OAK INVESTMENT MANAGEMENT GROUP

JANUARY (1) 2013: The United States and European Real Estate

Accounting for some $15 trillion the United States is the largest national economy in the world. It is only eclipsed on a regional basis by the E.U. whose nominal is $2 trillion higher. The numbers do not adequately reflect the flexibility, the innovation and the competitiveness that makes the U.S. the much deserved champion it is from a fundamentals point of view. Nor does it show how investable and intrinsically liquid the US market is from a financial point of view.

The United States economy is the turbine of the world from which, for example, German high end manufacturers and Chinese exporters derive so much business. It is also the bank of value of the world. Perennial budget surpluses of China have few as liquid outlets as US Treasurys. Often cited alternatives, like buying strategic resources such as African mines is simply not viable in the scale and in the manner required. Equally, the surplus of the US profitability is invested throughout the world. Europe has long benefited from the fact that the US does have a (some would say biased) natural investment affiliation towards the old continent.

A central pillar of global real estate liquidity in the decade before 2007 was Commercial or Residential Mortgage Bond Security (C/RMBS) issuance instigated, presided over, bought and sold by US or US inspired banking system. Europe was by far the biggest partner in this system. Hand ringing about that system and all its flaws should not obscure the fact that in one shape or form the re-emergence of the global real estate market from a fundamentals and from a liquidity point of view will start from the US nor that the return of C/RMBS issuance would disproportionately benefit Europe. In the US, the fiscal contraction which is inevitable one way or another in the medium to long term is a headwind, and shale gas exploration is a tailwind for this mega-economy. The net balance of these and many other factors will dictate the economic environment not only in the US, but globally for years to come. In Europe, C/RMBS issuance will not re-emerge without a US recovery.

Real estate is an important secure exchange of value, and so European real estate market is driven by the health of the US economy. Increased productivity of most productive country in the world drives up US real estate prices, as well as the value of the US dollar – this makes it doubly attractive for US investors to deploy resources elsewhere. The European real estate industry will, therefore, be a huge beneficiary of American economic growth but disproportionately challenged by US economic contraction.

As the 'securest' asset class outside corporate and government bonds real estate is the most affected by marginal migrations of capital between asset classes (as happened post-Lehman brothers bankruptcy when the collapse in equity values drove a sell down in real estate to re-weight portfolios) or between countries (as also happened post-Lehman brothers bankruptcy when the global C/RMBS market dried up). The debate about the 'fiscal cliff' in the US has more than academic consequences for the global real estate industry. Europe relies on the US to come to a workable solution on the fiscal cliff and on US growth prospects so that Europe can benefit from the return to normalcy of the world real estate economy.

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