

Global Market Insights

February 2024

The long march to recovery

The Q3 2023 GREFI All Funds Index reports a fifth consecutive quarter of negative returns in the global real estate markets. These figures, however, show significant improvement over the course of the past year as a part of the slow return to normality. Overall, GREFI recorded a global return of -1.37%. While still negative, this figure is a marked improvement from the trough of -4.19% seen in Q4 2022. The open question then becomes, how much longer will it be before the markets will be restabilized?

The improvement in fund returns is focused on Asia Pacific and the United States, where overall returns improved in Q3 by 67 and 146 basis points respectively. Meanwhile, European fund returns slipped by six basis points. Despite the slight decline in Europe's fund returns, however, their core funds are outperforming US and Asia Pacific core funds by 210 and 108 basis points, respectively. Indeed, Europe was the only region in which core strategies outperformed non-core.

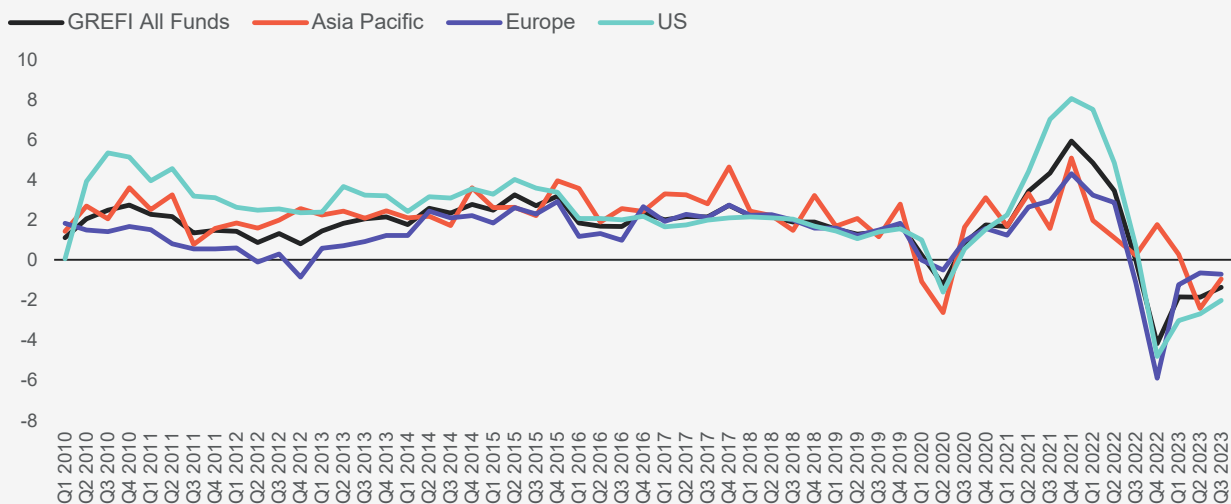
The best performing strategy in Q3 was Asia Pacific non-core, with a total return of -0.58% versus non-core returns of -1.79% in Europe and -1.82% in the US.

The current bear market was instigated by interest rate increases across the major economies (with the notable exceptions of China and Japan). These rate hikes, however, while sudden and more rapid than was generally expected, have not been outrageous by historical standards. Debt financing is not being rationed; it is just more expensive than before. Thus, while fund returns continue to be negative, their gradual improvement over the course of the past year points to cause for some optimism about the coming quarters.

During the past year we have seen that public and private real estate pricing has converged. In the US, the discount to NAV in the REIT market has narrowed from -23% to -4%, while in Europe public pricing is at a premium. This suggests that real estate has already become fairly priced, or nearly so.

Given recent broad recovery in the stock and bond markets, pressures driven by denominator effects have largely abated. We may therefore expect some of those investors who have been reluctant of late to return to the market in the coming quarters.

Figure 1: Total returns in local currency (%)



Source: GREFI Q3 2023

Real estate allocations largely unchanged

The current average allocation to real estate globally is 10.6%, only 20 bps above the average target allocation of 10.4% according to the 2024 ANREV/INREV/PREA Investment Intentions Survey. Only European investors still report being overallocated, which is related to lingering dominator effects in the region.

Asia Pacific investors are expecting to increase their allocation the most, with a planned boost of 130 bps above their current allocation. 41% of Asia Pacific investors expect to deploy capital in 2024.

Revaluation is a slow process and signs of further markdowns are becoming evident, so expectations for the subsequent quarter are that we are likely to once again see negative returns in Q4,

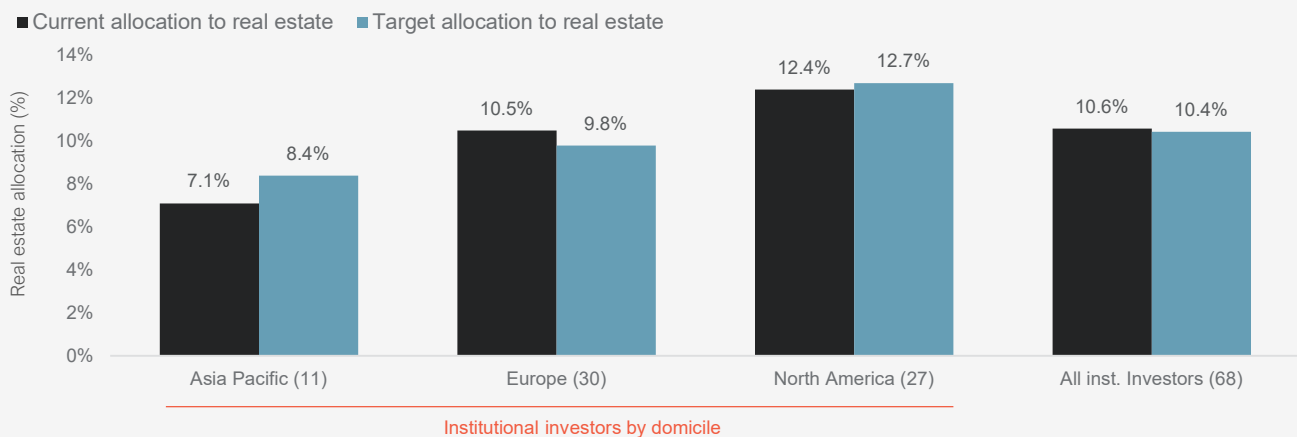
possibly continuing to move toward positive territory although stability has not yet been achieved.

The road to recovery in this cycle is proving to be long and slow, but the pieces are falling into place.

For the first time since its inception, the survey pointed to non-core strategies being more in favour amongst investors across all investor domiciles. This is unsurprising given the observation that strong vintages tend to follow periods of repricing. Moreover, the expectation that looming debt maturities will trigger some degree of distressed selling in the market is likely to be underpinning this investor preference. We expect this type of capital to play a role as a catalyst for the stabilisation of the market over the next few years.

For more on the results of the 2024 Investment Intentions Survey, please read [INREV snapshot](#) or [ANREV snapshot](#).

Figure 2: Current and target real estate allocations (weighted by total AUM)



Source: ANREV/INREV/PREA Investment Intentions survey 2024

Global Research Committee's View



Real estate market sentiment and investor behaviour remains closely tied to the dynamics between inflation, central bank policy, and bond markets' reactions. The publication of the recent 2024 PREA/INREV/ANREV Investment Intentions Survey highlighted that inflation and interest rate dynamics were front and centre for investors from all three regions. Meanwhile relatedly, the impact of the denominator effect caused by a repricing of the more liquid parts of investors' portfolios, like equities and government bonds, was also among the most salient factors on investors' minds. With the rapid upward move in rates during 2023, it is perhaps unsurprising that Q3 fund performance indicators remained in negative territory.

That said, over Q4 2023 and the early stages of 2024, financial market conditions loosened notably. Although it remains to be seen when major central banks will begin to reverse some of their recent policy tightening, bonds markets have seen a decline in real interest rates. In due course this should help ease pressures on real estate capital markets and we would expect to see this effect materialise into healthier real estate valuations, albeit with a lag.

A question that researchers are asked frequently is: what will it take for the market to heal? The survey highlights that institutional investors expect to deploy capital in 2024, the Global Research Committee expects that this flow of capital into the sector could prove helpful in improving liquidity and aiding price discovery. These are both pre-requisites to a stabilisation and eventual recovery of the market.