Top 10 questions

Real estate markets in 2025

A new dawn

UBS

The road to stability

2024 was a year of recovery, with GDP rising across most countries and inflation moderating, albeit remaining volatile. Ultimately, the much hoped-for soft landing was achieved. Improved financial conditions and investor sentiment fed through to a slow pick-up in real estate investment activity. The easing of monetary policy in 2024 has resulted in the prolonged downturn coming to an end. However, we think that the conditions prevailing in the post-GFC era will not be mirrored, with interest rates set to remain elevated and above pre-pandemic levels. We think that 2025 will be a year of progress, as we turn the corner, but that economic and political uncertainties will remain.

Looking back at our *2024 predictions*, we think they were fairly prescient. There were opportunities to access distressed assets at attractive and discounted pricing as the market bottomed out. Capital values rose or were flat across many markets in the residential, retail, and industrial sectors and we continued to see bifurcation in the office sector. Despite rate cuts in 2024, the higher-for-longer interest rate scenario continues to be relevant, with rates coming under renewed upward pressure in early 2025, and still expected to settle above pre-pandemic levels. Finally, the Bank of Japan ended its negative interest rates in 2024, as we predicted.

We have a year of change ahead, with many questions to consider, but have managed to narrow them down to our Top 10 for 2025. The key topics include analyzing Donald Trump's plans as he returns to the White House, with tariffs expected, and the potential impact on the real estate market. We also discuss where the real estate market is in the cycle and its rebound potential. Next, we revisit the topic of Artificial Intelligence (AI), analyzing the pressure it's putting on scarce electricity supplies and the resulting shift to nuclear power by BigTech. In addition, we discuss the slowdown in sentiment towards ESG, residential rent controls and how professional sports and real estate can interact for success or failure.

We've selected our Top 10 questions from a wide range of topics, though there are other important themes which we haven't covered, such as: investment opportunities in Japan, where we expect further interest rate rises this year, what is next for logistics, and whether the UK political backdrop is a headwind for its real estate market. We hope you find our answers insightful to navigate 2025.

How will Trump's tariffs impact real estate markets?

As Donald Trump takes office for a second term, it is almost certain that he will increase tariffs on US imports, though the exact size and extent of the increases are not yet clear. He has proposed tariffs ranging from 10-20%, with a higher rate of 60% specifically for China, and has also considered 25% tariffs for Canada and Mexico. These tariffs are expected to impact real estate markets in the US and beyond. According to data from the World Bank, goods trade across advanced economies (both exports and imports) accounted for 45% of their GDP in US dollar terms in 2023, with all of this trade passing through logistics facilities at some point.

The tariffs are likely to impact trade volumes, be it an actual pullback or just slower growth, and could pose a risk to occupier demand for logistics properties globally. Logistics facilities around transport nodes look most exposed – airports, ports and land borders. Those focused on the lower end of the distribution chain, to end consumers and retailers, look less at risk. Retaliatory tariffs from other countries, which seem likely, could curb trade further. On the other hand, industrial property and factories in the US may benefit from increased occupier demand as multinationals look to reshore manufacturing activities to avoid tariffs, though this will take time. Overall, we think caution is warranted on international logistics property moving into 2025.

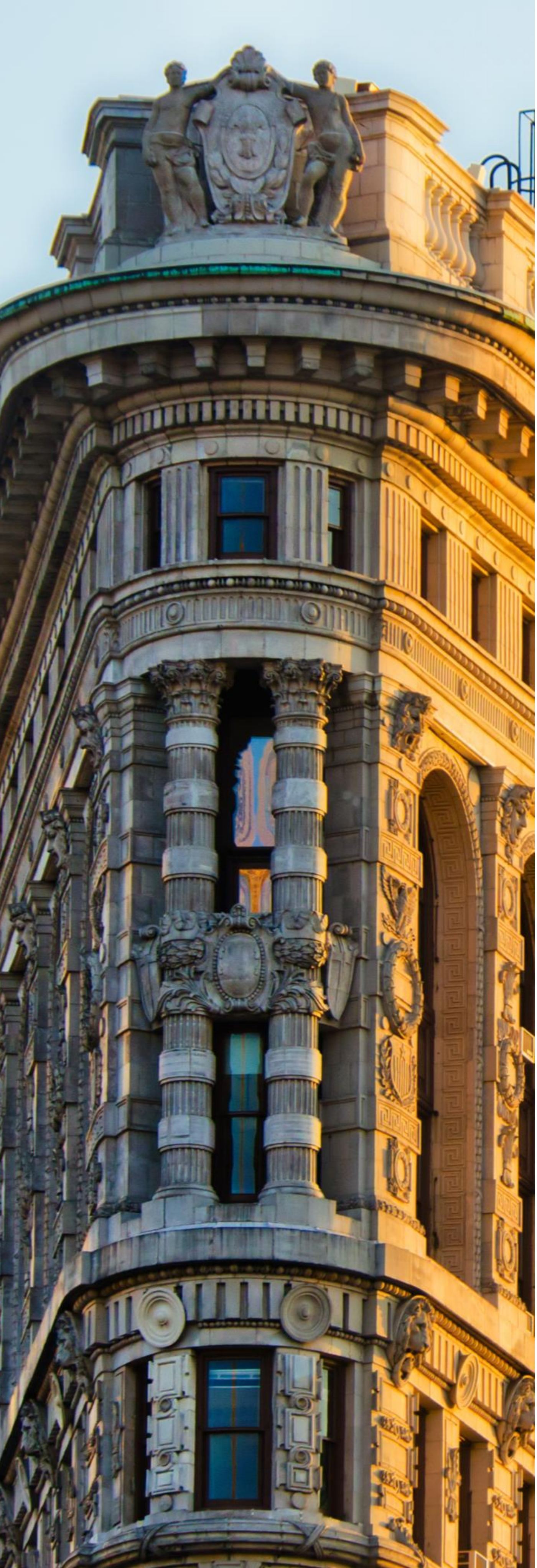
Whatever happened to good old fashioned asset management?

Two words: scale and competition. As real estate investment matured, institutional investment grew exponentially. Latest figures from MSCI estimate that the total investable universe exceeded USD 13.2 trillion by the end of 2023. Seizing the opportunity, the number of funds and managed accounts has exploded, with Preqin reporting over 2,700 private real estate funds operating across the globe as of September 2024. Investment portfolios evolved from regional to global and diversified into niche property types, a trend we expect to accelerate in 2025.

With this growth, yields compressed, and traditional asset management practices shifted to leverage technology. Tasks like overseeing operations, project planning and fine-tuning budgets remain critical but do not capture headlines the way technological innovation does. Modern firms should use technology to analyze ever-growing data flows as their responsibilities expand across assets, geographies and property sectors.

Real asset investing brings unique, real-time challenges that remote monitoring cannot fully address. While technology enhances efficiency, it cannot replace the critical human judgment and hands-on involvement necessary to navigate the complexities of asset management.

Good old-fashioned asset management has not disappeared; it has adapted. The fundamentals remain crucial, even as the industry evolves with technological advancements and increased competition. Active and informed management continues to play a vital role in achieving successful investment outcomes. Moreover, asset management is particularly important now that the tailwind of leverage, which prevailed and enhanced returns in the post-GFC era, is diminished.



What is the impact of increased geopolitical tensions on the real estate market?

The significant increase in geopolitical uncertainty in recent years has not left the real estate sector unaffected. On the one hand, it has led to a reassessment of certain markets. Countries and regions involved in or bordering countries exposed to military conflicts, trade disputes, sanctions or political instability are increasingly being avoided by investors. The immediate effect is a shift in cross-border capital flows. Investors often move their capital to perceived 'safe havens', such as stable residential markets or low-risk locations with predictable legal systems. As the investable universe is shrinking, investment pressure – and consequently prices – in safe haven locations is likely rising.

Besides these shifts, the geopolitical tensions are also affecting the attractiveness of certain sectors. As vulnerabilities of the globalized world were revealed by the pandemic and as protectionist tendencies in various countries are rising, securing domestic supply chains has taken on greater importance. Similarly, the topic of defense is taking on a significantly larger role in public disclosure. With re- and nearshoring, manufacturing and industrial assets are increasingly capturing investors' interest.

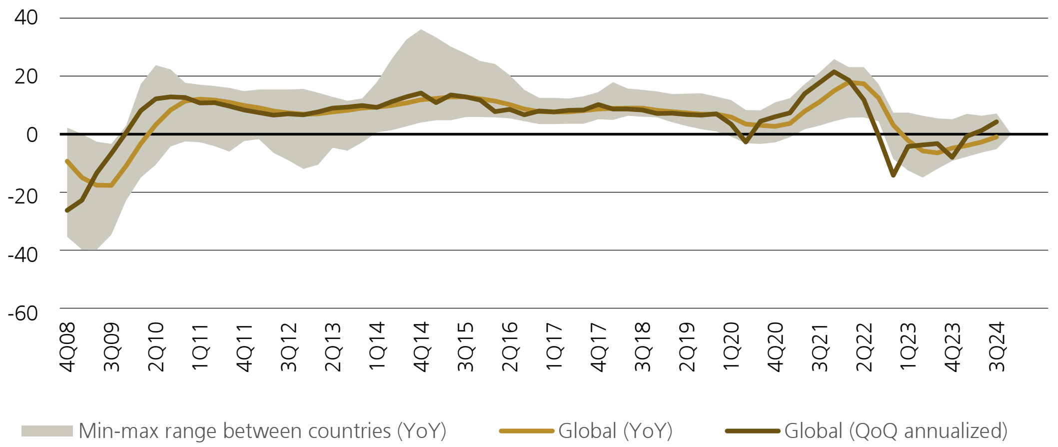
As such, geopolitical instability does not solely lead to retreat, but can create opportunities in markets that align with investor strategies focused on risk mitigation and adaptability.

Is real estate due for a rebound in 2025?

Figure 1 below depicts how total returns in global real estate markets have evolved since 2008. The grey area shows the max-min difference between countries in terms of annual total returns, analyzing 22 different countries. The global total returns are shown as annual and quarterly annualized.

So, is real estate due for a rebound in 2025? Yes, we think so! In fact, the rebound has already begun, as indicated by the annualized quarterly data currently surpassing the trailing annual data, which is a clear sign that momentum in returns is recovering. However, the data also tell us that we must be selective. The performance between markets – and this includes countries and sectors – is set to be notable. Globally, we expect offices to lag, while think that some of the smaller European markets will outperform. Keep a firm eye on your leasing fundamentals and how interest rates are developing. And when in doubt, give careful consideration to allocating capital: the real estate cycle has turned, but a rising tide does not lift all boats in the same way.

Figure 1: Real estate total returns (all property, %, local currency)



Source: MSCI; UBS Asset Management, 3Q24. **Past performance is not a guarantee for future results.**

What next for retail?

Retail faced challenges in early 2024 but ultimately rebounded, with weaker consumer confidence initially dampening some countries' markets while inflationary pressures eased. That said, when the final figures are in, we expect them to show that at the global level, retail was the highest returning real estate sector in 2024, and outperformed in both the US and the UK. In 2025, we think that consumers will rebuild confidence as real wages rise and inflation and interest rates decline.

As international tourism continues to grow, luxury shopping remains an important driver of visitors and retail markets. Indeed, a growing number of consumers globally is supporting the luxury retail market, which is brand-driven and characterized by prime pitches in top quality locations where vacancy is low. Tourist corridors and well-connected retail destinations are also important. In general, we expect rents to rise in these markets as well as for prime shopping centers, pushing capital values higher. Retailers continue to diversify their offerings through *omni-channelization*, incorporating entertainment and experiences to attract consumers. This includes the use of AI and in-store automation.

Although we expect e-commerce to continue to grow, it remains a minority of overall retail sales and physical stores are recovering some of their popularity. A well-run hybrid model can help companies capture a new wave of consumers. Convenience and neighborhood is another segment of retail that we expect to benefit from good fundamentals. Overall, the dark days of the rotation online and pandemic appear to be behind us, with good opportunities available for selective investment in retail. We expect the sector to perform more-or-less in line with the market overall.

Is the current drive to invest in ‘alternative’ property types sustainable and wise?

Investor appetite for alternative real estate sectors has surged in recent years. Their core investment thesis is usually ‘investing in the future’, riding on favorable megatrends in demographics, digitalization and post-pandemic consumer behavior shifts. For example, data centers are all the rage now as the world grows increasingly reliant on digital tools. Other alternative sectors that have received more attention include life sciences properties, cold and self storage, and various forms of residential sub-types.

Investing in alternative sectors typically comes with greater potential risks relating to exit liquidity, operations, regulations and small (albeit growing) occupier markets. In addition, development exposure is also common, given their relative nascency and limited core offerings. Nonetheless, their occupier demand outlook holds promise amidst structural tailwinds and investors are typically compensated with higher expected returns.

We think having some allocation to the alternative sectors will add investment alpha and potentially make a good diversification strategy. Nonetheless, we think caution is still required as real estate investment is ultimately a supply-demand play. All sectors, especially those with positive narratives, are exposed to the risks of excessive exuberance, which could lead to oversupply situations. Recent examples include logistics in some markets, while the US life sciences sector is also facing a reality check. Understanding the local market dynamics is crucial. It’s also important to work with experienced investment teams, more so than just investing in traditional real estate sectors, given the more nuanced requirements in managing and operating such property types. Overall, we think that exposure to these alternative sectors can benefit investors and that these sectors will grow in size.

Power to the people, or to AI data centers?

The high energy usage of AI threatens to overwhelm the current power grid, which is already under pressure. The competing demands for power are raising difficult questions as to where scarce electricity should be channeled. As AI becomes more widespread, growth in electricity demand is predicted to accelerate, spurred by other consumption shifts as well, such as towards electric vehicles. There are concerns that diverting power from regional grids to service data centers will undermine stability of supply and increase bills for consumers. Pinch points look likely in the near term, with the North American Electric Reliability Corporation warning that shortfalls in power supply could cause blackouts in both the US and Canada, maybe even in 2025.

In the longer term, the market will adjust, both by increased efficiency in electricity usage by businesses and homes, and by new power supply coming on stream. For example, BigTech is turning to nuclear power to run its new AI models as firms try to secure reliable, emission-free electricity. It's hoped that AI will significantly enhance productivity in the economy, though, and by 2032 Oxford Economics expects generative AI to boost US annual GDP by 2.9% and workforce productivity by over 10%. Overall, electricity looks set to become an increasingly prized resource.

Is the slowdown in sentiment towards ESG a normalization or a reversal?

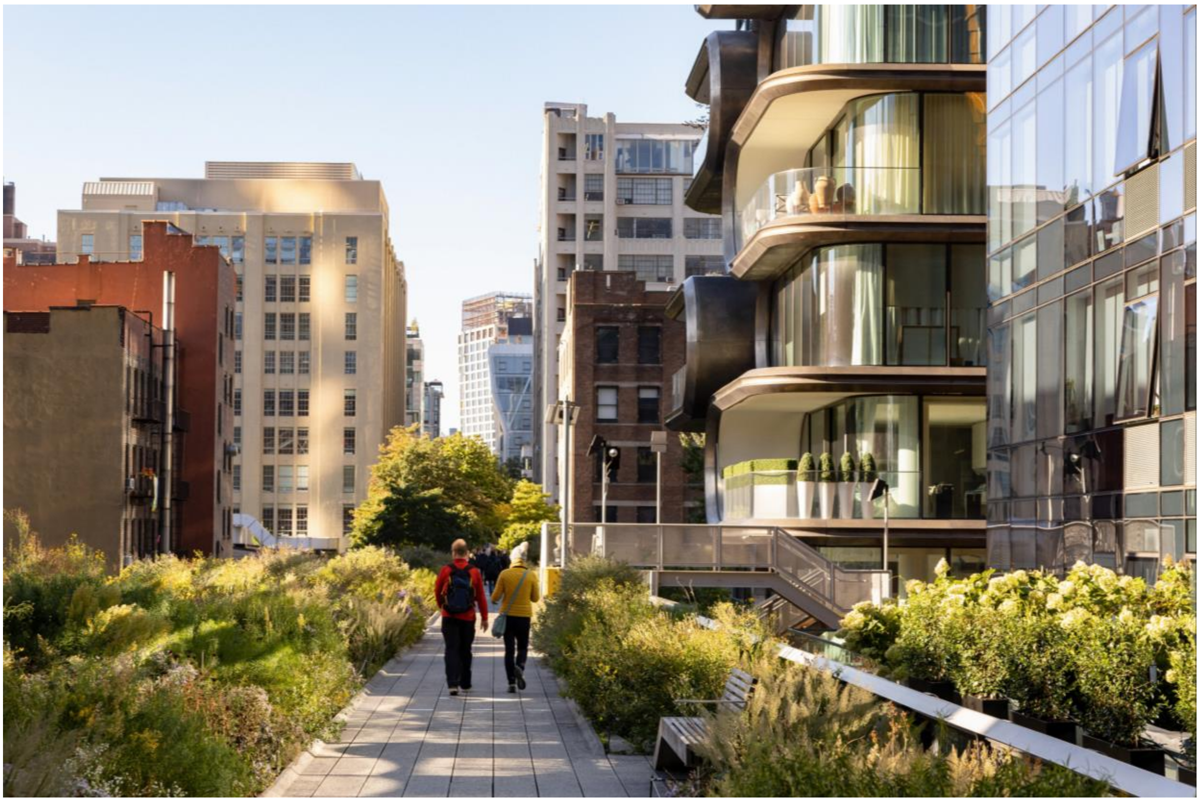
Following a groundswell of support over the past few years, the closing of 2024 saw a cooling of sentiment towards environmentalism within real estate. This has been driven in part by the market downturn, with environmental considerations (at least in the short term) seen by some as an unaffordable luxury. Also, in some markets political and public sentiment have shifted away from a previously ESG-friendly agenda. Is this simply a pullback from the breakneck growth in ESG, or will we see environmental factors minimized going forward?

The most acute impact of ESG for real estate investors comes from physical climate risk. Political affiliations and personal viewpoints are rendered irrelevant in the face of wildfires and tropical cyclones. With extreme adverse weather events continuing to rise, the assessment and mitigation of physical climate risks among real estate investors should be seen less as an environmental consideration and more, simply, as prudent financial underwriting.

Transition risk can be seen as slightly less tangible and therefore subject to greater flex within asset owners' capital budgets. Financial payback for decarbonization measures taken by landlords is broadly driven by three groups: investors, tenants and regulators. Sentiment is localized and varies widely between markets; in some we've seen this wane. However, in very few have we seen targets abolished entirely, while in most they remain, at worst, delayed. Moreover, multinationals look to bring consistency in their approach between markets.

Ultimately, we view this question as a balance between long-term risk mitigation and short-term capital spending. Budgeting decisions are often easier to make when markets are positive, something we hope to see return in 2025.

Do rent controls for residential real estate ever make sense?



For tenants, rent controls on residential properties offer the benefit of capped rents for those who can secure housing. However, these controls can also create a high demand, making it difficult for others to find available accommodation. Arguably, rent controls may limit the overall housing supply compared to a market with no such restrictions.

For landlords and investors, there is a general perception that residential rent controls and caps are bad. However, it isn't the controls themselves that are inherently bad, but rather the changes to them and the regulatory environment that can pose challenges. For instance, rent controls that limit rental growth may not necessarily be harmful for investors if these controls are fully accounted for in the property's purchase price and the expectations for rental growth are adjusted accordingly. Additionally, by creating excess demand, rent controls can lead to lower vacancy rates, shorter lease-up times, and greater certainty over future rental income streams.

On the other hand, a new and unexpected control that severely curtails rental growth could cause property values to take a significant hit. Uncertainty can cause landlords to pull back due to increased risk. For example, since the Scottish government introduced rent controls in 2022, there has been uncertainty over that market and how the controls will evolve. As the residential sector continues to attract a lot of interest, investors need to be laser-focused on new, unexpected rent controls and regulations, or changes to existing ones.

Can professional sports and real estate succeed together?

Professional sports combine competition, rivalry and strategic planning. Hence, the mindset and traits of professional sportspeople, such as being a team player, determination, understanding the competition, overcoming setbacks and having goal-oriented training programs, are all qualities that can be applied to real estate and lead to investment success.

In terms of projects, sports teams can use their branding to expand venues into mixed-used developments. By transforming surrounding areas with commercial and residential activity, the opportunity exists to contribute to sustainable urban development, while also helping sports teams drive revenues. However, relying on sports developments can also be a risk for private developers, especially as ancillary projects can be impacted by delays or changes to the main development. For example, Spanish football team Real Madrid's Santiago Bernabéu stadium redevelopment was supposed to be completed in 2022 but was delayed until mid-2024 due to COVID-19 and supply chain disruptions. The stadium has also drawn complaints from neighbors over noise from concerts.

Another key interaction is the 'Olympic effect', which sees increased trade and a boost to the local economy from hosting the Games. The London 2012 Olympics enabled the regeneration of the Stratford local area, including the opening of a Westfield shopping center, new residential builds and improved transport links. Average residential property prices in London rose 78% over the 10 years from June 2005, around the time when London won its Olympic bid, while those in East London, where the Olympic Park was built, saw a 90% increase. Another example is the Gold Coast 2018 Commonwealth Games in Australia. Athletes' accommodation was developed with design features which allowed for the subsequent successful conversion into rental apartments and the biggest multifamily development in Australia, a project UBS oversaw. We now turn our attention to Milano Cortina 2026 and LA 2028 and how they will affect their real estate markets.

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