Global Market Insights

July 2024

Anticipating recovery: Navigating regional complexities across markets

Despite some modest improvement in the first quarter of the year, the Global Real Estate Fund Index recorded its seventh consecutive quarter of negative returns. GREFI closed Q1 2024 with a return of -1.29% in local currency terms, an improvement of 195 bps over Q4 2023. The European and US markets showed gradual recovery during the quarter. European returns improved by 191 bps to 0.00%, making it the best performer among the three weak regions with a one-year annualised return of -3.24%. The US markets had the most significant improvement, with returns increasing by 288 bps; however, it remains the weakest region with Q1 returns of -2.14% and a one-year annualised return of -11.40%. Conversely, the Asia Pacific region's returns worsened by 82 bps to -1.71%, making it the only region not to show improvement in the first quarter. Asia Pacific's one-year annualised return stood at -5.83%, placing it in the middle of the performance spectrum.

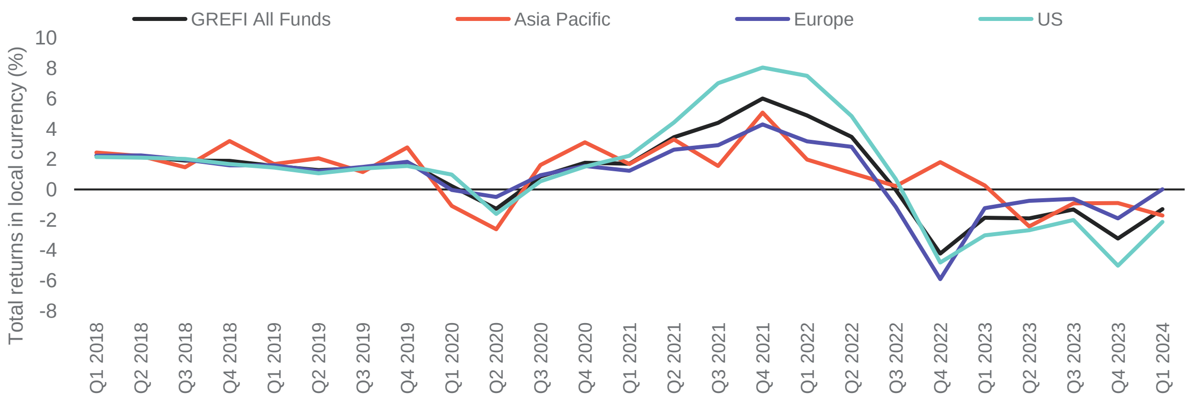
As investors seek clarity in the markets, one pressing question is what the long-awaited recovery will look like. Interest rates are moving differently across the regions, adding a layer of complexity for investors. Europe was the first region to begin cutting rates in an effort to promote growth.

In contrast, the US Federal Reserve has maintained high interest rates, leading to increased borrowing costs and heightened volatility in hedging costs. The Asia Pacific region presents a unique challenge with its diverse range of monetary policy approaches, resulting in varying interest rate environments across countries and contributing to greater uncertainty for investors.

Separately, differing asset valuation methodologies across regions play a critical role in price discovery in real estate markets. The UK tends to reset asset values more quickly than Europe, where a more conservative approach to asset valuation is generally employed. In the US, valuation techniques are relatively aggressive, and can lead to more rapid but also more volatile adjustments in asset pricing. The Asia Pacific region, characterized by a mix of valuation methodologies influenced by diverse economic conditions, is experiencing a slower revaluation process compared to Europe and the US.

A key concern for international investors is also the changing cost of currency hedging. Hedging costs in Europe are relatively stable compared to the US and Asia Pacific. Although strategies in Europe vary across countries and asset classes, expected ECB rate reductions could lower costs for European investors. In contrast, high US interest rates led to increased hedging costs in 2023 and 2024, and volatility remains high despite potential decreases projected later in the year. In Asia Pacific, hedging costs are more volatile still due to diverse economic conditions and varying interest rate policies.

Figure 1: GREFI total returns by region



Source: Global Real Estate Fund Index Q1 2024

ANREV, INREV & NCREIF Fund Manager Survey suggests need for nuance

The ANREV/INREV/NCREIF Fund Manager Survey 2024 highlights the complexities investors face in navigating the global real estate market's recovery. Real estate AUM reached USD 4.1 trillion at the end of 2023, a 2.5% decline from the previous year, marking the second consecutive year of contraction since the peak of USD 4.7 trillion in 2021. The survey attributes this decrease to a smaller sample of responding managers, falling asset values, and reduced capital-raising activity during 2023.

Despite the overall decline, the top 10 managers saw their total AUM grow to exceed USD 2 trillion, now representing 51% of the total AUM. This concentration underscores the resilience and ability of the largest managers to attract capital even in uncertain times.

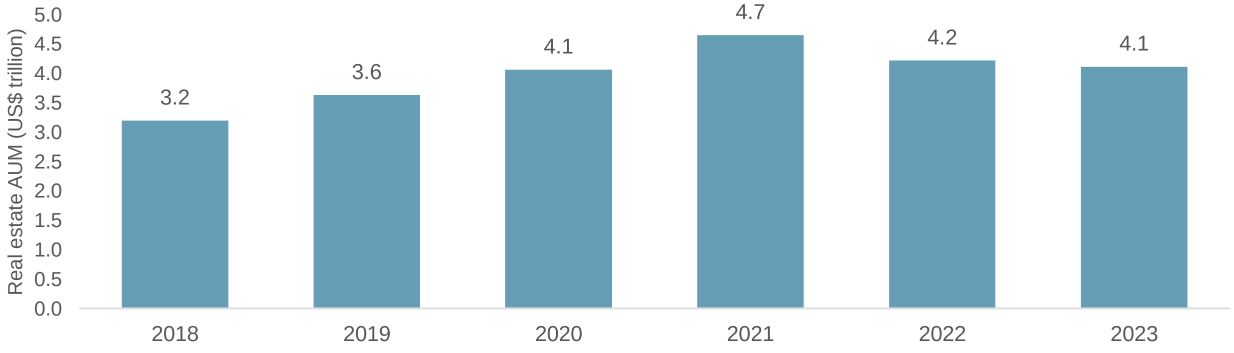
The shifting dynamics amongst the largest managers reflect the ongoing need for investors to adapt to changing market conditions.

Among non-listed real estate funds, real estate equity remains the largest portion of global AUM, constituting 82% of the total, with debt vehicles gaining momentum amid rising global interest rates. Debt AUM increased across all regions, reflecting strong investor interest and the necessity for adaptable investment approaches.

This survey underscores the importance of an investment approach that takes into account the diversity of economic conditions and pace of recovery across regions. Such a nuanced approach is important for institutional investors navigating the global real estate market as it struggles to recover.

For more on the results of the 2024 Fund Manager Survey, please refer to the ANREV/INREV/NCREIF Fund Manager survey report.

Figure 2: Total real estate assets under management



Source: ANREV/INREV/NCREIF Fund Manager Survey 2024

Global Research Committee's Review

With an increasing number of central banks globally lowering policy rates, many observers are positing a market recovery in the short term. A common supporting argument is that, in addition to benefitting from a more constructive capital market environment, real estate has also generally posted robust fundamentals.

'Beds & sheds,' generating solid income growth in most global markets, are attracting investor interest again, as are student housing and data centres due to their long-term structural tailwinds. Offices, however, are on investors' watch list in the Americas and Europe. Finally, retail may be turning the corner after a long period of sub-par performance.

Market dynamics are heterogeneous by geographies as well. Led by the UK and Sweden, European markets saw a deeper and faster correction, with the US not far behind. The correction in most APAC markets has been comparatively modest, if it happened at all, in part due to more benign interest rate policies and valuation practices.

Core and Non-Core strategies also faced the downturn with differing fortunes. Since 2022, Core real estate strategies have had to compete with fixed income and private credit. However, with rebased valuations and lower interest rates, discounted core opportunities are now 'in-the-money' again and seem poised for a recovery. Non-core strategies have not had the same degree of slowdown in attracting capital, and the recovery may be less noticeable.

If the downturn in 2022-23 seemed globally synchronized, the recovery will result in a wide spread of winners and losers by asset type, location, and risk style.