Global Market Insights

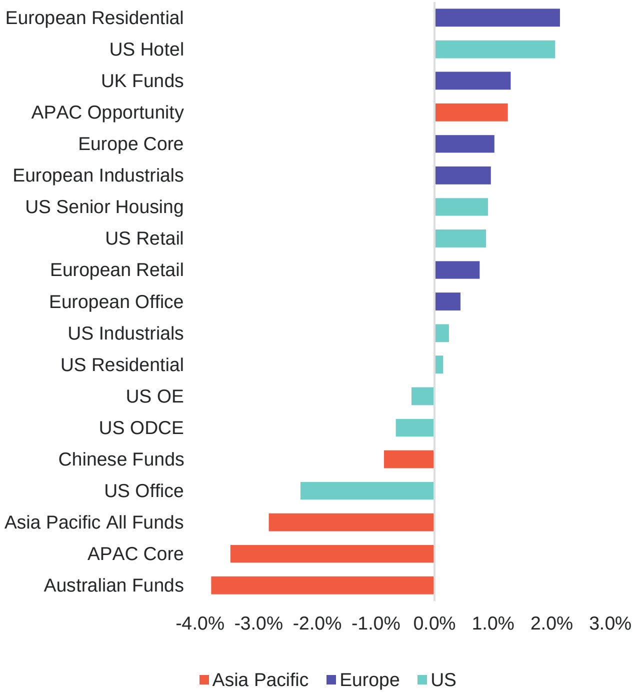
October 2024

Is it time to be more optimistic about real estate allocations?

In light of recent interest rate cuts by the Federal Reserve, followed by other major central banks, real estate is becoming more attractive for investor portfolios. But is now the time to adopt a more optimistic stance?

Some indicators point toward positive momentum. After eight straight quarters of negative returns, the Global Real Estate Fund Index (GREFI) improved by 92 basis points in Q2 2024, though remaining slightly negative at -0.32%. European funds lead with a 0.97% return for the second consecutive positive quarter, while the US and APAC remain in negative territory. Notably, NCREIF ODCE funds in the US have returned to positive performance as of Q3 2024.

Figure 1: Global return drivers Q2 2024



Source: Global Real Estate Fund Index Q2 2024

Globally, return drivers in Q2 2024 contrast sharply with those of a year ago. Markets that experienced swift repricing are now performing best, with industrial, residential, and hotel sectors showing strong returns. Retail is gaining momentum in Europe and the US, while Asia Pacific, slower to reprice, shows sluggish returns except for opportunistic funds.

In the US, capital flows show encouraging signs. Investors are initiating fewer redemption requests, secondary market discounts are improving, and large funds are seeing capital inflows again, reflecting rising confidence. By late next year, redemption queues may transform into capital inflows.

Europe also shows signs of recovery, with the Q2 2024 INREV European Fund Index reporting its first positive capital growth since Q2 2022. Increased transaction volumes and slower value declines signal further improvement.

In Asia Pacific, however, market repricing remains a challenge, especially in Australia. Australian core open-end funds have been in decline since October 2022, with significant value adjustments only occurring in early 2024. This has slowed transaction activity as investors delay recognizing losses.

Despite the improvements noted above, caution is still warranted. The office sector continues to see declining allocations, as investors prioritize asset quality and location. Niche sectors are gaining from this shift, with diversification strategies proving more attractive.

Still, specialization carries its own risks. Some investors are shifting towards value-add and opportunistic strategies, sensing potential distress and the opportunity for outsized returns. Core funds face challenges, with sector-specific funds, such as industrial-focused ones, gaining preference over diversified funds – particularly those with office exposure.

Launch of the Global ODCE TGER study

The Global ODCE Management Fees Publication marks the first global comparison of the Total Global Expense Ratio (TGER), produced by the Global Alliance – a collaborative effort between ANREV, INREV, and NCREIF to enhance transparency and standardisation in the global real estate market.

The study includes TGER data for 46 of the 49 funds in the Global ODCE Index, representing a total gross asset value (GAV) of USD 359 billion, or 98% of the index's GAV as of the end of 2023.

Little dispersion in TGERs amongst ODCE funds at a regional level

ODCE funds show narrow TGER ranges with respective interquartile ranges within their regions, indicating relative homogeneity in fees and vehicle costs.

US ODCE funds show the lowest TGERs

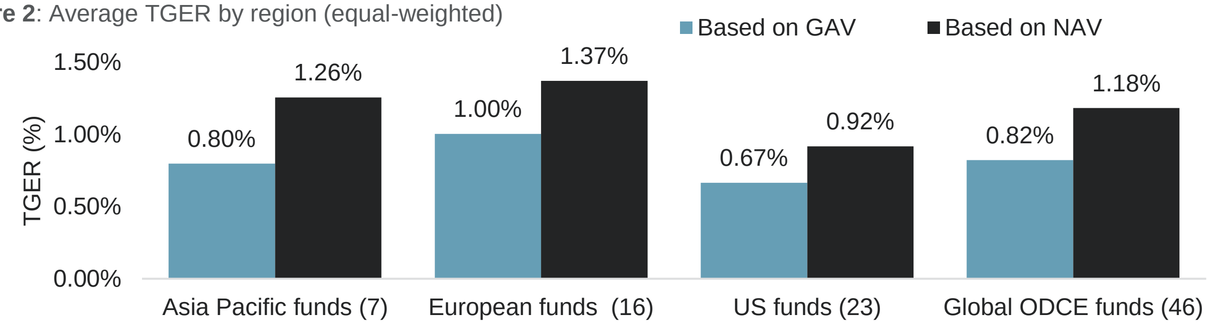
US ODCE funds report the lowest TGERs compared to their European and Asia Pacific counterparts, with an average equal-weighted TGER of 0.67% based on GAV and 0.92% based on NAV. Unsurprisingly, funds investing in multiple countries generally incur higher costs than those with a single-country strategy, partially explaining the lower TGERs for US ODCE funds. Fund size also impacts costs – the average US ODCE fund size (USD 13.7 billion) is significantly larger than those in Asia Pacific (USD 3.0 billion) and Europe (USD 2.7 billion).

Regional comparisons

Asia Pacific ODCE funds report lower average TGERs than European peers, with a difference of 21 basis points based on GAV (0.80% vs 1.00%) and 12 basis points based on NAV (1.26% vs 1.37%).

For 2023, the equal-weighted average reported TGER for Global ODCE funds stood at 0.82% based on GAV and 1.18% based on NAV.

Figure 2: Average TGER by region (equal-weighted)



Source: ANREV/INREV/NCREIF Global ODCE Fee study 2024

Global Research Committee's Review

As the global easing cycle begins, optimism is growing that the worst is behind us. However, unlike previous downturns, this recovery won't be even. While inflation has fallen to levels acceptable to central banks, risks remain, including volatile geopolitical prospects in the Middle East, Eastern Europe, and the South China Sea.

Portfolio managers must reassess risk appetite on asset class selection, given the interest rate reset and potentially tepid rent growth. Capital market volumes have improved but remain far below pre-Covid levels. As sellers and buyers narrow expectations, confidence may drive further volume recovery.

Europe is making strides as the ECB made its third rate cut, followed by the US. Japan remains a favorite for investors, offering positive spread and strong cash yields, even as the Bank of Japan prepares to normalize rates.

Office remains a challenge despite increasing return-to-work orders. However, investors are finding opportunities to convert some older assets into residential properties. Retail is gaining traction, especially supermarket-anchored properties with essential services. There's a growing focus on logistics assets supporting automation. Data centers are also in high demand, driven by the frenzy for AI.

Value-add strategies remain popular, but as re-pricing deepens, some investors are revisiting core strategies to rebuild and future-proof portfolios.