News release

M&G Investments

M&G predicts continued period of tighter lending for global real estate sector

- ***High quality assets with robust cashflows expected to outperform***
- ***Living sectors to be most resilient, with strong demand side fundamentals***
- ***Opportunities set to emerge, led by a repriced UK market***

London, 12 June 2023 – Global real estate is facing a prolonged period of tighter credit conditions as banks and other lenders adopt stricter financial controls – conditions which will hamper capital value growth and recovery, according to M&G's mid-year Global Real Estate update report, published today. Those with significant exposure to weaker or riskier assets and over-leveraged investors who now face refinancing risks will be most impacted.

However, the report's findings also demonstrate that, helped by the relative absence of risky lending in recent years, the banking sector is in far better shape compared to the Global Financial Crisis, providing reassurance of underlying systemic financial strength and averting wider contagion.

Other key takeaways include:

- In the US, continued disproportionate lending by mid-sized banks to owners and property developers is putting significant stress on the banking sector. Almost 30 per cent of all loans by US regional banks are to commercial real estate borrowers, compared to a little over five per cent in the UK and across the EU. Risk factors continue to vary widely between markets. In the Eurozone, tighter, more widespread regulatory thresholds are helping to contain the risk of bank failures and ensuring that lending opportunities are not undermined.
- Central banks are generally focusing more on maintaining financial stability now, rather than just taming inflation, limiting further interest rate rises, making the spectre of much higher rates less likely.
- Operating with a higher degree of risk aversion, lenders and investors are exercising caution around new investments and seeking greater compensation for taking on enhanced risk.
- A flight to quality is resulting in resilience for prime assets with secure cashflows versus vulnerability to occupational market risks and vacancy across poorer quality assets, particularly for offices and to an extent, retail. With less capital available, plans to upgrade the sustainability credentials of non-prime assets are likely to be delayed or shelved, impacting the future value of such assets in the wider context of the 'green premium'.

Key issues and opportunities for specific global markets include:

- **It appears that UK real estate** has won the global 'race to the bottom' with a much starker repricing of assets than in other world markets. Cautious optimism is emerging, particularly in industrials and some areas of retail, and the residential sector (where there is still a shortage of homes for rent) remains in favour. Non-core offices and assets which fail to meet increasingly tight environmental standards will continue to remain under pressure.
- **The Eurozone** is one or two quarters behind the UK with regards to repricing. In comparison to the US, office vacancy rates are far lower, particularly in prime central business districts where new supply – and therefore downside risks – are more limited.
- **In the US**, higher interest rates have already impacted on venture capital activity, which, combined with relatively muted post-pandemic 'return to the office' trends, has had significant implications for the office sector from New York to San Francisco, with big-tech businesses in particular reducing demand in response to more muted perceived growth potential.
- **In Asia**, while commercial real estate remains largely resilient, there are some markets where higher interest rates and tighter credit conditions are placing upwards pressure on yields, impacting Korean logistics and Australian offices in particular. It is also likely that Australian developers will be recycling capital out of non-core assets rather than raising new equity or debt.
  In South Korea, a glut of logistics development over the next 18 months is set to double the existing stock, putting pressure on those unable to secure lettings and potentially forcing sales assets at reduced value.

Jose Pellicer, Head of Investment Strategy at M&G Real Estate, says: "Global real estate markets are rebalancing, but we're not out of the woods yet. The good news is that we're not facing another global financial crisis - banks are now much better prepared to cope with long periods of turmoil and uncertainty. But we shouldn't forget that structural changes such as hybrid working and the rising importance of ESG means that some non-prime assets may not survive."

A copy of M&G's mid-year Global Real Estate Outlook report can be downloaded here:

M&G Real Estate is part of M&G plc's £76.6 billion private assets and alternatives division*.

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Notes to Editors

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

M&G recognises the importance of responsible investing and is a signatory to the United Nations Principles for Responsible Investment (UNPRI) and is a member of the Climate Bonds Initiative Partners Programme.

M&G plc has committed to achieve net zero carbon emissions on its total book of assets under management and administration by 2050 and committed to reduce operational carbon emissions as a corporate entity to net zero by 2030.

Its £32.8 billion property arm (as at December 2022 including cash), M&G Real Estate, is a leading financial solutions provider for global real estate investors, has a sector leading approach to responsible property management and is committed to continuously improving the sustainability performance of its funds.

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