The Future of Real Estate: Post COVID19

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Housing Price Index – some context

- Why measure house prices accurately?

  Steven Novella (Neurologist and “professional” sceptic: *“anecdotes generate questions, not answers”.*

  - Returns on real estate generally and housing in articular need to be ascertained to allow comparison with other assets – fixed income; equites; etc.
  - Financial sophistication needs to be underpinned by accurate measurement – the growth angle; the stability angle.
  - More high frequency numbers will allow for assessment of risks and returns as investors are increasingly seeking cost efficiency.

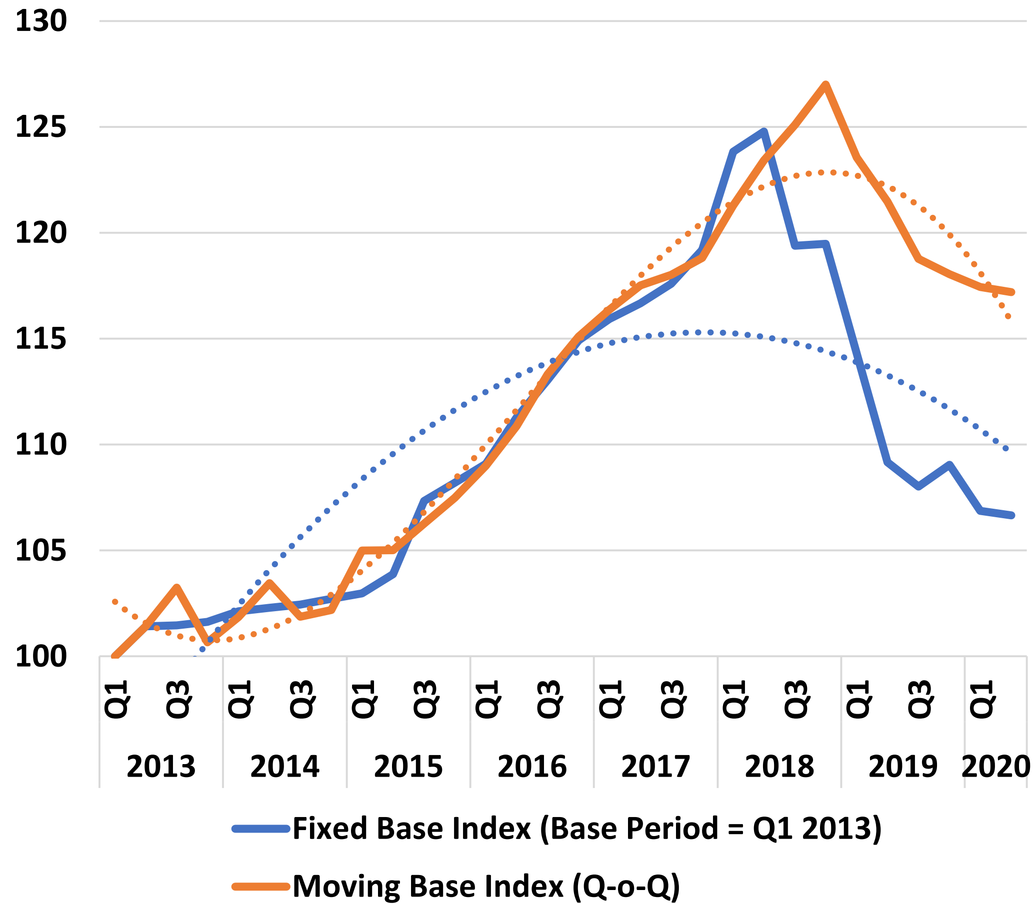
The Index – the mechanics

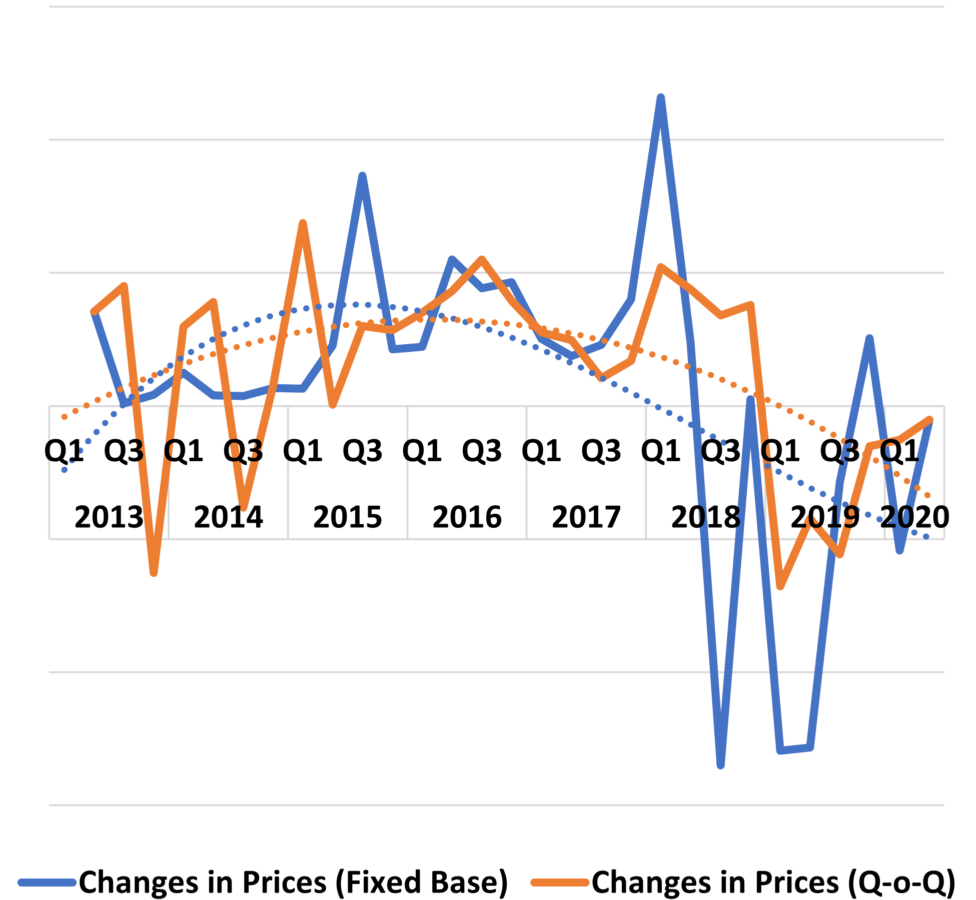
- The all too familiar:
  - Laspeyres price index – answers the question – "how much does a basket of goods and services cost now compared the price of the same basket of goods and services at a base year"
  - Paasche price index – answers the question – "how much does a basket of goods and services consumed now would have costed at the base period".
  - Not suitable for housing!
- For housing – the workhorse is the "hedonic model".
  - Like all indices, it's based on a representative sample.
  - Unlike the other indices, it acknowledges that housing has unique attributes (location , finishing, amenities etc.) as well as the quantitative aspects – (e.g. plinth area)
  - The hedonic function:

$$\boldsymbol{lnp_{it=}\alpha + \beta lnm_i} + \sum_{j=2}^{T} \boldsymbol{\alpha D_{ij}} + \sum_{j=1}^{T} \boldsymbol{\gamma_j X_{ij} + \varepsilon_{it}; i} = 1 \ldots. N$$

  - m = plinth areas; D= time dummies; x = qualitative attributes.

The Evolution of the Index





Demand and Supply Dynamics; and COVID19

- The Covid19 shock:
  - All segments of the economy almost in equal measure hit.
  - It is hardly surprising that real estate has been it hard.
  - Initial conditions were evidently unfavourable:
    - Softening of prices evident from late 2018;
    - Leading indicators aligned to the softening – profit warns from big players in the construction chain (e.g. steel and cement manufacturers)
  - While investors who are already locked in – either on the demand side or supply side – may take a sanguine posture, what the market has reveals point towards obvious risks crystalizing;
  - Asset quality of financiers worsening on account of the challenges that have afflicted households and businesses.
  - The defensive reactions: (a) financers scaling back – first order condition (b) investors scaling back – second order condition.
  - The broader macro policies have limitations (monetary and regulator measures are characteristically hard to target; fiscal side has no wiggle room – *another unfavourable initial condition*).

Some Key Highlights

- Market segmentation and skewness is more evident:
  - More supply on the upper end than demand can match.
  - The middle (both upper and lower) has been disrupted – recovery tied to the fortunes of the economy, especially when it turn the corner.
  - The lower end (affordable and/or social housing) requires careful more balancing: public good angle (beyond infrastructure) on the back of fiscal limitations; commercial angle on the back of limited scale that may compromise the affordability angle.

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