

## Real estate – time to enter?

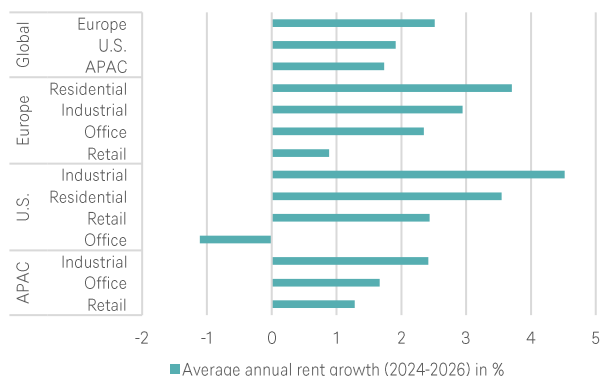
**Higher yields have proven to be a formidable headwind for both residential and commercial properties, but fundamentals have generally been stalwart.**

Nervousness has been most visible in the dramatic price swings of listed real-estate investment trusts (REITs). REITs have lately staged a recovery and have historically led private markets by about one year. However, they are an imperfect indicator.<sup>1</sup> Fundamentals, meanwhile, have generally been stalwart, with tight vacancies and rising rents (see our forecasts in the chart below) in many major markets and segments. E-commerce, coupled with efforts to bolster supply chains, is driving demand for warehouses. Widespread and chronic housing shortages persist while supply disruptions and rising wages have boosted construction costs. Together with tighter financing constraints this has already started to curb construction.

the dip, capitalize on attractive valuations and ride the next cycle,” argues Kevin White, Co-Head for Global Real Estate Research.

Timing, though, is tricky. As real-estate cycles turn, this can change how thick or thin markets are at different times, in ways that are similar to buying a good, a sandwich, say, in different places. In the economic jargon, mid-town Manhattan is a thick market for grabbing a lunchtime sandwich, giving a New York deli plenty of the cost advantages due to, say, workers being busy at all times, compared to, say, a similar eatery in small-town Iowa.<sup>4</sup>

### Expected rent growth by region and sector



Source: RREEF Management L.L.C. as of August 2023

Of course, there is plenty of variation across and within regions and segments. The office sector has been shaken by work-from-home arrangements, especially in the U.S., but opportunities lurk in other regions. In Western Europe, for example, many cities (e.g., Paris and Berlin) suffer a dearth of prime, ESG<sup>2</sup>-friendly office space. In Asian office markets, a cultural affinity for office-based interaction has limited the damage from remote working, particularly in South Korea and Japan.<sup>3</sup>

As real-estate prices now largely reflect higher interest rates, there may be scope for upside if and when yields fall. “Fortune may favor the brave investor who can look through

Going from boom to bust is a bit like suddenly finding yourself in small-town Iowa in search of your favorite lunchtime sandwich. During a downturn, real-estate markets suddenly become thin. Typically, transactions get pulled, specialized suppliers – of financing, in particular – get jittery and no one can quite know precisely when potential buyers will shift from being cautious to fearing they may already have missed the best entry points for the best assets.

The ideas behind thin markets versus thick markets is that it is often more efficient for economic activity to be concentrated in either time or in space. An economic upswing and a city are essentially similar phenomena; their longevity depends on how long the agglomeration effects underpinning them are likely to last. This can be quite helpful in figuring out where such assets can be found. Take data centers. In many parts of the U.S., provisioning the required power from local electric utilities – rather than scarcity of developable land – has become the main limiting factor.<sup>5</sup> Eventually, power production and electricity grids will adjust. By that point, however, innovative clusters may already have emerged, giving rise to additional agglomeration effects.<sup>6</sup>

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## Footnotes

<sup>1</sup> Like stock markets more broadly, real estate valuations tend to be volatile. Both listed and unlisted real estate have typically - sometimes dramatically - overshot underlying valuations. See, for example, Akerlof, G. and Shiller, R. (2009) "Animal Spirits: How human psychology drives the economy, and why it matters for global capitalism", Princeton University Press, esp. pp. 131-156.

<sup>2</sup> In consideration of environmental, social and governance criteria

<sup>3</sup> For more details on South Korea, see [A Korean sneak preview \(dws.com\)](#)

<sup>4</sup> Hall, R. (1989) Temporal Agglomeration NBER working paper 3143, available online: [w3143.pdf \(nber.org\)](#)

<sup>5</sup> [Equities retreat as earnings disappoint \(dws.com\)](#)

<sup>6</sup> As we previously described, patterns along these lines are already emerging in Northern Europe. See [Innovative clusters – northern lights, transforming Europe \(dws.com\)](#)

## Glossary

Investors increasingly take [environmental, social and governance \(ESG\)](#) criteria into account when analyzing companies in order to identify non-financial risks and opportunities.

A [Real Estate Investment Trust \(REIT\)](#) is a company that owns and, in most cases, operates income-producing real estate. REITs sell like a stock on the major exchanges and invest in real estate directly, either through properties or mortgages.

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