News release

M&G Investments

M&G's Global Outlook report highlights three most significant themes currently influencing global real estate investment

London/Amsterdam/Frankfurt/Milan/Paris, 16 November 2021 – M&G Real Estate – part of M&G plc's £65 billion private assets division – has today released the latest report in its Global Outlook series, which examines trends currently shaping commercial real estate markets. Inflation, planning for net zero, and potential for evolution in the retail sector are identified as some of the key sources of challenge and opportunity for property investors globally, in a post-pandemic era.

1) Real estate offers defensive play against rising inflation

Huge fiscal stimuli and more recently supply chain issues have converged to produce inflationary pressures which are now affecting many economies around the world. Central banks appear reluctant to hike interest rates in response to factors which may prove to be transitory, but the debate still continues as to how high rates will climb and how long for.

Opportunities:

- Even in a scenario of heightened inflation persisting, property offers protection and a potentially promising medium to long term investment play on the strength of its characteristics as a real asset
- Pent up demand and significant levels of household savings in Europe bode well for the economy and for real estate investors in areas such as Food & Beverage (F&B) and hotels
- Investors in Asia Pacific are still looking to real estate for yield in the context of a continuing disparity between property and bonds.

Challenges:

- Inflationary pressures are already visible in the form of higher raw material/construction costs, though this could be a temporary phenomenon caused by a rapid resurgence in demand and problems with supply chains
- Short-term price pressures in the EU will undoubtedly cause division over when the European Central Bank should raise interest rates.

2) ESG a big factor in value polarisation

As demand increases for well-located 'green' assets, the opposite applies to buildings with inferior ESG characteristics. The result is likely to be a growing value divergence based on asset quality and occupiers' sustainability demands. This means tenant-landlord relations will also be redefined on the road to net zero, requiring unprecedented levels of cooperation.

Technology is also having a particular impact on emerging sectors such as life sciences and data centres. A significant upturn in venture capital investment in European health, science and research - particularly in the wake of Covid-19 - has focused mainly on clusters associated with globally recognised educational institutes.

In Asia, the 'green revolution' will provide significant opportunities for investors, particularly through the financing of eco-friendly projects and the delivery of renewable energy and associated manufacturing and construction projects. Initiatives such as Singapore's CleanTech Park and Pangyo Technovalley 2 in South Korea offer investors opportunities to tap into clean tech growth and the longer term structural changes relating to ESG through direct investments into real estate facilities.

Opportunities:

- Investment in Life Sciences clusters represents a wide range of opportunities from tech and office space to student accommodation and residential investment.

Challenges:

- Buildings with inferior ESG characteristics are likely to come under increasing pressure
- Plans to tackle climate change issues will come at a high financial cost in APAC countries such as South Korea, Japan and China, which are among the most vulnerable to the impact of climate change and whose role in global efforts to address climate change will come under increased scrutiny
- Asset managers will face a balancing act of delivering ESG enhancements and the need to weigh up short term costs versus medium to long term performance benefits.

3) Green shoots in parts of the retail market but not all retail will prosper

COVID-19 might have accelerated the shift to e-commerce, but today's customers seem to want the best of both worlds. Though the retail sector continues to grapple with significant challenges, bricks and mortar assets will still have a defined role in many markets. No longer just spaces to buy, shops are places to enjoy shopping 'experiences', to browse and get a feel for products. They are also an essential part of fulfilling online orders. Retail parks in particular are well placed to benefit from this growing trend, as are assets in conurbations that tap into the click and collect market.

Following a protracted downturn, the retail sector could be reaching a turning point in its cycle, with early signs of growing capital values and improved sentiment in some parts of the market. As the economy recovers, retail rents may stabilise or even grow moving forward, potentially prompting the return of yield-hungry investors. This could lead to a rebound in pricing, as is already being seen in retail warehousing in the UK and elsewhere.

Caution is still necessary, as much of the retail sector globally continues to face an uncertain future. Some locations are hard to replicate, so assets with a 'sustainable' future as retail may represent the best value for investors.

Opportunities:

- Bricks and mortar stores are a vital component of the click and collect model – many online retailers are partnering with physical retailers to improve the customer experience and goods returns are increasingly being processed in physical retail assets
- Cheaper rents may encourage new entrants to take on new space and experiment with the latest innovative concepts, resulting in a more diverse tenant mix.

Challenges:

- Retail destinations will need to re-position away from fast fashion operators, as this part of the market increasingly shifts online.

Commenting on the report, Jose Pellicer, Head of Investment Strategy at M&G Real Estate, says: "We are witnessing a range of trends emerging as the relaxing of economic and social restrictions given way to higher consumer and occupier demand in certain locations but there is still tight supply, lockdowns and supply chain issues in others. The key is to identify winners in this environment.

“The pandemic has undoubtedly been a huge wake up call for ESG related issues for investors and tenants alike. Evidence is showing that tenants are paying ‘green premiums’ for buildings with strong ESG credentials and, conversely, are demanding ‘brown discounts’ for properties with weaker environmental performance. Stranded assets will be inevitable. Real estate investors will be wise to thoroughly prepare their portfolios for the 2030s.”

Please access the full outlook report here: M&G Global Real Estate Outlook

https://view.ceros.com/m-and-g/global-real-estate-outlook-nov-2021/p/1

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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.

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