nuveen
REAL ESTATE

October 2024

Is it time to reallocate to real estate?

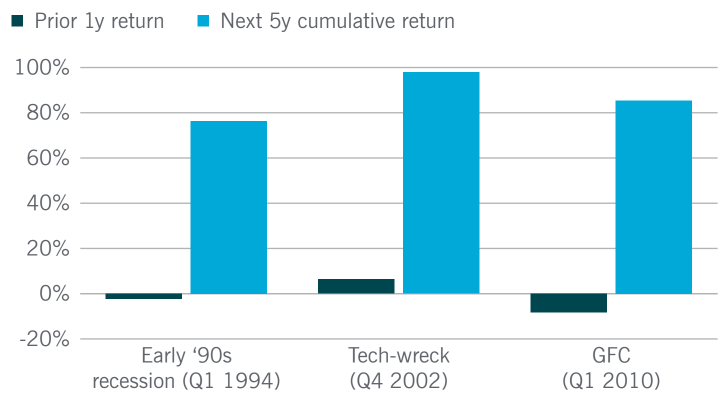
Donald Hall
Global Head of Real Estate Research

Global real estate returns turned positive in the second quarter following two years of cumulative losses, suggesting a budding recovery in the asset class.

In the era of low interest rates, real estate values were flying high. Globally, total returns reached 5.0% quarter-over-quarter in Q4 of 2021 and 17.8% year-over-year in the subsequent quarter – figures that were well above long-term averages. The tightening cycle that followed more than unwound those gains, with values now back to 2018 levels globally.[1]

We believe the real estate market correction is nearly complete and investors should take a fresh look at the asset class, which has historically generated stable income returns and portfolio diversification benefits over the long-term — and can offer robust returns during a recovery period. For example, after the early 90s recession, investors experienced a 76% cumulative return over the next five years. Following the tech-wreck, the five-year cumulative total return was 98% and in the aftermath of the Global Financial Crisis, 86% (Figure 1).

Figure 1: Total returns, U.S. NCREIF ODCE Index



Source: NCREIF ODCE Index (as of 2024); Nuveen Real Estate Research
Past performance is no guarantee of future results. It is not possible to invest in an index.

EVIDENCE OF A TURNAROUND IN…. VALUATIONS

In the second quarter of 2024, global value losses moderated to 0.74%, the lowest quarterly adjustment of the prior two years. With offsetting income returns of 1.07%, global real estate notched a positive 0.33% return, the first positive quarter since the second quarter of 2022 (Figure 2).

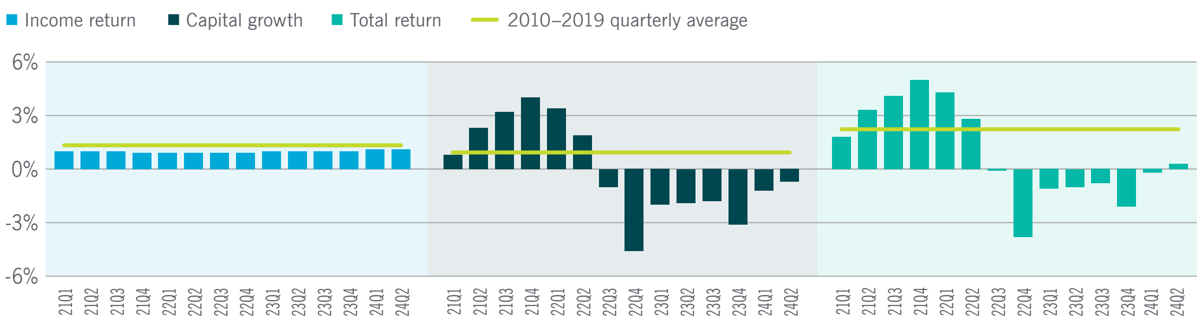
Across the 15 global markets that comprise of the MSCI Global Property Index, a slight majority experienced write-ups in real estate values during the second quarter for the first time since Q2 2022. Eight markets saw values increase from the prior quarter: Japan, South Korea, Singapore, Southern Europe, the Nordics, the Netherlands, France, and the United Kingdom.

Six markets saw value losses between 0.3% and 1.5%, all of which had moderated from the previous quarter. Only Australia recorded a larger write-down in the second quarter than it did in the first — a 4.2% correction which brought valuations more in line with the country's peer set. However, change in capital values is only one component of real estate returns. Historically, the larger component of total returns is income.[2]

...TOTAL RETURNS

Income returns are generally stable by nature and are often cited by investors as one of their primary reasons for investing in the asset class.[3] Capital returns plus income returns equal total returns, and in the second quarter total returns were positive nearly everywhere – twelve of fifteen countries (Figure 3). They were essentially flat in the U.S. (-0.09%), marginally negative in Ireland (-0.22%), and only significantly negative in Australia (-3.07%). Global data for the third quarter was not available at the time of publication, but preliminary data from the NCREIF ODCE index showed U.S. total returns ticking positive in Q3 (0.25%). With evidence of values beginning to rebound, we expect the positive trajectory in total returns to continue.

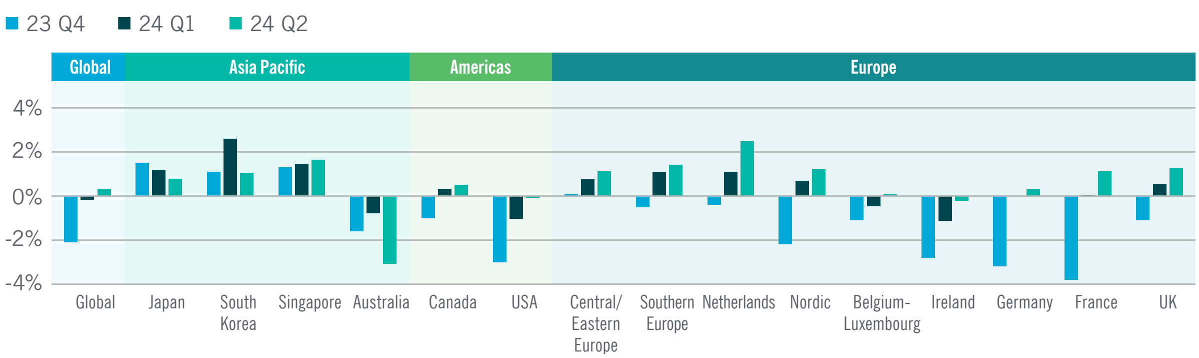
Figure 2: Quarterly returns Q1 2021 – Q2 2024



Source: MSCI Global Quarterly Property Index (Q2 2024 data as of 4 September 2024 data release); Nuveen Real Estate Research

Past performance is no guarantee of future results. It is not possible to invest in an index.

Figure 3: Total returns



Source: MSCI Global Quarterly Property Index (Q2 2024 data as of 4 September 2024 data release); Nuveen Real Estate Research

Past performance is no guarantee of future results. It is not possible to invest in an index.

...AND AROUND THE WORLD

Using the most recent data from the transaction market (Figure 4), we are starting to see further signs in a budding recovery. Of 11 countries with data available through MSCI's Commercial Property Price Index, five saw transaction prices increase in the second quarter — Japan, Canada, the United States, France and the United Kingdom. Prices in the U.S. were up more than any other country with gains in Chicago, Washington DC, Los Angeles, Orange County, New York City Suburbs and San Jose.

In each country, there is significant variation by property type and by market. For example, as of August prices in the beleaguered U.S. CBD office market fell 27.4% year-over-year but prices in the more resilient industrial market increased 6.9%.

Orange County in California saw price gains of 2.5% in the second quarter across property types, while the Greater San Francisco area experienced a 3.0% price decline. Even within a market there can be large differences — within the Greater San Francisco area, the city of San Francisco saw a 4.8% decline while the San Jose market saw a 1.7% increase in prices. This differentiation highlights the opportunity for outsized returns during a period of price discovery, if you invest in winning markets and property types (Figure 5).

STABILIZING FUNDAMENTALS

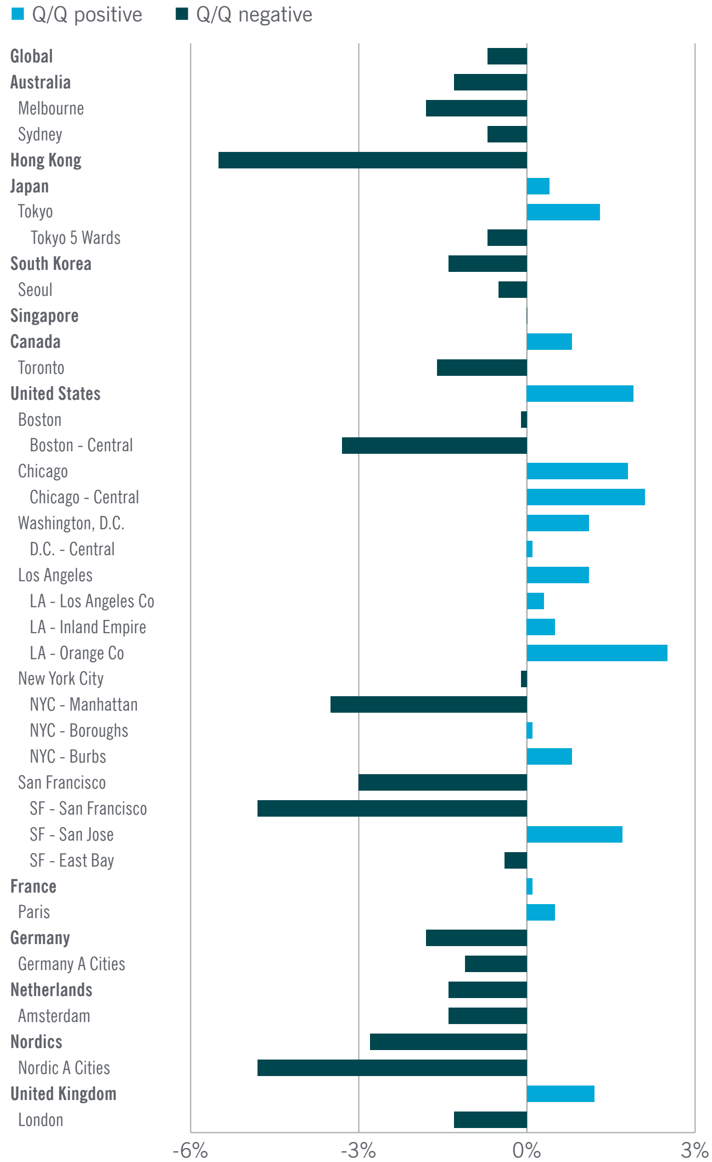
Stabilizing valuations and transaction market pricing both point towards a market that is likely near its bottom, but these signals alone would not indicate an attractive entry point for real estate. For market pricing and valuations to increase going forward, we would ideally see declining interest rates and strengthening property fundamentals going forward.

Most developed market central banks are beginning to taper interest rates, which should put downward pressure on financing rates, discount rates, and property capitalization rates — boosting the value of real estate assets.

A pullback in construction activity across sectors bodes well for property fundamentals in the medium term. The U.S. apartment and industrial

Figure 4: Global transaction pricing

Q/Q change in transition pricing (RCA CPPI)



Source: MSCI Real Capital Analytics (as of Q2 2024); Nuveen Real Estate Research

Notes: Price indexes are for commercial real estate (office, industrial, retail); Cities are metro areas unless otherwise indicated; German A Cities are Berlin, Cologne, Dusseldorf, Frankfurt, Hamburg, Munich and Stuttgart; Nordic A Cities are Copenhagen, Helsinki, Oslo and Stockholm

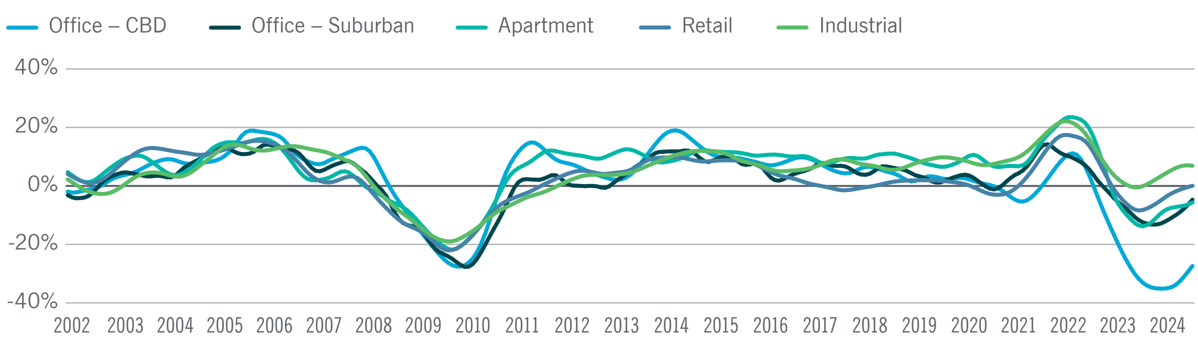
markets are seeing new construction starts less than one-third of peak levels with the amount of space currently under construction already back down to pre-pandemic levels (Figure 6). Interest rates may be moderating, but construction financing is still expensive. A pullback from local and regional banks (which often finance construction) should equate to a decline in construction activity going forward.

While these dynamics may offer challenges to property developers, for landlords and investors this is a welcome development. With supply headwinds waning, for markets that have positive demand due to population growth or structural changes (e.g. ecommerce), occupancies are set to increase in the medium term. Historically, occupancies and rent growth are well correlated, giving investors an opportunity to see gains from occupancies, rents, and the associated increase in property values going forward.

The outlook today for global private real estate seems to be looking up, but the rising tide is unlikely to lift all boats. For example, the U.S. office market still has challenges to work through and a broad recovery in that segment of the property market seems highly unlikely in the near-term. This supports the need for research and selectivity when investing.

Figure 5: U.S. commercial property index (2000-2024, annual)

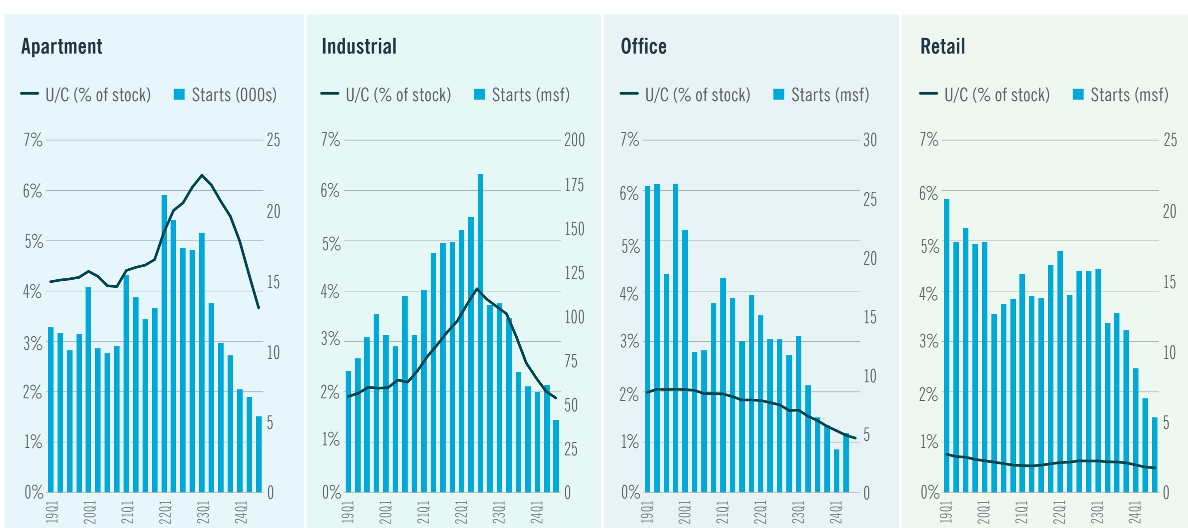
U.S. commercial property price index (Y/Y)



Source: MSCI Real Capital Analytics (data through August 2024 as of September 2024); Nuveen Real Estate Research

Figure 6: U.S. construction activity by property type

U.S. commercial property price index (YoY)



Source: CoStar (Q3 2024); Nuveen Real Estate Research

REBALANCE WITH REAL ESTATE

An uncertain economic and geopolitical environment creates additional risk, but the same could be said across all asset classes. Over the last two years, the weight of real estate in investors' portfolios has decreased materially — a result of resetting real estate values and a record stock market.

Investors today may consider fresh allocations to the private real estate market to bring their allocations up to a strategic weighting. Over the long-term, private real estate offers low correlations to other asset classes, strong income returns, and a degree of inflation-hedging. While there may yet be a bump or two in the road, we believe the market is starting to look up and there are excellent investment opportunities today for savvy investors.

For more information, please visit nuveen.com.

Endnotes

Sources

1 MSCI Global Quarterly Property Index (Q2 2024 data as of 4 September 2024 data release)

2 MSCI Real Capital Analytics CPPI (as of Q2 2024)

3 ANREV/INREV/NCREIF Fund Manager Survey 2024. Survey illustrated rankings of 96 fund managers globally by AUM as of 31 Dec 2023.

nuveen
REAL ESTATE

1781950 396573-0426