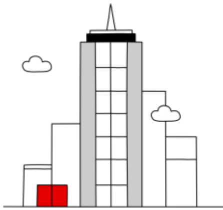
IPM monthly blog

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

Real estate



Finally, some promising signs

Market bottom is like a mythical being: many stories about it exist and some people swear they have glimpsed it, but the reality is that market bottom can only be seen in charts after the event. Yet, the likelihood of private, commercial real estate investors seeing market bottom in 2024 has increased across many countries and sectors.

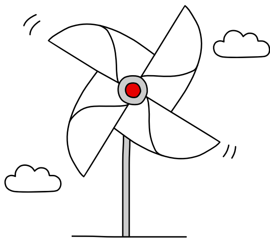
Real estate owners have now had two full years to adjust to a higher interest rate environment. Adjustment has meant planning for loan maturities, writing down values, and delaying the start of new construction projects. Two years is a long time, although there was a positive sign in 4Q23 – an increase in global transaction volumes led by APAC and Europe. Overall, in 2023, global transaction volumes are down 16% but between 3Q and 4Q23, volumes increased by 43%.

Transaction volumes tend to be a leading indicator for stabilization in prices. Price discovery from the small number of deals that trade each quarter is important information for informing the appraisal process in the private market.

Throughout 3Q23 – the most recent data point available – the MSCI Global Quarterly Property Fund Index posted a net total return of –1.61%. Total return is the combination of income return and capital return; the latter is largely based on appraised values. Despite the decline, the quarter marked the best performance since the index turned negative in 4Q22.

It is unlikely that private real estate values will turn positive during the first half of 2024, and performance in the US will likely lag. The more likely scenario is that values begin to stabilize by the middle of the year for all but the troubled Office sector, where forecasts remain weak for the foreseeable future. No one will witness the very bottom of the private real estate market. What is more important is being aware and ready to capitalize on opportunities as expectations improve throughout 2024.

Infrastructure



A healthy dose of animal spirits

We are seeing signs that a healthy dose of "animal spirits" returning to private infrastructure – major fundraising announcements and even M&A across infrastructure GPs have created a bit of a buzz.

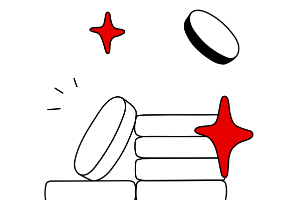
2023 was challenging for private infrastructure, as fundraising fell by 35% and transaction volumes fell by 20%. However, investor appetite remains strong. Based on a recent Infrastructure Investor survey, 41% of investors are looking to deploy capital into the asset class.

UBS

Despite having experienced a difficult year, there are signs of resilience: North American transaction volumes grew in 2023; asset class performance remains positive, and we have yet to see a major drawdown that some bearish investors anticipated. Slower inflation, the possibility of rate cuts, combined with the diminishing effects of the denominator effect, should all improve the overall outlook for infrastructure in 2024.

Alex Leung, Head of Infrastructure Research and Strategy, recently spoke to Infralogic on their Crossroads *Podcast*

Private credit



The opportunity set for 2024

The private credit opportunity set continues to evolve as markets react to central bank policy and an uncertain forward path for the economy. Key dynamics in credit markets include high base rates; a retrenchment of lenders (regional bank stress, regulatory driven); and a general tightening of credit spreads. Given these dynamics, we have been focused on identifying select credit segments that exhibit strong carry, attractive pricing both on an absolute and relative basis and solid fundamentals that would prove resilient across a variety of market environments. As a result, we have recently made opportunistic allocations to short duration homebuilder finance and reinsurance / Insurance Linked Strategies (ILS).

Short duration homebuilder finance

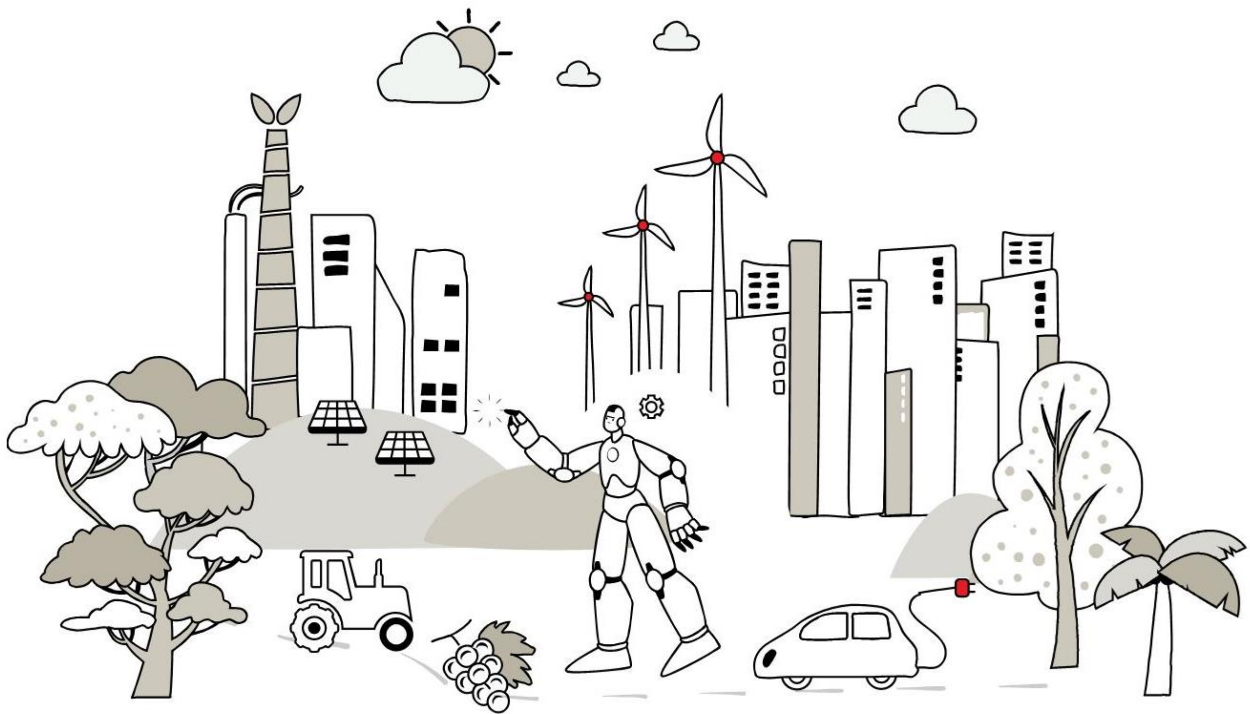
The strategy primarily focuses on partnering with homebuilders to fund the acquisition and development of land for building new residential master planned communities in core MSAs in the US. We have focused on shorter duration opportunities in acquisition, pre-development land deals and horizontal development (earlier phases of the homebuilding process prior to vertical construction). A&D Mortgage bridge loans are typically structured with low LTVs of 50-65% and 12-18 months.

Recourse land banking loans deals also have strong structuring, including several meaningful contractual enhancements, which includes attractive collateral with low loan to values (LTVs), and the ability to put the land back to the homebuilder at maturity. Given the shorter-term nature, complexity and niche off-balance sheet solution, homebuilders are willing to pay additional spread for these deals, with expected returns of 12-14%. The A&D loans have higher expected returns given wider spreads and fees, resulting in 15-20% gross unlevered IRRs. As the strategy offers strong structuring and credit protections, short duration and attractive yield, homebuilder finance remains a core allocation.

Reinsurance / ILS

The overall proportion of reinsurance capital represented by the alternative space has grown markedly over the years. However, interest in the strategy has ebbed and flowed with concerns over inadequate pricing, an excessive number of headline events, and climate change resulting in investor fatigue. Hurricane Ian in September 2022 (following the Katrina, Rita and Wilma in 2005) was the capstone event that resulted in the most attractive pricing since 2006 as investor interest in supplying capital waned while insurers simultaneously sought additional protection in both the cat bond and collateralized reinsurance markets. For ILS, pricing improvements registered in 2023 were largely maintained for the January 2024 renewal period.

Due to this elevated pricing, the strategy is positioned to generate an above-average loss-adjusted yield. Cat bond spreads are at higher-than-average levels (though off peaks witnessed in late 2022 after Hurricane Ian) and combined with the current high risk-free rate offer loss-adjusted net yields of approximately 11%. Following consecutive years of unexpected weather events, subsequent market repricing, and rising base rates, the reinsurance / ILS market now offers notably attractive carry via elevated risk premiums and no-loss returns across catastrophe bond and reinsurance strategies, respectively.



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