ISA
by LaSalle

Insights
Strategy
Analysis

Outlook 2024

LaSalle is one of the world's leading real estate investment managers, but we don't just invest in buildings at LaSalle.

We invest in insight-driven research, the intelligent use of technology and sustainable building practices.

We embrace collaboration, seek out diverse perspectives, drive a Culture of Care for our people and champion thoughtful decision- making at every level.

Our real estate investments are for a wide range of pension plans, sovereign wealth funds, insurance companies and others around the world. The opportunities we create and uncover today are designed to align with the long- term interests of the hundreds of thousands of people that our investors represent. We understand that the investments they make with us enable them to look after the wellbeing of their stakeholders, whoever and wherever they may be.

1 Asset class	**40+** Years investment expertise	**$89b** Assets under management
1,500+ Properties	**36.7m** Square metres area under management	**500+** Institutional investors in 36 countries
900+ Employees	**23** Cities with offices	**13** Countries with offices

Assets in US dollars; as of September 30, 2023

ISA Outlook 2024

LaSalle's Research and Strategy team plays a fundamental role in our investment process. Our global team of around 30 researchers, strategists and data scientists have developed a range of tools and models to help drive outcomes for our investors. LaSalle's investment leaders and I look to the team primarily for this proprietary analysis, but Research and Strategy is also instrumental in articulating our views to help our clients and partners navigate changing market conditions.

Each year, we share our global real estate investment outlook for the year ahead in this – our flagship report – the *ISA Outlook*. Now in its 31st year, the report brings together perspectives and investment ideas from our teams around the globe, based on a wide range of data sources and proprietary intelligence gleaned from our more than 1,500 assets that span geographies, property types and risk profiles. The *ISA Outlook* sits alongside the seven *ISA Briefing* notes and two *ISA Focus* reports that we released in 2023, as well as our first ever *ISA Portfolio View*, in addressing the key questions faced by global real estate investors.

An unsettled market

The opening sentence of this year's report says that "the context for real estate remains unsettled." It is indeed a complex and uncertain environment. This global chapter seeks to cut through the noise and focus on the key themes that underpin our analysis in this edition:

1. Searching for peak interest rates
2. Solving the capital stack equation
3. Fundamentals moderating in strong sectors
4. Understanding bifurcation within real estate sectors
5. The changing definition of quality and core real estate

What's new for 2024

This year, we will be releasing the *ISA Outlook* chapters sequentially, starting with the global outlook in mid-November, and continuing until early December with chapters framing the outlook for Europe, North America and Asia Pacific. This will allow us to do deeper dives into the regional and local nuances that shape the challenges and opportunities set across the geographies where LaSalle has exposure and is analyzing for relative value.

We are also introducing new "In hindsight" sidebars within the 2024 report, in which we look back at predictions and recommendations we made in 2023, noting what we got right as well as what we got wrong. No forecaster is always correct, but transparency and accountability about past views is a good foundation for improving future projections.

We look forward to hearing your feedback on this outlook and meeting with you as we conclude 2023 and advance toward the opportunities that 2024 will provide.

Best regards,

Mark Gabbay

Mark Gabbay
Global CEO

EXECUTIVE SUMMARY: LaSalle's global themes for 2024

In this global chapter of the *ISA Outlook 2024*, we will tackle our key themes for real estate across the globe. While not every one of them applies equally or in quite the same way in every market where we invest, we find tremendous value in engaging in "pattern recognition" – finding similarities and differences that can help inform strategy.

We start at high level, where we find that the macro context for real estate remains unsettled. Bond markets continue to exhibit volatility as markets **search for peak interest rates**. The bid-ask spread that is holding back real estate transaction activity is likely to persist until rates settle.

A lack of transaction activity increases the challenges around recapitalizing real estate investments that have been impacted by repricing. The math of higher interest rates has triggered a need to **solve the capital stack equation**, requiring injections of equity and debt. While there will no doubt be challenges, they come with opportunities to generate attractive risk-adjusted returns as a lender, or in providing rescue equity.

The good news is that, with some exceptions, real estate fundamentals remain strong. The "winning sectors" of logistics and residential continue to outperform on a relative basis, although the heat in their fundamentals is **coming off the boil**, causing a marked reduction in their NOI growth on an absolute basis.

Across the property markets, but especially in office and retail, there are clear performance gaps opening within sectors around differentiators like quality, sustainability features and submarket vibrancy. But whether this presents an investable opportunity requires investors to go **beyond bifurcation** to assess these changes within an intrinsic value framework.

Our **investment recommendations** remain focused on logistics, residential and their adjacent sub-sectors. Because they reprice quickly, debt and listed real estate also look attractive. All investment strategies should be aligned with changing definitions of quality and core.

Introducing

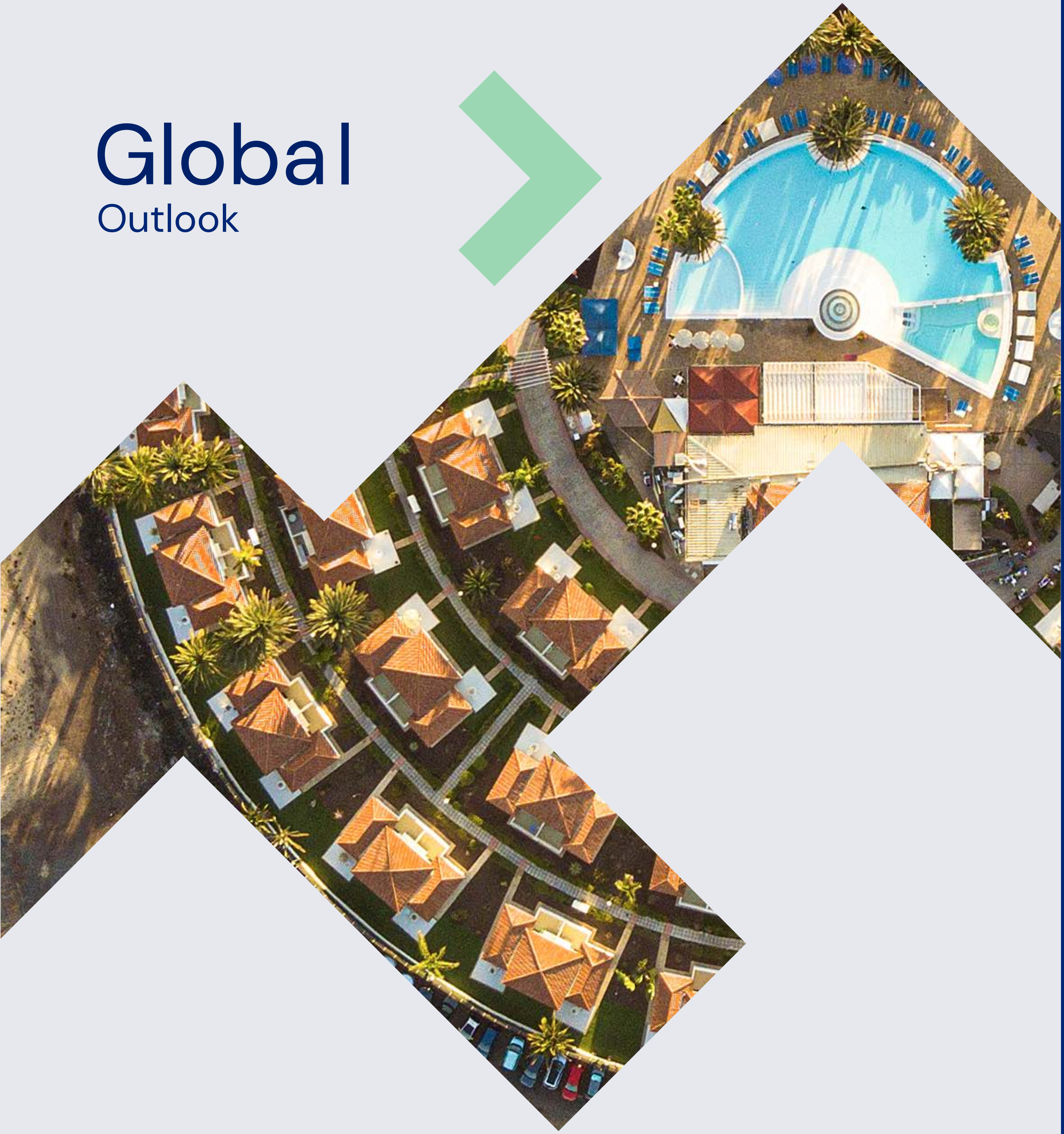
IN HINDSIGHT

Looking back on key calls from last year's *ISA Outlook* global chapter

Beginning with last year's *ISA Outlook*, we implemented a new section called "Looking ahead," which takes a forward view on markets and recommends strategies. In this year's edition, we introduce a new sidebar called "In hindsight," where we look back on key calls from the prior year's edition, assessing how well we did at predicting the direction of economies and property markets. We do not have a crystal ball. But we can learn a lot from looking back at our past predictions with honesty and accountability.

Right / Mostly right | Remains to be seen | Not right / Not quite right

Global
Outlook



Watch the conversation
with Eduardo Gorab and Brian Klinksiek
at lasalle.com/Outlook2024

Searching for peak rates

Mapping the macroeconomic context

The macro context for real estate remains unsettled, and more so than earlier in 2023. What a difference a few months makes. Until late summer, interest rates in most major markets[1] exhibited high volatility, but little overall trend. They moved mainly sideways, owing to cooling inflation and expectations that central banks were reaching the end of their tightening cycles. Speaking to clients earlier in the year, we likened rates to a hiker traversing the ridge line of a mountain trail, cautiously traveling an up-and-down section after a long earlier climb, but with no steep ascent ahead.

This relative stability – as well as the acceptance of new market realities that comes with the passage of time – had started to lay the foundation for a recovery in real estate transaction activity. With rates no longer subject to 2022's sharp upward climb, seller expectations could "catch down" to bids that had been driven lower by higher debt costs and higher yields on alternative investments.

An upward turn in the trail

As of the time of writing, this tentative easing in the standoff between buyers and sellers has been called into question by a renewed surge in interest rates in several key markets (see exhibit G-a). It has been as if the mountain hiker had turned a corner to see, unexpectedly, the trail rising sharply ahead. Corporate bond yields, which we use as a building block for our pricing models, have taken a clear turn upwards, reaching or surpassing levels last seen in late 2022.

IN HINDSIGHT

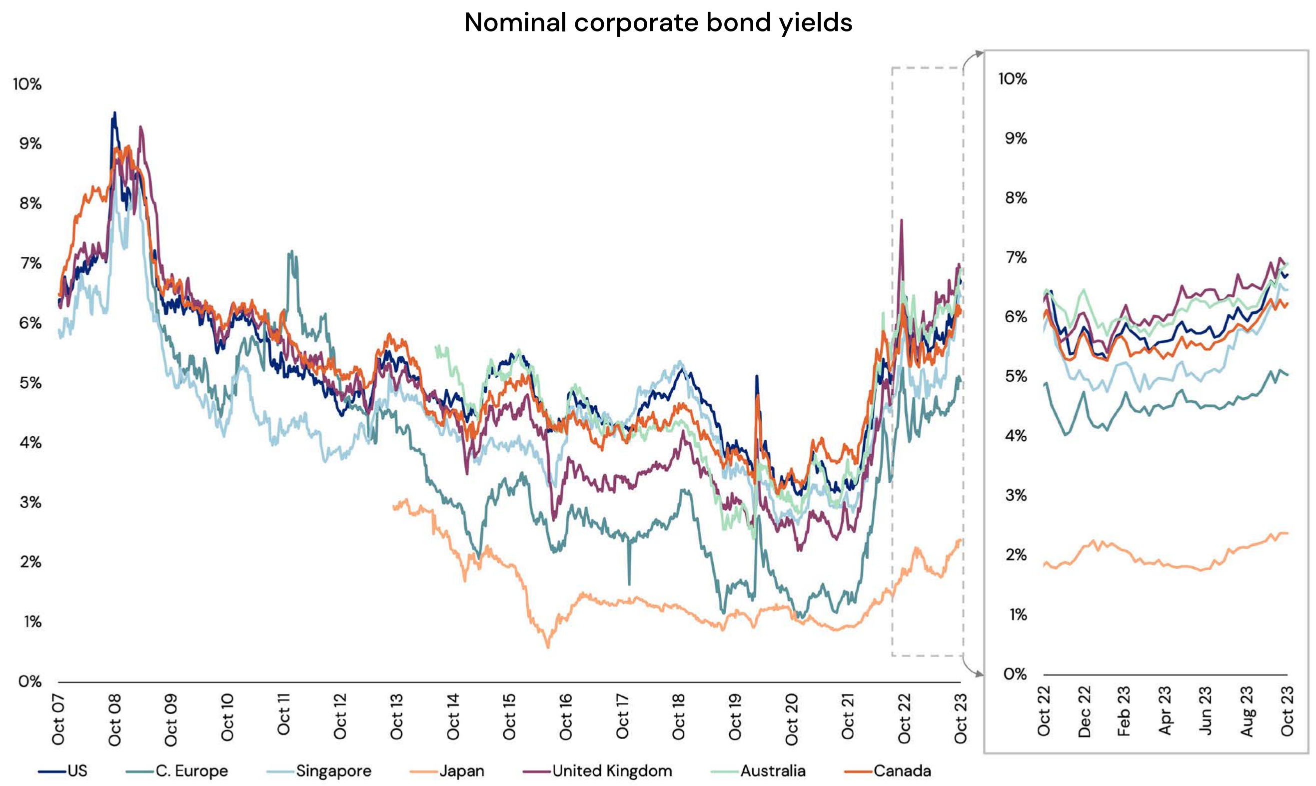
Energy-induced European recession

"Europe faces especially severe challenges stemming from an energy price shock, with ripple effects of unknown global scope… A recession is almost certainly already underway across Europe."
(ISA Outlook 2023 p15)

We underestimated Europe's resilience and called a recession too soon. Energy markets adjusted much more quickly than we expected to the shock caused by the end of Russian gas flows. Renewables and floating liquefied natural gas terminals picked up the slack. This allowed energy prices to moderate quickly, taking the pressure off European households (see our ISA Briefing: Energy back as key in real estate outcomes).

In trying to understand why rates have surged and what that means, it is helpful to break out the three components of bond yields: **the real risk-free rate of interest, inflation expectations** and **risk spreads**. Our analysis shows that, despite elevated headline inflation in the last year, long-run inflation expectations have not been driving the recent increase in rates (see exhibit G-b). As was discussed in the *ISA Outlook 2023*, inflation is not necessarily a bad thing for real estate.[2]

G-a Ridge line's corridor and recent spike



Source: LaSalle Global Solutions, Bloomberg data through October 31, 2023. The bond indices above are based on Moody's Baa US bonds with terms of 20 to 30 years. In other countries, comparables are used of similar credit quality and term.
Note: No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

Nor has late 2023's increase in corporate bond yields[3] been caused by an expansion in credit spreads,[4] which can occur when businesses are under strain, such as when going into a recession. These spreads have been mostly stable. That is encouraging and reflects still mostly benign corporate operating conditions and labor markets that remain tight, at least for now.

That leaves **real risk-free rates**, which have been driving the move.[5] The determinants of real interest rates are nebulous but reflect the fundamental characteristics of an economy that define its productive capacity – demographic profile, productivity growth potential, technological advancement and other factors that shape an economy's "desired" balance of savings and investment.

An upbeat interpretation of the uplift in real rates may be that markets are expecting technology – especially artificial intelligence (AI) – to drive a wave of productivity growth and thus spawn many attractive uses of capital. This would clearly be good for economic growth, though returns on all other types of investments would need to be higher for them to continue attracting capital. In other words, bonds, real estate and everything else would need to reprice accordingly.

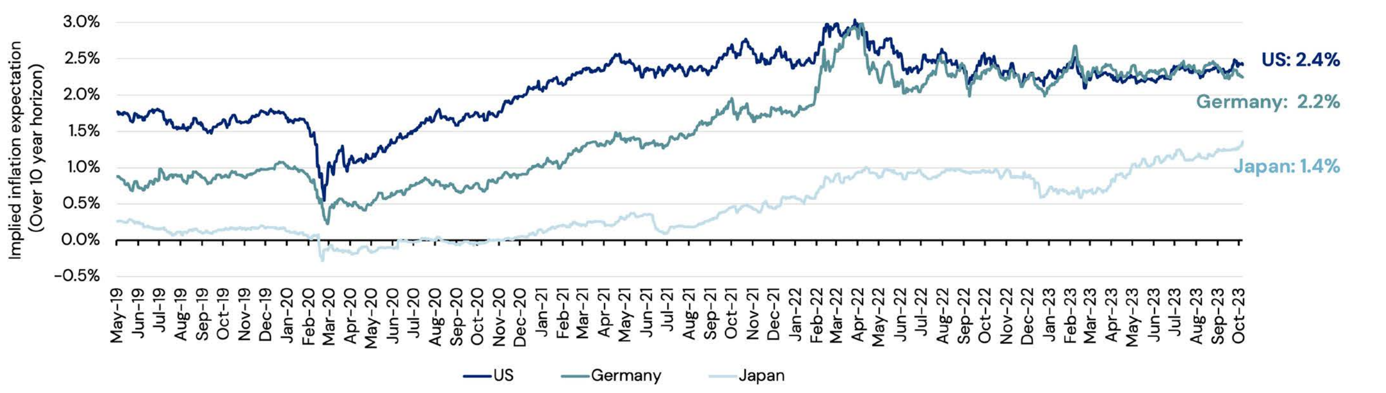
A less cheerful take on the move in "risk-free" real rates is that benchmark government bonds are increasing because government fiscal profligacy is creating expectations of a surplus in government bond issuance relative to demand, "crowding out" other investment opportunities. No matter the explanation, higher real rates are likely to have a further negative impact on property pricing.

1 As always, there is variation at the country level that partially defies these global generalizations. In particular, trends in the two largest Asia Pacific markets – Japan and China – are substantially different from those in other developed economies. We discuss these differences briefly below and dive deeper in the respective regional chapters of this *ISA Outlook*.
2 Real estate is a real-returning asset class; in other words, there is strong potential for the pass-through of inflation into higher cash flows. This means real estate should not necessarily suffer from higher inflation; rather, its impact depends on occupational fundamentals, lease structures and other factors.

3 These comments apply to Baa corporate bond yields, which we view as a key benchmark for pricing real estate in most markets. Other dynamics around credit spreads may be evident, for example in high-yield bond markets for some countries and sectors.
4 Statements about drivers of interest rate moves is based on LaSalle's analysis of Bloomberg data as of October 31, 2023.
5 This is especially true of the long end of the yield curve, which is why it could be argued that the increase in rates has been driven by higher "term premia".

G-b Long-term inflation expectations remained relatively stable this year except Japan

Expected long-term inflation:
Breakeven rate between nominal and inflation-protected risk-free rates



Source: Bloomberg. As of October 31, 2023.
Note: No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

No map to a soft or hard landing

It is notoriously difficult to predict the path of interest rates; our mountain hiker does not have a map, because none exists. The recent upward trend in rates may prove short-lived. But history suggests that whenever there is a big increase in interest rates, there is an increased risk that "something breaks" - whether a financial institution, a part of the capital markets or the like. History has also shown that extended periods of yield curve inversion (i.e., long-term rates below short-term rates) tend to presage economic downturns.[6] Both factors should raise the alert level for the global economy in 2024.

That said, real-time evidence does not point to an imminent global downturn, not least given the strength in the US and several other key economies. Labor markets have been surprisingly resilient and forecasts of economic growth have mostly been revised upward for 2023, as a potential slowdown is pushed into the future (see exhibit G-c).

The observed strength could merely reflect insufficient time for tighter policy to impact employment. As Milton Friedman said, monetary policy "operates with long and variable lags." But it is possible the inverted yield curve could prove a false signal, although this is rare.[7]

Cooler conditions

Fortunately, inflation is already cooling across advanced economies, especially in the US, Canada and the eurozone (see exhibit G-d). This has been partly enabled by less challenging year-over-year comparisons, as well as an energy market that adapted surprisingly well to the intense but short-lived shock triggered by the Russia-Ukraine war (see [ISA Briefing: Energy back as key in real estate outcomes]). But genuinely cooling core price pressures are also in evidence.[8]

Either way, inflation is moderating slowly and remains meaningfully above central bank targets. New risks, especially to energy prices, have emerged owing to the Israel-Hamas conflict. It is still far from clear that a so-called "immaculate disinflation" - a smooth reduction of inflation without a recession - can be achieved in the US or Europe.

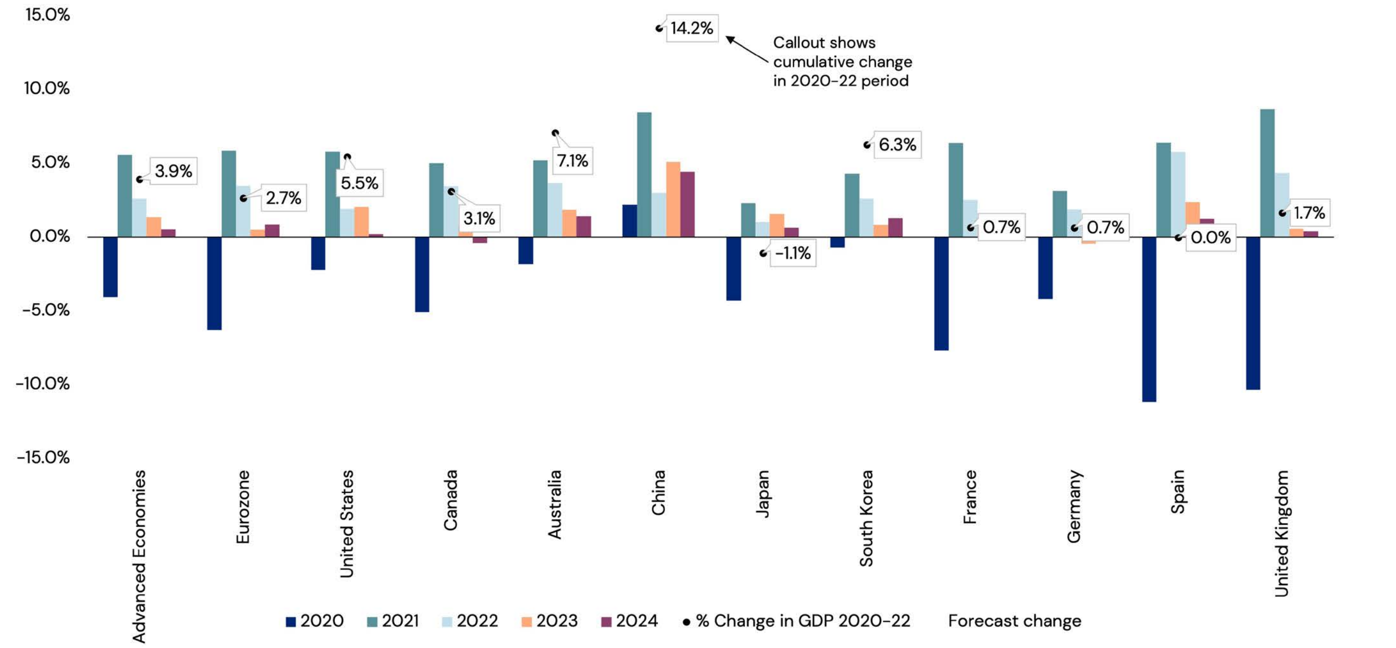
6 Source: https://www.chicagofed.org/publications/chicago-fed-letter/2018/404
7 False positive signals from an inverted US yield curve have been rare in over the last half century, with the most recent instances dating back to the 1960s. However, more recently the UK yield curve was inverted during the mid-1980s as well as around the turn of the millennium without leading to a recession.
8 Source: Oxford Economics

G-c The impact of tighter monetary policy on growth may be lagged

Oxford Economics global annual GDP forecasts

Full-year forecast revisions from the last ISA release (Oxford Economics)

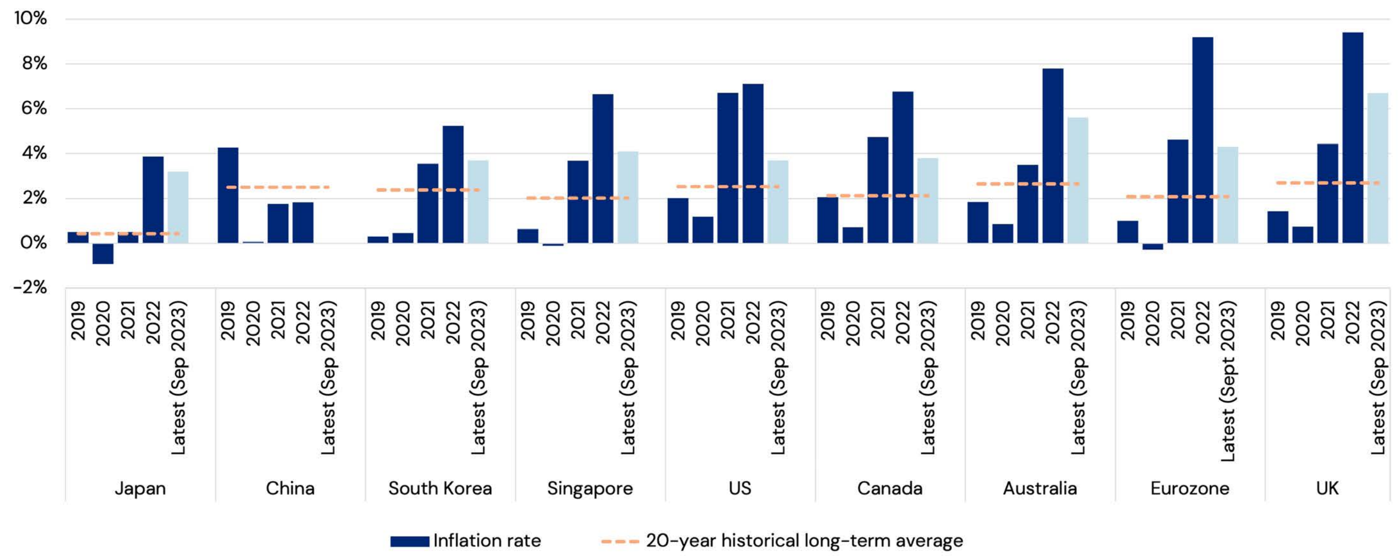
2023	141bps	63bps	240bps	206bps	12bps	92bps	69bps	-15bps	65bps	63bps	157bps	128bps
2024	-124bps	-129bps	-118bps	-298bps	-59bps	-23bps	-101bps	-106bps	-122bps	-238bps	-121bps	-134bps



*Aggregation based on Oxford Economics country classification: https://services.oxfordeconomics.com/api/definitions/WDMacro/GlobalMacroEconomicDatabank.pdf
Source: Oxford Economics Forecast most recent as of October 31, 2023
Note: No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

G-d Inflation cooling, especially in US, Canada and Eurozone

Inflation trend by country (year-over-year)



Note: 20-year historical long term average inflation rate is the average quarterly inflation rate from Q3 2003 to Q2 2023.
Source: Oxford Economics; latest monthly data from Australia Bureau of Statistics, Eurostat (eurozone), Singapore Department of Statistics, Statistical Bureau (Japan), Statistics Korea, National Bureau of Statistics (China), Statistics Canada, Office for National Statistics (UK), US Bureau of Labor Statistics. Latest data available as of October 31, 2023.
No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

No single global path

To this point, we have been generalizing about the global economy; of course, not all economies are in the equivalent part of their cycle or face the same circumstances. For example,[9] Canada is probably in recession now and growth in Germany has already turned negative, owing to its exposure to weak export markets. The US has a unique combination of risk from its quarrelsome policymakers and opportunity from its strong position to benefit from AI. Japan stands out as having loose monetary policy, which is gradually and partially normalizing but should remain far more accommodative than elsewhere. Chinese policymakers have been cutting rates amid a rebound that has undershot expectations, but tentative signs of improvement in its housing market are encouraging (see our ISA Briefing: Key economic questions for China and Japan). These and other regional and national nuances around economic factors, and their implications for real estate, will be explored in greater depth in the regional chapters of this *ISA Outlook*.

(L-R) LaSalle's Brian Klinksiek, Elysia Tse, Fred Tang and Wayne Qin discuss *ISA Briefing: Key economic questions for China and Japan*

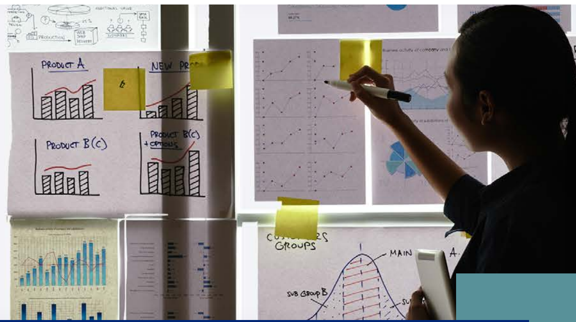
9 The country-level assessments that follow are based on LaSalle analysis of various economic data points, mostly national sources and publications of our economic analysis providers, principally Oxford Economics and Capital Economics.

LOOKING AHEAD

- **As of the time of writing, the semblance of interest rates stability that was observed earlier in 2023 is in doubt as rates experience a renewed spike. This could prove short lived, but it is having an impact on real estate capital markets, as discussed in the next section.**
- **We are loathe to make a specific interest rate forecast. Investors in real estate should approach macroeconomic questions with humility. If an investor had unique, high-conviction insight into the path of interest rates, trying to monetize that insight through specific bets on real estate – a lumpy, idiosyncratic asset class with inherent frictions like non-trivial transaction costs and incomplete information – would be inefficient to say the least.**
- **Questioning what the bond markets are indicating about the future is the same thing as taking a novel stance on macro. Our recommendation is to largely be a "taker" of bond market signals, reflecting them in valuation models but focusing on insight within real estate to find the best relative value. That is the focus of the remainder of the *ISA Outlook 2024*.**

Solving the capital stack equation

The math of higher interest rates driving challenges and opportunities



In last year's *ISA Outlook*, we noted that "the math" of higher interest rates was driving a repricing of real estate in many markets. This should be an instantaneous recalculation, but for private equity real estate, it is more of a process. There is a button in Microsoft Excel called "Update Values" that immediately triggers changed numbers in one cell to flow through to linked cells. How changes in the interest rate environment flow through into private equity real estate pricing and valuations is far less efficient than that; it also varies by market.

Debates around which markets are "ahead" and which are "behind" in repricing rely on a wide variety of data sources, which can paint contradictory pictures. At LaSalle, we approach this topic through an intrinsic value framework that is proprietary to our investment teams. Repricing is not a single road on which a market leads or follows, but a process of re-alignment with changed capital and occupier market relativities, which vary from market to market.

We are beginning to see pressures around how individual real estate deals are capitalized and property businesses are funded. The basic challenge is how to resolve issues in the capital stack of repriced real estate, especially as debt comes due and replacement finance is less available and more expensive. Solving the capital stack equation can either create risks or investment opportunities, depending on the situation of the investor, the assets and their current capitalization.

IN HINDSIGHT

Stabilizing rates, healing transaction markets

"The relentless math of higher interest rates will continue to weigh heavily on real estate values, at least until interest rates stabilize as inflation begins to subside. The bid-ask spread for private real estate should eventually close and transactions will resume in earnest at a rebased level." (ISA Outlook 2023 p14)

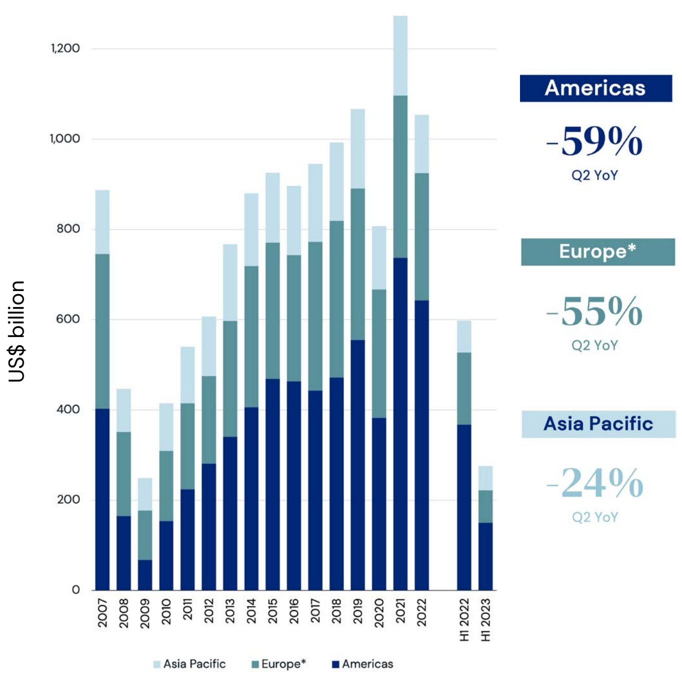
We stand by this call. The only question is: when? For much of 2023, interest rates remained volatile but moved largely sideways, exhibiting no overarching trend. This relative stability did indeed allow for tentative signs of improvement to emerge in real estate transaction markets. Later in 2023, however, a surge in interest rates pushed up borrowing costs again, acting like a wedge to drive the bid-ask spread wider again and causing a renewed slowdown in transactions.

Equity flows reduced

Would-be buyers of real estate, at least those that use leverage, feel the math of higher rates promptly. They borrow at today's cost of debt. By contrast, would-be sellers of real estate are slower to catch up; they may have fixed debt costs at lower levels and may opt to wait and see if their assets will eventually fetch backward-looking book valuations. This is the classic set-up for a bid-ask spread, which continues to characterize the market, resulting in today's subdued levels of transaction activity (see exhibit G-e). As noted above, signs of

G-e Uncertainty stalls transaction volumes

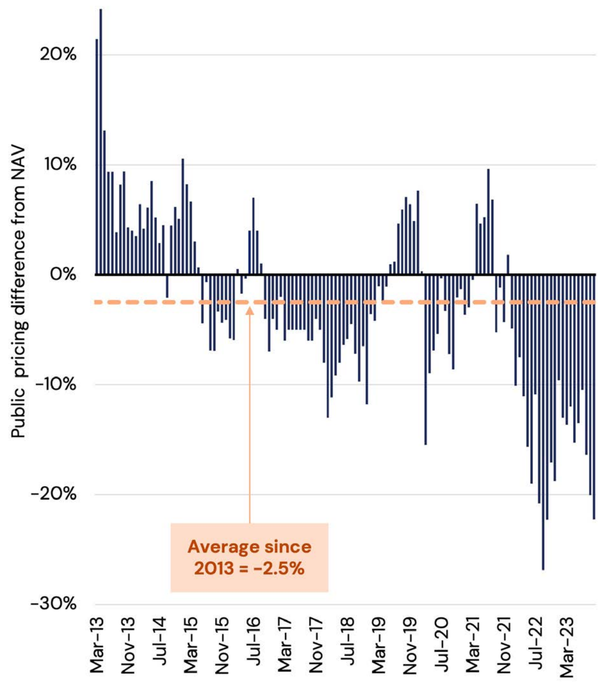
Direct global real estate investment volumes



* Includes a small amount of ex-Europe EMEA markets
Source: JLL Research, latest July 2023.
Note: No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

G-f Global REIT discount to NAV widened

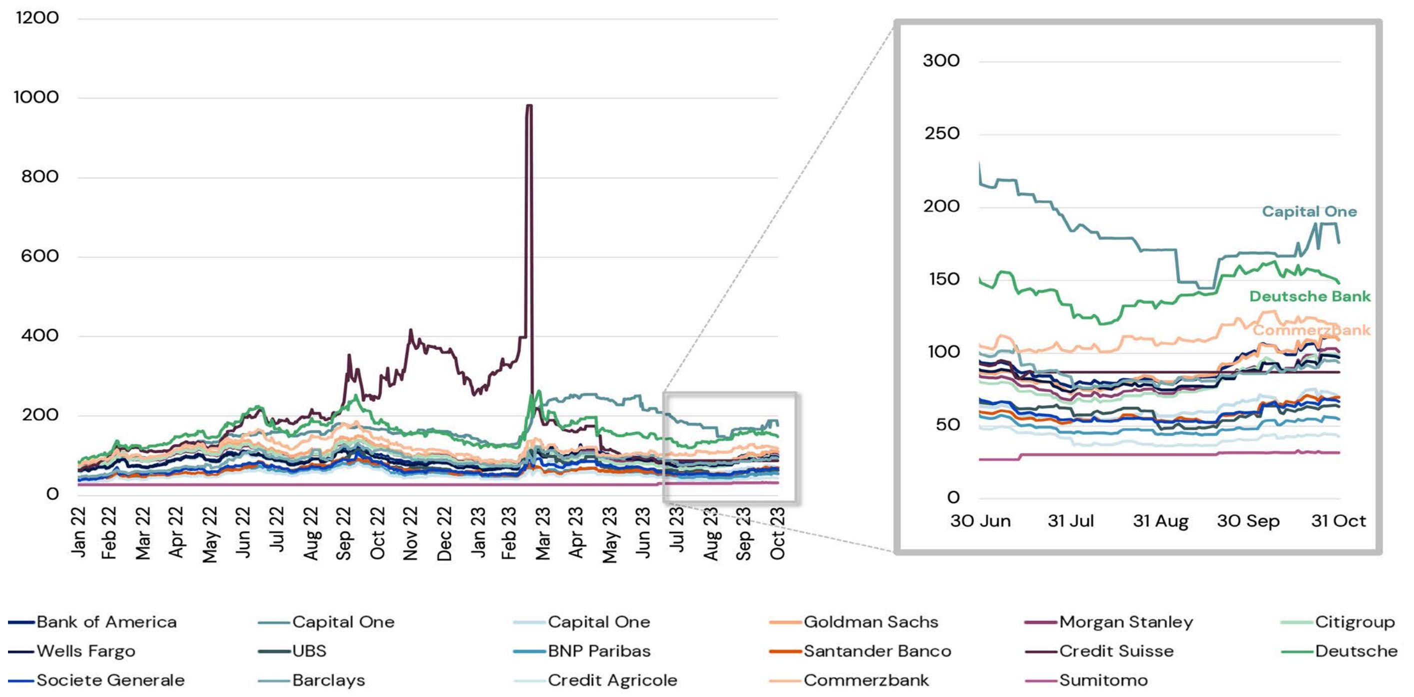
Global real estate securities premium / discount to net asset value



Source: EPRA/NAREIT, LaSalle Investment Management Securities. Discount to NAV data to October 31, 2023.
Note: No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

G-g Bank CDS spreads trend lower since the banking crisis

5-year CDS spreads on key global banks



Source: Refinitiv. As of October 31, 2023.
Note: No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

the bid-ask spread starting to resolve in mid-2023 had been called into question by volatile upward movement in rates and sluggish transactions markets by the time of writing.

In contrast to private equity markets, changes in rates flow through more quickly into the prices of listed real estate companies. Real estate securities continue to trade at meaningful discounts to NAV, because listed share prices have adjusted more than private market prices (see exhibit G-f). This gap persists even after accounting for differences in the composition of listed and private real estate market exposures.

Encouragingly, there is evidence that significant amounts of "dry powder" is waiting on the sidelines for transactions that meet its objectives. As of October 2023, Preqin estimated that dry powder destined for private real estate funds totaled US$406 billion, down only by 10% from its December 2022 peak.[10] This amount of dry powder is unlikely to prove as powerful as in the past given the dynamics in debt markets discussed below, and the fact that much of this capital is targeting higher-return strategies.

Debt more costly, less available

Higher debt costs, less debt availability, lower loan-to-value (LTV) ratios, tighter underwriting standards and reduced valuations can intersect to create a debt refinancing gap.[11] Putting a single figure on the size of this gap is virtually impossible, but suffice to say, it is not small. There will be "workouts" in some markets, and this process has only just begun, implying opportunities for investors prepared to find situational value.

Debt market dynamics remain complex, not least because of the role of banks. While the largest banks are healthier than they were going into the GFC, the failures of Silicon Valley Bank, Signature Bank and First Republic, and the hastily arranged merger of Credit Suisse into UBS, have brought banking sector risks into focus.[12] Worries abounded that commercial real estate loan exposures on bank balance sheets, particularly those of US regional banks, were going to put strain not only on the availability of real estate debt capital, but also the banking system generally. Our view has been that real estate's most acute challenges are concentrated in select market segments, such as US offices and Chinese for-sale residential, which are only subsets of banks' exposures and not large enough to be systemic.

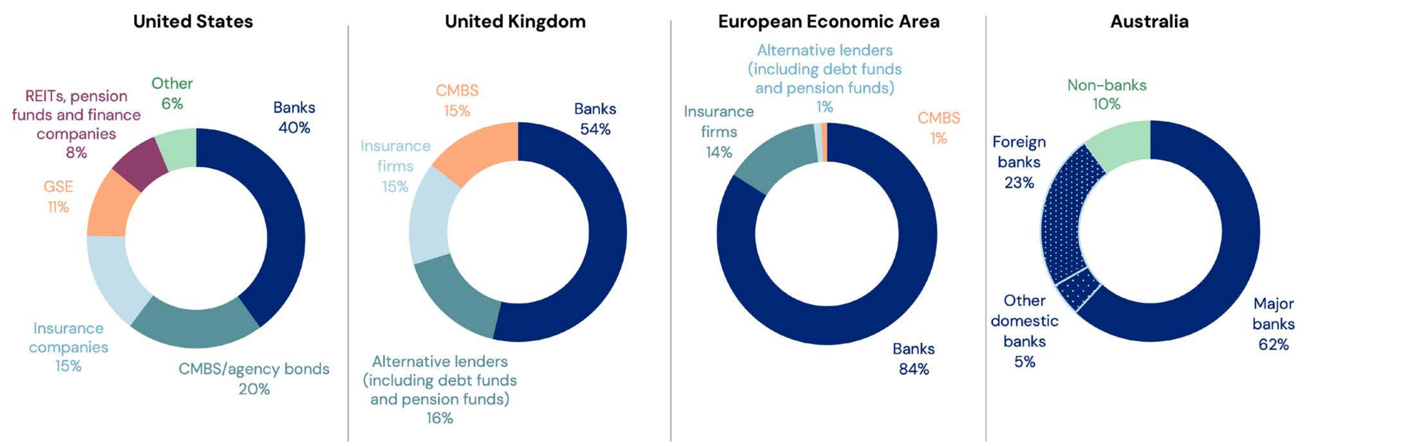
That perspective has been borne out by a general moderation in markets' pricing of bank failure risk (see stable or falling bank CDS spreads in exhibit G-g). While we do not expect systemic banking sector distress, further banking sector turbulence cannot be ruled out. This creates risks around the orderly flow of capital to real estate, though it could also surface attractive opportunities for private lenders.

Moreover, banks are only one piece of the real estate debt pie. In the US, banks account for 40% of outstanding debt collateralized by income-producing real estate, with insurance companies, government-sponsored enterprises, mortgage-backed securities and private debt funds also accounting for large shares (see exhibit G-h). Debt markets in other parts of the world tend to be more bank-dependent, though ex-US bank capital buffers mostly look healthy, and we do expect to see continued diversification of debt sources as has occured in the US.

10 Source: Preqin Dry Powder data as of October 2023
11 Based on LaSalle's analysis of data from JP Morgan, American Council of Life Insurers, Green Street Advisors, CBRE, CREFCOA, Cushman & Wakefield and PMA.
12 The fundamental trigger of these bank's challenges was unhedged long duration interest rate exposures on bonds in a rising rate environment, not real estate (see our *ISA Briefing: Banks, rates and the impact on property*).

G-h Banks are still an important source of real estate debt capital, but not the only one

Sources of debt market capital by geography



Source: Federal Reserve Flow of Funds, Bank of England, Refinitiv, Bayes Business School, European Banking Authority, European Insurance and Occupational Pensions Authority, Real Estate Capital, LaSalle (June 2023), Australian Prudential Regulation Authority, CLI Group Research (August 2023).
Note: No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

Different markets, different equations

It should be noted that the dynamic around bond markets and real estate pricing is not the same in all global markets. In some cases, that is simply because the bond market has not adjusted as significantly. In Japan, the relativities between real estate debt pricing and cap rates still allow levered real estate buyers to benefit from "positive leverage."[13] In other instances, bond markets may have adjusted, but the link to real estate pricing is weak for structural reasons, meaning the adjustment may be delayed or remain incomplete.[14] We will explore market-specific pricing dynamics in the forthcoming regional chapters.

13 Based on LaSalle's investment experience and supported by analysis of JLL and Bloomberg data as of Q2 2023
14 Barriers to the efficient flow of capital between asset classes, or across borders, can create segmentation in capital markets that allow real estate to price indefinitely at levels that might look expensive when viewed only in the context of relevant benchmark rates. Such disconnects can also occur when a market segment is considered a "store of value;" for example, prime, centrally located assets in global superstar cities may be seen by some investors as akin to a rare antique or precious metal, generating demand for assets that is insensitive to the broader capital markets. Investors in such segments should evaluate whether the underpinnings of such structural disconnects will remain in place before they accept pricing that appears disconnected to interest rates. History has both examples of such pricing disconnects persisting and of them ending.

LOOKING AHEAD

- **Widespread distress is unlikely – especially outside of US offices – but there will be ongoing market stress to solve the capital stack equation. On the equity side, this can create opportunities for investors with higher return targets in the form of equity rescues at adjusted values. Situations requiring the recapitalization of portfolios can also create opportunities for long-term core investors to get access to quality assets that would otherwise be inaccessible.**
- **The silver lining of the negative leverage faced by equity investors in some markets is that nimble investors able to invest in debt can potentially get a higher return for a safer part of the capital stack. We see a broad opportunity set in real estate debt, and in structured transactions with debt-like characteristics. Pricing in listed markets also looks relatively attractive.**
- **The limited willingness of debt and equity investors to fund development in many markets will help to limit supply of new properties over the medium term, limiting downside risk in real estate fundamentals. Occupier market conditions are the focus of the next section.**

Coming off the boil

"Winning sectors" decelerate, but remain relatively strong

The German proverb "trees don't grow to the sky" suggests that there are natural limits to growth; this also applies to real estate. To put it in the extreme, rent growth cannot exceed inflation by a large amount forever, or else it would cause an unreasonably large share of the economy to be devoted to paying rent. More prosaically, there are feedback mechanisms that limit how long a property market can stay hot until demand moderates or supply kicks in.

Occupational fundamentals are solid in many of the sectors and markets in which we invest. But we also see a significant cooling in sectors that have been riding high, especially logistics, rental housing and life sciences real estate. For example, logistics rent growth shows a marked slowing from peak levels, though it remains very strong compared to history and to other sectors (see chart G-i on next page).

The cooling trend in these recently boiling hot sectors can be attributed, in part, to macroeconomic slowing. It is also related to ripple effects originating from the pandemic shock. The onset of Covid-19 lockdowns triggered waves of disruption, adjustment and – eventually – normalization. Large segments of the economy were reconfigured almost overnight, dramatically shifting activity and investment. The waves of change have reverberated and attenuated; the hottest sectors coming off the boil is the tail end of that.

IN HINDSIGHT

Bullish on sheds and beds

"We remain reasonably bullish about the path of NOI in many logistics and residential or residential-adjacent assets across the globe." (ISA Outlook 2023 p17)

We got this one right. Most logistics and rental housing markets across the globe performed very strongly in 2023 in terms of rents and occupancy. We continue to expect them to perform well on a relative basis, if moderating in absolute terms, as we discuss in our *ISA Outlook 2024* global theme "Coming off the boil."

Demand ripples

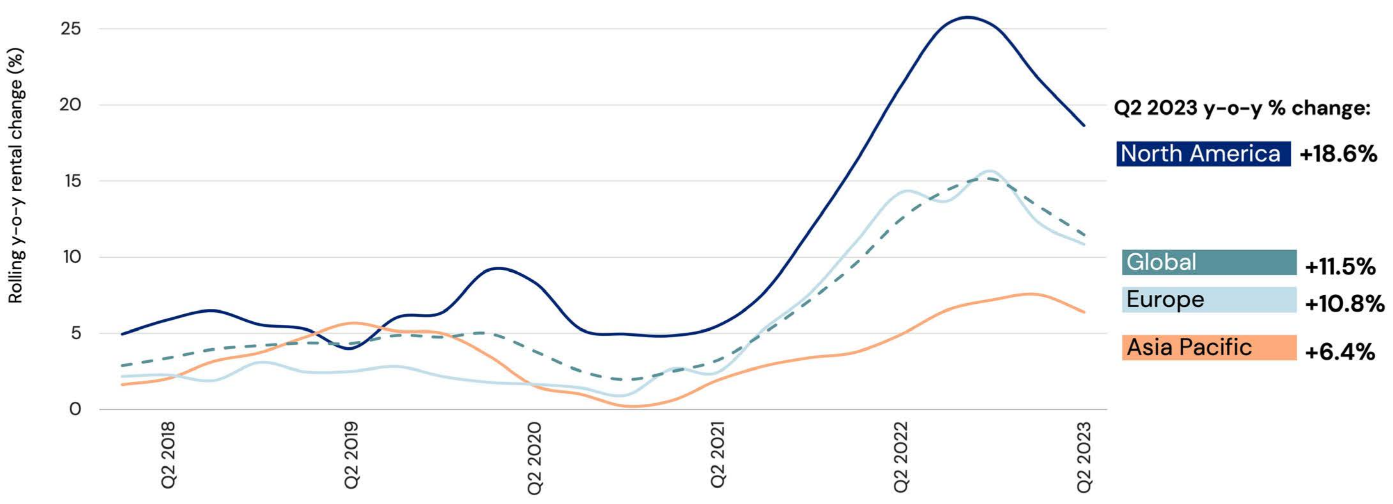
Some of the ripples relate to demand. The logistics sector is a case in point. Lockdowns caused a sudden step change in already growing e-commerce penetration, driving a frenzy of logistics leasing and pushing vacancy down sharply. Supply-chain issues prompted mindset shift from "just in time" to "just in case", further driving up desired inventory levels and requiring more space. But in 2022, as a portion of activity returned to physical retail, signs of logistics overcapacity emerged, most notably a halt by Amazon to large scale investment in new logistics facilities.[15] The normalizing trend in logistics demand continued in 2023.[16]

The theme of demand normalization is not confined to logistics.[17] In many markets, demand for rental housing slumped in 2020 as remote work and job

15 Source: https://www.bloomberg.com/news/articles/2022-09-02/amazon-closes-abandons-plans-for-dozens-of-us-warehouses
16 Sources: Green Street Advisors, LaSalle operating experience
17 The principal sources for the observations in these paragraph are Green Street Advisors, LaSalle analysis of various real estate data providers and LaSalle operating experience.

G-i Double-digit logistics rental growth slowing

Annual logistics rental growth by region



North America: average asking rents (inclusive of all stock A/B/C gradations) based on 55 city markets in the US and 9 city markets in Canada;
Europe: aggregate nominal rental growth based on prime headline rents in 23 city markets (weighted by city nominal GDP);
Asia Pacific: based on net effective rent in 40 city markets (unweighted);
Global: weighted average according to region's (US/Europe/Asia Pacific) share of total GDP.
Source: JLL, July 2023.
Note: No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

losses killed household formation, enabling a robust recovery in for-rent residential demand as the world reopened in 2021-22; this has since moderated as more normal demand patterns returned. Similarly, leisure-driven demand growth for resort hotels has cooled as travel to cities rebounded. Self-storage demand has likewise normalized. The market for life sciences space has also softened as a surge in funding for early-stage biotech ventures faded with higher interest rates.

Supply ripples

Other ripples relate to post-pandemic lumpiness in supply. In many pandemic-favored sectors - such as rented residential, logistics and life sciences - a temporary spike in supply is underway today before deliveries are expected to taper substantially later in 2024.[18] The current spikes stem from construction disruptions in 2020 pushing back deliveries, and a frothy capital markets environment in 2021. This flattered development economics, at least until construction cost escalation started to bite and exit yield assumptions headed back up. Encouragingly, unlike during the Global Financial Crisis (GFC), new supply is not elevated in all sectors and markets.

Cooling, not freezing

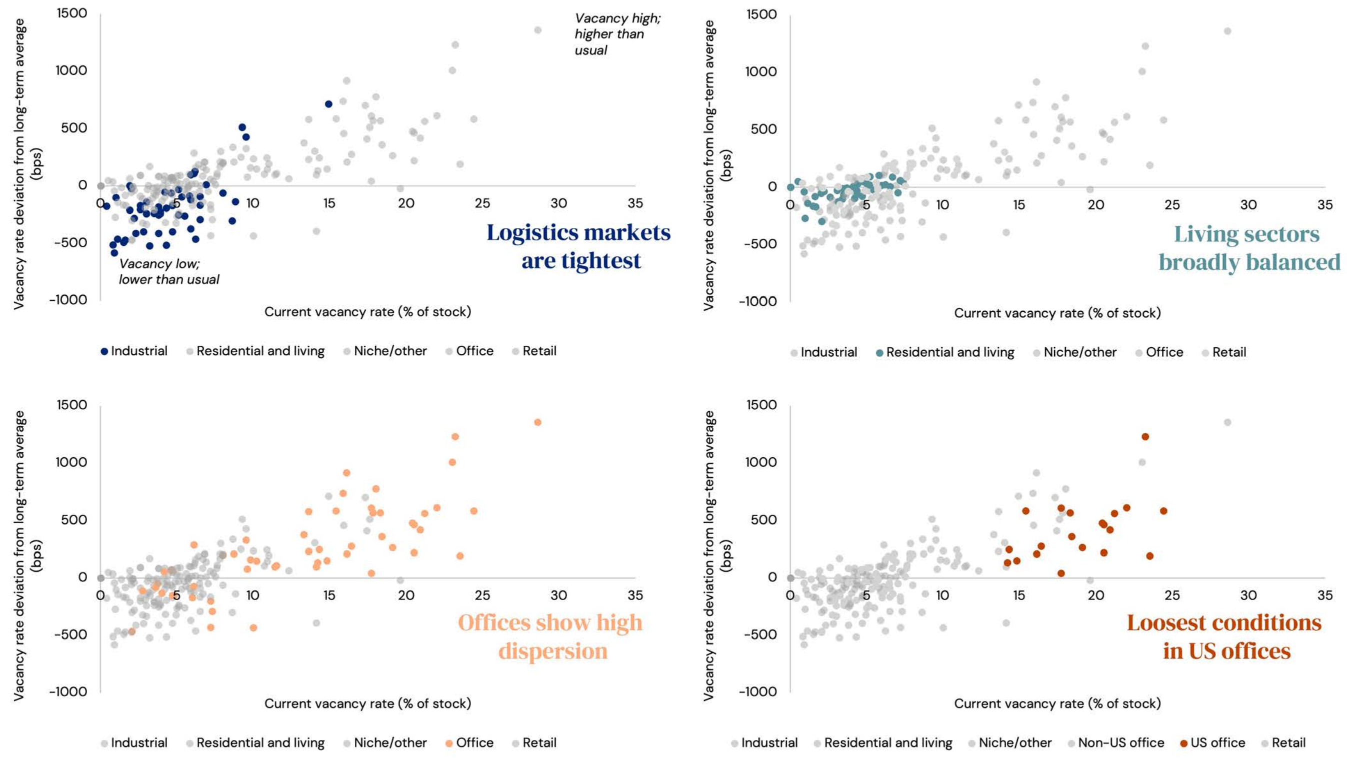
The pattern of cooling absolute growth in the strongest market segments does not substantially shift the relativities between sectors; our most favored sectors are still positioned for strong relative rental growth. One way to assess the "tightness" of a market is to compare current and long-term vacancy; markets tighter than normal tend to see growing rents (see exhibit G-j).

On this basis, logistics markets display some of the most consistently tight fundamentals, whilst residential and other living sectors are also tight, if a bit less so. The office sector stands out by the dispersion of markets as well as the deeply unfavorable conditions for rental growth in the US. Offices in other parts of the world display a fair amount of variability between tight and loose conditions.

18 Sources: Green Street Advisors, LaSalle analysis of real estate market data

G-j Global fundamentals closely tied to sector

Global vacancy rates by property type



The current vacancy rate refers to the latest available data point for each location and these dates range between Q1 and Q3 of 2023. Similarly, the measurement period of the long-term average will depend on data availability but represents the longest period available for each series.
Sources: JLL, CBRE-EA, CBRE, Real Page, MSCI, NCREIF, Canada Mortgage and Housing Corporation, ARES, Ichigo Real Estate Service, company reports and LaSalle Research and Strategy as of October 2023. Note: No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

LOOKING AHEAD

- **Our favored sectors of logistics and residential remain strong in terms of relative growth prospects, but their hot fundamentals coming off the boil are a reminder that above-inflation growth cannot continue forever. Lower absolute NOI growth prospects have made their fair value math incrementally more challenging, especially considering interest rate movements.**
- **Investors should be careful to apply reasonable assumptions for rental growth and occupancy. Predicting that frothy growth around peaks continues is a recipe for overpaying. Rigorous proprietary forecasts that span multiple years and include long-run assumptions, such as those developed by LaSalle, should help avoid simplistic extrapolation of current run rates.**
- **US offices stand out as having the weakest fundamentals of the many segments we track. Offices in other regions are better, but there is still dispersion. Retail segments have been unloved by investors, but merit another look as the sector is well advanced in the nearly decade-long adaptation to the realities of e-commerce; the surviving convenience and experience-focused retail properties clearly have a future, and the ranks of weaker assets have been heavily culled.**
- **Investors should also consider which property types are more and less sensitive to economic downturns, with an eye toward constructing portfolios anchored by defensive income.**
- **Global trends set the backdrop, but real estate remains very driven by local forces, and recognition of this nuance is essential. The Europe, North America and Asia Pacific chapters of the *ISA Outlook* will explore local market conditions in much greater depth than is possible here.**

Beyond "bifurcation"

Making sense of the changing definition of quality and core

The word "bifurcation" appears with increasing frequency in descriptions of real estate fundamentals. Higher- and lower-quality properties performing differently is nothing new. But there is a sense that divides within segments of the real estate market are widening, joining divides between sectors as key drivers of performance. In last year's *ISA Outlook*, we encouraged investors to look "beyond the sector chasm" to consider "widening gaps within sectors" around traits such as location, asset quality and energy efficiency. Since then, references to bifurcation have only become more widespread.

Is bifurcation the right word? Merriam-Webster defines it as "the state of being divided into two branches or parts." The actual underlying trends are more complex than that. Some have argued that there should be three branches - the best assets, properties that could be improved to restore competitiveness, and buildings that are hopelessly stranded. But "trifurcation" is still an arbitrary and inadequate concept. In practice, asset attractiveness is a spectrum, and it is futile to divide assets into a fixed number of discrete buckets.

No matter the terminology, performance gaps on a variety of dimensions have come to matter deeply. We are monitoring a variety of key divides in asset performance, for example:

- **Sustainability credentials** such as green certifications and alignment with net zero carbon pathways can be key differentiators for buildings. Our recent ISA Focus report on the *Value of Green* identified many empirical studies showing significant positive differences in rents and asset values for buildings with green features as compared to those that lack them.

IN HINDSIGHT

Widening divides within sectors

"Our analysis suggests that sector selection will continue to matter, but other asset and strategy traits are rising in importance. We expect quality divides to widen everywhere as the balance of power tips in favor of tenants and structural trends to accelerate the obsolescence of less modern and less green assets." (*ISA Outlook 2023* p20)

This call proved accurate. Gaps within sectors, particularly along building quality and sustainability lines, continued to widen throughout 2023. We discuss this in greater depth in our global theme, "Beyond bifurcation."

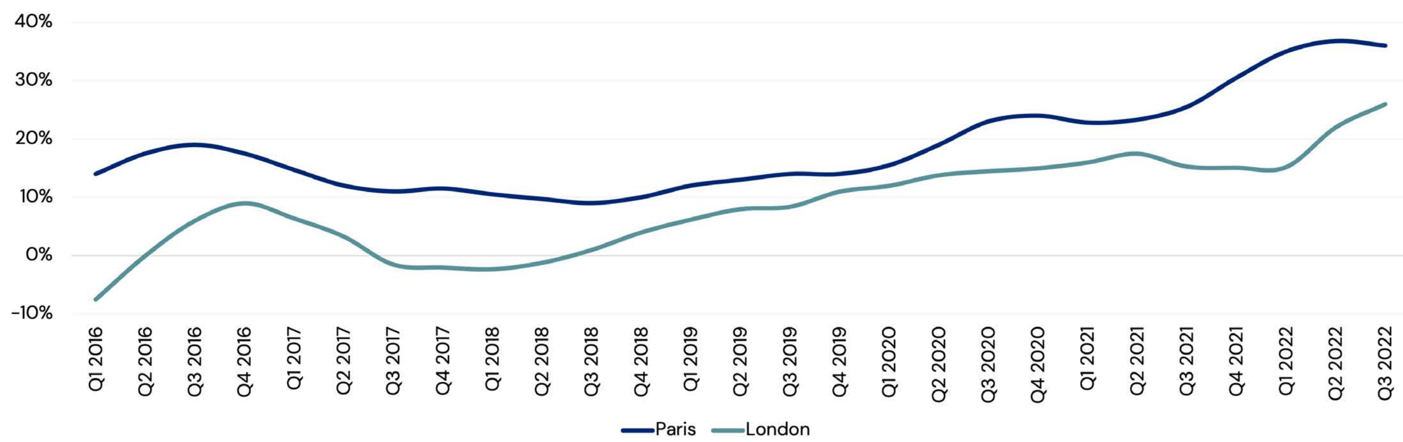
No big gains in return-to-office (RTO)

"Further large changes in the balance between in-person and virtual interaction are probably unlikely... It is probably wishful thinking to expect further large gains in office attendance anywhere in the world." (*ISA Outlook 2023* p23)

We got this mostly right. Throughout 2023, office attendance has trended essentially sideways, if with some slight improvement in the US, largely driven by companies tightening RTO policies. Investors dropping their "wishful thinking" about RTO has contributed to sharper price declines in office than in other sectors. The big exception has been China, where the end to start-stop lockdowns since its rapid reopening at the beginning of the year has allowed a swift and almost complete return to office normality.

G-k Sustainability agenda driving "Green Premium"

Sale-price gap for offices that have sustainability ratings



Source: MSCI, latest available November 2022.
Note: No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

These are borne out in the property market data that we monitor; for example, MSCI data show a steadily widening green premium for office buildings in London and Paris (see chart G-k). Sustainability-related bifurcation is driven by increased regulation of the built environment's energy intensity and a shortage of space that meets corporates' sustainability commitments. Research from JLL shows that demand for low-carbon office space in the US is expected to exceed supply by 75% through 2030.[19]

- **Quality of design and amenities** often separate successful office and retail properties from challenged ones. The rise of virtual modes of interacting, collaborating and shopping mean that the end-users of space have greater choice of where they do those things. On the discretionary retail side, shopping environments that offer compelling experiences have outperformed relative to less stimulating places, at least since the spike in e-commerce penetration in the 2010s.[20] "Compelling" generally means a high quotient of food and beverage outlets, a curated selection of popular and niche brands, and

19 Source: https://www.us.jll.com/en/trends-and-insights/research/soaring-demand-for-low-carbon-offices-will-outstrip-supply
20 Source: Green Street Advisors.

Canary Wharf, London
West End, London

Fulton Market District, Chicago
The Loop, Chicago

unique, locally inspired experiences. The rise of "experiential office" is a little more recent but involves similar differentiators such as a wide range of flexible work areas, wellness features and vibrant, socially focused amenities. For workers given the choice, the decision to come into the office is a matter of balancing the costs of a commute – money, time and discomfort – against the benefits. In many markets, the most successful office assets are those that enable a "**commute-worthy**" experience. A large share of the existing stock of office stock does not live up to this test, spelling trouble for their rents and values.

- **The resilience of live/work/play locations with gravitational pull** shows that the "commute-worthy" principle applies beyond the four walls of the office. In last year's *ISA Outlook*, we wrote that "urban places that offer a strong quality of life, a good amenity base and a sense of place [remain] resilient." Precincts that offer opportunities for acvitivies beyond just going to work – such as bars, restaurants and entertainment – have seen a generally stronger return to the office than submarkets dominated by office towers. For example, anecdotal evidence suggests that London's return-to-office rates vary significantly by submarket, with the mixed-use West End leading the way and Canary Wharf – which has a mix of uses more similar to a North American high-rise financial district – lagging. The relative resilience of mixed-use submarkets is also evident in patterns of residential choice. Research from the McKinsey Global Institute found that since the onset of the pandemic, outmigration from urban neighborhoods was greater for submarkets dominated by office buildings as compared to those with a wide range of uses (although suburban locations mostly outperformed both).[21]

It is clear that bifurcation – or whatever you choose to call it – is happening across many property market segments on a growing number of dimensions. The more important question is: What to do about it? Merely observing that part of a troubled market continues to do well is insufficient insight to inform strategy. Investors must go beyond the fact of bifurcation, to slice their market assessments according to new fault lines and devise differential assumptions. This way they can assess what outcomes are likely and compare those to what outcomes are priced in by asset markets.

21 "Empty space and hybrid places," McKinsey Global Institute, July 2023.

LOOKING AHEAD

- **Assessing how bifurcation should inform investment strategy requires assessing what future is priced into assets today; for example:**
  - **Is the winning side of a bifurcated sector strong enough and priced appropriately to generate a suitable risk-adjusted return? Maintaining occupancy levels is not the same as delivering a return commensurate with an appropriately risk-adjusted cost of capital.**
  - **How do the best segments of challenged sectors compare to the range of other investment alternatives? Sometimes the best segments of a weak sector are still inferior investments compared to the worst segment of a strong sector.**
  - **Is the value gap between winning and losing assets bridgeable through refurbishment and repositioning, and if so, does bridging that gap generate an appropriate risk-adjusted return? If not, pricing on the losing side may need to fall more, and sometimes the weak asset is simply "stranded" and will require redevelopment.**
  - **Is the driver of bifurcation sustainable for the long-term, or is it due to a more transitory factor? The value of being in a long-term vibrant location is less likely to erode than that from being in the newest building with the most up-to-date amenities.**
- **The best way to answer these questions rigorously is with a fair/intrinsic value framework that segments markets not at the level of traditional, aggregated definitions, but uses different assumptions based on how assets are positioned vis-à-vis bifurcation divides. It should be kept in mind that the best way to segment a market today does not need to be the most appropriate way to do so in the future. Discovering new dimensions of bifurcation before others should help drive outperformance.**
- **Differential performance by asset quality is nothing new. Real estate's enduring need for capital expenditure should not be mistaken for a novel bifurcation trend. It is essential to underwrite appropriate capex to keep an asset competitive for the long-term.**

Global recommendations summary

Growth, repriced assets, situational opportunities

> *"Now is always the hardest time to invest."*
> – Bernard Baruch

Tactics: Stay the course

Our investment recommendations have changed only subtly since last year's *ISA Outlook* (see exhibit G-l on the next page). We remain drawn to the long-term growth potential of logistics and residential, and their various adjacent sub-sectors. Office and retail sectors are by no means uninvestable, but their investment prospects are highly variable by market and sub-type, as well as vulnerable to divides by factors like property quality. We continue to be advocates for investing in the most dynamically repriced segments of the market such as listed equity and debt, and in structured investments with debt-like structures that allow the bridging of bid-ask spreads.

We recommend patient and flexible deployment of dry powder, given we expect situational opportunities to arise from dislocation within capital stacks in some markets. But over-caution can come to at the cost of missed opportunities. Although uncertainties abound as to the path of interest rates, economic growth and real estate fundamentals, history has shown that the best investment vintages tend to be those immediately following periods of disruption.[22]

More detailed, granular discussion of investment opportunities at the regional level will be contained in forthcoming *ISA Outlook 2024* chapters on real estate markets in Europe, North America and Asia Pacific.

Strategy: The changing definition of quality and core

Our investment recommendations for 2024 align with bigger-picture, longer-term shifts in the real estate universe that we expect to reshape the definition of high-quality, core real estate. As discussed in our analysis of property market bifurcation, the features that define the best quality assets increasingly incorporate experiential and sustainability-related factors.

Perhaps the most significant shift is around what is considered a "core" property type. The traditional "four food groups" of real estate – office, retail, industrial and apartments – have been joined by a host of niche sectors that do not fit within these categories, as well as various growing sub-sectors within them. Allocations are mostly falling for the most traditional of the four food groups – office and retail – and rising for everything else. Survey data on investors' target sector allocations show that between 2019 and 2023, retail allocations have fallen dramatically in all three global regions, while those for office have shrunk in the US and Europe and held steady in Asia Pacific (see exhibit G-m on the next page). Residential, logistics and niche allocations have all grown.

The story behind this property type rotation goes beyond medium-term differences in growth rates and relative value. It also reflects a reassessment of the basic qualities what makes a "good" real estate investment. Investors are moving beyond traditional rules-of-thumb (e.g., metrics like lease length) to consider how a sector performs in the real world. These indicators can still be useful proxies for risk, but they do not give the full picture of the central driver of any asset's value: its cash flows. (A stylized description of what we call the "new core" mindset is in exhibit G-m on the next page.)

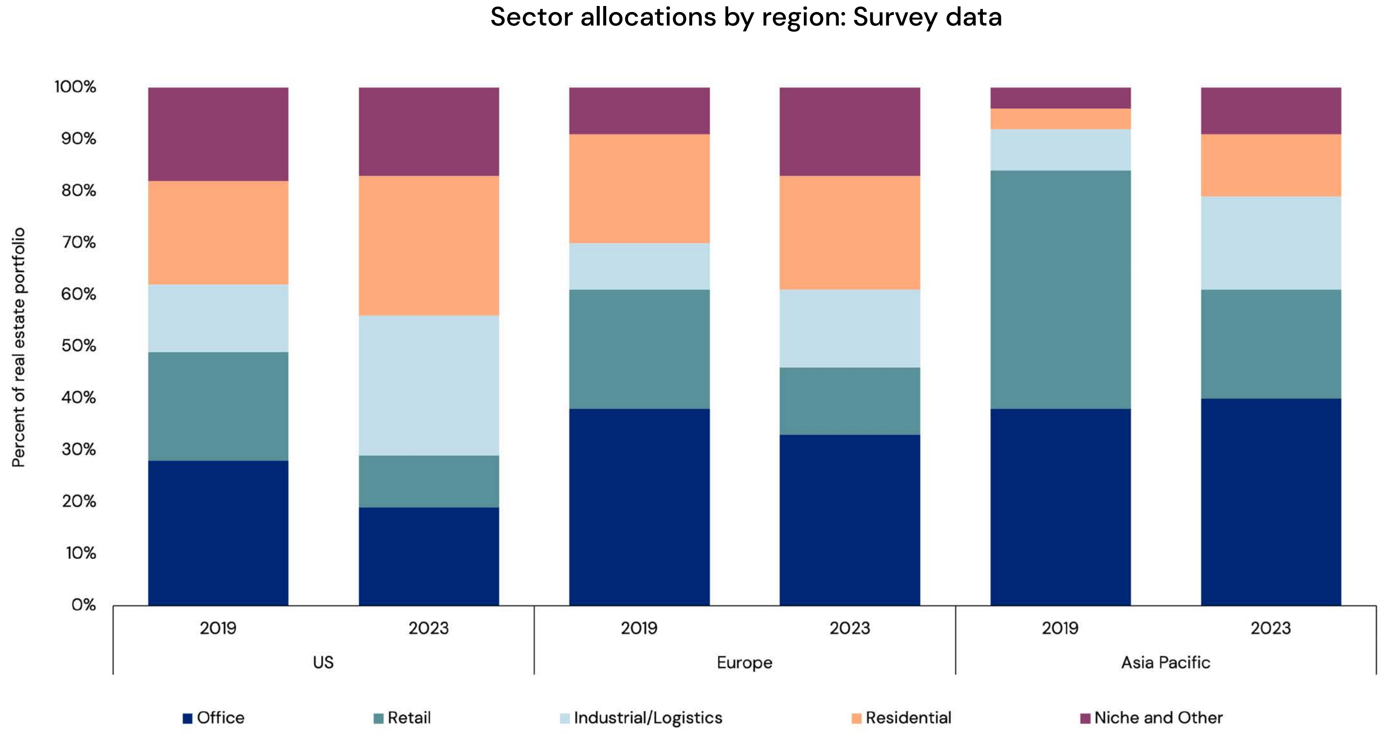
22 Source: LaSalle's analysis of data from the INREV Global IRR Index through Q4 2022 highlights that the IRRs of funds closed between 2008-2010 comfortable outperformed those raised before the GFC. See page 30 of our *ISA Portfolio View* for a more complete discussion of this analysis.

G-l

Global reccomendations summary

	North America	Europe	Asia Pacific
Strategic recommendations	Debt, debt-like positions and/or distressed equity		
	Logistics – Healthy markets with strong long-term demand and growth potential		
	Residential / beds		
	Apartment recaps with operational upside Scattered-site single-family rental	Student accommodation Tech-enabled hotel repositioning	Multi-family rental in Japan, Australia, China Tier 1 cities Hotel markets with recovery momentum
	Other sectors		
	Trade area-dominant retail with income growth potential	Top-quality office in high-barrier markets	Reposition office in highly selective markets Japan retail anchored by non-discretionary tenants
	Climate hardening and/or decarbonisation		
	Listed real estate		
Caution	Office	Regulated residential Commodity office	For-sale residential in China, South Korea

G-m **Sector allocations undergoing long-term shift**



Source: PREA Investor Intentions Survey, 2019 and 2023; NCREIF; NAREIT; NAV REIT data as of end-2022 from company reports published in 2023.
Note: No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

Assets with ostensibly short leases, like apartments or self-storage, can exhibit stable cash flows owing to the inherent granularity and diversification of their tenant base, as well as a liquid leasing market. Operational intensity and near-term capital expenditure are not to be feared, but embraced if execution risk is manageable, costs are predictable, and it comes with income growth potential. All these factors are supportive of more investment in our tactical target sectors; alignment of the medium and long view increases our conviction level in these calls.

As discussed in our *ISA Portfolio View*, key reasons to include real estate in the portfolio include the size of the asset class, the diversification potential it brings, and the potential for cash flow growth. None of these have been fundamentally altered by the recent shift in the capital market environment.

But with reversal of the multi-decade falling interest rate trend, care must be taken to align exposures with structural trends. Core investors should consider adjusting their portfolio allocations to be consistent with (or ahead of) evolving views on what constitutes core, quality real estate; value-add investors should consider creating stock that meets the evolving criteria of core investors through development or repositioning.

G-n

Traditional core mindset	"New core" mindset
Factors that are changing...	
Long leases[23]	Observed long-run income resilience and growth potential
Credit tenants	Low sensitivity of cash flows to the economic cycle
Lease clauses pass inflation on to tenants	Market conditions pass inflation into market rents
Minimal near-term capex	Predictable long-term capex
Low operational intensity	Established operating model
Traditional sector - office, retail, industrial, multi-family rented residential	Any sector that offers the above
Factors that have stayed the same...	
Flexible and defensive capital structure	
Locations with long-term tenant demand	

23 Only applies to markets that have long leases. In Japan, for example, the traditional lease length is two years and this has been viewed as core in that market.

Europe
Outlook

Watch the conversation
with Dan Mahoney, Dominic Silman and Petra Blazkova
at lasalle.com/Outlook2024

EUROPE

Published November 28, 2023

Getting ready to go

EXECUTIVE SUMMARY

In this chapter of the *ISA Outlook* 2024, we discuss how our key global themes apply in a European context. While property markets in Europe spent much – if not most – of 2023 in a waiting mode, rebased prices and strong fundamentals in many sectors suggest the time for action is drawing closer.

We begin by discussing the European real estate market at the end of 2023; city centers are coming back to life, migration is powering long-term growth and investment in decarbonization is creating opportunities. We also cover real estate capital markets and how refinancing needs will affect capital stacks. We then move to occupier market fundamentals, in which we observe considerable variation within sectors that drives opportunities. The chapter concludes with recommendations for specific investment strategies – underpinned by realism and targeted toward areas of forecast resilient income growth – for the year ahead.

European property markets enter 2024 after a year in waiting mode: waiting for a peak in European Central Bank and Bank of England policy rates, waiting for an end to the war in Ukraine and waiting for bid-ask pricing spreads to resolve. Some investors are likely to be rewarded for their patience during this period. But waiting, by itself, is only a partial strategy.

The proverb "time and tide wait for no one" also holds for the region's property markets. After an alpine climb up the mountain of interest rates (see global chapter), a bout of altitude sickness may have put European capital markets in this waiting mode, but they are increasingly acclimatizing.

Real estate owners are facing pressing questions on how to solve capital stack equations. Some of these equations are now inequalities, as many European banks, while still active, are seeking to reduce LTVs on new loans and are marking down values. Alternative lending debt strategies can help make these inequalities equations again; they also offer income returns over 300 basis points higher than two years ago (see Figure EU-a), against collateral still benefiting from healthy occupier demand growth.

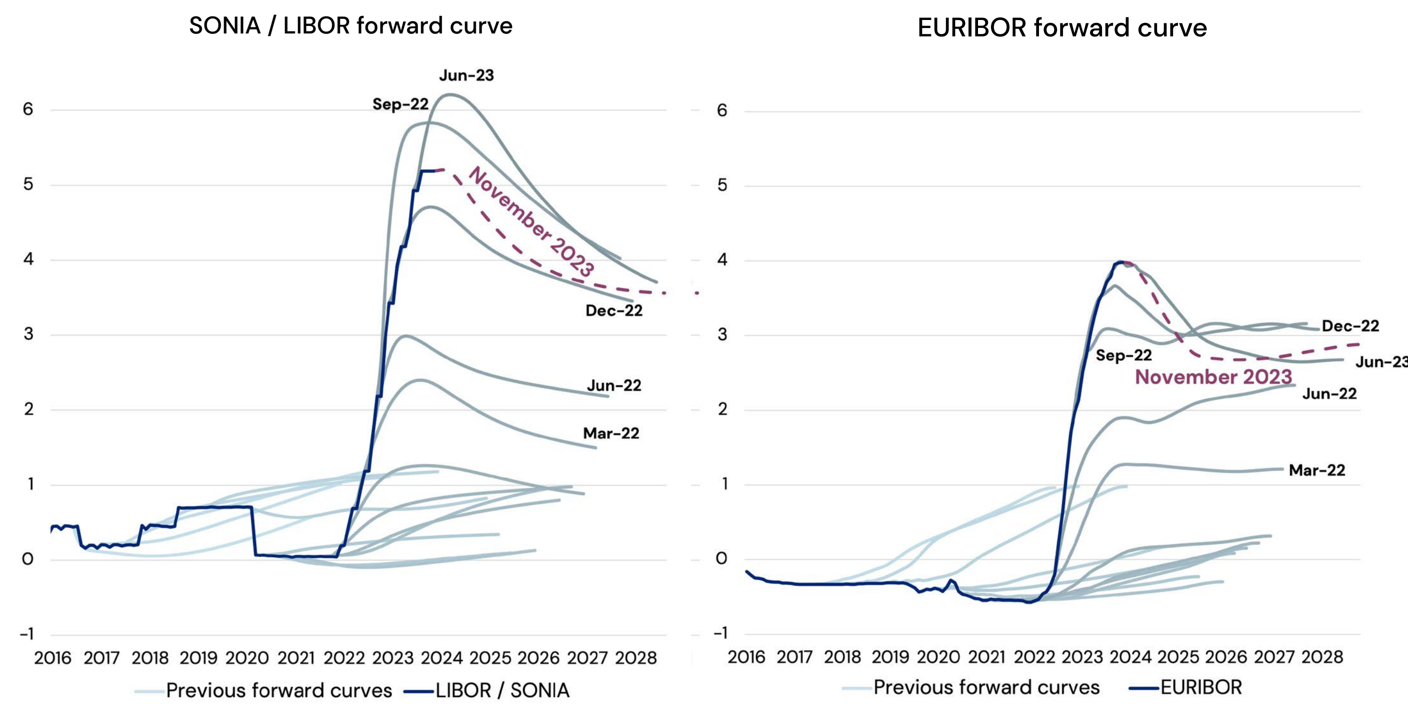
Those ready to move out of waiting mode, with pragmatic strategies that acknowledge the current operating environment but with conviction in the lasting themes that will sustain tenant demand, are likely to benefit in the year ahead.

Royal Crescent, London, UK

The Paris Olympic Aquatic Centre under construction adjacent to the Stade de France.
Both will be served by the new Saint-Denis Pleyel station, a hub of the Grand Paris Express.

Photo courtesy of Nicolas Michaud.

EU-a SONIA and EURIBOR forward curves show shifting peak rate expectations



Source: LaSalle analysis of data from Refinitiv / Thomson Reuters. Data through November 20, 2023. Each expectation line is five years long and they are shown at six-month intervals.
Note: No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty. Past performance is not indicative of future results.

Europe today

Europe's 2023 story is notable in part for fears that did not materialize: The European economy, helped by the retreat of natural gas prices, did not fall into recession early in 2023, nor did it spiral into a wider banking crisis.[1]

European economies can still count a number of blessings as 2024 approaches. The region no longer depends on Russian natural gas after a remarkable two-year energy transformation. TTF natural gas futures[2] prices are down more than 40% over the past year. The unemployment rate in the eurozone is near a record low, supporting solid residential and retailer space demand. And tourism, which constitutes a larger share of the European economy than other regions, has been rebounding strongly, boosting GDP growth for Spain.

Yet we expect headwinds to have the upper hand over the coming year. Europe is on the cusp of a likely recession. Inflation, while moving in the right direction, is proving stubborn relative to other regions, especially in the United Kingdom. Inflation has induced higher ECB and other central bank policy rates, and these are just beginning to bite.

Mortgage rates for homeowners are an important transmission mechanism between higher rates and the real economy, as we examined in our *ISA Briefing on mortgage resets*. While fixed rates are dominant in some markets like France and Germany, variable rate (or fixed converting to variable) products are common elsewhere, notably in Sweden, the UK, the Netherlands and Spain. More borrowers will see their spending power reduced by mortgage payment increases in 2024.

On top of this headwind, factory orders are weakening, and many European governments, with the notable exceptions of Nordic markets and Germany, face fiscal constraints. The shadow of 2022's bond market reaction to British Prime Minister Liz Truss's mini-budget hangs over not just the UK, but any country with elevated deficits and debt, particularly Italy.

Nevertheless, looking ahead from this short-term economic cycle, there are five trends that give us conviction that Europe's property markets will bounce back from their short-term headwinds and continue to earn the region an important place in investors' property portfolios.

1. **Europe's city centers are getting their mojo back**, with levels of vibrancy, footfall, and occupier demand at or above pre-Covid levels. Long-awaited infrastructure investments have helped. In London, Crossrail finally opened as the Elizabeth Line in 2022 and ramped up to its full frequency in 2023, leading to a surge in passenger trips – and office desirability - around enhanced nodes like Farringdon and Liverpool Street (see Figure EU-b). Germany's €49 *Deutschlandticket* has boosted travel and Deutsche Bahn data shows that long-distance rail trips, which are not even covered by the discounted ticket, are on track to reach their 2019 level in 2023.

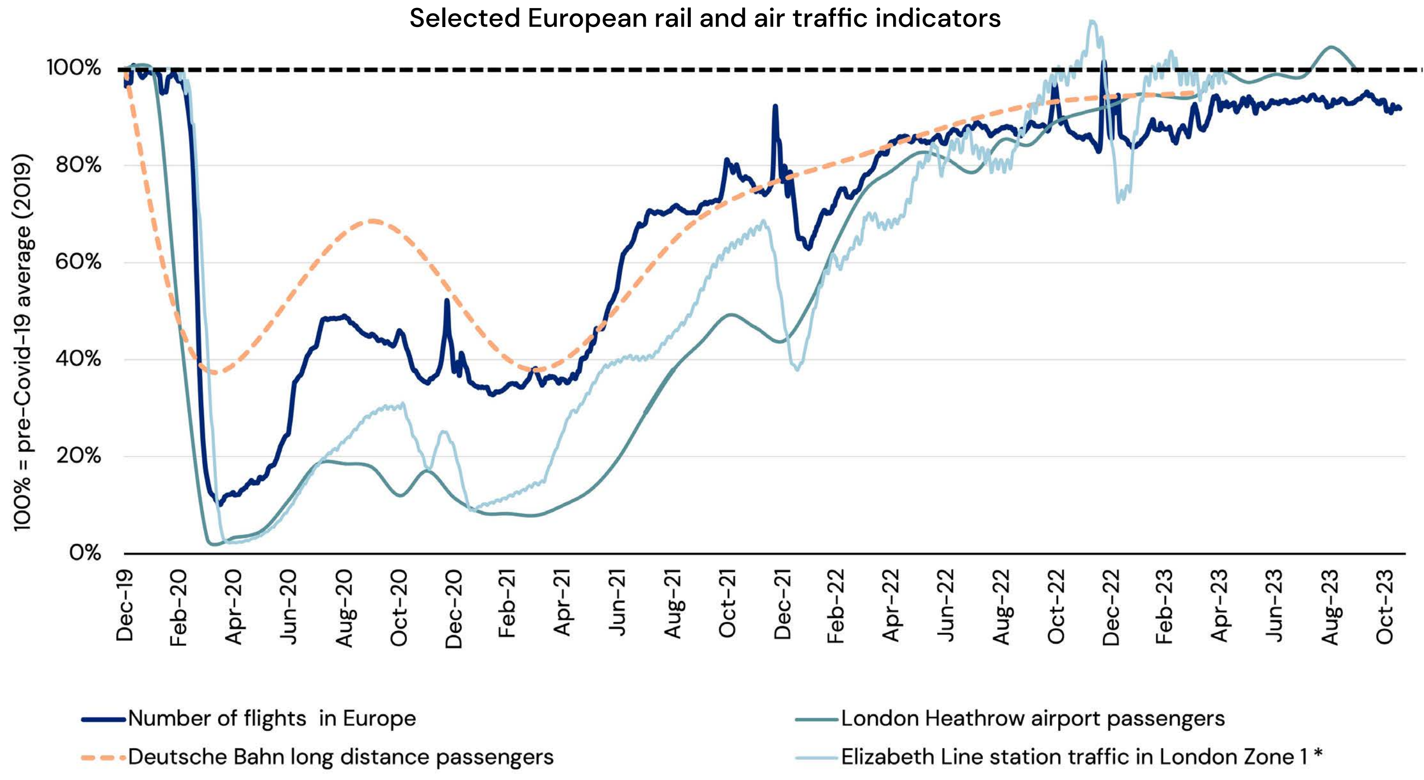
London's Oxford Street voids are being backfilled and Paris's Champs-Élysées footfall is above pre-Covid levels.[3] Paris is also now home to Europe's largest urban infrastructure project, the Grand Paris Express, which is expanding the city's metro system – with the new Saint-Denis Pleyel station due to open for the Olympics in 2024. Workers in Paris and Madrid are back in the office at over 90% of their pre-Covid level.[4]

The health and resilience of Europe's city cores is creating a gravitational pull for occupiers to relocate from peripheral to more central locations, as well as for capital to focus more intensely on central locations, with yield spreads between central and secondary locations at cyclical highs.

2. The second noteworthy European secular trend relates to **investment and innovation in decarbonization**, spurred not just by government regulation but also by the priorities of private organizations and individuals. The UK government's recent delay of electric vehicle requirements and EPC requirements for homes, as well as a dilution of German boiler replacement requirements are new speed bumps, but they do little to change the direction of travel.

1 For more on this crisis and how we are monitoring the market for the next one, see our *ISA Briefing: Banks, rates and the impact on property*.
2 The TTF, or Title Transfer Facility, is a virtual point for natural gas transfer in the Netherlands used to standardize natural gas trading contracts. Operated by Gasunie Transport Services B.V., TTF natural gas contracts are the most traded in Europe – representing volumes about 80 times larger than Dutch natural gas consumption – and useful as a price measure for the overall region.
3 2024 planned openings include Ikea and HMV, following new Pandora, Under Armour, and Steve Madden in 2023. High street footfall data compiled in Cushman & Wakefield's 2023 Le Match des Artères Européennes report.
4 Based on LaSalle analysis of 2023 Savills and JLL occupancy data.

EU-b **Europe mobility returns to pre-Covid levels**



Sources: Transport for London, Eurocontrol, Deutsche Bahn and Heathrow. Most recent data available as of November, 17, 2023.
European flights area seven day rolling average. Heathrow data is monthly, Deutsche Bahn data is biannual, and *Elizabeth line data is seven day rolling average for swipe-ins at London Underground stations in Zone 1 at which the Elizabeth line stops.
Note: No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty. Past performance is not indicative of future results.

Evidence of this is visible in market data from the European Union's Emissions Trading System (ETS), under which the price of carbon is near €85 per metric tonne at the time of writing, remaining not far off its record high seen early in 2023 and three times higher than in 2020.[5] In European office markets as well, tenants' actions are speaking loudly. LaSalle's analysis[6] of announced large tenant relocations in London since 2019 shows that the median relocation was from an office with no BREEAM rating and an EPC of D, to a BREEAM Excellent-rated building with an EPC of B or better.

3. A third trend is that **migration is powering long-term growth** in Europe, representing an upside surprise to many demographers.[7] 2022 was a tragic outlier due to massive displacement from Ukraine, especially to Poland. Even with that unusual year excluded, net migration has averaged over 0.5% of the population every year of the past decade in Germany, Sweden, the Netherlands and the UK.[8]

5 See more on the EU ETS here: https://climate.ec.europa.eu/eu-action/eu-emissions-trading-system-eu-ets_en
6 Based on LaSalle's analysis of various sources including proprietary internal data and occupier market data providers.
7 The UN projected in 1998 that Germany's population would peak around 2005 and decline thereafter. Today, the country's population is above those forecasts and expected to increase through 2030.
8 LaSalle analysis of World Bank, Statistisches Bundesamt (Germany), Statistiska centralbyrån (Sweden), Centraal Bureau voor de Statistiek (Netherlands), and ONS (UK) data.

IN HINDSIGHT

Energy-induced European recession

"A recession in early 2023 is inevitable in Europe." (*ISA Outlook 2023* page 42)

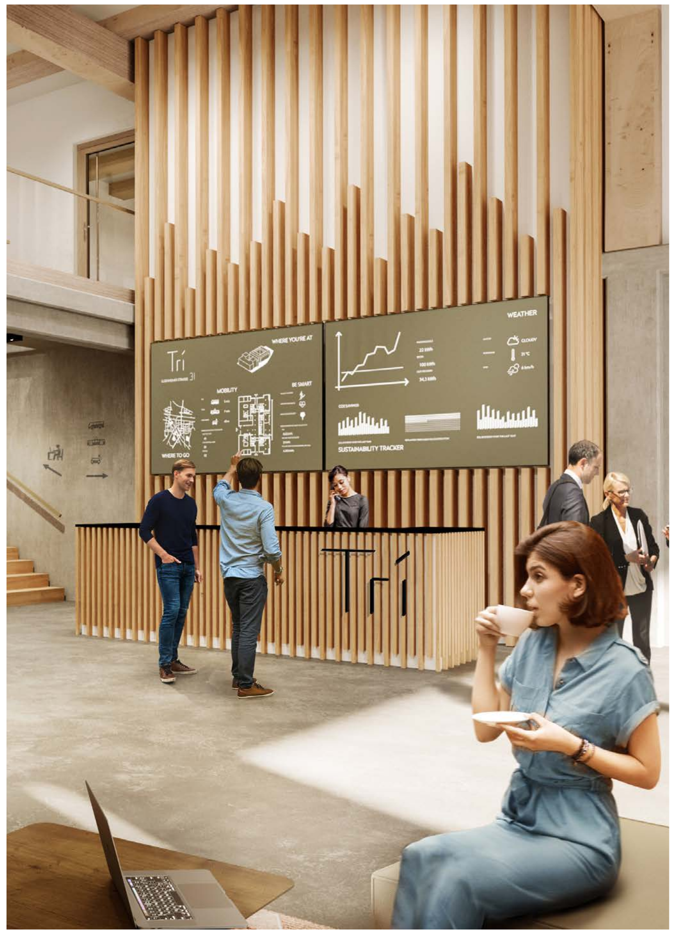
Fortunately, most European markets sidestepped recession during the first half and this prediction proved overly negative. European energy markets adapted to the natural gas price shock better than expected, with Germany rapidly building liquified natural gas import capacity, consumers conserving and renewable power accounting for a record share of generation – over 30% in the EU for the first time in May.[1] Unfortunately, recession risks for the region remain high in late 2023.

1 Based on research of monthly electricity generation data by Ember, available here: https://ember-climate.org/insights/research/eu-fossil-generation-hits-record-low-as-demand-falls/

Tri, Munich

Europe's attractiveness – and relative recent openness – to migration is sometimes under-appreciated, though a strong political reaction favoring tighter restrictions has also emerged and is shaping the region's political landscape. European countries best able to attract and integrate these arrivals, who help counteract slowing demographic growth due to population aging, have an edge. Temporary migration by students is also a European strength and one less directly tied to the economic cycle.

4. A fourth European trend to watch is the **changing complexion of the European Union**. The EU's last new member, Croatia, joined in 2013 and EU enlargement has been at the bottom of the agenda for a decade. But amid the ongoing war in Ukraine, the prospect of EU enlargement from 27 members today to as many as 36 has regained traction. Initial steps discussing potential Ukrainian accession will make headlines in 2024. EU growth, possibly enabled through *de facto* tiers of membership, could support long-term growth by continuing to reduce trade barriers.



5. Lastly, EU property markets stand out for their **high prevalence of inflation-indexed commercial leases**. High single-digit inflation has continued to translate directly into revenue growth over the past year. Indexation helps make EU office, logistics and retail cash flows different from those in many other regions. Indexation uplift can be sustained when market rental growth keeps pace, or only in the short term in cases where market rent growth lags. While sticky inflation could keep interest rates higher for longer, it could also help long-term real estate income growth exceed 2% central bank targets.

Villaverde logistics, Madrid

IN HINDSIGHT

On transaction volume and pricing

"Real estate capital markets will likely stall until bid-ask spreads narrow further." (*ISA Outlook 2023* page 42)

This unfortunately proved accurate. JLL and MSCI Real Capital Analytics data shows European transaction volume in 2023's first three quarters declined approximately 60% relative the same period of the previous year, to the lowest pace since 2010. There continues to be elevated uncertainty on prices due to limited transactions and substantial gaps in buyer and seller expectations. Price discovery is making progress, however, and we expect quarterly volume will begin moving gradually higher in 2024.

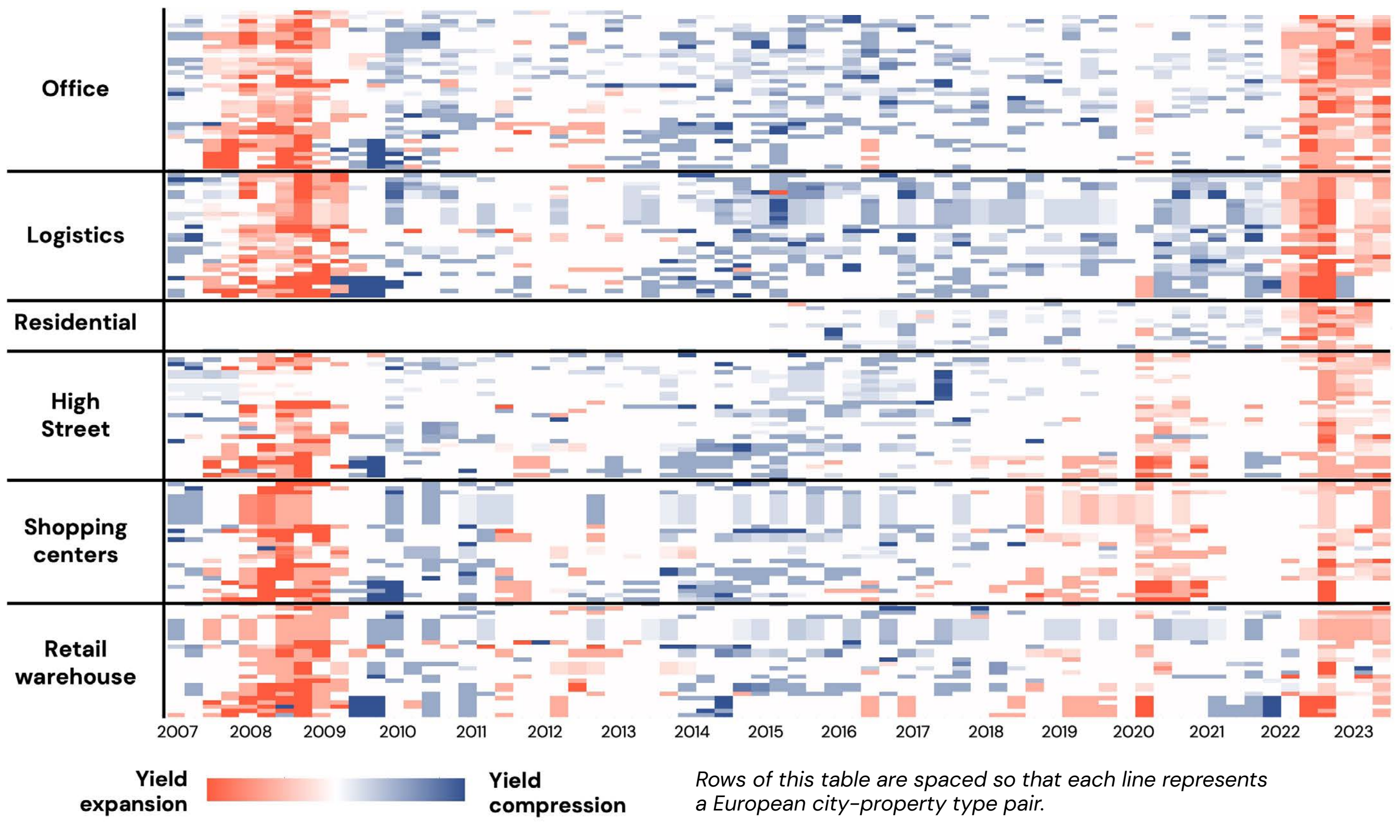
Real estate capital markets

Yields have continued to rise across Europe for all property types. In the UK, indices have reflected this faster, but we believe the underlying change in market pricing is similar between the UK and the EU. Figure EU-c shows the yield trend across property types, with each row representing a European market.

Bid-ask spreads are now narrowing, and transaction volume is poised to increase in 2024, albeit gradually. It is notable that centrally located, modern offices in Paris and Munich remain liquid, with sales attracting respectable bidder pools.

Debt is very much the elephant in the room, not so much for a lack of availability, but due to its cost, with interest rate coverage ratios proving a constraint. We expect refinancing needs – solving the capital stack equation – to keep downward pressure on non-prime, peripheral commodity office prices in 2024. On the other hand, logistics pricing, which has seen yields move out more than other property types, is close to finding its level.

EU-c Net initial yield trend



Source: LaSalle analysis of JLL estimated yields. Data to Q3 2023. Sectors ordered by largest absolute yield shift since 2021.
Note: No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty. Past performance is not indicative of future results.

Occupier market fundamentals

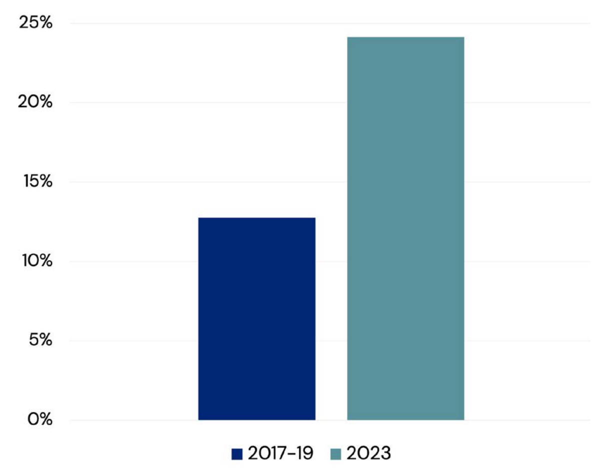
Europe's economic cycle influences tenant demand, but the correlation varies by property type, lease structure, location and building quality. As noted in the global chapter, rent growth is coming off the boil in Europe. We expect slower rent growth in 2024 than in any year since 2020, but this is an average of many different underlying trends between and within property types.

For the European **office** market, the trend of "bifurcation" no longer does justice to the patterns of widening gaps between leading and lagging offices (requiring going "beyond bifurcation" per the global chapter). The tails of the distribution for rents and yields are getting fatter; tenants are judging space along the spectrums of sustainability credentials, location, design and amenities. This has given rise in London to the "super-prime" concept, which describes office buildings commanding rent premiums to "prime" averages. This premium has increased in recent years (see Figure EU-d) as occupiers have focused on a narrower set of buildings that meet more demanding new standards. Across Paris and London, the JLL vacancy rate for new offices is near 3%, three times less than for second-hand offices.

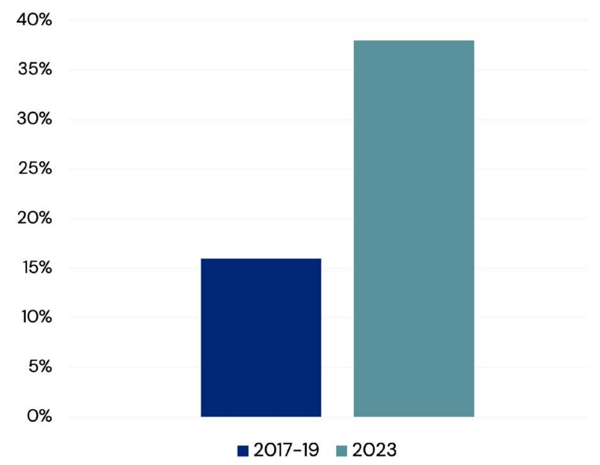
Retail, even more than office, is comprised of idiosyncratic individual assets with a wide dispersion around the property type average. While e-commerce market penetration in the EU has room to run and will be a headwind, ignoring the sector would be a mistake. Some retail assets, such as outlet centers, benefit from turnover-linked leases, which have lifted revenues thanks to solid recent nominal sales growth. After a long and deep decline in values and rents, beginning in 2016 in the UK, higher yields have made the retail sector less sensitive to interest rates. And the tenants still standing are leaner and better positioned, making rent rolls across Europe stronger.

EU-d Super-prime office rent premium widens

Difference between prime and super-prime rents, Central London

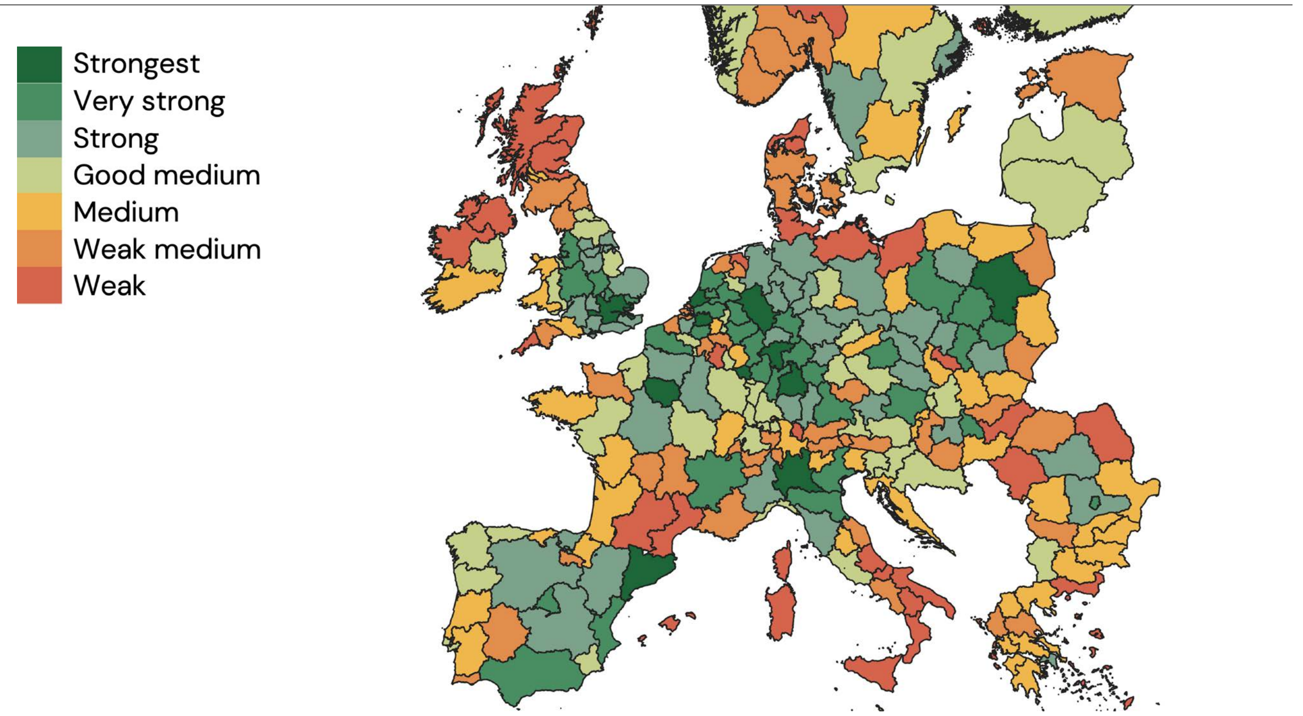


Percentage of lease transactions above the market prime, Central London



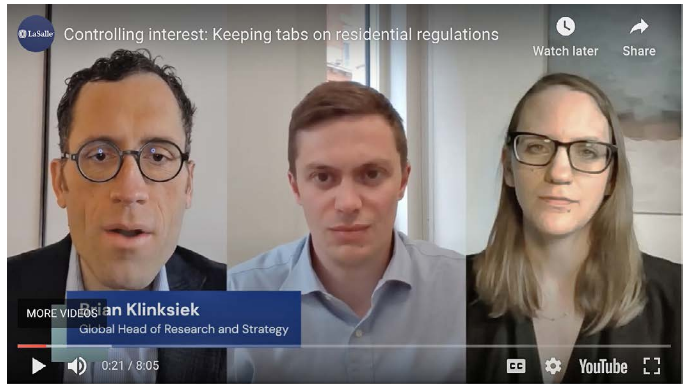
Sources: JLL, as of Q3 2023. Note: No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty. Past performance is not indicative of future results.

EU-e Path of Distribution Score (PoDS)



Source: LaSalle Research and Strategy analysis.
Note: No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty. Past performance is not indicative of future results.

Logistics demand has cooled across Europe and vacancy is ticking up from extremely low levels. But the construction pipeline is shrinking, and the long-term demand outlook remains very bright. Occupiers, when they have multiple options, are seeking buildings with sustainable features, both to control costs and align their businesses with scope three emission targets. Our new European Path of Distribution score shown in Figure EU-e measures where distributors can reach the greatest number of consumers at the lowest transportation and labor cost. It rates Rotterdam and the Ruhr as the distribution centers of gravity for the continent.



(L-R) LaSalle's Brian Klinksiek, Ryan Daily and Jen Wichmann discuss ISA Briefing: Controlling Interest

The strong growth in **residential** rents seen in 2022 continued in 2023, in part driven by outsized immigration. Student demand is also surging. Moreover, rising mortgage rates are making owner-occupation more expensive, resulting in more people needing to rent for longer, and later, in life. Most of Europe's conventional rented residential markets are mediated by a patchwork of local regulation, which we examined in our *ISA Briefing: Controlling Interest*. While regulated residential strategies like German and Dutch residential have capped upside, they are also relatively more resilient in a downturn.

European real estate strategies for 2024

Our top recommendations for the region can be grouped under three themes, each quite specific to Europe.

1. Strategies rooted in barriers to supply. Development constraints in Europe are high and rising. Europe's dense and ancient city centers guard their heritage fiercely, constraining new construction. In London, policymakers are increasingly considering embodied carbon when granting planning approvals.[9] Paris will begin putting their new *plan local d'urbanisme* (PLU) *bioclimatique* into practice in 2024, which we expect will effectively prevent long-term growth in the city's office inventory.

Office demolitions and conversions have averaged a hefty 1.7% of stock per annum over the past decade in London, Paris and Amsterdam.[10] These dynamics are helping to keep office vacancy low and rents growing in central submarkets even as the supply-demand balance becomes less favorable in lower barrier, peripheral locations. Redevelopment projects to create super-prime assets in central submarkets are attractive investment strategies because they – and the skills required to execute them – are scarce.

Supply barriers do not stop with office. Logistics developers report a lack of suitable sites as their biggest challenge, whereas occupiers rate a lack of supply in the top half of their most important concerns,[11] suggesting that long-term rental growth is poised to outpace inflation.

Residential undersupply in Europe is chronic. As shown in Figure EU-f, France, Germany and the UK are set to undershoot their target for housing delivery by 30% in 2023 – a fairly typical miss compared to the 10-year history. Calls for a policy shift toward YIMBY ("yes-in-my-backyard") approaches are likely to grow in 2024, yet recent history suggests that NIMBY interests will remain ascendant.

IN HINDSIGHT

The EU's future

"There will likely be lasting ramifications [from the energy shock and the war in Ukraine] for the project of European integration." (ISA Outlook 2023 page 39)

The war in Ukraine is tragically an ongoing conflict at the time of writing, with far-reaching impacts, particularly for Europe, that are only likely to be truly evident over time. This prediction was prescient in that the EU's appetite for expansion beyond 27 members, somewhat surprisingly, has become more positive. Poland's recent record-turnout election is one of many events influenced by these geopolitics.

Widening spreads between property leaders and laggards

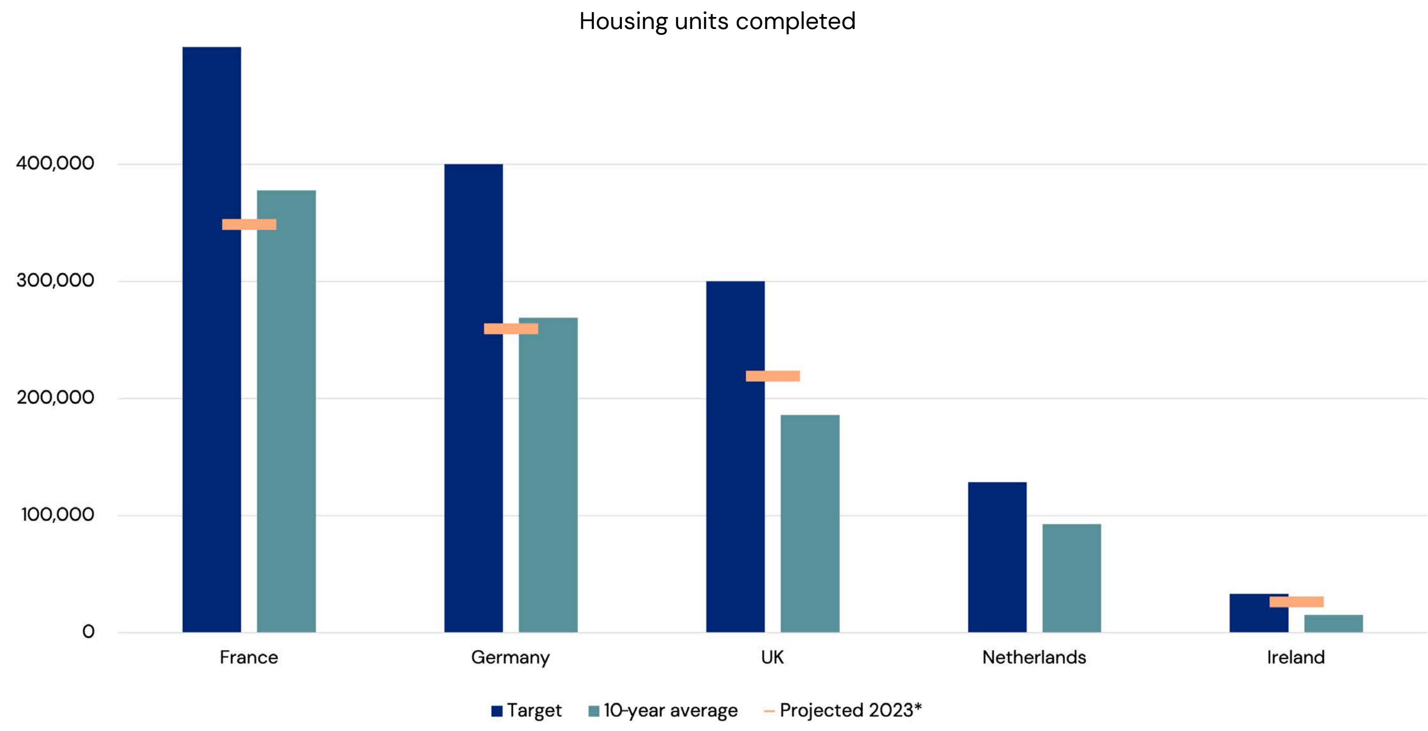
"Prospects for income growth will be strongest for the best-located assets of a given type—for example, offices in vibrant mixed-use zones or logistics assets on crossroads of multiple trans-modal routes." (ISA Outlook 2023 page 45)

Widening spreads in yields between central and peripheral locations in 2023, and greater rent premiums for super-prime assets are evidence that this trend has indeed materialized.

Our outlook is bullish for residential income growth in less regulated markets, such as UK rented multi-family/build-to-rent (BTR), though pricing is relatively sharp. Repriced rented residential in more regulated markets also represents a large opportunity in Europe. Purpose-built student accommodation (PBSA) is a top pick across Europe because student demand tends to be somewhat less cyclical and because it also benefits from constrained housing supply.

9 A notable example was the decision, announced in July 2023, by the UK's Department for Levelling Up, Housing & Communities to reject planning permission for the redevelopment of Marks & Spencer's store on Oxford Street. The stated rationale was concern for the additional embodied carbon involved in demolition and rebuilding relative to reuse of the existing structure.
10 Based on LaSalle analysis of JLL data.
11 Savills survey of 109 European logistics occupiers and 60 developers, conducted over H1 2023.

EU-f National targets for housing completions versus actual deliveries



* Projected based on current permits and historic permit to completion conversion rate.
Source: LaSalle analysis of UK, Ireland, Netherlands, Germany and France national housing statistics. Note: No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty. Past performance is not indicative of future results.

2. Compelling debt strategies. For many European borrowers, the capital stack equation is currently an inequality. Interest rates today are significantly higher than when loans were taken out three to five years ago. In many cases, asset values are lower than original valuations.

Asset owners may therefore choose to inject equity to rebalance debt quanta, with the goal of higher go-forward returns, or seek incremental leverage. In the latter situation, Europe's evolving debt markets can offer sponsors financing from a wider range of sources than before, including a growing range of debt funds, insurers and other alternative lenders, besides the commercial banks that have been the mainstay of European real estate lending for decades.

Originating debt can offer access to a wide variety of sectors and projects with the opportunity to set lender-favorable terms. Unlike equity valuations, floating-rate debt solves for repricing in real-time, and refinancings offer exposure to key target sectors and geographies even when acquisitions markets are quiet.

3. Operational real estate strategies. All real estate has some operational characteristics, but truly operational strategies are distinguished by revenues that mark to market frequently (shorter lease terms) and require more specialist expertise to run. These strategies are especially attractive relative to long leases when underlying demand growth is strong, and when there is potential to enhance efficiency, build platforms and aggregate smaller-asset portfolios (consistent with our global observation of a changing definition of quality and core). We expect niche and residential markets to continue maturing in Europe over time and to provide a likely tailwind for exiting these investments. Specifically, our outlook for demand is strongest for European limited-service hotels, PBSA, self-storage and UK private medical facilities.

LOOKING AHEAD

- Foreshadowed by weak purchasing managers' indices (PMIs), fiscal limits and mortgage payment resets, Europe is likely to tip into recession, with average annual growth in 2024 forecast to be near zero. We expect most European real estate segments to see slower – but still positive – rent growth in this environment.

- Sticky inflation in 2024 will likely continue to lift revenues for many European properties with lease indexation. Inflation should cool but is still likely run above central banks' 2% targets.

- Debt strategies and equity investments in operational real estate are especially attractive today in Europe. Across property types, logistics in the Netherlands, France and Germany are our top 2024 investment picks. Student accommodation, private medical, self-storage, rented multi-family/BTR and strategies to create super-prime offices also rank highly.

- European commodity office capital stacks face stress in 2024, which will keep upward pressure on their yields. However, 2024 is also likely to see other sectors begin to turn the corner, with a few sectors likely to see slight yield compression later in 2024.

- Retail investments are likely to improve on relative value metrics over the next year, especially in cases where capital expenditures are well understood.

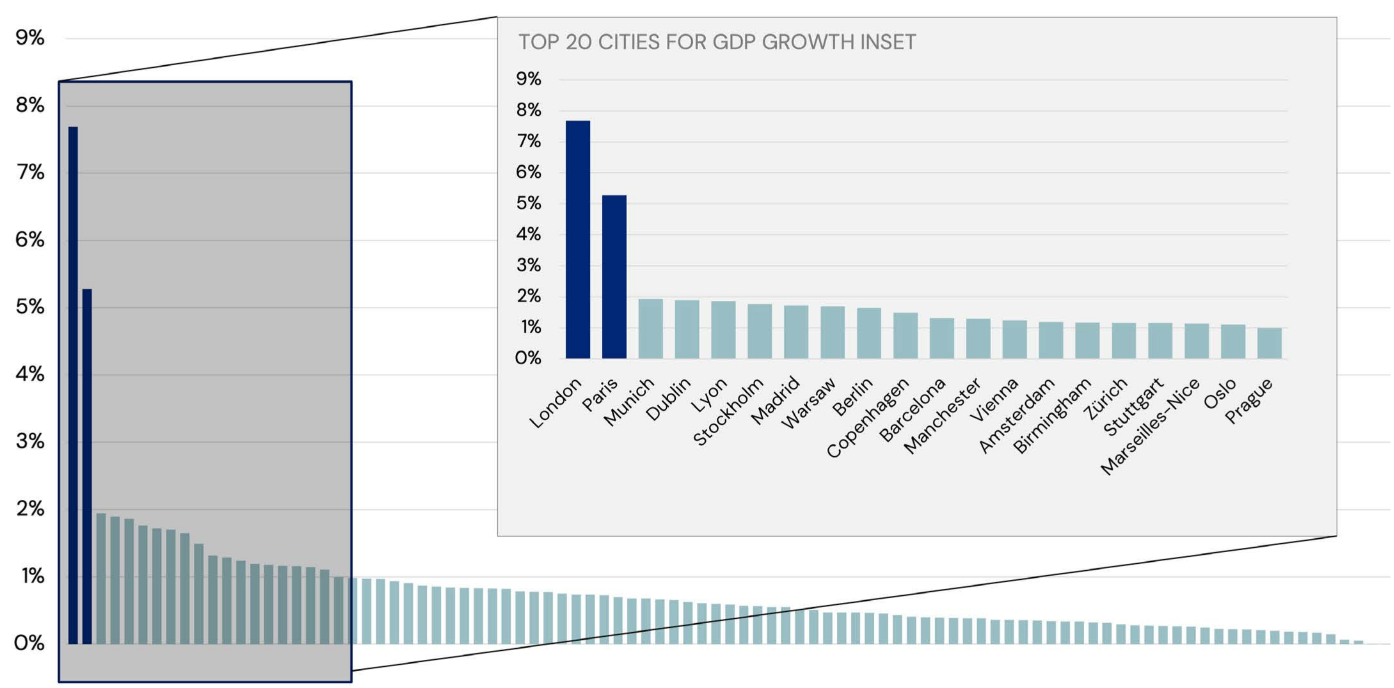
- After a year when Europe experienced its hottest summer on record and Greece suffered the continent's largest-ever wildfire, extreme heat and climate risk are likely to remain on investors' radar.[12]

- Across Europe's cities, there remain two giants when it comes to growth; together London and Paris have expected output growth over the next 10 years equal to the next nine cities combined (see Figure EU-g).[13] Significant allocations to the best locations in these two markets remain essential for European property portfolios.

12 For this reason, we added expected future change in extreme heat days to our European Cities Growth Index (ECGI) scoring in 2023.
13 According to analysis of various data sources by LaSalle as part of the LaSalle ECGI.

EU-g London and Paris have unparalleled absolute growth outlook

Percentage of all expected economic growth in Europe over next 10 years



Note: LaSalle has aggregated NUTS 2 and UK ITL regions to best match functional metropolitan market regions, encompassing both the central city and its connected suburbs throughout the ECGI analysis. The analysis above is based on all 95 cities included in ECGI. Detailed sources and methodology are available here: https://www.lasalle.com/research-and-insights/lasalle-european-cities-growth-index-2023/. No assurances are given that these forecasts will materialize as forecasted. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

Brent Cross Town, London

North America
Outlook

Watch the conversation
with Richard Kleinman and Chris Langstaff
at lasalle.com/Outlook2024

NORTH AMERICA

Published December 5, 2023

Healing gradually

EXECUTIVE SUMMARY

In the North America chapter of *ISA Outlook 2024*, we discuss how our key global themes apply in the context of the United States and Canada. Property markets in both countries spent much if not most of 2023 wondering when the US and Canada would hit their peak rates. At the time of writing, the answer to that question remains uncertain.

We begin by discussing how this search for peak interest rates has had on the North American real estate markets, namely how the battle against inflation has meant cooling conditions for some sectors. However, there is enough variation within sectors that opportunities are emerging with high-quality assets. Variation also exists between the two countries, for example in the residential sector, where population growth in Canada has translated into persistent undersupply. The chapter concludes with investment strategies for the coming year based on three broad themes where we see growing potential.

Approaching the close of 2023, the US and Canadian real estate markets are still adapting to significant macroeconomic changes, with the prospect of further adjustment and potential stresses in 2024. Based on our observations and analysis, we do not expect a rapid recovery. In our view, it will not be until the second half of 2024 at the earliest that we see signs of an inflection point.

The *ISA Outlook* global chapter frames the macroeconomic backdrop, with the headlines of "Searching for peak rates," "No map to a hard or soft landing," and "Cooler conditions" all relevant to our view of conditions in North American markets.

Suburban housing development, San Antonio, Texas

The search for peak rates is negatively impacting liquidity

The negative impacts of higher interest rates on real estate values dominated other macroeconomic dynamics in the second half of 2023. The trend of higher long-term interest rates (shown in Figure NA-a) continues to put downward pressure on real estate values across all property types in the US and Canada.

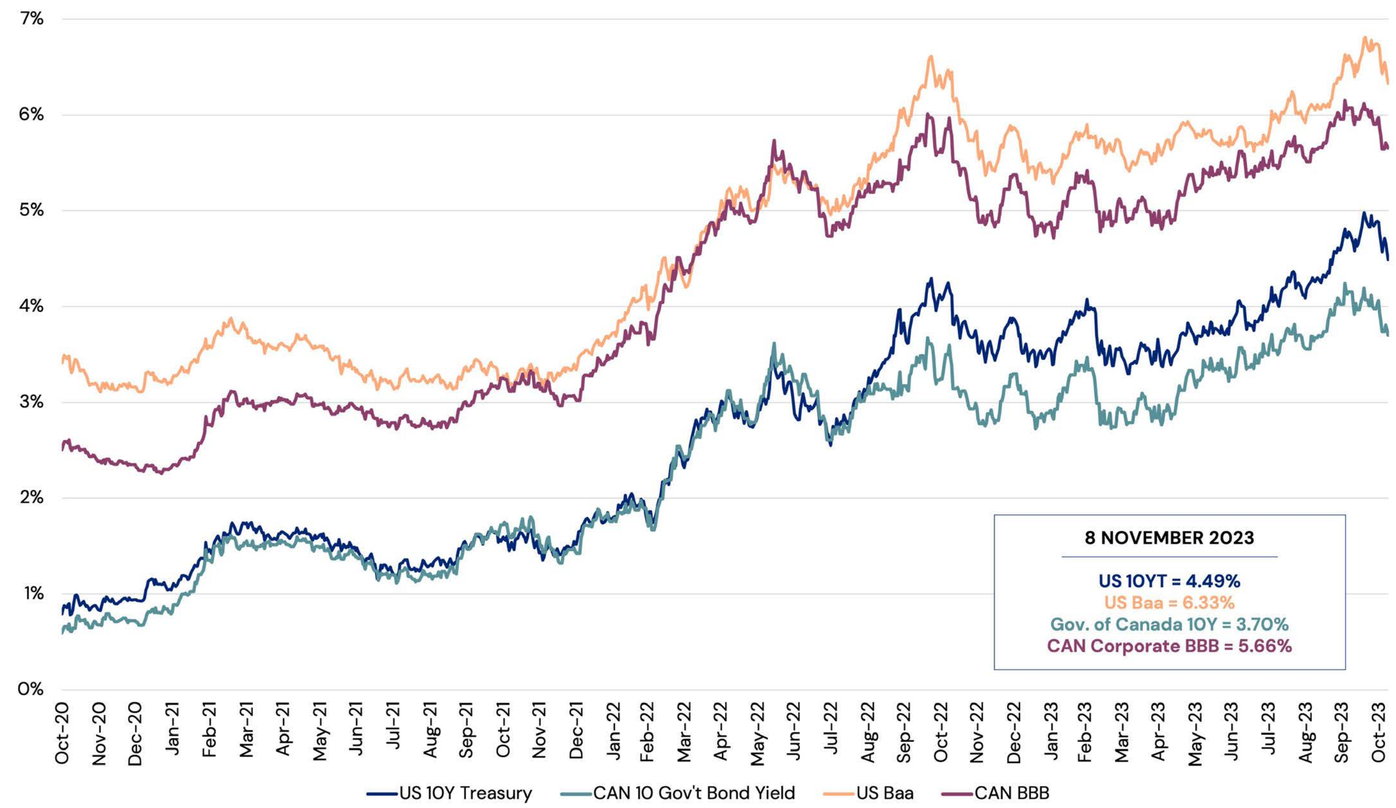
In some market segments, income growth is providing a degree of insulation, but even in the strongest sectors, that only partially offsets the downward pressure on values. And the "higher for longer" narrative taking hold during Q3 2023 in the US is leading to a somewhat larger impact of higher rates in the US than in Canada.[1]

As always, the direction of interest rates is uncertain and extremely difficult to predict, so we choose not to base investment strategies on views of future interest rates. The more pertinent question is to what extent real estate pricing has digested the impact of higher rates. We observe in our market activity that this varies across markets based on levels of liquidity. The most transacted sector is US apartments, followed by US industrial.[2] These sectors provide more data points that help guide other buyers and sellers on market pricing in a dynamic environment. In contrast, office transaction volume is so thin that both buyers and sellers (along with lenders) have little market information to support valuation calls. In this case, limited trading breeds a more challenging transaction environment.

1 "Higher for longer" is more prominent in the US because, as discussed later, economic growth in the US has been more resilient through 2023.
2 Source: RCA – see chart NA-d for detail.

NA-a Long-term interest rates trend higher in 2023

Treasury and bond yields



Source: Bank of Canada, Bloomberg, Economy.com. Data through November 8, 2023.
Note: Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue.

No map to a soft or hard landing

While interest rates have been the dominant macroeconomic driver in the past two years, economic growth challenges could be more of a headline story in 2024 (see Figure NA-b). Currently US growth is still strong, but concerns about a potential recession remain front and center.[3]

In Canada, signs of a recession were clear at the beginning of 2023; the country indeed entered what has so far been a mild, shallow recession in Q2 2023.[4] While both the US and Canadian central banks paused interest rate increases at their most recent meetings, both indicated that inflationary risks remain elevated, and there could be further increases. However, with Oxford Economics forecasting slower economic growth in the US and muted growth in Canada into 2024, we expect central banks to shift their focus to stimulating growth. But that dynamic will take several quarters to play out, and in the interim, there could be negative impacts on real estate fundamentals from slowing growth.

IN HINDSIGHT

Rate-induced US recession

"Although a recession in the US and Canada in 2023 is our base case, the North American economy remains surprisingly strong. The lagged impact from tighter financial conditions appears to finally be feeding through, with preliminary signs that inflation is cooling. But many uncertainties remain." (ISA Outlook 2023 page 46)

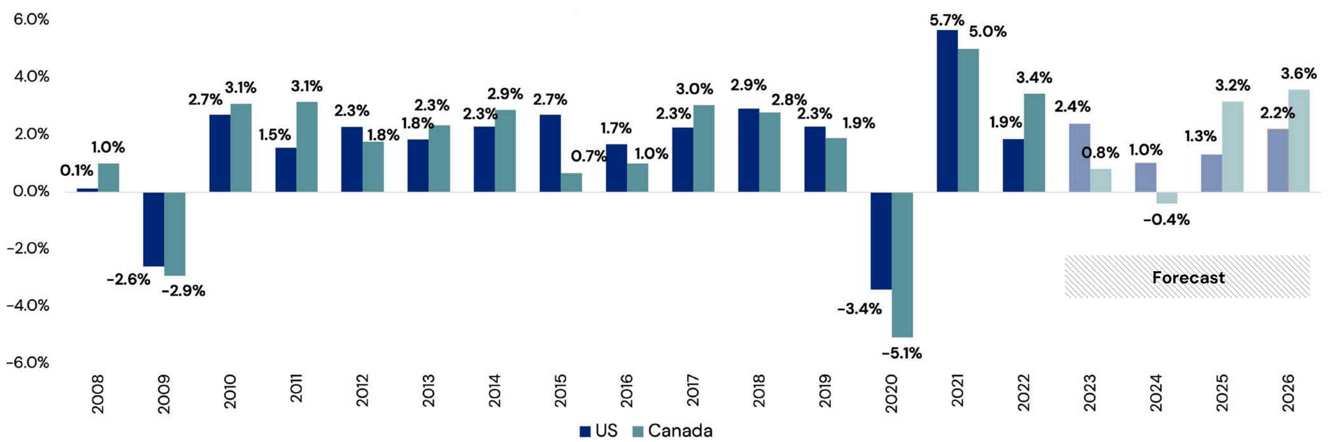
The US seems to have avoided a recession in 2023 as the strong fundamentals at the start of the year carried through. Inflation has continued to cool through 2023.

That said, we believe an economic slowdown will not severely impact real estate demand. It is broadly our view that secular forces will remain more important than cyclical dynamics for real estate demand, both positively and negatively; this is explored on a sector-by-sector basis below. There are also longer-term dynamics that we expect will enable the North American economies to get back on track quickly and mitigate the long-term impact a near-term recession could have on real estate demand.

3 Source: Oxford Economics
4 Canadian real GDP fell at a 0.2% annual rate in Q2 2023, following a 2.6% gain in Q1, according to Statistics Canada.

NA-b Weak growth in 2024 followed by recovery

Real annual GDP, US and Canada – 2008-2026



Source: US Bureau of Economic Analysis, Statistics Canada, Oxford Economics. LaSalle. Data and forecast most recent as of November 2023.
Note: Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue or that any forecasts shown herein will materialize as expected.

Cooler conditions

The link between growth and interest rates is inflation. As illustrated in Figure NA-c inflation is down in 2023, but not to the extent the Federal Reserve and Bank of Canada are aiming for, and more inflation heat could return from increases in oil prices.

Our view is inflation will remain contained, which is consistent with the pricing of inflation-protected bonds. The shelter component of inflation has been a major recent contributor to inflation and is worth watching; while historically strong population growth is exceeding new supply and boosting apartment rents in Canada, we expect US housing cost inflation to slow meaningfully.

IN HINDSIGHT

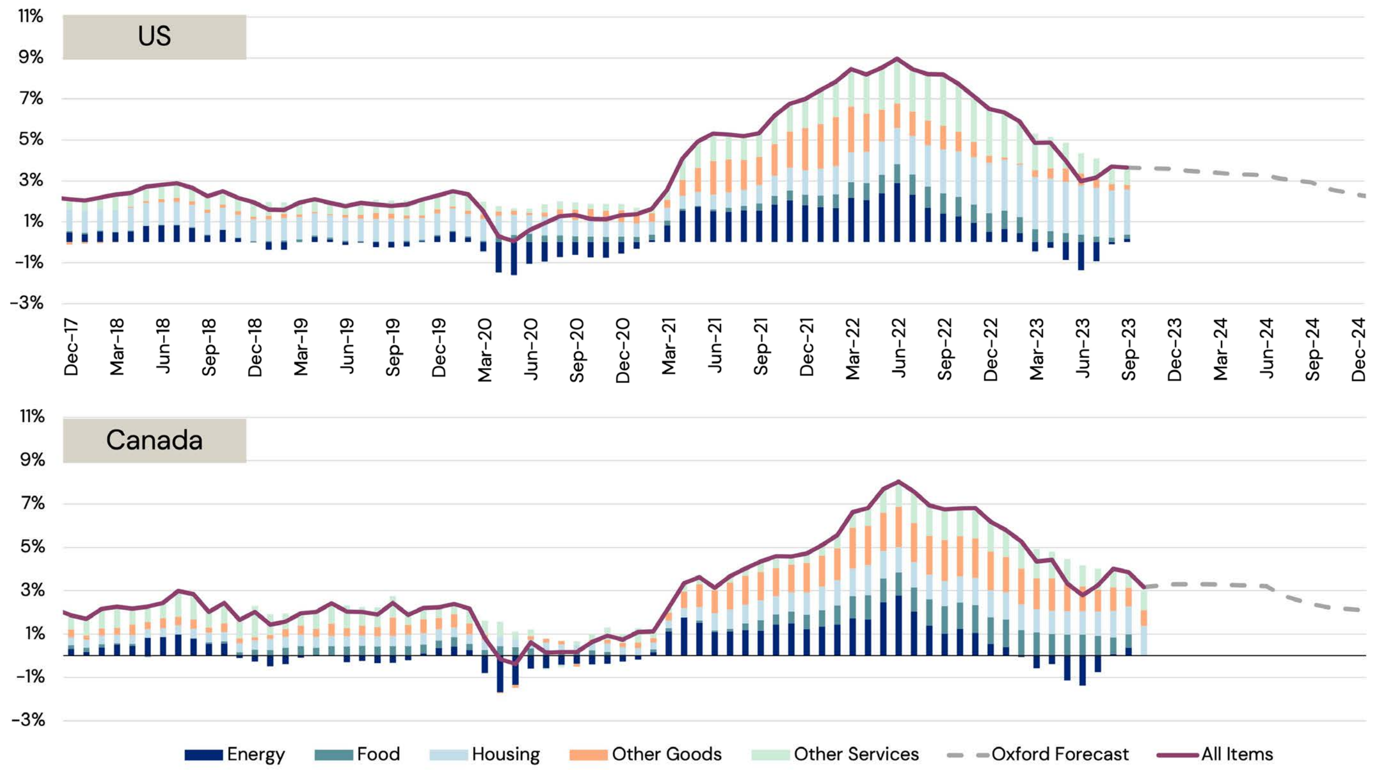
Real estate pricing correction

"Real estate pricing in North America will adjust to higher interest rates at varying speeds across sectors depending on the level of liquidity, strength of the ties to the fixed income/equities markets and the motivation of sellers. For core real estate investors, a long-term view on interest rates is as important as the near-term trajectory of central bank policy rates."
(ISA Outlook 2023 page 55)

This is playing out as expected, but unfortunately the process is still underway. Consistent with expectations, it was the increase in long-term rates in the second half of 2023 rather than the expected increases in short-term rates at the start of the year that had a greater impact on the real estate capital markets.

NA-c Downward inflation trend expected to continue

Contributors to Consumer Price Index (CPI) inflation
Percentage point contribution by major category



Source: Bank of Canada, Bloomberg, Economy.com. Data through November 8, 2023.
Note: Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue.

Real estate capital markets

North American real estate capital markets were directly impacted by increasing interest rates, with debt costs up, transaction volumes below typical levels (as shown in Figure NA-d) and prices down.[5] This creates a mix of challenges and opportunities driven by an investor's situation.

We expect 2024 to look a lot like 2023 at the start, but as the year progresses, there could be shifts that drive increasing transaction volume. If interest rates come down or even just stabilize, in our view that should enable a gradual increase in transaction volumes.

Thus far in this downturn, there has been limited motivation to sell. That could change due to several factors including the need to deliver liquidity in open-end funds or to generate cash for refinancing in closed-end funds. Traditional office is the most stressed market segment, and a stand-off between borrowers and lenders limits distressed transaction volume. However, we think this is likely to come to an end at some point because offices require a large amount of ongoing capital investment. It will be in lenders' interest to adopt structures that preserve value by finding sources for that capex; we think this will lead to more distressed office asset sales.

In 2024, the pressure to transact could also hit US multi-family properties that were acquired in late 2021 and early 2022 at peak pricing and financed with high levels of floating rate debt. These properties could be in a position where they need capital to refinance or extend loans. In contrast to office, these apartment lenders might be more ready to push for a quick resolution as property values are likely to remain above the debt balance. The logical outcome is either outright sales or recapitalization opportunities.

Higher interest rates are also driving capital flows to real estate lending. The analysis shown in Figure NA-e indicates the current premium for core equity investment relative to real estate lending is less than in normal market conditions. Our view is that now is an attractive time to create a real estate debt allocation in the context of a diversified real estate portfolio. The current opportunity might prove fleeting, but the ability to act quickly to get capital placed in the lending market is appealing. However, a major caveat is that downside operating risks need to be carefully underwritten. Office debt is both expensive and hard to find given that the risks associated with office extend even into more senior portions of the capital stack.

IN HINDSIGHT

Denominator effects dominate

"Denominator effects and higher borrowing costs will keep a meaningful fraction of core and higher return buyers on the sidelines, especially at the start of 2023. For well-capitalized buyers, this creates opportunities to deploy capital in a less competitive market and will allow investors to add strategic targets to diversified portfolios." (ISA Outlook 2023 page 55)

This has been true, but has extended past the first part of 2023.

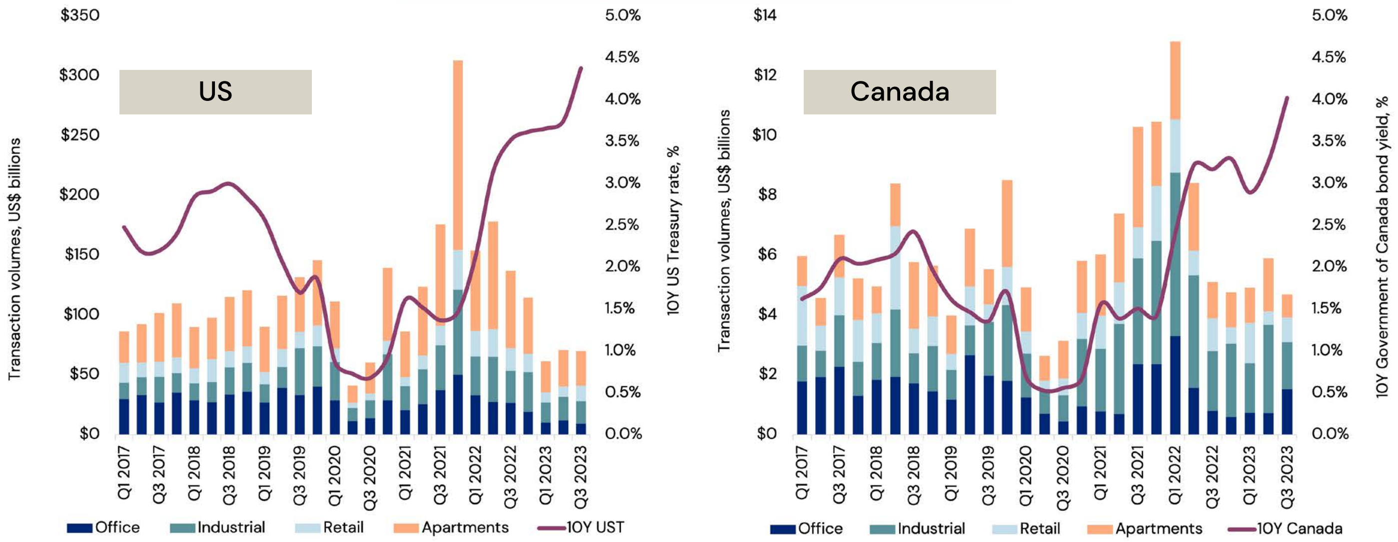
5 Source: Green Street Advisors

NA-d Transaction volumes stabilize at lower levels

Transaction volumes

Trailing year transaction volume as percent of 10-year average

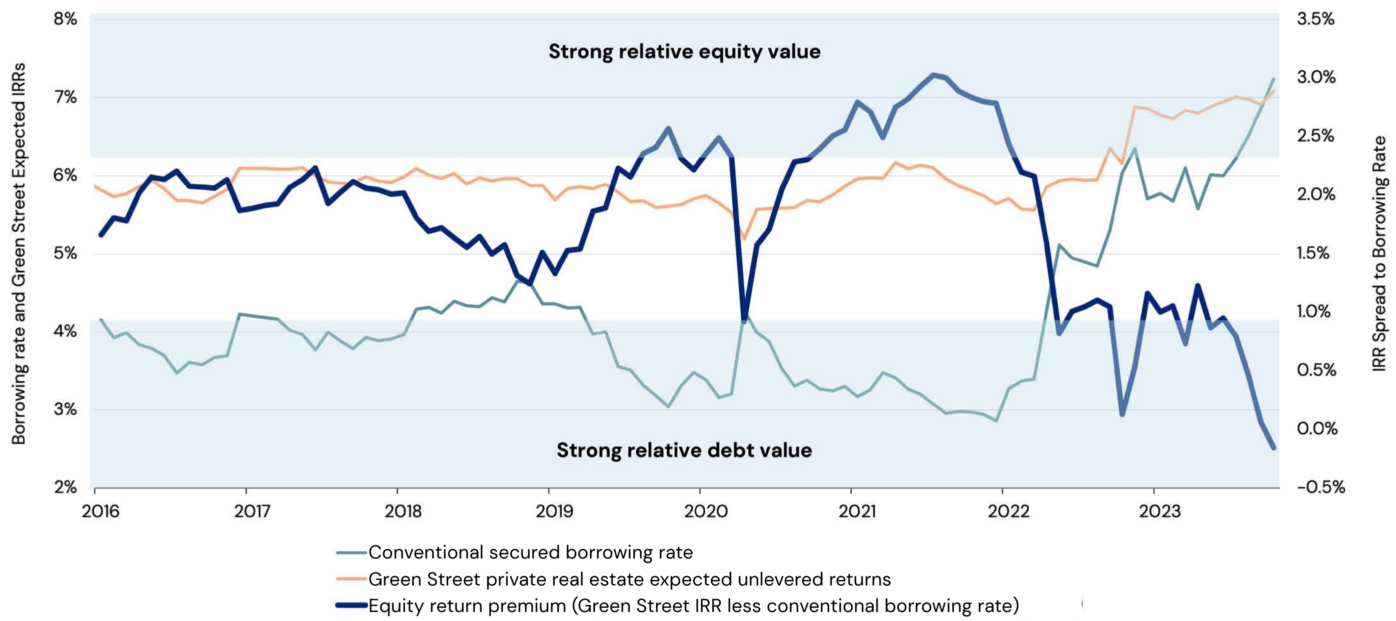
	US	Canada
Retail	73%	55%
Office	41%	58%
Industrial	106%	134%
Apartment	76%	84%
Total	72%	84%



Source: RCA. Note: Closed transactions; excludes privatizations, hotels, senior housing, and development sites. Excludes transactions with a gross value of less than US $5 million. Data through September 2023. Most recent as of November 6, 2023.
Note: Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue.

NA-e Real estate lending screens as solid value

Real estate debt and equity pricing comparison



Source: LaSalle Investment Management.; Green Street Data as of November 16, 2023;
Note: Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue or that any forecasts shown herein will materialize as expected.

Occupier market fundamentals

Residential

In 2023, the US apartment market definitely came off the boil after strong demand pulled back unexpectedly in 2022, despite a healthy economy. Many Sunbelt metros that performed the best previously have seen the sharpest reversal of momentum.[6] In 2024, we expect steady demand, helped by affordability challenges in the for-sale housing market. Still, we expect to see elevated deliveries of projects started when market conditions are stronger. Thus, parts of the US residential market are expected to see fundamentals weaken further, leading to rent declines. Other segments (i.e., sub-types, markets or submarkets) are not seeing as much competitive new supply and thus are well-positioned. In the longer term, we expect US residential demand to recover. And with higher costs, higher interest rates and lower stabilized property values, the economics of development have become much less attractive, leading to more limited starts (as shown in Figure NA-f). This limited new supply from 2025 onward is expected to drive a strong rent recovery.

IN HINDSIGHT

A slowdown in rent growth

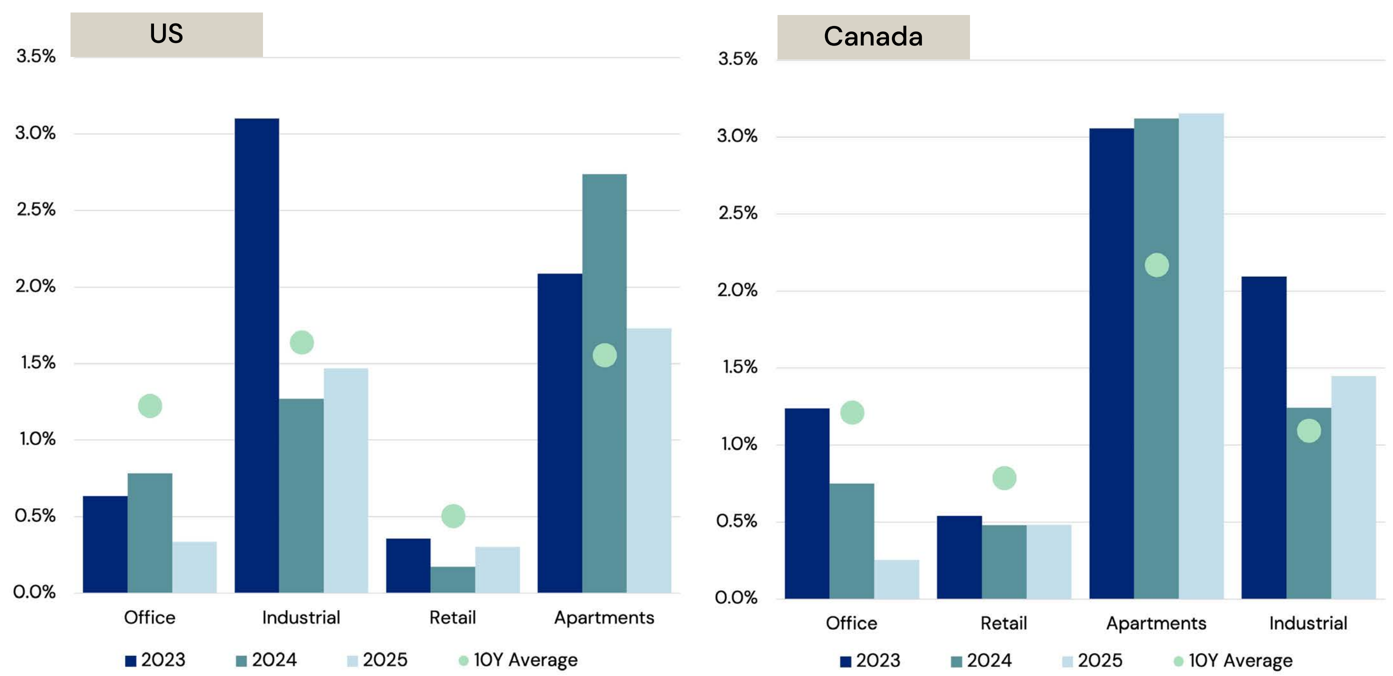
"Weaker demand and still-elevated new supply will shift vacancy rates up in 2023 and lead to a slowdown, but not stagnation, in rent growth. And metros with more new supply will see a greater slowdown and even some rent declines. In 2024, we expect a swift recovery as lower levels of new supply and recovering demand enable declines in vacancy." (ISA Outlook 2023 page 52)

2023 has largely played out as expected, but with a potential recession still to come and the wave of new supply still looming, we no longer expect that swift recovery to come in 2024.

6 Source: RealPage

NA-f Supply to slow due to capital market shifts

New supply as percent of existing stock



Sources: CBRE Canada, CBRE-EA, CMHC, LaSalle. Data to Q1 2023 for office and industrial, year-end 2022 for retail and apartments. US data to Q3 2023
Note: Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue or that any forecasts shown herein will materialize as expected.

With supply a key factor in the near-term outlook, we expect to see more variation in market, submarket and asset-specific performance variation than in recent years. Some US apartment markets and submarkets, along with scattered-site single-family homes for rent, are positioned to outperform as they have less new competitive supply coming. While the long-term outlook is solid, we could see some short-term stresses that depress pricing, as weak fundamentals pair with maturity-driven capital needs (as noted above). This may create an opportunity for those with capital to deploy, but a challenge for those who need to sell.

The Canadian apartment market is markedly different from the US. Canada's persistent supply-demand imbalance is expected to continue. This is fueled by record immigration-driven population growth over the past two years, which is expected to continue in 2024.[7] While purpose-built apartment supply has been rising sharply, it is not keeping pace with population growth. As a result, Canadian apartment vacancy hit a 21-year low in 2023 and is expected to fall further as new projects are delayed due to higher interest rates and high construction costs.

Industrial

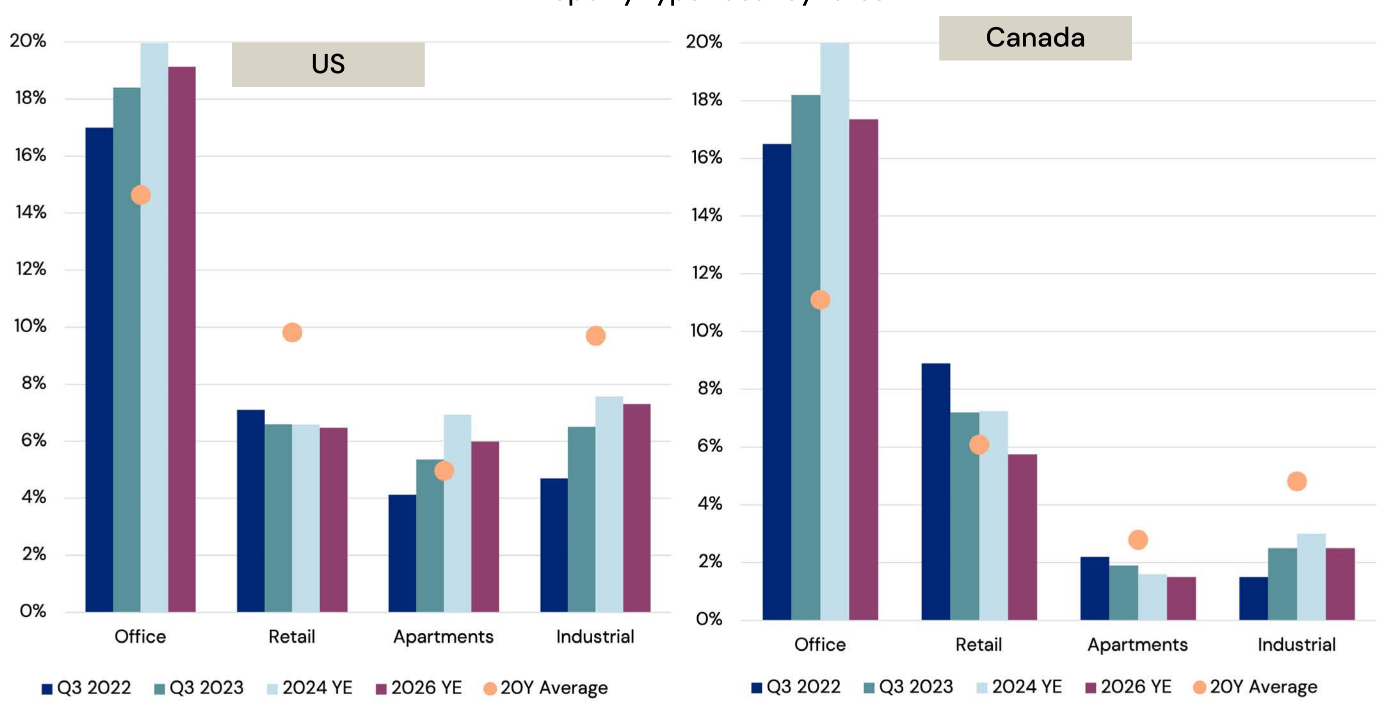
The super-heated North American industrial markets are also "coming off the boil" from peak performance levels. The strongest performing metro areas from the last several years provide the clearest evidence that "trees do not grow to the sky." But while some residential markets could be going from the burner to the freezer, industrial markets are generally moving from a rolling boil to a soft simmer.

North American industrial markets generally remain tight, with availability rates well below long-term averages (see Figure NA-g). However, slowing economies, elevated new supply and excess leasing in 2021-22 will cause fundamentals to soften in many markets. This impact is already seen with rent growth slowing and even turning negative on a quarter-over-quarter basis in some markets.[8] In 2024, we expect rent declines in some of the industrial markets that experienced the greatest gains during the post-pandemic period. This will come as tenants regain leverage and landlords are willing to sign leases below peak levels, but still above even their wildest expectations from a few years ago. Looking ahead to 2025, we expect a

7 Source: Statistics Canada and Immigration, Refugees and Citizenship Canada.
8 Source: Based on our observations of market activity

NA-g Property type vacancy shows great variation

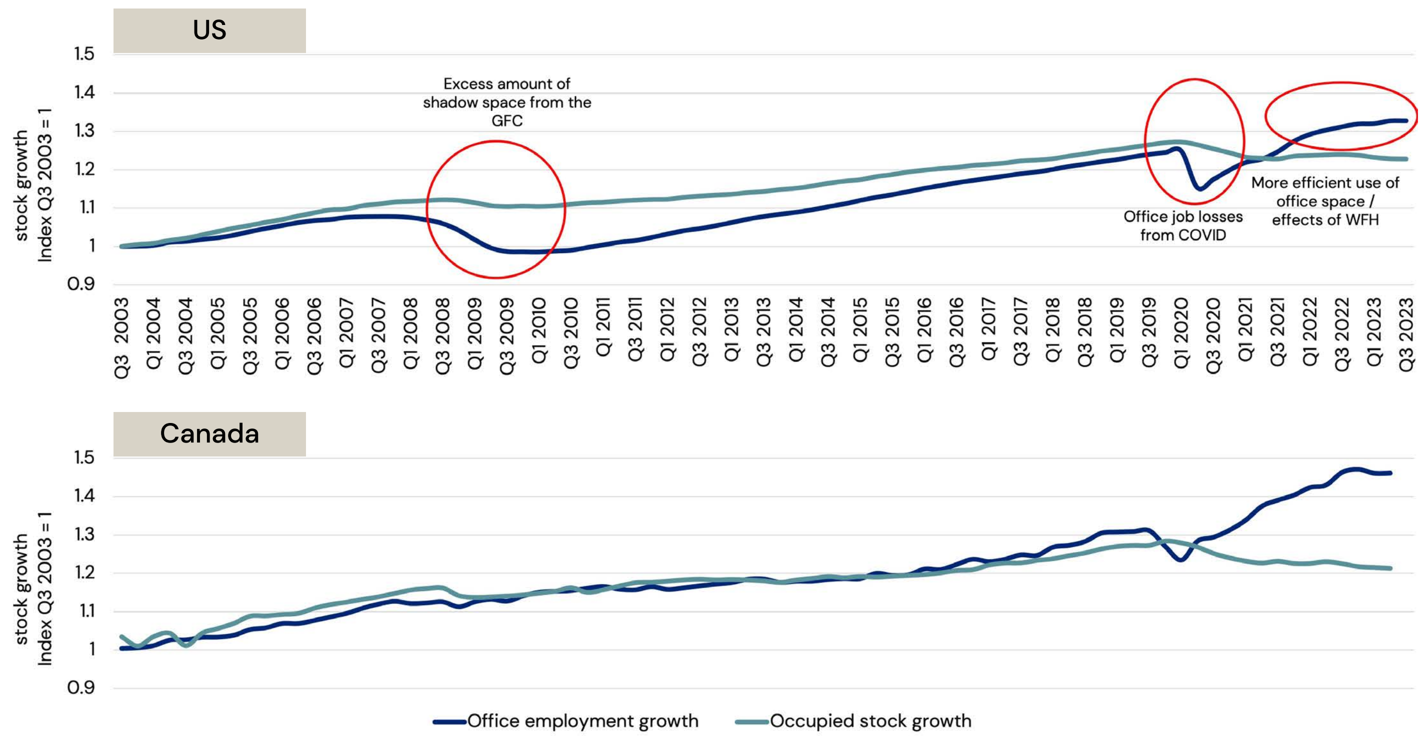
Property type vacancy rates



Source: Realpage (US Apartments), CBRE EA (US and Canada Industrial and Office), CoStar (US Open-Air Retail), MSCI (Canada Retail) and CMHC (Canada Apartments). Data to Q3 2023, forecast as of Q2 and Q3 2023 - latest available as of November 2023.
Note: Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue or that any forecasts shown herein will materialize as expected.

NA-h Property type vacancy shows great variation

Change in office employment and occupied stock through cycles, 2003-2023



Office occupancy is implied based on leased space (inventory - vacancy rate). Canada office-using employment is the sum of NAICS sectors: Finance, insurance, real estate and leasing, Professional, scientific, and technical services; Business, building & other support services; Information, culture, and recreation; Public administration. US office-using employment is the sum of NAICS sectors: Information, Finance and insurance, Real estate and rental and leasing, Professional and technical services, Management of companies and enterprises, and Administrative and waste services. Source CBRE-EA, Moody's, CBRE Canada, Statistics Canada (Labour Force Survey), LaSalle. Data from October 2023. Note: Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue.

shift again as limited new supply meets recovering demand. This should allow industrial markets to tighten quickly and power to shift back to landlords.

Office

North American office market conditions range from awful to apocalyptic for investors. Across the US and Canada, the sustained acceptance of working from home continues to weigh on occupier demand as illustrated by the decline in occupied space shown in Figure NA-h. Tenants still communicate a desire to bring employees back to the office, but progress toward that goal remains incomplete. Office buildings that can help employers achieve this goal of bringing employees back to the office (owing to their location, amenities or quality of the space) are positioned to see stronger demand, consistent with the global theme of "bifurcation" by quality. But we believe the structural weakness of the office market will weigh on all assets to some degree. As rents in the best buildings are stable or growing while others are falling, the potential profit from closing that gap will lead to investments that will increase the stock of buildings competing for the best tenants. The flip side is that some tenants will be tempted into lower-quality space just by the significant cost savings that can be achieved.

IN HINDSIGHT

North American office market conditions range...

"Office investments in the US will face significant challenges in 2023 as lenders and core buyers view the sector as particularly risky. Highly leveraged buyers with loans coming due – and in many cases their lenders – will face hard choices on how to proceed. In the US, transaction activity could become dominated by distressed sales later in 2023. In Canada, distressed sales will be less likely given the higher concentration of institutional ownership in the office market, much of which is unlevered." (ISA Outlook 2023 page 55)

Nothing good has helped the US office market in 2023, but distressed sales have been surprisingly limited. The hard choices for leveraged owners and lenders are still to be made, so this prediction is pushed out to 2024 at the earliest.

Beyond demand, another challenge for the office market is heightened investor recognition of the amount of capital required to sustain revenue in a market where tenants have numerous options. This is especially acute in the US, where some leases are barely generating positive cash flow on a net economic basis. Canada is somewhat better positioned, as tenant expectations and the structure of leases that pass a portion of capital expenditures to tenants provide owners a cash flow boost.

While the office outlook today is grim, we believe office demand will recover at some point. And we could see offices trade at sufficiently deep discounts to create attractive opportunities. We expect some investors could earn exceptionally high returns from office acquisitions in the coming year, but that will depend on a combination of good asset strategy and luck with tenants. For those with an appetite for risk, that possibility might be hard to ignore, but on average we still do not see current pricing yet at a point that generates an appropriate risk-adjusted return.

Retail

While the retail sector overall still faces challenges and there is risk from a potential economic slowdown, North American shopping centers align with the "beyond bifurcation" global theme. On the positive side, competitive new supply is not an issue. On the demand side, we observe that investors have more confidence in which sub-types and specific properties are positioned to succeed. This creates an opportunity for investors to identify properties benefiting from durable long-term retailer demand, and they can achieve return premiums when this more positive outlook is not yet reflected in pricing. Sub-sector themes can be identified in some cases, such as the positive reception of US grocery-anchored retail properties from investors. Still, this is often about picking the best-positioned assets, even when there are challenges for the sector overall. But unlike office, we think there is a greater ability to see which assets will be winners based on the challenges experienced over the past decade.

Specialty sectors

The US offers investors the broadest and deepest menu of alternative sector options of any market around the world.[9] As more of these specialty sectors mature and get on the radar screen of core investors, it is increasingly important to focus on the risk-return profile of each sector individually. As we do that work, we continue to see strength in segments we have recommended for years, including medical office and self-storage. Life sciences is facing a wave of new supply[10] and a period of weaker-than-average demand that will weigh on the sector. Opportunities are emerging from sub-sectors of the major property types, such as single-family homes for rent and industrial outdoor storage (IOS). In the Canadian market, strong recent and forecast population growth supports self-storage, student housing and data centers as particularly attractive sectors. Among the range of options, it is easier to say what we like than what we don't like, but we note that sometimes we are silent on sectors where we do not have high enough conviction in our views rather than a negative conviction.

Brampton Industrial, Ontario, Canada

9 See LaSalle's ISA Portfolio View
10 Source: JLL

Themes and strategies

We identify three broad strategic themes in common among our recommended strategies:

1. Finding supply gaps

With the strongest property types facing near-term stress from new supply, investors who can identify properties insulated from that in the next year should do well. Looking beyond that, it is about finding opportunities for quick recoveries that are not yet priced into the market.

2. Solving capital stacks

Higher interest rates and, in some cases, challenged operations will create stress that can sometimes create opportunities to solve creatively. These opportunities could be working with office lenders, over-leveraged apartment owners or helping core funds meet elevated redemptions. Those who can understand sellers' needs might find superior returns or access to transactions that are generally unavailable through a traditional sale process.

3. Emerging property types

The need for core portfolios to find assets to replace the historic heavy weight to office assets will become more real when capital starts to flow back to real estate. When this occurs, we believe the choice of options will be more diverse than ever, and a new wave of what we have labeled "going mainstream" will occur. This should create a new pool of buyers with a lower cost of capital than those that have played in the past in some of these emerging sectors.

LOOKING AHEAD

- **A meaningful recovery in transaction volume is not likely to occur in the first half of 2024. But activity may pick up in the second half as pressure to transact mounts, and there is potential for the interest rate environment to become more favorable. That said, interest rates are notoriously difficult to forecast, so investors should not rely upon a decline in rates.**

- **Interest rates will continue to be more important to real estate performance than economic growth. If the economy slows and interest rates fall, it will be a net positive for existing real estate portfolios while "higher for longer" will be a net negative for the performance of those portfolios if sustained through 2024.**

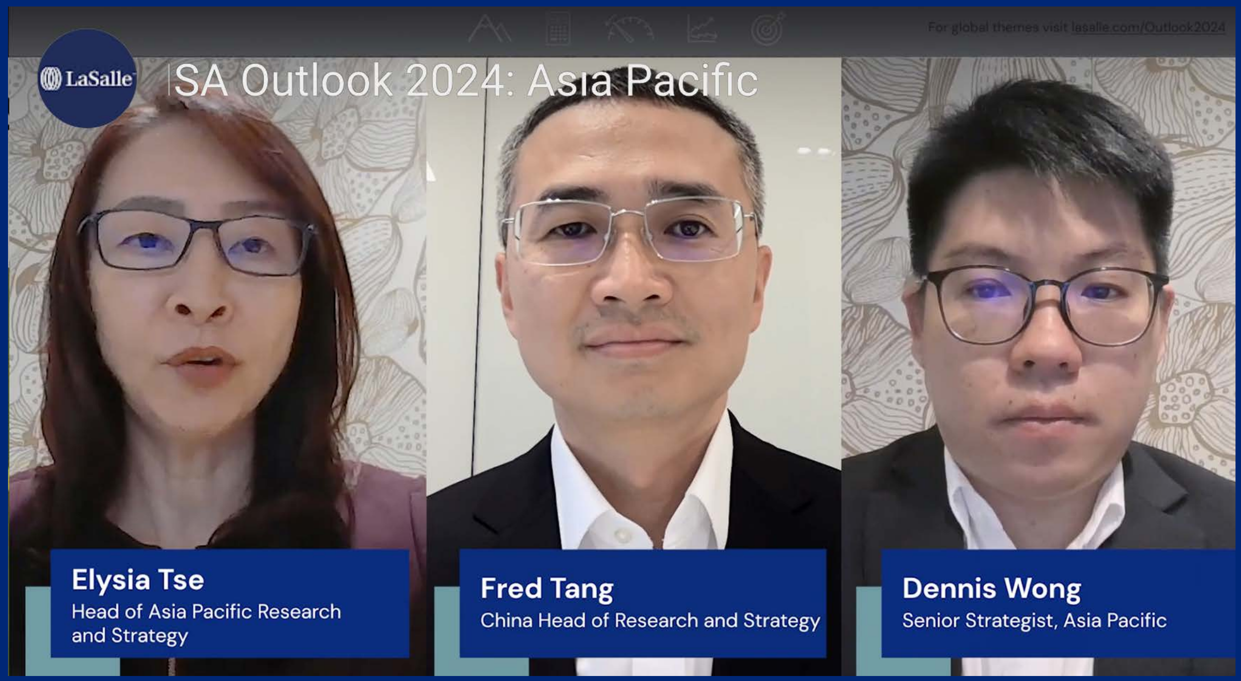
- **Supply will weigh on real estate fundamentals in 2024. Vacancy will likely climb, and rents should fall nationally for US apartments and in several industrial markets. However, a period of limited supply after 2024 will enable a full recovery for many market segments.**

- **Office investment will be a high-risk, high-reward endeavor in the coming year. In time, some of these investments are likely to prove very successful, but overall pricing has not yet fallen enough to reward office investors on a broad basis.**

- **A low-cost basis per square foot will be a common and justified rationale for investment. Opportunities to acquire below replacement cost will be plentiful, but replacement cost can be a moving target based on land values, construction costs and financing costs.**

Molly Brook on Belmont, North Haledon, New Jersey

Asia Pacific
Outlook



Watch the conversation
with Elysia Tse, Fred Tang and Dennis Wong
at lasalle.com/Outlook2024

ASIA PACIFIC

Published December 12, 2023

A tale of three realms

EXECUTIVE SUMMARY

In this final chapter of *ISA Outlook 2024*, we discuss how our global themes for the coming year translate to Asia Pacific, arguably the world's largest and most complex real estate market. With the exception of Japan and China, the key global theme of interest rates is still the dominant factor in real estate values, financing and transactions across the region.

China faces challenges brought about by the Covid-19 pandemic and its central bank is focused on restoring domestic confidence, whereas Japan appears to be emerging from two decades of deflation and is focused now on carefully managing the transition to an environment of positive, if low, inflation. The rest of Asia Pacific is facing tight financial conditions to varying degrees, but we believe that where conditions diverge from global patterns, it's possible to extract regional uniqueness in several sectors to drive real estate investment strategy. We conclude the chapter with observations that we believe institutional investors can look to when setting strategy for 2024.

Asia Pacific is a place of three realms: China, Japan and the rest of the region. China and Japan stand apart with their unique monetary policies significantly impacting the macroeconomic outlook over the next 12–18 months.

Central banks elsewhere are not in an enviable position; ideally, they would engineer a scenario under which inflation eases while demand holds up and job markets remain resilient. Historically, central banks have either overshot or undershot their aims. Is the recent news of easing inflation good news? The crystal ball is murky, but we see three distinct trends emerging in Asia Pacific.

Mezzo Apartments, Wentworth Park, Sydney, Australia

Tokyo, Japan, seen from Mt. Takao

Logiport Huizhou Boluo, Shenzhen, China

China:
A loosening bias to restore confidence

The Chinese government is facing unprecedented challenges in the wake of the pandemic. It needs to repair domestic confidence while facing reduced external demand and ongoing geopolitical tensions. The People's Bank of China (PBOC) is an outlier among global central banks. There is a high probability that the PBOC could continue to ease monetary policy in the first half of 2024.

In the absence of massive stimulus, China's macroeconomic environment is stabilizing, supported by various targeted monetary and fiscal measures and regulatory shifts. It takes time for stimulus measures to take effect. Nonetheless, there are early signs of recovery, as evidenced by China posting the lowest unemployment rate among those aged 25-59 since 2018[1] and increasing sales volume among Tier 1 for-sale residential markets.

1 Source: The National Bureau of Statistics of China, as of October, 2023

IN HINDSIGHT

A below-trend recovery in China

"Economic growth in China in 2023 should be below historical averages, but strong enough to make it one of the fastest growing large economies." (ISA Outlook 2023 page 30)

✓ China's GDP expanded 5.2% y-o-y in the first three quarters of 2023. Although this is below its annual average of 6.2% during 2013–2022, it is much faster than the growth rates in largest economies such as Japan. We expect the economy to maintain a modest growth rate in 2024.

China is experiencing the highest real wage growth among major Asia Pacific economies (Figure AP-a), with headline inflation fluctuating around 0% in recent months. The government's avoidance of "bazooka" stimulus to invigorate the economy represents a conservative approach that could help ensure sustainable, albeit gradual, long-term growth. Nonetheless, China still has many policy options if it needs them; it benefits from the world's largest foreign exchange reserves, the central government's low budget deficit ratio and some room for the PBOC to cut rates further.

China is undergoing a structural change from an investment-led economy to a service-led one. The fast-growing "New Economies," such as high-tech manufacturing, new energy, biotechnology and medical services, account for a larger share of the GDP than the for-sale residential sector,[2] and are expected to drive growth going forward. The Chinese economy will likely reach the government's 5% GDP growth target by the end of this year.[3] Even if China's GDP growth falls below 5% in 2024, the world's second-largest economy is still expected to deliver one of the highest growth rates.[4] China's modest economic recovery and gradually improving business and consumer confidence should point to a rebound in commercial real estate demand, although it could be still weak in the near term.

IN HINDSIGHT

The emerging REIT market in China supports domestic market liquidity

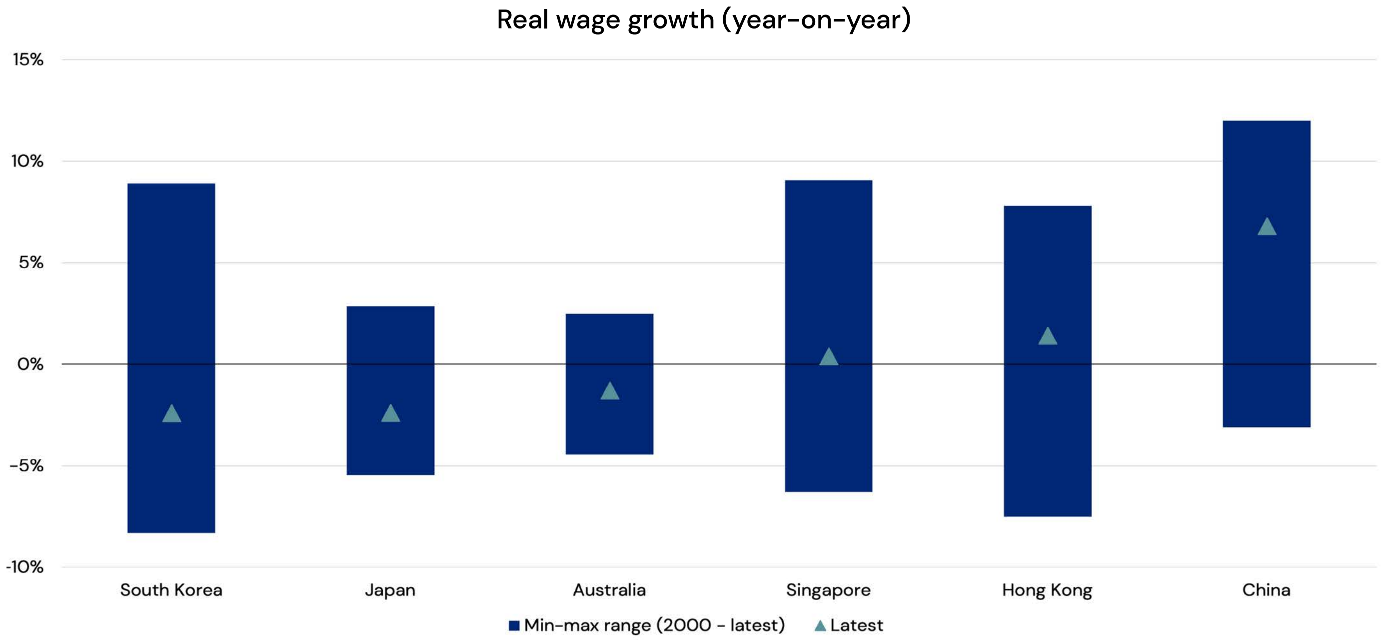
"In China, easing monetary policy and the rapid development of the REIT market are expected to support real estate market liquidity, particularly from domestic investors." (ISA Outlook 2023 page 37)

We rightly pointed out that domestic investors, particularly insurance companies, would be the key support of real estate market liquidity in China. However, despite the rapid development of the REIT market in China, most acquisitions from Chinese REITs have been recapitalization of assets from their sponsors. Open market acquisitions by REITs are rare. We expect domestic investors to remain active in 2024.

2 According to the National Bureau of Statistics of China, the "Three New Economies" (i.e., new industries, new forms of business and new business models, including modern agriculture, advanced manufacturing, new energy, ESG-related industries, the internet, modern professional services, etc.) accounted for over 17% of China's GDP and grew by 6.5% y-o-y in 2022.

3, 4 Source: LaSalle analysis based on data sources including the National Bureau of Statistics of China, the IMF, the World Bank and Oxford Economics, November 2023.

AP-a Strong real wage growth in China



Note: The min-max range of the real wage growth data is from 2000 to the latest, except China (from 2014 to the latest), Hong Kong (from 2005 to the latest) and South Korea (from 2009 to the latest).
Source: The Census and Statistics Department of Hong Kong, as of Q2 2023; Statistics Korea, as of August 2023; the Australian Bureau of Statistics, WIND for China, the Ministry of Health, Labour and Welfare of Japan and the Singapore Department of Statistics, as of Q3 2023.

Japan: Hoping to bid farewell to deflation

For the first time in more than two decades, the Japanese economy is not threatened by deflation. Although recent inflation has exceeded the Bank of Japan's (BoJ's) 2% target, it has primarily been driven by imported inflation and a weak yen. In contrast to China, real wage growth remains negative in Japan, even with recent wage hikes (see Figure AP-a).

The BoJ is adopting a more flexible approach to yield curve control (YCC), while awaiting signals of sustained inflation and wage growth. Japan has been patient for the past 25 years and can afford to be patient over the next 12 months. Although the BoJ's policy adjustments over the past year have gradually moved long-term interest rates higher, Japan is expected to maintain the lowest interest rates among the world's developed economies in the near term (see Figure AP-b). Any attempt to abandon YCC and negative interest

IN HINDSIGHT

Japan remains attractive with accommodative interest rates

"We expect Japan to remain attractive to investors, primarily supported by its accommodative monetary policy and stable political environment." (ISA Outlook 2023 page 32)

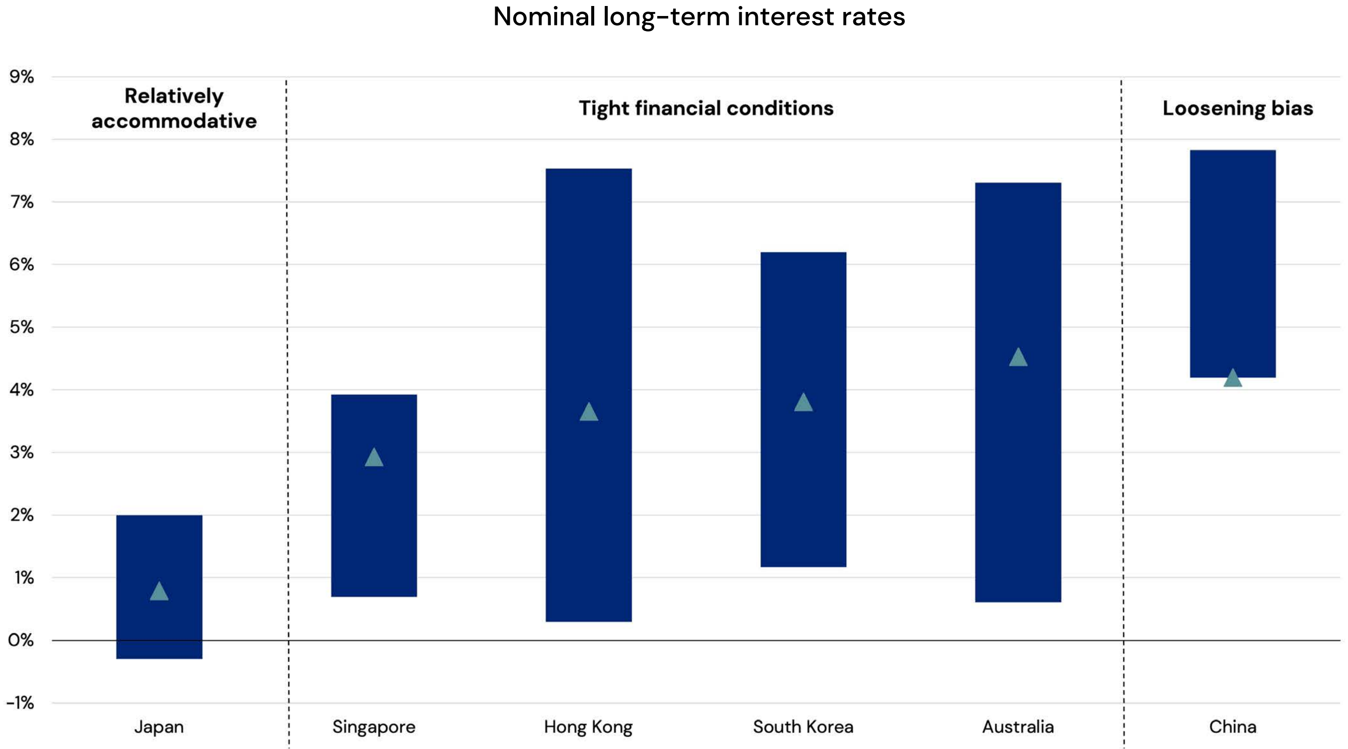
We stand by this call. Japan remains the largest commercial real estate market in Asia Pacific in terms of transaction volume and the number of deals transacted in the first three quarters of 2023. If Japanese government bond (JGB) yields continue to rise over the next 12 months, the magnitude and pace of rate rises likely to be modest and gradual compared to other developed markets. Spreads between Japanese real estate and JGB yields are likely to remain wide relative to other asset classes in Japan, which is attractive to investors, especially domestic ones.

Frontier Grand Nishishijuku, Tokyo, Japan rates is likely to be measured and gradual. Since over 70% of mortgage loans[5] in Japan are on floating rates, a sharp rise in short-term interest rates could shock the financial system. Corporate profitability is also a factor that the BoJ needs to watch closely. If the BoJ raises interest rates too quickly, it could jeopardize business confidence and corporate profits. Most likely, even in an environment where inflation can sustainably exceed the 2% target, interest rates in Japan are likely to be substantially lower than those in the rest of the world.

Barring exogenous shocks, the Japanese economy is expected to continue to grow above its historical average in the near term, as it transitions from an ultra-accommodative monetary environment to a still-accommodative one. While the weak yen has benefited industries like vehicle manufacturers and tourism, import-dependent industries like wholesalers and transport companies are facing challenges due to rising operating costs. We expect real estate occupiers to be cautious in making decisions on their real estate space needs.

5 Source: Japan Housing Finance Agency, as of March 2023

AP-b Lowest interest rates in Japan



Note: The min-max range of the nominal interest rate data is from 2000 to latest, except Singapore (from 2007 to latest) and South Korea (from 2006 to latest). The long-term interest rate is based on the 10-year government bond yield for all markets except China (the 5-year loan prime rate and the base rate for medium- to long-term loans (5-year +)) and Hong Kong (7-year government bond yield). For China, the interest rate data before August 2019 is based on the base rate for medium- to long-term loans (5-year +) and from August 2019 onwards is based on the 5-year loan prime rate (LPR).
Source: WIND (China's interest rate), as of October 2023; and Bloomberg (interest rate for all countries except China), as of November 15, 2023.

The rest of the region: Tight financial conditions to varying degrees

Central banks in Australia, Hong Kong, Singapore and South Korea are near the end of their rate-hiking campaigns. However, interest rates are expected to remain elevated until there is a disruption in the global economy. If there is an acute economic slowdown or a recession in the next 12 to 18 months, central banks could cut rates, but that would likely be accompanied by reduced demand in the near term.

Australia: Juggling a triple mandate

The Reserve Bank of Australia (RBA) is one of the few central banks with an explicitly defined triple mandate to maintain price stability, promote full employment and ensure financial stability. The RBA intends to pause rate hikes to balance the three objectives. However, if the US continues to lift interest rates, the RBA may have to follow suit to curb imported inflation. Systemic risks remain low, as Australian banks maintain strong provisioning levels and conservative lending practices. Nonetheless, tight financial conditions are expected to moderate economic growth and inflationary pressures. As a counterbalance, positive net migration is supporting domestic demand, but could keep inflation above the RBA's target range of 2%-3% in the short run. Real wages have fallen to levels last seen in 2009-2010[6] (see Figure AP-a), adding pressures on Australian households amid declining savings, high living costs and elevated mortgage payments. The Australian economy, facing some challenges in the short term, is expected to grow below its historical trend in 2024;[7] however, a recession is unlikely next year. Given the outlook, demand for commercial real estate in Australia is expected to remain weak in the near term.

IN HINDSIGHT

Tight logistics occupier markets in Sydney and Melbourne drive rental growth

"Logistics demand in Sydney and Melbourne, where vacancies are near zero, is expected to be supported by retailers' shift from brick-and-mortar retail to the omnichannel model." (ISA Outlook 2023 page 34)

We were mostly right. The logistics occupier markets in Sydney and Melbourne remain tight supported by the strong tenant demand and limited availability. Although we projected some of the strongest rental growth in Sydney and Melbourne among major Asia Pacific logistics markets, net effective rental growth in these two markets exceeded our expectation even with substantial increases in operating expenses. We expect the Australian logistics markets continue to outperform other sectors in Australia.

Hong Kong: Tagging along

Hong Kong's economy is rebounding, underpinned by the increase in private consumption and inflow of Chinese tourists. Since the Hong Kong dollar is pegged to the US dollar, interest rates in Hong Kong usually move in tandem with those of the US. The worst of Hong Kong's cyclical downturn may not be behind us, as the risk of a recession remains if the US enters one. The economy in Hong Kong is undergoing a structural shift. While its status as a global financial center has been challenged by the outflows of expats and foreign companies since 2019, it remains a gateway city to China with growing significance. Hong Kong, being the largest offshore renminbi clearing center, handled about three quarters of the world's RMB payments in 2022.[8] The structural shift is leading to a rising share of real estate tenants and investors from mainland China, particularly for office and multi-family rental assets.

6 Source: The Bureau of Statistics of Australia, as of Q3 2023
7 Source: Oxford Economics, as of October 2023
8 Source: SWIFT, as of 2022

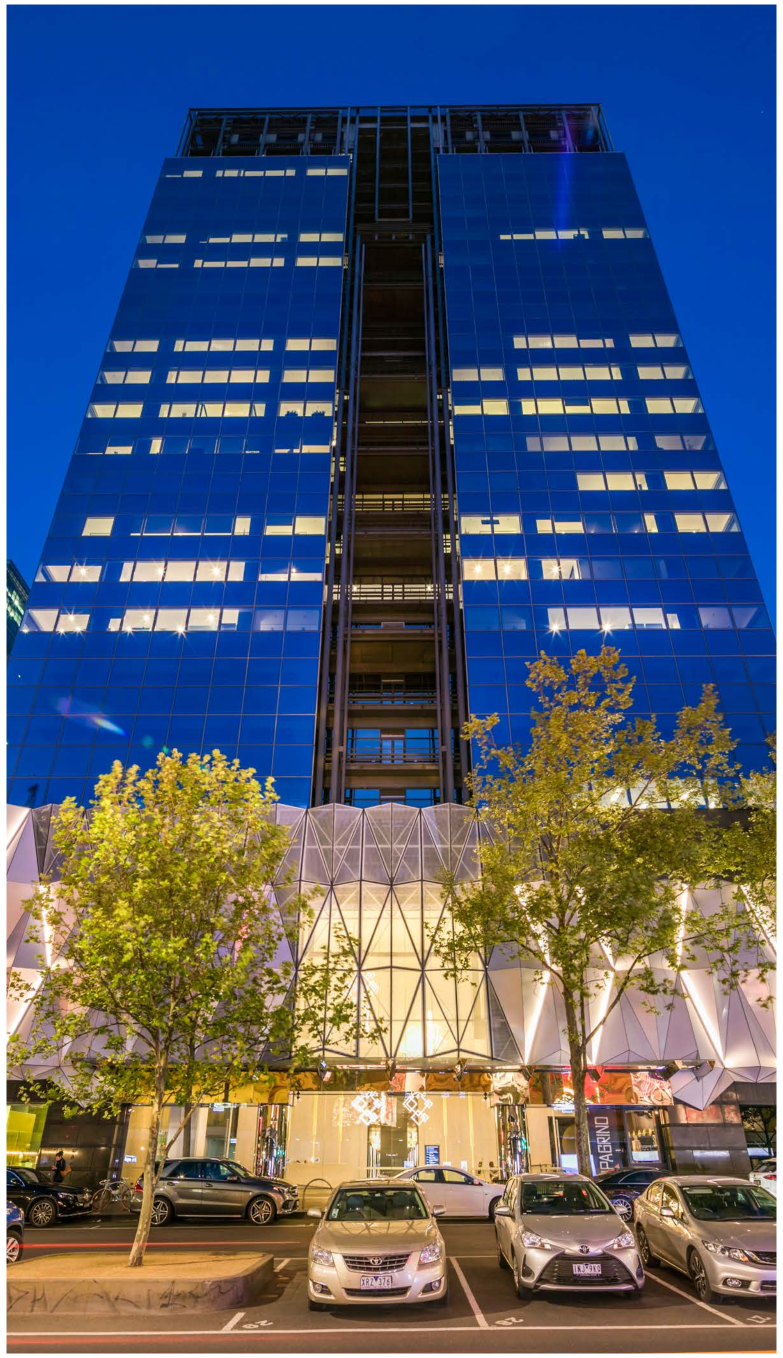
South Korea: likely to be first-in-first-out

The South Korean economy is highly sensitive to fluctuations in global energy prices and external demand. Economic growth is expected to remain under pressure due to weak external demand and tight financial conditions. More than 60% of outstanding corporate debt in South Korea is on floating rates,[9] leaving corporates vulnerable to high borrowing rates. The Bank of Korea (BoK) was the first central bank to raise interest rates, even before the US Federal Reserve. Considering the risk to the financial system, the BoK might not be able to raise interest rates further even if the US continues to do so. The BoK is likely to be the first to end its rate-hike cycle. We believe GDP growth in South Korea could fall short of 2% over the next 12 months, but a recession is unlikely.

Singapore: Similar trend, but slightly favorable

Singapore has been leading in reopening momentum, but as the tailwind fades and global demand softens, its economic growth is expected to slow in 2024. The tight labor market could weaken but are unlikely to completely derail. The Monetary Authority of Singapore (MAS) manages monetary policies through the foreign exchange markets; this unique approach of the MAS historically has resulted in lower interest rates than those of the US. Given the pressures from imported inflation and shortage of labor, the MAS is also unlikely to ease monetary policy in the near term. Nonetheless, the government might utilize targeted fiscal measures to support the economy in 2024, if needed. Tight financial conditions are expected to dampen demand from both businesses and households, indicating that the performance of some commercial real estate sectors, particularly office, has passed their cyclical peaks.

9 Source: The Bank of Korea, as of September 2023



222 Exhibition St, Melbourne, Australia

Some relative winners in Asia Pacific, yet no immunity

Asia Pacific is not immune to reduced capital market liquidity, as there is a general trend of cross-border investors pausing or reducing real estate allocations to Asia Pacific, primarily driven by the denominator effect and high interest rates in their home countries. However, there are relative winners among Asia Pacific capital markets. Japan, supported by domestic investors, remains relatively resilient. Cross-border and domestic investors continue to favor Singapore driven by its relatively low cost of debt and stable political environment. In the meantime, real estate market liquidity in China is gradually improving.

Although punching below its weight, **Japan's** real estate capital market is performing reasonably well. Despite expectations for interest rates to stay low in Japan compared to its global peers, we are not complacent about the impacts of gradually increasing long-term interest rates on exit cap rates. The good news is that domestic investors play a vital role in Japan's real estate transaction market. Their substantial and stable presence (see Figure AP-c) helps to mitigate some adverse effects from the moderate increase in interest rates. Nonetheless, spreads between Japanese real estate and JGB yields are not only positive, but well above those of major markets globally.[10] The uniquely wide positive spreads between cap rates and borrowing costs are expected to keep income-producing Japanese real estate investments attractive, especially for domestic investors.

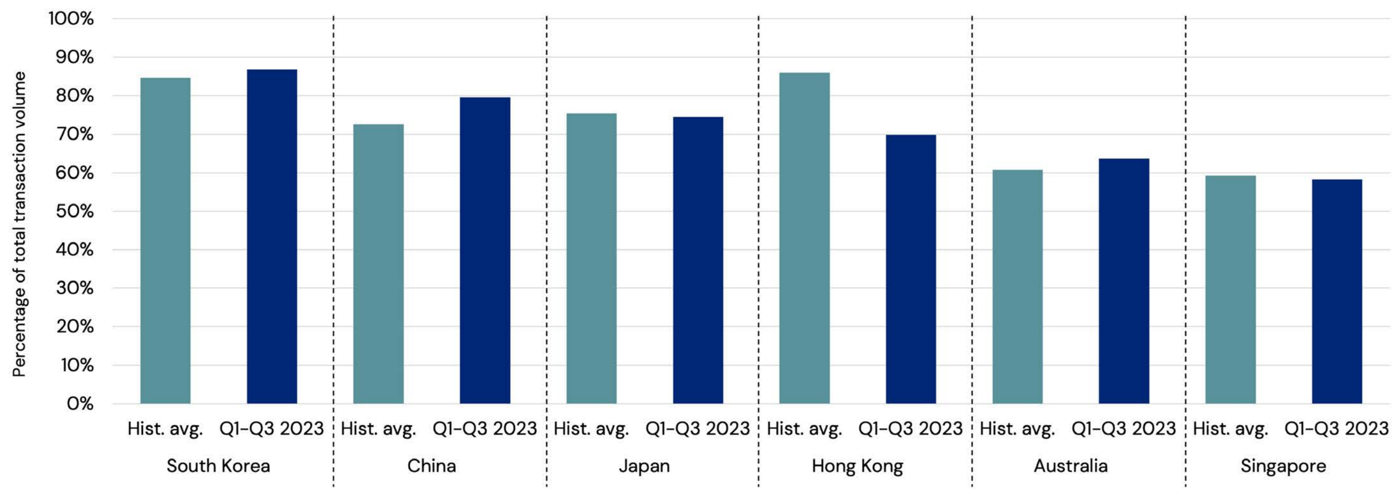
The impact of high borrowing costs in **Singapore** remains relatively benign in a regional context. While investors are concerned about high interest rates, borrowing costs have stabilized. On a relative basis, Singapore's relatively low cost of debt and healthy liquidity by regional standards[11] should remain attractive to investors seeking wealth preservation amidst global capital market uncertainties.

Despite interest rate cuts in **China**, by historical standards the real estate capital market has been relatively inactive over recent years. Some cross-border investors are taking a wait-and-see view due

10 Source: LaSalle analysis based on data sources including JLL REIS, CBRE, Savills, Bloomberg, as of November 15, 2023
11 Source: LaSalle analysis based on data sources including WIND and Bloomberg, as of November 15, 2023

AP-c Domestic investors are the cornerstone

Domestic buyers' share of commercial real estate transaction volume



Note: The historical average is from 2007 to 2022. The transaction volume data includes office, industrial, retail, hotel and multifamily rental deals above US $10 million, but excludes development sites and niche property types (e.g., self-storage). Domestic buyers in Hong Kong refers to buyers from both Hong Kong and mainland China.
Source: MSCI/ RCA, data downloaded as of November 3, 2023

to the slow economic recovery and continuing geopolitical tensions. After sinking to a nadir, the US-China relationship has begun to improve in recent months.[12] We expect a rotation back into Chinese assets as the economy recovers, albeit at a gradual pace. However, the liquidity gap left by cross-border investors who had reduced their share in China's commercial real estate transaction volume from slightly over 40% in 2019 to 23% year-to-date in 2023,[13] is unlikely to be fully filled. Real estate owners who are under pressure to sell may need to consider adjusting their price expectations. The supportive monetary environment, price adjustments among sellers who need liquidity and the opening-up of the domestic REIT market are expected to encourage domestic investors to increase real estate investments. We expect domestic investors, especially insurance companies, state-owned enterprises, RMB funds and REIT managers, to continue to dominate the capital market (see Figure AP-c) and some could even speed up the pace of investments in the next 12 to 18 months.

Tight financial conditions in **Australia**, **Hong Kong** and **South Korea** are negatively impacting real estate capital market liquidity, a situation most aligned with our global observation discussed in the "solving the capital stack equation" section of the *ISA Outlook 2024* Global chapter. The wide gaps between the price expectations of buyers and sellers are projected to remain in 2024, particularly in the office sector. The wide bid-ask spread has translated into slow transaction activity, which is likely to continue unless either buyers or sellers relent. Real estate valuations have not adjusted in many Asia Pacific markets/sectors, except for office in Australia, China and Hong Kong, logistics in China's Tier II markets and South Korea, and several retail segments. As financial conditions continue to remain tight in these markets, some price adjustments could filter through in the near term, particularly for office and retail properties. Hence, investors with assets to sell in their portfolios may have to be flexible on their exit timing.

As noted in the global chapter, the capital markets environment carries challenges and opportunities. Volatility can present tactical opportunities for both equity and debt positions in preferred markets/sectors in the short run. Investors with longer investment horizons should be patient in seeking attractive entry points.

Extract regional uniqueness beyond global similarities to drive strategy

Consistent with the global trends discussed in the *ISA Outlook* 2024 global chapter, investors in Asia Pacific are still confident in winning sectors, such as logistics and multi-family rentals; however, these winning sectors are to some extent "coming off the boil" as growth cools. But conditions in Asia Pacific also diverge from global patterns. For example, the region offers market segments with the strongest performance, even in unfavored sectors such as office.

The dispersion among major Asia Pacific **office** occupier markets is wide, with the Seoul and Osaka office markets being the tightest, and the China and Australia office markets being the weakest (see Figure AP-d). Some tenants are holding off on office expansion or relocation plans due to global economic uncertainties. Office availability rates are expected to increase in some markets (e.g., Tokyo and Singapore), but unlikely to reach their Global Financial Crisis peaks due to moderate supply pipelines. Some office development projects have been halted or delayed due to rising construction costs and tight lending conditions. Rental growth is expected to be muted or slightly negative as landlords compete for tenants, except in the Seoul office market. We expect Seoul office occupier fundamentals to remain relatively healthy through 2026 and continue to drive positive rental growth in the near term, bolstered by a limited supply pipeline, as well as upgrade and expansion demand among technology and professional services tenants. Although office performance is expected to vary by tenant credit and building specifications – with those offering work-live-play attributes outperforming, consistent with the global theme of "bifurcation" – the wide dispersion of the region's office occupier market fundamentals is expected to provide attractive investment opportunities for investors with different risk appetites.

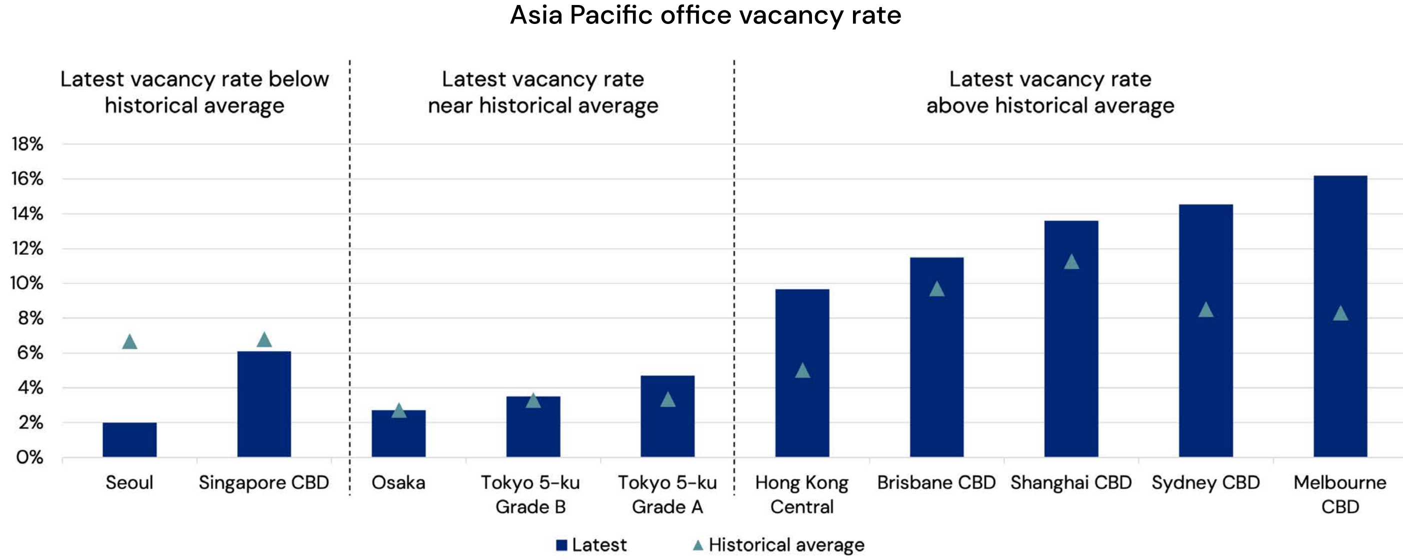
Despite the popularity of the **logistics** sector, the occupier fundamental dispersion among major Asia Pacific markets is as wide as that of the office sector. Australia and Singapore remain the tightest logistics markets in the region, while the supply-demand dynamics of Greater Seoul and Greater Beijing are the weakest. Dispersion is primarily driven by increasingly differing demand drivers and varying exposures to new supply. E-commerce players remain a key demand source in most markets as online shopping behaviors remain sticky (Figure AP-e). Furthermore, in Japan, logistics demand is led by third-party logistics (3PLs). In China, new energy vehicle makers, cross-border e-commerce players and cold-chain tenants have become non-negligible sources of new demand for logistics space.

However, supply risk over the next two years tends to be high in markets where existing stock per capita is relatively low. In China, for example, local governments' balance sheets complicate the supply outlook. Local governments with weak balance sheets tend to shore up their finances by selling land, which could lead to unexpected new supply. With rising inflation and operating costs, logistics occupiers are expressing less desire to occupy the most expensive space in urban locations. However, most tenants still want to be in established logistics submarkets with reasonable rents, easy access to labor and proximity to highways. Going forward, landlords may have to trade rents for occupancy due to high supply and cost-conscious tenants, a key trend for investors to watch.

Following the global trend, **retail** fundamentals in Asia Pacific continue to be affected by e-commerce disruption. However, the uniqueness of the region's retail sector comes from several factors, including a preference for in-store shopping

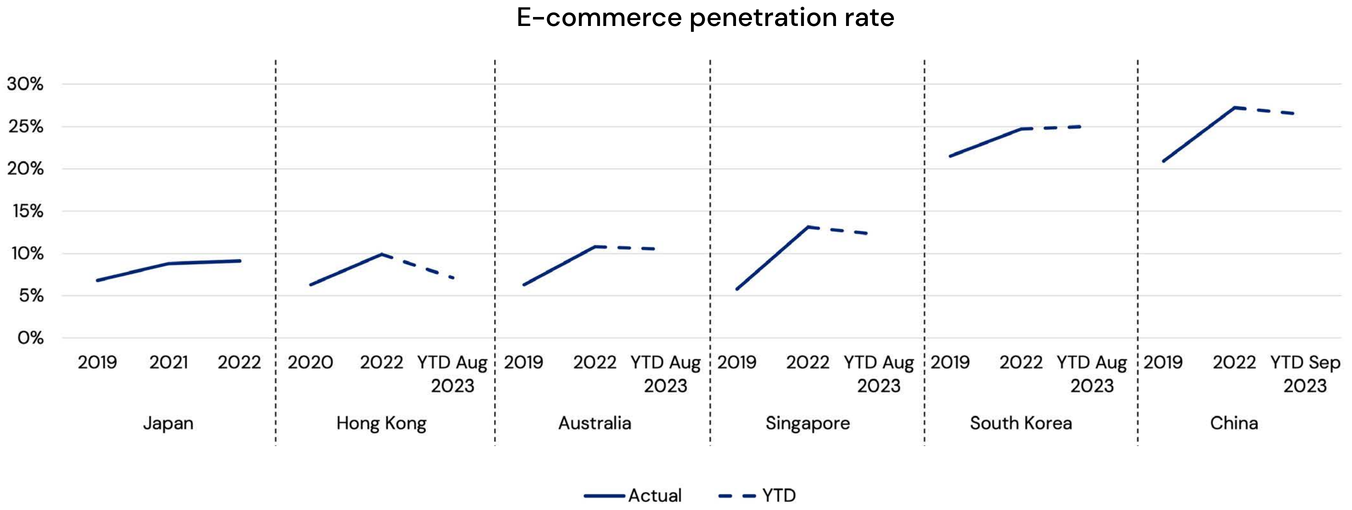
12 The US Secretary of State visited China in June, the Treasury Secretary in July, and the Secretary of Commerce in August 2023. US President Biden and China's President Xi also met at the Asia-Pacific Economic Cooperation (APEC) conference in San Francisco in November 2023.
13 Source: MSCI/RCA, as of November 21, 2023.

AP-d Some strong markets in an underperforming sector



Note: Australia offices include only prime grade offices, Osaka offices include the central 5 kus, and Seoul offices include CBD, Yeouido and Gangn. The latest vacancy rates are as of Q3 2023. The since-inception date for the historical average data for each market/sector is from Q1 2000 except Tokyo 5-ku Grade B office (Q4 2002) and Osaka 5-ku office (Q4 2004).
Source: JLL REIS, as of Q3 2023

AP-e Online shopping behaviors remain sticky



Source: The Ministry of Economy, Trade and Industry of Japan, as of 2022; the Australia Bureau of Statistics, the Census and Statistics Department of Hong Kong, the Singapore Department of Statistics and the Statistics Korea, as of August 2023; and the National Bureau of Statistics of China, as of September 2023; LaSalle Investment Management, as of November 2023.

and relatively low e-commerce penetration rates in markets such as Japan (see Figure AP-e). We expect malls anchored by non-discretionary retailers to continue to outperform those anchored by discretionary retailers in the near term. Rising operating expenses and interest rates continue to weigh on retail space demand, but limited supply is providing some stability to the sector. As a result of stabilizing fundamentals for centers with supermarket anchors in markets such as Australia and Singapore, retail valuations are stabilizing faster than those of offices in these markets. There could be interesting investment opportunities even in a generally unfavored sector.

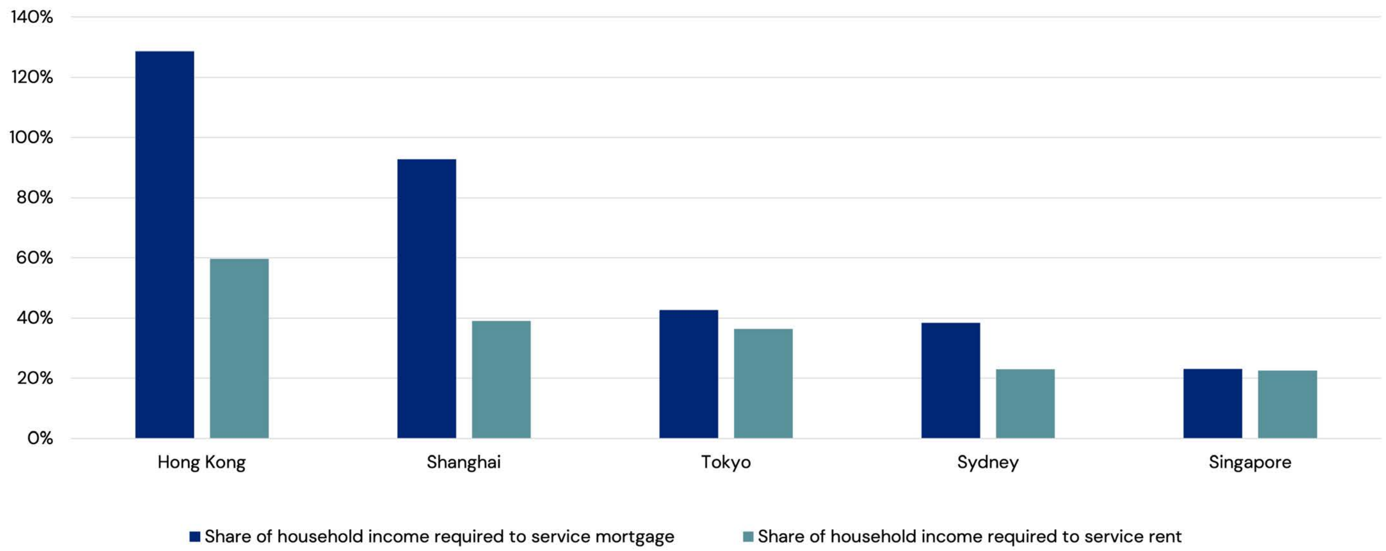
Demand for **multi-family** rental in major Asia Pacific markets is supported by tailwinds such as a rising preference for renting (Figure AP-f), especially among younger people,[14] positive net migration and a high return-to-office ratio. We see particular strength in locations with work-live-play attributes. These factors are expected to support further rental growth, although high entry prices driven by strong investor appetite may dampen returns. Rental growth of multi-family rental assets is expected to come off the peak levels (see our global theme "coming off the boil") seen over the past 12-24 months, as favorable fundamentals and policy tailwinds encourage new supply in markets such as China and rising inflation and negative real wage growth in markets such as Australia and Japan constrain tenants' ability to pay higher rents. Overall, we continue to favor multi-family rental assets due to their resilient market fundamentals and the sector's ability to hedge inflation through relatively short lease terms.

The **hotel** sector in major Asia Pacific markets continues to improve, driven primarily by a recovery in domestic travel and to a lesser extent, inbound tourism. Countries with relatively weak currencies (e.g., Japan and South Korea) are seeing higher hotel demand from inbound travelers, while keeping domestic travelers onshore. Domestic tourists account for a large majority of total hotel guests in Japan, China, Australia and South Korea (see Figure AP-g). Domestic travels in these markets are expected to remain a key driver of the hotel sector recovery in the near term. International travelers, particularly Chinese tourists, could gradually contribute to the improvements in hotel performance in the near term. The strong recovery momentum and rising operating costs have incentivized hotel operators to prioritize raising average daily rates over occupancy levels. Hotels can be an attractive momentum play for investors with a higher risk tolerance.

14 Source: The Japan Ministry of Internal Affairs and Communications Housing and Land survey, as of 2018; Australia Bureau of Statistics Census data, as of 2021.

AP-f Rising preference for renting

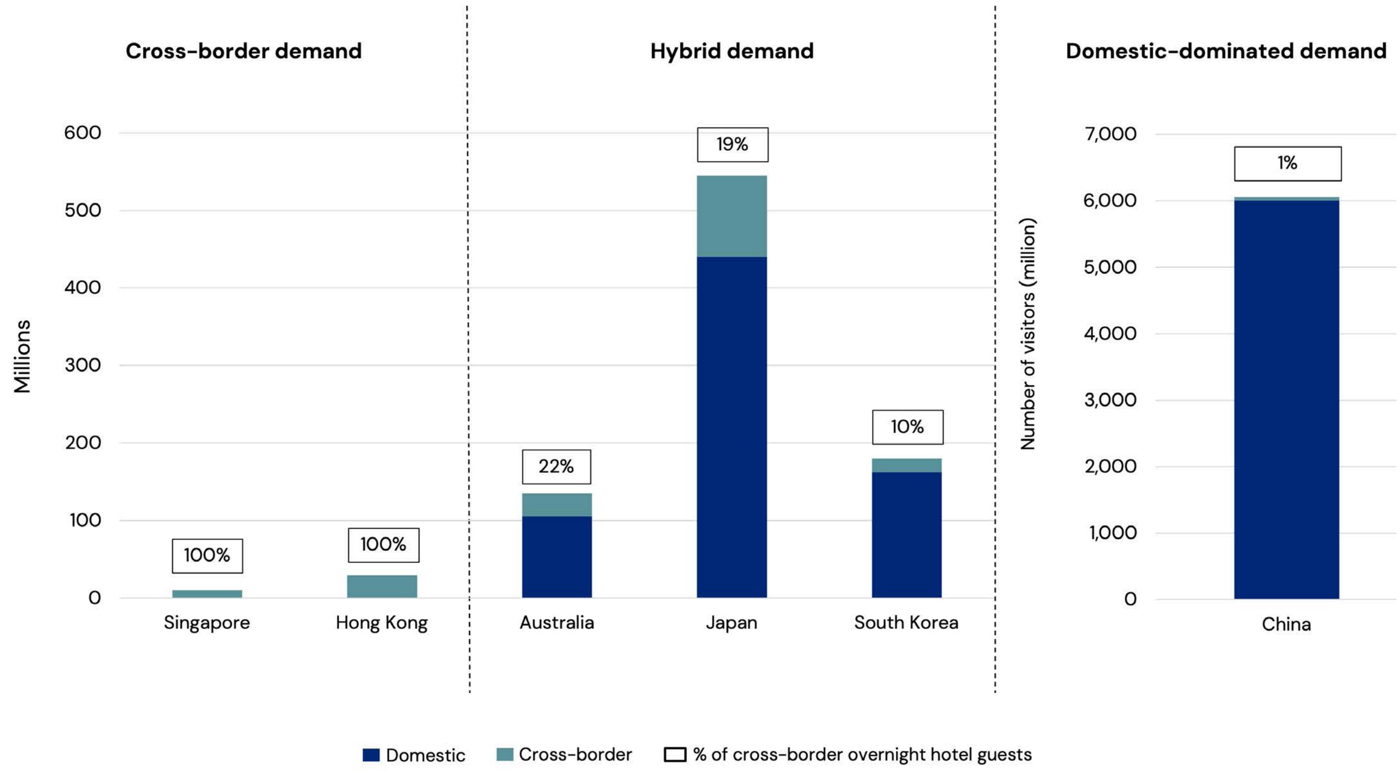
Share of household income required to service mortgage and rent



Note: The residential unit size used in the above analysis is based on the typical unit size in each market: 65 sqm for Australia, 75 sqm for China, 49 sqm Hong Kong, 70 sqm for Japan and 85 sqm for Singapore. The down payment requirements for 25- to 35-year mortgage loans are based on local practices: 20% of the purchase price for Australia, 30% of the purchase price for China, 10% of the purchase price for Hong Kong, 10% of the purchase price for Japan and 25% of the purchase price for Singapore.
Source: Household income: Australia Bureau of Statistics, Oxford Economics (China) and Singstat (Singapore), as of December 2022; and the Census and Statistics Department of Hong Kong, as of March 2023. Home price and rent: The Rating and Valuation Department of Hong Kong, as of December 2022; CREIS (China home price) and WIND (China home rent), as of March 2023; the Urban Redevelopment Authority of Singapore, as of Q3 2023; Tokyo Kantei (Japan home rent) and the Japan Real Estate Economic Institute (Japan home price), as of September 2023; SQM Research (Australia), as of 27 October 2023. Mortgage rates: the RBA (Australia), the People's Bank of China (China), Centaline Property (Hong Kong), Diamond Fudosan (Japan) and DBS Bank (Singapore), as of October 2023.

AP-g Diverging hotel demand base in Asia Pacific

Number of overnight hotel guests (millions) domestic versus cross-border, pre-pandemic (proxy of a normalized environment)



Note: All data are as of 2019 except for Hong Kong (2018). We applied 2018 data to reflect Hong Kong's pre-pandemic condition as the city's tourism industry was affected by social unrest in 2019. We applied the number of visitors for China, since the overnight hotel guest information is not available.
Source: United Nations World Tourism Organization (Singapore, Australia and Japan, as of 2019); China National Statistics Bureau (number of visitors), as of 2019; Hong Kong Tourism Board (number of overnight visitors), as of 2018; and OECD (South Korea number of domestic overnight visitors and number of total international visitor arrivals), as of 2019

LOOKING AHEAD

- **Japan is expected to remain the largest and most liquid institutional real estate market in Asia Pacific for the foreseeable future, albeit with some volatility.**
- **The worst is likely over for China's economy, but the recovery could be gradual and bumpy. Domestic investors are expected to continue to dominate the capital market in China and some could even speed up the pace of investment in the next 12 to 18 months. Real estate capital market liquidity is expected to recover in 2024 but could remain low by historical standards.**
- **Logistics and multi-family are expected to continue to offer attractive relative value among major commercial real estate sectors in the near term, but there could be strong entry prices coupled with a decelerating rental growth outlook in select markets with rising supply pipelines. Spotting unique occupier dynamics in these favored sectors are critical in driving investment performance going forward.**
- **There could be a short-term investment window for Seoul offices ahead of the supply influx in 2027 and beyond and Sydney offices with green credentials if entry prices adjust.**

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