

Rethinking Real Estate Post COVID-19

Featuring: **Will Robson**, Head of Global Real Estate Solutions Research

Adam Bass: This is MSCI Perspectives, your source for weekly research insights as investors respond to the COVID-19 pandemic. I'm your host, Adam Bass, and today is May 7th, 2020. This week, some of you may be listening to us on Spotify, Stitcher, or Apple Podcasts. We're excited to reach you where you do the rest of your podcast listening. On today's episode, how and where we work could end up looking very different than it did before the pandemic. That uncertainty can be reflected in the valuations of commercial real estate. For more, we turn to Will Robson, Head of Global Real Estate Solutions Research at MSCI. Will you stand out among the guests we've had on in that working from home is not a new thing for you?

Will Robson: Exactly, yeah. I joined MSCI over three years ago. I'd say I was one of those super commuters. I traveled like two hours each way every day that I'd come into the office. Over time I've gradually started to work a bit more from home. Now I do that about two days a week.

Adam Bass: And now every day.

Will Robson: Yeah, every day and with kids around. It's a bit more challenging.

Adam Bass: Let's talk real estate. There's lots of opinions and a lot of chatter out there about the end of the office as we know it lately.

Will Robson: Yeah. Well, I think you've seen a lot of movement in the environment in terms of how property is being occupied or not at the moment because of the COVID crisis. It's natural for people to talk about the situation they're in today and think about how that might be in the future.

Adam Bass: There's nothing like a crisis to force a change, right? We've been hearing about flexible work for years. Some companies experimented with it, others who had been called everyone back to the office. What are we seeing now?

Will Robson: Companies have very quickly had to really scale up the kind of working from home technology that's needed for mass use. There's been a lot of money thrown at the problem to kind of make sure everyone is at least as productive at home as they are in the office. From a cultural point of view, the CEOs of major corporations, which may have had a slightly more kind of old school view of the benefits from working at home, have really had to throw themselves behind it and kind of tell their workforces how great it's going to be through this crisis.

Adam Bass: That must be affecting how some companies think about office space. Is that reflected in real estate valuations?

Will Robson: Well, I'm going to say at real estate, we track the private valuations and construct indexes in those. Just a feature of private marketeers is that the pricing is valuation appraisal based and so you tend to see them move more slowly than in the listed markets. For private market valuations, we've seen pretty muted response so far. We're talking about in the region of two to 5% say for different markets and different property sectors. That seems pretty small compared to the movements you've seen in listed real estate companies, which have been in the order of 10, 20, 30% depending on which markets and which sectors.

Adam Bass: Which sectors have been hit hardest?

Will Robson: Obviously retail has been pretty hard hit because there's just no shoppers in the shops at the moment. Hotels because of the travel industry has been hit. No one's flying in planes and occupying hotels. The short-term impacts on those kinds of property sectors are being pretty severe. You've seen that kind of impact is coming into the private valuations as valuers are assessing the shorter term impacts of cashflow. You've seen lots of tenants asking for either rent holidays or rent deferrals kind of through the period of the crisis, so maybe for a quarter or two. You've seen some tenants, whether they're asking for it or not, just not able to pay the rent.

Obviously a very short-term kind of big hit to net operating income and that seems to be suggesting that it's that kind of short term impact to cash cashflow that is being factored into the valuations in the early stages of this crisis. Those kinds of smaller movements in the valuations are kind of supported by some modeling work that we've done. It seems like in the listed markets, investors there are factoring other elements into the prices, either longer-term hits to growth expectations so that there's more of a structural change in the cash flows of real estate assets or it's just risk appetite and had to [inaudible 00:04:44] for those assets.

Adam Bass: Retail real estate under pressure, that's not a new story.

Will Robson: The weakness you've just seen in retail is obviously through the impact of lockdown and social distancing, but that was a kind of a trend that we were seeing before the COVID crisis. Online retailing had been putting a lot of pressure on retail real estate for a number of years in many property markets. You've seen in many markets the returns from retail real estate entering into negative territory months or years before this crisis hit. I think we're just seeing this crisis kind of exacerbating or accelerating those trends that were already beforehand. Offices, it's not as dramatic, but you still had a sense of disruption on the horizon from the kind of co-working business model.

Obviously in the short-term, that kind of co-working model of offices is very stressed, but depending on how people think about the new normal for office work, the extent to which people are going to from home or want to work more locally to their homes, but perhaps not in their homes. Maybe that model could come back in a slightly different guise.

Adam Bass: How about clients? What's on their minds? What are they asking you about?

Will Robson: Clients are very focused in the short-term and just being able to collect rents where they can and help their tenants through this crisis. I think that the thing that we're grappling at the moment with is the extent to which tenants can get their businesses open again and start receiving revenues so that they can start paying rent. If this is kind of a three to six month thing and you can help your tenants through, it's in the best interest of everybody to make sure these businesses stay viable. Now, you contrast that with the comment I said about this crisis exacerbating some trends that are already there. There may be certain sections of the tenant base or the economy that kind of challenged business models anyway and this has just accelerated that.

Adam Bass: As veteran of working from home, Will, any words of wisdom for when we all go back to the office, whatever that ends up looking like?

Will Robson: Although everyone's doing this virtually, I think people have more of a personal connection with the people they work with now because they see a bit more of their lives through a Teams call or a Zoom call, kids popping in the background, that kind of thing. I hope one of the things that stays after this is a better realization of the balance between work life and home life.

Adam Bass: That's all for this week. Thanks to Will and to all of you for joining us. If you have a moment, be sure to leave a comment and to subscribe so you can stay up to date on our latest episodes and insights. For more from MSCI, check out our ESG Now Podcast. This Friday's episode looks at palm oil, meat packers, and India. I'll be listening. As always, you can follow us on the MSCI LinkedIn page and please bookmark www.msci.com/coronavirus for all our crisis related content. Until next week, I'm your host Adam Bass, and this is MSCI Perspectives. Stay safe everyone.

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