AMERICAS

2024 Real Estate Outlook

Investment Research

Hear From Our Experts

EXECUTIVE SUMMARY
AMERICAS

Real estate is adjusting to elevated interest rates, with expectations of buyers and owners still far apart. We estimate those expectations will not converge until property values fall another 10%.

Nevertheless, property incomes remain resilient. U.S. rent growth will decelerate, but generally remain positive, as newly built properties deliver and demand moderates.

The best opportunities are concentrated in credit and REIT markets. As property values reprice and transactions markets thaw, multifamily and niche residential, and Mexico industrial, are first on our shopping list.

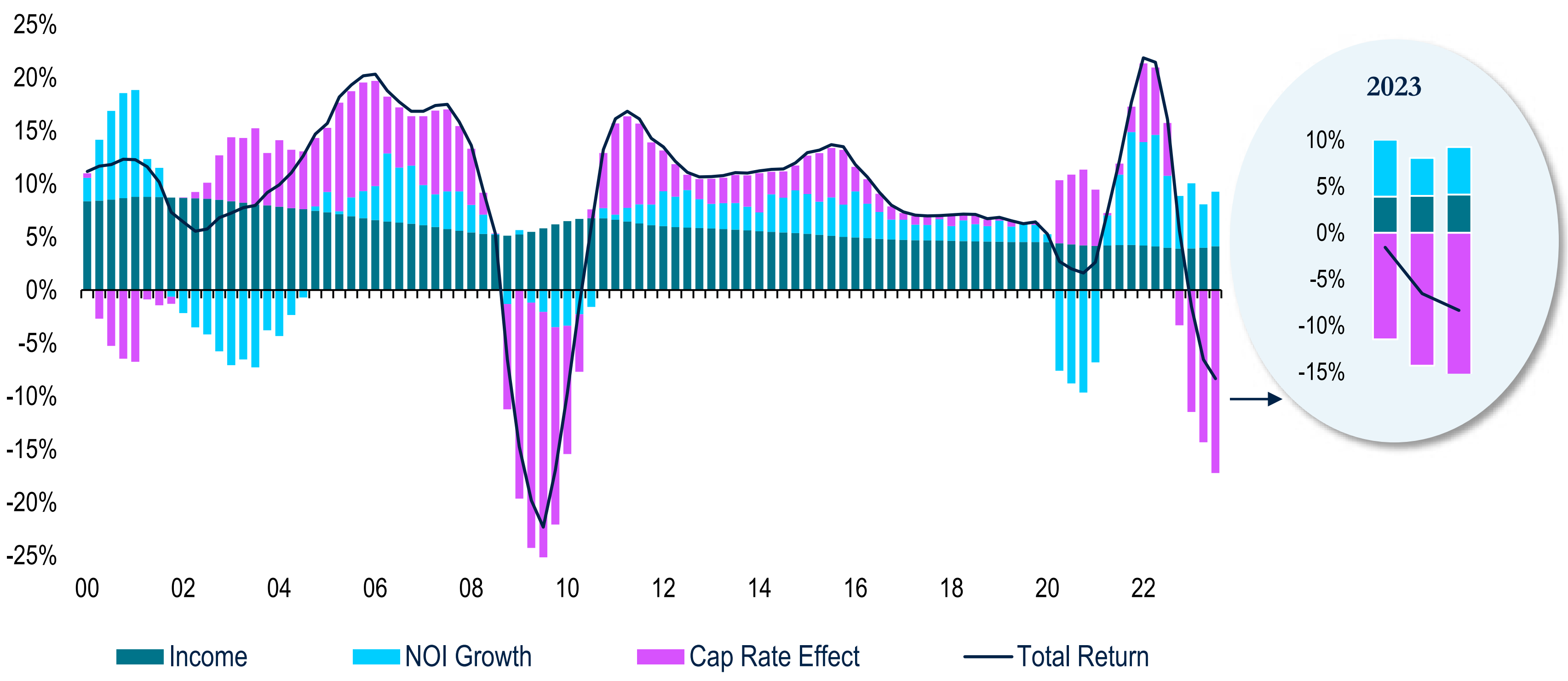
MARKET OUTLOOK

A slowing economy combined with elevated interest rates will cause property financing to remain scarce, extending the slide in property values and activity through 2024.

1

Real Estate Is Still Repricing to Higher Interest Rates…

Unleveraged Real Estate Returns (Trailing 4 Quarter %)

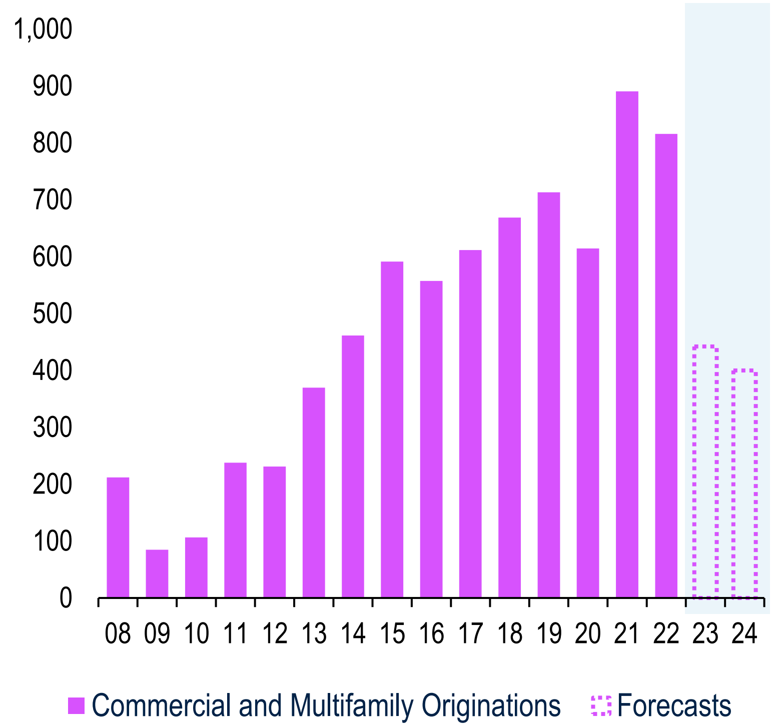


Sources: NCREIF, PGIM Real Estate. As of November 2023.

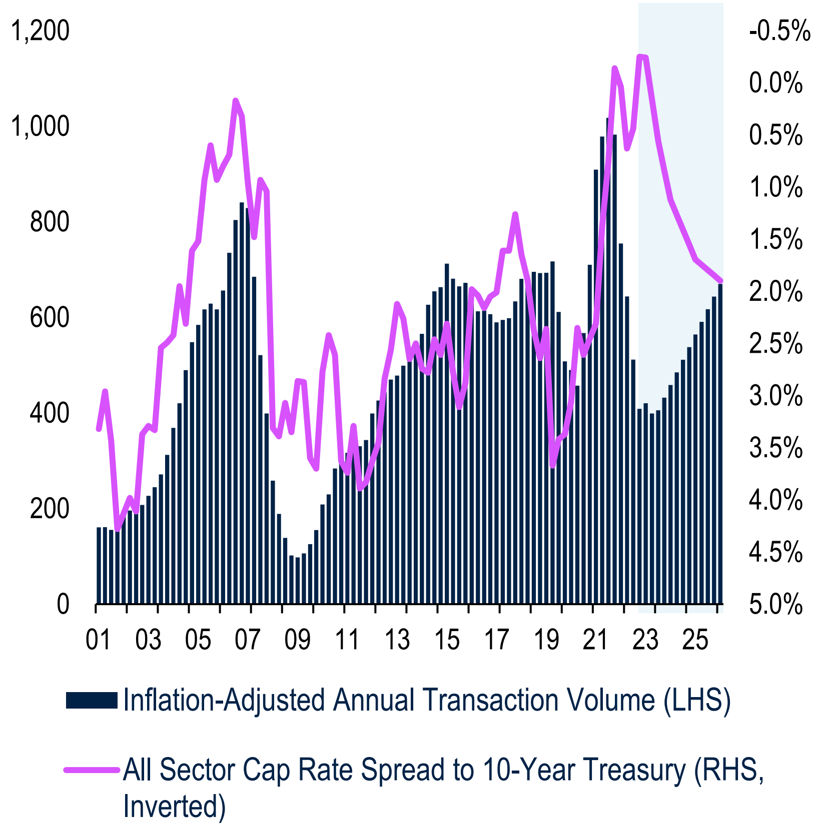
Private U.S. real estate values fell by 8.1% in the first three quarters of 2023. Economic growth surprised to the upside, keeping net operating income (NOI) growth positive, but real estate cap rates have been pressured higher by the rapid rise in interest rates.

...Scarce Debt Is Suppressing Transaction Volumes…

Commercial and Multifamily Mortgage Debt Originations ($ Billions)



Transaction Volume ($ Billions) vs. Yield Spread to Treasury (Inverted, Basis Points)



Sources: Mortgage Bankers Association, NCREIF, Oxford Economics, Real Capital Analytics, PGIM Real Estate. As of November 2023.

LEFT

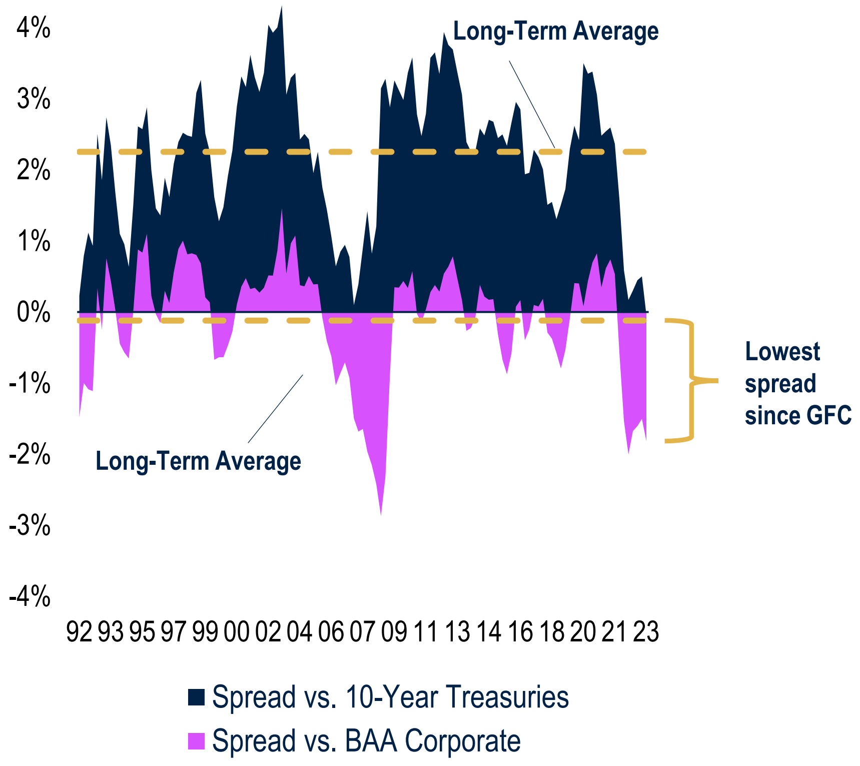
Real estate debt originations have further declines ahead, due to rising lender caution and greater regulatory scrutiny after multiple banks failed in the spring.

RIGHT

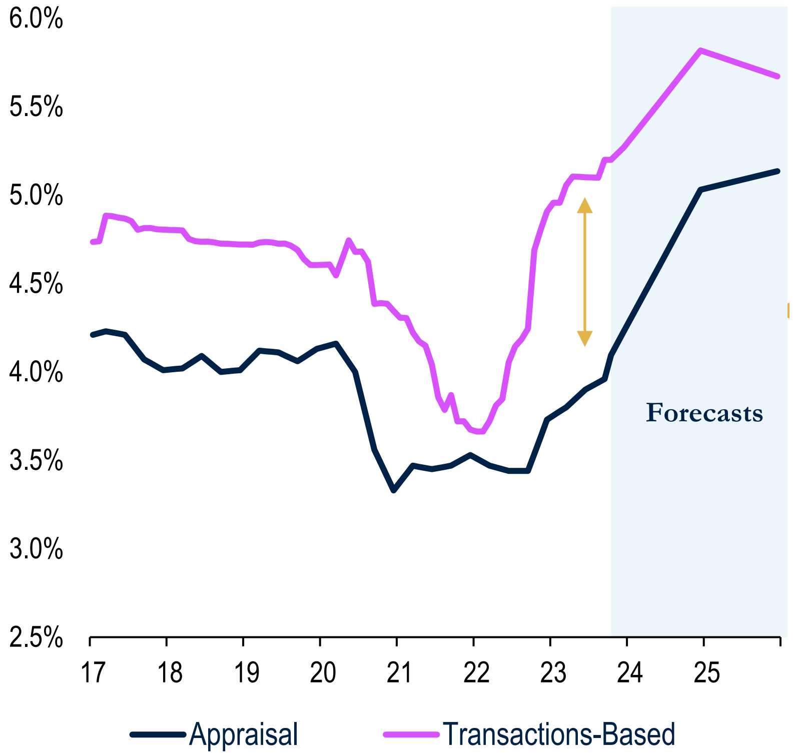
Scarce debt and price declines are contributing to slowing transaction volume. The 60% inflation-adjusted volume decline is the most severe since the Global Financial Crisis (GFC).

…And the Appraisal vs. Market Gap Is Still Wide

Appraisal Cap Rate Spreads (%)



Core Fund Appraisal Cap Rates vs. Transaction-Based Estimates, Apartment Sector (%)



Sources: Green Street Advisors, NCREIF, PGIM Real Estate. As of November 2023.

LEFT

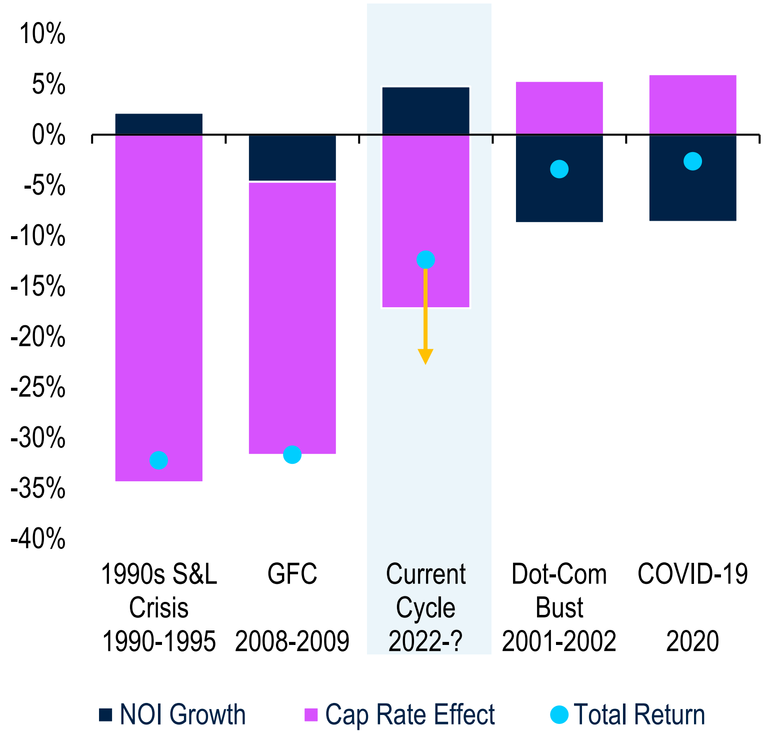
Private real estate appraisal cap rates are too low. The spread between private appraisal cap rates and the risk-free rate collapsed by 50 basis points in 3Q 2023, as U.S. Treasury yields soared. Real estate is expensive versus corporate debt too.

RIGHT

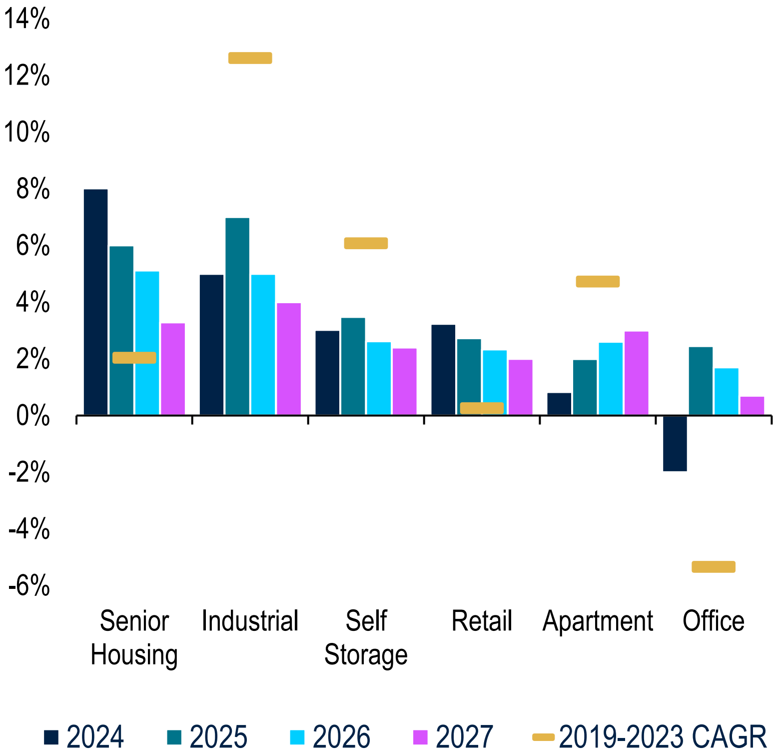
A bid-ask standoff persists, with no end yet in sight. For example, the spread between core apartment appraisal cap rates and estimated transaction Class A apartment cap rates has nearly doubled from its 2017-2020 average.

This Time Is Different: Resilient Income, Repriced…

Value Corrections (%)



Forecasted Change in Property Market Revenue* (% p.a.)



*Note: Market revenue is a combined measure of rent and occupancy.
Sources: Green Street Advisors, NCREIF, PGIM Real Estate. As of November 2023.

LEFT

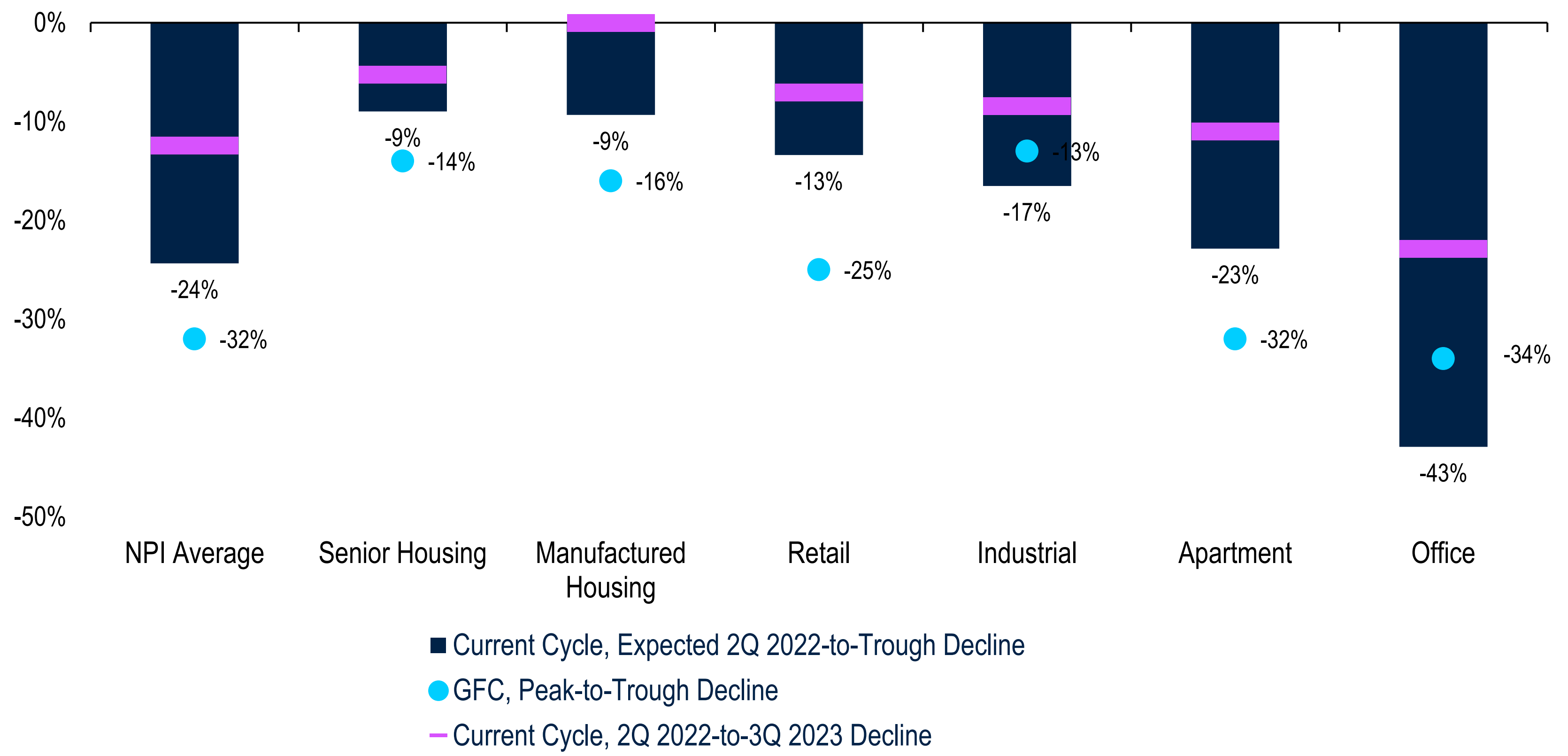
Value declines so far this cycle are mostly due to the higher risk-free rate, plus lower (but positive) expected future income growth. In comparison with most real estate downturns, positive NOI is partially offsetting the negative impact of higher cap rates.

RIGHT

We forecast positive revenue growth across all sectors over the next four years. Look for deceleration in industrial, storage and apartments, and improving income growth in the senior housing, retail and office sectors.

…And Sector Differences Are Wider Than the GFC

Expected Peak-to-Trough Value Change, by Property Sector (%)



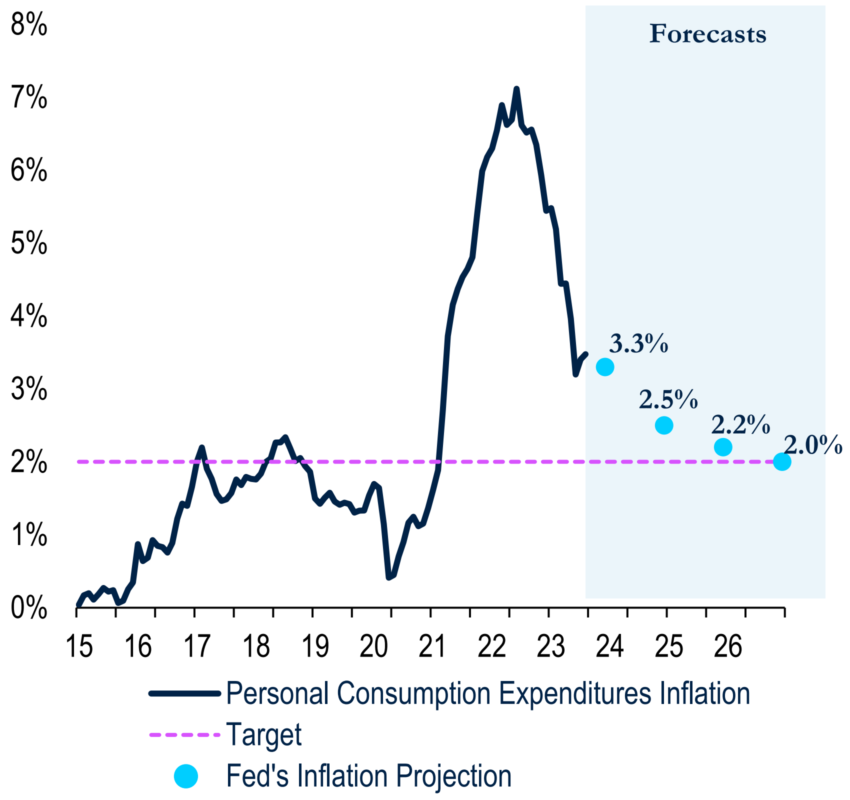
Sources: NCREIF, PGIM Real Estate. As of November 2023.

Values still have ~10% to fall. As usual in a real estate downturn, office will be the most impacted sector. Necessity-based real estate (defensive retail, senior housing and manufactured housing) should emerge comparatively better off.

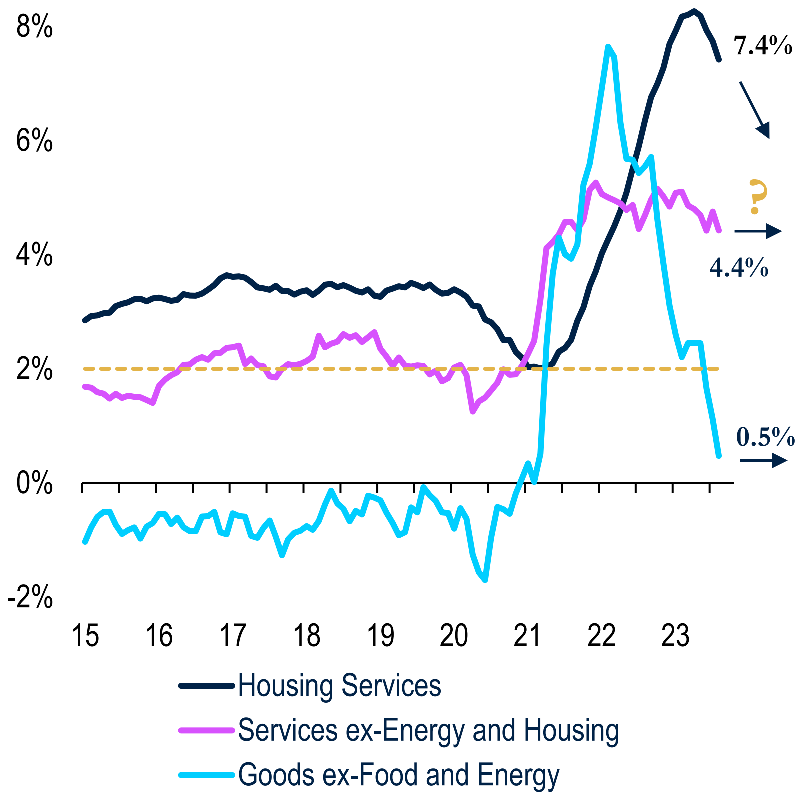
As compared with the GFC, we anticipate lower average value losses in this cycle. Office is the most notable outlier.

Real Estate Price Declines Depend on Inflation Trajectory…

Inflation (% p.a.)



Personal Consumption Expenditures (% p.a.)



Sources: Oxford Economics, U.S. Bureau of Labor Statistics, U.S. Bureau of Economic Analysis, Federal Reserve Board, PGIM Real Estate. As of November 2023.

LEFT

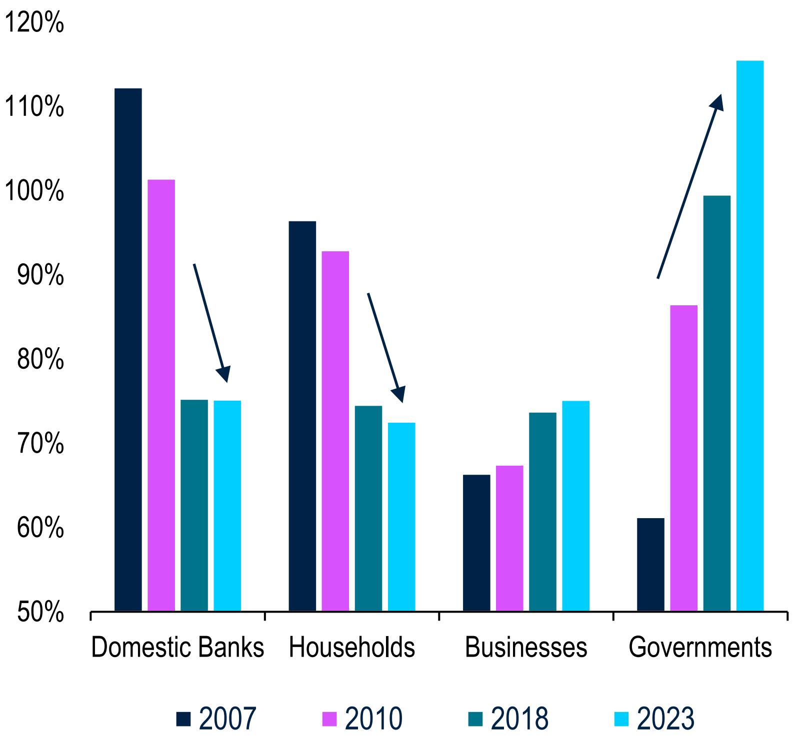
U.S. economic growth surprised to the upside in 2023, keeping labor markets resilient while inflation trended down. But U.S. monetary policy remains focused on achieving the Fed's 2.0% inflation target.

RIGHT

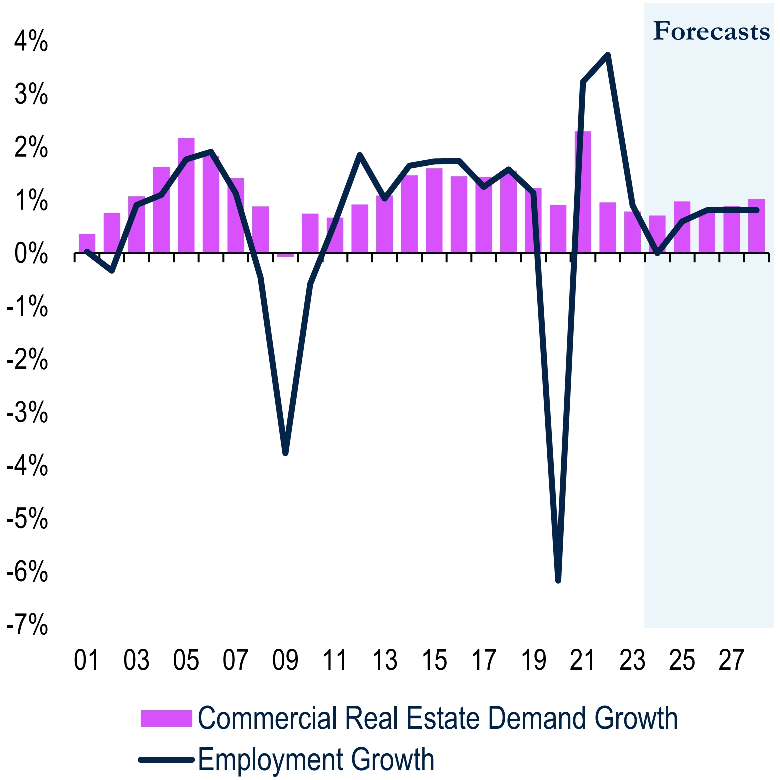
Breaking PCE inflation into three core categories helps illuminate the challenges ahead. Shelter inflation has peaked and is trending down – although higher mortgage rates exacerbate shelter inflation pressures. And services inflation is stubbornly high.

…And Waning Fiscal Stimulus Raises Recession Risk

Debt Outstanding, as a Share of GDP (%)



Employment and Tenant Demand Growth (% p.a.)



LEFT

Higher interest costs and waning fiscal stimulus both pose economic risks to the downside. Households and banks have broadly deleveraged, but the federal government has levered up by more than 50 percentage points of U.S. GDP since 2007.

RIGHT

Our base case calls for decelerating real estate demand and job growth in 2024, both slowing to well below trend as higher interest rate pressures ripple through the economy.

Sources: Consensus Economics, Oxford Economics, U.S. Bureau of Labor Statistics, U.S. Bureau of Economic Analysis, Federal Reserve Board, PGIM Real Estate. As of November 2023.

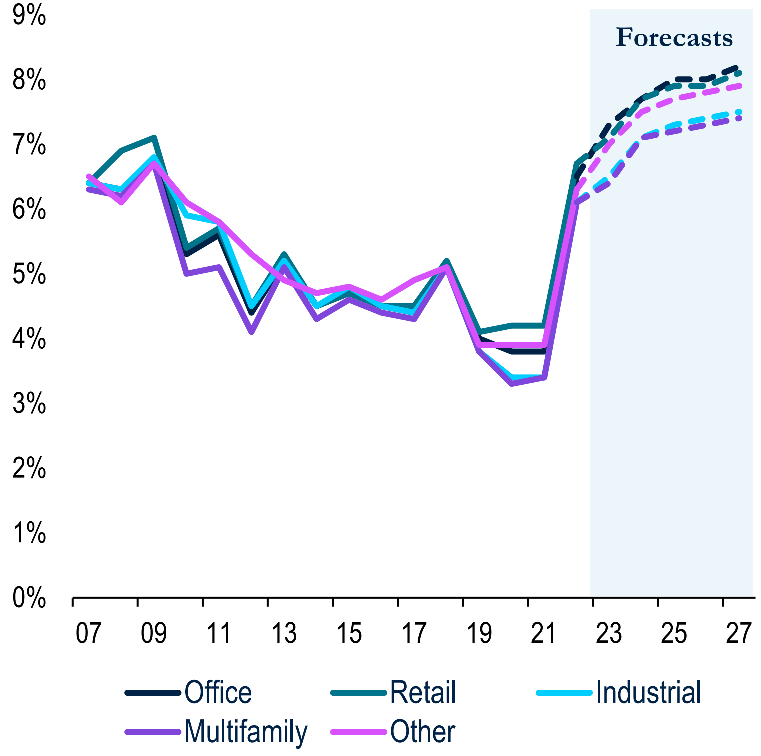
2

INVESTMENT THEMES

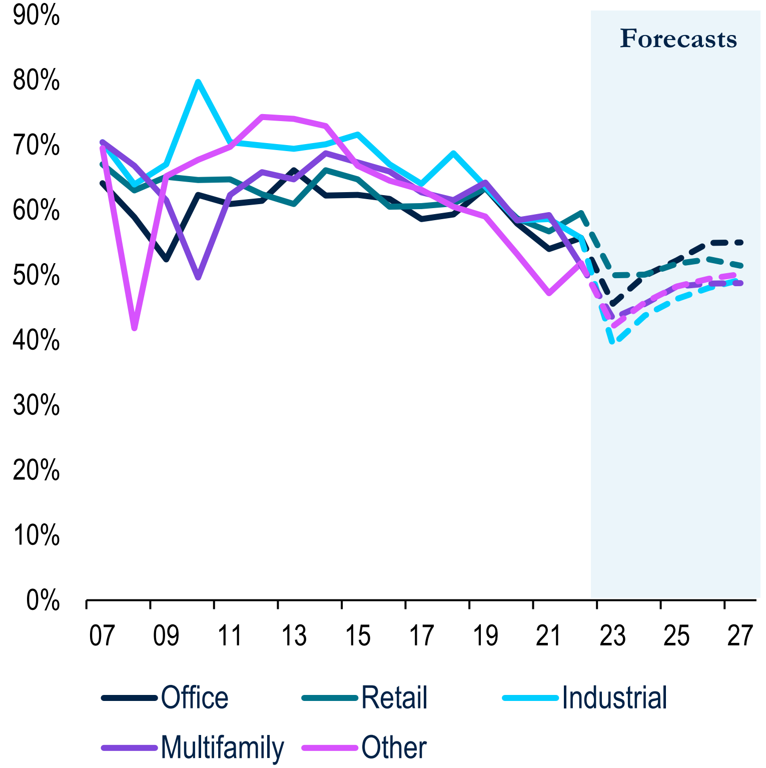
Debt returns are attractive in today’s market. Select situations to invest at lower prices may emerge, beginning with REITs at an impressive discount. As the year progresses, expect defensive and needs-based opportunities to stay in favor.

Core Debt: Strong Risk-Adjusted Returns…

Higher Debt Coupons as All-in Real Estate Debt Costs Rise Alongside Increasing Reference Rates[1]



Restricted Leverage on New Issue Loans Due to Increased Focus on Debt Serviceability[2]



[1] All-in fixed rate senior debt costs for loans of mixed terms.
[2] LTV on new issue fixed rate senior loans constrained by 1.5x ICR.
Sources: Bloomberg, Chatham Financial, Giliberto-Levy, CREFC, ACLI, RCA, Cushman & Wakefield, PGIM Real Estate. As of November 2023.

AMERICAS

LEFT

After real estate borrowing costs have risen more than 300 basis points due to higher base rates, we believe core lending will offer the most attractive risk-adjusted return in years.

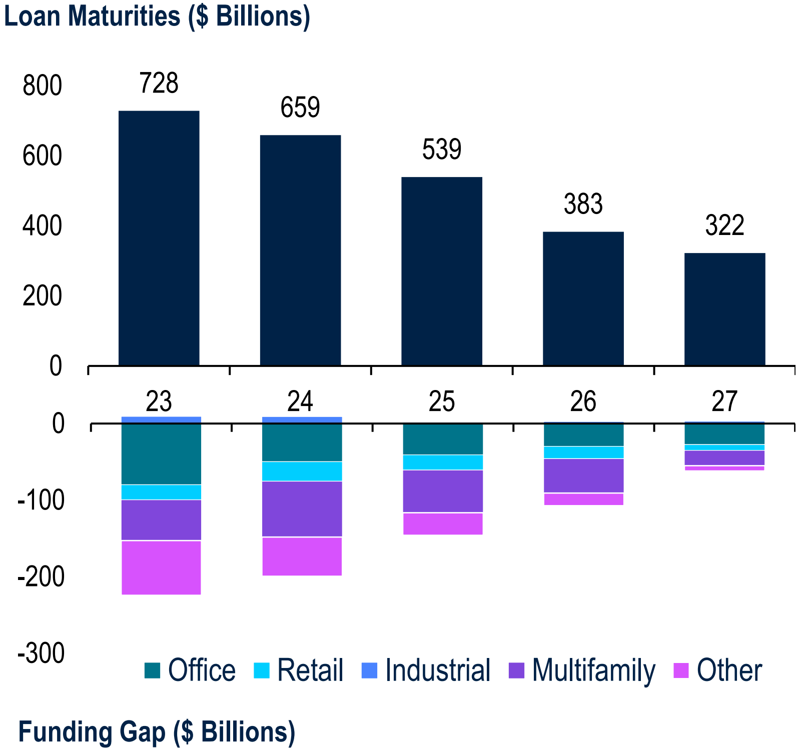
RIGHT

Further protecting lenders, loan terms are among the most conservative in decades. Demand from borrowers will be high due to refinancing needs, even if transaction activity remains muted.

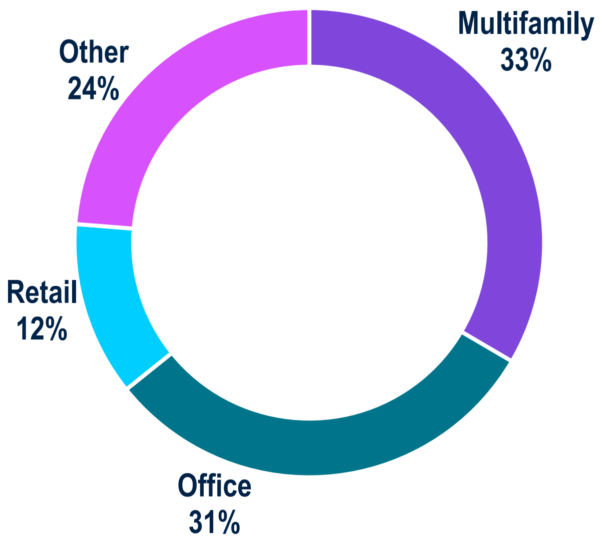
INVESTMENT THEMES

Non-Core Debt: …Paired With Distressed Buying and Lending Opportunities

Lower Leverage Offered for Upcoming Loan Maturities, Leading to a Wider Funding Gap



It's Not Just Office. Multifamily Has the Biggest Funding Gap



Sources: Mortgage Bankers Association, Bloomberg, Chatham Financial, Giliberto-Levy, CREFC, ACLI, RCA, Cushman & Wakefield, PGIM Real Estate. As of November 2023.

AMERICAS

LEFT

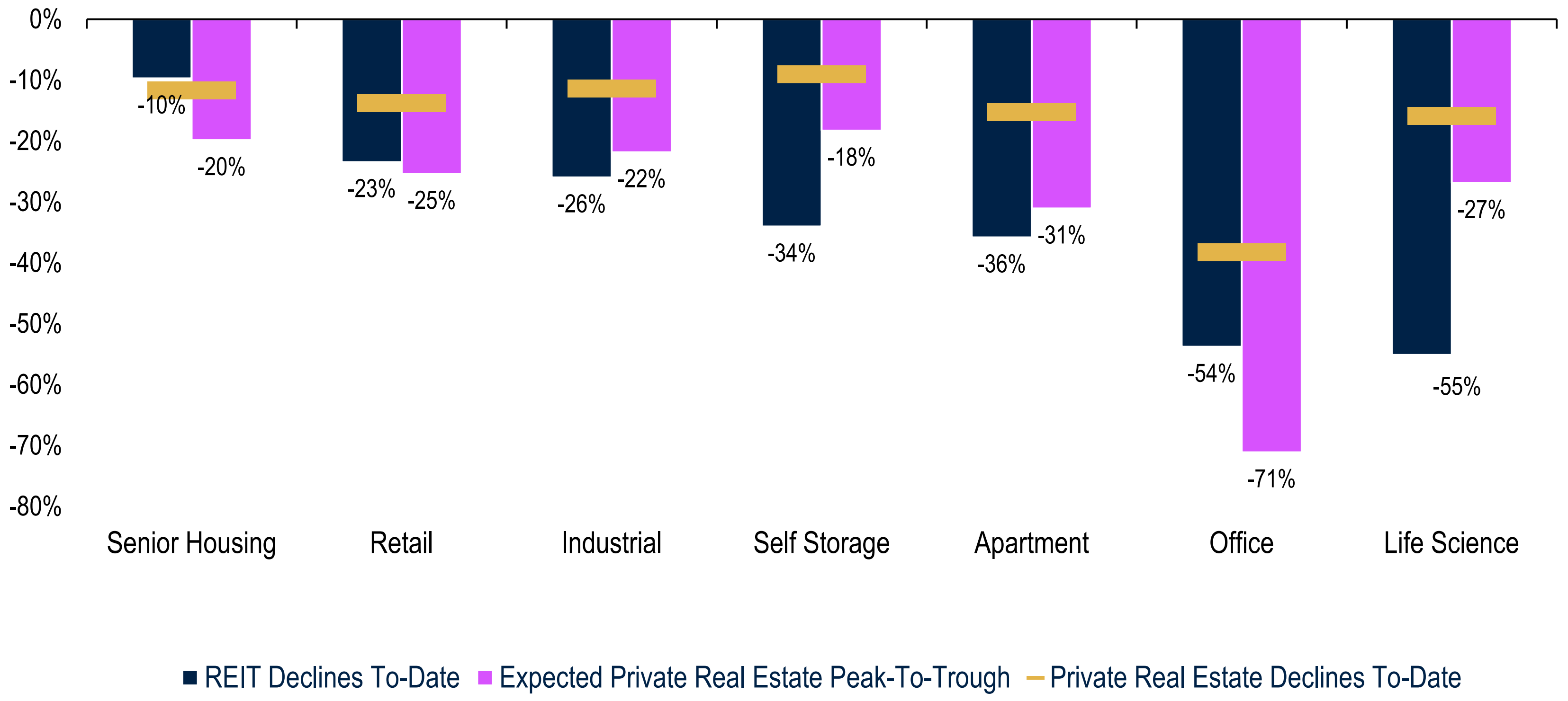
More than $1 trillion in commercial real estate loans is coming due over 2024 and 2025, which we estimate will leave a refinancing gap of more than $300 billion.

RIGHT

New-vintage multifamily properties and older assets in appealing locations will be part of this mix, along with distressed office, retail and lodging collateral.

Public Equities: Share Prices Already Reflect Future Value Losses

Leveraged Private vs. Public Real Estate Price Declines

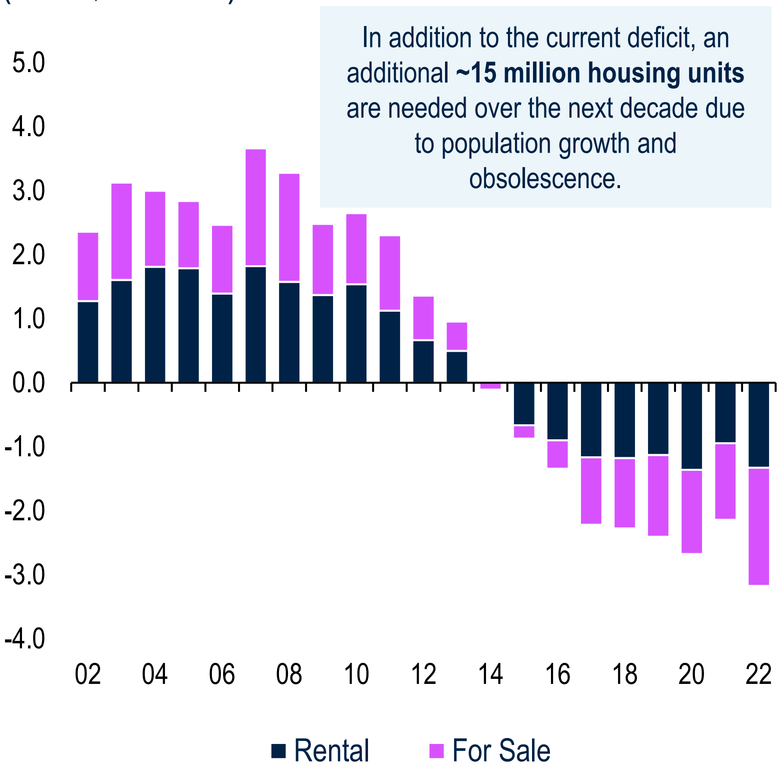


Leveraged private real estate value estimates are calculated at REITs' leverage ratios by sector as of end-2021 and an assumed debt cost of 4%.
Sources: NAREIT, Green Street Advisors, NCREIF, PGIM Real Estate. As of November 2023.

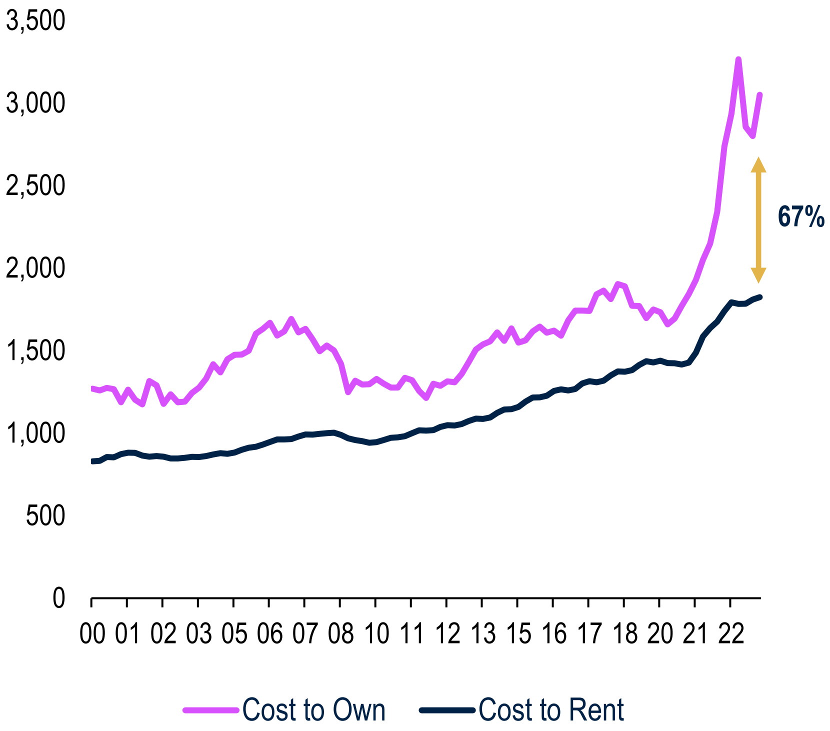
Core sector REIT prices largely already incorporate our expected full-cycle, leveraged value corrections, and some are priced for recession already. With high-quality real estate portfolios and full liquidity on demand, public REITs offer an attractive entry point today.

Residential: Undersupply and Expensive For-Sale Housing Support Rentals

Estimated Surplus / Deficit in Housing Stock (Units, Millions)



Cost to Buy Versus Cost to Rent (Monthly Payment in Dollars)



Sources: Census Bureau, RealPage, PGIM Real Estate. As of November 2023.

LEFT

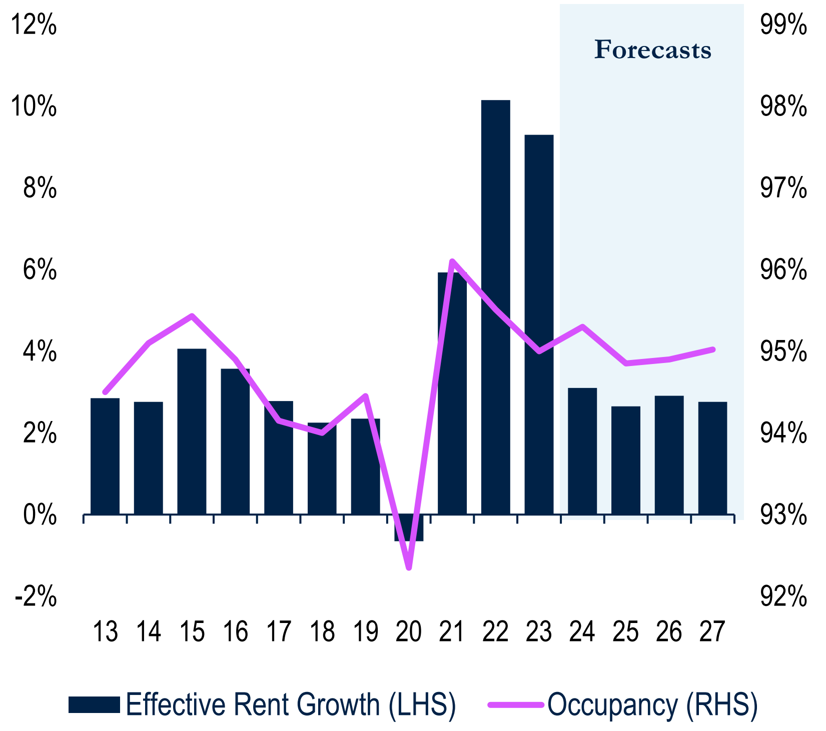
The U.S. has underbuilt housing for nearly a decade, while household formation has surged and millennials age into a preference for single-family and suburban homes.

RIGHT

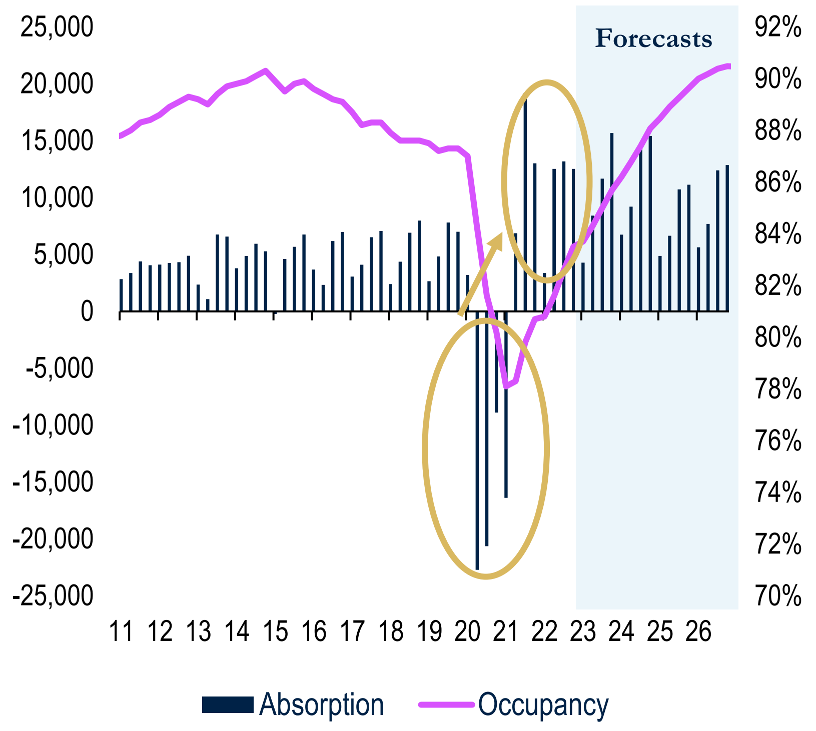
Rapid house price increases plus the recent rapid runup in mortgage rates makes renting a compelling option.

Student Housing and Senior Housing: Cyclical and Structural Support

Student Housing Effective Rent Growth and Occupancy*



Senior Housing Quarterly Absorption and Occupancy (%)



*Note: Represents RealPage's Top 175 universities.
Sources: RealPage, NIC, Green Street, PGIM Real Estate. As of November 2023.

LEFT

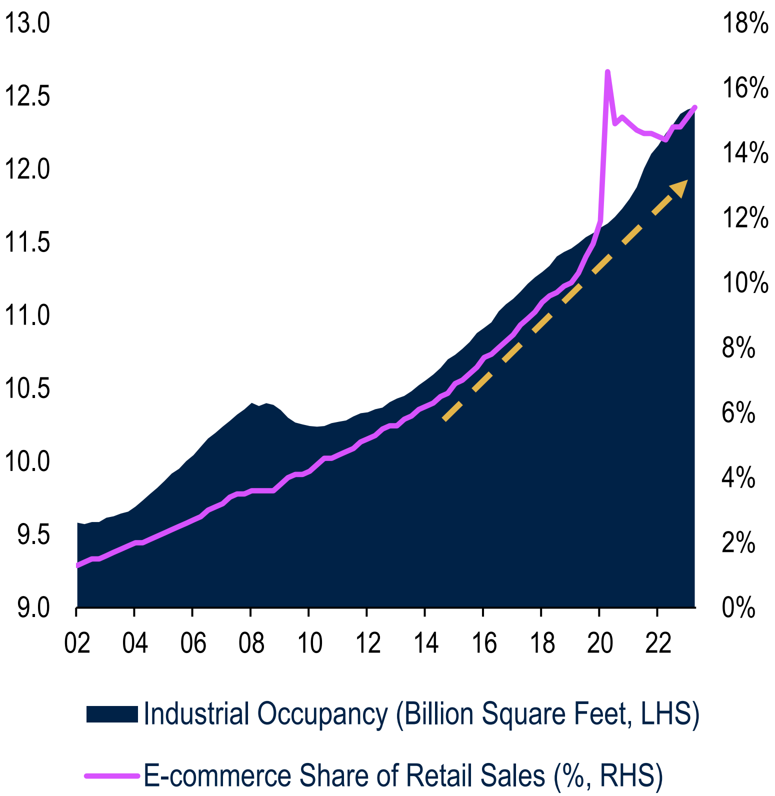
The post-pandemic rebound in student housing demand leaves the sector with healthy occupancy, setting the stage for continued rent growth.

RIGHT

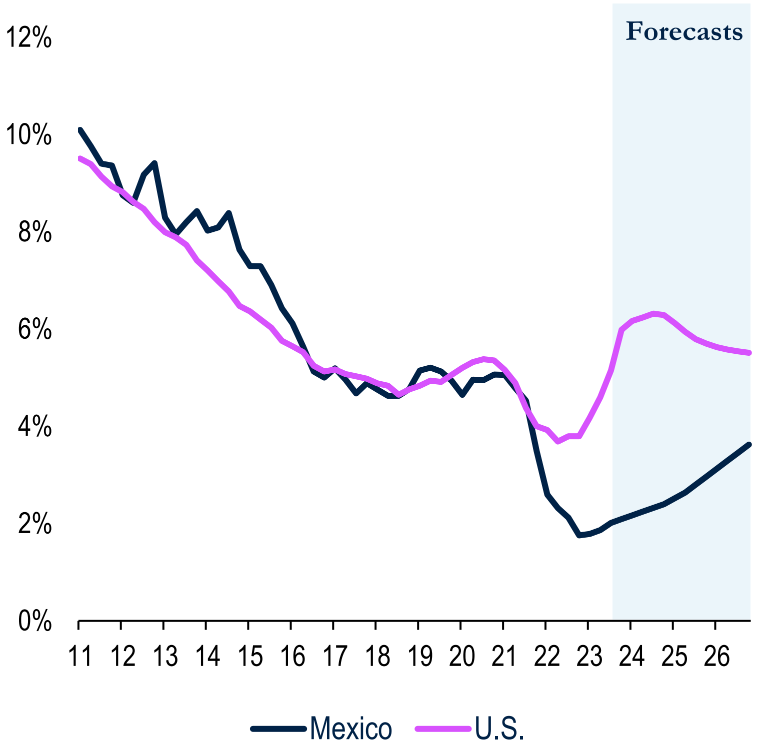
The cyclical rebound in senior housing continues, with occupancies now nearing pre-pandemic norms and net absorption running at about double the average of the last decade. We expect occupancies to fully recover by 2025.

U.S. and Mexico Logistics: Now a Cross-Border Strategy

U.S. Industrial Demand (Billion Square Feet) and U.S. E-commerce Market Share (%)



Mexico and U.S. Industrial Vacancy



Sources: CoStar, CBRE, U.S. Census Bureau, PGIM Real Estate. As of November 2023.

AMERICAS

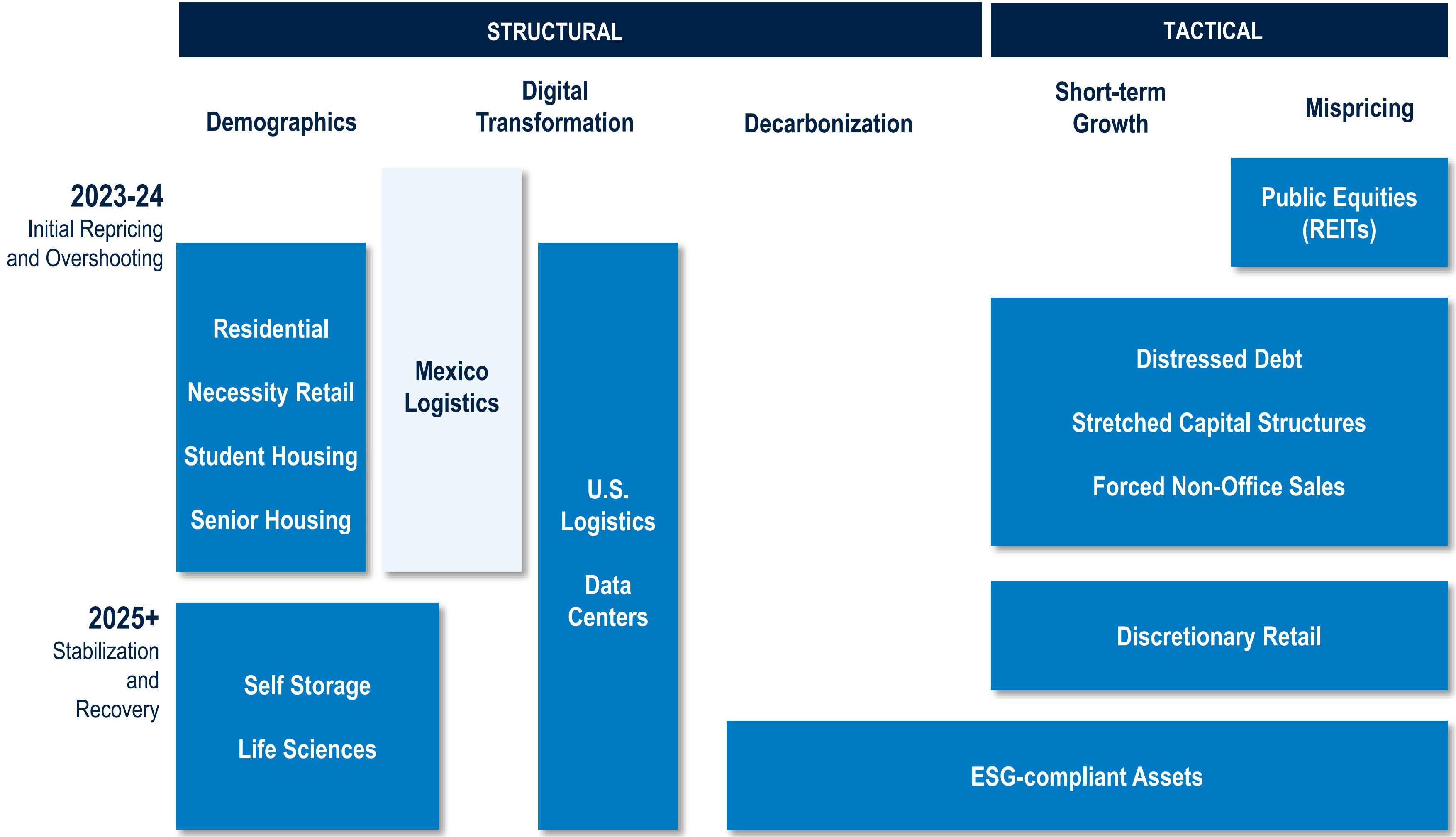
LEFT

E-commerce penetration is re-accelerating after a brief pullback post-2020. We believe well-located and smaller properties, best-suited for last-mile delivery, will continue to outperform.

RIGHT

Industrial vacancy in Mexico remains below 2% even as vacancies rise to pre-COVID-19 levels in the United States. The USMCA and nearshoring trends are continuing to create demand for Mexican industrial.

Dynamic Opportunity Set



For illustrative purposes only. Source: PGIM Real Estate. As of November 2023.

AMERICAS

Our global investment convictions are built upon structural growth of digitalization, demographics, and decarbonization themes which drive long-term secular shifts in occupier demand across real estate sectors and geographies.

Core lending at attractive attachment points, REITs pricing at compelling discounts to NAV, and logistics investments capitalizing on U.S. – Mexico nearshoring trends are our preferred tactical opportunities today.

PGIM REAL ESTATE

www.pgimrealestate.com/regionaloutlooks

IMPORTANT INFORMATION

For Professional and Institutional Investors only. All investments involve risk, including the possible loss of capital. Past performance and target returns are not a guarantee and may not be a reliable indicator of future results.

GENERAL/CONFLICTS OF INTEREST

These materials represent the views, opinions and recommendations of the author(s) regarding the economic conditions, asset classes, securities, issuers or financial instruments referenced herein. Distribution of this information to any person other than the person to whom it was originally delivered and to such person’s advisers is unauthorized, and any reproduction of these materials, in whole or in part, or the divulgence of any of the contents hereof, without prior consent of PGIM Real Estate is prohibited. Certain information contained herein has been obtained from sources that PGIM Real Estate believes to be reliable as of the date presented; however, PGIM Real Estate cannot guarantee the accuracy of such information, assure its completeness, or warrant such information will not be changed. The information contained herein is current as of the date of issuance (or such earlier date as referenced herein) and is subject to change without notice. PGIM Real Estate has no obligation to update any or all of such information; nor do we make any express or implied warranties or representations as to the completeness or accuracy or accept responsibility for errors.

IMPORTANT INFORMATION (CONTINUED)

These materials are not intended as an offer or solicitation with respect to the purchase or sale of any security or other financial instrument or any investment management services and should not be used as the basis for any investment decision. Past performance is no guarantee or reliable indicator of future results. No liability whatsoever is accepted for any loss (whether direct, indirect, or consequential) that may arise from any use of the information contained in or derived from this report. PGIM Real Estate and its affiliates may make investment decisions that are inconsistent with the recommendations or views expressed herein, including for proprietary accounts of PGIM Real Estate or its affiliates.

The opinions and recommendations herein do not take into account individual client circumstances, objectives, or needs and are not intended as recommendations of particular securities, financial instruments or strategies to particular clients or prospects. No determination has been made regarding the suitability of any securities, financial instruments or strategies for particular clients or prospects. For any securities or financial instruments mentioned herein, the recipient(s) of this report must make its own independent decisions.

Conflicts of Interest: Key research team staff may be participating voting members of certain PGIM Real Estate fund and/or product investment committees with respect to decisions made on underlying investments or transactions. In addition, research personnel may receive incentive compensation based upon the overall performance of the organization itself and certain investment funds or products. At the date of issue, PGIM Real Estate and/or affiliates may be buying, selling, or holding significant positions in real estate, including publicly traded real estate securities. PGIM Real Estate affiliates may develop and publish research that is independent of, and different than, the recommendations contained herein. PGIM Real Estate personnel other than the author(s), such as sales, marketing and trading personnel, may provide oral or written market commentary or ideas to PGIM Real Estate's clients or prospects or proprietary investment ideas that differ from the views expressed herein. Additional information regarding actual and potential conflicts of interest is available in Part 2 of PGIM's Form ADV.

INFORMATIONAL PURPOSES

These materials are for informational or educational purposes. In providing these materials, PGIM (i) is not acting as your fiduciary and is not giving advice in a fiduciary capacity and (ii) is not undertaking to provide impartial investment advice as PGIM will receive compensation for its investment management services.

These materials do not take into account the investment objectives or financial situation of any client or prospective clients. Clients seeking information regarding their particular investment needs should contact their financial professional.

The information contained herein is provided on the basis and subject to the explanations, caveats and warnings set out in this notice and elsewhere herein. Any discussion of risk management is intended to describe PGIM Real Estate's efforts to monitor and manage risk but does not imply low risk.

These materials do not purport to provide any legal, tax or accounting advice. These materials are not intended for distribution to or use by any person in any jurisdiction where such distribution would be contrary to local law or regulation.