Savills Investment Management Outlook 2023:

Urban industrial & logistics, essential retail, affordable housing and real estate debt likely to be safest havens in 2023

Latest Savills Investment Management global investor outlook report highlights how investors need to go back to basics and assess the fundamentals in order to weather what is likely to be a challenging year for property markets.

Nevertheless, opportunities will present themselves in sectors with strong, long-term growth characteristics, since markets always over-react – there is value to be found in every sector, but there is an increasing focus on top-quality locations, robust ESG credentials and strong fundamentals.

London, 14th December 2022, Savills Investment Management (Savills IM), the international real estate investment manager, today outlines its global outlook for real estate investment markets in 2023.

While 2023 may prove challenging for all investors, in the context of global market turbulence, Savills IM sees select opportunities in asset classes with strong long-term fundamentals such as urban industrial and logistics, affordable housing and essential retail.

Savills IM identifies the threats to the near-term macro picture, the most notable being rising inflation, interest rates and recessionary risks impacting investment and occupier markets.

Interest rates will impact those with high levels of debt, with £60bn of outstanding loans due to be refinanced in the UK within the next two years. The picture is similar across many other markets. Occupier markets are also likely to experience instability, as reduced growth and the threat of recession increases the likelihood of occupier distress.

However, those who prepare well now will be well positioned to benefit when the next upturn arrives; those assets with strong income streams and robust ESG credentials are particularly inviting for investors.

In terms of sectors, Savills IM believes that affordable housing presents a long-term growth story, with strong demand, predictable yields and a compelling social impact. But 2023 could see reforms that may liberate the affordable housing sector to better utilise both state grants and private capital. One thing is clear, the public sector cannot afford to meet demand for social housing on its own, and the private sector is increasingly keen to help fund new developments, and improve existing stock, by working in partnership with housing associations and local authorities over the long term.

Elsewhere, real-estate debt markets provide opportunities for alternative providers. Against a backdrop of volatility, traditional lenders are likely to act with a high degree of caution in 2023, restraining the supply of debt finance. As those looking to refinance are forced to lock into higher rates and face more restrictive terms, alternative providers will be able to undercut banks and cherry pick the very best and most reliable borrowers.

APAC is also increasingly being seen as a relatively safe haven to diversify away from the turbulence being experienced in other markets. Less aggressive inflation and a resilient jobs market means that economies in Asia are much better positioned to drive an economic recovery. As interest rates normalise, the income component of returns will become much more important. Those investors and asset owners able to adapt to new trends, such as providing well-equipped buildings that occupiers find appealing, and that meet increasingly demanding ESG regulations, will be rewarded.

Kiran Patel, Global Chief Investment Officer and Deputy Global CEO, Savills IM, commented:

“It is clear that 2023 will present challenges for real estate investors. The scale of yield expansion remains to be seen, and payment shocks await those seeking to refinance within the next 12-24 months. However, this time of high market stress will present opportunities to those investors with the requisite market knowledge.

“In the residential sector, we are positive on the outlook for affordable housing, where the role of private capital is only set to grow in importance, and despite rising yields we also see attractive entry points for investors in multifamily as valuations fall in line with the wider real estate market.

"Debt markets continue to provide attractive risk-adjusted returns with downside protection. Transaction flow for active lenders is likely to involve a high level of refinancing enquiries as loans previously eligible for traditional bank debt now fall more squarely into the investment criteria for alternative lenders."

Savills IM's 2023 sector outlook:

European outlook 2023

Offices

- Structural trends such as working from home are changing the use and characteristics of existing office stock, increasing the risks to the sector, in particular the security of its income.
- With a shortage of the type of space demanded by tenants, and the excessively high prices of the few available core products, there is an opportunity to invest in well-located grade B stock and create the office stock of tomorrow's flexible occupation needs, which can generate sufficient rental growth to offset higher operating costs. However, this needs careful thought, and must meet strict ESG and energy efficiency standards to warrant the rent and avoid obsolescence due to inadequate facilities or ESG credentials.

Logistics & Industrial

- One of the key sectors with some of the strongest fundamentals. There will be robust occupier demand for higher-quality industrial and logistics buildings, most particularly in urban settings for the proximity to the end consumer. But in those settings the shortfalls of suitable quality space are exaggerated by the intense competition for alternative uses e.g. housing.
- The standard distribution logistics sector proved its resilience at the height of the pandemic. It fulfilled its supply mandate superbly and is expected to continue its strong performance despite the current challenging economic environment.
- Substantial structural supply and demand imbalances will create market resilience, complemented by the potential for value enhancement, which should cushion cyclical risks very well.
- The "Urban Logistics & Light Industrial" sector will benefit more than most, adding to opportunities in income-resilient sectors such as housing, big-box logistics and food retail.

Retail

- The retail real-estate market remains challenging at a headline level, but the detail is more interesting and opportunities prevail.
- Investors must not compromise on quality of location and accessibility, although they must assess the capacity of the tenants to afford these "premium" rents.

- The cost-of-living crisis and rising inflation in many markets means consumers will spend less on discretionary items while focusing on necessities.
- Essential retail showed its resilience during the pandemic and will continue to provide a relatively safe haven as demand for life's necessities will remain, while demand for luxuries is likely to fall. As example, supermarkets and retail parks anchored by supermarkets have shown exceptional resilience since the pandemic began.

Living

- The living sector will come of age through this cycle, as investors recognise the compelling portfolio characteristics, most notably long and stable incomes uncorrelated with the commercial sectors.
- We believe that opportunities will emerge in the living sector, particularly in multifamily where demographics, social trends and supply/demand imbalances will present investment opportunities. The short-term outlook is difficult and prices are likely to fall further, but that gives investors an attractive entry point into a sector with strong long-term fundamentals.
- Equity investors will be at an advantage in 2023 as lending criteria is likely to tighten.
- Affordable housing is a key area with massive undersupply and constant demand that needs urgent investment from the public and private sectors; 2023 will be a pivotal year in challenging the status quo and diverting investment into the sector to facilitate more and better housing that matches the needs of residents with those of investors.
- The quality of Europe's housing stock is inadequate, typically old, not energy efficient and of the wrong size and in the wrong locations. This provides opportunities to provide the right stock for emerging demographics and trends, at affordable rents for median earners in the locations they wish to live.

Debt

- Rising interest rates are set to be a dominant factor in investors' minds as they consider the options available to them in 2023.
- We believe that in the short term, finance from traditional bank lenders will be restrictive as they assess risk exposures across their portfolio, meaning enhanced returns available to lenders who are able to step into the gap.

APAC outlook 2023:

APAC is at a different stage of the economic cycle relative to much of the West. While inflation is hitting multi-decade highs in the US, Europe and UK, it is relatively muted in APAC. This makes it an attractive diversification play, not just for Western investors, but for local, APAC investors too. It also has strong fundamentals that mean it is likely to fall by less than Western markets in 2023 and recover more quickly. Within the region we favour:

Japan multi-family

- The multi-family sector in Japan is one of the most robustly performing real-estate asset classes anywhere in the world. Despite the overall population declining in Japan, the substantial number of people moving to the cities from around the country is driving urban population growth. They need somewhere to live, and because of changing socio-economic trends, they are tending to rent, in smaller family units, often single-occupier homes, and for longer periods.

Urban Industrial & Logistics

- We are positive on the logistics sector. With a low level of modern logistics stock and substantial growth in the e-commerce sector, most Asian markets have a structural deficit in warehousing and logistics space. The underlying secular themes are therefore strong, and income is stable. But investors still need to be picky on location and quality.

Essential retail

- We believe there is a sweet spot in neighbourhood retail formats, weighted towards the non-discretionary trade-mix, and located close to population centres.

Offices

- Outside Australia, most APAC office centres have not embraced remote working, although it is a clear trend. Instead, a 'hub-and-spoke' office model is growing in popularity - a firm may now look to retain a CBD office location and augment it with a satellite office to give workers greater flexibility over locations. We believe that good quality office assets in selective non-primary locations could present good value as rent growth could outpace the overall market rent growth – although they need to be well equipped and have strong ESG credentials.

Ends

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About Savills Investment Management

- Savills Investment Management is an international real estate investment manager with offices in Amsterdam, Bangkok (as part of a cooperation with Savills Thailand), Frankfurt, Hamburg, Katowice, Kuala Lumpur (as part of a cooperation with Savills Malaysia), London, Luxembourg, Madrid, Milan, Munich, Paris, Singapore Stockholm, St. Helier, Sydney, Tokyo and Warsaw.

- As of 30 June 2022, Savills Investment Management managed total assets of €26.9 billion.

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