# Focusing on the correct type of growth in real estate investing

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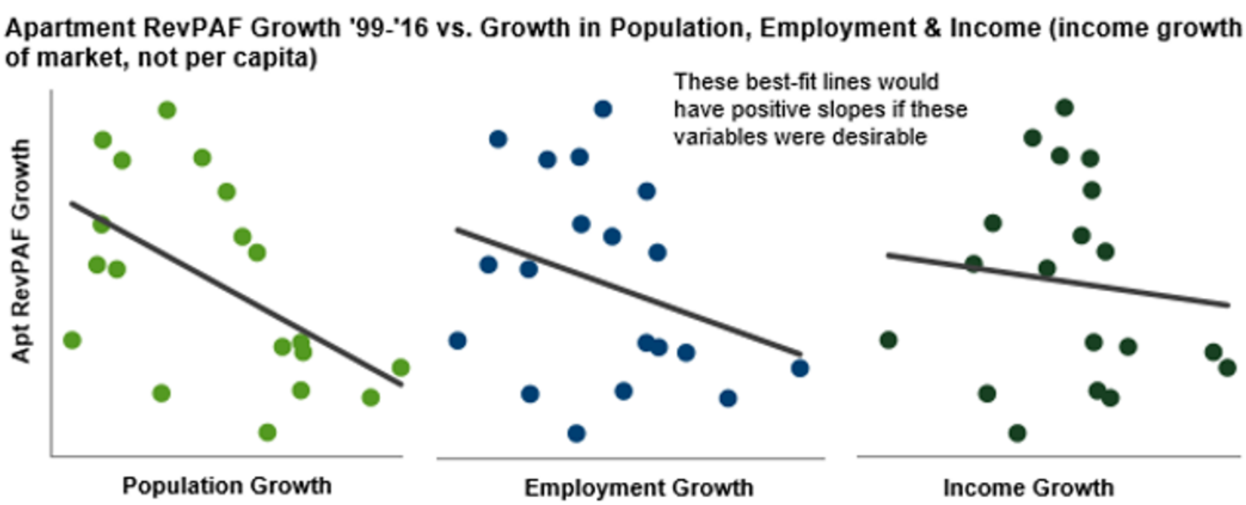
*According to research by real estate experts GreenStreet Advisors (GSA), property investors have historically been assessing demand growth metrics incorrectly. The focus has been on:*
- *Population growth*
- *Employment growth*
- *Income growth*

*However, the emphasis should be on income growth on a* ***per capita*** *basis. Income per capita combined with changes in supply are the key to determining real estate fundamentals.*

Whilst historically touted as important demand drivers, evidence indicates that increases in population, employment and total market income have been negated by increases in supply. This ramp-up in supply has acted as the release valve which has diminished the bargaining power of landlords. Effectively, the three demand drivers – as traditionally viewed – have been nullified by offsetting increases in supply.

The above rationale has been implicitly dismissed by investors for years, despite its clear logic. This principle applies to real estate investing in a general sense.

However, using the German apartment sector as a practical example, GSA illustrates that growth in population, employment and total income have not had a significant statistical relationship with Revenue Per Available Foot (RevPAF) of space. In fact, the downward slopes in the charts below indicate a somewhat negative correlation between these demand drivers and RevPAF, which is entirely contrary to conventional wisdom.

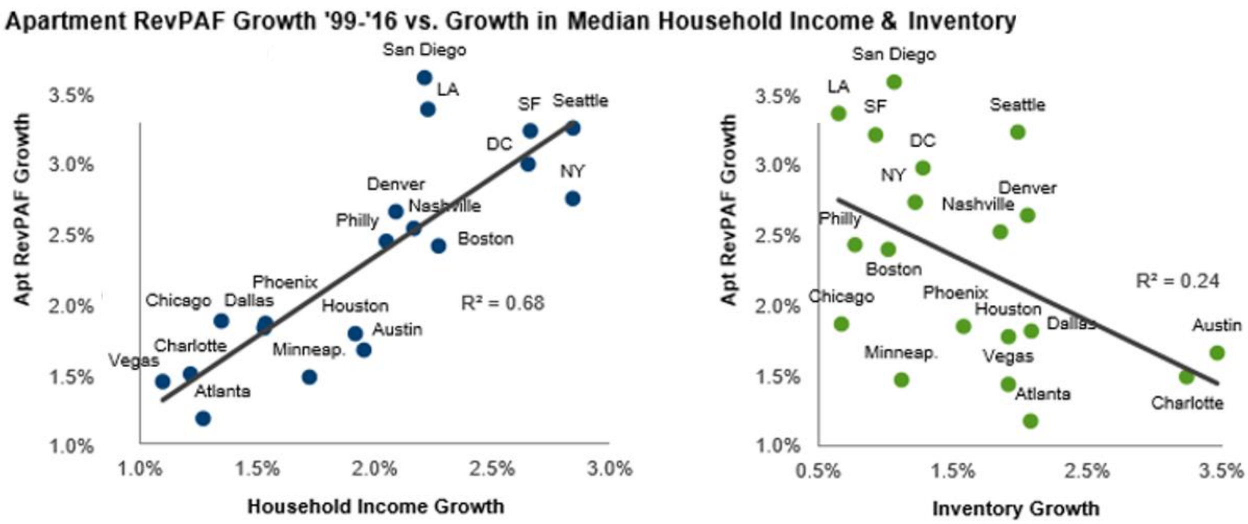



*Source: GreenStreet Advisors*

*The only measure of demand that **has** shown to be correlated to improving fundamentals is median household income growth* (a proxy for consumer purchasing power).

In the chart below (left), there is a positive correlation between household income growth and RevPAF. 68.7% of the variation in RevPAF growth is derived from changes in household income growth. This provides strong evidence that there is a significant statistical relationship between household income growth and RevPAF growth.

There is, of course, a negative correlation (slope) between inventory growth and RevPAF growth. This can also be seen below.




*Source: GreenStreet Advisors*

The data above reveals that – contrary to conventional wisdom – it does not profit to invest in real estate based on demand growth metrics as usually defined. Instead, the investor needs to assess demand growth *per capita*.

Taking the example of the German apartment market further, compared to 2015 levels, according to GSA research the German population is expected to **decrease** by 8% by 2050. This means that as long as total GDP growth continues to grow, there would of course be meaningful increases in per capita income. Combined with persistent under-building (i.e., supply constraints), this continues to make the German apartment market an attractive investment proposition.

A notable caveat to the above – and something that is always relevant – is that the German as well as many other national markets are made up of a multitude of real estate sectors and sub-sectors. As importantly, each of these has their own fundamental dynamics which tend to change over time at different rates. This is essential for the real estate investor to fully accept and use advantageously.

Our current portfolio positioning aims to exploit the favourable fundamentals of the German apartment market, including supply constraints as well as strong demand drivers, which are expected to continue to propel robust cash flow and dividend growth.

**Conclusion**

GDP growth is essentially a function of population and productivity growth. However, regions with declining populations can still offer compelling investible opportunities, as long as per capita incomes are rising. This is particularly true from a real estate investor perspective.

In the world of real estate investing, statistical evidence suggests that focusing on expanding per capita incomes serves to counter the negative impact of supply increases that have tended to negate the would-be positive fundamental impact of growth in population, employment and total market income over time. This approach ultimately leads to superior real estate investment decisions over the long term.

For more information about Reitway Global Property Funds, please visit our website at www.reitwayglobal.com or contact us at 021 551 3688.