

COVID 19 and real estate: a major challenge

This issue comes at a time of significant economic and societal disruption because of the COVID-19 crisis. With the majority of the population isolated in their homes, universities closed but providing education online and many companies inactive, the contents of this issue seem to reflect another world.

At the moment, the extent to which this health crisis will affect the real estate market is unknown. However, most of the economic effects highlighted by the experts anticipate a direct and negative impact on the commercial market, which depends mainly on the real estate sectors of the economy.

Recent academic research identifies two types of effects. The first and immediate type is related to world production (no longer domestic, given the globalisation of the value chain), which will decrease because of measures taken by governments worldwide to combat the virus. COVID-19 and isolation *per se* have distorted the value chain (starting with China, one of the world's largest producers), reducing trade (and transportation of goods) and generating shortages in non-essential products because of lack of supplies (Choi *et al.*, 2020). Social distancing and isolation measures have had a sudden impact on the tourism, hospitality and transport sectors causing a collapse in demand (Fernandes, 2020). The scale of reduction in final wealth generation has yet to be assessed. However, given that social isolation occurs progressively in different countries, the distortion in the value chain may last for some time. This fact and its global impact will lead companies to rethink their location and investment strategies for the future, perhaps evaluating the possibility of resuming domestic production for security reasons but in exchange for accepting lower levels of competitiveness. Mann (2020) predicts that this disruption in the value chain will be temporary and that the recovery of the industrial sectors will be in a "V" shape once the isolation ends. On the contrary, the same effect will not occur in non-storable tradeable services sectors such as tourism, transport and related services, whose recovery may follow an "L" shape (Mann, 2020, p. 82).

The second type of effect from COVID-19 would come from increased uncertainty about the near future. Researchers agree that the most significant impact does not come from short-term uncertainty itself, but if it persists. Short-term uncertainty would cause market players, both investors and consumers, to follow a "wait and see" policy (Baldwein and Weder, 2020, pp. 15-16) and delay their economic decisions. However, uncertainty regarding the perceived end of the crisis would potentially change investor and consumer sentiment and expectations for the future, with the effect of increased volatility lasting for longer. Cecchetti *et al.* (2020) assess how increased volatility and change in sentiment would contribute to this loss of investor confidence and affect the financial position of companies. The acceleration of medium-term volatility would be a resulting element of both effects (Ramelli and Wagner, 2020), with consequent effects on investment decision making. In this area, monetary policy remains constrained by low-interest rates, except in cases of sharp increases in liquidity and strong fiscal policy interventions (Gali, 2020; Ramelli and Wagner, 2020).

There are, however, sectors that have shown a positive reaction within this crisis period, such as commodities, health materials and the fall in oil prices, which would favour those countries experiencing the worst of the crisis, reducing the cost of the expected increase in energy demand when the recovery comes (Ramelli and Wagner, 2020).



The real estate sector is on the front line of the effects of COVID-19. The retail, hospitality, transport and leisure industries are experiencing the immediate effects of isolation with a dramatic drop in production, employment and a decline in household incomes for their employees. If the disruption effects are temporary as estimated, recovery may occur soon. This time window would provide an opportunity to rethink both real estate investment strategies or buildings' uses and property management.

The experience of a massive expansion in teleworking in many sectors during the isolation period could contribute to long-term change, if it impacts perceptions of the efficient use of space or the current cost structure of the organisation. These changes would represent new investor sentiments that literature identifies, which would lead new building designs or more sustainable spaces, after COVID-19.

The monetary policy measures announced by the ECB with the implementation of the PEPP (ECB, 2020) and the evaluation of bond issues to finance member states health expenditure to control the virus are another issues playing in this field. More abundant monetary liquidity with low-interest rates and significant volatility would affect investment incentives. The global risk perception would attract capital to real estate assets again; thus, mitigating the adverse effects that the health crisis is having in the short term.

Serendipitously, this Issue 13(1) covers several aspects that the COVID-19 crisis threatens to change. From a global perspective, medium- or long-term effects of the virus can alter the evolution of real estate and housing cycles and their synchronicity. Two excellent pieces of work show what the status quo of global cycles has been until a few months ago. John Duca shows the increase in synchronisation of macro variables and policies, which have fostered housing prices to evolve towards a synchronised cycle worldwide. However, the process has not been continuous, reflecting non-uniform fundamentals affecting housing prices and large shifts in those housing markets, which are highly open to immigration and capital markets influences. Martin Hoesli discusses the contributing factors to explain global house price synchronisation. He shows that the cities with more synchronised housing price cycles are also those experiencing similar demand factors and are housing supply constrained. The paper finds existence of significant risk in supply-constrained cities. Furthermore, global house price synchronisation is found to be related to not only the economic recovery but also the low-interest rate environment and the quantitative easing policies.

Dulfitinena and Pynnönen examine the long-term dependence between house price returns and volatility in Finnish regions. They show evidence that returns among the types of dwellings are dependent in the long run, confirming long-term spillovers previously evidenced in other markets.

Wilhelmsson *et al.* demonstrate the existence of spillover effect of new apartment prices developed on infill land in Stockholm over low-income housing market areas during a period of sharp increase in housing demand and in the presence of shortage of land. The new construction projects have substantial positive effects on the city, although it would not necessarily benefit low-income households.

Two additional papers cover cross-border investment, volatility and real estate values in this issue. Oertel *et al.* analyse the attractive target markets to explain cross-border office market investments across 28 European cities. They find evidence confirming that capital movements follow the city attractiveness with a lag-time stable pattern, suggesting that the "risk-averse cross-border investors" accelerate the investment flows into real estate markets in particular cities.

Finally, Juha Mäki analyses the relationship between property investment appraisals and property earnings. He finds that companies (with better performance) use external

valuations more intensively that give more conservative estimation for investment properties. Fair value differs depending on the company size and performance and whether the appointed appraiser is internal or external.

Whether the cycles will remain globally synchronised in real estate prices or the volatility will maintain its patterns, affecting returns and differentiating the type of investors, after the COVID-19 crisis are unknown issues which require more research. Public sector, private companies and investors need to understand how COVID-19 has impacted the market and how agents react to this disrupted time. Therefore, *JERER* is calling for research work relating to the effects of COVID-19 on real estate markets and would provide information that can help researchers, investors and market agents to make better decisions in these uncertain times. I hope to receive your research soon.

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Further reading

- European Commission (EU) (2020), "Proposal for a regulation of the European Parliament and of the Council", COM (2020) 141 final, 2020/0058 (COD).