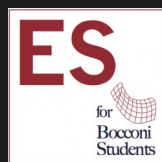




A TALE OF TWO CITIES



INTRODUCTION

The Covid-19 pandemic has been, for the economy and society, an exogenous shock of undeniable impact. In particular, the labor market has been undergoing over the last three years structural changes that are shaping how people are going to work in the future.

The here-to-stay **surge in remote working**, which had failed to spread significantly before despite the availability or viable technology supporting it, is the most **evident product of the pandemic shock**.

As a consequence of remote working, many American CBDs (central business districts) have lost vitality and dynamism. Given that -since Marshall's times- the productivity of workers is usually considered to be enhanced by the set of interactions they can have with colleagues at the office, with other workers in the city, and across businesses, the **welfare effects** of the shift towards remote working, especially at non-managerial level, may become **worrying in the medium run**.

In light of this, it can become quite difficult to still consider congested cities like New York and San Francisco as one of humankind's greatest inventions, which make us "richer, smarter, and happier" by fostering innovation and creativity, as Professor Edward Glaeser (Harvard) used to argue in much more positivist times in his 'Triumph of the City'.

It is becoming also difficult to see what Professor Enrico Moretti (UC Berkeley) used to see a decade ago in his 'The New Geography of Jobs': the clusterization of top brain talent in a few dynamic centers like San Jose seems to have stopped, if not reversed.

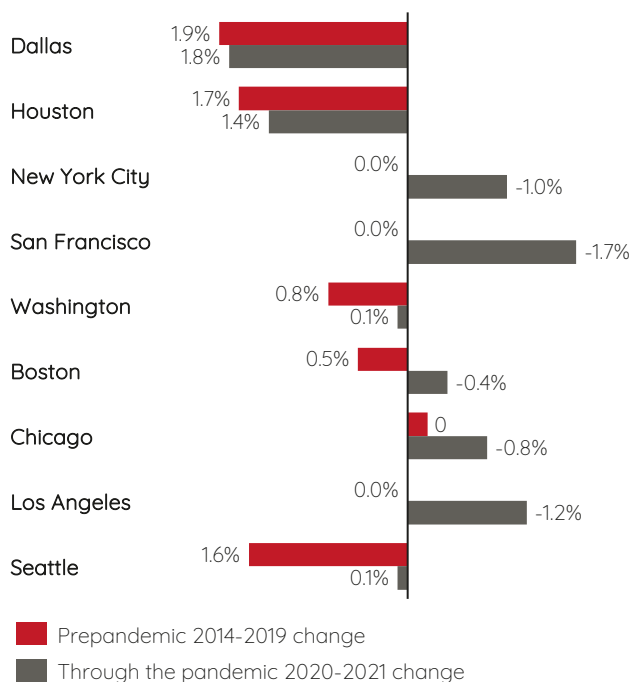
At the moment, according to new research, the effect of Covid on the basic organization of work within cities does not seem to be the same everywhere: while **bigger cities** appear on average **incapable of going back to pre-pandemic levels** of business activity and instead appear stuck in an emptier and more forlorn new state, **smaller CBDs** seem to **have restored the original vibrancy** despite the negative short-term impact of Covid.

.Why is this the case? What is the underlying economic mechanism leading to such a differential behavior in bigger versus smaller CBDs?

The recently published 'Remote Work and City Structure' academic paper by Ferdinando Monte (Georgetown) et al., featured in the Financial Times' article 'Big US city downtowns "stuck" behind smaller rivals in pandemic recovery', tries to disentangle this by combining both a theoretical model with some supporting empirical evidence.

Big cities such as New York are characterized by what Monte et al. recognize as **multiple stationary equilibria**, where the old pre-pandemic equilibrium will never be reached once again. With new priorities in mind that the pandemic made them conscious of, and thanks to the remote working possibility, as well as the hot four-day week, **many professionals are fleeing the city in search of more affordable, more livable, and less congested alternatives in the surroundings**.

Exhibit 1: Population growth per year in the U.S., %



Source: "Empty spaces and hybrid places: The pandemic's lasting impact on real estate", McKinsey Global Institute (2023)

Are such phenomena confined to the United States, whose labor market has historically always been more flexible than the European and whose high degree of innovation has made them pioneer of many economic and social trends, or do they characterize also the Old Continent (and in particular our beloved country, Italy)?

As underlined by McKinsey, in many U.S. cities, the trend of suburbanization was already underway and was further expedited by the pandemic. In contrast, among the European cities we examined, except for Paris and Munich, the prevailing trend had been urbanization prior to the pandemic. Therefore, the **shift toward suburbanization in these European cities** marked a **reversal of their previous urbanization trends**.

The current work aims to figure out if the current trend affecting U.S. could potentially happen similarly in Europe, specifically in Italy, as we are observing **some underlyings been replicated**.

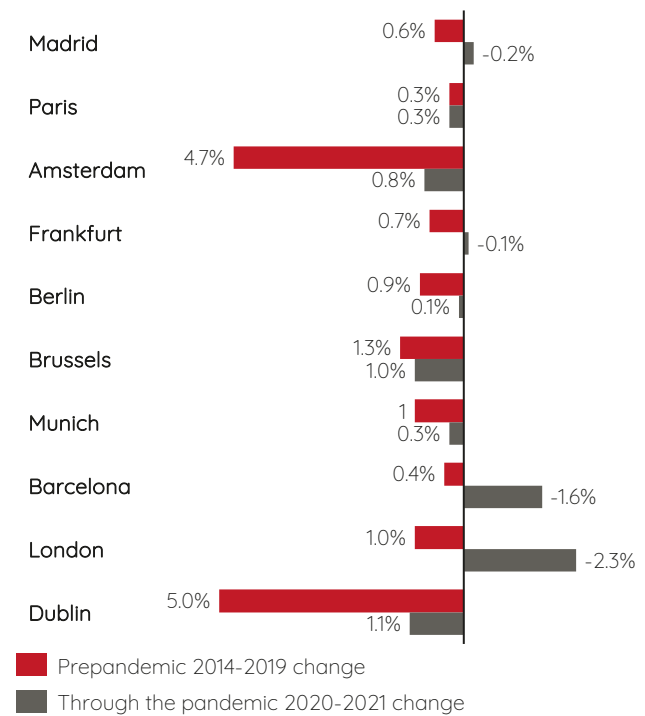
THE ITALIAN SCENARIO

An outlook of Metropolitan Italian cities: population distribution and trends

Metropolitan Cities in Italy consist of **14 entities** and encompass **1,268 municipalities** (16% of all Italian municipalities). Over half of these municipalities have fewer than 5,000 residents, while a third fall within the range of 5,000 to 20,000 residents. Eleven percent have populations ranging from 20,000 to 50,000 inhabitants, and 3.5% have populations exceeding 50,000 residents. The total area covered is 46,637 square kilometers, equivalent to **15.4% of the national territory**. In these areas, a total of 21.3 million people reside, which accounts for **36.2% of Italian population**.

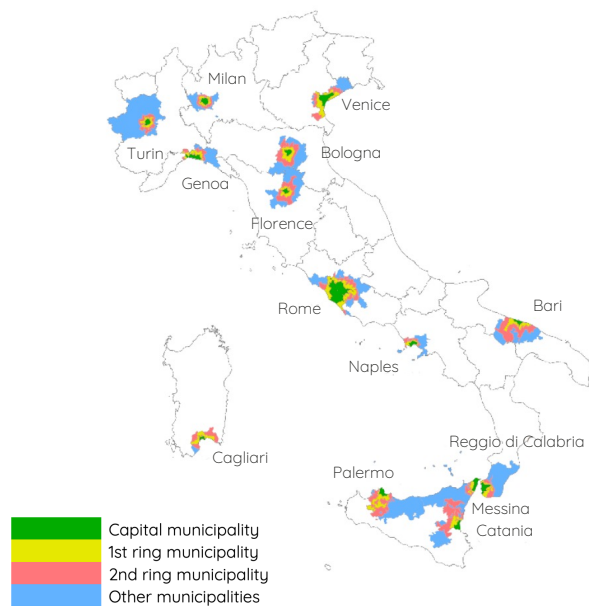
The 14 urban centers represented by the capital municipalities, where almost half of the metropolitan city's population lives (43.2%), while 177 municipalities in the first suburban areas accounts for 18.1% of the population.

Exhibit 2: Population growth per year in Europe, %



Source: "Empty spaces and hybrid places: The pandemic's lasting impact on real estate", McKinsey Global Institute (2023); Statbel; Instituto Nacional de Estadística

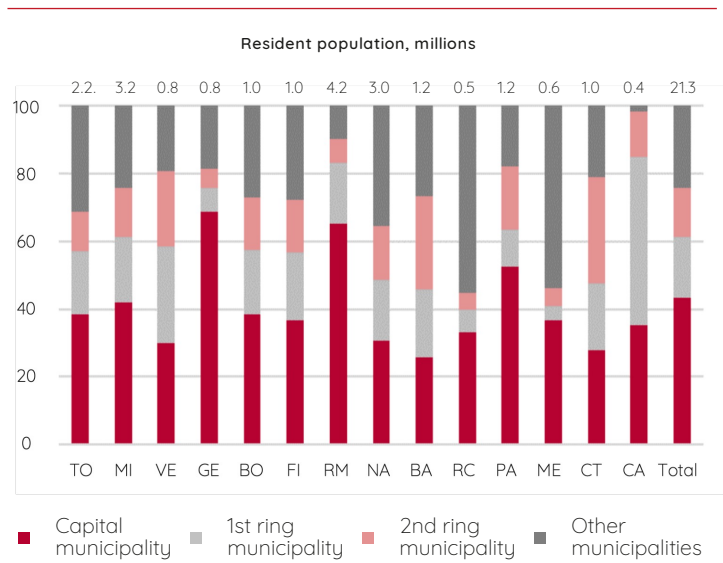
Exhibit 3: Metropolitan areas in Italy, 2022



Source: "PROFILI DELLE CITTÀ METROPOLITANE - ANNI 2020-2022", Istat (2023)

According to ISTAT, when looking at how the population is distributed within these regions, we can observe **varying trends in terms of where people choose to live**. In the seven metropolitan cities in the North and Center, along with Palermo in the South, the **main city serves as a central attraction for residents compared to the surrounding areas**. It's the place where the population is most concentrated, although the percentage varies, ranging from 69% in Genoa to 65.5% in Rome, and going down to 30% in Venice. As one moves away from the urban core, especially in cities like Turin, Milan, Bologna, Genoa, and Florence, the **second most popular choice for settling is often in municipalities that are farther from the main city**, in the outermost ring. This is followed by the first suburban area.

Exhibit 4: Resident population in capital cities and urban rings, % on total population of metropolitan area

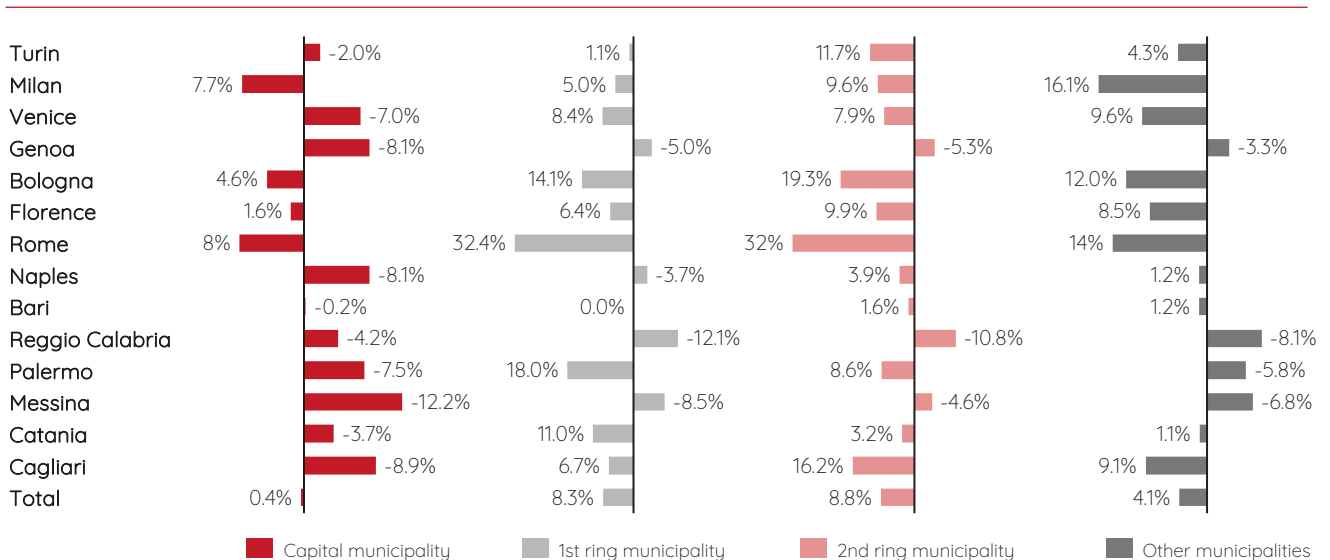


Source: "PROFILI DELLE CITTÀ METROPOLITANE - ANNI 2020-2022", Istat (2023)

But what happens when it comes to population evolution through the years?

If we look at the **geographical distribution** within metropolitan cities, we can see that, in many regions, **both the capital cities and their surrounding suburban areas are experiencing a decline in population**, with more pronounced declines seen in the capital cities and the first two suburban rings. However, in the metropolitan area of Milan, the expected population growth by 2030 can be entirely attributed to the capital city itself, accounting for 7% of the increase, as it continues to attract migrants.

Exhibit 5: Population variation in capital cities and urban rings, % 2001-2021



Source: "PROFILI DELLE CITTÀ METROPOLITANE - ANNI 2020-2022", Istat (2023)

BEFORE THE PANDEMIC

In the realm of economic theory, the role of cities as innovation hubs has been a topic of substantial interest and debate (Jacobs 1969 and Bairoch 1988). Indeed, **urban environments** are characterized by **potent knowledge spillovers**, given the proximity of individuals and firms in cities that facilitates the rapid transmission of ideas and knowledge (Romer 1986 and Lucas 1988).

Enrico Moretti's work, as outlined in "The New Geography of Jobs," categorizes American cities into three distinct groups (see classification on the right).

Turning our attention to Italy, we find strong parallels with the American narrative.

Turin, once renowned for its manufacturing industry, is handling economic shifts similar to the dynamics seen in Detroit. On the other hand, Milan has witnessed an influx of human capital and innovation, resulting in a surge of talent, just like the American "star" cities.

Classification of cities according to E. Moretti



The **first group** comprises "star" cities like San Francisco, Seattle, Boston, and New York, characterized by **high levels of innovation and the concentration of high-value-added companies and human capital**. These star cities are, admittedly, expensive for workers and employers, but they attract high-tech employers and workers due to their remarkable productivity and innovation levels: they cost more, but they produce much more (Gruber, Johnson, and Moretti, 2020)



The **second group** includes cities like Detroit and Cleveland, **former manufacturing hubs** that once experienced economic prosperity during the mid-20th century, but which have since then faced economic decline **characterized by decreased productivity and a brain drain**



Lastly, the **third group** consists of **stable areas with consistent dynamics**; these areas, however, **can transition to either the first or second group** if their equilibrium is disrupted, for better or worse

AFTER: A STORY OF MULTIPLE STATIONARY EQUILIBRIA

After the pandemic, **some expected cities to simply go back to the pre-Covid levels** of commuting. However, **this has not been true for all urban areas**. Take the United States: by observing the data, we find that, while smaller cities have essentially gone back to pre-pandemic levels of congestion, bigger ones are lagging behind, with losses close to 40% in terms of trips made to central business districts (CBDs).

In the abovementioned paper 'Remote Work and City Structure', the authors claim that **differences in commuting to CBDs are based on differences in the mix of activities carried out in the city center itself**.

Thanks to the evidences provided by McKinsey, it is possible to build up the **profile of the in-migrator**: respondents who moved because of the pandemic were **younger than those who did not move** (averaging 36 years of age as opposed to 43); were more prone to say that they were "likely" or "extremely likely" to **quit their jobs if forced to go to the office five days a week** (39 percent versus 26 percent); were **likelier to be caregivers** (59 percent versus 44 percent); and had **bigger households**, on average (3.1 people versus 2.9).

| | Moved for pandemic-related reasons | Did not move during the pandemic |
|----------------------------------------------------------------------------------------------------------|------------------------------------|----------------------------------|
| Average age, years | 36 | 43 |
| Reported "likely" or "extremely likely" to quit a job if forced to attend the office five days a week, % | 39 | 26 |
| Reported being a primary caregiver, % | 59 | 44 |
| Average household size, people | 3.1 | 2.9 |

In Remote Work and City Structure, the developed model of commuting that takes into account **various factors affecting the decision of the worker about whether to commute to the CBD**, or work remotely. In particular, the peculiarity of this model is that it considers the **positive externality of commuting to the city center**.

There are indeed several advantages arising from commuting, which can be translated into an increase in the productivity of CBDs-workers. This means that the advantage of commuting stems, at least partially, from the fact that other people decide to put up with the inconveniences of moving to the CBD to work (traffic jams, transportation costs, etc).

An implication of this model is that cities that display higher positive externalities from commuting to the CBD are the ones more sensitive to the overall degree of commuting.



Type-1 cities

For different levels of congestion, **more “sensitive” cities display multiple equilibria**, corresponding to lower or higher general levels of commuting. We will refer to those cities as “type-1”

Type-2 cities

There exist **less “sensitive” cities**, where workers are less affected by the positive externalities of in-person-work. Here, there is **only one possible equilibrium**, determined by other factors such as the structure of production. We will refer to those cities as “type-2”



This may help to explain the latest commuting trends that we have explored. Let us consider the pandemic shock, where restrictions regarding remote work are imposed. In the immediate aftermath of the shock, **type-2 cities will simply go back to the preceding level of commuting**, as the current level of commuting does not affect the workers’ decision.

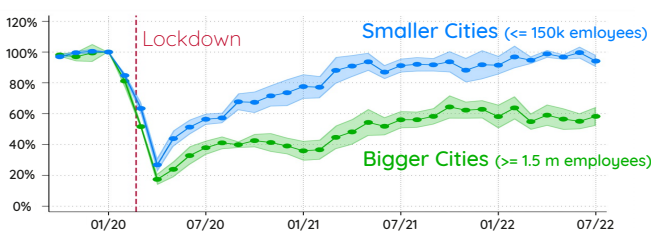
Instead, workers in **type-1 cities are less incentivized to commute**, as they are more affected by the lower current level of congestion. Indeed, in these cities, a lower level of commuting translates into a lower benefit from commuting, which attenuates workers’ incentive to overcome the difficulties associated with working in person.

Up until now, we have simply assumed that type-1 and type-2 cities differ in the degree of “sensibility” to current level of commuting. But where do those differences come from?

One explanation may regard **differences in the production mix** between the two types. Cities within the **first type** may be more “sensitive” because they **employ workers in the service sector**, requiring more intense in-person interaction.

In contrast, cities within the **second type** may be less “sensitive” because they employ **workers producing physical goods**, in the agricultural and manufacturing sector, where positive externalities arising from in-person interaction are less pronounced.

Exhibit 6: Visits to the CBDs relative to January 2020 in the U.S.



Source: Monte et al. (2023)



Milano is endowed with a mix of more service-related activities. This falls into **type 1**, meaning that a sudden decline in commuting, as the one we had with Covid-19, would imply a shift to a **lower equilibrium level**

INFLUENCES ON ITALIAN POPULATION SHIFTS

Demographic decline is a common trend in almost all metropolitan cities, although the magnitude of this decline varies.

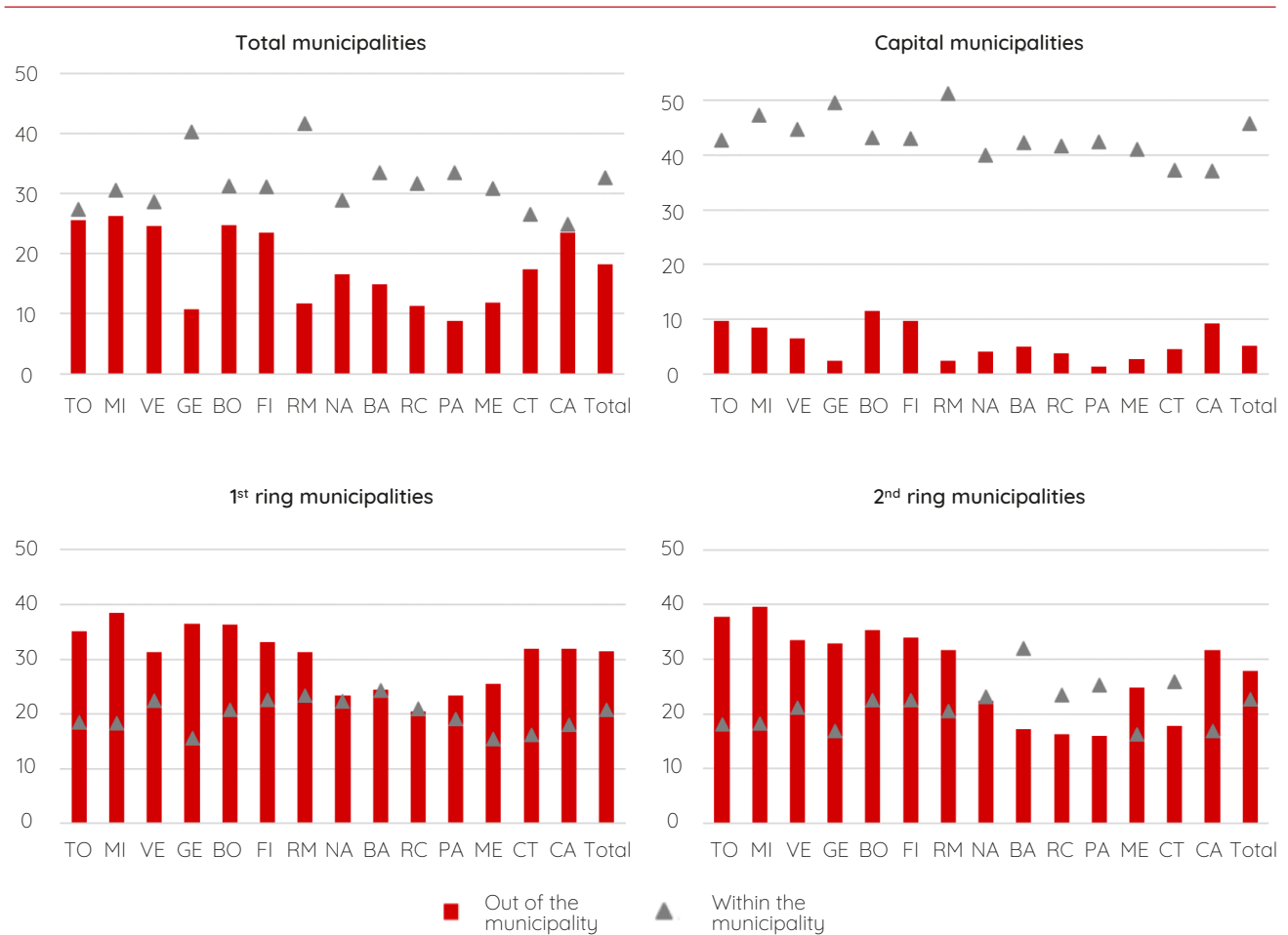
Additionally, it's noteworthy that the first two **suburban rings have a higher proportion of young residents**, while the capital cities have a relatively smaller young population.

In the metropolitan cities of Bologna, Florence, Turin, Milan, and Genoa, employment rates in the first and/or second suburban rings either match or exceed those in their corresponding capital cities, sometimes by a margin of over two percentage points. Notably, in the metropolitan city of Catania, the employment rate in the first suburban ring outpaces that of the capital city by a significant five-point margin.

Around 51% of the total population in metropolitan cities commutes daily for work or study, which is a figure that closely aligns with the national average and has seen a three-percentage-point increase since 2011.

Metropolitan cities characterized by a nearly one-to-one ratio, indicating a **strong balance between local and non-local mobility**, are also the ones where extra-municipal commuting is significantly higher than the metropolitan area averages, exceeding them by at least five percentage points. Examples include Milan and Turin, where 26% of the population commutes outside their own municipality, and this trend is followed by Bologna, Venice, Florence, and Cagliari.

Exhibit 7: "Daily transfers for study or work reasons per destination", values per 100 inhabitants, 2019



Source: "PROFILI DELLE CITTÀ METROPOLITANE - ANNI 2020-2022", Istat (2023)

AN OVERVIEW OF THE ITALIAN REAL ESTATE MARKET

Looking at the **Italian Living Market**, in 2022, according to Agenzia delle Entrate, there was a notable increase in the Number of Normalized Transactions (NNT), which grew by 784,486. This represented the highest growth since 2011, with a **4.7% year-on-year (YoY) increase**. However, it's important to note that this growth rate was significantly slower compared to the remarkable 34% YoY growth seen in 2021.

Despite achieving this record performance, the effects of **higher interest rates** and a more restrictive monetary policy began to manifest in the **last quarter of 2022**. During that period, the **number of normalized transactions started to decrease by 2.1%**.

In the first half of 2023, the total NNT stood at 350,855, reflecting a 12% YoY decline. This drop was primarily a **result of the full impact of the interest rate hikes**, which had now been fully factored into mortgage costs.

A recent report jointly published by Gabetti, Professionecasa, and Grimaldi highlights a **growing trend in property demand**. The report identifies several key preferences among prospective buyers and renters.

Key preferences in property demand



There is an increasing interest in multifunctional homes that offer larger living spaces with **adaptable layouts suitable for remote work**



Properties featuring **outdoor spaces like gardens or terraces** are in higher demand

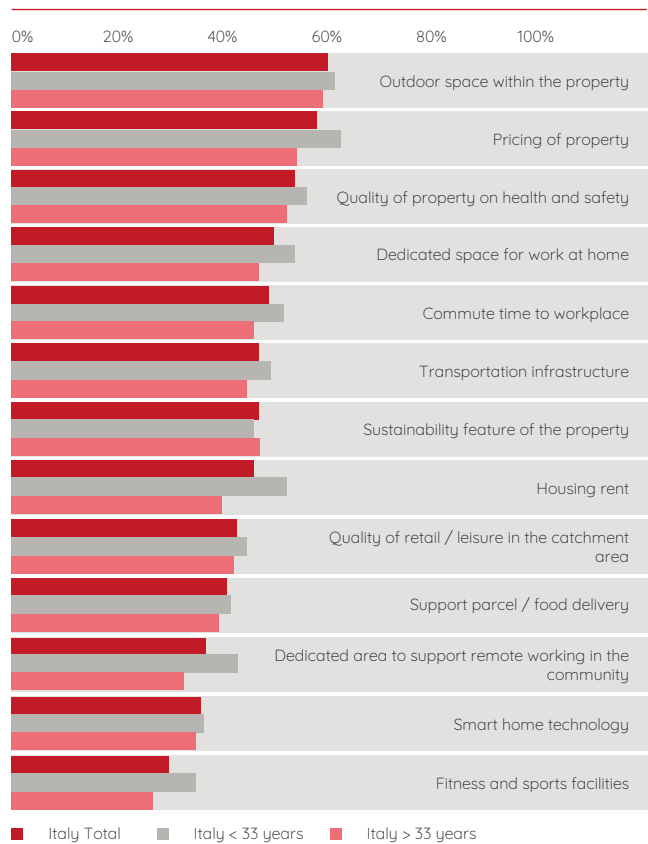


Condominium units that come with additional amenities such as **gyms, garages, and multifunctional common rooms** are also attracting attention



There's a notable demand for **larger second homes**

Exhibit 8: Increase in importance of below factors in property choice and/or living choices since the Covid pandemic in Italy



Source: "Voices from Italy: How will people live, work and shop in the future?", CBRE Research (2023)

The findings of this report are substantiated by Idealista, a reputable real estate platform. Vincenzo de Tommaso, the head of the Idealista Study Center, emphasizes that two years ago, the real estate landscape experienced a significant shift. Initially, experts had predicted a dire scenario for property sales and prices during the early months of the pandemic. However, this pessimistic forecast did not materialize. Instead, **with the easing of restrictions, demand surged**. This was driven by **historically low prices, highly favorable mortgage conditions, and changing housing needs** influenced by the ongoing health crisis.

De Tommaso underscores that the nature of housing demand is undergoing a profound transformation. Homes are now being reimagined to **prioritize comfort and convenience**, especially since remote work has become an integral part of daily life for many companies. This **shift is altering the way we perceive and design our living spaces**.

MAIN CONCLUSIONS – THE FUTURE ITALIAN LIVING MARKET

Current Shift of Demand

Italians prefer to move away from major population hubs, expressing their interest in rural or decentralised location. This trend aligns with the European and US results

Hybrid Work

Despite remote work, having a short and comfortable commute time to workplace with good transportation infrastructure available close to home is still relevant



Home Selection Criteria

Outdoor space within the property and space for remote working will be ones of the most important factor in home selection, so central in Multifamily development

Where will Gen Z live?

Evidences show that younger generations have a greater inclination to live in more central locations, but demands for flexible work and sustainability

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