

Flight to the familiar

Optimism in the US real estate market is picking up but a full recovery is not expected to begin until next year, according to AFIRE's first mid-year survey, presented by CEO Jim Fetgatter



For the past 17 years the Association of Foreign Investors in Real Estate (AFIRE) has monitored the attitudes and trends of international real estate investors. The last annual foreign investment survey was conducted in the final quarter of 2008 and the results were released in February of 2009.

However, in May AFIRE conducted its first mid-year survey. The reasons for an update were obvious. With the escalation of the credit crisis, the rapid changes in the economy, and the government stimulus programmes, it was considered important to gauge any changes in investor sentiment.

INVESTMENT LEVELS DROP

Real Capital Analytics (RCA) reports that global real estate transactions have plummeted to one-sixth of their level from two years ago and have fallen 73% from one year ago. Seventeen nations saw sales slip 80% from first quarter 2008 to 2009. Further, international investors accounted for a smaller proportion of transactions so far in 2009 than they did in 2008 or 2007. RCA speculates that the rapid globalisation of real estate may have stalled due to the following reasons:

- ❑ The de-coupling theory, which states that emerging markets are no longer correlated with the US and Western Europe, has been largely disproved by the global financial crises;
- ❑ Investors seeking higher returns in emerging markets may find comparable investment returns much closer to home;
- ❑ Small, local lenders appear to be the ones willing to lend today, while the larger, international banks have experienced the most financial difficulty and credit constriction.

that many fingers of blame were pointing in late 2007 when disastrous weaknesses in the world's credit structures were exposed.

There are tough questions for a valuation profession needing to bring greater rigour and consistency to its analytical processes. Are valuers willing, for instance, to re-skill themselves to understand the intricacies of multi-layered securitisation techniques in a now illiquid market struggling to unravel a challenging blend of real estate and finance? How responsive are they to the demands for a shared-data culture to support more transparent disclosure? Can they adopt more consistent international valuation standards, calibrate their disparate global qualifications and promulgate a workable system for monitoring professional ethics in today's reward-based business environments?

In this fast-paced age of instant communications and breaking news alerts, valuations tend to be demanded instantly and, having been received, typically have a shelf life of only hours. Clients are becoming increasingly litigious; yet the valuation profession is difficult to police given the its dizzying complexity. Valuations cover a vast array of asset types ranging from residential and commercial properties (many sliced into complex interests for indirect funding), to business intangibles, personal property, machinery and equipment, art and antiques, agricultural properties and taxable holdings. The number of interests and rights carved out of a single asset, and the purposes for which a valuation is required, are immeasurable. In turn those relying on a valuer's work consist of a range of public or private interests (and in the case of public-private partnerships, a blend of each), lenders, owners, investors, trusts and developers. And as if this were not sufficiently complex, valuers must be prepared to contribute intelligently to ongoing public-interest debates on such topics as sustainability, renewable energy, urban planning, transportation corridors, land title, fair taxation and disaster management.

With such a dauntingly broad professional coverage, regulatory oversight of valuation for securitised investment vehicles seems unlikely to prove effective. The broader solutions for defending the profession's credibility must be addressed from within the profession's own structural fabric.

The world's valuation organisations must collaborate in redefining and strengthening the profession's global profile, and become proactive in competing and reclaiming equal standing for valuers among the world's most highly respected professionals.

In 2008, foreign investment plunged to 2003-2004 levels. Australian investors, for several years one of the largest investor groups, dropped out of sight in 2008. German open-ended funds suffered massive withdrawals and many were subsequently frozen and thus prevented from investing. Middle Eastern investors, the largest foreign source in 2008, were reeling from the rapid decline in oil prices and a melt-down in their own domestic real estate markets. Thus far in 2009, investment into the US has been minimal. The majority of what little has actually taken place has been by German investors.

THE 2008 SURVEY

Yet, in the AFIRE survey released in January 2009, foreign investors ranked the US as the best place for capital appreciation, increasing their scoring significantly over the past several years. China's ranking in this assessment had risen to challenge the US recently and was widely predicted to outrank the US. However, both China and India fell sharply in the rankings in the last survey. In a surprise move, Brazil was named the second-ranked country for capital appreciation, the first time Brazil had appeared in the top 10 countries. Washington, DC was named the top global city for real estate and five of the top 10 cities were in the US.

As a non-profit association, it is not the mission or purpose of AFIRE to promote investment in US real estate. Rather, AFIRE is guided by the dictates and interests of its international investor members. For many years, increasing global diversification and allocations have broadened AFIRE members' focus on emerging markets. However, based upon the 2008 foreign investment survey and anecdotal evidence, it appeared that international investors were turning their attention back to US real estate. Real estate investors sense both safety and impending value: the elimination of many domestic US investors, especially private equity funds, offers foreign investors the opportunity to buy choice assets not previously available to them.

2009 MID-YEAR SURVEY RESULTS

In the latest survey, three-quarters (75%) of those surveyed had not yet invested in 2009. However, 67% of them planned to invest some debt or equity in US real estate before the end of the year. Equity investors expect to place seven times more equity in the remainder of 2009. Debt investors expect to place three times more debt. While these are significant increases, the current level of investment is quite low. Thirty-one percent of respondents said they were more optimistic than they were at the beginning of the year; 16% were more pessimistic, and 53% said they felt about the same.

Washington, DC was named the top US city again, but that lead was greatly extended in the most recent poll, with twice as many respondents selecting Washington as their city of choice over second-place New York. At the end of the 2008, these two cities were almost tied for first place.

Offices were picked as the product-type of choice, moving ahead of multi-family housing that had garnered the number one spot in 2008. The return to offices continues an increased interest in US offices begun many years ago. Offices have been the product of choice for foreign investors for years, making up approximately one-half of their global and US portfolios. It could be argued that foreign investors may be returning to their historic preference because better office investment opportunities are again more readily available. Certainly, Washington, DC is a predominantly office market.

In a look to the future, a majority of AFIRE members surveyed said they expect to see a recovery in the US real estate market by the end of the second quarter of 2010 (chart 2). The familiar landscape of US real estate appears to be attracting the attention of international investors again. There is a sense that the US, along with London, will lead the economic recovery. Only time will tell if their plans and strategies will turn into action.