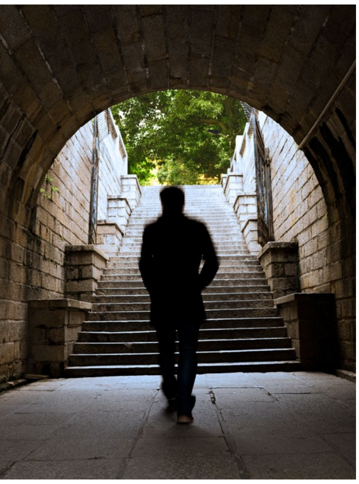
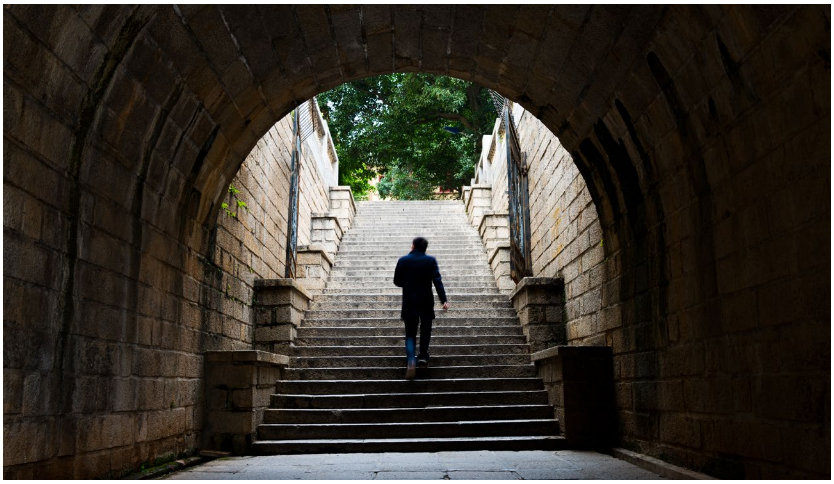
Hines Global Perspectives

2024 MID-YEAR OUTLOOK | PROPRIETARY RESEARCH

Walking Through the Threshold

JUNE 2024

CONFIDENTIAL AND PROPRIETARY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A Letter from David Steinbach

GLOBAL CIO

The term "liminal space" derives from the Latin word "limen," meaning threshold. In modern psychology, it describes the transitional phase when we move from one state, role or identity to another without having fully embraced the new one. This period is inherently marked by uncertainty and vulnerability.

In contemporary architecture, this concept refers to areas such as hallways or stairways – spaces that are not destinations themselves but pathways to get from Point A to Point B. These in-between areas symbolize transition and movement.

As I reflect on where we are at the halfway point of 2024, this idea of liminal space is what's on my mind. It's as if we are walking in a hallway that's leading us away from an era of low interest rates and easy monetary policy to another environment that has yet to fully unfold.

This time of transition has been fraught with uncertainty, fear and doubt. However, just as a hallway eventually leads to a new room, this journey will guide us to a new and potentially prosperous phase in the market cycle. By understanding and embracing this concept of liminal space, we can better navigate the challenges and opportunities that lie ahead.

The new market cycle won't suddenly announce itself as if turning on a dime, but there will be early signals of what's ahead. We're already seeing some of these signs. For example, in retail (where we're starting to witness a new demand reality as the sector looks poised for recovery) and global living (where housing shortages are sparking a growing trend in build-to-rent communities) and even in office (where the U.S. trophy office segment continues to show strength).

In this shifting landscape, there does seem to be at least one constant: higher interest rates will be with us for the foreseeable future (after being unusually low for an extended period of time) as the U.S. Federal Reserve continues to work to bring inflation down. As has been the case since they started their hiking campaign in 2022, predictions on the Fed's next move on rates continue to grab headlines and dominate conversations. These policy decisions will continue to cause distress across many property types including multifamily and office—but could also open the door to interesting opportunities in credit (as traditional lenders continue to pull back) and equity (as pricing becomes more favorable).

> ***"By understanding and embracing this concept of liminal space, we can better navigate the challenges and opportunities that lie ahead.***

Inflation is, of course, a global phenomenon, and similar decisions on interest rates are top of mind for policymakers, market watchers and investors around the world. (In fact, as of the finalization of this paper in early June, the European Central Bank (ECB) announced its first rate cut in nearly five years.) My colleagues **Josh Scoville** (Head of Global Research), **Ryan McCullough**, (Head of Americas Research), **James Purvis** (Head of European Research) and **Tim Jowett** (Head of Asia Research) offer their perspectives on opportunities in a "higher for longer" rate environment in subsequent sections of this paper.

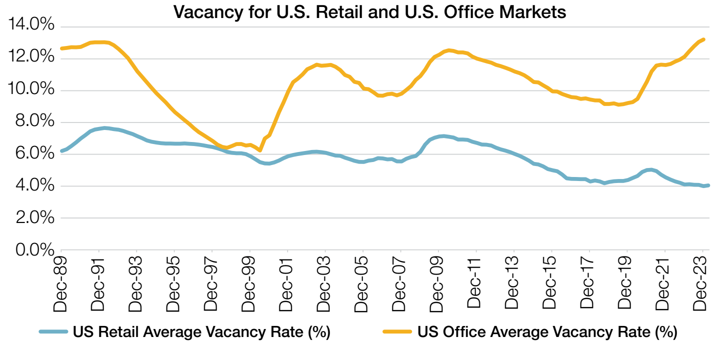
To compete in this new era, we are increasingly focused on prudent underwriting and executing asset-level business plans to help deliver results. Below, I outline a few of the specific areas and themes where we are especially focused in the second half of 2024—and beyond:

RETAIL

Starting around the end of 2017, U.S. Retail NOI growth slowed, and price growth followed in response to e-commerce headwinds. Today, retail seems to be right-sizing to a new demand reality and looks to be set for a recovery. In other words, the sector has arguably already undergone its "structural shift." Even with lower demand, muted supply has resulted in historically low vacancies (see Exhibit 1). We're seeing opportunity to invest in the right locations and sub-types to take advantage of this recovery in rents and values. In particular, that appears to be grocery-anchored, open-air, lifestyle and service-oriented retail formats. Likewise in Europe, where the market has stabilized after years of repricing, potentially making it an opportune time for re-entry.

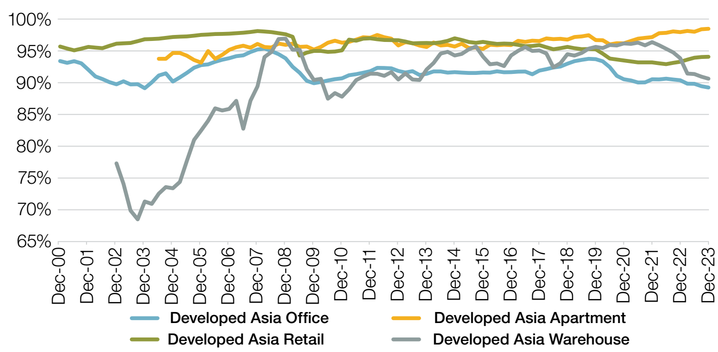
In Asia, retail has followed the global trend of improving fundamentals and increased domestic and cross-border tourism. Based on our proprietary data, after bottoming in mid-2021, Asian retail seems to be on the path to recovery. In fact, based on our proprietary scores, which measure the health of leasing markets, Asian retail has been on a sharp upward trend since mid-2021 with occupancies increasing again (see Exhibit 2). Exhibit 2 also highlights the consistently strong performance within the Developed Asia apartment sector.

Exhibit 1
U.S. Retail Is Not U.S. Office



Sources: Costar, Hines Research. As of 1Q 2024.

Exhibit 2
Historical Vacancy for Developed Asia Property Markets by Sector



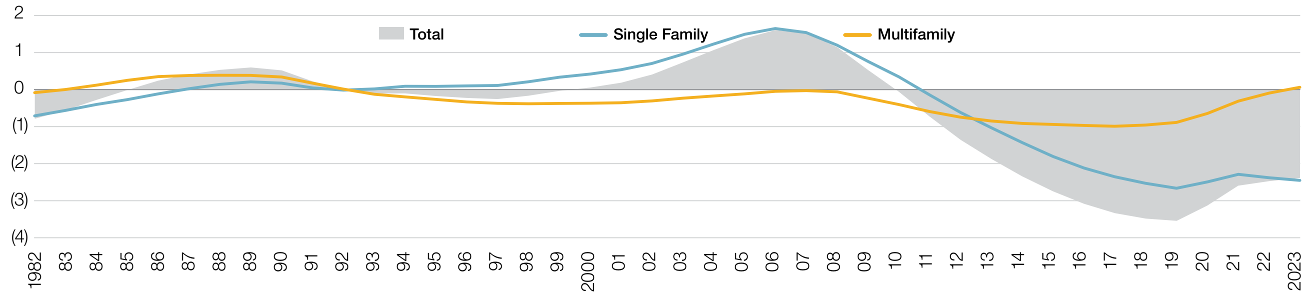
Sources: JLL, CoreLogic, ARES and Hines Research. As of 4Q 2023. Developed Asia includes Australia, Hong Kong, Japan, New Zealand, Singapore and Korea.

LIVING

A shortage of housing units in the U.S. (see Exhibit 3) has led to rising prices, making homeownership increasingly difficult. Supply chain issues combined with higher interest rates have compounded this problem by increasing construction and borrowing costs. Additionally, many homeowners have been hesitant to sell due to higher mortgage rates, which has further limited the supply. Multifamily portfolio and residential REIT take-private transactions in the first half of 2024 reflect confidence in long-term appreciation and rental yields, with a growing trend towards build-to-rent communities to meet strong rental market demand.

Exhibit 3

U.S. Housing Surplus/(Deficit), millions

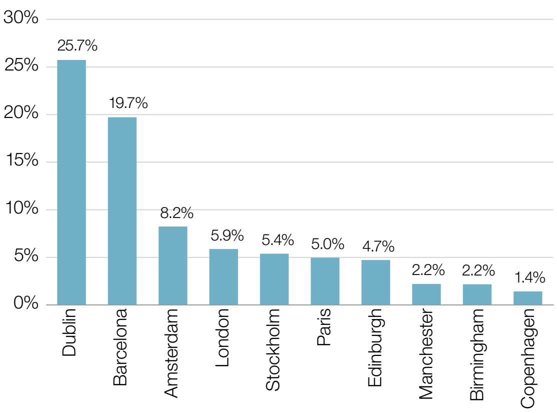


Sources: Census Bureau, McKinsey and Hines Research. As of 4Q 2023.

In Europe and nascent for-rent residential markets in parts of Asia, we're focused on student housing and build-to-rent markets (where applicable) given the relatively small size of the institutional-quality markets combined with improving liquidity conditions. In fact, according to estimates by our research team, while the U.S. multifamily market is well established at over a third of the total value of the U.S. commercial property market for the four major sectors, it's about half that in Europe and even smaller in Asia, see Exhibit 5. The bottom line is there are opportunities that we believe globally-minded investors will find favorable.

Exhibit 4

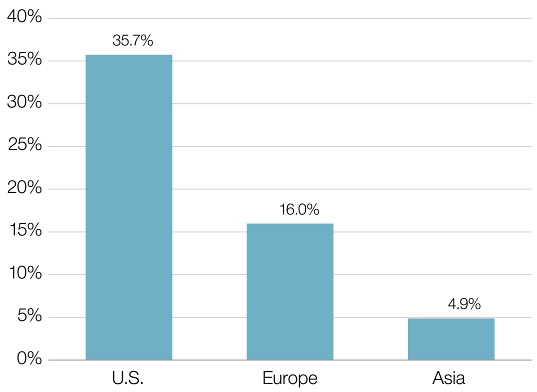
European Housing Shortfalls as % of Stock



Sources: Moody's, National Statistics Authorities and Hines Research. As of 4Q 2023. Note: Housing shortfall as percentage of stock is calculated by comparing household growth since 2004, when data begins for most metros in Europe, to official housing stock numbers. The difference is an indication of a shortfall in institutional-quality, investible housing stock. This is taken as a percentage of the number of housing units for the as of date.

Exhibit 5

Apartment Share of Total Property Market Value Across the U.S., Europe and Asia



Sources: MSCI Real Capital Analytics, Oxford Economics and Hines Research. As of 1Q 2024. Market value is a Hines Research estimate of the total value of investible property across the four major property types (Apartment, Industrial, Office and Retail). Transaction volumes are rolling four-quarter sums.

OFFICE

U.S. trophy-grade office has continued to see demand despite broader office market challenges (see Exhibit 6). This segment of the U.S. office market makes up just about 6.5% of the overall market inventory (as of 4Q 2023), but has garnered more than 25% of office positive net absorption since 2000.[1] Globally, with more than 70% of the workforce back in the office—we must remind ourselves that work-from-home (WFH) is a more of a U.S. challenge (see Exhibit 7). While there are pockets of U.S.-style dynamics, such as in the U.K. and Australia, office fundamentals in markets outside the U.S. have behaved as we might have expected pre-COVID. In Europe, as an example, rents have risen and growth has favored downtown central business districts (see Exhibit 8).

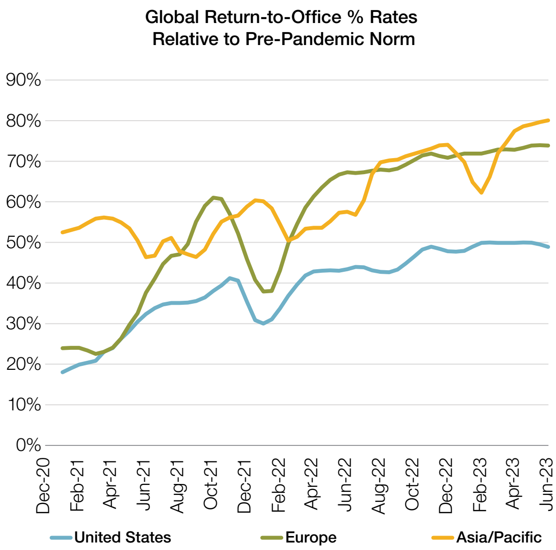
Exhibit 6

Trophy Office Continues to Attract Demand

Sources: CoStar, Hines Research. As of 4Q 2023. CoStar has a quality grade that uses star ratings. We have used a 5-star rating as Trophy, 4-star as Class A and 1-, 2- and 3-star as the lower grades of D, C and B, respectively.

Exhibit 7

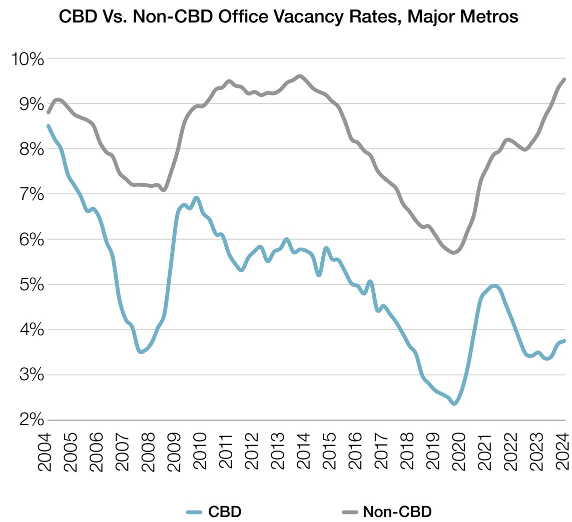
Return to Office Trends: Asia, Europe and the U.S.



Sources: JLL, Hines Research. As of 2Q 2023. Based on survey results led by JLL Research. Hines confirms that, to the best of its knowledge, more updated information is not available and that the above information remains materially accurate.

Exhibit 8

In Europe, Tight Conditions Persist in Central Business Districts ("CBDs")



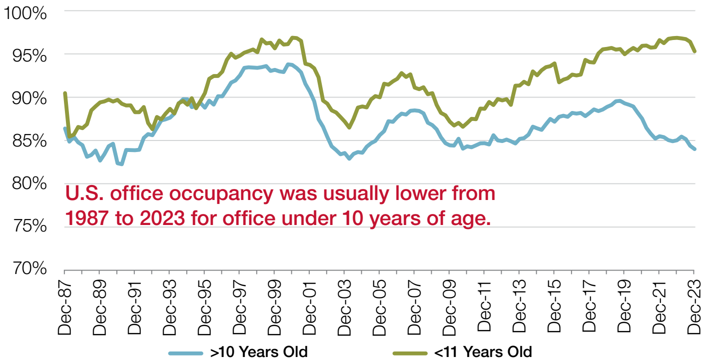
Sources: Hines Research, CBRE. As of Q1 2024.

1 CoStar, Hines Research. As of 4Q 2023.

Even without a full "return to work", we believe specific segments of the U.S. office market can and will likely thrive. For example, there is growing evidence that higher-quality and "younger" office space (built in the last decade) can attract sufficient demand. NCREIF office properties built within the last 10 years have outperformed in terms of occupancy (see Exhibit 9). Newer space has averaged about 95% occupancy versus about 84% for all others. There isn't much of that space at 8.6% of the U.S. office inventory (refer to Exhibit 10).

Exhibit 9

Occupancy of U.S. Office Buildings Held in NCREIF Property Index by Age

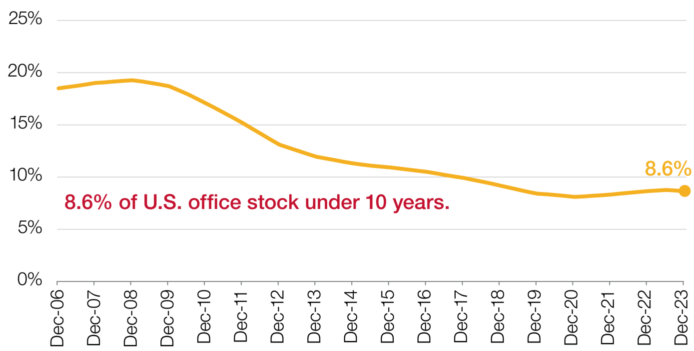


Sources: NCREIF, Costar and Hines Research. As of 4Q 2023.

All told, trailing annual rent growth could exceed long-term averages as early as the end of 2025 for the highest-quality, fit-for-purpose offices. With better pricing, higher entry capitalization rates to fund higher credit costs and stable occupancy for the right assets, we believe investors can find bright spots in the office market across the capital stack.

Exhibit 10

% of U.S. Office Stock <10 Years of Age



Sources: NCREIF, Costar and Hines Research. As of 4Q 2023.

SOMETHING ELSE ON MY MIND

AI's Energy Needs

Over the last few decades, energy consumption in the U.S. has remained relatively flat, thanks, in part, to advancements in renewables. However, AI applications, which are reliant on data centers to power their backend systems, are disrupting this trend. In fact, recent Goldman Sachs research[2] found that data center electricity use is expected to more than double by 2030—comprising 8% of U.S. power demand vs. 3% in 2022.

We're already seeing specific strains around the world. Ireland halted new data center developments due to capacity concerns, while Northern Virginia, where many of the world's data centers are housed, faces significant grid stress.

These examples highlight this growing global issue: aging electric grids are not equipped to handle AI's needs. Substantial infrastructure investment is needed to upgrade systems while also leveraging renewables to sustainably meet this rising demand. Without action, we risk energy shortages, higher costs and increased carbon emissions—all of which could hamper growth.

2 Goldman Sachs, "AI, data centers and the coming U.S. power demand surge." April 28, 2024.

FINDING OPPORTUNITY WHILE PREPARING FOR WHAT'S AHEAD

We are clearly at a moment of transition as we stand on the threshold of a new economic regime, but there are several clear signs of positives in this "liminal space." For example, as recently pointed out in our piece "No Need to Call the Bottom," historically, some of the best fund vintages have occurred at times when values are correcting.

Our research found that 1993 in particular stands out as a good example of a year when book valuations were still two years away from finding a bottom, but funds launched that year delivered the second-best vintage in the history of Preqin's North American funds data.[3] Given that context, history would suggest that 2024 may be an excellent vintage to put fresh capital to work.

Although the transition continues, we are well-prepared for what lies ahead and look forward to navigating the new economic environment with our current and future partners.

DAVID STEINBACH
Global Chief Investment Officer
Co-Head of Investment Management, Hines

3 Note: Past performance does not guarantee future results.

MID-YEAR MARKET UPDATE

Slowly Moving in the Right Direction

By Joshua Scoville
Head of Global Research

As we enter the second half of 2024, liquidity certainly feels like it is improving with more active bidders and a general narrowing of the bid-ask gap, particularly when it involves motivated sellers seeking liquidity to meet redemption requests. Book valuations in the U.S. remained elevated relative to transaction values, but Europe appears to be closer to nearing a bottom with cap rate increases slowing from their pace from a year or so ago.

That said, transaction volume in Q1 2024 was lower than any quarter in 2023 in all three global regions per data from MSCI RCA, though that is likely a result of a low number of deals consummated near the end of 2023 that closed in the first quarter. In addition, though volume continued to decline in the first quarter, the pace of decline has eased in all three regions, indicating a potential floor in the near term.

> ***"Rather than waiting and/or hoping for cap rates to come back down, skilled managers and investors that can take advantage of the market's healthy occupier fundamentals to drive alpha by growing NOI will likely enjoy success despite a still choppy capital markets environment.***

Taken as a whole, global fundamentals have softened a bit from their post-COVID bounce but remain about average. Of course, that average masks many differences across sectors and geographies.

DECLINE IN NEW CONSTRUCTION STARTS

Given higher financing, construction costs and cap rates, there has been a material decline in new construction starts, particularly in the U.S. and across all four major sectors regardless of their fundamental health or long-term demand drivers. In fact, in the U.S., net new starts in the office sector over the past three quarters, accounting for demolitions and conversions, have been negative as of Q1 2024, according to data from CoStar. Soft office fundamentals in the U.S. justify the decline in new construction but starts have fallen significantly in the other sectors as well. The lack of new supply in the latter half of 2025 and into 2026 will certainly be part of the recovery story once fundamentals find a bottom.

THAWING U.S. CAPITAL MARKETS

Despite still-low transaction volumes, there are signs that the capital markets may be thawing. If not thawing, then at least setting up for a thaw as the year progresses. Banks in the U.S. remain saddled with existing loans that are being extended or otherwise worked out, and the lack of loan paybacks has had an impact on their ability to make new loans.

The Commercial Mortgage-Backed Securities (CMBS) market in the U.S. is experiencing more activity with narrowing spreads, while debt funds are increasing their market share in the absence of the banks. Despite their lack of activity, we have seen encouraging trends in the banking sector stemming from the Federal Reserve's Senior Loan Office Survey.

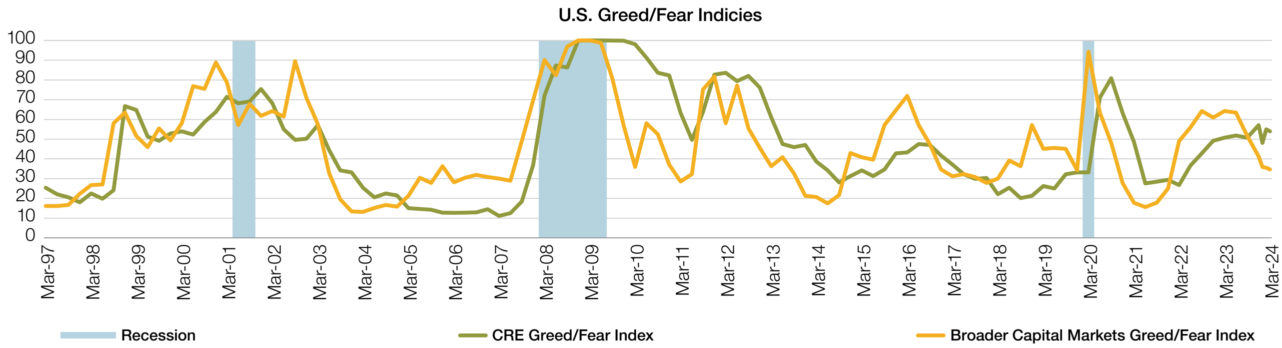
In the four surveys leading up to Q3 2023, the Fed reported that the percentage of banks tightening standards for commercial real estate lending was averaging greater than 60%. That declined to an average of 41% across the three major commercial real estate questions in the fourth quarter and fell further to less than 30% in the most recent survey released in April 2024.

For perspective, once the percentage of banks tightening standards fell under 30% post-Global Financial Crisis (GFC) it took another five quarters for the banks to go from defense to offense. It took six quarters after the dotcom bust. This offers quantitative evidence for the commonly heard phrase, "stay alive 'till 25."

Using data on commercial real estate loan spreads from the American Council of Life Insurers (ACLI), we can construct a greed-fear index (GFI) like the one often seen in the broader capital markets which uses BBB corporate bond spreads over 10-year Treasuries. In Exhibit 11, the data for each has been normalized on a scale of 0-100 with higher values equating to greater fear, 50 equal to the long-term average, and lower values equating to greater greed.

Exhibit 11

Commercial Real Estate Has Yet to Follow the Broader Capital Markets Improvement



Sources: ACLI, Federal Reserve, NBER and Hines Research. As of March 2024.

As recession concerns subsided by mid-2023, fear dissipated in the broader capital markets and animal spirits were unleashed. However, that has not been the case in the commercial real estate market where this index is still a bit above average through March.

Like fundamentals though, there are large differences across the major sectors. In March, the office sector hit a cyclical high of 90, indicating extreme fear, while the apartment, industrial and retail sectors all notched readings slightly below 50.

The ACLI data are interesting because it starts in the mid-1960s rather than the 1980s which is when most sources of real estate data such as NCREIF start. According to the ACLI data, cap rates rose from 8.5% in 1966 to a peak of 13.5% in 1981 during an extended bout with inflation.

Unsurprisingly, the commercial real estate GFI was elevated during much of that time, averaging 77 from 1966 through 1977. As a result, and similar to today's U.S. office sector, construction activity slowed, averaging about 150 million SF per year. To put that in perspective, from 1983 to 1989, when the GFI averaged 16, more than 300 million SF of office space was delivered per year.

Due to the lack of construction as well as the greater prevalence of inflation-indexed leases in a period of high inflation, income growth was significantly stronger in the rising cap rate environment from 1966 to 1981. Though the data are far from perfect, the implied cumulative value creation during that 15-year period is significantly greater than it has been from 1981 to date, a period spanning 43 years using the same methodology.

Be on the lookout for a more detailed analysis of this concept in a future publication.

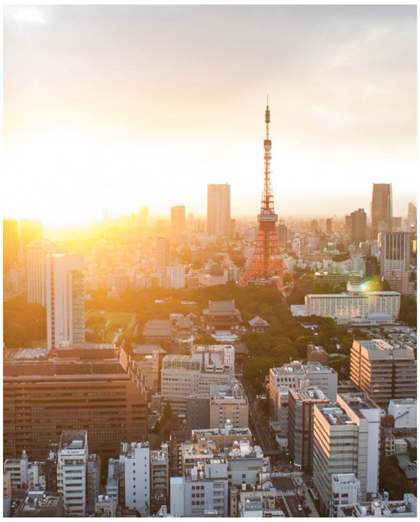
A CLOSER LOOK AT EUROPEAN CAPITAL MARKETS

In Europe, the ECB and Bank of England (BOE) conduct similar surveys as the U.S. Federal Reserve, but the ECB only started to ask specifically about real estate during the pandemic. As of the latest Q1 2024 data, 17.3% of European banks tightened standards for CRE loans over the past six months, while 14.4% expected to do so over the next six months. The BOE's survey simply asks about credit conditions for U.K. CRE, which flipped from negative to positive in the most recent data, perhaps signaling an earlier thaw there.

The other notable differential in Europe vs. the U.S. is the much lower redemption queues in European open-ended funds, likely a result of slightly more aggressive write-downs than we've seen in similar U.S. funds. In addition, the greater prevalence of inflation-indexation within European as well as Asian leases, coupled with little in the way of new supply in many European markets, has helped grow NOIs while also pushing up the numerator in cap rates. Spreads to sovereign bond yields are still fairly skinny relative to long-term averages, but the difference is generally lower in Europe than the U.S. or the major Asian economies. The ECB's recent rate cut could put less upward pressure on cap rates sooner.

The broader capital markets GFI in Europe never got as high as it did in the U.S. in 2022, barely eclipsing 50, and has also declined over the past 18 months, notching a reading of 32 in April. That's a tick higher than March, but still just a notch above a sub-30 reading which could be considered extreme greed.

EXAMINING ASIA'S CAPITAL MARKETS ACTIVITY



Within the broader capital markets, the GDP-weighted average GFI for Australia, Japan and South Korea rose to 66 near the end of 2022, but has eased to 41 as of April, which is still a touch higher than we've seen in Europe or U.S. markets. This is likely because of contagion fears due to China's struggles as well as the presence of inflation and higher rates in Japan.

Like most things in Asia, there are large variations of this measure across countries. In Australia, the index peaked in late 2022 at 78, but has been in extreme greed territory in each of the last four months, with an April reading of 27.[4] Similarly, Japan fell from a high of 66 in mid-2023 to a reading of 31 in April.

BBB bond spreads in Japan were well above 100 basis points for most of 2023 but have fallen well below their average since the data start in 2003, indicating renewed confidence in the Japanese economy's ability to navigate higher inflation and rates. South Korea saw its index improve significantly over the past six months but remained elevated at 74 as of May 29, 2024.

According to MSCI RCA's liquidity scores, Tokyo – 5 Wards was the most liquid market for all income-producing Commercial Real Estate ("CRE") in the first quarter, despite a relatively elevated GFI. Four of the top 10 were in Asia, including Sydney, the rest of Tokyo, and Melbourne. However, the long-term average for Tokyo – 5 Wards is 87 with a high degree of stability since the data started in 2008.

Relative to Tokyo's own history, its current liquidity is in the third percentile, so while liquid relative to other markets, it's very low on a historical basis. Based on first quarter data, which, as mentioned earlier, is more reflective of late 2023 dealmaking, cross-temporal liquidity scores comparing a market to its own history are generally below average in all three global regions, but the Asian market average was significantly higher than the Americas or EMEA, coming in at a slightly below-average 44, versus a cool 29 in the Americas and fairly cold 23 in EMEA. This should be a good indicator to keep an eye on in the coming quarters to see if it reflects what currently feels like improved capital markets activity.

HEALTHY FUNDAMENTALS OPENING DOORS TO POTENTIAL OPPORTUNITY

While not all metrics are signaling an all-clear, the broader real estate market appears to be heading in the right direction. When central banks continue to cut interest rates it should provide some stimulus for improved confidence and greater deal activity.

Fundamentals in many markets, perhaps cooler than they were a year ago, are still quite healthy. Rather than waiting and/or hoping for cap rates to come back down, skilled managers and investors that can take advantage of the market's healthy occupier fundamentals to drive alpha by growing NOI will likely enjoy success despite a still choppy capital markets environment.

4 MSCI RCA liquidity scores use a range of factors to rank market liquidity including volume, unique buyers, the percent of institutional and cross-border investment, as well as the presence or absence of what they call "market makers", both globally and regionally.

A FOCUS ON THE AMERICAS MARKETS

Squarely in the Post-COVID Era

By Ryan McCullough
Head of Americas Research

In recent quarters, macro conditions have fallen into step across the Americas to a degree seldom seen within the region. Inflation has settled in the 3 to 4% range in most countries (a high figure for the U.S. and Canada, moderate for Mexico and Brazil) while interest rates have remained high relative to pre-COVID benchmarks. Both job and economic growth have been impressively strong and consistent (with the exception of Canada's relatively sluggish GDP figures). This macro conformity suggests a common outlook across the region, with inflation and growth spurring commercial real estate demand and interest rates potentially holding back supply.

> ***"Cap rate spreads over Treasuries remained tight, but tighter spreads may prove sustainable in a higher interest rate environment.***

Within the U.S., market dynamics have transitioned from a COVID-dominated landscape to a post-COVID environment in which demographic and technological trends have become predominant. The chaos of pandemic migration has eased; rather, demand for living product has now emerged from the changing needs of aging Millennials. The end of the stimulus-fueled spending binge has likewise caused warehouse and retail fundamentals to moderate.

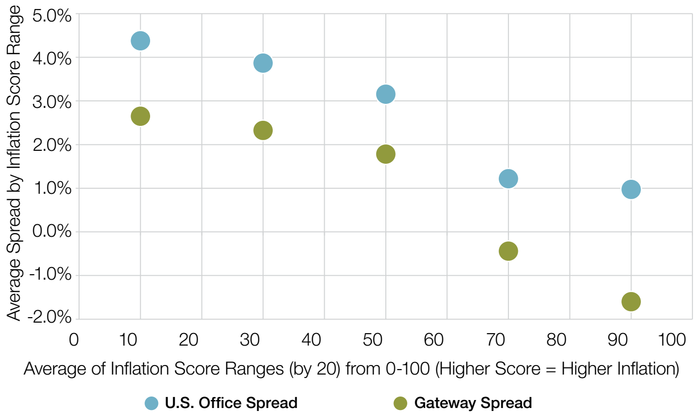
Going forward, we expect manufacturing to exert more influence in industrial demand while the benefits of e-commerce shopping will likely be split more evenly across online and in-store retail formats.

As we forecast in our 2024 Outlook, office has not shaken off the detrimental impacts of WFH, but incrementally positive office-usage patterns and leasing momentum for magnet office (the highest quality class office product) offer hope that an inflection point may be imminent. Alternative asset classes, especially those that benefit from demographic shifts and increasing use of tech (such as senior housing, medical office and data centers) should experience strong tailwinds across the entire region.

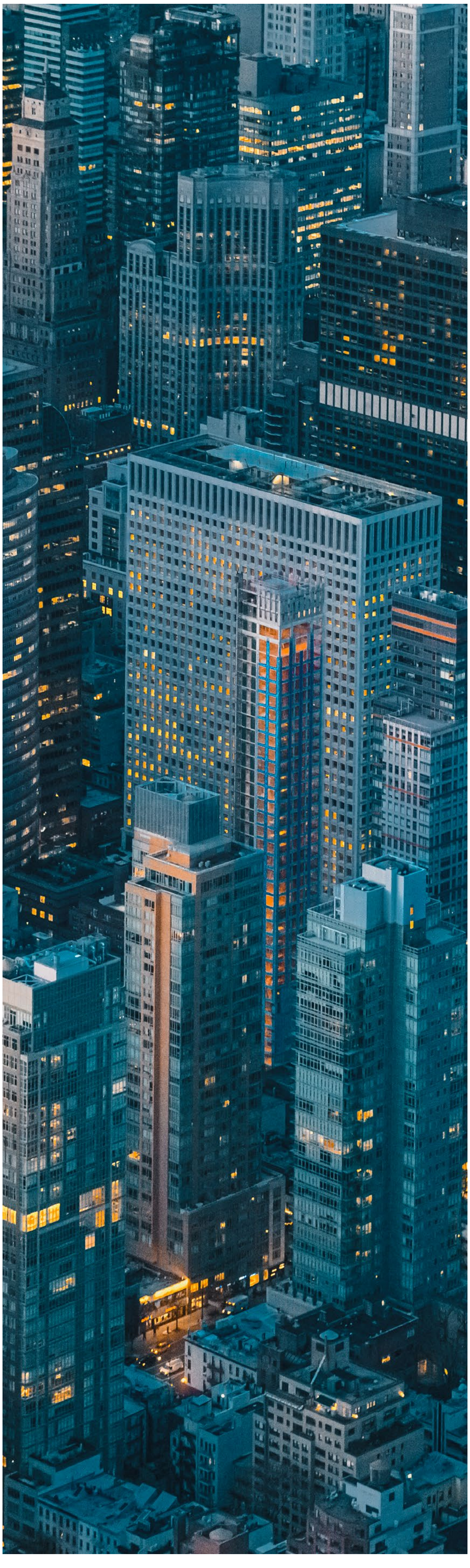
The investment outlook is improving as prices become more affordable. Within the Hines Research framework, we are starting to see generationally cheap pricing emerge in various office and multifamily markets. Cap rate spreads over Treasuries remained tight, but tighter spreads may prove sustainable in a higher interest-rate environment – the 1980s offer a precedent in which attractive returns were generated through income growth despite inverted spreads.

Exhibit 12

U.S. Office Capitalization Rates Spreads to the U.S. 10-Year Treasury Yield Relative to Inflation



Sources: Source: CoStar, NCREIF and Hines Research. As of 1Q 2024. Note: Gateway here is defined as Chicago, New York, San Francisco, Seattle and Washington D.C. This analysis covers the period from 1981 to the as of date shown. We choose 1981 because that is when data becomes consistently available across the markets analyzed. Trailing annual CPI (inflation) is calculated for every quarter since 1981 and scored relative to the historical average and standard deviation to create a 0-100 score for each quarter where a higher score equates to higher inflation. Then the average capitalization spread to the 10-Year Treasury yield was calculated for every quarter falling into ranges of 20 (0-20, 20-40, 40-60, 60-80 and 80-100) and plotted here with the ranges shown as the average of each range.



A FOCUS ON EUROPEAN MARKETS

Optimism Building Around Strong Occupier Market Fundamentals

By James Purvis
Head of European Research

Economic activity in the Eurozone surprised to the upside in Q1 2024, with real GDP growth accelerating to +0.3% quarter-over-quarter. That result was in line with the region's long-run trend, and up from an average of virtually zero in 2023. The return to growth was broad-based across larger economies, with only the Netherlands recording a small contraction (-0.1%). Germany, France and Italy all recorded growth close to the regional average, while Spain continued to lead.

Looking ahead, the consensus is bullish that growth will now remain robust over the next couple of years. Central Bank policymakers also remain on track to bring inflation closer to their 2% target in the near term, and as a result, markets are pricing in earlier and faster rate cuts from the ECB vs the Fed—a trend that has already kicked off with the ECB's rate cut in early June 2024.

Meanwhile, as outlined in our 2024 Global Outlook, the data are increasingly suggesting that the correction in European real estate markets is close to complete. On our pan-European index, prime cap rates across the main commercial sectors moved out by seven basis points quarter-over-quarter in Q1 2024. That was the slowest pace of cap rate expansion since interest rates started rising and was driven by only a small minority of markets that have been slower to correct. The majority saw cap rates stabilize.

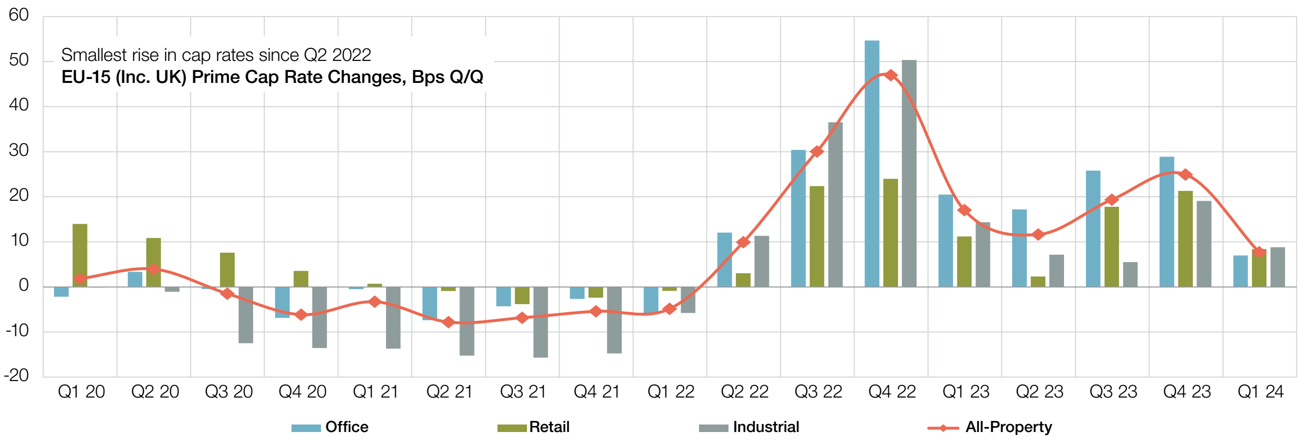
> ***"The data are increasingly suggesting that the correction in European real estate markets is close to complete.***

We are also observing a continued recovery in European listed real estate share prices, which are up 16% year-over-year at the time of this writing in late May. Public market prices tend to lead the private market by around six months. Hence, the potential for a near-term rebound in direct real estate values appears to have improved.

However, there still remains uncertainty around where interest rates, real estate capital markets activity and cap rates will ultimately land. Where we have greater conviction is around occupier market fundamentals, which are unusually strong for this point in the cycle.

Exhibit 13

Correction in Real Estate Values Showing Signs of Stabilization



Sources: Hines Research, CBRE. As of Q1 2024.

Indeed, employment in Europe was at a record high while, outside of the logistics sector, there has been very little supply growth in the past 15 years. Construction starts have also fallen from generally low levels across the board over the past 12 to 24 months. Therefore, against a backdrop of improving economic growth, competitive rental tensions are likely to persist and the potential to deliver alpha through growing NOI appears favorable.

A FOCUS ON THE ASIAN MARKETS

Wide Divergence in Fundamentals Across Property Types and Geographies

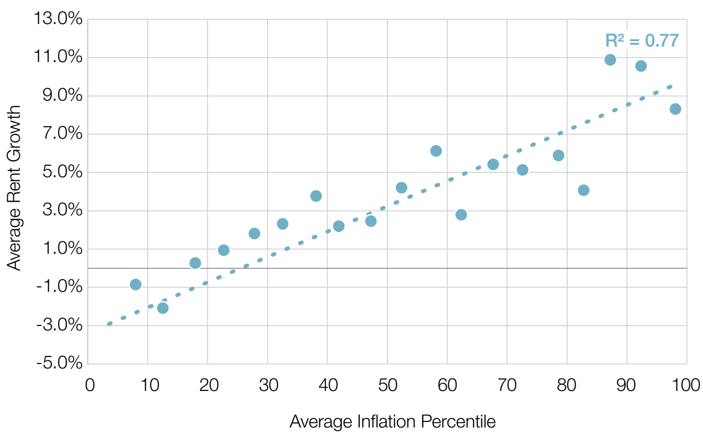
By Tim Jowett
Head of Asia Research

In Asia, the macro story is mixed, with the real estate market price correction mild in comparison to the U.S. and Europe, thanks to relatively healthy fundamentals and resilient domestic liquidity. Inflation generally has remained sticky and while trending down, has been meaningfully above pre-pandemic levels. This has kept interest rates elevated. The exceptions remain China (where deflationary pressure is apparent due to domestic economic weakness) and Japan (where rates rose for the first time in 17 years in March 2024).

> ***"Our research shows rents in developed Asia have historically exhibited strong growth in periods of higher inflation.***

This rate environment has been a primary determinant of real estate capital market conditions. Across developed Asia, 12-month trailing transaction volume has fallen from US$145 billion in Q1 2022 to just under $70 billion by Q1 2024.[5] This has largely been driven by a sharper fall off in volumes in markets with the most severe interest rate increases: Australia, South Korea and Hong Kong.

Exhibit 14
Relationship Between Inflation and Rent Growth (Asia)



Sources: JLL, CBRE, Oxford Economics and Hines Research. As of 3Q 2023. Note: Long-term analysis designed to establish the relationship between inflation and rent growth. R squared: Coefficient of determination ranging between 0 -1 (0 -100), reflecting percentage of the response variation reflected by the linear model/factor. The higher the number, the higher the correlation with 1 (100), reflecting a complete correlation.

Liquidity in Japan has remained strong, thanks to still accretive financing and positive spreads. We see the decline in transaction volumes bottoming through the next two quarters as investors gain greater certainty on the trajectory of rates coupled with narrowing bid-ask spreads. Overall, prices in developed Asia were down around 10% on average from their peak in local currencies—but were cheaper once currency effects are considered.

5 MSCI Real Capital Analytics, Hines Research. As of 1Q 2024.

We see a wider divergence in fundamentals across property types post-pandemic:

- **Living** remained robust regionally, with high occupancies supporting above-inflation rent growth
- Momentum in the **warehouse** sector has softened as new supply has trended up in response to healthy occupier demand, notably in South Korea and Japan
- After years of underperformance, **retail** has been in a recovery phase bolstered by positive demographic and tourism trends in many key Asian cities as well as constrained new supply
- The **office** sector has continued to face the greatest headwinds, but there are pockets of health. Seoul continues to deliver strong year-over-year rental growth. With a surge in leasing demand in Tokyo over the last 12 months, supported by improving health in corporate Japan, we believe we are in the early stages of an upward trend in rent

Looking forward to the second half of 2024, sustainable income growth remains our priority. With higher rates, we expect spreads to be lower than pre-pandemic levels, but our research shows rents in developed Asia have historically exhibited strong growth in periods of higher inflation.

Conclusion

As we pause to reflect on developments so far in 2024, an overarching theme we're observing is that we remain in a period of transition from an era of unusually low interest rates and easy financial conditions to a new market regime that has yet to fully take shape. This period, which our Global CIO has defined as the "liminal space," is inherently defined by uncertainty and vulnerability.

Meanwhile, because elevated inflation continues to stubbornly stick around, we continue to find ways to adapt and thrive in the "higher for longer" interest rate environment that has become the new normal. As we operate at the threshold of a new economic cycle, we're seeing some clear opportunities emerge across sectors and geographies:

RETAIL

We think this sector has arguably already undergone its "structural shift." Even with lower demand, muted supply has resulted in historically low vacancies. We're seeing opportunity to invest in the right locations and sub-types to take advantage of this recovery in rents and values.

OFFICE

Trophy-grade office has continued to see positive demand despite broader office market challenges. In fact, this segment of the U.S. office market makes up just 6.5% of the overall market inventory, but has garnered more than 25% of office positive net absorption since 2000. Similar trends have emerged in office space built in the last 10 years. As more workers return to work, competition for these desirable spaces will only increase. And we must remind ourselves that WFH appears to be largely a U.S. challenge, so we would argue that the office investment opportunity is more widespread and higher conviction in markets outside the U.S.

LIVING

The housing shortage in the U.S., Europe and part of Asia is pronounced and being further pressured by high interest rates and disrupted supply chains as these factors undermine the economics of new development. Recent multifamily portfolio and residential REIT take-private transactions reflect confidence in long-term appreciation and rental yields, with a growing trend towards build-to-rent communities to meet strong rental market demand.

U.S.

There are opportunities to be found across Europe and Asia to be sure, but we're becoming increasingly bullish on the U.S. market, where continued growth is expected over the second half of 2024 on the back of a resilient labor market and strong consumer spending. At its core, strong economic growth is the basis for strong real estate fundamentals performance. Globally-minded investors can, however, find opportunities, often complementary, in all three major global regions. Global diversification, as we ourselves evince in our Hines business model, offers investors and real estate allocations a broader and more compelling investment opportunity over the mid- and long-term.

CREDIT (AND EQUITY)

Elevated interest rates continue to cause distress across many property types including multifamily and office—but are also opening the door to interesting opportunities in credit (as traditional lenders continue to pull back) and equity (as pricing becomes more favorable).

PRIVATE WEALTH

The rise of private investors in commercial real estate marks a significant shift in capital allocation as investors seek higher yields and protection against volatility. With private wealth portfolio compositions now venturing beyond the traditional 60/40 stock and bond mix to include up to 30% alternative investments, real estate can offer the possibility of enhanced portfolio performance. A recent paper by our Research team explored this opportunity in greater detail.

VINTAGE TIMING

Historically, some of the best fund vintages have occurred at times when values are correcting. From a historical standpoint, Hines Research has identified that 1993 especially stands out as a year where book valuations were still two years away from finding a bottom, but funds launched that year delivered the second-best vintage in the history of Preqin's North American funds data. Given that context, history would suggest that 2024 may be an excellent vintage to put fresh capital to work.

We look forward to working together with our partners around the globe to explore these opportunities in more detail as we navigate together through the second half of 2024 and look ahead to 2025.

Learn more about the Hines Proprietary Research Team here.

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The NCREIF NPI, short for the NCREIF Property Index is a quarterly index tracking the performance of core institutional property markets in the U.S. The objective of the NPI is to provide a historical measurement of property-level returns to increase the understanding of, and lend credibility to, real estate as an institutional investment asset class. The universe of investments: 1) is comprised exclusively of operating properties acquired, at least in part, on behalf of tax-exempt institutions and held in a fiduciary environment; 2) includes properties with leverage, but all returns are reported on an unleveraged basis and 3) includes Apartment, Hotel, Industrial, Office and Retail properties, and sub-types within each type. The database fluctuates quarterly as participants acquire properties, as new members join NCREIF, and as properties are sold. Sold properties are removed from the Index in the quarter the sales take place (historical data remains). Each property's market value is determined by real estate appraisal methodology, consistently applied. Please note that when returns are computed for the NPI, the returns for the levered properties are computed on a delevered basis, i.e. the impact of financing is excluded A benchmark Index is not professionally managed. Investors cannot invest directly in an index.

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