AN OUTLOOK ON GLOBAL REAL ESTATE INVESTMENT: FINDING OPPORTUNITIES AFTER THE STORM

ALVAREZ & MARSAL
LEADERSHIP. ACTION. RESULTS.℠

CONTENTS

INTRODUCTION

Whilst the impact of rising costs and interest rates is still being felt throughout the economies of the world, real estate investors appear to be positioning themselves for better times ahead. The past two years saw the fastest surge in interest rates in 40 years, along with sluggish economic growth and dramatic shifts in global real estate dynamics.

This outlook emerged from Alvarez & Marsal (A&M)'s survey with 101 real estate fund managers around the world, who reported they are now more optimistic towards real estate investments in the next 12 to 18 months despite the challenging macroeconomic backdrop.

While the landscape for real estate investments remains complex, concerns about a severe global recession seem to be giving way to expectations of steadier conditions, with improved visibility on the end of interest-rate hikes boosting sentiment and likely facilitating transaction activity in 2024 and beyond.

According to the research, 80% of investors plan to invest significant amounts in the next 12 to 18 months, primarily across North America, Europe, U.K. and Asia. The focus is on hospitality and leisure, as well as a repositioning play for offices and retail. The latter two in particular have suffered from a shift in sentiment resulting from changes to their use, a trend that was accelerated by the pandemic. In line with the more positive outlook of the market, a majority of investors in the survey expect improvements both in the cost of capital and in investment returns.

The survey also found that investors are nearly unanimous in their views on sustainability, ethics and governance, with a whopping 97% saying that ESG forms an important part of their investment strategy. Energy efficient upgrades, smart building technology and green building certifications are the key focus areas for ESG-oriented investors.

In this report, we explore these and other key findings from the survey, providing insights on where real estate investment is headed after a period of heightened macroeconomic uncertainty and major secular transformations.

ABOUT THE SURVEY

This report is based on data from online surveys conducted by Alvarez & Marsal among **101 real estate fund managers and investment professionals from 15 countries in Europe, North America and Asia.** Funds in the survey, which include institutional capital, private capital firms and sovereign wealth funds, have assets under management (AUM) of **$62.5 billion**, on average. The survey was conducted in November 2023 and comprised a questionnaire of 19 questions.

101 Real estate fund managers and investment professionals

15 Countries

19 Questions

EXECUTIVE SUMMARY

1 Investor sentiment in real estate investment is improving

2 Hospitality is the most preferred asset allocation choice, with the tide turning for office space

3 Investments in developed countries favoured over emerging markets

4 ESG is increasingly important in real estate strategies

BY THE NUMBERS

56%

of investors are optimistic about real estate investing in U.K. and Europe in the next 12-18 months

86%

of investors expect to invest in hospitality & leisure properties

71%

of investors plan to invest in offices

67%

of investors look to invest in retail

97%

of investors say ESG forms an important part of real estate strategy

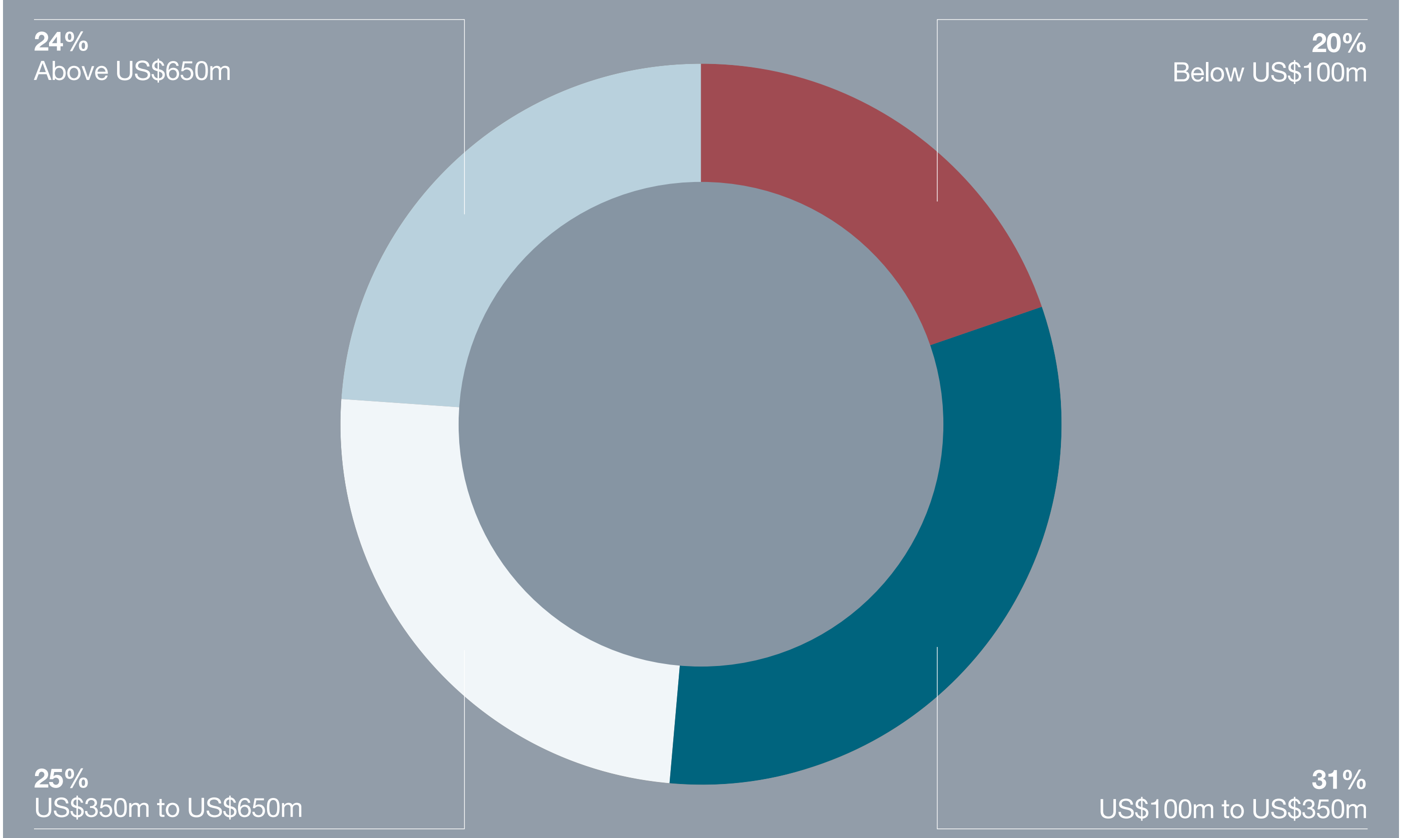
KEY FINDINGS FROM THE SURVEY

1 Investor sentiment is improving

The results show that 80% of the investors are planning to invest $100 million or more in the next 12 to 18 months across multiple regions, with the U.K. and Europe being targeted by half of the investors surveyed (50%), followed by North America (45%), Asia (34%) and the Middle East (1%). More than half of the investors surveyed (56%) have an optimistic outlook towards the U.K. and European real estate investment market over the next 12 to 18 months. That indicates that sentiment is turning after a rough couple of years for the sector, even though concerns linger about higher financing costs, subdued property prices and longer-term changes in the use of properties.

Commercial real estate, in particular, has been impacted as an investment class since major central banks began to increase interest rates from early 2022 onwards to counter rising inflation. The sudden shift away from the previous decade of low rates prompted investors to seek higher yields, which in turn reduced demand and added to downward pressure on property prices to realign yields. Property owners with highly leveraged assets were particularly affected as the interest rate-hiking cycle began. Now, after a bruising couple of years in which soaring interest rates sparked worries about the viability of returns in the real estate space, investors seem to be positioning themselves for better times. Indeed, 2024 may prove to be a pivotal year for real estate as growing consensus that interest rates have peaked indicates that the worst of the rates uncertainty may be behind us.

What is your anticipated real estate investment volume in the next 12 to 18 months?



KEY FINDINGS FROM THE SURVEY

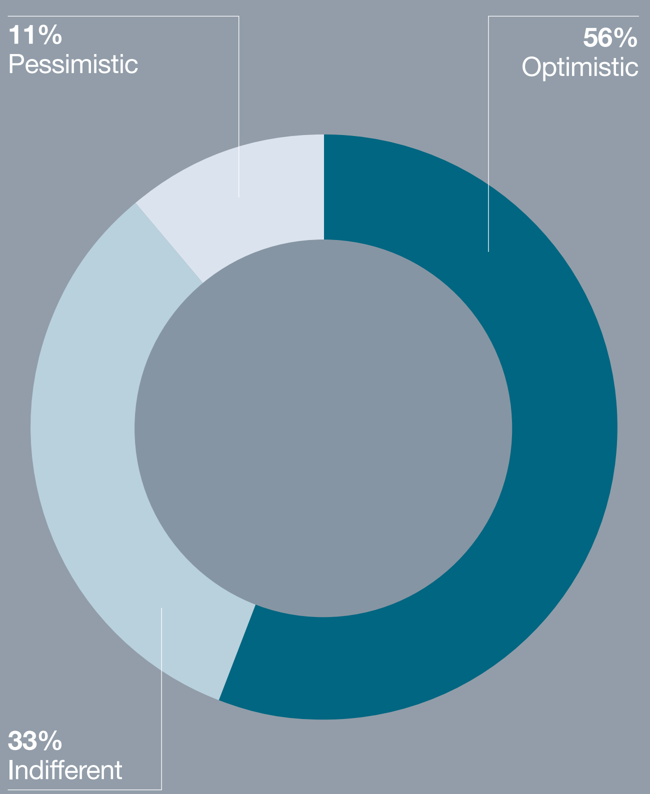
At present, the real estate market still faces headwinds from tightened credit conditions overall, while the economic backdrop remains weak. However, investor optimism over the next 12-18 months indicates they expect conditions to start improving after hitting a trough in the coming months, particularly as central banks begin lowering rates.

Our recent conversations with fund managers also reflect that although there is still some nervousness about the cost of debt compared with returns achievable on real estate, investors have significant amounts of cash available to invest, particularly given the very low transaction volume seen in the past 12-18 months. That means investors are entering 2024 with improved visibility on the macroeconomic front, with a certain amount of pent-up demand waiting to be unleashed.

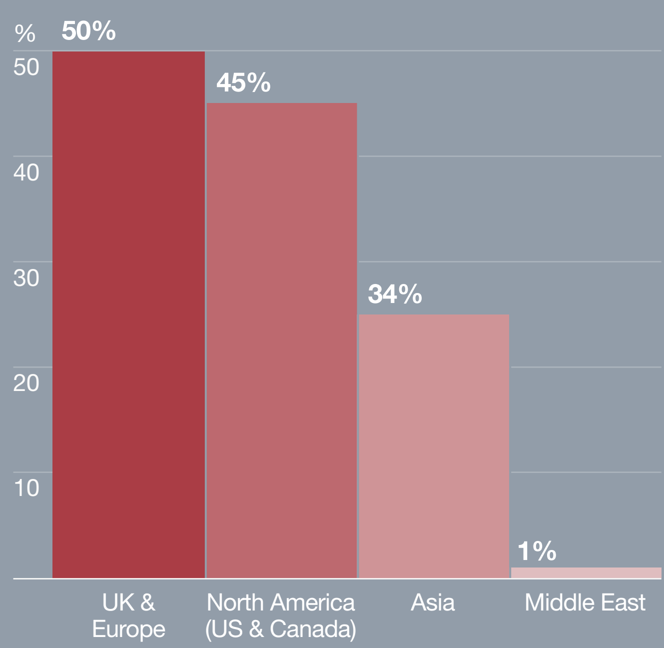
Looking ahead, respondents in our survey named cost of capital and investment returns as the areas they are most optimistic about. Some 62% of investors expect cost of capital to improve in the next 12 to 18 months, with 59% expecting investment returns to improve as a result. Looking out over the next 12-18 months, any downward movement in the cost of debt could turn the scales back in favour of real estate versus currently higher-yielding assets like government bonds.

Some investors may be willing to take the risk in the current environment, where there is less competition, while others may wait on the sidelines for signs of capital growth, even if it means lower income for a duration of time. Coming out of a prolonged period of uncertainty, investors are likely to be discerning in the types of properties they are willing to back. In the next section, we will look at their top preferences.

What is your sentiment towards the UK & European real estate investment market over the next 12 to 18 months?



Which regions do you typically / intend to invest in?



KEY FINDINGS FROM THE SURVEY

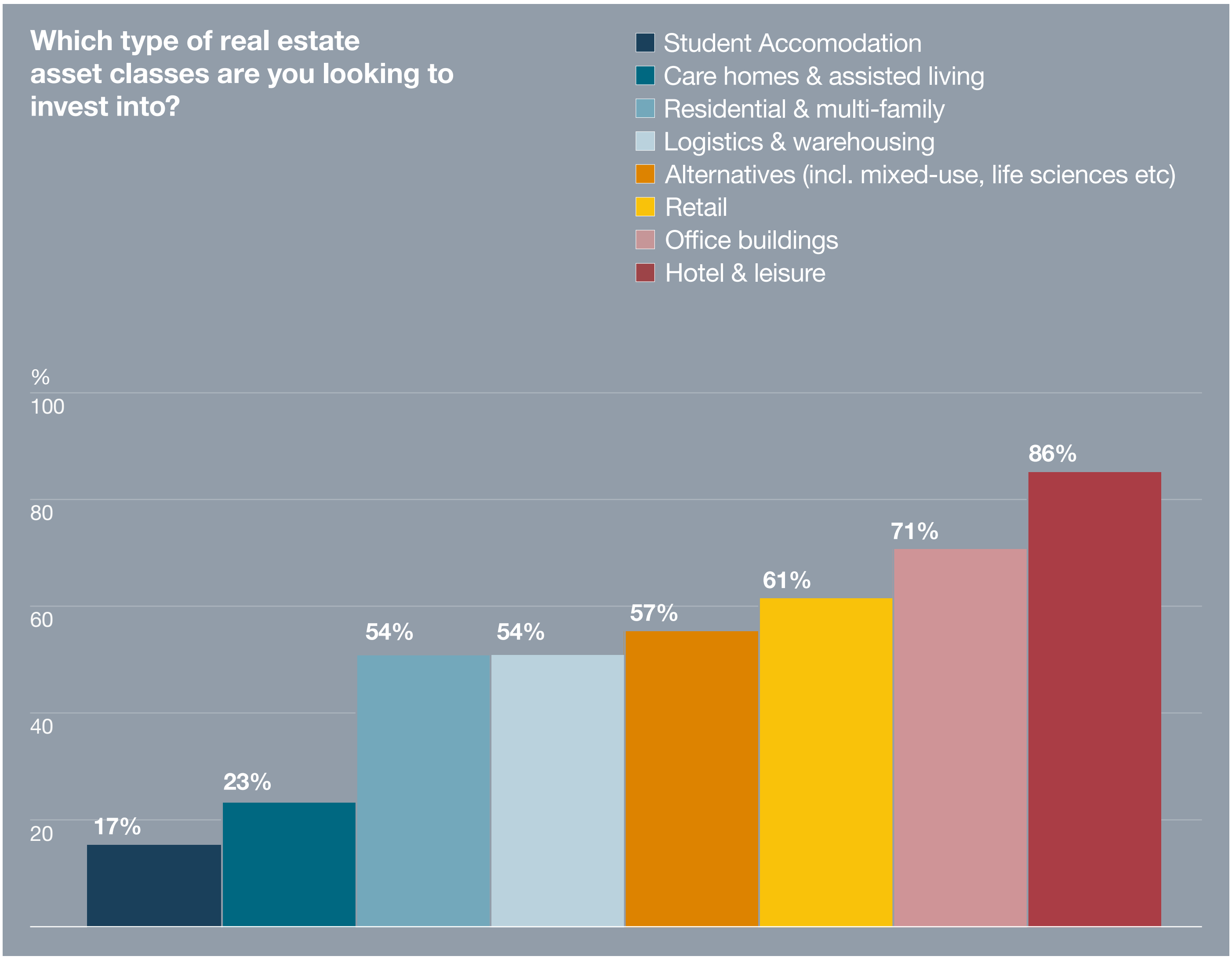
2 Work, travel, play and shop: Mantras for investment

In the next 12-18 months, investors are keenest to back ventures that cater to travel and leisure, work and shopping. Our survey shows that the top three sectors for investors within real estate in the next 12-18 months are hospitality and leisure (86%), offices (71%) and retail (67%).

Hospitality and leisure has been a hot sector in the past couple of years as economic reopenings following Covid-19 lockdowns boosted demand for tourism. worldwide. While the “revenge travel” trend seen in the immediate aftermath of the pandemic may be subsiding, we are witnessing a more sustained shift towards people prioritising holidays over other items of discretionary spending, as A&M’s recent hospitality survey revealed.

Moreover, travel and leisure is a growth sector in markets such as the Middle East and East Asia. For example, four out of five respondents from the Middle East in our recent hospitality survey said they are spending more on travel. Hotel brands are keen to retain existing customers by offering different experiences at different price-points, which is increasing demand for real estate investments.

Longer term, there is also an expectation from some quarters that changes to work patterns and the increased deployment of artificial intelligence may increase productivity, akin to the industrial revolution, and leave consumers with more time for travel and tourism pursuits.



KEY FINDINGS FROM THE SURVEY

Office space, on the other hand, has been one of the worst hit by post-pandemic shifts in behaviour. With many employees switching permanently to hybrid or remote working arrangements, office property prices have fallen significantly.

With office occupancy still well below pre-pandemic levels in many major cities, and lower-risk assets such as government bonds yielding high returns, it may take a further drop in prices before the tide turns for commercial real estate. However, high-quality office space in prime locations is still commanding interest as employers ramp up efforts to woo workers back to the workplace.

The office segment may offer choice opportunities for contrarian investors before the market reawakens, as asset valuations remains depressed and credit concerns persist. Some landlords are also exploring ways to convert empty offices into spaces for other uses, or adapt them for flexible working practices. Investors will likely focus on properties that are:

- **Centrally located, making it attractive and convenient for employees to commute to**
- **Possess attractive office layouts that encourage collaboration and accommodate; different styles of working**
- **Energy efficient, as this will have a positive impact both in terms of managing the environmental footprint as well as reducing the cost of running the office.**

KEY FINDINGS FROM THE SURVEY

Investors are also keen to invest in real estate in the retail sector, which is showing signs of improving sentiment after being beaten down in recent years.

After years of decline in the sector, which was accelerated by the pandemic, there is renewed demand for physical premises. Similar to what is being seen in the hospitality and leisure sector, that demand is focusing on physical experiences, with technology playing an ever-increasing part.

Technology, and in particular AI, will also play a key part in optimising supply chains. The pandemic, followed by global tensions, have put these in the spotlight. Going forward there will be a continuing focus on de-risking supply chains, and more local storage undoubtedly has a part to play in this.

Retail is also appearing attractive to investors on a relative basis, as the investment climate in other sectors have become more challenging.

In the U.S., consumer sentiment has improved on a year-on-year basis for the past several months. While consumer confidence in Europe is weaker, there are signs that retail property investments are weathering economic challenges better than other areas of commercial real estate.

According to research from BNP Paribas, retail property investments in Europe are benefiting from a shift within different categories of commercial real estate in the past 12 months, with the asset class suffering a less pronounced decline than others.

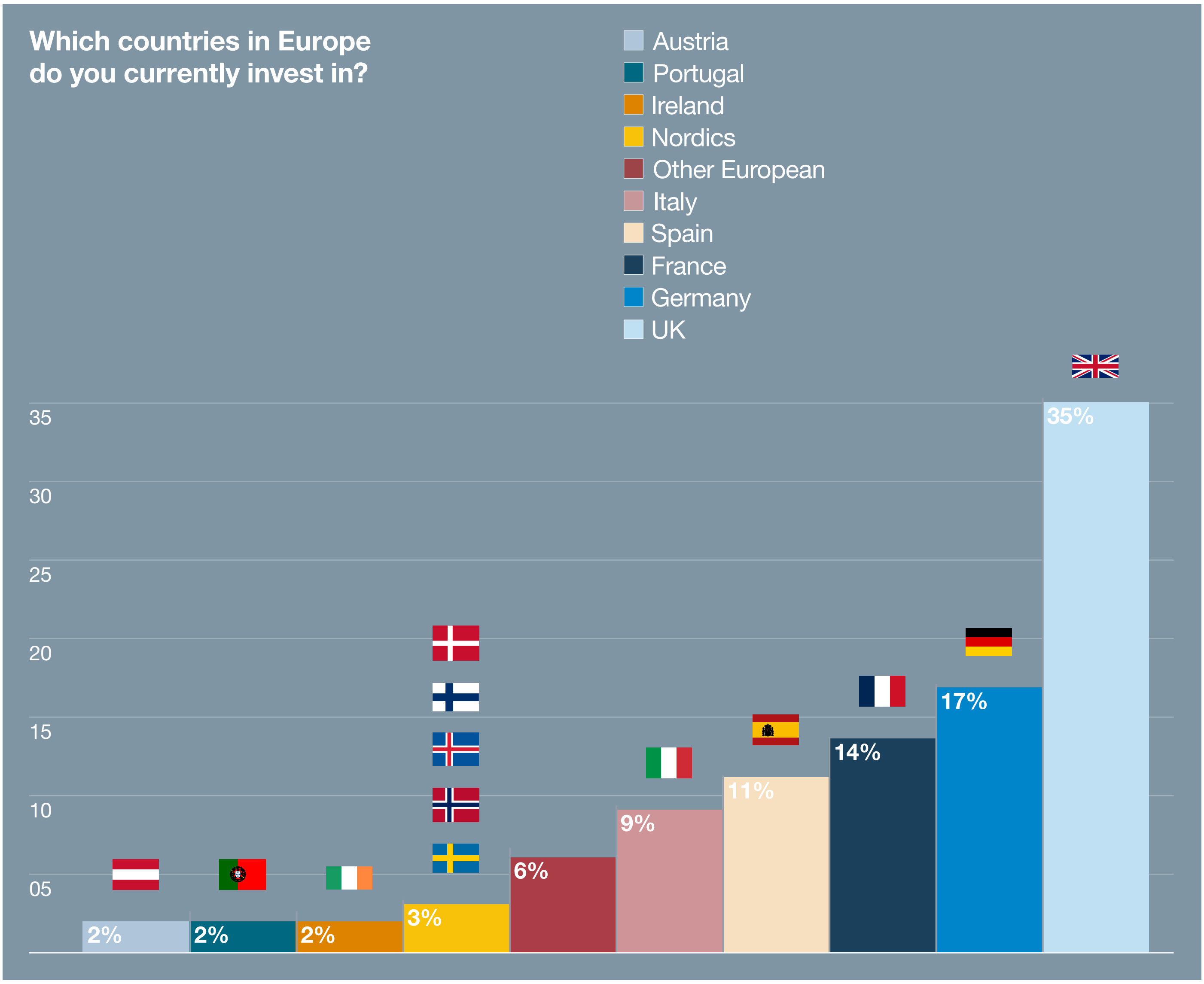
KEY FINDINGS FROM THE SURVEY

3 Stable wins favoured over emerging markets

Region-wise, 50% of the respondents in the poll said they were investing in the U.K. and Europe, followed closely by North America (45%). About a third said they were investing in Asia.

Investor preference for developed markets such as Europe, U.K., U.S. and Canada reflect a shift towards risk-adjusted or lower-risk investments with stable returns. More than 60% of those investing in the U.K. and Western Europe said they are mostly planning to increase their investments in the next 12 to 18 months.

Within the European continent, the U.K. attracted investments from the biggest chunk of the respondents, at 35%. About 17% of investors invested in Germany, 14% in France and 11% in Spain.



4 ESG is a key part of real estate strategies

Environmental, social and governance factors matter more than ever to investors, with 97% of those surveyed saying that ESG is a very important or somewhat important part of their investment strategies.

Whether it is residential or commercial real estate, occupiers are increasingly demanding that properties possess strong ESG credentials. Net zero goals and green initiatives by regulators in different countries also make it imperative that properties meet certain standards when it comes to energy efficiency in the coming years.

For example, investors are paying close attention to updates on deadlines for U.K. residential landlords to meet certain requirements related to their properties' Energy Performance Certificate ratings. While a previous deadline of 2025 was recently scrapped in England and Wales, Scotland has retained the requirement, but pushed forward the deadline to 2028.

In our survey, the most popular ESG initiatives that investors consider are energy efficient upgrades, smart building technologies and green building certifications.

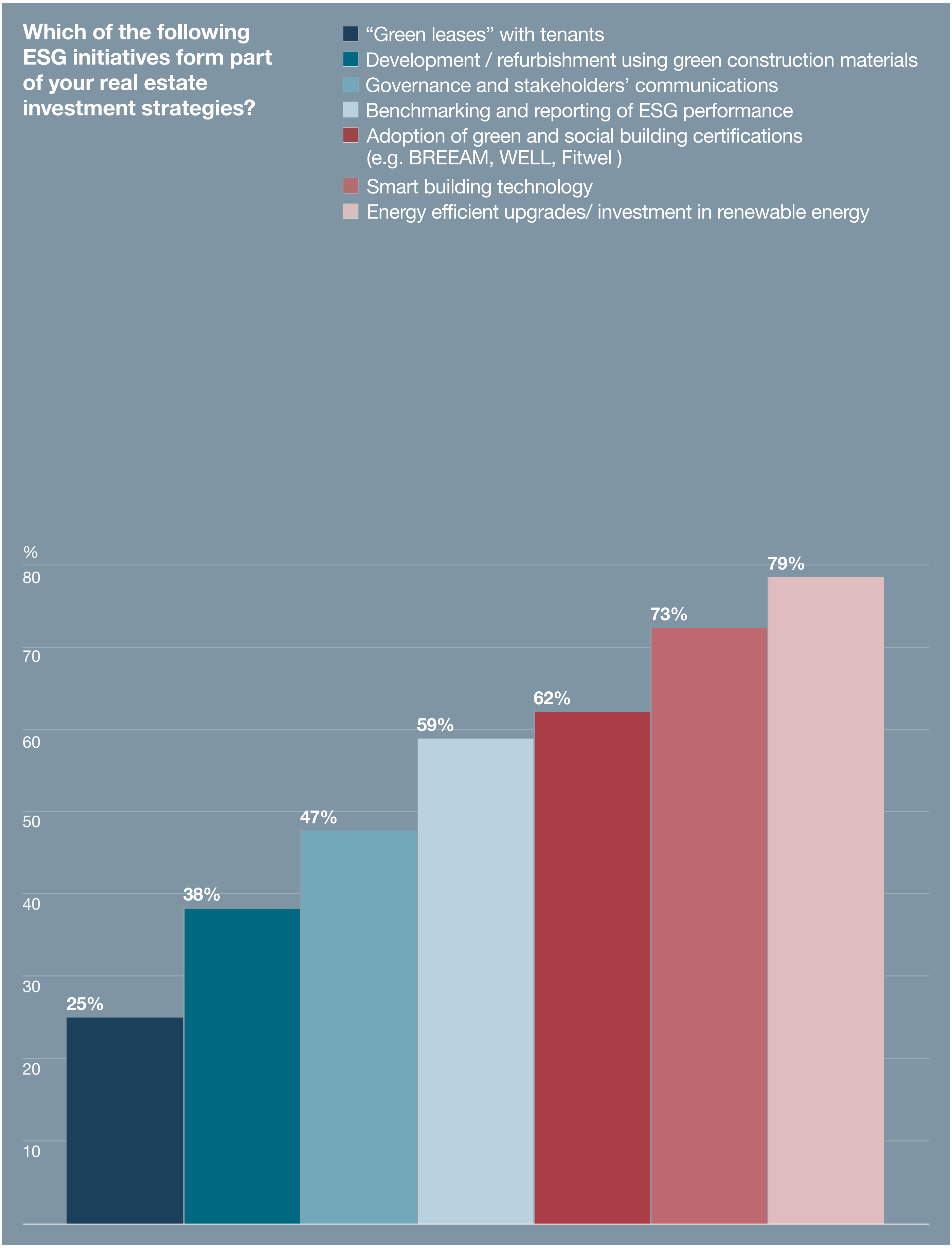
Moves to improve energy efficiency could include upgrading property insulation, converting heating mechanisms from gas (fossil fuel) to electricity, switching to windows with better insulation and updating older plants and machinery.

Properties could also deploy a network of smart systems and automated processes that work together and have the ability to share data across separate systems for optimal energy consumption. This may include smart sensors, remote monitoring software and "Internet of Things" technology.

Investors are also increasingly looking to back properties that already meet certain sustainability requirements, which can be assessed by their green building certifications. Such certifications may differ in requirements based on the type of building, such as homes or commercial buildings. They incentivise large-scale adoption of green initiatives when it comes to new projects.

> In our survey, the most popular ESG initiatives that investors consider are energy efficient upgrades, smart building technologies and green building certifications.

KEY FINDINGS FROM THE SURVEY



CONCLUSION

In conclusion, investors are emerging from a prolonged period of uncertainty, with a certain amount of pent-up cash waiting to be deployed. For the next 12-18 months, investors show a preference for stable incomes in well-established markets rather than riskier bets. And lastly, sustainability is no longer a footnote when it comes to investment strategies, and energy efficiency is of growing importance.

The macroeconomic backdrop remains challenging, but at the same time, growing consensus that interest rates have peaked is giving investors something to look forward to as the impact of higher rates works its way through the market. The balancing act between risk and reward may make investors particularly cautious and discerning in the types of properties and markets they invest in.

KERSTEN MULLER
MANAGING DIRECTOR

+44 778 579 7902
kmuller@alvarezandmarsal.com

MELISSA NG
SENIOR DIRECTOR

+44 788 129 2132
mng@alvarezandmarsal.com

PRASAM PATEL
MANAGING DIRECTOR

+44 777 672 2033
prasam.patel@alvarezandmarsal.com

ABOUT ALVAREZ & MARSAL

Companies, investors and government entities around the world turn to Alvarez & Marsal (A&M) for leadership, action and results. Privately held since its founding in 1983, A&M is a leading global professional services firm that provides advisory, business performance improvement and turnaround management services. When conventional approaches are not enough to create transformation and drive change, clients seek our deep expertise and ability to deliver practical solutions to their unique problems.

With over 8,500 people providing services across six continents, we deliver tangible results for corporates, boards, private equity firms, law firms and government agencies facing complex challenges. Our senior leaders, and their teams, leverage A&M's restructuring heritage to help companies act decisively, catapult growth and accelerate results. We are experienced operators, world-class consultants, former regulators and industry authorities with a shared commitment to telling clients what's really needed for turning change into a strategic business asset, managing risk and unlocking value at every stage of growth.

To learn more, visit: **AlvarezandMarsal.com**

Follow A&M on:

ALVAREZ & MARSAL
LEADERSHIP. **ACTION. RESULTS.**℠