Emerging Trends in Real Estate®
Road to recovery

Europe 2022

pwc

Urban Land Institute

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Europe 2022
A publication from PwC and the Urban Land Institute

Front cover image: 22 Bishopsgate, London, UK
(Jeremy Felson)

Image: 22 Bishopsgate, London, UK
(Edmund Sumner)

Contents

"One of the biggest challenges in the industry is this expectation of short-term returns, as opposed to saying what can I do to help the community to grow? Over time, the value of that real estate increases. But it's a long-term view."

Pan-European adviser

Executive summary

"There is a compelling investment case for Europe, and that will attract capital from around the globe because the underlying economics of it, relative to other opportunities, make a lot of sense."

Managing director, global asset manager

Image: European Central Bank, Frankfurt, Germany (Shutterstock)

As European economies have started to recover from the pandemic, there is a clear upturn in confidence among property industry leaders although many are still coming to terms with the radical changes to the business of real estate brought about or accelerated by COVID-19.

Emerging Trends in Real Estate® Europe reflects a broad sense of relief and short-term optimism that the industry has successfully worked through the worst of the pandemic and that real estate remains a favoured asset class.

Industry leaders draw comfort from the strength of economic growth across much of Europe following government and central bank support measures. As a result, business confidence and profitability expectations have recovered to pre-COVID levels. For many, this means the performance of real estate looks relatively strong for 2022 with higher forecast returns than a year ago.

Such confidence is further supported by continuing strong investor demand. Debt and equity are expected to be plentiful although there are clearly big differences between sectors that performed well during the pandemic and those that suffered significantly.

But with a society and real estate industry that have no experience of coming out of a pandemic and what "restarting the economy" really means, there continues to be volatility and uncertainty.

The biggest current uncertainty relates to inflation and supply chains, impacting mostly construction prices and delivery schedules, just at a time when the industry wants to resume delayed developments or advance repurposing initiatives.

As a consequence, we are seeing strong sentiment swings, as the industry struggles to interpret the potential impact of supply chain disruptions, surging energy costs and labour shortages on real estate, and how long these issues might last.

Against this backdrop, it is no surprise that the city rankings are little changed from last year. London regains the top spot from Berlin for overall investment and development prospects. The prominence of those two capitals as well as the other German cities and Paris, in third place, indicates that investors remain careful about where they deploy capital.

In other words, there is an understandable focus on cities that offer liquidity, at least for the short term. Much depends on the post-lockdown shape of office demand – still to be determined. Even so, survey respondents are suggesting more encouraging medium-term prospects for regional cities in continental Europe, which have been less adversely affected by fluctuations in workplace occupancy during the pandemic than the major capitals.

The pandemic has also reinforced the trend of investors targeting contra-cyclical sectors that profit from megatrends and therefore generate resilient income. Those sectors that are seen to benefit from compelling supply/demand dynamics and strong demographic drivers continue to find favour – notably logistics and most forms of housing, although interviewees acknowledge that the latter remains politically sensitive.

Alternative, or niche, sectors such as data centres, life sciences and new energy infrastructure offer many of the same qualities. Despite this continued strong interest, they will not attract the most capital in 2022, and, as many interviewees point out, they are yet to offer the liquidity required by most investors. But their high ranking signals a direction of travel, part of a longer-term and fundamental shift into more operational real estate that the industry is navigating while making the most of the immediate economic upturn. And at the same time, it demonstrates a more granular approach to real estate investing, drilling down into the specifics of subsectors when making asset allocation decisions.

Uncertainty is the key word when looking further ahead over the next three to five years, not only because of structural changes, but also concerns over almost all business, real estate, and social and political issues, which all come out higher than for the coming 12 to 18 months.

Over several years, *Emerging Trends Europe* has identified the growing importance of operational assets but also the need for far greater emphasis on customer service, brand and reputation, technology, an increasingly pressing environmental, social and governance (ESG) agenda and diversity in the workplace.

All of the above have been elevated to a new level of prominence as a result of the pandemic – becoming significant criteria in the real estate industry's "license to operate" and drivers of future success.

The distinctions between these barometers by which the industry will be judged are evidently becoming more fluid, with a strong emerging theme of the next decade likely to feature their fusion into a more holistic notion of what constitutes successful, high-quality real estate.

As this year's survey and interviews reveal, the force of the structural change in the industry now disrupting the products and services being offered is paving the way for a defining period of transformation in business models and strategy. Over two-thirds of survey respondents acknowledge that organisational transformation will be a key priority over the next five years, which will demand an unprecedented shift in mindsets, skills and leadership across the industry.

"We're taking into account a different relationship with our tenants going forward. So, we're rewriting some of our rental contracts to be more flexible and more business-related."

Head of real estate, pan-European asset manager

Chapter 1

Business environment

"All in all, COVID and sustainability are leading to a market where there will be a group of people that can benefit from the changes, while there will be companies with big legacy portfolios that will suffer."

Global real estate developer

Image: La Défense, financial district, Paris, France (Getty Images)

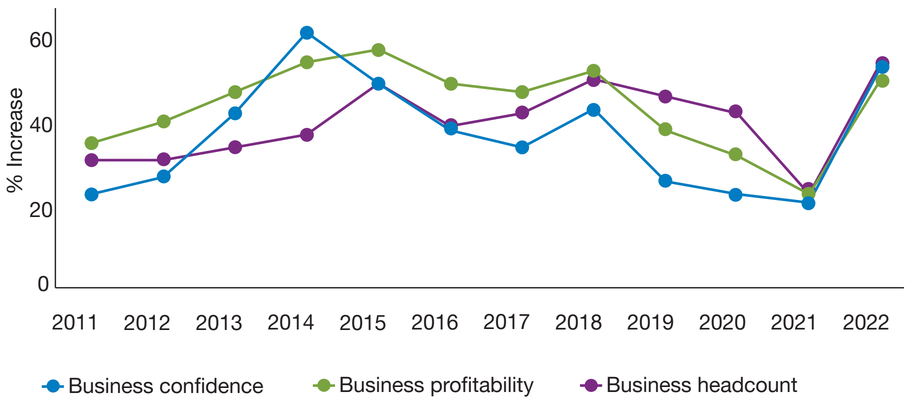
With real estate professionals across Europe signalling robust profit expectations and a significant leap in confidence going into 2022, it might seem logical to assume that the effects of the COVID-19 pandemic have largely been archived.

Yet despite the property industry on the whole displaying remarkable agility in navigating the health crisis – and at times, profiting from the altered landscape – *Emerging Trends in Real Estate® Europe* reveals that the pandemic has changed the business of real estate in a profound and potentially permanent way.

Certainly, the survey reflects an upturn in sentiment, as European economies recover from the gloom and uncertainty of 2020 and property leaders report better-than-expected financial results. Success with work-from-home (WFH) strategies, the industry's increasing digitalisation, and the confirmation of long-term investment theses have all contributed to a broad sense of relief.

But COVID-19's role as a trend accelerator – highlighted in last year's survey – has hardened into fact. Alongside this, its impact on supply chains and labour mobility has translated into very real, rising construction costs just at a time when property professionals are trying to catch up on delayed developments or push repurposing initiatives. The importance of environmental, social, and governance (ESG) matters has crystallised in the wake of the pandemic, gaining renewed urgency amid rising energy costs across Europe. (see page 19).

Figure 1-1 **Real estate business sentiment 2011–2022**



Source: *Emerging Trends Europe* survey 2022

While the residential sector continues to appeal to the industry due to its defensive fundamentals, investors are aware that housing remains a political hot potato. Elsewhere, logistics retains its lustre as a pandemic winner, while the appealing income profiles of data centres, new energy infrastructure, and life sciences all underline the continued enthusiasm for alternatives and operational real estate.

Perhaps unsurprisingly, the survey confirms that the dominance of offices and retail is over in terms of allocations. There is a feeling of "wait and see" around the office sector, with some respondents enthusiastic about the future of flexible, prime assets, while others envisage an inevitable contraction in overall demand.

> "The pandemic slowed down a lot of processes in acquiring assets, but the business performed surprisingly well in the end.

Whatever happens, the question over the future of office demand is unlikely to be confined to tenant and employee preferences. The survey reveals that the location of assets may become crucial, with regional cities in continental Europe having been less adversely affected by fluctuations in workplace occupancy during the pandemic than the major capitals.

"I think London and Paris are the two cities in Europe that will see the largest change in the use of office space going forward. The cost of occupation and the expense and time of commuting are substantially higher there than in other cities," says a European private equity fund manager.

However, the widespread use of WFH strategies in the past 18 months has also sparked a universal appreciation for choice.

"We really appreciated the flexible working style. I think the reasons for going into an office have changed," notes the research director of a global investment manager. "It's about team bonding and building, about culture."

Industry leaders suspect that remote working may continue to place pressure on the urbanisation trend, although it is not clear for how long. Within a few years, sentiment may change again.

"I think the big mega-cities will absolutely be back in favour, even though there is an immediate trend to more decentralised suburban living, which is more COVID related," says one global player. "I think the moment the immediate COVID impact goes away, people focus on jobs and careers and education and medical care and all of that."

In this light, opinions on city prospects seem to be coalescing around major metropolises once again. London is back as the most-favoured city for combined investment and development opportunities for the year ahead, with Berlin in second spot. Germany's dynamic city hubs – including Frankfurt, Munich, and Hamburg – are also highly regarded. The survey furthermore suggests that Paris will always have wide appeal among investors – although the city's downtown micro-locations are safest for investment.

In many respects, the global health crisis has activated a new level of vigilance for the uncertain. If COVID-19 was the epitome of a black swan crisis, the survey reveals that real estate professionals are on high alert for the next disruptive event.

A number of fears are political in nature, from Brexit and the ramifications of the recent election in Germany to political rows in eastern Europe. Worries over social unrest translate to a clearer focus on issues of diversity and equity in the industry.

It is that same hypervigilance that has the industry monitoring the risks of cybersecurity. With the rapid digitalisation of many real estate processes and the diffusion of sensitive data into people's homes due to remote working, the issue is viewed both as an everyday risk and a potentially high-level, even terrorist threat.

More directly, rising interest rates and inflation are a matter for concern, although Europe may be more sheltered than markets such as the US from the effects of the latter.

Set against this, property professionals seem less worried about the end of government support packages – in a world already awash with capital, pockets of distress would make a welcome change – and the spectre of an economic crash has all but vanished.

> "London and Paris will see the largest change in the use of office space going forward. The cost of occupation is substantially higher there than in other cities.

Confidence restored

The positive outlook in this year's *Emerging Trends Europe* reflects a sense that there is light at the end of the tunnel in terms of the pandemic. The interviews and survey, which were conducted between July and September, relay 12 months of measured success despite continued lockdowns and travel restrictions. For most respondents, the best is yet to come.

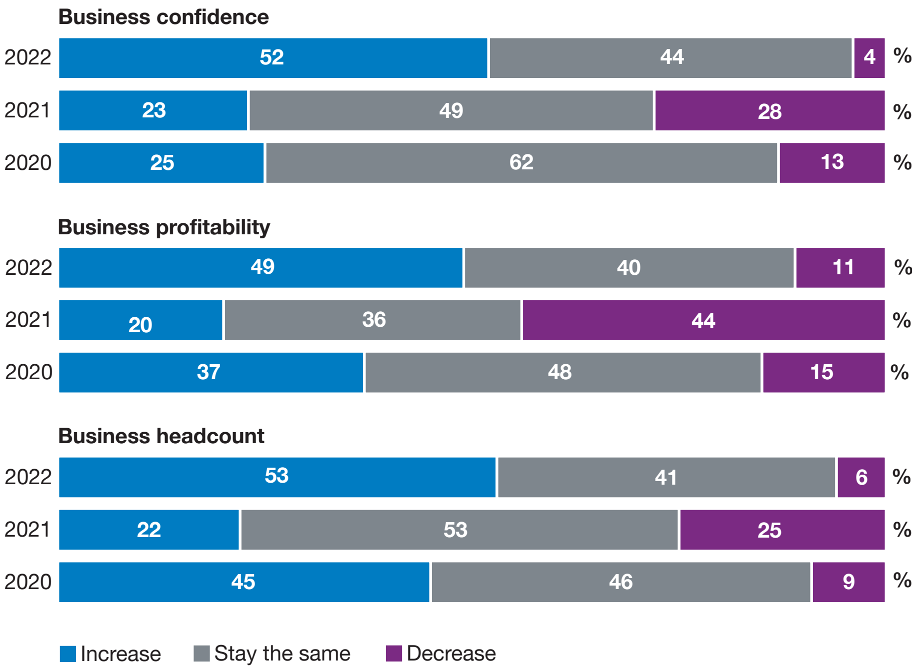
"The pandemic slowed down a lot of processes in acquiring assets, but the business performed surprisingly well in the end, especially when you think how things were at the beginning of 2020," says one global real assets investment manager.

Compared with last year's climate of pessimism and uncertainty, when only 23 percent of respondents felt that business confidence, profitability, and headcounts would improve, around half of those surveyed now think that all three metrics will rise in the coming year.

These responses mark the highest levels of business confidence for the survey since 2014, with positivity about staffing reaching its highest point in over a decade.

Europe's successful vaccination programme is a part of this, with the European Centre for Disease Prevention and Control reporting that 75.2 percent of adults in the EU/EEA were fully vaccinated by the end of October.

Figure 1-2 **Business prospects in 2022**



Source: *Emerging Trends Europe* survey 2022

As a result, travel has largely resumed within and between the bloc and the UK, and fears of further lockdowns across the region have diminished. However, while the picture is fairly rosy in Europe, industry professionals perceive that the full impact from the pandemic may yet take some years to play out on the global stage.

"I believe this will be a transitory year, with strong recovery from mid-2022. I'm talking about Europe, of course; for the rest of the world, this is not over, and will probably take three, four years," says a pan-European developer.

If last year's immediate fears over economic growth and business interruption have receded, this year's concerns reflect the rapidly unfolding post-lockdown climate for business, real estate, society, and politics.

> "I believe this will be a transitory year, with strong recovery from mid-2022.

The principal issues raised by respondents for the next 18 months are largely in line with their worries over the next five years. Top of mind are cybersecurity and inflation, with business interruption the only general business issue expected to be less of problem in the next five years. Deglobalisation and business liquidity – both key concerns last year – have dropped to the bottom of the list, perhaps as a result of respondents' positive experiences over the past 12 months.

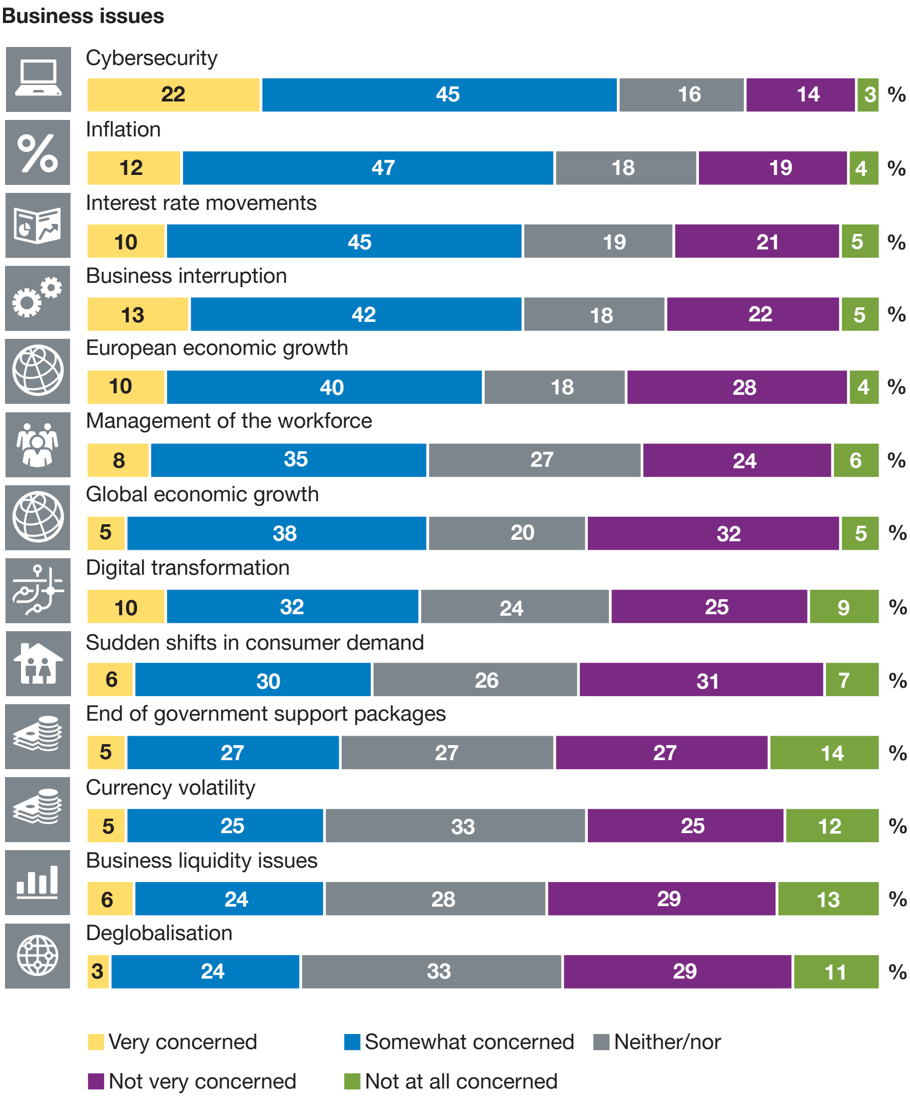
Last year's survey revealed that more than half of industry leaders thought cybersecurity would get worse in the future. For 2022, it is the most pressing business matter, with 67 percent of respondents concerned about its impact.

"Cybersecurity is one of the many things that we have to deal with, especially now that the digitalisation of offices is becoming more relevant," says one global developer. "We are maybe even looking at a sort of terrorism, where people could freeze a building and then ask for money."

For a pan-European property services adviser, the risk is more mundane. "Crime seeks the easy way in, and when we utilise the internet for everything, it's an obvious target."

A global fund manager adds: "We all went through cybersecurity training because it is a very serious threat."

Figure 1-3 **European business environment in 2022**



Source: *Emerging Trends Europe* survey 2022

Cybersecurity is one of the many things that we have to deal with, especially now that the digitalisation of offices is becoming more relevant.

The next most persistent business issues are inflation and interest rates, not just for 2022 but potentially over the next five years.

However, fears over the impact of that inflation are measured on the whole, reflecting a broader sense that its drivers are transitory in nature.

"Most of the inflation talk is temporary. I wouldn't say we currently have high inflation rates; it's simply the reflection of strong price decreases a year ago or low price increases," notes the chief economist of a global investment manager.

In July, the European Central Bank (ECB) reformulated its inflation target – for the first time in 18 years – to 2 percent, over the medium term. This reformulation is generally interpreted as a greater tolerance for temporary shifts beyond the 2 percent target.

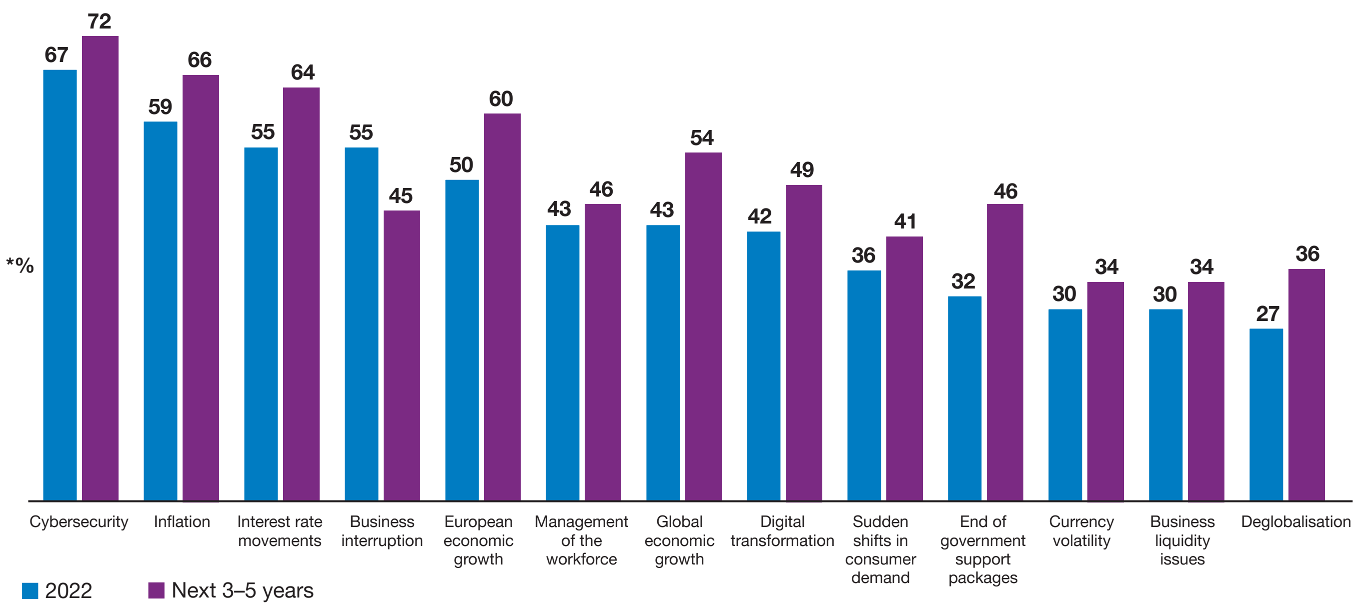
"Inflation should step up a level, but you're not going to get banks increasing interest rates substantially. There are two reasons for that: one, the ECB has changed its inflation target; and by keeping interest rates low, governments can have a higher level of debt and it doesn't cost very much," says the managing director of a global investment manager. "It's also linked to governments not wanting to take too many risks with economic recovery."

Yet the inflation threat persists as a result of rising energy costs and a worldwide crunch in supply chains and labour mobility.

"The spike in inflation is due to short-term supply-side disruption," notes a global fund manager. "More capital is going to come into our asset class and into other real assets as a result of that inflation fear."

"More capital is going to come into our asset class and into other real assets as a result of inflation.

Figure 1-4 **European business environment concerns for 2022 and over the next three to five years**



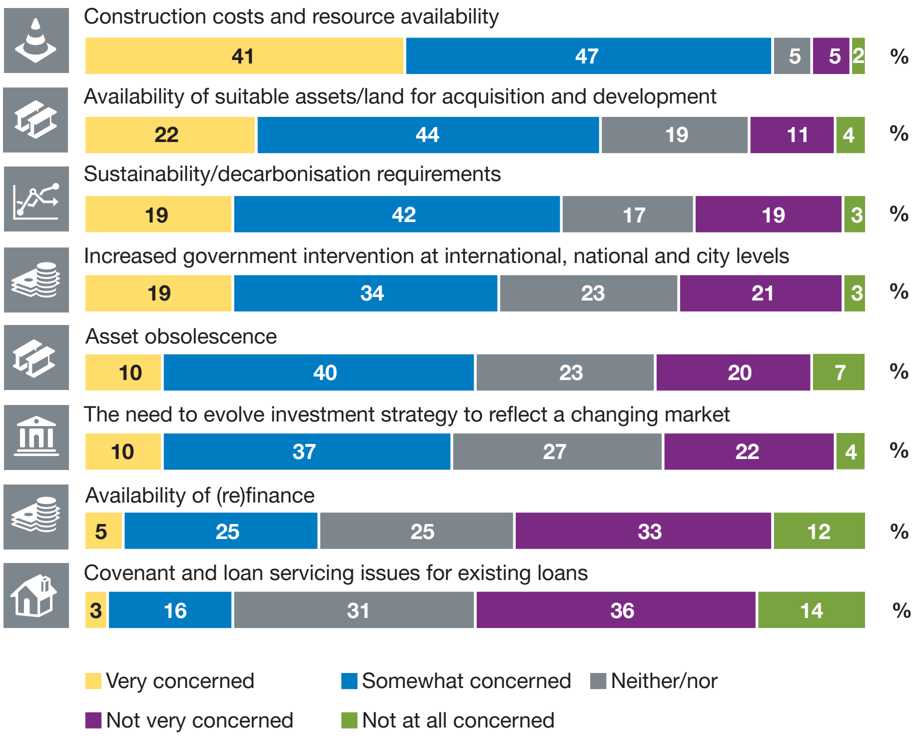
***Note:** Combined percentage of "concerned" and "very concerned" respondents.
Source: *Emerging Trends Europe* survey 2022

While this thesis backs the idea that real estate remains more attractive than equities and bonds, the downside is the inflationary pressure on labour and especially raw materials, which has translated into a worrying spike in construction costs.

"Construction costs are increasing because of a lack of people, an interruption of supply chains during the pandemic, and also because of a general rise in commodity prices. That is affecting us," notes a global fund manager. "Will that continue for the next two years? I doubt it, as supply chains smooth out and as people get back to work. But during these two years, if you are starting a new development project now, construction cost will be high."

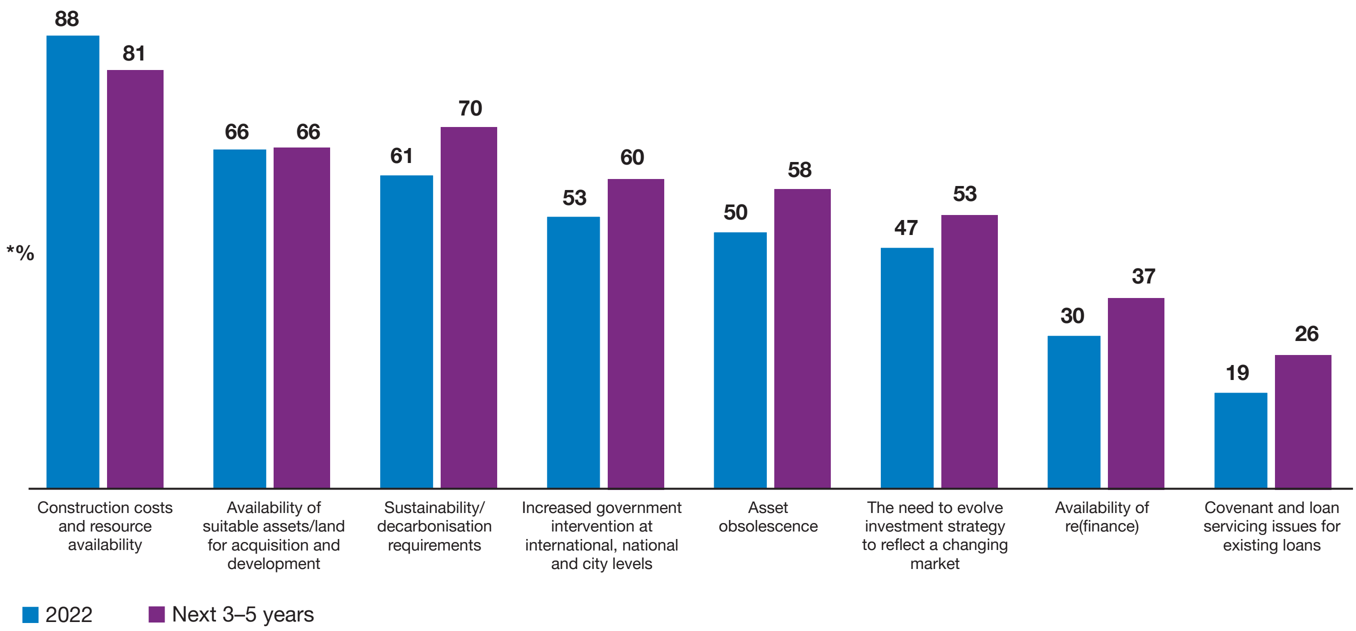
During the months that the survey was conducted, global lumber prices rose and fell, but with steel, transport, and labour costs still high, developers and asset managers face a number of development dilemmas.

Figure 1-5 **Real estate business issues in 2022**



Source: *Emerging Trends Europe* survey 2022

Figure 1-6 **Real estate business issues in 2022 and over the next three to five years**



***Note:** Combined percentage of "concerned" and "very concerned" respondents.
Source: *Emerging Trends Europe* survey 2022


Image: Trucks at large warehouse with roofed solar panels (Getty Images)

"Construction costs will further increase, but on the other hand, the price for wood is again at the start of 2020 levels. Hence, inflation will be temporary," suggests the CEO of a European listed real estate company.

However, this view is not universal. "We're hearing that bricks, cement, glass, marble, and even timber – these costs are accelerating quite rapidly because of Brexit," notes one British housebuilder, citing the compounded disruptions faced by UK-based firms. Ultimately, the medium-term outlook for inflation and the wider economy remains unclear, and could be worse beyond Europe's borders.

"Inflation is coming back a bit in the US, and we expect it to come back a bit in Europe, but this will really depend on the COVID environment," says one global investment manager. "We're also wondering about government measures to reimburse the huge debt that has been accumulated in the last two years – so there are a lot of uncertainties around inflation."

Given the risk of inflation, it is no surprise that construction costs take over from availability of suitable assets as the main real estate business concern. In the medium term, sustainability requirements are likely to become more of an issue than construction expenses.

All these factors dovetail in a series of pressures on the industry to invest in improving the environmental profile of standing stock, while seeking to attract the top occupiers with prime properties.

"You have an interesting position in the office sector, with an occupier preference for assets as new buildings versus a planning preference for recycling," notes the managing director of a global asset manager. "If you can recycle and hit the sweet spot for what occupiers want, that is going to be snapped up very quickly."

Environmental issues top the list of social/political concerns, with housing affordability in second place and social inequality a step behind that. While sustainability is a widely acknowledged part of the industry's long-term future, investing in social housing is seen by some as a smart near-term strategy.

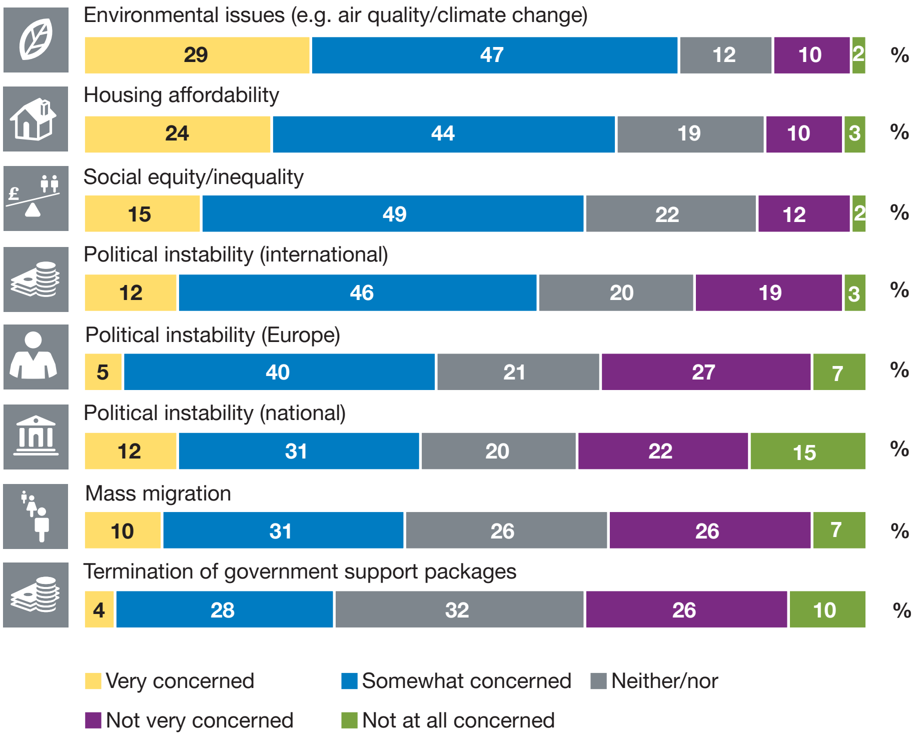
"Addressing affordable housing and matters such as homelessness gives us a chance to tackle the 'S' in ESG," notes a UK residential developer.

Looking to the next five years, alongside the environment, political instability is another concern for more than half of those surveyed – and a more pronounced concern than it is for 2022. This is perhaps surprising with Brexit, the ramifications of the German election, and eastern European political spats all real-time issues. Though Spanish respondents express a high level of concern for national political instability in the coming year, they are the exception to the rule. The broader industry view appears fairly sanguine despite – or perhaps because of – the eventfulness of the past few years.

"I think most of the political instability is in the past. Trump's gone, thankfully. Brexit is behind us," says one global investment manager. "There is an outside chance that Merkel moving on in Germany could lead to more instability within the EU than perhaps some are anticipating."

At the same time, the end of government support packages does not seem as big a concern as might have been anticipated. One Spanish real estate developer suggests that their resolution "will not be dramatic". However, another global asset manager strikes a note of caution: "It all depends on how the government decides to stop and taper its support. The key lesson from the global financial crisis is that going from a period of support to a period of austerity can be devastating both economically and politically."

Figure 1-7 **Social-political issues in 2022**



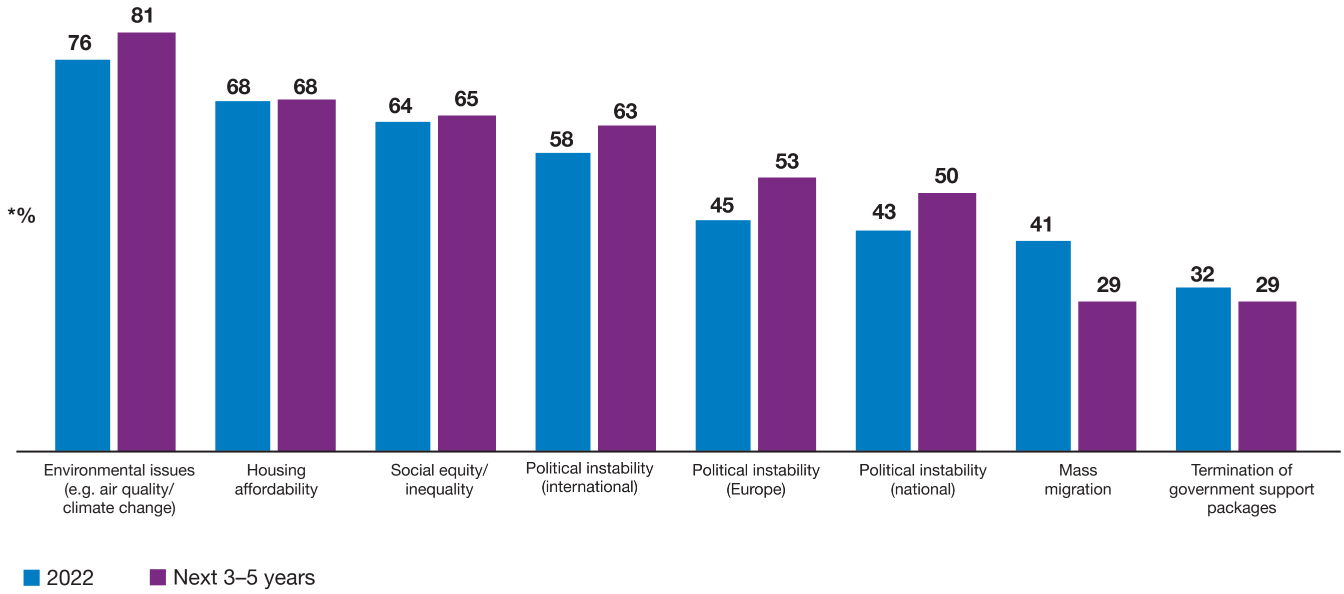
Source: *Emerging Trends Europe* survey 2022

However, significant pockets of distress seem unlikely to emerge, to the chagrin of some investors. "We hoped for distress, but we didn't really find it," notes a global investment manager.

"There may be distressed deals, but to build a strategy around it is very hard to do," says another global player. "Coming out of the pandemic, there may be a transition between equity owners and banks, as a lot of assets have been propped up where the banks have been patient and the government has been subsidising."

> "There may be distressed deals, but to build a strategy around it is very hard to do.

Figure 1-8 **Social-political issues for 2022 and over the next three to five years**

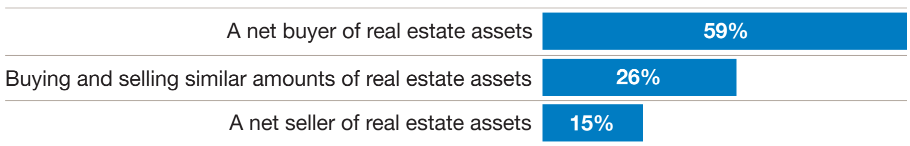


***Note:** Combined percentage of “concerned” and “very concerned” respondents.
Source: *Emerging Trends Europe* survey 2022

Against this backdrop of uncertainty and relief, 59 percent of survey participants expect to be net buyers of real estate assets. This is up on last year (55 percent), partly reflecting the confidence factor and partly the inherent attraction of real estate versus other asset classes.

Many investors also believe that the bumpy post-lockdown path continues to create opportunity. “The selling market is even better than it was before the pandemic,” says the general manager of a southern European real estate company. There is potential, too, in out-of-favour sectors. “Repositioning offers opportunities,” affirms one global fund manager; other respondents cite the non-homogeneous qualities of retail, with supermarket yields hardening. The bullish sentiment overall perhaps reflects the nature of the business. “If you’re not expecting to be a net buyer of real estate, what are you doing in this game?” asks one global investment manager.

Figure 1-9 **Appetite for European real estate in 2022**



Source: *Emerging Trends Europe* survey 2022

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If you’re not expecting to be a net buyer of real estate, what are you doing in this game?

Longer-term challenges

While COVID-19 is off the list of chief concerns, the real estate industry is now challenged in the longer term to impose itself on a host of trends that have either been hastened or unleashed by the pandemic.

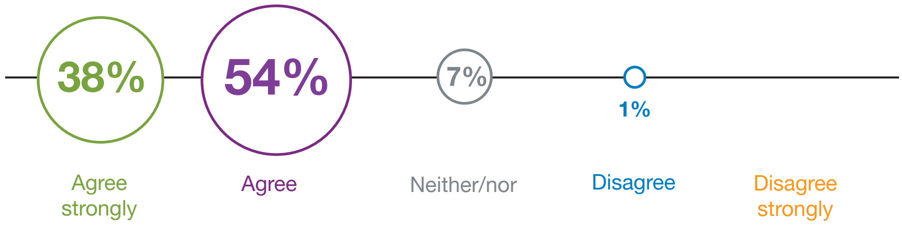
Almost all business, real estate, and social and political issues are seen as more of a concern over a five-year term than over the coming 12 months.

Some of these issues directly affect the evolution of stock, which should be clean, green, and amenity-rich going forward to fulfil the shift towards property as a service and more volatile income streams. More than 80 percent of survey respondents, for instance, believe that landlords and tenants will consider new models for leases – significantly up on last year.

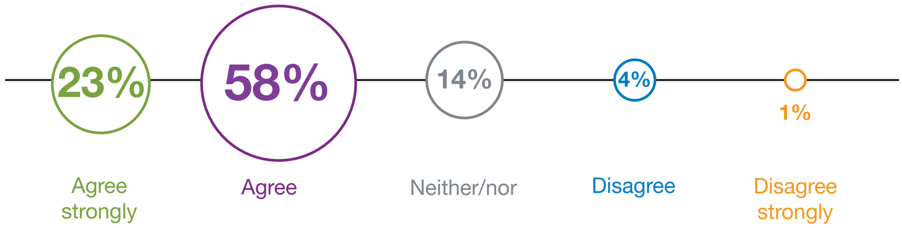
Although increased regulations around ESG reporting and an impetus for portfolio transformation pre-dated the health crisis, aspects such as sustainability, real estate's role in the community, and creating truly human-centric buildings now resonate across all asset classes. Offices, challenged as they are to justify employee presence going forward, will have to work harder than ever.

As one adviser puts it: "The big thing with offices has been that it's just accelerated all the ESG discussions around what is a good office, how does a good office work, what does it have to offer to people?"

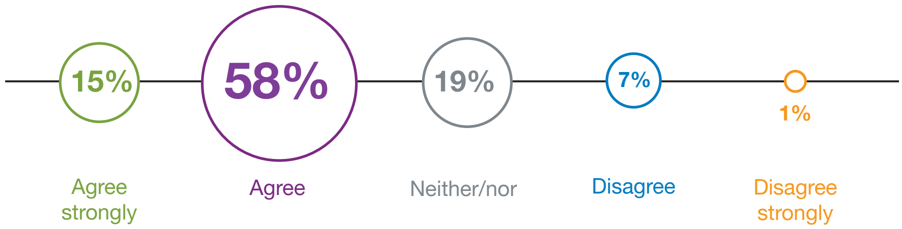
Health and wellbeing will remain a very important factor across all sectors of real estate



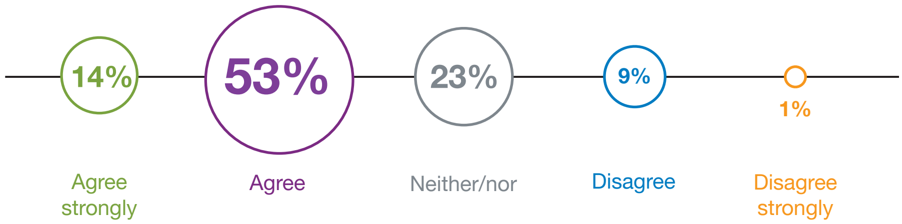
Landlords and tenants will consider new models for leases



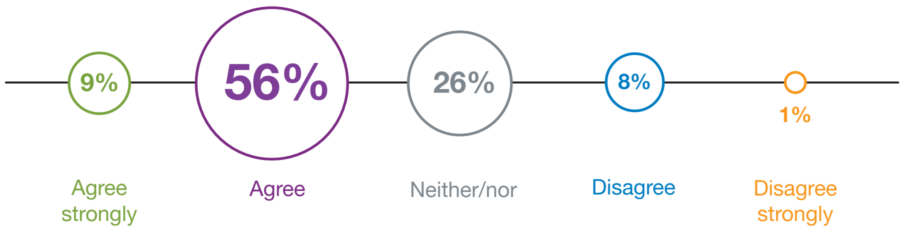
There will be more distress in certain sectors in the next 12 months



There will be more forced sales of assets in parts of the retail, leisure and hospitality sectors in the next 12 months



There will be more consolidation in the real estate sector



Source: *Emerging Trends Europe* survey 2022

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> The greatest barrier to change is often mindset and taking people out of their own comfort zones.

But offices are not the only area where an overhaul of landlord-tenant relationships is on the cards. Retail models have evolved so far that neither traditional nor turnover rents offer a one-size-fits-all answer. Asset managers must also come to terms with the complexities of operational real estate to understand how to underwrite the income while meeting the expectations of occupiers.

This is just one sign of the growing recognition that real estate needs to broaden its skill base – far beyond traditional asset management – as part of a bigger industry shakeup. As many as two-thirds of survey respondents cite organisational transformation as a priority over the next five years, which is examined in more detail in Chapter 4.

“Real estate’s always been about putting together a multidisciplinary set of people working together for a good outcome. In the past, it was real estate people working with financial people. It’s now so much broader than it’s ever been, and that brings challenges,” concludes one pan-European investment manager. “The greatest barrier to change is often mindset and taking people out of their own comfort zones.”

Image: Food bar in Germany (Getty Images)

Top trends

Energy crisis stokes inflation fears

"Inflation is very much driven currently by energy prices and energy costs in general," says the head of real estate at one pan-European asset manager.

If anything, escalating energy prices – based on a surge in demand and an ongoing supply crunch – have become much more of a drag on the global economy since interviews were conducted for this report in the summer.

With no let-up in sight for businesses or consumers, the energy crisis is only adding to the uncertainty around already heightened real estate concerns over inflation. The potential implications are many and varied. The most immediate risk from above-average inflation lies in suppressing consumer spending, which inevitably casts further doubt on the retail and hospitality sectors, still struggling against structural and pandemic-related headwinds.

Another obvious challenge lies in construction, which is invariably flagged as a big issue in *Emerging Trends Europe*.

But where industry leaders highlighted construction capacity constraints in previous editions, the main focus had been on labour costs. Labour mobility remains a problem, but this time rising energy prices are also driving up the cost of production of building materials. As a result, there seem to be more serious concerns expressed around the knock-on effect on profit margins in development than before.

Though relatively high-value sectors may be able to bear the higher construction costs, lower-margin – but no less important – developments will be the first to suffer. "If construction prices for affordable and social housing go up, then there's no margin left. And that's where the big problem is today," says one Central and East European residential specialist.

On a broader level, the construction-cost factor allied to continuing pressure on public finances could impede the whole move to a more sustainable built environment, possibly stifling national governments' investment in much-needed green infrastructure.

And unless those same governments take control of the energy crisis, there is the more pressing fear that it will disproportionately affect poorer members of society, which feeds through into the survey. Social equity/inequality is a major concern for over 60 percent of respondents.

It is no coincidence, however, that at a time of rising energy prices, some in the industry see an opportunity to expand beyond mainstream real estate, identifying new energy infrastructure as the leading investment prospect for 2022.

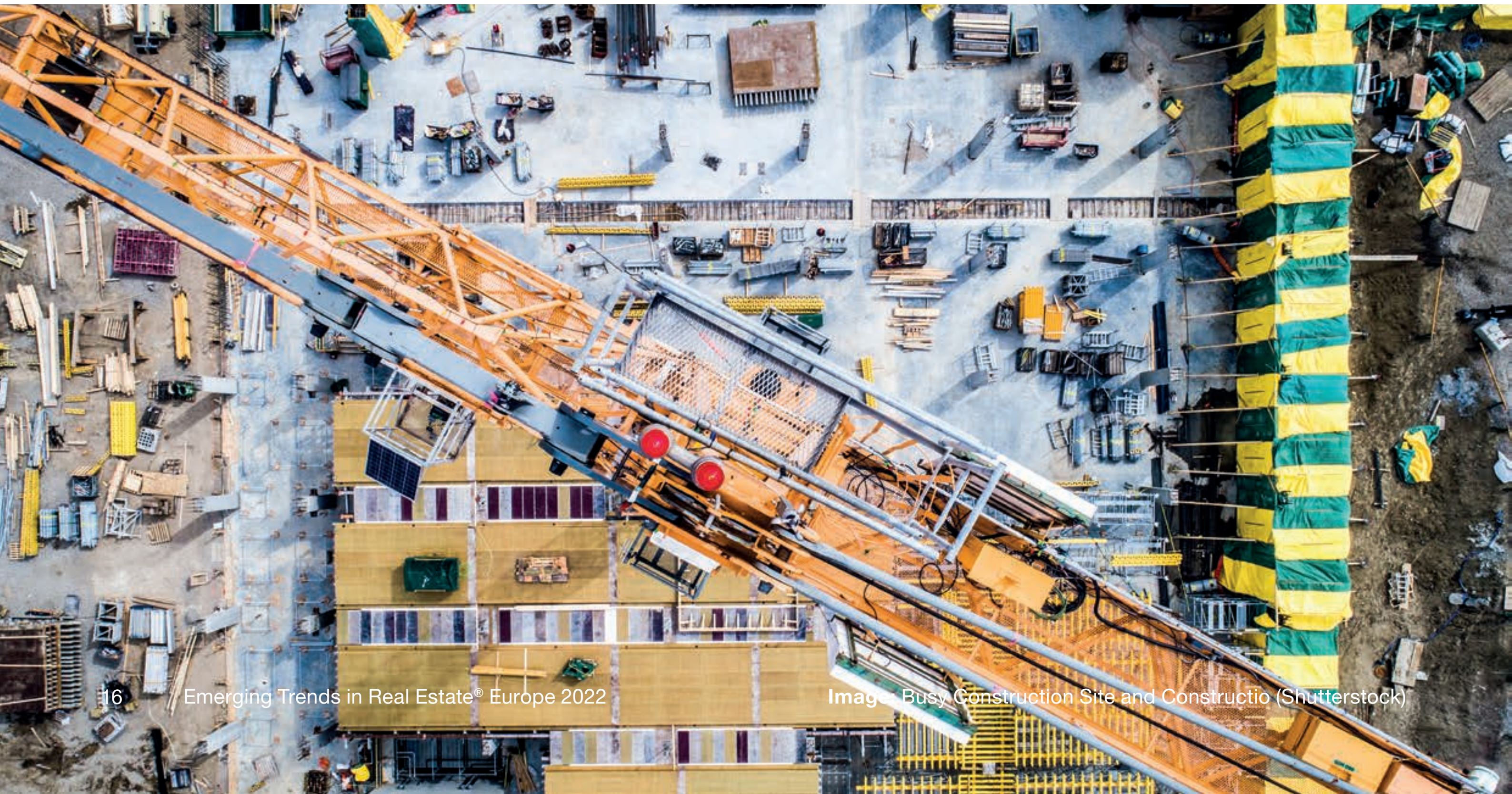


Image: Busy Construction Site and Constructio (Shutterstock)

Image: Modern apartment block with solar louvres (Getty Images)

Affordable housing – the social choice

One lesson from COVID-19 was how it disproportionately affected society's most vulnerable, making the issues of house prices and supply more visible than ever and hence even more political.

While the real estate industry is bullish on increasing investment allocations into residential and broader living-sector assets, it remains a delicate moment to be a landlord. As one global developer summarises: "It's so touchy to be making profit in an area where there's so much pain from people that don't have affordable housing. A lot of people in my company rather would not touch it."

However, its topicality creates an argument for tackling the issue. "If we don't produce new housing, then the prices will only go up and the problem will get bigger. So, we're not here to win the popularity vote. We're here to try to make profit and also try to do the good things and the right things."

In the context of the survey, the issue is a particular concern in the Netherlands, where a remarkable 90 percent of respondents cite housing affordability as a significant near-term problem for the industry. More than three-quarters of UK-based firms are also worried about its impact on their business.

Affordable and social housing is seen by many as the acceptable face of compromise, backed by clear figures of undersupply. "Affordable housing is an example of adding social value as part of our ESG strategy," reflects an impact investment specialist.

Technology also offers pathways to profitability. "There's an argument for fast-track, low-cost construction to make housing affordable in the long run," says an Austrian real estate investor. But not all markets are equal. "If you're in the affordable housing and regulated market, you want to be in Germany, Sweden, France, and the Netherlands because those have the regulations which are most restrictive and therefore the most positive in terms of protecting your cash flow," suggests a global investment banker.

> "If we don't produce new housing, then the prices will only go up and the problem will get bigger. So, we're here to try to make profit and also try to do the right things.

Growing demand for operational assets

The drive for income has seen the industry pivot to increasingly operational asset types in recent times, requiring a more granular approach to real estate investing.

This year's survey highlights the compelling fundamentals of data centres, new energy infrastructure, and life sciences. Living-sector asset types – from senior housing to student homes – also have appeal but are equally dependent on the competence of the operator.

Data centres are perceived as the most promising sector in terms of both their income profile and development potential, with life sciences offering the second-most-interesting income outlook. New energy infrastructure and logistics are seen as strong development plays.

New energy infrastructure is also viewed as the asset type with the best investment prospects, with life sciences, logistics facilities, and data centres following.

"It is difficult to convince banks to lend against shopping centres. They will more easily lend against data centres and residential, and life sciences," confirms one global asset manager.

It should be noted that with the exceptions of logistics and residential, the strong survey sentiment is tempered by a relatively low number of respondents who are active players in some of these operational sectors. The survey and interviews also reflect a note of caution about focusing on more granular asset types.

"Assets like data centres and life sciences have not grown enough yet to offer the liquidity of offices or logistics," says the director of a pan-European advisory firm. There are also questions around entering property types which require additional asset management skills.

"Compared to the UK, the US, and Canada, in continental Europe we're lagging behind in the recognition of how much value an asset manager brings, although this is evolving rapidly. This is certainly the case for the new alternative asset classes such as data centres, where there's an operator and therefore an additional skillset is required," notes a global investment manager.

Yet overall, there is enthusiasm for the growth metrics of alternatives, with an appreciation of their complexities. "You have to be really careful that you are investing with people who really do know the life sciences businesses and are in the hubs. And at the end of the day, they're office buildings, which have to be in the right spots like anything else," adds a global investment manager.

Finding the path to net zero

The EU aims to be climate neutral by 2050 – an economy with net zero greenhouse gas emissions. This matter remains the ultimate challenge for an industry that is one of the biggest generators of carbon in the world.

Standing stock, in various degrees of obsolescence, represents the lion's share of the problem.

"Inner cities are fully developed, so repurposing will be important. This also fits into the ESG focus as it is more sustainable to refurbish than buy new," suggests one Nordic developer.

However, while real estate professionals are nominally in favour of a net zero push, the survey reveals increasing tensions about translating this into action.

"It's easier today to obtain financing for new developments rather than refurbishment projects," notes the head of a European real estate advisory firm. The interviews indicate that many occupiers still prefer new-build assets to meet their own net zero targets, which may hinder the drive towards refurbishment and repurposing highlighted in Chapter 3.

Image: Newly built houses with solar panels on the roofs (Shutterstock)

There are also more questions than answers about the net zero pathway – and who pays for the industry's transformation? "A lot of our work is refurbishing buildings to bring them up to a new standard, but there aren't very many governments out there right now making it very clear what that standard looks like," says a global asset manager.

"Top-down incentives from the public sector will be important to balance things out and not have a complete exodus from secondary assets," warns a pan-European commercial real estate researcher. The role of technology remains an outside hope. "We think that all real estate has to be upgraded. And we don't think that the world has enough hands to do that, or at least Europe doesn't. And therefore, we have to have innovation. We have to have smart solutions where things are not done building by building, but more on a factory level," suggests a global developer.

" It's easier today to obtain financing for new developments rather than refurbishment projects.

ESG: industry struggles to set standards

While most real estate professionals acknowledge the importance of ESG, a lack of consistency and transparency in benchmarking and the measurement of energy performance continues to plague the industry.

"I still don't think we have a credible way of quantifying the impact of ESG. We don't even have unified standards across countries or the globe," says one international investor. "So, it's not really feasible to talk about the payback period of ESG. It's just something we'll have to do to future-proof our assets, and we will have to take the hit."

Energy efficiency is the most measured and reported element of ESG, with the majority of respondents suggesting it has increased in importance over the past year. "We have an industry that is the biggest user of energy of all industries. So, I expect a lot of pressure on real estate coming from regulators, but you have to take your own responsibility first," suggests the CEO of a pan-European real estate company.

Building certification remains the tool most used to measure and report on issues such as energy efficiency and the reduction of carbon emissions, but its usefulness is questioned when it comes to charting the environmental cost of operating assets. There are also concerns around its role in greenwashing.

"We're pushing GRESB [the global ESG benchmark for real estate] to continue to raise the bar because that's the only way we're going to get there. As an example, in GRESB you get a lot of points when you have building certifications, but it doesn't say what the certification should be," one global investment manager observes.

Figure 1-10 **Environmental issues measured by the industry**

Source: *Emerging Trends Europe* survey 2022

A real estate company CEO adds: "The big tenants are now saying, 'Please provide us with net zero buildings,' and that means for new developments, they want to have full embodied carbon calculated and offset or reduced, and they really want a measure of what is happening in the building. They don't say, 'Okay, it's a LEED Platinum building. That's great.' They really want to follow week by week what are the emissions in the building – and that comes from the tenants. But now the owners are recognising that, and they also have their own policies."

At the same time, attention to the societal impacts of real estate tends to lag the work on energy, despite matters of inequality and social justice being thrust to the forefront of public perception in recent times.

"We do quite a bit of our own internal metrics and reporting, trying to figure out ways of improving those aspects. And we have a lot of different kinds of innovative entrepreneurial groups that are working on projects that could have longer-term outcomes," says a director at a pan-European consultancy.

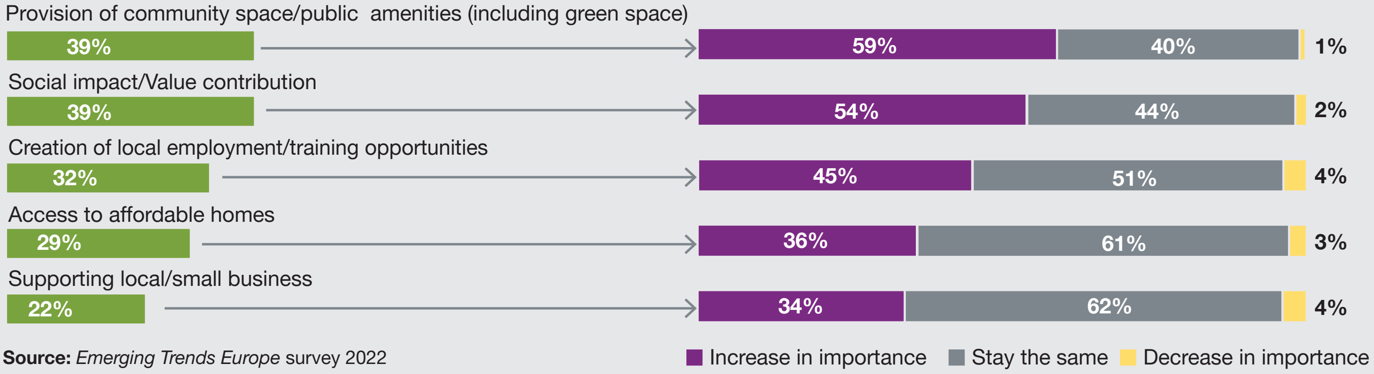
Though 60 percent of survey respondents see the provision of community space and value contribution as becoming more important, the interviews suggest the industry is still seeking a consensus on how to measure the "S" in ESG.

"We have a couple of social projects that we're doing, but if you're in real estate and you really want to tackle the social question, then the affordability of homes and even offices and other spaces is becoming a major issue," notes a global real estate developer.

Others strike a note of caution about the nebulous nature of the "S" factor.

"As there was previously a lot of greenwashing, we now also see a lot of 'social-washing'. It means that everybody really cares about it, which is good, but it's hard to come up with a proper definition and how to implement that in a portfolio," says a Dutch investment manager.

Figure 1-11 **Social issues measured by the industry**



Source: *Emerging Trends Europe* survey 2022

Chapter 2

Real estate capital markets

"It's one of the most interesting times in my career to be investing. It's the first cycle I've been in where there's a huge disparity between different parts of the real estate market."

Head of real estate, global investment bank

Image: Canal and street in Hamburg, Germany (Shutterstock)

The post-lockdown recovery in European real estate capital markets is certainly underway, and as industry leaders point out, equity and debt capital, on the whole, are plentiful – but not for everything.

Demand for core assets continues to increase dramatically, although the definition of what counts as core is changing, forcing prices up in some sectors, pushing investors into new areas and others towards development to find returns. Traditional lenders are supporting the safer end of the market while a healthy range of alternative lending sources is mostly open to higher-risk opportunities.

At the same time, a changing definition of what constitutes secure income continues to influence the rise in demand for alternative sectors as diverse as new energy infrastructure, life sciences, and data centres. Yet investors remain aware that such sectors might offer less income risk but come with more managerial complexity and lower liquidity. The same trend sees residential continue to dominate the top of the chart of investor preferences.

Among the established targets for capital, logistics is the only one experiencing abundant investor appetite, while for others – notably the much-debated office sector – there is uncertainty over what is and is not financeable.

Perhaps most significantly for all sectors, there is a recognition among industry leaders that the moment has arrived when the environmental sustainability of an asset starts to affect its price.

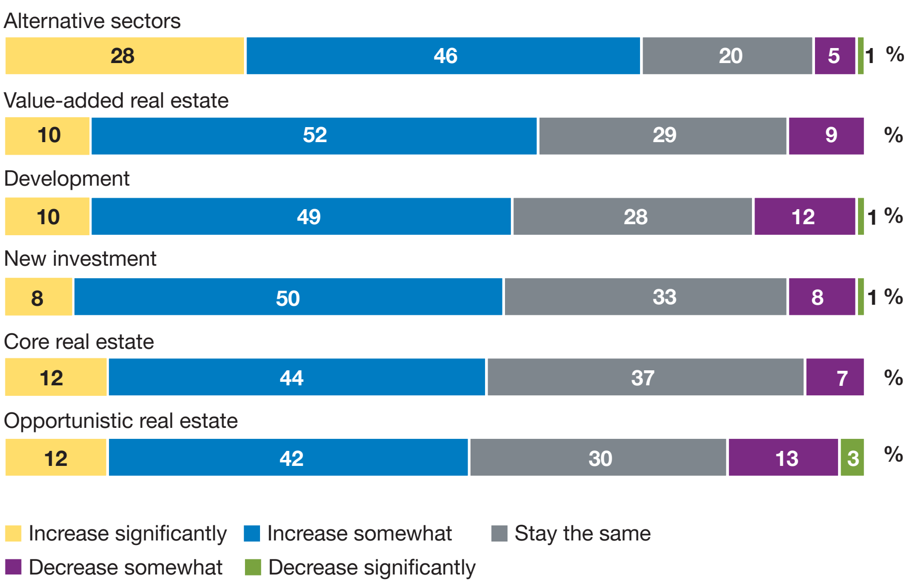
"Capital is unlimited at the moment. It's the most I've ever seen in 35 years of doing this," says one veteran investor, summing up the industry view. As the survey shows, the equity available for all types of real estate is expected to increase in 2022.

Multiple factors are at play. Operationally, real estate was badly hit by the pandemic: shops, hotels, and offices were closed, and health care assets were stretched. But apart from hotels and retail, the latter of which was already suffering, income held up well. And capital values broadly held up well, too.

"From the investment perspective, the real estate market as a whole has proved to be resilient in times of a large economic crisis, which will lead to larger capital inflows in the next three to five years," one German lender hypothesises.

Real estate's resilience owes a lot to central bank intervention to stabilise economies during the pandemic, which has kept interest rates low and maintained a decade-long trend of real estate yields looking good compared with fixed income.

Figure 2-1 **Access to equity in 2022**

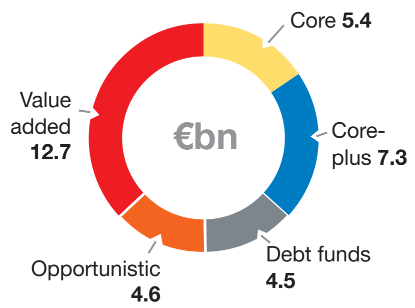


Source: *Emerging Trends Europe* survey 2022

Inevitably, a shift has occurred in the source of capital buying European real estate. But this is more a result of practicality than appetite, and it is not as pronounced as might have been expected. "With the inability to travel and do due diligence, investing in your backyard was just more popular, so you had Europeans buying European assets," one investor points out.

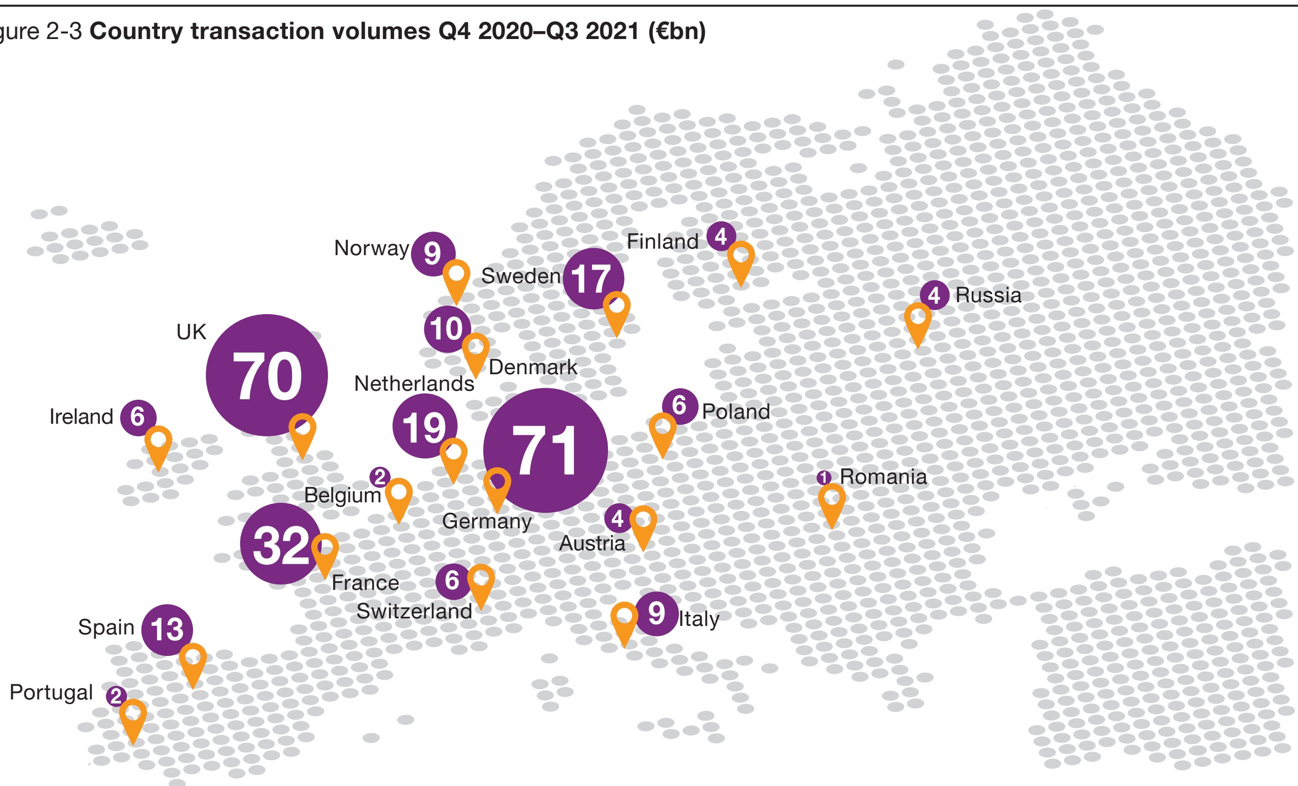
But Real Capital Analytics (RCA) data show that the balance did not shift hugely: Asian investors accounted for 12 percent of equity capital into Europe between March 2020 and September 2021, down from 16 percent in the previous six quarters – not a huge drop despite the restrictions on travel. European investment actually only rose from 56 percent to 60 percent in the same period. That is partly explained by the fact that experienced global players with teams present in foreign markets were able to continue to invest in as normal a way as possible.

Figure 2-2 **Capital raised by Europe-focused private equity funds Q4 2020–Q3 2021**



Source: *Preqin Pro*

Figure 2-3 **Country transaction volumes Q4 2020–Q3 2021 (€bn)**

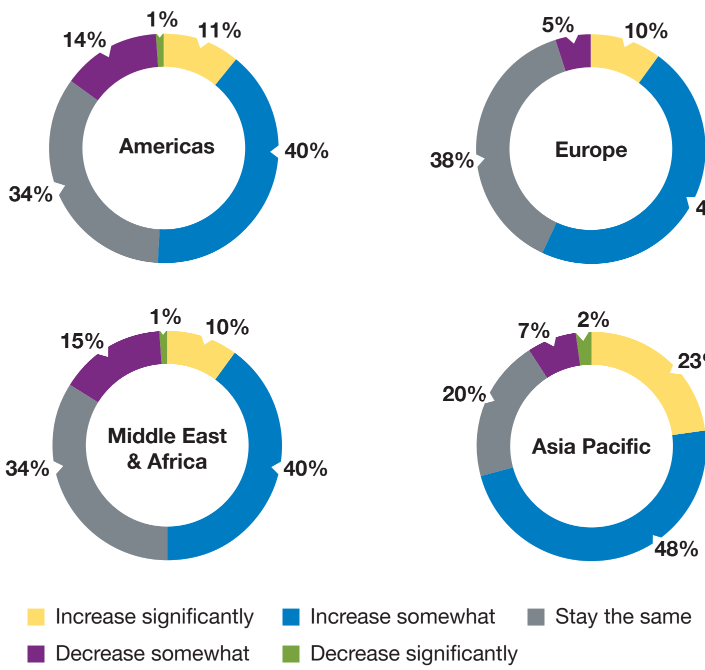


Source: *Real Capital Analytics*
Note: *Countries with transactions over €1billion.*

Image: Modern building façade in Spain (Getty Images)

As and when life normalises, Asian investors are expected to return in force. The survey indicates there will be an upturn in capital flows from all regions compared with previous years as a result of an underweighting towards European real estate generally. But the expectation is strongest – supported by 71 percent of survey respondents – for an increase in capital from Asia Pacific, which is similar to pre-pandemic sentiment.

Figure 2-4 **Expected cross-border capital into Europe in coming three to five years**



Source: *Emerging Trends Europe* survey 2022

Debt debate

Industry leaders are also generally confident about the availability of finance from lenders, albeit not as optimistic as they are about equity. It is only when it comes to availability of debt for alternative sectors that more respondents believe availability will increase than reckon it will stay the same or decrease.

"With alternative assets, when the fundamentals are strong, banks will be more open-minded, but they're often alternatives because of their size or liquidity issues," says a pan-European adviser. "Assets like data centres, life sciences, have not grown enough yet to offer the liquidity of, say, offices or logistics."

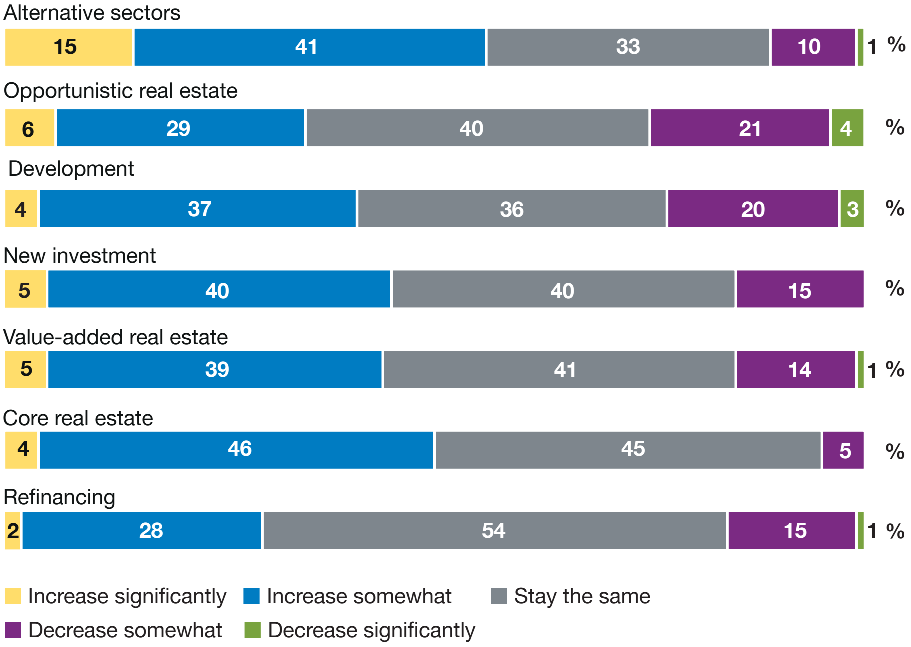
That said, the picture is significantly better than last year, with survey respondents predicting that all types of lenders will increase their lending in 2022 compared with 2021.

There is a feeling among interviewees that the growing diversity of lenders active in Europe means there is likely to be a source of debt for almost any type of deal, with a few notable exceptions.

While banks are seen as least likely to increase their lending in the coming years, they still play a huge, if changing, role in the market.

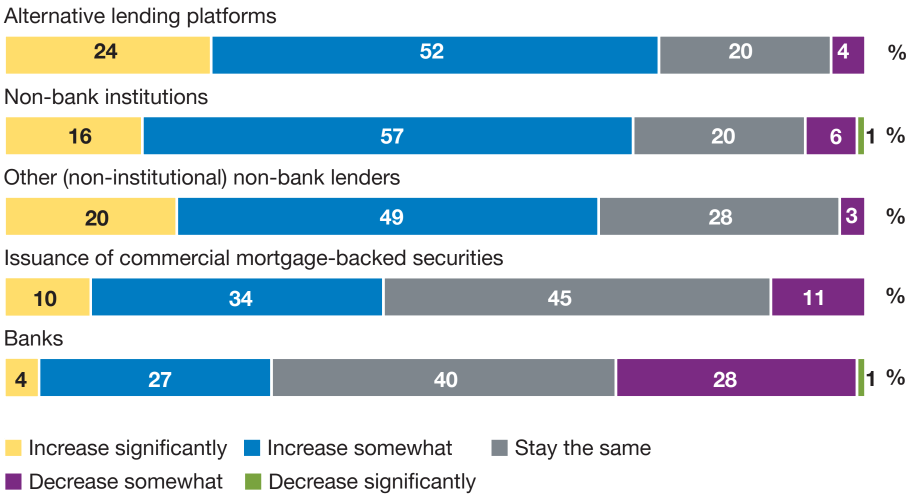
"What's going to happen is banks are going to drift down into leveraging other people's debt investments, so [they will be] financing high-quality core and core plus," one investor says.

Figure 2-5 **Access to debt in 2022**



Source: *Emerging Trends Europe* survey 2022

Figure 2-6 **Sources of debt in 2022**



Source: *Emerging Trends Europe* survey 2022

Banks, and increasingly insurance companies, are expected to be the financiers of choice at the safer end of the market, while debt funds of various stripes take on more risk.

"We did more deals in the six months after COVID than in our five-year history before that," one debt fund manager says. "People left the market and there was less appetite for risk, and less competition. Now we're quiet again as everyone is back." Another investor says a growing number of debt funds are looking for lower-risk, lower-return deals, "not looking to make the sort of high returns that you typically associate with equity".

Though the breadth of the market is keeping liquidity high, not every sector can find debt. Lenders almost universally agree that shopping centres and hotels are off limits at the moment. Student housing remains tricky until there is more certainty regarding international travel. And when it comes to offices, assets seen as the "best of the best" find favour, whereas value-add deals are harder to finance. As one banker puts it: "Am I looking to fund spec office development? Not right now."

"Am I looking to fund spec office development? Not right now.

Image: Back to the office (Getty Images)

Brighter outlook

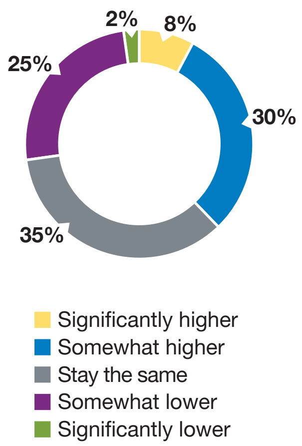
Perhaps unsurprisingly, the performance of real estate looks relatively strong for 2022, with 38 percent of survey respondents predicting higher returns, against 25 percent in the survey looking at 2021 and 13 percent the year before that. The post-lockdown bounce-back, promoted by a receding of the virus and government and central bank support measures, have underpinned return expectations in most sectors.

"Government support schemes across Europe have been an important factor in propping up economic activity and employment," one banker says. "Soon they're going to have to pull that back and see if the patient can start walking on their own two legs. The health of the patient remains to be seen." Despite seeing the benefit of government support packages, survey respondents rank termination of such measures as the lowest among their worries for the coming year.

At the macro level, inflation has become an issue for the industry for the first time in a decade. Among survey respondents, 82 percent expect inflation to increase in the next year, compared with just 34 percent at the same point last year. This is expected to feed through to interest rates, with 44 percent expecting an increase in short-term rates, and 62 percent expecting an increase in long-term rates – much higher than last year.

Yet if anything, the real estate industry is downplaying the inflation risk compared with the wider business community, which fears a damaging impact on the European economy. Among interviewees there is no excessive concern that inflation would lead to a rapid rise in interest rates, dragging real estate yields up in their wake and eroding the sector's appeal.

Figure 2-7 **Returns targeted in 2022 compared to previous years**



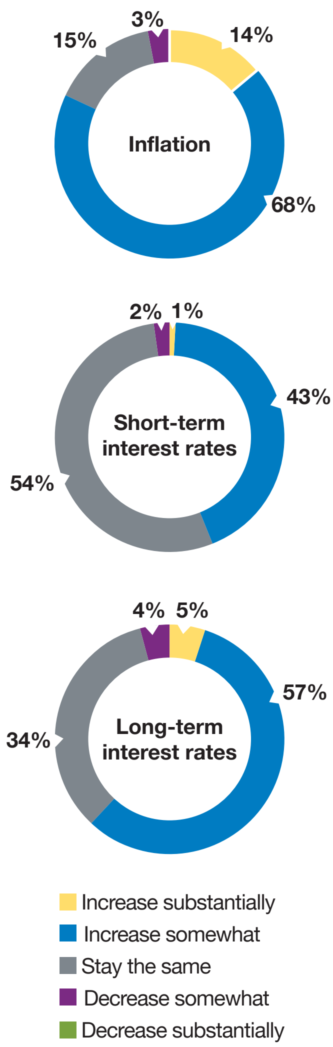
Source: *Emerging Trends Europe* survey 2022

"I don't think inflation is going anywhere in Europe, to be honest with you," one pan-European investment manager says. "The inflation that you see at the back end of COVID has been a largely US phenomenon, and it seems to be transitory, associated with specific sectors of the economy that had big supply chain issues. It is going to be on people's agendas more frequently now because of all of the discussion around how disruptive COVID was to supply chains. But I'm not sure that it's a huge issue in Europe because you've got so many deflationary pressures here."

There is also the old argument, put forward by some interviewees, that a bit of inflation is good for real estate: rents rise in line with inflation, and the sector is seen as a good hedge against it.

"Inflation is going to be on people's agendas more frequently now because of how disruptive COVID was to supply chains."

Figure 2-8 **Inflation and interest rates in 2022**



Source: *Emerging Trends Europe* survey 2022

If you can’t buy it, build it

Several of the trends circulating in this year’s report revolve around the concept of “developing to core”. As many as three-quarters of survey respondents believe that development or redevelopment is the best way to acquire prime property.

Prime assets to buy seem to be in short supply: the ones that are available are getting more expensive as a growing amount of capital chases a shrinking pool of assets that are considered core.

“It’s pushed more money to certain sectors, including residential and logistics,” one investor says. “I don’t think it’s had a massive proportionate impact country by country because it’s affected all countries basically in exactly the same way. But I do think it’s skewed the way in which capital has been allocated between different sectors.”

With interest rates at record lows, investors looking for core product can afford to pay lower yields for good assets. But pension funds and insurers still have liabilities to meet, meaning there is only so low they can go, and that is where development comes into play.

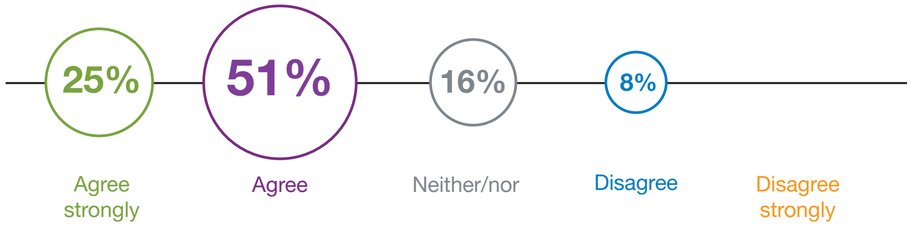
“We’re also active on the development side,” one global pension fund investor says. “And that goes to the type of investor one is. We target higher absolute returns, and therefore we have been active on the development side where we can achieve the higher returns.”

But the move into development also goes beyond financial returns, and says something about the changes society is undergoing and, in some sectors, uncertainty around the future. It is clear that the world needs more houses, logistics assets, and life sciences labs, so building them seems like a sound strategy.

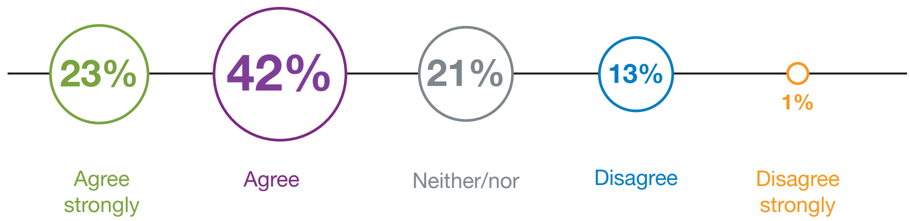
And though interviewees still regard new offices with long leases as good institutional investments, they acknowledge that investors might feel more comfortable building new assets that are fit for purpose in a new future. Buying older assets carries the risk of obsolescence.

“At a time like this, when you’re not sure about where things are going, I’d rather be building a new office that I know is going to meet the ESG requirements and have a better chance of providing the kind of space that corporates want in future,” one investment manager says.

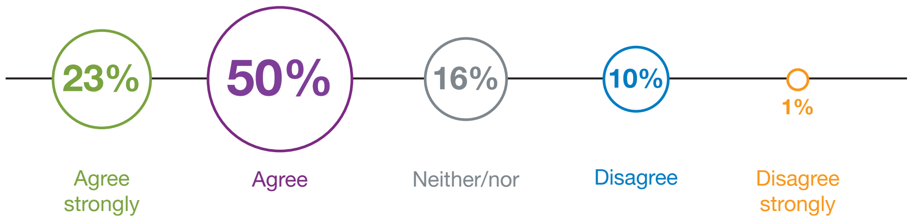
(Re)development is the most attractive way to acquire prime assets



Prime assets are over-priced



Quality of cash flow/income will predominantly drive valuations in the next 12 months



Source: *Emerging Trends Europe* survey 2022

The flip side of this, of course, is the growing focus on embodied carbon created by new development – the emissions created during the construction and demolition process of a building, which by some estimates account for up to 70 percent of the carbon produced during an asset's lifetime. Once embodied carbon is taken into account, building new assets rather than buying existing ones – especially in sectors like office where there is vacancy in the sector – potentially runs counter to the sustainability goals that investors are so keen to trumpet. One possible fix for this paradox is to refurbish or repurpose existing assets rather than build from the ground up, which is examined in greater detail in Chapter 3.

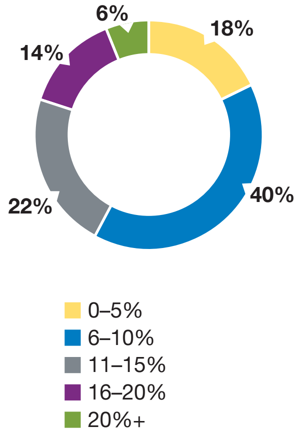
For core investors, development pushes them further up the risk curve, and also moves them into the territory of the private equity fund managers, listed companies, and private investors that have typically followed this course.

"The challenge for those of us who work in a value-add or opportunistic space is when the core capital starts to crowd into your space, you'd better be more than a one-trick pony," one value-add manager says. "You better come up with something else to do. Because the places that you know you used to go grazing in the Serengeti are now going to find an awful lot more grazers. And so, you're going to go hungry if you haven't figured out some rules to go seeking your food supply."

The proportion of survey respondents seeking returns of 10 percent–plus in 2022 has risen compared with hopes for 2021 and 2020. And higher-return investors are not necessarily seeking those returns through distress.

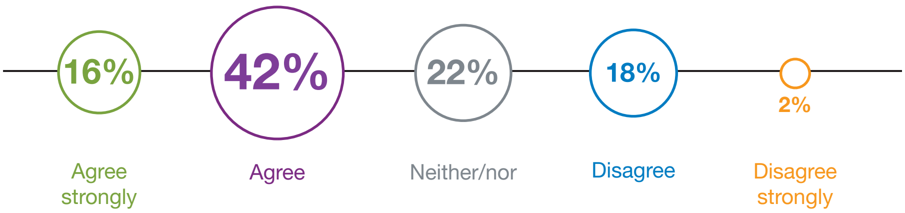
Even though 58 percent of survey respondents say buying distressed assets is a good way to acquire real estate, there is not much hope among interviewees that there will be a global financial crisis-style wave of distressed sales following the pandemic. And those distressed sales that do emerge, and how to make money from them, will be different from those earlier sales.

Figure 2-9 **Returns targeted in 2022**



Source: *Emerging Trends Europe* survey 2022

Buying distressed assets is becoming an attractive way to acquire real estate



Source: *Emerging Trends Europe* survey 2022

"

The challenge for those who work in value-add is when core capital starts to crowd into your space.

Image: Mechanical arms working in temporary storage (Getty Images)

"This time around, banks are a lot better capitalised, and central banks stepped in to support markets a lot faster," one global fund manager says. "Post-Lehman, everything went down in value at the same rate, and then everything came back up again," another says. "This time around, it's a lot more differentiated." As many interviewees conclude, plenty of distressed retail assets are available for purchase, particularly in the UK, but few investors have much appetite to take them on. "I just can't underwrite it. I don't know what the income or the capex will be," one opportunistic investor says.

Hotels could be bought at discounts to long-term value in 2020, but the amount of capital chasing the same trade meant the opportunity disappeared fairly quickly, with plenty of investors willing to buy into an expected rebound in leisure travel.

For business-focused hotels, as with retail, even if assets could be bought, there is little appetite from investors who cannot tell when demand and income will recover.

So where can investors go to seek higher returns? For some, the answer lies in building or buying platforms in the sectors with strong growth prospects, such as logistics, or taking over private listed companies. "Instead of moving up the risk curve, you get a lot of groups that start moving up the complexity curve," one manager says. "If you're a core investor and you've been buying single logistics buildings, and then you come into your investment committee and you've got a paper that says that you want to do a take-private [on a listed company] – well, that's a lot more complicated than you've done before."

For such transactions, less competition means better returns, but only if everything goes as planned.

> "Instead of moving up the risk curve, you get a lot of groups that start moving up the complexity curve.

Alternatives prove their resilience

One distinct trend this year is the focus on alternatives – those sectors outside the traditional big three of office, retail, and industrial. Survey respondents predict equity and debt will be most plentiful for alternative real estate asset classes, while beds-based asset classes – alongside sectors like life sciences, data centres, and energy infrastructure – dominate the top of the sector rankings. Among traditional sectors, only industrial gets a look-in.

If anything, the pandemic has reinforced the long-term trend of investors looking for resilient income from sectors that are seen to benefit from strong demographic drivers, notably residential and life sciences.

One institutional fund manager cites a recently launched fund with a target of 8 percent in office and 8 percent in retail; it also covers medical office, life sciences, residential, logistics, student housing, and real estate debt, and it could include data centres and self-storage. "Five years ago, office and retail would have dominated the portfolio. Not today," this manager says. "We are increasingly focused on what's broadly defined as alternative assets."

Sometimes there can be a disconnect between opinions about where the real estate market is heading and where capital actually flows: the industry has been slow to respond to change. But interestingly, the hard numbers indicate that change is already happening.

From the end of March 2020 through September 2021, offices remained the largest sector for European real estate, taking 38 percent of all deals while overall volumes fell 27 percent to €255 billion, according to RCA. But the sector is down from 49 percent in 2019 and the first quarter of 2020. By contrast, the share of apartment deals rose from 16 percent to 24 percent, and industrial rose from 13 percent to 21 percent. On a global basis, says RCA, apartment deals overtook offices for the first time on record.

"Five years ago, office and retail would have dominated the portfolio. Not today.

Table 2-1 **Sector prospects in 2022**

	Overall prospects	Rank	Investment	Rank	Development	Rank	Income
1	New energy infrastructure	1	4.81	2	4.60	4	4.36
2	Life sciences	2	4.65	4	4.49	2	4.48
3	Logistics facilities	3	4.60	3	4.55	3	4.41
4	Data centres	4	4.55	1	4.63	1	4.49
5	Health care	5	4.46	6	4.31	5	4.19
6	Retirement/assisted living	6	4.44	5	4.33	8	4.13
7	Industrial/warehouse	7	4.40	8	4.25	7	4.18
8	Affordable housing	8	4.33	9	4.22	13	3.88
9	Self-storage facilities	9	4.32	12	4.13	9	4.10
10	Private rented residential	11	4.29	7	4.27	10	4.07
11	Housebuilding for sale	10	4.29	10	4.21	6	4.18
12	Social housing	12	4.15	11	4.15	12	3.90
13	Multi-let/flexible industrial parks	13	4.09	13	3.98	11	3.91
14	Co-living	14	3.96	15	3.88	15	3.76
15	Student housing	15	3.93	14	3.93	14	3.79
16	Serviced apartments	16	3.84	16	3.72	16	3.64
17	Flexible/serviced offices and co-working	17	3.74	17	3.54	18	3.45
18	Leisure	18	3.74	18	3.41	19	3.37
19	Central city offices	19	3.60	19	3.35	17	3.48
20	Retail parks	20	3.56	22	2.98	20	3.29
21	Business parks	21	3.40	20	3.10	21	3.13
22	Hotels	22	3.36	21	3.05	23	3.00
23	Parking	23	3.12	23	2.80	22	3.03
24	Suburban offices	24	3.01	24	2.79	24	2.90
25	High street shops	25	2.82	25	2.48	26	2.59
26	Out-of-town shopping centres/retail destinations	26	2.79	26	2.32	25	2.62
27	City centre shopping centres	27	2.69	27	2.32	27	2.54

Generally good = above 3.5 Fair = 2.5–3.5 Generally poor = under 2.5

Source: *Emerging Trends Europe* survey 2022

Note: Respondents scored sectors' prospects on a scale of 1=very poor to 5=excellent, and the scores for each sector are averages; the overall rank is based on the average of the sector's investment and development score. The survey also covered communication towers/fibre but the number of respondents rating the prospects for this niche sector was too small for it to be included in the rankings.

Investing in alternative sectors is not without its challenges. The greater operational intensity of most of these sectors has been addressed by this report before, but in many alternative sectors like the high-ranking life sciences, data centres, or energy infrastructure, the lack of availability of deals is also a problem.

The number of schemes to buy in life sciences, for instance, is minuscule, and even if investors were to choose to build, opportunities are rare. Such market dynamics have pushed up prices, and yet the sector still seems set to grow in popularity.

"It's just very compelling," one global investor says. "The amount of R&D spend from these biotech companies is just enormous. And they definitely just have to be next to where the talent is. Their research budgets are monstrous, so whether they are paying £40 per square foot or £70 per square foot, it almost doesn't matter."

Liquidity on the buy side is one factor facing those that want to buy into these alternative sectors, but institutional investors seem increasingly comfortable with life sciences investment, with global players like GIC and AXA IM Alts, for instance, recently completing large European deals.

But such sectors are a long way from being universally accepted among the pension funds and insurance companies that for years have been comfortable buying offices, retail, and industrial, but little else.

"Whether biotech companies are paying £40 per square foot or £70 per square foot, it almost doesn't matter.

Image: Man wearing mask while grocery shopping (Getty Images)

This perhaps gets to the heart of the issue surrounding the redefinition of core, and why it is such an interesting moment for real estate.

The two largest traditional asset classes, offices and retail, are going through a period of transition, meaning some assets in the sector no longer appeal to investors looking for stable income. Industrial is flying, of course, and continues to grow, but some of the new asset classes that investors think offer the characteristics they want from core real estate, like stable income and strong demographic support, are not yet large or liquid enough to be considered core in the way all offices and retail once were. They are a lot more complicated to manage, as well.

"You've got a lot of core capital funnelling into a narrower channel of deployment," one opportunity fund manager says. "And so that means rental residential or logistics or student housing – these other things get pushed up by just this wall of money because you think about the amount of money that went into retail and office that can no longer be deployed there. So if you want to deploy in core, you've got a fairly limited universe."

Investors still favour beds and sheds

As has been the case for several years, various strands of residential occupy many of the top 10 places among asset classes that survey respondents think will perform well in coming years.

The supply/demand imbalance in residential is a complex issue that creates benefits but also potential pitfalls. Housing shortages across Europe are leading to institutional investors, which had previously shunned the sector, increasing their exposure.

There is a sense that the sector proved its resilience during the pandemic: tenants kept paying their rent and the investment market grew rather than shrank, as the previously mentioned data from RCA indicate.

"From our perspective, residential is an interesting fit to the overall portfolio," one institutional fund manager says, adding that the fund expects residential to grow as a proportion of its portfolio from zero a few years ago to up to 15 percent. "We try to be as diverse as much as we can. We still want to go acquire assets in the best locations, and the best-quality residential offers you potential for long-term stable income."

But for several interviewees, the issue is weighing the undoubted demand against the looming regulatory risk in this most socially important sector.

"Residential is definitely on the horizon," says one. "The challenge for us is the ability to scale up and put a meaningful amount of capital into the sector. The advantage there is solid rental growth, although there is the question relating to social unrest – for how long rents can keep growing until the government steps in and says it is becoming unaffordable."

So far, political activism over ownership of housing by financial institutions seems mainly restricted to Germany – and centred on Berlin – and to a lesser degree Spain. But it is something investors are watching closely.

No such qualms exist about logistics, which by common consent has prospered during the crisis. The shift of a greater proportion of consumption online, whether retail goods or food, has rocket-charged a sector that was already doing well. Whether the increase in delivery remains as European economies recover is a key question. But the signs are encouraging.

> "
> The best-quality residential offers you potential for long-term stable income.

Image: Artist painting street mural (Getty Images)

"Take-up statistics are extraordinary," one large investor in the sector says. "So far in the UK in 2021 we've had as much take-up as we had in the full calendar years of 2019 or 2020. It is leading almost to price insensitivity among occupiers, and definitely to rental growth. I don't know if that will recede, but I have been surprised at how strong take-up has been."

Urban logistics and light industrial/warehouses in and around big cities in particular benefit from a dynamic of limited supply and occupiers that feel they need to be in these locations – not just e-commerce or last-mile delivery firms, but traditional light-industrial occupiers like mechanics or small manufacturers that want to be near their workers and customers.

Another investor points to pockets of potential oversupply in Madrid and some parts of central and eastern Europe. But the Continent is set to benefit from the fact that e-commerce penetration is lower than in the UK, with southern Europe behind northern and western Europe and likely to catch up.

Retail is the flip side of the same coin, and for many investors and lenders, shopping centres, particularly those in the UK, remain an untouchable sector, an exception in a world of abundant capital.

Grocery-anchored retail and retail parks are finding more favour, the former because of the resilience of food retail. Both formats have benefited from ease of access by car and their efforts to make social distancing easier during the pandemic.

Quality counts with offices

Correlation is not causation, but it would be a huge coincidence if the drop in the proportion of real estate investment taken up by offices is not to some extent a result of uncertainty over the future of occupier demand. Survey respondents put both city-centre and suburban offices towards the bottom of the pile when it comes to investment and development prospects, and interviewees report a market that has quickly bifurcated.

For high-quality offices – those with modern amenities, strong ESG credentials, good air quality, and the right location – rents and capital values per square metre are still touching record highs in some markets. Companies want access to good space in cities that have strong economies because they believe it helps attract and retain talent, says one office investor, adding: “There’s just not a lot of that good space about, and so the landlord-tenant negotiating leverage is pretty favourable to the landlord.”

But interviewees point out that once you stray outside that realm of good-quality, well-located, newly built space – and not even that far off the beaten track – things are very different.

Not everyone will comply, according to one investment banker: “There’s a tendency from investors during a crisis to focus on the major countries with more liquidity and more certainty and the major asset classes with less operational risk.”

But for many investors, a new reality is emerging: income from the asset class is no longer as bond-like as it was considered to be before.

“If you’re in tougher real estate, in secondary locations, it is brutal,” another investor says. “There’s some stuff we bought in 2012: you would have thought anything you bought then you could just close your eyes and sell it at a profit, but we’re struggling.”

The spectrum of opinion about the impact greater remote working will have on office demand covers the full range among interviewees, from the bullish view that things will barely change to worries that demand could drop by 30 percent or more.

One opportunity fund investor outlines how secondary offices may suffer a decline in values similar to that of retail, working on the basis that overall occupier demand could drop 20 percent because of new ways of working. “You might see 20 to 25 percent net rental declines for those buildings, and then you could see the cap rate shift up very quickly. You get the double whammy that happened in retail – rents 20 percent lower and 150 to 200 bps added to the cap rate – and your value is off 40 percent. And then if any of them have financing, they’re instantly LTV [loan-to-value] under water, which is what happened in the whole retail sector.”

> “
> If you’re in tougher real estate, in secondary locations, it is brutal.

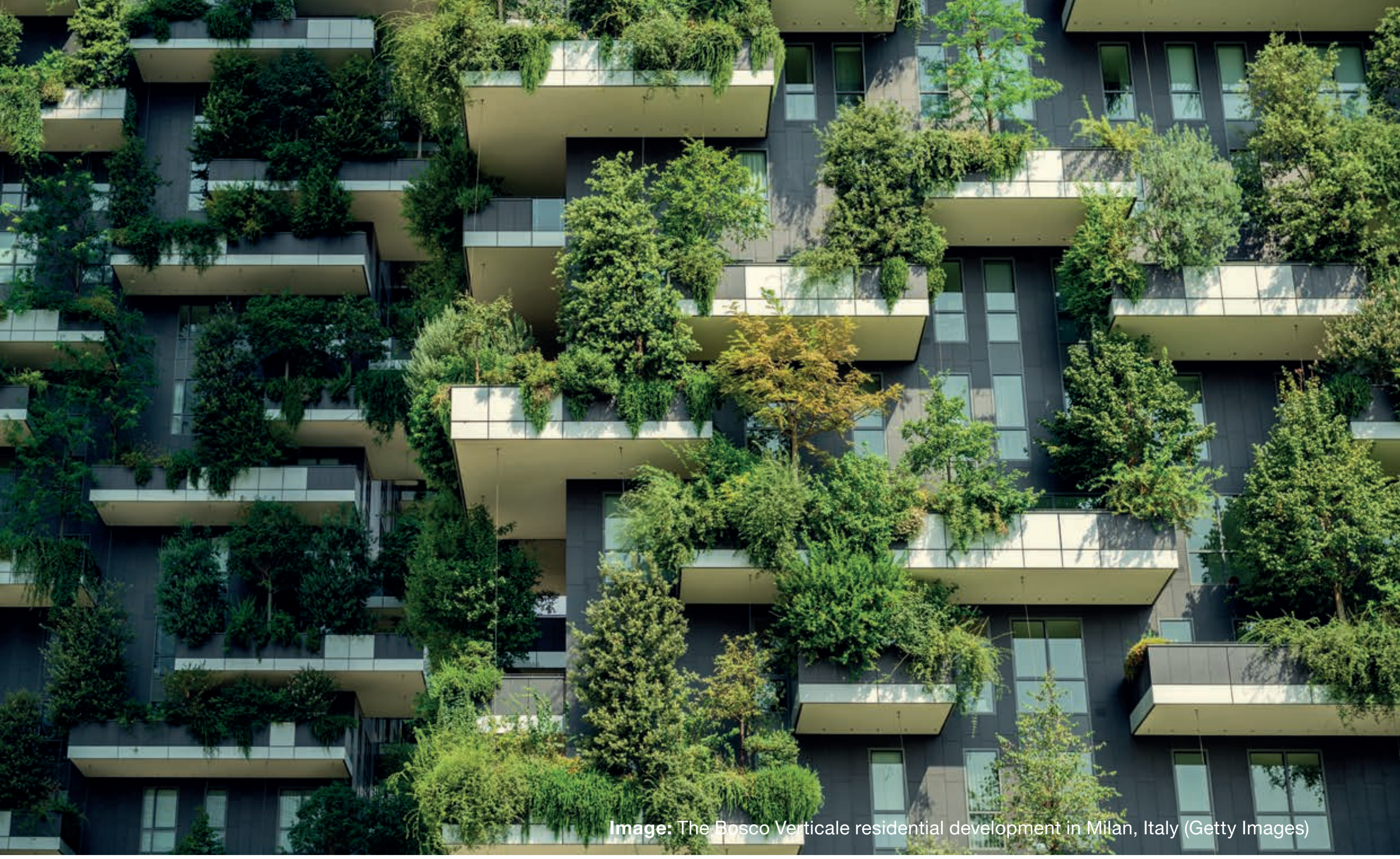


Image: The Bosco Verticale residential development in Milan, Italy (Getty Images)

The future is now

One capital markets trend worth marking is the fact that investors see sustainability having an impact on real estate investment in the here and now rather than at some vague future date. More than 61 percent of survey respondents say they are concerned about sustainability requirements, up from 49 percent in last year's survey.

This is an extension of the issues influencing the debate about office investment. If investors think it will cost too much to refurbish assets to meet government-imposed sustainability standards or self-imposed net zero targets, they simply will not buy them.

"It is getting harder and harder to get a bid on secondary assets," one value-add fund manager says, "because people are fundamentally questioning the sustainability of cash-flow streams and the capex cost that's going to be associated with sustaining cash flows – not because of the usual tenant incentives, but because somebody imposes a [sustainability] burden on them from outside, like the EPC [energy performance certificate] in the UK."

Of course, it is mainly larger investors with longer hold periods that are currently the most insistent about shying away from potential "stranded" assets, and some will not have such stringent ESG requirements. But many interviewees report that the "brown discount" for less sustainable assets is now a common part of the investment strategy.

"

It is getting harder to get a bid on secondary assets because people are fundamentally questioning the sustainability of cash-flows.

Chapter 3

Markets to watch

"The economic drivers have to be there in cities. But the more enlightened investors are starting to look at talent or workforce, affordability metrics, mobility."

Director, pan-European consultancy

Image: Business district, Paris, France (Getty Images)

With effective vaccines against COVID-19 available across Europe, the prospects for real estate are brighter as its countries and cities reopen for business. But while the general outlook has improved, some markets – particularly those more reliant on tourism – have been hit harder in the pandemic, potentially giving them farther to bounce back.

London has moved up one place in the *Emerging Trends Europe* survey to become the most favoured city for combined investment and development prospects for the year ahead, with a degree of positivity reflected by a score well ahead of Berlin's winning figure last year. The UK capital has always benefited from the depth of its market and undoubted gateway status, but this year industry leaders believe it also offers better value than some of its rivals. There is a widely perceived yield gap of about 1 percentage point between London offices and their continental equivalent.

"Everyone was talking down London because of the pandemic and Brexit. But then a year later they will say that it is undervalued, and they will run to London," says a private equity investor.

Whether London can completely shake off the legacy of Brexit is a moot point, however, because there is evidence that over 400 financial firms shifted some of their activities or staff from Britain to continental Europe up to April 2021, according to think tank New Financial.

Further ahead, London may have the potential to reinvent itself. According to a pan-European fund manager, "London has a great opportunity post-Brexit to become more than just financial, with a move into technology – as already seen with Facebook, Google, and Amazon – and also into the life sciences." However, there are some question marks about whether the City of London, in particular, will be able to regain its former vibrancy in the wake of COVID-19. One German lender sees a risk of "losing all the add-on services, the coffee shops, and so on".

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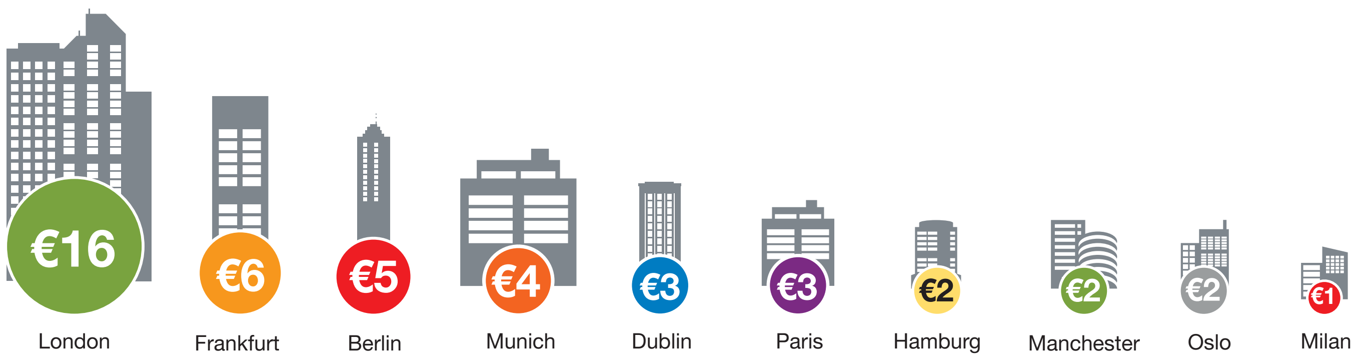
Everyone was talking down London because of the pandemic and Brexit. But a year later they say it is undervalued.

Figure 3-1 **Europe's 10 most active markets, Q4 2020–Q3 2021 (bn)**



Source: *Real Capital Analytics*

Table 3-1 **Overall real estate prospects**

Overall rank (2021)		Overall prospects
1 (2)	London	2.62
2 (1)	Berlin	2.24
3 (3)	Paris	1.97
4 (4)	Frankfurt	1.93
5 (7)	Munich	1.81
6 (8)	Madrid	1.80
7 (5)	Amsterdam	1.77
8 (6)	Hamburg	1.73
9 (13)	Barcelona	1.68
10 (12)	Brussels	1.37
11 (9)	Milan	1.26
12 (10)	Vienna	1.25
13 (11)	Dublin	1.22
14 (20)	Zurich	1.20
		Mean
15 (14)	Warsaw	1.15
16 (15)	Lisbon	1.02
17 (17)	Luxembourg	1.01
18 (18)	Copenhagen	1.00
19 (16)	Stockholm	0.96
20 (22)	Manchester	0.93
21 (23)	Rome	0.82
22 (25)	Birmingham	0.76
23 (28)	Athens	0.72
24 (19)	Helsinki	0.71
25 (24)	Prague	0.65
26 (21)	Lyon	0.58
27 (27)	Edinburgh	0.53
28 (29)	Oslo	0.46
29 (26)	Budapest	0.45
30 (30)	Istanbul	0.38
31 (31)	Moscow	0.24

More than 1 standard deviation above mean
+/– 1 standard deviation of mean
More than 1 standard deviation below mean

Source: *Emerging Trends Europe* survey 2022

Table 3-2 **Local outlook: Change expected in rents and capital values in 2022**

Overall rank		Rents	Capital values
1	Athens	3.72	3.93
2	Copenhagen	3.41	3.56
3	Berlin	3.47	3.58
4	Hamburg	3.41	3.50
5	Munich	3.44	3.66
6	Zurich	3.20	3.52
7	Vienna	3.36	3.57
8	Amsterdam	3.36	3.53
9	Madrid	3.34	3.49
10	Milan	3.37	3.57
11	Paris	3.23	3.42
12	Warsaw	3.21	3.45
13	Lisbon	3.14	3.42
14	Stockholm	3.37	3.51
15	Luxembourg	3.31	3.51
16	London	3.10	3.24
17	Oslo	3.42	3.55
18	Birmingham	3.35	3.33
19	Helsinki	3.12	3.49
20	Frankfurt	3.27	3.40
21	Prague	3.26	3.41
22	Dublin	2.96	3.24
23	Manchester	3.16	3.25
24	Lyon	3.07	3.28
25	Barcelona	3.04	3.28
26	Brussels	3.08	3.23
27	Rome	3.21	3.36
28	Budapest	3.35	3.41
29	Edinburgh	3.07	3.14
30	Istanbul	2.94	3.06
31	Moscow	2.95	3.00

Increase — Stay the same Decrease

Source: *Emerging Trends Europe* survey 2022

Note: Respondents who are familiar with the city scored the expected change for 2022 compared to 2021 on a scale of 1=decrease substantially to 5=increase substantially and the scores for each city are averages; cities are ranked on the basis of the average of expectations for rents and capital values.

Image: Elephant Park, London, UK (Lendlease)

Still, the UK's flexibility continues to appeal to many investors. "We always see the UK as attractive because it's a very dynamic market where rents adjust quickly, where yields adjust quickly," says one global player.

Partly due to this relative pricing, last year's favourite, Berlin, slips to second place. It shares many of the advantages of the other German cities in the top 10 – Frankfurt, Munich, and Hamburg, which are ranked fourth, fifth, and eighth, respectively. As one fund manager says, they all gain from a "robust economy and transparency".

But Berlin has its own special appeal, particularly for international investors. According to one UK-based developer: "Berlin is a sleeper city. Thirty years since the wall came down, it's still growing. It has tech and it's a very civilised place, but it still hasn't quite made it."

Besides their strong economic underpinnings, another perceived advantage of the German cities is their "strong investment and development opportunities", says one pan-European manager.

"Berlin is a sleeper city. Thirty years since the wall came down, it's still growing.

However, they are “complex markets, because a lot of players are there; it’s not easy to enter if you don’t have people on the ground”.

As the survey shows, the availability of assets and opportunities for new development are the most important considerations when selecting a city for investment. With today’s market conditions, however, asset availability may be more of a nice-to-have than an easy-to-get. Economic prospects and forecast real estate returns come close behind on investors’ wish lists.

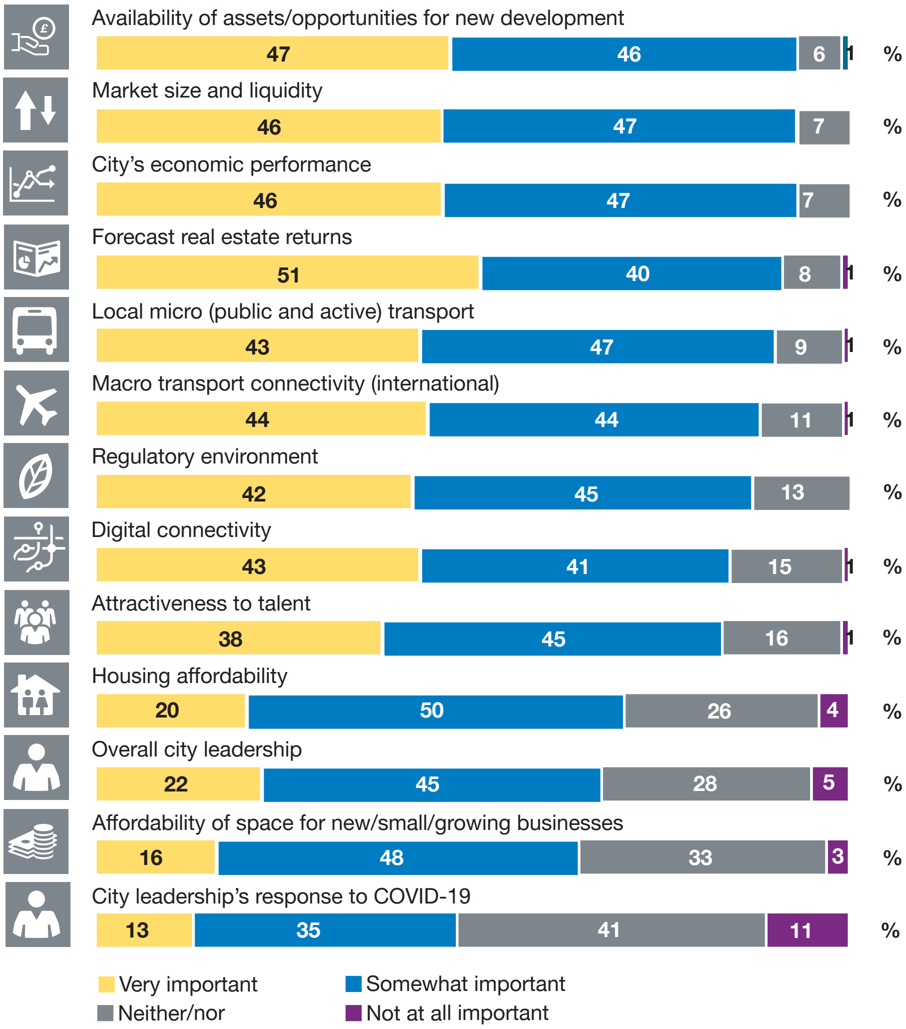
Indeed, breadth of economic activity is seen as an advantage for Frankfurt, providing “the defensive stability to repurpose buildings or to tap into trends like urban logistics or inner-city residential”, according to a private equity investor.

Older people are being encouraged by the authorities to return to Frankfurt and Munich city centres via public transport improvements, further enhancing investment opportunities by opening up new potential in senior living and health care facilities, for example.

All the German cities benefit from relatively short commute times to the centre compared with Paris and London, a feature that has come to the fore during the pandemic but may also favour their office markets over the longer term.

Like last year, Paris ranks third in the survey, reflecting its gateway status. For one European fund manager, Paris has many advantages: “the upcoming Olympic Games, exceptional transport networks, the largest office market in continental Europe, low rents with good potential for growth, and the largest number of head offices in Europe”.

Figure 3-2 **Importance when selecting a city for investment or development**



Source: *Emerging Trends Europe* survey 2022

“In the city centre [of Paris], there are still opportunities to buy assets with good rental growth prospects.


Image: Cyclist in Paris, France (Getty Images)

"There is a low vacancy rate for offices, and in the city centre there are still opportunities to buy assets with good rental growth prospects," says a pan-European investor.

Within Paris, however, location is key. "There's far more interest in the centre than anything else," comments another large manager. "It can extend to the first circle around the centre, but beyond that there's much less appetite. Outside of the Périphérique, there are difficulties in getting finance, meaning that assets are less liquid." Similarly, one private equity investor claims to be "a little nervous about anything that's towards La Défense or the western edge", while some interviewees say La Défense is lacking in vitality, despite city plans to boost investment.

Madrid has moved up two places to sixth, with a score that now rivals the leading German cities. Interviewees point out that it offers good opportunities across sectors such as residential and logistics, as well as a strong office market. One effect could be "a decentralisation of offices as is already happening in London or Paris", although commutes are "much more comfortable", according to one global manager.

Another global player believes that it shares a pricing advantage with other parts of southern Europe, where there has "historically been a relative nervousness", although this may mean that a local presence is needed to realise their "good return prospects".

Amsterdam, a city that has consistently ranked highly, places seventh, supported by an influx of financial firms in the wake of Brexit. According to an adviser, these companies are not just those previously based in the UK, but also "US firms now landing on the continent".

While the mayor of Paris has been actively promoting the concept of the "15-minute city", Amsterdam may in fact be nearer this ideal, with many younger people living close enough to cycle or walk to their workplace. The ability of such cities to attract a talented workforce is highlighted in the survey as growing in importance to investors. But small scale can also mean supply challenges. As a UK-based developer says, "It's lovely, but very small and difficult to build. Everybody would like to go to Amsterdam if they could, but they can't."

Barcelona moves up four places to number nine, having been regarded as distinctly average last year. Like Madrid, its attractions for international investors bridge the main sectors, with one value-add fund manager saying, "in logistics we are buying tons of stuff in Barcelona because whether Spain does well economically or not, Barcelona still does well". A local developer notes that some investors may be reluctant to invest in Barcelona given the ongoing political situation, "but it will always keep its solid economic basis; industries such as biomedical research, chemical and tech innovation are in its DNA".

Brussels's location at the heart of Europe favours the in-demand logistics sector, helping the city move up two places to number 10. Interviewees like its reputation for innovation and a relatively youthful demographic. There are, however, short-term concerns over its office market, one local investor seeing the potential for rising vacancy rates, with "a lot of big corporates, including banks, taking on less space and a big increase in available stock". It has also been reported that the European Commission plans to close half its 50 office buildings across Brussels by 2030.

"It's lovely, but very small and difficult to build. Everybody would like to go to Amsterdam if they could.

Although falling two places to number 11, Milan's rental and capital value prospects are regarded positively, and its overall prospects score remains similar to last year's. As one opportunistic fund manager comments: "It has a lot of wealth, and a strong, dynamic economy in relative terms. There are supply constraints in a lot of sectors, and while it's not totally transparent, the demand side is strong."

This positivity contrasts sharply with Rome, at number 21, where the performance outlook is not rated as highly and investors generally regard the market as less mature. It also relates to concerns about how quickly Italy as a whole can recover from the pandemic, even as the Eternal City reasserts its place on the tourist trail.

Survey respondents see good transport infrastructure – both locally and at an international level – as key to a city's future success. Partly for this reason, the central European cities of Vienna and Zurich, at numbers 12 and 14, respectively, offer strong investment and development opportunities. A Swiss manager sees an "economic high" in 2022 leading to strong cash-flow potential for Zurich's offices and retail, in particular.

Dublin slips two places to number 13, perhaps reflecting that the gains from Brexit have now largely been realised. "A number of companies have moved or opened new EU head offices there," says an international adviser. However, a private equity investor enthuses that "every language under the sun is spoken by the people, and the tax regime is beneficial" – advantages that are seen as favourable across investment sectors.

A global investment manager also sees Luxembourg, holding its position at number 17, as benefiting from Brexit, given the dominance of financial markets there. One local housing developer expects prices to keep escalating, although he fears affordability may start to bite in the medium term. Housing affordability has proved to be a growing concern among survey respondents in choosing where to invest.

Among the eastern European cities in the survey, Warsaw emerges as the clear favourite at number 15, with local observers already witnessing a "strong comeback" in investment, despite growing political frictions with the EU. They predict that 2022 will be a good year for office leasing, based on a big push to get staff back on site.

Although standing at a relatively lowly 25 in the rankings, Prague is viewed as having strong potential, particularly by logistics investors. Supply constraints in this sector are seen as an advantage, as long as stock can be found. Meanwhile, an international adviser believes that cities like Budapest, at number 29, which have good leadership and can easily connect remotely, could benefit from a reshuffling of traditional city rankings as the European economy recovers from the pandemic.

Some 84 percent of survey respondents highlight the importance of digital connectivity when selecting a city for investment.

At number 16, Lisbon leads the other remaining southern capitals, Athens and Istanbul, which rank 23rd and 30th respectively. Leisure tourism–related real estate should bounce back strongly here from the ravages of COVID, says one local adviser, who also sees "Germans, Swiss, and some Spanish investors very aggressive and keen to buy in the office market".

Relatively few survey participants are active in the Athens market, but they believe the city offers some of the strongest growth prospects anywhere in Europe. This relates not just to the potential recovery of tourism, but also to Greece's relative political stability compared with Turkey. "Greece, for the first time in decades, has a stable, pro-business government," says one private equity investor. "This stability is set against a contrasting situation in Turkey."

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Milan has a dynamic economy. There are supply constraints in a lot of sectors, and while it's not totally transparent, the demand side is strong.

Image: Cirkelbroen on the Inner Harbour of Copenhagen, Denmark (Getty Images)

Prospects for the Nordic markets of Copenhagen, Stockholm, Helsinki, and Oslo – numbers 18, 19, 23, and 27, respectively – are generally regarded positively. Their position in the lower half of the table – with scores similar to last year's – is mainly explained by their relatively small market sizes. One regional investor/developer likes them because "they are some of the fastest-growing urban areas in Europe," rating them "high on liveability". Copenhagen especially stands out as "young, up-and-coming, and smartly managed", one global manager says. Though some regard Stockholm and Oslo as relatively expensive, local players in Oslo have only good things to say about the city. "The price of homes will continue to increase," says a developer, while its "earnings and risk profile" appeals to an adviser.

The UK's regional cities of Manchester, Birmingham, and Edinburgh stand at 20, 22, and 27 in the ranking, again partly because of their relatively small scale. The same is true of Lyon, number 26, in France. But one private equity investor thinks "the UK government emphasis on levelling up, combined with the fact that rents are low," makes the prospects for Manchester and Birmingham relatively positive going forward. For the likes of Lyon and Edinburgh, investors may need to be imaginative to exploit the revival in tourism and hospitality when it comes – for example, through "experiential retail and a mix of uses that can create the desire and need to visit", according to one global manager.

Istanbul ranks one place from the bottom in the survey, largely because of the economic backdrop to investment in the city. "Turkey is blacklisted for good reason – because of their macroeconomic policies and how they treat their currency and balance their budget," says one consultant. "It's a high-risk model of running the economy."

Moscow also remains an outlier, not just geographically, but also in its longstanding place at the foot of *Emerging Trends Europe*'s city rankings. An international adviser notes that "the centre is full of 25-year-old office buildings that were poorly built and cannot be leased to modern, international companies". Another says that if you have already invested there, you are stuck: "There are no buyers for the product."

> "The Nordic markets are some of the fastest-growing urban areas in Europe.

Repurposing of assets gathers pace

"In the big inner cities in Europe, every third or fourth building will be touched with urban repurposing in the years to come," says one of the industry leaders interviewed for *Emerging Trends Europe*.

The survey results bear out such a bold prediction. In 2020, the pandemic interrupted repurposing plans, as it did much development activity, but more than half of survey respondents indicate they have increased the proportion of assets repurposed over the past year. Moreover, the trend appears to be accelerating, with almost three-quarters of respondents expecting the proportion of assets repurposed to increase over the next five years.

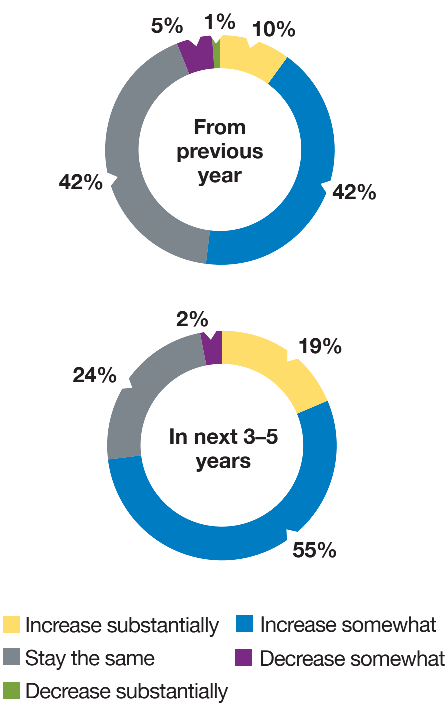
COVID-19 has given further impetus to the structural changes driving repurposing activity. As home working becomes more widespread, the future role of the existing office stock is being rethought. Meanwhile ever more shopping centres and high street shops have been emptied of tenants as consumers switch to online purchases. It is no surprise that survey respondents report offices and retail were the most commonly repurposed asset types last year.

It has long been clear that Europe generally has too much shopping space. Interviewees identify the need to transform pure retail centres into mixed-use destinations to recapture trade as vaccinated populations venture outside once again, and to repurpose excess space, particularly on upper floors, for more in-demand uses. "A lot of retail is historically in pretty good places," says a pan-European fund manager. "Where locations are attractive, there are opportunities. People are exploring building apartments on top of retail facilities or using part of the parking space to build a new apartment block."

Another interviewee observes that the need for retail repurposing is particularly pronounced in the UK because compared with continental shopping destinations, less of its retail space is anchored by hypermarkets and grocery stores, which have proved more resilient than comparison goods outlets. The UK saw 5,251 chain stores and hospitality and leisure businesses close in the first half of 2021 alone, according to Local Data Company analysis.

"Repurposing seems far more apparent in the UK compared with continental Europe, and I think the pricing of retail in the UK is remarkably different to a lot of retail in Europe," notes a London-based, pan-European asset manager.

Figure 3-3 **Change in the number of assets repurposed**



From previous year

Increase	%
2022	52
2021	34
2020	47

In next 3–5 years

Increase	%
2022	74
2021	71
2020	67

Source: *Emerging Trends Europe* survey 2022

How swiftly, and to what extent, the trend will take hold in the rest of Europe is the subject of speculation. “That’s going to come now, maybe more quickly than we thought. We might see it in markets with a bigger supply of retail like Germany, Benelux, or Spain,” predicts an adviser. Repurposing retail is still predominantly a western trend, suggests a southern European interviewee. “In other countries, like Turkey, Romania, Greece, and Italy, where the stock is older, you might be looking either at higher capex, which might not be viable, or developing new stock altogether.”

Some interviewees are examining how logistics-related uses may be substituted for retail. A logistics specialist adds a caveat, however: “We have done quite a lot of analysis, and the opportunity is not as big as one would have thought it would be to convert shopping mall space to last-mile logistics, or to make it work from a numbers point of view.”

Smaller-scale projects that seek to reposition shops as part of the e-commerce supply chain may offer more potential for widespread activity. “I live in Berlin, and of the small shops that had to close during the pandemic, all are leased again to the 10-minutes delivery services businesses. They are growing, and they can’t find enough space,” says an interviewee. “If you could repurpose retail to make it become a logistics pickup centre, it might not have the same rent that you could generate from a retail unit, but it’s still got a purpose, and you can repurpose it and refit it,” muses another.

“

If you could repurpose retail to a logistics pickup centre, it might not have the same rent but it’s still got a purpose.

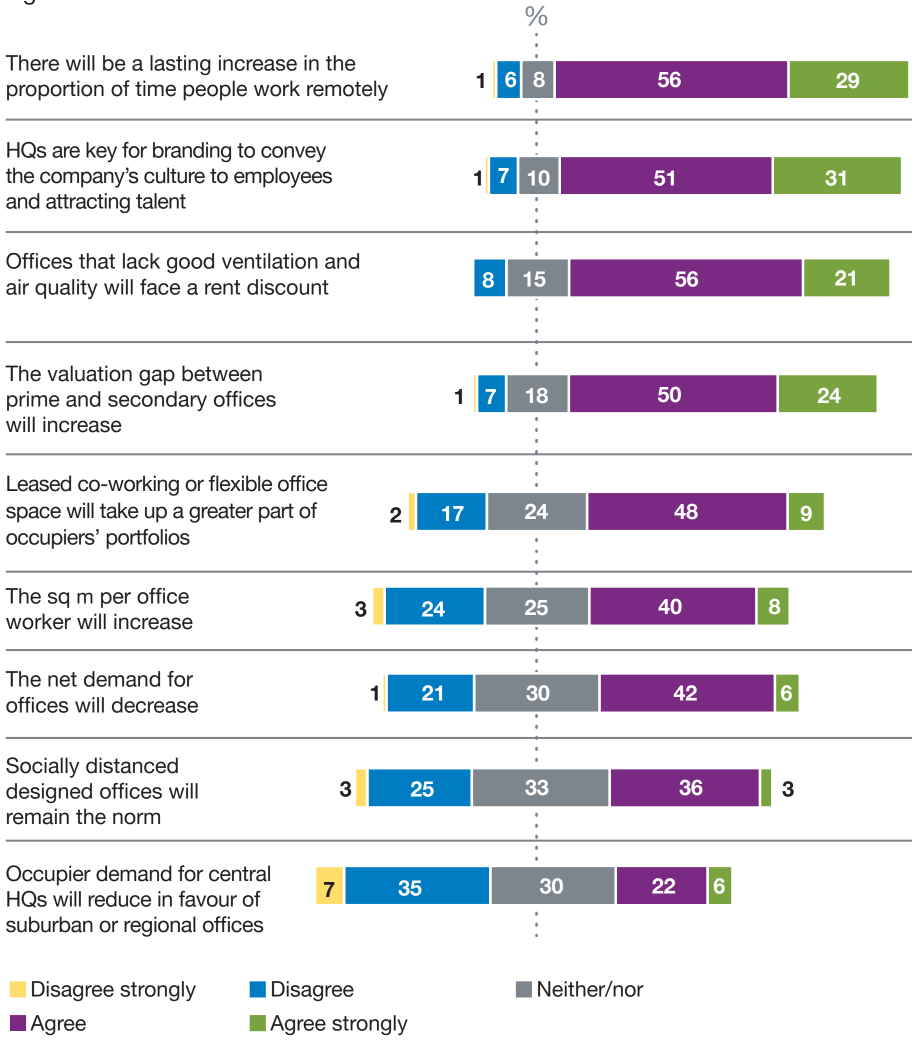
Image: Office Building in Edinburgh, UK (Shutterstock)

While the European property market was already braced for the effect of e-commerce on retailing, it has had less opportunity to ponder the conundrum posed by the pandemic over the future of offices. Some investors are already beginning to turn away from the sector that has always represented the greatest share of the investible real estate universe. "Traditionally, the biggest sector was offices, but there are question marks around it, so capital is shifting to residential. It was a trend that was already happening but has been accelerated by the current conditions," says an adviser.

Most interviewees nonetheless remain convinced that many workers will return to offices as the pandemic is brought under control. However, an overwhelming majority of survey respondents also expect a lasting increase in remote working. The extent to which that will affect demand for offices is the subject of debate, but the majority view is that the reduction in activity is likely to be more pronounced for lower-quality space. As many as three-quarters of survey respondents expect to see the valuation gap between prime and secondary offices increase.

Greater selectivity when buying and developing offices is a common theme. "The share of offices in our portfolio will probably remain the same, but not the type of offices," says a global investor. "If the office product is commoditized, then its operating risk is embedded in the asset. To make tenancies stickier, it is important for office space to give flexibility, amenities, and connection with the transportation structure. We are actively developing offices. But it's wrong to think of offices as just one thing."

Figure 3-4 **The future of offices**



Source: *Emerging Trends Europe* survey 2022

Many interviewees stress quality of experience – both within the office building itself and in its surrounding environment – as crucial to supporting value. "The office buildings that do well will be first-class office buildings that are close to good transportation nodes and ideally well located for connections to where we live," says one global investment manager. "Office buildings that aren't in the right locations, aren't near transportation nodes, are older, don't have those amenities are going to be challenged."

As work becomes more dispersed, new mixed-use districts could begin to emerge. "Location will be a crucial factor for a lot of property types, but it's a less siloed idea of location," one pan-European investment manager predicts. "It's not about the right office, retail, or residential location, but more about locations within the city fabric that try to combine different uses. This won't be completely mixed use, but maybe it's placing offices next to retail, with some integration of leisure activity."

Image: Friends using scooters in the city (Getty Images)

"After COVID-19, people will not be prepared to work just anywhere," argues a pan-European fund manager, who stresses the importance of connectivity to public transport and the quality of the neighbourhood matching the quality of office. For big tenants, that is going to be crucial. "Maybe that's a campus, if you're really big, or maybe an environment in which other like-minded individuals go to work, and you have the meeting points partly outside the office – you've got the cafés and the occasional bar for after-work drinks."

Other interviewees believe that individual buildings will be repurposed to provide a mixture of uses. A Paris-based interviewee looks back to the Baron Haussmann–designed layout of the French capital's streets – with retail on the ground floor, and offices and residential space above – to set the template for the future. "Conversion to residential is always a nice idea, but it often ends nowhere because you can't make it work. Instead, you have hybrid uses, still keep some office space, but you also have gastro on the rooftop and an Amazon pick-up station downstairs in the basement."

Similar themes are playing out across many European cities simultaneously, notes an investment manager. "Saying that one city is a no-brainer versus another one is not that clear today because the same thing happened in all the cities. This trend is not specific to Berlin or Paris. It's really the generic trend. This trend is happening everywhere."

Nevertheless, some interviewees note that these themes may play out a little differently in mega-cities, where longer commuting times could drive need for satellite offices closer to the suburbs. "In a city like London, where you have a huge agglomeration that's quite challenging to get around, a hub and spoke situation might emerge for certain large employers. But in general, I wouldn't see that model emerging across continental Europe."

Some office buildings, particularly those that cannot be adapted to meet more ambitious environmental goals, will be left stranded by the changing tide of the post-COVID-19 market, with repurposing playing to real estate's growing focus on the ESG agenda. "From an ESG perspective, one would prefer refurbishment and repurposing to knock down and rebuild because there's much less embedded carbon in that process," says a fund manager.

> "From an ESG perspective, one would prefer repurposing to knock down and rebuild because there's much less embedded carbon in that process.

A UK-based broker adds: "There are some really big environmental opportunity wins on the road to net zero. My understanding is the government is looking at some tax advantages, so there are some potentially financially viable solutions that might help with the costs of repurposing. Is that going to happen tomorrow? Possibly not. Next three to five years, I would like to say yes."

An Irish interviewee offers a radical prediction about the future preeminence of repurposing over redevelopment: "In 10 years' time, building new buildings will be a very rare occurrence. I think we're moving towards an era where retrofitting and reuse is going to become much more [prevalent] than rebuilding. And I think the carbon agenda, and carbon pricing, is going to make it very expensive to build new buildings."

Central and eastern Europe also face a distinct set of challenges involving obsolescence, argues an adviser based in the region. "In the 1990s and early 2000s, the modern post-industrial infrastructure was created in cities like Moscow, Prague, and Warsaw as they emerged from centrally planned systems. And now it has started becoming obsolete. These cities face urban decline. There is a challenge for city governments to allow redevelopment into something else – maybe residential apartments or hotels."

The survey shows that the most common reuse for obsolete office buildings last year was conversion to residential, a situation that is expected to persist. As one investor puts it: "What do you do with an old office building? You turn it into a residential building. Why? Because in Europe, in most cases, residential values are three to four times higher than office values in most urban locations."

"What do you do with an old office building? You turn it into residential because in Europe, in most cases, residential values are three to four times higher.

Image: Old to new, Wilhelminian-style residential building (Shutterstock)

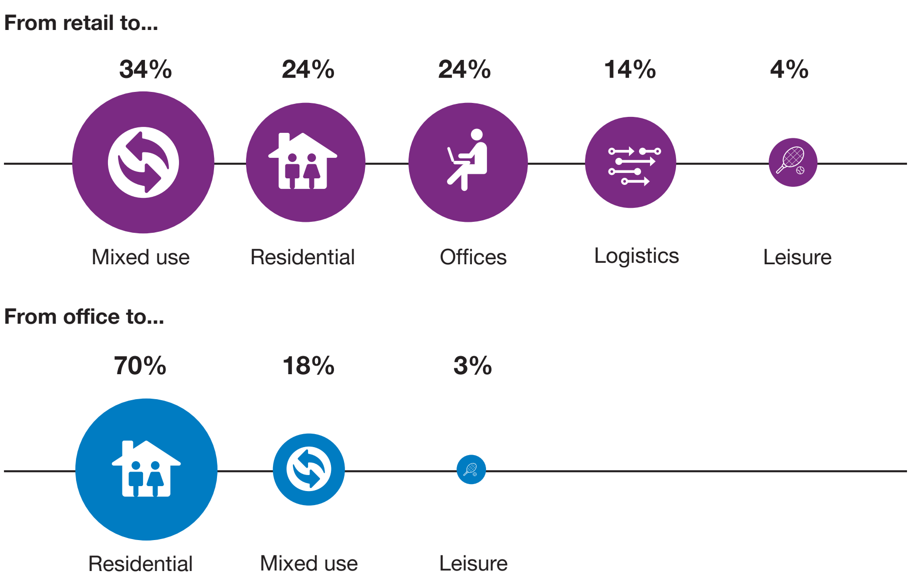
Not all such projects have been notable for the quality of the end product, however. Some office-to-residential conversions delivered in the UK under a recently instituted, permissive planning regime have been criticised in the media as "slums of the future".

The pandemic has not yet resulted in widespread asset-level distress, so some investors are looking to repurposing as a method of grasping opportunities presented by underlying market stress. Says one: "If some kind of semi-distressed deal came along with weaker B- or C-quality offices, in previous cycles we might have said, 'we'll put a bit of capex in, lease it up and sell it'. This time around, I'd probably say that building is permanently impaired and not going to recover, so it needs to be repurposed for something else."

Interviewees agree that repurposing buildings remains highly challenging to execute, however, with a variety of hurdles. Sometimes permitting is the problem: "Changing planning rights can be a cumbersome and never-ending story in some cities." Cost is also an issue – "The cost of repurposing an asset is big, and in a period of high construction costs, it's even harder" – as are persistently high price expectations: "I think you will find it's difficult to repurpose if you haven't landed on the right valuation at today's prices. Values are still too high to allow for a big project redevelopment."

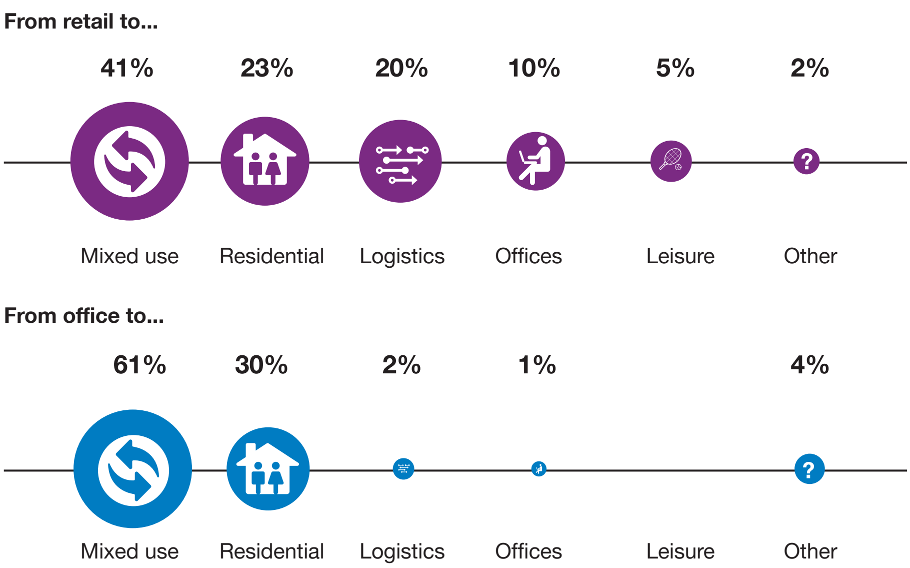
A chasm remains between ambition and execution, and innovative private- and public-sector solutions are needed to fill it. "Repurposing assets is very important in conversation but super difficult to implement in terms of administrative issues, regulations, technical impacts, costs," one global investment manager concludes. "It's a lot easier to say that you're going to transform thousands of square metres of offices into ready assets in big cities than to do it."

Figure 3-5 **Most common building types repurposed last year**



Source: *Emerging Trends Europe* survey 2022

Figure 3-6 **Most common building types to be repurposed in the next five years**



Source: *Emerging Trends Europe* survey 2022

Chapter 4

Business transformation

“At present, it’s more attractive to work for tech companies than in real estate. When you’re asking people to work in a museum, you lose the younger generation.”

Scandinavian developer

Image: Co-working space, Amsterdam, The Netherlands (Spaces/IWG)

For decades, real estate's business model has been based on long-term stable income. This surety of income and consequent slower pace of life has been largely responsible for the industry's reputation for being slow to change, with companies open to modernisation but rarely transformation.

But the force of the structural change in the industry now disrupting the products and services being offered is foreshadowing inevitable transformation of business models and strategy. What a successful business model in real estate looks like in five to 10 years' time is not clear, but the path to that change has moved front and centre of the industry's priorities.

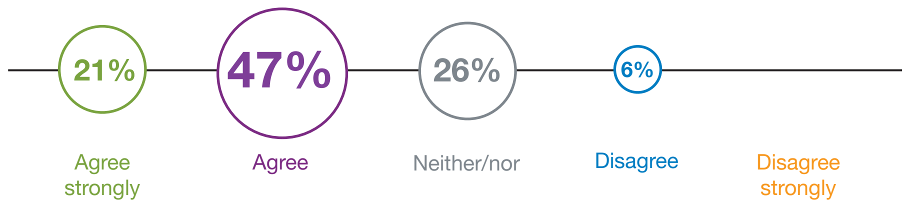
This new urgency – undoubtedly reinforced by the impact of COVID-19 on business generally – demands major shifts in mindsets, roles, capabilities, and digital enablers. Its importance is confirmed by this year's *Emerging Trends Europe* survey, with 68 percent of respondents agreeing that organisational transformation will be a key priority over the next five years.

At the core of this trend is the fact that occupiers and consumers are demanding greater flexibility and shorter contracts to meet their fast-changing needs, often combined with a desire for a higher level of amenity, service, health and wellbeing, and digital connectivity.

This shift towards more customer-centric products and leases comes through strongly in the survey. A remarkable 89 percent of respondents believe that real estate as a service and changing customer demands are influencing organisational transformation in the industry (see sidebar, page 61).

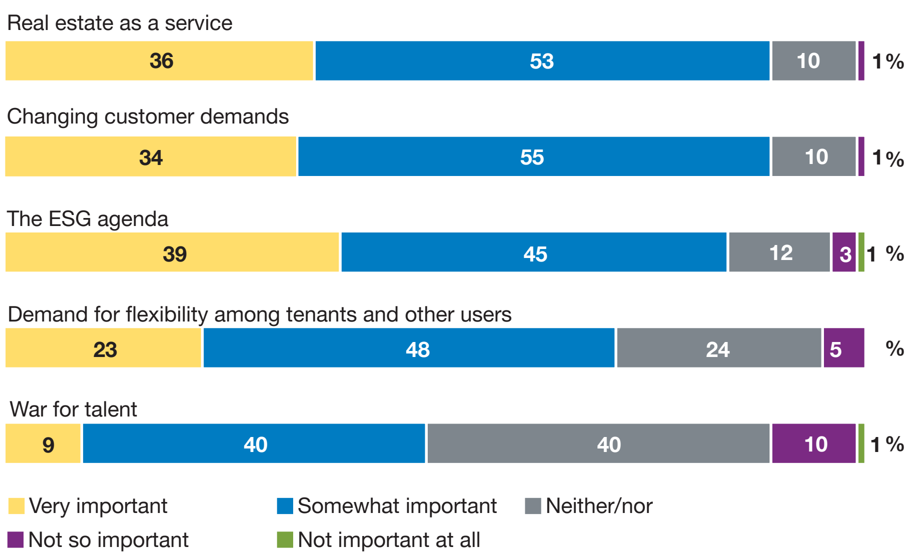
"The DNA of real estate is changing dramatically, with more and more short-term arrangements – leasing for one, two, or three years, particularly for retail," says one consultant. "The office space situation during the pandemic will mean more co-working and remote working."

Organisational transformation of real estate business is a key priority for the next three to five years



Source: *Emerging Trends Europe* survey 2022

Figure 4-1 **Drivers of organisational transformation**



Source: *Emerging Trends Europe* survey 2022

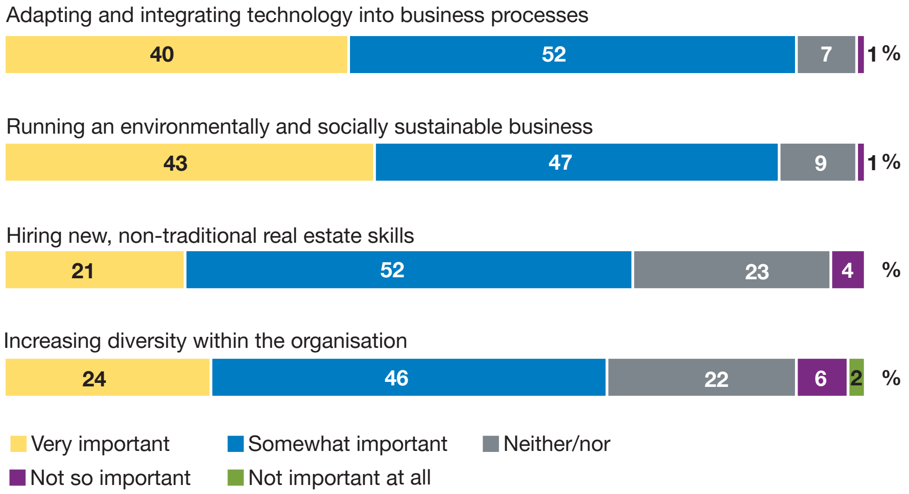
Unsurprisingly, the ESG agenda is rapidly gaining ground and is the third-ranked influence, with 84 percent of respondents considering it important. From another perspective, 90 percent of respondents indicate that successful transformation is inextricably linked to running an environmentally and socially sustainable business.

The interviews suggest that the growing importance of ESG is partly attributable to the seriousness of the climate crisis. It is also clear that investor and public sentiment is driving this agenda as people increasingly expect companies to deliver environmental and social as well as financial returns.

Whatever the motive, most large real estate firms are at least starting to put ESG strategies in place – and in many cases accelerating existing policies – in the wake of the pandemic. Many companies are hiring a head of ESG if they had not already done so, although in most cases the position is yet to be elevated to board level.

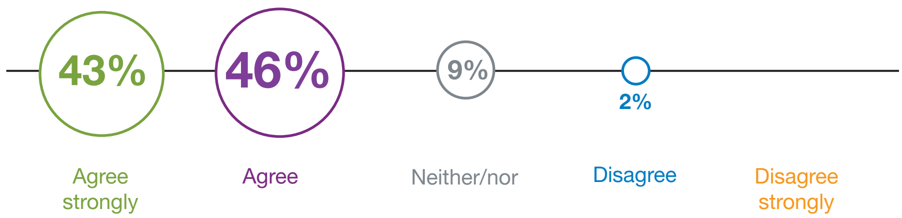
Such strategies invariably involve addressing a wide set of environmental and social factors: decarbonisation, social equity, community impact, health and wellbeing, and diversity. In the minds of nearly 90 percent of industry leaders who participated in the survey, a very important link also exists between the entire ESG agenda and brand success. And in turn, two-thirds believe that the reputation and brand of real estate owners will be crucial to their success.

Figure 4-2 **Successful organisational transformation**

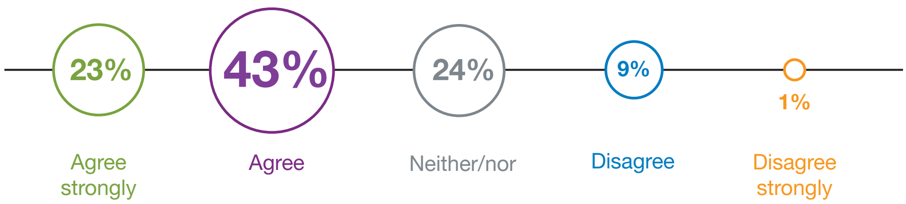


Source: *Emerging Trends Europe* survey 2022

Considering all ESG factors is an important element of brand success



The reputation and brand of real estate owners will become a key success factor



Source: *Emerging Trends Europe* survey 2022

The seriousness of the response to these factors going forward will not just enhance brand and reputation but will determine the concept of "licence to operate", which is the ongoing acceptance from consumers or clients that a real estate firm aligns with industry standards and best practice.

By contrast, only half the survey respondents regard the "war for talent" as an important influence on organisational change, which seems relatively low as the industry repositions itself for growth in a recovering European economy. It is a muted response, too, given all the rhetoric around this topic in the wider business community, although some interviewees insist there is greater urgency and activity here than the survey implies.

There is "a fight for talent" as the leasing and sales side of real estate "becomes more digital", says one pan-European player: "This time last year there were some questions about how transactions would be done because there was less activity and you couldn't visit buildings or see clients. But now that the market is back, there's huge activity in recruiting for this [digital] area."

Keeping up with technology

More effective use of technology and data is clearly a big factor if businesses are to navigate the challenges and opportunities ahead successfully. This can be done only by adopting property technology (proptech) innovations and solutions at a faster pace than before, thereby enhancing their productivity and service offer. But to succeed in this area requires digital capabilities and skillsets that traditionally have not existed in real estate organisations, as well as the leadership vision to identify which skills are likely to be most relevant and adapt the business model accordingly.

"The skillset needed by managers will start to change. And not every manager will be able to develop the skillset," says one global investor. "The differentiation between good, less good, and bad managers will start to become even clearer with the increase in services expected."

An overwhelming majority of survey respondents – 92 percent – see adapting and integrating technology into business processes as critical to transforming an organisation and setting it on the right course for future success. Slightly fewer – 73 percent – highlight the importance of introducing non–real estate skills to the industry, and yet digital transformation would not be possible without some of those new skills. Such a mismatch in responses perhaps reveals an industry that in large part may be willing to change but does not yet know how to effect that change.

Indeed, the ability of the industry to adapt at the speed and with the intensity required is also open to question. For some investors, the motivation for change must surely be diminished given the huge amount of capital waiting to be deployed into European real estate right now – and deployed as a relatively attractive capital and income play above all else.

"I think the biggest barrier to change for us as an industry is that real estate has done everything the same way for so long," says one respondent. "You could look at the lease structures in some countries; you could look at the lack of diversity in the industry. I think there's a movement to change lots of these things, but real estate has always been slower than other industries."

"The differentiation between good and bad managers will start to become even clearer with the increase in services expected.

This entrenchment is apparent in respondents' views on the barriers to transformation. Concerns over the costs of reorganisation come third on the list at 63 percent, behind perceived risks, ranked second at 71 percent. But it is breaking through the existing culture of an organisation to achieve change that is seen as the greatest barrier, with 83 percent of respondents.

Belief in the superiority of existing arrangements is the obstacle respondents are least concerned about, but at 56 percent it is still significant.

This sentiment is also closely linked to the expected integration of technology across the industry. "We see a lot of great [proptech] ideas, especially a lot of enthusiastic young teams. But when I look outside, I see a construction site and it looks exactly the same as it would in the 1950s," says one developer.

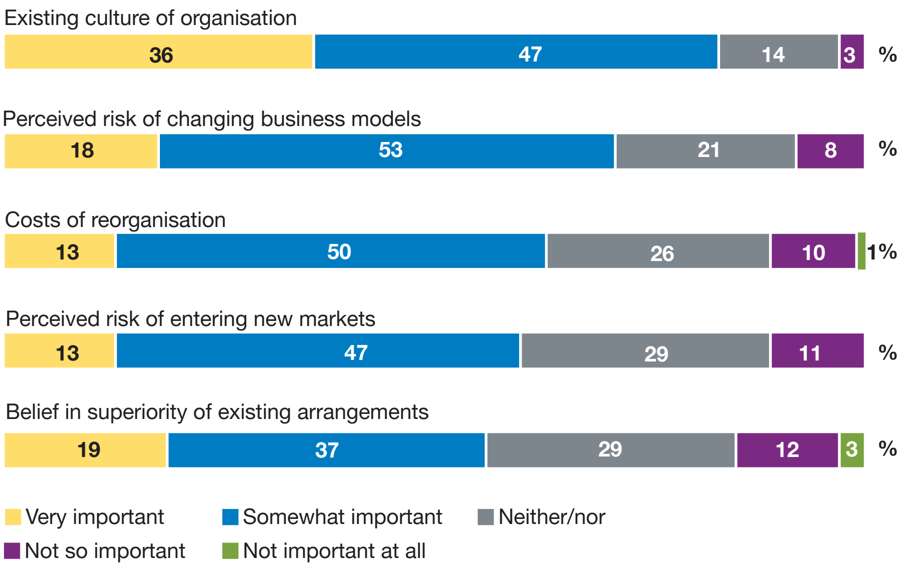
For some interviewees, there is still scepticism over just how transformational the impact of technology will be: expectations are for efficiencies rather than wholesale change. Others believe a successful outcome will owe more to chance than good judgement on backing the right start-ups and making the correct calls on how much to digitalise business processes or make use of artificial intelligence and machine learning.

"We're still trying to figure out how technology really changes us and our operations," says one investment manager. "There is currently a huge hype around proptech, but many of its aspects are not of huge use to our professional business." Another interviewee says not enough examples are evident of proptech concepts that can scale up.

Even the larger firms are generally still in the early stages of reshaping their organisation. Instead, much of the investment has been financial, with a few interviewees mentioning proptech subsidiaries, backing starts-ups through their balance sheets, or co-investing with private equity funds that invest in proptech. Others see it as a possible investment opportunity for themselves: "We're actually going to launch our own proptech fund as well," says a global investment manager. "I would say that's different from many other real estate players."

This level of research and investment suggests the industry is still in the foothills when it comes to digital integration, though many interviewees claim they at least now know what needs to be done, as reflected in leadership changes. One, for instance, says a chief technology officer now has a seat on the global board, and the company now has regional heads of technology. Even this interviewee, however, acknowledges that the company has a long way to go in embedding digital ways of working across the business.

Figure 4-3 **Barriers to organisational transformation**



Source: *Emerging Trends Europe* survey 2022

"We're still trying to figure out how technology really changes us and our operations.

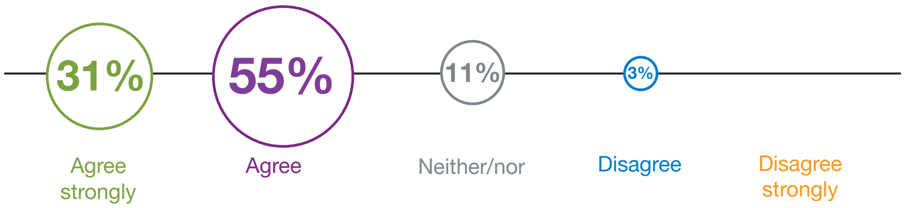
Image: Boardroom meeting on forecasting and projecting (Getty Images)

Where proptech is having a more material impact on organisational change is in the operational as well as asset and property management parts of the value chain. This can involve apps offering a closer connection between landlord and tenant; automated business processes; or machine learning and data collection to improve the management of properties. "We're trying to broaden the range of skills within the organisation from the viewpoint of using new technologies and digitalisation," says one investor.

Another is looking to outside help to build capacity as well as hiring data scientists and other digital talent. "We've kept it fairly simple in the way we invest [in technology], but we do data mining where we appoint companies to help us to identify trends," says one investment manager.

Such action is already reaping rewards, this interviewee says. As soon as the reality of the pandemic was understood, the company started asking its data specialists to examine different metrics to inform its response.

Following the COVID-19 crisis, real estate companies will massively scale up the use and the integration of technology in their broader operations



Source: *Emerging Trends Europe* survey 2022

"One of the things we quickly realised is that all businesses were suffering and any historic data you were looking at in terms of accounts and credit strength of tenants was irrelevant. So that's where you start to use the [real-time] digital data coming in to make maybe more informed decisions on how we should support a particular tenant in this difficult environment."

For all the lingering scepticism regarding the need for business transformation, the lasting impact of COVID-19 cannot be underestimated. An extraordinary 86 percent of survey respondents are signalling a massive scaling up of the integration of technology in the broader operations of European real estate companies as a result of the pandemic.

One investment manager refers to the big commitment in time and effort involved in developing data-handling capacity in house.

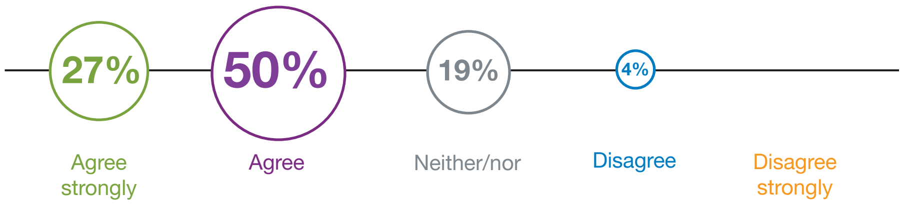
Image: Solar panels being mounted (Shutterstock)

"We set up our own internal system, which was all about having golden source data. We've just been through the first phase of what we're calling our single data platform, which has taken 18 months. But now we can analyse it and get the richness from it."

At the same time, however, bridging the knowledge gap between technology and real estate firms is challenging. According to one consultant, this works – or does not work – in one of two ways. Either somebody with a property background is charged with leading on technological integration or transformation and fails because they do not understand technology; or outside technology specialists approach a property business with what they think is a solution but fail because they do not understand real estate.

The hope is that this is a transitional phase for companies because technology will eventually be so integral to successful real estate that the waters will cover over any early differences in disciplines.

For successful transformation, real estate needs new non–real estate related skills



Source: *Emerging Trends Europe* survey 2022

"We've just been through the first phase of what we're calling our single data platform, which has taken 18 months. But now we can analyse it and get the richness from it.

Broadening the skills base

Expansion of the industry's skills base is seen as fundamental to a meaningful and lasting organisational change, with greater diversity of teams likely to be a natural, positive consequence.

At a company level, there is more openness to leadership from outside the industry. "I think real estate has to be a little bit like the automotive industry, where people from other industries bring new ideas, not only in terms of leadership style, but also in terms of how we tackle certain problems in the market," says one interviewee.

According to the leaders canvassed by *Emerging Trends Europe,* there is more evidence of this outside influence at all levels. In addition to data managers, companies are looking at specialist ESG asset managers, climatologists, and socio-economists. One firm is going further by hiring a chemist to understand what is happening on a particle level in buildings and a neuroscientist to understand human reaction to movements around office space.

As radical as these roles may sound for real estate, some interviewees suggest they still only reflect firms dipping their toe in the water rather than making permanent changes to the employee roster, although that time is expected to come. "You can work with consultants in these areas up to a certain point, but you need to have control and understanding of the intellectual property and not just hope someone does the job for you," says one interviewee. "You will need to have a source that is not replaceable and cannot be acquired by the competition."

Other interviewees stress the need for real estate firms to reach "a critical mass" of people with new skills; otherwise, the whole process of change is compromised. In other words, hiring a number of people with similar (non-property) skills stands a much better chance of success. "If you hire one person with an expertise, they will have no one who speaks their language and will not engage."

Part of the issue here comes back to the cultural differences between real estate and other industries. As some point out, success in the technology sector, for instance, often comes at a younger age than in real estate. The challenge – not yet resolved – is how to attract such talent into an industry that is so hierarchical and structured?

Interviewees also strongly emphasise the growing importance of knowledge and skills – and possible training required – for those working in asset and property management. This involves technology but leans much more into the influences of ESG and real estate as a service. These two structural shifts demand a renewed focus on driving value through the assets and through the more operational sectors.

One likely consequence of this trend will be a status upgrade for asset managers in a hierarchy where until now, as one interviewee puts it, "acquisitions people always had pride of place". The asset managers' operational understanding and granular knowledge of adding value will win out. "They probably need to be a better all-round professional that can really translate what they hear into specific recommendations for the type of lease, length of lease, flexibility of the lease, what kind of space, what kind of amenities."

Certainly, the skills required to execute a wider ESG strategy go far beyond simply a sound understanding of environmental sustainability. "We've had 13 different working groups, so [skills needed range] from net zero to wellness," says one executive, adding that remuneration policies have been amended at the firm to drive change.

"We've changed the metrics on our bonuses to have ESG threaded throughout the whole team. It is a collective, collaborative endeavour across the board."

> "You can work with consultants in these new areas up to a certain point, but you need to have control and understanding of the intellectual property.

”For those teams offering real estate as a service or working in more operational sectors, there is already a shortage of the right resources to bring about the expected transformation, not least in the repurposing of offices and retail assets. “There’s a constant need to scale up the capabilities and the skills of asset managers to make sure that asset values are protected or enhanced,” says one pan-European investment manager. “Today in Europe, the true value and the need for asset managers is sometimes still not well understood.”

Those landlords and investors embracing the service side of real estate have started recruiting people from industries such as hospitality. One interviewee floats the idea of hiring customer-facing staff from the world of theatre, while another believes it is vital that diverse skills are brought in at every level of an organisation; it is not enough to bring in somebody from hospitality with a warm smile and engaging manner to sit at reception.

Adds an investor: “Now you don’t just need financial people or asset and property managers, but also people who have the client top of mind, where ‘client’ means the tenant. It’s much more [akin to] the approach of people from the hospitality sector. They can bring added value to real estate organisations in general. We’re quite arm’s-length in this, but we’re very keen on selecting the right partners that really do understand this point.”

“
There’s a constant need to scale up the capabilities and skills of asset managers to make sure that asset values are protected or enhanced.

Image: Workers at creative office space (Getty Images)

Image: Partitioned working area (Getty Images)

Improving diversity

Real estate's reputation as being male dominated and predominantly white has come into sharp focus in recent years, with various company- and industry-wide initiatives seeking to address this issue.

In effect, there is a growing acceptance that with its stated aim of creating better places for diverse communities, the industry must foster its own diversity of thought and experience.

"You've got to represent the people you're seeking to serve," says one global investment manager. A pan-European player puts it more bluntly: "You can't be serious about working on impact investing with a team of grey-haired white people."

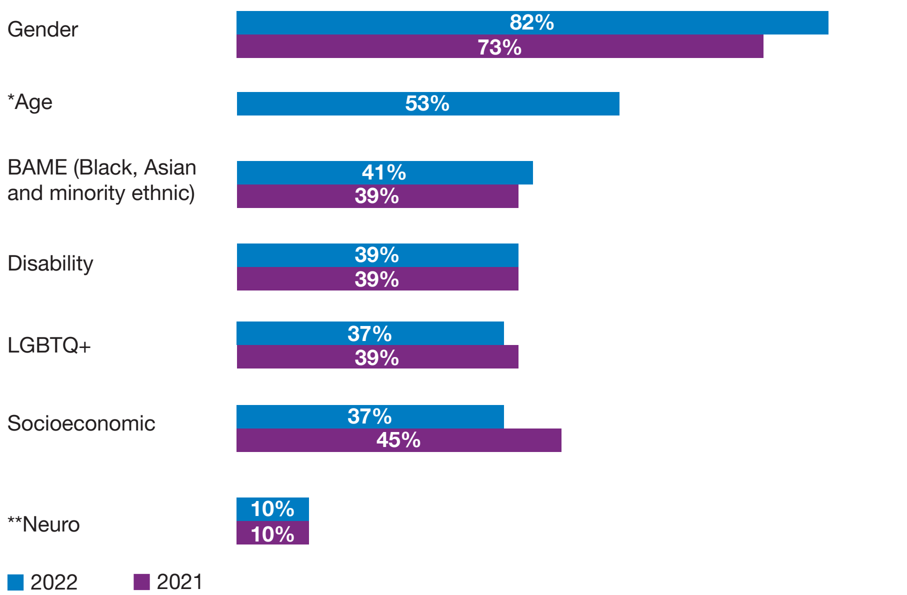
At the same time, many interviewees believe that promoting greater diversity will pave the way for positive change in their own businesses and in the way they conduct business. "A landlord needs to understand and connect with the tenants during the entire rental period because that is what makes the tenants renew their contracts. This is a lot easier with cultural diversity among employees in property management companies," says one Scandinavian CEO.

Whether needing new skills or hiring people from other industries, there is the opportunity to open pathways to those from different ethnic, socioeconomic, and other under-represented groups in real estate.

However, the survey suggests there is a long way to go. Just 70 percent of respondents believe that increasing diversity is important in transforming an organisation – well behind the perceived need for policies to develop technology or promote ESG.

Perhaps predictably, the diversity focus for the industry continues to be on gender, with 82 percent of survey respondents – up from 73 percent last year – saying their organisations are proactively addressing gender in relation to diversity and inclusion in the workplace.

Figure 4-4 **Diversity and inclusion categories actively addressed by real estate firms**



*Age not asked in 2021
**Neurodiversity refers to alternative thinking styles, such as dyslexia, autism, ADHD and dyspraxia.

Source: *Emerging Trends Europe* survey 2022

Barely half the respondents actively address age discrimination, and just 41 percent are addressing BAME (Black, Asian and minority ethnic) diversity in their organisations. There is "an awareness that the industry is challenged", observes one director of a pan-European consultancy firm. "Unfortunately, the biggest drivers of diversity have been legislative rather than pressure or responsibility from the industry."

The more progressive companies are moving forward by establishing formal policies to improve diversity and inclusion, encouraging agile working, and setting clearer processes for reporting and dealing with discrimination. Some property professionals interviewed for this report argue that a valid incentive for change would be to link directors' bonuses directly to their diversity employment targets.

Nonetheless, a strong belief exists that the pressure for greater diversity will flow through into recruitment. "[Companies] will hire people with a more diverse background, both in terms of gender, ethnicity, and people with different university degrees such as architectural design, technology, social sciences, sustainability, finance, engineering," says one developer.

Those in recruitment have the opportunity to be pivotal in the change. "The more diverse you are as an organisation, the better the performance you achieve," says one senior investment manager. "We want to challenge our recruitment agents or headhunters to think outside the box – not just contact those who are coming with surveying experience or finance experience. Let's not bring in clones of ourselves. Let's bring in people from different backgrounds, different socioeconomic backgrounds, people who are wired differently. We need disruptors." Recruitment agents are also now asked to provide metrics to show diversity in their procedures.

While bringing in people with different backgrounds, the industry must be encouraged to continue to embrace its cross-disciplinary approach. "I want to see more people who are able to connect disparate dots," says one senior investment manager. "The industry is transforming before our eyes – maybe not as fast as people would like, but it's happening."

> "The more diverse you are as an organisation, the better the performance you achieve.

Image: Colleagues at workplace (Shutterstock)

New ways to manage customers and cash flow

A recurring theme among industry leaders involves the stability of cash flow from real estate as an asset class, and by extension the resilience of that income for their own businesses.

They acknowledge the need for change in a market where the pandemic has accelerated a shift towards shorter leases and more volatile cash flow alongside greater flexibility and service demanded by occupiers for most sectors. The question now is whether real estate firms could, or should, respond by adopting new business models to serve their customers more efficiently.

Global investor Hines signalled its move to a more vertically integrated business model in September when it acquired Helix, a UK property firm that had managed many of Hines's European assets over the previous 10 years as an outsourced supplier. Hines says its intention is to have its own "customer-centric and experience-focused management services and operations platform" across Europe.

Though far from conclusive, the *Emerging Trends Europe* interviews suggest that the pandemic has helped promote the idea of vertically integrated real estate services as the way forward.

The vice president of a global private equity firm says it has steered out of trouble in the hard-hit retail and hospitality sectors because "we're more vertically integrated than some of our peers. That allowed us to get control of the situation quickly and therefore switch into a more acquisition mode and focus on new investments rather than putting out fires."

Another convert believes the greater service culture today demands more internal operations and less outsourcing. "The business is reaching out to the end user and the consumer, making sure that they want to come to you ahead of anybody else. That's the same whether you're doing sheds or offices," this interviewee says. "Competitive advantage is what people are going to seek, and that's going to mean higher costs and implications for third parties. It takes a long time to work out what's really adding value."

Those higher costs are about truly understanding how new roles can add value on this side of the business such as customer insight and big data. "Eventually, they'll work out that most of it is costing them a lot of money," the interviewee says. "Management teams have got to be quite careful because it's not certain when rents are going to go back up, and they're going to have to really make sure that what they're doing is genuinely driving competitive advantage."

Others are not convinced. One pan-European private equity player recognises the fundamental shift from stable lease income to property as a service and "the need to understand how to underwrite those cash flows". But their strategy is simply to find "the right operating partners" rather than bring the required expertise in house.

Whichever business model is pursued, it is widely accepted that the pandemic has reinforced the need for far greater attention to detail in the management of real estate. "A lazy management team and a lazy asset allocator will get lazy returns," says the CEO of a UK property company. "COVID has exposed some of the weaknesses [in the industry]. Those businesses that tend to focus on trying to do it as best as they can all the time through thick and thin are probably better positioned to react faster. It's just basic business, but most people in real estate do not focus on the operations side."

> "
> The business is reaching out to the end user and the consumer, making sure that they want to come to you ahead of anybody else.

City prospects

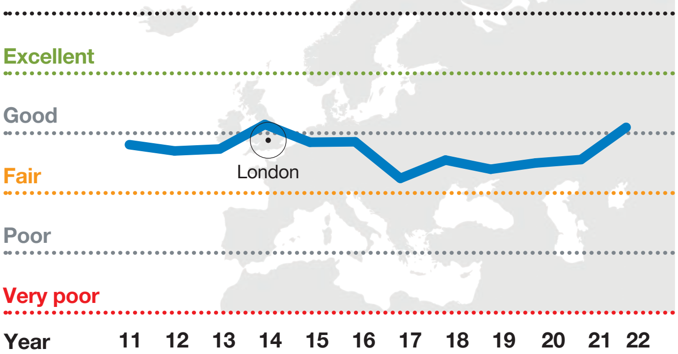
The city rankings are based on overall prospects, which are ranked according to how much they deviate from the average/mean score; these are shown in Table 3-1. The scoring is based on the views of both those who are familiar with the city and others who potentially could be investing or developing there but are not.

The investment and development prospects provide the local outlook. For these, respondents who are familiar with the city scored the expected change for 2022 compared with 2021 on a scale of 1=decrease substantially to 5=increase substantially, and the scores for each city are averages.

London (1)

City ranking 2022 (2021)	1 (2)
Investment prospects	⋀ 3.85
Development prospects	⋀ 3.75

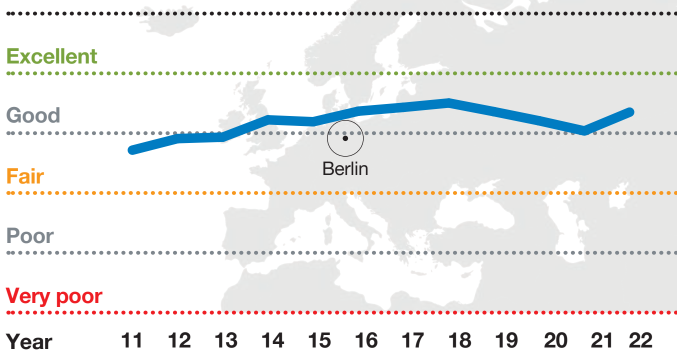
Investment prospects: local outlook, 2011–2022



Berlin (2)

City ranking 2022 (2021)	2 (1)
Investment prospects	⋀ 4.11
Development prospects	⋀ 3.94

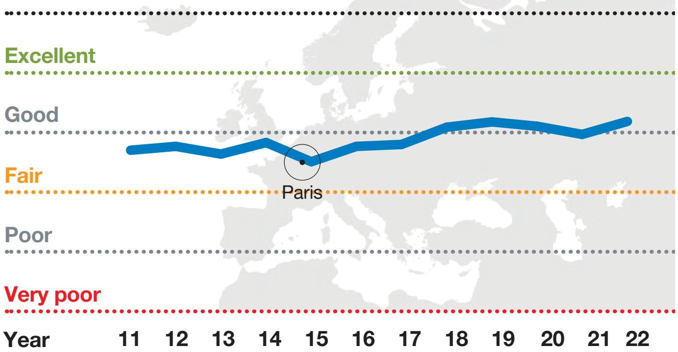
Investment prospects: local outlook, 2011–2022



Paris (3)

City ranking 2022 (2021)	3 (3)
Investment prospects	⋀ 3.96
Development prospects	⋀ 3.80

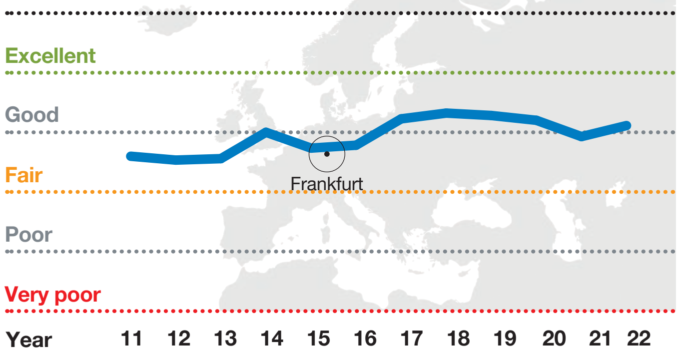
Investment prospects: local outlook, 2011–2022



Frankfurt (4)

City ranking 2022 (2021)	4 (4)
Investment prospects	⋀ 3.87
Development prospects	⋀ 3.27

Investment prospects: local outlook, 2011–2022



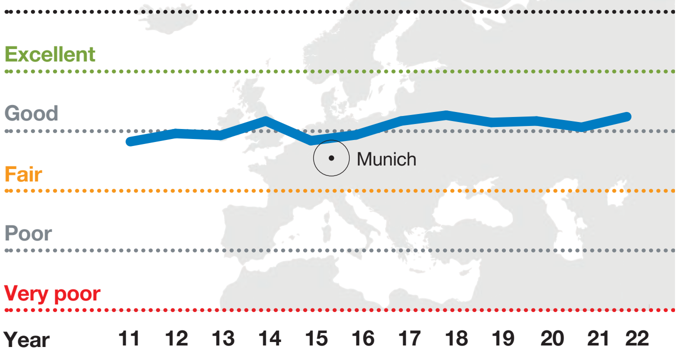
Source: *Emerging Trends Europe* survey 2022

⋀ Increase — Stay the same ⋁ Decrease

Munich (5)

City ranking 2022 (2021)	5 (7)
Investment prospects	^ 4.03
Development prospects	^ 3.89

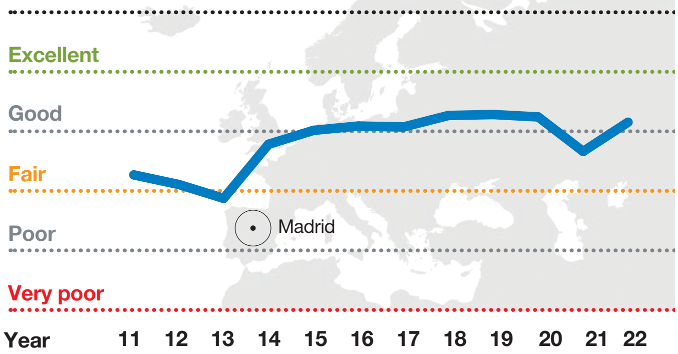
Investment prospects: local outlook, 2011–2022



Madrid (6)

City ranking 2022 (2021)	6 (8)
Investment prospects	^ 3.92
Development prospects	^ 3.87

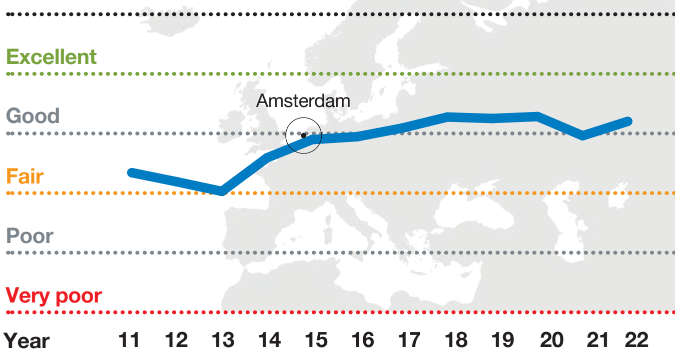
Investment prospects: local outlook, 2011–2022



Amsterdam (7)

City ranking 2022 (2021)	7 (5)
Investment prospects	^ 3.98
Development prospects	^ 3.84

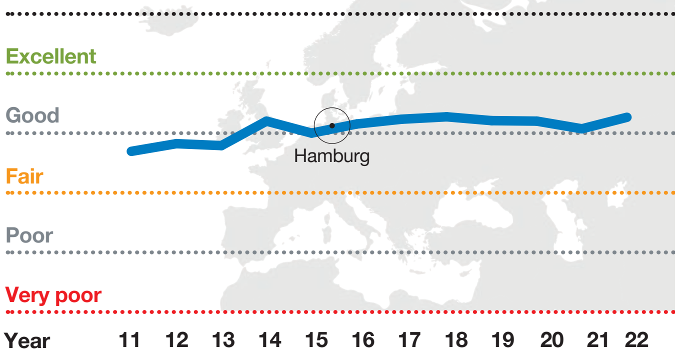
Investment prospects: local outlook, 2011–2022



Hamburg (8)

City ranking 2022 (2021)	8 (6)
Investment prospects	^ 4.06
Development prospects	^ 3.87

Investment prospects: local outlook, 2011–2022



Source: *Emerging Trends Europe* survey 2022

^ Increase — Stay the same ˅ Decrease

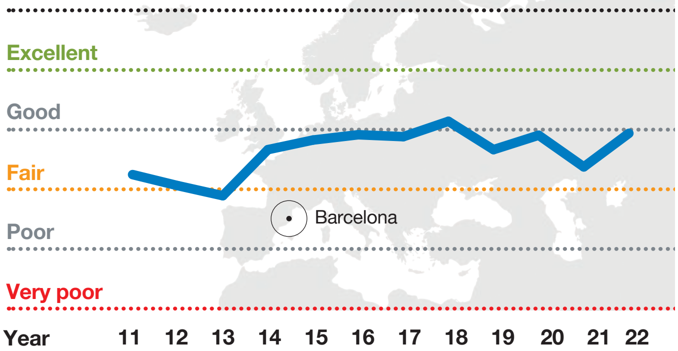
"A lot of people are being priced out of Germany and Paris. And by default, they look at alternative markets – Lisbon, Madrid, Milan and Amsterdam continue to benefit from that."

Partner, pan-European capital markets consultancy

Barcelona (9)

City ranking 2022 (2021)	9 (13)
Investment prospects	3.66
Development prospects	3.54

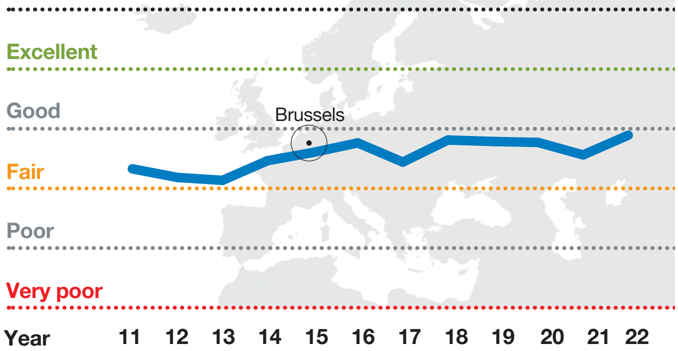
Investment prospects: local outlook, 2011–2022



Brussels (10)

City ranking 2022 (2021)	10 (12)
Investment prospects	3.60
Development prospects	3.54

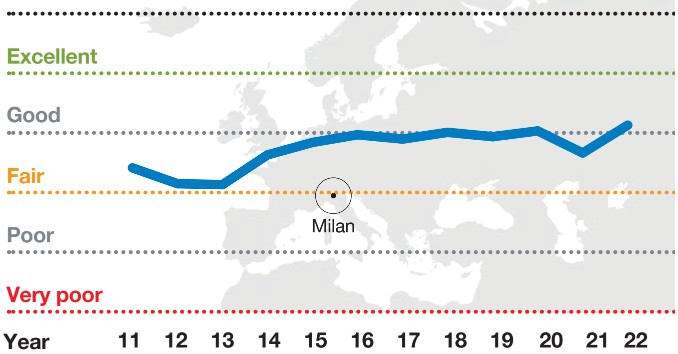
Investment prospects: local outlook, 2011–2022



Milan (11)

City ranking 2022 (2021)	11 (9)
Investment prospects	3.89
Development prospects	3.90

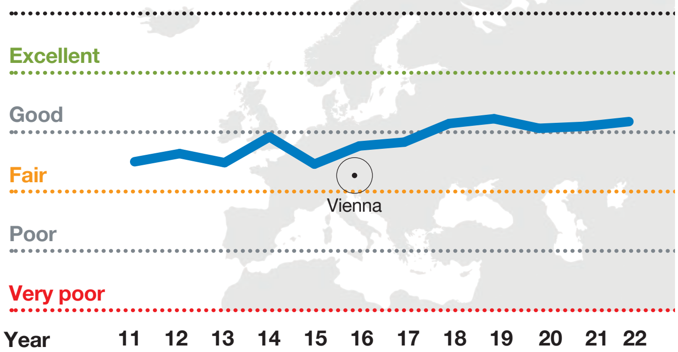
Investment prospects: local outlook, 2011–2022



Vienna (12)

City ranking 2022 (2021)	12 (10)
Investment prospects	3.95
Development prospects	3.88

Investment prospects: local outlook, 2011–2022



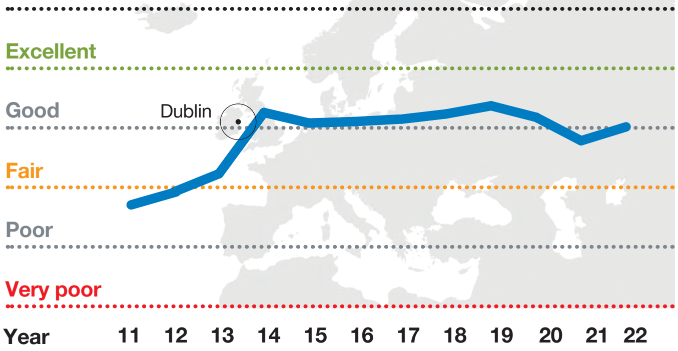
Source: *Emerging Trends Europe* survey 2022

Increase — Stay the same Decrease

Dublin (13)

City ranking 2022 (2021)	13 (11)
Investment prospects	↑ 3.75
Development prospects	↑ 3.59

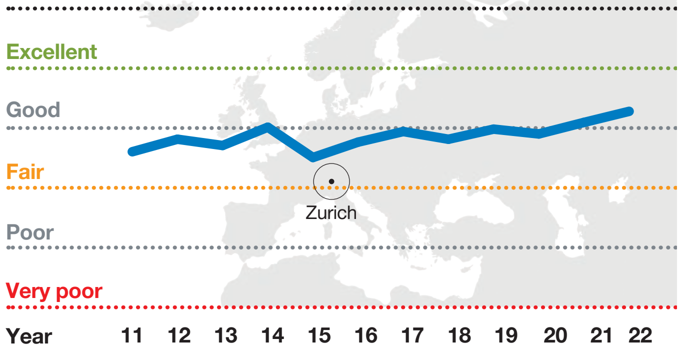
Investment prospects: local outlook, 2011–2022



Zurich (14)

City ranking 2022 (2021)	14 (20)
Investment prospects	↑ 4.02
Development prospects	↑ 3.83

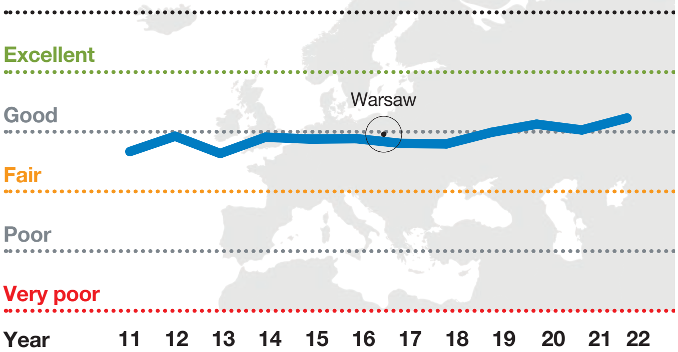
Investment prospects: local outlook, 2011–2022



Warsaw (15)

City ranking 2022 (2021)	15 (14)
Investment prospects	↑ 3.96
Development prospects	↑ 3.73

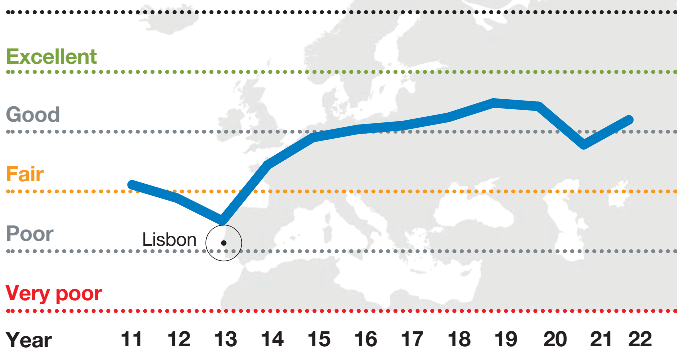
Investment prospects: local outlook, 2011–2022



Lisbon (16)

City ranking 2022 (2021)	16 (15)
Investment prospects	↑ 3.92
Development prospects	↑ 3.80

Investment prospects: local outlook, 2011–2022



Source: *Emerging Trends Europe* survey 2022

↑ Increase — Stay the same ↓ Decrease

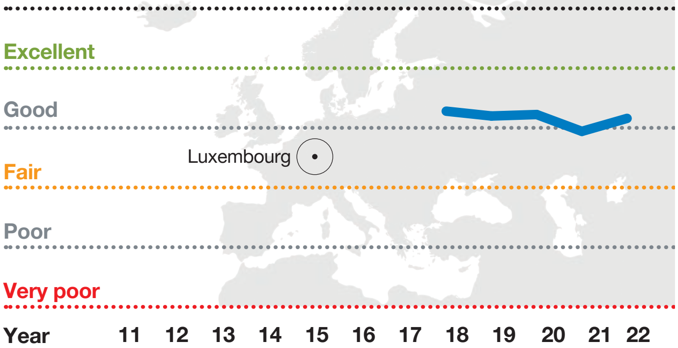
> "To be attractive, cities need enlightened management at the public level to motivate investors to invest."

Head of real estate, global investment manager

Luxembourg (17)

City ranking 2022 (2021)	17 (17)
Investment prospects	∧ 3.87
Development prospects	∧ 3.75

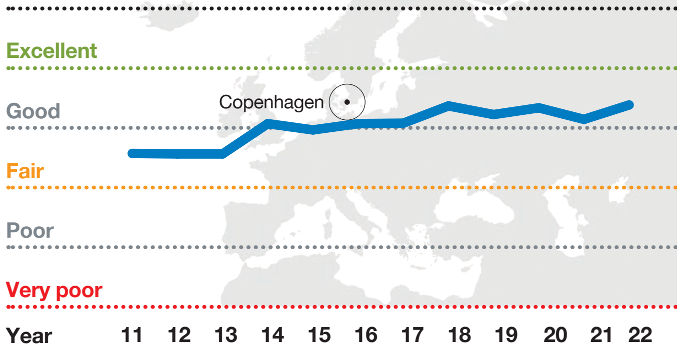
Investment prospects: local outlook, 2011–2022



Copenhagen (18)

City ranking 2022 (2021)	18 (18)
Investment prospects	∧ 4.15
Development prospects	∧ 3.97

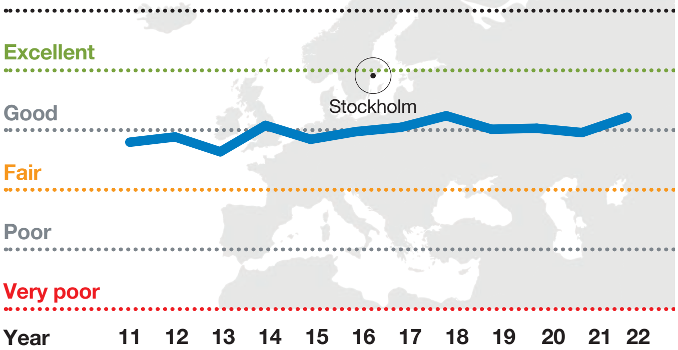
Investment prospects: local outlook, 2011–2022



Stockholm (19)

City ranking 2022 (2021)	19 (16)
Investment prospects	∧ 3.94
Development prospects	∧ 3.68

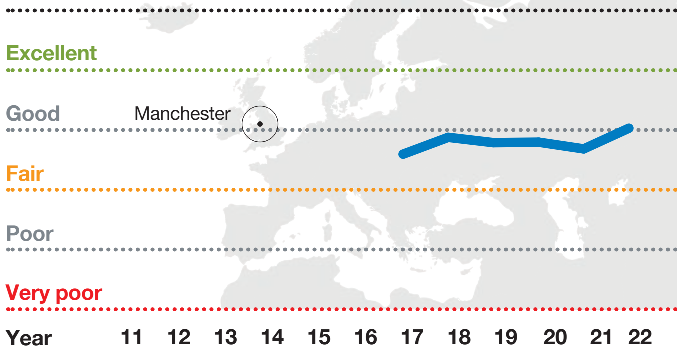
Investment prospects: local outlook, 2011–2022



Manchester (20)

City ranking 2022 (2021)	20 (22)
Investment prospects	∧ 3.71
Development prospects	∧ 3.66

Investment prospects: local outlook, 2011–2022



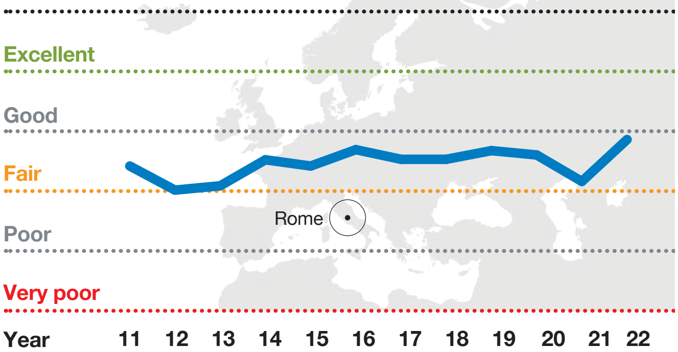
Source: *Emerging Trends Europe* survey 2022

∧ Increase — Stay the same ∨ Decrease

Rome (21)

City ranking 2022 (2021)	21 (23)
Investment prospects	3.50
Development prospects	3.53

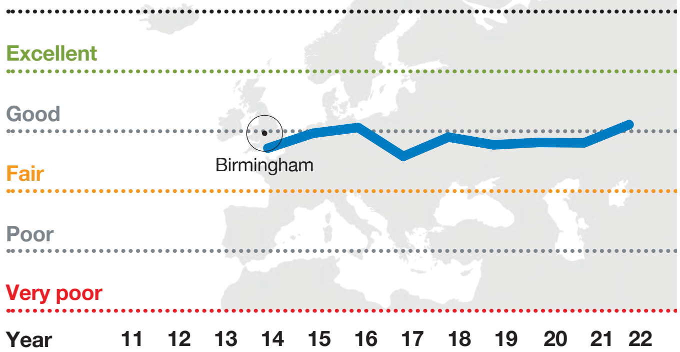
Investment prospects: local outlook, 2011–2022



Birmingham (22)

City ranking 2022 (2021)	22 (25)
Investment prospects	3.81
Development prospects	3.75

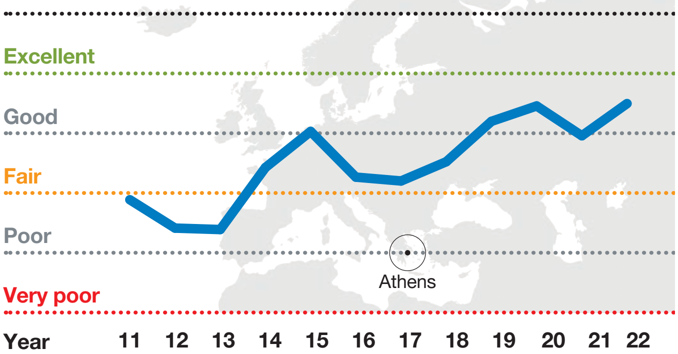
Investment prospects: local outlook, 2011–2022



Athens (23)

City ranking 2022 (2021)	23 (28)
Investment prospects	4.29
Development prospects	4.24

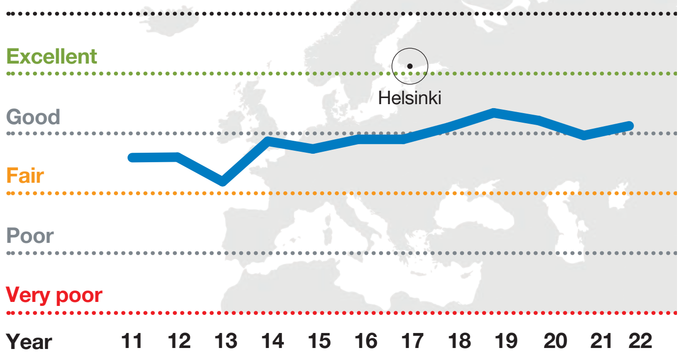
Investment prospects: local outlook, 2011–2022



Helsinki (24)

City ranking 2022 (2021)	24 (19)
Investment prospects	3.83
Development prospects	3.73

Investment prospects: local outlook, 2011–2022



Source: *Emerging Trends Europe* survey 2022

Increase — Stay the same Decrease

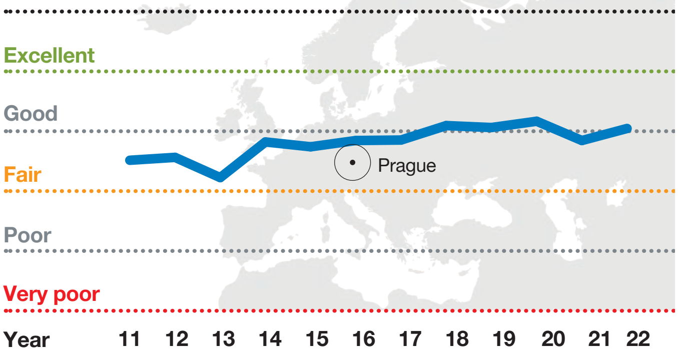
"Our most direct issue will be how we respond to climate change – how we move around cities, and how we use cities. This is what has generally always driven change in real estate.

CEO, UK property company

Prague (25)

City ranking 2022 (2021)	25 (24)
Investment prospects	∧ 3.73
Development prospects	∧ 3.70

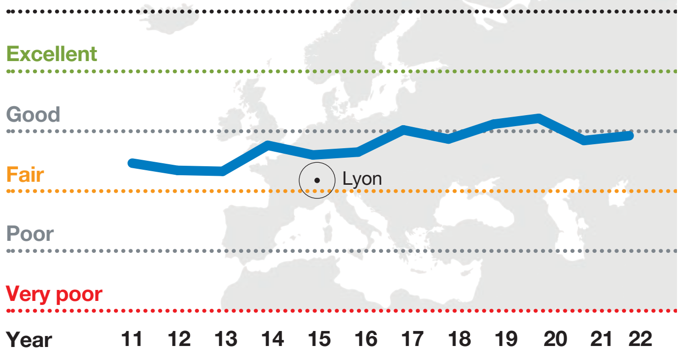
Investment prospects: local outlook, 2011–2022



Lyon (26)

City ranking 2022 (2021)	26 (21)
Investment prospects	∧ 3.68
Development prospects	∧ 3.58

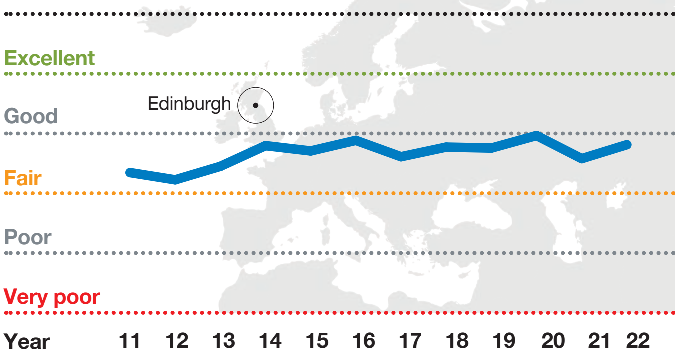
Investment prospects: local outlook, 2011–2022



Edinburgh (27)

City ranking 2022 (2021)	27 (27)
Investment prospects	∧ 3.44
Development prospects	∧ 3.28

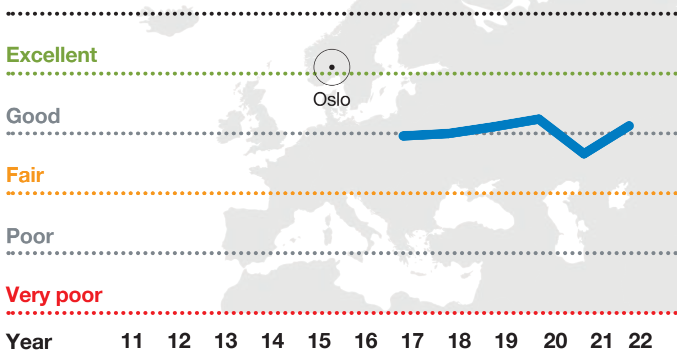
Investment prospects: local outlook, 2011–2022



Oslo (28)

City ranking 2022 (2021)	28 (29)
Investment prospects	∧ 3.83
Development prospects	∧ 3.77

Investment prospects: local outlook, 2011–2022



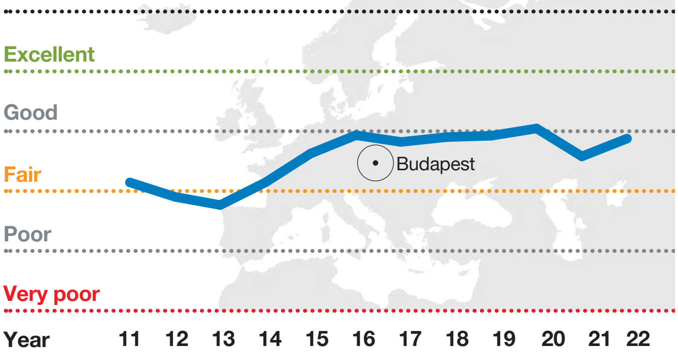
Source: *Emerging Trends Europe* survey 2022

∧ Increase — Stay the same ∨ Decrease

Budapest (29)

City ranking 2022 (2021)	29 (26)
Investment prospects	⋀ 3.52
Development prospects	⋀ 3.41

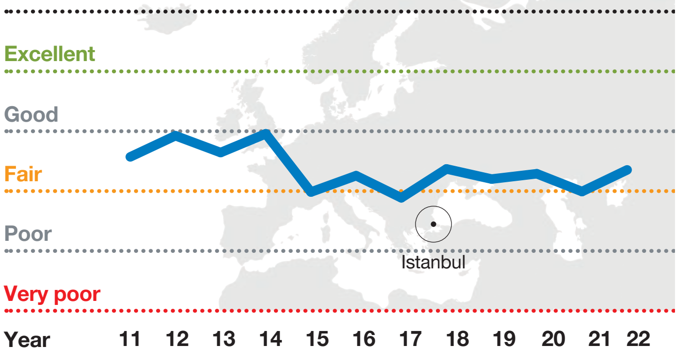
Investment prospects: local outlook, 2011–2022



Istanbul (30)

City ranking 2022 (2021)	30 (30)
Investment prospects	⋀ 2.87
Development prospects	⋀ 3.30

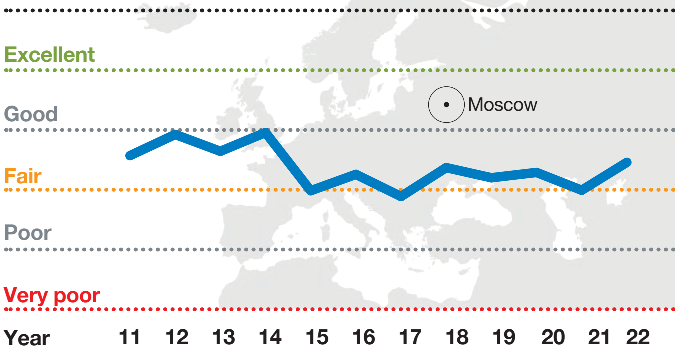
Investment prospects: local outlook, 2011–2022



Moscow (31)

City ranking 2022 (2021)	31 (31)
Investment prospects	⋀ 3.00
Development prospects	⋀ 3.95

Investment prospects: local outlook, 2011–2022



Source: *Emerging Trends Europe* survey 2022

⋀ Increase — Stay the same ⋁ Decrease

"Moscow is full of poorly built offices, and you cannot lease them to international or modern companies. The big issue is city transformation. And this will be a challenge not only for Russia, but for all emerging markets."

Director, CEE consultancy

About the survey

"I've never seen anything go so fast as ESG. People have become conscious of carbon, and that will be very substantive in its impact on the market – new, lighter, brighter, easier, techier, healthier spaces with amenities."

UK developer

Image: Eco apartment building, Copenhagen, Denmark (Shutterstock)

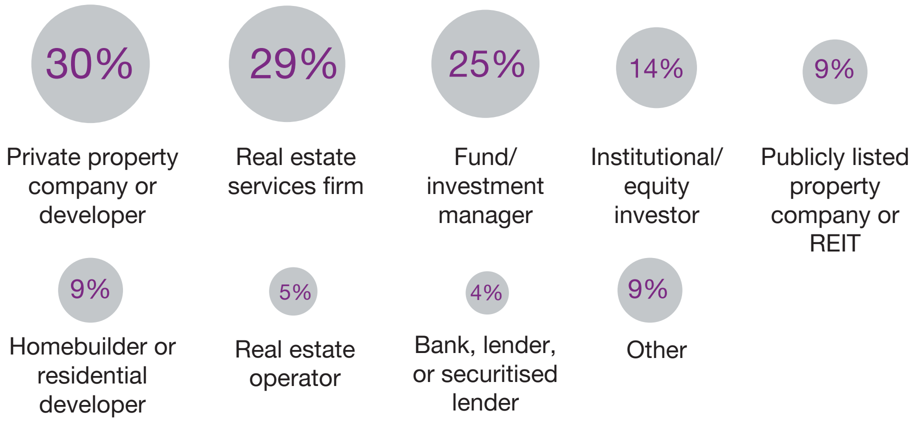
***Emerging Trends in Real Estate® Europe*, a trends and forecast publication now in its 19th edition, is a highly regarded and widely read report in the real estate industry.**

Undertaken jointly by PwC and the Urban Land Institute, the report provides an outlook on investment and development trends, capital markets, cities, sectors and other real estate issues throughout Europe. *Emerging Trends Europe* 2022 reflects the views of 844 property professionals who completed surveys, were interviewed or took part in a series of roundtable meetings across Europe as a part of the research for this report. The views expressed are from these surveys, interviews and roundtable meetings and do not express the opinions of either PwC or ULI.

The interviewees and survey participants represent a wide range of industry experts, including investors, fund managers, developers, property companies, lenders, brokers and consultants. A list of the interviewees and roundtable participants in this year's study appears on the following pages. To all who helped, ULI and PwC extend sincere thanks for sharing valuable time and expertise. Without their involvement, this report would not have been possible.

What are your business's primary activities?

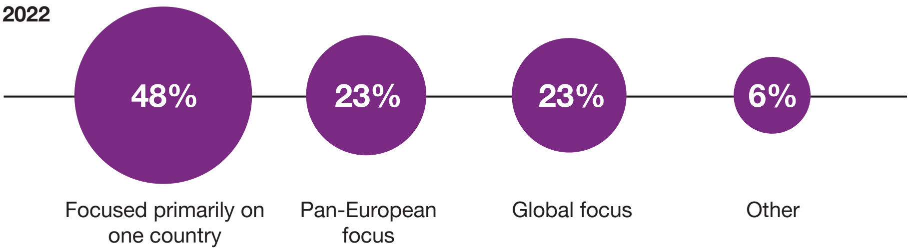
2022



Source: *Emerging Trends Europe* survey 2022

Survey responses by geographic scope of firm

2022



Source: *Emerging Trends Europe* survey 2022

Survey responses by geographic scope of firm (%)

Source: *Emerging Trends Europe* survey 2022

About the survey

Interviewees

AB Sagax
Jaakko Vehanan

AEW
Thomas Poulis-Leinberger

AF Eiendom
Otto Christian Groth

Akademiska Hus
Caroline Arehult

Aliseda Inmobiliaria
Enrique Used

Allianz Real Estate
Dr. Holger Braun
Alexander Gebauer
Kari Pitkin
François Trausch

Alma Property Partners
Robert Landtman

alstria office REIT
Alexander Dexne

Altera Vastgoed
Jaap van der Bijl

Ampega Investment
Djam Mohebbi-Ahari

Annexum
Huib Boissevain

Annington
Jos Short

APG Asset Management
Robert-Jan Foortse

Apollo
Roger Orf

Aspelin Ramm
Gunnar Bøyum

ASR Real Estate
Dick Gort

Asset Buyout Partners
Karl Otto Eidem

Avant Capital Partners
Lorenz Merk

Avara
Harri Retkin

Bain Capital Credit
David Cullen

Balder Danmark
Flemming Joseph Jensen

Bank of America Securities
Struan Robertson

Banque Cantonale de Genève
Sylvie Hoecht

Bayerische Landesbank (BayernLB)
Gero Bergmann

Beisheim Holding
Martin Bruns

Belfius Insurance
Annemie Baecke

Berlin High End
Jon Svenningsen

Berlin Hyp
Dennis de Laat

Besqab
Carola Lavén

Blackstone
James Seppala

BNP Paribas Real Estate
Isabella Chacón Troidl
Nathalie Charles
Sigrid Duhamel
Vanessa Hale

Borio Mangiarotti
Edoardo De Albertis

Bovieran Danmark
Susanne Joseph Schou

Brunswick Real Estate
David Hävermark
Hanna Rauhala
Jes Rovsing

Cairn Real Estate
Pieter Akkerman

Cale Street Partners
Ed Siskind

Canada Pension Plan Investment Board (CPPIB)
Andrea Orlandi

CapCo
Ian Hawksworth

CapMan
Juhani Erke
Peter Gill
Mika Matikainen

Catella
Thomas Beyerle

CBRE
Marie Hunt

CBRE Investment Management
Rik Eertink
Paul Gibson
Paul Oremus

CDP Immobiliare
Marco Doglio

Chris Igwe International
Chris Igwe

Cibus Nordic Real Estate
Lauri Tiensuu

Collector Bank
Alexander Firsching

Commerz Real
Jens Böhnlein

Continuum Capital
Bernd Knobloch

Core Property Management
John Bødker

Covivio
Alexei Dal Pastro

Credit Suisse
Marc-Oliver Tschabold
Rafael Metternich

Croisette Real Estate Partner
David Almqvist
Olle Håkanson Nobel

CULMIA
Francisco Javier Pérez Medina

Cushman & Wakefield
Eric van Leuven
Denis Sokolov

Danica Ejendomme
Kenneth Olsson

Deutsche Pfandbriefbank
Charles Balch

Dromeus Capital Group
Nick Balanis

ECE Work & Live
Henrie Kötter

Echo Investment
Maciej Drozd

EDGE
Coen van Oostrom

Edmond de Rothschild REIM
Pierre Jacquot

Eiendomsspar
Jon Rasmus Aurdal

Einar Mattsson
Stefan Björklund

ELF Development
Kristian Hare
Jan Kristensen

Elo
Tatu Pakarinen

EPP
Tomasz Trzósło

eQ Asset Management
Tero Estovirta

Europa Capital
Rob Sim

Fabege
Åsa Bergström

Fabritius Gruppen
Asgeir Solheim

Fokus Asset Management
Peter Haahr

Fredensborg Bolig
Magnus Aune Hvam

Genesta
Tuomas Ahonen

Gladsheim
David Dahlgren

Goldman Sachs
Tavis Cannell
Jim Garman

Goodbody
Colm Lauder

Greenberg Traurig
Jolanta Nowakowska-Zimoch

Greystar
Claire Solon

Hanna Rauhala
Jes Rovsing

Hammerson
Renaud Mollard
Aurélie Siha

Helaba
Michael Kröger

Hemsö
Nils Styf

Hibernia REIT
Kevin Nowlan

Hines
Lars Huber
Brian Moran

About the survey

Interviewees

HRS
Thierry Müller

ICAMAP
Laurence Desmazières

Ilmarinen
Mikko Antila
Kenneth Nyman

Industrials REIT
Julian Carey

INOWAI
Vincent Bechet

Intrum Hellas REO Solutions
Konstandinos Georgiakos

Invimit
Giovanna Della Posta

ION
Davy Demuynck

IPUT Real Estate
Caroline McCarthy

Irish Institutional Property
Pat Farrell

Irish Residential Properties
Margaret Sweeney

Istanbul Real Estate Valuation & Consulting Inc.
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