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2025 OUTLOOK

NAVIGATING

A SHIFTING LANDSCAPE

GLOBAL REAL ESTATE

CONVERSATIONS

In an environment characterized by change, our real estate debt and equity experts weigh in on the challenges and opportunities investors are likely to encounter across the global real estate markets in the year ahead.

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JOHN OCKERBLOOM (MODERATOR): The new year will usher in a new administration in the U.S. How do you think this change will affect real estate markets?

NASIR ALAMGIR: The election is just behind us, so it's still hard to determine how much of Donald Trump's pre-election rhetoric will make it into policy. In North America, one big unknown is how much influence the executive branch will have over monetary policy going forward, although I would argue we will see more oversight. What that means for markets is hard to predict, but for a variety of reasons, I think we can expect to see greater inflationary pressure.

Deregulation—or a "lack of re-regulation"—also seems likely under Trump 2.0, and that is something that could ultimately help the broader capital markets. This is especially true with respect to banks and bringing liquidity back into the system to finance acquisitions and refinance deals, which would be healthy for real estate and the economy overall. A lack of re-regulation would likely also affect the way banks handle the non-performing loans they're holding that are facing maturity. Specifically, banks may have the ability to push some of their troubled loans further out. At the end of the day, as we all know, banks are essential for the functioning of a real estate market, and they have been largely absent from the market for the last two years. So, that deregulation or lack of re-regulation will take many forms, but easing the capital for some of the troubled loans will be one of the essential ones.

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NICK PINK: In Europe, the impact on real estate markets will depend heavily on the extent and specifics of Trump's potential tariff moves. Most European-U.S. trade involves the service sector, which doesn't appear to be the target of tariffs at this point. Rather, manufacturing seems to be more of the focus, which means countries like Germany could face increased economic challenges given its dominant automotive industry. While the impact could exacerbate the stress we've seen in the country's real estate markets, we could also see some interesting deals emerge, on an opportunistic basis, over the next 12 months.

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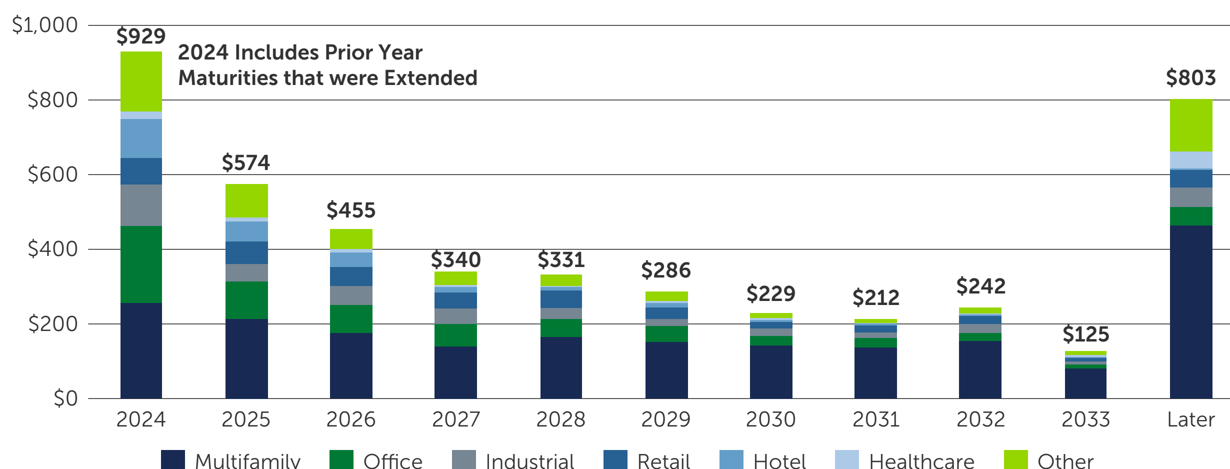
MAUREEN JOYCE: Tariffs are a big question mark in the U.S. as well, and I would also add mass deportations to the list of unknowns—which if combined with tariffs would likely result in a more inflationary environment. In our view, this scenario would be challenging not only for the broader economy, but also, by extension, real estate markets. Specifically, we could see an increase in input costs for new construction, especially for those facing tariffs, like lumber from Canada. Certainly, if we see a mass deportation of immigrants, many of whom work in the construction trades, the cost of labor could also increase. On the positive side, smart deregulation would likely spur innovation in certain industries, which could feed through to real estate markets and create interesting opportunities.

JOHN OCKERBLOOM: For the last few years in real estate, debt has been a key focus, providing attractive risk-adjusted returns on a relative-value basis. Nasir, what do you expect for the asset class in the year ahead—will the environment be supportive of both debt *and* equity?

NASIR ALAMGIR: Real estate debt certainly benefitted in a rising-rate environment, and there are questions as to whether that attractiveness can continue in a lower-rate environment (which may be less likely under Trump 2.0). We think it can, for a few key reasons. One involves the dynamics I mentioned earlier around banks—with a lack of re-regulation under Trump, banks will likely have the ability to extend their maturity walls and push out their troubled loans for longer, which means bank debt will remain constrained longer-term **(Figure 1)**. Another contributing factor is the changing investor base. While it may have been true historically that a dollar raised for equity is a dollar taken from debt, that's not the case today. Traditional real estate investors may see debt as less attractive in a falling-rate environment, but we're still in an elevated rate period—and we're increasingly seeing credit investors moving into this space alongside areas like direct lending. As we think about the outlook for 2025, this is one of the real changes that's emerging: real estate debt as a core allocation from credit portfolios.

All of that said, deregulation will also likely lead to some liquidity from banks returning to the real estate market, and with valuations appearing to have bottomed-out, we expect to see green shoots on the equity side as well. Investors will likely be able to look at both debt and equity and see opportunities to deploy capital in either asset class. In fact, those green shoots on the equity side are great for debt because improving valuations mean that the debt is more secure.

Figure 1: CRE Loan Maturity Wall by Property Type ($B)

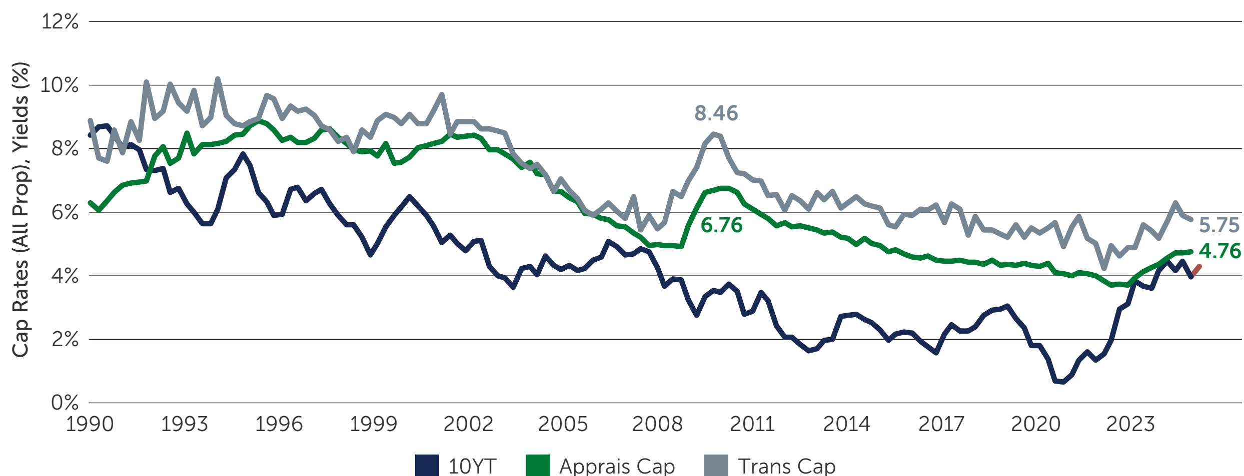


Source: Barings Real Estate Research; Newmark; MBA; FDIC. As of September 30, 2024.

MAUREEN JOYCE: I agree with Nasir—ultimately, equity markets need debt markets to function, and the environment can be supportive of both markets at the same time. The decade or so following the financial crisis, when rates were at very low levels, was certainly a positive for equity. But relative to history, rates that low are more the exception than the rule. A U.S. Treasury rate of 4-4.5% is not unusual, in the context of history, and real estate equity can function very well when U.S. Treasuries are around 4%. When it comes to equity, the most important thing is a strong economy, as that's what ultimately drives increases in rents and increases in value. While cap-rate compression drove significant value over the last 10 years **(Figure 2)**, what the market really needs is top-line growth. The U.S. economy looks well-positioned for growth going into 2025, and the combination of policies and legislation already in place—with the potential for lower taxes and lighter regulation from the incoming administration—should have a multiplier effect on the economy. With the potential for strong liquidity and economic growth, 2025 could be a particularly good vintage year for real estate equity.

Additionally, while we're likely to see gradual improvement in the U.S. going forward, rather than steep increases in values, the good news is that values have reset. This provides a solid starting point for managers to acquire assets that capitalize on the strengthening economy.

Figure 2: Cap Rates



Source: Barings Real Estate Research; NCREIF; Bloomberg. As of November 11, 2024.

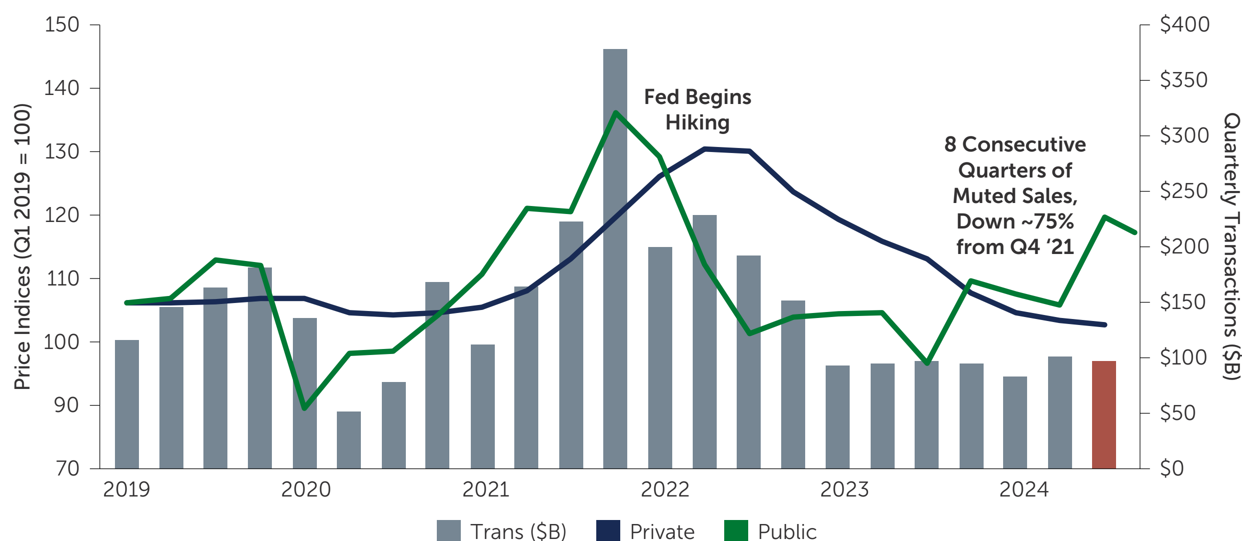
NICK PINK: Europe is in a very different place than the U.S. economically speaking, but the real estate markets are arguably headed in a similar direction. In fact, we are positive about the prospects for gradual improvement in property values through 2025. For years, aside from one or two bright spots, European economic growth has been lackluster. And in the near term, the forces of deglobalization and rising political risk will likely impact Europe more than the U.S. in terms of economic performance. This could lead to a faster pace of rate cuts in Europe over the next 12 months, which should have a positive effect on prime real estate values, particularly in gateway cities and undersupplied markets where the outlook for rental value growth remains strong.

Earlier this year, we found stability returning in most European markets. Now that we're on the cusp of a gradual improvement in values, we may well be underestimating the weight of money that could come back in and the pace at which it could flow as policy rates trend down—which makes a positive case for equity. Encouragingly, and ahead of expectations, we're seeing core capital come back in Europe, which is the ultimate engine for real estate markets more broadly. If core capital is back, value-add investors have an exit, which has been lacking in the market for quite some time.

JOHN OCKERBLOOM: After a challenging few years in real estate, we are seeing greener shoots and brighter lights. What will be likely be the biggest differentiating factor between debt and equity in 2025?

MAUREEN JOYCE: In two words: the election. We entered 2024 with a lot of uncertainty. We were unsure about inflation and still feeling the shock of the rapid increase in interest rates. That meant there was also a lot of uncertainty around valuations. As we've mentioned, these things have settled down now. As expected, it took around eight quarters for valuations to bottom out—with the first negative return in the NPI during the fourth quarter of 2022, and the first positive turn in the third quarter of this year **(Figure 3)**. This sets a good foundation, and I think that overall, there is a greater sense of clarity around growth in the coming year.

Figure 3: Emerging from a Downturn



Source: Barings Real Estate Research; NCREIF; Bloomberg. As of November 11, 2024.

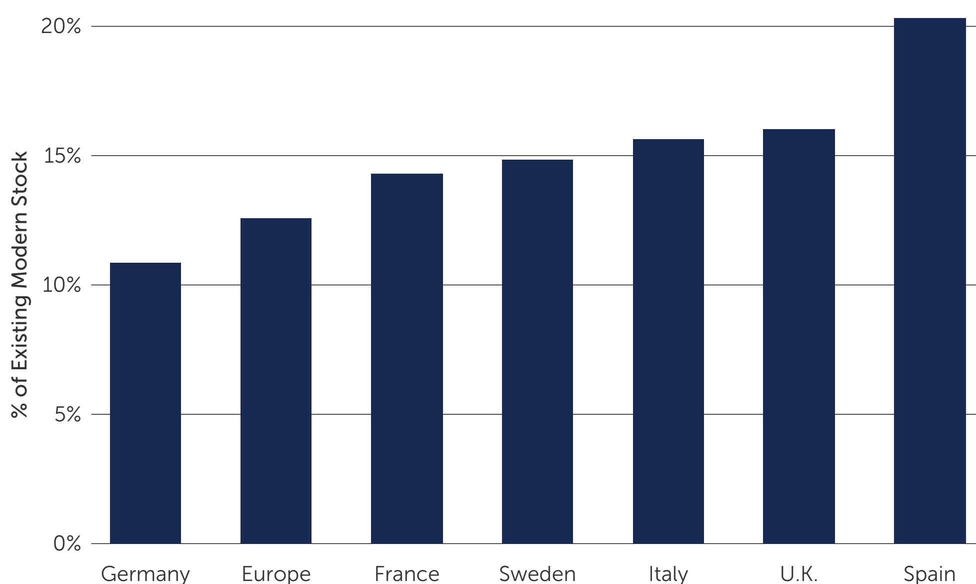
NASIR ALAMGIR: It appears as though the incoming administration will move quickly given they only have a four-year window to enact policy changes, or maybe only two years if the composition of Congress changes as is common in mid-term elections. If that's the case, I would go back to my view that the new administration is likely to exert greater influence over monetary policy, which is potentially a big risk for debt markets. The last time that happened was during the Nixon era, and we saw significant inflation. That will be one thing to watch closely in 2025.

JOHN OCKERBLOOM: In a market where there's some stabilization, and with liquidity and transaction volumes likely to increase going forward, where are you seeing the most exciting opportunities across sectors?

NICK PINK: Despite the challenges of the last few years, positive structural fundamentals remain in place for prime real estate. At the same time, there are a number of tailwinds in Europe—including demographic and political trends like globalization and decarbonization—that continue to shape opportunities in sectors such as residential and logistics. Since demand is patchier in Europe given the uneven economic outlook, the key for us is to identify those pockets of demand and respond by creating or acquiring the spaces that tenants want to occupy.

For instance, in logistics, we are very focused on prime logistics corridors in Europe. The potential for trade wars could intensify the established reshoring and near-shoring trends that underpin demand for prime logistics, as supply chains respond to the new environment. Specifically, we think an additional 33 million sq m of logistics space will be required over the next five years.[1]

Figure 4: E-Commerce Logistics Demand Forecast to Rise Across Europe (2024–2028)



Source: CBRE; Oxford Economics; Euromonitor; Barings' calculations. As of December 2023.

1. Source: CBRE; Oxford Economics; Euromonitor; Barings' calculations. As of December 2023.

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Within the residential sector, many European sub-sectors, such as purpose-built student accommodation (PBSA), are immature relative to the U.S. In this specific sector, European student numbers continue to outstrip the supply of PBSA. As a result, we see value in markets that are offering early-mover advantages, such as Spain and Italy, as they look well-positioned to benefit from a rise in international students.

MAUREEN JOYCE: In U.S. equity, one area of focus going forward relates to the housing crisis, which is being driven by a lack of new supply and challenged affordability. For investors that can provide the capital to modernize the stock of housing across the country, there is an opportunity to not only meet this socioeconomic challenge, but also to improve return prospects for the investment.

Perhaps counterintuitively, we also see value in retail assets going forward, both necessity and lifestyle. Consumers have cash in their pockets and they are shopping—for example, third quarter retail sales, excluding gas stations, were up 2.8% year-over-year.[2] And consumers are not only shopping online, they're going to lifestyle centers that offer restaurants, stores and an experience.

> "There is a lot of data pointing to a potential recovery in the office sector, or at least a bottoming out."

NASIR ALAMGIR: This may be less bold, but I'm going to say office. There is a lot of data pointing to a potential recovery in the office sector, or at least a bottoming out. Leasing activity is picking back up to pre-pandemic levels. Granted, there is a lot of vacancy that needs to be absorbed, but I don't think we can discount the good news. You have a pro-business president coming into office, and business wants people back in the office five days a week. And if you start seeing that in the federal government, I think the office sector could recover faster than many predict.

In the years ahead, we also expect to see strong performance in assets that are less dependent on people for their performance—storage and logistics assets, for example, may be at an advantage over hotels and senior housing, which rely on a workforce population that may be at greater risk under certain policy changes. Asset classes that can transmit net operating income (NOI) into cash flow, with as little friction as possible, will continue to be very desirable.

This piece has been adapted from our 2025 Global Real Estate Outlook. Watch the full webinar here.

2. Source: Bureau of Labor Statistics; Census. As of September 30, 2024.

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