BCLP Client Intelligent

Insights

REAL ESTATE 2024: REASONS TO BE CHEERFUL

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SUMMARY

After a challenging landscape for the European real estate sector in 2023 and the echo chamber of pessimism, we think it is important to challenge conventional wisdom with some reasons to be cheerful about 2024 and what it could look like.

WEIGHT OF CAPITAL

DRY POWDER

A mountain of dry powder has been waiting for valuations to fall. All markets go through cycles. There are reasons to believe that some investors will see opportunities on the other side of the holiday season while everyone else is still recovering from a hangover.

GLOBAL CAPITAL

Global macroeconomic events over this past 18-24 months have caused capital to accumulate in petrostates such as the UAE and Saudi Arabia, which have historically had a robust allocation to European prime real estate. Investors from these jurisdictions are often all-cash buyers and are poised to take advantage of current market conditions. Aldar's recent $291m acquisition of UK developer London Square is a sign of things to come in 2024.

MATURING FUNDS

Fund managers have been allowed some forbearance by institutional investors but a more stable and liquid market will allow managers and investors to move on through realisations. The growth of the real estate secondary market will provide a further avenue for liquidity.

EMERGENCE OF ALTERNATIVE LENDERS

The banking sector has faced capacity constraints and a reduced appetite for risk but investors now have a greater choice of increasingly active alternative providers of debt and quasi-debt often supported by banks through loan on loan facilities. As a result there will be more competition to finance deal activity.

MACRO-ECONOMIC CONSIDERATIONS

MATURING DEBT

There are a huge number of real estate loans maturing through 2025 including at least:

Declines in capital values and the increased cost of debt will impact refinancing options and generate distressed opportunities with lenders pushing for consensual sales and turning to creative enforcement strategies where necessary.

WEWORK

WeWork filed for bankruptcy protection in the US in November paving the way for re-possessions and distressed sales globally and a spectrum of opportunities for competitors and investors.

MODERATING INFLATION

Soaring inflation has reduced more quickly than expected on a sustainable basis. Although there is further to go to achieve central banks' long term targets, the direction of travel is down.

STABLE INTEREST RATES

Interest rates have peaked. Conventional wisdom is that they will stay higher for longer but it seems more likely than not that rates will start to come down in 2024 resulting in a better deal environment.

FALLING TREASURY/GILT YIELDS

Falling treasury/gilt yields will make investment in real estate more appealing while capital value corrections have left real estate yields looking increasingly attractive. This combination could lead to some prospective cap rate compression.

REAL ESTATE FUNDAMENTALS

OCCUPATIONAL DEMAND

Occupational demand across many sectors remains buoyant. Even in less fashionable sectors such as offices, continued momentum behind the return to office working is supporting take-up.

RENTAL GROWTH

Rental growth has been stronger than expected for prime assets in many sectors. This combined with increased cap rates due to higher gilt yields will attract investors seeking to underwrite opportunities with higher operating yields and projected total returns.

FALLING CONSTRUCTION PRICES

Construction costs have fallen sharply in the second half of 2023 following a well-documented price spike. This was in spite of the decline in availability of certain materials. Falling construction prices will finally feed through into build costs in 2024.

POLICY AND REGULATION

ENVIRONMENTAL REGULATION

Building owners, operators and occupiers have obligations to decarbonise. The conventional view is that this is difficult, laborious and expensive to achieve but the path to net zero is becoming better understood and more affordable and reliable and the commercial benefits of achieving it are becoming more apparent. What some see as a challenge, others will see as an opportunity.

REPURPOSING

Buildings may be experiencing obsolescence bought about or accelerated by a range of factors including Covid, new working patters, outdated design features, rules and regulations or technology and automation. In some cases repurposing will become an option for rejuvenating a property. Some offices have already been repositioned for residential or life science use.

POLITICAL DRIVE FOR DEVELOPMENT AND PROMOTION OF NEW INFRASTRUCTURE

Europe is facing some long term growth and environmental challenges and there is a broad political consensus around the need for a strategic approach to improving infrastructure for the future (from data to transport) even if there are disagreements about priorities. Whether this is achieved through de-regulation, planning intervention or public investment, this will present opportunities for brave investors and developers.

UNDERLYING TRENDS

TECHNOLOGY

AI is starting to transform the real estate industry whether by reducing use of energy, lowering the carbon footprint of a building and optimising operating costs or by speeding up the construction of buildings. It may not be a silver bullet but nor was internet connectivity 30 years ago. AI and technology generally will also continue to drive the need for functionally excellent and well-located data centres.

DE-GLOBALISATION: NEAR SHORING AND FRIEND SHORING

Global hot spots and growing protectionism has resulted in companies and Governments increasingly resorting to near-shoring and friend-shoring to immunise supply chains from future shocks. This trend will continue to affect the real estate sector, most notably prime logistics assets which have continued to enjoy high occupancy and positive rent rises.

MARKET PSYCHOLOGY

VALUATIONS

More deal flow will generate more data, provide buyers and sellers with more pricing certainty and confidence about transacting which in turn will generate deal flow and create a virtuous deal circle.

MARKETS ARE CYCLICAL

Most investors forget that markets are cyclical or do not have the risk appetite, investor support or conviction to be early adopters but the real winners begin to buy from tired investors at low prices when the general mood is still bearish. This may be a bet against general market sentiment or a bet against sentiment in relation to particular asset classes. As night follows day others eventually get on the bandwagon resulting in yield compression which in turn will attract the laggards and give early movers opportunities to cash in and achieve strong returns. The lethargy of 2023 provides a perfect launch pad for dissonance among investors.

BOREDOM AND FOMO

Finally…. Twiddling your thumbs? Spending too much of your day doom scrolling? When opportunities arise as the restructuring cycle picks up, investors will not want to miss out. Boredom coupled with FOMO could lead to a surge in activity and a robust deal environment in 2024.

RELATED PRACTICE AREAS

- Corporate Real Estate and Funds

MEET THE TEAM

John Bennett

London

john.bennett@bclplaw.com
+44 (0) 20 3400 4363
