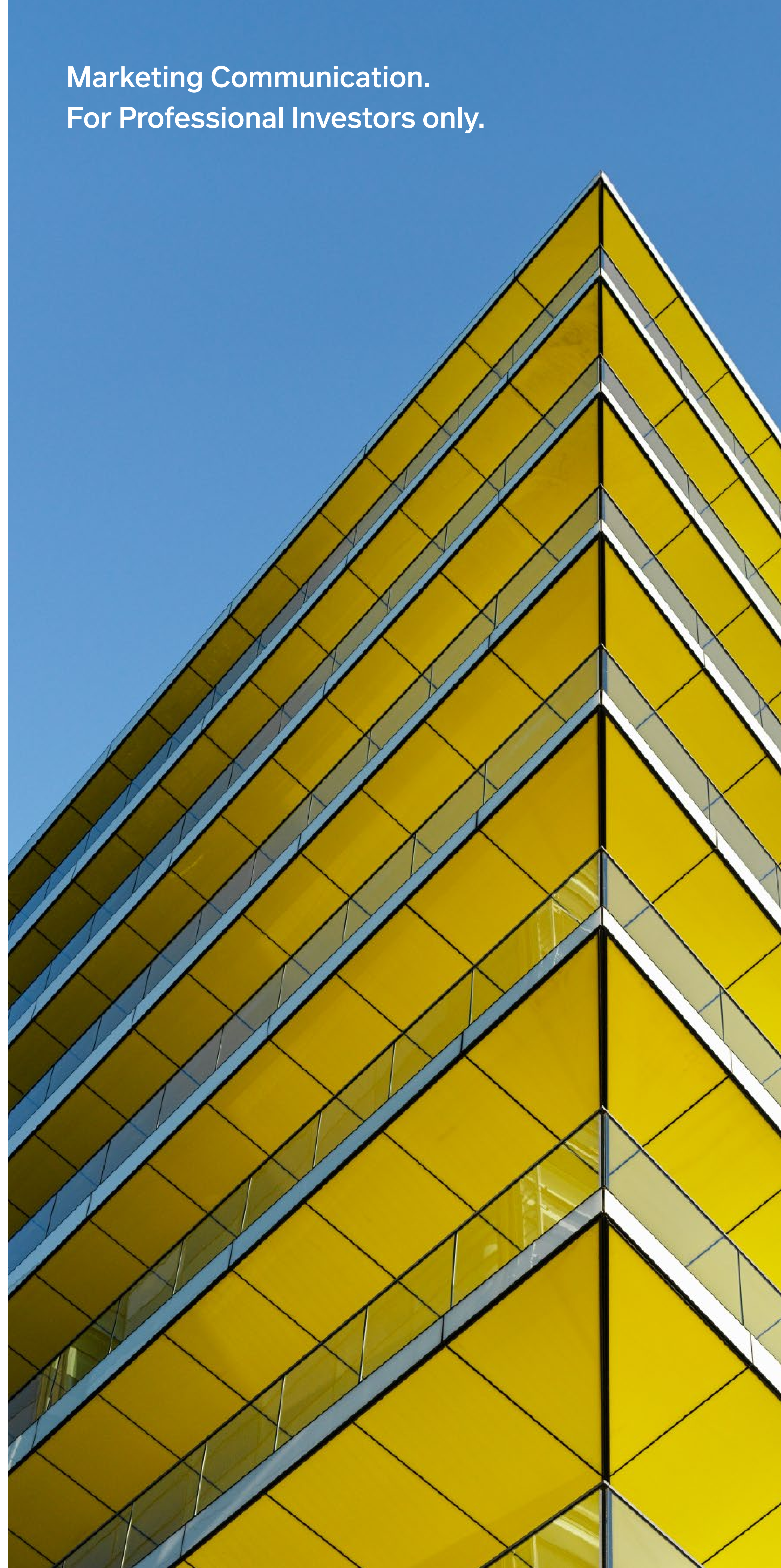


Global Real Estate Outlook 2025: A new chapter begins

Introduction

Appetite for real estate investments is continuing to rise, given most global markets have reached a turning point, with capital values largely stabilised and some having begun their recovery phase. As we enter a new cycle, we believe lower entry prices, coupled with strengthening rental growth, make for attractive return potential.

We see ripe conditions for investors to leverage structural sector tailwinds, underpinned by supply constraints and increasing demand. However, as we expect the market recovery to be uneven, backing the right asset in the right place is likely to be the key to outperformance.

Heightened uncertainty around the degree and duration of interest rate cuts, following the outcome of the US election, could also mean investors need to rely more heavily on investments that offer greater scope for rental growth to meet return requirements. Supported by asset repricing, we believe repositioning weaker assets early on in the cycle could be an effective route, with the potential to generate additional value as the recovery strengthens.

With increased optimism moving into 2025, we believe it is an opportune time to take advantage of real estate markets' upswing, tapping into the most attractive performance prospects the asset class has seen in many years.

The value of investments will fluctuate, which will cause prices to fall as well as rise and investors may not get back the original amount they invested.
The views expressed in this document should not be taken as a recommendation, advice or forecast. Past performance is not a guide to future performance.
Information is subject to change and is not a guarantee of future results.

Key trends

Embracing this cycle's upswing

The last two years have been a period of painful adjustment for real estate, almost irrespective of sector or geography. Now though – even in more challenged markets – valuations have largely stabilised, setting the scene for the next chapter. After pain, inevitably comes recovery and even burgeoning optimism about the opportunities that the beginning of a new cycle can bring.

At a new, adjusted price point, reasons for investing in real estate now look more compelling. In our view, we believe the next five years to reflect the strongest performance that real estate has seen for the best part of a decade, driven by a combination of more attractive income return potential and strengthening rental growth, as recovering demand meets heavily constrained supply.

While not universal, some yield compression also looks likely to re-emerge as confidence grows, risk aversion starts to fade and investors begin to compete for the most attractive assets, bolstering performance. Core assets, particularly in the ever-attractive 'beds and sheds' sectors – and even in parts of the retail or office sectors – look best-positioned to likely benefit in the early stages of the cycle.

For some investors, now too could be the time to consider moving further up the risk curve. We believe structural challenges, combined with cyclically depressed prices, offer attractive opportunities to reposition assets to generate alpha – outperformance against the wider market – as the recovery strengthens.

Sizing up a K-shaped recovery

As a continuing market recovery unfolds, opportunities are arising to embrace the upswing and tap into assets that stand to benefit from such growth. But it won't be an even climb.

We see a K-shaped recovery – meaning that while we're confident in many assets enjoying an upward trajectory, we also believe some assets face further decline. Offices are a clear example. Best-in-class buildings should continue to outperform and see their values rise, while weaker assets look destined to continue on a downward leg, amidst rising risk of obsolescence.

At the same time, location also looks to be a key driver for the next cycle, especially for retail and office assets where occupier focus continues to narrow.

Potential for distress materialising from assets that may struggle to secure refinancing could prolong their pricing pain. It could also bring opportunities for improved returns thereafter, for investors that are able to acquire assets more cheaply.

Equally, we believe investing on the other side of the capital structure, through real estate debt, could help to mitigate the downside risk associated with assets that could be more vulnerable to a downward trajectory.

Investors with the ability to execute brown-to-green strategies could shift an asset's course altogether, perhaps moving it from the downward leg of the 'K' to the upward one. This strategy could prove particularly successful for well-located buildings.

Even when backing resilient asset types, however, how assets are managed and operated is integral to their ongoing performance. Understanding tenants' evolving needs and staying sharp to operational risks like technological change, for example, cannot be underestimated.

The global housing challenge persists

Although inflation levels have now fallen dramatically from their recent peaks in developed economies, housing costs look set to continue experiencing elevated rates of potential growth.

Despite wage growth, affordability has become more stretched than ever in many housing markets, underpinned by structural drivers.

While the heightened strength of rental growth across housing tenures can be attributed, in part, to a confluence of post-pandemic market dislocations, structural supply-demand imbalances persist in developed economies across the world. Demand for housing is set to continue to grow apace in major urban areas as a result of ongoing robust population growth, driven by high levels of internal and international migration.

Housing supply has struggled to keep pace with elevated demand, especially following a period when market uncertainty as well as high costs of debt and construction have weighed on activity. However, this has been a longer-term issue, with ambitious government targets for new housebuilding in developed economies having rarely been met, often hampered by funding constraints. Lower-income households have borne the brunt of the resulting deterioration of housing affordability, especially as affordable housing development has been most severely affected by viability challenges.

This presents an opportunity for institutional capital to help address this pressing social need by investing in affordable housing solutions. Unlocking more housing supply, across both ownership and rental tenures, will be critical to alleviating the strain on household budgets and improving liveability in the world's major cities.

UK

Economic highlight:
Fading headwinds to support growth potential

The UK economy has demonstrated unexpected resilience in 2024, marking a shift from its recent lacklustre performance and helping to drive an uptick in economic sentiment. With growth leading the G7 through the first half of the year, both the OECD and IMF were prompted to revise their GDP forecasts upward for 2024 and 2025.

From a cyclical perspective, the UK continues to experience low levels of unemployment and in October, inflation dipped below the Bank of England's 2% target for the first time since April 2021. In this context, we expect both further interest rate cuts and real wage growth to support consumer demand moving forwards.

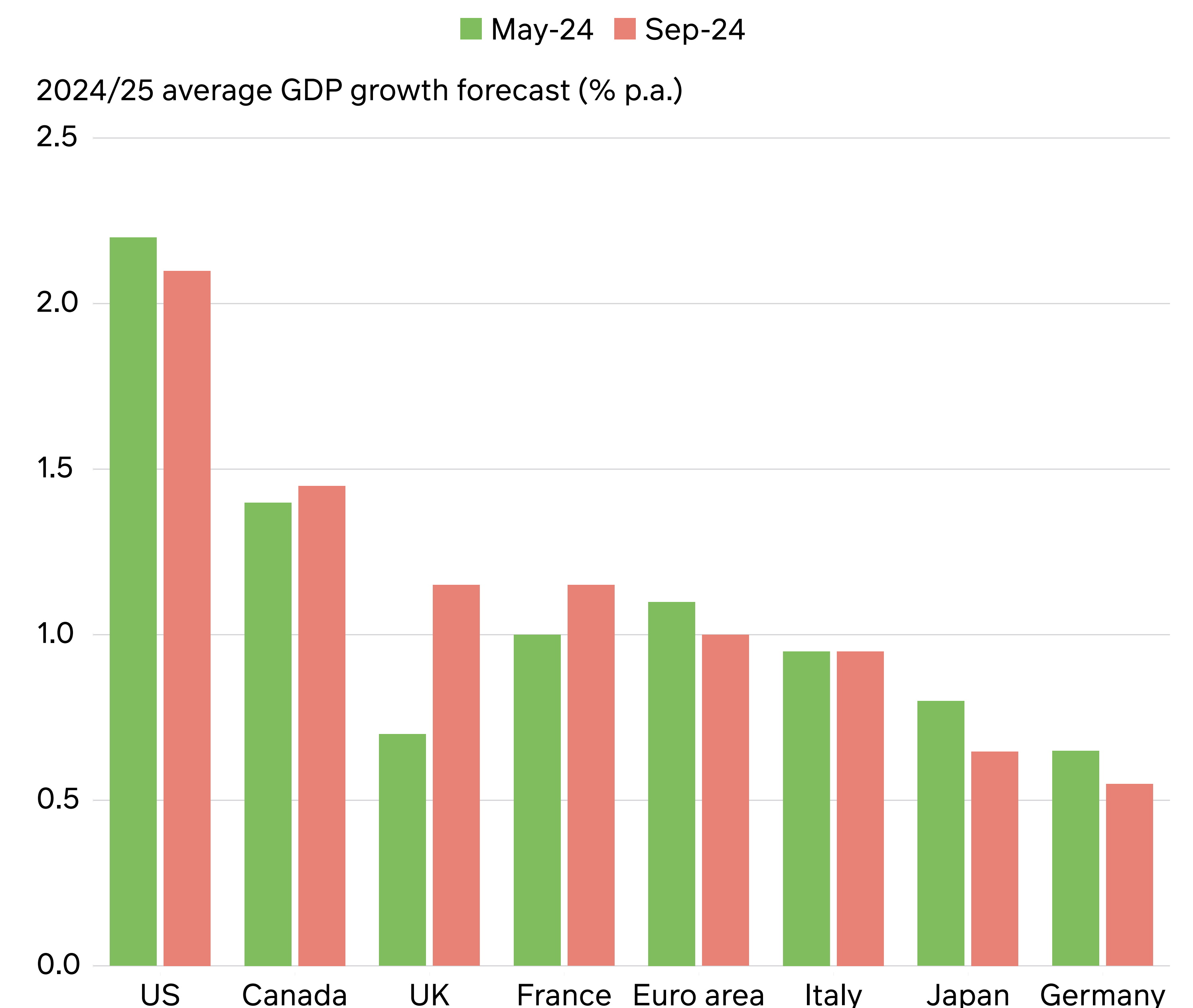
Perhaps more significantly though, the UK appears to have emerged from a prolonged period of uncertainty relative to other developed economies, in which numerous challenges including Brexit, the 'mini-budget' and political instability harmed confidence and investment in the economy.

Having navigated this period of uncertainty, we believe the UK is now better positioned to benefit from renewed economic momentum.

This is not to say that the UK does not face challenges. The UK continues to face elevated interest rates compared to European and many advanced Asian economies, meaning relatively high debt servicing costs. Like many developed economies, there are mounting concerns about the long-term fiscal burden. In our view, the most pressing challenge facing the UK lies in improving productivity and fostering long-term growth, while operating within tight fiscal constraints.

Nonetheless, the economy looks to have moved beyond some of the very pessimistic scenarios that dominated headlines in recent years, reducing uncertainty and creating conditions for investment, as well as spurring on occupier demand.

Growing optimism over the outlook for the UK economy relative to other G7 countries



Source: OECD Economic Outlook (2024).

UK

Real estate theme one: Building returns through the recovery

Given a brighter political and economic outlook, and average capital values having returned to growth, we believe UK real estate looks well positioned for investors looking to cautiously move up the risk curve as recovery sets in, benefiting accordingly from stronger performance.

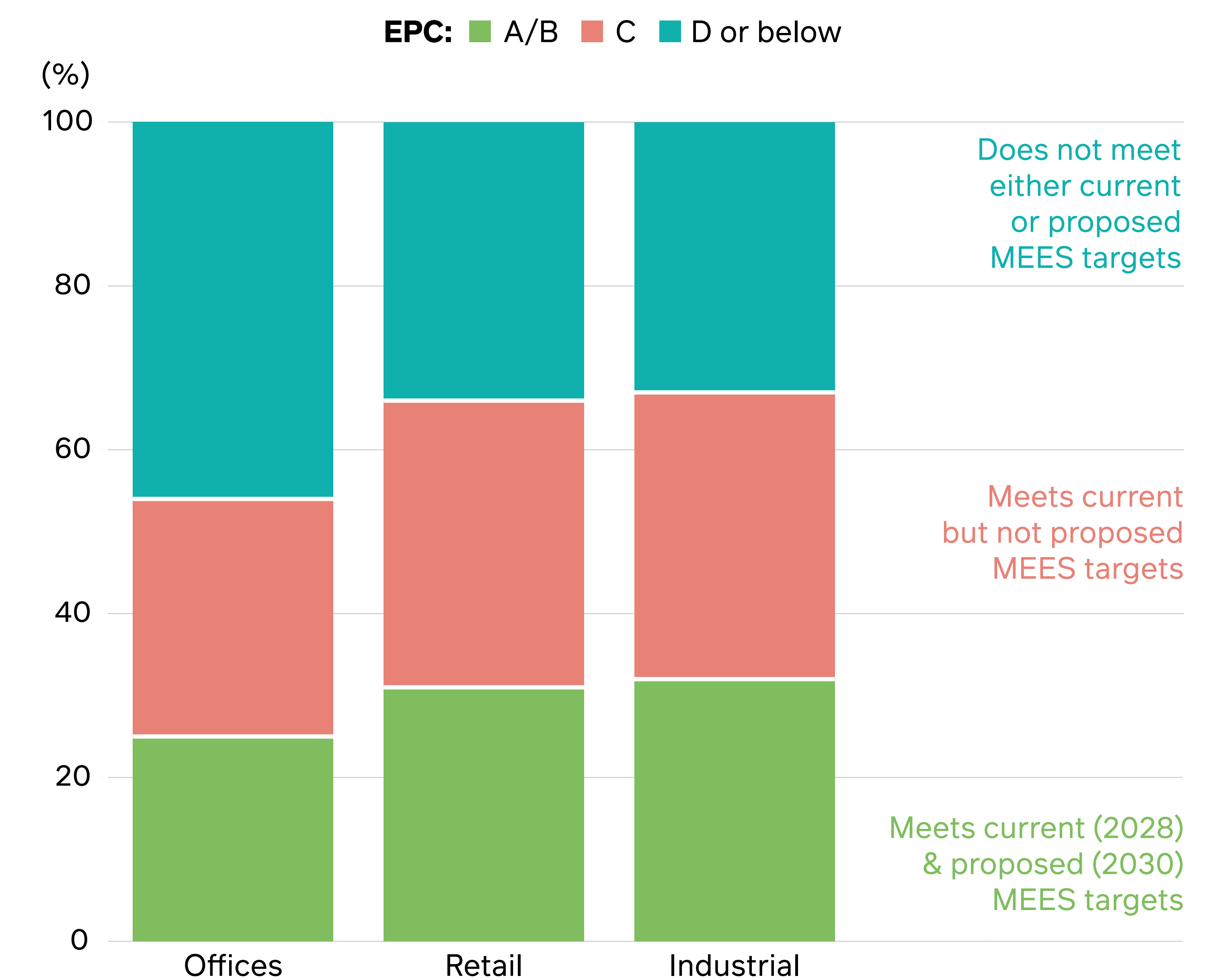
Structural undersupply looks set to define the next cycle; the provision – and creation – of the best quality and most sought-after stock is likely to be a key route to achieving strong returns, in our view.

The multi-let industrial sector remains near the top of investors' hit lists. However, with available stock hard to find and even harder to acquire, investors that are keen to allocate more capital to the sector may have to think outside the box. Build-to-core strategies could offer an attractive access route while boosting performance potential by taking on development risk.

Brown-to-green strategies, meanwhile, could offer an even greater opportunity for investors to create higher quality, more sustainable stock as the UK begins its new cycle. Market repricing has widened the discount both in rent and valuation terms between 'the best and the rest', particularly in the office sector. Local authority attitudes are also shifting towards 'retrofit first'. Against this backdrop, we believe selectively upgrading some of the 70% of space that currently falls below proposed required Minimum Energy Efficiency Standards (MEES)[1] increasingly makes financial, and not just environmental, sense.

With income likely to be the main driver of returns for the market as a whole, we expect core plus or value add strategies that can improve existing assets or build new ones could generate alpha and outperformance in this cycle.

Upwards of two-thirds of existing floorspace does not meet proposed future MEES requirements



Source: Knight Frank, Meeting the Commercial Property Retrofit Challenge, Q3 2024.

[1] Commercial Property Retrofit Challenge, Q3 2024, Knight Frank.

UK

Real estate theme two: The need for social investment provides an opportunity for real estate investors

Increasing investment and productivity are currently pressing topics in the UK, with the economic uncertainty of the last few years having limited capital spending from both the public and private sectors.

Having navigated these challenges, the UK looks well-positioned for recovery, and with a new government whose stated focus is creating conditions for growth, emphasis is shifting towards harnessing private capital to boost investment and productivity.

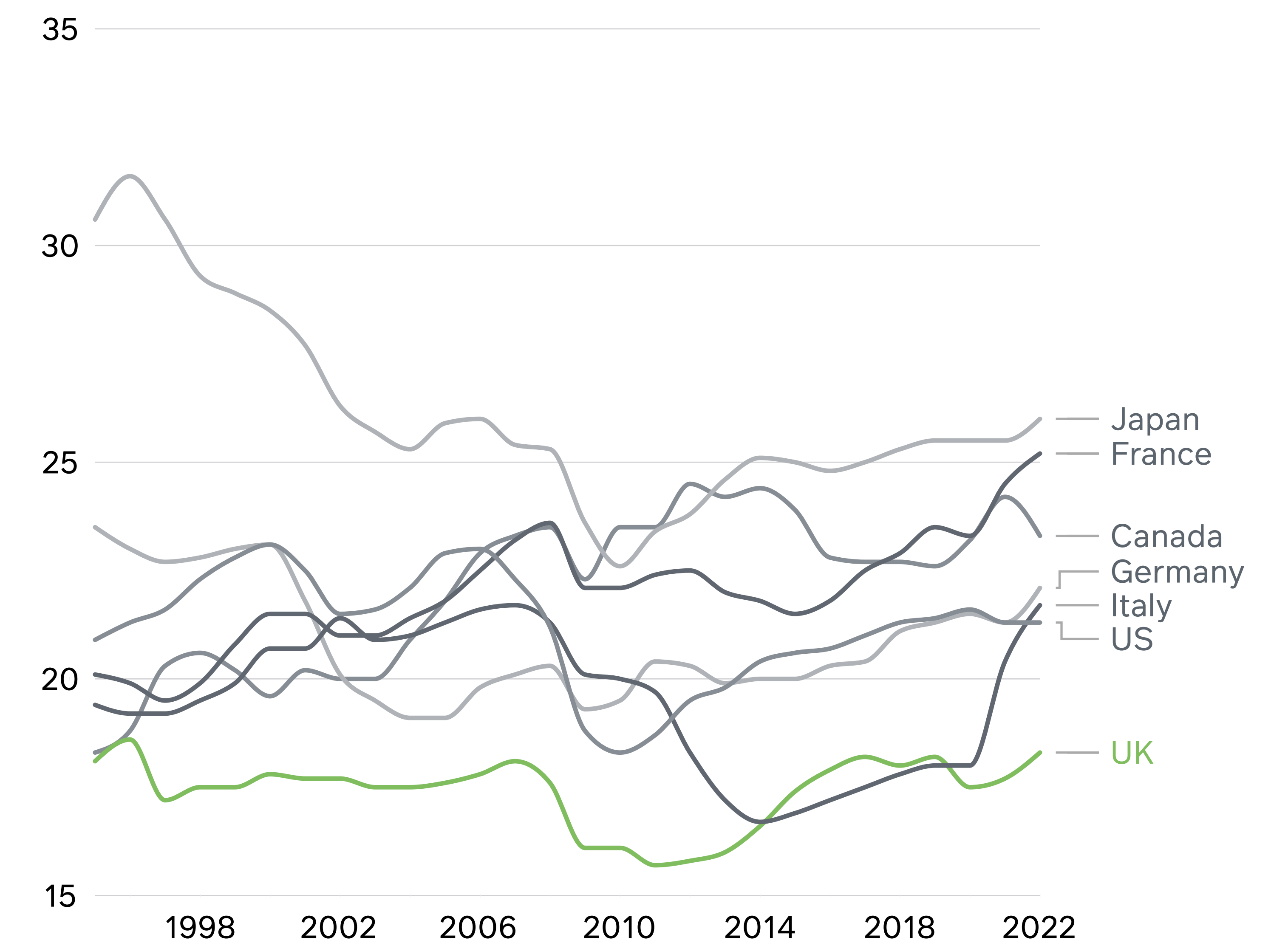
With decades of underinvestment in essential UK infrastructure such as housing and healthcare, we believe investors could tap into a significant opportunity to drive growth.

This structural requirement is supported by strong cross-party political backing, a shortage of aligned private capital and an ambitious investment pipeline, creating what we see as an abundant landscape for holistic, private asset investing.

For real estate investors, this provides a significant opportunity to accelerate and enhance economic and social outcomes. However, importantly, this may come with the potential to access an attractive, income-led return in our view.

The UK's significant market repricing provides the ability to access key needs-based investments in sectors like housing, healthcare or education at a more potential attractive yield, while risk-adjusted returns are further supported by the defensive and often inflation-linked nature of lease structures in these sectors.

New supply looks set to be restrained in most markets... but not everywhere



Source: ONS 2023, whole economy investment (Gross Fixed Capital Formation, public and private sectors).

UK

Real estate theme three: The right asset in the right place

In the last cycle, structural sector tailwinds, as well as greater potential for yield compression, meant even investing in poorer-quality, high yielding industrial assets provided an average return of more than 10% per year. Contrast this with the retail sector, where performance was below average throughout the sector, even for the best assets[2].

This cycle could play out differently, however. Even while wider macro trends are likely to remain supportive for industrial and challenging to retail and offices, the micro-level story is no longer as straightforward.

The surge in the supply of logistics space over the last couple of years has driven significant variation in vacancy rates even for the best quality stock. Prime logistics vacancy in Yorkshire, Northern England is close to recent highs and more than double the rate in London, for example, limiting rental growth potential.

Meanwhile, the UK's more dominant regional shopping centres look set to buck the subsector's performance trend, with the high yields on offer likely to be supplemented by rental growth as occupiers resume targeting space in the 'right' locations.

Offices remain beset by negative rhetoric, but this is not the whole story. Prime, well-located assets remain very successful in attracting occupiers, and investor demand is there from long-term, patient capital like insurance companies.

Changing dynamics within sectors themselves suggests that in the near-term, UK performance is likely to evolve from being sector-driven to asset-driven. Having the right asset in the right place may be the key to outperformance as the cycle turns.

[2] MSCI Quarterly Index, Q3 2004.

UK

Strategic calls

Resilient

Affordable housing: With a supply backlog of 4.3 million homes versus the average Western European country[3], and house prices close to historic highs, the UK's need for more homes, and particularly, affordable homes, is only likely to grow. Supportive supply and demand dynamics and the potential to create positive social outcomes, combined with attractive RPI-linked income streams, underpin the investment case for the sector.

Urban multi-let industrials: While rental growth is unlikely to return to levels seen over the last few years, rental prospects still look appealing for this undersupplied subsector. With investor demand still focused on this part of the market, as a result – particularly in London and the South East – we also expect yield compression to bolster returns over the medium-term in our view.

Tread with caution

Life sciences: A clear winner from the pandemic, the recent sharp reduction in venture capital funding for life sciences, given higher inflation and interest rates, has highlighted the cyclical nature of the life sciences sector. While still attractive given its links to major structural tailwinds, the weaker occupier backdrop highlights the importance of focusing on top-tier, academic-led markets, such as Oxford or Cambridge, to benefit from continued growth potential.

Longer-term opportunities

Data centres: In our view, the digitalisation megatrend looks set to drive significant occupier and investor demand for data centres, and therefore potentially strong performance prospects. However, the sector isn't without its challenges: the sheer speed of technological advance as data centres seek to adapt to more data-intensive AI uses, for example, could mean some assets face rapid obsolescence. Careful stock selection and deep knowledge of the science and technology backing the sector is vital.

Single-family housing (SFH): While existing Build to Rent stock is largely weighted towards multi-family housing, single-family housing makes up more than half of the wider private rented sector. Given supportive demographic trends and the more challenged owner occupier affordability seen for houses, especially given high mortgage rates, we believe significant potential exists to boost risk-adjusted returns by diversifying portfolios into suburban SFH.

Dominant regional shopping centres: More than a decade of retail structural change is finally receding and the best quality shopping centres are starting to see growing occupier demand and a return to rental growth, after significant rent rebasing. We believe yields are also now looking attractive on a risk-adjusted basis, suggesting an attractive return profile for these assets.

[3] The housebuilding crisis, Centre for Cities, February 2023.

Europe

Economic highlight one: An uneven economic recovery on the continent

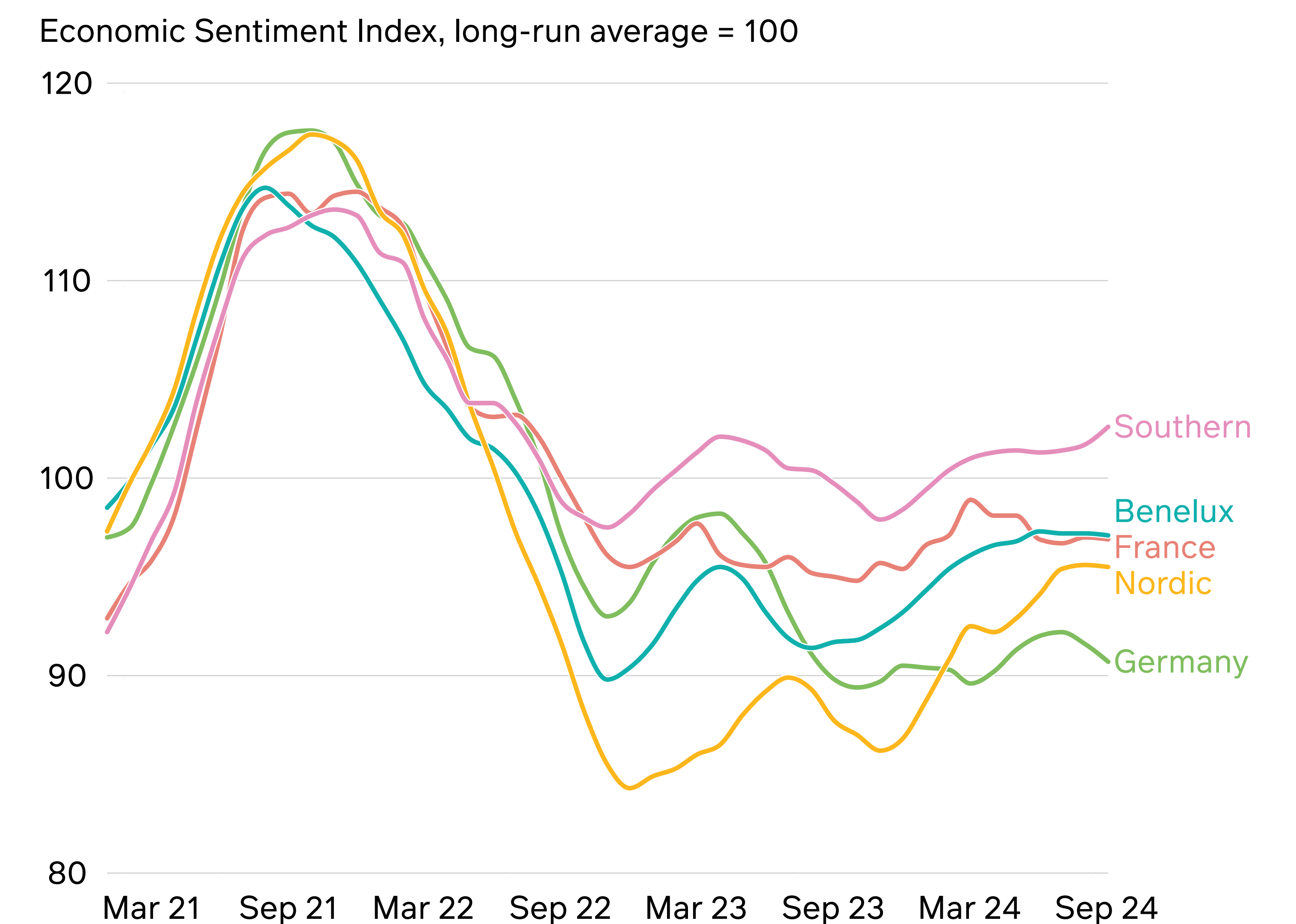
Continental Europe's economy has been on a bumpy ride over the last few years. Sharp inflation combined with rising interest rates and slowing global economies, as well as compounding domestic consumer caution, have negatively impacted business confidence and ultimately the region's economic growth. There have, however, been some bright spots of resilience and strong growth in some areas.

Looking forward, the region is likely to show signs of a cyclical recovery in 2025 as a number of these factors fade or even go into reverse. The recovery is likely to be uneven across Europe, however. This is particularly the case at the national level, but also in a more granular sense when looking at different economic sectors (eg services versus manufacturing), and at the city level.

Some European economies may continue to face structural headwinds. Examples include Germany, whose heavy industrial base is challenged by high and volatile energy costs, and France, where political risk and fiscal concerns are already being reflected in higher borrowing costs for the government.

On a more positive note though, cyclical beneficiaries of falling interest rates are likely to be the Netherlands and Nordic economies, which can be more interest rate sensitive, especially within the household sector. Spain – and southern Europe more broadly – looks set to continue its economic outperformance. This stems from a strong tourism sector, lower economic sensitivity to high energy costs, and immigration driving growth – while public spending alongside high levels of foreign investment also boosts GDP.

Divergence in economic sentiment indices likely to feed through into real economy



Source: M&G Real Estate based on European Commission (October 2024).
Notes: Based on trailing three-month average; Regional scores are individual country-weighted as follows: Benelux (Netherlands 60%, Belgium 30%, Luxembourg 10%); Nordic (Sweden 33%, Denmark 33%, Finland 33%); Southern (Spain 40%, Italy 40%, Portugal 20%). Source: M&G Real Estate based on European Commission (October 2024).

Europe

Economic highlight two: Consumer caution beginning to thaw

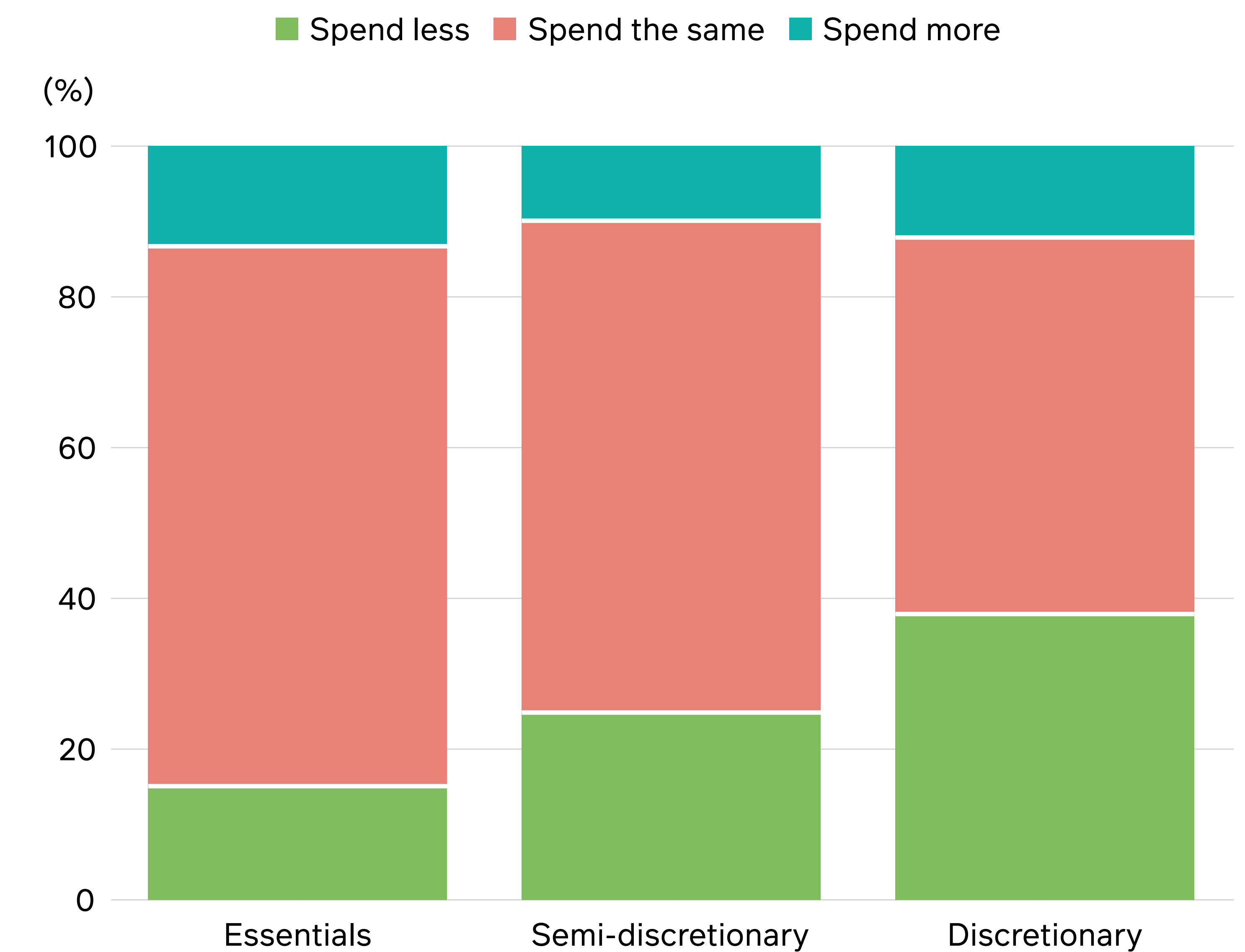
European consumers have been vulnerable in light of the region's economic stagnation. Adjustments in spending habits in the recent period of high inflation can be balanced against longer-term trends in how and where consumers purchase both goods and services.

Buoyed by a tight labour market and, to an extent, collective bargaining agreements for unionised workforces, employed Europeans have seen strong nominal wage growth over the last three years. Only since inflation has fallen, though, have these positive developments actually begun to improve their real spending power. And with higher interest rates, household savings rates have remained surprisingly high as persistent consumer caution has not yet translated into a decisive positive move on retail spend.

However, looking forward, we expect consumer behaviour to trend more positively – with knock-on impacts particularly for the retail, logistics, leisure and hospitality sectors.

The shape of this recovery in consumer spending should mirror national economic trends, in our view, with spending reflected differently across the spectrum of goods and services. Broadly speaking, we expect necessity spend (eg groceries) to continue to exhibit stable characteristics, while more volatile elements of discretionary spend could benefit from a cyclical upswing as the economy and consumer confidence improves.

Growing consumer spending is expected to flow through to essential items ahead of discretionary expenses



Source: M&G Real Estate based on McKinsey (September 2024).
Notes: Sample from McKinsey ConsumerWise EU-5 Sentiment Data (France, Germany, Italy, Spain, and UK), Aug 2024, (n = 5,094). Products classified by McKinsey; average scores of essentials (7 items), semi-discretionary (7 items), and discretionary (22 items).

Europe

Real estate theme one: Low supply still a tailwind for growth

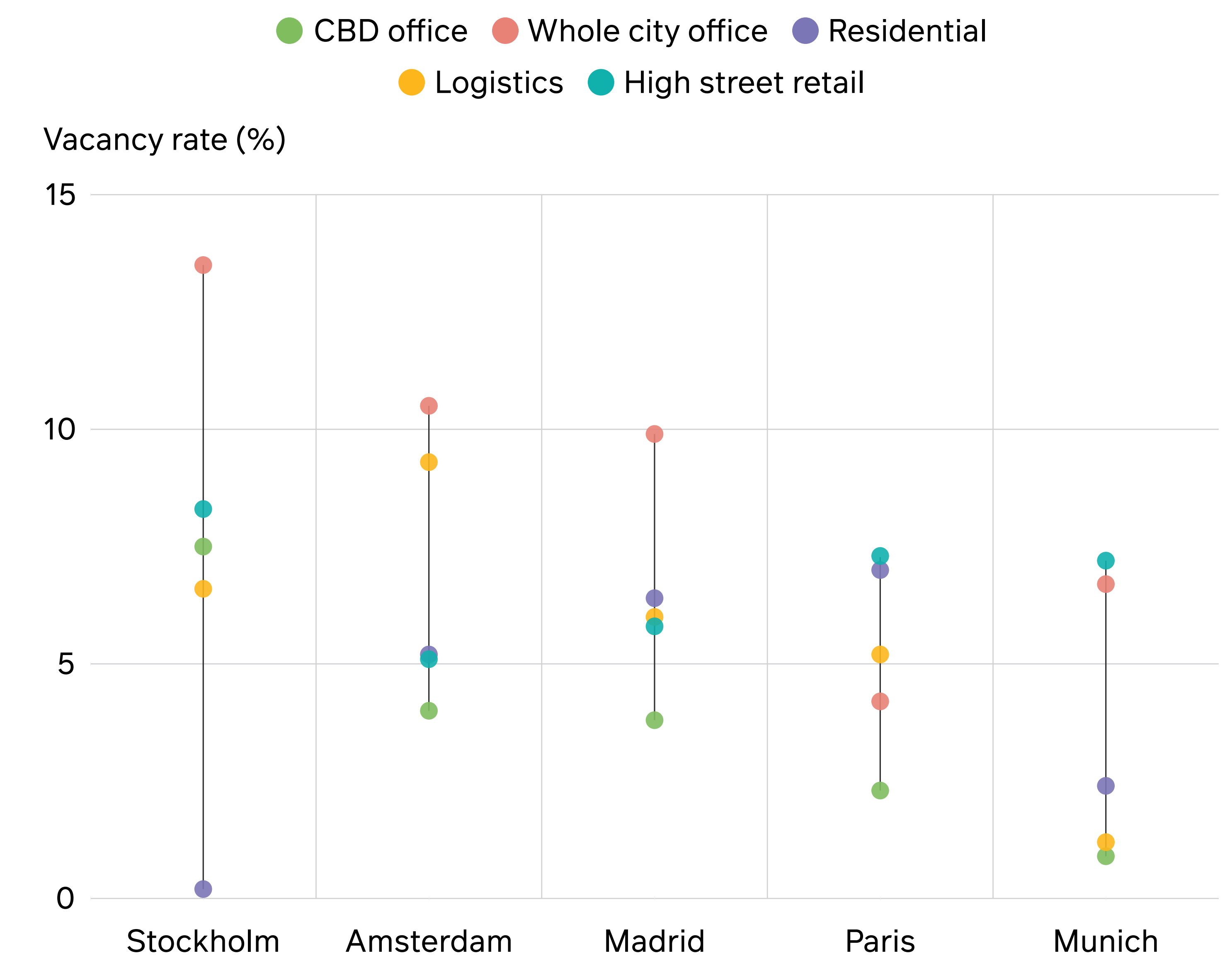
In most European occupational markets, the supply side has remained in check over the last few years – vacancies are low by global and historical standards – and we believe this remains a tailwind for strong rental performance moving forward. The demand picture, meanwhile, has remained resilient in some corners and strong in others. Some asset types are, however, better placed than others.

In the residential sector, already tight rental markets are set to be met by falling completions and dwindling rental unit availability, as financial issues like higher mortgage costs push many private landlords to exit the market, whilst existing tenants reduce their propensity to move. For new leases, and where regulation permits, we expect rental growth to stay elevated through 2025 as fundamentals in many European cities continue to reflect attractive qualities for those owning, or building, rented apartments.

In the logistics sector, development has eased off somewhat from the peak delivery in 2022 and 2023. Demand has moderated and vacancy rates are edging upwards from record lows. However, growing economic confidence should help to spur continued rental growth across the logistics sector, particularly for supply-constrained urban sub-markets, high-quality new build schemes, and assets with strong ESG attributes.

New supply in the office sector over recent years has typically been concentrated on edge-of and out-of-town locations, rather than in historical central areas. Central Business District (CBD) vacancies have remained low – on average 4.6% against the cross-city average of 8.1%[4] – despite some markets experiencing high supply recently. Their rental prospects are significantly stronger than secondary sub-markets as a result.

Many European cities have limited supply, resulting in low vacancy rates and supporting prospects for rental growth



Source: M&G Real Estate based on PMA (2024), CBRE (2024), Cushman & Wakefield (2024), Local Statistical Authorities (2024).
Notes: All data latest available, commercial data mostly Q2 2024, residential 2021-23.

[4] Based on a select sample of 13 major European cities, data for Q2 2024 from local broker reports.

Europe

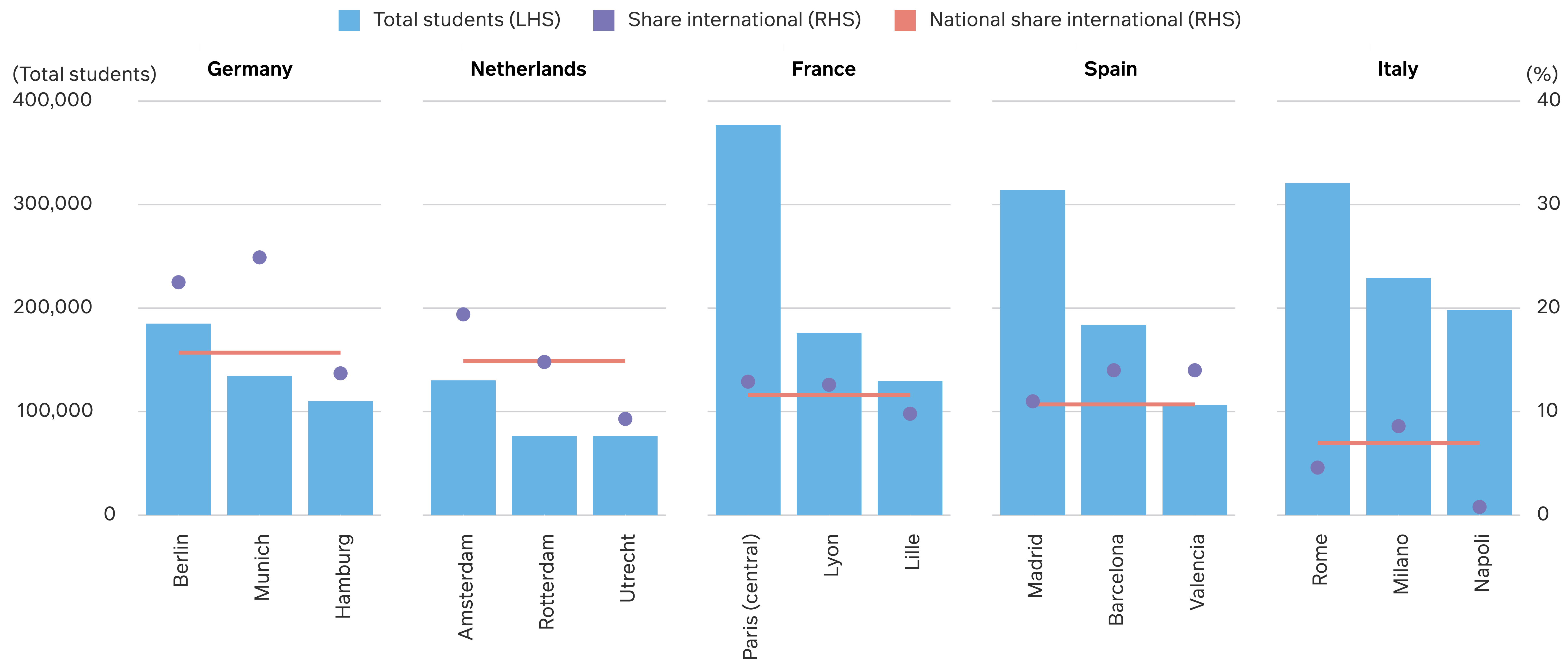
Real estate theme two: Demand dynamism in Europe's living sector

The strength of housing need is a relatively ubiquitous story across Europe's major cities. Despite some years of macroeconomic challenges, demand for the right homes from different demographic cohorts and income groups is set to continue growing apace. Long-term structural tailwinds have combined with short-term cyclical boosts to create a perfect storm for new investment into Europe's burgeoning living sector.

Student numbers have risen 8.5% over the last decade, with international enrolments (+72%) driving this. We expect continued growth in higher education enrolment, with 10% more students by the 2027/28 academic year based on positive domestic demographic trends and further growth of international mobility. This demand is not, however, uniform across countries, or indeed cities. Markets with multiple high-quality institutions, a growing number of English-taught programmes, and attractive cost profiles (for both tuition and lifestyle) are likely to see a dynamic evolution of demand for purpose-built student accommodation – and create attractive opportunities for building new schemes.

Within the wider private rented sector, long-term trends of urbanisation, inbound migration and stretched owner-occupier affordability are set to continue driving demand for rented residential properties. Cyclical factors may have receded marginally from their recent highs but remain strong push factors driving rental demand. For example, falling interest rates will make owner occupation a little cheaper – but in almost all cities, mortgage costs are still higher than rents – and particularly strong international migration following COVID-19 is now moderating. Nevertheless, household formation is set to remain a strong driver – and particularly for new arrivals to a city, their first dwelling is most likely to be a rented unit.

Demand for PBSA in Europe's major student cities is characterised by above average international shares, though some big cities buck the trend



Notes: Data show largest 3 student cities by total enrolled students in academic year 2022/23 (latest available across all markets).

Source: M&G Real Estate based on Local Stastical Authorities and Higher Education Statistics (both 2024).

Europe

Real estate theme three: An attractive entry point for alternative lenders?

The sharp rise in interest rates caused a stagnation in the property transaction market and a slowdown in new debt issued against purchases, or in refinancing deals. With rates expected to have already peaked and moving lower going forwards, as well as fundamentals holding up, confidence is returning to the market for both equity and debt investors.

The coming year could be an attractive market entry point for alternative lenders to target outsized risk-adjusted returns as the market continues to recover. The end of lenders' "extend and pretend" mentality is likely to lead to more refinancings across sectors and geographies, while new deals – including refurbishments and developments – will need their equity supported by leverage.

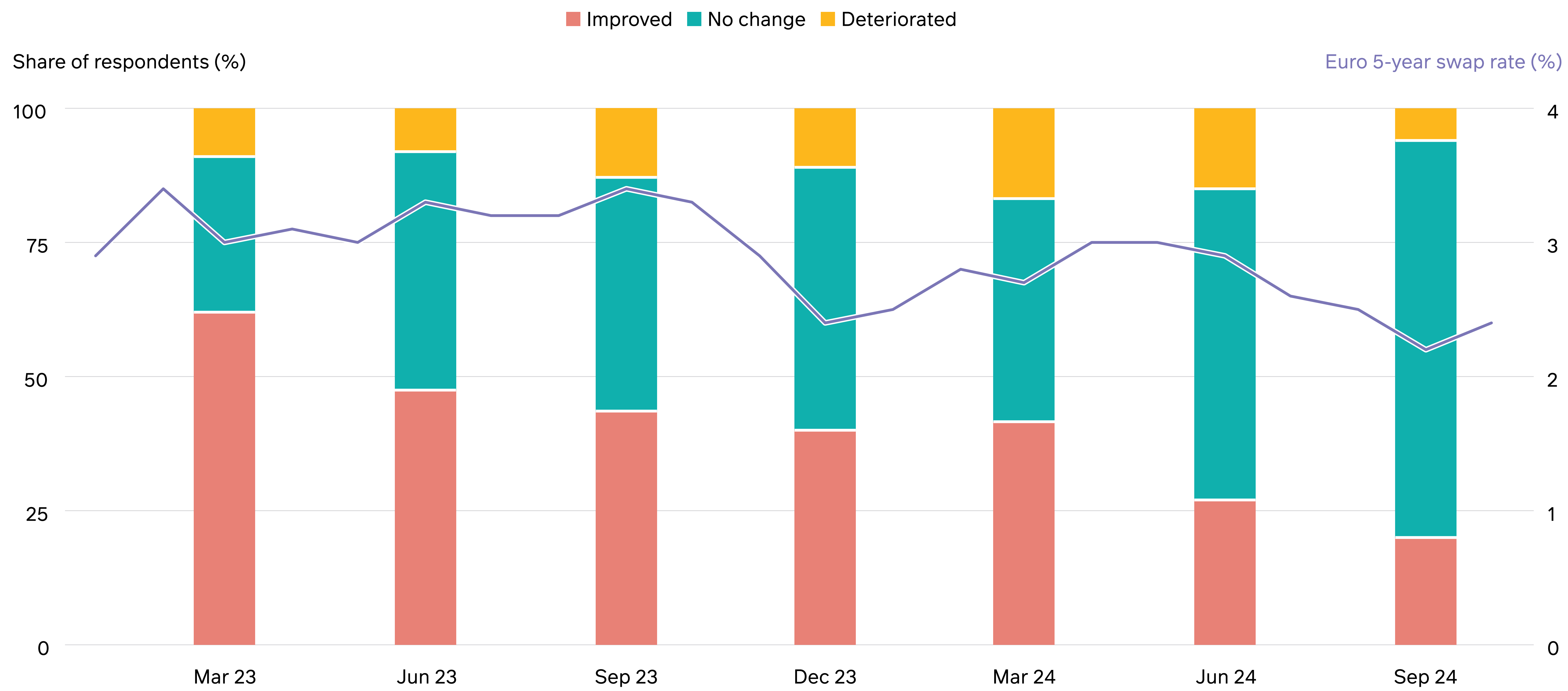
Any lingering concerns over further value erosion may be negated by lending in a senior position in the capital stack. For those looking for higher returns, other forms of lending may also be appealing, for example mezzanine financing for transformation projects; convertible debt; or preferred equity structured slices.

With the supply pipeline looking increasingly constrained, we also see opportunities for development lending to deliver new assets – across sectors – into tight future rental markets.

While we expect demand for debt to pick up, traditional banks including Pfandbrief lenders are unlikely to be able to meet the wide-ranging demands within the market. Alternative lenders – including debt funds – can play a significant role in filling the gap.

[4] Based on a select sample of 13 major European cities, data for Q2 2024 from local broker reports.

Divergence in economic sentiment indices likely to feed through into real economy



Source: M&G Real Estate based on INREV (October 2024) and Macrobond (November 2024).

Europe
Strategic calls

Resilient

New-build multi-family housing: Consistently strong occupancy and potential attractive rental growth prospects are expected for this market segment, as supply-demand imbalances remain across Europe's capitals and gateway cities. Newer stock can have operational benefits, such as lower energy costs, and also tends to sit within the less regulated part of the residential market. Forward funding and other routes to building new stock may be particularly attractive at this point in the cycle.

Prime CBD offices: While sentiment towards the office sector is broadly negative, resilient performance has been visible for best-in-class assets. Europe's core office districts are usually in supply-constrained historic centres, limiting the impact of new supply and keeping vacancy rates low enough to promote strong rental growth. Demand for the best locations has persisted amidst the wider leasing slowdown, and should continue through the economic recovery.

Tread with caution

Fashion-led shopping centres: The erosion of in-store consumer spending on fashion items to online retail is forecast to continue across many European markets, representing a significant area of weakness within the broader retail sector, which is otherwise fairly in balance. For better locations, we believe turnaround strategies for existing schemes should focus on diversifying the tenant base or creating a fully-fledged mixed-use asset – such as adding hotels, medical offices, or other asset types.

'Brown' and non-core warehouses: While the logistics sector more broadly is forecast to continue its strong rental performance, older buildings located in poorer locations represent an area of vulnerability. Schemes with lower technical specifications, eg the inability to add solar panels, or those outside of main logistics corridors, are likely to face both lower tenant and investor demand moving forward. Lower land values may also make existing stock susceptible to being superseded in their local markets by new developments.

Longer-term opportunities

Senior living: Europe's demographic profile moving forward is likely to create a significant demand wave for accommodation fit for active seniors. Government policy incentives and changing social expectations are gradually encouraging retirees to sell their family home and move into a purpose-built scheme, while growing maturity on the operator side will help to hone the product further to align with consumer expectations.

Dominant retail warehouse parks: With resilient tenant demand, growing footfall and attractive entry yields, prime retail parks are at the forefront of the retail renaissance in Europe. Sticky core tenants, such as supermarkets and DIY stores, make for high occupancies, translating into decent rental growth prospects. Like all retail, location is paramount – the scheme should be accessible (normally by car), with a large and relatively affluent population within its catchment area.

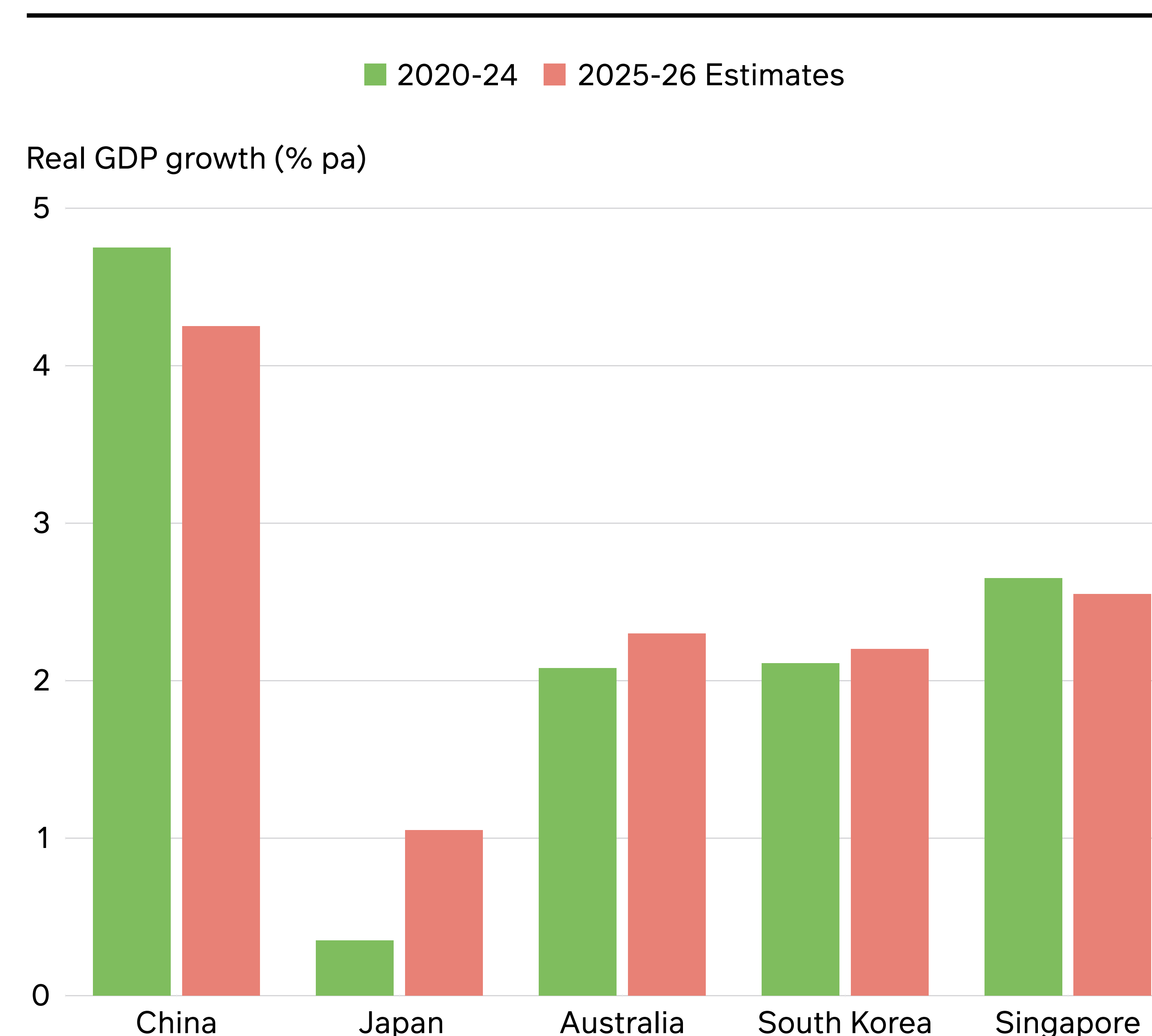
Asia Pacific

Economic highlight one: Cyclical upswing with possible tailwinds

Developed Asia Pacific economies grew faster than expected from the middle of 2024. Key exports in South Korea and Singapore expanded by 8-12% year-on-year in Q3 2024, and we believe momentum is likely to continue on the back of strong global demand for semiconductors and other AI-related electronics[5].

Despite slower growth in China, most developed APAC economies – particularly Japan – are expected to expand faster in 2025-26, compared to the last five years. Moreover, broad-based improvements in investment and consumption should support demand for offices, logistics, retail and hotel assets across the region.

GDP growth in most developed APAC economies expected to go from strength to strength



Source: M&G Real Estate based on PMA (October 2024).

Additional tailwinds could come from monetary and fiscal policies across the region. Following interest rate cuts by the US and European central banks, South Korea and Hong Kong have lowered their own rates for the first time in over four years. Australia and Singapore are also likely to loosen monetary policy in the near-term.

Furthermore, potential revitalisation of China's economy, following the government's bold stimulus package, could reduce its drag on close trading partners such as Australia. Marked increases in investment by Japan and South Korea into defence[6] and semi-conductor manufacturing could further provide multiplier effects through their economies.

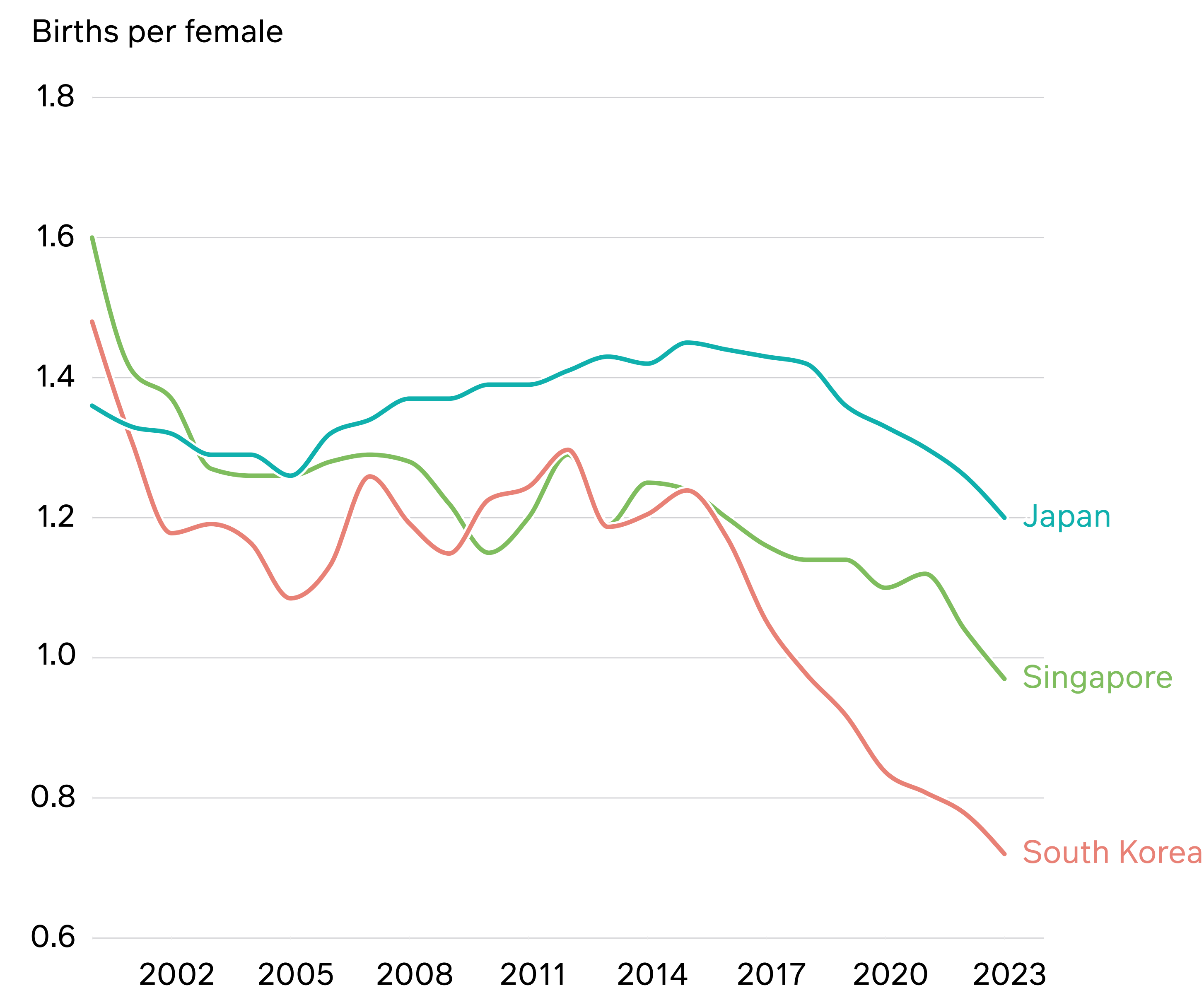
[5] Source: Enterprise Singapore, Korea Customs Service, as at October 24.
[6] South Korea's defense budget for 2025 has been set at over 60 trillion won (45.5 billion USD) for the first time ever. Source: Korea JoongAng Daily, August 24.

Asia Pacific

Economic highlight two: Governments adapt to shifting demographics

Developed APAC is ageing rapidly. Birth rates have decreased for several decades but took a sharp step down after the pandemic. To sustain and invigorate economic growth, therefore, governments are likely to redouble efforts to draw more working age population into their cities. In 2024, China legislated to bring in statutory retirement age increases, while Australia raised its annual skilled migrant numbers by c.50% to address occupational shortages[7]. In Japan, new regulations were introduced to attract more digital nomads and help graduating foreign students to join the workforce[8].

Declining birth rates have accelerated since the pandemic



Source: M&G Real Estate based on Department of Statistics Singapore, Statistics Korea, Japan Health and Welfare Ministry (October 2024).

Social infrastructure, including housing, will be needed to support cities' sustainable long-term growth. In Australia, for instance, a sharp rise in residential rents has led the government to propose limits on international student inflows for 2025.

Globally, more policies are likely to be put in place to facilitate development of more rental residential units for young professionals and students in cities. As lifespans are getting longer, more healthy seniors are also choosing to live alone, and are seeking new rental options close to leisure and entertainment within cities. Providing housing in pockets of high demand within the living sector could therefore create significant opportunities for investors.

[7] Permanent skilled migration planning levels have increased from 89,063 in 2020-21 to 132,200 for 2024-25. Source: Department of Home Affairs, as at October 2024.
[8] Source: The Japan Times, Nikkei Asia, as at August 2024.

Asia Pacific

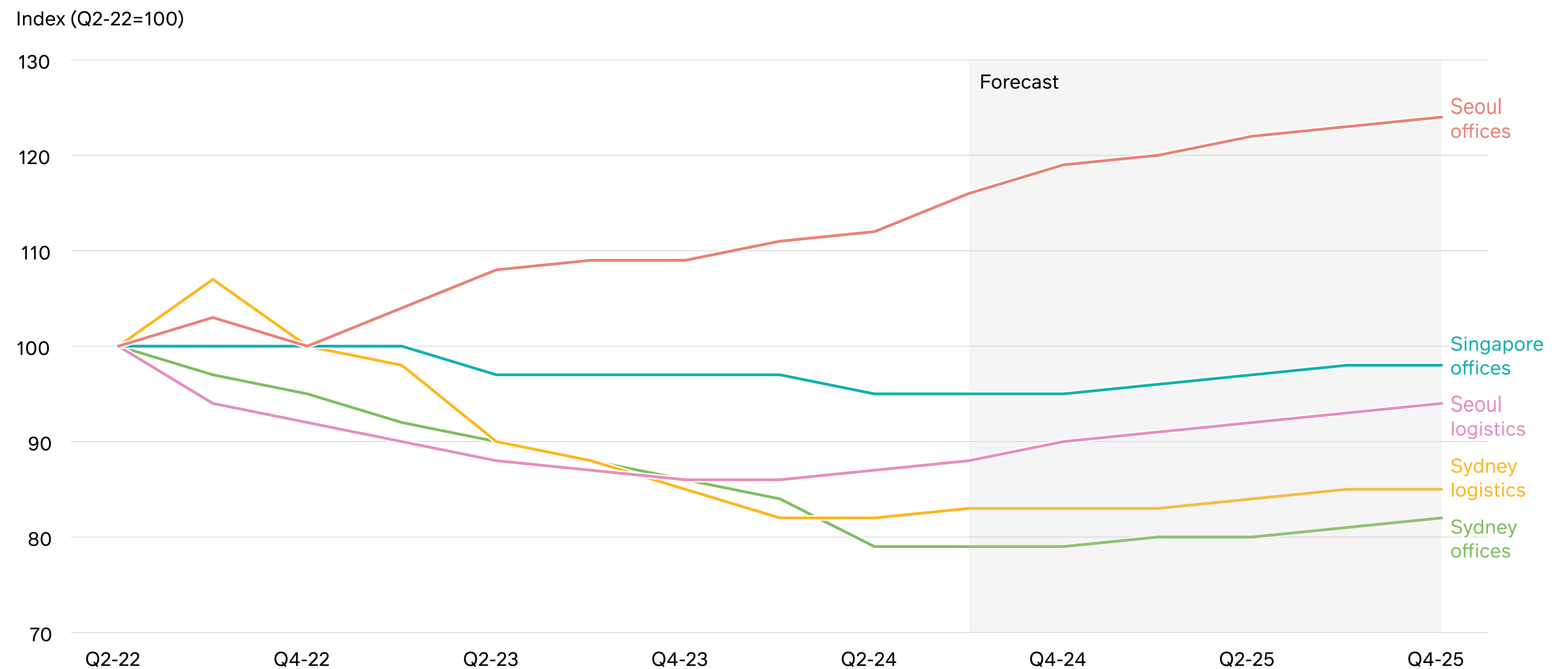
Real estate theme one: Turning a corner

Asset values in many developed APAC markets turned a corner in Q3 2024, after falling by up to 20% over the last two years. Investment volumes also increased 28% year-on-year[9], back to levels seen before the rate hike cycle began in Q2 2022, as investors became more optimistic around the economic outlook and market entry.

With a reset in asset values, real estate yields in many parts of developed APAC are now at their highest levels in a decade. Taking into account resilient rental growth, we expect annualised total returns over the next 3-5 years to significantly exceed those seen in the couple of years prior to mid-2022 when real estate markets began turning down. In our view, Yield compression is expected to contribute less than a fifth of total return as interest rates are unlikely to decline as significantly as they had in prior cycles.

While interest rates are expected to decrease in 2025, investors are likely to deleverage their portfolios further as expiring loans will still need to be refinanced against lower capital values and higher rates than 3-4 years ago. This could motivate asset divestments and open up buying opportunities for well capitalised investors.

Capital values in markets which saw downturns appear to have stabilised and show signs of recovery



Source: M&G Real Estate based on JLL (October 2024).

[9] About USD 38.8 bn of commercial real estate investments were transacted in APAC, marking this the highest deal volume since the rate hike cycle began in 2022 Q2. Source: JLL, as at October 24.

Asia Pacific

Real estate theme two: Rate rises in Japan

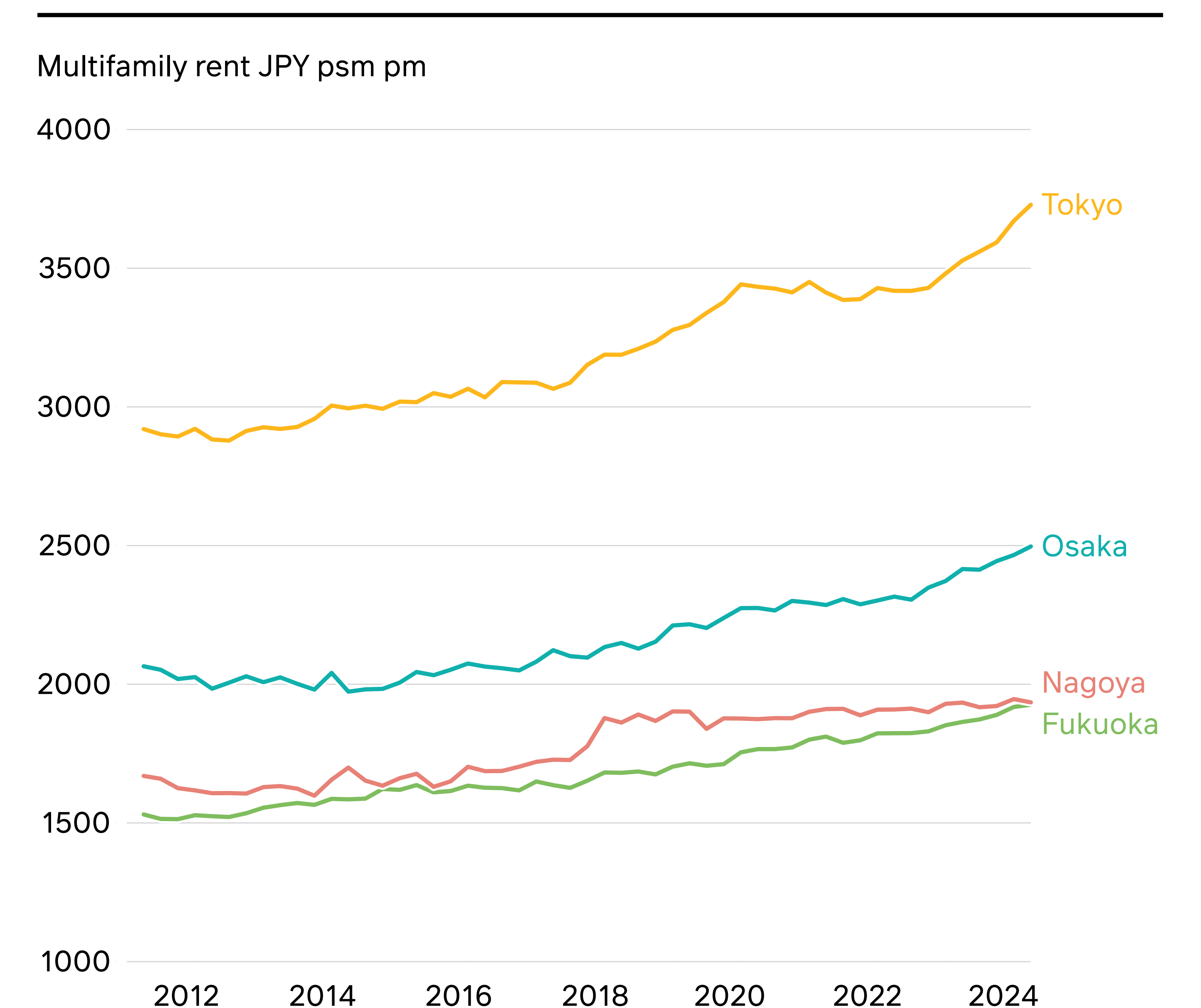
In July, Japan raised its policy interest rate by 0.25% – the largest hike since 2007. Wage growth has surprised on the upside for the last two years and firms are starting to pass on price increases to consumers. Consumption, which accounts for around 60% of Japan's economic output[10], surprised expectations while labour market turnover and services firms' sentiment are rising steadily.

While interest rates are expected to rise further, the impact on real estate values is nuanced. Funds may require a commensurate increase in investment returns, potentially through a higher cap rate or higher stabilised rental growth. Theoretically, a 50 bps increase in funding costs could be offset by a 50 bps increase in stabilised rental growth, without an expansion in cap rates.

Some sectors have shown considerable growth in 2024. In the year to date, office and multi-family housing rents have increased 5% year-on-year, while retail rents have surged by 16%[11]. We expect Japan's multi-family rents to continue to grow in tandem with rising wages. Tokyo multi-family rents have outpaced inflation in 19 of the last 23 years[12].

However, downside risks are increasing for assets with a weaker rental outlook. Investors will also need to proactively manage their loans, operational expenses and development costs to minimise the impact of rising rates to their returns. As the cost of capital rises, we expect more companies to consider divesting non-core businesses or real estate to improve their return on equity, which could open up buying opportunities for real estate investors.

Tokyo multi-family rents rose 5.5% year on year in the first nine months of 2024



Source: M&G Real Estate based on PMA (October 2024).

[10] Source: Bank of Japan, as at September 2024.
[11] Source PMA, as at October 2024.
[12] Source: PMA, as at October 2024.

Asia Pacific

Real estate theme three: AI winners

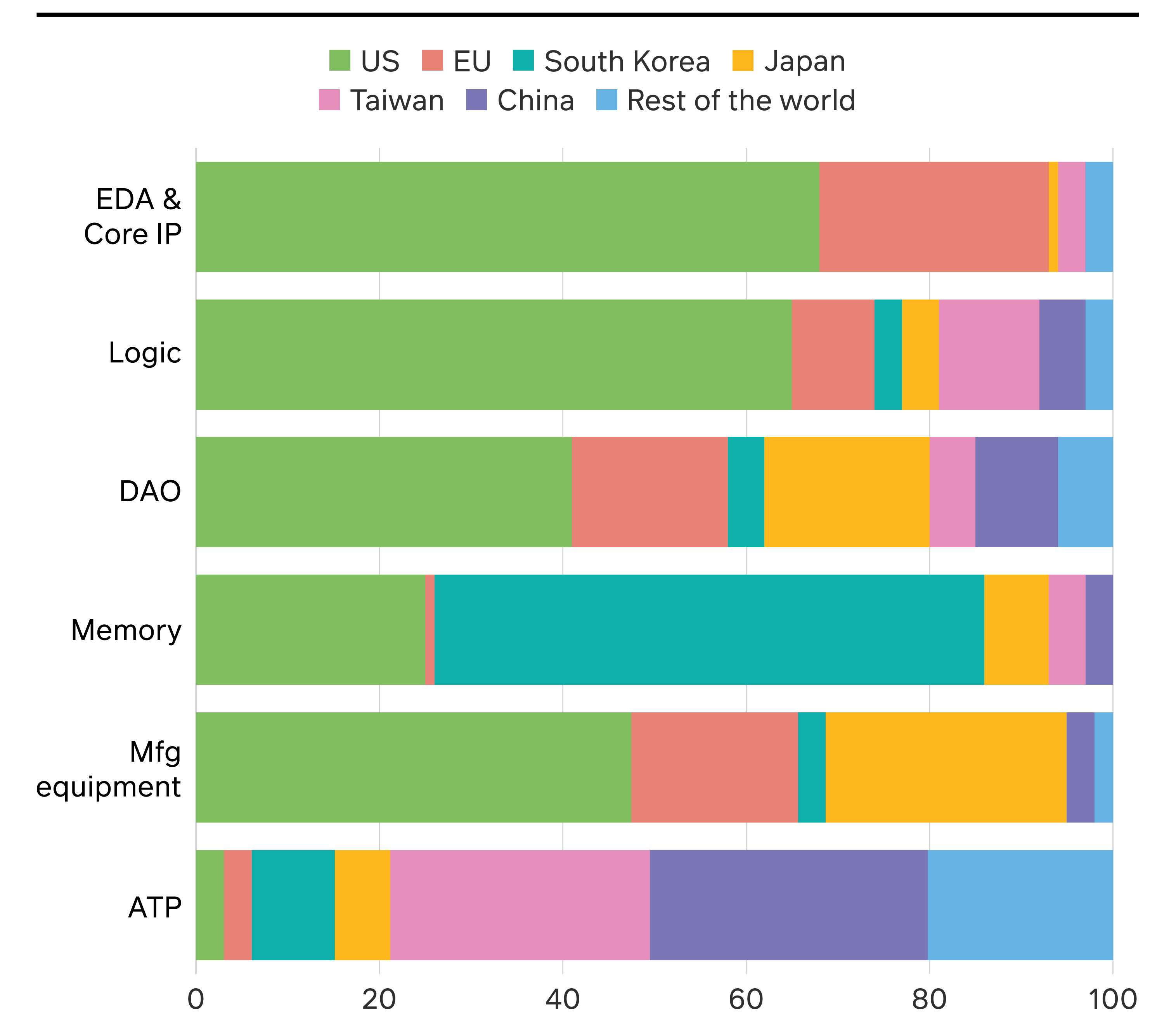
In the last year, new adoption of generative AI for copywriting, image generation and coding tasks has impacted white collar jobs. As AI use expands, we expect to see greater geographic dispersion, and winners and losers among cities over time.

With AI's likely significant impact on job security and income propensity, we expect highly mobile skilled professionals to migrate towards AI-enabled cities to maximise their earnings potential. These cities would invest into AI infrastructure, carefully harness the latest available related tools, and proactively regulate intellectual property rights, data integrity and privacy issues.

As companies and capital follow the flow of talent in order to compete, we expect to see residential and commercial rents and values in winning cities outpace inflation and other asset classes over a sustained period. Singapore, Japan, South Korea and Australia are ranked in the top 10th percentile in the IMF's AI preparedness index.

Meanwhile, strong demand for AI-related semiconductors and fabrication equipment is set to continue to grow, benefiting APAC exporters. Japan is a major semiconductor machinery producer, accounting for about 26% of global market share. Additionally, almost 70% of fabrication capacity for chips under 10-nanometres, which are required to execute advanced AI functions, is located in South Korea and Japan.

Semiconductor industry value-added by activity and region



Source: M&G Real Estate based on Semiconductor Industry Association (October 2024).

Asia Pacific
Strategic calls

Resilient

Tokyo multi-family housing
The strong pick up in Tokyo multi-family rents in 2024 is just the start of a multi-year trend, in our view. Increasing migration rates, sustained higher annual wage growth and rental affordability support robust demand. Rising house prices are also likely to keep households renting for longer. Supply is likely to become more constrained, as housing starts are falling in the face of higher construction and financing costs.

Korea, Japan modern logistics
Modern logistics demand and rents in South Korea and Japan continue to outperform, while supply has peaked. Both countries are building on their well-established status in the global semiconductor supply chain, anchored by their deep ecosystems of component suppliers, skilled labour and advanced digital infrastructure.

Tread with caution

Non-core offices in secondary locations
Wider adoption of generative AI could reduce the need for back-office jobs in the next few years. Typically, firms have outsourced these roles to lower cost locations, in emerging countries or secondary office hubs in Sydney, Singapore, Seoul and Tokyo. This trend will add to the headwinds that non-core offices are already facing from decarbonisation-related capex, and structural changes such as hybrid working.

Longer-term opportunities

Australia regional retail centres
Melbourne and Sydney regional retail yields have expanded to levels last seen a decade ago. Yet tenant demand has proven resilient, even during softer economic periods, with sales anchored by population growth and essential purchases. The rental outlook is positive given a measured supply pipeline[13], rising wages and potentially lower interest rates and cost of living pressures.

Living sectors in Australia
Australia's residential rents and prices recently showed signs of easing, as the government continues to right-size the inflow of immigrants[14]. That said, the medium-term outlook for Australian living sectors remains intact, underpinned by continued and carefully calibrated population growth, limited dwelling completions, and supportive tax legislation revisions.

[13] The supply of sub-regional and neighbourhood shopping centre space projected over the next two years is around 70% of the 20-year average, and there is no development of regional shopping centres. Source: JLL, as at October 2024.
[14] Dwelling prices rose 0.5% in Sydney but fell 1.10% in Melbourne for the September quarter. Meanwhile, the national rental index inched up marginally 0.1% over the same period, the smallest rolling three-month increase in four years and may reflect a 15% slowdown in migration from its peak in early 2023. Source: CoreLogic, Australia Bureau of Statistics, as at October 2024.

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