**01:**
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All eyes have been on the global real estate market in the last 12 months. Rising financing costs and the prospects of a global recession slowed returns in many areas of the office and retail sectors. Swift portfolio rebalancing and liquidity redemptions became the dominant themes of 2022.

But in the wash emerged some of the best opportunities in the sector. Global fund manager Nuveen, which manages more than US$178 billion in real estate assets, anticipates a pricing reset that sits between five and 25%, depending on the sub-sector.

This year will also see the pricing gap widen between Class A and Class B properties, which makes a more discerning play into the sector more critical.

In this issue, Nuveen explains where the growth lies in real estate this year and in the years beyond.

Michelle Baltazar
Director of Media & Publishing

# Global real estate in 2023 and beyond

As chief investment officer and head of funds management for Nuveen Real Estate's US$123 billion Americas platform[1], Shawn Lese oversees the end-to-end investment process and leads a team of seasoned portfolio managers in driving investment performance and partnering with clients on their real estate investments.

Looking ahead, while headwinds are rising for private real estate, Lese says the fundamentals of the market remain sound and economic pressures will unearth buying opportunities across geographic and sector specific themes.

The benefits of investing in private real estate are well established. It is a good source of income, capital appreciation and stability of return. It also adds diversity to a portfolio because of its low correlation with other asset classes, and importantly at times like we are seeing now – it serves as an inflation protection potential. But the current environment is testing most asset classes. So, can private real estate continue to deliver?

Most sectors of the global real estate market have performed well operationally in 2022. Properties are occupied, and rents have been rising, especially in the industrial, housing, and alternative sectors, such as technology and healthcare related real estate.

But there are headwinds from the tightening of debt capital markets as official interest rates rise to combat inflation. Debt funding has become harder to access for many types of real estate, and more expensive, which drives down asset prices, and we've seen a reset of between 5% and 25% depending on the specific sector you are looking at.

## Buying opportunities to emerge after global economic downturn

We think fundamentals remain sound and firmly believe in the long-term case for carefully sourced private real estate investments, but we also expect we're entering a phase where slowing deal flow and challenged liquidity will be important near-term drivers.

If inflation continues to be pervasive, and we see further increases in official rates, that could continue to impact capital markets and flow onto operational performance.

Nuveen is forecasting a mild recession in many places around the world in 2023 after which we expect a relatively strong operational performance from real estate markets, but with relatively attractive pricing, certainly cheaper than in pre COVID times.

We therefore see that as a buying opportunity. However, not all real estate is created equal. In any area around the world, you'll find a different stage of the economic cycle with different risks pervading. Across sectors, there are varying tailwinds and headwinds.

## Not all sectors are equal

We foresee that the housing, industrial and alternative sectors will continue to perform very well on a global scale.

When it comes to sectors such as retail and office buildings, investors need to be much more selective.

For instance, in the US, there is a tale of two cities when it comes to office buildings. Modern office buildings that are brand new or highly renovated with a lot of amenities and the latest health-and-safety and ESG attributes, are performing reasonably well. However, class B properties, for example, are likely to require heavy investment to make them perform well.

## Global cities approach

We remain focused on investing in global cities experiencing growing, educated, and diverse populations.

We're also seeing differentiated, compelling, and idiosyncratic opportunities across geographies. In the US, we're focused on specialized medical offices that benefit from an increasing move toward outpatient procedures; we like European suburban housing (specifically rentals) in areas enjoying growing industrialisation; and in Asia we prefer investments such as Tokyo senior living facilities and Australian student housing benefiting from demographic trends.

## Consider including debt

One approach to this more challenging environment is to invest in real estate debt as well as equity. Given debt markets are currently tight, risk adjusted returns are relatively strong, so there has probably never been a better time to invest in real estate debt. Across debt markets, we see the best opportunities in the industrial sector and, to a lesser extent, housing.

As we head into a global economic downturn, real estate debt benefits from a substantial degree of downside risk mitigation provided by the buffer of the sponsor's equity. While there is typically no additional upside to debt returns in a rising market, the sponsor's equity can often absorb the first loss in a falling market. In addition, contractually agreed interest payments insulate the lender from the volatility of a changing rental income profile.

**The quote**

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## How investors can access the market

Traditionally, direct commercial real estate investing has provided immense wealth, but only for the select few. Historically, investors needed specific knowledge, the right connections and most importantly access to large amounts of capital.

Beyond specific sectors capitalising on wider structural and demographic shifts, investors can diversify their real estate portfolios by tapping into opportunities previously difficult for individual investors to access. Certain types of real estate vehicles such as public and private real estate investment trusts (REITs) are a good example. They are an innovative way for investors to gain exposure to real estate that is driven much more by valuations. They also enable investors to get more liquidity in an otherwise illiquid asset class.

When choosing a fund manager, it is important to ensure you have access to the necessary skillset including geographic knowledge and an on the ground presence; sector expertise; and an ability to play across the debt-equity risk spectrum.

While we do anticipate slower rates of growth for real estate, fundamentals remain strong. Vacancies are at record lows in residential and industrial sectors. Developers across property types have been much more supply-disciplined during the recent build-up (partly due to supply chain issues), which should help keep rental levels high. And a recession would not affect all global markets equally, which should help global well-diversified investors achieve a smoother ride.

We believe real estate markets should benefit from long-term structural trends. Urbanisation continues, as well as the drive for more sustainable buildings. Technology should continue driving job growth, and e-commerce supports growing market share. In addition, some trends favouring local real estate may gain traction, such as re-shoring of production to developed markets in the US and Europe.

Despite the headwinds ahead, now is an opportune time to take advantage of the rebound that may come after the economic downturn, and to ensure you benefit long term from the predicted benefits that private real estate can provide in a balanced portfolio. **FS**

1. As of 30 Sep 2022


Watch the video on www.fsitv.com