Panel Discussion:
Real Estate Investment – Theory & Practice

Chair: Dr Robin Goodchild FRICS - International Director, Global Research & Strategy and Visiting Professor, University of Aberdeen Business School
Outlook for Real Estate Markets

Back to Basics

Dr Robin Goodchild FRICS - International Director, Global Research & Strategy and Visiting Professor, University of Aberdeen Business School
Back to Basics / Applying First Principles

Using the Donald Rumsfeld approach
Outlook for Real Estate Markets: Back to Basics

Outline

How Real Estate Markets Work

- **Known Knowns:**
  - Markets are Cyclical
  - Effect of economics on Real Estate performance
  - Importance of Capital Markets / Debt & Equity Flows
  - Scale of Development Pipeline
  - Obsolescence
  - Success of Higher Risk Strategies

- **Known Unknowns:**
  - How will economy perform?
  - What will happen to Interest Rates / Capital Markets trigger?
  - Will Development Pipeline surprise?
  - Tax & Regulatory changes
  - Geo-Political
  - Where are we in the Cycle?

- **Unknown Unknowns**

- **So what should Investors be doing?**
‘Known Knowns’
Known Knowns: Markets are Cyclical

Real Offices Values in Major Global Markets: a Volatile Story

Sources: PMA, Wheaton & Barranski, Vallis, Devaney, Turvey, RICS, Bjorklund & Soderberg
Known Knowns: Markets are Cyclical

Real Offices Values in Major Global Markets: a Volatile Story (esp in HK)

Sources: PMA, Wheaton & Barranski, Vallis, Devaney, Turvey, RICS, Bjorklund & Soderberg
Known Knowns: Effect of economics on Real Estate
UK GDP with Rents and Returns

GDP & Rents – All Property

-15 -10 -5 0 5 10 15 20 25
% per annum

Correlation: 0.60

Sources: MSCI, ONS

GDP & Returns – All Property

-30 -20 -10 0 10 20 30 40
% per annum

Correlation: 0.57

GDP
ERV Growth
Total Returns
Known Knowns: Importance of Capital Markets
UK Capital Flows and Yields

Sources: AREF, MSCI
Known Knowns: Importance of Capital Markets
Composition of UK Capital Value Growth 1981-2015

Source: MSCI, LaSalle
Known Knowns: Importance of Capital Markets

Source: MSCI, LaSalle
Known Knowns: Scale of Development Pipelines

Most of Europe’s Cities should have below average supply (2016-18)

Source: PMA (02/16)
Cities highlighted have stronger supply forecasts compared to their historic averages
Known Knowns: Scale of Development Pipelines
And New Supply through Vacancy has a big effect on Rental Growth

City of London Office Rents and Vacancy

Correlation co-efficient: -0.80

Sources: PMA, IPD
Known Knowns: Obsolescence
Prime Office Rents & Capital Values rise faster than Existing Properties

Sources: JLL, MSCI
Known Knowns: Success of Higher Risk Strategies
US evidence suggests that Value-Add has under-performed

Reported Fund Performance by Fund Type
(17 years to 31 December 2012)

Source: Pagliari Jr (2013) from NCREIF/Townsend & Author’s own calculations
Known Knowns: Success of Higher Risk Strategies
European evidence is similar but Value-Add has performed better post 2012

Europe fund performance

- Core
- Value Added

Annualised total return

Source: INREV
Known Knowns: Success of Higher Risk Strategies

Value-Add performs in rising market – effect of greater leverage?

Source: NCREIF
Known Knowns: Success of Higher Risk Strategies

Is there anything Wrong with the Data?

- Time-Weighted not Money-Weighted Returns
- Annual/Periodic Returns not Fund Life IRRs / Equity Multiples

What else does this remind us?

- Errors seriously damage performance
- Distribution of returns is skewed to the left
- Hard for Winners to compensate for any Losers
- Best fund managers avoid mistakes
The Attractions of Lending to RE in a Boom

(without awareness of property cycles)
UK Lending to Corporate Real Estate
Highly correlated with the 3 Cyclical Peaks

Bank Lending to CRE as a % of all Lending

Sources: Bank of England, IPD
Why is CRE lending so cyclical?

Write-off rates on lending to UK businesses

Lending by UK monetary financial institutions. The series are calculated as annualised quarterly write-offs divided by the corresponding loans outstanding at the end of the previous quarter. The data are presented as four-quarter moving averages and are non seasonally adjusted. Lending in both sterling and foreign currency, expressed in sterling terms.

Source: Bank of England and Bank calculations
Similar data for USA show GFC explosion in Loss Ratio
Delinquency Levels for US CMBS loans 2000-15

Source: Trepp LLC
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General Risks of Investing in Private Real Estate Funds

Investments in private real estate funds are speculative and involve special risk and there can be no assurance that a fund’s investment objectives will be realized or that suitable investments may be identified. An investor could lose all or a substantial portion of his or her investment. Private funds are generally not subject to the same regulatory oversight as registered funds. Investments may involve complex tax structures resulting in delays in distributing important tax information, may not be required to provide periodic pricing or valuation information, lack diversification, limited transparency, and may employ leverage and other speculative investment practices. A comprehensive list of potential risk factors is outlined in the Fund’s Private Placement Memorandum.

Real Estate Risks

The securities of issuers that are principally engaged in the real estate sector may be subject to risks similar to those associated with the direct ownership of real estate. These include: declines in real estate values, defaults by mortgagors or other borrowers and tenants, increases in property taxes and operating expenses, overbuilding, fluctuations in rental income, changes in interest rates, possible lack of availability of mortgage funds or financing, extended vacancies of properties, changes in tax and regulatory requirements (including zoning laws and environmental restrictions), losses due to costs resulting from the cleanup of environmental problems, liability to third parties for damages resulting from environmental problems, and casualty or condemnation losses. In addition, the performance of the local economy in each of the regions in which the real estate owned by a portfolio company is located affects occupancy, market rental rates and expenses and, consequently, has an impact on the income from such properties and their underlying values. No investment strategy or risk management technique can guarantee return or eliminate risk in any market environment.

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Panel Discussion: Real Estate Investment – Theory & Practice

Panelists:
- Tom Geurts - The George Washington University
- Stephen Roulac - Roulac Global & University of Ulster
- Steffen Sebastian - University of Regensburg
- Paloma Taltavull de La Paz - University of Alicante

Some Discussion Topics:
- International Real Estate in a multi-asset portfolio, same as domestic?
- Characteristics for successful international investing
- Data challenges
- Student interest in international investment
- How much do you include Economic History/ knowledge of Property Cycles and in your teaching of Real Estate Investment?
- Ditto. - with Behavioural Finance?