IMPACT OF THE COVID 19 PANDEMIC ON THE GLOBAL REAL ESTATE MARKET

Bashkim NUREDINI1

UDC: 616.98:578.834-036.21:[334.124.4(100)"2020"

ABSTRACT

This paper addresses the effects and impact of the global pandemic caused by COVID-19 on the real estate global market, by presenting the data from the trend of real estate cycles in different countries of the world. All predictions were that after several years of growth across all segments of the real estate market, 2020 was anticipated to confirm this trend. Nevertheless, since late December 2019, a new type of Coronavirus began to spread across the world from China. In February and March 2020, most of the European countries were hit by the pandemic and were forced to impose restrictive measures on their economies and the free movement of citizens. Along the economy, the residential real estate market has also been affected. Undoubtedly, the pandemic caused has a massive impact on financial markets and the economy worldwide. Many investors, property owners, potential home buyers and landlords are therefore asking themselves: Is the Coronavirus crisis also affecting the real estate market? Are the property prices rising or falling?

Key words: COVID-19, real estate, commercial real estate, investment, value added.

INTRODUCTION

Real estate involves the land along with any permanent improvements attached to the land, whether natural or man-made – including water, trees, minerals, buildings, homes, fences, and bridges. Real estate is a form of real property (Chen, 2020). It differs from personal property, which are the things not permanently attached to the land, such as vehicles, boats, jewelry, furniture, and farm equipment. In understanding the real estate, people often use the terms land, real estate, and real property interchangeably, but there are some subtle distinctions between them. The land itself refers to the earth's

1 PhD. Bashkim NUREDINI, bashkim.nuredini@ubt-uni.net, University for Business and Technology UBT, Law Faculty, 10000 Prishtina, Kosovo
surface down to the center of the earth and upward to the airspace above, including the trees, minerals, and water, while real estate is the land, plus any permanent man-made additions, such as houses and other buildings. By definition, real property implied one of the two main classifications of property such as the interests, benefits and rights inherent in the ownership of real estate.

Broadly speaking, real estate includes the physical surface of the land, what lies above and underneath it, what is permanently attached to it, plus all the rights of ownership, including the right to possess, sell, lease, and enjoy the land. The real property should not be confused with personal property, which encompasses all property that does not fit the definition. The primary characteristic of personal property is that it is movable. Examples include vehicles, boats, furniture, clothing, and smartphones.

The global outbreak of the COVID-19 affects the real estate market in many ways. The managers and owners are concerned how to maintain the value from dropping while facing increased requirements by the government measures to keep the premises safe and clean, including the tenants residing in them. As the phenomenon is ongoing, potential impacts and consequences are difficult to be measured and foreseen, because, the COVID-19 outbreak was an unpredictable event. The pandemics by limiting the movement and visitors has also blocked tourism in many countries, thus decreasing the interest of the buyers/sellers for potential transactions in resorts and related real estate. In this way, the pandemics is not a problem of health but also of many other sectors and professions such as, housing, investment, settlements, and it has disrupted almost all economic sectors and even the system (Nicola et al., 2020).

Apart from what is actually in place as real estate, construction has also slowed down out of the fear that the prices of future real estate may fall as it is not yet known how long the pandemics will last and what its potential consequences are likely to be. However, it is possible to track the initial impact which this paper aims at discussing by focusing on the real estate market. The rest of the paper is organized as follows. After introduction, subsection one outlines the physical characteristics of real estate with a reference to immobility, indestructibility, and uniqueness. Subsection two discusses economic characteristics which are more diversified than physical ones. Types of real estate are elaborated in subsection three. Section two outlines the methods used. Commercial real estate is analyzed in section three, while the section four focuses on investing in commercial real estate through direct and indirect investment. Section five deals with the resulting economic recession of the COVID-19 and its comparison with the 2008-2010 financial crisis where the first is likely to have more harmful effects than the latter which already has gone (Strauss-Kahn, 2020).
Physical Characteristics of Real Estate

Land has three physical characteristics that differentiate it from other assets in the economy:

i) Immobility. While some parts of land are removable and the topography can be altered, the geographic location of any parcel of land can never be changed. While the buildings and other structures and assets can be altered, removed or even destroyed, land is immobile and cannot change its geographic location. Because of this fixed characteristic, the land is often named simply as immovable property. Its use is subject to governmental rules and regulations, which among others, may include long-term lease, e.g., for 99 years.

ii) Indestructibility. Land is durable and indestructible (permanent). This is defined by the area in which it lies, regardless of what activities are undertaken above and underneath. In this respect, land as real property is mainly identified by the zone or location. Its value may be determined by time and activities. Sometimes the land may be depreciated while in other times appreciated. Uniqueness. No two parcels of land can be exactly the same. Even though they may share similarities, every parcel differs geographically. The rest may have a variety of differences, beginning with the zones (urban or rural), type (soil, rocky or hill terrain), use (own or rent), and so on.

Economic Characteristics of Real Estate

Land also has some distinct economic characteristics that influence its value as an investment:

- Scarcity: While land isn’t considered rare, the total supply is fixed. Land may only become more valuable to meet the demand of raising population and urbanization.
- Improvements: Any additions or changes to the land or a building that affects the property’s value is called an improvement. Improvements of a private nature (such as homes and fences) are referred to as improvements on the land. Improvements of a public nature (e.g., sidewalks and sewer systems) are called improvements to the land.
- Permanence of investment: Once land is improved, the total capital and labor used to build the improvement represent a sizable fixed investment. Even though a building can be razed, improvements like drainage, electricity, water, and sewer systems tend to be permanent because they can’t be removed (or replaced) economically.
- Location or area preference. Location refers to people’s choices and tastes regarding a given area, based on factors like convenience, reputation,
and history. Location is one of the most important economic characteristics of land (thus the saying, "location, location, location!").

1.3.1. Types of Real Estates
The literature on property rights distinguishes five main types of real estate: 1) Residential real estate: Any property that used for residential purposes. Examples include single-family homes, condos, cooperatives, duplexes, townhouses, and multifamily residences with fewer than five individual units. 2) Commercial real estate: Any property used exclusively for business purposes, such as apartment complexes, gas stations, grocery stores, hospitals, hotels, offices, parking facilities, restaurants, shopping centers, stores, and theaters. 3) Industrial real estate: Any property used for manufacturing, production, distribution, storage, and research and development. Examples include factories, power plants, and warehouses. 4) Land: Includes undeveloped property, vacant land, and agricultural land (farms, orchards, ranches, and timberland). 5) Special purpose: Property used by the public, such as cemeteries, government buildings, libraries, parks, places of worship, and schools (Chen, 2020).

Real estate can have advantages and disadvantages. Among others, Garay (2016) lists five advantages and three disadvantages. The first five include the potentials to: i) offer absolute returns, ii) hedge against unexpected inflation, iii) provide diversification against stocks and bonds, iv) provide steady cash inflows, and iv) provide income tax advantages. The three disadvantages relate to i) heterogeneity, or as described earlier in terms of land, it can be unique by location, use, destination or design, ii) lumpiness, which can constrain investors from creating an optimal portfolio, and iii) illiquidity, or lowering of opportunity to sell it at fair market prices.

One of the major features of all types of real estate is its destination or allocation. Thus the real estate is also heterogeneous by the role it serves such as, construction of office buildings, housing apartments, business premises, renting, etc. This also dictates the benefits to be derived from such an allocation. It has also an impact on potential sale and transactions.

MATERIALS AND METHODS

The methodology used in this study, consists of data provided on macroeconomic changes and the real estate sector as secondary data were used to provide the basis for analysis and generalization of the prevailing situation. Due to the prevailing situation, during the pandemic, which prevents the smooth conduct of physical surveys in many countries and also including, the assessment and data collection has been carried out mainly based on review reports published by relevant institutions by the real estate market,
publications and news in the mainstream media, as well as all other publications attributed to the impact and effects of the global pandemic on the real estate market and sector.

Commercial real estate (CRE) is property that is used exclusively for business-related purposes or to provide a workspace rather than as a living space, which would instead constitute residential real estate. Most often, commercial real estate is leased to tenants to conduct income-generating activities. This broad category of real estate can include everything from a single storefront to a huge shopping center.

CRE includes several categories, such as retailers of all kinds, office space, hotels and resorts, shopping malls, restaurants, and healthcare facilities. Compared to housing real estate, RCE is more volatile to life cycle arising from the competition between businesses. Prices for CRE rise and fall more quickly than for housing real estate (Glaeser and Gyourko, 2006). CRE also bears more risk if economic activity continues to decline. Commercial property prices in the market experience boom and bust depending on circumstances. This is in part because lenders or investors are more interested in the CRE in order to be more able to generate expected benefits or returns. In determining the value or price of one (housing) versus CRE, supply and demand play a decisive role, but the latter (CRE) is more appreciated or depreciated in short to medium term.

RESULTS

Experience proves that, commercial real estate investing has been rich with benefits, providing millions of investors with attractive risk-adjusted returns (Fundrise. 2020). As an alternative asset class, it also has a track record of providing powerful portfolio diversification. Because the success of a particular commercial real estate asset is tied to the trends or behaviors of its surrounding local market, a smart commercial real estate investment can be a great way for you to grow your investment along with the local and broader economies.

Investing in commercial real estate can be lucrative and serve as a hedge against the volatility of the stock market. Investors can make money through property appreciation when they sell, but most returns come from tenant rents. There is no limit in the CRE market, but the difference with housing is that transactions in the CRE are made by professional investors who know the potential of generating benefits, or the risk of failure (Gyourko, 2009). The investment in CRE can be direct and indirect.
When we talk about direct investment, we are referring to investments in which investors can use direct investment where they become property owners through the ownership of physical property. People best suited for direct investment in commercial real estate are those who either have a considerable amount of knowledge about the industry or who can employ firms who do. Commercial properties are a high-risk, high-reward real estate investment. Such an investor is likely to be a high-net-worth individual since CRE investing requires a considerable amount of capital.

The ideal property is in an area with low CRE supply and high demand which will give favorable rental rates. The strength of the area's local economy also affects the value of the CRE purchase. Direct investment also involves buying a portion or stake in CRE, which also sets conditions for expected benefits or share in profit. Another source can be debt investing, which implies the loan that is given as a collateral by real estate.

An indirect investment can be the purchase of a property, plant, units in a company or shares without the need to buy the property itself (Chen, 2020). This type of investment is about where investors may invest in the commercial market indirectly through the ownership of various market securities such as Real Estate Investment Trusts (REITs), exchange-traded funds (ETFs) that invest in commercial property-related stocks, or by investing in companies that cater to the commercial real estate market, such as banks and realtors. The risk through indirect investment may be smaller and this often may pave the way for making direct investment or buying the whole property or the real estate.

The ongoing threat of COVID-19 has taken the real estate sector into crisis, a crisis which continues. Much of the work has switched to digitalization and online business, to avoid the risk posed by the pandemics. But that does resolve many segments in the market of real estate without physical contact, transactions, visit, inspection and access to. It is considered a much worse crisis than the global financial crisis of 2008-2010. While during financial crisis the problem was with the lack of money or liquidity, during the COVID-19 the problem is with the real sector where, the money can be available, but many goods and services may not due to restrictions imposed as a defense from the pandemics. And this does again affect the financial sector by reducing the cash flow, returns, and this is reflected across the value chain. Figure below shows how the market for real estate was affected from the beginning of 2019 until March 13, 2020 when national emergency was declared in the US, the until mid-April 2020 or within six weeks.
Within the first month of declaring the national emergency, the sales have dropped by 45% from the base or zero. Otherwise, the fall was even greater compared to 2019 when the average increase was around 10%. This is a much worse situation of housing bubble burst that gave rise to global financial crisis more than a decade earlier. The U.S. commercial property market took a big hit during the 2008-2009 recession, but it has experienced annual gains since 2010. These gains have helped recover nearly all recession-era losses. There will be minimal appreciation in values, but income returns should remain healthy. However, other indicators suggest the commercial property market has peaked in the post-recession growth cycle. According to California real estate firm, Ten-X Growth, commercial property pricing ended 2018 up just 1% from 2017. A Ten-X report noted that the 2018 final total for commercial properties confirms their view of the late economic cycle pricing. The firm's research found that vacancies are rising, rent growth is slowing, and market interest rates are on the rise. As reported by Forbes, the retail sector, in particular, has proved a pain point in the broader commercial property market, as widespread store closures intensified in 2017 and continued into 2018. For example, popular mall REIT Westfield Corporation saw their stock price shed about 30% between mid-2016 and late 2017 before reversing some losses through January 2018. Unibail-Rodamco SE acquired Westfield for US$15.8 billion, creating Unibail-Rodamco-Westfield (URW) (Berry, 2020). Most firms, however, maintain that the property market remains healthy overall. J.P. Morgan, in its "2019 Commercial Real Estate Outlook," largely echoed CBRE's view stating that 2018 was the ninth year of
increases in commercial property rents and valuations. Morgan predicts this pace will slow but continue and do not see a downturn until after 2019 (Jones Lang LaSalle, 2020). Note that the COVID-19 pandemic, so far, has not really caused real estate value to drop substantially, and property values have remained steady or even have risen, much like the stock market through the Fall of 2020. This is a key difference between the economic fallout occurring in 2020 and what happened a decade earlier.

Table 1: The impact of previous pandemics and economic downturns in commercial real estate

<table>
<thead>
<tr>
<th>Pre-event (4 quarters)</th>
<th>GDP</th>
<th>CRE Price Index</th>
<th>Real estate investment trusts (REITs)</th>
<th>Transactions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asian flu; recession</td>
<td>Q3 1957–Q1 1958</td>
<td>Flat to positive</td>
<td>Flat to positive</td>
<td>Flat to positive</td>
</tr>
<tr>
<td>Recession; 9/11 attack</td>
<td>Q1 2001–Q4 2001</td>
<td>Declining but positive</td>
<td>Flat to positive</td>
<td>Flat to positive</td>
</tr>
<tr>
<td>SARS</td>
<td>Q4 2002–Q2 2003</td>
<td>Negative</td>
<td>Flat to positive</td>
<td>Flat to positive</td>
</tr>
<tr>
<td>Global financial crisis; Swine Flu</td>
<td>Q1 2008–Q1 2010</td>
<td>Data not available</td>
<td>Flat to positive</td>
<td>Flat to positive</td>
</tr>
</tbody>
</table>

In previous crisis and recessions such as the one in 1957-8 (Asian flu), then September 11, 2001 terrorist attacks, SARS chicken flu in 2002-3 and global financial crisis 2008-10, the GDP growth continued to be positive before the recession taking place. The CRE Price Index was negative before the chicken flu and declining in 2008-10 but positive. When the event of chicken flu came into effect, it lowered the GDP, CRE Price Index and REITs Index in two periods (1957-8 and 2001), recovered in 2002-3, but experienced negative growth during global financial crisis. The CRE Price Index in post events of Asian flu and 2001 was negative, declining but still positive after SARS and
growing once the financial crisis was over. Although global financial crisis was associated with the swine flu, it never had the effect on real property neither before nor after the event like in the current COVID-19 crisis as shown in Figure 1. That is why the COVID-19, as can be noticed by the comparison of indicators in Figure 1 and Table 1, has far more negative effects than all previous crisis and recessions, including the trends of GDP. It is worth noting that, the economy of Eurozone is forecasted to decline by 6.3%. The downturn will be the deepest in countries that were severely hit by the pandemic – Italy where decline by 9.1% is expected and Spain with expected decline by 8.0%. The German economy, the biggest trading partner of the Czech economy, is forecasted to decline by 7.0% (Skolimowski and Look, 2020). This by no doubt will affect the real estate cycle and prices. Here too, like in the US, the negative impact and consequences of COVID-19 so far have been greater, and likely to continue.

DISCUSSIONS

The COVID-19 pandemics has already hit the real estate market on a global scale. The quick loss of jobs has been unprecedented since the 2008-2010 global financial crisis. The explanation in aggregate terms is simple: the sudden lock of the countries in the spring 2020 has disrupted a wholesale chain of economic activities, especially the international trade and the peoples’ mobility. Despite eased measures undertaken by many countries, the crisis is not over yet and continues to hit hard many sectors like in a domino effect. Real estate transactions continue to be hampered by, among others, the requirement to restrict travel and keep a distance in live negotiations. Within a matter of weeks, people have been limited to a physical space, and this has created a crisis in real estate, because, the longer the crisis continues, there will be less interest in looking for buying of additional real estate. Lower prices may also not be an incentive indicator to buy. If a business is already constrained in using its premises at fuller capacities than before anti-COVID-19 measures were introduced (and many continue to remain still in force), then it is more likely to buy less additional space. That is in aggregate terms and exceptions do apply.

The economy of Eurozone has been growing for 6 years since 2012–2013 Eurozone Sovereign Debt Crisis. However, this economic boom has been terminated by COVID-19 pandemic that has spread from China to the entire World. Europe was one of the worst hit region, especially countries Italy and Spain. To combat the pandemic severe lockdown (restriction of movement) of economies had to be imposed. The resulting economic recession will be even deeper than 2008–2010 Financial Crisis. Services are hit to greater extent by
lockdown than manufacturing which is evident from developments of purchasing managers' indices.
The rest of large and medium large economies are also expected to witness a decline in the interest, invest and purchase of real estate. In Turkey, one of the world’s largest attraction, the COVID-19 outbreak on real estate development is described as an unforeseen event with negative effects in the real estate existing sector, costs estimates, values and rates of return in general, especially by travel bans and restrictions on domestic and foreign tourists, thus causing a decline in revenues, lowering of the volume of transactions, increase in operating costs, decrease of rent collection and investment value also tends to decline (Tanrivermis, 2020).

From the indicators presented, it can be noticed that the crisis in different periods to some extent experience a similar pattern in different categories such as GDP, CRE Price Index, REITs and Transactions before, during, and after the events, with some notable differences. In general, GDP kept growing except during 2008-10 when it went negative, along with CRE, REIT and transactions, but recovered to positive growth. The problem with the COVID-19 is that the crisis is present and cannot be predicted how long it will last, therefore, its pattern is not yet known. While we know how the indicators referred to fared before the crisis, we are missing the period “during the event” because it is incomplete or not yet over, and we cannot even predict a post event because the phenomenon is unique.

To sum this section up, the impact of COVID-19 so far has been more severe than one could anticipate, most likely because it was a phenomenon with a new virus never seen or experienced before. Consequently, it caused a panic on a global scale by locking many people inside the residential premises and closed many businesses. The negative effects were immediate also in the real estate sector by declining prices and fall in investment due to restrictions imposed on the movement of people and capital. Although easing measures by the governments are underway, the risk still persists and this is likely to continue affecting the real estate worldwide.

**CONCLUSIONS**

This paper found that the outbreak of COVID-19 pandemics in March 2020 is unique event never seen or experienced before by the scale it affected almost all human activities on a global scale, the real estate market in particular. The sudden closure of the borders between the countries directly affected the international trade and national economies. Furthermore, the great panic forced most countries to impose strict rules of blocking the people inside their residential areas for a certain period of time, and this move negatively affected
not only the economy, but also the peoples’ life. The consequences remain to be estimated for the years to come. Although the impact of the pandemics in the economy is multi-dimensional or affecting all of its sectors, this paper sought to discuss the implications on real estate, which so far proved to have negative impacts. The immediate impact of restrictions in the movement of people and businesses was reflected in the fall of purchases and investment in the real estate sector. Despite that the pandemic may be brought under control soon by potential invention of the vaccines, it has already scared both people and businesses who in the near future may be reluctant to either buy new premises and buildings or invest in new one, because, in case of restrictions like the one in the Spring 2020 and being locked, they might think that the rest of their real estate is not worth apart from the one where they are located. In this way, by all accounts, the COVID-19 pandemics is a far greater crisis than the global financial crisis of 2008-2010. During the financial crisis, the problem was with the money, and when it got resolved, the economy continued through a positive moderate economic growth. But in COVID-19 era, the harmful effect is far greater and more complicated as the battle rages on and the vaccine has not yet been invested. In such a situation, the real estate sector is heavily affected, and its future prospect is to depend on battling the consequences which brought about this situation, i.e. a solution to the COVID-19 pandemics. That is also when future research should be focused on. As long as there is an uncertainty how long the negative impact of the pandemics will continue, the attention at this point should be focused on monitoring the measurements of the indicators such as prices and transactions in the real estate market in the ongoing pandemic, so we would have more consolidated data for the period “during” and “after” the event which are missing in this paper as the COVID-19 pandemics continues.

REFERENCES


