News release

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M&G Real Estate: 2024 is likely to mark the bottom of the cycle and a restart to growth and recovery in certain markets

London, 25 June 2024: M&G Real Estate's mid-year global real estate outlook concludes that rental growth and the strongest prospects will come from the living sectors, best-in-class offices and urban logistics, all of which are – in most markets – suffering from structural undersupply and limited development. This income growth, coupled with yields which today are significantly higher than a year or two ago, will help to drive total returns for investors moving forward.

As asset values hit their lowest point in many markets this year, and the property market cycle shifts over the next 12 months, the next half of 2024 is likely to usher in recovery and growth in some real estate markets after the pandemic and a prolonged economic slowdown.

Residential rental pressures exacerbated as a lack of development bites

Germany's private rented sector (PRS) is one of the most attractive and resilient markets in Europe, but it is facing a significant challenge: the lack of financing for high quality rental accommodation that can meet the needs and preferences of a growing population. Due to the significant gap between supply and demand, rents in Germany's PRS have soared to record highs and show no signs of slowing. Vacancies in the country's major cities are now below 1% with very limited foreseeable future supply, which is driving expectations of strong rental growth of above 3% per annum:

PRS rental growth since start of 2022 in key German cities[1]			
Berlin: 17%	Hamburg: 7%	Munich: 6%	Frankfurt: 5%

Heightened by development shortfalls and affordability, this upward trend has also been prevalent across various other leading cities worldwide:

PRS rental growth since start of 2022 has reached historically high rates[1]				
Sydney: 44%	Melbourne: 42%	Madrid: 32%	London: 19%	Manchester: 16%

A similar story is emerging in Europe's purpose built student housing sector. Countries such as Spain, Portugal and Italy have the lowest provision of student housing in Europe (at 8%, 5% and 3% respectively[2]), with demand driven up by attracting more international students and more local students enrolling locally. Despite these markets being higher yielding compared to the rest of Europe and the UK, limited development restricts market-entry opportunities.

Seoul: bucking working from home trends

Offices of all qualities across much of the world have been indiscriminately tainted by broad perceptions of the negative impact of remote working. However, Seoul's office market has maintained occupancy rates higher than 2019's pre-pandemic levels and currently has a lower vacancy rate than all other major cities at sub -2%. With a very limited development pipeline, rent expectations have increased as occupiers compete for suitable spaces that meet their needs, helping to support capital values despite rising interest rates in the last two years. Markets such as Seoul demonstrate how focussed analysis based on local occupier fundamentals is necessary to identify opportunities for outperformance.

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Debt market risks

Once dominated by the banks, the €1.5 trillion real estate finance market now sees increased participation from alternative lenders – who today represent circa 39 percent of outstanding debt in the UK and 10-15 percent in Continental Europe. As banks reduce their commercial real estate exposure, the sector will see a $250 billion debt funding gap by 2026. Whilst a cause for concern to certain investors facing challenging financing events, it is also an opportunity for alternative lenders such as real estate debt funds taking advantage of attractive risk-adjusted returns to step in to fill the gap.

Distress is likely to be confined to weaker offices and specific markets such as Germany and the US, particularly in older buildings with low quality specifications, lack of amenities and poor ESG credentials. The risks to wider market recovery are more centred around a cautious traditional lending market, and while some future credit losses on loans cannot be ruled out, wider systemic risk remains an unlikely scenario.

Richard Gwilliam, Head of Property Research at M&G Real Estate, comments: "While 2024 is likely to mark the bottom of the cycle and an end to significant capital value falls, investors still need to navigate downside risks; especially for assets with structural challenges and high leverage. The higher for longer interest rate environment means that investors should focus on income as the main route to achieving target returns. Investment transactions over the next few quarters in the right kind of assets look set to benefit from high entry yields and strong rental growth in many markets."

Read the full report here.

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1: PMA: Spring 2024 data and forecasts
2: JLL (2023): 2021/22 data

About M&G Investments

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For nearly nine decades M&G Investments has been helping its customers to prosper by putting investments to work, which in turn creates jobs, homes and vital infrastructure in the real economy. Its investment solutions span equities, fixed income, multi asset, cash, private debt, infrastructure and real estate.

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