Five Emerging Global Trends for 2019

As 2019 unfolds, a number of dramatic developments are starting to reset the landscape for real estate investment. Here at MSCI, we see our real estate investing clients – who range from small family offices to some of the largest pensions and sovereign wealth funds globally – coming to terms with challenges such as environmental, social and governance-related (ESG) risks, geopolitical uncertainty and disruptive technology. In this article we discuss our top five emerging global trends.

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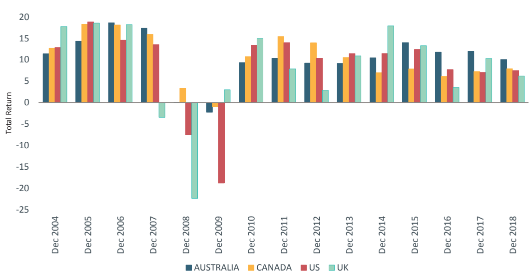
1. ESG risks on the investment horizon

It is now clear that real estate investors are starting to take account of ESG considerations in structuring their portfolios, particularly as they come to realise that climate change could have a direct impact on the value of their own property assets and the way these need to be managed. At the same time they are becoming more and more aware of the real estate sector's contribution to energy use and carbon emissions.

The U.S. government's Fourth National Climate Assessment report, issued in November 2018, directly linked recent extreme weather events to changes in the climate.[1] Meanwhile a European Commission report from July 2018 warned that the economic damage from coastal flooding in Europe could approach €1 trillion per year by 2100 without new investment in adaptation to climate change.[2] But climate change looks set to have a bigger impact on property in some places than in others. For example, in the near future, the value of real estate in coastal zones with a high risk of flooding may well fall relative to less flood-prone inland areas. This risk is highlighted in MSCI's "ESG Trends to Watch in 2019" report.[3]

2. There are few places left to hide from geopolitical risk

In the past real estate investors mainly bought assets in their home markets, but now many are shifting toward more internationally diversified portfolios.[4] This is sometimes driven by a desire to improve yields and potential returns, but is more often focused on reducing market-related risk for the overall portfolio. Yet as 2019 unfolds, most of those on this path are facing growing geopolitical risks to their investments. 2018 was a year of political discord in both developed and emerging markets, and this trend shows no signs of abating in 2019. Uncertainty in the U.K. about the practicalities of Brexit, the nationwide protest movement in France, the U.S. government shutdown and U.S.-China trade tensions remained major concerns at the start of the year. The increasingly international nature of real estate capital markets means that investors will find it more and more difficult to escape these global risks. Global Gateway Cities, such as London and Paris, are particularly exposed to these internationally driven capital flows.[5]



Source: MSCI

3. Technology-driven disruption

Technology is driving fundamental changes in the role of real estate in tenants' businesses around the world, with big implications for the amount and type of space they want to occupy. In the past, no-one questioned the essential part played by real estate in many industries. For example, retailers could only reach their customers through bricks and mortar stores, while traditional communications technology limited the potential of flexible working for office employees. Technology is changing all this, and means that landlords need to understand their tenants' business models better than ever. This doesn't just apply to their space requirements but also to the add-on services they need and the kind of contracts that will best suit evolving landlord-tenant relationships.

This technological transformation could ultimately impact real estate cash flows, perhaps making them less predictable and more like those from equities rather than fixed income. In turn this could change the role real estate plays in the investment portfolio.

But real estate investors are also making new technology work for them. For example, we have recently seen virtual reality used to market assets around the clock and data from satellites and mobile devices employed to gain a better understanding of shopper behaviour. Meanwhile Artificial Intelligence may soon be used to value buildings, reducing the cost and potentially raising the frequency of valuations. This could ultimately enhance real estate transparency and boost the sophistication of analysis in the sector.

4. Real estate investing in the age of transparency

The coming of passive and factor investing to equity markets – which has been driven by market transparency and sophisticated analytics – has increased efficiency for investors, but has also made it more difficult for them to earn alpha. As a result, capital has gradually shifted to private asset classes such as real estate, where market inefficiencies still exist and pricing remains relatively opaque.[6]

Real estate allocations are likely to continue growing through 2019. For example, according to INREV (the European Association for Investors in Non-Listed Real Estate Vehicles), half of all investors worldwide expect to increase their allocations to real estate over the next two years.[7] But the sector is also attracting more scrutiny, as investors expect transparency and insight into this less liquid and previously more opaque asset class. This is a particular need in emerging investment markets around the world, where existing data series may be relatively short, and also for newer asset types, such as data centres.

5. The cycle is still with us

More than 10 years into the expansionary phase of the current real estate cycle, many investors believe recent strong performance cannot be sustained at the same pace. At the same time, there is still a great deal of capital in the market, as demonstrated by Blackstone's creation of the largest-ever real estate fund in January.[8]

These conflicting signals are making investors question how they should position their portfolios for the years ahead. Some may act defensively to hedge against a possible downturn, searching for properties that are unlikely to follow the market and may provide more secure income streams. Others may look to meet their growth requirements through potential cash flow increases, perhaps as compensation for weakening yield compression. Regardless of the approach taken, digging deeper into the data — for example, by using asset-level historical data to understand how specific combinations of risk factors have performed throughout different market conditions — can help investors gain a better understanding of how portfolios have performed at different points in the cycle.

Below we highlight how different global markets have performed since 2004. While all of these markets have tended to move in the same direction, the magnitude and timing of performance have varied. For investors looking to limit the risks of a downturn, cross border investments may provide significant diversification benefits.

Source:

1 U.S. Global Change Research Program. (2018). "Fourth National Climate Assessment."
2 Vousdoukas, M. I. et al. (2018). "Climatic and Socioeconomic Controls of Future Coastal Flood Risk in Europe."Nature Climate Change, doi:10.1038/s41558-018-0260-4
3 Lee, L.-E. and M. Moscardi (2019). "ESG Trends to Watch in 2019." MSCI Research Insight.
4 Aussant, J.M., P. Hobbs, Y. Liu and P. Shepard (2014). "The Erosion of the Real Estate Home Bias." MSCI Research Insight.
5 Nihalani, A. (2018). "Global Gateway Cities: The Performance Behind the Hype." MSCI Research Insight.
6 Willis Towers Watson. (2018). "Global Pension Assets Survey — 2018."
7 ANREV / INREV / PREA Investment Intentions Survey 2019
8 "Blackstone raises $20bn for largest-ever property fund." Financial News. Jan. 17, 2019.

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