Cavendish Maxwell

How Does Geopolitics Affect Real Estate Markets?

OPINION

Geopolitics is on everyone's mind

The days when Francis Fukuyama could plausibly argue that the world had reached 'The End of History' seem a very long time ago now.[1] The cozy consensus that he envisaged, and which for a time seemed an accurate forecast of the 21st Century, has now been replaced by fissures between nations. Territorial and ethnic disputes have escalated into war, as in Ukraine; profound disagreements over state legitimacy and coexistence have spiralled into open conflict as seen most recently in the 'Twelve Day War' between Israel and Iran; and even trade and tariffs have divided nations – witness the disputes between the United States and China. Only the threat of nationalisation can be said to have declined almost uniformly around the globe; the experience of Venezuela in that regard has served as a cautionary tale to Governments everywhere.[2]

How do real estate markets react to crisis?

The short answer is, it depends on how the crisis unfolds and how long it lasts. It also depends on how geopolitical risk is measured. It is easy enough to identify points of dramatic inflection, such as the Russian invasion of Ukraine or the recent Twelve Day War. It is much harder to incorporate such points into a scale that can be used to make comparisons. Those who have attempted to answer the question have, for example, used a daily geopolitical risk (GPR) index. This index involves counting the frequency of articles mentioning adverse geopolitical events in leading newspapers assembled on a global scale, making it suitable for comparison with global asset class indicators.[3] So, for example, there is evidence that globally real estate proved highly resistant to geopolitical risk fluctuations when the war with Russia broke out.[4]

But what investors really want to know, certainly what they always ask, is how real estate markets in neighbouring countries, as well as national, regional and even local real estate markets, react to actual crises. Here there is much less research, possibly because although crises are easy to identify, deciding on their start and finish is a highly subjective decision.

What we know, however, is that prices in the Kyiv real estate market barely flickered as the Russian tanks were stopped at its outskirts, and actually rose by 3% in the year to March 2023[5] at the same time as GDP fell by 29.1%.[6] It may be that, as Caldara and Iacoviello claim, higher geopolitical risk foreshadows lower investment, stock prices, and employment, but it does not necessarily do the same for real estate markets. Indeed, rental prices in Kyiv rose even further, by 15–20% between April and June 2022.[7] This was an even more pronounced lack of impact than seen in the Manhattan market after 9/11, which did experience a short-term decline in both office rents, as hotels were pressed into service as makeshift offices, and residential prices, but had recovered by January 2002.[8]

Subsequently, that part of Ukraine not directly affected by the war has seen further increases in residential real estate prices. In neighbouring Romania, the influx of Ukrainian refugees has seen rental prices rise as the effect of the linear relationship between population increase and residential prices takes effect.[9] Even in far-afield markets such as Australia, real estate prices have risen as a result of a rise in land prices and increased construction costs constraining the profitability of construction and hence supply.[10]

The Twelve Day War is an even starker example: despite simmering tensions the war itself was over almost as soon as it began. Real estate markets in the region simply did not have time to catch up even if there was any sign of them reacting negatively, which there was not. Even real estate investment trusts (REITs) quoted on public markets in surrounding locations such as Saudi Arabia and Dubai did not react negatively: their prices have been remarkably stable over the recent months, even rising in some cases.[11 12] Construction company share prices can also benefit from war contracts, as in Ukraine.[13]

Wars must be prolonged, such as the Syrian Civil War, before the effect on real estate prices takes a grip, as it did in Damascus, where prices fell up to 89% in the city centre during the nadir of market confidence (the effect was somewhat less in peripheral regions).[14] There is no universal rule governing this balance: during the equally prolonged conflict in Colombia, rural areas were much more badly affected than the capital, and real estate values reflected this disparity.[15]

What about transaction volumes?

However, the effect on willingness to trade and hence liquidity is a different matter. Transaction volumes in Kyiv fell 8–12 times in 2022 compared to 2021, with sales of new housing in Kyiv and the region last year amounting to about 5–7% of the 2021 level. These transaction levels have recovered, but not to pre-war levels. The effect of a prolonged war can even be the evaporation of the market altogether. The Lebanese Civil War saw just such a collapse of long-term liquidity even as real estate construction proceeded under the control of different factions.[16]

Under such circumstances of prolonged inability for markets to work as they should, or even at all, patient capital need to be very patient indeed, with the inevitable severe curtailment of returns if calculated on an annual basis. Where it can, capital also escapes to safe havens in neighbouring markets or even further afield, much of it entering overseas real estate markets. A good example of this phenomenon is the capital inflow Dubai experienced during the Iraq War and during many other international crises, even Brexit,[17] as a result of political stability and an investor-friendly environment, good financial returns included.

A longer term perspective

Human geographers, who have had the luxury to reflect upon the issue at more leisure, have focused on the role of real estate in the creation and maintenance of 'soft power' more generally, rather than on the effect of particular events.[18] They argue that although this is not new – think of the role land played in the Silk Road or the colonisation of Africa – it has now become instrumental in the status and influence of nation states worldwide.

What perhaps is less understood is how the pathway runs both ways – nations create power both through the value and trajectory of their domestic real estate markets and their capacity to use Sovereign Wealth Funds to support overseas markets. As a result, cities worldwide actively court foreign investors and Governments. While the geopolitics of conflict may often dominate the headlines, it is this underlying current that arguably has more significance in the long term.

Conclusion: Managing geopolitical risk is a priority

Short-term geopolitical events have a perhaps surprisingly shallow effect on real estate markets. Even at the start of wars, prices do not necessarily fall even though liquidity can drain out of the market very quickly, if temporarily. So long as the market can continue and investors retain hope that normality will return, the evidence is strongly that prices are not likely to collapse. Neighbouring markets, especially those with an already cultivated strong reputation as safe havens, are in fact likely to experience a fillip as capital flows to them.

This relatively benign conclusion does not, however, excuse a failure of vigilance on the part of investors. Threats to security remain. Gaining and maintaining a reservoir of geopolitical knowledge from expert organisations and the consultants they employ, as well as from a wealth of contacts, is always money well spent. Diversification across multiple markets is another highly desirable risk management strategy.

Countries often face economic disruptions during periods of political unrest, as seen during the Arab Spring, which affected key sectors such as tourism and employment. In contrast, the UAE maintained resilience through its political stability and diversified economy, continuing to attract investment and talent. Dubai, in particular, emerged as a leading destination for real estate investment, especially among individuals seeking stability and portfolio diversification. Following the COVID-19 pandemic, the city's luxury property segment witnessed strong growth, driven by high-net-worth individuals. Political stability has played a central role in reinforcing Dubai's reputation as a secure and attractive real estate market.

Ronan Arthur
Director, Head of Residential Valuation

Cavendish Maxwell

Key Contacts

Ronan Arthur
Director, Head of Residential Valuation
ronan.arthur@cavendishmaxwell.com
+971 50 296 1411

Zacky Sajjad
Director, Business Development and Client Relations
zacky.sajjad@cavendishmaxwell.com
+971 50 297 9654

Julian Roche
Chief Economist
Cavendish Maxwell
julian.roche@cavendishmaxwell.com

Ali Siddiqui
Research Manager
ali.siddiqui@cavendishmaxwell.com
+971 50 877 0190

Dubai
+971 4 453 9525
dubai@cavendishmaxwell.com
2205 Marina Plaza, Dubai Marina, P.O. Box 118624, Dubai, UAE

Dubai | **Abu Dhabi** | **Sharjah** | **Ajman** | **Ras Al Khaimah** | **Muscat** | **Kuwait City** | **Riyadh**

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