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Fundamentals of real estate investing

October 2024

Historically and internationally, real estate has been the asset class of choice for generations of investors to build wealth as it provides both a stable rental income over the short and medium term, plus the prospect of capital growth over the long term.

Mark Twain said it best: "Buy land, they're not making it anymore". Real estate investing remains, for many, a cornerstone of wealth creation. According to Statista, the global real estate market is expected to reach a valuation of USD 634.90trn in 2024 and grow at a steady 3.4% between 2024 and 2028. With over 90% of the world's millionaires attributing their wealth to real estate investments, it is imperative to understand the fundamentals of real estate investing for a successful journey of wealth accumulation.

This publication outlines the key aspects of real estate investing, serving as a guide for both novice and experienced investors.

Key facts

According to Statista, the real estate market worldwide is expected to reach a staggering value of USD 634.90trn in 2024

Global real estate market value (USD, trillions)

Source: Statista.com

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What is real estate investing?

Real estate investing encompasses the acquisition, ownership, management and sale of properties with the primary objective of generating profit.

This form of investment offers a range of opportunities, from purchasing residential homes to investing in commercial properties, and even land development. Real estate is a tangible asset, providing investors with potential for income, capital appreciation, protection against inflation and tax benefits, making it an attractive option for building wealth.

Types of real estate investing

Residential real estate | Commercial real estate | Industrial real estate | Retail real estate | Land investment | REITs

Residential real estate

Residential real estate includes properties intended for private living. This category encompasses single-family homes, condominiums, townhouses, duplexes and vacation homes. Investors can profit by renting out these properties or selling them at a higher price. The demand for residential properties often makes them a stable investment, with rental income providing a steady cash flow. Additionally, properties can appreciate over time, further boosting returns.

Commercial real estate

Commercial real estate refers to properties used for business purposes. This includes office buildings, retail spaces, industrial properties and multi-family residential buildings with five or more units. Investing in commercial properties can be more complex and costly than residential real estate, but it often offers higher returns. Lease agreements are typically longer term, providing greater income stability. Investors in commercial real estate benefit from the economic growth that drives demand for business spaces.

Industrial real estate

A sub-category of commercial real estate, industrial properties include warehouses, manufacturing facilities, distribution centers, and research and development buildings. The rise of e-commerce has significantly increased demand for industrial spaces, particularly warehouses and fulfillment centers. Investors can benefit from long-term leases and a growing need for logistical hubs in strategic locations.

Retail real estate

Retail real estate encompasses properties that house consumer-oriented businesses, such as shopping centers, strip malls and individual retail stores. The performance of retail real estate investments is closely tied to consumer spending and economic health. However, the sector has faced challenges due to the growth of online shopping, requiring investors to adapt by focusing on experiential retail spaces and locations with strong foot traffic.

Land investment

Land investment involves purchasing vacant land that can be developed or held for future appreciation. Investors can buy raw land, sub-divide it and sell it to developers, or develop it themselves. Land investments can be speculative, as the value depends on future development and market trends. However, they can offer substantial returns if the land is located in a high-growth area.

Real Estate Investment Trusts (REITs)

For those looking for a more hands-off approach, REITs offer a way to invest in real estate without directly owning properties. REITs are companies that own and manage a portfolio of real estate assets, such as shopping malls, office buildings and apartments. Investors buy shares in these companies and earn dividends from the income generated by the properties. REITs provide liquidity, as they are traded on major stock exchanges and allow investors to diversify their portfolios.

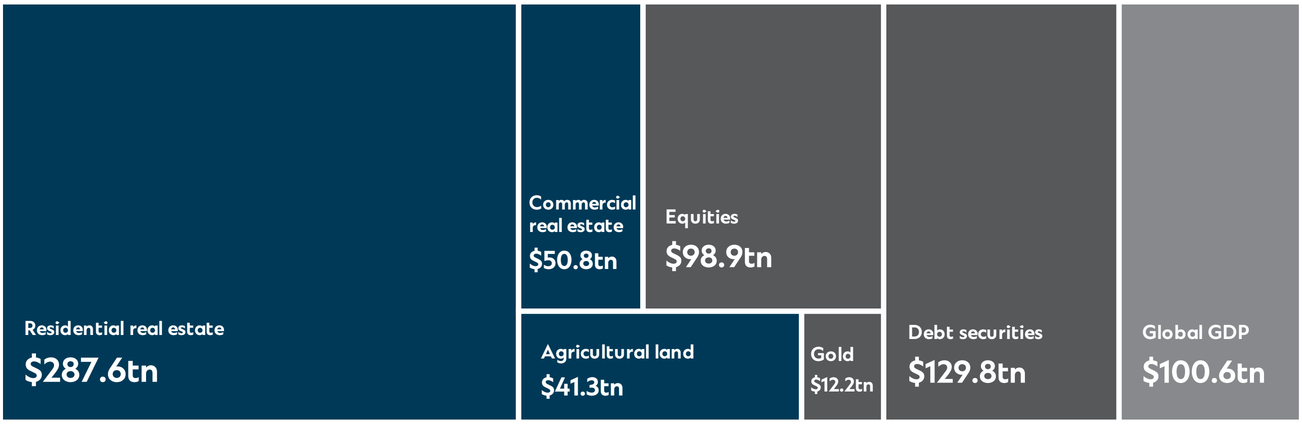
While REITs offer some exposure to physical real estate, real estate mutual funds invest in companies engaged in the real estate business. They help gain indirect exposure to real estate, making it suitable for beginners in their investment journey. However, their high correlation with other asset classes (especially equities) makes them inefficient from a diversification perspective.

Real estate investing offers diverse opportunities for income and growth. From residential homes to commercial properties and REITs, investors can choose a path that aligns with their financial goals and risk tolerance. While each type of real estate investment has its unique challenges and benefits, the potential for long-term appreciation and income makes real estate a compelling option for building wealth.

Key facts

Real estate is by far the most significant store of wealth, representing close to 3 times total global GDP

Global real estate universe relative to other major asset classes in 2022



Source: Savills Research, and Savills Research using World Bank, Bank for International Settlements, World Federation of Exchanges, World Gold Council

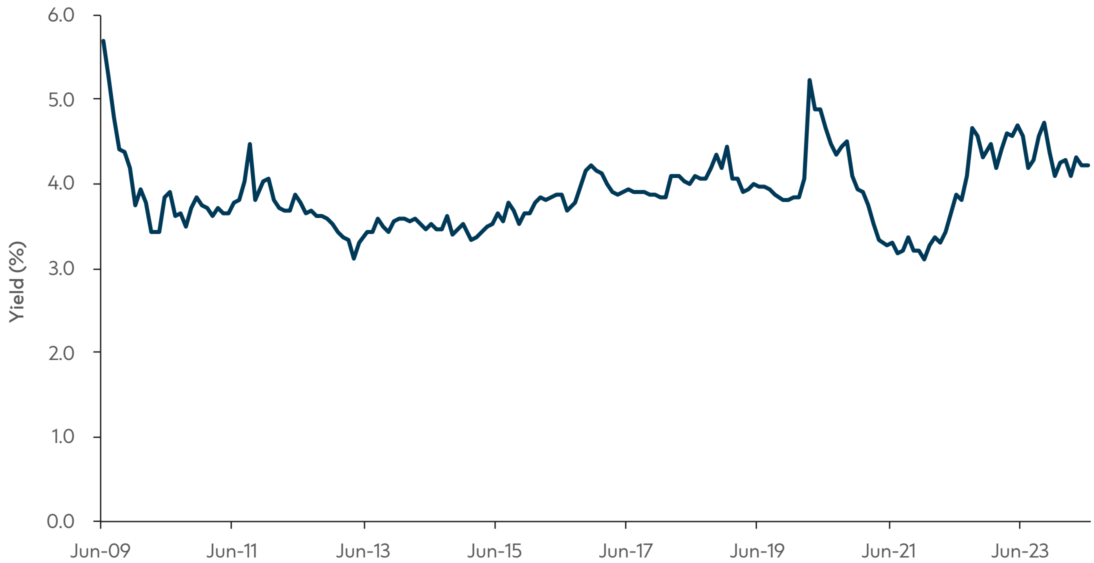
Why should an investor consider real estate investing?

Steady income stream

Income can be generated through dividends, interest, rental yields, fees or royalties. Investing in rental properties provides a reliable and regular income stream. This provides investors with a consistent source of cash flow, which can be especially appealing in times of economic uncertainty.

Fig. 1

Historical yields of global REITs index



Source: Bloomberg, Standard Chartered

Appreciation and capital growth

Real estate properties tend to appreciate over time. This appreciation can lead to significant capital gains when the property is sold. The value of real estate tends to be less volatile than many major asset classes, providing a stable growth potential. Historical data shows that despite short-term fluctuations, real estate generally increases in value, offering long-term wealth accumulation.

Tax benefits

Real estate investors often enjoy various tax advantages in many markets, such as deductions for mortgage interest, property taxes, operating expenses and depreciation. These deductions can significantly reduce taxable income, thereby enhancing overall returns.

Inflation hedge

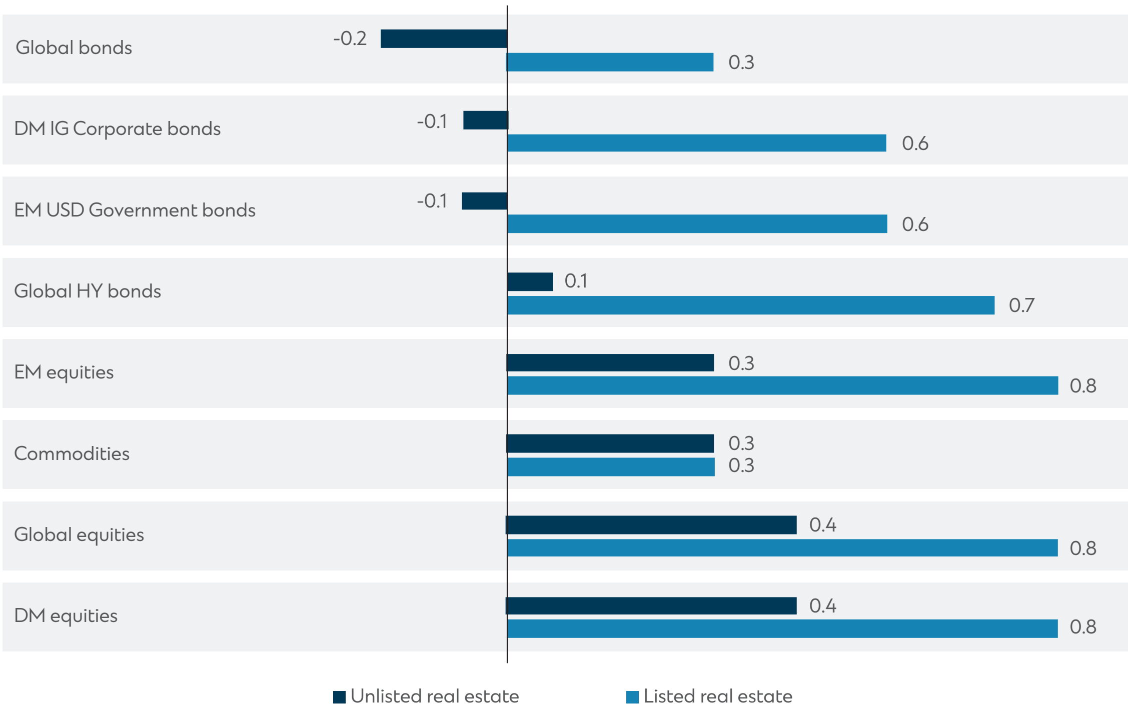
In the long run, real estate investments often align with inflation, as rising inflation typically leads to higher wages, which in turn allows landlords to increase rents. Moreover, inflation usually accompanies a strong economy, which boosts consumer confidence and spending. For real estate investors, this dynamic results in increased rental income and property appreciation, effectively preserving purchasing power and offering a hedge against rising costs. This correlation makes real estate a valuable asset class during inflationary periods, providing both income growth and long-term value appreciation.

Portfolio diversification

Real estate offers a valuable opportunity for diversification within an investment portfolio. While publicly listed real estate investments can correlate closely with risk assets like global equities, private or unlisted real estate typically shows low correlation with traditional asset classes. This low correlation helps to reduce overall portfolio risk, providing a stabilising effect on returns and offering a buffer against market volatility. As a result, including real estate in a portfolio can enhance resilience and provide more consistent performance across varying market conditions.

Fig. 2

Forward looking correlation between global real estate assets with various investments



Source: Mercer, Standard Chartered

Understanding the real estate market cycle

The commercial real estate market moves through a predictable cycle: recovery, expansion, hypersupply and recession. Each phase varies in length, influenced by economic conditions, government policies and market dynamics.

Recovery

The recovery phase marks the turning point at the cycle's lowest ebb. During this time, new construction is scarce, and leasing activity remains subdued. Occupancies are low, and any rent growth is typically minimal or below the inflation rate. Savvy investors see this phase as a prime opportunity to acquire distressed properties at bargain prices. These assets often benefit from strategic value-add initiatives, such as renovations or repositioning, setting the stage for improved performance as the market rebounds.

Expansion

As the market enters the expansion phase, demand surges, driving up prices and reducing vacancy rates. This period is characterised by a flurry of construction activity, with developers eager to meet the growing demand. However, this can also lead to overbuilding if not carefully managed. The broader economic backdrop is generally positive, with rising GDP, robust job growth and low unemployment. For investors, this phase presents an ideal time for development or redevelopment projects, supported by increasing rents and strong market fundamentals. It is also a favourable moment for refinancing properties to capitalise on rising values.

Hypersupply

The hypersupply phase emerges when the market becomes oversaturated, either due to excessive construction or a drop in demand. Economic factors like a slowdown in GDP growth or rising unemployment can exacerbate this situation, causing a mismatch between supply and demand. While rent growth may still occur, it often slows considerably. In this phase, investors might choose to sell assets before further market softening, as increased inventory pressures cap rates and reduces property values. Owners may need to offer incentives or lower rents to maintain occupancy.

Recession

The recession phase is characterised by an oversupply of properties, leading to high vacancy rates and declining rents. Economic conditions are typically weak, with negative or negligible rent growth. For investors, this phase offers unique opportunities to acquire distressed assets at significant discounts. By implementing effective value-add strategies, such as property upgrades or repositioning, investors can enhance the appeal of these assets and achieve substantial returns once the market recovers.

This cycle is a fundamental concept in real estate investing, guiding strategic decisions at every stage.

The real estate cycle

Phase 1 **Recovery**	Phase 2 **Expansion**	Phase 3 **Hypersupply**	Phase 4 **Recession**

Phase 1 Recovery	Phase 2 Expansion	Phase 3 Hypersupply	Phase 4 Recession
Decreasing vacancy	**Decreasing** vacancy	**Increasing** vacancy	**Increasing** vacancy
Low construction rates	**Moderate/high** construction rates	**Moderate/high** construction rates	**Low** construction rates
Low rental rate growth	**Moderate/high** rental rate growth	**Moderate/low** rental rate growth	**Low/negative** rental rate growth
Moderate absorption	**Moderate** absorption	**Low** absorption	**Low** absorption

Source: Standard Chartered

Key strategies in real estate investing

Choosing an investment strategy hinges on the objectives, resources and risk appetite; an investor can focus either on generating passive income, capitalising on value appreciation or actively pursue a combination of both.

Fig. 3
Real estate investment strategies

Strategy	Structure	Purpose
Buy-and-hold	Purchase and hold property.	Generate steady cash flow, appreciation and tax benefits.
House hacking	Portion of the house/office is leased or rented out. Usually implemented on homes.	Reduces cost of living, establishes passive income.
Fix-and-flip	Buy distressed properties or at discounted value, renovate and sell. Used by professionals in realty businesses.	Sell at a profit. Generates short-term profits.
BRRR (Buy-Renovate-Rent-Refinance-Repeat)	Buy a property at discount, renovate, put it on rent. Refinance to cash out the equity appreciation. Use funds to buy another property.	Generates passive income. Existing property finances the purchase of another property.
BURL (Buy Utility, Rent Luxury)	Buy property with essential features in a strategic location. Strategically renovate for premium rental yields.	Establishes high-yield rentals. Minimises initial costs.
Wholesaling	Similar to fix-and-flip but does not take possession of property. In some states, must be a licensed realty professional.	Capital appreciation without having a lot of investment capital.
Pre-construction	Buy property at the onset of development and sell upon completion.	Short term capital appreciation. Speculative bet.
Vacation rentals	Renting out property for vacationers.	Sporadic high-yield rentals from idle property.
REITs	Indirect exposure to real estate projects, lower fund outlay.	90% of the income is paid out as dividend by REITs to claim tax benefits.
REIGs	Professionals pool resources to invest in properties as a group.	Access to big ticket investments and higher profit potential.
Crowdfunding platforms	Finance RE projects through online platforms	Rental income and capital appreciation. Lower capital requirement.

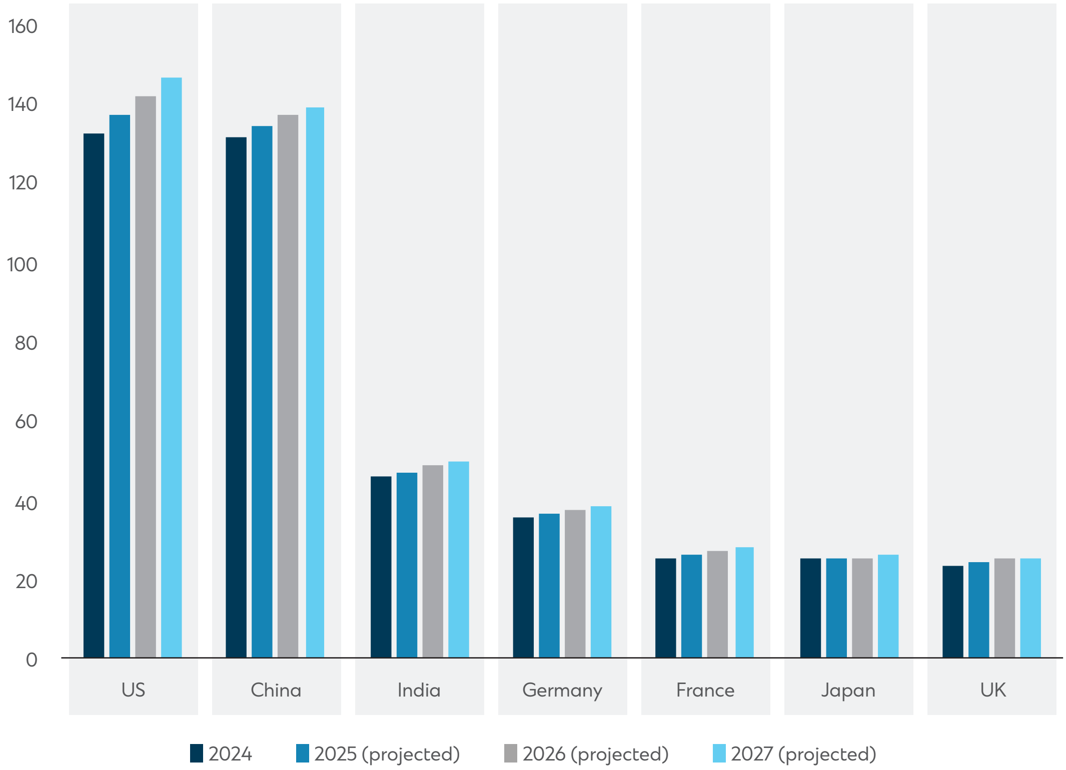
Source: Standard Chartered

The buy-and-hold strategy remains the most popular among the ones discussed; typically, the holding period will exceed 10 years. Each strategy comes with its own set of opportunities and risks, making it important to conduct thorough research and set specific objectives for the investment made. Prior to the actual purchase, it is necessary to conduct a thorough due diligence to ensure a clean title to the property and fair valuation. The property upon purchase needs to be maintained and managed to preserve and grow its equity. Investing via REITs and crowdfunding platforms may not require external financing; however, they require the same amount of diligence whilst investing.

Key facts

The US has overtaken China as the world's most valuable real estate market since 2022. In the global ranking, China follows closely, holding the second position and representing nearly 20% of the global real estate market. Together, the G7 nations, along with China, account for over two-thirds of the total global real estate value, underscoring their significant influence in the industry

Top 7 countries by real estate value (USD, trillions)



Source: Statista.com

Risk exposure and mitigation

Real estate investment carries unique set of risks that investors must navigate to achieve success.

Market volatility poses a significant risk, as property values can fluctuate due to economic conditions, interest rates and market demand. To mitigate this, investors should diversify their portfolios across different types of properties and locations, ensuring they are not overly reliant on a single market segment.

Economic downturns can impact rental income and property values. Investors should maintain a strong financial cushion and focus on properties with stable, long-term tenants. Additionally, investing in recession-resistant sectors, such as affordable housing or essential services, can provide stability.

Regulatory changes, including zoning laws and tax regulations, can affect property values and operational costs. Staying informed about local and national regulations and engaging with legal experts can help investors navigate these changes.

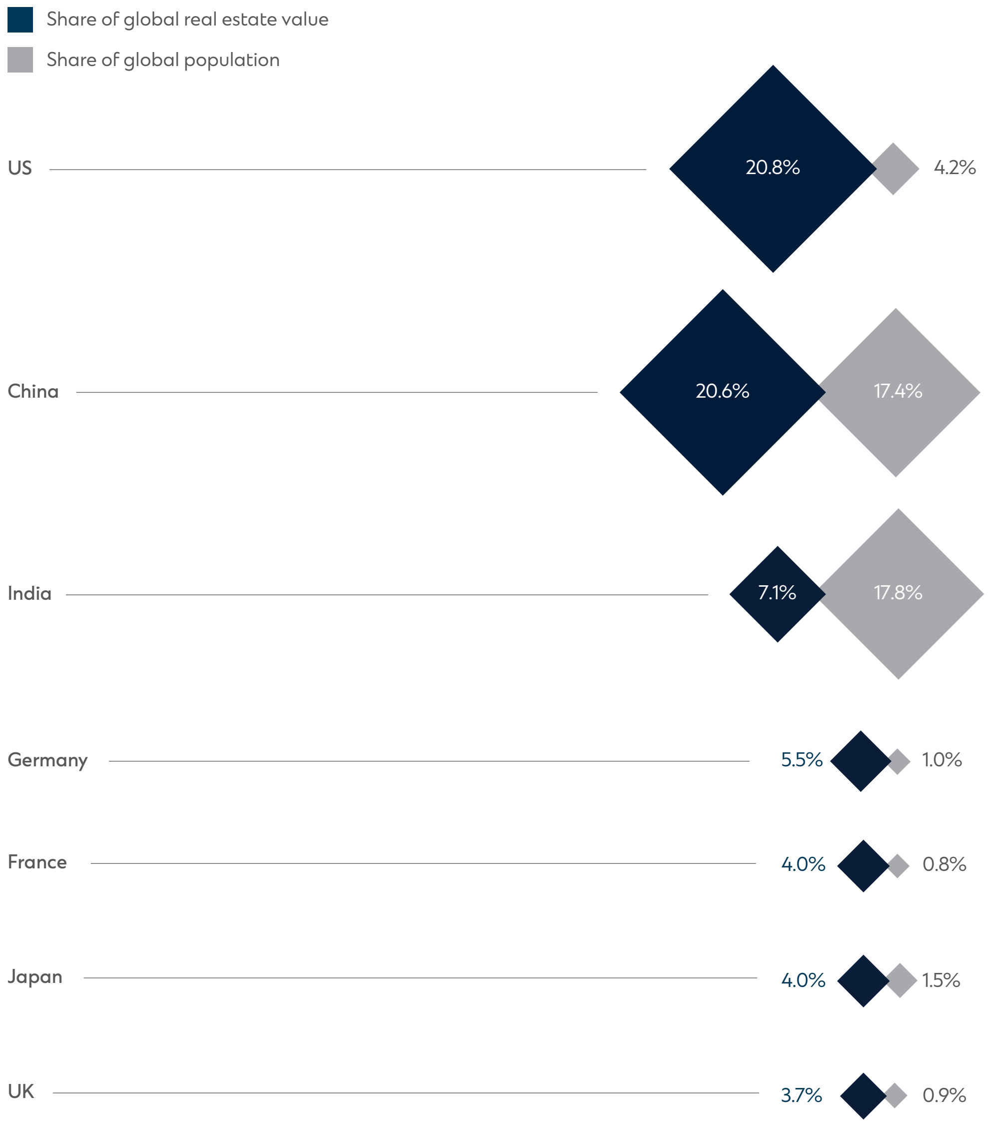
Property-specific risks include issues like structural damage, environmental concerns and maintenance costs. Conducting thorough due diligence, including property inspections and environmental assessments, is crucial. Investing in quality insurance coverage can also protect against unforeseen events.

To further mitigate risks, investors should stay informed about broader market trends and economic indicators, enabling proactive decision-making. Building a network of trusted professionals, including real estate agents, property managers and financial advisors, can provide valuable insights and support. By understanding and addressing these risks, investors can make informed decisions, reduce potential losses and enhance their real estate investment success.

Key facts

Property values in Europe and North America represent nearly half of the global real estate market, despite these regions housing less than 20% of the world's population. In contrast, Asia is home to more than 60% of the global population but contributes less than 20% to the global real estate wealth. This disparity highlights the concentration of real estate value in wealthier, more developed regions and underscores the potential for growth in emerging markets

Regional distribution of global real estate value compared to population (%)



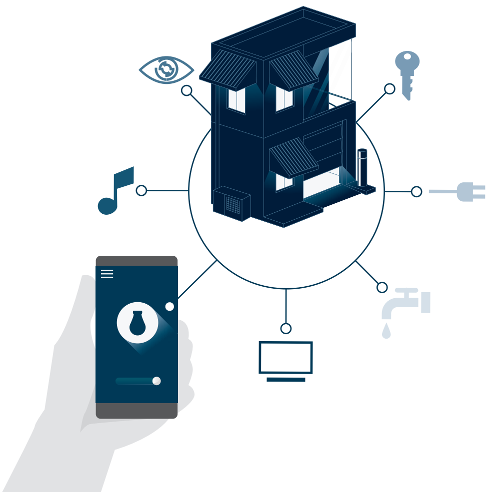
Source: Worldometer.infor, Statista.com. Data as of July 2024

Upcoming trends in real estate investing

Future trends in real estate investing are shaped by evolving technology, demographic shifts and changing societal needs. Here are some key trends to watch:

1 Smart homes and PropTech

The integration of smart home technology and property technology (PropTech) is transforming how properties are managed and experienced. Investors are increasingly looking at properties with advanced automation, energy efficiency and smart security features.



2 Sustainability and green buildings

Eco-friendly construction and sustainable practices are becoming more important. Investors are focusing on energy-efficient buildings, sustainable materials and designs that reduce environmental impact, driven by both regulatory requirements and consumer preferences.

3 Remote work and suburban shift

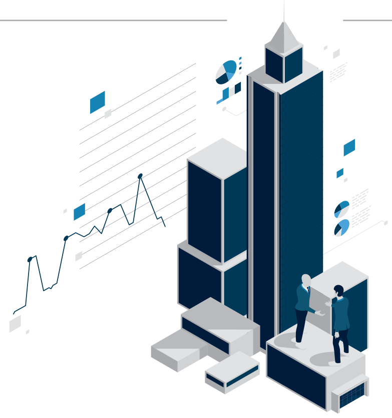
The rise of remote work is leading to a shift from urban centers to suburban and rural areas. This trend is influencing real estate investments in these regions, with increased demand for larger homes, better amenities and more outdoor space.

4 Co-living and shared spaces

Co-living spaces are becoming popular, especially in urban areas, as a more affordable and flexible living arrangement. This trend caters to younger generations seeking community and affordability.

5 Data analytics and AI

Data analytics and artificial intelligence are playing a growing role in real estate investing. These technologies help investors analyse market trends, property values and potential risks more accurately, leading to better investment decisions.



6 Blockchain and real estate tokenization

Blockchain technology and real estate tokenization are emerging trends that could revolutionise property transactions. They offer more transparent, secure and efficient ways to buy, sell and invest in real estate.

By embracing these future trends, an investor can access a wide range of opportunities for diversification, innovation and strategic growth.

Conclusion

Real estate investing continues to be a cornerstone of long-term wealth creation, offering the dual benefits of generating passive income and providing portfolio stability through asset diversification.

Additionally, the potential for long-term appreciation enhances its appeal. In today's rapidly evolving market, technological advancements and a growing emphasis on sustainability are reshaping the landscape of real estate investing. New and innovative investment opportunities are emerging, driven by these trends.

For astute investors, this dynamic environment presents an exciting opportunity to optimise returns while aligning with broader economic and environmental goals. By embracing cutting-edge technologies and sustainable practices, investors can not only enhance the value of their portfolios but also contribute positively to society and the planet. Leveraging thorough research and market analysis is crucial in this context, enabling investors to make well-informed decisions that support ongoing wealth creation and profitability. As the industry evolves, staying ahead of these trends is key to maximising the potential of real estate investments.

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