Behind the Markets: Looking at new economy real estate in December 2023

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Christopher Gannatti, CFA
Global Head of Research

We recently spoke with Uma Moriarty, the Senior Investment Strategist and Global ESG Lead for CenterSquare Investment Management on Behind the Markets. WisdomTree has a relationship with CenterSquare, licensing the CenterSquare New Economy Real Estate UCITS Index for the WisdomTree New Economy Real Estate UCITS ETF (WTRE).

A wall of maturities coming in the real estate debt market

Let's face it—since the Global Financial Crisis of 2008-09, interest rates around the world have been very low, encouraging entities to take out more and more debt at a low cost. Now, a lot of real estate loans are maturing and interest rates are expected to be 'higher for longer', to take the popular expression. Uman noted that it's all about the underlying asset, that is, if the underlying asset is an old office in a secondary or tertiary market, then there are structural issues and holding that debt may not be beneficial. At the same time, if someone is looking at a multi-family home and the asset is performing, then debt taken out against it may not be as problematic.

Real estate for the modern economy data centres

Over time, people are shifting their preferences and behaviours and this is driving the importance of different, newer types of real estate. Data centres are a prime example. Globally, both businesses and individuals are consuming and storing more data than ever before. This trend is being accelerated in 2023 with the proliferation of large language models (LLMs) like GPT-4, LLAMA and most recently Gemini.

Uma discussed the difference between developing and training these models versus running them for live inference calculations. Developing and training can occur in secondary markets where power and land are less expensive. Read 'secondary' as meaning 'further away from major population centres.' When a model is deployed for inference, however, people want it to feel 'faster.' In technical jargon, this means that you want to minimise latency. One way to do this is to locate the data centres much closer to major population centres. There's only so much space and power in these areas, so the data centre real estate investment trusts (REITS) that have built platforms with lots of these assets located near major cities are extremely valuable and becoming only more so with the Cambrian explosion of artificial intelligence (AI) applications and LLMs.

Data centres are seeing increased rents, which is notable. Five years ago the supply coming online was very much aligned with the demand, but in today's world the demand is ramping up much faster. When

you wonder where all those Nvidia graphics processing units (GPUs) are being deployed, the answer is largely these data centres.

The day before we had our conversation with Uma, there was an article published in the Wall Street Journal noting that Blackstone and Digital Realty were teaming up to develop $7 billion in data centres[1].

Real estate for the modern economy ecommerce logistics centres

Uma spoke of Amazon as somewhat the 'gold standard' in how to set up a supply chain over an extended period of time that's led to consumers being able to place an order and receive it in as little as two hours (in some cases). Being able to do this has led to reconceptualising the supply chain and in many cases thinking of a larger number of smaller industrial spaces. If these spaces can be closer to the end consumers it makes the largest costs, labour and transportation, lower for companies seeking to provide ecommerce solutions to their customers. Over time, we will see the different solutions being invested in today being deployed, be it the potential for drones, autonomous vehicles or other technologies.

Uma noted that the supply of these smaller industrial spaces closer to customers is in decline, so the pricing of these pieces of real estate has been increasing and CenterSquare sees the potential for this to continue.

Real estate or the modern economy life sciences

Uma cited that in the United States, roughly 10,000 people turn 65 years old each day. Many societies are getting older and will need more and more healthcare solutions. Jeremy noted that he and I can work from anywhere and record podcast episodes like this from anywhere, but the innovations behind life sciences require very specific real estate.

During the week that we spoke to Uma, the Economist released an article discussing specific life sciences real estate[2]. We'd also note that one of WisdomTree's contrarian ideas for 2024 relates to biotechnology, a segment of megatrend investing that has underperformed in recent years; it may turn.

While data centres and ecommerce logistics real estate, per Uma's views, have seen a decreasing supply, life sciences real estate has experienced an increasing supply. This has led to a bit of a valuation discount in this area of new economy real estate, which could be an opportunity for investors with an expected growth acceleration in demand in the future.

Real estate is changing—investments should reflect these shifts

Real estate has been an asset class for a long time, but our relationship with CenterSquare is meant to provide investors with an option to shift real estate investments more in line with the types of real estate in demand today. For those wanting to learn more, click here to listen to the full episode.

[1] Source: Grant, Peter. "Blackstone, Digital Realty Team Up to Develop $7 Billion in Data Centers." The Wall Street Journal. December 7, 2023.

[2] Source: "American life-sciences firms are moving labs downtown." The Economist. December 7, 2023.

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