

OUTLOOK GLOBAL 2025

Published on November 19, 2024



**The dawn of a new
real estate cycle**



A MESSAGE FROM MARK GABBAY

For over 30 years, our annual *ISA Outlook* has been LaSalle's most anticipated and widely read research publication. 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 the 1,200+* assets that we manage, spanning geographies, property types and risk profiles. Our global team of researchers, strategists and data scientists have developed a range of tools and models to synthesize this wealth of information and help you, our investors and partners, understand real estate markets at both the global and local level.

I encourage you to read our outlook for 2025 alongside the broader suite of Insights, Strategy and Analysis (ISA) publications the team produced throughout 2024, including eight *ISA Briefing* notes, three *ISA Focus* reports and our annual *ISA Portfolio View*, which address key questions faced by global real estate investors. These, and a range of other real estate investment-focused thought leadership, are available for you at lasalle.com/insights.

The dawn of a new cycle?

This year, the *ISA Outlook* identifies what appears to be the dawn of a new real estate cycle. As with the start of every new day, both opportunities and challenges lie ahead. We examine these through four broad themes in this year's report:

- 1 The **morning sky**, where we focus on a mostly benign macro environment characterized by falling inflation and softening rates, while keeping an eye on risks that remain on the horizon;
- 2 The **capital stack hangover**, which looks at opportunities presented by broken capital structures that exist despite the prospect of healing capital markets;
- 3 The **breakfast menu** tackles the question of how investors can make sense of ever-more complex investment options; and finally
- 4 The **early bird**, where the proverbial "worm" is the attractive risk-adjusted returns that may come with entry points early in the real estate cycle.

*Data as of October 31, 2024



Revisiting *ISA Outlook* 2024

Last year, for the first time we released the four chapters of the *ISA Outlook* sequentially, beginning with the global chapter in mid-November, followed by the Europe, North America and Asia Pacific chapters over the following weeks. We also introduced new "in hindsight" sidebars, where we looked back at predictions made the previous year, noting what we got right as well as what we got wrong. As we said last year, no forecaster is always correct, but transparency and accountability about prior calls is a strong foundation for improving future projections.

The feedback we received from you was that you appreciated both of these elements, so I am pleased to confirm that we will be maintaining them going forward. As always, we look forward to your feedback and meeting with you throughout 2025 as we look ahead to the dawn of a new cycle in the world of real estate.

Warm regards and best wishes
for a successful 2025,

Mark Gabbay

Mark Gabbay
Chief Executive Officer



Global Headquarters,
Chicago

LaSalle Singapore

LaSalle London

EXECUTIVE SUMMARY



THE MORNING SKY



THE CAPITAL STACK HANGOVER




THE BREAKFAST MENU



THE EARLY BIRD

The dawn of a new real estate cycle


Almost three years after interest rates began to spike leading into the Great Tightening Cycle (GTC), the first light of a new real estate cycle is clearly visible on the horizon. In *LaSalle's ISA Outlook 2025*, we look at how to make the most of this new dawn and the opportunities it may present, but with a watchful eye on ways the new day could go off track.


Sunrises are different depending on from where they are observed; accordingly, we also highlight the considerable variation in conditions across global markets. We discuss this mix of optimism and risk in our analysis of **the morning sky** .

Some parts of the market may be a little slow to rise, especially after the stimulus-laden party that was 2021. Excesses from that period embedded challenges in capital stacks that surfaced when rates started to rise. Although real estate is not characterized today by widespread distress, there are pockets of opportunity for rescue capital, both in the form of equity and debt.

Our discussion about curing **the capital stack hangover**  looks at the investment opportunities inherent in providing a resolution to such situations through fresh capital and active asset management.

Two mornings are rarely the same; there are considerable differences between this cycle and prior ones. Specifically, bond markets do not expect as rapid a pace of interest rate declines, or to as low a level. Moreover, conditions across real estate sectors and markets are deeply uneven. These differences suggest that investing into the new real estate cycle will not be a simple story of a "rising tide lifts all boats"; selectivity at the sector,

market and sub-market level is highly likely to add value. There are also more investment options than before to consider. Like a diner facing a menu with a choice of Continental breakfast, pancakes, dim sum, or a Full English, a real estate investor today would be forgiven for being overwhelmed. We counsel on how to make the most of this complex investment menu and recommended a mix of discernment and diversification in our analysis of **the breakfast menu** .

Finally, our discussion of the virtues of being **the early bird**  argues that investors who recognize and act upon opportunities presented by this new cycle earlier are likely to be advantaged compared to laggards. We conclude by laying out our preferred investment targets.

Global patterns and local exceptions

The case of Japan and China

As a global real estate investor, we see significant benefits from engaging in pattern recognition across the regions where we invest. But the existence of common patterns does mean all markets are the same, or that there are no exceptions to the overall trend. The global chapter of *ISA Outlook 2025* faces the challenge of describing global patterns across a wide range of local conditions. The global interconnectedness of financial markets means that the themes that we discuss in this chapter apply to many markets, if varying in timing and intensity. However, there are two major exceptions that deserve a special mention:

China is undergoing a generationally unique period of weak growth, low liquidity and challenged property fundamentals. China has been loosening both fiscal and monetary policy for several years, and more stimulus is expected. In addition, geopolitical divides between China and the rest of the world have been widening. As such, many of the comments we make in this chapter do not apply to the Chinese market.

Policymakers in **Japan** retain a tightening bias compared other global central banks, notwithstanding political uncertainty which is likely to delay their action. While a normalization of Japanese interest rates and monetary policy can be viewed in a positive light, given Japan's many years on the brink of deflation, the timing, pacing and magnitude of tightening represent key uncertainties. Our comments in this global chapter of expected interest rate cuts do not apply to Japan.

For more discussion of these and other variances from global trends, please read the forthcoming regional chapters of the *ISA Outlook 2025*.



THE MORNING SKY

Falling rates but risks on the horizon

A change in the interest rate environment is the key driver behind the dawn of a new cycle. The probable direction of policy interest rates in most countries is clearly weighted downward for the first time in over two years. On the back of evidence of substantially lower inflation, the Bank of Canada and European Central Bank (ECB) kicked off the global easing cycle in June 2024 (see exhibit G-a).

These moves were followed later in the year by the Bank of England and the US Fed's historically large 50 basis point cut in September; a 25 basis point cut by the Bank of Korea in October was the first rate cut by a major Asia Pacific central bank. Japan remains a notable exception; the direction of travel for Japanese monetary policy is likely toward higher rates — with uncertainties around magnitude and timing — though unexpected political uncertainty may keep tightening on hold for the time being.

The impact of rate cuts on long-term market interest rates appears more muted than when looking at policy rates alone, because cuts were to some extent already priced in. Indeed, US 10-year Treasuries are now up more than 50 basis points since the Fed's first cut, suggesting that markets recognize that a soft landing would not likely be consistent with a steep fall in rates. That said, long-term corporate bond yields (our preferred benchmark for pricing real estate) have largely exhibited a stable or gently downward trend, owing in part to narrowing credit spreads; this trend is welcome after a long period of episodic interest rate volatility around a broadly sideways path (see exhibit G-b). Relatively narrow credit spreads are themselves a sign that markets are not expecting weakness in the real economy to dent corporates' prospects.

When it comes to cycles, there's no morning routine

Two mornings are rarely if ever the same; our experience of investing across multiple cycles reinforces that the same is true of real estate cycles. Investors who look back at the post-Global Financial Crisis (GFC) interest rates cutting cycle and the one triggered by Covid-19 might be tempted to expect rapid rate cuts to ultra-low levels. But in our view, monetary policymakers are unlikely this time to cut as steeply, or to such a low level.¹ And as we wrote in an ISA Briefing note, [“The Red Sweep and real estate”](#), the US election result, all else equal, points to incrementally higher growth, inflation and rates.

Moreover, the so-called neutral rate of interest (often called R-star or r^*), the interest rate that would occur when the economy is at full employment and inflation is stable, may be higher now due to a range of structural factors, such as higher productivity growth potential due to advances in artificial intelligence (AI) and less regulation. Although r^* is fundamentally unknowable, central bankers are aware that cutting interest rates back to near-zero levels may risk setting an inflationary spiral back into motion.

◀ IN HINDSIGHT

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



Right / Mostly right



Remains to be seen



Not right / Not quite right

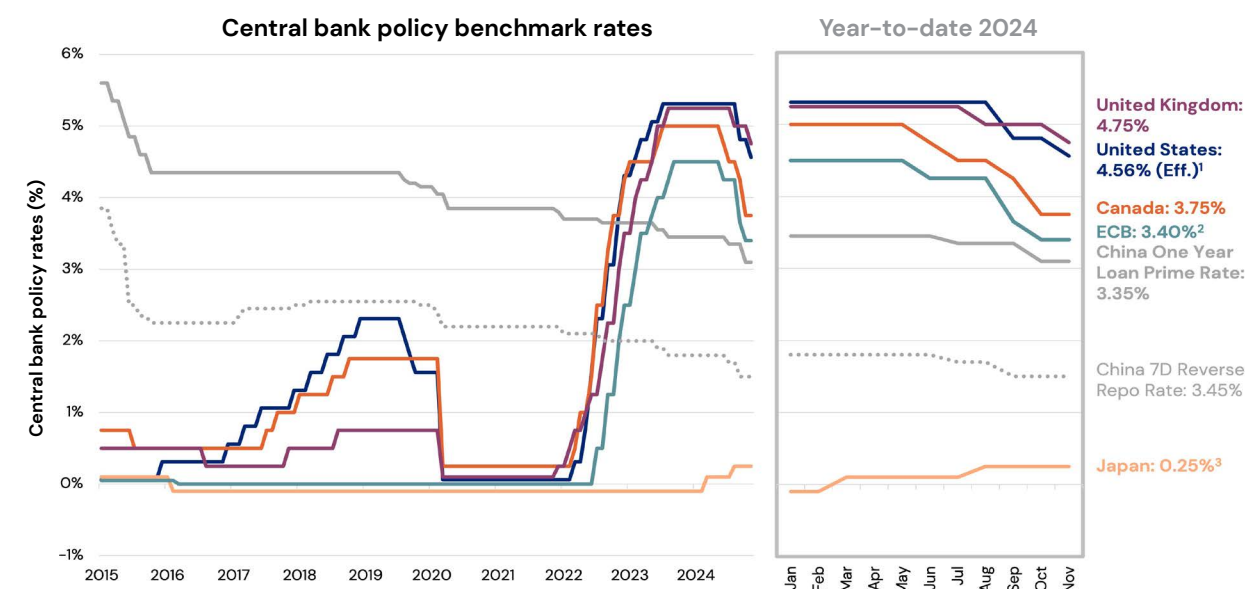


“Inflation is moderating slowly and remains meaningfully above central bank targets. New risks, especially to energy prices, have emerged owing to the Israel-Hamas conflict. It is still far from clear that a so-called “immaculate disinflation” – a smooth reduction of inflation without a recession – can be achieved in the US or Europe.” (ISA Outlook 2024 p. 10).

Inflation has continued to moderate and is now near central bank targets in many geographies. So far, the US economy seems to be on track for a soft landing, but these are exceedingly rare in economic history and that there are various risks to consider. For example, the conflict in the Middle East, noted last year, has only intensified.

G-a

Global central banks nearly all in cutting mode



Notes 1. Effective Fed Funds rate shown rather than target range. 2. ECB main refinancing rate shown. 3. Negative interest rates in Japan apply to marginal increases to reserves. Japan cash rate / complementary Deposit Facility. Source: Refinitiv, central bank websites, LaSalle. Data through November 7, 2024.

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.

1. This view, discussed in the following paragraph, was shaped by our own research and our review of analysis by our macroeconomic data providers, such as Oxford Economics and Piper Sandler. This comment excludes China, where interest rates are already near record lows.

Red skies in morning? Falling rates but risks abound

An ancient mariners' rhyme advises that some dawns come with signs of trouble ahead: "Red sky at night, sailors' delight. Red sky at morning, sailors take warning."² Real estate investors observing the dawn of a new real estate cycle are wise to scan the horizon for hints of redness and prepare for unexpected conditions.

One key alternative scenario to a soft landing is an economic downturn. Indeed, a stock market roller coaster over the summer reflected growing concerns of a US recession at the time, with markets reacting negatively to any signs of weakness, such as a soft jobs report or disappointing earnings release. This marked a change from the market reaction function earlier in the year and in 2023, when economic softness was welcomed by markets as a harbinger of lower rates — a kind of "bad news is good news" paradigm.

Thankfully, a quick read of current economic conditions points to a mostly benign global picture — if one containing weaker spots such as parts of Europe, Canada and China. Inflation is almost universally on a steady cooling trend (see exhibit G-c), with the notable exception of Japan. Global economic growth continues at a muted but generally steady pace (see exhibit G-d), and a US recession is not our base case. Job growth in the US remains strong, even if it has been increasingly driven by non-cyclical employers such as the government and healthcare sectors, rather than the more cyclical industries which tend to lead during upswings.³ Strong migration into the US and Canada has been an important structural support for growth, owing to an expanding labor force and household formation representing tailwinds. In the US, policy changes following the election may change the mix of growth drivers, but on first assessment, the outcome appears to

be positive for the GDP outlook. Elsewhere, we expect weak but positive growth in Europe, as several countries that had been in or on the edge of recession in 2024, such as Germany, could return to growth in 2025.⁴ Countries like Spain and Poland have seen solid growth, and the outlook for the UK continues to improve as financial markets tolerated the first budget of the UK's new Labour government without anything like their volatile reaction in 2022.

But there are some concerning signs for the global economy. There is evidence of considerable bifurcation in consumer fortunes in the US and Europe, with higher-income households doing well but stresses from higher living expenses weighing on lower-income households.⁵ This has started to impact sentiment measures and credit card delinquency. The most notable global soft spot today is the Chinese economy, which is burdened by residential real estate oversupply and weak consumer sentiment.⁶ As we will discuss in the Asia-Pacific chapter, the performance of the Chinese economy is probably much worse than the official statistics suggest.

In addition to the balance of the usual cyclical factors, several exogenous risk factors also threaten to derail global growth. Intensifying conflict in the Middle East — with the prospect for the Israel-Hamas conflict to broaden into a regional war — could disrupt global energy supplies, and would likely be simultaneously inflationary and negative for growth. High valuations for AI-related tech companies highlight the risk that share prices come back to earth in a disorderly way. Domestic political circumstances also carry potential risks.⁷ These include the transition to Trump as the new US president, a minority caretaker government in France with little room for fiscal maneuver, the collapse of Germany's ruling coalition, and a shock election loss by Japan's longtime ruling party. Rising protectionism is a global phenomenon with broad implications for markets.

2. The phrase goes back at least to Biblical times; it is referenced in Matthew 16:2–3. It also appears elsewhere in culture, for example in Shakespeare's *Venus and Adonis*. There is a scientific logic to this saying. In the northern hemisphere, where weather systems tend to move from west to east, redness in the morning sky signifies that a high-pressure air mass is moving away from your position and something menacing might be coming in its place.

3. Based on analysis by Piper Sandler.

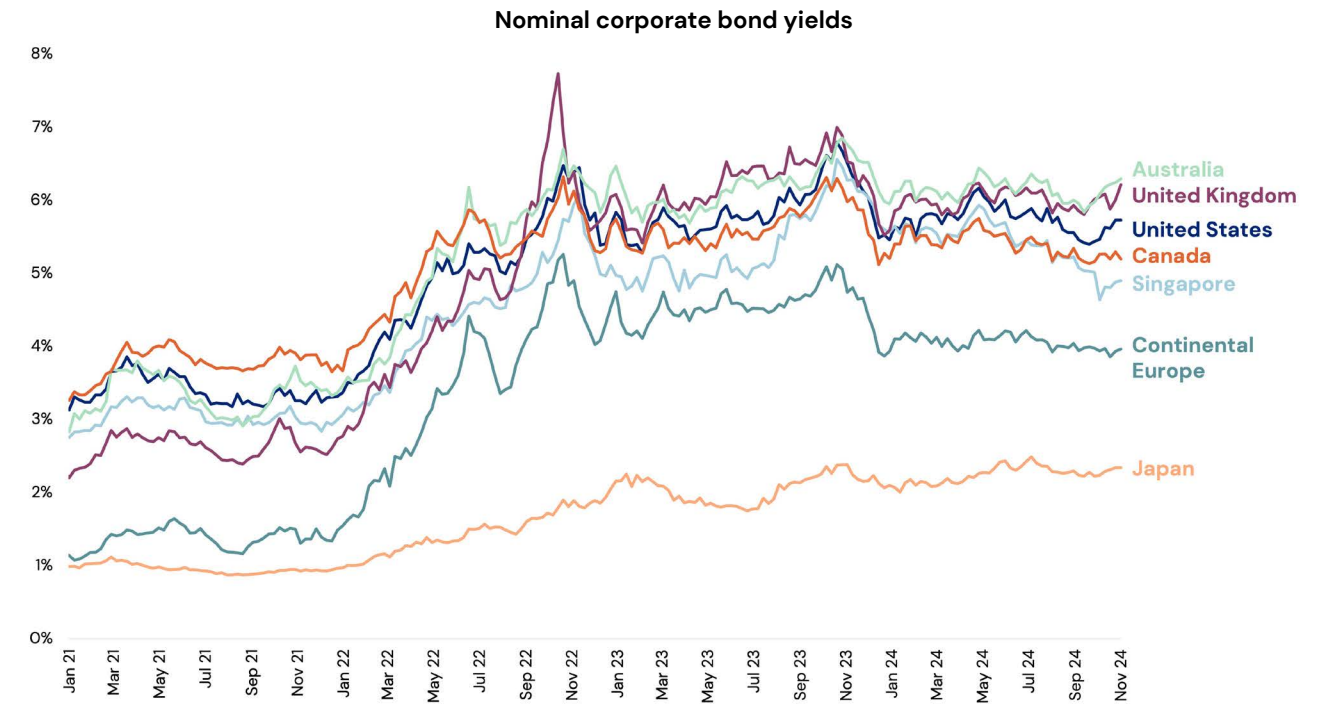
4. Prediction based on LaSalle research and strategy analysis of Oxford Economics forecasts.

5. According to analysis by Piper Sandler.

6. According to analysis by Oxford Economics and Piper Sandler.

7. In our *ISA Briefing*, "[Elections everywhere all at once](#)," we discuss the implications of political and geopolitical risk for real estate. In that piece, we argue that the implications for real estate of political developments are often exaggerated, but should be tracked and developed into "what if" scenario analyses. In our most recent *ISA Briefing*, "[The Red Sweep and real estate](#)", we update those views in the context of the US election result.

G-b Corporate bond yields steady or easing



Source: LaSalle Global Solutions, Bloomberg data through November 1, 2024. 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. 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.

Sense and sensitivities

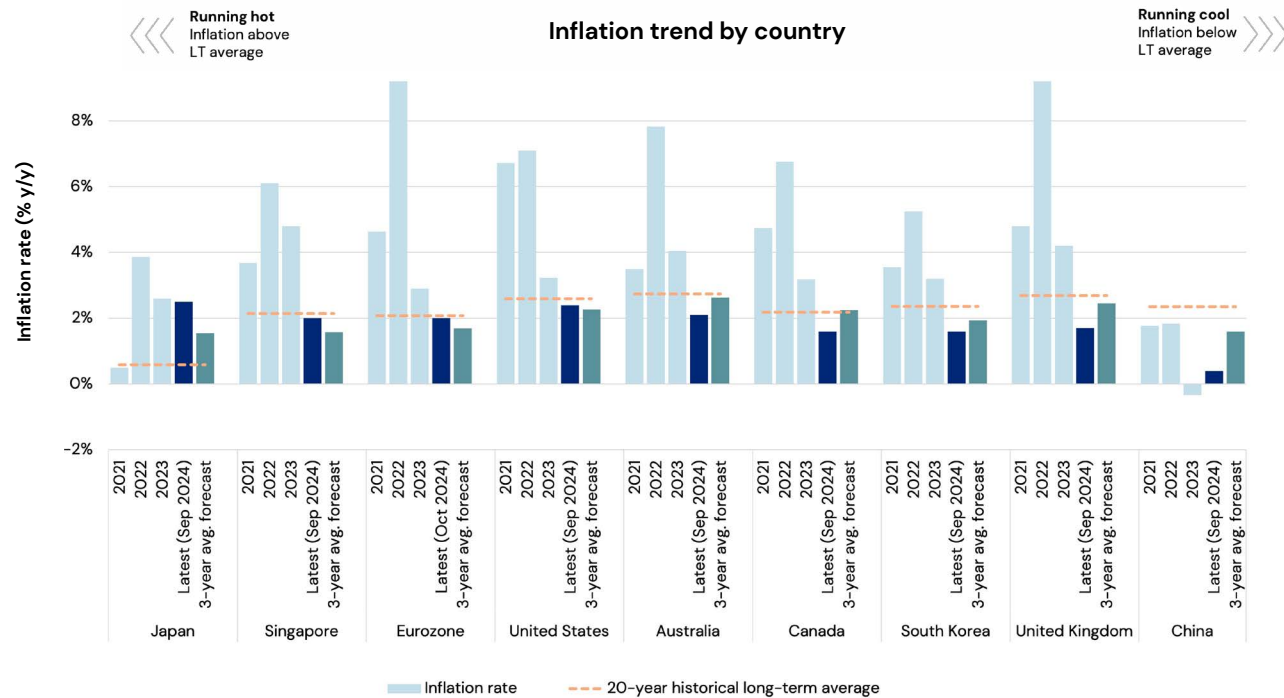
What is the appropriate strategic response to an environment characterized by high but gradually moderating interest rates, but with non-trivial risks to growth? A deliberate approach is critical because a recession, or even an extended period of economic softness, would shape relative winners and losers in real estate. The basic question comes back to the dynamic, also played out in the stock market, of whether "bad news is good news" or "bad news is bad news." In other words, does the benefit of lower interest rates offset the harmful impact of weaker cash flows, and vice versa? This duality exists because real estate is an asset class that blends characteristics of both equity and fixed income.⁸ The answer likely varies by sector and geography; it hangs on assets' relative degrees of sensitivity to interest rates versus economic growth. We recommend a portfolio construction approach that is aware of such exposures.

As a complement to our established fair and relative value analysis (discussed below), which is the core of our house view process, we developed our **Portfolio Balance framework**.⁹ This analysis segments sector/market combinations according to their cash flows' sensitivity to economic activity (a measure of "beta") and their capital values' sensitivity to interest rate changes (a measure of "duration"). This creates a four-quadrant segmentation that we divide into buckets: rate-led, growth-led, reactive and stable. For more discussion of Portfolio Balance, see the sidebar on the following page. Investors contemplating different economic scenarios can use this framework to thoughtfully build a diversified portfolio.

8. We further discuss the characteristics of real estate as an asset class in our [ISA Portfolio View](#) report.

9. This framework owes its inspiration and foundation to work by Green Street Advisors, "All eyes on the numerator" (2016) and "Margin review" (2024).

G-c Inflation continues to cool

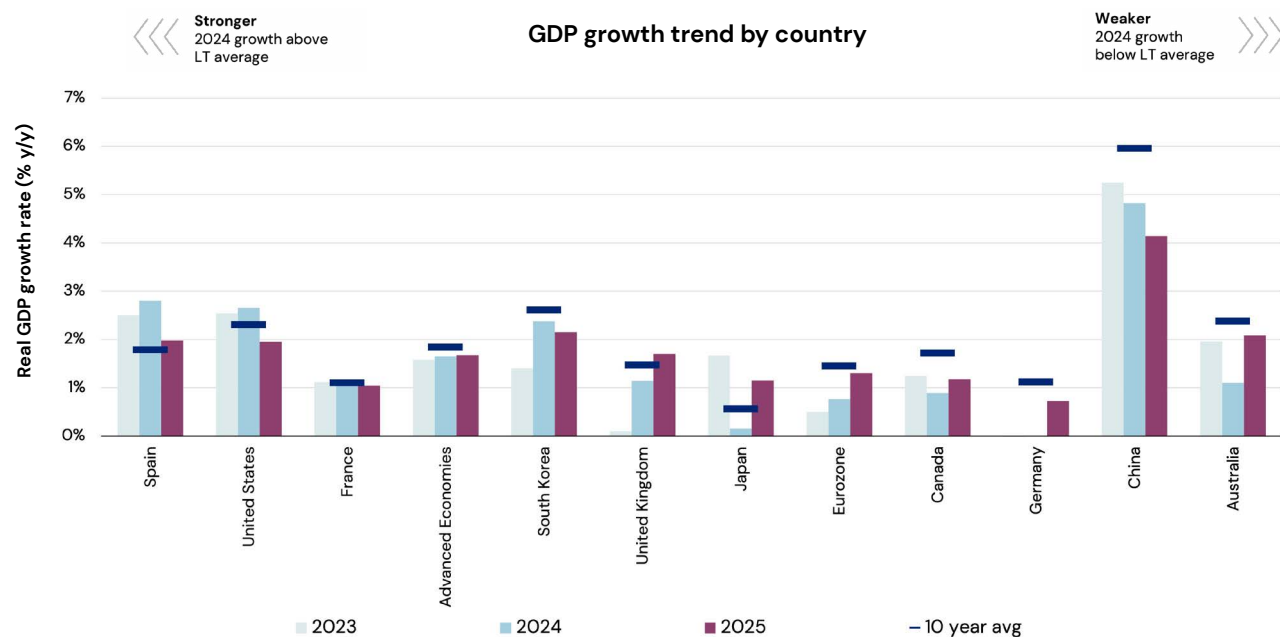


Note: 20-year historical long term average inflation rate is the average quarterly inflation rate from Q3 2004 to Q2 2024. 3-year average forecast is for 2025-27.

Source: Oxford Economics; latest monthly data from Australia Bureau of Statistics (Australia), Eurostat (Eurozone), Singapore Department of Statistics (Singapore), Statistical Bureau (Japan), Statistics Korea (South Korea), National Bureau of Statistics (China), Statistics Canada (Canada), Office for National Statistics (UK), US Bureau of Labor Statistics (US). Latest data available as of October 31, 2024.

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 GDP growth divergences evident across countries



Aggregations based on Oxford Economics country classifications.

Source: Oxford Economics forecast, most recent as of October 31, 2024.

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.

LaSalle's Portfolio Balance framework

The Portfolio Balance framework starts by measuring the historical sensitivity of sectors' and markets' performance to economic growth and to interest rates to use as a guide to how they might perform in the future.¹⁰ Plotting these factors in two-dimensional space and segmenting them into quadrants (see exhibit G-e) yields insights. However, it should be noted that placing sector/geography combinations in the quadrant categories is an exercise based on analysis of historical data, which are variable in quality and number of observations; these categorizations should be considered directional rather than predictive of go-forward performance.

"Rate-led" assets are those with a high sensitivity to interest rates, but a low sensitivity to growth. These tend to be relatively low-yielding, long-let property types. Based on our analysis of historical performance, sectors with very low absolute yields, such as industrial and multi-family in Japan, and German residential likely belong to this category. Rate-led assets are, by definition, likely to benefit when rates fall, even when they do so because economies weaken. In other words, they may to some degree exhibit a "bad news is good news" effect. They could be expected to outperform other assets in an environment in which rates fall quickly in response to a faltering economy.

"Growth-led" assets are those with the reverse characteristics — they are relatively less sensitive to interest rates, but exhibit a high sensitivity to the economy. These tend to be sectors with especially demand-sensitive, shorter-duration cash flows.

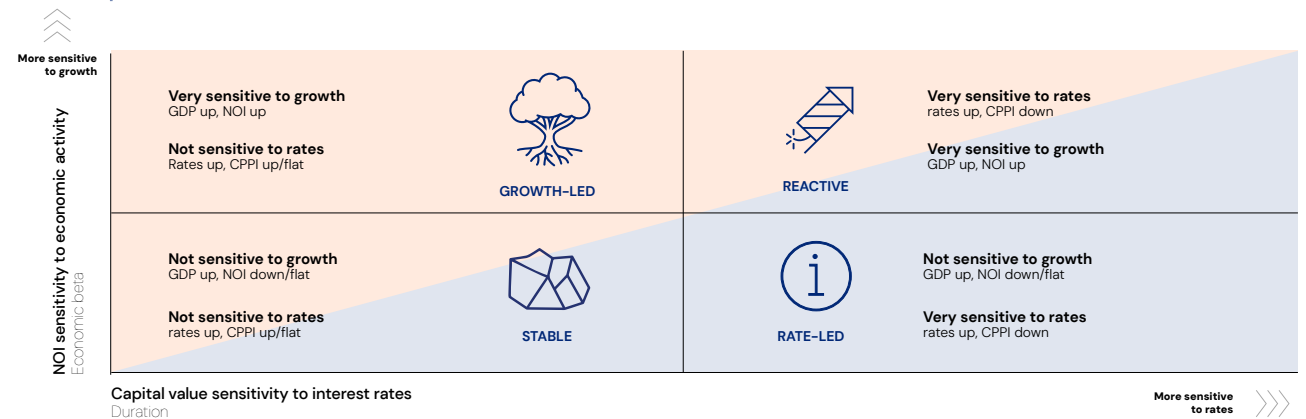
According to our analysis, US industrial markets in coastal or sunbelt markets, some office markets in Central Europe and US hotels likely belong to this category. Growth-led assets should on net react negatively to bad economic news — "bad news is bad news." If economic growth really takes off, even if accompanied by higher rates, these sectors could outperform.

"Reactive" assets are those with a high sensitivity to both interest rates and the economy. Our analysis suggests that German office markets, some industrial markets along Australia's eastern seaboard, and Japanese office markets could be placed in this category. Assets in this category can be expected to perform well under the benign conditions of a soft landing, but may be contributors of volatility if the environment is less benign.

"Stable" assets are those with a low sensitivity to both interest rates and economic growth. These assets, while relatively rare, may be considered contributors of stability and resilience to the portfolio across a wide range of macro conditions. Such assets may include, based on our analysis, some US niche sectors like manufactured housing and self-storage, and prime European high street retail.

How can an investor use this framework in investment strategy? We advocate for building diversified, long-horizon direct real portfolios with an awareness of assets' expected sensitivities to rates and growth, alongside other considerations, especially fair value. It may also be possible to use the framework to place bets on specific economic scenarios, such as views on the impact of the US election, though we would caution that macroeconomic outcomes are difficult to forecast. Either way, investors should have a sense of how their portfolios may perform under different economic scenarios.

G-e Portfolio Balance framework



Source: LaSalle Research and Strategy.

10. Methodological note: Duration is the sensitivity of capital values to changes in the interest rate. We measured the % change in CPPI consistent with a 1%pt movement in 10-year bonds. The figures are then normalized as z-scores. A value of 1 means that the point is +1 standard deviations larger than the mean, -1 implies a figure is 1 standard deviation below the mean. Beta is the sensitivity of Market NOI to changes in the output gap. We estimated the % change in MNOI consistent with a 1%pt movement in the national output gap. The figures are normalized as z-scores. A value of 1 means that the point is +1 standard deviations larger than the mean, -1 implies a figure is 1 standard deviation below the mean. Data sources used for this analysis are Green Street, Oxford Economics, LGS PortWatch, and Bloomberg.

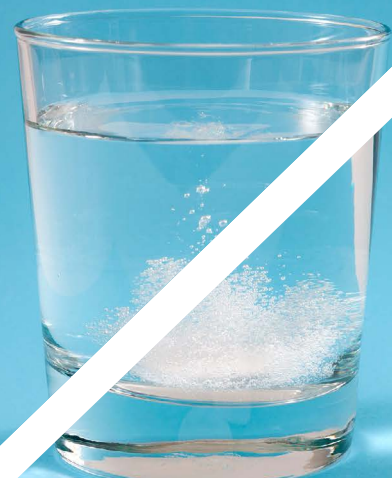


US election implications

Every four years, our annual release of the *ISA Outlook* comes shortly after a US presidential election. This time, the full sweep by Republicans of the presidency, Senate and House of Representatives was a surprise compared to our base case expectation of divided government. We do not view this outcome as dramatically changing the picture

for real estate, but we do see a marginal shift toward potentially higher growth, higher inflation and higher interest rates compared to the prior base case. For a deeper look at our views on the election result, see our recent *ISA Briefing, "The Red Sweep and real estate"*.





THE CAPITAL STACK HANGOVER

Clear-headed investors have an advantage

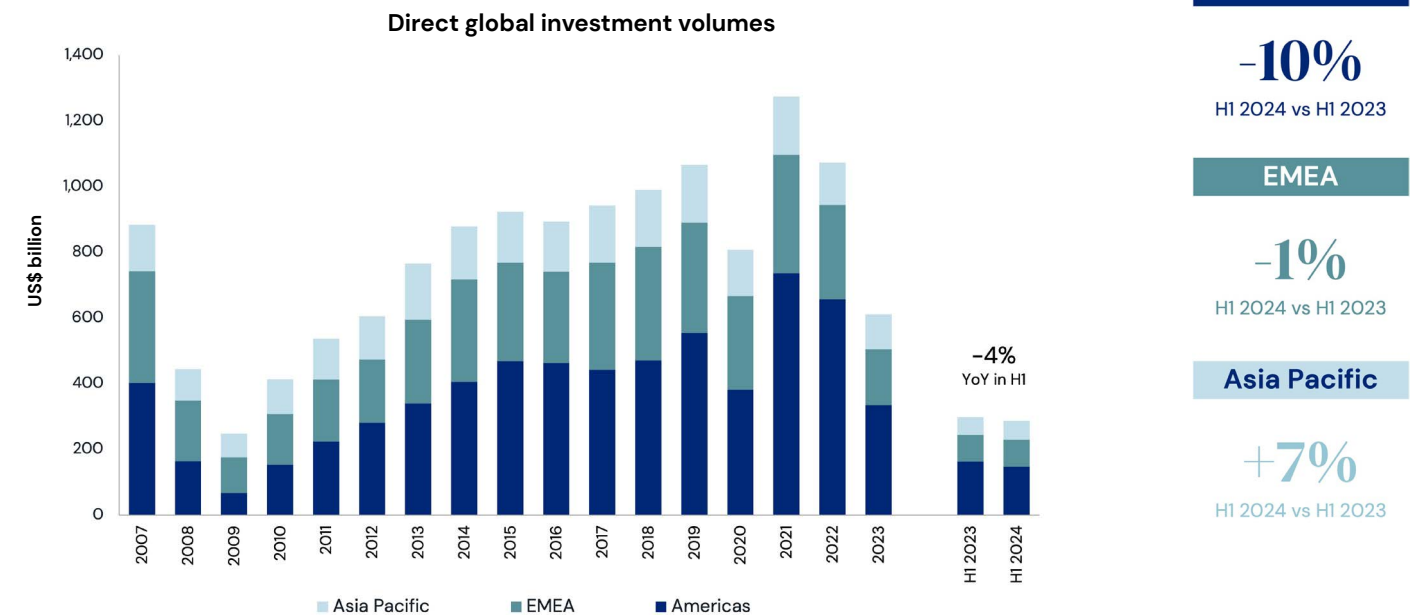
Although the dawn of a new interest rate cycle should help bring a new day for real estate capital markets, a hangover from before interest rates spiked will likely take some time to cure. Attractive investment opportunities are likely to spring from the resolution of legacy capital stack issues, both in the form of providing higher-returning rescue capital, as well as by opening attractive entry points to long-term holds and supplying capital to less flush segments of the market.

Capital market healing

Greater clarity on the direction of interest rates should help drive healing of the capital markets. Hesitant sellers may gain confidence as pricing starts to come in closer to their expectations. In-process transactions will be more likely to close, facilitated by a gradual easing in the cost of capital during due diligence periods. Reduced uncertainty should also help some lenders re-enter the market as confidence in their existing loan book increases. Segments of the debt markets which had been essentially shut down, such as Commercial Mortgage-Backed Securities (CMBS) in the US, have already come back to life. In several segments of the global real estate lending markets, interest margins came down this year, and debt is becoming accretive again in more markets and sectors.

G-f

Investment activity remains relatively soft



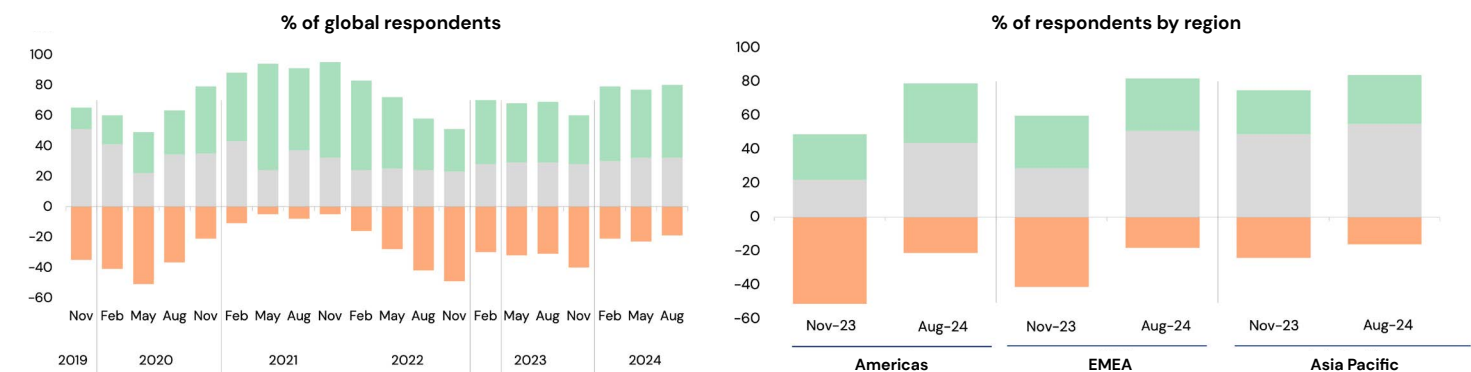
G-g

Gradual and modest improvement in investment sentiment

Global real estate sentiment

Over the next six months, do you think market conditions will:

↑ Improve → Stay ↓ Worsen



IN HINDSIGHT



"Widespread distress is unlikely – especially outside of US offices – but there will be ongoing market stress to solve the capital stack equation." (ISA Outlook 2024 p. 16)

Distress has continued to surface given the pressure of higher rates on capital structures and less debt availability, but it is by no means widespread and remains concentrated in select pockets of the market. Likewise, there are investment opportunities to remedy capital stack issues, but not on a widespread basis.

Global transaction volumes, a backward-looking indicator of market activity, do not yet show much evidence of a recovery (see exhibit G-f). However, more forward-looking indicators are starting to turn positive. For example, surveys of global real estate sentiment are now gradually improving following a long period of negativity (see exhibit G-g). Our colleagues at JLL, who have a large proprietary data set on bidding trends, are seeing more bidders in transactions and a narrowing bid-ask spread.¹¹

Healing broken capital structures

Although improving capital markets would help relieve the pressure on stressed capital structures, some will remain challenged. Loans are expiring

at a time when both cyclical and structural factors make the availability of new debt relatively constrained,¹² and lower valuations limit the proceeds of replacement financing. In some cases, difficulties have been deferred through “extend and pretend” tactics, but this cannot be sustained indefinitely. As mentioned, we do not expect rates to fall sharply, meaning that falling rates alone are unlikely to be sufficient to bail out many legacy deals.

Issues with distressed capital structures are not new; in last year’s *ISA Outlook*, we discussed how the basic math of higher interest rates was creating a need to “solve the capital stack equation.”¹³ Luckily, distress remains limited outside of the weakest segments of the office market and situations of over-leverage. It is difficult to objectively measure

the quantum of distress, but tracking of newly distressed assets¹⁴ by MSCI suggests that global levels of stress are higher than they have been for some time, but remain far below the levels seen in the GFC (see exhibit G-h).

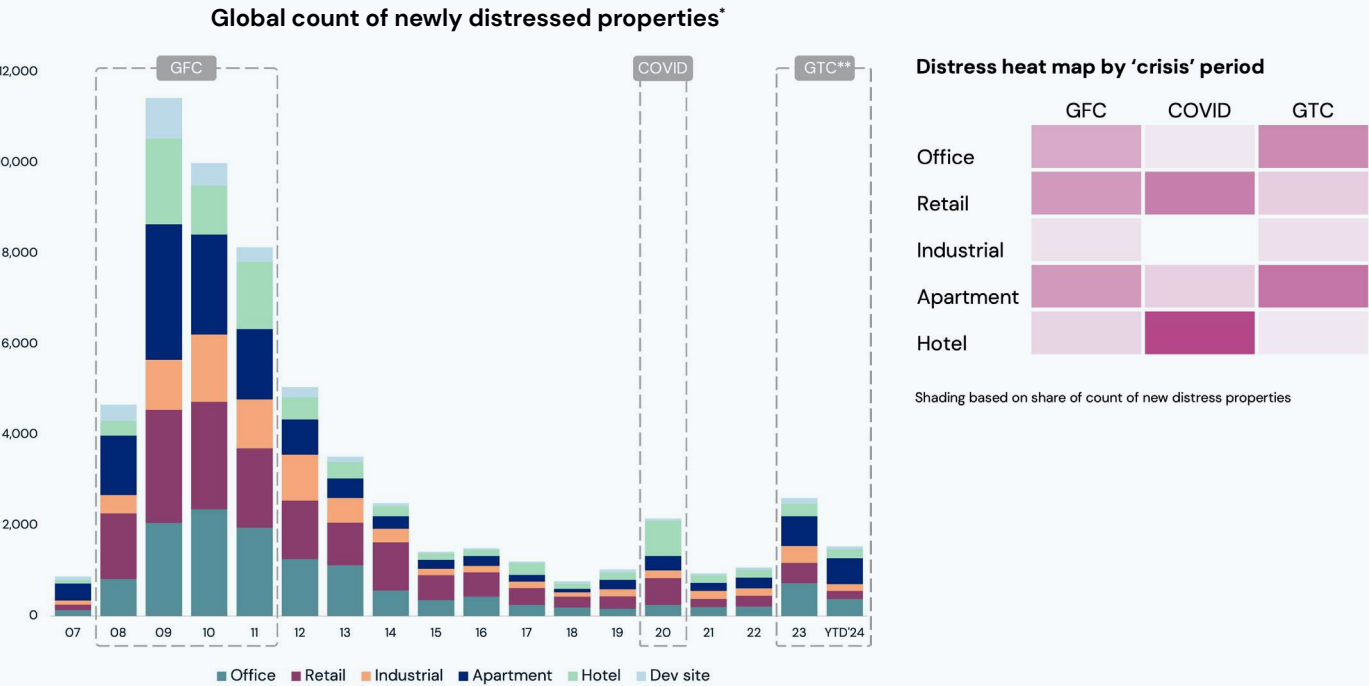
The breakout of distress by sector is telling. Distress in the GFC was broadly distributed; during the height of the COVID-19 pandemic it was concentrated in sectors dependent on travel and in-person interaction, such as hotels and retail, remaining nearly non-existent in industrial. In the current period, office and apartments account for the largest shares of newly distressed assets. The office challenges are widely known (see discussion below), but the apartment observation may seem counterintuitive. The distress in residential mostly reflects instances of over-leveraged deals and softer net operating income (NOI) in the US, where conditions have cooled substantially, and Germany, where regulation has limited the ability to pass inflation through to rents.

Given such an environment of largely contained challenges, we do not see a blanket opportunity to capitalize on distress at scale or by following an easily replicable transaction template. However, we anticipate a range of situation-specific opportunities for creative, structured solutions to provide rescue capital. Examples of the types of opportunities we are tracking include:

- Using **mezzanine and preferred structures** to solve capital stack issues and potentially achieve attractive risk-adjusted returns, without taking on full equity risk.

- **Buying high-LTV loans at a discount** in situations with limited downside risk to the value of the underlying collateral and potential for upside. For example, these may exist in the multi-family sector for assets financed in 2021, a time of peak pricing, and currently seeing a near-term slowdown in fundamentals.
- Capitalizing on the **stresses faced by developers**. Developers that borrowed to build when interest rates were much lower face loan maturities and lower-than-anticipated exit values. In some cases, the opportunity takes the form of providing rescue capital with elements of downside protection; in other cases, it involves opportunistically getting access to land at a discount.
- Selecting assets with **operational low-hanging fruit**, such as when capital structure issues are constraining the availability of capital needed to complete essential asset management initiatives like leasing and refurbishments. Injecting capital in such situations can make a stark difference for an asset’s medium-term cash generation prospects.
- Identifying opportunities where issues above the asset level put pressure on an owner to be a **motivated seller**. Examples include fund life expirations or business strategy decisions to exit certain markets. This is especially relevant in sectors with very limited buying interest, such as US office.

G-h | Distress levels tick up but far below GFC



*Indicates direct knowledge of property-level distress. Known through announcements of bankruptcy, default and court administration as well as significant publicly reported issues—such as significant tenant distress or liquidation—that would exemplify property-level distress. This also includes CMBS loans transferred to a special servicer.

Note: Excludes senior housing and care. YTD through Q3. **GTC = Great Tightening Cycle.

Source: MSCI, October 2024.

An active approach

All the coffee in the world cannot cure some hangovers; sometimes you just have to get active and exercise. The same is true about actively managing the real estate impacted by capital stack hangovers. A couple of years of focus on issues like curing debt covenant breaches and rolling over expiring loans may have directly or indirectly distracted some owners from asset-level execution. We have noticed a strong overlap between assets with challenged capital structures and those in need of a renewed asset-level approach. Thoughtful capital structure solutions should be paired with an active approach to asset management.

14. MSCI tracks distress through announcements of bankruptcy, default and court administration as well as significant publicly reported issues (such as significant tenant distress or liquidation) that would exemplify property-level distress. This also includes CMBS loans transferred to a special servicer.



THE BREAKFAST MENU

Making sense of complex investment options

For an investor starting the morning and wondering what real estate exposures to add to their plate, today's investment menu can feel especially daunting. First, it is a long menu, because the growth of specialty sectors and sub-sectors have multiplied the number of viable investable sectors. Second, it is a complex menu, because current property market conditions mean that dimensions beyond basic sector and market lines are likely to be key determinants of performance. Finally, the menu options have recently changed, as relative sector performance has been especially dynamic of late.

Fundamentals and the menu

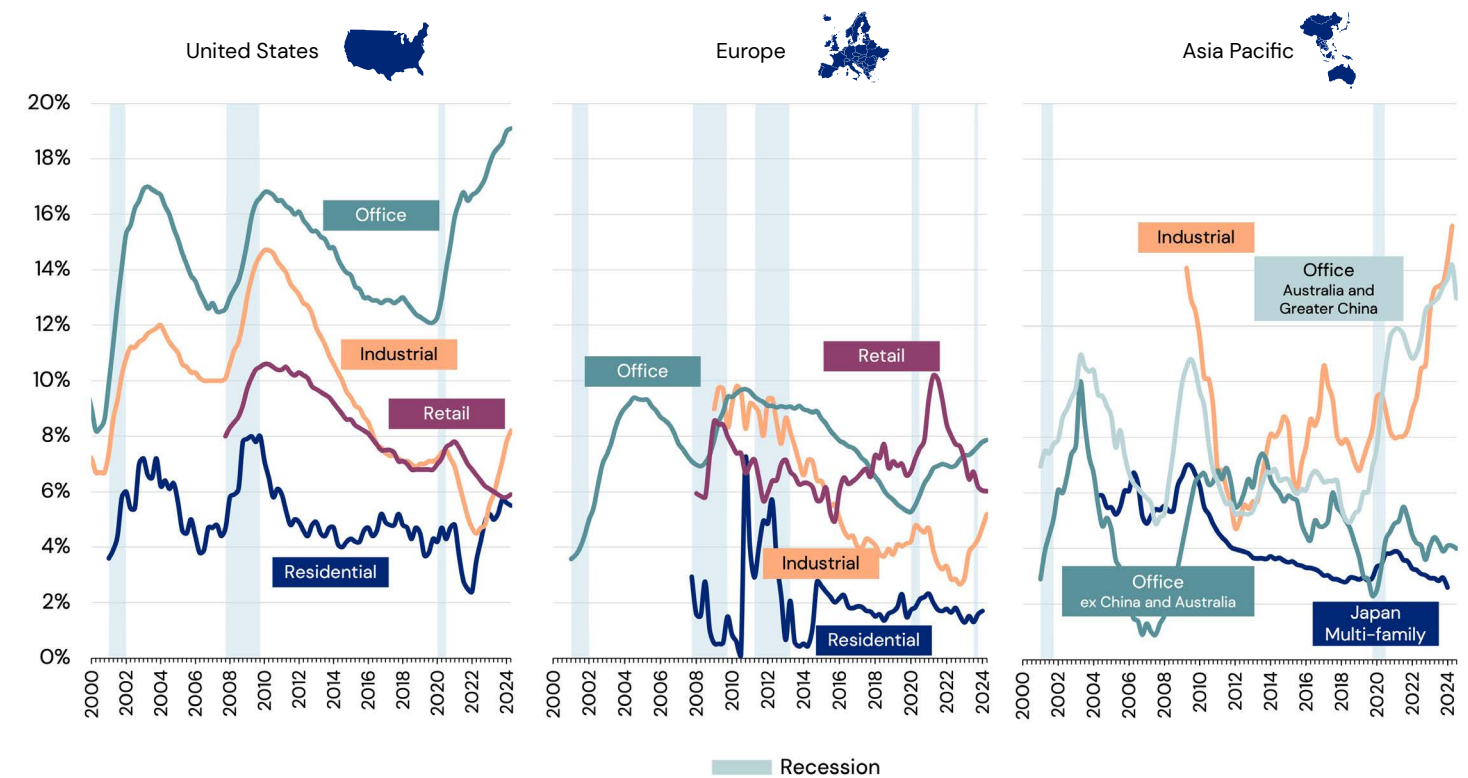
The investment option set is shaped by occupational fundamentals. A look at global vacancy rates by sector and region shows that there is a diverse mix of property fundamentals globally, with strength in many sectors, but also pockets of considerable weakness (see exhibit G-i). We have highlighted the occupational market themes behind these data in recent ISA publications.¹⁵ For the most part, our prior observations continue to apply, and they contribute to the diversity and complexity of the investment option set:

- **Wide quality chasms** Differences in assets' outlooks continue to be heavily influenced by intra-sector factors like building quality, sustainability credentials, amenity offering, micro-location accessibility and submarket vibrancy. This

¹⁵. Relevant publications are cited in the footnotes on the following page.

G-i | Property markets show general strength, pockets of weakness

Vacancy/availability rates by sector and region



*Availability shown for industrial and retail; * Retail includes community and neighborhood centers.

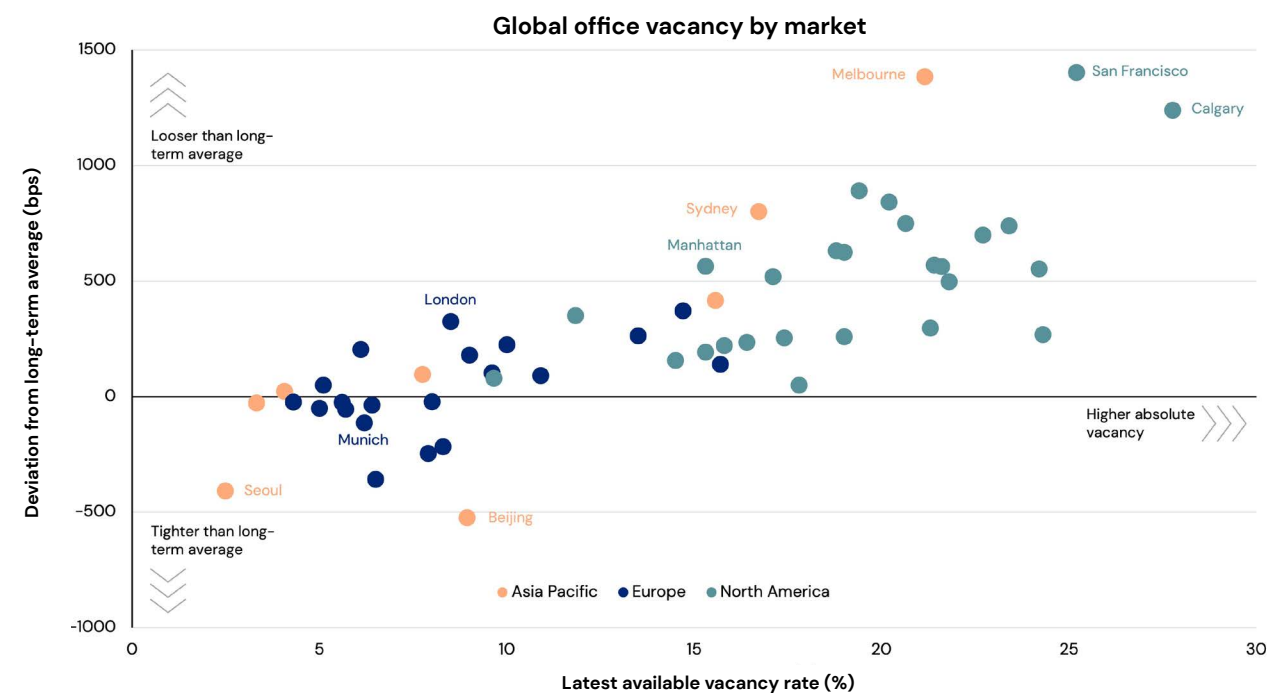
Source: The Association for Real Estate Securitization (Japan multi-family), as of Q1 2024; Ichigo Real Estate Services (Japan logistics), as of Q2 2024; JLL REIS (all other markets except Japan logistics and multi-family), as of Q3 2024. CBRE-EA (Sum of Markets), CoStar, RealPage Analytics, LaSalle, JLL (Europe office and industrial), MSCI (Europe residential and retail). Data through Q2 2024 (US and Europe) and Q3 2024 (APAC). 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.

◀ IN HINDSIGHT

✓ *"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." (ISA Outlook 2024 p. 16)*

✓ *"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." (ISA Outlook 2024 p. 18)*

Changes in construction costs and higher rates have radically altered the math of development viability, while capital for new construction remains constrained. These factors have indeed put downward pressure on new supply. Although completions may have only recently hit a peak in many markets, new groundbreakings have fallen precipitously, contributing to our conviction that it is best to "ride the wave" of new supply.



The current vacancy rate refers to the latest available data point for each location and these dates range between Q1 and Q3 of 2024. 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, company reports and LaSalle Research and Strategy as of October 2024.

is not a new trend. In our *ISA Outlook 2023* we noted that divides within sectors were becoming at least as important as those between them.¹⁶ A year later, we dug deeper into this theme by seeking to parse where opportunities are — and where they are not — amidst the so-called “bifurcation” of real estate sectors.¹⁷ What has changed more recently is that repricing has resulted in more cases of attractive entry points across these divides, adding a range of investment options back to the menu.

- **A wave of supply** In mid-2024, we highlighted that a significant, but likely temporary “wave of supply” was causing a bout of “renewed cyclicity” in some key segments of the real estate market, especially US apartments and logistics globally.¹⁸ This wave of new development, which we identified early on as the once-boiling hot winning sectors “coming off the boil,”¹⁹ is already ending as new starts have started to nosedive. This is not a universal reality, with some sectors, such as European residential and Australian

industrial, remaining largely unaffected by new supply. But the severity of supply’s effect on short-term market conditions in some markets is great enough that it creates underwriting challenges for today’s prospective buyers. Selecting impacted markets off the menu requires taking a thoughtful medium- and long-term view on the recovery path.

- **“All over the map” office** As we highlighted in our recent *ISA Focus* report on the prospects for office market recovery,²⁰ the office sector faces widely varying circumstances globally, with conditions ranging from some of the strongest among global property sectors (e.g., Seoul office) to some of the weakest (many North American office markets; see exhibit G-j).

In that report, we argued that a range of forces are likely to contribute to an eventual rebalancing of currently oversupplied office markets, but that the main driver of rebalancing is likely to be an extended period of no or very low supply. This suggests that, while the office sector will eventually recover, it could take some time for conditions to strengthen.

None of this is fundamentally new. What has changed is that office pricing has by now adjusted substantially; transaction pricing is off around 50% since pre-COVID levels for US offices, and just over 30% for Europe.²¹ At the same time, demand for office space has largely stabilized or started to improve in most markets. A mix of the increasing prospect of a recovery (if muted) and lower prices are bringing more segments of the office market back closer to fair value. While far short of being the right time to issue a blanket “buy” call on offices, the viable option set is expanding to include offices again.

- **Rebalanced retail** The retail sector, having emerged from a roughly decade-long period of rebalancing, now stands out as a generally stable, and in many cases strong, performer. Retailer business models have adapted to the realities of operating alongside e-commerce, helping stabilize demand; meanwhile, minimal new supply and the demolition of failed properties helped reduce vacancy. Retail today faces neither the near-term structural realignment afflicting many office markets, nor the digestion of a wave of supply that is creating weakness in some apartment and logistics markets. While retail is back on the menu, a key challenge is that retail is not a monolith. Rather than a single uniform sector, it is really a constellation of sub-sectors²² with very different characteristics. Moreover, idiosyncratic asset and submarket dynamics, ranging from lease co-tenancy clauses to submarket void analysis, carry high relevance for retail. As such, value determinations in the retail sector must be highly granular in nature.

A structurally longer menu

The length and breadth of the menu is also growing in line with structural changes in how real estate portfolios are built.²³ Namely, the institutionalization of specialty sectors and sub-sectors is driving a **proliferation of investable sectors and sub-sectors**. We have framed this process with our Going Mainstream framework and argued that many of these sectors have achieved core or near-core status, reflecting the “changing definition of core.”²⁴ However, the sheer number of investable sectors and sub-sectors adds further complexity to the menu of investment options. Another key shift is awareness that is important to consider investment across the four quadrants of real estate. The experience of the recent tightening cycle reminded investors to seek value across both public-private and debt-equity lines.

Vaughan Mills
Vaughan, Ontario, Canada



16. See “Beyond the sector chasm – other factors gaining in importance” on pages 18–20 of LaSalle’s *ISA Outlook 2023*.

17. See “Beyond bifurcation – Making sense of the changing definition of quality and core” on pages 20–22 of LaSalle’s *ISA Outlook 2024*.

18. See “Renewed cyclicity – Ride the (supply) wave” on pages 4–5 of LaSalle’s *ISA Outlook 2024 Mid-Year Update*.

19. See “Coming off the boil – ‘Winning sectors’ decelerate, but remain relatively strong” on pages 17–19 of LaSalle’s *ISA Outlook 2024*.

20. See *ISA Focus: Rebalancing past and present — What past periods of occupier market dislocation tell us about the property outlook today*.

21. Based on estimates by LaSalle transaction teams and confirmed against readings from the Green Street Advisors Commercial Property Price Index (CPPI). The price adjustment for Asia-Pacific office is not cited here, because it would show a very wide dispersion, with meaningful declines in Australia and stability in markets like Japan.

22. The large variety of retail sub-sector nomenclature across markets belies not just the proliferation of retail sector terminology, but also highlights the design, layout and functional differences across retail in different markets. For example, US retail sub-sectors include neighborhood centers, community centers, power centers and regional malls. In Europe, the moniker “retail parks” has elements of some of those US typologies, but also has its own unique characteristics, and so does not translate directly.

23. For a deeper discussion of both of these, see “Why be sector smart?” and “Why be quadrant smart?” in our *ISA Portfolio View* report.

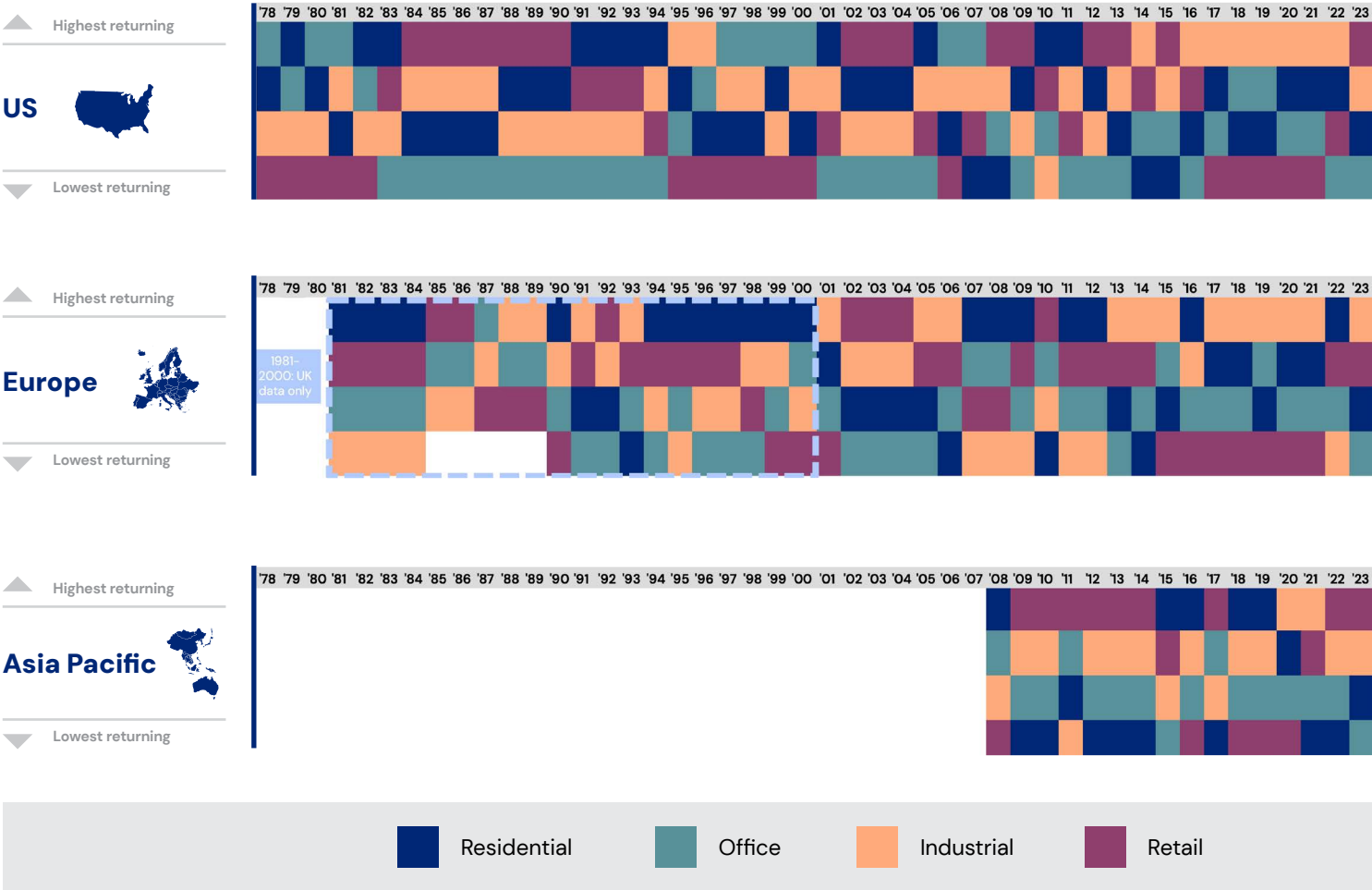
24. See our May 2024 article in PREA Quarterly, “The Changing Definition of Core Real Estate”.



Canal Crossing Logistics Center
Phoenix, Arizona, USA

G-k | Sector performance ranking dynamic over time

Private equity real estate index returns – ranking of major sectors



Sources: MSCI and NCREIF, data to 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.

“A long view of sector performance rankings for US, European and Asia-Pacific private real estate suggests that there are both extended periods of one sector dominating the performance rankings, as well as phases in which the sector in the leading spot rotated from year-to-year.”

Ordering “the usual” — Is sector performance persistent?

One approach to making a choice from a daunting menu is to just re-order something good you had last time. In recent years, ordering “the usual” in property investment has meant a heavy helping of logistics and residential. But after a long period of persistent performance leadership by those sectors — especially logistics — we may be entering a period of less consistent relative sector performance and a narrower range of dispersion among sectors.

A long view of sector performance rankings for US, European and Asia-Pacific private real estate²⁵ suggests that there are both extended periods of one sector dominating the performance rankings, as well as phases in which the sector in the leading spot rotated from year-to-year (see exhibit G-k). But the recent period has been unusual for the extended period of dominance by the same sectors. Logistics was the top returning sector in the US for seven years (ending with 2022), and in Europe, it was the top returning sector for nine of the past eleven years (residential was top in the other two).

Financial theory suggests that a single factor, like the strength of a specific real estate sector, is unlikely to remain incompletely priced such that it can outperform indefinitely. At some point, the market will catch up and the price will adjust.²⁶ Historically, periods of persistent sector outperformance have tended to reverse, and sometimes by a wide margin. For example, in the US the top sector over the late 1980s (retail) and late 1990s (office) flipped to being the worst performing sector. There have also been similar reversals of fortune in the other direction, with persistent underperformers quickly moving to be the top slot.

The supply wave impacting some residential and logistics markets, as well as moves in relative pricing, may be drivers of less persistent relative performance in the coming years. Indeed, retail was again the highest-returning sector in the US in 2023. With this context, we recommend investors be more flexible in considering a wider range of asset types; it may not be the right time to just re-order “the usual”!

25. Based on LaSalle analysis of data from NCREIF (US) and MSCI (Europe and Asia-Pacific).
26. The explanation for the cases of extended consecutive performance is probably that there is a momentum effect, relating to an inefficient spread of information in private markets and a potential impact from behavioral factors like consistency bias and loss aversion.

Use fair value analysis (FVA) as a guide

For the reasons discussed above, a multi-dimensional approach to building portfolios is essential in today's market. Determinations of attractive, fair and unattractive value do not fall neatly along the lines of broad groupings. Strategy-building today is not a matter of making big country-picking or sector-picking calls, but layering in a range of nuance. For example, sectors that are amongst the best and the worst performing occupier markets in the Asia-Pacific region are in the same country: Australian office and Australian logistics.

Our approach to identifying attractive value across a large and complex menu of options is fair value analysis (FVA). At its core, FVA involves a comparison of expected returns (market return forecasts) and required returns (returns that appropriately compensate for that risk in today's markets). Assets for which the expected return meets the required return are said to be fairly priced; for those with an expected return in excess of the required are especially attractive (see exhibit G-I for an example of how FVA can be visualized). We believe that utilizing fair value models meaningfully improves investment decision-making.²⁷

Building a balanced breakfast

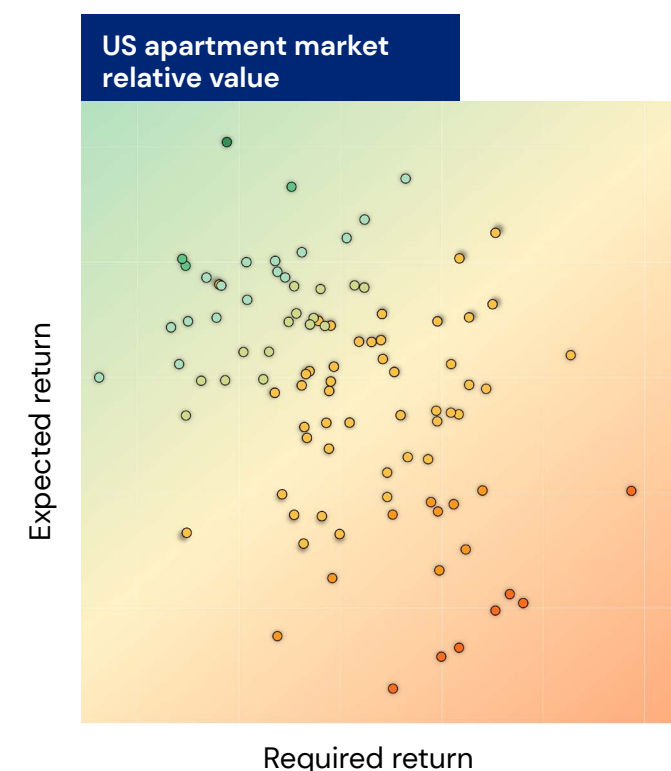
Given a large and complex investment menu, and the specific challenges of identifying value in today's environment, FVA is key to selecting between the many options. But a model's outputs are of no use if pools of capital are too constrained by limitations on sector and geography to be deployed dynamically as relative value assessments change. Specialist funds can work well for narrow investment windows, but for open-end funds and other long-horizon strategies, the ability to shift strategy as fair value assessments change is critical. In our view, we are entering an environment where this flexibility will be especially important.

The benefits of diversification are well documented across the financial economics literature, by other managers and by LaSalle, especially in our [ISA Portfolio View](#) report. But a diversified strategy does not necessarily imply an index-tracking approach that delivers mostly market beta. Instead, we favor diversification across a curated list of high-conviction strategies with strong risk-adjusted return prospects. This can offer the best of both worlds: the benefits of diversification along with overweight exposures to the markets and sectors with the best prospects. In our final section below, we explore our specific investment recommendations for 2025.



G-I

Sample of FVA outputs



IN HINDSIGHT

✓ *"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." (ISA Outlook 2024 p. 22)*

The importance of getting right the capital expenditure required to keep an asset competitive has only been highlighted by the continued segmentation of the market by quality. For example, the value declines in some office markets are only partly a story about work from home, but also about pricing in the appropriate amount of ongoing capex.

²⁷ Based on LaSalle's investment experience. While the specific outputs of our FVAs are proprietary, they do help shape our investment recommendations throughout the ISA Outlook.

Source: LaSalle Investment Management. Data and forecast most recent as of November 12, 2024.



THE
EARLY BIRD

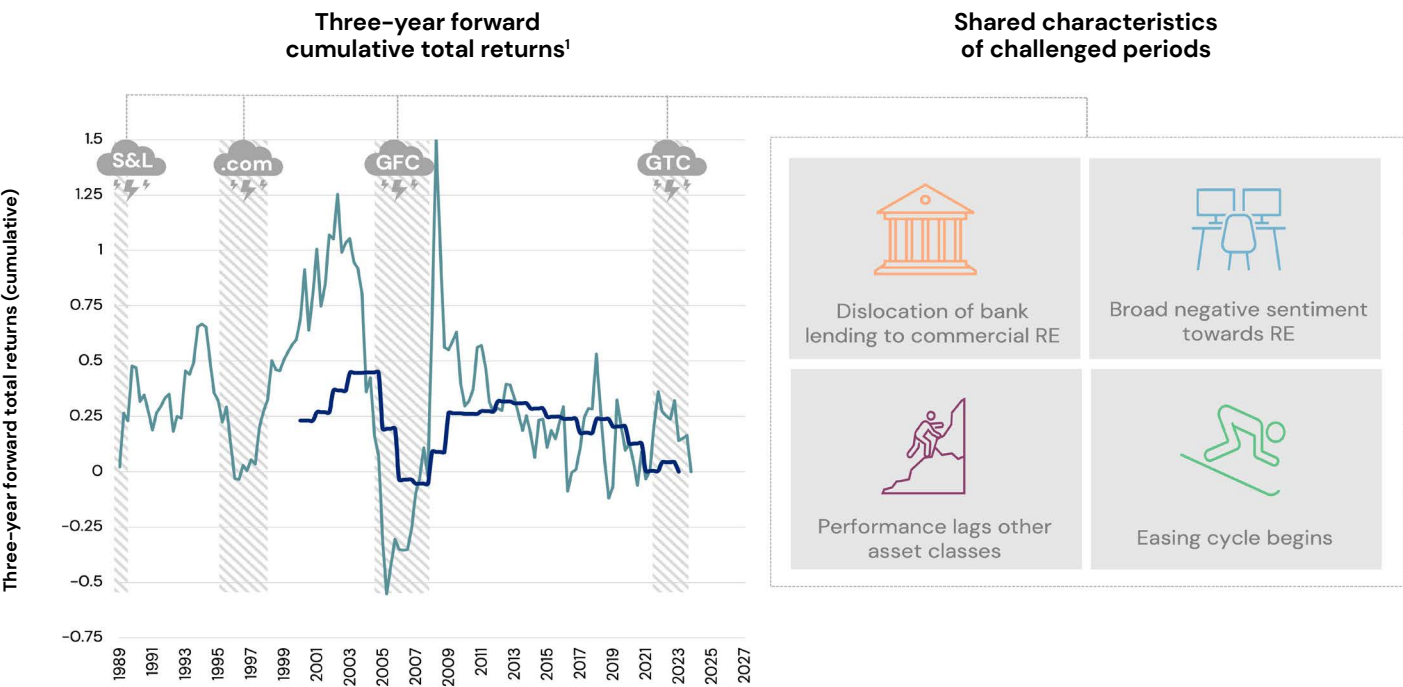
The best market entry
points tend to be
early in the cycle

The expression “the early bird catches the worm” can be traced to the early 17th century; it first appeared in book of English proverbs by William Camden. Real estate return data do not go back nearly that far, but an analysis of its much shorter history suggests a similar observation can be made about real estate cycles: The early (in the cycle) investor is likely to see attractive investment performance.

In a recent report,²⁸ we examined prior periods of dislocation, specifically the savings and loan (S&L) crisis, the dot-com bust, the GFC, and the recent global tightening cycle (GTC). Looking across these periods, we identified four conditions that have tended to be in place just as the real estate cycle was transitioning away from being challenged: dislocation of bank lending to real estate, broad-based negative sentiment around the asset class, extended under-performance of real estate versus other asset classes, and a pivot to an easing or reset of financial conditions. When all these conditions were in place, contemporaneous conditions were weak but thereafter returns for both listed and non-listed real estate have tended to turn positive (see exhibit G-m). Given that the recent environment can be characterized by these four factors, the outlook for returns today does seem bright, even if the pace and depth of interest rate cuts is likely to be less this time.

28. See our ISA Briefing, “A new ‘golden era’ for REITs and real estate?”

G-m | Strongest periods of performance tend to be preceded by disruption

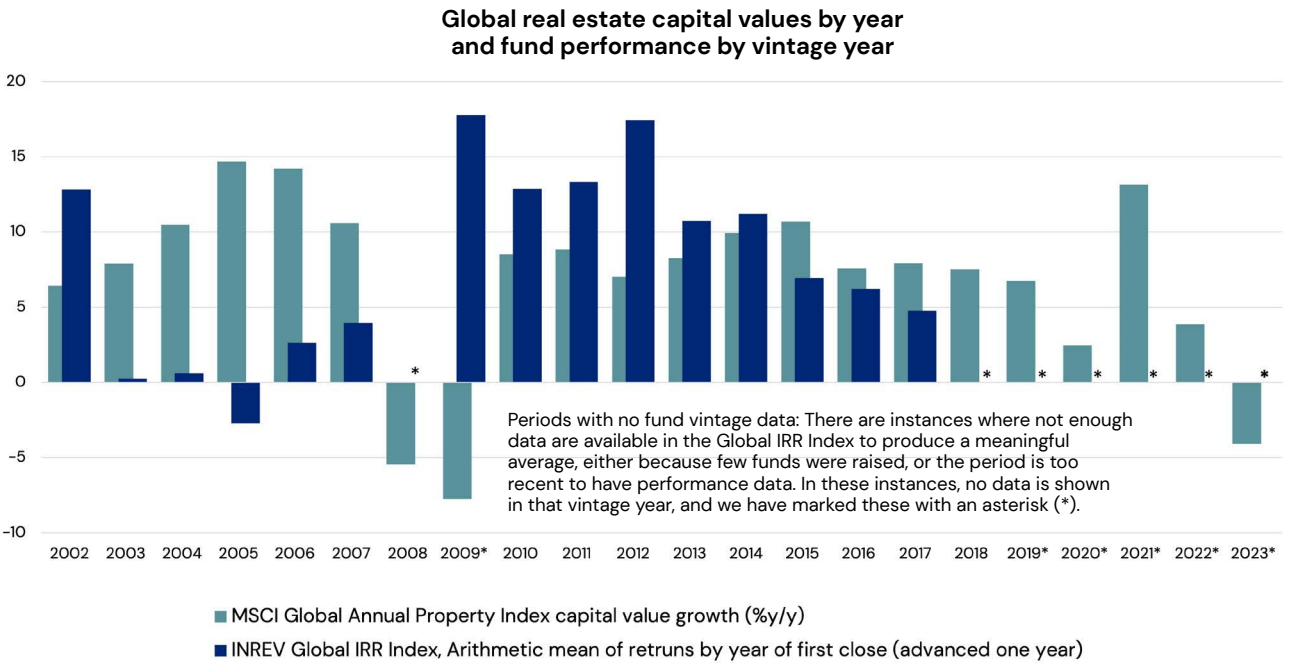


Source: LaSalle, S&P Developed REITs Index, MSCI Global Annual Property Index, Returns are cumulative and in USD. Three-year forward rolling total returns as at the end of each quarter.

1. For the period of December 31, 2021 through September 30, 2024, returns end on September 30, 2024, and do not reflect a full 3-year cumulative return.

S&L: Savings and Loan Crisis; .com: dot-com bubble; GFC: Global Financial Crisis; GTC: Global Tightening Cycle.

G-n | Best performing funds are those launched early in the cycle



The INREV Global IRR Index provides an arithmetic mean of the performance of the cohort of funds for a given vintage. They define vintage based on the date of the first close of the fund. Typically, funds will subsequent closes afterwards. For this reason, and the fact that it usually takes some time for a fund to deploy dry capital, we have advanced the fund returns by one year to better align with capital market conditions. 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.

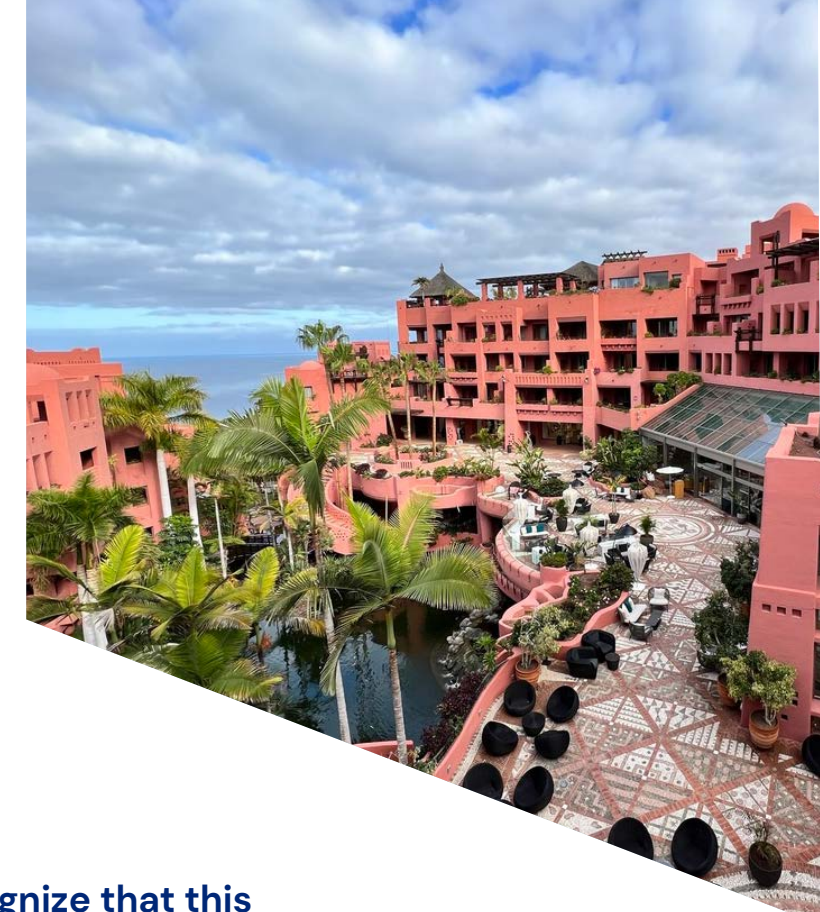
Sources: MSCI Global Annual Property Index and INREV Global IRR as of October 18, 2024.

“If the benefits of being the early bird are clear, there are still many choices to be made about where and how to look for the worm.”



The early bird thesis is also supported by an analysis of global fund performance data by vintage year. Our analysis shows that funds that had their first close in the early stages of a recovery substantially outperformed the broader market (see exhibit G-n). There is much nuance beneath this global finding, as well as various data challenges, but this observation appears to hold across global markets.

If the benefits of being the early bird are clear, there are still many choices to be made about where and how to look for the worm. Each year, we summarize our investment recommendations for the coming year in a table in this report (see exhibit G-o). These recommendations are based on a combination of near-term cyclical patterns, long-term structural and secular changes, intelligence from our on-the-ground teams and the current conclusions from our fair value analyses.

The Ritz Carlton Tenerife, Abama
Tenerife, Spain

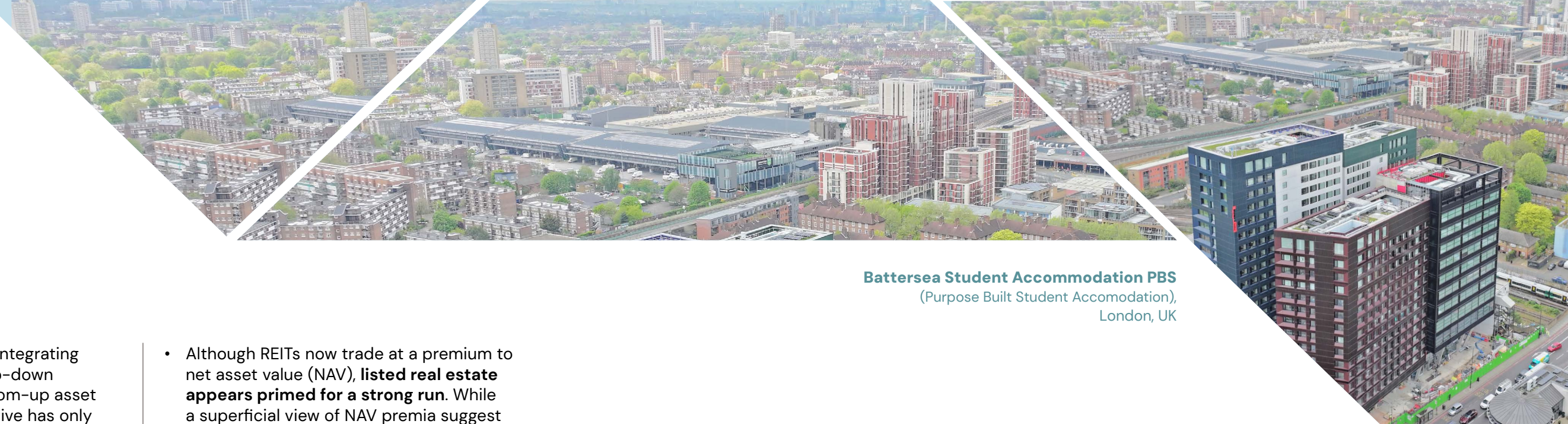


G-o | LaSalle’s recommendations for 2025

| | North America | Europe | Asia Pacific |
|--|---|--|---|
|  Strategic recommendations | Logistics Healthy markets with strong demand and growth potential Markets targeted by our suite of proprietary tools (e.g., Paths of Distribution) | | |
| | Industrial outdoor storage | | |
| | Residential / living | | |
| | Apartments in low-supply submarkets Apartment development Canada apartments | Student accommodation “Flex living” concepts | Multi-family rental in Japan Co-living in Australia |
| | Retail | | |
| | Trade area-dominant retail with income growth potential | Outlet centers Select shop parades and mixed-use shopping center transformation | Non-discretionary retail in Japan |
| | Office and other | | |
| | Medical office Self-storage | London and Paris office refurbishment Tech-enabled hotel repositioning | Seoul office Highly selective office repositioning in Japan Non-luxury hotel in Japan |
| | Debt, debt-like positions and/or distressed equity | | |
| | Climate hardening and/or decarbonization | | |
| | Active, selective listed real estate | | |
|  Caution | Commodity office | Non-prime and peripheral office | China Some segments of office market in Australia |

Below we discuss some of the key recommendations for 2025. We recognize that this is a broad list, but that is reflective of the current favorable position we are in after the cycle bottom.

- The **long-term tailwinds for the logistics and residential/living sectors** remain intact, despite near-term issues. We retain high conviction that these will remain strong performers over the long run. However, a wave of supply continues to negatively impact near-term fundamentals in some markets. There is nothing new about being highly discerning in picking markets and submarkets, but doing so is especially important in today’s environment. We have built proprietary tools to help our teams select markets and submarkets from the many options.
- **Retail is back** on the investment menu in a big way in many markets. Solid fundamentals are in evidence across many of retail’s many incarnations across the globe following a nearly decade-long rebalancing. The wide variation in how retail functions requires discernment in each geography; a blanket approach to the sector is unlikely to work. Our specific calls under the retail umbrella include European outlet malls, US power centers (non-grocery open-air retail) and non-discretionary centers in Japan.
- The **investability of office is increasing**, even in hard-hit markets, owing to stabilizing occupational fortunes and re-based pricing. The road to fully rebalanced conditions is a long one, however, and extreme caution about assets falling on the weaker side of deep quality divides is warranted.
- We see a broadening opportunity in selectively **providing new capital to strong development projects**. The traditional mechanisms of developers’ funding all face challenges, including regulatory pressures on bank lending and issues with legacy projects. A confluence of factors is opening an opportunity to invest in development across strong property types like residential and logistics.
- **Debt strategies** remain an attractive way to invest in real estate. However, the case for debt is evolving with improvement in the capital markets environment. As all-in debt costs and unlevered yields come back closer to their historical relationships, the near-term pricing argument gives way to a focus on the attractive long-term risk-adjusted return proposition of debt investing. We also observe that structural changes underpin the growth potential of non-bank lenders.



Battersea Student Accommodation PBS
(Purpose Built Student Accommodation),
London, UK

- We continue to advocate for integrating **physical climate risk** into top-down investment strategy and bottom-up asset capex planning. This perspective has only been reinforced by the devastating impact of hurricanes Helene and Milton in the Southeastern US, several powerful typhoons in Asia and severe floods across Europe, most recently in Southern Spain.
- Addressing physical climate risk is different from investing in the **decarbonization of assets**. Although spiking rates have shifted the narrative away from sustainability in some geographies, decarbonization of the built environment remains a long-term consideration. Getting ahead — but not too far ahead — of market and regulatory changes while being cognizant of the differences between jurisdictions is key to generating strong returns and in identifying attractive brown-to-green plays.
- Although REITs now trade at a premium to net asset value (NAV), **listed real estate appears primed for a strong run**. While a superficial view of NAV premia suggest that REITs again look expensive relative to private real estate, a recent move to an NAV premium can also be interpreted as a strongly positive sign for REITs and real estate as a whole. Historically, it has been both a predictor that private real estate prices are positioned to rise, and a signal to REIT management that they face accretive growth opportunities which they can take advantage of over the next several years.²⁹
- The market continues to see a **changing definition of core real estate**. Core is evolving to include a range of specialty sectors and sub-sectors, and to be more embracing of shorter leased, more operational asset types. As we have for some time, we recommend that core investors incorporate a broader selection of sectors into their portfolios, while investors targeting higher returns look to manufacture “new core” stock through development, repositioning or aggregation. A global perspective can give an investor informational and operational advantages in parts of the world that are later in the process of adopting these changes.

The regional chapters of the ISA Outlook will explore our investment recommendations with greater granularity and detail.



29. According to analysis by Green Street Advisors, these factors mean that REITs tend to have a run of good performance lasting several years after REIT pricing flips into premium to NAV territory.

LOOKING AHEAD



- A new real estate cycle is dawning. But it is essential to avoid overconfidence and remain realistic about what the new day has in store. There are a range of risks on the horizon that require monitoring. In addition, investors should not expect a rapid decline in interest rates or for them to again reach ultra-low levels. Changes in policy enabled by the Republican sweep of the US presidency and Congress should be monitored for impacts, but the outcome generally reinforces our view that rates will not go back to ultra-low levels.
- We are consistent in pointing out that interest rates are extremely difficult to predict; the timing and magnitude of interest rate declines, as well as the eventual level at which they will settle, remain highly uncertain. The new cycle could be cut short in its morning hours if expectations of easing rates turn out to be false, or if interrupted by a shock. But as of the date of publication, we see a mostly bright picture.
- Capital markets are poised for a recovery as financial conditions ease, but it will not be enough to bail out some capital structures. Levels of distress remain far lower than during the GFC, but there are still opportunities to participate in the resolution of issues in stressed capital structures.
- The multi-year performance dominance of “sheds and beds” may be coming to an end in many markets. Logistics and residential still have attractive long-term fundamentals, but investors are advised to focus on diversified core strategies that are flexible and broad enough to adapt to a complex and evolving relative value landscape. A comprehensive look at value across a wide range of sectors and markets will be required to build a well-positioned real estate portfolio.
- **Be the early bird. History has shown that investing early in a cycle tends to lead to relatively strong performance.**

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