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Global Market Insights

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Investors awaiting proper valuation adjustments

In the last quarter of 2023, the Global Real Estate Fund Index declined at a rate of -3.22%, its sharpest drop in a year. Notably, this is the steepest quarterly decline since Q4 2022, when the index fell by -4.20%. Asia Pacific achieved fourth quarter returns of -0.97%, a decline led by Australian funds. Excluding Australia, Asia Pacific had positive returns of 2.86%. European funds earned a return of -1.70%, and returns on North American funds came in at -3.50%.

These Q4 2023 results mark the sixth consecutive quarter of negative GREFI returns. From a regional perspective, Asia Pacific has seen negative returns for three consecutive quarters, and Europe for six quarters. Returns in North America have been negative for the past four quarters, and for six of the last seven quarters.

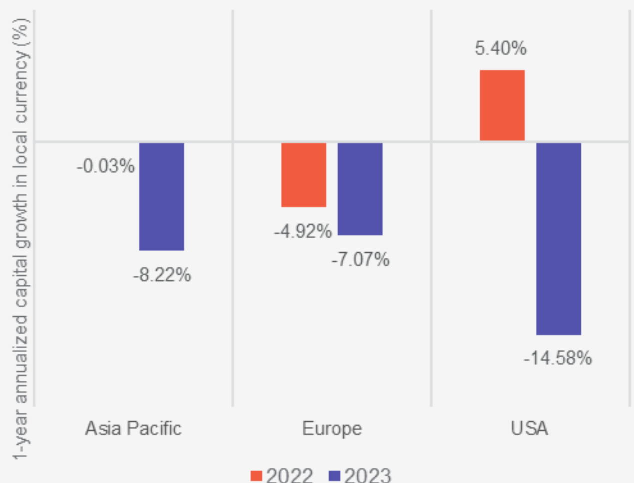
Looking back at the onset of inflationary pressure and the subsequent interest rate increases that have dampened real estate markets in recent quarters, Q1 2022 can be marked as the approximate beginning of the higher interest rate era. The Bank of England kicked off a run of 14 rate hikes in December 2021. The US Federal Reserve then launched a string of 11 policy rate increases in March 2022, and the European Central Bank raised theirs ten times beginning in July 2022. The BoE's policy rate went from 0.1% to 5.25%, the federal funds rate climbed from 0.08% to 5.33%, and the ECB increased their policy rate from -0.5% to 4.0%. All major global economies except for Japan and China saw significant rate increases over the same period, resulting in higher borrowing costs that have squeezed investment yields.

Unsurprisingly, investors have pulled back, with many choosing to remain on the sidelines awaiting clearer signals on price discovery before making new acquisitions. This is borne out by the notable decline in transaction volumes around the world since the post-covid rebound in 2021. In just the past year, volumes have declined in all three regions covered by GREFI, falling by 20% in Asia Pacific, 49% in EMEA, and 53% in the Americas.[1] This sharp decline in transaction volume begs the question whether investors believe that valuations of held – i.e., non-transacted – assets accurately reflect current values.

From the onset of the rising interest rate cycle in Q1 2022 through Q4 2023, a two-year period, GREFI has experienced a cumulative total return growth rate of -4.46% (+3.85% in 2022 and -8.00% in 2023). Breaking this down by region, total returns were a cumulative 0.93% in Asia Pacific over the course of 2022 and 2023, -5.42% in Europe, and -5.18% in North America during the same two-year span. Meanwhile, over 2022 and 2023, the capital growth component of those returns has declined in all three regions. Asia Pacific, the region with the least drop-off in transaction volume, saw cumulative capital growth of -8.25% during the higher rate era. Europe charted cumulative capital growth of -11.64% in the same timeframe. North America, which saw the steepest decline in transaction volume last year, saw cumulative two-year capital growth of -9.97%. As investors sit on the sidelines, valuations fall in search of the market clearing point. Still, it seems clear that further markdowns are needed to draw in reluctant buyers. The question is what degree of revaluation in the "higher for longer" environment will be sufficient to entice them back into the market.

1. MSCI Capital Trends Global 2023. Includes development sites.

Figure 1: Capital growth since rate hikes began



Source: Global Real Estate Fund Index Q4 2023

Capital raising reaches a record low

Capital raising activity experienced a significant decline in 2023. Investment managers surveyed raised at least $129 billion in new capital for investment in the non-listed real estate market, marking a 51% decrease compared to the previous year.

Economic uncertainty, shifts in investor sentiment, market challenges, and high interest rates have collectively influenced capital raising activities on a global scale. There was a steep decline year-on-year across the board of capital raised for investor domiciles Asia Pacific (-55%), Europe (-41%) and North America (-62%).

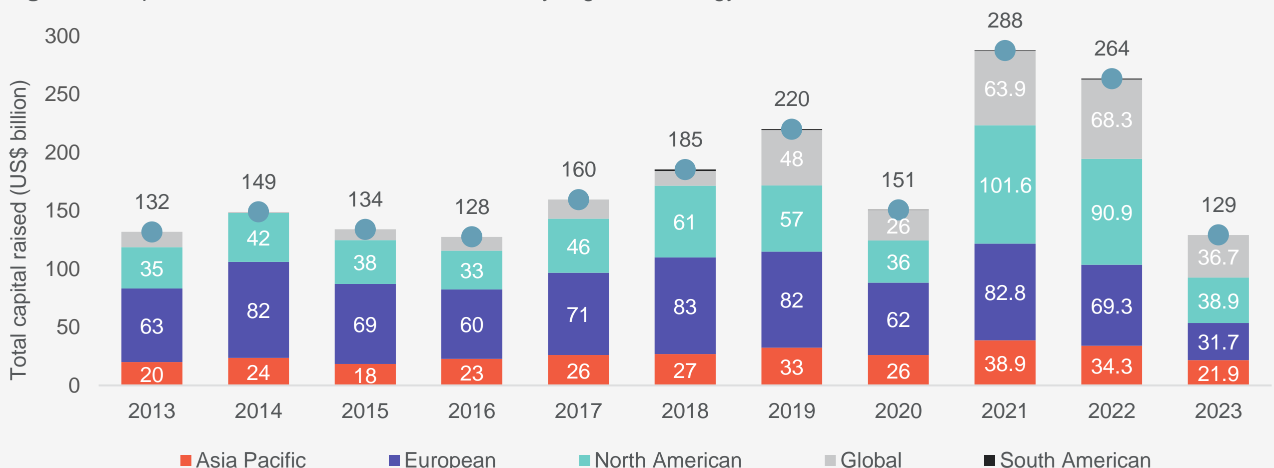
Not only has capital raising activity decreased significantly this year, but deployment of capital has been seriously challenged as well. Only 16% of the capital raised in 2023 has been invested, with a record high of 84% of the capital remaining to be invested.

An important finding from this year's survey is the high level of concentration of capital raising among just a few investment managers. The top 10 managers raised 73% of the total capital, which amounted to USD 94.3 billion. At the lower end, 37 managers raised less than USD 1 billion.

The global high interest rate environment has benefited non-listed debt products, which accounted for 24% of the total capital raised in 2023, compared with 8% in 2022.

For more on the results of the 2024 Capital Raising Survey, please read the ANREV/INREV/NCREIF Capital Raising survey.

Figure 2: Capital raised for non-listed real estate by regional strategy



Source: ANREV/INREV/NCREIF Capital Raising survey 2024

Global Research Committee's View

The prevailing discourse within the real estate investment industry is predominantly anchored by the outlook on interest rates, specifically the timing and number of cuts, and the point of stabilization. Investors appear hesitant to make commitments in the face of a barrage of perplexing signals regarding inflation and its persistence, currency volatility, corporate profitability, and employment conditions, among other factors. Meanwhile, the intensification of geopolitical conflicts and structural shifts in occupier behavior contribute to a protracted pricing discovery process.

Unlike previous corrections, which were primarily driven by financial crises, the current correction in 2023 has been more orderly, with less pressure from lenders forcing existing owners to liquidate assets. Financial stress is expected to persist, fueled by a combination of factors. These include the roll-off of debt facilities signed at lower interest rates, the need to address increasing regulatory changes around energy efficiency and other corporate governance requirements, and rising structural vacancies of properties falling out of favor due to shifting occupier trends. Despite these challenges, the current cycle may witness less 'outright distress' of assets compared to the Global Financial Crisis. Instead, opportunities to invest on the back of 'motivated sellers' are likely to endure for a longer period.

Given their relatively benign outlook, investors are increasingly venturing beyond traditional asset types to explore emerging sectors that stand to benefit from secular demand. These include various forms of living, facilities to accommodate the burgeoning demand induced from the growth of Generative AI, and specialized warehousing/logistics/manufacturing facilities. Over time, we may see a rise in transaction levels for these types of investments to potentially shift the investment landscape.