Global Real Estate Mid-Year Outlook 2023

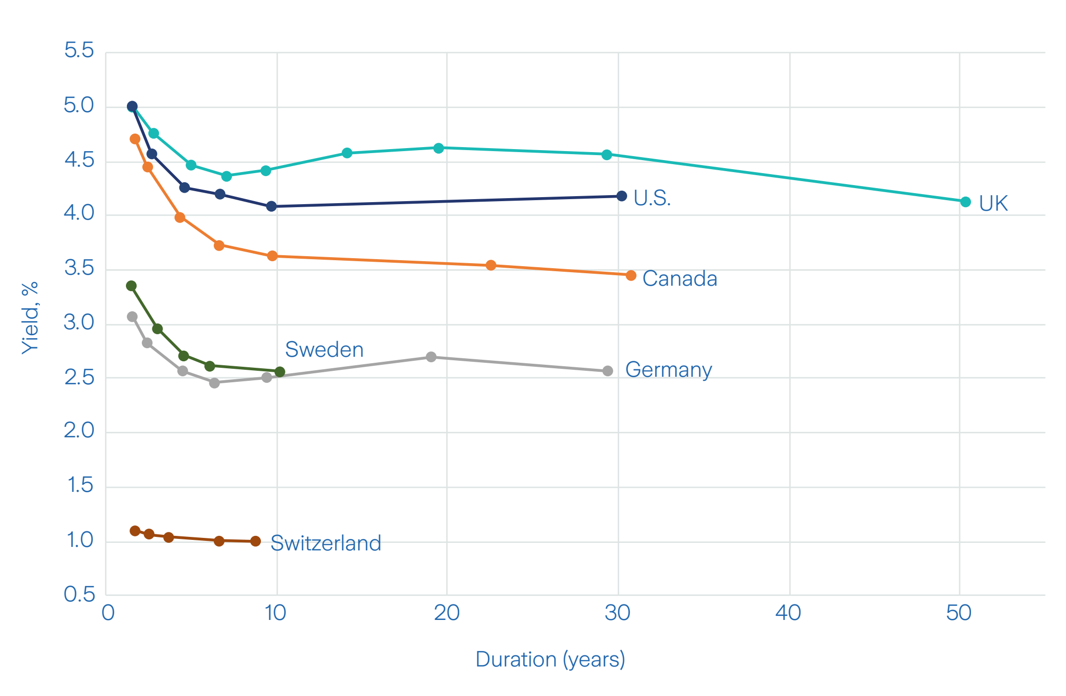
Working harder to stay standing

August 2023

Cross currents: working harder to stay standing

The mid-year outlook by our Market Strategy and Macroeconomics team cites a number of powerful cross currents at play in global markets. Economic growth has been resilient so far this year, due to strong services activity and buoyant consumer spending helped by full employment in many regions. But a deeply persistent inverted U.S. yield curve signals scepticism about the enduring strength of conditions. And it's not the only market (Figure 1).

Figure 1: Yield curves, %. latest = August 1, 2023



Source: Refinitiv, latest = July 7, 2023

For an industry known for its optimism, a "glass third full" mentality pervades.

In terms of inflation, headline has fallen sharply, but core remains troublesome, which is keeping central bank rhetoric hawkish. Global policy rates are edging higher, lending conditions are tightening and the cost of money is beginning to bite. Just ask smaller companies and many households. So it feels slightly awry that equity markets are back in bull-market territory.

Cross currents are also evident in global real estate markets. Resilient economic growth has generally been supportive of occupational fundamentals. This is especially true in the logistics and residential sectors, where a structural lack of space has powered rents higher, increasingly to the chagrin of tenants. The retail sector is also better positioned after a precarious few years. Footfall has recovered, rents have rebased and pricing has found a new equilibrium. Then of course, there is the much-maligned office sector. While the occupational story isn't as universally bad as sensationalist headlines would have you believe, undeniably there are some troubled spots. Inflation cuts in different directions. While forcing central bankers' hands and eroding consumer purchasing power, inflation can also be positive for income returns when there is index-linking. It is also a force dampening an oversupply of space.

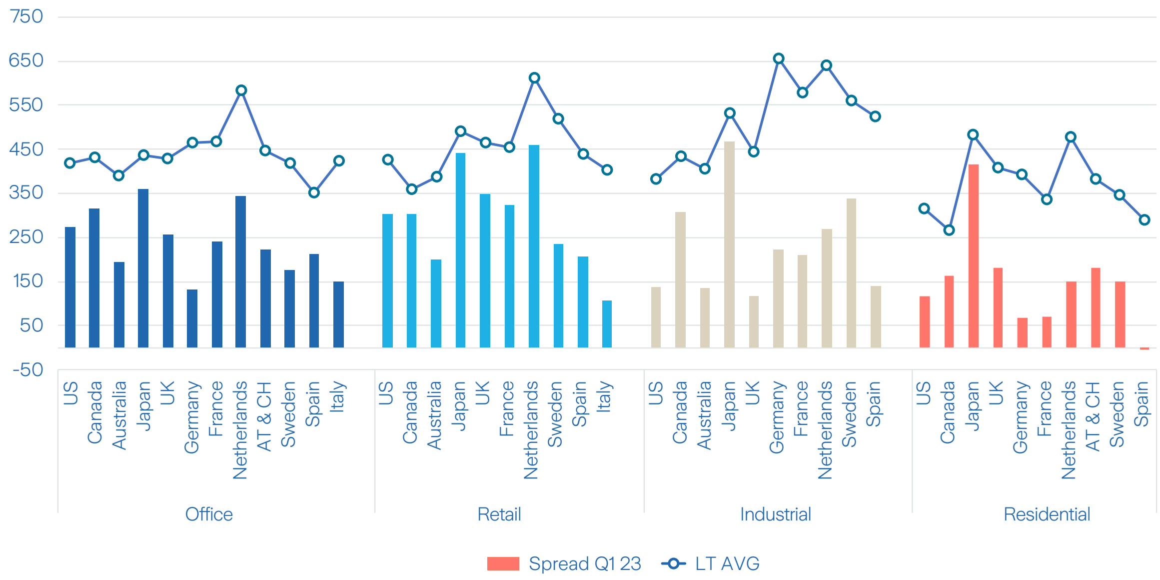
It's a very different picture to 18 months ago. For an industry known for its optimism, a "glass third full" mentality pervades. Given these cross currents, real estate investors will have to work harder to stay standing.

In this Global Real Estate Mid-Year Outlook, we take a pure real estate focus, looking first at the recent evolution of capital markets and the impact on performance before exploring sector trends and stating our preferred investment strategies. We conclude on a positive note, offering reasons for regional optimism in the second half of the year.

Constrained Capital Markets

Real estate is a big consumer of credit, so the abrupt change in interest rates has confounded investors. Last year's rate hikes are not fully reflected in real estate valuations and tighter credit conditions have kept many investors on the side-lines. Property's compelling yield spread to government bonds – a powerful catalyst for net inflows into the asset class over the past decade – has evaporated in recent quarters (Figure 2).

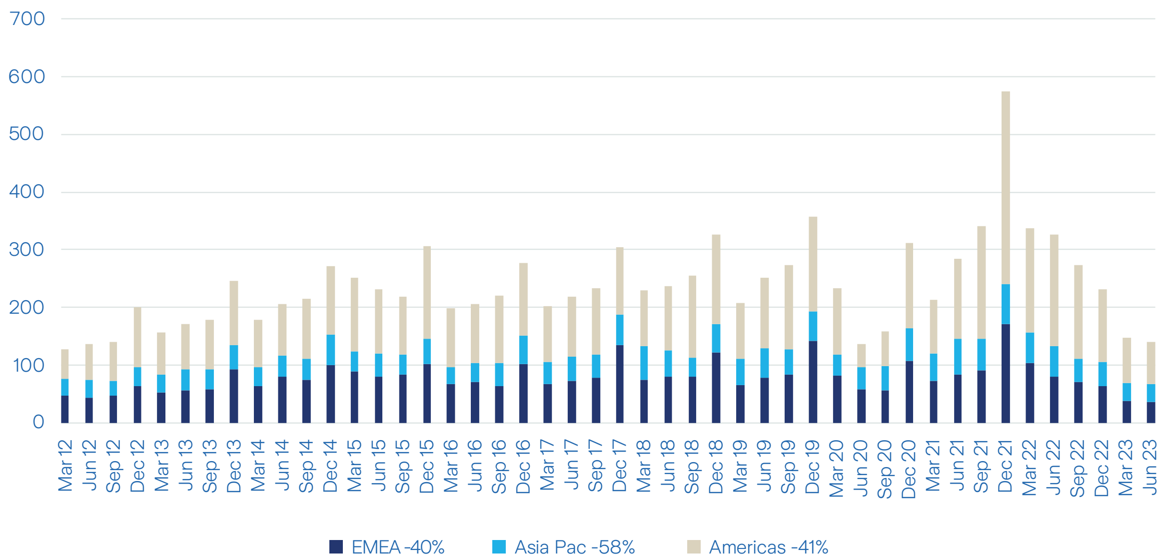
Figure 2: Average transactional cap rate spreads to government bonds, bps



Source: Bloomberg, Real Capital Analytics, latest = Q1 2023

As a result, transactional volumes have fallen sharply from recent historical highs (Figure 3) and real estate allocations are under greater scrutiny.

Figure 3: Investment volumes by region excluding development sites, USDbn, % is half year annualised change

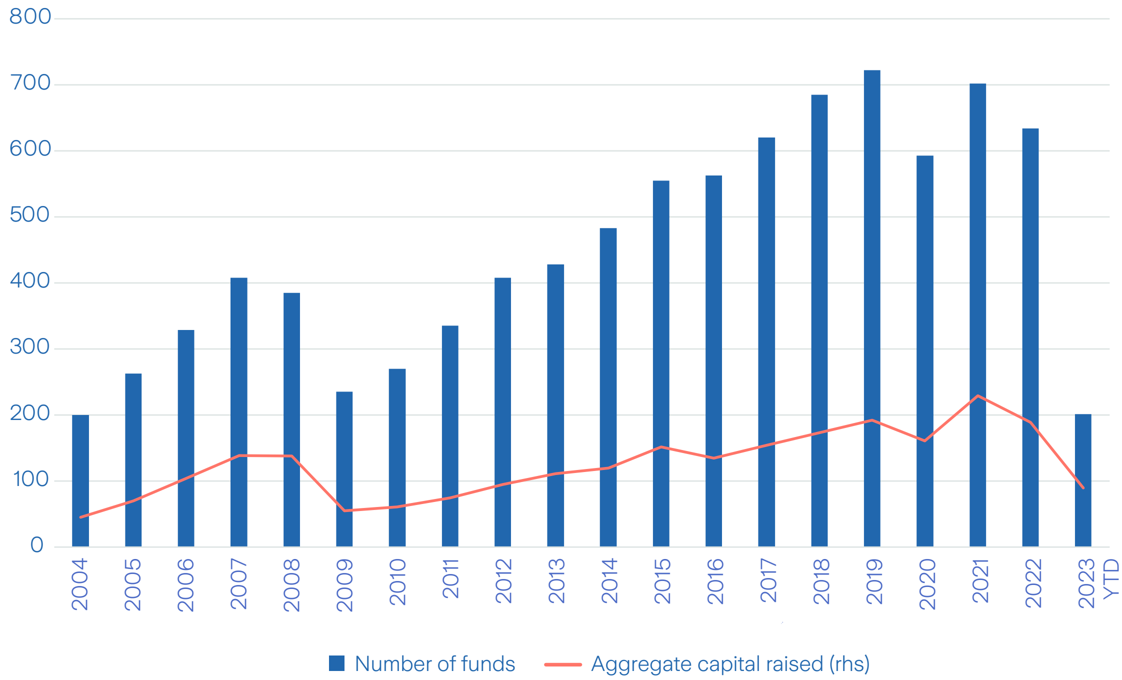


Source: Real Capital Analytics, latest = Q2 2023

This is especially true in Europe, where many institutional investors were already at capacity with their real estate positions in 2022, meaning the relative strength of equity markets so far this year hasn't been enough to unwind the denominator effect. According to the latest INREV investment intentions survey, a quarter of global investors are planning to reduce their exposure to real estate over the coming year.[1] This of course is easier said than done given constrained capital markets.

Considering these dynamics, capital raising activity has slowed significantly, with both the number of funds and aggregate amount of money raised at their lowest level in a decade (Figure 4).

Figure 4: Global private equity real estate fund raising (all investment styles), # of funds and amount raised, USD



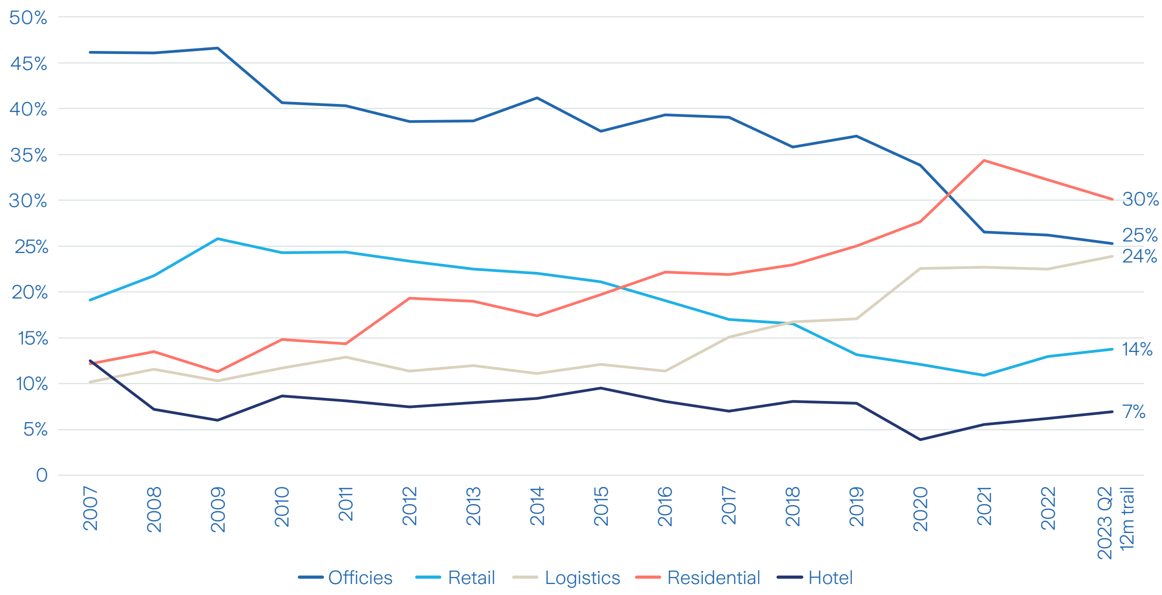
Source: Preqin, Q2 2023

Admittedly this comes after a couple years of buoyant fund raising activity, suggesting that there is dry powder for dealmaking. Investor intention surveys and successful capital raises are pointing to opposite ends of the risk return spectrum as preferred destinations for development. On the one hand, 2023 is seen by some as a good vintage year for enhanced return strategies, while for others real estate credit is the safer place in the capital stack as valuations are being written down.

At sector level, logistics and residential continue to dominate attention both in terms of fund raising as well as deployment (Figure 5).

[1] https://www.inrev.org/news/inrev-news/investment-intentions-survey-2023

Figure 5: Global investment activity, share by sector, %

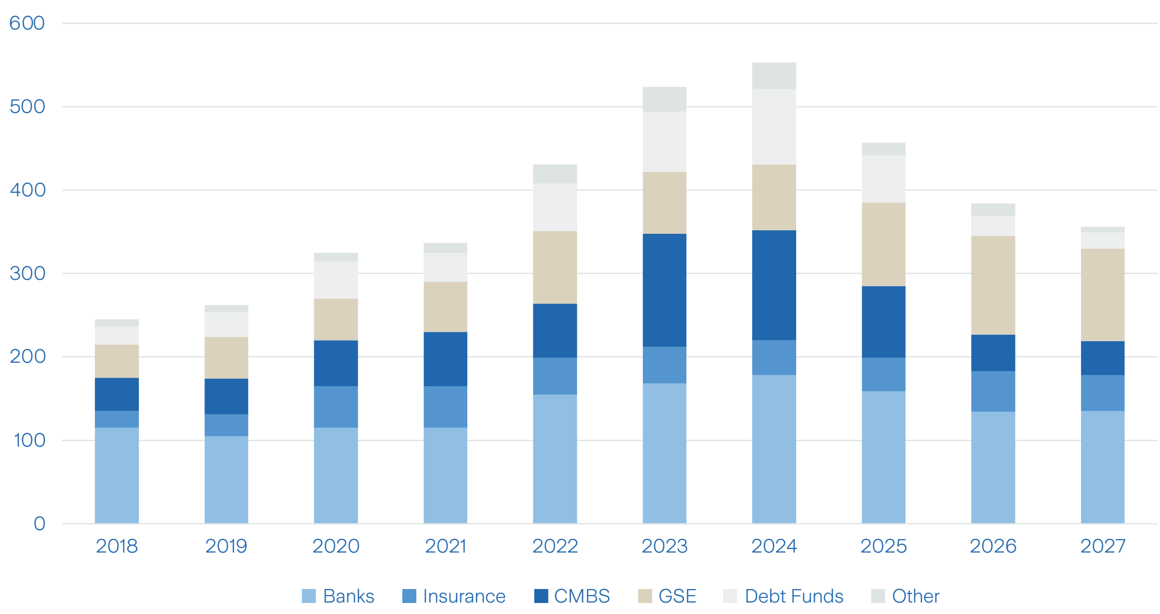


Source: Real Capital Analytics, latest = Q2 2023

This is a result of investors rebalancing portfolios in line with favourable structural trends, something which we'll explore later in this report.

The first half of the year saw the collapse of high profile regional U.S. banks and the merger of two globally systematically important banks. While the events didn't trigger a global financial or systemic banking crisis, credit conditions have tightened further with more lenders having less capacity to finance real estate. This comes as a significant amount of commercial debt needs to be refinanced over the coming years (Figure 6).

Figure 6: U.S. commercial mortgage maturities by original loan term, USDbn



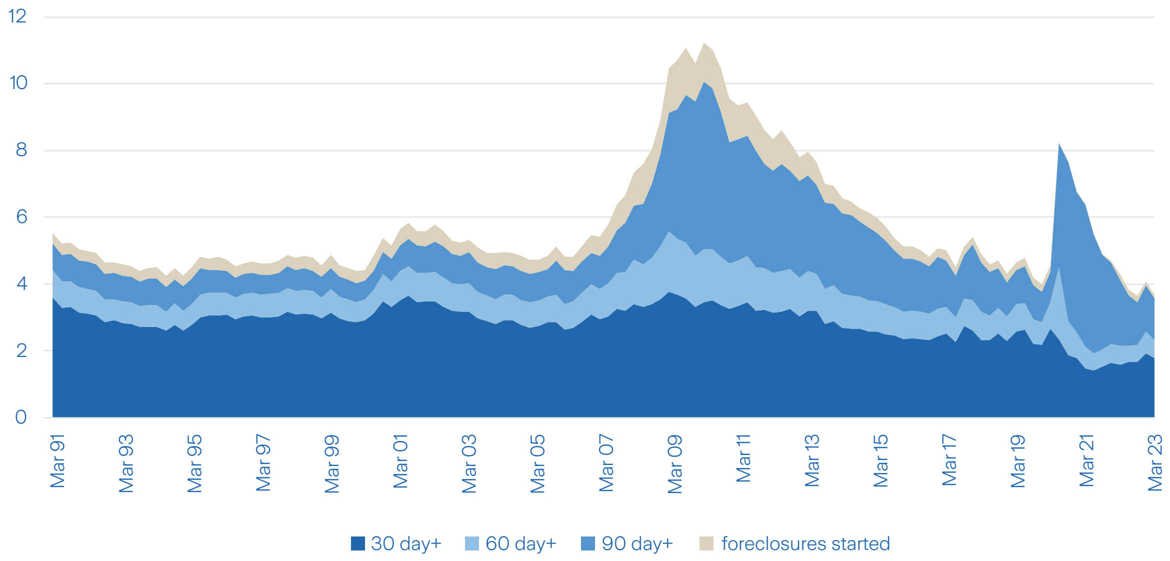
Source: Goldman Sachs, Newmark, Real Capital Analytics, latest = Q1 2023

In the U.S., a worryingly high amount of loans are backed by office assets and sitting on traditional bank balance sheets.

> Borrowers will be challenged with higher financing costs and falling valuations, while lenders face the prospect of having keys handed back.

To date, commercial real estate loan delinquencies are in line with long run trend, but this is a backward looking indicator (Figure 7).

Figure 7: U.S. commercial real estate loan delinquencies, % of total loans, seasonally adjusted



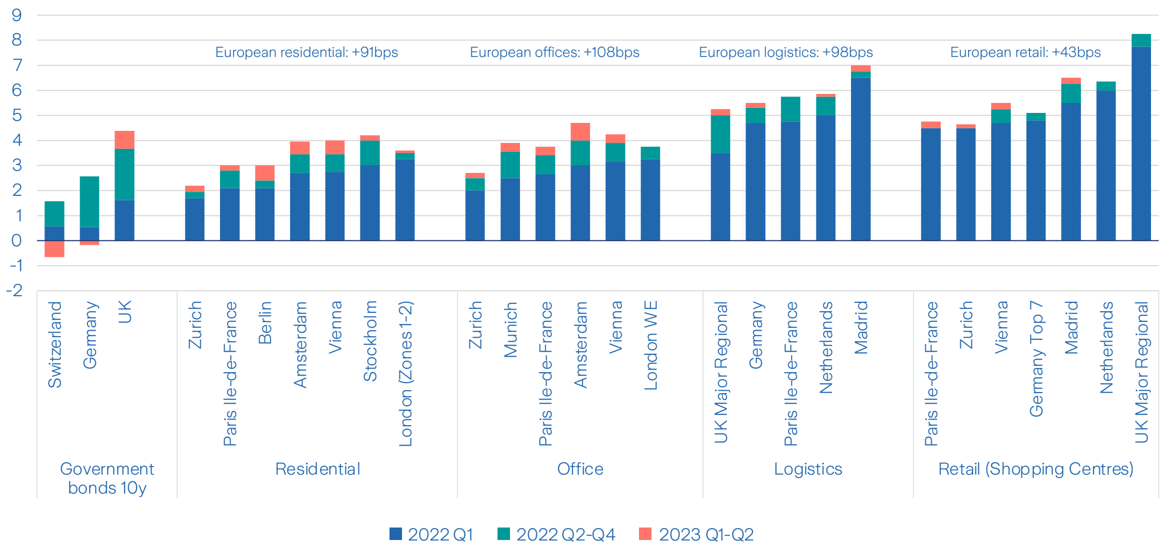
Source: U.S. Federal Reserve

With the cost of capital beginning to bite, more loan breaches are inevitable. This should be a catalyst to force decision making and may hasten price discovery.

Polarised performance

After a decade of record low interest rates, last year's abrupt shift in monetary policy has quickly transmitted to real estate valuations in the form of higher discount rates and yield expansion. Figure 8 illustrates the cumulative yield shift for government bonds and real estate in Europe from recent lows through Q2 2023.

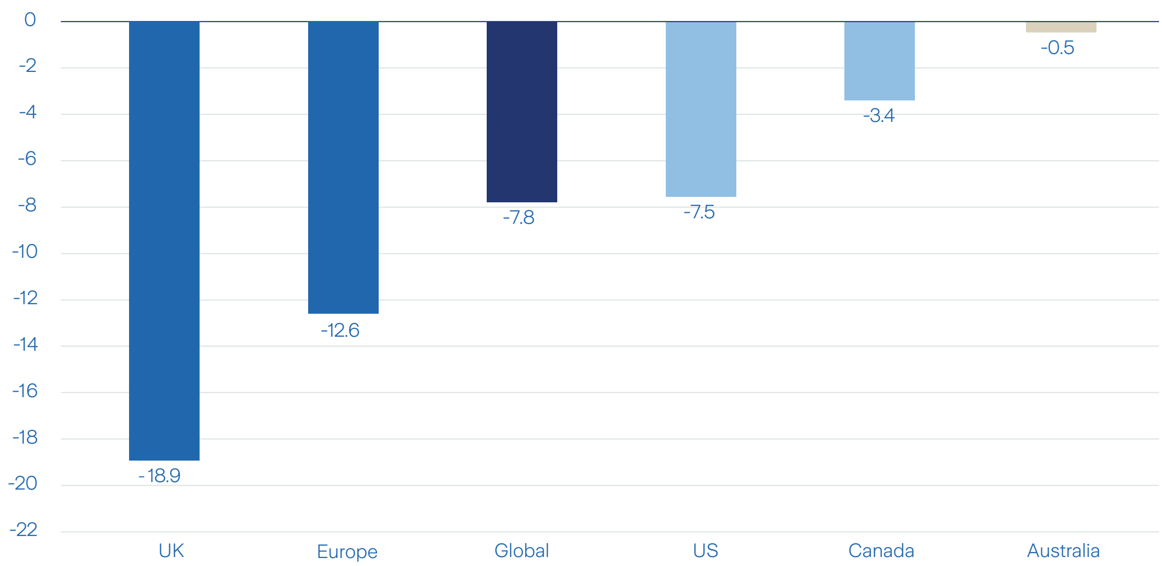
Figure 8: Change in european yields, %



Source: Bloomberg, CBRE June 2023
Labelled sector yield shift is from Q1 2022 to Q1 2023

As a result, capital values are adjusting downward, though the speed and magnitude of correction has varied by market (Figure 9).

Figure 9: Cumulative change in capital value from Q3 2022 to Q1 2023 %

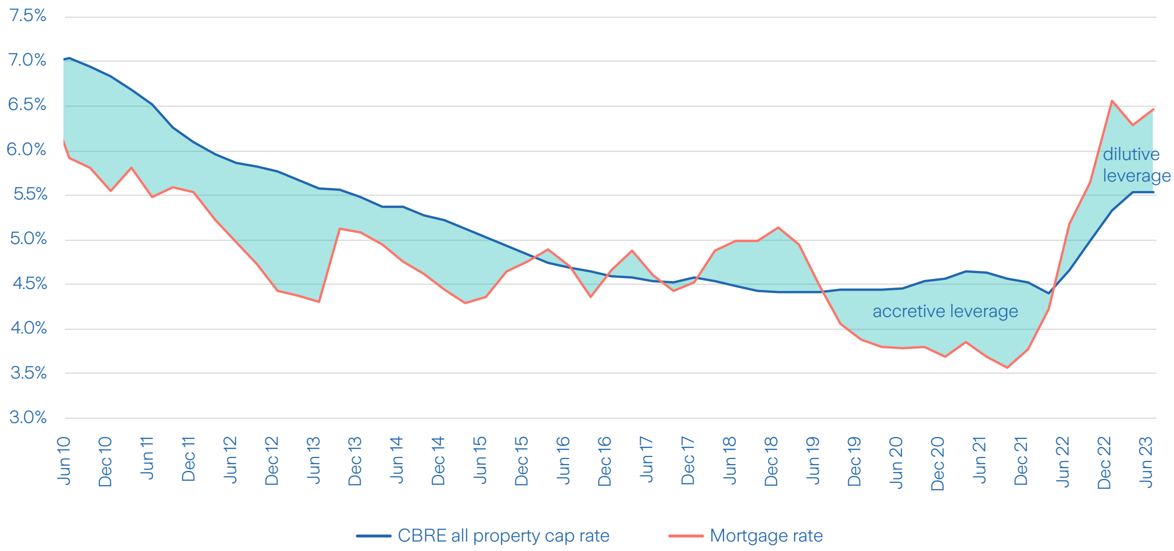


Source: MSCI, latest = Q1 2023

Accelerated by last year's disastrous mini-budget, the UK is furthest along in terms of price discovery, with all property values having already fallen by nearly a fifth versus their 2022 high. While painful in terms of realised performance, it does position the market favourably from a re-entry perspective. Unlike the aftermath of the Global Financial Crisis (GFC), valuations in much of Europe have been responsive to changing capital market conditions. The upward adjustment to office and logistics yields in Germany, France, and the Netherlands has been particularly pronounced and is expected to continue through year end, albeit at a slower pace. A contrasting situation exists in Switzerland where values have been resilient to date, with appraisers guiding only a modest downward movement by year end.

The U.S. also stands as an outlier. Despite a radically different interest rate environment compared to 18 months ago, all property values have not moved in sympathy with the increased cost of capital. This is especially perplexing for structurally weaker sectors where occupier conditions have deteriorated and there is a negative spread between the cost of financing and in-going cap rates (Figure 10).

Figure 10: U.S. all property cap rates versus the cost of financing, %



Source: Real Capital Analytics, latest = Q2 2023

A potential wave of distressed office sales and softening demand due to less conducive economic conditions suggest that the risk to values is to the downside over the near term.

AsiaPac is a bit of a mixed bag as it has both the highest and lowest interest rates of developed markets in New Zealand and Japan. While the region has also seen a sharp drop in investment volumes, the impact on values has been less stark, due in large part to a dearth of transactional evidence.

Understandably, the ongoing downward shift in capital values has had a negative impact on real estate performance, which has been the weakest since the GFC. At an aggregate global level, annualised returns were negative in Q1 2023 according to MSCI, with the range of outcomes between best and worst performing sectors and regions especially wide (Table 1).

Polarisation is the watchword and we see the recent divergence in performance as a harbinger of things to come.

Table: 1 Annualised unlevered direct real estate returns to Q1 2023, %

Markets	All	Office	Retail	Industrial	Residential
Global	-2.4	-5.7	0.0	-1.5	-0.4
Europe	-7.4	-6.8	-2.3	-11.0	-5.0
UK	-13.0	-12.2	-7.9	-20.4	-3.5
US	-1.6	-10.2	0.1	3.4	-0.5
Canada	0.9	-6.3	-2.9	12.4	3.9
Australia	5.4	3.3	5.9	9.8	NA

Source: MSCI, latest = Q1 2023

Looking forward, cross currents continue. A high interest rate environment and constraints on real estate allocations suggest that investors will be precious in the strategies they pursue. While cyclical yield expansion appears to be culminating, the delayed impact on real estate valuations will weigh on sentiment and delay a much hoped for rebound in deal activity. In an environment of reduced liquidity, conviction themes will become crowded. At the same time rapidly evolving tenant expectations and accelerated rates of asset obsolescence will put pressure on net operating income. In order to generate alpha, active asset management will be necessary to drive operational efficiencies and maintain properties to the exacting standards of ever fickle tenants. To better understand what they want, let's explore evolving sector trends.

In an environment of reduced liquidity, conviction themes will become crowded.

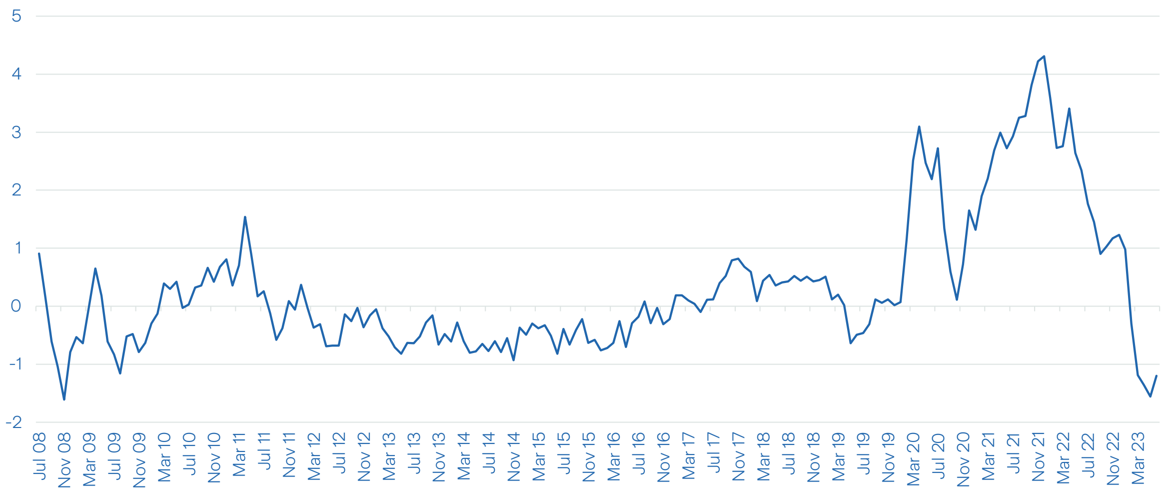
Exploring Sector Trends

Logistics: normalising after years of superlative performance

Globally, the logistics sector was the darling of the pandemic. Historically strong performance was fuelled initially by occupiers rapidly expanding ecommerce fulfilment capacity to meet insatiable consumer demand brought about by increased spending on online shopping. Sector fundamentals were bolstered further by supply chain disruption, with firms building resiliency into their operations and development complicated by skyrocketing construction costs. This resulted in vacancy rates testing low single digits, re-leasing spreads of 30% or more in some markets and investors bidding down yields below other commercial property types. Such activity was superlative in many ways, and in hindsight, valuations became overstated.

But as we've put the pandemic in the rear view, consumer behaviour has reverted to previous norms and supply chain pressures have eased significantly (Figure 11).

Figure 11: United States: Global supply chain pressure index



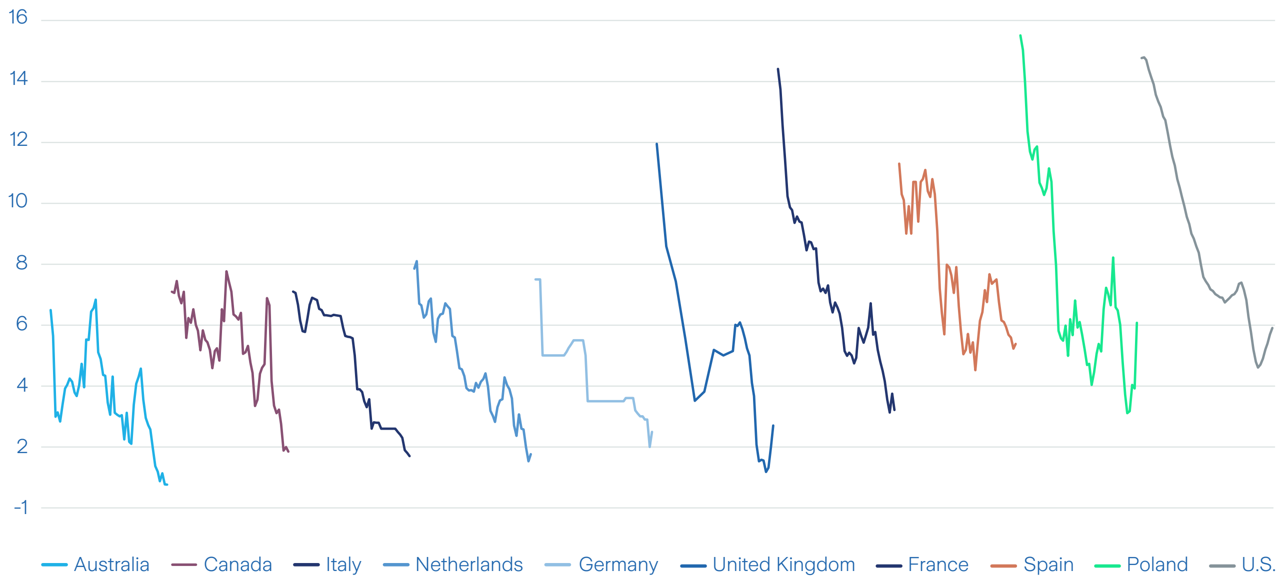
Source: Refinitiv, latest = June 2023

The index is normalized such that a zero indicates that the index is at its average value with positive values representing how many standard deviations the index is above this average value (and negative values representing the opposite).

Furthermore, a softening economic backdrop is being felt in occupational markets, with affordability concerns being voiced and sub-let space on the rise. So in recent quarters,

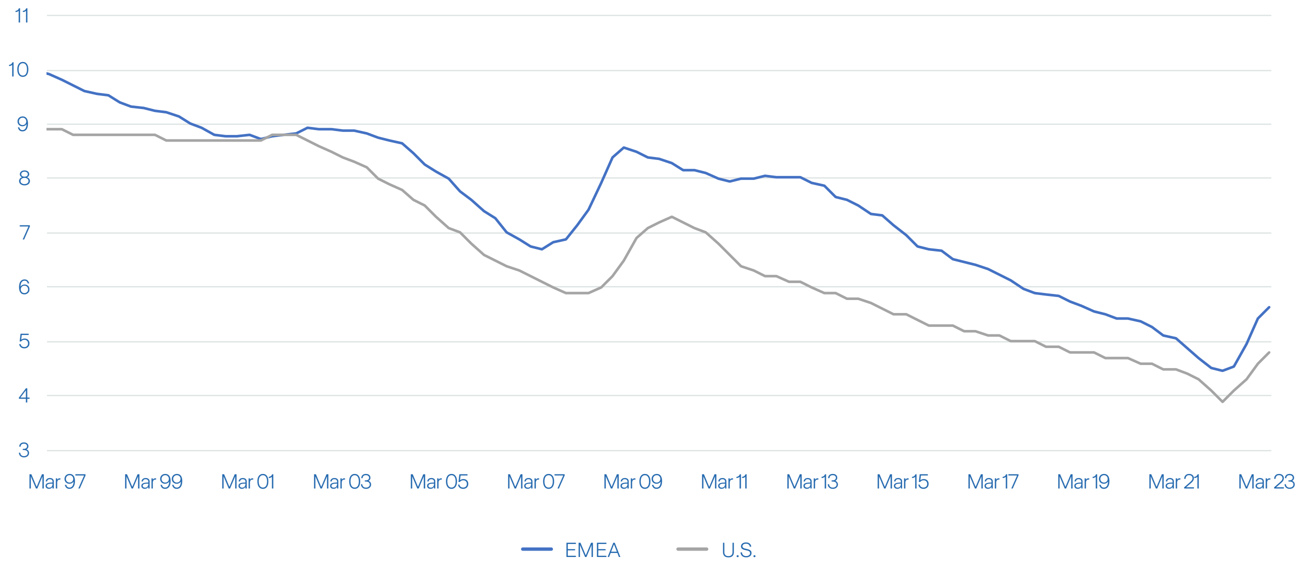
> the overriding theme for the global logistics sector has been one of normalisation, gradually in the case of rising vacancy rates and suddenly in terms of net initial yields (Figures 12 and 13)

Figure 12: National logistics vacancy rates Q1 2011-Q1 2023, %
Countries sorted by current vacancy rate



Source: CBRE, JLL, MSCI

Figure 13: Logistics yields, %



Source: CBRE, latest = Q1 2023

Yet, while the sector has lost some momentum compared with the past few years, we still see a favourable performance outlook, especially considering new entry pricing. We anticipate positive absorption in major logistics markets as new supply is kept in check by the high cost of development finance. Relevant too, green field development is increasingly difficult in markets like the Netherlands and France, while local resistance to the “boxification” of rural landscapes and the noxious side effects of truck traffic is growing louder. Also, given the automation of warehouse facilities, the typical developer argument of local job creation has become less compelling to planning authorities. These forces can result in lengthier approval processes for logistics facilities, or preclude new development altogether, thus buffering the supply side.

We see logistics rental growth in the markets where we operate settling in the mid-single digits, still exceeding inflation while generating an attractive income return. For these reasons, the logistics sector tops our preferred global investment strategies.

We prioritise modern logistics facilities with leading sustainability credentials in in-fill locations where values are underpinned by alternative uses.

Furthermore, we see an early mover advantage in markets where ecommerce growth is expanding rapidly and there is a dearth of supply that is fit for purpose. While offering different risk profiles, Australia and Chile are of interest to us, in this regard.

Residential: in search of affordability

When canvassing our global real estate teams for views on local residential markets, there was one theme that resounded:

there is an inadequate supply of affordable housing in nearly all of the countries where we invest.

Quite simply, tenant demand continues to outpace the market's capacity to add new residential supply. This can be a function of outdated planning systems, developers seeing greater profits elsewhere or NIMBYism curtailing the creation of relevant housing stock. Whatever the causes, the plight is real. The Urban Land Institute, starkly states that a lack of affordable housing has consequences for individuals by lowering their quality of life and more widely affects city competitiveness and social cohesion.[2]

Given this backdrop, investor intention surveys indicate residential, in its various tenures and including affordable and social housing, as having favourable prospects for development and investment (Table 2).

Table 2: European Real Estate Sector Prospects, 2023

Overall prospects

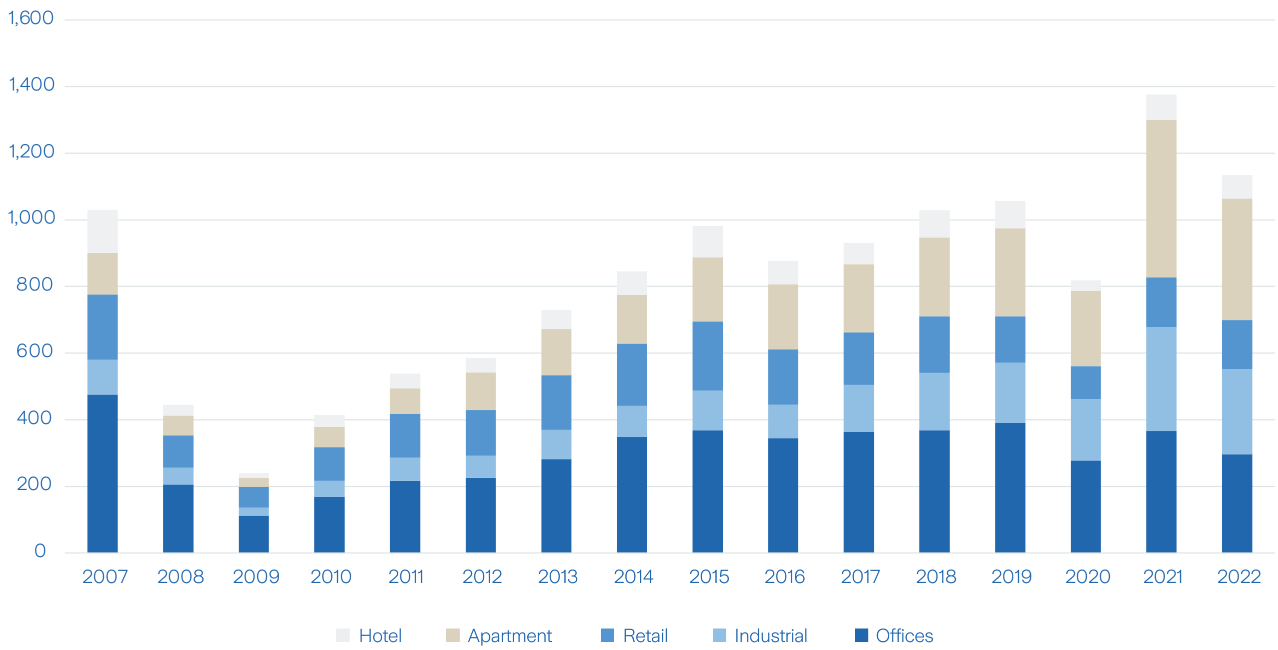
1	New energy infrastructure	4.45
2	Life sciences	4.35
3	Data centres	4.15
4	**Social housing**	4.13
5	**Retirement/assisted living**	4.12
6	**Affordable housing**	4.10
7	Self-storage facilities	4.10
8	Logistics facilities	4.04
9	**Co-living**	4.04
10	**Private rented residential**	3.99
11	Industrial/warehouse	3.98
12	**Student housing**	3.97
13	Leisure hotels	3.90
14	**Serviced apartments**	3.77
15	Parking	3.74
16	Healthcare	3.72
17	**Housebuilding for sale**	3.60
18	Flexible/serviced offices	3.58
19	Leisure	3.54
20	Central city office	3.34
21	Retail parks	3.17
22	Business hotels	3.13
23	Business parks	3.04
24	High street shops	2.94
25	City centre shopping centres	2.68
26	Suburban offices	2.62
27	Out-of-town shopping	2.49

Source: Urban Land Institute, Emerging Trends Europe 2023

[2] Urban Land Institute: Promoting housing affordability, best practices to deliver intermediate housing at scale. February 2020.

The pronounced supply/demand imbalance positions residential as a resilient sector. This shift of capital led to apartments (private rented residential) overtaking offices to become the number one global sector by deal volume in 2021, retaining top spot in 2022 with more than US$365 billion of sales, according to Real Capital Analytics (Figure 14).

Figure 14: Global investment volumes by property sector, US$ bn



Source: Real Capital Analytics, latest = Q1 2023

Furthermore, since interest rates began to adjust upward in mid-2022, performance has generally been less volatile than other real estate sectors. This is a function of net operating income seeing a quicker inflation pass-through. But local practices with regard to regulation as well as institutional ownership structures have tended to mean more stable returns than pro-cyclical property types.

While the sector at large is perceived positively, residential markets are beginning to diverge in terms of their attractiveness. This is because of the threat of government intervention including rent controls and punitive taxation regimes. In Europe, markets like the Netherlands, Berlin and Barcelona have lost some of their lustre from an investment perspective, despite the many favourable characteristics the cities offer, including healthy rates of population growth. In North America, vacancy taxes on condominiums in the San Francisco Bay area or increased residential development charges in Toronto have proven a disincentive for some investors. Conversely in Australia and South Korea, both emerging build-to-rent markets, planners appear to be taking a more constructive stance toward creating more rental housing supply by offering land tax relief or fast tracking projects to cushion the blow from a softening for-sale market.

Government interference in the residential sector is a thorny topic. But our experience in Switzerland, a heavily regulated market, underscores that it needn't be destructive to returns over the long run. It's unforeseen changes in regulation that spook investors, which can ultimately result in less housing supply being created and necessary cap ex being made.

Considering the characteristics outlined above,

> we hold high conviction in affordable for-rent residential as a preferred investment strategy.

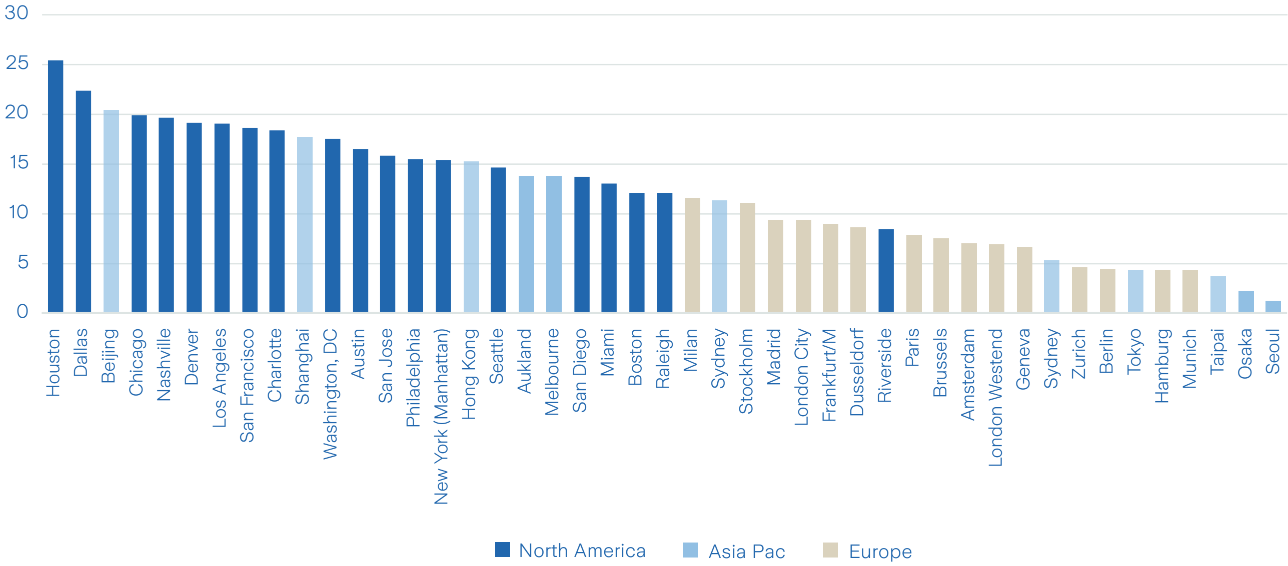
We will continue to unlock opportunities in highly institutionalised and regulated markets where we have historically been successful. Additionally, we will look to alternative residential tenures such as student housing or micro living to generate enhanced returns.

Offices: there's a greater threat than remote working

The demise of the office as a result of remote working has been grossly overstated.

Projections by outspoken market participants in the early stages of the pandemic of a 50% decline in demand never came to bare. Yet while life is generally back to normal post-pandemic as evidenced by public transit journeys and visits to leisure destinations, offices stand out as a glaring exception. Return to office (RTO) rates have certainly improved, but they appear to have stalled in recent quarters, admittedly at different levels in different cities. There is a strong linkage to global office vacancy rates (Figure 15). The reasons are myriad and we would suggest yet to fully play out.

Figure 15: Office vacancy rate by region, % as at Q1 2023



Source: CBRE, JLL, latest = Q1 2023

For starters, patterns of RTO are not one-size-fits-all. There are generational, geographical, and cultural factors that can vary widely from one city or company to another. Also, given tight labour conditions and the Great Resignation hanging over job markets (Figure 16), employees still have the upper hand in dictating workplace preferences.

Figure 16: United States total non-farm job quits, thousands, seasonally adjusted level, three month moving average

Source: U.S. Bureau of Labor Statistics, latest = May 2023

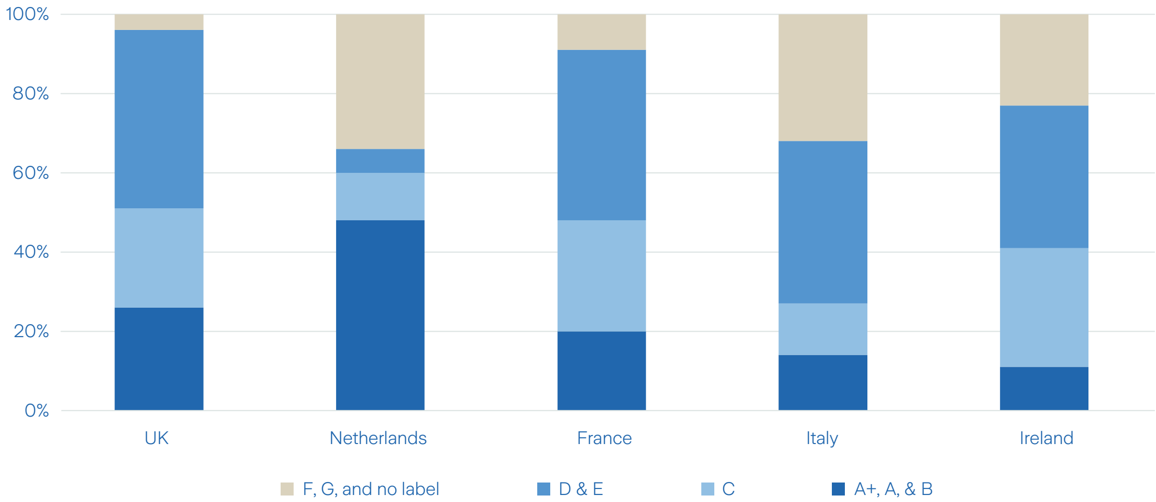
There needs to be political capital with a workforce to demand employees return to the office. Heavy-handed employers demanding a RTO of four or five days a week are still the minority. Also, the much-anticipated recession with a spectre of job cuts has been slow in coming. So the need for job protecting office presenteeism has been less acute. And finally, leasing events are not synchronised across markets. Lengthy in-place lease commitments and inertia in the immediate post-pandemic period have limited the offloading of surplus space. That may come, but we see it being a multi-year recalibration process, both in terms of aggregate office demand as well as terminal rates of RTO.

From our perspective,

> the bigger challenge facing global office markets isn't workplace behavioural change, but rather climate change.

And specifically how transitional climate risks and sustainability related cap-ex will influence asset values and ultimately obsolescence. While the transition to a low-carbon built environment transcends all property types, we see offices as a focal point. This is because the sector comprises a significant share of the built environment as well as institutional portfolios. Moreover, much of today's office stock doesn't currently meet minimum energy requirements (Figure 17).

Figure 17: Share of European office stock relating to each EPC label, %



Source: Savills, latest = 2022

In other words, needle moving outcomes can be achieved through targeted green cap-ex. Such actions can help office investors meet their decarbonisation targets, while creating office space that is most in demand.

Zurich Insurance Group's decarbonisation targets for investments are aligned with the goals of the Paris Agreement and the efforts of the Net Zero Asset Owners Alliance. As such, we have established intermediate, science-based targets for our real estate investment portfolio. By 2025, we aim to reduce the intensity of emissions of direct real estate investments by 30%, in terms of kilograms of CO2 equivalent per square meter, from a 2019 baseline. As this is within asset business plans, the value at risk of deferring net zero compliant decisions is tangible. Also, given the speed at which legislation and environmental requirements are advancing, particularly in Europe, there is also the risk of future taxation penalising excessive carbon emissions or operational inefficiencies within a building.

Given the forces facing the office sector, investor attention has turned to the case for repurposing assets into other uses, with residential often seen as an obvious choice. As previously highlighted, there is a fundamental supply/demand imbalance of affordable housing in many of the markets where we invest. So, the case for converting offices into residential can be compelling as the demand prognosis has high certainty. Also the creation of housing in municipalities where supply is most lacking can help investors meet social impact targets, which is increasingly in focus. However, it can be very difficult to convert offices, given planning rules, physical design, and the required expenditure. Outdated offices often require significant structural retrofitting to make them attractive to residential tenants, undermining their investment appeal. The dilemma for owners of average to poorer quality offices is whether you invest more into cap-ex in a softening letting market or sell at a reduced price for residential conversion. This is a contributing factor why bid/ask spreads for prospective office sales remain wide.

Despite the well documented challenges,

> we fundamentally believe in a future for offices.

This is why the sector remains integral to our preferred investment strategies. However, this comes with important caveats. For starters, we expect rental growth to slow in most markets as labour conditions cool and occupiers right-size their space commitments in response to structural forces. Also we expect offices to comprise a smaller share of institutional portfolios than they historically have and we aim to be on the right side of this evolution. As a consequence, the characteristics of the offices we will buy and hold continues to be refined. Tenant requirements of flexible and productive space have evolved in a profound way in a very short span of time. We seek to meet and even exceed these expectations by acquiring and transforming well-located space with leading environmental and wellness credentials. Success in delivering such outcomes requires diligent cap-ex budgeting and ultimately embedded carbon accounting. Allied to our corporate sustainability ambitions, we prefer to reposition, rather than sell brown assets and shift decarbonisation challenges onto less informed buyers.

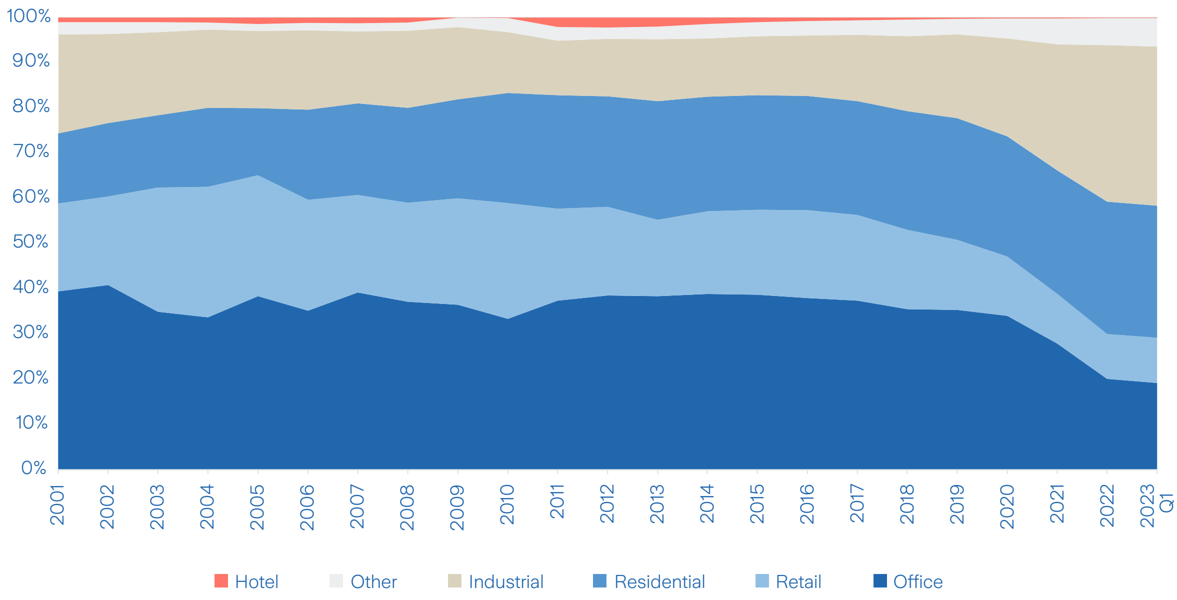
Retail: taking a constructive stance

Over the past 20 years, physical retail has undergone a profound transformation. Traditional bricks and mortar sales channels were disrupted by ecommerce offering the convenience of shopping from home. Then came mobile phones with the ease of buying anything anywhere. And of course Covid lockdowns turned retailing on its head, albeit for a relatively short period, though it may not have felt like it at the time. Yet despite these formidable forces, physical retail still persists. And for good reason: we are social creatures who crave tactile experiences. So, it should come as little surprise that as we move into the second half of 2023 footfall has returned to dominant shopping schemes the world over, prime high streets are bustling with "revenge spending" tourists, and convenience retail remains convenient as ever.

While Zurich Insurance Group isn't well known as a retail investor, we are taking a constructive stance toward the sector. This is because retail, in its many formats, has adapted to the challenges thrown its way. Redundant space has been repurposed and retailing models have evolved. Rents have rebased, and yields have adjusted to a sustainable level. Lenders are also taking a pragmatic stance for the right types of assets, especially those complimenting mixed-use schemes.

But we also acknowledge that operationally, retail has become increasingly idiosyncratic. Core investors used to buy retail with a passive asset management approach, a model that no longer works. Over-levered public real estate companies are also in a bind. They will be net sellers given higher financing costs, as well as limited in their ability to make necessary investment into existing schemes. As a result, there is a narrowing pool of protagonist retail investors. This is evidenced by a dwindling share of retail in real estate sector allocations (Figure 18).

Figure 18: USA ODCE index composition, % of total by capital value



Source: NCREIF, latest = Q1 2023

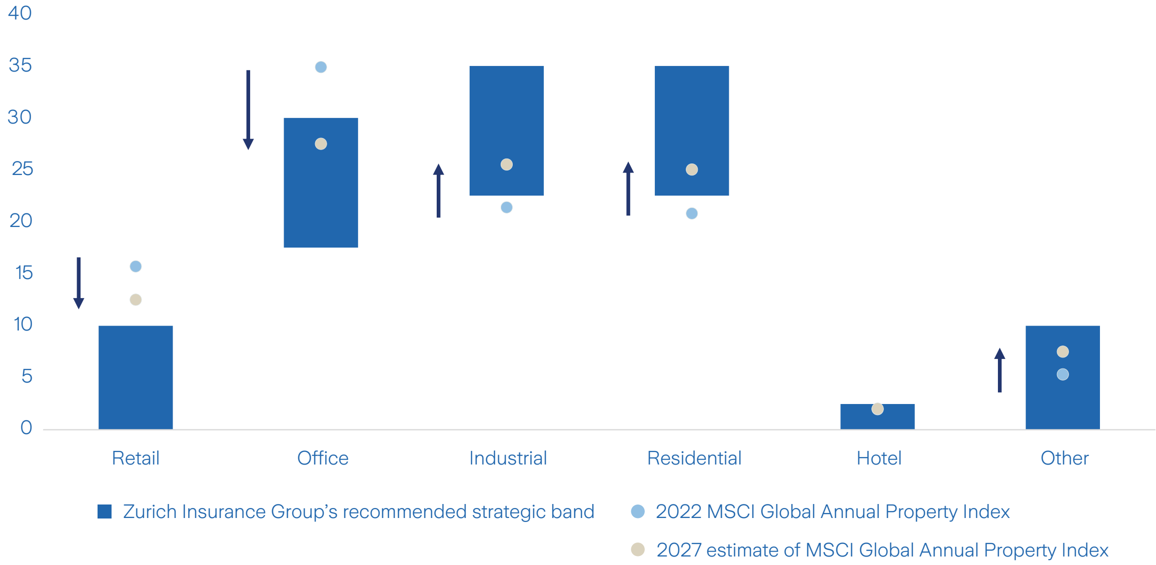
> It's important not to think about tomorrow's retail by referring to yesterday.

In devising our preferred investment strategies, we consider the sector afresh. While we are privileged in having no legacy retail positions weighing on our portfolio, we will remain cautious with regard to deploying new capital into the sector. We are comfortable maintaining an underweight position relative to established industry benchmarks. That said, we see the performance prospects that retail-oriented mixed-use can deliver. So with regards to our preferred investment theme for retail, we look to generate a diverse income profile by optimizing building use, ideally with a minority retail position.

H2 2023 Model Portfolio

Our preferred investment strategies can also be expressed in our unconstrained global real estate model portfolio. Using the 2022 MSCI Global Annual Property Index as a proxy for our investable universe, we estimate the expected evolution over the coming five years to contextualise the bandwidth we would like to operate in. Figure 19 highlights our recommendation to build an overweight position to “beds and sheds”, reduce office exposure and maintain a cautious approach toward retail.

Figure 19: Zurich Insurance’s proposed unconstrained global real estate model portfolio, sector %



Source: MSCI, Zurich Insurance

It also acknowledges the growth we foresee in other property types, such as data centres, self-storage and life sciences. The execution of the model portfolio will of course be influenced by local market circumstances.

Reasons for optimism

Throughout this Global Real Estate Mid-Year Outlook, we've focussed on the overlapping sector trends globally. And while we tend to see more similarities than differences, it is important to acknowledge local real estate conditions. And so we conclude by offering a few reasons to adopt a positive stance in the major regions that we operate as we enter the second half of the year.

North America

- The long term prognosis for cities is encouraging as they are centres of human interaction and innovation. Inevitably, there is a tactical element to real estate investing, however we remain long cities.
- The demise of offices, much like retail before it, in our view, is overstated. Be careful when hearing phrasing like "forever" and "permanent". Office markets will adjust and bounce back, including those where vacancy rates have recently skyrocketed and sentiment is most negative.
- As cities and office markets reinvent themselves in the face of well-documented structural headwinds, alternative real estate sectors offer a compelling diversification angle. The U.S. is a hotbed of innovation and non-traditional property types offer a route to access a secular growth story. The opportunity set is expanding rapidly.

Europe

- Europe is at the forefront of the ESG revolution. For the protagonists, there is scope to generate performance alpha in existing portfolios as well as to share best practices globally.
- The Swiss property market has proven remarkably resilient to many of the challenges highlighted in this report. The residential sector, in particular, is fundamentally healthier than much of Europe, with an affluent population compelled to a for-rent model as well as structurally constrained supply. We anticipate a stable return outlook across the Swiss property market and advocate at least a proportionate share of investment relative to its size.
- The U.K. is furthest along in asset repricing, which presents a compelling entry point in a global context. All of the preferred investment themes identified in this Mid-Year Outlook are at play in the market.

Asia Pacific

- The long term Asia growth story is irrefutable. A burgeoning middle class and young population will help power the global economy for years to come. As such, we anticipate that the region will comprise an increasingly greater share of real estate investment activity.
- Much of Asia Pacific lags behind on the ESG journey. There is a compelling early mover advantage in delivering assets with leading environmental sustainability credentials.
- From a capital markets perspective, more money is expected to flow into Australian superannuation funds due to legislative changes. As real estate makes up an important component of asset allocations, we see fund flows into both domestic and global markets increasing.

Latin America

- The region has a growing middle class that is looking for secure investment options that offer inflation hedging characteristics. Real estate in the region, with a prevalence of index-linked leases, presents an obvious choice.
- There is a lack of modern logistics stock to meet growing demand from ecommerce. Develop-to-core strategies are particularly interesting in many markets.
- The re-orientation of global supply chains and advent of near-shoring is expected to benefit Mexico, leading to greater flows of foreign direct investment, including the development of much needed modern real estate and infrastructure.

Throughout this House View, we've reflected on the many cross-currents at play in global markets.

Resilient economic growth has generally been supportive of real estate occupational fundamentals, which is helpful for the asset class as it contends with recessionary risks. But real estate is a big consumer of credit, and interest rate hikes are not fully reflected in valuations.

This has kept many investors on the side-lines and allocations under scrutiny. Structural change has been a powerful determinant of recent performance outcomes. Nowhere is this more true than the office sector, where demand is being reshaped by new ways of working and environmental obsolescence. But structural change also provides reason for optimism as new real estate sectors emerge or where targeted green cap-ex can be a catalyst for generating alpha.

It's a very different picture to 18 months ago. Given the cross-currents at play, real estate investors will have to work harder to stay standing.

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