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Q1 2025 Property Market Outlook

29 January 2025

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FTSE ERPA/NAREIT Index Returns as of 12/31/24 (USD)						
	QTD	1 Year	2023	2022	3 Year	5 Year
Global	-9.6%	1.6%	9.8%	-24.0%	-5.2%	-1.0%
Europe	-17.8%	-8.7%	21.2%	-40.0%	-12.9%	-6.5%
North America	-6.7%	7.4%	13.0%	-25.0%	-3.0%	3.3%
Asia	-13.4%	-7.5%	-0.6%	-11.0%	-6.4%	-4.9%
US						
Industrial	-16.7%	-17.9%	19.1%	-29.0%	-11.6%	4.9%
Retail	-3.5%	14.0%	10.5%	-14.0%	2.8%	4.4%
Residential	-4.2%	12.8%	7.7%	-32.0%	-6.0%	3.2%
Office	0.1%	25.9%	6.4%	-35.0%	-4.3%	-1.9%
Lodgings/resorts	3.1%	-2.0%	25.2%	-15.0%	1.3%	-1.4%
Europe						
Industrial	-23.8%	-21.4%	24.7%	-49.0%	-20.8%	-2.8%
Retail	-14.4%	5.0%	25.8%	-15.0%	3.9%	-8.3%
Residential	-16.9%	-4.6%	29.3%	-52.0%	-15.8%	-6.9%
Office	-22.3%	-19.8%	17.1%	-31.0%	-13.4%	-9.1%
Lodgings/resorts	-12.9%	19.7%	36.1%	-31.0%	4.1%	-4.3%
Asia						
Industrial	-14.8%	-18.4%	5.1%	-28.0%	-17.8%	-5.5%
Retail	-15.4%	-1.0%	2.9%	-8.0%	-2.1%	-2.6%
Residential	-18.6%	-21.0%	-4.6%	-19.0%	-15.0%	-8.1%
Office	-8.8%	-5.4%	-5.6%	-19.0%	-10.1%	-7.3%
Lodgings/resorts	-6.0%	-5.6%	-3.4%	-15.0%	1.6%	-7.4%

Source: Bloomberg

REITS Pricing Indication

- **US has been the best performing market**
  - The 5-year returns are mostly positive led by industrial retail and residential
  - US industrial was the worst performing but much of it was reflection of slowing (but still positive) fundamentals
- **Europe and Asia both weak across most sectors**
  - In Europe most sectors gave back their 2023 gains, but hotels continue to be strong
  - Asia is weak across all sectors
- **2022 returns highlight impact of rising rates**
  - The 3-year return incorporates the rate increases and the markets acceptance of higher for longer

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GREFI Returns 3Q24

	1 year	3 year	5 year
GREFIAll Funds	**-4.38%**	**0.02%**	**2.58%**
US	-7.52%	-0.08%	3.24%
Europe	-0.44%	-0.04%	2.08%
Asia Pacific	-4.48%	0.75%	2.51%
Non Core	**1 year**	**3 year**	**5 year**
Total	**-5.55%**	**1.52%**	**4.97%**
US	-6.30%	2.46%	6.84%
Europe	-8.36%	-2.63%	-0.57%
Asia Pacific	1.57%	1.93%	4.68%
Core	**1 year**	**3 year**	**5 year**
Total	**-4.10%**	**-0.29%**	**2.12%**
US	-8.04%	-1.04%	2.05%
Europe	0.17%	0.15%	2.29%
Asia Pacific	-5.71%	0.46%	1.98%

Source: Inrev

Private Market Returns

- **US has been the best performing market over 5-years**
  - US underperformed on the 1-year basis which could reflect funds accepting a difficult capital markets
  - Transaction volumes remain low difficult for funds to get true market values

Non-core strategies continue to outperform core

  - Non-core contain the alternative sectors that have outperformed and likely to contain less office
  - Non-core typically are repositioning or new developments that have faster growing NOI than core preserving value
- **3-Year incorporate rate increases**
  - Comparing 1, 3, and 5 year returns shows the impact of Covid (5 year), rate increases (3 year) and acceptance of higher for longer (1 year)

Property – Factors Driving Outlook Summary

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Factors	Comments	Historical Range
Valuations	Valuations appear to be stabilizing albeit likely at lower levels Transaction market is remains slow and may not reflect recapitalization that may not be recorded publically	Bearish — Neutral — Bullish (1Q: Neutral; 4Q: Neutral)
Fundamentals	NOI growth remains largely positive Lack of new supply will shore up fundamentals Office leasing improving but new vs. old gap large	Bearish — Neutral — Bullish (1Q: Neutral; 4Q: Neutral)
Technical	Dry powder may not be sufficient to provide a floor Low volumes making price discovery difficult Lack of ROC barrier to new commitments How much post-GFC new capital stays/returns	Bearish — Neutral — Bullish (1Q: between Bearish and Neutral; 4Q: between Bearish and Neutral)
Macro Impact	NOI growth slowing from the peak levels in all sectors Concern of impact of rising interest rates on tenants Political uncertianty settled policies may provide boost especially increased on-shoring	Bearish — Neutral — Bullish (1Q: Neutral; 4Q: Neutral)
9-12 month view		Bearish — Neutral — Bullish (1Q: Neutral; 4Q: Neutral)

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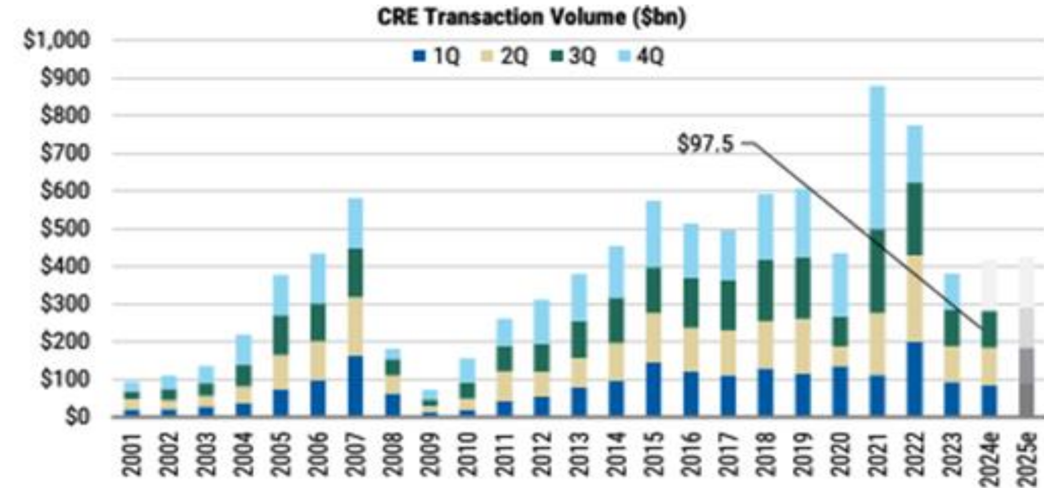
2025 Outlook

Summary – 2025
Higher For Longer

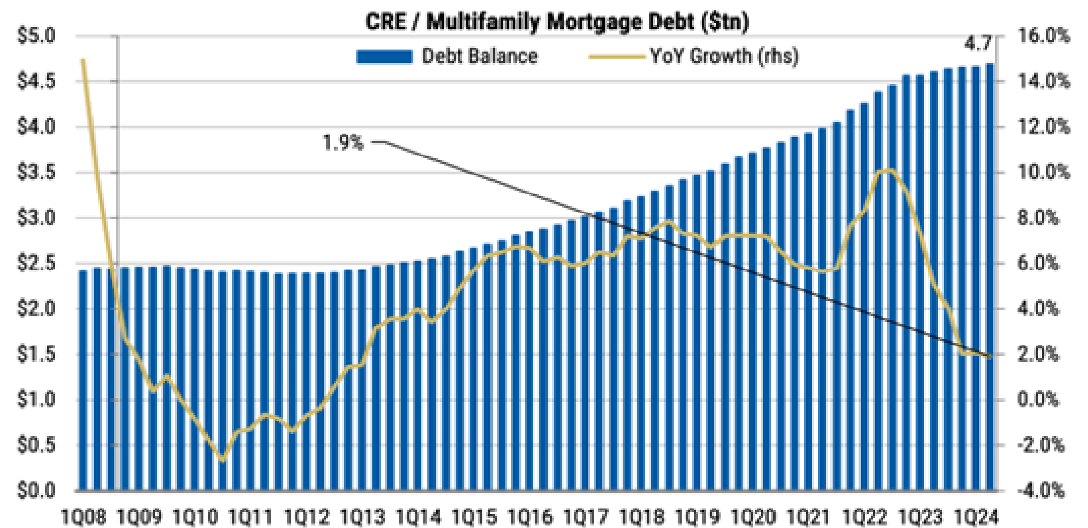
- 2025 Industry is accepting higher for longer
  – Lenders and owners will need to act
- Debt maturities remain the largest issue
  – Higher for longer will force action
  – Re-equitizing assets is taking place and may not show up in transactions
- Higher rates stopping new development
  – Demand for modern space is driving rent growth in modern product
  – Many troubled loan were value-add assets and should benefit
- Liquidity remains a challenge
  – Lack of redemptions slows new commitments
  – How much post-GFC capital will stay
- Offices
  – New developments and renovated buildings dominate absorption
  – Expect continue distress as debt levels eclipse asset value
- Continued growth in alternatives
  – Data centers, senior living, student housing, cold storage
- Continued on-shoring
  – Pressure on industrial stock and building trades
  – Revitalize the rust belt cities?
- Data centers
  – Insatiable demand meets Deep Seek

Transaction Volume

- Transaction volumes still well below peak
  - Makes real price discovery difficult
  - Recapitalizations could mask the true number
- Maturity wall still an issue
  - New reality of higher rates may force transactions
  - Bank largest holders of RE debt does not seem to be pressure to act
  - Lower loan-to-value loans and healthy fundamentals keep operating defaults low
  - Still refinancing in higher environment will create maturity defaults unless extended
  - Do not see current administration forcing banks to address their issues



Source: RCA, Morgan Stanley Research



Source: MBA, Morgan Stanley Research

As of Dec 2024.

Property Fundamentals

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- Operating fundamentals still healthy
  - NOI growth strong except for office but even there strong rent growth in modern office assets
  - Higher rates keep new supply and vacancy rates low and upward pressure on rents
  - Have not seen any mention on the impact of higher insurance rates but could start filtering through
- Cap Rates
  - Many markets still below GFC peaks
  - Spread to 10-Year at record tightness
  - Could continue to widen especially if 10-year increases

Exhibit 83: Comparison of Global Cap Rates

		2008 - 2022		3Q24 vs.		Date	
	3Q24	Max	Min	Max	Min	Max	Min
Madrid	6.8%	6.9%	3.9%	-0.1%	2.9%	3Q14	2Q19
London	6.1%	7.0%	4.2%	-0.9%	1.9%	3Q09	4Q22
Chicago	6.1%	7.8%	5.2%	-1.7%	0.9%	3Q09	1Q21
NYC	5.8%	6.6%	4.0%	-0.8%	1.9%	3Q09	1Q18
Paris	5.7%	6.7%	4.2%	-1.1%	1.4%	4Q10	1Q22
Dallas	5.6%	7.6%	4.5%	-2.0%	1.1%	4Q09	3Q22
LA	5.6%	7.2%	4.5%	-1.6%	1.1%	4Q09	2Q22
Sydney	5.2%	8.7%	3.9%	-3.5%	1.3%	1Q13	4Q22
Seoul	4.0%	6.8%	3.2%	-2.8%	0.9%	3Q09	1Q23
Tokyo	3.8%	5.7%	3.6%	-1.9%	0.2%	3Q12	4Q21
Hong Kong	3.1%	4.5%	2.4%	-1.4%	0.7%	1Q08	1Q19

Source: Real Capital Analytics, Morgan Stanley Research

Real Estate Fundamentals

	Totals	Office	Industrial	Apartments	Retail
Transactions					
3Q24 $B	$97.5	$12.8	$23.4	$35.8	$11.7
% of Sales		13%	24%	37%	12%
Y/Y Volume Change	-19.0%	13.0%	-2.0%	9.0%	-27.0%
Prices					
Y/Y Price Change 3Q24	-1.4%	-8.0%	6.7%	-6.3%	-1.5%
MS Est % of Peak	-15.9%	24.7%	11.6%	19.5%	-9.4%
Actual Peak to Trough	-12.5%	-23.0%	-2.0%	19.9%	-9.6%
Distressed Sales					
% of Distress Sales		56%	2%	16%	19%
Distress as % Total Sales					
3Q23	2.2%				
1Q24	3.8%				
Vacancy (NCREIF)	6.3%	14.6%	3.1%	6.3%	7.2%
NOI Growth					
Y/Y 3Q34	4.7%	-4.3%	13.4%	5.2%	4.0%
Peak 4Q21	12.4%				
Trough 4Q20	-8.0%				

Source: Morgan Stanley

Debt Markets are Recovering

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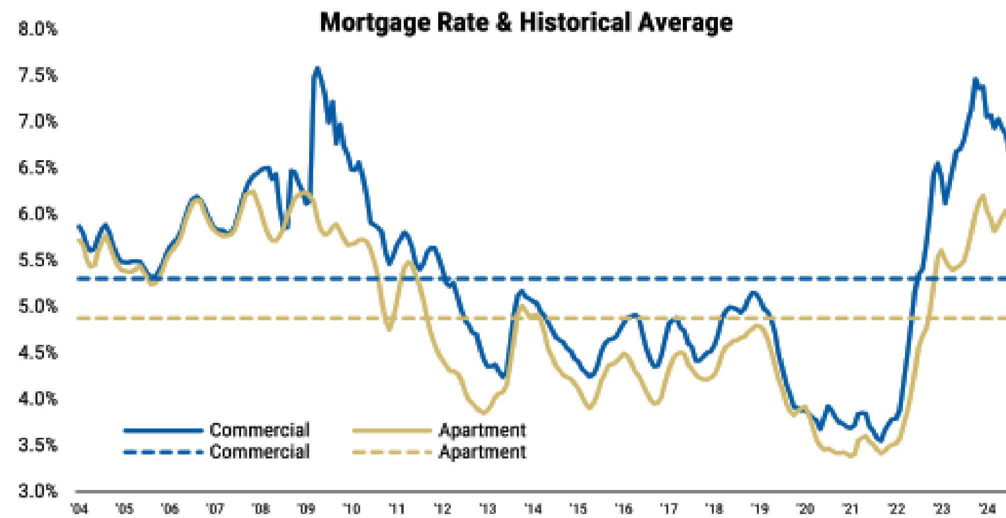
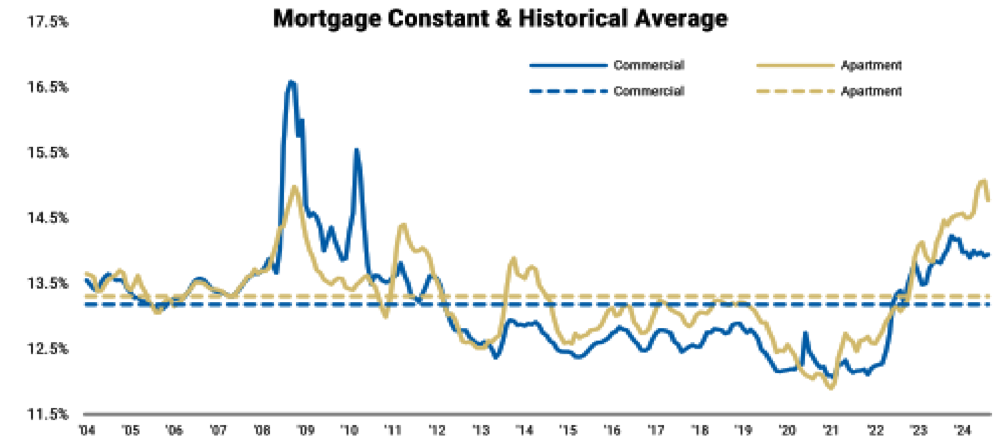
- Originations increased 59% Y/Y in 3Q24 indicating a thawing in the capital markets
- Debt for office still very difficult and for only top assets
- CMBS taking market share at the expense of banks like after the RTC
- Mortgage rates down but mortgage constant are higher and LTV still well below historical levels

Exhibit 87: Mortgage Rate & Historical Average



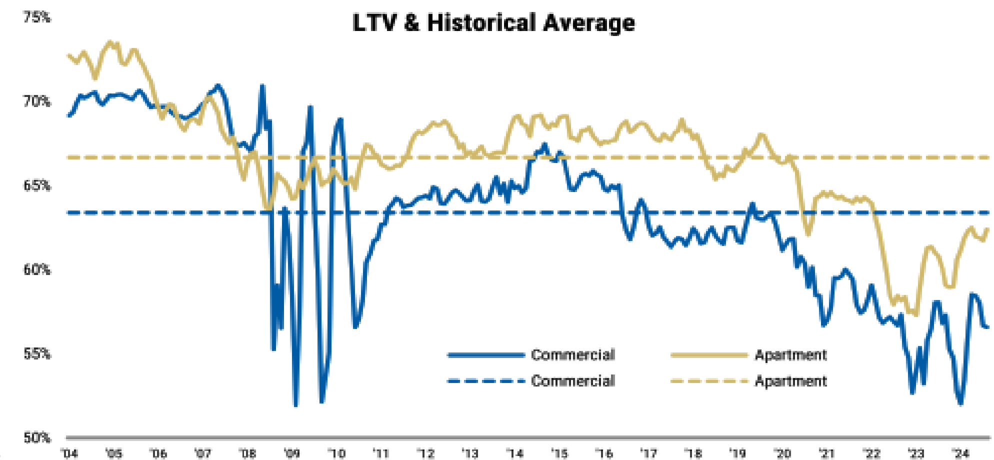
Source: Real Capital Analytics, Morgan Stanley Research

Exhibit 91: Mortgage Constant & Historical Average



Source: Real Capital Analytics, Morgan Stanley Research

Exhibit 88: LTV & Historical Average



Source: Real Capital Analytics, Morgan Stanley Research

Real Estate Liquidity – Need Strong Capital Flows for Fund Exits

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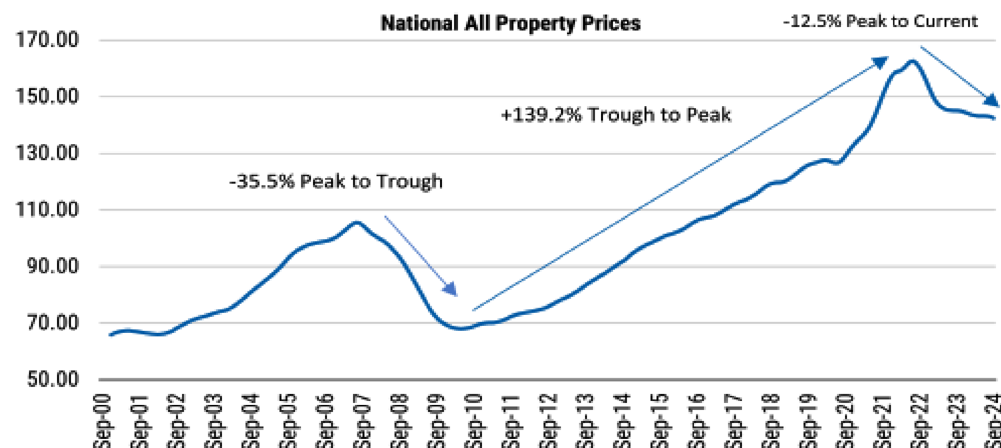
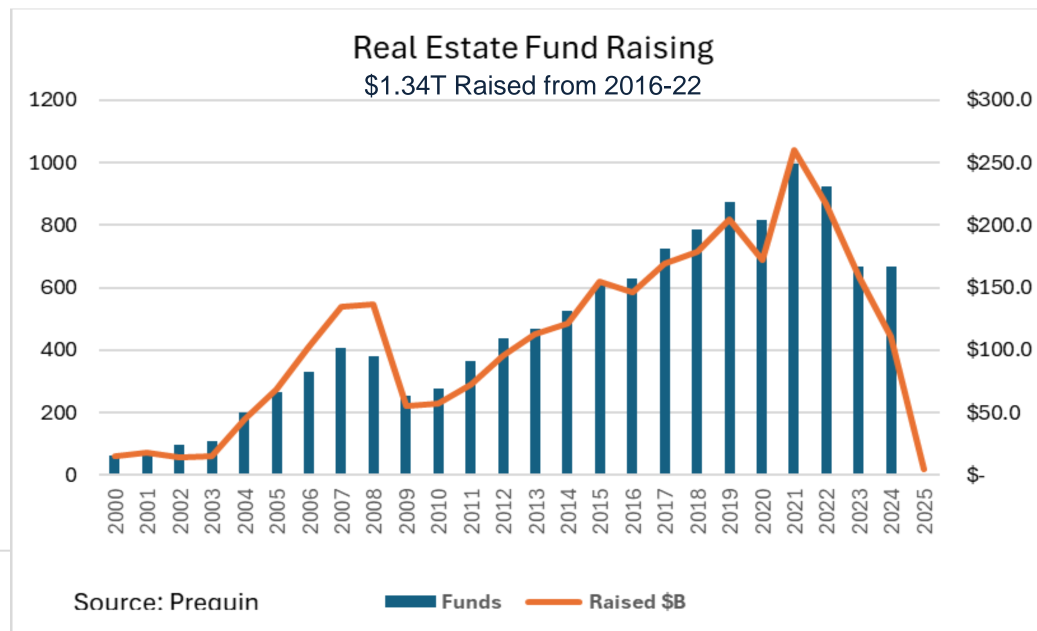
- $2.1T was raised for real estate from 2009-22 in over 8,600 vehicles
- Vintages impacted by the rise in rates is ~2016-22 are 5,570 funds that raised $1.3T in equity
- Most funds are from managers with multiple vintages most of which will under perform their projected returns
- As experienced many managers will hold on to assets until the maximum of the fund to wait for improved performance and to maintain fee streams
- Many of the 3,600 funds raised from 2019-22 will be most impacted as they paid pre-pandemic pricing, had their business plans put on hold, faced rising interest rates and likely borrowed short-term
- Uncertain how much of the 2009-22 capital is TINA capital and will not return but will be a large part of any recovery

Exhibit 36: National CRE Property Prices (All Property Sectors)



Source: Real Capital Analytics, Morgan Stanley Research



Distress is Building But Still Below Historical

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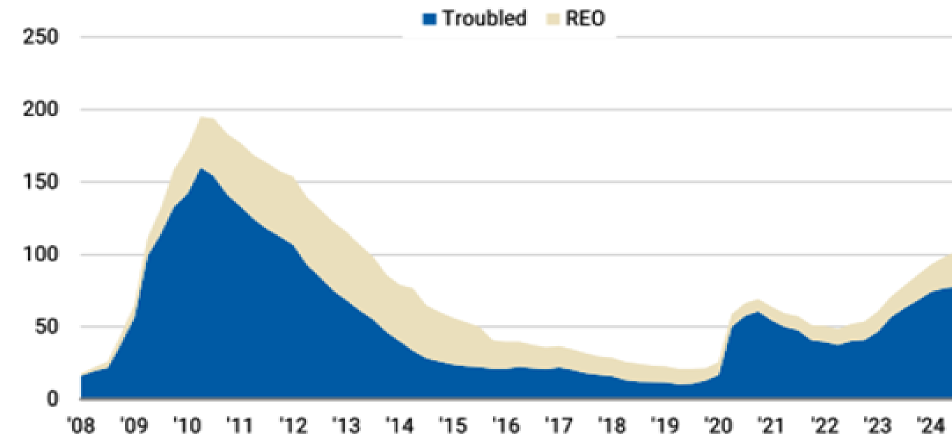
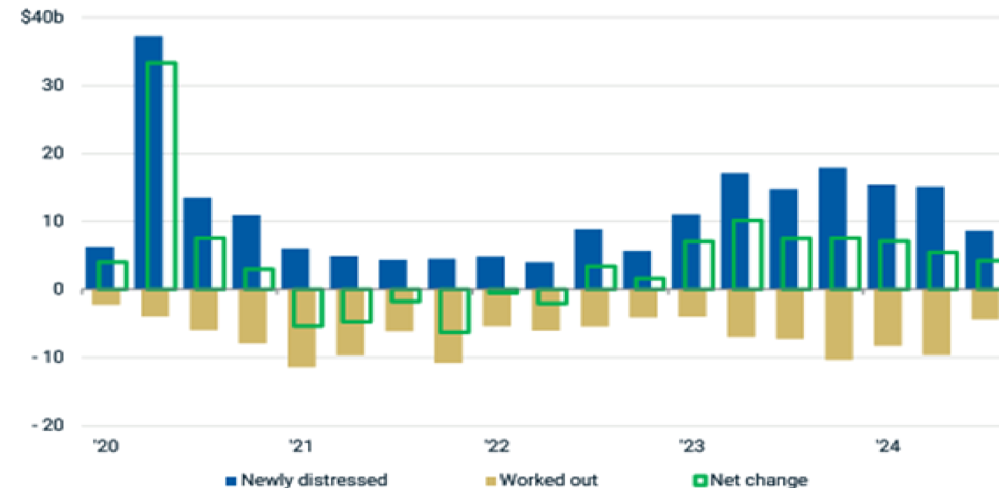
- Distress is building but still not near expectation
  - GFC distress did not materialize until 3-4 years after
  - Operational distress masked by low interest rates
  - Most distress will be office where there are weak fundamentals and tight capital markets
- Unsure on level of distress – at least published
  - Low LTVs and strong operating fundamentals allow borrowers to remain current on debt service
- Distress could be masked by recapitalization
  - RE PE investors all are making mezzanine or preferred equity investments to bridge the capital stack
  - Unsure how lenders are recording this or if they are?

Exhibit 70: Cumulative Distress through 3Q24



Source: Real Capital Analytics, Morgan Stanley Research

Exhibit 69: Additions and Reductions to Distress ($b)



Source: Real Capital Analytics, Morgan Stanley Research

As of Dec 2024.

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Summary

- 2025 will be more challenging
  - Rates staying higher
  - Debt maturities getting closer
- Fundamentals are expected to remain ok but could be impacted if there is recession
  - Will deleveraging of the larger economy impact space use
  - Return to work will help office and urban retail
- Investment theme will be distress
  - Do not think it will be large portfolio sales
  - The dry-power floor may fall out – need to deal with portfolio issues and not enough for loan re-equitization

5 Factors Driving Outlook for Property

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- **Macro Environment/Trends**
  - E-commerce growth accelerated driving logistics and hammering retail
  - Aging population's housing and medical needs pushing senior housing and life sciences/healthcare
  - Affordable housing needs highlighted
  - Urbanization – WFH ending should benefits cities
  - US Student Housing – Cost/Benefit ?
  - Data Centers – impact unknown on space use
- **Valuations** – Expect decline to slow but need more transactions
  - Recapitalization capital could be more than existing dry powder
  - NOI growth only backstop to cap rate driven value declines
- **Fundamentals** – Still positive
  - Inflation in cost and banks retrenching keeping supply low
- **Interest rates**
  - Impact of rising rates on economic activity
  - Rate stability positive but new normal still painful
  - Will investor leave sector for better returns
- **Level of distress** – How will investor react to losses

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Outlook for Respective Premia

- **Investors looking for more opportunistic and distress**
  - Demand remains strong supporting strong managers that can borrow and deliver new or repositioned assets
- **Continued need for modern assets**
  - Demand for new, better located and more efficient product continues across all sectors
- **Supply and demand across most sectors remain in check**
  - Inflation and stricter lending standards stopping marginal projects
  - Need to understand the impact of layoffs and any recession
- **Managers will be on damage control for 2015-2020 vintage funds**
  - Importance of lender relationships
  - How much dry powder will be used for paydowns

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Need to Change Inputs to Outlook Based on Drivers & Catalysts

- **Recession**
  - Impact on demand
- **Rising interest rates**
  - Impacting refinancing of short-term debt requiring equity paydowns
  - Investors leaving the sector as fixed income returns increase
- **Repricing based on increase in rates**
  - Expect those that can will pursue opportunistic deals
  - Dry powder providing floor maybe tested, and exits for value-add deals to core buyers will be tested
- **Catalyst for a Change in Outlook**
  - Valuation declines once transactions return
  - Weakening NOI due to recessionary pressures

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Catalysts That Could Change Your View

- Inflation not slowing and reducing rate cuts
- Health of underlying tenants

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Debt investments (such as, but not limited to, investment grade, high yield, emerging market debt, asset backed securities and insurance linked securities) involves special considerations and certain risks, including risk of default and price volatility, and such securities are regarded as being predominantly speculative as to the issuer's ability to make payments of principal and interest.

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Modelling Assumptions:

Forward looking return, volatility, and correlation assumptions have been derived by SECOR, and are based on a combination of: a) the historic performance of each asset class based on what we consider to be appropriate indices or suitable proxies, and over a period that we consider to be appropriate in light of prevailing market conditions (typically 10 years); and b) our judgement in relation to how historic performance, and its various components, may differ in the future. This may include, for example, ad-hoc adjustments to reflect our view that markets are over or under valued.

The resulting assumptions are assumed to be appropriate for asset and liability projections over the medium to long term i.e. 10 to 20 years or longer, and are net of all ongoing management costs and fees.

Expected returns for an asset class are generally built up from and include an allowance for our projected return on cash, inflation, spreads, risk premiums, liquidity premiums, potential losses, valuation adjustments, alpha for active management, management fees, other ongoing costs, and any other factors that we may consider are appropriate for the asset class and/or prevailing market conditions. Expected returns generally do not allow for SECOR advisor or fiduciary management fees, or any transition or rebalancing costs between asset classes or an existing portfolio.

A material risk factor is that the projected returns modelled are underpinned by historic market returns combined with SECOR's assumptions on future market returns, meaning that the projected net returns used for modelling portfolios may not be realised within expected timeframes.

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