Tanka Group Research - January 2024

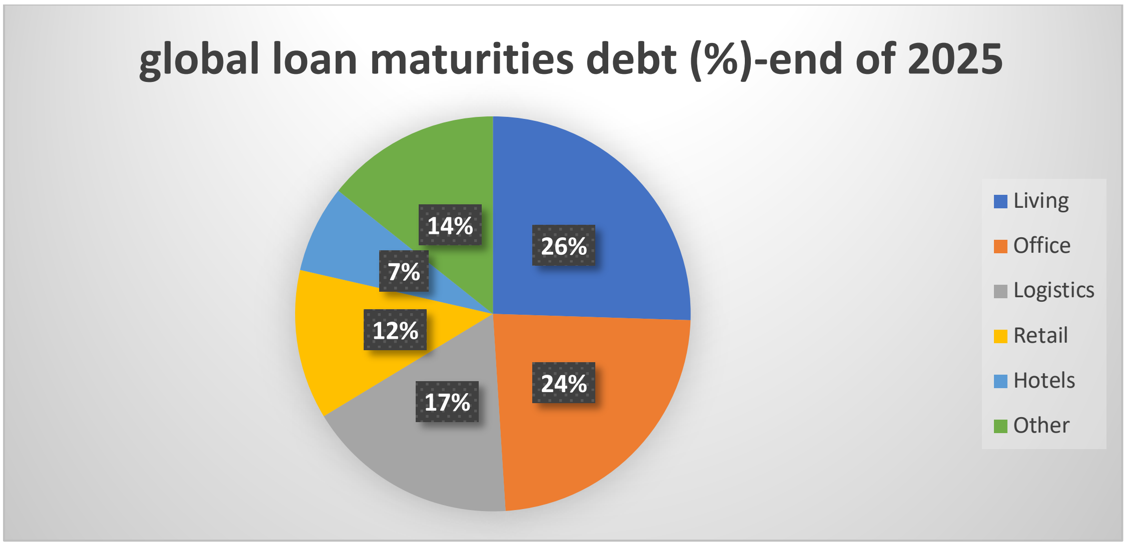
Investment Global Outlook

Clear insights into various markets have been scarce due to unexpectedly persistent inflation, a surge in interest rates, and looming recession risks.

Towards the close of 2023, central banks' efforts to curb inflation began to show results. This has led investors to believe that interest rates may have reached their peak. However, despite the challenges, many global economies have demonstrated resilience, indicating that interest rates are likely to remain relatively high throughout 2024. This stability in interest rates is expected to bring greater predictability to debt expenses, leading to more stable pricing, increased loan origination, and enhanced liquidity.

Real estate investors are now paying significant attention to debt markets. Credit strategies are gaining popularity due to their diversification benefits and strong performance in high-interest-rate environments. New debt sources are emerging to complement financing options in markets and sectors where lenders exercise caution. Debt funds have also expanded their lending capacity, particularly since the Global Financial Crisis. Tanka Group estimates that approximately $3.0 trillion worth of global real estate assets will have maturing debt by the end of 2025.

Based on the average loan-to-value ratios observed across global markets, these loans collectively amount to an approximate total of $2.1 trillion. Notably, due to the robust and well-established real estate lending market, approximately 77% of this sum is situated in the United States. On a global scale, it is anticipated that the living/multi-housing sector will represent 25% of these loan maturities, closely followed by offices at 23%.



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In light of the decline in real estate values since the market reached its peak in early 2022, numerous scenarios will necessitate fresh equity infusion to maintain stable loan-to-value ratios and fulfill ongoing debt service commitments. The most significant concern pertains to assets that were financed during the period from 2019 to 2021 when valuations were at their peak. The gap in refinancing, signifying the amount of new equity required to address these loan maturities, is estimated to fall within the range of $270 to $570 billion, contingent upon the extent of value depreciation at the maturity date.

Investors are advised to explore opportunities across the capital structure and risk spectrum, including mezzanine financing, rescue capital, or other financial structures to gain exposure to emerging property sectors and regions.

Although capital raising for real estate funds has decreased compared to pre-pandemic levels, a substantial amount of uninvested capital, approximately $402 billion as of October 2023, remains available. As investors recalibrate their expectations for risk and return, they are increasingly seeking higher yields. Capital deployment is now focused on strategies with greater potential returns and seizing the first-mover advantage in markets where property values appear to have hit their lowest point. Real estate investors should prioritize sectors and regions with the most reliable rental growth forecasts

In spite of recent concerns related to the denominator effect and the increased focus on fixed-income strategies due to allocation pressures, the enduring appeal of commercial real estate (CRE) as an asset class remains unaltered. Early indicators suggest that the denominator effect is starting to diminish. CRE offers superior protection against inflation, exhibits lower volatility, maintains a reduced correlation with other asset classes, provides stable income, and delivers diversification advantages. We anticipate that strategic asset allocations to real estate will stay steady in the long term and may even show an upward trend for many investors.

When examining the dynamics of sector-specific investments within the real estate landscape, portfolio strategies had been gradually evolving in the decade leading up to the pandemic.

Presently, the market is witnessing the initial phases of a substantial capital reallocation. Diversification strategies will vary across global markets, and even sectors that are currently less favored still have a role to play in diversified global portfolios. Currently, the residential sector is attracting the largest share of global capital, followed closely by logistics. Although sectors like offices have experienced net outflows recently, we anticipate their recovery, with a primary focus on high-quality assets. New strategies may encounter deployment challenges due to varying entry barriers, competition, and crowded strategies. This underscores the importance of investors' agility and real-time market engagement.

The growth potential of the real estate asset class will extend beyond major sectors. Long-term opportunities will arise from technological advancements, societal shifts, evolving business models, and the expansion of dynamic industries, such as life sciences and data centers. As many cities and companies transition towards cleaner energy solutions, there will be an increased demand for supporting infrastructure, manufacturing, and distribution facilities. Advanced manufacturing presents another opportunity and will witness heightened demand for research & development, production, and logistics assets.

As the future outlook becomes clearer, investors should assess their existing holdings and explore opportunities for income generation and capital appreciation across a wide spectrum of real estate assets, geographical regions, and deployment strategies.