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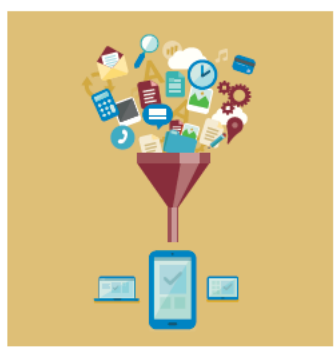

Let's raise a glass to 2020

For real estate investors, the uncertainty created by the Covid-19 pandemic manifested itself in widespread market opportunities. Many across the industry are gearing up for an exciting 2021 on the heels of the roller coaster that shaped 2020.

By Deborah Smith,
The CenterCap Group

If one had paid attention to the major media pundits in 2020 it would have been fairly easy to conclude that the sky had fallen on the real estate market. We think the pundits had it plain wrong in many respects. Based on the conversations we have every day with owners, operators, investors and investment managers, we are not the only ones. Let's step back and take stock of what we saw in 2020 that inspired us and continues to do so. Through the uncertainty, enlightenment loomed and the enormous opportunities to create value are, and continue to be, in the making.

Let's start with where we were at the turn of the new decade. Conventional wisdom had the institutional real estate market focused primarily on the top 10 or so urban US markets for investment opportunities across all the major asset groups — multifamily, industrial, office and to a lesser extent retail — with a growing desire for investment into alternative real estate sectors, primarily to generate additional alpha over the NCREIF Index and secondarily as a nod to evolving demographic and consumer trends. We were also starting to see increasing numbers of institutional investors globally galvanize around the UN Principles for Responsible Investing, encapsulating ESG and impact investing in their liquid and illiquid strategies. Real estate players realized it behooved them to invest time into figuring out how to support sustainability mandates. Our view going into 2020 was that the concept of social infrastructure would probably migrate from a purely housing focus and weave its way, in some shape or form, into every mainstream and niche real estate dialogue over the next decade. It might take time, and progress perhaps less obvious, but it would happen and the early movers would benefit.

> “Ahead of the Covid-19 pandemic, many of our clients were already making office location choices based, in part, on tax-efficiency considerations. Tired of high tax climates, they had been evaluating new regional offices in favorable tax locations, or had simply relocated altogether.”

Change as an agent of opportunity

Then Covid-19 struck. Now the top 10 investing markets may be up for redefinition or, at a minimum, the conversation is evolving into one about the top 25 markets, perhaps more. Covid-19 led to shake ups in where people choose to live, how they choose to work, and where and how they choose to shop. So where are people going and will it be permanent? Will people physically return to work, continue working from home, or a combination of the two? What about urban versus suburban office markets?

Ahead of the Covid-19 pandemic, many of our clients were already making office location choices based, in part, on tax-efficiency considerations. Tired of high tax climates, they had been evaluating new regional offices in favorable tax locations, or had simply relocated altogether.

> “The pandemic has shown that physical retail centers are, and will remain, an important component of social infrastructure.”

Then there is the impact of Covid-19 on already evolving shopping habits. According to eMarketer estimates, approximately 14% of all retail sales were conducted online in 2020, up from 11% from the year prior. It's a big increase. While we can debate what the statistics mean to the relevance of malls, shopping centers and neighborhood hangouts, it seems clear that shoppers can't or won't buy exclusively online. The pandemic has shown that physical retail centers are, and will remain, an important component of social infrastructure. On a basic level, the retail sector plays a role in offering food, medical services and last-mile logistics opportunities. While we hypothesize about the permanency of population migration, let's also think about how those shifts impact traffic patterns, shopping habits and lifestyle choices, in addition to what people buy, how they buy it and where. Our view is change creates opportunity.

The continued rise of the niche plays

2020 also highlighted the role niche real estate sectors play in the industry.

> “When the world hunkered down and abruptly shifted to a mostly remote, Internet-based existence, sectors like data centers and cell towers began receiving more investor attention, as did manufactured and affordable housing (of all kinds) as governments struggled to keep people in their homes despite increased levels of unemployment from the pandemic shutdown.”

Cold storage has proven to be a resilient asset class and has consistently performed even during times of economic distress. Consumer behavior changes driven by evolving demographic trends in both suburban areas and urban metropolises have led to increased online purchases of not only traditional retail products, but also fresh and frozen foods and produce. Consumers are demanding more “farm to fork” products and for them to be delivered fresh and just in time. Cold storage also plays a central role in the logistics supply chain for pharmaceutical storage, as well as life sciences and medical services. These trends have been catalyzed by Covid-19, and coupled with undersupply, are making institutional investors pay attention to this sector.

Similarly, when the world hunkered down and abruptly shifted to a mostly remote, Internet-based existence, sectors like data centers and cell towers began receiving more investor attention, as did manufactured and affordable housing (of all kinds) as governments struggled to keep people in their homes despite increased levels of unemployment from the pandemic shutdown. It has become clear that supply has not kept up with demand in any of these sectors.

The increased focus on sustainability mandates

Then there is the increased focus on sustainability mandates. The real estate industry is a long way from developing consensus on what it means, and how to, effect impact investing. To be clear, it is not ESG and shouldn’t be confused with it. At its foundation, impact investing is an old concept; it is about serving the dual mandate of generating positive social (or environmental) change and generating financial returns. Put differently, it requires taking ESG principles and executing them into a distinct investment strategy. For real estate, it has easily been identified with improving the resilience of vulnerable communities and providing access for improved lifestyles, improved health services and livelihood opportunities. A straightforward example is affordable housing. As the boundaries of impact investing are not yet defined, investors have a role in helping to define them, and more importantly, to execute on them. The good news is that the pandemic is creating political motivation within local, state and federal governing bodies to work with, and in support of, investors.

Defining the role of technology going forward

In the integration of technology into the real estate sector, the new ways of doing old things present exciting opportunities for investors. We do not mean apps at office buildings, but how big data can be used to improve the risk-reward equation. The visibility technology has into our daily lives from shopping patterns, time spent in stores and which ones, to where we go after we leave them, is already here. If we know more about buyers, sellers and consumers, doesn’t that mean investors are taking less risk for the same reward? Then there are the cost efficiencies associated with substituting artificial intelligence for labor costs. New construction technologies are here, too. Technology can enable us to provide faster, cheaper and more efficient ways to build and replicate real estate assets — and it can also be used to replicate (or supplement) what people do in underwriting, building, managing, buying and/or selling properties. We are only in the first inning of capturing the value technology will bring to the real estate industry.

So, 2020 wasn’t all bad. This isn’t the return of the last financial crisis. The real estate market of 2021 is marked by uncertainty, but so far there isn’t a credit crunch. That makes it unique and exciting to be a part of. Let’s raise a glass and get back to work. ◆

Deborah Smith is Co-Founder and Principal at The CenterCap Group.