**Subject:** FW: Global House View - Final

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In many ways, this year has been notable for a lack of surprises, particularly since we went into it wondering what an unpredictable and potentially disruptive political environment might bring us. By and large, it’s brought us more of the same: slow but positive economic growth, historically high but moderating transactions activity, and, seemingly more capital to buy real estate than sellers willing to part with it.

And yet, as I look through the global and regional House Views from this year, while things might not have changed much, our outlooks certainly have. In terms of the economic and political environment, we entered the year with a lot less conviction than we have now. We were particularly worried about tenant demand. With so much uncertainty, we questioned whether we could count on the leasing growth needed to keep our stabilized properties full, and to execute our value-add strategies.

The answer to that question has been a solid ‘yes’ in most of our markets, and we have increasingly strong conviction that the momentum will continue.

Tenant demand continues to match new supply in the United States, keeping occupancies steady at historically high levels and keeping rental growth positive. Elsewhere, we’ve gained conviction around improving conditions, with Continental Europe offering a great combination of the highest economic growth since the Great Recession along with very low supply. We are convinced that the softer Asian markets – notably South Korea and Singapore – have turned a corner, and we are anticipating positive net absorption across all major sectors in the region. The UK is the only market where we have adopted a “wait-and-see” approach, given the lack of clarity around the ultimate impact of Brexit.

At the same time, executing in this improved supply and demand environment has become harder as the year has progressed. In a market with ample capital to invest and no urgency for owners to sell, bid-ask spreads have not narrowed, and in some cases may have widened. We are experiencing this both as a buyer and a seller.

On the sell side, particularly in the United States, we’re finding that some of our core, stabilized assets only attract bids from non-core buyers with inflated returns expectations. Most of the time, we have decided to hold onto these assets for at least a little longer.

On the buy side, we’re bidding on what we view as value-add assets, only to discover that the owners are not willing to part with them unless they can achieve core pricing. We are faced with the dilemma of whether to meet the market by assuming higher rental growth, particularly in Europe, or to accept lower returns.

One option in this competitive environment is to simply wait out this wide bid-ask environment, holding on to most of what we own and waiting for more motivated sellers to come into the market. While this is tempting, there is no reason to believe this environment is likely to change anytime soon. We have already moderated our investment activity this year and while I don’t see a reason to significantly pick up the pace next year, we’re also not going to sit on the sidelines.

So what should we do? Where we’re most worried about pricing, we are making some of our investments behind first-loss equity positions, through PreCAP VI in the UK, our PREDS joint venture with PGIM Real Estate Finance in the United States, and our equity funds in mezzanine construction loans. While we feel good about these investments, we are also mindful of the amount of debt capital that has been raised, meaning that the space is no longer a safe refuge from the competitive equity investment environment.

For our equity funds, we need to focus on being active buyers and sellers. Fortunately, as discussed in our regional House Views, we have identified opportunities even in market environments in which we are not entirely sure if cap rates are headed up, down or sideways. These include:

* **Finding value outside of the most competitive segments of the markets**, such as investing in Osaka rather than Tokyo office, and in Class B suburban apartments in the United States.
* **Taking on leasing and development risk** where we have high conviction about sustained tenant demand, including major cities in Germany and France, and in the Kyoto hotel market with its robust tourism growth.
* **Judiciously expanding to non-traditional property types** that provide core-like income streams, including the manufactured housing sector in the United States (which our Investment Research team recently covered in its [latest paper](http://click.e.email-prudential.com/?qs=f0f422f79eca2f18cab0ea70623400887098284f8162d33105484cf268d1c7fe7c7885f8d9aa327af7fff7b348f2b768)).
* **Remaining active and disciplined sellers**, including capitalizing on excess liquidity in China by exiting an office investment in Shanghai, and the diligent pruning of non-strategic assets being carried out in the United States that will likely result in our U.S. funds being net sellers this year.

While it is a highly competitive environment, I take comfort that we have done enough hard work over the past few years to enable all our funds to withstand whatever comes next. We are also now well-positioned to take on risk, even in competitive markets, with the conviction that we are able to deliver on our core and value-add investment strategies.