OAK INVESTMENT MANAGEMENT GROUP

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Forex and Real Estate

Following years of unprecedented monetary stimuli throughout the world taking different forms – politicians seem to be edging towards another fiscal lever: currency devaluation. What does this mean for international real estate investing? It means yet another risk factor needs to be assessed and mitigated when executing a cross border transaction or when positioning an international real estate portfolio.

Where devaluation is asymmetric (i.e. effects only one country) and long lasting then that country 's real estate becomes relatively cheaper but its income returns also become less valuable relative to the rest of the world. It would be very unfortunate, therefore, to make an unhedged real estate investment just before devaluation as this would destroy assumed returns over the lifetime of the real estate investment. Equally, it would be fortuitous to make an unhedged real estate investment just before an asymmetric and long lasting appreciation of the currency.

An asymmetric devaluation of a currency should theoretically draw in a wider universe of investors to real estate. Even a collapse of the currency need not necessarily destroy intrinsic value of real estate as physical assets are an (imperfect) hedge against monetary collapse. The problem is that in practice, devaluation could be a sign of much deeper problems in the target country for the real estate investment. Factors which affect the wider economy in productivity of labour, resources and capital – all of which then affect the performance of the real estate sector, and the likely underlying performance of the real estate asset in question.

Symmetric devaluations and (therefore) appreciations are much easier to handle. Real estate is a long lifed asset class so as long as the original capital investment is well managed (or hedged against the returns currency), and the coupon covers the local borrowing requirements the investor can wait to a pre-determined and acceptable strike price to reconvert local currency. Short, medium and long term currency volatility should, nonetheless, be watched closely.

Managed devaluations originate from political rather than economic causes. Just like inflation, which is an internal debasement of the currency, managed devaluation is an external debasement of a currency. Unlike inflation, which is slow moving and persistent, managed devaluation is much more volatile and adaptable. It is this abruptness which is critical for real estate sector.

Competitive devaluation in the end is a zero sum game. But some are better than others at playing this game such as those that have better pricing power; value add is more assured; inputs are sensitive and outputs are insensitive to price changes in comparison to their peers. In the race to the bottom these countries will do relatively better. But all will do absolutely worse because the time lag will effectively create investment uncertainty, resource misallocation and muted activity. The last twenty years have lived in relatively benign environment for real estate Forex decisions, today this is not the case. The key to real estate investment now is to be aware of macro-economic issues at stake and manage the timings of resource allocations to various currencies accordingly.

Nicholas Frankopan is Managing Director of Oak Investment Management Group pan-European real estate investment manager. To contact the author please email nfrankopan@oakadvisors.co.uk or learn more about the group at www.oakimg.com. *© All rights are asserted please request permission for reproduction.*