LaSalle Investment Management

2024 outlook for Americas real estate investment markets

Chase McWhorter, Institutional Real Estate, Inc.'s managing director, Americas, recently spoke with **Richard Kleinman,** Americas head of research and strategy and co-CIO with LaSalle Investment Management, to discuss what institutional real estate investors can expect in the new year. Following is an excerpt of that conversation.

What are the biggest unknowns heading into 2024?

Some of the same unknowns from 2023 are still unknowns going into 2024: What is going to happen with interest rates? What is going to happen with economic growth? At some level, the unknown on inflation is dialed back a bit — we see a downward trend there. As we think about these unknowns, our base-case assumption is that economic growth will slow in what may be a short and shallow recession. Maybe we will do better; maybe, worse. Interest rates may come down a little, but probably not a lot.

What is your sector outlook for 2024, and which sectors do you think will be the winners?

With 2024's economic outlook framed by still-high interest rates, it is going to be challenging across a lot of sectors. Relative to where we've been, there is a lot of new supply coming into the apartment market throughout 2024. In warehouse, we could see a slowdown in new supply through the year, but it will still be weighing on the market. In terms of fundamentals, interestingly, retail appears to be set up to be a winner because there is not a lot of new supply. Industrial could start to emerge as a winner as we get into the second half of the year, with supply coming down and — hopefully, toward the back half of the year — demand coming back to that sector.

We're also seeing an emergence of some real winners within specialized, emerging or niche sectors, as well as some differentiation among them. We see scattered-site single-family homes as a winner because of the challenges people have buying a home given the high mortgage rates. On the flip side, build-to-rent, because of location, is at risk of the same oversupply dynamics as apartments, especially in outlying locations and some Sun Belt metros. While demand fundamentals are favorable in the near term, how that plays out in real estate portfolios over the long term is to be determined.

We see medical office getting to that traditional role of being stable through the cycle. It doesn't have exposure to oversupply in the way some other sectors do. It doesn't get exposed to economic ups and downs the way a lot of other sectors do. And it certainly doesn't have the same structural headwinds as traditional office.

How would you break down the retail sector into retail subcategories?

We have a great deal of experience in the grocery-anchored retail space, and we see that doing quite well. There likely will be winners showing up in other parts of retail, as well. It won't be as broad a call as all malls or all power centers, but investors will be able to identify the strongest centers within any of the subtypes, which have survived this historic period of demand stress from ecommerce and are poised to emerge as winners. Underlying it all is the fact that you just don't have a lot of competitive new supply in retail, so if you have space tenants want, they're not going to have a lot of other alternatives in terms of good centers to jump to.

What about office? Will it continue its decline, or do you see a potential stabilization?

Broadly, we're not quite at stabilization in the office sector. Office is positioned to see a lot of challenges. The headwinds from remote working are still playing out in terms of the landlord/tenant dynamic. A lot of tenants still have leases signed pre-pandemic that have yet to roll, and as those tenants are able to downsize a bit, we see that as a significant headwind on demand. The one area of stabilization will be the number of workers coming to the office. I think that's going to continue to recover. But there is a long path to go before the sector sees stabilization, and there remains a lot of stress and distress to be worked through in office overall. While individual markets will vary a bit, these dynamics are pretty widespread across the office sector. We'll see more differentiation among markets as we move further along in the decade.

Private credit is having a huge moment. Do you foresee that continuing in 2024?

There is still a lot of reshaping of how debt is sourced in real estate. That's running toward the benefit of alternative lenders, debt funds and private credit. It does feel as though there's some nice runway for that segment of real estate investment in the coming year and beyond because there are pieces of the capital stack that need to be reframed. We're seeing that happen pretty actively, but it will be a multi-year issue to work out. The wild card will be interest rates. If we do see a substantial decline in interest rates, that might reframe the debt versus equity dynamic a bit, and the rush to private credit might slow. If the base case of just a little bit of interest rate decline materializes, there could be appealing opportunities on the debt side, as well as the equity side. If interest rates go down more than we expect, equity could emerge as a true value play.

What do you think it will take for capital fundraising to come back to levels we saw in 2022 or 2021?

I would point to two issues. One, more on the open-end fund side, is some stabilization of values. Investors are looking at the continued write-downs and wondering when we're going to hit bottom. Once we do, there are some investors interested in committing to funds who will jump at that opportunity. The other issue is the broader dynamics around overallocations to real estate getting resolved, which is around both the denominator and numerator. That could happen through strong stock market returns, interest rates coming down to help bond-portfolio values or real estate values coming down to a level that brings investor allocations at or below their target levels. Once that happens and there is confidence on value, we're going to see a quick turn in capital raising. I wouldn't make a prediction about whether that occurs in 2024. But whether it's 2024 or 2025, we will come back to those levels. The appetite for having real estate in portfolios is still there. We just need to have the real estate value story run its full course through this cycle. When the story is fully told of this period, the case for real estate as a diversifier in a portfolio is going to still be there. The case for real estate as an inflation hedge has been reinforced through the past five-year period in a major way. We just need to get to the other end of the cyclical dynamics before those long-term structural trends kick in again.

LaSalle is invested across the Americas. What are some key differences between the U.S. and Canadian markets?

While the United States and Canada have very similar markets in terms of growth and interest rates, there are some interesting differences that show up in real estate investment. Interest rates, for instance, are biting a bit more in the Canadian economy right now because of the country's home-mortgage market structure. Canada saw economic growth slow more quickly and more substantially in 2023, but that then sets the stage for stronger growth coming out of it.

Another difference is the migration policies in Canada have been allowing a large amount of population growth, which has set the stage for significantly more residential demand. While in the United States, we have a concern about oversupply of rental residential in the next year, Canada still has record-low vacancy rates and is undersupplied.

The office sector has some of the same challenges in Canada as in the United States. On the demand side, Canada has the same work-from-home challenges, but the general structure of the office market is healthier in terms of that balance between tenant and landlord. While the office market in Canada will probably not be a winner in 2024, it probably is closer to being a winner beyond this year than is the U.S. office market.

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Rich Kleinman is Americas head of research and strategy and serves as co-chief investment officer for the Americas. He serves on the Americas investment committee and is the lead representative of the research and strategy team for several LaSalle funds and separate accounts to develop investment strategies for clients, formulate a house view on the real estate market outlook, assess market conditions associated with specific investment decisions, and monitor capital market conditions. Kleinman helps represent LaSalle's U.S. market views and research process to clients and consultants.

COMPANY OVERVIEW

LaSalle Investment Management is one of the world's leading real estate investment managers. On a global basis, the firm manages approximately $87 billion of assets in private equity, debt and public real estate investments, as of the third quarter of 2023. The firm sponsors a complete range of investment vehicles, including open- and closed-end funds, separate accounts, and indirect investments. Its client base includes public and private pension funds, insurance companies, governments, corporations, endowments, and private individuals from across the globe. For more information, visit **www.lasalle.com.**

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