ISA
Insights
Strategy
Analysis
by LaSalle

Outlook 2025

LaSalle | Investing today. For tomorrow.

LaSalle | Investing today. For tomorrow.

ISA Outlook 2025

Published December 2025

ISA by LaSalle | Insights Strategy Analysis

OUTLOOK
GLOBAL
2025

The dawn of a new real estate cycle

LaSalle | Investing today. For tomorrow.

ISA Outlook 2025

G-2 Global

A MESSAGE FROM MARK GABBAY

For over 30 years, our annual *ISA Outlook* has been LaSalle's most anticipated and widely read research publication. The report brings together perspectives and investment ideas from our teams around the globe, based on a wide range of data sources and proprietary intelligence gleaned from the 1,200+* assets that we manage, spanning geographies, property types and risk profiles. Our global team of researchers, strategists and data scientists have developed a range of tools and models to synthesize this wealth of information and help you, our investors and partners, understand real estate markets at both the global and local level.

I encourage you to read our outlook for 2025 alongside the broader suite of Insights, Strategy and Analysis (ISA) publications the team produced throughout 2024, including eight *ISA Briefing* notes, three *ISA Focus* reports and our annual *ISA Portfolio View*, which address key questions faced by global real estate investors. These, and a range of other real estate investment-focused thought leadership, are available for you at lasalle.com/insights.

The dawn of a new cycle?

This year, the *ISA Outlook* identifies what appears to be the dawn of a new real estate cycle. As with the start of every new day, both opportunities and challenges lie ahead. We examine these through four broad themes in this year's report:

1 The **morning sky**, where we focus on a mostly benign macro environment characterized by falling inflation and softening rates, while keeping an eye on risks that remain on the horizon;

2 The **capital stack hangover**, which looks at opportunities presented by broken capital structures that exist despite the prospect of healing capital markets;

3 The **breakfast menu** tackles the question of how investors can make sense of ever-more complex investment options; and finally

4 The **early bird**, where the proverbial "worm" is the attractive risk-adjusted returns that may come with entry points early in the real estate cycle.

Revisiting *ISA Outlook 2024*

Last year, for the first time we released the four chapters of the *ISA Outlook* sequentially, beginning with the global chapter in mid-November, followed by the Europe, North America and Asia Pacific chapters over the following weeks. We also introduced new "in hindsight" sidebars, where we looked back at predictions made the previous year, noting what we got right as well as what we got wrong. As we said last year, no forecaster is always correct, but transparency and accountability about prior calls is a strong foundation for improving future projections.

The feedback we received from you was that you appreciated both of these elements, so I am pleased to confirm that we will be maintaining them going forward. As always, we look forward to your feedback and meeting with you throughout 2025 as we look ahead to the dawn of a new cycle in the world of real estate.

Warm regards and best wishes for a successful 2025,

Mark Gabbay
Chief Executive Officer

*Data as of October 31, 2024

EXECUTIVE SUMMARY

THE MORNING SKY

THE CAPITAL STACK HANGOVER

THE BREAKFAST MENU

THE EARLY BIRD

The dawn of a new real estate cycle

Almost three years after interest rates began to spike leading into the Great Tightening Cycle (GTC), the first light of a new real estate cycle is clearly visible on the horizon. In *LaSalle's ISA Outlook 2025*, we look at how to make the most of this new dawn and the opportunities it may present, but with a watchful eye on ways the new day could go off track.

Sunrises are different depending on from where they are observed; accordingly, we also highlight the considerable variation in conditions across global markets. We discuss this mix of optimism and risk in our analysis of **the morning sky**.

Some parts of the market may be a little slow to rise, especially after the stimulus-laden party that was 2021. Excesses from that period embedded challenges in capital stacks that surfaced when rates started to rise. Although real estate is not characterized today by widespread distress, there are pockets of opportunity for rescue capital, both in the form of equity and debt.

Our discussion about curing **the capital stack hangover** looks at the investment opportunities inherent in providing a resolution to such situations through fresh capital and active asset management.

Two mornings are rarely the same; there are considerable differences between this cycle and prior ones. Specifically, bond markets do not expect as rapid a pace of interest rate declines, or to as low a level. Moreover, conditions across real estate sectors and markets are deeply uneven. These differences suggest that investing into the new real estate cycle will not be a simple story of a "rising tide lifts all boats"; selectivity at the sector, market and sub-market level is highly likely to add value. There are also more investment options than before to consider. Like a diner facing a menu with a choice of Continental breakfast, pancakes, dim sum, or a Full English, a real estate investor today would be forgiven for being overwhelmed. We counsel on how to make the most of this complex investment menu and recommended a mix of discernment and diversification in our analysis of **the breakfast menu**.

Finally, our discussion of the virtues of being **the early bird** argues that investors who recognize and act upon opportunities presented by this new cycle earlier are likely to be advantaged compared to laggards. We conclude by laying out our preferred investment targets.

Global patterns and local exceptions

The case of Japan and China

As a global real estate investor, we see significant benefits from engaging in pattern recognition across the regions where we invest. But the existence of common patterns does mean all markets are the same, or that there are no exceptions to the overall trend. The global chapter of *ISA Outlook 2025* faces the challenge of describing global patterns across a wide range of local conditions. The global interconnectedness of financial markets means that the themes that we discuss in this chapter apply to many markets, if varying in timing and intensity. However, there are two major exceptions that deserve a special mention:

China is undergoing a generationally unique period of weak growth, low liquidity and challenged property fundamentals. China has been loosening both fiscal and monetary policy for several years, and more stimulus is expected. In addition, geopolitical divides between China and the rest of the world have been widening. As such, many of the comments we make in this chapter do not apply to the Chinese market.

Policymakers in **Japan** retain a tightening bias compared other global central banks, notwithstanding political uncertainty which is likely to delay their action. While a normalization of Japanese interest rates and monetary policy can be viewed in a positive light, given Japan's many years on the brink of deflation, the timing, pacing and magnitude of tightening represent key uncertainties. Our comments in this global chapter of expected interest rate cuts do not apply to Japan.

For more discussion of these and other variances from global trends, please read the forthcoming regional chapters of the *ISA Outlook 2025*.

THE MORNING SKY

Falling rates but risks on the horizon

A change in the interest rate environment is the key driver behind the dawn of a new cycle. The probable direction of policy interest rates in most countries is clearly weighted downward for the first time in over two years. On the back of evidence of substantially lower inflation, the Bank of Canada and European Central Bank (ECB) kicked off the global easing cycle in June 2024 (see exhibit G-a).

These moves were followed later in the year by the Bank of England and the US Fed's historically large 50 basis point cut in September; a 25 basis point cut by the Bank of Korea in October was the first rate cut by a major Asia Pacific central bank. Japan remains a notable exception; the direction of travel for Japanese monetary policy is likely toward higher rates — with uncertainties around magnitude and timing — though unexpected political uncertainty may keep tightening on hold for the time being.

The impact of rate cuts on long-term market interest rates appears more muted than when looking at policy rates alone, because cuts were to some extent already priced in. Indeed, US 10-year Treasuries are now up more than 50 basis points since the Fed's first cut, suggesting that markets recognize that a soft landing would not likely be consistent with a steep fall in rates. That said, long-term corporate bond yields (our preferred benchmark for pricing real estate) have largely exhibited a stable or gently downward trend, owing in part to narrowing credit spreads; this trend is welcome after a long period of episodic interest rate volatility around a broadly sideways path (see exhibit G-b). Relatively narrow credit spreads are themselves a sign that markets are not expecting weakness in the real economy to dent corporates' prospects.

When it comes to cycles, there's no morning routine

Two mornings are rarely if ever the same; our experience of investing across multiple cycles reinforces that the same is true of real estate cycles. Investors who look back at the post-Global Financial Crisis (GFC) interest rates cutting cycle and the one triggered by Covid-19 might be tempted to expect rapid rate cuts to ultra-low levels. But in our view, monetary policymakers are unlikely this time to cut as steeply, or to such a low level.[1] And as we wrote in an *ISA Briefing* note, "The Red Sweep and real estate", the US election result, all else equal, points to incrementally higher growth, inflation and rates.

Moreover, the so-called neutral rate of interest (often called R-star or r*), the interest rate that would occur when the economy is at full employment and inflation is stable, may be higher now due to a range of structural factors, such as higher productivity growth potential due to advances in artificial intelligernce (AI) and less regulation. Although r* is fundamentally unknowable, central bankers are aware that cutting interest rates back to near-zero levels may risk setting an inflationary spiral back into motion.

IN HINDSIGHT

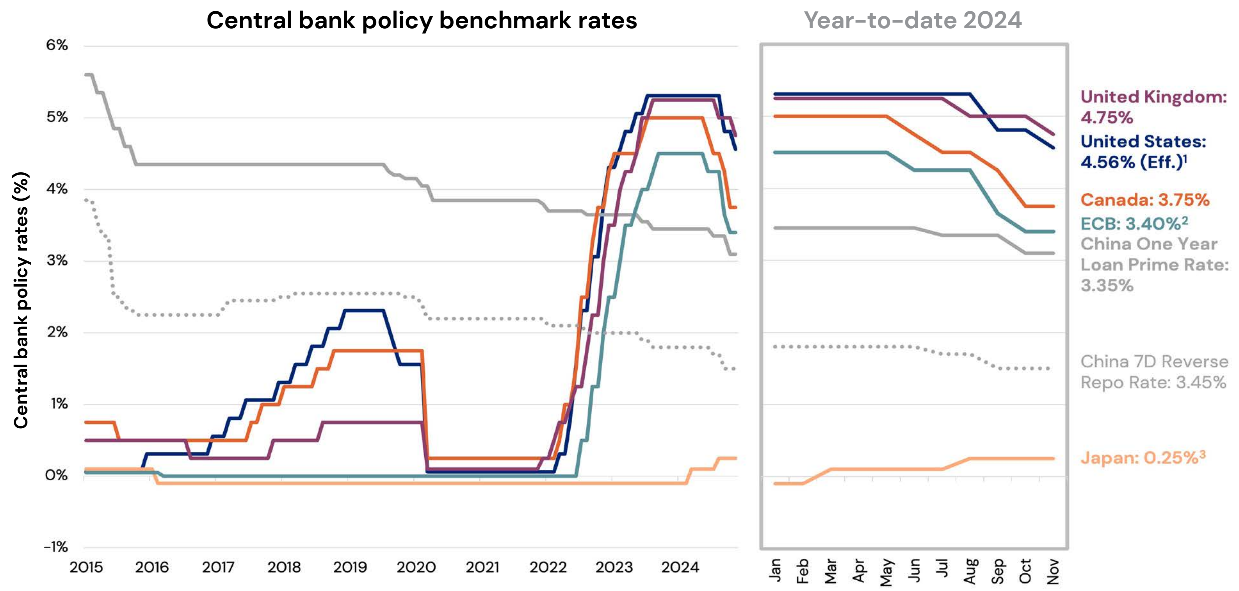
Looking back on key calls from last year's *ISA Outlook* global chapter

Right / Mostly right | Remains to be seen | Not right / Not quite right

"Inflation is moderating slowly and remains meaningfully above central bank targets. New risks, especially to energy prices, have emerged owing to the Israel-Hamas conflict. It is still far from clear that a so-called "immaculate disinflation" – a smooth reduction of inflation without a recession – can be achieved in the US or Europe." (ISA Outlook 2024 p. 10).

Inflation has continued to moderate and is now near central bank targets in many geographies. So far, the US economy seems to be on track for a soft landing, but these are exceedingly rare in economic history and that there are various risks to consider. For example, the conflict in the Middle East, noted last year, has only intensified.

G-a Global central banks nearly all in cutting mode



Notes 1. Effective Fed Funds rate shown rather than target range. 2. ECB main refinancing rate shown. 3. Negative interest rates in Japan apply to marginal increases to reserves. Japan cash rate / complementary Deposit Facility. Source: Refinitiv, central bank websites, LaSalle. Data through November 7, 2024.

No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

1. This view, discussed in the following paragraph, was shaped by our own research and our review of analysis by our macroeconomic data providers, such as Oxford Economics and Piper Sandler. This comment excludes China, where interest rates are already near record lows.

Red skies in morning? Falling rates but risks abound

An ancient mariners' rhyme advises that some dawns come with signs of trouble ahead: "Red sky at night, sailors' delight. Red sky at morning, sailors take warning."[2] Real estate investors observing the dawn of a new real estate cycle are wise to scan the horizon for hints of redness and prepare for unexpected conditions.

One key alternative scenario to a soft landing is an economic downturn. Indeed, a stock market roller coaster over the summer reflected growing concerns of a US recession at the time, with markets reacting negatively to any signs of weakness, such as a soft jobs report or disappointing earnings release. This marked a change from the market reaction function earlier in the year and in 2023, when economic softness was welcomed by markets as a harbinger of lower rates — a kind of "bad news is good news" paradigm.

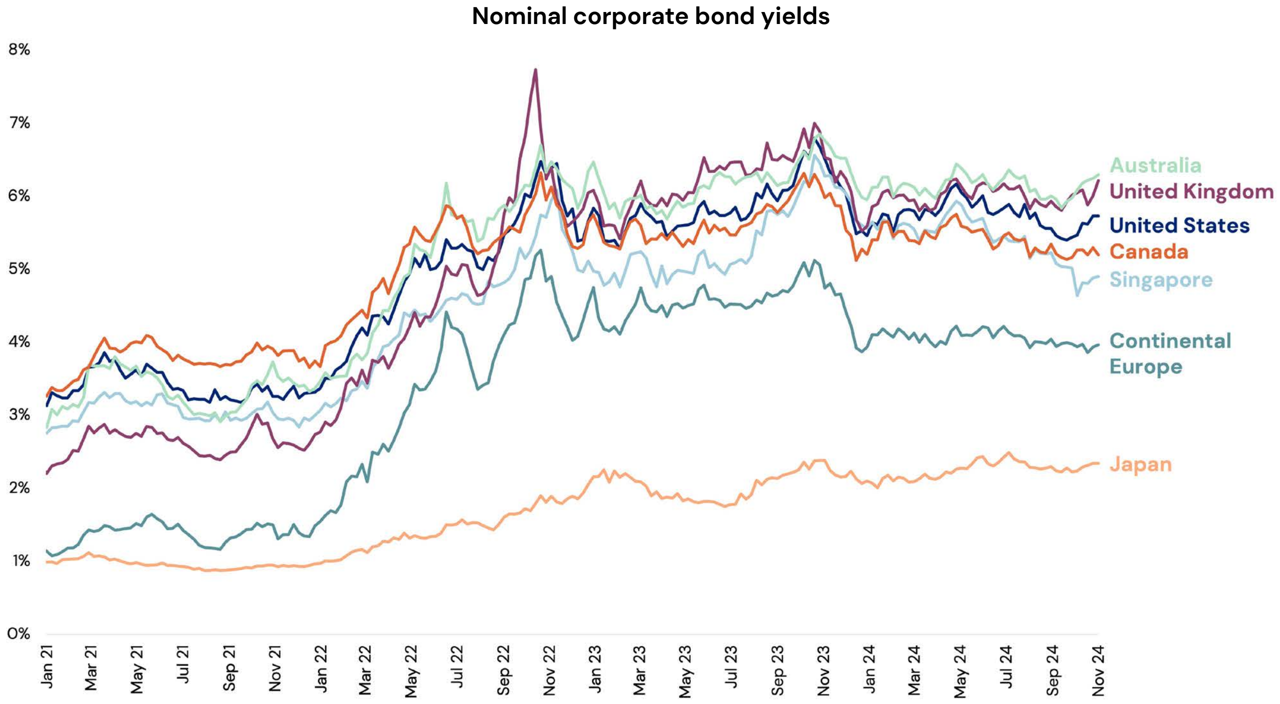
Thankfully, a quick read of current economic conditions points to a mostly benign global picture – if one containing weaker spots such as parts of Europe, Canada and China. Inflation is almost universally on a steady cooling trend (see exhibit G-c), with the notable exception of Japan. Global economic growth continues at a muted but generally steady pace (see exhibit G-d), and a US recession is not our base case. Job growth in the US remains strong, even if it has been increasingly driven by non-cyclical employers such as the government and healthcare sectors, rather than the more cyclical industries which tend to lead during upswings.[3] Strong migration into the US and Canada has been an important structural support for growth, owing to an expanding labor force and household formation representing tailwinds. In the US, policy changes following the election may change the mix of growth drivers, but on first assessment, the outcome appears to be positive for the GDP outlook. Elsewhere, we expect weak but positive growth in Europe, as several countries that had been in or on the edge of recession in 2024, such as Germany, could return to growth in 2025.[4] Countries like Spain and Poland have seen solid growth, and the outlook for the UK continues to improve as financial markets tolerated the first budget of the UK's new Labour government without anything like their volatile reaction in 2022.

But there are some concerning signs for the global economy. There is evidence of considerable bifurcation in consumer fortunes in the US and Europe, with higher-income households doing well but stresses from higher living expenses weighing on lower-income households.[5] This has started to impact sentiment measures and credit card delinquency. The most notable global soft spot today is the Chinese economy, which is burdened by residential real estate oversupply and weak consumer sentiment.[6] As we will discuss in the Asia-Pacific chapter, the performance of the Chinese economy is probably much worse than the official statistics suggest.

In addition to the balance of the usual cyclical factors, several exogenous risk factors also threaten to derail global growth. Intensifying conflict in the Middle East — with the prospect for the Israel-Hamas conflict to broaden into a regional war — could disrupt global energy supplies, and would likely be simultaneously inflationary and negative for growth. High valuations for AI-related tech companies highlight the risk that share prices come back to earth in a disorderly way. Domestic political circumstances also carry potential risks.[7] These include the transition to Trump as the new US president, a minority caretaker government in France with little room for fiscal maneuver, the collapse of Germany's ruling coalition, and a shock election loss by Japan's longtime ruling party. Rising protectionism is a global phenomenon with broad implications for markets.

2. The phrase goes back at least to Biblical times; it is referenced in Matthew 16:2-3. It also appears elsewhere in culture, for example in Shakespeare's Venus and Adonis. There is a scientific logic to this saying. In the northern hemisphere, where weather systems tend to move from west to east, redness in the morning sky signifies that a high-pressure air mass is moving away from your position and something menacing might be coming in its place.
3. Based on analysis by Piper Sandler.
4. Prediction based on LaSalle research and strategy analysis of Oxford Economics forecasts.
5. According to analysis by Piper Sandler.
6. According to analysis by Oxford Economics and Piper Sandler.
7. In our *ISA Briefing*, "Elections everywhere all at once," we discuss the implications of political and geopolitical risk for real estate. In that piece, we argue that the implications for real estate of political developments are often exaggerated, but should be tracked and developed into "what if" scenario analyses. In our most recent *ISA Briefing*, "The Red Sweep and real estate", we update those views in the context of the US election result.

G-b | Corporate bond yields steady or easing



Source: LaSalle Global Solutions, Bloomberg data through November 1, 2024. The bond indices above are based on Moody's Baa US bonds with terms of 20 to 30 years. In other countries, comparables are used of similar credit quality and term. No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

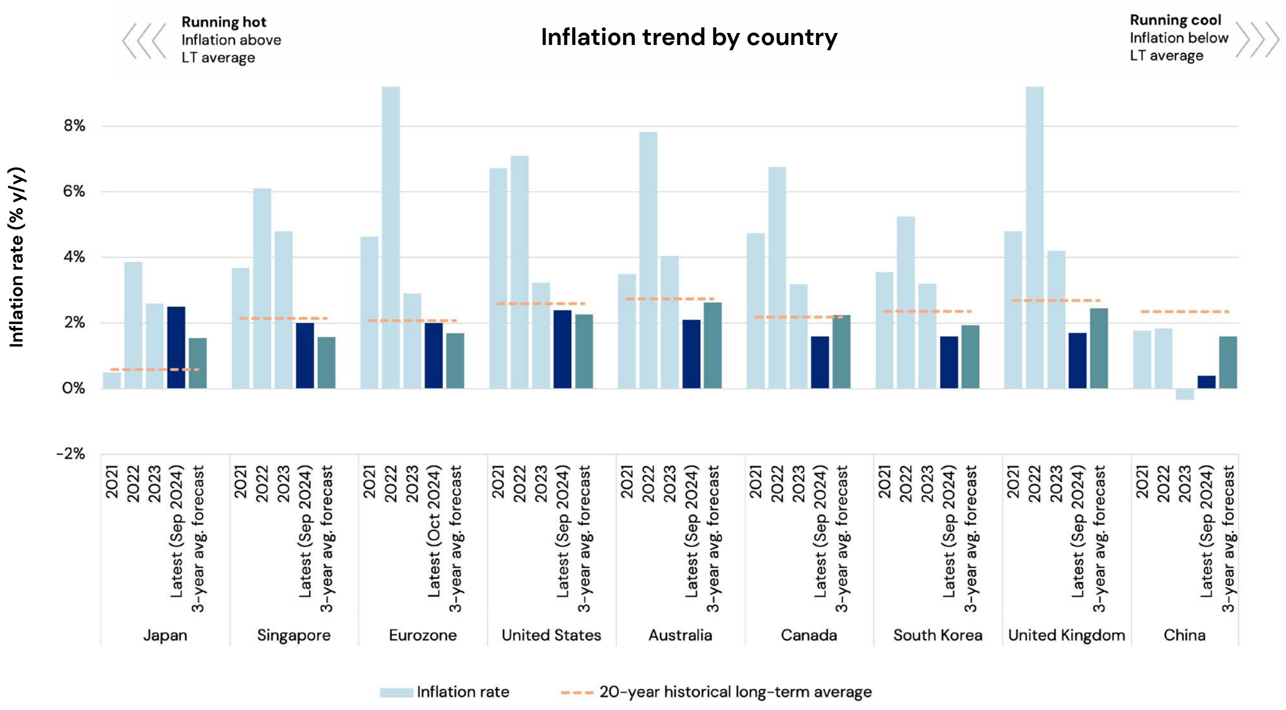
Sense and sensitivities

What is the appropriate strategic response to an environment characterized by high but gradually moderating interest rates, but with non-trivial risks to growth? A deliberate approach is critical because a recession, or even an extended period of economic softness, would shape relative winners and losers in real estate. The basic question comes back to the dynamic, also played out in the stock market, of whether "bad news is good news" or "bad news is bad news." In other words, does the benefit of lower interest rates offset the harmful impact of weaker cash flows, and vice versa? This duality exists because real estate is an asset class that blends characteristics of both equity and fixed income.[8] The answer likely varies by sector and geography; it hangs on assets' relative degrees of sensitivity to interest rates versus economic growth. We recommend a portfolio construction approach that is aware of such exposures.

As a complement to our established fair and relative value analysis (discussed below), which is the core of our house view process, we developed our **Portfolio Balance framework**.[9] This analysis segments sector/market combinations according to their cash flows' sensitivity to economic activity (a measure of "beta") and their capital values' sensitivity to interest rate changes (a measure of "duration"). This creates a four-quadrant segmentation that we divide into buckets: rate-led, growth-led, reactive and stable. For more discussion of Portfolio Balance, see the sidebar on the following page. Investors contemplating different economic scenarios can use this framework to thoughtfully build a diversified portfolio.

8. We further discuss the characteristics of real estate as an asset class in our *ISA Portfolio View* report.
9. This framework owes its inspiration and foundation to work by Green Street Advisors, "All eyes on the numerator" (2016) and "Margin review" (2024).

G-c | Inflation continues to cool

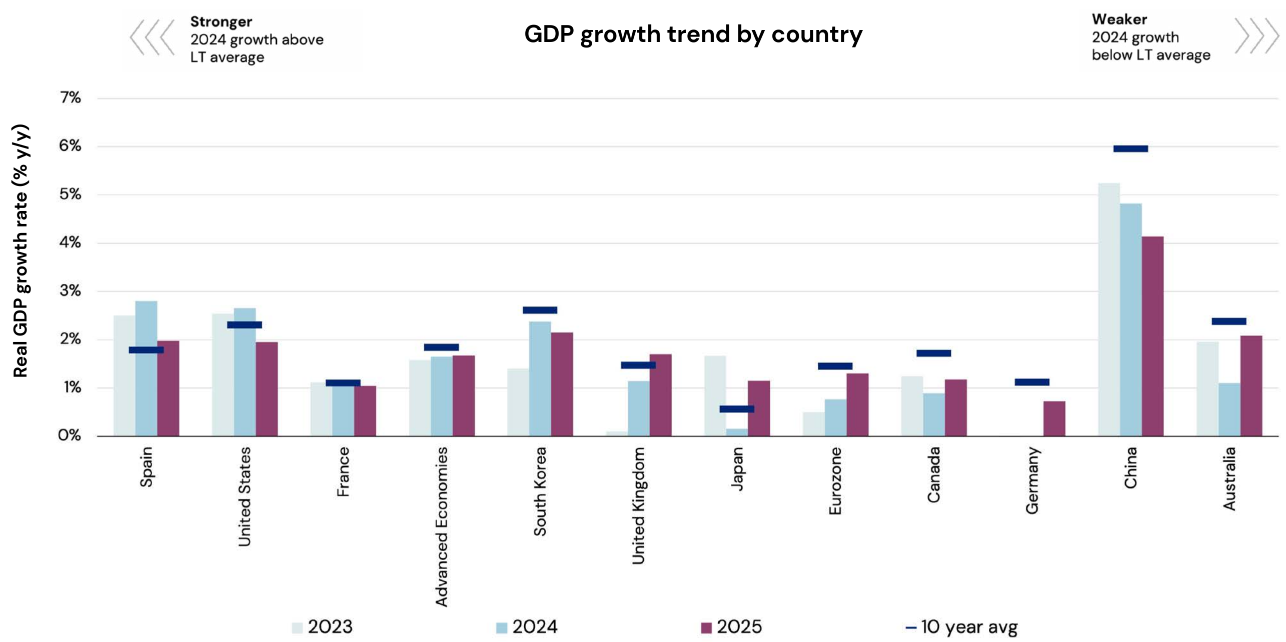


Note: 20-year historical long term average inflation rate is the average quarterly inflation rate from Q3 2004 to Q2 2024. 3-year average forecast is for 2025-27.

Source: Oxford Economics; latest monthly data from Australia Bureau of Statistics (Australia), Eurostat (Eurozone), Singapore Department of Statistics (Singapore), Statistical Bureau (Japan), Statistics Korea (South Korea), National Bureau of Statistics (China), Statistics Canada (Canada), Office for National Statistics (UK), US Bureau of Labor Statistics (US). Latest data available as of October 31, 2024.

No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

G-d | GDP growth divergences evident across countries



Aggregations based on Oxford Economics country classifications.

Source: Oxford Economics forecast, most recent as of October 31, 2024.

No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

LaSalle's Portfolio Balance framework

The Portfolio Balance framework starts by measuring the historical sensitivity of sectors' and markets' performance to economic growth and to interest rates to use as a guide to how they might perform in the future.[10] Plotting these factors in two-dimensional space and segmenting them into quadrants (see exhibit G-e) yields insights. However, it should be noted that placing sector/geography combinations in the quadrant categories is an exercise based on analysis of historical data, which are variable in quality and number of observations; these categorizations should be considered directional rather than predictive of go-forward performance.

"Rate-led" assets are those with a high sensitivity to interest rates, but a low sensitivity to growth. These tend to be relatively low-yielding, long-let property types. Based on our analysis of historical performance, sectors with very low absolute yields, such as industrial and multi-family in Japan, and German residential likely belong to this category. Rate-led assets are, by definition, likely to benefit when rates fall, even when they do so because economies weaken. In other words, they may to some degree exhibit a "bad news is good news" effect. They could be expected to outperform other assets in an environment in which rates fall quickly in response to a faltering economy.

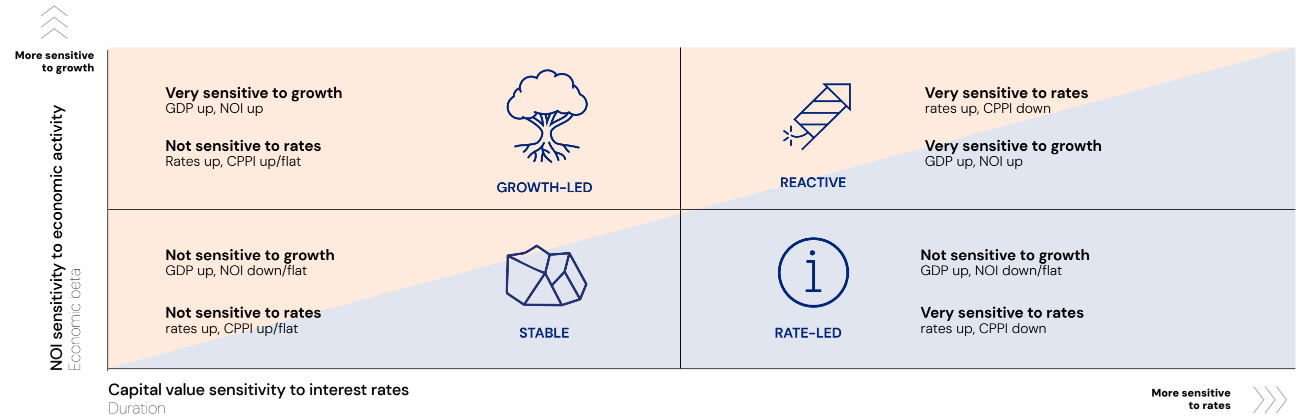
"Growth-led" assets are those with the reverse characteristics — they are relatively less sensitive to interest rates, but exhibit a high sensitivity to the economy. These tend to be sectors with especially demand-sensitive, shorter-duration cash flows. According to our analysis, US industrial markets in coastal or sunbelt markets, some office markets in Central Europe and US hotels likely belong to this category. Growth-led assets should on net react negatively to bad economic news — "bad news is bad news." If economic growth really takes off, even if accompanied by higher rates, these sectors could outperform.

"Reactive" assets are those with a high sensitivity to both interest rates and the economy. Our analysis suggests that German office markets, some industrial markets along Australia's eastern seaboard, and Japanese office markets could be placed in this category. Assets in this category can be expected to perform well under the benign conditions of a soft landing, but may be contributors of volatility if the environment is less benign.

"Stable" assets are those with a low sensitivity to both interest rates and economic growth. These assets, while relatively rare, may be considered contributors of stability and resilience to the portfolio across a wide range of macro conditions. Such assets may include, based on our analysis, some US niche sectors like manufactured housing and self-storage, and prime European high street retail.

How can an investor use this framework in investment strategy? We advocate for building diversified, long-horizon direct real portfolios with an awareness of assets' expected sensitivities to rates and growth, alongside other considerations, especially fair value. It may also be possible to use the framework to place bets on specific economic scenarios, such as views on the impact of the US election, though we would caution that macroeconomic outcomes are difficult to forecast. Either way, investors should have a sense of how their portfolios may perform under different economic scenarios.

G-e | Portfolio Balance framework



Source: LaSalle Research and Strategy.

10. Methodological note: Duration is the sensitivity of capital values to changes in the interest rate. We measured the % change in CPPI consistent with a 1%pt movement in 10-year bonds. The figures are then normalized as z-scores. A value of 1 means that the point is +1 standard deviations larger than the mean, -1 implies a figure is 1 standard deviation below the mean. Beta is the sensitivity of Market NOI to changes in the output gap. We estimated the % change in MNOI consistent with a 1%pt movement in the national output gap. The figures are normalized as z-scores. A value of 1 means that the point is +1 standard deviations larger than the mean, -1 implies a figure is 1 standard deviation below the mean. Data sources used for this analysis are Green Street, Oxford Economics, LGS PortWatch, and Bloomberg.

US election implications

Every four years, our annual release of the *ISA Outlook* comes shortly after a US presidential election. This time, the full sweep by Republicans of the presidency, Senate and House of Representatives was a surprise compared to our base case expectation of divided government. We do not view this outcome as dramatically changing the picture for real estate, but we do see a marginal shift toward potentially higher growth, higher inflation and higher interest rates compared to the prior base case. For a deeper look at our views on the election result, see our recent *ISA Briefing*, "The Red Sweep and real estate".

THE CAPITAL STACK HANGOVER

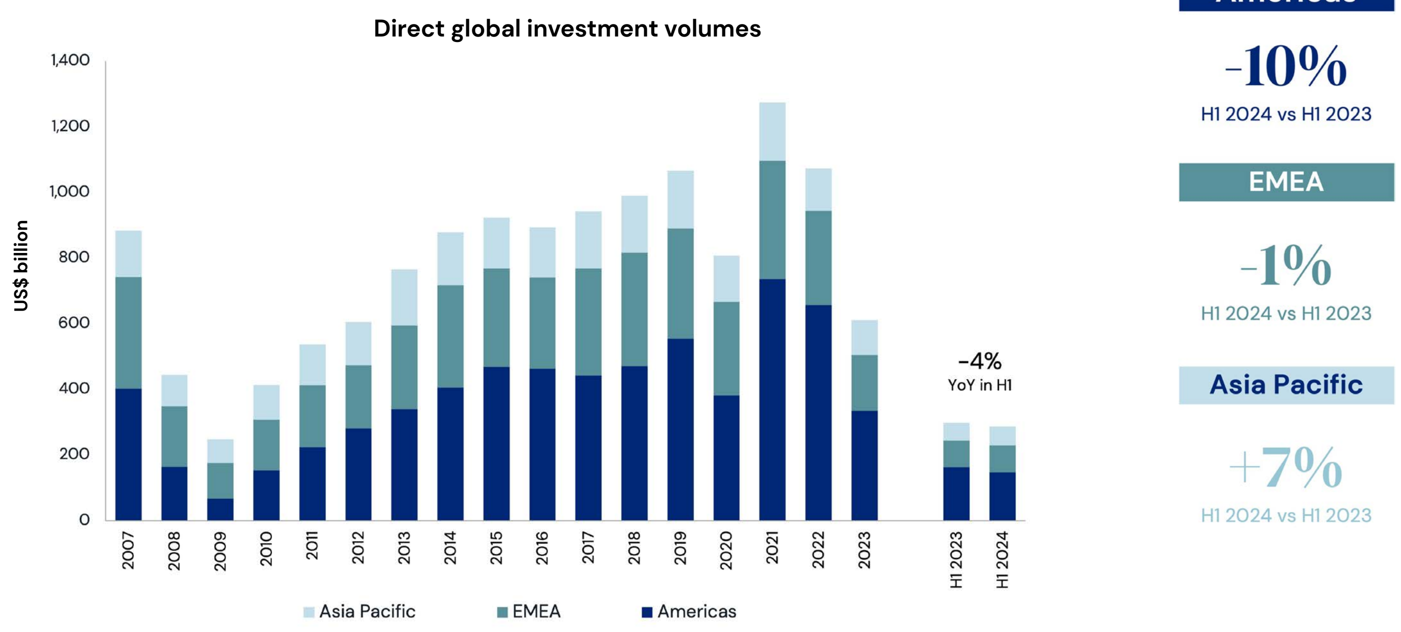
Clear-headed investors have an advantage

Although the dawn of a new interest rate cycle should help bring a new day for real estate capital markets, a hangover from before interest rates spiked will likely take some time to cure. Attractive investment opportunities are likely to spring from the resolution of legacy capital stack issues, both in the form of providing higher-returning rescue capital, as well as by opening attractive entry points to long-term holds and supplying capital to less flush segments of the market.

Capital market healing

Greater clarity on the direction of interest rates should help drive healing of the capital markets. Hesitant sellers may gain confidence as pricing starts to come in closer to their expectations. In-process transactions will be more likely to close, facilitated by a gradual easing in the cost of capital during due diligence periods. Reduced uncertainty should also help some lenders re-enter the market as confidence in their existing loan book increases. Segments of the debt markets which had been essentially shut down, such as Commercial Mortgage-Backed Securities (CMBS) in the US, have already come back to life. In several segments of the global real estate lending markets, interest margins came down this year, and debt is becoming accretive again in more markets and sectors.

G-f | Investment activity remains relatively soft



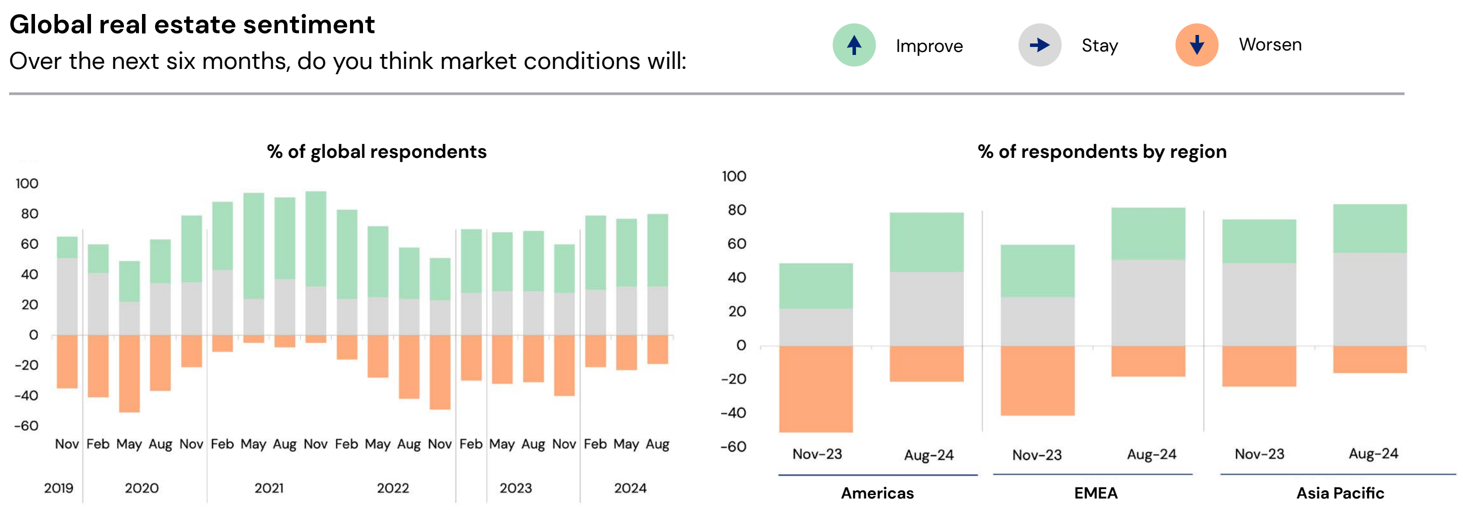
Source: JLL Research, Latest August 2024.

No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

G-g | Gradual and modest improvement in investment sentiment

Global real estate sentiment

Over the next six months, do you think market conditions will:



Source: JLL Research, Latest May 2024.

No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

IN HINDSIGHT

"Widespread distress is unlikely – especially outside of US offices – but there will be ongoing market stress to solve the capital stack equation." (ISA Outlook 2024 p. 16)

Distress has continued to surface given the pressure of higher rates on capital structures and less debt availability, but it is by no means widespread and remains concentrated in select pockets of the market. Likewise, there are investment opportunities to remedy capital stack issues, but not on a widespread basis.

Global transaction volumes, a backward-looking indicator of market activity, do not yet show much evidence of a recovery (see exhibit G-f). However, more forward-looking indicators are starting to turn positive. For example, surveys of global real estate sentiment are now gradually improving following a long period of negativity (see exhibit G-g). Our colleagues at JLL, who have a large proprietary data set on bidding trends, are seeing more bidders in transactions and a narrowing bid-ask spread.[11]

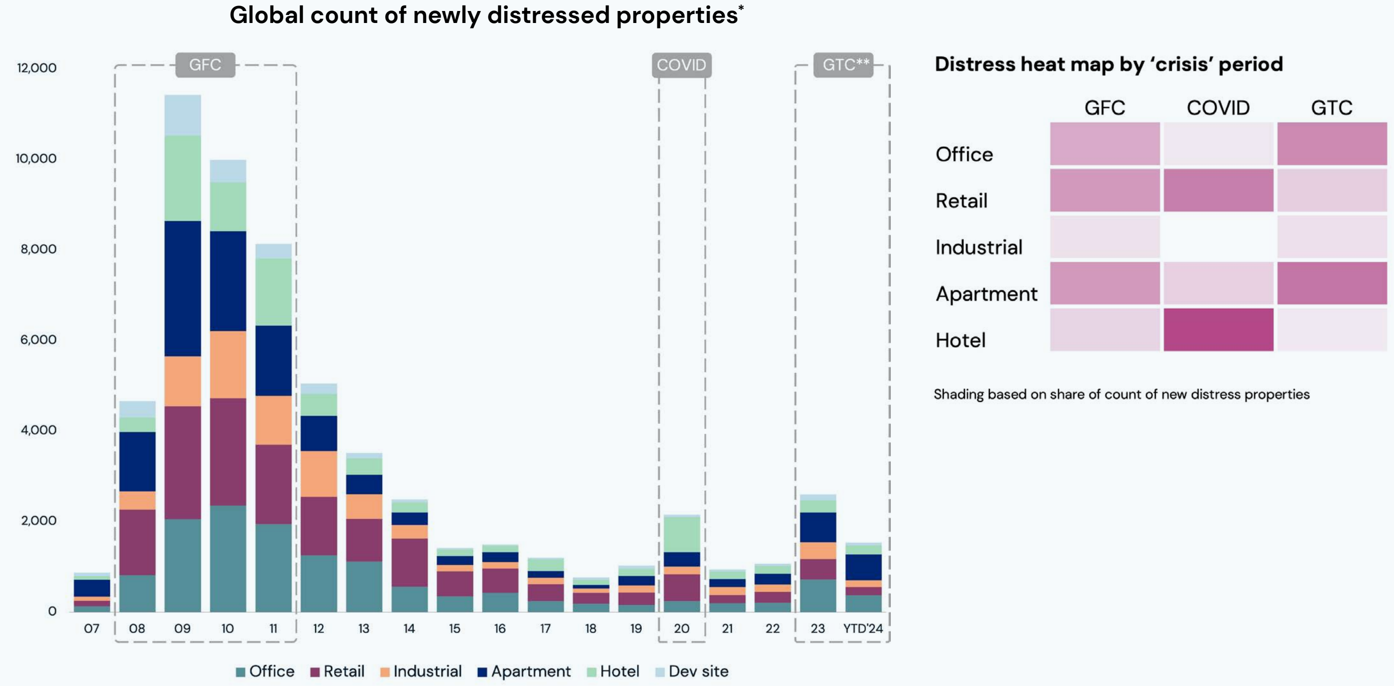
Healing broken capital structures

Although improving capital markets would help relieve the pressure on stressed capital structures, some will remain challenged. Loans are expiring at a time when both cyclical and structural factors make the availability of new debt relatively constrained,[12] and lower valuations limit the proceeds of replacement financing. In some cases, difficulties have been deferred through "extend and pretend" tactics, but this cannot be sustained indefinitely. As mentioned, we do not expect rates to fall sharply, meaning that falling rates alone are unlikely to be sufficient to bail out many legacy deals.

Issues with distressed capital structures are not new; in last year's *ISA Outlook*, we discussed how the basic math of higher interest rates was creating a need to "solve the capital stack equation."[13] Luckily, distress remains limited outside of the weakest segments of the office market and situations of over-leverage. It is difficult to objectively measure

11. According to proprietary JLL market intelligence.
12. For more discussion of debt capital markets, see our report, *ISA Focus: Investing in Real Estate Debt*.
13. See "Solving the capital stack equation – The math of higher interest rates driving challenges and opportunities" on pages 13-16 of LaSalle's *ISA Outlook 2024*.

G-h | Distress levels tick up but far below GFC



*Indicates direct knowledge of property-level distress. Known through announcements of bankruptcy, default and court administration as well as significant publicly reported issues—such as significant tenant distress or liquidation—that would exemplify property-level distress. This also includes CMBS loans transferred to a special servicer.

Note: Excludes senior housing and care. YTD through Q3. **GTC = Great Tightening Cycle.

Source: MSCI, October 2024.

the quantum of distress, but tracking of newly distressed assets[14] by MSCI suggests that global levels of stress are higher than they have been for some time, but remain far below the levels seen in the GFC (see exhibit G-h).

The breakout of distress by sector is telling. Distress in the GFC was broadly distributed; during the height of the COVID-19 pandemic it was concentrated in sectors dependent on travel and in-person interaction, such as hotels and retail, remaining nearly non-existent in industrial. In the current period, office and apartments account for the largest shares of newly distressed assets. The office challenges are widely known (see discussion below), but the apartment observation may seem counterintuitive. The distress in residential mostly reflects instances of over-leveraged deals and softer net operating income (NOI) in the US, where conditions have cooled substantially, and Germany, where regulation has limited the ability to pass inflation through to rents.

Given such an environment of largely contained challenges, we do not see a blanket opportunity to capitalize on distress at scale or by following an easily replicable transaction template. However, we anticipate a range of situation-specific opportunities for creative, structured solutions to provide rescue capital. Examples of the types of opportunities we are tracking include:

- Using **mezzanine and preferred structures** to solve capital stack issues and potentially achieve attractive risk-adjusted returns, without taking on full equity risk.
- **Buying high-LTV loans at a discount** in situations with limited downside risk to the value of the underlying collateral and potential for upside. For example, these may exist in the multi-family sector for assets financed in 2021, a time of peak pricing, and currently seeing a near-term slowdown in fundamentals.
- Capitalizing on the **stresses faced by developers**. Developers that borrowed to build when interest rates were much lower face loan maturities and lower-than-anticipated exit values. In some cases, the opportunity takes the form of providing rescue capital with elements of downside protection; in other cases, it involves opportunistically getting access to land at a discount.
- Selecting assets with **operational low-hanging fruit**, such as when capital structure issues are constraining the availability of capital needed to complete essential asset management initiatives like leasing and refurbishments. Injecting capital in such situations can make a stark difference for an asset's medium-term cash generation prospects.
- Identifying opportunities where issues above the asset level put pressure on an owner to be a **motivated seller**. Examples include fund life expirations or business strategy decisions to exit certain markets. This is especially relevant in sectors with very limited buying interest, such as US office.

An active approach

All the coffee in the world cannot cure some hangovers; sometimes you just have to get active and exercise. The same is true about actively managing the real estate impacted by capital stack hangovers. A couple of years of focus on issues like curing debt covenant breaches and rolling over expiring loans may have directly or indirectly distracted some owners from asset-level execution. We have noticed a strong overlap between assets with challenged capital structures and those in need of a renewed asset-level approach. Thoughtful capital structure solutions should be paired with an active approach to asset management.

14. MSCI tracks distress through announcements of bankruptcy, default and court administration as well as significant publicly reported issues (such as significant tenant distress or liquidation) that would exemplify property-level distress. This also includes CMBS loans transferred to a special servicer.

THE BREAKFAST MENU

Making sense of complex investment options

For an investor starting the morning and wondering what real estate exposures to add to their plate, today's investment menu can feel especially daunting. First, it is a long menu, because the growth of specialty sectors and sub-sectors have multiplied the number of viable investable sectors. Second, it is a complex menu, because current property market conditions mean that dimensions beyond basic sector and market lines are likely to be key determinants of performance. Finally, the menu options have recently changed, as relative sector performance has been especially dynamic of late.

Fundamentals and the menu

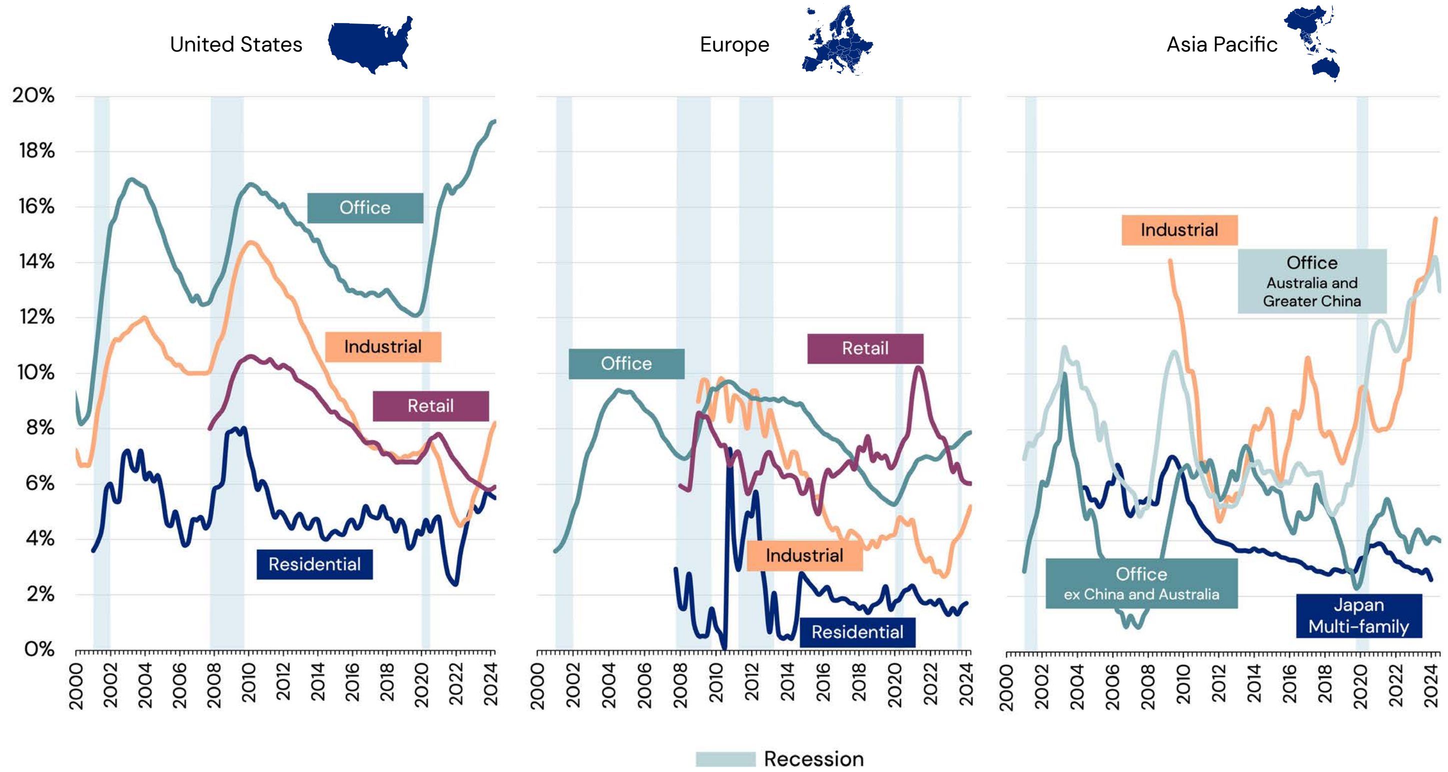
The investment option set is shaped by occupational fundamentals. A look at global vacancy rates by sector and region shows that there is a diverse mix of property fundamentals globally, with strength in many sectors, but also pockets of considerable weakness (see exhibit G-i). We have highlighted the occupational market themes behind these data in recent ISA publications.[15] For the most part, our prior observations continue to apply, and they contribute to the diversity and complexity of the investment option set:

- **Wide quality chasms** Differences in assets' outlooks continue to be heavily influenced by intra-sector factors like building quality, sustainability credentials, amenity offering, micro-location accessibility and submarket vibrancy. This is not a new trend. In

15. Relevant publications are cited in the footnotes on the following page.

G-i | Property markets show general strength, pockets of weakness

Vacancy/availability rates by sector and region



*Availability shown for industrial and retail; ° Retail includes community and neighborhood centers.

Source: The Association for Real Estate Securitization (Japan multi-family), as of Q1 2024; Ichigo Real Estate Services (Japan logistics), as of Q2 2024; JLL REIS (all other markets except Japan logistics and multi-family), as of Q3 2024. CBRE-EA (Sum of Markets), CoStar, RealPage Analytics, LaSalle, JLL (Europe office and industrial), MSCI (Europe residential and retail). Data through Q2 2024 (US and Europe) and Q3 2024 (APAC). No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

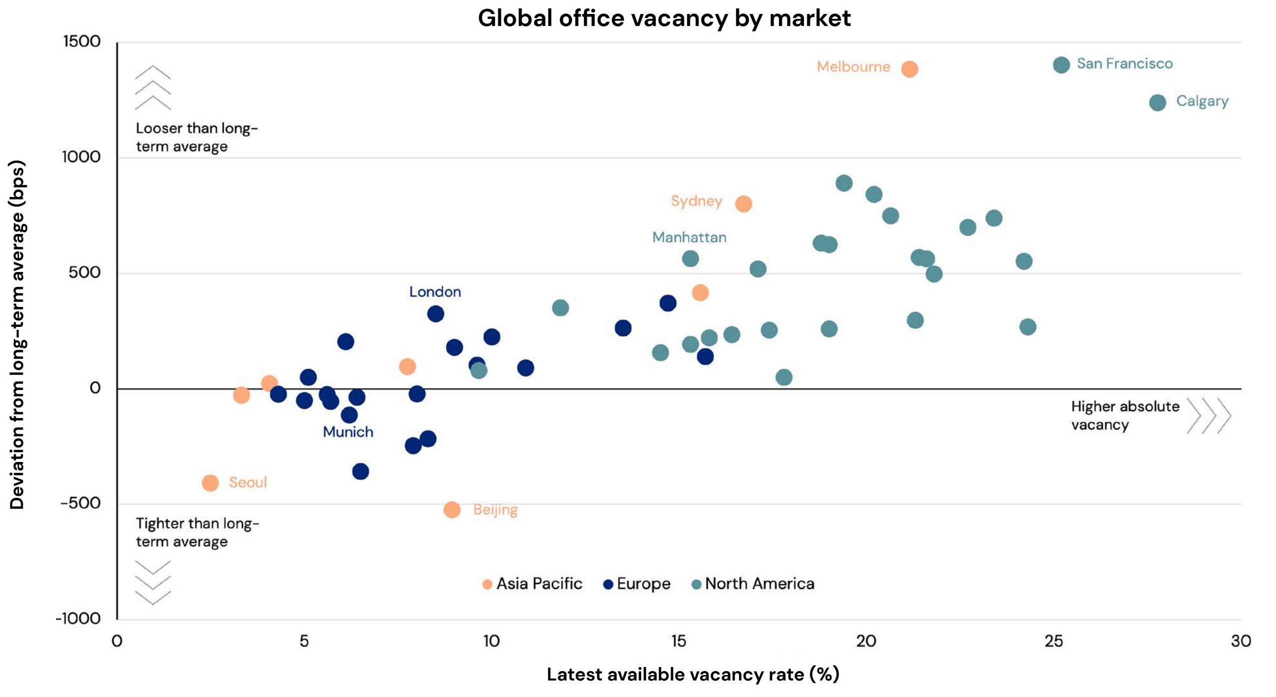
IN HINDSIGHT

"The limited willingness of debt and equity investors to fund development in many markets will help to limit supply of new properties over the medium term, limiting downside risk in real estate fundamentals." (ISA Outlook 2024 p. 16)

"In many pandemic-favored sectors – such as rented residential, logistics and life sciences – a temporary spike in supply is underway today before deliveries are expected to taper substantially later in 2024." (ISA Outlook 2024 p. 18)

Changes in construction costs and higher rates have radically altered the math of development viability, while capital for new construction remains constrained. These factors have indeed put downward pressure on new supply. Although completions may have only recently hit a peak in many markets, new groundbreakings have fallen precipitously, contributing to our conviction that it is best to "ride the wave" of new supply.

G-j | Office conditions “all over the map”



The current vacancy rate refers to the latest available data point for each location and these dates range between Q1 and Q3 of 2024. Similarly, the measurement period of the long-term average will depend on data availability but represents the longest period available for each series.

Sources: JLL, CBRE-EA, CBRE, Real Page, MSCI, NCREIF, Canada Mortgage and Housing Corporation, company reports and LaSalle Research and Strategy as of October 2024.

our *ISA Outlook 2023* we noted that divides within sectors were becoming at least as important as those between them.[16] A year later, we dug deeper into this theme by seeking to parse where opportunities are — and where they are not — amidst the so-called “bifurcation” of real estate sectors.[17] What has changed more recently is that repricing has resulted in more cases of attractive entry points across these divides, adding a range of investment options back to the menu.

- **A wave of supply** In mid-2024, we highlighted that a significant, but likely temporary “wave of supply” was causing a bout of “renewed cyclicality” in some key segments of the real estate market, especially US apartments and logistics globally.[18] This wave of new development, which we identified early on as the once-boiling hot winning sectors “coming off the boil,”[19] is already ending as new starts have started to nosedive. This is not a universal reality, with some sectors, such as European residential and Australian industrial, remaining largely unaffected by new supply. But the severity of supply’s effect on short-term market conditions in some markets is great enough that it creates underwriting challenges for today’s prospective buyers. Selecting impacted markets off the menu requires taking a thoughtful medium- and long-term view on the recovery path.

- **“All over the map” office** As we highlighted in our recent *ISA Focus* report on the prospects for office market recovery,[20] the office sector faces widely varying circumstances globally, with conditions ranging from some of the strongest among global property sectors (e.g., Seoul office) to some of the weakest (many North American office markets; see exhibit G-j).

16. See “Beyond the sector chasm – other factors gaining in importance” on pages 18-20 of LaSalle’s ISA Outlook 2023.
17. See “Beyond bifurcation – Making sense of the changing definition of quality and core” on pages 20-22 of LaSalle’s ISA Outlook 2024.
18. See “Renewed cyclicality – Ride the (supply) wave” on pages 4-5 of LaSalle’s ISA Outlook 2024 Mid-Year Update.
19. See “Coming off the boil – ‘Winning sectors’ decelerate, but remain relatively strong” on pages 17-19 of LaSalle’s ISA Outlook 2024.
20. See *ISA Focus: Rebalancing past and present — What past periods of occupier market dislocation tell us about the property outlook today.*

In that report, we argued that a range of forces are likely to contribute to an eventual rebalancing of currently oversupplied office markets, but that the main driver of rebalancing is likely to be an extended period of no or very low supply. This suggests that, while the office sector will eventually recover, it could take some time for conditions to strengthen.

None of this is fundamentally new. What has changed is that office pricing has by now adjusted substantially; transaction pricing is off around 50% since pre-COVID levels for US offices, and just over 30% for Europe.[21] At the same time, demand for office space has largely stabilized or started to improve in most markets. A mix of the increasing prospect of a recovery (if muted) and lower prices are bringing more segments of the office market back closer to fair value. While far short of being the right time to issue a blanket “buy” call on offices, the viable option set is expanding to include offices again.

- **Rebalanced retail** The retail sector, having emerged from a roughly decade-long period of rebalancing, now stands out as a generally stable, and in many cases strong, performer. Retailer business models have adapted to the realities of operating alongside e-commerce, helping stabilize demand; meanwhile, minimal new supply and the demolition of failed properties helped reduce vacancy. Retail today faces neither the near-term structural realignment afflicting many office markets, nor the digestion of a wave of supply that is creating weakness in some apartment and logistics markets. While retail is back on the menu, a key challenge is that retail is not a monolith. Rather than a single uniform sector, it is really a constellation of sub-sectors[22] with very different characteristics. Moreover, idiosyncratic asset and submarket dynamics, ranging from lease co-tenancy clauses to submarket void analysis, carry high relevance for retail. As such, value determinations in the retail sector must be highly granular in nature.

A structurally longer menu

The length and breadth of the menu is also growing in line with structural changes in how real estate portfolios are built.[23] Namely, the institutionalization of specialty sectors and sub-sectors is driving a **proliferation of investable sectors and sub-sectors**. We have framed this process with our Going Mainstream framework and argued that many of these sectors have achieved core or near-core status, reflecting the “changing definition of core.”[24] However, the sheer number of investable sectors and sub-sectors adds further complexity to the menu of investment options. Another key shift is awareness that is important to consider investment across the four quadrants of real estate. The experience of the recent tightening cycle reminded investors to seek value across both public-private and debt-equity lines.

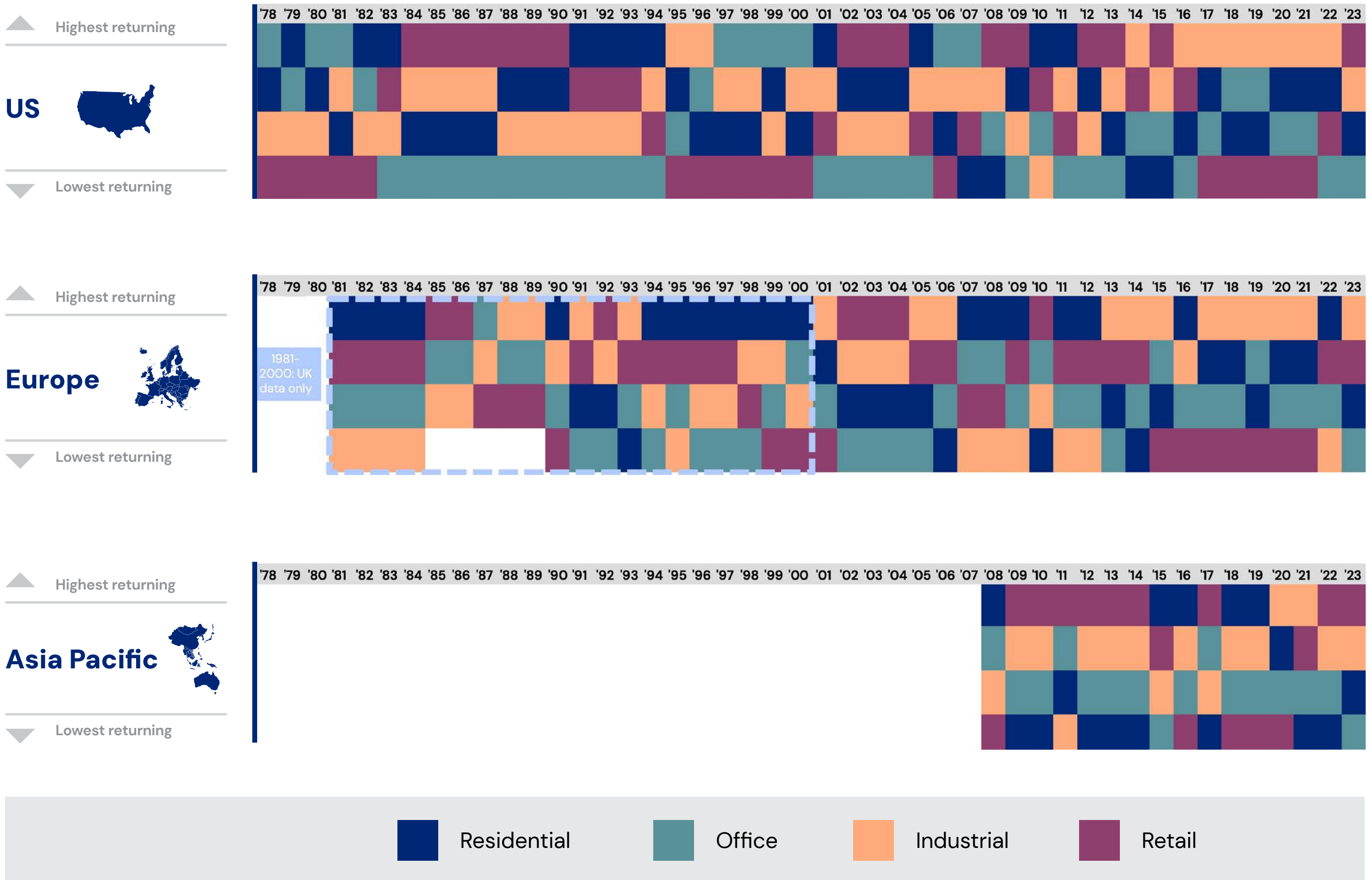
Vaughan Mills
Vaughan, Ontario, Canada

21. Based on estimates by LaSalle transaction teams and confirmed against readings from the Green Street Advisors Commercial Property Price Index (CPPI). The price adjustment for Asia-Pacific office is not cited here, because it would show a very wide dispersion, with meaningful declines in Australia and stability in markets like Japan.
22. The large variety of retail sub-sector nomenclature across markets belies not just the proliferation of retail sector terminology, but also highlights the design, layout and functional differences across retail in different markets. For example, US retail sub-sectors include neighborhood centers, community centers, power centers and regional malls. In Europe, the moniker “retail parks” has elements of some of those US typologies, but also has its own unique characteristics, and so does not translate directly.
23. For a deeper discussion of both of these, see “Why be sector smart?” and “Why be quadrant smart?” in our *ISA Portfolio View* report.
24. See our May 2024 article in PREA Quarterly, “The Changing Definition of Core Real Estate”.

Canal Crossing Logistics Center
Phoenix, Arizona, USA

G-k | Sector performance ranking dynamic over time

Private equity real estate index returns – ranking of major sectors



Sources: MSCI and NCREIF, data to 2023. No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

> "A long view of sector performance rankings for US, European and Asia-Pacific private real estate suggests that there are both extended periods of one sector dominating the performance rankings, as well as phases in which the sector in the leading spot rotated from year-to-year."

Ordering "the usual" — Is sector performance persistent?

One approach to making a choice from a daunting menu is to just re-order something good you had last time. In recent years, ordering "the usual" in property investment has meant a heavy helping of logistics and residential. But after a long period of persistent performance leadership by those sectors — especially logistics — we may be entering a period of less consistent relative sector performance and a narrower range of dispersion among sectors.

A long view of sector performance rankings for US, European and Asia-Pacific private real estate[25] suggests that there are both extended periods of one sector dominating the performance rankings, as well as phases in which the sector in the leading spot rotated from year-to-year (see exhibit G-k). But the recent period has been unusual for the extended period of dominance by the same sectors. Logistics was the top returning sector in the US for seven years (ending with 2022), and in Europe, it was the top returning sector for nine of the past eleven years (residential was top in the other two).

Financial theory suggests that a single factor, like the strength of a specific real estate sector, is unlikely to remain incompletely priced such that it can outperform indefinitely. At some point, the market will catch up and the price will adjust.[26] Historically, periods of persistent sector outperformance have tended to reverse, and sometimes by a wide margin. For example, in the US the top sector over the late 1980s (retail) and late 1990s (office) flipped to being the worst performing sector. There have also been similar reversals of fortune in the other direction, with persistent underperformers quickly moving to be the top slot.

The supply wave impacting some residential and logistics markets, as well as moves in relative pricing, may be drivers of less persistent relative performance in the coming years. Indeed, retail was again the highest-returning sector in the US in 2023. With this context, we recommend investors be more flexible in considering a wider range of asset types; it may not be the right time to just re-order "the usual"!

25. Based on LaSalle analysis of data from NCREIF (US) and MSCI (Europe and Asia-Pacific).
26. The explanation for the cases of extended consecutive performance is probably that there is a momentum effect, relating to an inefficient spread of information in private markets and a potential impact from behavioral factors like consistency bias and loss aversion.

Molly Brook on Belmont
North Haledon, New Jersey, USA

Use fair value analys is (FVA) as a guide

For the reasons discussed above, a multi-dimensional approach to building portfolios is essential in today's market. Determinations of attractive, fair and unattractive value do not fall neatly along the lines of broad groupings. Strategy-building today is not a matter of making big country-picking or sector-picking calls, but layering in a range of nuance. For example, sectors that are amongst the best and the worst performing occupier markets in the Asia-Pacific region are in the same country: Australian office and Australian logistics.

Our approach to identifying attractive value across a large and complex menu of options is fair value analysis (FVA). At its core, FVA involves a comparison of expected returns (market return forecasts) and required returns (returns that appropriately compensate for that risk in today's markets). Assets for which the expected return meets the required return are said to be fairly priced; for those with an expected return in excess of the required are especially attractive (see exhibit G-I for an example of how FVA can be visualized). We believe that utilizing fair value models meaningfully improves investment decision-making.[27]

Building a balanced breakfast

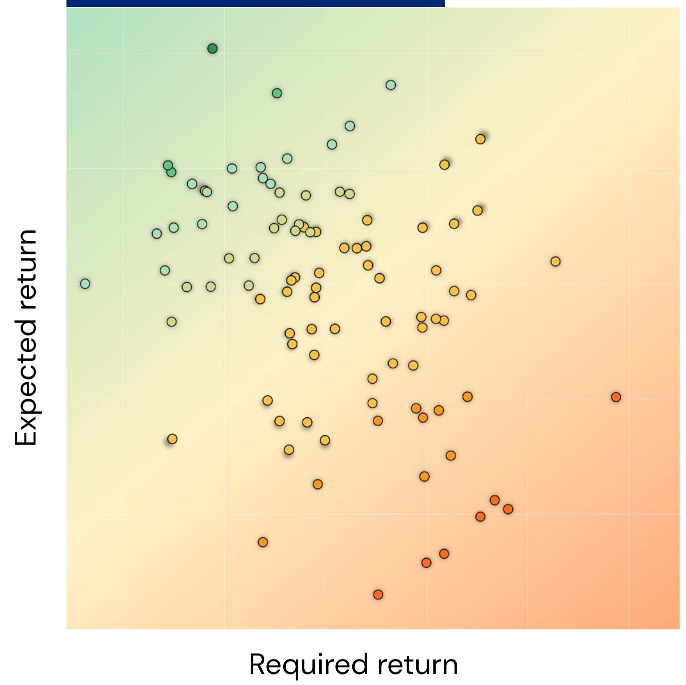
Given a large and complex investment menu, and the specific challenges of identifying value in today's environment, FVA is key to selecting between the many options. But a model's outputs are of no use if pools of capital are too constrained by limitations on sector and geography to be deployed dynamically as relative value assessments change. Specialist funds can work well for narrow investment windows, but for open-end funds and other long-horizon strategies, the ability to shift strategy as fair value assessments change is critical. In our view, we are entering an environment where this flexibility will be especially important.

The benefits of diversification are well documented across the financial economics literature, by other managers and by LaSalle, especially in our *ISA Portfolio View* report. But a diversified strategy does not necessarily imply an index-tracking approach that delivers mostly market beta. Instead, we favor diversification across a curated list of high-conviction strategies with strong risk-adjusted return prospects. This can offer the best of both worlds: the benefits of diversification along with overweight exposures to the markets and sectors with the best prospects. In our final section below, we explore our specific investment recommendations for 2025.

27. Based on LaSalle's investment experience. While the specific outputs of our FVAs are proprietary, they do help shape our investment recommendations throughout the ISA Outlook.

G-I | Sample of FVA outputs

US apartment market relative value

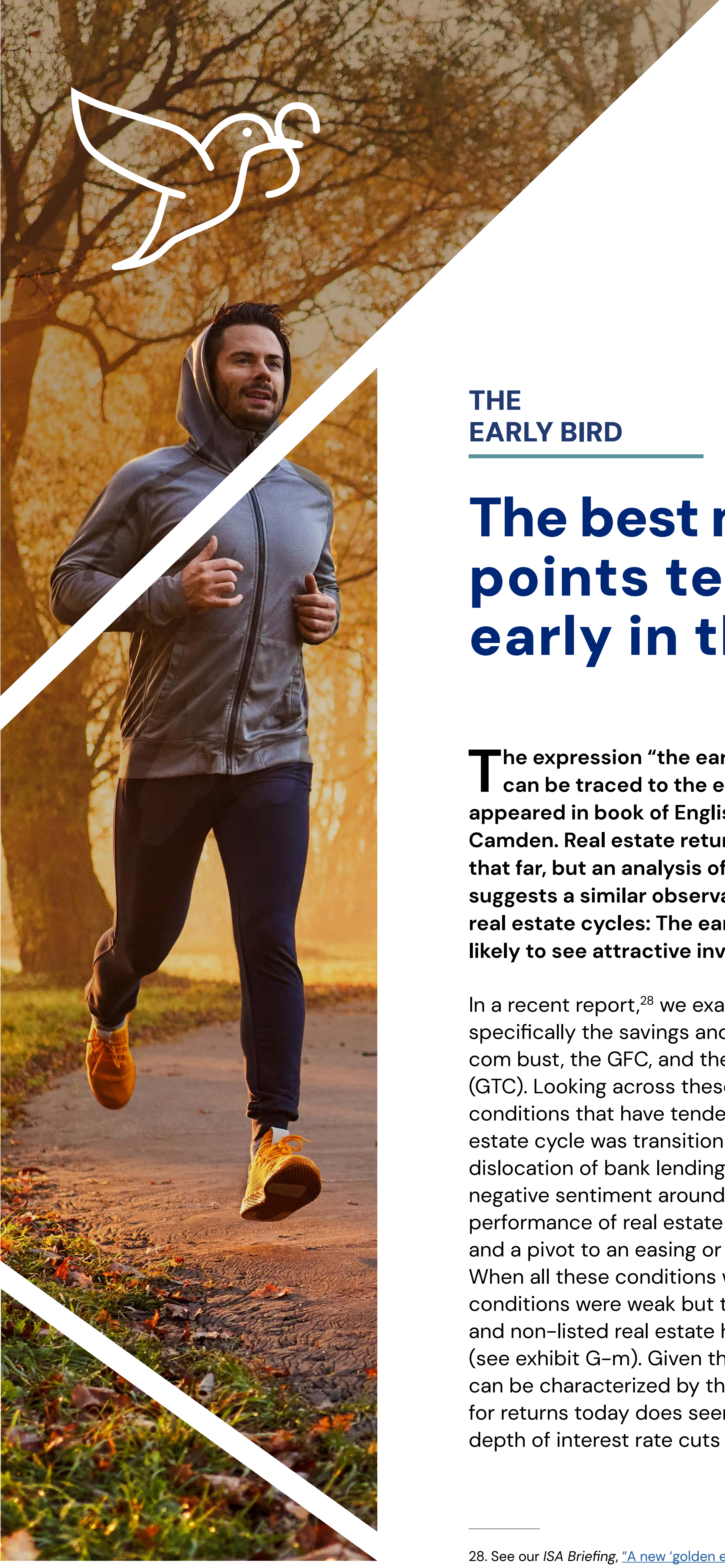


Source: LaSalle Investment Management. Data and forecast most recent as of November 12, 2024.

IN HINDSIGHT

"Real estate's enduring need for capital expenditure should not be mistaken for a novel bifurcation trend. It is essential to underwrite appropriate capex to keep an asset competitive for the long-term." (ISA Outlook 2024 p. 22)

The importance of getting right the capital expenditure required to keep an asset competitive has only been highlighted by the continued segmentation of the market by quality. For example, the value declines in some office markets are only partly a story about work from home, but also about pricing in the appropriate amount of ongoing capex.



THE
EARLY BIRD

The best market entry points tend to be early in the cycle

The expression "the early bird catches the worm" can be traced to the early 17th century; it first appeared in book of English proverbs by William Camden. Real estate return data do not go back nearly that far, but an analysis of its much shorter history suggests a similar observation can be made about real estate cycles: The early (in the cycle) investor is likely to see attractive investment performance.

In a recent report,[28] we examined prior periods of dislocation, specifically the savings and loan (S&L) crisis, the dot-com bust, the GFC, and the recent global tightening cycle (GTC). Looking across these periods, we identified four conditions that have tended to be in place just as the real estate cycle was transitioning away from being challenged: dislocation of bank lending to real estate, broad-based negative sentiment around the asset class, extended under-performance of real estate versus other asset classes, and a pivot to an easing or reset of financial conditions. When all these conditions were in place, contemporaneous conditions were weak but thereafter returns for both listed and non-listed real estate have tended to turn positive (see exhibit G-m). Given that the recent environment can be characterized by these four factors, the outlook for returns today does seem bright, even if the pace and depth of interest rate cuts is likely to be less this time.

28. See our *ISA Briefing*, "A new 'golden era' for REITs and real estate?"

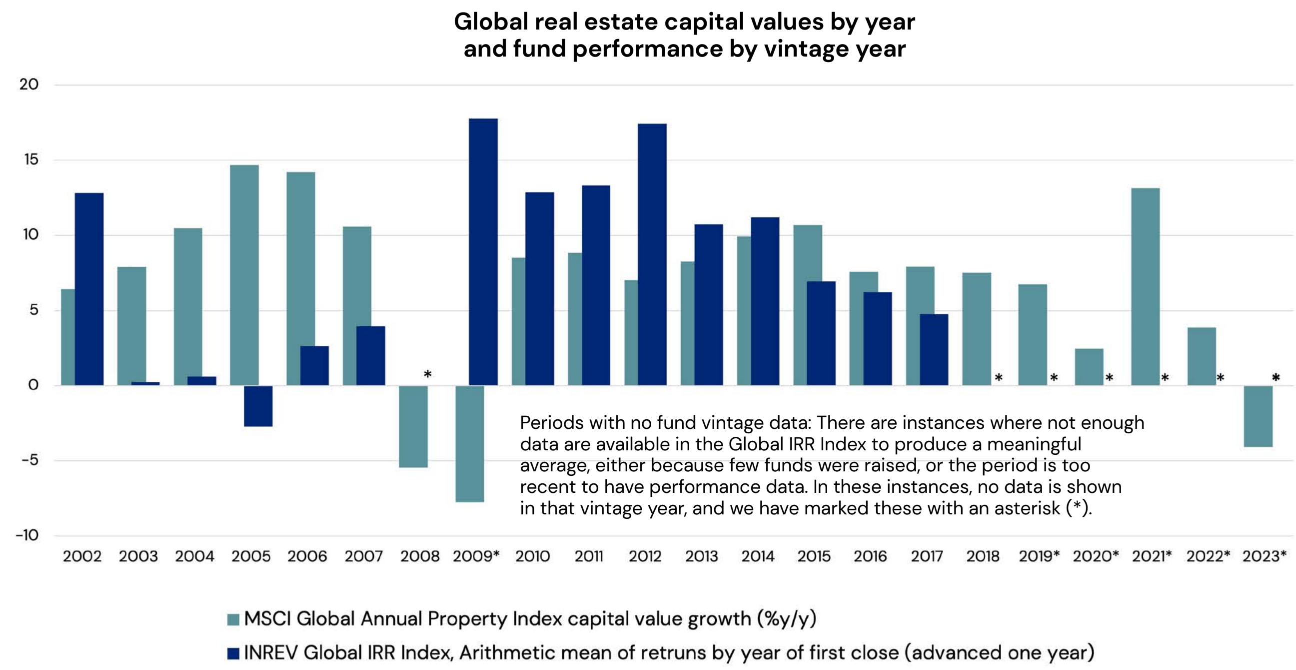
G-m | Strongest periods of performance tend to be preceded by disruption

Source: LaSalle, S&P Developed REITs Index, MSCI Global Annual Property Index, Returns are cumulative and in USD. Three-year forward rolling total returns as at the end of each quarter.

1. For the period of December 31, 2021 through September 30, 2024, returns end on September 30, 2024, and do not reflect a full 3-year cumulative return.

S&L: Savings and Loan Crisis; .com: dot-com bubble; GFC: Global Financial Crisis; GTC: Global Tightening Cycle.

G-n | Best performing funds are those launched early in the cycle



The INREV Global IRR Index provides an arithmetic mean of the performance of the cohort of funds for a given vintage. They define vintage based on the date of the first close of the fund. Typically, funds will subsequent closes afterwards. For this reason, and the fact that it usually takes some time for a fund to deploy dry capital, we have advanced the fund returns by one year to better align with capital market conditions. No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

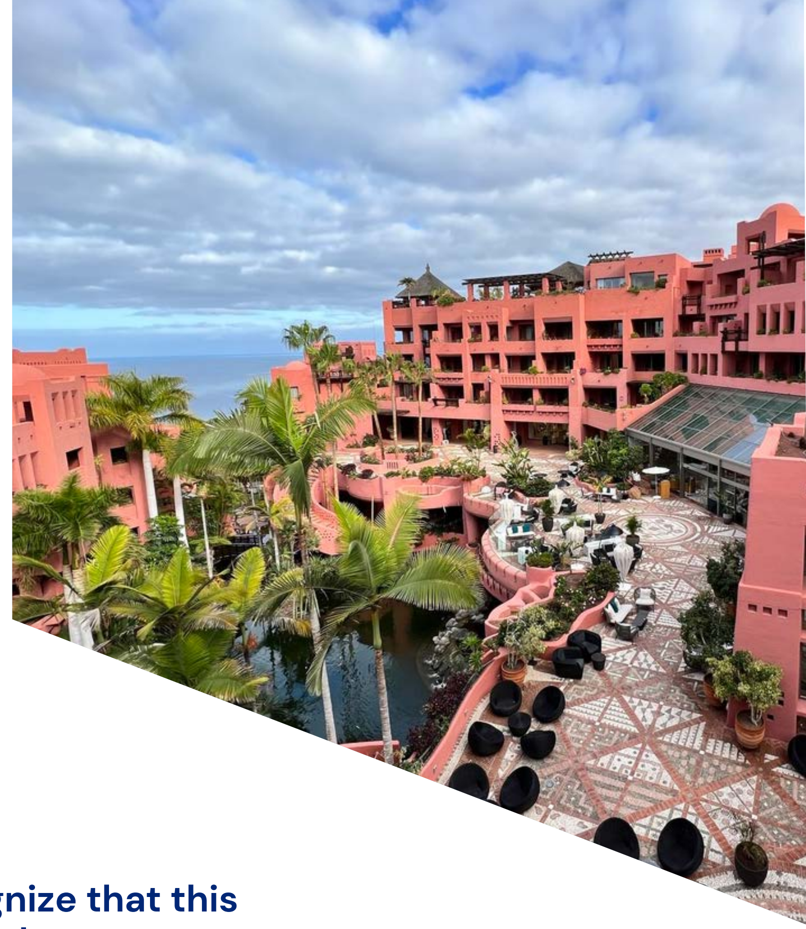
Sources: MSCI Global Annual Property Index and INREV Global IRR as of October 18, 2024.

"If the benefits of being the early bird are clear, there are still many choices to be made about where and how to look for the worm."

The early bird thesis is also supported by an analysis of global fund performance data by vintage year. Our analysis shows that funds that had their first close in the early stages of a recovery substantially outperformed the broader market (see exhibit G-n). There is much nuance beneath this global finding, as well as various data challenges, but this observation appears to hold across global markets.

G-o | LaSalle's recommendations for 2025

	North America	Europe	Asia Pacific
Strategic recommendations	**Logistics** Healthy markets with strong demand and growth potential Markets targeted by our suite of proprietary tools (e.g., Paths of Distribution)		
	Industrial outdoor storage		
	Residential / living		
	Apartments in low-supply submarkets Apartment development Canada apartments	Student accommodation "Flex living" concepts	Multi-family rental in Japan Co-living in Australia
	Retail		
	Trade area-dominant retail with income growth potential	Outlet centers Select shop parades and mixed-use shopping center transformation	Non-discretionary retail in Japan
	Office and other		
	Medical office Self-storage	London and Paris office refurbishment Tech-enabled hotel repositioning	Seoul office Highly selective office repositioning in Japan Non-luxury hotel in Japan
	Debt, debt-like positions and/or distressed equity		
	Climate hardening and/or decarbonization		
	Active, selective listed real estate		
Caution	Commodity office	Non-prime and peripheral office	China Some segments of office market in Australia



The Ritz Carlton Tenerife, Abama
Tenerife, Spain

If the benefits of being the early bird are clear, there are still many choices to be made about where and how to look for the worm. Each year, we summarize our investment recommendations for the coming year in a table in this report (see exhibit G-o). These recommendations are based on a combination of near-term cyclical patterns, long-term structural and secular changes, intelligence from our on-the-ground teams and the current conclusions from our fair value analyses.

Below we discuss some of the key recommendations for 2025. We recognize that this is a broad list, but that is reflective of the current favorable position we are in after the cycle bottom.

- The **long-term tailwinds for the logistics and residential/living sectors** remain intact, despite near-term issues. We retain high conviction that these will remain strong performers over the long run. However, a wave of supply continues to negatively impact near-term fundamentals in some markets. There is nothing new about being highly discerning in picking markets and submarkets, but doing so is especially important in today's environment. We have built proprietary tools to help our teams select markets and submarkets from the many options.
- **Retail is back** on the investment menu in a big way in many markets. Solid fundamentals are in evidence across many of retail's many incarnations across the globe following a nearly decade-long rebalancing. The wide variation in how retail functions requires discernment in each geography; a blanket approach to the sector is unlikely to work. Our specific calls under the retail umbrella include European outlet malls, US power centers (non-grocery open-air retail) and non-discretionary centers in Japan.
- The **investability of office is increasing**, even in hard-hit markets, owing to stabilizing occupational fortunes and re-based pricing. The road to fully rebalanced conditions is a long one, however, and extreme caution about assets falling on the weaker side of deep quality divides is warranted.
- We see a broadening opportunity in selectively **providing new capital to strong development projects**. The traditional mechanisms of developers' funding all face challenges, including regulatory pressures on bank lending and issues with legacy projects. A confluence of factors is opening an opportunity to invest in development across strong property types like residential and logistics.
- **Debt strategies** remain an attractive way to invest in real estate. However, the case for debt is evolving with improvement in the capital markets environment. As all-in debt costs and unlevered yields come back closer to their historical relationships, the near-term pricing argument gives way to a focus on the attractive long-term risk-adjusted return proposition of debt investing. We also observe that structural changes underpin the growth potential of non-bank lenders.

- We continue to advocate for integrating **physical climate risk** into top-down investment strategy and bottom-up asset capex planning. This perspective has only been reinforced by the devastating impact of hurricanes Helene and Milton in the Southeastern US, several powerful typhoons in Asia and severe floods across Europe, most recently in Southern Spain.

- Addressing physical climate risk is different from investing in the **decarbonization of assets**. Although spiking rates have shifted the narrative away from sustainability in some geographies, decarbonization of the built environment remains a long-term consideration. Getting ahead — but not too far ahead — of market and regulatory changes while being cognizant of the differences between jurisdictions is key to generating strong returns and in identifying attractive brown-to-green plays.

- Although REITs now trade at a premium to net asset value (NAV), **listed real estate appears primed for a strong run**. While a superficial view of NAV premia suggest that REITs again look expensive relative to private real estate, a recent move to an NAV premium can also be interpreted as a strongly positive sign for REITs and real estate as a whole. Historically, it has been both a predictor that private real estate prices are positioned to rise, and a signal to REIT management that they face accretive growth opportunities which they can take advantage of over the next several years.[29]

- The market continues to see a **changing definition of core real estate**. Core is evolving to include a range of specialty sectors and sub-sectors, and to be more embracing of shorter leased, more operational asset types. As we have for some time, we recommend that core investors incorporate a broader selection of sectors into their portfolios, while investors targeting higher returns look to manufacture "new core" stock through development, repositioning or aggregation. A global perspective can give an investor informational and operational advantages in parts of the world that are later in the process of adopting these changes.

The regional chapters of the ISA Outlook will explore our investment recommendations with greater granularity and detail.

29. According to analysis by Green Street Advisors, these factors mean that REITs tend to have a run of good performance lasting several years after REIT pricing flips into premium to NAV territory.

Battersea Student Accommodation PBS
(Purpose Built Student Accomodation),
London, UK

LOOKING AHEAD

- A new real estate cycle is dawning. But it is essential to avoid overconfidence and remain realistic about what the new day has in store. There are a range of risks on the horizon that require monitoring. In addition, investors should not expect a rapid decline in interest rates or for them to again reach ultra-low levels. Changes in policy enabled by the Republican sweep of the US presidency and Congress should be monitored for impacts, but the outcome generally reinforces our view that rates will not go back to ultra-low levels.

- We are consistent in pointing out that interest rates are extremely difficult to predict; the timing and magnitude of interest rate declines, as well as the eventual level at which they will settle, remain highly uncertain. The new cycle could be cut short in its morning hours if expectations of easing rates turn out to be false, or if interrupted by a shock. But as of the date of publication, we see a mostly bright picture.

- Capital markets are poised for a recovery as financial conditions ease, but it will not be enough to bail out some capital structures. Levels of distress remain far lower than during the GFC, but there are still opportunities to participate in the resolution of issues in stressed capital structures.

- The multi-year performance dominance of "sheds and beds" may be coming to an end in many markets. Logistics and residential still have attractive long-term fundamentals, but investors are advised to focus on diversified core strategies that are flexible and broad enough to adapt to a complex and evolving relative value landscape. A comprehensive look at value across a wide range of sectors and markets will be required to build a well-positioned real estate portfolio.

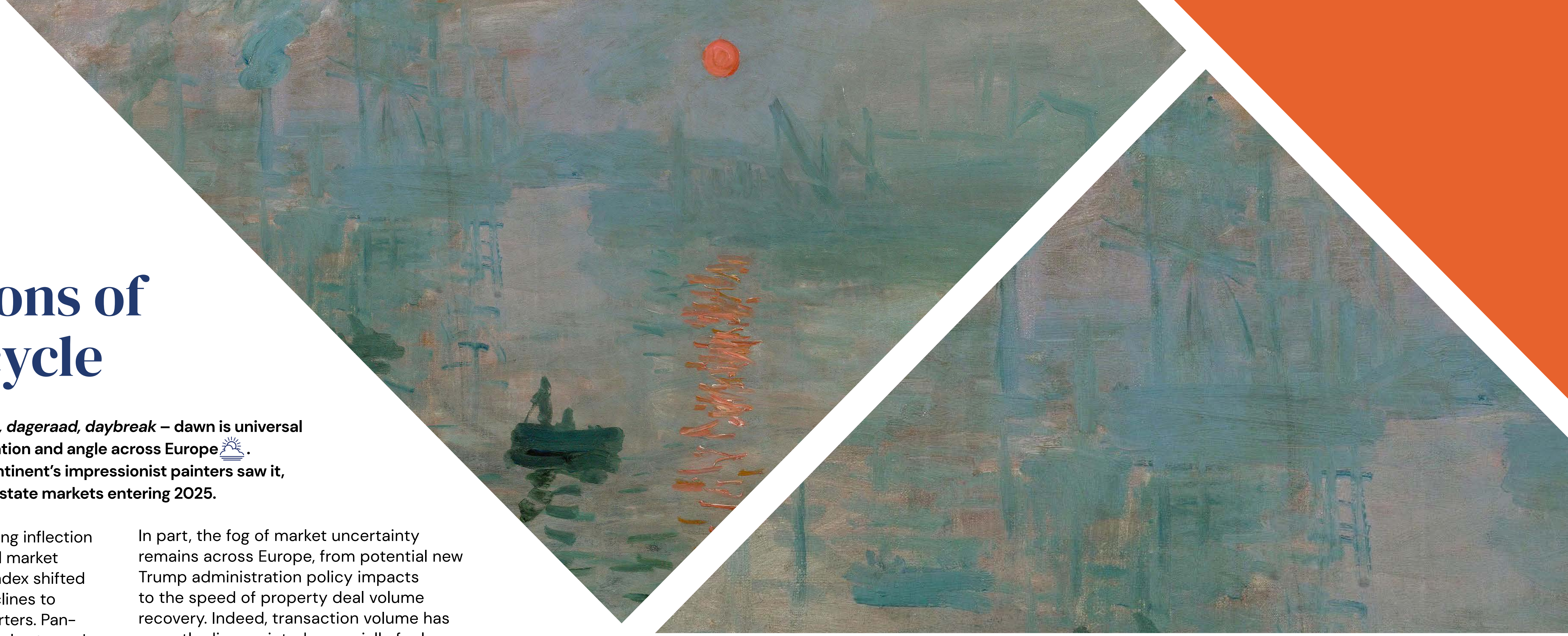
- **Be the early bird. History has shown that investing early in a cycle tends to lead to relatively strong performance.**

ISA
by LaSalle
Insights
Strategy
Analysis

OUTLOOK
EUROPE
2025

LaSalle | Investing today. For tomorrow.

ISA Outlook 2025



EUROPE

Impressions of a rising cycle

L'*aube, Morgendämmerung, dageraad, daybreak* – dawn is universal but different for every location and angle across Europe. This was certainly how the continent's impressionist painters saw it, and it is true of Europe's real estate markets entering 2025.

European real estate is transiting inflection points following a deep capital market correction. The INREV ODCE index shifted in the latest quarters from declines to positive after seven down quarters. Pan-European real rent growth has also turned. Data tracked by LaSalle's asset managers show 2024 rents for new and renewed commercial leases across LaSalle's European portfolio grew 2.7% relative to expiring passing rent, representing a return to an above-inflation pace.

Against this backdrop of a new cycle for real estate equity, real estate debt's strong and steady performance – lighting the way through the recent correction – stands out (see exhibit EU-a).

In part, the fog of market uncertainty remains across Europe, from potential new Trump administration policy impacts to the speed of property deal volume recovery. Indeed, transaction volume has recently disappointed, especially for larger office lot sizes. London saw no office sales over £100 million in the first half of 2024 for the first time in 25 years.[1] But this fog is burning off. Europe-wide trailing year investment volume ticked up in Q3 2024 after seven consecutive declines.[2] Capital is slowly returning to the market as real estate return and yield spreads now exceed their long-term averages. We believe expected go-forward returns for the overall European property market are now at their highest level in over a decade[3] – favoring **early bird** investors.

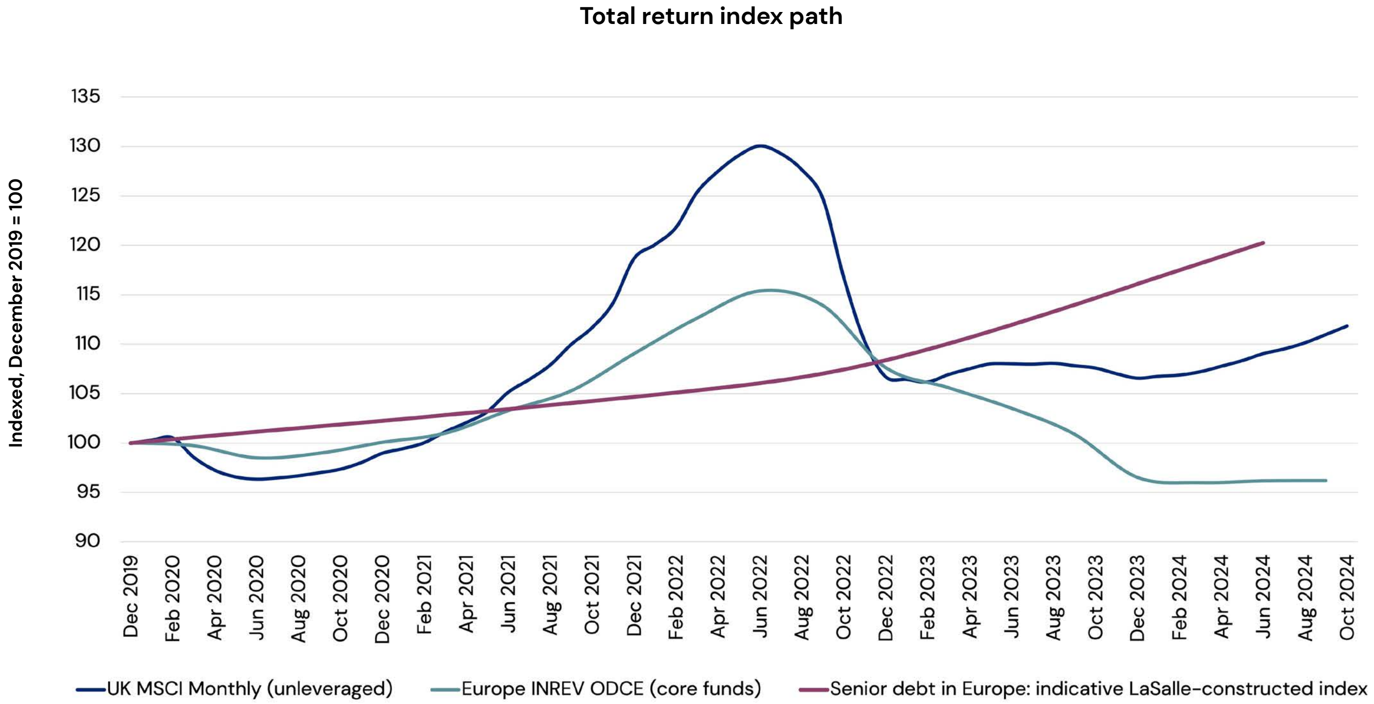
Our *ISA Outlook 2025* global chapter focuses on four themes for the year ahead. Look for these icons throughout this chapter whenever we tie back our observations for Europe to these global themes.

THE MORNING SKY	THE CAPITAL STACK HANGOVER	THE BREAKFAST MENU	THE EARLY BIRD
Falling rates but risks on the horizon	Clear-headed investors have an advantage	Making sense of complex investment options	The best market entry points tend to be early in the cycle

1. Data from LaSalle Asset Management Leasing Tracker based on 2024 leases through September.
2. Based on MSCI Real Capital Analytics data, for existing assets.
3. Based on LaSalle's Europe fair value analysis, and consistent with Green Street Advisors' real estate spread analysis.

Impression, Sunrise
Claude Monet

EU-a | European real estate has likely found a bottom



Source: LaSalle analysis of INREV and MSCI data. UK data is monthly (based on trailing three months) to October 2024. INREV to Q3 2024. The LaSalle constructed indicative senior debt index is based on blended European swap rates in each quarter and senior debt margins for the relevant period. No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

In this, the Europe chapter of the *ISA Outlook 2025*, we take a closer look at what makes the region's real estate market different: where it leads as well as where it lags. And then we share our 2025 Europe strategy picks.

Our conviction recommendations span every major property type, like a breakfast buffet covering all food groups 🍳. Mispricing still exists in the fragmented European market, but it is now more likely to be present across risk style, metro, micro-location and asset profile factors than it is along property-type lines. The moniker "beds and sheds" may bring an element of insight in a strategic approach to allocation, but it is just too reductive to accurately describe the European opportunity set today.

Seeing compelling opportunities across property types should not be confused with an argument for blanket diversification for diversification's sake. It is a market conducive to situational opportunities across a variety of sectors. We recommend combining a specific array of the best strategies, from debt to outlets, flexible living to storage, and logistics to Paris office development. We use our fair value analysis to zero in, interrogate and update these target strategies. Crowdsourcing knowledge across the LaSalle platform into our own estimates of market pricing and market forecasts are key inputs to this process, which we regularly backtest against actual results.

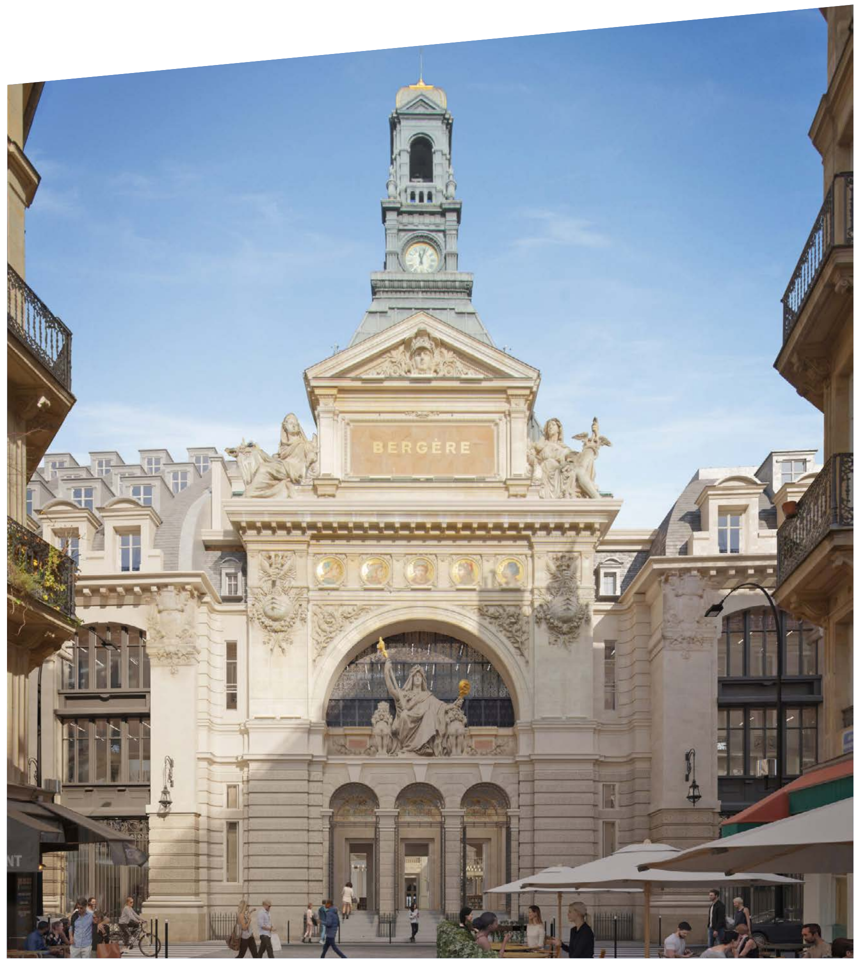
IN HINDSIGHT

Looking back on key calls from last year's *ISA Outlook* Europe chapter.

Right / Mostly right | Remains to be seen | Not right / Not quite right

"We expect headwinds to have the upper hand over the coming year… higher ECB and other central bank policy rates…are just beginning to bite." (ISA Outlook 2024 p. EU-30)

Tight monetary policy has impacted Europe's real economy with a lag, as expected. Looking back at 2024, Germany has seen near zero GDP growth for the second straight year. This tight monetary policy has also helped to bring inflation back in line with ECB and Bank of England targets.

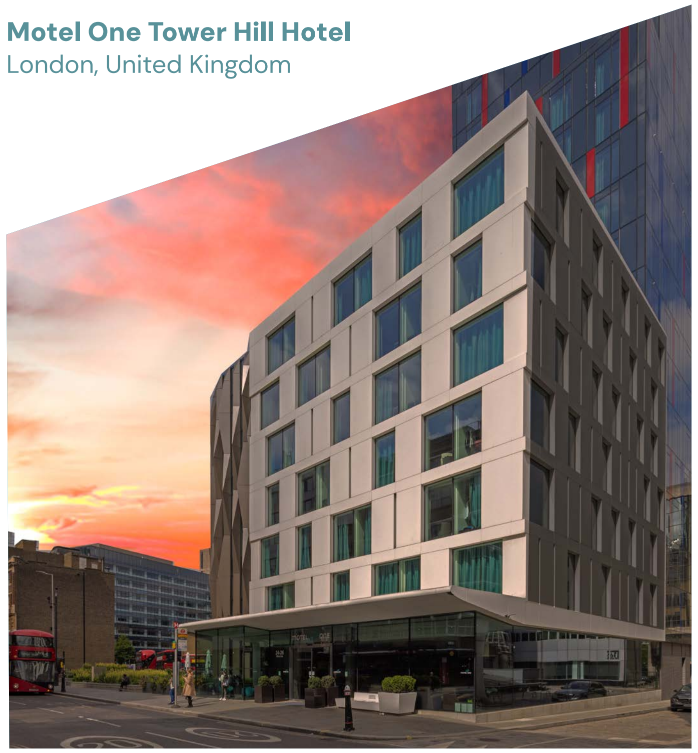


Bergère
Paris, France

Early and late risers

When it comes to the drivers behind space demand and capital markets, both cyclical and structural, Europe shines brightly in some areas and stumbles badly in others. We examine three examples of each in this section, and what they mean for real estate strategy. The incoming US Trump administration's potential 10-20% tariffs on Eurozone goods exports are a notable economic vulnerability, though as described below, expected real estate demand impacts in Europe are not all negative. Seeing the market for what it is – and not necessarily how we might wish it to be – is the first step toward investment strategies that make the most of the true opportunity set.

Motel One Tower Hill Hotel
London, United Kingdom



EARLY RISERS

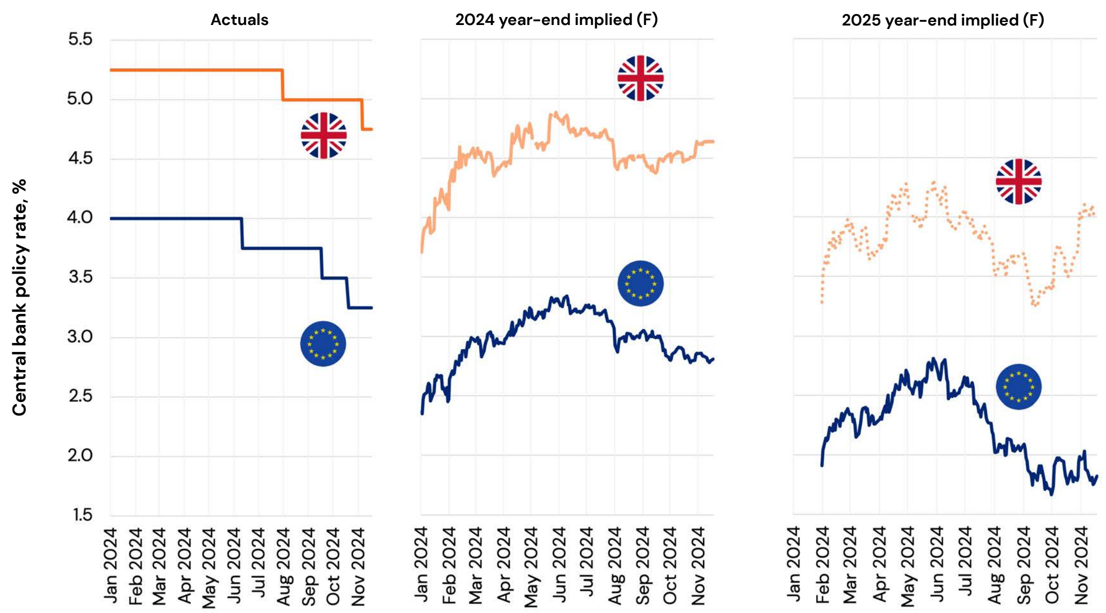
In our view, European markets are leading the way into 2025 across three spheres.

EARLY RISER 1

The monetary backdrop in Europe is at an inflection point. Falling inflation enabled the European Central Bank to cut policy rates first among the major central banks this cycle, followed by the Bank of England in August. These expected declines (see exhibit EU-b) are reflected in longer term swap rates.[4]

Real estate implications Debt has become more accretive to go-forward returns this year in the Eurozone, where swap rates are over 200 basis points lower than in the UK.[5] And real estate yields are changing direction. Real estate indices in the UK proved the fastest to incorporate this cycle's pricing adjustment among major markets globally. Indices have adjusted more slowly in the Eurozone, but average prime yields, based on estimated market pricing, have stabilized (see exhibit EU-c). As we anticipated a year ago, a few sectors have already started to see yields decline in late 2024, notably German and Dutch logistics and UK retail warehouses.[6]

EU-b | Market implied rate expectations on downward path

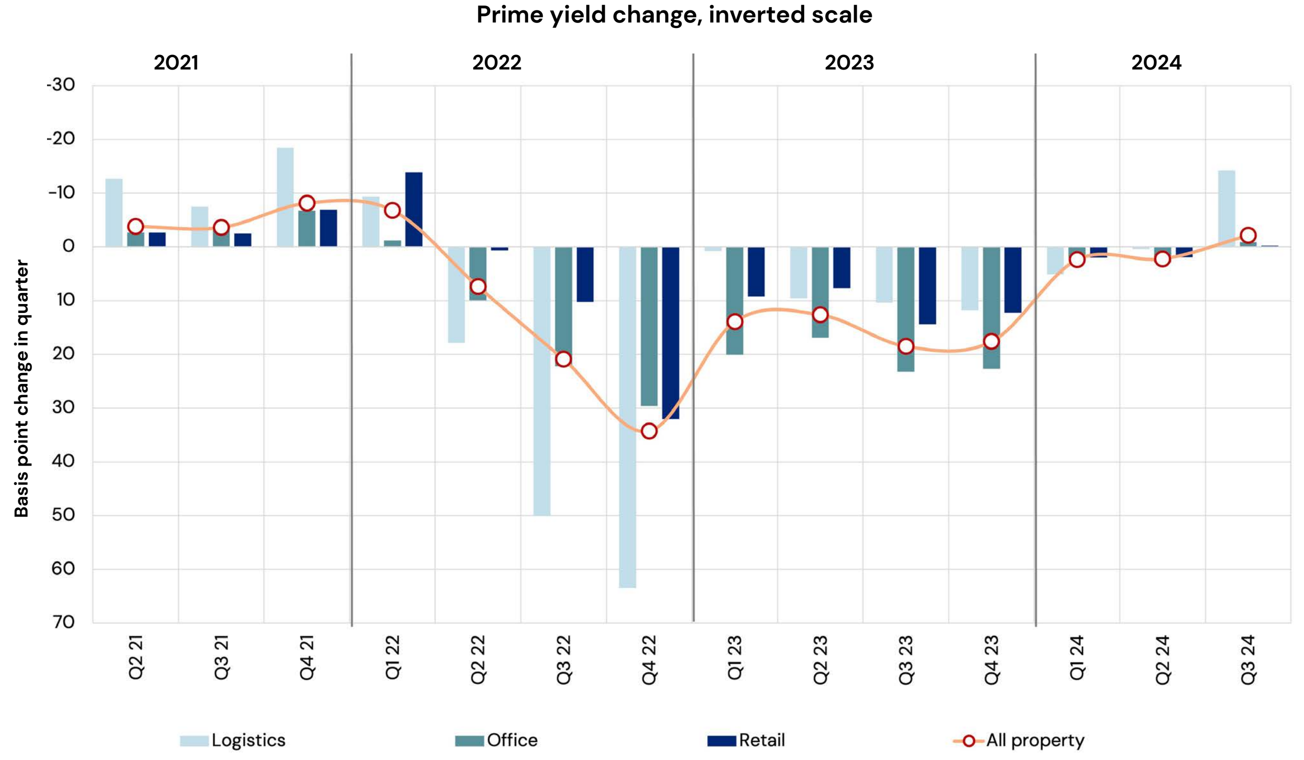


Source: Refinitiv Eikon LSEG Latest data available as of November 19, 2024.

No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

4. SONIA and EURIBOR swaps, in the UK and Eurozone respectively, embed expectations regarding policy rates and serve as the base rate for real estate debt pricing.
5. As at the time of writing, based on source data tracked by LSEG data and analytics.
6. Based on LaSalle analysis of JLL, Cushman & Wakefield, and CBRE yield estimates.

EU-c | Europe prime yields stabilize



Source: LaSalle analysis of JLL estimates through Q3 2024.

No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

EARLY RISER 2

The **magnetism of Europe's central cities** – fueled by one-of-a-kind urban spaces, a robust return to the office, high-quality transport, public safety, high-income residents and creative cultural events – remains exceptional. A gravitational momentum is attracting office tenants, visitors and residents to city centers to a degree that distinguishes Europe. Barcelona recorded its highest ever number of overnight stays this past summer, with expenditures by international travelers in Spain up by over 40% from 2019.[7] And passenger traffic at London Zone 1 tube stations served by the Elizabeth Line is up 10% relative to a year ago.[8]

Real estate implications Positive feedback loops in central locations make properties there likely to benefit first from improving liquidity and yield compression. Paris central business district (CBD) net office absorption easily outstripped that of all peripheral Paris submarkets in the first half of 2024, despite extremely low availability. Redeveloping top quality office space in these locations is often compelling.

EARLY RISER 3

Europe is pushing ahead with the **decarbonization** of the electricity grid, the primary driver of Scope 2 emissions for building occupiers. This was exemplified by a recent UK milestone. Nearly a century and a half ago, the world's first coal power plant was built in the UK, in London's Holborn. But in 2024, the country became the first G7 economy to close its last coal power plant, at Ratcliffe-on-Soar. Europe overall generated 66% of its energy last year from renewables, nuclear and hydro power, about double the global average.[9]

Real estate implications Europe's real estate investors and occupiers have strongly prioritized decarbonization and signed up to ambitious emissions reduction goals. For tenants, changing the carbon intensity of space they occupy – helped by the improving grid – is often one of the most direct levers to follow through on those commitments. JLL estimates that tenant demand for low carbon office space in Paris through 2030 is likely be double the expected supply, supporting take-up and rents for top-decile offices.

7. Barcelona City Council data as of July 2024, and CaixaBank analysis through August 2024.
8. LaSalle analysis of Transport for London data. Based on 30-day trailing average to end of August 2024.
9. Based on the 2024 Statistical Review of World Energy published by the Energy Institute.

IN HINDSIGHT

"2024 is also likely to see other sectors begin to turn the corner, with a few sectors likely to see slight yield compression later in 2024." (ISA Outlook 2023 p. EU-38)

This was a somewhat edgy prediction one year ago, when yields were moving outward for nearly all property types. By Q3 2024, prime yields began to decline for German and Dutch logistics, UK retail warehouses, and Paris CBD offices.[10]

LATE RISERS

So, if those are the areas the region is seizing the day, in what ways is Europe a sleepier, later riser?

LATE RISER 1

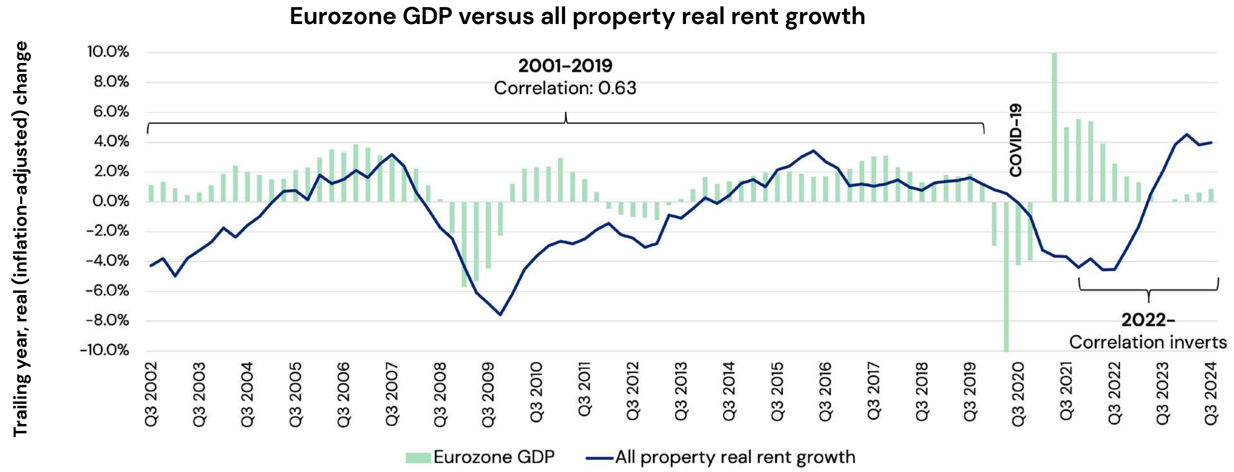
A clear area of lagging performance is Europe's **economic growth**. It has been measly in Europe in aggregate, just below 1% in 2024 and expected to be slightly above 1% in 2025.[11] In contrast to the US, there simply has not been much "cycle" to Europe's economic cycle. While the European economy has proven resilient to the energy price shock after Russia invaded Ukraine in 2022, recent performance has been sluggish and its global competitiveness has eroded.[12] Within Europe, however, there are both bright and dim spots; Germany has been a 2024 laggard, whereas growth in Spain, Poland and Denmark performed notably better. Potential new US tariffs are likely to reinforce this pattern, weighing on German exports while a stronger US dollar could be a net positive for international tourism to Europe.

Real estate implications We expect the low-growth environment to persist – constrained by demographics, fiscal contraints and vulnerability to potential new goods tariffs from the US. However, the underwhelming rate of growth has decoupled from real estate fundamentals since the pandemic (see exhibit EU-d). GDP was positively correlated with rents in Europe most of the time from 2001-2019, but then it became uncorrelated during the pandemic and this is likely to continue in 2025.

We believe this is driven by a lack of supply in central locations, which drives prime rents. And structural changes, such as polarization by quality, have confounded the direct correlation with GDP. Even as new US tariffs may weigh on GDP, a stronger dollar could boost demand for European student accommodation.

We expect that weak GDP growth next year will reinforce occupier demand patterns toward the nucleus of each market from the periphery across Europe, weighing heavily on edge-of-center locations but with less drag on the center. In the long term, low growth in Europe may eventually imply a lower neutral rate of interest, and therefore also lower property yields.[13]

EU-d | Occupier markets have decoupled from GDP since before the pandemic



Source: LaSalle analysis of JLL and Oxford Economics data to Q3 2024.

No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

10. Source: Yield estimates from JLL, CBRE and Cushman & Wakefield.
11. Based on forecasts from both Oxford Economics and the European Central Bank.
12. As highlighted in a landmark 2024 European Commission report assembled by Mario Draghi.
13. Risk-free rates impact property yields via both relative and absolute channels. In the widest, relative sense, risk-free rates set the price of systemic risk in an economy, and so falling rates lead to a fall in investors' required returns, allowing property yields to fall. In a practical sense, policy rates are the common reference point for floating-rate loans, which in turn impact a leveraged purchaser's willingness and ability to pay a given yield.

LATE RISER 2

Structural fractures are festering in Europe. The EU's pace of progress toward an integrated single market has slowed, and in some areas the bloc is trending toward fragmentation. Recent elections, notably in France, have produced gains for parties on the wings of the political spectrum. And opposition to banking consolidation highlights how the region remains quite far from being a single market in many sectors. In post-Brexit Britain, jumpy bond markets are passing stern judgment on budgets and expecting long-term inflation to be significantly higher than in the Eurozone. In Germany, differences between coalition partners on fiscal policy details has also led to the dissolution of Scholz's coalition and new elections.

Real estate implications Nothwithstanding negative effects on efficiency and fiscal maneuvering room, fragmentation may also contribute to more meaningful potential diversification benefits, as markets move to their own beat. We also believe that alternative credit strategies able to select risk and returns across markets, where local banking sector differences produce different credit environments, may see more mispriced opportunities as a result.

LATE RISER 3

Lastly, **housing construction** has declined across Europe. Regulatory and zoning obstacles give NIMBY[14] interests outsized blocking power, with some planning bodies having little incentive to support growth. Widening gaps between market and in-place rents in regulated markets can make finding an apartment an onerous six-month gauntlet for would-be tenants. Housing underproduction has become such a structural problem in Europe that fixing it formed a key plank in the UK Labour party's winning 2024 election platform.

Real estate implications We believe flows of institutional capital will be crucial to improve these housing market imbalances. The dysfunction also supports demand for more creative approaches to address housing needs, such as flexible living concepts. Unfortunately, in some cases, policy responses that seem to address dysfunctional housing markets – like rent controls – backfire and have the opposite of the intended effect.[15] The imbalances are so deep that improvement is likely to be gradual, suggesting that the challenges and opportunities are likely to persist for the foreseeable future.

14. NIMBY, or "not in my back yard," views are characterized by mechanical, automatic support for strict land use regulation and opposition to new housing development.
15. Scotland's rent controls are a notable case: they contributed to a sharp drop in construction and a subsequent spike in market rents.

Strategy themes for 2025

Taking these market forces for what they are, we recommend a European investment strategy built around five themes in 2025.

These strategies throw light on the ways that the simple, and successful, European "beds and sheds" strategy is no longer sufficient for today's market in Europe. Consider that office rent growth has been stronger than logistics over the last year in numerous cases. Prime office rent growth in London, Paris and Amsterdam exceeded prime logistics rent growth in Warsaw, Brussels and Madrid.[16] The same surprising reversal has occurred for other property types. MSCI data show trailing-year retail returns for Stockholm, Manchester and Hamburg well ahead of residential returns in Frankfurt and Paris.[17]

These observations reflect that markets adapt and have priced in changing expectations, and that segmentation is more complex than only along property-type lines. We use our fair value analysis to consistently compare required and expected returns across nearly 100 European market/sector combinations, and to spot areas of mispricing and attractive value.

1. Don't forget a (real estate debt) umbrella
2. Follow the hexagons for logistics
3. Retail back on the menu
4. Master adapters: How Europe's office markets are different
5. A residential and living smörgåsbord

16. Based on LaSalle analysis of JLL prime rent data through Q3 2024.
17. Based on LaSalle analysis of MSCI Europe quarterly index total returns through Q2 2024.

1.

PREPARING FOR EUROPE'S VARIABLE WEATHER

Don't forget a (real estate debt) umbrella

Glancing out of the window at daybreak, one might wonder what the weather has in store for real estate's new cycle. Should we bring sunglasses or an umbrella? Having access to both might be prudent: recent experience has shown that real estate investors can guard against inclement market conditions by allocating to credit, putting a proportion of their assets beneath a protective layer of equity.

Credit strategies have matured significiantly since the Global Financial Crisis. In prior real estate cycles, the lending market was dominated by regulated banks, reducing the option set available to institutional investors. LaSalle's research (see our *ISA Focus: Investing in real estate debt*) has documented the wider variety of lending opportunities open to private credit providers in this changing regulatory landscape. Alternative lenders in the UK now hold over 42% of outstanding debt, compared to the 37% held by domestic banks.[18] In Europe outside the UK, the opportunity remains for significant growth of non-bank lender market share.

As the lender base has diversified, so too has the spread between the property types with the largest and smallest debt margins; that difference was 120 basis points in 2012 but widened to over 300 basis points in 2023.[18] Lenders with real estate expertise can play this diversity, taking informed views on how pricing aligns with actual risk. These points of differentiation may not be reflected in other facets of real estate markets. For example, recent experience has shown that hotels with a management agreement structure in place are often better able to grow revenue per available room (RevPAR) than those that are leased, yet these hotels have historically traded at higher yields than leased properties. These experiences can be rapidly incorporated into lending terms.

New performance data for European debt funds shows the benefits of preparedness; MSCI's senior debt fund index has outperformed European real estate equity indices by a wide margin since 2022. Debt investors are also taking advantage of the choice between fixed-rate and floating-rate lending positions and the diversification benefits of investing in both.

LaSalle's research has also found that debt funds play a vital role in financing development by stepping in for banks, whose risk appetite has changed in response to regulation. Access to this financing is a vital enabler of the new real estate cycle in Europe.

18. Based on data in Bayes Business School's survey of CRE lending in the UK.

Project Garnet
Logistics portfolio in Sweden, Spain, Germany and Poland

2.

THE INDUSTRIAL OUTLOOK CHANGES SHAPE

Follow the hexagons

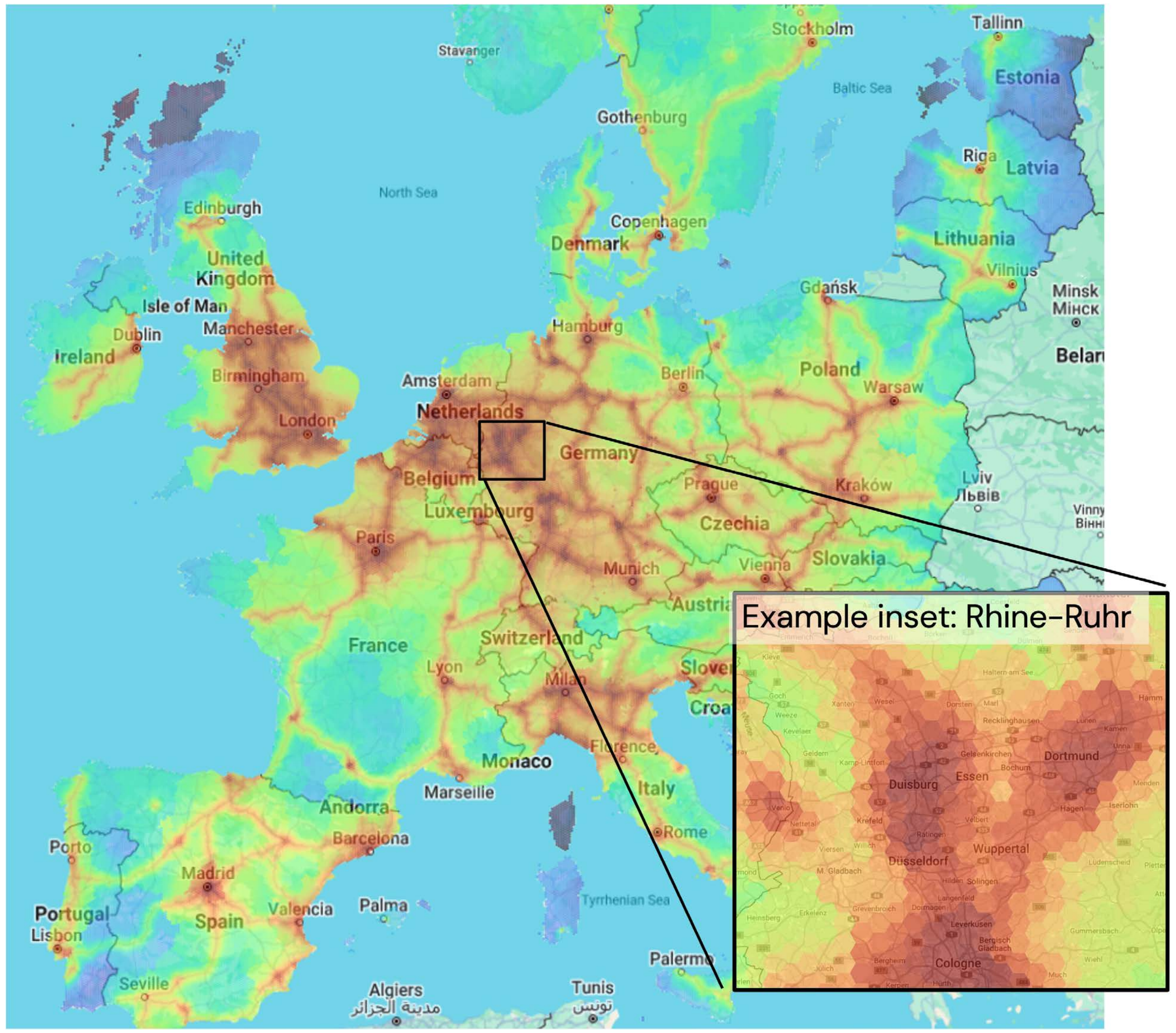
European logistics real estate has earned a larger role in investor portfolios; indeed, it had the highest returns of any European property type in eight of the last 10 years (see exhibit G-k). Yet this landscape is changing, and industrial's advantage has eroded. The logistics vacancy rate in Europe rose 170 basis points in the past year, the sharpest change of any property type. Rent growth has cooled and is now near the pace of inflation. It looks likely that industrial will lose its crown as the best performing property type when year-end 2024 figures are in.

These are cyclical headwinds and we remain convinced that industrial income growth will likely beat all-property averages over a five-year horizon. Absolute vacancy rates are low and e-commerce demand is picking back up. Yet logistics will likely outperform by a narrower margin going forward. To do better than the average in this sector, we believe that industrial location selection is crucial.

That is why we recommend 'following the hexagons'. Our [Paths of Distribution Score analysis](#) (see exhibit EU-e) maps Europe into 158,455 hexagons with a 10-kilometer width. It scores them on their centrality, from an occupier perspective, for distributing goods to the most consumers at the lowest cost. We favor logistics strategies that focus on top-scoring hexagons within the highest ranked markets in our Fair Value analysis: France, the Netherlands and Germany.

EU-e | Logistics location matters

LaSalle Paths of Distribution score



Source: Persyn, D., Díaz-Lanchas, J., and Barbero, J. (2019). Estimating road transport costs between EU regions. JRC Working Papers on Territorial Modelling and Analysis No. 04/2019, European Commission, Seville, 2019, JRC114409; openrouteservice.org by HeiGIT; [https://human-settlement.emergency.copernicus.eu/; LaSalle](#), 2024.

AFTER THE RESET

3. Retail back on the menu

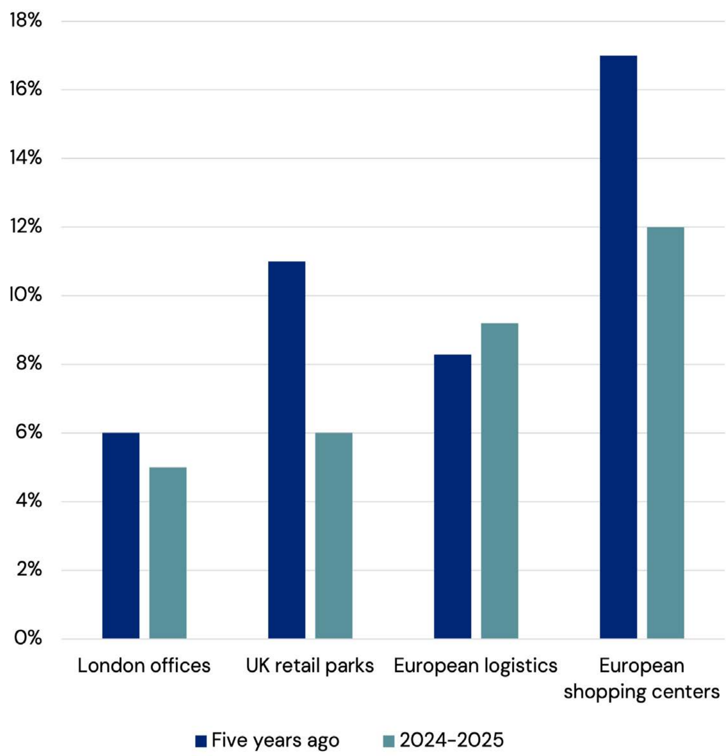
After facing stiff headwinds and false dawns, European retail has been through a deep reset. Looking ahead, select retail formats now look too attractive to ignore in 2025 – a shift we anticipated a year ago. Over the past year, European retail rents saw their strongest growth in 10 years. And some retail sectors, like UK retail warehouses, were among the first this cycle to see yield compression.

In fact, retail rents – when considered as a share of tenant revenue – have converged with European logistics (see exhibit EU-f). The retailers left standing have been thoroughly tested by 20 years of rapid growth in e-commerce penetration, Covid-19 and a cost-of-living crisis. And they are now spending much less on rent. Headwinds from e-commerce have not gone away, but the pace of change has slowed significantly.

Investors should and can still be choosy on retail strategies given low expected rent growth. But several niche retail formats stand out as especially attractive to us in 2025, led by outlet centers across both Western Europe and the UK. These offer visitors a differentiated experience from commodity shopping centers, have proven resilient to e-commerce penetration, and offer strong alignment between tenants and operators to maximize sales and income. Spanish and French retail parks, and convenience shopping centers in the Netherlands, are also attractive high income return strategies.

EU-f | Retail occupier costs converging with logistics

Rent share of occupier revenue



Source: LaSalle Research and Strategy analysis of data from ONS, British Land and PMA. No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

IN HINDSIGHT

"Retail investments are likely to improve on relative value metrics over the next year." (ISA Outlook 2024 p. EU-38)

European retail rents grew 2.4% year-over-year in Q3 2024, compared to a 10 year average of 0.4%, and this improvement is expected to be sustained. Retail yields stabilized (and even declined in the case of UK retail warehouses) in 2024 at the highest levels for any property type.[19]

19. Source: LaSalle analysis of JLL data to Q3 2024.

4.

HOW EUROPE'S OFFICE MARKETS ARE DIFFERENT

Master adapters

The urban fabric of Europe's most desirable office locations is predominantly mid-rise and mixed-use, making it different from that of many other parts of the world. In Paris CBD, classic Haussmannian buildings do not wear their use on their sleeves – a given asset could be an office, apartments, hotel or something else. Similarly, Munich, Amsterdam and Madrid's centers might not have Haussmann's design imprint, but they do tend to have moderately sized buildings under 10 stories with a large variety of nearby amenities.

This fabric has long created a fluidity of uses that can facilitate rebalancing away from oversupplied sectors. Across Europe, about 1% of office stock each year has been repurposed into other uses for the last decade, a dynamic supported by high land prices and regulatory constraints on density. European office markets are therefore leading the way toward a rebalanced office market.[20]

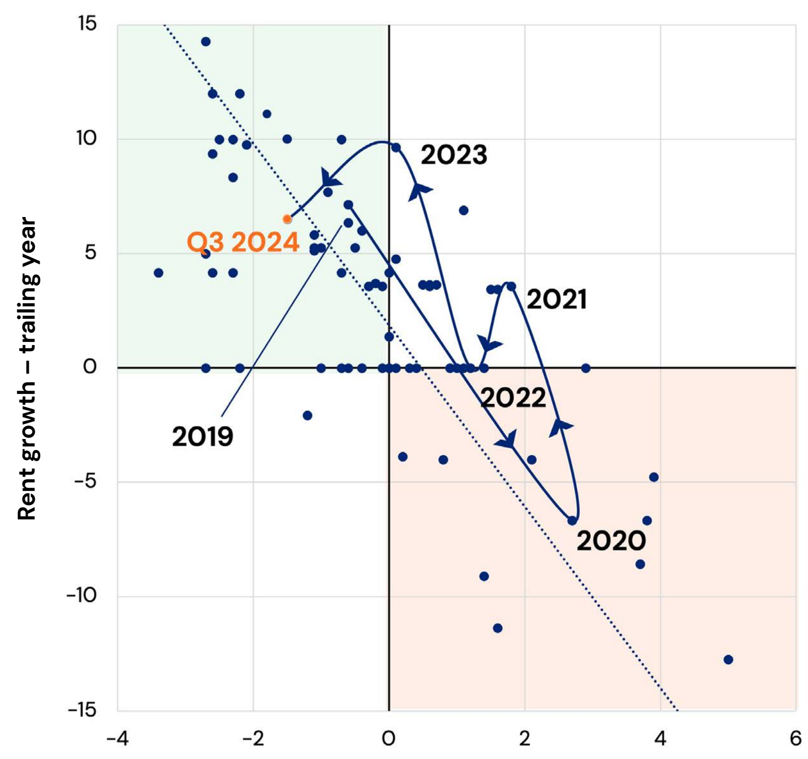
Rebalancing is not a distant next buyer prospect for many of Europe's office markets — it is arriving now. This is evident in return-to-office figures as well as property fundamentals. The City of London office market vacancy has now declined for five consecutive quarters. There is a strong historical relationship in this market between periods of vacancy decline and prime rent growth (see exhibit EU-g).

As the City of London's vacancy increased in 2020-22, rents fell or stagnated. But as vacancy has begun to fall, prime rent growth has turned positive and the market appears to be reaching a sweet spot for rental growth potential. The City of London and central Amsterdam are our top picks for stabilized offices in 2025. While we continue to expect subdued demand for commodity office stock, renovation strategies in central locations allow investors to swim with the tide of rising tenant expectations for quality and low carbon intensity space.

20. Our latest *ISA Focus* report, "Rebalancing Past and Present" takes a closer look at these historical patterns of rebalancing.

69 Haussmann
Paris, France

EU-g | City of London occupier conditions move into strong upper left quadrant



10 Greycoat Place
London, United Kingdom

Source: LaSalle analysis of JLL data through Q3 3024. No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

BEDS ON THE MENU

5. A residential and living smörgåsbord

European residential (or living) is not really a single property type; it is a large collection of sub-sectors with widely varying cash flow profiles, pricing, regulation and target occupiers. The range of strategies on offer is highlighted in exhibit EU-h.

In the UK during 2024, purpose-built student accommodation (PBSA) transaction volume exceeded that of multi-family build-to-rent. This showcases how some alternative sub-sectors can match the maturity of more conventional sectors. And indeed, other sub-types are continuing to "go mainstream" quickly: UK single-family rental (SFR) investment volume also surged to nearly the same total as multi-family rentals.[21]

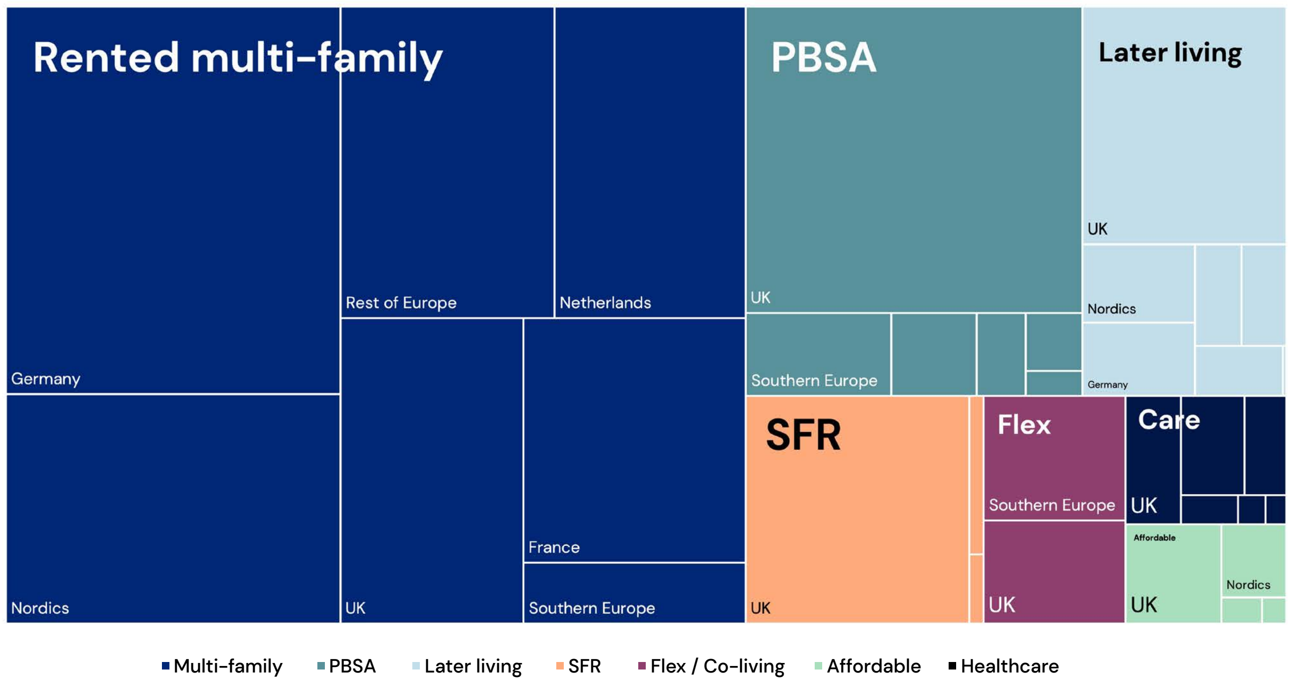
A blanket allocation shift toward European regulated residential would not enhance nominal returns, because yields tend to be below the all-property average. For example, average Dutch and French multi-family rental yields are below 4%.[22] As such, European living's inclusion in portfolios needs to be predicated on a risk-adjusted view underpinned by structural undersupply. Even on a risk-adjusted basis, returns can be tight; for example, in some cases prices for rented residential assets have been bid up by buyers looking to break them up for individual sale.

This makes sector selection within residential paramount; we use our fair value analysis to build our conviction in specific locations and market segments. For 2025, student accommodation in Spain and Germany stands out as attractively positioned (we sized up the PBSA opportunity in our *ISA Briefing: Head of the class*). Flexible living concepts also jump out as being worthy of over-weights. These emerging types play an essential role in giving residents a housing solution when facing fierce competition for limited available regulated units.

21. Based on JLL Capital Markets data.
22. Based on LaSalle analysis of JLL, Cushman & Wakefield, and CBRE yield estimates.

EU-h | Fragmented residential transaction activity

Europe living sectors – rectangles sized by 1H 2024 transaction volume



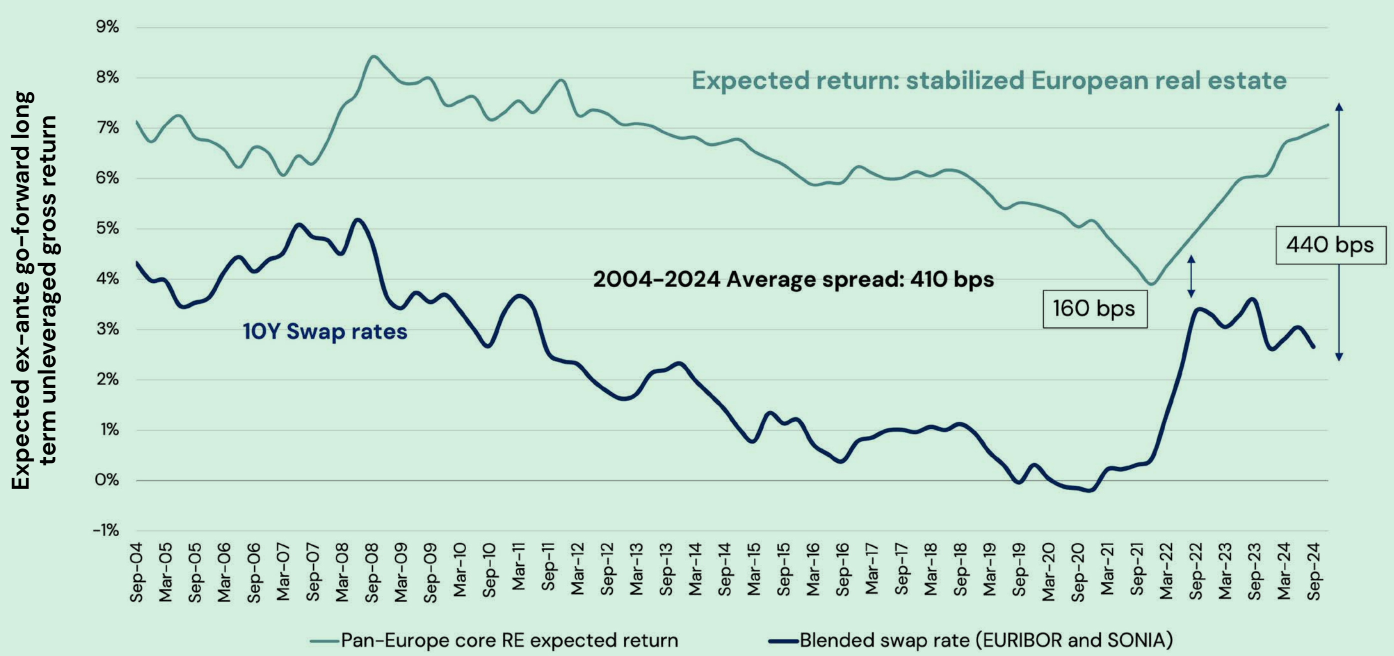
Source: JLL. Southern Europe = Spain, Italy, Portugal. Rest of Europe = Austria, Belgium, Czech Rep. Poland, Switzerland, Ireland. Nordics = Norway, Sweden, Finland, Denmark. No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

LOOKING AHEAD

- Europe offers its own takes on early birds. In Sweden – *morgonstund har guld i mun* – morning hours come with gold in hand. And this spirit is evocatively captured in the French expression: *l'avenir appartient à ceux qui se lèvent tôt*: the future belongs to those who wake early. We believe the future does belong to real estate investors who can take advantage of improving capital markets and a return to attractive relative return spreads for real estate (see exhibit EU-i).
- The investment menu has become more scrambled. There are specific compelling sector opportunities within each major property type in Europe. There is also notable convergence in outlook between recently favored sectors, living and logistics, and formerly out-of-favor sectors. The spectrum of risk-return within each sector goes beyond even "trifurcation." Look for more retail and office niches, in some specific locations, to flip the script on relative performance in 2025. And expect the most central locations – for transacting business and shipping goods – to continue turning the corner first.
- Watch for European market fundamentals to diverge from a sluggish economic growth backdrop. Structural trends in preferences for low carbon emission offices, a slowing e-commerce transition and supply barriers are interacting with cyclical vacancy rates to drive fundamentals more than GDP growth.
- Our top Europe strategy recommendations include student accommodation and flexible living, office repositioning in central London and Paris, German and Dutch logistics, and outlet centers.
- Don't forget a "debt" umbrella! Investment in debt has proven a powerful diversifier through the storm of the recent capital market correction for equity. Solving capital stack problems for borrowers continues to offer healthy go-forward returns, and adding real estate credit strategies builds more resilient portfolios, according to our analysis (see our recent *ISA Focus: Investing in real estate debt*, on the topic).

EU-i | European real estate moves back to fair value

Europe core real estate expected return versus swaps



Source: LaSalle analysis of LSEG Eikon and Green Street data to September 2024, and LaSalle's fair value analysis as of November 2024.

No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results and accordingly the information is subject to a high degree of uncertainty.

ISA by LaSalle | Insights Strategy Analysis

OUTLOOK NORTH AMERICA 2025

LaSalle | Investing today. For tomorrow.

ISA Outlook 2025

NA-2 North America

A partly cloudy sunrise

The morning sky - Falling rates but risks on the horizon: Economic outlook

The capital stack hangover: Distress

Making sense of complex investment options: Real estate fundamentals

The early bird-The best market entry points tend to be early in the cycle: Capital markets

NORTH AMERICA

A partly cloudy sunrise

The global themes around the "dawn of a new cycle" certainly ring true in our outlook for the US and Canada markets. We use these themes to frame our outlook, which is broadly structured as a review of the economic outlook, an exploration of distress in the market, real estate fundamentals and then our capital markets outlook.

Vancouver, Canada

THE MORNING SKY: FALLING RATES BUT RISKS ON THE HORIZON

Economic outlook

The summer and autumn of 2024 saw growing optimism among real estate investors. The belief that the dawn of 2025 would open with sunny skies for the real estate market was driven by falls in interest rates from peak levels, fading economic growth concerns and real estate valuations now more aligned with market transactions. For Canada, optimism is perhaps a bit more contained as economic performance has lagged (see NA-a), due in part to the greater bite that rising interest rates has taken out of consumer spending.

More uncertainty crept into the picture in late 2024, especially around longer-term interest rates. Since the start of the fourth quarter, long-bond rates have moved higher. As of the time of writing, 10-year Treasury rates are still below the peaks seen last fall, but they are up almost 80 bps from a low of 3.64% in mid-September (see NA-b).[1] As was the case last year, real estate values remain closely tied to interest rates, in part because fundamentals are generally sound with demand steady and new supply falling sharply. Two challenges that emerge from performance being linked so closely to interest rates include the difficulty in forecasting interest rates, and the dynamic it can create where good economic news leads to higher rates but then is perceived as bad news for real estate values.

Our *ISA Outlook 2025* Global chapter focuses on four themes for the year ahead. The North American chapter is organized according to these four themes, providing region-specific insight for each of them.

THE MORNING SKY	THE CAPITAL STACK HANGOVER	THE BREAKFAST MENU	THE EARLY BIRD
Falling rates but risks on the horizon	Clear-headed investors have an advantage	Making sense of complex investment options	The best market entry points tend to be early in the cycle

1. Source: Bloomberg, data as of November 13, 2024.

NA-a | US growth beats expectations, Canada lags

Source: US Bureau of Economic Analysis, Statistics Canada, Oxford Economics. LaSalle. Data and forecast most recent as of November 2024.

Note: Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue or that any forecasts shown herein will materialize as expected.

IN HINDSIGHT

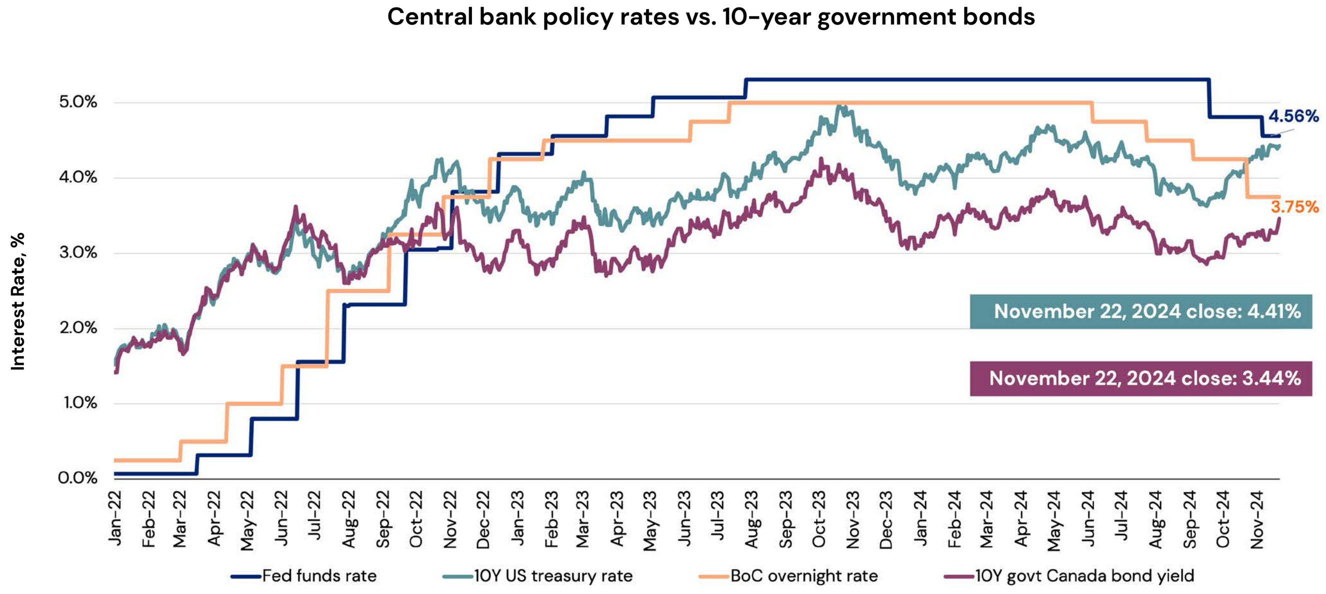
Looking back on key calls from last year's *ISA Outlook* North America chapter.

Right / Mostly right | Remains to be seen | Not right / Not quite right

☑ *"A meaningful recovery in transaction volume is not likely to occur in the first half of 2024. Activity, however, may pick up in the second half as pressure to transact mounts."* (*ISA Outlook 2024* p. NA-52)

Quite accurate. The acceleration in the second half was perhaps not that robust, but sentiment seemed to shift as 2024 progressed.

NA-b | Long-term rates rising as short-term rates fall



Source: Bloomberg, Economy.com.

US 10-Year Treasury Rate and 10-Year Government Canada Bond as of November 13, 2024.

Note: Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue or that any forecasts shown herein will materialize as expected.

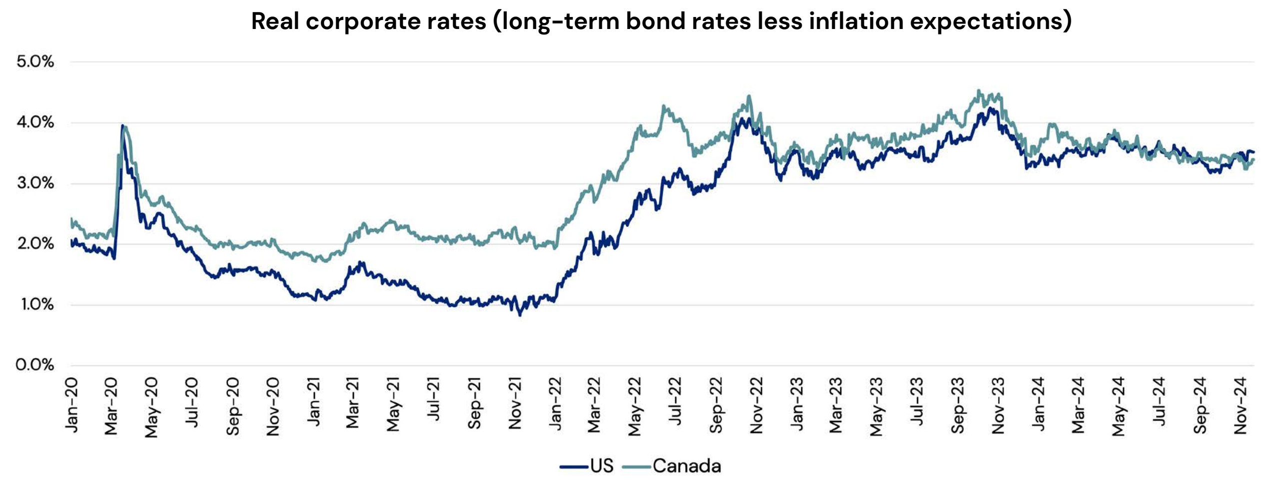
The recent rise in interest rates is a reminder of the unpredictable path they can take, with long rates moving higher even as the Fed has started reducing short-term rates. Events linked to the rise in rates were initially better than expected economic data[2] and then the election of Donald Trump, which the markets seemed to read as pro-growth but with higher inflation risks[3]. The Fed's long-term outlook on rates remains consistent with a 10-year rate of around 4%[4], but the market has become skeptical they will remain on as steep an easing path as before. On the other hand, Canada's central bank has so far been more aggressive in lowering its policy rate, cutting by 125 basis points in 2024 through November, with further cuts expected in December and in 2025. While inflation has fallen more sharply in Canada than the US, the US and Canada remain linked, driving concern that lower Canadian rates could negatively impact the Canadian dollar and make imports more expensive. Furthermore, President-elect Trump's overtures on tariffs, immigration and a potential renegotiation of the USMCA trade agreement could have impacts on Canada in the coming years.

The recent volatility is a reminder that the goldilocks environment referenced in *ISA 2019* has still not returned. Pandemic-era reverberations continue as we adjust to a new normal that includes at least the fear of higher inflation – if not higher inflation itself. But it is too simplistic to look at nominal interest rates in isolation. A look at real corporate rates pulls out the part of higher rates that are due to higher inflation expectations, while also accounting for the economic risk measured by corporate bond spreads (see NA-c). Throughout 2022 and 2023, higher nominal interest rates were closely linked to increases in the real corporate rate. Recently, however, higher interest rates have been driven by higher inflation expectations and corporate bond spreads have compressed. This blunts the impact on real estate values because real estate investments can generate higher returns with higher inflation and the risk spread for corporate bonds is often used as a proxy for real estate risk.[5]

Looking beyond the near-term cyclical dynamics, a long-term positive for the US and Canada has been population growth boosting overall GDP and job growth (see NA-d). Population

2. Interest rates moved higher following the strong September jobs report on October 4, 2024.
3. See our *ISA Briefing Note regarding the impacts of the election outcome.*
4. The Fed dot plot median is 2.9-3.0%, with 100 bps spread to the 10-year being in the normal range.
5. Many forecasters, including Green Street Advisors, use the Baa Corporate Bond rate as a starting point for assessment of relative real estate value.

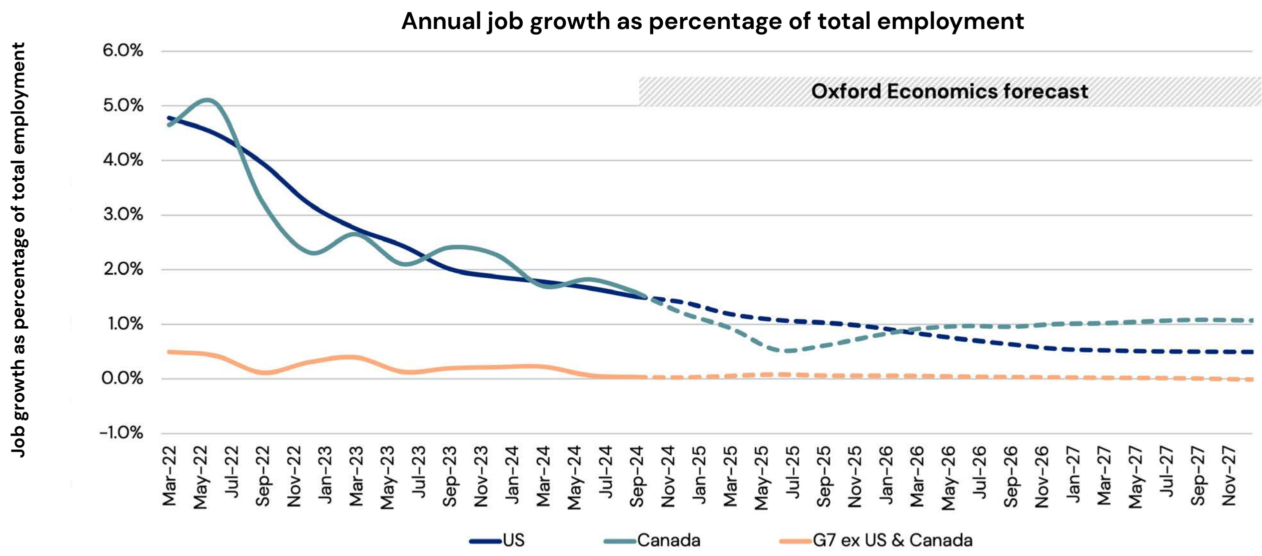
NA-c | Real corporate rates stable as interest rates rise



Source: LaSalle Securities, Bloomberg, Economy.com. Data through November 11, 2024.

Note: Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue or that any forecasts shown herein will materialize as expected.

NA-d | Migration helps US and Canada growth lead G7



Source: BLS, Oxford Economics. LaSalle Investment Management. Historical data through Q3 2024. Latest available as of November 4, 2024.

Note: Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue.

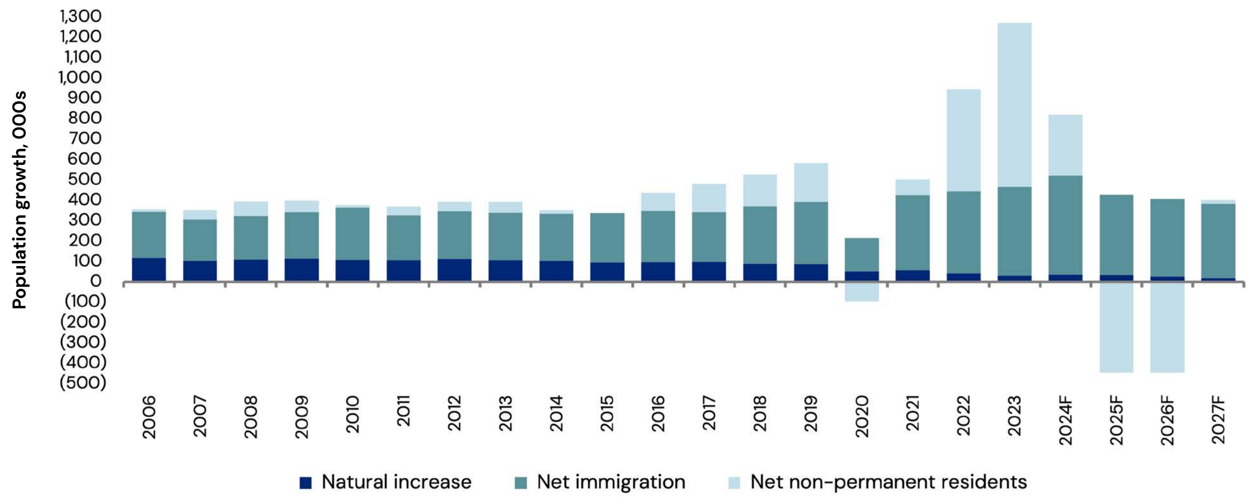
IN HINDSIGHT

"Interest rates will continue to be more important to real estate performance than economic growth… [Lower rates] will be a net positive for existing real estate portfolios while "higher for longer" will be a net negative…" (ISA Outlook 2024 p. NA-52)

If pricing in the public market is any guide, it seems that the best performance came from news that supported a "soft-landing" more than the "no-landing" scenario.

NA-e | Lower immigration targets will slow Canada's strong population growth

Population growth, Canada, 2006-2023 and forecast 2024-2027



Notes: Data is trailing 12 months ending December 31, in thousands. Natural increase is births, deaths, and residual deviation. Net immigration is permanent immigrants, emigrants, returning emigrants and net temporary emigrants (excludes non-permanent residents).

Sources: Statistics Canada, RBC Capital Markets, LaSalle.

Note: No assurances are given that these trends will continue or materialize as expected.

declines can be detrimental to real estate demand, while population growth helps create new investment opportunities in building the real estate that people need. Migration has been a key driver of North America's positive economic performance but currently there is elevated uncertainty regarding migration levels in both the US and Canada. President-elect Trump has long made curtailing immigration a key part of his messaging. His success in this area was mixed during his first term, but his second-term pledges include restrictions that could negatively impact real estate demand, hitting apartment demand most directly. Canada has been more open to migration than the US, but high levels of temporary foreign worker and student admissions to Canada following the pandemic are likely to be lowered sharply in 2025 and 2026 to ease pressure on the housing market. Permanent immigration will continue (see exhibit NA-e), but likely at levels roughly 20% lower than in 2023 and 2024.[6] Canada should continue to lead the G7 in the rate of population growth, but at lower levels than in recent years.

Local, rather than national, policies are often more important for real estate performance, especially relative performance. Local policies impacting performance and strategy in recent years include rent control, restrictions on how residential landlords can operate, industrial development restrictions (e.g. AB 98 restrictions in California[7]) and carbon/energy efficiency mandates. A positive result for real estate in the recent elections was the defeat in California of yet another attempt to remove the Costa-Hawkins state-wide restriction on new rent controls. But the idea of rent control as a solution to housing affordability issues continues to be raised in California and other places. While rent control can be a clear negative for real estate investors,[8] even seemingly business-friendly policies like Florida's "Live Local" law, which encourages affordable residential development, can lead to more new supply and impact the performance of existing real estate. Broadly speaking, national and local policy leans towards being marginally negative for apartments, while restrictions on industrial development could have a positive impact on industrial performance. Climate and energy rules are likely to remain local, and require detailed assessment of how each property is positioned relative to the risks around current and potential future policies.

6. For further details see the Canadian government immigration plan.
7. This recently passed law will restrict the locations in California where industrial development is allowed.
8. For additional detail on this complex topic see LaSalle's PREA Quarterly article on a new wave of rent control from 2020.

THE CAPITAL STACK HANGOVER

Distress

As a morning can be affected by the night before, some market segments and assets will continue to be impacted by recent excesses. Some assets will remain stressed under any realistic outlook for economic growth and interest rates. The Global chapter discusses how interest rates are not likely to repeat the dramatic declines at the outset of other recent cycles. This means that many capital stacks will not be cured by lower rates, and the "pretend and extend" approach to distressed assets will eventually require some resolution.

In North America, distress in US office is rising fast (see exhibit NA-f), with US residential and retail seeing some limited distress. MSCI estimates that there is US$50 billion of office distress outstanding from a total US$65 billion potential distress, while for apartments there is US$76 billion potential distress, of which only US$14 billion is currently outstanding.[9] In Canada, the number of distressed commercial properties in 2024 is expected to double from 2023 levels; however, on a dollar-volume basis this is a small fraction of US levels, with much of the distress in construction receiverships of new condominium and apartment developments.

IN HINDSIGHT

"Supply will weigh on real estate fundamentals in 2024. Vacancy will likely climb, and rents should fall nationally for US apartments and in several industrial markets."
(ISA Outlook 2024 p. NA-52)

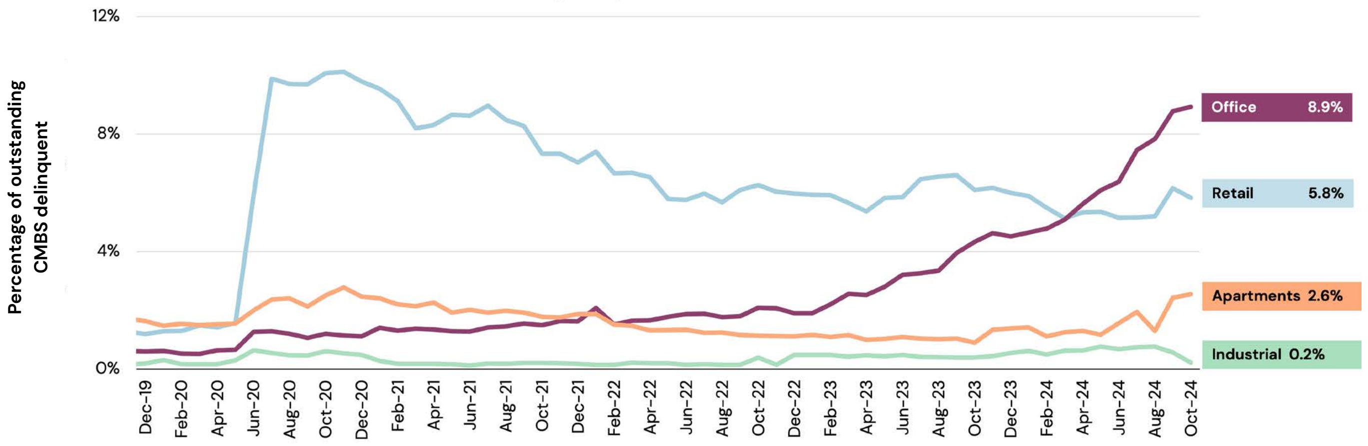
The industrial outlook was accurate with rising national vacancy, but rents are falling in only some markets. Apartments outperformed expectations due to strong demand, and rental growth stayed marginally positive.

For US office, there are many situations where existing equity is likely to be wiped out. Some of these are moving towards resolution, with lenders taking control of assets or sales processes. New equity is taking control and is positioned to invest the capital required to preserve and grow asset value. This is often done in conjunction with existing debt-adjusting terms to help create an investment opportunity not otherwise available. Apartment distress is less severe, and we think it will be addressed with more limited pain for lenders, with the pain falling to existing equity investors. With apartment values often above the loan balance, but below a level that can be refinanced, we expect investment opportunities to come from working with the existing capital stack and identifying structured entry points. These might be high-leverage debt, preferred equity, or new partnerships with existing investors.

9. MSCI/RCA US Distress Tracker, published October 31, 2024. This differs slightly from CMBS delinquency because of the limited amount of apartment loans in CMBS loan pools.

NA-f | Office delinquency rising; other sectors stable

Delinquency rate for US CMBS



Source: JPMorgan. Data through August 2024, latest as of September 27, 2024.

Note: Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue..

MAKING SENSE OF COMPLEX INVESTMENT OPTIONS:
THE BREAKFAST MENU

Real estate fundamentals

The metaphor of a wider menu of investment options certainly applies to North America. And like a New York diner menu, there is a lot available, but you should be careful what you pick. A market summary like this one is not sufficient to address the nuance in terms of sector, market and asset quality. Instead, we share generalized views and ask the reader to understand there is a wide range of variation within segments. We expect that variation to become more important because the impact of sector selection on relative performance is likely to continue to diminish (see exhibit NA-g). This is not to say sector allocation will become unimportant, especially in terms of allocation to specialty sectors, but market, micro-location, sub-type and quality will become more meaningful.

Apartments – The performance of US and Canada multi-family has diverged in recent years due to different supply and demand dynamics. In 2025, US apartments will still be dealing with the hangover from a supply boom that followed spiking rents, low cap rates and soaring values in 2021 and 2022. While there are market level differences, our national view is that 2026 will be the year that hangover clears, while 2025 will be another year to muddle through. It seems some investors are looking past the near-term challenges. We believe there are bright days ahead and current entry points are not a great opportunity for core investors today. For higher-return investors with structured entry points into the capital stack, the view can be quite different; 2025 might be the optimal year to act.

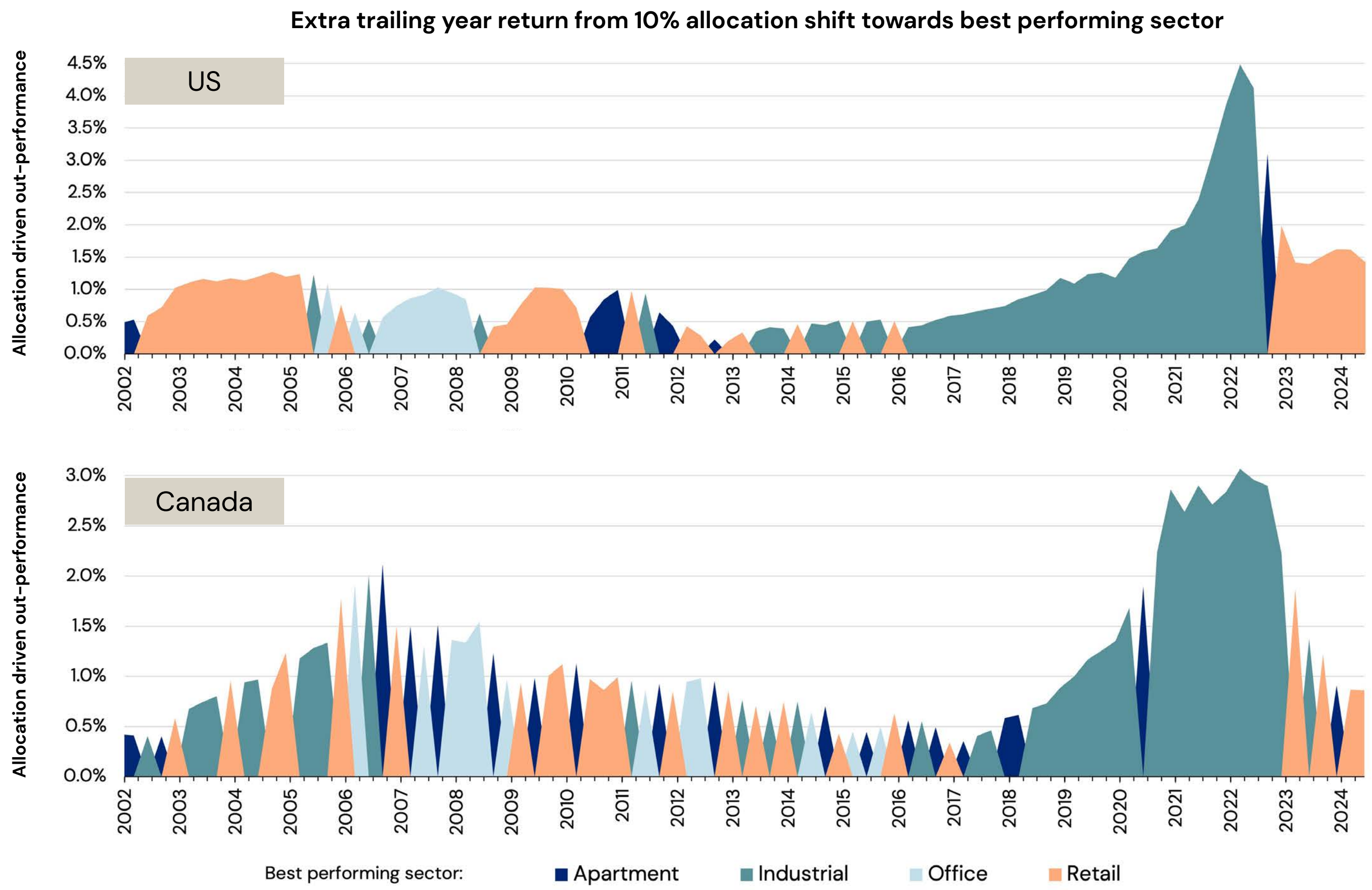
"The performance of US and Canada multi-family has diverged in recent years due to different supply and demand dynamics."

It is worth noting the patchwork of rent regulations in the US is growing more complex and apartment investors need to carefully navigate these. Rent regulations are made at the state or local level and are becoming more fluid. At the margin, this increases the risk of apartment investment, and makes it more difficult to identify superior investment opportunities.

In Canada, apartment fundamentals remain strong due to migration-related demand drivers, but competing factors are changing the dynamic. The federal government's planned slowing of immigration levels from 2025 – 2027 will cool the frothy demand of recent years and vacancy will increase modestly from the 40-year low levels recorded in 2024. Furthermore, shadow supply competition from rental condominiums is easing availability pressures in some locations. However, high construction financing costs have pushed some developers to delay or cancel new apartment projects, maintaining downward pressure on vacancy. Canada has its own patchwork of rent regulations investors must navigate, mainly annual rent increase guidelines in several provinces that move based on CPI inflation. However, there is generally less change expected in these rules than in the US.

Vaughan Mills
Ontario, Canada

NA-g | Sector selection impact diminishing

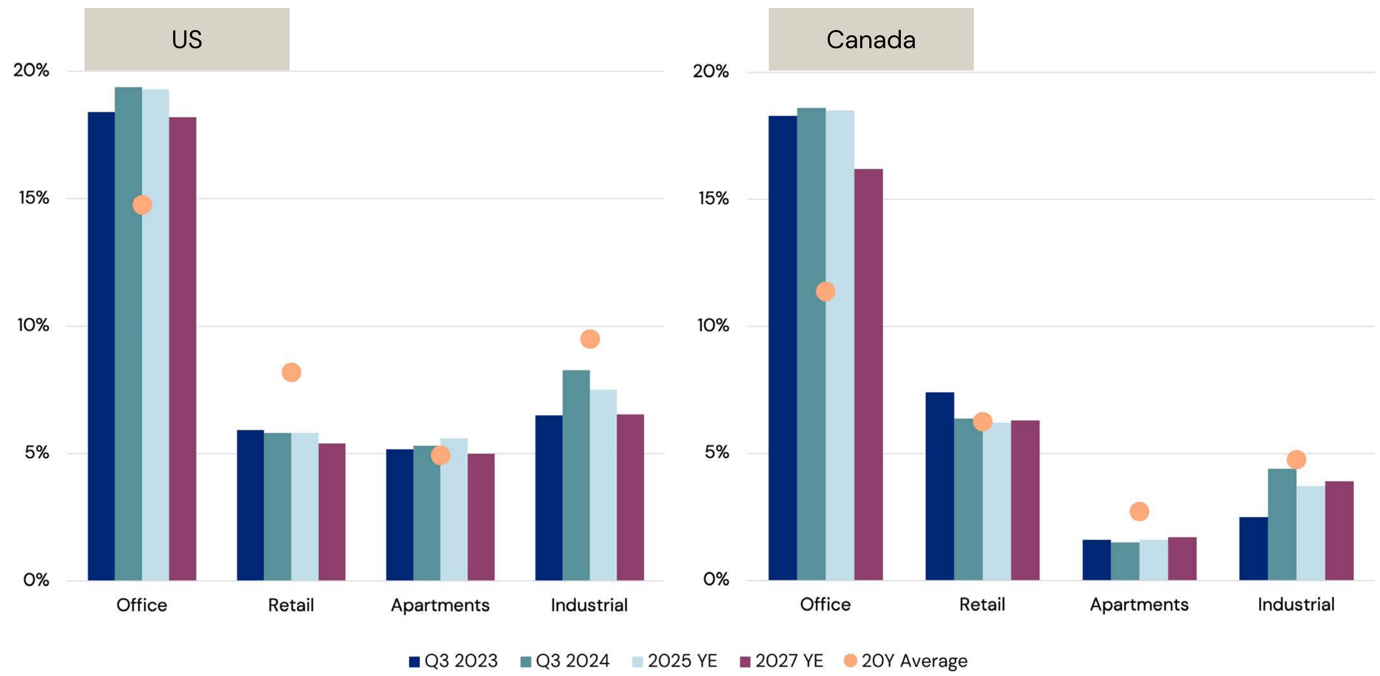


Source: MSCI/REALPAC Canada Annual Property Index, NCREIF Expanded National Property Index, LaSalle Investment Management. Data as of Q2 2024 and Q3 2024.

Note: Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue or that any forecasts shown herein will materialize as expected.

NA-h | Vacancy forecast to decline for most sectors

Property type vacancy rates



Source: Realpage (US Apartments), CBRE EA (US and Canada Industrial and Office), CoStar (US Open-Air Retail), MSCI (Canada Retail) and CMHC (Canada Apartments). Historical data to Q3 2024, forecasts as of Q2 and Q3 2024 - latest available as of October 2024.

Note: Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue or that any forecasts shown herein will materialize as expected.

Industrial – Our view of industrial performance in 2025 is more favorable than for apartments, largely because the supply hangover is already ending, leaving fundamentals better positioned. In addition, it appears there has been greater repricing, perhaps because apartments are seeing stronger capital flows from private investors while industrial transaction activity is more dependent on more constrained institutional capital flows.

We believe secular tailwinds for industrial will continue, with e-commerce a positive and policy oriented towards boosting domestic manufacturing a growing benefit. Local policy oriented towards making industrial development more difficult is also a benefit to owners of existing stock. We expect 2025 to be the start of a solid recovery for industrial; entry points today appear attractive.

Retail – The retail outlook continues to improve after an extended period as the least-favored sector; and that has been recognized by investors. Across North America, retail construction has been and is expected to remain very low. This has helped fundamentals, especially for the best centers in growing markets and sub-markets. Rent growth remains moderate as tenants' ability to bear higher rents is constrained, but we believe entry yields in some retail sub-segments provide an attractive investment opportunity.

However, the depth of appealing properties in retail is much narrower than in other sectors, and in both the US and Canada there are situations where pricing runs past what we believe is justified based on a center's NOI growth outlook. Retail will likely provide investment opportunities, but it requires detailed asset selection. Some raise concerns about the risks created by inflation or weak consumer confidence, but we believe good retail properties can deliver durable performance through varying economic environments.

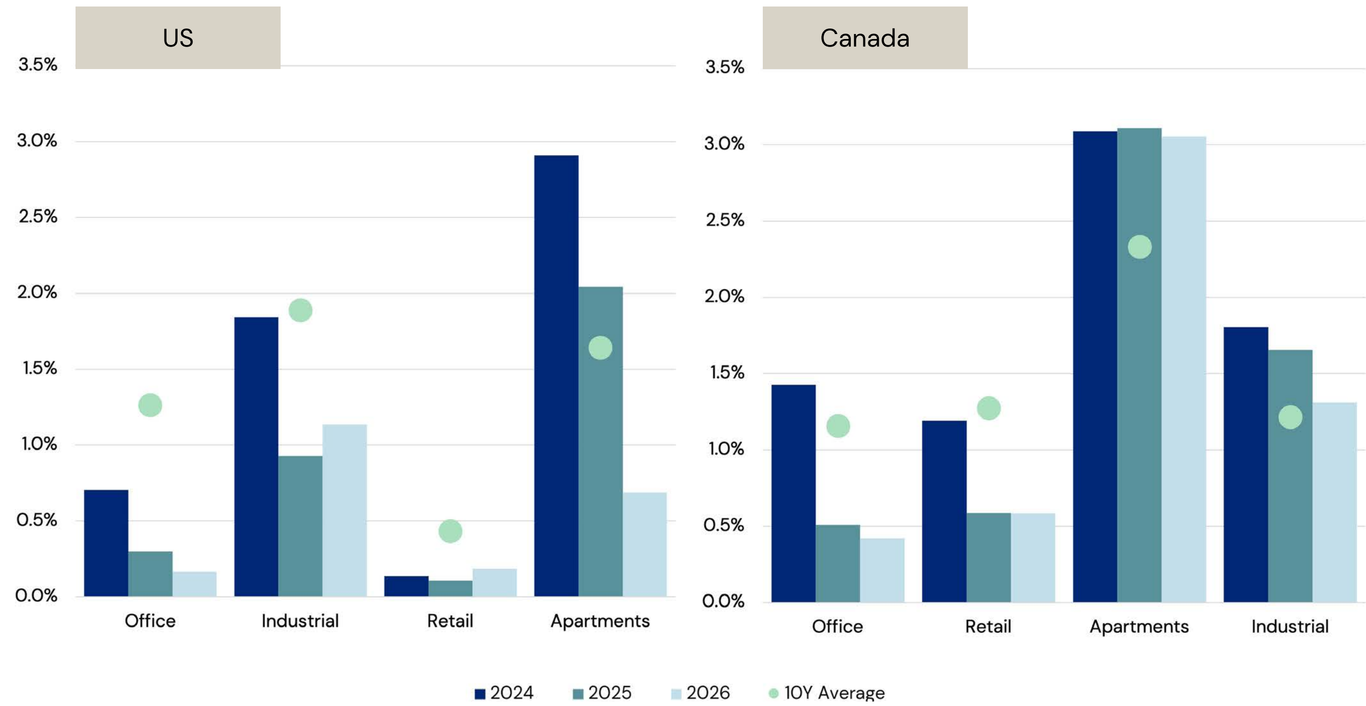
Office – US office continues to generate headlines in the popular press and it remains the most discussed sector in the investment community. Our expectation that remote working is a major negative impact on office demand remains, but at some point economic growth will outweigh that negative factor.[10]

10. For a more detailed discussion of the dynamics of a recovering property type please see our report *ISA Focus: Rebalancing past and present.*

Buckeye85
Arizona, United States

NA-i | Slowing new supply boosts outlook

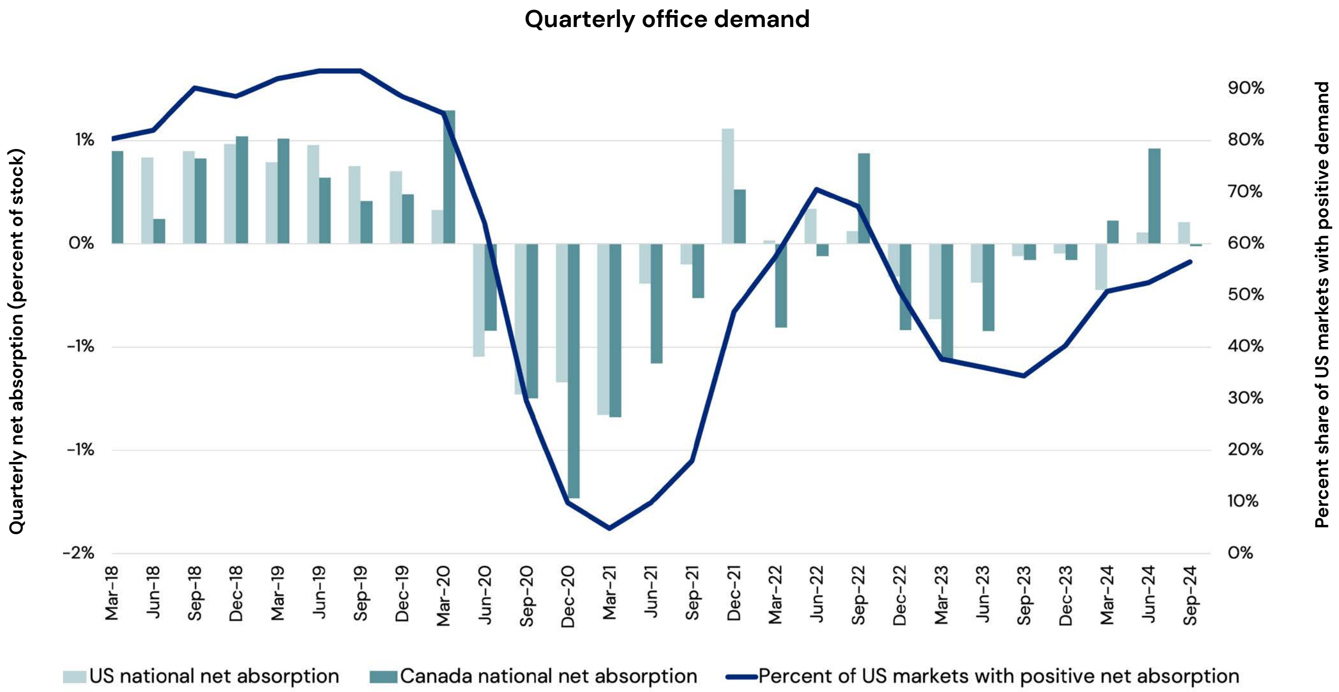
New supply as percent of existing stock



Sources: CBRE Canada, CBRE-EA, CMHC, LaSalle. Data to Q3 2024 for office and industrial, H1 2024 for retail and year-end 2023 for apartments. US data to Q3 2023.

Note: Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue or that any forecasts shown herein will materialize as expected.

NA-j | Office demand stabilizing after extended decline



Sources: CBRE-EA, LaSalle. Data to Q3 2024.

Note: Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue or that any forecasts shown herein will materialize as expected.

This applies to both the US and Canada, but in Canada leasing economics remain more favorable to landlords than in the US. A few other details on our office outlook:

- **Demand** — The impact from remote working can be viewed as a one-time demand shock. The magnitude can be debated, but it has been significant, pushing US and Canada office vacancy rates to all-time highs. Our view is we are reaching a peak in vacancy. Going forward, we expect fewer tenants will downsize as leases roll and more will take additional space for planned growth. Indeed, in recent quarters, net absorption has moved positive nationally in both the US and Canada (see exhibit NA-j). But the pace of net absorption means vacancy rate declines are likely to be slow. Market-level performance continues to vary, often based on overall economic growth
- **Quality** — Asset quality is an important driver of asset performance. Analysis by JLL finds newer buildings are outperforming in terms of occupancy, leasing activity and rent levels.[11] Top-tier buildings are running out of space; the question is if that will lead to out-sized rent growth in top tier buildings or spill-over demand to the next tier of buildings.
- **Leasing economics** — Most of the pain for office landlords has come from reduced occupancy and higher tenant improvement (TI) burdens impacting effective rent levels. Face rents have been surprisingly stable, at least on a nominal basis. This positions office for a recovery when occupancy improves, as long as capital expenditures can be controlled through more strategic leasing arrangements.

11. JLL, October 2024.

In 2025 we expect attractive office investment opportunities to emerge, with pricing at least 50% below prior levels. Office investment will require pricing discipline as every discount opportunity is unlikely to be a good one; asset selection will be key. Canada will also likely provide opportunities, but the required discount to the prior peak is likely to be less due to better landlord leasing economics.

Specialty sectors: The depth of the US real estate market continues to offer new specialty sectors to evaluate and assess investment merits. We find some – but not all – specialty sectors attractive. LaSalle has been active in US medical office buildings for over two decades and we continue to see appealing value in this segment, although deal flow is limited. The outlook for single-family homes for rent (SFR) is varied. The long-term location dynamics of many build-to-rent projects appears challenging; meanwhile, infill scattered site has appealing fundamentals, but pricing is challenging because of a strong for-sale housing market and portfolio trades are limited. Industrial outdoor storage (IOS) is our preferred emerging specialty sector. Infill locations in major markets provide a mix of growth, capex profiles and yields that is very appealing.

Specialty sectors are less developed in Canada, but data centers are an area where it has unique advantages relative to other markets. The climate in Canada is friendlier to running these cooling-intensive assets and abundant hydropower in some locations is another advantage. It remains to be seen how these advantages will play out as large companies increase their investment in computing power, but Canada could emerge as a leader in this sector. Recent immigration-driven student population growth in Canada makes student housing compelling there, alongside population-driven sectors such as self-storage.

Creekview Crossing
Oregon, United States

THE EARLY BIRD:
THE BEST MARKET ENTRY POINTS TEND TO BE EARLY IN THE CYCLE

Capital markets

As discussed above and in the Global chapter, we believe there are signals that we are at the start of a new cycle, and there are good reasons to invest early in a new cycle. Looking back at historical real estate returns, timing matters regardless of the investment vehicle. Exhibit NA-k shows that the years right after the Global Financial Crisis (GFC) represented exceptionally strong vintage years for investment. We expect 2025 to be the best year in this cycle for entry into appraisal-based funds, and second best to 2024 for entry at market pricing. But we caution that our view on interest rates not falling back to the low levels from the last cycle means pricing dynamics will not likely enable returns at the same level as in that post-GFC period.

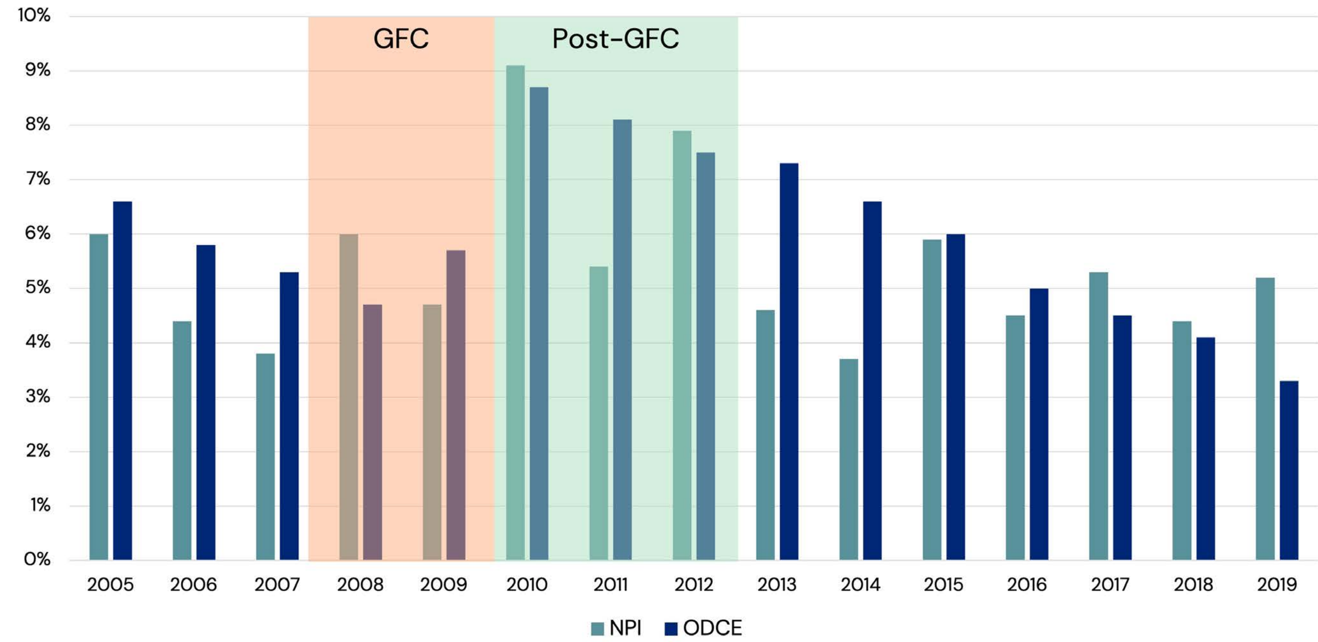
Despite our expectation of a strong vintage year, we believe transaction volume will only grow slowly throughout 2025 (see exhibit NA-l). We expect that many sellers will look ahead and believe that lower interest rates and stronger fundamentals are coming in 2026 and thus delay sales. On the buyer side, challenges to growing capital flows will remain as capital slowly moves back into real estate.

Predictions of capital flows start with the performance of the broader capital markets and the implications for real estate allocations, which then impact real estate capital flows (with a lag). US pension fund data in exhibit NA-m shows that changes in real estate allocations are often driven by the performance of other asset classes. The last two years of strong stock market performance have increased the total value of institutional portfolios, and with real estate values now lower, real estate allocations have moved down. With actual allocations declining, and no trend of reducing target allocation targets, we expect an increase in capital commitments in 2025.

But there are challenges that could impact capital flows. The first is the slow return of capital from closed-end funds over the last few years as fund managers wait for stronger market conditions to close positions. Exhibit NA-n shows closed-end fund distributed capital being slow in recent years across vintages. And for the capital allocated to closed-end funds, deployment is challenging because leverage and growth are not giving enough lift to returns. If interest rates come down and fundamentals improve as expected through 2025, the leverage and growth equation should help closed-end capital flows.

NA-k | Best vintage years come after challenges

Since inception total returns



Methodology: Returns are annualized through Q2 2024. NPI is calculated from respective vintage year start dates, while ODCE returns are annualized from Q1. For NPI, each vintage year starts in Q2 and includes all investments executed in that calendar year. ODCE includes all active investments (non-vintage) in each quarter.

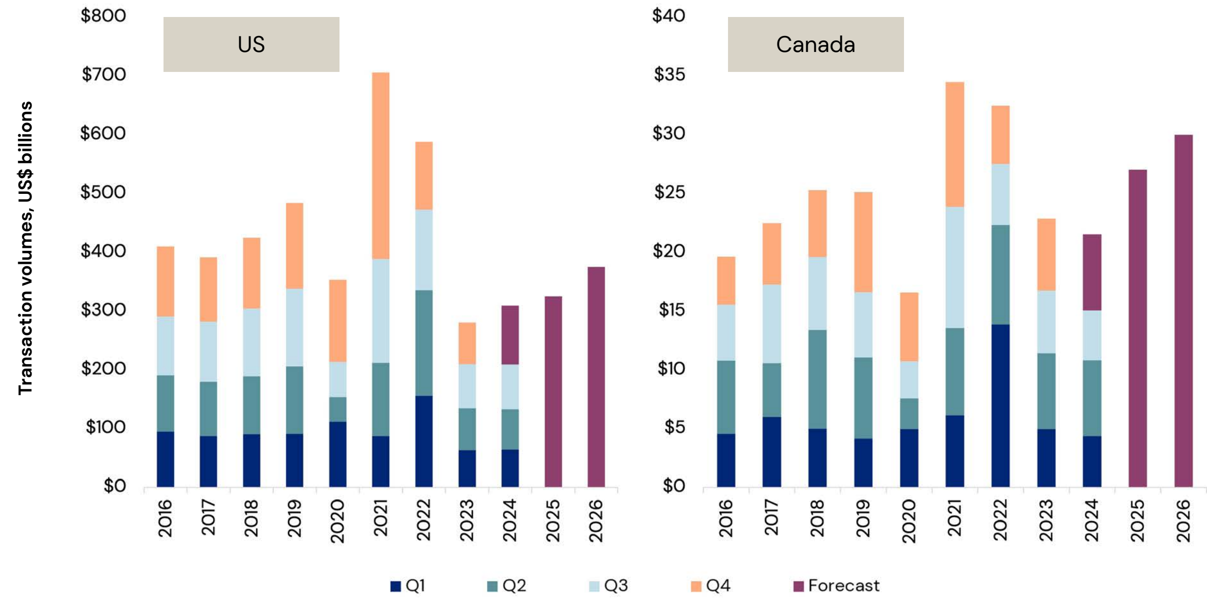
Source: LaSalle analysis on NCREIF NPI and ODCE (Q2 2024).

Note: Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue.

NA-l | Capital markets improve, but slow rebound in transaction volume forecast

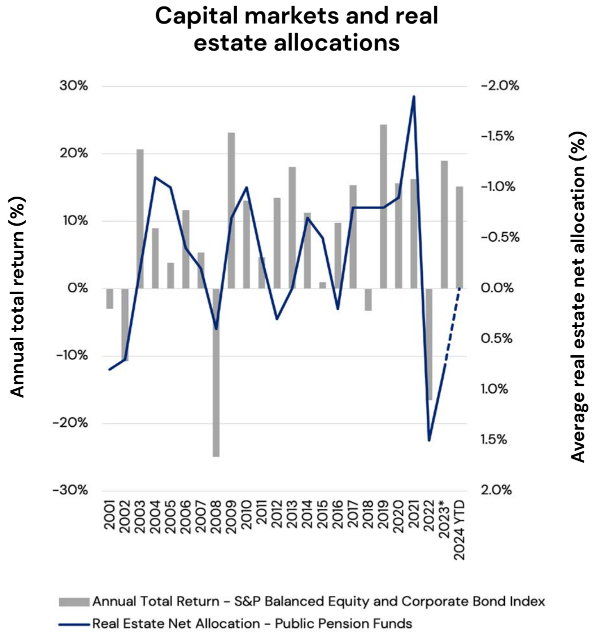
Transaction volumes

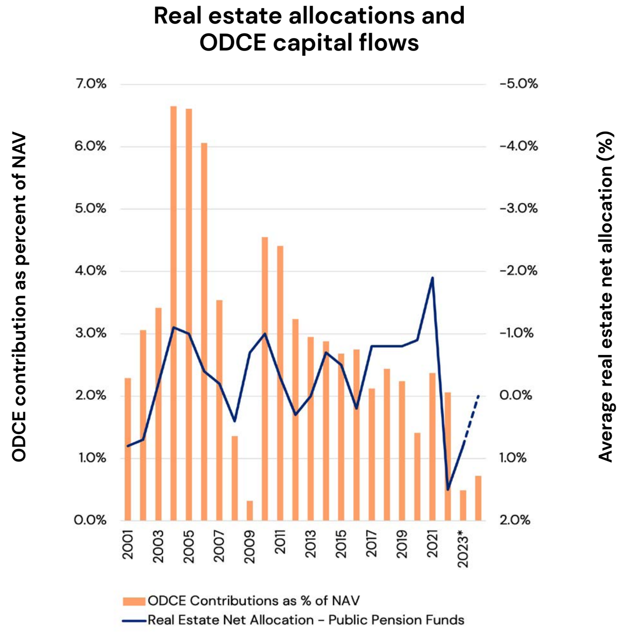
Trailing year transaction volume as percent of 10-year average		
	US	**Canada**
Retail	72%	84%
Office	45%	43%
Industrial	85%	118%
Apartment	62%	101%
Total	64%	88%



Source: RCA, Bloomberg. Note: Closed transactions; excludes privatizations, hotels, senior housing, and development sites.
Excludes transactions with a gross value of less than US$5 million. Data through September 2024. Most recent as of October 29, 2024.
Note: Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue.

NA-m | Capital markets improve, but slow rebound in transaction volume forecast





*Note: 2023 Public Pension Fund data is partial and includes information for 66% of the 228 Pension Funds surveyed. Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue.

Source: LaSalle analysis on Public Plans Database (September 2024), NCREIF (Q2 2024) and Bloomberg (September 2024). Public pension funds database includes information from 228 for a total value of US$4.8 trillion as of December 2022.

Another challenge for capital flows has been appraisal lag. Open-end core and core-plus funds are popular investment vehicles for institutions and individual investors, and pricing for these is based on appraisals. The appraisal lag means fund values do not bottom at the same time that market values bottom. So, while market pricing seems to have hit bottom at the end of 2023,[12] for the first half of 2024 the early bird targeting open-end funds might not have gotten the worm as appraisal values continued to trend lower.[13] But we believe the lag has run its course, and the opening of 2025 could be the time investors get comfortable with appraised values. This would help capital flows, but investors might still be troubled by funds with large redemption queues, and we agree it is better to have new capital contributions helping buy real estate rather than redeeming other investors.

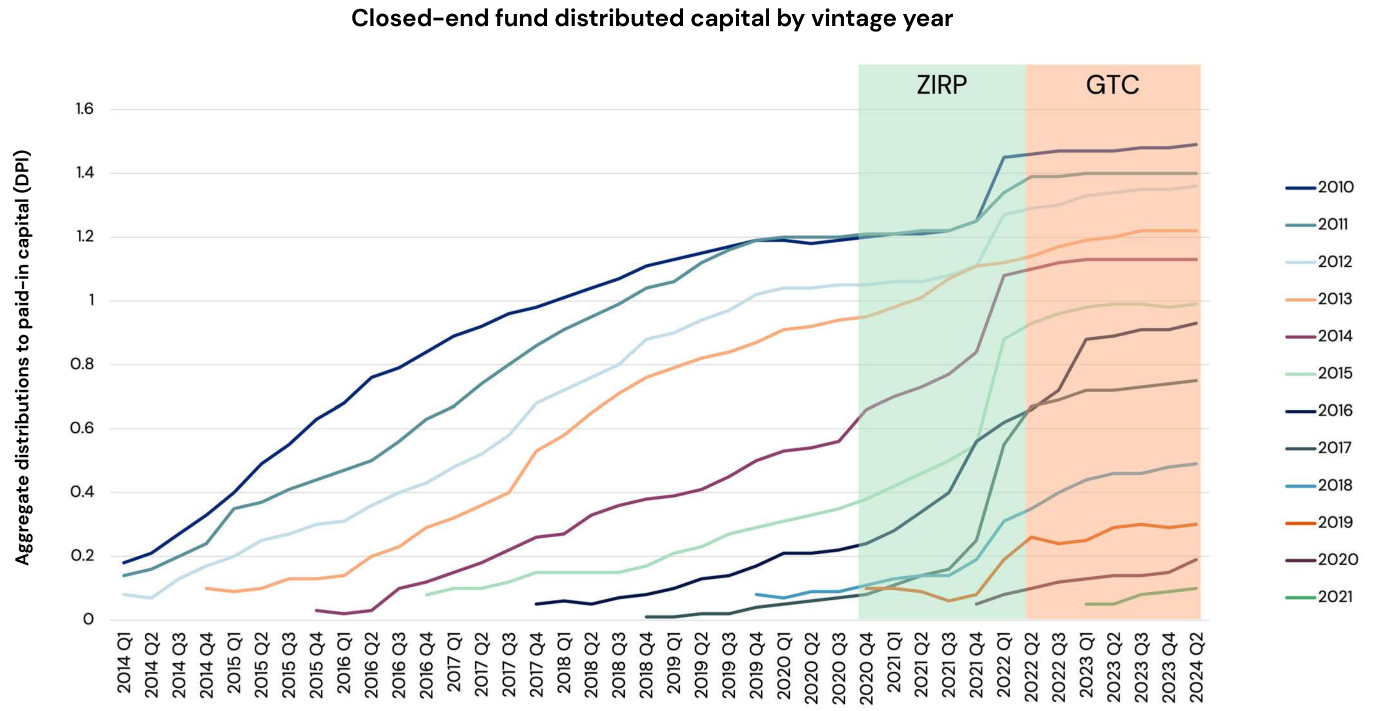
Another entry point is through the public REIT market, but that turning point has already occurred, with REITs up 7.6% YTD (and up 35% from their trough in late October 2023.)[14] This is not to say REITs are over-priced, and LaSalle's recent paper[15] makes the case for REITs ability to use share price premiums and attractively priced unsecured debt to acquire attractively priced real estate and generate strong returns.

The best path to access the market today is with capital placed directly into new acquisitions. Direct real estate investment enables this, but that is only available to the largest investors. Co-investment alongside a fund can also fill this need and provide an investor an important tactic for market entry. Short of those options, investors should seek out funds where new capital is being placed in the market rather than being used to pay redemptions to existing investors.

The cycle for debt investment is distinct from equity investment and requires different framing. Debt investments are particularly attractive when the upside from equity is more than outweighed by the downside protection in a debt position. That time seems to have passed, but there are still reasons to allocate to debt in today's environment. First, interest rates remain high relative to historic levels, which is a benefit to investors seeking high absolute current cash yields. Second, there are structural tailwinds to private real estate debt investment as banks dial back direct mortgage activity in favor of providing cross-collateralized "back-leverage" to debt portfolios. Finally, debt can have a role to play in investment portfolios across cycles by offering diversification, income-driven returns, and downside protection. These features can be particularly appealing in periods of elevated volatility, like we are in today.[16]

12. Green Street Advisor's CPPI shows the value trough at the end of 2023.
13. NCREIF ODCE index had negative appreciation through Q3 2024 and negative total returns in H1 of 2024.
14. Based on S&P's U.S. Equity All REIT index total returns. As of November 21, 2024.
15. See LaSalle's report ISA Briefing: A new "golden era" for REITs and real estate?
16. For additional detail see LaSalle's report ISA Focus: Investing in real estate debt.

NA-n | Slow return of capital from closed-end funds in recent years



Source: LaSalle analysis of Cambridge Associates data (through Q2 2024).
Note: Past performance is not indicative of future results. There is no guarantee that any trends shown herein will continue.

ZIRP: Zero Interest Rate Policy – Pandemic and post-pandemic periods of zero interest rates
GTC: Great Tightening Cycle – Inflationary period of rising interest rates

LOOKING AHEAD

- Real estate transaction volumes should continue their slow recovery. Market conditions should bring more liquidity, but the appetite to sell and capital to buy will remain below average for the next year.
- Real estate index returns should trend higher, with income providing most of the total return and appreciation adding a small lift.
- Industrial rent and value growth should outperform apartments as fundamentals recover faster due to a supply pipeline that is falling faster to below-average levels.
- Office investment is expected to be back on the menu for investors seeking higher returns. Risks remain elevated and pricing could run past what we consider attractive value, but early signs are that attractive options will be available.
- Climate change and residential rental affordability challenges increase the risk that local regulations will impact investment performance. We expect this to be a growing priority for investors to navigate those local dynamics as national policy in these areas is limited.

ISA by LaSalle | Insights Strategy Analysis

OUTLOOK ASIA PACIFIC 2025

LaSalle | Investing today. For tomorrow.

ISA Outlook 2025

ASIA PACIFIC

Potential structural and cyclical changes colliding

The current cycle in Asia Pacific is not a simple repetition of a typical cycle. While Asia Pacific economies have not been immune to supply chain disruptions and elevated inflation, interest rates and construction costs, real estate capital market liquidity in the region (ex-China and Hong Kong) has fared much better than in other parts of the world.

We see signs of structural changes and a distinctly different cycle from historical norms in the macroeconomy, as well as in several real estate markets and sectors. As a case in point, China could easily be mistaken for Japan 10-20 years ago, struggling with deflationary pressures and an erosion in land prices.

Certain factors, such as climate change or the acceleration of artificial intelligence (AI), are not unique to the region. Some, such as adjustments in monetary policy, could have a relatively immediate impact on economies and real estate fundamentals. Others, such as labor market reforms (e.g., in Japan) or supply chain restructuring, could take years or even decades to manifest. Signs of structural change and a markedly different cycle point to the potential for a significant deviation from historical norms and a lack of mean reversion to historical trends. These factors could have a combination of positive and negative implications for investors, some of which may only become apparent years later.

Our *ISA Outlook 2025* Global chapter focuses on four themes for the year ahead. Look for these icons throughout this chapter whenever we tie back our observations for Asia Pacific to these global themes.

THE MORNING SKY
Falling rates but risks on the horizon

THE CAPITAL STACK HANGOVER
Clear-headed investors have an advantage

THE BREAKFAST MENU
Making sense of complex investment options

THE EARLY BIRD
The best market entry points tend to be early in the cycle

Project Platinum
Tokyo, Japan

Stark contrast between China and Japan

The most pronounced signs of structural change or a distinctly different cycle can be observed in China and Japan. These two major economies in the region demonstrate the starkest contrast to global trends in the region, and stand in sharp contrast to one another (see exhibit AP-a). In China, the plummeting housing market and a multi-decade low in consumer confidence are exerting deflationary pressure on the economy. The People's Bank of China (PBOC) has pushed interest rates to record lows. In contrast, Japan in 2024 appeared to be exiting its roughly 30 year-long deflationary environment. In March 2024, the Bank of Japan (BOJ) made a historic shift from its unorthodox monetary policy and began to raise policy interest rates.

IN HINDSIGHT

Looking back on key calls from last year's *ISA Outlook* Asia Pacific chapter.

Right / Mostly right

Remains to be seen

Not right / Not quite right

Japan: *"Most likely, even in an environment where inflation can sustainably exceed the 2% target, interest rates in Japan are likely to be substantially lower than those in the rest of the world."* (*ISA Outlook 2024*, p. AP-60)

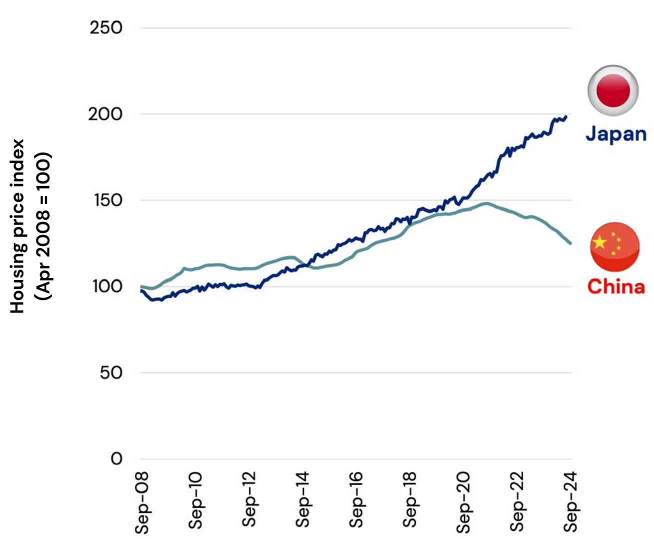
We stand by this call. The BOJ raised interest rates in 2024. Interest rate hikes in Japan are likely to continue in the next 12 months. However, the magnitude of interest increase is likely to be moderate due to the narrowing interest rate differential between it and the US following the Fed rate cut. Moreover, the BOJ is also expected to exercise caution in the near term, given the potential for some political uncertainties before the 2025 Upper House election.

From September to mid-November of 2024, **China** launched the largest economic stimulus campaign since the pandemic, including a substantial package of fiscal measures, policy changes and historically low interest rates. While the latest stimulus measures represent a step in the right direction, they are far from sufficient to address the current economic problems, namely a depressed housing market, lack of consumer and business confidence, indebted local governments, and a shrinking and aging population. Given heightened geopolitical tensions between the US and China, and the absence of impactful structural reforms or larger-scale stimulus packages, the Chinese economy is likely to remain depressed for an extended period. These circumstances should contribute to a challenging environment for China's residential and commercial real estate markets over the next few years.

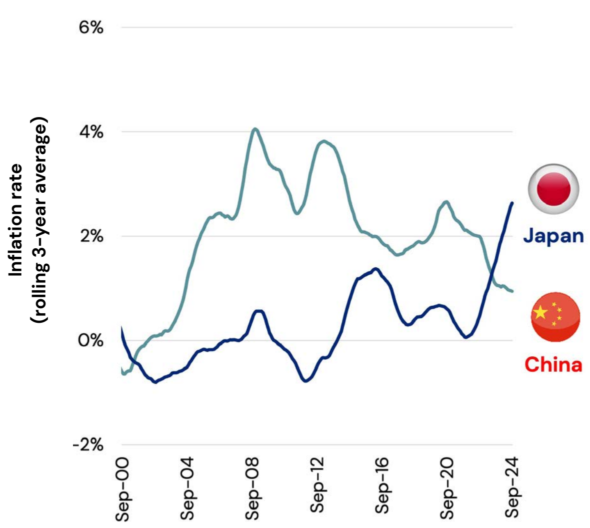
With a bias toward raising rates and reflation, **Japan** is in a considerably different position. That said, the BOJ is emphasizing flexibility and predictability after the Japanese stock market experienced historic volatility following the July rate hike. The snap election on October 27, 2024 resulted in a surprise defeat for the Liberal Democratic Party (LDP), which lost its outright majority in the Lower House for the first time in 15 years. A degree of political uncertainty is likely until the Upper House election, likely to be in July 2025. Japan could muddle through this period, if wage growth continues beyond 2025 and the government deploys more ammunition to boost household spending to cope with the high cost of living. The BOJ might have to be mindful of raising interest rates too quickly or too sharply in the interim, which could be welcome news for real estate investors.

AP-a | Diverging trends in China and Japan

Housing price index



Headline inflation

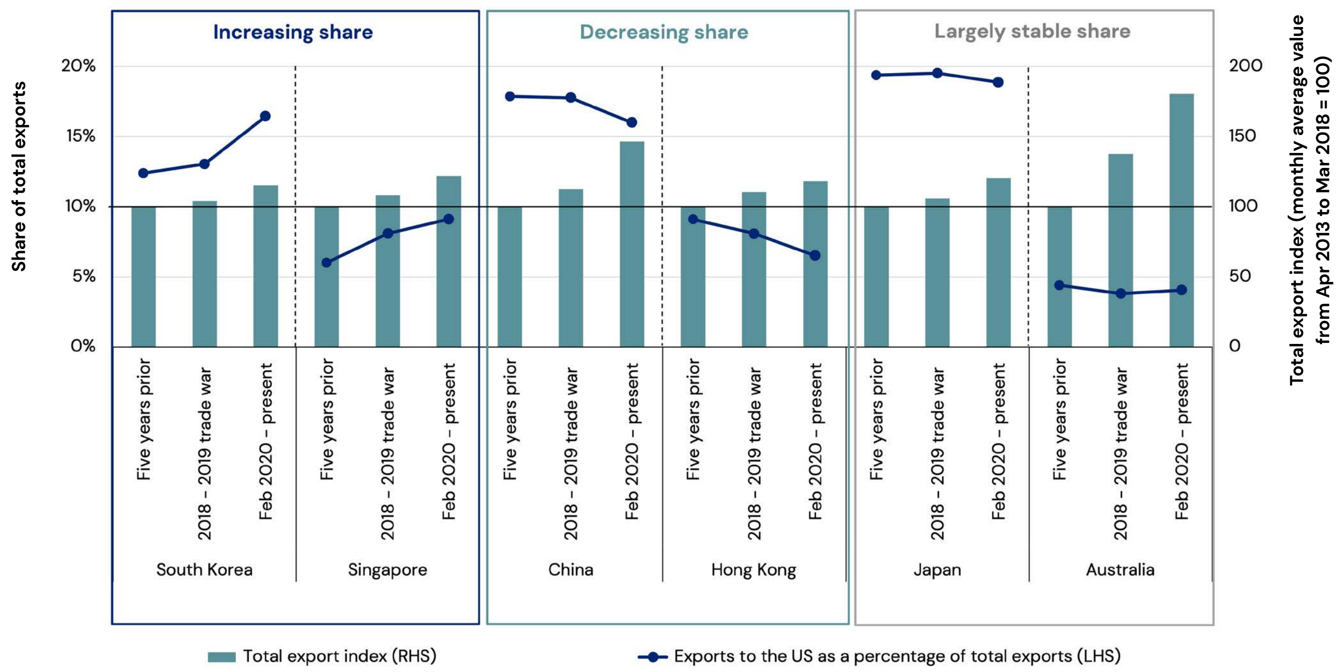


Note: The housing price index is based on existing home sales prices in 70 major cities in China and on new and existing condominium prices in Japan.

Source: WIND (China housing price), CEIC (Headline inflation and Japan housing price), as of September 2024.

AP-b | Total exports increased during the 2018-2019 Trade War

Total exports and share of exports to the US



Note: The total export index and the share of exports to the US are based on monthly export data for each market. The 2018-2019 trade war was from April 2018 to January 2020, five years prior to the 2018-2019 trade war was from April 2013 to March 2018 and present is as of September 2024 for Australia, Hong Kong, Japan and Singapore and as of October 2024 for China and South Korea.

Exports are based on local currency except for China and South Korea which are in USD.

Source: The Australian Bureau of Statistics, the Census and Statistics Department of Hong Kong, the Ministry of Finance of Japan and Enterprise Singapore, as of September 2024; the General Administration of Customs of China and Korea Customs Service, as of October 2024.

Trade and Trump 2.0

Adding to the complexity, US President-elect Donald Trump's victory is likely to usher in a period of heightened economic uncertainty and capital market volatility for most Asia Pacific economies.[1] Trump 2.0 may come to be characterized by aggressive trade policies, pockets of strained geopolitical relationships and a need for strategic adaptation among the region's governments, businesses and investors. China is particularly vulnerable and, to a lesser extent, Hong Kong. Other Asia Pacific nations will need to balance their relationships with both the US and China. Potential supply chain disruptions in countries such as Australia, Japan, South Korea and Southeast Asian countries linked to China also cannot be ignored, as China remains their largest trading partner. All countries in the region will have to consider whether trade barriers require a domestic policy response, such as stimulus measures.

That said, it is too early to tell whether the US will end up imposing tariffs that are as broad or as high as what was pledged on the campaign trail, or if the Trump Administration will take the opportunity to negotiate bilateral trade agreements with key trading partners in the region. The 2018-2019 trade war demonstrated that the imposed tariffs can be lower than those proposed if China imports more US goods to narrow the US trade deficit. While the share of exports going to the US varied, total exports of major Asia Pacific economies in value terms generally increased (see exhibit AP-b). Looking ahead, the Trump 2.0 era could lead to periodic episodes of capital market volatility. Investors may therefore consider focusing on Asia Pacific real estate markets/sectors that are anchored by domestic demand (e.g., Japan multi-family, Australia industrial) and domestic capital (e.g., Japanese real estate, Seoul office).

1. While we covered the global and US implications of the US election result in our *ISA Briefing, "The Red Sweep and real estate,"* the implications specific to the Asia-Pacific region deserve special treatment.

SOUTH KOREA

Two engines with uneven thrust

South Korea's economic performance in 2024 resembles a dual-engine plane flying with one engine noticeably underperforming. Exports (particularly of semiconductors) are the powerful primary engine, propelling the country's economy on the global stage. However, domestic consumption, the second engine, is running at a reduced capacity, limiting the plane's ability to reach its full potential. This imbalance makes the economy more susceptible to unexpected headwinds. The risk of a potential US-China trade war 2.0 clouds the outlook for South Korea's exports, particularly the semiconductor exports. While the global AI boom presents a mitigating factor, it may take time for South Korean firms to secure market share in this evolving landscape. The recent developments in domestic politics further complicate the outlook, potentially hindering the effectiveness of fiscal policy support. Nonetheless, the Bank of Korea is taking a proactive monetary policy approach to mitigate some potential external shocks and stimulate domestic demand. While we recognize the difficulty of predicting precise economic outcomes, economic growth in South Korea is expected to decelerate in 2025, suggesting no or limited growth potential even in resilient real estate sectors (e.g., office).

AUSTRALIA

Slowing tailwinds

The tailwinds to Australia's economic growth momentum are weakening. The government's objective to reduce net migration by 2025 could reduce immigration's contribution to GDP growth from the peak level seen over the past two years. Government spending is projected to reach a record high by the end of 2025[2] but could slow thereafter as tax revenue declines. The good news is that more jobs are being created, especially in healthcare, keeping the unemployment rate comfortably below the historical average.[3] However, the tight job market contributes to elevated inflation which remains broad-based and stubbornly above the Reserve Bank of Australia's (RBA) 2-3% target. Due to elevated inflation and the low unemployment rate, financial conditions in Australia are expected to remain tight in the near term. Furthermore, even after the July 2024 tax cuts, consumer spending is expected to remain tepid by historical standards, as households prioritize savings and debt reduction over discretionary purchases. In 2025, economic growth is expected to remain below its historical trend for a third consecutive year, though a recession is unlikely. Amid the decelerating economic growth outlook, the recovery in unfavored real estate sectors (e.g., office) is likely to be constrained in the near term, while continued strong growth in favored sectors (e.g., industrial and living) should be limited.

2. Source: Westpac Banking Corporation, as of October 16, 2024.
3. The historical average unemployment rate was 5.2% from 2004 to 2023. Source: The Australian Bureau of Statistics, as of 2023.

IN HINDSIGHT

South Korea: *likely to be first-in-first-out, "The BoK [Bank of Korea] is likely to be the first to end its rate hike cycle."* (ISA Outlook 2024, p. AP-62).

We rightly pointed out that the BoK was likely to be the first to end its rate hike cycle in Asia Pacific. In light of the US Federal Reserve's initial rate cut in September 2024 and the stabilization of inflation and household debt levels in South Korea, the BoK proceeded to cut interest rates by 25 bps on October 11, 2024. This was done with the objective of rebalancing the export-reliant economy by stimulating domestic demand and investment.

IN HINDSIGHT

Australia: *"The Reserve Bank of Australia (RBA) is one of the few central banks with an explicitly defined triple mandate to maintain price stability, promote full employment and ensure financial stability. The RBA intends to pause rate hikes to balance the three objectives."* (Outlook 2024, p. AP-61).

We were mostly right. Over the past 12 months, the RBA has maintained interest rates at their current levels, largely due to concerns over inflation and the near-historically low unemployment rate. In the near term, uncertainty over inflation and government spending is likely to keep interest rates high-for-longer.

Project Genesis
Seoul, South Korea

SINGAPORE

Growth momentum peaking

Singapore's economy demonstrated resilience for most of 2024, buoyed by an unexpected increase in global demand, particularly within trade-related sectors. Nevertheless, should the US impose heavy tariffs on Singapore or its key trade partners, there could be a potential slowdown in the recent trade momentum. Conversely, should the US-China geopolitical tensions intensify, Singapore could continue to attract investment inflows diverting from China and Hong Kong, particularly in the wealth management industry. During the first eight months of 2024, there was an 18% increase in the number of family offices.[4] While wage growth is coming off its cyclical peak, the labor market remains healthy. Singapore's economy is expected to grow by 1-3% in the next two years,[5] slightly below the historical average. As the growth momentum of several real estate demand drivers decelerates, the potential for rental growth in real estate sectors with near-term supply is limited.

IN HINDSIGHT

China: *"We expect domestic investors, especially insurance companies, state-owned enterprises, RMB funds and REIT managers, to continue to dominate the capital market and some could even speed up the pace of investments in the next 12 to 18 months."* (ISA Outlook 2024, p. AP-64).

Although we correctly predicted that domestic capital sources would continue to dominate the capital market in China, we did not anticipate a significant deceleration in the pace of capital deployment. Due to deteriorated occupier fundamentals and the weak economic outlook, domestic investors have become highly selective, with the majority of transactions conducted on a non-arm's length basis.

HONG KONG

Weighed down by China

Hong Kong's economic growth has slowed, mainly driven by declining retail sales due to cost-conscious mainland Chinese tourists, a strong Hong Kong dollar and Hong Kong residents diverting spending to across the mainland border. These trends are expected to continue in the near to medium term. The territory's close link to US monetary policy through the US dollar currency peg could provide some relief to capital market liquidity, if the US Fed continues to ease interest rates. However, we maintain a high degree of caution about the outlook for Hong Kong's economy and capital market liquidity, due to its close ties to mainland China.

4. Source: The Straits Times "Single family offices in Singapore balloon to 1,650 amid thriving wealth management sector," as of September 7, 2024.
5. Source: Bloomberg, as of November 8, 2024.

Regional opportunities and risks

The diverse and complex Asia Pacific macroeconomic environment addressed on the preceding pages presents a variety of opportunities for real estate investors with a range of risk-return profiles.

MULTI-FAMILY

At a nascent stage, except Japan

The living sectors across Asia Pacific are undergoing significant transformation driven by demographic shifts and policy support. For example, as household sizes shrink in most major Asia Pacific markets due to delayed marriages and low fertility rates (see exhibit AP-c), there is a growing preference for renting over owning. In the near term, we maintain a positive rental growth outlook for most multi-family rental markets in Asia Pacific, recognizing their ability to pass through inflation due to typically short lease terms.

Japan multi-family leads as a well-established market characterized by stable net operating income (NOI), deep institutional ownership and healthy liquidity, keeping it attractive to core investors. Despite high entry prices, recent wage growth momentum creates opportunities for investors to pursue value-add strategies, such as retrofitting of older buildings and improving amenities.

Markets in the rest of the region are still in their infancy in terms of professionally managed multi-family rental units, implying potential for institutionalization. The Australian government plans to reduce net migration by 2025 while maintaining migration pathways for the long run. Going forward, it may be difficult to achieve high returns in Australia due to normalizing rental demand and high interest rates, but the living sectors remain attractive to investors with long or flexible investment horizons.

Similar to Australia, young adults in South Korea opt to rent due to lifestyle preferences and high housing prices. In addition, tenants are shifting from Jeonse[6] to monthly rent contracts, and this trend is expected to continue. Investment opportunities could emerge in areas where a young population concentrates. Since the multi-family rental sector is still in its infancy, exit liquidity is not yet proven. It would therefore take time to fully unlock value in this emerging sector.

In China, despite favorable policy toward the sector, the near-term outlook remains uncertain. For example, in Shanghai, the government's commitment to social security housing[7] and tax reductions for landlords and operators have spurred investments, but have also led to oversupply in selected submarkets. Non-core districts are more vulnerable to supply risk than core districts. Additionally, ongoing concerns over job security and income reductions could continue to weigh on tenant affordability.

OFFICE

Navigate cycle changes versus potential for structural shifts

The office landscape in Asia Pacific is more complex than ever. Office markets in Seoul, Singapore and Japan are undergoing somewhat of a typical cycle, while Greater China and Australia are demonstrating signs of potential structural changes (see exhibit AP-d). Office market performance across the Asia Pacific region is likely to vary significantly by market, location, tenant profile, building specification and sustainability credentials. In addition, the timing of entry and exit and risk mitigation plans are becoming increasingly important.

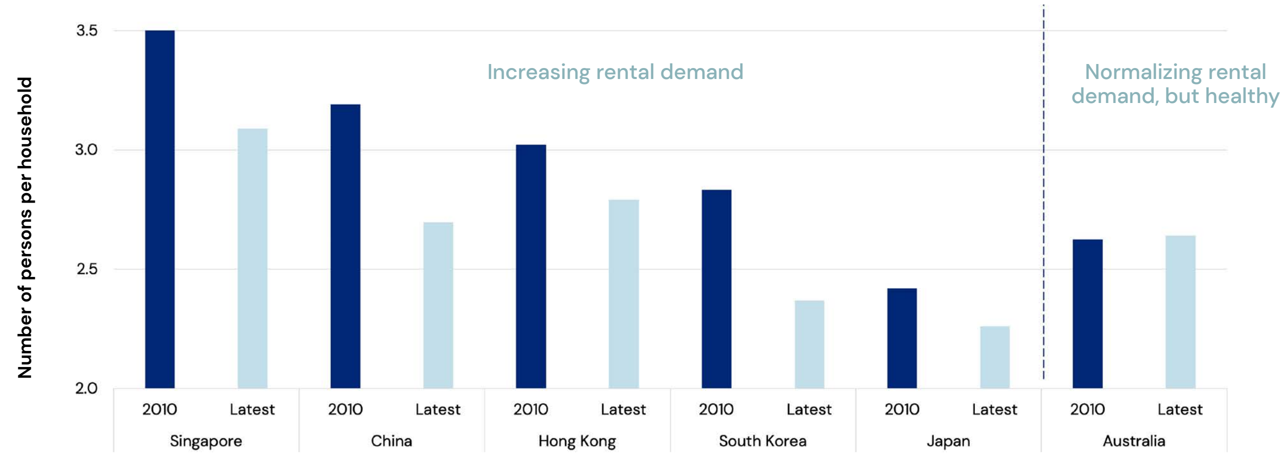
6. Jeonse is a unique residential rental system in South Korea. In lieu of regular monthly rental payments to the landlord, a one-time lump sum payment (up to 50-80% of the property's value) is made for the duration of the contract. Monthly rental contracts have overtaken Jeonse contracts since 2023.
7. Social security housing is a type of multi-family in which rents are set at 10% below market rates and annual rent growth is capped at 5%. The interiors and indoor facilities of social security housing are similar to those of market-rated multi-family.

Seoul stands out as the healthiest office market in the region, with low single-digit vacancy rates. Strong demand is mainly driven by domestic conglomerates supported by technology and export-oriented industries. Looking ahead, the potential economic deceleration due to uncertainty in exports, particularly semiconductor exports, suggests no or limited rental growth potential in the Seoul office sector in 2025. For higher-return strategies, asset-level leasing plans and disciplined investment horizons are critical, as net effective rent has grown over 50% since 2019,[8] and more pipeline projects will be coming to the market after 2028.

8. Source: JLL REIS, Q3 2024

AP-c | Asia Pacific Multi-family: A supportive demographic trend

Average household size: 2010 versus latest

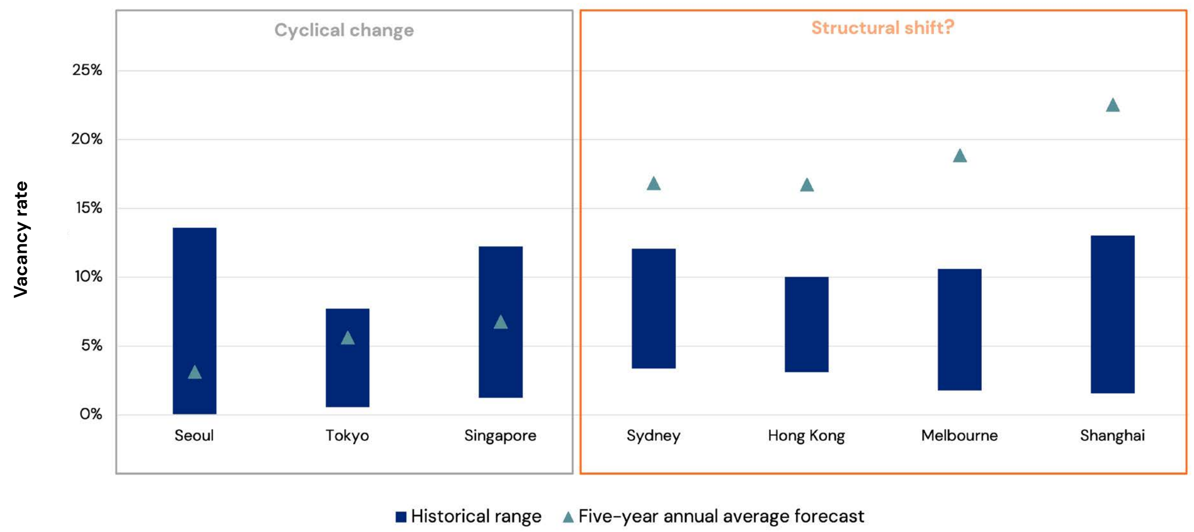


Note: Due to data availability, the latest data for Australia is as of 2016, for Japan and China are as of 2020, for Singapore is as of 2022, for Hong Kong and South Korea are as of 2023.

Source: Oxford Economics, as of 2023.

AP-d | Asia Pacific Office: Navigate cycle changes versus potential for structural shifts

Office vacancy rate: Long-term historical range versus five-year forecast



Note: The long-term historical vacancy rate time series for most markets are from 2000 to 2019, except for Shanghai (from 2007 to 2019).

The five-year annual average vacancy rate forecast is from 2025 to 2029.

Vacancy rates are based on all-grade offices for Melbourne CBD and Sydney CBD, grade-A offices in Tokyo 5-ku and investment-grade offices in Shanghai CBD, Hong Kong (including Hong Kong Island, Tsimshatsui and Kowloon East), Singapore CBD and Seoul (including CBD, Gangnam and Yeouido).

Source: JLL REIS, LaSalle Investment Management, as of October 14, 2024.

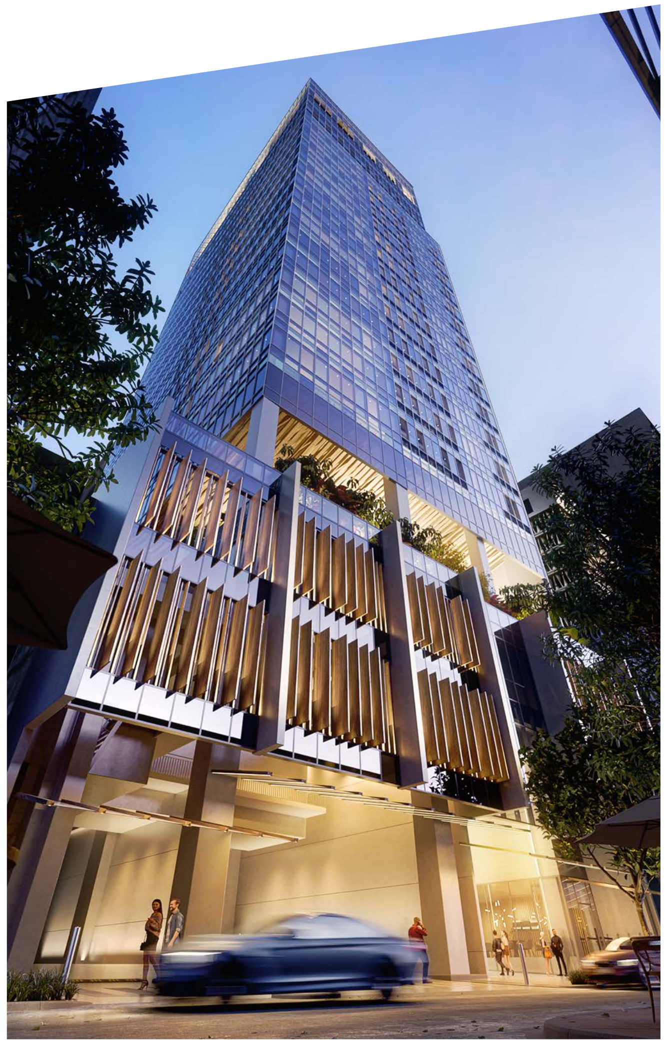
“In Singapore, both occupier fundamentals and capital values are peaking.”

Office market fundamentals in Japan remain relatively sanguine by global standards, but there are potential risks associated with rising interest rates and high supply pipelines in select locations. Most Japanese companies are encountering challenges in attracting talent. In response, the government has introduced a series of labor market reforms to enhance worker mobility and re-skilling. Additionally, the outlook for corporate profitability varies by company size and industry, influencing tenant preferences. Large conglomerates and companies in growth industries like technology are in a favorable position to afford high-quality offices, while tenants with constrained corporate budgets should continue to prioritize affordable rents in locations with convenient commutes to attract talent. Additionally, leasing strategies that target specific tenant profiles and preferences are crucial to drive NOI growth and mitigate risks going forward.

In Singapore, both occupier fundamentals and capital values are peaking. In the next 12-18 months, the market is likely to experience limited expansionary demand and higher new supply. However, for investors with flexible investment horizons or seeking to preserve wealth over the long term, freehold offices in prime locations, which are scarce, remain an attractive proposition despite cooling fundamentals.

In China, Hong Kong and Australia, which are showing signs of potential structural change, a near-term return of market fundamentals to their historical norm would not likely be in the offing. Weak business conditions and the downsizing of foreign companies in China and Hong Kong have significantly reduced office demand, casting uncertainty over whether demand will return to pre-pandemic levels. Despite easing financial conditions, low liquidity and weak fundamentals should continue to impact capital values.

It is too early to enter these office markets despite discounted prices. In Australia, the potential increase in return-to-office mandates in 2025 may improve office utilization, but it is unlikely to materially improve the supply-demand imbalance over the next three to five years. Moreover, starting in July 2025, government tenants will have a higher minimum NABERS energy rating requirement for new office leases.[9] This is likely to further concentrate demand for prime-grade offices, at the expense of secondary-grade offices. The weak office fundamental outlook and a high-for-longer interest rate environment suggest that office capital values in Australia are likely to remain under downward pressure in the next few years. Therefore, it is likely too early to enter the Australian office market unless prices are adjusted to reflect these risks.



Project Solitaire
Singapore

9. NABERS refers to the National Australian Built Environment Rating System. It provides sustainability measurement across property sectors.

LOGISTICS

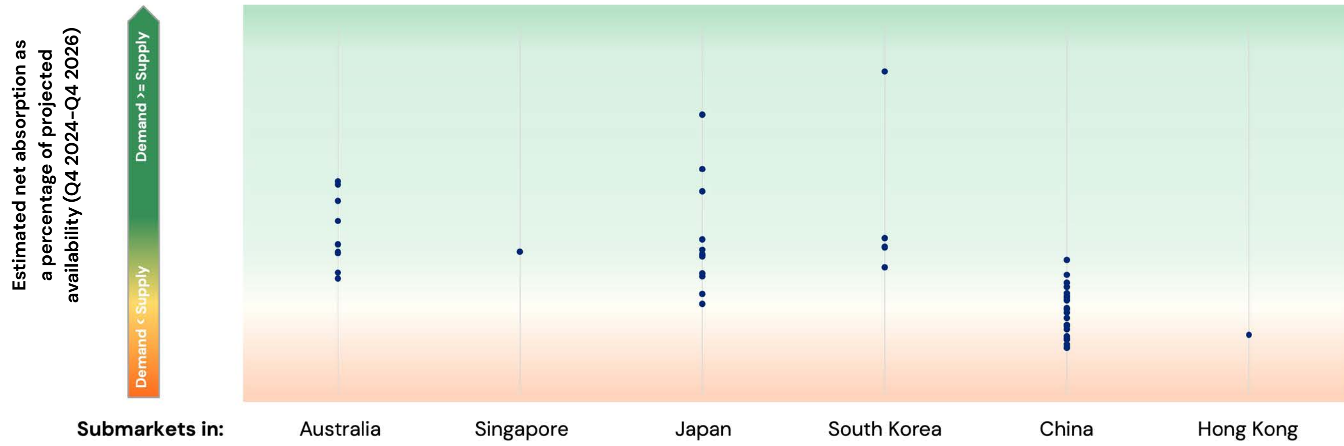
Not a clear outperforming sector

The dispersion of performance across logistics markets in Asia Pacific has widened. Australia, Singapore and several markets in Japan, such as Greater Fukuoka, are maintaining relatively balanced supply-demand dynamics. While investment opportunities remain in these markets, logistics prices are high despite a slowing outlook for rental growth, pushing down return expectations. In China and Hong Kong, high supply and/or plummeting demand have led to a substantial supply-demand imbalance and a sharp decline in rents, which is expected to continue for an extended period. Despite the correction in asset prices, investors might want to consider avoiding these markets in the short to medium term, unless they have a high risk appetite or long or flexible investment horizons.

The supply-demand dynamics also differ drastically across logistics sub-sectors and submarkets (see exhibit AP-e). For instance, in Greater Seoul, the oversupply of cold storage facilities has led to their underperformance relative to dry warehouses. With improving borrowing costs in South Korea and a conservative underwriting approach, discounted entry prices have created select opportunities for leased or pre-leased dry warehouses. On the contrary, in Greater Tokyo, dry warehouses in selected submarkets are facing increasing supply in the near term. But there remains a shortage of modern cold storage facilities, creating opportunities in locations close to suppliers, consumers, expressways, existing aging stock (to capture demand for upgrades) and, most importantly, near port areas (to capture demand for imported food). These nuances suggest that market, submarket and sub-sector selection remain important but may be insufficient to generate the returns that investors were accustomed to a few years ago.

AP-e | Asia Pacific Logistics: Australia the healthiest, China and Hong Kong the weakest

Logistics: Supply versus demand at the submarket level



Note: The projected availability is based on the sum of existing vacancies and projected supply pipelines from Q4 2024 to the end of 2026. The estimated net absorption is based on historical demand over the last three years and adjusted with forward-looking demand drivers over the same period as the projected availability.

The latest data is as of Q3 2024 except for Japan, which is as of July 2024.

Source: Ichigo Real Estate Services (Japan), as of July 2024; JLL REIS (all markets except Japan), as of Q3 2024; LaSalle Investment Management, as of October 14, 2024.

Logiport Tama Mizuho
Tokyo, Japan

Kishiwada CanCan Bayside Mall
Osaka, Japan

For logistics value-add and development strategies in the region, in-house leasing and execution capabilities are key to outperformance under the current market environment of elevated land and construction costs. Furthermore, for development strategies in Japan, labor shortages pose another challenge, so the ability to secure general contractors is essential.

RETAIL

Distinctive consumption patterns

Asia Pacific's retail sector is dynamic and heterogeneous, encompassing a wide range of sub-sectors and markets with distinct consumption characteristics. As such, it is not fair to say with a broad brush, as we have in other markets, that it has "rebalanced." Only well-managed retail assets that have adapted their tenant mixes and market positioning in response to changing consumption habits will outperform, adding to operational intensity. Some assets are transforming into vibrant social hubs that offer a diverse range of experiences (e.g., live performances, libraries), cater to local tastes (e.g., seasonal festivals) and adopt omnichannel strategies. A granular, asset-level approach to investment is crucial, given the performance variations across markets and subsectors.

China's recent trends reveal a marked consumption downgrade, as evidenced by a reduction in luxury spending, a preference for discount retailers, delayed big-ticket purchases (e.g., automobiles) and increased household savings. This retrenchment is expected to continue and weigh down occupier demand and asset valuations. In the near term, real consumer spending in Singapore is expected to be relatively flat, while in the Australian and Hong Kong markets, it is expected to decline. However, a widespread, pronounced consumption downgrade analogous to China's is not foreseen in these markets. Although some retail asset valuations have been adjusted downwards, it is premature to consider investments in these markets unless there is a rationale for deal-specific strategies.

The retail sector in Japan is characterized by distinctive dynamics, notably a strong preference for in-store shopping compared to other Asia Pacific markets and tourist consumption supported by a relatively weak yen. Consumer spending has recovered to pre-pandemic levels in value terms. However, consumers are cost conscious due to inflationary pressures, and are expected to continue to prioritize non-discretionary and service-oriented spending in the near term. There could be selective core or value-added opportunities in Japanese retail, particularly for non-discretionary and service-oriented asset types, or to a lesser extent, tourism-driven properties.

HOTEL

Momentum mostly priced in, except Japan

Outside Japan, Asia Pacific's hotel sector offers only a limited set of investment opportunities that are attractive on a risk-adjusted basis. Hotel markets such as Australia, Singapore and South Korea are trending towards normalization in demand (see exhibit AP-f on the next page), given the outlook of slowing domestic consumption and the lack of inbound Chinese tourists. Furthermore, hotel transaction prices in these markets indicate that the post-pandemic recovery has been reflected in current prices. Therefore, there are limited opportunities for high-return strategies in these markets over the near term.

The hotel sector outlooks for China and Japan, the two largest hotel markets in the region, present contrasting dynamics. China's hotel sector, predominantly reliant on domestic demand, is expected to continue to face headwinds from excessive existing hotel stock and declining tourism spending per person. A decrease in transaction prices is not sufficient to compensate for these risks. In contrast, the

IN HINDSIGHT

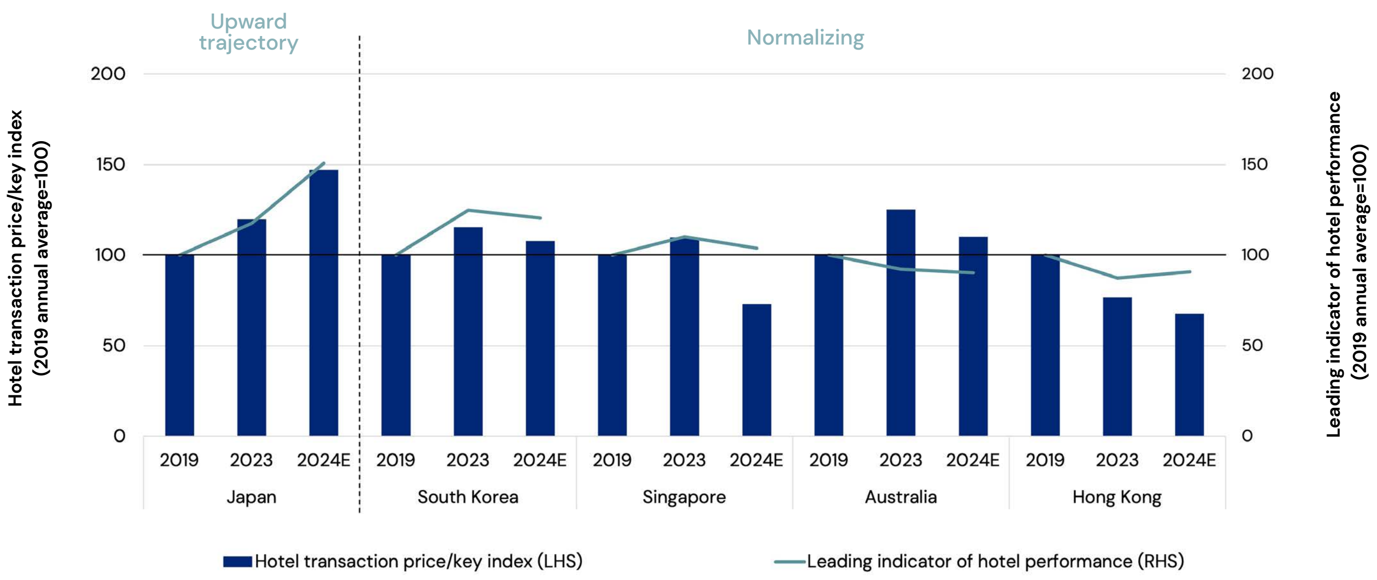
Hotel: *"Countries with relatively weak currencies (e.g., Japan and South Korea) are seeing higher hotel demand from inbound travelers, while keeping domestic travelers onshore." (ISA Outlook 2024, p. AP-66)*

We are mostly right. The relatively weak yen has encouraged Japanese residents to vacation within the country and attracted an increasing number of inbound tourists. Most economists expect that the yen will strengthen but remain relatively weak by historical comparison over the next two to three years, which is likely to support both domestic and inbound tourism in the near term.

Project Tifety
Okinawa, Japan

AP-f | Asia Pacific hotel: Momentum mostly priced in, except Japan

Leading indicator of hotel performance versus hotel transaction price trend



Note: The index on median hotel transaction price per key is derived from median prices in local currency. The estimated 2024 hotel transaction price per key is as of Q3 2024. Due to limited data availability for South Korea, RevPAR is utilized as a proxy for hotel performance in 2019 and 2023.

The Skift hotel health score measures the performance of the hotel sector based on searches for future hotel stays, reservations made for upcoming stays, and key performance indicators, including hotel occupancy and average daily rate (ADR) based on the average scores for the first nine months of 2024.

Source: MSCI/ RCA (median hotel transaction price per key), as of Q3 2024; Skift Research (hotel performance leading indicators for all markets except South Korea), as of September 2024; The Korea Hotel Association (historical RevPAR for South Korea), as of 2023; Yanolja (2024E leading indicator of hotel performance for South Korea), as of Q3 2024.

Japanese hotel market is set to continue its growth trajectory, driven primarily by domestic demand and, to a lesser extent, inbound tourists. These factors propelled hotel transaction prices in Japan to a record high in 2024. However, performance is expected to vary across segments, influenced by operational challenges such as labor shortages and rising labor costs. Survey results indicate that 85% of Japanese hotel operators anticipate ongoing capacity restrictions.[10] Consequently, maximizing occupancies may prove difficult, especially for small hotel operators. There could be opportunities to acquire non-luxury hotels from owners who lack the capital to upgrade existing rooms and facilities through strategic repositioning and operational improvements. Moreover, hotel operators with access to labor and greater staffing flexibility are in an advantageous position to improve revenue per available room (RevPAR) in Japan.

Capital market conundrums

Commercial real estate liquidity in Asia Pacific has demonstrated resilience compared to other global regions but is still constrained to varying degrees, except for Japan. Capital raising for Asia Pacific real estate was the lowest in over a decade in early 2024,[11] underscoring investor caution. Of the major markets in the region, China is the least liquid and has seen significant reductions in prices. To a lesser extent, Australia has also been experiencing price declines, particularly for office assets. By contrast, despite varying degrees of liquidity, CRE prices in Japan, Singapore and South Korea have been relatively resilient (see exhibit AP-g on the next page).

10. Source: A survey conducted by the Japan Federation of Service and Tourism Industries Workers' Unions in May 2024 showed that 85% of travel and hospitality operators were forced to restrict their operations either by reducing the number of operation days or by reducing the number of rooms for sale due to labor shortages.
11. Source: "The trends shaping the APAC real estate market," PERE, as of September 9, 2024.

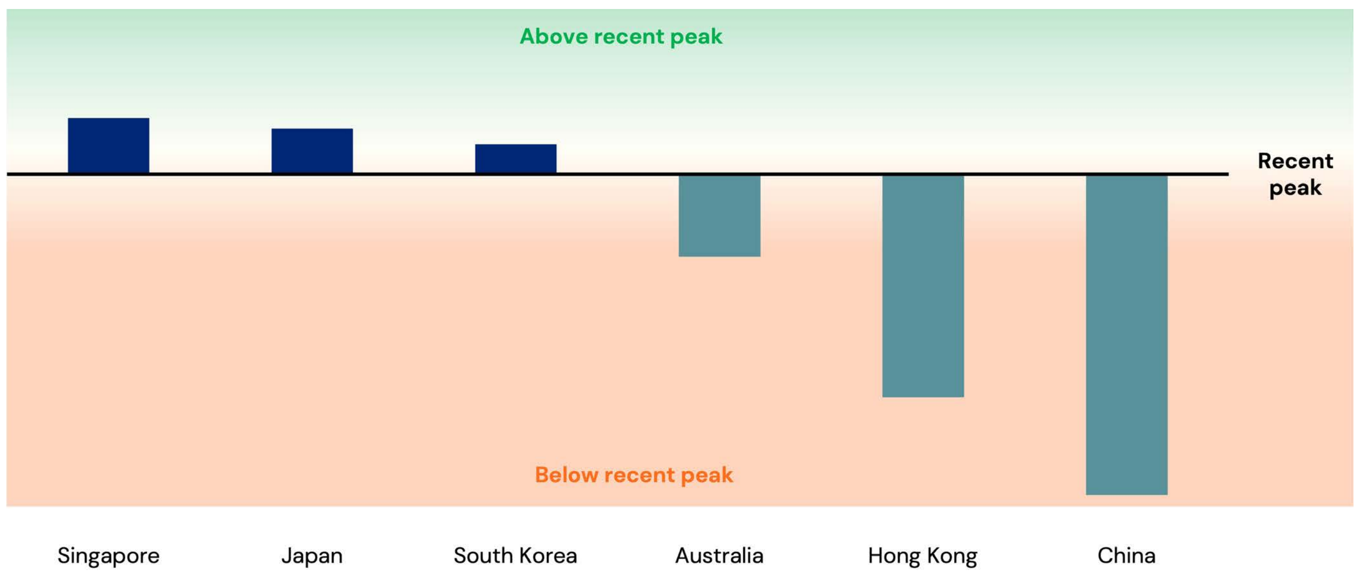
The resilience of CRE prices in these markets has presented challenges for some investors, particularly in markets and sectors where there is uncertainty over NOI growth. The gap between buyer and seller expectations is weighing on liquidity. In Japan, the long-awaited return of inflation, if sustained, could provide opportunities for cash flow growth, but could also impact cap rates. Nevertheless, interest rates in Japan are likely to remain the most accommodating in the region, despite the likelihood of further increases in the near term. Historically, domestic investors have accounted for 76-81% of the total CRE transaction volume in Japan.[12] Should the substantial domestic investor base in Japan continue to anchor the capital market, the potential downside risk to cap rates or capital values is likely to be limited.

Conservative lending practices also mark a common thread. Banks and other traditional lenders continue to finance CRE in most markets. However, lenders are highly selective, focusing on prime assets in good locations while remaining cautious on lower-quality assets and development projects in secondary locations. In particular, stringent lending standards in Australia and the reluctance to lend in China have led to a bifurcation in debt availability and costs across asset qualities and borrower profiles.

12. Source: MSCI/RCA, as of Q3 2024

AP-g | Diverging commercial real estate pricing

Change in commercial property price from recent peak



Note: The commercial property price index for Singapore, Japan, South Korea and Australia is based on MSCI/RCA transaction data for office, industrial and retail. For China and Hong Kong, the commercial property price index is based on the stock-weighted capital value data which is calculated using JLL's stock and capital value data for office, industrial and retail. The recent peak of the commercial property price index for Singapore, Japan, South Korea and Australia was in Q2 2022, and for China and Hong Kong in Q1 2022.

Source: MSCI/RCA commercial property price index for all markets except China and Hong Kong, JLL REIS (stock-weighted capital value index for China and Hong Kong) as of Q2 2024.

> "Savvy investors understand that the best cyclical returns sometimes come from vintages in the wake of cycle turning points or when signs of structural change emerge."

The implementation of monetary easing policies in Hong Kong, Singapore and South Korea could provide some relief to capital market liquidity, but it is likely to be accompanied by some downside risk on NOI. The expectation of high-for-longer interest rates in Australia will likely force some property owners to address the funding gaps.

Some investors are adopting a wait-and-see approach due to challenges in existing portfolios, denominator effects and home-country bias. Some of these hurdles prevent investors from investing in what could turn out to be the best investments in a few years. Savvy investors understand that the best cyclical returns sometimes come from vintages in the wake of cycle turning points or when signs of structural change emerge.

LOOKING AHEAD

- Investors in Asia Pacific real estate must navigate new investments and existing portfolios in a complex environment with signs of structural change and a distinctly different cycle compared to historical norms. Investment strategies focusing on operational intensity (e.g., transaction execution, in-house leasing, etc.) are important for value creation and preservation.
- The current economic climate, coupled with the impending changes brought about by Trump 2.0, is set to present significant challenges for the Chinese economy and real estate markets in the coming years and, to a lesser extent, Hong Kong. Beyond China and Hong Kong, it is difficult to predict clear winners or losers from the election result, given the rest of the region's close trade relationship with China. However, select real estate markets or sectors could benefit from supply chain rebalancing, such as Fukuoka logistics. In the event of significant dislocation or capital market volatility resulting from Trump 2.0, there could be attractive entry points or creative, structured solutions to address capital stack issues for some troubled owners or developers.
- While Japan remains a liquid market in the region with inflationary growth prospects, investors should consider the potential impact of further interest rate hikes and capital market volatility. It is crucial to allow for flexibility and the potential for unanticipated outcomes when evaluating prospective investment opportunities.

Managing editors

Petra Blazkova
Europe Head of Core and Core-plus Research and Strategy

Eduardo Gorab
Managing Director, Global Research and Strategy

Richard Kleinman
Head of Americas Research and Strategy, Co-CIO Americas

Brian Klinksiek
Global Head of Research and Strategy

Chris Langstaff
Canada Head of Research and Strategy

Ben Lentz
CIO, Global Quantitative Strategy, LaSalle Global Solutions

Daniel Mahoney
Europe Head of Research and Strategy

Wayne Qin
Associate Strategist, Asia Pacific

Dominic Silman
Europe Head of Debt and Value-Add Capital Research and Strategy

Fred Tang
Greater China Head of Research and Strategy

Elysia Tse
Asia Pacific Head of Research and Strategy

Contributors: Research and Strategy team

Mary Burke
Frederik Burmester
Zuhaib Butt
Simone Caschili
Jade Cheong
Amanda Chiang
Ryan Daily
Carly Ellis
Heidi Hannah
Kayley Knight
Tobias Lindqvist
Sierra Pierre
Chris Psaras
Wayne Qin
Kyra Spotte-Smith
Sophia Sul
Matthew Wapelhorst
Jen Wichmann
Dennis Wong
Jannie Wu
Hina Yamada

LaSalle leadership

Louis Bowers
Global Chief Financial Officer

Keith Fujii
Head of Asia Pacific

Mark Gabbay
Global Chief Executive Officer

Brad Gries
Head of the Americas

Samer Honein
Global Head of Investor Relations

Lisa Kaufman
Head of LaSalle Global Solutions

Tim Kessler
Global Chief Operating Officer

Philip La Pierre
Head of Europe

Julie Manning
Global Head of Climate and Carbon

Kunihiko Okumura
Head of Japan and Co-Chief Investment Officer, Asia Pacific

Gordon Repp
Global General Counsel

Darline Scelzo
Global Head of Human Resources

Matt Sgrizzi
Co-Chief Investment Officer, LaSalle Global Solutions

Claire Tang
Head of Greater China and Co-Chief Investment Officer, Asia Pacific

Dan Witte
Co-Chief Investment Officer, LaSalle Global Solutions

Jon Zehner
Vice Chairman of LaSalle

Michael Zerda
Head of Debt and Value-Add Strategies, Europe, and Co-Chief Investment Officer, Europe

Contributors: Marketing and Communications

Joshua Coger
Alexandra Constantin
Liam Fitzpatrick
Joe Oslawski
Joe Poljski

LaSalle® | Investing today. For tomorrow.

Amsterdam
Atlanta
Baltimore
Chicago
Denver
El Segundo
Hong Kong
London
Los Angeles
Luxembourg
Madrid
Munich
New York
Paris
San Diego
San Francisco
Seoul
Shanghai
Singapore
Sydney
Tokyo
Toronto
Vancouver
Washington DC

lasalle.com