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Shed, Strike, and Scale: Musings in the Year of the Snake

The misunderstood Snake: A case of bad PR?

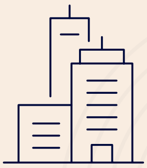
Throughout human history, snakes have slithered into our collective consciousness, often burdened with a negative connotation. Its reputation, steeped in symbolism, has rarely been kind. The Biblical serpent, sly and persuasive, led Eve to the forbidden fruit in the Garden of Eden. Media and literature have been equally unkind. The film adaptation of Rudyard Kipling's The Jungle Book portrays Kaa the python as a villain with hypnotic powers. In contemporary literature, J.K. Rowling's Harry Potter introduces the snake Nagini, who was Voldemort's sinister yet loyal companion. Even in the classic game of Snakes and Ladders, a snake's square is synonymous with misfortune, sending players tumbling back from their hard-earned progress.

History, too, seems to conspire with the snake's darker narrative. Years marked by the Chinese zodiac's Snake have often coincided with global turmoil. The stock market crash of 1929, the attack on Pearl Harbor in 1941, the Tiananmen Square tragedy of 1989, and the double blow of the dot-com bubble's burst and 9/11 in 2001, all fell under the shadow of the Snake's year. It is as though the snake's unpredictability has been etched into the fabric of historical upheavals.

Yet, according to Chinese astrology, the Year of the Snake is always a time of transformation, renewal, and growth. The snake is also a symbol of wisdom, agility, and adaptability. People born in the Year of the Snake are known for their intelligence, creativity, and resourcefulness. As much as the snake has been a convenient symbol of treachery, it occupies a place of reverence and awe.

In Chinese culture, the snake is often celebrated as a "little dragon" (小龙), a relative of the mythical beast associated with prosperity and power. Its ability to shed its skin, transforming itself anew, is viewed as a gesture of reinvention and resilience. The shed skin has earned the endearing moniker of the "dragon's coat" (龙衣), a symbol of rebirth and hardiness. In Chinese mythology, Nüwa is honoured as the maternal deity who created humans and is typically illustrated with a human head and a snake-like body, the serpent's connection to life and fertility. The snake is also revered for its ties to wealth and longevity, often depicted alongside the turtle and the crane in traditional Chinese art as a symbol of enduring prosperity.

The Year of the Snake feels particularly relevant for commercial real estate, a sector that has been tiptoeing through a minefield of disruptions for a few years. As we forge ahead, the themes of transformation and adaptability are poised to resonate strongly. Herein lies a deeper message: This Year of the Snake will exemplify our ability to embrace renewal, adapt to shifting circumstances, and emerge stronger.



The snake represents transformation, adaptability, and renewal.

Shedding old skin: Metamorphosis beckons

The metaphor of shedding skin speaks directly to the state of the real estate market in 2025. The past few years have seen significant changes in the investment landscape, but the disruptions have also set the stage for new beginnings.

Globally, the tide of monetary tightening is beginning to turn. Central banks in the United States and Europe have started to cut interest rates, setting the stage for a potential domino effect across the global market. South Korea and Hong Kong have already followed suit, reducing rates for the first time in over four years, signalling a shift in monetary policy. The pivotal moment came in September 2024, when the U.S. Federal Reserve reversed course, easing monetary policy after an extended period of aggressive rate hikes. This marked the beginning of the end for the high-rate regime that had entrenched bid-ask pricing standoffs in global real estate markets.

The real estate market in 2025 is poised for transformation and renewal.

This easing cycle could unlock a long-awaited phase of market recalibration. Lower rates are expected to narrow the bid-ask spreads that have stymied transactions over the past two years, providing a clearer framework for price discovery. As cost of debt becomes less punitive and liquidity improves, transactional activity is poised for a resurgence in 2025 and beyond. Investors and market participants, who had been sidelined by the pricing stalemates of the high-rate era, are now beginning to explore opportunities in a landscape that is gradually regaining its momentum. This unfolding monetary easing not only signals a fresh start for real estate markets but also underscores the resilience and adaptability of the sector amid shifting macroeconomic tides.

The Reserve Bank of Australia (RBA) has held interest rates steady, grappling with the dual challenges of inflationary pressures and an unemployment rate hovering near historic lows, at 4% as at December 2024. While the exact timing remains uncertain, absent any external shocks, there is broad consensus that the RBA will begin lowering rates in the first half of 2025. Yet in Japan, July 2024 marked a significant moment as the Bank of Japan (BOJ) raised its short-term policy rate to 0.25%, the second and largest hike since 2007. It followed up with another hike to 0.5% in January 2025. This policy shift signals a significant departure from Japan's historically accommodative stance. The BoJ's strategy will need to carefully balance the domestic economic recovery, international monetary dynamics, and the inherent risks of a policy shift to make sure that adjustments are sustainable and beneficial to Japan's overall financial stability. Our view is that any further shift in monetary policy will be measured and gradual. Japan will continue to offer some of the most accommodating interest rates in the region, if not globally, ensuring its relative appeal for real estate investors.

We believe the denominator effect that drove a reduction in global real estate allocations is beginning to subside. During the market turbulence of 2022 and 2023, as equity and bond markets experienced sharp declines, fund managers adjusted their real estate exposure to remain within asset allocation thresholds and mitigate portfolio risk. Now, with equity and bond markets staging a partial recovery, real estate's proportional weight in portfolios has shifted, leaving it possibly underweight compared to strategic asset allocation targets. This shift has created a renewed urgency for fund managers to rebalance by increasing their allocations to real estate, setting the stage for heightened investment activity in the sector.

Striking fast, striking smart: Investing with precision

Snakes are not known for hesitation. When they see an opportunity, snakes act with precision and purpose, a quality that commercial real estate investors would do well to emulate. The property market is not a level playing field. Pockets of recovery exist alongside areas of stagnation, creating a patchwork landscape that rewards those who can discern the difference.

Europe's real estate markets have undergone a sharper and more pronounced repricing than other regions, creating a compelling opportunity for investors to acquire core assets at more attractive valuations. The UK, in particular, stands out for its significant market recalibration, offering a unique entry point for value-driven acquisitions.

At the same time, Europe's debt markets are presenting another avenue for strategic investment, with growing opportunities for structured recapitalisation and re-financing. Unlike in the U.S., where non-bank lending accounts for approximately half of the real estate debt market, the equivalent sector in Europe remains in a nascent stage. Heightened regulatory scrutiny and a reduced risk appetite among commercial banks have paved the way for non-bank lenders to fill the funding gap. This shift creates a distinct advantage: real estate lending in these markets now delivers attractive income returns for investors while mitigating property risk through the substantial equity buffers required by lenders.

We expect a K-shaped trajectory to manifest in Asia-Pacific, as the dichotomy between the good and the average widens within markets and sectors. Across markets, Japan and Australia are poised for greater investment participation and outcomes, while markets like China and Hong Kong would fare less favourably. Looking at sectors, the living and industrial segments should outperform, underpinned by positive drivers, leaving the retail and office sectors to play catch-up in many markets. Yet, even within one sector, the gaps are widening creating a range of returns. This is most apparent in the office sector, where the flight to quality will separate the winners from the laggards. Hence, investment performance is likely to be driven at the asset level rather than sectoral. This means investors and managers can no longer be passive allocators, and must have the local know-how to exploit any potential arbitrage.

Investors that can capitalise on the value-creation in assets are better positioned to capture the alpha. Elevated construction costs, constrained debt availability, and persistent uncertainty around occupier demand over the past few years have collectively dampened the visible real estate supply pipeline which now needs to play catch up. Moreover, demand remains resilient, underpinned by robust labour markets that continue to drive job creation and bolster household spending. For instance, there have been more publicised cases of investor activism in Japan, which are focused on unlocking value from the balance sheet and extracting better capital efficiency. We believe that there will be significant deal flow in the Japan commercial real estate sector from this year, as non-core office holdings are being disposed. While not always the case, we believe non-core assets held by Japanese non-property firms are often not in the best of condition, and therein lies the scope for value creation. In some cases, investors may ride on the performance in the property market to capitalise on leasing uplifts and positive rent reversions.

The drivers of total returns in real estate are undergoing a significant shift. In previous cycles, capital growth often dominated the narrative, acting as the primary engine of overall returns. However, as we move into the next cycle, income returns are poised to take centre stage. It is crucial for investors to focus more intensely on the operational performance of their assets to enhance returns. This is particularly important given that interest rates are expected to stabilise at levels significantly higher than those observed after the Global Financial Crisis.

Scale: Stay with structural themes such as Beds and Sheds

The snake's scales, both literal and figurative, are a fitting metaphor for growth. Just as the snake's body expands and its scales adjust to accommodate its larger form, real estate investors can scale up their strategies to match the structural shifts shaping the landscape. In the global real estate sector, the past decade has been transformational to say the very least. Accelerated and seismic shifts in demographics, technology and the society have resulted in this evolving real estate landscape that we now operate in.

Structural opportunities in private equity real estate are driven by profound, lasting changes in societal priorities, technological innovation, and environmental imperatives. These shifts demand a forward-thinking approach, where real estate assets are reimagined and adapted to align with the evolving needs of communities and businesses. While pursuing these opportunities often entails longer investment horizons and significant upfront capital, the rewards can be substantial. Assets that address these structural trends are likely to experience sustained demand, command premium rental yields, and exhibit long-term resilience in a competitive market. By embracing these transformational forces, investors have the chance to scale up and future-proof their portfolios.

Many nations are contending with the twin challenges of aging populations and declining birth rates. However, gateway cities around the world present a contrasting narrative. These urban centres are thriving, fuelled by rising urbanisation, positive net migration, and a workforce that is often younger and more dynamic than national averages. As populations in these cities expand, driven by both inter-regional and intra-national migration, they generate a localised demographic dividend. This concentration of youthful, economically active individuals creates vibrant markets and sustained demand for housing, commercial spaces, and mixed-use developments.

The residential real estate sector has consistently proven its resilience, outperforming other asset classes during both the global financial crisis and the recent COVID-19 pandemic. The need for housing remains a fundamental constant as it is non-discretionary. This inherent stability makes residential real estate particularly attractive to long-term investors, offering reliable income even during economic uncertainty.

Looking ahead, the convergence of housing shortages and rising rental demand in Europe and Asia provides strong tailwinds for continued rental growth. For investors, this means access to stable, durable income streams supported by structural demand. While Europe's evolving regulatory environment poses challenges, strong rental growth has mitigated the pressure from rising yields, preserving appealing returns for investors focused on income generation. Urbanisation trends further bolster the appeal of residential real estate. In Europe, urban growth is now outpacing national averages, intensifying pressure on housing supply and driving down vacancy rates in many cities.

These dynamics highlight the enduring value of residential real estate as an investment. With ongoing demand fuelled by demographic shifts and urban growth, the sector offers a combination of stability and long-term potential, making it an essential component of a resilient portfolio.

On the back of growing e-commerce penetration, demand for logistics space in urban areas is surging, driven by the need for proximity to consumers and critical business networks. In cities where land is scarce, this growing demand is pushing rents higher. The emphasis on supply chain efficiency has made location a critical factor, especially in urban environments where operational costs and productivity play a decisive role in business success.

At the same time, the push to address housing shortages has significantly increased land values, especially for urban brownfield sites that were once predominantly reserved for industrial uses. These sites, now highly sought after for residential development, are being repurposed to meet growing demand for housing. These have acted together to create a robust environment for sustained rental growth, particularly in core logistics hubs where demand remains strong.

Despite economic challenges and rising costs, occupiers recognise the value of premium logistics facilities. They are increasingly willing to pay higher rents for properties that offer strategic locations, state-of-the-art features, and modern infrastructure. These investments in operational efficiency, such as reduced transportation costs and faster delivery times, justify the higher cost per square meter, as they deliver significant improvements in overall supply chain performance.

This combination of robust structural demand, limited land availability, and the ongoing push for modernisation makes the industrial and logistics sector a standout investment opportunity. As urbanisation and e-commerce growth continue to reshape supply chain needs, properties in prime urban locations are well-positioned to deliver long-term value for investors.

Conclusion

For real estate investors, the Year of the Snake offers a wealth of opportunities for those who are ready to shed old strategies, embrace the new, and scale up with an eye on the future. The global property market, while buoyed by optimism, is not without its challenges. Geopolitical tensions pose significant risks that could have ripple effects across the world.

Ultimately, always keep in mind that the real estate universe presents a unique mix of cyclical and secular trends. By combining structural plays in resilient sectors with well-timed tactical investments, investors can position themselves to capitalise on both immediate opportunities and long-term growth drivers. Precision, patience, and a healthy respect for risk will be the keys to success in this transformative year.

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