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OUTSIDE LOOKING IN:

HOW FOREIGN INVESTORS SEE THE US REAL ESTATE MARKET TODAY

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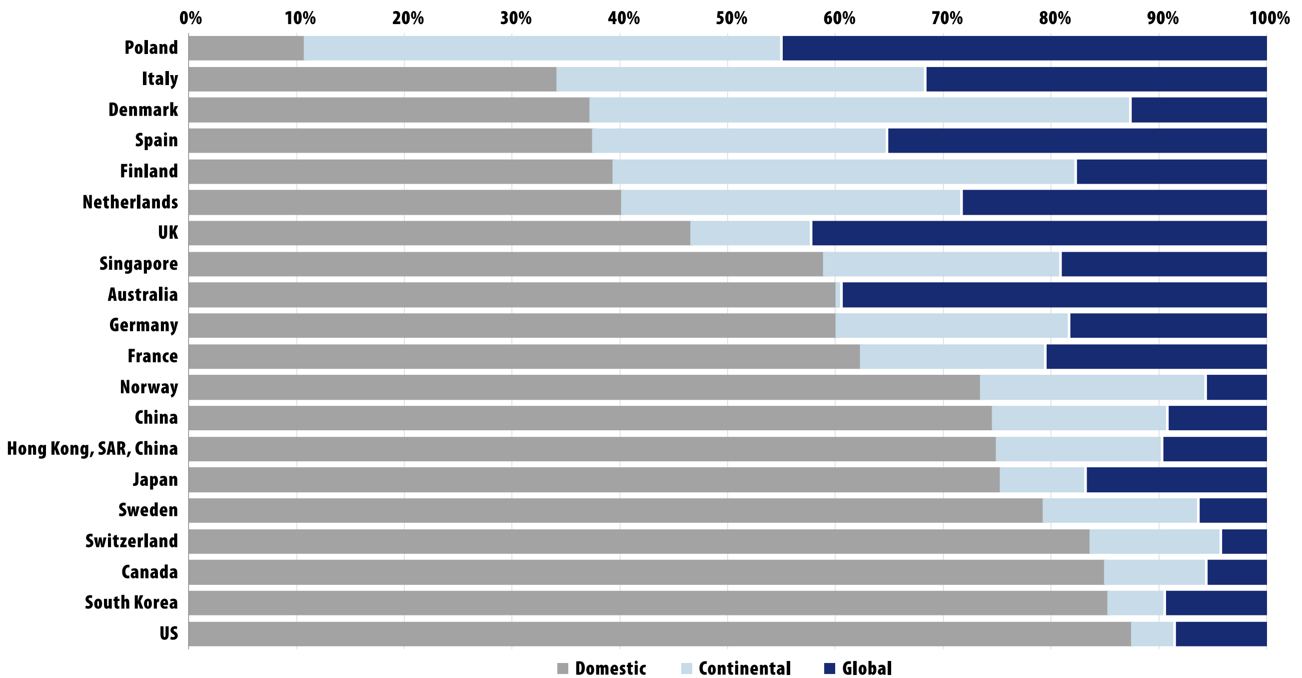
Foreign investors are an important—if far from dominant—source of capital for US commercial real estate. Since 2010, foreign investors have made up around 12% of total US investment activity, compared with the 30%–60% range for most other major developed markets, according to MSCI Real Capital Analytics (Exhibit 1). However, foreign investors also play a meaningful role as limited partners in funds. According to the PREA Investor Composition Survey, investors from outside the US in 2022 held nearly 18% of the NCREIF Fund Index—Open End Diversified Core Equity (NFI-ODCE) net asset value, a share that has risen steadily from less than 5% in 2012. Moreover, in some phases of the market, offshore capital has acted as the marginal buyer of certain types of real estate, giving an outsize impact on pricing.

Investors broaden their real estate holdings outside their home countries for many reasons, including to diversify, expand the opportunity set, and avoid crowded capital markets at home. The drive to expand globally is especially strong for investors in countries with excess savings in the form of well-funded defined benefit pension systems (e.g., Northern Europe), mandatory retirement savings programs (superannuation in Australia), or sovereign wealth funds (many energy exporters). LaSalle has long been an advocate of "going global"; while not the focus of this article, LaSalle covers the case for global investing in its ISA Portfolio View report.

Exhibit 1: Buyer Origin for Top 20 Investment Markets (2010–2023)

Foreign investors have made up a smaller share of activity in the US than other major markets.

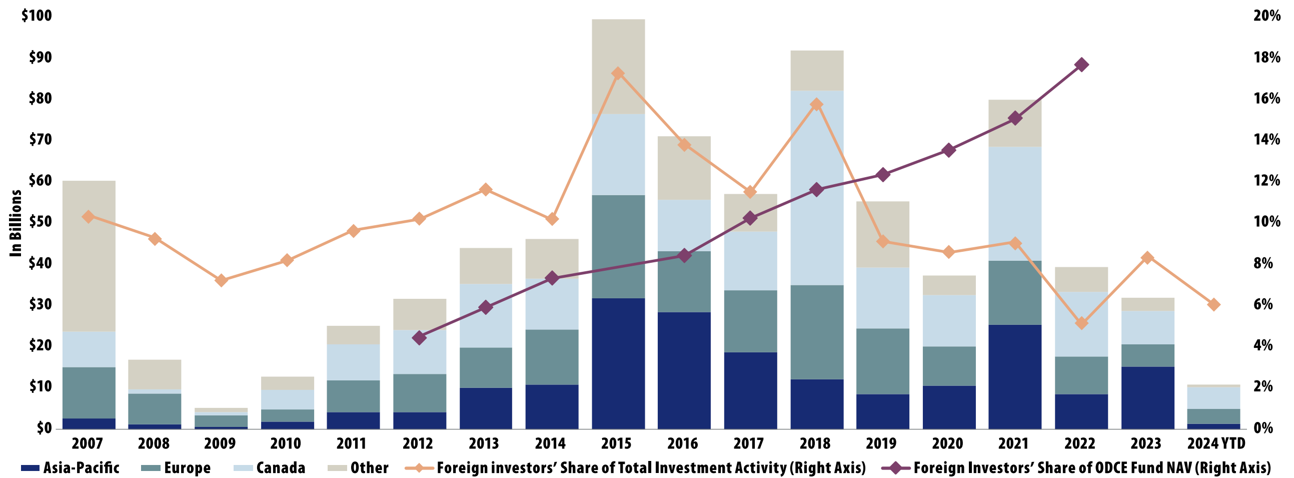


Source: MSCI Real Capital Analytics

Notes: Income-producing properties above $10 million only. Continental refers to foreign capital from the same continent. Global represents capital from elsewhere in the world. The quality of these data relies on MSCI Real Capital Analytics' classifications of investor origins. When two or more parties are involved, investment origin is credited to the country of the player with headquarters farthest from the property. When no underlying investor is known, it is credited to the headquarters domicile of the investment manager. This tends to lead to overcounting of US-source investment, given the large number of US-based real estate managers.

Exhibit 2: Foreign Investment Into US Real Estate

Foreign investment into US real estate has declined, and the balance has shifted away from Asia.

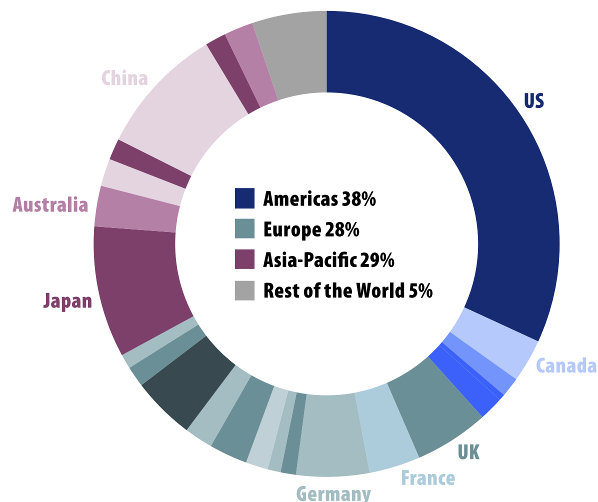


Sources: MSCI Real Capital Analytics, PREA Investor Composition Survey 2023

Notes: Includes all commercial real estate and development sites of properties over $2.5 million only. The quality of these data relies on MSCI Real Capital Analytics' classifications of investor origins. When two or more parties are involved, investment origin is credited to the country of the player with headquarters farthest from the property. When no underlying investor is known, it is credited to the headquarters domicile of the investment manager. This tends to lead to overcounting of US-source investment, given the large number of US-based real estate managers.

Exhibit 3: Share of the Institutional Invested Real Estate Universe

Percentage of Global Total by Country



Source: LaSalle; estimates as of June 30, 2023

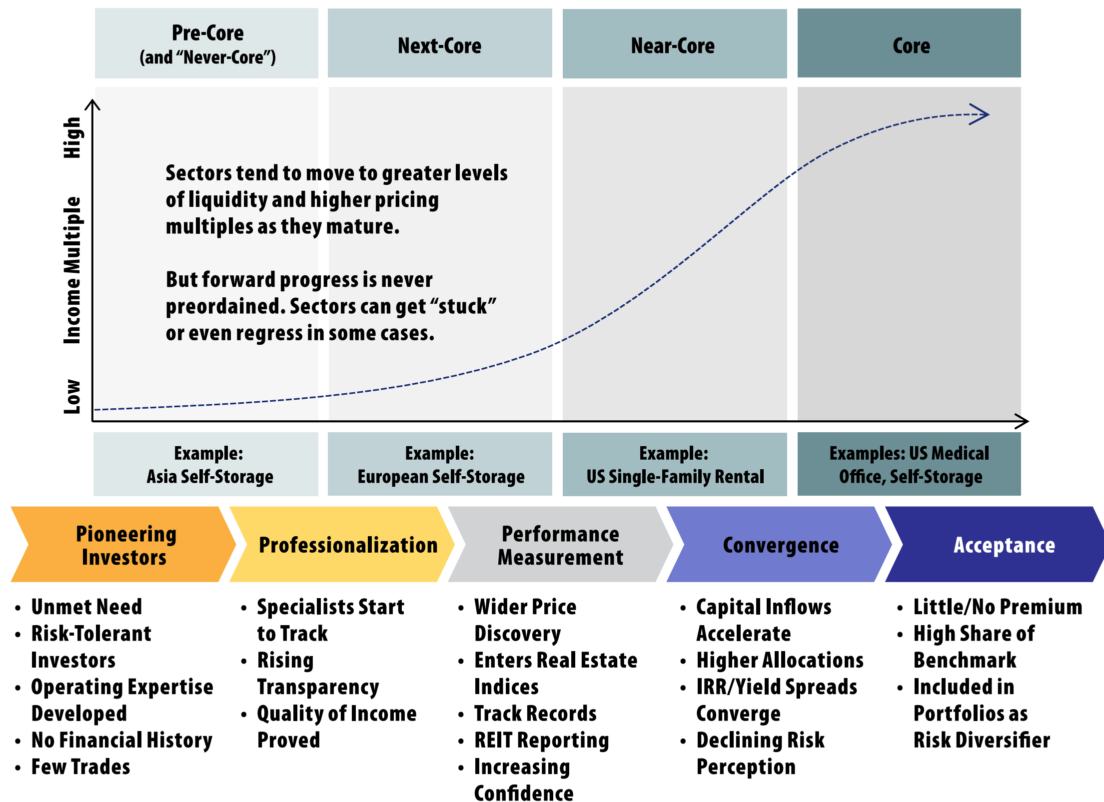
The recent trend in foreign investment into US real estate is downward, both in absolute terms and as a share of total deal volume, falling to around 6%–8% of total activity (Exhibit 2). What is going on? LaSalle's global footprint, both in terms of investing and in capital formation, gives a comprehensive perspective on how non-US investors see the US market today. In general, nine common themes explain how foreign investors think about US real estate today. (See "Domicile-Specific Observations" at the end of this article for a perspective on the nuances behind the bigger themes.)

Size Matters

The US is often the first port of call for investors seeking real estate exposure outside their home countries. The key driver of this is simple: the US is a huge market (Exhibit 3). According to LaSalle's estimates of the global real estate investable universe, the US makes up roughly one-third of the total capitalization of global institutional real estate, 3.6 times the size of the next-largest market, Japan. The sheer size of the US market creates efficiencies for cross-border investors. Every new market added to their portfolios involves both a learning curve and the "brain damage" of determining appropriate legal and tax structures. For larger markets, the costs and time of these factors can be amortized over a larger base of deployed capital. In other words, there's a bigger bang for the same brain-damage buck.

Exhibit 4: LaSalle "Going Mainstream" Framework

The US has the most sectors that have "gone mainstream."



Pioneering Investors	Professionalization	Performance Measurement	Convergence	Acceptance
• Unmet Need • Risk-Tolerant Investors • Operating Expertise Developed • No Financial History • Few Trades	• Specialists Start to Track • Rising Transparency • Quality of Income Proved	• Wider Price Discovery • Enters Real Estate Indices • Track Records • REIT Reporting • Increasing Confidence	• Capital Inflows Accelerate • Higher Allocations • IRR/Yield Spreads Converge • Declining Risk Perception	• Little/No Premium • High Share of Benchmark • Included in Portfolios as Risk Diversifier

Source: LaSalle Research and Strategy; as of November 2023

European investors are an exception to this observation but for a reason that highlights another advantage the US enjoys. Continental European investors tend to allocate earlier and heavier to other European countries than to the US or the rest of the world, in part because of their common currency (the euro). Investors from non-eurozone countries do not have the convenience of sharing a currency with other major investable markets, but the status of the US dollar as the world's reserve currency means they may already have significant US dollar holdings in other asset classes and may even think of the dollar as one of their "base" currencies.

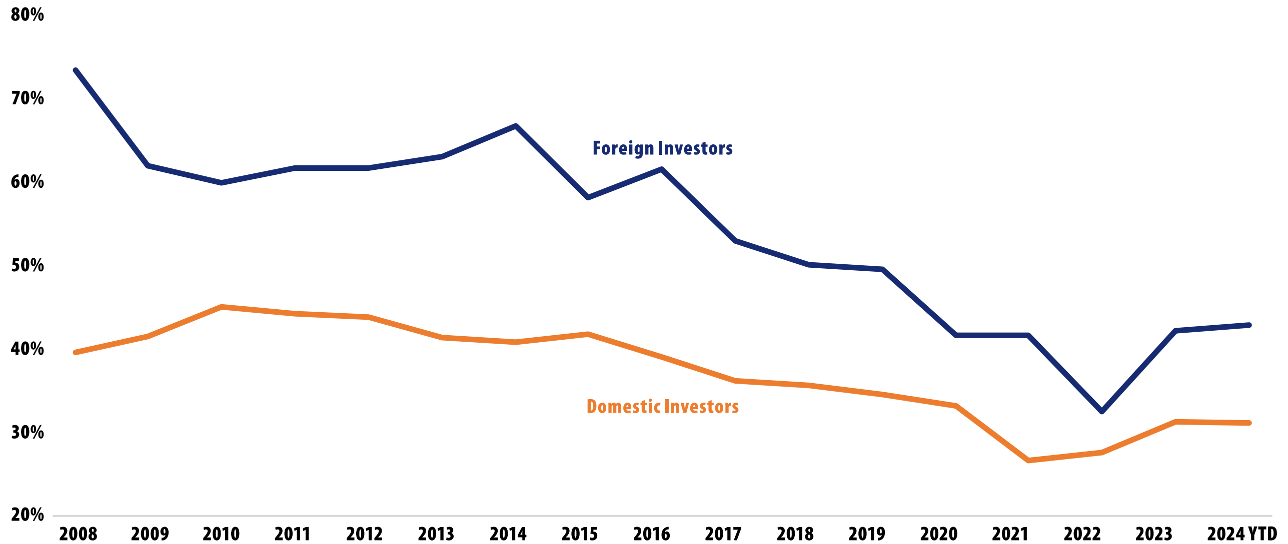
The Broadest Investment Menu

Cross-border real estate investors rightly see the US as having the deepest and most diverse menu of property types in the world, with large and transparent markets for specialty sectors, specialty subtypes, and residential. Sectors such as self-storage, medical office, single-family rental, and industrial outdoor storage are perceived as among the most attractive sectors for investment globally. However, in many countries, these sectors are just beginning to emerge or are nonexistent; non-US investors seeking exposure to them often find it difficult to achieve that at home (Exhibit 4). The same is true of the apartment market, which is larger and more institutionalized in the US than anywhere else.

The diversity of the US investable option set is extensive and, while appealing, can make sector allocation decisions more complex, especially for non-US players that may be less familiar with so many business models. LaSalle advocates for investment guided by a relative value framework that evaluates the various sectors' pricing levels, short- and long-term income growth

Exhibit 5: Major Metros as a Share of Total US Investment Volume by Investor Type

Foreign investors are broadening their geographic targets.



Source: MSCI Real Capital Analytics

Notes: Major metros are defined according to MSCI Real Capital Analytics' definition of the largest six markets: Boston, Chicago, Washington DC Metro, Los Angeles Metro, New York City Metro, and San Francisco Metro. The quality of these data relies on MSCI Real Capital Analytics' classifications of investor origins. When two or more parties are involved, investment origin is credited to the country of the player with headquarters farthest from the property. When no underlying investor is known, it is credited to the headquarters domicile of the investment manager. This tends to lead to overcounting of US-source investment, given the large number of US-based real estate managers.

rates, and capital expenditure (capex) requirements on a comparable basis. LaSalle believes that this is the best way to methodically make sector allocation decisions in a complex world that goes far beyond the "four food groups" of the traditional property types.

Metro-Curious

In addition to the diversity of sectors, the US includes many metropolitan areas, given its large landmass and decentralized population. That said, foreign investors historically took what they felt was a conservative approach, concentrating their US investments in "gateway" markets such as New York, Washington DC, Boston, San Francisco, and Los Angeles (Exhibit 5). These markets were seen to be more liquid, and conveniently, they are easy to reach on nonstop flights from much of the world. Offshore investors' bias in favor of global cities led to more geographically concentrated portfolios than those built by domestic US players.

Over time, however, international investors have become more comfortable with a broader geographic scope, including both large metros not generally considered gateways (such as Dallas and Atlanta) and smaller ones leaping up the league tables (e.g., Nashville, TN). This has happened in parallel with the broader trend of increasing overall investor interest in smaller metros, especially as many of these locations have recently enjoyed above-average in-migration of households and business activity. In our experience, some foreign investors lag in their familiarity with smaller non-gateway markets, suggesting they can benefit from working with a manager who has granular knowledge of the entirety of the deep US opportunity set.

Divided on Office Woes

Office was once the most preferred sector for cross-border investment globally, owing to widespread familiarity with the asset type and its tenant base of well-known corporates. But in its ISA Outlook Mid-Year Update, LaSalle stated that global office market conditions were "all over the map"—both literally and figuratively. This is because office markets in parts of Asia and Europe remain relatively

healthy, while those in the US are very weak. Dissecting the reasons behind this divergence is beyond the scope of this article, but suffice it to say that key drivers include structural differences around who bears the cost of capex in the context of very different supply-demand-balance conditions and differing levels of hybrid work.

This divergence means that when foreign investors look at US office markets, some do so with a degree of incredulity of how things have gotten so bad. After all, for most of them, the severe weakness in the US office market is not consistent with their experience at home. More important, they have varying opinions on what to do about the situation, ranging from categorizing offices as a "hard avoid" to seeing this moment as an opportunity to buy assets they expect to be viable over the long run at discounts to replacement cost. In possessing this range of views, foreign investors are not dissimilar from their domestic counterparts; however, they are in a unique position to consider comparisons and contrasts with their home markets.

Politics: Grab the Popcorn

In recent meetings with investors across the globe, LaSalle was often asked, Who will be the next US president? Investors are clearly very interested in American politics, and many closely follow political news from the US. They accurately observe that American politics has become very polarized and that policymaking has become less aligned with its historical norms of promoting free trade and military interventionism to maintain a US-led liberal world order.

That said, based on feedback LaSalle is getting, foreign investors are generally unshaken by the news cycle and are confident the US will remain a key investment target regardless of political developments. Even as the US plays a less-engaged strategic role globally than during the Cold War era, increasing the risk of conflict in other parts of the world, foreign investors see the US as a relative safe haven because of its location and domestic energy supply. Moreover, they note that a high likelihood of a split government—that is, no single party controlling the presidency, House of Representatives, and Senate at once—makes sweeping policy changes unlikely.

Tracking Specific Policy Topics

Even if global investors are reasonably sanguine on the US political news flow, they are not uninterested in following specific policy topics that may impact their investment opportunities. Recent events they are tracking include these:

- The US Treasury Department issued final domestically controlled REIT regulations, which may impact the existing and future investment structures of sovereign investors.
- The US Supreme Court ruled that courts must no longer defer to an administrative agency's interpretation (via regulations) of a federal statute—ending the "Chevron doctrine"—and this may have as-yet-unknown impacts on tax regulations.
- Twenty-three states have adopted or have proposed legislation regulating foreign investment in real estate, with a focus on China but including investors from other countries.
- The US Treasury Department also proposed rules that would expand the authority of the Committee on Foreign Investment in the United States to review certain transactions by foreign persons involving real estate close to 59 additional military installations, for a total of more than 250 military installations.
- Building environmental performance standards are being implemented by more than 30 US states and local governments, which will create a patchwork like the one in Europe, potentially covering around a third of investable US real estate over the next few years.

Seeking Value in Green

The point about environmental regulation deserves a closer look because it highlights differing investor perspectives on sustainability across and within regions. In some cases, non-US investors have ambitious climate goals and would like to see an aggressive approach to sustainability that goes beyond the US norm. For example, in Europe greater cultural consensus around a net-zero carbon (NZC) future means that funds undertaking NZC goals and investments in decarbonizing buildings are seen as being in line with fiduciary duty because this approach aligns with common agreement around where

market demand and regulations will go in European markets. An investor with strong green ambitions will find the regulatory signals in the US much more varied by jurisdiction, with a strong impetus for decarbonization in some states and cities and none in others.

The common denominator is identifying evidence of how investments in sustainability impact the bottom line—what LaSalle has called the "value of green" in its ISA Focus report on the topic. Regardless of their level of green ambition, all investors want to understand the link between sustainability and investment performance. Leading investment managers are thinking carefully about which markets and asset classes are earning premiums for green attributes or suffering discounts for lacking them. This includes looking beyond office to opportunities in industrial properties that can support solar and multifamily properties with green features, among others.

Cautiously Optimistic in the Short Term

Investors in US real estate, both domestic and cross border, have largely been waiting for values and inflation to stabilize before making new investments. As of early August, investors increasingly expect that the Federal Reserve will begin cutting rates soon. They also tentatively recognize that many segments of the real estate market have returned to fair value. For core open-end funds, the increase of ODCE yields to greater than 4.0% has gained attention. That said, many investors have been waiting to see positive ODCE appreciation as a sign that stabilization has been reached, and that is now on the horizon as many funds anticipate an end to write-downs in the near future. An additional challenge specific to foreign investors is short-term US interest rates have stayed elevated, increasing prospective hedging costs; a factor

related to this is that the US dollar has been strong, potentially causing some to question the entry point timing from a foreign-exchange risk perspective. Either way, LaSalle characterizes domestic and international investors similarly—both are cautiously optimistic that a turning point in US real estate markets is near but a rapid V-shaped rebound in prices is not likely unless interest rates decline substantially.

Bullish on the Long Term

If foreign investors' short-term perspective on the US can be characterized as transitioning to optimism, the long-term view continues to be, based on conversations with investors, firmly bullish. Investors view the US as arguably the world's best-positioned economy to both drive and benefit from technological innovation. The US has world-class universities and is a key hub for artificial intelligence and biotechnology innovation. These both support specific property opportunities, including data centers and life sciences real estate, and provide the prospect for economy-wide investment, productivity, and economic growth. The US is also notable in being well-positioned demographically, with a more positive long-term outlook for population growth than many

Domicile-Specific Observations

While the key themes apply across most investors, a few specific to key jurisdictions are worth calling out.

European Investors

Most UK and European investors perceive the adjustment of real estate valuations in Europe one or two quarters ahead of the US, largely down to sticky office valuations in the US. (UK valuations practice allows proxies to be used to justify valuation adjustments, while the US system emphasizes comparable transactions; as such, US market segments with minimal transaction activity can see valuations move more slowly.) That said, larger European investors are looking for an attractive entry point to the US market and are focused on living and logistics strategies, as well as specialty sectors such as medical office, data centers, and self-storage, especially in the higher-returning space.

Although European investors generally are highly aware of sustainability considerations, they are relatively more focused on achieving those objectives in their European portfolios rather than in US portfolios. Some have adopted policies tied to the EU Sustainable Finance Disclosure Regulation classifications, with many Dutch investors, for example, targeting Article 8 funds at a minimum. European investors appreciate the depth of energy-related building data available in the US, which tracks actual energy consumed rather than the estimates based on physical characteristics that drive Europe's energy performance certificates. Additionally, European investors, particularly those that use Carbon Real Estate Risk Monitor curves, tend to look at the total carbon impact of an investment (building energy use and grid energy mix combined). European investors are divided on whether the slower pace of decarbonization of the US grid should be a factor that counts against US real estate.

There is some variation by European country in appetite for US real estate, with Dutch investors benefiting from efficient tax treatment in the US, for example, and French and Italian investors facing a significant tax leakage on both capital and income returns.

Canadian Investors

With a population of fewer than 40 million, Canada has a relatively concentrated domestic market—with a small number of major metro areas, a handful of large pension fund players, several large banks, and a domestic investable universe heavily weighted toward traditional property types. As such, Canadian investors have a strong appetite to access strategies and sectors not readily available in the domestic market, such as specialty sectors. The largest Canadian pension funds make US investments on a direct basis with operators and developers, while utilizing commingled funds in sectors in which they cannot execute directly. Smaller investors use a variety of strategies to access foreign investments, ranging from country/regional funds to funds of funds.

Japanese Investors

Japanese investors' stance toward foreign real estate markets tends to be tied closely to Japan's yield and currency relativities with the rest of the world. Although Japan has started down the path of monetary policy normalization, a wide gap remains between Japan's bond yields and those of the US and other developed markets, which translates into a weak Japanese yen and high hedging costs for Japanese investors. Japanese investors tend to be core investors, but with a US ODCE yield of around 4% and Japanese yen-to-US-dollar hedging costs that were until recently as high as 500 basis points, many Japanese investors struggle to achieve their target cash yields in US core strategies. As a result, some Japanese investors are waiting for the yield difference to decline, whereas others have shifted toward value-added or debt strategies.

Other Asia-Pacific Investors

Among investors from elsewhere in Asia, appetite is generally strongest for credit strategies, in part because more-predictable cash flow profiles make currency hedging easier. Like Japanese investors, other Asian investors are currently less active in US real estate than they were historically but for varying reasons. South **Korea** used to be one of the largest foreign sources of capital for US real estate, but appetite is down because many Korean investors are still overallocated to real estate and because some remain focused on challenges faced by their US office assets. Investors from **China** face government controls on their ability to place capital abroad. To the extent that they can do so, Chinese investors looking abroad seem to be placing greater emphasis on European over US real estate, given US-China political tensions. Investment flows from **Malaysia** have for now been negatively impacted by the weakening ringgit and related instructions from the government not to move capital offshore. Like other players, investors from **Australia** have exhibited a clear preference for credit strategies, and they are constrained by regulations around how superannuation fund fee burdens are disclosed, with implications for which strategies they are able to pursue.

other developed countries, especially Japan and much of Europe. Finally, it is consistently ranked among the top few most transparent real estate markets, per the LaSalle/JLL Global Real Estate Transparency Index.

In summary, foreign investors remain very interested in US real estate. Their recent pullback as a share of volume appears rooted in cyclical factors or idiosyncratic issues at home rather than anything more permanent. In the long term, the US is likely to remain a top target for global capital—and rightly so in LaSalle's view. ■

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