Global Research

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Global Real Estate Perspective – Highlights

Investor and Corporate

SEE A BRIGHTER WAY

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Overview

Subdued activity as uncertainty delays occupier and investor decision-making

Economic conditions remain challenging in many countries with inflation still stubbornly high, interest rates continuing to climb and softening labor markets, while distress in the banking sector has added to volatility. This is leading to more defensive strategies from occupiers as they pause requirements. Continued uncertainty and elevated borrowing costs are also impacting investor sentiment and inhibiting transaction markets.

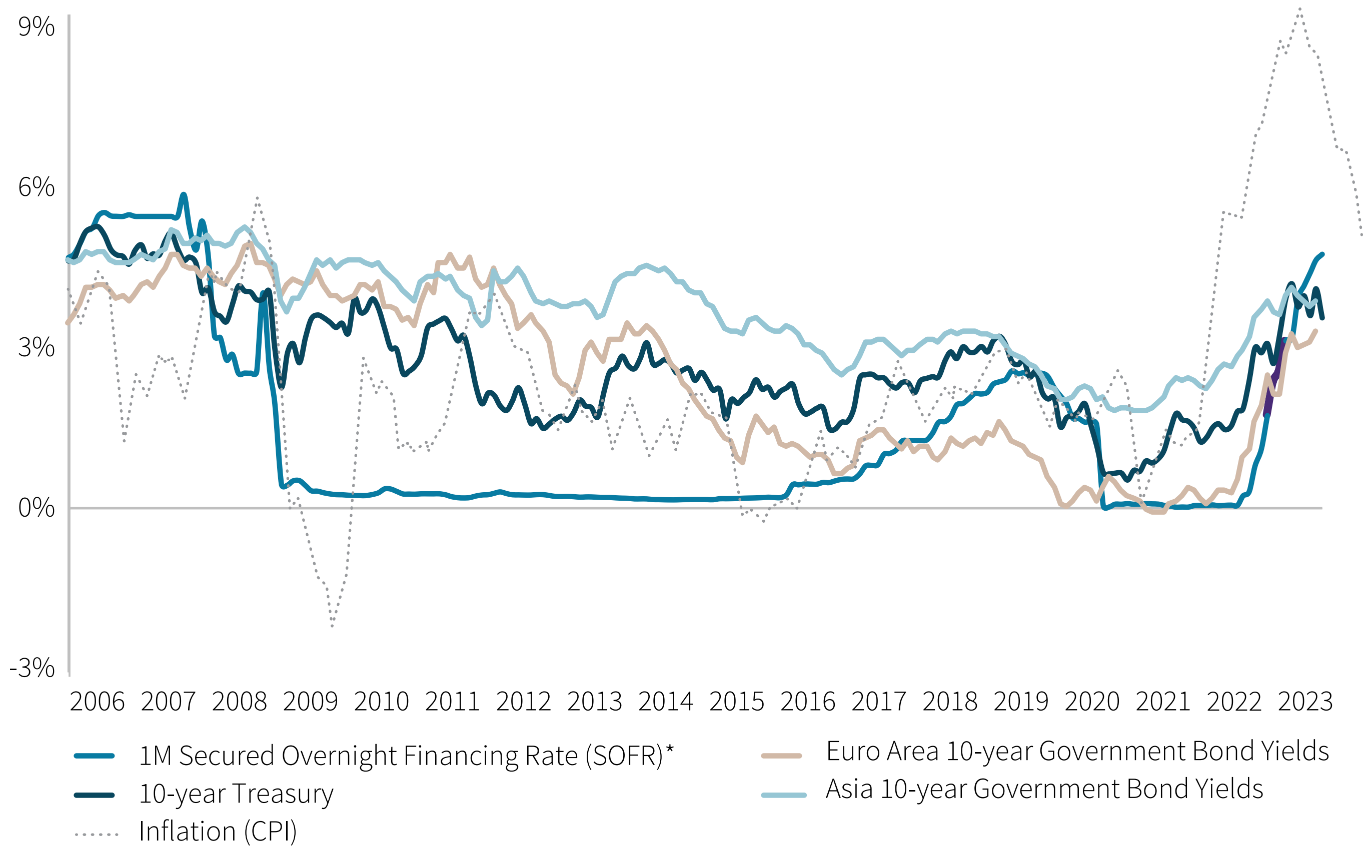
Global Capital Flows

Debt markets

All eyes on interest rates and the debt market

The start of 2023 has been marked by the continuation of volatility from late last year, with rate increases and an uncertain economic outlook impacting investor sentiment. And amid the ongoing rate hike cycle, distress in the banking sector has introduced additional volatility to real estate lending. These factors have led to tightening lending standards in most markets around the world, further affecting debt originations in an already-challenged market. While rate hikes have impacted real estate lenders broadly, the onset of the banking failures has predominantly affected banks, who now face concerns from regulators about commercial real estate (CRE) exposure. Despite market challenges, however, a diversity of lenders remains active with a heightened focus on sponsor, sector and asset quality.

Benchmark yields, 2006 – March 2023



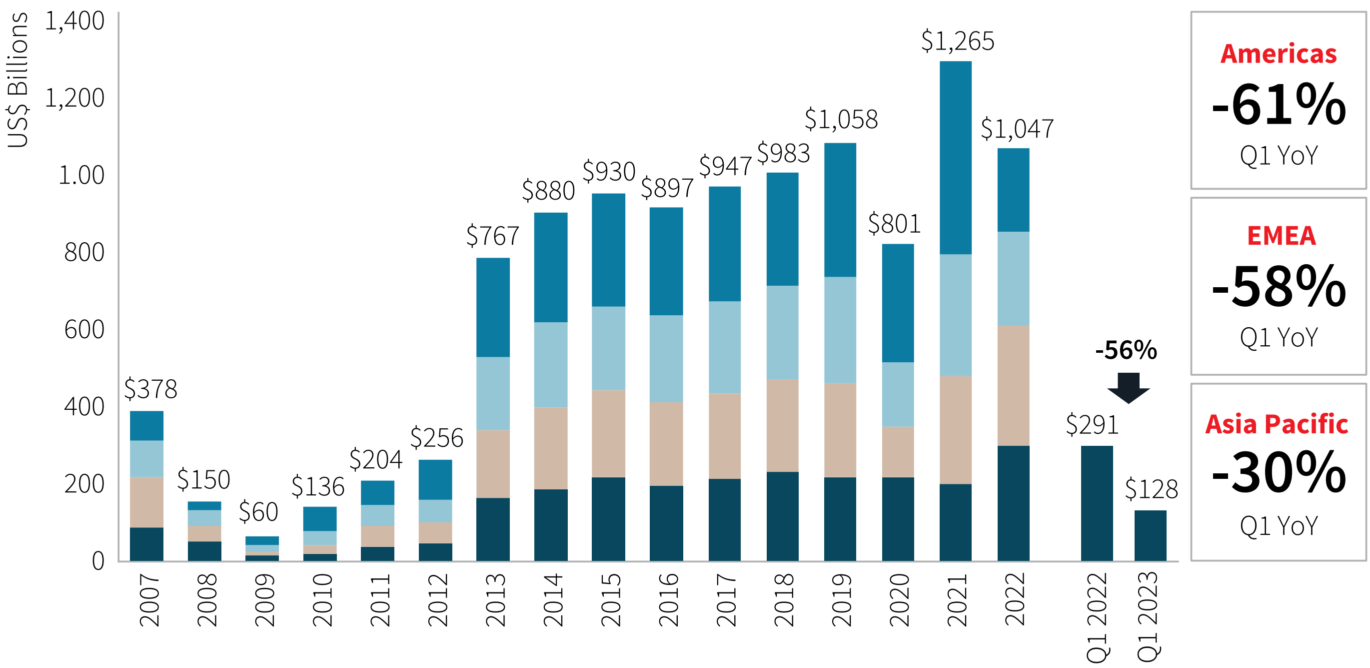
Source: JLL Research; Bloomberg Finance L.P., as of March 2023; *30D LIBOR prior to Sept. 2019; U.S. is used as a global benchmark

Investment activity

Global capital flows weakened further during Q1

The pressures facing markets during 2022 persisted into 2023 as uncertainty stalled decision-making further and stunted investment activity. Global direct investment experienced a slow start to the year, with Q1 volumes softening 56% year-over-year to US$128 billion. Over the trailing 12-month period, global volumes have declined 35% compared to the prior 12-month period. The first quarter represented the slowest quarter of investment activity since Q2 2020, the depths of the pandemic, and the slowest first quarter since 2012. During this period, as institutional investors remain cautious, there has been more activity involving private capital and in smaller deal sizes.

Global transaction volumes by quarter, Q1 2007 – Q1 2023



Source: JLL, April 2023

Pricing

Price discovery continues, with early signs of bottoming out evident

Continued uncertainty and elevated borrowing costs are inhibiting transaction markets, which require further price discovery. Asset pricing around the world has already adjusted over the past 12 months, led by the U.S. which has seen significant adjustments from peak values in early 2022. In Europe, the UK experienced the greatest adjustment in pricing in 2022, with more markets in the region seeing yields shift over the past year. Pricing dynamics are more nuanced across Asia Pacific. Globally, bidding intensity remains challenged but has seen stability during the first quarter as investor propensity to bid is improving. Looking ahead, the improvement in bid intensity is an encouraging leading indicator for price discovery and an improvement in transaction activity as we get into the latter half of 2023.

Sector dynamics

Divergent sectoral dynamics as capital focuses on growth sectors

The cyclical and secular outlook for sectors remains mixed, with investor preference for growth sectors amplified as investors develop longer-term strategies and portfolio shifts. This is bringing continued focus to the industrial & logistics and living sectors. High-quality retail space is in demand from growth-oriented retailers, while hotels are benefitting from pent-up leisure travel and growing group and corporate demand. The office sector continues to lag behind the broader market as fundamentals weaken and bidder pools remain shallow, reflecting the structural challenges facing the future performance of office assets. However, despite the downturn in demand, best-in-class assets in core locations are performing well.

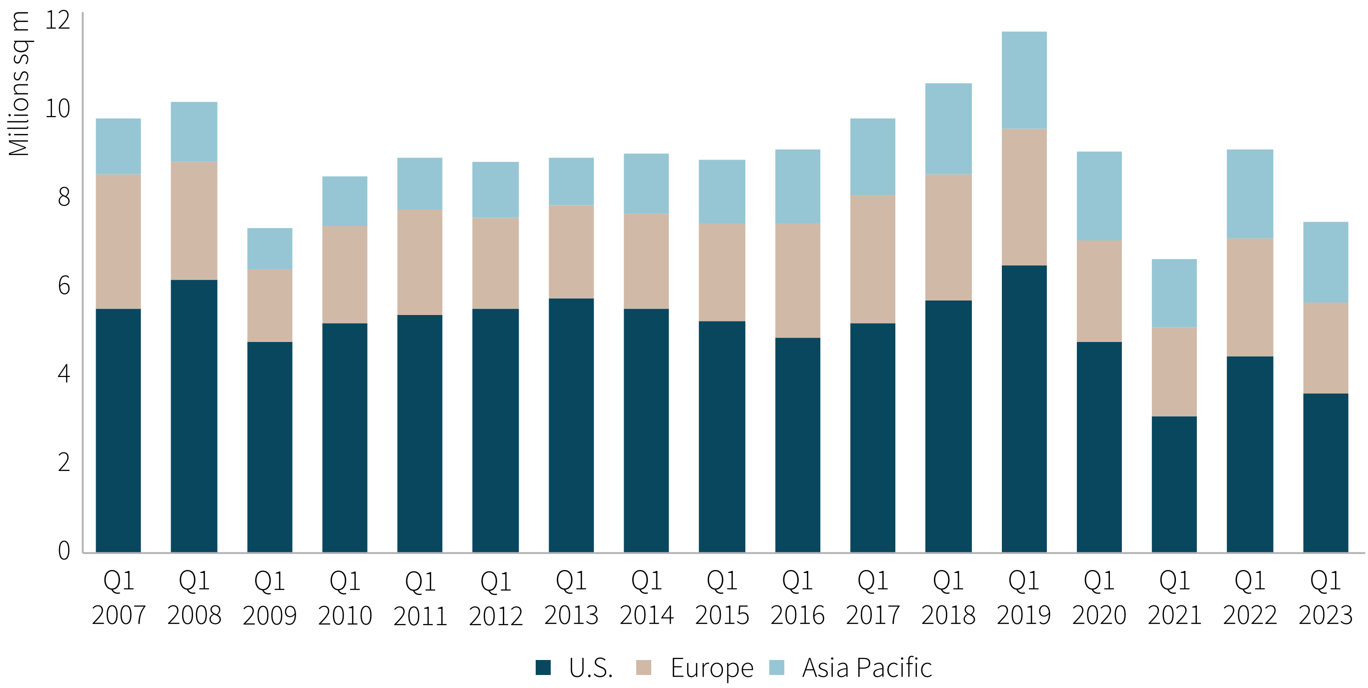
Property Sectors

Offices

Muted demand as occupiers delay activity

The impact of economic headwinds and heightened uncertainty became more evident in office markets during Q1, with greater caution among occupiers leading to slower decision-making and delays to large-scale space requirements. Global office leasing volumes in Q1 were 13% below Q4 2022 and 18% lower than in Q1 2022. Leasing activity declined across all three regions in the first quarter, with Europe recording the sharpest decrease (-24% year-over-year) followed by the U.S. (-19%) and Asia Pacific (-9%). Occupancy losses accelerated in North America, although Europe and Asia Pacific registered positive absorption over the quarter.

Global office gross leasing volumes, Q1 2007 – Q1 2023



23 markets in Europe; 50 markets in the U.S.; 22 markets in Asia Pacific
Source: JLL, April 2023

In most markets newer, high-quality assets are continuing to significantly outperform the rest of the market as occupiers focus on upgrading space. For example, despite overall negative net absorption in the U.S., offices developed since 2015 generated another 0.6 million square meters of positive absorption in Q1. The global vacancy rate rose another 35bps to 15.3% in the quarter with the largest rise recorded in North America (+53bps) followed by Asia Pacific (+42bps), while it moved up 10bps in Europe.

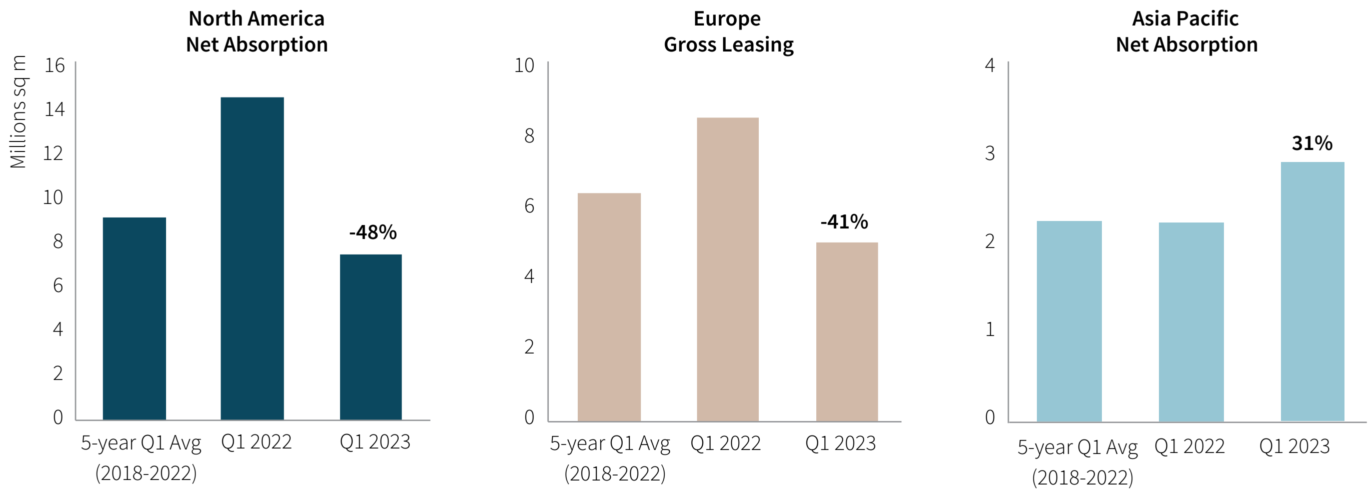
Logistics

Activity cools in Q1

The logistics sector cooled in many markets during the first quarter, with the U.S. and Europe posting declines in leasing activity as the effects of occupiers' lengthier decision-making played out. Market fundamentals, though, remain strong overall. The sector is supported by low vacancy levels despite a healthy supply pipeline and relatively high completions in some markets.

Even with a modest uptick in vacancy rates as new deliveries came online, rental growth continued in Q1 with year-over-year increases of 20.6% in the U.S., 12.2% in Europe and 7.5% in Asia Pacific. Looking ahead, demand is anticipated to continue to moderate as headwinds weigh further on the sector due to global economic conditions. As leasing demand softens, the rate of rental growth will slow but stay positive. Meanwhile, construction start activity is likely to constrict with the increasing cost of capital.

Regional logistics demand, Q1 2022 and Q1 2023



North America: net absorption, based on 55 city markets in the U.S. and 9 city markets in Canada; Europe: gross leasing (take-up) based on 13 national markets; Asia Pacific: based on 35 city markets.
Source: JLL, April 2023

Retail

Cautious optimism for relevant retail places

Consumer demand softened in several major retail markets globally during Q1. The broader squeeze on disposable incomes has triggered many consumers to become more cautious in their spending, although pockets of strong retail sales growth remain, notably across the Asia Pacific region. India, the Philippines and Indonesia are among the fastest-growing markets, while retail sales are recovering in Mainland China and Hong Kong after the government lifted most of its Covid-19 measures. The resumption of overseas tourism from China is expected to provide an additional boost to retail spending across Asia Pacific and in many major cities globally.

Following a slow start to the year, retailer demand for quality space strengthened in February and March in a number of major retail markets. Absorption in Q1 was lower but positive in the U.S., leasing was healthy across Asia Pacific, and demand rose in several European cities. Well-capitalized retailers are consolidating their physical store footprints by taking advantage of better space and larger units that have become available across some of the most attractive retail destinations.

Living

Headwinds slow transaction activity

Investor demand continues to target the living sectors globally, with robust fundamentals and still-strong operating performance driven by structural undersupply across asset types. However, higher financing costs, macroeconomic headwinds and uncertainty in the market mean that deal-making remains difficult, with wide bid-ask spreads on transactions. Investment volumes were significantly reduced across regions in Q1 as many investors maintained a ‘wait and see’ approach.

The U.S. living sector remains resilient despite rental growth easing and interest rates continuing to pressure transaction activity. Transaction volumes in Q1 2023 were down 65% from Q1 2022, although dry powder levels at record highs indicate a large amount of latent demand once financing rates begin to fall. Lagging supply and a slowing housing market further deepened the demand-supply imbalance across Europe, but challenging financing conditions resulted in additional declines in investment volumes. The Asia Pacific region continues to see growing interest in the living sector, although slowing activity in Japan amid a thinning foreign buyer pool and widening bid-ask spreads helped push regional volumes lower.

Hotels & hospitality

Strong performance kickstarts 2023

The hotel sector continues to recover, with global RevPAR through the first two months of 2023 surpassing the same period in 2019 by 6.8%. Recovery is strongest in the Middle East, followed by the Americas and Europe. While Asia Pacific remains the only region not yet back at pre-pandemic levels, performance has accelerated significantly over the past three months underpinned by China’s reopening. The surge in global pent-up demand is expected to accelerate further throughout the year driven by sustained leisure travel and growth in business and group demand.

Despite ongoing macroeconomic headwinds, hotel performance across the Americas continues to improve, with all subregions exceeding 2019 RevPAR performance. The hotel industry in Europe has also demonstrated resilience with its RevPAR now recovered above 2019 levels. Following China’s reopening domestic tourism has surged, lifting Asia Pacific’s RevPAR recovery to 89.6%. With China’s 2022 tourism spending US$149 billion lower than 2019, the lifting of travel restrictions is expected to play a major role in boosting hotel performance recovery in the region and in the broader global market.

The full Global Real Estate Perspective report is available on request. To find out more or to discuss how we can support your global real estate market strategy with research and strategic advice, please contact the global research team.

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