Real estate values were weakened by swift monetary tightening that hurt valuations and made debt servicing more expensive. (UBS)

Is a real estate rebound on the way?

05 June 2024, 6:40 pm CEST, written by UBS Editorial Team

Real estate investing has come under pressure in recent years, with valuations falling amid fast-rising rates while some sectors' rental incomes failed to keep pace with inflation. Parts of the market have also suffered from structural headwinds like e-commerce, working from home, and environmental upgrading. But a turning point for the asset class could be on the way as the rate-cutting cycle proceeds.

Selective fund managers have been able to avoid weaker parts of the market, and excessive investor pessimism has left some valuations looking attractive.

Private real estate investments have faced both economic and structural headwinds in recent years.

- Real estate values were weakened by swift monetary tightening that hurt valuations and made debt servicing more expensive.
- Rental incomes on older properties in less appealing locations may not have kept pace with inflation, especially for assets not meeting green building standards.
- More remote working since the pandemic and the rise of e-commerce hurt weaker parts of the office and retail sectors.

But selective managers have been able to avoid the most challenging areas, focusing on areas of resilience.

- Although parts of the real estate market have been strained, especially less desirable office space, skilled managers have avoided trouble spots by focusing on location, high-quality and modern assets where vacancy rates are lowest.
- The continuation of the global rate cutting cycle should also reduce debt servicing burdens and provide a boost to valuations.

So, we see conditions improving, and advise investors on missing out on the likely upturn.

- We foresee over 3% capital gains and an income return above 4%for global direct real estate in 2024.
- Investors should focus on quality, including energy-efficient office buildings in prime locations—an area where demand has remained robust.
- Demand for data centers is also climbing along with the rise in AI.

Did you know?

- With USD 5.8 trillion in debt, some US commercial real estate investors remain concerned about the risks of potential credit stress, asset write-downs, and reduced liquidity for some private markets managers.
- In direct real estate we expect transaction volumes to rise from USD 600bn in 2023 to USD 900bn in 2024, indicating a revival in market activity.
- We estimate that private equity alone is sitting on more than USD 425bn of unlevered dry powder with much of that capital oriented toward distressed, opportunistic, and real estate debt strategies.

Investment view

Given the multi-year investment horizon of the commercial real estate markets, we suggest investors adopt a long-term perspective and be prepared for a potential continuation of short-term volatility in pockets of the market. We favor biasing investments toward high-quality assets with strong fundamentals in growing markets that can withstand an expected gradual deceleration in the US economy as 2024 progresses.

Main contributors - Christopher Swann, Matthew Carter, Thomas Veraguth, Jonathan Woloshin

Original report - **Is a rebound in real estate on the way?, 5 June 2024.**

Important information
As a firm providing wealth management services to clients, UBS Financial Services, Inc is registered with the U.S. Securities and Exchange Commission (SEC) as an investment adviser and a broker-dealer, offering both investment advisory and brokerage services. Advisory services and brokerage services are separate and distinct, differ in material ways and are governed by different laws and separate contracts. It is important that you carefully read the agreements and disclosures UBS provides to you about the products or services offered. For more information, please visit our website at www.ubs.com/workingwithus.
© UBS 2024. All rights reserved. UBS Financial Services Inc. is a subsidiary of UBS AG. Member FINRA/SIPC.
There are two sources of UBS research. Reports from the first source, UBS CIO Global Wealth Management, are designed for individual investors and are produced by UBS Global Wealth Management (which includes UBS Financial Services Inc. and UBS International Inc.). The second research source is UBS Group Research, whose primary business focus is institutional investors. The two sources operate independently and may therefore have different recommendations. The various research content provided does not take into account the unique investment objectives, financial situation or particular needs of any specific individual investor. If you have any questions, please consult your Financial Advisor. UBS Financial Services Inc. is a subsidiary of UBS AG and an affiliate of UBS International Inc.

Non-Traditional Assets

Non-traditional asset classes are alternative investments that include hedge funds, private equity, real estate, and managed futures (collectively, alternative investments). Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. An investment in an alternative investment fund is speculative and involves significant risks. Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments, there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

Interests in alternative investment funds are not deposits or obligations of, or guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other governmental agency. Prospective investors should understand these risks and have the financial ability and willingness to accept them for an extended period of time before making an investment in an alternative investment fund and should consider an alternative investment fund as a supplement to an overall investment program.

In addition to the risks that apply to alternative investments generally, the following are additional risks related to an investment in these strategies:

- Hedge Fund Risk: There are risks specifically associated with investing in hedge funds, which may include risks associated with investing in short sales, options, small-cap stocks, "junk bonds," derivatives, distressed securities, non-U.S. securities and illiquid investments.
- Managed Futures: There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.
- Real Estate: There are risks specifically associated with investing in real estate products and real estate investment trusts. They involve risks associated with debt, adverse changes in general economic or local market conditions, changes in governmental, tax, real estate and zoning laws or regulations, risks associated with capital calls and, for some real estate products, the risks associated with the ability to qualify for favorable treatment under the federal tax laws.
- Private Equity: There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.
- Foreign Exchange/Currency Risk: Investors in securities of issuers located outside of the United States should be aware that even for securities denominated in U.S. dollars, changes in the exchange rate between the U.S. dollar and the issuer's "home" currency can have unexpected effects on the market value and liquidity of those securities. Those securities may also be affected by other risks (such as political, economic or regulatory changes) that may not be readily known to a U.S. investor.