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AI: The Real Estate Opportunity

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Key Takeaways

- Digital disruption and AI constitute a mega force reshaping both economic trends and investment performance, comparable to the industrial revolution.
- AI is transforming real estate by automating tasks, optimizing operations, and reshaping demand among businesses and consumers.
- Real estate investors use AI-driven changes as a lens to identify sectors poised for growth, as well as those that will become increasingly challenged.

Introduction

Mega forces are big, structural changes that BlackRock has identified as having a major impact on investing now - and far in the future. Digital disruption and AI is one of the most profound, shaping future economic trends and asset performance in this market cycle.

This signifies the beginning of a new intelligence age, on par with the first industrial revolution (steam engine), the second (electricity), or the information revolution (internet).

AI models are advancing rapidly as data, processing power, and algorithms improve, making them increasingly complex and capable of handling more sophisticated tasks.

One way to chart this growth is the sophistication of AI models, which have grown from 10 parameters in the 1950s to 10 million in the following 60 years, then to 10 billion in under a decade. But scaling brings challenges–complexity, computing power, data storage, and energy demands. These all drive the need for substantial capital investment.

The AI evolution is developing in three key phases. Today we are still in AI's build-out phase, whereby the built environment needs to keep pace with the exponential growth of AI models.

Three phases of the AI revolution

Phase 1 Buildout	Phase 2 Adoption	Phase 3 Transformation
The first phase involves a race to develop the necessary AI infrastructure, with tech giants currently investing record levels amounts into data centers, AI models, and the supporting power systems.	As AI infrastructure and applications advance, adoption will accelerate, with companies investing in AI to transform operations and drive growth.	As companies fully realize AI's value in the form of productivity gains and new business models, they will invest heavily in the next step, artificial general intelligence, or AGI.

Source: Blackrock, March 2025

What does this mean for real estate?

AI will have far reaching impacts on how we live, work and play, and therefore how we interact with the built environment. Advances in machine learning and generative AI are accelerating innovation, automating complex tasks, and unlocking new efficiencies and revenue opportunities for companies.

As these new technologies change the business landscape for companies, they're also changing the ways that companies use real estate. If not today, they will impact in the very near future.

No one truly knows how this transformation will reshape society. What we do know however, is that this is not a short-lived phenomenon.

By identifying the property sectors positioned for success and those likely to face challenges in an AI-driven future, we can build conviction on which sectors and markets will outperform.

For example. Real estate investors will play a crucial role in the data-center value chain. At the same time, real estate investors can also benefit from AI's potential to support the energy transition.

AI and sectoral convictions

The rapid expansion of the AI ecosystem and its supporting infrastructure will be a significant driver of real estate demand globally. But strategic asset and location selection will be crucial, as certain property types and markets are better positioned to benefit from AI-driven growth.

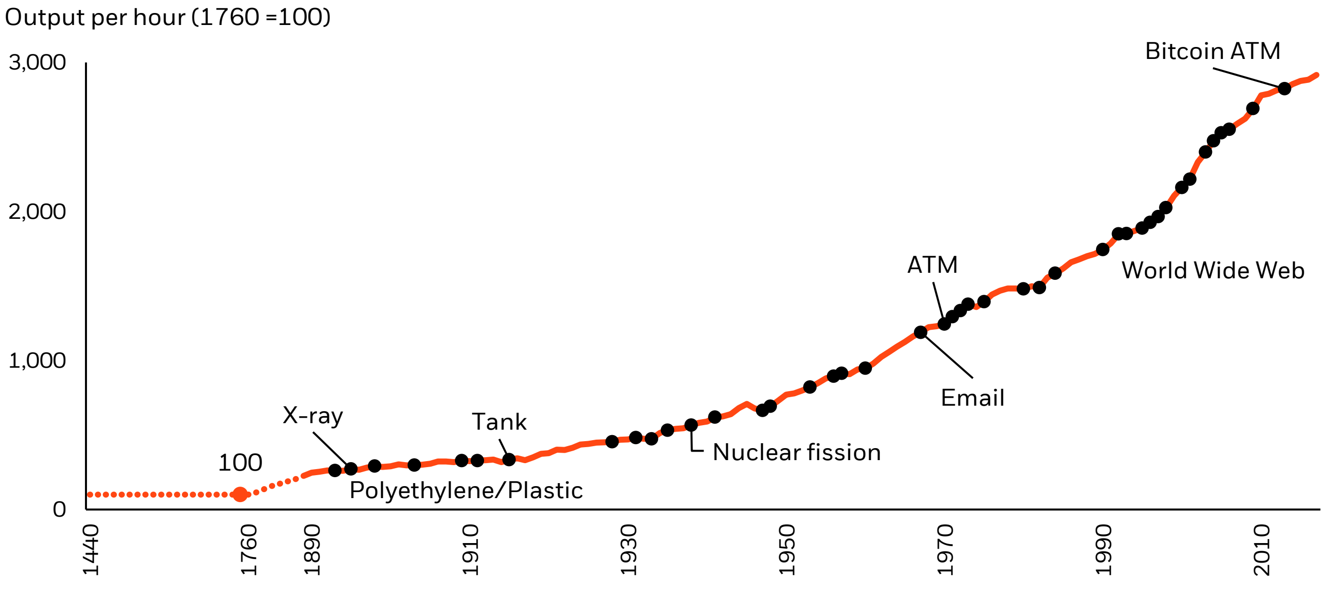
One of the biggest questions is how AI will impact the way that we work. Studies suggest that by 2030, 30% of all hours worked could be automated by AI[1]. This rapid evolution will likely mean occupational transitions will start to play out soon, particularly in the U.S. and Europe.

Throughout history, technological advancements have reshaped industries and changed the constitution of workforces. For example, in the 1950s, the introduction of automated telephone systems rendered the role of switchboard operators obsolete, impacting almost half a million people in the U.S.

But the employment market has always and will always evolve alongside technological advances that improve productivity and create new business opportunities. The important consideration for real estate investors is what this will mean for how people and businesses occupy and use space.

Growth through change

While new technologies have transformed careers, they have vastly increased overall productivity.

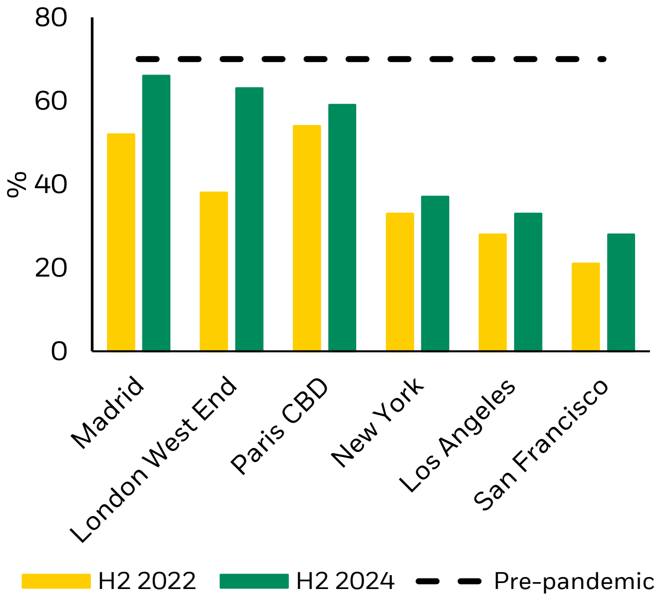


Source: Note: Labour productivity index (1760-100) created using UK and US data. UK data from 1760 to 1889 taken from BoE's 'a millennium of macroeconomic data for the UK'. US historical series from 1890 to 2017 created using Kendrick (1961) and BLS (non-farm business sector; real output per hour) data. US and UK historical series spliced together to arrive at a longer data history starting from 1760 up until 2017. Source: Kendrick (1961), BLS, BOE, Barclays Research, Blackrock, March 2025. The black dots represent the new technological innovations with the major ones labeled.
Note: [1] Mckinsey – Generative AI and the Future of Work in America, 07/26/2023.

Many major economies are grappling with the challenge of aging populations and shrinking workforces, which prima facie constrains long term future growth. AI will likely provide a partial solution, allowing businesses and governments to offset labor shortages, boost productivity, and foster innovation, creating the possibility for sustained economic progress.

The post-pandemic era demonstrated that offices still have a place in society, but selectivity is more important than ever. The pandemic and the subsequent return to office attendance highlights that, while remote work is technically possible, human nature and good wellbeing means that collaboration is often most effective when done face-to-face. As shown below, occupancy rates are increasing in all major markets, demonstrating that although offices may not be utilized in the same way as the were pre pandemic, they still perform a critical role in work and society.

Office occupancy rates by city



Source: Savills Research, BlackRock, March 2025

Offices within mixed-use developments, located in dynamic and vibrant city centers, will likely be the outperformers. By integrating amenities such as hospitality, gyms, green spaces, and easy access to transport, offices can become destinations that blend work, leisure, and social interaction. Over the long term, we believe that there will be a widening polarization in the office market, and widespread AI adoption will accelerate this trend.

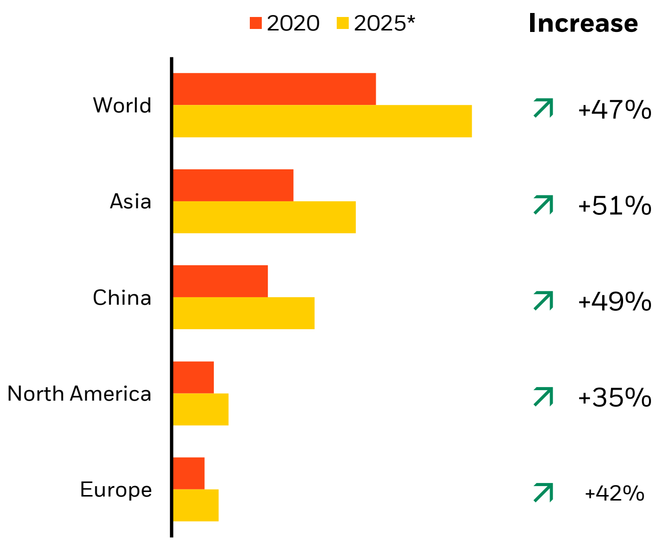
Investor interest in the logistics sector has surged in the past decade. Structural e-commerce driven tailwinds have shifted the demand landscape. Geopolitical uncertainty has provided an additional tailwind as resilience is built into global supply chains. AI creates both opportunities and risks to logistics operators.

AI has the potential to help logistics facilities to optimize space utilization more effectively. Advanced AI-driven analytics will be able to streamline inventory management, maximize storage capacity, and enhance warehouse layouts, this will minimize unused space.

Estimates suggest AI-powered tools can unlock 7-15% additional capacity in warehouse networks today, and this figure is only likely to increase[2]. This may result in an oversupply of logistics spaces. To protect against this potential oversupply, our focus is on logistics spaces in supply-constrained areas, where further development is restricted.

The retail sector has long been challenged by digital competition. AI has the ability to make e-commerce more accessible, reducing demand for physical retail spaces. There are, however, some parts of the retail sector that could be immune to this, such as retail and luxury stores that provide an experience that cannot be achieved virtually. On the other end of the spectrum, discount retailers without the profit margin to manage online platforms may continue to operate solely in physical stores. As with offices, the social benefits of retail focused locations offering an experience will continue be the stronger performers.

Pace of ecommerce growth (US$B)



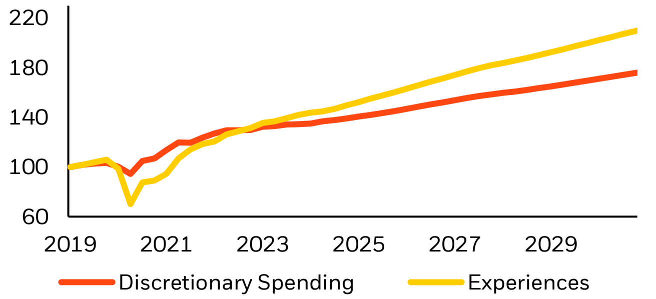
* projected
Source: Statista Digital Market Outlook, BlackRock, March 2025. **There is no guarantee that any forecasts made will come to pass.**

Note: [2] McKinsey and Company, 11/15/2024

There are several use cases for AI that could benefit physical retailers. Through inventory management systems, AI may be able to better predict demand for certain products by analyzing data and automatically replenishing stock to help stores maintain optimal inventory levels. According to McKinsey, AI-powered forecasts in supply-chain management can reduce errors by up to 50%, reducing lost sales and unavailability by up to 75%[3]. This could boost turnover. The tenants with the strongest covenants in the future are likely to be those that use AI to boost efficiency, as they are likely to be the most resilient.

Experience-driven businesses also stand to benefit. AI has the capacity to free up people's time, whether by automating their weekly grocery orders or shortening their working days through increased efficiency. This may create more time for socializing, travelling, and pursuing hobbies. This dovetails with a generational shift towards valuing experiences over material goods.

U.S. consumer spending index (Q1 2019 = 100)



Source: Spending taken in US$, Oxford Economics, BlackRock, March 2025. There is no guarantee that any forecasts made will come to pass.

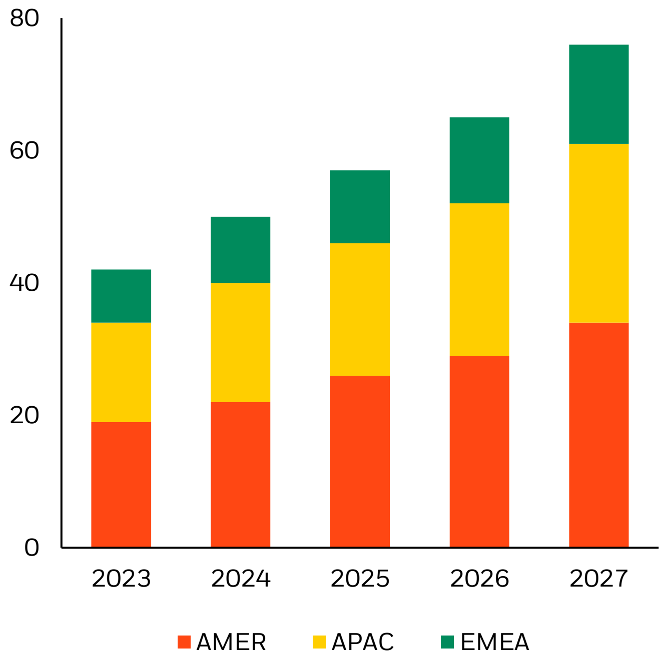
For this reason, we have a high conviction for the hospitality and hotel sectors. The leisure sector is similarly set to benefit, as businesses that can cater to health, wellness, and passion-driven experiences will thrive as people have more time to prioritize their personal lives.

The hotel sector has already benefited directly from the integration of AI, by using AI to optimize pricing strategies using competitor pricing and historical booking trends to adjust room rates in real time. AI-driven systems can also collect data from guest preferences, booking history, and interactions, allowing hotels to offer tailored services, increasing efficiency and increasing revenues.

Data centers

Real estate investors will play a crucial role in the evolution of the AI value chain. The scale-up of AI is fueling enormous demand for data centers. AI is valued as a roughly US$4 trillion global opportunity[4]. Data center demand is a representation of the physical infrastructure needed to achieve that.

Projected data center capacity (GW)



Source: JLL Research, 2024, Structure Research, Note: Capacity includes hyperscale and colocation, BlackRock, March 2025. There is no guarantee that any forecasts made will come to pass.

Data centers share similar fundamentals with traditional real estate, such as logistics, however they are more complex than simply a 'shed with power'. Both rely on site selection, land availability, connectivity, and infrastructure, but data centers do not have docks, have increased site coverage and can have different physical characteristics. The availability of power, however, is vital, along with proximity to urban hubs and transport routes. Investment timelines are also similar, with typical hold periods of around four years.

The acute supply-demand imbalance in the data center market is evident, as existing infrastructure struggles to meet the soaring demands of AI applications. For instance, in North Carolina, which is the location of the world's largest data center, The availability of power for lease dropped from 47MW to 38 MW between 2022 and 2023[5].

Note: [3] McKinsey and Company, 02/15 /2022, [4] McKinsey and Company, 01/28 /2025, [5] McKinsey – The Economic Potential of Generative AI, 06/14/2023.

Supply constraints are driving rental rates higher. In Silicon Valley, where the vacancy rate has hit a record low of 2.9%, top monthly rates per kW have surged to US$233, a 43% increase from 2022 levels[6].

As with any growing sector, real estate investors should consider risks related to data centers, especially regarding exit strategies and liquidity. Strong expertise and robust relationships with key stakeholders and operators are essential to ensure a favorable risk-return profile.

At many points in the data-center supply chain, investment into data centers follows a duration and level of risk appetite that can align with the risk return profile of value-add real estate investment.

It's a common misconception, though, that access to data centers can only be achieved through infrastructure investment.

Real estate investment opportunities in data centers fall into three categories: Land Banking, Development, and Operations. These options are explained below.

1. Land Banking

Real estate equity at this stage involves speculative, strategic acquisitions of land suitable for data-center development. There are two primary routes for achieving this.

The higher-risk option is a balance sheet acquisition, investors purchase land directly, without certainty that a data center can be developed. This carries significant upfront risk but forecasts suggest this can generate IRRs above 100% upon successful entitlement.

The alternative is optioned land promotion, which involves acquiring land through options. This reduces capital exposure and entitlement risk, leading to lower but still attractive returns.

2. Development

At this stage, real estate equity transitions to structured development risk, typically through powered shell or fully fitted data center delivery.

Powered shell developments provide tenants with essential power, but minimal internal fit out. Fully fitted developments, on the other hand, deliver operational, fully equipped data centers, and requires higher upfront capital.

3. Operations

In the operational phase, data center investment for real estate equity involves stable income generation.

This is more appropriate for a core or core-plus real estate risk appetite, with predictable income streams backed by long term contracts with hyperscale tenants.

Each stage represents a different part of the data-center value chain, presenting varying risk-return profiles from opportunistic to core. Real estate investment can serve as a conduit for investors to access data centers and capitalize on the AI-driven shift, offering opportunities across different risk-return profiles.

They do, however, come with operational risks that differ substantially from those observed in traditional real estate, namely the challenges associated with limited historical data availability and risk of obsolescence due to changing space requirements.

Conclusion

The integration of AI into real estate is set to redefine the industry, creating both opportunities and challenges for investors and occupiers alike. As AI continues to shape economic trends, real estate markets must adapt by identifying resilient sectors and embracing data-driven decision-making. By strategically aligning with AI's growth while addressing sustainable opportunities, investors can position themselves for long-term success in an increasingly digitized world. Those who proactively leverage AI-driven insights and innovations will be best equipped to navigate the evolving landscape and capitalize on emerging trends.

Note: [6] Brightlo, 04/08/2024

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