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The Long Term Thematic Trend is Your Friend

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Why long-term thematics matter for real estate

- Real estate reflects the economy. It prioritises how people use buildings and what kind of space they need. It reflects how we live, work and play. Anticipating changes in human needs, and being at the forefront of these requirements, is key to investing in real estate that could outperform in the future.
- Increasing digitisation and social connectivity are affecting all aspects of business, society and the economy. The proliferation of data that needs to be transmitted, stored and analysed is also affecting real estate.
- These changes are fundamentally reshaping business models, and modifying how products are designed, produced and distributed. This in turn affects the way companies communicate and provide services. Office and workplace requirements are shifting towards collaboration and connectivity and physical retail is being refocused towards brand interaction and consumer experience.
- There has been a momentous effort by organisations to reconfigure their supply chains in light of the changes in the way we are shopping, playing and working. In turn, this has led to an explosion of demand for additional warehouse space of all shapes and sizes over the past decade.
- There are three current thematic trends in real estate. Firstly, **advancing technology** that is linked to the proliferation of data generation. Secondly, **demographic change** as a result of an ageing population and different lifestyle choices compared with previous generations. Thirdly, the crucial societal changes linked to the increasing drive for **sustainability**. These are set to have a profound impact on the kinds of real estate that will be in high demand and relevant in the future.
- Throughout the past few decades, recognising and taking advantage of thematic changes has been a relatively 'free lunch' for real estate investors. Those who can take advantage of these new trends are likely to be rewarded handsomely in the future.
- There is a range of other trends that could also have a significant impact on real estate, such as artificial intelligence, big data, and online grocery shopping. They have had minimal impact on real estate so far, but they have the potential to significantly disrupt the status quo in the future.

Advancing technology

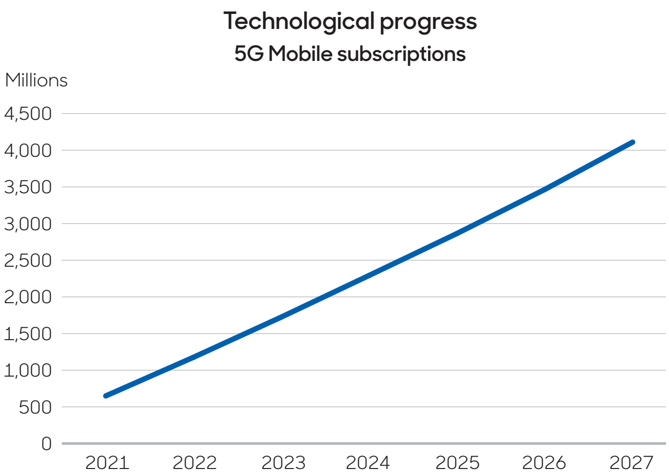
According to Big Data statistics, we are generating 2.5 quintillion bytes of data on a daily basis. The growth in data generation has been exponential. A recent study by Statista estimates that by 2025 the amount of data created, captured, copied and consumed worldwide will be 90 times larger than the data generated via these sources in 2010. The level in 2020 was 32 times. Ten years ago, you wouldn't have been able to buy a plane ticket, book an Uber or rent an Airbnb on your phone. In today's world, we can do all these things and a lot more from our handheld devices.

Data centres and cell towers

Global Web Index estimates that 59% of the world's population uses social media. Why does this matter for real estate? All the digital infrastructure needed to provide this data is housed in physical real estate. Although data providers store data in 'the cloud', in reality, this is a data centre with an earth-based location. Data centres are benefiting from the exponential growth in data generation. And although the sector is relatively small in terms of investable assets, it is growing rapidly. The sector is expected to become a key element of real estate portfolios in the future.

It is a similar story for cell towers as 5G mobile subscriptions follow the same exponential trajectory as the data generated (see chart one). As a result, the cell tower sector is also expected to become a key part of institutional investors' real estate portfolios in the future.

CHART ONE: Technological progress – the exponential rise in 5G mobile subscriptions



Exponential increases in data creation will lead to strong demand for digital infrastructure

Source: Ericsson Mobility Visualizer Mobility report 2020, abrdn.

Industrial and logistics infrastructure

What about all the goods being bought over the internet? Compta estimates that global online sales are predicted to reach 22% of all retail sales in 2023. The goods that are bought on smartphones, iPads, laptops and other smart devices are dispatched, housed and delivered via the industrial and logistics infrastructure across the country. This could be regional distribution centres, smaller edge-of-town delivery units or even last-mile delivery hubs in the heart of towns and cities. There is huge demand for these assets and that is the reason why the industrial sectors have been outperforming the wider All Property benchmark over the past decade. These assets have also benefited from technological progress in the shape of autonomous vehicles, whereby automated robot 'pickers' whirr around warehouses seamlessly picking goods.

Vacancy rates have fallen sharply for industrials and logistics, rents have risen markedly, and occupiers have scrambled for the space they need to cope with the huge increase in goods bought online. Given the expected exponential growth of smartphone ownership in the future, we anticipate that the demand for real estate space that is related to the growth of technology is a trend that is going to continue.

Changing demographics

There is a raft of recent statistics that emphasise the slow-moving trend where the world's population is getting older. Seniors are also choosing different lifestyle options as they age, compared with previous generations. According to the Lancet, there are as many people turning 80 as there are new-borns, globally. Furthermore, Euromonitor reports that there are more 65-year-olds than children under 15 in North America. Roland Berger details that the average life expectancy is anticipated to increase from 72.3 years in 2020 to 76.8 years in 2050.

Senior living

Does this matter for real estate? The ageing demographic is already starting to affect the kind of real estate that will be in demand in the future. For example, there has already been an increase in demand for senior housing and assisted-living assets. There is also an underlying desire for more healthcare and life-science facilities that cater for the ageing demographic, particularly as we are living longer and have more health concerns as we age. Furthermore, equity-rich empty-nesters, whose children have grown up and left, are looking for a vibrant urban environment and a sense of community – hence the rise in senior living communities.

Home ownership versus renting

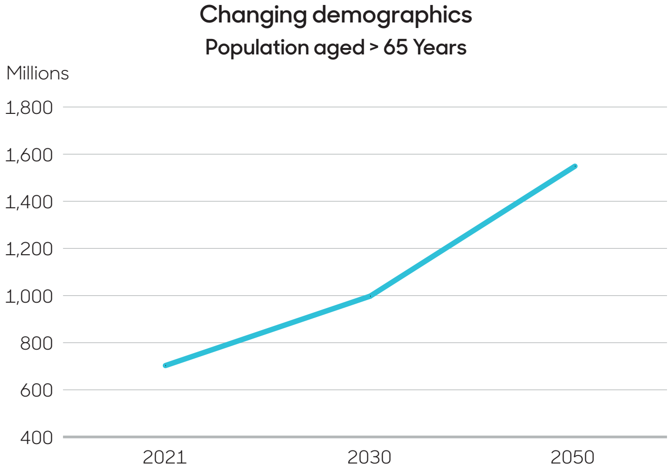
Demographic pressures are also having an impact on the residential sector. More people are looking to start families and move into larger accommodation, but there is simply not enough supply due to limited construction and a lack of downsizing by older people over the past few decades to meet the increased demand, particularly in larger cities. People often can't afford to buy because of elevated house prices, or they feel they may get better-quality accommodation in the rental market. For many younger generations, it is also a lifestyle choice to rent. Millennials and Generation Y, for example, value flexibility and are more likely to favour renting and hence the growing importance of the Private Rented Sector (PRS) as an investment opportunity for landlords.

Adapting existing buildings

Another aspect of the ageing demographic is the effect it has on existing buildings. To better cater for more older people, innovative landlords (particularly in Japan) are adding more facilities to their shopping centres to encourage seniors to shop there and engender loyalty. These facilities include wider aisles for mobility devices, lower tables, and more seating.

If landlords are going to take advantage of this slow-moving trend, they need to change their sector mix to include these new and emerging sectors. They also need to adapt their existing assets to meet the needs of an increasingly older population (see chart two).

CHART TWO: Changing demographics – the rapidly ageing global population



The doubling of the senior population will lead to higher senior housing and healthcare demand

Source: United Nations Department of Economic and Social Affairs: World Population Ageing 2019, abrdn.

Sustainability

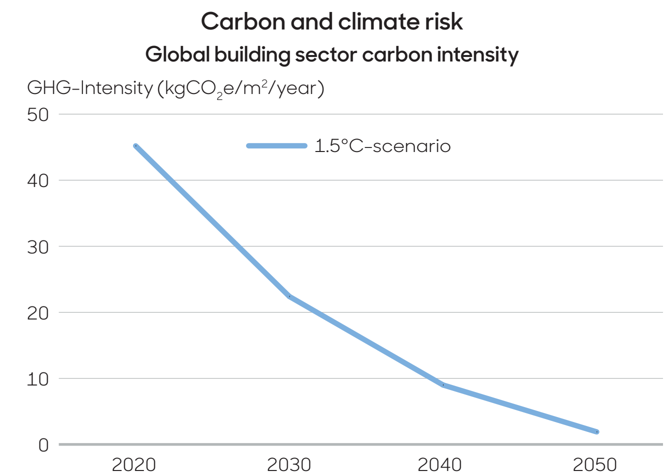
The long-term thematic trend that is expected to have the most impact on real estate is climate and carbon risk. How 'green' a building is will determine how viable or not it will be in the future and how beneficial it will be to performance (see chart three). Given the very visible impacts of climate change and the pressure on governments to reduce carbon emissions from businesses and households, regulations have tightened over the past few decades.

Given these regulatory pressures and the capital expenditure that is required to reduce carbon emissions from real estate assets, there are clear trends emerging. Higher-specification, more-sustainable assets command a premium, while those that are more polluting are becoming vulnerable to price reductions.

As regulatory pressures intensify and investors become more proficient at estimating the future costs associated with sustainable and non-sustainable buildings, there is likely to be more of a divergence between assets. Those that can be made more sustainable will benefit, but the rest of the market will face the increasing probability of obsolescence. This is a result of punitive future costs, less demand from tenants and larger pricing discounts.

With the effects of climate change becoming more tangible, and regulatory demands more onerous in this area, the sustainability theme has much further to run. Clearly, a pragmatic approach towards acquiring and developing assets will reduce future capital expenditure, increase operating efficiency, and enhance tenant demand.

CHART THREE: Carbon and climate risk – the pathway to net zero

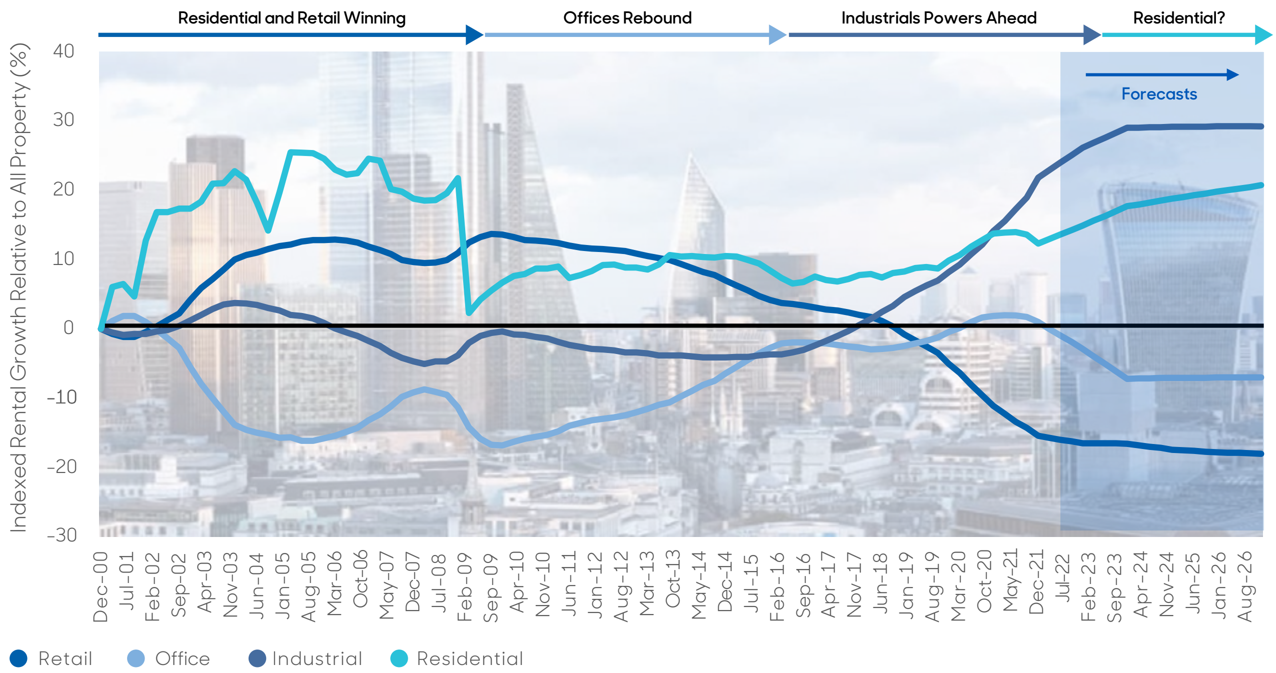


Political and societal pressure to reduce emissions will lead to higher demand in sustainable infrastructure

Source: CRREM Global pathways, abrdn, January 2022.

What does this all mean for real estate investors?

CHART FOUR: Relative outperformance driven by thematics



Long-term thematics are vital for understanding future trends for real estate assets. The changing trends that directly relate to how we live, shop and work, have driven significant outperformance in the past as illustrated in chart four. Indeed, they were tailwinds for sector performance. Similarly, when these trends reverse, they become major headwinds for the sector, which can lead to significant underperformance as also illustrated.

The three thematic trends we've highlighted are expected to have a profound impact on the asset class in the future. Being on the right side, or wrong side, of these trends will have a significant effect on performance. The long-term trends are clear, no matter where we are in the real estate cycle.

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