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Global Outlook, Issue 9

Global Outlook

International Realty Valuation, Inc.

In this Report:

"From past real estate cycles we know that, eventually, expansion must give way to either a softer patch of returns or an outright downturn that features falling capital values."

PGIM – Trends 2020

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Reset Real Estate

By Lance W. Doré, FRICS, MAI

I have spoken in the past about the dynamic nature of Real Estate and the need to be nimble and evolutionary. But this is a mixed metaphor when compared to the reality of real estate which is immovable and inflexible. None the less, the current Covid-19 virus pandemic has forced real estate to once again evolve and be nimble, or become entirely obsolete. We have entered the Real Estate era where there must be a reset. Control – Alt – Delete regarding the old ways and find new ways.

In 4Q 2019, real estate was in the goldilocks zone and was the golden child of investment strategy. Except for some systemic weaknesses in retail and predicted slowing overall, we were on a long-term pattern of stable returns, albeit at lower levels because the risk was mitigated and foreseeable.

The prediction that the recession was the proverbial *can being kicked down the road* is no longer. The recession is here. It does not matter the cause. It could have been rate hikes, or trade disputes, or a virus. But most likely it is how all recessions begin – an endemic pathogen of financial myopia.

Financial myopia is the constant evaluation of short-term market performance inspite of the long-term consequences. The FM (Financial Myopia) causes market participants to set aside rational long-term strategy because the investment fails to yield desirable results in the short term. Quick buck yields unpredictable value.

We have to remember that pre-CV19 the global real estate market was showing signs of age. Opportunities were scarce and there was a great deal of investment cash on the sidelines because there were very limited attractive investments. Class A real estate in Tier 1 cities was exhausted in 2014 to 2016. Class B real estate in Tier 2 cities was exhausted in 2017 to 2018 and Class C real estate was exhausted in 2019 to current. There are no more brass rings to grab on the real estate merry-go-round.

Time to Reset – but what will the real estate screen refresh to?

Despite the short-term impact of CV19, the fundamentals in real estate will realign. Retail continues to reshuffle its deck into cowork/coexist/cooperative health (gyms, medical, adult day care, education). Anchored grocery neighborhood centers will be the unsexy darlings. Office space requirements will shrink farther. Remote workers have a taste of freedom and flexibility and are unlikely to go back to 5 days per week with 1 to 2-hour commutes. There will be renewed expectations for technology with state-of-the art conference/video rooms, private office spaces and lots of perks (parking, childcare, shopping services). Multi-Family, while taking an immediate hit with higher vacancies with the unemployment rate spiking, will settle down with vacancies likely increasing 2 to 3%. Watch for suburban and rural locations to show increased demand due to remote workers going farther out for affordable housing. Industrial continues to outperform and for good reason – logistics, specialized processes, flex and warehousing hit all the reset buttons for a sector that morphs into what buyers, sellers and tenants require. E-commerce will only expand, and technology will continue to evolve. This puts industrial front and center. Expect to see some of that retail in hub areas convert to the many faces of industrial.

Projections for 2020 are as follows:

Highly leveraged real estate is at risk. Even short term impacts due to CV19 will create exposure to landlords and lenders. Defaults are inevitable.

Gateway cities may fall out of favor because these are the primary social and economic links to the world. Economic diversity in gateway cities also creates diverse risk (social, financial, governmental, environmental).

Cash is king (always) – there will be opportunities in all sectors of real estate and in all geographic corners of the globe. The areas most impacted may see the most upside. Invest with a 15 to 20-year horizon. Look into Agriculture (See Highlights).

Technology drivers will be the key for real estate. Demands of tenants must be met to fill space. Infrastructure accessibility is paramount (power grids, transportation linkages, broadband connectivity.

Time to Reset.

"I am very focused on understanding the downside"

Sam Zell -

International Realty Valuation, Inc.

Over the short term, particularly in H1 2020, investment activity in global commercial real estate is expected to slow. Investors will apply more due diligence and will experience a lower practical ability to execute transactions. Extended transaction timelines and delayed launches are already evident in highly affected markets; however, technology will be used to connect parties and reduce some of the barriers to execution.

JLL – Covid19 Global Real Estate Implications

Globalization v. Globalrealization

Real Estate value and its worth is based on fundamentals. Value is created by demand, use, uniqueness, money. Understanding these fundamentals creates the first step in the Investment Pyramid.

The benchmark is Highest and Best use. The cornerstone of maximizing value in real estate factors in the primary three categories: 1) what is legally allowed? 2) what is physically possible and 3) what make the most economic sense? The inattention to this simplistic metric is the predictor for a failed or successful project.

What happens now in the global real estate community when looking at these fundamentals?

Globalization of real estate is at a crossroads as we approach the new ***Globalrealization***.

Globalization at the core is the dynamic of international trade, cross-border finances, skilled and un-skilled labor movement, and information flow across borders.

Investment Pyramid – "The Secret of Real Estate Revealed"

However, when globalization is interrupted by social, environmental, economic or governmental forces, your real estate cannot be maximized.

Let's look at our current examples:

Social - when people can no longer connect, we lose the ability to exchange information. Transparency is compromised and differentiation is limited.

Environmental – when a pathogen disrupts the fabric of livelihoods and life, we lose demand for our product

Economic – when financial markets shut down or are at risk, we lose the ability to transfer our real estate. We lose money.

Government – when a city, or county, or nation delays or denies a property's approvals for development, our real estate cannot function for what we intended.

The Globalrealization is that we are all connected and that the outcome of our vision (local to global) has rippling impacts on how we invest, own or dispose of real estate.

Globalization will slow. China, the US, the EU, the UK, Asia, the EMEA, Pan- Pacific and Latin regions will reevaluate the realities of global v. local.

Prioritization will occur for local employers, local employees, local education, and local financial relationships.

Localization is prioritization.

The reality is unadulterated global naivety has been exposed without appropriate checks and balances and redundancies.

Be prepared for less exposure to Gateway cities like New York, London, Berlin, Paris, Tokyo, Hong Kong, and Singapore, with increased emphasis on Sub-Gateway cities like Seoul, Sydney, Toronto, Beijing, Istanbul, Vancouver and Barcelona.

Real estate success has always been about diversification of risk for income stream, location or sector (industrial, retail, office, residential).

Real Estate has entered the new globalrealization.

Highlights: Global Agriculture

At the forefront of the CV19 impacts is the unique focus on those industries and sectors that appear to thrive – namely staple industries such as food, sundry, and medical support. The related real estate sectors that provide support to these industries are industrial (logistics, warehouse and specialized technology) and agriculture.

Food and agribusiness form a $5 trillion global industry that is expanding.

Farmland accounts for about 50% of all real estate in the world. Employment in agriculture represents over 50% in some countries.

According to the USDA Global Agriculture, total demand for various products over the next 10 years is shown as follows:

Wheat is projected to show an increase in trade of almost 16 percent. Rice trade is projected to increase by almost 15 percent. Soybean trade is projected to increase by 23.5 percent. Corn is projected to increase by almost 17.4 percent. Barley trade is projected to increase by about 20 percent. Cotton trade increases by 27 percent. Combined global consumption of beef, pork, and poultry meat increases 16.7 percent.

Overall there is not a sector of farmland that shows instability or decline over the next 10 years. While there may be fluctuations in trade between the various countries, the overall demand for farmland and its product is almost recession immune.

Returns on long term agricultural leases range from 2% to 4%, which in an unsettled economy can be an alternative to more risky investments.

The top producers in the world are 1) China, 2) India and 3) United States. The US is the leading global food exporter.

Farmland functions similar to traditional real estate and is a good alternative to diversify over long-term holding period and is an increasingly scarce resource with traditional return metrics with rental income, portfolio diversification and hedge against inflation.

The only difference with farmland when compared to traditional real estate is that tenants grow on trees. But unlike traditional real estate, the land actually grows wealth.

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As a Founding Partner and President of International Realty Valuation, Inc., Lance W. Doré manages the operations of the firm. He is actively engaged in a myriad of valuation assignments involving a wide variety of properties, with special expertise in the valuation of energy facilities, conservation land, open space/ ranches, and litigation support to public and private clients.

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About IRV, Inc.

International Realty Valuation, Inc. (IRV) is a global network of independent and highly competent professionals committed to providing expert financial reporting, forensics, consultation, and valuation services for both tangible and intangible assets to the most discerning of public and private clients. With a number of affiliate firms in several countries, our team has cumulative cutting edge knowledge of global and regional markets, as well as international standards and requirements. This enables us to complete a wide variety of assignment, including valuation of large portfolios with multiple locations, in a thorough, objective, timely, and cost effective manner. We serve major national, regional and international banks, lenders, developers, investors, governmental agencies, public and private companies.