THE DAILY CHECK-IN WITH GOLDMAN SACHS

GUEST: Nora Creedon, Managing Director, Private Real Estate, Asset Management Division
HOST: Liz Bowyer, Global Head of Brand and Content Strategy
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Liz Bowyer: Hi Nora.

Nora Creedon: Hi Liz.

Liz Bowyer: You're a long time investor in the real estate sector. How that broad parts of the US economy are reopening, what's happening with the real estate market?

Nora Creedon: The real estate market is recovering really strongly in the US as vaccinations have been rolled out and as the stimulus has worked its way through the economy. And so, if we look at real estate security prices as one good measure of that, they're up about 40 percent from when we last spoke a year ago, Liz. And they're up 17 percent this year alone.

And what's interesting is, momentum is building. And the recovery is broadening out to more sectors. So, the best performing sector year to date is actually shopping centers and malls. That may surprise people. But in addition to seeking exposure to the vaccine, investors are also seeking exposure to the stimulus and where that's played out in the economy. And so, consumer-oriented sectors in real estate are performing really well.

I would say one area that's still being pretty hotly contested is the office arena. So, what happens with the return to work? And so, that's one area that has been lagging that we can talk about later on.

Liz Bowyer: So, among the sectors that are outperforming, what's driving that activity?

Nora Creedon: If you look at airline bookings on a forward basis, they've picked up tremendously over the months of March and April. And in particular, leisure travel is experiencing a really strong recovery. So, if you look at the Google searches for hotels and resorts, they're at the ten year high. So, a lot of people are feeling probably like you and I are, Liz, where we want to take vacations again. And so, we're seeing a very strong recovery play out in the leisure space.

One area that had been hit quite hard last year was the urban multifamily in markets like New York and San Francisco. And there we saw the largest drops in occupancy on record for the public companies in that space. And in fact, they were able to meet the market with much lower rents. And by the end of last year, we saw those declines start to slow down. And so, they've been slowly rebuilding their rents and their occupancy over the last few months. So, we're really seeing a very broad based recovery in real estate fundamentals.

Liz Bowyer: But you also mentioned challenges around commercial and office real estate spaces. And clearly, companies are debating what the future of work will look like. How do you expect that to play out?

Nora Creedon: Well, a hallmark of successful investing is staying humble and knowing what you don't know. And we don't know the answer yet on office. I will say that were there's this much uncertainty in a market, it's possible that there could be some great investment opportunities in office. And we will know a lot more in the coming weeks as more and more CEOs have started outlining what their expectations are for return to office.

So, where are we on this issue? We look at a number of different data points. We look at the key card swipes in major office buildings in big, urban areas. We look at transit data. So, the number of people that are going through commuter hubs like Penn Station and Grand Central Station. And this data has stayed persistently week. In fact, it's one of the few pieces of data that we track across the entire real estate spectrum that is very stubbornly refusing to go back to pre-COVID levels.

I think the answer, ultimately, while maybe a little unsatisfying, the answer may be somewhere in the middle. I think a lot of CEOs are telling us that they have felt they've pushed their workforce to the limit of productivity that they can achieve outside the office. They do want their culture to resume the way it was. They very much care about the onset of new employees coming into their organization. And so, there is a deep desire to get people back into the office. At the same time, we can't ignore the fact that for a year we were able to successfully migrate a lot of white collar jobs to more flexible situations. And so, it'll be unlikely that having gone through that for a year you'd have no change.

By the way, I don't think change is a bad thing. I think it's possible we could keep more people in the workforce that have historically needed more flexibility. And once employers understand the flexibility that their employees want, they're sort of able to price that into the agreement, if you will. So, I think it ultimately will end up in a good place.

And incidentally, I will say on office, if you're thinking about flexibility, it's a really good time to be an office developer where you can respond to the changes in what the employers and the employees want in a post-COVID era. And so, I think there will be really interesting investment opportunities that come from that.

Liz Bowyer: And how about those urban areas that you mentioned? There was a lot of talk during the pandemic about people leaving big cities like New York and San Francisco. How has that evolved?

Nora Creedon: It's a great question, Liz. And it's clearly tied up in the office question we just discussed because offices, in many cases, have been the centrifugal force in markets like New York and San Francisco. And I think we're going to have a better way to judge this, as well, as the vaccinations get more rolled out in these markets and we see people return to work.

So, let's step back for a minute and think about the non-gateway markets, the sunbelt markets. They have a lot going for them. They've got great weather. They've got affordable housing. They've got, in many cases, a lower tax and regulatory burden than some of those gateway markets. And so, this has been going on for some years, that people have been moving into the sunbelt markets. In fact, you know, New York has lost delegates in Washington since the 1940s. Those have been generally taken up by those sunbelt markets. So, we've been an active investor in those markets, in both their public and private real estate strategies for many years.

I do think this is something that's subject to a lot of, you know, going down the anecdotal rabbit hole. Everyone has a friend who's moving or knows someone who's moving. And so, we've tried to take a little bit more of a data driven approach to observing this. We know the home builders are experiencing a surge of out of state relocation. And they generally build across the sunbelt markets. We know one of the sunbelt multifamily REITs reported in the first quarter that about half of their new lease applications came from out of state. And half of those came from New York and California. And we can look at US Postal Service data and we can see that over the course of 2020, there was roughly a 9 percent decline in population in New York City, and a 14 percent decline in San Francisco. About a quarter of those moved just to the surrounding suburbs. But the remainder we clearly saw big targets of those relocation address forms going to sunbelt markets. So, we certainly want to position our investors to be in the growthiest markets that we can. And so, we're very focused on the sunbelt in particular.

Liz Bowyer: And how about valuations? How are the valuations that we're seeing in the real estate sector now compare with the pre-pandemic levels?

Nora Creedon: I think you'd be hard pressed to find any investor in any asset class today who thinks valuations are cheap. The fact is we all price our assets, whether those are equities or forms of credit or real estate, you know, all of them ultimately get priced up the risk-free rate. And we live in a world with a very low risk-free rate and a lot of capital looking for a home.

So, on an absolute basis, valuations aren't cheap in real estate. At the same time, we live in a relative world. And so, we get comfort looking at what the implied cap rate is to own real estate. That's simply the cash flow as a percentage of the value of the property. We look at that cap rate versus various interest rate benchmarks. And as long as we see a healthy spread, we think it's still a safe time to invest in real estate.

If you look at real estate versus stocks, they trade a little bit cheaper on a multiple versus the S & P. And lastly, a lot of real estate specialists think about what replacement cost is. So, what could I build this property for if I had to start over again? And that really differs asset by asset, sector by sector. And certainly, demands an active approach to your investment management.

Liz Bowyer: So, given all of the activity that you've described, how does that impact the broader investment landscape around the real estate?

Nora Creedon: Well, our investors are used to finding interesting investment opportunities no matter what the macro environment is. I will say what's sort of interesting, may surprise people, is that there's been remarkably little in the way of distressed investment opportunities to date in this cycle. Again, given what we went through last year, I think we would have expected more to have shaken loose. And in fact, I think distressed sales were only about 2 percent of the investment transactions that occurred in the private markets in Q1. So, certainly more to come there. There's the possibility that more will shake loose in the coming months.

Liz Bowyer: So, the Biden administration recently introduced its infrastructure package. What provisions in the legislation are you focused on that might create opportunities for real estate investors?

Nora Creedon: There's actually been a lot to digest in the infrastructure package for real estate investors. The single largest line item in the package was about $400 billion for home healthcare and senior care. So, clearly that's going to have some impact across the senior housing industry in real estate. That's a lot larger, for instance, than the 115 billion that was allocated for road and highway repair that we sort of think of as traditional infrastructure.

There was also roughly $200 billion earmarked for affordable housing, which is a big focus for our multifamily investors. And then, finally, another 100 billion that has been earmarked for expanding broadband access, which will be really important to the cell tower companies. So, actually quite a bit that's there to digest for real estate investors.

Liz Bowyer: So, finally Nora, as we move towards a post-pandemic world, what sort of long-term changes do you expect that we might see across the real estate sector?

Nora Creedon: You know, Liz, my feeling is that all real estate has fundamentally changed from what we went through last year. And that's because we, as the users of real estate, have been fundamentally changed. I do think it's marked a new investing cycle, what we've been through. And I just think the amount of digitization that has occurred in our economy, while you know, a lot of our behaviors may go back to what they looked like pre COVID, there's going to be methods and parts of that that have really changed from what we've been through.

And if you think about even the specific segment of the population, let's take the baby boomers, a huge part of our population and where the growth is happening in baby boomers is clearly really important for real estate investors to find a way to service that community. They're some of the fastest growing users of a lot of the technology, the digital payments and other forms of digitization that we've seen in the last year. And so, they're going to require a different way of being serviced from a real estate perspective.

We also, you know, clearly talked about the impact of how people work and changes in productivity. I think employers are going to rethink how and where they locate their employees as a result of the pandemic. And all of us, whether you're a real estate investor or not, are going to ultimately absorb the changes to the economy that came from adding trillions of dollars in debt in order to respond to this pandemic. And so, I think we've entered a new era for real estate investing. And we're really excited at trying to find new, interesting investment opportunities as a result.

Liz Bowyer: Thanks Nora.

Nora Creedon: Thanks Liz.