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Global Capital Flows in a World of Increasing Nationalism and Protectionism

DISCUSSION PAPER

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Global Capital Flows in a World of Increasing Nationalism and Protectionism

Discussion Paper

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Research Team

Matthew Richardson, *Didobi*
Stephen Ryan, *Didobi*
Simon Mallinson, *Real Capital Analytics*
Anna Walker, *Control Risks*
Giulia Zino, *Control Risks*
Joseph Smith, *Control Risks*
Charles Hecker, *Control Risks*

Project Steering Group

Andrew Angeli, *CBRE Global Investors*
Ben Sanderson, *Hermes Real Estate Investment Management*
Ben Thatcher, *Barings Real Estate Advisers*
David Dix, *The Townsend Group*
Simon Wallace, *DWS*
Pam Craddock, *IPF*

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CONTENTS

1.	Introduction		1
2.	Protectionism, Nationalism and the CRE Market		2
	2.1	Setting the Scene	2
	2.2	Setting the Scene - The Real Estate Perspective	4
	2.3	How Did We Get Here?	8
	2.4	How Did We Get Here? - The Real Estate Perspective	10
3.	Scenarios - Outlook to 2030		15
	3.1	Scenario 1: Growing Global Uncertainty	15
	3.2	Scenario 2: Fragmentation of the Global Order	16
4.	Potential Impact on Real Estate Markets		17
	4.1	Capital Flows	17
	4.2	Investors	19
	4.3	Occupiers	21
	4.4	Research, Data and Technology	21
	4.5	Politics	22
	4.6	Financial Markets	23
	4.7	Challenges and Opportunities	24
5.	Conclusion		26
	5.1	Immovable Asset Class	26
	5.2	Residential and Logistics to Bear the Brunt	26
	5.3	Transaction Volumes Drive Revenues	27
	5.4	Mitigating Factors	27
	5.5	Final Thought	27

Global Capital Flows in a World of Increasing Nationalism and Protectionism

1. INTRODUCTION

The global political and economic landscape has undergone rapid change over the past decade. Popular and political reactions to the 2008-2009 Global Financial Crisis (GFC), increasingly multipolar geopolitics and the asymmetric impact of new technologies have converged in the rise of political populism, and in turn that of the nationalist, protectionist and isolationist movements. Investors, including those in the commercial real estate sector (CRE), face greater unpredictability and strategic uncertainty and are under pressure to adapt by becoming more resilient, more flexible and more diverse.

Against this backdrop, this paper focuses on the threats and opportunities posed by growing nationalism and protectionism to global capital flows in the real estate investment sector.

Two scenarios have been chosen to outline potential trajectories for the global political and economic landscape through to 2030 and what these may imply for the real estate investment sector. The scenarios are – in the authors' view – highly plausible, though not necessarily the two most likely trajectories during this period. They have been chosen primarily to stimulate debate within the real estate investment sector, and to help the industry respond as the political and economic landscape evolves over the next 10 years.

2. PROTECTIONISM, NATIONALISM AND THE CRE MARKET

2.1. Setting the scene

The aftermath of the 2008-2009 GFC has caused growing distrust in the ability of established political parties to act as guarantors of economic and social progress. This has allowed populist movements to make significant electoral gains – particularly across Western Europe and in the US – by pitting themselves against the political mainstream. Political populism can be seen in the rise of nationalist, protectionist and isolationist movements, some of which have xenophobic tendencies. These movements have injected a high degree of instability into the political landscape and in some cases caused unpredictable shifts in government policy. Even in countries where they do not have significant representation in government, populists have reinforced political polarisation and strongly influenced economic policy.

Broadly speaking, the post-Cold War centrist political consensus in the US and Europe that supported both economic liberalisation and the development agenda is being dismantled by left- and right-wing political movements seeking greater national control of economic and security policy. Their positions on trade and immigration expose deep economic and social divisions between the perceived winners and losers from globalisation. Among other factors, populism reflects prolonged economic crisis (which has driven rises in unemployment and falls in income), public spending policies (contributing to greater economic inequality) and – particularly since 2014 – external threats (notably uncontrolled migration and transnational terrorism). These are not necessarily new developments. What is new is that populist movements are seizing specific political opportunities, from the Brexit movement in the UK to the 2016 US presidential election, to challenge and change the status quo.

Meanwhile, nationalism has become more influential in international relations. Instead of promoting global or multilateral norms and institutions, many countries are explicitly promoting national sovereignty as the basic unit of international relations.

These trends have primarily materialised in Europe and the US and, to a lesser extent, in Latin America and Asia.

2.1.1. In Europe, populist and nationalist parties have been on the rise in recent years, and in some cases have entered national and regional parliaments. This has been particularly visible in the UK, where the June 2016 referendum on leaving the EU can be seen as both fuelling growing populism and protectionism and contributing to an increase in these trends. In Germany, the far-right Alternative for Germany party (AfD) increased its seats in the European Parliament in the May 2019 election, and in regional elections on 1 September this year in the states of Brandenburg and Saxony the AfD saw a surge in its vote share. In France, the 2017 presidential and May 2019 European Parliament election results have shown Marine Le Pen's far right and nationalist National Rally (RN) emerging as a credible opponent to ultimate victor Emmanuel Macron. Eurosceptic and populist parties have also been on the rise in Italy, fuelled by irregular migration and the perceived lack of EU support to handle the large number of arrivals on Italian shores. Spain's far-right nationalist party Vox has gained popularity vis-à-vis the two previously dominant centre-right and centre-left parties – it more than doubled its number of seats in the November 2019 election, to become the third most powerful party. Nationalist-conservative and Eurosceptic political parties are also strong in Central and Eastern European EU member states, such as Poland and Hungary.

2. PROTECTIONISM, NATIONALISM AND THE CRE MARKET

2.1.2. In the US, the administration of President Donald Trump has elaborated a foreign policy under the banner of 'America First', which focuses on reducing US trade deficits and includes nationalism and militarism as key tenets. The Trump administration has strained relations with key allies by calling into question US security commitments (especially in Europe and East Asia); undermining global climate mitigation efforts (notably by withdrawing from the 2015 Paris Agreement on climate change; withdrawing from or attacking trade agreements (including the Trans-Pacific Partnership and the North America Free Trade Agreement); increasing trade barriers and tariffs; and withdrawing from the Iran nuclear deal (Joint Comprehensive Plan of Action).

Trump's America First policy has found its most dramatic expression in US trade policy, which broadly seeks to assert national sovereignty, reduce nominal bilateral trade deficits – which the administration perceives as economically disadvantageous – and protect and strengthen US manufacturing industries. A protectionist trade policy has also been promoted as a way of strengthening national security. The Trump administration views the World Trade Organization (WTO) and other multilateral institutions – all of which the US helped create after the Second World War – as unacceptable constraints on sovereignty at a time of increased geopolitical competition, rather than as a vehicle for global leadership. Politically, Trump views decisive action on international trade as important to sustaining domestic support – particularly as the 2020 presidential election approaches. In particular, the US has mounted a broad spectrum of trade challenges against China, expanded non-tariff economic measures on Beijing, accused it of election interference and increased US Freedom of Navigation Operations in the disputed South China Sea.

2.1.3 Latin America has also experienced a rise in personality politics and populism, with topics such as corruption and crime becoming the central concerns for voters beyond the traditional socio-economic and political cleavages of left and right. This has been seen in the region's largest economies, Mexico and Brazil, with the elections of President Andrés Manuel López Obrador in July 2018 and Jair Bolsonaro in October 2018 – though their political tendencies fall on the left and far-right, respectively.

2.1.4 In Asia-Pacific, economic protectionism remains a driving force and dampens prospects for a significant expansion of intra-regional trade in the coming years, despite a broad regional commitment to trade liberalisation. Protectionism persists in countries such as Indonesia, India and Malaysia and there is limited political will to dilute barriers in sensitive economic sectors over fears of losing public support. A persistent economic slowdown in China as a result of deep-seated economic structural challenges and the US-China trade disputes will continue to increase downward pressure on other regional economies. This is likely to lead to individual country leaders attempting to shore up their domestic popularity through increased economic nationalism and populist politics in the next few years. However, in a rare sign of resistance to the trends elsewhere, support remains strong for regional trade initiatives such as the Comprehensive and Progressive Trans-Pacific Partnership and the Regional Comprehensive Economic Partnership.

2. PROTECTIONISM, NATIONALISM AND THE CRE MARKET

2.2. Setting the scene – the real estate perspective

Real estate markets do not operate in isolation and have not been immune to the broader economic and political changes taking shape across the globe in the decade since the GFC. However, before looking at how these have impacted the global real estate industry, it is worth noting that international real estate investment markets have never become fully integrated into a global market in the way that equity and debt markets have. This is important because real estate investments, being physical assets, are more easily controlled by national governments and an obvious target for taxation and regulation.

This is partly because real estate assets are lumpy, heterogeneous, tied to one location and less liquid than listed equities or bonds. It can also be explained by the fact that access to land and the ownership of property have been emotive topics. Despite the recent globalisation of many investment markets, ownership of property has remained more tightly controlled than other assets and foreign investors restricted or excluded from owning assets in many countries. By way of example, private ownership of property has never been permitted in India while in Vietnam, China and much of South East Asia buyers have not been able to acquire full freehold rights.

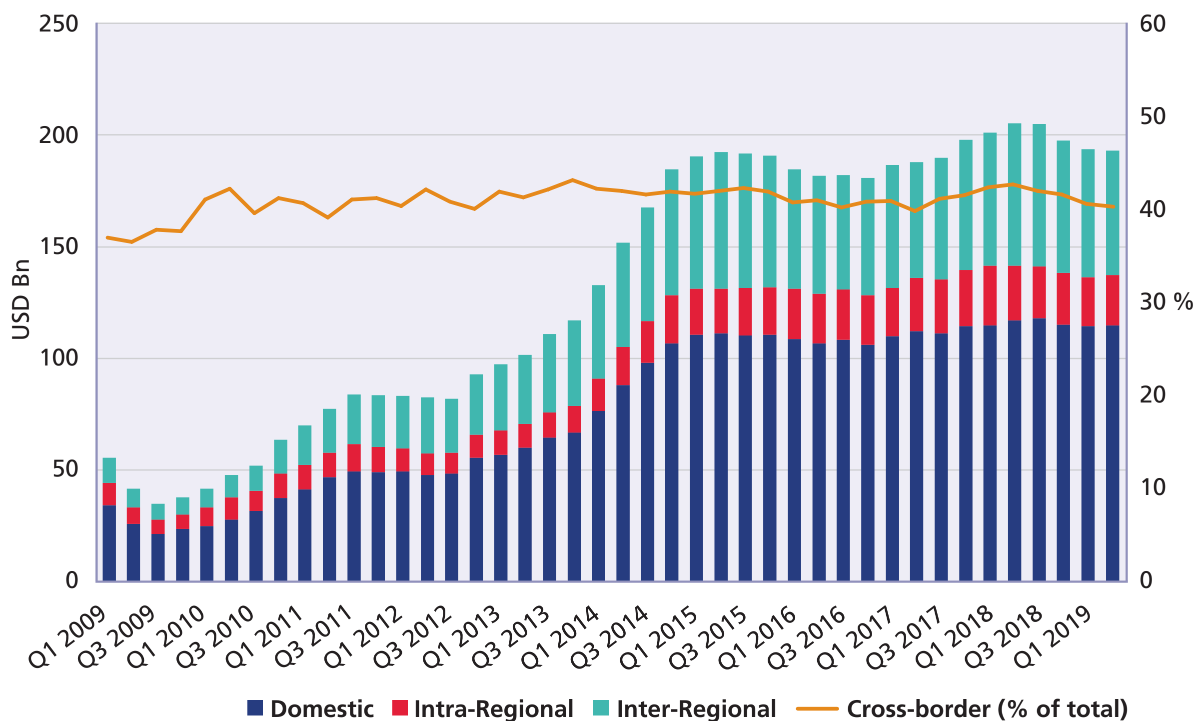
Direct legislation to curb foreign investment has a long history. In 1980, the US introduced the Foreign Investment in Real Property Tax Act (FIRPTA), whereby overseas investors are subject to a withholding tax (generally set at 15%) when they sell their US investments. The buyer is the withholding agent because it is easier to collect tax from someone with a US connection. The foreign seller then settles their final tax liability with the Internal Revenue Service, which may be less than the amount withheld. Curiously the original rationale for FIRPTA was a concern about increasing foreign ownership of farmland, not buildings. The US Treasury Department recently (September 2019) proposed new regulations[1] to tighten government scrutiny on foreign investments including a wide range of real estate deals in the US. The regulations, which focus on property situated near military installations, airports and ports, take effect early in 2020 and their impact might be to further depress Chinese investment in US commercial real estate.

However, as with other investment asset classes the last 30 years has seen a steady increase in cross-border investment flows in real estate markets.

[1] The regulations implement the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA)

2. PROTECTIONISM, NATIONALISM AND THE CRE MARKET

Figure 2.1: Global Transactions by Volume, 2009-2018



Source: JLL.

A key feature of the growth in cross-border investment activity has been its relatively high concentration in a small number of international markets. The top 20 cities made up over 50% of total transaction volumes in the period 2007 to first half of 2019[2], when some of the most popular cities for residential investment were Berlin, London, Los Angeles, New York, Tokyo and Washington; for commercial real estate, the busiest locations were principally the same cities plus Amsterdam, Chicago, Frankfurt, Paris and Sydney. While politicians have largely ignored the growth of foreign ownership in commercial property markets[3], the impact on local residential markets has prompted a widespread political backlash in many countries as local buyers feel themselves ‘priced out of their home market’ by richer foreign investors.

[2] Source: Real Capital Analytics
[3] Possibly because foreign commercial ownership is less visible and large-scale projects are achievable only with foreign capital

2. PROTECTIONISM, NATIONALISM AND THE CRE MARKET

The rise in international ownership has led to a number of concerns that have resonated with nationalist and protectionist themes:

- A growing resentment towards the globalisation of residential assets (particularly at the prime end of the market) has led to local and central government implementing a range of legal and tax restrictions on foreign buyers. While much of this global capital has been concentrated on demand for high-end apartments the trickle-down effect has contributed to a general rise in house prices.
- The globalisation of the residential market has fuelled the perception that transient residents (such as tourists, students or 'digital nomads'[4]) are consuming excessive amounts of the available stock of housing. Transient residents are blamed for making housing unavailable for long-term residents, for undermining local community cohesion or for anti-social behaviour. Closely related to the first two issues is the 'Airbnb factor'. In many European tourist centres, the success of Airbnb and similar online platforms has enabled many homeowners to become small-scale hoteliers. This has led to investors buying up a growing percentage of the housing stock and making them available on short lets. This trend is thought to have contributed to a marked rise in rental values and in asset prices in cities such as Amsterdam, Athens, Florence, Lisbon, Paris, Rome and Venice.
- The perception that foreign ownership is hollowing out some neighbourhoods. Foreign investors in residential assets who leave those assets unoccupied may be blamed for creating 'ghost streets': this charge is often levelled at Asian investors in London, Sydney, Vancouver and elsewhere.
- A sense that foreign ownership could result in a loss of national heritage. This idea was occasionally aired in the late 1980s in the US when Japanese investors bought iconic assets (including Rockefeller Center and Pebble Beach golf course); it also surfaced in the UK when Norway's sovereign wealth fund invested in London's Regent Street.
- Concerns that growing foreign ownership is a threat to national security is mentioned as justifying restrictions (though less often than is the case with infrastructure investment).

New laws have been passed to address many of these issues and some examples are shown below. Responses have varied from fairly invasive in Canada and New Zealand to minimal in Ireland. Interestingly, many of the countries implementing restrictions have traditionally been amongst the most open and transparent markets – namely Australia, Canada, New Zealand, the UK and the US.

[4] People who use telecommunications technologies to earn a living and, more generally, conduct their life in a nomadic manner. Such workers often work remotely from foreign countries, coffee shops, public libraries, co-working spaces, or recreational vehicles (source: Wikipedia).

2. PROTECTIONISM, NATIONALISM AND THE CRE MARKET

2.2.1. Restrictions on foreign ownership

In 2016, British Columbia introduced a law that makes foreign purchasers of residential property in the Greater Vancouver Regional District liable to a new 15% property transfer tax[5]. The tax was increased to 20% in 2018. New-build homes were exempt from this charge but have subsequently been targeted with other measures, including a registry of 'home flippers', aiming to combat tax evasion. As a direct consequence of these measures the volume of house sales in Vancouver has now dropped to its lowest level in decades[6]. Similarly in 2017, Ontario followed suit with its Non Resident Speculation Tax, which levied a 15% tax on the purchase or acquisition of an interest in residential property located in and around Toronto by individuals who are not citizens or permanent residents of Canada or by foreign corporations (foreign entities). In 2018, New Zealand banned non-residents from purchasing most types of homes – but they will be able to make limited investments in new apartments within large developments. Foreigners with residency status in New Zealand – as well as non-resident Australian and Singaporean nationals – are not affected by the ban[7].

2.2.2. Restrictions on Airbnb and similar

The restrictions take various forms, such as a cap on the number of days per year that a residential unit may be let out (30 days in Amsterdam, 90 days in Dublin and London, 120 days in Paris) or a cap on the amount of space that can be let out (50% in Munich). Such rules may be accompanied by other requirements relating to reporting (for tax purposes) or health and safety requirements.

The aim of these rules is to reduce investor demand, to stabilise rents and prices, to free up housing stock for long term residents or to restore a neighbourhood's essence. It is too early to gauge the impact of these rules, though a study in 2017 did suggest that restrictions on Airbnb in New York and Barcelona were slowing the rate of growth of Airbnb listings[8].

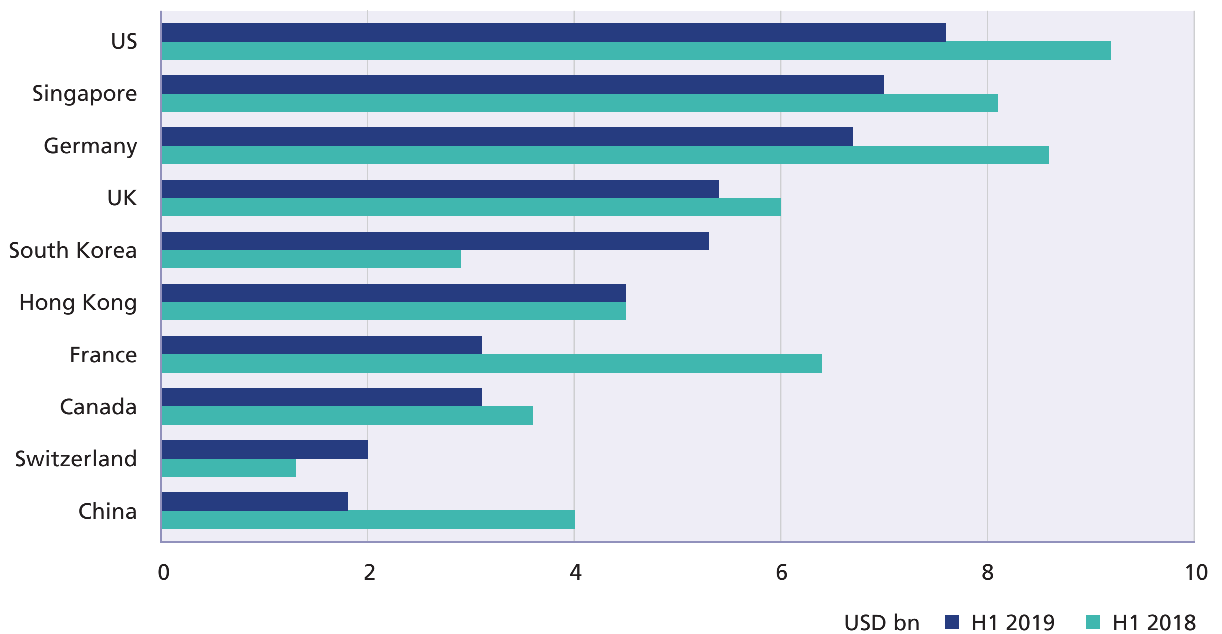
2.2.3. Restrictions on Capital Flows

The weight of capital looking to find a home in real estate markets can be problematic for those countries that have been major exporters of liquidity. Such has been the scale of capital exports from China that in December 2017 legislation was introduced whereby investors wishing to invest in real estate overseas worth over USD300m per transaction were required to obtain a licence for each transaction. This measure has influenced overall cross-border flows. In its latest report (to end Q2 2019) JLL note that cross-border flows in general have been slowing. Among the key factors behind this decline is lower outbound acquisition activity relative to prior years from Asian investors, notably Chinese groups. Mainland Chinese groups were among the most active cross-border investors in prior years, but investment has been curbed due to increased regulatory oversight on foreign investments.

[5] https://www.pwc.com/ca/en/services/tax/publications/tax-insights/bc-imposes-new-15-percent-tax-on-foreign-buyers-residential-property.html
[6] Source: FT "Why buyers are turning away from luxury property", 03 08 2019
[7] https://www.bbc.com/news/world-asia-45199034
[8] https://www.cnbc.com/2017/04/13/airbnb-growth-slowing-regulation-ubs.html

2. PROTECTIONISM, NATIONALISM AND THE CRE MARKET

Figure 2.2: Top 10 Cross-border Purchasers by Source of Capital, 2018 versus 2019



Source: JLL

2.3. How did we get here?

Popular and political reactions to the 2008-2009 GFC have converged with increasingly multipolar geopolitics and the asymmetric impact of new technologies to provoke a continuing crisis of legitimacy in the international political and economic system of institutions and norms built following the end of the Second World War. This system emphasises synergy among capitalism, democracy, free trade, open borders and minimal state intervention in economic affairs. Globalisation – the process by which business dramatically diversified the geography of supply chains, manufacturing and distribution – grew within this architecture, but also stretched it and, in some cases, distorted it.

Accelerated by the global financial crisis, a new global economy has emerged as a result of rapid growth in the developing world, where large economies like China and India, and regions like South-East Asia and sub-Saharan Africa, increasingly lead trade and investment opportunities. In turn, the post-Cold War system crafted by the US, Europe and their allies is contested in terms of military primacy, institutional dominance and ideological attractiveness.

2. PROTECTIONISM, NATIONALISM AND THE CRE MARKET

Against this background, several trends have emerged:

2.3.1. Emerging markets have become rising powers

Globalisation has driven the rise of emerging markets – fast-growing economies developing from low- to middle-income status – creating a more diverse global economy and eroding the dominance of the US, Europe and other high-income countries. In turn, rapid economic growth in emerging markets has fostered the emergence of rising powers with the desire and means to shape geopolitics in favour of national interests. This has created a more complex and multipolar world order distinct from the post-Cold War era of US hyper-power or unipolarity.

2.3.2. Rise of nationalism

Countries are explicitly endorsing national sovereignty over global or multilateral norms and institutions. The nationalist shift in US foreign policy under the Trump administration has accelerated this trend, given that the US was a key architect and main guarantor of the post-Cold War system and globalisation. This move is encouraging allies in the Middle East and Asia-Pacific to pursue more independent foreign policies. China and Russia, as well as regional powers such as Turkey and Saudi Arabia, are espousing narratives of national greatness in pursuit of regional and global spheres of influence.

2.3.3. Inequality is fuelling institutional resentment

The drivers of economic inequality are complex and include issues beyond geopolitics, such as technology, automation and access to resources. However, globalisation has played a key role in shifting where work is done and how much it is worth. This has prompted a backlash from constituencies that feel that they have suffered as a result of globalisation. They question the global architecture and seek to roll back the internationalisation of previous decades. The anti-globalisation movement renewed its momentum after the 2008-2009 GFC, though more recently it has gained support in right-wing politics amid the rise of nationalist populism in the US and Europe.

2. PROTECTIONISM, NATIONALISM AND THE CRE MARKET

2.4. How did we get here? The real estate perspective

2.4.1. Political decisions to deregulate capital markets

The late 1970s and early 1980s were marked by fundamental changes in the macroeconomic policies of industrial countries. In the UK and US, the new economic policies included a commitment to curb the role of the public sector in the economy and loosen its regulatory grip on private enterprise. In the case of Japan, where the issue and trade of government bonds had been subject to greater restrictions than in other countries, these restrictions were lifted in stages between 1977 and 1985 and capital controls were progressively lifted following negotiations between Japan and the US in 1984.

This new approach involved far-reaching reforms and liberalisation of major sectors of their economies, including the financial services industry[9]. The 'Big Bang' of 1986, which deregulated London's Stock Exchange, is an example. There were three key elements to this initiative:

- Abolition of minimum fixed commissions on trades;
- Ending of the separation between traders and client advisers; and
- Allowing foreign firms to own UK brokers.

"By ending fixed commissions Big Bang allowed more competition; by ending the separation of dealers and advisors it allowed mergers and take-overs; and by allowing in foreign owners it opened London's market to international banks. Coupled with the new magic of electronic trading, the City jumped from the 19th Century to the threshold of the 21st".[10]

Foreign ownership was also facilitated by two earlier initiatives: floating exchange rates, which were introduced in the early 1970s, and removal of exchange controls (starting in 1979 in the UK). For example, the dramatic change in financial firms' business models precipitated by financial deregulation, combined with rapidly evolving technology, changed the physical requirements of these occupiers, which meant integrated trading floors were needed. The resultant change in occupier demand for large floor plates led in time to the development of Canary Wharf and similar locations globally.

2.4.2. New investors, new market structure

Since the 1980s, ownership and control of UK commercial property has changed. Privatisation and globalisation have led to a diminished role for the traditional owners (in the UK, for example, the Crown, the Church, Oxford and Cambridge Colleges, central and local government) and an increased role for overseas investors such as sovereign wealth funds and foreign pension funds[11]. In 2005, direct investment by UK insurance and pension funds remained the largest single element of the investment market, accounting for 29% of the stock by value, whereas, by the end of 2017, stock held by overseas investors had doubled to 30%[12] and the share held by UK pension funds and insurance companies had decreased to just 16%.

[9] See Financial Deregulation and the Globalization of Capital Markets, World Bank (1988)
[10] BBC report in 2016
[11] See International Real Estate: An Institutional Approach (2004), Chapter 10 by Andrew Baum
[12] The Size and Structure of the UK Property (2018), IPF

2. PROTECTIONISM, NATIONALISM AND THE CRE MARKET

In the US, pension funds became a major force in real estate in the 1970s. This was partly a reaction to the stock market crash of 1973-1974 and partly a reaction to high inflation. In the 1980s, the number of real estate advisers and consultants exploded, the early investment experience was positive and the diversification benefits, emphasised by the Employee Retirement Income Security (ERISA) Act 1974, were real. Creation of the National Council of Real Estate Investment Fiduciaries (NCREIF) index facilitated performance measurement. A building boom, combined with the recession of the early 1990s, caused returns from US property to falter, but that decade also featured a surge in both Real Estate Investment Trust (REIT) capitalisation and the issuance of commercial mortgage-backed securities. The dotcom bubble of the early 2000s cemented the attraction of core US real estate for many domestic and foreign investors, and US cities continue to rank among the top destinations for global real estate investment[13].

Traditionally, real estate investment markets were insular and tended to be dominated by domestic investors and lenders. However, this changed in the 1980s and 1990s, as financial markets became increasingly deregulated and integrated. While the physical buildings remained in situ, the financial means by which they were acquired, refurbished or redeveloped changed dramatically, as technology enabled greater transparency and investors sought opportunities outside their home markets.

New types of investor emerged: sovereign wealth funds, giant pension schemes (for example, from Australia, Canada and the Netherlands) and US opportunity funds with cross-border investment strategies. German open-ended funds invested in the UK and beyond.

Table 2.1: Top 10 Institutional Real Estate Investors, 2018

Rank	Investor	Country	Real Estate Assets (USD bn)
1	Allianz Real Estate	Germany	72.40
2	China Investment Corporation	China	52.85
3	ADIA	UAE	51.23
4	APG	Netherlands	48.38
5	TIAA	US	47.16
6	AXA	France	36.31
7	Temasek	Singapore	35.32
8	QIA	Qatar	35.00
9	Canada Pension Plan Investment Board	Canada	33.90
10	CalPERS	US	33.43

Source: IPE Real Assets, December 2018

The 10 biggest institutional investors in real estate as at December 2018 are shown in Table 2.1. The IPE Real Assets survey captured more than USD1.34tn (€1.2tn) in real estate assets held by pension funds, sovereign wealth funds and other institutional capital owners (i.e. not managers). Four are sovereign wealth funds rather than traditional institutions.

[13] 11 of the top 20 cities, as measured by deal volume, are in the US (source: RCA)

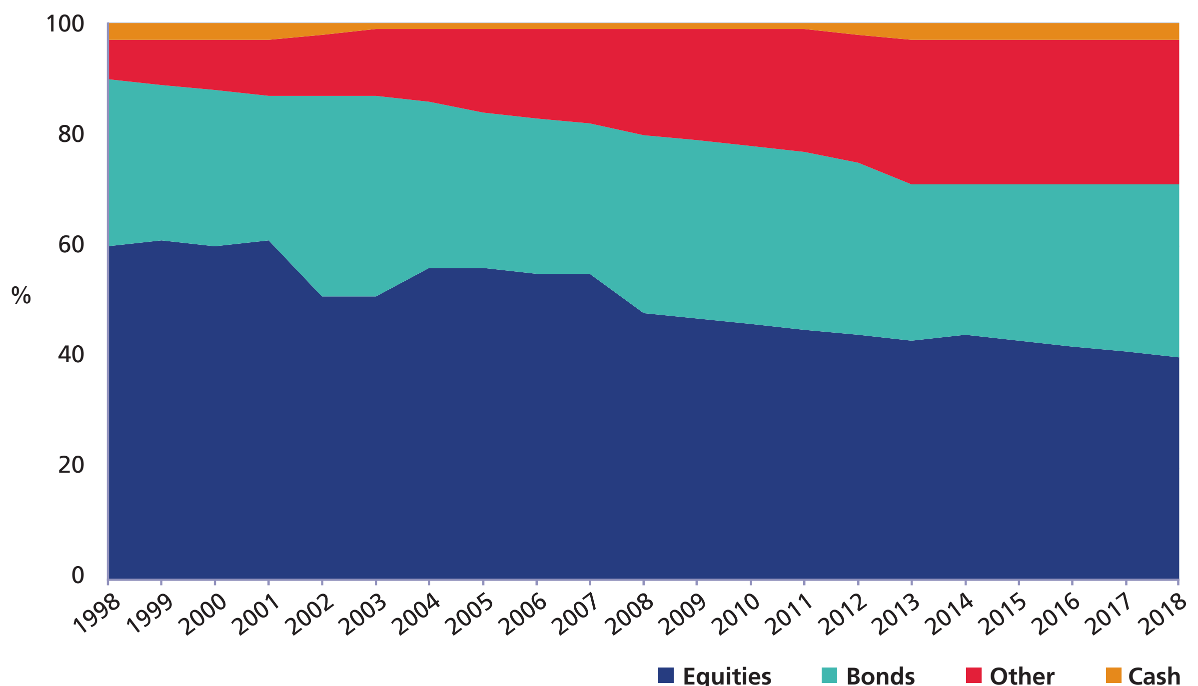
2. PROTECTIONISM, NATIONALISM AND THE CRE MARKET

2.4.3. Global diversification

Investors traditionally focused on equity and bond markets, but, encouraged by modern portfolio theory (which emphasises diversification) and high inflation, investors from the 1980s onwards looked for alternative asset types. The rise in institutional investment in real estate is part of a wider trend favouring 'alternative' asset classes over traditional asset classes.

Since 2008 and 2009, the widespread use of quantitative easing (QE) policies in Europe and North America has precipitated a collapse in government bond yields around the world, which, in turn, has forced investors to look at higher yielding assets, such as real estate, to meet their pension and insurance obligations. The net result has been a surge in property prices across the developed world.

Figure 2.3: Aggregate P7[14] Asset Allocations, 1998-2018



Source: Thinking Ahead Institute and secondary sources.

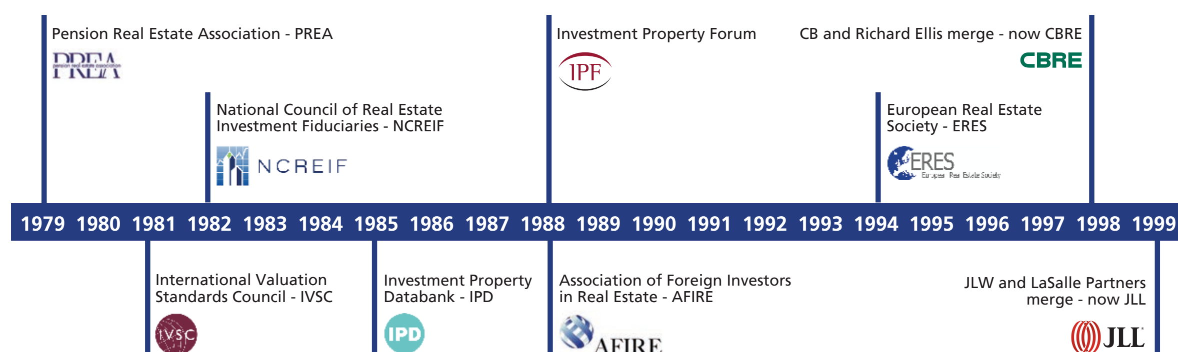
[14] P7 being the seven biggest pension markets, namely, Australia, Canada, Japan, the Netherlands, Switzerland, the UK and the US.

2. PROTECTIONISM, NATIONALISM AND THE CRE MARKET

2.4.4. Revolution in telecommunications and information technology

Technological development has played a pivotal role in the development of a global real estate investment market and it is no coincidence that the surge in cross-border activity coincided with growth in widespread access to cheap and reliable telecommunications. Listed securities and debt markets could use Bloomberg, Dow Jones, Reuters and other platforms; the CRE private sector responded by initiating data services such as CoStar, IPD (now MSCI) and RCA. The industry also displayed greater willingness to align property valuations and accounting standards for real estate vehicles across-borders.

Figure 2.4: Scale, Transparency and Institutionalisation of Global Real Estate Industry, 1979-1999



Source: Didobi.

2.4.5. Greater choice of investment vehicles and strategies

A virtuous circle emerged in the 1990s whereby greater interest in international investment spurred the creation of new access routes to the real estate market; and new access routes, in turn, encouraged more investment. Access routes to the real estate market included direct investment, a separate account, some form of unlisted pooled vehicle (a joint venture, a club or a fund), a listed entity (a REIT or a Real Estate Operating Company) or a property derivative.

Regional and inter-regional investment was undertaken around this time. The first pan-European funds were launched, and US and European investors started to make investments in Asian CRE markets.

Unlisted pooled vehicles have proliferated since 2002, to the extent that a pan-European trade association INREV (Investors in Real Estate Vehicles) was founded in 2003 and now maintains a database of 464 vehicles. In addition, INREV has a sister organisation in Asia, ANREV, while two US-based organisations also operate in this area[15].

[15] PREA (Pensions Real Estate Association) and NCREIF (National Council of Real Estate Fiduciaries)

2. PROTECTIONISM, NATIONALISM AND THE CRE MARKET

Listed entities have also proliferated; to date 26 countries worldwide have functioning REIT markets[16]. In Europe alone there are close to 500 listed property vehicles, of which 194 are REITs[17]. EPRA (the European Public Real Estate Association) represents the listed real estate sector in Europe. Founded in 1999, its membership has grown from 25 to 275 today.

In additional to a more varied choice of vehicle, investors also benefit from a real estate of investment styles. Just as equity investors have long been able to choose between recognised styles such as growth and value, real estate investors can now filter pooled vehicles by style, the main ones being core, value added and opportunistic[18].

2.4.6. Emergence of global advisory businesses

The period from the mid-1980s to today witnessed the creation of global advisory businesses (legal, investment consulting, brokerage and other) to service global occupiers and investors. This marked another step in the evolution of real estate from an operator-driven 'cottage industry' to an institutional asset class. Advisers operating globally have created economies of scale that have often reduced professional fees for investors.

2.4.7. Financialisation of markets

Financialisation has been defined as the "growing scale and profitability of the finance sector at the expense of the rest of the economy and the shrinking regulation of its rules and returns."[19] In terms of real estate, it can be defined as the transformation of opaque, local, non-standardised goods, highly dependent on local legislation and developments, into liquid, globally traded financial assets[20]. Turning real estate into 'just another asset class' requires a degree of transparency and liquidity that was unimaginable 30 years ago but is now much closer thanks to developments such as better indices, a body of high-quality academic research and greater use of secondary trading by investors in property vehicles.

2.4.8. This is how we got here

The question 'how did we get here?' can be answered from a real estate perspective by pointing to the convergence of seven trends:

- Political decisions to deregulate capital markets;
- New investors and new market structures;
- Global diversification;
- Revolution in telecommunications and technology;
- Greater choice of investment vehicles and strategies;
- Emergence of global advisory businesses; and
- Financialisation of markets.

To summarise, until the 1990s real estate was "set back"[21] from the other major asset classes; it is now more closely (though not fully) integrated with them.

[16] Source: PwC
[17] Source: EPRA
[18] Other styles are core plus and long income
[19] Forbes https://www.forbes.com/sites/mikecollins/2015/02/04/wall-street-and-the-financialization-of-the-economy/#6457473c5783
[20] https://www.tandfonline.com/doi/abs/10.1080/09654313.2016.1277693
[21] Andrea Carpenter's description, from her book "High Rise and Fall: The Making of the European Real Estate Industry"

3. SCENARIOS – OUTLOOK TO 2030

Against the backdrop outlined in Section 2, this section introduces two potential scenarios for the global political and economic landscape through to 2030, and the implications for real estate investors specifically. Both scenarios – in the authors' view – are plausible, but not necessarily the two most likely trajectories for the next decade. They have primarily been designed to stimulate debate within the real estate investment industry, and we hope that they will do just that.

3.1. Scenario 1: Growing global uncertainty

3.1.1. Snapshot

This scenario sees a broad continuation of recent trends. Global capital flows continue but become more difficult; they are gradually redirected away from traditional investment destinations.

3.1.2. Potential triggers

- Trump is re-elected in the November 2020 presidential election in the US. (Even if the Democrats are successful in winning power in 2020 or 2024, it will take years for the US to repair strained relations with key allies and redefine its place in the new global order.)
- China approaches technological self-sufficiency. The amount of inputs it needs to purchase from US manufacturers decreases.
- France becomes the leading political actor in the EU as shifts in Germany's domestic politics weaken its influence in the bloc.
- Western scrutiny of and pressure on Turkey escalates, driving the country out of the Western sphere of influence.
- Geopolitical tensions in the Middle East and Asia-Pacific remain high, but do not escalate into full-scale conflict.
- As the impact of climate change becomes more evident, the Paris Agreement on climate change (minus the US) remains largely intact, with most regions broadly committed to its key goals.
- Monetary policy remains generally loose as governments and central banks seek to kickstart growth. QE remains a favoured policy option but becomes less and less effective as a stimulus tool.
- Technological change supports growing access to finance and drives financial inclusion across emerging markets, even as longstanding financial centres remain dominant.

3.1.3. Developments/Implications

- The Trump administration's markedly nationalist foreign policy continues to inject significant uncertainty globally through to 2024 at the very least. The US continues to reject multilateral trade agreements in favour of bilateral ones. The WTO becomes increasingly dysfunctional as a result of US intransigence, leading to other countries more frequently resorting to unilateral – and potentially damaging – trade defence measures. Meanwhile, China and other emerging global powers fill the trade vacuum with their own multilateral trade initiatives.
- The impact of climate change continues to accelerate and complicate internal displacement, migration and urbanisation patterns, particularly in developing countries. Rising demographic pressure on large, highly populated urban areas will undermine socio-economic growth and foreign investment, in turn contributing to political instability, civil unrest and crime.

3. SCENARIOS – OUTLOOK TO 2030

3.2. Scenario 2: Fragmentation of the global order

3.2.1. Snapshot

Our second scenario sees a dramatic intensification of the trends outlined in the first scenario, which results in the fragmentation of the global order and a significant disruption in global capital flows.

3.2.2. Potential triggers

- US-China disputes over trade and technology escalate significantly, for instance resulting in the US banning the use of Chinese technology in US infrastructure or cancelling visas for all Chinese students and tech industry employees. China retaliates like-for-like.
- A major security incident involving US military or civilian assets occurs, for instance in the Gulf or on the Korean peninsula, either as a result of a deliberate attack or misidentification, miscalculation or accident.
- The core of the EU, including the European Parliament, becomes governed by extremist, disruptive governments hostile to European institutions.
- Key countries withdraw from the Paris Agreement, which in effect collapses and no longer binds countries to emission reduction targets.

3.2.3. Developments/Implications

- Global economic activity is divided largely into two spheres – one led by the US, the other led by China – and it becomes increasingly difficult to do business successfully in both countries. Capital flows are largely kept within each sphere of influence, as countries will have to choose between their largest trading partner (China) and major defence ally (US) – particularly in Asia-Pacific. National security, technology, trade and protectionism become inseparable in all economic, diplomatic and military relations between the US and China. Rising nationalism and a more confrontational US foreign policy lead to a major conflict, involving global and regional powers. Trade and commodity flows are greatly disrupted, and global energy prices spike. Global supply chains are severely disrupted, forcing a temporary drop in industrial output as new, shorter supply chains are re-established. As a result, global GDP growth stalls and, deeper into this scenario, a global recession takes hold.
- Key EU member states now governed by right-wing governments – for instance, Italy and/or Poland – seek to leave the bloc. The euro weakens substantially, and the Schengen Agreement[22] is suspended. Unprecedented monetary stimulus measures prove insufficient to tackle the disruption, and governments have limited resources at their disposal to provide a fiscal boost.
- With the collapse of the Paris Agreement, collective efforts to reduce carbon emissions and expand the renewable energy industry are fatally undermined. Towards the end of the scenario period and beyond, growth in global emissions accelerates further. Developing economies have increasingly fewer resources to devote to climate change mitigation and adaptation, partly as developed countries fail to offer any assistance. Competition over water resources significantly escalates in the Middle East, South Asia and sub-Saharan Africa, resulting in civil unrest and periodic border conflicts.

[22] The Schengen Agreement, signed in June 1985, created Europe's Schengen Area, in which internal border checks have largely been abolished; 22 EU member states and four non-EU member states are part of the Schengen Area.

4. POTENTIAL IMPACT ON REAL ESTATE MARKETS

Rising protectionism and a desire by many governments to reduce the influence of capital markets through either taxation or legislation is likely to have a major impact on the global CRE investment markets. We have chosen to summarise the implications under the following topic headings:

1. Capital flows;
2. Investors;
3. Occupiers;
4. Research, data and technology;
5. Politics;
6. Financial markets; and
7. Challenges and opportunities.

4.1. Capital Flows

Any restriction on capital flows will affect the investors who own the capital and the receiving real estate "ecosystem"[23]. Restrictions will force investors to find other locations (or asset classes) to invest in and ecosystems to find other sources of capital.

For certain countries the challenge posed by protectionist restrictions may be less problematic. These are the countries that invest broadly the same amount of real estate capital as they attract. These countries have the potential to be largely self-sufficient and therefore less exposed to capital flow restrictions. The US fits into this category. While such countries may need to repatriate – that is, to redirect capital aimed at foreign markets back home – they will escape lightly from any ramping up of protectionism by others. However, such countries may also introduce their own protectionist measures in order to protect their repatriated position.

For many other countries, however, it is not possible to strike this balance because:

- The pool of domestic investment capital may be too large to be absorbed by the domestic real estate market. This could the case where a country's pension assets are very large (for example, the Netherlands and Canada) or its revenues from natural resources such as oil are high (for example, Norway and many Gulf countries).
- The domestic property market may be too large for domestic investors to digest. This could be the case when the property market of the capital city is exceptionally deep and actively traded (for example, London and Paris) or where institutional investors are less of a force (such as Madrid).

[23] Mentioned earlier, it is the network of brokers, valuers, lenders, assorted advisers/consultants and tax authorities involved in transactions

4. POTENTIAL IMPACT ON REAL ESTATE MARKETS

In either case, these countries are more exposed to capital flow restrictions. Under Scenario 1, global capital flows continue but become more difficult; they are gradually redirected away from traditional investment destinations with higher levels of capital seeking investment opportunities in their home markets. The countries that could fare worst are those which (i) have historically been reliant on foreign capital and (ii) do not have enough domestic capital to make up the difference when foreign capital is diverted. These countries, grouped into Tier 1 (very exposed) and Tier 2 (exposed, but less so) are:

Tier 1: Belgium, Canada, Denmark, Finland, India, Ireland, Italy, Russia, Spain, UK; and

Tier 2: Australia, Austria, China, France, Germany, the Netherlands.

Under Scenario 2, capital flows are entirely restricted to Eastern or Western spheres of influence, but within them, flows are weak and face significant obstacles. The countries listed above are still exposed, but the most exposed among them are those who rely on the 'wrong' type of foreign capital: that is, countries in the West that rely on Eastern capital (such as the UK) and countries in the East that rely on Western capital (such as Singapore and South Korea).

Historically, more capital has flowed from East to West (for example, South Korean, Singaporean, Chinese and Gulf investors buying real estate in the US, Europe and Australia) than the other way around. Between 25% and 30% by value of cross-border deals have been deals between the two spheres of influence, and within that figure around 80% have been East-to-West.

An entire ecosystem of brokers, valuers, lenders, assorted advisers/consultants and tax authorities depend on transactions for revenue, and for every person directly employed there are a further three to four people in indirect or induced jobs. Lower volumes over a sustained period will lead to 'right-sizing' among corporates and a search for alternative revenue sources for the taxman.

In a world of reduced free trade and lower growth, it seems unlikely that alternative tax revenues will be required. If this is problematic, the gap will lead to either more government borrowing, reduced public services or even higher real estate taxes.

There could also be a once-off adjustment followed by a new era of lower transaction volumes. Volumes would be lower because domestic players on their own are unlikely to generate the same volume as a combination of domestic and foreign, for many reasons including (i) no opportunity to benefit from shifts in currency, (ii) shared risk premium, (iii) fewer diversification benefits, and (iv) a shallower pool of capital.

The once-off adjustment could be more severe in Scenario 2; indeed, in extreme cases foreigners' legacy assets may become 'stranded' behind new barriers. Note that under IORP II[24], pension schemes must include in their risk assessment risks related to "the depreciation of assets due to regulatory change ('stranded assets')". In Scenario 1 there could be more time given to adjust; Scenario 2 could express itself in abrupt measures (potentially a boon for lawyers but a less appealing scenario for investors).

[24] EU Directive on the activities and supervision of Institutions for Occupational Retirement Provision, adopted in 2016

4. POTENTIAL IMPACT ON REAL ESTATE MARKETS

If investors repatriate and markets become more localised, inertia may set in, which means that globalisation will be harder to 'switch on' a second time.

In terms of valuations, there are two key points to make. First, a gradual reduction in volumes in any given market could increase the illiquidity premium, which has the effect (all other things staying the same) of pushing down values. On the other hand, international flows tend to increase volatility by exposing a market to foreign liquidity events (for example, the Chinese pull-back adversely impacted Manhattan tower prices in 2018)[25]. Reduced volatility should be reflected in a lower overall risk premium, perhaps negating or at least mitigating the illiquidity effect. This is a possibility under Scenario 1.

Second, a less diversified investor base can have an impact on the required rate of return. It has been shown in prior research that foreign investors may not share the same views as local investors.

4.2. Investors

Investors may be inclined to (or forced to) retrench that is, to invest locally or at home to a greater extent than before. Under Scenario 1, this could manifest itself as an inclination to direct future cash flows homeward. Under Scenario 2, this could be an inclination or possibly a regulation to point future cash flows homeward and to sell legacy assets in the now out-of-favour countries. It may also prompt a complete withdrawal of capital from direct real estate as investors simply revert to indirect exposures via equity and debt markets.

International portfolios are generally preferred by investors because the different property markets are not correlated (bringing diversification benefits) and the opportunity set is always greater. When the investable universe shrinks, diversification potential and the opportunity set shrink too. Under Scenario 1, investment committees and other decision-makers will need to balance the political risk of investing abroad with the domestic bias that comes from not doing so. In certain situations, this balance could point towards investment or continued investment in a wide range of global markets[26].

Scenario 1 emphasises the potential macro-economic benefits for three particular markets: Brazil, Mexico and Vietnam. According to JLL, Brazil and Mexico are on the cusp of having their real estate markets considered 'Transparent'.[27] However, these three countries together account for less than 4% of the world's real estate investment market, so there is a limit on their ability to absorb much more capital. In short, there is not necessarily a direct link between stronger economic growth and either willingness or ability for global CRE investors to acquire assets on any major scale.

Europe's insurers and pension schemes rank geopolitical risk as no. 6 in terms of priority in recent surveys. Geopolitical risk is worsening, according to the latest half-yearly assessment from EIOPA.

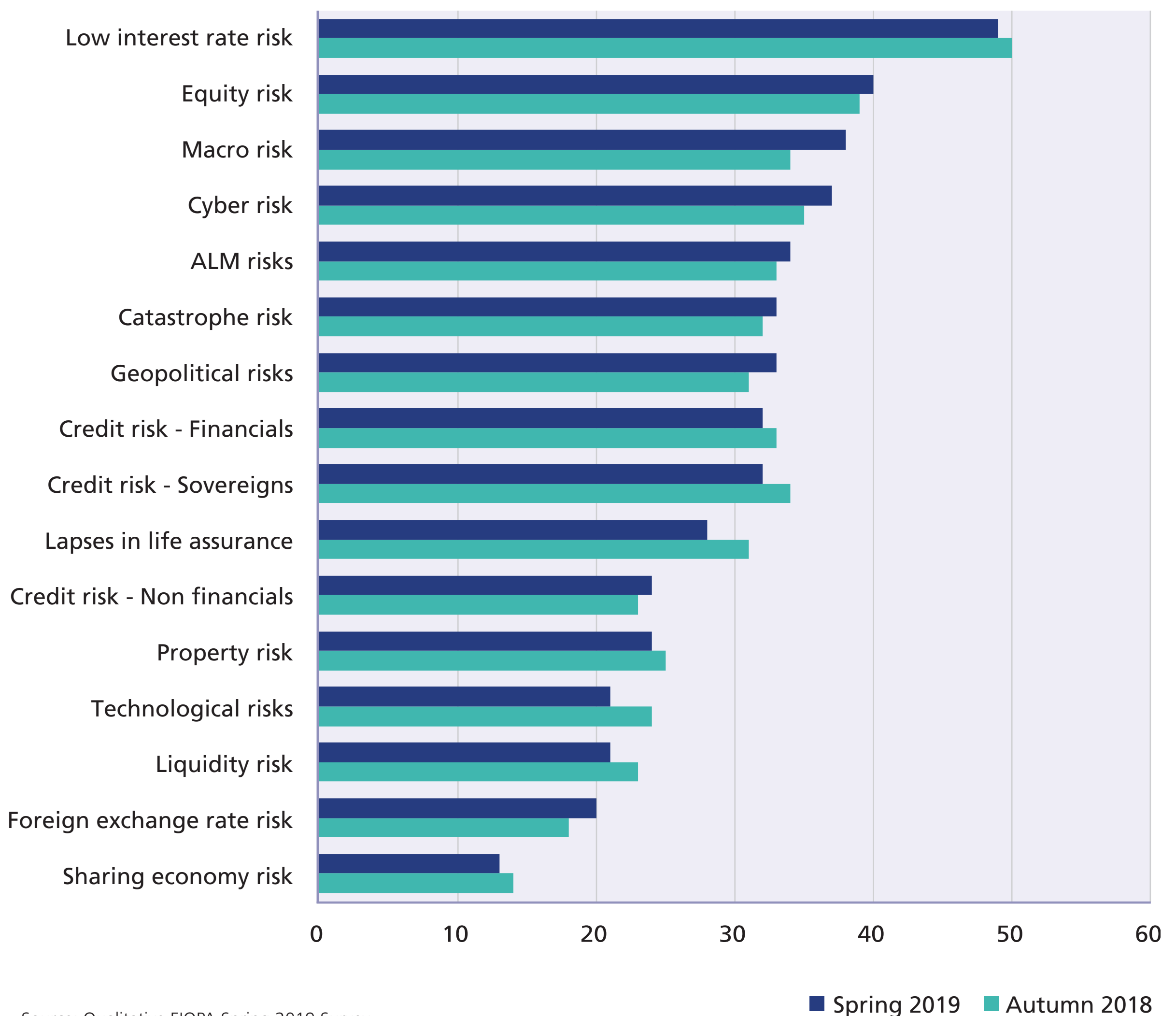
[25] Source: IPF

[26] It is possible that developing economies may lose out because they are considered less vigilant in the area of flood risk or other environmental risks such as air pollution.

[27] JLL GREIT, 2018 report page 9

4. POTENTIAL IMPACT ON REAL ESTATE MARKETS

Figure 4.1: Insurance Sector Ranking of Risk, Autumn 2018 versus Spring 2019



Source: Qualitative EIOPA Spring 2019 Survey

In Scenario 2, investor flexibility will be much reduced – Eastern money will stay in the East and Western in the West. Investors in both spheres will lose out in terms of long-term returns and diversification.

In a less globalised world, there will be less competition between professional advisers and it is probable, therefore, that professional fees will increase.

4. POTENTIAL IMPACT ON REAL ESTATE MARKETS

4.3. Occupiers

Occupiers will grapple with several issues.

Under Scenario 1, Europe is expected to remain politically stable and to see sustained, but moderate, economic growth. Outside Europe, rejection of multilateral trade agreements in favour of bilateral agreements could force a rethink of global 'one size fits all' strategies and value chains. Occupiers that are managed globally may change to multi-regional or multi-country structures. Scrutiny of inbound investment into the US and China on national security grounds will increase political risk and uncertainty for businesses.

For some occupiers, especially those active outside Europe, businesses could be detrimentally affected[28], leading to a reduction in floorspace requirements constraints on rental budgets. One solution is that firms embrace co-working/flex space even more, as a risk management tool. An alternative may be that businesses see fewer expansion options and fewer ways to invest. Some occupiers may choose to be owners (abandoning asset light models[29]), reducing the size of the professionally managed investable universe and, therefore, the availability of real estate for investment.

Under the more extreme Scenario 2, global GDP growth stalls and, deeper into this scenario, a global recession takes hold. Global supply chains are severely disrupted, forcing a temporary drop in industrial output as new, shorter supply chains are re-established. Firms that rely on cheap labour (clothing, tech manufacturing and others) are very severely affected (unless they have already embraced other technologies, such as 3D printing). Protectionist rules that restrict free movement of people may stifle businesses as much as other restrictions, such as tariffs on goods. Occupiers depart from countries that are in or moving towards the 'wrong' (i.e. other) sphere of influence. This is more likely to occur when the firm's operation in that country is not mission-critical but will be a wrenching experience for businesses with a presence in each sphere.

4.4. Research, data and technology

Under Scenario 1, market research provided by global firms such as data providers and the major agents and consultants may shrink in coverage as some countries drop off investors' radar (e.g. Turkey) while others gain priority (e.g. Brazil, Mexico and Vietnam).

Generating data continues to become easier over the period to 2030 thanks the Internet of Things, drones, smart buildings, geolocation and other advances. However, willingness to share data is a separate issue entirely and under Scenario 1, a move to bilateral rather than multi-lateral relationships between countries may impede willingness to share across regions. It is unlikely that governments intent on increasing trade barrier and tariffs will be simultaneously willing to become more open and transparent with their data assets.

Under Scenario 2, data will be hoarded within the two main spheres of influence and as a result research will follow suit. Preferential access to data and research will become the norm and prices are likely to increase.

[28] https://www.ecb.europa.eu/press/key/date/2018/html/ecb.sp180406.en.html
[29] Asset light model is a business model where a business owns relatively fewer capital assets compared to the value of its operations

4. POTENTIAL IMPACT ON REAL ESTATE MARKETS

Regarding technology, in May 2019 the Trump administration effectively barred American firms from selling components and software to Huawei, ramping up a cold war between China and the US over technology and trade[30]. The US Commerce Department maintains a list of companies deemed a national security risk, effectively preventing them from buying or licensing American parts and technology without special permission from Washington. Chinese entities that find themselves on the so-called 'Entity list' are not necessarily saved by having US joint venture partners[31]. China aims, and is on track, to catch up with the US in AI research by 2020[32].

Through controlling the rules of the internet, the Chinese government has nurtured a trio of domestic internet giants, Alibaba, Baidu and Tencent, who are all in lockstep with the government's ultra-strict regime. The so-called Chinese Firewall could lead to two distinct internets. The US will dominate the Western internet and China will dominate the internet for all of Asia[33].

Political focus will meet legal challenge, which may fuel more populist backlash (judges equalling 'enemies of the people') or may result in less change as property rights are upheld. However, the direction of travel seems populist.

4.5. Politics

Politicians will continue to focus on the residential sector and the ensuing political output (in the form of laws, byelaws, regulations and decrees) is likely to follow suit.

A more insidious manifestation of protectionism and nationalism is also possible – no new laws are passed, but local regulators interpret existing laws in a way that suits local incumbents more than their foreign competitors. In effect, market participants could quickly become divided into 'insiders' and 'outsiders', with established local players holding a distinct advantage over new entrants.

[30] https://www.nytimes.com/2019/05/20/technology/google-android-huawei.html
[31] https://www.extremetech.com/computing/293677-the-us-just-banned-amds-chinese-joint-venture-from-developing-and-selling-hardware
[32] https://www.wired.com/story/china-catching-up-us-in-ai-research/
[33] Some users will strive to use both, to the extent possible

4. POTENTIAL IMPACT ON REAL ESTATE MARKETS

4.6. Financial Markets

Under Scenario 1, technological change in the period to 2030 supports growing access to finance and supports financial inclusion across emerging markets, even as longstanding financial centres remain dominant. Crowdfunding, microloans and similar advances should encourage business and investment in emerging markets. Conversely, this may create more opportunities for real estate debt and equity funds.

Under Scenario 2, interbank operations could be jeopardised as a result of political and regulatory interference. This would be extremely serious because the interbank market is central to the entire financial system, which, in turn, support the CRE investment markets: it is the main venue for banks to obtain short-term financing. Any problems with the interbank market could threaten financial stability, which could create a ripple through effect on liquidity and credit availability within many CRE investment markets.

4.6.1. Currency

Scenario 2 predicts that Italy and Poland will leave the EU, as a consequence of which Italy would also leave the eurozone. The departure of heavily indebted Italy from the eurozone will likely strengthen that currency in the long run, though volatility is likely. For investors or potential investors in Italian real estate, the reintroduction of the Italian lira adds a further dimension to decision-making. Conversely, the exit of weaker economies from the eurozone may prompt a sharp rise in the value of the euro, thereby pushing up property values in US dollar terms across much of northern Europe.

4.6.2. Debt

If interbank operations are jeopardised under Scenario 2, there are also implications for CRE debt markets. Banks have become a less important source of debt-financing in real estate due to the emergence of debt funds or public markets as alternatives. However, they are still important players and problems in the interbank market will have a negative impact. In addition, foreign lenders may find enforcement is hampered by unilateral debt forgiveness extended to favoured local borrower or otherwise. For lenders, the ability to execute is paramount. Scarcity of debt or an increase in borrowing costs will be problematic for operators, managers and individual investors. A secular economic slowdown under Scenario 2 conditions will lead to covenant breaches, borrower extensions, write-downs and lower returns.

4.6.3. Insurance

Under Scenario 1, European insurers and their clients continue to benefit from the single market while in other countries cross-border insurance is likely to depend on any relevant bilateral agreement. A reduction in competition, whether through exclusion (under Scenario 2) or otherwise, could lead to an increase in premiums and a decrease in the availability of niche types of insurance in a restricted market.

4. POTENTIAL IMPACT ON REAL ESTATE MARKETS

4.7. Challenges and Opportunities

This paper has considered two scenarios: a core scenario has been assumed, whereby the world will become less globalised over the coming years and an alternative and more extreme scenario where the world order completely fragments, breaking into two rival spheres of influence, split between west and east.

Capital flows will be restricted under either scenario, but more dramatically under fragmentation.

For real estate investment markets in general, the consequences of either scenario include:

- Fewer cross-border transactions;
- Lower fee income for the real estate ecosystem;
- Shrinking footprint for global advisers;
- Possibility of mergers and 'right-sizing';
- Less competition among advisers; and
- Higher operational fees in each protected market.

These consequences will not have the same impact in every market. Certain economies will resist the trend towards protectionism, staying open to international capital while others apply restrictions. Countries that choose to disengage may go for two-way restrictions – that is, restrictions on foreign capital entering and on domestic capital leaving. Asset class quotas could be used to achieve the second objective.

For real estate investors, the consequences of either scenario include:

- A reduction in portfolio diversification as some national markets become uninvestable;
- Lower effective rents as occupiers struggle in a less globalised market;
- Stranded assets if protectionist measures impede exits;
- Devaluation of prime assets in the most protected (closed) markets;
- Reassessment of political risk; and
- Shrinking global footprint and greater reliance on partners.

4. POTENTIAL IMPACT ON REAL ESTATE MARKETS

Protectionist measures will affect private markets in general, not just real estate. (Infrastructure could be even worse hit, given the sensitivity surrounding security of infrastructure assets.) The largest institutional investors need to diversify their assets and will work together to keep private markets open, if possible. Public markets find it easier to relocate when necessary but a wholesale move away from all private markets to public markets by institutional investors is unlikely.

While this report focuses on protectionism and nationalism, other political risks exist in parallel, and investors/managers will try to agree what level of 'steady state' political risk is acceptable. They should recall that political risk includes own-country risk (e.g. abrupt tax changes). Not all risk is political and agents, valuers, lawyers and others dependent on transactions should recognise that migration patterns and a warming planet could bring unexpected deal flow. They should also remember that lower transaction volumes may be less of an existential threat than that posed by artificial intelligence.

For direct real estate markets, the consequences under either scenario are likely to mean that:

- Those market that have benefitted most from globalisation of capital markets (such as Amsterdam/Randstad, Brussels, Dublin, Helsinki, Hong Kong, London, Madrid, Milan, New York, Paris, Prague, Rome, Shanghai, Sydney, Warsaw and Washington) could see significant structural changes in their sources of capital, with global investors being replaced or at least partially replaced by local ones. This could lead to a fall in turnover and ultimately falling prices, especially in the event of the forced sale of prime assets. The markets that are likely to be worst affected are those CRE investment markets that lack a sufficiently large-scale domestic savings industry capable of replacing international capital (for example, Helsinki and Madrid).
- A major reduction in cross-border capital flows is likely to have the biggest impact on the demand for prime assets rather than secondary markets, where local investors have tended to be dominant. The yield spread between prime and secondary assets that opened up after the GFC may start to close in many markets as the demand for prime assets dries up and pricing is increasingly determined by local buyers.
- At a sector level, the markets most likely to be affected, especially under Scenario 2, are prime residential markets in Australia, Canada, New Zealand, the UK and the US, logistics units supporting internet retail sales or just-in-time manufacturing supply chains[34] and prime CBD offices in major financial centres.
- At a market level, the entire sector may suffer a crisis of confidence with investors simply deciding that the risks no longer justify the return. The risk cost of holding immovable physical assets may cause many investors to exit the market in favour of indirect real estate exposures via equity and debt instruments.

[34] This could be particularly acute in highly integrated manufacturing operations such as aerospace and autos.

5. CONCLUSION

The last 30 years have witnessed unprecedented changes in both local and international real estate investment markets driven by widespread political support for liberalisation of economic policies and the arrival of technology that has enabled real estate investors and financiers to develop global strategies. However, since the 2008-2009 GFC rising nationalism and populism have undermined support for global institutions, and protectionist measures have been introduced in the real estate markets, notably in residential.

Market participants in 2030 could be operating in a very different environment to 2019. Global capital flows will continue to be affected by nationalism and protectionism, and while it is not clear how this will play out, it is unlikely to be positive. Therefore, to facilitate a wider industry debate, this paper has postulated what a more nationalist/protectionist world would look like and what it could entail for real estate investors specifically.

Forecasting economic and political trends is difficult at the best of times but the current levels of uncertainty surrounding the global economy make predicting the future very difficult for even the most seasoned commentators. Despite the uncertainty, we believe that in terms of global capital flows being affected by nationalism and populism, three predictions can be made with confidence:

- Real estate and infrastructure, being immovable, are more exposed than liquid asset classes;
- Within real estate, the residential and logistics sectors will be most affected; and
- Transaction volumes will reduce, and market participants will lose revenue.

5.1. Immovable Asset Class

By its very nature real estate cannot be moved and remains a sector where direct political interference can take place in a way that is no longer possible in equity or debt markets. The implications of this could be quite profound in either scenario. Real estate is an easy target for populist politicians looking to buy votes or raise taxes with residential rent and price controls. In the most extreme cases, politicians could simply seize assets on behalf of the state.

The paper highlights many examples of this in recent years. It is a power that individual national governments no longer have over other parts of the economy as the ongoing debate surrounding the tax bills of multinational tech businesses clearly demonstrates. Unfortunately, in the face of local market protectionism, this may result in direct real estate markets losing out to alternative and more liquid asset classes that are better suited to circumventing or resisting increased government interference.

5.2. Residential and Logistics to Bear the Brunt

Residential and logistic properties are most likely to be most exposed to these changes. Investment in residential is prone to opposition from local buyers who consider themselves disadvantaged by foreign investors, and logistics relies on extended supply chains that cross multiple countries. In both sectors, demand for prime assets is likely to be hardest hit. Ironically, in the current market these two sectors form the basis of the current ‘beds and sheds’ investment strategy that is so popular around the world with portfolio managers.

5. CONCLUSION

5.3. Transaction Volumes Drive Revenues

Whether the world continues drifting away from globalisation (Scenario 1) or fragments (Scenario 2), transaction volumes could decrease, and revenues could therefore also decrease. To take a simplified example: if transaction volumes drop by 10%, fees earned by the real estate ecosystem (brokers, valuers, lenders, assorted advisers/consultants) will drop accordingly and the amount of lost revenue could be USD1.3bn per annum[35]. The loss of revenue will not be evenly spread across the world because transactions, measured by value, tend to concentrate in a small number of locations.

5.4. Mitigating Factors

It is not all doom and gloom – there are mitigating factors:

- Technology and the need for global investment diversification (ironically, often driven by state-owned sovereign wealth funds) will continue to generate a demand for cross-border investment activity.
- While governments may start to exercise greater control over immovable assets, their ability to unilaterally control global capital markets will remain very limited. In short, the changes of the last few decades cannot be easily undone.
- Many of the drivers that have made real estate part of the global investment market may well go into reverse in the face of more nationalist and protectionist government policies, but it would be simplistic to assume that real estate investment markets simply revert to their modus operandi prior to the 1980s.

5.5. Final Thought

Looking forward to 2030, global capital flows will undoubtedly be affected by increasing nationalism and protectionism. Political risk and liquidity risk, often considered to be separate risks, will increasingly be viewed as intertwined. In a world of state interference and rising nationalism the price of liquidity may need to be recalculated to include hard economic and political factors.

[35] Based on average annual transaction volumes going back to 2007 and an estimated cost excluding stamp duty of 1.8%

RESEARCH

Investment Property Forum
New Broad Street House
35 New Broad Street
London EC2M 1NH

Telephone: 020 7194 7925
Fax: 020 7194 7921
Email: ipfoffice@ipf.org.uk
Web: www.ipf.org.uk

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