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Viewpoint
Imagining a post-COVID-19 world of real estate

Introduction

Many countries have imposed stringent restrictions on outdoor activities due to the ongoing COVID-19 pandemic. The lockdown measures require staying at home almost '24/7' over many weeks and residents are only allowed to go outside for limited essential purposes. With most economic activities paused across countries, the boundaries between working, living and leisure have been distorted like never before. As a result, the world, full of real estate, has transformed around us. With the service-sector workers who instil much vibrancy to the city centres working from home, retail units closed and deemed non-essential, and leisure activities stopped and deemed non-essential, otherwise undeniable use-values of office, retail and leisure units are being increasingly scrutinised. City centres as a manifestation of the real-estate market appear to face an existential threat and we know from many decades of research and understanding that the real-estate sector adjusts and evolves slowly. We can only join Batty (2020) in musing on the dangers of moving to a decentralised, isolated kind of world where crowding has disappeared and everybody lives at much lower densities.

The world of real-estate investment

An immediate and obvious effect of the pandemic is the unprecedented bleakness in terms of economic outlook, with implications at least for the sovereign debt of the Western economies in their battle against social and economic collapse caused by the lockdown. For the UK, this can translate to huge public-sector net borrowing. The economic shocks are very relevant to the real-estate sector, as we have seen in the not-so-distant past how the relationship between jobs, income, borrowings and

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real estate created the 2008 global financial crisis (Martin, 2011). Moreover, intense financialisation of real estate since the 1980s has opened up investment channels and driven funds flowing from all directions into every sub-sector of real estate, such as housing, office, retail, industrial, hospitality, etc. It has shaped the city centres and high streets around the world with an increasingly connected global finance system and flow of foreign capital (McAllister and Nanda, 2016). Therefore the post-COVID-19 world and associated economic crisis may present structural shifts in the shape of real-estate investment markets and in the volume and direction of foreign investment in real estate.

The current economic shocks may have a seismic impact on the business side of real estate, but the COVID-19 crisis may also entail significant implications for the real-estate analytical toolbox. For instance, comparables based on past sales or rents are often used as direct or indirect sources of information in various techniques employed for predictions, appraisal and valuation (IAAO, 2018). Eriksen et al. (2019) stress how the appraisal bias of residential property played a key role in the 2008 global financial crisis and subsequent recession, identifying comparable selection to be the primary source of this bias. A limited time horizon of past price information can be a key change during extreme shocks (Dubé et al., 2018), implying that pre-pandemic comparables might not be a significant source of information. New models and analytical tools would then need to be built from post-pandemic data and market dynamics. The unprecedented global changes during the pandemic and post-pandemic periods will generate a wealth of economic, social and behavioural data, the robust analysis of which will produce unique insights in most fields, including real estate.

The world of real-estate locations

A key question is whether the COVID-19 pandemic will cause a significant shift in the location preferences of households and firms. This could spell an overturn of the current growth of city centres. Many urban residents in city centre apartments without access to private outdoor space may subscribe to this shift. Conversely, rural residents, especially those in high-risk groups, may feel isolated with limited access to food deliveries and online services, exacerbated by the potentially lower quality of Internet connection.

The lockdown has forced even less technology-oriented sectors to shift many of their activities online, potentially reducing the need for an office space even after the lockdown. As long as social distancing measures need to be observed in the workspace, which may be quite protracted, the required space per worker will significantly increase. This may lead to unexpected, substantial shifts in commercial real-estate demand, but on balance it is reasonable to expect significant decreases. Before the

COVID-19 pandemic, a common response to vacant office space has been conversion into apartments due to the strong urbanisation trend, which may see significant changes in the post-pandemic period. Furthermore, investors and developers have limited capacity to react to sudden shifts in consumer preferences, due to the typical real-estate sector attributes of durability, long lags, high transaction costs and spatial fixity.

These potentialities in locational preferences and demand for space can cause major disruption in property markets. Investments in the pre-COVID-19 world may turn out to be catastrophic if people and firms abandon city centres. Strong digitalisation and the penetration of fast broadband connectivity can be expected to play an increasing role in location choice and exacerbate any lockdown trends and habits. The collapse of public transport demand during the lockdown is understandable, but the extent to which habits, fear and other behavioural factors will shape post-COVID-19 transport demand is completely unclear. The sustainability of our physical networks, especially in the long term, is an issue we have avoided thinking very hard about (Batty, 2020). Change in urban accessibility and transport networks will inevitably impact the land gradient and urban form in the long term (Ahlfeldt and Wendland, 2011). The need for evolving beyond the bid rent theory as the main framework of economic thinking on location preferences has never been more obvious.

The world of work

One of the key features of the office sector over the past ten to 15 years has been the evolution of the workplace and the change from a hierarchical office design, leased on a fixed basis, to flexible co-working space. Why has this happened? Whilst cost management is still important, attracting and retaining staff and improving productivity are high up the agendas of companies. Staff account for 90 per cent, real estate for 9 per cent and energy for 1 per cent of corporate costs (WGBC, 2014).

Duffy (1998) identified four categories of office organisation – *hive*, *den*, *cell* and *club* – distinguished by the level of interaction and autonomy involved in the work process. Whilst the 'hive', characterised as individual routine process work, still dominates many workplaces, such as call centres, many professional service firms have adopted activity-based working, incorporating a range of space to facilitate *create, collaborate, concentrate* zones, as in the Co-op HQ in Manchester. This enables organisations to provide employees with choice, flexibility and independence and not force a 'one-size-fits-all' approach onto staff.

The amount of space allocated to shared work settings in the UK has increased, often to 45–50 per cent of the total in agile workplaces, compared with 25 per cent in traditional workplaces. Whilst fewer individual desks are required, the average workplace density has only reduced from 9.9 per cent in 2013 to 9.6 per cent (9.6 square metres or 103 square feet per person). Where desk space used intensively, as in the 'hive' style, the maximum density suggested is 6 per cent (BCO, 2018). The co-working model shows 50 per cent of the traditional office density (Cushman and Wakefield, 2018).

Alongside changing workplace design has been the growth in co-working space, providing a flexible, social working environment which is very important to the millennial/generation Y (born between 1980 and 2000) workforce (WGBC, 2014).

The trend towards flexible workstyles should be accelerated by four-generational workplaces and COVID-19. The biggest surprise has, perhaps, been the ability for 'hive' process work to be carried out from home. It is likely to lead to a reduction in city centre office demand and the growth of regional hub offices where workers can meet for some of the week to satisfy the innate instinct for social contact. For knowledge-intensive and creative work, the demand for face-to-face contact in flexible workplaces may still be strong.

The world of retail real estate

Unlike the office space, where businesses can keep operating with some major adjustments, revenues mostly stop in the retail sector when the physical shops are closed and there is no online presence. Following the official government lockdown restrictions, record declines were observed in the retail sector. The volume of retail sales in April 2020 fell by a record 18.1 per cent, following the strong monthly fall of 5.2 per cent in March 2020 (ONS, 2020).

The silver lining for the retail businesses may come from online retail, which has been seen as the 'biggest enemy' of high-street retail. The proportion spent online soared to the highest on record in April 2020 at 30.7 per cent, compared to 19.1 per cent reported in April 2019 (ONS, 2020). Before the pandemic, online retail was already gaining momentum, with food being slower than other retail sectors. However, the COVID-19 pandemic has caused much acceleration in changes. The retail platforms powered by digital technology – for example, UBER Eats and Deliveroo – would continue to support this change as consumers and retail business adjust to extended social distancing rules. If this change sustains, the online food retail industry might be able to see significant uptick by removing pre-pandemic barriers. The changes in preferences regarding food and alcohol consumption in bars, clubs and restaurants are expected to be significantly different in the post-pandemic period.

Previous studies shed some light on how online retail has been changing the structure of the retail real-estate sector. More recently, Jones and Livingstone (2018) suggested that demand in the retail-property sector might reduce in future and found that the emergence of online retail (including the click+collect mode) has pushed some high-street retailers to retail parks, benefiting the out-of-town shopping centres. In the post-COVID-19 world, as suburbs start to attract more attention from residents and businesses, such trends might gain more momentum. Previous research also found that experience-oriented retail businesses would not be significantly affected by online retail (Zhang et al., 2016). However, if social distancing becomes a norm, experience-based retail businesses may face very different challenges, needing innovative means of incorporating the personalisation and privacy of experiences. For other retail businesses, the physical shop may have to function lot more closely to an integrated online shopping presence. The physical presence of retail space may need to have a seamless virtual presence, using new digital technologies. Closer integration with the supply chain may require custom warehousing solutions for retailers, adding further to the demand for industrial real estate.

The world of hospitality real estate

Hospitality real estate is perhaps the hardest-hit sector due to the COVID-19 pandemic. Much remains uncertain as to when there may be some revival of demand. This sector is especially susceptible to measures to neutralise pandemics because of restricted mobility and social distancing (Gössling et al., 2020). However, if we were to imagine what it might be, hotels will probably need to transform fundamentally to operate in the post-COVID-19 world and those transformations may have to remain for a significant period. Embracing technology across all aspects of the hospitality operation will be important for customer experience and satisfaction. The average customer will be very selective, due to COVID-19 risks and also to a higher level of competition. Personalisation of experiences may become a significant differentiator. Although it is too early to tell, some budget hotels may not be able to operate and sustain the changes required to ensure the highest level of safety standards and customer expectations.

Conclusion

As history shows, pandemics change urban living conditions. Drawing on knowledge from previous pandemics, the last taking place about a century ago, only offers a limited, overarching realisation that societies and their living conditions can be significantly affected. While the transformations are panning out in front of our eyes and a degree of permanency in certain aspects of these changes is beginning to be conceivable, it is very difficult to foretell what the world of real estate will indeed look like in the post-pandemic period. It would be hasty to draw conclusions yet with much confidence. Therefore, in this Viewpoint, our thoughts have mostly been speculative, yet grounded on pre-pandemic knowledge and trends that were already shaping up. We identify the areas of potential change that may indicate probable directions for the future. These can be regarded as areas of future academic research, and can also be considered by practitioners and policy makers as potential areas of impact and cases for intervention.

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