Geopolitical Risk: Political, Capital Markets and Real Estate Uncertainty

Volume 46, Number 4 - August 5, 2022 • Written by: Mr. Constantine Korologos, CRE

Photo: posteriori/Shutterstock.com

 Mr. Constantine Korologos, CRE

has worked in the real estate industry for 38 years, and has held several senior executive and managing director positions at Wachovia Securities, Bear Stearns and Co., GE Capital Real Estate, Moody's Investors Service, Equitable Real Estate Investment Management and Deloitte & Touché, where he focused on the capital markets, valuation, structured finance, consulting and investment banking. In addition to his own consulting business as founding principal of Leonidas Partners, LLC, he is a managing director with Eyzenberg and Co. where he is involved in the placement of real estate debt capital, ground lease and C-Pace financing, and a managing director with Frontstage Capital, where he is a FINRA registered representative executing securities transactions through their affiliate broker dealer, Moody Capital. Complementing his professional experience, he is a full-time Clinical Assistant Professor, teaching graduate real estate finance, capital markets and portfolio risk courses with the New York University Schack Real Estate Institute, where he has been on the faculty for 30 years.

Geopolitical Risk was listed as the #2 issue in the 2022-23 Top Ten Issues Affecting Real Estate® by The Counselors of Real Estate®.

> ***"With continued political uncertainty providing significant headwinds, the ultimate impact on commercial real estate will be greater than if the political risk didn't exist. The longer it takes to moderate, the more the accretive impact can have negative implications for the industry."***

Understanding the direct implications of geopolitical risks attributable to real estate can be challenging to measure. These risks, both global and domestic, generally materialize as volatility due to uncertainty about the future impact on economies and financial markets. Whether a conflict like the war in Ukraine, additional production shutdowns due to elevated COVID infection rates in China, or local politics surrounding rent regulations and sustainable development and renovation requirements, they are difficult to isolate and measure. Additional complexity surrounds these risks when they occur in an environment of increasing interest rates and inflation levels at a 40-year high. When you add in the complexities around supply chain stress, an improving but still unresolved pandemic hangover and energy costs, the lines between these risks become more blurred. While the focus is on the most visible geopolitical risks, the Ukraine and Russia war and the most recent lockdowns in China, these are not the only political risks affecting the broader markets.

Commodities Pricing, Supply Chain, and Inflation

Inflation and supply chain challenges are affected by factors outside of political risks, but some of the impact is being elevated because of it. Russia is one of the largest exporters of energy and food commodities, with Russia and Ukraine exporting 30% of the world's wheat, a key product in the world's food supply. Wheat futures rose 40% year-to-date and 57.8% over the last 12 months.[1] Russia and Ukraine also produce a third of the world's ammonia and potassium exports, which are essential ingredients in the production of fertilizer. Much of the impact is already being felt in less affluent nations, in addition to the U.S., spurring concerns of a global food crisis. Other key commodities like steel and nickel had seen 30 and 45% increases, respectively, between early 2022 and late April, although prices have come down a bit.

China's zero-COVID policy and the related lockdowns have driven production and port activity to levels not seen since the beginning of the pandemic. Sectors like the automobile industry and electronics manufacturing haven't recovered from the initial phase of the pandemic, and these new challenges are adding to the stress. When you add the impact of other commodities involved in automobile manufacturing such as aluminum, copper, and nickel[2] coming out of Russia and Ukraine, more inflationary pressure builds.

Higher energy costs, especially over an extended period, can also have a negative effect on real

estate. High prices at the gas pump can affect consumer sentiment and spending, potentially hurting an already weakened retail and hospitality market. As the probability of an extended conflict increases and possibly taking us into the winter months, this could mean higher heating costs on top of the growing gas prices.

Globally, the availability of products challenged by traditional distribution has countries focused on reconfiguring their supply chain management strategies, particularly sourcing. Terms like “dual sourcing”, “nearshoring”, and “friend shoring” are being used to describe collaborative efforts to manage the challenges. In the short term, the challenges will likely grow before beginning to recede.

Cyber Risk

Cyberattacks have increased and continue to impact global stability as they target critical infrastructure. The Center for Strategic International Studies reported that on February 24, the date of the Russian invasion, cyberattacks increased significantly including disruptions to Ukrainian military communications, power grids, and telecommunications.[3] These attacks are expected to continue, and resources are focusing on the protection and mitigation. With increasing investments into smart buildings, granular building infrastructure also becomes susceptible to cyber risk.

Consumer Confidence and Real Estate Considerations

All the challenges mentioned above have a direct effect on consumer spending, be it product cost, availability, or even how the products are purchased, online or in person. Higher-priced necessities could limit consumer spending, including retail, travel, and services. Central banks, looking to manage inflation with interest rates, have a narrow lane to land the planes on to avoid a recession, or worse, stagflation. If inflation is exacerbated by geopolitical volatility, something that interest rate policy can’t manage, then the impact of that volatility becomes more significant.

With continued political uncertainty providing significant headwinds, the ultimate impact on commercial real estate will be greater than if the political risk didn’t exist. The longer it takes to moderate, the more the accretive impact can have negative implications for the industry. We pray for bloodshed and the loss of life to end. Then we can hope for market stability and leaving the pandemic and financial effects behind.

Endnotes

[1] Wheat Continuous Contract, *Wall Street Journal*. https://www.wsj.com/market-data/quotes/futures/W00

(Accessed June 6, 2022).

[2] "War in Ukraine: Twelve Disruptions changing the World," McKinsey & Co. (May 9, 2022). https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/war-in-ukraine-twelve-disruptions-changing-the-world.

[3] *Ibid.*