

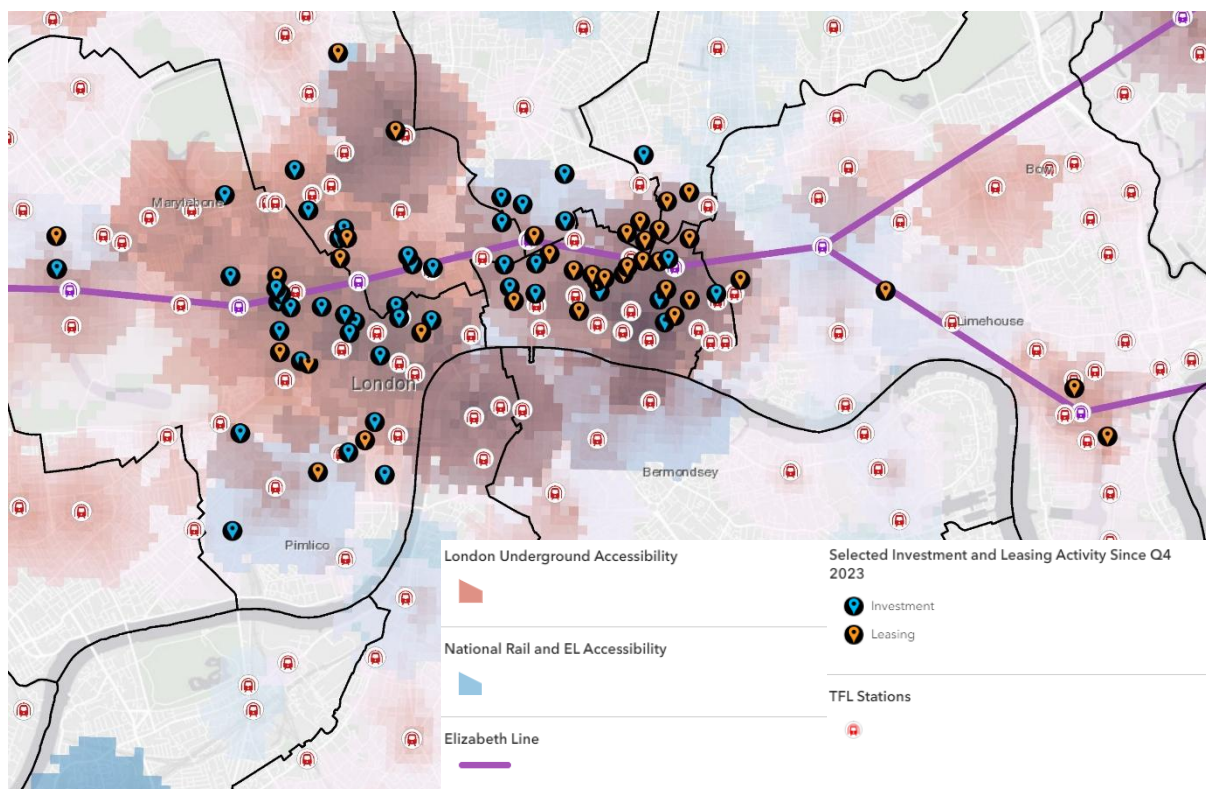
## 7 MINUTES IN TRANSIT

We recently came across a [mention of a report](#) from Goldman Sachs's Tokyo office discussing how office market vacancy rates in Japan's capital fluctuate based on closeness to transit stops. This report highlights a significant trend: connectivity to public transit is gaining prominence as a way for in-person companies to compete for talent. In Japan's relatively loose labour market, workers are empowered to split hairs as they choose which companies they'd like to work for. One way this materialises is in commutes, where a difference of even a few minutes can become a deciding factor in whether to accept a job.

In this sense, office placement is a key value driver for Japanese companies. This trend is not only relevant to Tokyo, but also to other cities with public transit infrastructure – including London, which has one of the world's largest commuter rail networks.

As a result of its size, London's economy draws in commuters from both within the city limits who use the London Underground Network, as well as people who live further afield, who are more likely to use the National Rail Network to commute into the city. Like the denizens of other cities, Londoners have highlighted the cost of commuting as a key hindrance to working in the office. A survey by the Centre for Cities found that 42% of London workers cited the cost of travel as a benefit of working from home, while only 17% of workers reported not liking the office itself. This suggests that businesses seeking in-office attendance would do well to recognise the growing sensitivity to the time and money required for a daily commute, and one way they are doing so is by selecting micro-locations with excellent access to public transportation networks.

Figure 1: London office market activity and transit accessibility<sup>1</sup>



<sup>1</sup> Castleforge analysis based on data from TFL and Doogal

One way we can observe this trend is by mapping recent office deals with Transport for London’s Public Transport Accessibility Level (PTAL) scores. PTAL scores rate locations based on their accessibility to public transport services. The PTAL score considers factors like the distance to the nearest public transport stops and the frequency of services at those stops. In the above map, areas with good access to the Tube are shaded in red, while areas with good access to National Rail (including the Elizabeth Line) are shaded in blue. By overlapping these layers, we can identify places that have the best access to commuter services, which are shaded most darkly. By viewing major office transactions from the past year onto the map, we see a correlation between easily accessible areas and office market activity.

Data from CoStar, released last year, finds a similar connection. Areas that are a short walk away from major train stations such as Euston and Paddington have outperformed the rest of the Central London office market. These well-connected zones have vacancy rates 200 basis points below average, and their rents have grown over the past two years, while rents in the rest of Central London have stagnated.<sup>2</sup>

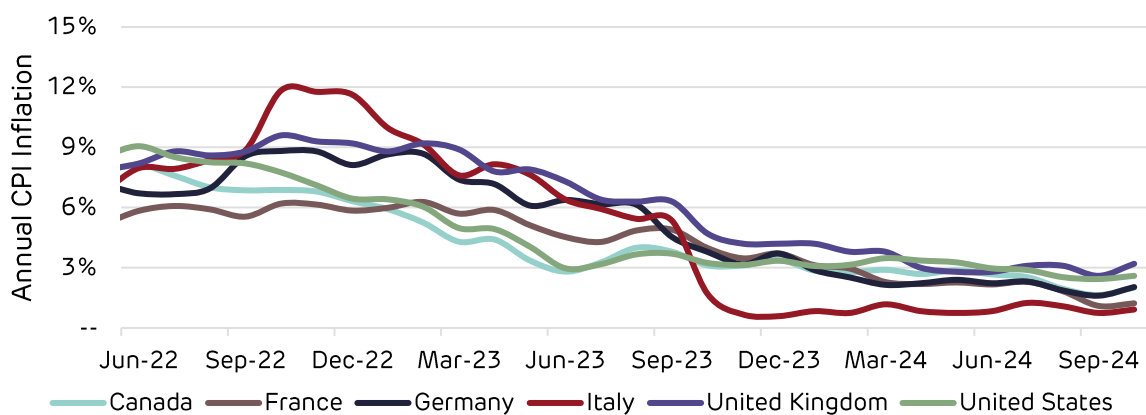
Both employees and employers benefit from a well-connected office. Having an office near a transit stop saves employees time and money. From an employer’s perspective, locating an office in an accessible area raises the number of workers who could reasonably commute in, thereby raising the number of potential employees available for hire. For example, TFL data shows that roughly 1 million people live within 30 minutes of Liverpool Street Station, but only around 750,000 people live within 30 minutes of Paddington.

As more employees return to in-person work in the capital, occupiers have an opportune moment to acquire best-in-class space with convenient links to the Greater London Area at a discount before office values fully recover.

### (STILL) STUMBLING TOWARDS EQUILIBRIUM<sup>3</sup>

Over the past year, major global economies (with the exception of Canada) have made admirable progress in taming inflation without dramatically spiking unemployment. In the last few quarters, we’ve seen the central banks of the UK, EU, and US begin to finally loosen monetary policy after a long period of restriction, and the focus has finally shifted to how many cuts are expected.

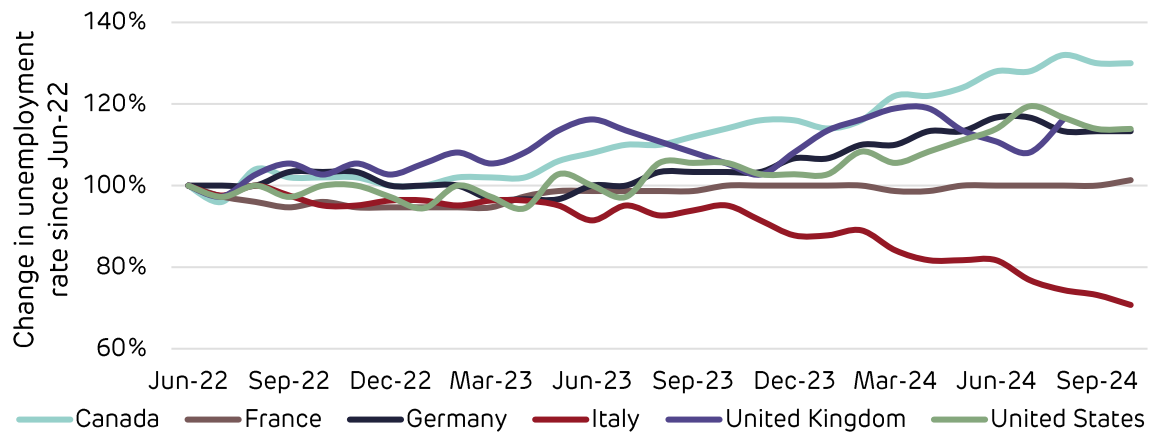
Figure 2: Sometimes you really can have your cake...



<sup>2</sup> CoStar via CityAM

<sup>3</sup> Astute readers will recognise this title as a reference to our January letter last year.

Figure 3: ... and eat it, too<sup>4</sup>



While it may seem like the path to normalcy is ahead of us, recent political events could abruptly end or even reverse the pace of rate cuts. The global economy seems primed for international trade conflict as President Donald Trump returns to the Oval Office with a vendetta against trading arrangements he deems unfair to the US. A highest-case universal tariff could raise US CPI by as much as 2.2 percentage points by the end of 2025, putting a damper on the progress reducing inflation so far.<sup>5</sup> Other countries could respond in kind, raising the cost of international business globally. Moreover, the widespread deportation of undocumented immigrants, if accomplished, could raise the cost of goods and wages, further inflating the American economy and potentially destabilising other countries in Central and South America.

These trends suggest that the last few steps toward steady 2% inflation may be elusive, and we may expect to see central banks pare down their rate cut expectations soon.

Yet, there are some reasons to expect the needle to point the other way. Pledges to cut spending from the US and UK in the face of rising government debt levels could prove to be disinflationary, as could the newly proposed Department of Government Efficiency’s (DOGE) pledge to drastically reduce the size of the US federal workforce.

These conflicting trends point to an uncertainty over the global neutral rate of interest, or  $R^*$ .<sup>6</sup> Economists seem to have trouble agreeing on where the figure is going. Among seven commonly used estimates, two measured  $R^*$  as having risen since 2018, two measured it as having fallen, and three showed no change.<sup>7</sup>

As for the Federal Reserve, they seem to believe that the neutral rate is ticking upward, as evidenced by the gradual rise of their longer run interest rate predictions. The median longer run rate expectation grew from 2.5% in December 2023 to 3.0% last month, but, notably, the volatility implied in the spread of expectations has increased over the past year.

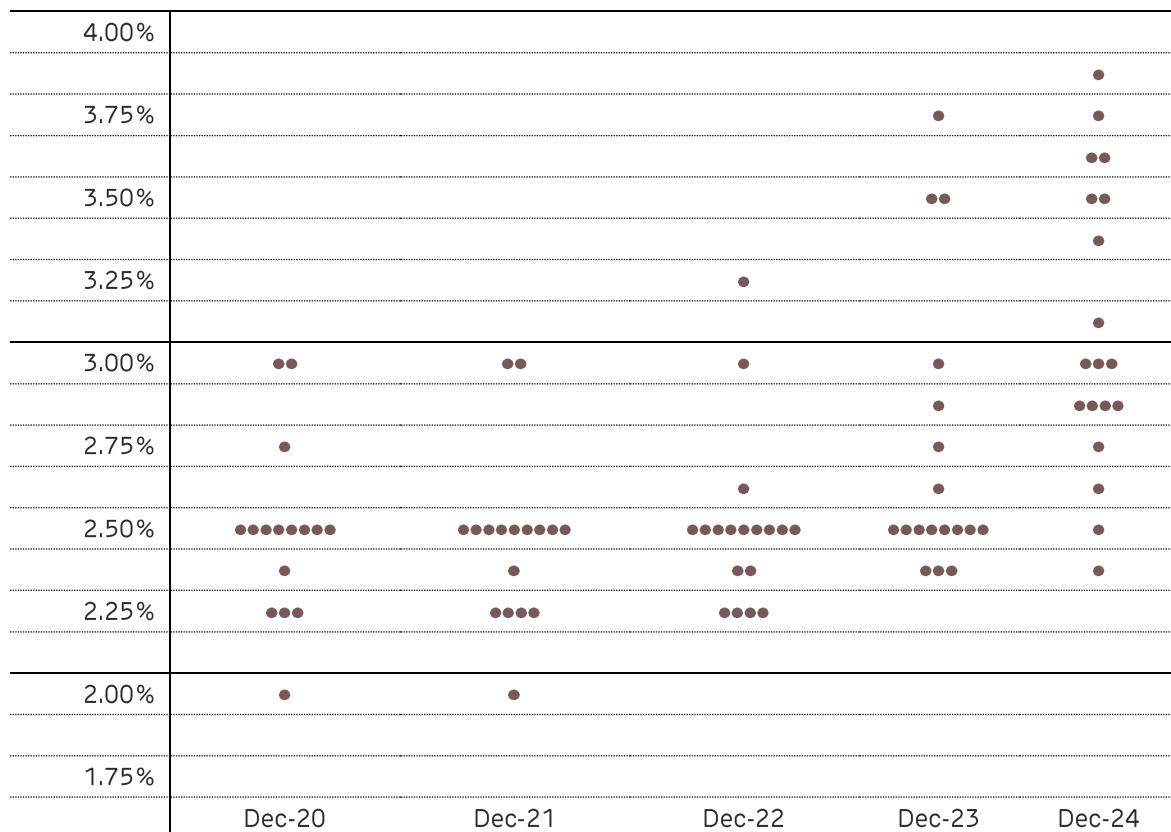
<sup>4</sup> OECD

<sup>5</sup> Pantheon Macroeconomics

<sup>6</sup> According to JPMorgan, the neutral rate of interest is, “the real interest rate that is neither expansionary nor contractionary when the economy is at full employment.”

<sup>7</sup> Goldman Sachs

Figure 4: FOMC longer run federal funds rate expectations<sup>8</sup>



The global macroeconomic outlook therefore remains somewhat unclear despite many investors’ desires to see a return to lower borrowing costs. We think this uncertainty (along with factors such as demographics and the green transition) will ultimately prevent the next equilibrium from resembling the one seen after the Global Financial Crisis in 2008, and investors would do well to remember just how rare zero-interest rate eras are. Analysis by Bank of America shows that global interest rates have only hovered around zero for three periods in the past 5000 years: during the Great Depression, after the 2008 Financial crisis, and during covid. This historical context underscores the exceptional nature of the current economic environment and the high likelihood that new strategies will have to be developed as conditions continue to evolve. Whether we’re right or wrong about that, what seems clear is that the path toward reaching that equilibrium may not be direct, with major institutions continuing to stumble onwards.

### NOT ALL DOOM AND GLOOM: GATEWAY CITY RECOVERY SINCE COVID

When cases of a mysterious illness called “the novel coronavirus” started spreading around the world half a decade ago, there was much concern over the future of cities. Almost overnight, gateway cities emptied out as citizens were asked to cut back on nonessential travel, turning bustling hotspots like Times Square and Shinjuku into shells of their ordinary selves. Density and connectedness are the defining characteristics of gateway cities, but in the early days of the pandemic, we saw how these qualities could quickly become detrimental and even dangerous.

<sup>8</sup> Federal Reserve. Notes: Each dot represents the opinion of a single FOMC member at the time of the survey. Longer run predictions refer those with a horizon of over three years.

As people locked down, masked up, and logged in to remote work, predictions abounded about what the pandemic meant for the future of cities. One of the most influential hypotheses came from real estate economist Dr. Stijn van Nieuwerburgh, who predicted that migration away from cities and declining real estate values could kickstart a vicious cycle of urban decline, which he termed a “[doom loop](#)”.

The idea of an empty city seemed plausible. London’s population began to fall for the first time in years when an estimated 76,000 people left the city between 2019 and 2021.<sup>9</sup> Large cities in the US, such as New York, Los Angeles, and Chicago, lost on average 182,000 residents between 2020 and 2022.<sup>10</sup> Paris faced a more drastic emigration, with over 1 million people estimated to have left the Greater Paris region for the provinces during the first lockdown.<sup>11</sup>

Just as the migration of people set off alarm bells, so too did the relocation of businesses. In the tech world, companies like Oracle and Tesla moved out of the Bay Area. Similarly, large finance companies, which were traditionally based in NYC, expanded to cities like Miami in defiance of longstanding norms. Examples include Citadel, Point72, and Blackstone. The trend was less pronounced in the UK due to the primacy of London, but there was nonetheless concern as some companies shifted operations to secondary cities such as Bristol and Manchester during the pandemic.

During the depths of the lockdown, it seemed reasonable to question whether the exodus of people and companies from gateway cities would be permanent. However, the novel coronavirus is not so novel anymore, and over the years, we’ve seen ample evidence that the changes were not as drastic as initially thought. Gateway cities have quickly bounced back to full strength.

Take populations, for example. Preliminary estimates suggest that London’s population has grown back to pre-pandemic levels and is likely to continue growing.<sup>12</sup> Similarly, almost all of America’s largest cities have more residents today than they did before covid.<sup>13</sup> Immigration undoubtedly plays a large role in this trend, with advanced economies seeing record levels of migration over the past few years to compensate for low birthrates and slower population growth. Gateway cities attract workers from around the world due to their abundance of job opportunities and connectivity to other regions.

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<sup>9</sup> Centre for Cities

<sup>10</sup> Brookings

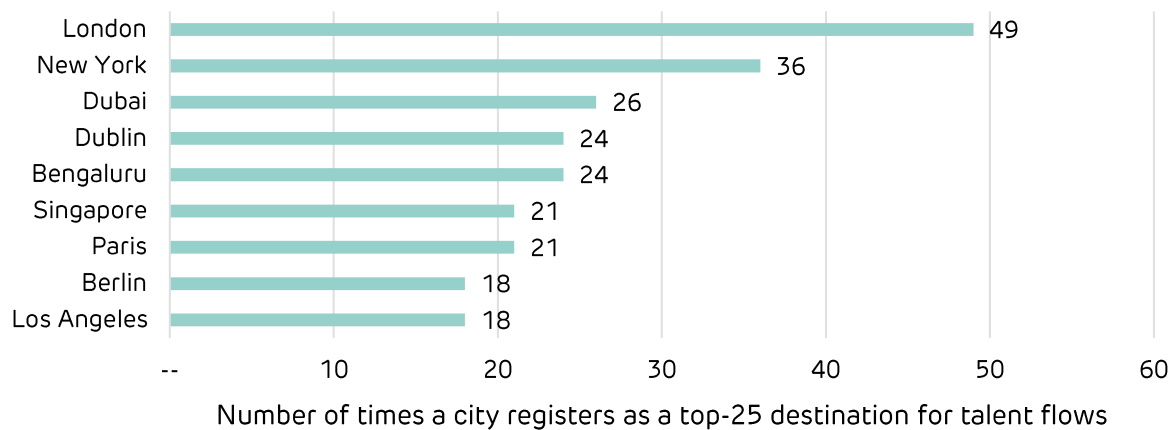
<sup>11</sup> The Economist

<sup>12</sup> London Datastore

<sup>13</sup> Bloomberg



Figure 5: Ranking global cities by talent flows<sup>14</sup>



Similarly, while upstart cities like Miami and Austin continue to be viable alternatives to traditional economic centres, it'd be premature to say that Miami's Brickell is ready to replace New York's FiDi. As for AI, while high-profile corporate relocations to Austin made waves, San Francisco and New York still account for a quarter of all US-based AI job postings.<sup>15</sup> Instead of being a zero-sum decision, large companies seem to use digital working tools to straddle operations between traditional and new centres of business. Consider Citadel as an example. While the hedge fund has been [vocal](#) about its move to Miami, it is also building a new tower on Park Avenue and leasing 250,000 square feet in Broadgate.

Urban planners Richard Florida, Vladislav Boutenko, Antoine Vetrano, and Sara Saloo discuss the complicated growth of gateway cities in their work [The Rise of the Meta City](#). The authors discuss how digital tools enable companies and workforces to, "share economic and social functions" across large geographic areas, ultimately finding that the business landscape of gateway cities has been defined more by expansion than by exodus. Places like London are therefore not losing out to regional cities but could instead be viewed as growing their reach to new satellite regions, creating more expansive networks of exchange.

Covid lockdowns will have certainly accelerated a number of trends that were already happening such as hybrid work, but it's very unlikely that covid alone will reverse any trends so powerful as benefits to agglomeration that large cities have to offer. To give our readers a sense of just how unique and strange an event covid lockdowns and restrictions were (some might argue an *overreaction*), the following example is illustrative. The oldest village fair in the UK is in Reach, Cambridgeshire, about 70 miles from London. It has been operational since the year 1201, and in those 800+ years only closed for four of them: twice during the English Civil War in the 17th Century, and twice in 2020 and 2021 due to covid restrictions.<sup>16</sup> The 800-year constancy of the Reach Fair throughout the Barons' War, Great Famine, the Black Death, the War of the Roses, the 17th Century Plague, the Spanish Flu and the Blitz – and yet not during Covid-19 – is thought-provoking. It might seem to us that the pandemic's perceived impact and actual impact were/will be on par, given the human susceptibility to recency bias. But in fact, the actual impact of covid lockdowns could fall well short of its perceived impact reported on by the Doom Loopers in the heat of the moment.

<sup>14</sup> Harvard Business Review

<sup>15</sup> Brookings

<sup>16</sup> Cambridge News

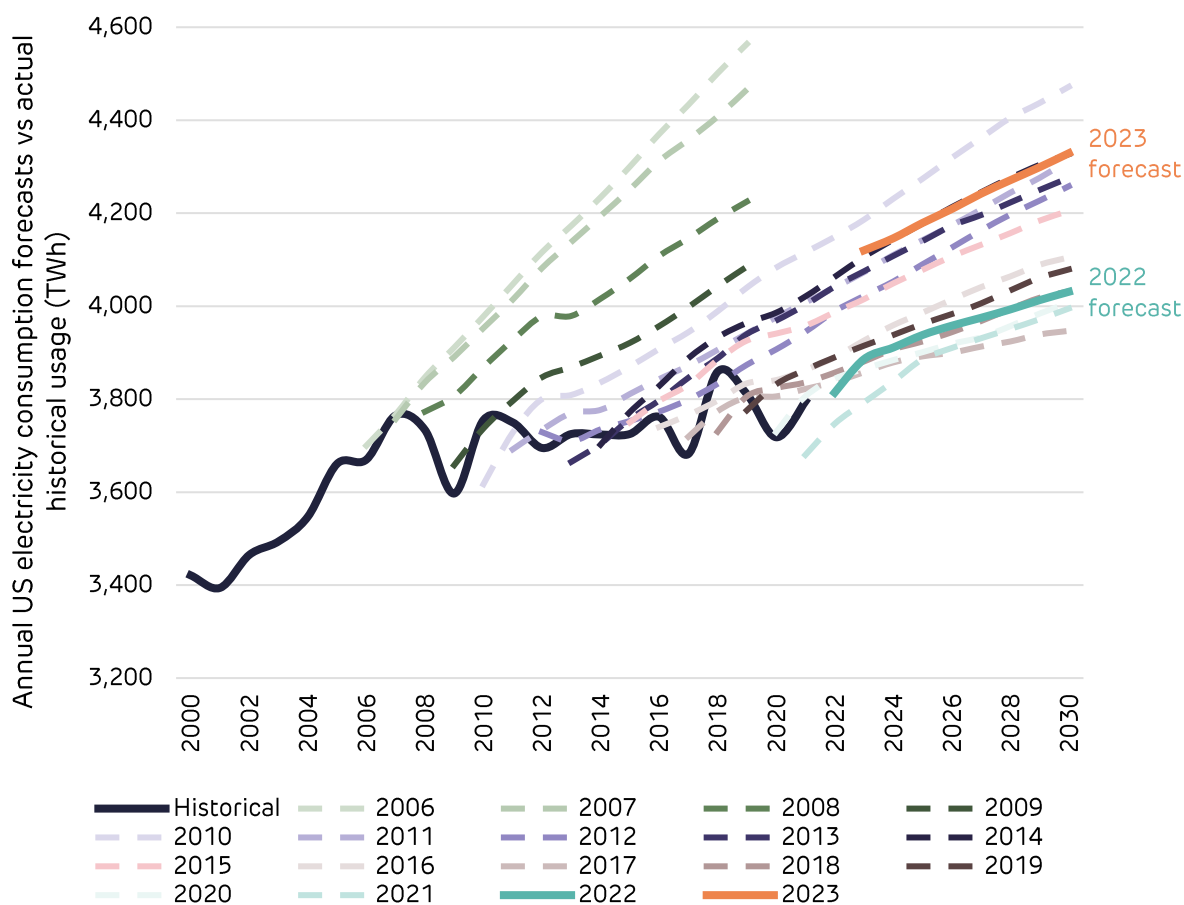
As we continue to gather data, we can expect to better understand how the covid pandemic changed urban landscapes around the world. Despite the many shifts experienced over the past five years, the appeal of gateway cities remains strong. Connectivity and density will continue to make these places desirable places to work, visit, and live in, which bodes well for the many types of real estate needed to sustain them.

## A SHOCKING TURNAROUND

Jaws was on TV the other night here in the UK, which of course brought Mike back to his teenage years watching syndicated movies on TBS. In one of the movie’s most memorable scenes, the audience gets a first look at the shark as Roy Scheider is casually chumming the waters. Having realised that the monster is a lot larger than once expected, he backs into the cabin of the small Orca, he mumbles to Robert Shaw [“You’re gonna need a bigger boat.”](#)

It got Mike thinking about a graph he had seen recently, about power demand projections for developed countries. It looked a lot like the “hairy charts” he had seen on interest rate forecasts, and drove home the idea that the world had been operating under one set of assumptions for the past 10-15 years, but that it is quite possible a new set will be needed or the next 10-15 years.

Figure 6: Energy forecasters are the new economists<sup>17</sup>

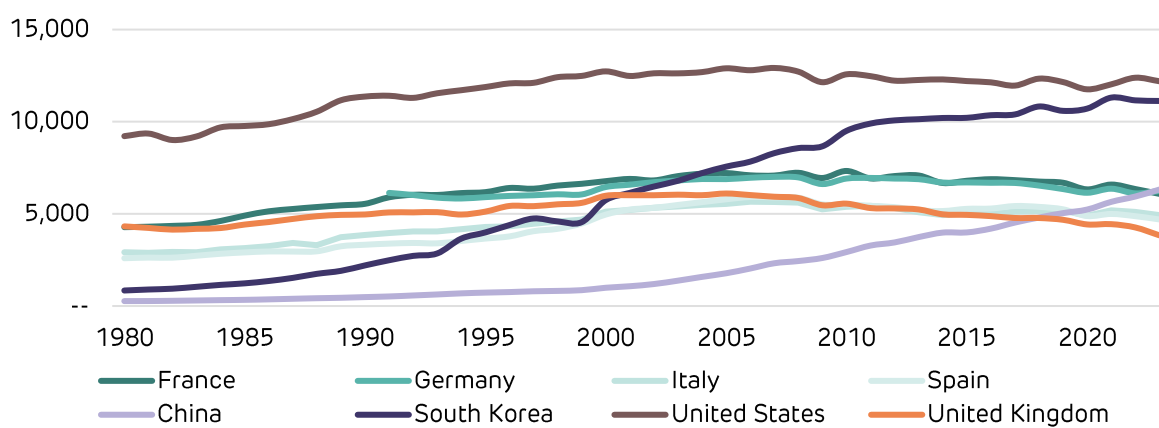


<sup>17</sup> S&P Global

Indeed, one of the key themes identified in a recent Bank of America report on thematic investing for 2030 was “More! Exponential growth of tech requiring more resources like infrastructure, compute, bandwidth, human capital, energy, water, skills and data centres.” There seems to have been this idea in the first two decades of the 21st Century that because developed countries were ageing, and because an ageing society leads to deficiencies in aggregate demand (actually not necessarily true, in any event), maybe we wouldn’t actually need to continue to re-invest into the developed world’s ageing infrastructure. After all, who would the developed world be capexing for, anyhow? Well, times have changed, and nowhere does it seem likely more apparent than in the world of energy and power.

Reflecting on one’s power usage over time reveals an intriguing paradox. Despite individuals having more gadgets than ever and widespread electrification of services like heating and transportation, aggregate electricity usage in many western economies has stagnated or even fallen.

Figure 7: Per capita electricity consumption since 1980<sup>18</sup>



Per-capita electricity usage in Europe, the UK, and the US peaked just before 2008 in spite of these countries’ wealthy populations having first access to cutting-edge innovations like electric vehicles and the internet over the years. This unexpected trend may be partly due to better efficiency in home appliances. Between 1980 and 2023, for example, electric ovens and fridges became 73% and 15% more efficient, respectively.<sup>19</sup> Lighting fixtures likely improved even more with the development of highly efficient LED technology.

However, the more likely culprit for falling national electricity usage might be related to deindustrialisation, which saw the UK offshore much of its manufacturing capacity to East Asia as the economy shifted to favour the service sector. Industrial energy consumption is estimated to have fallen by over 60% since 1970.<sup>20</sup> Manufacturing capacity in East Asia (especially China) grew during this same period, and in turn pushed the region’s energy use toward European levels.

At the time, offshoring industrial capacity seemed like an ideal way for countries like the UK to both develop jobs in the knowledge economy and demonstrate progress toward climate goals. However, the lack of electricity consumption may have also limited demand for expansion of the grid, which has become increasingly strained over the past few decades. As we’ve mentioned in an [earlier letter](#), the UK’s large power transformers tend to be in operation decades beyond their rated lifespans, hampering the grid’s ability to provide more power for the places that needed it. The country also

<sup>18</sup> EIA, World Bank

<sup>19</sup> DESNZ

<sup>20</sup> DESNZ



underspends on transmission system improvement, with only 25p invested in the grid for every £1 spent on increasing generation.<sup>21</sup>

Today, the UK has the potential to see a quick reversal on electricity demand. We've [repeatedly harped](#) on the potential for data centres to draw immense amounts of power – for both AI and non-AI related digital tasks. Beyond that, significant electricity demand could also come from EVs, heat pumps, and reindustrialisation. In some ways, looking at the growth of these new technologies makes us feel like Roy Scheider peering out the back of that fishing boat, realising the scale of the challenge facing us might be larger than expected. After years of underinvestment in power infrastructure, countries like the UK might find that it is impossible to ignore the issue if they want to stay ahead.

You're gonna need a bigger power grid.



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<sup>21</sup> Bloomberg NEF