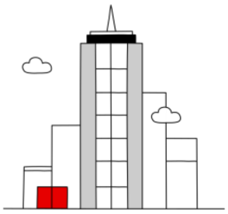
IPM monthly blog

Our monthly insights into private markets – **January 2024**

Real estate



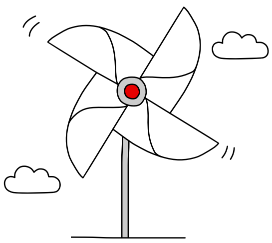
Interest rate outlook see-sawing

Interest rates are key for real estate performance and market expectations have been volatile, moving to a higher-for-longer narrative last October as war started in the Middle East, before falling sharply in December following dovish comments from the Fed and then being tempered in January as inflation showed a small uptick. Overall, we expect some cuts in interest rates to come through in 2024 and that these will support real estate markets bottoming out. Bigger cuts could lead to a sharper market bounce back, while interest rates being held higher-for-longer would be a drag on the market.

Preliminary data from MSCI for 4Q23 showed, after allowing for seasonal effects, that global investment activity slipped again, while data from NCREIF showed a 5.8% QoQ drop in capital values for US Open End Diversified Core Equity (ODCE) funds and MSCI/AREF reported a 1.9% QoQ drop in capital values for the UK All Balanced Open-Ended Property Fund Index.

Unlike during the post-Global Financial Crisis (GFC) decade, real estate today does not have the tailwind of low interest rates and debt to fuel returns. Hence generating good performance will rely more on asset management initiatives such as reducing vacancies, reducing lease-up times and improving assets to drive rental growth. Once interest rates have eventually fallen significantly and the market has fully re-priced, we expect debt, once again, to enhance returns.

Infrastructure



The acceleration of infrastructure fund consolidation

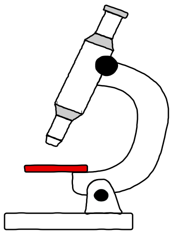
In the last five months, we have seen four major deals for infrastructure funds: BlackRock's purchase of Global Infrastructure Partners; General Atlantic's purchase of Actis; Bridgepoint's purchase of Energy Capital Partners; and CVC's purchase of DIF Capital Partners, with BlackRock CEO's declaration that "the future in private markets will be infrastructure" (adding an exclamation point to all this activity).

However, this trend is not surprising to industry insiders. Infrastructure has long exhibited strong resilience under different economic environments, while enjoying growth tailwinds. These recent transactions simply validate the growing appreciation that markets have for the asset class.

Future consolidation will likely further bifurcate the infrastructure markets: one end will continue to be dominated by generalist mega-funds, while the other will see smaller and more innovative niche strategies. This is already happening: since 2021, 30% of infrastructure funds raised were for sector-specific strategies[1], vs. only 10% back in 2019.

Note: **1** Infrastructure Investor Fundraising Report, October 2023

Private equity

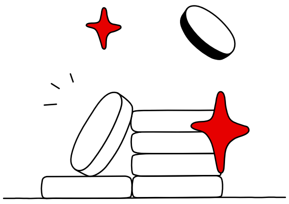


Attractive environment for co-investments and secondaries

We believe that 2024 will be a better year for private equity exits, assuming the global economy is able to achieve a soft landing. Market participants are becoming more accustomed to lower prevailing valuations for private companies, which, compared to public valuations, can be lower due to higher debt expense. This should facilitate a greater volume of transactions. While we do not yet see an imminent opening of IPO markets, this possibility remains for 2024. A trickle-down to earlier stages of venture capital would be expected to follow, bolstering the valuations of early-stage companies by increasing visibility to an important exit path.

The current private equity fundraising environment remains challenging for all but the highest quality sponsors. Timelines have been greatly extended and paired with increased need for equity capital due to higher interest rates. There is significant demand for LP co-investment capital. PE secondaries continue to be an attractive area for investment, with the current environment characterized by attractive assets and entry valuations at discounts to net asset values.

Private credit



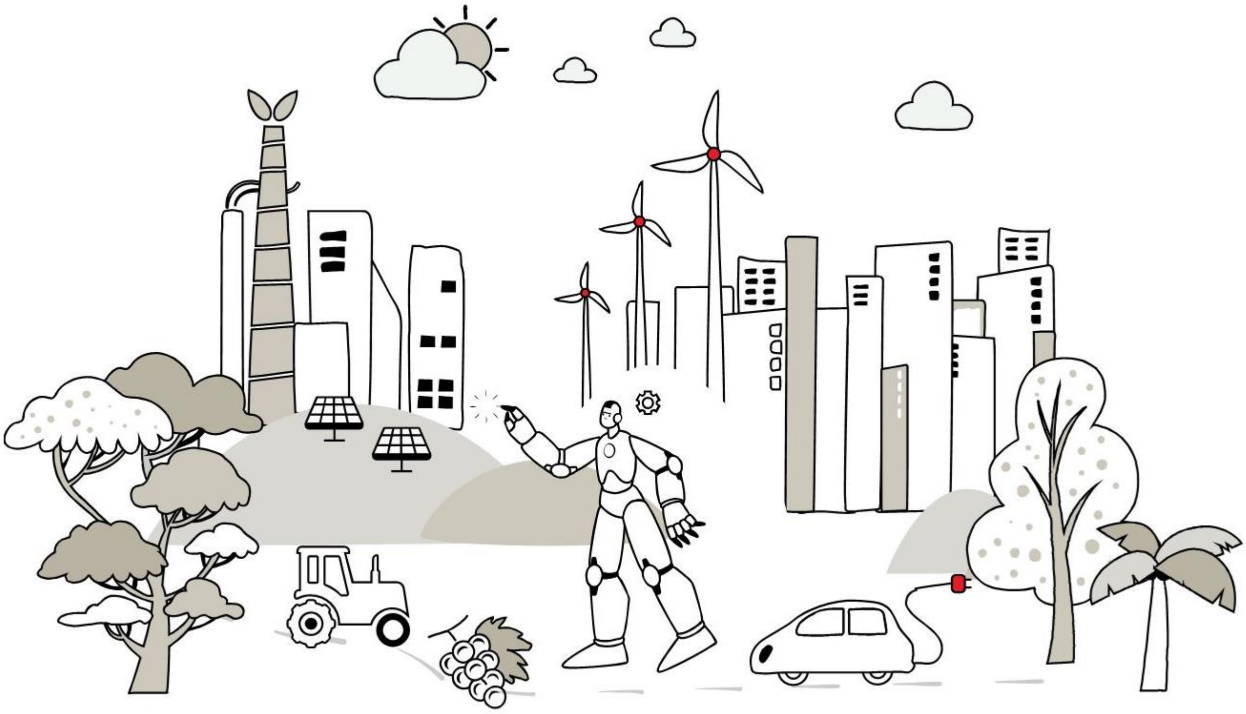
US housing market update: a mixed bag

US housing markets were a mixed bag in 2023, but proved more resilient than expected, largely bucking industry calls for a broad decline. However, rising mortgage rates, declining affordability and chronic undersupply led to a significant market slowdown. After a rather mild -4.8% decline in median home prices across MSAs in 2023 (following 45% increase since the start of COVID-19), there now appears to be a stalemate between record unaffordability and lack of supply, keeping the market from moving in either direction.

Green shoots appear to be emerging. Home price appreciation (HPA) has stabilized across most metro areas with a sustained recovery since October 2023 and an +8.1% annualized gain (Case Shiller Index). November housing starts picked up to 1.56 million, while homebuilder sentiment, though still negative, recovered on expectations of rate cuts. Mortgage rates also declined to ~6.42% as the economy began to slow. Delinquencies remain low, and most US borrowers have locked in rates well below the prevailing rate. Finally, supply remains significantly constrained due to a decade of below-demand construction following the Global Financial Crisis. Supply is further exacerbated given slowed current construction, and homeowner vacancy rates at all-time lows.

However, headwinds remain, primarily due to record unaffordability with the worst conditions in 41 years. Per the National Association of Realtors, the average mortgage payment is now 112% higher than at the start of COVID. Renting is more economical than buying, with many renters blocked from homeownership.

Looking forward, the 2024 outlook for housing is mixed with consensus calls for modest growth of 2-3%. Some optimistic investors expect as much as 5% HPA, hoping that rate cuts reignite the market. Affordability and supply will likely remain pivotal factors in the market's direction. With limited ability to improve supply in the near term, the market will likely continue grappling with this mixed bag until there is more clarity on rates.



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