom

Technological advancements in the fields of aeronautics and transport have led to a boom in international travel. The relative ease, safety and affordability with which people can travel today means demand for travel seems insatiable.

Japan, in particular, has benefited from a rapid increase in inbound tourism. Considered for many years as expensive, remotely located and difficult to enter, the number of tourists visiting Japan has increased from 4.757 million in 2000 to 28.691 million in 2017.[12] Various factors have contributed to Japan's growth as a tourist destination. The weakness of the Japanese yen, the rise of budget airlines flying to and from Japan, as well as the easing of visa restrictions for visitors from China and other developing Asian countries means Japan is the fastest-growing destination for global tourism.

Having originally hoped to welcome 20 million visitors per year by 2020, the Japanese Tourism Board doubled its target to 40 million after surpassing its objective in 2016.[13 & 14] The outlook for continued growth looks promising with the impending Rugby World Cup taking place in 2019 followed by the Tokyo Olympics in 2020.

To support further growth in overseas tourists to 60 million by 2030, the government is considering or implementing further reforms including: legalizing casinos; further relaxing visa requirements and repairing and maintaining some 200 cultural assets across Japan; while multi-language services are also being implemented.[15]

The tourism boom has already had a significant impact on the economy. Travel and tourism contributed 6.8 per cent of GDP in 2017, a figure expected to rise to 7.4 per cent of GDP in 2018[16] and up from 5 per cent in 2012.[17]

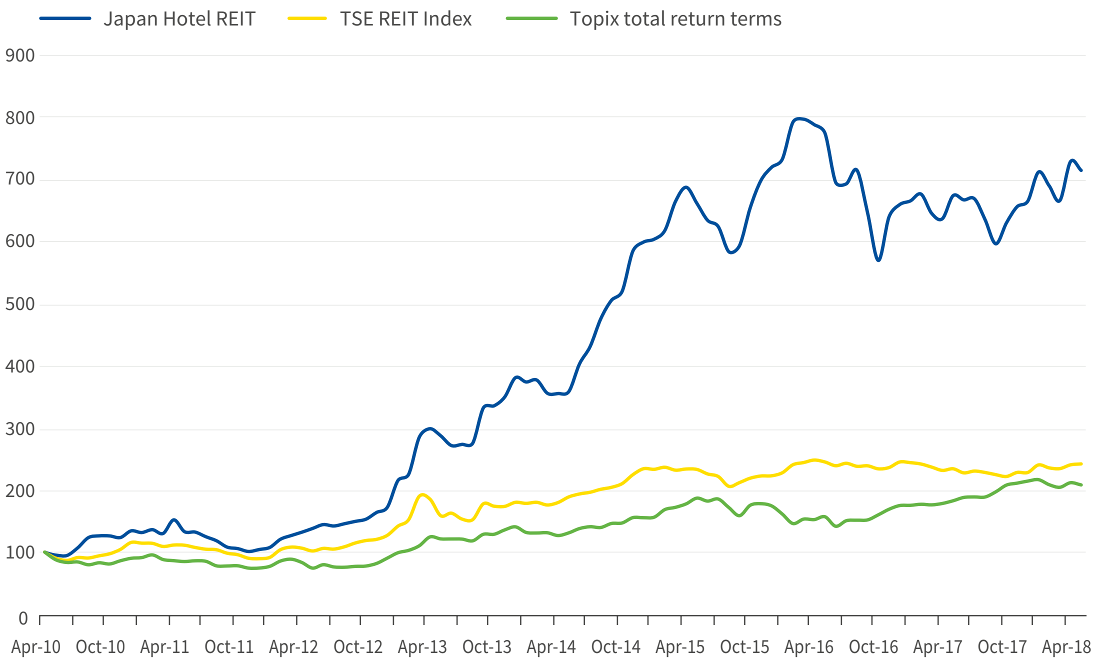
12 'International tourism arrivals', World Bank, August 2018
13 'Japan tourism statistics', Japan Tourism Research & consulting Co., July 2018
14 'Japan tourist target', Japan Times, March 2016
15 'Investors taking note of tourism boom' JLL Capital markets, May 2018
16 'Economic impact of tourism on Japan', World Travel & Tourism Council, 2018
17 'Record tourism to Japan', CNBC, January 2015

The surge in tourist numbers is also having a considerable impact on the real estate sector. In particular there has been a boom in the construction of new hotels and a huge surge in the supply of lodging is expected to come onto the market in 2018 and beyond. The number of hotels could increase by 20 per cent in some cities in the next few years. However, Japan's existing tourism infrastructure is inadequate and new hotels are needed to replace ageing lodging stock both at the budget and the premium level. The projected strong growth in inbound tourism numbers further suggests the outlook for the hotel sector remains positive.[18]

The buoyant tourism sector has attracted the attention of foreign hotel chains as well as domestic players with the likes of Marriot, Hilton and Hyatt of the US and the UK's InterContinental Group expanding in the country.[19]

Japan's largest hotel REIT, Japan hotel REIT, has benefitted from the increase in inbound tourism. The REIT has grown its dividend distributions by 20.88 per cent at a compound annual growth rate over the last five years and has significantly outperformed the Japanese REIT and Equity markets over the period.

Figure 3. **Japan Hotel REIT outperforms**



Source: Aviva Investors, August 2018

Past performance is not a guide to future returns

18 'Spotlight Japan Hospitality', Savills World Research Japan, February 2018
19 'Foreign hotel chains eye Japan', Asian Nikkei Review, January 2018

Beware the risks

So far we have largely focused on the positive impact of demographic forces on real estate fundamentals. However, investors must also consider the increased risks – both immediate and longer term.

The most apparent current risk is the invariable timing mismatch between long-term demographic changes and a near-term supply response. As the wave of millennials and baby boomers move through their life-cycles over many years, supply can lead to a near-term glut of space in response to anticipated demand. This can be seen in the US where new senior and skilled nursing facilities currently outpace expected demand over the next 12-24 months and as a result expected Net Operating Income growth is likely to be subdued in the near term.

At the other end of the spectrum, short-term spikes in tourism demand may spur a supply response in the form of new hotel construction projects. And while bookings are typically made only days or weeks prior to arrival, landlords and developers must forecast demand for rooms months and years in advance. Further compounding the issue are the rise in home-sharing services such as Airbnb which make it difficult to measure the full extent of shadow-supply at any point in time.

Finally, while changing demographics and social preferences are spurring demand in sectors such as healthcare, housing and hotels, it is also apparent some sectors will see a decrease in demand in the future.

A decline in the number of workers per retiree, for example, could spur a decline in demand for office space, shops and factories. Globally, the ratio of the number of workers to each retiree is expected to fall from around eight currently to just four by the year 2050. Ratios for individual countries vary widely, but the overall trend is clear.[20] Technological developments such as automation and artificial intelligence will also play a key role.

Consider the impact of an ageing population on the retail sector, for example. According to a study by KPMG, the rising influence of older shoppers could see sales shift towards the categories and methods of shopping that they favour. So "health, DIY and home maintenance retailers, which attract a large share of elderly households' budgets, should benefit from this change, whereas retailers selling clothing, beer and soft drinks, which are geared towards a more youthful market, could lose out", concludes KPMG.[21]

Of all the variables real estate investors factor in when assessing the long-term viability of their assets we feel that one stands out clearly above the rest: People. If real estate investors keep their eyes firmly focused on the demographic trends shaping the world around us then they should find their portfolios stand the test of time as well.

20 'Ratio of workers to retirees declines globally', Yale University, December 2015
21 'UK demographic trends and retailing' KPMG/ Retail Think Tank, August 2013

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