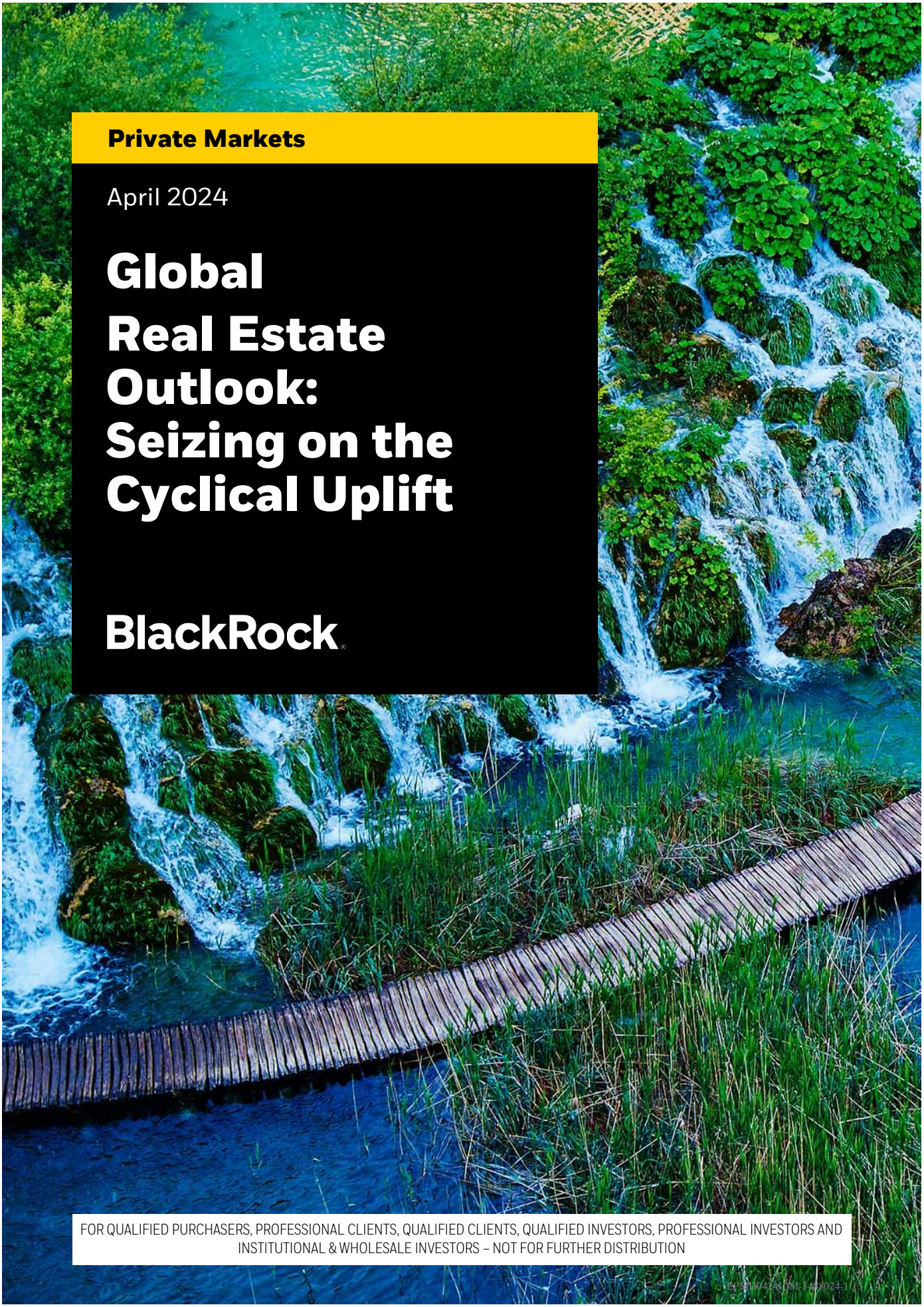

Private Markets

April 2024

Global Real Estate Outlook: Seizing on the Cyclical Uplift

BlackRock®

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Global Real Estate Viewpoint

BlackRock Real Estate Research & Strategy

April 2024

Key highlights

- The global real estate market appears to be emerging from the downturn in capital values; stabilization in interest rates is driving this shift.
- As a result, we believe meaningful recovery in transaction volume will occur in 2024 after a muted 2023.
- There are nascent signs of life for improving investment activity with institutional investors hopping back into bidding tents and lenders coming back to the market.
- We believe demand drivers will likely be resilient over the next few quarters, supporting real estate fundamentals; however, there are concerns over supply.
- The rewiring of supply chains will likely lead to more investment in industrial real estate. This trend will likely take years to play out and real estate investors need to make sure properties are future proofed for the supply chains of tomorrow.

Finding a bottom

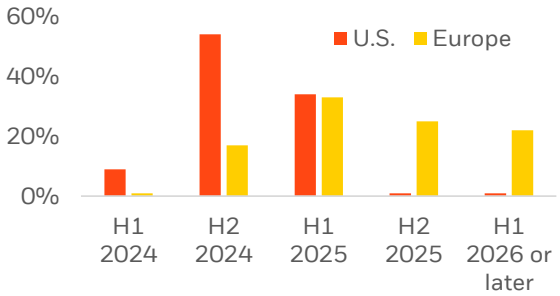
The global real estate market appears to be emerging from the most recent downturn in capital values. Interest rate stabilization is providing some clarity to pricing and driving more buyers to the table.

The most recent downturn was largely driven by rising and volatile interest rates. Transaction volumes were muted globally in 2023 as institutional investors reallocated to stocks and bonds, and others had difficulty pricing with the volatile rate environment. Overall volumes were down 48% year-over-year in 2023 (source: MSCI). We believe transaction volumes will likely recover meaningfully especially in the second half of 2024, aiding price discovery for many market participants.

We have started to observe nascent signs of life for improving investment activity, and lenders have also started to come back to the market to take advantage of high-quality collateral at attractive all-in yields. The market is currently in a transitory period where institutional investors are starting to move from the sidelines and bringing more price discovery to the market. While the market is gaining clarity on the direction of rates, investors should be cautious as the future investment landscape will likely be more volatile than what was experienced in the post-GFC era.

We believe there were several signs in the first quarter of 2024 that the market is near a bottom.

Expectations of when investment activity will pick up



Source: CBRE and BlackRock, from the 2024 U.S. Investor Intentions Survey and 2024 European Investor Intentions Survey as of February 2024.

Anecdotally, some investors have started to edge back into the market during the early months of 2024 based on participation in bidding tents. Dry powder on the sidelines (JLL estimates at USD $402 billion globally as of YE 2023), the need for some sponsors to realize sales for liquidity needs, and increased refinancing challenges will likely trigger more activity over the next 12 months. Investors have the advantage of acquiring properties at material discounts to replacement costs and potentially take advantage of increased distress and forced sellers in the market.

Investors today can benefit from entering the cyclical trough and capitalizing on dislocated pricing while aligning with key structural trends to drive future returns. Dispersion will likely continue to be high, thus providing more alpha creation potential.

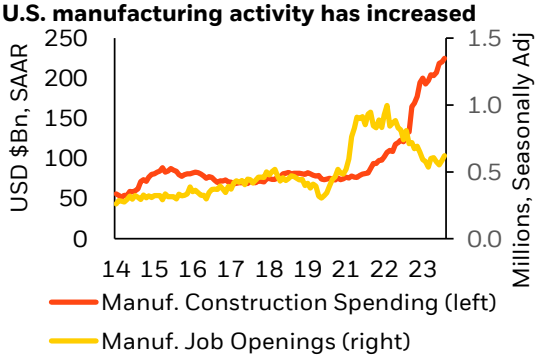
Geopolitical fragmentation

A whole new world of reshoring and near-shoring

Geopolitical fragmentation is a key mega force that will shape the future world in the new investment regime of higher macro and market volatility, and the BlackRock Investment Institute has highlighted it as a is a key investment theme for all asset classes. A cascading of recent events, including the U.S. trade wars, the pandemic, and the Ukraine invasion, have built on each other and exacerbated volatility. The result is more persistent uncertainty and thus, volatility.

Companies globally have been adjusting to this new world by rewiring their supply chains to build greater resilience in the face of disruptive events. Localizing supply chains can shield against supply risks and help businesses adjust quickly to changes in demand and supply. The U.S. has seen an uptick in investment in manufacturing, consistent with higher-than-average job openings in manufacturing and good wage growth. In Europe, nearly two thirds of countries say they plan to restructure their supply chain in the next five years, with the most noted concern being ongoing political instability (source: Inverto).

U.S. manufacturing activity has increased



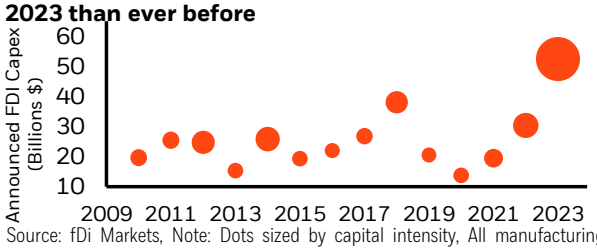
Source: U.S. Census Bureau and Bureau of Labor Statistics, as of January 2024.

Though the concept of nearshoring has been considered by investors for a long time, we are now seeing the impact of changing corporate preferences materialize in terms of tenant demand. For example, in the UK, manufacturing related deals in the industrial market accounted for 29% of the market in 2023 (source: Savills) with supply chain resilience cited as a driver for space.

Asia Pacific has similarly not been immune to supply chain disruption. In 2023, the number of companies in the region shifting their manufacturers/suppliers to home markets doubled (source: The Economist, Trade in Transition). Furthermore, the introduction of the Regional Comprehensive Economic partnership, an APAC centered trade deal, could cause companies to realign their supply chains to benefit from the advantages offered by the agreement, such as lowered input costs.

The rewiring of supply chains will likely create more investment opportunities for real estate investors. For tenants, having the right industrial/logistics assets is key for an optimized and more localized supply chain.

More foreign capital was pledged to manufacturing projects in European nearshoring destinations in 2023 than ever before



Source: fDi Markets, Note: Dots sized by capital intensity, All manufacturing FDI excluding energy industries. Countries included have at least 25% of FDI in manufacturing since 2010

Ancillary real estate close to manufacturing plants, data centers or distribution warehouses such as attainable housing and necessity-based retail will be important for the workforce ecosystem.

Disruption in trade flows will likely pave the way for opportunities in markets that were not historically viewed as institutionally investible. Industrial real estate investors generally look for assets located close to ports, airports, highways, rail hubs or manufacturing plants. The location ideally would be centralized for regional distribution. Reshoring and near-shoring of manufacturing activity will likely focus on lower cost areas. In the United States, the Sunbelt will likely continue to attract more manufacturing activity, and the focus has been on the high value computer and electronics category. As near-shoring comes more into play, Mexico and Canada will likely be beneficiaries of a shift in manufacturing locations to serve the U.S. market. This may point to a rejiggering of logistics networks to serve major markets in the United States.

The rewiring of supply chains is anticipated to be a prolonged trend, unfolding over several years. While the industrial property type has grown immensely thanks to e-commerce, we believe it can continue to expand due to this key driver in place. At the same time, real estate investors likely need to ensure investments are future proofed for the supply chains of tomorrow, with tall clear heights, sufficient bay depth and width, truck court and parking availability, and critically with sufficient power.

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Regional outlook

United States: Seize the moment

Investors can capitalize on dislocation to gain access to properties at discounted pricing. Real estate fundamentals are forecast to be reasonably stable, but values came down during the past year due to higher cost of capital. The values appear to be stabilizing at the current level, due in part to shift in interest rates; the 10-year Treasury yield has come down from the recent peak reached in the Fall 2023; the 10-year Treasury was 4.2% in early April, 80 bps lower than the recent peak reached on October 19, 2023, of 5.0%.

Forecasting interest rates is always challenging, but there are reasons to believe the hiking cycle is over for now. Inflation decelerated substantially over the past year and a half, from a peak of 8.9% year-over-year in June 2022 to 3.2% in February 2024 (source: U.S. Bureau of Labor Statistics). Nevertheless, the Federal Reserve is monitoring the economy cautiously, and would like to see evidence of persistence in the current direction of inflation. The BlackRock Investment Institute expects the Fed to start cutting rates around mid-2024 for a total of three cuts during the year.

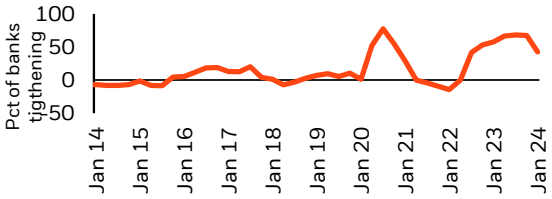
This stability in the economy has been evident in the property market. **Real estate fundamentals remain solid** with NOI growth at 5.5% year-over-year as of December 31, 2023 (source: NCREIF). NOI growth was 12.8% for industrial and 4.5% for multifamily over the past year as of December 31, 2023, and both are forecast to have positive income growth going forward, albeit at a slower rate. Supply is a risk for both sectors in the near term but mitigated by continued demand and an expected drop off in deliveries after this year.

Transaction volume is expected to increase as clarity comes to the capital market. Higher rates have contributed to repricing and the rate volatility has reduced the amount of capital available for investment. Both equity and debt participants pulled back from the market late in 2023. As it takes upwards of 90-days to close a deal, this information is just starting to show up in the data. Only $27bn closed in January 2024, 53% below the monthly average since the pandemic began (source: Real Capital Analytics). Activity on the ground has improved markedly since then, suggesting that closed volumes will likely improve over the next few months.

There is data showing green shoots in the capital market since beginning of the year. According to the latest Senior Officer Loan Survey in Q4 2023 (source: Federal Reserve), there was a significant reduction in net percent of bank tightening commercial real estate lending standards. This suggests that lending activity will improve over the next few quarters, although with bias towards higher-quality properties. 2024 will likely be a transitional year when we anticipate institutional investors to return in a bigger way.

Senior Officer Loan Survey

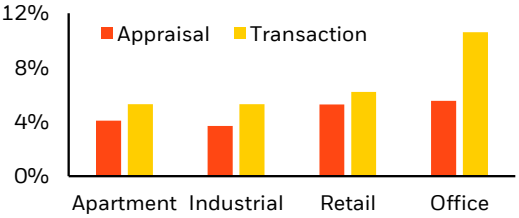
Net Percentage of Domestic Banks Tightening Standards for Commercial Real Estate Loans Secured by Nonfarm Nonresidential Structures



Source: Federal Reserve, as of February 5, 2024

Good quality assets with solid cash flows are still sought after, but prices have adjusted by 15-20% or more relative to peak values based on cap rate movements. In many instances, properties can be acquired at below replacement cost. Appraisal values will likely continue to decline further, but the transactions market is likely already reflecting adjusted pricing, benefitting investors with dry powder.

Gap between appraisal and transaction cap rates



Source: BlackRock and NCREIF, as of December 31, 2023. Appraisal cap rates from the NCREIF Property Index (NPI)

Dislocation today presents a compelling opportunity for investors over the next 24 months. Maturing debt over the next few years and the need to refinance construction loans for completing projects may act as catalysts for further price discovery.

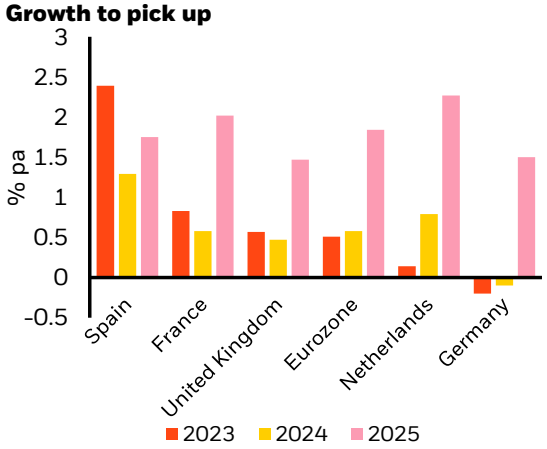
Note: The figures shown relate to past performance. **Past performance is not a reliable indicator of current or future results.** Index returns are for illustrative purposes only. Index performance returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. All dollar ($) amounts refer to USD.

Europe: Pronounced sentiment shift, inflection imminent

Timing the bottom of the cycle is impossible, however, indicators are starting to point to us being there, or thereabouts. Sentiment has shifted markedly, as inflationary pressures have subsided, and a loosening of monetary policy seems probable over the course of the year.

The European **economy has proven more resilient** than once expected. Fortunately, the economy did not sink into a deep recession, instead growth remained subdued. 2024 is likely to be characterized by muted growth, and dispersed recovery. Given the procyclical nature of real estate, we see the vintage advantage that can be obtained at this point in the cycle. There is also a diversification benefit to be had by the dispersion in recovery, as investors can tilt their strategy towards countries and cities with heightened levels of stability. Such economic resilience has meant that the occupier market has held up relatively well compared to other cyclical downturns.

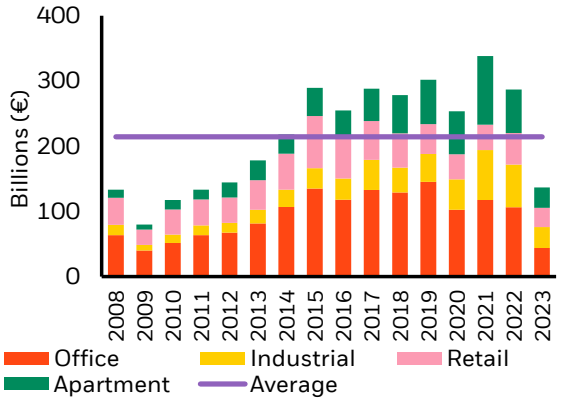
Growth to pick up



Source: OEF, 27 Feb 2024. Forecasts may not come to pass.

With significant value correction behind us, the question is the degree to which sentiment will improve and the time horizon for such improvement. To date, values have declined by 25% in the UK and 15% in Europe (source: MSCI). We believe that significant market correction is behind us, and today we are starting to see signs of stabilization. As the economy weakens, inflation declines and interest rates fall, the relative attractiveness of good quality real estate will improve. Greater focus should be on quality of income as we see measures of insolvency rising, increasing tenant risk.

Slowdown in capital market activity



Source: RCA 2023 Transaction Volumes, 19 Mar 2024.

Given the procyclical nature of real estate, we see now as the opportune time to enter the market to benefit from better entry prices. A differentiating factor in this cycle is the that rates will not return to the historically low levels investors had become accustomed to, in turn we see alignment with the long-term mega forces as key to ensure outsized returns. Despite subdued capital market activity last year, Q4 2023 total transaction volumes far exceeded other quarters in the year demonstrates that confidence may be starting to return the market (source: RCA).

Broadly speaking sectoral convictions remain consistent but importantly the **new cyclical opportunity will be characterized by a wider distribution of performance** within sectors. The most successful strategies will maintain granularity throughout the decision making and asset management process, to not only consider country wide idiosyncrasies but also city level opportunities.

Overall, we favor the logistics and living sectors. Both sectors benefit from a structural undersupply, alongside meaningful alignment with the megatrends namely digitalization and demographics. However, this is not to say accretive opportunities do not exist in both offices and retail. Despite being sidelined by investors in recent years, primarily owing to structural divestment, significant correction will enable to investors to capture best-in-class stock at an attractive price. We continue to recognize that the way society interacts with the built environment has changed. Sectors that are typically bucketed as 'alternative' are no longer alternative, growing in popularity exponentially with investors. Student housing, retirement living, cold storage and life sciences provide an increasingly attractive opportunity set.

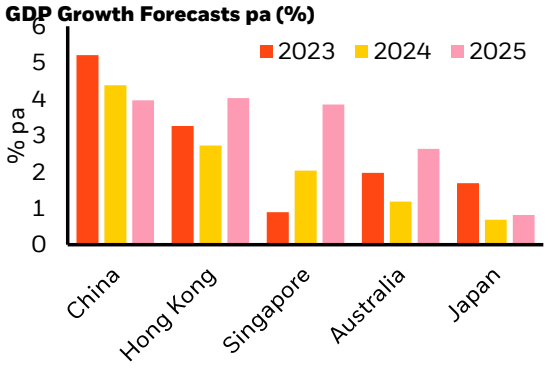
Asia Pacific: Differentiated markets driving diverse opportunity

APAC on average is well positioned for growth, but the trajectories of each market will likely vary substantially across the region. However, target countries, such as Australia, Hong Kong and Singapore, look set to benefit from easing macro-economic headwinds, but recovery is dispersed. As inflation has slowed, the downward interest rate cycle in the region is expected to commence. At the time of writing, Australian interest rates are at a 12-year high of 4.35%, however the market is pricing in near-term cuts. A similar dynamic has been in observed in both Hong Kong and Singapore, as they closely mirror the policy setting of the Fed.

Japan has been the exception to this. The BOJ's move to raise rates into positive territory for the first time since 2007, and ending its yield curve control, is a historical turning point in the country's battle with deflation. Despite monetary policy remaining accommodative, this has signaled an 'economic revival', whereby wage growth may have the potential to further stimulate growth, however a focus on domestic Japanese monetary policy underestimated the currency implication of such a move.

Recovery has remained challenging in China, as deflationary pressures persist, and the property sector remains distressed. As such, fiscal stimulus is becoming increasingly expansive, but 2024 is still anticipated to be a year of more muted growth than the central government would have hoped.

Varied recovery across the region



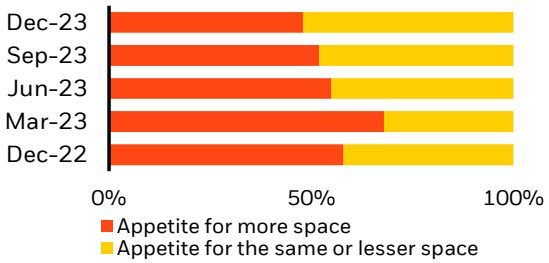
Source: OEF, 27 March2024. Forecasts may not come to pass.

Idiosyncrasy of risk remains attractive. Diverging monetary environment, and drivers of growth is expected to continue attracting investors who seek to tap into the diversification benefits associated with investing in the region.

The region was not immune to the challenges faced by the global real estate market last year, causing a sharp drop in liquidity. As we see a global shift to more accommodative monetary policy, sentiment will likely improve and deal activity increase, driving greater price transparency and capital market activity. We are entering new phase in the cycle.

The correction in real estate values has been less pronounced in APAC. To date in Australia values have declined c. 6% versus the 15% devaluation observed in Europe. However, pockets of opportunity have emerged whereby investors can benefit from attractive entry pricing and potentially distressed selling due to breached covenants.

Logistics leasing sentiment in APAC



Source: CBRE Asia Pacific Leasing Sentiment Index, Dec 2023.

Logistics is set to remain resilient. Despite macroeconomic challenges and geopolitical tensions, solid market growth drivers persist, with strong demand fueled by 3PLs leasing and increasing manufacturing demand in Southeast Asia. As shown, occupier demand has remained resilient, we expect the slowdown in construction and subsequent undersupply in key markets to drive rental growth in the medium term.

The retail sector remains depressed. Despite the recovery in tourism which positively impacted footfall, demand, and sentiment, high inflation and the fading of pent-up demand have started to negatively impact some markets in the region.

In the office sector, investors must continue to focus their attention on best-in-class stock with strong occupier demand. Brown-to-green retrofits are becoming increasingly important as regulation grows in breadth and depth.

Performance in the residential sector remains varied. Low vacancy in housing stock in Australia, alongside a strong demographic dynamic continues to drive rents. In Japan, multifamily remains favored due to the sector's steady cash flows. We anticipate that this sector will outperform all property given continued demographic tailwinds alongside structural undersupply.

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