Hines Global Perspectives

2025 GLOBAL INVESTMENT OUTLOOK | PROPRIETARY RESEARCH

A New Dawn

Seizing Real Estate's Moment of Opportunity

DECEMBER 2024

CONFIDENTIAL AND PROPRIETARY

A Letter from David Steinbach

GLOBAL CHIEF INVESTMENT OFFICER

As we enter 2025, we remain in the midst of a massive transition in the investment landscape. The momentum of the distant past (where unusually low interest rates helped propel growth, asset appreciation, and easy leverage) has long since faded, replaced by a more challenging, higher-interest-rate environment that requires an increasingly strategic, methodical approach.

But we believe a new era of recovery (and opportunity) is upon us…

As many central banks have begun cutting interest rates, fundamentals are improving, more capital is coming into markets, and global growth is showing signs of strength. From a wide-angle perspective, broader themes such as meaningful global demographic shifts (that are helping to reshape economies, industries, and geographies); the rise of AI and automation (which are transforming industries and workplaces); and a continued global focus on decarbonization are also guiding our increasingly positive forward-looking investment thesis.

These are all reasons investors should approach the new year with both confidence and optimism. In fact, it's our view that we'll likely look back on 2025 as a pivotal moment of recovery in many areas of the commercial real estate sector. For investors, we believe the time is now to reposition portfolios as the window opens in the year ahead.

As a new dawn emerges, we're excited about the opportunities we're seeing on the horizon to put fresh capital to work. Our priority sectors and high-conviction themes for the year ahead include:

> ***"We'll likely look back on 2025 as a pivotal moment of recovery."***

Living: An acute housing supply shortage, unprecedented home unaffordability issues, and changing demographics have transformed the global living sector. We now see a pronounced proclivity to rent on a global scale, with households showing momentum for renting over buying in developed markets. Given these developments, exciting pockets of opportunity are emerging at the macro and local levels.

Retail: After years of turmoil, a transformed retail sector has emerged with winners and losers in the sector sorted. Robust wage growth, strong consumer sentiment, and stabilizing global inflation indicate that this turnaround should continue. We believe that these realities are converging into a compelling investment thesis, particularly for open-air, grocery-anchored retail subtypes.

Industrial: Despite softening fundamentals post-pandemic, the capital markets have remained bullish on the industrial sector. As such, it remains fairly if not fully priced. This is particularly true for assets with short-term rollover of seasoned leases, where buyers can underwrite large NOI gains on expiring leases given accrued market rent growth. As long as demand growth continues, most markets should avoid a downturn and experience renewed rent growth as supply and demand come more into balance.

Office/Debt and Alternatives: Return-to-work continued to gain traction just as the supply of the most desirable office spaces remained limited. Given that demand has broadened, the potential to improve older spaces to meet evolving tenant needs is real. In this environment, we see an opportunity for investors to sequence their exposure to the office market—a process we believe starts with a risk-adjusted approach to tactically leveraging debt. And as we'll explore further in this paper, certain niche areas such as student housing, self-storage, digital infrastructure, and more could offer compelling opportunities in the current landscape.

Challenges still linger, however, and although we remain largely bullish on markets in 2025, some key risks remain. For starters, although interest rates have started to fall, it will take time for them to normalize. Therefore, the focus must remain on disciplined investment, recognizing that higher rates demand a more cautious, long-term approach to growth. In this environment, rent growth (not cap rate compression) will likely drive value creation across sectors and geographies—highlighting investors' need to execute at the asset level.

On the geopolitical front, Russia's invasion of Ukraine continues to weigh on global energy markets and global alliances. The ongoing turmoil in the Middle East is further exacerbating global instabilities. Any intensification of these conflicts could have truly negative consequences. And while AI is causing a tidal wave of transformation, the current infrastructure is simply not equipped to manage the demand of AI's data centers. Substantial investment is required to meet rising energy needs.

A New Dawn Emerges

2024 saw several significant elections around the world, most recently in the United States. With campaigning wrapped up and a new season of governing about to begin, we're taking stock of the potential impacts of a new administration in Washington. While we remain optimistic about the near-term outlook, it remains to be seen what outcomes could result from potentially dramatic shifts in global tariffs, immigration, and broader fiscal policies. Despite this longer-term uncertainty, it's worth noting that private equity real estate investments have delivered consistent average annual returns across both Republican and Democratic administrations in the U.S. since 1981—highlighting an overall resiliency that transcends politics.[1]

As we stand amid these seismic shifts, we approach 2025 with a renewed sense of curiosity, clarity, and confidence. We believe our globally aligned platform, on-the-ground execution capabilities, and strong capital position will enable us to navigate the terrain ahead while taking advantage of new opportunities as they present themselves.

DAVID STEINBACH
Global Chief Investment Officer

Past performance does not guarantee future results.

Assessing the Global Real Estate Cycle as We Close the Door on 2024

By Joshua Scoville
Head of Global Research

Significant repricing, largely as a result of multiple central banks' attempts to squash inflation via the rapid introduction of higher rates, characterized much of the last 18-24 months. But as we turn the page on 2024 and look ahead to what's likely to come in the new year, that same repricing could very well have set the table for an attractive entry into the next cycle. In other words, we see a promising, albeit complex, landscape ahead. In fact, as fundamentals continue to improve globally, our analysis finds that just over 66% of global markets are in some phase of the Buy cycle—the highest level in eight years.

However, that is a broad generalization more relevant in some markets than others. In addition, despite the universally higher cost of capital, fundamental conditions vary considerably across global markets and must be considered within the context of market pricing to fully assess the cycle.

Applying the Hines Research Real Estate Cycle Framework

Real estate market cycles historically take predictable turns, and Hines considers in tandem the intersection of two key factors: **1.)** The fundamentals cycle, driven by supply and demand and assessed by occupancy rates and rent growth, and **2.)** The capital markets cycle, driven by the cost of capital and capital flows, measured by market pricing both on a relative basis (the price of real estate relative to other asset classes) and on an absolute basis (the price of real estate relative to its own history).

Recall the description of real estate cycle phases as introduced in our 2024 Outlook:

EARLY BUY: Coming out of a pronounced downturn at the very beginning of a market cycle, fundamentals are typically weak, and capital markets are usually dislocated, which means prices are low. In this part of the cycle, it takes a bit of boldness to be a first mover in markets with fundamentals that are extremely poor, but history suggests the odds are high for favorable outcomes on new investments.[2]

BUY: Next, given the dearth of supply deliveries as markets emerge from downturns amidst the inevitable recovery in tenant demand, fundamentals begin to improve but the capital markets haven't woken up to this improvement. This is what we refer to as the Buy phase. While investing in this phase is still going against the herd a bit, it's easier to get comfortable putting new capital to work because the recovery in fundamentals is visible.

STRONG BUY: In the next phase of the cycle, fundamentals further improve, and pricing is still attractive. Markets don't tend to hang out in this phase for long, particularly when there is an abundance of dry powder, but when they are here, we refer to this as the Strong Buy phase of the cycle.

LATE BUY: With strong rent growth and rising occupancies clearly visible, the capital markets finally begin to fully emerge from their slumber. As a result, prices tend to rise from their lows but are still considered to be fairly valued.

PREPARE FOR SALE: Increased competition for assets in markets with still-strong fundamentals drives prices even higher to the point where we consider them overvalued. Note that markets can stay in this phase for an extended period of time, so selling shouldn't be considered imminent. However, the bar should be high on new investments.

SELL: Capital markets momentum keeps prices high even as fundamental cracks emerge. The disposition process should be robust with still plenty of market liquidity.

LATE SELL: Fundamentals continue to soften but there are still active investors who haven't adjusted their strategy. After all, it had been working well to this point so many are simply rinsing and repeating. As a result, it's still possible to sell assets at attractive prices.

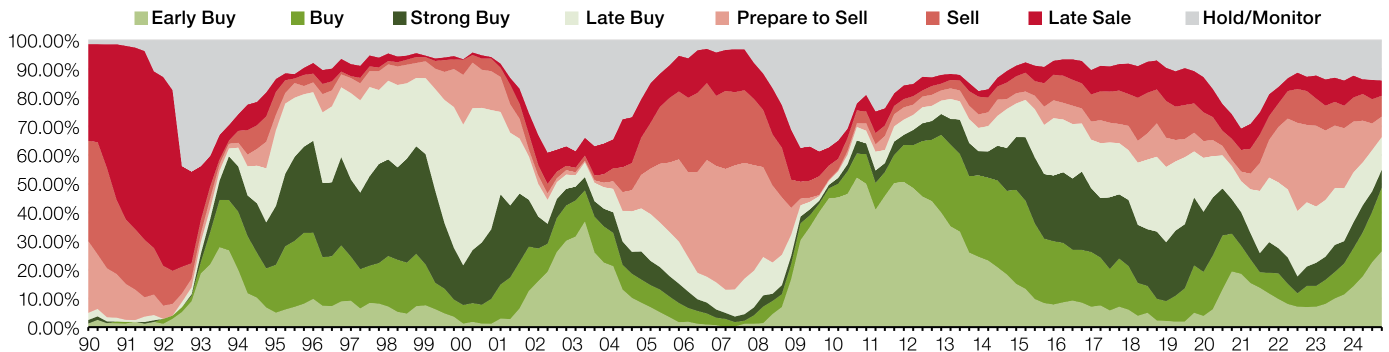
HOLD/MONITOR: As the capital markets finally begin to react to poor fundamentals, prices soften, falling back into fair value territory but not fully reflective of the challenging market fundamentals. We call this the Hold/Monitor part of the cycle, which proceeds the Early Buy phase. At this point, owners may need to work out the loans they put on assets bought late in the cycle or on assets where they missed the opportunity to harvest gains.

Where Are We in the Cycle Now?

Exhibit 1 illustrates the percentage of the 534 global real estate markets[3] tracked by Hines Research in each of the various cycle phases described above since Q1 1990.

Exhibit 1

Percentage of Global Markets in Various Real Estate Cycle Phases



Sources: NCREIF, CoStar, Green Street, CBRE, JLL, MSCI, and Hines Research. As of Q3 2024.

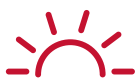
As of the third quarter of 2024, just over 66% of global markets were in some phase of the Buy cycle, the highest level since 2016.

GLOBAL: As of the third quarter of 2024, ***just over 66% of global markets were in some phase of the Buy cycle, the highest level since 2016*** and akin to the early years of the post-GFC recovery in the second half of 2010. This is also a similar level to the mid-1990s as the U.S. emerged from the S&L crisis.[4] While both of those post-downturn periods had their fundamental challenges at the time, they were excellent vintages to put new money to work in a re-priced environment.

EUROPE: Within the major regions, greater re-pricing in Europe has pushed 75% of European markets into the Early Buy (33%), Buy (27%), or Strong Buy (15%) zones, the highest cumulative total of any of the regions. In addition, another 3% of European markets are in the Late Buy phase, mainly because of modest repricing in industrial markets that still have strong fundamentals.[5]

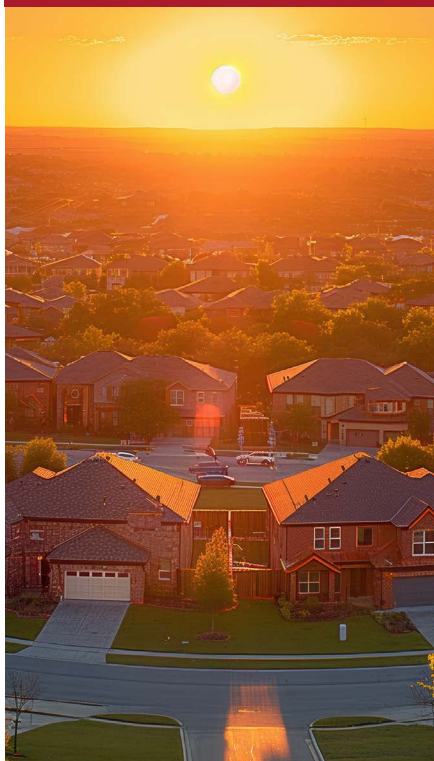
NORTH AMERICA: This geography is slightly lower with just over 60% of markets in one of the first three Buy zones where attractive pricing combines with various fundamental states from poor (mostly office, but also some apartment markets) to good (primarily retail markets). However, North America has a greater share of markets in the Late Buy (19%) phase, characterized by markets that are still fair value but experiencing strong fundamental momentum. Like Europe, this is driven largely by (1) a re-priced industrial sector where fundamentals are still quite strong in some markets, (2) markets from the generally healthy U.S. retail sector, and (3) a handful of smaller Midwest and Northeast apartment markets.

ASIA: As usual, Asia is more of a mixed bag. The correction has been more pronounced in mainland China and Hong Kong, but elevated economic and geopolitical uncertainty is contributing to the lack of foreign capital flows, particularly to the mainland, and that is unlikely to change soon. High rates in Australia pushed prices down, particularly in the hard-hit office sector, but cap rate spreads in the nascent residential and fundamentally healthier industrial sector remain fairly skinny relative to historical norms. In Japan, yields have remained accretive and like Japanese inflation, rent growth has strengthened as of late, providing potential upside in prices through Net Operating Income (NOI) growth rather than cap rate compression.



Key Takeaway

Proclivity towards renting is gaining traction globally as a widespread housing shortage has contributed to an affordability crisis.



The Living Sector

Relatively Inelastic Demand, Perennially Undersupplied

Despite the disparity of real estate cycles across regions, countries, and cities, the living sector probably has the most similarities across the globe. The housing shortage, which is well-documented in developed countries is a fairly universal phenomenon. That said, the degree of undersupply does vary across countries and product types. In addition, the proclivity toward renting is gaining market share globally as the widespread housing shortage has contributed to an affordability crisis given higher mortgage rates in many places. In total, we estimate a sizeable global housing shortage of roughly 6.5 million units.[6]

In fact, this lack of affordability is creating significant demand for rental units, particularly in developed economies. Over 80% of households we analyzed showed clear momentum for renting over buying, with renting households growing much more quickly than home-owning ones.[7] In many of these countries, the ownership of rental properties is extremely fragmented, with relatively little institutionally built, owned, and managed product.

This creates an opportunity to develop the asset class, almost from scratch, and bring lessons learned over the last 40 years of U.S. institutional ownership of apartments to nascent markets in countries like Canada, Australia, and Brazil. While local regulatory environments in some jurisdictions do present challenges to this thesis, others are more open and unlikely to create regulatory barriers to builder's desires to add much-needed new housing to the local inventory.

Despite the general housing shortage, the traditional for-rent, highly amenitized, and professionally managed apartment sector in the U.S. has been suffering from near-term over-supply in many markets, particularly in the Sunbelt. The resultant market softness has put downward pressure on prices, tilting the current opportunity more toward acquisition rather than development (although the recapitalization of existing broken developments remains an interesting proposition).

Indeed, high construction costs and plateauing rents in parts of the U.S. have disrupted the profitability of development, and new starts have slowed dramatically. Tenant incentives and concessions have stoked demand which has rebounded strongly, but the market still needs to work through the more than 700,000 units still underway in the U.S. apartment pipeline, as of 3Q 2024. That should keep market fundamentals soft to neutral over the next 12-18 months, though there are regions in the U.S., particularly the Midwest and Northeast, where market fundamentals are firmer.

We expect the wave of cyclical supply to slow in 2026-27, and then market rent growth should accelerate from its current lows. That's good news for fundamentals but if that rent growth begins to bleed into general inflation data where housing makes up about 35% of the U.S. consumer price index, renewed inflation pressures could cause another round of moderate tightening which could have implications for future cap rates.

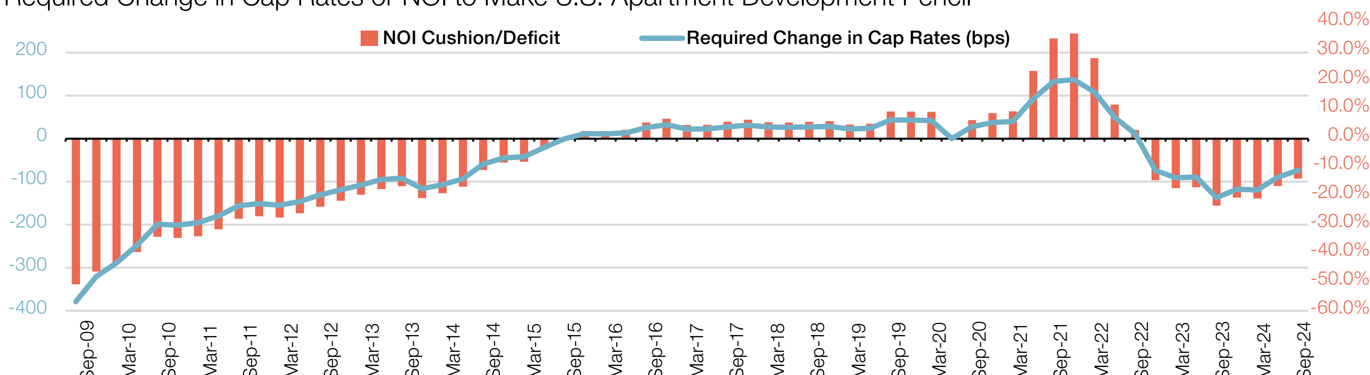
As shown in Exhibit 2, we estimate that U.S. NOI would have to increase by about 15% or cap rates would need to decrease by 75 basis points (or some combination thereof) for new development to pencil at the national level, though the range of those estimates varies at the local market level. While there is still a gap, this is a notable improvement from a year ago (3Q 2023) when NOI was more than 20% lower and cap rates were more than 100 basis points higher than needed to kick start a new development.

As we noted, the economics for development can vary at the local level, but for investors with the ability to identify the right markets, we believe the dynamics currently limiting development from a top-down national level only serve to limit overall supply—providing another tailwind for well-planned strategies in the right markets.

Meanwhile, some less traditional forms of housing are offering investment opportunities globally. For example, the European student housing sector is being driven by a growing secondary school cohort and increasing international student demand which is driving rent growth around high-quality universities that lack sufficient housing for students. This is somewhat the case in the U.S. as well, but total enrollment peaked about a decade ago, and investors need to be aware that much of the reported growth in many colleges and universities is being driven by online enrollment—which has little to no impact on student housing demand.

Exhibit 2

Required Change in Cap Rates or NOI to Make U.S. Apartment Development Pencil



Sources: NCREIF, CoStar, Green Street, Bureau of Labor Statistics, and Hines Research. As of Q3 2024.

In the U.S., the difficulty of homeownership attainment seems to be boosting single-family and townhome rental housing. Per our research, it is now more attractive to rent versus buy in the U.S. housing market than it has ever been, starting with data in 1980.[8] Additionally, with strong growth in the 35- to 54-year-old cohort forecasted for the U.S., the demographic tailwinds are now blowing for single-family or townhome rentals over traditional multifamily.

In Asia, Australia's for-rent market is where the U.S. was arguably 30-40 years ago, as institutional investment is just getting started and most existing product is owned by individual investors with little professional management or property amenities. The Japanese apartment sector is well established and enjoying headier inflation-driven rent growth than it has traditionally. Meanwhile, South Korea's apartment sector is exhibiting Japan-like characteristics from a decade ago, signaling the potential for growth in institutional investment, given structural idiosyncrasies in the local rental market (heavy rental deposits required upfront) and positive demographics (such as growing single-person households in Seoul). Despite its relatively benign demographics, the increasing number of single-person households and evolving lifestyle preferences point towards a need for bespoke rental product in Seoul.

Per our research, it is now more attractive to rent versus buy in the U.S. housing market than it has ever been, starting with data in 1980.

Key Takeaway

Globally, retail has the second highest percentage of markets in some phase of the Buy cycle.

The Retail Sector

Healthy Fundamentals Following a Decade of Adjustment

The retail sector has spent much of the past decade "rightsizing" itself in many countries and is currently bearing the fruits of that elongated and, in many cases, painful transition. As a result, changing market dynamics and evolving consumer behavior have created attractive opportunities for investors who recognize this shift and are no longer redlining the property sector due to the perceived threat of e-commerce or the impact of economic downturns.

This process has resulted in a more balanced market where new supply has been de minimis for more than a decade in many markets, and the process of sorting the winning centers from the losing ones has largely played out. The end result for the losing centers has been:

1. **Obsolescence:** Where the centers have lost a critical mass of tenants, making them no longer competitive for new tenants.
2. **Significant Repositioning and/or Redevelopment:** Where entire portions (or the centers entirely) have been razed and replaced with other forms of real estate—that could range from multifamily housing, e-commerce fulfilment industrial space, to new forms of open-air retail and/or mixed-use development.

Meanwhile, the winning centers often have waiting lists of tenants looking to lease space given the consolidation of retail sales into these thriving centers. As a result, rent growth has been rather impressive.

Given this evolution, the retail sector has offered improving and, in many markets, even strong, fundamentals. Positive NOI growth in many subtypes is increasingly the norm in the U.S., particularly for grocery-anchored neighborhood centers but also for power centers and other open-air formats as well.

In Europe and Asia, rent growth has also been on an upward trajectory. Because Europe is in the earlier process of sorting the winners and losers, growth is less broad and confined to more specific submarkets. That said, given its lower square footage per capita, Europe has less sorting to do than the U.S., so it isn't likely to take as long to work through.

In the U.S., more than 450 million square feet of retail space has been demolished over the past 24 years, a trend that gathered steam following the GFC. But one sign of the "retail apocalypse" nearing an end is that the pace of this trend has been slowing dramatically in recent years. A decade ago, the growth in demolished retail space was growing at an annual pace of nearly 40%. As of Q3 2024, the pace had slowed to less than 4%.[9] In addition, the explosion of e-commerce demand necessitated by the pandemic has slowed dramatically and growth is now below pre-pandemic levels.[10]

Further, online-only retailers have woken to the benefits of omni-channel retailing, and much of the leasing of late has been coming from these retailers opening physical stores.

Despite broad tailwinds, not all retail is created equal and the need for selectivity in targeting specific retail subtypes and locations should be a point of emphasis. In the U.S., open-air grocery-anchored centers have consistently outperformed their non-grocery counterparts. This trend holds true across various subtypes like neighborhood, community, and power centers, suggesting the importance of grocery stores as traffic drivers and anchors for retail success.

Across the four major property types in NCREIF, the retail sector has ranked first in total returns in the U.S. for each of the past eight quarters through Q3 2024.

That said, there is a growing trend of grocery conversions in what might overwise have been historically non-grocery uses. Indeed, despite limited ground-up retail development, the number of grocers within 1.5 miles of existing grocers has increased almost 19.1% from 2022-24 due to these conversions.[11] As a result, while the demographics of surrounding households are an important consideration in retail investments, it's important to consider those demographics within the context of competitive supply. This may be particularly true in a more consolidated grocery environment in the future.

A decade's worth of general disinterest in the retail sector by capital markets was exacerbated by the pandemic, particularly in the U.S. and Europe. This has generated attractive pricing and yields that are relatively high compared to the industrial and residential sectors. As a result, across the four major property types in NCREIF, the retail sector has ranked first in total returns in the U.S. for each of the past eight quarters through Q3 2024.

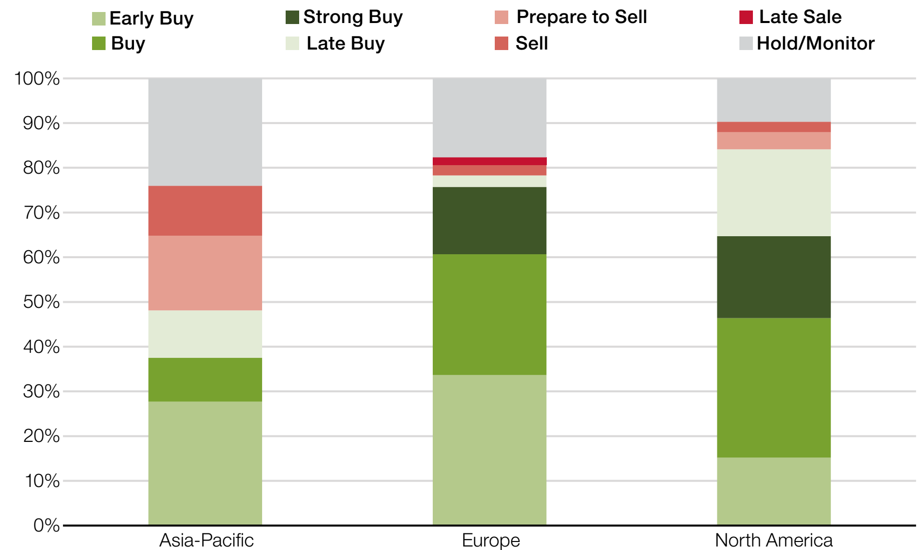
Globally, retail has had the second highest percentage of markets in some phase of the Buy cycle, trailing only the office sector. However, unlike the office sector where fundamentals are challenged in many markets, thereby placing the majority of the office markets in the Early Buy phase, the retail sector's stronger fundamentals have more of the markets in the Buy, Strong Buy, or Late Buy phases.

Across the regions, the retail opportunity appears greatest in Europe and North America as shown in Exhibit 3, but strong fundamentals in the latter add to the confidence in making investments in the sector while European retail fundamentals are still in the process of sorting themselves out.

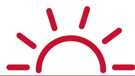
However, European cities that benefit from both strong local retail spending and high tourism offer promising opportunities for high street and other retail investments. This is true in Asia as well, where the resurgence of tourism in the region has supported retail sales and property fundamentals in key markets like Tokyo and Seoul. In addition, dominant centers in Australia can be accessed at relatively attractive pricing given capital markets dislocation in markets such as Sydney with strong demographic tailwinds that should support retail sales as economic conditions strengthen.

Exhibit 3

Percentage of Retail Markets in Various Parts of Their Cycles, by Region



Sources: NCREIF, CoStar, CBRE, JLL, MSCI, and Hines Research. As of Q3 2024.



Key Takeaway

Regional variances in the office sector are notable, as is the dislocation in the capital markets in the face of weak fundamentals. But signs of momentum and opportunity are emerging.

The Office Sector

Beleaguered but Potentially Turning a Corner

Office fundamentals are dislocated in many markets, but the regional variances are significant. In general, and with the notable exception of Australia, market fundamentals have been stronger in Asia and weaker in North America, with European markets somewhere in the middle, mostly because of higher supply constraints and a smaller impact from work-from-home trends compared to North American markets. As would be expected, capital markets are particularly dislocated in office markets with weaker fundamentals, which creates challenges—but also opportunities.

In the most extreme cases, many U.S. markets haven't been this inexpensive relative to long-term trends since the post-S&L crisis in the early-to-mid 1990s, with values 50% or more below where they would likely be if not for the economic and secular impact of the pandemic. While extremely weak, it's important to note that, on average, fundamentals are no longer weakening in most U.S. markets, and our gauge of fundamentals health—the leasing environment health score[12]—has ticked up modestly over the last few quarters on positive net absorption for the first time in recent years.

The highest quality space has held up relatively well throughout this period of weakness, but we have noticed absorption seeping into the next tier office assets in the last couple of quarters. These are assets that are still very good but not necessarily the best of the best. In the U.S., submarkets that provide a mix of residential, retail, and office space have fared best while traditional office-only submarkets with limited residential and retail amenities continued to wane.

The highest quality space has held up relatively well throughout this period of weakness, but we have noticed absorption seeping into the next tier of office assets in the last couple of quarters.

While many attribute weakness in tenant demand to the secular work-from-home shift, there is a cyclical component to the U.S. office sector that many analysts may be overlooking: office-using employment growth in the U.S. is approaching 0% annually, and many major U.S. markets have actually been shedding traditional office-using jobs over the past year, ending in October—a trend that could continue as a result of AI's integration. Naturally, less job growth would lead to less tenant demand, but that is a cyclical factor rather than a secular one, likely tied to the sensitivity of many office-using jobs to the interest rate environment. The good news is that once growth inevitably returns, this cyclical headwind should subside.

The lack of office-using job growth conflicts with the recent uptick in leasing activity and absorption in the United States. But that phenomenon supports the notion that deferred leasing decisions over the last several years may now be coming to a head as tenants are closer to finding clarity in their future office needs, even if that results in smaller footprints for some tenants. Anecdotally, within our own portfolio, tenants were giving about a third of their space back upon renewals 12-18 months ago, but that has slowed to about 10% more recently. Still less space, but that's a significant improvement should it persist.

With the modest boost in U.S. office demand, coupled with the slowing in office-using employment growth, leased space per office-using employee has stabilized over the past year and has even risen modestly. This follows over two years when that metric plummeted more than 10% as tenants shed space despite continuing to add employees.

Using Moody's office-using employment growth forecast for the U.S., we then ran three scenarios:

1. Office usage per employee remains at its current all-time low
2. Office usage per employee gets halfway back to its long-term trend
3. Office usage reverts to its long-term trend

Given the decline in office construction activity—net starts have been negative in each of the first three quarters of 2024 as the market is converting and/or razing more office space than is being started (and the few starts that are occurring are primarily build-to-suits and medical office product per data from CoStar), we then ran a projection based on those three scenarios to determine the potential trajectory of national vacancy rates.[13]

- In the most pessimistic scenario (where tenants maintain their current near-record low level of office usage), vacancy rates fall about 300 basis points over the following 3-4 years, but are still a couple of hundred basis points above their pre-pandemic cyclical low into 2028.
- In the halfway back scenario, vacancy rates plummet nearly 1,000 basis points by 2028, falling well below their dotcom boom low and more akin to where they were in the early 1980s.
- In the fully back scenario, we run out of office space by 2028.

Barring an economic setback, the likely path is somewhere between the two extremes, but the analysis does highlight just how under-officed the market could be as we approach the latter half of the decade.

In Asia, Seoul has been arguably the heathiest office market on the planet with low single-digit vacancy rates and strong rent growth. Meanwhile, Japan's office market appears to have reached a bottom and is beginning to look like it is on an upswing. Softer fundamentals persist in Melbourne.

In Europe, cyclical conditions appear attractive for tactical office acquisitions in Paris, London, and Amsterdam. With the exception of perhaps some German markets, limited new supply in major European markets in the latter half of this decade will likely be a major driver of even stronger fundamentals. This is particularly true for energy

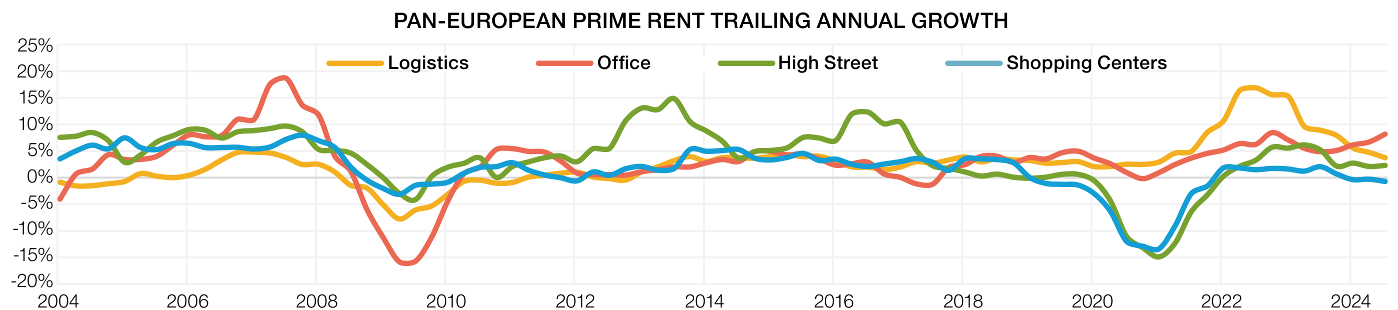
efficient buildings as tenants with specific carbon targets likely have limited lease options that match those goals. Already, despite less than robust economic conditions, European prime office rent growth accelerated even as the other property sectors cooled (see Exhibit 4). Note that this growth is primarily in major Central Business Districts, while suburban submarkets in Europe remain soft.

The dislocation in U.S. office capital markets has created opportunities across the capital stack. As existing loans mature, the lack of traditional financing needed to meet refinancing requirements has created a situation where debt may be a more attractive investment than equity. Although office values have declined considerably, today's debt yields often exceed equity yields, particularly on high-quality office assets.

This presents a favorable opportunity for debt investors to secure strong cash yields on re-set valuations, thereby producing attractive risk-adjusted and absolute returns. In total, estimates of maturing debt in the U.S. office market approximate $400 billion through 2027, providing plenty of runway to provide debt on office assets at attractive lender terms over the next several years.

Exhibit 4

Prime Office Rents Rising Robustly in Europe Reflecting Lack of High-Quality Space



Sources: CBRE and Hines Research. As of Q3 2024.

Key Takeaway

Despite moderating fundamentals, the industrial sector remains attractive due to embedded NOI growth. We expect to see renewed rent growth as supply and demand come into closer alignment in the year ahead.

The Industrial Sector

Embedded NOI Growth Despite Some Moderating Fundamentals

Within commercial real estate, the industrial sector was arguably the largest benefactor of the pandemic for several reasons:

- The necessity to shop online converted holdouts, primarily older consumers, who had otherwise never done so.
- The supply shortages that ensued during the pandemic highlighted the need for just-in-case inventory control versus the predominance of just-in-time that had been the hallmark of optimized inventory control for several decades.
- Supply chain reconfiguration aimed to get goods closer to end users with heightened pressure from geopolitical tensions, the onset of trade-wars, and de-globalization.
- Industrial policy, particularly in the U.S., further promoted domestic investment.

Given the above forces, industrial absorption exploded during the pandemic, and high levels of tenant demand persisted for several years. This phenomenon started in the U.S., but quickly found its way to the U.K., then to continental Europe, and finally to Asia and other countries such as Canada and Brazil. Watching these trends take place in succession was truly a textbook case of global pattern recognition.

The fundamental drivers that kick-started that wave of demand are well past their peak, even if they continue to have influence into the near future. In the U.S., we've seen a moderation in demand and rent growth from what were unsustainable highs. Like the initial uptick, this slowing started in the U.S., spilled over to the U.K., and found its way into Europe and Asia more recently.

Despite the softening in fundamentals, capital markets have remained enamored with the industrial sector, particularly because of the longer-term drivers highlighted earlier. As such, the industrial sector remains fairly if not fully priced. This is particularly true for assets with short-term rollover of seasoned leases where buyers can underwrite large NOI gains on expiring leases given the accrued market rent growth that has occurred since the lease was signed. By way of example, consider Exhibit 5, which illustrates a five-year Sydney industrial lease with CPI-based annual rent increases that reset to market every five years.[14]

In the U.S. we've seen a moderation in demand and rent growth from what were unsustainable highs.

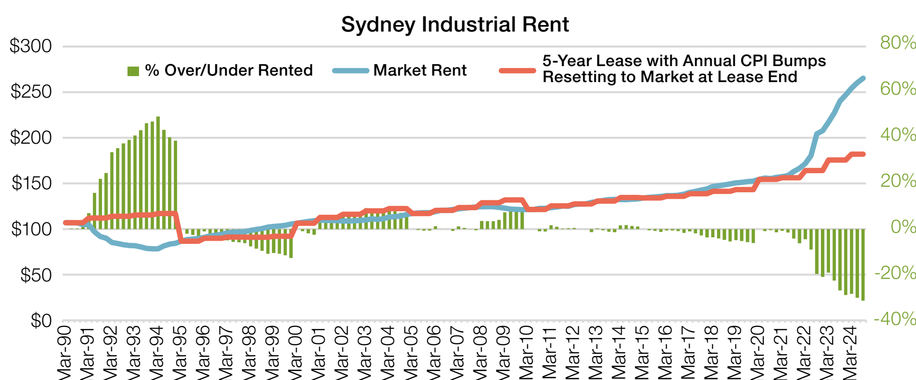
In this simplified example, the initial lease was signed in Q1 1990, and rolled to market rents every five years. So, the most recent lease was signed in Q1 2020. With inflation-based lease bumps, the current lease has risen 17.8% since that renewal. However, market rents have risen 71.7% since the lease was signed. As a result, the in-place lease is 31% below market rent (a record in this analysis) and is set to renew in Q1 2025. If the asset transacted on the market at a 5% cap rate, the buyer is likely expecting the uplift in NOI upon renewal to bring the yield up to the high 6s in short order. Therefore, they may be willing to take negative leverage initially to be awarded the deal in a competitive auction environment. These are the types of deals that have been driving the industrial market over the past couple of years.

However, with slowing rent growth, or even falling rents in some markets, this phenomenon could run its course in the near term for a few reasons:

- Long-term leases with 5+ years of remaining term do not benefit from the above as buyers have less confidence in getting to the NOI uplift. Therefore, cap rates have typically been higher on those types of deals.
- The NOI uplift on assets with relatively newer leases signed in the last year or two in markets with flat or falling rents may be increasingly questioned, which could also push cap rates higher.
- Rising availability rates may cause would-be buyers to lower renewal probability assumptions as tenants have more options today than they have had in many years.

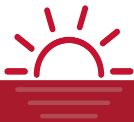
Exhibit 5

Industrial Market Rent Growth Has Created Embedded NOI Growth



Sources: JLL, Australian Bureau of Statistics, and Hines Research. As of Q3 2024.

The good news for the industrial sector is twofold. First, it does look like fundamentals have suffered the sharpest declines in specific segments of the market, at least in the United States. Boxes of 500,000-1M square feet or 1M+ square feet are bearing the brunt of oversupply, so smaller sized assets may prove more defensive in the short-term. Second, like other forms of real estate, construction has slowed dramatically in response to higher construction costs, stabilizing/falling rents, and reduced tenant demand. Furthermore, unlike other forms of real estate, industrial construction timelines are typically much shorter and/or larger projects are usually phased in. As such, as long as demand growth continues, even at a more normalized pre-pandemic pace, most markets should avoid an elongated and pronounced downturn. The more likely scenario is a short pause, followed by renewed rent growth as supply and demand come more into balance in late 2025 and into 2026.



Key Takeaway

Investment opportunities within niche sectors can vary significantly across regions. Success often depends on understanding local market nuances.

Other Sectors

Niche sectors like student housing, senior living, life sciences, self-storage, and cold storage—each derivative of traditional core property sectors—present attractive investment opportunities due to their unique demand drivers and growth potential. However, these sectors are relatively small compared to traditional, well-established sectors like industrial, retail, and office. In addition, they are more opaque from a research perspective with limited data and fewer, if any, cycles to analyze historical patterns.

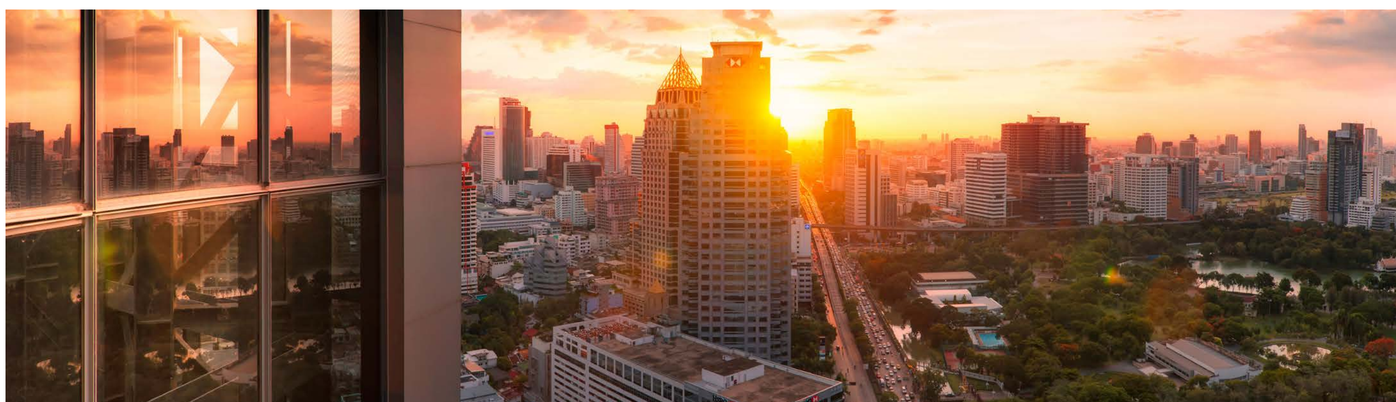
Global demographic trends, particularly the growth of specific age cohorts, significantly influence demand in certain niche sectors. For example, the expanding secondary school population in Europe and, to a lesser extent, the U.S., supports the student accommodation sector. Similarly, the aging population in many developed countries creates potential demand for senior living while the difficulty of homeownership attainment should boost single family and townhome rental housing, particularly in countries like the U.S. with strong growth among adults between the ages of 35 and 54. While that age cohort may be marrying later and having fewer children than their parents did, the urban apartment lifestyle that has been in favor with young adults in their 20s is ill-suited for even small families.

Each niche sector has unique demand drivers that investors need to understand to make informed decisions. For example, research funding plays a crucial role in driving demand for life science real estate, with funding concentrated in specific geographic clusters like the "Golden Triangle" regions in the U.K. In the self-storage sector, markets with constrained supply relative to household growth tend to experience stronger rent growth, making supply dynamics a key consideration for investors. For cold storage, demand is linked to GDP per capita growth and agricultural exports, suggesting higher growth potential in emerging markets.

Each niche sector has unique demand drivers that investors need to understand to make informed decisions.

Investment opportunities within niche sectors can vary significantly across different regions, and given the lack of data, success often depends on understanding local market dynamics and nuances. For instance, while the student accommodation sector has benefitted from favorable demographics in both the U.S. and Europe, rent growth in the U.S. has lagged. In Europe, student housing properties located near high-quality universities commanded a rent premium, highlighting the importance of not just the market generally, but location within the market specifically. Similarly, the self-storage market is more mature in the U.S. than in Europe and Asia, presenting different risk and reward profiles for investors.

One of the hottest niche sectors is data centers. The explosion in AI over the last several years has added juice to a demand curve that was already on an exponential trend. With power availability currently acting as a natural near-term (2-3 years at least) supply barrier, it's easy to understand why heady competition for megawatts, particularly among hyperscalers (cloud computing providers that operate large-scale data centers), has driven significant rent growth within the space. There are many ways to participate in this wave, but we believe one of the highest risk-adjusted opportunities is to source land, entitle it, work with local utilities to receive power commitments, and then sell that land to a hyperscaler or data center developer.



Conclusion

The significant repricing driven by central banks' efforts to control inflation has created attractive entry points into the next cycle, though this varies by region and market type. Fundamentals and capital markets cycles, driven by supply-demand dynamics and the cost of capital respectively, are crucial in assessing market opportunities. Overall, the varied phases of the real estate cycle across regions and sectors highlight the importance of strategic investment decisions tailored to local market conditions.

In Europe, extensive repricing has positioned many markets in the Early to Strong Buy phases, while North America shows a mix of Early and Late Buy opportunities, particularly in the industrial and retail sectors. Asia's market remains mixed, with relative value in many retail markets offering opportunity.

The living sector continues to face a global housing shortage, driving demand for rental units, while the retail sector benefits from a decade of adjustment, showing strong fundamentals in key markets. The office sector, though beleaguered, offers tactical opportunities, especially in regions with limited new supply. The industrial sector, despite moderating fundamentals, remains attractive due to embedded NOI growth. Niche sectors like student housing and data centers present unique opportunities driven by specific demand factors.

As we close the door on 2024 and look ahead to 2025, our data finds that the global real estate market presents a promising, but complex, landscape. Overall, it's our conviction that the year ahead will bring stability, clarity, and potential opportunity for global real estate investors as the dust settles and the asset class turns a corner into recovery. And as many central banks continue their interest rate easing campaigns, we're likely at a key moment in the cycle to put fresh capital to work.

Joshua Scoville
Head of Global Research

ABOUT THE AUTHOR AND THE HINES PROPRIETARY RESEARCH TEAM

Joshua Scoville serves as Head of Global Research and is a member of the firm's Investment Committee. He and his team are responsible for constructing the Hines macroeconomic view and outlook for commercial real estate market fundamentals and pricing, as well as assisting with the development of investment strategies for the firm's investment programs. They also work closely with the local and fund management teams, clients, and partners and support U.S., regional, and international country heads in identifying market/submarket opportunities and risks. The team also includes Michael Hudgins, Ryan McCullough, James Purvis, Tim Jowett, Erik Thomas, Michael Spellane, and Anthony Witkowski.

ENDNOTES

1 Sources: NCREIF, Britannica, Hines Research. As of 3Q2024. Using only presidencies with full terms over the period from 1977 to 2024, with the first full-term starting in 1981. Note, we use the current presidential term as a full term given it is short only one quarter. Returns are unlevered, so do not reflect the impact of using debt capital.

2 For a more detailed explanation of these phases, please refer to page 25 of our 2024 Outlook at https://www.hines.com/globaloutlook-2024

3 A market being defined as a metro/property type combination such as Paris Office or Los Angeles Retail, etc.

4 The early data in Exhibit 1 is more U.S.-centric as the international data on price and fundamentals required to assess the cycle start later.

5 The cycle doesn't always progress linearly from one phase to the next; in this case, European industrial markets with strong fundamentals that were previously a bit overvalued and in the Prepare to Sell phase re-priced due to the higher cost of capital, causing them to retreat to the Late Buy phase.

6 Sources: Oxford Economics, Eurostat, U.S. Census Bureau, Statistics Canada, Statistics Korea, Australian Bureau of Statistics, Hong Kong Census and Statistics Department, Statistical Bureau of Japan, and Hines Research. As of 2Q 2024.

7 Sources: Oxford Economics, Eurostat, U.S. Census Bureau, Statistics Canada, Australian Bureau of Statistics, Hong Kong Census and Statistics Department, Statistical Bureau of Japan, and Hines Research. As of 2Q 2024.

8 Sources: Census Bureau, Moody's, CoStar, Zillow, and Hines Research. As of 2Q 2024.

9 Sources: CoStar, Hines Research. As of 3Q 2024.

10 Sources: CoStar, Hines Research. As of 3Q 2024.

11 Sources: CoStar, Hines Research. As of 3Q 2024.

12 A composite index of tenant demand growth, occupancy rate, and rent growth

13 Sources: CoStar, Hines Research. As of 3Q 2024.

14 European and Asian commercial leases are more likely partially or fully indexed to inflation, but this example gets to the point of investors' desire for near-term mark-to-market industrial leases.

Disclaimer

CONFIDENTIAL INFORMATION

Past performance is no guarantee of future results. Investing involves risks, including possible loss of principal. The opinions presented herein cannot be viewed as an indicator of future performance.

Confidential Information
This document is intended only for the recipient to whom it has been furnished by Hines. The reproduction of this document in whole or in part is prohibited. You are not permitted to make this document, or the information contained herein and/or the information provided to you, available to any third parties.

Preliminary Selective Information
This document is being provided to you on a confidential basis for the sole purpose of providing you with initial and general information at your own responsibility. This document is not suitable to inform you of the legal and factual circumstances necessary to make an informed judgment about any prospective investment. Prospective investors are requested to inform themselves comprehensively and, in particular, to verify the contractual documentation that will be provided in the future.

Not An Offer
This document does not constitute an offer to acquire or subscribe for securities, units or other participation rights. The distribution of this document is reserved to institutional investors and may be restricted in certain jurisdictions. It is the responsibility of the recipient of this document to comply with all relevant laws and regulations.

Third-Party Information
This material contains information in the form of charts, graphs and/or statements that we indicate were obtained by us from published sources or provided to us by independent third parties, some of whom we pay fees for such information. We consider such sources to be reliable. It is possible that data and assumptions underlying such third-party information may have changed materially since the date referenced. You should not rely on such third party information as predictions of future results. None of Hines Interests Limited Partnership ("Hines"), its affiliates or any third-party source undertakes to update any such information contained herein. Further, none of Hines, its affiliates or any third-party source purports that such information is comprehensive, and while it is believed to be accurate, it is not guaranteed to be free from error, omission or misstatement. Hines and its affiliates have not undertaken any independent verification of such information. Finally, you should not construe such third party information as investment, tax, accounting or legal advice.

Forward-Looking Statements
This material contains projected results, forecasts, estimates, targets and other "forward-looking statements" concerning proposed and existing investment funds and other vehicles. Due to the numerous risks and uncertainties inherent in real estate investments, actual events or results or the actual performance of any of the funds or investment vehicles described may differ materially from those reflected or contemplated in such forward-looking statements. Accordingly, forward looking statements cannot be viewed as statements of fact. The projections presented are illustrations of the types of results that could be achieved in the given circumstances if the assumptions underlying them are met but cannot be relied on as accurate predictions of the actual performance of any existing or proposed investment vehicle.

Disclaimer
The statements in this document are based on information that we consider to be reliable. This document does not, however, purport to be comprehensive or free from error, omission or misstatement. We reserve the right to alter any opinion or evaluation expressed herein without notice. Statements presented concerning investment opportunities may not be applicable to particular investors. Liability for all statements and information contained in this document is, to the extent permissible by law, excluded.

©2024 Hines. All rights reserved.