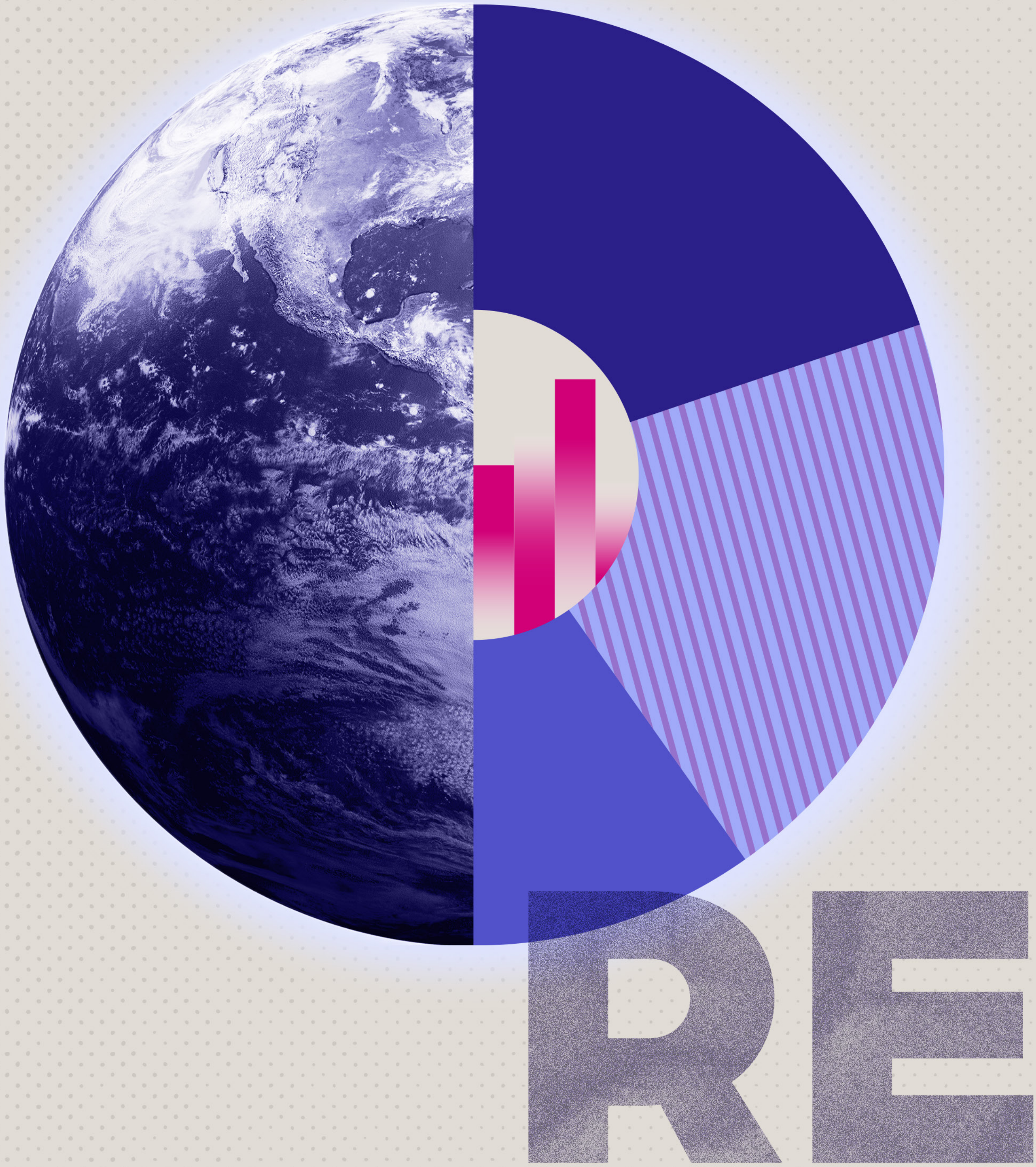
insights+

Preqin Global Report

Real Estate 2025



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Executive summary

The deal market shows early signs of recovery but fundraising continues to cool

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The prolonged global monetary-tightening cycle, spanning nearly three years, appears to be nearing its end as major economies announce interest rate cuts. Expectations of this shift have ignited activity in the real estate capital market, with total deal value across major markets showing growth in the first nine months of this year compared with the same period in 2023.

The APAC region stands out, with significant growth in real estate deal flow fueled by an increase in the number of transactions. However, according to Preqin data, global fundraising activity has remained subdued in 2024. The aggregate capital raised from the first quarter to the third has fallen behind the same period in 2023, with no closures of funds exceeding $10bn, as seen in the previous year. This may indicate investors are still in a wait-and-see mode.

Beside fundraising and deal activity, other trends have emerged to capture the attention of market participants. Real estate debt, influenced by increasing expected returns following years of rate hikes, has garnered interest from investors. The strategy warrants scrutiny within the context of rate normalization. Additionally, real estate investment trust (REIT) prices have experienced significant declines and demonstrated deep discounts over the net asset values of underlying properties, lagging their private counterparts in performance.

This disparity has sparked debate on whether REITs effectively reflect the performance of private real estate, given their shared asset class. Furthermore, with traditional sectors such as office space facing challenges from declining demand, interest in niche sectors has been growing – especially in purpose-built student accommodation.

In this Global Report, we offer an in-depth analysis of the market's pivotal trends and activities. By combining qualitative and quantitative perspectives, our aim is to provide a comprehensive understanding of investment dynamics and insights, to help you navigate upcoming opportunities and challenges within the real estate realm. With our forecast on the real estate market's trajectory and our latest investor survey results, we also hope to provide a glimpse of the future landscape of private real estate, particularly against the backdrop of a potential paradigm shift spurred by global rate reductions.

Key findings

1 Real estate fundraising continues to slow

The pace of real estate fundraising continues to slow. From the start of 2024 to the end of September, global fundraising has remained on a sluggish trajectory, with both the number of funds closed and the aggregate capital raised declining compared with the same period in 2023. Notably, there were no closures of funds exceeding $10bn, contributing to a substantial 22% contraction in global capital raised. With investors maintaining their interest in large and medium-sized funds, capital flowing into those funds has surged – the proportion of total capital raised by the top 11–50 largest funds expanding from 33% to 44%.

2 Residential drags on growth of North America deal-making

Across major regions, the total deal value in real estate for the first three quarters has increased year on year. However, North America – known for commanding a significant portion of global deal value – has experienced the slowest growth in aggregate deal value, at a modest 5%. During the first three quarters of 2024, the residential sector, which makes up the largest share of North America's deal value, has fallen by 3% vs. the same period the previous year. This decline marks the second consecutive year of reduced residential contributions to the total regional deal value.

3 Surge in LP direct investments in Europe

With direct investments by local LPs representing three of the top five largest deals in Europe during the first three quarters of 2024, total deal value for LP direct investments in the region jumped by 175% from the 2023 annual total. In expectation of upcoming rate cuts triggering a recovery in valuations, these substantial deals underscore investors' aspirations for future real estate potential. By directing capital into familiar regional markets, investors aim to secure a higher level of certainty for their investments.

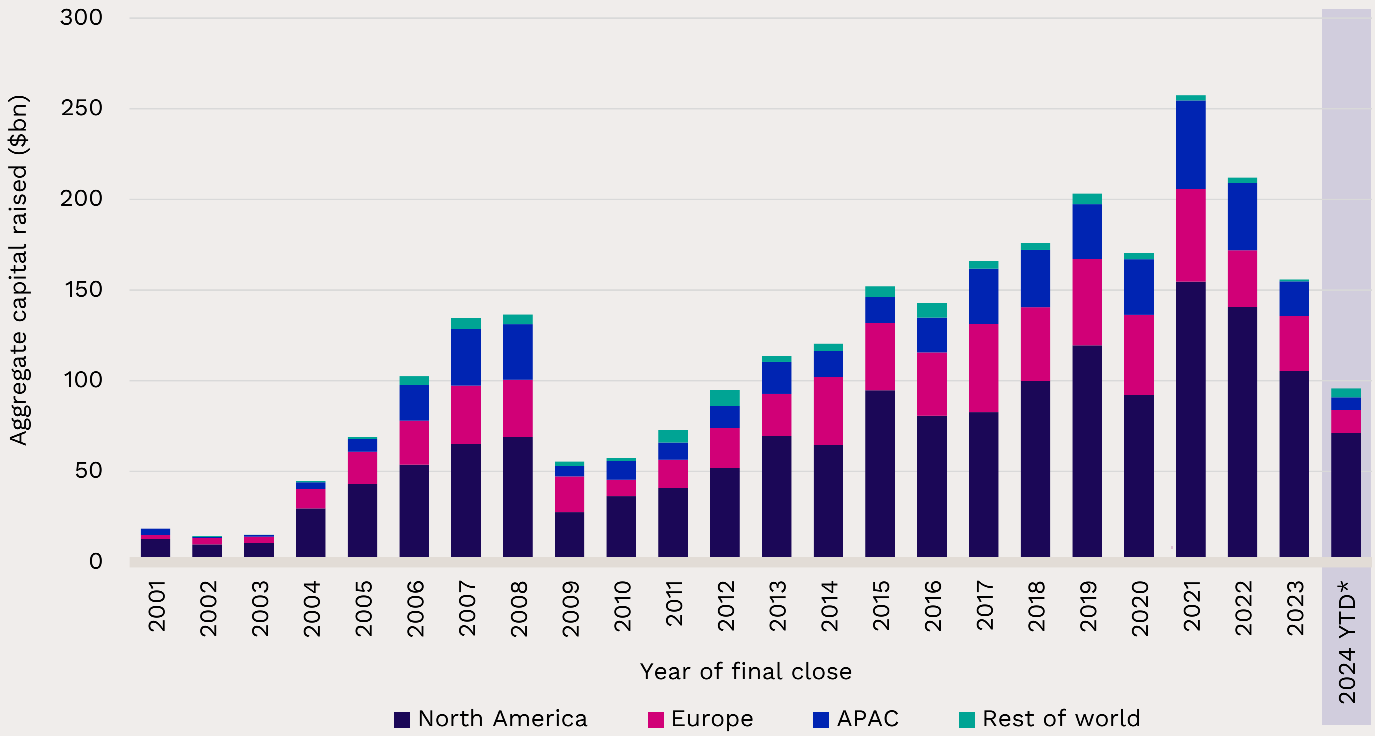
4 REIT index understates the performance of private real estate

An analysis comparing the performance of private real estate funds to the REIT total return index reveals a weak correlation between the two indices. From the data of Preqin and S&P Capital IQ, the average quarterly return difference of -3.8% highlights the shortcomings of the REIT index in accurately representing the long-term returns of its private counterparts. Furthermore, the significant gap in valuation between REIT traded prices and the underlying real estate NAV, particularly the deep discount since 2022, may render the REIT index unsuitable as a benchmark for a significant portion of investors.

Chart of the year

North America-focused funds dominate in 2024

Real estate aggregate capital raised by primary geographic focus



*YTD to end-Q3 2024

Source: Preqin Pro

> With fund commitments held back in 2024 and a resurgence in deal-making accelerating fund redemption, the year ahead could offer a more positive fundraising environment

The long-awaited normalization of interest rates began in 2024, albeit later than anticipated. The first rate cuts came in the European Union and UK, followed by the US, in the third quarter. With the real estate market showing no clear signs of a recovery earlier in the year, investors remained cautious about committing capital to new funds. This affected their full-year plans of new fund investment. As a result, aggregate capital raised for real estate in the first three quarters of 2024 was 22% lower than in the same period in 2023, with Europe- and APAC-focused funds experiencing sharper declines than North America-focused funds.

However, the resurgence in global deal-making in 2024 could accelerate fund exits. Potential real estate commitments in 2025 look more positive given that commitments to new funds during 2024 have been held back. At the same time, aggregate capital targeted by funds in the market has fallen, meaning less competition for fund closing. This could, in turn, facilitate real estate fundraising in 2025.

→ Global fundraising in review

Real estate fundraising moderated slightly in 2024, as total capital raised in the first nine months hit only 61% of last year's total, but core and value-added stand out in terms of year-on-year change

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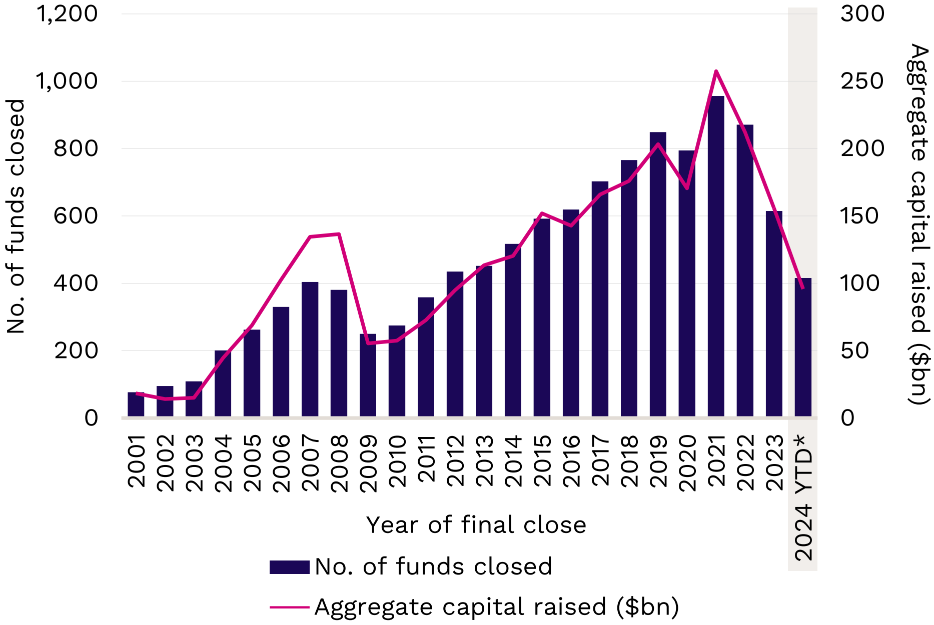
In the first three quarters of 2024, 416 real estate funds globally raised an aggregate $96bn (Fig. 1.1). Both figures are lower than what was recorded during the same period in 2023, down by 22% and 6% year-on-year, respectively.

Fig. 1.1: Real estate fundraising slows in 2024

Global private real estate fundraising



*YTD to end-Q3 2024

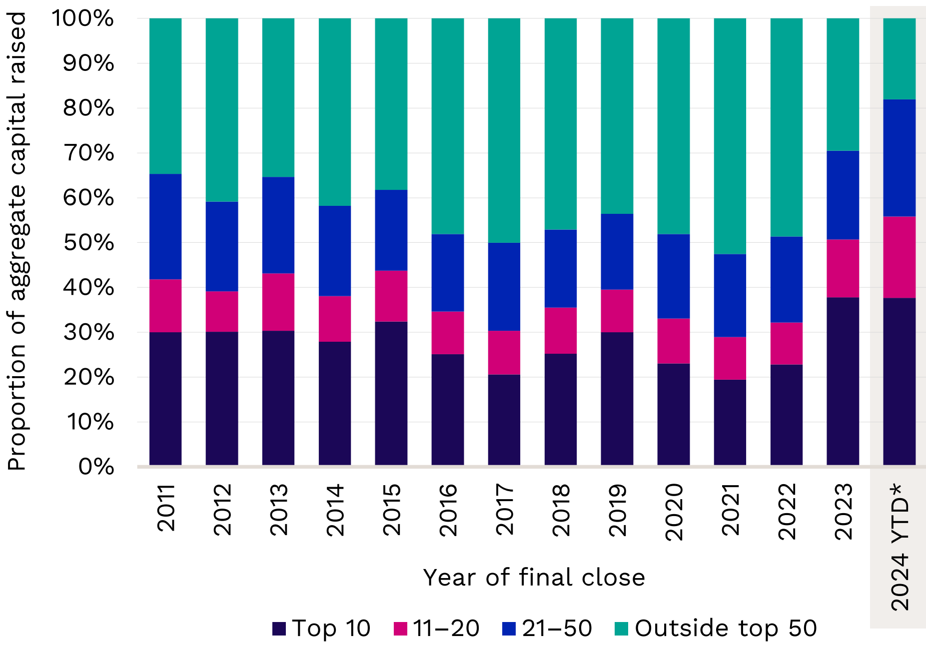
Source: Preqin Pro

While 2023 saw the closing of a mega real estate fund,[1] exceeding $30bn as per our data, the largest fund to close so far in 2024 is Goldman Sachs Asset Management's West Street Real Estate Credit Partners IV, at just $7bn.[2] Nevertheless, the trend of the largest-sized funds dominating fundraising, highlighted in Preqin's 2024 Global Report: Real Estate,[3] has continued. The top 10 real estate funds have maintained a 38% share of total capital raised from full-year 2023 to the third quarter of 2024 (Fig. 1.2). This shows investors overall still prefer larger managers who can carry out higher degrees of diversification within their portfolios to mitigate market risk. Additionally, the top 11–50 funds have grown their share of total capital raised. Notably, funds in the 21–50 range account for over a quarter of the total capital raised in 2024 so far, up from less than 20% in 2023. Similarly, funds in the 11–20 range account for 18% of the total capital raised, an increase of 5 percentage points on last year.

1 https://pro.preqin.com/funds/40507
2 https://pro.preqin.com/funds/151696
3 https://www.preqin.com/insights/global-reports/2024-real-estate

Fig. 1.2: Mid-sized funds gain share of real estate fundraising

Proportion of real estate aggregate capital raised by the largest funds closed



*YTD to end-Q3 2024

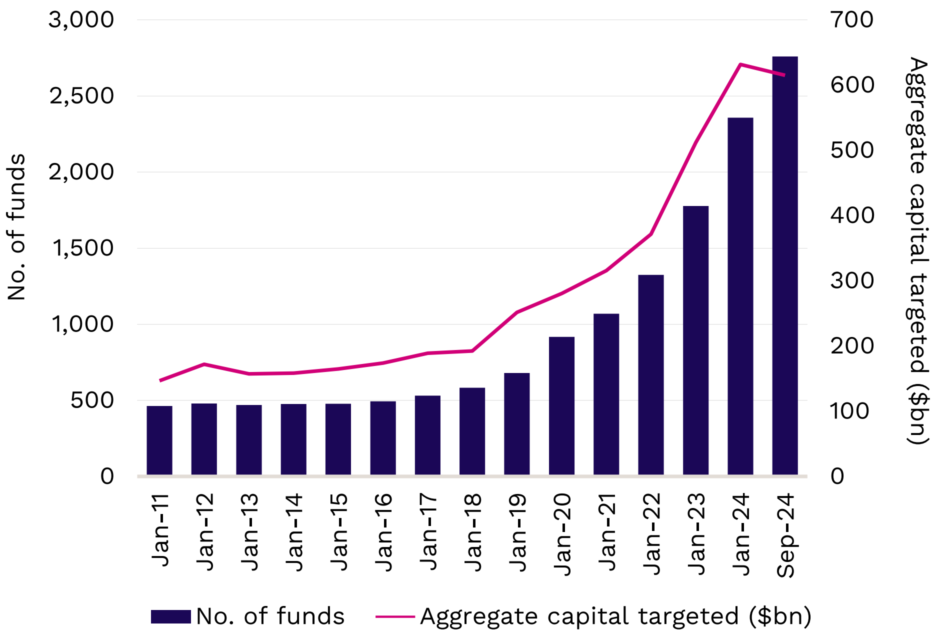
Source: Preqin Pro

Decline in capital targeted by funds in market is a promising indicator

If the current pace persists, 2024 is unlikely to see fundraising levels as high as last year's, although there are other indications of an improving landscape for funds closing. By September 2024, aggregate capital targeted by funds in market had decreased from \$632bn in January to \$615bn – the first decline since 2013 (Fig. 1.3). The average capital targeted by funds in market contracted by \$45mn, to \$223mn, indicating an increase in the portion of smaller-size funds in the market, according to Preqin data.

Fig. 1.3: Funds rein in capital-raising ambitions

Private real estate funds in market

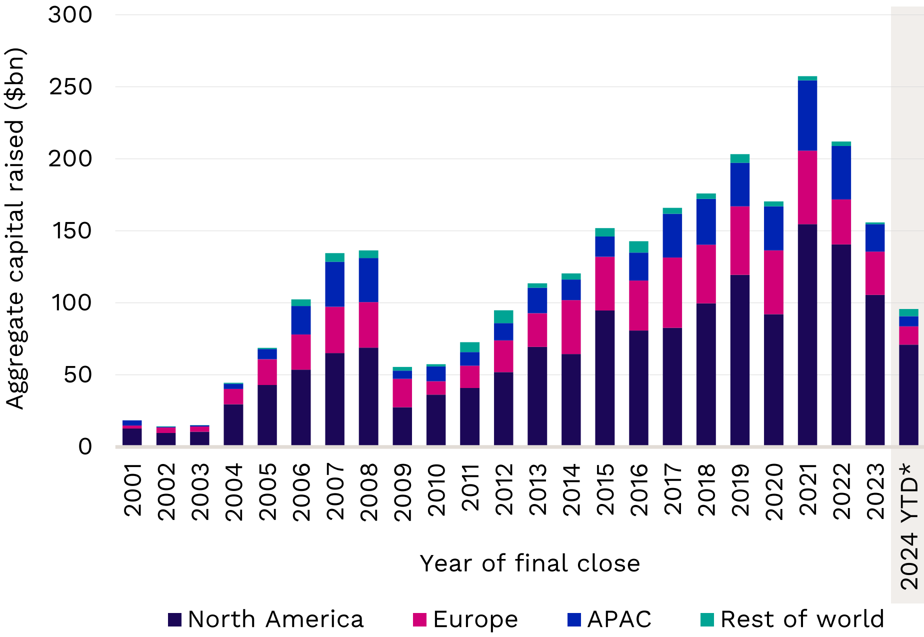


Source: Preqin Pro

In terms of region, aggregate capital raised by North America-focused funds in the first nine months of 2024 was down 14% from the same period last year, but still more resilient than Europe- and APAC-focused funds (Fig. 1.4). With fundraising by Europe- and APAC-focused funds down by 46% and 55%, respectively, from the first three quarters of 2023, North America is poised to claim a larger share of global fundraising year on year for a fourth consecutive year. As of September 2024, North America-focused vehicles account for 74%, up from 68% in 2023.

Fig. 1.4: North America-focused fundraising grows share again

Real estate aggregate capital raised by primary geographic focus



*YTD to end-Q3 2024

Source: Preqin Pro

Core was only strategy to raise more capital in 2024

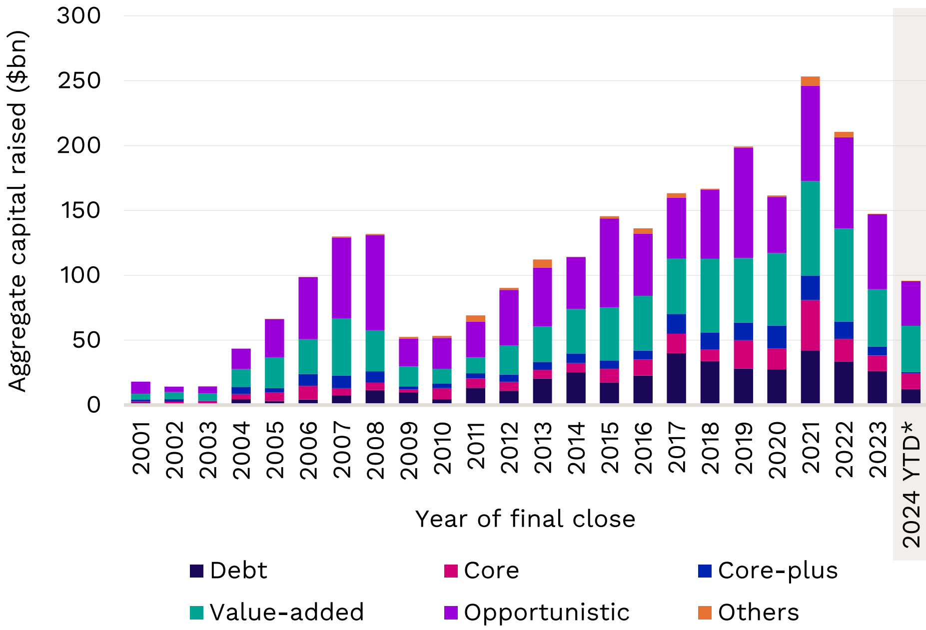
Core stands out as the only real estate strategy to raise more capital so far in 2024 than in the whole of 2023 (Fig. 1.5). In 2023, opportunistic led fundraising, securing 43% ($52bn) in the first three quarters of the year. However, value-added has demonstrated strong resilience and overtaken opportunistic in 2024, accounting for 37% ($36bn).

The analysis in our Real Estate Q3 2024 update indicates that as key real estate markets implement rate cuts, the valuations of existing properties are expected to improve.[4] Consequently, strategies such as core and value-added, which emphasize buy-and-hold and adding value to properties, will likely see greater recovery in performance and regain investors' attention.

4 https://preqin.com/insights/research/quarterly-updates/q3-2024-real-estate

Fig. 1.5: Core real estate fundraising sees uptick in 2024

Real estate aggregate capital raised by strategy



*YTD to end-Q3 2024

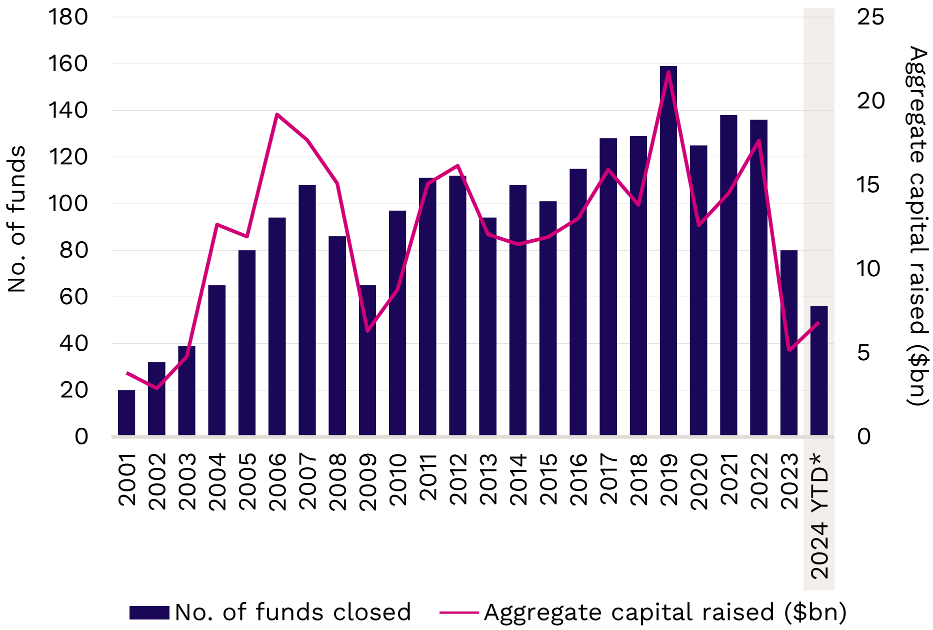
Source: Preqin Pro

First-time fundraising has rebounded this year from a low base

Beyond the shift in investors' strategy preferences, our data indicates a potential increase in risk appetite. Following a significant drop of over 70% in aggregate capital raised in 2023, first-time private real estate fundraising has rebounded this year from a low base. So far in 2024, aggregate capital raised by first-time funds has already surpassed 2023's full-year total by $1.7bn, to reach $6.8bn (Fig. 1.6).

Fig. 1.6: Investors revive interest in first-time funds

First-time private real estate fundraising



*YTD to end-Q3 2024

Source: Preqin Pro

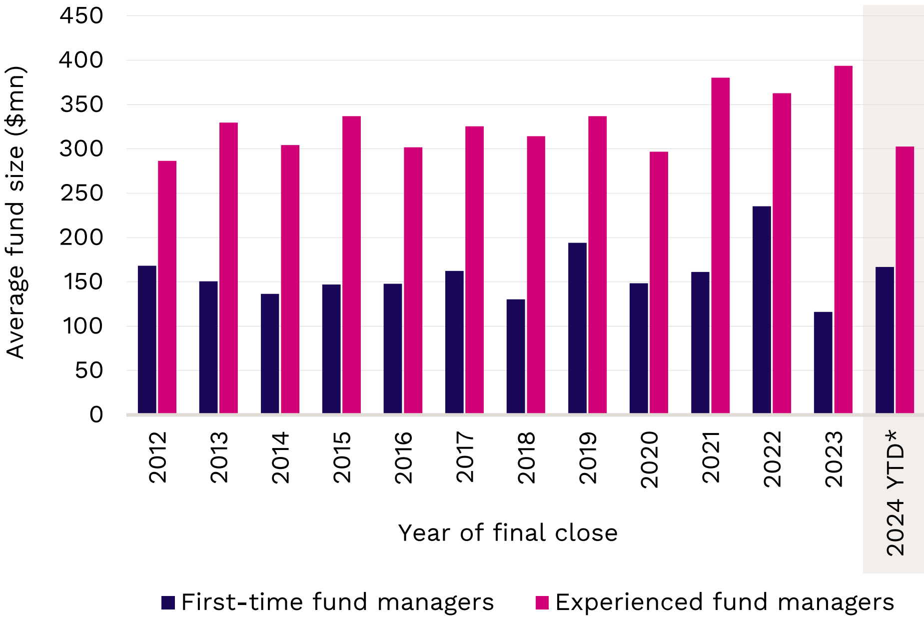
The ability of first-time managers to close larger funds has narrowed the difference between first-time and experienced funds when it comes to average size to $136mn in 2024 – the second-lowest level of the last 10 years (Fig. 1.7). Last year in Preqin's 2024 Global Report: Real Estate, we conducted an empirical analysis comparing the performance of first-time funds to established large-scale funds.[5] First-time funds demonstrated higher median internal rates of return, but also greater return variance. First-time funds were expected to keep getting attention from investors optimistic about real estate in the long term. Better fund terms than general funds to help attract the first group of investors could even bring more upside for investors.

The later-than-expected rate cuts may have delayed the pace of investors' deployment of new capital to funds. However, as we have shown, investors are altering their allocations in terms of strategy and risk exposure in anticipation of a new cycle in interest rates.

5 https://www.preqin.com/insights/global-reports/2024-real-estate

Fig. 1.7: First-time funds catch up in size

Average private real estate fund size: first-time vs. experienced fund managers



*YTD to end-Q3 2024

Source: Preqin Pro

→ North America deal-making in review

North America deal value improved slightly in 2024 as rate cut was delayed to the third quarter. Residential still had the highest deal value, although market share was shrinking due to supply surge

2

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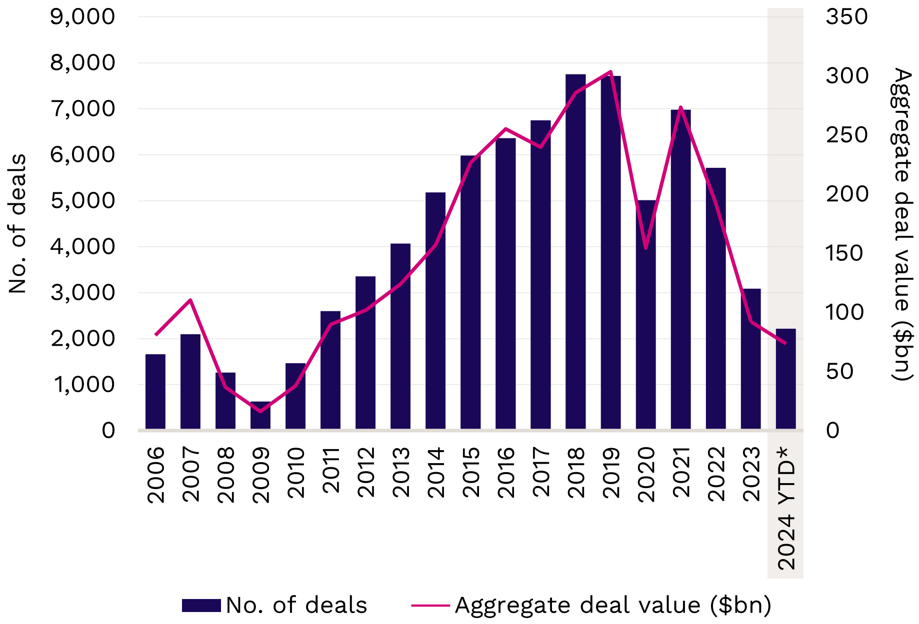
The total value of North America real estate deals had reached $74bn by the end of the third quarter of 2024, marking a 5% increase on the same period last year (Fig. 2.1). Given that the US accounted for over 98% of the deals closed (by number and value) in North America in 2024, according to Preqin data, this chapter focuses primarily on the US market.

Fig. 2.1: Deal value picked up slightly in Q1–Q3 2024

Number and value of North America real estate deals



*YTD to end-Q3 2024

Source: Preqin Pro

The US maintained high interest rates for an extended period in 2024. With cuts initially expected in the first quarter delayed to September, investment sentiment was down, and the real estate deals market experienced its weakest activity since the first quarter of 2023. As a result of this slow start, North America has observed a more modest rebound in deal sizes in 2024 than other major regions.

Onset of rate normalization has sparked a rebound in REIT prices

The first half of 2024 saw two property portfolio acquisitions via corporate buyout by Blackstone, amounting to a combined $14bn and equivalent to more than 18% of the total value of direct real estate deals in North America. One of the transactions, the privatization of AIR Communities[1] for $10bn, was completed through Blackstone Real Estate Partners X – closed in 2023 at a size of $30.4bn. As highlighted in our Real Estate Q2 2024 update, corporate acquisition, including privatization, allows fund managers to swiftly deploy substantial capital and access a diversified portfolio in terms of property numbers.[2] This approach is particularly advantageous for managers who have recently closed large-scale funds, as those funds can promptly deploy capital and start earning the management fee.

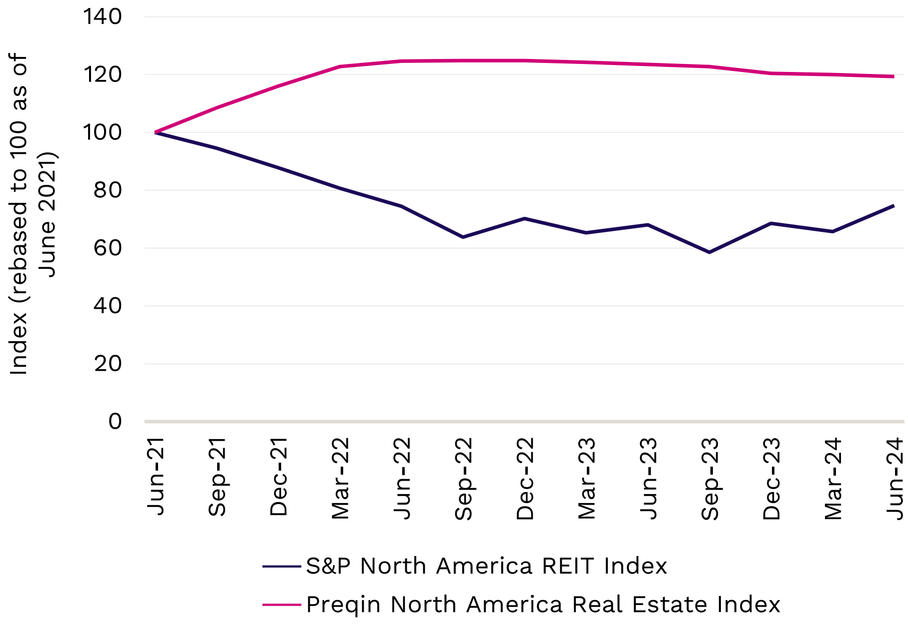
1 https://pro.preqin.com/deal/722737

2 https://www.preqin.com/insights/research/quarterly-updates/q2-2024-real-estate

In the three years to the second quarter of 2024, listed properties lagged private properties in terms of total return by 47.7%, making discounted listed properties an attractive option for private fund managers (Fig 2.2). However, the onset of rate normalization has sparked a rebound in real estate investment trust (REIT) prices. According to S&P Capital IQ, the S&P North America REIT Index rose by 8.5% in the two months to the end of September 2024. The median discount on underlying US REIT properties recovered from 15.5% to just 4.1%, significantly increasing the cost of REIT privatization.

Fig. 2.2: Public real estate far behind private

S&P North America REIT Index vs. Preqin North America Real Estate Index



Source: Preqin, S&P Capital IQ

Despite these trends, with the market anticipating fewer rate cuts toward the end of 2024, growth in REIT prices has stalled, at the time of writing. We anticipate that for this market cycle, 2024–2025 may be the final opportunity to pursue privatization for potential upside gains, given the pricing disparity between listed and private assets.

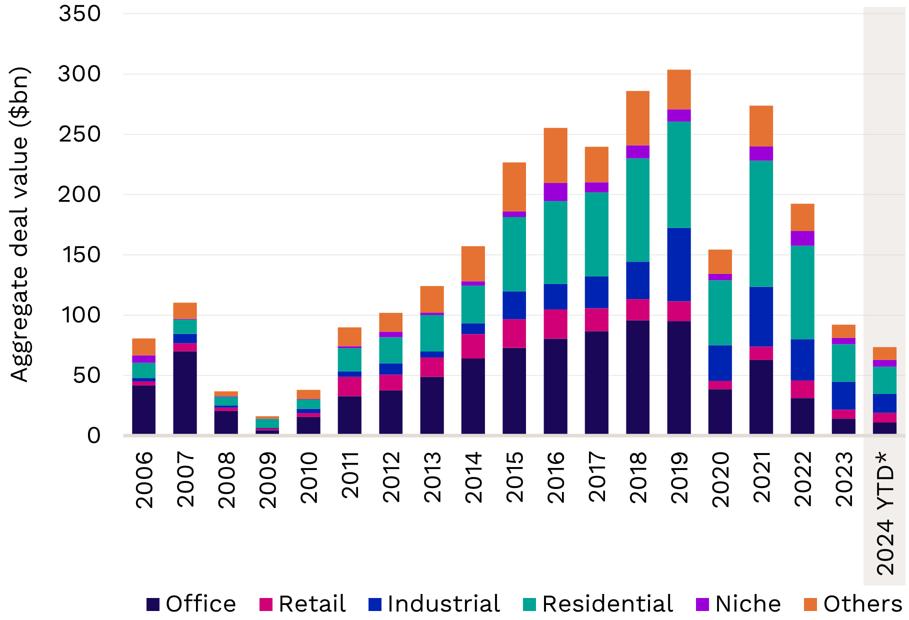
Residential remains largest sector for deals, but there is reason to be cautious
The residential sector, primarily focusing on multi-family assets, continues to hold the largest share of North America's total transaction value. The sector accounted for $23bn in the first nine months of 2024, falling behind the same timeframe in 2023 by around 3% (Fig. 2.3). A more significant drop is seen if residential deal activity is measured by number of deals closed: only 599 transactions closed in the first three quarters of 2024 – around a 10% reduction on the same period last year.

For a second consecutive year, residential deals have accounted for a decreasing share of North America's total deal value year on year, declining from 40% in 2022 to 31% up to the third quarter of 2024 (Fig. 2.4). There are reasons to be cautious about this sector as we move into 2025. The second quarter of 2022 marked the start of an upward trend in the completion of multi-family housing units (five units or more) (Fig. 2.5). The substantial influx of new supply surpassed demand levels, impacting both net absorption rates and rental growth pressures. According to Cushman & Wakefield data,[3]

3 https://cw-gbl-gws-prod.azureedge.net/-/media/cw/marketbeat-pdfs/2024/q3/us-reports/national/q3-2024-u-s-multifamily-marketbeat.pdf?rev=b9d4e21ac7f0462a80f87ebcb167a722&hash=0849021784B8F7D5667546E3F20B13A3

Fig. 2.3: Residential still leads real estate market

North America real estate deal value by sector



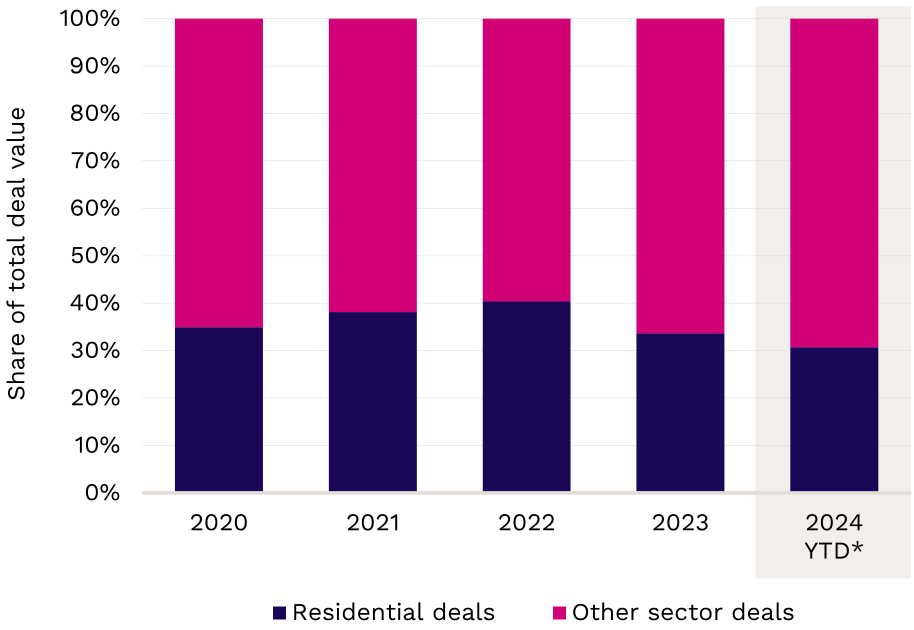
*YTD to end-Q3 2024

Source: Preqin Pro

the asking rent for multi-family properties has increased by a mere 2.2% since the end of 2023, significantly slower than the 10% year-on-year growth in 2021. Compounding this situation, in July 2024 the US government introduced a proposal[4] for a federal rent increase cap of 5% for multi-family properties with 50 units or more for the next two years. If implemented, it could constrain the potential for future acquisitions of multi-family rental rates and deter investment in the space.

Fig. 2.4: Residential's share of total deal value contracts slightly

Portion of North America deal value claimed by residential sector



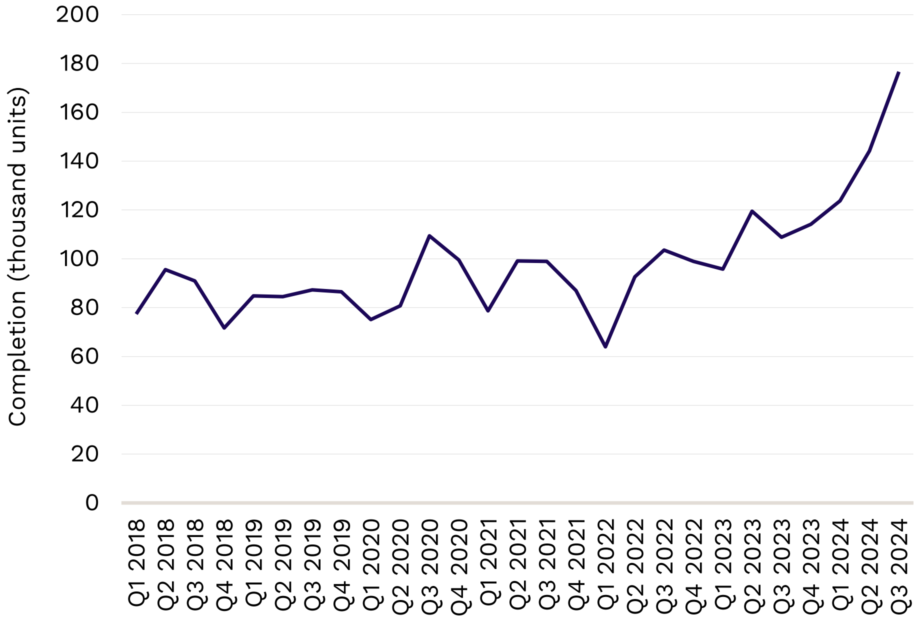
*YTD to end-Q3 2024

Source: Preqin Pro

4 https://www.costar.com/article/1511314184/biden-administration-asks-congress-to-cap-apartment-rent-growth-at-5

Fig. 2.5: Supply of US multi-family units swings up

Completion of US multi-family units*



*Only includes multi-family with at least five units

Source: US Census

The typical timeline for developing multi-family properties spans three to four years. According to data from the US Census, the construction of multi-family units reached its peak in mid-2023 (Fig. 2.6). Consequently, it is probable that the supply pipeline for multi-family units in the US will remain robust in 2025, and possibly also in 2026. Assuming the demand for multi-family properties remains consistent, the momentum of rental growth in this sector still struggles due to more options for tenants. Unlike the office sector, which is facing a structural decline in demand as a result of post-COVID-19 remote working trends, the outlook for multi-family properties is more certain. There is optimism that a balance between supply and demand may be achieved following a peak in the completion of multi-family properties in 2025 or 2026.

Niche sector more than doubles its share of total deal value

While the residential sector has shown subdued deal value in the first nine months of 2024, and offices are still suffering from the adoption of hybrid working, the niche sector has seen some significant increases.

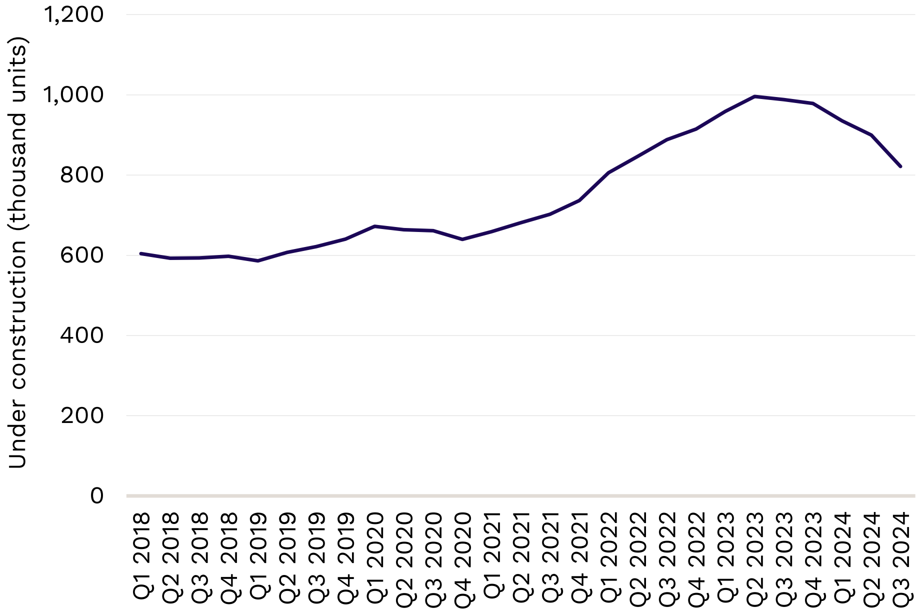
The niche sector's transaction value has surged in 2024, expanding its share of North America's total deal value from 3.3% in 2020 to 7.7% by September 2024, and surpassed that of the hotel sector (Fig. 2.7), a major player in commercial real estate, for three consecutive years – highlighting the increasing significance of niche real estate in investors' portfolios, including student accommodation, healthcare facilities, senior housing, and self-storage.

In April 2024, KKR acquired a student housing portfolio from Blackstone for $1.6bn – the largest niche deal since 2016. Student housing has experienced a significant surge in deal value, with the sum of the first three quarters of 2024 up 150% on 2023's total. It has emerged as the most transacted niche sector in terms of both volume and value. For further insights on purpose-built student accommodation, see the 'Sector in focus: Purpose-built student accommodation' chapter.

We anticipate that in 2025 residential real estate will continue to be a foundational sector in US investment portfolios due to its substantial market presence. Nevertheless, amid heightened supply levels, investors will likely seek opportunities in alternative sectors, leading to a shift away from residential properties. Simultaneously, despite a significant privatization deal closure in 2024, the new rate cycle has compressed the overall REIT discount, potentially limiting the upside for privatization. We expect market participants to prioritize direct real estate transactions for asset acquisitions in 2025.

Fig. 2.6: Multi-family units under construction peaked in Q2 2023

US multi-family units under construction*

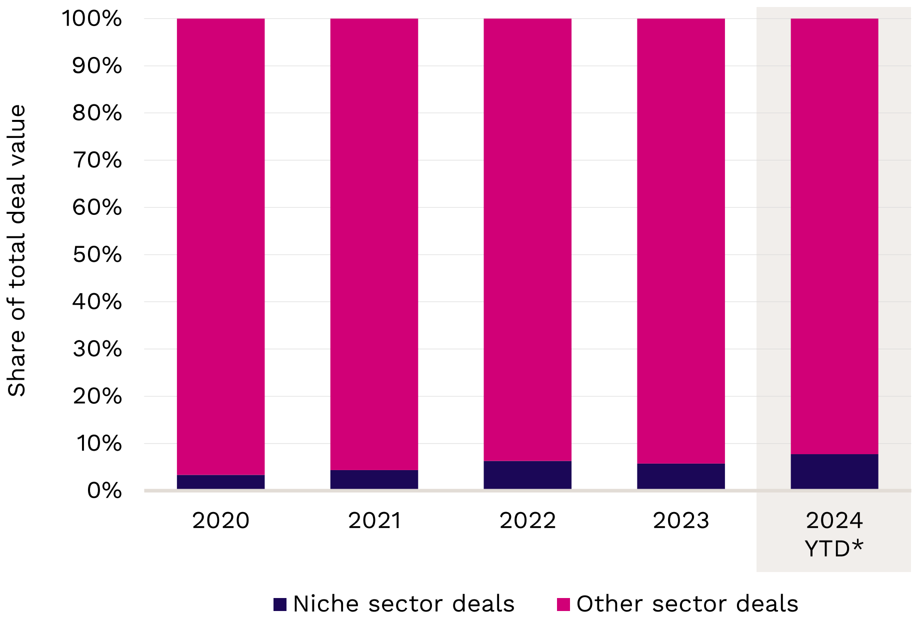


*Only includes multi-family with at least five units

Source: US Census

Fig. 2.7: Niche sector edges up share of North American deals

Portion of North America deal value claimed by niche sector



*YTD to end-Q3 2024

Source: Preqin Pro

Private credit is unlocking growth in the fast-expanding senior housing sector

Alternative lenders such as Locust Point Capital are filling the financing gaps left by traditional lenders and addressing the unique needs of the senior housing sector

Eric Smith
CEO, Co-founder,
Locust Point Capital

What distinguishes the senior housing sector from other real estate sectors, and why is it attractive to investors?
In my view, investing in the senior housing sector is a prime opportunity to tap into powerful demographic shifts. The US population aged 85 and older is set to nearly triple from 6.5 million in 2020 to an estimated 13.7 million by 2040, largely driven by the aging baby boomer generation.[1] With around 70% of people turning 65 expected to need long-term care services at some point during their lifetime, there's a stable demand for senior housing for the foreseeable future.[2]

But even with this clear growth trajectory, the sector is significantly undersupplied. By 2030, an additional 755,000 units will be required to meet the needs of this aging population.[3] Construction starts, however, are lagging, with only 23,897 new units in 2022 and just 13,322 in 2023.[4]

Our view is that this significant drop off in construction starts is primarily the result of the contracting capital markets. This supply-demand imbalance suggests existing facilities will see high occupancy rates, creating substantial room for growth in new developments.

Additionally, the senior housing sector is highly fragmented, with nearly 73% of facilities owned by operators that manage less than 25 facilities.[5] Many of these facilities were built before 2010, and some as far back as the 1960s, highlighting the need for redevelopment.

Overall, we believe that the senior housing sector can be a strong foundation for long-term investment. We're looking at compelling demographic trends, a clear undersupply, and a market that's primed for growth. For investors, it's a resilient, needs-driven sector with solid potential for both returns and sustained demand well into the future.

How are alternative lenders better positioned to meet the needs of senior housing compared with traditional lenders?
The senior housing sector is distinct because it blends both real estate and corporate lending elements, as financing typically supports not only the property itself but also the business operations that provide essential healthcare services to elderly residents.

Most traditional lenders keep their real estate and corporate credit divisions separate, with very little crossover. But senior housing requires expertise in both areas, which can make it challenging for conventional lenders to fully meet the sector's demands.

Financing these projects also means navigating a range of operational complexities, including projecting occupancy, Medicaid and Medicare reimbursements, and strict regulatory compliance. These factors can vary significantly from state to state and often call for customized financing solutions that accommodate the extended timelines needed to stabilize assets.

Traditional bank products tend to be standardized, so they generally lack the flexibility to address these unique nuances. Plus, regulatory constraints often make banks more risk-averse, limiting their willingness to lend to sectors with such complex operational factors.

This is where alternative lenders, such as Locust Point Capital, can add value. With a deep understanding of the senior housing sector, we're able to provide tailored financing solutions that meet the specific challenges of the sector.

As a non-bank lender, we can structure financing that addresses the full range of capital needs, from senior debt to mezzanine financing and preferred equity. Our loan structures are designed to fit the cash flows of the facilities we are financing. For instance, we often provide bridge loans that enable operators to stabilize their assets before transitioning to permanent financing through programs like Fannie Mae, Freddie Mac, or the US Department of Housing and Urban Development.

1 US Census Bureau (data as of 2024) 2023 Profile of Older Americans (acl.gov) https://acl.gov/sites/default/files/Profile of OA/ACL_ProfileOlderAmericans2023_508.pdf
2 https://acl.gov/ltc/basic-needs/how-much-care-will-you-need
3 NIC MAP® VISION: Senior Housing Market Outlook, Opportunities from a supply and demand imbalance 2024
4 NIC MAP® Data Service, powered by NIC MAP Vision | NIC MAP Construction Starts Trends 1Q2024 | All Markets
5 NIC Investment Guide Sixth Edition (data as of 2019)

We are also able structure deals that align with the realities of the senior housing market – whether that means extended lease-up periods or fluctuating occupancy rates. We combine this adaptability with deep industry knowledge, which allows us to underwrite loans with a clear understanding of the sector's specific risks and opportunities. As a result, we're able to serve as a true strategic partner, offering not just capital but also insights and support to help our borrowers succeed.

How has the senior housing finance landscape changed with rising interest rates, and what do you foresee for the future of financing in this sector?

To fully grasp the impact of rising rates, you have to look back to the pre-COVID environment. Before 2020, traditional lenders such as banks dominated the financing landscape for senior housing, providing most of the capital for development and acquisitions. Back then, with low borrowing costs, banks offered highly competitive terms and were the primary source of financing in the sector.[6]

By early 2022, however, the industry was still dealing with the lingering effects of COVID and inflation. The pandemic caused a major drop in occupancy across the board, and inflation-driven cost pressures have only further squeezed operating margins and affected overall performance.[7]

As rates began to rise, the cost of capital surged, putting pressure on loan covenants. Banks responded by tightening their underwriting criteria, and many simply pulled back from the sector as challenges emerged within their commercial real estate portfolios which impacted their ability to originate new commercial loans.

The higher rates also created significant refinancing challenges. Loans that were initially issued at near-zero interest rates suddenly couldn't be refinanced at maturity without major rebalancing, forcing many borrowers to negotiate extensions. With fewer refinancings, banks' balance sheets became more constrained, reducing their capacity to issue new loans and tighten capital availability across all commercial real estate. This shift revealed a gap in the financing landscape. Higher borrowing costs and stricter lending terms made it tough for traditional lenders to meet the unique needs of the senior housing sector. Alternative lenders, such as Locust Point Capital, can offer much-needed capital tailored to the sector's specific requirements environment.

Moving forward, with rate cuts on the horizon, we might see traditional banks becoming more active again as the cost of capital goes down. However, this won't necessarily end the 'golden era' of private credit – especially in sectors like senior housing. In our experience, both institutional investors and borrowers have come to value customized financing solutions that traditional banks often can't match.

There's still a strong demand for specialized, strategic capital, and alternative lenders will keep playing an essential role in sectors such as senior housing. In these areas, traditional lenders often aren't equipped to meet the nuanced financing needs. We foresee private credit remaining a critical part of the landscape, supporting growth in industries where tailored financing is key.

6 NIC Investment Guide Sixth Edition (data as of 2019) (page 79)

7 NIC MAP® VISION: Senior Housing Market Outlook, Opportunities from a supply and demand imbalance 2024 (pages 5–9)

Eric Smith is the CEO and Co-Founder of **Locust Point Capital**, a boutique asset management firm specializing in the US senior housing sector. Under his leadership, Locust Point Capital has become a prominent lower mid-market lender, providing tailored financing solutions that drive the growth of senior living communities across the US. Since co-founding the firm, Eric has been instrumental in defining its investment strategy and building its reputation as a trusted partner for operators and investors alike.

→ Europe deal-making in review

Although deal-closing slowed in Europe in 2024, deal value in the first three quarters was higher than in the same period in 2023, thanks to revived direct investment by domestic limited partners

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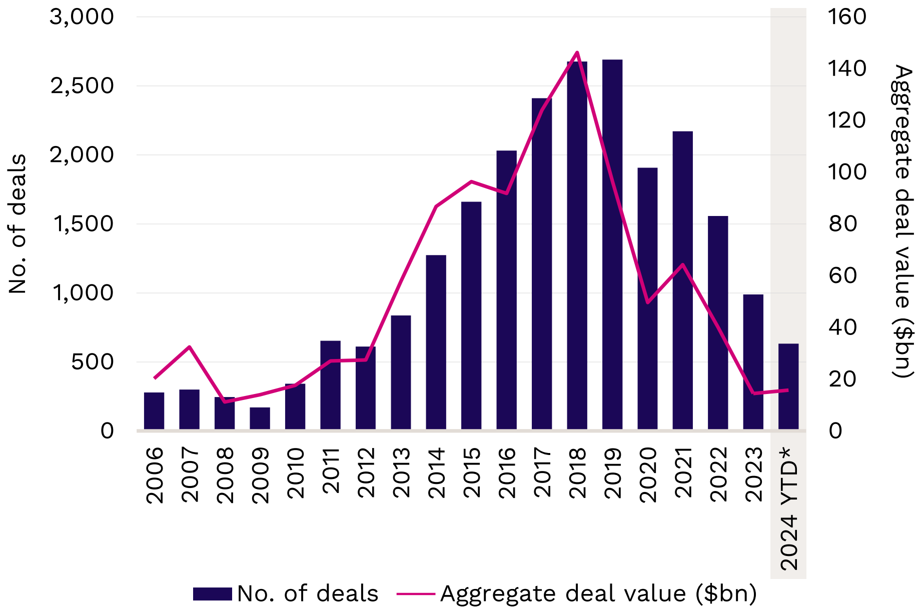
In Europe, fewer real estate deals closed in the first three quarters of 2024 than during the same period in 2023, falling from 721 to 632. Nevertheless, a notable surge in the total size of direct investments marked the start of a new trend this year, with increased involvement from Europe investors. This helped total deal value in 2024 outrun 2023's full-year figure of $15bn, reaching $16bn in the first nine months (Fig. 3.1).

Fig. 3.1: Europe's real estate deals market grows in value

Number and value of Europe real estate deals



*YTD to end-Q3 2024

Source: Preqin Pro

Several major direct LP investments occurred in Europe this year. For example, the Federal Holding and Investment Company, a sovereign wealth fund based in Belgium, acquired an office portfolio in Brussels,[1] while the Universities Superannuation Scheme, a UK pension fund, purchased a local multi-family portfolio.[2] However, the largest was the acquisition of Via Monte Napoleone, 8 in Milan[3] by Kering, a luxury goods holding company based in Paris – also the largest retail property sale since 2018. One of Kering's brands, Saint Laurent, currently occupies the property as a tenant.

Momentum of direct investment deals to persist in short term

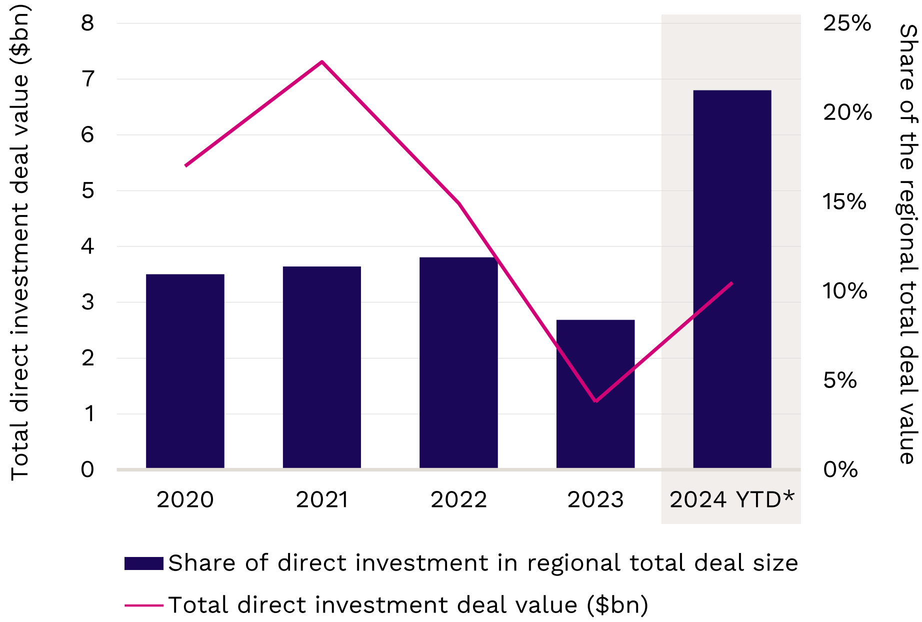
There is a strong rationale for LPs to carry out direct investments, as they are a means to access real estate returns quicker than fund investments. The substantial direct investments in Europe in 2024 (Fig. 3.2) reflect investors' confidence in betting on the future revival of the real estate market. Nevertheless, direct property acquisitions come with investment risks. To mitigate these, particularly when a consistent and solid recovery of market has not yet materialized, LPs may bet on a local market, or a market with local property investment teams set up, which would ease deal sourcing, due diligence, and investment management.

We expect Europe LPs will continue to show interest in significant direct investments within their local markets, particularly at the onset of the rate normalization cycle in 2025. This strategic positioning will allow investors to enter the market before it recovers, potentially yielding higher returns as property valuations increase with declining discount rates.

1 https://pro.preqin.com/deal/R116517
2 https://pro.preqin.com/deal/R119349
3 https://pro.preqin.com/deal/R116056

Fig. 3.2: Surge in LPs investing directly in Europe

Total direct investment deal value and share of regional total deal value



*YTD to end-Q3 2024

Source: Preqin Pro

Geographical distribution of deal size has pivoted
Sizable direct investments in local markets by LPs have boosted total deal value in some country markets. Consequently, there has been a noticeable shift in the geographical distribution of deal value. For instance, according to Preqin data, Belgium, which saw transactions total less than $50mn in the whole of 2023, experienced a remarkable surge to nearly $1bn in the first nine months of 2024 – triggered mainly by the aforementioned Federal Holding and Investment Company acquisition. Similarly, driven by the sale of Via Monte Napoleone 8, Italy's total deal value skyrocketed by over six times compared with 2023, putting it in second place in terms of total transaction value among Europe country markets.

Retail deal value almost triples from 2023
In the UK and the European Union (EU), there has been a reversal of the downward trend in retail sales since 2022. Retail sales volume bottomed out in 2024, and increased by 2.4% and 1.2% year on year in the UK and the EU,[4] respectively, up to August 2024 (Fig. 3.3). This resurgence has reignited expansion plans among retailers and food & beverage (F&B) tenants, consequently reducing the vacancy rates of retail spaces. For instance, in prime London locations like the West End, vacancy rates dropped to their lowest since the second quarter of 2019, at 3.7%, according to Savills.[5] This limited availability of retail spaces drove a 2.4% increase in rent prices in Europe's retail sector in the first half of 2024, based on CBRE data.[6]

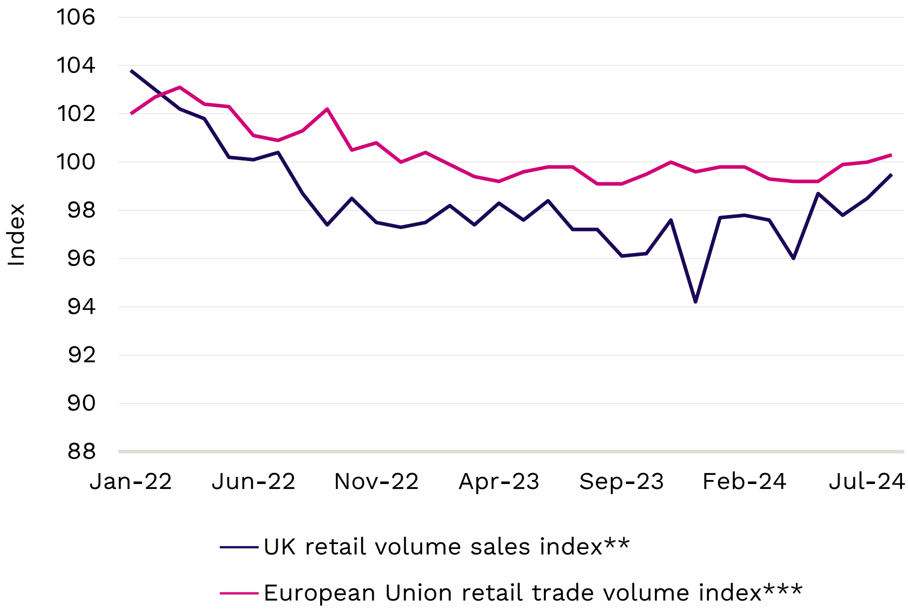
As a result, aggregate deal value has jumped in the retail sector, with retail assets becoming highly coveted in the real estate market. Aggregate deal value soared to $4.6bn in the first nine months of 2024, nearly tripling the value recorded in the same period during 2023 and surpassing that of 2022 (Fig. 3.4).

Overall, the strong demand for retail spaces will likely continue into 2025, making retail assets an attractive investment option. The consumer price index in the UK[7] and the EU[8] has gradually decreased throughout 2024. In particular, the EU's annual inflation rate dropped to just 1.7% in September 2024. This decline moderates the

4 https://ec.europa.eu/eurostat/en/web/products-euro-indicators/w/4-07102024-ap
5 https://www.savills.co.uk/research_articles/229130/365298-0#:~:text=For%20example%2C%20the%20prime%20West,%25%20to%203.0%25%20in%20Q2
6 https://www.cbre.com/insights/reports/european-retail-market-summary-h1-2024
7 https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/l55o/mm23
8 https://ec.europa.eu/eurostat/web/products-euro-indicators/w/2-17102024-ap

Fig. 3.3: Retail sales in Europe appear to have bottomed out

Retail sales volume index of the UK and European Union*

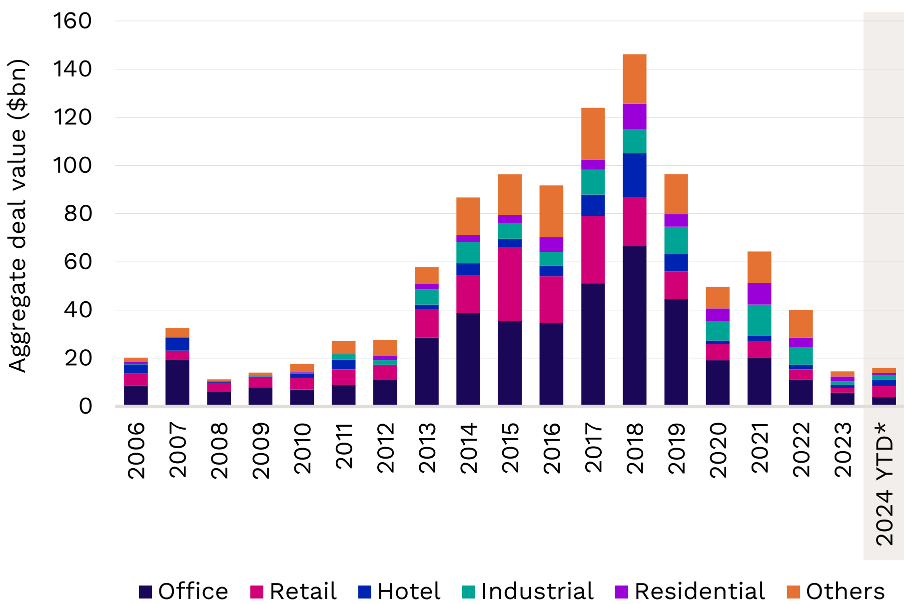


*Both indices are seasonally adjusted
**Index 2022 = 100
***Index 2021 = 100

Source: Office for National Statistics (UK), Eurostat

Fig. 3.4: Rebound in retail deal-making in Europe

Europe real estate total deal value by sector



*YTD to end-Q3 2024

Source: Preqin Pro

erosion of household purchasing power and could provide an opportunity for real household disposable income to stabilize or even rebound, potentially stimulating retail spending. Simultaneously, retailers and F&B establishments may encounter less pressure from rising operating costs, making their expansion plans more viable.

The new trajectory of future interest rates has shifted Europe's real estate investment landscape. With monetary tightening paused, we anticipate improved market sentiment and a further increase in deal activity in 2025.

→ APAC deal-making in review

The office sector continues to claim the most regional deal value in APAC's rebounding market, driven by Japan. Australia is responsible for an increase in the retail sector

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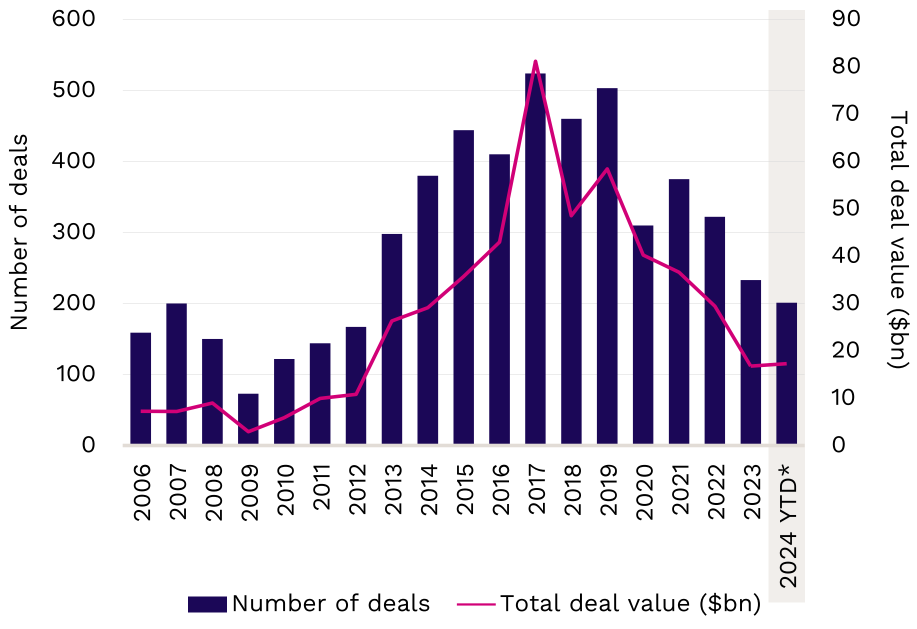
The real estate transaction value in APAC for the first three quarters of 2024 reached $17bn, surpassing 2023's annual total by $0.5bn (Fig. 4.1). This marks the first upturn in annual transaction value since 2019, indicating a resurgence in sentiment. In contrast to Europe and North America, where office real estate investments have fallen post-COVID-19, the APAC office sector continues to attract investor interest, maintaining its share of total transaction value over the first nine months of 2024 (Fig. 4.2).

Fig. 4.1: Deal flow in 2024 accelerates

APAC total value and number of real estate deals

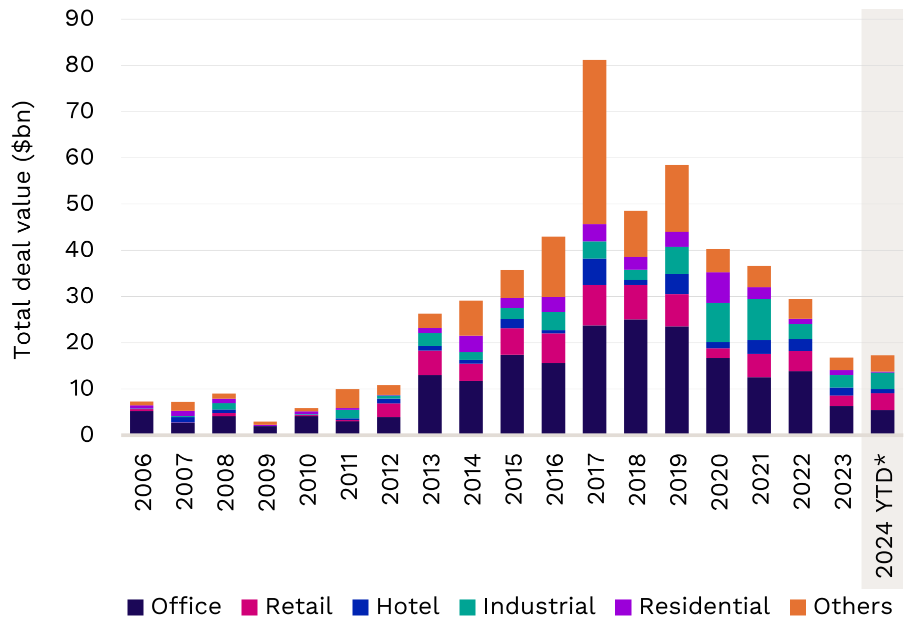


*YTD to end-Q3 2024

Source: Preqin Pro

Fig. 4.2: Office is still the largest real estate sector in APAC

APAC real estate total deal value by sector



*YTD to end-Q3 2024

Source: Preqin Pro

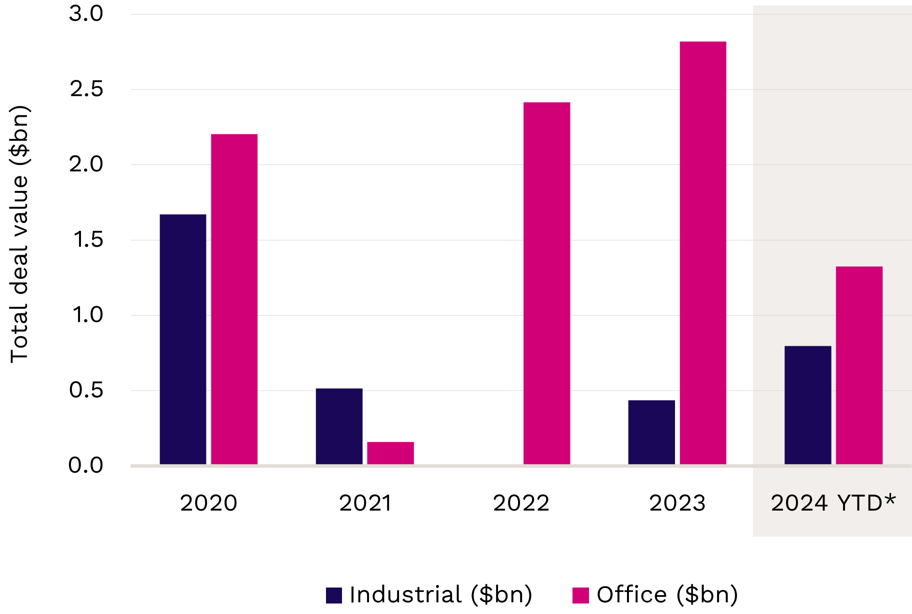
Solid leasing demand reinforces Japan office investor confidence
Japan is the primary contributor to office deal value within the APAC region so far. In the first quarter, Japan witnessed robust office transactions amounting to $1.6bn, highlighted by the sale of Shibuya Sakura Stage, a newly-built office building, for $673mn.[1] This transaction is the largest office deal in Japan since 2020, according to Preqin data.

Our research note on Japan's real estate market points out that the surge in new supply introduced to the market in the latter half of 2023 was effectively absorbed by strong leasing demand for prime office spaces in Tokyo.[2] This phenomenon has bolstered investor confidence in the office sector, driving capital into the market. Despite the expected rate hikes, the cost of real estate loans remains nominal, coupled with favorable lending conditions from financial institutions. Leveraging these factors, office assets present attractive leveraged yields, even though their capitalization rates trail those in other APAC markets such as South Korea and Australia.

Industrial and office sectors drive deal value in South Korea
The momentum driving office deal activity in South Korea moderated slightly from 2023, with transactions totaling $1.3bn in the first three quarters of 2024 – a 21% year-on-year decrease over the same period (Fig. 4.3). Nonetheless, several significant office sales have already concluded in October, and ongoing negotiations for office assets indicate a potentially robust pipeline of office deals for the full year of 2024.

Fig. 4.3: South Korea: deal-making of industrial revived while office market cools

Total deal value of industrial and office in South Korea



*YTD to end-Q3 2024

Source: Preqin Pro

Industrial transaction values in South Korea surged in 2024, bolstered by investments initiated by foreign players. LaSalle[3] and GIC[4] are reported to have delved into its logistics sector, executing acquisitions worth at least $700mn combined.

1 https://pro.preqin.com/asset/RE100363/deals

2 https://www.preqin.com/insights/research/research-notes/how-will-japans-real-estate-market-respond-to-the-end-of-negative-interest

3 https://www.theasset.com/article/52225/lasalle-closes-us-450-million-logistics-deal-in-greater-seoul

4 https://en.seoulpi.co.kr/87465/

Distressed sales play an important role in Asia retail deals
In 2024, the retail sector has emerged as a significant area of interest for APAC, alongside office space. Total retail deal values from the first to the third quarter of 2024 reached $3.6bn, surpassing the total for 2023 by 64% (Fig. 4.2).

Retail property transactions in Asia have been predominantly characterized by distressed sales during 2024, particularly concentrated in Greater China. Mainland Chinese developers are seeking to offload their commercial assets, including retail properties, for liquidity amid sluggish new home sales. Concurrently, in Hong Kong (SAR), the escalation of real estate debt costs since 2022 – stemming from the Hong Kong dollar's peg to the US dollar – has placed pressure on local developers and landlords. Key distressed transactions include New World Development's sale of the D-PARK in Hong Kong and Link REIT's acquisition of Shanghai Qibao Vanke Plaza.

Recovery is key to sparking retail transactions in Australia
The Australian market stands out in supporting the APAC retail sector's deal activity. Unlike distressed sales, asset acquisitions in Australia have mainly been driven by the improving market outlook. Retail turnover growth in Australia has accelerated, with the year-on-year rate increasing to 3.1% in August 2024[5] from the 0.9% recorded in December 2023. At the same time, consumer confidence is on the rise, as indicated by the Westpac-Melbourne Institute Consumer Sentiment Index, which climbed to 89.8 in October 2024[6] – its highest point in two-and-a-half years.

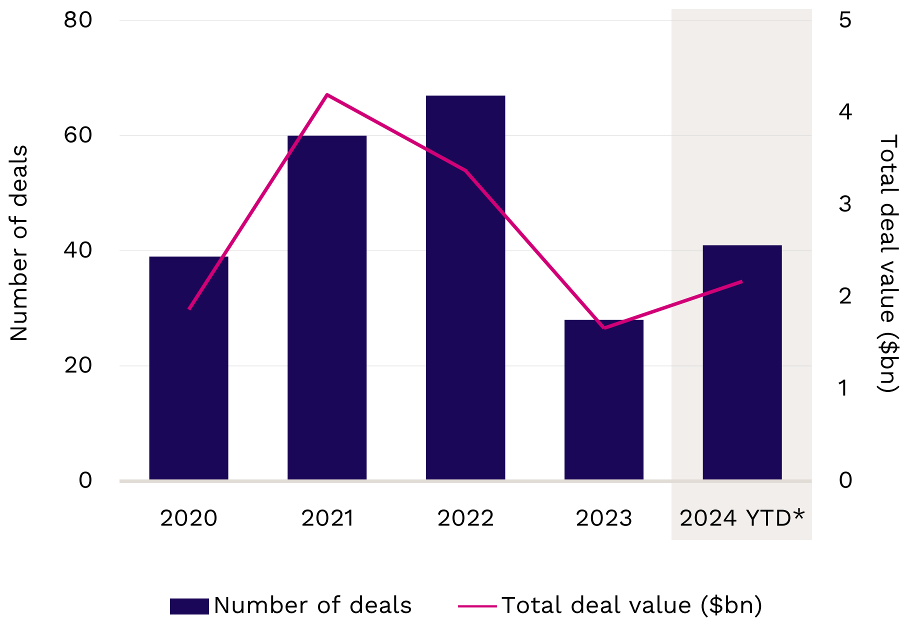
While retail leasing demand is expected to strengthen on increased retail spending, high interest rates and construction costs pose challenges to property development. This limits retail space supply in the medium term. According to JLL, the projected completion of retail space between 2024 and 2025 is only expected to meet 21% of the annual average over the past 10 years.

A more stable market outlook has facilitated retail deal flow in Australia throughout 2024, with $2.2bn in retail transactions closing in the first nine months, marking a 31% increase compared with the total for the entire year in 2023 (Fig. 4.4).

5 https://www.abs.gov.au/statistics/industry/retail-and-wholesale-trade/retail-trade-australia/latest-release
6 https://melbourneinstitute.unimelb.edu.au/__data/assets/pdf_file/0005/5116757/PressReleaseCSI20241008.pdf

Fig. 4.4: Improving fundamentals stimulate market interest in Australia retail

Total value and number of retail deals in Australia



*YTD to end-Q3 2024

Source: Preqin Pro

Additionally, QIC, a fund manager supported by the Queensland government, is set to sell Woodgrove Shopping Centre in Melbourne for approximately AUD 900mn,[7] representing the largest single retail asset sale ever in Australia as per our data.

Interest rate trajectories have diverged across key APAC markets in 2024. South Korea implemented a rate cut as of October, while Australia maintained stable rates, and Japan has raised rates twice. Despite these fluctuations, the total transaction value and number of deals in the first three quarters has already outrun the entirety of 2023. If progressive rate normalization occurs in 2025, it is likely to stimulate further deal-making in the APAC region. Cheaper financing also implies diminishing opportunities for distressed asset acquisition, which usually involves discounts beyond market average. Buyers targeting such assets may need to speed up their deal sourcing and closing process as they move into 2025.

7 https://www.afr.com/companies/retail/qic-to-set-record-900m-mall-deal-as-it-embarks-on-more-sell-downs-20241002-p5kf50

Real estate for the future: diversification, credit, and the impact of climate change

Nuveen Real Estate's Donald Hall explains the signals of a real estate recovery, and what to expect over the next decade

Donald Hall
Global Head of Research,
Nuveen Real Estate

The past two years have been volatile for the global real estate market. What is the current situation, and are there signs of a recovery?
We're starting to see signs of a rebound globally. In the second quarter of this year, global total returns were positive for the first time in two years. Of the 15 global markets that comprise the MSCI Global Property Index, eight saw valuation write-ups and 12 saw positive total returns. We're seeing similar trends in the transaction indices. Numerous global markets saw pricing gains in the second quarter, including Japan, Canada, the US, France, and the UK. Anecdotally, we're seeing more competition for the assets we're bidding on and those we're selling. It feels like we've crossed the bridge to recovery, and we're returning to a sense of normality.

Why should investors allocate to real estate in a portfolio now?
Real estate offers excellent diversification benefits, and most global investors are now significantly below their ideal allocation. If you rewind the clock to the final quarter of 2021, global institutional investors were 140 basis points below their target allocation to real estate.[1] As we entered 2022, private real estate continued to perform well for investors, while the value of stocks and bonds fell precipitously. This raised investors' allocations to real estate significantly over target, so by late 2022, everyone in real estate was talking about the denominator effect. Fast forward to today, and we're in the exact opposite situation. Real estate values are down 15% globally.[2] The equity market is near an all-time high, and real estate allocations are now generally below investors' targets. With the signs of a budding rebound, investors are rightly making plans to return to the asset class in 2025. Broadly speaking, the greatest interest from investors today is in higher-returning strategies and in niche sectors. We think there are excellent opportunities there, but we also think core real estate is looking compelling.

How will the new market environment change existing real estate opportunities, and which new opportunities may present themselves?
With traditional lenders pulling back a bit from the asset class, we continue to see good opportunities in real estate credit. As a lender today, you have the advantage of higher base rates and wider spreads, and you're lending on an asset with a reset value, so the returns are compelling, particularly on a risk-adjusted basis.

Separately, both cyclical and secular shifts are creating opportunities across sectors. On the cyclical side, investors have largely ignored retail over the last decade, which has given the sector time to heal. On the secular side, a rapid increase in the need for computing power due to AI is creating an opportunity for digital real estate, and e-commerce is continuing to offer tailwinds for industrial.

What are the expected short-term risk factors and medium-to-long-term prospects for the global real estate market? How can investors navigate these challenges and capitalize on opportunities?
In the short term, we're still working through elevated levels of deliveries in some sectors, for example the US apartment market. But very little construction has started over the last two years, which means this short-term headwind is already beginning to heal itself. As a result of the fall-off in new starts, construction levels are already down to pre-pandemic levels, so the worst of the supply headwinds are behind us.

In the medium term, there's an opportunity for investors to capitalize on improving fundamentals as a result of decreasing new supply amid rebounding demand. Meanwhile, reset values and the opportunity for price appreciation further sweetens the pot.

Which regional differences in real estate will play out over the next few years, when looking at North America, Europe, and APAC?
We think there are excellent opportunities in all three major regions. Particularly purpose-built student accommodation in Europe and APAC, where supply is low relative to demand. Necessity retail is also a compelling opportunity in the US, Europe, and Australia, where we're seeing strong fundamentals,

1 Hodes Weill's 2021 Institutional Real Estate Allocations Monitor – https://www.hodesweill.com/single-post/2021-institutional-real-estate-allocations-monitor

2 15.3% from Q2 2022 to Q2 2024, MSCI Global Quarterly Property Index

almost no supply risk, resilient pandemic-tested demand, higher yields, and less competition. We think senior housing is a good opportunity, particularly in the US and Japan, due to a mix of demand tailwinds, current supply, and the frameworks in which those assets operate in those countries.

In terms of some differences, we're not actively investing in traditional offices in the US, but we do think there are some opportunities outside of the US, particularly in Asia. Both Seoul and Singapore, for example, continue to have very low vacancies and have remained resilient. There may also be opportunities in Australia's East Coast markets in the medium term, as new supply continues to abate there.

What consequences will megatrends such as urbanization, rising inequality, and the impact of climate change have on real estate?

We expect continued urbanization will help winning cities continue to thrive in a world where we're starting to see a declining working-age population at a macro level. We focus on identifying what we call Tomorrow's World cities.

Regarding rising inequality, we continue to invest in and develop affordable housing communities. In that strategy, we're focused on what we call the double bottom line, meaning we can provide social good and benefits to residents while offering stable returns to our investors.

On the climate front, we continue to use the most advanced models possible to make sure we're properly accounting for potential flooding, drought, and wildfire among others, in our target market lists and our asset underwriting models.

What regulatory changes can investors expect in real estate?

Investors should expect continued increases in residential rent regulations, sustainability regulations with specific environmental targets, and disclosure regulations to prevent greenwashing. None of that is particularly new. Between 2020 and 2022, the prevalence of the term 'sustainability' across regulatory content increased 47-fold.[3] While some states in the US offer competing views of how to address ESG issues, that doesn't necessarily reduce disclosure regulation. Rather, it leads to calls for further transparency on green claims.
In addition to disclosure regulations, there are also many states or cities with building performance standards in place or forthcoming, which is consistent with the trend we've seen in Europe and Asia. Overall, investors should be prepared for greater complexity and ensure they're keeping abreast of the shifting regulatory landscape.

What is the outlook for real estate for the future?

Real estate has historically offered investors consistent income returns, a degree of inflation protection, and low correlation with other asset classes. All this benefits a portfolio. Over the next five, 10, and 15 years, we believe all those attributes to remain true. We've seen investors consistently increase their allocations to the asset class over the last decade, and I expect that to continue. When investing in real estate, you need to take a long-term view, but at the same time, be comfortable shifting your portfolio as various cycles play out, as new trends emerge, and as new data become available.
In 15 years, your portfolio isn't going to look like what it looks like today. Overall, we believe investors will continue to diversify within real estate, adding more exposure to non-traditional sectors and continually getting comfortable entering new markets.

3 The Evolution of ESG Regulation, Cube Global, 2023 – https://cube.global/resources/report/the-evolution-of-esg

Donald Hall is the Global Head of Research at **Nuveen Real Estate**. Using a mix of nontraditional and traditional data sources and the expertise of the professionals within the organization, Donald strives to uncover insights that help shape market-beating property portfolios.

→ Real estate:
Preqin's forecasts through 2029

Monetary policy worldwide could help revive real estate fundraising and investment performance in the long term. AUM is set to trend up beyond the dip in 2023

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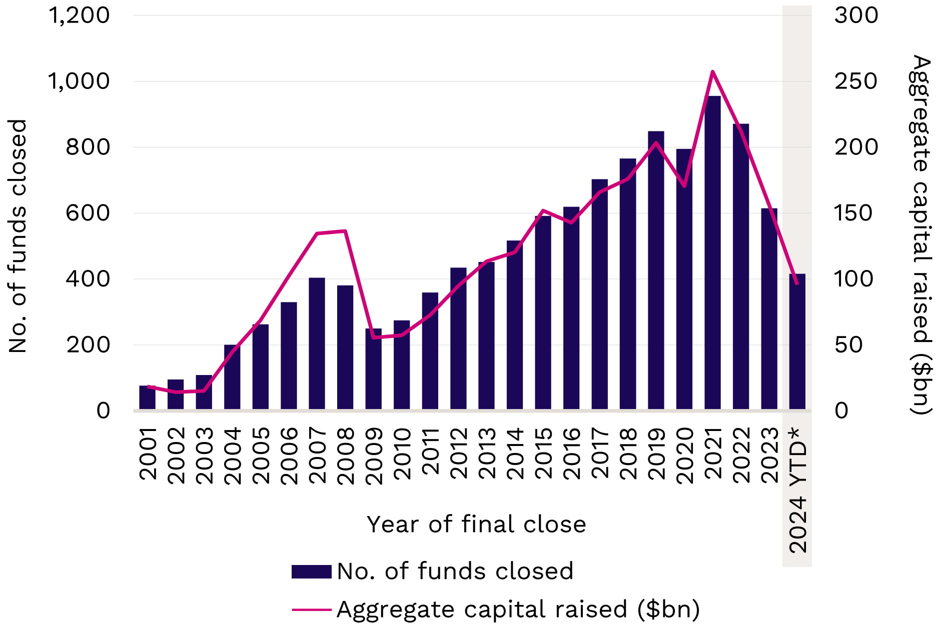
The aggressive global monetary-tightening cycle that began in 2022 has continued to weigh heavily on the capital raised by closed-end real estate funds up to now. After two years of annual contractions, fundraising for the first three quarters of 2024 amounted to only $96bn, representing just 61% of 2023's total (Fig. 5.1).

Fig. 5.1: 2024 yet to see a solid rebound in real estate fundraising

Global private real estate fundraising



*YTD to end-Q3 2024

Source: Preqin Pro

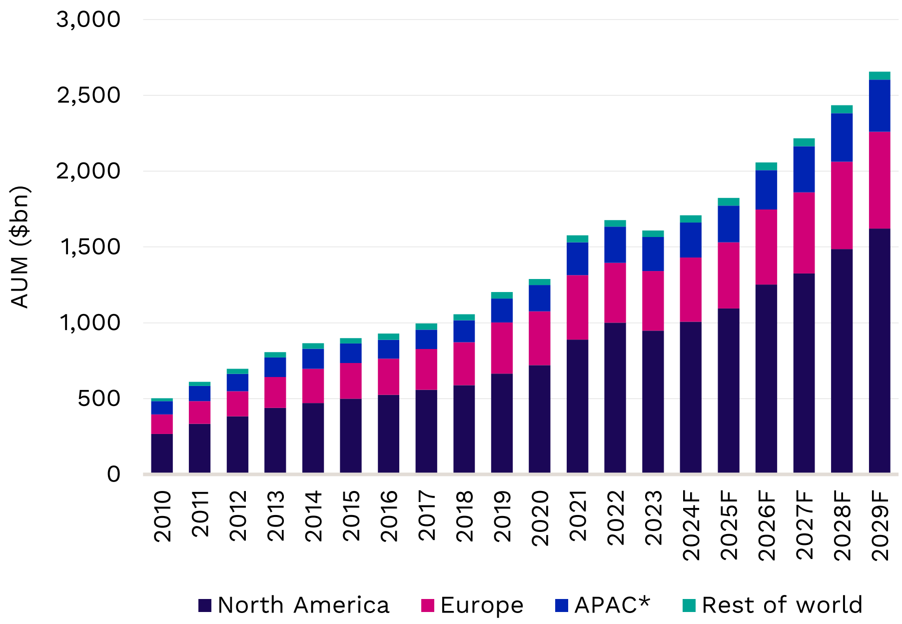
Europe set for strongest rebound in fundraising

Fresh capital commitments to real estate funds play a crucial role in bolstering the level of dry powder, a key component of global real estate assets under management (AUM). However, the subdued fundraising levels were insufficient to fully offset the capital deployed in 2023, leading to a decline in real estate AUM that year – a first since our records began (Fig. 5.2). While major economies have initiated rate reductions, the fundraising forecasts from our Future of Alternatives 2029 report suggest a significant resurgence in capital raised by closed-end real estate funds is more likely to materialize in or after 2025F.[1] Overall, we anticipate an annualized fundraising growth rate of 5.1% through 2029F based on current projections, outpacing broader private capital by 0.8 percentage points (ppts).

1 https://preqin.com/insights/research/reports/future-of-alternatives-2029

Fig. 5.2: Real estate AUM dipped in 2023 for the first time since records began

Real estate AUM by primary region focus*



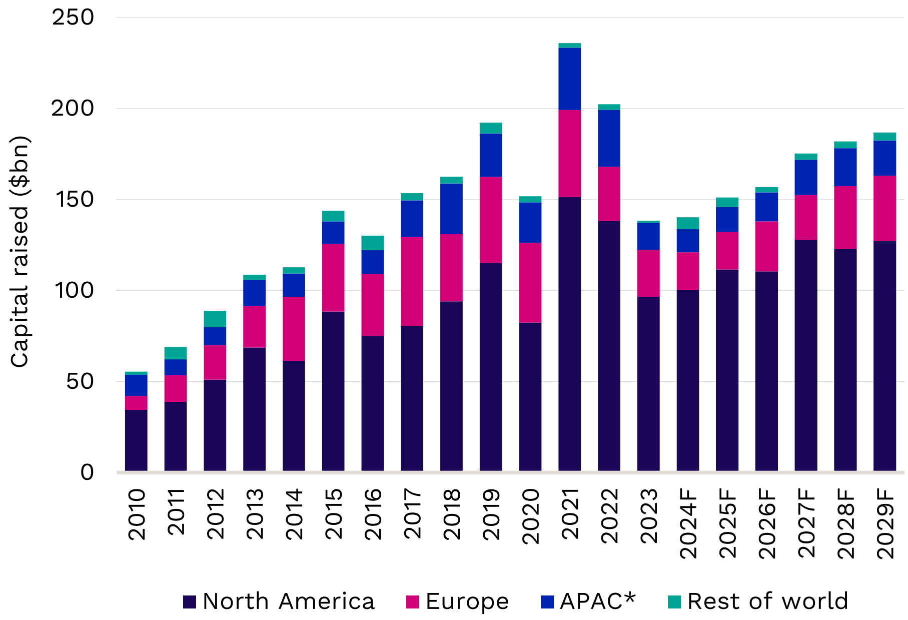
*AUM figures exclude funds denominated in yuan renminbi
Values relate to end of year
To avoid double-counting, total excludes secondaries and funds of funds

Source: Preqin

In terms of region, Europe-focused funds experienced the most pronounced contraction, with a 16.1% annualized decline between 2020 and 2023. Nevertheless, it is positioned for the most rapid recovery among the major regions, with a projected average annual growth rate of 5.7% through 2029F, driven in part by the low base effect (Fig. 5.3).

Fig. 5.3: Strongest rebound in fundraising anticipated for Europe-focused funds

Real estate historical and forecast fundraising by region



*Capital raised figures exclude funds denominated in yuan renminbi
Values relate to end of year
To avoid double-counting, total excludes secondaries and funds of funds

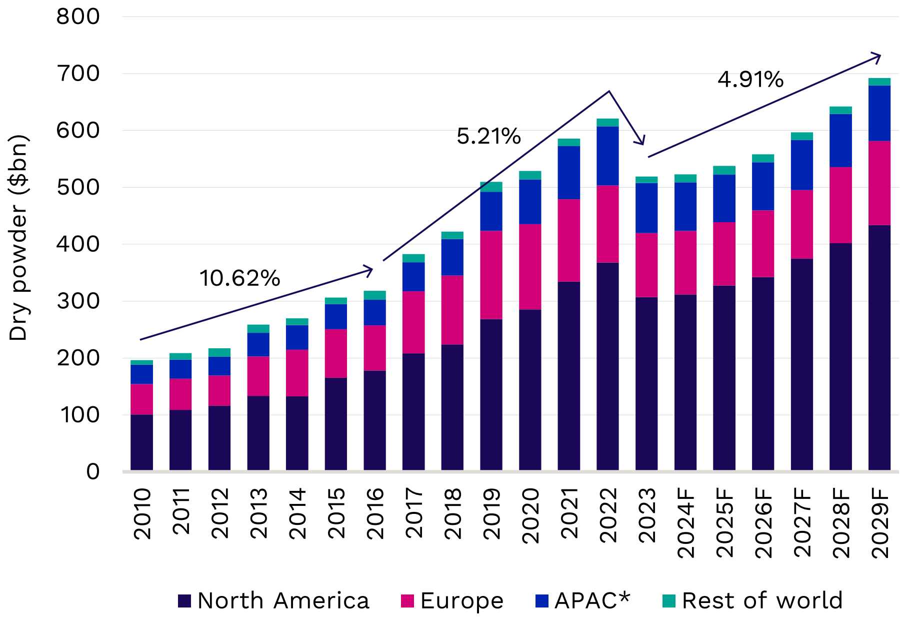
Source: Preqin

Dry powder to take years to recover to 2022 peak

The expected recovery in global fundraising over the forecast period is projected to facilitate an average annual growth rate of 4.9% in total dry powder for real estate funds from 2023 to 2029F, as per our model (Fig. 5.4). While the earlier stages of the forecast period may see a modest uptick in global fundraising, this could result in dry powder growing at a lower rate than the 5.2% recorded during the 2017–2023 period. Our projections indicate that dry powder will surpass 2022's total by 2028F, to reach $692bn by 2029F.

Fig. 5.4: Dry powder to expand at lower rate than 2017–2023

Real estate dry powder by primary region focus*



*Dry powder figures exclude funds denominated in yuan renminbi
Values relate to end of year
To avoid double-counting, total excludes secondaries and funds of funds

Source: Preqin

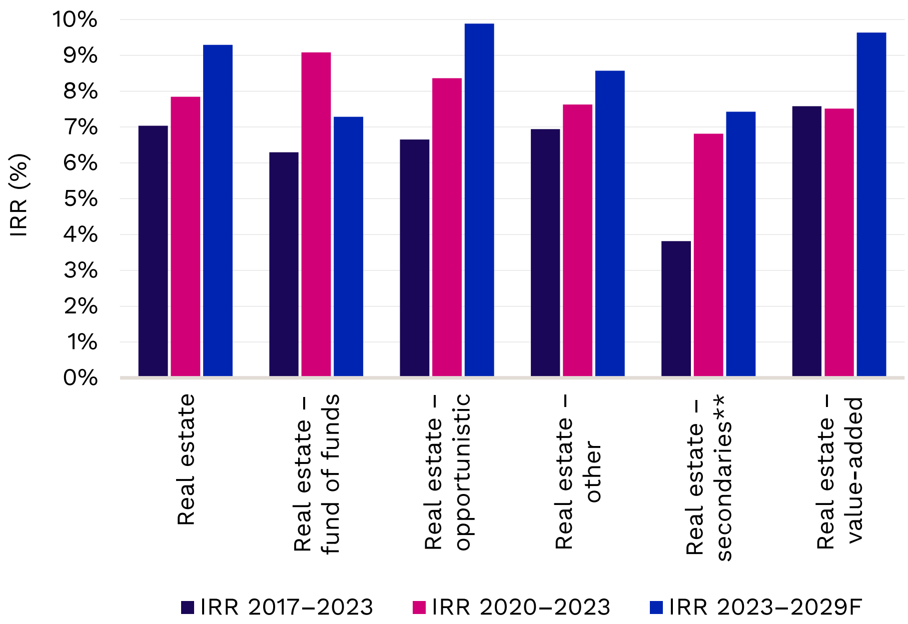
Value-added would be the strategy with greatest performance pick-up

According to the International Monetary Fund's projected base case for the global economy,[2] inflation is anticipated to decrease, granting central banks the flexibility to normalize rates closer to their long-term targets. Such an economic backdrop could boost real estate valuations by reducing risk-free rates utilized in asset-pricing models. This outlook aligns with our prediction of a resurgence in global real estate returns, with the forecast internal rates of return (IRR) reaching 9.3% for the period 2023–2029F – a notable increase on the 7.8% IRR recorded for 2020–2023 (Fig. 5.5).

2 https://www.imf.org/en/Publications/WEO/Issues/2024/04/16/world-economic-outlook-april-2024

Fig. 5.5: Value-added to show strongest rebound in performance

Real estate historical and forecast performance*



Source: Preqin

*When we calculate performance we exclude funds denominated in yuan renminbi
**In the case of APAC, we exclude secondaries in real estate
Values relate to end of year
To avoid double-counting, we exclude secondaries and funds of funds from all the remaining aggregates

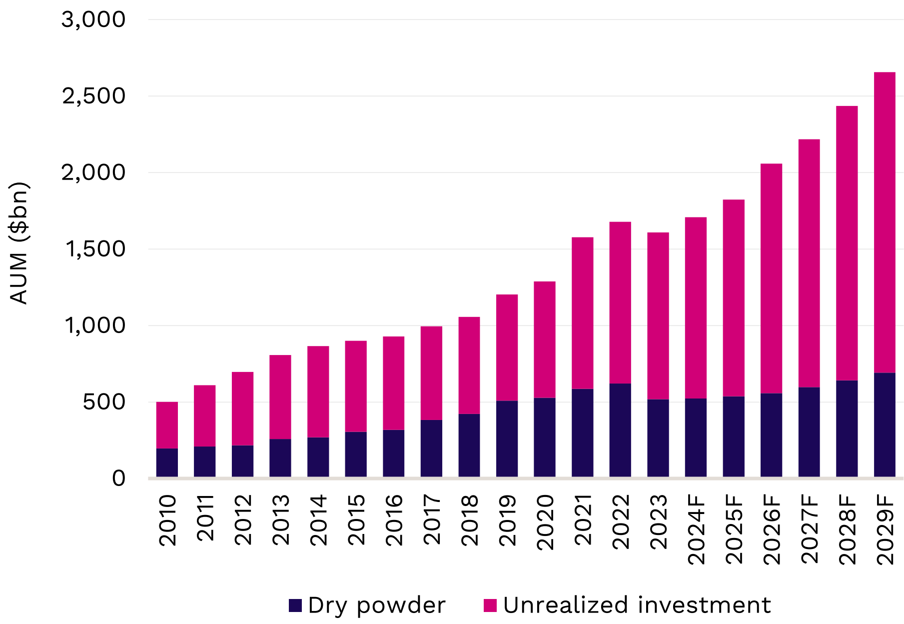
Strategies involving the acquisition of existing properties, particularly value-added approaches, are poised to reap the most substantial gains from the upsurge in valuations. Value-added strategies are projected to yield an IRR of 9.6% for the period 2023–2029F. This would be the most significant increase in IRR among all real estate strategies compared with 2020–2023, adding a notable 2.1ppts to the 7.5% IRR observed in the earlier period. Meanwhile, opportunistic strategies are set to continue offering the highest returns, with an IRR of 9.9% expected through 2029F.

AUM growth trajectory set to improve after 2023 dip

Enhanced real estate performance is expected to facilitate the accumulation of unrealized investment from deployed capital. Additionally, the low-rate environment presumed in the forecasting scenario will likely lower the financing expenses associated with property acquisitions. This would broaden the gap between property yield and real estate debt costs, streamlining the deal origination process and expediting the conversion of dry powder into unrealized investment within overall real estate AUM. According to our model, over the forecast period, unrealized investment is projected to play an increasingly significant role in total AUM. Specifically, the share attributed to unrealized investment is anticipated to rise from 68% at the end of 2023 to 74% by 2029F (Fig. 5.6).

Fig. 5.6: Unrealized investment to take larger portion of total real estate AUM

Real estate AUM by dry powder and unrealized investment*



*AUM figures exclude funds denominated in yuan renminbi
Values relate to end of year
In case of APAC we exclude secondaries in real estate
To avoid double-counting, total excludes secondaries and funds of funds

Source: Preqin

The expected increase in fundraising, set to boost total AUM, may also counterbalance capital outflows from investor redemptions. Improved real estate performance could accelerate the accumulation of unrealized investment, a component of total AUM. Combining these favorable elements, our models predict a reversal in the trajectory of real estate AUM following the decline in 2023. Global real estate AUM is projected to rise steadily after the temporary drop in 2023, to a new peak of $2.66tn by 2029F. This represents anticipated annualized growth of 8.7% during the period, stronger than the 8.3% annualized growth between 2017 and 2023.

→ Real estate debt

Real estate debt's future is intrinsically linked to the growth of the wider asset class, as a source of more flexible capital for sponsors

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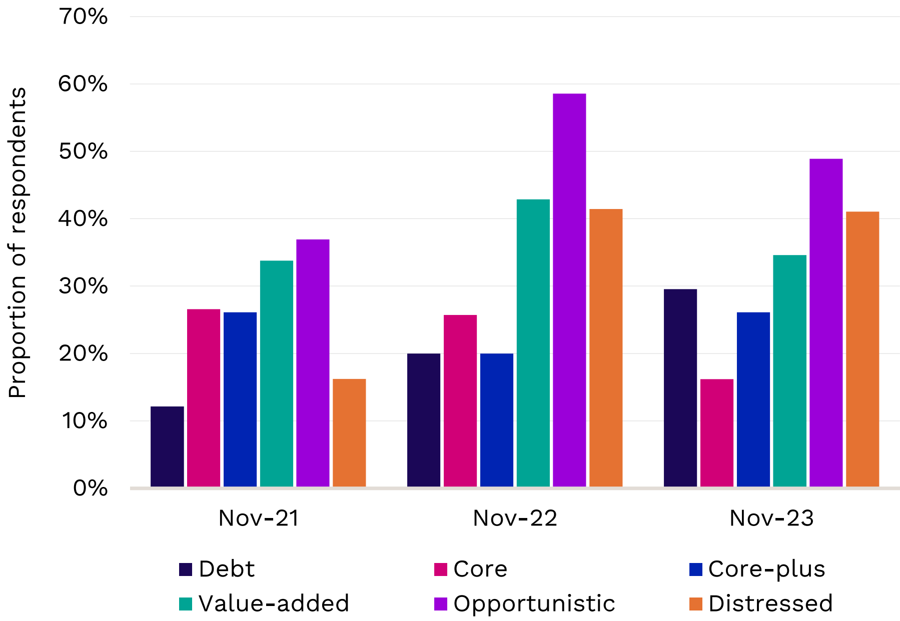
With so much investor attention on private debt, the opportunities in real estate debt have been somewhat overshadowed. While still a minority, as of June 2023, real estate debt funds make up around 16% of assets under management (AUM) for the asset class. By comparison, the figure stood at 8% in 2012.

Real estate investors have consistently reported increased interest in the debt strategy, with the proportion saying it offers the best opportunities over the next 12 months increasing from 12% in November 2021 to 30% in November 2023 (Fig. 6.1). Interest in the strategy has overtaken that for core and core-plus funds which, if sustained, means it could come to represent more of the total AUM.

Fig. 6.1: Interest in real estate debt has almost tripled in three years

Real estate investor views on the fund types presenting the best opportunities in the next 12 months



Source: Preqin investor surveys, November 2021 – 2023

2012 real estate debt vintage target returns drop

Preqin data reveals how the real estate debt strategy has developed a lower risk profile over time. Mid-point target internal rates of return (IRRs) in the 2007 vintage, at 15.6%, were far higher than recent vintages and comparable to the real estate funds combined figure of 15.5% (Fig. 6.2). This reflects the higher-risk strategies that real estate debt funds pursued then, especially among distressed assets. It also aligns with the early development of the private debt asset class, which in 2010 had a 42.4% share of its AUM in distressed funds, compared with 19.4% in 2022.[1]

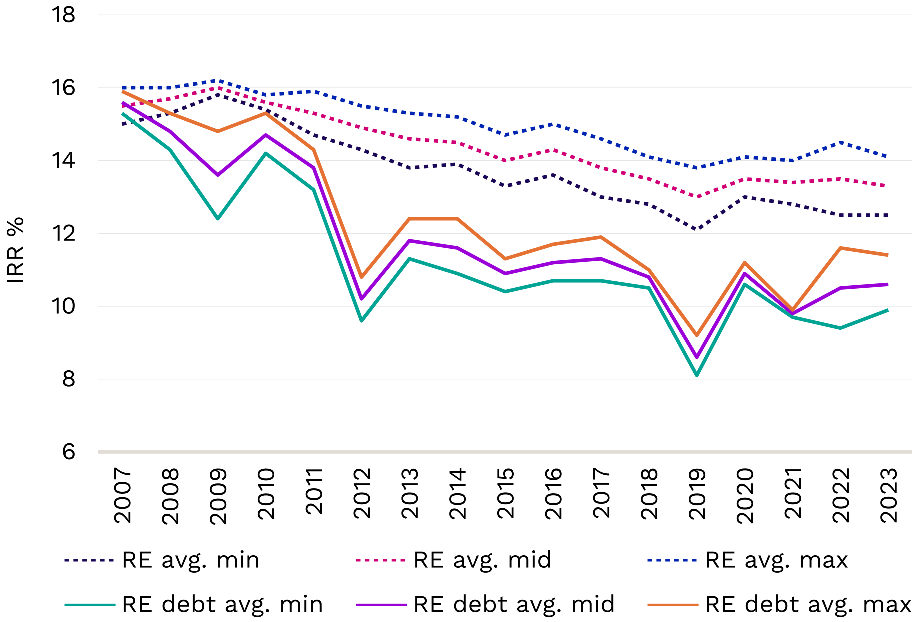
A turning point in the development of real estate debt funds came in 2012, when the vintage recorded the steepest drop in target returns. Mid-point target IRRs went from 13.8% in 2011 to 10.2% a year later. While the onset of quantitative easing is a key factor, the drop also reflects some reduction in the inherent risk within the sub-strategies.

Fast forward to 2019 and the expansion of real estate debt during years of loose monetary policy had also led these funds to pursue lower-risk strategies. This can be seen in the average target IRR of 8.6% for real estate debt funds, compared with 13% for equity funds that year. Recently, though, monetary tightening and increases in the risk profile of the asset class, with the once-dominant office sector remaining a drag on activity, have combined to increase the value and spread of real estate debt fund target returns.

1 https://www.preqin.com/insights/research/reports/future-ofalternatives-2028

Fig. 6.2: Target returns for real estate debt are falling

Real estate target returns by vintage



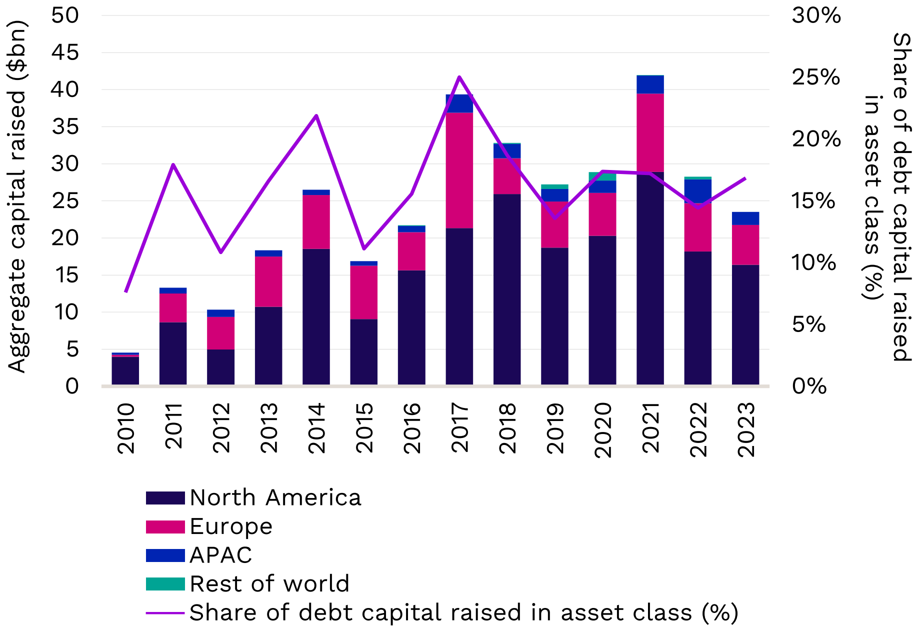
Source: Preqin Pro

Real estate debt fundraising as share of asset class is still low

Recent real estate debt strategy fundraising reveals how much scope for growth remains for these funds. Even in real estate, where debt funds' potential has been more widely known for more than a decade, their share of the capital raised has been volatile until recent years. However, it appears to have settled at an average of 16% between 2019 and 2023 (Fig. 6.3).

Fig. 6.3: Real estate debt fundraising down from peak

Capital raised by real estate debt funds by primary region focus



Source: Preqin Pro. Data as of January 2024

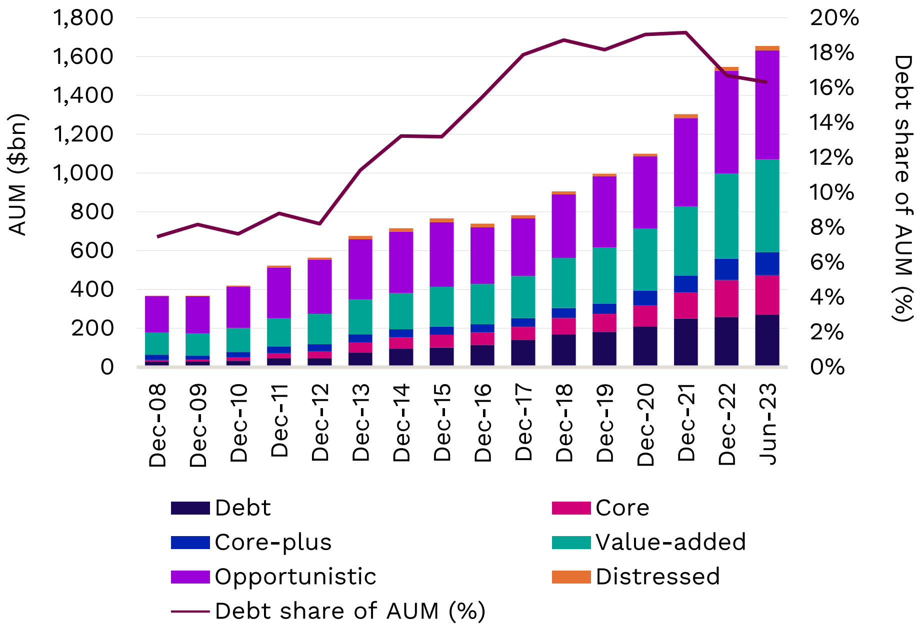
While real estate debt funds constituted an average 14% share of all real estate funds closed in the period, they were on average larger than their asset class peers. As with the rest of real estate, most of the capital raised targets North America, averaging 68% annually over 2019–2023. This is unsurprising given the region is the main market for the deployment of real estate equity fund capital. As such, the development of real asset debt funds is intrinsically linked to the expansion of GPs in the wider asset class as the main market for debt fund lending.

Real estate debt AUM share falls back

In real estate, debt funds' AUM grew in absolute terms in the 18 months to the end of June 2023, but much more slowly than other strategies. It grew by 8% over this period, against respective increases of 23% and 35% in opportunistic and value-added funds, which together made up 63% of the asset class by June 2023. As a result, the share of real estate AUM taken by debt funds fell to 16% as of this date (Fig. 6.4).

Fig. 6.4: Growth of real estate debt overshadowed by higher-risk strategies

Real estate AUM by strategy

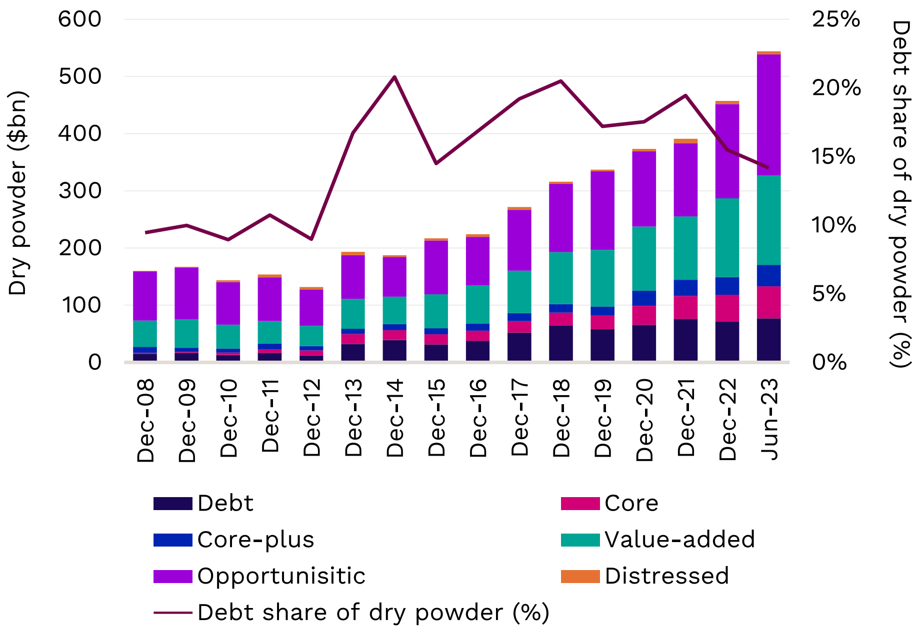


Source: Preqin Pro

As of the end of June 2023, the proportion of asset-class dry powder in real estate debt funds (14%) was lower than these funds' share of overall AUM (16%) (Fig. 6.5). This implies that, despite the nascency of these strategies, funds are deploying effectively, with lower levels of dry powder relative to AUM compared with other strategies. At the strategy level, real estate debt dry powder occupies 29% of these funds' AUM, against 33% of AUM across the wider asset class in dry powder.

Fig. 6.5: Real estate debt dry powder share falls

Real estate dry powder by strategy



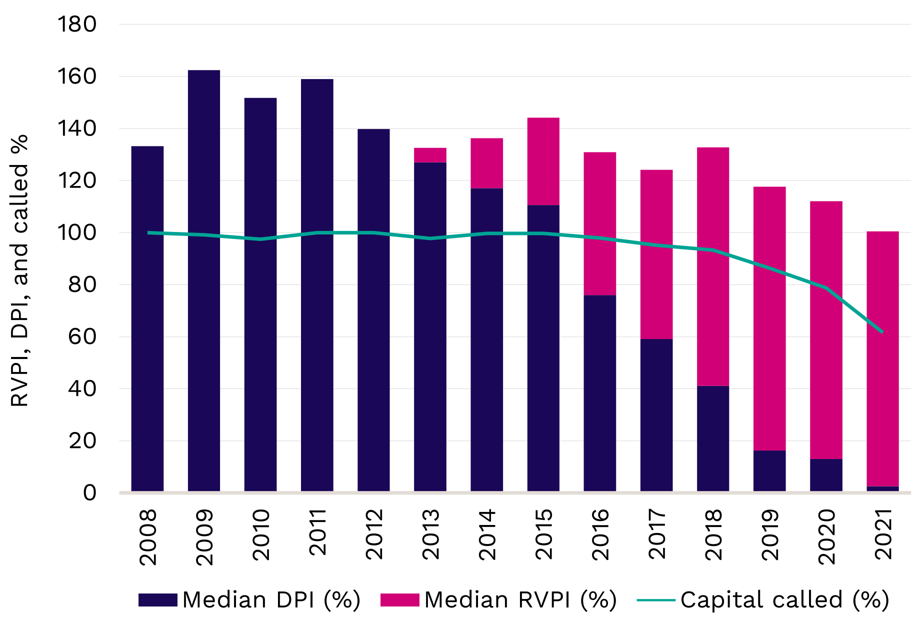
Source: Preqin Pro

Solid downside protection for investors despite limited upside

As would be expected, total value to paid-in capital (TVPI) – residual value to paid-in capital (RVPI) and distributions to paid-in capital (DPI) – for older vintage debt funds tends to be lower than for the general asset class (Fig. 6.6 and Fig. 6.7) because returns in debt strategies are lower than equity, given their limited access to upside risks. This is evident in the all-asset class performance results, heavily weighted toward equity strategies (the dotted lines) whose spreads dominate the higher levels of IRRs, and which are 5.8 percentage points (ppts) higher than real estate debt performance, based on the average of vintages between 2010 and 2020 (Fig. 6.8).

Fig. 6.6: 2009–2011 vintages stand clear with higher TVPIs

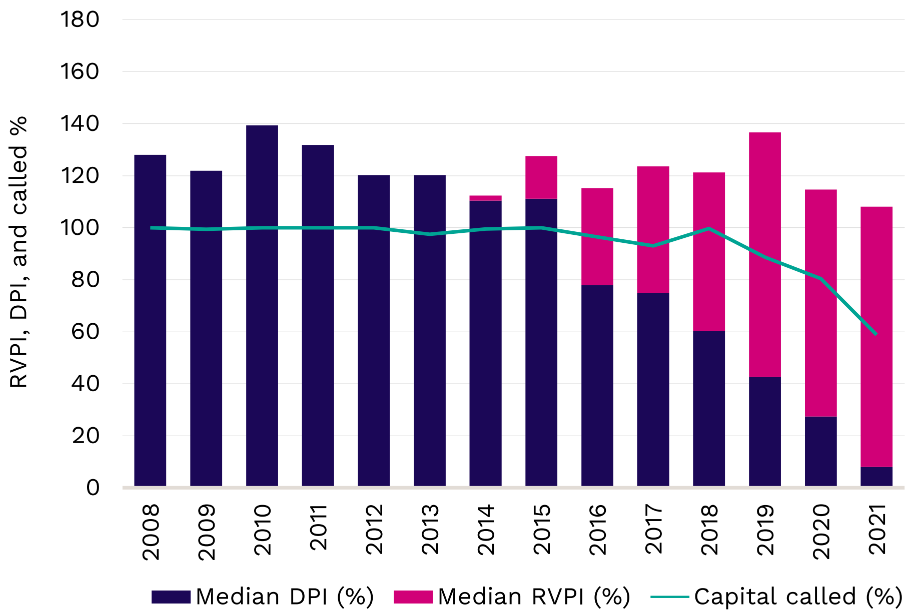
RVPI, DPI, and capital called (%) for real estate funds by vintage



Source: Preqin Pro

Fig. 6.7: 2018 real estate debt vintages called capital particularly promptly

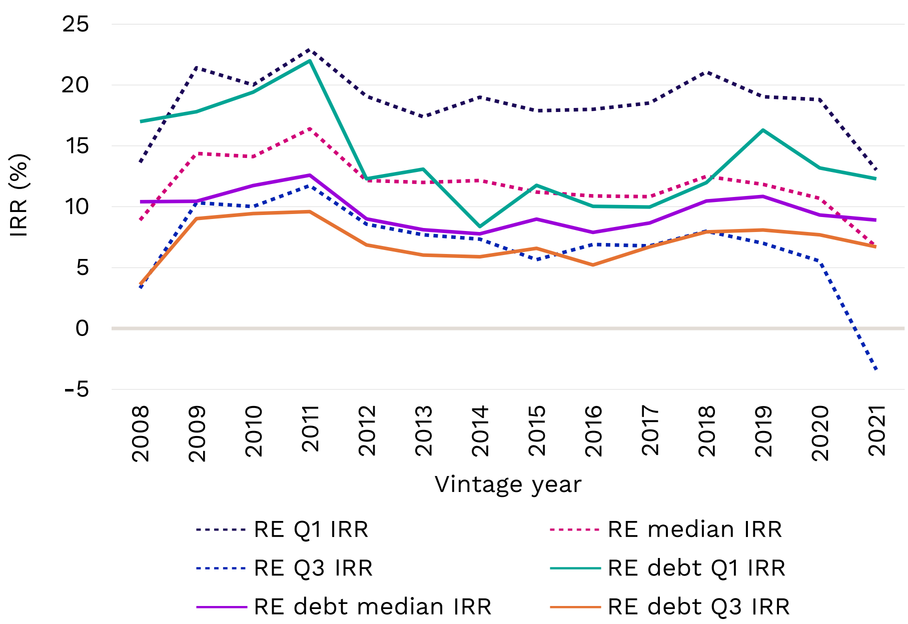
RVPI, DPI, and capital called (%) for real estate debt funds by vintage



Source: Preqin Pro

Fig. 6.8: Downside protection compensates for lack of upside risk exposure

Median, Q1 and Q3 quartile IRR of all real estate and debt funds by vintage



Source: Preqin Pro

Real estate debt funds' performance has also been far more resilient in the most recent vintages compared with equity funds. The 2021 vintage funds report consistently lower IRRs than their 2020 peers, with median IRRs falling 4ppts to 6.7%, but IRRs of the 2021 vintage of debt funds look favorable against the longer term, with median IRRs just 0.4ppts lower than the 2020 vintages. This might result from 2021 equity funds paying more for assets amid the exuberance in 2021, before monetary contraction in 2022 brought valuations back down.

Contracts as a source of collateral

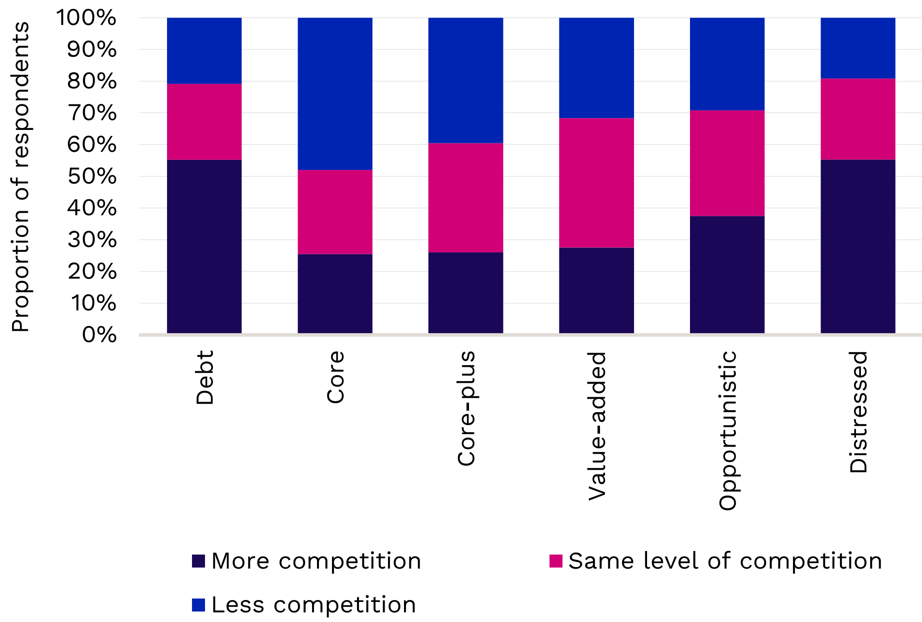
Median IRRs of real estate debt funds are on average 2.7ppts lower than the asset class overall through the 2010–2020 vintages, while lower-quartile IRRs are just 0.5ppts lower, reflecting the lower risk and more defensive characteristics of debt strategies. For investors who value stability in returns, real asset debt strategies offer this, as well as the opportunity to access diversification benefits via real asset business models. Real assets are often characterized by more stable revenue models, either through building leases or long-term offtakes in infrastructure. This relative stability, backed by contracts for real assets, is an attractive feature for debt lenders, allowing them to accept lower interest cover ratios than they would in other asset classes.

Uncertainty drives opportunity for distressed and debt funds

Ongoing uncertainty across real estate creates opportunities for higher-risk equity, as well as debt strategies, because asset owners are either forced to sell to distressed strategy funds looking to buy impaired assets, or must raise debt to hold on to assets. Real estate managers' views around competition for transactions reflect this, with distressed and debt funds at opposite ends of the risk spectrum provoking the stiffest competition (Fig. 6.9).

Fig. 6.9: More deal competition in real estate debt and distressed

Managers were asked 'How has the level of competition for deals changed over the last 12 months?'

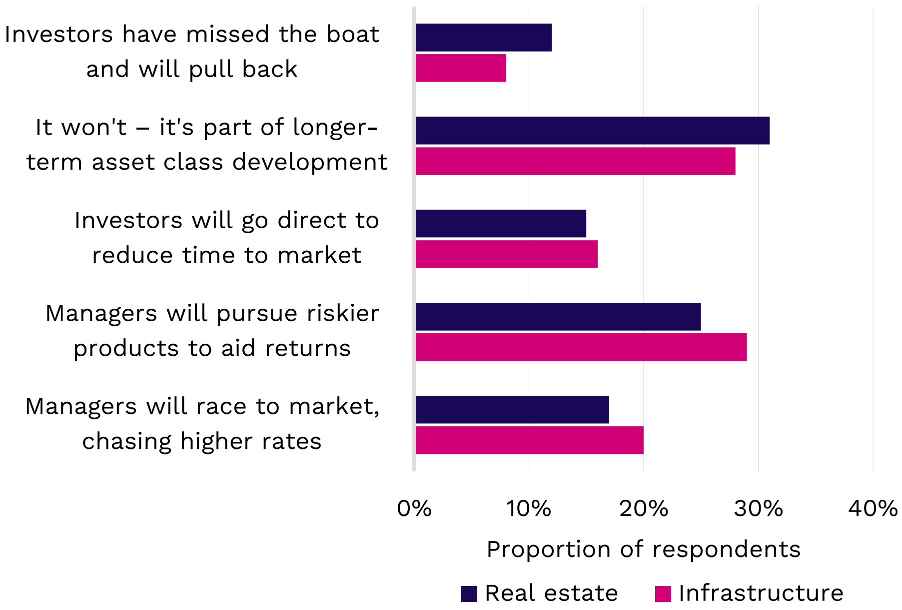


Source: Preqin fund manager survey, November 2023

On the potential longer-term growth of real asset debt funds, many believe their future is part of a longer-term development of the asset class. In a Preqin Global webinar in early 2024, we asked our audience of managers, investors, and service providers, among others, for their views on the impact of reducing rates on the development of debt funds in real estate and infrastructure. For real estate, the most popular view, held by 31% of respondents, was that reducing rates would not hamper the growth of these strategies (Fig. 6.10), as they are part of the asset classes' longer-term development.

Fig. 6.10: Real asset debt will develop with asset class maturity, not interest rates

Survey asked: 'How will reducing rates impact the appetite for real asset debt strategies?'



Source: Global real estate and infrastructure webinars, Preqin, January 2024

For LPs, private credit in real estate is here to stay

Greystar's Kevin Kaberna on the role credit will continue to play when rates begin to fall

Kevin Kaberna
Executive Director, North America Investment Management Leader, Greystar

Private credit has enjoyed a period in the limelight over the last 12 months. Looking to the future, what areas of the market are the most interesting and exciting for Greystar?
We tend to follow demographic tailwinds and focus on asset classes with strong underlying fundamentals across the living sector. Specifically, we focus on markets in which we operate at scale, have steady household formation and positive supply-demand fundamentals, boast liquidity, and provide cash-flow resiliency against credit risk.

National and regional banks, which have played an outsized role in commercial real estate lending over the last cycle, are now seeing incremental regulatory and capital requirements which may limit commercial lending appetite and provide 'white space' for private lenders to step in. We see secular tailwinds to the private lending markets as we anticipate there will likely be further regulation and capital standards on traditional lenders going forward.

We created the credit business at Greystar around a void of flexible capital at leverage levels moderately above where traditional lenders have demonstrated comfort. This capital is valued by sponsors that have a consistent need for capital to acquire, develop, refinance, and renovate assets, and who value the flexibility of a type of debt that can be repaid at any time.

The sweet spot today exists in transition financing. A large percentage of these opportunities are in lending to developers that are trying to lease up and are carrying high-cost construction financing. Developers need a few years to turn the rent rolls and improve cash flows and thus are looking to fill this gap with temporary financing.

Given the amount of product delivering in the near term, we anticipate there is significant opportunity in this segment on the horizon based on our current pipeline. Additionally, we anticipate other segments of the market will heat up for private lending as we enter a new phase of the cycle, like value-add and construction financing from private lenders.

What is the market looking for from private credit today?
The appetite for private credit has been very strong over the past few years given its solid 'equity like' returns which are extremely attractive on a risk-adjusted basis. Credit positions in housing have provided durable, low double digit returns at a great basis in an asset class that has demonstrated cash flow resiliency.

We lend almost exclusively to rental housing projects with sound underlying fundamentals, given the structural shortage in the US and minimal volatility in cash flows. We believe that our strategy may be more appealing on a risk-adjusted basis than asset types with more uncertainty around demand fundamentals, such as office or hospitality.

There tends to be more concern as you move up leverage levels, but we feel comfortable slightly above where the larger regional banks and national banks and agencies tend to lend given our vertically integrated national rental housing platform.

Our partners are quite keen to focus on operational experts within the credit space. We expect resilience in rental housing and apply meaningful operations expertise coupled with a deep understanding of cash-flow risk when underwriting opportunities.

Private credit has been a hot topic for over a year now in the US. What do you say to those who might assume that the opportunities will decrease as rates fall?
I think we're still in the early innings of credit opportunities given the sheer volume of maturities, amount of new product being delivered that requires bridge lending, and a recognition that there's less debt capital available from the banking sector given current exposure and increased regulatory scrutiny.

Although base rates and spreads may move going forward, we do not believe they are returning to ultra-low rates. As rates start to come in, there may be opportunities, particularly at the leverage levels needed to continue to develop the volume of housing that our country needs.

Given the scale of the institutional rental housing market in the US, we believe we'll continue to see a consistent volume of opportunities in private credit, but we'll remain nimble as the rate environment shifts.

Kevin Kaberna leads **Greystar**'s Investment Management platform, including fund management, portfolio management, capital projects, and asset management in North America. Kevin is also a member of the Greystar Executive Committee. Under his leadership, the North America Investment Management business has grown to over 195,247 units and student beds owned. Kevin maintains oversight over logistics and housing investments, including conventional, student, build for rent, active adult, and credit.

→ Performance benchmarking

We consider the suitability of the REIT index as a proxy for private real estate performance and examine its correlation to a private index

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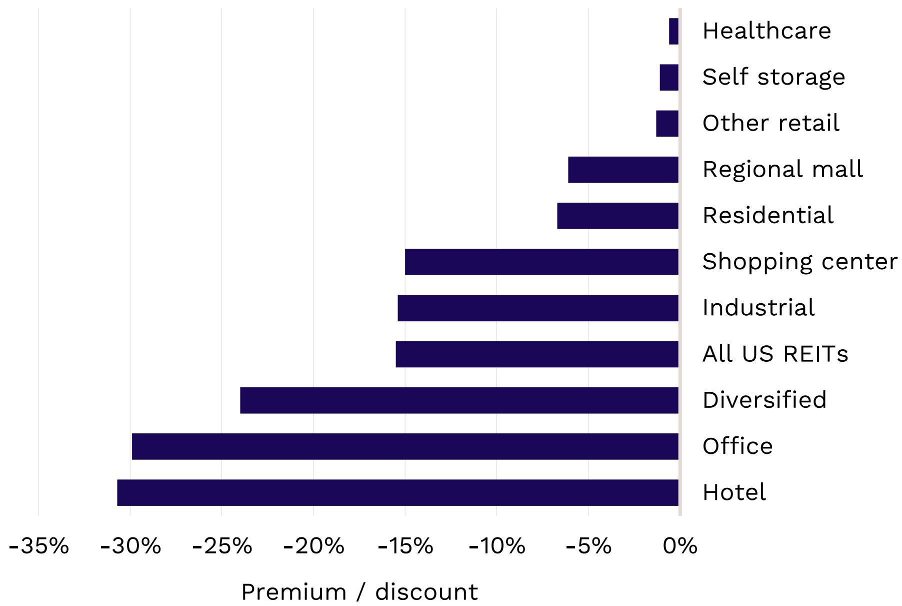
In the realm of private real estate, the presence of real estate investment trusts (REITs) provides a means for investors to gauge the performance of private real estate investments against their listed counterparts. This comparison often involves applying REIT total return indices as benchmarks for private real estate investments, encompassing closed-ended funds. Given that both indices contain properties as underlying assets, there is a perceived positive correlation between the performance of private real estate and REIT indices.

However, REIT price changes are triggered by market expectations, which can eventually swing far beyond the fair value of underlying properties and fail to demonstrate the actual value changes of underlying properties. Based on data from S&P Capital IQ and taking the US REIT market as an illustration, at the end of the second quarter of 2024, the median discount over net asset value (NAV) among all REITs was 15.5% (Fig. 7.1). Given the expectation of a rate cut by the Federal Reserve, in the third quarter the median REIT discount recovered to just 4.1% for overall US REITs with a 10.4-percentage-point surge (Fig. 7.2). That percentage-point change was volatile compared with the return time series of private real estate, as the greatest quarterly return, in magnitude, for the Preqin North America Real Estate Index from 2012 was just 8.5%.

Fig. 7.1: REITs were deeply discounted even as of Q2 2024

Median premium (discount) to NAV of US REITs as of end of Q2 2024



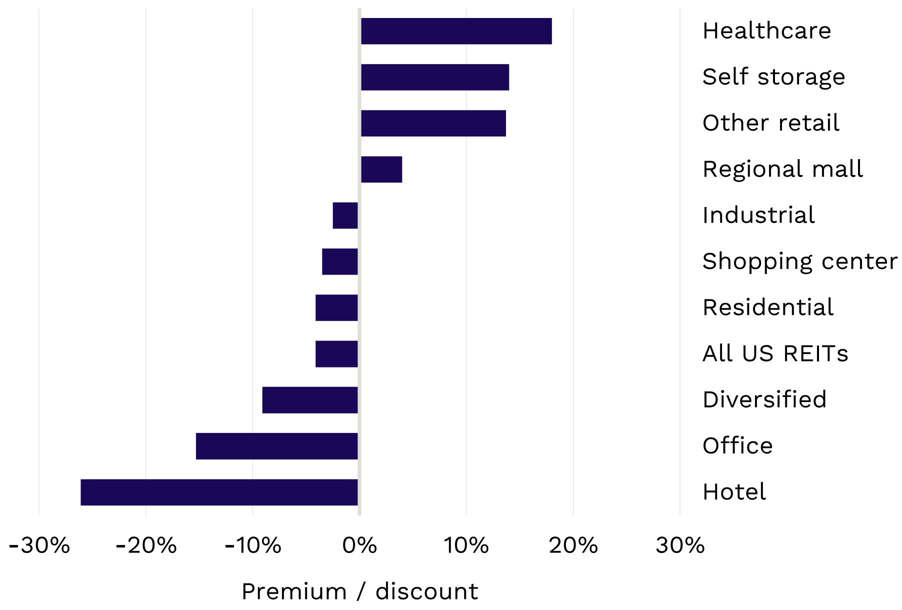
Source: S&P Capital IQ

Lack of correlation between REIT index and private real estate index

In assessing the suitability of the REIT index as a proxy for private real estate performance, we utilized Preqin fund data to create a North America-focused real estate performance index (Preqin NA RE Index) for comparison with the S&P North America REIT Index. This analysis aimed to evaluate the correlation of quarterly total rate of return between the two indices, shedding light on their linear relationship. Additionally, we examined how closely the return time series of the REIT index aligns with that of the private real estate index by measuring the tracking error.

Fig. 7.2: REITs' discount significantly narrowed in Q3 2024

Median premium (discount) to NAV of US REITs as of end of Q3 2024



Source: S&P Capital IQ

The correlation coefficient serves as a prevalent statistical tool for assessing the linear connection between two sets of data over time. Ranging between -1 and 1, this coefficient denotes whether the selected data exhibits an inverse or direct linear relationship. For the quarterly returns of the S&P North America REIT Index and Preqin NA RE Index from the first quarter of 2012 to the second quarter of 2024, the correlation coefficient was -0.11, indicating a weak negative relationship between the two indices (Fig. 7.3). Notably, the REIT index offers limited predictive insight into the future trends of the private real estate index. However, when compared with the return series of the private index lagged by one and three quarters, the correlation coefficient of the two series becomes slightly positive, at 0.22 and 0.28, respectively.

Fig. 7.3: Correlation between REIT and private fund indices with lag

Quarterly return correlation analysis: Preqin North America Real Estate Index and S&P North America REIT Index*

		Correlation	No. of quarters in the analysis
Preqin North America Real Estate Index	S&P North America REIT Index	-0.11	50
Preqin North America Real Estate Index **(1 quarter lagging)**	S&P North America REIT Index	0.22	49
Preqin North America Real Estate Index **(2 quarters lagging)**	S&P North America REIT Index	0.07	48
Preqin North America Real Estate Index **(3 quarters lagging)**	S&P North America REIT Index	0.28	47
Preqin North America Real Estate Index **(4 quarters lagging)**	S&P North America REIT Index	0.13	46

*Data timeframe: Q1 2012 – Q2 2024

Source: Preqin, S&P Capital IQ

The variation of the REIT index is influenced by shifts in the supply and demand dynamics of underlying REIT stocks, shaped by investors' perceptions of future REIT prices. Having said that, market sentiment driving REIT prices may stem from forecasts on the future real estate market, which may ultimately impact the valuation of private real estate assets. However, probability values of the correlation analysis with the private index lagged by one and three quarters are equal to 0.134 and 0.056, respectively. Those can be classified as insignificant under 95% confidence, suggesting a weak linear relationship between the return time series of REIT and the private index.

REIT indices tend to underestimate the performance of private real estate
Despite the limited correlation in return time series between the REIT and private real estate indices, a notable divergence exists in their quarterly returns. Between the first quarter of 2012 and the second quarter of 2024, the average deviation of the S&P North America REIT Index quarterly returns from those of the Preqin NA RE Index stood at -3.8% (Fig. 7.4). This indicates the REIT index tends to underestimate the performance of private real estate when used as a benchmark. If we repeat the comparison with the Preqin NA RE Index lagged by three quarters, which shows a stronger positive correlation with the S&P North America REIT Index, the average quarterly return deviation widens to -4.4%.

Fig. 7.4: REIT index tends to understate private real estate performance

Quarterly return discrepancy analysis: Preqin North America Real Estate Index and S&P North America REIT Index*

*Data timeframe: Q1 2012 – Q2 2024

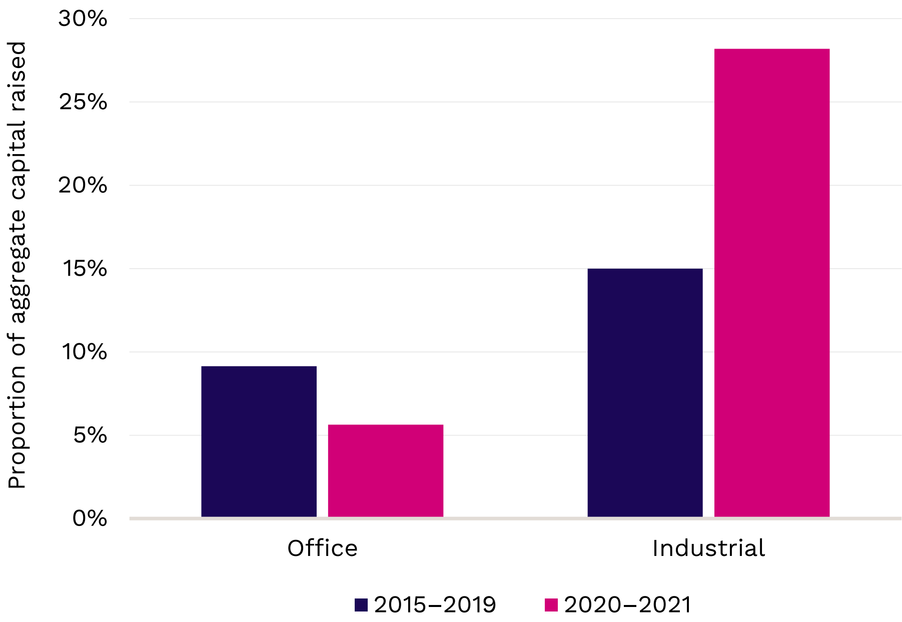
Source: Preqin, S&P Capital IQ

Investment managers' sector selection ability also contributes to private index return
The private real estate performance index for weighing closed-end funds is based on fund NAV. Therefore, index sector exposure alters gradually when funds in the liquidation phase are replaced by those that have just closed or are fully invested. Sectors favored by managers of recently closed funds receive greater representation in the private fund index. For example, when comparing the pre-COVID-19 fundraising period 2015–2019 to the period 2020–2021, among North America sector-focused

funds, the proportion of total capital raised by industrial-focused funds surged from 15% to 28% (Fig. 7.5). In contrast, the share of funds focused on offices decreased from 9% to 6% during the same period. In private real estate investment, fund managers often launch new funds with targeted sector allocations reflecting their confidence in specific sectors. These funds, whether partially or fully invested, are believed to wield significant influence in the private real estate fund index in terms of sector weighting. Consequently, private index sector exposure indirectly incorporates the sector selection capabilities of fund managers.

Fig. 7.5: Industrial up, office down, in terms of single-sector fundraising

North America capital raised by sector-focused funds: overall, office, and industrial*



*Includes sector-focused funds only

Source: Preqin Pro

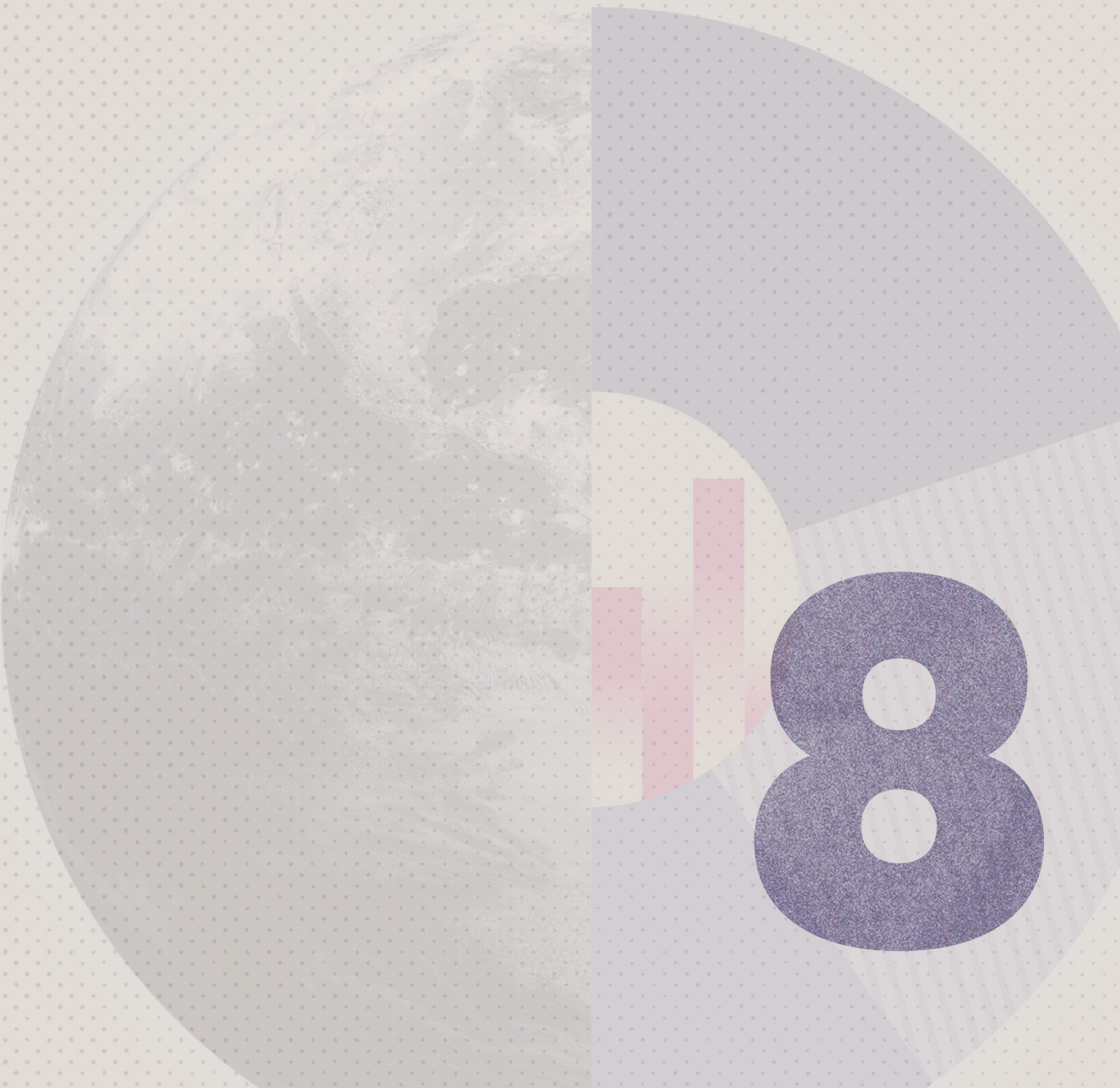
Sector exposure mismatch in REIT index vs. that of overall private real estate

REIT indices typically employ market capitalization or free-floating market capitalization weighting. Changes in sector exposure primarily hinge on fluctuations in REIT share prices, barring significant events like listings, privatizations, or liquidations. Even so, as the REIT market becomes mature, listing or delisting REITs hardly affects the REIT index sector allocation. As per S&P Capital IQ, newly listed constituents in the S&P North America REIT Index post-2021 only constitute 2% of the total market capitalization within the index. Consequently, over the past three years, overall sector exposure alteration within the REIT index has relied on historical share price changes, which can be regarded as backward-looking. The REIT index fails to capture the overall sector selection capability of private real estate fund managers, which is forward-looking. The REIT index will therefore lag the private index performance if the outlook of the overall market is correct.

Different pricing and index construction mechanisms between the two mean the REIT index has shortcomings in the tracking of real estate performance. While a specific private real estate fund index remains essential for private real estate investment benchmarking, listed or private index providers can now provide an index customization service, which makes it possible to build an index with weighting to match users' portfolio or target sector allocation. This kind of product solution could alleviate the sector's misalliance problem for standard indices.

→ Sector in focus: Purpose-built student accommodation

As students return to in-person learning, purpose-built accommodation is becoming a necessity again. We examine how real estate funds can meet demand



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Following the COVID-19 pandemic, the need for purpose-built student accommodation (PBSA) decreased as universities shifted their priorities in line with new market demands. In the UK, the Universities and Colleges Admissions Service reported in February 2024 that the undergraduate application rate has been falling since 2020,[1] which has in turn led to lower student accommodation occupancy rates. Enrolment numbers also declined in the US and other regions during the pandemic,[2] and have remained flat in subsequent years.

Yet PBSA remains an attractive proposition. Colleges and universities globally benefit from consistent demand, outside of global shocks, with a guaranteed steady flow of new students every year. There are currently 254 million students enrolled in universities around the world,[3] an increase of 75 million in the last 10 years. And with a tight supply of PBSA in many regions, funds targeting this sector are on the upswing.

Student accommodation fundraising rebounds

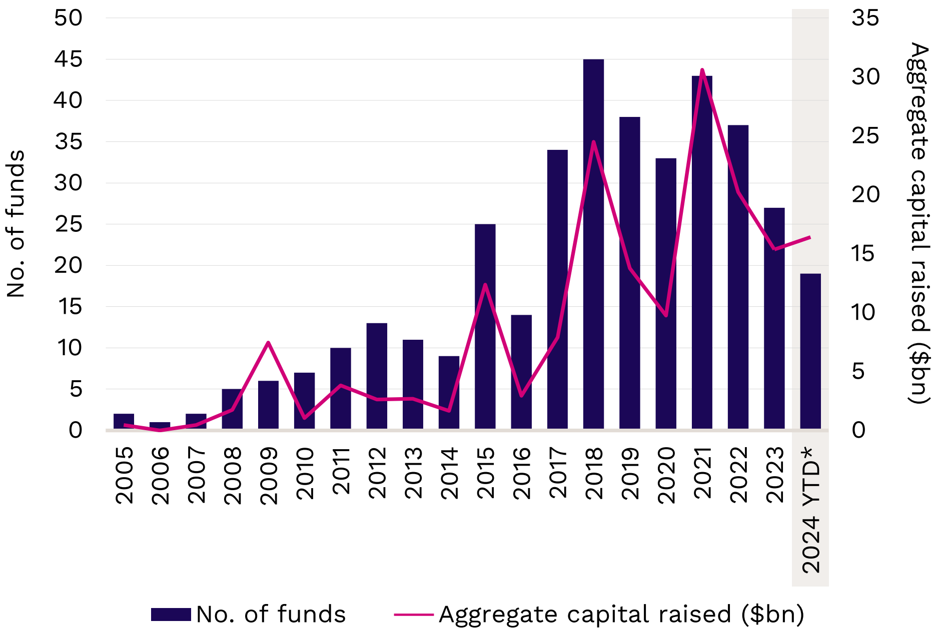
Real estate fundraising has seen a decline in the past three years, and funds with exposure to PBSA have not been exempt. Aggregate capital raised by funds with exposure to student accommodation fell by 60% between 2018 and 2020 as the effects of the pandemic hit hard (Fig. 8.1).

The shift to online learning meant students were able to attend lectures digitally, leading to decreased demand for new student accommodation projects and lower occupancy rates. However, as universities and colleges started to reintroduce in-person teaching in 2021, demand for PBSA began to grow again globally, and funds with exposure to student accommodation saw a resurgence in aggregate capital raised, from just $9.7bn in 2020 to $31bn in 2021.

1 https://www.ucas.com/undergraduate-statistics-and-reports/ucas-undergraduate-releases/applicant-releases-2024-cycle/2024-cycle-applicant-figures-31-january-deadline
2 https://www.statista.com/statistics/236360/undergraduate-enrollment-in-us-by-gender/
3 https://www.unesco.org/en/higher-education

Fig. 8.1: Less funds are closing and capital raised is beginning to recover

Fundraising by funds with exposure to student accommodation



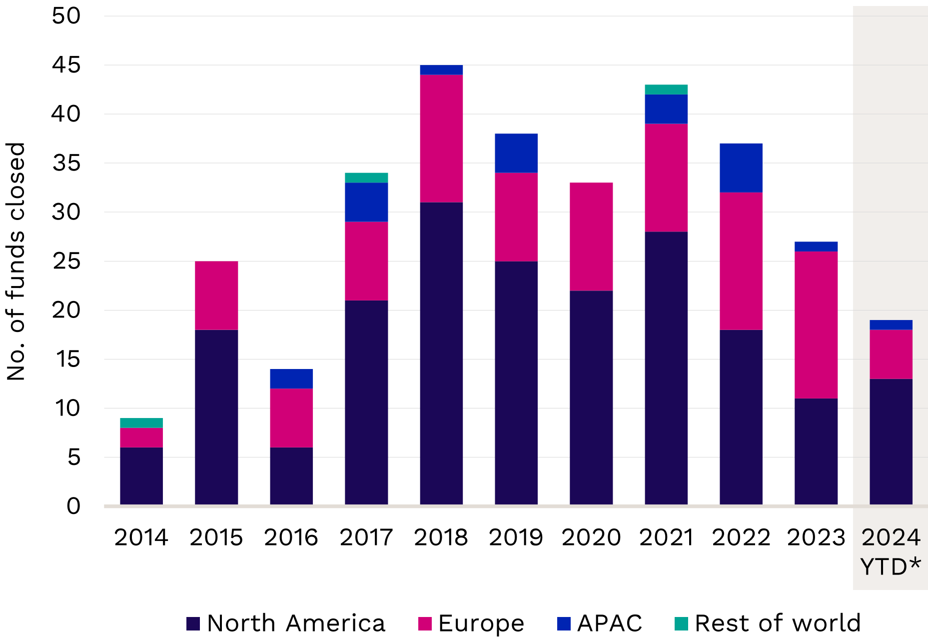
*YTD to end-Q3 2024

Source: Preqin Pro

North America has historically led the major regions in total number of funds with PBSA exposure closed over the past decade, but in more recent years, Europe has taken a more noticeable share (Fig. 8.2). In 2023, Europe overtook North America as the region with the most fund closes, accounting for over 50% of the total closures that year. Although enrolment at for-profit four-year colleges in North America increased in 2023,[4] enrolment at all other institutions fell – a potential factor in the fewer closes in the region. Savill's European Living Investor Survey estimated that a further 93,600 beds being added to the European market to meet growing demand could equate to a further $12bn in investment.[5]

Fig. 8.2: Europe has become a prominent region for student accommodation funds

Student accommodation funds closed by primary region focus



*YTD to end-Q3 2024

Source: Preqin Pro

Funds focused exclusively on student accommodation could be on track for their best year of fundraising since 2019. In the first three quarters of 2024, the same number of funds closed as in the whole of 2023, and aggregate capital raised exceeded the total raised in each of the last four years. Depending on how the rest of the year pans out, it could exceed the $1bn mark for the first time in five years (Fig. 8.3). In the high inflationary environment, student accommodation has proved an effective solution to inflationary effects, with the most common lease being annual, allowing for more efficient measures of increasing rental value[6] and enabling more accuracy on pricing in their agreements. Declining interest rates across the major regions will also likely boost financing opportunities, which could in turn boost these funds to end the year in a strong position.

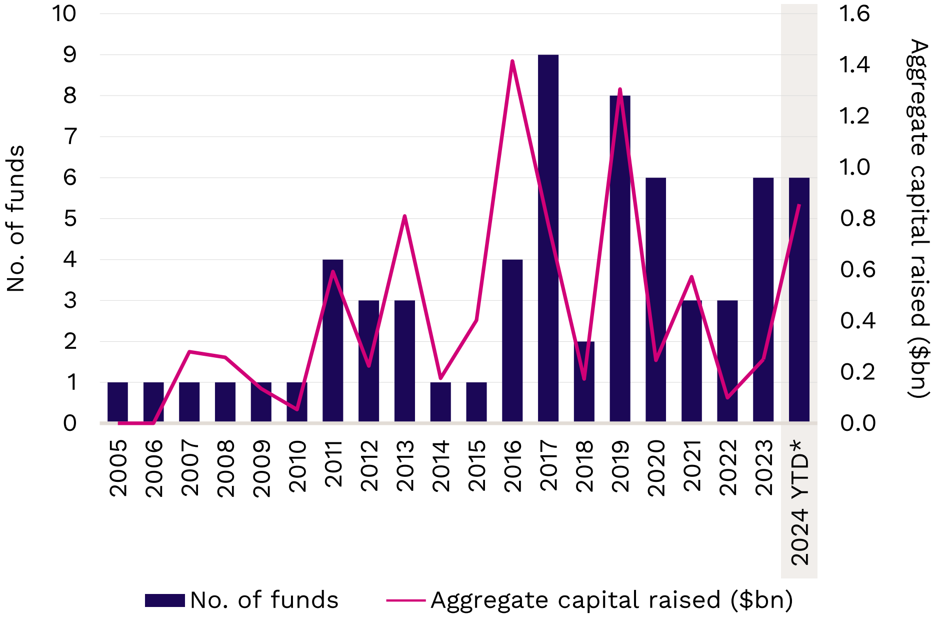
4 https://nscresearchcenter.org/current-term-enrollment-estimates/

5 https://www.savills.com/research_articles/255800/353717-0

6 https://www.trackcapital.co.uk/news-articles/student-accommodation-advantages-and-disadvantages/

Fig. 8.3: 2024 could be the best year for student accommodation funds in recent history

Fundraising by funds exclusively focused on student accommodation



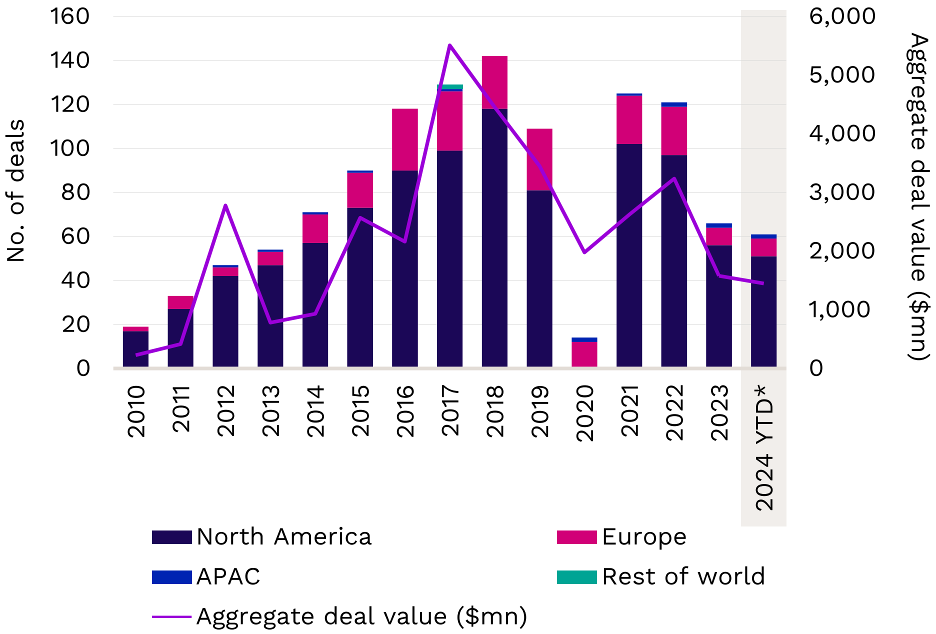
*YTD to end-Q3 2024 Source: Preqin Pro

Deal activity still awaiting recovery

Much like in fundraising, North America leads deal activity. Since 2010, the region has consistently accounted for more than 70% of the total number of student accommodation deals every year, although this is not the case when it comes to share of value, with North America's share dipping below 70% in the past three years. Global deal volume has been in decline since 2022, making competition for assets more intense. In the first nine months of 2024, there were 51 deals, compared with 56 overall in 2023, but aggregate deal value was down $130mn (Fig. 8.4).

Fig. 8.4: Competition for assets is driving overall deal volume down, but deal value up

Student accommodation real estate deals by region



*YTD to end-Q3 2024 Source: Preqin Pro

Rent trends in North America are more volatile than in Europe, which could lead to a shift in where the majority of deals occur.[7] For instance, many of the top-tier universities in the US are the only university in the city they are located in, meaning a single source captures the enrolment and therefore demand for PBSA in that location. Comparatively, in the UK, there are often multiple universities in a single city, so there is demand for accommodation from multiple institutions. This allows deal-makers to incorporate risk management techniques as they do not rely on a single entity to complete deals in the region. The second quarter of 2024 was the strongest since 2022 for investment in UK PBSA,[8] although a large part of this is attributed to Mapletree Investments' £1bn acquisition of Cuscaden Peak Investments.[9]

With the availability of properties becoming more constrained, demand could begin to outweigh supply – the opportunity for establishing and financing new projects therefore becomes more a question of when not if. CBRE reported this year that the UK is facing a shortage of 580,000 beds,[10] showcasing the growing demand. The factors impacting PBSA deal activity in 2023, including high inflation, interest rate rises, and spikes in financing costs, seem to have peaked, indicating a change in fortune for future deals. Additionally, as the cost of debt also decreases, the financing of new projects will become more feasible, which could cause a surge in student accommodation deal activity.[11]

Exposure to student accommodation is increasing

Following the lull in 2022, the number of funds in market with exposure to student accommodation has been increasing year on year. As of October 2024, the number of funds with exposure to student accommodation in Europe had grown significantly, accounting for 38% of all funds in market, compared with just 24% at the start of 2021 (Fig. 8.5). Europe is viewed as a more mature market than North America, with the number of international students that enrol in the region[12] one of the main drivers. Europe's relatively cheap tuition and living costs compared with North America are key reasons for the greater numbers of international students. Additionally, even for European Union citizens, the freedom of movement facilitates students being able to study away from their home countries. This all factors into the favorability of the Europe student accommodation market over North America, and the shift in where funds in market are targeting.

Value-added and opportunistic strategies lead the market in terms of exposure to student accommodation, with opportunistic strategies exposed to PBSA also targeting the most capital (Fig. 8.6). In Europe, the recent macro and geopolitical climate prices have been pushed down by 20–40%, offering potential lower price investment as the cost of financing begins to reduce.[13] Notably, the number of debt funds in market with exposure to PBSA ranks third compared with the other strategies. Cost of debt is stabilizing and financing is becoming more viable. The growing interest in student accommodation is likely due to higher occupancy rates and rental growth, offering a more guaranteed income stream and making the sector more favorable in securing debt.

7 https://www.lasalle.com/wp-content/uploads/2024/03/isa-briefing-march-20-2024-pbsa-europe.pdf

8 https://content.knightfrank.com/research/169/documents/en/uk-student-housing-q2-2024-11358.pdf

9 https://www.mapletree.com.sg/News%20and%20Publication/Press%20Releases/2024/April/Mapletree%20Deepens%20Student%20Housing%20Footprint%20in%20the%20UK%20with%20Strategic%20Acquisition.aspx

10 https://www.cbre.co.uk/insights/books/uk-real-estate-market-outlook-2024/student-accommodation

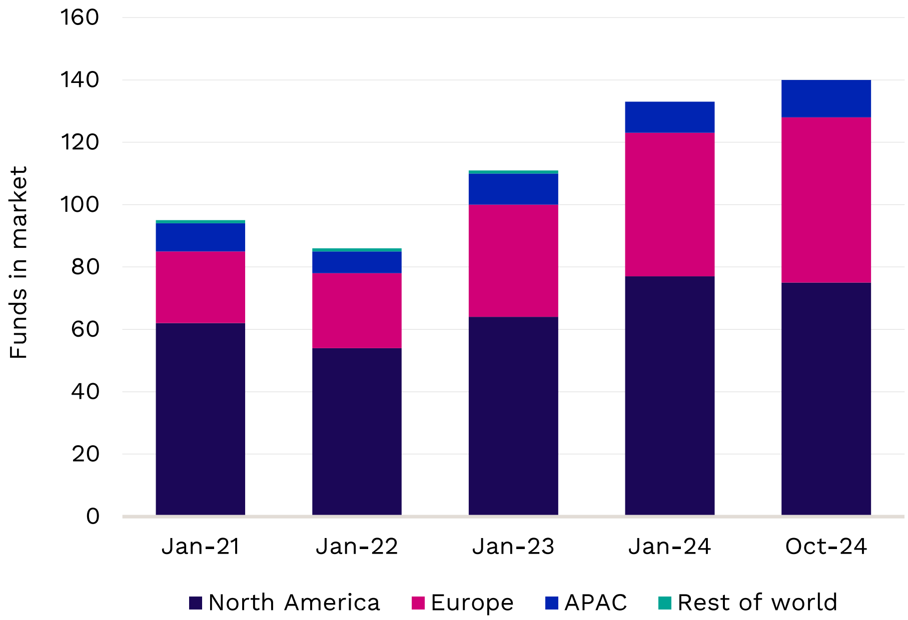
11 https://content.knightfrank.com/research/169/documents/en/uk-student-housing-q2-2024-11358.pdf

12 https://www.hesa.ac.uk/news/08-08-2024/sb269-higher-education-student-statistics/location

13 https://www.kkr.com/insights/bright-outlook-for-european-real-estate

Fig. 8.5: Funds exposed to student accommodation looking to Europe

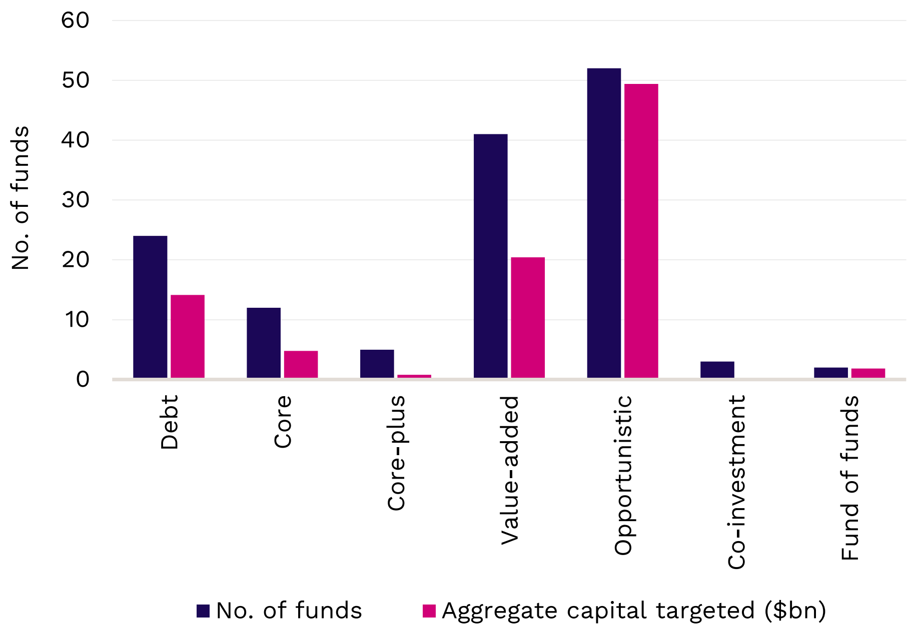
Funds in market with exposure to student accommodation by primary region focus



Source: Preqin Pro

Fig. 8.6: Opportunistic and value-added strategies most interested in student accommodation

Funds in market with exposure to student accommodation (closed-ended) by strategy



Source: Preqin Pro. Data as of October 2024

Our survey: Taking the pulse

Optimism is growing among real estate fund managers and investors, who believe the worst may be over

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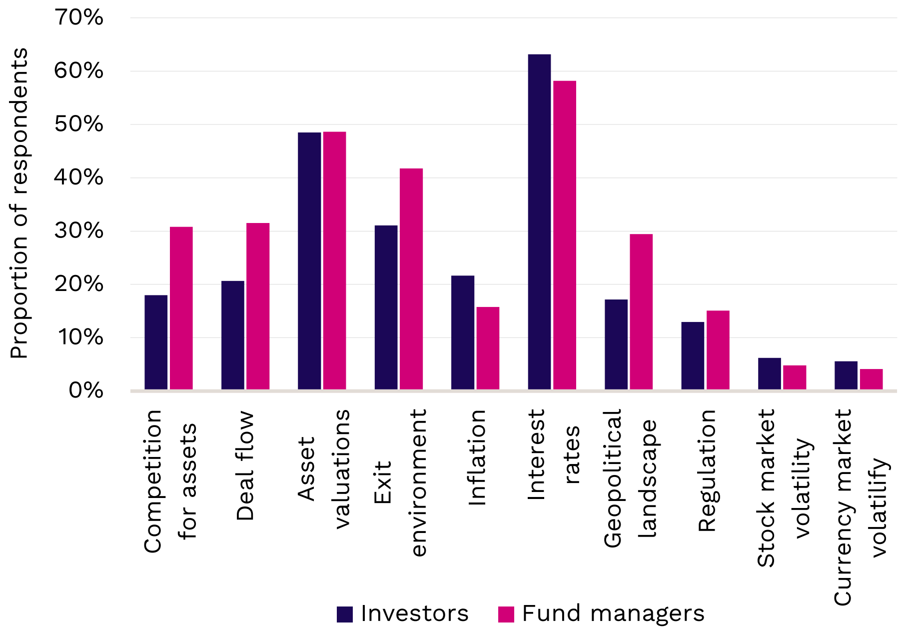
Interest rates remain a major concern when it comes to generating real estate returns over the next 12 months. Our November 2024 survey found that 58% of fund managers and 63% of investors view rates as a key challenge (Fig. 9.1). Given the impact of interest rates on performance and asset valuations, fund managers (49%) and investors (49%) also highlighted asset valuations as a significant consideration.

However, the recent easing of rates across major developed markets, such as North America and Europe, has positively influenced fund managers' perceptions of asset valuations to date. In our November 2024 survey, 59% of respondents said real estate assets are now either fairly valued or undervalued – a significant increase from 29% in 2022 and 24% in 2023 (Fig. 9.2). Consequently, 43% of fund managers reported finding it easier or significantly easier to identify attractive investment opportunities, an 11-percentage-point (ppt) increase on the 32% who held this view in last year's survey (Fig. 9.3).

Fig. 9.1: Interest rates are the main concern for investors and managers

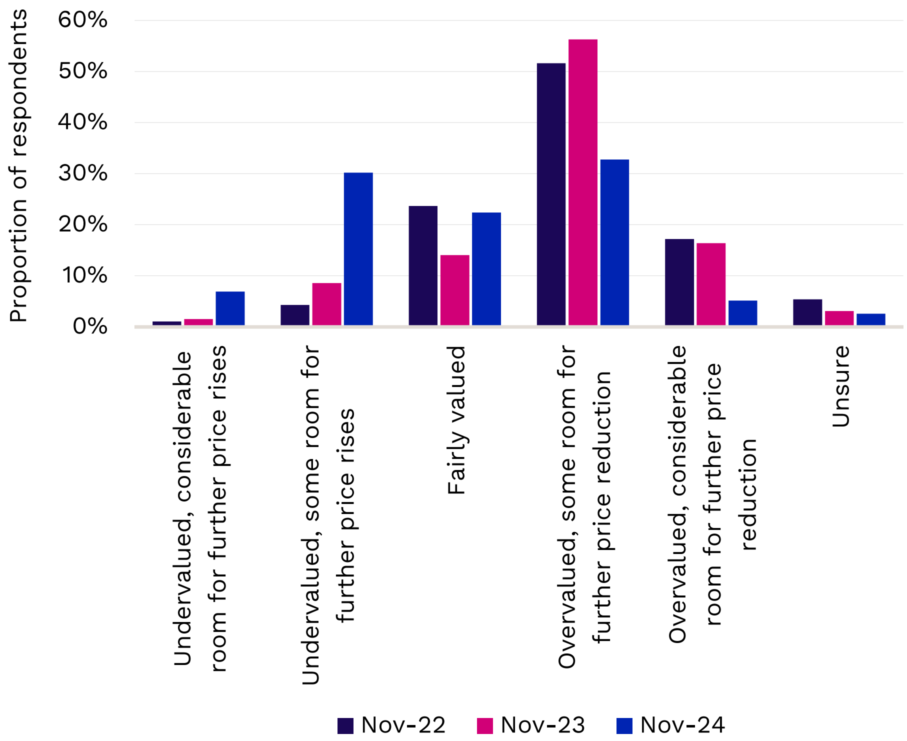
Views on the key challenges for real estate return generation in the next 12 months, investors vs. fund managers



Source: Preqin investor and fund manager surveys, November 2024

Fig. 9.2: More managers view assets as undervalued

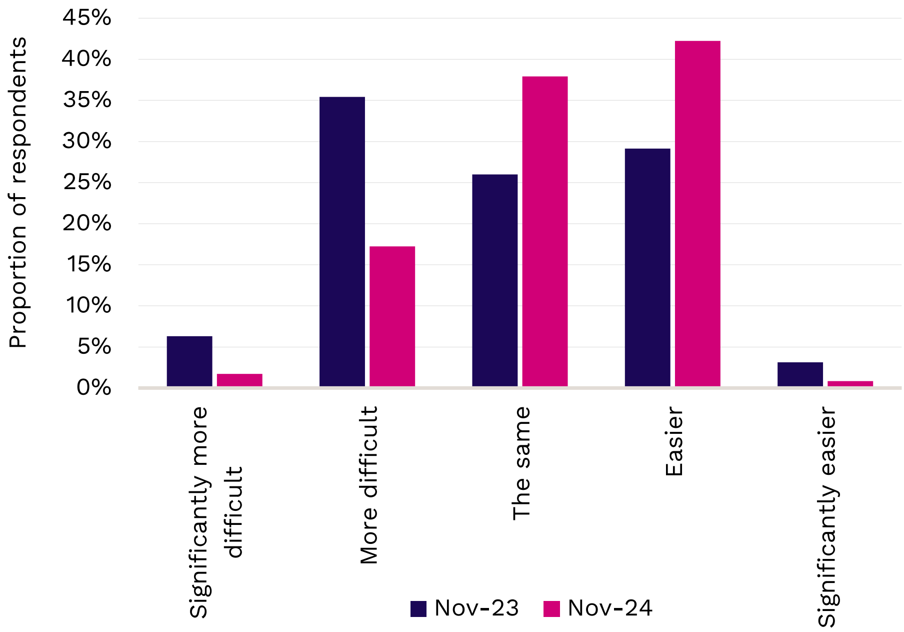
Manager views on real estate asset pricing



Source: Preqin fund manager surveys, November 2022 – 2024

Fig. 9.3: Finding investment opportunities has become easier

Real estate manager views on the difficulty of finding attractive investment opportunities vs. 12 months ago



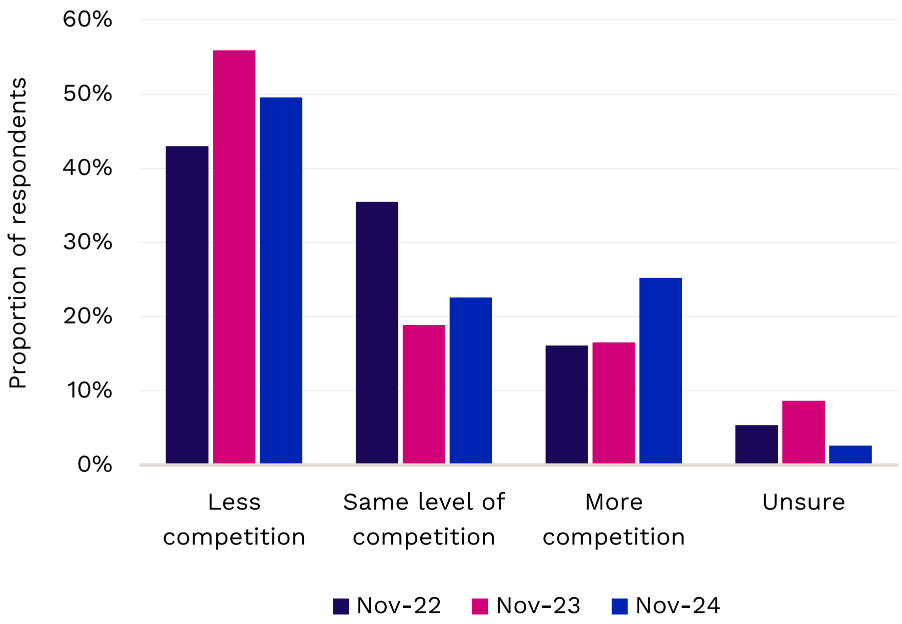
Source: Preqin fund manager surveys, November 2023 – 2024

The improved perception of valuations and the investment outlook are expected to be tailwinds for future deal activity. However, this has not yet been fully reflected in the market. Our Real Estate Q3 2024 update shows deal activity has remained relatively flat over the past seven quarters, with only a slight uptick in deal volume in the third quarter of 2024.[1]

Competition for deals may intensify for debt and distressed
Even with a slightly optimistic outlook for the deal market, half of the fund managers surveyed still expect less competition compared with a year ago – a small drop from the 56% who expressed this view in our November 2023 survey (Fig 9.4). This current landscape tends to favor large real estate fund managers with ample dry powder because emerging fund managers with less dry powder would be more selective in deal-making, as reflected by several big deals in the first nine months of 2024.

Fig. 9.4: Only half of fund managers see less deal competition

Fund manager views on competition for real estate transactions vs. 12 months ago



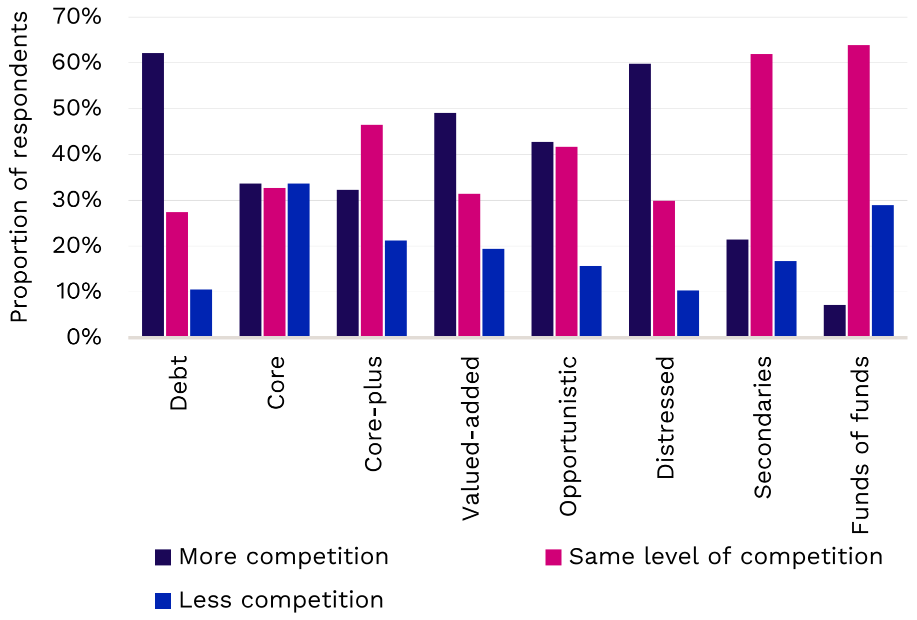
Source: Preqin fund manager surveys, November 2022 – 2024

However, not all strategies are experiencing this reduced competition for transactions. Debt and distressed strategies remain highly competitive for 62% and 60% of fund managers, respectively – similar to last year's survey (55% for both strategies) (Fig. 9.5). The normalization of rates, compounded with a positive outlook of future property prices, could raise the lending sentiment of traditional lenders who stepped back during the rate hike. This is anticipated to help property owners to refinance and become less dependent on financing from real estate debt or distressed investment managers.

1 https://www.preqin.com/insights/research/quarterly-updates/q3-2024-real-estate

Fig. 9.5: Intensified deal competition in real estate debt and distressed

Fund manager views on competition for transactions by strategy

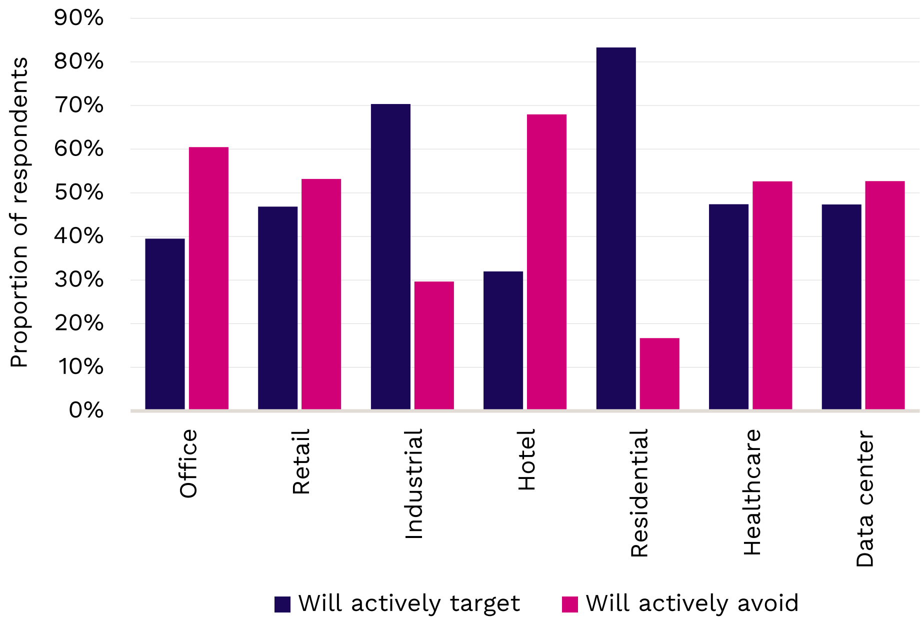


Source: Preqin fund manager survey, November 2024

In terms of sector focus, 83% of fund managers plan to actively target residential properties in 2025, while 70% expect to focus on industrial properties (Fig. 9.6). This trend is already evident in 2024, with residential real estate emerging as the most favored property type globally in the first three quarters, capturing the largest share of global deal value.

Fig. 9.6: Residential and industrials top targets for fund managers

Fund managers were asked 'Will you change your investment approach to the following sectors in 2025?'

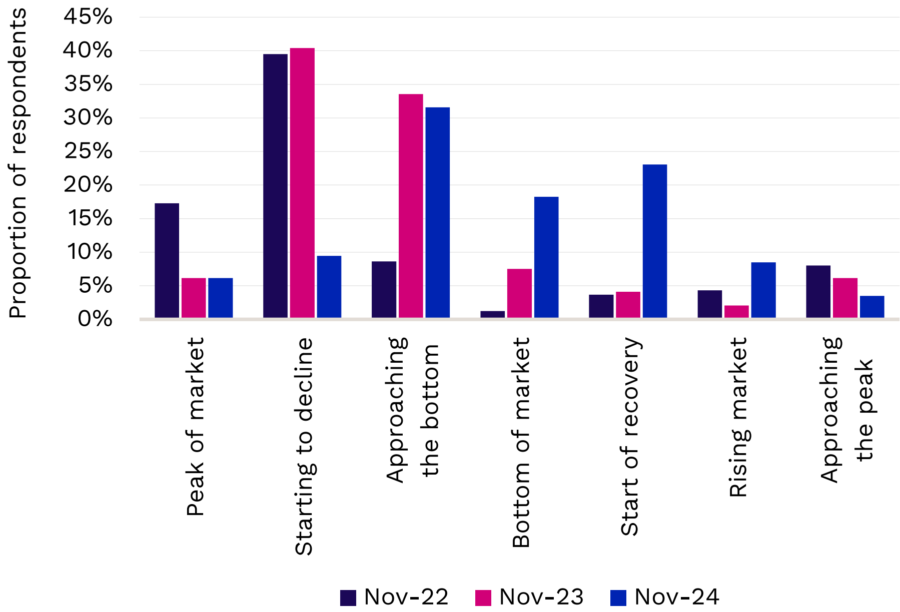


Source: Preqin fund manager survey, November 2024

Improvement in investor appetite could bring relief to fundraising
Real estate investors are increasingly optimistic that the real estate market is about to turn a corner. Our November 2024 survey reveals most investors believe the real estate market cycle is reaching its low point. Among these, 23% of respondents hold the view that the market cycle is beginning to recover – a significant increase of 19ppts from the 4% who shared this view over the past two years (Fig. 9.7).

Fig. 9.7: Investors believe real estate is turning a corner

Investors were asked 'How would you describe the current point in the real estate market cycle?'

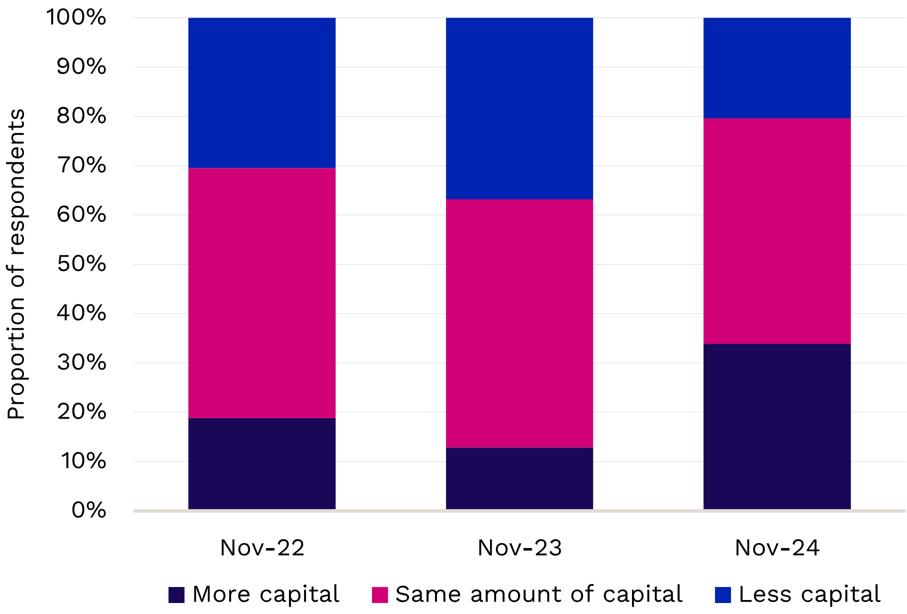


Source: Preqin investor surveys, November 2022 – 2024

In the next 12 months, 34% of respondents plan to allocate more capital (Fig. 9.8), while 36% aim to increase their long-term investments in real estate (Fig. 9.9), marking the highest interest level since 2022. While this indicates a potential recovery in fundraising, actual real estate fundraising has yet to align with these optimistic intentions and remains muted. This continued lag places pressure on fund managers seeking capital, with 79% reporting increased competition for fundraising, down from 84% in 2023 (Fig. 9.10).

Fig. 9.8: Investors are willing to allocate more capital

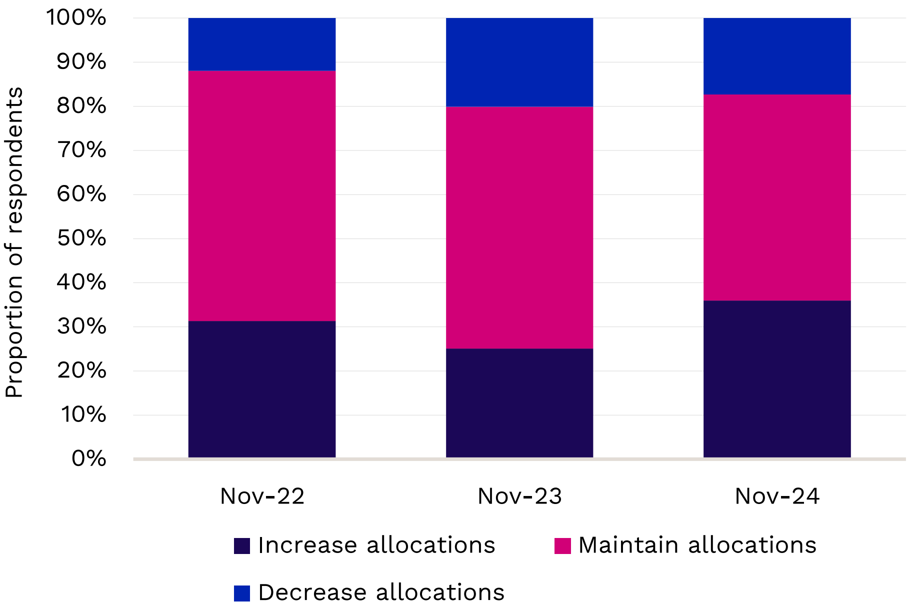
Real estate investor intentions for capital in the next 12 months



Source: Preqin investor surveys, November 2022 – 2024

Fig. 9.9: More investors seek to add real estate allocations

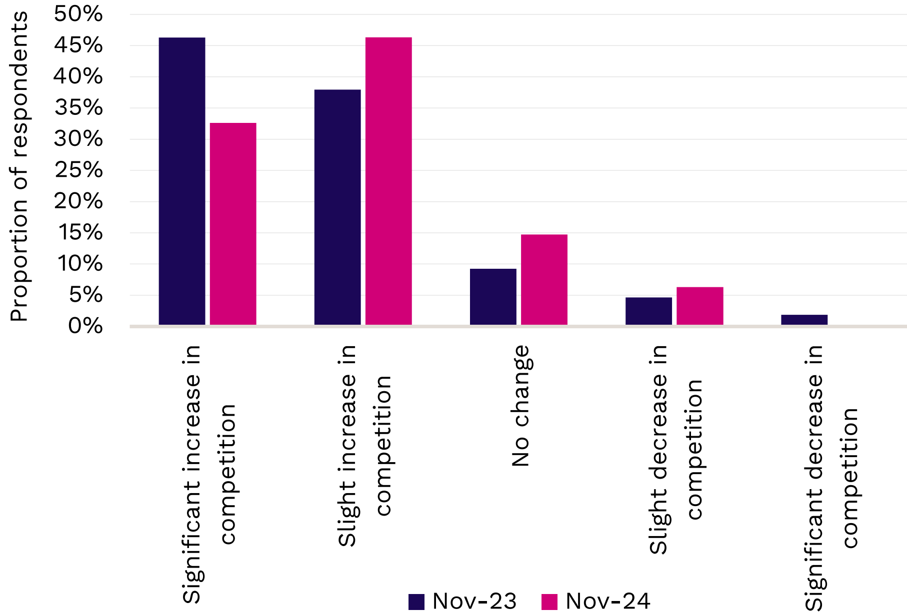
Real estate investor intentions for allocations in the longer term



Source: Preqin investor surveys, November 2022 – 2024

Fig. 9.10: Fundraising competition less intense but still there

Real estate fund manager views on whether competition for investor capital will increase in the next 12 months

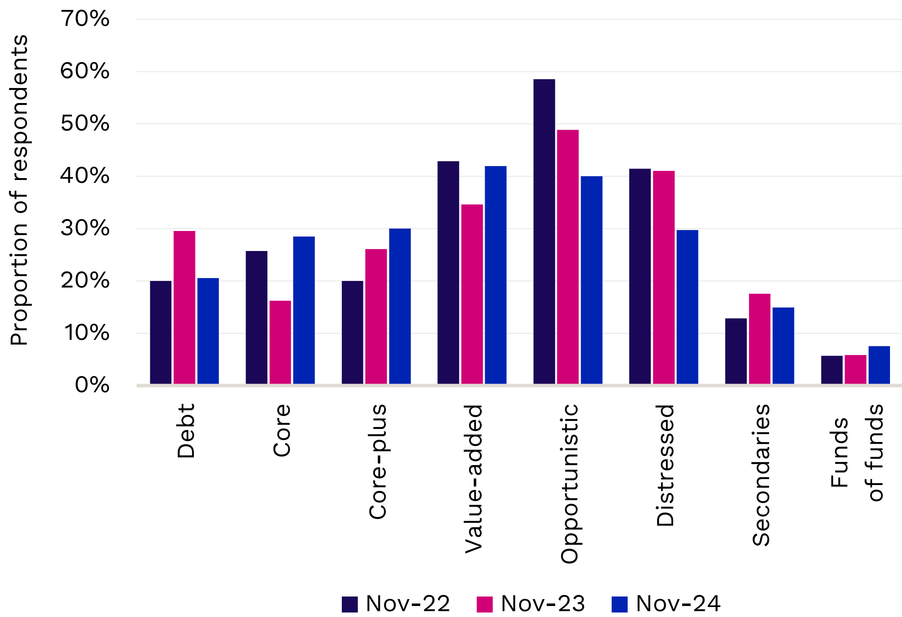


Source: Preqin fund manager surveys, November 2023 – 2024

Investors and fund manager views beginning to align except on emerging markets
In last year's Global Report on real estate, we highlighted differing views among investors and fund managers on which strategies had the best prospects for the next 12 months. More risk-averse investors favored debt, while those with a higher risk tolerance leaned toward opportunistic and distressed strategies. Meanwhile, fund managers were primarily focused on value-added and core-plus strategies. Interestingly, investor sentiment has shifted, coming closer to fund managers' views. Core-plus, in particular, has grown in popularity, with an increase from 20% of investor respondents in 2022 to 30% in 2024 (Fig. 9.11). Overall, more investors now

Fig. 9.11: Investor sentiment shifts toward value-added

Real estate investor views on the fund types presenting the best opportunities in the next 12 months

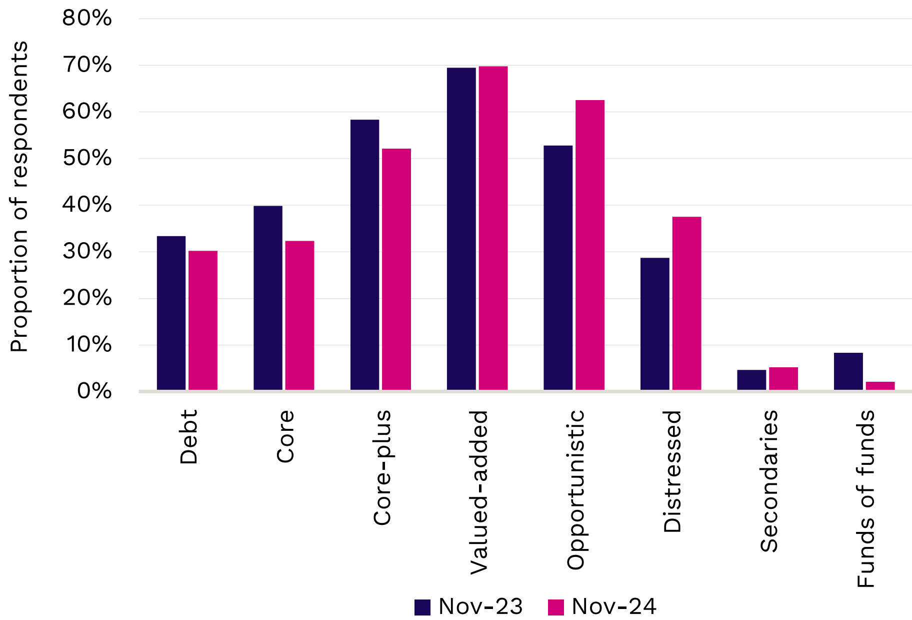


Source: Preqin investor surveys, November 2022 – 2024

see opportunities in core, core-plus, and value-added strategies compared with 2023. Interest in debt, opportunistic, and distressed strategies, previously favored, has declined, while the opposite is true for fund managers (Fig. 9.12).

Fig. 9.12: Value-added the key strategy for fund managers

Strategies to be actively targeted by fund managers in 2024



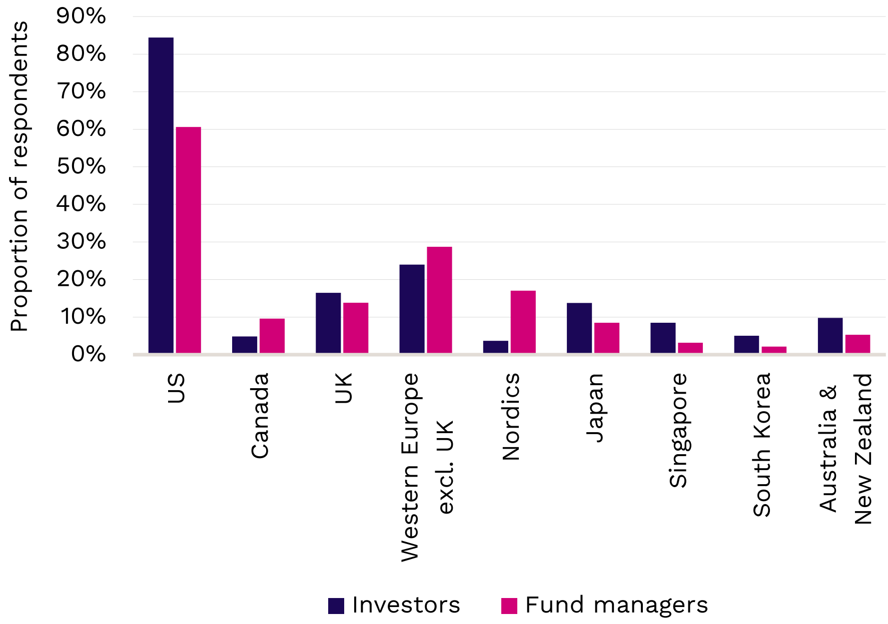
Source: Preqin fund manager surveys, November 2023 – 2024

Nevertheless, value-added remains the top choice for both investors (42%) and fund managers (70%). As inflation is expected to decline and interest rates stabilize, we expect value-added strategies to be well positioned to benefit most from the expected rise in property valuations. In the chapter 'Real estate: Preqin's forecasts through 2029', we project that value-added strategies will deliver an internal rate of return (IRR) of 9.6% from 2023 to 2029, marking the highest increase in IRR among real estate investment strategies.

The convergence in views also extends to developed markets, with both fund managers and investors generally in line. The US stands out, particularly for investors, with 84% viewing it as attractive vs. 61% of managers (Fig. 9.13). The main discrepancy lies in the Nordics, where just 4% of investors see potential, compared with 17% of fund managers.

Fig. 9.13: Investors and fund managers continue to favor the US

Developed markets targeted by real estate fund managers vs. investors in the next 12 months

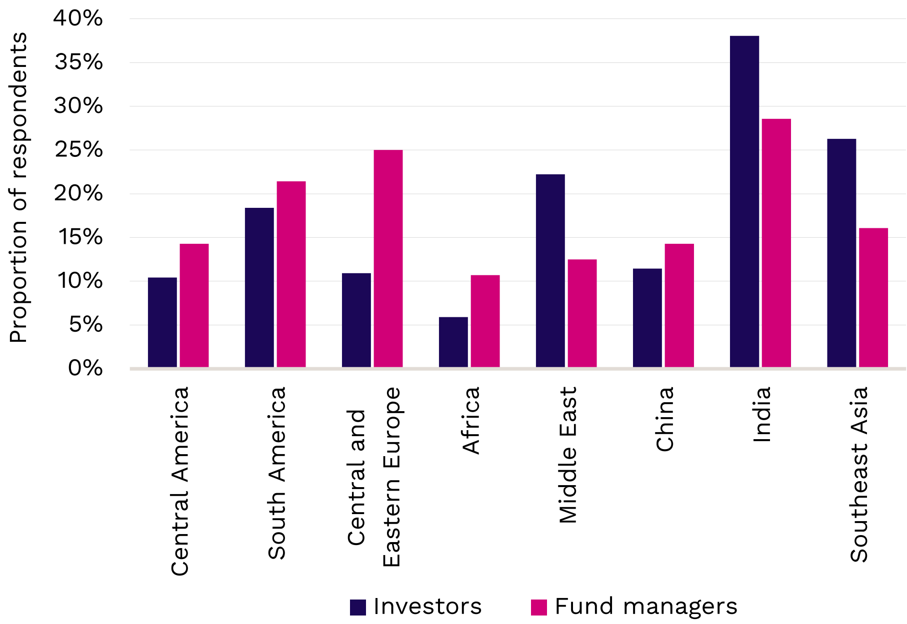


Source: Preqin investor and fund manager surveys, November 2024

In emerging markets, India remains the top destination for both investors (38%) and fund managers (29%) (Fig. 9.14). Beyond this, opinions generally diverge. Southeast Asia comes second in the list of preferred destinations for investors (26%) and the Middle East third (22%), while fund managers put Central and Eastern Europe second (25%) and South America third (21%).

Fig. 9.14: India the top destination for fund managers and investors

Emerging markets targeted by real estate fund managers and investors in the next 12 months

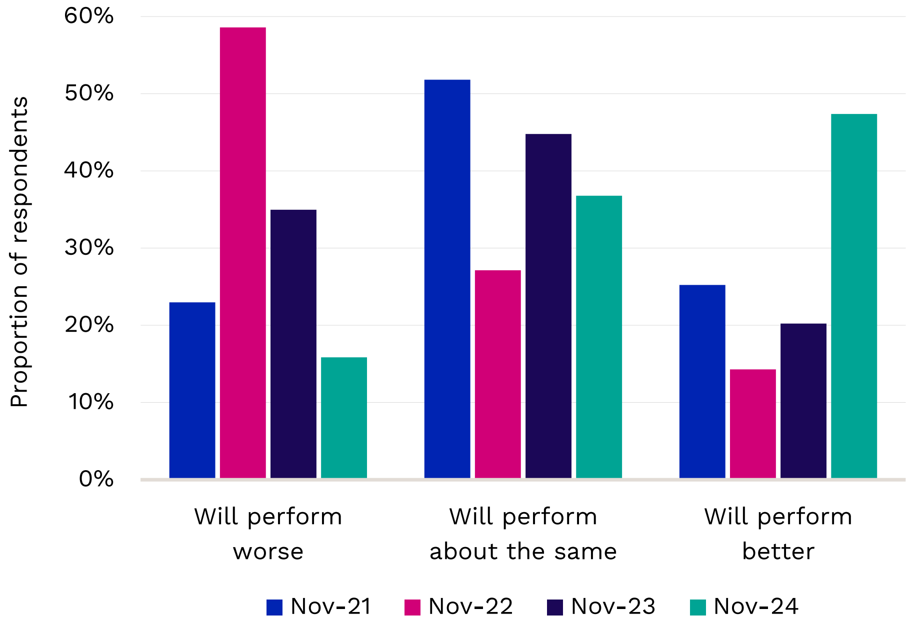


Source: Preqin investor and fund manager surveys, November 2024

Investors are showing increased signs of optimism about the real estate market, suggesting the worst may be over. According to our survey, 47% of respondents expect real estate to perform better over the next 12 months than in the previous year – the highest level of confidence recorded since 2021 (Fig. 9.15).

Fig. 9.15: Expectation for better performance highest in four years

Investor expectations for real estate performance in the next 12 months vs. the previous 12 months



Source: Preqin investor surveys, November 2021 – 2024

Real estate: Fees and terms

Headline fee rates, management fee discounts, and GP catch-ups are all comparatively LP-friendly

10

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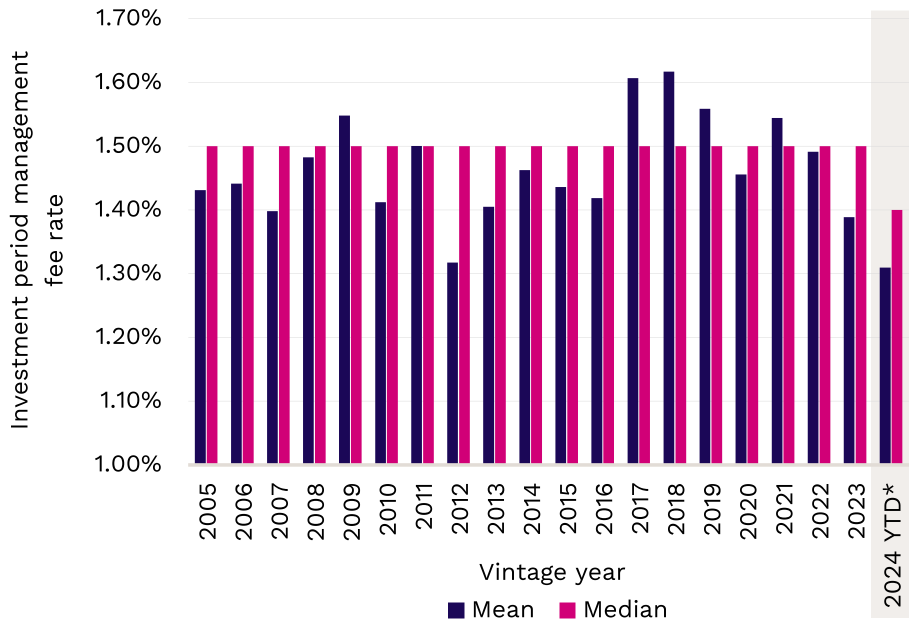
Real estate has had a bumpy ride since 2020. Rate hikes have affected real estate loan-to-value ratios and valuations to the point that real estate was the only asset class to see a contraction in assets under management in 2023. The upside is that fees look favorable for LPs.

Management fee rates declining

Between 2005 and 2023, the median real estate management fee rate was stable at 1.5% while the mean varied by about 12 basis points (bps) above and below this. In 2024[1], average management fee rates in real estate dropped to a 20-year low: the mean fell to 1.31% and the median to 1.40% (Fig. 10.1). This decrease is likely to be in part a result of fundraising challenges, as GPs face competition in raising capital while fundraising amounts have yet to rebound strongly, as revealed in the 'Global fundraising in review' chapter.

Fig. 10.1: Real estate management fee rates at a 20-year low

Real estate funds' average management fee rates by vintage year



*2024 (funds raised YTD and closed)

Source: Preqin Pro. Data as of end-June 2024

Since 2014, the distribution of management fee rates has evolved. In 2014, about 28% of fee rates were less than 1.50%; by 2024, that category rose above 55% (Fig. 10.2). Real estate fee rates at or above 2.50% peaked above 7% of all fee rates as recently as 2021, but have since dwindled to 0% as of the latest reading. This shifting composition could be related to a combination of factors, including fundraising and fund size. Across asset classes, a more difficult fundraising environment is associated with lower fees. And in real estate funds, the largest fund sizes – those $2bn and larger – and the smallest – those under $250mn – are associated with higher fee rates than those of between $250mn and less than $2bn.[2]

Variations in management fee rates and performance

When rates are segmented by fund size, the median fee rates of recent vintage funds[3] are consistently at 1.50% (Fig. 10.3). However, the mean rates show an inverted arch formation, with the middle fund sizes – those at or above $250mn and below $2bn –

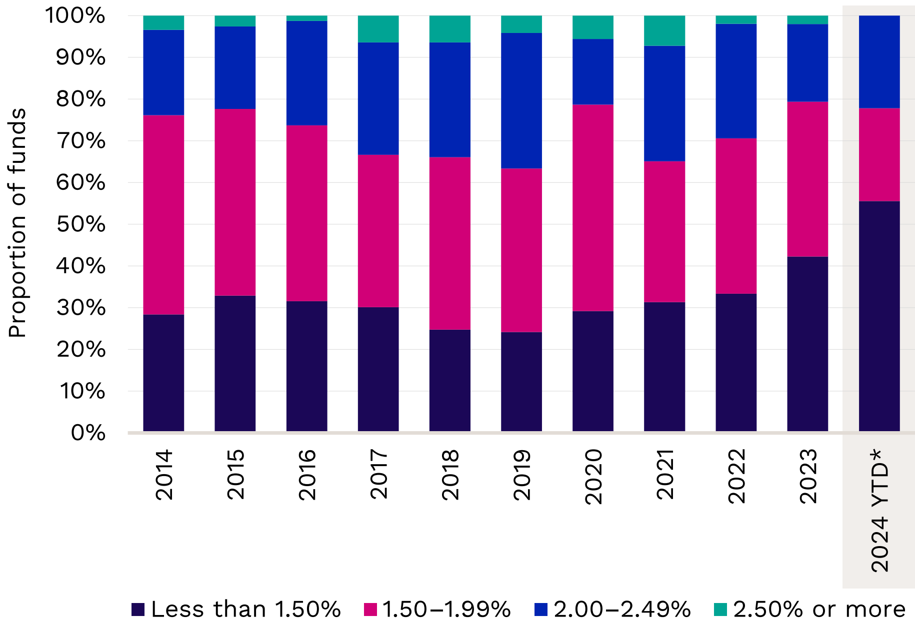
1 2024 readings are through June.

2 For more information on the relationship between fund size and fee rate, see the Real Estate chapter of Preqin's 2024 Fund Terms Advisor report: https://preqin.com/insights/research/reports/the-2024-preqin-private-capital-fund-terms-advisor

3 Funds being raised and closed in 2023 and 2024.

Fig. 10.2: Over half of real estate funds have management fees below 1.5% in 2024

Real estate funds' investment period management fees by vintage year

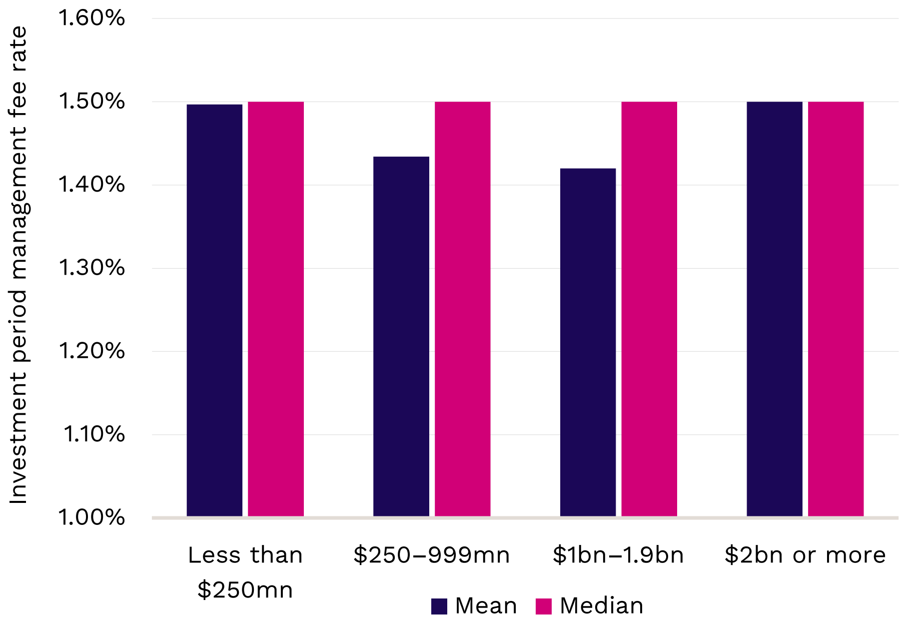


*2024 (funds raised YTD and closed)

Source: Preqin Pro. Data as of end-June 2024

Fig. 10.3: Mean real estate management fee rates are lower in funds $250mn–$1.9bn

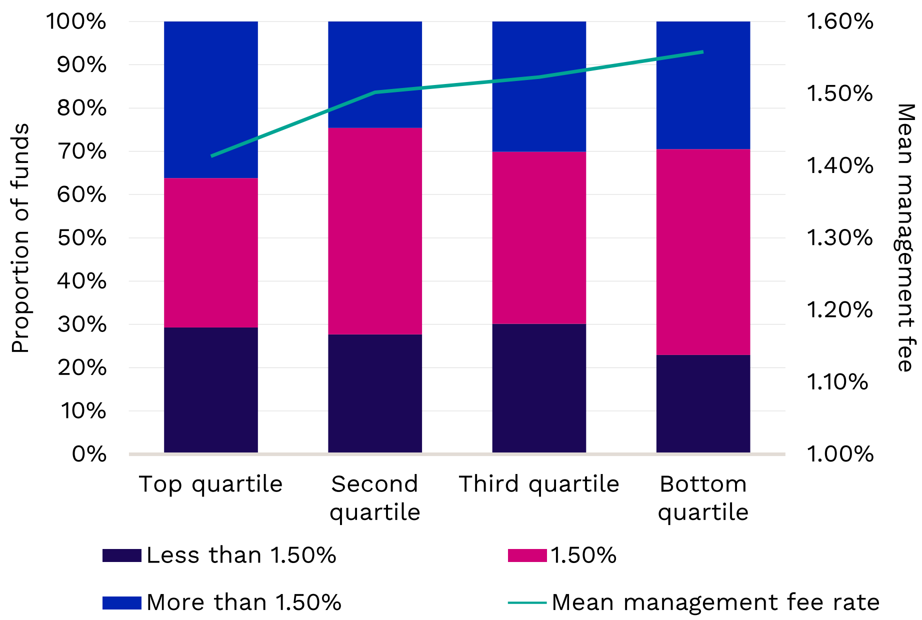
Real estate funds' average management fee rates by fund size (raising and closed 2023 and 2024 funds)



Source: Preqin Pro. Data as of end-June 2024 charging lower fees, in the 1.42–1.43% range. This formation is distinct from other asset classes, such as private equity, private debt, and infrastructure, where the smallest and largest fund sizes charge lower fees. The reason for the real estate inverse arch form could be competition among the middle fund sizes leading fees downward. Smaller funds may have to charge higher rates to cover their costs, and larger funds could be associated with larger fund managers that cover other asset classes, where 1.50% management fees are competitive.

Fig. 10.4: Top quartile ranking funds coincide with a lower mean management fee rate

Real estate funds' management fees by fund quartile ranking (vintage 2015–2024 funds)



Source: Preqin Pro. Data as of end-June 2024

Since 2015, the top performance quartile has had a mean management fee of 1.41%, lower than the mean management fees of other performance quartiles (Fig. 10.4). We note that correlation does not imply causality. Further, the top performance quartile had a higher proportion of fees above 1.5%.

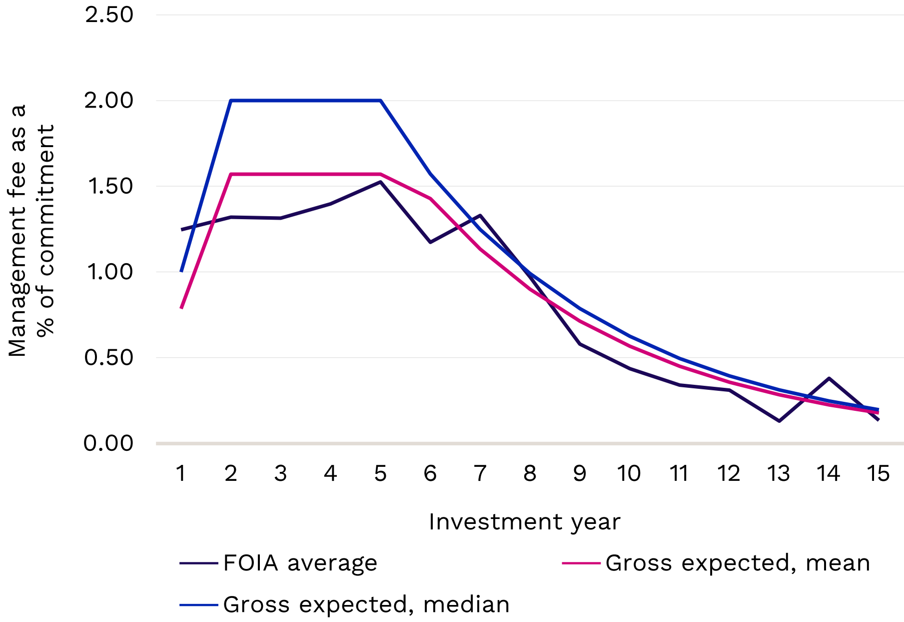
Fee discounts and offsets mean gross-to-net management fee spread can be sizeable

This year, we have modeled management fee rates over the life of a real estate fund and compared net fees paid to gross fees expected.[4] Over a 12-year lifespan, the gross-to-net spread could range from 67bps to more than 3 percentage points (Fig. 10.5). A large portion of the spread can be explained by management offsets and discounts. Though not as common in real estate as in other asset classes, management fee offsets can reduce the net fees paid.

4 For assumptions of the model, refer to Preqin's 2024 Fund Terms Advisor report: https://preqin.com/insights/research/reports/the-2024-preqin-private-capital-fund-terms-advisor

Fig. 10.5: Real estate net management fees paid could be considerably lower than gross over fund's life

Management fees by investment year as a percentage of commitment

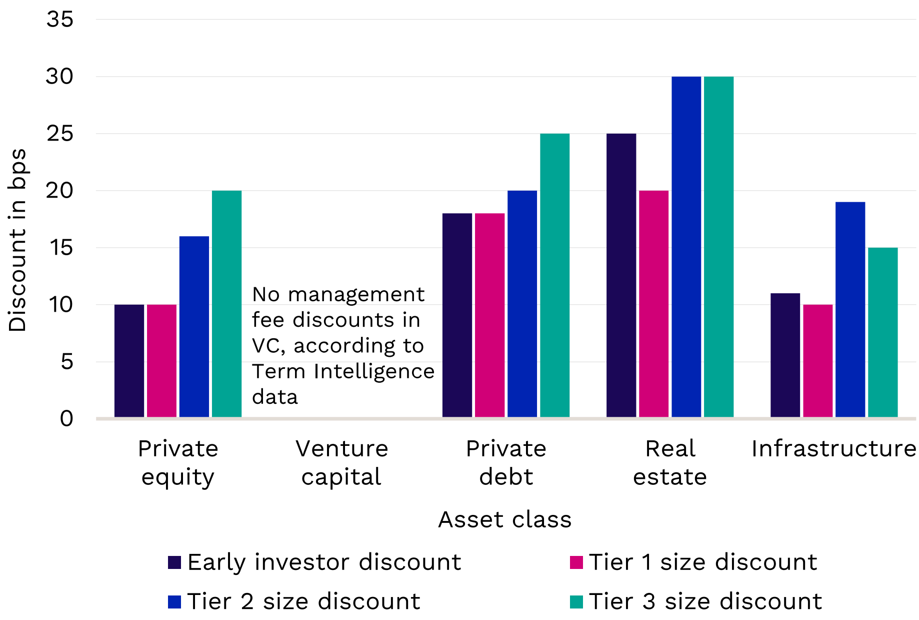


Source: Freedom of Information Act (FOIA) and Term Intelligence

In addition, management fee discounts can lower management fee rates. Such discounts are available to early investors – those who commit before the first close – and LPs with large commitments. What constitutes a large commitment can vary by fund size and GP. Discounts are most generous to LPs in real estate, with the median early investors discount of 25bps and a median size discount range of 20–30bps (Fig. 10.6).

Fig. 10.6: Real estate funds have largest discounts

Amounts of median management fee discounts in basis points (vintages 2020 onward)*



*All funds are closed

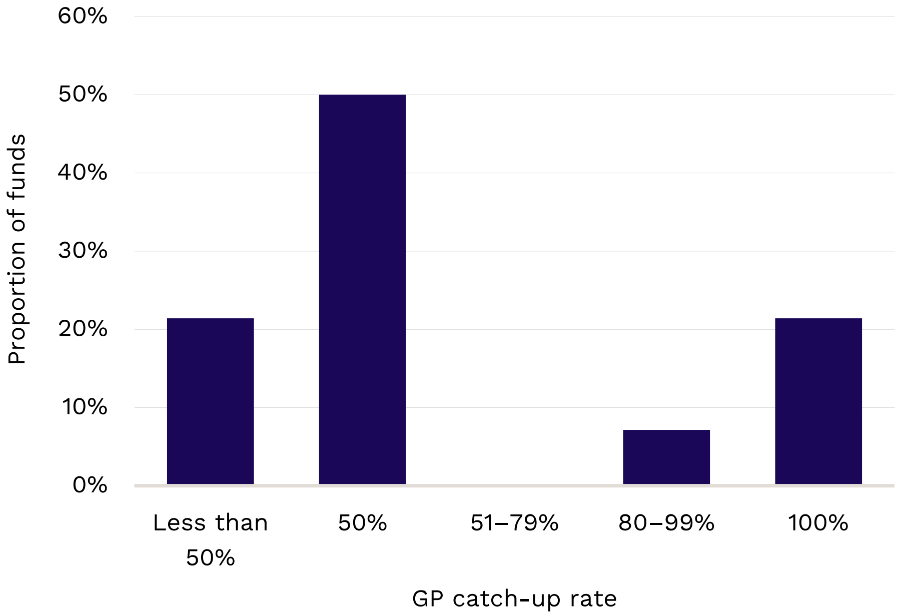
Source: Term Intelligence

GP catch-ups favorable to LPs

Similar to private debt, real estate hurdle and carry rates vary by level of risk. At the low end of the risk spectrum, real estate debt has mean hurdle rates of 6.5% and mean carry rates of 18.3%. At the higher end, opportunistic strategy has an 8.7% mean hurdle rate and a 19.7% mean carry rate (Fig. 10.7).

Fig. 10.7: GP catch-up rate in real estate is 50% half the time

GP catch-up rate real estate (raising, and closed 2023 and 2024 funds)



Source: Preqin Pro. Data as of end-June 2024

One aspect of the waterfall distribution – GP catch-ups – has received more attention as distributions have slowed across private markets. Lower GP catch-ups are more favorable to LPs because it means their distributions will be less likely to see a drastic drop in the GP catch-up phase. In recent real estate funds, the 50% catch-up was found in about half of funds.

For additional details on real estate fees, read The 2024 Preqin Private Capital Fund Terms Advisor.[5]

5 https://preqin.com/insights/research/reports/the-2024-preqin-private-capital-fund-terms-advisor

Predictions

1 Real estate deal flow will keep recovering

Market enthusiasm over further interest rate cuts from 2024 onwards is likely to reinforce a higher aggregate deal value for real estate in 2025. In what could be a last opportunity for bottom fishing, new players are expected to enter the market, speculating on a rebound in property values. This potential surge in capital is set to drive a gradual increase in global total transaction value over the year, reflecting a revived real estate market characterized by increased investment activity and a dynamic economic landscape.

2 More positive outlook for capital raising in 2025

In 2024, despite a continued rise in the number of funds in the market, aggregate capital targeted by these funds declined for the first time since records began, indicating a less-saturated capital-raising market. Shifts in investor sentiment toward the end of 2024 are expected to drive increased commitments to new real estate funds in 2025. A surge in real estate transactions could expedite fund exits, freeing up capital from liquidated funds to recycle into fresh ventures. This trend should act as a catalyst for real estate fundraising endeavors in 2025.

3 Value-added strategy draws continued investor interest

In 2025, strategies focusing on acquiring existing properties, especially those employing value-added approaches, are expected to yield significant gains. This will result from a property valuation surge led by the decline in risk-free rates used for asset pricing. Our projections indicate value-added strategies are likely to experience the most substantial increase in IRR through 2029 and to remain an attractive option for investors, drawing continued interest and investment traction in the real estate market.

4 Real estate AUM to resume its growth

Global real estate AUM suffered a dip in 2023, primarily due to a decrease in dry powder as fundraising stagnated from 2022. With expectations of improved fundraising supported by investor plans to allocate more in real estate – as shown by our latest investor survey – dry powder in real estate is projected to increase once again, allowing real estate AUM to return to growth. However, the projected growth in dry powder would take years to offset the losses incurred as a result of the contractions of the past three years. Unrealized investments, another pillar of real estate AUM, are therefore set to play a more significant role and overshadow the impact of growth in dry powder.

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