Researchers identify the best indicators to monitor market risk in different commercial real estate sectors

August 12 2024, by Chris Mahony

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The most reliable metrics for identifying real estate price bubbles vary between property type, new research suggests.

Academics from Bayes Business School (part of City St George's, University of London) found that the yield curve is a good predictor for 'price explosiveness' in the retail and industrial property sectors, with inflation also a good indicator for the former. However, rent growth is more effective in predicting a possible bust in the office space market—and also serves as a good indicator for dangerous price exuberance in the industrial property sector.

Meanwhile, inflation also seems to be a good predictor of possible price over-exuberance in the market for office premises, as well as in retail property.

A bubble hunt

Research led by Professor Giovanni Urga, Director of Bayes' Center for Econometric Analysis (CEA), and real estate expert Professor Sotiris Tsolacos, drew on the MSCI real assets database to systematically monitor signals and detect bubble price formation in the UK commercial property sector between December 1986 and April 2022.

The team identified periods of price exuberance in all property sectors—but largely at different times, with the boom between 2003 and 2007 being the only stretch when each sector was exuberantly buoyant.

In the paper, which is published in the *Journal of Financial Stability*, CEA researchers note that such variation is understandable "as offices, retail and industrials respond differently to macroeconomic conditions and they are affected by distinct sector specific trends, such as e-commerce impacting on the retail sector."

Professor Urga said, "Acknowledging the risks to financial stability from adverse price developments in real estate markets, the center's research explicitly focuses on detecting and providing early indications of such developments for use by investors, lenders and regulators.

"The Bayes CEA can provide real-time or monthly data so policymakers can issue warnings, lenders can reconsider their lending criteria and fund managers can take action to mitigate risks to their portfolios."

Professor Tsolacos noted, "In the aftermath of high inflation, our research suggests that the main commercial real estate sectors are most likely not experiencing a price bubble.

"However, monthly price monitoring in the commercial markets is even more important during a time of uncertainty and flux. The research also shows that anyone monitoring the health of commercial real estate markets needs to use the most appropriate indicators for each sector."

They found that while the distribution warehouse sector experienced a post-COVID price bubble, prices gradually adjusted to more sustainable levels.

More information: Peter Cincinelli et al, Price exuberance episodes in private real estate, *Journal of Financial Stability* (2024). DOI: 10.1016/j.jfs.2024.101300

Provided by City University London