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2024 Outlook: Private Real Estate

By: Morgan Stanley Real Estate Investing (MSREI) | January 4, 2024

Real Estate Investors Eye Opportunity Amid Strong Fundamentals Fueling Growth for High Quality Assets

KEY POINTS

1. Real estate has re-priced meaningfully over the last two years; returns following periods of re-pricing have typically exceeded historical averages.
2. Strength in real estate fundamentals should support rent growth for high quality assets in sectors backed by long-term demand drivers.
3. We believe debt maturities and the higher-for-longer interest rate environment will lead to idiosyncratic seller distress and attractive recapitalization/credit investment opportunities.

What We Are Seeing

Against a resilient macroeconomic backdrop, real estate fundamentals (with the exception of offices) have remained robust in most global markets. Low existing vacancy, elevated construction costs, and the lack of available financing are likely to limit supply in the near-term, which should support above-average rent growth for high quality, well-located assets.

We expect fundamentals in the industrial, residential, and alternative sectors to outperform, although rental growth has begun to normalize and select pockets of oversupply may create market-specific softness. The higher interest rate environment has led to lower levels of debt being provided to owners of real estate. Morgan Stanley Real Estate Investing (MSREI) believes that owners will face increased pressure to deleverage in the near- to medium-term, creating opportunities for others to acquire these assets or to deploy capital into recapitalizations and structured credit investments

What We Are Doing

In what we expect will be a less competitive market environment, we will look to acquire repriced industrial and infill¹ and last-mile² logistics in supply-constrained markets in the U.S., Europe and Asia Pacific. We will continue to use existing relationships to aggregate residential assets in major cities in Japan that are benefiting from population flows and wage growth, taking advantage of relatively low financing costs. We are looking at opportunities to acquire assets from or to provide capital solutions to public companies, funds, and private owners in need of liquidity.

We are pursuing the highest quality assets that meet post-COVID-19 occupier requirements. We are also seeking to leverage our asset management expertise to drive income growth and target environmental, social, and governance (ESG) retrofit opportunities to optimize energy efficiencies. We are evaluating investments in niche sectors including hospitality, senior living and student housing that we expect will benefit from strong demand tailwinds and increasing investor interest. We are considering sale leaseback opportunities given their relative attractiveness as an alternative source of financing in today's higher interest rate environment.

What We Are Watching

We are monitoring geopolitical, economic, inflation and interest rate signals. We are on the lookout for signs of distress or forced selling. We are watching for heightened regulatory risks, such as new bank regulation and rent control, as well as real estate taxes.

We have our eyes on global dislocation, supply chain reconfigurations, and divergent recovery cycles by region, market, and sector. We are observing shifts in structural demand drivers and how they impact occupier preferences and the definition of core real estate. Examples include on-shoring/near-shoring, ESG, artificial intelligence and aging populations. We are paying close attention to investor sentiment, allocations, and strategy preferences.

¹ Infill locations are characterized by having a high level of demand, due to increased property values in desirable.

² Last mile refers to the short geographical distance traveled to provide services to end-user customers.

Risk Considerations: Historical performance information is not indicative of future results. Alternative investments are speculative and include a high degree of risk. Investors could lose all, or a substantial amount, of their investment. Alternative instruments are suitable only for long-term investors willing to forgo liquidity and put capital at risk for an indefinite period of time. Alternative investments are typically

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Real estate investments are subject to risks similar to those associated with the direct ownership of real estate and they are sensitive to such factors as management skills and changes in tax laws.



Morgan Stanley Real Estate
Investing (MSREI)

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