Lower Real Estate Valuations: Bargains for Patient Investors?

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With interest rates returning to more historically normal levels, market uncertainty has resulted in a reset of real estate values. However, for investors with a long-term perspective, now could be an ideal time to diversify investment portfolios by adding an allocation to real estate at attractive valuations.

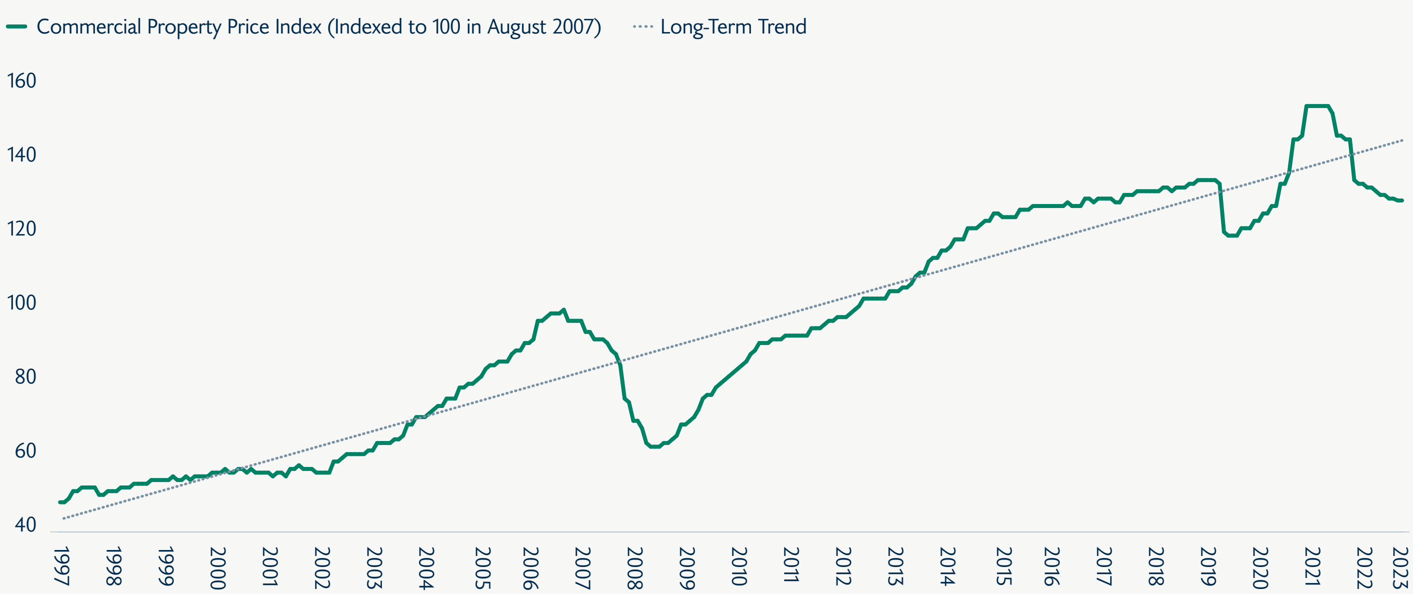
Real estate has historically provided investors with attractive returns, income generation, diversification and inflation protection. We believe that investors now under-allocated to the asset class are in a good position to take advantage of the current reset in valuations.

Investors Must Be Both Aggressive and Patient

With high interest rates and stubborn sellers limiting deals, real estate prices are down meaningfully from post-pandemic peaks. A widely used commercial property price index (**Figure 1**) shows property prices have dropped below their long-term trend line, suggesting what we believe could be a potential buying opportunity.

Figure 1: Valuation Reset Suggests Long-Term Value Emerging

Commercial Property Price Index vs. Trend Line



Long-term trend plots known points, using the least squares method. The Commercial Property Price Index is a time series of unleveraged property values across these sectors and markets and captures the prices at which commercial real estate transactions are currently being negotiated and contracted.
Source: Green Street Advisors, data as of July 31, 2023.

Despite the valuation reset, operating fundamentals remain healthy across most real estate sectors, with uncertainty mostly confined to low-quality properties. Stress on real estate values is a result of monetary policy decisions as central banks seek to moderate inflation. We don't see distress within real estate broadly, but we see an opportunity to capitalize on stress from capital markets to acquire assets at good prices.

We believe the current disruption presents an attractive long-term entry point to carve out an allocation to real estate or add to existing allocations. Investors should expect to see some quality assets for sale at meaningful discounts as the cost of borrowing remains elevated and the gap between sellers' and buyers' expectations widens.

Learning From the Past

Institutional investors such as pension funds and endowments have been allocating more of their portfolios to real estate for years, knowing that a long time horizon makes these alternatives to stocks and bonds an attractive way to diversify their returns. We believe the same approach makes sense for individual investors today.

More than 30 years of real estate experience, spanning multiple real estate cycles, has taught Brookfield to look beyond the noise and focus on the fundamentals that drive real estate returns, supply and demand, entry price, conservative financing and operational excellence.

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