

Recovery

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RECOVERY POSITION Hugo Llewelyn

Follow the white rabbit – invest in ‘virtual resistant’ real estate

I was recently asked by my chairman at Newcore, Andy Baum, to set a question for some of his postgraduate students in relation to how technology is changing society.

I came up with the following: “You are an investor living in the time of *The Matrix* [the cult 1999 film starring Keanu Reeves]. What real estate would be a good investment?”

In the film, society as we know it today is delivered through an internet mainframe called the Matrix, so that human beings – now for the most part controlled by intelligent computers – live a virtual existence, kept alive on “human farms” to feed the energy needs of those computers, while their brains are being stimulated with a virtual reality akin to 1990s society. Some people rebel against and escape from this virtual world to a harsher reality and strive to bring down this dystopian system.

My own answer to the above question is that the savvy investor would target real estate that was “virtual resistant” – the human farms, defence infrastructure, docking ports, housing for the rebels – and possibly data centres, if you could get them.

The film was a sci-fi fantasy when it was made in 1999. However, only recently, neuroscientist and artificial intelligence programmer Demis Hassabis sold his DeepMind technology business to Google for

£400m. That business, it would seem, takes computers one step closer to thinking for themselves. So, while *The Matrix* is perhaps not yet a near-term reality, the least we can do as property investors is to think about the internet’s deeper social consequences to physical society.

Rise of machines

The growth of the internet is increasingly leading to a distinction between “real estate” and “virtual estate” – the latter being where the internet can partly or wholly do the job that real estate was originally intended to do.

Where services and products can be delivered virtually as well as via bricks and mortar, the rise in supply to the channels of provision can lead only to structural rental value decline for the real estate, except where there are unusual circumstances.

As a result, at Newcore our aim is to invest in “virtual-resistant” real estate. We summarise these sectors as social infrastructure, accommodation and storage – sectors that overlap with each other.

Our view is that these asset sectors are more likely to be delivered physically in the future than through the internet – although even here the internet has an effect. In the case of prisons, for example, there are reports that prisoners may one day be housed in their own homes, using technology that

prevents them from moving or meeting others. Again, tertiary education is available very effectively online.

No sector is completely immune. However, the internet can often be complementary to the improvement of the use of that physical sector (for example, part of one’s home is now often used as an office and a means of purchasing retail goods) and, on balance, is more likely to assist rental growth than dampen it.

These sectors broadly exclude retail and office investments, which we do not target, and recategorise certain other uses, such as parts of the industrial market. There are, of course, excellent strategies in these traditional areas, with strong current rental growth potential. But our view is that, in general, these sectors are most exposed to rental growth erosion from the internet. We also believe that it will be much more

difficult to predict rental growth patterns, given that, as yet, no one really understands the power of the internet itself.

The property investor of the future will not only have to consider all the usual supply and demand issues relating to that asset and sector, but how much the internet is going to affect the services or products that it facilitates. It goes without saying that a reliable broadband connection will soon be almost as critical as basic utilities such as electricity, water and sewerage.

So, in the time of *The Matrix* – and hoping that I choose to rebel – you will find Newcore investing in human farms, defence infrastructure and docking stations. As I think about it, we will naturally need an office from which to work. I am hoping that, as a result, the rent will be reasonable.

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