# News release

M&G Investments

## M&G: higher interest rates creating a shift in mindset for property investors

- ***Market slump in China already impacting some areas of global economy***
- ***Demand for high quality office space holding up***
- ***Net Zero Carbon transition continues to raise new risks for meeting green targets***

**London, 28 November 2023** – Global property investors will need to rely more heavily on generating high yields and growth to successfully compete in an economic environment of increased interest rates and debt costs which now pervade many markets, according to **M&G's Global Real Estate Outlook report**, published today.

**Jose Pellicer, Head of Investment Strategy at M&G Real Estate, says:** "The days of 'lower for longer' interest rates are firmly behind us. Global property investors can no longer rely on yield compression and cheap debt to drive returns – there needs to be a fundamental shift in mindset.

Investors may be naturally drawn to growth, but income is also of key importance given today's higher rates. Investing in areas with strong demand drivers, such as the Living and Industrial sectors, could offer attractive returns through high income growth; as could sectors which allow inflation to be passed onto tenants, such as long lease supermarkets. Committing to asset improvements or investing in unloved properties with high income yields could also generate attractive income prospects.

As global real estate markets adjust to a weakened Chinese economy, growing complexities around Net Zero Carbon and changing patterns of demand and occupancy, we expect to see signs of greater confidence as investors recalibrate their approach to a drastically different economic landscape."

While real estate debt costs have ballooned, the report finds that distress has been limited to date, but anticipates forced sales over the next few years with 30-40 percent of commercial real estate loans across the UK and Europe due to be renegotiated by the end of 2025 at significantly higher rates than borrowers currently enjoy.

As hybrid working continues to force occupiers and investors to re-evaluate space requirements, the report highlights significantly different motivations for returning to the office, depending on the market. The extreme challenges felt in the US – where office attendance remains at only 50 percent of pre-pandemic levels – are not nearly as acute across many European or Asian markets, where it is 75 percent or higher.

The findings also indicate an increasingly sharp divergence between city centre and out-of-town offices, as well-located, high specification schemes remain in demand, particularly those with strong ESG credentials. In Asia, the number of corporates committing to Net Zero Carbon targets has trebled in the last three years, highlighting the increased tenant focus on taking space which helps meet stringent carbon emissions requirements.

**Other key takeaways include:**

- **China's recent economic slump** has largely been caused by its heavily-indebted property sector. With GDP growth expected to slow from around 5 percent in 2023 to between 4.2 – 4.4 percent in 2024, this downturn is anticipated to create continued widespread economic uncertainty – not just in Asia Pacific, but also in Europe where Germany is most exposed through heavy reliance on exports to China.

- **Logistics is a crucial sector for investors** aiming to expedite the shift to net-zero carbon and manage portfolio risk. The Report notes that distribution warehouses generally produce 60-70 percent lower greenhouse gas emissions than other commercial buildings and 20-25 percent lower than residential assets. Occupier demand is increasingly targeted at newly built, green-certified stock, where features such as on-site solar energy production and electric vehicle chargers are deemed essential. Tenants are usually willing to pay a rental premium for the best space and vacancy risks are currently negligible.

- **In the UK,** where continued high inflation and high interest rates have already raised concerns about a possible recession, average real estate values have fallen by more than 20 percent since mid-2022. Existing loans may increasingly fail to meet the terms set by banks, leading to refinancing challenges and distressed sales. This may provide an opportunity for alternative lenders to step in and offer debt investors a chance to capitalise on the UK's repricing, providing the potential for attractive returns at a lower risk point. On a more positive note, retail rents are stabilising having significantly rebased and with the best quality stock yielding above 8 percent – shopping centres could offer strong income potential once depreciation is appropriately priced in.

- **In Continental Europe**, rising construction costs and expensive financing are already impacting European developers. In most markets, the demand for residential permits has decreased. Over the next few years, completions look set to fall well below housing requirements, which will boost demand for homes in the private rented sector, student housing, and senior living schemes.

- **In Asia**, office occupier demand across most of Asia Pacific (APAC) remains underpinned by a stronger inclination towards office-based working. However, the 'return-to-office' momentum in Australia has lagged behind other APAC markets. The sector's outlook is increasingly polarised as occupiers and investors focus on prime, ESG-compliant offices in core locations of which there is limited availability.

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**Notes to editors**

M&G's 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*.

**About M&G Investments**

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

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.