Silver Linings Playbook: Here's How Recessions Make Real Estate Better

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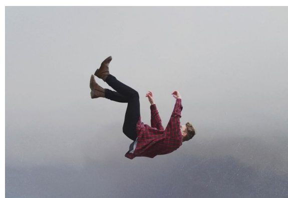
Recessions change behaviour. And they change real estate markets radically.

We're all going to take a tumble, thanks to pandemic-inspired lockdown. Faced with a global recession of unprecedented severity – UK GDP shrinking by 14% this year, the eurozone's by 7.4%, and the U.S. by somewhere between the two — only a fool would ignore the lessons of history.

The current crisis and ensuing downturn will be painful. The fact that this recession has been born of a public health crisis gives it an extra, tragic edge.

But what we have seen from previous crises is that good things come out of recessions too. After each of the last three or four major real estate crashes, the sector has evolved, and bad practices been rooted out. Things change for the better, as well as for the worse. From debt levels to development, from politics to who has the capital to invest.



Bisnow asked some of the real estate industry's most senior and seasoned figures to draw on their experience of recessions, slumps and bumps in the road since the 1970s. Their testimony reveals reasons for hope about how things might change following this recession. And reasons to be very careful indeed.

Robert Houston is former global chairman and chief executive at ING, and one of the big beasts of investment management for the last 30 years. Today he is senior partner of St Bride's Partners, the global investment manager, and a recently recovered victim of the coronavirus. It has already changed how he thinks.

“I've had it, and today I really don't fancy jumping on a train or a bus again,” he told *Bisnow*. “But maybe that is a short-term feeling, not a permanent change.”

According to Houston, whilst recessions do not have silver linings, they do have interesting consequences. That usually means sweeping one set of players off the property board, and introducing somebody new.

In the wake of the coronavirus, Houston predicts that high net worth private investors may be the people to leave the game, and that investment in social infrastructure-related property could be the big winner.

Houston bases his prognosis on a lifetime in real estate, beginning with the sharpest downturn of the 1970s.

The 1973-75 secondary banking crisis hit the UK property sector like a speeding train. The causes were a complicated, deadly mix of local and international politics, beginning with the the Arab-Israel Yom Kippur War of 1973. It has been argued the crisis cleared away the post-war economic rubble, smoothing the path for the steady growth of the last 40 years. For the property market it meant the old guard went, and new arrivals took over.

“The 1973 crash changed the shape of the property market,” Houston said. “Until then it had been dominated by property companies and development companies, with funding from banks. But we got the first signs of greed, we got overheating, we got inflation up to 25% by the end of the crisis, and then rent freezes and development land taxes, and the result of that was to transfer the muscle in the property market from the property companies to the pension funds.”

“They believed, erroneously as it turned out, that property was a hedge against inflation. And I think you see this a lot, each crash results in a different set of parties dominating the market.”

The slow-motion property market slump of the early 1980s cleared another group out of a dominant market position: property unit trusts.

They in turn were replaced by REITs as a new entrant to the property world was born from the ruins of the old.

Houston predicts something similar for 2020. This time high net worth private investors, so visible over the last decade, will slip out of view. This is not necessarily a good or a bad thing, but it will mark a significant change from recent years, when wealthy individuals have been big players in global real estate markets, many investing for the first time.

“I suspect the big change will be where the money comes from and how it is deployed," he said. Investors, particularly institutions, came to believe the yield gap they were enjoying over the last few years was a justification in its own right for investing in property. But now, with rents likely to fall and rising vacancy rates there is a challenge to that yield gap, confidence in it as a motivation will be dented, Houston argued.

“As a minimum we need a widening of the yield risk premium, which will frighten off a lot of investors,” Houston said. “And private investors and banks will not want to buy into real estate, so it won't be a happy time. The biggest impact will be on the high net worth individuals who have never had to bear the costs of a vacant building. Private investors like that might run for the hills.”

Overseas high net worth investors will stay at home and won't be big investors in the post-coronavirus world of reduced travel, he said. “Investors like that like to look at their buys, they won't be happy with a Zoom meeting. So for a while it's going to be very tricky. I think we'll see more domestic investors in the market than overseas investors.”

In the medium-term the pull toward the world's key megacities and dense urbanisation will not change, Houston said. Working from home will be a temporary thing, he predicted.

But one enduring consequence of the pandemic, and the recession that follows, will be that the social impact of property will be at the centre of

everyone's attention in a way that, so far, it has not. And that is not a bad thing — far from it.

“This is going to be the biggest area of possible upheaval," Houston said. "Look at the trauma in care homes, often owned by private equity whose sole aim is to get as much out of them as quickly as they can. The government is going to have to bridge the gap between social care and the NHS, and we're all going to need an intermediary between the investors and the residents, much like we have in student accommodation. We need a guarantor, an operator with proven expertise of a kind the big institutional investors will want to support. And there will be significant property implications in all this,” he said.

“You learn something from every crisis, but I can't see how there could possible be any economic silver lining to the current pandemic, and if there was one we won't see if for years. There could be upsides, they just won't necessarily be economic ones,” Houston concluded.

Neil Sinclair is chief executive at Palace Capital and one of the big wheels of London surveying, whose roles include executive chairman of Baker Lorenz. He's been in the property business for 60 years.

Sinclair does not say whether he has been ill with the coronavirus, but he keenly remembers being sick during the deadly 1957-1958 pandemic of Asian flu. It killed 1 million people worldwide, considerably more than the 266,000 so far attributed to the coronavirus.

“I was off school for five weeks, with a sky-high temperature and along with a friend of mine, there was a genuine worry we wouldn't make it, but like all the plagues of history, [society] recovers,” Sinclair told *Bisnow*.

Sinclair vigorously agrees with Houston that one of the big consequences of today's pandemic will be a larger focus on the social impact of property and economic policy. But he also suggests that property will need to relearn how to engage with politics in an era when a question mark hangs over the neoliberal consensus of the last three decades.

“The 1973-75 crisis saw British Land shares sink to 2p, people forget that,” Sinclair said, pointing to a raft of unhelpful government interventions at the time, ranging from rent freezes to development land taxes that helped drive the property market to crisis. Sinclair said this unhappy mix recalls today's government prohibition of landlords taking rental enforcement action against tenants.

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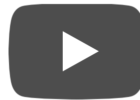

The crisis began to unwind when property got smart with politics, a lesson from which 2020 property could learn.

The 1970s rent freeze was imposed by the Conservatives, but property impressed on a Labour government that won a mid-1970s general election that they shouldn't bash property because the pension funds were big owners.

"We got together pension trustees who were trade unionists — my job was to work with the National Union of Mineworkers — and those trustees were very forceful with the government about the damage to pension funds. What came out of it was a greater understanding for everyone of the benefits of real estate. Property was seen not as an ogre, but as a positive contributor to society,” Sinclair said.

“Where property is going wrong now is on announcements like moratoriums on winding up defaulting tenant companies, they have

applied these rules to everybody when their real target was to protect high street shops. So tenants in other sectors are refraining from paying and the government is allowing them to do it. I've got a few who are not paying a bean. Property needs to bring the right people to the meetings, like we did in the 1970s."

Jon Neale is head of UK research at JLL. His working life began three decades after the 1973 crash but he says we can still feel the shock waves.

"The boom, then the crash, of the early 1970s probably helped clear the way for London to emerge as a world financial centre of the '80s and '90s," he said. "And that in turn helped its office market to grow so dominant. And maybe looking at these longer-range views shows the way even bad events can have good outcomes.

"You can see the same effect in the dot-com crash of 2000-2001. That was about online selling, and the market had spotted a trend correctly but got carried away. The outcome was growth in places like Clerkenwell and Shoreditch which we enjoy today. So what looked irrational in the short-term looks more rational in the long-term."

Neale said the same could be true of the Great Financial Crash of 2008. Before 2008 the consensus was that boom and bust had been abolished. After 2008 we all knew that wasn't true.

"The good outcome was everybody realised property comes in cycles. This time round people avoided massive debt and irrational exuberance, and we saw more regulation," he said.

So what will be the accidentally good outcome of the 2020 crisis? Neale pondered a moment, and replied: "Maybe we will be asking questions about the shadow banking sector."

Socially inspired property development, cannier politics, the retreat of high net worth investors and — perhaps — a little further thought on the $50 trillion shadow banking sector and the way it supports property. These could be the silver linings of the upcoming recession.