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FIVE QUESTIONS

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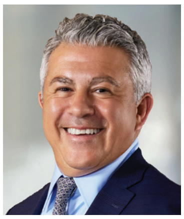
Real estate: The world's simplest, most complicated asset class



MARK GABBAY
global CEO

Significant growth in real estate investment managers' offerings has created unprecedented opportunities for investors to customize portfolios. But as Mark Gabbay, LaSalle global chief executive officer, explains, understanding relative value across sectors and geographies is crucial to long-term returns and outperformance.

What are the most significant changes you have seen happen in the private real estate industry over the past decade?

The industry has transformed dramatically. Continued allocation to the real estate asset class has driven explosive growth in capital formation, with Preqin data showing that real estate fund launches doubled from 400 funds in 2011 to 800 by 2024, expanding investors' options significantly.

Geographically, capital sources have continued to diversify. While North America historically dominated private equity fundraising, the past decade has witnessed substantial cross-border capital flows from Europe, the Middle East and APAC markets including Korea, Japan and Australia.

The investor base has also evolved. Traditional sources – pension funds, insurance, sovereign wealth funds and corporates – now share the stage with a growing wave of retail investors. Many investment managers have either started retail-oriented distribution or plan to develop investment products catering to that investor group.

The growing acceptance that real estate is fundamentally operational has also contributed to the complexity of investment opportunities in the market.

In that context, how has your firm's approach to capital formation evolved over that period?

We have recalibrated our approach to mirror our global footprint. We were always global, but now we are much more integrated. This integration enables the delivery of cohesive, customized solutions aligned with clients' strategies. LaSalle now offers both direct and indirect investing options, more diversified funds across equity and debt, and has strategically expanded into retail capital.

Global events have highlighted two critical dimensions of diversification: within real estate portfolios across property types, sectors and geographies; and using real estate itself as a strategic diversifier within broader investment portfolios.

Global diversification will become even more important in the coming years, considering that the trend toward a less integrated global economy is likely to lead to less correlated cycles. Trade relationships, regulatory environments and capital flows are evolving differently across regions. Our global perspective helps clients navigate these challenges while considering vintage effects and portfolio construction.

Debt strategies have become increasingly central to our business. Debt investing presents an attractive, long-term, risk-adjusted return proposition, and structural changes underpin significant growth potential for non-bank lenders.

Real estate plays a key role as a portfolio diversifier in today's market environment. By blending characteristics of both equity and fixed income, it provides a mix of stable cashflows and the potential to benefit from growth and the pass-through of inflation. While many assets correlate strongly during periods of market stress, real estate often follows different patterns, enhancing portfolio resilience.

Similarly, how has your firm's approach to dealmaking evolved?

We have developed a globally consistent framework centered on relative value. We use data to look at different opportunities and weigh them from a fair market value approach, across sectors and geographies.

This involves comparing expected returns against required returns – those that appropriately compensate for risk in today's markets. Assets where expected returns meet or exceed required returns represent attractive investment opportunities.

The current market presents a complex investment menu that can challenge investors. With so many options across sectors, geographies and risk profiles, we believe using fair value analysis is essential for building well-positioned portfolios. This is especially important as we see a broader range of attractive investment options today as compared to recent years, when logistics and residential dominated.

As an example of this, in North America our models have long indicated that office investments were likely to underperform given the market's under-appreciation for the level of capex required to keep them leased and competitive. This was long before the covid work-from-home shock and allowed us to allocate away from office before the sector's challenges became widely recognized. More recently, the huge repricing of office has started to move the relative value needle back in the direction of this sector.

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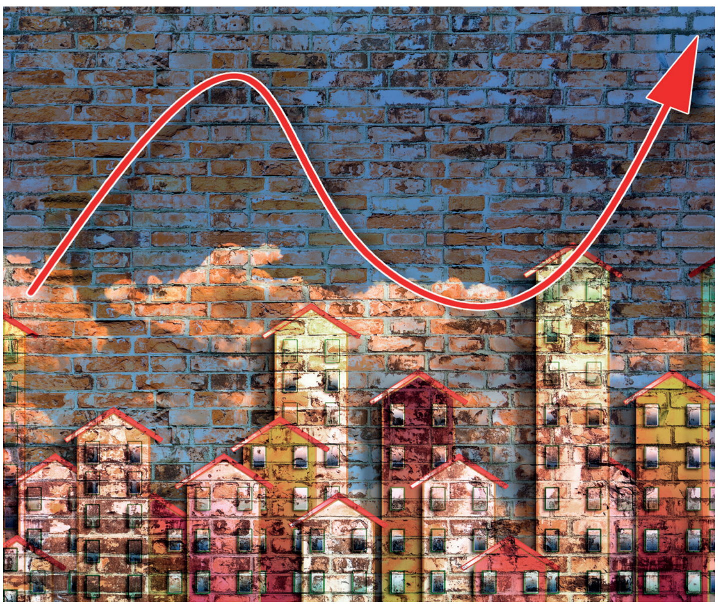

And how has the composition of your team changed?

As technology and data become table-stakes, we value a blend of experienced professionals who have seen many cycles, alongside talent that brings fresh perspectives. We have over 800 people on the ground in our target geographies, helping us see trends that may differ from published data.

We also prioritize an owner-investor mindset. You run your business differently when you are an owner versus an employee. If you have a room full of owners, consensus is not easy, and that is a good conversation to have. Long term, we believe that proprietary access to market data, such as through our parent company JLL, and analyzing alternative datasets will drive differentiated performance.

What are the biggest risks for the industry today, and which risks should be monitored closely for the future?

Real estate presents a paradox as the world's simplest and most complicated asset type. While fundamentally it is composed of bricks and mortar that everyone understands, that hides its complexity. A significant opportunity, and risk, lies in integrating technology and data into the investment process. The number of macro- and micro-level variables that we input into an investment decision continues to expand. Doing that right will be one key to success.

By far the largest risk, however, is the continued relative performance of the real estate asset class compared to other investment opportunities. Real estate needs to earn its keep in multi-asset portfolios, but the past couple of years have not been kind to it in that regard. We expect that to change.

Going forward, we see the potential for real estate to shine as it acts as a diversifier in a volatile world and faces potentially less demanding valuations than, say, large-cap equities. But it will be essential to be nimble and adapt to fast-changing relative value within our asset class. ■